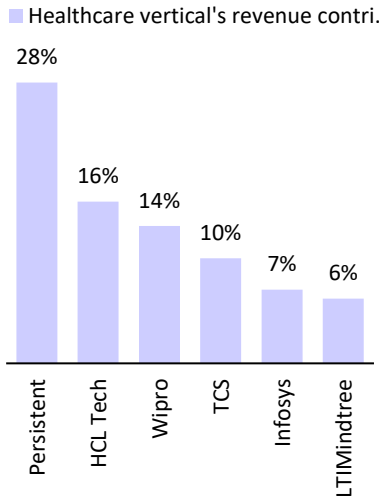


PSYS tops the revenue contribution from healthcare vertical



Healthcare vertical: A pause in the party?

The healthcare vertical has been the fastest-growing vertical and has done heavy lifting for growth in recent times. However, with the potential return of Mr. Donald Trump as US President and the prospect of new healthcare reforms, there could be some short-term uncertainty in healthcare spending. In this note, we explore how these potential changes might impact the healthcare sector and what it could mean for the vertical's growth trajectory. We also examine the implications for Indian IT companies with significant exposure to this sector, assessing how their performance might be influenced by the shifts in the US healthcare landscape.

US healthcare: Bracing for impact

- Mr. Trump's second term is likely to bring many changes to US healthcare policy, with a focus on repealing the Affordable Care Act (ACA), altering Medicaid funding mechanisms, and potentially reshaping drug pricing regulations.
- The healthcare industry is bracing for these shifts, indicating expectations of a more favorable environment for private insurers and Medicare Advantage plans.
- Mr. Trump's reelection is likely to have a mixed impact on providers and hospitals, which face challenges from reduced reimbursements and rising costs.
- The life sciences sector has a mixed outlook, with expedited FDA approvals boosting revenues but increased scrutiny on drug pricing pressuring margins.

Indian IT: Healthcare structurally strong, could have short-term snags

- Persistent Systems (PSYS) has the highest reliance on the healthcare vertical with 28% revenue contribution, followed by HCL Tech (16%) and Wipro (14%).
- PSYS has achieved impressive growth, averaging 51% YoY, in its healthcare vertical over the last four quarters on the back of the ramp-up of large deals. While this has to moderate going forward as the initial ramp-up recedes, we believe the company could continue to deliver growth as BFS and Hi-tech, its two other key verticals, recover in FY26.
- HCLT's healthcare vertical has been slightly erratic (down 4% QoQ in 1QFY25 followed by ~3% growth in 2QFY25), whereas for Wipro it has clocked an ~8.5% CAGR over the past two years, underscoring structural tailwinds in the sector.

Plotting the recovery: Healthcare ranks one

- As highlighted in our recent thematic report ([Bounce-Back! Charting the path to revival for the IT services](#)), we expect healthcare to be the fastest-growing vertical over the medium to long term due to neutral tailwinds from rate cuts, a low threat of insourcing, and stable spends backed by the need for investment in drug discovery, biotechnology and clinical trials.
- However, we would watch out for commentary on the vertical in the upcoming earnings season and a potential impact from the new administration in the US. While we expect growth to moderate in the short term, it should resume once policy clarity emerges in 1HCY25.

Mixed-bag impact on US healthcare vertical

- The reelection of Mr. Trump as US President will impact the healthcare sector, particularly regarding the ACA and broader healthcare policies. Here are key areas:
- The upcoming Trump administration is expected to repeal or replace the ACA, raising concerns over a drop in potential enrollments due to the expiration of enhanced subsidies. **Medicaid Changes:** There may be a shift toward block grant funding for Medicaid, which could reduce services and enrollment.
- **Medicare Advantage Focus:** There is likely to be a continued emphasis on Medicare Advantage plans, which have gained popularity. The administration may introduce incentives for beneficiaries while also facing scrutiny over practices related to these plans.
- **Drug Pricing Initiatives:** The Trump administration may seek to undo some of the Biden-era reforms aimed at controlling drug prices. These include potential rollbacks of regulations introduced by the Centers for Medicare & Medicaid Services (CMS), which could affect Medicare recipients' access to affordable medications.
- As seen in Exhibit 1, payers may see positive growth from increased enrollment in Association Health Plans and HSAs, despite potential margin pressures from deregulation.
- **Providers face a negative outlook due to reduced Medicaid and Medicare reimbursements and rising operational costs**, while hospitals are threatened by decreased federal support and higher uncompensated care costs.

