

IT Sector Q3FY23E Preview

IT sector outlook

Macro-economic challenges continued to aggravate globally during Q3FY23 led by Inflationary pressures triggered by interest rate hikes. US Fed's Quantitative tightening program led to rise in interest rate from 0.25% in March2022 to 4.5% in December2022. **During this period on an average USD has appreciated over 13.1% v/s global currencies. The highest weakness has been witnessed by Yen, GBP and Euro. However, despite being an emerging economy India remained quite resilient during this period and INR has weakened by 9% v/s USD from Mar22-Dec22. In Q3FY23 INR has depreciated by 3% qoq against USD to an average USD/INR rate of 82.2.**

As articulated in Q2FY23 preview, we believe the increased interest rates by US Fed will start witnessing impact on overall spends (not just IT sector related) from US geography. And US being one of the dominant markets for IT services, Indian IT companies will start witnessing some delay in technology spends by clients from fag end of CY2022.

Thus Q3FY23 Mgmt. commentary of Indian IT companies has to be keenly followed to get feelers onto the expected client budgets for CY24. Also its more important to know what areas of IT spends continue to stay indispensable and relevant, where large Enterprises would continue to spend even in current period of economic turmoil.

BCG collaborated with NASSCOM to identify key technological big bets that can potentially deliver disproportionate growth for the tech industry. The report identifies 12 technologies at the sweet spot of rapid innovation and robust private funding. The list includes autonomous analytics, sustainability tech, augmented reality (AR) and virtual reality (VR), sensor tech, and smart robots (constituting 60% of total funding in the 12 technologies) that cut across industries; to distributed ledger tech, autonomous driving, and space tech, which are niche. Interestingly, 5G/6G, edge computing, computer vision, and deep learning emerged on top, and as key enablers for other technologies.

Thus we have long-term structural positive view on the nature and size of IT spends that would continue to happen by large Enterprises globally.

Q3FY23 Expectations

The constant currency growth is expected to remain weak led by the seasonality impact of holidays and furloughs in some of the verticals. However, there is positive cross-currency movement of ~2% qoq during Q3FY23, which will benefit the Top-line growth numbers of Indian IT companies in reported USD terms. Moreover, the growth in INR terms will also remain strong as the average quarterly INR has depreciated by 3% qoq against USD to 82.2 during Q3FY23. To some extent this will help Indian IT companies to stay resilient on margin front.

Key data points to be highly noted during Q3FY23 results are;

- 1. Ground update on signs of US recession impacting US economy,**
- 2. Feelers on Client Budgets for FY24,**
- 3. TCV of deal wins & deal pipeline,**
- 4. Nature and areas of IT spends expected despite of weaker macros,**
- 5. Intensity in Hiring or Layoffs,**
- 6. Attrition rates, whether have continued to decline or are stable,**
- 7. Will Pricing improvement continue to stay for few more quarters or is done with.**

