INDIAN IT SERVICES INDUSTRY

Hiring to remain muted over the next two-three quarters amid slowing growth

DECEMBER 2023

Highlights

ICRA

Click to Provide Feedback

Between Q2 FY2023 to Q2 FY2024, ICRA's sample set companies recorded a net decrease of 49,606 employees (compared to a net increase of 245,248 during Q2 FY2022 to Q2 FY2023). This is because the companies have not completely backfilled the attrition and have focused on improving employee utilisation amidst a weakened demand environment.*

The Covid-19 pandemic accelerated the demand for digitisation, which led to a significant gap between the demand and supply of digital tech talent in the Indian IT services industry. As a result, there was a surge in hiring by industry participants, leading to record net employee additions in FY2022 and H1 FY2023. Simultaneously, the attrition rate in the industry also intensified to 22-23% due to the increased demand for talent.

The Indian IT services companies expected the accelerated demand for their services to remain high. This led to a record hiring of 273,000 employees in FY2022 and another 94,400 employees in H1 FY2023 by the top five companies in the industry. However, the macro-economic challenges in the key markets of the US and Europe resulted in a slowdown in demand for IT services since H2 FY2023, and thus companies have hired fewer employees in the last four quarters, as they were able to meet demand with manpower that had been added in FY2022 and H1 FY2023.

The average LTM attrition for ICRA's sample set companies declined to ~14% as of September 30, 2023, against ~23% in September 2022, owing to resolution of the demand-supply mismatch experienced by the industry amid accelerated demand during the pandemic. Moreover, with slowdown in growth in recent quarters, employee turnover rates have also reduced considerably.

ICRA expects hiring to remain muted over the next two-three quarters amidst slowdown in demand, with companies focusing on maintaining their profitability in the backdrop of lower revenue growth.

The employee cost as a percentage of revenues for ICRA's sample set increased to 57.6% in H1 FY2024 from 54.5% in FY2022 due to rising wage costs and slower revenue growth in an uncertain macroeconomic environment. This led to a moderate 260 bps decline in operating profit margin (OPM) for these companies. However, ICRA expects the same to stabilise in the near term, supported by relatively reduced hiring and lower wage increases.

**ICRA's sample set of five companies: HCL Technologies Ltd., Infosys Ltd, Tata Consultancy Services Ltd., Tech Mahindra Ltd. and Wipro Ltd.; LTM: Last Twelve Months*

AGENDA

1 Hiring and headcount trend for top 5 IT services companies

2 Key reasons for slowdown in hiring in the IT services industry

3 Trend in employee cost and OPM

4 Outlook

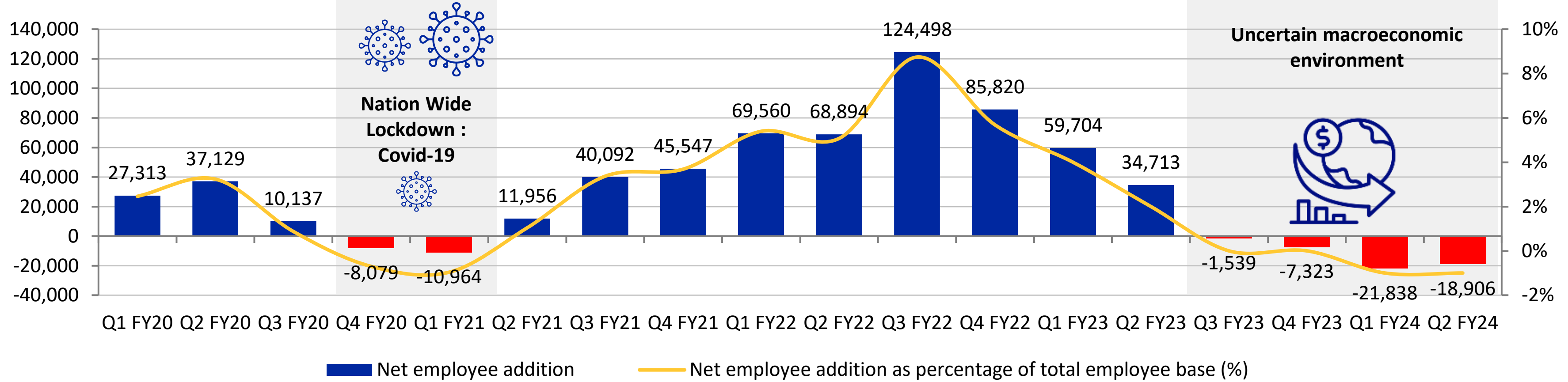
5 Rating actions

Hiring and headcount trend for top 5 IT services companies

Muted hiring in the last one year; trend expected to continue over next two-three quarters

