

Information Technology Summer 2023



Sector overview

Following the strong demand for products and services throughout 2020 and 2021, which will be considered a peak period in this current cycle, the Information Technology (IT) industry continues to show signs of a subdued marketplace in 2023.

With global economic conditions proving challenging, IT is not immune to this downturn, with many focusing on 2024 as a realistic year of stability and a hopeful return to growth.

The pandemic years generated exceptional demand for IT devices, with global supply chains struggling to keep up. Vendors invested aggressively in headcount to facilitate the increasing expenditure; the distribution and reseller channel did the same whilst also changing their procurement habits, switching to larger speculative orders to avoid missing out on sales opportunities and increasing freight cost.

So far this year, 2023 has presented the global economy with stubborn inflation and increasing interest rates - a combination which has had a material impact on the traditionally low margins seen in the IT industry. Following such substantial investment in overheads and with demand for technology falling in many businesses, we have seen a negative impact on profitability. So much so, that vendors and distributors are comparing their current financial

performance to that in the year before the pandemic period, which is now seen as an exceptional performance.

PC sales, for example, have seen a complete collapse in demand compared to prior years. In Q1 2023, we have seen sales at Apple drop by 40%, Dell by 31%, ASUS and Lenovo both by 30% and HP by 24%. Gartner reports that worldwide PC sales for Q1 2023 declined by 30% compared to Q1 2022. This has led vendors to reduce average selling prices and offer increased rebate incentives. In May 2023, HP Inc. announced it would miss second quarter revenue targets due to inflation-hit customer demand.

Whilst industries operating within the manufacture and sale of IT hardware have found trading conditions to be challenging, we see continued growth and appetite in the software as a service (SaaS), artificial intelligence (AI), cloud, cyber, automation and vertical solutions technology sectors. This is driven by the subscription/contract nature of these services, but also due to a greater awareness of governments and organisations protecting their intellectual property, maintaining connectivity and identifying new opportunities.

In April, Gartner forecast worldwide IT spending would grow 5.5% to \$4.6 trillion in 2023. This is driven by the ongoing digital transformation and centres on the software segment, which has forecast double-digit growth. Gartner followed up that prediction with a view that government spending will grow by 8% in 2023, driven by workforce scarcity and the abilities of governments to respond to service delivery mechanisms and accountability.

Whilst 2023 has been a challenging period for IT devices, services remain robust and are driving growth for the foreseeable future. There needs to be a concentrated focus on slow-moving and obsolete stock over the coming months, while factoring in the impact of inflation and interest rate risk related to refinancing.

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Notable insolvency events

Complete Business Solutions - £100m turnover office products supplier.

Silicon Valley Bank - \$212bn lender. Whilst not an IT business itself, the failure of SVB could have been material due to its lending exposure to the tech sector.

Economic data - UK

- > **Insolvency statistics:** In April 2023, UK insolvencies were 15% lower than in the previous year.
- > **In April 2023, the UK reported GDP growth of 0.2%.** This was driven by a rebound in consumer spending and fewer national strikes. The avoidance of a recession in 2023 remains uncertain however, with the full impact of increasing interest rates to come.
- > **In June, the Bank of England raised interest rates again 4.5% to 5%.** Inflation was reported at 8.7%, well above the 2% target.

Strengths

- > **Software and solutions remain a growth segment, with services often contract led, providing guaranteed reoccurring income.** Organisations are seeking to prioritise spending in areas that will capture competitive advantages and improvements in productivity and automation.
- > **Many organisations upgraded their IT capabilities and hardware in 2020.** IT hardware has a short 3-5-year optimum shelf life and there is optimism that customers will have to refresh existing devices from 2024. It is also hoped that global inflation pressures will have abated during that time and the IT channel will have managed out the current bloated stock profile.
- > **IT is a fast-moving industry.** There are always new opportunities and emerging technologies that could kickstart the industry into growth mode. The impact of AI is one to watch and observe in these early years.

Challenges

- > **Bloated stock levels and slow-moving products are commonplace across the channel.** Difficult conversations are being held between distributors and vendors, who continue to push targeted sales volume. Distribution partners are resisting citing already high stock levels, but mindful of the wider relationship.
- > **Increased cost of borrowing and tightening liquidity.** IT is typically a low-margin industry, especially at the distributor level which relies heavily on invoice discounting and supply chain finance. Several years ago, vendors looked to rationalise the number of distribution partners they worked with. We are currently seeing concentration issues at the tier 1 distributor level.
- > **Heavy discounting.** The shelf life of IT products are typically short. With many finding sales difficult to come by, we are aware of heavy discounting to unwind the working capital tied up in stock. Components such as SSD and HDD storage devices have seen aggressive discounting in recent months.
- > **Increased volatility in emerging markets.** We are seeing an increasing occurrence of currency convertibility in parts of South America and Africa. Weaker sovereign nations can offer attractive commercial opportunities, though the wider political risk factor must be considered.

