India IT Services

State of IT demand: Spend revival now expected in H2

Price Objective Change

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Equity
India
IT Services

Kunal Tayal >>
Research Analyst
BofAS India
+91 22 6632 8663
kunal.tayal@bofa.com

Jatin Kalra, CFA >>
Research Analyst
BofAS India
+91 22 6632 8390
jatin.kalra3@bofa.com

Q3: A quarter of unchanged expectations

Q3 earning season saw IT services companies meet the low bar of street expectations. Key highlights included: (1) Aggregate revenue growth for the top 5 companies was flattish yoy (vs. 1% in Q2). (2) Deal win value for the top 4 normalized to $17bn, in comparison to the uptick seen in Q2 ($27bn). (3) Headcount declined 4%yoy, as companies continued to focus on improvement in utilization of existing resources. Commentaries on the demand outlook made for a two-way read as it included views ranging from an unchanged demand environment to some mentions of green shoots. Consensus earnings expectations were unchanged for Infosys and Wipro.

NASSCOM, global peers keep up debate on recovery pace

As per NASSCOM, its annual CEO survey indicates that almost 80% of the providers expect an uptick in growth rate during the coming year. For most, this is predicated on an expected increase in technology spending. Segments with green shoots include engineering services, global capability centers and AI. In comparison, the cumulative read of CY24 outlooks by Capgemini, Cognizant, EPAM and Globant indicate an unchanged organic growth rate vs. CY23 (Exhibit 28). The expected cadence is of a bottom in Q1CY24, followed by a recovery in H2. Globant described the environment as showing signs of recovery but still below normalized level of demand.

Lead indicator inching up; macro dependent H2 recovery?

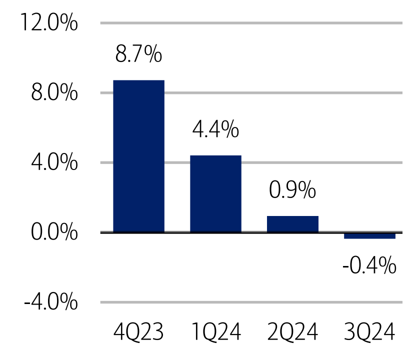
We update BofA India IT Services Indicator for input data available till January '24. This suggests a mild uptick vs. the low level seen in July '23. Given the leading nature of the indicator to topline growth by about 6months, the indicator concurs with our view as well as the corporate viewpoint of a potential bottom in the growth outlook. That said, akin to last year, expectations of a recovery in H2 still appear to be macro dependent amidst expectations of a recovery in discretionary spends post start of the rate cut cycle in US. The spending stance of US corporates, ahead of elections in November, could be a key consideration for such an assumption to play out.

Expect a pause in rally, pending an upgrade in earnings

With recovery expectations shifting to the later part of CY24, we think that the recent rally in the sector could take a pause. In the interim, our relative stock screens are contingent on (1) Ramps available from existing deal wins and (2) Probability of being a net winner in the upcoming spends around AI. We find Infosys scoring well on both these parameters. Adjust PO's (Exhibit 2) as we increase our FY26E EPS multiple by 1x-3x (Exhibit 15 for details) amidst comfort of a bottom now being in place for growth rates.

Exhibit 1: Aggregate rev. growth for the top 5 companies was flattish yoy in Q3

YoY organic revenue growth (cc)



Source: Companies, BofA Global Research

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Exhibit 2: PO change summary

Adjust PO's as we increase our FY26E EPS multiple by 1x-3x (Exhibit 15 for details)

	Rating	Old PO (INR)	New PO (INR)
Infosys	Neutral	1,535	1,735
Wipro	U/P	395	415

Source: BofA Global Research estimates

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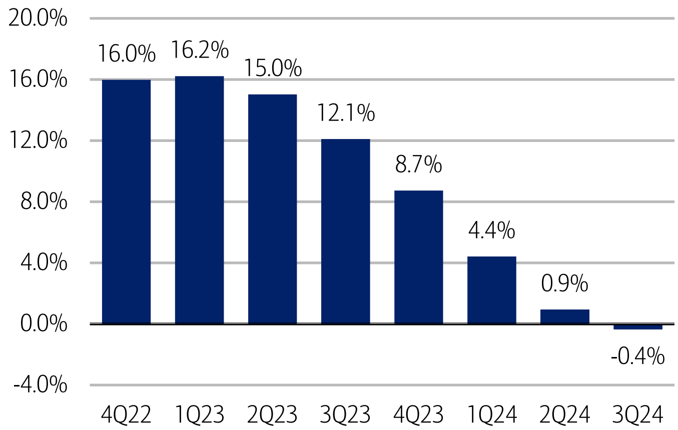
Refer to important disclosures on page 19 to 23. Analyst Certification on page 18. Price Objective Basis/Risk on page 17. **12664241**

Q3: A quarter of unchanged expectations

Aggregate revenue for top 5 was flattish in Q3

Q3 revenue growth on an aggregate basis, for top 5 India IT Services companies, decelerated to -0.4% (yoy, constant currency) vs. 1% in last quarter & 12% last year. On a sequential basis, revenues were up 1%qoq, helped by a strong quarter at HCL whereas ex-HCL, sequential growth was flat.

Exhibit 3: YoY organic revenue growth (cc) – Top 5 India IT companies
Aggregate revenue growth for top 5 companies decelerated to -0.4% YoY constant currency in Q3 (vs. 1% in Q2)



Source: Companies, BofA Global Research

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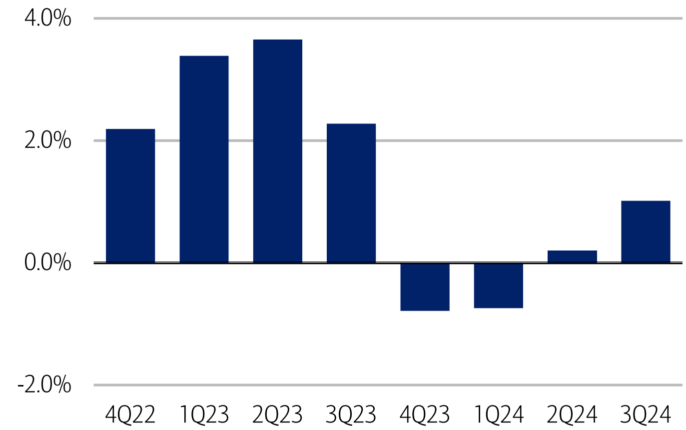
Exhibit 4: QoQ organic revenue growth (cc) – Top 5 India IT companies
Revenues for the top 5 companies on an aggregate basis was up 1%qoq, helped by a strong 6%qoq quarter at HCL



Source: Companies, BofA Global Research

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Bottoming of growth rather than a quick recovery

Management commentaries on the demand outlook made for a two-way read as it included views ranging from an unchanged demand environment to some mentions of green shoots. On an aggregate level, we read these comments as signs of bottoming / stabilization rather than a quick recovery, as our checks on budgets and discretionary spends are yet to suggest a meaningful uptick.

Exhibit 5: Commentary on customer spend intentions
Commentaries on demand outlook made for a two-way read as it included views ranging from an unchanged demand environment to some mentions of green shoots

Company	Commentary on demand outlook
TCS	• As per company, the spend environment remains unchanged while the pipeline for large, cost take out deals is healthy. • Ramps in recent deal wins could help the large segment of financial services return to growth from next quarter. • Current tight spending by customers could result in catch-up spending for when the macroeconomic situation improves.
Infosys	• Management described customer spend trend as having neither improved nor deteriorated. • Customer approach in financial services was described as still cautious and in value maximization mode while decision cycles remain long in retail and telecom sectors. Manufacturing, energy, and life sciences have relatively better spend scenarios. • In continuation of the trend of Q3, Q4 is also likely to see impact of furloughs.
HCL	• At a broad level, there has been no change to customer spend, and discretionary spending also remains at a similar level. • Customer spend sentiment change on the back of US rate cuts could take a couple of quarters to filter through. • Transformation programs are seeing some delays in starting off, while cost take-out programs are moving briskly.
Wipro	• There is no change in customer spend trend, but some green shoots are visible and expectations of return to growth in the coming months. The budget trend for CY24 is likely to be clearer after February. • The consulting business saw a 10%+ uptick in bookings during the quarter.
TECHM	• On growth, management expects demand uncertainty to remain for the next 2 quarters, particularly in the telecom vertical. • As per company, it is early to call for definitive signs of recovery given the business issues facing the customers.

Source: Company transcripts

Exhibit 6: Revenue growth – quarterly trends
Within the top 5 India IT Service companies, HCL grew the fastest whereas Wipro trailed (revenues down 7%yoy)

	Q3 21	Q4 21	Q1 22	Q2 22	Q3 22	Q4 22	Q1 23	Q2 23	Q3 23	Q4 23	Q1 24	Q2 24	Q3 24
Revenue growth (cc, yoy)													
TCS	0.4%	5.9%	16.4%	15.5%	15.4%	14.3%	15.5%	15.4%	13.5%	10.7%	7.0%	2.8%	1.7%
Infosys	6.6%	9.6%	16.9%	19.4%	21.5%	20.6%	21.4%	18.8%	13.7%	8.8%	4.2%	2.5%	-1.0%
Wipro	-2.0%	0.5%	21.3%	28.8%	28.5%	28.5%	17.2%	12.9%	10.4%	6.5%	1.1%	-4.8%	-6.9%
HCL	1.1%	2.6%	11.7%	10.5%	15.0%	13.3%	15.6%	15.8%	13.1%	10.5%	6.3%	3.4%	4.3%
TECHM	-4.6%	-0.5%	10.8%	15.5%	17.5%	22.6%	21.2%	16.8%	12.7%	6.3%	-0.9%	-5.9%	-5.4%
LTTS	-5.2%	-0.6%	18.6%	22.3%	19.5%	19.4%	19.9%	18.1%	13.5%	12.1%	10.0%	1.4%	11.0%
Revenue growth (cc, qoq)													
TCS	4.1%	4.2%	2.4%	4.0%	4.0%	3.2%	3.5%	4.0%	2.2%	0.7%	0.0%	-0.1%	1.1%
Infosys	5.3%	2.0%	4.8%	6.3%	7.0%	1.2%	5.5%	4.0%	2.4%	-3.2%	1.0%	2.3%	-1.0%
Wipro	3.4%	3.0%	12.0%	8.1%	3.0%	3.1%	2.1%	4.1%	0.6%	-0.6%	-2.8%	-2.0%	-1.7%
HCL	3.5%	2.5%	0.7%	3.5%	7.6%	1.1%	2.7%	3.8%	5.0%	-1.2%	-1.3%	1.0%	6.0%
TECHM	2.8%	0.7%	3.9%	7.2%	4.7%	5.4%	3.5%	2.9%	0.2%	0.3%	-4.2%	-2.4%	1.1%
LTTS	6.6%	3.8%	4.3%	6.0%	4.2%	3.6%	4.7%	4.5%	0.0%	2.2%	-2.9%	3.2%	0.9%

Source: Companies, BofA Global Research

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Glance at mid-cap IT performance and commentary

We provide below the quarter's performance and management comments from mid-cap IT names (listed, uncovered) from their recent earnings calls. LTIM doesn't expect any significant change in demand trends from Q3 to Q4. Coforge indicated green shorts in pockets but its read of client budgets suggest no significant uptick in budgets in CY24 over CY23. Mphasis indicated stability in the mortgage business but hasn't seen notable volume pickup yet.

