

GLOBAL EMERGING MARKETS



SEPTEMBER 2024

For institutional investors in the US only

A RECIPE FOR SUCCESS?

IT services meets India



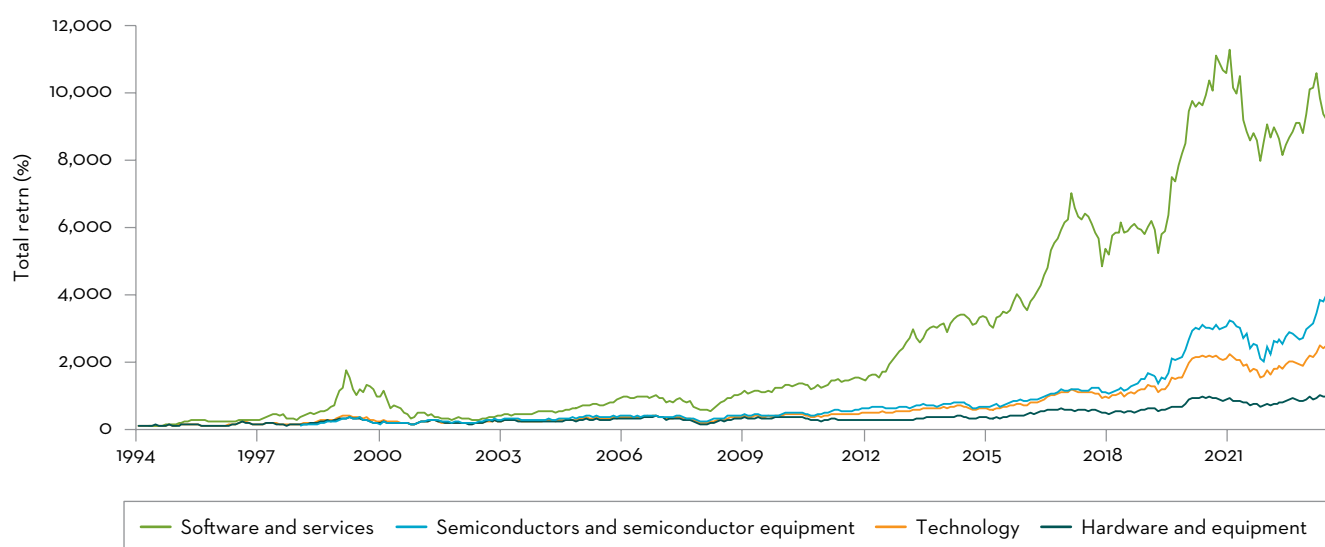
A strategically significant growth industry meets a country characterised by high quality companies, and an entrepreneurial, educated and large workforce. A recipe for success? We think so.

- IT services has been a core driver of emerging markets (EM) technology performance historically and is a significant opportunity for the future
- Services and solutions required to support increasingly complex IT infrastructure will help drive future growth in the industry
- Artificial intelligence (AI) can further support innovation and growth in IT services
- EM, especially India can fill the labour shortfall for highly-skilled, English-speaking talent in IT services globally

IT services has a strong history of delivering

Over the past 30 years, the IT services sector has consistently outperformed the broader sector, thanks to advancements in technology hardware that often result in the need for investment in software and IT services solutions. Additionally, the Indian IT services sector has benefited from the maintenance and development of older IT systems globally.

MSCI Emerging Markets long-term technology sector and industry group performance



Past performance is no guarantee of future results.

Source: FactSet, as at 30 June 2024. Sector and Technology Hardware and Equipment inception 31 December 1994, Software and Services inception 31 March 1995, Semiconductor and Semiconductor Equipment inception 31 December 1998.

A perpetual growth opportunity?

