



Achintya Securities Limited

Deep Dive into the Indian IT Sector:

Trends and Future Drivers



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Introduction

The second quarter of Financial Year 2026 has marked a significant stabilization and cautious comeback for the Indian IT services industry, following a challenging period of Q1 characterized by subdued demand, project deferrals, and a focus on cost optimization by global clients due to recessionary risk specially in US and UK.

While the first quarter of FY26 saw the industry with issues like delayed wages and weak revenue, the Q2 results brought positive signs: more deals, better efficiency, and, most importantly, the start of earning money from Artificial Intelligence (AI).



Q2 FY26 Performance Highlights

Large-Cap Firms: Muted Sequential Growth

- **Revenue Outlook:** The top-tier firms (TCS, Infosys, HCL Tech, Wipro) experienced subdued sequential revenue growth, generally ranging from 0% to 5.10% quarter-on-quarter in constant currency. Analysts expect a full-year FY26 growth to remain modest, around 1-3%, with a potential recovery in FY27.
- **Strong Deal Momentum:** Despite soft near-term discretionary spending, firms reported robust large deal bookings and strong pipelines (e.g., TCS TCV of \$10 billion, Wipro at \$4.7 billion). This suggests clients are signing large, cost-takeout deals that include an AI component, with an expectation of future project ramp ups driving a better second half of FY26 and FY27.
- **Margins:** Operating margins showed slight improvement, primarily aided by favourable currency depreciation (INR/USD) and internal cost optimization efforts like tighter utilization and bench management.



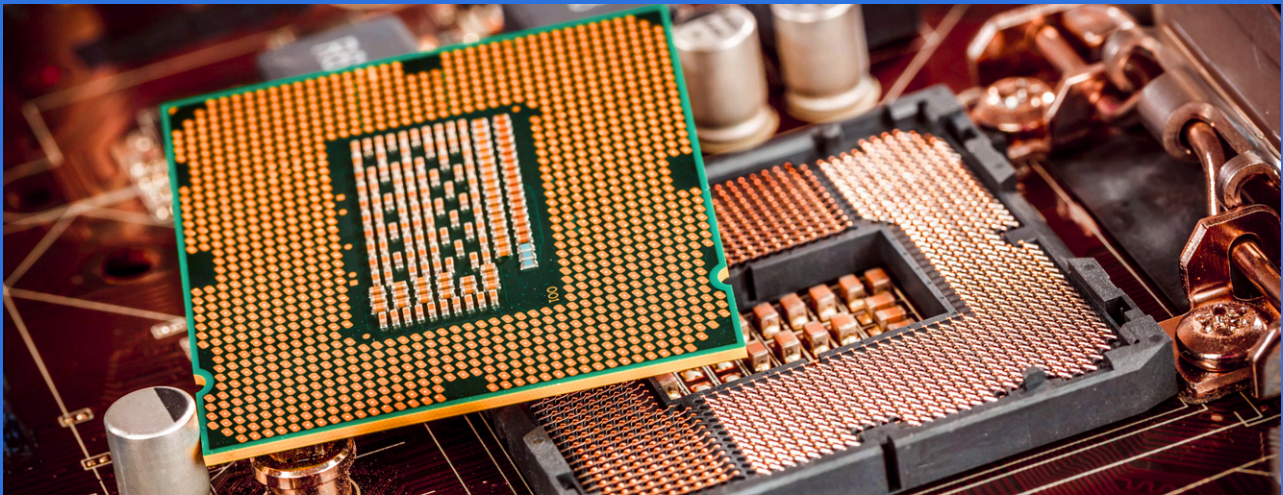
Mid-Tier Firms: The Agility Advantage

- **Outperformance:** Mid-tier firms like Persistent Systems, Coforge, and Mphasis have significantly outpaced their larger counterparts, leveraging their smaller scale and specialized focus in high-growth niches (e.g., healthcare, BFSI). The top 12 mid-tier firms are collectively projected to reach \$12 billion in annual revenue by Q2 FY26.
- **Decoupling Growth from Headcount:** A major trend is the decoupling of revenue growth from workforce addition. For example, in Q2 FY26, Persistent Systems saw a 23.6% YoY revenue rise with a minor 1.1% headcount increase. This non-linear growth is a direct result of embedding Generative AI and automation into their delivery models, significantly increasing revenue per employee.
- **Structural Advantage:** Their smaller scale and focus on specialized, niche services (like BFSI and Healthcare) often allow them to adopt new technologies faster and undertake more non-linear, platform-led, and IP-driven contracts.



Generative AI: The Core Structural Driver

GenAI is rapidly transforming the Indian IT delivery model, moving from a buzzword to a measurable factor in operational and financial performance.



- **Productivity Gains:** GenAI tools are projected to boost productivity across the sector by an estimated 15% to 20% in the near term, with even higher gains (up to 45-60%) projected for core areas like software development, BPO, and IT consulting over the next five years. This is enabling firms to achieve better revenue per employee.
- **Focus on Outcomes:** Client engagements are shifting from traditional time-and material models to outcome-based and platform-led services. Companies are now expected to disclose and quantify their "AI revenue" beyond just Proofs of Concept (PoCs). HCLTech, for example, became one of the first Indian firms to disclose over \$100 million in advanced AI revenue in a quarter. This is enabling firms to achieve better revenue per employee.
- **Deflationary Pressure and Investment:** While GenAI is a long-term growth driver, in the short term, it may exert a deflationary effect (2-3% over 2-3 years) on traditional deals as clients demand productivity pass throughs. Consequently, IT companies are reinvesting savings into training, upskilling, and building out new AI platforms and Intellectual Property (IP).

Geopolitical and Regulatory Headwinds

External factors, particularly from the US market, are intensifying the need for localization and new delivery models.

- **H-1B and Visa Reforms:** Recent proposed changes in the H-1B visa process and the introduction of legislation like the HIRE Act (which proposes a tax on companies using foreign labor) are increasing delivery-model risks.
- **Mitigation Strategy:** Indian IT firms are actively accelerating localization, nearshore capacity building (e.g., in Eastern Europe, Mexico), and expanding Global Capability Centres (GCCs) in India's Tier II cities (e.g., Vizag, Coimbatore, Nagpur) to reduce reliance on the traditional onshore-offshore model and mitigate regulatory uncertainties.
- **Talent Restructuring:** The sector is witnessing a workforce rationalization or restructuring, particularly at the middle and senior levels, as companies seek to realign their workforce with AI and platform-led delivery models. TCS's layoff announcement in Q2 FY26, affecting about 2% of its workforce, is a notable example of this strategic pivot towards becoming a "future-ready organization."



Forward View

The Q2 FY26 results underscore that the Indian IT sector is fundamentally sound but is undergoing a profound structural change. The coming quarters will be about:

- **AI Monetization:** The key differentiator will be the speed and effectiveness with which firms can move their GenAI expertise from pilot projects to large, measurable, and repeatable revenue streams, demonstrating true non-linear growth.



- **Portfolio Rebalancing:** Firms will continue to shed legacy and low-margin business (like the layoffs indicate) to aggressively invest in Cloud Modernization, Cybersecurity, and AI/ER&D (Engineering R&D)—the new high-growth verticals.
- **GCC and Talent War:** The expansion of GCCs in India and the push for nearshore delivery will create a new competition for specialized AI talent, making talent acquisition and retention a critical battleground for both Indian IT players and global captives.

This next phase is less about overall market growth and more about market share gains driven by superior operational efficiency and GenAI-led value creation.



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