Exhibit 7: Snapshot of revenue growth and EBIT margins for mid-cap IT names
Divergent trends on growth within the mid-cap space, with Coforge and Persistent growing significantly ahead of LTIM and Mphasis

Revenue growth cc - QoQ	Q1 22	Q2 22	Q3 22	Q4 22	Q1 23	Q2 23	Q3 23	Q4 23	Q1 24	Q2 24	Q3 24
LTI Mindtree	5.9%	10.6%	7.5%	3.2%	5.0%	5.5%	1.9%	0.7%	0.1%	1.7%	0.7%
Coforge	7.0%	3.9%	5.7%	5.0%	4.7%	6.2%	3.7%	4.7%	2.7%	2.3%	1.8%
Mphasis	5.7%	6.6%	7.9%	4.3%	2.0%	1.8%	-2.5%	-4.5%	-3.5%	0.0%	1.0%
Persistent (USD terms)	9.2%	9.3%	9.2%	9.1%	11.1%	5.8%	3.4%	3.9%	3.0%	3.1%	3.1%

Revenue growth cc - YoY	Q1 22	Q2 22	Q3 22	Q4 22	Q1 23	Q2 23	Q3 23	Q4 23	Q1 24	Q2 24	Q3 24
LTI Mindtree							16.3%	13.5%	8.2%	4.4%	3.1%
Coforge	25.6%	20.7%	23.5%	23.4%	20.7%	23.4%	21.1%	20.7%	18.4%	14.1%	12.0%
Mphasis	17.8%	17.2%	26.4%	26.8%	22.1%	16.8%	5.7%	-3.1%	-8.4%	-10.1%	-6.8%
Persistent (USD terms)	27.3%	34.0%	36.2%	42.2%	44.8%	40.2%	32.8%	26.3%	17.1%	14.1%	13.8%

EBIT margins	Q1 22	Q2 22	Q3 22	Q4 22	Q1 23	Q2 23	Q3 23	Q4 23	Q1 24	Q2 24	Q3 24
LTI Mindtree			18.5%	18.1%	17.4%	17.5%	13.9%	16.4%	16.7%	16.0%	15.4%
Coforge	10.8%	13.6%	14.8%	15.5%	12.5%	14.5%	14.6%	15.5%	11.5%	11.9%	13.8%
Mphasis	15.9%	15.1%	15.1%	15.2%	15.3%	15.3%	15.3%	15.3%	15.4%	15.5%	14.9%
Persistent (USD terms)	15.5%	13.9%	14.0%	14.0%	14.3%	14.6%	15.4%	15.4%	14.9%	13.7%	14.5%

Source: Companies, BofA Global Research. Note: Reported margins for Coforge (inclusive of ESOP costs). Excluding the growth from SLK acquisition starting from Q1'22 to Q1'23 for Coforge

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Exhibit 8: Commentary on near-term demand outlook from mid-caps

LTIM doesn't expect any significant change in demand trends from Q3 to Q4. Coforge indicated green shorts in pockets but its read of client budgets suggest no significant uptick in budgets in CY24 over CY23. Mphasis indicated stability in the mortgage business but hasn't seen notable volume pickup yet.

Company	Commentary on demand outlook
LTIM	• Furloughs were expected to be higher-than-usual, but they ended up being even higher, both in terms of their degree and extent of impact as macro remained unchanged & client spending remained restrained. • Expect Q4 performance to remain similar as Q3. Some of the furloughs will reverse in Q4 but not all will come back. • A lot of clients are still not frozen their budgets for the calendar year. There is a delay in decision-making which was there earlier also and continues to go on as of now. • BFSI continues to show a cautionary approach towards new spends and weakness in the vertical likely to persist in Q4 as well.
Coforge	• Faced higher-than-normal headwinds because of unusually high furloughs in the BFSI industry and confronted a depressed demand environment generally. Expect to recoup all of the furloughs back in Q4. • Retained the 13%-16%yoy cc guidance for FY24 & likely to finish around the bottom end. • Clients have finished their budgeting cycle for CY24 and what we picked up about budgets from clients globally, doesn't reflect any significant uptick in budgets in CY24 over CY23. Though given the investments made in sales and capabilities by the company, it expects to eke out robust and sustained growth next year. • There are greenshoots in pockets in areas of new product proposition, driving agility in software delivery and compliance / regulatory requirements.
Mphasis	• Not much changed between the start and end of the quarter around deal closure pace and conversion from deals to revenue. • Impact of furloughs was a fair bit higher in the quarter & ramp-up of some deals is taking longer but have seen pace of conversion pick up in the last few weeks. • Though macro-driven overhang continues in select verticals, company saw stability in revenue ex-seasonality factors. Expect to deliver growth beyond seasonality in Q4, led by BFS and TMT, aided by certain recent deals. • Mortgage business remained stable this quarter & has now bottomed, driven by the new deal wins from previous quarters. Softening of 30-year interest rates on the mortgage side over the last few weeks but that still hasn't resulted into any notable volume pickup. General expectation is that mortgage rates will gradually decline through' providing a platform for the company to benefit from the cycle. • Within BFS, capital markets is stressed as deal volumes are nowhere near where they should be in a normal environment & this segment is probably going to be a lot harder to recover i.e. will recover only when deal activity improves, whereas seeing a lot of investments going into consumer banking, asset / wealth management and risk / governance areas.
Persistent	• Demand environment was described as fluid. Seeing some green shoots in discretionary spends but wouldn't say that there are too many. The environment is not any significantly different from the last few quarters. • Company's focus on account mining and large deals were key factors that aided healthy order bookings and top quartile revenue growth in the quarter. Most of the company's growth is coming from proactive efforts that they have had in both existing and new customers, and winning longer range deals than earlier.

Source: Company transcripts

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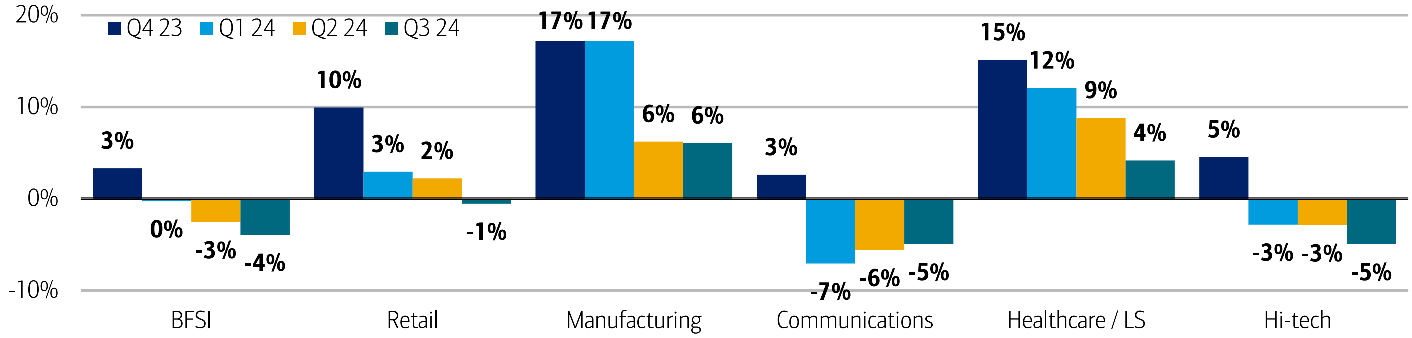
Industry trend: BFSI, Hi-tech and Communications remained the slowest growing.

Exhibit 9: Vertical wise yoy cc growth for top 4 India IT companies on an aggregate basis – quarterly trends
BFSI, communications & hi-tech remain the most impacted verticals.



