# IT Services

## Good times to continue

| Sector Outlook | Positive |
|---|---|

### Discretionary spend to be key growth driver in FY12

Indian IT services companies generate ~30% of revenues from discretionary spend. **Discretionary spend environment is improving sharply as visible from both Oracle and SAP, recording yoy growth in new license sale greater than 25%.** Management commentary of technology bellwethers suggests a more buoyant discretionary spend environment in North America and emerging economies than Europe. We believe increased spend on discretionary projects is critical because **these have better pricing when compared to maintenance projects**. Coupled with secular offshore shift to manage costs, the bounce back in discretionary spend augurs well for Indian IT services companies. We remain positive on the sector and expect returns to be driven by robust earnings growth.

### HCL Technologies: All positive priced in

HCL Technologies (HCLT) has been able to catch-up and even outperform its larger peers in revenue growth by acquiring Axon and also by investing in Remote Infrastructure Management (RIM). However, the story is not same when it comes to other metrics such a margins, cash generation and return ratios. Though HCLT's revenue growth has been impressive and would continue to be inline with larger peers, led by its RIM practice, **our concern is on HCLT's margin owing to: aggressive pricing especially in RIM, lower than peer fresher recruits, increased contribution from RIM business and relatively low SG&A spend. We do not share consensus optimism in HCLT improving operating margins by 100bps in FY12.** We do not expect HCLT's P/E to bridge the gap with Tier-1 owing to relatively weak financial metrics. Initiate coverage on HCLT with Reduce/Underperform rating with a price target of Rs. 465.

### Tech Mahindra – Mahindra Satyam: Marriage on the cards

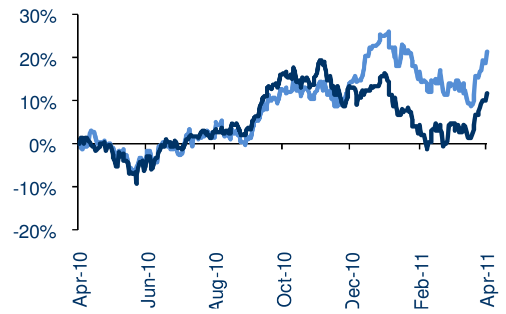
Management of Tech Mahindra (TECHM) have indicated time and again that TECHM and Mahindra Satyam (MSAT) would be merged. With some of the obstacles out, we too believe a merger is realistic possibility in the next 12-18 months. In this context, TECHM and MSAT should **not be looked at in isolation by investors in our opinion. On a combined basis, we expect the duo to have a sales of US$ 2.5bn** of revenues in FY12E making it **the fifth largest India listed IT services company.** Moreover, the business would exhibit a diversified revenue profile, a luxury TECHM hitherto did not enjoy.

We expect both companies to lag industry revenue growth – TECHM owing to a weak demand environment in the telecom vertical; MSAT due to their inability to participate in large deals in the past 24 months. On the margins front, TECHM would have a muted expansion, on the contrary we expect MSAT to expand operating margins by ~650bps over next 24 months. At current prices, the combined entity is trading at a P/E of 12.2x FY12E EPS and 9.0x FY13E, attractive in our view. Given the attractive valuation we believe investors should buy into both TECHM and MSAT in a manner that would result in them having the same stake in both the companies. We prefer this approach as a protection against the as-yet-uncertain swap ratio that would be used for the merger. Our target multiple for the combined entity is **12x 1 year forward EPS** based on a **20% discount to HCLT target multiple of 15x**. We believe the discount in multiple is warranted given HCL Tech's higher earnings growth and more diversified business.

| Date | Apr 05, 2011 |
|---|---|

| Market data | |
|---|---|
| BSE SENSEX | 19686 |
| NIFTY | 5910 |
| CNXIT | 7314 |

**CNXIT vs Nifty**




**Performance (%)**

| | 1m | 3m | 12m |
|---|---|---|---|
| Nifty | 5 | (5) | 10 |
| CNXIT | 4 | (5) | 19 |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# IT Services

## HCL Tech vs. TechM and Mahindra Satyam – A quick Take

**Sector Outlook** **Positive**

| Factor of Comparison | HCL Technologies (HCLT) | Tech Mahindra (TECHM) – Mahindra Satyam (MSAT) (TECH+MSAT) | Remarks |
|---|---|---|---|
| Verticals | Financial Services – 24.6%<br>Manufacturing – 27.1%<br>Telecom – 10.8% | Financial Services – 13%<br>Manufacturing – 21%<br>Telecom – 48% | HCLT has a more balanced vertical exposure than TECHM+MSAT. Telecom would be an overhang for TECHM+MSAT combo, and make it more vulnerable to Telecom's cyclical nature. |
| Horizontals | Enterprise Application Services – 21%<br>Engineering and R&D Services – 19%<br>Custom Application – 32%<br>Infrastructure Services – 23% | Enterprise Application Services – 22%<br>Engineering and R&D Services – 7%<br>Custom Application – 65%<br>Infrastructure Services – 6% | Both entities have ~20% exposure to Enterprise application and lack meaningful presence in BPO. However, HCLT has a stronger presence in Infrastructure Service and Engineering Services, which is matched by TECHM+MSAT strength in applications. |
| Geographies | Americas – 57.1%<br>Europe – 26.6%<br>Rest of World – 16.3% | Americas – 44.3%<br>Europe – 41.6%<br>Rest of World – 14.1% | TECHM+MSAT have a more balanced geographic presence. Note that within Europe, both companies have high exposure to UK and TECHM+MSAT in particular. |
| Employees (FY12) | 96,488 | 73,926 | HCLT has a higher employee base, providing scope for better employee mix and higher utilisation. |
| Offshore: Onsite revenues | 42:58 | 61:39 | HCLT has a higher onsite owing to Axon, whereas TECHM+MSAT has a higher offshore due to high offshore in TECHM. However, BPO operations of both entities and HCLT's RIM practice is not included. |
| FY12 Revenues (Rs. mn) | 198,536 | 110,987 | TECHM+MSAT would become the fifth largest India listed IT services company after HCLT. |
| FY12 EBITDA (Rs. mn) | 31,862 | 15,390 | HCLT EBITDA margins would be 200bps higher than TECHM+MSAT. TECH+MSAT margins would be low due MSAT's low margins. |
| FY12 PAT (Rs. mn) | 20,675 | 10,892 | TECHM+MSAT would have a higher PAT margin owing to higher other income. |
| Current Market-Cap (Rs. mn) | 320,027 | 132,782 | TECHM+MSAT market cap is computed after adjusting for TECHM's stake in MSAT. |
| Revenue Growth (FY11-13E) | 23% | 13% | HCLT would outperform owing to TECHM+MSAT suffering from British Telecom overhang. |
| EBITDA Growth (FY11-13E) | 19% | 27% | HCLT margins would be flat, however we expect MSAT's robust margin expansion to drive TECHM+MSAT margins. |
| PAT Growth (FY11-13E) | 23% | 28% | Operating margin improvement would flow through to PAT for TECHM+MSAT, whereas higher other income would improve PAT growth. |
| Net Cash (Rs. mn) | -2,345 | 8,345 | TECHM+MSAT has strong cash balance even after adjusting for Unpaid and class action suit settlement. |

*Source: Spark Capital Research*

# IT Services

## Valuation

**Sector Outlook** **Positive**

| Company | Year End | Sales | | | EBITDA | | | Net Income | | | EPS | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | | FY11E | FY12E | FY13E | FY11E | FY12E | FY13E | FY11E | FY12E | FY13E | FY11E | FY12E | FY13E |
| eClerx | Mar | 3,391 | 4,420 | 5,755 | 1,444 | 1,619 | 1,902 | 1,273 | 1,459 | 1,548 | 42.5 | 48.5 | 51.5 |
| Firstsource | Mar | 20,533 | 23,913 | - | 2,880 | 3,575 | - | 896 | 1,257 | - | 1.9 | 2.7 | - |
| HCL Tech | Jun | 159,237 | 198,536 | 241,589 | 26,954 | 31,862 | 37,861 | 16,666 | 20,675 | 25,157 | 24.2 | 30.0 | 36.5 |
| Hexaware | Dec | 13,644 | 16,215 | - | 1,624 | 2,086 | - | 1,707 | 1,952 | - | 5.7 | 6.6 | - |
| Infosys | Mar | 277,916 | 344,210 | 403,856 | 92,477 | 113,302 | 131,532 | 69,632 | 86,778 | 102,707 | 121.5 | 151.4 | 179.2 |
| Infotech | Mar | 12,045 | 15,451 | 18,847 | 1,906 | 2,546 | 3,120 | 1,438 | 1,821 | 2,285 | 12.8 | 16.3 | 20.4 |
| Mahindra Satyam | Mar | 50,861 | 58,437 | 68,305 | 3,989 | 6,454 | 9,208 | 3,535 | 4,947 | 7,298 | 3.0 | 4.2 | 6.2 |
| MindTree | Mar | 15,215 | 18,239 | 21,800 | 1,947 | 2,851 | 3,310 | 1,033 | 1,805 | 2,306 | 25.3 | 44.2 | 56.5 |
| MphasiS | Oct | 53,434 | 64,942 | - | 10,418 | 13,145 | - | 9,104 | 10,334 | - | 43.1 | 49.0 | - |
| Patni | Dec | 37,046 | 40,813 | - | 6,911 | 7,716 | - | 4,897 | 6,115 | - | 36.4 | 45.5 | - |
| Persistent | Mar | 7,646 | 9,607 | 11,554 | 1,611 | 2,113 | 2,678 | 1,430 | 1,462 | 1,811 | 35.8 | 36.6 | 45.3 |
| Polaris | Mar | 15,729 | 19,032 | 21,233 | 2,183 | 2,678 | 3,186 | 1,970 | 2,211 | 2,718 | 19.7 | 22.1 | 27.2 |
| TCS | Mar | 374,723 | 467,246 | 551,779 | 112,331 | 137,159 | 159,547 | 87,468 | 102,308 | 119,897 | 44.7 | 52.3 | 61.3 |
| Tech Mahindra | Mar | 49,378 | 52,550 | 59,853 | 8,080 | 8,936 | 10,297 | 5,412 | 5,945 | 7,408 | 41.4 | 45.4 | 56.6 |
| TECHM+ MSAT | Mar | 100,240 | 110,987 | 128,158 | 12,068 | 15,390 | 19,505 | 8,947 | 10,892 | 14,706 | | | |
| Wipro | Mar | 311,777 | 376,403 | 446,131 | 66,889 | 81,302 | 78,109 | 53,038 | 61,322 | 67,545 | 21.7 | 25.1 | 27.6 |

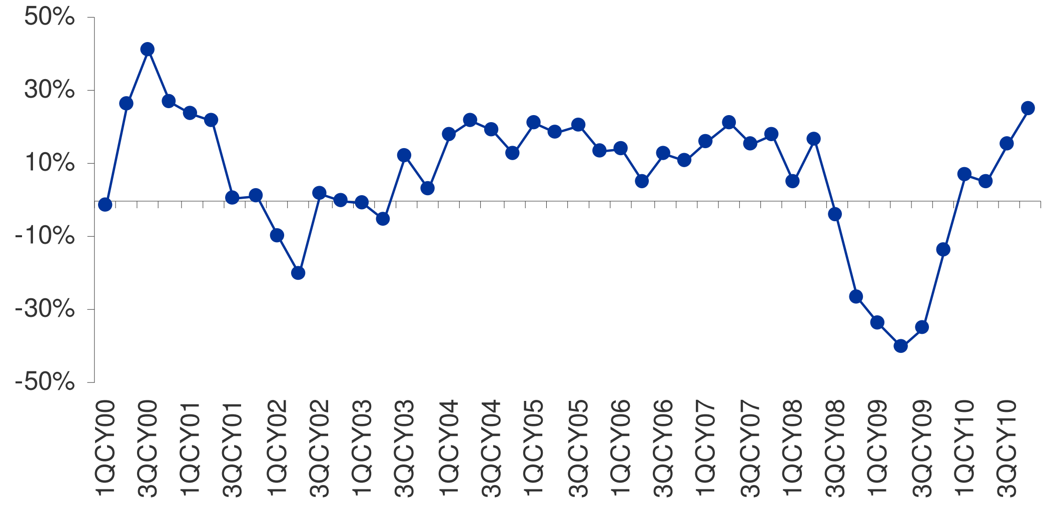
| Company | P/E | | | EV/EBITDA | | | EV/Sales | | | CMP | MCAP | TP | Rating | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | FY11E | FY12E | FY13E | FY11E | FY12E | FY13E | FY11E | FY12E | FY13E | (Rs.) | Rs. Mn | Rs. | Absolute | Relative |
| eClerx | 15.2x | 13.3x | 12.5x | 11.7x | 10.5x | 8.9x | 5.0x | 3.8x | 2.9x | 645 | 18,467 | 540 | SELL | UPF |
| Firstsource | 10.2x | 7.3x | - | 6.9x | 5.5x | - | 1.0x | 0.8x | - | 19 | 8,327 | 28 | BUY | OPF |
| HCL Tech | 19.7x | 15.8x | 13.0x | 12.0x | 10.1x | 8.5x | 2.0x | 1.6x | 1.3x | 475 | 320,027 | 465 | REDUCE | UPF |
| Hexaware | 12.2x | 10.6x | - | 9.5x | 7.4x | - | 1.1x | 1.0x | - | 70 | 20,088 | 60 | ADD | UPF |
| Infosys | 27.0x | 21.7x | 18.3x | 18.7x | 15.3x | 13.2x | 6.2x | 5.0x | 4.3x | 3,278 | 1,878,934 | 3,450 | ADD | OPF |
| Infotech | 12.4x | 9.8x | 7.8x | 7.8x | 5.9x | 4.8x | 1.2x | 1.0x | 0.8x | 160 | 17,864 | 190 | BUY | OPF |
| Mahindra Satyam | 22.3x | 16.0x | 10.8x | 14.6x | 9.0x | 6.3x | 1.1x | 1.0x | 0.9x | 67 | 78,926 | 77 | BUY | OPF |
| MindTree | 16.2x | 9.3x | 7.3x | 7.7x | 5.2x | 4.5x | 1.0x | 0.8x | 0.7x | 410 | 16,327 | 478 | BUY | OPF |
| MphasiS | 9.9x | 8.7x | - | 7.4x | 5.9x | - | 1.4x | 1.2x | - | 427 | 89,826 | 480 | ADD | UPF |
| Patni | 13.0x | 10.4x | - | 5.8x | 5.2x | - | 1.1x | 1.0x | - | 475 | 62,016 | 478 | ADD | UPF |
| Persistent | 11.0x | 10.7x | 8.7x | 7.8x | 6.0x | 4.7x | 1.6x | 1.3x | 1.1x | 392 | 15,680 | 500 | BUY | OPF |
| Polaris | 8.9x | 7.9x | 6.4x | 5.6x | 4.6x | 3.9x | 0.8x | 0.6x | 0.6x | 175 | 17,311 | 230 | BUY | OPF |
| TCS | 27.1x | 23.2x | 19.8x | 20.5x | 16.8x | 14.4x | 6.1x | 4.9x | 4.2x | 1,212 | 2,371,173 | 1,200 | ADD | OPF |
| Tech Mahindra | 16.9x | 15.4x | 12.4x | 12.4x | 11.2x | 9.7x | 2.0x | 1.9x | 1.7x | 700 | 87,525 | 810 | BUY | OPF |
| TECHM+ MSAT | 14.8x | 12.2x | 9.0x | 10.3x | 8.1x | 6.4x | 1.2x | 1.1x | 1.0x | - | 132,782 | - | BUY | OPF |
| Wipro | 22.2x | 19.2x | 17.4x | 16.5x | 13.5x | 14.1x | 3.5x | 2.9x | 2.5x | 481 | 1,177,042 | 485 | ADD | UPF |

*Source: Spark Capital, Bloomberg. Patni and Hexaware have Dec year-ends while MphasiS has an October year-end*

## Continued upswing in discretionary spend

| Sector Outlook | Positive |
|---|---|

**Figure 1: SAP license revenue growth YoY cc**

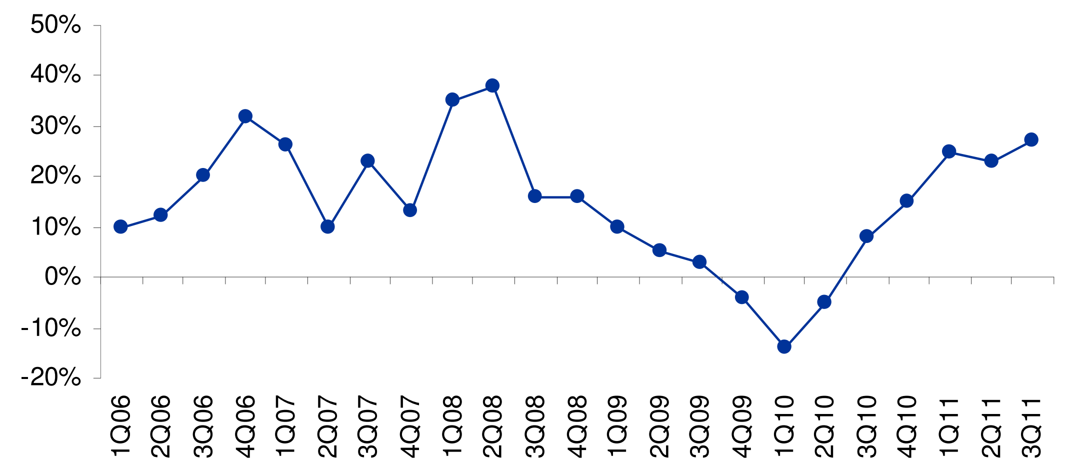



*Source: Company data, Spark Capital Research*

Indian IT services companies generate ~30% of revenues from discretionary spend. Key service offerings include application development, Enterprise Application Services and Testing. Hence the need to understand trends in discretionary spending in the global IT services industry. In most software projects, the application sale leads the implementation by one to two quarters. A typical Software project goes through four stages 1. **Vendor Selection:** IT consultants from firms such as IBM or Accenture typically do the business analysis and select the suitable product. 2. **Application purchase**: Customer negotiates terms with the product provider and purchases a license. 3**. Implementation** consultants from firms such as SAP or Accenture plan the installation of the Software 4. **Systems Integrators** such as Capgemini, Infosys, and HCL typically handle the roll-out, maintenance, product enhancement and training. Due to the nature of the implementation cycle, Systems Integrators lag the Software application company by around two quarters.

