India IT Services – Mid Caps

Research Analysts
Sunil Tirumalai
9122 6777 3714
sunil.tirumalai@credit-suisse.com
Bhuvnesh Singh
65 6212 3006
bhuvnesh.singh@credit-suisse.com
Sagar Rastogi
91 22 6777 3851
sagar.rastogi@credit-suisse.com

Asia Technology Research Analyst Team

Manish Nigam
(Head of Technology Research, Strategy, Foundries)

Randy Abrams
(Regional Foundries, Taiwan Testing & Packaging)

Jessica Chang
(Taiwan IC Design)

Pauline Chen
(Taiwan Hardware)

Darryl Cheng
(Tech LED, Solar, Networking)

Robert Cheng
(Regional Hardware)

MS Hwang
(Korea Technology, Taiwan Memory)

Felix Rusli
(Taiwan Display, Regional Handsets)

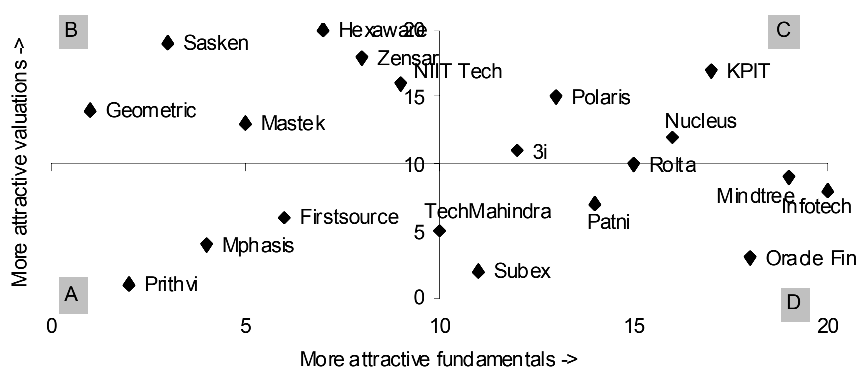
Bhuvnesh Singh
(IT Services)

John Sung
(Korea Technology)

INITIATION

Picking the next set of winners

Figure 1: **Positioning of companies on fundamental and valuation rankings**

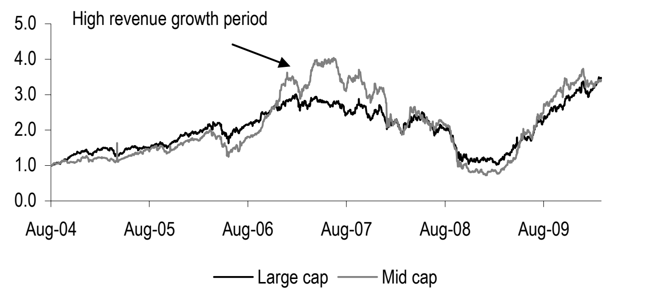


Source: Company data, Credit Suisse estimates

- **History shows that mid-cap IT stocks outperform large caps during high growth periods.** As we set out on a phase of revival in demand for the sector, select mid-cap investments could outperform the overall Indian IT sector. However, the choice of mid caps needs to be dealt with more than a fair share of caution – growth rates are volatile, margins are weak and smaller companies are increasingly marginalised in the market.
- **In this report, we introduce a comprehensive five-factor framework to compare and contrast 20 mid-cap Indian IT stocks.** We consider all the important factors that investors would look at into this sector – growth potential, margin upside, share price upside from buyouts, client concentration risks etc. Our factors are mostly quantitative and objective, and have in many cases involved detailed discussions with the companies involved. We then juxtapose rankings on fundamental factors with rankings on valuations to help identify potential investment options.
- **Stock calls.** KPIT Cummins, Nucleus, Polaris and 3i come out as the most attractive on our framework – as seen from the figure above. In this report, we initiate coverage of Polaris (OUTPERFORM), Infotech (OUTPERFORM), Mphasis (NEUTRAL) and Hexaware (UNDERPERFORM). Among the stocks that have already been covered, we retain OUTPERFORM on MindTree and Patni, and UNDERPERFORM on TechMahindra and Oracle Financial.

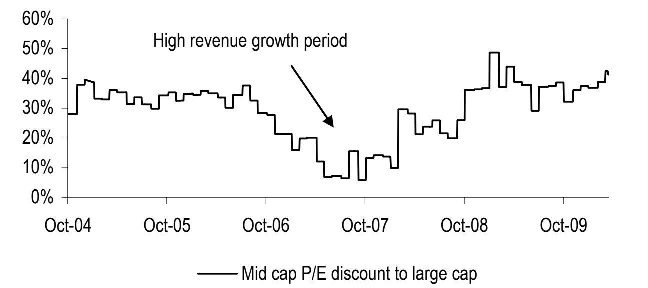
Focus charts

Figure 2: **Normalised price performance: mid caps tend to outperform large-cap IT stocks in high growth periods**



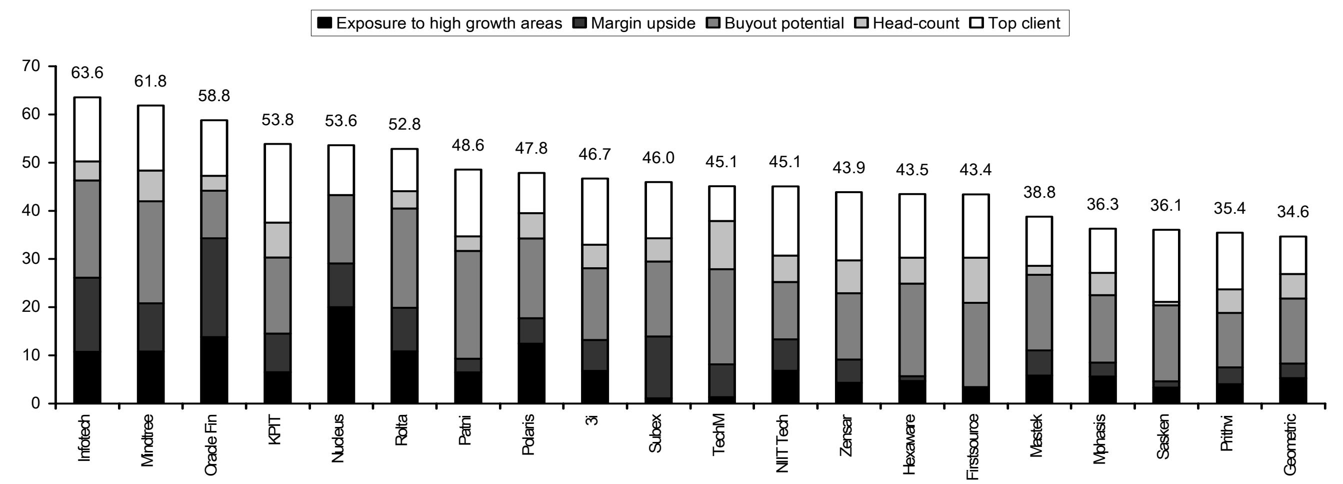
Source: Bloomberg, Credit Suisse estimates

Figure 3: **Mid-cap Indian IT discount to large caps converges in high revenue growth periods**



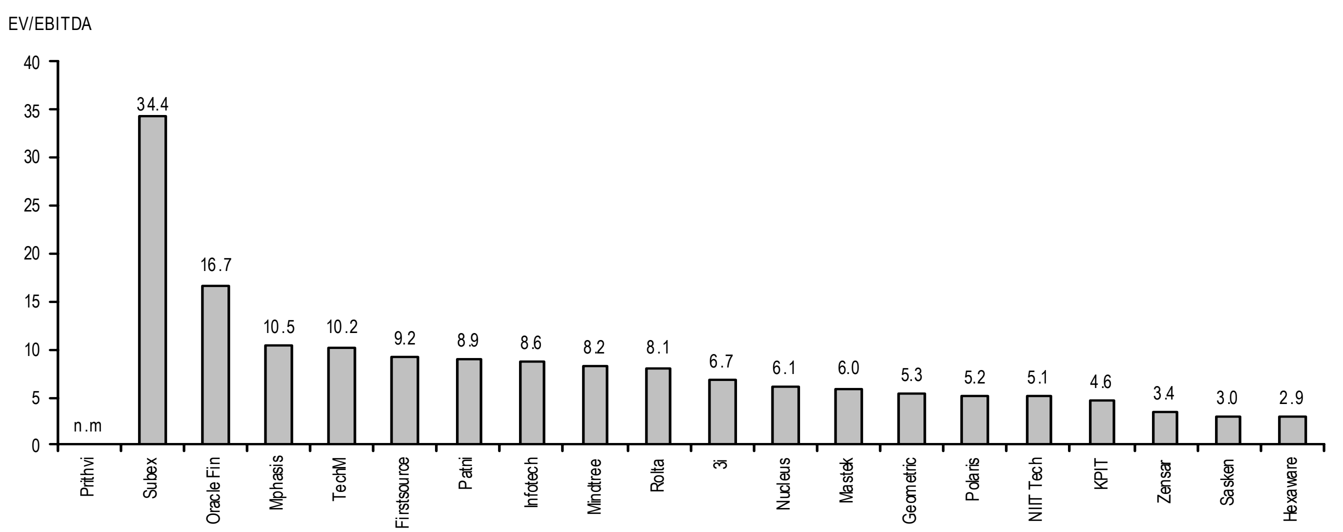
Source: Datastream, Bloomberg, Credit Suisse estimates

Figure 4: **Individual companies score on our comprehensive five-factor framework**



Source: Company data, Credit Suisse estimates

Figure 5: **EV/EBITDA of comparison across companies (trailing 12-month)**



Source: Company data, Credit Suisse estimates

Picking the next set of winners

As it becomes increasingly accepted that the Indian IT services sector is going through a phase of strong revival in demand, there is growing interest in finding the right investment ideas to ride this growth wave. The large caps have already been rerated. Mid-cap investment is a tricky ball game, where one needs to tread with caution. That does not mean that mid-cap IT does not give superior stock returns – mid caps outperformed large caps by 120%-plus in the year following June 2006 at the height of growth. To help chose stocks wisely, we develop a comprehensive five-factor framework to evaluate companies and to come up with likely stock ideas in the current up-cycle of demand.

The large caps have already rerated; mid-cap is a difficult ball-game

In this report, we also add coverage on Infotech, Polaris (both OUTPERFORM), Mphasis (NEUTRAL) and Hexaware (UNDERPERFORM), to add to our existing coverage of MindTree, Patni (both OUTPERFORM) and TechMahindra (UNDERPERFORM).

Rewards await the keen eye

The mid-cap Indian IT services space is not an easy investment area. In general, growth rates are lower (by more than 250 bp on a QoQ basis) and more volatile than large caps. Smaller companies work on lower margins (on average 1,000 bp lower than large caps). Further, smaller IT services companies could be increasingly marginalised given the new trends in the sector.

However, this does not mean that the entire mid-cap IT space should be painted with the same pessimistic brush. The previous growth cycle showed that select mid-cap names outperformed the industry by 6 p.p. on CAGR and by 700 bp on margin improvement. In particular, mid caps have higher operating leverage and could benefit from growth in sub-markets where they have strengths.

In the previous cycle, select mid-cap names outperformed the industry by 6 p.p. on CAGR and by 700 bp on margin improvement

Building a fundamental framework to rank mid caps

In developing this framework, we keep in mind various factors that investors look for in deciding investments in this space – like growth (we study exposure to high growth areas like BFSI, engineering/R&D, emerging markets), margin upside, business risks from customer concentration, buy-out potential and the management outlook. We have tried to keep our rankings objective to the extent possible (only 8% of the final score is decided by subjective factors). The top companies on our framework are Infotech, MindTree and Oracle Financial Services Software, in that order.

We keep in mind various factors that investors look for in deciding investments in this space

Prefer MindTree, Infotech and Polaris among rated mid caps

While obtaining a good comparison of companies on fundamental drivers is essential, it stops short of suggesting which stocks are good investments at current prices. For this analysis to be complete, we have to look at how companies fare on valuations. We have devised a simple score card on trailing valuations for the companies under study, and paired the rankings thus obtained with our rankings on fundamentals. The stocks that look attractive on both fundamentals and valuations are: Nucelus, KPIT, Polaris and 3i. The companies which score low on both counts are Prithvi, Mphasis and Firstsource.

Among the rated companies, we retain OUTPERFORM on MindTree and Patni, and UNDERPERFORM on Tech Mahindra. With this report, we initiate coverage on Polaris, Infotech (both OUTPERFORM), Mphasis (NEUTRAL) and Hexaware (UNDERPERFORM).

Global IT services valuation table

Figure 6: Global IT services valuations

05-Apr-2010 Company name	Ticker	Current price local currency	Market cap US$ mn	Rating	Target price local currency	P/E FY3/10	P/E FY3/11	EV/EBITDA FY3/10	EV/EBITDA FY3/11	EV/Sales FY3/10	EV/Sales FY3/11
Indian IT services											
Infosys Technologies Ltd.	INFY.BO	2,678	34,432	O	2,900	24.6	20.7	17.8	14.4	6.2	5.0
Wipro Ltd.	WIPR.BO	722	23,586	O	815	22.9	18.5	17.1	13.3	3.8	3.0
Tata Consultancy Services	TCS.BO	803	35,313	O	900	23.9	20.4	18.3	15.2	5.2	4.4
HCL Technologies	HCLT.BO	361	5,428	N	320	18.2	13.3	9.7	8.7	2.1	1.8
Oracle Financial Services	ORCL.BO	2,304	4,334	U	900	31.9	28.2	24.7	20.3	5.6	4.6
Tech Mahindra Limited	TEML.BO	861	2,351	U	760	16.8	14.1	10.4	10.7	2.5	2.3
Mindtree Ltd	MINT.BO	587	504	O	850	11.9	10.1	8.6	5.8	1.7	1.3
Patni Computer Systems	PTNI.BO	559	1,613	O	500	14.3	14.0	9.0	7.8	1.7	1.4
Infotech Enterprises	INFE.BO	378	214	O	440	12.8	10.0	7.4	5.3	1.6	1.2
Hexaware	HEXT.BO	69	226	U	60	7.6	9.9	3.1	3.9	0.6	0.6
Polaris	POLS.BO	171	381	O	200	11.4	8.1	5.3	4.0	0.9	0.6
Mphasis	MBFL.BO	637	3,031	N	620	14.0	13.0	9.7	7.8	2.3	1.8
Offshore IT services											
Cognizant	CTSH	50.8	15,119	O	52	28.6	24.3	19.1	15.8	4.1	3.3
Syntel	SYNT	38.4	1,591	N	35	13.5	16.4	11.3	12.4	3.8	3.5
Infosys Technologies ADR	INFY	171.4	381			11.4	8.1	-1.2	-1.0	-0.2	-0.2
Wipro ADR	WIT	637.4	3,031			14.0	13.0	0.2	0.2	0.0	0.0
Offshore BPO											
WNS Global Services	WNS.N	11.4	483	O	17	9.7	8.1	8.3	13.1	1.7	1.6
ExlService Holdings Inc.	EXLS	16.7	487	N	17	39.4	26.9	11.2	9.7	1.9	1.5
Genpact	G	17.0	3,692	O	19	23.0	20.3	13.1	11.9	2.8	2.4
European IT services											
Atos Origin	ATOS.PA	38	3,798	O	47	13.7	14.0	6.8	7.3	0.7	0.7
Capgemini	CAPP.PA	37	7,729	O	43	16.2	19.5	5.8	6.7	0.5	0.6
Indra	IDR.MC	15	3,401	O	20	11.9	12.3	7.6	7.6	1.0	1.0
Logica	LOG.L	138	3,362	U	115	11.9	11.2	8.1	8.6	0.7	0.7
Tieto	TIE1V.HE	18	1,708	U	12	15.0	15.9	6.9	7.0	0.7	0.8
US IT services											
Accenture Plc	ACN	41.8	32,902	O	55	15.8	N.A.	8.5	N.A.	1.3	1.2
Computer Sciences Corp.	CSC	54.3	8,238	N	55	10.8	10.2	3.9	3.7	0.6	0.5
IBM	IBM	128.3	173,073	N	130	11.6	10.6	7.3	7.1	1.9	1.8
US BPO											
Fidelity National Information Services	FIS	23.7	4,539	N	25	13.0	12.1	5.2	4.6	1.5	1.4
Global Payments, Inc.	GPN	45.6	3,643	N	50	17.7	15.9	10.6	10.0	2.6	2.3
Jack Henry & Associates	JKHY	24.4	2,069	N	24	17.9	16.2	8.0	5.5	2.3	2.1
Total System Services	TSS	15.8	3,100	N	16	16.3	15.1	5.1	4.0	2.0	1.9

Note: FY3/10 = CY09 for companies following December year-end, and FY6/10 for companies following June year-end

Source: Company data, Credit Suisse estimates

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Rewards await the keen eye

The mid-cap Indian IT services space is not an easy investment area, especially compared to the investing opportunities in larger companies. In general, growth rates are lower and more volatile than large caps'. Smaller companies work on lower margins. Further, smaller IT services companies could be increasingly marginalised, given the new trends in the sector.

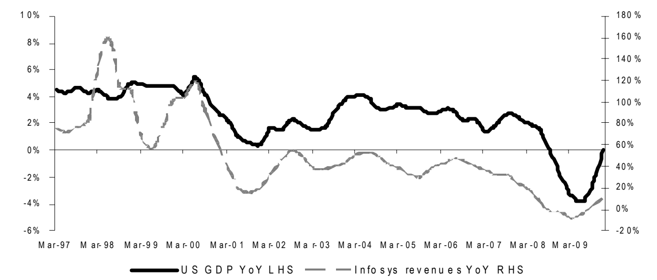
However, this does not mean that the entire mid-cap IT space should be painted with the same pessimistic brush. The previous growth cycle showed that select mid-cap names can materially outperform large caps on growth and margin performance, given the right mix of factors.

Macro indicators point to continued strong growth for Indian IT services

Growth rates of Indian IT services companies have historically followed the health of the US economy. After a dip last year, US GDP growth estimates have been on an increasing trend over the last nine months – as seen from the chart below.

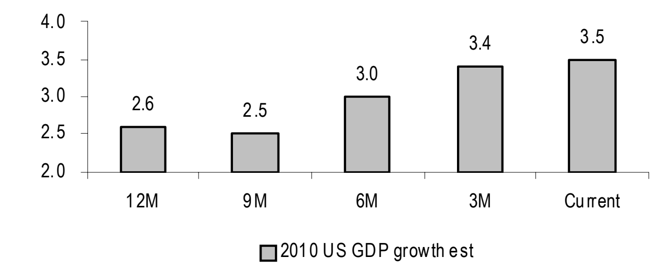
US GDP growth estimates have been on an increasing trend over the last nine months

Figure 7: Infosys revenue growth has a close correlation with US GDP growth



Source: Bloomberg, Company data, Credit Suisse estimates

Figure 8: CS estimates for US GDP growth have seen a steady increase over the past nine months



Source: Company data, Credit Suisse estimates

Further, our US economists' estimates suggest a sharp upsurge in business spending on equipment and software.

Figure 9: Credit Suisse US GDP forecasts suggest a sharp surge in business spending on equipment and software

QoQ%	2009				2010			
Changes at annual rates	**1Q**	**2Q**	**3Q**	**4Q**	**1Q**	**2Q**	**3Q**	**4Q**
Real GDP	-6.4	-0.7	2.2	5.9	3.3	4.0	3.0	3.0
Business investment	-39.2	-9.6	-5.9	-6.5	2.3	5.7	6.0	8.0
Equipment and software	-36.4	-4.9	1.5	18.2	9.0	10.6	10.4	10.1

Source: Credit Suisse estimates

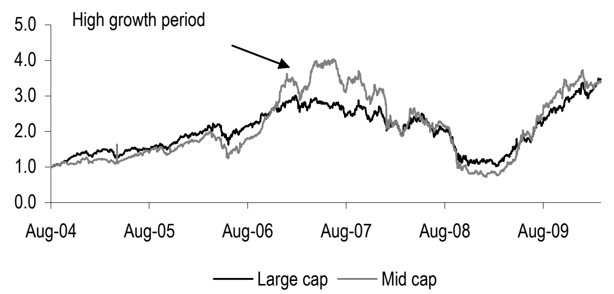
We thus believe that we are at the beginning of a period of high growth for the Indian IT services industry.

There is a window of opportunity for mid-cap outperformance

Experience during the previous high growth phase (FY06-07) showed that valuation discounts of Indian IT mid caps to large caps reduced from about 40% levels to less than 10%. Indian IT mid caps are currently trading at five-year-high discounts. As the Indian IT services sector returns to the high growth phase, we should expect discounts to contract once again. This makes mid-cap stocks a worthy play in the current scenario.

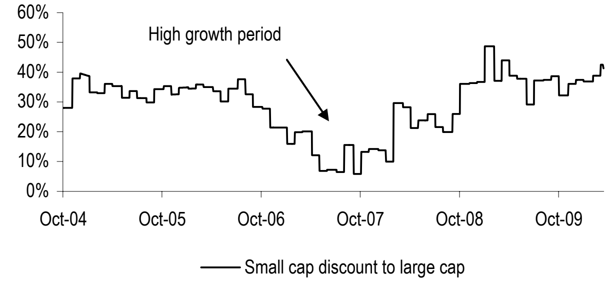
In the previous growth cycle, valuation discounts of Indian IT mid caps to large caps reduced from ~40% to less than 10%

Figure 10: **Normalised price performance: large-cap versus mid-cap Indian IT**



Source: Bloomberg, Credit Suisse estimates

Figure 11: **Mid-cap Indian IT discounts to large caps**



Source: Datastream, Bloomberg, Credit Suisse estimates

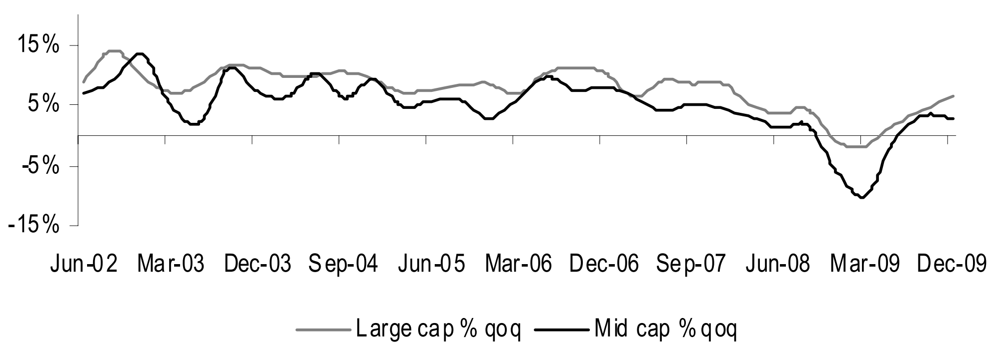
Mid-cap IT is not an easy investment

Growth of mid caps has been below that of large caps … and more volatile

Historically, growth rates of mid caps have been generally lower and more volatile than those of large-cap companies. In the chart below, between 2002 and 2006, mid-cap IT companies delivered an average annualised growth rate of 31%, versus 43% for large-cap companies.

Between 2002 and 2006, mid-cap IT companies delivered an average annualised growth rate of 31%, versus 43% for large-cap companies.

Figure 12: **Quarterly revenue growth for mid caps versus large caps**

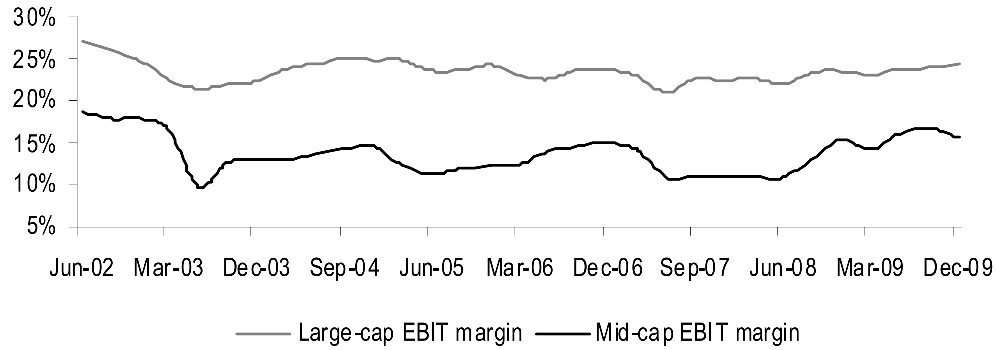


Note: 1) Large caps include Infosys, Wipro, HCL Tech, Cognizant (TCS excluded due to short history).
2) Growth rates exclude acquisition impact – i.e., only organic growth rates are depicted
Source: Company data

Mid-cap IT companies suffer lower margins

Mid-cap companies have lower operating margins than those for larger companies – possibly due to weak internal controls, greater top-line volatility or a lack of scale benefits on overheads.

Figure 13: **EBIT margin trend: large caps versus mid caps**



Source: Company data, Credit Suisse estimates

Large companies favoured for large contracts

For some of the large deals that are being won by Indian IT services vendors, deal sizes are significant compared with annual revenues of many medium-sized IT services companies. These deals require large-scale and quick ramp-ups, which would be difficult to service by the medium-sized companies. Thus, medium-sized companies may miss being considered for these deals.

Recent large deal sizes are significant compared with annual revenues of many medium-sized IT services companies.

Figure 14: **Recent large deal wins**

Month of announcement	Customer	Total contract size (US$ mn)	Duration (years)	Winning vendors	Avg. annual run rate per vendor (US$ mn)
March 2009	Aviva	1,000	5	HP	200
March 2010	National Employment Savings Trust, UK	937	10	TCS	94
August 2009	BP	1,500	5	IBM, Accenture, Infosys, TCS, Wipro	60
April 2009	CMEC, UK	80	2	TCS	40
June 2009	Telstra	355	5	Infosys, EDS	36
August 2009	Optus	150	3	HP,Accenture	25
November 2009	Cardiff City Council, UK	246	15	TCS	16
May 2009	LIC of India	42	5	Wipro	8
November 2009	Equitable Life Assurance	200	n.a	HCL Tech	n.a

Source: Company data, Credit Suisse estimates

Further, with no major technological revolution in recent years, the key platform to compete remains process efficiency, on which the large companies can easily score on.

Significant consolidation to happen

Most sectors in the world have three to five large firms cumulatively enjoying 50%-plus market share. In this backdrop, smaller players may be pushed further to the periphery as the industry consolidates.

Figure 15: **Globally industries are more concentrated than IT services**

Global industries	Top 5 market share (%)
Mobile handset	81.4
PC shipments	58.0
Auto	48.0
Soft drinks	60+
IT services	19.9
Steel manufacture	18.4

Source: Company data, Credit Suisse estimates

However, that does not mean mid caps do not outperform

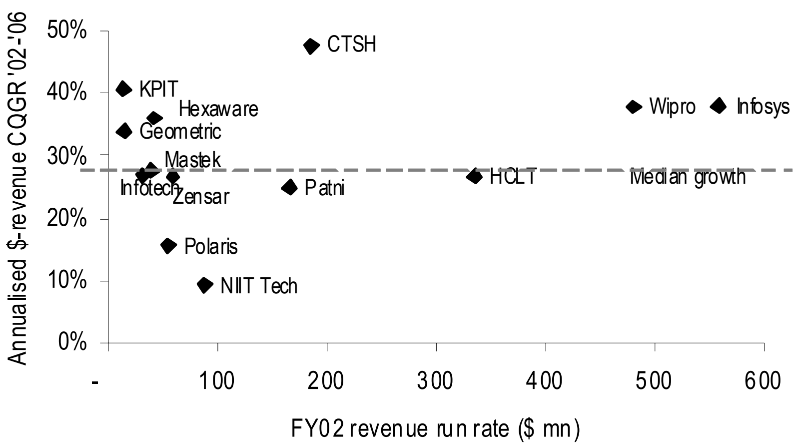
While we have seen that the mid-cap space tends to perform below the large cap IT companies, this statement is true only to an extent.

Exposure to the 'right' sub-markets helps

Each industry cycle brings out a few mid-cap IT services companies that grow at rates comparable to or exceeding those of large caps. For instance, we see in the figure below that at least four mid-cap IT services companies showed organic growth rates comparable to or higher than those of large companies during the four years following FY02. One mid cap – CTSH – actually broke away from the mid-cap space to become a large cap. A close look reveals that these companies had high exposure to the sub-markets that grew faster during the cycle.

One mid cap – CTSH – actually broke away from the mid-cap space to become a large cap

Figure 16: **Revenue growth CAGR in the four years following FY02**



Note: The chart depicts annualised average quarterly growth rate of US$-revenues from March 2002 to March 2006, after adjusting for acquisitions; Source: Company data, Credit Suisse estimates

Figure 17: **Factors that worked for companies with high growth rates in the previous cycle**

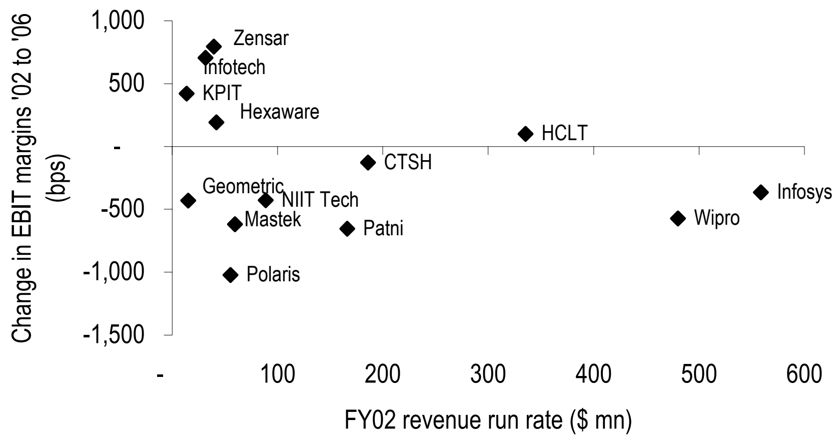
Company	What worked well for the company?
KPIT Cummins	Growth in the manufacturing vertical, led by top client Cummins
Hexaware	Growth in the focus areas of HR-ERP and airlines. Key client ramp-ups included Exult (Hewitt) and Deutsche Leasing.
Geometric	Cost-cutting drive from customers in focus verticals – autos and industrials
Mastek	Project wins in the UK public sector space (London congestion charging, NHS) and projects from its top client Capita

Source: Company data, Credit Suisse estimates

Higher operating leverage

Mid-caps' lower margins imply that the companies could see higher operating leverage in a growing environment. Indeed, in the previous growth cycle, a number of mid-sized companies benefited from the high growth phase and delivered sharp margin increases, as seen below.

