

India IT Services

Q3 preview and a look at India IT during past instances of US rate cut cycle

Price Objective Change

Q3: Deceleration in revenue growth to continue

We expect revenue growth for the IT services companies to continue decelerating into Q3 given year-end shutdowns / furloughs have likely been wider and more intense than typical. Industry discussions suggest that other than cuts to budget, the customer focus on squeezing out more value from existing dollars is also on the rise. From a vertical perspective, the feedback remains weak for financial services, retail and telecom while it has started to improve a small bit for the hi-tech segment. We forecast aggregate rev. growth of -1%yoy (vs. 1% last qtr) for top5 companies. The qtr could also be a modest one on the metric of deal wins given closures have potentially seen a pushout into C24 even as the pipeline activity was good.

Commentaries to indicate a 'wait and watch' approach

We expect company commentaries to indicate that ramp downs / leakage in existing discretionary projects to be like prior quarters. We expect to hear a wait and watch approach on stabilization of the base business. CY24 IT budgets could be viewed as being largely flat with a few cases of minor increase. On FY24 revenue guide, Infosys could suggest comfort in upper half of the band (1.5%-2.5%). We expect Wipro to guide for 2% qoq decline at low end of the range for Q4 and a flat qoq performance at upper end.

How fast can the equation change on back of rate cuts?

The focus topic this quarter is likely to be how fast could the customer spend appetite improve now that we are in a rate cut cycle in US. A few pointers: (1) The prior instances of 2007 & 2019 saw growth rates and multiples of India IT compress at the start of the rate cut cycle (Exhibit 3-6), (2) Our proprietary BofA India IT services indicator – that identifies directional trends in growth rate of the top 4 companies with a lead of 6months – is still hovering at a low level (Exhibit 7) & (3) Anecdotal discussions have suggested that squeezing more value out of existing IT spends could continue to be a customer focus in CY24.

Cost management to drive stable margins in the quarter

Companies likely continued to push for higher utilization & reduced sub-contracting in the qtr. Fx movement has been a non-event. We expect a 40bp qoq margin decline at Infosys/Wipro given impact of wage hikes.

High expectations at Wipro

Wipro has seen a recent rebound on expectations of a fresh round of restructuring & stability in consulting business. These are unlikely to hold. We adjust POs (Exhibit 8) on roll-forward by six months and macro linked (i.e peaked interest rates) 1 turn increase in target P/E multiple.

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Equity
India
IT Services

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Exhibit 1: Q3FY24 preview summary for Infosys and Wipro

We expect revenue growth for the IT services companies to continue decelerating into Q3

	Rev growth (QoQ, cc)	Rev growth (YoY, cc)	EBIT Margin (%)
Infosys	(0.8%)	(0.8%)	20.8%
Wipro IT	(3.0%)	(8.2%)	15.7%

Source: BofA Global research estimates
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Refer to important disclosures on page 6 to 10. Analyst Certification on page 4. Price Objective Basis/Risk on page 4.

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Q3 estimates

Exhibit 2: Q3FY24 preview table for Infosys and Wipro

We expect Infosys to report -0.8% qoq cc revenue growth

	Infosys	Wipro*
Rating	Neutral	Underperform
Investment opinion	B-2-7	B-3-7
Rev (INR mn)	389,725	217,934
%QoQ	-0.1%	-2.1%
%YoY	1.7%	-5.5%
Rev (USD mn)	4,680	2,617
%QoQ	-0.8%	-3.0%
%YoY	0.5%	-6.6%
%QoQ cc	-0.8%	-3.0%
%YoY cc	-0.8%	-8.2%
Cross Currency QoQ (bps)	0	0
EBIT %	20.8%	15.7%
QoQ (bps)	-43	-42
YoY (bps)	-72	-58
PAT (INR mn)	61,441	26,210
%QoQ	-1%	-1%
%YoY	-7%	-14%

