Multi-Company

13 June 2007 | 37 pages

Indian IT Services

Currency Largely Priced In; 2Q Guidance Likely Trigger

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- What currency are stock prices factoring in — While consensus downgrades in the sector have begun, we believe that stocks are already factoring in a stronger rupee. We see analyst downgrades as trailing a stock correction and should have little impact on the stock price going forward.
- Evidence of strong demand the key trigger — Strong 1Q should address demand related concerns and 2Q guidance should be robust – 2Q has historically been the strongest quarter for Indian IT Services. We expect good growth to return from 2Q onwards – with the wage, visa and rupee impact largely behind us.
- Living with a stronger rupee — Our new estimates are slightly more conservative than Citi economist's new INR forecasts – we now factor in Rs. 41, Rs. 40 and Rs. 39 for CY07E, CY08E and CY09E respectively.
- Cutting estimates to factor in stronger rupee — We have revised our estimates downwards by 2-8% for companies across our large cap coverage on account of rupee appreciation. In the case of midcaps, the change also incorporates 4Q results in addition to currency related changes.
- Infosys/TCS our top picks — Infosys/TCS should have strong margin levers going forward – we continue to have them as our top picks. We also like NIIT and Sasken in our coverage universe.

Figure 1. Valuation Comparison Table

Company	RIC Code	Rating	Mkt cap (US$m)	CMP* (Rs)	TP (Rs)	P/E (x) FY08E	P/E (x) FY09E	EV/EBITDA (x) FY08E	EV/EBITDA (x) FY09E
Infosys	INFY.BO	1L	27,976	1,987	2,440	24.8	20.4	20.2	16.2
TCS	TCS.BO	1L	29,305	1,215	1,460	23.8	20.0	19.6	16.1
Wipro	WIPR.BO	1L	19,386	539	650	22.3	18.3	18.1	14.5
Satyam	SATY.BO	1M	7,873	478	570	18.9	15.9	16.1	13.1
HCL Tech	HCLT.BO	1M	5,545	339	400	18.7	15.9	13.4	11.2
I-Flex	IFLX.BO	3M	4,866	2,359	2,025	48.3	35.0	34.8	25.5
Hexaware*	HEXT.BO	1M	536	164	214	15.9	13.0	11.0	8.7
Sasken	SKCT.BO	1M	358	509	643	19.0	13.5	11.9	8.3
KPIT	KPIT.BO	1M	269	144	180	17.8	12.8	12.2	9.2

Source: Powered by DataCentral; *Current market prices as of close of 12-Jun-07

See Appendix A-1 for Analyst Certification and important disclosures.

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Living with a stronger rupee

We incorporate our new currency assumptions and also incorporate the 4Q results for our mid cap coverage. This results in an earnings downgrade of 2-8% over FY08E-10E for our large cap universe with currency being the primary contributor to the downgrades. Business momentum continues to be strong – currency remains the only dampener from a stock performance point of view. We believe that after a sharp underperformance, negatives are largely priced in. Strong 1Q topline ($ terms) and 2Q guidance, we believe, will be the trigger – 2Q is a seasonally strong quarter and with visa costs and wage increases being taken care of, we expect the sector to do better going forward. Infosys and TCS are our top picks. We also like Sasken and NIIT among our coverage.

New estimates and target prices

We have reduced our earnings estimates to factor in the rupee appreciation. We have also tweaked our volume/pricing/other income assumptions. Our INR estimates are now at Rs. 41, Rs. 40 and Rs. 39 for FY08, FY09 and FY10 respectively (which is slightly more conservative than our economics team forecasts of Rs. 41.75, Rs. 40 and Rs. 39 respectively). For companies using cash-flow hedge accounting, INR revenue reflects exchange rate of 41.75, 40.5 and 39.5 respectively. Though EPS should be comparable as forex gains have been factored based on accounting policy followed by the company. Moreover, longer term margins would not be impacted by the forex accounting policy.

In the case of stocks other than the top five (Infosys, TCS, Wipro, Satyam and HCL Tech), the changes are on account of the rupee as well as due to incorporating the changes after the 4QFY07 results.

Figure 2. Earning revision and new target prices

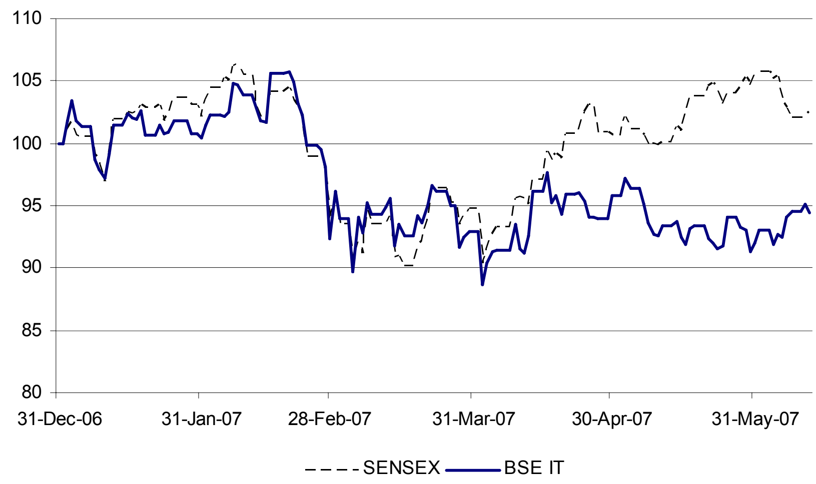
	New estimates			Downgrade			Target	TP	Upside	CMP*	Reasons for downgrade
	FY08E	FY09E	FY10E	FY08E	FY09E	FY10E	Multiple (x)	(Rs.)		(Rs.)	
TCS	50.9	60.7	68.3	-4.9%	-5.8%	-7.3%	24	1,460	20.2%	1215	Primarily currency
Wipro	24.14	29.53	33.01	-3.9%	-5.1%	-8.8%	22	650	20.5%	539	Primarily currency
Satyam	25.3	30.1	32.5	-2.1%	-3.1%	-6.3%	19	570	19.2%	478	Primarily currency
HCL Tech	18.5	22.1		-2.2%	-2.8%		18	400	18.0%	339	Primarily currency
I-flex	48.8	67.4	92.2	-7.2%	-4.9%		30	2,025	-14.2%	2359	Currency + disappointing qtr
Hexaware	10.30	12.57	15.03	-8.6%	-9.6%	-13.9%	17	214	30.5%	164	Currency + disappointing qtr
Sasken	26.9	37.8		-14.0%	-10.3%		SOTP	643	26.3%	509	Currency + disappointing qtr
KPIT	8.10	11.24	13.29	-9.5%	-11.2%		16	180	25.0%	144	Primarily currency

Source: Citigroup Investment Research estimates; *Current market prices as of 12-Jun-2007

What is factored into stock prices?

After a significant underperformance against the BSE SENSEX, stocks are already factoring in rupee appreciation, in our view. While we do agree that consensus downgrades are yet to be over, we believe that the negatives are largely priced in.

Figure 3. BSEIT vs. SENSEX YTD Performance



Source: DataStream

A basic analysis indicates that stock prices are already factoring in an appreciated rupee. Assuming a 24x 1-year forward multiple (Infosys has traded in the 20-28x 1-year forward band for the last one year with an average of ~24.3x) it implies that the price is factoring in an EPS of ~Rs.81.

IBES consensus estimate for FY08 at the end of March 2007 was Rs. 88.3. Assuming that it was based on currency of Rs. 44/$ and working backwards, the present estimate implies ~Rs. 41-41.8/$ (assuming the sensitivity that 1% Rupee appreciation impacts net profits by 1.2%-1.5%). With the rupee trading at ~Rs. 41, we believe that stock prices have factored in the rupee appreciation to a large extent.

Over the last three years, looking at IBES based P/E estimates (which looks at P/E based on consensus estimates at that point of time); Infosys has traded at 20-28x 1-year forward earnings. 20x FY09 estimate is similar to the current stock price – which in our view, suggests that downside is limited from present levels.

What are companies doing?

Our discussion with companies indicated that:

- Usually contracts do not have any pricing resets based on currency and hence companies will have to take the negative impact. However, in some BPO contracts, there are currency related pricing resets that companies have exercised.
- Companies are focusing on operational issues and trying to execute as best as possible. Cost optimization is also a key focus area.
- Over the longer term, companies are anyway focusing on diversifying their business across geographies. However, in the present scenario, even that would not have helped much as the rupee has appreciated against most currencies.

Will companies miss guidance?

Infosys has guided to an EPS of Rs. 80.29 – 81.58 for FY08 (using an assumption of Rs. 43.1/$) while Satyam has guided to an EPS of Rs. 25.32-25.73 for FY08 (using an assumption of Rs. 42.3/$).

Our assumption of Rs. 41/$ assumes another 5% appreciation from Rs.43.1/$ rate which Infosys has used for guidance (and ~3% from Rs. 42.3 that Satyam has used for their guidance).

We still believe that companies should be able to achieve their guidance for FY08. Our basic EPS forecast for Infosys is Rs. 81.62 while the same for Satyam is Rs. 25.98 (which is higher than guidance range).

Further upgrades could be driven by operational surprises on pricing and volumes over the course of the year.

G&A savings might not be significant – most models factor that

G&A costs are largely rupee denominated. In that case, the savings in G&A may not be as significant as what the street is building in. The same is illustrated in the table below:

Figure 4. G&A savings may not be significant

Exchange rate	45	41	
Revenues ($)	100	130	Assuming 30% growth
Revenues (Rs.)	4500	5330	
G&A (Rs.)	360	432	Assuming 20% growth
G&A (% of revenues)	8.0%	8.0%	

Source: Citigroup Investment Research

Despite G&A growing at 20% (which is 10% lower than the revenue growth of 30%), it remains 8% as proportion of revenues in both the years due to rupee appreciation. Hence, we are not factoring in any significant savings in G&A.

Analyzing margin levers

The margin levers for the sector remain:

- Pricing – We expect blended pricing increase of 1.5-2% for FY08 across our large cap coverage universe. Most companies have been indicating that new clients are coming in at ~5% higher rates while existing business is being renegotiated at ~2-3% better prices.
- Utilization – For companies like Infosys and Wipro, who are running at blended utilization of ~68% (and offshore utilization of ~60%), utilization should be a big margin lever for FY08. However, for companies like TCS and Satyam, it may be difficult to improve utilization as the utilization is already higher than 75% and they are in the process of flattening the employee pyramid.
- Employee pyramid – Leverage should be visible in the cases of Satyam, Wipro, TCS and HCL Tech while Infosys has already used this lever to a significant extent.

- Offshore proportion – While all companies do have some room to increase the offshore component, this lever should play out the best in TCS which is targeting at 300-400bp increase in offshore over the coming year.

Will Infosys trade lower than global peers?

Infosys trades at about 24x 1-year forward EPS which is at a 20-26% premium to global peers like Accenture and EDS.

