

RESEARCH
BOB ECONOMICS RESEARCH | INVESTMENT ACTIVITY

Is investment set to pick up

IT SERVICES | Q3FY23 PREVIEW

Margins likely to surprise on the upside

SUMMARY
INDIA ECONOMICS: INVESTMENT ACTIVITY

The New Year has started with positive news emerging on the investment side. This has been reflected by the CMIE data on new investment announcements made by firms for Q3FY23, which may be interpreted as investment intentions by firms, and could possibly reflect pick up in investment activity. Furthermore, the possible extension of PLI scheme in other sectors also bodes well for the investment cycle.

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IT SERVICES: Q3FY23 PREVIEW

- Despite furlough, revenue likely to deliver the pre-covid level but the pressure on existing business continues
- Margins to witness a modest uptick but demand commentary likely to be weak
- We assume coverage of INFO, TCS, WPRO, HCLT and TECHM with this report and rate INFO and HCLT as BUY, WPRO, TCS & TECHM as HOLD

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Daily macro indicators

Indicator	03-Jan	04-Jan	Chg (%)
US 10Y yield (%)	3.74	3.68	-6bps
India 10Y yield (%)	7.32	7.32	0bps
USD/INR	82.89	82.81	0.1
Brent Crude (US\$/bbl)	82.1	77.8	(5.2)
Dow	33,136	33,270	0.4
Hang Seng	20,145	20,793	3.2
Sensex	61,294	60,657	(1.0)
India FII (US\$ mn)	02-Jan	03-Jan	Chg (\$ mn)
FII-D	(0.7)	(100.6)	(100.0)
FII-E	201.1	(31.0)	(232.0)

Source: Bank of Baroda Economics Research

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INVESTMENT ACTIVITY

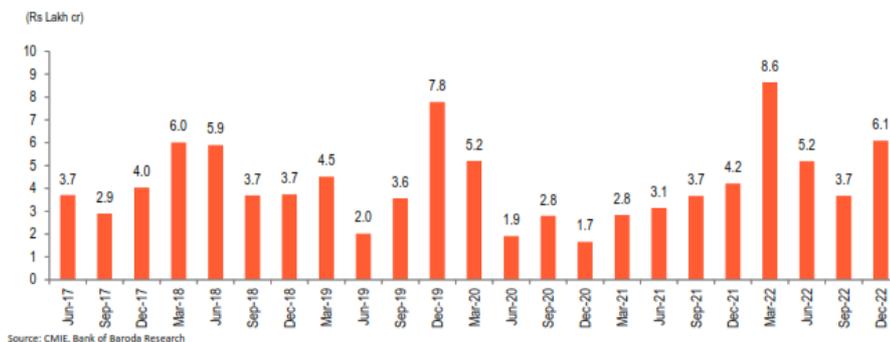
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Is investment set to pick up

The New Year has started with positive news emerging on the investment side. This has been reflected by the CMIE data on new investment announcements made by firms for Q3FY23, which may be interpreted as investment intentions by firms, and could possibly reflect pick up in investment activity. Furthermore, the possible extension of PLI scheme in other sectors also bodes well for the investment cycle.

Jahnavi
Economist

Chart 1: New Investment announcement has picked up pace



The chart explains new investment announcements across quarters for the last 5-years. New investment announced accelerated sharply to Rs 7.8 lakh cr in the December quarter of 2019. However with onset of Covid-19 pandemic and lockdown restrictions imposed across the country, investment took a back seat as has been visible with moderate pace of new investment till Dec'21. With reopening of economy gradual pickup in economic activity, new investment announced peaked at Rs 8.6 lakh cr in Mar'22. Since then, in Q1FY23 and Q2FY23 a dip in new announcements was noticed. However, things are now beginning to look optimistic. As of Dec'22, there has been as steady pick up in new announcements and stands at around Rs 6.1 lakh cr compared with Rs 3.7 lakh cr in Sep'22 and Rs 4.2 lakh cr in Dec'21.

On a cumulative basis, total investment announced has grown by over 36% in Apr-Dec'22 compared with last year. It is Rs 15 lakh crore for the 9-month period compared with Rs 11 lakh core last year. In fact the Rs 15 lakh crore of announcements made in FY23 so far is the highest in the last 5 years.

Sectors showcasing intentions

The table below talks about the sectors that have shown interest in investment with their announcements for the cumulative period of Apr-Dec'22. The important takeaways are:

- Chemicals and related products along with machinery accounted for 54.1% share of total new announcements made.



Margins likely to surprise on the upside

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Modest margin uptick likely despite a drag in quality of revenue: Post Covid, the outlook is turning bearish for upstream technology companies such as hyperscalers and software-as-a-service (SaaS) vendors. Digital revenue of downstream players is directly correlated with their upstream counterparts. Rising unemployment, headcount reduction by global tech companies and a near freeze in hiring by IT services vendors point to a slowdown ahead. On the other hand, an easing talent crunch is likely to soften attrition levels due to lower employee backfill cost. Recently hired staffs (reskilled/upskilled) are likely to deliver higher utilization. The change in revenue mix (increasing focus in Horizon 1 & automation) will likely lead the positive surprises in revenue and modest margin expansion in the near term.

Shift in long-term deal wins in Q3: Despite macro scenarios, clients are prioritizing their tech-spends without compromising on digital initiatives but due to the rising cost pressures, we see a change in customer preferences. As a result, companies are cutting back on tech budgets for cutting-edge solutions, which leads to a higher tech intensity in the enterprise business along with increased offshoring work for Indian IT companies. Positive traction to continue in Horizon-1 deal activities, but we expect slower traction in Horizon-3 deal wins especially large deals due to the longer payback period. Automation and cost-efficient projects remain main focus in the near term.

Valuations provide support despite macro headwinds: Central banks across the globe are tightening monetary policy to curb sticky inflation. As a result, a number of leading indicators are pointing to a recession/slowdown. The pain will exist for Indian IT companies mostly in interest rate-sensitive areas such as mortgage, capital markets, discretionary retail and pockets of manufacturing verticals. The divergent operating performance of Indian IT companies is likely to continue in FY24. We have noticed that the Tier I IT basket has corrected materially over the last few months. The sharp correction has created a significant potential for the Tier I IT companies to deliver more in the long run. We rate Infosys and HCL Tech as BUY and rate TCS, TECHM & Wipro as HOLD.

Recommendation snapshot

Ticker	Price	Target	Rating
HCLT IN	1,044	1,240	BUY
INFO IN	1,475	1,760	BUY
TCS IN	3,311	3,580	HOLD
TECHM IN	1,012	1,160	HOLD
WPRO IN	387	440	HOLD

Price & Target in Rupees | Price as of 5 Jan 2023



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Recommendation scale: Recommendations and Absolute returns (%) over 12 months

BUY – Expected return >+15%

HOLD – Expected return from -6% to +15%

SELL – Expected return <-6%

Note: Recommendation structure changed with effect from 21 June 2021

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