Source: BofA Global Research estimates

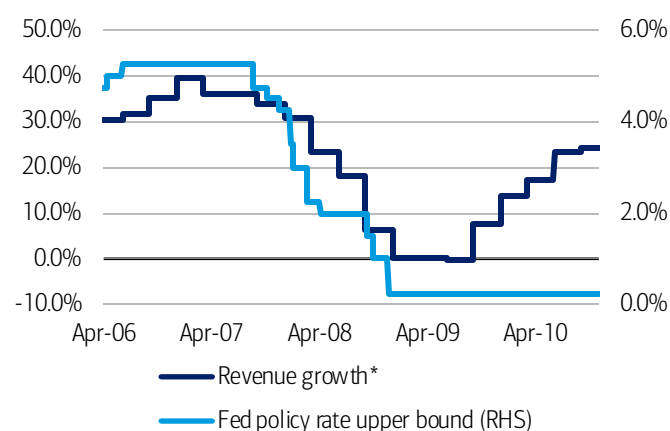
*Revenue and margins are for Wipro IT services and PAT is for entire company

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What happens during start of interest rate cut cycle in US?

Exhibit 3: The prior instances of rate cuts saw compression in revenue growth...

Rate cuts in US during September'07 to December'08

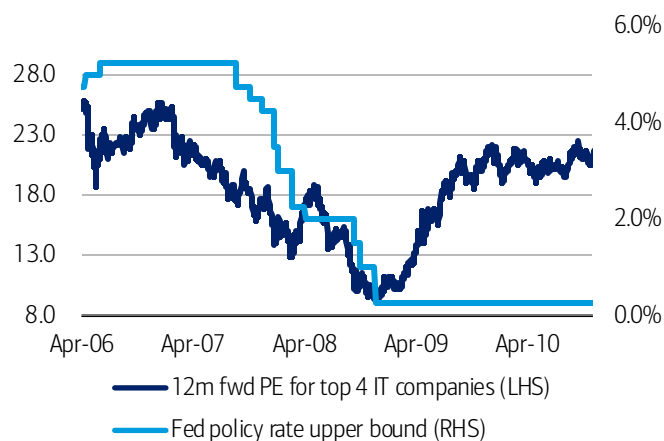


Source: Companies, Bloomberg, BofA Global Research. Aggregate revenue growth for top 4 India IT Services company in USD terms

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Exhibit 4: ... as well as valuation multiples at start of the rate cut cycle

Rate cuts in US during September'07 to December'08

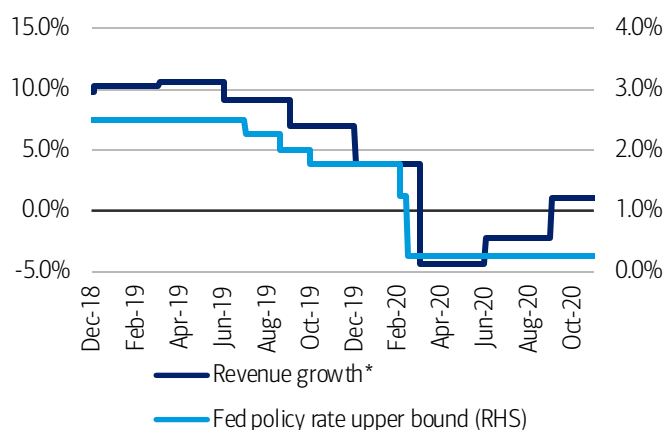


Source: Bloomberg, BofA Global Research

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Exhibit 5: The prior instances of rate cuts saw compression in revenue growth...

Rate cuts in US during July'19 to March'20

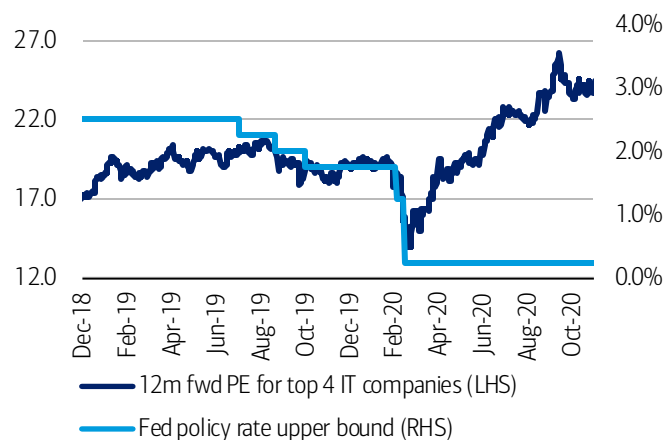


Source: Companies, Bloomberg, BofA Global Research. Aggregate revenue growth for top 4 India IT Services company in constant currency terms

