IDFC SSKI

INDIA RESEARCH

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Sector report

Indian IT services

Not out of woods

The Indian IT services sector faces strong headwinds as recesssion has concurrently hit most of its target markets. We expect tepid revenue growth over the next two years with volumes returning only in H2FY10. However, pricing (constant currency) could come off by 5-7% over FY10-11 and lead to flat-to-declining earnings. In view of this, we rule out stocks giving material absolute returns till business concerns start waning. However, stock valuations are close to historic lows and we see limited downside. We thus recommend market weight on IT services and prefer Tier 1 companies with a strong track record which assumes more importance post the Satyam debacle. We rate Infosys, TCS and Wipro as Outperformers with a year's view though the recent outperformance (as also guidance overhang for Infosys) would keep stock under pressure in near term and may also prevent their participation in bear market rally, if any. We have a Neutral stance on HCL Tech and rate Patni and Tech Mahindra as Underperformers.

Business challenges to persist…: With concurrent recession across developed economies, IT spend is likely to decline in 2009 and impact revenue growth of offshore IT companies. After growth slows to single digits in FY10 in constant currency terms, we expect a volume-led recovery to ~10% in FY11 but at the cost of realizations.

…offshore IT has room to grow but pain ahead: Offshore IT services business, we believe, is down but not out. India's market share within global IT & BPO services spend is still in single digits and with a gradual market share shift to offshore, we expect growth to return to 15-20% levels beyond FY11. While ADM services may see tepid growth, IMS, Consulting and BPO would emerge as the next growth drivers. In the interim, a 5-7% pricing decline over FY09-11E would lead to flat to declining earnings.

Valuations close to historic lows; but headwinds too strong: Facing multiple concerns, offshore IT companies would fail to register any noticeable earnings growth over FY09-11E. However, current valuations are close to historic lows and we do not see major downside from here. We recommend market weight on the sector and rate Infosys, TCS and Wipro as Outperformers in the uncertain market environment. We rate HCL Tech as Neutral and Tech Mahindra and Patni as Underperformers.

Comparative valuations

Company	Price	Mkt Cap	Reco	EPS CAGR (%)	FY10E		Target	Upside
	(Rs)	(Rs bn)		FY09-11E	PE (x)	EV/ EBITDA (x)	(Rs)	(%)
Infosys	1,310	751.0	Outperformer	0.7	13.1	9.3	1,500	14.5
TCS	516	504.6	Outperformer	4.1	9.9	6.5	630	22.2
Wipro	226	329.4	Outperformer	5.4	9.5	6.5	290	28.2
HCL Tech	120	81.0	Neutral	(0.4)	6.7	4.0	127	5.5
Tech M	234	30.5	Underperformer	(4.9)	4.1	2.6	230	(1.9)
Patni*	115	14.8	Underperformer	(14.5)	3.8	0.8	107	(7.0)

*Source: Bloomberg, Company reports, IDFCSSKI forecast; * Using CY07, CY08, etc. for FY08, FY09, etc.*
Prices as on 9 February 2009

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INVESTMENT ARGUMENT

A long and deep recession in most developed markets would likely nibble at IT spends in 2009, which implies sluggish revenue growth for offshore IT companies. Though we expect growth to return from single digits in FY10 (constant currency terms) to ~10% in FY11 as there is significant room to gain market share in non-conventional services, the recovery would be volume-led with a cumulative 5-7% pricing decline over FY10-11. In this backdrop, we expect flat-to-declining earnings for Indian IT companies over the period and rule out material absolute returns from stocks till business concerns start subsiding. However, stock valuations are close to historic lows and we do not expect significant downside as well. We recommend market weight on IT services and prefer Tier 1 companies with a clean corporate governance record which assumes more importance post the Satyam debacle. We rate Infosys, TCS and Wipro as Outperformers with a 12-month view though the recent relative outperformance may prevent near-term upside. We have a Neutral stance on HCL Tech and rate Patni and Tech Mahindra as Underperformers.

POOR DEMAND VISIBILITY IN THE NEAR TERM

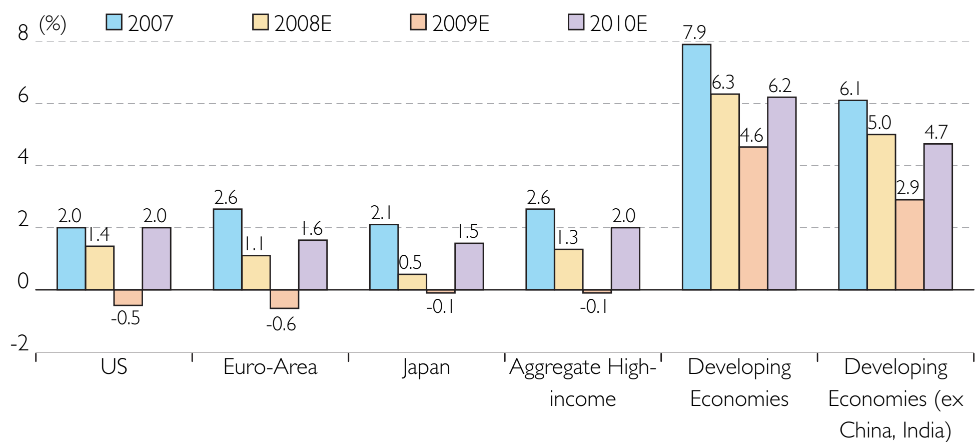
With developed geographies reeling under a recession, technology spend (hardware+ software+ network+ IT services) in these economies is likely to decline in 2009. However, within tech spending, IT services spend is relatively defensive as a large portion of it goes towards ***running*** the business vs ***building/ changing*** the business. Despite this, 2009 is likely to be the most challenging year for IT services vendors as budgets would be under pressure and clients demand pricing discounts to sail through challening times.

❑ Deteriorating economic environment…

Key markets for offshore IT in the throes of a recession…

The economic environment has been turning worse across developed economies including USA, UK, the Euro region and Japan – key markets for Indian IT services players. According to the latest World Bank publication (Global Economic Prospects; Decemebr 2008), beginning with an estimated contraction of 0.6% in the US economy in 2009 after a low 1.1% estimated growth for 2008, aggregate GDP of developed economies (high income countries) too would decline in 2009. For developing/ emerging economies, aggregate GDP growth is expected to come off from 7.5%+ over last two years to 6.3% in 2008 and 4.6% in 2009 (ex-China and India, growth of just 2.9% in 2009).

Exhibit 1: 2009 likely to be challenging across economies



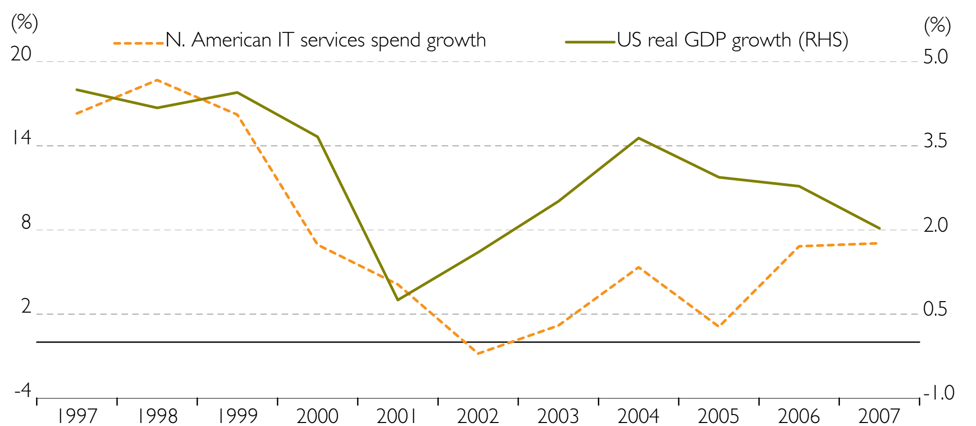
Source: World Bank

❑ …tech spending to decline for developed economies…

…IDC's forecast for global tech spending downgraded to 2.6% in 2009 from 5.9% earlier

Broader technology spending (networking, hardware, software and IT services) is cyclical and typically moves in tandem with economic growth. With the prevailing economic recession across global markets, overall technology spending is likely to slow considerably with a contraction not ruled out, especially for developed economies. Notably, IDC (International Data Corporation) has downgraded its global tech spending growth forecast to 2.6% in 2009 from 5.9% earlier to account for the prevailing financial crisis and economic recession in developed markets. Among the various sub-sectors within tech spending, IDC forecasts indicate a decline in the areas of PCs, servers, networks, etc; software spending is expected to grow at 4.6% yoy and IT services spend at 3.7% in 2009. In terms of regions, tech spending is likely to grow by ~1% in 2009 for USA, Western Europe and Japan and in mid-to-high single digits for Asia (ex-Japan), LatAm, Central & Eastern Europe, Middle East and Africa.

Exhibit 2: Correlation of N.American IT spend with US GDP



Source: Nasscom, Gartner, IMF

Overall tech spending could be flat in the worst case

IDC has predicted that overall tech spending could remain largely flat in 2009 in the worst case scenario, whereas it could decline by 1-2% for USA, Japan and Western Europe with other regions expected to see growth of 3-6%.

Around 70% of IT services spend on ''running the business''; thus, relatively less discretionary than other segments…

❑ …but IT services is about keeping the lights on

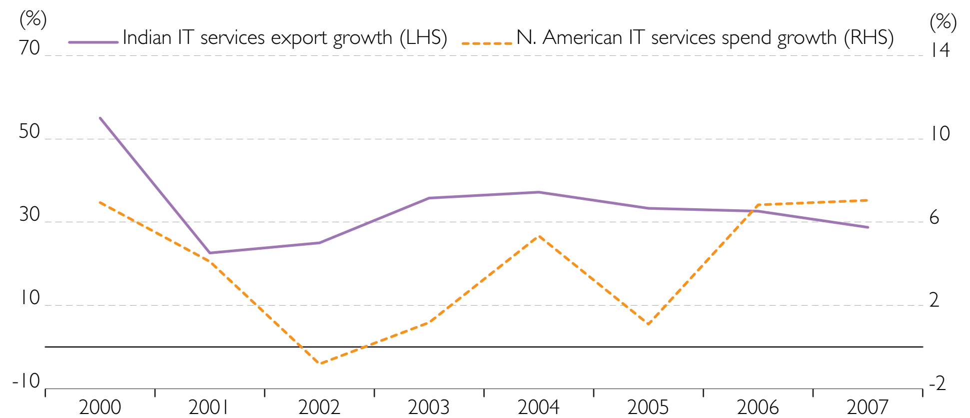
While tech spending is likely to be under pressure for the next two years, IT services spend is relatively less discretionary as a big chunk of it goes into keeping the lights on. Based on anecdotal evidence, ~70% of IT services spend is "run the business" while just ~30% is "change/ build the business". To that extent, IT services segment is relatively better placed vis-à-vis tech spend towards hardware, networking and software.

❑ Services spend vs outsourcing vs offshoring

…also, offshoring growing ahead of IT spend

Overall, IT services outsourcing is growing faster than IT services spend. This is being led by the gradual shift of IT spend from in-house to third party outsourcing as (i) it provides more flexibility in IT budgets for the client; and (ii) work delivered by an IT specialist yields cost savings on the back of scale efficiencies and shared service usage. Going forward, we expect the trend to continue and outsourcing (as also offshoring) to outpace IT services spend in terms of growth.

Exhibit 3: Correlation of Indian IT exports with N. American IT spend



Source: Nasscom, Gartner

❑ Global IT spend could decline by ~5% over the next two years…

IT spend from developed nations under pressure

Against a meagre~1% decline seen in global IT spend in the previous recession, and that too for only a year, we believe IT spend in North America could shrink by 5-10% over the next two years. Our view emanates from the length and depth of the current recession. The current recession seems to be more pronounced – geographically as well as in terms of industry verticals. Also, recession this time is likely to be longer and deeper than the one following the dot com bubble burst. According to various industry estimates, IT services spend this year is likely to decline by ~5% in US and other developed nations.

❑ …though average price realizations likely to be more resilient

Limited room for pricing rationalization as revenue mix in favour of stable industries…

Despite the shrinking IT spend in 2009 and 2010, we believe average price realizations for offshore IT companies would be more resilient during this business cycle. This can primarily be attributed to the fact that prices are currently at reasonable levels with little room for further cuts and that the revenue mix is in favour of stable industries, which will act as a support to pricing.

Current realizations are below the peak rates scaled in 2000-01. More importantly, several smaller companies are operating at wafer thin margins and are therefore unlikely to undercut larger players further. Also, the Satyam fiasco makes the case of premium pricing for Tier 1 companies stronger than ever. Satyam's clients would, in all probability, look for alternative offshore vendors to move their work to stable service providers with a cleaner corporate governance track record and stronger balance sheets. This, we believe, would be a key positive for Tier 1 IT services companies over the next two years.

…and revenue base well diversified

Also, IT services companies – unlike in the previous cycle – now generate a much larger share of revenues from BFSI, manufacturing and telecom verticals. This makes the revenue base more diversified and thereby relatively resilient to pricing pressures. In contrast, a significant share of work done by Indian IT companies in the previous business cycle was for internet start-ups that used to pay premium rates vis-à-vis average realizations. As several of these companies perished in the dot com bubble burst, the pricing decline was quite sharp and swift.

INDIAN IT: DOWN BUT NOT OUT

We see challenging times ahead for Indian IT services providers over the next 1-2 years in the backdrop of the tough business environment. However, while demand may be lower, we do not see any threat to market share (still in single digits) of offshore service providers. Having clocked significant gains in traditional ADM services (offshore IT industry started with ADM services and largely concentrated on that till early 2000s), Consulting, IMS and BPO services are the new growth vistas. TPI data on new deal wins (>US$25m of total contract value) shows that market share of India-based service providers has been on an upswing.

❑ The 'Big Picture' – India's share still in single digits…

India has ~30% share in ADM services, but low single-digit share in Consulting, SI, IMS, BPO, etc

India's market share in overall IT and BPO spend is still in single digits. While it has gained significant market share in ADM (application development & maintenance) services, there is still considerable room to grow in other service lines – Consulting & SI (System Integration), IMS (Infrastructure Managemnt Services) and BPO services. Each of these service lines is larger than the ADM services segment in size.

Exhibit 4: India's market share still in single digits within Global IT and BPO spend

(US$ bn)	Worldwide 2007 IT & BPO Spend	Indian exports (FY08)	Domestic rev (FY08)	Total Indian IT rev (FY08)	Indian IT mkt share (%)
ADM services	50.0	13.5	1.5	15.0	30.1
- Application development	25.3	9.9	0.5	10.4	41.4
- Application management	24.8	3.6	1.0	4.6	18.5
Consulting & system integration	144.6	1.6	3.9	5.5	3.8
IS & other outsourcing	157.9	5.7	0.4	6.1	3.9
Support & training	142.6	1.8	0.3	2.1	1.5
Total IT services	**495.1**	**22.6**	**6.1**	**28.8**	**5.8**
Finance & accounting	19.3	2.4	0.3	2.7	14.1
Customer care	29.6	4.7	0.3	5.1	17.1
Other services	412.8	3.7	1.0	4.7	1.1
Total BPO services	**461.8**	**10.9**	**1.6**	**12.5**	**2.7**
Total IT & BPO services	***956.9***	***33.5***	***7.7***	***41.3***	***4.3***

Source: Nasscom, IDC

❑ …Indian companies gaining market share

On-time and within-budget delivery…

Offshore IT services companies have been gaining share in the overall market for the last few years as offshoring inherently offers cost advantages over simple outsourcing due to delivery from low cost locations. Added to that, Indian IT companies have acquired an impeccable track record of on-time and within-budget delivery even for complex assignments. Apart from other quality certifications, most of the Indian IT companies (large as well as small) have acquired the SEI-CMM (Software Engineering Institute – Capability Maturity Model) level-5 accreditation, the highest standard of quality.

…quality accreditations and scale…

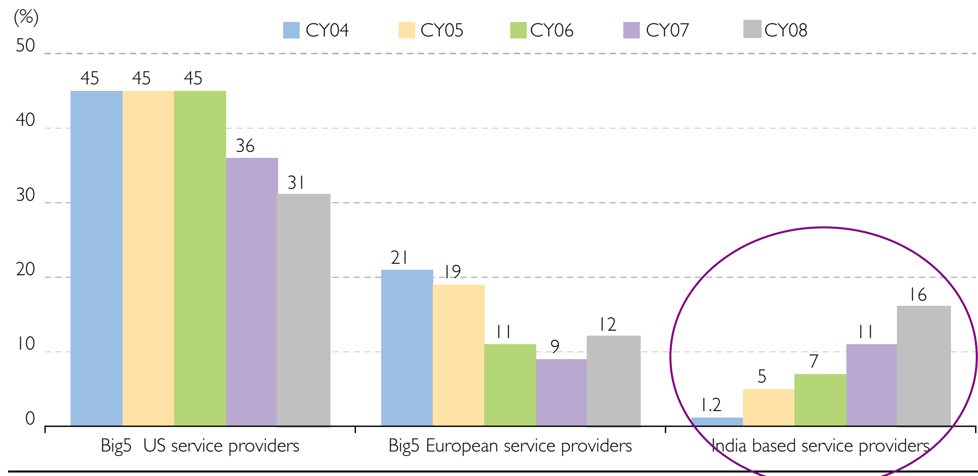
Along with the above-mentioned advantages, Tier 1 Indian IT companies also offer scale. The period 2003-04 was one of inflection for Indian IT companies when a few of them reached $1bn+ in revenues, thereby becoming eligible for large deals. In 2004, the erstwhile ABN AMRO gave out multi-year $100m+ contracts to Infosys and TCS for application maintenance services. Since then, most of the large Indian IT companies have bagged several multi-year, multi-million deals cutting across several service lines.

❑ TPI data suggests significant market share gains

…aiding market share growth for Indian IT services players

According to TPI (Technology Partner International) data, India-based service providers' market share has increased significantly from ~1% in 2004 to 16% in 2008. Market share is based on all publicly announced deals in addition to TPI-advised deals with a total contract value of $25m and above. It includes deals across service lines – ADM, IMS, Consulting, SI, etc. In our view, deal-win market share is a lead indicator of revenue market share.

Exhibit 5: Market share of key vendor groups in Broader Outsourcing market (TCV > US$25m)



Source: TPI Quarterly Index

TPI is a third party advisory to global corporates, helping them to get the best value from outsourcing their IT spend, with a market share of ~25%. TPI publishes a quarterly TPI index, wherein metrics cover commercial outsourcing contracts with insights for all contracts where the total contract value stands at $25m and above.

NEXT TWO YEARS LIKELY TO BE QUITE CHALLENGING

We expect revenue growth (in constant currency terms) for offshore IT companies to slow to single digit in FY10-11 as IT spend declines in developed markets. Also, we find a correlation between revenue growth of Indian IT services players and S&P 500 operating earnings growth, which corroborates our view that these companies face near-term revenue pressure. Latest quarterly results of some of the global technology companies too support our view of near-term uncertainty. We expect volume growth on qoq basis to recover only in second half of FY10. Also, we expect constant currency pricing to come off by 5-7% cumulatively over FY10-11. This would accelerate margin decline for offshore companies and ultimately lead to flat-to-declining earnings for Indian IT companies.