With this in mind, we analyze discretionary spend patterns as evidenced by the license revenues of enterprise software bellwethers SAP AG and Oracle. As Figures 1 and Figure 2 show, the 2007-09 recession had a significant negative impact on license sales, with SAP seeing ~**35% yoy license revenue decline and Oracle witnessing** ~**20% yoy** decline. Clearly, when customers cut back on packaged software, they cut back sharply. However, in the last four to five quarters, discretionary spend has bounced back sharply, as we see double-digit growth once again returning for the software bellwethers. SAP's software license figures generally lead IT services demand by three to four quarters. Also, Oracle management's comments during their most recent results call indicate solid company-specific momentum, and we feel it is reasonably safe to extrapolate this commentary to the broader IT demand environment.

**Figure 2: Oracle licence revenue growth YoY cc**

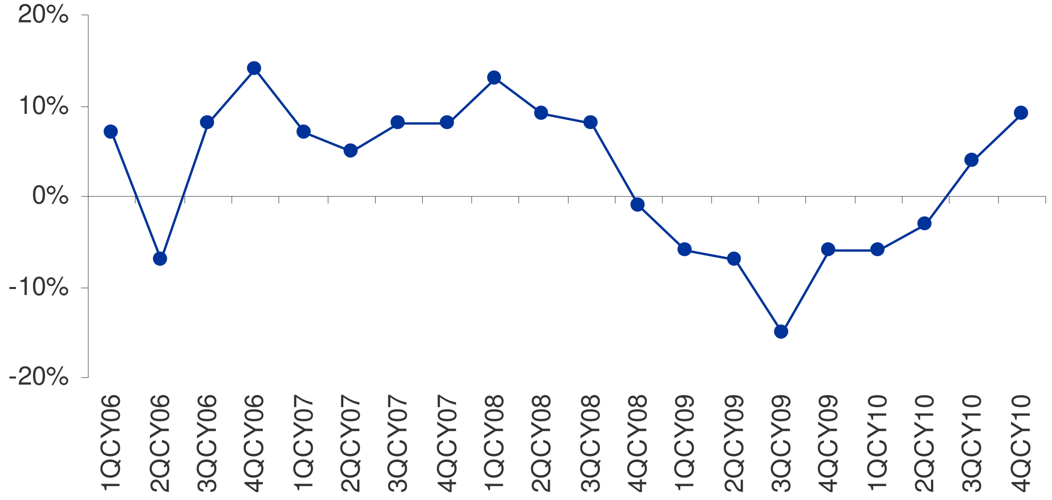



*Source: Company data, Spark Capital Research*

## Bellwether numbers indicate strong momentum

**Sector Outlook** | **Positive**

**Figure 3: YoY growth in IBM short term signings**

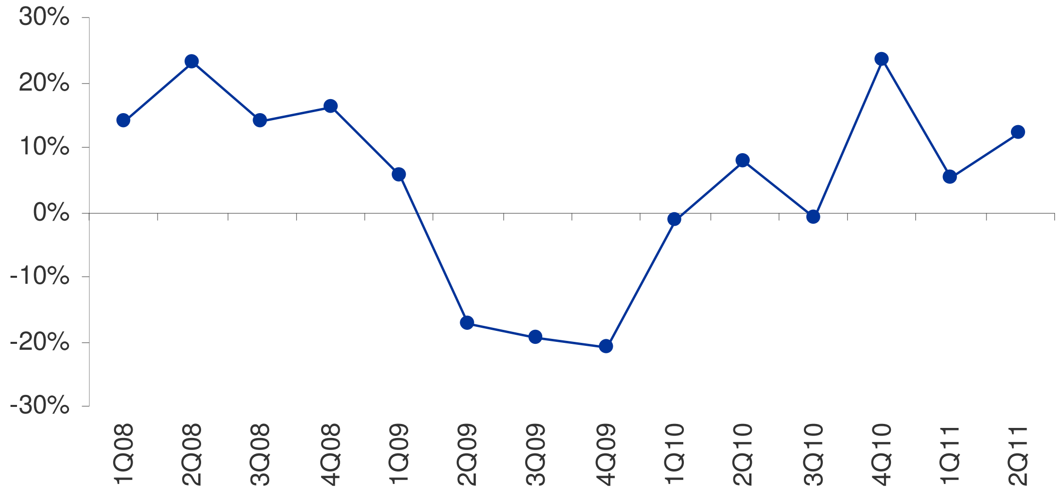



*Source: Company data, Spark Capital Research*

To take a step back and understand the relation between licences and IT services spend - into a downturn, the first leg of pull-back in tech spending results from the budget freeze, where discretionary spend sees a drastic cut. During this phase, Software application licenses see a sharp fall as IT discretionary Capex takes a severe hit. Typically, this gives way to a period of budget cuts, where the operating expense components of the budget are addressed. This results in falls in IT headcount (both in-house and outsourced) leading to declines in IT Services revenues. During the recovery cycle, Software licenses pick up first, as products drive efficiency gains during recovery. As an analogy, we can look at the relation between Software and IT Services, levels as being similar to the link between GDP growth and unemployment. Unemployment usually picks up after the beginning of GDP decline while the peak unemployment rate is hit way after the recovery in the GDP growth rates.

The results of IT services bellwethers IBM and Accenture are instructive, in our view. After a dip in consulting/short term bookings for a few quarters, the environment has become significantly better, and this is clearly reflected in the short term signings of IBM and Accenture. Accenture's commentary following the recent results is telling in this regard: "Systems integration bookings were strong again this quarter and the highest in 10 quarters. The primary driver is ERP, as clients are streamlining their operations and reducing their costs due to globalization, M&A, and regulation." They also indicated that this demand "reflects implementations on SAP, Oracle, and Microsoft platforms, as well as package enhancements and add-on industry-specific software, including analytics, that need to be integrated. " All of this points to significant discretionary spend momentum, in our view.

**Figure 4: YoY growth in Accenture's Consulting bookings**




*Source: Company data, Spark Capital Research*

# HCL Technologies

## All positives priced in

| | | | |
|---|---|---|---|
| CMP | Rs. 475 | Absolute | Reduce |
| Target | Rs. 465 | Relative | Underperform |

**HCL Technologies (HCLT) has been able to catch-up and even outperform its larger peers in revenue growth by acquiring Axon and also by investing in Remote Infrastructure Management (RIM). However, the story is not the same when it comes to other metrics such as margins, cash generation and return ratios. Though HCLT's revenue growth has been impressive and would continue to be inline with larger peers, led by its RIM practice, our concern is on HCLT's margin owing to: aggressive pricing especially in RIM, lower than peer fresher recruits, increased contribution from RIM business and relatively low SG&A spend. We do not share consensus optimism in HCLT improving operating margins by 100bps in FY12. We do not expect HCLT's P/E to bridge the gap with Tier-1 owing to relatively poorer financial metrics. Initiate coverage on HCLT with Reduce and Underperform rating with a price target of Rs. 465.**

**B'RIM'ing with growth:** HCLT's revenue growth profile has been stellar even through the downturn, and with sustained aggression we expect this trend to continue into succeeding quarters as well. The growth pillars we expect are RIM and EAS, with the uptick in discretionary spend expected to help HCLT. We expect a **24% revenue CAGR** from FY10-13E. with RIM being the prime **mover with a 32% CAGR over this timeframe**. Also, with substantial uptick expected in discretionary spending (where we draw inferences from our analysis of global tech bellwethers SAP, Oracle, Accenture and IBM), HCL's EAS practice (~21% of revenues) should benefit.

**Margins would settle at FY11E level:** Margins are the area where we continue to be cautious on HCLT - our estimates bake in a 120bps decline from FY11E to 15.7% in FY13E, which compares to our FY12E margin estimate of 16%. As a result of RIM contribution increasing to ~24% of revenues (100bps increase from Dec-10 quarter), BPO overhang and limited lateral hiring, margins would be muted in our view. Overall, we think wage hikes + muted pricing uptick are likely to hold sway over profitability improvements in RIM and BPO, which explains our cautious margin forecasts.

**Initiate with Reduce / UPF:** HCLT has outperformed CNXIT predominantly by delivering revenue growth ahead of estimates. On the back of this, consensus expectation have rolled forward to FY12E and expects a 100bps margin expansion to top up a high revenue growth expectation. However, we do not share this optimism due to reasons outlined above. We expect HCLT to post FY11-13E EPS CAGR of 23%. An analysis of HCL Tech's trading history indicates that the stock has traded at 1 year forward P/E of 15x on 64% of its trading history over last five year. We value HCLT at 15x 12 months **ended Sep-12 EPS of Rs. 31.5** to arrive at our price target of **Rs. 465. Initiate with Reduce and UPF.**

**Financial summary**

| Year | Revenues (Rs. mn) | EBITDA (Rs. mn) | PAT (Rs. mn) | EPS (Rs.) | P/E(x) | EV/EBITDA(x) |
|---|---|---|---|---|---|---|
| FY10 | 159,237 | 26,954 | 16,666 | 24.2 | 19.7 | 12.0 |
| FY11E | 198,536 | 31,862 | 20,675 | 30.0 | 15.9 | 10.1 |
| FY12E | 241,589 | 37,861 | 25,157 | 36.5 | 13.0 | 8.5 |

**Initiating Coverage**

| | |
|---|---|
| Date | Apr 05, 2011 |
| **Market Data** | |
| SENSEX | 19686 |
| Nifty | 5910 |
| Bloomberg | HCLT IN |
| Shares o/s | 674 mn |
| Market Cap | Rs 320bn |
| 52-wk High-Low | Rs 517-340 |
| 3m Avg. Daily Vol | Rs 498mn |
| Index member | Nifty |
| **Latest shareholding (%)** | |
| Promoters | 65 |
| Institutions | 27 |
| Public | 8 |

**Stock performance (%)**

| | 1m | 3m | 12m |
|---|---|---|---|
| HCLT | 1 | 1 | 31 |
| Nifty | 5 | (5) | 10 |
| CNXIT | 4 | (5) | 19 |

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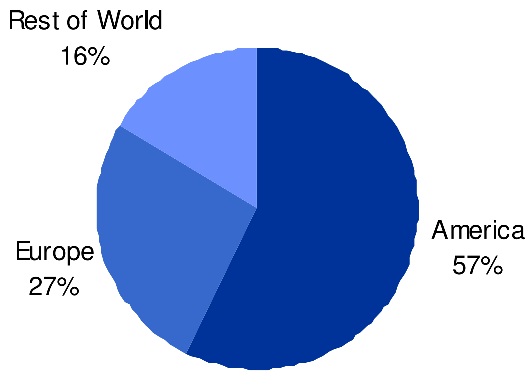
# HCL Technologies
## Business overview

| CMP | Rs. 470 | Absolute | REDUCE |
| --- | --- | --- | --- |
| Target | Rs. 465 | Relative | UPF |

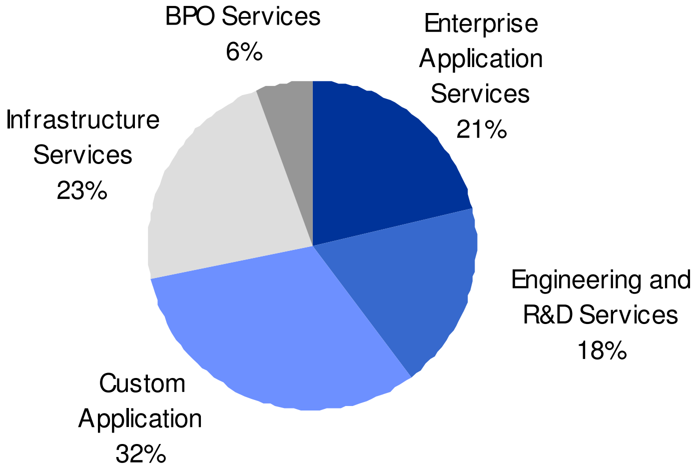
**Figure 5: Geographic split of revenues**




*Source: Company data, Spark Capital Research*

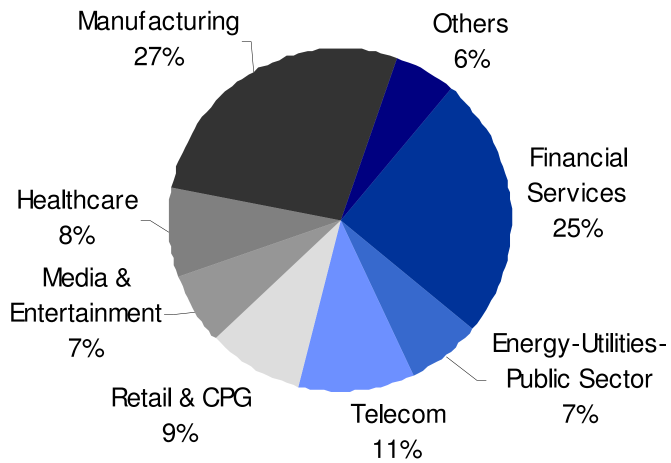
HCLT derives ~60% of its revenues from the Americas region, which is broadly similar to the large-cap IT players. However, it is on the service line front that HCL's distinguishing characteristics appear. **Enterprise Application Services accounts for ~21% of its revenues**, which means a significant chunk of its revenue base is exposed to discretionary spending. Secondly, Infrastructure services account for **~23% of revenues which gives the company an exposure to one of the most promising areas of IT services** from a structural growth perspective. The company also has a solid Engineering/R&D services practice which, under current demand trends, is likely to remain under duress in the near term (this business is similar to Infotech's EMI practice). Finally, we point to HCLT's limited **BPO practice, which accounts for only ~5-6% of** revenues - this piece of the business has been struggling and we think it is better for HCLT to get its BPO strategy right before expanding this service line further.

**Figure 6: Revenue split by service line**




*Source: Company data, Spark Capital Research*

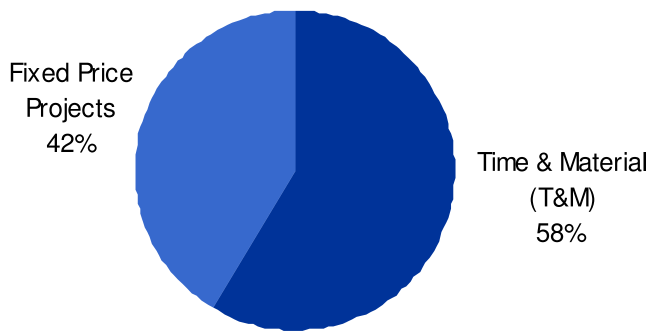
**Figure 7: Revenue split by vertical**




*Source: Company data, Spark Capital Research*

| CMP | Rs. 470 | Absolute | REDUCE |
|---|---|---|---|
| Target | Rs. 465 | Relative | UPF |

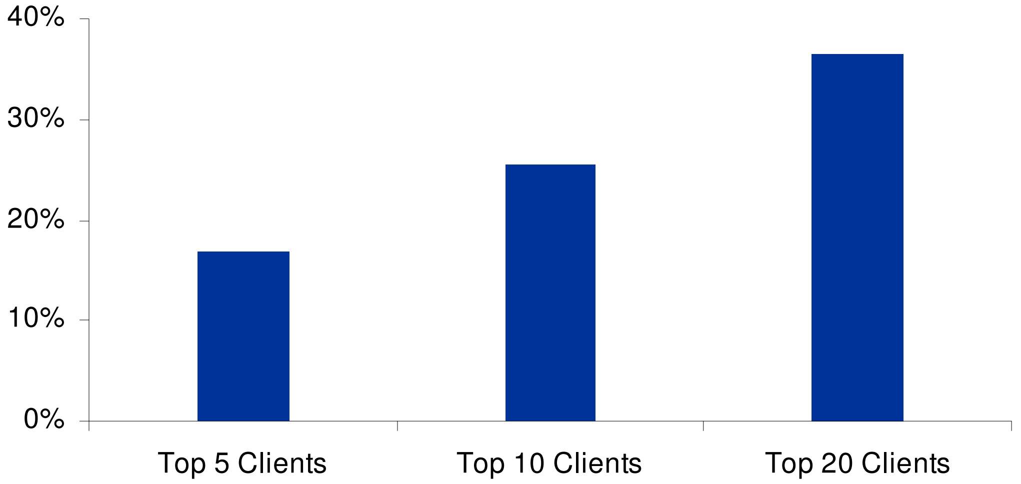
**Figure 8: Revenue split by project type**




*Source: Company data, Spark Capital Research*

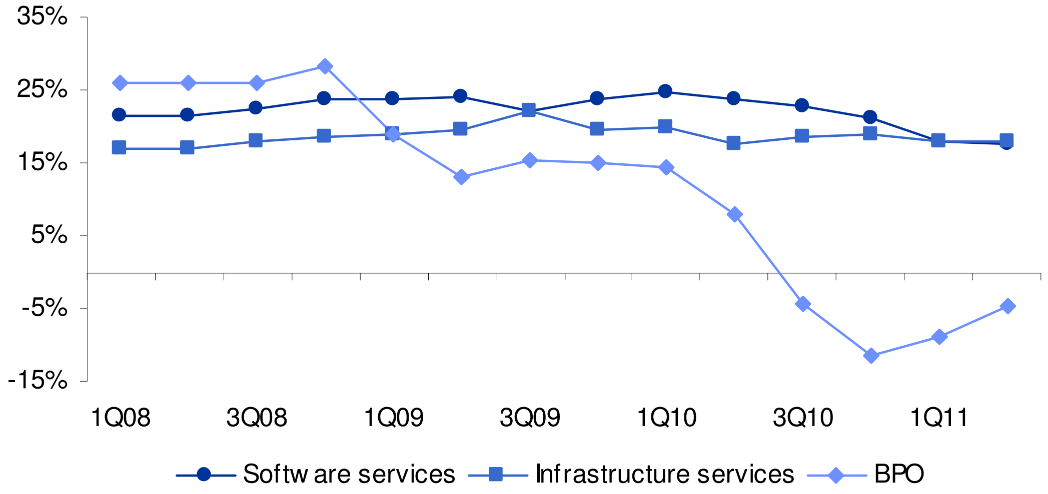
In terms of verticals, HCL Tech gets ~25% of its revenues from Financial services, which is comparable to that of Wipro in the large-cap space but significantly lags TCS and Infy. Also, manufacturing accounts for 27% of revenues, the largest proportion among large-caps. Telecom and CPG account for ~10% of revenues apiece, rounding off a vertical exposure profile that is significantly different from a typical large-cap. ~55-60% of HCL Tech's revenues come from T&M contracts, but we think this will gradually shift more towards FP projects as more outcome-based billing models begin to hold sway. Finally, in terms of margin profile, Software services and RIM are doing well for HCL Tech with ~20% margin levels, but the key issue is with BPO, in our view. BPO margins have declined due to: a) Restructuring of business to shift from voice to non-voice based work. b) **Investments in the modernization of Liberata's insurance platform. Company has noted that losses would continue in BPO till Dec'11.**

