

The Q2 FY09 performance of our universe of eight companies was largely in line with our overall modest expectations. The dollar revenue growth was dejecting (partly impacted by cross currency movements) but disparate across companies. Strong and stable pricing came as a positive surprise. Revenue growth in BFSI vertical and amongst large clients continued to be sluggish. A strong operating margin performance was the key highlight of the quarter while the growth in net profit was driven by the trend in forex losses. Acknowledging a waning revenue visibility, Infosys and Satyam preferred to cut annual outlook sharply and hence made it more achievable. The actual performances did not lead to any material changes in our estimates as we had already cut FY10 earnings of coverage companies significantly before the results season. We continue to remain cautious on the sector with a relative positive bias towards Tech M, TCS and Infotech.

Disparate dollar revenue growth highlights the company-specific fundamentals

Modest dollar revenue growth of 1.3% qoq and 18.7% yoy for our universe was in line with the lowered expectations of the street. To the extent of 1.5-2.5%, the sequential dollar growth of our universe was impacted by the cross currency movements ie dollar's appreciation against the GBP and Euro. However, the overall growth number camouflages the dissimilar topline performances of the individual companies. Amongst larger ones, Infosys lead with 5.3% qoq growth (driven by both volumes and pricing) followed by Wipro which clocked 4.4% growth (low volume growth but material pricing improvement) in its IT services division. HCL Tech reported flat revenues as business volume declined from couple of clients while Tech Mahindra delivered marginally negative growth due to its high GBP exposure. The two small-sized companies, Infotech and KPIT, clocked a far superior growth than bigger peers of 5.3% and 9.9% respectively. The reported volume growth of our universe companies varied from 1-6.5% qoq.

Largely positive trend in pricing surprised a bit

After some softness in pricing in Q1 FY09, we were anticipating some more negatives cues in Q2 FY09. However, we were pleasantly surprised by the resilient industry performance on the pricing front even in the current weak business environment. Despite being impacted by the dollar appreciation, the billing rates were either higher or stable for most companies in our universe except for HCL Tech that reported a marginal decline qoq. In constant currency terms, pricing has actually improved materially for some players. Wipro secured large billing rate hikes for the second consecutive quarter; not too surprising given the fact that company lagged peers in this area during FY08.

Revenue growth in Top 10 clients and BFSI vertical continues to disappoint

Most of the companies recorded a muted revenue growth in the BFSI vertical and in the Top 10 client bracket. Rather, some of the companies reported a material negative growth in these segments. In aggregate, BFSI revenue of our universe grew 2.2% qoq and 14.7% yoy and revenues from the Top 10 clients declined 4% qoq and increased just 11% yoy. Strong growth in Manufacturing vertical offset the modest BFSI growth for few players such as Infosys, TCS, Wipro and KPIT. Within geographies, Europe with fairly robust growth continued to outpace the US.

Strong operating performance with significant improvements in OPM

Aided by offshore shift, higher utilization, tight control on SG&A and the sharp rupee depreciation, the universe companies either reported significant improvement in OPM (non-salary hike companies such as Infosys, TCS, Tech M, Infotech and KPIT) or were able to arrest the decline in OPM (companies such as Wipro, Satyam and HCL Tech which implemented salary hikes). Amongst the eight companies covered, five reported 10%+ growth in operating profit, of which, three clocked 20%+ growth. Almost all the companies resorted to shifting revenues offshore and improving utilization in an effort to push profitability.



Bottomline performance skewed by the trend in forex losses

Below the EBITDA level, net profit performance was solely driven by the other income which included forex income and losses on account of hedged cover and translation. The extent of forex loss due to the sharp rupee depreciation was determined by the amount of hedge cover, the average rate of the cover and accounting policy followed by companies. TCS and Infosys reported significantly higher forex losses qoq while Satyam and HCL tech recorded significantly lower forex losses.

Outlook remains cloudy; Infosys and Satyam prefer to tread the path of caution

Though operational performance in Q2 FY09 has been reasonably healthy without any notable client specific issues, most of the large companies chose to be conservative in their outlook/guidance. Infosys and Satyam have lowered their annual guidance to such an extent that the required growth rates over Q3-Q4 FY09 are negative. Q3 FY09 guidance implies de-growth in revenues for both. In contrast, after delivering superior performance in Q2 FY09, Infotech and KPIT maintained their annual outlook and expressed confidence about achieving it.

Remain cautious on the sector; but Tech M, TCS, Infotech could outperform

Given the highly uncertain and unpredictable macro environment, we continue to remain negative on the sector with preference towards stocks with high revenue visibility or trading at deep discounted valuations. As we had already cut FY10 estimates of our coverage companies significantly before Q2 FY09 result season, there were no major changes in our estimates. The material changes in our recommendations within sector were the upgrade of TCS to BUY and downgrade of Satyam and HCL Tech to Market Performer. Presently, our preferred picks are Tech Mahindra, TCS and Infotech.