❑ Volume growth to remain muted…

We expect muted volume growth in the next few quarters

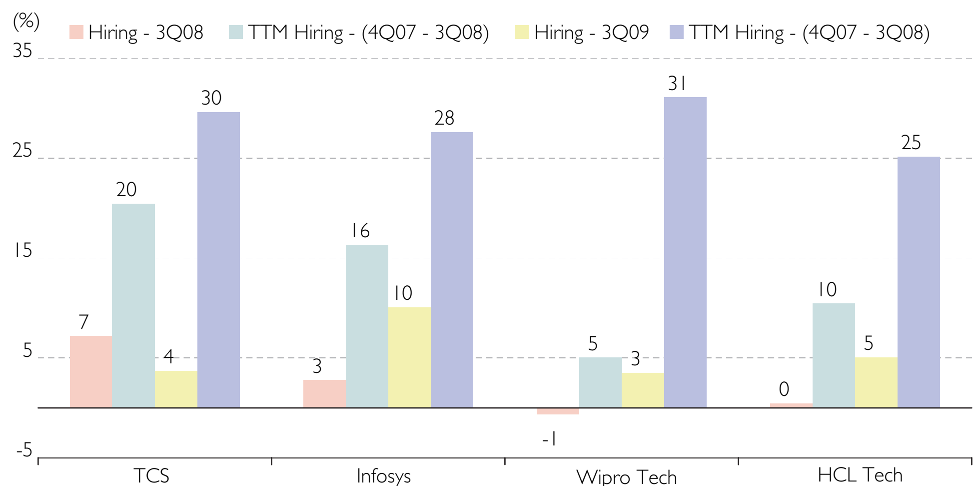
Volume growth, having slowed markedly in Q2 and Q3FY09, is likely to remain tepid for the next few quarters. We expect growth to rebound in the second half of FY10. Anecdotally, it has been seen that companies cut IT spending in times of uncertainty. However, when budgets are set to be curtailed, companies increase the share of offshore usage (low cost geographies) to get more work out of the available IT budget.

❑ …slowed hiring confirms the same

Companies going slow on hiring as volume growth has already slowed

Over the last year, most of the IT services companies have been going slow on hiring. In fact, several mid-cap companies have reported a net decline in headcount for the past few quarters.

Exhibit 6: Hiring pattern for select IT companies – 3Q and TTM this year and previous year



Source: Company

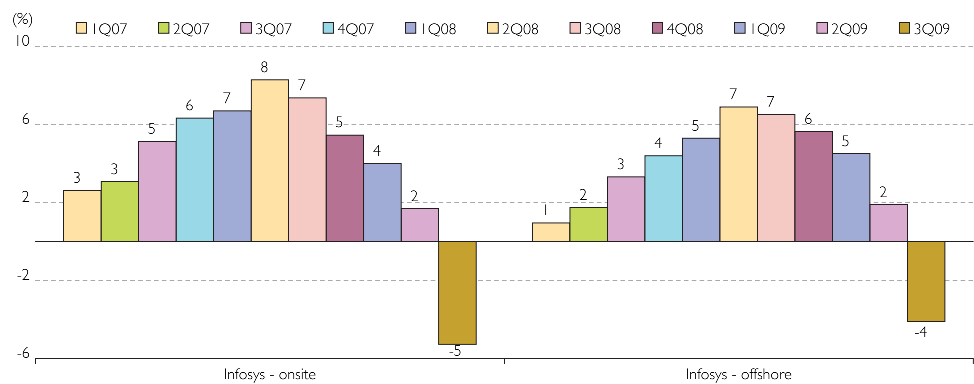
Most of the industry participants have staggered joining dates for fresh graduates with joining dates even spilling over into FY10 in some cases. Companies believe that given the eased supply situation, they can resort to just-in-time hiring as and when growth revives. In the meantime, we see players still having some headroom to improve employee utilization.

Benign currency movements leave scope for some price cuts

❑ Pricing likely to remain under pressure…

With budgeting season (usually November-January) falling in the midst of the global credit crisis, we expect price realizations to be under pressure as contracts get renegotiated at lower price points. Also, we expect offshore Indian IT companies to relent to the pricing pressure in view of the benign currency movement (INR-USD). In addition, cross-currency headwinds from depreciation of GBP and Euro will hit realizations. However, the decline in USD price realization due to cross-currency impact does not affect margins as there is a similar impact on onsite wage costs.

Exhibit 7: Infosys price realization yoy change – over last 11 quarters



Source: Company

The price decline that started in Q3FY09, we believe, will extend into the quarters ahead. Price realization has turned negative (yoy change) for the first time in case of Infosys in Q3FY09 – though cross-currency headwinds had partially contributed to this. We see realizations falling further in the coming quarters.

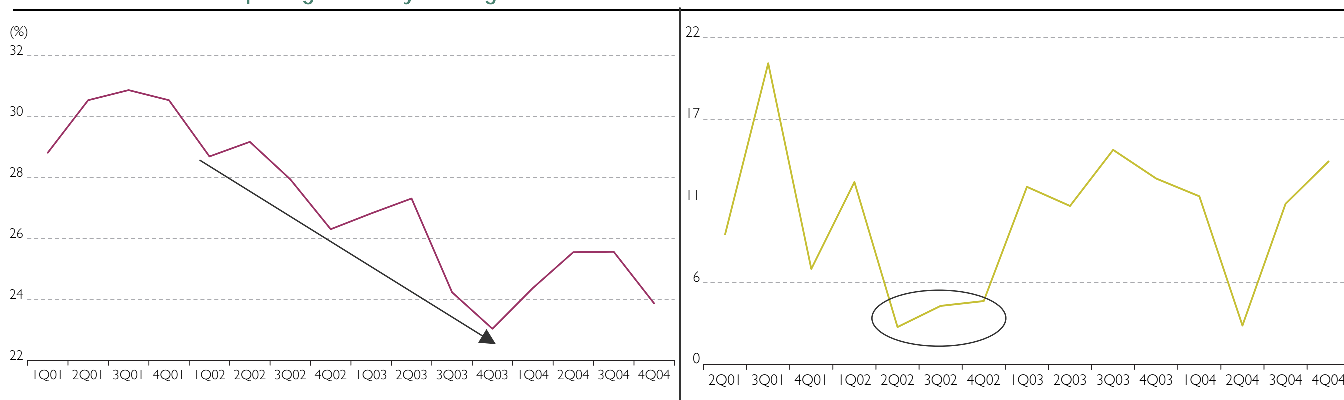
Further economic deterioration poses a downside risks to price decline of 5-7%

Our view of 5-7% pricing decline yoy in constant currency over the next two years for Tier 1 companies is based on expectations of developed economies returning to the consistent growth path from the last quarter of 2009. If that does not happen, our estimates face downside risk. Our view of limited pricing decline (5-7%) in case of growth returning Q4CY09 onwards is supported by industry dynamics, wherein any futher price cuts for marginal players (smaller companies) would lead them into operating losses. Price realizations for these players are already below that of Tier 1 IT companies and they also have lower scale efficiencies. Further, we do not see a case for Tier 1 price realizations to come off sharper than that for mid-tier and smaller players given (i) the higher value-added service offering of Tier 1 companies, and (ii) clients willing to pay higher prices for corporate governance track record and stability of IT services vendors, especially after the Satyam debacle.

Experiences from the previous slowdown – how Indian IT fared

During the period of IT spend slowdown post the dot com bubble burst, Infosys saw its volumes dipping for three quarters. While volume growth subsequently recovered, it was accompanied with pricing declines. The ongoing recession appears to be longer and deeper than the post dot-com bubble burst, and we believe volume recovery would come with pricing discounts.

Exhibit 8: Volume and pricing for Infosys during the IT slowdown of 2001-03



Source: Company

A few quarters of single-digit growth ahead before a volume-led recovery in 2HFY10

❑ Revenue growth likely to be muted…

With pricing likely to remain under pressure, revenue growth would be largely volume-led. Also, volume growth is expected to rebound only in 2HFY10, implying a few quarters of muted growth in the near term. We expect revenue growth to be in mid-single digits in constant currency term for FY10 – the lowest ever for the Indian IT industry. We expect revenue growth to pick up subsequently to ~10% in FY11 as we expect volume traction to continue while pricing decline gradually wanes. Beyond FY11, we expect revenue growth to rebound to 15-20% as the global economy stabilizes and IT services spend continues to shift towards offshoring.

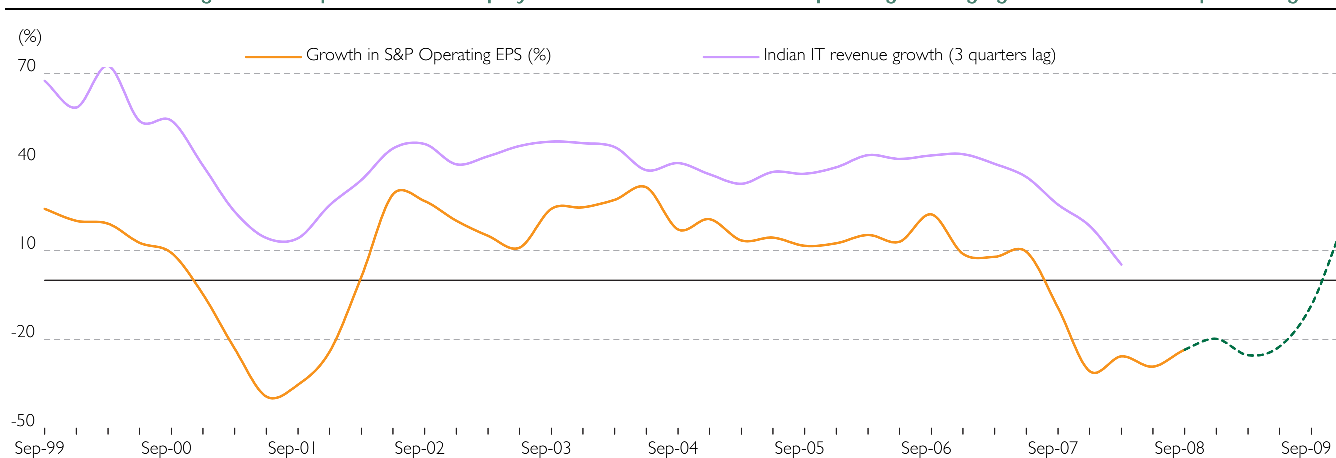
❑ …S&P500 operating earnings trend substantiates our thesis

We observe that revenue growth of Indian IT companies has a strong correlation (R2 of ~60%) with S&P 500 operating earnings growth but with a three quarter lag.

Operating profit of S&P 500 down by 25-30% yoy in last three quarters; a harbinger of growth slowdown

With S&P 500 operating earnings having declined by 25-30% yoy over the last three quarters, we believe Indian IT companies are bound to register the slowest ever yoy growth over the next few quarters. We note that revenue growth had slowed to low-teens (from 50%+ levels) in the previous US recession, when S&P 500 operating earnings declined by 40% yoy.

Exhibit 9: Revenue growth of top three Indian IT players fell in line with S&P 500 operating earnings growth but with a 3-quarter lag



Source: Standard & Poor Index Services, Company data, IDFC-SSKI Research

Our view of volume growth rebounding in 2HFY10 and FY11 is also supported by S&P 500 operating EPS growth returning to the positive territory in later part of 2009. Also, current hiring pattern of Tier 1 companeis and fresher offers during this academic season (for next fiscal year) corroborate this view. However, further economic deterioration, leading to developed economies slipping into the dreaded "D" word, could pose downside risk to our view of volume upturn in FY11.

❑ Readings from recent quarterly results of global technologies firms

Accenture

Accenture cut its FY09 guidance to 6-10% growth from 9-12% earlier in constant currency terms…

Accenture has reported 6% yoy growth in revenues for Q1FY09 (9% constant currency growth). The company has cut its full year growth guidance (year-end August 2009) to 6-10% in constant currency terms from 9-12% earlier. Accenture has reported a 2% yoy increase in the BFS business for the quarter, while US business continued to grow at 10% and EMEA (Europe, Middle East and Africa) grew at 4% (constant currency growth rates).

Oracle

…while Oracle has reported 5% growth in constant currency terms for the latest quarter

Oracle has reported new license sales decline of 3% yoy for Q2FY09 against its guidance of 2-12%. Growth in constant currency stood at 5% while cross-currency movement pushed growth by -8%. The company has guided to flat to ~10% growth in license sales for the next quarter. New license sales are a lead indicator of ERP business prospects of Indian IT companies.

❑ Wage hikes have moderated – though a minor tailwind

The trend of wage hike moderation may continue

Companies have some respite on the wage inflation front as salary hikes in FY09 have been moderate compared to the extent seen in the last few years. Freshers' wages remain flat though joining dates for fresh graduates have been postponed across the industry except by Infosys and TCS. Most of the Tier 1 companies believe that average wage hikes could fall further in FY10 on yoy basis – most likely to low-mid single digits for offshore and flattish for onsite employees.

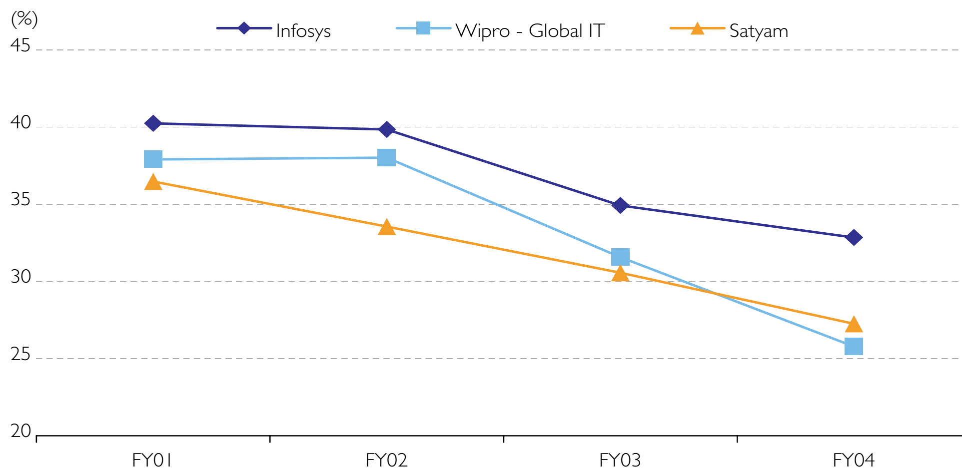
❑ Margins – secular decline to accelerate in FY10/ FY11

Margins for Indian IT services companies have been declining gradually for the last few years (except for Infosys). We see the trend accelerating over the next two years given the increasing pressure on realizations. TCS, Wipro and other Indian IT companies have registered a margin decline of 300-600bp over FY04-08 due to wage inflation and rupee appreciation. While margins came off gradually till FY07, the decline had been faster in FY08 led by the ~11% apreciation in rupee vis-à-vis the USD in FY08. Commendably, Infosys has managed to sustain its margins in the ~32% band over these years.

Margin decline to accelerate as realizations taper

Notably, the margin decline of FY01-04 was not only sharp but also across-the-board (including Infosys) and was driven by pricing pressure. In the prevailing scenario too, lower price realizations could lead to sharp margin declines from here.

Exhibit 10: Impat of declining price realization on margin during the previous slowdown



Source: Company, IDFC-SSKI Research

❑ Flat-to-declining earnings in FY10-11E

Earnings to be hit by slowing sales growth and margin pressure

With tepid sales growth and margin pressure arising from price declines, we expect flattish earnings profile (tilted towards the negative) for Indian IT companies over the next two years.

Exhibit 11: Table of revenue(USD) and earnings (INR) estimates

Company	Revenue (US$m)				Revenue CAGR (%)		EPS (Rs)				EPS CAGR (%)	
	FY08	FY09E	FY10E	FY11E	FY08-11E	FY09-11E	FY08	FY09E	FY10E	FY11E	FY08-11E	FY09-11E
Infosys	4,176	4,693	4,866	5,348	8.6	6.7	81.3	101.4	99.8	102.8	8.1	0.7
TCS	5,716	6,109	6,511	7,158	7.8	8.3	51.3	52.3	52.1	56.6	3.4	4.1
Wipro	3,647	4,334	4,455	4,835	9.8	5.6	22.1	23.3	23.8	25.9	5.3	5.4
HCL Tech	1,879	2,232	2,518	2,747	13.5	10.9	15.2	19.0	18.1	18.9	7.5	(0.4)
Tech M	935	1,004	958	1,081	5.0	3.8	58.8	68.9	56.8	62.3	2.0	(4.9)
Patni*	663	720	692	696	1.6	(1.7)	33.6	35.3	30.7	25.8	(8.4)	(14.5)

Source: Company, IDFCSSKI forecasts; * Using CY07, CY08, etc. for FY08, FY09, etc.

INORGANIC ACTIVISM: *STRING OF PEARLS* TO *GAME CHANGER*

Over the last few years, Indian IT companies have been acquiring companies with revenues of $5m-50m. Such smaller acquisitions are easier to integrate as also plug-and-play to fill gaps in service offering and/ or get foothold in new geographies/ verticals. This strategy has been well-articulated by the “String of Pearls” inorganic route by Wipro, though the same has been largely true for all offshore IT services companies. While Wipro has acquired cMango, NewLogic, mPower, Quantech, Enabler, Saraware, etc in the last 2-3 years, TCS has acquired FNS, Pearl, Comicrom, etc. Similarly, HCL Tech’s acquisition of Liberata and Control Point as also Infosys’ acquisition of Philips’ centers would fit into “String of Pearls” strategy.

However, Indian IT services players are now exhibiting whetted appetite to acquire bigger companies. Wipro’s acquisition of Infocrossing (revenues of $240m+) and CITOS ($125m+), TCS’s acquisition of Citi BPO ($260m+) and HCL Tech’s acquisition of Axon ($300m+) indicate that acquisitions are now game changing and not just about fitting into the current scheme of things. All these companies were acquired with the common objective of filling gaps in service offering and/ or getting foothold in a new geography/ sub-vertical. Importantly, the acquisitions are big enough to catapult the acquirer into a leadership position in the area of the target’s operation.

For example, Infocrossing acquisition has completed Wipro’s suite of IMS services (unmatched by any other offshore vendor) and integration of Axon would make HCL Tech one of the largest offshore players in the area of SAP Consulting. Also, acquisition of CITOS and Citi BPO came with exclusive relationship in that area of operation with Citi for Wipro and TCS respectively. The acquisitions also entailed revenue commitment of $500m and $2.5bn respectively.

VALUATIONS AT NEW HISTORIC LOWS

Most of the offshore IT services companies are currently trading close to historic low valuations – while Infosys is available at ~13x, TCS and Wipro too are trading at ~10x FY10E earnings. Valuations of other offshore companies like HCL Tech, TechM, Patni, etc are also hovering between 4-7x 12-month forward earnings.

