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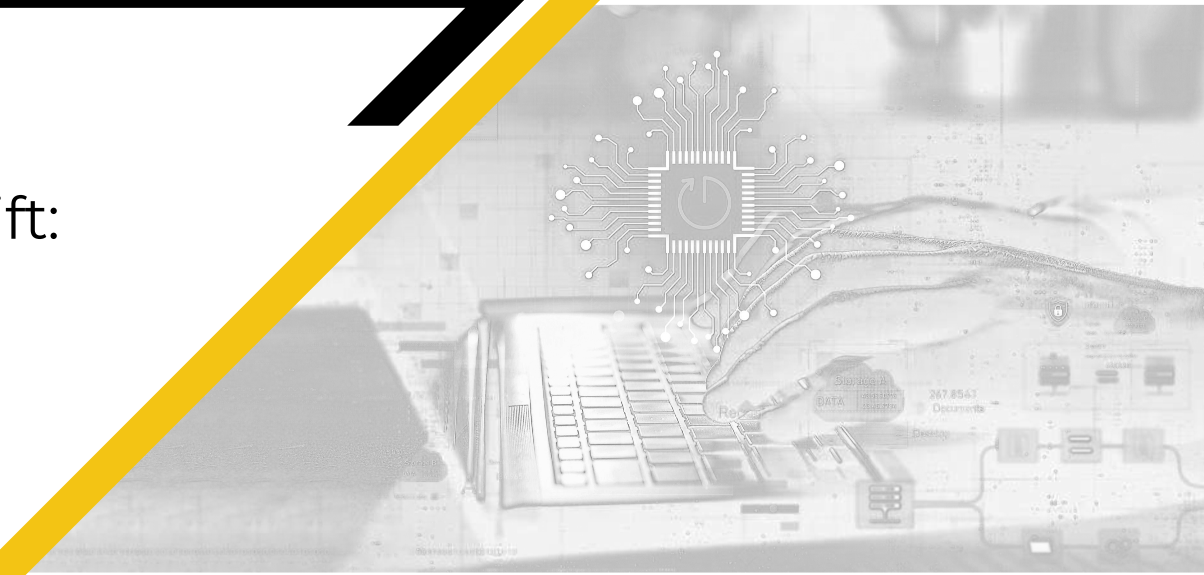

Ctrl+Alt+Shift: **Rebooting Indian IT**

India's IT sector continues to maintain its place of relative dominance primarily due to its ability to consistently adapt to technological disruptions, from the early outsourcing wave and Y2K preparedness to the more recent transitions into cloud and digital transformation. That legacy of adaptation continues today. However, the scale and scope of the shifts underway – driven by Artificial Intelligence (AI), automation, and changing business models – are redefining the sector landscape.

Unlike past transitions, today's shifts challenge the very structure of pricing, delivery, and growth, demanding not just adaptation, but reinvention. The sector stands at a critical juncture. Growth has moderated, legacy models are losing pricing power. Future winners will likely be those who can move swiftly up the value chain, building differentiated offerings in an increasingly commoditised space.

Structural Shifts in Motion

1 AI and Automation: From Efficiency to Differentiation

Recognising that AI and automation are the new frontiers of technology, Indian IT companies are pivoting toward AI-led efficiencies, AI-driven software development, and intelligent automation services. Inarguably, AI has now become a critical growth element not just for tech firms but across industries. Two parallel forces are at play:

Internal

Firms are leveraging AI to enhance productivity - achieving better output with fewer resources.

External

Client demand for intelligent solutions - such as predictive maintenance, advanced automation, and generative AI is rising sharply, making it imperative for IT companies to build and offer such capabilities/solutions.

Consequently, we are now observing the development of reusable AI platforms and high-margin, productised service models. These "service-as-a-software" solutions enable greater differentiation. While automation may reduce short-term revenue due to improved efficiency, it strategically positions firms to capture larger, long-term transformation deals and drive margin expansion.

