

# Sector Update

## IT

**Realistic Expectations, Reasonable valuations; Either recession fear overstated or growth moderation yet to play out**

*Festina Lente (meaning Make haste slowly) – Suetonius Augustus*

**Quick Summary:** We are making a case that IT services sector expectations are now reset at realistic level, and under a scenario of receding global macro-concerns, coupled with reasonable valuations (refer earlier note “pessimism overdone”– [link](#)) we are continuing with our view (elaborated in 2QFY23 preview) that there is near-term trading upside but medium term view is uncertain as it is too early to disregard macro-induced demand concerns (despite receding macro-concerns, we are likely to get clarity only by 1QCY23 and will reassess our medium term call). Long term, no point belaboring (again) that, anyway IT is a secular growth sector. Therefore, we continue with a view that there is near-term trading upside and to build position gradually with an option to consider buying aggressively only after clarity in/around 1QCY23 i.e. Festina Lente. We continue to prefer large-caps/larger-midcaps with top picks as Infosys (CMP INR 1636, Mcap INR 688,294 cr), LTI (CMP INR 4938, Mcap INR 86,607 cr) and Persistent (CMP INR 3971, MCap INR 30,346 cr) and LTTS (CMP INR 3886, Mcap INR 41,026 cr).

**IT sector reset at realistic expectations in near term:** Over last 2 quarters IT results are a study in contrast –not because sequential growth was materially different, but because, despite similar growth, 1QFY23 was considered underperformance while 2QFY23 is considered outperformance (refer exhibit 01). Implying, what has changed is our/street/consensus expectations, not companies performance per-se (infact, except for some details about few more geo/verticals facing headwinds, overall commentary about demand, pipeline, and contract booking is largely unchanged in 2Q v/s 1Q). This is in-line with our 2QFY23 preview (2QFY23 = 1QFY23 + some margin expansion) and made a case that IT stocks could be considered gradually buying for trading upside though it is too early to disregard macro-induced demand concerns.

### Exhibit 01: Growth performance (vs est) was better in 2Q vs 1Q despite almost similar growth trend

	1QFY23 Revenue growth			1Q23 Margins performance			2QFY23 Revenue growth			2Q23 Margins performance		
	QoQ	QoQ Est	P/F	EBITM	Est.	P/F	QoQ	QoQ Est	P/F	EBITM	Est.	P/F
TCS	1.3%	1.4%	in-line	23.1%	23.5%	U/PF	1.4%	1.2%	O/PF	24.0%	23.7%	O/PF
Infosys	3.8%	3.0%	O/PF	20.1%	21.1%	U/PF	2.5%	2.9%	U/PF	21.5%	20.5%	O/PF
Wipro	0.5%	2.8%	U/PF	14.3%	16.1%	U/PF	2.3%	2.2%	O/PF	15.1%	15.2%	U/PF
HCLT	1.1%	3.2%	U/PF	17.0%	17.7%	U/PF	1.9%	1.0%	O/PF	17.9%	17.3%	O/PF
TECHM	1.5%	3.0%	U/PF	11.0%	11.2%	U/PF	0.3%	0.5%	inline	11.4%	11.1%	O/PF
LTI	1.7%	3.4%	U/PF	16.0%	15.3%	O/PF	3.6%	2.0%	O/PF	16.1%	16.3%	U/PF
Mindtree	4.0%	5.0%	U/PF	19.2%	18.6%	O/PF	5.7%	4.4%	O/PF	19.1%	18.7%	O/PF
Coforge	2.7%	4.2%	U/PF	13.0%	14.5%	U/PF	3.4%	3.5%	In-line	15.2%	15.4%	U/PF
Persisten	11.0%	9.7%	O/PF	14.3%	13.5%	O/PF	5.8%	6.0%	In-line	14.6%	13.6%	O/PF
LTTS	3.2%	3.2%	U/PF	18.3%	18.2%	O/PF	3.2%	2.5%	O/PF	18.2%	18.0%	O/PF
Cyient	3.1%	1.5%	O/PF	11.5%	12.5%	U/PF	8.2%	9.3%	U/PF	8.8%	11.0%	U/PF

