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IT revenue growth may lose pace

The margins have also taken a hit at most of these companies due to costs related to backfilling attrition, fresher hiring, subcontractors, and discretionary spends such as travel.

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By Ayushman Baruah

However, a few cracks have begun to emerge, analysts at Kotak Institutional Equities said.

The revenue growth momentum of IT companies is likely to soften in the second half of the fiscal as the pandemic-induced demand for digital transformation slows down and clients cut down on IT budgets in select pockets.

The general consensus among the management of IT companies is that the demand environment continues to be strong in the near term and client conversations do not indicate pullback in tech spending. However, a few cracks

have begun to emerge, analysts at Kotak Institutional Equities said.

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According to research firm CareEdge, cloud computing, artificial intelligence (AI), cybersecurity, data analytics, and internet of things (IoT) are expected to be the key focus areas going forward. "However, a slowdown in the key markets of the US and the EU, uncertainties arising from the global macro-economic slowdown, and currency volatility can potentially play a spoilsport with respect to corporations spending on technology and may lead to postponing some of these spends," it said.

The deal total contract value (TCV) for key companies has flattened out or declined. The deal TCV on an annual basis was flat for Tata Consultancy Services (TCS) and Tech Mahindra, while it fell for Infosys. On the other hand, Wipro delivered strong year-on-year growth in TCV, but on a low base. HCL Technologies reported healthy y-o-y growth, driven by large deals.

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"The slowdown in TCV can hit revenue growth with a lag. There are pockets of stress in a few segments. The mortgage segment in financial services is under severe pressure. Capital markets have not done well globally and that could impact IT spends. High inflation, supply chain issues and geopolitical tensions

are impacting retailers and can reflect in tech budgets," the Kotak Institutional Equities report stated. "To be fair, some of the challenges are client-specific or company-specific for now but have potential to become sector-wide headwinds."

Cognizant Technology Solutions has lowered its full-year revenue growth guidance to 8.5-9.5% in constant currency, down from 9-11% earlier, indicating a slowdown in growth. Analysts have pointed out that peak revenue growth may be behind for these IT companies that reported robust earnings during the pandemic as demand for digital and cloud computing services soared.

"The performance of Cognizant points towards slowdown visible from weak bookings at $23.2 billion (on trailing 12 months) representing a decline of 3% on y-o-y comparison, modest headcount addition of just 900 employees, and key verticals such as financial services show no signs of revival. Growth has slowed down even in stronger vertical such as healthcare, while products vertical is also shifting to moderation," a post-earnings Kotak report stated.

Cognizant's voluntary attrition rate at 36% was highest among peers. In comparison, on a trailing 12-month basis, the voluntary attrition rate at TCS, Infosys, and Wipro stood at 19.7%, 28.4%, 23.3%, respectively, for the quarter ended June.

"This increase (in attrition) was slightly above the seasonal uptick we anticipated entering the quarter, impacting second quarter revenue performance. While we have seen some signs of improvement in July resignation rates, we continued to expect elevated attrition for the remainder of the year," Brian Humphries, CEO, Cognizant, said during the earnings call.

According to Gartner, during Covid-19 Indian IT companies managed to leverage the transformation wave triggered by the pandemic, which led to significant revenue growth. "Almost all of them had healthy pipelines. This growth was triggered by some unprecedented demand which came. It caused

attrition in the IT industry as providers were scrambling for resources to deliver on their commitments. This demand pipeline over a period is expected to stabilise and hence this growth we saw during the last year and a half may have to saturate somewhere as the transformations come to an end and they get into the run phase," DD Mishra, senior director analyst at Gartner, said.

The margins have also taken a hit at most of these companies due to costs related to backfilling attrition, fresher hiring, subcontractors, and discretionary spends such as travel. "The Ebit margin of tier-1 IT declined by a sharp 90-240 basis points on a sequential basis. The y-o-y decline was much sharper at 240-410 basis points and captures full impact of rising cost environment. We believe margins have bottomed out for the sector and will improve hereon," Kotak Institutional Equities said.

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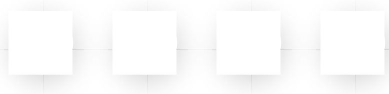

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