IT Services Firms Sober about FY19 Growth Prospects

Demand declines due to captive shift and insourcing

Quarter Preview

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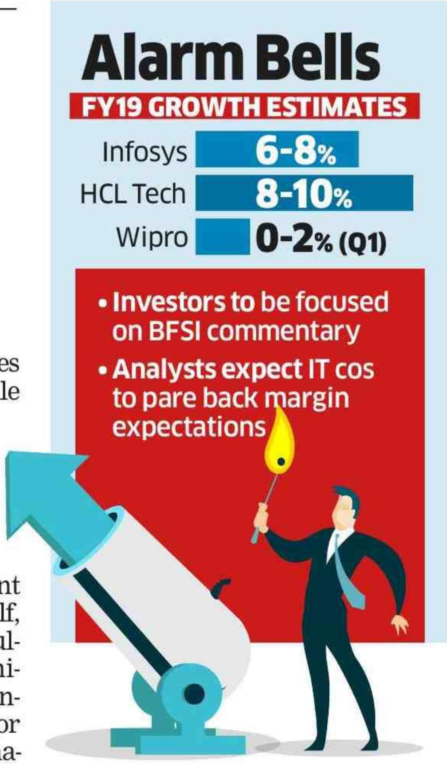

Bengaluru: Indian IT services firms are likely to be cautious while forecasting growth for FY19, even as analysts expect better growth than in FY18, as questions over the spending by banking and financial services clients remain.

Banking and financial services constitute the sector's largest client base and for the last year-and-a-half, IT companies such as Tata Consultancy Services, Infosys and Cognizant have been saying client spending has slowed. But a key investor concern remains that customers have moved their spending away. "We expect investor focus on demand outlook from large banking clients," Kawaljeet Saluja, analyst with Kotak Institutional Equities, said in a preview note. "IT spending of large banks is robust but is not translating into demand for Indian IT due to captive shift and insourcing. TCS, courtesy its large exposure, has been hit the most due to the change in sourcing strategy of banking clients."

Banks have been looking at moving work back from outsourcers or insourcing for the last few years as technology has been a competitive advantage as they look to compete against nimbler startups. Bank of America, American Express and UBS are some of the large banks that have publicly disclosed insourcing plans.

Investors will also look at uptick in digital spending and allocation of budgets to projects. Saluja added that he expects companies to start off "on a conservative note for FY19 revenue growth guidance".

Most analysts expect Infosys to forecast growth of 6-8% in constant currency, a target that will be lower that the 7-9% industry growth forecast made by the National Association for Software and Services Companies (Nasscom).

Some expect the IT company, which appointed Salil Parekh as CEO effective January, to grow even slower. "For FY19, we expect Infosys to give revenue growth guidance of 5%-7% in constant currency (CC or dollar revenue without influence of foreign exchange fluctuations) terms with 22%-24% EBIT margin… Based on deals wins till 3QFY18, and also based on published deal wins in 4QFY18, it looks as though Infosys would struggle to deliver even mid single-digit revenue growth in constant currency terms in FY19," Girish Pai, analyst with brokerage Nirmal Bang, said. He said the appointment of the new CEO would mean the expected pickup in discretionary spending might not benefit Infosys as new management teams needed time to "settle down".

HCL Tech, which has made a slew of IP acquisitions, is expected to forecast growth of 8-10%.

Growth for FY19 will be set up by the growth rate in the fourth-quarter, a term the IT industry calls its 'exit rate'. Despite the seasonal weakness of the period, Q42018 is expected to do slightly better as currency movements boost revenue and margins. "We estimate 1.9-2.5% QoQ organic USD revenue growth for the Top 5 players, helped by 100-120bps cross-currency uplift in a seasonally modest quarter," Pankaj Kapoor, analyst with JM Financial, said.