Domestic IT firms may face headwinds in second half

Margins may come under further pressure owing to large-scale hiring last year

DEBASIS MOHAPATRA
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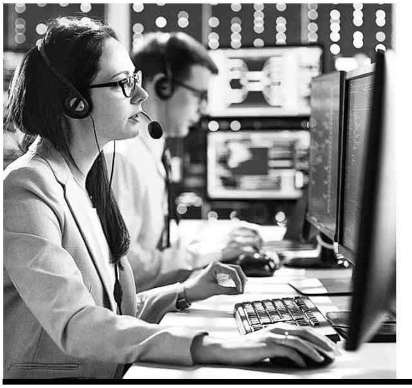

GROWTH PANGS

- Guidance of Accenture, Cognizant indicates low discretionary spend
- Nasscom scrapped its annual guidance citing uncertainty in key markets
- Fall in US GDP growth, Brexit, and trade war seen as factors for likely slowdown
- Client spending in healthcare, BFSI, retail, and automotive verticals likely to be low

Indian information technology (IT) service providers are likely to face growth headwinds in the second half of 2019, as concerns over less discretionary spend in the US owing to lower gross domestic product (GDP) growth coupled with uncertainty over Brexit may put brakes on the overall deal flow.

This has already been reflective in slashing of revenue guidance of US tech major Accenture for this year, along with a flattish growth outlook of Cognizant.

Industry body Nasscom on Wednesday decided to scrap the practice of giving growth projection for the IT and ITes industry, starting this year. It cited uncertainties in key markets as well as changing growth metrics for this.

"We believe that the first two quarters of this year are going to be strong for the sector as projects are already in place. However, growth is likely to slow down in the second half of this year," said Peter Bendor-Samuel, founder and chief executive officer (CEO) of global research firm Everest Group.

Discretionary spend is critical for domestic IT service firms, as they bet more on revenues from new technology areas, called as digital revenues in IT industry parlance, for driving revenue growth.

With a decline of traditional services business for most big firms, these companies are trying to increase the share of digital revenue to drive growth. Currently, digital revenue constitutes around 25-30 per cent of overall revenues of Indian IT biggies.

"Growth of all top Indian IT services providers is dependent on digital revenue because traditional business is not growing for anyone. As discretionary spending largely translates into more digital deals, slowdown will prompt clients to defer such spending decision or at least prioritise them," said Pareekh Jain of Pareekh Consulting.

According to Everest Research, top five Indian service providers grew at 7.1 per cent organically in constant currency term during last year. While market leader, Tata Consultancy Services is confident of achieving double-digit revenue growth in FY19 (April-March cycle), Infosys had raised its revenue guidance for the whole fiscal to 8.5-9 per cent.

To cash in the emerging growth opportunities, domestic firms have also ramped up hiring for delivering projects in time.

Top four IT firms such as TCS, Infosys, Wipro and HCL Technologies together hired more than 70,000 people during April-December period of 2018, which was around five times over the same period of 2017.

Even, hiring in onsite geographies — especially in US — also picked up as moving people from India became difficult due to protectionist policies under Trump administration.

"All these firms have ramped up hiring in anticipation of growth. If this doesn't materialise, operating margins will be the immediate casualty as carrying cost of these people in onsite geographies is high," said Jain of Pareekh Consulting.

Some analysts also said that tepid growth in verticals like banking and finance, healthcare, retail and automotive will drag overall IT spends in the current year.

"Factors impacting both Cognizant and Accenture is their large exposure to the US market where spending in BFSI (banking, financial services & insurance) and healthcare is slowing down a little. So, guidance from Indian vendors with large US exposure is going to be tepid," said Hansa Iyengar, senior analyst at London-based Ovum Research.

She, however, said revenue growth projections from individual vendors are not the right indication of global industry growth trends.