Figure 18: EBIT margin change during FY02 to FY06



Source: Company data, Credit Suisse estimates

Mid-caps' lower margins imply that the companies could see higher operating leverage in a growing environment.

Figure 19: Companies which saw increases in margin in the previous cycle

Company	What worked well for the company?
Zensar	1) Scale benefits from strong growth, 2) pricing improvements
Infotech	1)Strong growth (that helped increase utilisation) and 2) increasing share of higher margin engineering services
KPIT Cummins	1) Scale benefits from growth, 2) offshore shift and 3) price increments in a few key accounts
Hexaware	1) Strong growth and 2) offshoring shift (31% to 40% of sales in just four quarters)
HCL Tech	Scale benefits from growth

Source: Company data, Credit Suisse estimates

A comprehensive ranking framework to decide stock picks

The challenge for an investor lies in identifying these outperformers early on in the cycle – we try to address this challenge in the next section. We build a comprehensive score-card framework spanning various parameters which we believe help identify potential winners in the current cycle. We then juxtapose these scores with separate rankings based on current valuations, to arrive at stock picks.

Building a fundamental framework to rank mid caps

In this section, we introduce and develop a comprehensive five-factor framework to compare and analyse the mid-cap IT companies. In developing this framework, we have kept in mind various factors that investors look for in deciding investments in the space – growth, margin upside, business risks, buy-out potential, etc. We have tried to keep our rankings objective to the extent possible (only 8% of the final score is decided by subjective factors). The top companies on our framework are Infotech, MindTree and Oracle Financial Services Software, in that order.

We have tried to keep our rankings objective to the extent possible (only 8% of the final score is decided by subjective factors).

Five-factor frame work

We introduce a comprehensive five-factor framework to compare mid-cap Indian IT services companies on fundamentals. Among them, the parameters cover various aspects that one would look at to evaluate IT services companies: growth (factors one and three), margins (factor two), customer risks (factor five), and buy-out potential (factor four).

Each of these factors is measured by largely quantifiable sub-factors. We have allocated points/ranks on each sub-factor to the companies, based on their performance in each one. All sub-factors have an equal weightage in the final scores and rankings.

The sub-factors we choose for the framework are detailed below.

Figure 20: **Factors making up the framework**

Factor	Sub factor	Score range	% weightage in overall score	Score type: subjective/ objective	Method of allocating points
Exposure to high growth areas		**0-30**	**25.0**		
	BFSI exposure	0-10	8.3	Objective	10 = highest exposure; 0 = lowest exposure; rest prorated between the highest and the lowest
	Engineering/R&D exposure	0-10	8.3	Objective	10 = highest exposure; 0 = lowest exposure; rest prorated between the highest and the lowest
	Emerging markets exposure	0-10	8.3	Objective	10 = highest exposure; 0 = lowest exposure; rest prorated between the highest and the lowest
Upside potential on margins		**0-30**	**25.0**		
	Upside to utilisation (up to utilisation in three years)	0-10	8.3	Objective	10 = highest upside; 0 = lowest upside; rest prorated between the highest and the lowest
	Upside to utilisation (based on management comments)	0-10	8.3	Objective	10 = highest upside; 0 = lowest upside; rest prorated between the highest and the lowest
	Product sales as % of revenues	0-10	8.3	Objective	10 = highest upside; 0 = lowest upside; rest prorated between the highest and the lowest
Headcount momentum					
	Headcount growth in the last two quarters	**0-10**	**8.3**	Objective	10 = highest growth; 0 = lowest growth; rest prorated between the highest and the lowest
Potential as an acquisition target		**0-30**	**25.0**		
	Size (based on headcount)	0-10	8.3	Objective	10 = highest headcount; 0 = lowest headcount; rest prorated on headcount
	Presence of strategic investor	0-10	8.3	Objective	10 = lowest strategic investor stake; 0 = highest strategic investor stake; rest prorated between highest and lowest
	Attractiveness of offerings	0-10	8.3	Subjective	10 = highest ranking on attractiveness; 0 = lowest ranking on attractiveness; rest based on ranking
Client concentration		**0-20**	**16.7**		
	Top client exposure	0-10	8.3	Objective	10 = highest exposure; 0 = lowest exposure; rest prorated between the highest and the lowest
	Top client growth	0-10	8.3	Objective	10 = highest score on (top-client exposure x improvement in client growth outlook); 0 = highest score on (top-client exposure x improvement in the client growth outlook)
Total score		**0-110**	**100**		

Source: Company data, Credit Suisse estimates

We have run this framework on 20 mid-cap IT services companies, and the details are as follows.

1) Prefer exposure to high growth areas

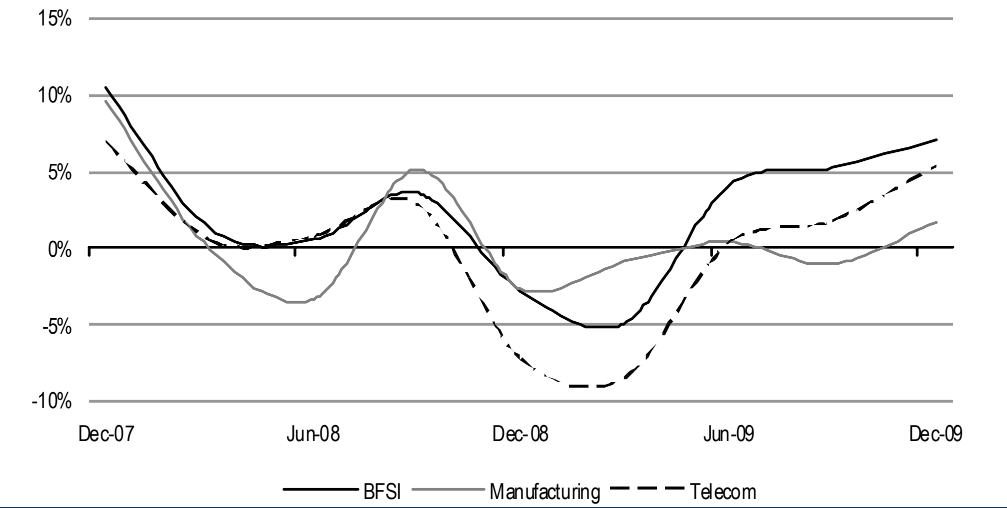
We highlight the areas in the IT services market which we believe have faster growth momentum in the near term. We believe that companies having higher exposure to these areas have a higher chance of outperforming the industry.

BFSI vertical (OFSS, Nucleus, Polaris score the highest)

The banking, financial services and insurance (BFSI) vertical has clearly demonstrated a faster recovery from the downturn than the other verticals – driven by M&A activities, regulatory needs to invest in systems and return to stability in financial markets. Data from TPI show an uptick in total contracts awarded by the BFSI vertical versus the decline in others – indicating BFSI growth should outpace the rest of the verticals' in the coming quarters.

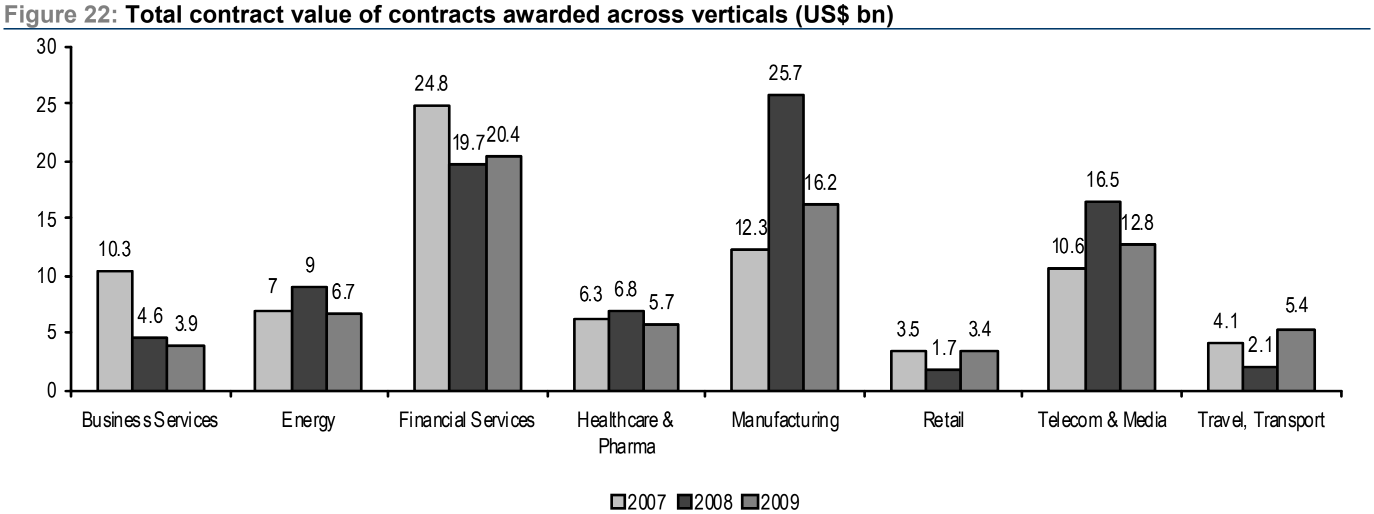
Data from TPI show an uptick in total contracts awarded by the BFSI vertical versus the decline in others

Figure 21: **Quarterly revenue growth rate (in US$ terms) for Infosys, TCS, Wipro, HCLT**



Source: Company data, Credit Suisse estimates

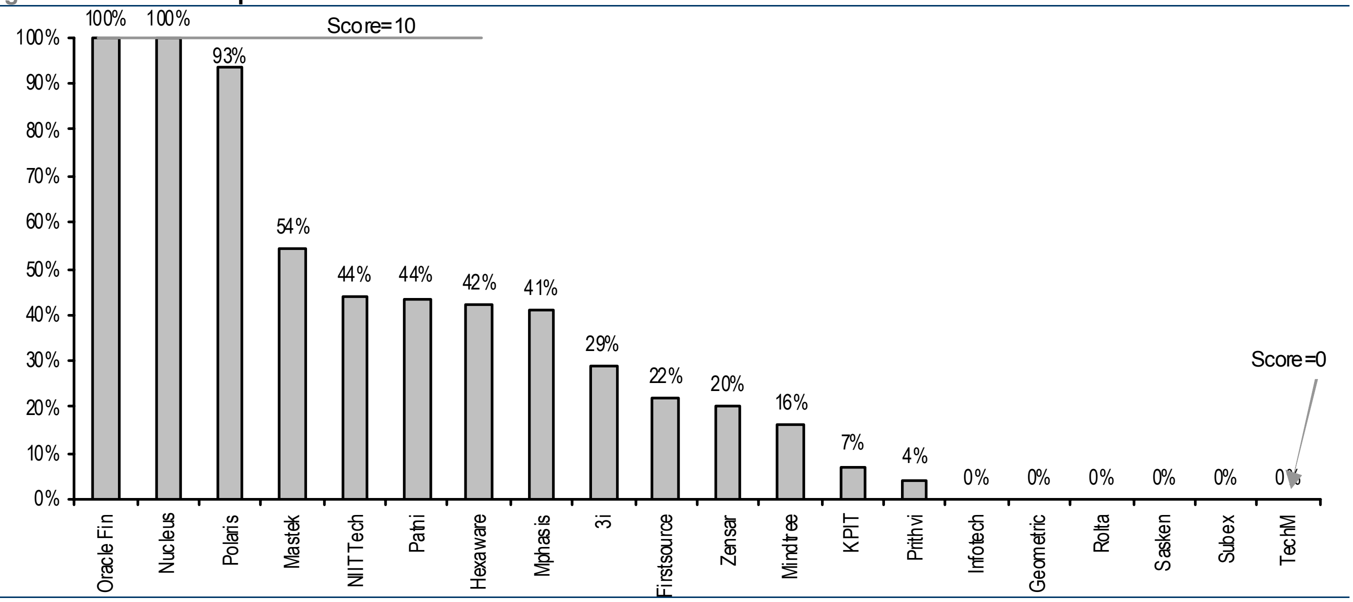
Figure 22: **Total contract value of contracts awarded across verticals (US$ bn)**



Source: TPI: Industrywide Contracts With Total Contract Value > US$25 mn

Among the companies under consideration, Oracle Financial, Nucleus, Polaris and Mastek have the highest exposure to this vertical.

Figure 23: **Revenue exposure to the BFSI vertical**

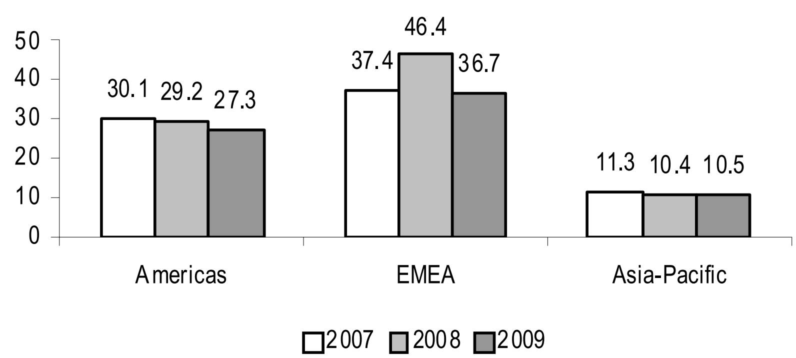


Source: Company data, Credit Suisse estimates

Emerging markets (Nucleus, Rolta, 3i)

While traditional markets like the US and Europe are important due to their sheer size, we note that the highest growth potential comes from emerging markets. According to TPI, outsourcing contract awards in Asia-pacific actually increased in 2009, versus declines seen in the US and Europe.

Figure 24: **Contract awards in 2009 across geographies (US$ bn)**

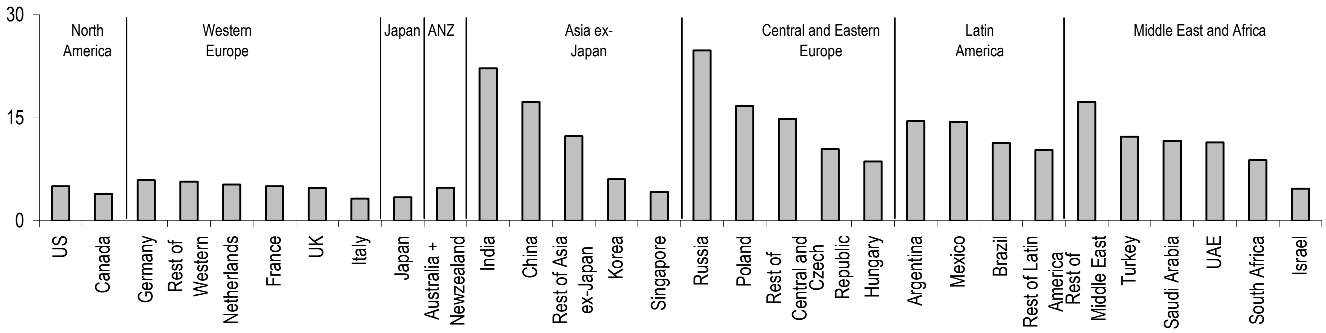


Source: TPI: Annual comparison by TCV of contract awards

The consulting group IDC estimates that some of the fastest growing IT services markets over the next few years will be Russia, India, China, Poland, Argentina and Mexico.

IDC estimates that some of the fastest growing IT services markets over the next few years will be Russia, India, China, Poland, Argentina and Mexico

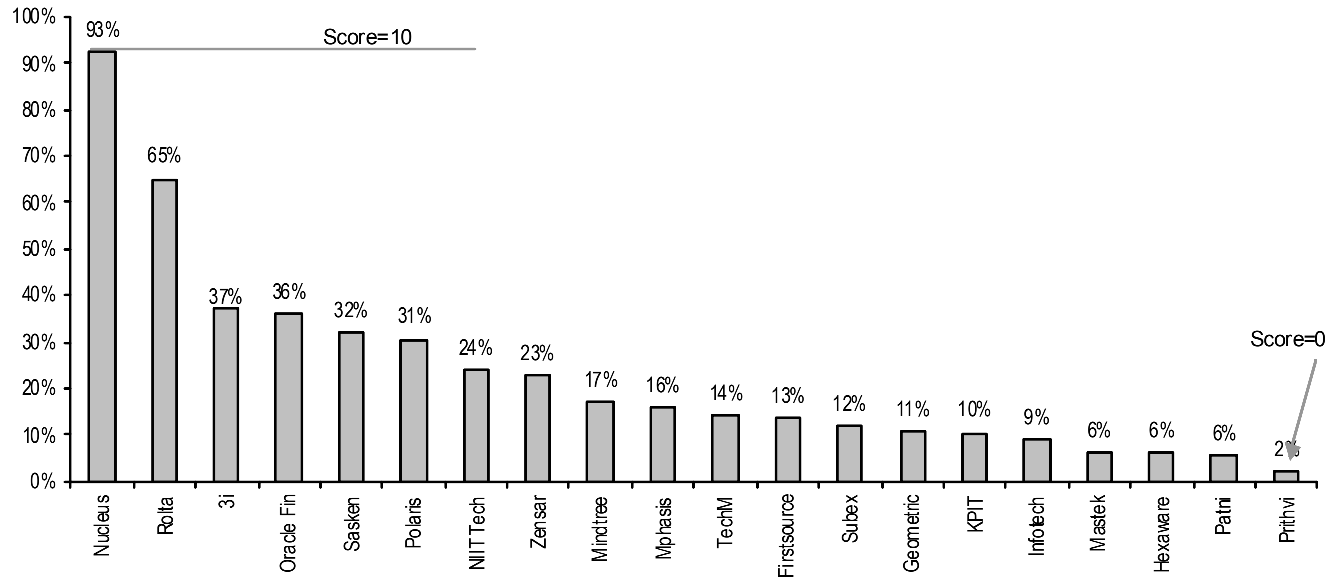
Figure 25: **IT services market growth across countries (% CAGR over 2007-11E)**



Source: IDC, Credit Suisse estimates

Among the companies under consideration, Nucleus, Rolta and 3i have the highest exposure to emerging markets.

Figure 26: **Revenue exposure to emerging markets**



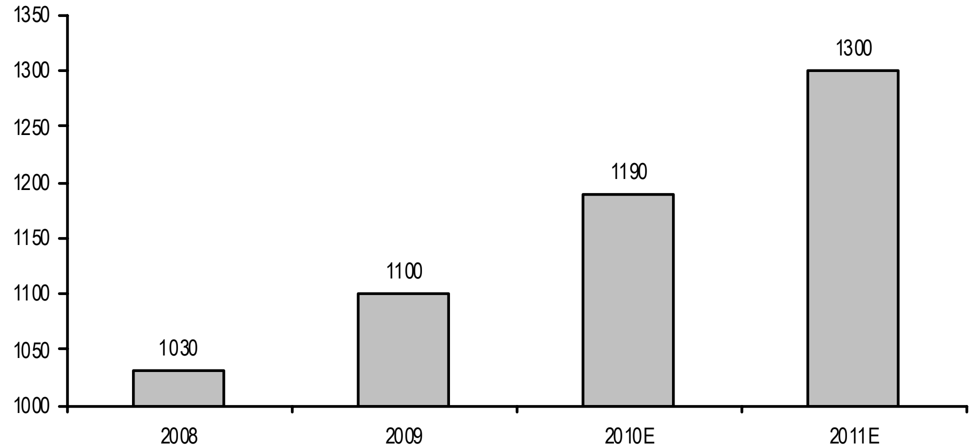
Source: Company data, Credit Suisse estimates

Engineering/R&D services (Infotech, MindTree and KPIT Cummins)

While IT services outsourcing rode the wave of growth in the past decade, the next frontier in outsourcing could be offshore engineering and R&D services. The engineering services worldwide market is estimated at ~US$750 bn (Booz Allen, Nasscom, 2004), of which the outsourced portion is only US$15 bn. The market is expected to grow to US$1.1 tn by 2020, with the outsourced market growing faster to US$200 bn. Including R&D services, estimates from Nasscom (National Association of Software and Services Companies) indicate that global engineering and R&D spending could show an 8% CAGR from 2008 through 2011. This compares with the 2-3% CAGR in global IT services spending.

The next frontier in outsourcing could be offshore engineering and R&D services

Figure 27: **Global R&D and engineering spending (US$ bn)**

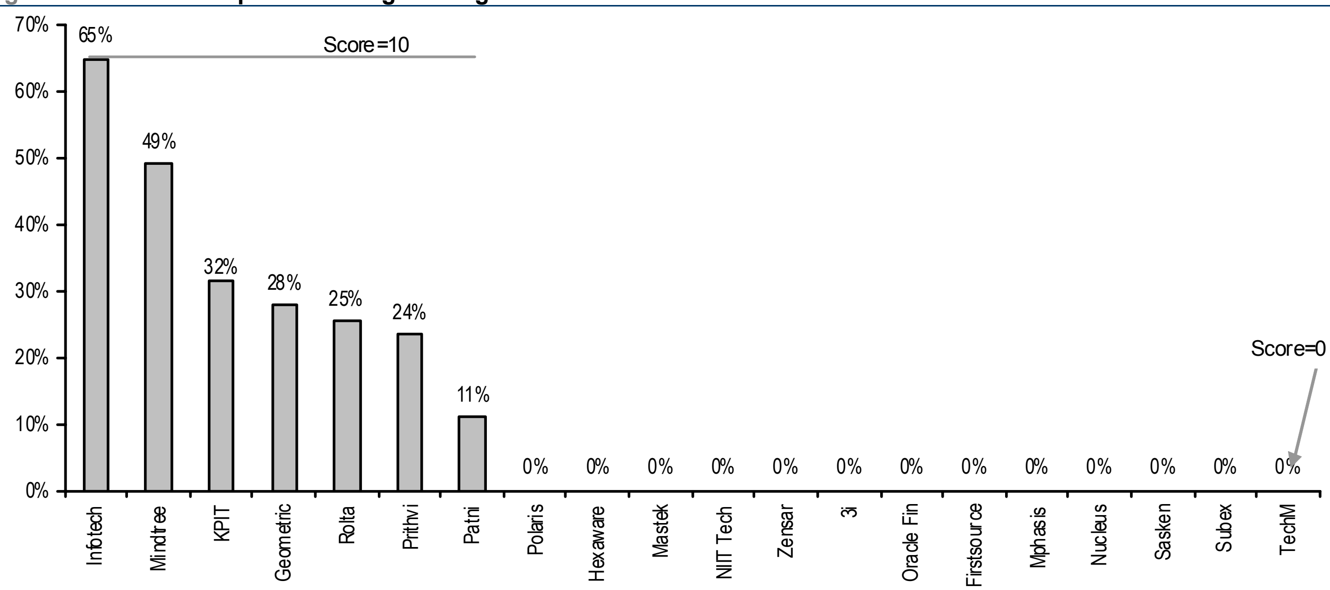


Source: NASSCOM, Credit Suisse estimates

We believe Indian IT companies, with their well-established offshore delivery models, are in a good position to expand into the engineering services business, and thus see this as a key growth opportunity. In fact, Airbus recently commented that it plans to outsource 40% of its aircraft design to India-based companies.

Among the companies under consideration, Infotech, Mindtree and KPIT Cummins have the highest exposure to the engineering and R&D business.

Figure 28: **Revenue exposure to engineering and R&D services**

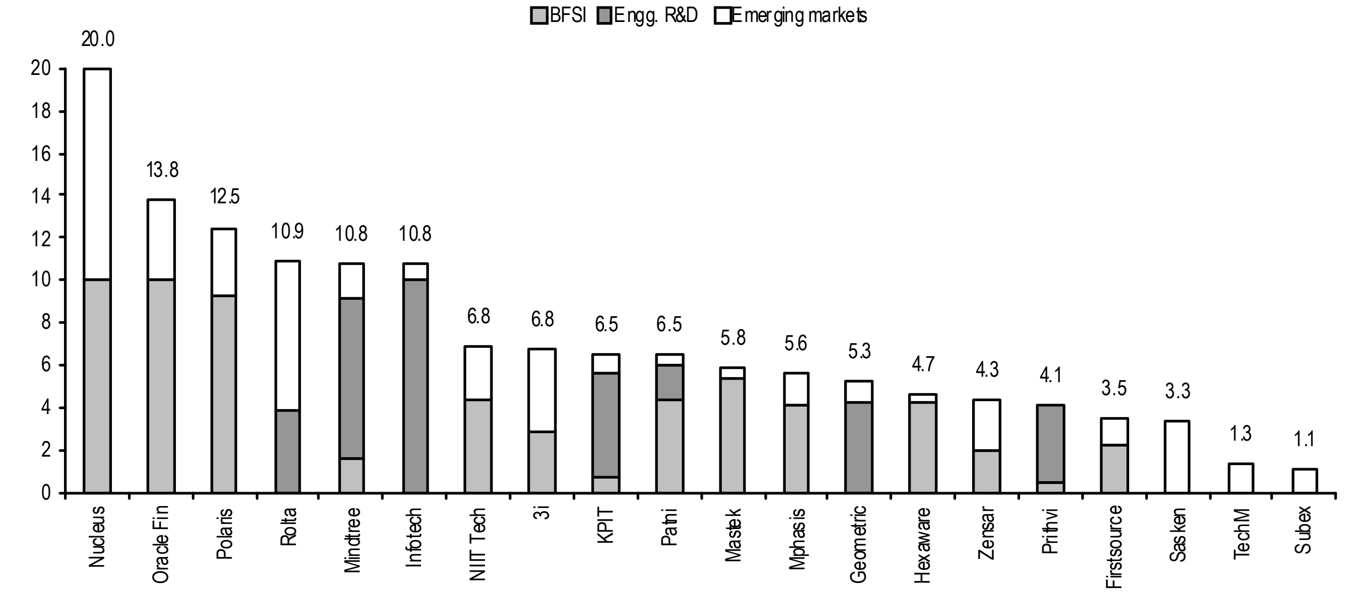


Source: Company data, Credit Suisse estimates

Consolidated score on exposure to high-growth areas (Nucleus, OFSS and Polaris)

We arrive at the consolidated score on this factor by summing up the scores on individual sub-factors. Among the companies under consideration, Nucleus, Oracle Financial and Polaris have the maximum score on exposure to high-growth areas.

Figure 29: **Consolidated score on exposure to high-growth areas**



Source: Company data, Credit Suisse estimates

Figure 30: **Consolidated score on exposure to high-growth areas**

Company	BFSI exposure (%)	Score on BFSI	Engineering, R&D exposure (%)	Score on engineering, R&D exposure	Emerging markets exposure (%)	Score on emerging markets	Total score	Total ranking
Nucleus	100.0	10.0	0.0	0.0	92.5	10.0	20.0	1
Oracle Fin	100.0	10.0	0.0	0.0	36.1	3.8	13.8	2
Polaris	93.4	9.3	0.0	0.0	30.6	3.2	12.5	3
Rolta	0.0	0.0	25.3	3.9	65.0	7.0	10.9	4
Mindtree	16.0	1.6	48.9	7.5	17.2	1.7	10.8	5
Infotech	0.0	0.0	64.9	10.0	9.0	0.8	10.8	6
NIIT Tech	44.0	4.4	0.0	0.0	24.0	2.4	6.8	7
3i	29.0	2.9	0.0	0.0	37.0	3.9	6.8	8
KPIT	7.1	0.7	31.6	4.9	10.4	0.9	6.5	9
Patni	43.5	4.4	11.1	1.7	5.7	0.4	6.5	10
Mastek	54.1	5.4	0.0	0.0	5.9	0.4	5.8	11
Mphasis	41.0	4.1	0.0	0.0	16.0	1.5	5.6	12
Geometric	0.0	0.0	27.9	4.3	10.7	1.0	5.3	13
Hexaware	42.3	4.2	0.0	0.0	5.9	0.4	4.7	14
Zensar	20.0	2.0	0.0	0.0	23.0	2.3	4.3	15
Prithvi	4.3	0.4	23.5	3.6	2.0	0.0	4.1	16
Firstsource	22.0	2.2	0.0	0.0	13.4	1.3	3.5	17
Sasken	0.0	0.0	0.0	0.0	32.0	3.3	3.3	18
TechM	0.0	0.0	0.0	0.0	14.0	1.3	1.3	19
Subex	0.0	0.0	0.0	0.0	12.0	1.1	1.1	20

Source: Company data, Credit Suisse estimates

2) Margin leverage potential

In the previous chapter, we saw examples of companies showing sharp margin improvements from scale benefits during the previous growth cycle. This could come from either increasing utilisation (in case of services revenues) or the greater product sales off-take on a relatively fixed cost base (in case of product revenues).