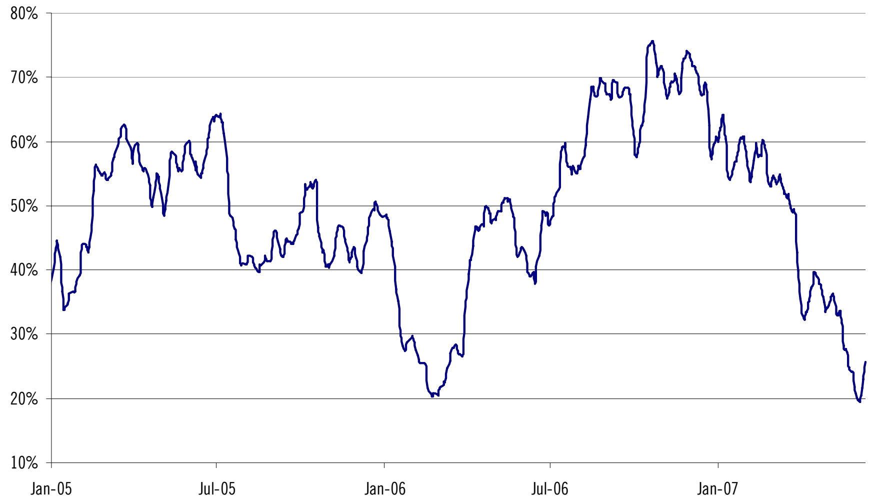
Figure 5. Global IT services sector: Valuation comparison table

Company	RIC Code	Year end	Rating	Mkt cap (US$m)	CMP LC	TP LC	P/E (x) FY08E	P/E (x) FY09E	EV/EBITDA (x) FY08E	EV/EBITDA (x) FY09E
Infosys	INFY.BO	31-Mar	1L	27,882	1,980	2,440	24.7	20.3	20.1	15.9
TCS	TCS.BO	31-Mar	1L	29,451	1,221	1,460	24.0	20.1	19.7	15.9
Wipro	WIPR.BO	31-Mar	1L	19,504	542	650	22.5	18.4	18.3	14.5
Satyam	SATY.BO	31-Mar	1M	8,182	497	570	19.6	16.5	16.8	13.3
HCL Tech	HCLT.BO	30-Jun	1M	5,654	346	400	18.7	15.6	13.7	11.3
Accenture*	ACN.N	31-Aug	2H	23,483	39.56	40.00	20.4	18.1	6.9	5.8
EDS*	EDS.N	31-Dec	3H	14,370	28.24	24.00	17.5	18.3	4.8	4.8
Cognizant*	CTSH.O	31-Dec	1H	10,979	76.37	114.00	34.4	24.7	16.1	11.2
CapGemini*	CAPP.PA	31-Dec	1H	10,186	52.80	70.00	17.0	14.0	7.1	6.1
Atos Origin*	ATOS.PA	31-Dec	3H	4,182	45.43	45.00	18.3	14.2	7.0	5.9

Source: Company Reports and CIR Estimates; *Using FY07E and FY08E for companies with fiscal year ending 2H of calendar (e.g. 31-Aug and 31-Dec year-ending). Stock prices as of June 11, 2007.

We believe that Infosys, with superior headline growth rates and return ratios, will continue to trade at a premium to global peers.

Figure 6. Infosys premium to Accenture PER



Source: DataStream, Company Reports and CIR Estimates

Lowest margin = maximum impact

Assuming all other things being equal, companies with the lowest margins would have the highest impact due to rupee appreciation. Our earnings downgrades for smaller companies are the highest – in line with this view.

Figure 7. Currency impact: Impact of 1% INR appreciation based on absolute EBITDA margin of the company

HIGH MARGIN				MEDIUM MARGIN				LOW MARGIN			
	$	Rs/$=44	Rs/$=41		$	Rs/$=44	Rs/$=41		$	Rs/$=44	Rs/$=41
Revenues	100	4400	4100	Revenues	100	4400	4100	Revenues	100	4400	4100
$ costs	37.4	1645.6	1533.4	$ costs	42.35	1863.4	1736.35	$ costs	47.3	2081.2	1939.3
Rs costs	30.6	1346.4	1346.4	Rs costs	34.65	1524.6	1524.6	Rs costs	38.7	1702.8	1702.8
EBITDA	32	1408	1220.2	EBITDA	23	1012	839.05	EBITDA	14	616	457.9
EBITDA margins	32.0%	32.0%	29.8%	EBITDA margins	23.0%	23.0%	20.5%	EBITDA margins	14.0%	14.0%	11.2%
Margin change			-2.2%	Margin change			-2.5%	Margin change			-2.8%
EBITDA decline			-13.3%	EBITDA decline			-17.1%	EBITDA decline			-25.7%
Margin change/%			33	Margin change/%			37	Margin change/%			42

Source: Citigroup Investment Research estimates

What about PEG?

Some technology investors do focus on PEG. With Indian IT Services growth rate being impacted due to currency (and further due to tax rates in 2010), there have been arguments about what PEG is sustainable going forward.

Our belief remains that P/E to growth is not linear. While high growth does result in higher P/E and vice-versa, we do not believe that the relationship is linear. Some arguments regarding the same are:

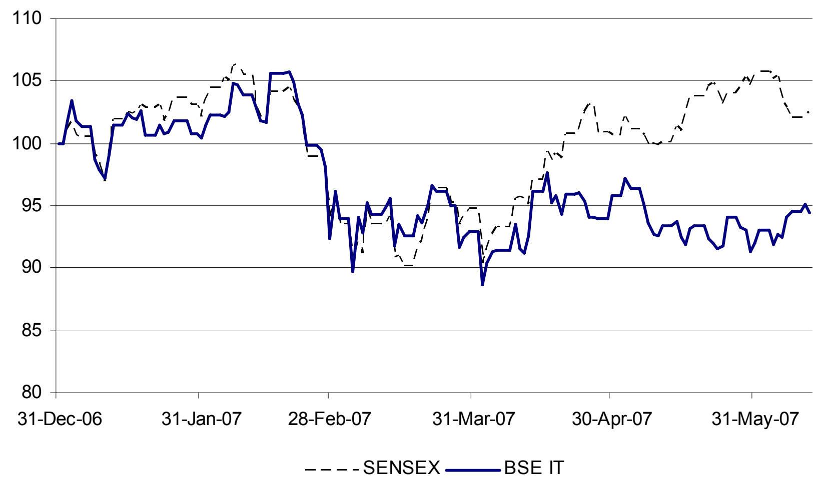
- Global peers to Infosys trade at 18-19x for earnings growth rates of 10-15% which does imply PEG of >1.
- Infosys's trading history indicates that the stock has traded at the highest PEG of 1.2-1.3 when the growth outlook was the worst while last year it was trading at PEG of 0.6-0.7 with outlook being possibly the best in the last few years.

With decent growth rates on a high base and superior return ratios, we expect the premium to global peers and Indian markets to sustain.

BSEIT has underperformed BSE Sensex YTD

BSEIT has underperformed the BSE Sensex by ~10% YTD primarily on account of currency-related concerns and also some concerns related to US slowdown.

Figure 8. BSE IT Index and SENSEX YTD performance



Source: DataStream

We like Infosys and TCS; NIIT, Sasken preferred mid-caps

We continue to prefer Infosys (top pick) and TCS in our large cap space.

Infosys remains our top pick in the sector:

- We expect 38% growth ($ terms) - highest in the sector led by strong volume growth and increase in revenue per employee.
- Strong margin levers – we expect improvement in utilization, lower sales and marketing expenses, reduced losses in consulting business and better pricing to help Infosys to counter the negative impact of wage hikes and rupee.
- Recent underperformance vs the BSE IT index – Infosys has underperformed the BSE Sensex by ~14% and the BSE IT index by ~8% YTD.
- We believe that the recent underperformance provides a good entry point for long term investors.

Figure 9. Indian IT coverage universe: Valuation comparison table (closing market price as of June 12, 2007)

Company	RIC Code	Rating	Mkt cap	CMP	TP	P/E (x)		EV/EBITDA (x)		Div. Yield (%)	
			(US$m)	(Rs)	(Rs)	FY08E	FY09E	FY08E	FY09E	FY08E	FY09E
Infosys	INFY.BO	1L	27,976	1,987	2,440	24.8	20.4	20.2	16.2	0.8%	1.0%
TCS	TCS.BO	1L	29,305	1,215	1,460	23.8	20.0	21.6	18.2	1.2%	1.3%
Wipro	WIPR.BO	1L	19,386	539	650	22.3	18.3	18.1	14.5	1.9%	2.2%
Satyam	SATY.BO	1M	7,873	478	570	18.9	15.9	16.1	13.1	1.7%	2.1%
HCL Tech	HCLT.BO	1M	5,545	339	400	18.3	15.3	13.4	11.0	2.4%	2.4%
Patni*	PTNI.BO	3M	1,816	531	565	16.7	15.2	10.4	9.9	0.7%	0.9%
I-Flex	IFLX.BO	3M	4,866	2,359	2,025	48.3	35.0	34.8	25.5	0.0%	0.0%
Hexaware*	HEXT.BO	1M	536	164	214	15.9	13.0	11.0	8.7	1.2%	1.5%
NIIT	NIIT.BO	1M	474	974	1,120	21.6	13.8	16.4	11.2	0.8%	0.8%
Sasken	SKCT.BO	1M	358	509	643	19.0	13.5	11.9	8.3	1.0%	2.0%
KPIT	KPIT.BO	1M	269	144	180	17.8	12.8	12.2	9.2	0.3%	0.5%

Source: Company Reports and CIR estimates; *Using CY06E and CY07E for these companies (31-Dec year-ending).

Company Focus

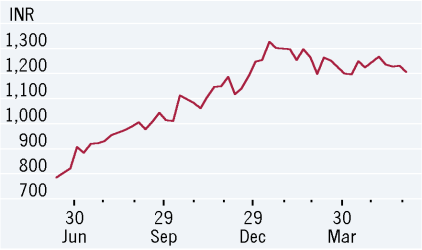
Tata Consultancy Services (TCS.BO)

Buy: Size matters

Rating change ☐
Target price change ☑
Estimate change ☑

Buy/Low Risk	**1L**
Price (13 Jun 07)	Rs1,215.00
Target price	Rs1,460.00
from Rs1,550.00	
Expected share price return	20.2%
Expected dividend yield	1.2%
Expected total return	**21.3%**
Market Cap	Rs1,189,012M
	US$29,362M

Price Performance (RIC: TCS.BO, BB: TCS IN)



Statistical Abstract

Year to 31 Mar	Net Profit (RsM)	Diluted EPS (Rs)	EPS growth (%)	P/E (x)	P/B (x)	ROE (%)	Yield (%)
2006A	29,074	29.71	39.1	40.9	20.4	64.3	0.6
2007A	40,608	41.50	39.7	29.3	13.4	55.1	0.9
2008E	49,845	50.94	22.7	23.9	9.5	46.5	1.2
2009E	59,427	60.73	19.2	20.0	7.0	40.4	1.3
2010E	66,873	68.34	12.5	17.8	5.4	34.5	1.5

Source: Powered by dataCentral

- Demand side continues to be strong — Our meeting with TCS senior management reaffirms our thesis of strong demand side environment for offshore IT services. TCS would be a key beneficiary of this trend because of its size, global reach and leadership in various verticals/service lines.

- Why we like TCS? — TCS is ahead of its peers in four key areas – a) building global delivery model (not just India centric delivery); b) addressing emerging markets like China, Latin America, etc; c) acquisition appetite and ability to leverage its sales muscle to extract synergies and d) ability to close gaps like BPO and getting it right using platform based approach.

- Best hedged for rupee appreciation — TCS has forex cover of US$1.3bn at the end of Mar'07 quarter and has further increased it during the quarter. Amongst our coverage universe, TCS and HCL Tech appear best hedged for the rupee appreciation scenario.

- Earnings revision factors our new INR forecast — We have incorporated Rs. 41, Rs. 40 and Rs. 39/$ for FY08, FY09 and FY10 respectively in our financial models. We have also changed our volume and pricing growth assumptions marginally - this has resulted in earnings downgrades of 4-8%.

- Maintain Buy; target price revised to Rs.1,460 — We revise our target price using new forecasts – maintaining our target multiple of 24x FY09E EPS. Our new target price of Rs.1,460 (previously Rs.1,550) indicates total expected return of over 21%.