ICRA

EXHIBIT: Trend in net employee addition (aggregate of leading listed Indian IT services companies*)



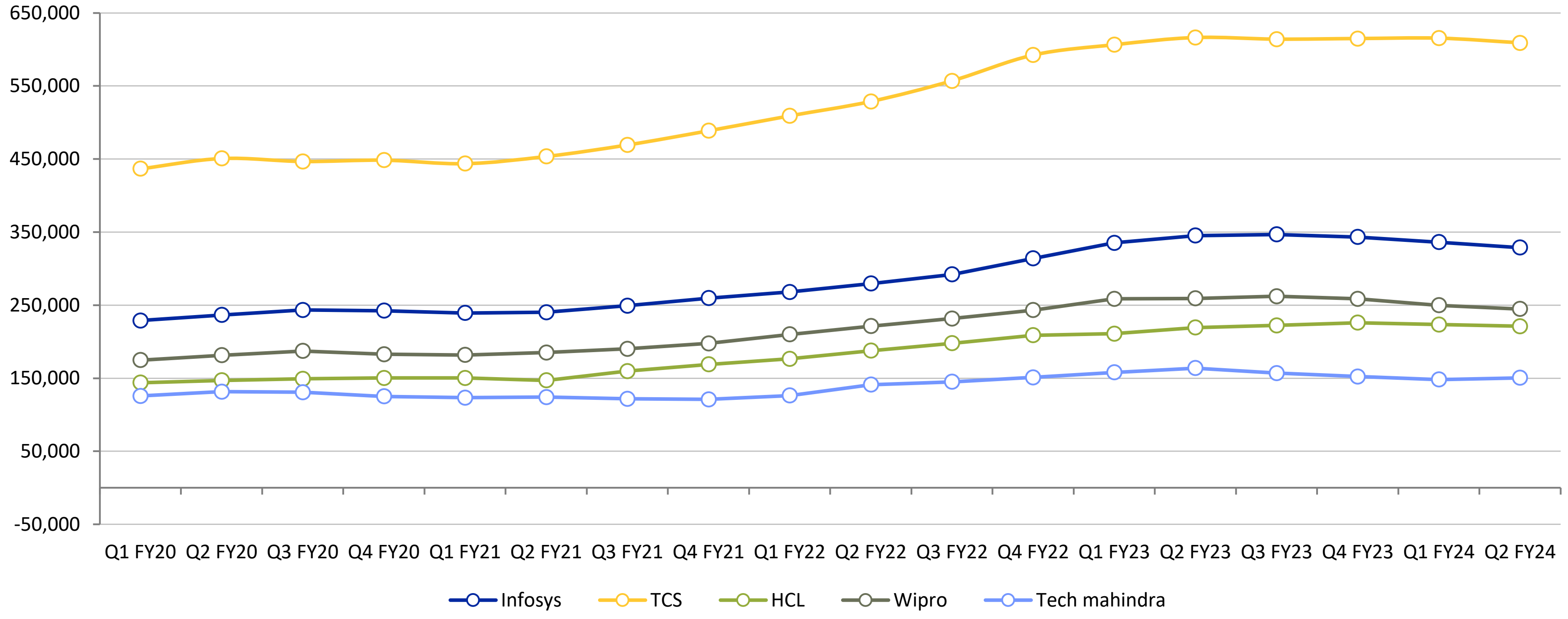
- Indian IT services companies hired extensively over Q2 FY2021 to Q2 FY2023, as demand for digitalisation accelerated following the Covid-19 pandemic. However, from Q3 FY2023 onwards, the overall demand environment for IT services weakened due to uncertainty in the global macroeconomic environment. This led to negative employee net addition during this period, as companies reduced hiring and focused on improving overall utilisation levels. This has helped companies maintain their employee cost and profit margins in the recent quarters.
- ICRA expects hiring to remain muted with marginal improvement in net addition in H2 FY2024 as companies continue to focus on improving employee utilisation to maintain their profit margins amidst expected continued slowdown in revenue growth.

Source: ICRA Research, ICRA's sample set of five companies: HCL Technologies Ltd., Infosys Ltd, Tata Consultancy Services Ltd., Tech Mahindra Ltd. and Wipro Ltd.

