

Q4FY23E Information Technology Preview



Information Technology

Seasonally weak quarter for IT companies on the back of adverse macro factors

MARKET DATA

	Close	1D (%)	1M (%)	YTD (%)
Nifty	17,624	0.1	1.2	-2.6
Sensex	59,814	0.1	1.1	-1.7
Nifty IT	29,041	0.9	-1.7	1.5
USD / INR	82.065	0.1	-0.3	-1.6

COVERAGE STOCKS

Company	Current Price (INR)	Target* (INR)	Upside (%)	Market Cap. (INR mn)	Fwd P/E 2024E (x)	Recommendation*
Infosys Ltd	1,402	1,805	28.7%	5,81,75,300	19.42	BUY
Tata Consultancy Services Ltd	3,205	3,739	16.6%	1,17,27,259	23.56	BUY
Wipro Ltd	370	471	27.2%	20,33,273	14.12	ACCUMULATE
HCL Technologies Ltd	1,087	1,119	2.9%	29,50,568	19.42	HOLD
Sonata Software Ltd	894	732*	TA	1,25,349	25.83	BUY
Happiest Mind Technologies Ltd	808	1,158	43.3%	1,18,665	43.91	BUY
Persistent Systems Ltd	4,501	4,697	4.3%	3,44,038	28.30	ACCUMULATE
Tech Mahindra Ltd	1,098	1,181	7.5%	10,70,539	14.41	BUY
Infibeam Avenues Ltd	14	28	100%	3,746	24.14	BUY

*Note: TP and recommendation has been retained from previous update reports; we will review it post detailed Q4FY23E results analysis and conference call of the said companies

Source: Bloomberg, NSE; Data as of April 11, 2023; UR stands for Under Review; TA stands for Target Achieved

SECTOR OVERVIEW

- Revenue growth:** In Q4FY23, IT service providers are expected to record median revenue increase of 0.8% QoQ and 8–10% YoY in constant currency. In terms of deal ramp up, the conversion of order book to revenue is also taking longer than the usual. For TCS, Infosys, and Wipro, we anticipate quarterly dollar sales increase of between 0.5% and 2%, while we anticipate annual dollar revenue growth of between 2% and 3% for HCL Tech (IT services). The Tier II IT businesses LTI Mindtree and Coforge are likely to record consistent QoQ CC revenue growth of 2% and 2.5%, respectively. Pipeline to TCV conversion is taking longer than expected, particularly for discretionary IT investment. Bookings are anticipated to remain high despite the fact that clients have not entirely abandoned their transformational journeys
- Margin Recovery:** While a negative economy is anticipated to have an impact on Q4FY23 revenue growth, lowering supply, a slowdown in attrition, and improved utilization should lead to some improvement in margins. Major currencies have gained value versus the dollar, which will provide them an advantage. Due to subpar topline growth, EBIT and PAT are anticipated to grow by 1.2 percent and 3 percent, respectively, QoQ. Given the near-term downturn in demand and high hiring last year, we anticipate a stop in net hiring in the fourth quarter. Moreover, we anticipate that subcontractor costs will moderate, with margins being supported by lower backfilling and retention.
- Attrition Rate and deal wins:** The attrition rate has decreased; for large IT players, it is now between 18% and 20%; however it has gone down but not as fast as we would like to have. The rate of attrition still has to decrease more quickly. Next financial year's attrition is expected to come back to normality which will improve the margins for the sector as a whole. The HCL Tech Fresher hiring is anticipated to proceed as scheduled at the beginning of the year, with 25k–30k freshers joining the workforce in FY23. While, wipro's fresher hiring in FY24E is likely to be much lower than the record high hiring in FY23E. As the current macroeconomic environment evolves and clients want to minimise costs, there will be some significant deal initiatives.