**Figure 9: Client concentration chart**




*Source: Company data, Spark Capital Research*

**Figure 10: Segmental EBITDA margins**




*Source: Company data, Spark Capital Research*

# HCL Technologies

## EAS – Prime mover

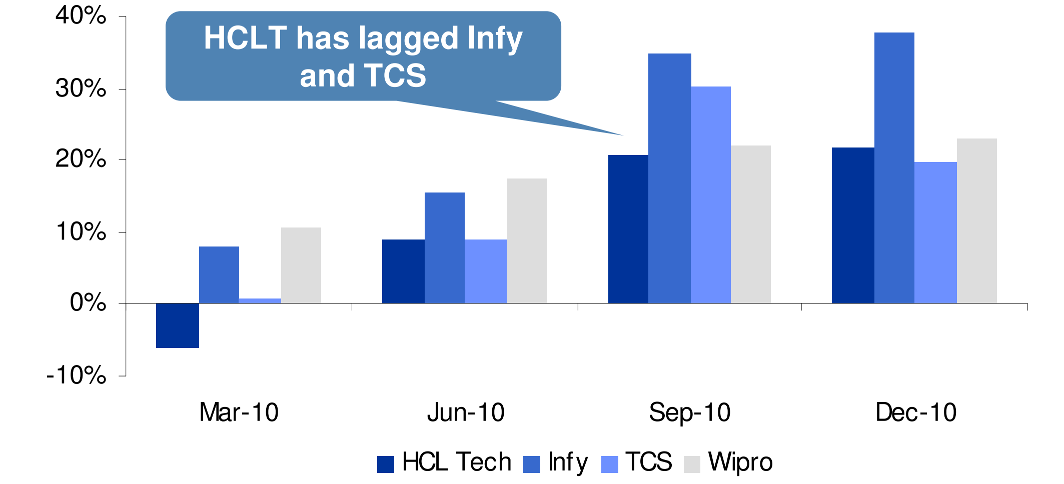
| CMP | Rs. 470 | Absolute | REDUCE |
|---|---|---|---|
| Target | Rs. 465 | Relative | UPF |

HCLT has a strong EAS franchise bolstered significantly by its acquisition of UK-based consulting firm Axon. Following a "reverse integration" process wherein HCL Tech's EAS employees were subsumed into the Axon group, HCL has built a formidable EAS franchise – arguably the strongest among the Indian IT pack. Figure 12 show the steep increase in revenues from EAS (quarterly and yearly) which is primarily a result of the Axon acquisition in Dec-08 (i.e. FY09). This also resulted in EAS share of HCL's revenues increasing from 10-11% previously to ~20-21% currently (Figure 12).

On the back of solid momentum in enterprise software license sale and bookings by consulting companies, we are surprised by HCLT lagging **TCS and Infosys in revenue growth from EAS over the three quarters. HCLT derives ~80% of its EAS revenues from consulting and implementation work, vs. ~50% for both Infosys and TCS. We find the trend of HCLT's EAS business growing slower than peers is worrying, as HCLT might be losing market share in a high growth market**. Though we have not assumed a market share decline in our models, we would be tracking relative growth on year-on-year basis keenly.

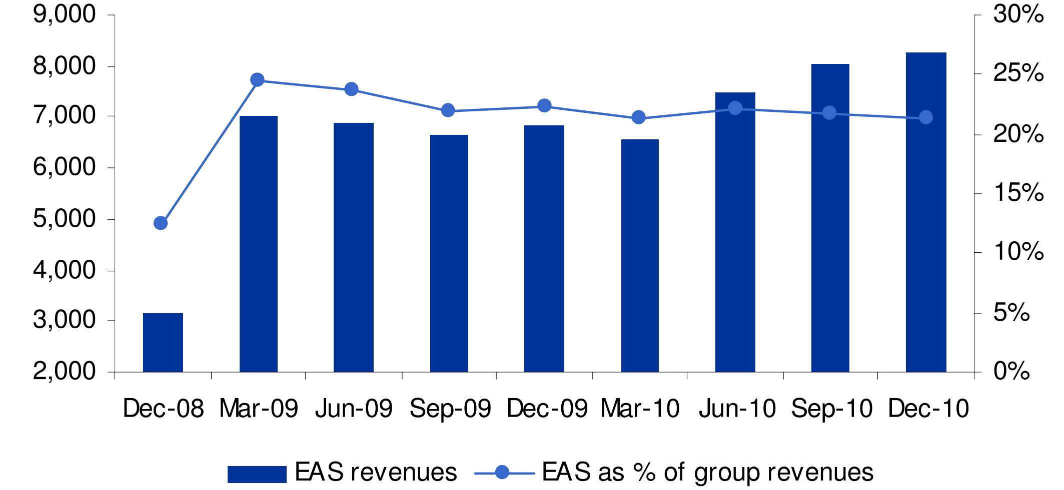
We believe that as a result of discretionary spend uptick, the share of EAS in HCL Tech's revenues should be closer to 23-25% on a sustainable basis. We believe the acquisition overall has been a success despite starting off on the back foot initially due to macroeconomic turmoil during 2008/09.

**Figure 11: Comparison of EAS revenue growth yoy**




*Source: Company data, Spark Capital Research*

**Figure 12: HCLT's EAS revenue progression**




*Source: Company data, Spark Capital Research*

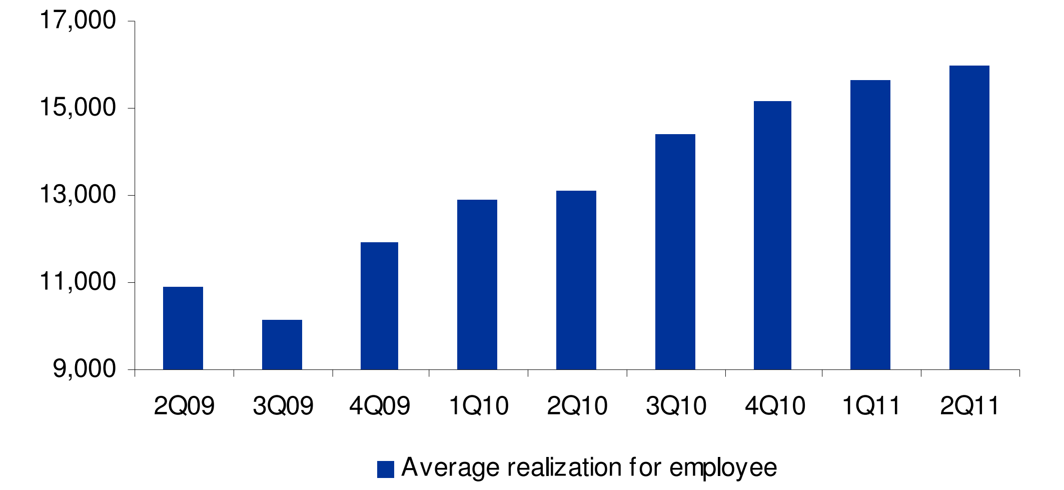
# HCL Technologies

## RIM – Growth, but at a price

| CMP | Rs. 470 | Absolute | REDUCE |
|---|---|---|---|
| Target | Rs. 465 | Relative | UPF |

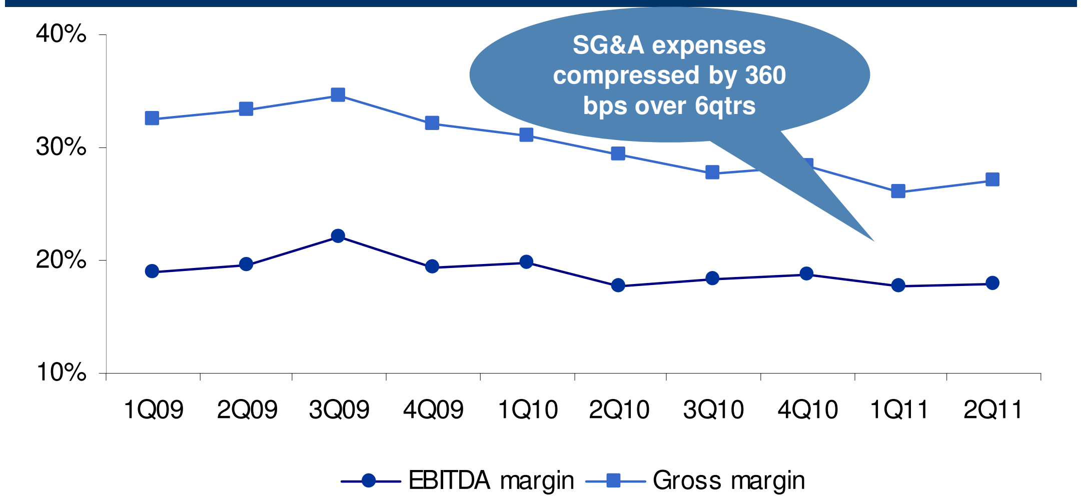
RIM is a key growth pillar for HCLT, and in our view RIM is the area where HCLT's aggressive go-to-market approach is most evident. Figure 15 shows the rapid up-scaling of growth in the RIM vertical quarter after quarter. HCLT's large deals e.g. the US$ 350mn outsourcing deal with publishing group Readers Digest, tend to have RIM as a key component – indeed, winning such large deals in the past by itself bestows upon HCLT the crucial **advantage of having an established track record in implementing large deals. HCLT's realisation per employee in RIM has seen a sharp increase over the last few quarters and we believe it is an outcome of rebadging onsite employees**. The other side of this growth is that margins have got eroded to some extent (Figure 13) as a result of HCLT's push into RIM and emphasis on gaining market share. We believe that going forward, HCLT would not be able to increase margins meaningfully, as it continues to adopt aggressive pricing and also due to high component of onsite work.

**Figure 14: Average realisation per employee have increased steadily**



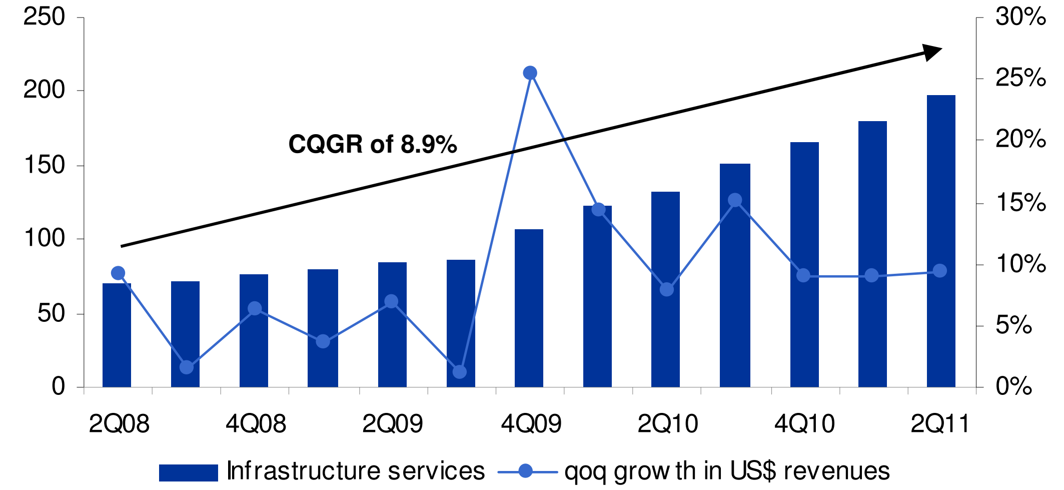

*Source: Company data, Spark Capital Research*

**Figure 13: RIM – Gross margin progression**




*Source: Company data, Spark Capital Research*

**Figure 15: RIM – US$ revenues (mn) and qoq growth (%)**




*Source: Company data, Spark Capital Research*

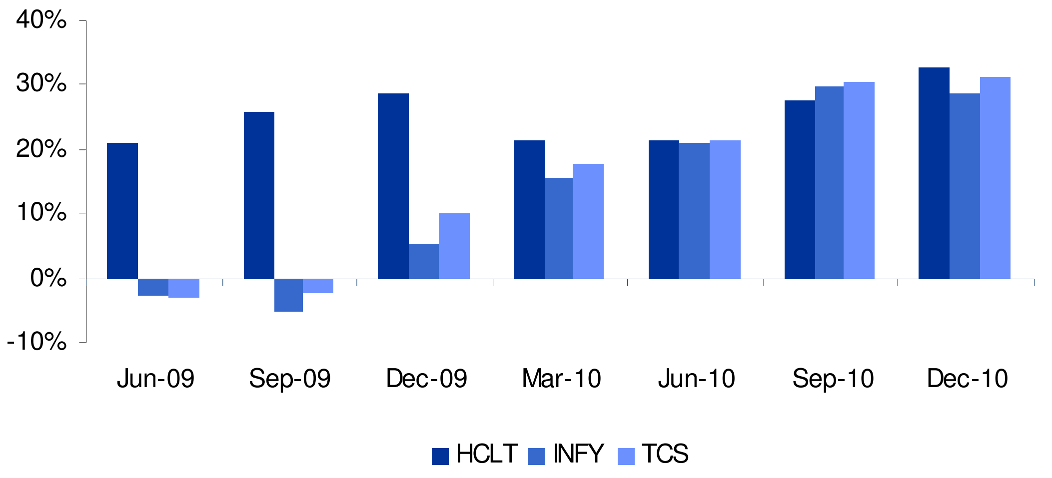
SPARK CAPITAL enhancing value

# HCL Technologies

## Growth measures up to peers, but margins need to catch up

| CMP | Rs. 470 | Absolute | REDUCE |
|---|---|---|---|
| Target | Rs. 465 | Relative | UPF |

**Figure 16: US$ revenue growth yoy**

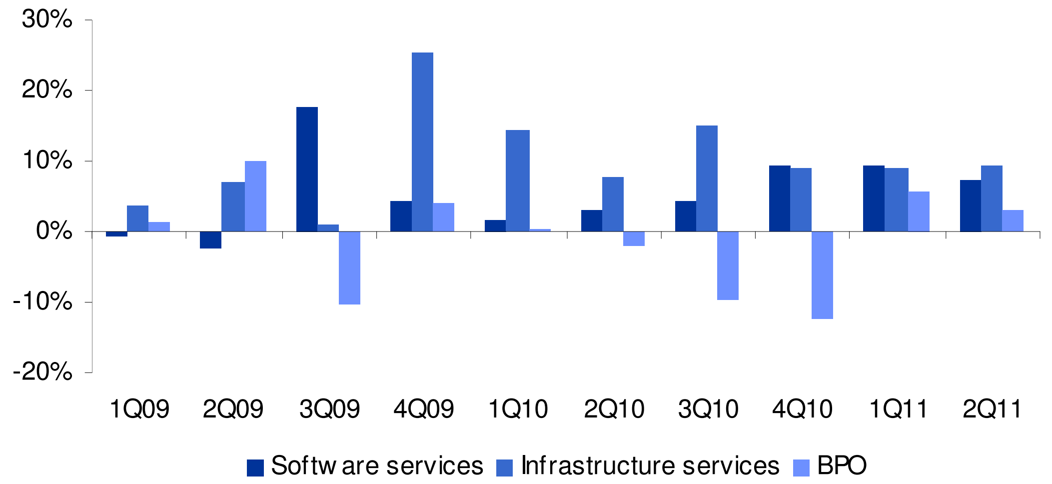



*Source: Company data, Spark Capital Research*

Figure 16 shows that HCLT's revenue growth profile measures up to that of large-cap peers, and sometimes even exceeds large-cap benchmarks. In terms of growth pillars, Figure 17 clearly shows that Infrastructure services is the prime mover whereas **BPO is a laggard – in our view, the BPO situation should reverse as their** investments in platform BPO take shape over the next four to five quarters.

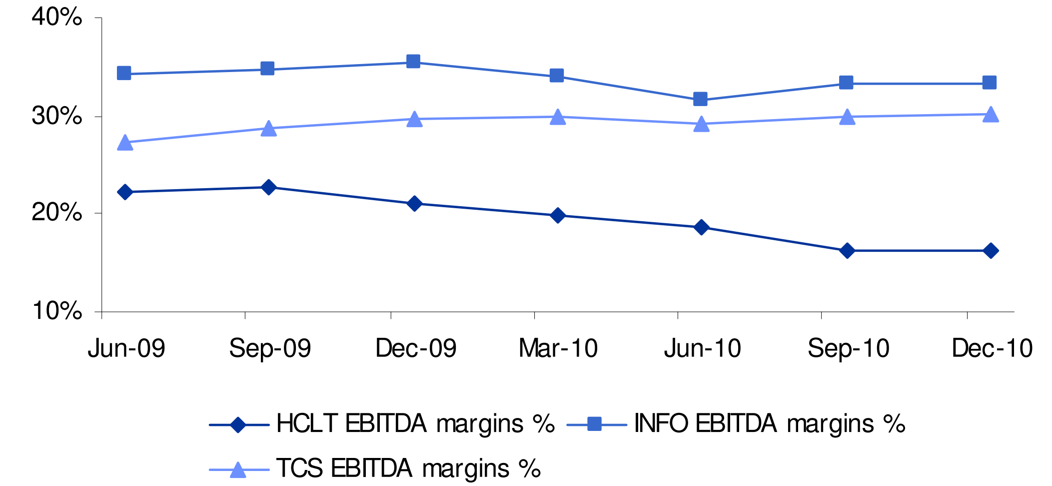
Some of this growth, in our view comes at the expense of margins, where Figure 18 shows a divergence in margin trends for HCL vs TCS and Infosys. While TCS and Infy exhibited immaculate operational and margin control right through the downturn, **HCL continued to focus on growth – which it did obtain, but at the expense of its margin profile**. On the positive side, we think margins have stabilized more-or-less at current levels, and we see more risks on the upside than downside currently on the margin front.

