

IT Services

Remain selective due to macro challenges

Summary

Q4FY24 results were weak due to slowdown in discretionary spend, elongation of deal cycle and weak macro. Most of the companies are banking on growth in H2FY25E thereby pushing growth expectation to FY26E. Consequently we have cut our Revenue and EPS estimates by 4% & 3% for FY25E in large cap and by 3% & 7% for FY25E in midcaps. Challenges still persist in terms of slow decision making, focus on cost efficiency program and reprioritization of spends. This has led to cooling of stock prices. However, we still remain cautious in the IT sector. We prefer companies where there is valuation comfort and has healthy growth expectation. Hence we prefer Wipro & Infosys in large caps and Newgen, Sonata & Cyient in mid-caps. Key upside risk in the sector is earlier than expected FED interest rate cut which could boost client budgets (although seems difficult).

Key Highlights

- **Revenue outlook:** Infosys guided for 1-3% YoY growth in FY25E vs 1.9% growth FY24. Further, Coforge gave a broad guidance without hard numbers for FY25E, Cyient has tapered growth expectation of double digit growth to high single digit growth and despite HCL Tech's robust Q4 exit the company guided for 3-5% YoY growth in FY25E. This indicates macro challenges persist and the broad reason highlighted for tapered growth expectations are slowdown in discretionary spends, ramp downs and slower conversion. This has led us to build in 3% YoY & 9% YoY for large-caps and 10% YoY & 16% YoY for mid-caps in FY25E & FY26E.
- **Margin outlook:** Q4 witnessed rationalization of sub con cost and higher utilization due to subdued demand expectation. Going forward, we expect utilization, pyramid and lower discretionary expenses to drive IT companies margins. Hence, we expect margins to improve in the range of 37-673 bps over FY24-FY26E. Only aberrations are Zensar (-14 bps) and Sonata (- 14 bps).

India IT Sector: Valuation and Rating

| Companies | Rating | CMP (Rs) | TP (Rs) | Upside (%) | Mkt Cap (Rs bn) | P/E (x) | |
|--------------|--------|-------------|------------|---------------|--------------------|---------|-------|
| | | | | | | FY25E | FY26E |
| TCS | HOLD | 3,960 | 4,300 | 9% | 14,328 | 27 | 24 |
| Infosys | BUY | 1,440 | 1,635 | 14% | 5,975 | 22 | 20 |
| HCL Tech. | HOLD | 1,320 | 1,410 | 7% | 3,582 | 21 | 19 |
| Wipro | BUY | 456 | 521 | 14% | 2,383 | 19 | 18 |
| Tech Mah. | HOLD | 1,269 | 1,265 | 0% | 1,240 | 23 | 18 |
| LTIMindtree | HOLD | 4,658 | 5,000 | 7% | 1,380 | 27 | 23 |
| Coforge | HOLD | 4,302 | 5,495 | 28% | 266 | 27 | 20 |
| Cyient | BUY | 1,754 | 2,210 | 26% | 195 | 23 | 20 |
| Birlasoft | BUY | 604 | 780 | 29% | 167 | 24 | 20 |
| Zensar Tech. | HOLD | 581 | 615 | 6% | 132 | 20 | 17 |
| Newgen | BUY | 946 | 1,072 | 13% | 133 | 40 | 30 |
| Sonata | BUY | 519 | 770 | 48% | 145 | 25 | 19 |

Source: IDBI Capital, Company

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Exhibit 1: Q4FY24 performance of IT companies

| Coverage | Q4FY24 | | | | | |
|------------------|--------|---------|---------|-----------|---------|---------|
| Revenues | US\$ | QoQ (%) | YoY (%) | Deal wins | QoQ (%) | YoY (%) |
| TCS | 7,363 | 1.1 | 2.3 | 13,200 | 63.0 | 32.0 |
| Infosys | 4,564 | -2.1 | 0.2 | 4,500 | 38.8 | 114.3 |
| Wipro | 2,665 | 0.2 | -6.1 | 3,600 | -5.3 | -12.2 |
| HCL Tech | 3,430 | 0.4 | 6.0 | 9,759 | 406.4 | 369.2 |
| Tech Mahindra | 1,548 | -1.6 | -7.2 | 500 | 31.2 | -15.5 |
| LTIM | 1,069 | -1.3 | 1.1 | na | na | na |
| Coforge | 287 | 1.7 | 8.5 | 774 | 118.6 | 157.1 |
| Birlasoft | 164 | 1.6 | 9.9 | 107 | 13.8 | -6.1 |
| Zensar | 148 | 2.3 | 0.4 | 182 | 8.7 | -6.8 |
| Cyient | 224 | 2.4 | 5.2 | 228 | -23.3 | 7.2 |
| Sonata | 82 | -2.4 | 24.2 | na | na | na |
| Newgen (Inr mn.) | 375 | 15.9 | 23.0 | na | na | na |

| Non coverage | US\$ | QoQ(%) | YoY(%) |
|---------------------|-------|--------|--------|
| Persistent | 311 | 3.4 | 13.2 |
| Mastek | 94 | -0.3 | 8.6 |
| Happiest Minds | 50 | 1.3 | 11.1 |
| Mphasis | 411 | 2.1 | -0.3 |
| Tata Elxsi (Rs. Mn) | 9,059 | -0.9 | 8.1 |
| LTTS | 305 | 5.2 | 19.6 |
| KPIT | 160 | 7.4 | 29.2 |