Exhibit 12: Indian IT services – Valuation comparison table

Company	Price (Rs)	Mkt Cap (Rs bn)	Mkt Cap ($ m)	Reco	PE (x) FY08	PE (x) FY09E	PE (x) FY10E	EPS CAGR (%) FY08-11E	EPS CAGR (%) FY09-11E	EV/EBITDA FY10E (x)	EV/Sales FY10E (x)
Infosys	1,310	751.0	15,453	OP	16.1	12.9	13.1	8.1	0.7	9.3	2.8
TCS	516	504.6	10,382	OP	10.1	9.9	9.9	3.4	4.1	6.5	1.5
Wipro	226	329.4	6,777	OP	10.2	9.7	9.5	5.3	5.4	6.5	1.5
HCL Tech	120	81.0	1,667	N	7.9	6.3	6.7	7.5	(0.4)	4.0	0.8
Tech M	234	30.5	628	UP	4.0	3.4	4.1	2.0	(4.9)	2.6	0.5
Patni*	115	14.8	304	UP	3.4	3.3	3.8	(8.4)	(14.5)	0.8	0.1

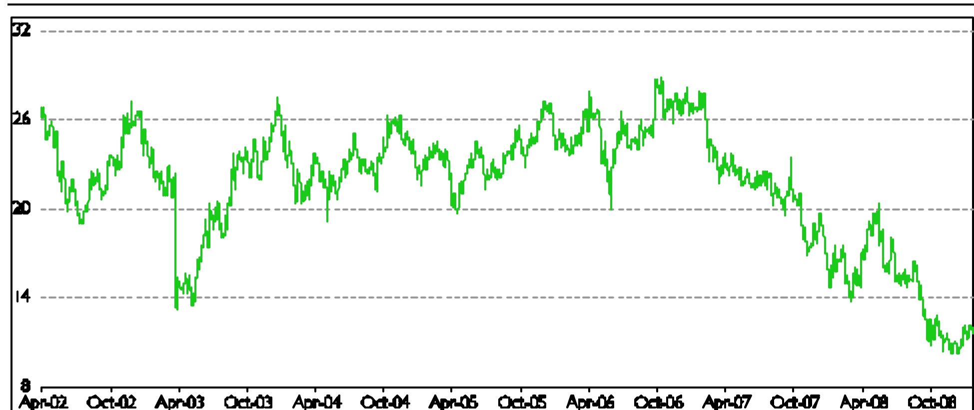
*Source: Bloomberg, Company, IDFC-SSKI Research; * Using CY07, CY08, etc for FY08, FY09, etc; Prices as on 9 February 2009*

❑ Dynamic PE ratio

A new valuation low touched recently

We have used the dynamic PE ratio for Infosys – calculated using consensus earnings estimates on the day of the price considered. Dynamic PE presents a better picture of valuations as any positive earnings surprise understates static PE ratio and negative surprise overstates the same. Pre-2008, Infosys had touched a low of 14x 12-month forward earnings while the stock has touched a new historic low of ~10x 12-month forward earnings during the recent correction seen around Q2FY09 results.

Exhibit 12: Dynamic PE valuation for Infosys



Source: Bloomberg, IBES

We see downgrades ahead for consensus earnings estimates

With poor visibility on business prospects, street earnings estimates could likely be downgraded. With this risk, we rule out any sustainable re-rating for Indian IT stocks in the near term. Stocks would get re-rated once visibility on business returns – which is expected only after there are some indications of the US economy coming out of recession.

Our estimates for our IT services universe are 5-10% lower than that of consensus for Tier 1 companies as we factor in lower price realizations for the next two years and a volume recovery not before second half of FY10. For HCL Tech, Tech Mahindra and Patni, our estimates are 5-20% lower than street estimates for FY10 and FY11.

Exhibit 13: IDFC-SSKI estimates with street estimates – a comparison

	IDFC SSKI EPS			Consensus EPS			Difference (%)		
(Rs)	FY09E	FY10E	FY11E	FY09E	FY10E	FY11E	FY09E	FY10E	FY11E
Infosys	101.4	99.8	102.8	102.4	106.8	113.6	(1.0)	(6.6)	(9.5)
TCS	52.3	52.1	56.6	55.0	57.5	60.2	(4.9)	(9.4)	(5.9)
Wipro	23.3	23.8	25.9	25.1	25.9	27.0	(7.5)	(8.1)	(4.4)
HCL Tech	19.0	18.1	18.9	20.4	19.8	19.8	(6.6)	(8.8)	(4.5)
Tech M	68.9	56.8	62.3	75.0	70.9	67.3	(8.1)	(19.8)	(7.4)
Patni	35.3	30.7	25.8	29.3	30.0	29.6	20.3	2.1	(12.9)

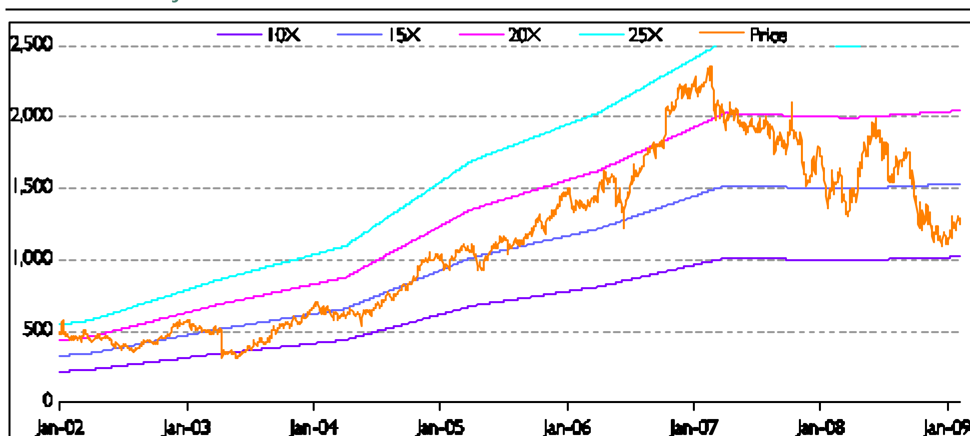
Source: Bloomberg, IDFC-SSKI Research

❑ Valuations and view

We have used Infosys's target PE as a benchmark to value TCS and Wipro

We have used the historic valuation band to arrive at a target PE for Infosys and then used it as the benchmark to value TCS and Wipro. For valuing other stocks, we have used Wipro's target multiple as the benchmark.

Exhibit 14: Infosys – 12-month PE band



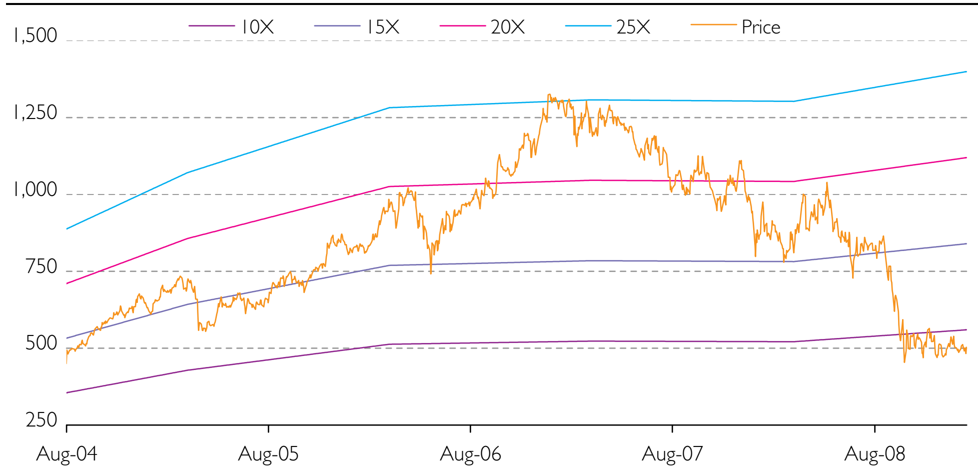
Source: Bloomberg, Company, IDFC-SSKI Research

We have valued Infosys at 15x FY10E EPS, and Wipro and TCS at a 20% discount to Infosys valuations

Infosys has traded in the range of 11-20x 12-month forward earnings with a mean/ median of ~15x since December 2007 (current US recession). We value the stock at 15x FY10E EPS based on its mean valuation during this period. We value Wipro and TCS at 12x, which is ~20% discount to Infosys's target multiple to factor in relatively better financial performance of Infosys in the recent past (and also during the previous US recession). This discount is in line with the average discount at which these two stocks have traded for the last one year.

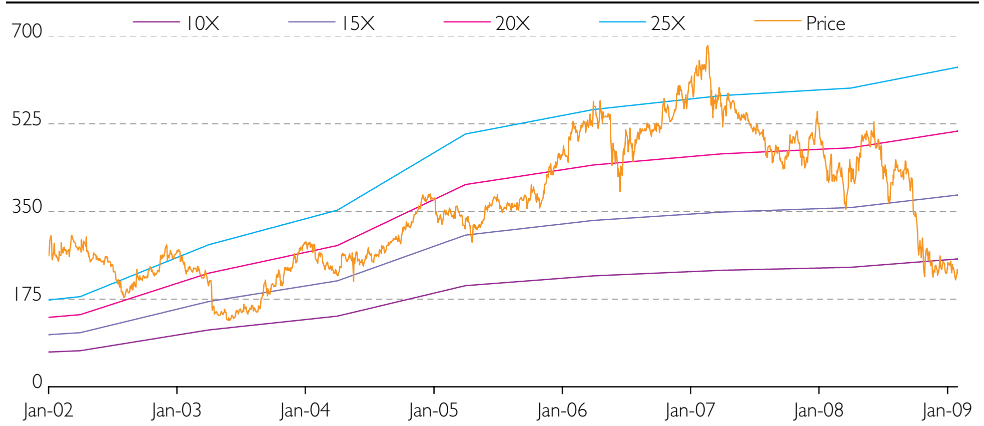
TCS and Wipro currently trade at historical trough valuations

Exhibit 16: TCS 12-month PE band



Source: Bloomberg, Company, IDFCSSKI forecast

Exhibit 17: Wipro 12-month PE band

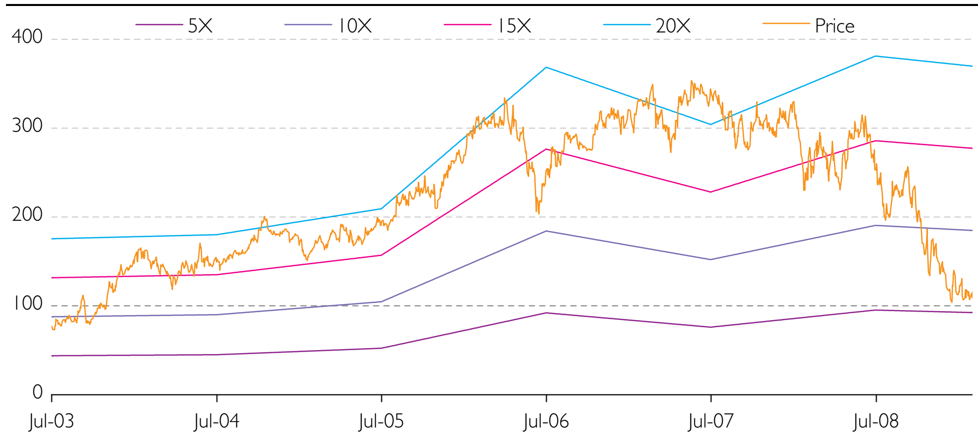


Source: Bloomberg, Company, IDFCSSKI forecast

We have valued HCL Tech at 7x FY10E EPS based on ~40% discount to Wipro's target multiple. This is in line with the average historical valuations and the discount to Wipro factors in its smaller size and relatively weaker organic growth seen during the previous US recession.

Stock de-rated post Axon acquisition

Exhibit 18: HCL Tech 12-month PE band

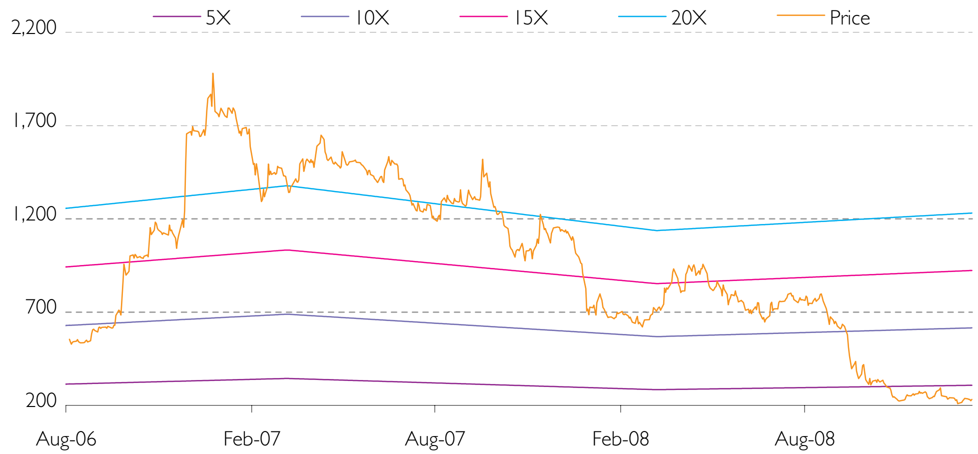


Source: Bloomberg, Company, IDFCSSKI forecast

We have valued Tech Mahindra at 4x FY10E EPS based on ~65% discount to Wipro's target multiple. The discount factors in Tech Mahindra's relatively smaller size, high client and sector concentration and lower earnings growth forecast vis-à-vis Wipro.

Business at high risk due to client and sector concentration

Exhibit 19: Tech Mahindra 12-month PE band

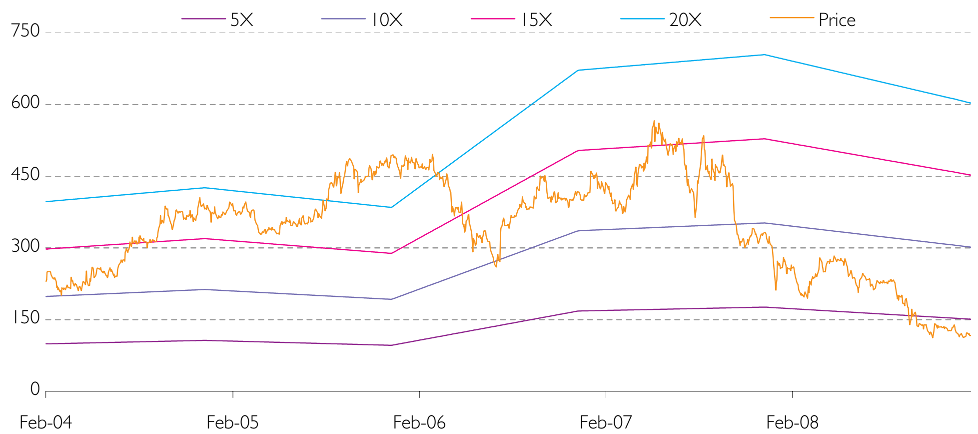


Source: Bloomberg, Company, IDFC-SSKI Research

For Patni, our target valuation of 3.5x CY09E EPS is based on ~70% discount to Wipro's target multiple. The discount factors in Patni's relatively smaller size and lower earnings growth forecast vis-à-vis Wipro.

We value Patni at the lower end of historic trading band

Exhibit 20: Patni 12-month PE band



Source: Bloomberg, Company, IDFC-SSKI Research

❑ Recommend market weight on IT services

While we have a Neutral stance on the sector, we rate Tier 1 as Outperformers with a 12-month view

We recommend market weight on IT services and prefer Tier 1 companies with a clean corporate governance record, which assumes high importance post the Satyam debacle. While we are cognizant of multiple sector headwinds leading to flat-to-declining earnings for Indian IT services companies over the next two years, we expect revenue and earnings growth to return to 15-20% levels only FY11 onwards. Thus, we rule out stocks giving material absolute returns till business concerns start waning. However, stock valuations are close to historic lows and we see limited downside. We recommend market weight on IT services and prefer Tier 1 companies with a strong track record. We rate Infosys, TCS and Wipro as

Outperformers with a 12-month view though the recent outperformance (as also guidance overhang for Infosys) would keep stock performane under pressure in the near term (next 3-4 months). We have a Neutral stance on HCL Tech and rate Patni and Tech Mahindra as Underperformers.

Tier 1 stocks offer 15-28% upside from CMP over a 12-month period

Exhibit 21: Target multiples, target price and upside

Company	Price	Reco	EPS (Rs)				Target	TP	Upside
	(Rs)		FY08A	FY09E	FY10E	FY11E	multiple	(Rs)	(%)
Infosys	1,310	OP	81.3	101.4	99.8	102.8	15.0	1,500	14.5
TCS	516	OP	51.3	52.3	52.1	56.6	12.0	630	22.2
Wipro	226	OP	22.1	23.3	23.8	25.9	12.0	290	28.2
HCL Tech	120	N	15.2	19.0	18.1	18.9	7.0	127	5.5
Tech M	234	UP	58.8	68.9	56.8	62.3	4.0	230	(1.9)
Patni*	115	UP	33.6	35.3	30.7	25.8	3.5	107	(7.0)

*Source: Company, IDFCSSKI estimates; * Using CY07, CY08, etc. for FY08, FY09, etc.*
Prices as on 9 February 2009

However, we rule out any positive movement during bear market rallies

We also note that Tier 1 IT stocks may not participate in bear market rallies due to their relative outperformance in the down-leg. Also, non-Tier 1 players like HCL Tech, Tech M and Patni would be laggards in such rallies due to the uncertainty on earnings.

COMPANIES

Company report

Infosys Technologies

Rs1310
OUTPERFORMER

Offshore IT bellwether

Mkt Cap: Rs751bn; US$15.5bn

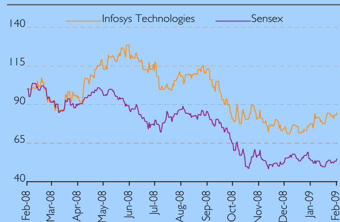
10 February 2009

BSE Sensex: 9647

Stock data

Reuters Code	INFY.BO
Bloomberg	INFO IN
1-yr high/low (Rs)	2046.5/1040
1-yr avg daily volumes (m)	2.32
Free Float (%)	83.5

Price performance



Performance (%)

	3-mth	6-mth	1-yr	3-yr
Infosys	3.9	(21.9)	(14.6)	(9.6)
Sensex	(3.8)	(36.8)	(45.1)	(4.6)

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Infosys maintains its lead vis-à-vis peers with 38% qoq CAGR in organic revenues (USD) and 33% CAGR in earnings over FY05-08. In line with business performance, the stock has outperformed peers and Sensex by 16-20% in CY08 as investors took flight to safety to counter market uncertainty. Despite a weak business environment, we expect Infosys to do relatively better than peers and maintain its margin lead in the face of pricing pressure. While the management is likely to guide to a 5-10% fall in revenues and earnings for FY10, this could keep the stock under pressure in the next 2-3 months. However, we expect 7% revenue (USD) CAGR and 1% EPS CAGR over FY09-11 as also strong return ratios. We recommend Outperformer at a 12-month price target of Rs1,500 (15x FY10E EPS).