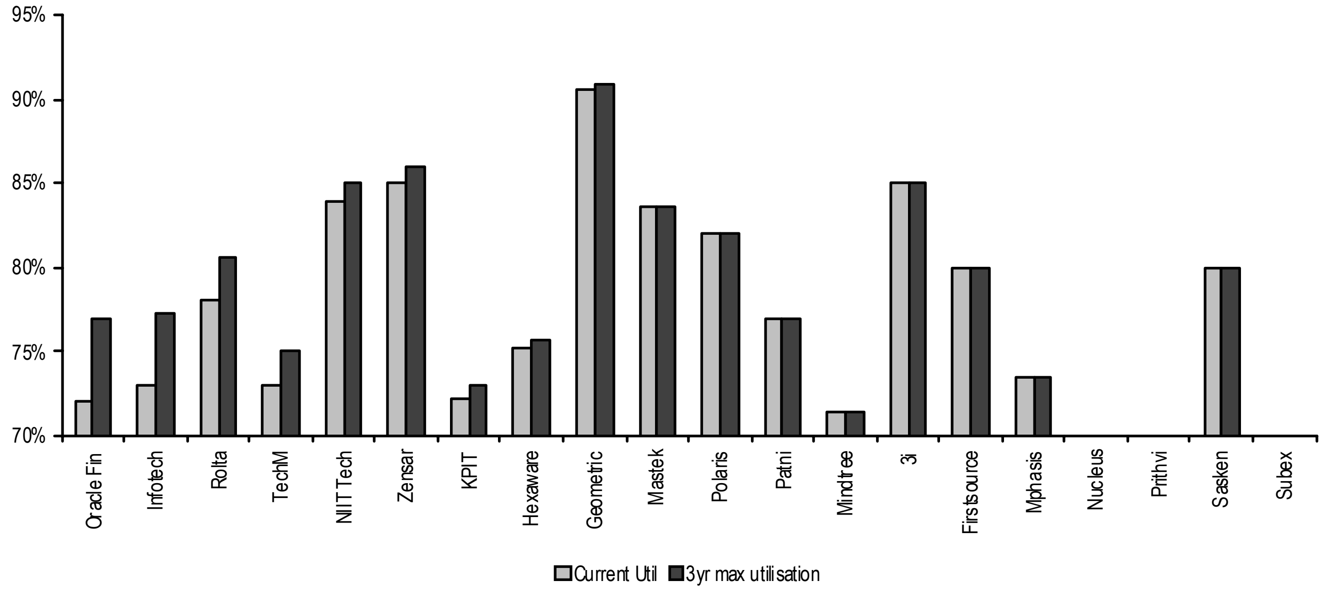
This could come from either increasing utilisation (in case of services revenues) or the greater product sales off-take on a relatively fixed cost base (in case of product revenues)

Utilisation upside – based on historical levels (OFSS, Infotech and Rolta)

The margin upside from low utilisation at the start of a growth phase is well known. However, the definition of utilisation is not uniform across the industry to do a comparison of absolute utilisation across companies. We thus look at current utilisation levels of companies in relation to their long-term (three-year) peaks. We prefer companies with greater upside to reach long-term levels.

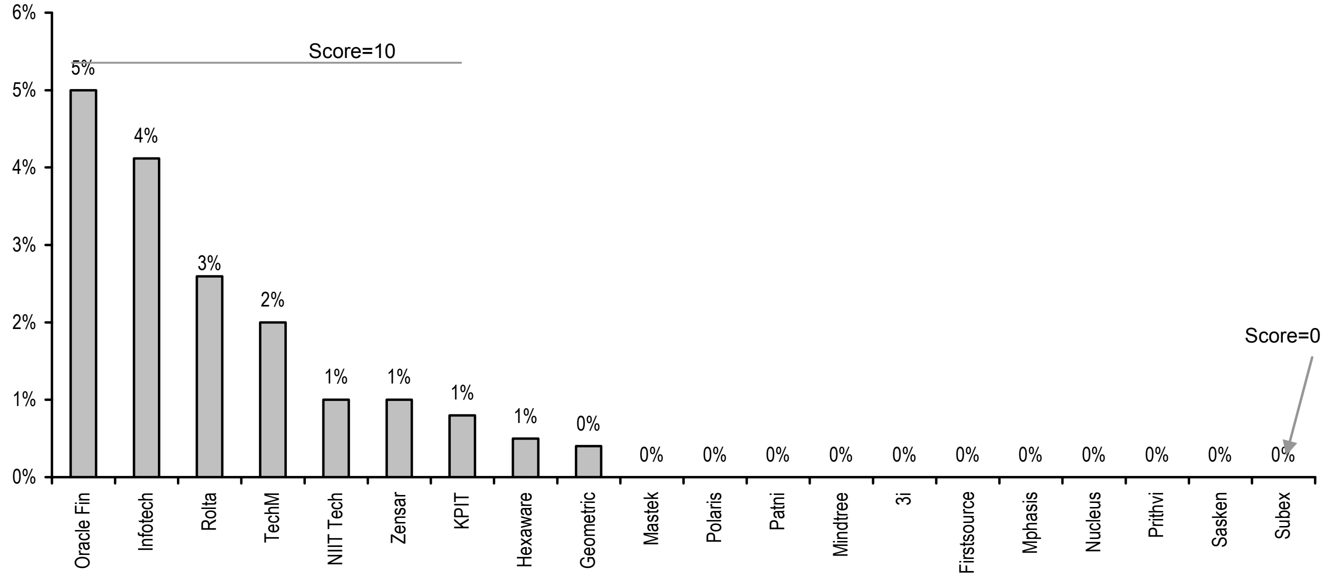
Among the companies under consideration, Oracle Financial, Infotech and Rolta have the highest upside to utilisation.

Figure 31: **Current utilisation and long-term peak utilisation**



Source: Company data, Credit Suisse estimates

Figure 32: **Upside to utilisation – based on historical levels**

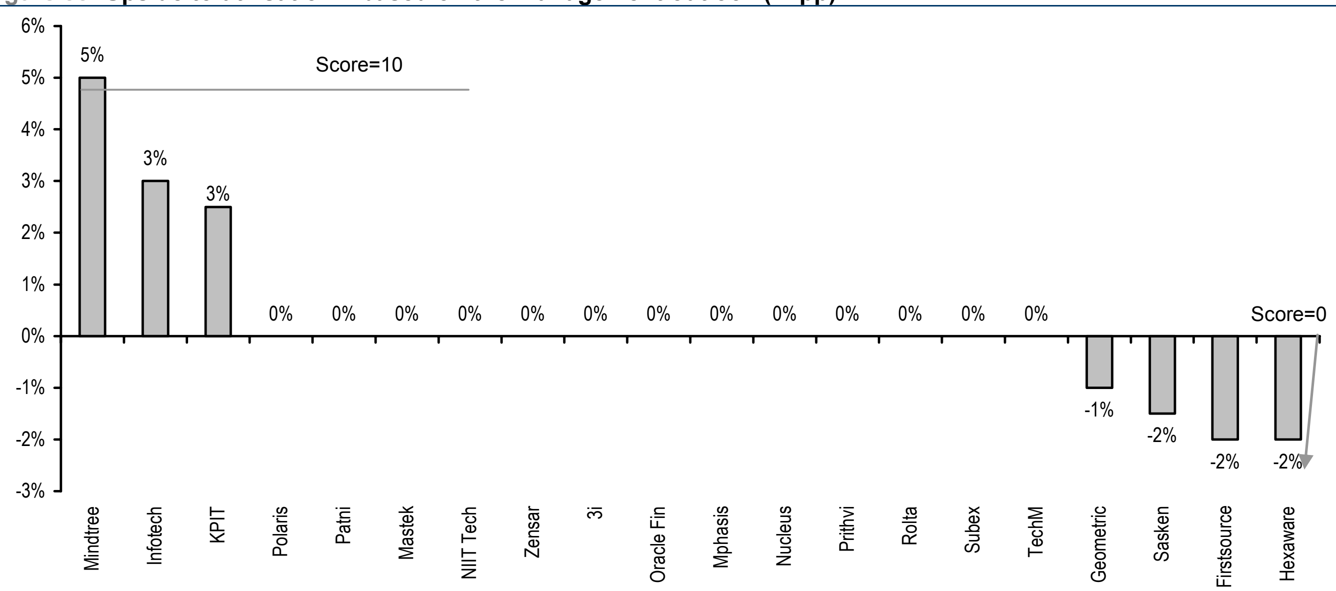


Source: Company data, Credit Suisse estimates

Upside to utilisation – from management outlook (MindTree, Infotech and KPIT)

While history provides one indicator of the level of upside to utilisation from current levels, managements' plans and outlook could be another indicator. We thus include a factor based on management comments on possible upside/downside to utilisation. Fortunately, during our conversations, managements were open to discussing upside to utilisation and margins, through they were not always open to quantify growth expectations.

Figure 33: **Upside to utilisation – based on the management outlook (in pp)**

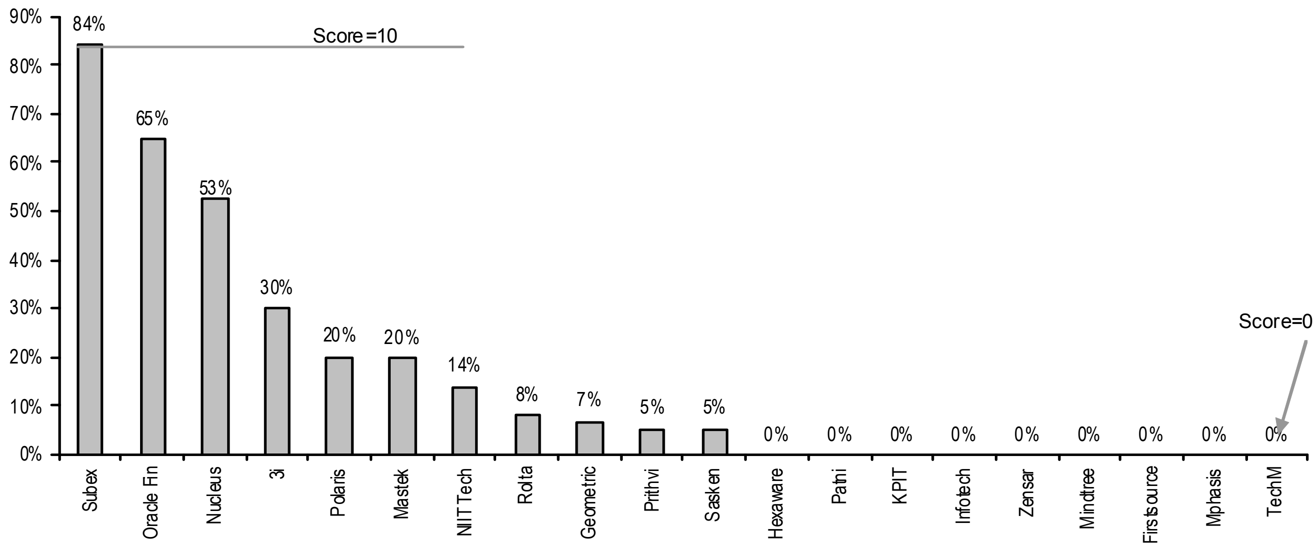


Source: Company data, Credit Suisse estimates

Significant product offering (Subex, OFSS and Nucleus)

Having significant proportion of revenues from product sales helps margins in growth phase due to relatively fixed cost base. We thus rank companies with higher product exposure higher. Among the companies under consideration, Subex, Oracle Financial and Nucleus have the highest revenue exposure to product sales.

Figure 34: **Revenue exposure to product sales**

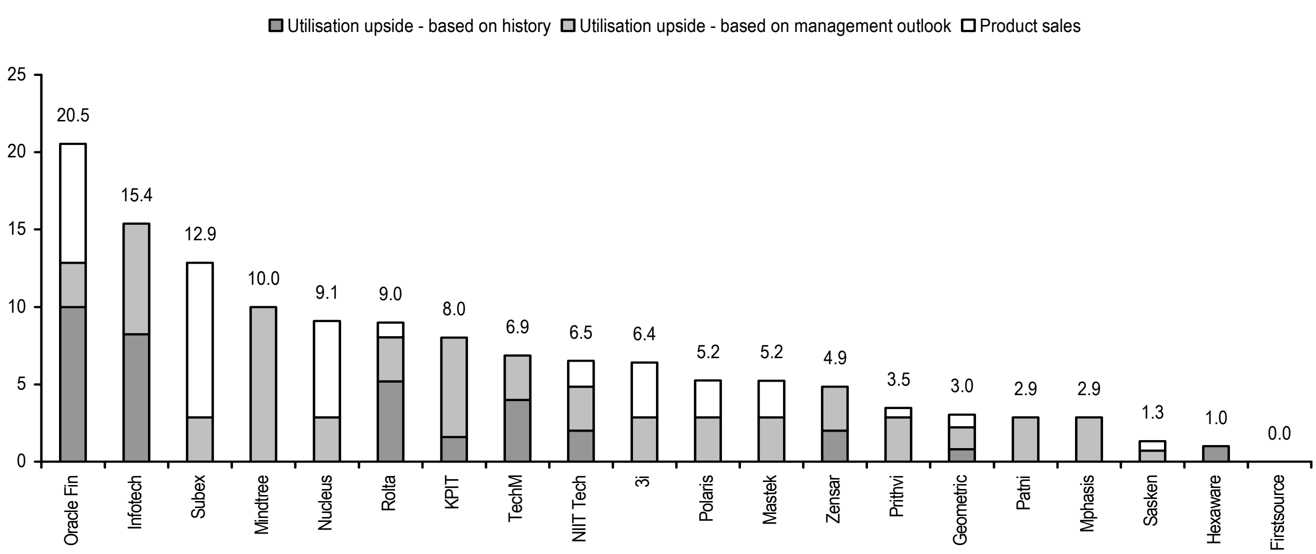


Source: Company data, Credit Suisse estimates

Consolidated score on margin upside potential (OFSS, Infotech and Subex)

We arrive at the consolidated score on this factor by summing up the scores on individual sub-factors. Among the companies under consideration, Oracle Financial, Infotech and Subex have the largest margin upside potential.

Figure 35: **Consolidated score on margin upside potential**



Source: Company data, Credit Suisse estimates

Figure 36: **Consolidated score on margin upside potential**

Company	Upside to utilisation – based on history (%)	Score based on history	Upside to utilisation – based on mgmt outlook (%)	Score based on mgmt outlook	Products as % of sales	Score on products as %age of sales	Total score
Oracle Fin	5.0	10	0.0	3	64.7	8	21
Infotech	4.1	8	3.0	7	0.0	0	15
Subex	0.0	0	0.0	3	84.2	10	13
Mindtree	0.0	0	5.0	10	0.0	0	10
Nucleus	0.0	0	0.0	3	52.5	6	9
Rolta	2.6	5	0.0	3	0.0	0	8
KPIT	0.8	2	2.5	6	0.0	0	8
TechM	2.0	4	0.0	3	0.0	0	7
NIIT Tech	1.0	2	0.0	3	14.0	2	7
3i	0.0	0	0.0	3	30.0	4	6
Polaris	0.0	0	0.0	3	20.1	2	5
Mastek	0.0	0	0.0	3	20.0	2	5
Zensar	1.0	2	0.0	3	0.0	0	5
Prithvi	0.0	0	0.0	3	5.3	1	3
Geometric	0.4	1	-1.0	1	6.8	1	3
Patni	0.0	0	0.0	3	0.0	0	3
Mphasis	0.0	0	0.0	3	0.0	0	3
Sasken	0.0	0	-1.5	1	5.2	1	1
Hexaware	0.5	1	-2.0	-	0.0	0	1
Firstsource	0.0	0	-2.0 -		0.0	0	0

Source: Company data, Credit Suisse estimates

3) Potential acquisition targets

At the first level, we notice a trend of hardware companies increasingly focusing on the services business (evident when we look at the recent acquisitions – HP-EDS, Dell-Perot and Xerox-ACS).

We notice a trend of hardware companies increasingly focusing on the services business

Further, with the global IT services market expecting a greater offshore push in the recovery from the downturn, it is but natural that some of the large global IT services companies would look to start/expand their delivery footprint in India. These companies could either follow an organic 'build' route (like Accenture) or grow quickly through acquiring smaller companies (ex. IBM-Daksh, Capgemini-Kanbay and EDS-Mphasis). With mid-cap valuations still reasonable and the fear of losing out on the immediate offshoring opportunity at the back of their minds, these global companies could be more attracted towards the second choice.

The table below lists some of the global IT services companies with a weak offshore presence, who could look to buy out smaller Indian IT services companies.

Further, some of the large global IT services companies could look to start/expand their delivery footprint in India

Figure 37: Global IT services vendors with weak offshore presence – prospective acquirers?

Company	Annual revenues (US$ mn)	Global headcount	Offshore headcount	Offshore headcount as % of global
Fujitsu (Technology Solutions)	29,764	108,446	2,000	1.8
NTT Data Corp	11,382	31,739	~1,000	3.2
Automatic Data Processing	8,867	42,000	2,500	6.0
Atos Origin	8,272	48,884	3,300	6.8
Unisys Corp	5,233	29,000	2,500	8.6
Logica	6,645	39,525	3,500	8.9
Capita	4,028	36,000	3,500	9.7
Dimension Data	3,973	11,032	1,500	13.6
Computer Sciences Corp	16,740	92,000	16,000	17.4
Capgemini	12,811	88,000	20,000	22.7

Source: Company data, Credit Suisse estimates

Thus, some of the smaller Indian IT services companies could be attractive acquisition targets in the coming quarters, resulting in significant upside to minority shareholders in case of open offers. Historically, such offers have resulted in 20-50% upside to the pre-announcement prices for minority shareholders.

Figure 38: Premium offered by acquirer over undisturbed price

Date	Acquirer	Target	% premium over close
7 December 2006	Oracle	iflex	20
26 July 2006	EDS	Mphasis	24
2 May 2008	Mindtree	Aztecsoft	49
30 November 2003	HP	Digital Global Soft	30

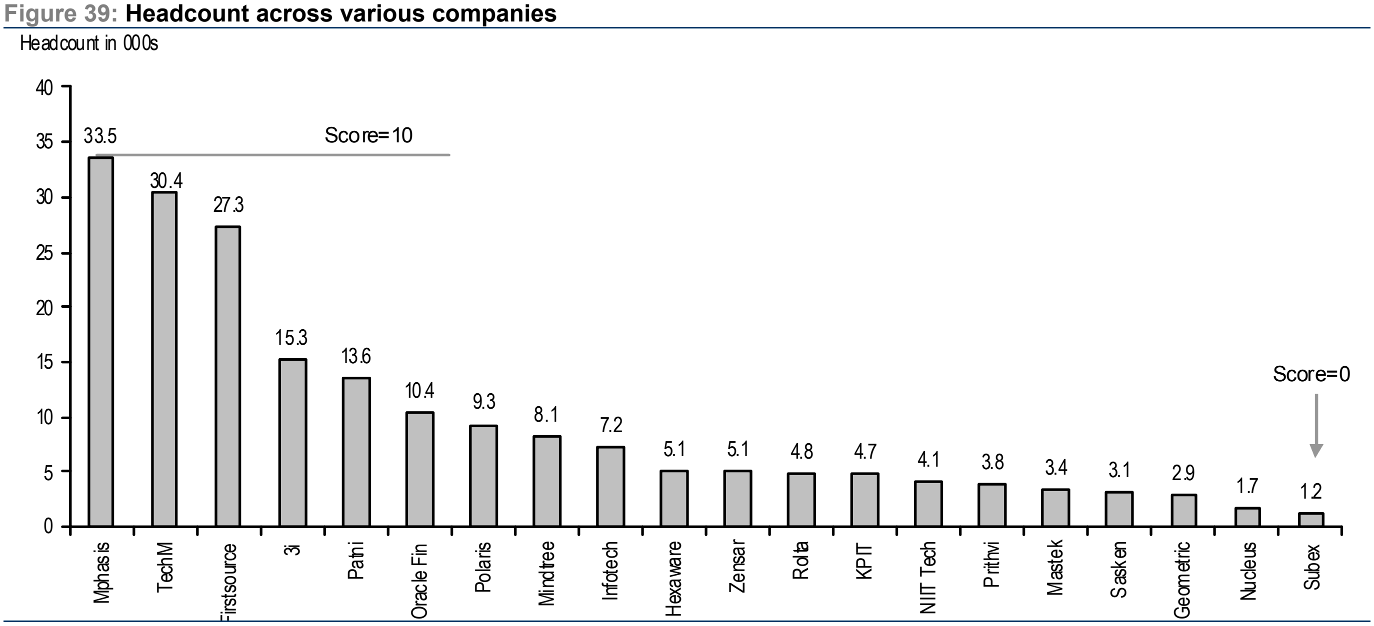
Source: Company data, Credit Suisse estimates

Potential acquirers could be driven by either of these three parameters – the size of workforce, differentiation/uniqueness and ease of acquisition.

Headcount size (Mphasis, TechMahindra and Firstsource)

For acquirers looking to ramp up offshore headcount, this could be the most important criterion.

Figure 39: Headcount across various companies



Source: Company data, Credit Suisse estimates

Unique strengths (Infotech, Rolta and MindTree)

This is a qualitative score, where we rank the companies based on the level of differentiation/uniqueness in their service offerings. The factors considered while doing the rankings include percentage concentration in specific services, verticals and geographies. We agree that this ranking could go against some of the rankings we made in the 'high growth' section – but we highlight that the priorities for an acquirer could be more long term (gaining a specific skill set, winning new customers, getting into new geographies, etc) than just the next few quarters' growth. Further, while we agree that there is some subjectivity involved in these rankings, we give out the unique strengths of each company that drove our rankings.

Finally, note that we exclude references to the qualities already captured by the other two parameters (size, ease of acquisition) in coming up with these rankings.

Figure 40: **Ranking of companies based on the differentiation/uniqueness in their service offerings**

Rank	Score	Company	Strength
1	20	Infotech	1) Engineering practice and 2) domain knowledge in aerospace and transportation
2	19	Rolta	1) Deep expertise in India government projects, especially defence (offset clause leverage)
3	18	Mindtree	1) Strong R&D and development skills and 2) experienced workforce
4	17	Patni	1) Manufacturing vertical expertise and 2) insurance vertical
5	16	Hexaware	1) ERP (HR) practice and 2) travel vertical strength
6	15	Polaris	1) BFSI exposure, 2) Citigroup relationship and 3) the product business
7	14	Oracle Fin	1) Market leading product offering for banks
8	13	KPIT	1) Strong engineering and R&D practise – especially auto and embedded systems
9	12	Sasken	1) Relationships with leading telecoms of the world
10	11	Subex	1) Unique product offerings in the telecom space
11	10	Mastek	1) Insurance domain knowledge, 2) Elixir product and 3) experience in UK government projects
12	9	TechMahindra	1) Telecom vertical expertise
13	8	Nucleus	1) Focus on the BFSI vertical and 2) leading presence in emerging markets and Japan
14	7	3i	1) Well-established India e-governance business
15	6	Geometric	1) Automotive industry domain, 2) engineering services and 3) OPD practice
16	5	Zensar	1) Strong enterprise application practice on both Oracle and SAP platforms
17	4	Firstsource	1) Leadership in US healthcare BPO and 2) growing presence in A-Pac telecom vertical
18	3	Mphasis	1) Strong BPO practice
19	2	NIIT Tech	1) European insurance vertical through ROOM solutions and 2) transportation vertical exposure
20	1	Prithvi	1) Presence in the US telecom vertical

Source: Company data, Credit Suisse estimates

Ease of acquisition (or presence of a strategic investor as stumbling block) (Subex, Rolta and Prithvi)

The presence of a strategic investor could make the process of takeover difficult, as these investors may be motivated by factors other than just the short-term gains from selling stake. This is a negative criterion, where we give a lower score to companies with high strategic investor holding.

Figure 41: **Ranking of companies based on the holding of strategic shareholders**

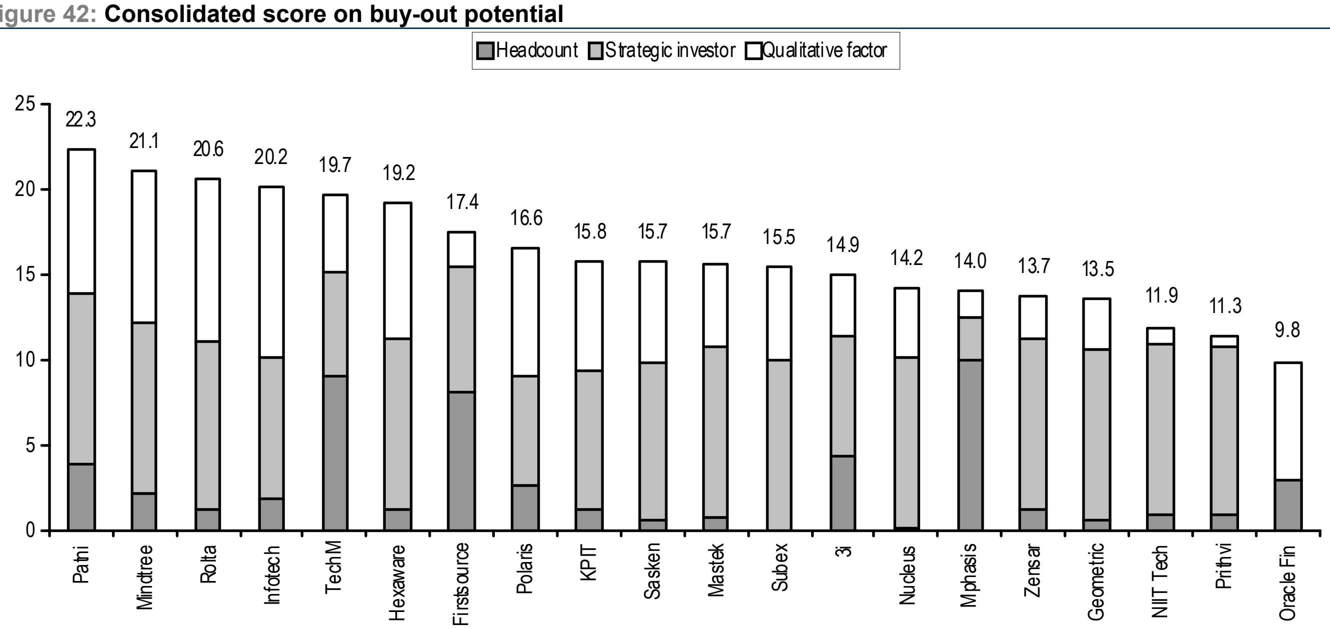
Rank	Company	Holding of strategic shareholders (%)	Score	Names of strategic shareholders
1	Oracle Fin	81.0	-	Oracle
2	Mphasis	60.6	3	HP
3	TechM	31.0	6	BT
4	Polaris	28.0	7	Citigroup
5	3i	24.0	7	ICICI Bank
6	Firstsource	21.4	7	ICICI Bank
7	KPIT	14.7	8	Cummins
8	Infotech	13.8	8	Pratt & Whitney
9	Sasken	6.9	9	Nortel
10	Zensar	0.0	10	n.a.
11	NIIT Tech	0.0	10	n.a.
12	Hexaware	0.0	10	n.a.
13	Patni	0.0	10	n.a.
14	Geometric	0.0	10	n.a.
15	Mastek	0.0	10	n.a.
16	Mindtree	0.0	10	n.a.
17	Nucleus	0.0	10	n.a.
18	Prithvi	0.0	10	n.a.
19	Rolta	0.0	10	n.a.
20	Subex	0.0	10	n.a.

Source: Company data, Credit Suisse estimates

Consolidated score on buy-out potential (Patni, MindTree and Rolta)

We arrive at the consolidated score on this factor by summing up the scores on individual sub-factors. Among the companies under consideration, Patni, Mindtree and Rolta have the largest likelihood of getting bought out.

