Multi-Company

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Indian IT Services

Revisiting Thesis: Remain Buyers; Prefer Tier-One Stocks

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- **We remain positive on the sector** — Managements' views on demand have been positive. We have adjusted our estimates to reflect 4Q results and new currency assumptions, and have revised our target prices after factoring in slightly lower multiples due to slower growth on account of base effects and the rupee's strength.

- **Key variables to focus on** — (1) Demand scenario amid talk of a US slowdown; (2) rupee appreciation; (3) increasing tax rates; (4) pricing; and (5) wage inflation. We have analyzed these variables and their impact on "fair multiples".

- **Valuations: different perspectives** — The "fair multiple" for IT services stocks has sparked a hot debate. We have analyzed current multiples with respect to historical valuations, the Indian market, global peers, and growth rates.

- **4Q below expectations; management commentary positive** — 4Q FY07 results were below expectations primarily due to slower growth in the BFSI space, and the rupee's appreciation. But Infosys's guidance reinforced the view that offshoring is a mega trend. Management commentaries by all the top players supported the view.

- **Infosys and TCS our top Buys** — Our view remains that companies with size, and a diversified presence across verticals and horizontals are better placed from a demand and supply perspective. Infosys and TCS remain our top picks in Indian IT Services. We also like HCL Tech in our large-cap coverage universe.

Valuation Snapshot

	Rating		Target Price		Current Year Estimates		Next Year Estimates	
Ticker	Old	New	Old	New	Old	New	Old	New
HCLT.BO	1M	1M	Rs385.00	Rs405.00	Rs15.40	Rs15.83	Rs18.23	Rs18.91
INFY.BO	1L	1L	Rs2,660.00	Rs2,580.00	Rs84.68	Rs83.26	Rs104.99	Rs103.07
SATY.BO	1M	1M	Rs582.00	Rs590.00	Rs25.18	Rs25.89	Rs30.22	Rs31.01
TCS.BO	1L	1L	Rs1,560.00	Rs1,550.00	Rs54.12	Rs53.58	Rs65.50	Rs64.44
WIPR.BO	1L	1L	Rs730.00	Rs685.00	Rs25.04	Rs25.12	Rs30.97	Rs31.13

Source Citigroup Investment Research estimates

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

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In search of "fair multiple"

After the 4Q results, we revisit our thesis for the sector. We have analyzed the key variables of investor focus — impact of US slowdown on demand, pricing, wage pressure, rupee appreciation and impact of STPI sunset clause on tax rates. We have explored how stocks stack up on commonly used valuation parameters — PER, relative to market, comparison with global peers and PER benchmarked to growth. We believe that while 4Q was below expectations, the outlook remains strong, as highlighted by Infosys, Satyam guidance and management commentary from other majors. Our top picks in the sector are Infosys and TCS; we also like HCL Tech.

Revisiting sector thesis – analyzing key questions

In our view the key variables to focus on are demand (and impact of any US slowdown on it), pricing, wage inflation, rupee appreciation and increases in tax rates. In this section, we analyze each of the variables and the likely impact.

US slowdown – impact on demand

The March quarter was muted in terms of volume growth, particularly compared with the past few quarters. A slowdown was witnessed in the BFSI sector, in which both Infosys and TCS reported flat numbers QoQ. However, both Infosys and TCS indicated that it was more a one quarter phenomenon, and demand remains strong in the vertical.