**Figure 17: HCLT – YoY revenue growth by service line**




*Source: Company data, Spark Capital Research*

**Figure 18: EBITDA margins vs peers**




*Source: Company data, Spark Capital Research*

# HCL Technologies

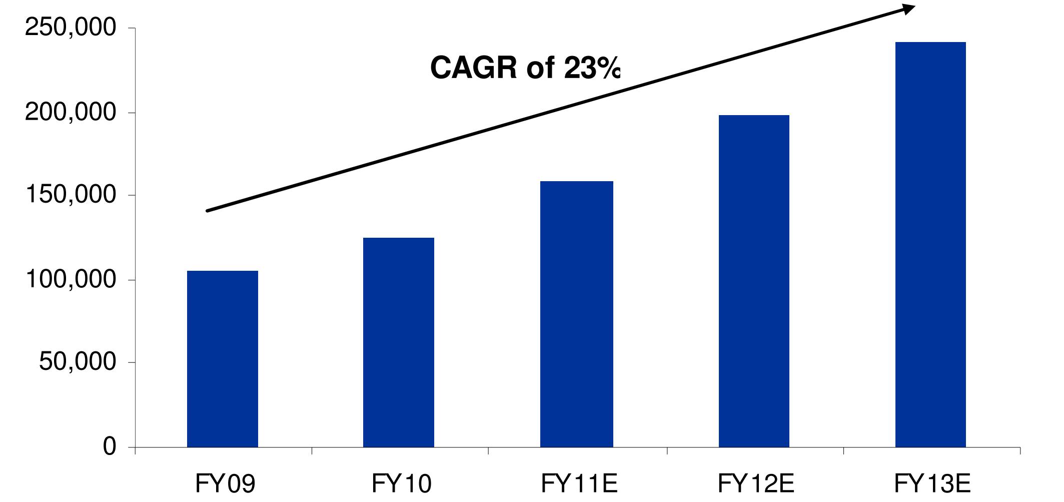
| CMP | Rs. 470 | Absolute | REDUCE |
| --- | --- | --- | --- |
| Target | Rs. 465 | Relative | UPF |

## Financials – Expect continued growth momentum; margins key

HCLT's revenue growth profile has been stellar even through the downturn, and with sustained aggression we expect this trend to continue into future as well. The growth pillars would be RIM and EAS, with the uptick in discretionary spend expected to help HCL Tech. Accordingly, our expectation is for a **24% revenue CAGR from FY10-13E.**

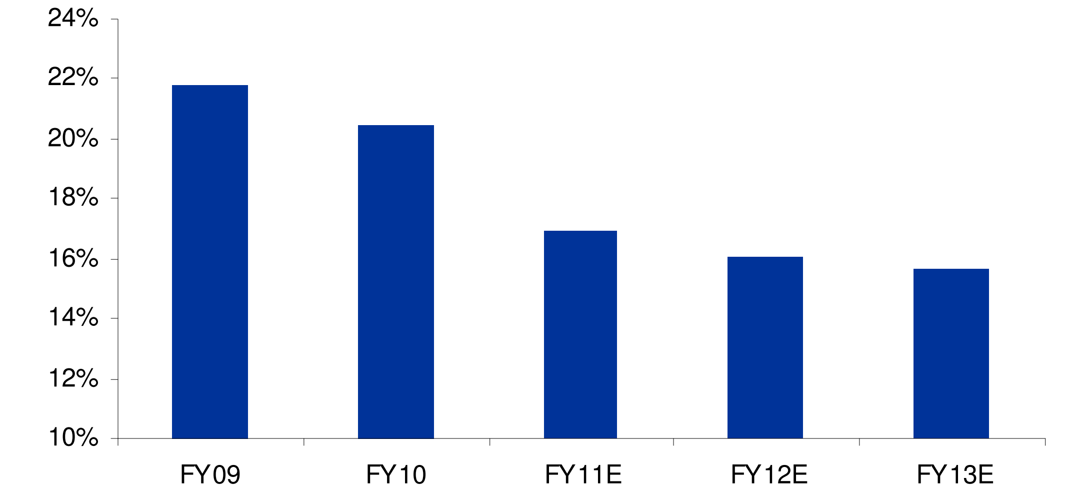
Margins are the area where we continue to be cautious on HCLT - our estimates bake in a 120bps decline from FY11E to 15.7% in FY13E, which compares to our FY12E margin estimate of 16%**. As a result of RIM contribution increasing to ~24% of revenues (100bps increase** from Dec-10 quarter), BPO overhang and limited lateral hiring, margins would be muted in our view. Upside risks to our margin estimate could, however, come from improved profitability in both BPO and RIM. Overall, we think wage hikes + muted pricing uptick are likely to hold sway over profitability improvements in RIM and BPO, which explains our cautious margin forecasts.

**Figure 20: HCLT – Revenue growth**



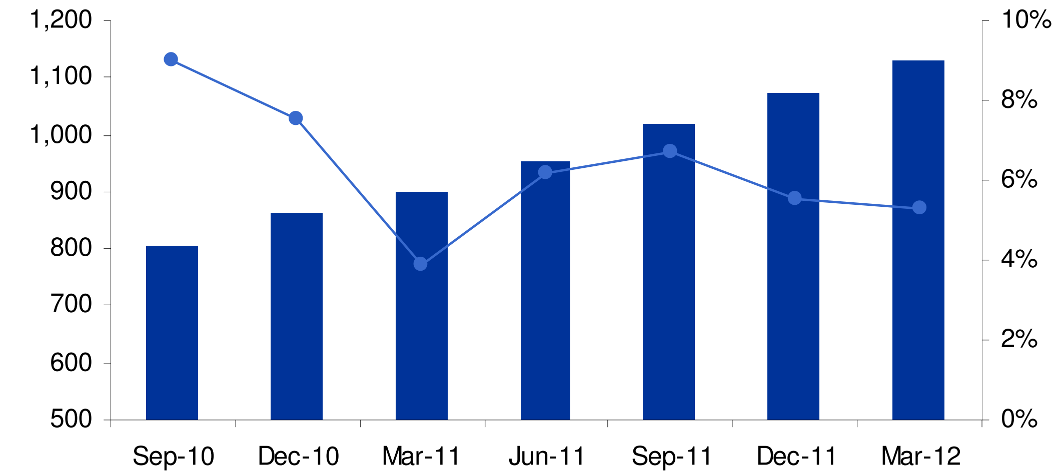

*Source: Company data, Spark Capital Research*

**Figure 19: HCLT – EBITDA margins**




*Source: Company data, Spark Capital Research*

**Figure 21: HCLT – qoq growth in US$ revenues**




*Source: Company data, Spark Capital Research*

# HCL Technologies

## Financials – Impressive metrics, but risks exist

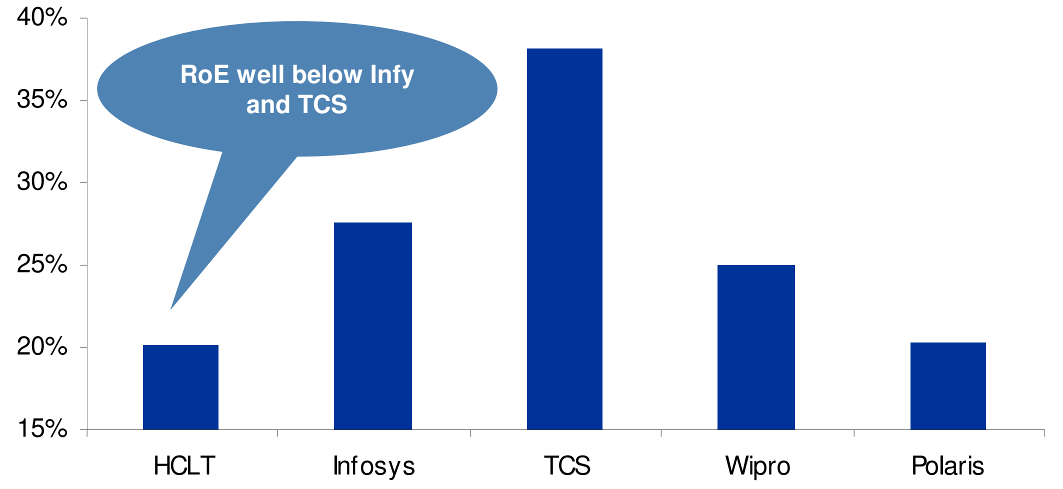
| CMP | Rs. 470 | Absolute | REDUCE |
|---|---|---|---|
| Target | Rs. 465 | Relative | UPF |

HCL Tech's earnings trajectory is solid, and we expect revenue growth (rather than margins) to help drive this over coming years. EPS CAGR is at ~24% in line with revenue growth mainly because of the shift in Other income and Foreign exchange gains from negative to positive territory over this time frame.

HCL Tech enjoys reasonably good conversion of its EBITDA to operating cash flows , which is encouraging in our view. **At ~60-70% levels (Figure 24). – in comparison, Infy is at ~75-80% on this metric.** Free cash flow generation, which not necessarily impressive on an absolute basis, are showing an improving trend, which is again positive in our view.

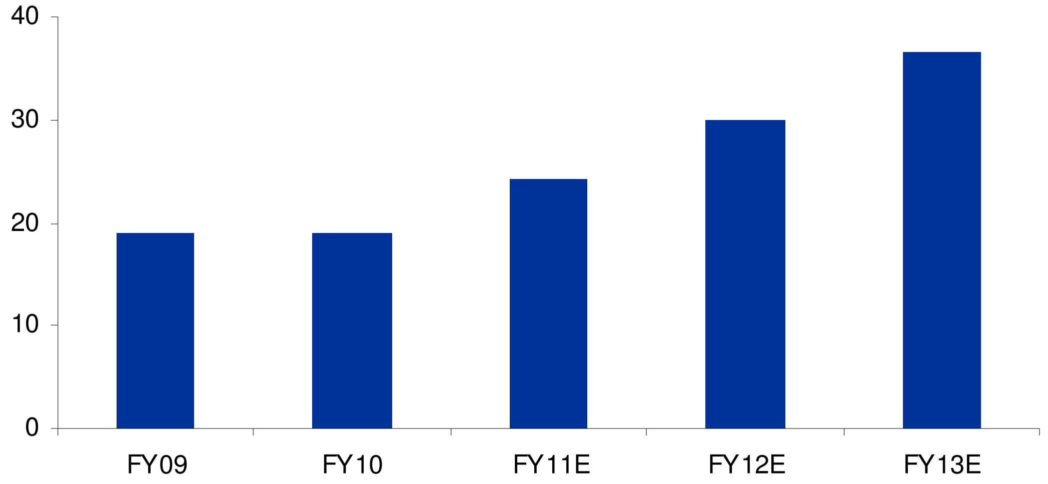
**On return ratios HCL scores poorly inspite of having debt to the extent of Rs. 25bn.** We believe a sustained improvement in return rations and cash generation would prove to be crucial for HCLT to rerate and bridge the gap with Tier-1 companies.

### Figure 23: Comparison of TTM RoE



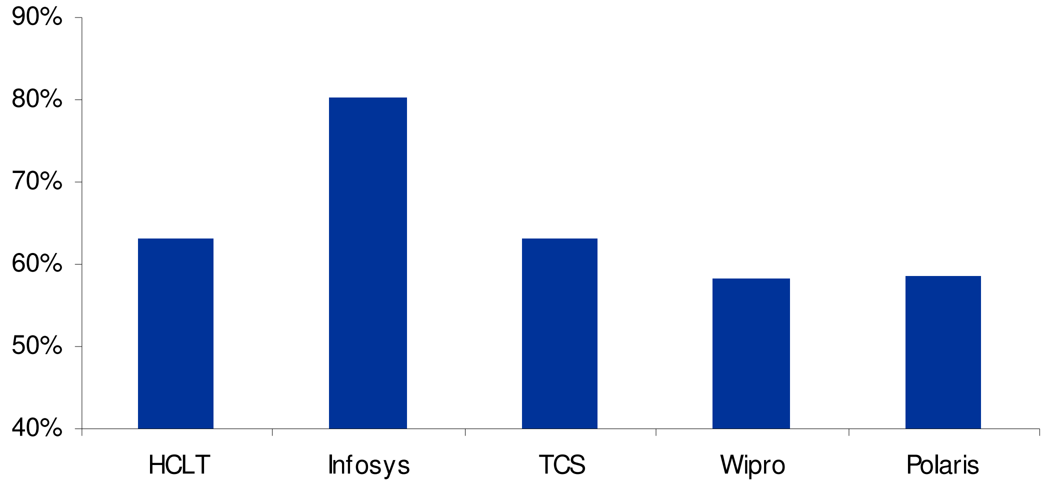

*Source: Company data, Spark Capital Research*

### Figure 22: HCL – EPS progression




*Source: Company data, Spark Capital Research*

### Figure 24: Comparison of CFO/EBITDA



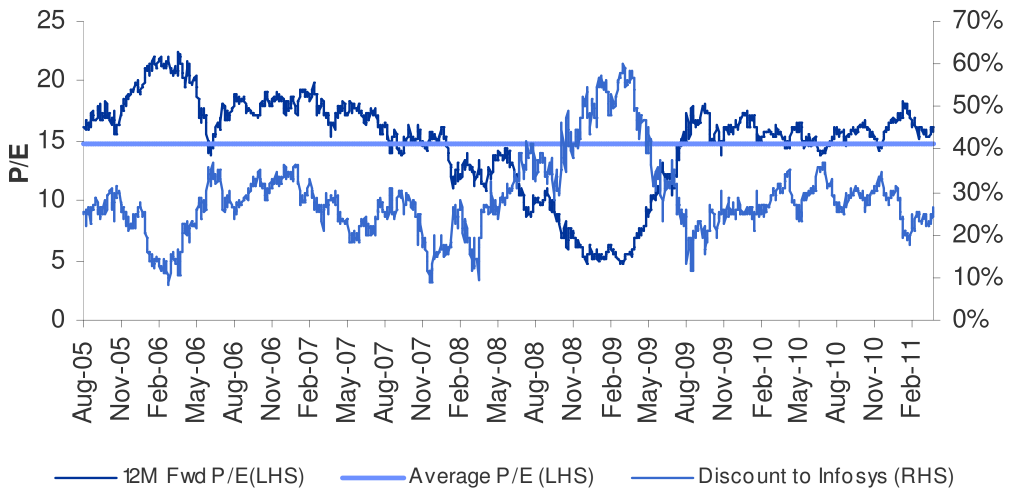

*Source: Company data, Spark Capital Research*

| | | | |
|---|---|---|---|
| CMP | Rs. 475 | Absolute | Reduce |
| Target | Rs. 465 | Relative | Underperform |

**All positives have been priced in – Initiate with Reduce**

HCL Tech's stock has been one of the better performers over the last 12 months, with the stock returning **31% versus CNXIT's return of 18%. An analysis of HCL Tech's trading history indicates that the stock has traded at 1 year forward P/E of 15x on 64% of its trading history.** Even though HCL Tech's EPS FY11-13E EPS CAGR of 23% is superior to Tier-1 companies, HCL Tech disappoints on other financial metrics such as RoE, CFO generation, predictable revenue and operating profit growth. Moreover, we do not share the consensus' optimism in HCL improving its operating margins by 100bps in FY12 due to HCL's aggressive pricing especially in RIM deals, lower than peer fresher recruits, increased contribution from RIM business and relatively low SG&A levels. HCL Tech would have to deliver superior revenue growth and more stable operating margin over a period of time to reduce the P/E gap it has with Tier-1 companies**. We value HCL Tech by attaching a multiple of 15x on the 12 months ended Sep-12 EPS of Rs. 31.5 to arrive at our price target of Rs. 465. Initiate with Reduce and UPF**.

**Figure 25: HCLT 12 month rolling forward P/E**




*Source: Company data, Spark Capital Research*

**Risks**

Key risks for HCL Tech outside the industry wide risks such as Wage pressure, foreign exchange fluctuation and macroeconomic concerns are:

- **Aggressive pricing:** HCLT's recent deal wins especially in RIM have been on the back of aggressive pricing. RIM contracts owing to its nature in most cases are priced for a period of three to five years at flat prices or minimal pricing increase. Moreover, analysis of HCLT RIM business indicates a sharp increase in onsite related RIM business. We highlight that in case a client decides to offshore a portion of the work; HCLT would have to incur substantial costs in restructuring some of the deals. Another risk emanating from highly competitive pricing is the inability to pass on cost pressures, especially cost-pressures emanating from wage hikes.
- High exposure to discretionary spend: **HCLT generates ~17% of its revenues from ERP consulting and implementation** work. As noted earlier, ERP works are pulled down drastically in the event of an economic downturn. Accenture's consulting bookings declined 20% yoy at the depth of the recession. Owing to its higher onsite component, the impact on margins is more pronounced.

