

March 26, 2026

Sound and Fury: The AI Question!

Sector Overview

The **Nifty IT index** has witnessed a sharp correction over the past few months, declining ~25% YTD, primarily driven by rising concerns around the potential impact of Generative AI (Gen AI) on the long-term business model of IT services companies, along with macro and geopolitical uncertainties. Large-cap and midcap IT stocks have corrected meaningfully despite relatively stable operating performance and continued deal wins, as investors reassess near-term growth visibility and the potential structural implications of AI on traditional services delivery models.

However, historical technology transitions such as ERP adoption, cloud migration and digital transformation cycles suggest that while new technologies may initially compress revenue growth, they eventually expand the total addressable market (TAM) for IT services companies.

Long term opportunity outweighs impact: Gen AI is expected to significantly improve productivity in software development and maintenance, potentially reducing the number of engineers required for certain tasks. **Industry commentary suggests that AI could lead to ~2-3% annual deflation in traditional services revenues for the next couple of years, as automation improves delivery efficiency & compresses effort-based pricing models.** On the other hand, **Industry estimates also suggest AI-led services could create an incremental TAM of USD300-400bn by 2030, representing a significant expansion relative to the current size USD 280 bn of the Indian IT services industry. It is also expected to create 170 mn jobs vs the 92 mn traditional jobs it displaces.** As a result, the sector may face near-term growth moderation but stronger structural opportunities over the medium term. **Thus, Gen AI is likely to reshape service delivery models but may also expand the overall technology services opportunity by accelerating automation and digital transformation initiatives.**

On earnings front, Accenture delivered a steady Q2 gaining market share with strong deal momentum, reflected in record bookings, of US\$22.1 billion. **Overall, for Indian IT, it is neutral, the read-through remains of a gradual recovery, with major rebound likely to be back-ended, execution-driven and dependent on scaling of AI use cases from pilots to enterprise-wide deployments.**

Valuation and Investment View

Following the sharp recent correction, most IT services stocks are now trading close to historically low valuation multiples, with market expectations already reflecting muted long-term growth assumptions. **However, given the evolving demand environment and recent market movements, we have revisited our estimates and investment calls incorporating updated assumptions around revenues (2-3% AI led revenue deflation in both FY27 & FY28), EBIT margins and EPS growth (Exhibit 4-7).**

Along with revising our revenue and EPS estimates, **we have also lowered our PE multiples (Exhibit 3) for the above stocks to reflect potential AI led revenue deflation and the delay/uncertainty in demand for traditional IT services.**

That said, these stocks are **currently trading at a steep discount to their 5-year average 1 year forward PE multiples (Exhibit 8),** offering valuation comfort at current levels with limited downside risk.

Our top picks in the sector includes Persistent Systems which is showing early monetisation traction in AI-led programs; **LTM (erstwhile LTIMindtree)** which has already absorbed productivity benefit passthrough and demand softness from a key client, potentially derisking future growth, and, **TCS** which is accelerating AI based investments/ capex to defend market leadership. **We believe that staggered investments (over the next couple of months) in the selected IT stocks will yield strong returns over the next 18-24 months.**

Sector view: Neutral

Company	Rating	TP	Upside
TCS	BUY	3,140	32%
Infosys	HOLD	1,400	9%
HCLTech	HOLD	1,500	9%
TechM	BUY	1,650	17%
LTM	BUY	5,200	21%
Coforge	BUY	1,350	16%
Persistent Systems	BUY	5,750	17%
Mphasis	BUY	2,550	20%

- Along with revenue and EPS estimate revision, we have revised our PE multiples downwards to factor in the AI led deflation and the delay/uncertainty of revenues from traditional IT services.
- Moreover, the stocks are trading at a steep discount to their 5 year average one year forward PEs, giving valuation comfort at this juncture with limited downside risk.
- The recent correction has largely been sentiment driven, reflecting investor concerns that AI-led automation could significantly reduce demand for traditional services such as coding, application development and maintenance (ADM), and legacy modernisation — areas that have historically generated significant revenue for offshore IT services vendors.

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Addressing key investor questions:**Q1. What is driving the recent correction in Indian IT stocks?**

The correction is primarily driven by rising concerns around Gen AI-led disruption, alongside macro headwinds and valuation reset. Frequent announcements from AI platform companies such as Anthropic, OpenAI and Palantir highlighting capabilities that automate complex tasks historically performed by IT services firms. These include AI tools capable of automating contract review in legal workflows, identifying software vulnerabilities in cybersecurity, accelerating ERP migrations (ECC to SAP S/4), and modernising legacy code such as COBOL. **Such developments have intensified concerns that AI could materially reduce human effort requirements in IT services, triggering debates around the future relevance of traditional outsourcing models.** Each such announcement has led to sharp reactions in IT stocks – both global & domestic, reinforcing the narrative that Gen AI could structurally disrupt the industry.

