

Technology

Cloud ACV growth decelerates! ISG moderates CY21 outlook

Mar-21 ISG Index suggested As-A-Service ACV growth decelerated vs Dec-20 (from 26% to 15% YoY), led by the sharp slowdown in IaaS' ACV. Even on absolute basis, As-A-Service ACV run-rate did not change much from pre-Covid levels. This is disappointing given the lofty counter-cyclical expectations around: 1) Covid-led acceleration in cloud migrations, and 2) the much needed optionality of variabilising fixed costs provided by cloud, which is particularly relevant in the current context. While ISG indicated that deal renewal / restructuring activity is healthy, new scope seems limited. As-A-Service growth outlook for CY21 was cut to 18% (from 20% in Jan-21). This hints at a deceleration vs pre-Covid levels (as against street expectations of acceleration). This further corroborates our argument that once the recovery is in the base, organic growth rates for Indian IT (Sep-21++) are unlikely to see a meaningful acceleration (vs pre-Covid). In conjunction with the sharp run-up in valuations, we maintain our anti-consensus cautious stance. In the near term, elevated negative news flow around Covid second wave in India and INR depreciation should translate into relative investor interest in the sector. HCLT, TCS, Infosys, and Cyient are good proxy plays on this tactical trend.

- **As-A-Service ACV growth decelerates; New scope in deal activity is limited.** Mar-21 ISG Index suggested As-A-Service ACV growth decelerated vs Dec-20 (from 26% to 15% YoY), led by the sharp slowdown in IaaS' ACV within core markets like the Americas and EMEA. We understand that as base catches up, it is normal for growth rates to decelerate. However, it is key to note that even on an absolute basis, As-A-Service ACV run-rate did not change much from pre-Covid levels (Mar-20). This is disappointing given the lofty counter-cyclical expectations around: 1) Covid-led acceleration in cloud migrations, and 2) the much needed optionality of variabilising fixed costs provided by cloud, which is particularly relevant in the current context.

While mega deal activity was stated to be good, it is interesting to note that it was largely led by renewals, restructuring and renegotiation rather than new scope. This will likely become a key nuance of investor interest even for individual firms going ahead.

- **CY21 outlook for managed services upgraded; that of As-A-Service cut.** For CY21, ISG now expects ~5% YoY growth in Managed Services (vs 3% in Jan-21) with a further upside risk in a scenario of continued strength in mega deal flows. Expectations around this segment are more or less similar vs pre-Covid. Margin impact of these large transactions will be a key theme to watch out for.

As-A-Service ACV growth outlook was downgraded to 18% YoY (vs 20% YoY in Jan-21). This hints at growth deceleration vs pre-Covid notwithstanding the favourable base of CY20. Notably, this goes against the current consensus expectations of a material acceleration in industry growth rates (overall, and particularly led by cloud / digital) post-Covid.

- **Organic growth of Indian IT unlikely to accelerate post-Covid, in our view:** Above data and outlook further corroborates our argument that once the recovery from trough is in the base (by Jun-21), organic growth rates of the Indian IT industry (Sep-21++) are unlikely to see a meaningful acceleration (vs pre-Covid). In addition, as some of the mega deals entered into by the industry in recent past seemingly have higher share of managed services component, margin headwinds are to be watched out. In conjunction with the sharp and quick run-up in multiples (up to ~70%, vs pre-Covid), we maintain our anti-consensus cautious stance on the sector.

However, in the near term, elevated negative news flow around Covid second wave in India and INR depreciation should translate into relative investor interest in the sector. HCLT, TCS, Infosys, and Cyient are good proxy plays on this tactical trend.