Data points on demand over the past few months have been mixed:

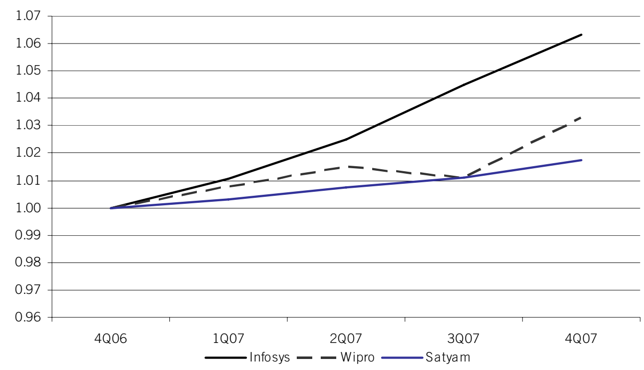
- Infosys guidance indicated that it did not see any demand slowdown. The view has been supported by other leading IT services players as well.
- Accenture reported a strong quarter and indicated a bright outlook for the consulting business.
- IBM reported a decline in signings YoY; however, short-term signings were up 10% yoy.
- TPI data for the first quarter of CY07 did indicate weakness – TPI expects CY07 TCV to be down 19% yoy and ACV to be up ~4% yoy. However, with Indian companies' presence being mostly in the $500m segment and business coming through renewals, TPI data trends matter relatively less.
- However, what did concern us was flat revenues in BFSI in both Infosys and TCS. While both companies did not indicate any slowness there, Cognizant's quarterly performance and outlook will be a key focus.

While we do continue to monitor it closely, our view remains that a sharp slowdown could impact Indian IT services growth in the short run but a soft landing would not really impact growth rates.

Pricing – Uptrend continues

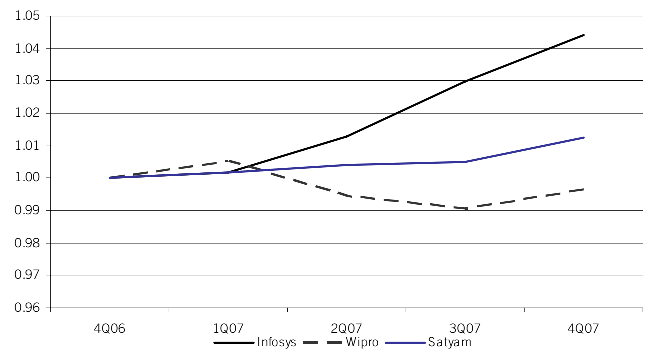
All the Tier I companies continued to indicate that pricing is moving up – both for business from existing as well as new clients. TCS reiterated its view that business from existing clients is coming in at 3-5% while for new clients it is coming in at 5-10%. In FY07, Infosys reported a 4.4% improvement in onsite realization and a 2.7% increase in offshore realization on a YoY basis.

Figure 1. Onsite Pricing Trend



Source: Company Reports

Figure 2. Offshore Pricing Trends



Source: Company Reports

Pricing trends were also supported by 4Q trends where Infosys witnessed a 1.7% increase in pricing while TCS witnessed a 0.9% increase in pricing. More importantly, there are supply-side shortages in both the US and Europe. With CY06 wages increasing by 5%+ after a gap of four years, we believe pricing should keep moving up.

Wage inflation – byproduct of strong demand environment

Wage inflation is a function of demand, in our view. With demand momentum remaining strong and companies continuing to hire at a good pace, wage inflation is expected to remain high across the sector.

Most of the larger companies have talked of a 12-16% increase in offshore wages and 3-6% in onsite wages. On a like-to-like basis, this does impact margins by ~250-400bps. However, with improved pricing, flattening of employee pyramid, better utilization and SG&A leverage, we believe that companies should be able to manage margins in a narrow band despite wage inflation.

INR/USD appreciation – joker in the pack

Rupee is clearly the joker in the pack. We believe that with pricing power coming back, improved utilization, SG&A leverage and flattening of employee pyramid, companies can maintain margins in a narrow band. However, the INR appreciation poses a big challenge to margins and reported EPS growth going forward. In terms of quantification, the exact impact of earnings is difficult to quantify as it depends on various factors including the hedge position at that point of time. One percent appreciation in the rupee impacts operating margins by 30-50bps, on our estimates.