Q2. Why is Gen AI perceived as a structural risk to the traditional IT services model?

Gen AI is expected to significantly improve productivity in software development and maintenance, potentially reducing the number of engineers required for certain tasks. **Industry commentary suggests that AI could lead to ~2–3% annual deflation in traditional services revenues for the next couple of years, as automation improves delivery efficiency & compresses effort-based pricing models.** This dynamic has led to investor concerns that the traditional FTE-driven revenue model of IT services companies may face structural pressure over time.

Q3. What does “deflation without demand offset” imply for the sector?

In the near term, the sector may experience a phase where productivity gains from AI reduce revenue growth without an equivalent increase in new demand. While companies are repositioning themselves as AI-led transformation partners, the market remains cautious about the potential for near-term revenue cannibalization before new AI opportunities scale up. Thus, **this creates a transient phase where efficiency-led revenue compression precedes the scaling of new AI opportunities resulting in the initial phase of Gen-AI adoption to be deflationary,** contributing to the current correction in sector valuations.

Q4. To what extent are macro and global factors contributing to the correction?

External factors have exacerbated the correction. Weakness in global technology and SaaS stocks has also weighed on sentiment toward Indian IT services companies. **Investors have thus, recalibrated valuation expectations amid slower growth and potential structural shifts in enterprise technology spending, resulting in a meaningful derating of IT stocks despite their relatively resilient balance sheets and strong cash generation.** Moreover, a prolonged US-Iran conflict could lead to Federal Reserve holding interest rates higher for longer, and delaying planned cuts until 2027, thereby delaying consumer spending, is also risk factor.

Q5. Why do we believe the long-term opportunity for Indian IT remains intact?

The Indian IT industry has **historically navigated multiple technological transitions, from ERP implementations to cloud and digital transformation, and has emerged stronger each time.** We believe the current AI disruption represents another such inflection point rather than an existential threat to the services model. **Enterprises adopting AI solutions will still require someone to customise, implement and manage these technologies within complex enterprise environments – roles that Indian IT services firms are well positioned to fulfil.**

Q6. Does AI expand or shrink the overall opportunity for IT services?

While AI may initially compress certain services and job roles, it is also expected to significantly expand the overall technology services opportunity. **Industry estimates suggest AI-led services could create an incremental TAM of USD300–400bn by 2030, representing a significant expansion relative to the current size ~USD 280 bn of the Indian IT services industry. It is also expected to create 170 mn jobs vs the 92 mn traditional jobs it displaces (Exhibit 1).** This suggests that

the current disruption could ultimately lead to larger long-term growth opportunities for IT services vendors.

Exhibit 1: Incremental TAM and jobs to be created from GenAI in the long-term



AI will cause an estimated 2–3% annual deflation across services — something the company has already modelled — it also opens up a massive new growth opportunity. It's 4% [AI] now and I think it can be a very powerful growth driver. It has grown 20% quarter on quarter, and we think it can get to USD2.5-3bn, much more than offsetting some of the decline that can happen in the existing business.

- C Vijayakumar, CEO, HCLTech

Q7. Will AI platforms displace IT services companies or work alongside them?

A partnership model is more likely. Rather than replacing IT services companies, **AI platform providers are increasingly expected to rely on them as implementation partners.** Enterprise adoption & deployment of AI requires integration with legacy systems, data governance frameworks and enterprise workflows, areas where IT services firms play a critical role. This mirrors previous technology cycles where product companies relied heavily on system integrators for enterprise-scale deployment, reinforcing the continued relevance of IT services players.

Q8. How should investors think about the timing of AI-driven opportunities?

Enterprise adoption of Gen AI is expected to follow a phased curve rather than a sudden disruption. **Gen AI adoption is expected to accelerate significantly after 1–2 years during which the technology shall be used for experimentation, pilot programs, and ROI validation. Consequently, the benefits of AI-led services opportunities are likely to be back-ended, with the sector experiencing near-term disruption before entering a stronger growth phase as adoption scales.**

Q9. What are the key phases of AI impact on the IT services sector?

