July 29, 2010

Patni Computers (PATCOM)

Rs 478

Rating matrix

Rating	:	**Add**
Target	:	Rs 516
Target Period	:	12 months
Potential Upside	:	8%

Key Financials

(Rs crore)	CY09	CY10E	CY11E	CY12E
Net Sales	3,146.1	3,170.9	3,559.1	3,971.6
EBITDA	619.1	626.9	684.8	760.1
EBITDA margin(%)	19.7	19.8	19.2	19.1
Adjusted Net Profit	586.5	540.9	524.1	572.3
Diluted EPS (Rs)	45.0	40.3	39.0	42.6

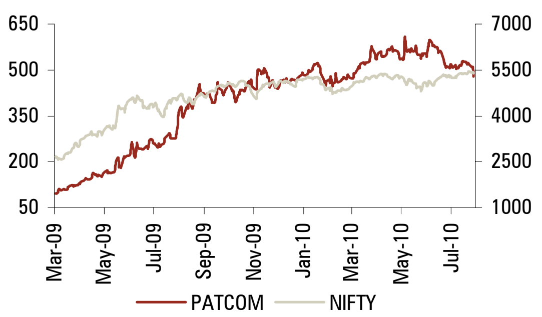
Valuation summary

	CY09	CY10E	CY11E	CY12E
PE (x)	10.6	11.9	12.2	11.2
Target PE (x)	11.5	12.8	13.2	12.1
EV to EBITDA (x)	3.5	3.5	3.2	2.8
Price to book (x)	1.7	1.5	1.4	1.2
RoNW (%)	16.5	13.6	11.8	11.5
RoCE (%)	13.4	12.5	12.2	12.1

Stock data

Market Capitalisation	Rs 6153 crore
Debt (Q2CY10)	Rs 0.77 crore
Cash (Q2CY10)	Rs 2165.5 crore
EV	Rs 3988.6 crore
52 week H/L	624/270
Equity capital	Rs 26 Crore
Face value	Rs. 2
FII Holding (%)	12.29
DII Holding (%)	6.45

Price movement



Analyst's name

Srishti Anand
srishti.anand@icicisecurities.com

Ankita Somani
ankita.somani@icicisecurities.com

WHAT'S CHANGED...

PRICE TARGET .... Changed from Rs 592 to Rs 516

EPS (CY10E) .... Changed from Rs 40.1 to Rs 40.3

EPS (CY11E) .... Changed from Rs 42.2 to Rs 39.0

EPS (CY12E) .... Changed from Rs 44.6 to Rs 42.6

RATING... Changed from Buy to Add

Attrition blues continue to haunt execution...

Patni Computers reported its Q2CY10 numbers that were way below Street as well as our expectation on revenues and operating front. The bottomline was saved by strong treasury gains as well as windfall forex gains from in the money hedges. The company underperformed its guidance on the back of a lapse in billable position due to skyrocketing attrition as well as project deferrals. The revenue guidance for Q3CY10 at 5-6% QoQ was muted considering it factors in the deferred revenues. The PAT guidance was also disappointing building in transition cost as well as lower treasury income.

- **Disappointing performance**
  The company reported revenues at Rs 762.9 crore (I-direct estimate: Rs 785.2 crore) with de-growth of 2.4% QoQ dragged down primarily due to 3.2% volume de-growth. The management foresees healthy demand but got handicapped on execution due to supply constraints. EBITDA margin dropped 260 bps QoQ to 18.9% largely due to the 12% wage hike given offshore as well as lower utilisation. The PAT stood tall at Rs 146.8 crore (I-direct estimate: Rs 129.3 crore) on the back of strong treasury income.

- **Demand landscape bright but execution to take time**
  The management has indicated that it is witnessing broad-based growth like its peers but burgeoning attrition is resulting in lengthening knowledge transfer time causing delay in kick off in some projects. They still hold 3-4% CQGR growth expectation from Q4CY10 onwards and are witnessing more large deals i.e. with total contract value (TCV) of $30-50 million that are cropping up for discussion. Patni intends to hire 1500 net employees in H2CY10 to map into the demand. Also, it saw attrition abating in July.

Valuation

We have scaled down our revenue growth expectation for CY10 from 12% to 7% YoY due to near term execution challenges. Overall, we have revised the revenue growth target for the company from 15% to 12% CAGR over CY09-CY12E. We have valued the company at 12x FY12 EPS of Rs 42.6 and arrived at a target price of Rs 516 and an **ADD** rating.