Fiscal year end 31-Mar	2006	2007	2008E	2009E	2010E
Valuation Ratios					
P/E adjusted (x)	40.9	29.3	23.9	20.0	17.8
EV/EBITDA adjusted (x)	32.0	23.1	19.3	15.6	13.1
P/BV (x)	20.4	13.4	9.5	7.0	5.4
Dividend yield (%)	0.6	0.9	1.2	1.3	1.5
Per Share Data (Rs)					
EPS adjusted	29.71	41.50	50.94	60.73	68.34
EPS reported	29.71	41.50	50.94	60.73	68.34
BVPS	59.69	90.98	127.92	172.64	222.98
DPS	6.75	11.50	14.00	16.00	18.00
Profit & Loss (RsM)					
Net sales	132,454	186,333	233,437	288,565	349,138
Operating expenses	-98,318	-139,888	-178,912	-221,954	-270,959
EBIT	**34,136**	**46,445**	**54,525**	**66,611**	**78,179**
Net interest expense	190	1,236	3,521	3,519	4,459
Non-operating/exceptionals	16	44	45	45	45
Pre-tax profit	**34,342**	**47,725**	**58,092**	**70,175**	**82,683**
Tax	-4,989	-6,700	-8,007	-10,508	-15,570
Extraord./Min.Int./Pref.div.	-279	-417	-240	-240	-240
Reported net income	**29,074**	**40,608**	**49,845**	**59,427**	**66,873**
Adjusted earnings	29,074	40,608	49,845	59,427	66,873
Adjusted EBITDA	36,946	50,629	59,607	72,640	85,082
Growth Rates (%)					
Sales	36.2	40.7	25.3	23.6	21.0
EBIT adjusted	26.9	36.1	17.4	22.2	17.4
EBITDA adjusted	29.8	37.0	17.7	21.9	17.1
EPS adjusted	39.1	39.7	22.7	19.2	12.5
Cash Flow (RsM)					
Operating cash flow	**22,978**	**41,834**	**40,591**	**37,800**	**56,109**
Depreciation/amortization	2,810	4,184	5,082	6,029	6,903
Net working capital	-8,995	-2,139	-11,055	-24,377	-13,447
Investing cash flow	**-7,012**	**-12,025**	**-11,379**	**-15,132**	**-18,693**
Capital expenditure	-7,012	-12,025	-11,379	-11,085	-13,805
Acquisitions/disposals	0	0	0	3,519	4,459
Financing cash flow	**-2,403**	**-10,641**	**-13,700**	**-15,658**	**-17,615**
Borrowings	0	0	0	0	0
Dividends paid	-6,606	-11,254	-13,700	-15,658	-17,615
Change in cash	**13,564**	**19,168**	**15,511**	**7,010**	**19,801**
Balance Sheet (RsM)					
Total assets	**85,626**	**130,880**	**169,180**	**212,561**	**269,088**
Cash & cash equivalent	3,965	22,605	41,398	55,734	84,642
Accounts receivable	32,790	42,857	51,356	60,599	73,319
Net fixed assets	15,072	22,912	29,209	34,265	41,168
Total liabilities	**25,655**	**40,234**	**42,389**	**42,002**	**49,270**
Accounts payable	0	0	0	0	0
Total Debt	979	1,184	0	0	0
Shareholders' funds	**59,972**	**90,646**	**126,790**	**170,560**	**219,818**
Profitability/Solvency Ratios (%)					
EBITDA margin adjusted	27.9	27.2	25.5	25.2	24.4
ROE adjusted	64.3	55.1	46.5	40.4	34.5
ROIC adjusted	72.4	69.3	65.4	59.8	52.7
Net debt to equity	-5.0	-23.6	-32.7	-32.7	-38.5
Total debt to capital	1.6	1.3	0.0	0.0	0.0

For further data queries on Citigroup's full coverage universe please contact CIR Data Services Asia Pacific at CitiResearchDataServices@citigroup.com or +852-2501-2791

Powered by: dataCentral

Company Focus

Wipro (WIPR.BO)

Buy: Near term to be impacted by sluggish telecom revenues

Rating change ☐
Target price change ☑
Estimate change ☑

Buy/Low Risk	**1L**
Price (12 Jun 07)	Rs539.10
Target price	Rs650.00
from Rs685.00	
Expected share price return	20.6%
Expected dividend yield	1.9%
Expected total return	**22.4%**
Market Cap	Rs786,374M
	US$19,386M

Price Performance (RIC: WIPR.BO, BB: WPRO IN)

Statistical Abstract

Year to 31 Mar	Net Profit (RsM)	Diluted EPS (Rs)	EPS growth (%)	P/E (x)	P/B (x)	ROE (%)	Yield (%)
2006A	20,270	14.08	24.3	38.3	9.7	29.9	0.9
2007A	29,271	20.26	43.9	26.6	7.6	32.5	1.1
2008E	34,864	24.14	19.1	22.3	6.3	31.2	1.9
2009E	42,657	29.53	22.4	18.3	5.2	31.6	2.2
2010E	47,675	33.01	11.8	16.3	4.4	29.7	2.8

Source: Powered by dataCentral

- Telecom likely to remain weak; Rest of business remains strong — Wipro continues to face uncertainty as few of its top clients go through M&A/restructuring. The visibility from those accounts remains low. Apart from these few accounts, Wipro continues to witness good growth.

- Forex front – highly exposed — Wipro had forex cover of US$222mn at the end of Mar'07 quarter – one of the least in the recent past. Company has increased the hedge position during the quarter – however the new hedges are at a lower rate.

- Earnings revision factors our new INR forecast — We have incorporated Rs. 41.75, Rs. 40.5 and Rs. 39.5/$ for FY08, FY09 and FY10 respectively in our financial models (rates are higher than rest of coverage universe to account for cash flow hedging impact – though similar impact on EPS after adjusting for forex gains using accounting policy impact). This has resulted in earnings downgrades of 4-9%.

- Maintain Buy; target price revised to Rs. 650— We lower our target price using new forecasts – maintaining our target multiple of 22x FY09E EPS. Our new target price of Rs.650 (previously Rs.685) indicates total expected return of 22%.

Fiscal year end 31-Mar	2006	2007	2008E	2009E	2010E
Valuation Ratios					
P/E adjusted (x)	38.3	26.6	22.3	18.3	16.3
EV/EBITDA adjusted (x)	29.9	21.7	18.0	14.2	11.9
P/BV (x)	9.7	7.6	6.3	5.2	4.4
Dividend yield (%)	0.9	1.1	1.9	2.2	2.8
Per Share Data (Rs)					
EPS adjusted	14.08	20.26	24.14	29.53	33.01
EPS reported	14.08	20.26	24.14	29.53	33.01
BVPS	55.69	71.12	85.56	103.46	121.87
DPS	5.00	6.00	10.00	12.00	15.00
Profit & Loss (RsM)					
Net sales	106,107	149,431	187,719	237,596	293,883
Operating expenses	-84,135	-119,423	-152,177	-192,845	-241,137
EBIT	**21,972**	**30,009**	**35,543**	**44,751**	**52,746**
Net interest expense	1,277	2,667	4,165	4,719	5,628
Non-operating/exceptionals	288	318	366	420	483
Pre-tax profit	**23,537**	**32,993**	**40,073**	**49,891**	**58,858**
Tax	-3,265	-3,723	-5,210	-7,234	-11,183
Extraord./Min.Int./Pref.div.	-2	0	0	0	0
Reported net income	**20,270**	**29,271**	**34,864**	**42,657**	**47,675**
Adjusted earnings	20,270	29,271	34,864	42,657	47,675
Adjusted EBITDA	25,137	34,208	40,683	50,854	60,194
Growth Rates (%)					
Sales	30.4	40.8	25.6	26.6	23.7
EBIT adjusted	23.0	36.6	18.4	25.9	17.9
EBITDA adjusted	23.0	36.1	18.9	25.0	18.4
EPS adjusted	24.3	43.9	19.1	22.4	11.8
Cash Flow (RsM)					
Operating cash flow	**18,906**	**36,050**	**26,919**	**38,176**	**42,266**
Depreciation/amortization	3,165	4,200	5,140	6,103	7,448
Net working capital	-3,723	5,029	-8,920	-5,865	-7,229
Investing cash flow	**-9,847**	**-18,325**	**-5,720**	**-9,696**	**-11,201**
Capital expenditure	-7,741	-12,964	-9,885	-14,416	-16,829
Acquisitions/disposals	-2,357	-7,034	0	0	0
Financing cash flow	**1,501**	**-4,710**	**-14,267**	**-17,121**	**-21,401**
Borrowings	0	859	0	0	0
Dividends paid	-8,131	-9,793	-16,322	-19,587	-24,484
Change in cash	**10,560**	**13,015**	**6,932**	**11,359**	**9,665**
Balance Sheet (RsM)					
Total assets	**100,266**	**146,102**	**160,580**	**193,627**	**227,544**
Cash & cash equivalent	39,186	52,060	58,992	70,351	80,016
Accounts receivable	20,593	28,467	34,972	44,264	54,751
Net fixed assets	17,777	26,541	31,287	39,599	48,981
Total liabilities	**21,502**	**44,634**	**38,516**	**46,026**	**53,669**
Accounts payable	4,146	7,060	6,049	7,525	8,930
Total Debt	705	3,781	3,781	3,781	3,781
Shareholders' funds	**78,764**	**101,468**	**122,065**	**147,601**	**173,875**
Profitability/Solvency Ratios (%)					
EBITDA margin adjusted	23.7	22.9	21.7	21.4	20.5
ROE adjusted	29.9	32.5	31.2	31.6	29.7
ROIC adjusted	55.1	56.9	50.9	51.0	46.7
Net debt to equity	-48.9	-47.6	-45.2	-45.1	-43.8
Total debt to capital	0.9	3.6	3.0	2.5	2.1

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Powered by: dataCentral

Company Focus

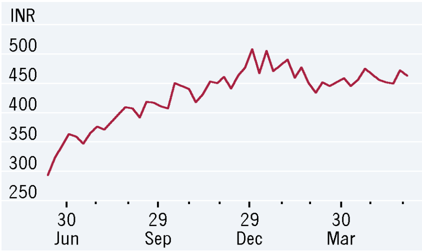
Satyam Computers Services (SATY.BO)

Buy: Ambitious guidance; delivery the key

Rating change ☐
Target price change ☑
Estimate change ☑

Buy/Medium Risk	**1M**
Price (12 Jun 07)	Rs478.45
Target price	Rs570.00
from Rs590.00	
Expected share price return	19.1%
Expected dividend yield	1.7%
Expected total return	**20.8%**
Market Cap	Rs319,371M
	US$7,873M

Price Performance (RIC: SATY.BO, BB: SCS IN)



Statistical Abstract

Year to 31 Mar	Net Profit (RsM)	Diluted EPS (Rs)	EPS growth (%)	P/E (x)	P/B (x)	ROE (%)	Yield (%)
2006A	9,979	15.09	36.9	31.7	7.2	26.2	0.7
2007A	14,047	20.81	38.0	23.0	5.5	27.9	0.7
2008E	17,100	25.34	21.7	18.9	4.6	27.1	1.7
2009E	20,287	30.06	18.6	15.9	3.9	27.0	2.1
2010E	21,902	32.45	8.0	14.7	3.3	24.9	2.5

Source: Powered by dataCentral

- ERP continues to drive growth — Satyam continues to do well in the ERP space, which has been a big growth driver over the past few years. We expect Satyam to report 38% revenues growth ($ terms) in FY08, which is highest in the sector (in line with Infosys).

- Employee pyramid likely a big margin driver — Satyam is now focusing on flattening the employee pyramid; we believe that along with pricing (our assumption is 2% blended pricing increase) are the key positive margin levers.

- Margin guidance difficult — In our view, the flat margin guidance for FY08 will be very difficult to achieve. Wages, RSU and currency have a negative impact of ~650bp on margins – pricing, employee pyramid and performance of subsidiaries may not be enough to mitigate the same.

- M&A difficult to predict — Despite repeated speculation, we prefer to go by Mr. Raju's statement a couple of quarters back - "Satyam, therefore, shall not indulge in any such pursuits of being acquired. We would continue to focus on aggressively expanding our business globally as an independent company".

- Earnings revision factors our new INR forecast — We have incorporated Rs. 41, Rs. 40 and Rs. 39/$ for FY08, FY09 and FY10 respectively in our financial models. We have also changed our volume/pricing/other income assumptions marginally – this has resulted in earnings downgrades of 2-6%.

- Valuations still look reasonable — Satyam now trades at 19x FY08E, which is at a 24% discount to Infosys – in its last one year trading band of 15-35%. Our new target price of Rs. 570 (previously Rs.590) implies return of 21% from present levels. Our new target price is based on our revised estimates.