Figure 3. INR/USD Movement Since Beginning of 2005

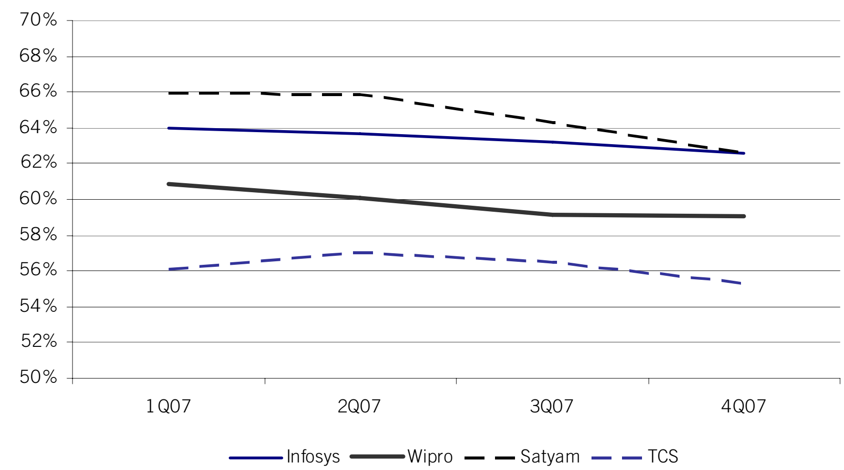
Source: DataStream

The factors which determine the impact of rupee appreciation on earnings are:

- Geographic mix improving – TCS, Wipro better off

A better geographic mix results in less impact of rupee appreciation against the dollar (assuming revenues in various currencies are broadly in line with the geographic breakdown of revenues).

Figure 4. US Share of IT Revenue

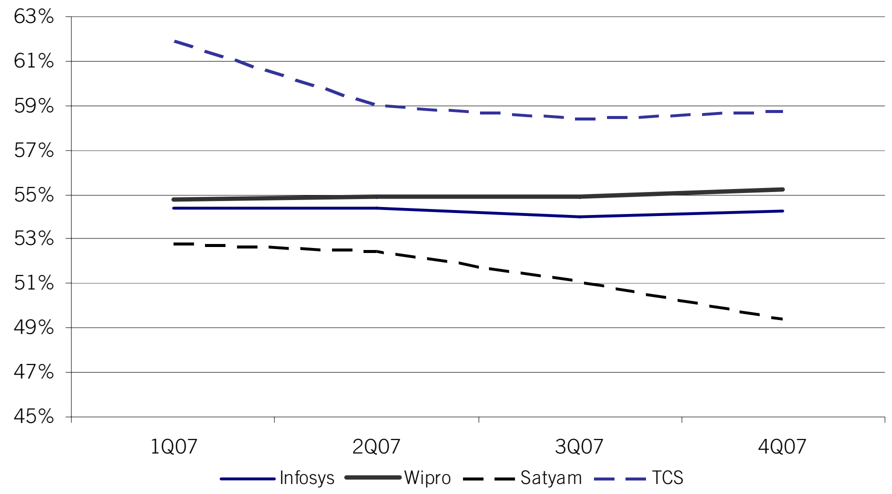


Source: Company Reports and CIR estimates; includes AsiaPac IT services revenue for Wipro

- Onsite proportion of revenues – function of new project starts

Higher onsite proportion implies higher onsite costs and hence the net impact is lower on operating margins.

Figure 5. Share of Onsite Revenue



Source: Company Reports and CIR estimates

- Hedge position – HCL Tech, TCS and Satyam seem better placed

IT companies have been proactively trying to hedge their forex exposures. In terms of forex cover, HCL Tech and TCS look the best hedged at this point in time.