Exhibit 1: Impact on revenues and profitability across sectors

Sector	Impact on Revenues	Impact on Profitability	Net Impact Rating
Payers	❖ Increased enrollment in Association Health Plans and short-term plans may boost revenue.	❖ Deregulation could lead to low premiums, potentially squeezing margins but allowing for more flexible pricing.	Positive
	❖ Potential for higher consumer engagement with HSAs could alter revenue dynamics positively.	❖ Risk of higher costs associated with managing risk and potential loss of ACA subsidies could offset gains.	
Providers	❖ Changes to Medicaid/Medicare could reduce volumes and reimbursement rates, hurting revenue.	❖ Increased operational costs due to regulatory changes may negatively affect profitability.	Negative
	❖ Focus on preventive care might shift service delivery models, potentially impacting revenue streams.	❖ Higher out-of-pocket costs for patients could lead to increased bad debt and reduced profitability.	
Hospitals	❖ Reduced federal support and changes in reimbursement models may lead to lower revenues.	❖ Financial stability threatened by rising operational burdens and increasing uncompensated care costs.	Negative
	❖ Potential increase in uninsured rates could further strain revenue from patient services.	❖ Profit margins may be squeezed due to decreased reimbursements from government programs.	
Life Sciences	❖ Potential for expedited FDA approvals may enhance revenue opportunities through faster market access.	❖ Increased scrutiny on drug pricing could pressure margins, requiring transparent pricing strategies.	Mixed
	❖ Domestic manufacturing incentives could lead to new contracts and partnerships, boosting revenues.	❖ Higher operational costs associated with reshoring production may impact overall profitability.	

Indian IT exposure to healthcare vertical

- PSYS has the highest reliance on the healthcare vertical, with 28% revenue contribution, followed by HCL Tech (16%) and Wipro (14%).
- PSYS has achieved impressive growth, averaging 51% YoY, in its healthcare vertical over the last four quarters on the back of the ramp-up in large deals. While this has to moderate going forward as the initial ramp-up moderates, we believe the company could continue to deliver growth as BFS and Hi-tech, its two other key verticals, recover in FY26.
- In the recent past, PSYS was able to more than offset the impact of a slowing vertical. As shown in Exhibit 3, a slowdown in the hi-tech vertical after 1QFY24 might have dragged down overall growth, but this was more than offset by blistering deal wins and ramp-ups in healthcare.
- Ironically, a slowing healthcare vertical this time could be offset by a recovery in hi-tech. We expect PSYS to be one of the fastest growing companies in our universe in FY26/FY27 with a CAGR of 18.8%.
- HCLT’s healthcare vertical has been slightly erratic (down 4% QoQ in 1QFY25, followed by ~3% growth in 2QFY25), whereas for Wipro it has clocked ~8.5% CAGR over the past two years, underscoring structural tailwinds in the sector.

