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IT SERVICES | Q4FY23 Review | 09 June 2023

Macro headwinds prompt us to stay selective

- **Demand remains affected by slower decision-making, caution around spending and project ramp-downs**
- **Focus on cost optimisation projects to continue until clients see a better economic turnaround**
- **Retain our preference for INFO within large-caps and PSYS & COFORGE within mid-cap IT**

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Weak Q4: Tier-1 IT services companies reported poor Q4FY23 revenue growth of -3.2% to 0.6% QoQ CC, impacted by a sequential decline in the communication and tech verticals. Revenues from the Americas and Europe fell, indicating weakness in both regions. Despite a disappointing Q4, aggregate growth for mid-sized firms was marginally higher than that of large IT firms. TCS and COFORGE disappointed the least while INFO underperformed the most.

Headwinds to continue; retail & CPG only bright spots: Earnings commentary from IT companies confirmed the dull demand environment and cuts in discretionary IT spends. While deal bookings were supported by cost takeout, efficiency and maintenance contracts, revenue growth was hit by project deferrals, delayed ramp-ups and project cancellations. IT firms have turned comparatively more cautious on the pricing environment. In Q4, Europe performed better than the US as sentiment worsened in America (~60% of aggregate revenue). IT firms highlighted weakness in the communication, tech, BFSI and manufacturing verticals, but outperformance in retail & CPG.

Muted growth guidance: IT firms expect a soft H1FY24 as evident from WPRO's Q1FY24 guidance of -3 to -1% QoQ CC revenue growth. A declining headcount and cautious pricing outlook suggest sharp moderation in FY24 – also evident from the full-year revenue growth guidance of 4-7%/6-8% from INFO/HCLT and -3% to -1% from WPRO. A weak exit from FY23 and soft H1 portend a comparatively subdued H2, in line with consensus dollar revenue growth expectations of 7% in FY24, which can be bettered only in the event of large deal wins/ramp-ups.

Prefer select tier-I and mid-cap players: We expect INFO and HCLT to deliver on the midpoint of their topline guidance band and anticipate greater downside risk in the near term rather than the medium term. We maintain our preference for INFO (Rs 1,760, BUY) within large-caps and PSYS (TP Rs 5,330, BUY) & COFORGE (Rs 4,830, BUY) within mid-cap IT.

Recommendation snapshot

Ticker	Price	Target	Rating
AFFLE IN	1,002	1,110	BUY
COFORGE IN	4,386	4,830	BUY
HCLT IN	1,127	1,240	BUY
INFO IN	1,283	1,760	BUY
MPHL IN	1,864	2,541	BUY
PSYS IN	4,926	5,330	BUY
TCS IN	3,236	3,580	HOLD
TECHM IN	1,071	1,130	HOLD
WPRO IN	400	420	HOLD

Price & Target in Rupees | Price as of 8 Jun 2023

Q4FY23 review

TCS (HOLD, TP Rs 3,580)

TCS delivered a soft quarter impacted by weakness in North America given its higher exposure to the BFSI vertical. EBIT margin was flat sequentially but is likely to improve as growth revives and cost of delivery normalises. We expect strong bookings to continue in continental Europe along with sustained momentum in the UK as vendor consolidation, cost optimisation and automation likely support deal win recovery in the medium term. Earlier CEO transition timelines as well as pent-up elements from deal deferrals can provide positive catalysts for H2FY24.

We believe TCS is well positioned to deliver industry-leading growth and margins in the long run. However, considering the current volatile macro environment, poor quality of deal wins and delays in client decision-making, we retain HOLD and continue to value the stock at 25x FY25E EPS for an unchanged TP of Rs 3,580.

Fig 1 – Financial performance

(Rs mn)	Q4FY23	Q3FY23	Q4FY22	QoQ (%)	YoY (%)	FY23	FY22	YoY (%)
US$ Revenue (US$ mn)	7,195	7,075	6,696	1.7	7.5	27,927	25,707	8.6
INR Revenue	5,91,620	5,82,290	5,05,910	1.6	16.9	22,54,580	19,17,540	17.6
EBIT	1,44,800	1,42,840	1,26,478	1.4	14.5	5,42,370	4,84,530	11.9
PAT	1,13,920	1,08,830	99,158	4.7	14.9	4,21,470	3,83,270	10.0
EBIT Margin (%)	24.5	24.5	25.0	(6bps)	(52bps)	24.1	25.3	(121bps)
PAT Margin (%)	19.3	18.7	19.6	57bps	(34bps)	18.7	20.0	(129bps)

Source: Company, BOBCAPS Research

Infosys (BUY, TP Rs 1,760)

INFO posted a sequential revenue decline in Q4FY23 due to a combination of deal cancellations and deferrals that were largely centered in North America (the BFSI and communication verticals in this market contracted 70% sequentially). We believe the company is likely to deliver on the midrange of its 4-7% revenue growth guidance band and see low probability of a structural risk to the operating margin. However, recent senior-level exits and the possibility of continued stress from large accounts are risks to growth.

