ArihantCapital
Generating Wealth

03rd July 2023

Information Technology_ Q1FY24 Preview

Steady Quarter for IT Companies

Tata Consultancy Services	
CMP (INR)	3,298
Rating	Accumulate
TP	3,629
PE FY25E	22x
Infosys Ltd	
CMP (INR)	1,338
Rating	Neutral
TP	1,453
PE FY25E	18x
Coforge Limited	
CMP (INR)	4,713
Rating	Accumulate
TP	4558
PE FY25E	25x
Persistent Systems	
CMP (INR)	5,007
Rating	Hold
TP	4,716
PE FY25E	29.7x
L&T Technology Services	
CMP (INR)	3,934
Rating	Neutral
TP	3,464
PE FY25E	28x
Route Mobile	
CMP (INR)	1,593
Rating	Accumulate
TP	1,595
PE FY25E	24x
Firstsource	
CMP (INR)	128
Rating	Hold
TP	125
PE FY25E	17x
Birlasoft	
CMP (INR)	358
Rating	Buy
TP	366
PE FY25E	15.5x

CMP as of 30th June 2023)
Source: Arihant Research

Abhishek Jain
abhishek.jain@arihantcapital.com
022 67114851

Jyoti Singh
jyoti.singh@arihantcapital.com
022 67114834

Based on our recent discussions with IT company management prior to their silent period, we have observed a consistent demand outlook over the past three months. The expectations for Q1FY24 are also in line with this steady performance, particularly following the strong performance of mid-cap and small-cap IT companies during Q4FY23. However, it is important to note that there are macroeconomic challenges impacting key industry verticals, such as banking and hi-tech, as well as key geographies like the US and Europe. These challenges arise from factors such as high interest rates and inflationary pressures, which have resulted in delays in discretionary technology spending. Additionally, deals are now subject to heightened scrutiny, leading to longer conversion times from pipeline to actual contracts. In certain cases, the conversion from the order book to revenue is also occurring at a slower pace. Accenture's recent quarterly results further reinforce this trend, with a decline in smaller deals centered around digital transformation and consulting, and an increased focus on larger cost optimization deals. Given this environment, we anticipate that contract durations will extend or shift to next quarter, further contributing to the delay in converting the order book into revenue. Consequently, there is an elevated risk associated with achieving the higher end of revenue growth guidance for Indian IT companies in FY24E.

Revenue: We expect tier I company's revenue growth to be narrow range given macroeconomic concern and slower on the client budget front. The Tier II companies will see headwinds on the wage hike and one time expenses due to acquisition during the quarter and Currency tailwinds of 20-30 bps. Revenue for the tier I companies will be in the flattish QoQ and 7%/3% YoY base range. Tier-II companies like Persistent, and Coforge are expected to report revenue growth of 2.5%/3.% on a QoQ basis and 17%/14% YoY basis. For the tier, III Route Mobile and Birlasoft are likely to report revenue growth of ~35%/1.3% on a YoY basis.

Margin: We anticipate that the margin performance of most companies in the upcoming quarter will be muted due to several factors. These factors include higher visa costs, supply-side pressures, and wage hikes. Specifically, tier I companies are expected to experience a contraction in margin on a QoQ basis. In the case of tier II companies like Coforge and LTTS, we anticipate a contraction in margin ranging from 240bps to 188 bps. This contraction is primarily attributed to one-time acquisition costs in the case of LTTS. Additionally, Persistent is likely to report a margin decline of around 25 bps on a QoQ basis. Moving on to tier III companies such as Route Mobile, FSL, and Birlasoft, their margin performance is expected to vary. Route Mobile and Birlasoft are projected to report a margin expansion ranging from 8 bps to 59 bps on a QoQ basis, while FSL is expected to see a margin decline by 77 bps. Overall, these factors indicate that margins in the industry are likely to be under pressure, with tier I companies experiencing the most significant contraction and varying margin performances observed across tier II and tier III companies on a QoQ basis.