Trend in headcount for top 5 IT services companies

ICRA

EXHIBIT: Trend in total headcount of top listed IT companies



Source: ICRA Research

Key reason for slowdown in hiring in the Indian IT services industry

Major reasons for slowdown in hiring in the Indian IT services industry

Demand slowdown

ICRA expects the revenue growth of the Indian IT services industry to moderate to 3-5% in FY2024 in USD terms* versus ~10% in FY2023 owing to uncertain macroeconomic environment in key markets i.e the US and Europe. The slowdown is expected to persist for another couple of quarters, leading to overall slowdown in hiring in the industry.

Reduction in attrition levels

The attrition rate has declined in recent quarters, which has helped reduce the demand-supply mismatch in the industry.

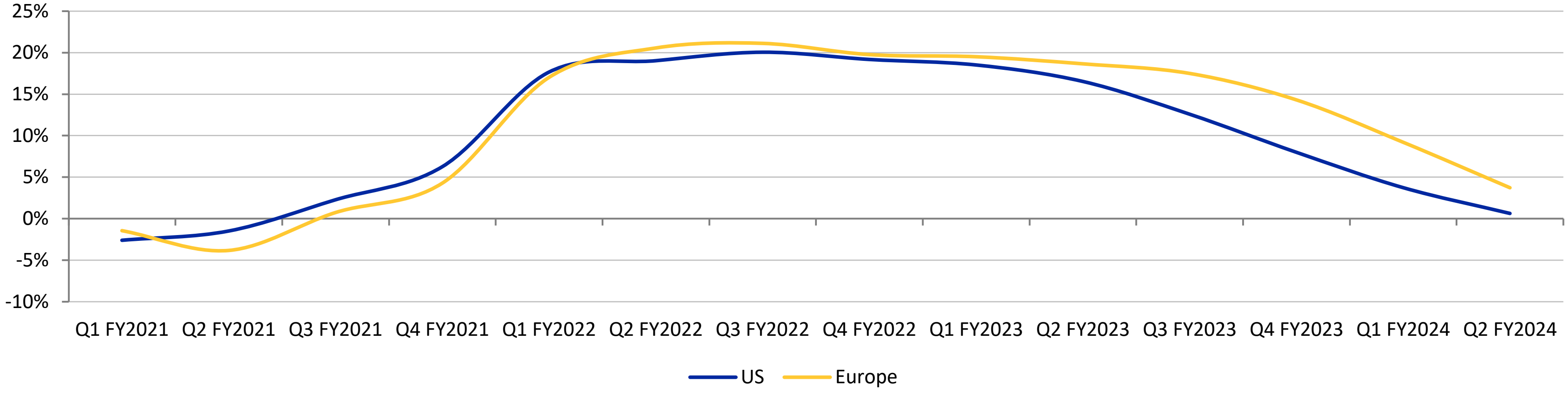
Excessive hiring in FY2022 and H1 FY2023

Indian IT services companies continue to utilise the excess capacity added in FY2022 and H1 FY2023. The freshers recruited then are now getting utilised, leading the company to not backfill the attrition to an extent.

*Source: ICRA Research, ICRA's sample set of five companies: HCL Technologies Ltd., Infosys Ltd, Tata Consultancy Services Ltd., Tech Mahindra Ltd. and Wipro Ltd. *The projection as per ICRA's last research note published in August 2023.*

Slowdown in growth in the key markets i.e US and Europe

Exhibit: Region-wise YoY Growth for ICRA Sample Set Companies in Constant Currency Terms