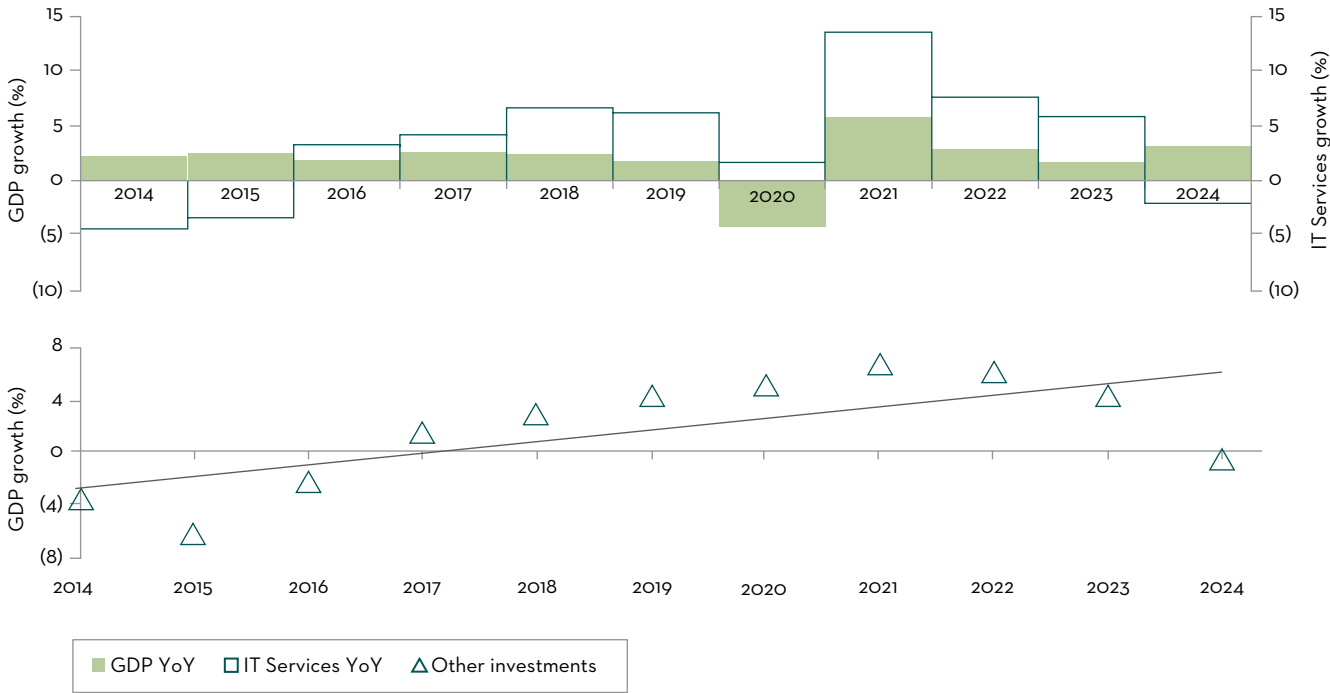
With each technology cycle (e.g., PC > internet > cloud), enterprises have become more, not less reliant on IT Services companies because it is not possible for companies nowadays to maintain the requisite expertise in house. Speaking to the IT services companies, they are busy building and developing potential solutions with their clients. IT services firms will also design, develop, and implement AI-driven solutions and workflows for enterprises.

Digital-focused IT service firms are best positioned for growth and success given they operate at the leading edge of technological change, although we should continue to look for new companies that may do so well. It is interesting that some companies not only have a strong record of execution and innovation but have also been investing in AI-driven intellectual property well before the AI hype began.

Even without the added boost from the adoption of AI, IT services present a significant opportunity. The existence of dated IT systems requiring ongoing upgrades, or services and solutions following technology change (such as the move to a cloud infrastructure) are important and ever-present drivers of growth in IT services.

IT services spending is correlated with Gross Domestic Product (GDP) growth, with increases in GDP leading to higher budgets for spending. This does not mean, however, that spending stops when GDP growth is weak. In this type of environment, typically any cost savings made in other areas of a business would be reinvested into IT systems given companies' dependence on reliable and secure technology.