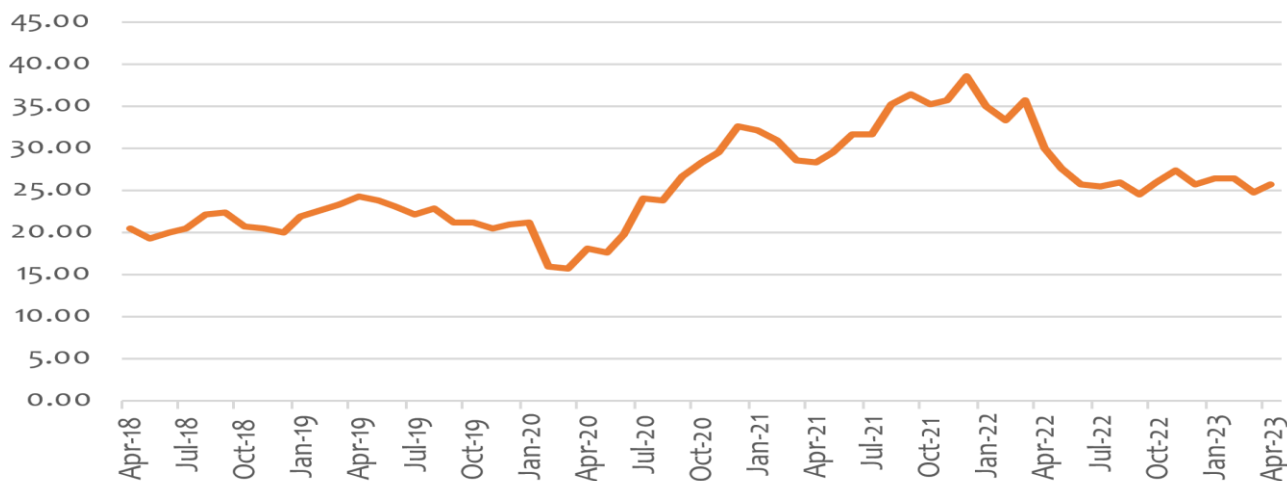
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SECTOR OVERVIEW

- Demand and Industry Outlook:** . While management has noted sustained secular demand in a few industries, they have also highlighted some hesitancy on the part of their clients and delays in decision-making due to the ongoing macro-overhang. Earnings of Indian information technology (IT) services companies are anticipated to be impacted by the recent banking crisis in the United States in Q4FY23. Cuts in IT investment and longer decision-making cycles enforced by clients in this sector are likely to have an impact on the companies' top line because Indian IT companies heavily rely on the Banking, Financial Services, and Insurance (BFSI) sector for their income. Some of the IT players have said explicitly that they have no appreciable exposure to regional US banks that are experiencing financial difficulties. Apart from BFSI, Hi-Tech, Manufacturing and Retail may also report muted growth in 4Q.
- Sector Valuation:** We believe Nifty IT has underperformed compared to the Nifty 50 index owing to the worsening macro economic scenarios and seasonal furloughs. Companies that provide IT services are noticing a move towards cost-optimization deals and an increase in vendor consolidation transactions in the works. prefer Tier-I (large-cap) players over their Tier-II (mid-cap) counterparts, given the former's attractive valuations, increased traction in vendor consolidation, and diversified client portfolios. TCS remains best positioned to benefit from long-term structural tailwinds in tech services and should see a relative pick-up in growth, aided by clients' focus on cost optimization and efficiencies. HCL Tech is one of the key beneficiaries of Cloud adoption at scale, given its expertise in IMS and it expects Infosys to deliver strong growth, backed by strong deal wins. Notwithstanding some short-term discomfort, we continue to be optimistic about the IT services sector, which is underpinned by a healthy medium- to long-term demand outlook.

NIFTY FMCG P/E and 5 Yr Average

Nifty IT P/E



Source: NSE

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Exhibit 1: Quarterly result expectation for companies under coverage