Source: IDBI Capital, Company

Exhibit 2: Q4FY24 Margin performance of IT companies

| Companies | Gross Margin (%) | QoQ ch (bps) | YoY ch (bps) | EBIT Margin (%) | QoQ ch (bps) | YoY ch (bps) |
|---------------|------------------|--------------|--------------|-----------------|--------------|--------------|
| TCS | 40.6 | 29 | 98 | 25.9 | 250 | 145 |
| Infosys | 29.0 | -100 | -200 | 20.1 | -41 | -94 |
| Wipro | 29.2 | -152 | -62 | 16.0 | 130 | 21 |
| HCL Tech | 29.6 | -161 | -139 | 17.6 | -213 | -57 |
| Tech Mahindra | 23.4 | 287 | -193 | 7.4 | 199 | -380 |
| LTIM | 27.3 | -42 | -55 | 14.7 | -66 | -164 |
| Coforge | 34.1 | 173 | 2 | 14.4 | 66 | -104 |
| Birlasoft | 43.6 | 272 | 311 | 14.7 | 34 | 282 |
| Zensar | 30.6 | -46 | -130 | 14.6 | -7 | 298 |
| Cyient | 31.6 | -21 | -2,659 | 14.4 | 14 | 17 |
| Sonata | 17.0 | 125 | 158 | 5.0 | -194 | -189 |
| Newgen | 55.0 | 397 | 140 | 30.7 | 901 | 129 |

Source: IDBI Capital, company

Exhibit 3: Subcontracting rationalization helped margins in Q4FY24

| Large Cap companies | Subcontracting cost (%) | QoQ ch (bps) | YoY ch (bps) |
|---------------------|-------------------------|--------------|--------------|
| TCS | 5 | -157 | -366 |
| Infosys | 13 | -61 | -141 |
| Wipro | 11 | -64 | -114 |
| HCL Tech | 13 | -110 | -140 |
| Tech Mahindra | 14 | 204 | -55 |

Source: IDBI Capital, company

Exhibit 4: Utilisation and attrition trends

| Companies | Utilization (%) | QoQ ch (bps) | YoY ch (bps) | Peak utilization (over 5 Yrs) | Attrition (%) | QoQ ch (bps) | YoY ch (bps) | Lowest attrition (over 5yrs) |
|---------------|-----------------|--------------|--------------|-------------------------------|---------------|--------------|--------------|------------------------------|
| TCS | 83 | 0 | 0 | 83 | 13 | -80 | -760 | 7 |
| Infosys | 84 | 80 | 350 | 89 | 13 | -30 | -830 | 11 |
| Wipro | 87 | 290 | 520 | 87 | 14 | 0 | -500 | 11 |
| HCL Tech | - | | | - | 12 | -40 | -710 | 10 |
| Tech Mahindra | 86 | -200 | 0 | 88 | 10 | 0 | -500 | 10 |
| LTIM | 87 | -50 | 520 | 87 | 14 | 20 | -580 | 14 |
| Coforge | 82 | 230 | 20 | 81 | 12 | -60 | -260 | 10 |
| Birlasoft | 86 | -80 | 150 | 87 | 12 | -20 | -970 | - |
| Zensar | 84 | 300 | 230 | 84 | 11 | -110 | -890 | 12 |
| Cyient | - | | | - | 17 | -100 | -830 | - |
| Sonata | 87 | 160 | 100 | 91 | - | - | - | - |

