

IT SERVICES

Q1FY24 Review

10 August 2023

Better times ahead

- Weakness in consulting, BFSI, consumer, hi-tech and telecom verticals led to deferral of order bookings
- Early signs of improvement visible especially in BFSI deal momentum from July onward
- HCLT (tier-I) and PSYS/MPHL (tier-II) relatively better placed but valuations look fair post runup

Saptarshi Mukherjee
 research@bobcaps.in

Revenue to get back on track: Despite a poor performance in Q1FY24, we expect technology companies under our coverage to deliver managed services revenue growth around the average guidance of 5% YoY for CY23. Average contract value for managed services grew 6% YoY in Q2CY23 driven by the manufacturing and healthcare verticals, while consulting, BFSI, retail and consumer packaged goods (CPG), hi-tech, and telecom were a material drag on growth. Cloud businesses were also down in Q1 as compared to the Covid phase.

Order bookings sluggish: Due to the difficult global macro climate, Q1 commentary universally pointed to tardy decision-making, elongated working capital cycles, longer approval thresholds for deal renewals/signings, and extended transition timelines from project start to finish that limit the pricing cushion on future deal wins. Companies, thus, resorted to various levers, such as productivity, pricing, utilisation, automation, subcontracting cost, pyramid structure and portfolio mix, to preserve margins. On the bright side, the EMEA region in general (and the UK in particular) saw demand traction, with 5 of 10 large deals wins for key players coming from the region.

Cost takeout still at the fore: Deal wins for the quarter sat in two broad categories (1) full-stack portfolio services deals from vendor consolidation and cost optimisation, and (2) growth and transformational deals backed by hyperscalers and newer technologies. Smaller client enterprises focused on cost-of-delivery models that include fresher billings, higher utilisation, lower subcontracting cost and lower SG&A expense.

Valuation: Within tier-I IT services, we believe **HCLT** (HOLD, TP Rs 1,240) is better placed than peers. Its IT and business services (IT&BS) segment was flattish in Q1, but we expect engineering and R&D services (ER&D) and software business to drive up the topline and margins once discretionary spend kicks in. Mid-caps that look better placed in the medium term are (i) **PSYS** (HOLD, TP Rs 5,330) with top client deal renewals, setup of offshore delivery centres and healthy deal wins/pipeline, and (ii) **MPHL** (HOLD, TP Rs 2,541) given resolution of mortgage-related issues with its top 5 clients and healthy deal wins/pipeline. However, given the recent runup in IT sector valuations, we would await a better entry point into these stocks.

Recommendation snapshot

Ticker	Price	Target	Rating
AFFLE IN	1,100	1,110	HOLD
COFORGE IN	5,147	4,830	HOLD
HCLT IN	1,134	1,240	HOLD
INFO IN	1,389	1,760	BUY
MPHL IN	2,349	2,541	HOLD
PSYS IN	4,845	5,330	HOLD
TCS IN	3,442	3,580	HOLD
TECHM IN	1,236	1,130	HOLD
WPRO IN	419	420	HOLD

Price & Target in Rupees | Price as of 10 Aug 2023



Fig 1 – TCS

(Rs mn)	Q1FY24	Q4FY23	Q1FY23	QoQ (%)	YoY (%)	Estimates	Variance (%)
US\$ Revenue (US\$ mn)	7,226	7,195	6,780	0.4	6.6	7,229	0.0
INR Revenue	5,93,810	5,91,620	5,27,508	0.4	12.6	5,94,224	(0.1)
EBIT	1,37,550	1,44,880	1,21,788	(5.1)	12.9	1,47,378	(6.7)
PAT	1,11,074	1,13,920	94,708	(2.5)	17.3	1,14,364	(2.9)
EBIT Margin (%)	23.2	24.5	23.1	(132bps)	8bps	24.8	(164bps)
PAT Margin (%)	18.7	19.3	18.0	(55 bps)	75bps	19.2	(54bps)

Source: Company, BOBCAPS Research

Fig 2 – INFO

(Rs mn)	Q1FY24	Q4FY23	Q1FY23	QoQ (%)	YoY (%)	Estimates	Variance (%)
US\$ Revenue (US\$ mn)	4,617	4,554	4,444	1.4	3.9	4,604	0.3
INR Revenue	3,79,330	3,74,410	3,44,700	1.3	10.0	3,78,449	0.2
EBIT	78,910	78,770	69,140	0.2	14.1	78,157	1.0
PAT	59,450	61,280	53,600	(3.0)	10.9	61,131	(2.7)
EBIT Margin (%)	20.8	21.0	20.1	(24bps)	74bps	20.7	15bps
PAT Margin (%)	15.7	16.4	15.5	(69bps)	12bps	16.2	(48bps)

Source: Company, BOBCAPS Research

Fig 3 – HCLT

(Rs mn)	Q1FY24	Q4FY23	Q1FY23	QoQ (%)	YoY (%)	Estimates	Variance (%)
US\$ Revenue (US\$ mn)	3,200	3,235	3,025	(1.1)	5.8	3,282	(2.5)
INR Revenue	2,62,960	2,66,060	2,34,640	(1.2)	12.1	2,69,780	(2.5)
EBIT	44,600	48,053	39,956	(7.2)	11.6	48,217	(7.5)
PAT	35,340	39,507	32,866	(10.5)	7.5	38,767	(8.8)
EBIT Margin (%)	17.0	18.1	17.0	(110bps)	(7bps)	17.9	(91bps)
PAT Margin (%)	13.4	14.8	14.0	(141bps)	(57bps)	14.4	(93bps)