INR Mn	Q4FY23E	Q4FY22A	YoY	Q3FY23A	QoQ	Remarks
Infosys Ltd						
Sales	3,60,105	3,29,130	9.4%	3,83,180	-6.0%	We expect overall sales to grow by about 9.4% YoY and decline by 6.0%, sequentially due to seasonally weak quarter for the company. Moreover, incremental pricing pressure from weak macros in the BFSI vertical of the US and European markets. The company is also witnessing delay in decision making leading to delay in deal closures as some cautious stance being taken by clients. We expect PAT to be decline by 3.6% and 2.0% on YoY and QoQ basis respectively. Key Parameters: (1) Status of deal closure (2) Performance at key geographies (3) Moderation of attrition expected (4) Impact of BFSI verticals along with other key business verticals
EBIT	72,549	84,830	-8.7%	82,420	-6.0%	
Net Profit	56,950	59,059	-3.6%	58,090	-2.0%	
EBIT (%)	21.5%	25.8%	-430 bps	21.5%	0 bps	
NPM (%)	15.8%	17.9%	-210 bps	15.2%	60 bps	
Wipro Ltd						
Sales	2,36,847	2,08,600	13.5%	2,32,290	1.9%	We expect overall sales to grow by about 13.5% YoY and 1.9%, sequentially due to incremental pressure from weak macros among some pockets in the US. The company is also witnessing delay in decision making leading to delay in deal closures as some cautious stance being taken by clients. We expect PAT to be flattish YoY as well as on a sequential basis due to lower utilizations and some incremental expenses in terms of facility, etc. Key Parameters: (1) Delay in deal closures (2) Lower utilization and weak revenues (3) Moderation of attrition expected (4) Impact of macros on its US retail, technologies and investment banking verticals
EBIT	35,763	33,470	6.8%	35,470	0.8%	
Net Profit	30,790	30,870	-0.3%	30,520	-0.8%	
EBIT (%)	15.1%	16.1%	-100 bps	13.1%	200 bps	
NPM (%)	13.0%	14.8%	-180 bps	13.1%	-10 bps	
TCS Ltd						
Sales	5,91,740	5,05,910	16.9%	5,82,990	1.5%	We expect revenue to grow by 16.9% YoY and 1.5% on a sequential basis, supported by continued deal momentum especially in cloud transformation segment in Q4FY23E. EBIT margins to improve by 10 bps on a sequential basis and decline by 10 bps on a YoY basis due to GBP and EUR appreciation against US. PAT margins are also expected to stay flattish for the current quarter. Key Parameters: (1) BFSI vertical revenue mix (2) Growth moderation in US (3) Strategy of new CEO on long term growth (4) deal momentum in cloud transformation (5) impact of furloughs in January.
EBIT	1,32,549	1,14,120	16.1%	1,30,160	1.8%	
Net Profit	1,13,614	99,590	14.1%	1,08,830	4.4%	
EBIT (%)	22.4%	22.5%	-10 bps	22.3%	10 bps	
NPM (%)	19.2%	19.6%	-40 bps	18.6%	60 bps	
HCL Technologies Ltd						
Sales	2,68,030	2,26,070	18.5%	2,67,000	0.4%	Q4 is seasonally a weak quarter due to fewer working days and furlough impact in January. We expect the revenue to grow by 18.5% on a YoY basis and witness a muted growth on a sequential basis. Its IT services business to witness growth on the back of continued momentum in ramp up of deals. EBIT margins to decline by 70 basis points on a sequential basis and increase by 100 bps YoY. PAT margins to stay under pressure due to seasonality weakness. P&P will likely impact QoQ on seasonality. Key Parameters: (1) Ramp up of deals (3) Weakness in Hi-tech media and entertainment verticals (4) Deal signing in the European regions to witness moderations (5) Continued growth momentum in ER&D business
EBITDA	39,132	30,850	26.8%	40,910	-4.3%	
Net Profit	40,740	35,990	13.2%	40,960	-0.5%	
EBIT (%)	14.6%	13.6%	100 bps	15.3%	-70 bps	
NPM (%)	15.2%	15.9%	-70 bps	15.3%	-10 bps	

