Indian IT firms may have to offer higher pay hikes onsite

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- Infosys and Tech Mahindra remain Jefferies' top stock picks in the Indian IT sector, given their strong growth outlook

Indian IT firms are likely to face margin headwinds from higher onsite wage hikes and rising travel costs which may partly be offset by replacement of subcontractors, as per global brokerage Jefferies. On a net basis, it estimates a 70-130 bps margin impact due to these factors for Top 5 IT firms.

“Over the past six months, US inflation rate has moved up sharply to 7%+ levels. In the past, onsite wage inflation for Indian IT firms ranged between 1.5-2% - in line with local inflation levels. If the current spike in inflation levels in the US sustains, then Indian IT firms may have to offer higher wage hikes onsite," the note added. Jefferies' analysis suggests that every 1% higher onsite wage inflation could lead to a 30 bps margin drag.

With rising acceptance of remote work/offshoring, while travel costs may not rise to pre-Covid levels, even if they increase to an average level of pre-Covid and Covid periods, they could also hit margins by 40-100 basis points (bps).

Further, higher onsite mix may impact margins, however the IT firms' ongoing pyramid rationalization and potential utilization tweaks could more than offset this hit, the global brokerage highlighted.

While rupee depreciation will partly offset this impact, Jefferies has lowered its FY23/24 EPS estimates by up to 3% to factor this. Infosys and Tech Mahindra remain Jefferies' top stock picks in the IT sector, given their strong growth outlook.

The global brokerage has Buy tags on Infosys with target price of ₹2,135, Tech Mahindra (TP: ₹1,890) and HCL Technologies (TP: ₹1,440) whereas it has Hold recommendations on Tata Consultancy Services (TCS) with target price of ₹3,870 and Wipro (TP: ₹550).

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