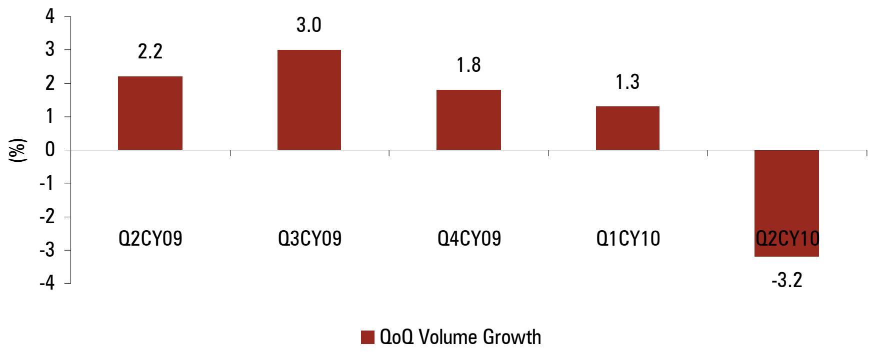
Exhibit 1: Financial Performance

(Rs Crore)	Q2CY10	Q2CY10E	Q1CY10	Q2CY09	QoQ(Ch %)	YoY(Ch%)
Net Sales	762.9	785.2	781.6	779.6	(2.4)	(2.1)
EBITDA Margin (%)	18.9	18.7	21.5	20.7	260 bps dip	181 bps up
Depreciation	29.1	35.3	28.6	54.1	1.6	(46.2)
Interest	0.3	1.6	2.2	2.0		
Other Income	52.6	47.8	52.9	58.4	(0.6)	(9.9)
Reported PAT	146.8	129.3	157.1	135.9	(6.6)	8.0
EPS (Rs)	10.9	9.7	11.8	10.6	(7.1)	3.5

Source: Company, ICICIdirect.com Research

The company reported 3.2% de-growth in its volume on account of project delays

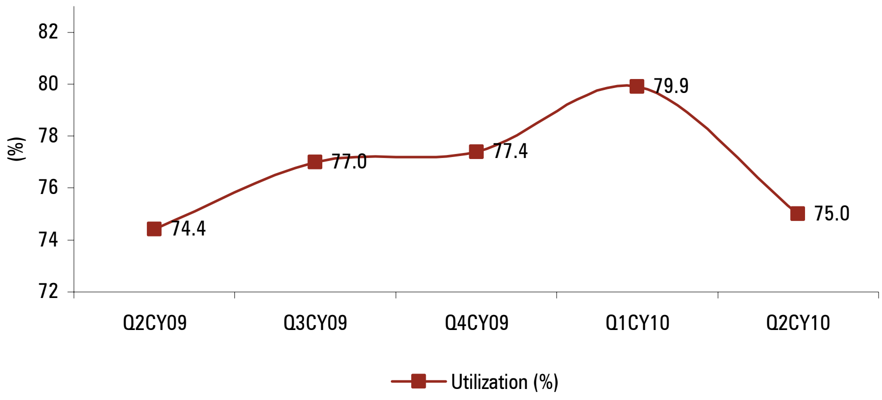
Exhibit 2: Trend in volume growth (QoQ)



Source: Company, ICICIdirect.com Research

The company's utilisation dropped by 490 bps to 75.0% on the back of a soaring attrition rate resulting in a lapse in billable positions in addition to induction of 934 employees, which are largely freshers. The company plans to maintain utilisation in the 74-75% range, going forward

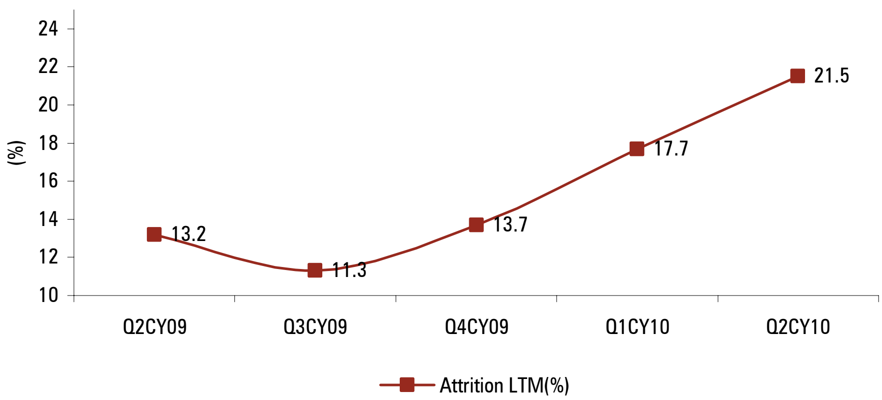
Exhibit 3: Trend in utilisation (QoQ)