The net impact of AI on IT services is expected to play out in two phases in our view:

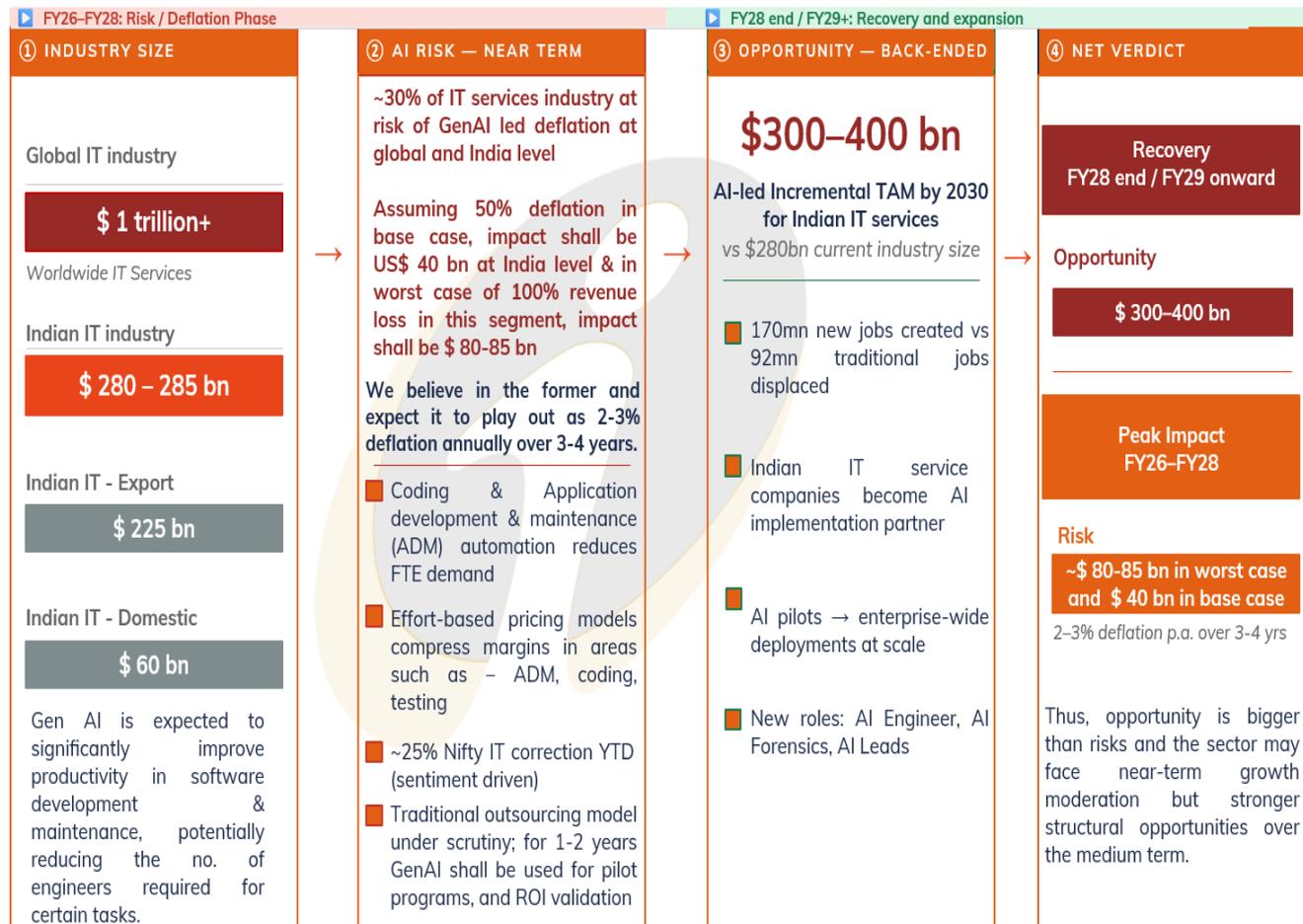
Stage 1: Deflationary Phase: Automation improves productivity and reduces service effort requirements, resulting in revenue compression before new demand emerges, coupled with lower need for additional manpower.

Stage 2: Expansion Phase: As enterprises accelerate AI adoption and transformation initiatives, the expansion in TAM and higher-value services begins to offset the earlier deflationary impact.

Q10. What is our overall investment view on the sector?

The sector is likely to face near-term growth moderation driven by AI-led disruption and macro uncertainty. However, structurally, Gen AI is expected to expand the technology services opportunity meaningfully over the medium term by accelerating automation and digital transformation initiatives. The current phase should be viewed as a transition, where deflationary pressures precede a broader expansion cycle. Over time, companies that successfully reposition themselves as AI-led transformation partners are likely to emerge as long-term beneficiaries of a significantly larger and evolving market (Exhibit 2).