Source: Company, BOBCAPS Research

Fig 4 – WPRO

(Rs mn)	Q1FY24	Q4FY23	Q1FY23	QoQ (%)	YoY (%)	Estimates	Variance (%)
US\$ Revenue (US\$ mn)	2,779	2,820	2,735	(1.5)	1.6	2,778	0.0
INR Revenue	2,28,310	2,31,903	2,15,286	(1.5)	6.0	228,352	0.0
EBIT	34,516	36,587	30,856	(5.7)	11.9	36,791	(6.2)
PAT	28,860	30,745	25,542	(6.1)	13.0	30,478	(5.3)
EBIT Margin (%)	15.1	15.8	14.3	(66bps)	79bps	16.1	(99bps)
PAT Margin (%)	12.6	13.3	11.9	(62bps)	78bps	13.3	(71bps)

Source: Company, BOBCAPS Research

Fig 5 – TECHM

(Rs mn)	Q1FY24	Q4FY23	Q1FY23	QoQ (%)	YoY (%)	Estimates	Variance (%)
US\$ Revenue (US\$ mn)	1,601	1,668	1,632	(4.0)	(1.9)	1,643	(2.6)
INR Revenue	1,31,590	1,37,182	1,27,079	(4.1)	3.5	1,35,055	(2.6)
EBIT	8,914	15,303	14,034	(41.7)	(36.5)	13,729	(35.1)
PAT	6,925	11,176	11,316	(38.0)	(38.8)	11071	(37.4)
EBIT Margin (%)	6.8	11.2	11.0	(438bps)	(427bps)	10.2	(339bps)
PAT Margin (%)	5.3	8.1	8.9	(288bps)	(364bps)	8.2	(293bps)

Source: Company, BOBCAPS Research

Fig 6 – PSYS

(Rs mn)	Q1FY24	Q4FY23	Q1FY23	QoQ (%)	YoY (%)	Estimates	Variance (%)
US\$ Revenue (US\$ mn)	283	275	242	2.9	16.9	284	(0.4)
INR Revenue	23,212	22,545	18,781	3.0	23.6	23,345	(0.6)
EBIT	3,466	3,466	2,688	0.0	28.9	3,576	(3.1)
PAT	2,288	2,515	2,116	(9.0)	8.1	2,802	(18.4)
EBIT Margin (%)	14.9	15.4	14.3	(44bps)	62bps	15.3	(39bps)
PAT Margin (%)	9.9	11.2	11.3	(130bps)	(141bps)	12.0	(215bps)

Source: Company, BOBCAPS Research

Fig 7 – MPHL

(Rs mn)	Q1FY24	Q4FY23	Q1FY23	QoQ (%)	YoY (%)	Estimates	Variance (%)
US\$ Revenue (US\$ mn)	398	412	429	(3.4)	(7.2)	406	(2.0)
INR Revenue	32,520	33,612	34,112	(3.2)	(4.7)	33,373	(2.6)
EBIT	4,995	5,152	5,204	(3.0)	(4.0)	5,121	(2.5)
PAT	3,961	4,053	4,019	(2.3)	(1.4)	3,961	0.0
EBIT Margin (%)	15.4	15.3	15.3	3bps	10bps	15.3	2bps
PAT Margin (%)	12.2	12.1	11.8	12bps	40bps	11.9	31bps

Source: Company, BOBCAPS Research

Fig 8 – COFORGE

(Rs mn)	Q1FY24	Q4FY23	Q1FY23	QoQ (%)	YoY (%)	Estimates	Variance (%)
US\$ Revenue (US\$ mn)	272	264	239	3.0	13.7	273	(0.4)
INR Revenue	22,210	21,700	18,294	2.4	21.4	22,441	(1.0)
EBIT	2,242	2,556	2,288	(12.3)	(2.0)	3,052	(26.5)
PAT	1,757	1,148	1,497	53.0	17.4	2,156	(18.5)
EBIT Margin (%)	10.1	11.8	12.5	(168bps)	(241bps)	13.6	(351bps)
PAT Margin (%)	7.9	5.3	8.2	262bps	(27bps)	9.6	(170bps)

Source: Company, BOBCAPS Research

Fig 9 – AFFLE

(Rs mn)	Q1FY24	Q4FY23	Q1FY23	QoQ (%)	YoY (%)	Estimates	Variance (%)
INR Revenue	4,066	3,558	3,475	14.3	17.0	3,738	8.8
EBIT	657	554	594	18.4	10.6	608	8.1
PAT	662	624	545	6.0	21.3	627	5.5
EBIT Margin (%)	16.2	15.6	17.1	57bps	(93bps)	16.3	(10bps)
PAT Margin (%)	16.3	17.5	15.7	(126bps)	58bps	16.8	(50bps)

Source: Company

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Registered office Address: **1704, B Wing, Parinee Crescenzo, G Block, BKC, Bandra East, Mumbai 400051**

SEBI Research Analyst Registration No: **INH000000040 valid till 03 February 2025**

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Note: Recommendation structure changed with effect from 21 June 2021

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