Source: Company, ICICIdirect.com Research

The company has experienced a sharp spike in the attrition rate, which is now standing at 21.5%. Patni has given wage hikes in Q2CY10 to the tune of 12% offshore. The attrition has now started abating i.e. as seen in July. The management expects it to normalise to 16% levels by the end of CY10

Exhibit 4: Trend in attrition (QoQ)



Source: Company, ICICIdirect.com Research

The company has been witnessing a steep spike in its attrition rate for the last two quarters. Hence, to fill back attrition as well as map the foreseen demand, the company posted a strong net addition number of 934. The onsite numbers were inflated by 200 on the back of CHCS acquisition. The management plans to hire another 1,500 people on a net basis in H2CY10

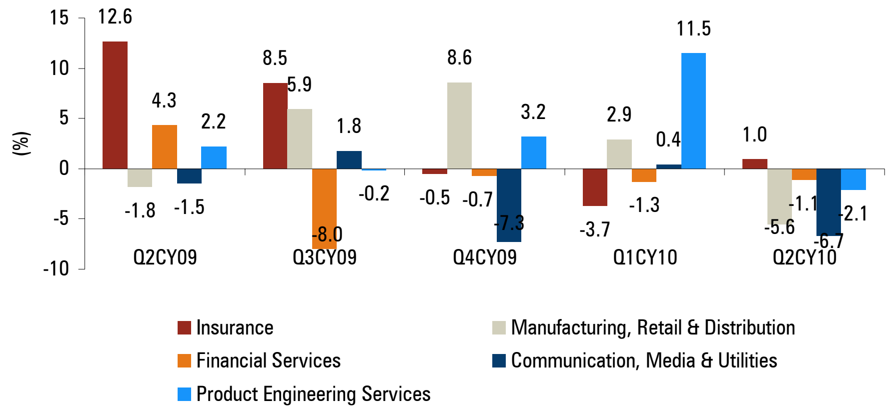
Exhibit 5: People management (net additions)

	Q2CY09	Q3CY09	Q4CY09	Q1CY10	Q2CY10
Onshore	-89	6	-33	110	278
Offshore	-671	-179	421	-146	656
Net Additions	-760	-173	388	-36	934

Source: Company, ICICIdirect.com Research

The company posted QoQ de-growth in almost all the industry verticals except insurance, which was also muted with 1.0% growth on a reported currency basis. Verticals like manufacturing, retail & distribution and communication, media & utilities, posted submissive growth of 2.9% and 0.4% QoQ, respectively. They posted sizeable de-growth this quarter of 5.6% and 6.7% QoQ, respectively. Product engineering services, which grew strongly at 11.5% QoQ in Q1CY10, also reported de-growth of 2.1% QoQ in Q2CY10

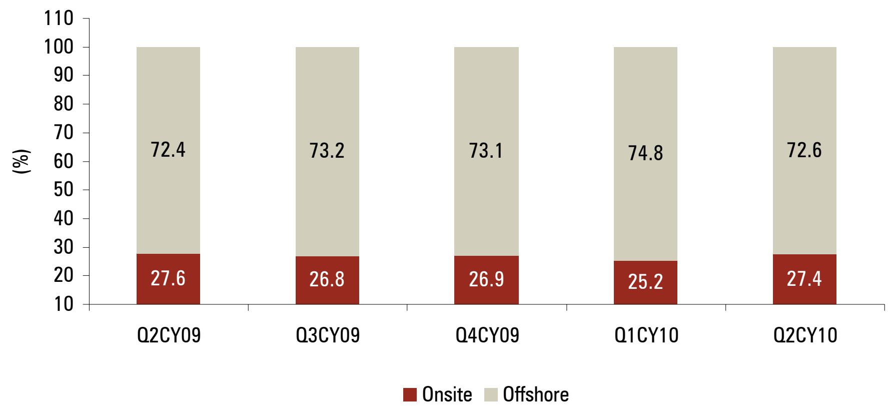
Exhibit 6: Industry performance (Reported QoQ)



