

Riding the airwaves

The Indian information technology and software space has lost its charm over the past one year due to the rising rupee as well as the imminent US slowdown, which is likely to result into cuts in IT-budgets of multinationals around the world.

This means slower revenue and profit growth for most software majors across the board. More so, discretionary IT expenditure would be the first to be chopped off by the clients abroad.

On the other hand, generic service providers catering to sectors like banking and financial services or insurance, with services which are somewhat indispensable too would face margin pressures due to lack of growth in the underlying sector, the loss of pricing power and the need to increase offshoring. One therefore wonders whether software services companies could be trusted or not for investing.

It is however, not yet the moment to despair, since there are other avenues in the technology space, which offer steady demand growth, and high margins. These are companies which provide specialised services to telecommunications companies. They thrive on the specific intellectual property they own, because of which they win their clientele and dominate the marketplace that they operate in. These factors act as significant entry barriers.

Considering only the Indian telecom space, the numbers that pop out are enormous. As on January 2008, there were over 237.9 million wireless subscribers with a 60 per cent y-o-y growth. Despite slower growth, the wired line subscriber base is increasing steadily from the present 273 million.

In other developing markets, the scenario is not very different. For the developed counterparts, even though the subscriber base may not be growing significantly, telecom majors are increasingly cross-selling value-added services (VAS).

We have handpicked companies offering software services and equipment to telecommunications players, which are indispensable in nature, thus making the technology spend non-discretionary. Since the demand for these services is directly proportionate to the growth in telecom subscriber base and the usage of various services, the good prospects for the telecom industry will augur well for these companies too.

Thus there is also potential for upward revision in valuations of these technology companies, which are almost half that of telecom majors.

Apart from the companies we recommend, frontrunners like Subex and Sasken Communication also are part of the game, but the recent turnout of negative events keeps them out of the outperformers' league. For these two companies, investors may want to wait and watch for positive signals over the coming fiscal.