Fitch sees stable outlook for IT services this year

THE outlook for Indian information technology (IT) services sector is stable for 2010, according to Fitch Ratings. Concerns for 2010 include currency volatility, imminent salary hikes for employees, US regulatory risks, and the pace of demand recovery.

Fitch projects a gradually improving quarterly revenue growth through 2010 for large players like TCS, Infosys and Wipro as revival of global economy leads to a gradual recovery in client demand for discretionary expenditure, and longer-term transformational engagements (that were postponed since 2009) in lieu of cost-reduction projects with near-term paybacks.

"IT services revenue growth will also benefit from growth opportunities relating to healthcare, telecom and internet security, along with a revival in demand of the banking, financial services and insurance (BFSI) sector. The BFSI sector is the second-largest purchaser of IT services worldwide behind the government market," a Fitch statement said.

The recently announced third quarter results of IT services companies have shown continued robust performance. Better capacity utilisation, hiring cutbacks and pay freeze, better negotiations with customers on pricing and increased off-shoring have resulted in better-than-expected margins for most of the IT companies. However, the long-overdue wage hike could put pressure on margins.

"The Indian IT sector has consistently generated positive free cash flow (FCF), resulting in significant cash balances of more than 20 per cent of total assets for the large IT companies - enabling them to weather the slowdown better than most other industries. Consequently, most IT service companies continue to be debt-free or have low leverage, and have strong credit-protection measures. Cash flow generation continues to be adequate to fund working capital and, in most cases, capex requirements as well," Fitch said.

Acquisition activities are expected to continue as companies are trying to utilise the excess cash to diversify service line mix, expand geographically, and/or add capabilities in targeted vertical markets.