Source: IDBI Capital, company

Exhibit 5: Vertical wise

| Vertical wise (%) in term of CC | BFSI | | | Manufacturing | | | Retail | | | Communication | | | Healthcare & Life-science | | | Hi-tech | | | Others | | |
|------------------------------------|--------|-----------|-----------|---------------|-----------|----------|--------|-----------|-----------|---------------|----------|----------|---------------------------|-----------|----------|---------|----------|-----------|--------|-----------|----------|
| | Q4FY24 | QoQ | YoY | Q4FY24 | QoQ | YoY | Q4FY24 | QoQ | YoY | Q4FY24 | QoQ | YoY | Q4FY24 | QoQ | YoY | Q4FY24 | QoQ | YoY | Q4FY24 | QoQ | YoY |
| TCS | 31 | -0 | -3 | 9 | 3 | 10 | 16 | 1 | 0 | 7 | -0 | -5 | 11 | 1 | 2 | 8 | -1 | -6 | 19 | 4 | 18 |
| Infosys | 26 | -7 | -8 | 15 | -3 | 9 | 14 | -4 | -3 | 12 | 6 | 4 | 7 | -6 | 2 | 9 | 11 | 9 | 16 | -1 | 3 |
| Wipro | 34 | 3 | -8 | 7 | -1 | -11 | 19 | -0 | -7 | 4 | -5 | -21 | 14 | 2 | 9 | 11 | -6 | -3 | 12 | 1 | -9 |
| HCL Tech | 22 | -0 | 8 | 20 | 2 | 13 | 9 | -5 | 7 | 12 | 19 | 39 | 16 | -0 | -1 | 12 | -3 | -9 | 9 | -9 | -9 |
| Tech Mahindra | 16 | 4 | -5 | 18 | -1 | 6 | 8 | -10 | -4 | 36 | -3 | -16 | - | - | - | 11 | 0 | -4 | 11 | -2 | -2 |
| Average | | -0 | -3 | | -0 | 5 | | -4 | -1 | | 3 | 0 | | -1 | 2 | | 0 | -2 | | -1 | 0 |

Source: IDBI Capital, company

Exhibit 6: Geowise

| Geo wise (%) in term of CC | USA | | | Europe | | | Asia | | | ROW | | |
|-------------------------------|--------|-----------|-----------|--------|----------|-----------|--------|-----------|-----------|--------|-----------|-----------|
| | Q4FY24 | QoQ | YoY | Q4FY24 | QoQ | YoY | Q4FY24 | QoQ | YoY | Q4FY24 | QoQ | YoY |
| TCS | 52 | -0 | -2 | 31 | 1 | 4 | 15 | 5 | 14 | 2 | 6 | 7 |
| Infosys | 60 | -1 | -2 | 29 | -1 | 6 | 2 | -10 | -15 | 10 | -10 | 2 |
| Wipro | 61 | 0 | -4 | 28 | 1 | -11 | - | - | - | 11 | -2 | -7 |
| HCL Tech | 65 | 2 | 8 | 29 | 0 | 6 | - | - | - | 6 | -7 | -14 |
| Tech Mahindra | 51 | -4 | -5 | 24 | 0 | -11 | - | - | - | 25 | 1 | -8 |
| Average | | -1 | -1 | | 0 | -1 | | -1 | -0 | | -2 | -4 |

Source: IDBI Capital, company

Exhibit 7: Concall highlights

| Large caps | Region | Vertical | Growth drivers |
|------------|--|---|---|
| TCS | | Good demand in BFSI within that insurance is doing well, green shoots is seen in consumer business, transportation is growing well, | Growth drivers of transformation deals are digital transformation, cloud migration, sustainability and integration of Gen AI and hyper personalization. |
| Infosys | | BFSI growth in FY25E is expected to be better than FY24. cautiously optimistic outlook in E&U mainly due to cost optimization deals, Manufacturing would see slower growth and could improve with traction in areas like IoT, supply chain, marc manufacturing and Retail is seeing improvement led by cost take out deals and Generative AI. | Strong traction in Generative AI across verticals. |
| Wipro | | Green shoots in BFSI sector and healthcare, E&U & manufacturing is expected to be soft in near term | |
| HCL Tech | | | Engineering & Research development spending and outsourcing will continue to grow globally. |
| Tech M | | BFSI practice with strengths in quite a few areas such as core banking, customer experience and insurance platforms, aided by acquisitions | Key markets and service lines to create a sustainable growth engine. |
| Mid caps | | | |
| LTIM | | BFSI could see recovery in Q1FY25E on the back of strong deal pipeline, Manufacturing would continue to show the seasonality impact | |
| Coforge | | Growth drivers would be three new verticals: Retail, Hi-tech & Healthcare, recovery in travel could be seen | |
| Birlasoft | | BFSI is doing good; Life-science would still show softness for two more quarters, however expects rebound post the softness | Traction in ERP, infra services and AI/ gen AI |
| Zensar | BFSI is growing good in US region than UK & South Africa | Hi-tech furloughs have continued and overall it would be under pressure. BFSI is growing good in US region than UK & South Africa and growth is expected in the sector. | |
| Cyient | | Near term challenges in aerospace & communication, new growth verticals to improve growth in FY25E. | Aerospace, sustainability and communication to drive growth. |
| Sonata | | Demand in healthcare & hi-tech to be in good momentum; BFSI and Hi-tech to show flattish to slight growth in near term and emerging to be continue in pressure. | Strong growth from digital based competencies like Managed cloud services and Digital Platformation Services (Microsoft & Open source) and focused verticals like TMT, Healthcare & Life Sciences, Manufacturing, Retail / CPG/ TTH and BFSI. |
| Newgen | Recovery in APAC region from next year onwards | Trade finance, digital engineering, supply chain solutions have good traction. | Insurance vertical to drive growth and expects major revenue share in next 2 years. |