Source: Companies, BofA Global Research

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Exhibit 10: YoY constant currency growth trends for key verticals for top 4 India IT companies
BFSI & Communications further decelerated for most companies barring HCL, which was helped by specific large deals

	TCS		Infosys		HCL		Wipro	
	Q2FY24	Q3FY24	Q2FY24	Q3FY24	Q2FY24	Q3FY24	Q2FY24	Q3FY24
BFSI	-0.5%	-3.0%	-7.3%	-5.9%	12.5%	12.9%	-9.5%	-13.2%
Retail	1.0%	-0.3%	9.2%	0.4%	8.1%	11.7%	-6.7%	-8.1%
Manufacturing	5.8%	7.0%	12.6%	10.6%	3.3%	5.8%	-3.6%	-10.5%
Communications	-2.1%	-4.9%	-4.3%	-8.0%	-10.4%	8.3%	-14.6%	-19.2%
Healthcare & Lifesciences	5.0%	3.1%	18.4%	6.3%	9.8%	0.5%	7.1%	9.9%
Hi-tech	-2.2%	-5.0%	-0.6%	-5.1%	-9.5%	-9.2%	1.7%	1.0%
Total	**2.8%**	**1.7%**	**2.5%**	**-1.0%**	**3.4%**	**4.3%**	**-4.8%**	**-6.9%**

Source: Companies, BofA Global Research

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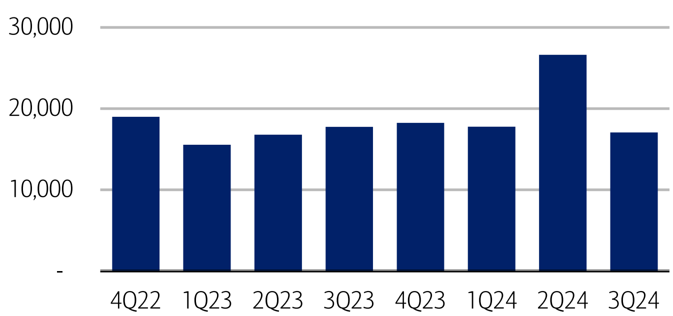
Deal wins normalized after a record Q2 but still good for a December quarter

After a record Q2, deal wins normalized in Q3 for the Indian IT Services sector. In 9MFY24, there has been a divergence in deal win performance between the top 3 (TCS, Infosys, HCL) & the next 2 (Wipro, TECHM) with the former set reporting much healthy deal win growth.

Exhibit 11: Deal wins trend (USD mn) – aggregate for top 4 India IT companies*
After a record Q2, deal wins normalized in Q3



Source: Companies, BofA Global Research.
Note: *Above growth numbers are based on All-deal TCV (new & renewal) for TCS & Wipro. Large-deal TCV (new & renewal) for Infosys & Net new deal TCV for HCL.

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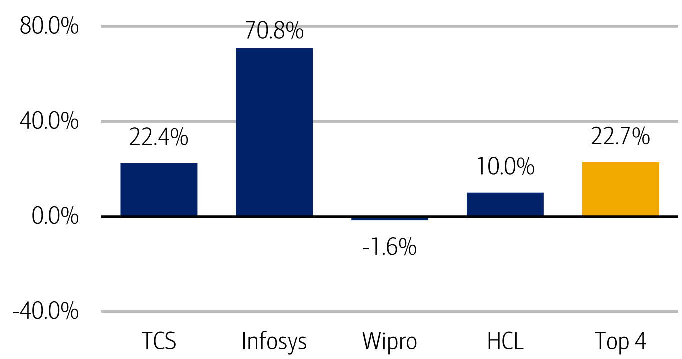
Exhibit 12: Deal wins YoY growth – 9MFY24
Infosys leading in FY24 on deal wins



Source: Companies, BofA Global Research.
Note: Above growth numbers are based on All-deal TCV (new & renewal) for TCS & Wipro. Large-deal TCV (new & renewal) for Infosys & Net new deal TCV for HCL.

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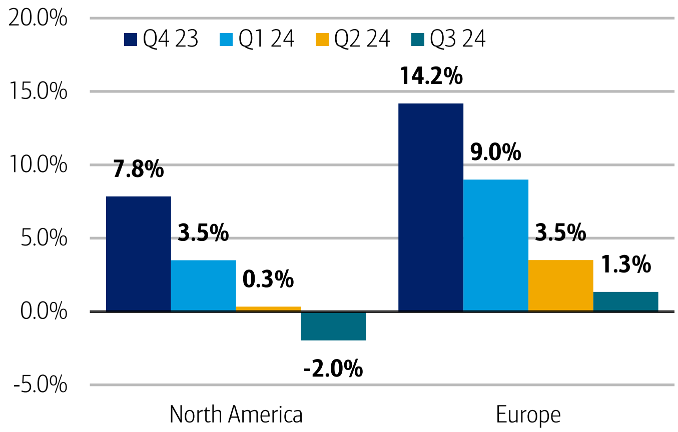
US continues to grow slower than Europe

Exhibit 13: CC YoY revenue growth for Top 4 Indian IT companies on an aggregate basis
North America now in a de-growth phase on a YoY basis



Source: Companies, BofA Global Research

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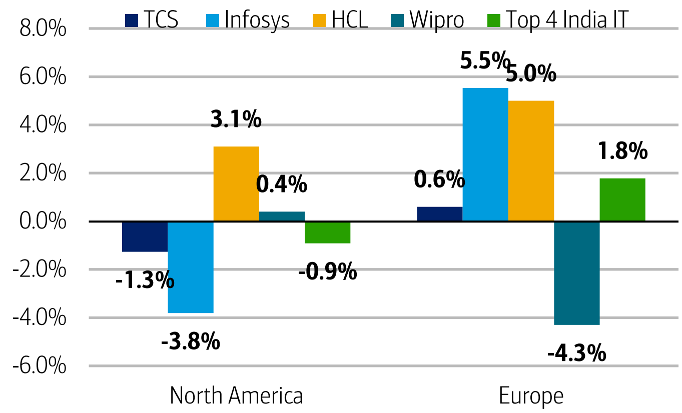
Exhibit 14: CC QoQ revenue growth for Top 4 Indian IT companies on an aggregate basis
Europe led the qoq growth whereas North America was down sequentially



Source: Companies, BofA Global Research

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Better margins restricted earnings cuts but expect a pause in stock rally, pending upgrades in earnings

Most companies displayed strong execution in margin management and benefits from initiatives that are part of the current cost optimization mode yielded better than our expectations. For the top 4 companies, margins (adjusted for one-offs) were ahead of expectations. On the talent side, companies hinted that focus remains on utilizing existing resources vs. resuming hiring.

At an aggregate level for the top 4 companies, margins expanded 30bps qoq as reduction in sub-contracting expenses & discretionary expenses, and uptick in utilization more than offset the impact of furloughs and wage hikes for 3 of the 4 companies. Within companies, TCS fared the best on margins which expanded margins both yoy & qoq. The strong execution on margin management helped avoid consensus cuts to FY25/26E (barring TECHM).

Expect a pause in rally, pending upgrades in earnings

With recovery expectations shifting to the later part of CY24, we think that the recent rally in the sector could take a pause. In the interim, our relative stock screens are contingent on (1) Ramps available from existing deal wins and (2) Probability of being a net winner in the upcoming spends around AI. We find Infosys scoring well on both these parameters. Adjust PO's as we increase our FY26E EPS multiple by 1x-3x (Exhibit 15 for details) amidst comfort of a bottom now being in place for growth rates. We retain Neutral on Infosys on balanced risk-reward and U/P on Wipro on unfavorable risk reward. For detailed investment rationales, see end of report.

Exhibit 15: PO change summary
Adjust PO's as we increase our FY26E EPS multiple by 1x-3x amidst comfort of a bottom now being in place for growth rates

		PO (INR)		FY26E EPS multiple (x)		
	Rating	Old	New	Old	New	Basis for new multiple
Infosys	Neutral	1,535	1,735	22	25	10% discount to sector leader; in-line with average of past 3years
Wipro	U/P	395	415	17	18	38% discount to sector leader; in-line with average of past 3years

Source: BofA Global Research estimates

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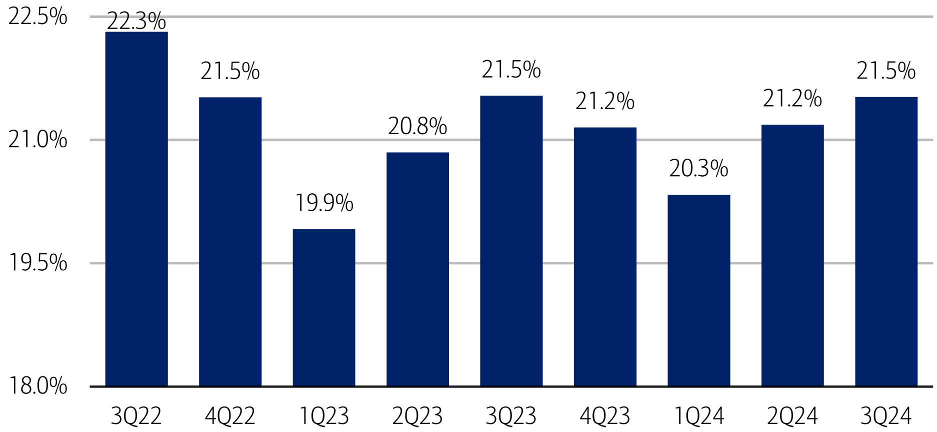
Exhibit 16: Aggregate EBIT margins for the top 4 India IT companies
Aggregate margins for the top 4 companies expanded qoq



Source: Companies, BofA Global Research

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Exhibit 17: Q-o-Q margin performance for top 5 companies in Q3FY24
For the top 4 companies, margins (adjusted for one-offs) were ahead of expectations

Company	EBIT margin actual vs. consensus	Margin headwinds (qoq)	Margin tailwinds (qoq)
TCS	Up 75bps qoq to 25.0% vs. BofAe of 24.6%	• Furloughs & 3rd party items (80bps)	• Productivity, realization improvement & lowered sub-contracting (130bps) • FX (25bps)
Infosys	Down 70bps qoq to 20.5% vs. BofAe of 20.8%	• 2 months of wage hike impact (70bps) • 1x impact from a subsidiary (60bps)	• Utilization uptick, lower sub-contracting, lower SG&A (50bps) • FX (10bps)
HCL	Up 125bps qoq to 19.8% vs. BofAe of 19.4%	• Wage hike for 90% of employees (65bps)	• Software seasonality (175bps) • FX (15bps)
Wipro IT	Down 10bps qoq to 16.0% vs. BofA of 15.7%	• Wage hikes	• Reduction in employee headcount and discretionary costs
TECHM	Cleansed EBIT margin (ex. one-off portfolio rationalization impact) down 35bps qoq to 7.0% vs. BofAe of 7.5%	• Negative operating leverage	• NA

Source: Companies, BofA Global Research

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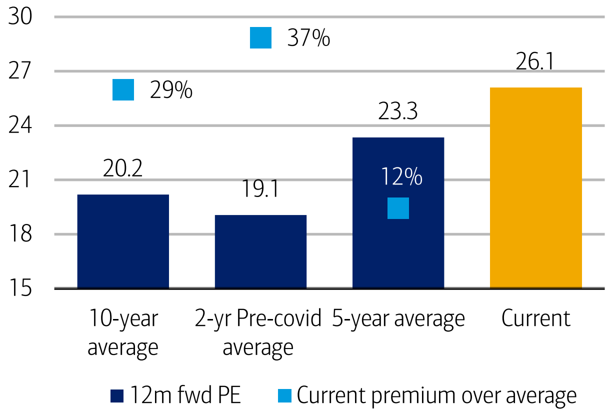
Exhibit 18: Sector (top 4 companies) absolute valuations
Free-float weighted average 12m fwd PE – current & historical....