Multiple levers to help protect the margin lead: While Infosys would find it difficult to stave off the accelerated margin decline for Indian IT service companies during the next two years, we do not expect the margin gap with peers to be plugged. Despite leading margins of 30%+, levers like employee utilization and variable wages are still available to Infosys to help partially mitigate the imminent pricing pressure.

Subdued guidance for FY10 a near-term overhang: Infosys is best positioned vis-à-vis peers to gain from the offshore shift in IT spend. However, given the challenging macro environment and its conservative guidance philosophy, Infosys is likely to guide to a 5-10% decline in both revenues and earnings for FY10. As seen historically, we believe the stock's performance would be subdued for the remaining 2-3 months to the guidance in April 2009.

Flight to safety continues but near-term pressure on stock performance: Despite ~20% outperformance in one month, valuations of ~13x FY10E EPS are close to historic lows. We expect Infosys to outperform over the next 12-18 months though we believe that it may re-test its recent historic low valuations over the next 2-3 months due to the guidance overhang. We rate Infosys as Outperformer with a 12-month price target of Rs1,500 (15x FY10E EPS).

Key financials

As on 31 March	FY07	FY08	FY09E	FY10E	FY11E
Net sales (Rs m)	138,930	166,920	215,248	227,444	244,603
Adj. net profit (Rs m)	37,250	46,590	58,167	57,217	58,914
Shares in issue (m)	563	572	573	573	573
Adj. EPS (Rs)	66.9	81.5	101.6	99.9	102.9
% change	*48.5*	*21.9*	*24.6*	*(1.7)*	*3.0*
PE (x)	19.6	16.1	12.9	13.1	12.7
Price/ Book (x)	6.5	5.4	4.2	3.4	2.9
EV/ EBITDA (x)	15.3	13.0	9.4	8.8	8.0
RoE (%)	40.7	37.2	36.8	28.9	24.6
RoCE (%)	42.4	37.0	39.7	31.4	26.9

INVESTMENT ARGUMENT

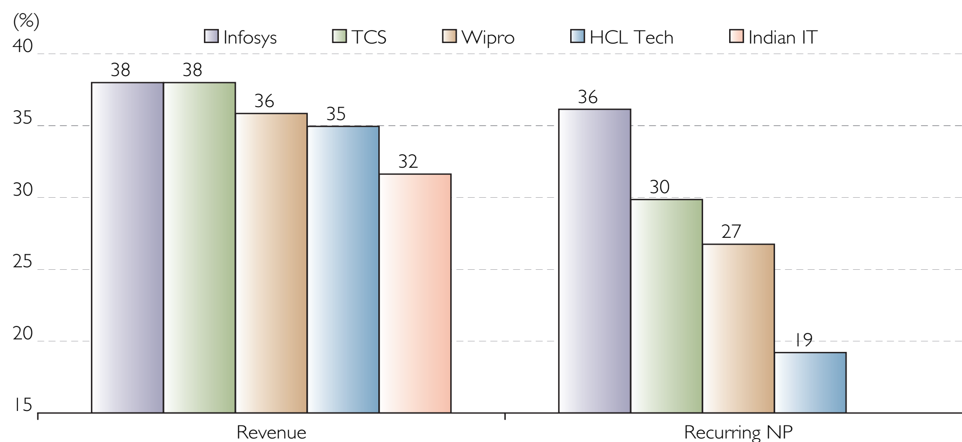
Infosys has grown ahead of peers – both on organic revenues (USD) and earnings fronts (38% and 33% CAGR respectively over the last three years). In line with the business performance, the stock has outperformed peers and Sensex by 16-20% in CY08 as investors flock to safe havens to beat the market uncertainty. Infosys is likely to Outperform over the next year as well though we expect the stock to remain under pressure till April 2009 due to the FY10 guidance overhang. We expect 7% revenue (USD) CAGR and 1% EPS CAGR for Infosys over FY09-11. We rate the stock Outperformer in a weak market environment owing to better corporate governance standards, sustained business performance and higher return ratios.

❑ Outperformance on all business metrics

Infosys offers healthy revenue and earnings growth, margin resilience and strong return ratios

Infosys has outperformed all other Indian IT services companies on most of the business paramaters – revenue growth, margin resilience, earnings growth, return ratios, etc. Infosys's revenues have registered 38% CAGR (all organic) over FY05-08 vs 35-38% increase for peers and 32% for the entire Indian IT industry. Over this period, Infosys's margins too have remained largely stable at ~32% while margins for peers have declined by 300-500bp.

Exhibit 1: Infosys's revenues and net profit (recurring) vs Tier 1 peers/ industry (3 year CAGR)

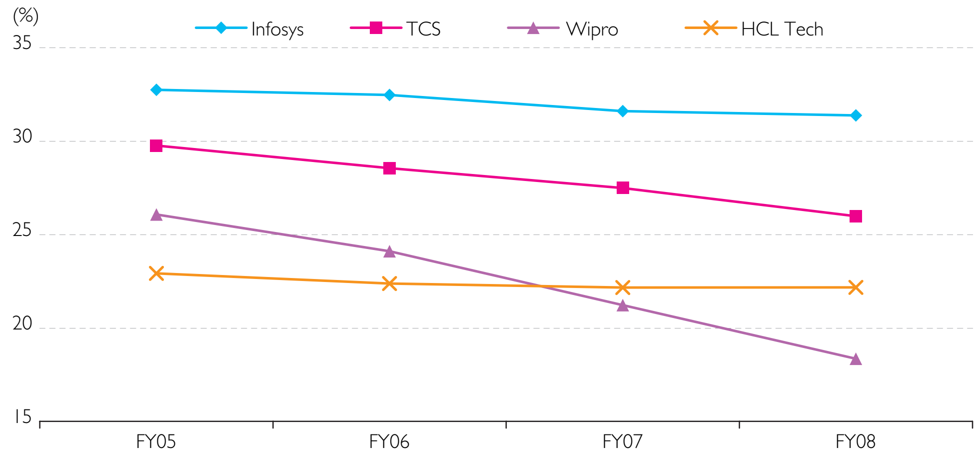


Source: NASSCOM, Company

Growth has been purely organic, thus no material goodwill on balance sheet

Importantly, growth has come entirely through the organic route and thus not at the expense of cash generated from business. In turn, the company's balance sheet is free of any significant goodwill, thereby resulting in high RoIC.

Exhibit 2: Margin trend for select Indian IT companies



Source: Company

❑ Margin decline imminent…though some levers still available

Margin levers like utilization and variable wages to help mitigate margin pressure

Given pricing headwinds, margins of all Indian IT services players are bound to fall over the next two years at an accelerated pace. In line with this, we expect Infosys's margins to come down. However, we believe Infosys is better placed vis-à-vis peers to protect its margins – and thereby maintain margin leadership in the space.

Infosys has had exhibited a stellar performance on the margins front in the last few years, but we still see some room to combat the onslaught on margins. Notable margin levers in the current environment include employee utilization and variable wages. Other margin levers like SG&A leverage and employee pyramid are a function of revenue growth, and would play out only when growth returns.

❑ FY10 guidance at end-FY09 – a near-term overhang

Infosys could guide for a decline in revenues and earnings for FY10

Infosys would be guiding to revenue and earnings growth for FY10 in April 2009 when it declares its Q4FY09 results. With a conservative management and considering the challenging economic environment, the company could likely guide to a decline in revenues and earnings for FY10 (in USD terms). However, we expect Infosys to clock 3-5% revenue growth in constant currency terms and flattish growth in USD terms in FY10.

We believe the muted guidance would be an overhang on the stock performance for the next 3-4 months as historically too, the stock has underperformed during the February-April period. However, we expect Infosys to do well over the next one year despite the uncertain business environment. Hence, we rate the stock as Outperformer with a 12-month view. Simultaneously, we do not rule out underperfomance in the near term, especially on the back of outperformance of 20% in CY08 and 19% YTD in CY09.

❑ Valuations close to historic low

Our 12-month price target for Infosys stands at Rs1,500

We have used the historic valuation band to arrive at a target PE for Infosys. Infosys has had traded in the range of 11-20x 12-month forward earnings with a mean/ median of 15x since December 2007. Based on 15x FY10E EPS, we value the stock at Rs1,500.

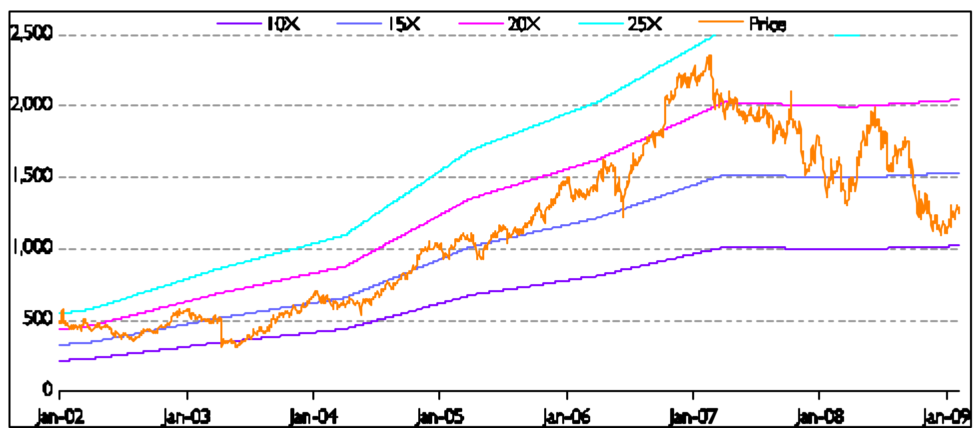
Exhibit 3: Infosys – historical 12-month PE chart

Source: Bloomberg, Company, IDFC-SSKI Research

On dynamic PER basis, Infosys has recently made a new trough of ~11x

We have also looked at dynamic PE ratio, computed using forward earnings estimates on the day of pricing (rather than using actual earnings). On dynamic PER basis, Infosys has recently made a trough of ~11x – lower than the previous low of ~14x made in April 2003 after a weak FY04 guidance in the backdrop of the Gulf war and SARS outbreak in Asia.

Exhibit 4: Infosys – historical 12-month PE band



Source: Bloomberg, Company , IDFC-SSKI Research

❑ Key risks and concerns

A longer recession in USA can put our numbers at risk; any performance disappointment also poses downside risk

While we are factoring in a recession in the US and other developed economies till Q3CY09, a longer and deeper recession poses a downside risk to our estimates. Also, Infosys is a consensus Overweight stock as investors take a flight to safety in the currently turbulent times. Any letdown in terms of financial performance could lead to significant downside for Infosys.

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Earnings model

Year to 31 March	FY07	FY08	FY09E	FY10E	FY11E
Net sales	**138,930**	**166,920**	**215,248**	**227,444**	**244,603**
% growth	*45.9*	*20.1*	*29.0*	*5.7*	*7.5*
Operating expenses	95,020	114,540	145,255	156,790	171,391
EBITDA	**43,910**	**52,380**	**69,993**	**70,654**	**73,212**
% change	*42.0*	*19.3*	*33.6*	*0.9*	*3.6*
Other income	3,720	7,040	4,635	7,476	11,261
Depreciation	5,140	5,980	7,289	8,448	8,916
Pre-tax profit	42,470	53,440	67,319	69,682	75,557
Deferred tax	5,110	6,850	9,152	12,465	16,643
Profit after tax	**37,360**	**46,590**	**58,167**	**57,217**	**58,914**
Minorities	(110)	-	-	-	-
Non-recurring items	1,310	-	-	-	-
Net profit after non-recurring items	38,560	46,590	58,167	57,217	58,914
% change	*56.8*	*20.8*	*24.8*	*(1.6)*	*3.0*

Key ratios

Year to 31 March	FY07	FY08	FY09E	FY10E	FY11E
EBITDA margin (%)	31.6	31.4	32.5	31.1	29.9
EBIT margin (%)	27.9	27.8	29.1	27.4	26.3
PAT margin (%)	26.8	27.9	27.0	25.2	24.1
RoE (%)	40.7	37.2	36.8	28.9	24.6
RoCE (%)	42.4	37.0	39.7	31.4	26.9
Gearing (x)	0.0	0.0	0.0	0.0	0.0

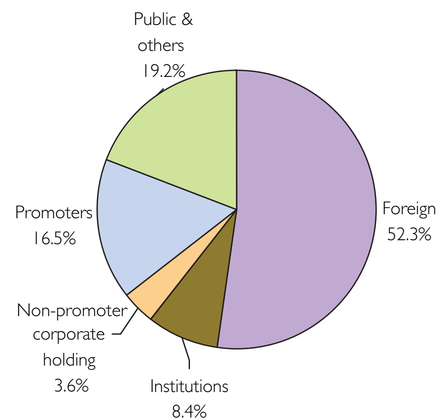
Valuations

Year to 31 March	FY07	FY08	FY09E	FY10E	FY11E
Reported EPS (Rs)	69.2	81.5	101.6	99.9	102.9
Adj. EPS (Rs)	66.9	81.5	101.6	99.9	102.9
PE (x)	19.6	16.1	12.9	13.1	12.7
Price/ Book (x)	6.5	5.4	4.2	3.4	2.9
EV/ Net sales (x)	4.8	4.1	3.1	2.7	2.4
EV/ EBITDA (x)	15.3	13.0	9.4	8.8	8.0
EV/ CE (x)	6.0	4.9	3.7	2.9	2.3

Balance sheet

As on 31 March	FY07	FY08	FY09E	FY10E	FY11E
Paid-up capital	2,860	2,860	2,860	2,860	2,860
Reserves & surplus	109,690	135,090	175,265	215,305	257,041
Total shareholders' equity	112,590	137,950	178,125	218,165	259,901
Total current liabilities	21,500	41,910	36,125	38,095	42,518
Total liabilities	21,500	41,910	36,125	38,095	42,518
Total equity & liabilities	**134,090**	**179,860**	**214,250**	**256,260**	**302,418**
Net fixed assets	37,710	47,770	54,697	56,574	60,149
Investments	250	720	1,980	1,980	1,980
Total current assets	95,210	130,180	156,193	196,325	238,909
Deferred tax assets	920	1,190	1,380	1,380	1,380
Working capital	73,710	88,270	120,068	158,231	196,392
Total assets	**134,090**	**179,860**	**214,250**	**256,260**	**302,418**

Shareholding pattern



As of December 2008

Cash flow statement

Year to 31 March	FY07	FY08	FY09E	FY10E	FY11E
Pre-tax profit	42,470	53,440	67,319	69,682	75,557
Depreciation	5,140	5,980	7,289	8,448	8,916
Chg in working capital	(9,410)	(3,770)	(8,468)	(3,346)	(2,859)
Total tax paid	(5,380)	(7,120)	(9,342)	(12,465)	(16,643)
Ext ord. Items	1,310	-	-	-	-
Operating cash Inflow	34,130	48,530	56,798	62,319	64,971
Capital expenditure	(20,590)	(16,040)	(14,216)	(10,325)	(12,491)
Free cash flow (a+b)	13,540	32,490	42,582	51,994	52,480
Chg in investments	7,300	(470)	(1,260)	-	-
Capital raised/(repaid)	10,762	(2,172)	(816)	-	-
Dividend (incl. tax)	(6,432)	(19,018)	(17,176)	(17,178)	(17,178)
Misc	(750)	(40)	-	-	-
Net chg in cash	24,420	10,790	23,330	34,816	35,302

Company report

TCS

Rs516
OUTPERFORMER

Big Daddy

Mkt Cap: Rs504.6bn; US$10.4bn

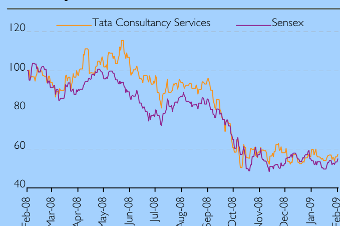
10 February 2009

BSE Sensex: 9647

Stock data

Reuters Code	TCS.BO
Bloomberg	TCS IN
1-yr high/low (Rs)	1,057/415
1-yr avg daily volumes (m)	1.94
Free Float (%)	23.7

Price performance



Performance (%)

	3-mth	6-mth	1-yr	3-yr
TCS	(1.9)	(39.1)	(42.7)	(38.2)
Sensex	(3.8)	(36.8)	(45.1)	(4.6)

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TCS, India's largest IT offshoring company, is expected to be a key beneficiary of the accelerating trend in offshoring as clients leverage low-cost geographies to contain IT services spend. TCS has, in the last few years, increasingly de-risked its business model by expanding into newer geographies (Continental Europe, China and Latin America) as also through signing long-term contracts. TCS derives ~30% of its revenues from non-US and non-UK geographies. We expect 8% revenue (USD) CAGR and 4% EPS CAGR for TCS over FY09-11. We value TCS at Rs630 (12x FY10E EPS; 20% discount to Infosys's target valuation) and rate the stock as Outperformer.

Large deal focus to pay off: TCS has signed several large deals in the last two years. Notable among the 20+ large deals signed are a $1.2bn multi-service deal with Neilson & Co and a $2.5bn BPO deal with Citi. We believe this would help the company de-risk its business model away from discretionary IT spend.

Best diversified geographically: Among offshore IT players, TCS has the best geographic mix in terms of both revenues and development centers. TCS derives ~30% of its revenues from non-US and non-UK markets – the highest among Tier 1 Indian IT services companies. Also, TCS has sizeable presence across key emerging economies including India, China and Latin America. This, along with its large deal focus, should help TCS de-risk its business model and deliver better results as IT services demand revives.

Valuation gap with Infosys to bridge as stake sale overhang dispels: At ~10x FY10E EPS, TCS trades at close to historic lows. We believe the valuation premium to peers like HCL Tech, Tech Mahindra, Patni, etc is justified in view of TCS's diversified portfolio mix, better earnings profile and good corporate governance track record. Though discount to Infosys's valuations remains at the higher end due to overhang of stake sale by promoter (Tata Sons selling stake for last two years to fund group acquisitions), the gap should get bridged as other Tata group companies fund their acquisitions.