Source: Companies, Bloomberg, Edelweiss Wealth research

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**Medium term, either there is no recession or earnings are too optimistic:** Despite wide fear of recession in key markets of Indian IT services companies, consensus estimates do not suggest any recession. S&P 500 consensus EPS estimate is US\$ 232.2 for CY23E, a growth of 5% over US\$ 221.1 estimate in CY22 (source: Factset). Historical data (since 1957 to 2020) of recession suggest peak-to-trough S&P 500 earnings cut of ~30% on an average, and excluding outliers (of Tech bubble 2000/01 and GFC 2008) average earnings cut of ~19%. If we just consider inflation-induced recessions in the historical data then average earnings cut was ~13%. So likely upcoming recession (in 2023 probably) will be a historically strange one where there will be no earnings contraction (but yet it will be labeled as “recession”). Similarly, Indian IT services companies earnings has again saw, on an average, earnings upgrade in 2QFY23 after sharp cut in 1QFY23 and some downgrades since 3QFY22 (refer Exhibit 02).

These data-points suggest either the fear of recession is unfounded or CY23/FY24 earnings estimates are too optimistic. So we need to wait till 1QCY23 at least for clarity to emerge.

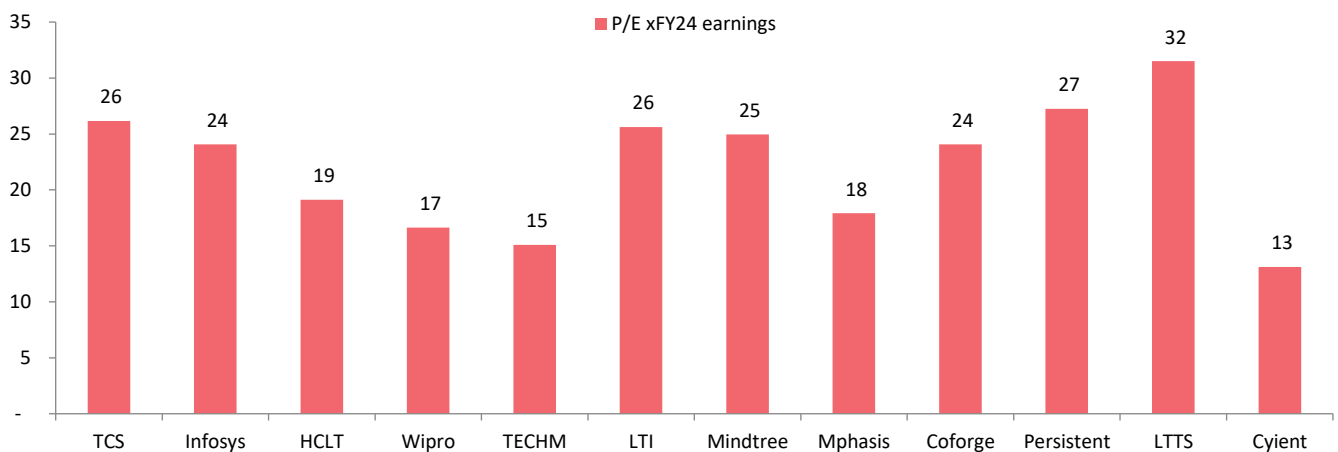
**Exhibit 02: Consensus EPS estimate change post 2QFY23 results vs post 1QFY23 results**