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Exhibit 6: ... as well as valuation multiples at start of the rate cut cycle

Rate cuts in US during July'19 to March'20



Source: Bloomberg, BofA Global Research

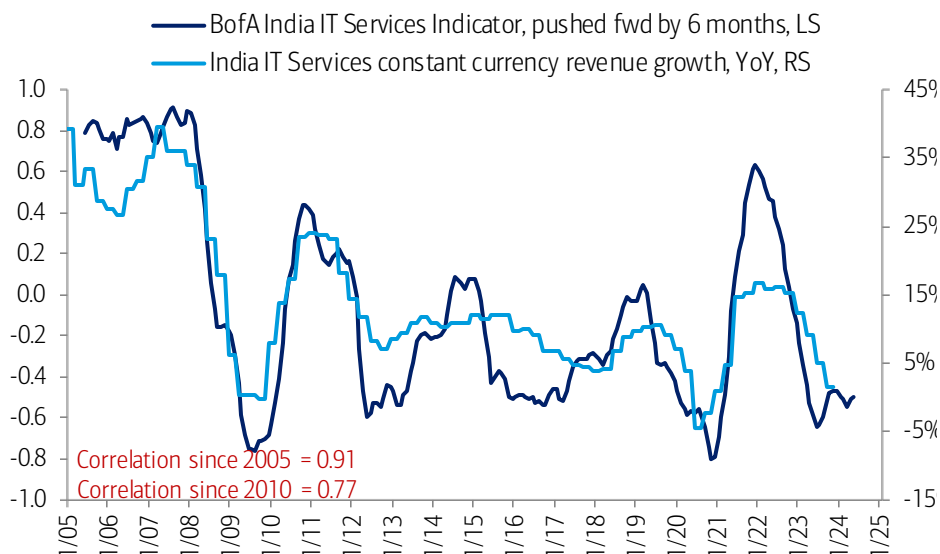
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Updating the BofA India IT Services Indicator

We update BofA India IT Services Indicator for input data available till Nov'23 (see here for the initiation version 30 Nov 2023). The Indicator identifies directional trends in growth rate of the top 4 companies with a lead of 6months. The indicator continues to hover around the lows, and remain unchanged on a MoM basis.

Exhibit 7: Our proprietary BofA India IT Services Indicator posted a flat MoM reading for the month of November

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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PO change summary

We adjust POs (Exhibit 8) on roll-forward by six months to FY26E EPS and a macro linked (i.e peaked interest rates) 1 turn increase in target P/E multiple.

Exhibit 8: PO change summary

We roll-forward to FY26 (vs. Sep-25 earlier) and increase target multiples factoring in peaked interest rates.

	Target PE multiple on FY26E EPS		Price Objective (INR)	
	Old	New	Old	New
Infosys	21	22	1,425	1,535
Wipro	16	17	350	395

Source: BofA Global Research

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We reiterate Neutral rating on Infosys on balanced risk-reward & Underperform on Wipro on negative risk-reward.

Exhibit 9: Stocks mentioned

Prices and ratings for stocks mentioned in the report

BofA Ticker	Bloomberg ticker	Company name	Price	Rating
WIPRF	WPRO IN	Wipro	Rs 477.15	B-3-7
INFYF	INFO IN	Infosys	Rs 1551.35	B-2-7
INFY	INFY US	Infosys Tech - A	US\$ 18.38	B-2-7
WIT	WIT US	Wipro	US\$ 5.57	B-3-7

Source: BofA Global Research

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Price objective basis & risk

Infosys (INFYF / INFY)

Our PO of INR1,535 (ADR: US\$18.4) is based on a target P/E of 22x for the 12 months ending Mar-26. Our target multiple for Infosys is at about 15% discount to our target multiple for TCS. This is in line with the average trading discount over the past 5 years.

Versus its own history, our target multiple is at a parity 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 INR395 (US\$4.8) is based on a target P/E of 17x for year-ending Mar-26. Our target multiple for Wipro is at a 38% discount to our target multiple for its closest peer. This is in-line with the 3yr average trading discount.

Versus its own history, our target is at a 8% discount to its 5-year average 12m forward PE multiple which we ascribe on account of the near-term macro challenges.