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2 Talent and Capability: From Volume to Value

India has long maintained its position as the outsourcing hub for the global IT software/services industry, anchored by a skilled workforce available at lower cost. However, this historical advantage is being tested. The demand for quality talent—particularly in emerging domains like AI, cloud, cybersecurity, and data engineering—is driving up costs and widening the gap between available skills and market needs.

While India continues to invest in reskilling its core tech force, two imperatives require urgent attention:

I

Bridge the digital skill gap at scale to maintain global competitiveness.

II

Firms should accelerate efforts to skill and upskill talent in newer and niche technologies to stay ahead of the curve.

Without proactive investment in capability building, even large-cap IT firms risk being outpaced by more agile, specialised, niche players better aligned with future demand.

3 Commoditisation of Traditional IT Services: The Push to Differentiate

As technology evolves, some IT service offerings inevitably become commonplace, losing their distinctiveness and pricing power. This is now evident in the Indian IT landscape, where increasing availability of standardised technology, broader adoption of cloud computing, and rising competitive intensity are driving the commoditisation of traditional services such as infrastructure management, ERP implementation, and basic application support (Coding, testing).

Margins in these segments are under pressure, not only from peers but also from global consulting firms offering similar solutions at scale. In this environment, firms that remain reliant on legacy outsourcing models may face significant headwinds.

To stay competitive, Indian IT companies must evolve beyond transactional delivery models and move up the value chain. This means shifting focus towards:

Niche, high-value solutions

AI consulting and productised AI offerings

IP-led platforms and domain-specific services

Such offerings not only enable differentiation but also support sustainable margins in a rapidly commoditising market.

Short-Term View: A Lull, Not a Low

At the current juncture, growth in India's IT sector remains ambiguous. According to NASSCOM, the industry's revenue reached USD 254 billion in FY24, reflecting a muted 3.25% YoY growth—markedly lower than the 11% growth seen in the previous year. The subdued trend has persisted into 2025, prompting NASSCOM to revise its earlier revenue target of USD 350 billion by FY26, extending it to FY30. This reset reflects a CAGR of approximately 5.5% (excluding hardware) between 2025 and 2030.

Multiple headwinds are shaping this cautious outlook:

- Subdued global demand and slower decision cycles.
- Policy uncertainty in key export markets, notably the US and Europe.
- FX volatility and scrutiny around discretionary tech spending.
- Erosion of pricing power and heightened scrutiny around discretionary tech spending.

Despite this, the opportunity set has not vanished - it has simply shifted. Companies that realign their capabilities toward AI, cloud-native services, and differentiated, value-led consulting may still find room to grow. In particular, mid-cap players with sharper focus and execution agility appear relatively well-positioned to navigate this recalibrated landscape.