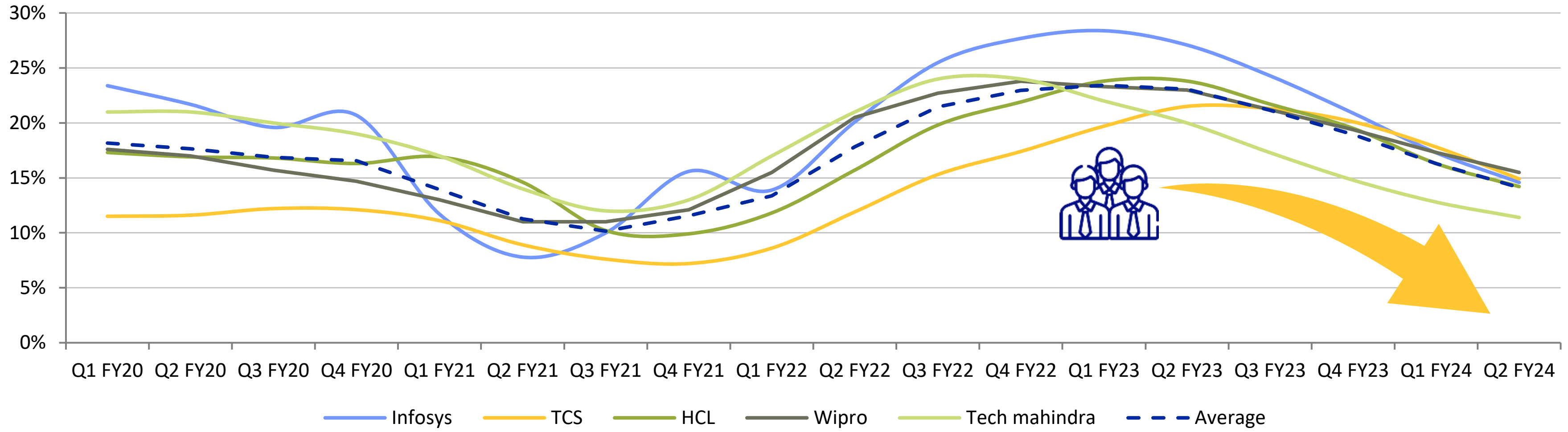


- The revenue growth from the US (~58-60% of the industry's revenues) witnessed a sharp moderation in recent quarters as macroeconomic headwinds continue to intensify coupled with instability in the banking sector in the US, which is a key vertical for the Indian IT services companies, leading to lower technological spending, specially towards discretionary and non-critical transformation programmes. The growth in Europe has also witnessed moderation, though it has remained more resilient compared to the US in the last few quarters, supported by healthy deal execution in the UK as reported by some of the Industry players.

Source: Company data, ICRA Research; ICRA sample set of four companies (HCL Technologies Ltd, Infosys Ltd, Tata Consultancy Services Ltd and Wipro Ltd.)

Attrition has tapered in the last few quarters

EXHIBIT: Trend in LTM attrition rate of key listed IT companies



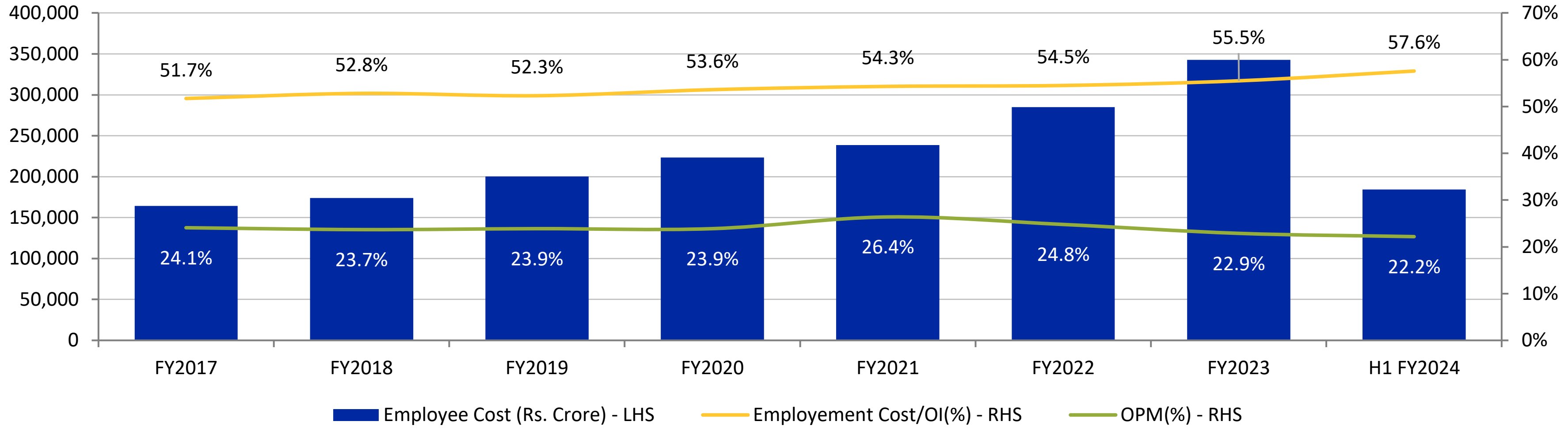
- Covid-19 pandemic-induced accelerated demand for digitisation led to considerable demand-supply gap, especially for digital tech talent in the Indian IT services industry during FY2022 and H1 FY2023. Consequently, there was a surge in attrition in the industry from Q4 FY2021 to Q2 FY2023
- However, the attrition is on a declining trend since Q3 FY2023 (LTM attrition of ~14% as of September 2023 versus ~23% as of September 2022*) on the back of excess hiring in FY2023 and demand slowdown in the current fiscal, thereby reducing the overall demand-supply mismatch that occurred in the last fiscal.