Despite INFO's cautious outlook on a few verticals such as communications, BFSI, we believe its strength in managing the twin journeys of digital transformation (Cobalt) and cost takeout will drive growth leadership. We maintain our BUY rating and continue to value the stock at 20.5x FY25E EPS, translating to an unchanged TP of Rs 1,760.

Fig 2 – Financial performance

(Rs mn)	Q4FY23	Q3FY23	Q4FY22	QoQ (%)	YoY (%)	FY23	FY22	YoY (%)
US$ Revenue (US$ mn)	4,554	4,659	4,280	(2.3)	6.4	18,212	16,311	11.7
INR Revenue	3,74,410	3,83,180	3,22,760	(2.3)	16.0	14,67,670	12,16,410	20.7
EBIT	78,770	82,420	69,716	(4.4)	13.0	3,09,050	2,80,150	10.3
PAT	61,280	65,860	56,860	(7.0)	7.8	2,40,950	2,21,100	9.0
EBIT Margin (%)	21.0	21.5	21.6	(47bps)	(56bps)	21.1	23.0	(197bps)
PAT Margin (%)	16.4	17.2	17.6	(82bps)	(125bps)	16.4	18.2	(176bps)

Source: Company, BOBCAPS Research

HCL Tech (BUY, TP Rs 1,240)

HCLT's revenue guidance implies a 1.5-2.2% CQGR in FY24, supported by (1) a pipeline that's near an all-time high, (2) more large-deal volumes in services (10 in Q4 vs. 22 in 9MFY23), and (3) stronger demand commentary in the Americas (64% of revenue) as compared to Europe (29% of revenue), conflicting with the outlook from TCS and INFO, based on its lower BFSI exposure and annuity portfolio that sees high renewals supported by infrastructure services. The telecom/tech verticals witnessed weakness during Q4FY24 due to higher exposure to discretionary projects.

HCLT's valuation has been supported by improved FCF generation in recent months, aiding higher payout and better return metrics. Given its deep capabilities in the infrastructure management services (IMS) space and strategic partnerships alongside continued investments in cloud/digital capabilities, we expect the company to emerge stronger on the back of rising demand from enterprises and the US market.

Strong sequential growth within IT services, robust headcount addition, healthy deal wins and a solid pipeline all indicate an improved business outlook. We retain BUY and continue to value the stock at 18.7x FY25E EPS, translating to an unchanged TP of Rs 1,240.

Fig 3 – Financial performance

(Rs mn)	Q4FY23	Q3FY23	Q4FY22	QoQ (%)	YoY (%)	FY23	FY22	YoY (%)
US$ Revenue (US$ mn)	3,235	3,244	2,993	(0.3)	8.1	12,586	11,481	9.6
INR Revenue	2,66,060	2,67,000	2,25,970	(0.4)	17.7	10,14,560	8,56,510	18.5
EBIT	48,360	52,280	40,449	(7.5)	19.6	1,84,830	1,62,040	14.1
PAT	39,830	40,960	35,929	(2.8)	10.9	1,48,510	1,34,990	10.0
EBIT Margin (%)	18.2	19.6	17.9	(140bps)	28bps	18.2	18.9	(70bps)
PAT Margin (%)	15.0	15.3	15.9	(37bps)	(93bps)	14.6	15.8	(112bps)

Source: Company, BOBCAPS Research

Wipro (HOLD, TP Rs 420)

WPRO's Q4FY23 revenue decline of -0.7% QoQ and guided range of -3% to -1% QoQ for Q1FY24 is based on cuts in discretionary spend (BFSI and tech verticals) and postponement of projects. Recent acquisitions have pushed up the share of consulting services which led to a disproportionate portfolio mix in Q4. The disconnect between revenue trajectory and strong deal bookings (large deal TCV at US$ 3.9bn in FY23 vs. US$ 2.3bn in FY22) also reflects high deal termination or above-normal leakage between bookings and revenue.

Despite a lack of triggers in the near term, the company's growth trajectory is likely to improve in H2FY24 due to the seasonality impact. That said, disappointing revenue guidance implies that the softness in the US market is likely to linger over the near term. We also believe that WPRO will face challenges defending its margin in the medium term due to an increased risk profile of the business. We thus retain HOLD with an unchanged TP of Rs 420, valuing the stock at 15.5x FY25E EPS.