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

Analyst Certification

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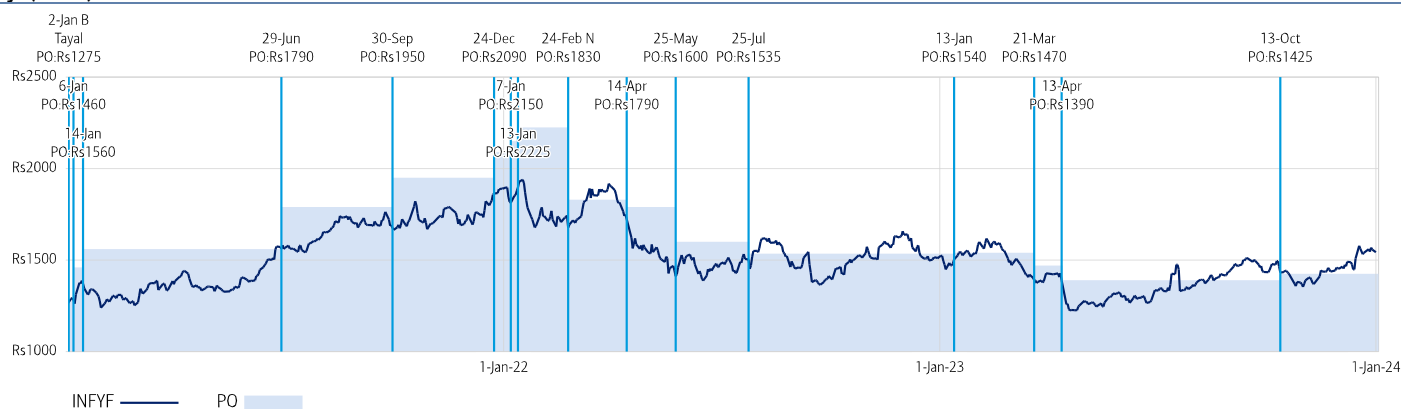
India - Software & IT Services Coverage Cluster

Investment rating	Company	BofA Ticker	Bloomberg symbol	Analyst
BUY				
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	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
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

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Infosys (INFYF) Price Chart



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

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Infosys Tech - A (INFY) Price Chart



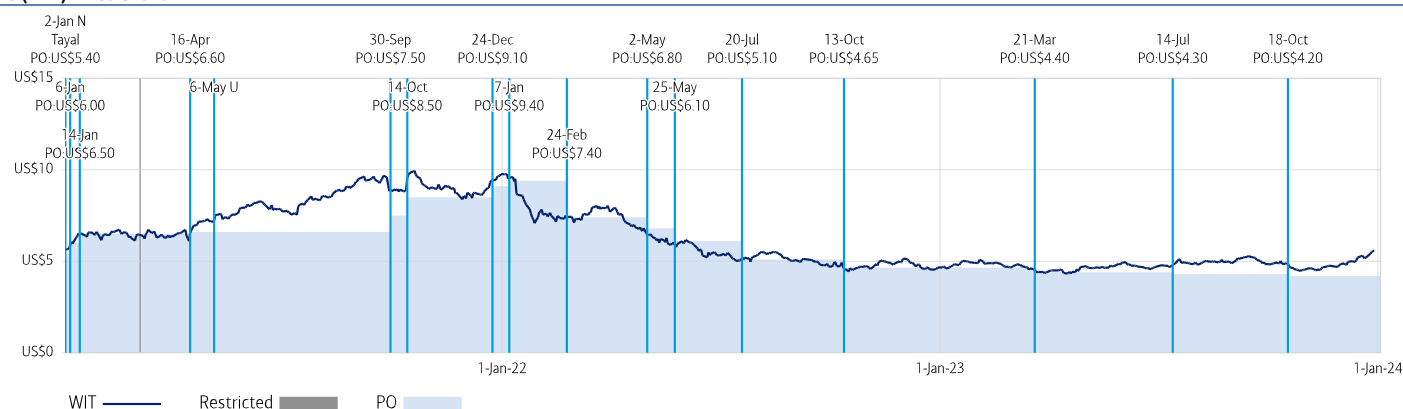
B: Buy, N: Neutral, U: Underperform, PO: Price Objective, NA: No longer valid, NR: No Rating

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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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