Source: IDBI Capital, company

Exhibit 8: Estimates for IT companies

| Coverage Revenues (US\$) | FY23 | FY24 | FY25E | FY26E | Growth YoY % | | |
|-----------------------------|--------|--------|--------|--------|--------------|-------|-------|
| | | | | | FY24 | FY25E | FY26E |
| TCS | 27,927 | 29,080 | 31,226 | 34,568 | 4.1 | 7.4 | 10.7 |
| Infosys | 18,212 | 18,562 | 19,253 | 20,983 | 1.9 | 3.7 | 9.0 |
| Wipro | 11,160 | 10,831 | 10,777 | 11,495 | -2.9 | -0.5 | 6.7 |
| HCL Tech | 12,586 | 13,270 | 13,820 | 15,040 | 5.4 | 4.1 | 8.8 |
| Tech Mahindra | 6,607 | 6,277 | 6,362 | 6,869 | -5.0 | 1.3 | 8.0 |
| LTIM | 4,106 | 4,287 | 4,550 | 5,105 | 4.4 | 6.1 | 12.2 |
| Coforge | 1,002 | 1,119 | 1,334 | 1,664 | 11.7 | 19.2 | 24.8 |
| Birlasoft | 595 | 637 | 701 | 813 | 7.1 | 10.0 | 16.0 |
| Zensar | 604 | 592 | 625 | 706 | -2.0 | 5.5 | 13.0 |
| Cyient | 746 | 863 | 962 | 1,070 | 15.6 | 11.4 | 11.2 |
| Sonata | 241 | 324 | 356 | 429 | 34.3 | 10.1 | 20.4 |
| Newgen (Inr mn.) | 974 | 1,244 | 1,579 | 2,017 | 27.7 | 26.9 | 27.7 |

Source: IDBI Capital, company

Exhibit 9: EBIT margin estimates

| Companies | FY23 | FY24 | FY25E | FY26E | Change (bps) FY24-26 |
|---------------|------|------|-------|-------|----------------------|
| TCS | 24.1 | 24.2 | 25.8 | 26.7 | 251 |
| Infosys | 21.1 | 20.7 | 22.0 | 22.0 | 134 |
| Wipro | 14.9 | 15.1 | 16.5 | 16.7 | 162 |
| HCL Tech | 18.2 | 18.2 | 19.0 | 19.4 | 116 |
| Tech Mahindra | 11.4 | 5.8 | 10.1 | 12.5 | 673 |
| LTIM | 16.2 | 15.7 | 16.7 | 17.6 | 194 |
| Coforge | 14.3 | 12.9 | 13.4 | 14.4 | 145 |
| Birlasoft | 12.3 | 14.2 | 15.1 | 15.4 | 116 |
| Zensar | 7.6 | 15.1 | 14.8 | 14.9 | -14 |
| Cyient | 12.4 | 14.4 | 14.6 | 14.8 | 37 |
| Sonata | 25.1 | 23.4 | 22.6 | 23.3 | -14 |
| Newgen | 19.3 | 20.9 | 21.4 | 22.4 | 149 |

Source: IDBI Capital, company

Exhibit 10: Stock price performance

| Change (%) | 1-mnth | 3-mnth | 6-mnth | 1-yr |
|---------------|--------|--------|--------|--------|
| SENSEX | -3.1% | 1.4% | 11.6% | 16.9% |
| BSEIT | -5.3% | -12.1% | 8.8% | 21.6% |
| TCS | 0.3% | -4.2% | 18.8% | 20.5% |
| INFOSYS | -3.7% | -14.9% | 5.2% | 14.0% |
| WIPRO | -4.2% | -6.7% | 20.2% | 18.8% |
| HCL TECH | -14.3% | -19.2% | 5.1% | 22.4% |
| TECH MAHINDRA | 1.4% | -3.1% | 11.5% | 21.3% |
| LTIM | -4.8% | -14.1% | -11.5% | 1.4% |
| COFORGE | -24.7% | -34.9% | -16.3% | 4.3% |
| BIRLASOFT | -17.1% | -27.9% | 3.6% | 96.8% |
| ZENSAR | -4.3% | -0.3% | 20.7% | 90.8% |
| CYIENT | -15.7% | -20.0% | 5.6% | 39.5% |
| SONATA | -31.6% | -35.0% | -21.3% | 21.8% |
| NEWGEN | 13.8% | 17.3% | 57.0% | 236.9% |

Source: Bloomberg



Notes

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