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IT SERVICES

10 October 2019

ISG Index call takeaways: Mixed signals for Q3CY19

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ISG Q3 Index reflects uptick in deal activity, return to double-digit growth…: ISG's global commercial annual contract value (ACV) for Q3CY19 stood at US$ 13.8bn, an increase of 13% YoY (vs. 5% YoY in Q2CY19), supported by a growth rebound in America and turnaround in managed services growth (formerly referred to as 'traditional sourcing'). America ACV rose 25% YoY backed by record high managed services deals. Q2 and Q3 America trends read together suggest that deal activity surged in the telecom (possibly led by AT&T deal) and travel & transportation verticals, while slackening in financial services and retail/CPG.

…but CY19 outlook toned down: ISG expects managed services (50% of 9MCY19 ACV) to grow 2.6% in CY19 vs. 3.6% forecast earlier on account of currency headwinds and likely topline weakness at a few of the large service providers. The growth outlook for 'software-as-a-service' (50% of 9MCY19 ACV) has been raised slightly to 22.2% from 22%.

Other highlights: (1) Digital as Default continues. About 48% of transactions awarded in Q3CY19 had digital-based scope vs. 38% in Q3CY18. Also, the size of digital-based contracts continues to trend up – 9MCY19 average ACV of digital-based awards stood at US$ 18.2mn, an increase of 14% YoY.

(2) Talent availability limits largescale insourcing but select few instances continue. The trend of 'IT getting closer to business' underpins the insourcing moves of clients. However, constrained (digital) talent availability and the disconnect between cost and capability limit large-scale insourcing.

(3) Incumbency not an advantage. As per ISG, 66% of managed service deal renewals underwent competitive renegotiations where incumbents lost some or all of the scope in 70% of such renegotiations. Moreover, the larger the deal size, the higher the risk of loss for incumbents.

Our view: While frequent revisions to the ISG index base make us cautious on data interpretation, the mixed signals from its Q3CY19 index are similar to those from recent industry newsflow. Challenges in traditional sourcing and opportunities in the digital field continue to shape demand trends for the IT services industry. We remain optimistic on the sector's long-term growth prospects, but see near-term headwinds from accelerating global trade tensions and flagging economic growth. We stay selective and prefer HCL Tech and TCS among large-caps and NIIT Tech and Mphasis among mid-caps.

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MPHL IN	909	1,150	BUY
MTCL IN	725	670	SELL
HEXW IN	356	390	ADD
PSYS IN	567	630	REDUCE
NITEC IN	1,362	1,550	BUY
ECLX IN	397	490	SELL

Price & Target in Rupees

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