Exhibit 2: PSYS has the highest revenue contribution from healthcare vertical

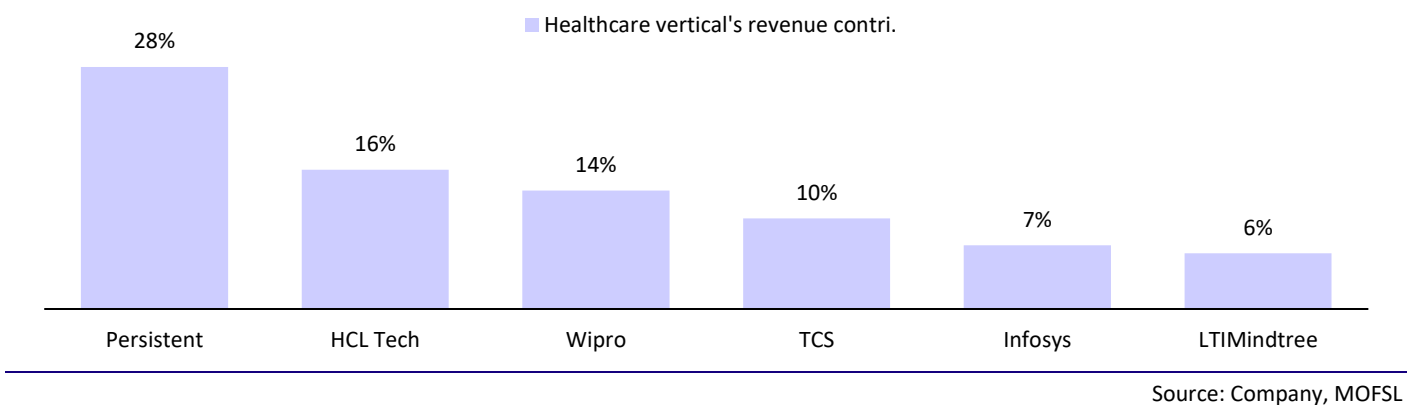


Exhibit 3: PSYS’s Healthcare and Life Science vertical has been offsetting the slowed Hi-tech growth

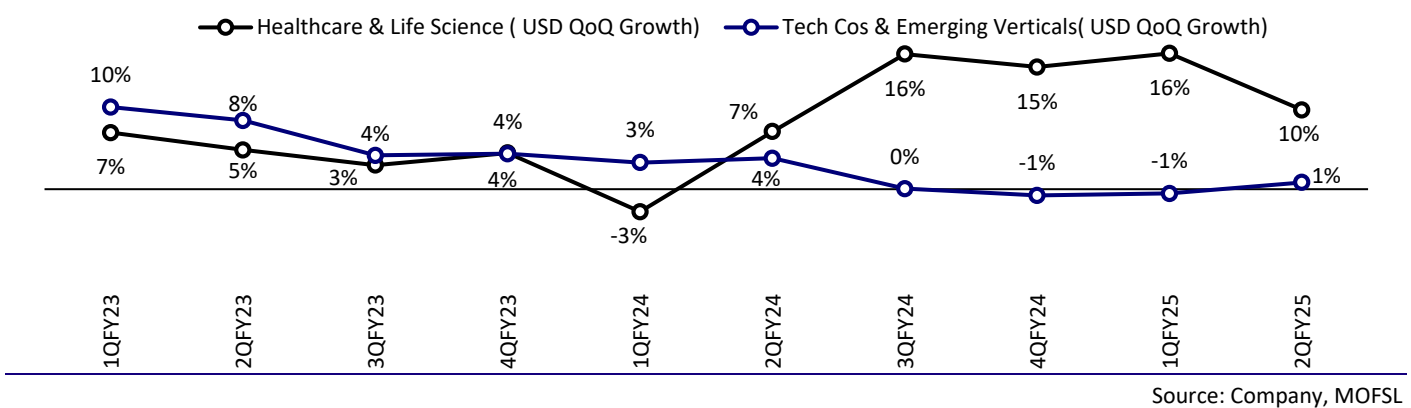
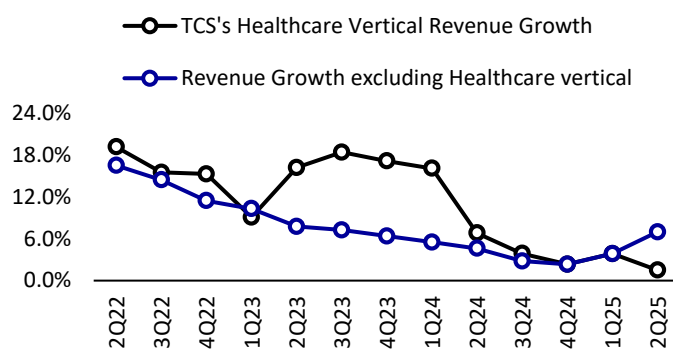
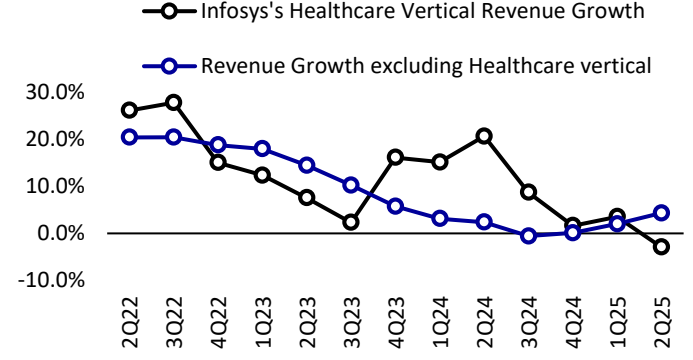