Figure 6. Hedge Position (at the end of Mar'06)

	Forex Cover (US$ m) - Mar'06			Revenue (Mar'06)	Hedge as % of quarterly revenue
	Forwards	Options	Total	US$ mn	
Infosys	170	206	376	863	44%
TCS	325	975	1300	1,184	110%
Wipro	300	33	333	691	48%
Satyam	100	353	453	406	112%
HCL Tech	900	0	900	362	248%

Source: Company Reports and Citigroup Investment Research

Increasing tax rates

With the STPI benefits expected to end in 2009, tax rates are expected to go up sharply in 2010. However, most IT companies are incrementally expanding through SEZs, which will make the increase more gradual and, more importantly, tax rates post 2010E will see a decline YoY.

Figure 7. How Effective Tax Rates Change in FY10E and Beyond

	FY07	FY08E	FY09E	FY10E	FY11E	FY12E
Revenue	**100**	**130**	**164**	**203**	**244**	**292**
- growth		*30.0%*	*26.0%*	*24.0%*	*20.0%*	*20.0%*
- onsite	50	64	80	97	115	135
- offshore	50	66	84	106	129	158
- SEZ	0	16	34	56	79	108
- STPI	50	50	50	50	50	50
Pretax (EBIT) margins						
- onsite	12.0%	12.0%	12.0%	12.0%	12.0%	12.0%
- offshore						
- SEZ	44.0%	43.5%	43.0%	42.5%	42.0%	41.5%
- STPI	44.0%	43.5%	43.0%	42.5%	42.0%	41.5%
- Other income (as % of revenue)	2.7%	2.5%	2.3%	2.2%	2.1%	2.0%
Pretax profits	31	40	49	61	73	88
- onsite	6	8	10	12	14	16
- offshore	22	29	36	45	54	66
- SEZ	0	7	14	24	33	45
- STPI	22	22	22	21	21	21
- Other income	3	3	4	4	5	6
Tax rates						
- onsite	33.0%	33.0%	33.0%	33.0%	33.0%	33.0%
- offshore						
- SEZ	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
- STPI	3.7%	5.0%	8.0%	33.9%	33.9%	33.9%
- Other income	33.6%	33.9%	33.9%	33.9%	33.9%	33.9%
Taxes	4	5	6	13	13	14
- onsite	2	3	3	4	5	5
- offshore	1	1	2	7	7	7
- SEZ	0	0	0	0	0	0
- STPI	1	1	2	7	7	7
- Other income	1	1	1	2	2	2
Profit after tax	27	35	43	48	60	73
- onsite	4	5	6	8	9	11
- offshore	21	27	34	38	47	59
- SEZ	0	7	14	24	33	45
- STPI	21	21	20	14	14	14
- Other income	2	2	2	3	3	4
Effective Tax rate	**12.0%**	**12.0%**	**12.5%**	**20.6%**	**18.3%**	**16.4%**

Source: Citigroup Investment Research

The above analysis uses the following assumptions:

1. All incremental work will be down out of SEZs (Special Economic Zone).
2. As of FY07, no work was being done out of SEZs
3. More importantly, tax benefits of SEZs remain unchanged.

While tax rates are likely to impact reported earnings growth, we believe that investors will focus more on the core business and EBITDA growth will be a bigger focus than the impact of tax rates.

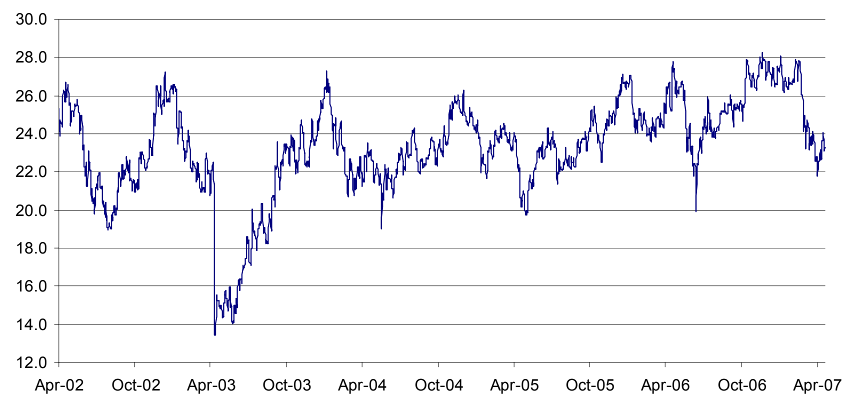
Valuations – In search of the "fair" multiple

Our valuation argument focuses on Infosys; our belief remains that Infosys valuations remain the sector's benchmark.