Fig 4 – Financial performance

(Rs mn)	Q4FY23	Q3FY23	Q4FY22	QoQ (%)	YoY (%)	FY23	FY22	YoY (%)
US$ Revenue (US$ mn)	2,823	2,804	2,722	0.7	3.7	11,160	10,356	7.8
INR Revenue	2,31,903	2,32,290	2,08,600	(0.2)	11.2	9,07,876	7,90,934	14.8
EBIT	37,800	37,863	35,462	(0.2)	6.6	1,39,606	1,40,286	(0.5)
PAT	30,935	30,650	30,925	0.9	0.0	1,13,665	1,22,329	(7.1)
EBIT Margin (%)	16.3	16.3	17.0	0bps	(70bps)	15.4	17.7	(144bps)
PAT Margin (%)	13.3	13.2	14.8	14bps	(149bps)	12.5	15.5	(213bps)

Source: Company, BOBCAPS Research

Tech Mahindra (HOLD, TP Rs 1,130)

TECHM delivered soft revenue growth and deal intake as well as a below-expected EBIT margin in Q4FY23. Growth during the quarter was led by the communications, media and entertainment (CME) vertical, partly offset by a sequential decline in the enterprise segment (retail and transport). TECHM continues to have an organic growth focus (vs. acquisition playbook earlier) despite less than three quarters remaining for CEO transition.

We see significant headroom for the company to improve margins on the back of growth recovery, SG&A leverage and levers of subcontracting cost, offshoring and business mix. However, the continued decline in top 5 client accounts and muted commentary on the communication vertical (TECHM's largest) by peers remain concerns.

Macro uncertainty led to the miss on margins in Q4 and we anticipate back-ended growth recovery in FY24. Given a subdued revenue and margin outlook, we continue to value the stock at 12.2x FY25E EPS (~20% discount to WPRO), translating to a TP of Rs 1,130 and retain our HOLD rating. Higher payout (dividend yield >5%) and >4% FCF yield should lend some support to valuations.

Fig 5 – Financial performance

(Rs mn)	Q4FY23	Q3FY23	Q4FY22	QoQ (%)	YoY (%)	FY23	FY22	YoY (%)
US$ Revenue (US$ mn)	1,668	1,668	1,608	0.0	3.7	6,607	5,998	10.2
INR Revenue	1,37,182	1,37,346	1,21,163	(0.1)	13.2	5,32,902	4,46,460	19.4
EBIT	15,303	16,459	16,042	(7.0)	(4.6)	80,286	80,200	0.1
PAT	11,176	12,966	15,056	(13.8)	(25.8)	48,570	56,301	(13.7)
EBIT Margin (%)	11.2	12.0	13.2	(83bps)	(208bps)	15.1	18.0	(290bps)
PAT Margin (%)	8.1	9.4	12.4	(129bps)	(428bps)	9.1	12.6	(350bps)

Source: Company, BOBCAPS Research

Persistent Systems (BUY, TP Rs 5,330)

PSYS did well in Q4 on the back of strong order booking (highest new deals), consistent big-ticket wins, increased deal participation, improved client mining, cross-selling and annuity contracts in the services business. Its US$ 5mn+ client count has tripled in three years by way of leveraging partnerships and recent acquisitions.

We see further scope for margin expansion supported by utilisation and efficiencies, SG&A leverage, and a rebound in top-client growth. An improved outlook for Top 2 accounts (includes US$ 100mn TCV deals) will support near-term growth

PSYS aspires to achieve above-industry growth of 7-10% for FY24 and is confident of clocking quarterly growth of 3-5%. The stock is currently trading at 25x FY25E EPS. We maintain BUY and a TP of Rs 5,330 based on 30x FY25E EPS (vs. the historical average of 34.4x over FY20-FY23).

Fig 6 – Financial performance

(Rs mn)	Q4FY23	Q3FY23	Q4FY22	QoQ (%)	YoY (%)	FY23	FY22	YoY (%)
US$ Revenue (US$ mn)	275	264	217	3.9	26.3	1,036	766	35.2
INR Revenue	22,545	21,694	16,379	3.9	37.6	83,506	57,108	46.2
EBIT	3,466	3,332	2,300	4.0	50.7	12,472	7,922	57.4
PAT	2,515	2,380	2,010	5.7	25.1	9,211	6,904	33.4
EBIT Margin (%)	15.4	15.4	14.0	1bps	133bps	14.9	13.9	106bps
PAT Margin (%)	11.2	11.0	12.3	19bps	(112bps)	11.0	12.1	(106bps)

Source: Company, BOBCAPS Research

Coforge (BUY, TP Rs 4,830)

Coforge achieved a US$ 1bn revenue milestone in FY23. After surpassing its guidance for the year, management expects revenue growth of 13-16% CC in FY24. The company believes that growth across its three core verticals, including insurance, will be in line with the overall guided range. However, rising concerns over the prospects of large economies along with prevailing supply-side constraints raise uncertainty over near-term growth. Even so, Coforge is confident of clocking quarterly growth of 3-5% QoQ.