View: The sector valuations are currently at elevated levels, leading us to adopt a cautious approach and observe the situation closely. We are concerned about near-term macroeconomic uncertainties that have resulted in delays in client budget spending and the shifting of deals from the current quarter to the next. As a result, we anticipate potential downside risks in H1FY24.
However, we expect a recovery in H2FY24, driven by anticipated improvements in the overall economy. Additionally, there is a high demand for cloud migration and digitalization within the sector, which is expected to contribute to the sector's recovery. In light of these factors, we suggest that investors consider adding high-quality companies like TCS in tier I, Coforge and Persistent in tier II, and Route Mobile and Birlasoft in tier III. These companies possess consistent strong management execution, have the ability to secure significant cost optimization deals during challenging macroeconomic conditions, and exhibit a focused approach to capitalize on digital transformation opportunities for their clients.

Recent Interaction with the Management

Birlasoft: The company anticipates no unexpected developments in the projected Q1FY24e figures. They anticipate a slight increase in growth and profitability due to favorable currency exchange rates and continued success in securing new deals. However, customer decision-making processes have been relatively slow. In the past, incentives were tied to the Total Contract Value (TCV), but now they are linked to revenue and margin, which is expected to result in better deals in the upcoming quarters. All segments of the company are performing well. Overall, there is an expectation that client budgets will improve in the future if circumstances improve.

Coforge Ltd: The company expects a stable quarter, although it may have a slower start compared to the strong performance in Q4FY23. The CQGR is projected to be in the range of 3-3.1%. In the previous quarter, the company received significant support from a large deal in the BFS sector. Q2FY24 is anticipated to be a robust quarter, and if the situation improves, it could exceed a growth rate of 13-16%. The company's margin will be impacted by 220-300 basis points due to wage hikes and visa costs, as well as an additional 20-50 basis points of expenses related to celebrating reaching $1 billion in revenue, which will be reported below EBITDA. The company will also benefit from currency tailwinds, which will contribute an additional 20-30 basis points. On the IT industry front, some clients are holding back, but this situation is not expected to persist for several more months, and there is no indication of worsening conditions. All three segments of the company are performing well, with a particular focus on improving performance in the healthcare sector in the US and increasing attention towards Austria and the UK.

Firstsource Solutions Ltd (FSL): There are no significant changes expected in Q1FY24. The BFS sector is projected to have moderate performance in H1FY24, with improvements expected in H2FY24. The company is experiencing positive traction in digital collections and remains focused on digital initiatives. While there is no budget constraint on the client side, spending has been slower. There has been some impact on client margins in their book. In the healthcare segment, the federal COVID-19 Public Health Emergency (PHE) declaration is set to end on May 11, 2023. Consequently, the CDC's authorization to collect certain types of public health data will expire. This change is seen as a positive development for the company in the next quarter, as they are a healthcare provider. The results of digital and legal collection volumes are yet to yield satisfactory outcomes. The outlook for offshore and onsite operations remains unchanged. In the CMT sector, revenue continues to show strength.

L&T Technology Services (LTTS): For FY24, the company has provided guidance for a constant currency revenue growth of over 20% (with organic growth exceeding 10%). The recent acquisition of SWC, which was completed on April 1st, 2023, will have a one-time impact on the company, resulting in an overall impact of 150-200 basis points, including factors such as wage hikes and currency tailwinds of 30-40 basis points. The company's goal is to achieve an EBIT margin of approximately 17% in FY24, largely influenced by the impact of the SWC acquisition.

In terms of segments, the transportation sector is showing positive momentum, while the aerospace, off-highway, and semicon sectors are also contributing to growth. The company is carrying out hiring activities in a normal manner, with a mix of lateral hires and freshers. Around 60% of the company's work is being offshored. The telecom sector is highly competitive, and while large deals with longer terms have higher margins, deals with shorter terms have lower margins.

Persistent Systems: Anticipates revenue growth of ~3% in the upcoming Q1FY24. There will be fluctuations in the ramp-up and ramp-down activities in the BFS segment, which may affect overall performance. Margin challenges are expected, with a one-time cost impacting margin below EBIT by approximately 100-200 basis points. The margin is projected to be within the range of 15-15.2%. Deal wins are expected to be lower, around 10-12%, as some deals are expected to be transferred to Q2FY24. There will be a ramp-up in the hi-tech segment. The company is hiring based on specific needs, with a greater focus on offshore resources.