Source: Company, ICICIdirect.com Research

The company demonstrated a shift in the effort mix towards onsite at 27.4% as few projects are still in the knowledge transition mode

Exhibit 7: Effort mix



Source: Company, ICICIdirect.com Research

The client pyramid of the company looked a bit stretched with three high-end clients migrating towards the lower end. The US$5-million bracket saw a loss of one client whereas the $10 million bracket saw two. The client addition also stood muted at eleven

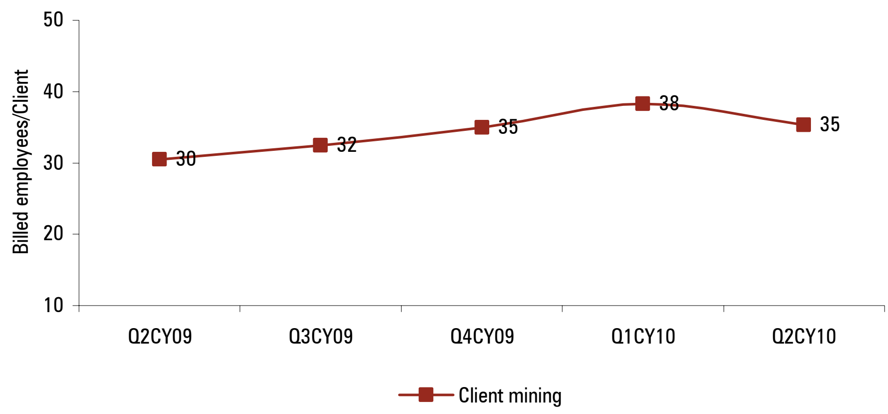
Exhibit 8: Client pyramid

Client Pyramid	Q2CY09	Q3CY09	Q4CY09	Q1CY10	Q2CY10
Top client (%)	12.3	11.9	11.2	11.7	11.2
US$ 1 million	90	92	92	92	92
US$ 5 million	26	27	26	27	26
US$ 10 million	17	16	15	16	14
US$ 50 million	2	2	2	3	3
No of new clients	7	7	20	9	11
No of active clients	294	283	272	260	280

Source: Company, ICICIdirect.com Research

The company's focus on increasing the wallet share from existing clients for the last four quarters ceased this quarter with client mining decreasing form 38 billed employees per client to 35 billed employees per client. This was on account of a spike in attrition, which resulted in experienced employees leaving the organisation while additions made are still in the training period

Exhibit 9: Client mining



Source: Company, ICICIdirect.com Research

Valuation

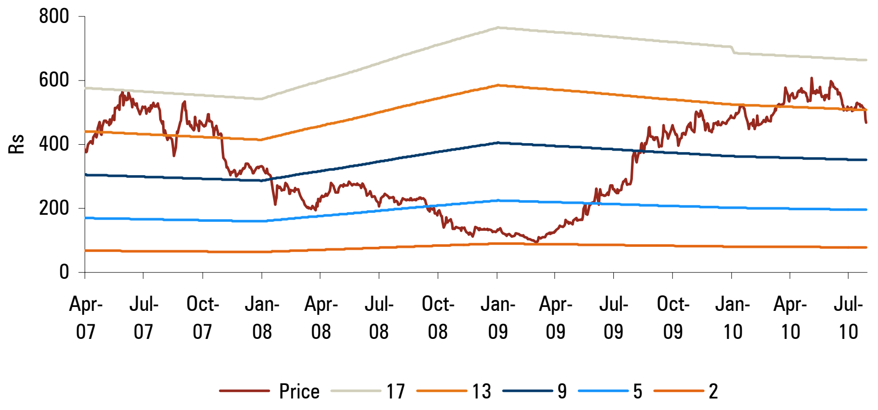
The company is confronted with execution challenges due to spirally moving attrition lengthening the knowledge transfer process, thus delaying project kick offs. Hence, though the demand pipeline looks healthy and broad-based, managing capacity has become a tall order for the company while the need of the hour is to cash in on growth. The company has got down to the hiring mode and plans to add 1,500 more people on a net basis in H2CY10. However, this will take time to translate into strong growth because of the training period lag effect. The management plans to hold utilisation close to 75% in order to be prepared for any surge in demand and avoid delays in execution of existing projects. These efforts will start fructifying only in Q4CY10 and we expect to see 3-4% CQGR growth. Thus, we have scaled down revenue growth for CY10 from 12% to 7% due to execution challenges seen in H2CY10 and overall growth for CY09-CY12E from 15% to 12% CAGR. On the operating front, the margins will face some pressure in Q3CY10 due to impending transition work for the five year, US$250 million healthcare insurance deal and also due to continued investment in the front-end team to scale up the Europe business. Overall, we expect the EBITDA margin to settle down to 19.8%, 19.2% and 19.1% for CY10, CY11 and CY12, respectively.

