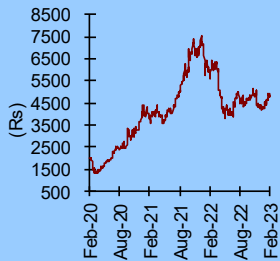


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Sector update

Technology

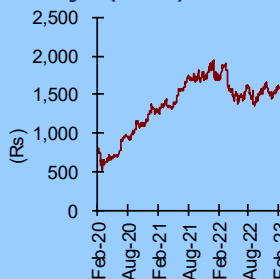
LTIMindtree (BUY)



TCS (ADD)



Infosys (ADD)



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INDIA



Technology

Retailers continue to focus on cost optimisation and digital transformation through tech spending, **BUY** LTIM, **ADD** INFY, TCS

US and European retailers' focus on investments in technology is intact and has not been impacted much by weak macros. The recent quarter (Dec'22) earnings call commentaries of several US and European retailers suggest they are committed to continue their investments in technology around optimising supply chain and store operations, direct-to-customer channel, digital commerce, data analytics and sustainability. However, retailers expect their revenue growth to be soft in CY23 over CY22 as pressure on volumes continues due to the ongoing high inflation and we believe this may lead to soft revenue growth in retail vertical in CY23 for Indian IT companies over CY22.

Having said that, technology focus of retailers remains intact. For example, **Walmart** plans to continue its investments in people and technology despite lower sales growth expected in FY24 vs FY23 (Walmart provided revenue growth guidance of 2.5-3% YoY CC for FY24), and thus, the company expects SG&A to delever slightly in FY24. Walmart management added it expects FY24 capex to be flat to up slightly in absolute dollars compared to last year driven by continued multi-year investment in technology and innovation to optimise supply chain and stores. **Carrefour** (French multinational retailer) management cited demand remains uncertain with continued volume pressure, but despite softness in demand, it plans to accelerate the digitalisation of stores and digitise customer experience by development of digital applications and catalogs in CY23.

Commitment to technology investments is fueled by cost saving benefits realised by the retailers through these investments. Marks & Spencer stated it is generating higher sales in new stores and is using technology to lower the cost of operations, thus, deriving quick paybacks on invested capital. For example, the two stores it opened last year are expected to pay back the capital invested in just over two years, as per the company. Therefore, ongoing efficiencies enabled by technology improvements in store, more than offset wage inflation for Marks & Spencer. Similarly, Walmart management mentioned that automation in its perishable foods DC (Distribution Centre) has yielded 50% better-than-expected results.

Indian IT companies have indicated weakness in certain segments of retail such as discretionary retail, while grocery retail, CPG, travel and hospitality are doing well. In Q3FY23, INFY, TCS, Wipro have highlighted that retail vertical is more exposed to weak macro environment. This is also reflected in softening revenue growth in retail vertical in Q3FY23 (Table 4). However, deal wins reported by IT companies in this vertical have been resilient. TCS reported retail vertical deal TCV of US\$1.2bn (20% YoY) in Q3. Infosys won 7 large deals in retail vertical out of total 32 deals reported in Q3. HCLT also won a large deal from Europe-based leading consumer group and retail company to deliver its digital and IT roadmap through cloud migration, digital workplace transformation and direct-to-consumer multi-channel platform development.

US and European retailers' commentaries, healthy deal activity for Indian IT companies in retail vertical suggest multi-year technology transformation agendas are intact and tech spends are expected to be resilient, in our view. We believe weakness in revenue growth in CY23 is largely priced in the stock prices at current valuations (NIFTY IT trading at 24x on one-year forward EPS, 11% premium to five-year average P/E). We continue to prefer LTIMindtree (BUY), followed by INFY (ADD) and TCS (ADD).