Route Mobile Limited: The company expects a slight decrease in revenue on a quarter-on-quarter basis, but overall, it remains positive when considering the annual performance. The business segment is experiencing strength and resilience. The volume of International Long Distance (ILD) is deepening due to market conditions. Additionally, there are plans for 2-3 large deals to be shifted to Q2FY24.

Tata Consultancy Services INR (Mn.)	Q1FY24E	Q4FY23A	Q1FY23A	QoQ	YoY	Remarks
Revenue (Mn USD)	7235	7195	6780	0.6%	7.0%	TCS is currently experiencing project cancellations and delays, with some projects being rescheduled for a later time. However, certain projects that were originally planned for a later timeframe have begun to ramp up in June. **Key things would watch for:** outlook on EBIT margin and its sustainability, 2) commentary on long term digital trends; 3) Banking, US & Europe outlook and 4)Strategy of new CEO.
Net Revenue	595,065	591,620	527,580	0.6%	12.8%	
EBIT	139,335	144,880	121,860	-3.8%	14.3%	
EBIT Margin	*23.42%*	*24.5%*	*23.1%*	-107bps	32bps	
PAT	108,025	113,920	94,780	-5%	14.0%	
Infosys (Mn.)	**Q1FY24E**	**Q4FY23A**	**Q1FY23A**	**QoQ**	**YoY**	
Revenue (Mn USD)	4560	4554	4444	0.1%	3.0%	We anticipate that the revenue in cc will remain relatively stable, with a minimal growth of 0.1% compared to the previous quarter due to reduction in discretionary spending. **Key factors would watch for:** 1) Impact on revenues sue to leadership changes 2) Outlook on conversion of pipeline and project run offs.
Net Revenue	375,275	374,410	344,702	0.2%	9.0%	
EBIT	78,905	78,770	69,142	0.2%	14.0%	
EBIT Margin	*21.03%*	*21.04%*	*20.06%*	-1bps	97bps	
PAT	61,060	61,280	53,602	-0.4%	14%	
Coforge Limited	**Q1FY24E**	**Q4FY23A**	**Q1FY23A**	**QoQ**	**YoY**	
Revenue (Mn USD)	272	264	238.7	3.0%	14.0%	We are expecting healthy growth in revenue by 3% QoQ supported by broad based demand momentum. **Key factors would watch for:** 1) Outlook on top clients; 2) New logo addition and client mining trend 3) Outlook on BFS vertical due to macro challenges; 4) Attrition trend;5) outlook on TTH and 6) Large deal wins.
Net Revenue	22395	21700	18294	3.0%	22.0%	
EBIT	2930	3359	2288	-13.0%	28.0%	
EBIT Margin	13.1%	15.5%	12.5%	-240bps	58bps	
PAT	1965	2474	1497	-21.0%	31.0%	
Persistent Systems	**Q1FY24E**	**Q4FY23A**	**Q1FY23A**	**QoQ**	**YoY**	
Revenue (Mn USD)	282	275	242	2.5%	17.0%	Clients are currently postponing their discretionary technology spending and delaying the implementation of new growth initiatives. **Key factors would watch for**: 1)outlook on BFSI, Healthcare, 2) Outlook on the geography, 3) Outlook on the client budget.
Net Revenue	23210	22545	18781	3.0%	24.0%	
EBIT	3510	3466	2688	1.0%	31.0%	
EBIT Margin(%)	15.1%	15.4%	14.3%	-25bps	81bps	
PAT	2730	2515	2116	9.0%	29%	
L&T Technology Services	**Q1FY24E**	**Q4FY23A**	**Q1FY23A**	**QoQ**	**YoY**	
Revenue (Mn USD)	259	255	240	1.6%	7.9%	We expect 1.6% QoQ CC revenue growth, Clients are currently postponing their discretionary technology spending and delaying the implementation of new growth initiatives **Key factors would watch for:** 1) outlook for large deal, 2) Outlook on telecom segment, 3) Outlook on the Margin.