# HCL Technologies
## Financial Summary

| CMP | Rs. 475 | Absolute | Reduce |
|---|---|---|---|
| Target | Rs. 465 | Relative | Underperform |

| Abridged Financial Statements | | | | |
|---|---|---|---|---|
| Rs. mn | FY10 | FY11E | FY12E | FY13E |
| **Profit & Loss** | | | | |
| Revenues | 125,650 | 159,237 | 198,536 | 241,589 |
| Direct Costs | 81,957 | 108,595 | 137,769 | 169,325 |
| Gross Profits | 43,692 | 50,642 | 60,768 | 72,264 |
| SG & A | 17,964 | 23,688 | 28,905 | 34,403 |
| EBITDA | 25,728 | 26,954 | 31,862 | 37,861 |
| Depreciation | 3,895 | 4,512 | 5,128 | 5,519 |
| Amortisation | 1,115 | 697 | 661 | 651 |
| EBIT | 20,718 | 21,745 | 26,073 | 31,691 |
| Foreign Exchange Gains / (loss) | (4,757) | (789) | - | - |
| Other Income, net | (532) | 370 | 1,131 | 1,411 |
| PBT | 15,429 | 21,326 | 27,204 | 33,101 |
| Provision for Tax | 2,403 | 4,660 | 6,529 | 7,944 |
| Share of Minority Interest | (2) | (2) | - | - |
| Net Income | 13,027 | 16,666 | 20,675 | 25,157 |
| EPS- Basic | 19.3 | 24.7 | 30.7 | 37.3 |
| EPS - Diluted | 18.9 | 24.2 | 30.0 | 36.5 |
| **Balance sheet** | | | | |
| Total Current Liabilities | 31,329 | 38,120 | 47,679 | 57,591 |
| Borrowings | 26,632 | 26,007 | 26,007 | 26,007 |
| Other Liabilities | 7,386 | 6,391 | 6,391 | 6,391 |
| Total Liabilities | 65,347 | 70,518 | 80,077 | 89,989 |
| Total Stockholders Equity | 70,368 | 83,100 | 98,314 | 118,009 |
| **Total - Sources of funds** | **135,715** | **153,618** | **178,390** | **207,998** |
| Cash & Cash Equivalents | 4,686 | 8,720 | 19,653 | 35,335 |
| Account Receivables, net | 25,139 | 28,590 | 35,759 | 43,193 |
| Fixed Deposits with Banks | 10,913 | 14,429 | 14,429 | 14,429 |
| **Total - Application of funds** | **135,715** | **153,618** | **178,390** | **207,998** |

| Key metrics | | | | |
|---|---|---|---|---|
| | FY10 | FY11E | FY12E | FY13E |
| **Cashflow** | | | | |
| Net cash from operations | 17,912 | 17,274 | 22,264 | 26,733 |
| Net cash from investing | -10,141 | 370 | 1,131 | 1,411 |
| Net cash from financing | -7,278 | -2,731 | -5,462 | -5,462 |
| Free cash flow | 13,089 | 26,165 | 31,862 | 37,861 |
| Cash at year-end | 4,833 | 19,600 | 26,653 | 42,335 |
| **Growth** | | | | |
| Revenues | 19% | 27% | 25% | 22% |
| EBITDA | 12% | 5% | 18% | 19% |
| PAT | 2% | 28% | 24% | 22% |
| EPS | 0% | 28% | 24% | 22% |
| **Margins** | | | | |
| EBITDA | 20.5% | 16.9% | 16.0% | 15.7% |
| PAT | 10% | 10% | 10% | 10% |
| **Return** | | | | |
| ROE | 20% | 22% | 23% | 23% |
| ROCE | 16% | 15% | 16% | 16% |
| **Valuation** | | | | |
| Fully diluted shares (mn) | 674 | 674 | 674 | 674 |
| Market cap (Rs. mn) | 320,027 | 320,027 | 320,027 | 320,027 |
| EV (Rs.mn) | 322,372 | 322,372 | 322,372 | 322,372 |
| EV/Sales (x) | 2.6 | 2.0 | 1.6 | 1.3 |
| EV/EBITDA (x) | 12.5 | 12.0 | 10.1 | 8.5 |
| P/E (x) | 25.1 | 19.7 | 15.8 | 13.0 |
| EPS(E) / Current market price | 4% | 5% | 6% | 8% |
| Revenue per employee (000's) | 2,152 | 2,223 | 2,252 | 2,321 |
| EBITDA per employee (000's) | 441 | 376 | 361 | 364 |
| PAT per employee (000's) | 223 | 233 | 234 | 242 |

# Tech Mahindra

## One side of the coin

| | | | |
|---|---|---|---|
| CMP | Rs. 700 | Absolute | Buy |
| Target | Rs. 810 | Relative | Outperform |

**TECHM's focus on telecom vertical has been both its biggest boon and its biggest bane. A boon, because of the strong growth the company witnessed in FY07and FY08, and a bane because the next three years have been lacklustre. From the time TECHM won the bid to purchase fraud-hit Satyam, the management's intention has been to merge both the companies. With some of the litigations pertaining to Mahindra Satyam cleared, we expect the proceedings for the merger of TECHM and MSAT to kick start over the next 12 – 18 months. The combined entity would have annual revenues of US$ 2.5bn (FY12) and a diversified revenues base in verticals, client concentration and service offering. Given the attractive valuation we believe investors should buy into both MSAT and TECHM in a manner that would result in the same stake in both the companies. We prefer this approach in order to protect against the swap ratio that could be used for the merger. Initiate coverage with BUY/OPF and a price target of Rs. 810.**

**Revenue growth would lag industry growth**

We expect TECHM revenue growth to lag the industry's growth rate owing to its focus on telecom vertical and also due to tight spending by its top client. With top client continuing at a similar **rate (GBP 70-72mn per quarter)** we expect non top client to drive revenue growth.

**Some of the concerns would be addressed post merger**

Investors have been concerned on high client concentration and TECHM being a single vertical company. Merger with MSAT would alleviate some concerns as top client concentration would **go down from 44% to ~21% and the** largest vertical albeit telecom would account for 48% of revenues. Moreover a merger would enable a more effective cross-sell of the strengths of both companies.

**Initiate with BUY/OPF**

TECHM and MSAT are companies that are bound to merge and we believe a merger would be consummated in the next 12 to 18 months. We recommend investors invest in both companies in a manner that would result in the same stake in both the companies. We prefer this approach to hedge against the swap ratio that would be used for the merger. We value the combined company on **P/E of 12x at a 20% discount to our target multiple for HCLT. We forecast the combined entity to post an earnings of Rs. 12.7bn for 12 months ending Sep-12 resulting in an upside of 16% Initiate coverage with a price target of Rs. 810.**

**Financial summary**

| Year | Revenues (Rs. mn) | EBITDA (Rs. mn) | PAT (Rs. mn) | EPS (Rs.) | P/E(x) | EV/EBITDA(x) |
|---|---|---|---|---|---|---|
| FY10 | 44,249 | 9,320 | 7,004 | 53.5 | 13.0 | 11.1 |
| FY11E | 49,378 | 8,080 | 5,412 | 41.4 | 16.9 | 12.9 |
| FY12E | 52,550 | 8,936 | 5,945 | 45.4 | 15.4 | 11.6 |

**Initiating Coverage**

| | |
|---|---|
| Date | Apr 05, 2011 |
| **Market Data** | |
| SENSEX | 19686 |
| Nifty | 5910 |
| Bloomberg | TECHM IN |
| Shares o/s | 125mn |
| Market Cap | Rs bn |
| 52-wk High-Low | Rs 915-476 |
| 3m Avg. Daily Vol | Rs. 196mn |
| Index member | BSE200 |
| **Latest shareholding (%)** | |
| Promoters | 73 |
| Institutions | 17 |
| Public | 10 |

**Stock performance**

| | 1m | 3m | 12m |
|---|---|---|---|
| TechM | 1 | (7) | (19) |
| Nifty | 5 | (5) | 10 |
| CNXIT | 4 | (5) | 19 |

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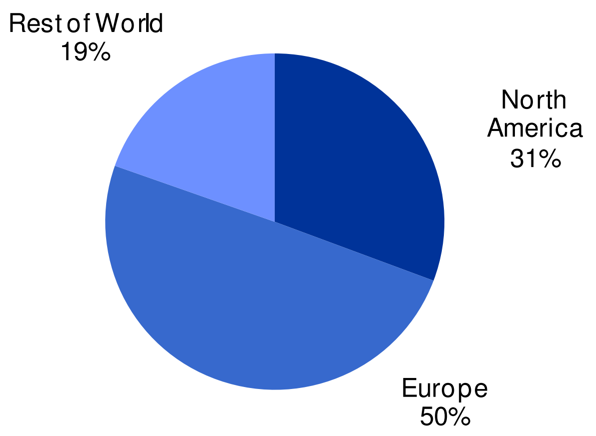
| CMP | Rs. 700 | Absolute | Buy |
|---|---|---|---|
| Target | Rs. 810 | Relative | Outperform |

**Figure 26: TECHM – Revenue by Geography**



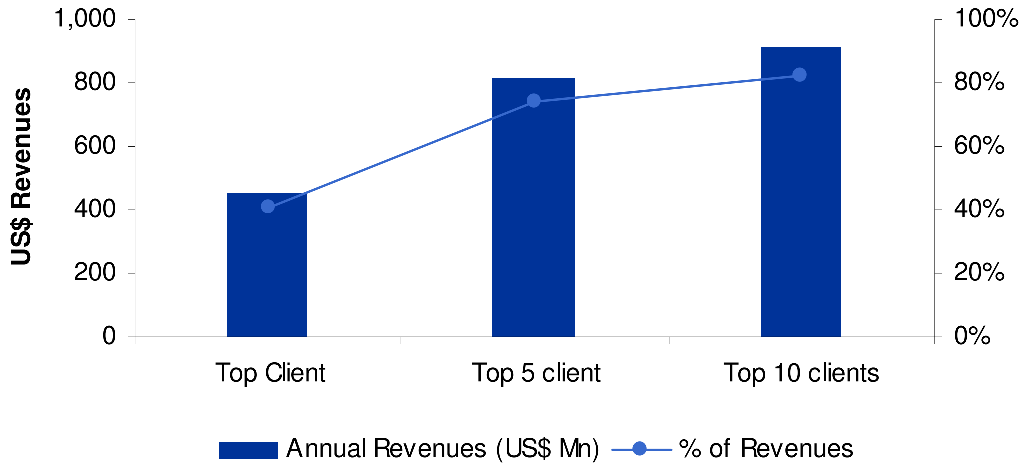

*Source: Company data, Spark Capital Research*

TECHM had its beginning as a joint-venture between Mahindra and Mahindra and British Telecom. Over the course of time, TECHM started servicing external clients also. Owing to its legacy TECHM focuses and generates all its revenues from the Telecom vertical. In Apr-09 TECHM won the bid to acquire the erstwhile Satyam Computers and ended up acquiring 42.66% stake in Satyam Computers and later renamed it as Mahindra Satyam.

TECHM generates its revenues mainly from the telecom service providers. Its clients include the likes of British Telecom, AT&T, Airtel, Zain and Vodafone. TECHM has a high client concentration ratio as its top client British Telecom accounts **for 44% of revenues (peak of 65%).** Owing to the nature of the telecom vertical, a handful of clients account for most of the revenues, a trait seen even in larger competitors such as Infosys.

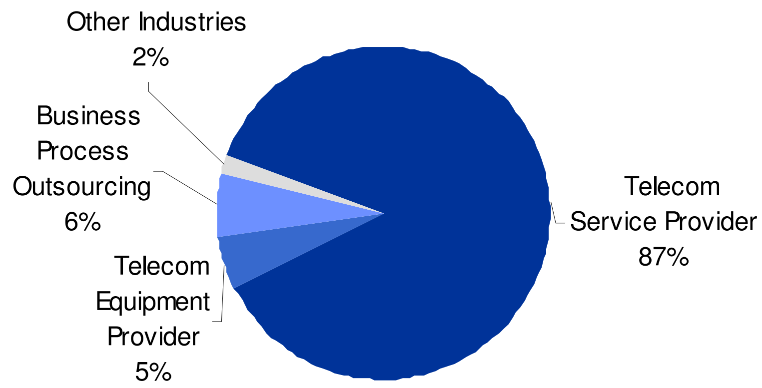
**Europe accounts for 50% of TECHM's revenues due to its largest client being located in UK. BPO services have been TECHM's area of growth.**

**Figure 27: TECHM – Client Concentration**



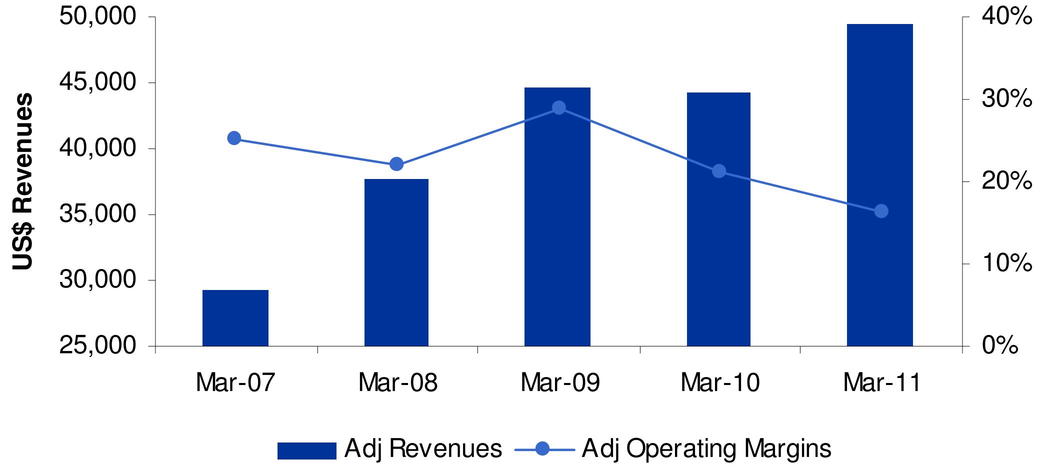

*Source: Company data, Spark Capital Research*

**Figure 28: TECHM – Revenue by vertical**




*Source: Company data, Spark Capital Research*

**Figure 29: TECHM – Revenue and margin trajectory**



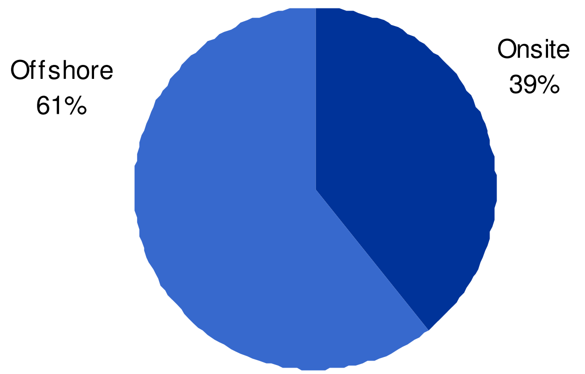

*Source: Company data, Spark Capital Research*

**British Telecom deal overview**

During the course of FY07 and FY08, TECHM entered into an agreement with British Telecom (BT), wherein TECHM paid a consideration of Rs. 9.65bn for two transactions, for guaranteed cumulative business of US$ 2bn over the next five to seven years. The consideration paid was treated as one-off expense and taken to P&L statement.

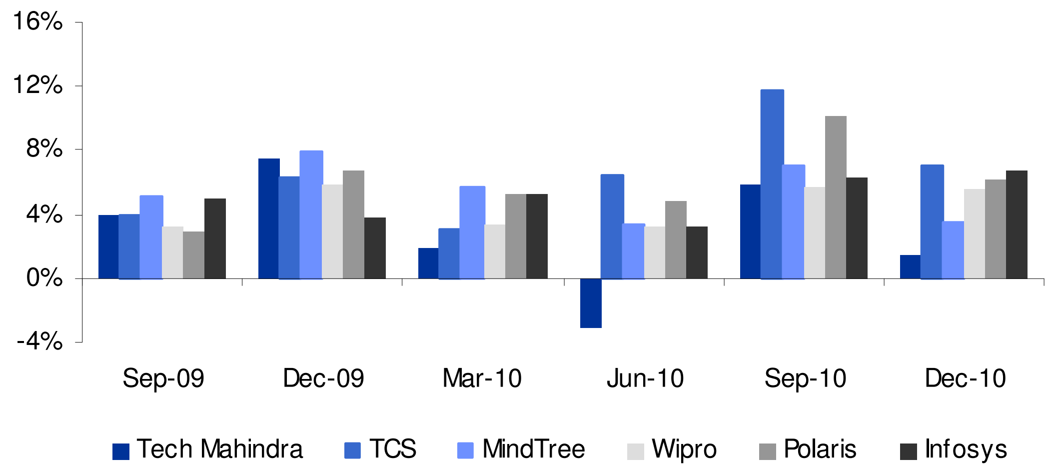
In Mar-09 BT restructured its deal with TECHM, as BT was not able to uphold it. As a part of restructured contract BT agreed to pay TECHM a sum **of Rs. 9.68 bn as a one-off restructuring cost and paid all of it. However, TECHM decided to amortize the inflow over a 16 quarter period** and recognize it as a part of revenues. We do not concur with this accounting treatment and hence have restated the financials to remove the impact of this transaction and the same has been noted as adjusted financials. However, we note that **for Income Tax purpose both the initial outflow and the inflow are amortized by the company.**

**Figure 30: TECHM – Higher offshore mix aids margins**




*Source: Company data, Spark Capital Research*

**Figure 31: TECHM has lagged peers in qoq US$ Revenues growth**



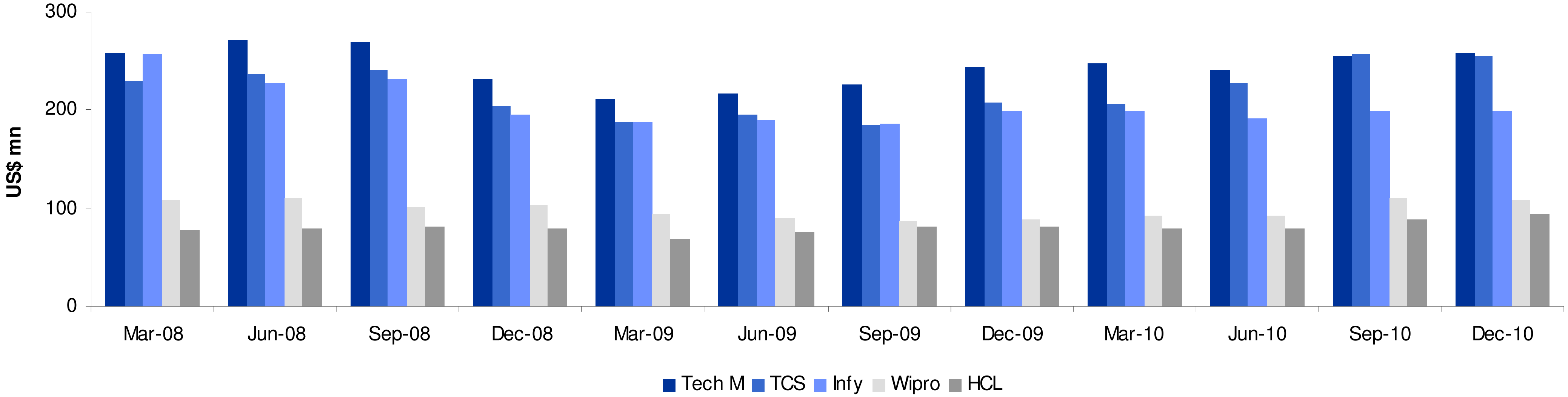

*Source: Company data, Spark Capital Research*

# Tech Mahindra

## Continues to be leader in telecom vertical

| CMP | Rs. 700 | Absolute | Buy |
|---|---|---|---|
| Target | Rs. 810 | Relative | Outperform |