Table 1: Retailers' commentaries indicate their focus on technology investments is intact

| | Market Cap (USD mn) | CY22/FY23 Revenue (USD mn) | Earnings call date | Earnings commentary |
|---------------------------|------------------------|----------------------------------|-----------------------|---|
| US Retailers | | | | |
| Walmart | 388,986 | 611,289 | 21st Feb 2023 | <p>Walmart expects FY24 capex to be flat to up slightly in absolute dollars compared to last year driven by continued multi-year investment in technology and innovation to optimise supply chain and stores. Walmart management mentioned that many of these tech enhancements are reaching a stage where they can rapidly deploy them across network, and now they have a clear line of sight towards better efficiencies and ROI on these investments in the medium term.</p> <p>Walmart is committed to continue its investments in people and technology. With sales growth expected at a lower rate vs prior year, the company expects SG&A to delever slightly in FY24.</p> <p>Examples of higher ROI tech initiatives being implemented at Walmart - 1) Automation in perishable food DCs (distribution centres) to increase throughput - actual results were 50% better than expected for the company. 2) Automation in e-commerce DCs to reduce 12 step process to 5 step process, making the process a lot more efficient.</p> |
| Home Depot | 301,985 | 157,403 | 21st Feb 2023 | <p>Home Depot has implemented new tools and technology in stores to reduce the complexity for associates and improve customer service. Home Depot's sales through digital channels increased by 4% YoY in Q4CY22 and approximately 45% of online sales were fulfilled through stores which highlight the strength of company's Omni channel retail strategy.</p> <p>Home Depot expects CY23 to be a year of moderation in demand for home improvement.</p> |
| European Retailers | | | | |
| Carrefour | 13,318 | 88,429 | 14th Feb 2023 | <p>Carrefour management mentioned that demand remains uncertain with some pressure on volumes continuing. In CY23, Carrefour plans to accelerate the digitalisation of stores, whether it may be shelf-stacking, inventory management or checkouts. It also plans to deploy data solution for assortment in all group countries, intends to continue to digitise customer experience, notably through the development of digital applications and catalogues.</p> |
| Sainsbury | 6,166 | 38,035 | 11th Jan 2023 | <p>Sainsbury is in a strong financial position driven by cost-saving benefits derived from investment in value, innovation and improving service, and availability. This also implies that Sainsbury can continue to invest in improving sales.</p> |
| H&M | 209,201 | 21,781 | 27th Jan 2023 | <p>H&M continues to invest in technology, AI and supply chain. An important part of its supply chain is its logistics system. It currently has several global initiatives involving new highly-automated logistics centres, with focus on innovation. H&M has also made large long-term investments with focus on digital.</p> |
| Marks & Spencer | 2,957 | 14,013 | 9th Nov 2022 | <p>Company mentioned that ongoing efficiencies enabled by technology improvements in store, more than offset wage inflation. Marks & Spencer's expenses increased this year due to investments in technology, data and digital initiatives among others.</p> <p>Marks & Spencer is generating higher sales in new stores. It is using technology to lower the cost of operations and thus, deriving quick paybacks on the invested capital. For example, the two stores it opened last year are expected to pay back the capital invested in just over two years, as per the company.</p> <p>Marks & Spencer has identified at least GBP150mn of cost savings for FY24 from efficiency of supply chain, retail operations, optimisation of technology and digital spend and simplification of the whole organisation.</p> <p>Marks & Spencer is focusing on technology investments revolving around - 1) digital product development for scaling the use of its mobile app. 2) Data and data science development including migration to new enterprise data platform and 3) new personalisation and recommendation platform.</p> |
| Metro AG | 3,196 | 31,202 | 9th Feb 2023 | <p>Metro's adjusted EBITDA decreased to minus EUR2mn due to expansion efforts and also other investments in digitisation. Metro was hit by a cyberattack in Oct '22 and intends to increase its investments in this direction to prevent such attacks. Metro's management mentioned that IT upgradation and transformation spends will continue as a normal part of its business. Metro is also focusing on digitalisation of processes and growing digital sales.</p> |