Net Revenue	21355	20962	18737	1.9%	14.0%	
EBIT	3600	3927	3434	-8.3%	4.8%	
EBIT Margin	16.9%	18.7%	18.3%	-188bps	-147bps	
PAT	3160	3109	2750	1.6%	15%	
Route Mobile	**Q1FY24E**	**Q4FY23A**	**Q1FY23A**	**QoQ**	**YoY**	
Net Revenue	9810	10087	7290	-2.7%	35.0%	We expect revenue to de-grow QoQ but better on annual basis on the back of better deal momentum. EBITDA Margin is likely to expand by 8bps sequentially led by better growth momentum and few deal shifted in next quarter. **Key factors would watch for**: 1) Outlook on large deal, 2) outlook on the client budget, 3) outlook for the next quarter.
EBIT	1226	1253	799	-2.0%	53.0%	
EBIT Margin	12.5%	12.4%	11.0%	8bps	154bps	
PAT	989	1016	710.7	-3.0%	39.0%	
Firstsource Solutions	**Q1FY24E**	**Q4FY23A**	**Q1FY23A**	**QoQ**	**YoY**	
Revenue (Mn USD)	195	190	191	2.8%	2.2%	There is no budget constraint on the client side, spending has been slower. There has been some impact on client margins in their book. In the healthcare segment, the federal COVID-19 Public Health Emergency (PHE) declaration is set to end on May 11, 2023. **Key factors would watch for**: 1) Outlook on the healthcare segment, 2)Outlook on the mortgage segment, 3) Outlook on the guidance front.
Net Revenue	16045	15568	14720	3.0%	9.0%	
EBIT	1730	1799	1170	-4.0%	48.0%	
EBIT Margin	10.8%	11.6%	7.9%	-77bps	283bps	
PAT	1305	1413	850.9	-8%	53.0%	
Birlasoft	**Q1FY24E**	**Q4FY23A**	**Q1FY23A**	**QoQ**	**YoY**	
Revenue (Mn USD)	150.5	149	149	0.9%	1.3%	The company anticipates no unexpected developments in the projected Q1FY24e figures **Key factors would watch for:** 1) new logo addition and client mining trend 2) Outlook on EBIT margin; 3) outlook on BFSI, manufacturing & hitch due to high inflation trend; 4) commentary on client related issues; 5) outlook on Europe and 6) strategy & organizational restructuring by new CEO.
Net Revenue	12350	12264	11544	0.7%	7.0%	
EBIT	1543	1460	1552	5.7%	-0.6%	
EBIT Margin	*12.49%*	*11.90%*	*13.44%*	59bps	-95bps	
PAT	1201	1122	1207.0	7.0%	-0.5%	

Source: Arihant Research

Arihant Research Desk

Email: instresearch@arihantcapital.com

Tel. : 022-42254800

Head Office	Registered Office
#1011, Solitaire Corporate Park	
Building No. 10, 1st Floor	Arihant House
Andheri Ghatkopar Link Road	E-5 Ratlam Kothi
Chakala, Andheri (E)	Indore - 452003, (M.P.)
Mumbai – 400093	Tel: (91-731) 3016100
Tel: (91-22) 42254800	Fax: (91-731) 3016199
Fax: (91-22) 42254880	

Stock Rating Scale	Absolute Return
BUY	>20%
ACCUMULATE	12% to 20%
HOLD	5% to 12%
NEUTRAL	-5% to 5%
REDUCE	-5% to -12%
SELL	<-12%

Research Analyst Registration No.	Contact	Website	Email Id
INH000002764	**SMS: ‘Arihant’ to 56677**	www.arihantcapital.com	instresearch@arihantcapital.com

Arihant Capital Markets Ltd.
1011, Solitaire Corporate park, Building No. 10, 1st Floor,
Andheri Ghatkopar Link Road, Chakala, Andheri (E)
Tel. 022-42254800Fax. 022-42254880