**Figure 32: Overview of offshore vendor market share in Telecom vertical**



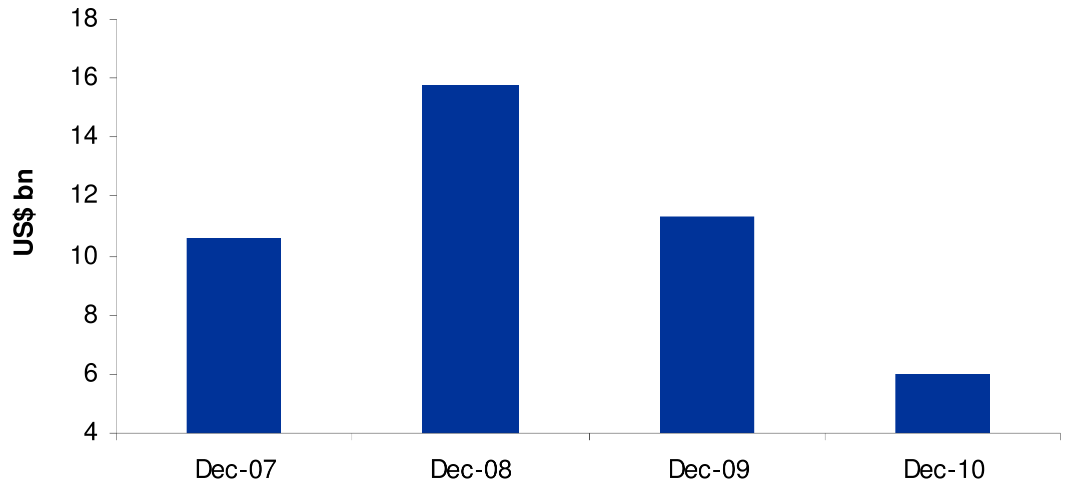

*Source: Company data, Spark Capital Research*

**TECHM has maintained market-share**

Figure 32 indicates revenues from telecom vertical amongst TCS, Infosys, Wipro, HCL and TECHM. Inspite of a lot of changes, we note that, TECHM's market share has not declined and continues to be around 28%. This is inspite of TECHM's top client (accounts for ~45% of revenues) reducing business by over 15% in a weak environment for telecom deals. TECHM continues to be one of the largest offshore vendors in the telecom vertical and would capitalise on any avenues for growth. Moreover as indicated by figure 33, deal closures in Telecom and Media verticals have been very week over the last couple of years.

Recent conversations with TECHM and other offshore vendors indicate minimal revival in spending by telecom company's in developed nations. A surge in IT spend by telecom companies would enable TECHM to grow its revenues at a much healthier rate than now.

**Figure 33: Deal flow in Telecom and Media vertical has been weak**




*Source: TPI, Spark Capital Research*

**Emerging markets continues to be a focus area**

Emerging markets account for 14% of TECHM overall revenues now vis a vis 7% three years ago. Strong growth has been possible as Tech M has one many end-to-end systems integration deal, wherein they have helped operators to launch telecom operations in a circle or country from scratch. TECHM is a strong contender and has won a number of deals in the merging markets including India on the back of its strong telecom expertise. According to press reports systems integration deals with Etisalat and STel are cases in point. With the roll out of 3G/LTE and many emerging markets still having low penetration of telecom services, Tech M is well positioned to capture growth in our opinion.

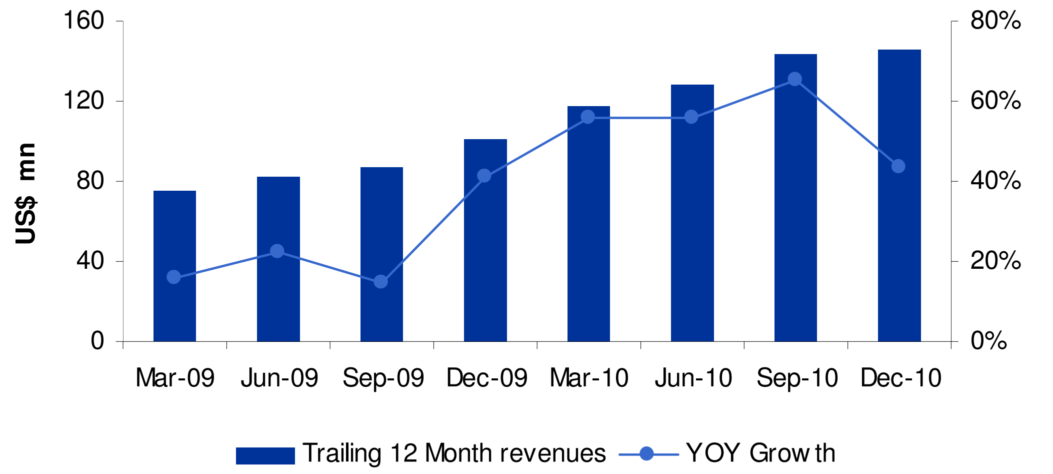
**Non top client growth continues to be impressive**

Revenues from British Telecom has been muted post the restructuring. Most of TECHM's revenue growth has been driven by other clients in the emerging and developed markets. TECHM has been able to leverage its deep domain expertise in the area of telecom to add new clients and also mine many of its existing clients to improve its market share. Over the next 12 – 18 month revenue growth of TECHM would be driven by its non-top clients.

**Service Expansion - A key growth driver**

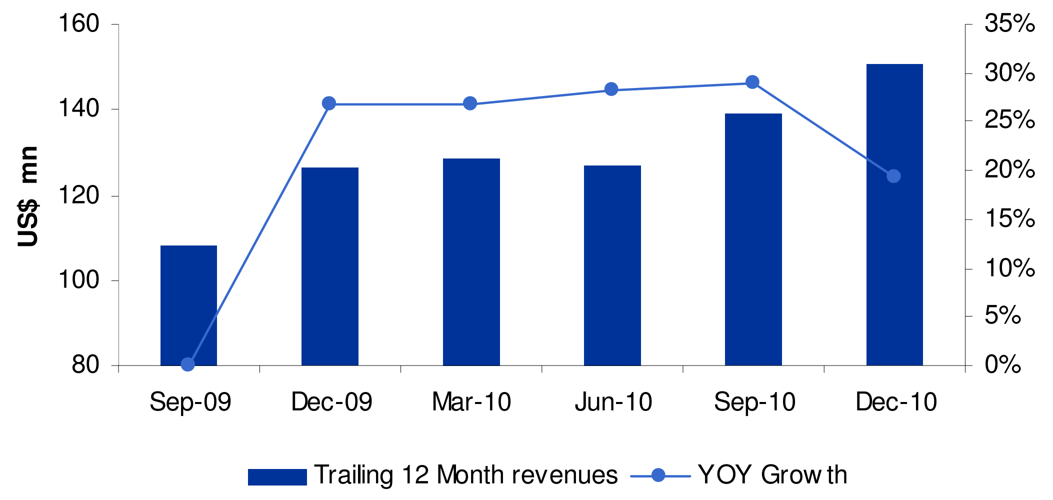
TECHM has been expanding its service portfolio to include BPO and is also trying to leverage MS's expertise in the EAS domain. The recent deal win with Airtel, ie – to provide BPO services to a part of African business is a significant win for TECHM's BPO practise. We are positive on the deal, because with deal TECHM would enter the African market and also gain scale in its BPO business. Over the course and FY12, we expect the business to ramp up and result in ~35% revenue growth for the BPO business in FY12.

**Figure 34: TECHM – Emerging markets have grown sharply**




*Source: Company data, Spark Capital Research*

**Figure 35: TECHM – Robust growth in non top-client revenues**




*Source: Company data, Spark Capital Research*

# Tech Mahindra

## Muted growth across all fronts

| CMP | Rs. 700 | Absolute | Buy |
|---|---|---|---|
| Target | Rs. 810 | Relative | Outperform |

**FY11-FY13 Revenue CAGR of 14%**

We expect TECHM's revenue growth to be lower than industry owing to its Telecom focus. However initial discussions indicate a mild pickup in spend environment of Telecom verticals. We have not factored in material improvement in business momentum from its top client and expect the growth to be driven by its non-top client. However, any improvement in spend from its top-client would improve revenue growth trajectory substantially.

**Minimal expansion to margins 3QFY11 base**

TECHM's operating margins have declined by ~1000 bps from Mar-09 to Dec-10. Decline is margins can be predominantly attributed to depreciation of GBP by ~18% and pricing cuts from its top-client. In the near term, TECHM has few margin levers to manage and improve its margins namely – pricing, employee pyramid and utilisation.

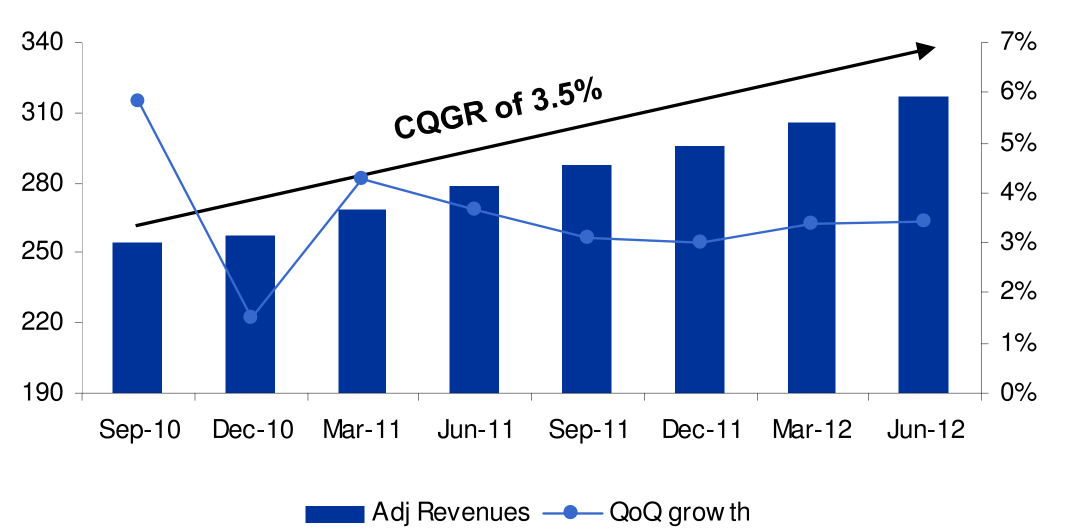
TECHM's employee mix in the 0-3 years buckets is well below industry average and the company is targeting to improve it by hiring increased number of freshers and has made offers to 3,500 campus recruits for FY12.

**EPS CAGR of 17% over FY11-13E**

We forecast EPS CAGR of 17% over FY11-13E, driven by operating income and improved other income. We expect cash generation to improve as DSO would decline, as TECHM would receive substantial portions of payments pertaining to a large systems integration deal undertaken in 2QFY11.

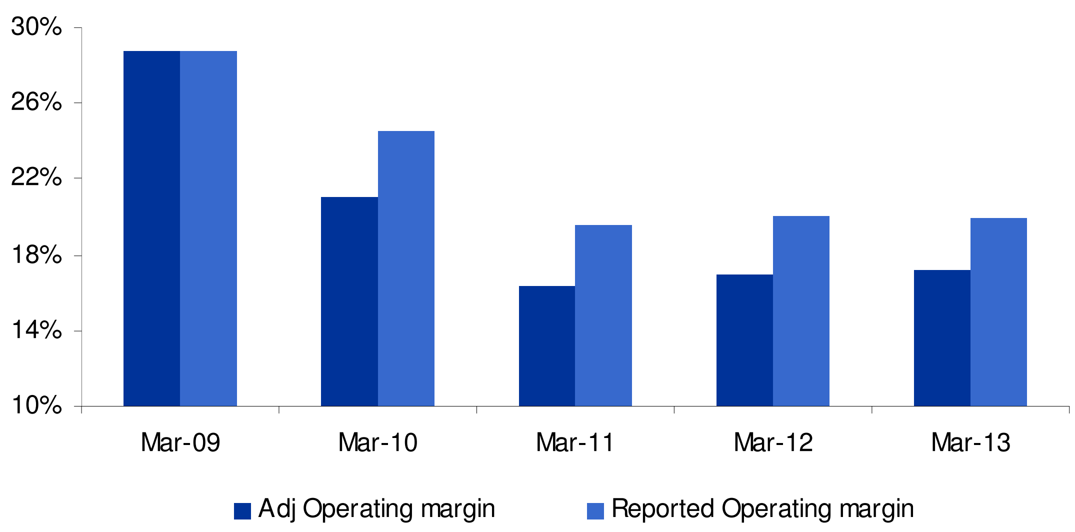
We note that all our forecast are after adjusting for the amortisation resulting from the BT restructuring deal. However, the companies actual reporting would be higher than our forecast.

**Figure 36: TECHM – Steady growth in sequential revenues**




*Source: Company data, Spark Capital Research*

**Figure 37: TECHM – Margins would continue to be subdued**




*Source: Company data, Spark Capital Research*

# Tech Mahindra

## Valuation/Risk

| CMP | Rs. 700 | Absolute | Buy |
|---|---|---|---|
| Target | Rs. 810 | Relative | Outperform |

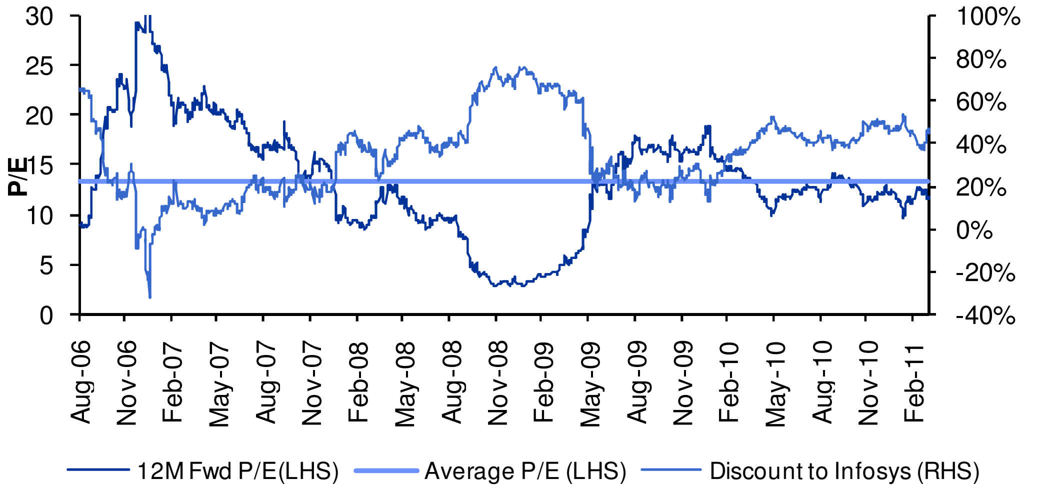
**Prefer a proportionate stake in TECHM and MSAT – Initiate with a BUY**

TECHM and MSAT are companies that are bound to merge and we believe a merger would be consummated in the next 12 to 18 months. We recommend investors invest in both companies in a manner that would result in same stake in both the companies. We prefer this approach to hedge against the swap ratio that would be used for the merger.

We prefer to value both the companies together by attaching a **P/E of 12x on the combined profit for 12 months ending Sep-12. Our target multiple of 12x is at a 20% discount to our target multiple for HCLT.** We believe the combined entity would trade at a discount owing to slower revenue growth.

**Combined entity is trading at P/E of 12.2x FY12E and 9.0x FY13E, attractive for an entity with revenues of US$ 2.2bn. We initiate coverage with Buy with a price target of Rs. 810, indicating an upside of 16%.** Our target price is arrived at by applying the potential upside from a merged entity scenario to CMP.

**Figure 38: TECHM 12 month rolling forward P/E**




*Source: Company data, Spark Capital Research*

**Risks**

Key risks for TECHM outside the industry wide risks such as Wage Pressure, Foreign exchange fluctuation and Macroeconomic concerns are:

- British Telecom is TECHM's largest client contributing 44% of revenues and also holds ~29% stake in the company. With Mahindra & Mahindra waiving their first right of refusal, any stake sale by BT would be construed as precursor to decline in business. We believe TECHM is one of the largest and longstanding vendor for British Telecom and would not correlate stake sale to reduction in business. We note that Polaris, in which Citi (a investor and top client) has reduced its stake in the company from 40% to 20%. However Citi has not only continued its relationship, but in fact it is a growing account for Polaris.
- One of TECHM's India customers stands the risk of having its 2G licenses cancelled. TECHM has undertaken a large systems integration deal with this company and as a part of the deal, payment for TECHM services would be paid over next 12 quarters. Though there exists risk of bad debt, we note that TECHM has mitigated the risk by taking a bank guarantee from the client for the entire value of the contracts, which TECHM could invoke in the case of default
- MSAT accounts for ~**42% of TECHM's market cap**, and any material decline in MSAT's market cap value would impact TECHM's stock price. In page 29 we have discusses in detail risk's to MS
- MSAT's merger with Tech M is very likely in our view though the form, shape and timeline of merger is still uncertain. Integration of both the companies would be crucial for the fortunes of both companies. Moreover this would be the largest integration for both of companies respectfully. However, we derive some solace, from the fact that MSAT has been in the stewardship of TECHM and also the fact that members of the senior management of MSAT are from TECHM.