	EPS est (post-1Q23)		Change post-1Q23		EPS est (post-2Q)		Change post-2Q23	
	FY23E	FY24E	FY23E	FY24E	FY23E	FY24E	FY23E	FY24E
TCS	115	129	-2.7%	-3.1%	115	130	0.1%	0.6%
Infosys	58	65	-3.4%	-5.8%	58	68	1.1%	4.6%
HCLT	52	59	-3.4%	-4.2%	53	59	1.5%	0.0%
Wipro	21	24	-11.1%	-10.9%	21	24	-0.9%	1.0%
TECHM	61	72	-8.8%	-7.1%	60	72	-0.7%	-0.1%
LTI	155	175	0.6%	-4.2%	162	193	4.4%	10.2%
Mindtree	119	137	3.6%	2.6%	122	138	2.1%	0.3%
Mphasis	92	109	-1.1%	-3.1%	92	107	-0.5%	-1.2%
Coforge	133	162			133	164	-0.1%	1.1%
Persistent	117	141			121	146	3.8%	3.3%
LTTS	109	134	0.7%	4.9%	107	123	-2.3%	-7.9%
Cyient	52	62	-2.5%	1.8%	49	61	-5.0%	-2.3%

Source: Bloomberg, Edelweiss Wealth research

**IT sector at reasonable valuations:** We elaborated earlier that IT stock’s valuation has corrected 17%-49% and Nifty IT index valuation corrected by 27%. Since then, valuations have inched up but valuation is broadly within the reasonable band (albeit at higher side of the band) adjusted for RoCE & growth rate expansion post-pandemic.

**Exhibit 03: Valuations (using Bloomberg consensus estimate)**



Source: Edelweiss Wealth Research.

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**EWM View and Top Picks:** We continue to maintain based on reasonable valuation and positive demand/pipeline commentary (divergent from street fear of recession) we may see near term trading upside. But it is too early to discard global-macro induced demand slowdown concerns, either recession fear was overstated or earnings cut is yet to play out. In our previous note we made a case that 2 of 3 concerns – 1st, margin and 2nd, cost-of-capital – related price corrections are mostly done. 3rd concern about demand impact from global macro-concerns is yet to play out though recent macro signals (US Fed-speak/Fed-pivot, etc) suggest receding concern and possibly upcoming “recession” might be “different this time” with no negative earnings impact. However, we believe it will be prudent to let clarity emerge by/around 1QCY23.

**Therefore, we continue with our trading upside call and suggest to gradually build position in IT stocks with an option to buy aggressively once there is clarity, i.e. Festina Lente (Make haste slowly).**

We continue to prefer large-caps/larger-midcaps within the sector with top picks largely unchanged as Infosys (CMP INR 1636, Mcap INR 688,294 cr), LTI (CMP INR 4938, Mcap INR 86,607 cr) and Persistent (CMP INR 3971, MCap INR 30,346 cr) and LTTS (CMP INR 3886, Mcap INR 41,026 cr).

	CMP	Mcap (INR Cr)	Revenue (INR Cr)			EBIT Margins			EPS (INR)			P/E (x)			ROE (%)		
			FY22A	FY23E	FY24E	FY22A	FY23E	FY24E	FY22A	FY23E	FY24E	FY22A	FY23E	FY24E	FY22A	FY23E	FY24E
TCS	3,389	12,40,290	1,91,754	2,23,505	2,43,218	25%	24%	25%	104	117	128	33	29	26	44	45	43
INFOSYS	1,636	6,88,294	1,21,641	1,49,164	1,62,996	23%	21%	22%	52	59	68	31	28	24	29	31	31
HCL TECH	1,128	3,06,155	85,651	1,01,715	1,14,606	19%	18%	18%	50	52	60	23	22	19	22	23	25
WIPRO	403	2,20,979	79,093	92,000	1,06,639	17%	15%	17%	22	22	28	18	18	14	20	17	19
TECH M	1,080	1,05,153	44,646	53,600	59,834	15%	12%	13%	63	61	72	17	18	15	22	19	20
LTI	4,938	86,607	15,669	19,705	22,424	17%	17%	18%	131	163	194	38	30	25	29	30	32
Mindtree			10,525	13,647	15,689	19%	19%	17%	100	121	132				34	33	30
Coforge	3,945	24,059	6,432	8,189	9,504	15%	15%	16%	110	146	184	36	27	21	27	28	28
LTTS	3,886	41,026	6,570	8,128	9,430	18%	18%	19%	91	112	135	43	35	29	25	26	27
Persistent Systems	3,971	30,346	5,711	8,205	9,587	14%	15%	15%	90	119	144	44	33	28	22	25	25
Birlasoft	294	8,023	4,130	4,926	5,590	14%	13%	15%	16	18	24	18	16	12	20	19	21
Cyient	797	8,805	4,133	4,534	5,891	14%	13%	12%	48	54	61	17	15	13	17	16	17
eClerx	1,429	7,250	2,160	2,635	3,005	26%	22%	24%	81	92	107	18	16	13	27	27	26
Newgen	348	2,436	779	922	1,104	23%	17%	22%	23	23	30	15	15	12	22	22	24