Thus, the company is mending its pyramid problem by planning to keep a stable bench of 25%. Also, it is venturing into inorganic initiatives to drive strong growth. Patni acquired CHCS in June 2010 for a consideration of US$6 million, which will enable it to service as third-party administrator for its insurance clients. Also, it acquired a managed service platform from one of its manufacturing clients at US$13 million. This will give it a stable revenue stream from it as well as enable it to market it to other clients in the same domain.

We have valued the stock at 12x CY12 EPS of Rs 42.6 and arrived at a target price of Rs 516 and an **ADD** rating.

The stock is currently trading at 11.9xCY10E, 12.2xCY11 and 11.2xCY12E EPS of Rs 40.3, Rs 39.0 and Rs 42.6, respectively

Exhibit 10: One year forward P/E chart



Source: Company, ICICIdirect.com Research

ICICIdirect.com Coverage Universe (IT)

					Sales (Rs Cr)	EPS (Rs)	PE (x)	EV/EBITDA (x)	RoNW(%)	RoCE(%)
Infosys					**Sales (Rs Cr)**	**EPS (Rs)**	**PE (x)**	**EV/EBITDA (x)**	**RoNW(%)**	**RoCE(%)**
Idirect Code	INFTEC	**CMP(Rs)**	2832.1	**FY09**	21693.5	104.6	27.1	20.2	32.8	37.9
		Target(Rs)	3144.0	**FY10**	22742.1	109.5	25.9	18.5	26.9	34.2
Mcap(crore)	161712.9	**Upside(%)**	11.0	**FY11E**	26502.5	116.6	24.3	16.7	21.0	29.5
				FY12E	31968.5	143.0	19.8	14.1	22.4	31.3
TCS					**Sales (Rs Cr)**	**EPS (Rs)**	**PE (x)**	**EV/EBITDA (x)**	**RoNW(%)**	**RoCE(%)**
Idirect Code	TCS	**CMP(Rs)**	854.5	**FY09**	27813.3	26.4	32.3	22.0	33.2	39.6
		Target(Rs)	960.0	**FY10**	30027.9	35.1	24.3	18.2	37.4	42.2
Mcap(crore)	167232.954	**% Upside**	12.4	**FY11E**	34915.2	40.4	21.1	15.6	33.2	38.2
				FY12E	41641.7	46.0	18.6	13.4	30.0	35.3
HCL Technologies					**Sales (Rs Cr)**	**EPS (Rs)**	**PE (x)**	**EV/EBITDA (x)**	**RoNW(%)**	**RoCE(%)**
Idirect Code	HCLTEC	**CMP(Rs)**	372.6	**FY09**	10630.5	19.0	19.6	11.0	22.5	14.9
		Target(Rs)	439.0	**FY10E**	12338.6	18.8	19.8	10.0	20.1	15.5
Mcap(crore)	25285.0	**Upside(%)**	17.8	**FY11E**	14024.3	25.1	14.8	9.5	22.7	14.4
				FY12E	16594.5	30.7	12.1	7.7	23.0	16.5
Tech Mahindra					**Sales (Rs Cr)**	**EPS (Rs)**	**PE (x)**	**EV/EBITDA (x)**	**RoNW(%)**	**RoCE(%)**
Idirect Code	TECHM	**CMP(Rs)**	716.7	**FY09**	4464.8	77.4	9.3	8.4	52.2	65.6
		Target(Rs)	735	**FY10**	4625.4	53.6	13.4	9.0	25.3	27.3
Mcap(crore)	8886.5	**Upside(%)**	2.6	**FY11E**	4605.5	50.1	14.3	11.8	21.4	19.7
				FY12E	5087.1	48.7	14.7	10.8	17.5	19.7
Wipro					**Sales (Rs Cr)**	**EPS (Rs)**	**PE (x)**	**EV/EBITDA (x)**	**RoNW(%)**	**RoCE(%)**
Idirect Code	WIPRO	**CMP(Rs)**	414.8	**FY09**	25699.5	15.9	26.0	19.7	28.6	23.3