Valuations and Recommendations

Company	CMP Rs	EPS (Rs)		P/E (x)		Target Rs	Up/(Down) %	Reco
		FY09E	FY10E	FY09E	FY10E			
Infosys	1,378	100.1	104.9	13.8	13.1	1259	(8.7)	MP
TCS	549	55.0	58.5	10.0	9.4	650	18.4	BUY
Wipro	276	25.9	26.2	10.7	10.5	288	4.4	MP
Satyam	300	34.0	34.8	8.8	8.6	300	-	MP
HCL Tech	175	26.7	25.3	6.6	6.9	175	-	MP
Tech M	337	78.9	79.2	4.3	4.3	469	39.2	BUY
Infotech	145	23.0	23.0	6.3	6.3	184	26.9	BUY
KPIT	32	8.0	7.7	4.0	4.2	40	24.2	BUY

Source: India Infoline Research

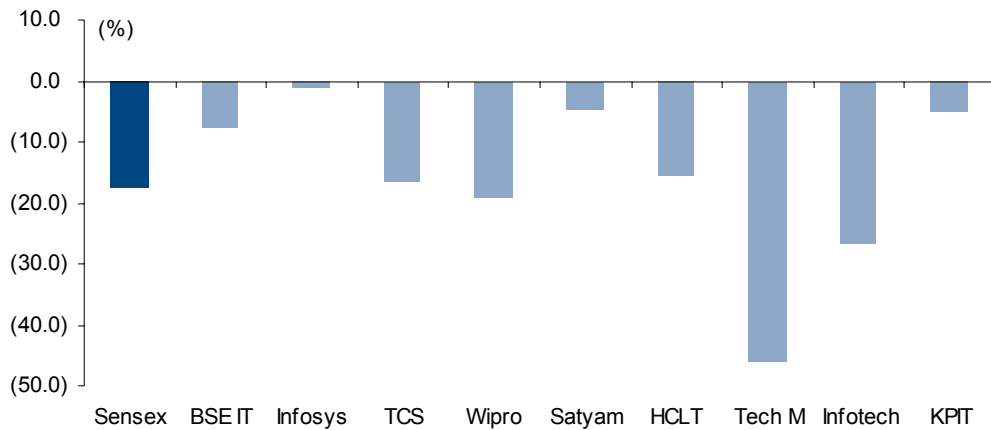
Q2 FY09 Performance Snapshot Table

Particulars	Infosys	TCS	Wipro	Satyam	HCL Tech	Tech M	Infotech	KPIT
Topline Performance								
Revenue growth qoq (%) - Re terms	11.6	8.5	8.3	7.6	9.2	4.3	10.4	12.1
Revenue growth qoq (%) - US\$ terms	5.3	3.2	4.4	2.3	0.1	(0.8)	5.3	9.9
Volume growth qoq (%)	6.5	6.0	1.2	4.0	1.0	-	5.6	-
Pricing trend qoq	Higher	Marginally higher	Materially higher	Marginally lower	Lower	Stable	Stable	Stable
Revenue growth yoy (%) - Re terms	32.0	23.3	37.4	38.8	38.6	29.8	37.5	30.5
Revenue growth yoy (%) - US\$ terms	19.0	14.7	-	27.8	17.6	22.1	28.4	31.5
Operating Performance								
OP growth qoq (%) - Re terms	21.3	18.8	4.2	2.9	4.5	13.7	24.0	25.8
Change in OPM qoq (bps)	260.0	230.0	(80.0)	(100.0)	(100.0)	230.0	230.0	160.0
Change in SG&A% qoq (bps)	(70.0)	(150.0)	40.0	120.0	0.0	20.0	40.0	10.0
Offshore shift qoq (bps)	70.0	190.0	(20.0)	100.0	180.0	0.0	-	370.0
Change in Offshore utilization qoq (bps)	90.0	10.0	260.0	240.0	50.0	(500.0)	-	90.0
Bottomline Performance								
Other Income growth qoq (%) - Re terms	(43.6)	-	49.0	140.3	-	-	246.3	-
PAT growth qoq (%) - Re terms	12.7	1.4	7.8	6.1	186.3	(8.9)	42.0	28.8
PAT growth yoy (%) - Re terms	30.2	1.2	18.8	42.0	18.2	29.6	38.3	18.6
Specific Performance Indicators								