Fiscal year end 31-Mar	2006	2007	2008E	2009E	2010E
Valuation Ratios					
P/E adjusted (x)	31.7	23.0	18.9	15.9	14.7
EV/EBITDA adjusted (x)	25.1	18.5	15.8	12.5	10.4
P/BV (x)	7.2	5.5	4.6	3.9	3.3
Dividend yield (%)	0.7	0.7	1.7	2.1	2.5
Per Share Data (Rs)					
EPS adjusted	15.09	20.81	25.34	30.06	32.45
EPS reported	15.09	20.81	25.34	30.06	32.45
BVPS	66.53	87.41	104.35	123.87	143.58
DPS	3.50	3.50	8.00	10.00	12.00
Profit & Loss (RsM)					
Net sales	47,926	64,851	81,176	102,531	124,861
Operating expenses	-37,637	-50,958	-65,639	-83,426	-102,479
EBIT	**10,289**	**13,893**	**15,536**	**19,105**	**22,382**
Net interest expense	1,113	1,674	3,895	4,348	4,996
Non-operating/exceptionals	-1	0	0	0	0
Pre-tax profit	**11,401**	**15,566**	**19,432**	**23,453**	**27,378**
Tax	-1,509	-1,520	-2,332	-3,166	-5,476
Extraord./Min.Int./Pref.div.	87	1	0	0	0
Reported net income	**9,979**	**14,047**	**17,100**	**20,287**	**21,902**
Adjusted earnings	9,979	14,047	17,100	20,287	21,902
Adjusted EBITDA	11,662	15,377	17,476	21,447	25,091
Growth Rates (%)					
Sales	36.1	35.3	25.2	26.3	21.8
EBIT adjusted	36.3	35.0	11.8	23.0	17.2
EBITDA adjusted	34.3	31.9	13.7	22.7	17.0
EPS adjusted	36.9	38.0	21.7	18.6	8.0
Cash Flow (RsM)					
Operating cash flow	**7,689**	**10,541**	**13,228**	**15,027**	**17,322**
Depreciation/amortization	1,373	1,484	1,940	2,341	2,708
Net working capital	-2,685	-2,925	-1,916	-3,254	-2,293
Investing cash flow	**-1,292**	**-2,462**	**740**	**-617**	**-340**
Capital expenditure	-3,167	-4,135	-3,156	-4,965	-5,335
Acquisitions/disposals	0	0	0	0	0
Financing cash flow	**1,092**	**716**	**-5,953**	**-7,441**	**-8,930**
Borrowings	838	452	0	0	0
Dividends paid	-2,562	-2,600	-5,953	-7,441	-8,930
Change in cash	**7,489**	**8,796**	**8,015**	**6,968**	**8,053**
Balance Sheet (RsM)					
Total assets	**51,371**	**68,951**	**82,490**	**98,295**	**115,704**
Cash & cash equivalent	31,117	39,914	47,929	54,897	62,950
Accounts receivable	11,684	17,432	19,571	24,439	29,761
Net fixed assets	5,573	8,223	9,439	12,062	14,690
Total liabilities	**8,157**	**11,425**	**13,817**	**16,777**	**21,213**
Accounts payable	4,370	5,745	7,306	9,228	11,237
Total Debt	1,027	1,479	1,479	1,479	1,479
Shareholders' funds	**43,214**	**57,526**	**68,673**	**81,518**	**94,491**
Profitability/Solvency Ratios (%)					
EBITDA margin adjusted	24.3	23.7	21.5	20.9	20.1
ROE adjusted	26.2	27.9	27.1	27.0	24.9
ROIC adjusted	81.0	78.0	65.3	64.5	56.1
Net debt to equity	-69.6	-66.8	-67.6	-65.5	-65.1
Total debt to capital	2.3	2.5	2.1	1.8	1.5

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Company Focus

HCL Technologies (HCLT.BO)

Buy: Large deal strategy paying off

Rating change ☐
Target price change ☑
Estimate change ☐

Buy/Medium Risk	**1M**
Price (12 Jun 07)	Rs338.90
Target price	Rs400.00
from Rs405.00	
Expected share price return	18.0%
Expected dividend yield	3.0%
Expected total return	**21.0%**
Market Cap	Rs224,922M
	US$5,545M

Price Performance (RIC: HCLT.BO, BB: HCLT IN)

Statistical Abstract

Year to 30 Jun	Net Profit (RsM)	Diluted EPS (Rs)	EPS growth (%)	P/E (x)	P/B (x)	ROE (%)	Yield (%)
2005A	6,104	9.56	9.1	35.4	2.9	18.1	1.5
2006A	7,091	10.46	9.4	32.4	5.4	18.1	2.4
2007E	10,776	15.77	50.8	21.5	4.5	24.2	2.4
2008E	12,701	18.49	17.3	18.3	4.0	24.5	2.4
2009E	15,178	22.10	19.5	15.3	3.4	25.3	2.4

Source: Powered by dataCentral

- Demand environment remains strong — HCL Tech has been winning a lot of decent sized deals in the recent past – in the last quarter, they announced 6 deals in the $25-50m range. With its strategy of focusing on unconquered niches, we believe HCL Tech will continue to witness decent growth rates going forward.

- Large deal strategy paying off — The large deal strategy adopted by the management in the past has started paying off – QoQ volatility has reduced and HCL Tech should be able to use the employee pyramid much better as size of engagements keeps going up.

- Margin leverage across business segments — We believe that HCL Tech has several margin levers across its three business segments to minimize the impact of INR appreciation – a) improving utilization in IT services especially Enterprise Solutions segment; b) better employee pyramid; c) shift to higher share of global business in Infrastructure segment and d) scale benefits.

- Best hedged for rupee appreciation — HCL Tech has forex cover of US$900mn at the end of Mar'07 quarter covering net receivable for next 12 months. Amongst our coverage universe, HCL Tech is the best hedged for the rupee appreciation scenario.

- Earnings revision factors our new INR forecast — We have incorporated Rs. 41, Rs. 40 and Rs. 39/$ for FY08, FY09 and FY10 respectively in our financial models. We have also changed our volume and pricing growth assumptions marginally - this has resulted in earnings downgrades of ~2%.

- Maintain Buy; target price revised to Rs. 400 — We lower our target price using new forecasts – maintaining our target multiple of 18x FY09E EPS. Our new target price of Rs.400 (previously Rs.405) indicates total expected return of 21%

Fiscal year end 30-Jun	2005	2006	2007E	2008E	2009E
Valuation Ratios					
P/E adjusted (x)	35.4	32.4	21.5	18.3	15.3
EV/EBITDA adjusted (x)	26.5	22.3	16.2	13.3	10.7
P/BV (x)	2.9	5.4	4.5	4.0	3.4
Dividend yield (%)	1.5	2.4	2.4	2.4	2.4
Per Share Data (Rs)					
EPS adjusted	9.56	10.46	15.77	18.49	22.10
EPS reported	9.56	10.46	15.77	18.49	22.10
BVPS	118.64	63.27	74.58	85.01	99.40
DPS	5.00	8.00	8.00	8.00	8.00
Profit & Loss (RsM)					
Net sales	33,694	44,007	60,471	75,285	92,956
Operating expenses	-27,527	-36,847	-50,438	-63,332	-78,278
EBIT	**6,167**	**7,161**	**10,032**	**11,953**	**14,678**
Net interest expense	1,079	578	1,795	2,448	2,743
Non-operating/exceptionals	-469	-22	-68	-74	-70
Pre-tax profit	**6,778**	**7,717**	**11,760**	**14,327**	**17,350**
Tax	-674	-626	-983	-1,626	-2,172
Extraord./Min.Int./Pref.div.	0	0	0	0	0
Reported net income	**6,104**	**7,091**	**10,776**	**12,701**	**15,178**
Adjusted earnings	6,104	7,091	10,776	12,701	15,178
Adjusted EBITDA	7,722	9,193	12,544	15,110	18,400
Growth Rates (%)					
Sales	31.2	30.6	37.4	24.5	23.5
EBIT adjusted	51.7	16.1	40.1	19.1	22.8
EBITDA adjusted	48.4	19.0	36.5	20.4	21.8
EPS adjusted	9.1	9.4	50.8	17.3	19.5
Cash Flow (RsM)					
Operating cash flow	**4,975**	**7,423**	**8,433**	**13,149**	**15,868**
Depreciation/amortization	1,555	2,032	2,512	3,156	3,722
Net working capital	-1,605	-1,121	-3,060	-260	-289
Investing cash flow	**-8,903**	**-3,469**	**-4,033**	**-6,876**	**-7,676**
Capital expenditure	-3,416	-4,179	-4,666	-6,876	-7,676
Acquisitions/disposals	-5,668	29	291	0	0
Financing cash flow	**2,257**	**-5,710**	**-2,078**	**-4,368**	**-4,073**
Borrowings	-73	-1,225	-8	0	0
Dividends paid	-5,684	-5,816	-5,816	-5,816	-5,816
Change in cash	**-1,671**	**-1,756**	**2,322**	**1,905**	**4,119**
Balance Sheet (RsM)					
Total assets	**46,242**	**50,445**	**60,731**	**70,602**	**83,618**
Cash & cash equivalent	19,899	18,799	22,122	25,027	30,146
Accounts receivable	6,408	9,628	13,396	16,643	20,586
Net fixed assets	6,596	8,742	10,896	14,616	18,569
Total liabilities	**8,260**	**9,780**	**12,154**	**15,140**	**18,794**
Accounts payable	6,633	8,952	11,084	14,070	17,724
Total Debt	1,308	83	75	75	75
Shareholders' funds	**37,982**	**40,665**	**48,578**	**55,463**	**64,825**
Profitability/Solvency Ratios (%)					
EBITDA margin adjusted	22.9	20.9	20.7	20.1	19.8
ROE adjusted	18.1	18.1	24.2	24.5	25.3
ROIC adjusted	40.5	33.1	37.9	36.5	38.6
Net debt to equity	-48.9	-46.0	-45.4	-45.0	-46.4
Total debt to capital	3.3	0.2	0.2	0.1	0.1

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Company Focus

I-Flex Solutions (IFLX.BO)

Sell: Valuations expensive; play on delisting

Rating change ☐
Target price change ☑
Estimate change ☑

Sell/Medium Risk	3M
Price (12 Jun 07)	Rs2,358.95
Target price	Rs2,025.00
from Rs1,850.00	
Expected share price return	-14.2%
Expected dividend yield	0.0%
Expected total return	**-14.2%**
Market Cap	Rs197,381M
	US$4,866M

Price Performance (RIC: IFLX.BO, BB: IFLEX IN)

Statistical Abstract

Year to 31 Mar	Net Profit (RsM)	Diluted EPS (Rs)	EPS growth (%)	P/E (x)	P/B (x)	ROE (%)	Yield (%)
2006A	2,190	28.26	7.8	83.5	13.4	17.6	0.1
2007A	2,756	35.20	24.6	67.0	11.3	18.4	0.0
2008E	3,819	48.79	38.6	48.3	9.1	20.9	0.0
2009E	5,280	67.45	38.2	35.0	7.2	23.1	0.0
2010E	7,219	92.23	36.7	25.6	5.6	24.8	0.0

Source: Powered by dataCentral

- Quarter below expectations — I-flex Solutions revenue grew 5.3% qoq while EBITDA margin declined 49bps qoq (due to lower license revenue in product business). Higher taxes led to almost flat earnings for the quarter.

- Services business reported a strong quarter — Growth of 10% was above our expectations while margin expansion of 840 bps surprised us positively. This was driven by a) milestone recognition in fixed price contract, b) higher utilization and d) higher growth from non-top client.

- Margin leverage from product business — Product business continues to do well – there were 16 new client wins. FLEXCUBE won a deal to replace the entire retail banking platform for Allied Irish bank and two Islamic banking wins. New signings during the quarter were at US$15.8 mn with quarter-end tank size of US$82.5 mn - highest level reached till date.

- Product business to provide margin leverage — With most of the investments in FLEXCUBE over (including localization for most of geographies), we expect margins in product business to expand. This is likely to give significant leverage to I-flex despite margin erosion in services business on the back of wages and rupee appreciation.

- Earnings revision incorporates lower 4Q and new forex — We have incorporated forex rates of Rs.41 and 40 for FY08and FY09 respectively. After incorporating new forex and weak 4Q07, we cut our FY08-09 estimates by 5-7%; we have also introduced FY10 estimates.

- Maintain Sell — We roll forward our target price to FY09 earnings (from avg. FY08-09 EPS earlier) while maintaining target multiple of 30x to get our new target price of Rs.2025 (Rs.1,850). Stock trading at 95% and 71% premium to Infosys valuation on FY08 and FY09 earnings, we see limited upside from the current levels. Maintain Sell/Medium Risk (3M).