Figure 42: **Consolidated score on buy-out potential**



Source: Company data, Credit Suisse estimates

Figure 43: **Consolidated ranking on buy-out potential**

Company	Headcount ('000s)	Score due to headcount	Stake of strategic shareholders (%)	Score on stake of strategic shareholders	Score on uniqueness / differentiation	Total score	Total rank
Patni	13.6	3.84	0	10.00	8.50	22.34	1
Mindtree	8.1	2.15	0	10.00	9.00	21.15	2
Rolta	4.8	1.11	0	10.00	9.50	20.61	3
Infotech	7.2	1.86	14	8.30	10.00	20.16	4
TechM	30.4	9.04	31	6.17	4.50	19.71	5
Hexaware	5.1	1.22	0	10.00	8.00	19.22	6
Firstsource	27.3	8.08	21	7.36	2.00	17.44	7
Polaris	9.3	2.52	28	6.54	7.50	16.56	8
KPIT	4.7	1.10	15	8.18	6.50	15.79	9
Sasken	3.1	0.58	7	9.15	6.00	15.73	10
Mastek	3.4	0.67	0	10.00	5.00	15.67	11
Subex	1.2	0.00	0	10.00	5.50	15.50	12
3i	15.3	4.37	24	7.04	3.50	14.91	13
Nucleus	1.7	0.15	0	10.00	4.00	14.15	14
Mphasis	33.5	10.00	61	2.51	1.50	14.01	15
Zensar	5.1	1.20	0	10.00	2.50	13.70	16
Geometric	2.9	0.52	0	10.00	3.00	13.52	17
NIIT Tech	4.1	0.91	0	10.00	1.00	11.91	18
Prithvi	3.8	0.81	0	10.00	0.50	11.31	19
Oracle Fin	10.4	2.85	81	0.00	7.00	9.85	20

Source: Company data, Credit Suisse estimates

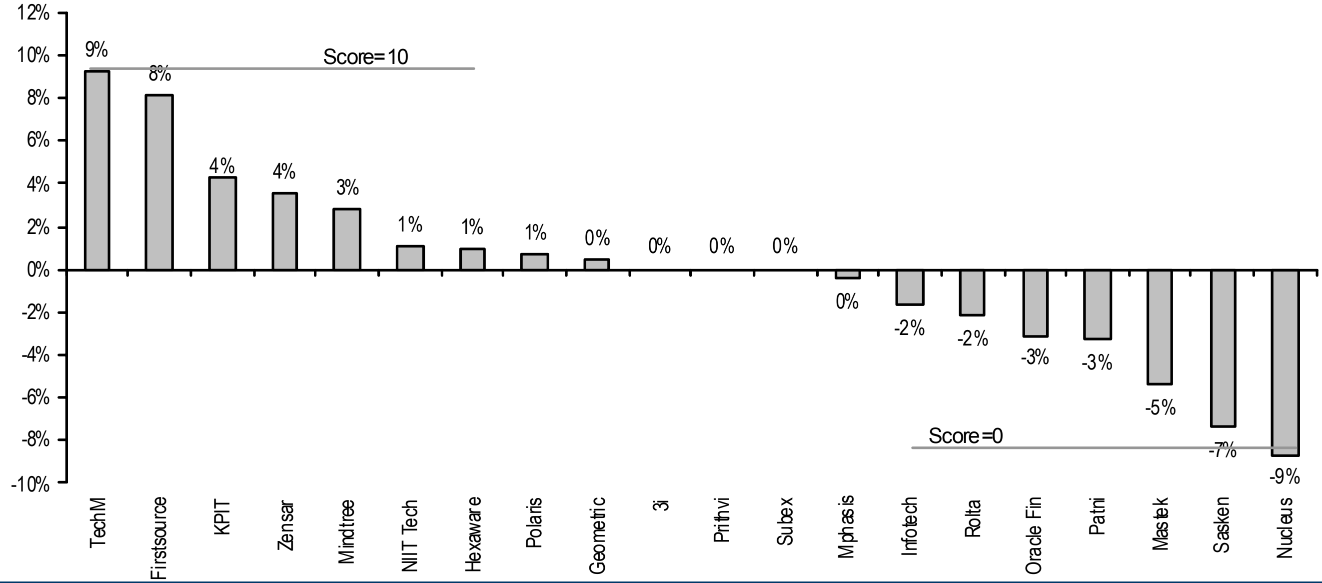
4) Near-term headcount momentum

(Tech Mahindra, Firstsource, KPIT Cummins)

While the above discussed factors compare companies on various long-term parameters, we note that there could be a number of company-specific factors that may not be captured in these metrics – which could cause near-term growth for companies to differ from the scores derived above. The best indicator of this near-term outlook would have been the management guidance – unfortunately very few companies give guidance. As a proxy for management outlook on growth, we could look at the momentum in headcount additions. We base our rankings on this factor on the CQGR (Cumulative Quarterly Growth Rate) in headcount over the last two quarters – higher the growth in headcount better is management's near-term outlook.

As a proxy for management outlook on growth, we could look at the momentum in headcount additions

Figure 44: **Average quarterly growth rate in headcount over July-December 2009**



Source: Company data, Credit Suisse estimates

5) Client concentration

We look at this factor at two levels. On the one hand, high exposure to a single large client is known to be detrimental to long-term business models – in our scoring, we penalise companies with high revenues exposure to a single client in our scoring. However, we also acknowledge that in the short term, some of these top customers could be going through a healthy growth phase in their own businesses, giving a positive ripple effect to the IT services companies who serve them. Hence, we also look at the health of the top customers of each of the 20 companies, to arrive at the consolidated score.

Risk due to client concentration (Mphasis, TechMahindra and Polaris)

High exposure to a single large client is known to be detrimental to long-term business models

Excessive revenue exposure to a single client can prove detrimental to growth as was seen in the case of Hughes Software (Hughes Telecom), Polaris (Citigroup), TechMahindra (BT).

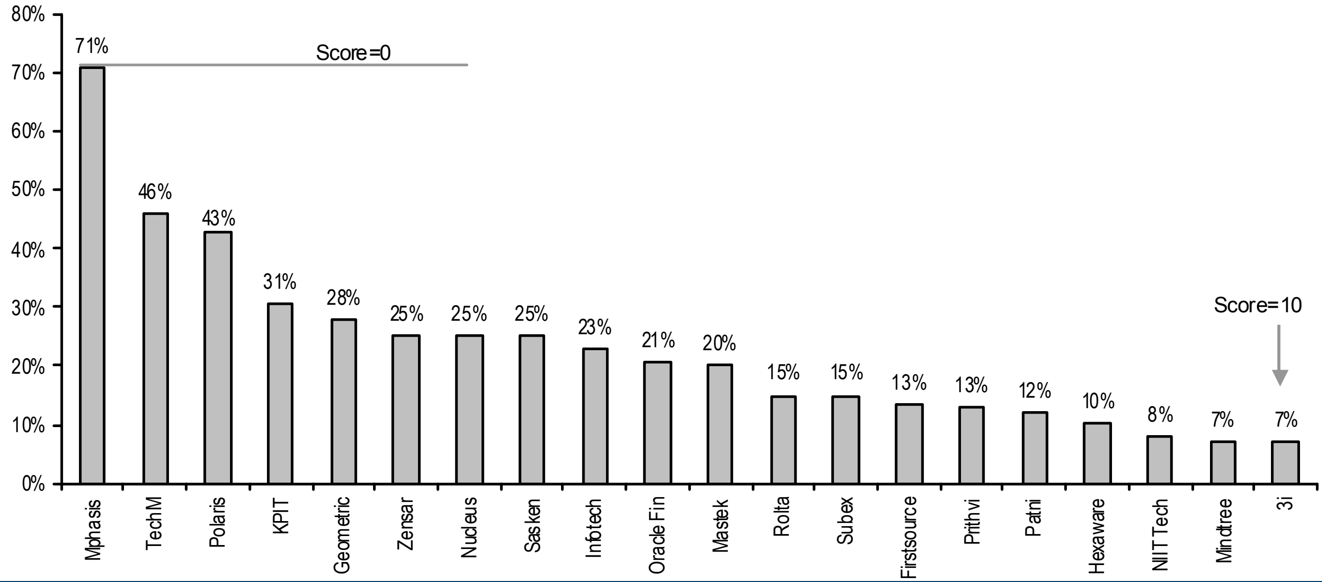
Figure 45: **Excessive revenue exposure to a single client can prove detrimental**

Company	Client	Year	Comment
Hughes Software	Hughes Telecom	2002	During the global downturn in the telecom industry, revenues from parent Hughes Telecom for Hughes Software dropped by half in just three-four quarters. Hughes Telecom was accounting for nearly half the revenues for Hughes Software before this fall.
Polaris	Citigroup	2004-07	Revenues from Citigroup have remained almost stagnant for four years, while the rest of the company showed a 35% CAGR. Citigroup contributed 62% to Polaris's revenues at the start of this period.
Tech Mahindra	BT	2008-09	Revenues from BT, which accounted for 63% of Tech Mahindra's sales in June 2008, fell 36% in just three quarters. BT recently negotiated rate cuts from Tech Mahindra. Earlier, Tech Mahindra had also entered into contracts with BT which required savings to be paid upfront in cash.

Source: Company data

Among the companies under consideration, 3i, Mindtree and NIIT Tech have the lowest exposure to a single client.

Figure 46: **Revenue exposure to the biggest client**



Source: Company data, Credit Suisse estimates

Leverage to client's growth (KPIT Cummins, Mphasis and Sasken)

We use the change in growth expectations of the customer as an indication of the health of the customer in its business. We further weigh this metric by the exposure of IT services vendor to the particular client, in order to transform the client's health score into the IT services vendor's context.

Some companies may benefit from improvement in health of large customers

Figure 47: **Positive impact of top client**

Company	Top customer	% sales contribution (1)	2009 rev growth (%)	2010 rev growth (%)	Swing in growth rate (2)	(1)*(2) *10,000
KPIT	Cummins	30.6	-24.7	4.0	28.7	880
Mphasis	HP	71.0	-3.2	7.6	10.9	771
Sasken	Nokia Siemens	25.0	-19.2	4.0	23.2	580
Zensar	Cisco	25.0	-8.7	10.3	19.0	475
Infotech	UTC	22.8	-9.7	4.4	14.1	321
Patni	GE	11.9	-13.9	-0.2	13.7	163
NIIT Tech	BA	8.0	-11.2	7.3	18.5	148
Firstsource	ICICI Bank	13.3	6.1	13.2	7.1	95
Polaris	Citigroup	43.0	-4.2	-2.6	1.7	71
3i	ICICI Bank	7.0	6.1	13.2	7.1	50
Hexaware	Hewitt	10.3	-4.8	-0.5	4.3	44
Oracle Fin	Citigroup	20.6	-4.2	-2.6	1.7	34
Mindtree	Microsoft	7.2	5.0	6.8	1.8	13
TechM	BT	46.0	-3.4	-3.8	-0.3	-15
Nucleus	ACOM	25.0	-14.7	-15.9	-1.2	-30
Subex	AT&T	15.0	3.4	-0.8	-4.3	-64
Prithvi	T-Mobile	13.1	4.8	-2.2	-7.0	-91
Mastek	Capita	20.0	17.8	9.9	-7.8	-157
Geometric	Dassault	28.0	4.9	-6.4	-11.3	-315
Rolta	Ministry of defence, India	15.0	34.2	4.0	-30.2	-453

Note 1) For banks, we have taken growth expectation on asset base and 2) for the Indian ministry of defence, we have used the growth rate in budgetary allocations to defence
Source: Company data, Credit Suisse estimates, Datastream consensus for non-rated companies.

Among the companies under consideration, KPIT, Mphasis and Sasken have the most to gain due to the strong improvement in growth rates of their top client.

Figure 48: **Other top customer accounts**

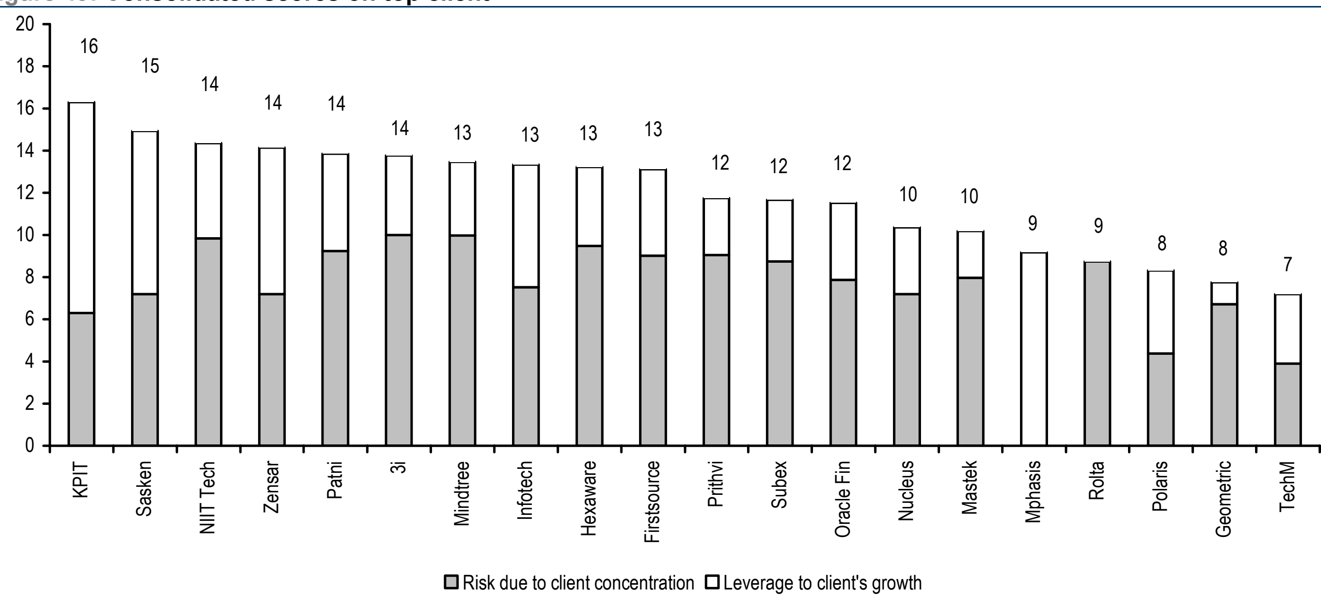
Company	Other key customers
Hexaware	Unisys, Citigroup, Deutsche Leasing
Patni	State Farm, Motorola
Infotech	Bombardier, Boeing
Geometric	GM, Caterpillar, Siemens, Ford
Mastek	BT
NIIT Tech	Sabre, DBS, SEI, ING Group
Zensar	Marks & Spencer, Land mark, Fujitsu, National Grid
Mindtree	Volvo, AIG
Firstsource	BskyB, Verizon, United Healthcare
Nucleus	Shinsei Bank, HDFC Bank, ICICI Bank, GMAC
Sasken	Alcatel Lucent, Nortel, TI, Motorola
Subex	BT
TechMahindra	AT&T

Source: Company data, Credit Suisse estimates

Consolidated score on top client (KPIT Cummins, Sasken and NIIT Tech)

We arrive at the consolidated score on this factor by summing up the scores on individual sub-factors. Among the companies under consideration, KPIT and Sasken are the best positioned; Tech Mahindra is the worst positioned.

Figure 49: **Consolidated scores on top client**



Source: Company data, Credit Suisse estimates

Composite ranking on the five factors

Looking across our five-factor ranking framework, Infotech, Mindtree and OFSS come out on top among the companies studied.

Figure 50: **Composite ranking on five factors**

	Exposure to high growth areas				Margin upside				Buyout potential				Top client				
Company	**BFSI**	**Engg/ R&D**	**Emerging mkt**	**Total score**	**Util-history**	**Util-mgmt outlook**	**Products**	**Total score**	**Head-count**	**Strategic stake**	**Qual. rank**	**Total score**	**Conc risk**	**health**	**Total score**	**Headcount growth**	**Comp score**
Infotech	-	10	1	11	8	7	-	15	2	8	10	20	8	6	13	4	63.6
Mindtree	2	8	2	11	-	10	-	10	2	10	9	21	10	3	13	6	61.8
OracleFin	10	-	4	14	10	3	8	21	3	-	7	10	8	4	12	3	58.8
KPIT	1	5	1	7	2	6	-	8	1	8	7	16	6	10	16	7	53.8
Nucleus	10	-	10	20	-	3	6	9	0	10	4	14	7	3	10	-	53.6
Rolta	-	4	7	11	5	3	1	9	1	10	10	21	9	-	9	4	52.8
Patni	4	2	0	6	-	3	-	3	4	10	9	22	9	5	14	3	48.6
Polaris	9	-	3	12	-	3	2	5	3	7	8	17	4	4	8	5	47.8
3i	3	-	4	7	-	3	4	6	4	7	4	15	10	4	14	5	46.7
Subex	-	-	1	1	-	3	10	13	-	10	6	16	9	3	12	5	46.0
TechM	-	-	1	1	4	3	-	7	9	6	5	20	4	3	7	10	45.1
NIITTech	4	-	2	7	2	3	2	7	1	10	1	12	10	5	14	5	45.1
Zensar	2	-	2	4	2	3	-	5	1	10	3	14	7	7	14	7	43.9
Hexaware	4	-	0	5	1	-	-	1	1	10	8	19	9	4	13	5	43.5
Firstsource	2	-	1	3	-	-	-	-	8	7	2	17	9	4	13	9	43.4
Mastek	5	-	0	6	-	3	2	5	1	10	5	16	8	2	10	2	38.8
Mphasis	4	-	2	6	-	3	-	3	10	3	2	14	-	9	9	5	36.3
Sasken	-	-	3	3	-	1	1	1	1	9	6	16	7	8	15	1	36.1
Prithvi	0	4	-	4	-	3	1	3	1	10	1	11	9	3	12	5	35.4
Geometric	-	4	1	5	1	1	1	3	1	10	3	14	7	1	8	5	34.6

Source: Company data, Credit Suisse estimates

Prefer Infotech, MindTree and Polaris among rated mid caps

While obtaining a good comparison of companies on fundamental drivers is essential, it stops short of suggesting which stocks are good investments currently. For this analysis to be complete, we also have to look at how companies fare on valuations. We devise a simple score card on trailing valuations for the companies under study, and pair the rankings thus obtained with our rankings on fundamentals in the previous chapter.

We devise a simple score card on trailing valuations for the companies under study, and pair the rankings thus obtained with our rankings on fundamentals in the previous chapter

We retain our OUTPERFORM ratings on MindTree and Patni, and UNDERPERFORM on TechMahindra. In this report, we initiate coverage on Polaris, Infotech (both OUTPERFORM), Mphasis (NEUTRAL) and Hexaware (UNDERPERFORM).

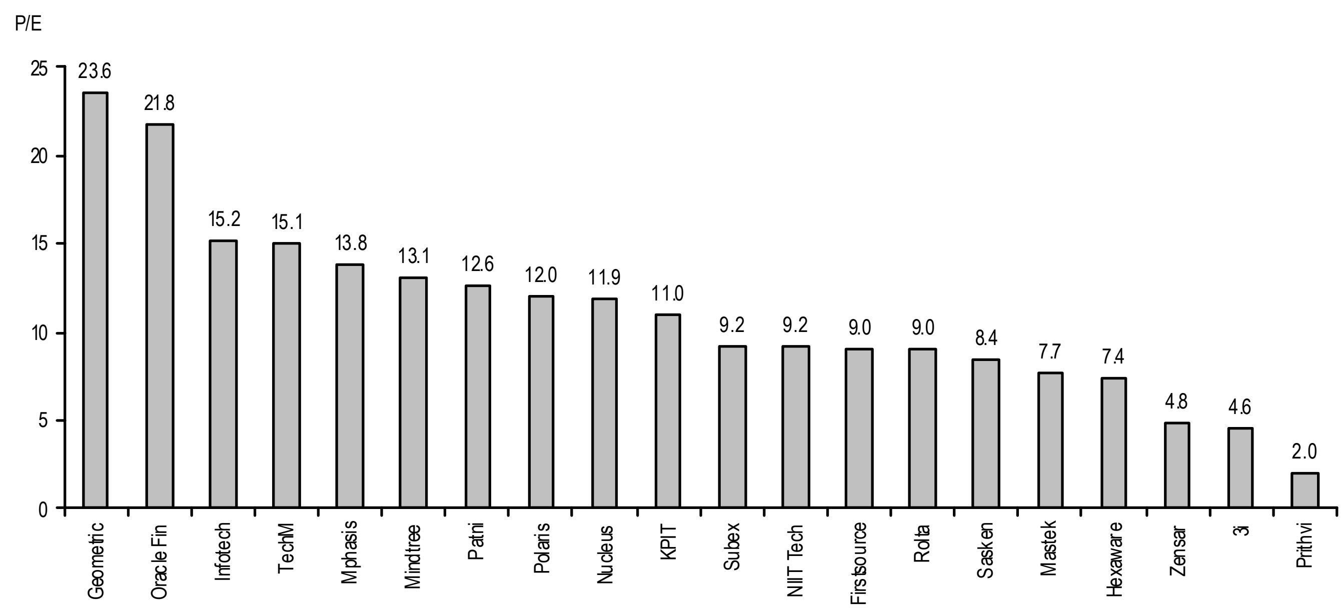
Scorecard on valuations

While we have arrived at rankings on relative attractiveness of underlying businesses in the previous section, those rankings need to be seen alongside relative attractiveness on valuations. For this purpose, we have created a separate scorecard based on valuations – using the following sub-factors:

P/E multiple misses the varying levels of debt and forex loss treatment

The P/E multiple is the most commonly used valuation metric to compare IT services stocks.

Figure 51: **Companies under consideration trade at a wide range of P/Es (chart depicts trailing 12M P/E)**

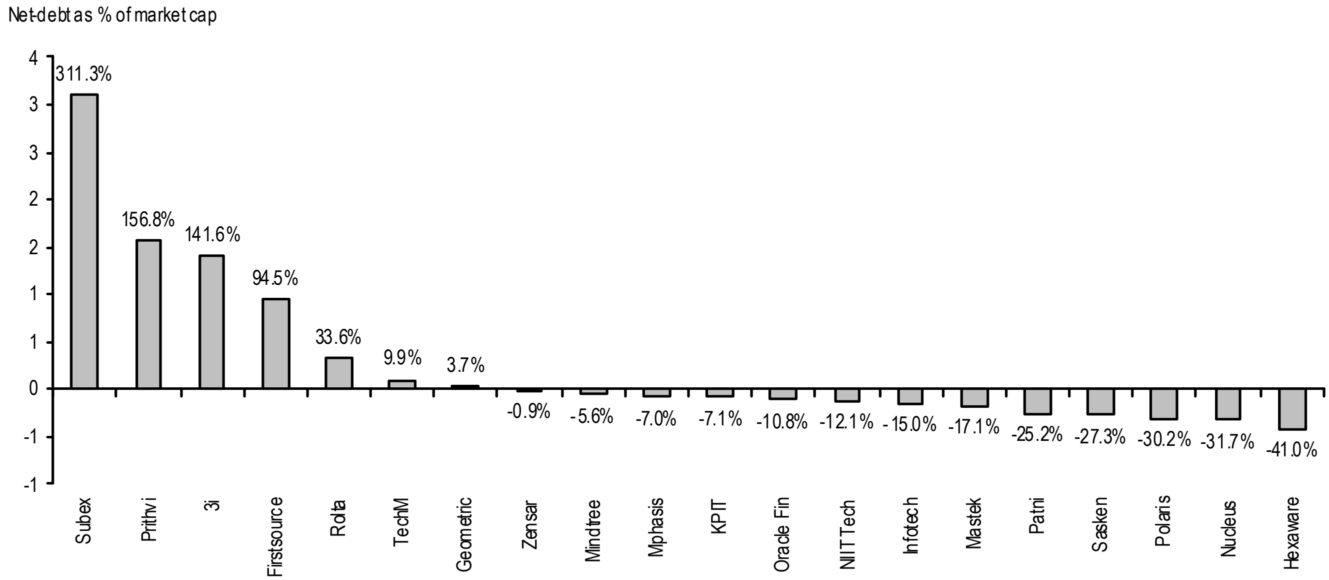


Note: P/E based on closing prices as of 5-Apr-10

Source: Company data, Credit Suisse estimates.

However, comparing all mid-caps on P/E multiples would be misguiding due to significantly different levels of debt (in many cases zero-coupon FCCBs) in the balance sheets.

Figure 52: Companies vary widely in terms of net debt (the chart depicts net debt as % of market cap)



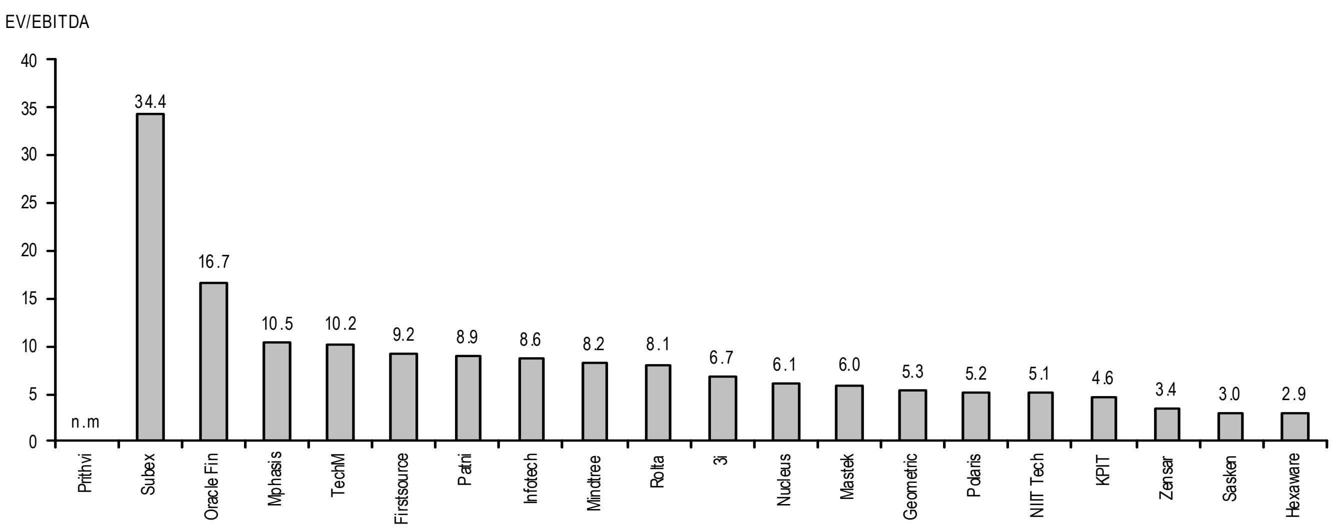
Source: Company data, Credit Suisse estimates. Note: Market capitalisation based on closing prices as of 5-Apr-10

Further, reported earnings are affected by varying levels of currency hedges taken on by companies. Thus, we believe that P/E distorts valuation comparison.

Hence, we use EV/EBITDA as a metric to compare valuations

On EV/EBITDA, OFSS, Subex and Mphasis come out the most expensive, while Hexaware, Sasken and Zensar come out the least expensive.

Figure 53: EV/EBITDA of comparison across companies (trailing 12M)

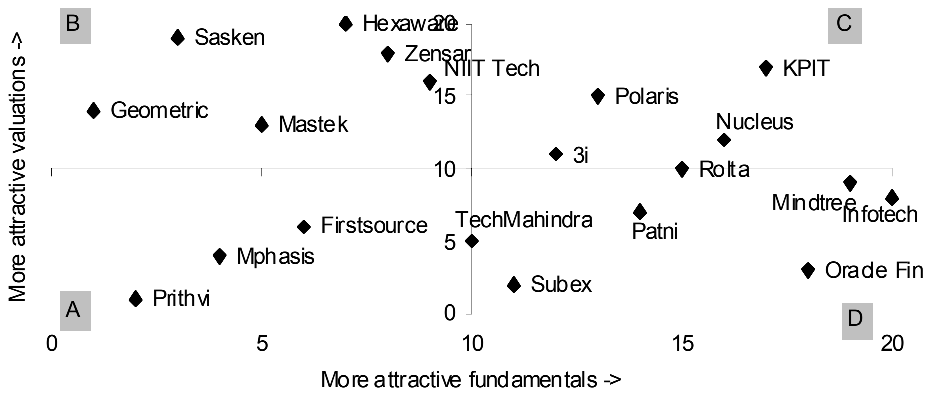


Source: Company data, Credit Suisse estimates

Juxtaposing fundamental and valuation rankings

We now proceed to the last stage of our stock comparison, by juxtaposing ranks on fundamentals with rankings on valuations. In the 2D chart below, all stocks in block C and some in block B and block D are suitable for investments.

Figure 54: **Juxtaposing fundamental and valuation rankings**



Source: Company data, Credit Suisse estimates

We reiterate our OUTPERFORM rating on Patni and MindTree, and UNDERPERFORM rating on TechMahindra.

Initiate with OUTPERFORM on Polaris and Infotech, UNDERPERFORM on Hexaware, and NEUTRAL on Mphasis

We are positively disposed on Polaris and Infotech due to the near-term growth momentum for these companies, along with potential margin upside. We thus initiate with an OUTPERFORM rating.

For Mphasis, while near-term growth could be strong benefitting from HP account, we fear further rate cuts forced from the parent – which could keep margins and earnings growth low. We thus initiate with a NEUTRAL rating on this stock.

Hexaware is facing near-term growth headwinds, with a prospect of an earnings decline in 2010. We thus initiate with an UNDERPERFORM rating on this stock.

Figure 55: **Ratings and target prices on initiating companies**

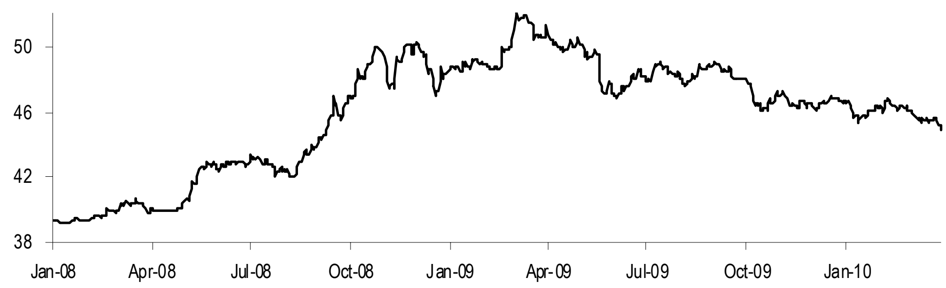
	CMP (Rs)	TP (Rs)	Upside (%)	Rating	TP methodology
Polaris	171	200	17%	O	50% discount to Infosys P/E on FY3/11E Adj. EPS – in line with history
Infotech	372	440	18%	O	50% discount to Infosys P/E on FY3/11E EPS – in line with history
Mphasis	637	620	-3%	N	40% discount to Infosys P/E on FY3/11E EPS – in line with history
Hexaware	69.6	60	-14%	U	60% discount to Infosys P/E on FY3/11E EPS – in line with history

Source: Company data, Credit Suisse estimates

Currency remains a risk

The volatility in currency exchange rates has been a key influencer of share price performance of the India IT services industry over the last three years. Over the last few weeks, the INR has appreciated sharply against the USD – with 3.4% appreciation during the March 2010 quarter.

Figure 56: **INR/USD exchange rate trend (Rs/US$)**



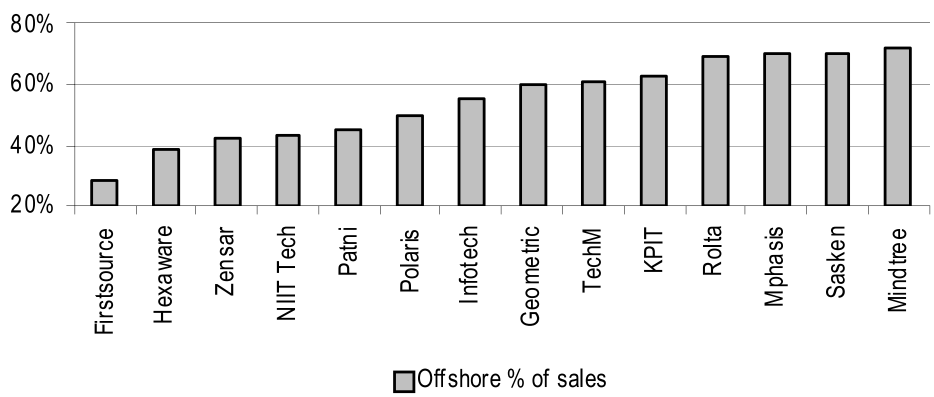
Source: Bloomberg

The volatility in exchange rates affects companies at two levels – 1) operating profits and 2) currency hedges.

