

January 5, 2022

Strong revenue momentum to continue despite seasonality

Normally, this quarter is seasonally weak due to furloughs. However, last year (Q3FY21), we saw an aberration to this trend. Q3FY22 is expected to be another strong quarter for IT companies after strong performance witnessed in Q2FY22. Growth momentum is expected to continue further with mid-caps outperforming Tier I companies. We expect companies to report healthy revenue growth in this quarter led by lower furloughs, ramp up of deals won in the previous quarters. There would be some cross currency headwinds, which will dampen dollar revenues to some extent in the quarter. The companies are also seeing a demand tailwind in terms of investment in newer technologies like cloud transformation, AI/ML, block chain, which further propel demand in coming quarters. In terms of margins, we expect them to remain stable (barring Coforge that is expected to post strong QoQ margin expansion) since supply side pressure would restrict margin expansion in proportion to revenue growth.

We expect Tier-1 IT companies to see revenue growth in the range of ~2.5-4% QoQ (on an organic basis) in constant currency terms. However, there would be cross currency headwinds in the range of 50-70 bps, which would impact dollar revenue growth negatively. Among tier 1, TCS, Infosys & Wipro are expected to see dollar revenue growth of 2-3.5% QoQ, respectively. HCL Technologies (HCLT) is expected to witness dollar revenue growth of 3.0%. Among Tier 2, LTI & Mindtree are expected to see dollar revenue growth of 5.0% and 4.5% QoQ while Coforge is expected to witness organic revenue growth of 3% QoQ (5% including acquisition). We prefer Infosys, LTI in tier-1 and Coforge in midcap.

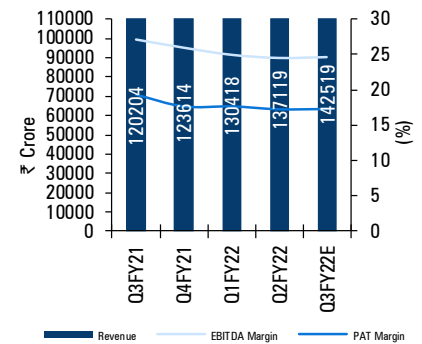
Margins expansion to be restricted due to supply side pressure

HCL Tech's margins in the last quarter were impacted by weak performance from P&P business, however for Q3FY22, we expect margins to improve sequentially despite wage hike (to selected set of employees) impact. For TCS, we expect margins to improve sequentially due to pyramid optimisations and higher offshoring. For Wipro, margins are anticipated to be marginally lower QoQ due to higher employee costs. For Infosys, we expect margins to improve sequentially.

Exhibit 1: Estimate for Q3FY22E (₹ crore)									
Company	Revenue	Change (%)		EBITDA	Change (%)		PAT	Change (%)	
	Q3FY22E	YoY	QoQ	Q3FY22E	YoY	QoQ	Q3FY22E	YoY	QoQ
HCL Tech	21,529.4	11.5	4.2	5,124.0	-5.9	5.9	3,362.4	-15.5	3.0
Infosys	30,993.1	19.5	4.7	8,169.8	10.2	4.3	5,737.1	10.4	5.8
L&T Infotech	4,003.0	27.0	6.3	784.6	7.2	7.0	585.3	12.7	6.1
Mindtree	2,740.3	35.4	6.0	572.7	22.4	7.9	425.2	30.2	6.6
Coforge	1,673.6	40.6	6.6	307.9	53.3	12.5	172.4	41.3	17.4
TCS	48,382.9	15.2	3.2	13,644.0	11.8	4.0	9,941.2	14.3	3.3
Teamlease	1,598.5	21.1	2.7	34.0	20.0	13.0	24.6	52.9	42.3
Tech Mahindra	11,360.7	17.8	4.4	2,101.7	10.9	5.3	1,405.7	7.3	5.0
Wipro	20,237.8	29.2	2.9	4,362.7	4.5	2.3	2,952.6	-0.5	0.7
Total	142,519.3	18.6	3.9	35,101.3	7.8	4.4	24,606.5	6.3	4.1

Source: Company, ICICI Direct Research,

Topline, Profitability (Coverage Universe)



Dollar growth, QoQ

IT Services	Q3FY22E	Q2FY22	Growth (%)
TCS	6,459.7	6,333.0	2.0
Infosys	4,137.9	3,998.0	3.5
Wipro ^	2,665.1	2,580.0	3.3
HCL Tech	2,874.0	2,790.7	3.0
Tech M	1,516.8	1,472.6	3.0
LTI	534.5	509.0	5.0
Mindtree	365.9	350.1	4.5
Coforge	223.4	212.8	5.0
Staffing (in ₹)			
Teamlease	1,598.5	1,523.6	4.9
^ IT services			

Top Picks

Infosys, LTI & Coforge

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Revenue, margin guidance outlook key monitorable

In the current quarter, key thing to watch will be improvement in deal pipeline, upgrades in revenue guidance (we expect Infosys to up their FY22 revenue guidance further from 16.5-17.5% given in Q2), hiring & attrition trends, margin outlook and business impact due to sudden rises in Covid cases globally. Further, outsourcing trend in Europe, trends in digital technologies, vertical specific commentary, offshoring and long-term IT trends become important from an investor's perspective.