Fiscal year end 31-Mar	2006	2007	2008E	2009E	2010E
Valuation Ratios					
P/E adjusted (x)	83.5	67.0	48.3	35.0	25.6
EV/EBITDA adjusted (x)	64.3	52.8	34.5	25.0	18.4
P/BV (x)	13.4	11.3	9.1	7.2	5.6
Dividend yield (%)	0.1	0.0	0.0	0.0	0.0
Per Share Data (Rs)					
EPS adjusted	28.26	35.20	48.79	67.45	92.23
EPS reported	28.26	35.20	48.79	67.45	92.23
BVPS	175.76	209.16	257.95	325.40	417.62
DPS	1.50	0.00	0.00	0.00	0.00
Profit & Loss (RsM)					
Net sales	14,835	20,381	25,526	32,511	40,995
Operating expenses	-12,389	-17,628	-20,965	-26,119	-32,231
EBIT	**2,446**	**2,753**	**4,561**	**6,392**	**8,765**
Net interest expense	275	350	213	250	316
Non-operating/exceptionals	3	-5	0	0	0
Pre-tax profit	**2,724**	**3,098**	**4,774**	**6,641**	**9,081**
Tax	-534	-342	-955	-1,361	-1,862
Extraord./Min.Int./Pref.div.	0	0	0	0	0
Reported net income	**2,190**	**2,756**	**3,819**	**5,280**	**7,219**
Adjusted earnings	2,190	2,756	3,819	5,280	7,219
Adjusted EBITDA	2,950	3,585	5,487	7,481	10,034
Growth Rates (%)					
Sales	30.1	37.4	25.2	27.4	26.1
EBIT adjusted	0.5	12.6	65.7	40.1	37.1
EBITDA adjusted	6.5	21.5	53.0	36.4	34.1
EPS adjusted	7.8	24.6	38.6	38.2	36.7
Cash Flow (RsM)					
Operating cash flow	**1,770**	**738**	**2,803**	**3,772**	**5,320**
Depreciation/amortization	504	832	925	1,089	1,269
Net working capital	-741	-2,387	-1,729	-2,348	-2,852
Investing cash flow	**-1,543**	**-1,157**	**-1,587**	**-1,550**	**-1,484**
Capital expenditure	-1,393	-1,500	-1,800	-1,800	-1,800
Acquisitions/disposals	78	0	0	0	0
Financing cash flow	**139**	**-5**	**0**	**0**	**0**
Borrowings	-2	0	0	0	0
Dividends paid	-132	0	0	0	0
Change in cash	**366**	**-424**	**1,216**	**2,221**	**3,837**
Balance Sheet (RsM)					
Total assets	**17,768**	**19,669**	**23,489**	**28,769**	**35,988**
Cash & cash equivalent	6,873	6,448	7,664	9,885	13,722
Accounts receivable	5,257	6,850	8,579	10,927	13,779
Net fixed assets	2,174	2,842	3,717	4,427	4,958
Total liabilities	**4,144**	**3,297**	**3,297**	**3,297**	**3,297**
Accounts payable	140	140	140	140	140
Total Debt	30	30	30	30	30
Shareholders' funds	**13,623**	**16,373**	**20,192**	**25,472**	**32,692**
Profitability/Solvency Ratios (%)					
EBITDA margin adjusted	19.9	17.6	21.5	23.0	24.5
ROE adjusted	17.6	18.4	20.9	23.1	24.8
ROIC adjusted	39.8	33.9	36.3	39.4	43.2
Net debt to equity	-50.2	-39.2	-37.8	-38.7	-41.9
Total debt to capital	0.2	0.2	0.1	0.1	0.1

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Company Focus

Sasken Communication Technologies (SKCT.BO)

Buy: Product business leverage to play out

Rating change ☐
Target price change ☑
Estimate change ☑

Buy/Medium Risk	1M
Price (12 Jun 07)	Rs508.90
Target price	Rs643.00
from Rs653.00	
Expected share price return	26.4%
Expected dividend yield	0.6%
Expected total return	26.9%
Market Cap	Rs14,504M
	US$358M

Price Performance (RIC: SKCT.BO, BB: SACT IN)

Statistical Abstract

Year to 31 Mar	Net Profit (RsM)	Diluted EPS (Rs)	EPS growth (%)	P/E (x)	P/B (x)	ROE (%)	Yield (%)
2006A	229	8.09	-40.2	62.9	3.7	8.7	0.6
2007A	452	15.86	96.1	32.1	3.4	11.2	0.6
2008E	766	26.85	69.4	19.0	3.0	17.0	1.0
2009E	1,078	37.76	40.6	13.5	2.6	20.7	2.0
2010E	1,378	48.31	27.9	10.5	2.2	22.6	2.0

Source: Powered by dataCentral

- Services business impacted by telecom OEM consolidation — Services business has been impacted by consolidation in the Telecom OEM space. We expect 1Q to be slow and growth to pick up 2Q onwards.

- Product roadmap remains healthy — Product roadmap remains very healthy with the first Motorola phone getting launched in this quarter. Tying up with Motorola for multimedia applications for all Symbian UIQ phones is a big positive in our view.

- 4QFY07 was below expectations — 4QFY07 was below expectations primarily on the services side with services revenues being flat QoQ. Product revenues did pick up – Sasken reported ~$2m product revenues in the quarter.

- Earnings revision factors our new INR forecast — Using our new INR forecast, we have downgraded Sasken's earnings for FY08 and FY09 by 14% and 10% respectively. The downgrade is primarily on account of currency and factoring in the below-expectation 4Q.

- Revising target price downwards — We also lower our target price in line with our estimates. Our new target price is Rs. 643 (previously Rs.653) based on SOTP valuation.

Fiscal year end 31-Mar	2006	2007	2008E	2009E	2010E
Valuation Ratios					
P/E adjusted (x)	62.9	32.1	19.0	13.5	10.5
EV/EBITDA adjusted (x)	28.5	19.3	13.9	9.5	7.4
P/BV (x)	3.7	3.4	3.0	2.6	2.2
Dividend yield (%)	0.6	0.6	1.0	2.0	2.0
Per Share Data (Rs)					
EPS adjusted	8.09	15.86	26.85	37.76	48.31
EPS reported	8.09	15.86	26.85	37.76	48.31
BVPS	138.10	150.09	171.57	198.34	235.82
DPS	3.01	3.00	5.00	10.00	10.00
Profit & Loss (RsM)					
Net sales	3,081	4,751	6,397	8,103	10,222
Operating expenses	-2,779	-4,262	-5,627	-6,898	-8,689
EBIT	**303**	**489**	**770**	**1,205**	**1,532**
Net interest expense	0	0	0	0	0
Non-operating/exceptionals	63	73	170	85	101
Pre-tax profit	**365**	**562**	**940**	**1,290**	**1,634**
Tax	-69	-109	-174	-213	-255
Extraord./Min.Int./Pref.div.	-68	0	0	0	0
Reported net income	**229**	**452**	**766**	**1,078**	**1,378**
Adjusted earnings	229	452	766	1,078	1,378
Adjusted EBITDA	472	706	1,048	1,506	1,865
Growth Rates (%)					
Sales	27.4	54.2	34.7	26.7	26.1
EBIT adjusted	42.0	61.4	57.7	56.5	27.1
EBITDA adjusted	33.0	49.5	48.4	43.7	23.8
EPS adjusted	-40.2	96.1	69.4	40.6	27.9
Cash Flow (RsM)					
Operating cash flow	**149**	**277**	**888**	**1,316**	**1,567**
Depreciation/amortization	170	218	278	301	332
Net working capital	-250	-393	-156	-63	-144
Investing cash flow	**-454**	**-451**	**-550**	**-686**	**-709**
Capital expenditure	-454	-449	-550	-686	-709
Acquisitions/disposals	0	0	0	0	0
Financing cash flow	**2,332**	**1,174**	**-346**	**-508**	**-435**
Borrowings	-3	904	-183	-183	-110
Dividends paid	-96	-98	-163	-325	-325
Change in cash	**2,027**	**1,001**	**-8**	**121**	**423**
Balance Sheet (RsM)					
Total assets	**4,243**	**5,908**	**6,435**	**7,239**	**8,473**
Cash & cash equivalent	2,015	717	766	958	1,469
Accounts receivable	653	1,108	1,367	1,665	2,100
Net fixed assets	1,011	2,996	3,268	3,653	4,029
Total liabilities	**392**	**1,694**	**1,613**	**1,665**	**1,847**
Accounts payable	0	0	0	0	0
Total Debt	12	916	733	550	440
Shareholders' funds	**3,850**	**4,218**	**4,821**	**5,573**	**6,627**
Profitability/Solvency Ratios (%)					
EBITDA margin adjusted	15.3	14.9	16.4	18.6	18.2
ROE adjusted	8.7	11.2	17.0	20.7	22.6
ROIC adjusted	14.8	12.1	13.0	19.9	23.7
Net debt to equity	-52.0	4.7	-0.7	-7.3	-15.5
Total debt to capital	0.3	17.8	13.2	9.0	6.2

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Company Focus

Hexaware Technologies (HEXT.BO)

Buy: Margin challenges remain

Rating change ☐
Target price change ☐
Estimate change ☑

Buy/Medium Risk	1M
Price (12 Jun 07)	Rs163.60
Target price	Rs214.00
Expected share price return	30.8%
Expected dividend yield	1.2%
Expected total return	32.0%
Market Cap	Rs21,731M
	US$536M

Price Performance (RIC: HEXT.BO, BB: HEXW IN)

Statistical Abstract

Year to 31 Dec	Net Profit (RsM)	Diluted EPS (Rs)	EPS growth (%)	P/E (x)	P/B (x)	ROE (%)	Yield (%)
2005A	913	7.50	49.1	21.8	5.6	29.7	0.4
2006A	1,242	9.02	20.2	18.1	3.6	26.2	1.0
2007E	1,492	10.30	14.2	15.9	2.8	20.7	1.2
2008E	1,820	12.57	22.0	13.0	2.4	20.0	1.5
2009E	2,177	15.03	19.6	10.9	2.0	20.4	1.7

Source: Powered by dataCentral

- 1Q07 below expectation; Q2 guidance muted — Hexaware reported revenue of US$60.1mn up 11.8% qoq – marginally below expectation. Moreover, higher SG&A expenses and higher taxes led to net profit at Rs.252 mn (again below our expectation). Management guided for Q2 revenue of US$64-65 mn and net profit of US$7-7.2 mn.

- Hiring plan curtailed; Focus on utilization — Company had a manpower decline of 78 people in 1Q as management focused on better utilization – utilization was up 250 bps. Also, hiring guidance for FY07 was reduced from 2,000 additions earlier to about ~1,500 additions for the full year.

- Improved client metrics; new order wins — Company added 20 new clients during the quarter while US$1mn accounts grew by 5 to 46 at the end of Mar'07. Hexaware bagged US$10 mn deal from its existing top 5 account for cargo management system. Company had two other significant wins – new generation airline reservation domain and BI-related analytics engagement.

- Estimates cut post 1Q07 and currency impact — We have factored in new currency estimates and also incorporated lower than expected 1Q07 into our estimates. Our new EPS estimates are 8-10% lower than previous estimates.

- Target price maintained at Rs.214; Maintain Buy (1M) — We roll forward our target multiple to CY08 while maintaining multiple of 17x - our target price is maintained at 214 indicating an upside of 32% from the current levels.