Source: Bloomberg, BofA Global Research. Top 4 India IT companies used in above chart are TCS, Infosys, HCL & Wipro

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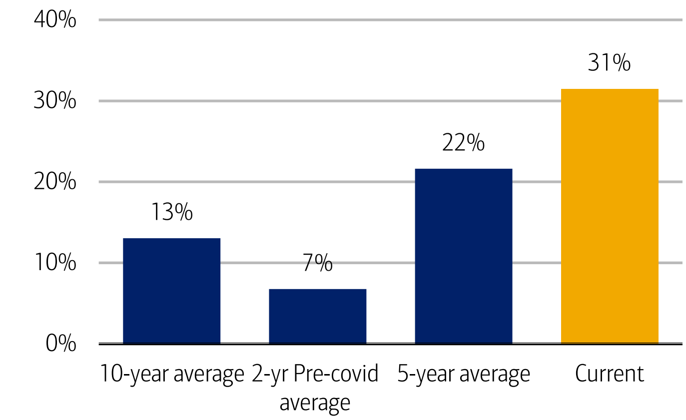
Exhibit 19: Sector (top 4 companies) valuations relative to NIFTY
.... and the associated premium over NIFTY



Source: Bloomberg, BofA Global Research. Top 4 India IT companies used in above chart are TCS, Infosys, HCL & Wipro

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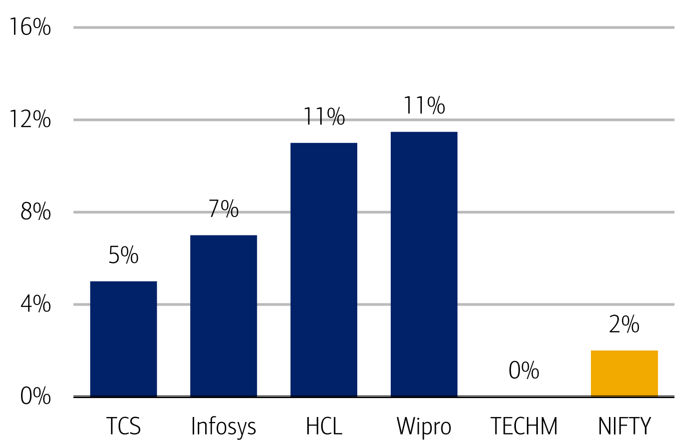
Exhibit 20: Current 12m fwd PE valuations vs. historical – company wise
Valuations remain significantly above historic averages

	TCS		Infosys		HCL Tech		Wipro		TECHM	
	12m fwd PE	Current premium	12m fwd PE	Current premium	12m fwd PE	Current premium	12m fwd PE	Current premium	12m fwd PE	Current premium
10-year average	23.1x	24%	19.7x	27%	15.9x	59%	16.7x	38%	15.6x	55%
2-yr pre-covid average	22.7x	26%	18.0x	40%	13.5x	87%	15.3x	50%	14.4x	68%
5-year average	26.6x	8%	23.0x	9%	17.6x	44%	18.7x	23%	17.0x	42%
Current	28.6x		25.1x		25.3x		23.0x		24.2x	

Source: Based on Bloomberg consensus, BofA Global Research

BofA GLOBAL RESEARCH

Exhibit 21: YTD returns
IT Services stocks have outperformed NIFTY so far this year but all led by uptick in valuation multiples....



Source: Bloomberg

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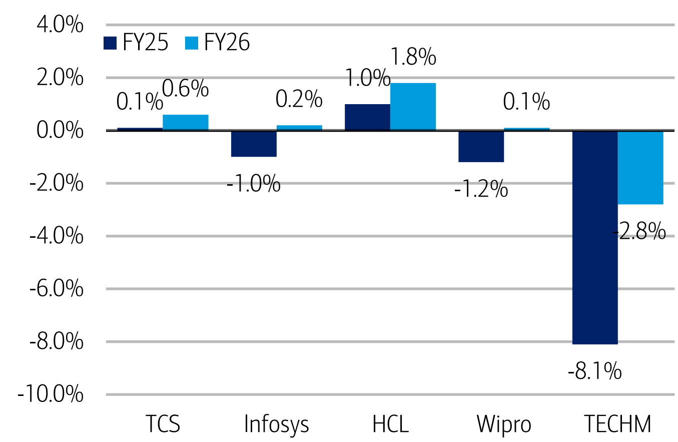
Exhibit 22: YTD EPS revisions
... as EPS estimates largely remained unchanged



Source: Bloomberg

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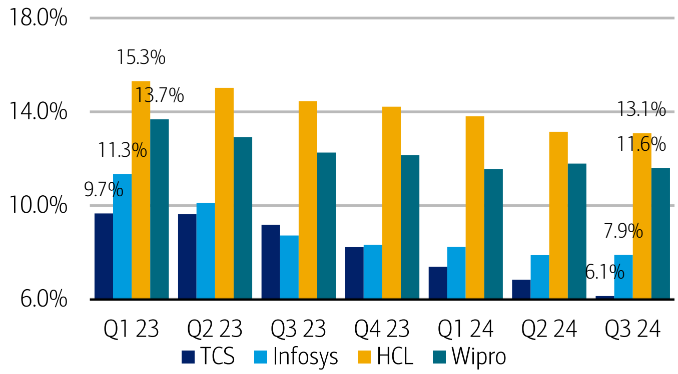
Margins were helped by reduction in sub-contracting, utilization uptick and the commensurate headcount reduction

Exhibit 23: Sub-contracting expenses as a % of revenue – quarterly trends
Sub-contracting expenses as a % of revenue are on a declining trajectory and aiding margin management



Source: Companies, BofA Global Research

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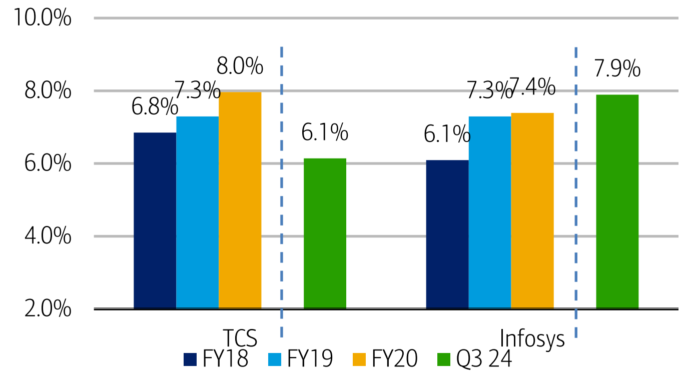
Exhibit 24: Sub-contracting expenses as a % of revenue – pre-covid vs. current levels
Sub-contracting expenses as a % of revenue are now closer to pre-covid levels for Infosys and even lower than that for TCS



Source: Company, BofA Global Research

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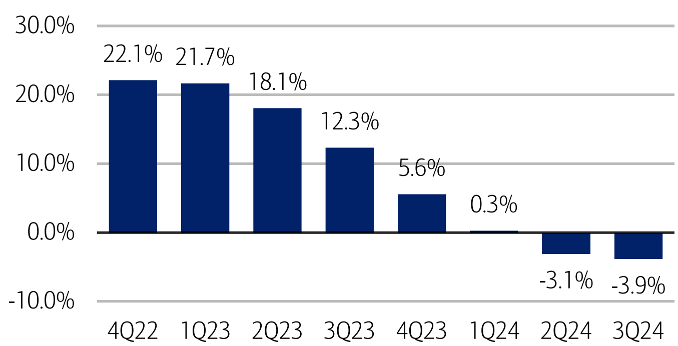
Exhibit 25: YoY headcount growth – top 5 India IT companies
Companies hinted that focus remains on utilizing existing resources vs. resuming hiring



Source: Companies, BofA Global Research

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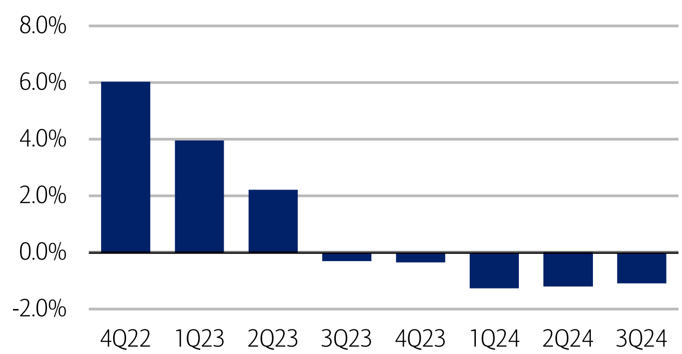
Exhibit 26: QoQ headcount growth – top 5 India IT companies
Employee headcount shrank sequentially for the 5th straight quarter at an aggregate level



