

IT Services

ISG 2QCY24 KTAs: Hopes and fears

ISG, a technology advisory firm, in its 2QCY24 conference call, confirmed recent demand trends while raising few concerns. Overall contracting activity (measured in ACV terms) ticked up (+7% YoY). Although the internals were not as encouraging. Cloud spend (IaaS up 15% YoY), led by Hyperscalers, drove overall ACV. Managed Services ACV – more relevant for India IT – was however flattish, dragged by BFSI. Standalone ADM declined, underlining sustained pressure on discretionary spend. USD 500mn decline in mega deals value (same count) could signal rising pricing pressure. HCL's recent comment around players' irrational pricing behaviour and TCS' remark around sporadic instances of pricing aberration point in that direction. ISG expects genAI to drive up to 30% cost reduction in ADM/IMS service delivery. HCL, in its latest earnings call, indicated potential 10-50% cost reduction across service lines. If realised, this could prove significantly deflationary for GSI's revenues. While genAI led volume deflation is here and now, incremental work (cloud migration, data readiness) is still at an exploratory stage. That could be a concern. Reduction in managed services' growth expectation (from 3% to 2%) indicate a still soft demand environment.

- Overall ACV trends:** Combined market ACV for the quarter stood at USD 24.8 bn up 7% YoY. Growth was led by As-a-service (XaaS) growth which was up 11% YoY. Cloud ACV was up 11% YoY, with most of the growth coming from infrastructure-as-a-service, while SaaS bookings were up just 2% YY. Managed services was up 1% both QoQ and YoY. Mega deals value shrunk by USD 500mn, down 28%. Restructuring reduced 5% whereas New scope rose 5%. These could merely be quarterly fluctuations.
- Managed Services trends:** Managed Services ACV was USD 10.1bn (+1% YoY). This has stagnated around USD 10bn mark over the past 5 quarters. Among Geos, decline in EMEA (-9%) was offset by pick-up in APAC (+27%). APAC momentum confirms positive trends seen in ACN's Growth markets as well as TCS' Regional markets. Among service lines, ITO was up 5% YoY while BPO declined 25% YoY. In ITO, standalone ADM saw a decline while ADM bundled with Infra saw a rise of 57%. BPO ACV decline was primarily due to AI based disruption and companies delaying awards in anticipation of AI-led cost savings. Within BPO, customer engagement related BPO declined 36% (1H24 vs 1H23).
- As a Service trends:** As a Service ACV grew 11% YoY. This was the second consecutive quarter of double digit growth. This was led by 15% growth in Infrastructure-as-a-Service (IaaS). Top-3 Hyperscalers, which constitute 75% of IaaS ACV, grew 30% driving IaaS demand. ISG's buying behaviour data indicates 50% of enterprises plan to renew or expand current cloud infrastructure over the next 12 months, indicating a possible end of cloud optimization cycle. AI is also helping. SaaS growth was however muted (+2%), as budget constraint and technical debt is impacting adoption. This is in-line with our recent observations ([An intriguing slope of optimism](#), 4 June 2024).
- Industry-wise trends:** BFSI sector, which forms 25% of the market, remains under pressure. The weakness, which was isolated to Americas till now, spilled to EMEA also. Certain sectors however have performed well. Healthcare has been strong of late. PSYS' large deal win a few quarters back and TCS's healthy growth in HLS in 1QFY25 are other evidences. Manufacturing and Telecom also did well. This is in contrast to decline in Telecom reported by TCS and some concerns around Auto OEMs raised by HCL.
- Gen AI – boom or gloom:** Enterprises are experimenting with revenue generating POCs in genAI. ISG estimates that AI work as % of revenue stands at 2.5% for companies that report AI-related numbers, and grew by 61% (TTM QoQ). AI growth might therefore be masking underlying weakness in IT services. ISG expects AI related revenues to reach to 5-10% eventually from current 2.5%. Importantly, **ISG sees cost reductions up to 30% due to GenAI on ADM and IMS projects.** Gen AI project implementation however will likely be affected by budgets constraints as well as technical debt. Companies need to modernise systems and clean data foundation for implementation of AI solutions. Those, when commence, will offset deflationary impact of genAI-driven cost reduction.



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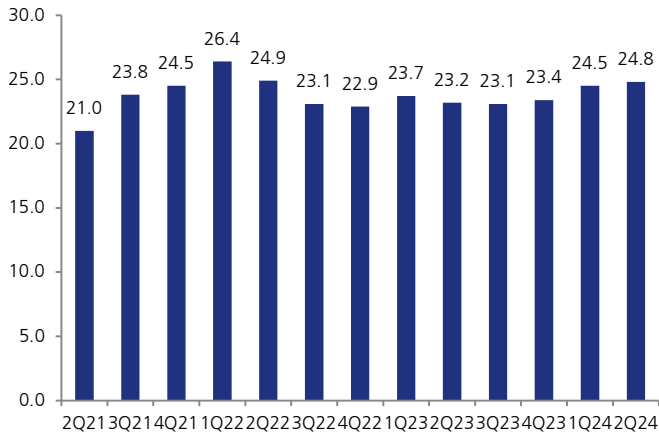
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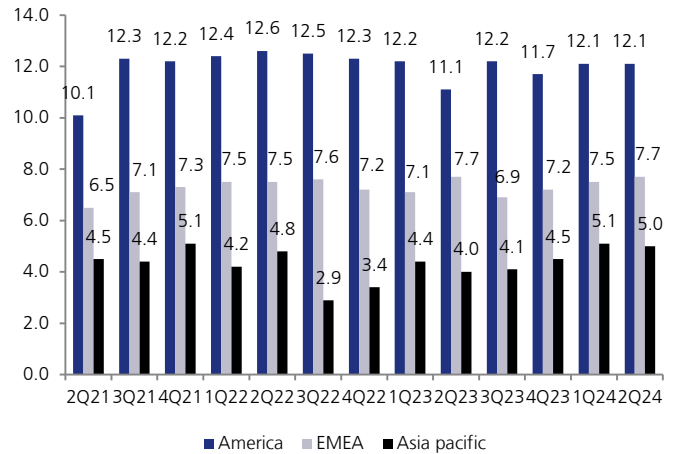
Key Charts