Impact on operating profits

The risk stems from mismatch of currencies in which revenues are billed and costs are booked in the offshore Indian IT services model. In absence of data on currency-wise split of revenues across companies, we use the proportion of revenues from offshore sales as a metric for comparison – greater the offshore proportion of sales, greater the mismatch in currencies as described above, and hence greater the margin impact from the INR appreciation. MindTree, Sasken and Mphasis have the highest proportion of revenues from the offshore model among the companies we studied. Firstsource, Hexaware and Zensar have the least exposure.

Figure 57: **Greater offshore sales implies greater impact on operating margins**



Source: Company data, Credit Suisse estimates

Impact of hedges

Due to varying levels of hedges among companies, they could benefit to varying extents from the appreciating rupee. A greater exposure to currency hedges could result in larger gains in an appreciating rupee environment. Adjusted for foreign currency receivables, we find that TechMahindra, KPIT Cummins and Geometric have the highest net exposure (hedges – receivables) as a proportion of annualised sales.

Figure 58: Currency hedges could help offset negative impact of INR appreciation

	Hedges ($mn)	(Hedges – receivables)/ annualised sales (%)
Mastek	3	-23.7
Rolta	-	-16.5
Infotech	34	-6.8
Nucleus	10	-2.9
Firstsource	86	7.6
Patni	256	18.0
Sasken	47	25.8
Mindtree	158	39.5
NIIT Tech	124	43.7
Polaris	180	44.7
Hexaware	131	46.2
Mphasis	708	50.0
Geometric	76	52.6
KPIT	130	64.7
TechM	1,166	94.4

Source: Company data, Credit Suisse estimates

Asia Pacific / India
Software

Polaris Software Lab Ltd.

(POLS.BO / POL IN)

Rating	**OUTPERFORM* [V]**
Price (05 Apr 10, Rs)	171.50
Target price (Rs)	200.00[1]
Chg to TP (%)	16.6
Market cap. (Rs mn)	16,971.81 (US$ 382.38)
Enterprise value (Rs mn)	11,793
Number of shares (mn)	98.96
Free float (%)	70.84
52-week price range	201.95 - 53.50

**Stock ratings are relative to the relevant country benchmark.*
[1]Target price is for 12 months.
[V] = Stock considered volatile (see Disclosure Appendix).

Research Analysts

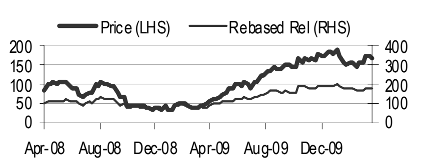
Sunil Tirumalai
9122 6777 3714
sunil.tirumalai@credit-suisse.com

Bhuvnesh Singh
65 6212 3006
bhuvnesh.singh@credit-suisse.com

Strong momentum in the near term

- **We initiate coverage of Polaris with an OUTPERFORM** rating and Rs200 target price (17% potential upside).
- **Our positive stance on Polaris is based on:** 1) the strength in its largest customer account (Citigroup), 2) high leverage to the BFSI vertical which we believe could grow faster than the other segments in the short term and 3) earnings boost from forex losses of FY10 turning into forex gains in FY11. These factors could lead to Polaris reporting among the highest EPS growths in the industry for FY3/11 at 41% YoY. Note that this is a tactical OUTPERFORM based on near-term factors which we would review in 12 months.
- **We expect Polaris to deliver growth rates better than the rest of the mid-cap** Indian IT space in the coming quarters (on the back of strength in Citi account) leading to 20% YoY growth in FY3/11. This could be the key driver for the stock price, in our view.
- **Polaris is trading at 8.1x FY3/11E P/E, which is at the lower half** of its historical range of 4-19x. The P/E discount to Infosys at 62% is also near all-time highs. Thus, the stock is cheap when valued on forward earnings multiples. Further, with 30% of market cap accounted for by net-cash on balance sheet, there is sufficient downside support for the stock.

Share price performance



The price relative chart measures performance against the India - NSE S&P CNX Nifty Index index which closed at 5368.4 on 05/04/10
On 05/04/10 the spot exchange rate was Rs44.82/US$1

Performance Over	1M	3M	12M
Absolute (%)	7.5	-9.3	251.1
Relative (%)	1.9	-10.9	110.0

Financial and valuation metrics

Year	3/09A	3/10E	3/11E	3/12E
Revenue (Rs mn)	13,779.4	13,494.9	15,675.0	18,003.6
EBITDA (Rs mn)	2,335.3	2,200.3	2,485.4	2,850.7
EBIT (Rs mn)	1,947.5	1,853.6	2,115.8	2,415.3
Net income (Rs mn)	1,307.5	1,482.8	2,088.7	2,299.2
EPS (CS adj.) (Rs)	13.25	15.03	21.16	23.29
Change from previous EPS (%)	n.a.			
Consensus EPS (Rs)	n.a.	15.3	19.2	21.0
EPS growth (%)	78.6	13.4	40.8	10.1
P/E (x)	12.9	11.4	8.1	7.4
Dividend yield (%)	1.7	1.7	1.7	1.7
P/B (x)	2.2	1.9	1.6	1.4
ROE	16.6	16.9	19.8	18.4
Net debt/equity (%)	net cash	net cash	net cash	net cash

Source: Company data, Thomson Financial Datastream, Credit Suisse estimates.

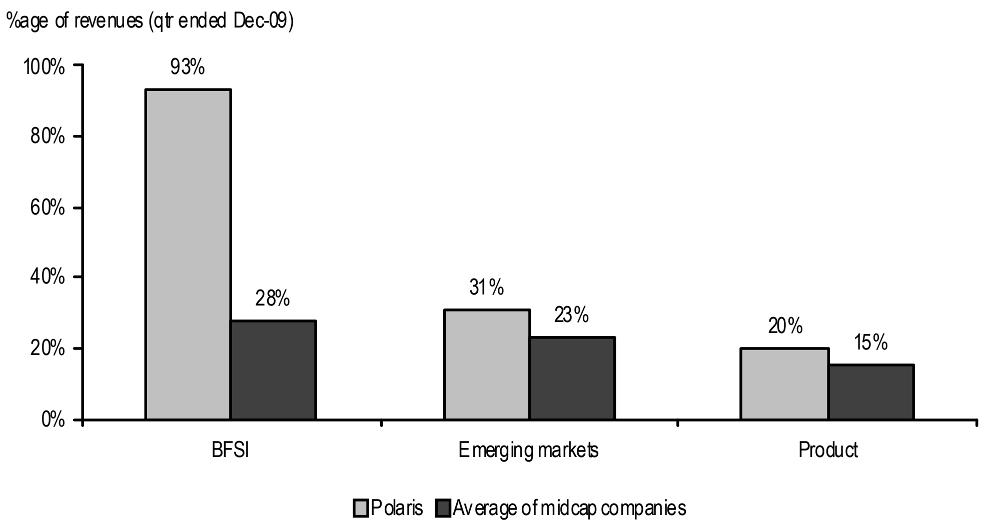
Strong momentum in the near term

Leveraged to high-growth segments

Polaris derives 93% of revenues from BFSI and 30% from emerging markets – which we have identified as high-growth segments in the earlier part of this report.

Further, the company's 'Intellect' product suite contributes about 20% of revenues providing a degree of non-linearity to overall revenues, helping long-term margins. Management hopes to take the contribution from products to overall sales to 30% in three years.

Figure 59: **Polaris is well-positioned for strong growth**



Note: Average of the 20 mid-cap companies considered in the earlier part of this report
Source: Company data.

The product competes with Oracle Financial (formerly Iflex Solutions) and Temenos (TEMN.S, SFr31.90, NEUTRAL [V], TP SFr27.00, OVERWEIGHT). Over the last two to four years, Polaris has invested in the porting of the product suite into an SOA-based architecture in order to expand the addressable market for the product. We note that Polaris recognises product license revenues over the entire period of implementation, unlike most other companies which recognise license revenues upon the sale. While this helps making the revenue profile less lumpy, it also results in product revenues becoming back-end loaded versus that of peers.

Citigroup account shows positive momentum

While Polaris discontinued publishing the revenue contribution from Citigroup a year ago, we understand that this account still accounts for 40%-plus of company revenues. Further, our discussions with management indicate that this account has seen a strong growth momentum in recent quarters (6%+ QoQ growth), which is expected to continue. While in general we are negatively biased towards the company's high exposure to a single client (more so since the client is also a major shareholder), we believe that the momentum in Citi account in the near term could benefit Polaris.

Expect strong growth in the near term

Driven by momentum in the Citi account, and high leverage to the BFSI vertical, we expect Polaris to grow faster than mid-cap average growth in the near term. Note that our growth estimates for mid-caps remain lower than those for large-cap companies.

Figure 60: **USD-based organic growth rates for our coverage universe**

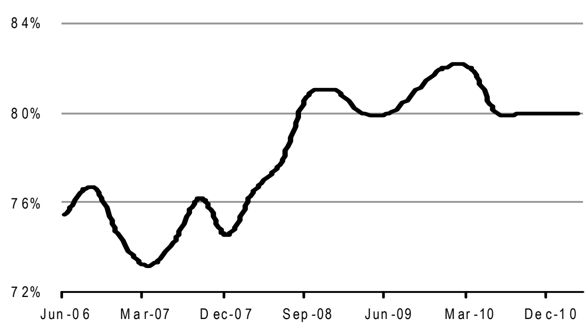
USD-based revenue growth	QoQ growth (%)		YoY growth (%)	
Organic growth excluding acquisitions	**Mar-10E**	**Jun-10E**	**FY11E**	**FY12E**
Polaris	4.5	6.6	20.4	14.9
Hexaware	(6.5)	6.8	3.5	17.9
Infotech	3.6	6.2	21.5	19.4
Mphasis	4.4	4.3	19.9	16.9
Patni	3.6	4.7	15.4	19.5
MindTree	3.9	5.8	20.7	22.2
Mid-cap average	**3.3**	**5.1**	**17.8**	**18.2**
Infosys	4.5	5.9	22.7	21.2
TCS	4.5	5.7	22.2	18.6
Wipro	4.1	4.9	21.4	20.3
HCLT	3.1	3.6	14.7	14.3
Large-cap average	**4.2**	**5.3**	**21.1**	**19.2**

Note: FY11 corresponds to year ending Dec-09 for Patni and Hexaware, and Jun-10 for HCLT and year ending Mar-11 for all other companies.
Source: Company data, Credit Suisse estimates

Margin gains to sustain

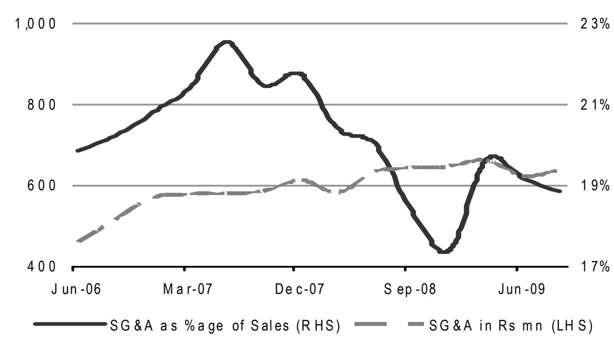
Polaris has displayed strong margin improvement over the last two years, partly aided by the favourable currency movement, and also from internal cost controls. The company has steadily worked on increasing the utilisation rate, from a low of 70% seen 2006 to over 80% currently. In addition, SG&A costs have been maintained almost flat for more than a year.

Figure 61: **Utilisation has increased steadily**



Source: Company data, Credit Suisse estimates

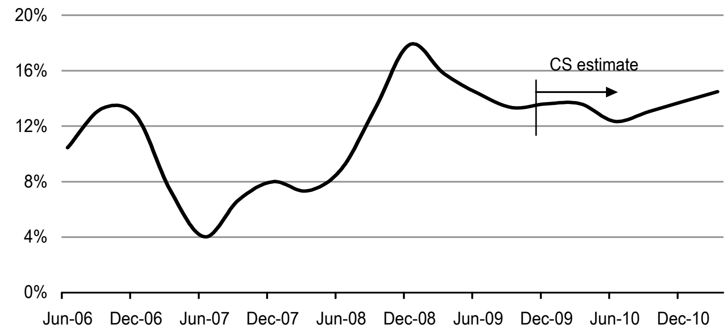
Figure 62: **SG&A costs have remained almost flat in absolute terms for over a year**



Source: Company data, Credit Suisse estimates

Going forward, we expect the company to sustain current margin levels at about 15%. While wage pressures could impact margins for a quarter, we expect volume growth to help overcome this over the year.

Figure 63: **Polaris's EBIT margin improvement**



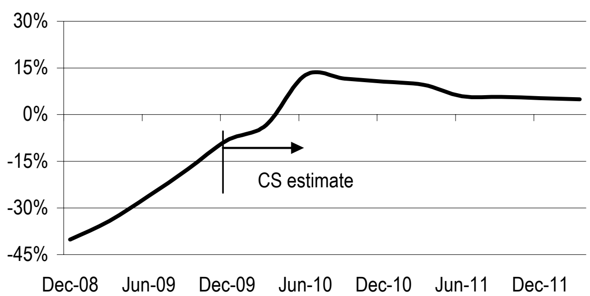
Source: Company data, Credit Suisse estimates

Forex gains next year – a boost to earnings

Like many other Indian IT services companies, Polaris also suffered from losses on forex derivatives last year, with forex losses eroding over 40% of PBT in peak quarters. However, given the profile of derivatives on hand (FY3/11 derivatives are hedged at Rs48.28/USD), the derivatives are expected to generate gains in FY3/11.

Figure 64: **Forex gains to boost earnings next year**

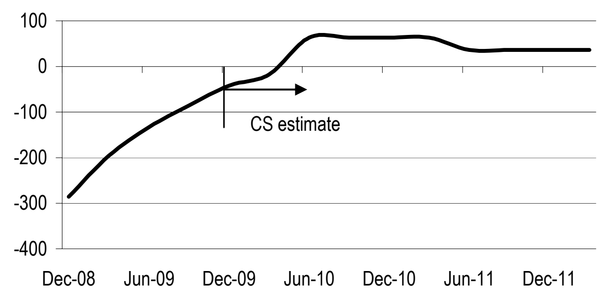
Forex losses as % of PBT before forex



Source: Company data, Credit Suisse estimates

Figure 65: **Forex losses set to turn into gains next year**

Forex losses in US$ mn



Source: Company data, Credit Suisse estimates

We note that these are cash losses from cash-flow hedging.

41% EPS growth in FY3/11E, aided by forex

We build in 15% YoY EPS growth for Polaris (ex-forex) for FY3/11E. However, given the expected profile of forex losses, the reported EPS growth could come to about 41% YoY for the company.

Figure 66: **EPS growth – reported and adjusted for forex losses**

(Rs mn)	FY3/10	FY3/11E	FY3/12E
Net profit (reported basis)	1,483	2,089	2,299
EPS (reported basis)	15.0	21.2	23.3
% YoY	**13.4**	**40.8**	**10.1**
Net profit (Forex adj.)	1,761	1,836	2,046
EPS (Forex adj.)	16.9	19.4	21.6
% YoY	**2.5**	**14.9**	**11.0**

Source: Company data, Credit Suisse estimates

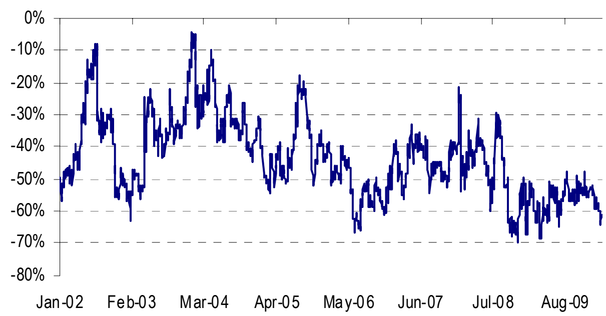
Valuations cheap, cash provides downside protection

Polaris is trading at 8.3x its 12-month forward P/E based on consensus, which is at the lower half of its historical range of 4-19x. The P/E discount to Infosys at 62% is also at the higher end of the historical range of 18-70%. Thus, the stock is inexpensive when valued on forward earnings multiples.

Figure 67: Polaris's 12M fwd P/E based on consensus

Source: Company data, Credit Suisse estimates

Figure 68: P/E discount to Infy (based on consensus)



Source: Company data, Credit Suisse estimates

Further, Polaris had over Rs5 bn of cash on its balance sheet in December 2009. This translates into about 30% of its market cap at current prices, providing good downside protection to the stock.

Estimates higher than consensus

With higher growth expectations and better margins built in, our EPS estimates are 9% and 6% above consensus for FY11 and FY12, respectively.

Figure 69: Polaris estimates – CS vs consensus

	CS			Consensus estimates			CS versus consensus (%)		
Year-end 31 March	**2010E**	**2011E**	**2012E**	**2010E**	**2011E**	**2012E**	**2010E**	**2011E**	**2012E**
Revenue (Rs mn)	13,495	15,675	18,004	13,475	14,908	17,108	0.2	5.1	5.2
EPS (Rs)	15.0	21.2	23.3	15.3	19.4	22.0	-1.6	9.1	6.0

Source: Company data, Credit Suisse estimates

Initiating with OUTPERFORM and Rs200 target price

We initiate coverage of Polaris as a tactical OUTPERFORM as we expect the company to deliver strong growth in the near term. Our target price of Rs200 (17% upside to current prices) is based on a P/E of 10.5x (a 50% discount to our Infosys target multiple – in line with history) on normalised (forex adjusted) FY3/11E EPS of Rs19.4 (Figure 66). Note that reported earnings for Polaris in FY3/11E would be 9% higher than the normalised EPS we have used in our target price.

We highlight that our OUTPERFORM rating on Polaris is a near-term tactical call, based on the current strong momentum for the company.

Key risks to our positive view on Polaris include:

- Unexpected weakness in the largest customer account – Citigroup – which could lead to weak top-line growth and downside risks to our profit estimates
- If the expected strong demand from BFSI segment does not materialise, our estimates would be at risk since Polaris has among the highest exposures to this segment.
- Sharp appreciation of the rupee, which could impact margins and profitability.

Financial summary

Figure 70: **Polaris – financial summary**

Year-end 31 March (Rs mn)	2007A	2008A	2009A	2010E	2011E	2012E
Income statement						
Net sales	10,324	10,993	13,779	13,495	15,675	18,004
Gross profit	3,260	3,086	4,538	4,444	5,125	5,872
Gross margins (%)	31.6	28.1	32.9	32.9	32.7	32.6
EBIT	1,132	722	1,948	1,854	2,116	2,415
EBIT margins (%)	**11.0**	**6.6**	**14.1**	**13.7**	**13.5**	**13.4**
Depreciation	481	460	388	347	370	435
EBITDA	1,613	1,182	2,335	2,200	2,485	2,851
EBITDA margins (%)	15.6	10.8	16.9	16.3	15.9	15.8
Total non-operating income	63	173	(453)	(101)	486	457
Pre-tax income	1,194	895	1,494	1,752	2,602	2,872
Income tax exp/(gains)	199	161	209	265	513	573
Net income	1,011	733	1,307	1,483	2,089	2,299
EPS (Rs)	**10.3**	**7.4**	**13.2**	**15.0**	**21.2**	**23.3**
Balance sheet						
Total current assets						
Cash and short-term investments	930	1,551	3,400	5,278	6,951	8,883
Receivables and other current assets	3,987	4,550	4,225	3,520	4,213	4,754
Net fixed assets						
Gross fixed assets	4,417	4,717	5,427	5,776	6,089	6,449
Less : depreciation	(2,186)	(2,583)	(3,137)	(3,507)	(3,877)	(4,312)
Capital work in progress	-	-	-	-	-	-
Other assets	414	207	392	697	697	697
Total assets	**7,562**	**8,441**	**10,306**	**11,763**	**14,073**	**16,470**
Total current liabilities	1,529	1,848	2,509	2,864	3,428	3,868
Total other long-term liabilities	18	18	70	98	98	98
Total equity	6,015	6,575	7,727	8,801	10,547	12,504
Minority interest	-	-	-	-	-	-
Total liabilities	**7,562**	**8,441**	**10,306**	**11,763**	**14,073**	**16,470**
Cash flow statement						
Net income	1,011	733	1,307	1,483	2,089	2,299
Add : Depreciation	437	397	554	370	370	435
Total gross cash flows	1,400	954	2,311	1,950	1,972	2,278
Change in working capital	(771)	(244)	986	1,060	(129)	(101)
Cash flow from operation	**629**	**711**	**3,298**	**3,010**	**1,843**	**2,177**
Change in LT investments – share of profit	8	-	-	-	-	-
Change in fixed asset	(292)	(300)	(710)	(349)	(313)	(360)
Change in other asset	(57)	207	(184)	(305)	-	-
Cash flow from investing	**(270)**	**88**	**(859)**	**(464)**	**(50)**	**(17)**
Equity dividend	(253)	(173)	(342)	(342)	(342)	(342)
Change in debt and liabilities	(16)	0	52	28	-	-
Change in equity	(152)	(1)	186	(67)	-	0
Cash flow from financing	**(429)**	**(181)**	**(592)**	**(672)**	**(120)**	**(228)**
Change in cash	**(71)**	**618**	**1,846**	**1,873**	**1,673**	**1,932**

Source: Company data, Credit Suisse estimates

Figure 71: **Polaris – key ratios**

Year-end 31 March	2007A	2008A	2009A	2010E	2011E	2012E
Margins (%)						
Gross margins	31.6	28.1	32.9	32.9	32.7	32.6
EBITDA margins	15.6	10.8	16.9	16.3	15.9	15.8
EBIT margins	11.0	6.6	14.1	13.7	13.5	13.4
Net profit margins	9.8	6.7	9.5	11.0	13.3	12.8
YoY growth (%)						
Revenue growth	25.1	6.5	25.3	-2.1	16.2	14.9
Gross profit growth	52.5	-5.3	47.0	-2.1	15.3	14.6
EBITDA growth	109.2	-26.7	97.6	-5.8	13.0	14.7
EBIT growth	309.6	-36.2	169.9	-4.8	14.1	14.2
Net profit growth	374.2	-27.4	78.3	13.4	40.9	10.1
Return ratios (%)						
ROE	17.4	11.7	18.0	18.0	21.6	19.9
ROIC	16.9	10.2	26.6	28.9	34.6	37.1
Turns ratios (x)						
Working capital turns	3.0	2.9	4.5	6.7	6.7	6.7
Fixed asset turns	4.6	5.2	6.0	5.9	7.1	8.4

Source: Company data, Credit Suisse estimates

Figure 72: **Polaris – operational parameters**

Year-end 31 March	2007A	2008A	2009A	2010E	2011E	2012E
Billing rates YoY growth %						
Onsite	-8.5	-3.2	-4.9	7.5	3.1	0.0
Offshore	-18.7	-1.1	6.3	5.0	2.4	0.0
Blended	-9.5	-0.5	-0.2	0.7	2.7	0.0
Billed man months YoY growth %						
Onsite	13.9	3.8	2.7	-7.5	14.0	20.7
Offshore	24.9	18.7	10.8	-2.9	12.1	18.0
Total	21.0	13.7	8.4	-4.2	12.6	18.7
Revenue						
Onsite YoY growth (%)	26.2	11.5	5.5	-13.1	16.1	20.7
Offshore YoY growth (%)	32.6	19.5	13.0	-2.5	14.4	18.0
Onsite (% of revenue)	62.5	60.9	59.2	56.4	56.8	57.4
Utilisation						
Utilisation rates (%)	71.0	72.6	72.5	74.3	77.1	76.6

Source: Company data, Credit Suisse estimates

Asia Pacific / India
Computer Services & IT Consulting

Hexaware Technologies

(HEXT.BO / HEXW IN)

Rating	UNDERPERFORM* [V]
Price (05 Apr 10, Rs)	69.60
Target price (Rs)	60.00[1]
Chg to TP (%)	-13.8
Market cap. (Rs mn)	10,049.96 (US$ 226.43)
Enterprise value (Rs mn)	5,344
Number of shares (mn)	144.40
Free float (%)	71.35
52-week price range	99.05 - 27.10

**Stock ratings are relative to the relevant country benchmark.*
[1]Target price is for 12 months.
[V] = Stock considered volatile (see Disclosure Appendix).

Research Analysts

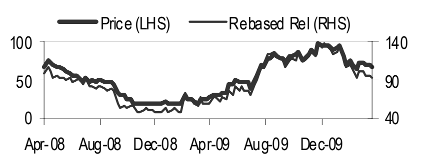
Sunil Tirumalai
9122 6777 3714
sunil.tirumalai@credit-suisse.com

Bhuvnesh Singh
65 6212 3006
bhuvnesh.singh@credit-suisse.com

Near-term headwinds could rock the boat

- **We initiate coverage of Hexaware with an UNDERPERFORM** rating and Rs60 target price (14% downside from current levels).
- **Hexaware has been facing a number of growth and margin headwinds in 2010** including: 1) ramp-downs in key customers leading to degrowth in the March 2010 quarter and sub-5% YoY growth for the full year, 2) the roll-back of wage cuts that were affected in 2009 and 3) continuing forex hedge losses (25-30% of PBT in nine months ended September 2010). With these factors, Hexaware could face about 22% earnings degrowth in 2010.
- **While top-line headwinds are reasonably well understood, we believe that margin implications are yet to be factored in** by consensus. We expect 2010 EBIT margin to decline 500 bp+ from 2009, on the back of weak top line, the roll-back of wage cuts and wage hikes forced by a booming job market. We expect consensus downgrades to follow weak results in the coming quarters – we are 12% and 5% below consensus for 2010 and 2011, respectively.
- **Hexaware is trading at 10x CY10E P/E, which is in line** with its historical average of 9-10x. The P/E discount to Infosys at 55% (CS estimate) is lower than historical levels. Our target price is based on 2010E P/E of 9x (a 60% discount to Infosys target-implied multiple – in line with history) applied on our 2010E EPS of Rs7.

Share price performance



The price relative chart measures performance against the India - NSE S&P CNX Nifty Index index which closed at 5368.4 on 05/04/10
On 05/04/10 the spot exchange rate was Rs44.38/US$1

Performance Over	1M	3M	12M
Absolute (%)	-3.7	-24.3	158.3
Relative (%)	-8.7	-25.6	54.5

Financial and valuation metrics

Year	12/09A	12/10E	12/11E	12/12E
Revenue (Rs mn)	10,386.0	10,161.1	11,977.9	12,952.6
EBITDA (Rs mn)	2,023.0	1,445.2	1,671.3	1,819.4
EBIT (Rs mn)	1,752.8	1,181.4	1,383.2	1,504.0
Net income (Rs mn)	1,342.8	1,045.1	1,540.0	1,698.4
EPS (CS adj.) (Rs)	9.14	7.03	10.35	11.42
Change from previous EPS (%)	n.a.			
Consensus EPS (Rs)	n.a.	11.0	13.2	—
EPS growth (%)	123.4	-23.1	47.3	10.3
P/E (x)	7.6	9.9	6.7	6.1
Dividend yield (%)	2.0	1.9	1.9	1.9
P/B (x)	1.2	1.1	1.0	0.9
ROE	15.8	11.2	14.4	13.9
Net debt/equity (%)	net cash	net cash	net cash	net cash

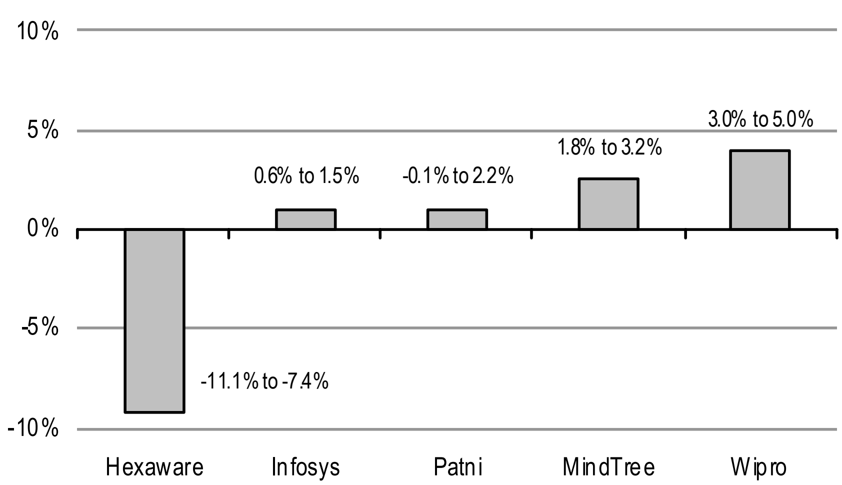
Source: Company data, Thomson Financial Datastream, Credit Suisse estimates.

Near-term headwinds could rock the boat

Near-term growth looks weak

The near-term growth outlook for Hexaware is at divergence with the positive outlook by sector peers – as the company is facing ramp-downs from two large customers (who are unique to Hexaware in the Indian IT services space). This is also visible in the divergence in the guidance for the March 2010 quarter versus other companies which give a quarterly guidance.