Historical valuations

Over the past year, Infosys has traded in a 20x-28x one-year forward earnings band with an average of 25.5x.

Figure 8. Dynamic P/E Ratio Chart for Infosys (using IBES estimates on price date)



Source: DataStream, Company Reports and IBES estimates

Relative to Indian market

Infosys' one-year forward P/E multiple has gradually been coming down compared with the market. However, we believe it has largely been due to improving growth prospects in other sectors. Infosys continues to deliver as far as strong earnings growth is concerned. With good prospects and superior return ratios, the premium should continue.

Figure 9. Infosys P/E Ratio Premium to Sensex P/E Ratio; 3-year Average

Source: DataStream, Company Reports and Citigroup Investment Research estimates

Global peers

In terms of global peers, Indian IT Services stocks are richly valued compared to global peers – however, in our view, these are justified considering better growth rates and prospects, better return ratios and a disruptive business model

Figure 10. Valuation Comps for Leading Indian IT Companies and Global Peers

Company	RIC Code	Year end	Rating	Mkt cap (US$m)	Current Price (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	28,224	2,055	2,580	24.3	19.6	19.6	15.4
TCS	TCS.BO	31-Mar	1L	29,547	1,256	1,550	23.2	19.2	18.7	15.1
Wipro	WIPR.BO	31-Mar	1L	20,016	571	685	22.8	18.4	17.9	14.1
Satyam	SATY.BO	31-Mar	1M	7,638	476	590	18.9	15.8	14.5	11.5
HCL Tech	HCLT.BO	30-Jun	1M	5,348	335	405	18.4	15.3	13.0	10.6
Accenture*	ACN.N	31-Aug	2H	22,842	38.48	40.00	19.8	17.6	6.7	5.6
EDS*	EDS.N	31-Dec	3H	15,124	29.40	24.00	18.6	19.0	5.2	5.1
Cognizant*	CTSH.O	31-Dec	1H	12,586	88.21	114.00	40.4	28.9	27.8	18.9
CapGemini*	CAPP.PA	31-Dec	1H	11,505	58.75	70.00	19.0	15.6	8.1	7.1
Atos Origin*	ATOS.PA	31-Dec	3H	5,138	54.87	45.00	22.1	17.2	8.3	7.0

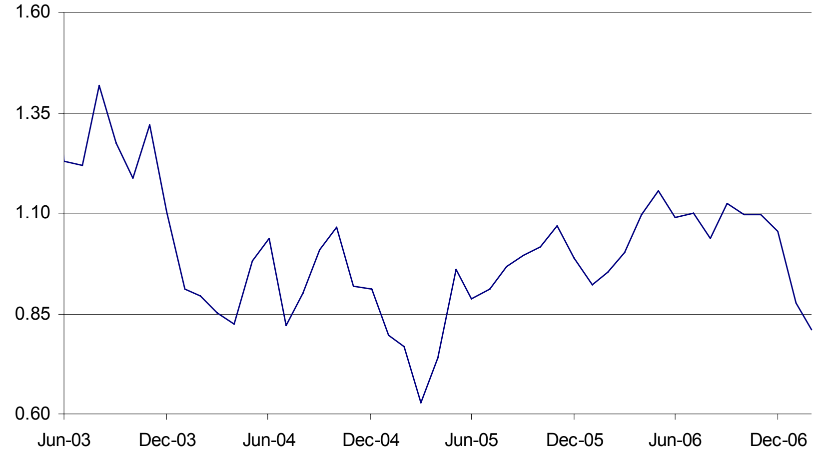
Source: Company Reports and Citigroup Investment Research estimates; *Using FY07E and FY08E for companies with fiscal year ending 2H of calendar (e.g. 31-Aug and 31-Dec year-ending).