Key financials

As on 31 March	FY07	FY08	FY09E	FY10E	FY11E
Net sales (Rs m)	186,333	228,614	278,923	304,358	327,434
Adj. net profit (Rs m)	41,918	50,191	51,186	50,996	55,427
Shares in issue (m)	979	979	979	979	979
Adj. EPS (Rs)	42.8	51.3	52.3	52.1	56.6
% change	*39.9*	*19.7*	*2.0*	*(0.4)*	*8.7*
PE (x)	12.0	10.1	9.9	9.9	9.1
Price/ Book (x)	5.6	4.1	3.1	2.6	2.1
EV/ EBITDA (x)	9.4	8.4	6.9	6.5	5.5
RoE (%)	56.6	47.2	36.1	28.5	25.5
RoCE (%)	59.8	47.6	43.2	34.3	31.5

INVESTMENT ARGUMENT

TCS is well poised to benefit from the IT spend shift in favour of offshoring. Over the last few years, TCS has relatively de-risked its business model by (a) expanding into newer geographies – Continental Europe, China and Latin America – and (b) signing larger and longer-term contracts. Notable among them are the $1bn Neilson & Co deal and a $2.5bn BPO deal with Citi. TCS derives ~30% of its revenues from non-US and non-UK geographies, the highest among Tier 1 peers. We expect 8% revenue (USD) CAGR and 4% EPS CAGR for TCS over FY09-11. We value TCS at Rs630 based on 12x FY10E EPS; Outperformer.

❑ A de-risked business model

Well-diversified revenue base and larger deals have de-risked the business model

TCS management has, over the last three years, worked extensively on de-risking the company's business model through geographic diversification of revenues. Among Tier 1 peers, TCS has the highest proportion of revenues coming from markets other than US and UK. Also, the company has been signing large deals to enhance revenue visibility.

❑ Best diversified geographically

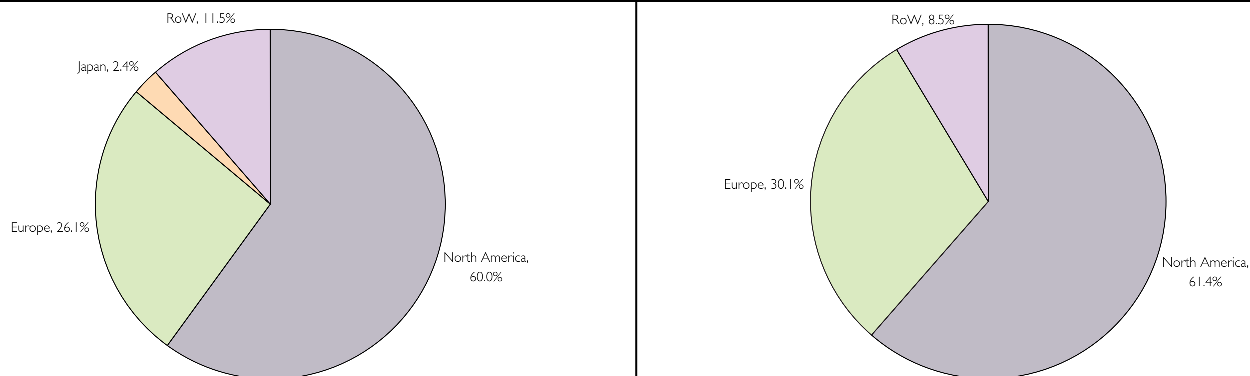
At 30% of total, non-US and non-UK revenues for TCS highest among Tier 1 peers

TCS, with its Indian market presence post the acquisition of CMC, has been relatively less dependent on traditional US and UK geographies. The company has further diversified into non-traditional developed markets of France and Germany as well as emerging economies like China, Latin America and Western Europe. TCS gets ~30% of its revenues from these markets – highest amongst Tier 1 peers.

Exhibit 1: TCS/ Infosys – geographic mix

Source: Company

Exhibit 2: Wipro/ Indian IT exports – geographic mix



Source: Company, NASSCOM

TCS's $1bn deal with Neilson & Co and $2.5bn deal with Citi imparts high revenue visibility

❑ Deal size becoming larger

TCS has signed several large deals in the last 2-3 years – at least a dozen every year. This has helped the company improve its revenue visibility and de-risk the business model. Notable among those have been two mega deals (i) the $1bn deal with Neilson & Company, and (ii) the $2.5bn deal with Citi for BPO operations. The Neilson contract is a 10-year multi-service agreement for IT- and operations-support worldwide. The deal with Citi involves taking over CGSL and entails a revenue commitment of $2.5bn over a 9.5-year period. TCS has signed several other large deals in the range of $50m-100m across services and verticals.

Expect muted revenue and earnings growth for TCS over FY09-11

❑ Financials

In line with our sector thesis, we expect muted revenue and earnings growth for TCS over FY09-11. We have built in volume growth of 20% and 13% with a pricing decline of 11% and 3% in FY10 and FY11 respectively. A significant part of the volume growth in FY10 would be contributed by CGSL acquisiton. Pricing decline can also be attributed to the mix tilting towards BPO services and cross-currency headwinds. This is likely to lead to flattish earnings for the next two years.

We expect EPS to decline marginally to Rs52.1 in FY10 from Rs52.3 in FY09 while we are building in growth of 9% yoy for FY11.

Since December 2007, TCS has traded in the 8-19x band with a mean of 14.5x 12-month forward earnings

❑ Valuations close to historic low

We have valued TCS at Rs630 based on 12x FY10E earnings (20% discount to our target multiple for Infosys), arrived at by using the historic valuation band and historical discount to Infosys. Since December 2007, TCS has traded in a band of 8-19x with a mean of 14.5x 12-month forward earnings.

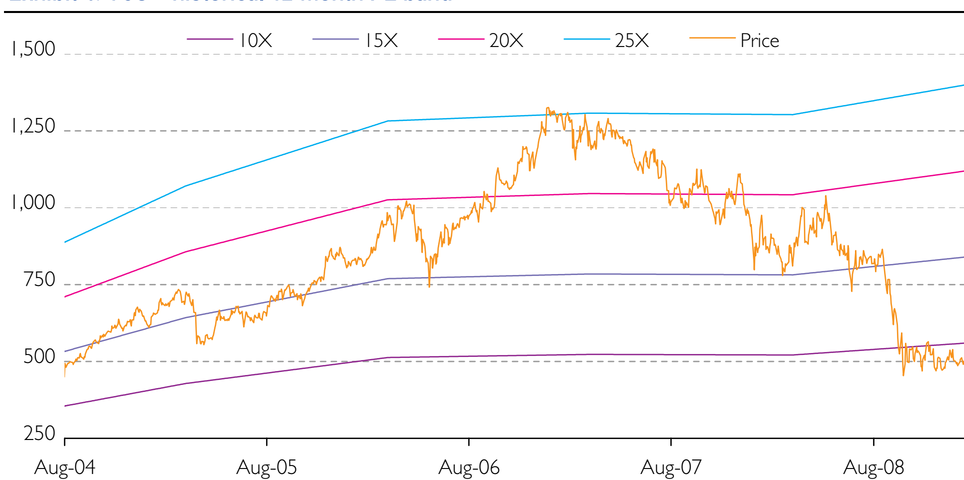
Exhibit 3: TCS – historical 12-month PE chart

Source: Bloomberg, Company, IDFC-SSKI Research

TCS has traded at an average 20% discount to Infosys in the last one year

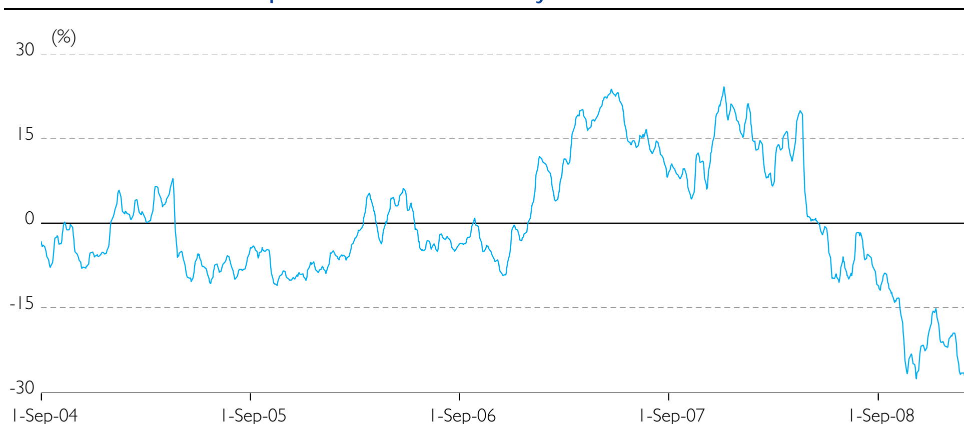
The discount to Infosys's target multiple has been assigned to factor in Infosys's relatively better financial performance in the recent past (and also during the previous US recession). It is also in line with the average discount at which TCS stock has traded relative to Infosys stock for the last one year.

Exhibit 4: TCS – historical 12-month PE band



Source: Bloomberg, Company, IDFC-SSKI Research

Exhibit 5: TCS – valuation premium/ discount to Infosys PE



Source: Bloomberg, Company, IDFC-SSKI Research

❑ Key risks and concerns

Besides a longer recession beyond Q3CY09, stake selling by promoter remains a concern

While we are factoring in a recession in the US and other developed economies till Q3CY09, a longer and deeper recession poses a downside risk to our estimates. Also, TCS promoters (Tata Sons) have sold part of their stake in the market to fund the recent acquisitions of Tata group companies. While there are no payments due in the immediate future, certain payments on bridge loans and term loan are due beyond next 3-4 months. Hence, a risk of further selling by Tata Sons cannot be ruled out altogether. Further selling, if any, could prevent any re-rating of the stock and thus limit narrowing of discount to Infosys's PE valuations.

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Earnings model

Year to 31 March	FY07	FY08	FY09E	FY10E	FY11E
Net sales	**186,333**	**228,614**	**278,923**	**304,358**	**327,434**
% growth	*40.7*	*22.7*	*22.0*	*9.1*	*7.6*
Operating expenses	135,101	169,217	208,062	233,169	249,135
EBITDA	**51,232**	**59,397**	**70,861**	**71,189**	**78,298**
% change	*35.4*	*15.9*	*19.3*	*0.5*	*10.0*
Other income	1,943	4,450	(4,599)	(3,500)	(450)
Depreciation	4,184	5,746	5,419	5,868	6,113
Pre-tax profit	48,991	58,101	60,843	61,821	71,735
Current tax	6,700	7,494	9,071	10,245	15,728
Profit after tax	**42,290**	**50,607**	**51,772**	**51,576**	**56,007**
Minorities	(373)	(416)	(586)	(580)	(580)
Net profit after non-recurring items	41,918	50,191	51,186	50,996	55,427
% change	*39.9*	*19.7*	*2.0*	*(0.4)*	*8.7*

Balance sheet

As on 31 March	FY07	FY08	FY09E	FY10E	FY11E
Paid-up capital	25,351	1,979	1,979	1,979	1,979
Reserves & surplus	64,287	121,023	158,508	195,804	235,573
Total shareholders' equity	89,638	123,001	160,487	197,783	237,552
Total current liabilities	37,044	44,772	52,995	57,828	62,212
Total debt	1,184	4,550	7,645	7,645	7,645
Other non-current liabilities	3,617	3,530	3,523	3,523	3,523
Total liabilities	41,845	52,852	64,163	68,996	73,380
Total equity & liabilities	**131,483**	**175,853**	**224,650**	**266,779**	**310,932**
Net fixed assets	22,912	35,765	41,774	43,595	45,482
Investments	8,035	26,062	27,621	27,621	27,621
Total current assets	85,504	100,305	124,991	165,298	207,566
Other non-current assets	15,032	13,721	30,264	30,264	30,264
Working capital	48,460	55,533	71,995	107,470	145,353
Total assets	**131,483**	**175,853**	**224,650**	**266,779**	**310,932**

Cash flow statement

Year to 31 March	FY07	FY08	FY09E	FY10E	FY11E
Pre-tax profit	48,991	58,101	60,843	61,821	71,735
Depreciation	4,184	5,746	5,419	5,868	6,113
Chg in working capital	(2,139)	(19,231)	(8,726)	(4,705)	(4,269)
Total tax paid	(6,700)	(7,494)	(9,071)	(10,245)	(15,728)
Ext ord. Items	44	8	(2)	20	20
Operating cash Inflow	44,379	37,130	48,463	52,759	57,871
Capital expenditure	(14,027)	(20,554)	(13,896)	(7,689)	(8,000)
Free cash flow (a+b)	30,353	16,576	34,567	45,070	49,872
Chg in investments	(962)	(17,825)	(1,559)	-	-
Debt raised/(repaid)	-	4,550	3,095	-	-
Capital raised/(repaid)	567	(3,127)	-	-	-
Dividend (incl. tax)	(11,254)	(13,700)	(13,700)	(13,700)	(15,658)
Misc	540	2,553	(14,666)	(600)	(600)
Net chg in cash	19,243	(10,974)	7,736	30,770	33,614

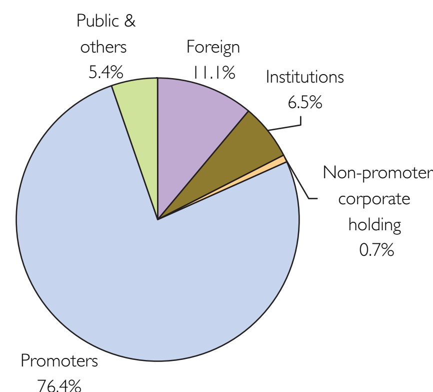
Key ratios

Year to 31 March	FY07	FY08	FY09E	FY10E	FY11E
EBITDA margin (%)	27.5	26.0	25.4	23.4	23.9
EBIT margin (%)	25.2	23.5	23.5	21.5	22.0
PAT margin (%)	22.5	22.0	18.4	16.8	16.9
RoE (%)	56.6	47.2	36.1	28.5	25.5
RoCE (%)	59.8	47.6	43.2	34.3	31.5
Gearing (x)	0.0	0.0	0.0	0.0	0.0

Valuations

Year to 31 March	FY07	FY08	FY09E	FY10E	FY11E
Reported EPS (Rs)	42.8	51.3	52.3	52.1	56.6
Adj. EPS (Rs)	42.8	51.3	52.3	52.1	56.6
PE (x)	12.0	10.1	9.9	9.9	9.1
Price/ Book (x)	5.6	4.1	3.1	2.6	2.1
EV/ Net sales (x)	2.6	2.2	1.8	1.5	1.3
EV/ EBITDA (x)	9.4	8.4	6.9	6.5	5.5
EV/ CE (x)	5.1	3.8	2.9	2.2	1.7

Shareholding pattern



As of December 2008

Company report

Wipro

Rs226
OUTPERFORMER

Best portfolio of services

Mkt Cap: Rs329.4bn; US$6.8bn

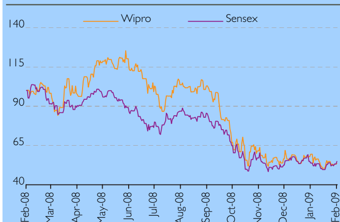
10 February 2009

BSE Sensex: 9647

Stock data

Reuters Code	WIPR.BO
Bloomberg	WPRO IN
1-yr high/low (Rs)	538/180
1-yr avg daily volumes (m)	2.02
Free Float (%)	20.6

Price performance



Performance (%)

	3-mth	6-mth	1-yr	3-yr
Wipro	(13.0)	(48.3)	(46.4)	(55.4)
Sensex	(3.8)	(36.8)	(45.1)	(4.6)

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With offshoring becoming megatrend and clients leveraging low-cost geographies to contain IT services spend, Wipro would be one of the key beneficiaries of these trends. Wipro has a strong portfolio of services with a full-service suite in IMS (US$1bn of revenues in 2008) as also strong offerings in BPO, product engineering and testing. With a rich portfolio of services, Wipro is well placed to capture a fair share of opportunities in IT services. We expect 6% revenue (USD) CAGR for Wipro IT & BPO service; for the consolidated entity, we expect 6% revenue and 5% EPS CAGR over FY09-11. We value Wipro at Rs280 (12x FY10E EPS); Outperformer.

A rich service portfolio: With acquisition of Info-crossing, Wipro has a full-range suite of sub-services even within IMS and one of the best portfolios of services among Indian IT services players. The company has an IMS practice of ~US$1bn, testing practice of $500m and product engineering practice of $300m as of date.

Recent inorganic activism – a paradigm shift: Wipro has acquired more than a dozen companies – most of them in the sub-$50m. While the acquisitions have been in line with its stated "String of Pearls" strategy, Info-crossing ($600m) and CITOS ($127m) are relatively bigger in size and indicate Wipro's preparedness to acquire and assimilate bigger acquisitions. Post Info-crossing acquisition, Wipro's full suite of IMS offering is unmatched by any other offshore service provider. Also, CITOS acquisition has given Wipro an anchor client and exclusive relationship for offshoring of Citi's IMS needs.

Valuations at historic lows; premium to Tier 2 justified: Wipro trades at ~9.5x FY10E EPS – which is close to historic lows. Also, we see the premium to mid-tier peers like HCL Tech, Patni and Tech Mahindra as justified in view of Wipro's stronger revenue and earnings profile as also its relatively cleaner corporate governance and delivery track record.

Key financials

As on 31 March	FY07	FY08	FY09E	FY10E	FY11E
Net sales (Rs m)	149,431	197,427	254,210	267,671	289,522
Adj. net profit (Rs m)	29,130	32,239	33,859	34,727	37,642
Shares in issue (m)	1,425	1,450	1,454	1,454	1,454
Adj. EPS (Rs)	20.2	22.1	23.3	23.8	25.9
% change	*43.3*	*9.7*	*5.0*	*2.6*	*8.4*
PE (x)	11.2	10.2	9.7	9.5	8.8
Price/ Book (x)	3.2	2.5	2.3	2.3	1.9
EV/ EBITDA (x)	8.1	8.1	6.6	6.4	5.5
RoE (%)	32.3	27.9	25.1	24.7	24.2
RoCE (%)	32.3	23.8	23.1	24.5	26.2

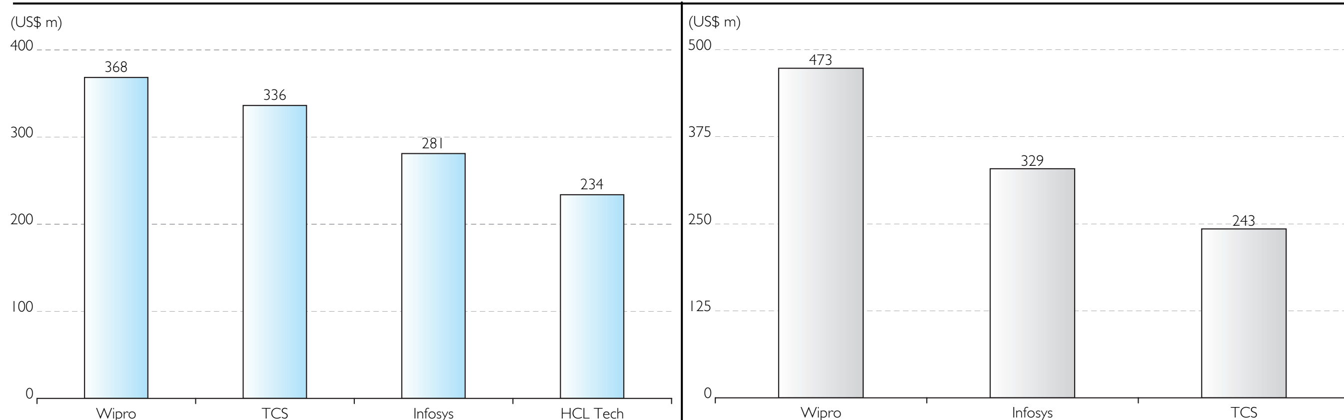
INVESTMENT ARGUMENT

We expect Wipro to perform well over the next few years as it has a strong portfolio of services in non-ADM services, the next growth drivers for offshoring IT companies. Wipro has a full-service suite in IMS (US$1bn revenues) along with strong offerings in BPO, product engineering and testing. Wipro is also well-positioned to capture a fair share of opportunities in IT services. We expect 6% revenue (USD) CAGR for Wipro IT & BPO service over FY09-11; for the consolidated entity, we expect 6% revenue and 5% EPS CAGR over the period. High inorganic activism raises the risk of Wipro overpaying for some of its acquisitions. We value Wipro at Rs280 based on 12x FY10E EPS.