Figure 73: **March 2010 quarter QoQ revenue growth guidance**



Source: Company data, Credit Suisse estimates

Margins could come under pressure

After expanding sharply over five quarters, Hexaware's margins declined sharply in the December 2009 quarter, on the back of one-off items (in 3Q) and lower working days. Going forward, we expect margins to come under further pressure on the following factors:

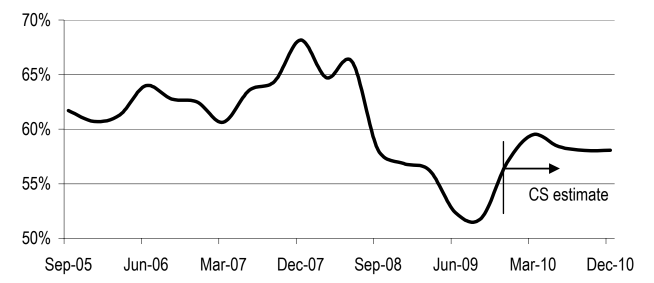
Weak top-line growth

An increase in utilisation rates had driven a large part of the margin increase last year, with utilisation increasing from 65% to 75% over four quarters. However, given the ramp-downs expected in the near term, we expect utilisation rates to decline once again, thus affecting margins.

Roll-back of wage cuts

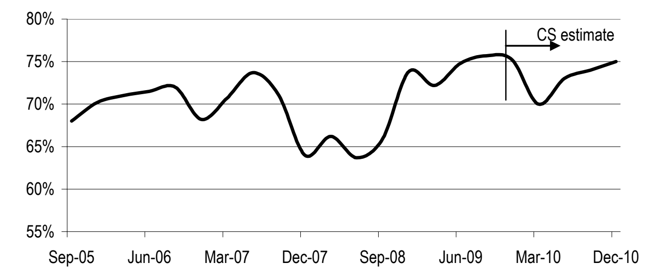
Hexaware has rolled back its 2009 wage cuts with effect from January 2010. This could have a 250-300 bp negative impact on margins. This would be accompanied by a wage hike in April 2010, giving further margin pressure.

Figure 74: **Direct costs as % of sales**



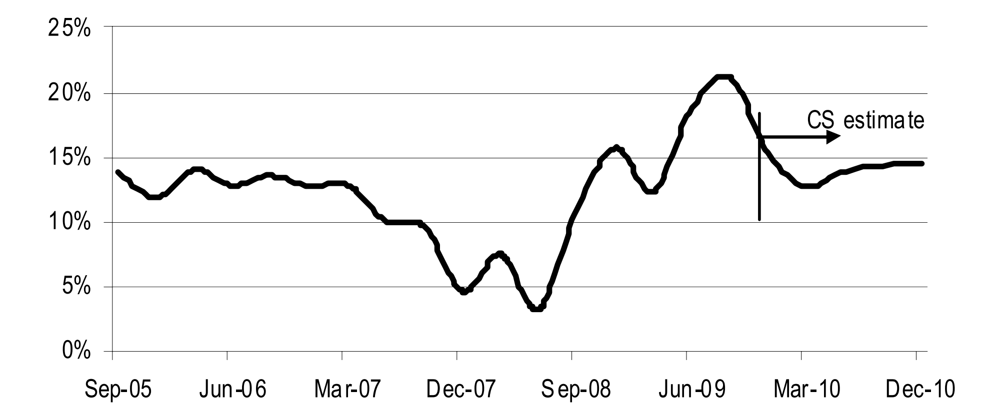
Source: Company data, Credit Suisse estimates

Figure 75: **Utilisation trend**



Source: Company data, Credit Suisse estimates

Figure 76: **EBIT margin trend**

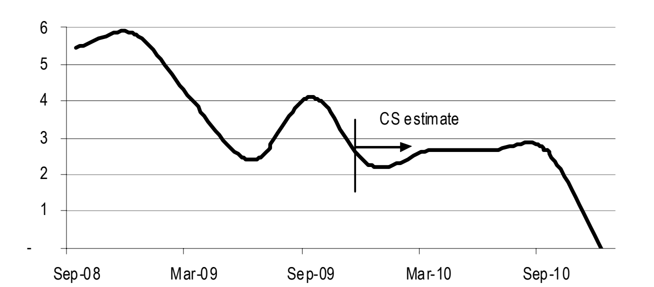


Source: Company data, Credit Suisse estimates

Forex losses to continue till September 2010

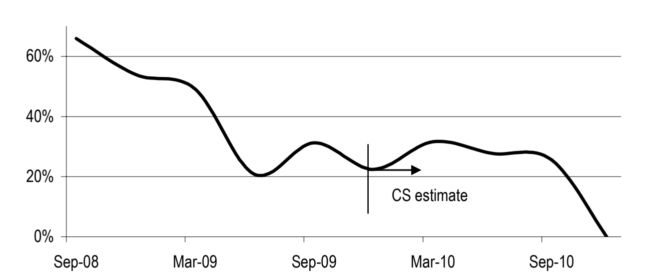
Due to past excesses, Hexaware has suffered large forex losses over the last two years which eroded profits. We note that though the peak of forex losses is now behind the company, it would remain significant for three more quarters. We estimate forex losses will erode 25-30% of PBT in nine months ending September 2010, before decreasing in intensity.

Figure 77: **Quarterly forex losses (US$ mn)**



Source: Company data, Credit Suisse estimates

Figure 78: **Forex losses as % of PBT before forex**



Source: Company data, Credit Suisse estimates

Expect earnings decline in 2010

Client-specific issues mentioned earlier should lead to a prospect of low single-digit growth for Hexaware in 2010, versus 15%-plus growth for peers.

Figure 79: USD-based organic growth rates for our coverage universe

USD-based revenue growth	QoQ growth (%)		YoY growth (%)	
Organic growth excluding acquisitions	**Mar-10E**	**Jun-10E**	**FY11E**	**FY12E**
Polaris	4.5	6.6	20.4	14.9
Hexaware	(6.5)	6.8	3.5	17.9
Infotech	3.6	6.2	21.5	19.4
Mphasis	4.4	4.3	19.9	16.9
Patni	3.6	4.7	15.4	19.5
MindTree	3.9	5.8	20.7	22.2
Mid-cap average	**3.3**	**5.1**	**17.8**	**18.2**
Infosys	4.5	5.9	22.7	21.2
TCS	4.5	5.7	22.2	18.6
Wipro	4.1	4.9	21.4	20.3
HCLT	3.1	3.6	14.7	14.3
Large-cap average	**4.2**	**5.3**	**21.1**	**19.2**

Note: FY11 corresponds to year ending Dec-09 for Patni and Hexaware, Jun-10 for HCLT, Oct-10 for Mphasis and year ending Mar-11 for all other companies.
Source: Company data, Credit Suisse estimates

This also should lead to a decline in EPS in 2010 over 2009, offset to some extent by reducing forex losses.

Figure 80: EPS growth – reported and adjusted for forex losses

(Rs mn)	2009	2010	2011
Net profit (reported basis)	1,343	1,047	1,555
EPS (reported basis)	9	7	10
% YoY	122.7	-22.9	47.3
Net profit (forex adj.)	1,756	1,282	1,638
EPS (forex adj.)	12	9	11
% YoY	87.0	-27.8	26.7

Source: Company data, Credit Suisse estimates

Initiate with UNDERPERFORM

Hexaware is trading at 6.2x its 12-month forward P/E, which is at the lower half of its historical range of 2-18x. The P/E discount to Infosys at 72% is also at the higher end of the historical range of 22-85%.

Figure 81: Hexaware's 12M fwd P/E based on consensus

Source: Company data, Credit Suisse estimates

Figure 82: P/E discount to Infy (based on consensus)

Source: Company data, Credit Suisse estimates

However, we believe that the consensus numbers do not fully factor in the revenue and margin headwinds. Our EPS estimates are 12% and 5% below consensus for 2010 and 2011, respectively, with a 22% earnings decline expected in 2010.

Figure 83: **Hexaware estimates – CS vs consensus**

	CS			Consensus estimates			CS versus consensus (%)		
Year-end December	**2010E**	**2011E**	**2012E**	**2010E**	**2011E**	**2012E**	**2010E**	**2011E**	**2012E**
Revenue (Rs mn)	10,161	11,978	12,953	10,095	11,334	13,547	0.7	5.7	-4.4
EPS (Rs)	7.0	10.5	11.6	8.0	11.0	13.2	-12.0	-4.8	-12.1

Source: Company data, Credit Suisse estimates

In this context, we believe that the stock is expensively valued. We initiate coverage of Hexaware with an UNDERPERFORM rating and Rs60 target price (implying 14% downside to current levels). Our target price is based on 2010E P/E of 9x (a 60% discount to Infosys target-implied multiple – in line with history) applied on our 2010E EPS of Rs7.

A possible buy-out candidate?

While the largest service line for Hexaware is the application development/maintenance segment, the company also has a number of unique strengths that could make it a good target for acquisition for MNCs looking to expand their offshore footprint. This could provide an upside risk to the share price.

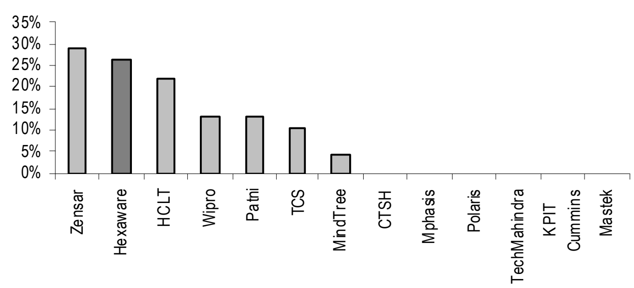
Strong enterprise solution practice

Hexaware boasts of a strong practise in enterprise application solutions, in particular a strong expertise in HR solutions (from its erstwhile Peoplesoft relationship). Within the Indian IT services landscape, Hexaware gets among the highest contribution from enterprise solutions as a percentage of total revenues.

Focused testing services business

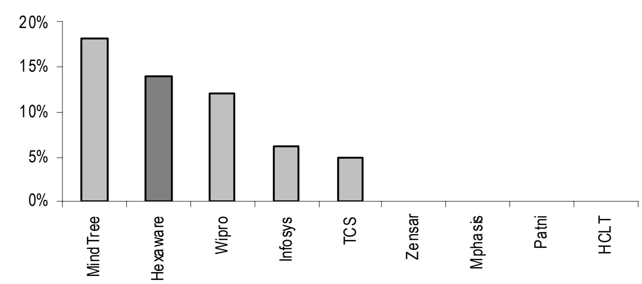
Hexaware has among the highest contribution to revenues from testing services in the industry. These are high-end testing skills (closer to consulting type of skills) obtained through the acquisition of FocusFrame in 2007.

Figure 84: **% share of revenues from enterprise solutions**



Source: Company data, Credit Suisse estimates

Figure 85: **% revenues from testing services**



Source: Company data, Credit Suisse estimates

Key risks to our negative view on Hexaware include:

- If company is able to quickly replace the ongoing project ramp downs with new business, there would be upside risks to our estimates.
- As we have pointed out above, Hexaware could be seen as an attractive buy-out candidate by MNC firms looking to expand offshore presence in India. Such an event could lead to open offers to minority shareholders at significant premiums, much above our target price.

Financial summary

Figure 86: **Hexaware – financial summary**

Year-end 31 Dec (Rs mn)	2007A	2008A	2009A	2010E	2011E	2012E
Income statement						
Net sales	**10,398**	**11,520**	**10,386**	**10,161**	**11,978**	**12,953**
Gross profit	3,493	4,174	4,473	3,722	4,258	4,613
Gross margins (%)	**33.6%**	**36.2%**	**43.1%**	**36.6%**	**35.5%**	**35.6%**
EBIT	968	1,098	1,753	1,181	1,383	1,504
EBIT margins (%)	**9.3%**	**9.5%**	**16.9%**	**11.6%**	**11.5%**	**11.6%**
Depreciation	232	284	270	264	288	315
EBITDA	1,201	1,382	2,023	1,445	1,671	1,819
EBITDA margins (%)	11.5%	12.0%	19.5%	14.2%	14.0%	14.0%
Total non-oper. income	265	177	310	375	444	535
Pre-tax income	1,233	744	1,446	1,204	1,873	2,084
Income tax exp/(gains)	133	155	103	159	333	386
Net income	**1,101**	**590**	**1,343**	**1,045**	**1,540**	**1,698**
EPS (Rs)	**7.8**	**4.1**	**9.1**	**7.0**	**10.4**	**11.4**
Balance sheet						
Total current assets						
Cash and short-term investments	3,212	2,849	4,262	4,869	5,906	7,077
Receivables and other current assets	3,354	3,100	2,639	2,901	3,231	3,487
Net fixed assets						
Gross fixed assets	4,274	5,700	5,762	6,270	6,869	7,517
Less : depreciation	(997)	(1,202)	(1,404)	(1,668)	(1,956)	(2,271)
Capital work in progress	-	-	-	-	-	-
Other assets	45	84	110	110	110	110
Total assets	**9,888**	**10,531**	**11,369**	**12,482**	**14,160**	**15,920**
Total current liabilities	2,828	3,711	2,709	2,978	3,317	3,580
Total other long-term liabilities	-	-	-	-	-	-
Total equity	7,060	6,626	8,498	9,342	10,680	12,177
Minority interest	-	-	-	-	-	-
Total liabilities	**9,888**	**10,532**	**11,370**	**12,482**	**14,160**	**15,920**
Cash flow statement						
Net income	1,101	590	1,343	1,045	1,540	1,698
Add : Depreciation	232	284	270	264	288	315
Total Gross cash flows	**1,068**	**1,228**	**1,920**	**1,286**	**1,338**	**1,434**
Change in working capital	1,062	1,137	(541)	7	9	7
Cash flow from operation	**2,130**	**2,365**	**1,379**	**1,293**	**1,347**	**1,441**
Change in LT investments-share of profit	-	-	-	-	-	-
Change in fixed asset	(1,008)	(1,505)	(130)	(508)	(599)	(648)
Change in other asset	(48)	(39)	(26)	-	-	-
Cash flow from investing	**(1,056)**	**(1,544)**	**(156)**	**(508)**	**(599)**	**(648)**
Equity Dividend	(155)	(168)	(202)	(202)	(202)	(202)
Change in debt and liabilities	-	195	(32)	-	-	-
Change in equity	(1,386)	(856)	731	(0)	0	0
Cash flow from financing	**(1,276)**	**(1,183)**	**190**	**(179)**	**288**	**378**
Change in cash	**(202)**	**(363)**	**1,413**	**607**	**1,036**	**1,171**

Source: Company data, Credit Suisse estimates

Figure 87: **Hexaware – key ratios**

Year-end 31 Dec	2007A	2008A	2009A	2010E	2011E	2012E
Margins (%)						
Gross margins	33.6	36.2	43.1	36.6	35.5	35.6
EBITDA margins	11.5	12.0	19.5	14.2	14.0	14.0
EBIT margins	9.3	9.5	16.9	11.6	11.5	11.6
Net profit margins	10.6	5.1	12.9	10.3	13.0	13.3
YoY growth (%)						
Revenue growth	22.6	10.8	-9.8	-2.2	17.9	8.1
Gross profit growth	17.8	19.5	7.2	-16.8	14.4	8.3
EBITDA growth	-9.2	15.1	46.3	-28.6	15.6	8.9
EBIT growth	-13.7	13.4	59.6	-32.6	17.1	8.7
Net profit growth	-11.4	-46.4	127.7	-22.0	48.5	11.1
Return ratios (%)						
ROE	15.1	8.6	17.8	11.6	15.1	14.4
ROIC	18.9	16.4	29.3	18.6	20.7	20.8
Turns ratios (x)						
Working capital turns	5.2	10.9	13.8	10.7	11.7	11.2
Fixed asset turns	3.6	3.0	2.3	2.3	2.5	2.6

Source: Company data, Credit Suisse estimates

Figure 88: **Hexaware – operational parameters**

Year-end 31 Dec	2007A	2008A	2009A	2010E	2011E	2012E
Billing rates YoY growth %						
Onsite	1.1	3.5	2.5	3.0	0.0	0.0
Offshore	(1.9)	(1.3)	0.4	2.7	(0.0)	0.0
Blended	2.7	(1.0)	(1.1)	0.3	4.7	0.0
Billed man months YoY growth %						
Onsite	35.9	(0.6)	(22.2)	(1.7)	23.4	7.9
Offshore	26.6	7.2	(16.2)	5.0	9.4	7.7
Total	29.2	4.9	(17.8)	3.2	13.0	7.8
Revenue						
Onsite YoY growth (%)	37.4	2.9	(20.2)	1.2	23.4	7.9
Offshore YoY growth (%)	24.2	5.7	(15.8)	7.8	9.4	7.7
Onsite (% of revenue)	66.6	65.9	64.7	63.3	66.0	66.0
Utilisation						
Utilisation rate (%)	70.6	70.8	68.5	75.6	51.7	53.9

Source: Company data, Credit Suisse estimates

Asia Pacific / India
Software

Infotech Enterprises Ltd

(INFE.BO / INFTC IN)

Rating	**OUTPERFORM* [V]**
Price (05 Apr 10, Rs)	371.95
Target price (Rs)	440.00[1]
Chg to TP (%)	18.3
Market cap. (Rs mn)	20,643.23 (US$ 465.09)
Enterprise value (Rs mn)	15,490
Number of shares (mn)	55.50
Free float (%)	76.75
52-week price range	376.30 - 91.35

**Stock ratings are relative to the relevant country benchmark.*
[1]Target price is for 12 months.
[V] = Stock considered volatile (see Disclosure Appendix).

Research Analysts

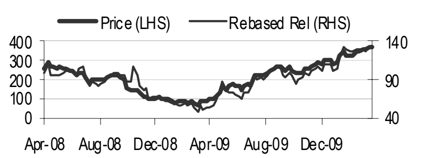
Sunil Tirumalai
9122 6777 3714
sunil.tirumalai@credit-suisse.com

Bhuvnesh Singh
65 6212 3006
bhuvnesh.singh@credit-suisse.com

Riding the engineering wave

- **We initiate coverage of Infotech with an OUTPERFORM** rating and Rs440 target price (18% potential upside).
- **Our positive thesis on Infotech is based on:** 1) its leadership position in the offshore engineering/R&D space which we believe would be a strong growth area, 2) the company's deep customer relationships, with increasing penetration into R&D budgets of top customers and 3) high margin upside stemming from low utilisation.
- **We expect Infotech to deliver industry leading FY11 growth in top line** (22% YoY in USD terms) and earnings (45% YoY). The company's recent contract wins from large customers like Hamilton Sundstrand should start flowing into numbers in the coming quarters, leading to strong growth and driving consensus upgrades (our FY3/11E EPS is 31% ahead of estimates).
- **Infotech is trading at 10x our FY3/11E P/E**, which is at the lower half of the historical range of 4-20x. The P/E discount to Infosys at 55% is also higher than historical averages. Our target price is based on P/E multiple of 11.5x applied on our FY3/11E EPS of Rs38.

Share price performance



The price relative chart measures performance against the India - NSE S&P CNX Nifty Index index which closed at 5368.4 on 05/04/10
On 05/04/10 the spot exchange rate was Rs44.82/US$1

Performance Over	1M	3M	12M
Absolute (%)	5.6	20.4	295.3
Relative (%)	0.1	18.4	136.4

Financial and valuation metrics

Year	3/09A	3/10E	3/11E	3/12E
Revenue (Rs mn)	8,897.5	9,637.6	11,771.8	14,053.0
EBITDA (Rs mn)	1,785.3	2,116.5	2,631.2	3,155.0
EBIT (Rs mn)	1,319.7	1,661.1	2,164.0	2,656.2
Net income (Rs mn)	924.5	1,616.9	2,101.4	2,646.2
EPS (CS adj.) (Rs)	20.20	29.42	37.97	47.81
Change from previous EPS (%)	n.a.			
Consensus EPS (Rs)	n.a.	27.0	28.6	31.9
EPS growth (%)	8.3	45.6	29.0	25.9
P/E (x)	18.4	12.6	9.8	7.8
Dividend yield (%)	1.0	0.5	0.5	0.5
P/B (x)	1.2	2.2	1.8	1.5
ROE	11.0	16.2	17.6	18.3
Net debt/equity (%)	net cash	net cash	net cash	net cash

Source: Company data, Thomson Financial Datastream, Credit Suisse estimates.

Riding the engineering wave

Engineering outsourcing is a different ball game

While many IT services companies do offer engineering outsourcing services (in addition to pure-play engineering services firms), it is important to understand that the engineering services market is different from the IT services market in many aspects.

Most importantly, the customer in engineering services is normally the head of the research/new product development teams at customer organisation, while the customer in a IT services project is the CIO of the client organisation. Engineering services projects are normally shorter and more likely to be from the discretionary budget component.

Figure 89: **Comparison between engineering services and IT services**

	Engineering services	**IT services**
Target division within customer organisation	Engineering /R&D department	IT division / CIO
Contract structure	Shorter duration projects Low annuity component	Longer duration projects High annuity component
Targeted budget	Largely discretionary	Largely non-discretionary
Key value proposition	Reduced time-to-market for new products	Reduced execution time
Key skills required	Engineering/design skills	IT/software skills

Source: Company data, Credit Suisse estimates

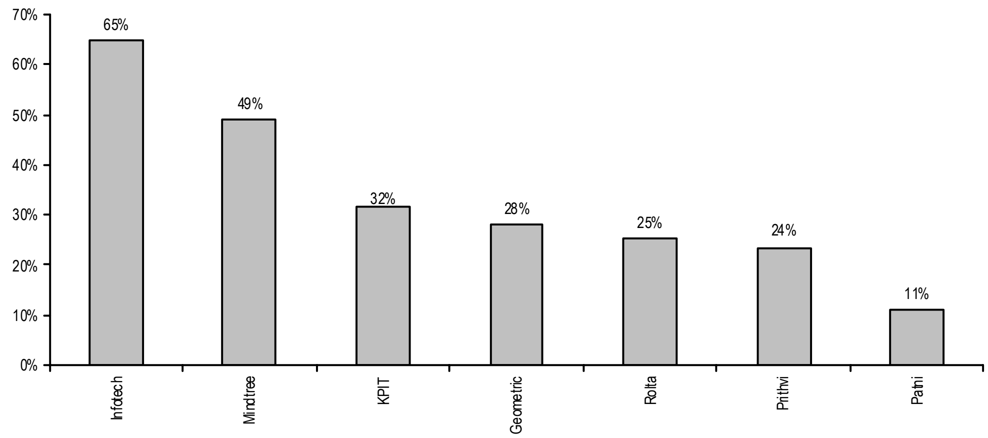
By outsourcing engineering/R&D efforts, customer organisations gain from shorter time-to-market of new products. In addition, customer organisations are also looking towards outsourcing destination countries as end-markets themselves – in which case local support becomes important.

Infotech is the leader in offshore engineering services

Earlier we discussed the growth potential offered by offshoring of engineering and R&D services to Indian companies. Infotech Enterprises has the highest exposure to engineering services in the Indian IT services space, at 65% of sales.

To give an indication of the growth potential in this business, the engineering division of Infotech has risen at a 25% four-year CAGR on revenues, helping the company transform from a high focus on lower-margin GIS business to greater focus on engineering services. We note that contracts in engineering and R&D (ER&D) are typically of long duration unlike regular IT services contracts – giving good revenue visibility.

Figure 90: **Revenue exposure to engineering services**



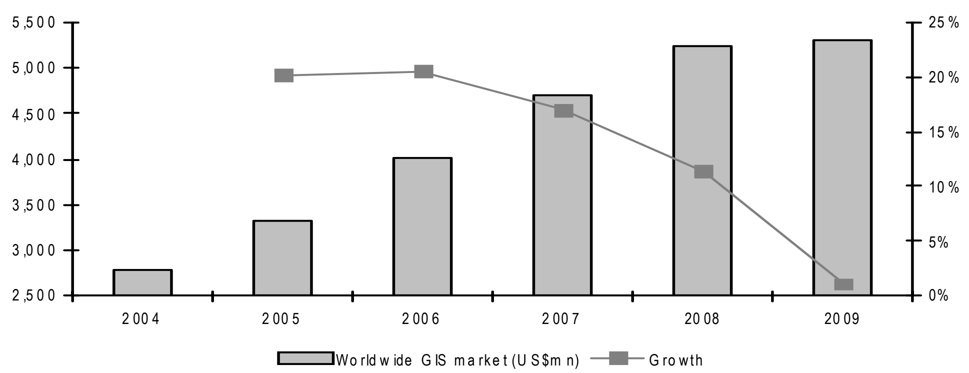
Source: Company data, Credit Suisse estimates

GIS services – low margin but potential is large

Worldwide GIS industry expected to grow at a 9% CAGR

The worldwide market for Geospatial Information Systems (GIS) is estimated at US$5.3 bn in 2009, and is forecast to grow 50% over the next five years, representing a compound annual growth rate of 9.3% (source: ARC Advisory Group). We note that the growth rate has averaged 11% over the last six years (source: Datatech).

Figure 91: **Worldwide GIS market**



Source: Company data, Credit Suisse estimates

Customers from non-cyclical industries

Customers for GIS services companies like Infotech are from the non-cyclical industries like utilities (telecom, transportation, water supply, power) and government (city municipalities, defence forces, land records, police and internal security). These customers could be shielded from economic cycles (with the probable exception of telecom) unlike customer industries of traditional Indian IT services companies like banking, financial services and manufacturing. Other industries which are customers for GIS services companies include oil and gas.

Penetrating deeper into customer relationships

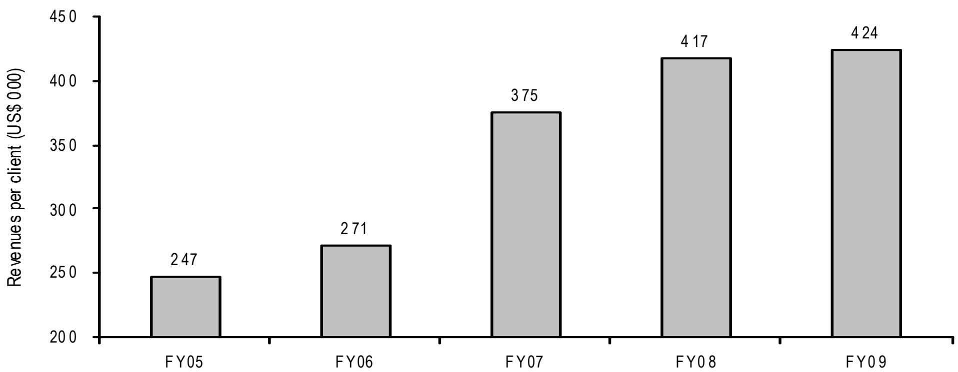
Over a period of time, Infotech has been able to develop deep relationships with many large companies in its target segment. This has enabled it to capture a greater share of customer wallet as indicated by increasing revenue per customer.

Figure 92: **Infotech has strong relationships with key customers**

UTC companies	■ Partnership started in the year 2000. ■ In December 2008, UTC awarded ACE (Achieving Competitive Excellence) Supplier Gold to Infotech in recognition of excellent quality of services. ■ In January 2009, UTC conveyed its long-term commitment to receive engineering services from Infotech by extending the contract for offshore engineering services for six years.
Bombardier	■ Relationship started in FY04. ■ In FY09, Bombardier signed a new agreement to extend the relationship for a further five years. ■ In the same year, five associates from Infotech won "Bogies Engineering Awards"
Boeing	■ Established direct business relationship in FY08. ■ Infotech team was awarded by Boeing Partner Council after helping reduce the weight of a critical component by 35% by optimising the design. ■ In FY09, 13 associates received the "Pride at Boeing Awards".
Tele Atlas	■ Largest GIS customer. ■ In FY09, Infotech acquired a 10% stake in Tele Atlas Kalyani (India) Limited (TAKI).

Source: Company data, Credit Suisse estimates

Figure 93: **Infotech has been able to successfully mine more revenues per client**



Source: Company data, Credit Suisse estimates

Recently, Infotech signed a large new contract with its key client Hamilton Sundstrand (part of UTC group), which will ramp up to 400 employees in three years (13% of current employee base in the ER&D segment). Along with another large contract in the ER&D segment, the company has visibility on at least 600 employee hires for FY3/11 (20% of the current ER&D headcount).

Expect sector leading growth

We build in 22% YoY growth for Infotech in FY11 (USD based), higher than the rest of the mid-cap space and on par with large-cap companies. A strong visibility through recent contract wins drives on confidence on near-term growth for the company.

Figure 94: **USD-based organic growth rates for our coverage universe**

USD-based revenue growth	**QoQ growth (%)**		**YoY growth (%)**	
Organic growth excluding acquisitions	**Mar-10E**	**Jun-10E**	**FY11E**	**FY12E**
Polaris	4.5	6.6	20.4	14.9
Hexaware	(6.5)	6.8	3.5	17.9
Infotech	3.6	6.2	21.5	19.4
Mphasis	4.4	4.3	19.9	16.9
Patni	3.6	4.7	15.4	19.5
MindTree	3.9	5.8	20.7	22.2
Mid-cap average	**3.3**	**5.1**	**17.8**	**18.2**
Infosys	4.5	5.9	22.7	21.2
TCS	4.5	5.7	22.2	18.6
Wipro	4.1	4.9	21.4	20.3
HCLT	3.1	3.6	14.7	14.3
Large-cap average	**4.2**	**5.3**	**21.1**	**19.2**

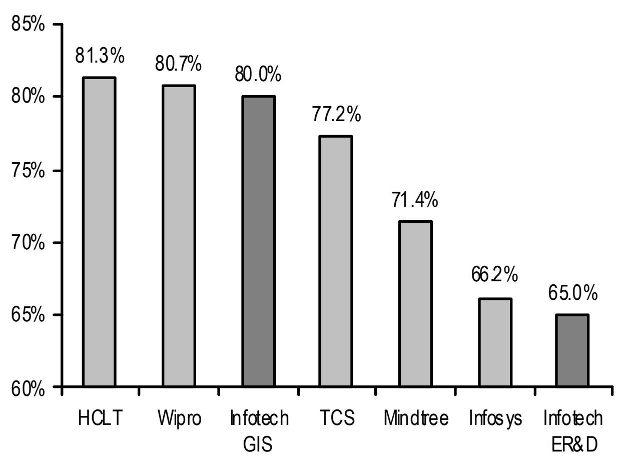
Note: FY11 corresponds to year ending Dec-09 for Patni and Hexaware, Jun-10 for HCLT, Oct-10 for Mphasis and year ending Mar-11 for all other companies.