Q3FY23E, FY23E and FY24E estimations of Top 5 Indian IT companies under coverage

IT Sector Q3FY23E Preview Figures	Infosys	TCS	HCL Tech	Wipro	Tech M
CMP	1495	3314	1036	390	1020
Mcap (Rs cr)	6,29,066	12,12,628	2,81,163	2,13,847	99,330
FY24E PE (x)	22.2	25.8	17.4	16.9	15.6
Q3FY23E					
Net Sales (Rs cr)	38,811	58,366	26,269	23,587	13,728
% chg qoq	6.2%	5.5%	6.4%	4.6%	4.6%
% chg yoy	21.8%	19.4%	17.6%	16.1%	19.9%
Net Sales (US\$mn)	4,722	7,101	3,196	2,870	1,670
% chg qoq (Reported USD terms)	3.7%	3.3%	3.7%	1.8%	2.0%
% chg yoy (Reported USD terms)	11.1%	8.8%	7.3%	7.5%	8.9%
% chg qoq (Constant Currency terms)	1.7%	1.3%	1.7%	0.2%	0.0%
EBITDA (Rs cr)	9,578	15,646	5,926	4,379	2,196
EBITDA margin (%)	24.7%	26.8%	22.6%	18.6%	16.0%
bps chg qoq	0.3%	0.6%	0.6%	1.1%	0.9%
bps chg yoy	-1.6%	-0.7%	-1.6%	-2.0%	-2.0%
EBIT (Rs cr)	8,491	14,368	4,936	3,579	1,689
EBIT margin (%)	21.9%	24.6%	18.8%	15.2%	12.3%
bps chg qoq	0.3%	0.6%	0.9%	1.2%	0.9%
bps chg yoy	-1.6%	-0.4%	-0.3%	-1.7%	-2.5%
PAT (Rs cr)	6,469	11,151	3,879	2,922	1,311
% chg qoq	7.4%	6.9%	11.2%	9.9%	2.0%
% chg yoy	11.4%	14.1%	12.7%	-1.6%	-4.2%
Diluted EPS (Rs)	15.4	30.5	14.3	5.3	14.8
% chg qoq	7.4%	6.9%	11.2%	9.8%	2.0%
% chg yoy	11.4%	15.4%	12.9%	-1.8%	-4.2%
FY23E					
Net Sales (Rs cr)	1,50,220	2,26,150	1,01,578	91,833	53,779
% chg yoy	23.5%	17.9%	18.6%	16.1%	20.5%
Net Sales (US\$mn)	18,618	27,996	12,595	11,392	6,664
% chg yoy	14.2%	8.9%	9.7%	8.7%	11.1%
EBITDA (Rs cr)	36,555	60,012	22,286	16,955	8,456
EBITDA margin (%)	24.3%	26.5%	21.9%	18.5%	15.7%
bps chg yoy	-1.6%	-1.1%	-2.0%	-2.4%	-2.2%
EBIT (Rs cr)	32,378	54,970	18,350	13,774	6,468
EBIT margin (%)	21.6%	24.3%	18.1%	15.0%	12.0%
bps chg yoy	-1.5%	-1.0%	-0.9%	-1.9%	-2.5%
PAT (Rs cr)	24,796	42,828	14,571	11,381	5,187
% chg yoy	12.2%	11.7%	7.9%	-6.9%	-6.8%
Diluted EPS (Rs)	59.1	117.1	53.8	20.7	58.6
% chg yoy	12.4%	13.0%	8.1%	-7.1%	-7.5%
FY24E					
Net Sales (Rs cr)	1,68,052	2,46,376	1,12,831	99,249	59,063
% chg yoy	11.9%	8.9%	11.1%	8.1%	9.8%
Net Sales (US\$mn)	20,483	30,030	13,753	12,096	7,199
% chg yoy	10.0%	7.3%	9.2%	6.2%	8.0%
EBITDA (Rs cr)	41,285	65,873	24,549	18,726	9,676
EBITDA margin (%)	24.6%	26.7%	21.8%	18.9%	16.4%
bps chg yoy	0.2%	0.2%	-0.2%	0.4%	0.7%
EBIT (Rs cr)	36,853	60,886	20,563	15,536	7,549
EBIT margin (%)	21.9%	24.7%	18.2%	15.7%	12.8%
bps chg yoy	0.4%	0.4%	0.2%	0.7%	0.8%
PAT (Rs cr)	28,253	46,983	16,163	12,644	5,803
% chg yoy	13.9%	9.7%	10.9%	11.1%	11.9%
Diluted EPS (Rs)	67.3	128.4	59.7	23.0	65.6
% chg yoy	13.9%	9.7%	10.9%	11.1%	11.9%

Note: 1. We expect Wipro IT Services to post 1.9% qoq growth to US\$2851mn in Q3FY23E. However including India SRE business & IT Products revenues Wipro is expected to post total Topline growth of 1.8% qoq to US\$2870mn as mentioned in above table, which reflects Wipro's aggregate growth and margin figures. 2. CMPs of above IT companies are based on 4th January 2023 stock prices.

Following are the Q3FY23 expectations from the Tier 1 IT companies under our coverage:

TCS

We have estimated TCS to register Topline growth of 3.3% qoq to US\$7101mn in reported terms and 1.3% qoq in CC terms. EBIT margins to be up 91bps qoq to 24.9% in Q3FY23 led by cross-currency benefit and as TCS had already given Industry level annual salary hikes effective 1st April2022. Thus, led by stable overall performance we expect TCS to report 6.9% qoq spike in PAT to Rs11,151cr in Q3FY23.

Infosys

We have estimated Infosys to register Topline growth of 3.7% qoq to US\$4722mn in reported terms and 1.7% qoq in CC terms. EBIT margins are expected to be up 30bps qoq at 21.9% led by cross-currency benefit. PAT is expected to be up 7.4% qoq to Rs6,469cr in Q3FY23.

HCL Tech

We have estimated HCL Tech to register Top-line growth of 3.7% qoq to US\$3196mn in reported terms and 1.7% qoq in CC terms led by strong seasonal revenue growth in Product & Platform segment (which was down 10% qoq in Q2). EBIT margins are expected to be up 85bps qoq at 18.8% led by strong growth in P&P revenues and cross-currency benefit. Thus, we expect HCL Tech to report 11% qoq uptick in PAT to Rs3,879cr in Q3FY23.

Wipro

We have estimated Wipro to register growth of 1.9% qoq to US\$2851mn in IT services revenues in reported terms and 0.2% qoq in CC terms. Including other revenue segments, we estimate Wipro to post overall Topline growth of 1.8% qoq to US\$2870mn. We estimate Wipro's overall EBIT margins to be up 122bps qoq at 15.2% in Q3FY23 led by improved Utilization and cross-currency benefit. Thus, we expect Wipro to report 10% qoq spike in PAT to Rs2922cr in Q3FY23.

Tech Mahindra

We have estimated Tech Mahindra to register Topline growth of 2% qoq to US\$1670mn in reported terms and flat qoq in CC terms. EBIT margins to be up 90bps qoq to 12.3% in Q3FY23 led by operational efficiencies and cross-currency benefit. Tax rate will get normalized to 25% v/s lower in Q1 & Q2FY23. Thus, Tech Mahindra is expected to witness 2% qoq uptick in PAT to Rs1311cr in Q3FY23.