Research Analysts:

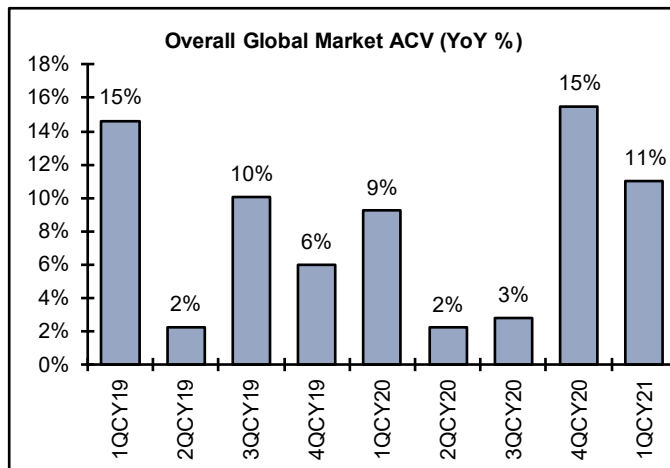
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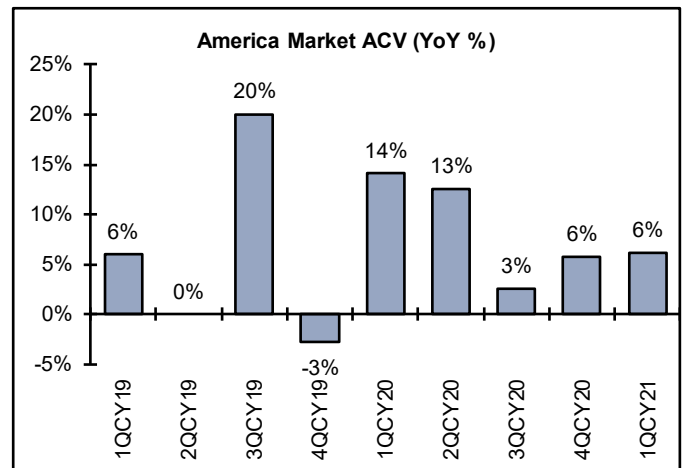
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Chart 1: Global market ACV