Exhibit 4: TCS' HC vertical outperformed revenue growth (ex. HC vertical) on an average...



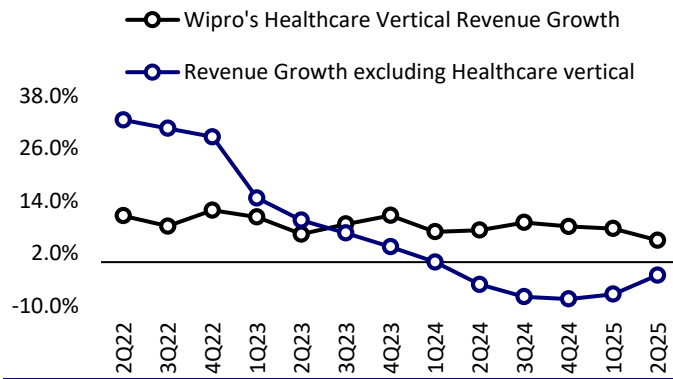
Source: Company, MOFSL

Exhibit 5: ...Infosys also follows a similar trend



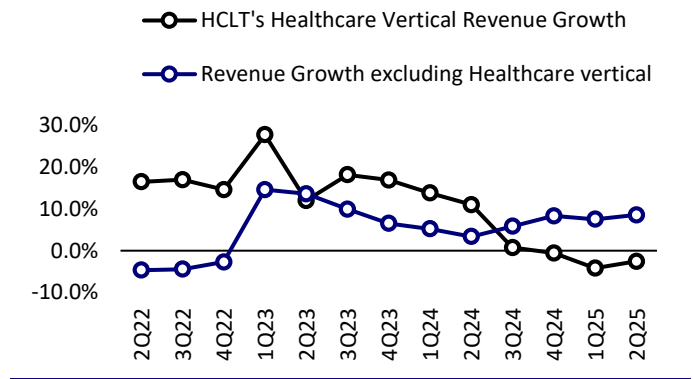
Source: Company, MOFSL

Exhibit 6: WPRO's healthcare vertical has maintained its growth trajectory across times



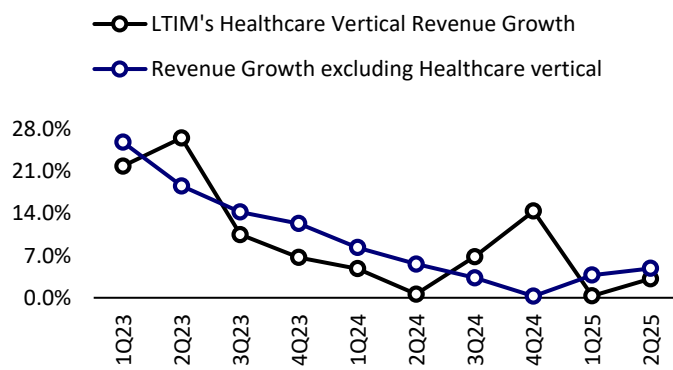
Source: Company, MOFSL

Exhibit 7: HCLT's healthcare vertical underperformed overall revenue growth recently