Fiscal year end 31-Dec	2005	2006	2007E	2008E	2009E
Valuation Ratios					
P/E adjusted (x)	21.8	18.1	15.9	13.0	10.9
EV/EBITDA adjusted (x)	19.1	15.3	11.4	8.7	6.8
P/BV (x)	5.6	3.6	2.8	2.4	2.0
Dividend yield (%)	0.4	1.0	1.2	1.5	1.7
Per Share Data (Rs)					
EPS adjusted	7.50	9.02	10.30	12.57	15.03
EPS reported	7.50	9.02	10.30	12.57	15.03
BVPS	29.11	45.46	58.85	68.86	80.92
DPS	0.60	1.60	2.00	2.40	2.80
Profit & Loss (RsM)					
Net sales	6,787	8,482	11,299	13,748	17,143
Operating expenses	-5,913	-7,360	-9,850	-11,907	-14,810
EBIT	**874**	**1,122**	**1,449**	**1,841**	**2,333**
Net interest expense	139	241	269	261	288
Non-operating/exceptionals	0	0	0	0	0
Pre-tax profit	**1,012**	**1,363**	**1,718**	**2,102**	**2,621**
Tax	-100	-120	-225	-281	-444
Extraord./Min.Int./Pref.div.	0	0	0	0	0
Reported net income	**913**	**1,242**	**1,492**	**1,820**	**2,177**
Adjusted earnings	913	1,242	1,492	1,820	2,177
Adjusted EBITDA	1,084	1,322	1,679	2,111	2,643
Growth Rates (%)					
Sales	24.3	25.0	33.2	21.7	24.7
EBIT adjusted	43.1	28.4	29.1	27.0	26.7
EBITDA adjusted	40.5	22.0	27.0	25.7	25.2
EPS adjusted	49.1	20.2	14.2	22.0	19.6
Cash Flow (RsM)					
Operating cash flow	**537**	**1,032**	**1,244**	**1,302**	**1,624**
Depreciation/amortization	210	200	231	270	310
Net working capital	-485	-202	-210	-527	-574
Investing cash flow	**-173**	**-1,768**	**-958**	**-861**	**-1,124**
Capital expenditure	-173	-1,768	-958	-861	-1,124
Acquisitions/disposals	0	0	0	0	0
Financing cash flow	**40**	**2,962**	**-332**	**-132**	**-170**
Borrowings	10	-61	0	0	0
Dividends paid	-164	-247	-315	-393	-458
Change in cash	**403**	**2,227**	**-47**	**310**	**330**
Balance Sheet (RsM)					
Total assets	**4,713**	**9,211**	**10,605**	**12,248**	**14,578**
Cash & cash equivalent	1,187	3,414	3,319	3,629	3,958
Accounts receivable	1,836	2,063	2,476	3,013	3,757
Net fixed assets	933	2,501	3,228	3,819	4,633
Total liabilities	**1,239**	**1,712**	**2,263**	**2,478**	**3,089**
Accounts payable	0	0	0	0	0
Total Debt	62	0	0	0	0
Shareholders' funds	**3,474**	**7,500**	**8,391**	**9,819**	**11,537**
Profitability/Solvency Ratios (%)					
EBITDA margin adjusted	16.0	15.6	14.9	15.4	15.4
ROE adjusted	29.7	26.2	20.7	20.0	20.4
ROIC adjusted	36.9	31.3	26.8	27.9	27.6
Net debt to equity	-32.4	-45.5	-39.6	-37.0	-34.3
Total debt to capital	1.7	0.0	0.0	0.0	0.0

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Company Focus

KPIT Cummins Infosystems (KPIT.BO)

Buy: Differentiated service offering

Rating change ☐
Target price change ☑
Estimate change ☑

Buy/Medium Risk	1M
Price (12 Jun 07)	Rs143.85
Target price	Rs180.00
from Rs173.00	
Expected share price return	25.1%
Expected dividend yield	0.3%
Expected total return	**25.5%**
Market Cap	Rs10,923M
	US$269M

Price Performance (RIC: KPIT.BO, BB: NKPIT IN)

Statistical Abstract

Year to 31 Mar	Net Profit (RsM)	Diluted EPS (Rs)	EPS growth (%)	P/E (x)	P/B (x)	ROE (%)	Yield (%)
2006A	326	3.66	7.0	39.3	7.3	26.3	0.2
2007A	505	5.67	55.0	25.4	5.4	29.6	0.2
2008E	659	8.10	42.9	17.8	4.2	28.7	0.3
2009E	914	11.24	38.7	12.8	3.2	30.1	0.5
2010E	1,081	13.29	18.3	10.8	2.5	27.3	0.5

Source: Powered by dataCentral

- Strong 4Q; beats expectations — KPIT reported revenue of Rs.1.3 bn (up 11.3% qoq and 44.6% yoy), 3% ahead of our estimates. EBITDA margin at 15.8% was marginally ahead of estimates. The company completed the year with revenue above its guidance and net profits within guided range.

- Bullish guidance; a stretch, in our view — Company has guided for revenue of US$143 mn (40% growth) and net profit of Rs. 700-730 mn (39-45% growth) assuming forex rate of 43 INR/USD. We believe this is a stretch especially given the sharp rupee appreciation. Our current estimates for FY08 are 6% lower than the lower end of guidance as we factor currency of 41.75 INR/USD.

- Hiring guidance indicates strong business pipeline — The company has added 1,134 employees (54% of year ago base) over FY07. Management indicated plans of 2,400 gross hiring over FY09. Healthy hiring indicates a strong business pipeline.

- Minor operational upgrade; cutting estimates for INR appreciation — We revise our estimates factoring in strong Q4 and better hiring guidance. However, this upgrade is overshadowed by lower currency rates. We cut our FY08-09 estimates by 9-11% while incorporating new estimates for FY10.

- Maintain Buy (1M) — We raise our target price to Rs.180 (previously Rs.173) as we roll forward the target to FY09 EPS while maintaining target multiple of 16x. Our new target price indicates 25% upside from current levels.

Fiscal year end 31-Mar	2006	2007	2008E	2009E	2010E
Valuation Ratios					
P/E adjusted (x)	39.3	25.4	17.8	12.8	10.8
EV/EBITDA adjusted (x)	24.0	16.0	12.0	8.7	6.7
P/BV (x)	7.3	5.4	4.2	3.2	2.5
Dividend yield (%)	0.2	0.2	0.3	0.5	0.5
Per Share Data (Rs)					
EPS adjusted	3.66	5.67	8.10	11.24	13.29
EPS reported	3.66	5.67	8.10	11.24	13.29
BVPS	19.67	26.62	34.18	45.30	58.63
DPS	0.35	0.35	0.50	0.75	0.75
Profit & Loss (RsM)					
Net sales	3,182	4,637	6,015	8,013	10,196
Operating expenses	-2,804	-4,043	-5,229	-6,943	-8,848
EBIT	**378**	**594**	**786**	**1,070**	**1,348**
Net interest expense	0	0	0	0	0
Non-operating/exceptionals	-19	-39	-48	-43	-26
Pre-tax profit	**359**	**555**	**737**	**1,028**	**1,322**
Tax	-33	-52	-81	-113	-238
Extraord./Min.Int./Pref.div.	0	2	3	-1	-3
Reported net income	**326**	**505**	**659**	**914**	**1,081**
Adjusted earnings	326	505	659	914	1,081
Adjusted EBITDA	462	715	945	1,256	1,552
Growth Rates (%)					
Sales	26.0	45.7	29.7	33.2	27.2
EBIT adjusted	24.9	57.3	32.2	36.2	25.9
EBITDA adjusted	38.1	54.9	32.1	32.9	23.5
EPS adjusted	7.0	55.0	42.9	38.7	18.3
Cash Flow (RsM)					
Operating cash flow	**-156**	**777**	**757**	**875**	**985**
Depreciation/amortization	84	121	160	186	204
Net working capital	-587	109	-107	-268	-328
Investing cash flow	**-519**	**-979**	**-316**	**-353**	**-492**
Capital expenditure	-500	-940	-267	-310	-466
Acquisitions/disposals	0	0	0	0	0
Financing cash flow	**540**	**414**	**-346**	**-364**	**-362**
Borrowings	505	348	-300	-300	-300
Dividends paid	-26	-30	-43	-65	-65
Change in cash	**-135**	**212**	**95**	**159**	**131**
Balance Sheet (RsM)					
Total assets	**2,675**	**3,842**	**4,142**	**4,892**	**5,829**
Cash & cash equivalent	411	625	723	881	1,009
Accounts receivable	868	1,102	1,269	1,647	2,095
Net fixed assets	826	1,427	1,534	1,658	1,921
Total liabilities	**1,253**	**1,849**	**1,536**	**1,436**	**1,354**
Accounts payable	0	0	0	0	0
Total Debt	875	1,223	923	623	323
Shareholders' funds	**1,422**	**1,993**	**2,606**	**3,456**	**4,474**
Profitability/Solvency Ratios (%)					
EBITDA margin adjusted	14.5	15.4	15.7	15.7	15.2
ROE adjusted	26.3	29.6	28.7	30.1	27.3
ROIC adjusted	24.8	24.1	26.0	31.8	31.7
Net debt to equity	32.6	30.0	7.7	-7.5	-15.3
Total debt to capital	38.1	38.0	26.2	15.3	6.7

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Tata Consultancy Services

Company description

TCS is India's largest and among the oldest IT companies. It is part of the diversified Tata Group, one of the largest corporate groups in Asia. It has more than 83,500 employees, including its subsidiaries, with marketing presence across 32 countries and development presence in 10 countries besides India. It provides a comprehensive range of IT services to industries such as banking and financial services, insurance, manufacturing, telecommunications, retail and transportation. It had more than 780 active clients at end-4Q07, including six of the Fortune Top 10 companies in the US. The company started with data processing work in 1968, and was the first to provide offshore services in 1974. Over the last three decades, the company has come a long way with deep technical and project management expertise in handling complex client projects and strong offshore processes.

Investment thesis

We rate TCS as Buy/Low Risk (1L) based on a fundamental 12-month view. As India's largest and most experienced IT services firm, TCS looks well positioned to benefit from the growing demand for offshore IT services. It is a well-regarded stock among investors familiar with India and the IT-services sector. We believe TCS' margins in its international IT services business (around 95% of EBIT) are likely to trend down over the next few years. However, we expect this decline to be relatively modest, as we expect positive leverage from a better onsite-offshore mix, more hiring of fresh graduates, and improved utilization with a strong demand outlook to offset margin pressures from wage inflation. We expect a revenue CAGR of 25% and an EPS CAGR of 20% in FY07-10E.

Valuation

Our target price of Rs1,460 is based on a P/E of 24x FY09E EPS, derived from a 4% discount to our target 25x FY09E EPS for Infosys, TCS's closest peer on business model. We expect TCS to continue to trade at slightly lower multiples than Infosys due to its slower long-term growth and investors' greater comfort and familiarity with Infosys. Our target price assumes a one-year forward P/E of 40-50% above the average BSE Sensex multiple, which we think is justified given TCS' superior FCF, RoIC and growth rates than the overall market, and it actually implies a slightly lower premium than that for Infosys. We believe P/E remains the most appropriate valuation measure given TCS' profitable track record and strong earnings visibility.

Risks

We rate TCS as Low Risk, consistent with our quantitative stock-volatility based risk-rating system. Fundamentally also, given the stock's below-market beta, its relatively high earnings visibility, strong cash flows and balance sheet - along with our Low Risk rating for its local peers Infosys and Wipro - we believe a Low Risk rating for TCS is reasonable. The key downside risks that could impede the stock from reaching our target price include: (1) Any significant appreciation of the rupee against the US Dollar/Euro/GBP; (2) A sharp slowdown in the US economy; (3) H1B visa quotas; (4) Large exposure to the GE Group; (5) Large exposure to fixed-price contracts; (6) TCS's higher onsite revenue contribution (~60% of total); and (7) Acquisition-related risks, including M&A with other Tata-group IT firms.

Wipro

Company description

Wipro is India's leading Indian company with business interests in IT and BPO services exports, domestic hardware, consumer lighting and consumer care. It has one of the widest range of services, including systems integration, IT-enabled services, package implementation, software application development and maintenance, and R&D services. Wipro is the first P CMM Level 5 and SEI CMM Level 5 certified IT services company in the world. It has close to 600 clients spanning the BFSI, Manufacturing, Retail, Utilities and Telecom verticals. Its IT services exports team has more than 50,000 employees and BPO operation has around 17,000 employees.

Investment thesis

We rate Wipro as Buy/Low Risk (1L). Being one of the top three Indian IT services firms, Wipro looks well positioned to benefit from the growing demand for offshore IT services. Apart from economies of scale in offshore delivery, one of Wipro's key strengths is its full-service model. This includes a strong position in the infrastructure/R&D services business, which offers significant long-term growth potential. It has strong exposure to the BPO segment, which should offer above-average growth in the long term. Wipro's management has actively pursued acquisitions to strengthen its service portfolio. We expect Wipro's global IT revenues to grow above the industry average rates over the next 2-3 years. We believe wage inflation will be largely offset by gains from improved employee mix, an improving offshore-onsite ratio and better utilization. We expect 25% revenue CAGR and 18% EPS CAGR over FY07-10E. For the global IT business, we expect 23% revenue CAGR.

Valuation

Our 12-month target price of Rs650 is based on 22x FY09E EPS - a 12% discount to our target multiple for Infosys. Our target multiple is supported by a P/E-band analysis of Wipro's historical trading pattern and peer group valuations. Because of its small free float, strong exposure to R&D services and a model leveraged to large SI and IT outsourcing deals, Wipro has historically (over the past three years) traded at a premium of 10-20% to Infosys. But now Wipro has started trading at a discount to Infosys due to Wipro's lower growth and RoIC/RoE in the recent past. We think Wipro will continue to trade at a marginal discount to Infosys given expected sub-par growth vs. Infosys in the coming years. We believe P/E is the most appropriate valuation measure given Wipro's profitability and earnings visibility.