❑ Best portfolio of services

Wipro has acquired scale in several of the new high-growth service lines. Among Indian IT services companies, Wipro is the leader across three major service lines – Infrastructure Management Services, BPO services and Testing Services.

Exhibit 1: BPO and testing practice – select Indian IT companies

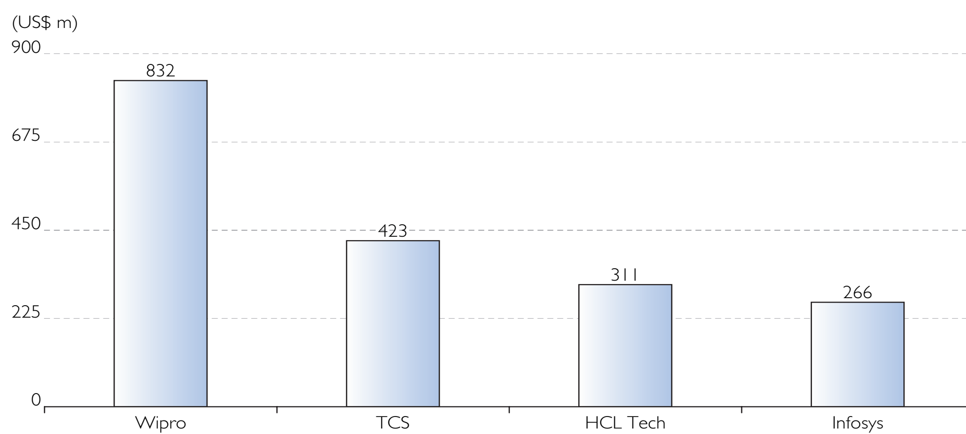


Source: Company

Post Info-crossing acquisition, Wipro has a complete suite of IMS offering including data centers hosting – unmatched by any other offshore IT service provider.

Wipro's IMS offering includes data centre hosting and is unmatched by any other offshoring IT company…

Exhibit 2: IMS practice – select indian IT companies



Source: Company

Positioned for stronger growth for the next few years

This positions Wipro for stronger growth over the next few years as we believe that the next leg of India's IT exports growth would be led by non-ADM services.

❑ Inorganic strategy to pay off

In line with its well-articulated "String of Pearls" acquisition strategy, Wipro has been acquiring companies with revenues of $5m-50m over the last few years. These acquisitions have been done to fill the gaps in service offering and/ or get foothold in new geographies/ verticals. Wipro acquired cMango, NewLogic, mPower, Quantech, Enabler, Sarawaoe, etc in the IT services space, and Unza and Hydrato in other businesses over the last 2-3 years.

Acquisition of Info-crossing and CITOS has catapulted Wipro into a leadership position in the IMS space

Wipro has recently become more enterprising on the acqusition front. The company has acquired Info-crossing (revenues of $240m+) and CITOS ($125m+), which could be classified much bigger than "small pearls" for a string. Importantly, Info-crossing acquisition has completed Wipro's suite of IMS services (unmatched by any other offshore vendor) and CITOS acquisition has come with exclusive relationship in offshore IMS for Citi and a revenue commitment of $500m over the next five years. These acquisitions can catapult Wipro into a leadership position in the IMS space and make it a key competitor for the likes of IBM and HP-EDS.

❑ Valuations close to historic low

Since December 2007, Wipro has traded in a band of 8-22x with a mean of ~16x 12-month forward earnings

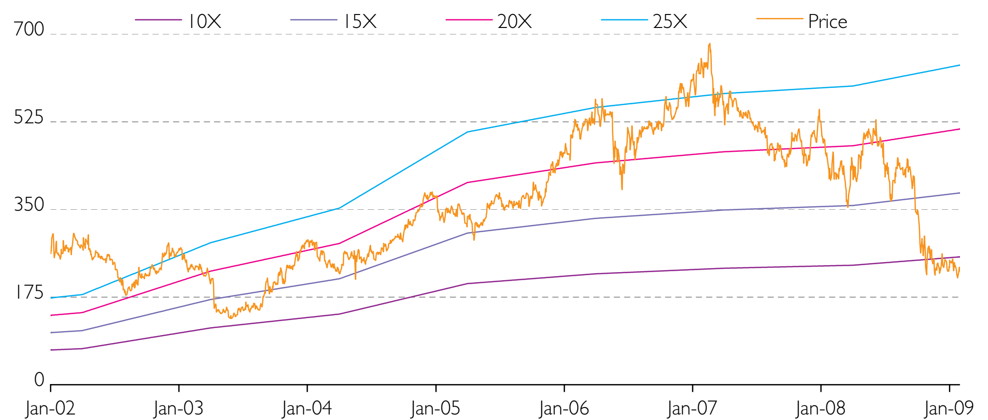
We have valued Wipro at Rs290 based on 12x FY10E earnings (~20% discount to our target multiple for Infosys), arrived at by using the historic valuation band and historical discount to Infosys. Since December 2007, Wipro has traded in a band of 8-22x with a mean of ~16x 12-month forward earnings.

Exhibit 3: Wipro – historical 12-month PE chart

Source: Bloomberg, Company, IDFC-SSKI Research

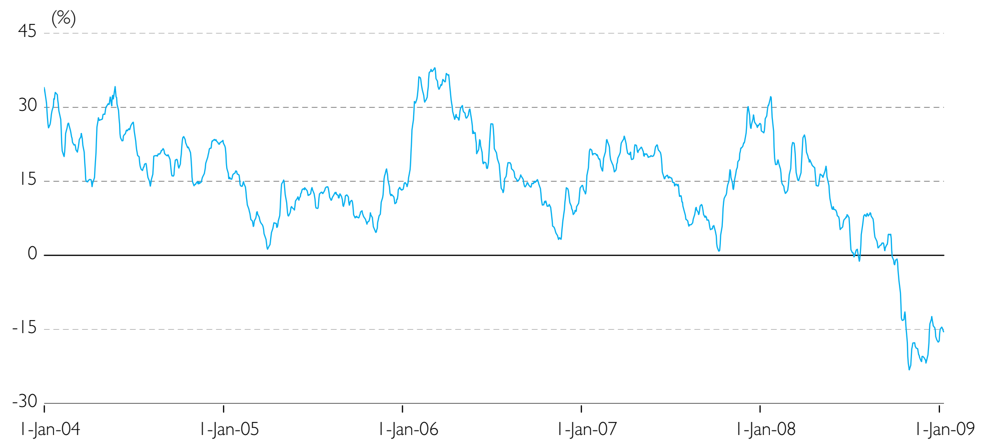
The discount to Infosys's target multiple has been assigned to factor in Infosys's relatively better financial performance in the recent past (and also during the previous US recession). It is also in line with the average discount at which Wipro stock has traded relative to Infosys stock for the last one year.

Exhibit 4: Wipro – historical 12-month PE band



Source: Bloomberg, Company, IDFC-SSKI Research

Exhibit 5: Wipro – valuation premium/ discount to Infosys PE



Source: Bloomberg, Company, IDFC-SSKI Research

❑ Key risks and concerns

Failure to integrate any of its acquisitions is a key concern for Wipro besides the global recession extending beyond Q3CY09

While we are factoring in recession in the US and other developed economies till Q3CY09, a longer and deeper recession poses a downside risk to our estimates. Also, Wipro has aggressively used the inorganic route to acquire new skill sets and fill the gap in its services offering – this could pose a risk if any of its acquisitions do not work on expected lines. In addition, there could be a possibility of the company overpaying for some acquisitions.

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Earnings model

Year to 31 March	FY07	FY08	FY09E	FY10E	FY11E
Net sales	**149,431**	**197,427**	**254,210**	**267,671**	**289,522**
% growth	*40.8*	*32.1*	*28.8*	*5.3*	*8.2*
Operating expenses	115,128	157,881	203,842	215,189	232,722
EBITDA	**34,303**	**39,546**	**50,368**	**52,482**	**56,799**
% change	*34.9*	*15.3*	*27.4*	*4.2*	*8.2*
Net interest	2,667	2,167	(2,137)	(1,600)	(1,200)
Depreciation	4,200	5,960	8,085	8,307	8,878
Pre-tax profit	32,852	36,136	39,327	41,431	47,178
Current tax	3,723	3,873	5,402	6,629	9,436
Profit after tax	**29,130**	**32,263**	**33,924**	**34,802**	**37,742**
Minorities	0	(24)	(65)	(75)	(100)
Net profit after non-recurring items	29,130	32,239	33,859	34,727	37,642
% change	*43.7*	*10.7*	*5.0*	*2.6*	*8.4*

Balance sheet

As on 31 March	FY07	FY08	FY09E	FY10E	FY11E
Paid-up capital	2,918	2,923	2,927	2,927	2,927
Reserves & surplus	98,550	126,444	137,609	163,609	192,528
Total shareholders' equity	101,468	129,481	140,743	166,818	195,837
Total current liabilities	39,601	47,004	72,450	76,286	82,514
Total debt	3,781	44,055	44,476	24,476	19,476
Other non-current liabilities	1,252	2,759	5,257	5,257	5,257
Total liabilities	44,634	93,818	122,183	106,019	107,247
Total equity & liabilities	**146,102**	**223,299**	**262,926**	**272,837**	**303,084**
Net fixed assets	26,541	39,822	50,842	51,475	53,615
Investments	1,599	1,343	1,965	1,965	1,965
Total current assets	101,098	128,341	144,078	153,356	181,463
Deferred tax assets	49	-	56	56	56
Other non-current assets	16,815	53,793	65,985	65,985	65,985
Working capital	61,497	81,337	71,628	77,070	98,949
Total assets	**146,102**	**223,299**	**262,926**	**272,837**	**303,084**

Cash flow statement

Year to 31 March	FY07	FY08	FY09E	FY10E	FY11E
Pre-tax profit	32,852	36,136	39,327	41,431	47,178
Depreciation	4,200	5,960	8,085	8,307	8,878
Chg in working capital	2,812	(17,822)	(1,165)	(4,408)	(2,632)
Total tax paid	(3,741)	(3,824)	(5,458)	(6,629)	(9,436)
Ext ord. Items	-	-	-	-	-
Operating cash Inflow	36,123	20,449	40,788	38,701	43,988
Capital expenditure	(19,998)	(55,308)	(28,111)	(8,940)	(11,018)
Free cash flow (a+b)	16,126	(34,859)	12,677	29,762	32,970
Chg in investments	(556)	256	(622)	-	-
Debt raised/(repaid)	3,076	40,274	421	(20,000)	(5,000)
Capital raised/(repaid)	3,701	6,679	(4,243)	1,145	1,150
Dividend (incl. tax)	(9,786)	(9,872)	(9,873)	(9,873)	(9,873)
Misc	314	(460)	(9,235)	-	-
Net chg in cash	12,874	2,018	(10,874)	1,034	19,247

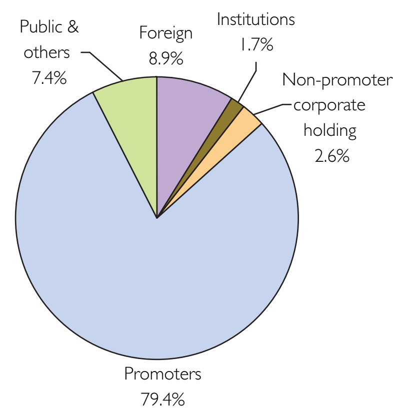
Key ratios

Year to 31 March	FY07	FY08	FY09E	FY10E	FY11E
EBITDA margin (%)	23.0	20.0	19.8	19.6	19.6
EBIT margin (%)	20.1	17.0	16.6	16.5	16.6
PAT margin (%)	19.5	16.3	13.3	13.0	13.0
RoE (%)	32.3	27.9	25.1	24.7	24.2
RoCE (%)	32.3	23.8	23.1	24.5	26.2
Gearing (x)	0.0	0.3	0.3	0.2	0.1

Valuations

Year to 31 March	FY07	FY08	FY09E	FY10E	FY11E
Reported EPS (Rs)	20.2	22.1	23.3	23.8	25.9
Adj. EPS (Rs)	20.2	22.1	23.3	23.8	25.9
PE (x)	11.2	10.2	9.7	9.5	8.8
Price/ Book (x)	3.2	2.5	2.3	2.3	1.9
EV/ Net sales (x)	1.9	1.6	1.3	1.3	1.1
EV/ EBITDA (x)	8.1	8.1	6.6	6.4	5.5
EV/ CE (x)	2.6	1.8	1.7	2.0	1.6

Shareholding pattern



As of December 2008

HCL Technologies

Rs120
NEUTRAL

6%+ dividend yield

Mkt Cap: Rs81bn; US$1.7bn

Company report

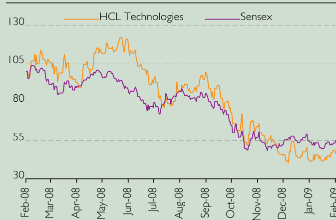
10 February 2009

BSE Sensex: 9647

Stock data

Reuters Code	HCLT.BO
Bloomberg	HCLT IN
1-yr high/low (Rs)	325/102
1-yr avg daily volumes (m)	1.29
Free Float (%)	32.7

Price performance



Performance (%)

	3-mth	6-mth	1-yr	3-yr
HCL	(27.4)	(46.8)	(53.5)	(61.1)
Sensex	(3.8)	(36.8)	(45.1)	(4.6)

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HCL Tech's (HCLT) blue ocean strategy has helped it bag several large deals in markets relatively under-penetrated by offshore services providers. While beneficial in the long term, we believe the recent Axon acquisition is expensive and could lead to near-term challenges as recession is likely to hit Axon's target markets (Europe and SAP Consulting) more severely. We expect 10% revenue (USD) CAGR and flat EPS for HCLT over FY09-11. We have valued the stock at Rs127 based on 7x FY10E EPS. A liberal dividend policy and dividend yield of 6%+ as also inexpensive valuations offer downside support to the stock. We rate HCL Tech as Neutral.

Axon an expensive acquisition; beneficial only in the long term: Axon, acquired at a time when its business cycle was close to the peak, has come at rich valuations. Also, the Euro area – Axon's key geography – has been severely hit by recession post the global financial crisis. ERP implementation too is late-cyclical and would see slow revenue growth in the next two years. While the leadership acquired by HCLT in SAP consulting through Axon is a positive for the longer term, challenges do exist in the near to medium term.

HCL Tech more vulnerable to recession: We believe the ongoing economic recession would impact HCLT's revenues to a greater extent due to (i) higher share of PI revenues (from Axon) which are showing signs of weakness, and (ii) high exposure to BFSI and Hi-Tech manufacturing sectors with the two verticals accounting for ~50% of HCLT's current revenues. Also, we do not see any near-term respite from some client-specific issues in the BFSI vertical.

Valuations at historic lows; but no re-rating triggers in sight: At 6.3x FY10E EPS, the stock trades at close to historic lows. However, several sector-specific headwinds are likely to keep earnings muted beyond FY09, and we do not expect significant re-rating of the stock. On the positive side, dividend yield of 6%+ would provide downside support. We rate HCLT as Neutral.

Key financials

As on 31 March	FY07	FY08	FY09E	FY10E	FY11E
Net sales (Rs m)	60,337	76,394	104,814	115,498	123,949
Adj. net profit (Rs m)	13,549	11,245	13,550	12,837	13,389
Shares in issue (m)	653	664	668	669	669
Adj. EPS (Rs)	20.8	16.9	20.3	19.2	20.0
% change	*71.8*	*(18.5)*	*19.9*	*(5.5)*	*4.3*
PE (x)	5.8	7.1	5.9	6.3	6.0
Price/ Book (x)	1.6	1.5	1.5	1.4	1.3
EV/ EBITDA (x)	4.2	3.3	4.1	4.0	3.8
RoE (%)	29.8	21.9	25.6	23.4	23.1
RoCE (%)	23.3	25.3	25.0	20.3	20.5

INVESTMENT ARGUMENT

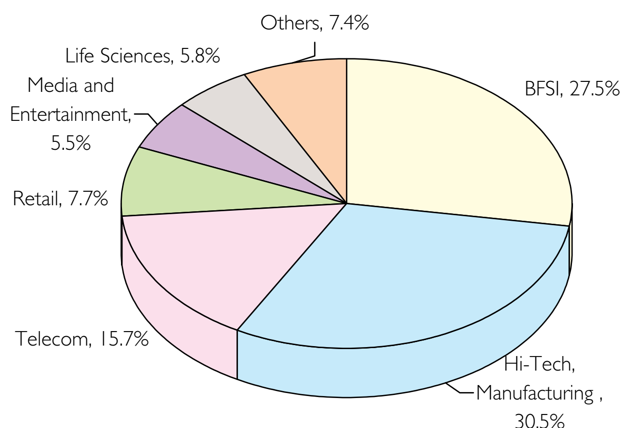
HCLT's high exposure to Hi-tech manufacturing and BFSI puts growth in organic business at risk while Axon acquisition, expensive in our view, raises the near-term risk profile due to high exposure to ERP and Europe. While beneficial in the long term, we believe the recent Axon acquisition is expensive and could lead to near-term challenges as recession is likely to hit Axon's target markets (Europe and SAP consulting) more severely. In the longer term, we believe HCL Tech's blue ocean strategy of serving relatively under-penetrated markets by offshore peers would pay off. We expect 10% revenue (USD) CAGR and 1% EPS CAGR for HCL Tech. We have valued the stock at Rs120 based on 7x FY10E EPS. A liberal dividend policy and dividend yield of 6%+ as also inexpensive valuations offer downside support to the stock. We rate HCL Tech as Neutral.

❑ High concentration on BFSI and Hi-Tech verticals to hurt business

BFSI and Hi-Tech the worst hit verticals in the current recession…

HCLT is highly leveraged to BFSI and Hi-Tech – two of the worst affected verticals in this recession. This is likely to hurt HCLT's business in the near to medium term.