Source: ICRA Research, ICRA's sample set of five companies: HCL Technologies Ltd., Infosys Ltd, Tata Consultancy Services Ltd. , Tech Mahindra Ltd. and Wipro Ltd.;
**Average of ICRA's sample set companies*

Trend in employee cost and OPM

Steady increase in employee cost in recent years

EXHIBIT: Trend in employee cost*

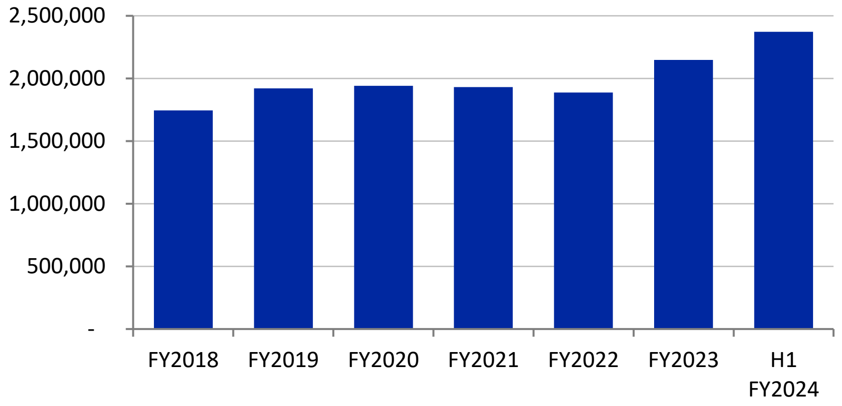


- Employee cost as a percentage of operating income for Indian IT services companies has increased steadily in the recent years from around 54% in FY2021 to almost 58% in H1 FY2024. due to lower revenue growth in H1 FY2024.
- While this has exerted some pressure on profit margins, major IT services companies have been able to mitigate the impact to some extent through increased operating efficiencies.

Source: ICRA Research; ICRA's sample set of five companies: HCL Technologies Ltd., Infosys Ltd, Tata Consultancy Services Ltd. , Tech Mahindra Ltd. and Wipro Ltd.

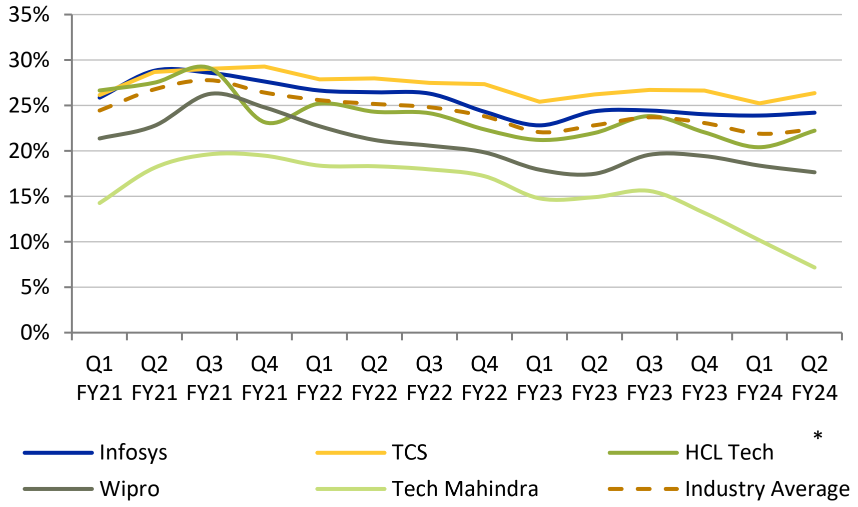
Contraction in operating profit margins in recent quarters

EXHIBIT: Average cost per employee (Rs.)