# Tech Mahindra

## Financial Summary

| CMP | Rs. 700 | Absolute | Buy |
|---|---|---|---|
| Target | Rs. 810 | Relative | Outperform |

| Abridged Financial Statements | | | | |
|---|---|---|---|---|
| Rs. mn | FY10 | FY11E | FY12E | FY13E |
| **Profit & Loss** | | | | |
| Revenue from services | 46,254 | 51,383 | 54,554 | 61,858 |
| Adj Revenues | 44,249 | 49,378 | 52,550 | 59,853 |
| Cost of Services* | 28,711 | 34,239 | 36,072 | 41,391 |
| Gross Profit | 17,543 | 17,144 | 18,483 | 20,467 |
| Adj Gross Profit | 15,538 | 15,139 | 16,478 | 18,462 |
| SGA | 6,218 | 7,060 | 7,542 | 8,165 |
| Operating Profit | 11,325 | 10,084 | 10,941 | 12,302 |
| Adjusted Operating profit | 9,320 | 8,080 | 8,936 | 10,297 |
| Other Income | 754 | 950 | 825 | 1,378 |
| Interest Expense | 2,184 | 1,038 | 1,008 | 1,008 |
| Depreciation | 1,339 | 1,399 | 1,414 | 1,408 |
| Profit before Tax | 6,551 | 6,593 | 7,339 | 9,260 |
| **Provision for taxes** | 1,440 | 1,334 | 1,394 | 1,852 |
| Profit after tax before exceptional | 7,117 | 5,259 | 5,945 | 7,408 |
| PAT before Associate | 7,004 | 5,264 | 5,945 | 7,408 |
| Profit after tax | 7,004 | 5,412 | 5,945 | 7,408 |
| PAT As per company reporting | 9,009 | 7,417 | 7,950 | 9,413 |
| EPS - Basic | 56.0 | 43.3 | 47.5 | 59.2 |
| EPS- Diluted | 53.5 | 41.4 | 45.4 | 56.6 |
| **Balance sheet** | | | | |
| Total Shareholders Equity | 28,865 | 36,282 | 44,231 | 53,644 |
| Long Term Debt | 7,500 | 7,500 | 7,500 | 7,500 |
| Unsecured Loan | 6,172 | 6,172 | 6,172 | 6,172 |
| **Total - Sources of funds** | **50,353** | **55,760** | **61,705** | **69,113** |
| Total Fixed Assets & Materials | 11,312 | 12,312 | 13,312 | 14,312 |
| Cash and Equivalents | 2,187 | 7,076 | 13,545 | 20,911 |
| **Total - Application of funds** | **50,353** | **55,760** | **61,705** | **69,113** |

| Key metrics | | | | |
|---|---|---|---|---|
| | FY10 | FY11E | FY12E | FY13E |
| **Cashflow** | | | | |
| Net cash from operations | 14,503 | 5,977 | 7,653 | 7,995 |
| Net cash from investing | -29,925 | -50 | -175 | 378 |
| Net cash from financing | 12,216 | -1,038 | -1,008 | -1,008 |
| Free cash flow | 10,395 | 4,977 | 6,653 | 6,995 |
| Cash at year-end | 2,213 | 7,076 | 13,545 | 20,911 |
| Growth | | | | |
| Revenues | 3.6% | 11.1% | 6.2% | 13.4% |
| Adj Op profit | -27.3% | -13.3% | 10.6% | 15.2% |
| PAT | -31.0% | -22.7% | 9.8% | 24.6% |
| EPS | -32.1% | -22.7% | 9.8% | 24.6% |
| **Margins** | | | | |
| Adj op margin | 21.1% | 16.4% | 17.0% | 17.2% |
| PAT | 15.1% | 10.5% | 10.9% | 12.0% |
| Return | | | | |
| ROE | 29.0% | 16.6% | 14.8% | 15.1% |
| ROCE | 26.7% | 15.2% | 15.2% | 15.7% |
| **Valuation** | | | | |
| Fully diluted shares (mn) | 131 | 131 | 131 | 131 |
| Market cap (Rs. mn) | 91,345 | 91,345 | 91,345 | 91,345 |
| EV (Rs.mn) | 103,842 | 103,842 | 103,842 | 103,842 |
| EV/Sales (x) | 2.3 | 2.1 | 2.0 | 1.7 |
| EV/Adj EBIT (x) | 11.1 | 12.9 | 11.6 | 10.1 |
| P/E (x) | 13.0 | 16.9 | 15.4 | 12.3 |
| EPS(E) / Current market price | 7.7% | 5.9% | 6.5% | 8.1% |
| Revenue per employee (000's) | 1,534 | 1,461 | 1,380 | 1,381 |
| Adj EBIT per employee (000's) | 309 | 230 | 226 | 230 |
| PAT per employee (000's) | 232 | 154 | 150 | 165 |

# Mahindra Satyam

## The other side of the same coin

| CMP | Rs. 67 | Absolute | Buy |
|---|---|---|---|
| Target | Rs. 77 | Relative | Outperform |

**MSAT is staging a strong comeback on the strength of improved client addition, business flow and employee addition. 2 years after Tech Mahindra won the bid to become the majority shareholder in the fraud-hit Satyam, Mahindra Satyam has stemmed both revenue decline and client attrition. Today the management of MSAT is focused on adding new clients, improving employee retention and expanding margins. Management of Tech Mahindra has indicated that an eventual merger of both the entities would happen, though the form of timeline is still not known. The Merged entity would be the fifth largest IT services company in the listed space, with revenues of US$ 2.5bn (FY12). We expect the merged entity to be a fairly diversified revenue base. Investors should buy into both MSAT and Tech M in a manner that would result in the same stake in both the companies. We prefer this approach in order to hedge against the swap ratio that would be used for the merger. Initiate coverage with BUY/OPF and a price target of Rs. 77.**

**Growth is back:** Following the fraud, MSAT lost more than half its clients and revenues. However over the last three quarters revenues have stabilised and in fact started to grow, as is evident from the 40+ client additions over the last 15 months and US$ revenue growth of 4% posted in 3QFY11. MSAT along with its parent TECHM is focussed on driving growth by leveraging each others strength and by also being selective in the markets they would compete. The combined entity would focus on Manufacturing, Telecom, Enterprise Application services and vertical BPO. We are positive on this strategy, as competing on every vertical and horizontal would not be possible at this stage of the evolution.

**FY11-13E EPS CAGR of 60% :** Earnings growth would be driven by revenue growth of 16% and EBITDA Margin expansion of ~650bps. Our forecast for margin expansion would stem from volume growth, improved employee pyramid, pricing and operating leverage. Led by strong operating performance, we expect MSAT to post a EPS CAGR of 60% over FY11-13E.

**Initiate with BUY/OPF**

TECHM and MSAT are companies that are bound to merge and we believe a merger would be consummated in the next 12 to 18 months. We recommend investors invest in both companies in a manner that would result in the same stake in both the companies. We prefer this approach to hedge against the swap ratio that would be used for the merger. **We value the combined company on P/E of 12x at a 20% discount to our target multiple for HCLT. We forecast the combined entity to post an earnings of Rs. 12.7bn for 12 months ending Sep-12 resulting in an upside of 16%. Initiate coverage with a price target of Rs. 77.**

**Financial summary**

| Year | Revenues (Rs. mn) | EBITDA (Rs. mn) | PAT (Rs. mn) | EPS (Rs.) | P/E(x) | EV/EBITDA(x) |
|---|---|---|---|---|---|---|
| FY10 | 54,810 | 5,556 | 2,923 | 2.5 | 27.2 | 10.5 |
| FY11E | 50,861 | 3,989 | 3,535 | 3.0 | 22.5 | 14.7 |
| FY12E | 58,437 | 6,454 | 4,947 | 4.2 | 16.1 | 9.1 |

**Initiating Coverage**

| Date | Apr 05, 2011 |
|---|---|
| **Market Data** | |
| SENSEX | 19686 |
| Nifty | 5910 |
| Bloomberg | SCS IN |
| Shares o/s | 1,176 mn |
| Market Cap | Rs 78bn |
| 52-wk High-Low | Rs 114-54 |
| 3m Avg. Daily Vol | Rs. 545mn |
| Index member | - |
| **Latest shareholding (%)** | |
| Promoters | 43 |
| Institutions | 20 |
| Public | 37 |

**Stock performance**

| | 1m | 3m | 12m |
|---|---|---|---|
| MSAT | 4 | (8) | (29) |
| Nifty | 5 | (5) | 10 |
| CNXIT | 4 | (5) | 19 |

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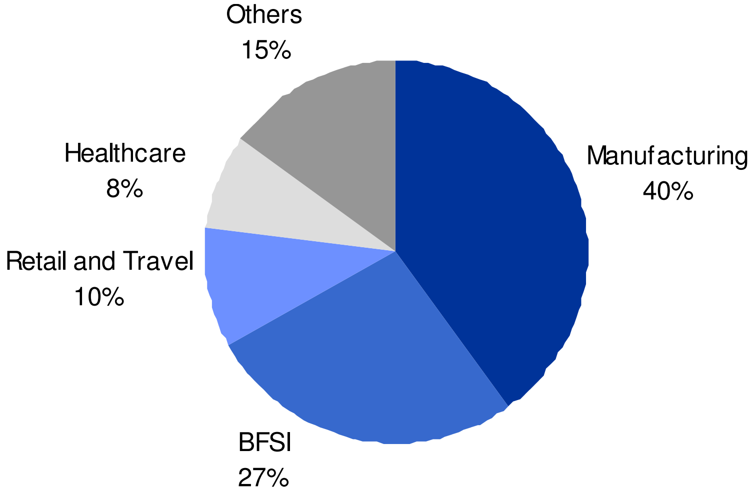
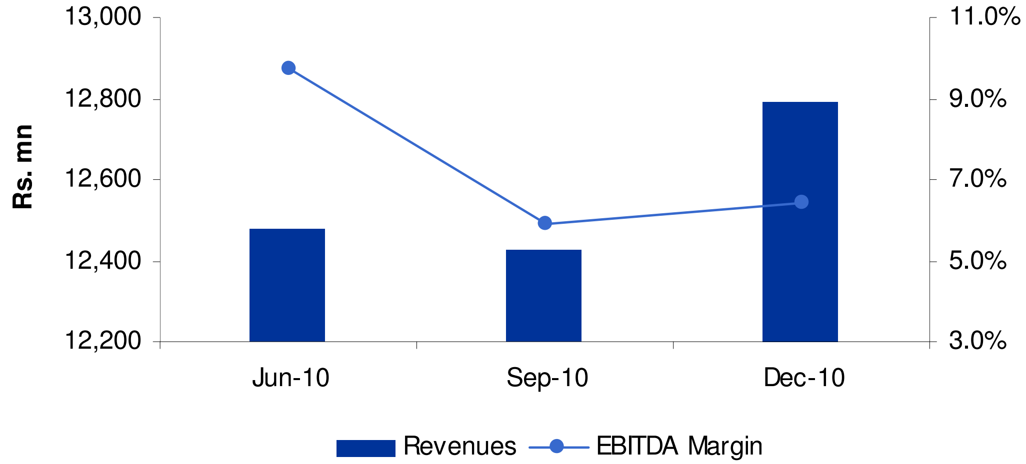
**Figure 39: MSAT – Revenue breakup by vertical**



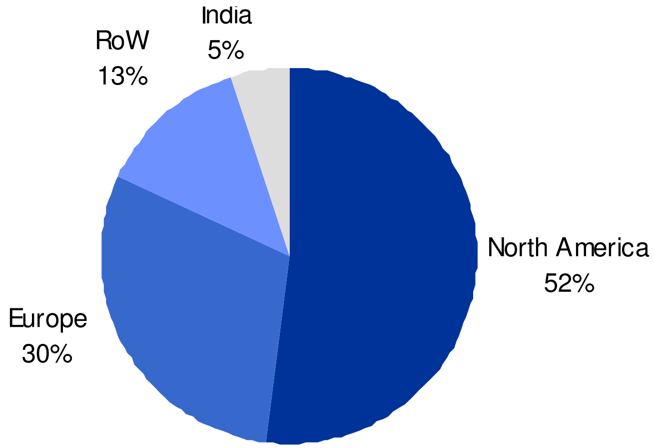

*Source: Company data, Spark Capital Research*

**Figure 41: MSAT – Revenue and EBITDA Margins**



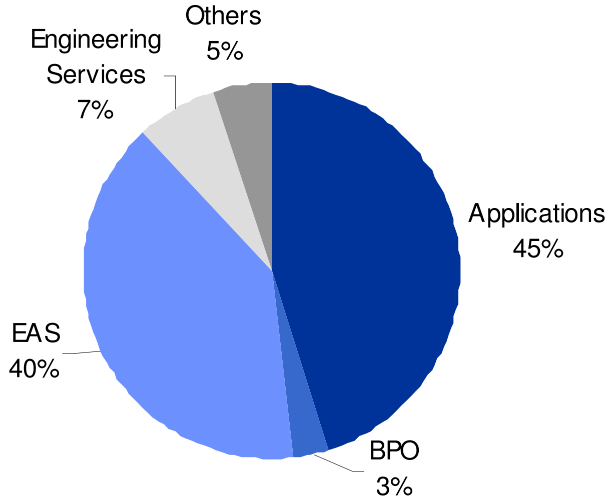

*Source: Company data, Spark Capital Research*

**Figure 40: MSAT – Revenue breakup by geography**




*Source: Company data, Spark Capital Research*

**Figure 42: MSAT – Revenue breakup by horizontal**




*Source: Company data, Spark Capital Research*

# Mahindra Satyam

## With revenues stabilising growth is back in agenda

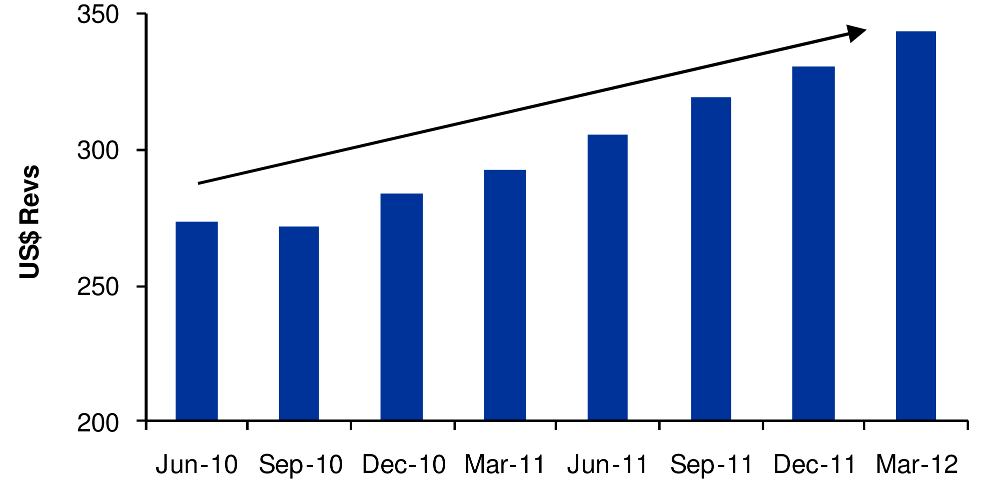
| CMP | Rs. 67 | Absolute | Buy |
|---|---|---|---|
| Target | Rs. 77 | Relative | Outperform |

**Well laid out strategy to drive revenue growth**

Revenue decline and client attrition were the key worries MSAT had to contend with, following the fraud by the erstwhile promoter. Number of active clients declined from ~500 in FY09 to 217 as of 3QFY11 However over the last three quarters, revenues have stabilised at with the last quarter even posting a sequential growth of 4%. Management highlighted growth is clearly the agenda and the following factors would drive revenue growth in our opinion.

- MSAT is approaching the customers, who had stopped working with MSAT post the fraud to get empanelled for new work. MSAT is experiencing initial success with some of the clients empanelling the company
- During the period of the fraud, MSAT financials were not known, thereby limiting its participation in many deals, especially deals over US$ 50mn. With the financials being up-to-date now, MSAT is bidding for some of these deals and stands a better chance of winning some. We note that as in a survey conducted by a leading research house, financial stability was ranked No 2, parameter in deciding outsourcing partner
- In Nov'10, TECHM and MSAT held a joint industry analyst session to communicate its strengths, focus verticals and horizontals. The duo would focus on its existing strength in the verticals of Telecom and Manufacturing with BFSI and CPG being satellite verticals. In horizontals, Enterprise application services continues to be the thrust area. The duo decision to target a few verticals and pick their battle is a sensible decision, as, to compete head on across verticals without scale would be futile. The buoyant spend environment in the broad ERP market would dovetail with MS strength
- MSAT and TECHM are exploring cross selling of respective service offering to each other's clients. MS strength in ERP and BI would enable it to garner deals with TECHM's existing clientele. Similarly, MSAT is using TECHM's strength in areas of infrastructure management to offer it to its existing clients.