		Target(Rs)	474.0	**FY10**	27141.3	18.9	22.0	16.7	26.5	22.4
Mcap(crore)	101597.0	**Upside(%)**	14.3	**FY11E**	31400.6	21.9	18.9	14.4	24.8	21.4
				FY12E	36691.8	24.9	16.6	12.5	23.0	21.7
Rolta					**Sales (Rs Cr)**	**EPS (Rs)**	**PE (x)**	**EV/EBITDA (x)**	**RoNW(%)**	**RoCE(%)**
Idirect Code	ROLIND	**CMP(Rs)**	171.5	**FY09**	1372.8	18.2	9.4	8.2	22.7	15.7
		Target(Rs)	225.0	**FY10E**	1551.3	16.5	10.4	6.5	17.7	13.3
Mcap(crore)	2764.7	**Upside(%)**	31.2	**FY11E**	1786.5	18.4	9.3	5.5	17.9	14.6
				FY12E	2087.3	22.5	7.6	4.7	18.4	16.4
Mastek					**Sales (Rs Cr)**	**EPS (Rs)**	**PE (x)**	**EV/EBITDA (x)**	**RoNW(%)**	**RoCE(%)**
Idirect Code	MASTEK	**CMP(Rs)**	258.2	**FY09**	942.6	52.5	4.9	3.4	31.3	24.4
		Target(Rs)	231.0	**FY10**	713.8	25.2	10.3	6.2	12.8	10.4
Mcap(crore)	695.5	**Upside(%)**	(10.5)	**FY11E**	684.7	14.5	17.9	8.4	6.9	6.9
				FY12E	750.7	20.3			9.1	9.9
NIIT					**Sales (Rs Cr)**	**EPS (Rs)**	**PE (x)**	**EV/EBITDA (x)**	**RoNW(%)**	**RoCE(%)**
Idirect Code	NIIT	**CMP(Rs)**	66.5	**FY09**	1168.5	4.2	15.7	11.7	15.8	16.5
		Target(Rs)	77	**FY10**	1199.3	4.3	15.6	8.8	14.2	18.0
Mcap(crore)	1097.9	**Upside(%)**	15.2	**FY11E**	1262.8	5.2	12.9	7.9	15.8	18.4
				FY12E	1419.0	6.6	10.1	6.5	18.1	20.6

Source: Company, ICICIdirect.com Research

RATING RATIONALE

ICICIdirect.com endeavours to provide objective opinions and recommendations. ICICIdirect.com assigns ratings to its stocks according to their notional target price vs. current market price and then categorises them as Strong Buy, Buy, Add, Reduce and Sell. The performance horizon is two years unless specified and the notional target price is defined as the analysts' valuation for a stock.

Strong Buy: 20% or more;
Buy: Between 10% and 20%;
Add: Up to 10%;
Reduce: Up to -10%
Sell: -10% or more;

Pankaj Pandey **Head – Research** **pankaj.pandey@icicisecurities.com**

ICICIdirect.com Research Desk,
ICICI Securities Limited,
7th Floor, Akruti Centre Point,
MIDC Main Road, Marol Naka,
Andheri (East)
Mumbai – 400 093

research@icicidirect.com

ANALYST CERTIFICATION

We /I, *Srishti Anand MBA (FIN) Ankita Somani MBA (FIN)* research analysts, authors and the names subscribed to this report, hereby certify that all of the views expressed in this research report accurately reflect our personal views about any and all of the subject issuer(s) or securities. We also certify that no part of our compensation was, is, or will be directly or indirectly related to the specific recommendation(s) or view(s) in this report. Analysts aren't registered as research analysts by FINRA and might not be an associated person of the ICICI Securities Inc.