Note: Employee cost dividend by year end headcount is considered to calculate average cost per employee

EXHIBIT: Trend in operating profit margins



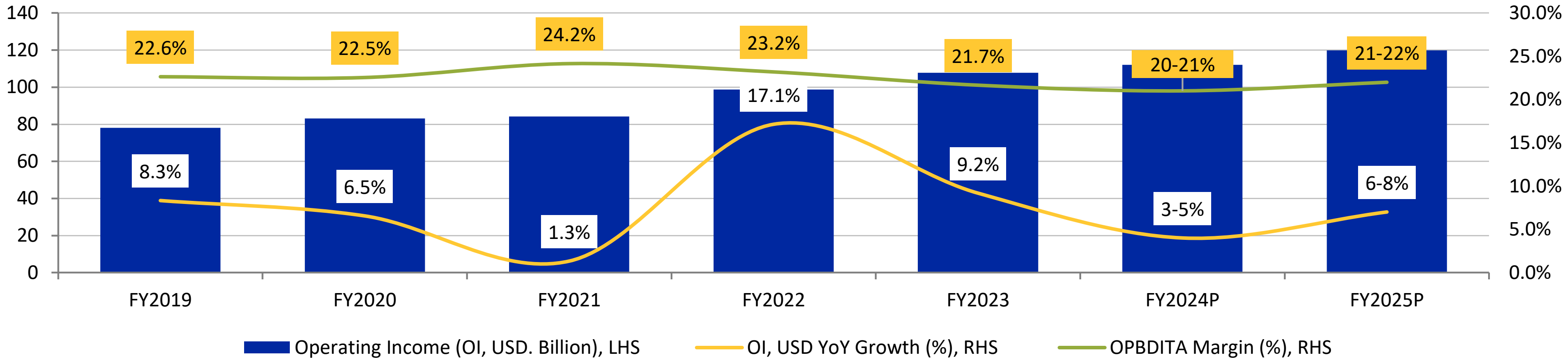
- Due to high attrition in FY2022 and H1 FY2023, the average employee cost increased by ~14% YoY in FY2023 and 15% YoY in H1 FY2024. This led to high employee cost as a percentage of revenues in FY2023 and H1 FY2024.
- The OPM in recent quarters witnessed moderation owing to the higher employee cost and overall slowdown in revenue growth, reducing the operating leverage for the sector.

Source: ICRA Research, ICRA's sample set of five companies: HCL Technologies Ltd., Infosys Ltd, Tata Consultancy Services Ltd. , Tech Mahindra Ltd. and Wipro Ltd.

Outlook

Despite moderation in revenue growth in the near term, OPM to remain healthy

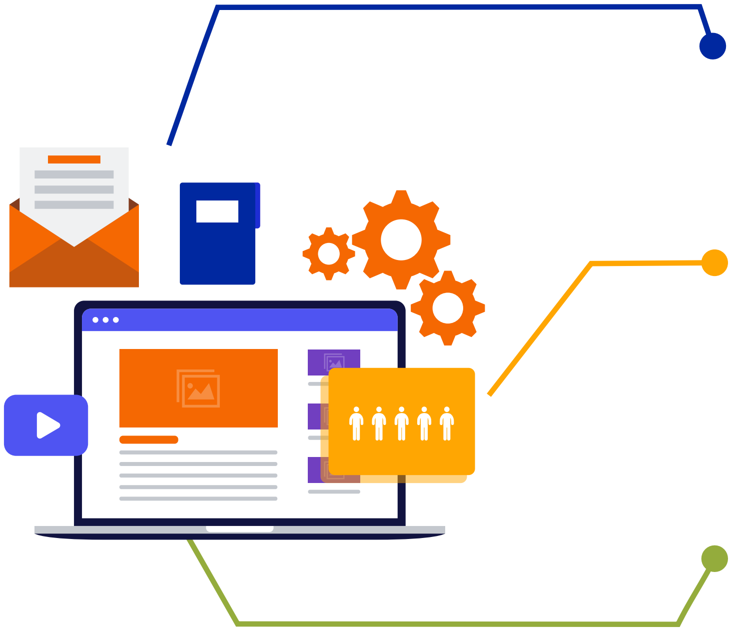
Exhibit: Growth and profitability indicators for ICRA sample set companies



- The revenue growth for ICRA's sample set of Indian IT services companies is expected to moderate to 3-5% in FY2024 from 9.2% in FY2023 owing to persistent uncertainty in key markets resulting in delay in decision-making by customers as visible from the slowdown in the conversion of deals to revenues to some extent and slowdown in discretionary technological spending. ICRA expects revenue growth to improve in FY2025 to about 6-8%, supported by strong order book and deal pipeline for majority of the industry players.
- ICRA expects the OPM to moderate by ~70-100 bps to ~20-21% in FY2024 versus 21.7% in FY2023, owing to lower operating leverage. However, the OPM will remain healthy, with some improvement likely over the medium term, supported by stabilisation of wage costs with optimisation of employee pyramid and employee utilisation.