LC = local currency

Growth rates command premium valuations

We have also done a historical analysis of Infosys' 1-year forward PER compared to 2-year forward growth rates as built in by IBES estimates at the time of price dates. The average of the ratio works out to around 1x while the range is 0.6-1.4 over the last four years. The ratio has remained volatile in the past, as highlighted in the following figure. Though we do not rely on this ratio for our valuation methodology, we discuss it as some technology investors use it as one of their valuation benchmarks.

Figure 11. PE (1 yr forward) to Growth (2 yr forward) ratio for Infosys



Source: Company Reports and IBES Estimates

Our view on valuations – factoring in some de-rating

Taking a view on target multiples becomes very challenging given the fact that the two biggest concerns in the sector are non-operational (to the extent that they are not in management control) – currency and tax rates.

Non-operational concerns:

- Tax rates – As the STPI benefits come to an end in FY2010, we expect tax rates to peak at 20-22% levels and then start falling again as incremental business comes in from SEZs (assuming that the SEZ tax benefit continues till that time). While growth rates will be impacted by tax rates in 2010E, the benefit will be witnessed in numbers 2011E onwards.

- Rupee appreciation – While the non-dollar proportion of revenues continues to grow, Indian companies are still exposed significantly to the dollar. Also the translation impact is significant – Infosys' 26-28% EPS guidance ($ terms) translates into a 20-22% EPS guidance (Re terms) for FY08E.

Operationally the key concerns are:

- Demand impact of US slowdown – We believe that a US slowdown should not change the longer-term outlook for offshoring due to the value proposition of the business model. Positive management commentary still supports our positive thesis on demand outlook. However, any sharp US slowdown could impact a few quarter growth rates and result in a de-rating of the sector.

- Wage hikes – Wage hikes, in our view, are a function of the robust demand environment in the sector. We believe that as long as growth persists, we will continue to witness high wages in the sector – expect 13-15% offshore wage hikes and 3-6% onsite wage hikes in FY08. However, more importantly, pricing power is returning to the sector and should help in mitigating the negative impact of wage hikes.

While we believe that investors are more likely to focus on the operational issues going forward, the tapering of growth rates (largely on account of a high base as well) could lead to a gradual de-rating of the sector.

We are reducing our target multiple for Infosys to 25x FY09E earnings from 28x average FY08-09E earnings. This is close to the midpoint of the last one-year trading band of 20-28x 1-year forward earnings and factors in some deceleration in growth. However, it is also important to note that the growth is largely impacted due to rupee appreciation – excluding that growth rates continue to look strong.

Our valuation framework for the sector is based on discount to Infosys, given that investors consider Infosys as the sector benchmark.

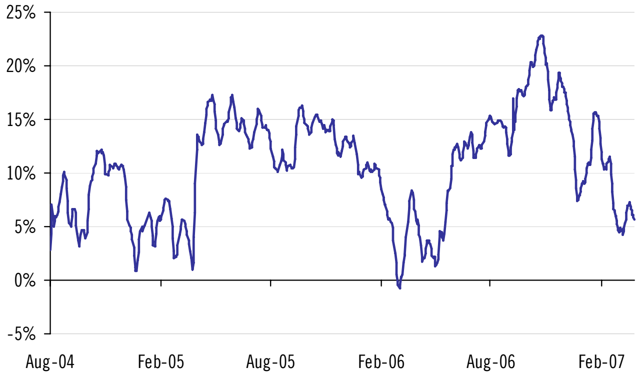
Figure 12. New target multiples and target prices