Exhibit 2: Company Specific view

Company	Remarks
TCS	The company expected to continue its revenue momentum, however supply side pressure would restrict margin expansion. TCS is expected to register 2.7% QoQ growth in constant currency led by continued improvement in demand from BFSI, healthcare and retail, acceleration in digital technologies, ramp up of deals. Further, cross currency headwind would lead to revenue growth of 2.0% QoQ in dollar terms. In rupee terms, revenue is expected to increase 3.2% QoQ. EBIT margins are expected to expand by 20 bps QoQ to 25.2% led by flattening employee pyramid, higher offshoring. PAT is expected to improve 3.3% QoQ mainly led by better operating performance. Investor interest : i) supply-side challenges and attrition ii) margin outlook iii) deal momentum iv) subcontracting costs v) CY22 IT budgets
Infosys	We expect some ramp up in Dailmer deal as well as continued growth momentum, however supply side pressure would restrict margin expansion. Infosys is expected to register 4% QoQ growth in CC led by continued strong momentum from financial services, retail, communication, energy and manufacturing. Cross currency headwinds are expected to lead to 3.5% QoQ growth in dollar term. Rupee revenues are expected to increase 4.7% QoQ. EBIT margins are expected to expand 20 bps QoQ. PAT is expected to improve ~5.8% QoQ. Investor interest: some colour on demand environment in FY23E (We expect the company to increase revenue guidance for FY22), vertical wise commentary, ramp up of Daimler deal, traction in digital technologies, and pricing environment
Wipro	Wipro had guided for 2-4% CC growth in Q3 for IT services. We expect the company to report 4.0% QoQ CC growth in revenues in IT services. We expect dollar revenue growth of 3.3% QoQ, factoring in 70 bps cross currency headwind. The company is expected to report 3% QoQ rupee growth. EBIT margins in global IT services are expected to decline 10 bps QoQ, due to impact of salary hike for the lower pyramid amid higher attrition. Overall EBIT margins are expected to decline 30 bps QoQ due to continued weak performance from ISRE. Consequently, PAT is expected to flattish QoQ. Investor interest: Commentary on recent M&A and potential benefits, deal wins, further wage hike, vertical commentary, commentary of client's IT budget and revenue guidance
HCL Tech	HCL Technologies is expected to report 3.5% QoQ revenue growth in CC terms mainly led by broad based growth across verticals and re-bound in product revenues (which had seen sharp decline QoQ in the last quarter). The revenues are expected to be partially offset by cross currency impact of 50 bps for the quarter, dollar revenues are expected to up 3% QoQ. EBIT margins for the quarter are expected to improve 20 bps QoQ, negating 80-90 bps impact due to salary hikes, on operating leverage and rebound in P&P business. PAT is expected to improve 3% QoQ. Investor interest: FY23E revenue & margin guidance, commentary on deal pipeline especially multi-year as well as pricing
Tech Mahindra	Tech Mahindra is expected to witness 3.5% QoQ growth in CC revenues. However, dollar revenue is expected to grow 3% QoQ due to 50 bps cross currency headwinds. Rupee revenues are expected to grow 4.4% QoQ. We expect EBIT margin to improve 10 bps QoQ to 15.3% as supply side challenges restrict margin expansion. PAT is expected to improve 5% QoQ due to lower tax and higher other income. Investor interest: Outlook on margin, large deals and incremental order flow from 5G services

Source: Company, ICICI Direct Research

EBIT/EBITDA margin impact

EBIT margins	Q3FY22E	Q2FY22	Change (bps)
TCS	25.8	25.6	20
Infosys	23.7	23.6	16
Wipro ^	17.6	17.7	(10)
HCL Tech	19.2	19.0	20

EBITDA margins

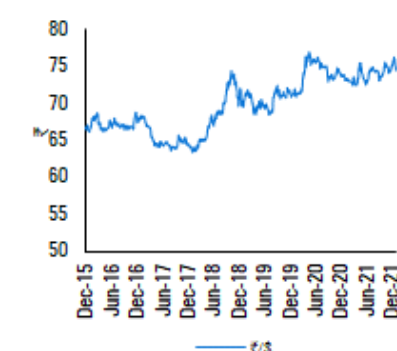
Tech M	18.5	18.3	16
LTI	19.6	19.5	14
Mindtree	20.9	20.5	38
Coforge	18.4	17.4	96

Staffing (in %)

Teamlease	2.1	2.2	(12)
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^ IT services