Source: Company, I-Sec Research, Note: Market Cap is as on 23-02-2023

Table 2: Revenue growth of US and European retailers to pick up in CY24 & CY25

| Revenue growth YoY \$ | CY20/FY21 | CY21/FY22 | CY22/FY23 | CY23E/FY24E | CY24E/FY25E | CY25E/FY26E |
|--------------------------|-----------|-----------|-----------|-------------|-------------|-------------|
| Walmart | 7% | 2% | 7% | 3% | 3% | 4% |
| Target Corp | 20% | 13% | 1% | 3% | 2% | 4% |
| Costco Wholesale | 9% | 17% | 16% | 7% | 6% | 6% |
| Home Depot | 20% | 14% | 4% | 1% | 3% | 3% |
| Walgreens Boots Alliance | 2% | 9% | 0% | 2% | 5% | 5% |
| Lowe'S Cos | 24% | 7% | 1% | -8% | 2% | 3% |
| Kroger Co | 8% | 4% | 8% | 2% | 1% | 2% |
| Tesco Plc | 1% | 12% | -6% | 2% | 1% | 4% |
| Carrefour Sa | -1% | 7% | 0% | 5% | 4% | 4% |
| Hennes & Mauritz | -18% | 16% | -7% | 5% | 3% | 4% |
| Marks & Spencer Group | -7% | 24% | -6% | 2% | 3% | 4% |
| Sainsbury | 2% | 9% | -7% | 0% | 0% | 3% |
| Metro AG | -6% | 3% | 5% | 5% | 3% | 4% |

Source: Bloomberg, I-Sec Research

Table 3: IT companies have indicated weakness in discretionary retail, while grocery retail, CPG, travel and hospitality are doing well

| Company | Commentary on retail vertical |
|-------------|---|
| TCS | In retail, growth was driven by travel and hospitality as retailers had production freezes during the holiday season in Dec '22 quarter. TCS' management stated CPG sector is going through multiple forms of transformation, with significant investments in direct-to-customer channel strategy transformation. Also, analytics, sustainability etc. are continuing to find a lot of traction and continued investment among retailers. Management added that within retail, grocery is doing well, and discretionary retail is impacted in specific markets. |
| INFY | INFY's management indicated that retail vertical, among few other verticals, is more impacted by weak macros. Its management said: "Retailers are seeing uncertainty on consumer spending as a result of high inflation, high interest rates and softer economy. However, at the same time, direct-to-consumer and digital commerce are opening up many new opportunities on the back of our growing presence in leading e-commerce platforms and also our very own Infosys Equinox." |
| HCLT | One large deal win by HCLT in Q3FY23 was from a client in retail vertical - A Europe-based leading consumer group and retail company selected HCLT to deliver its digital and IT roadmap through cloud migration, digital workplace transformation, and direct-to-consumer multi-channel platform development. |
| Wipro | Wipro's management mentioned consumer vertical is doing good. Within consumer, retail is a bit more exposed to weak macros. |
| LTIMindtree | LTIMindtree management mentioned: "Within retail and CPG, clients are being cautious because of high inflation. Even so, they continue to invest in digital and data platforms to drive their digital transformation journeys." Within retail, LTIMindtree has some exposure to real estate segment which has been impacted by rising interest rates. |