Underwriting approach

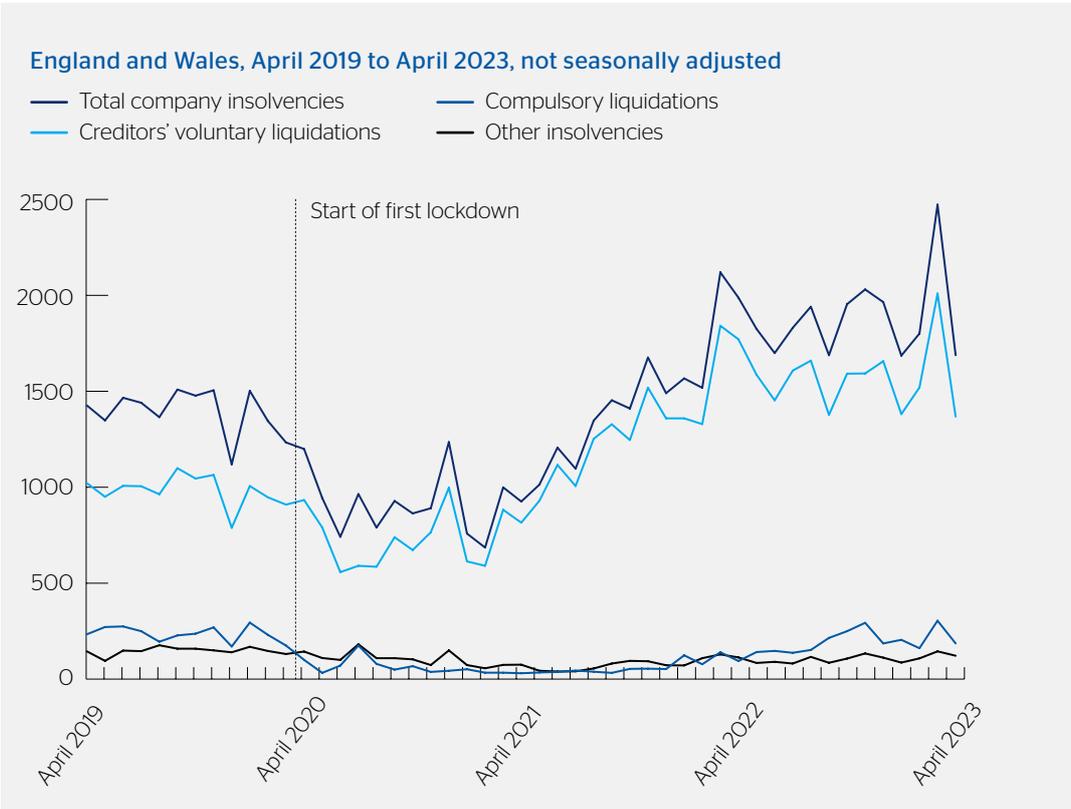
- > **Stable underwriting stance in place for IT, with closer scrutiny on stock turn and cost base:** supportive on the whole, with certain verticals requiring greater scrutiny, such as electronics retail and office products.
- > **Information remains key:** Up-to-date financial records, covenant compliance and cash flow forecasts remain important tools for assessing credit worthiness.

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Sources: Financial Times

The number of registered company insolvencies in May 2023 was higher than in the same month last year, driven by a higher number of CVLs.



Sources: Insolvency Service www.gov.uk

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Preliminary Worldwide PC Vendor Unit Shipment Estimates for 1Q23 (Thousands of Units)

Company	1Q23 Shipments	1Q23 Market Share (%)	1Q22 Shipments	1Q22 Market Share (%)	1Q23-1Q22 Growth (%)
Lenovo	12,828	23.3	18,375	23.3	-30.2
HP Inc.	12,019	21.8	15,866	20.1	-24.2
Dell	9,541	17.3	13,804	17.5	-30.9
Apple	4,819	8.7	7,324	9.3	-34.2
ASUS	3,91	7.1	5,584	7.1	-30.0
Acer	3,523	6.4	5,531	7.0	-36.3
Others	8,514	15.4	12,268	15.6	-30.6
Total	55,154	100.0	78,752	100.0	-30.0

Notes: Data includes desktop and laptop PCs that are equipped with Windows, macOS and Chrome OS. All data is estimated based on a preliminary study. Final estimates will be subject to change. The statistics are based on shipments selling into channels. Numbers may not add up to totals shown due to rounding.

Sources: Gartner

Worldwide IT Spending Forecast (Millions of U.S. Dollars)

	2022 Spending	2022 Growth (%)	2023 Spending	2023 Growth (%)	2024 Spending	2024 Growth (%)
Data Center Systems	216,095	13.7	224,123	3.7	237,790	6.1
Devices	717,048	-10.7	684,342	-4.6	759,331	11.0
Software	793,839	8.8	891,386	12.3	1,007,769	13.1
IT Services	1,250,224	3.5	1,364,106	9.1	1,502,759	10.2
Communications Services	1,424,603	-1.8	1,479,671	3.9	1,536,156	3.8
Overall IT	4,401,809	0.5	4,643,628	5.5	5,043,805	8.6

Sources: Gartner

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