Risks

Although our quantitative risk-rating system suggests Medium Risk for Wipro, we rate Wipro as Low Risk given its diversified services and vertical portfolio. This is in line with our risk ratings for other large peer-group companies in our coverage universe. The key downside risks that could impede the stock from reaching our target price include: high exposure to the telecom/tech sectors (36% of total); risks to earnings from a sharp US slowdown; any significant appreciation of the rupee against the US Dollar/Euro/GBP; a sharp slowdown in the US economy; a slowdown in the banking, financial services and insurance (BFSI) sector; H1B visa quotas; and acquisition-related risks.

Satyam Computers Services

Company description

Satyam is the fourth-largest IT solutions provider from India and is one of the pioneers of offshore IT services delivery. The company has more than 500 clients across the globe and employs over 38,500 professionals across IT and BPO services. Satyam was an early entrant into IT consulting/package implantation work. As of 4Q FY07, ~42% of its revenue came from this service line. It has domain competencies in verticals such as Manufacturing, Banking & Financial Service and Insurance, among others.

Investment thesis

We rate Satyam as Buy/Medium Risk (1M). We believe offshore IT outsourcing is now a mainstream option and Satyam, which has achieved meaningful scale with its top-five position in India, appears well positioned to benefit from growing business volumes. Over the past several quarters, volume growth has trended at over 5% qoq. With revenue of over US$1bn, Satyam becomes a strong contender for winning large deals. It has won at least three large deals over the past four quarters. We expect a gradual margin decline (rather than steep), as wage inflation should be partly offset by positive leverage from a better onsite-offshore mix, hiring strategies and improved utilization. Overall, we forecast 24.4% revenue CAGR and 16% EPS CAGR over FY07-10E.

Valuation

Our 12-month target is Rs570, based on 19x FY09E earnings. We value Satyam on a P/E basis relative to its medium-term growth potential and also on its valuation relative to peer Infosys, which is the industry benchmark. Given that we expect Satyam's earnings to grow at 16% CAGR over the next three years, we believe the stock should trade toward the upper end of its historical three-year trading range of 12-21x 12-month forward earnings. Satyam has traded at a 10-40% discount to Infosys in the past two years due to its lower growth rates. Our forward P/E is based on a ~25% discount to our target multiple of 25x for Infosys.

Risks

Although our quantitative risk-rating system suggests Low Risk for Satyam, we rate Satyam as Medium Risk given the similar risk ratings for other mid-sized IT peer-group companies in our coverage universe. The key downside risks that could impede the shares from reaching our target price include: (1) A slowdown in enterprise software license revenues; (2) The supply side situation becoming more difficult; (3) Risks to earnings from a sharp US slowdown; (4) Any significant appreciation of the rupee against the US Dollar/Euro/GBP; (5) A sharp slowdown in the US economy; (6) A slowdown in the banking, financial services and insurance (BFSI) sector; and (7) Limited H1B visa quotas.

HCL Technologies

Company description

HCL Tech is the fifth-largest Indian IT services company. Founded in 1991, HCL Tech focused on technology and R&D outsourcing before diversifying into enterprise applications. In the infrastructure business, it has been gradually shifting focus from domestic sales to global services. In BPO, it is the third-largest offshore services provider and boasts strong ties with British Telecom and SBC. The company leverages off its extensive offshore infrastructure and its global network of 26 offices in 15 countries to deliver solutions across verticals including Banking, Insurance, Retail & Consumer, Aerospace, Automotive, Semiconductors, Telecom and Life Sciences. HCL Tech has more than 230 clients across verticals, and a workforce of 40,000.

Investment thesis

We rate HCL Tech as Buy/Medium (1M) Risk. Based on our analysis, offshore IT services demand will remain strong, with industry revenues forecast to grow 25-30% pa over the next four years. HCL Tech has been at the forefront of pursuing large deals. It has won at least four multi-year US$50m-plus deals in the past fiscal year. Significant presence across IT services, BPO services and IMS has helped HCL Tech to qualify for multi-year outsourcing deals. Infrastructure-management services, R&D and BPO service offerings should enable it to post strong revenue growth. We forecast 28% revenue CAGR and 28% EPS CAGR for FY06-09. The stock has underperformed the Sensex for the past two quarters.

Valuation

Our 12-month target price is Rs400 based on 18x FY09E EPS. We value HCL Tech relative to Satyam, which is similar to HCL Tech in terms of revenue. We expect a 28% CAGR in earnings for the next three years, and believe the stock should trade toward the higher end of its historical three-year trading range of 14-23x 12-month forward earnings. HCL Tech has traded on a par with Satyam in the past two years. Our P/E target is based on a ~5% discount to our target multiple of 19x for Satyam primarily because of lower growth and return ratios than Satyam. We believe P/E remains the most appropriate valuation measure given HCL Tech's past profitability and future earnings visibility.

Risks

We rate HCL Tech as Medium Risk based on our quantitative risk-rating system, which tracks 260-day historical share price volatility. The key downside risks that could impede the stock from reaching our target price include: (1) significant QoQ volatility in growth rates; (2) any significant appreciation of the rupee against the US dollar/euro/pound; (3) a sharp slowdown in the US economy; (4) a slowdown in the banking, financial services and insurance (BFSI) sector; (5) H1B visa quotas; (6) acquisition-related risks; and (7) the strategy of pursuing large deals could have negative margin implications.

I-Flex Solutions

Company description

I-Flex Solutions is a leading software vendor for the banking and financial services vertical. Its core banking product suite - FLEXCUBE - has been ranked the world's No. 1 selling Core Banking Solution for four years in a row since 2002. The company has gained from its focus on a single vertical. It employs more than 9,000 people serving more than 660 customers in over 120 countries. I-Flex's services business has also grown rapidly in the past few years – the services business is focused on the BFSI industry. The company also offers high-end transaction processing services through its KPO subsidiary.

Investment thesis

We rate I-Flex as Sell/Medium Risk (3M). Our view is primarily on valuation concerns. We maintain a positive view on the overall IT services and software sector in India. Flexcube (I-Flex's flagship product) has been ranked No. 1 by IBS (in terms of the number of licenses sold) for the past four years. Also, we believe the Oracle acquisition of a majority stake in I-Flex would lead to better revenue growth for I-Flex solutions because it can leverage the marketing strength of Oracle for selling its banking product to banks in developed countries. According to mgmt, American financial companies are more receptive to I-Flex's product suite after the Oracle stake acquisition. We estimate 26% revenue CAGR and 38% EPS CAGR over FY07-10. We expect operating margins to rebound after the sharp declines in FY06 and FY07. We forecast EBITDA margin to increase gradually to 24.5% for FY10E on strong revenue growth and product leverage. At current valuations, we think the stock has largely factored in all the upside from the Oracle synergies. We believe this valuation makes the risk/reward unfavorable for new investors and leaves little upside potential.

Valuation

Our 12-month target price is Rs2,025 based on a target multiple of 30x FY09E earnings. Our target multiple is based on the average of the past year valuation P/E band of 22-39x 12-month forward earnings. I-Flex has in the past few quarters started trading at a sizeable premium to the valuation of Infosys – the market leader in the Indian IT services space. Since the acquisition of a majority stake by Oracle, I-Flex has continued to trade at a high premium; many investors see the stock as providing exposure to a possible delisting – historically, all the delistings in the Indian IT space have yielded attractive returns for investors. We believe I-Flex will continue to remain the most expensive IT stock given operating leverage in the business, synergies from the Oracle ownership relationship, and a scarcity premium as the only large listed Indian product play. We believe P/E-based valuation is the most appropriate given I-Flex's profitable track record and widespread investor use of this tool.

Risks

Although our quantitative risk-rating system, which tracks historical 260-day share price volatility, suggests Low Risk for I-Flex Solutions shares, we rate I-Flex as Medium Risk given the high quarterly volatility of its revenue and our similar risk ratings for other mid-sized IT peer-group companies in our coverage universe. The key upside risks to our target price include (1) any significant depreciation of the rupee against the US dollar/euro/pound; (2) a sharp pick-up in discretionary spending by the banking sector; (3) an exceptionally strong quarter; (4) increased deal flow; (5) the possibility of de-listing of I-Flex on the open offer from Oracle; (6) I-Flex acquiring a small- to mid-size company at attractive valuations.

Sasken Communication Technologies

Company description

Bangalore-based Sasken was established in 1989 and initially worked on electronic design automation projects. It now offers embedded software services to network equipment manufacturers, device manufacturers and service providers in the wireless and broadband space, and semiconductor vendors. Key clients include large tier-one vendors such as Nokia and Nortel. Sasken has also been investing in a products business.

Investment thesis

We rate Sasken as Buy/Medium Risk (1M). Increasing competition is driving telecoms vendors to outsource software and services to countries such as India. R&D services are being outsourced from India. Sasken, with a strong focus on the telecoms and embedded space, is benefiting from this trend. We expect Sasken's services business to record a 29% CAGR over FY07-10. The acquisition of Botnia has helped in accelerating growth. The products business is in investment mode, but the number of design-ins is encouraging. We expect a ramp-up and a turnaround in the products business in FY08; we forecast a 68% CAGR in revenues over FY07-10 and see the business turning around from losses to a 30%-plus margin in FY10.

Valuation

Our 12-month target price of Rs643 is based on a sum-of-the-parts valuation for the services business and the loss-making products business. We apply an FY09E EV/EBITDA target of 11x for Sasken's services business, which is supported by the target valuations of comparable mid-caps. We value Sasken's products business at 3x EV/Sales, similar to the valuation Motorola paid for Sasken's largest competitor, TTPCom, and is supported by our forecast 30%-plus margin in FY09. Our target price implies a P/E of 17x FY09E EPS — in line with mid-cap valuations.

Risks

Our quantitative risk rating system, which tracks 260-day historical share price volatility, rates Sasken as Medium Risk. Risks that could impede the stock from reaching our target price include: (1) high client concentration; (2) slowdown in the telecoms industry; (3) delays in the handset launches in which Sasken is involved, or poor customer response to the handsets; (4) technology obsolescence; (5) wage inflation and currency appreciation; and (6) volatility in QoQ revenues, as investors are used to more linear models of growth for most Indian IT services companies.

Hexaware Technologies

Company description

Hexaware was established in 1992 and began international operations in 1995. In February 2001, it merged with the software division of Aptech. The merged entity was later de-merged from the training arm of Aptech and listed as Hexaware Technologies. In NASSCOM's 2006 rankings, Hexaware was the 12th-largest IT service exporter in India. It offers BPO service through 100% subsidiary CaliberPoint. Hexaware has built its business by scaling up in such niche areas as ERP, airlines and BFSI. It employs nearly 6,000 people in its IT and BPO operations, and has more than 150 clients.

Investment thesis

We rate Hexaware as Buy/Medium Risk (1M). Offshore IT outsourcing has now become the norm, with scale IT services players as well as smaller companies with niche focus benefiting. Hexaware has carved a niche for itself in several small though scalable areas, and has targeted under-penetrated markets. Ties with PeopleSoft/Exult have helped Hexaware develop expertise in HR-IT, and relationships with Air Canada/Lufthansa have led the company to the broader travel and transportation vertical. Hexaware is developing expertise in testing solution through organic and inorganic initiatives. We forecast a 26% revenue CAGR and a 19% EPS CAGR for Hexaware over 2006-09, driven by niche segments and the company's ability to mine clients.

Valuation

Our 12-month target price of Rs214 is based on 17x the average EPS for CY08E, which is derived by using a ~10% discount to our target multiple for Satyam of 19x. We believe the discount is fair, as Satyam is a larger and more diversified company. For Hexaware, we expect a 26% revenue CAGR and a 21% net profit CAGR over FY06-09. However, dilution from the GAP stake and ESOPs lowers the fully diluted EPS CAGR to 19% over the same period. We use Satyam as a benchmark to value all mid-tier IT services companies. We believe 17x is a fair multiple given the growth we expect for Hexaware over the next three years. Our target multiple is also supported by a two-year historical valuation range of 12-20x forward earnings. We believe a P/E-based valuation is appropriate given Hexaware's earnings track record and the widespread use of this methodology.

Risks

Our quantitative risk-rating system, which tracks 260-day historical share price volatility, rates Hexaware Technologies as Medium Risk. Risks that could impede the stock from reaching our target price include: (1) high client concentration; (2) a slowdown in the financial and transportation industry; (3) a slowdown in the US/global economies; (4) losing edge to scale players; (5) supply-side situation becoming more difficult - wage inflation being higher than that factored in our model; (6) upside surprises in currency appreciation; and (7) limited H1B visas.