	FY09E EPS (Rs.)	Target multiple	Target price (Rs.)	Upgrade/(Downgrade)
Infosys	103.07	25.0	2580	-3.0%
TCS	64.44	24.0	1550	-0.6%
Wipro	31.13	22.0	685	-6.2%
Satyam	31.01	19.0	590	1.4%
HCL Tech	22.73	18.0	405	5.2%

Source: Citigroup Investment Research

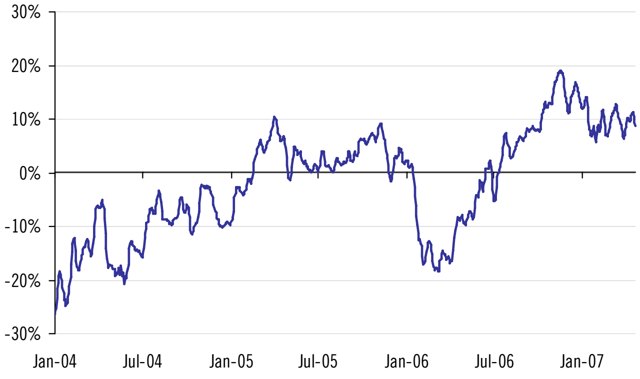
Some interesting charts

Figure 13. TCS P/E discount/(premium) to Infosys



Source: DataStream, Company Reports and CIR Estimates

Figure 14. Wipro P/E discount/(premium) to Infosys

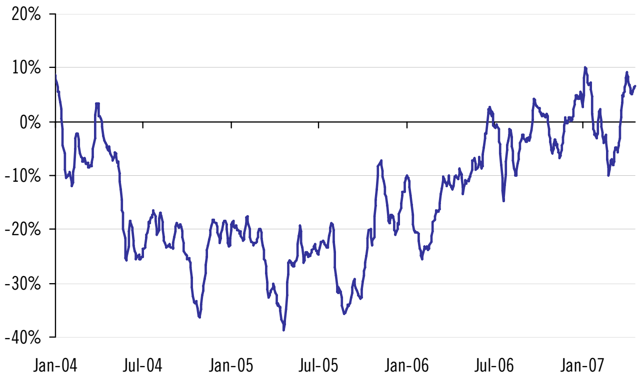


Source: DataStream, Company Reports and CIR Estimates

Figure 15. Satyam P/E discount/(premium) to Infosys

Source: DataStream, Company Reports and CIR Estimates

Figure 16. HCL Tech P/E discount/(premium) to Satyam



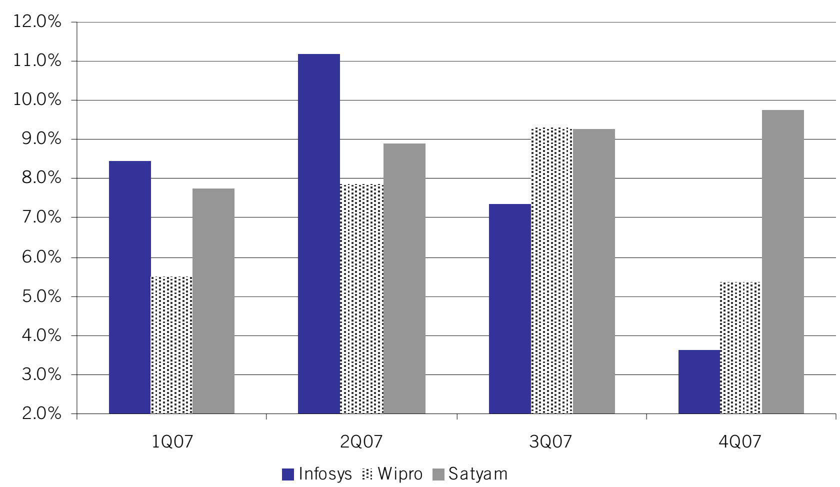
Source: DataStream, Company Reports and CIR Estimates

4QFY07 – below expectations…..