Exhibit 1: HCL Tech – vertical mix



Source: Company

…evident from 11% and 15% qoq decline in constant currency revenues from top five and next five clients respectively

Early signs of the downturn are visible in the latest quarter results, with revenues from top five clients declining by 11% qoq and that from the next five clients slipping by 15% qoq. Though we concede that cross-currency headwinds would have impacted USD revenues, the decline has been quite sharp even after adjusting for the currency swings. We believe the tough operating environment for a few of its key clients as also HCLT's high exposure to BFSI and Hi-Tech verticals would likely impact its organic revenues over the next 4-6 quarters..

❑ Axon – a good acquisition but near-term challenges ahead

Axon has proved to be an expensive acquisition in the changed business scenario…

HCL Tech has recently completed three acquisitions including Control Point Solution, Liberata and Axon. Axon – the largest one – was done by over-bidding the first offer from Infosys. Also, the severe global credit crisis immediately after HCLT's bid has led to significant changes in the IT services market place and made Axon's valuations quite expensive in hindsight. We believe the acquisition is likely to be EPS-dilutive for HCLT in the next few quarters.

…though HCLT is now a preferred partner for SAP consulting work

Axon is the leader in the SAP consulting space in the UK and European markets and is likely to catapult HCLT into the league of preferred partners for SAP consulting work. However, the benefits of the acquisition would accrue over a longer period of time. Slowing ERP license sale for key ERP vendors like Oracle and SAP has further increased the risk profile for HCLT's business.

❑ Valuations close to historic low

Since December 2007, HCLT has traded in a band of 3-10x with a mean of ~6.5x 12-month forward earnings

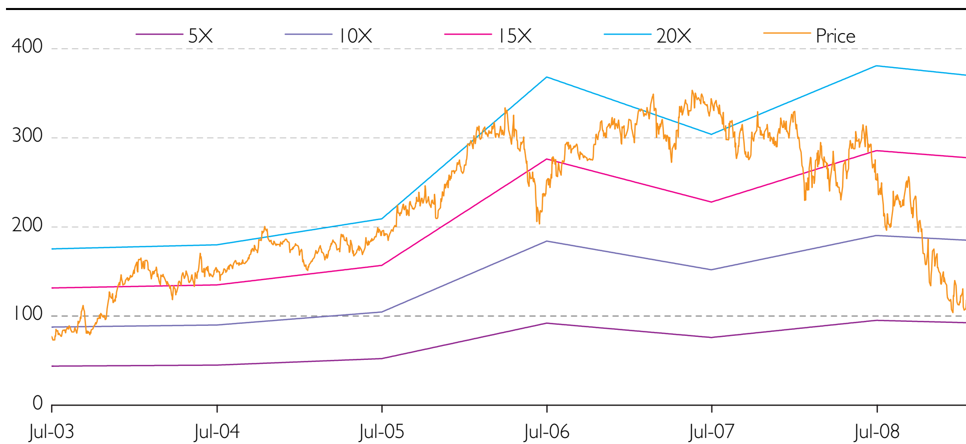
We have valued HCLT at Rs127 based on 7x FY10E earnings and ~40% discount to our target multiple for Wipro – arrived at by using its historic valuation band and historical discount to Wipro. Since December 2007, HCLT has traded in a band of 3-10x with a mean of ~6.5x 12-month forward earnings.

Exhibit 2: HCL Tech – historical 12-month PE chart

Source: Bloomberg, Company, IDFC-SSKI Research

The discount to Wipro's target multiple has been assigned to factor in Wipro's relatively better financial performance in the recent past (and also during the previous US recession). It is also in line with the average discount at which HCLT has traded relative to Wipro for the last one year.

Exhibit 3: HCL Tech – historical 12-month PE band



Source: Bloomberg, Company, IDFC-SSKI Research

Also, dividend yield of 6%+ would provide downside support to the stock price.

A faster recovery in global economies, large deal wins and faster ramp-ups in existing deals could be upside to our numbers

❑ Key risks and concerns

While we are factoring in a recession in the US and other developed economies till Q3CY09, a longer and deeper recession poses downside risk to our estimates. However, there is upside risk to our estimates and target price if the global economies revive faster than what is built into our estimates. Significant deal wins and faster than expected ramp-ups in existing deals could also provide upside to our estimates for HCLT.

Exhibit 4: HCL – valuation premium/ discount to Wipro PE

Source: Bloomberg, Company, IDFC-SSKI Research

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Earnings model

Year to 30 June	FY07	FY08	FY09E	FY10E	FY11E
Net sales	**60,337**	**76,394**	**104,814**	**115,498**	**123,949**
% growth	*37.1*	*26.6*	*37.2*	*10.2*	*7.3*
Operating expenses	46,966	59,455	82,012	92,071	99,584
EBITDA	**13,371**	**16,939**	**22,802**	**23,426**	**24,365**
% change	*35.8*	*26.7*	*34.6*	*2.7*	*4.0*
Other income	978	1,697	1,283	(1,079)	(961)
Depreciation	2,532	3,033	3,961	4,355	4,514
Pre-tax profit	15,098	12,536	15,931	14,392	15,290
Current tax	1,485	1,272	2,375	1,515	1,841
Profit after tax	**13,613**	**11,264**	**13,556**	**12,877**	**13,449**
Preference dividend	9	5	6	40	60
Minorities	(55)	(14)	-	-	-
Non-recurring items	(972)	(899)	(733)	(720)	(720)
Net profit after non-recurring items	12,577	10,346	12,817	12,117	12,669
% change	*77.4*	*(17.7)*	*23.9*	*(5.5)*	*4.6*

Key ratios

Year to 30 June	FY07	FY08	FY09E	FY10E	FY11E
EBITDA margin (%)	22.2	22.2	21.8	20.3	19.7
EBIT margin (%)	18.0	18.2	18.0	16.5	16.0
PAT margin (%)	22.5	14.7	12.9	11.1	10.8
RoE (%)	29.8	21.9	25.6	23.4	23.1
RoCE (%)	23.3	25.3	25.0	20.3	20.5
Gearing (x)	0.0	0.0	0.6	0.5	0.5

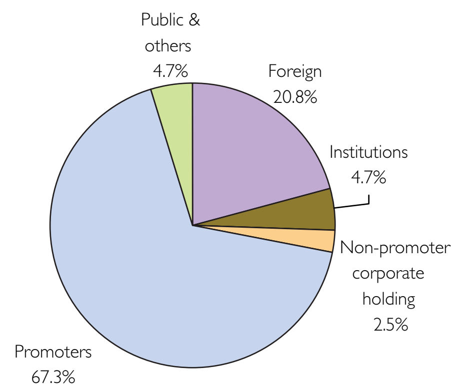
Valuations

Year to 30 June	FY07	FY08	FY09E	FY10E	FY11E
Reported EPS (Rs)	19.3	15.6	19.2	18.1	18.9
Adj. EPS (Rs)	20.8	16.9	20.3	19.2	20.0
PE (x)	5.8	7.1	5.9	6.3	6.0
Price/ Book (x)	1.6	1.5	1.5	1.4	1.3
EV/ Net sales (x)	0.9	0.7	0.9	0.8	0.7
EV/ EBITDA (x)	4.2	3.3	4.1	4.0	3.8
EV/ CE (x)	1.1	1.0	1.0	1.0	0.9

Balance sheet

Year to 30 June	FY07	FY08	FY09E	FY10E	FY11E
Paid-up capital	50,146	52,177	53,430	56,391	59,905
Total shareholders' equity	50,291	52,234	53,433	56,354	59,808
Total current liabilities	11,660	22,145	32,492	35,804	38,424
Total debt	0	0	30,983	30,983	30,983
Other non-current liabilities	1,292	5,959	8,000	8,000	8,000
Total liabilities	12,952	28,104	71,475	74,787	77,407
Total equity & liabilities	**63,243**	**80,338**	**124,908**	**131,142**	**137,216**
Net fixed assets	10,495	13,317	17,469	19,250	20,658
Investments	96	101	164	164	164
Total current assets	42,246	52,272	57,430	61,883	66,548
Other non-current assets	10,406	14,648	49,845	49,845	49,845
Working capital	30,586	30,127	24,937	26,079	28,124
Total assets	**63,243**	**80,338**	**124,908**	**131,142**	**137,216**

Shareholding pattern



As of December 2008

Cash flow statement

Year to 30 June	FY07	FY08	FY09E	FY10E	FY11E
Pre-tax profit	14,126	11,637	15,198	13,672	14,570
Depreciation	2,532	3,033	3,961	4,355	4,514
Chg in working capital	(3,488)	2,227	(1,858)	(751)	(594)
Total tax paid	(1,485)	(1,272)	(2,375)	(1,515)	(1,841)
Ext ord. Items	(26)	(107)	(60)	(80)	(120)
Operating cash Inflow	11,659	15,518	14,866	15,682	16,529
Capital expenditure	(3,952)	(7,379)	(42,373)	(6,136)	(5,923)
Free cash flow (a+b)	7,707	8,139	(27,506)	9,546	10,607
Chg in investments	(583)	1,944	1,041	-	-
Debt raised/(repaid)	(83)	-	30,983	-	-
Capital raised/(repaid)	2,963	(1,497)	(4,717)	-	-
Dividend (incl. tax)	(5,952)	(6,818)	(6,847)	(9,155)	(9,155)
Net chg in cash	4,052	1,768	(7,047)	391	1,451

Company report

Tech Mahindra

Rs234
UNDERPERFORMER

High client concentration

Mkt Cap: Rs30.5bn; US$628m

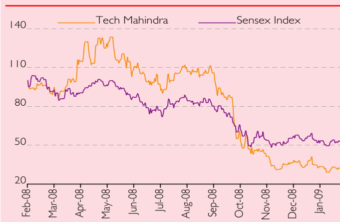
10 February 2009

BSE Sensex: 9647

Stock data

Reuters Code	TEML.BO
Bloomberg	TECHM IN
1-yr high/low (Rs)	990/204
1-yr avg daily volumes (m)	0.208
Free Float (%)	16.7

Price performance



Performance (%)

	3-mth	6-mth	1-yr	3-yr
Tech Mah.	(29.3)	(70.2)	(67.0)	-
Sensex	(3.8)	(36.8)	(45.1)	(4.6)

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Tech Mahindra (TechM) has built its business around the telecom vertical and derives 80% of revenues from top five clients. Despite efforts to diversify the client base, top two clients (BT, also a strategic shareholder, and AT&T) still contribute 70% to revenues. Though higher offshore spending by BT drove 64% CAGR in revenues (USD) over FY05-08, partly aided by stronger GBP/ Euro, TechM is exposed to risks and business cycles at the clients' end. Going forward, we believe the peaking of BT's core tech spending and recent weakness in GBP would weigh on TechM's financials. With expected revenue CAGR of 4% and a compounded annual decline of 5% in earnings over FY09-11, we rate TechM as Underperformer.

High client and sector concentration: With ~60% of revenues accruing from the top client (80% from top five) and 100% revenues from telecom vertical, TechM faces high client and sector concentration risks. While TechM clocked 64% revenue CAGR over FY05-08 led primarily by higher tech spending by BT and ramp-up of AT&T account (second largest client), revenues from BT have peaked. This and the weakness seen in GBP, we believe, will translate into slower revenue growth and declining earnings for TechM over FY09-11.

Limited margin levers: Tepid sales growth and the need to spend aggressively to grow non-top two clients would prevent any meaningful SG&A leverage for TechM. Also, we see limited headroom for TechM in employee utilization. Hence, margins are likely to remain under pressure due to lower price realizations and cross-currency headwinds.

Stock inexpensive; but growth prospects challenging: Trading at 4x FY09E EPS, TechM stock valuations appear cheap. However, with significant headwinds from a mature top client (accounting for ~60% of revenues) and high sector and client concentration risks, we do not see near-term respite for Tech Mahindra. Underperformer with target price of Rs230 (4x FY10E EPS).

Key financials

As on 31 March	FY07	FY08	FY09E	FY10E	FY11E
Net sales (Rs m)	29,290	37,661	45,188	44,763	49,456
Adj. net profit (Rs m)	6,124	7,696	8,962	7,385	8,100
Shares in issue (m)	109	121	122	122	122
Adj. EPS (Rs)	56.2	63.5	73.7	60.7	66.6
% change	*148.3*	*13.1*	*16.0*	*(17.6)*	*9.7*
PE (x)	4.2	3.7	3.2	3.9	3.5
Price/ Book (x)	2.7	2.2	1.3	1.0	0.8
EV/ EBITDA (x)	3.3	3.3	1.9	1.7	0.9
RoE (%)	78.4	68.5	51.9	29.9	25.9
RoCE (%)	87.7	66.5	61.1	34.6	30.5

Investment Argument

TechM's revenue (USD) CAGR of 64% over the last three years has been the highest in Indian IT industry on the back of (i) increased offshore spending by its top client – BT; and (ii) stronger GBP/ EURO vs the USD. TechM has built its business around the telecom vertical anchoring BT as a key strategic shareholder and top client over the years. Despite efforts to diversify client base, the company still derives ~70% of its revenues from the top two clients – BT and AT&T. In our view, the recent weakness in GBP and peaking of BT's core tech spending would weigh on financials of TechM. We expect revenue CAGR of 4% and compounded annual 5% decline in earnings for TechM over FY09-11. We value TechM shares at Rs230 (4x FY10E EPS); Underperformer.

❑ Dependence on a single vertical (telecom)

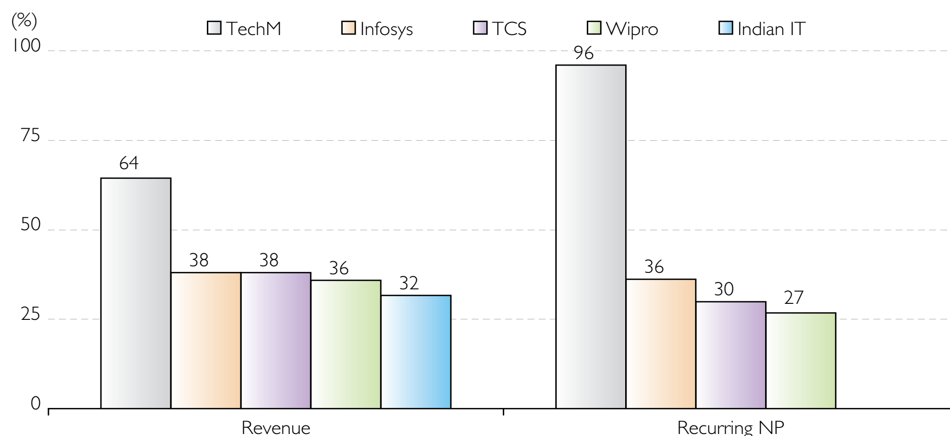
TechM derives ~92% of its revenues from TSPs, 6% from TEMs and 2% from telecom software vendors

TechM is a mid-sized IT services company focussed entirely on the telecom space with 92% and 6% of revenues coming from telecom service providers (TSP) and telecom equipment manufacturers (TEM) respectively. The company gets the remaining ~2% of the revenues from software vendors focussed on the telecom vertical. TechM also has a BPO services offering focussed on the telecom vertical.

Sharp focus has helped TechM deliver impressive performance

The sharp focus has helped TechM deliver stellar performance over the last few years when IT spend in this vertical was on an upswing. In the last three years, TechM registered a 64% revenue (USD) CAGR against 32% CAGR for the Indian IT industry. TechM also benefitted from weaker USD vs GBP and Euro during the last few years.

Exhibit 1: Tech M's revenues and net profit (recurring) vs Tier 1 peers/ industry (3 year CAGR)



Source: Company, NASSCOM

❑ High client concentration – 70% of revenues from BT and AT&T

However, TechM exposed to single vertical and client concentration risk

Along with exposure to a single vertical, TechM is also highly dependent on just a handful of clients. TechM derives ~60% of its revenues from the top client BT and the next four clients contribute another 20% (of which, 10% only from AT&T). Thus, top two clients account for more than two-thirds of the company's business – leaving it vulnerable to risks and business cycles at the clients' end.

❑ Tough business environment – earnings likely to decline

Clients face adverse business conditions, which would translate into lower revenues for TechM

With concurrent global recession in most of the developed markets, several TSPs are going through a rough patch. Thus, IT spend from TSPs is likely to decline over the next two years. The management concedes that its largest client (BT) has already peaked in terms of IT services spend. This, coupled with weakness in GBP, would likely lead to a decline in TechM's revenues in FY10 over FY09.

With declining revenues in a tough business environment, margins for TechM are likely to remain under pressure. We expect recurring earnings to decline by 17% in FY10 before growing by 10% in FY11 on a lower base.

❑ Valuations close to historic low

Client-specific issues aggravate sector headwinds for Tech M

We have valued TechM at Rs230 based on 4x FY10E earnings and ~65% discount to our target multiple for Wipro. Target multiple of 4x is closer to the lower end of its historical trading band to factor in multiple sector headwinds and client-specific issues for TechM – BT, the largest client, has peaked its IT services spend and revenues from the company are likely to decline hereon over the next 4-6 quarters.

Exhibit 2: Tech M – historical 12-month PE chart

Source: Bloomberg, Company, IDFC-SSKI Research

The discount to Wipro's target multiple has been assigned to factor in (i) Wipro's scale, (ii) diversity and depth, and (iii) relatively better financial performance expected over the next three years as seen during the previous US recession.

Exhibit 3: Tech M – historical 12-month PE band

Source: Bloomberg, Company, IDFC-SSKI Research

Exhibit 4: Tech M – valuation premium/ discount to Wipro PE

Source: Bloomberg, Company, IDFC-SSKI Research

❑ Key upside risks

Higher IT spend than estimated could bring upside to our numbers

While we are factoring in a recession in the US and other developed economies till Q3CY09, a faster than expected recovery in the business environment poses an upside risk to our estimates for TechM. A higher spend on IT services from top few clients of TechM in the near to medium term could be an added upside.