Exhibit 2: Indian IT Industry and GenAI: Front ended risks followed by massive back ended opportunities



Source: ICICI Direct Research | Infosys Investor Day PPT | Management commentary

Exhibit 3: Attractive valuation multiples as post correction most stocks trade near or below historical multiples

Company	Rating	Old TP	New TP	Old Multiple	New Multiple	CMP	Upside
TCS	BUY	3,780	3,140	23	20	2,377	32%
Infosys	HOLD	1,550	1,400	19	18	1,279	9%
HCLTech	HOLD	1,650	1,500	20	19	1,381	9%
TechM	BUY	2,000	1,650	23	20	1,408	17%
LTM	BUY	7,400	5,200	30	22	4,293	21%
Coforge	BUY	1,980	1,350	32	22	1,163	16%
Persistent Systems	BUY	7,200	5,750	41	35	4,928	17%
Mphasis	BUY	3,250	2,550	24	20	2,132	20%

Source: ICICI Direct Research

Exhibit 4: Change in absolute revenue estimates

Company	USD Revenue (in mn)					
	Old		New		Change (%)	
	FY27	FY28	FY27	FY28	FY27	FY28
TCS	31,588	33,638	31,163	32,736	-1%	-3%
Infosys	21,220	22,610	21,119	22,085	0%	-2%
HCLTech	15,645	16,818	15,564	16,576	-1%	-1%
TechM	6,831	7,312	6,767	7,165	-1%	-2%
LTM	5,237	5,771	5,180	5,635	-1%	-2%
Coforge	2,117	2,360	2,104	2,314	-1%	-2%
Persistent Systems	1,961	2,292	1,910	2,202	-3%	-4%
Mphasis	1,983	2,200	1,928	2,095	-3%	-5%

Source: ICICI Direct Research

Exhibit 5: Change in revenue growth estimates

Company	USD Revenue YoY growth (%)			
	Old		New	
	FY27	FY28	FY27	FY28
TCS	5.2	6.5	3.8	5.1
Infosys	5.0	6.5	4.5	4.6
HCLTech	6.5	7.5	6.0	6.5
TechM	6.7	7.0	5.7	5.9
LTM	9.6	10.2	8.5	8.8
Coforge	12.9	11.5	12.2	10.0
Persistent	18.2	16.9	15.4	15.3
Mphasis	12.2	11.6	9.5	9.3

Source: ICICI Direct Research

Exhibit 6: Change in EBIT margin estimates

Company	EBIT Margin (%)					
	Old		New		Change (bps)	
	FY27	FY28	FY27	FY28	FY27	FY28
TCS	25.2	25.4	24.9	25.0	-28 bps	-48 bps
Infosys	21.1	21.3	20.6	20.7	-50 bps	-65 bps
HCLTech	18.5	18.8	18.1	18.4	-38 bps	-43 bps
TechM	14.4	14.9	14.0	14.6	-40 bps	-30 bps
LTM	16.1	16.3	15.8	16.0	-30 bps	-30 bps
Coforge	13.7	14.1	13.7	14.1	0 bps	0 bps
Persistent Systems	16.5	16.7	16.2	16.2	-30 bps	-45 bps
Mphasis	16.0	16.5	16.0	16.3	0 bps	-20 bps

Source: ICICI Direct Research

Exhibit 7: Change in EPS estimates

Company	EPS (₹)					
	Old		New		Change (%)	
	FY27	FY28	FY27	FY28	FY27	FY28
TCS	152	164	148	157	-2%	-4%
Infosys	75	81	73	77	-3%	-5%
HCLTech	75	83	73	79	-3%	-4%
TechM	76	86	73	83	-4%	-4%
LTM	217	246	212	237	-3%	-4%
Coforge	53	62	53	61	-1%	-2%
Persistent Systems	147	175	141	164	-4%	-6%
Mphasis	118	135	116	128	-2%	-5%