Source: Company data, ICRA Research; ICRA sample set of 16 companies (Birlasoft Ltd., Coforge Ltd., Cognizant Technology Solutions Corp, Cyient Ltd., HCL Technologies Ltd., Infosys Ltd., LTIMindtree Ltd., L&T Technology services Ltd., Mastek Ltd., Mphasis Ltd., Oracle Financial Services Software Ltd., Persistent Systems Ltd., Tata Consultancy Services Ltd., Tech Mahindra Ltd., Wipro Ltd. and Zensar Technologies Ltd.) and their publically available disclosures

Key Takeaways



Hiring: FY2022 and H1 FY2023 witnessed record net employee addition; however, since Q3 FY2023, there has been a considerable decline in total employee base due to overall slowdown in demand and the companies continue to utilise excess capacity added in FY2022 and H1 FY2023. ICRA expects hiring to remain muted over the next two-three quarters till the demand scenario remains weak as companies utilise the capacity added in the past and improve overall utilisation levels.

Revenue growth: In H1 FY2023, ICRA's sample set companies recorded revenue growth of 3.3% YoY in USD terms versus 9.6% in FY2023 and 18.1% in FY2022, owing to intensifying macroeconomic headwinds in the key markets of the US and Europe. ICRA expects revenue growth for its sample set companies in FY2024 to remain low at ~3-5% in USD terms.

Profitability: In H1 FY2024, the sample set companies recorded an OPM of 22.2% versus 22.9% in FY2023 and 24.8% in FY2022, owing to reduced operating leverage. However, most companies' ability to work with multiple levers such as an onshore-offshore mix, utilisation levels, employee pyramid optimisation, etc. to manage costs, is expected to support profitability in the near to medium term.

Source: ICRA Research

Rating actions

Rating actions by ICRA: IT Services

ICRA

Exhibit: Ratings Upgrade/ Downgrade Across IT Services Companies

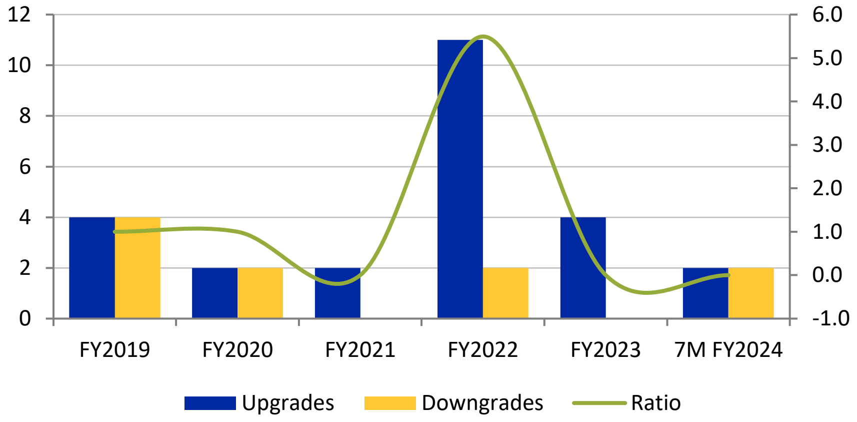
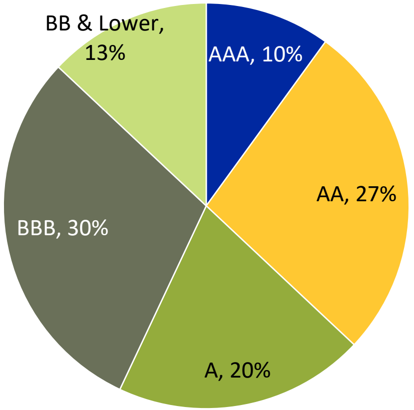


Exhibit: Distribution of Ratings for IT Services Industry



- ICRA has a total of 31 entities rated under the IT and BPO industry, distributed across IT Services and IT BPO.
- Approximately 87% of the rated entities are in investment grade category for the IT services sector. This is a reflection of the healthy cash flow generation led by higher margins and low working capital requirements. Further, with low capex requirements, entities in the industry have been generating free cash flows leading to net surplus of cash and liquid investments.
- There have been four upgrades in FY2023 and two in 7M FY2024 driven by a strengthening of their credit profile, aided by healthy growth and increased accrual generation, while maintaining a comfortable capital structure. There were two downgrades in 7M FY2024 - one owing to irregularity in debt servicing.

