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Slowdown fears haunt Indian IT

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Just when the $70 billion IT-ITeS industry thought that the growth in the US market will be back and pre-recession glory days are not far away, the tech sector is now doubting any such good news. Fears of a double-dip recession in the US, sovereign debt crisis concerns in Eurozone countries and the overall slower global growth expectations— analysts admit things could turn bad depending on the severity of the US recession. Hopes are already dwindling as basic fundamentals like revenue estimates, hiring forecasts, margin increase and high contract value in the IT industry seem to be affected. But India's tech firms are taking steps to prepare for tougher times. They reckon that the industry is well prepared to face this crisis, which was not the case in 2008.

The grim scenario has been exacerbated recently by the uncertain global financial environment following the downgrade of US' long-term credit rating. The United States' economic recovery has slowed further in the past few quarters and unemployment levels have persisted above 9% levels, triggering fears of yet another recession as well as slowdown in global growth. Eurozone countries also continue to be plagued by sovereign debt crisis concerns.

Recently, Citigroup and Goldman Sachs lowered estimates of IT firms, slashing price targets of tech stocks across the board against the backdrop of the deteriorating macroeconomic situation in the US and Europe. The US and European region account for over 85% of the revenues of the over $70 billion Indian IT-BPO sector. To complicate matters further, recruitment by IT companies seems to have witnessed a slowdown in August, according to a survey by a leading recruitment tendering platform MyHiringClub.com. Hiring activity saw a 49% drop in the IT-BPO sector in August compared to July.

"The fall in IT stocks is a function of sentiments that are in the US and Europe and are undergoing uncertainty. The valuation of stocks is degrading despite the fact that there have been no earning cuts by companies themselves," says Dipen Shah, head, Private Client Group Research, Kotak Securities. But industry captains feel that the fears are not new, they are just accelerated now. "The US growth has been slow for quite some time now. People thought it will improve, but it has not been improving. The real issue is that is there going to be a growth at all rather than the fact that there will be decline," says NV "Tiger" Tyagarajan, president & CEO of Genpact.

Another optimistic man is Vineet Nayar, vice-chairman and CEO of the country's fourth largest IT company, HCL Technologies. "In our assessment, the S&P downgrade of the US or the Euro debt crisis would not have an impact on our market segment as the IT outsourcing demand environment largely remains unchanged. HCL is focused on total IT outsourcing as a core market segment which is driven by a need for better processes, higher visibility and flexibility and lower cost."

Rohit Kapoor, CEO, EXL Service says, "The BPO industry will get lesser impacted than the IT industry during this slowdown as BPO vendors do more of day-to-day work for the customers. The sectors which will get impacted are banking and financial services, where EXL's exposure is minimum, that is, 8% of our total revenues. Other sectors like insurance, travel and transport are expected to see steady growth."

According to Kapoor, IT-BPO companies are better prepared for a slowdown than in 2008. "In 2008, the growth rate went from slow to negative. But today, we are just preparing ourselves for a slowdown. In times of uncertainly, diversification into different geographies is the obvious remedy. But actually the truth is that Europe is in worse conditions than the US," he adds.

Impact on predicted numbers

Industry players might say that this crisis is not affecting the companies at this moment, but the impact will soon be seen, predict analysts. A recent report by Kotak Institutional Equities predicts a deceleration in volume growth of the IT sector and some pricing pressure on account of increased macro uncertainty. The report lowered its revenue growth estimates for FY2013 for IT companies. For the Tier-I stocks, it came down to 13-17% from 18-22% earlier and for the Tier-II names to 10-15% from 13-21% earlier.

The main reason behind this downfall in expected revenues is the increased macro uncertainty to drive a modest deceleration in volume growth and lead to some pricing pressure across all players. Lower revenue growth estimates also drive modest reductions in margin estimates—a 5-10% cut in expected FY2013 EPS estimates for Tier-Is and 3-15% for Tier-IIs.

"In the future, the contract value might go down as the companies will cut spending and smaller contracts might go out to a large number of people. Budget cuts often lead to smaller contracts," notes a financial analyst of a leading research firm.

Even Tyagarajan says, "Deal sizes

became smaller in 2008-09 and it continues to happen. Clients wanted to do things in smaller pieces and it continues to happen. As compared to 2008, companies like us have a much diversified portfolio of geographies, services and industry verticals to tackle this." HCL Technologies head of marketing Krishnan Chatterjee says, "The contracts with $500 million to $1 billion value are over for quite some time now; all that we experience today is contract values of $50-$150 million."

A report by Everest Consulting too mentions that the average contract value in the global outsourcing market is diminishing.

It is evident that the size of contracts is becoming smaller. In the April-June quarter this year, in the IT outsourcing (ITO) space, the transactions signed did increase by 8%, but the average contract value (ACV) decreased by 13% compared to the first quarter.

Effects at macro level

V Suresh, executive vice-president and national head (sales) at Naukri.com says, "There is a cautious optimism in hiring in the IT sector. Replacement of executives, senior level hiring might get delayed. Slight indicators reveal that there is a decrease in the packages that were offered 6 months back and now to the candidates." As per the job portal's July index, the IT and ITeS sectors witnessed 24% and 11% dips in their indices in July, 2011 when compared to June, 2011. On an annual level, hiring in the sector was 16% lower than August 2010.

There are other speculations around the discretionary spending which are going on in the market. "The whole wave of discretionary spend that was a resound after the previous recession has softened a bit. So the growth that we saw in 2009-10 when the economies were recovering and the pent up demand was back—it is now moderated. This is because of the natural uncertainty in the market rather than the debt crisis" says Vikash Jain, partner at Everest Group.

Jain says that there might be pressure on some of the spending that the US government has planned—the biggest being around healthcare. Some of those measures which were pushed aggressively around the healthcare reforms might be taken back or slow down.

Not a double dip recession

"There is a lot of difference between the 2008 recession and now. Then there were failures across banks and enterprises. But this time the effect will primarily be on the expectation of the US growth, " notes Sid Pai, partner & managing director, TPI India mentions. Hinduja Global Solutions CEO Partha DeSarkar adds, "This environment is more of a government and sovereign problem than a client problem. But we have reduced our dependence on the US as a market from 85% at a point to 60% now. We have expanded into markets like Europe and the UK. We have diversified the risk. The US will continue to be very big though."

Nasscom president Som Mittal agrees, "We should all be concerned because there is a change happening. However, I think we are a very small part of the global gambit. If there is double dip recession—our industry or country will not be suffering the most. The point not to forget is that the US or European governments are taking many many steps to improve this." Nevertheless, he emphasises that there are concerns. "We did speak to our members and clients through Nasscom. The sentiment is that though there is no confluence of all the negatives happening together, there is a probability that a negative impact could happen on the IT industry. There are enough people working together to avoid it."

As the industry prepares itself for another test, optimism seems to be the mantra what is letting these biggies get going with this macro uncertainty.