Source: Companies, Edelweiss Wealth Research

# Sector Update

## IT

### The Team

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Sagar Doshi	Head - Trading
Arun Jain	Practice Head - Trading
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Amit Agarwal	Infra, Real Estate, Hotels
Praveen Sahay	Consumer Durables, Building materials, Healthcare services, Hospitality
Kapil Jagasia	Consumption, Textile, QSR, Retail
Raj Jha	BFSI, NBFC
Jigar Jani	BFSI, NBFC
Ranvir Singh	Pharma, Chemicals
Himanshu Yadav	Cement, Logistics, Mid-caps
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Ankit Narshana	Option Trader
Nikhil Shetty	Mid Caps

Sales Team	Location
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Ketan Malkan	Mumbai
Vikas Sharma	Bengaluru
Abhishek Agarwal	Kolkata
Vivek Khanna	Delhi

### Coverage Universe

Sr. No	Coverage
1	Aditya Birla Fashion & Retail Ltd
2	Aegis Logistics Ltd
3	Amber Enterprises India Ltd
4	Astral Ltd
5	Balaji Amines Ltd
6	Bata India Ltd
7	Birla Corporation Limited
8	Can Fin Homes Ltd
9	Century Plyboards India Ltd
10	Cholamandalam Inv and Finance Ltd
11	City Union Bank Ltd
12	CreditAccess Grameen Ltd
13	Crompton Greaves Consumer Electricals Ltd
14	CSB Bank Ltd
15	Deepak Nitrite Ltd
16	Easy Trip Planner Ltd
17	Escorts Ltd
18	Finolex Industries Ltd
19	Home First Finance Company India Ltd
20	Indo Count Industries Ltd
21	K P R Mill Ltd
22	KNR Constructions Ltd
23	Krishna Institute of Medical Sciences Ltd
24	Lumax Industries. Ltd
25	Metropolis Healthcare Ltd
26	Minda Industries Ltd
27	Motherson Sumi Ltd
28	Navin Fluorine International Ltd
29	Neogen Chemicals Ltd
30	Newgen Software Technologies Ltd
31	Orient Electric Ltd
32	PSP Projects Ltd
33	Rossari Biotech Ltd
34	Shriram Transport Finance Company Ltd
35	SRF Ltd
36	Vinati Organics Ltd
37	Voltas Ltd
38	Westlife Development Ltd
39	Zydus Wellness Ltd
40	Tarsons Products Ltd
41	MTAR Technologies Ltd.
42	S J S Enterprises Ltd

Sr. No	Tactical Buy
1	ACC Ltd
2	Ajanta Pharma Ltd
3	Ambuja Cements Ltd
4	Ashok Leyland Ltd
5	Axis Bank Ltd
6	Bharat Electronics Ltd
7	Brigade Enterprises Ltd
8	DLF Ltd
9	eClerx Services Ltd
10	Globus Spitiis Ltd
11	GNA Axles Ltd
12	HDFC Life Insurance Co. Ltd
13	ICICI Bank Ltd
14	Indusind Bank Ltd
15	Jamna Auto Industries Ltd
16	JK Cement Ltd
17	Larsen & Toubro Ltd
18	Mahindra and Mahindra Ltd
19	Max Financial Services Ltd
20	Max Healthcare Institute Ltd
21	PNC Infratech Ltd
22	RBL Bank Ltd
23	Sun Pharma Ltd
24	TechMahindra Ltd
25	Ultratech Cement Ltd
26	Elecon Engineering Company Ltd
27	Kennametal India Ltd

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