**Figure 43: MSAT- Quarterly revenue progression**




*Source: Company data, Spark Capital Research*

**Key Contracts won by Mahindra Satyam over the recent past**

| | |
|---|---|
| **Jul-10** | Selected as the key partner for UID project along with Morpho |
| **Oct-10** | Signed deal with Commonwealth of Kentucky, Cabinet for Health and Family Services |
| **Nov-10** | Signed a SAP implementation contract with IRDA |
| **Jan-11** | Chosen by a US logistics and tracking company to develop a comprehensive system to support its customers' operations |
| **Feb-11** | Chosen by a top US based semiconductor manufacturers in the areas of SAP support, and Windows7 migration |
| Mar-11 | Won an end-to-end build and managed services engagement with Aspire Zone in Qatar |

*Source: Company Data, Press Reports, Spark capital research*

**Figure 44: MSAT's employee pyramid from now to FY13E**

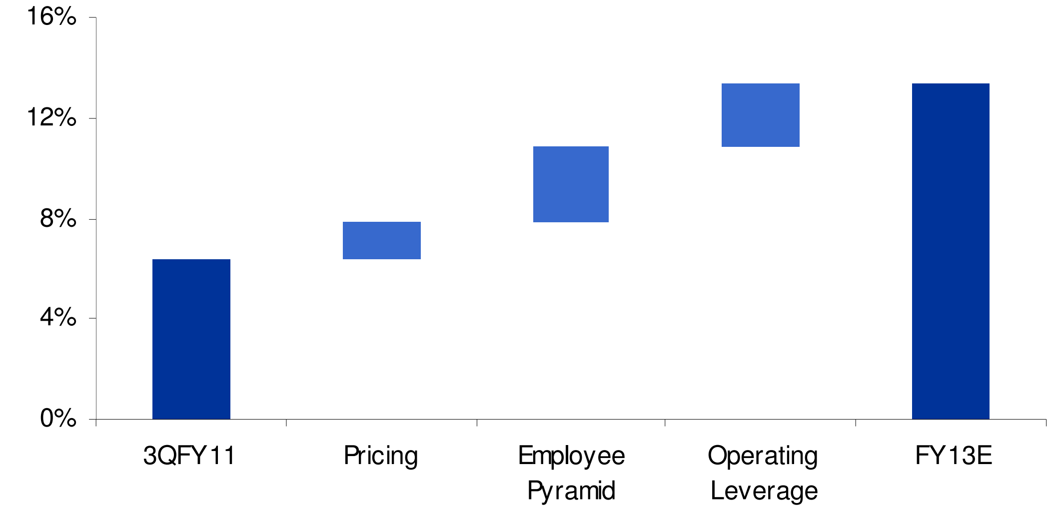

*Source: Company data, Spark Capital Research*

**Bottomed out margins, to expand with revenue growth**

MS's reported EBITDA margins of 6.4% in 3QFY11, well below peers. Though company aspires for industry level margins we believe it would not be a achievable target in the next 18 months. Key levers for margin improvement include:

- MS's employee pyramid is the inverse of industry and company is taking efforts to change by hiring more freshers. For FY12 company is hiring 3,500 campus hires
- MS had to give discounts during the troubled period to retain clients. With the spend environment improving, MS is trying to claw back atleast some part of these discounts. Moreover, company is seeing an uptick in pricing in new contracts and also in select pockets within existing customer
- Utilisation and Operating leverage are other levers MS has and we expect it to contribute ~300bps to margin expansion

**Figure 45: MSAT – EBITDA margin evolution**




*Source: Company data, Spark Capital Research*

# Mahindra Satyam

## Earnings to grow driven by margin expansion

| CMP | Rs. 67 | Absolute | Buy |
|---|---|---|---|
| Target | Rs. 77 | Relative | Outperform |

**Revenue growth to be lower than industry**

MSAT's revenue decline on a sequential basis has been arrested and we expect the recent growth momentum to continue. We forecast US$ revenue CAGR of 16% over FY11-13E. Our confidence stems from client additions, MS's value proposition in the manufacturing and EAS segment and increased penetration in existing clients. We have also factored gradual pricing improvement over FY12 and FY13E.

**Margin expansion would be steady and ongoing**

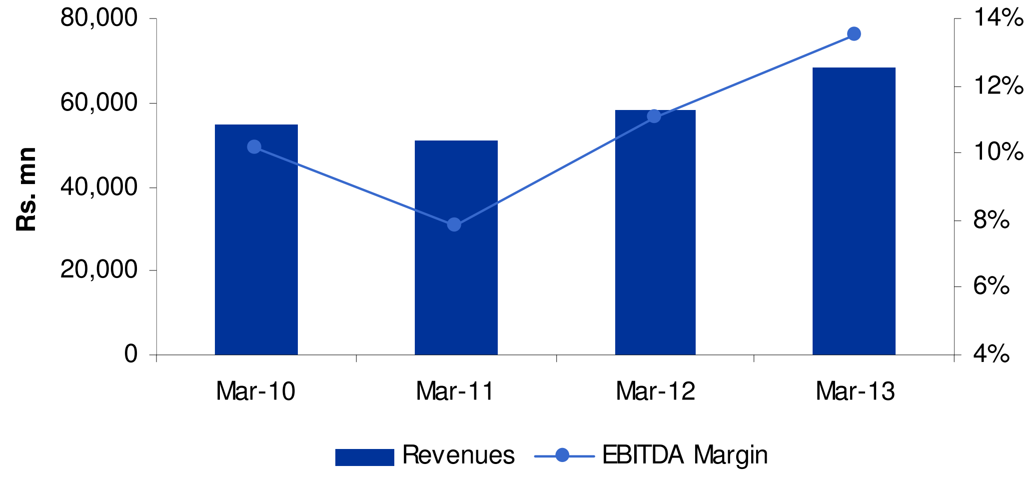
Our thesis on margin expansion is hinged on MSAT delivering on volume growth assumptions and thereby using it to expand employee pyramid, improve pricing and drive operating efficiencies. We would be more focussed on year-on-year margin expansion than a sequential basis, as we believe there could exist aberration on a quarterly basis. Wage hikes would be the key headwind for margins. We have assumed industry levels salary hikes for MSAT too. In the event more than forecasted volume growth, margin expansion could surprise on the upside, as MSAT would be able to increase fresher mix and also drive operating efficiencies. Our EBITDA margin forecast of 13.4% for FY13E is ~150 bps below mid-cap IT companies under our coverage as we believe margin convergence would be a medium term target, than a short term.

**FY11-13E EPS CAGR of 60%**

Our EPS forecast is underpinned **by EBIT CAGR of 80% over FY11-13E and effective tax rates of 24% and 22% for FY12E and FY13E. We have assumed cash out flow of US$ 195 mn during 1QFY12, for the settlement of Upaid and Class Action suit litigation, hence as per our forecast other income would decline substantially from FY11E.**

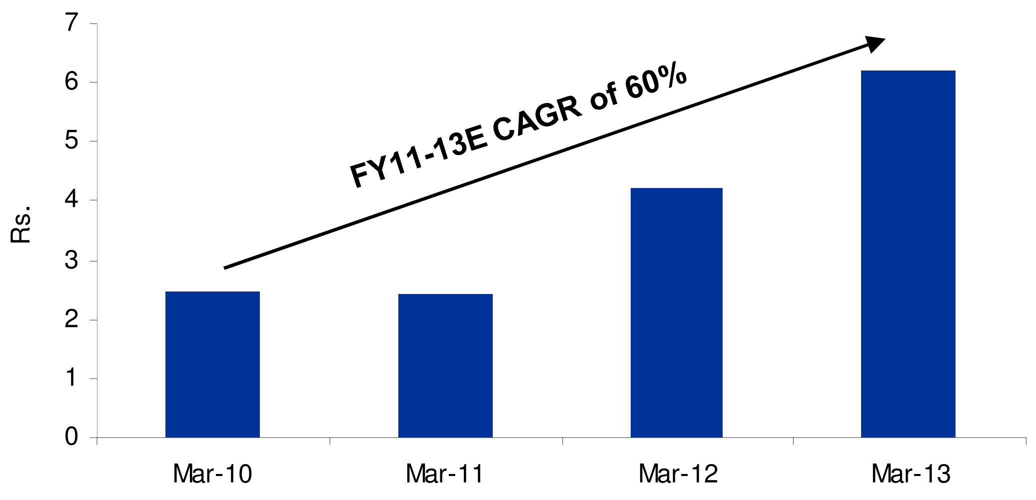
We note that MSAT has accumulated losses **of ~Rs. 90bn and tax treatment** for the same is not clear. In the event of Tax authorities allowing it as an allowable expense, we expect that losses to provide a tax shield of ~Rs. 20bn.

**Figure 46: Revenue growth and EBITDA margins**




*Source: Company data, Spark Capital Research*

**Figure 47: EPS set to record strong growth**




*Source: Company data, Spark Capital Research*

# Mahindra Satyam

## Valuation/Risk

| | | | |
|---|---|---|---|
| CMP | Rs. 67 | Absolute | Buy |
| Target | Rs. 77 | Relative | Outperform |

**Risks from Litigation**

MSAT faces a number of litigation, two of which have been settled. MSAT settled its case with Upaid for a sum of US$ 70mn, however the cash is still reflected in the books of MSAT, because of a follow up litigation filed by Upaid regarding the tax liability on the settlement amount.

MS has entered into an agreement to settle the class action suit by paying a consideration of US$ 125mn and also 25% of any net recovery MS may obtain in the future from PwC related entities. However, this settlement does not include the class action suit filed by Aberdeen along with its two trusts. Aberdeen has made a claim for US$ 68mn. Also, the US SEC had served "Wells Notice" to MSAT, to initiate filing of fraud charges and to seek monetary relief in relation to the accounting prior to 2009 – this has now been settled for US$ 10mn.

Income Tax department has made a claim for Rs. 6.16 bn for the company (under earlier management) having claimed Rs. 3.45bn of tax credit fraudulently. MS has taken the case with Andhra Pradesh high court. Though the correctness of these claims is unclear in our view, we note that settlement of these tax claims would be crucial to merger with TECHM.. Moreover the tax treatment of losses risen from the restatement of MS's financial is unclear. FY09 and FY10 losses amount to Rs. 90bn and in the event of Income Tax authorities allowing it as an allowable expense would result in a tax shield of at least Rs. 20bn in our view.

Entities relating to the former promoter has made a claim for Rs. 12.3bn, as these funds were lent to erstwhile Satyam Computers

**Merger with TECHM**

MSAT's merger with TECHM appears very likely in our view though the form, shape and timeline of merger is still uncertain. Integration of both the companies would be crucial for the fortunes of both companies.Moreover this would be the largest integration for both companiesy. However, we take solace from the fact that MSAT has been in the stewardship of TECHM and the senior management of MSAT are from TECHM.

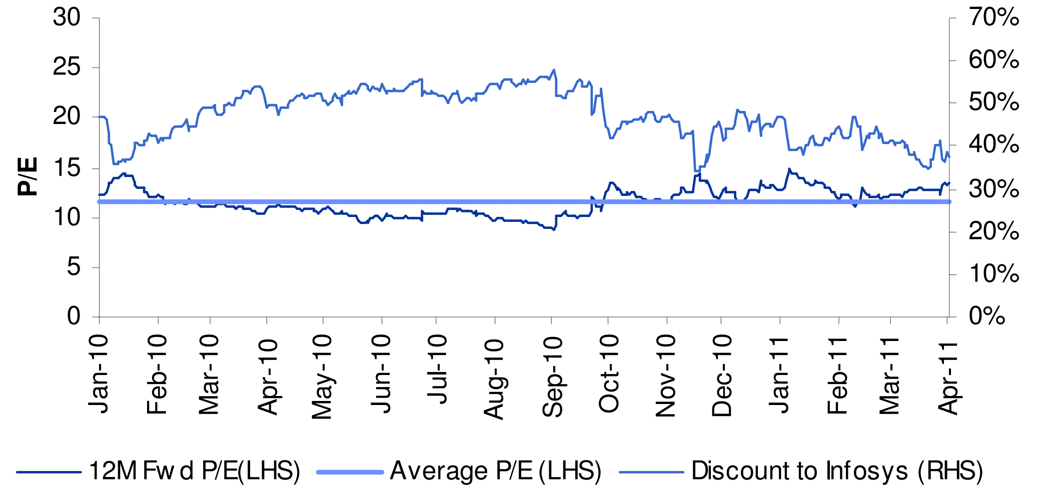
**Prefer a proportionate stake in Tech M and MS – Initiate with a BUY**

TECHM and MSAT are companies that are bound to merge in our view and we believe this should be consummated in the next 12 to 18 months. We recommend investors invest in both companies in a manner that would result in same stake in both the companies. We prefer this approach to protect against the swap ratio that could be used for the merger.

We prefer to value both the companies together by attaching a **P/E of 12x on the combined profit for 12 months ending Sep-12. Our target multiple of 12x is at a 20% discount to our target multiple for HCLT. We believe** the combined entity would trade at a discount owing to slower revenue growth.

Combined **entity is trading at P/E of 12x FY12E and 8.9x FY13E, attractive for an entity with revenues of US$ 2.2bn. We initiate coverage with buy with a price target of Rs. 77. Our target price is arrived at by applying the potential upside from a merged entity scenario to CMP.**

**Figure 45: MSAT– 1 year forward P/E**




*Source: Bloomberg, Spark Capital Research*

# Mahindra Satyam

## Financial Summary

| CMP | Rs. 67 | Absolute | Buy |
|---|---|---|---|
| Target | Rs. 77 | Relative | Outperform |

| Abridged Financial Statements | | | | |
|---|---|---|---|---|
| Rs. mn | FY10 | FY11E | FY12E | FY13E |
| Revenues | 54,810 | 50,861 | 58,437 | 68,305 |
| Employee Cost | 39,811 | 36,081 | 40,123 | 45,960 |
| Operating and Administration Exper | 9,443 | 10,792 | 11,861 | 13,138 |
| **EBITDA** | **5,556** | **3,989** | **6,454** | **9,208** |
| Depreciation | 2,144 | 1,804 | 1,920 | 2,089 |
| EBIT | 3,412 | 2,185 | 4,534 | 7,119 |
| Other Income | 69 | 2,468 | 1,976 | 2,238 |
| Interest and Financing Charges | 329 | 73 | 0 | 0 |
| Exceptional Items | 4,169 | 696 | 0 | 0 |
| PBT | -1,017 | 3,884 | 6,509 | 9,356 |
| Tax | 222 | 1,022 | 1,562 | 2,058 |
| PAT | -1,239 | 2,862 | 4,947 | 7,298 |
| Minority Interest | 7 | 23 | 0 | 0 |
| **PAT after Minorty and exceptio** | **2,923** | **3,535** | **4,947** | **7,298** |
| EPS - Basic | 2.5 | 3.0 | 4.2 | 6.2 |
| **EPS - Diluted** | **2.5** | **3.0** | **4.2** | **6.2** |
| **Balance sheet** | | | | |
| Cshare apital | 2,352 | 2,352 | 2,352 | 2,352 |
| Loan Funds | 422 | 422 | 422 | 422 |
| Deferred Tax Liability | 39 | 39 | 39 | 39 |
| Amounts Pending Investigation Sus | 12,304 | 12,304 | 12,304 | 12,304 |
| **Total - Sources of funds** | **59,266** | **59,289** | **59,289** | **59,289** |
| Fixed assets incl CWIP | 9,865 | 10,561 | 11,441 | 11,752 |
| Investments | 6,268 | 6,268 | 6,268 | 6,268 |
| Sundry Debtors | 9,230 | 9,688 | 9,740 | 10,508 |
| Cash and Bank Balances | 21,768 | 22,655 | 28,845 | 37,895 |
| Net current assets | 15,577 | 17,743 | 21,810 | 28,796 |
| **Total - Application of funds** | **59,266** | **59,289** | **59,289** | **59,289** |

| Key metrics | | | | |
|---|---|---|---|---|
| | FY10 | FY11E | FY12E | FY13E |
| **Cashflow** | | | | |
| Net cash from operations | 163 | 919 | 7,014 | 9,213 |
| Net cash from investing | -22,204 | -32 | -824 | -162 |
| Net cash from financing | 21,036 | 0 | 0 | 0 |
| Free cash flow | -1,421 | -1,581 | 4,214 | 6,813 |
| Cash at year-end | 3,378 | 22,655 | 28,845 | 37,895 |
| **Growth** | | | | |
| Revenues | -37.8% | -7.2% | 14.9% | 16.9% |
| EBITDA | 84.2% | -28.2% | 61.8% | 42.7% |
| PAT | nm | nm | 72.9% | 47.5% |
| EPS | nm | nm | 20.9% | 40.0% |
| **Margins** | | | | |
| EBITDA | 3.4% | 10.1% | 7.8% | 11.0% |
| PAT | nm | nm | 5.6% | 8.5% |
| **Return** | | | | |
| ROE | nm | 6.1% | 10.7% | 15.8% |
| ROCE | nm | 4.7% | 9.8% | 15.4% |
| **Valuation** | | | | |
| Fully diluted shares (mn) | 1,178 | 1,178 | 1,178 | 1,178 |
| Market cap (Rs. mn) | 79,456 | 79,456 | 79,456 | 79,456 |
| EV (Rs.mn) | 58,614 | 58,614 | 58,614 | 58,614 |
| EV/Sales (x) | 1.1 | 1.2 | 1.0 | 0.9 |
| EV/EBITDA (x) | 10.5 | 14.7 | 9.1 | 6.4 |
| P/E (x) | 27.2 | 22.5 | 16.1 | 10.9 |
| EPS(E) / Current market price | 3.7% | 4.4% | 6.2% | 9.2% |
| Revenue per employee (000's) | | 1,764 | 1,899 | 1,948 |
| EBITDA per employee (000's) | | 138 | 210 | 263 |
| PAT per employee (000's) | | 123 | 161 | 208 |

# IT Services

| Sector Outlook | Positive |
|---|---|

| Absolute Rating Interpretation | |
|---|---|
| BUY | Stock expected to provide positive returns of > 15% over a 1-year horizon |
| ADD | Stock expected to provide positive returns of <=15% over a 1-year horizon |
| REDUCE | Stock expected to fall <=15% over a 1-year horizon |
| SELL | Stock expected to fall >15% over a 1-year horizon |

| Relative Rating Interpretation | |
|---|---|
| OUTPERFORM | Stock expected to outperform sector index /sector peers in our coverage |
| UNDERPERFORM | Stock expected to underperform sector index/ sector peers in our coverage |

**Recommendation History**

| Date | CMP | Target price | Absolute Rating | Relative Rating |
|---|---|---|---|---|
| Initiating Coverage | | | | |
| | | | | |
| | | | | |
| | | | | |
| | | | | |

### Analyst Certification

The Research Analyst(s) who prepared the research report hereby certify that the views expressed in this research report accurately reflect the analyst(s) personal views about the subject companies and their securities. The Research Analyst(s) also certify that the Analyst(s) have not been, are not, and will not be receiving direct or indirect compensation for expressing the specific recommendation(s) or view(s) in this report.

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