Source: Companies, BofA Global Research

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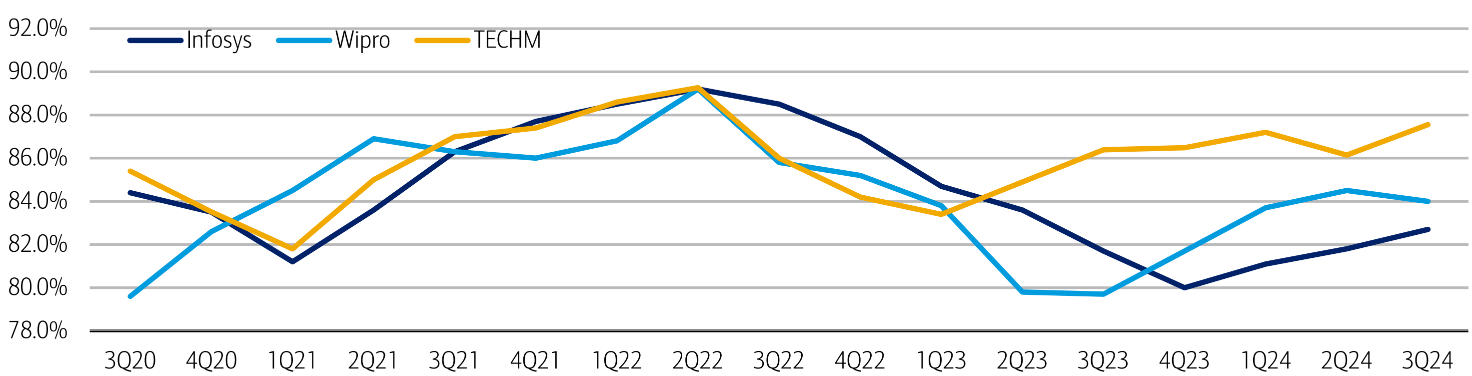
Exhibit 27: Utilization trends (excluding trainees)
Utilization levels have picked up in the last few quarters



Source: Companies, BofA Global Research

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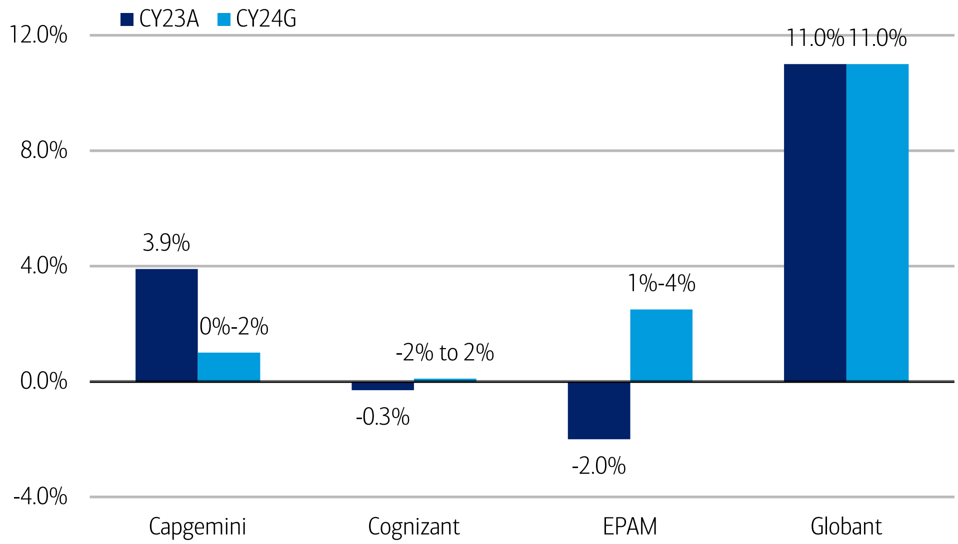
Read-across from key sector events since start of the year

#1 Guidance and CY24 outlook from 4 global peers

4 important peers of India IT gave out CY24 outlook in past one month (with 3 of them in the past 2 weeks).The cumulative read of CY24 outlooks by Capgemini, Cognizant, EPAM and Globant indicate an unchanged organic growth rate vs. CY23. The expected cadence is of a bottom in Q1CY24, followed by a recovery in H2. Globant described the environment as showing signs of recovery but still below normalized level of demand.

Exhibit 28: CY24 organic revenue growth guidance by global peers vs. CY23 organic growth
CY24 guidances from global peers have been below trend levels.



Source: Companies, BofA Global Research

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Capgemini

- CY24 organic revenue growth outlook of 0-2%yoy. This compares with about 3.9% growth in CY23.
- Expect Q1CY24 to be a bottom in growth and gradual recovery starting Q2. Attractive exit growth rate in Q4 (mid to high single digits), setting up for rebound in CY25.
- Expect North America to recover a bit faster than Europe. Interest rate might go down in US before it goes down in Europe. Timing of that has an impact of the investment cycle.

EPAM

- CY24 revenue growth outlook of 1% to 4%yoy. This compares vs. about 2% decline in CY23.
- Seeing some improvement but demand environment remains uneven. This will persist at least in first half of CY24.
- Assumption of H2 recovery based on view that future delays would be difficult to hold.

Globant

- CY24 organic revenue growth outlook of about 11%yoy. This is same as organic growth rate in CY23.
- Outlook considers a demand environment, while showing signs of recovery, is still below a normalized level of demand.
- Believe the guidance is neither conservative nor extremely aggressive.

Cognizant

- CY24 revenue growth outlook of -2% to 2%yoy, which at the midpoint calls for a second consecutive year of no growth. (CY23 yoy cc revenue growth of -0.3%)
- Company sees little change in their assessments in recent quarters about uncertain & weak discretionary spending in the early part of 2024.

#2 Key takeaway from NASSCOM CEO survey

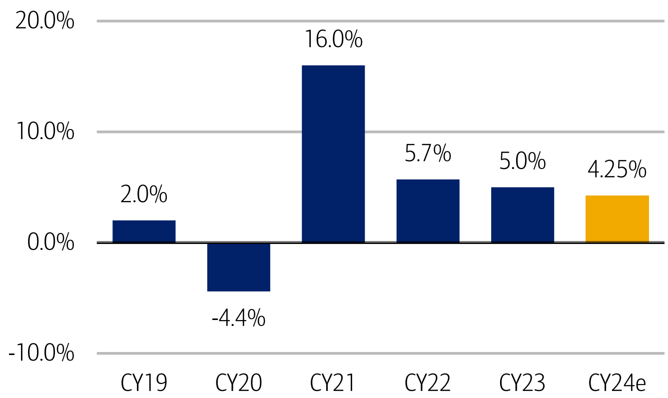
As per NASSCOM, its annual CEO survey indicates that almost 80% of the providers expect an uptick in growth rate during the coming year. For most, this is predicated on an expected increase in technology spending. Segments with green shoots include engineering services, global capability centers and AI.

#3 Deal advisor ISG sees CY24 IT budgets as flat vs. CY23

Key comments from the January ISG call as below:

- ISG highlighted that most of their client discussions indicate that IT budgets for CY24 have been firmed up and are likely flat vs. last year's level.
- Managed services ACV (Annual contract value) was up 5%yoy in CY23 & ISG expects growth to mildly taper to 4.25%yoy in CY24 which would still be driven by cost optimization deals like last year but faces a tough compare on mega deal wins. CY23 was the 2nd best year of mega deals in the last 10 years (Exhibit 30).
- ACV in 2023 had a higher-than-typical share of contract renewal / contract restructuring deals as against deals with new scope of work.
- Customer focus on cost optimization is likely to remain for another 1-2 quarters before they go back to build mode again. ISG thus sees a 2nd half recovery for discretionary spends but quantum very unlikely to be like the post-covid pent-up demand phase.

Exhibit 29: ISG Managed services ACV growth
Managed services ACV (Annual contract value) was up 5%yoy in CY23 & ISG expects growth to mildly taper to 4.25%yoy in CY24



Source: ISG

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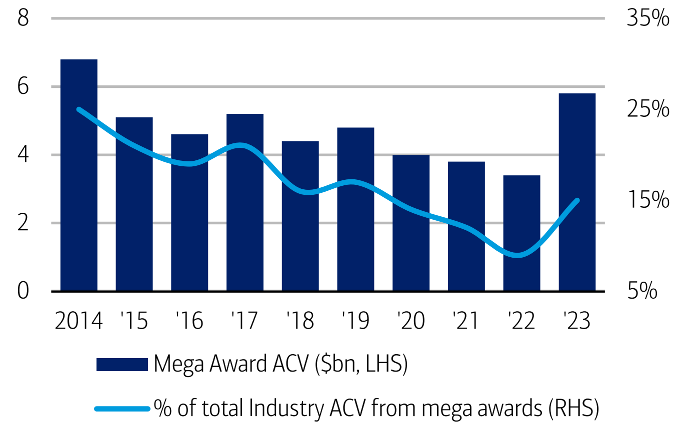
Exhibit 30: ISG Mega deal ACV ($bn)
CY24 faces a tough comp on large deal wins



Source: ISG

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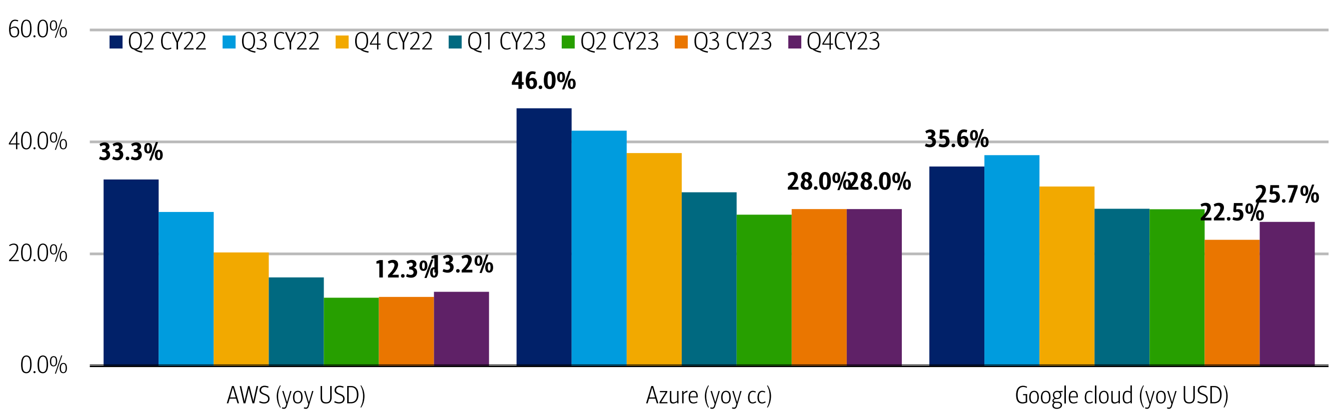
#4 Read across on spend intentions from hyperscalers