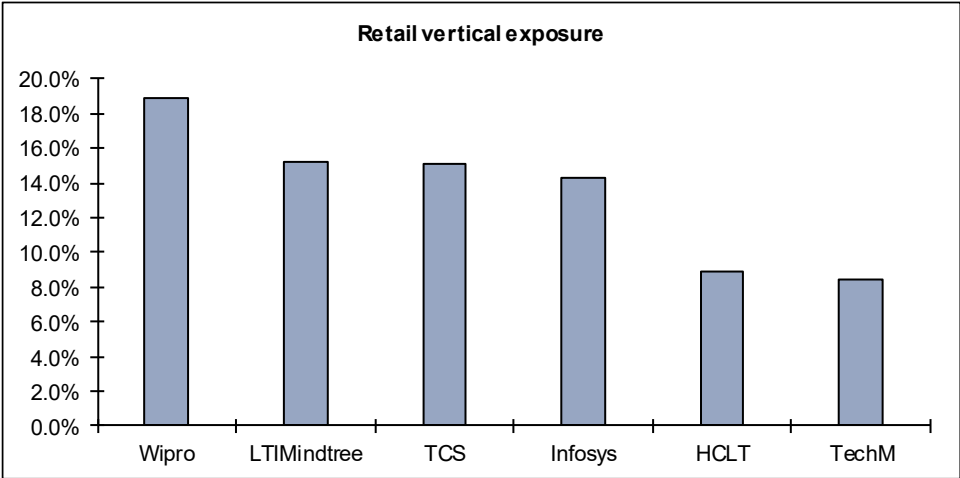
Source: Company, I-Sec Research

Table 4: Revenue growth in retail vertical has been slowing down since last three quarters due to weak macros

| | Q1 FY20 | Q2 FY20 | Q3 FY20 | Q4 FY20 | Q1 FY21 | Q2 FY21 | Q3 FY21 | Q4 FY21 | Q1 FY22 | Q2 FY22 | Q3 FY22 | Q4 FY22 | Q1 FY23 | Q2 FY23 | Q3 FY23 |
|--|---------|---------|---------|---------|---------|---------|---------|---------|---------|---------|---------|---------|---------|---------|---------|
| Retail vertical revenue growth YoY \$ | | | | | | | | | | | | | | | |
| TCS | 6.5% | 2.4% | 4.3% | 2.9% | -14.5% | -3.7% | -2.6% | 3.6% | 28.6% | 20.0% | 19.2% | 18.7% | 18.4% | 15.1% | 12.8% |
| Infosys | 5.5% | -0.6% | 1.3% | 1.8% | -9.8% | 1.1% | 4.2% | 7.9% | 27.1% | 18.3% | 19.2% | 14.5% | 13.6% | 10.8% | 8.1% |
| HCLT | 20.1% | -0.5% | 16.7% | 13.9% | -20.3% | -7.6% | 4.9% | 5.0% | 61.0% | 41.7% | 17.0% | 7.7% | -1.4% | 3.7% | -10.2% |
| Wipro | 4.5% | 3.9% | 10.9% | 3.6% | -3.9% | -1.5% | -4.1% | 5.0% | 36.7% | 38.3% | 37.6% | 33.1% | 21.2% | 17.8% | 13.4% |
| TechM | | | | | | | | | 16.4% | 18.1% | 23.6% | 18.8% | 21.4% | 15.5% | 8.3% |
| LTIMindtree | | | | | | | | | | | | | 29.7% | 11.8% | 11.0% |
| Retail vertical revenue growth QoQ \$ | | | | | | | | | | | | | | | |
| TCS | 1.6% | -0.7% | 3.3% | -1.3% | -15.5% | 11.8% | 4.4% | 5.0% | 4.9% | 4.3% | 3.7% | 4.7% | 4.5% | 1.4% | 1.6% |
| Infosys | 1.7% | -1.4% | 1.7% | -0.1% | -9.9% | 10.6% | 4.7% | 3.5% | 6.1% | 2.9% | 5.6% | -0.7% | 5.3% | 0.4% | 3.0% |
| HCLT | -1.4% | -7.0% | 25.5% | -1.0% | -31.0% | 7.8% | 42.4% | -0.9% | 5.9% | -5.1% | 17.6% | -8.8% | -3.1% | -0.3% | 1.8% |
| Wipro | -5.4% | 3.1% | 8.0% | -1.6% | -12.3% | 5.6% | 5.2% | 7.7% | 14.2% | 6.9% | 4.7% | 4.3% | 3.9% | 3.9% | 0.7% |
| TechM | | | | | | 6.6% | 8.4% | -2.4% | 3.2% | 8.1% | 13.5% | -6.2% | 5.5% | 2.9% | 6.4% |
| LTIMindtree | | | | | | | | | | 18.7% | 1.8% | 3.5% | 3.7% | 2.3% | 1.1% |

Source: Company, I-Sec Research

Chart 1: Retail vertical constitutes ~12-18% of revenue for IT companies



Source: Company, I-Sec Research

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