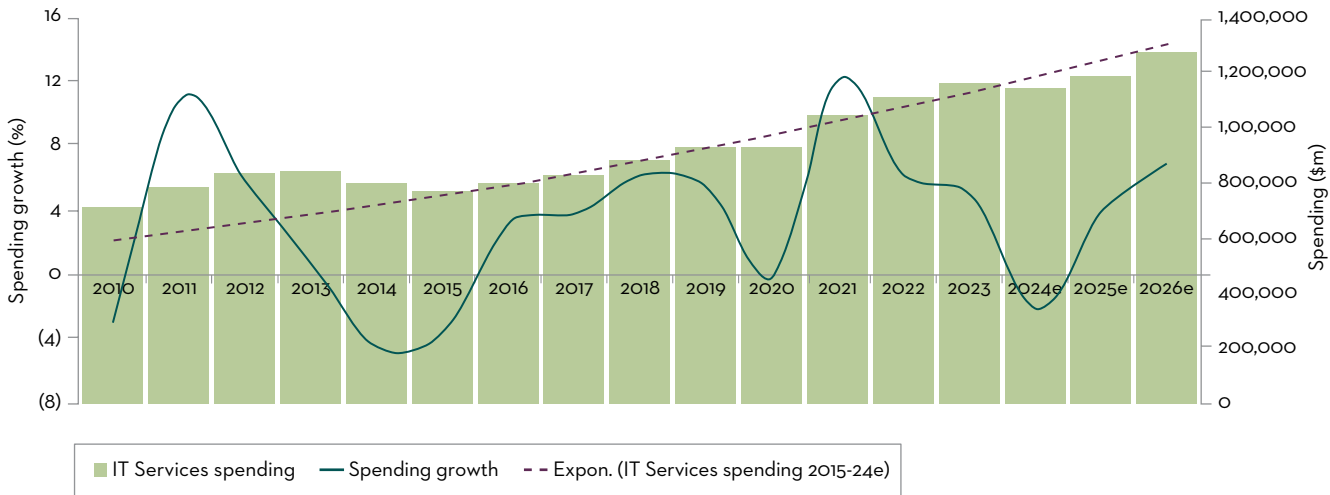
Global GDP growth relative to IT Services spending 2014-24e



Source: Gartner, Goldman Sachs Global Investment Research as at 24 June 2024. Americas Technology: IT Services.

Similarly, spending in IT services has consistently grown in the past 10-15 years and set to continue on an upward trajectory. The need for increased servicing and more complex and tailored solutions for clients' needs should be supportive of industry growth.

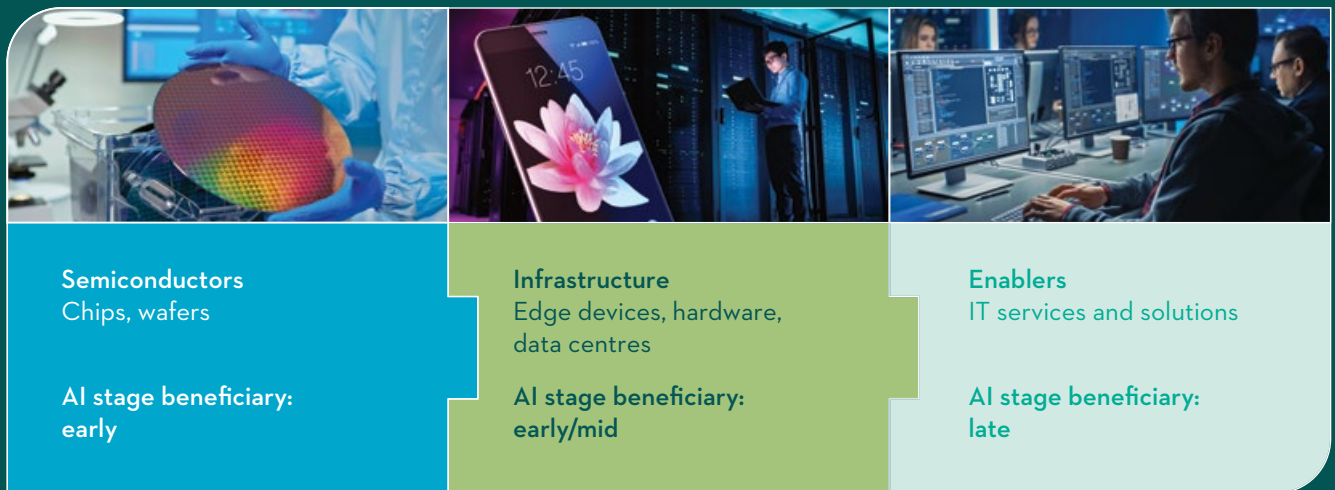
Forecast of IT Services growth (2025-26)



