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Press Release

Indian software stocks had to crash with or without US slowdown: A Skoch report

- **Overvaluation – the main culprit**
- **Current state is a correction and not a crisis**
- **Further downward correction of up to 35% to reach realistic levels**
- **Sentiments may still keep the prices skewed**
- **IT may fail to contribute to GDP growth targets**
- **Hype theatre shifts to Japan and Europe**

New Delhi, 18 April 2001: Indian software stocks are finally facing the inevitable, the slowdown in US economy notwithstanding – this is the finding of "A Fresh Perspective for the Indian Software Industry" – a report on strategy alternatives by Skoch Consultancy Services Pvt. Ltd. to be released in May 2001. While releasing the excerpts and the major findings of the financial aspects from the soon-to-be released report, Sameer Kochhar, Managing Director, Skoch Consultancy Services Pvt. Ltd. said, "Indian software stocks had fallen victim to *'irrational exuberance'* driven by feel good factors and investors' fascination for technology stocks without much knowledge about it."

The first of the feel good factors identified by the report are unrealistic price valuations and recommendations of most financial analysts. For example, BETA (a measure of the volatility of the stock relative to the overall market) used by most of them for Indian software companies has stayed at 1, when a company like Oracle has a BETA of 2.18 and Microsoft Corporation that of 1.34. Another, Cisco Systems has a beta of 2.17.

Similarly, as the multipliers used on EPS to arrive at share valuations were unrealistically high based on high growth rate projections in spite of an impending US slowdown that was clearly visible even two quarters back. Extremely high growth rates were assumed and accepted even for companies that had already gained a threshold size and were therefore unlikely to be able to maintain blazing growth rates. The PE ratio calculations based on the same high growth rates would also result in over-inflated share prices.

Even the share price over operating profit (EBITDA - Earnings before Interest, Tax, Depreciation, Amortization) ratio that does not usually exceed 10 has exceeded 100 in many cases due to abnormally inflated share prices leading to a crash. "Based on all these factors, we believe that there is need of a further correction up to 35 per cent. Therefore, what can be expected is only attempts at boosting market sentiments rather than business fundamentals," warns Kochhar.

The sectoral predictions were based on export performance figures that till last year were not even officially compiled by the government. Fortunately in the new Exim Policy this has been corrected which may dampen the spirits further if the compiled figures are at variance with previously available data and projections thereof.

This may not be good news for the Indian stock market, which is currently driven largely by technology stocks. "So much so that even the financial targets pegged at $87 billion, was always far fetched, now seem to be even more improbable," says Kochhar. "Even the basic impact on GDP calculations bear this out."

Based on this $87 billion target, India's IT contribution has to grow from 1.3% of GDP to 7-8% of GDP, as high as the US. This would tantamount to almost every dollar of FDI inflow and every knowledge worker produced in India getting absorbed in the IT sector and still leaving a huge resource gap to arrive anywhere near the $87 billion figure.

The toned down projections of 40% growth for the current fiscal as compared to 55% during last year, is overly optimistic, as they are based on Japan and Europe narrowing the hiatus created by US slowdown. Japan is already reeling under pressures that are more acute than the US. Europe, all these years, has held steady even without Indian software industry intervention. It is also not as major a technology destination or base, as the US happens to be. This coupled with the language and regulatory issues are unlikely to make Europe an immediate fix for all that ails the Indian software industry.

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