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Earnings model

Year to 31 March	FY07	FY08	FY09E	FY10E	FY11E
Net sales	**29,290**	**37,661**	**45,188**	**44,763**	**49,456**
% growth	*135.7*	*28.6*	*20.0*	*(0.9)*	*10.5*
Operating expenses	21,924	29,403	33,580	35,240	38,831
EBITDA	**7,366**	**8,258**	**11,608**	**9,523**	**10,625**
% change	*175.1*	*12.1*	*40.6*	*(18.0)*	*11.6*
Other income	76	1,044	(508)	64	564
Net interest	(61)	(62)	(2)	-	-
Depreciation	516	796	1,054	985	1,088
Pre-tax profit	6,865	8,444	10,044	8,602	10,101
Current tax	741	748	1,082	1,217	2,002
Profit after tax	**6,124**	**7,696**	**8,962**	**7,385**	**8,100**
Non-recurring items	(4,911)	(4,396)	673	-	-
Net profit after non-recurring items	1,213	3,300	9,635	7,385	8,100
% change	*(48.5)*	*172.1*	*192.0*	*(23.4)*	*9.7*

Key ratios

Year to 31 March	FY07	FY08	FY09E	FY10E	FY11E
EBITDA margin (%)	25.1	21.9	25.7	21.3	21.5
EBIT margin (%)	23.4	19.8	23.4	19.1	19.3
PAT margin (%)	20.9	20.4	19.8	16.5	16.4
RoE (%)	78.4	68.5	51.9	29.9	25.9
RoCE (%)	87.7	66.5	61.1	34.6	30.5
Gearing (x)	0.0	0.0	0.0	0.0	0.0

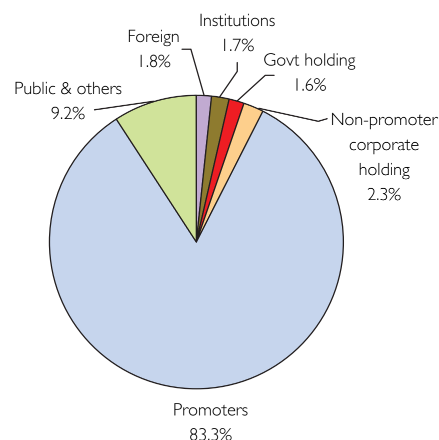
Valuations

Year to 31 March	FY07	FY08	FY09E	FY10E	FY11E
Reported EPS (Rs)	11.1	27.2	79.3	60.7	66.6
Adj. EPS (Rs)	56.2	63.5	73.7	60.7	66.6
PE (x)	4.2	3.7	3.2	3.9	3.5
Price/ Book (x)	2.7	2.2	1.3	1.0	0.8
EV/ Net sales (x)	0.8	0.7	0.5	0.4	0.2
EV/ EBITDA (x)	3.3	3.3	1.9	1.7	0.9
EV/ CE (x)	2.6	2.1	1.0	0.6	0.3

Balance sheet

As on 31 March	FY07	FY08	FY09E	FY10E	FY11E
Paid-up capital	1,212	1,214	1,214	1,214	1,214
Reserves & surplus	7,973	11,358	19,958	26,162	33,079
Total shareholders' equity	9,471	12,983	21,583	27,787	34,704
Total current liabilities	6,455	9,268	9,941	9,848	10,880
Total liabilities	6,455	9,268	9,941	9,848	10,880
Total equity & liabilities	**15,926**	**22,251**	**31,524**	**37,634**	**45,585**
Net fixed assets	3,412	5,996	7,173	6,994	7,609
Total current assets	11,430	16,195	24,292	30,580	37,916
Deferred tax assets	74	60	60	60	60
Other non-current assets	1,009	-	-	-	-
Working capital	4,976	6,927	14,350	20,732	27,036
Total assets	**15,926**	**22,251**	**31,524**	**37,634**	**45,585**

Valuations



As of December 2008

Cash flow statement

Year to 31 March	FY07	FY08	FY09E	FY10E	FY11E
Pre-tax profit	6,865	8,444	10,044	8,602	10,101
Depreciation	516	796	1,054	985	1,088
Chg in working capital	(2,448)	(1,990)	(2,760)	76	(161)
Total tax paid	(704)	(734)	(1,082)	(1,217)	(2,002)
Ext ord. Items	(4,911)	(4,396)	673	-	-
Operating cash Inflow	(682)	2,121	7,929	8,446	9,026
Capital expenditure	(2,039)	(2,371)	(2,231)	(806)	(1,702)
Free cash flow (a+b)	(2,720)	(251)	5,698	7,640	7,324
Debt raised/(repaid)	170	130	-	-	-
Capital raised/(repaid)	2,040	905	-	-	-
Dividend (incl. tax)	(223)	(818)	(1,036)	(1,182)	(1,182)
Misc	115	(5)	-	-	-
Net chg in cash	(617)	(38)	4,663	6,458	6,142

Company report

Patni

Rs115
UNDERPERFORMER

No catalyst in sight

Mkt Cap: Rs14.8bn; US$304m

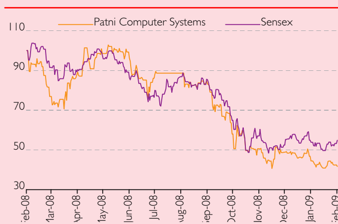
10 February 2009

BSE Sensex: 9647

Stock data

Reuters Code	PTNI.BO
Bloomberg	PATNI IN
1-yr high/low (Rs)	290/108
1-yr avg daily volumes (m)	0.22
Free Float (%)	53.2

Price performance



Performance (%)

	3-mth	6-mth	1-yr	3-yr
Patni	(17.6)	(50.1)	(58.3)	(76.5)
Sensex	(3.8)	(36.8)	(45.1)	(4.6)

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Patni has been a laggard among peers with growth restricted due to high exposure to the sluggish ADM services vertical and lack of scale in fast-growing verticals (IMS, PI, testing, BPO, etc). Sub-scale business in high-growth verticals has also led to Patni being sidelined in the vendor consolidation process. Patni has been marginalized in AT&T and erstwhile ABN AMRO accounts by other stronger vendors with offshore presence. Going forward, we expect Patni's revenues to decline in line with lower IT spend and due to preference for Tier 1 vendors. Though the stock looks attractive at 4x CY09E earnings, cramped growth leads us rate Patni as Underperformer with a price target of Rs107.

Revenue mix tilted towards ADM services: With 65% of revenues coming from the slow-growing ADM services vertical, Patni has relatively lower exposure to high-growth verticals like infrastructure management, package implementation, testing and BPO. In our view, this as also higher exposure to mature client accounts like GE will lead to Patni (11% CAGR over CY06-08E) lagging Tier 1 peers even in the coming years.

Limited margin levers: Patni has efficiently used low-hanging margin levers like utilization and has delivered well on per capita wage bill (employee pyramid) in the last two years. However, despite moderating wage hikes, we do not expect margin levers to play out over the next 2-3 years for Patni in the absence of strong growth.

Stock inexpensive; however, no catalyst in sight: Valuations of 4x CY09E EPS appear cheap. Also, ~70% of Patni's market cap is in net cash ($280m), making it one of the least expensive Indian IT stocks on EV/ EBITDA basis. However, not all of this cash has been internally generated. Patni has raised capital thrice – $57m as PE investment in September 2002, $68m from its Indian IPO in February 2004 and $99m from ADR listing in December 2005. We do not see any near-term catalyst for re-rating; Underperformer.

Key financials

As on 31 Dec	CY06	CY07	CY08	CY09E	CY10E
Net sales (Rs m)	26,140	26,950	31,877	32,600	32,004
Adj. net profit (Rs m)	3,567	4,658	4,783	3,932	3,307
Shares in issue (m)	138	139	136	128	128
Adj. EPS (Rs)	25.7	33.3	35.2	30.7	25.8
% change	*22.2*	*29.5*	*5.9*	*(13.0)*	*(15.9)*
PE (x)	4.5	3.5	3.3	3.8	4.5
Price/ Book (x)	0.7	0.6	0.6	0.5	0.4
EV/ EBITDA (x)	0.7	0.6	0.9	0.3	(0.1)
RoE (%)	16.6	18.9	17.6	13.5	10.2
RoCE (%)	18.5	15.1	14.6	13.2	9.8

INVESTMENT ARGUMENT

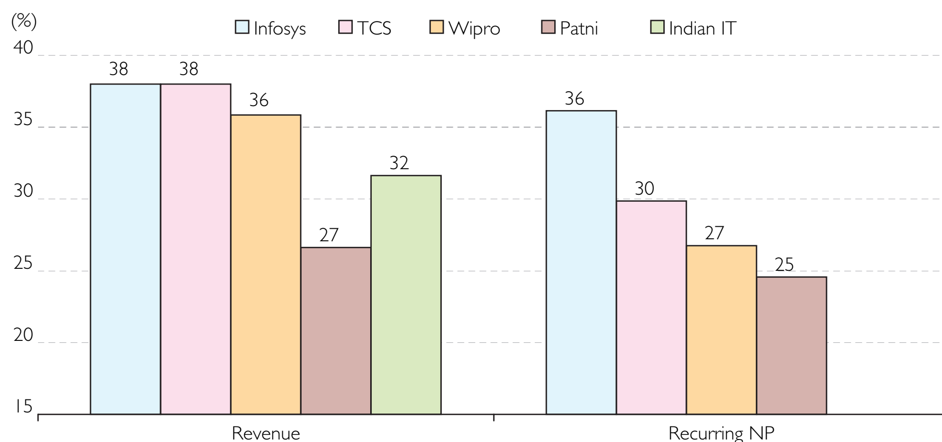
Patni's revenue (USD) CAGR of 11% over CY06-08E is significantly less than that of Tier 1 players. We expect Patni's revenues to decline over the next two years as IT spend slows and it further loses out to Tier 1 players in the vendor consolidation process. Patni's service offering is dominated by ADM services and the company is still sub-scale in newer high-growth offerings like IMS, BPO and package implementation. Patni's lack of scale in these areas makes it a relatively less attractive vendor. Patni has recently lost two key clients during the vendor consolidation exercise. We value the stock at Rs107 (3.5x CY09E EPS) and rate it an Underperformer.

❑ Stark underperformance to peers

Growth restricted due to higher exposure to slow-growing ADM services verticals and lack of scale in high-growth areas

Over the past few years, Patni's financial performance has lagged that of Indian IT industry and Tier 1 peers. Growth, we believe, has been restricted due to Patni's higher exposure to slow-growing ADM services verticals and sub-scale business in fast-growing areas. Exposure to mature clients like GE has also contributed to lower overall growth for Patni. Patni had client specific issues, wherein business from a few accounts declined significantly in the wake of consolidation of offshore vendors by clients.

Exhibit 1: Patni's revenues and net profit (recurring) vs Tier 1 peers/ industry (3 year CAGR)



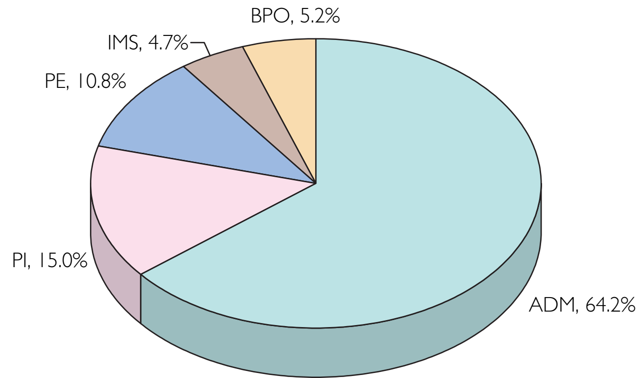
Source: Company, NASSCOM

❑ Large ADM exposure a key risk to growth

Around 65% of revenues accrue from ADM services…

With ~65% of its revenues coming from ADM services, Patni has relatively lower exposure to other high growth services. Patni's practice in some of these high-growth areas is still sub-scale with revenues of $35m in IMS, $80m in package implementation and $40m in BPO on annualized basis.

Exhibit 2: Patni – service mix



Source: Company

...lack of scale in newer services verticals leads to market share loss

❑ Lower exposure to high-growth verticals a key risk to growth

Due to its limited service offering and relatively smaller offerings in newer services, Patni has lost ground in the vendor consolidation process over the last few years. Patni lost out on significant business revenues from AT&T as the client consolidated its offshore vendors post the AT&T-SBC-Cingular merger. In the erstwhile ABN AMRO account, Patni was one of the preferred vendors for new application development services for US geography – however, revenues from this account declined gradually as Patni conceded share to others like Infosys, TCS and Accenture.

At Rs107, we have valued Patni at a 70% discount to Wipro's target valuations

❑ Valuations close to historic low

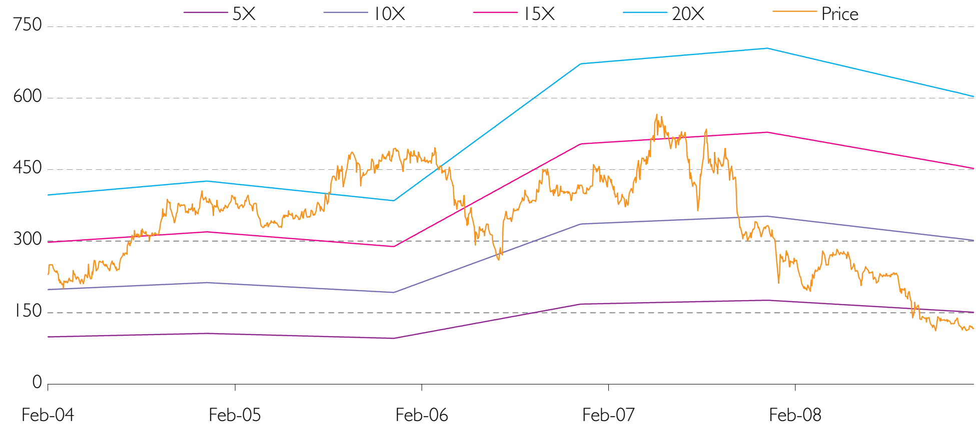
We have valued Patni at Rs107 based on 3.5x FY10E earnings and ~70% discount to our target multiple for Wipro.

Exhibit 3: Patni – historical 12-month PE chart

Source: Bloomberg, Company, IDFC-SSKI Research

The discount to Wipro's target multiple has been assigned to factor in (i) Wipro's scale, (ii) diversity and depth, and (iii) relatively better financial performance expected over the next three years as seen during the previous US recession.

Exhibit 4: Patni – historical 12-month PE band



Source: Bloomberg, Company, IDFC-SSKI Research

Exhibit 5: Patni – premium/ discount to Wipro PE

Source: Bloomberg, Company, IDFC-SSKI Research

❑ Key upside risks

A faster recovery in global economies, higher than estimated IT spend and a meaningful acquisition – key upside risks

While we are factoring in a recession in the US and other developed economies till Q3CY09, a faster than expected recovery poses an upside risk to our estimates. Also, higher spend on IT services from top few clients in the near-to-medium term could bring in incremental revenues for Patni.

With high cash on its books, Patni could also acquire a company to gain scale in some of the high-growth verticals. Moreover, Patni is ideally placed to gain from Satyam's loss, as some of the latter's clients could opt to work with an offshore service provider offering lower biling rates vis-à-vis Tier 1 players. Patni's billing rates – comparable to Satyam's – are lower than those of Infosys, Wipro and TCS.

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Earnings model

Year to 31 Dec	CY07	CY08	CY09E	CY10E	CY11E
Net sales	**26,140**	**26,950**	**31,877**	**32,600**	**32,004**
% growth	*31.8*	*3.1*	*18.3*	*2.3*	*(1.8)*
Operating expenses	21,240	22,085	26,561	27,271	27,442
EBITDA	**4,901**	**4,865**	**5,315**	**5,330**	**4,563**
% change	*27.4*	*(0.7)*	*9.3*	*0.3*	*(14.4)*
Other income	564	763	1,345	774	961
Depreciation	840	964	1,093	1,273	1,268
Pre-tax profit	4,499	5,604	5,036	4,831	4,256
Current tax	932	946	254	899	949
Profit after tax	**3,567**	**4,658**	**4,783**	**3,932**	**3,307**
Non-recurring items	(913)	0	0	0	0
Net profit after non-recurring items	2,654	4,658	4,783	3,932	3,307
% change	*(0.9)*	*75.5*	*2.7*	*(17.8)*	*(15.9)*

Balance sheet

As on 31 Dec	CY07	CY08	CY09E	CY10E	CY11E
Paid-up capital	22,434	26,837	27,477	30,970	33,838
Total shareholders' equity	22,434	26,837	27,477	30,970	33,838
Total current liabilities	5,271	4,370	5,738	5,868	5,761
Total debt	17	13	11	11	11
Other non-current liabilities	509	1,960	1,594	1,467	1,280
Total liabilities	5,797	6,343	7,343	7,346	7,052
Total equity & liabilities	**28,231**	**33,180**	**34,819**	**38,316**	**40,890**
Net fixed assets	5,547	6,740	7,775	8,359	8,650
Total current assets	19,858	20,963	20,580	23,446	25,767
Other non-current assets	2,826	5,477	6,465	6,511	6,473
Working capital	14,587	16,593	14,842	17,578	20,006
Total assets	**28,231**	**33,180**	**34,819**	**38,316**	**40,890**

Cash flow statement

Year to 31 Dec	CY07	CY08	CY09E	CY10E	CY11E
Pre-tax profit	4,499	5,604	5,036	4,831	4,256
Depreciation	840	964	1,093	1,273	1,268
Chg in working capital	(213)	(1,754)	(572)	(420)	(237)
Total tax paid	(932)	(946)	(254)	(899)	(949)
Ext ord. Items	(913)	-	-	-	-
Operating cash Inflow	3,281	3,868	5,303	4,784	4,338
Capital expenditure	(2,707)	(3,873)	(2,678)	(1,857)	(1,558)
Free cash flow (a+b)	574	(5)	2,625	2,927	2,779
Chg in investments	(227)	516	(804)	(173)	(149)
Debt raised/(repaid)	(1)	(4)	(2)	-	-
Capital raised/(repaid)	(165)	232	(3,703)	0	-
Dividend (incl. tax)	(473)	(488)	(440)	(439)	(439)
Misc	-	-	-	-	-
Net chg in cash	(292)	251	(2,323)	2,316	2,192

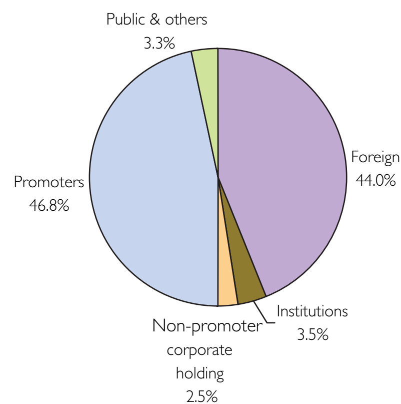
Key ratios

Year to 31 Dec	CY07	CY08	CY09E	CY10E	CY11E
EBITDA margin (%)	18.7	18.1	16.7	16.3	14.3
EBIT margin (%)	15.5	14.5	13.2	12.4	10.3
PAT margin (%)	13.6	17.3	15.0	12.1	10.3
RoE (%)	16.6	18.9	17.6	13.5	10.2
RoCE (%)	18.5	15.1	14.6	13.2	9.8
Gearing (x)	0.0	0.0	0.0	0.0	0.0

Valuations

Year to 31 Dec	CY07	CY08	CY09E	CY10E	CY11E
Reported EPS (Rs)	19.1	33.3	35.2	30.7	25.8
Adj. EPS (Rs)	25.7	33.3	35.2	30.7	25.8
PE (x)	4.5	3.5	3.3	3.8	4.5
Price/ Book (x)	0.7	0.6	0.6	0.5	0.4
EV/ Net sales (x)	0.1	0.1	0.2	0.1	(0.0)
EV/ EBITDA (x)	0.7	0.6	0.9	0.3	(0.1)
EV/ CE (x)	0.1	0.1	0.2	0.1	(0.0)

Shareholding pattern



As of December 2008

IDFC - SSKI INDIA

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1. Outperformer: More than 10% to Index
2. Neutral: Within 0-10% to Index
3. Underperformer: Less than 10% to Index

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