Source: Company data, Credit Suisse estimates

Low utilisation gives good margin upside …

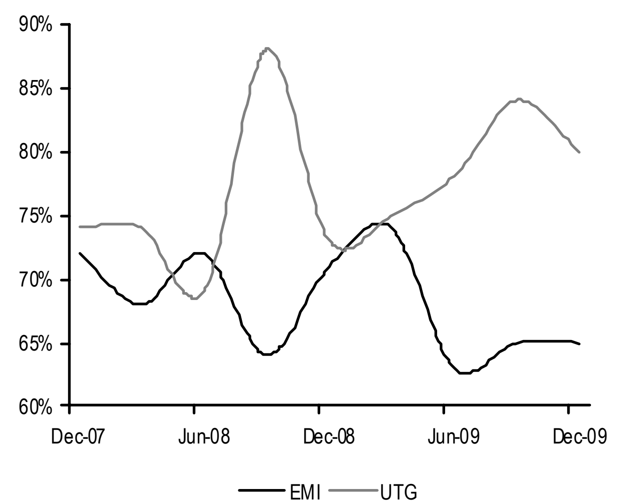
Infotech has low utilisation in the ER&D segment, which provides it with significant operating leverage in the scenario of increased demand.

Figure 95: **Infotech has low utilisation compared to peers**



Source: Company data for qtr ended Dec-09 (incl trainees)

Figure 96: **Infotech's EMI utilisation is at historical low**



Source: Company data

… leading to high earnings growth

As a result of strong growth and margin improvement, we expect Infotech to deliver about 30% earnings growth in FY3/11, at the higher end of the industry.

Figure 97: **Revenue and earnings growth for Infotech**

(%)	**FY3/09A**	**FY3/10E**	**FY3/11E**
Revenue growth (US$ based)	16.7	5.2	26.5
EBIT margins	14.8	17.2	18.4
EPS growth (Rs)	**8.3**	**45.6**	**29.0**

Source: Company data, Credit Suisse estimates

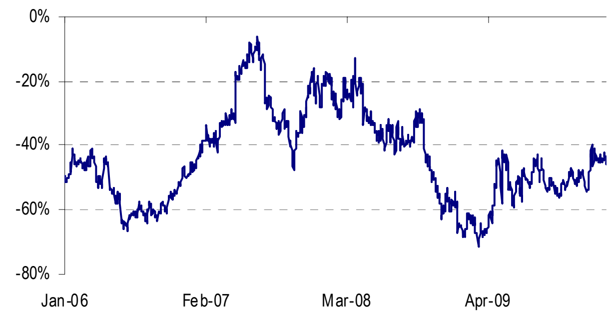
Consensus could be conservative

Infotech is trading at 11.9x its 12-month forward consensus P/E, which is in the middle of its historical range of 4x-20x. The P/E discount to Infosys at 46% is also in the middle of the historical range of 6%-72%. However, we believe that consensus estimates could be conservative on both growth and margins, and we expect upgrades to consensus as recent contract wins start flowing into revenues.

Figure 98: **Infotech 12M fwd P/E based on consensus**

Source: Bloomberg, Datastream

Figure 99: **P/E discount to Infy (based on consensus)**



Source: Bloomberg, Datastream

Figure 100: **Infotech estimates – CS vs consensus**

	CS			Consensus estimates			CS versus consensus (%)		
Year ended 31 March	**FY3/10E**	**FY3/11E**	**FY3/12E**	**FY3/10E**	**FY3/11E**	**FY3/12E**	**FY3/10E**	**FY3/11E**	**FY3/12E**
Revenue (Rs mn)	9,638	11,772	14,053	9,611	11,136	12,790	0.3	5.7	9.9
EPS (Rs/share)	29.4	38.0	47.8	27.2	29.0	32.3	8.2	31.1	47.9

Source: Company data, Credit Suisse estimates

Initiate with OUTPERFORM

We have a positive outlook on Infotech owing to growth visibility and margin upside potential. As a result, we initiate coverage of Infotech with an OUTPERFORM rating, with a Rs440 target price (18% upside to current levels). Our target price is based on P/E of 11.5x (a 50% discount to Infosys's target implied multiple – in line with history) applied on our FY3/11E EPS of Rs38.

Key risks to our positive view on Infotech include:

- Our thesis is based on expected ramp ups in recent contract signings with large customers of Infotech. If these ramp ups do not happen as expected, our revenue and profit numbers are at risk.
- Given the type of work undertaken by Infotech (Engineering / R&D), it is at greater risk of seeing revenues impacted if the global economy gets into another round of weakness.
- Adverse currency movements could lead to revenues and profits coming below our expectations.

Financial summary

Figure 101: **Infotech – financial summary**

Year-end 31 March (Rs mn)	2007A	2008A	2009A	2010E	2011E	2012E
Income statement						
Net sales	5,425	6,741	8,898	9,638	11,772	14,053
Gross profit	2,580	2,809	3,536	3,817	4,871	5,888
Gross margins	47.6%	41.7%	39.7%	39.6%	41.4%	41.9%
EBIT	878	853	1,320	1,661	2,164	2,656
EBIT margins	**16.2%**	**12.7%**	**14.8%**	**17.2%**	**18.4%**	**18.9%**
Depreciation	256	366	466	455	467	499
EBITDA	1,134	1,219	1,785	2,117	2,631	3,155
EBITDA margins	20.9%	18.1%	20.1%	22.0%	22.4%	22.5%
Total non-operating income	53	187	(335)	380	546	804
Pre-tax income	931	1,040	985	2,041	2,710	3,461
Income tax exp/(gains)	187	258	140	549	729	935
Net income	837	855	925	1,626	2,101	2,645
EPS (Rs)	**23.6**	**18.7**	**20.2**	**29.4**	**38.0**	**47.8**
Balance sheet						
Total current assets						
Cash and short-term investments	1,127	3,486	3,736	5,348	7,193	9,600
Receivables and other current assets	1,188	2,612	3,230	3,502	4,386	5,096
Net fixed assets						
Gross fixed assets	2,324	4,088	5,198	5,487	5,840	6,262
Less : depreciation	(1,183)	(1,793)	(2,189)	(2,645)	(3,112)	(3,611)
Capital work in progress	-	-	-	-	-	-
Other assets	30	(16)	165	165	165	165
Total assets	**3,484**	**8,377**	**10,140**	**11,856**	**14,472**	**17,512**
Total current liabilities	599	1,226	2,238	2,426	3,039	3,531
Total other long-term liabilities	152	424	195	195	195	195
Total equity	2,734	6,724	7,703	9,232	11,235	13,783
Minority interest	-	3	3	3	3	3
Total liabilities	**3,484**	**8,377**	**10,140**	**11,856**	**14,472**	**17,512**
Cash flow statement						
Net income	837	855	925	1,626	2,101	2,645
Add : Depreciation	256	366	466	455	467	499
Total Gross cash flows	947	963	1,645	1,572	1,902	2,220
Change in working capital	(105)	(798)	395	(83)	(272)	(218)
Cash flow from operation	**842**	**165**	**2,040**	**1,489**	**1,630**	**2,002**
Change in LT investments – share of profit	93	70	80	130	120	120
Change in fixed asset	(732)	(1,520)	(1,179)	(289)	(353)	(422)
Change in other asset	(4)	46	(181)	-	-	-
Cash flow from investing	**(577)**	**(1,179)**	**(1,575)**	**228**	**319**	**509**
Equity dividend	(61)	(88)	(97)	(97)	(97)	(97)
Change in debt and liabilities	149	276	(229)	-	-	-
Change in equity	(158)	3,224	152	0	-	0
Cash flow from financing	**(83)**	**3,374**	**(215)**	**(105)**	**(103)**	**(103)**
Change in cash	**182**	**2,359**	**249**	**1,612**	**1,845**	**2,407**

Source: Company data, Credit Suisse estimates

Figure 102: **Infotech – key ratios**

Year-end 31 March	2007A	2008A	2009A	2010E	2011E	2012E
Margins (%)						
Gross margins	47.6	41.7	39.7	39.6	41.4	41.9
EBITDA margins	20.9	18.1	20.1	22.0	22.4	22.5
EBIT margins	16.2	12.7	14.8	17.2	18.4	18.9
Net profit margins	15.4	12.7	10.4	16.9	17.8	18.8
YoY growth (%)						
Revenue growth	49.7	24.3	32.0	8.3	22.1	19.4
Gross profit growth	48.1	8.9	25.9	8.0	27.6	20.9
EBITDA growth	69.0	7.5	46.5	18.6	24.3	19.9
EBIT growth	80.9	-2.8	54.7	25.9	30.3	22.7
Net profit growth	66.5	2.1	8.2	75.9	29.2	25.9
Return ratios (%)						
ROE	30.7	16.6	11.7	17.6	19.4	20.2
ROIC	37.0	19.9	22.7	24.6	31.0	35.6
Turns ratios (x)						
Working capital turns	4.8	3.3	4.7	4.7	4.7	4.7
Fixed asset turns	4.8	2.9	3.0	3.4	4.3	5.3

Source: Company data, Credit Suisse estimates

Figure 103: **Infotech – operational parameters**

Year-end 31 March	2007A	2008A	2009A	2010E	2011E	2012E
Billing rates YoY growth %						
Onsite	10.8	7.4	2.8	-6.1	1.9	0.0
Offshore	6.1	0.7	1.9	0.4	2.1	0.0
Blended	6.2	0.7	0.1	-4.7	2.4	0.7
Billed man months YoY growth %						
Onsite	13.9	3.8	2.7	-7.5	14.0	20.7
Offshore	24.9	18.7	10.8	-2.9	12.1	18.0
Total	21.0	13.7	8.4	-4.2	12.6	18.7
Revenue						
Onsite YoY growth (%)	26.2	11.5	5.5	-13.1	16.1	20.7
Offshore YoY growth (%)	32.6	19.5	13.0	-2.5	14.4	18.0
Onsite (% of revenue)	62.5	60.9	59.2	56.4	56.8	57.4
Utilisation						
Utilisation rates (%)	71.0	72.6	72.5	74.3	77.1	76.6

Source: Company data, Credit Suisse estimates

Asia Pacific / India
Computer Services & IT Consulting

Mphasis Ltd

(MBFL.BO / MPHL IN)

Rating	NEUTRAL* [V]
Price (05 Apr 10, Rs)	637.65
Target price (Rs)	620.00[1]
Chg to TP (%)	-2.8
Market cap. (Rs mn)	133,727 (US$ 3,013)
Enterprise value (Rs mn)	115,989
Number of shares (mn)	209.72
Free float (%)	39.37
52-week price range	779.25 - 201.85

*Stock ratings are relative to the relevant country benchmark.
[1]Target price is for 12 months.
[V] = Stock considered volatile (see Disclosure Appendix).

Research Analysts

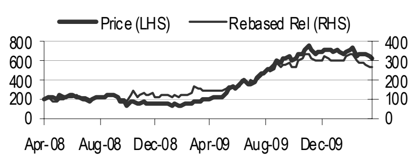
Sunil Tirumalai
9122 6777 3714
sunil.tirumalai@credit-suisse.com

Bhuvnesh Singh
65 6212 3006
bhuvnesh.singh@credit-suisse.com

The HP connection – good or bad?

- **We initiate coverage of Mphasis with a NEUTRAL** rating and Rs620 target price (3% downside).
- **We believe that Mphasis will continue to deliver strong volume growth** with downstream services revenues from parent HP. However, this could be offset by a few negatives that we are concerned about. We fear that the price cuts that started in the January 2010 quarter could continue in the coming quarters, leading to margin declines and low growth in profitability. The company could thus have sub-10% earnings growth over the next two years.
- **Repeated instances of price cuts from HP** could have strong negative implication on share prices, even though Mphasis could continue to deliver sector leading growth with high visibility in the HP account. Thus, we expect shares to be range bound. We also highlight the risk of adverse corporate action if HP decides to merge and delist Mphasis – we recall similar experience when Digital Globalsoft was delisted in 2003-04.
- **Mphasis is trading at 13.5x our 12M forward P/E**, which is in the lower half of its historical range of 4-28x. The P/E discount to Infosys at 35% is slightly higher than the historical level. Our target price is based on a P/E of 13x (a 40% discount to Infosys's target implied multiple – in line with historical average) on 12M forward EPS of Rs46.5.

Share price performance



The price relative chart measures performance against the BOMBAY SE 30 SHARE SENSITIVE index which closed at 17935.68 on 05/04/10
On 05/04/10 the spot exchange rate was Rs44.38/US$1

Performance Over	1M	3M	12M
Absolute (%)	-4.9	-13.1	203.3
Relative (%)	-9.9	-14.3	75.0

Financial and valuation metrics

Year	10/09A	10/10E	10/11E	10/12E
Revenue (Rs mn)	42,639.0	50,208.8	58,497.6	68,747.1
EBITDA (Rs mn)	11,274.7	11,963.8	13,803.2	17,520.4
EBIT (Rs mn)	9,252.5	9,984.9	11,656.4	15,134.9
Net income (Rs mn)	9,086.9	9,593.7	10,341.3	13,482.2
EPS (CS adj.) (Rs)	43.18	45.54	49.08	63.99
Change from previous EPS (%)	n.a.			
Consensus EPS (Rs)	n.a.	48.3	52.4	56.5
EPS growth (%)	205.5	5.5	7.8	30.4
P/E (x)	14.8	14.0	13.0	10.0
Dividend yield (%)	0.55	0.55	0.55	0.55
P/B (x)	5.8	4.2	3.2	2.5
ROE	38.7	29.7	24.8	24.8
Net debt/equity (%)	net cash	net cash	net cash	net cash

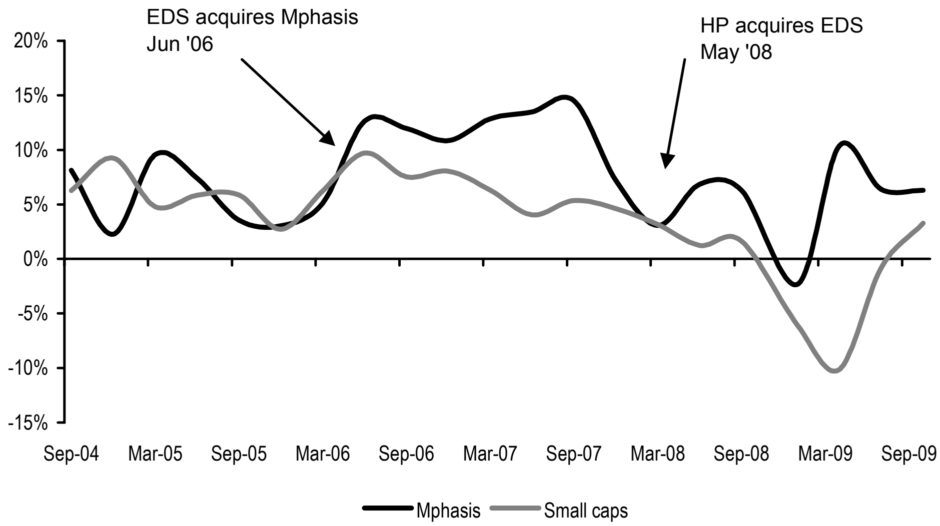
Source: Company data, Thomson Financial Datastream, Credit Suisse estimates.

The HP connection – good or bad?

The HP advantage

Ever since Mphasis got acquired by EDS in June 2006, the company has delivered growth rates higher than the rest of the mid-cap universe. This trend has continued post HP's acquisition of EDS. Mphasis is benefitting from being the captive offshore unit for internal/external work of HP.

Figure 104: QoQ revenue growth (USD based)



Note: 1) Only organic growth excluding impact of acquisitions is shown here 2) for Mphasis, qtr ending Jan-09 or later corresponds to qtr ending one month prior for mid-cap companies. For example, qtr ending Jan '09 corresponds to qtr ending Dec '08 for mid cap companies
Source: Company data, Credit Suisse estimates.

We expect Mphasis to continue to deliver decent growth rates over the next two years.

Figure 105: USD-based organic growth rates for our coverage universe

USD-based revenue growth	QoQ growth (%)		YoY growth (%)	
Organic growth excluding acquisitions	**Mar-10E**	**Jun-10E**	**FY11E**	**FY12E**
Polaris	4.5	6.6	20.4	14.9
Hexaware	(6.5)	6.8	3.5	17.9
Infotech	3.6	6.2	21.5	19.4
Mphasis	4.4	4.3	19.9	16.9
Patni	3.6	4.7	15.4	19.5
MindTree	3.9	5.8	20.7	22.2
Mid-cap average	**3.3**	**5.1**	**17.8**	**18.2**
Infosys	4.5	5.9	22.7	21.2
TCS	4.5	5.7	22.2	18.6
Wipro	4.1	4.9	21.4	20.3
HCLT	3.1	3.6	14.7	14.3
Large-cap average	**4.2**	**5.3**	**21.1**	**19.2**

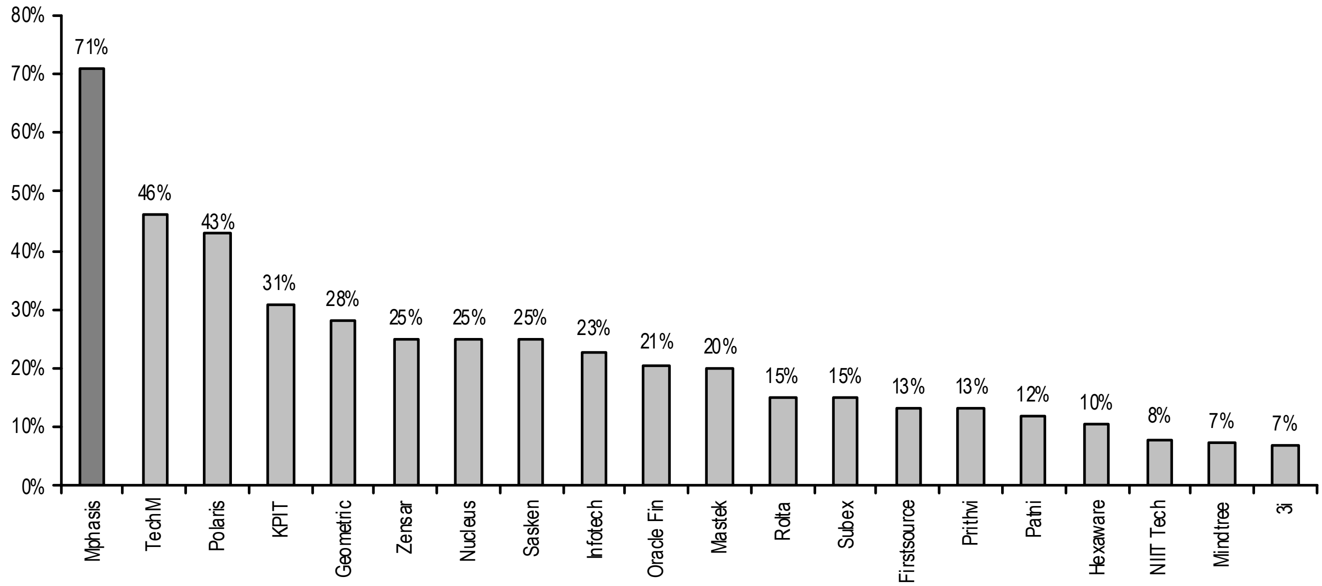
Note: FY11 corresponds to year ending Dec-09 for Patni and Hexaware, Jun-10 for HCLT, Oct-10 for Mphasis and year ending Mar-11 for all other companies.
Source: Company data, Credit Suisse estimates

The HP disadvantage

Expect further downward revisions to pricing

As discussed earlier, high customer concentration is risky for any IT services company. With an exposure of 71% to one customer, Mphasis is exposed to this risk.

Figure 106: **Revenue exposure to top client**



Source: Company data, Credit Suisse estimates

Further, in Mphasis's case, HP is also the majority shareholder (with a 61% stake), which increases the risk further. A case in point is TechMahindra – which recently renegotiated lower prices from its largest customer BT in return for committed volumes. We have already seen its impact in terms of recent rate cuts that Mphasis offered to HP in the January 2010 quarter (ITO pricing declined 18% QoQ).

We expect rate cuts to occur in the apps and BPO segments in the coming quarters – we expect pricing in these two segments to reduce 6-7% over the next 12 months from current levels.

Risk of delisting with adverse impact on minority shareholders – lessons from Digital Globalsoft

HP does not have any listed subsidiary globally, and it is reasonable to expect that Mphasis will be delisted and merged with HP over time. Past experience of a similar transaction involving HP shows that the merger may be detrimental to interests of minority shareholders:

- Digital Globalsoft became a subsidiary of HP when the latter acquired Compaq in 2002 (Digital Globalsoft was a 50.6% subsidiary of Compaq prior to this).
- In June 2003, a merger scheme between Digital Globalsoft and HP's India operations was announced, post which HP's stake in Digital Globalsoft increased to 76.2%. The merger scheme valued HP's India operations (HPISO) at 1.08x the market cap of Digital – despite HPISO having less than 60% of DG's sales and lower margins. Thus, the merger scheme was unfavourable to minority shareholders of Digital Globalsoft.
- In November 2003, HP announced an intention to buy back the remaining shares of Digitial Globalsoft and eventually delist the firm. The price was fixed at Rs750, at a 14% premium to the prevailing share price of Digital Globalsoft. However, after little

shareholder interest, HP was forced to raise the offer price to Rs850 in January 2004 (a 30% premium to pre-announcement price).

- The stock got delisted at end-March 2004, nine months after the first merger announcement.

HP's India operations excluding Mphasis have an headcount of about 30,000 as per the latest available numbers (end-2007).

Earnings growth to remain low for two years

While Mphasis could see strong top-line growth from the HP account, this could be at the cost of pricing (and margins) as we earlier explained. We expect the lower pricing to result in a 180 bp margin reduction from FY10/09 to FY10/10.

In addition, Mphasis is seeing an increase in tax rates due to phasing out of STPI units from tax breaks.

As a result of the above two factors, EPS growth for Mphasis could remain sub-10% over the next two years, in our view.

Figure 107: **Mphasis: revenue and EPS growth could diverge over the next two years**

(%)	FY10/09A	FY10/10E	FY10/11E
Revenue growth (US$ based)	20.5	25.0	16.9
EBIT margins	21.7	19.9	19.9
Tax rates	6.6	10.8	15.8
EPS growth (Rs based)	78.2	5.5	7.8

Source: Company data, Credit Suisse estimates

Valuations reasonable

Mphasis is trading at 13.1x its 12-month forward P/E, which is in the middle of its historical range of 4-28x. The P/E discount to Infosys at 40% is also in line with history.

Figure 108: **Mphasis 12M fwd P/E based on consensus**

Source: Bloomberg, Datastream

Figure 109: **P/E discount to Infy (based on consensus)**

Source: Bloomberg, Datastream

EPS estimates below consensus

While our revenue estimates for Mphasis are ahead of consensus for the next two years, our EPS estimates are about 6% below consensus owing to the margin headwinds we discussed earlier.

Figure 110: **Mphasis estimates – CS vs consensus**

	CS estimates			Consensus estimates			CS versus consensus (%)		
Year-end Oct	2010E	2011E	2012E	2010E	2011E	2012E	2010E	2011E	2012E
Revenue (Rs mn)	58,498	68,747	78,815	48,767	57,283	65,449	20.0	20.0	20.4
EPS (Rs)	45.5	49.1	64.0	48.3	52.4	56.5	-5.7	-6.4	13.2

Source: Company data, Credit Suisse estimates

Initiate with NEUTRAL

While Mphasis could continue to deliver strong top-line growth owing to momentum in the HP account, margin headwinds could keep earnings growth low. We thus initiate coverage on MindTree with a NEUTRAL rating and Rs620 target price (3% downside to current levels). Our target price is based on a P/E of 13x (a 40% discount to Infosys's target implied multiple – in line with historical average) on 12-month forward EPS of Rs46.5.

Key risks to our NEUTRAL rating on Mphasis include:

- We expect further pricing pressure from Mphasis' largest customer account – HP – in the coming quarters. However, if no price cuts happen, our revenue and profit estimates could see upside risk.
- We build industry-leading volume growth for Mphasis based on its strength in HP account. In case this volume growth does not materialise, our growth numbers are at risk.

Financial summary

Figure 111: **Mphasis – summary financials**

(Rs mn)	FY3/08A	FY10/08A	FY10/09A	FY10/10E	FY10/11E	FY10/12E
Income statement		7-month period				
Net sales	24,231	19,066	42,639	50,209	58,498	68,747
Gross profit	5,495	4,811	13,846	14,777	17,398	21,871
Gross margins	22.7%	25.2%	32.5%	29.4%	29.7%	31.8%
EBIT	2,792	2,880	9,253	9,985	11,656	15,135
EBIT margins	**11.5%**	**15.1%**	**21.7%**	**19.9%**	**19.9%**	**22.0%**
Depreciation	1,402	1,005	2,022	1,979	2,147	2,386
EBITDA	4,194	3,885	11,275	11,964	13,803	17,520
EBITDA margins	17.3%	20.4%	26.4%	23.8%	23.6%	25.5%
Total non-oper. income	(130)	218	475	776	633	1,227
Pre-tax income	2,662	3,098	9,728	10,761	12,289	16,362
Income tax exp/(gains)	109	143	641	1,167	1,948	2,880
Net income	2,553	2,955	9,087	9,594	10,341	13,482
EPS (Rs)	**12.25**	**14.13**	**43.18**	**45.54**	**49.08**	**63.99**
Balance sheet						
Current assets						
Cash and short-term investments	953	731	1,786	6,981	15,897	27,880
Receivables and other current assets	8,760	12,169	16,305	19,597	23,096	26,838
Net fixed assets						
Gross fixed assets	7,702	9,463	10,044	10,792	11,962	13,337
Less : depreciation	(4,824)	(6,058)	(6,880)	(8,671)	(10,817)	(13,203)
Capital work in progress	755	731	127	144	144	144
Other assets	2,709	3,304	11,253	14,391	14,391	14,391
Total assets	**16,054**	**20,340**	**32,635**	**43,234**	**54,672**	**69,387**
Total current liabilities	4,430	5,923	9,147	10,950	12,905	14,996
Total other long-term liabilities	57	54	35	26	26	26
Total equity	11,569	14,363	23,453	32,257	41,740	54,364
Minority interest	-	-	-	-	-	-
Total liabilities	**16,055**	**20,340**	**32,635**	**43,234**	**54,672**	**69,387**
Cash flow statement						
Net income	2,553	2,955	9,087	9,594	10,341	13,482
Add : Depreciation	1,402	1,005	2,022	1,979	2,147	2,386
Total gross cash flows	4,085	3,742	10,634	10,796	11,855	14,641
Change in working capital	(1,516)	(1,916)	(912)	(1,489)	(1,544)	(1,651)
Cash flow from operation	**2,569**	**1,826**	**9,722**	**9,308**	**10,312**	**12,990**
Change in LT investments-share of profit	-	-	(7,612)	(3,171)	-	-
Change in fixed asset	(2,516)	(1,508)	(1,177)	(953)	(1,170)	(1,375)
Change in other asset	179	(595)	(337)	33	-	-
Cash flow from investing	**(2,468)**	**(1,885)**	**(8,651)**	**(3,315)**	**(537)**	**(148)**
Equity Dividend	(807)	(490)	(858)	(858)	(858)	(858)
Change in debt and liabilities	28	(3)	(19)	(8)	-	-
Change in equity	(262)	329	861	69	0	(0)
Cash flow from financing	**(1,041)**	**(163)**	**(16)**	**(798)**	**(858)**	**(858)**
Change in cash	**(940)**	**(221)**	**1,055**	**5,195**	**8,916**	**11,984**

Source: Company data, Credit Suisse estimates

Figure 112: Mphasis – key ratios

	FY3/08A	FY10/08A	FY10/09A	FY10/10E	FY10/11E	FY10/12E
Margins (%)						
Gross margins	22.7	25.2	32.5	29.4	29.7	31.8
EBITDA margins	17.3	20.4	26.4	23.8	23.6	25.5
EBIT margins	11.5	15.1	21.7	19.9	19.9	22.0
Net profit margins	10.5	15.5	21.3	19.1	17.7	19.6
YoY growth (%)						
Revenue growth	37.6	34.9	30.5	17.8	16.5	17.5
Gross profit growth	24.4	50.1	67.9	6.7	17.7	25.7
EBITDA growth	37.1	58.8	69.3	6.1	15.4	26.9
EBIT growth	36.6	76.8	87.4	7.9	16.7	29.8
Net profit growth	41.8	98.4	79.4	5.6	7.8	30.4
Return ratios (%)						
ROE	23.6	22.8	48.1	34.4	28.0	28.1
ROIC	23.4	20.4	45.2	33.6	31.8	38.7
Turns ratios (x)						
Working capital turns	4.9	3.1	5.4	4.4	3.9	4.0
Fixed asset turns	6.8	4.1	10.3	17.2	30.5	74.2

Source: Company data, Credit Suisse estimates

Figure 113: Mphasis – operational parameters

	FY3/08A	FY10/08A	FY10/09A	FY10/10E	FY10/11E	FY10/12E
Billing rates YoY growth % (blended)						
Applications	2.7	6.5	2.1	4.5	-4.9	0.5
BPO	11.0	0.0	-8.7	-24.6	-4.4	0.0
ITO	8.2	2.2	4.5	-14.6	-2.1	2.7
Billed man months YoY growth %						
Applications	37.3	10.9	10.9	21.2	25.0	20.2
BPO	31.4	64.4	-8.7	35.8	15.2	8.3
ITO	116.2	81.0	-2.1	19.1	17.0	8.2
Revenue						
Onsite YoY growth (%)	37.5	27.9	18.3	31.6	28.9	23.3
Offshore YoY growth (%)	51.3	26.8	5.4	19.1	21.7	15.9
Onsite (% of revenue)	22.9	25.5	26.7	30.4	31.9	33.2
Utilisation						
Utilisation rates (%)	63.7	64.9	67.6	74.1	76.6	76.7

Source: Company data, Credit Suisse estimates

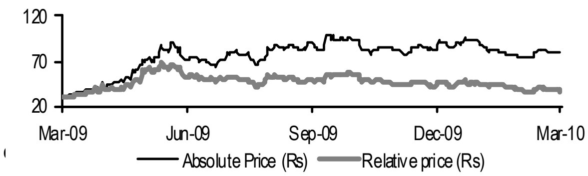
Non-rated company section

Notes from discussions with managements

3i Infotech

Figure 114: **Key numbers**

Year ending March 31st	FY08	FY09	9MFY10
YoY US$-based revenue growth (%)	106.6	62.7	2.7
EBIT margins (%)	19.1	15.9	15.3
YoY Rs-based EPS growth (%)	32.0	56.3	0.0
P/E (x)	5.8	3.7	4.2
Headcount			15,325
Annualised EPS	13.4	21.0	18.6



Source: Company data. Note: Relative price is with respect to Infosys

Expect FY3/11 to be a 15% YoY growth year

3i's management sees revenue growth of 15% in FY3/11. Strong growth in emerging markets could be offset by the weakness in developed markets:

- The US (55% of sales): Management has indicated that the demand environment is not yet recovered in the US – the larger companies could be benefitting from vendor consolidation. Management expects 5-8% YoY growth in the US in FY11. Growth would be driven by transaction processing and J&B product sales.
- W. Europe (6% of sales): Management expects about 5% YoY growth here.
- India (26%): India and South Asia could deliver 20%, driven by managed IT services and infrastructure management services. The largest account ICICI Bank could remain muted in FY11 – pricing pressure in this account continues.
- Middle-East (7% of sales): This market is expected grow 25% YoY, driven by banking product sales.
- APAC (4% of sales): Countries like Malaysia, Vietnam and Indonesia, which had gone slow on IT spending last year, have started opening up.