Source: Gartner, Goldman Sachs Global Investment Research as at 24 June 2024. Americas Technology: IT Services.

Artificial intelligence

For AI, the first pillar is semiconductors, the second pillar is infrastructure (i.e., hardware, software), and the third pillar is enablers (i.e., IT services). The value that will be generated by the third pillar has yet to be realised because the second pillar is still being built.



The first stage beneficiary of AI has been the semiconductor industry, where EM companies are significant suppliers. As AI use cases become better developed and companies see increasing opportunities to implement AI solutions, we expect the next beneficiaries to be IT infrastructure names. But we also see huge potential for IT services, who will be enabling and implementing AI solutions, to benefit over the long-term.

The positive impact on people in IT services is twofold. Within software services, the minority of developer time is actually spent coding. AI has the potential to reduce both the non-coding time by improving efficiencies, as well as improve productivity in coding, such that the remainder of time can be devoted to understanding rapidly evolving client needs and discussing unique solutions. In addition, as companies start implementing AI, their spending on the solutions and services to maintain it will increase. This should boost growth in the services industry.

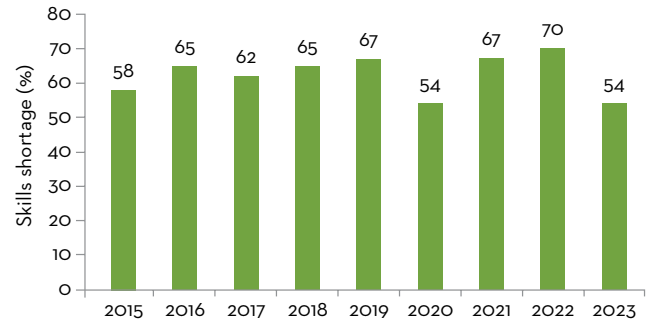


EM software engineers can close the labour shortfall

A lack of software engineers in developed markets is a catalyst for IT outsourcing. Technology talent is cheaper in developing markets but more importantly, countries like India not only have engineering talent at low relative cost¹ but they also have an existing, vast IT services ecosystem².

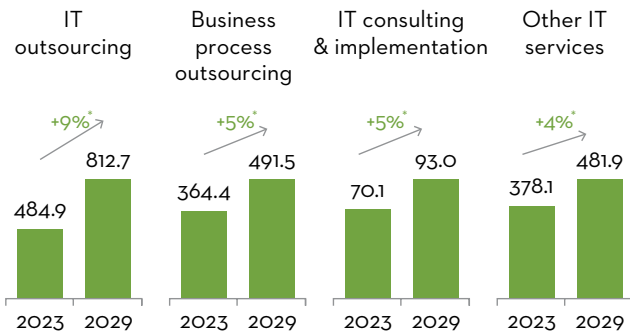
There is a clear shortfall in the demand for developers and the supply. This impacts companies' abilities to adapt and change in an increasingly complex technological landscape. Crucially, a key opportunity is driven by the US, where the forecast shortfall increases from 63% in 2024 to 73% in 2030³.