\$/₹



\$ vs. global currencies

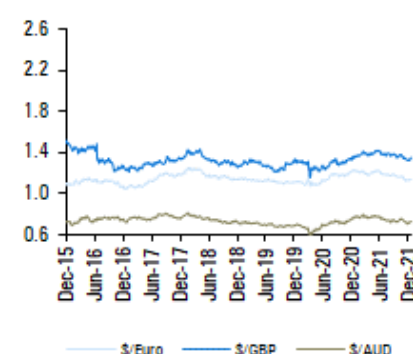


Exhibit 3: Company Specific views

Company	Remarks
Larsen & Toubro Infotech	The company is expected to continue revenue momentum but supply side pressures are expected to restrict margin expansion. The company is expected to report 5.5% QoQ CC growth. Growth would be broad based and led by ramp up of deals & improvement in discretionary spend. In dollar term, the growth is expected to be 5% QoQ due to 50 bps cross currency headwinds. In rupee terms we expect revenues to increase 6.3% QoQ. However, we expect LTI's EBIT margin to expand 20 bps QoQ at 17.4% due to supply side pressure and lower utilisation. PAT is expected to grow 5% QoQ. Investor Interest: Outlook on 14-15% net profit margin for FY23, deal pipeline
MindTree	The company is expected to register 5.0% QoQ growth in CC terms mainly led by ramp up of deals in BFSI, improvement in travel vertical and healthy growth in top client. In dollar terms, revenues are expected to grow 4.5% QoQ due to 50 bps cross currency headwinds. Rupee terms revenues are expected to increase 6.0% QoQ. EBIT margins are expected to improve by only 20 bps QoQ despite strong growth, due to elevated employee expenses amid talent crunch. Investor interest: Traction in Europe, multi-year annuity deals, progress of health vertical, mining of strategic accounts, revenue & margin outlook for FY23E, travel vertical outlook, growth in top client and merger with LTI
Coforge	Coforge is expected to register 5.5% QoQ growth in revenues of in CC terms, out of which 3% is organic and rest is led by acquisition of SKS global. In dollar terms, we expect 5% QoQ growth due to 50 bps QoQ impact on cross currency headwinds. In terms of rupee, we expect the company to post 6.6% QoQ growth. EBIT margins are expected to expand 120 bps QoQ on strong revenue growth and deferred license revenue from Q2. PAT is expected to grow 17% QoQ. Investor interest: commentary on revenue guidance, outlook on travel vertical, large deal pipeline in BFSI, insurance & healthcare, margin and demand outlook
Teamlease Services	We expect the company's overall revenues to improve 4.9% QoQ mainly led by 5% QoQ in general staffing while specialised staffing (mainly led by traction in IT staffing) is expected to witness a muted performance due to some impact of furlough. We expect margins to decline 10 bps QoQ to 2.1% mainly led by investments in manpower (especially at the top level) and some impact of weakness in other HR services. Hence, we expect PAT to decline 4% QoQ. Investor interest: PF trust related commentary

Source: Company, ICICI Direct Research

Exhibit 4: ICICI Direct Coverage universe (IT)

Company Name	CMP	TP (₹)	Rating	Mcap (₹)	EPS (₹)			P/E			RoCE (x)			RoE(x)		
					FY21	FY22E	FY23E	FY21	FY22E	FY23E	FY21	FY22E	FY23E	FY21	FY22E	FY23E
HCL Tech (HCLTEC)	1,335	1,475	BUY	362,274	45.8	50.6	60.9	29.1	26.4	21.9	23.5	24.1	27.6	20.8	20.5	23.2
Infosys (INFTEC)	1,901	2,060	BUY	808,134	45.5	54.8	64.3	41.8	34.7	29.6	31.7	34.0	37.0	25.2	27.8	30.3
TCS (TCS)	3,878	4,530	BUY	1,434,860	87.6	110.9	133.0	44.2	35.0	29.2	45.9	51.9	55.8	37.5	43.8	46.8
Tech M (TECMAH)	1,783	2,150	BUY	172,291	50.2	64.7	76.8	35.5	27.5	23.2	19.8	22.8	24.4	17.8	20.4	21.4
Wipro (WIPRO)	722	815	BUY	395,439	19.1	21.9	27.8	37.9	33.0	26.0	21.3	22.5	28.3	19.5	21.7	27.5
LTI (LTINFC)	7,560	7,650	BUY	132,721	111.0	137.3	169.9	68.1	55.1	44.5	31.9	33.0	34.0	26.5	27.6	28.5
Mindtree (MINCON)	4,777	4,915	HOLD	78,676	67.4	89.8	109.2	70.9	53.2	43.7	32.5	36.0	36.3	25.7	28.2	28.2
Coforge (NIITEC)	6,112	5,870	BUY	37,995	73.3	115.2	146.7	83.4	53.0	41.7	23.3	28.6	30.9	18.5	25.0	27.1
TeamLease (TEASER)	4,191	4,220	HOLD	7,192	46.5	66.7	101.0	90.2	62.8	41.5	14.2	16.3	19.9	11.6	15.7	18.7

Source: Company, ICICI Direct Research

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Sell: <-15%



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