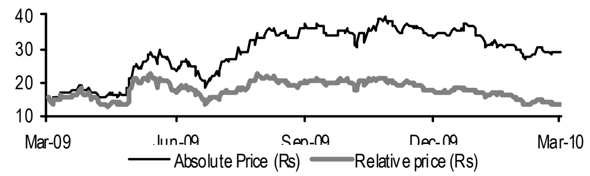
Margins to remain stable

Management expects margins to remain stable at current levels. While low margin transaction services are growing faster, this could be offset by strong growth in product revenues. IT services utilisation at 85% is at the optimal level, and may not go up much. Around 55% of sales come from non-linear business models, giving long-term upside to margins, said management.

Firstsource

Figure 115: **Key numbers**

Year ending March 31st	FY08	FY09	9MFY10
YoY US$-based revenue growth (%)	70.7	21.3	7.3
EBIT margins (%)	13.8	13.4	13.7
YoY Rs-based EPS growth (%)	-7.5	-76.9	nm
P/E (x)	9.3	40.5	9.5
Headcount	17,369	21,570	27,308
Annualised EPS	3.1	0.7	3.0



Source: Company data. Note: Relative price is with respect to Infosys

Growth could accelerate slightly into FY11

Firstsource's management has indicated that the growth rate in FY3/11 may be slightly higher (10-15% YoY) than the 10-11% constant currency YoY growth seen in FY3/10. This is because BPO companies are yet to see the resurgence in demand that IT companies have been enjoying over the last one to two quarters. For Firstsource in particular, transaction volumes should pick up (for example: more mortgages being issued) which is not yet happening.

Growth would continue to be driven by the US-based telecom, media and collections business. In the US, the payer segment is still weak though the provider segment is going strong. The non-collections part of BFSI could remain subdued for some more time. While FY10 was a high growth year in India's domestic business, FY11 could slow down.

Over the longer term, management expects an uplift in volumes of the US healthcare vertical from the new healthcare reforms.

In the short term, the March 2010 quarter growth could be strong on the back of US tax reimbursements.

Should reach 12% EBIT margins by FY12

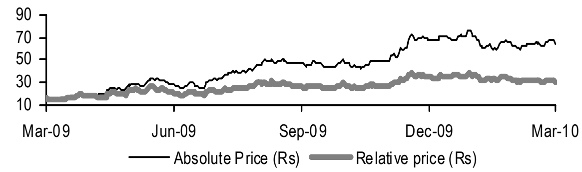
Management expects the margin gains of FY10 to continue over the next two years to reach 12% EBIT margins in FY3/12 (from 8% in FY09 and 10% in FY10). This would be on the back of: 1) improving margins in the collections business due to growth 2) improving profitability in the India business, which is currently negative at the EBIT level and 3) increased seat capacity utilisation from 80% currently to about 85% over the longer term.

However, over the near term, management expects utilisation to dip slightly on hiring.

Geometric

Figure 116: **Key numbers**

Year ending March 31st	**FY08**	**FY09**	**9MFY10**
YoY US$-based revenue growth (%)	133.4	6.5	-14.2
EBIT margins (%)	6.1	9.4	13.0
YoY Rs-based EPS growth (%)	-16.5	-127.0	193.2
P/E (x)	12.5	nm	8.7
Headcount	2,629	2,936	2,869
Annualised EPS	5.2	-1.4	7.5



Source: Company data. Note: Relative price is with respect to Infosys

Revenue growth has bottomed

Geometric's management has indicated that most customer budgets are finalised and expected to be flat for 2010. While customers were in a cost-cutting mode last year in trying to do away with non-essential services, this year the emphasis would be on IT/R&D investments that help market positioning for customers. Going by the order book visibility and recent wins, management feels that the revenue trend has bottomed out.

However, growth could remain low, as management expects the manufacturing vertical to take time to recover fully. Further, the recent eastern European crisis could delay good growth rates.

Dassault – the largest customer – has seen a nice ramp-up in business with 1,000 associates working for the customer now versus 850 a year ago. Geometric is also gaining share as a preferred vendor with Volvo and Caterpillar, explained management. Management expects Modern Engineering (the automotive vertical-focused engineering subsidiary) to start growing in FY3/11, after a couple of years of decline in revenues.

Increased hiring could bring down utilisation

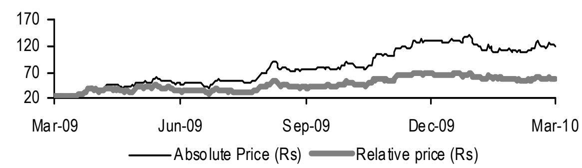
Most of the hiring over the past two years has been experienced hires, and management plans to increase fresher mix from this year. With this, management expects utilisation to come down by about 100 bp over the next couple of quarters. However, utilisation could remain high as 40% of the business is structurally on high utilisation (modern engineering due to onsite heavy nature and Dassault account due to high visibility).

Management has indicated that pricing pressure in the market has eased, though price increases are still some time away.

KPIT Cummins

Figure 117: **Key numbers**

Year ending March 31st	FY08	FY09	9MFY10
YoY US$-based revenue growth (%)	41.3	20.2	-15.7
EBIT margins (%)	11.1	15.8	18.7
YoY Rs-based EPS growth (%)	15.6	27.0	39.3
P/E (x)	18.0	14.2	10.8
Headcount	4,481	4,576	4,749
Annualised EPS	6.7	8.5	11.1



Source: Company data. Note: Relative price is with respect to Infosys

Cummins account to stabilise after last year's decline

The company's top account – Cummins (31% of sales) – shrunk considerably last year (a 17% decline QoQ in a single quarter). However, the account has now stabilised and management expects it to remain flat or grow slightly in FY3/11. Management has indicated that KPIT has gained share within the Cummins IT spend budget over the last couple of years

Automotive/semiconductor segments to be growth drivers

The automotive segment (27% of sales) is expected to grow strongly in the near term, driven by clients' R&D investments into hybrid cars and fuel efficient cars. Customers in this segment are expanding their spending on engineering/R&D post the downturn.

The semiconductor segment (5% of sales), had a weak December 2009 quarter due to the closure of key milestones in projects. However, these have now been replaced with new business and management expects growth to continue, along with growth in the automotive segment.

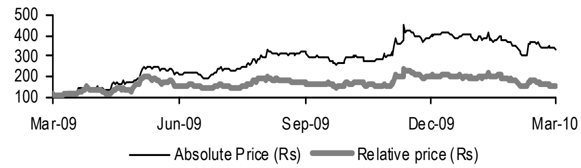
Upside on utilisation

Management sees significant upside to utilisation from current levels – offshore from 72% to 74-75% levels and onsite from 88% to 93-94% levels. This gives confidence on maintaining margins at 20%-plus levels, despite wage hikes expected from April 2010.

Mastek

Figure 118: **Key numbers**

Year ending June 30th	FY08	FY09	6MFY10
YoY US$-based revenue growth (%)	22.1	5.4	-26.3
EBIT margins (%)	14.2	15.2	13.8
YoY Rs-based EPS growth (%)	22.0	18.6	-31.1
P/E (x)	7.5	6.3	8.9
Headcount	4,071	3,759	3,363
Annualised EPS	44.2	52.5	37.1



Source: Company data. Note: Relative price is with respect to Infosys

Zurich implementation to go live next quarter

Zurich implementation of Elixir for Capita is currently on and would go live in the June 2010 quarter, explained management. This is part of the recent agreement with Capita, wherein Capita has agreed to pay £25 mn over 24 months for various implementations in Europe.

Post this implementation, Mastek would look for partners in the US for selling Elixir. Sales in the US have already started in a small way, with the roll-out of a distribution module in the last quarter.

BT account frozen for some time

Management has explained that the release of new budget from BT has been frozen for a while, and could remain the case for some time. Vendor consolidation by BT is also happening. However, given the long standing relationship of Mastek with BT, the impact on Mastek may be minimal, feels management.

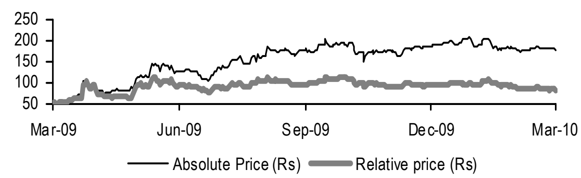
Utilisation near peak

The employee utilisation excluding virtual bench at 84%, is nearing all-time high. Depending on demand, the company will step up recruiting (both from within the virtual pool and outside).

Rolta

Figure 119: **Key numbers**

Year ending June 30th	FY08	FY09	6MFY10
YoY US$-based revenue growth (%)	62.3	7.5	1.3
EBIT margins (%)	23.5	20.2	19.1
YoY Rs-based EPS growth (%)	-33.3	27.1	42.3
P/E (x)	12.4	9.8	12.1
Headcount	5,269	4,980	4,763
Annualised EPS	14.4	18.3	14.8



Source: Company data. Note: Relative price is with respect to Infosys

About 15% growth expected, primarily driven by GIS

The GIS business (50% of sales) has remained stable through the downturn, and management expects this segment to deliver 15-20% YoY growth going forward. India accounts for 55% of sales in this segment, half of which is from the defence sector. Rolta is working on moving up the value chain in this segment, through offering SI and BI services.

In the engineering segment (25% of sales) revenues have stabilised after having fallen 25% in quarterly run-rate last year. 60% of revenues comes from the oil & gas sector, where demand has stabilised but recovered to earlier levels. Growth in the engineering space could be 10-15% YoY.

Among geographies, emerging markets (65% of sales) are driving growth while demand from North America is still subdued.

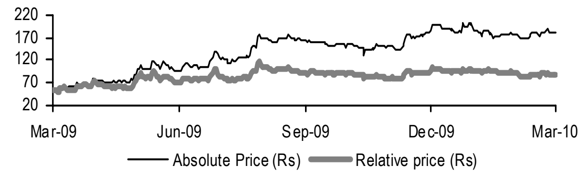
Margins could remain stable; product sales could provide long-term upside

Management believes that margins could remain stable at current levels despite increasing the share of higher value services, as costs are also increasing. However, over the longer term, rising product sales could help improve margins, feels management.

Sasken

Figure 120: **Key numbers**

Year ending March 31st	FY08	FY09	9MFY10
YoY US$-based revenue growth (%)	34.9	5.6	-25.1
EBIT margins (%)	6.6	18.1	12.2
YoY Rs-based EPS growth (%)	57.9	9.9	45.0
P/E (x)	13.2	12.0	6.9
Headcount	3,623	3,277	3,051
Annualised EPS	13.8	15.2	26.4



Source: Company data. Note: Relative price is with respect to Infosys

'Finding it difficult to keep up with demand'

After going through reducing demand last year, Sasken is seeing a sudden surge in demand starting January 2010. Many customer accounts that were small earlier have grown up quickly into sizeable accounts (For example, Samsung, Sony Ericsson, Infineon etc). In some areas, the company is finding it hard to service the rebound in demand. Sasken has been able to push price increases of 2-3% in January 2010 (after a price reduction that was taken in 2009).

The largest customer account – Nokia – is growing strongly. The long-standing relationship with Nokia is paying out with Nokia recognising Sasken as a key partner, says management.

While customer R&D budgets could remain flat in 2010 YoY, management is seeing a definite shift towards outsourcing. Growth is primarily driven by the handset/semiconductor segments while the network equipment segment is still weak.

Management's visibility into the top ten accounts (which account for 80% of sales) gives confidence to management on at least 20-25% YoY growth in FY3/11. After 10% QoQ growth in the December 2009 quarter, management expects to sustain 5%-plus growth in the March 2010 quarter.

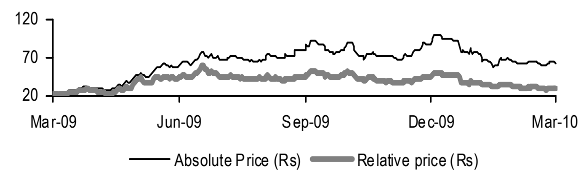
Will retain margins in narrow band

While high growth could provide margin upside, management would like to invest the surplus into the business, and limit EBITDA margins in a narrow range of 19-20%. The company is hiring heavily (100 net hires every month on a base of about 3,000), which could bring down utilisation (currently near all-time high of 80%). Wage hikes will be awarded in July 2010, and the quantum will depend on the market.

Subex

Figure 121: **Key numbers**

Year ending March 31st	**FY08**	**FY09**	**9MFY10**
YoY US$-based revenue growth (%)	60.2	-0.6	-24.9
EBIT margins (%)	-17.5	5.2	10.3
YoY Rs-based EPS growth (%)	-193.4	176.9	-152.2
P/E (x)	nm	nm	2.2
Headcount	1,175	1,075	1,180
Annualised EPS	-19.5	-54.1	27.7



Source: Company data,. Note: Relative price is with respect to Infosys

15-20% YoY growth expected in FY3/11

After a sharp 20% YoY revenue decline (in nine months ending December 2009), management expects FY3/11 to see 15-20% YoY revenue growth. The turn in growth trajectory could have started from the December 2009 quarter itself, when revenues grew 10% QoQ.

In general, customers have resumed decision making on IT spending. Management has explained that the company's area of specialisation in the telecom vertical (business optimisation) has started growing fast – versus 7-8% three years ago the industry is growing at about 20% levels currently. This is driven by increased focus on operational efficiency post the downturn.

Speaking on key clients, management said that the largest account (AT&T) has stabilised at around US$20 mn revenue run-rate, after having declined by a third a year ago. The second largest client – BT – (12% of sales) has also stabilised.

Margins could rise sharply

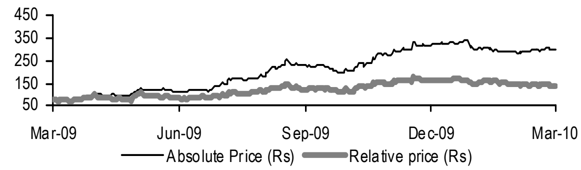
From current 28% EBITDA margins, management expects margins of 35-40% in two years. We note that all-time peak margins for the company were 41%.

The key margin driver would be strong product revenue growth on a relatively fixed cost base (apart from wage inflation, management does not expect an increase in any other cost component). This would also be aided by reducing share of low margin services business due to slower growth in this segment.

Zensar

Figure 122: **Key numbers**

Year ending March 31st	FY08	FY09	9MFY10
YoY US$-based revenue growth (%)	45.4	0.0	-1.8
EBIT margins (%)	11.2	12.7	16.8
YoY Rs-based EPS growth (%)	10.3	35.0	57.6
P/E (x)	11.0	8.2	5.3
Headcount	4,483	4,684	5,074
Annualised EPS	26.8	36.1	55.7



Source: Company data. Note: Relative price is with respect to Infosys

Early signs of demand recovery

Zensar's management has indicated that the US and UK markets are showing signs of recovery. In general, deal pipelines have improved and conversion rates have increased. Customer IT budgets are flat or have increased slightly for 2010.

In the US, a fair amount of Oracle/SAP implementation spends that was postponed is now coming back (the enterprise application segment accounts for 29% of Zensar's sales).

Among key customer accounts, Cisco (largest customer with 34% revenue contribution) is growing faster than the company. Fujitsu and Marks&Spencer accounts have remained stable over the last few quarters. Landmark and National Grid have seen slight declines.

The company is on the lookout for a suitable acquisition in the infrastructure management space, which currently accounts for about 10% of sales.

Margins could trend down

Zensar's management explained that utilisation rates at 85% are at optimal levels, and could go down on hiring. Management has planned for 1,000-1,200 hires over the next five quarters (as against December 2009 headcount of 5,074). Further, Zensar could make some investments into the sales team. All these factors could lead to a down trend in margins. In addition, there is uncertainty over currency.

Management has explained that wage hikes for the year were given in September 2009 quarter (about 8% on an average). During that process, the company also introduced a variable compensation structure.

Companies Mentioned *(Price as of 05 Apr 10)*
Accenture Plc (ACN, $41.84, OUTPERFORM, TP $55.00)
Acom (8572, ¥1,499)
ACS (ACS.MC, Eu35.10, UNDERPERFORM, TP Eu30.00, OVERWEIGHT)
Atos Origin (ATOS.PA, Eu38.40, OUTPERFORM, TP Eu47.00, OVERWEIGHT)
British Airways (BAY.L, 248.90 p, OUTPERFORM [V], TP 285.00 p, OVERWEIGHT)
BT Group (BT.L, 124.80 p, OUTPERFORM, TP 170.00 p, OVERWEIGHT)
Capgemini (CAPP.PA, Eu37.16, OUTPERFORM [V], TP Eu43.00, OVERWEIGHT)
Capita (CPI.L, 775.00 p, OUTPERFORM, TP 910.00 p, MARKET WEIGHT)
Cisco Systems Inc. (CSCO, $25.83, OUTPERFORM [V], TP $32.00)
Citi (C, $4.18, NEUTRAL [V], TP $4.50)
Cognizant Technology Solutions Corp. (CTSH, $50.81, OUTPERFORM, TP $52.00)
Computer Sciences Corp. (CSC, $54.25, NEUTRAL, TP $55.00)
Cummins Inc. (CMI, $62.34, OUTPERFORM [V], TP $68.00)
Dassault Systemes (DAST.PA, Eu44.56, NEUTRAL, TP Eu39.00, OVERWEIGHT)
Dell Inc. (DELL, $15.05, NEUTRAL [V], TP $12.50)
Fidelity National Information Services (FIS, $23.69, NEUTRAL, TP $25.00)
General Electric (GE, $18.33)
Genpact (G, $17.01, OUTPERFORM, TP $19.00)
Global Payments, Inc. (GPN, $45.64, NEUTRAL, TP $50.00)
HCL Technologies (HCLT.BO, Rs360.30, NEUTRAL [V], TP Rs320.00, MARKET WEIGHT)
Hewitt Associates, Inc. (HEW, $39.55)
Hewlett-Packard (HPQ, $53.24, OUTPERFORM, TP $65.00)
Hexaware Technologies (HEXT.BO, Rs69.60, TP Rs60)
ICICI Bank (ICBK.BO, Rs985.00, NEUTRAL [V], TP Rs804.00)
Indra (IDR.MC, Eu15.34, OUTPERFORM, TP Eu20.00, OVERWEIGHT)
Infosys Technologies Ltd. (INFY.BO, Rs2676.00, OUTPERFORM, TP Rs2900.00, MARKET WEIGHT)
Infotech Enterprises Ltd (INFE.BO, Rs371.95, TP Rs440)
International Business Machines (IBM, $128.25, NEUTRAL, TP $130.00)
Jack Henry & Associates (JKHY, $24.35, NEUTRAL, TP $24.00)
Logica (LOG.L, 138.10 p, UNDERPERFORM [V], TP 115.00 p, OVERWEIGHT)
Microsoft Corp. (MSFT, $29.16, OUTPERFORM, TP $36.50)
Mindtree Ltd (MINT.BO, Rs585.50, OUTPERFORM [V], TP Rs850.00, MARKET WEIGHT)
Mphasis Ltd (MBFL.BO, Rs637.65, TP Rs620)
Nokia (NOK1V.HE, Eu11.69, UNDERPERFORM [V], TP Eu9.00, MARKET WEIGHT)
Oracle Financial Services (ORCL.BO, Rs2308.00, UNDERPERFORM [V], TP Rs900.00, MARKET WEIGHT)
Patni Computer Systems Ltd. (PTNI.BO, Rs560.00, OUTPERFORM [V], TP Rs500.00)
Polaris Software Lab Ltd. (POLS.BO, Rs171.50, TP Rs200)
Shinsei Bank (8303, ¥114, NEUTRAL [V], TP ¥100, MARKET WEIGHT)
Syntel (SYNT, $38.44, NEUTRAL [V], TP $35.00)
Tata Consultancy Services (TCS.BO, Rs803.00, OUTPERFORM, TP Rs900.00, MARKET WEIGHT)
Tech Mahindra Limited (TEML.BO, Rs861.45, UNDERPERFORM [V], TP Rs760.00, MARKET WEIGHT)
Tieto (TIE1V.HE, Eu17.56, UNDERPERFORM, TP Eu12.00, OVERWEIGHT)
Total System Services (TSS, $15.83, NEUTRAL, TP $16.00)
United Technologies (UTX, $74.13)
Volvo (VOLVb.ST, SKr73.85, UNDERPERFORM [V], TP SKr45.00, MARKET WEIGHT)
Wipro Ltd. (WIPR.BO, Rs723.10, OUTPERFORM [V], TP Rs815.00, MARKET WEIGHT)
WNS Global Services (WNS.N, $11.40, OUTPERFORM [V], TP $17.00)
Xerox Corporation (XRX, $9.99)
3i Infotech (III IN, NOT RATED, Rs78)
Firstsource (FSOL IN, NOT RATED, Rs30)
Geometric (GEO IN, NOT RATED, Rs68)
KPIT Cummins (KPIT IN, NOT RATED, Rs118)
Mastek (MAST IN, Not rated, Rs336)
NIIT Technologies (NITEC IN, Not rated, Rs173)
Nucleus Software (NCS IN, Not rated, Rs146)
Prithvi Info (PRIS IN, Not rated, Rs66)
Rolta (RLTA IN, Not rated, Rs182)
Sasken (SACT IN, Not rated, Rs178)
Subex (SUBX IN, Not rated, Rs65)
Zensar (ZENT IN, Not rated, Rs276)

Disclosure Appendix

Important Global Disclosures

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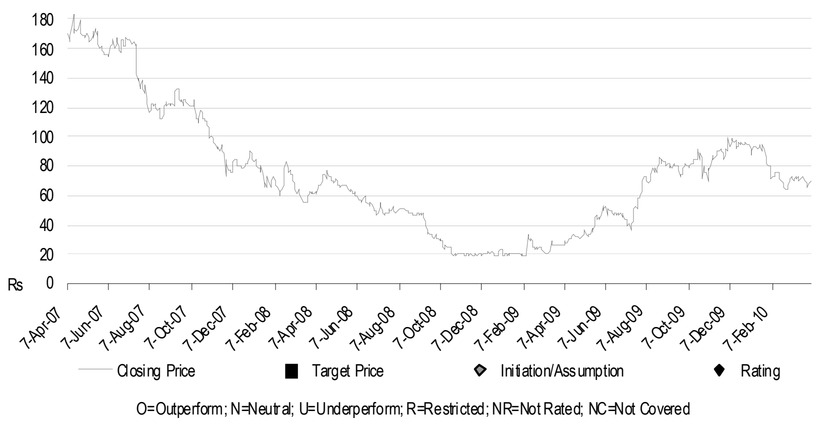
3-Year Price, Target Price and Rating Change History Chart for HEXT.BO

HEXT.BO Date	Closing Price (Rs)	Target Price (Rs)	Rating	Initiation/ Assumption

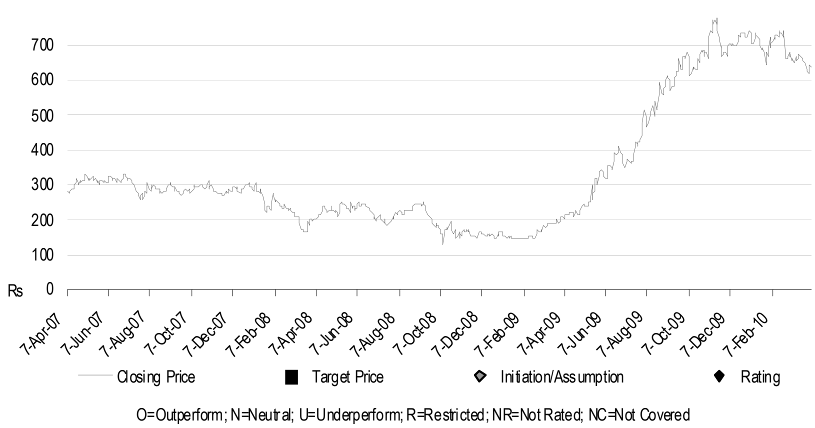


3-Year Price, Target Price and Rating Change History Chart for INFE.BO

INFE.BO Date	Closing Price (Rs)	Target Price (Rs)	Rating	Initiation/ Assumption

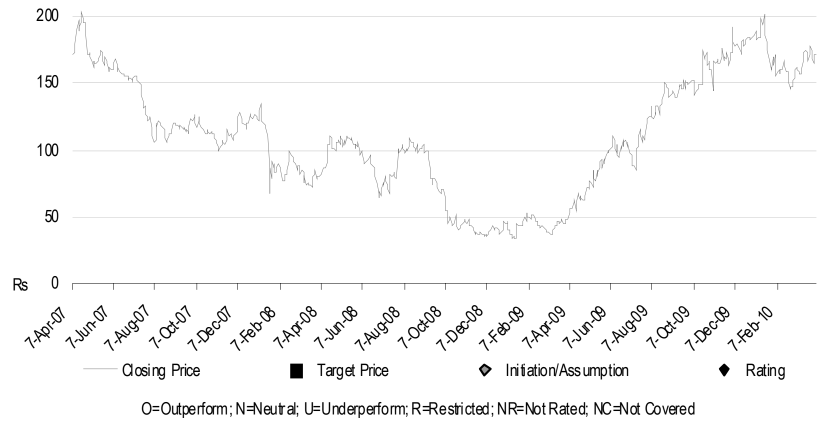
3-Year Price, Target Price and Rating Change History Chart for MBFL.BO

MBFL.BO Date	Closing Price (Rs)	Target Price (Rs)	Rating	Initiation/ Assumption



3-Year Price, Target Price and Rating Change History Chart for POLS.BO

POLS.BO Date	Closing Price (Rs)	Target Price (Rs)	Rating	Initiation/ Assumption



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Restricted	2%	

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Price Target: (12 months) for (HEXT.BO)

Method: We use a P/E multiple of 9x on our CY10E EPS of Rs7 for Hexaware to arrive at target price of Rs60.

Risks: If the expected rampdowns from key clients of Hexaware does not take place, then revenues and margins could surprise on the upside leading to upside risk on our target price.

Price Target: (12 months) for (INFE.BO)

Method: We use a P/E multiple of 11.5x on our FY3/11E EPS of Rs38 for Infotech Enterprises, to arrive at target price of Rs440.

Risks: The key risks to our target price include: 1) Our positive thesis on Infotech is based on expected strong growth in Engineering/R&D offshoring. If this growth does not take place, there is a downside risk to our profit estimates and target price 2) A sharp appreciation of INR against USD could offset strong growth and erode profitability

Price Target: (12 months) for (MBFL.BO)

Method: We use a P/E multiple of 13x on our 12M fwd EPS of Rs46 for Mphasis, to arrive at target price of Rs620

Risks: The key risks to our target price include: 1) Strong growth in business from HP without any pricing pressures from this account could lead to revenues and profits surprising positively. 2) Any adverse movements in the HP account, either on volumes or pricing could cause profits to surprise negatively, thus giving downside risks to pricing

Price Target: (12 months) for (POLS.BO)

Method: We use a P/E multiple of 10.5x on our FY3/11E forex-adj. EPS of Rs19 for Polaris to arrive at target price of Rs200

Risks: Our near-term positive outlook on Polaris is based on expected momentum in Citi account. If this growth does not materialise, revenues could remain weak as this is an important customer account for Polaris. Further, any weakness in the BFSI segment could impact Polaris due to its high exposure to this space.

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Asia/Pacific: +852 2101-6000