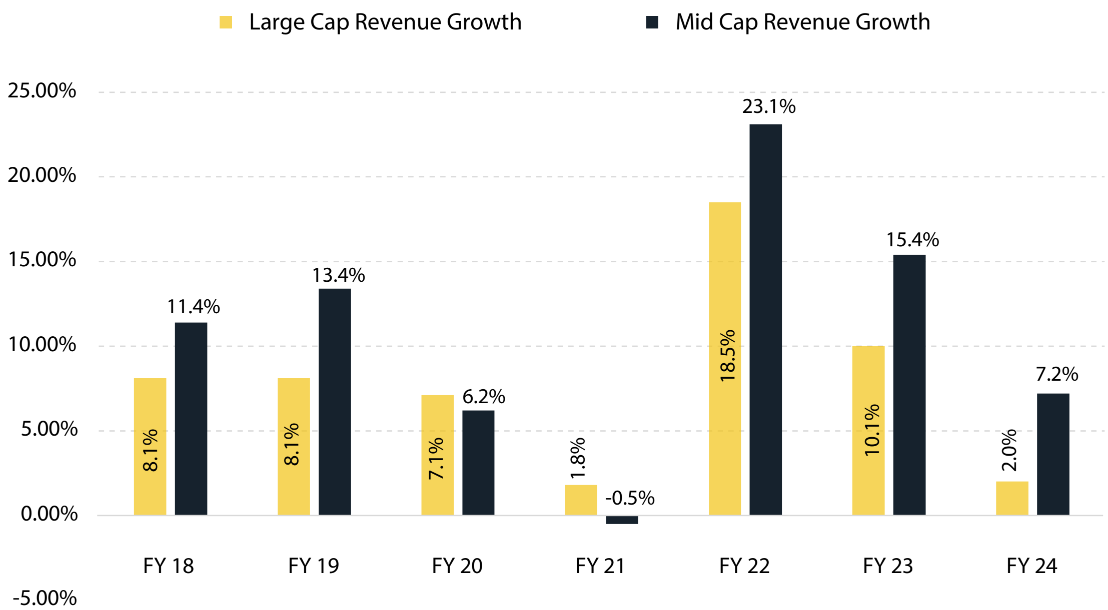
Implications for Investors

While near-term growth may remain subdued, this transition is setting up a wide divergence between legacy-heavy firms and those building scalable, IP-led or platform-based models. At the current juncture, a combination of selective growth oriented mid-caps and some well-positioned large-caps, especially those with niche strengths in specific themes like AI, Cloud, product designing, ER&D, etc., can offer both stability and long-term growth. Further, actively managed funds (IT sector-focused) with a differentiated positioning vis-à-vis the passive index could be considered for portfolio exposure.

As the Indian IT sector undergoes recalibration, selectivity will be key. Investors must look beyond surface-level growth rates and evaluate firms on their ability to embed AI capabilities, build differentiated IP, and attract next-gen tech talent. The decade ahead may reward those willing to back reinvention, not just resilience.

Exhibit: Performance of mid-cap IT companies vs large-cap IT companies

Mid-cap IT: Sustained outperformance even during growth moderation



Source: Web sources and Multi-Act research

Exhibit: Share of revenue shift across various players

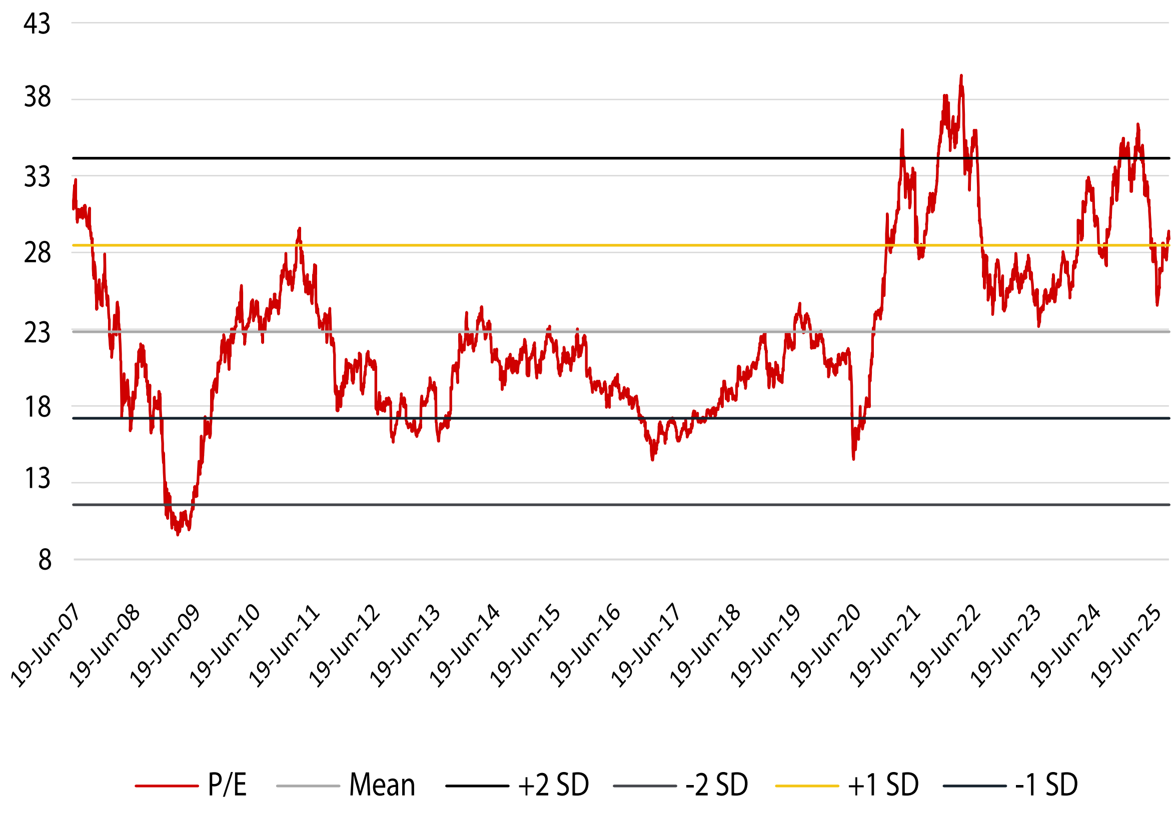
Specialised service areas gaining share from traditional delivery

