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IT firm margins will shrink on US local-hire pressure: Report

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Even as a strong dollar helps Indian IT services companies, their margins will continue to be under pressure as they are forced to hire locally in the US due to increased visa restrictions under the Trump administration.

Despite the currency benefit as well as use of operating levers, profitability has remained flat in FY2019 at 22.5 percent on account of higher onsite hiring and sub-contracting cost necessitated by visa curbs, pricing pressure, increased regulatory costs and wage inflation, according to a new study from ICRA.

USCIS issued 10 percent less H-1B visas (fresh and renewals) during FY2018 (October-September) at 3,35,000 compared to preceding year's 3,73,400. The recent amendment (implemented from April 1, 2019) by USCIS (United States Citizenship and Immigration Services) reversing the process for H1-B selection favouring advanced degree holders will have an adverse financial impact on the companies.

This will culminate in approximately 10 percent reduction in H1-B visa approvals for regular applicants (without advanced degree - master's or higher from US universities) which form major part of the H1-B visa requirements. This will lead to higher onsite hiring. The overall margins are estimated to decline from 22.5 percent in FY2019 to 21.5 percent in FY2020 for ICRA sample companies.

The share of fixed price contract improved to 55.2 percent in FY2019 (53.4 percent in FY2018) while employee utilisation levels remained flat for the sample companies — two critical factors associated with generating operational efficiencies.

Despite pressure on growth and margins, the credit profile of the companies is expected to remain stable underpinned by their ability to sustain free cash flows. The credit profile is also supported by net cash position with significant liquidity in the form of surplus investments generated out of past cash flows despite healthy dividend payout and share buybacks.

"Over the next decade, ICRA also expects consolidation in the industry especially among small and mid-size players as margin pressure will intensify leading to lower returns for shareholders. Geo-political issues restricting movement of skilled labour or increase in minimum salary requirement will have negative impact on the sector outlook," Gaurav Jain, Vice President - Corporate Ratings, ICRA, said.

Companies have reported higher deal wins during the preceding year while net employee addition has increased during the FY2019 across majority of sample companies, indicating a stable demand environment for the sector. The net employee additions show positive trend with approximately 1,13,787 additions during FY2019 compared to 11,600 during FY2018 and 93,500 in FY2017.

Among the sectors, banking and financial services continues to see some weakness led by current macro-economic conditions including low interest rates; continued focus on cost optimisation, managing their discretionary spends as well as insourcing by a few clients for want of greater control. Insurance vertical is supporting the overall growth for BFSI which contributes 30 per cent of the ICRA sample revenues.

Retail vertical grew healthy during FY2019 compared to flattish trend in FY2018 supported by improved consumer sentiments and higher discretionary brick mortar retail demand.