Disclosures:

ICICI Securities Limited (ICICI Securities) and its affiliates are a full-service, integrated investment banking, investment management and brokerage and financing group. We along with affiliates are leading underwriter of securities and participate in virtually all securities trading markets in India. We and our affiliates have investment banking and other business relationship with a significant percentage of companies covered by our Investment Research Department. Our research professionals provide important input into our investment banking and other business selection processes. ICICI Securities generally prohibits its analysts, persons reporting to analysts and their dependent family members from maintaining a financial interest in the securities or derivatives of any companies that the analysts cover.

The information and opinions in this report have been prepared by ICICI Securities and are subject to change without any notice. The report and information contained herein is strictly confidential and meant solely for the selected recipient and may not be altered in any way, transmitted to, copied or distributed, in part or in whole, to any other person or to the media or reproduced in any form, without prior written consent of ICICI Securities. While we would endeavour to update the information herein on reasonable basis, ICICI Securities, its subsidiaries and associated companies, their directors and employees ("ICICI Securities and affiliates") are under no obligation to update or keep the information current. Also, there may be regulatory, compliance or other reasons that may prevent ICICI Securities from doing so. Non-rated securities indicate that rating on a particular security has been suspended temporarily and such suspension is in compliance with applicable regulations and/or ICICI Securities policies, in circumstances where ICICI Securities is acting in an advisory capacity to this company, or in certain other circumstances.

This report is based on information obtained from public sources and sources believed to be reliable, but no independent verification has been made nor is its accuracy or completeness guaranteed. This report and information herein is solely for informational purpose and may not be used or considered as an offer document or solicitation of offer to buy or sell or subscribe for securities or other financial instruments. Though disseminated to all the customers simultaneously, not all customers may receive this report at the same time. ICICI Securities will not treat recipients as customers by virtue of their receiving this report. Nothing in this report constitutes investment, legal, accounting and tax advice or a representation that any investment or strategy is suitable or appropriate to your specific circumstances. The securities discussed and opinions expressed in this report may not be suitable for all investors, who must make their own investment decisions, based on their own investment objectives, financial positions and needs of specific recipient. This may not be taken in substitution for the exercise of independent judgment by any recipient. The recipient should independently evaluate the investment risks. The value and return of investment may vary because of changes in interest rates, foreign exchange rates or any other reason. ICICI Securities and affiliates accept no liabilities for any loss or damage of any kind arising out of the use of this report. Past performance is not necessarily a guide to future performance. Investors are advised to see Risk Disclosure Document to understand the risks associated before investing in the securities markets. Actual results may differ materially from those set forth in projections. Forward-looking statements are not predictions and may be subject to change without notice.

ICICI Securities and its affiliates might have managed or co-managed a public offering for the subject company in the preceding twelve months. ICICI Securities and affiliates might have received compensation from the companies mentioned in the report during the period preceding twelve months from the date of this report for services in respect of public offerings, corporate finance, investment banking or other advisory services in a merger or specific transaction. ICICI Securities and affiliates expect to receive compensation from the companies mentioned in the report within a period of three months following the date of publication of the research report for services in respect of public offerings, corporate finance, investment banking or other advisory services in a merger or specific transaction. It is confirmed that *Srishti Anand MBA (FIN) Ankita Somani MBA (FIN)* research analysts and the authors of this report have not received any compensation from the companies mentioned in the report in the preceding twelve months. Our research professionals are paid in part based on the profitability of ICICI Securities, which include earnings from Investment Banking and other business.

ICICI Securities or its subsidiaries collectively do not own 1% or more of the equity securities of the Company mentioned in the report as of the last day of the month preceding the publication of the research report.

It is confirmed that Srishti Anand *MBA (FIN)* Ankita Somani *MBA (FIN)* research analysts and the authors of this report or any of their family members does not serve as an officer, director or advisory board member of the companies mentioned in the report.

ICICI Securities may have issued other reports that are inconsistent with and reach different conclusion from the information presented in this report. ICICI Securities and affiliates may act upon or make use of information contained in the report prior to the publication thereof.

This report is not directed or intended for distribution to, or use by, any person or entity who is a citizen or resident of or located in any locality, state, country or other jurisdiction, where such distribution, publication, availability or use would be contrary to law, regulation or which would subject ICICI Securities and affiliates to any registration or licensing requirement within such jurisdiction. The securities described herein may or may not be eligible for sale in all jurisdictions or to certain category of investors. Persons in whose possession this document may come are required to inform themselves of and to observe such restriction.