BFSI Revenue growth qoq (%)	1.9	1.8	7.7	(2.6)	0.9	-	-	(6.8)
BFSI Revenue growth yoy (%)	8.9	11.0	41.2	10.1	12.7	-	-	(20.4)
Manufacturing Revenue growth qoq (%)	15.0	6.1	6.2	2.6	0.1	-	-	10.9
Manufacturing Revenue growth yoy (%)	72.1	(0.6)	41.8	25.7	20.4	-	-	41.5
Retail Revenue growth qoq (%)	4.4	8.0	9.3	(9.0)	(6.7)	-	-	-
Retail Revenue growth yoy (%)	15.2	35.9	36.0	60.2	10.9	-	-	-
US/NA Revenue growth qoq (%)	3.4	1.7	3.3	4.5	(0.0)	3.7	5.1	5.1
US/NA Revenue growth yoy (%)	16.9	10.7	32.1	35.7	24.4	47.8	30.0	25.2
Europe Revenue growth qoq (%)	8.4	7.0	4.0	1.2	(1.2)	(5.0)	9.7	14.3
Europe Revenue growth yoy (%)	22.0	24.5	20.0	25.4	9.6	12.3	15.2	47.7
Top 10 Client Revenue growth qoq (%)	(2.1)	(1.9)	1.5	4.0	(1.7)	(1.9)	3.6	2.3
Top 10 Client Revenue growth yoy (%)	11.4	11.8	20.0	18.1	13.3	22.1	17.0	22.2
Employee data								
Net Additions	5,927	5,328	910	1,814	1,973	766	553	(41)
yoy change in %	30.8	(42.5)	(81.9)	(40.3)	(42.7)	(60.8)	(31.1)	-
% of Q1 FY09 base	6.3	4.6	1.2	3.9	3.9	3.1	7.6	-
Attrition %	12.8	12.4	11.0	12.3	14.2	-	-	-
yoy change in %	(1.4)	(0.4)	(5.6)	(1.6)	(2.3)	-	-	-
Guidance or Outlook								
FY09 US\$ Revenue growth yoy %	13.0-15.0	-	-	19.0-21.0	-	-	30-35	23-26*
Upgrade/(Downgrade)	(6.0)	-	-	(5.0)	-	-	Maintained	Maintained
FY09 US\$ Earnings growth yoy %	10.3	-	-	17.6-20.0	-	-	-	27-31*
Upgrade/(Downgrade)	(4.0-6.0)	-	-	1.6-2.0	-	-	-	Maintained
Q3 FY09 US\$ Revenue growth qoq %	0.3-(3.4)	-	1.0	0-(2.8)	-	-	-	-

Source: India Infoline Research; * KPIT guidance in Re terms

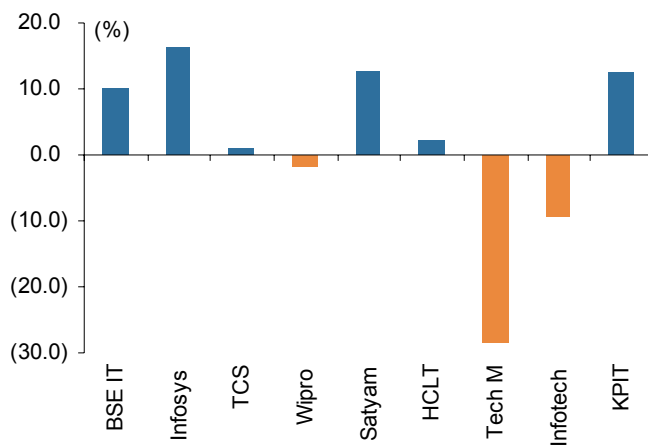


Stock performance over the past one month

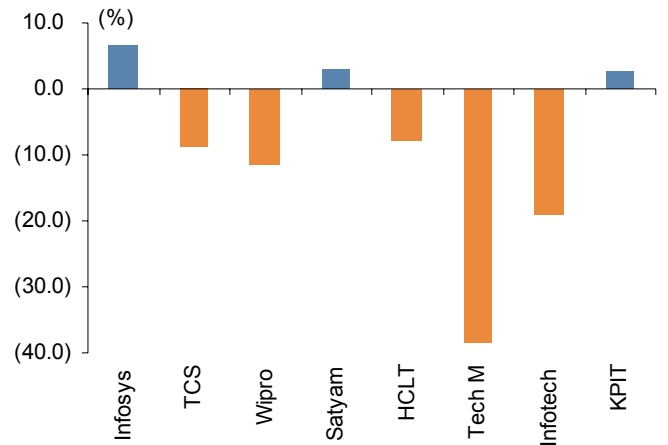


Source: Bloomberg

Performance v/s Sensex



Performance v/s BSE IT



Source: Bloomberg

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