Technology organisations experiencing skills shortage worldwide 2017-2023



Source: Statista, Nash Squared and Cionet as at November 2023

Forecast growth in IT services sub-industries 2023-2029

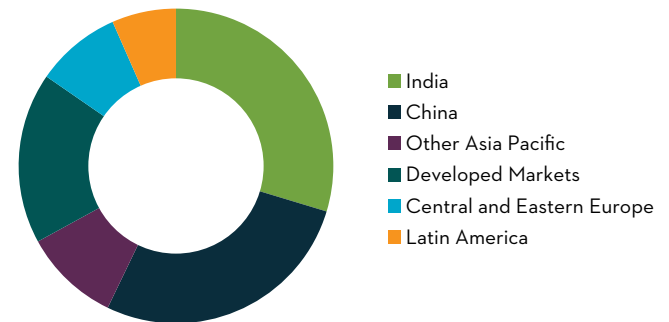


Source: Statista Market Insights as at August 2024, p.10.
*Compound annual growth rate.

This employment shortfall can be addressed through outsourcing. Indeed, this is the area of IT services which is forecast to see the highest growth in the current decade.

EM countries have some of the highest graduation rates for students studying science, technology, engineering and mathematics (STEM) subjects. This has created a highly skilled and well-populated workforce which can address the shortfall in developers through outsourcing. Importantly, India's established IT services ecosystem is a key area of potential growth for these reasons but also because of language accessibility - the demand for English-speaking talent is high in a global context and India has this.

Software engineer graduates by region



Source: OCED data and courtesy J.P. Morgan Chase & Co., Copyright as at 6 June 2024. IT & BPO Services. p33.

¹Source: California Review Management as at 20 December 2023. Leveraging Engineering and Research Talent in India with Global Capability Centers.

²Source: Statista as at July 2024. IT Services: market data & analysis.

³Source: Courtesy J.P. Morgan Chase & Co., Copyright as at 6 June 2024. IT & BPO Services. p32.

India's role in the industry's future success

The IT services industry in India has played a significant role in enhancing the country's global competitiveness, innovation, and reputation, as well as creating employment opportunities, social benefits, and digital inclusion for millions of Indians. But India has progressed beyond being simply a provider of low-cost labour and basic outsourced IT functions; the industry has diversified its service offerings, from basic software development and maintenance to complex and high-value services such as cloud computing, AI, data analytics, digital transformation, and cybersecurity. IT services firms will be crucial in delivering AI solutions for their clients, in addition to the ongoing public cloud migration by corporations.

In the past five years, India has witnessed a growing trend of foreign IT companies establishing their operations in the country, attracted by its large talent pool, low-cost advantage, favourable business environment, and strategic location. These not only provide IT services and solutions to their global clients, but also engage in research and development, innovation, and digital transformation initiatives, contributing to the growth and diversification of the Indian IT industry.

Our recent visit to IT companies in India revealed the opportunity for further growth and diversification in the Indian market, due to the increased demand for digital solutions and services amid and following the pandemic. We visited two portfolio companies in their Indian offices. Both companies are capitalising on this opportunity by setting up and expanding their operations in India, using the country's talent, cost, and location advantages.

These are examples of how foreign IT companies are tapping into the potential of the Indian market, while also contributing to its growth and development. By establishing their operations in India, they are providing employment and skill development opportunities to the local talent and enhancing the competitiveness and innovation of the Indian IT industry. They are also creating positive social and environmental impacts in the country, through their initiatives and practices. As India emerges as a global leader in the digital economy⁴, foreign IT companies such as Globant and EPAM will play a vital role in shaping and transforming its future.

A recipe for success?

We think that emerging market companies will play a crucial role in the AI-driven technology cycle and that this will drive growth in all parts of the industry including semiconductors, infrastructure and IT services. The impact of increasing AI demand has already been felt in semiconductors and is beginning to bear fruit in infrastructure companies. We believe that the largest unrealised opportunity lies within IT services as companies will have greater need and dependency on more complex and tailored solutions to service their new AI-enabled infrastructure. India's resources of talent, cost benefit and location will help it continue to play a crucial role in the success of the services industry. We are very excited for this opportunity to be realised, across not only domestic best-of-breed Indian companies but also the many foreign companies with growing Indian operations.

⁴Source: ET Government as at 30 July 2024. India is leading global digital revolution: RBI report.



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