Exhibit 1. Overall contracting activity picked-up...
Global combined market trends – ACV (USD bn)



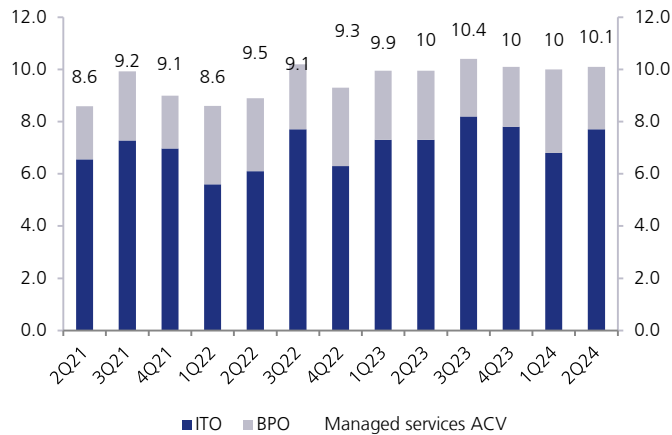
Source: ISG, JM Financial

Exhibit 2. ...led largely by Asia Pacific while Americas remain soft
Global combined market ACV, by geography (USD bn)



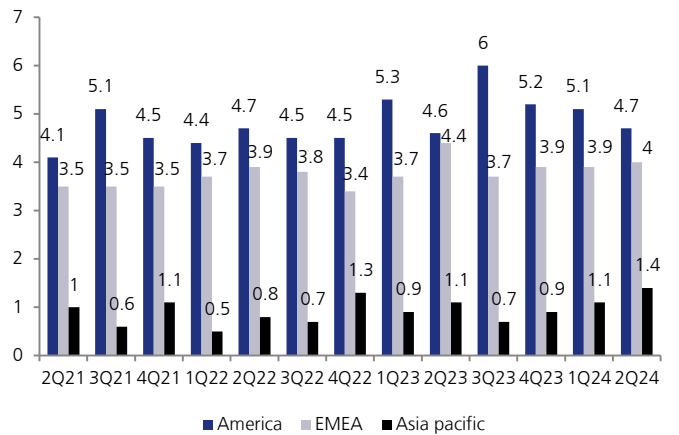
Source: ISG, JM Financial

Exhibit 3. Managed Services ACV has stagnated ...
Global Managed Services ACV (USD bn)



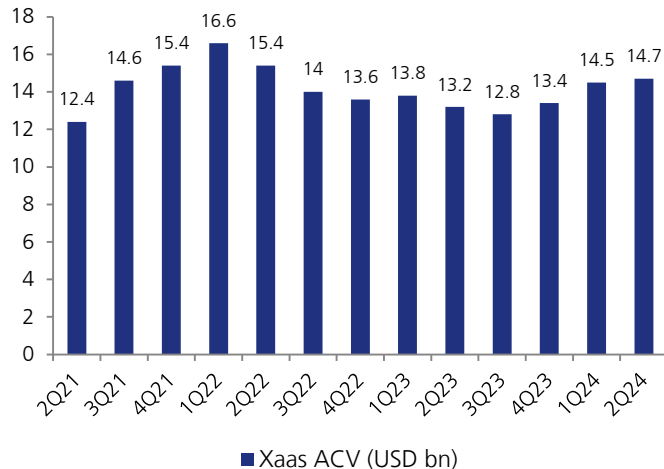
Source: ISG, JM Financial

Exhibit 4. ...led by softness in BFSI in Americas
Managed Services ACV, by geography (USD bn)



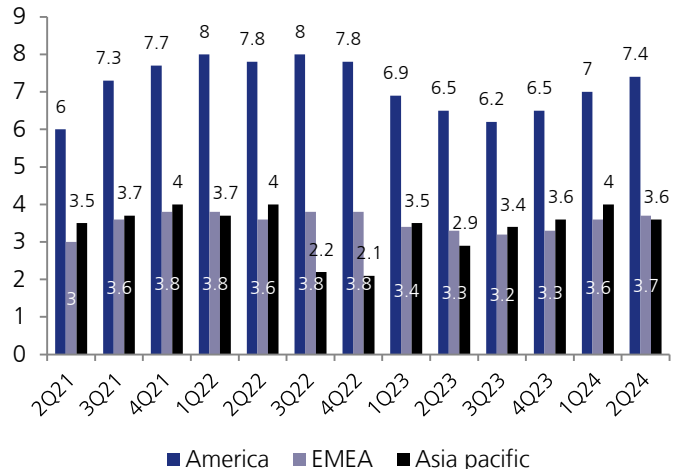
Source: ISG, JM Financial

Exhibit 5. Global As-a-Service ACV (USD bn)



Source: ISG, JM Financial

Exhibit 6. As-a-Service ACV, by geography (USD bn)



Source: ISG, JM Financial

APPENDIX I

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