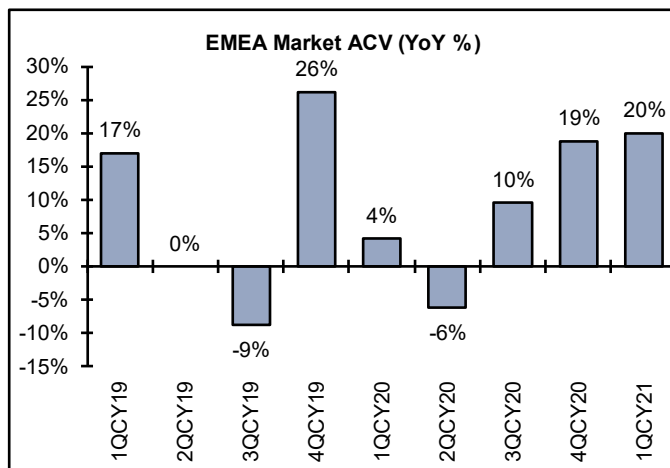
Source: ISG, I-Sec research

Chart 2: America market ACV



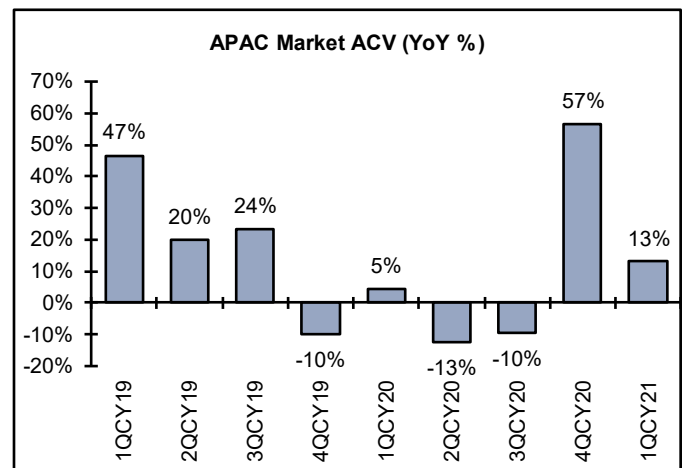
Source: ISG, I-Sec research

Chart 3: EMEA market ACV



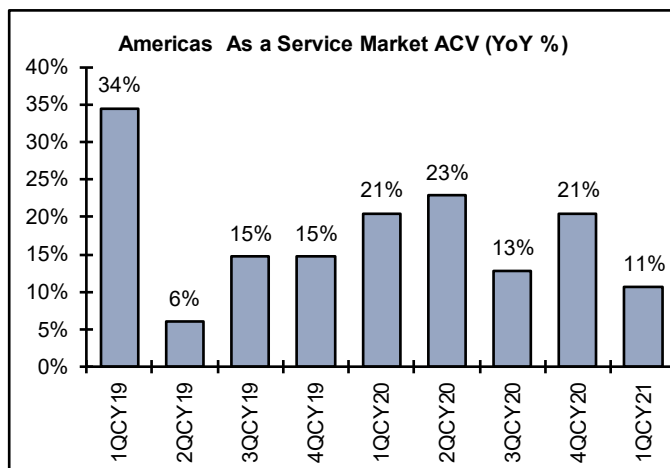
Source: ISG, I-Sec research

Chart 4: APAC market ACV



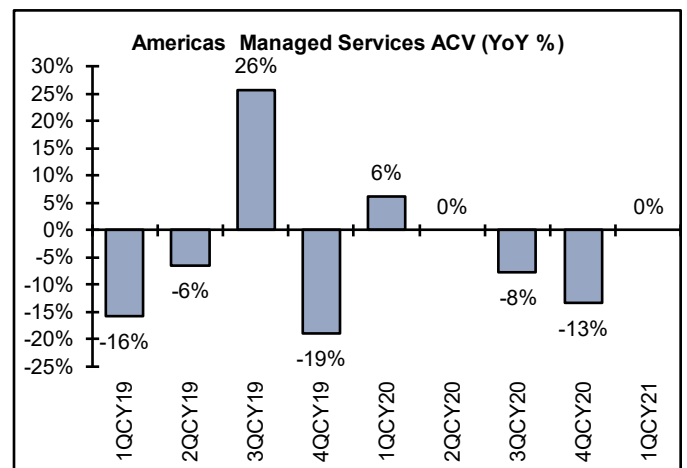
Source: ISG, I-Sec research

Chart 5: As-A-Service in Americas



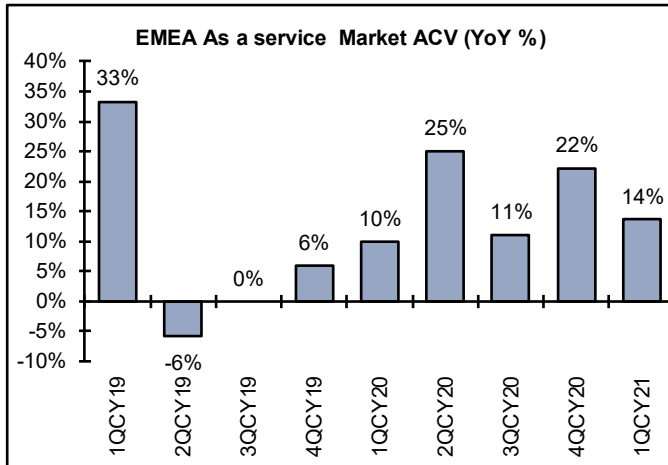
Source: ISG, I-Sec research

Chart 6: Managed Services in Americas



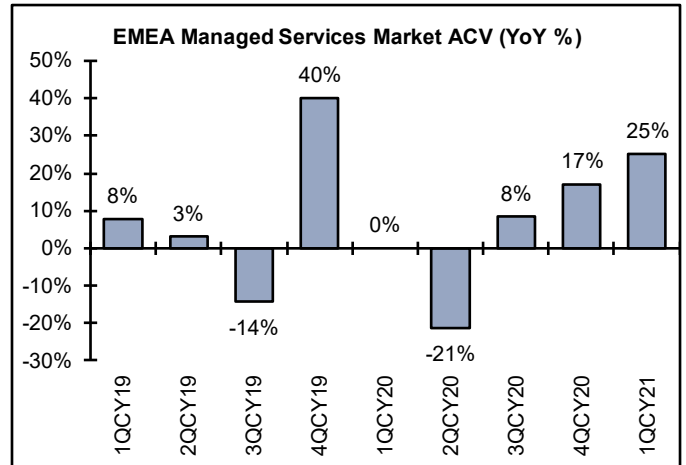
Source: ISG, I-Sec research

Chart 7: As-A-Service in EMEA