Recent results from the top 3 hyperscalers and their commentaries indicated a reduction in cost optimization headwinds & expectations of stability or acceleration in growth in coming quarters helped by AI demand. Key comments on the cloud business outlook:

- **Microsoft Azure**: Microsoft indicated that the period of "optimization only and no new workload start" has likely ended.
- **AWS**: AWS growth came in at 13.2%yoy in the December quarter which was a slight acceleration from the last quarter. Amazon management guided to AWS acceleration in 1Q, and indicated AI-driven demand is ramping. It also noted that cost optimization "attenuated very significantly", with the "lions share" of optimization now in the past. Larger new deals are also accelerating with existing migrations growing, as mgmt. noted "rapidly" accelerating revenues in AI, and "significant interest" among customers in GenAI services.
- **Google Cloud**: Cloud growth accelerated again in the December after a dip in the prior quarter, aided by increasing contribution from AI. Management commentary suggested less client expense optimization headwinds.

Exhibit 31: Cloud revenue growth for the top 3 hyperscalers
Marginal acceleration in growth for AWS whereas Azure maintained growth



Source: Companies, BofA Global Research

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#5 Spend intentions of large US banks for CY24

We scan through latest commentaries (Q4CY23 earnings) of some of the large US banks to gauge their spend intentions for CY24. Summary below:

- **JP Morgan**: Company projects its overall expenses to be up 8%yoy in CY24. Broader drivers of this increase included (i) Expectations of volumes picking up in parts of business where volumes have been depressed, (ii) Branch expansion, (iii) Marketing & (iv) higher volume-related technology expense.

- **Bank of America**: 2023 was a year of good discipline on eliminating work and reducing headcount and on the current base, the bank wants to grow its overall expenses at the rate of half of prevailing inflation. New technology initiatives spend at $3.8bn for CY24 is largely flattish vs. the last 2 years.

- **Citi**: The bank consolidated its trading and reporting platforms, and retired 6% of legacy applications for the second year in a row. It saw a shift from third-party expenses to insourcing in 2023 and expects the trend to continue. Cost discipline is likely to continue in 2024 as well as the firm expects overall expenses to dip slightly in 2024 vs. 2023.

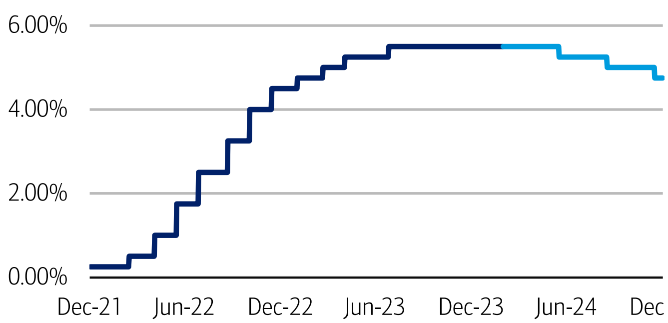
#6 US macro – inflation coming down but not there yet

Following the January FOMC meeting, our economists took the March cut out of their baseline and **shifted the first rate cut to June**. The January inflation print that came later & topped expectations also added support to this view, raising concerns that the road ahead for inflation might be bumpy. Our economists highlight that the **current Fed is more data-driven and has indicated that it needs greater confidence that inflation is sustainably moving toward 2%** before it begins any rate cut cycle.

Our economist's estimate of underlying PCE (personal consumption expenditure) inflation has fallen from a peak of 4.5% annualized in late 2021 to 2.8% today, based on data through 4Q 2023. If trends continue, underlying PCE inflation could fall to 2.3-2.6% by mid-year, supporting a first Fed cut in June. **But the risk that it stops declining – or reaccelerates – is worth monitoring since the US economy continues to surprise to the upside**. If decline in inflation stalls, the Fed may be forced to delay beyond June.

Exhibit 32: Our US economists expect the first rate cut in June and a total of 3 in the year

Fed funds rate (upper bound) – actual and BofA forecasts



Source: BofA Global Research estimates

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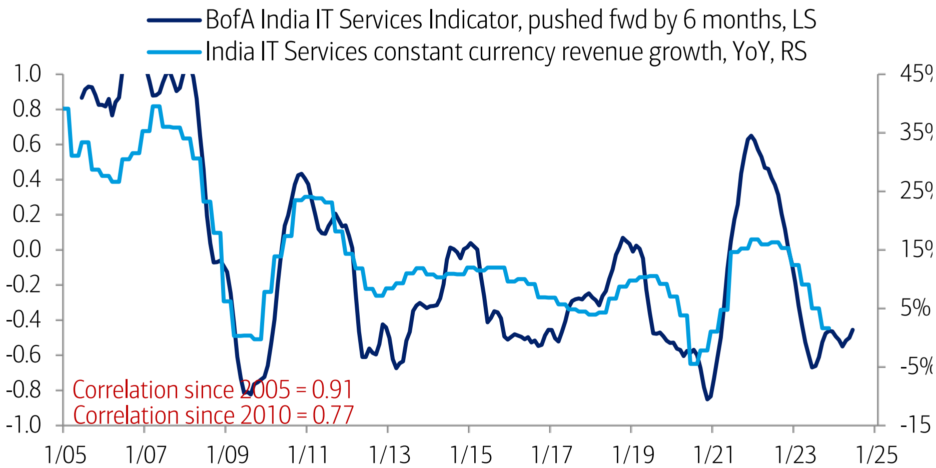
Latest read from our BofA India IT Services Indicator

We update BofA India IT Services Indicator for input data available till Jan'24 (see here for the initiation version 30 Nov 2023). This suggests a mild uptick vs. the low level seen in July '23. Given the leading nature of the indicator to topline growth by about 6months, the indicator concurs with our view as well as the corporate viewpoint of a potential bottom in the growth outlook. That said, akin to last year, expectations of a recovery in H2 still appear to be macro dependent amidst expectations of a recovery in discretionary spends post start of the rate cut cycle in US. The spending stance of US corporates, ahead of elections in November, could be a key consideration for such an assumption to play out.

Exhibit 33: BofA India IT Services Indicator vs. constant currency revenue growth of top 4 India IT Services companies

BofA India IT Services Indicator vs. constant currency revenue growth of top 4 India IT Services companies
Historical correlation of 0.91 since 2005 with a lead of 6 months



Source: BofA Predictive Analytics, Company data. Notes: Constant currency revenue growth is at an aggregate level for top 4 India IT Services companies i.e. TCS, Infosys, HCL Technologies and Wipro. Revenue growth in constant currency terms from June 2014; for prior periods revenue growth is in USD terms due to disclosures not available in constant currency. Disclaimer: The indicator is intended to be an indicative metric only and may not be used for reference purposes or as a measure of performance for any financial instrument or contract, or otherwise relied upon by third parties for any other purpose, without the prior written consent of BofA Global Research. The indicator was not created to act as a benchmark.

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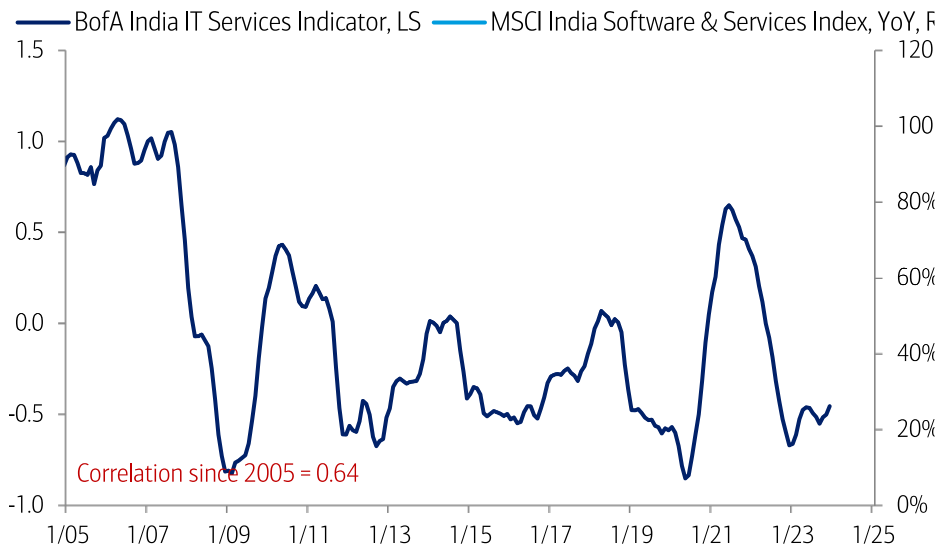
Exhibit 34: BofA India IT Services Indicator vs. MSCI India Software & Services Index, YoY

Historical correlation of 0.64 since 2005



Source: BofA Predictive Analytics, Company data. Disclaimer: The indicator is intended to be an indicative metric only and may not be used for reference purposes or as a measure of performance for any financial instrument or contract, or otherwise relied upon by third parties for any other purpose, without the prior written consent of BofA Global Research. The indicator was not created to act as a benchmark.

