

We engaged with IT professionals from Top Tier firms, including senior technology leaders and delivery heads, to understand the industry perspective on AI's potential impact. Building on industry perspective, AI is reshaping the IT services landscape; however, enterprise complexity, governance requirements and integration challenges are expected to moderate the pace of disruption.

- **Moderate Pricing Deflation:** With proactive GenAI adoption, pricing deflation in existing engagements is expected to remain limited at ~2–3%. Complex enterprise environments, legacy dependencies and integration challenges act as buffers against aggressive pricing compression.
- **Enterprise Complexity Limits Rapid Disruption:** AI adoption in large enterprises is structurally slower. Mission-critical systems often involve multi-decade architectures, strict compliance requirements and complex integrations, making system integrators essential for implementation and governance.
- **Capability Maturity Model Integration (CMMI) Level-5 firms may face AI-driven productivity pressure** as process-heavy tasks like coding, testing and maintenance become automated, challenging the traditional labour-arbitrage model. However, their strong process discipline, data assets, and enterprise trust enables scalable AI adoption. **Industries impacted: Aerospace, Defence, BFSI, HLS, Government IT Contracts and large enterprise software outsourcing.**
- **Data Security Remains a Key Constraint:** Several global enterprises remain cautious about sharing sensitive data due to security, privacy, and regulatory concerns. Since AI models rely heavily on data access, these restrictions may limit the pace and extent of AI-led disruption.
- **Human Oversight Remains Critical:** While AI will gradually introduce non-linearity in workforce structures, critical enterprise processes will still require human monitoring and decision-making by senior professionals to ensure accuracy, compliance, and accountability.
- **Overall, the sector is entering a structural transition, with winners defined by their shift to AI-enabled, outcome-led platform models where presently Mid-Caps are well positioned. Hence, our long-term investment ideas are COFORGE, PSYS, HAPPSTMN and KPITTECH.**

### Market Misconceptions vs. Industry Reality

Misconception	Industry Reality
AI will rapidly replace enterprise IT work	Enterprise adoption is structurally slower due to legacy complexity, security and integration challenges. System integrators remain essential.
AI can automate software development completely	Coding is only ~30% of SDLC. Architecture, integration, testing and deployment (~70%) require enterprise context and human judgement.
AI agents will replace IT vendors	Enterprises will deploy multiple AI agents across vendors. <b>Orchestration, governance and integration layers</b> will create new opportunities for IT services firms.
AI only reduces services demand	AI is creating <b>new service lines</b> , such as AI factories, data center infrastructure, AI governance and legacy modernization.
AI reduces relevance of IT services model	The model is evolving towards <b>platform-led delivery with proprietary AI tools and accelerators</b> , driving higher <b>revenue per employee</b> .
AI-led Job Disruption	Rather than complete job disruption, AI adoption would encourage re-skilling and learning new tools to stay relevant with evolving workflows.

### Mid-Caps in the Sweet Spot to Capture AI-Led Transition Cycle

**Agility Over Scale:**  
Leaner mid-caps retrain, reprice and redeploy faster than large-cap peers.

**Proven Share Gain:**  
Tier-II outgrew Tier-I in major past technology transition cycles.

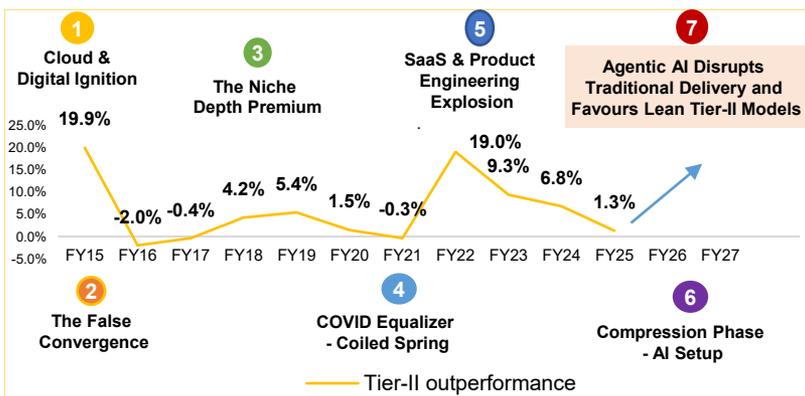
**Data Engineering Moat:**  
Better placed for AI adoption with Data Engineering & Platforms-based business models

**Faster Margin Recovery:**  
Tighter cost structures drive sharper operating leverage versus Tier-I peers.

**Diversification De-risks Earnings:**  
Broadening vertical mix reduces concentration risk; resilience improving across cycles.

**Valuation Gap Closed, Growth Intact:**  
Tier II valuation premium normalised post-correction; growth differential argues for improving relative risk-reward.

### Tier-II Firms Structurally Better Positioned Post Major Technology Transitions



- 1 Tier-II pivoted fully to cloud; Tier-I defended legacy on-prem revenues.
- 2 Tier-I deployed capital into digital acquisitions defensively. Tier-II absorbed FY15 hypergrowth
- 3 Tier-I had multiple vertical exposure, however, Tier-II enjoyed pricing moats with exposure in few verticals.
- 4 Macro freeze hit both; Tier-II rebounded leaner with pent-up demand.
- 5 VC-funded tech firms chose Tier-II's product engineering. Cloud-native builds at speed Tier-I could not replicate
- 6 Both prior troughs preceded the outperformance
- 7 **AI contracts favour Tier-II's lean, outcome-based pricing. Agentic AI reduces headcount needs, disrupting Tier-I model**

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<b>Large Cap*</b>	
BUY	The security is expected to generate upside of 15% or more over the next 12 months
ADD	The security is expected to show upside returns from 5% to less than 15% over the next 12 months
REDUCE	The security is expected to show upside or downside returns by 5% to -5% over the next 12 months
SELL	The security is expected to show downside of 5% or more over the next 12 months
<b>Mid &amp; Small Cap*</b>	
BUY	The security is expected to generate upside of 20% or more over the next 12 months
ADD	The security is expected to show upside returns from 5% to less than 20% over the next 12 months
REDUCE	The security is expected to show upside or downside returns by 5% to -10% over the next 12 months
SELL	The security is expected to show downside of 10% or more over the next 12 months
<b>Other Ratings</b>	
NOT RATED (NR)	The stock has no recommendation from the Analyst
UNDER REVIEW (UR)	The stock is under review by the Analyst and rating may change
<b>Sector View</b>	
POSITIVE (P)	Fundamentals of the sector look attractive over the next 12 months
NEUTRAL (N)	Fundamentals of the sector are expected to be in stasis over the next 12 months
CAUTIOUS (C)	Fundamentals of the sector are expected to be challenging over the next 12 months

\*Large Cap: More Than INR 20,000 Cr Market Cap  
\*Mid & Small Cap: Less Than INR 20,000 Cr Market Cap

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