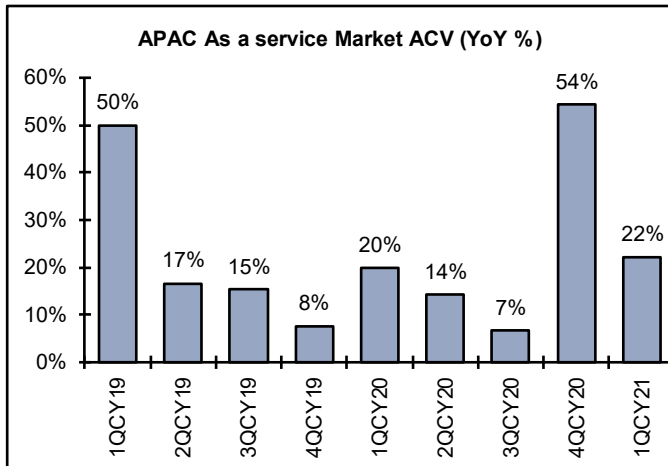
Source: ISG, I-Sec research

Chart 8: Managed Services in EMEA



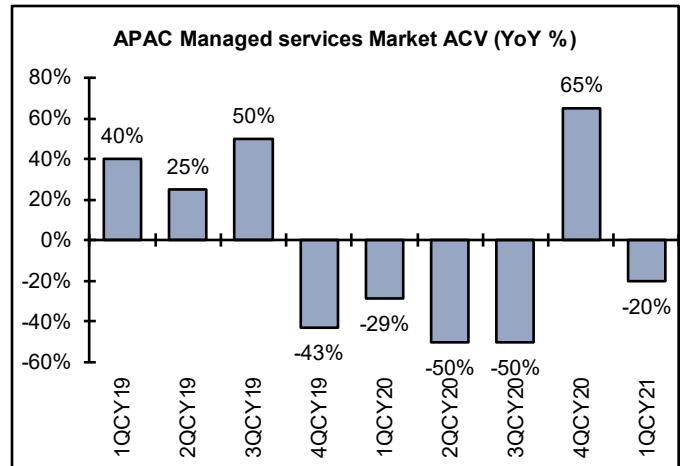
Source: ISG, I-Sec research

Chart 9: As-A-Service in APAC



Source: ISG, I-Sec research

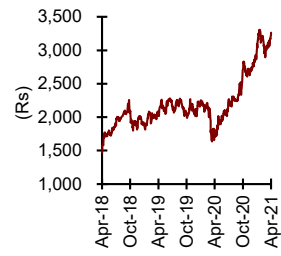
Chart 10: Managed Services in APAC



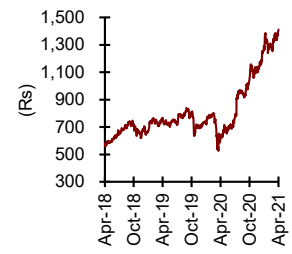
Source: ISG, I-Sec research

Price charts

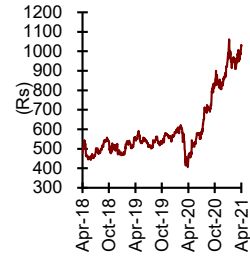
TCS



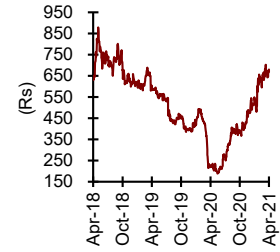
Infosys



HCL Technologies



Cyient



Source: Bloomberg

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