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Exhibit 35: Month-on-month trends for the components of the Indicator

Factors that have a 70% weight in the index ticked up on a month-on-month basis where the remaining ones declined MoM

Input	Feb-23	Mar-23	Apr-23	May-23	Jun-23	Jul-23	Aug-23	Sep-23	Oct-23	Nov-23	Dec-23	Jan-24
Global Services PMI												
Global Services PMI, Future Activity												
Global 3-month Earnings Revision Ratio (ERR)												
IT Services Earnings Revision Ratio (ERR): India relative to Global												
Naukri JobSpeak Index for IT Software / Services (YoY%)												
US Business Applications from Corporations: Finance & Insurance												
India IT Newspulse												
India IT Corporate Sentiment												

Source: BofA Predictive Analytics

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Appendix

Exhibit 36: Employee headcount – quarterly trends
Another quarter of sequential decline in headcount for most companies

	Q3 21	Q4 21	Q1 22	Q2 22	Q3 22	Q4 22	Q1 23	Q2 23	Q3 23	Q4 23	Q1 24	Q2 24	Q3 24
Employee headcount growth (QoQ)													
TCS	3.5%	4.1%	4.2%	3.9%	5.3%	6.3%	2.4%	1.6%	-0.4%	0.1%	0.1%	-1.0%	-0.9%
Infosys	3.8%	4.1%	3.2%	4.4%	4.5%	7.5%	6.7%	3.0%	0.5%	-1.0%	-2.0%	-2.2%	-1.9%
Wipro	2.7%	3.9%	6.2%	5.5%	4.7%	4.9%	6.4%	0.2%	-0.2%	-0.7%	-2.8%	-2.0%	-1.8%
HCL	4.3%	5.8%	4.5%	6.3%	5.4%	5.6%	1.0%	4.0%	1.3%	1.7%	-1.1%	-1.0%	1.6%
TECHM	-1.9%	-0.7%	4.3%	11.8%	2.7%	4.2%	4.5%	3.7%	-4.2%	-3.0%	-2.7%	1.6%	-2.9%
LTTS	1.1%	2.4%	3.2%	6.0%	11.9%	3.7%	2.7%	0.2%	0.8%	2.7%	1.4%	2.1%	-2.4%
Employee headcount growth (YoY)													
TCS	5.1%	9.0%	14.7%	16.6%	18.7%	21.2%	19.1%	16.5%	10.2%	3.8%	1.5%	-1.2%	-1.7%
Infosys	2.4%	7.0%	12.0%	16.4%	17.1%	21.0%	25.1%	23.5%	18.8%	9.3%	0.3%	-4.8%	-7.0%
Wipro	1.6%	8.1%	15.4%	19.5%	21.7%	23.0%	23.2%	17.1%	11.7%	5.7%	-3.4%	-5.6%	-7.2%
HCL	7.0%	12.3%	17.4%	22.6%	23.9%	23.6%	19.5%	16.9%	12.4%	8.2%	5.9%	0.8%	1.1%
TECHM	-6.8%	-3.3%	2.3%	13.6%	19.0%	24.9%	25.2%	16.1%	8.3%	0.8%	-6.2%	-8.1%	-6.9%
LTTS	-4.3%	-2.6%	2.0%	13.1%	25.2%	26.8%	26.3%	19.4%	7.6%	6.6%	5.7%	7.3%	3.5%

Source: Companies, BofA Global Research

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Exhibit 37: EBIT margin & attrition trend
For the top 4 companies, margins (adjusted for one-offs) were a beat whereas TECHM disappointed. Attrition levels continue to moderate.

	Q3 21	Q4 21	Q1 22	Q2 22	Q3 22	Q4 22	Q1 23	Q2 23	Q3 23	Q4 23	Q1 24	Q2 24	Q3 24
EBIT margins													
TCS	26.6%	26.8%	25.5%	25.6%	25.0%	25.0%	23.1%	24.0%	24.5%	24.5%	23.2%	24.3%	25.0%
Infosys	25.4%	24.5%	23.7%	23.6%	23.5%	21.6%	20.1%	21.5%	21.5%	21.0%	20.8%	21.2%	20.5%
Wipro	21.7%	21.0%	17.8%	17.7%	17.6%	17.0%	15.0%	15.1%	16.3%	16.3%	15.1%	14.8%	14.8%
HCL	22.9%	20.4%	19.6%	19.0%	19.0%	17.9%	17.0%	18.0%	19.6%	18.1%	17.0%	18.5%	19.8%
TECHM	15.9%	16.5%	15.2%	15.2%	14.8%	13.2%	11.0%	11.4%	12.0%	11.2%	8.8%	7.3%	7.0%
LTTS	15.2%	16.6%	17.3%	18.4%	18.6%	18.6%	18.6%	18.3%	18.1%	18.7%	17.2%	17.1%	17.2%
yoy change (bps)													
TCS	159	175	191	(59)	(159)	(189)	(242)	(160)	(50)	(47)	7	25	48
Infosys	348	330	100	(180)	(193)	(292)	(361)	(201)	(198)	(51)	74	(33)	(100)
Wipro	329	341	(117)	(145)	(410)	(405)	(287)	(263)	(129)	(62)	16	(31)	(147)
HCL	266	(50)	(93)	(265)	(389)	(244)	(257)	(100)	60	13	(7)	55	16
TECHM	373	648	508	98	(111)	(324)	(411)	(382)	(284)	(208)	(227)	(405)	(502)
LTTS	(158)	140	517	473	341	205	137	(11)	(57)	5	(144)	(125)	(87)
LTM Attrition													
TCS	7.6%	7.2%	8.6%	11.9%	15.3%	17.4%	19.7%	21.5%	21.3%	20.1%	17.8%	14.9%	13.3%
Infosys	11.0%	10.9%	13.9%	20.1%	25.5%	27.7%	28.4%	27.1%	24.3%	20.9%	17.3%	14.6%	12.9%
Wipro	11.0%	12.1%	15.5%	20.5%	22.7%	23.8%	23.3%	23.0%	21.2%	19.2%	17.3%	15.5%	14.2%
HCL	10.2%	9.9%	11.8%	15.7%	19.8%	21.9%	23.8%	23.8%	21.7%	19.5%	16.3%	14.2%	12.8%
TECHM	12.4%	13.3%	17.2%	21.2%	23.5%	23.5%	22.2%	19.6%	17.3%	14.8%	12.8%	11.4%	10.3%
LTTS	10.7%	12.2%	14.5%	16.5%	17.5%	20.4%	23.2%	24.1%	23.3%	22.2%	18.9%	16.7%	15.8%

Source: Companies, BofA Global Research

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Investment rationale

Infosys: On the back of improved strategic clarity/positioning vs. the past few years, Infosys is likely to remain growth leader in the coming year but we think that its higher absolute valuation makes it more sensitive to the upcoming demand risks. We have a Neutral rating as we see balanced risk-reward as the current sectoral risks on demand slowdown gets balanced by Infosys's sector leading win rates even in a weak macro, also aided by vendor consolidation.

Wipro: The restructuring at Wipro under the new CEO is showing some promising signs, especially with regards fortification of sales team and simplification of structure. However, we have an U/P as we think that the recovery can get slow in a tough climate & expect that the underperformance to peers on revenue growth could continue in the near term as enterprises look to consolidate their spends a tough macro.

Exhibit 38: Stocks mentioned
Prices and ratings for stocks mentioned

BofA Ticker	Bloomberg ticker	Company name	Price	Rating
INFYF	INFO IN	Infosys	Rs 1660.15	B-2-7
INFY	INFY US	Infosys Tech - A	US$ 19.99	B-2-7
WIPRF	WPRO IN	Wipro	Rs 532.9	B-3-7
WIT	WIT US	Wipro	US$ 6.32	B-3-7

Source: BofA Global Research

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Price objective basis & risk

Infosys (INFYF / INFY)

Our PO of INR1,735 (ADR: US$20.8) is based on a target P/E of 25x for the 12 months ending Mar-26. Our target multiple for Infosys is at about 10% discount to our target multiple the sector leader. This is in line with the average trading discount over the past 3 years.

Versus its own history, our target multiple is at a 10% premium to its 5-year average 12m forward PE multiple.

Downside risks to our price objective are (1) risks to IT spends in a weakening global macro (2) risks related to the strengthening of INR vs. USD. Upside risks to our PO are (i) faster than expected rebound in demand post upcoming rate cuts in US & (ii) faster than expected revenue conversion from recently won large deals.

Wipro (WIPRF / WIT)

Our PO of INR415 (US$5) is based on a target P/E of 18x for year-ending Mar-26. Our target multiple for Wipro is at a 38% discount to our target multiple for the sector leader. This is in-line with the 3yr average trading discount. Versus its own history, our target is at a 5% discount to its 5-year average 12m forward PE multiple which we ascribe on account of the near-term macro challenges.

Upside risk are: Faster-than-expected large deal closures, especially in infrastructure management services. Downside risk are (i) increasing competition in a macro fragile environment (ii) appreciation of INR against USD

Analyst Certification

I, Kunal Tayal, hereby certify that the views expressed in this research report accurately reflect my personal views about the subject securities and issuers. I also certify that no part of my compensation was, is, or will be, directly or indirectly, related to the specific recommendations or view expressed in this research report.