ICRA-rated entities in IT services industry

Name of Issuer	Long-term Rating	Outlook / Special Symbol	Short-term Rating
24/7 Customer Private Limited	[ICRA]BBB	Stable	[ICRA]A3+
Ascendum Solutions India Private Limited	[ICRA]BBB-	Stable	
ASM Technologies Limited	[ICRA]BBB	Stable	[ICRA]A3+
C-Edge Technologies Limited	[ICRA]AA-	Stable	[ICRA]A1+
Conneqt Business Solutions Limited	[ICRA]A+	RWDI	[ICRA]A1+
Datamatics Global Services Limited	[ICRA]A+	Stable	[ICRA]A1+
Embee Software Private Limited	[ICRA]BBB+	Stable	[ICRA]A2
Emudhra Limited	[ICRA]A-	Stable	[ICRA]A2+
Genisys Information Systems (India) Private Limited	[ICRA]BB+	Stable	[ICRA]A4+
HCL Technologies Limited	[ICRA]AAA	Stable	[ICRA]A1+
IBM India Private Limited	[ICRA]AA+	Stable	[ICRA]A1+
IGT Solutions Pvt. Ltd.	[ICRA]A-	Stable	
In-Solutions Global Limited	[ICRA]BBB	Stable	[ICRA]A3+
Iris Business Services Limited	[ICRA]BB+	Stable	[ICRA]A4+
Kochar Infotech Limited	[ICRA]BBB	Stable	[ICRA]A3+

ICRA-rated entities in IT services industry

Name of Issuer	Long-term Rating	Outlook / Special Symbol	Short-term Rating
KPIT Technologies Limited	[ICRA]AA	Stable	[ICRA]A1+
Lentra AI Private Limited	[ICRA]BB-	Stable	
Mastek Limited	[ICRA]AA-	Stable	[ICRA]A1+
Motherson Technology Services Limited	[ICRA]AA-	Stable	[ICRA]A1+
Mphasis Limited	[ICRA]AA+	Stable	[ICRA]A1+
Onward Technologies Limited	[ICRA]BBB	Stable	[ICRA]A3+
Ramco Systems Limited	[ICRA]A-	Negative	[ICRA]A2+
Sasken Technologies Limited			[ICRA]A1+
Sify Digital Services Limited	[ICRA]A+	Stable	[ICRA]A1+
Sify Technologies Limited	[ICRA]AA-	Stable	[ICRA]A1+
Tata Consultancy Services Limited	[ICRA]AAA	Stable	[ICRA]A1+
Trigyn Technologies Ltd.	[ICRA]BB-	Stable	[ICRA]A4
Wipro Limited	[ICRA]AAA	Stable	[ICRA]A1+
Zensar Technologies Limited	[ICRA]AA+	Stable	[ICRA]A1+
Epicenter Technologies Private Limited	[ICRA]BBB	Stable	[ICRA]A3+
Sagility India Private Limited	[ICRA]BBB-	Stable	[ICRA]A3

Click to Provide Feedback

Analytical Contact Details

Name	Designation	Email	Contact Number
Shamsher Dewan	Group Head	shamsherd@icraindia.com	0124 – 4545 328
Kinjal Shah	Co-Group Head	kinjal.shah@icraindia.com	022 – 6114 3442
Deepak Jotwani	Sector Head	deepak.jotwani@icraindia.com	0124 – 4545 870
Pawan Mundhra	Senior Analyst	pawan.mundhra@icraindia.com	020 – 6606 9918

ICRA Business Development/Media Contact Details

Name	Designation	Email	Contact Number
L Shivakumar	Chief Business Officer	shivakumar@icraindia.com	022-61693304
Neha Agarwal	Head – Research Sales	neha.agarwal@icraindia.com	022-61693338
Rohit Gupta	Head Business Development - Infrastructure Sector	rohitg@icraindia.com	0124-4545340
Vivek Bhalla	Head Business Development - Financial Sector	vivek.bhalla@icraindia.com	022-61693372
Vipin Saboo	Head Business Development – Corporate Sector - West & East	vipin.saboo@icraindia.com	022-61693348
Shivam Bhatia	Head Business Development – Corporate Sector - North & South	shivam.bhatia@icraindia.com	0124-4545803
Naznin Prodhani	Head – Media & Communications	communications@icraindia.com	0124-4545860

ICRA

ICRA

Thank You!