Share shift across various players. Revenue as a % of Tier -1 total

(%)	FY14	FY20	FY25
Tier-2	6.8	6.9	8.4
Accenture - Total	81.4	73.8	79.9
Accenture - Managed services	38.1	32.5	39.1

Source: Web sources and Multi-Act research

Exhibit: Nifty IT PE



Source: NSE & Multi-Act research

Q&A

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Within the IT sector, what is your view on the growth prospects of mid-caps vs large-caps?

Over the last seven years, mid-cap IT companies have consistently outpaced large-caps in revenue growth, recording a median growth of 11.4% versus 8.1%. This performance can be attributed to their greater agility in adopting emerging technologies and focus on specialised areas. Such specialisation has enabled faster market share capture within niche segments. Even during periods of macroeconomic uncertainty, mid-caps have demonstrated relative resilience. For instance, in FY24, mid-caps recorded a YoY revenue growth of 7.2%, while large-caps delivered just 2%.

Despite an increase in the size of the opportunity, do you think that competitive intensity is likely to increase?

Competitive intensity is likely to remain elevated across both Consulting and IT service players. Tier-2 firms, in particular, have made meaningful strides - broadening capabilities across verticals and geographies, enhancing sales effectiveness, and aligning leadership incentives to growth outcomes. Many now offer more personalised client experiences, often with senior-level access that is harder to secure with Tier-1 firms. With several having crossed the US$1 billion revenue threshold, these players are now pursuing ambitious growth targets—doubling revenues in 4–5 years through both organic and inorganic means, raising the bar across the board.

How should investors position themselves in the sector, in context of recent sector underperformance?

The Nifty IT Index declined ~16% in the last quarter (March 2025), primarily due to external overhangs such as US policy uncertainty and muted growth. While cost pressures and competitive intensity persist, valuations have become more reasonable. After breaching +2 standard deviations from the mean during the 2021–22 cycle, the Nifty IT Index P/E is now correcting towards long-term average levels.

Given this backdrop, investors may consider positioning themselves in line with the sector's index weight for now, with the flexibility to add further as sector valuations become more attractive. Selective exposure to quality IT firms—especially those with scalable platforms, domain-led differentiation, and agility in adapting to emerging themes like AI, cloud, and productisation—can offer a blend of stability and long-term growth. Actively managed IT-focused funds with a differentiated strategy versus the passive index may also merit consideration.

Statutory Disclosure and Disclaimer:

Statutory Disclosure: Portfolio Manager – Multi-Act Equity Consultancy Private Limited (Registration No. INP000002965)

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