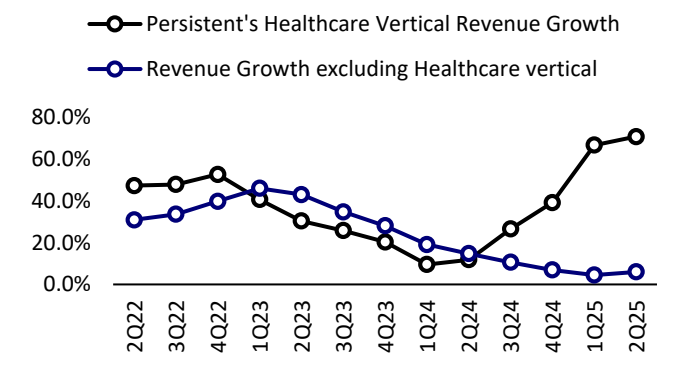
Source: Company, MOFSL

Exhibit 8: LTIM's healthcare vertical has grown in-line with revenue growth (ex. Healthcare vertical)



Source: Company, MOFSL

Exhibit 9: PSYS's healthcare vertical posted consistent growth owing to deal ramp up

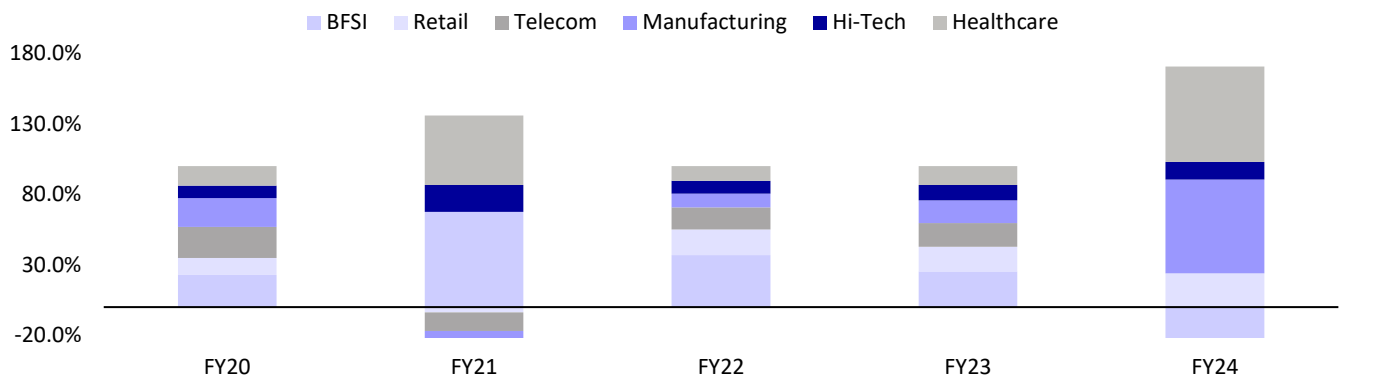


Source: Company, MOFSL

Healthcare: Long-term tailwinds, short-term snags

- As highlighted in our recent thematic report ([Bounce-Back! Charting the path to revival for the IT services](#)) published in Sep’24, we analyzed three key factors for recovery in sectors that Indian technology vendors are exposed to. The healthcare vertical emerged as a strong growth vertical, ranking first among these sectors.
- We dissected recovery based on tailwinds from US Fed rate cuts, insourcing threat (co-existence of GCCs and service integrators) and a boost from pre-GenAI investments.
- The rate cut cycle will be agnostic to healthcare technology spends – we believe outsourcing penetration remains relatively low and clients could continue to spend on digital transformation.
- The healthcare vertical also experiences a low threat of insourcing. Outsourcing penetration is low and there is a long runway of growth. Further, a lower adoption of GCCs in the vertical ensures low insourcing risk.
- With rising demand for innovative solutions in drug discovery, bio-technology and clinical trials, investments in technology will ensure spending momentum sustains.

Exhibit 10: Incremental revenue contribution by verticals (%) - top 5 players



Source: Company, MOFSL

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SELL	< - 10%
NEUTRAL	> - 10% to 15%
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