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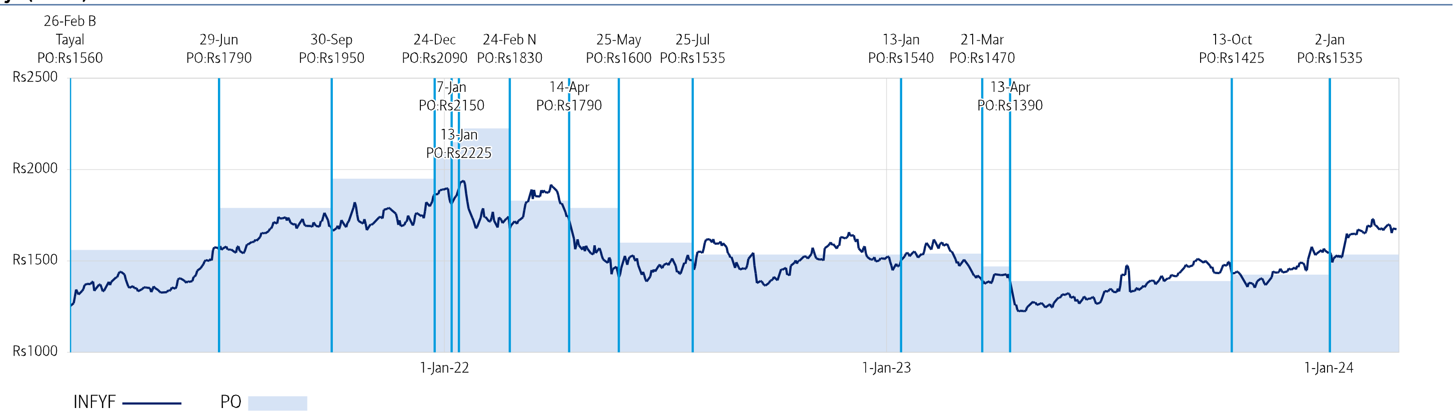
India - Software & IT Services Coverage Cluster

Investment rating	Company	BofA Ticker	Bloomberg symbol	Analyst
BUY				
	ExlService Holdings, Inc.	EXLS	EXLS US	Kunal Tayal
	Genpact Ltd	G	G US	Kunal Tayal
	WNS Holdings Ltd	WNS	WNS US	Kunal Tayal
NEUTRAL				
	HCL	XHCLF	HCLT IN	Kunal Tayal
	Infosys	INFYF	INFO IN	Kunal Tayal
	Infosys Tech - A	INFY	INFY US	Kunal Tayal
	Tata Consultancy	TACSF	TCS IN	Kunal Tayal
	Tata Technologies	XZTLF	TATATECH IN	Kunal Tayal
UNDERPERFORM				
	L&T Technology Services	XLNSF	LTTS IN	Kunal Tayal
	Tech Mahindra	TECHM	TECHM IN	Kunal Tayal
	Wipro	WIPRF	WPRO IN	Kunal Tayal
	Wipro	WIT	WIT US	Kunal Tayal

Disclosures

Important Disclosures

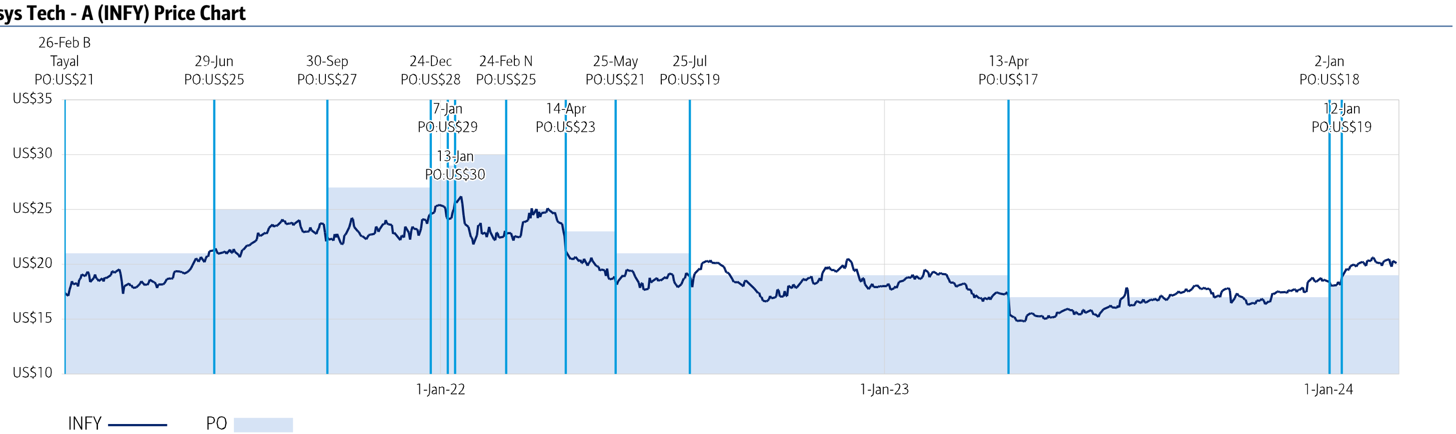
Infosys (INFYF) Price Chart



B: Buy, N: Neutral, U: Underperform, PO: Price Objective, NA: No longer valid, NR: No Rating

The Investment Opinion System is contained at the end of the report under the heading "Fundamental Equity Opinion Key". Dark grey shading indicates the security is restricted with the opinion suspended. Medium grey shading indicates the security is under review with the opinion withdrawn. Light grey shading indicates the security is not covered. Chart is current as of a date no more than one trading day prior to the date of the report.

Infosys Tech - A (INFY) Price Chart



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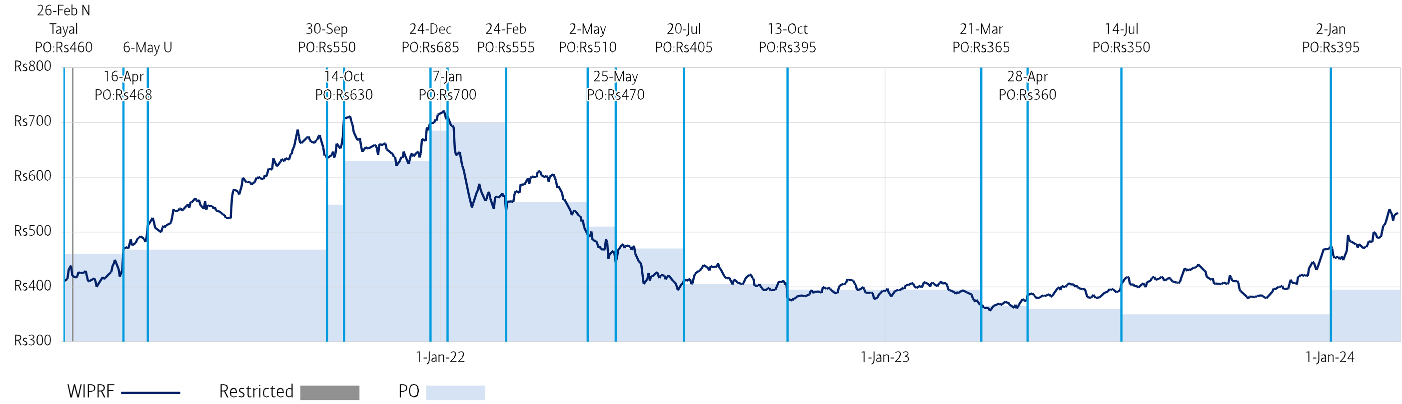
Wipro (WIPRF) Price Chart



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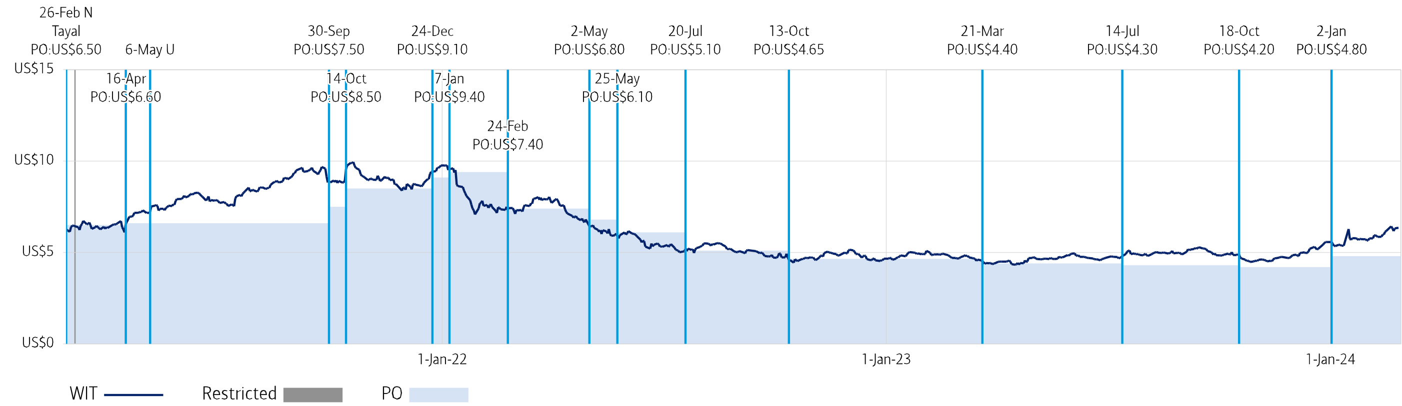
Wipro (WIT) Price Chart



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Equity Investment Rating Distribution: Industrials/Multi-Industry Group (as of 31 Dec 2023)

Coverage Universe	Count	Percent	Inv. Banking Relationships [R1]	Count	Percent
Buy	45	50.56%	Buy	25	55.56%
Hold	26	29.21%	Hold	13	50.00%
Sell	18	20.22%	Sell	7	38.89%

Equity Investment Rating Distribution: Technology Group (as of 31 Dec 2023)

Coverage Universe	Count	Percent	Inv. Banking Relationships [R1]	Count	Percent
Buy	215	53.09%	Buy	111	51.63%
Hold	97	23.95%	Hold	45	46.39%
Sell	93	22.96%	Sell	24	25.81%

Equity Investment Rating Distribution: Global Group (as of 31 Dec 2023)

Coverage Universe	Count	Percent	Inv. Banking Relationships [R1]	Count	Percent
Buy	1895	53.62%	Buy	1083	57.15%
Hold	832	23.54%	Hold	454	54.57%
Sell	807	22.84%	Sell	383	47.46%

[R1] Issuers that were investment banking clients of BofA Securities or one of its affiliates within the past 12 months. For purposes of this Investment Rating Distribution, the coverage universe includes only stocks. A stock rated Neutral is included as a Hold, and a stock rated Underperform is included as a Sell.

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Investment rating	Total return expectation (within 12-month period of date of initial rating)	Ratings dispersion guidelines for coverage cluster[R2]
Buy	≥ 10%	≤ 70%
Neutral	≥ 0%	≤ 30%
Underperform	N/A	≥ 20%

[R2]Ratings dispersions may vary from time to time where BofA Global Research believes it better reflects the investment prospects of stocks in a Coverage Cluster.

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