Source: ICICI Direct Research

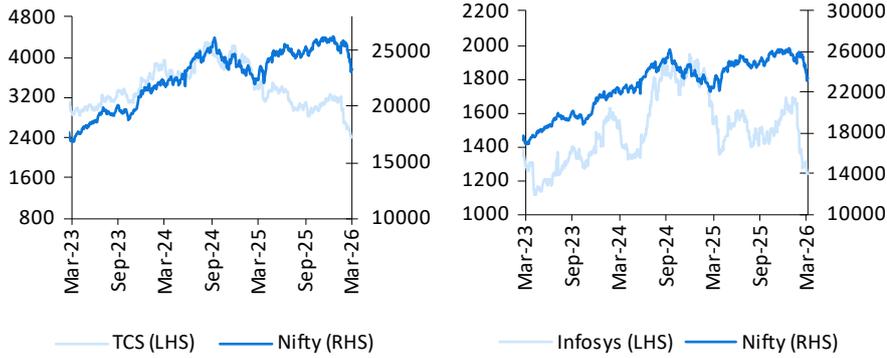
Exhibit 8: Valuations - Companies trading at a steep discount to its 5-year average

Company	Current 1 yr forward PE	5 yr avg 1 yr forward PE	Discount to 5 yr avg 1 yr forward PE
TCS	16	27	-41%
Infosys	18	23	-23%
HCLTech	19	23	-17%
TechM	19	28	-30%
LTM	20	31	-35%
Coforge	22	39	-43%
Persistent Systems	35	38	-9%
Mphasis	18	27	-31%

Source: ICICI Direct Research

Exhibit 9: TCS Price Chart

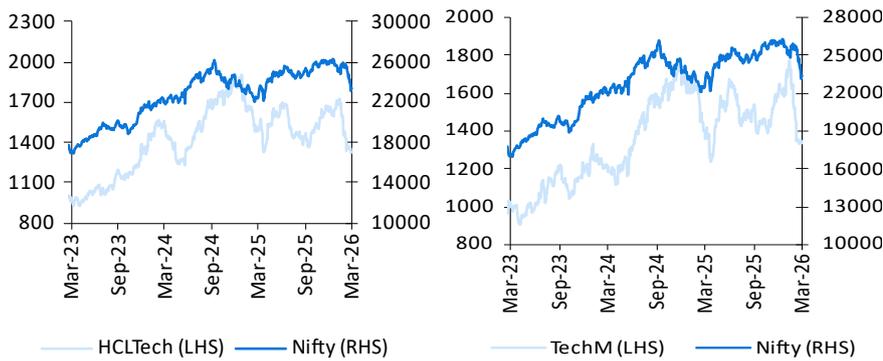
Infosys Price Chart



Source: ICICI Direct Research

Exhibit 10: HCLTech Price Chart

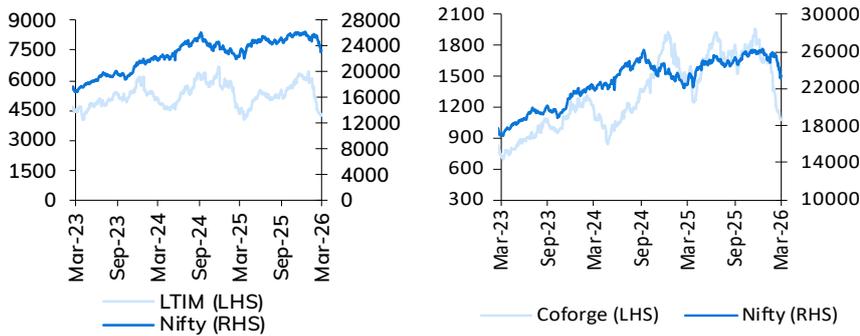
Tech Mahindra Price Chart



Source: ICICI Direct Research

Exhibit 11: LTI Mindtree Price Chart

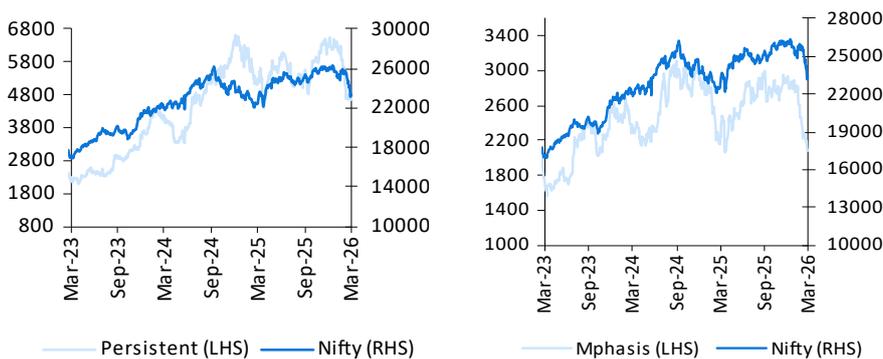
Coforge Price Chart



Source: ICICI Direct Research

Exhibit 12: Persistent Systems Price Chart

Mphasis Price Chart



Source: ICICI Direct Research

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