Consistent deal wins and good revenue visibility support our bullish outlook on the company. We retain BUY and a TP of Rs 4,830 based on 24x FY25E EPS – a 20% discount to mid-cap peer PSYS.

Fig 7 – Financial performance

(Rs mn)	Q4FY23	Q3FY23	Q4FY22	QoQ (%)	YoY (%)	FY23	FY22	YoY (%)
US$ Revenue (US$ mn)	264	252	232	5.0	13.8	1002	866	15.7
INR Revenue	21,700	20,558	17,429	5.6	24.5	80146	64320	24.6
EBIT	2,872	3,074	2,590	(6.6)	10.9	10838	8615	25.8
PAT	2,327	2,282	2,077	2.0	12.0	8117	6617	22.7
EBIT Margin (%)	13.2	15.0	14.9	(172bps)	(163bps)	13.5	13.4	13bps
Adj. PAT Margin (%)	10.7	11.1	11.9	(37bps)	(119bps)	10.1	10.3	(16bps)

Source: Company, BOBCAPS Research

Mphasis (BUY, TP Rs 2,541)

MPHL's FY23 revenue growth at 9.7% CC was impacted by a decline in Digital Risk (400bps impact) and DXC (160bps impact). We believe that both businesses would remain a drag on growth for FY24. Direct international business (ex-Digital Risk) contracted in Q4 and management expects a soft Q1FY24 with subsequent sequential recovery. The company's deal pipeline increased 35% YoY including an uptick in the non-BFSI pipeline, which is a sign of portfolio diversification and/or relative stress in the BFSI vertical (60% of revenue).

Growth in Digital Risk and DXC combined (to US$ 173mn revenue based on the annualised Q4 run-rate) coupled with potentially higher deal bookings (of >US$ 1bn+ in line with the five-year average) can support incremental revenue of US$ 120mn+ for MPHL over FY23-FY25, per our estimates. We maintain BUY and our TP of Rs 2,541, valuing the stock at 22.2x FY25E EPS – in line with the three-year mean.

Fig 8 – Financial performance

(Rs mn)	Q4FY23	Q3FY23	Q4FY22	QoQ (%)	YoY (%)	FY23	FY22	YoY (%)
US$ Revenue (US$ mn)	409	426	435	(4.1)	(6.1)	1,712	1,606	6.6
INR Revenue	33,612	35,062	32,777	(4.1)	2.5	1,37,985	1,19,614	15.4
EBIT	5,152	5,354	4,973	(3.8)	3.6	21,087	18,269	15.4
PAT	4,053	4,123	3,921	(1.7)	3.4	16,379	14,309	14.5
EBIT Margin (%)	15.3	15.3	15.2	6bps	16bps	15.3	15.3	(0.3bps)
PAT Margin (%)	12.1	11.8	12.0	30bps	10bps	11.9	12.0	(20bps)

Source: Company, BOBCAPS Research

Affle (BUY, TP Rs 1,110)

AFFLE's Q4FY23 revenue declined QoQ due to seasonal weakness and the impact of macro headwinds in the food tech and entertainment verticals in developed markets. International business witnessed a steep sequential decline along with a sharp fall in converted users The company has strengthened its strategic partnerships and execution strategies, and aims to secure multimillion-dollar contracts with supply-side partner OEMs and operator partners. It has also introduced all cost per converted user (CPCU) use-cases on its connected TV product, enabling greater competitiveness in the advertising market.

We expect AFFLE to perform well in its key domestic and global emerging markets given that it is well diversified with regards to use cases, platforms and customers/ publishers. We thus maintain BUY and have a TP of Rs 1,110, valuing the stock at 50.6x FY25E EPS.

Fig 9 – Financial performance

(Rs mn)	Q4FY23	Q3FY23	Q4FY22	QoQ (%)	YoY (%)	FY23	FY22	YoY (%)
US$ Revenue (US$ mn)	3,558	3,761	3,151	(5.4)	12.9	14340	10817	32.6
EBITDA	690	803	584	(14.1)	18.2	2882	2135	35.0
PAT	624	690	528	(9.6)	18.2	2446	2139	14.4
EBITDA Margin (%)	19.4	21.4	18.5	(196)	86	20.1	19.7	36
Adj. PAT Margin (%)	17.5	18.3	16.8	(81)	78	17.1	19.8	(272)

Source: Company, BOBCAPS Research

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Note: Recommendation structure changed with effect from 21 June 2021

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