PRESS RELEASE
April 9, 2020

Coronavirus pandemic to hurt IT Services sector, lower US$ growth expected in FY2021e; at 3-5% compared to earlier estimate of 6-8%: ICRA

- ***As growth slows down during the first half of FY2021, the margins will be adversely impacted and are estimated to gradually recover in FY2022***
- ***Credit outlook remains stable led by healthy free cash flows cushioning short term disruptions with significant liquidity in the form of surplus investments generated out of past cash flows***

The Indian IT Services industry is expected to have short term adverse impact due to coronavirus outbreak. As per an ICRA note, the sector is expected to grow at 3-5% in FY2021e versus ICRA's earlier expectation of 6-8%. With the slowdown in growth during the first half of FY2021, the margins will also be negatively impacted before a likely recovery in FY2022. However, the credit profile of Indian IT Services companies is expected to remain stable.

Explaining this further, Mr. Gaurav Jain, Vice President, ICRA says, "The global spread of the coronavirus is resulting in simultaneously supply and demand shocks. We expect these shocks to materially slow economic activity. The US and the Euro zone which generates more than 80% of IT Services export revenues will see their GDP growth fall from 2.3% and 1.2% in CY2019 to 1.5% and 0.7% respectively in CY2020. The forecast assumes gradual recovery during the second half of the year, however the evolution of virus remains highly uncertain and the full extent of the economic costs remain unclear at this point of time."

On the demand side, developed economies which contribute to majority of the revenues will see delayed off-take of scheduled new projects, reduced discretionary spend as well as overall lower spend owing to sluggish economic growth. The BFSI vertical (30% of sector revenues) which is already seeing weakness across US and Europe will be further impacted primarily owing to short term impact of coronavirus on economic growth, lower credit off-take and other banking services. Other key sectors such as Oil and gas will be impacted because of record low crude oil prices leading to reduced discretionary spends by such companies. Manufacturing sector which has been one of the key growth drivers is also expected to be adversely hit due to overall lower consumption. Travel and Hospitality followed by Retail will be impacted as consumers will restrict outdoor activities to essentials in the foreseeable future.

On the supply side, Indian IT services will face issues such as travel restrictions to developed countries as well as closure of offices / work from home at various offshore development centers as well as onshore thereby impacting movement of labour. At the initial stages of projects, movement of labour at client's site is essential while later the same can be managed remotely. New projects to be commissioned will be delayed by minimum of 3-6 months while projects in pipeline will also face delays.

As growth slows down during the first half of FY2021, the margins will be adversely impacted though ICRA expect them to gradually recover in FY2022. The margins for the Indian IT Services are already facing challenging operating environment characterised by continued pressure on commoditised IT services, wage inflation, higher onsite costs necessitated by visa curbs as well as lower discretionary spend by corporate. ICRA expects large size companies with diversified presence across sectors to manage such headwinds better compared to mid-size companies which have moderately high proportion of revenues coming from few sectors. Nevertheless, the credit profile of Indian IT Services companies is expected to remain stable underpinned by its ability to sustain free cash flows despite pressure on short term revenue growth and margins.

"With aggregate operating margins of ICRA sample set at 22.0% in FY2020e (FY2019 at 22.4%) coupled with moderate capex (organic as well as inorganic) and working capital requirements, the free cash flows have remained robust historically. Despite growth and margins expected to remain under pressure over the medium term, these factors are unlikely to impact the free cash flow generation ability of Indian IT Services companies though there could be moderation in the quantum of such cash flows. The credit profile is also supported by net cash position with significant liquidity in the form of surplus investments generated out of past cash flows. Our sample set (13 leading companies) will report surplus liquidity (net of debt) of approximately Rs. 1,651 billion March 2020e despite maintaining healthy dividend pay-out of approximately 35-40% of profits in addition to share buybacks," adds Mr. Gaurav Jain.

For further information, please contact:

Media Contacts:

Naznin Prodhani
Head Media & Communications
ICRA Ltd
Tel: + (91 124) 4545300, Dir - 4545860
Email: naznin.prodhani@icraindia.com

Poornima Tyagi
Deputy Manager- Media & Communications
ICRA Ltd
Tel: +(91-124)4545300, Ext: 840
Email: poornima.tyagi@icraindia.com

Girish Dikey/ Khushal Devera
Ketchum Sampark
Mob: 7738020260/ 9819666376
Email:girish.dikey@ketchumsampark.com/
khushal.devera@ketchumsampark.com

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