KPIT Cummins Infosystems

Company description

KPIT Cummins Infosystems is a mid-tier IT services provider focused on two verticals: manufacturing services and BFSI (banking, financial services and insurance). Within these two verticals, the company is focused on a few key customers. Among service lines, in addition to regular application development and maintenance services, KPIT Cummins offers VLSI and embedded software services, package implementation, business intelligence, and BPO services. The company has close to 2,500 employees working for over 80 clients.

Investment thesis

We rate KPIT Cummins as Buy/Medium Risk (1M). With offshoring becoming mainstream, clients are increasingly using offshore for newer service areas like product engineering, embedded software, and engineering design services. KPIT Cummins has a head-start in the fast-growing embedded software and VLSI design services due to its Cummins and Renesas relationships. With client access to 7 of the top 10 auto OEMs and 13 leading tier 1 & 2 auto suppliers and five of top 10 semiconductor manufacturers, KPIT Cummins could become one of the top offshore vendors in auto electronics and semiconductor design – leading to 36% revenue and 45% earnings CAGRs over FY06-09E.

Valuation

Our 12-month target price is Rs180 based on 16x our FY09E EPS. Our target multiple is derived by applying a ~15% discount to our target multiple for peer Satyam. We apply this discount as Satyam is a large and diversified company while KPIT is a niche-focused mid-tier IT player. We believe 16x is a fair multiple given the strong growth that we expect from KPIT over the next three years. Our target multiple is also supported by an historical valuation range of 10-20x forward earnings (average 15x) for the KPIT stock over the past two years. We believe a P/E-based valuation is most appropriate given KPIT's profitable track record and widespread investor use of this metric.

Risks

Our quantitative risk-rating system, which tracks 260-day historical share price volatility, rates KPIT Cummins as Medium Risk. Risks that could impede the stock from reaching our target price include: (1) high client concentration; (2) a slowdown in the auto-electronics industry; (3) a slowdown in the US/global economies; (4) technology obsolescence; (5) supply-side situation becoming more difficult – wage inflation being higher than that factored in our model; (6) currency appreciation more than that factored in our model; and (7) limited H1B visas.

Appendix A-1

Analyst Certification

We, Surendra Goyal, CFA and Hitesh Shah, research analysts and the authors of this report, hereby certify that all of the views expressed in this research report accurately reflect our personal views about any and all of the subject issuer(s) or securities. We also certify that no part of our compensation was, is, or will be directly or indirectly related to the specific recommendation(s) or view(s) in this report.

IMPORTANT DISCLOSURES

Tata Consultancy Services (TCS.BO)

Ratings and Target Price History - Fundamental Research

Analyst: Surendra Goyal (covered since October 5 2006)

#	Date	Rating	Target Price	Closing Price
1:	24 Aug 04	1M	1,050.00	NA
2:	7 Oct 04	1M	*1,285.00	548.38
3:	16 Oct 04	1M	*1,350.00	568.85
4:	14 Jan 05	1M	*1,600.00	648.47
5:	20 Apr 05	1M	*1,440.00	557.83
6:	29 Jun 05	1M	*1,580.00	666.63
7:	12 Oct 05	1M	*1,740.00	NA
8:	12 Jan 06	1M	*2,000.00	839.13
9:	10 May 06	*1L	*2,330.00	1,011.97
10:	4 Oct 06	1L	*1,185.00	988.10
11:	16 Oct 06	1L	*1,300.00	1,130.45
12:	15 Jan 07	1L	*1,560.00	1,327.90
13:	23 Apr 07	1L	*1,550.00	1,246.10

*Indicates change.

Covered
Not covered

Wipro (WIPR.BO)

Ratings and Target Price History - Fundamental Research

Analyst: Surendra Goyal (covered since October 5 2006)

#	Date	Rating	Target Price	Closing Price
1:	8 Jul 04	1M	*333.50	250.50
2:	7 Oct 04	1M	*372.50	316.05
3:	16 Oct 04	1M	*390.00	319.35
4:	24 Jan 05	1M	*410.00	323.65
5:	25 Apr 05	1M	*392.50	325.30
6:	29 Jun 05	1M	*440.00	377.13
7:	22 Jul 05	1M	*430.00	357.48
8:	12 Sep 05	1M	430.00	371.90
9:	18 Jan 06	1M	*535.00	461.15
10:	19 Apr 06	*1L	*640.00	559.90
11:	4 Oct 06	1L	*615.00	509.10
12:	18 Oct 06	1L	*650.00	557.25
13:	25 Jan 07	1L	*730.00	650.40
14:	23 Apr 07	1L	*685.00	567.00

*Indicates change.

Covered
Not covered

Satyam Computers Services (SATY.BO)

Ratings and Target Price History - Fundamental Research

Analyst: Surendra Goyal (covered since October 5 2006)

#	Date	Rating	Target Price	Closing Price
1:	7 Oct 04	1M	*237.50	196.77
2:	20 Oct 04	1M	*242.50	189.77
3:	24 Jan 05	1M	*230.00	186.80
4:	29 Jun 05	1M	*300.00	244.48
5:	20 Oct 05	1M	*350.00	293.75
6:	22 Jan 06	1M	*450.00	363.13
7:	23 Apr 06	*1L	*465.00	386.73
8:	4 Oct 06	*2M	*475.00	401.42
9:	8 Nov 06	*1M	*510.00	415.20
10:	6 Feb 07	1M	*582.00	490.65
11:	23 Apr 07	1M	*590.00	480.65

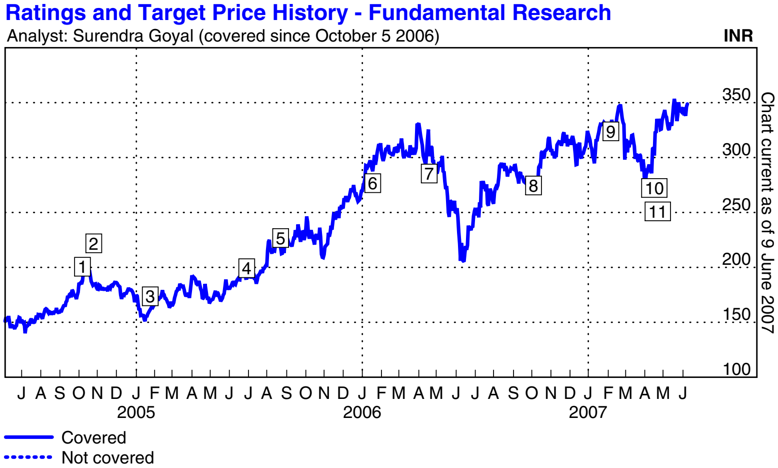
*Indicates change.

Covered
Not covered

HCL Technologies (HCLT.BO)

Ratings and Target Price History - Fundamental Research

Analyst: Surendra Goyal (covered since October 5 2006)



#	Date	Rating	Target Price	Closing Price
1:	7 Oct 04	2H	*207.50	187.73
2:	26 Oct 04	2H	*212.50	184.30
3:	25 Jan 05	2H	*187.50	161.60
4:	29 Jun 05	*2M	*205.00	190.23
5:	23 Aug 05	2M	*235.00	218.13
6:	18 Jan 06	2M	*307.50	287.55
7:	19 Apr 06	*2L	*310.00	301.15
8:	4 Oct 06	*1M	*340.00	276.70
9:	6 Feb 07	1M	*385.00	328.33
10:	17 Apr 07	1M	385.00	301.90
11:	23 Apr 07	1M	*405.00	329.05

*Indicates change.

I-Flex Solutions (IFLX.BO)

Ratings and Target Price History - Fundamental Research

Analyst: Surendra Goyal (covered since October 5 2006)

#	Date	Rating	Target Price	Closing Price
1:	4 Oct 06	3M	1,540.00	1,430.55
2:	6 Feb 07	3M	*1,850.00	1,979.00

*Indicates change.

Sasken Communication Technologies (SKCT.BO)

Ratings and Target Price History - Fundamental Research

Analyst: Surendra Goyal (covered since December 7 2006)

#	Date	Rating	Target Price	Closing Price
1:	25 Apr 06	1M	430.00	358.30
2:	7 Dec 06	1M	*653.00	496.15

*Indicates change.

KPIT Cummins Infosystems (KPIT.BO)

Ratings and Target Price History - Fundamental Research

Analyst: Hitesh Shah (covered since December 15 2006)

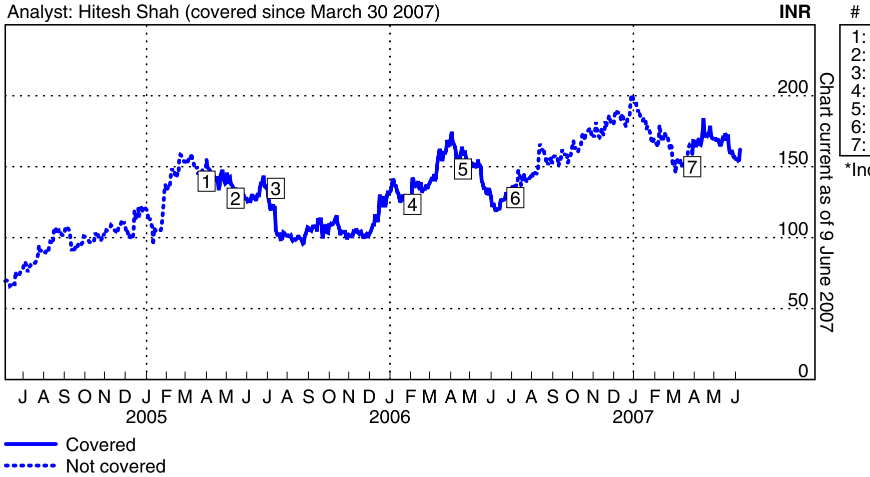
#	Date	Rating	Target Price	Closing Price
1:	14 Dec 06	1M	140.00	117.75
2:	25 Jan 07	*3M	*173.00	167.85
3:	8 Mar 07	*1M	173.00	120.00

*Indicates change.

Hexaware Technologies (HEXT.BO)

Ratings and Target Price History - Fundamental Research

Analyst: Hitesh Shah (covered since March 30 2007)



#	Date	Rating	Target Price	Closing Price
1:	1 Apr 05	1M	176.00	154.73
2:	16 May 05	1M	*160.00	135.15
3:	14 Jul 05	*3H	*100.00	105.20
4:	3 Feb 06	*2M	*140.00	142.25
5:	20 Apr 06	*3M	*150.00	159.20
6:	7 Jul 06	Coverage suspended		
7:	29 Mar 07	*1M	*214.00	159.00

*Indicates change.

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Citigroup Investment Research Ratings Distribution

Data current as of 31 March 2007	Buy	Hold	Sell
Citigroup Investment Research Global Fundamental Coverage (3215)	45%	40%	15%
% of companies in each rating category that are investment banking clients	45%	42%	32%
Computer Services and IT Consulting -- North America (23)	57%	39%	4%
% of companies in each rating category that are investment banking clients	38%	33%	100%
IT Services -- Europe (9)	44%	22%	33%
% of companies in each rating category that are investment banking clients	25%	0%	0%
India -- Asia Pacific (130)	58%	14%	28%
% of companies in each rating category that are investment banking clients	42%	50%	42%

Guide to Fundamental Research Investment Ratings:

Citigroup Investment Research's stock recommendations include a risk rating and an investment rating.

Risk ratings, which take into account both price volatility and fundamental criteria, are: Low (L), Medium (M), High (H), and Speculative (S).

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For securities in developed markets (US, UK, Europe, Japan, and Australia/New Zealand), investment ratings are: Buy (1) (expected total return of 10% or more for Low-Risk stocks, 15% or more for Medium-Risk stocks, 20% or more for High-Risk stocks, and 35% or more for Speculative stocks); Hold (2) (0%-10% for Low-Risk stocks, 0%-15% for Medium-Risk stocks, 0%-20% for High-Risk stocks, and 0%-35% for Speculative stocks); and Sell (3) (negative total return).

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Investment ratings are determined by the ranges described above at the time of initiation of coverage, a change in investment and/or risk rating, or a change in target price (subject to limited management discretion). At other times, the expected total returns may fall outside of these ranges because of market price movements and/or other short-term volatility or trading patterns. Such interim deviations from specified ranges will be permitted but will become subject to review by Research Management. Your decision to buy or sell a security should be based upon your personal investment objectives and should be made only after evaluating the stock's expected performance and risk.

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