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INR Mn	Q4FY23E	Q4FY22A	YoY	Q3FY23A	QoQ	Remarks
Sonata Software Ltd						We expect sales to grow significantly by 56.7% YoY and by 1.5% on a sequential basis. EBIT and PAT to witness exponential growth on a YoY basis due to a low base. EBIT margins to stay flat at 0 bps increase YoY and improve by 20 bps QoQ. PAT margins to improve 110 bps sequentially while witness a decline 50 bps on a YoY basis. Key parameters: (1) Quant Systems acquisition to add capabilities and expand opportunity size (2) Strong and stable relationship with microsoft (3) Higher re-investment accelerating the growth.
Sales	22,947	14,636	56.7%	22,608	1.5%	
EBIT	1,491	950	56.9%	1,426	4.5%	
Net Profit	1,445	1,008	43.3%	1,177	22.7%	
EBIT (%)	6.5%	6.5%	0 bps	6.3%	20 bps	
NPM (%)	6.3%	6.8%	-50 bps	5.2%	110 bps	
Happiest Mind Technologies Ltd						On a YoY basis, we do expect some improvement in the revenue but on a QoQ basis, due to macro economics conditions we expect the growth will be stagnant. The EBIT and PAT are also expected to grow slightly by 0.60% and 1.83% on a QoQ basis and the EBIT and PAT margin is estimated to have minor impacts. Key Parameters: (1) Management expects some reduction in the BFSI sector. (2) Investing in different segments to grow the business (3) Some lag in growth can be witnessed in the coming quarter
Sales	3737.45	3005.70	24.35%	3668.80	1.87%	
EBIT	800.21	628.30	27.36%	795.40	0.60%	
Net Profit	586.32	521.10	18.49%	575.80	1.83%	
EBIT (%)	21.41%	20.90%	51 bps	21.68%	-27 bps	
NPM (%)	15.69%	17.34%	-82 bps	15.69%	0 bps	
Persistent Systems Ltd						We expect that the company would continue to grow as the pressure has been slightly easing off on a YoY basis but on a QoQ basis, this growth can be impacted due to the macro economic conditions. We also expect that the EBIT would also improve as there is no major pressure in attrition rate, hence we expect the EBIT margin to be at 13.94%, a hike of 74 bps. Key Parameters: (1) Strong Deal Wins, (2) Improvement in EBIT, (3) Acquired businesses over the previous 4-5 quarters has been fully integrated and will aid Persistent Systems Ltd to grow.
Sales	13,328.07	11,133.58	19.71%	12,986.60	2.63%	
EBIT	2326.11	1464.24	58.86%	1728.93	34.54%	
Net Profit	1601.53	1377.59	16.26%	1499.24	6.82%	
EBIT (%)	13.94%	13.20%	74 bps	13.31%	63 bps	
NPM (%)	12.02%	12.40%	-38 bps	11.54%	48 bps	
Tech Mahindra Ltd						We expect sales to grow at 10.5% YoY and 2.12% QoQ as the impact, of clients not working with the company due to macroeconomic conditions, has reduced. We expect that from here onwards we can view some surge in the revenue growth. We expect improvement in the EBIT and EBIT margin as the management had already reached its pre-COVID utilization rate and it was estimated to increase in the upcoming quarters. The EBIT and PAT margin has also improved by 532 bps and 409 bps respectively on a YoY Basis. Key Parameters: (1) Sustainable deal win growth (2) Retrieve the loss of the business (3) High Utilization Rate (4) Expectation on improvement in the top 5 clients' revenue
Sales	125,172.56	113,019.16	10.75%	122,569.63	2.12%	
EBIT	25,878.98	17,351.69	49.14%	22,105.68	17.07%	
Net Profit	20,663.57	14,033.35	47.25%	17,656.71	17.03%	
EBIT (%)	20.67%	15.35%	532 bps	18.04%	263 bps	
NPM (%)	16.51%	12.42%	409 bps	14.41%	210 bps	

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Exhibit 1: Quarterly result expectation for companies under coverage

INR Mn	Q4FY23E	Q4FY22A	YoY	Q3FY23A	QoQ	Remarks
Tata Elxsi Ltd						We believe that the sales for the company would improve by 29.45% on a YoY basis and 7.92% on a QoQ basis as the company expects some improvement in IDV and SIS business in the coming quarters. However, the EBIT margins on a YoY basis can witnessed some dip due to some macro economic issues and a hike in wages. Key Parameters: (1) Improvement in IDV and SIS segments (2) Improvement in top 5 clients at a slower pace. (3) Addition of new clients from newer geographies.
Sales	8824.89	6817.39	29.45%	8177.43	7.92%	
EBIT	2497.44	2053.62	21.61%	2254.29	10.79%	
Net Profit	1941.48	1600.12	21.33%	1946.79	-0.27%	
EBIT (%)	28.30%	30.12%	-182 bps	27.57%	73 bps	
NPM (%)	22.00%	23.47%	-147 bps	23.81%	-181 bps	
Infibeam Avenues Ltd						
Sales	4,197	3,695	13.6%	4,147	1.2%	We expect revenue to grow by 13.6% YoY and 1.2% on a sequential basis, supported by increase in the gross transaction. However, sequential growth in expected to be flattish due to change in transaction mix towards non-credit transactions. EBIT margins to improve by 10 bps on a 10 bps on a QoQ and YoY basis due to better Net Take Rates (NTR) in the non credit transaction. PAT margins are also expected to improve due to higher other income.
EBIT	323	282	14.5%	315	2.5%	
Net Profit	373	282	32.3%	354	5.4%	
EBIT (%)	7.7%	7.6%	10 bps	7.6%	10 bps	Key Parameters: (1) Growth in transaction volume ex-GEM (2) Mix of credit and non credit transactions (3) Improvement in NTR (4) Performance in internal markets.
NPM (%)	8.9%	7.6%	130 bps	8.5%	40 bps	

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Rating Legend (Expected over a 12-month period)	
Our Rating	Upside
Buy	More than 15%
Accumulate	5% – 15%
Hold	0 – 5%
Reduce	-5% – 0
Sell	Less than – 5%

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