4QFY07 operating results for most of the leading companies under coverage were below our expectations. However, higher other income and lower tax rates resulted in a net income surprise across the sector.

- Volume growth was muted – Except for Satyam, volume growth for most of the companies in the sector was relatively muted in 4Q.

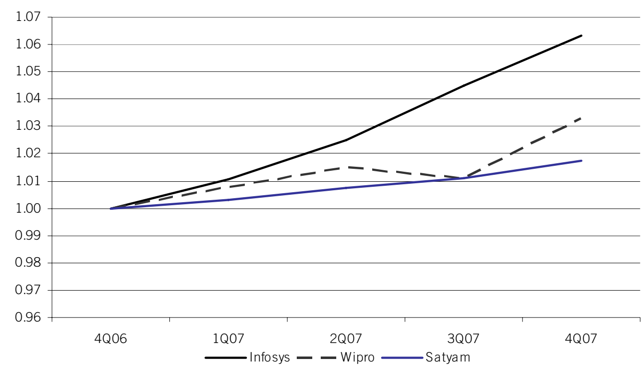
Figure 17. Volume growth – last four quarters



Source: Company Reports

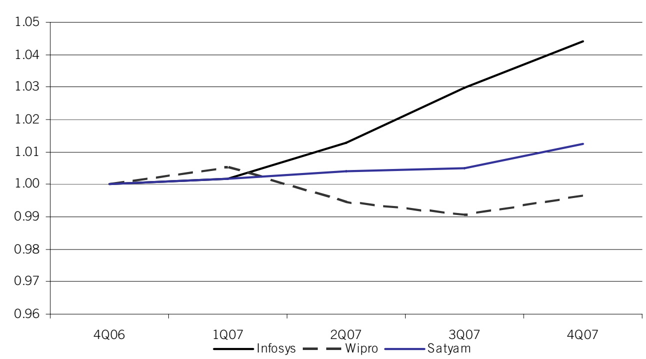
- Pricing uptick accelerates – Pricing uptick for all the companies accelerated; companies witnessed a ~70-200bp improvement in pricing qoq. On a YoY basis, pricing increase has been ~100-400bp – Infosys continues to lead the pack.

Figure 18. Onsite Pricing Trend



Source: Company Reports

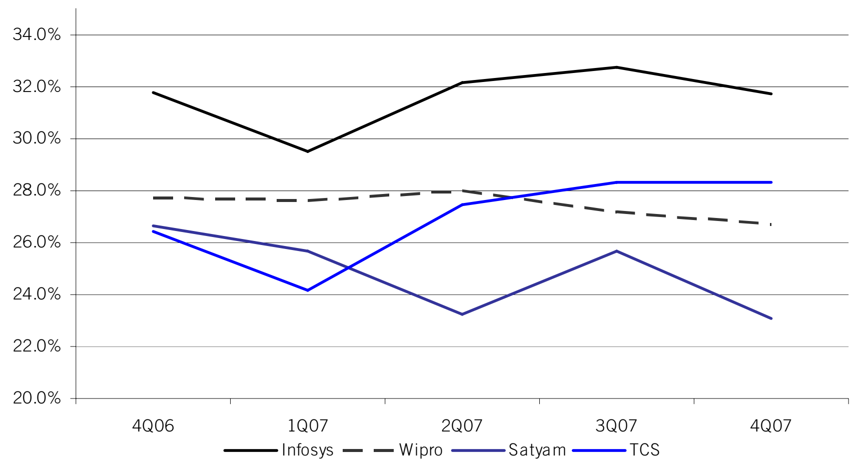
Figure 19. Offshore Pricing Trends



Source: Company Reports

- Margins decline QoQ – Margins for 4Q declined across the sector primarily on account of rupee appreciation. Only TCS reported flat EBITDA margins QoQ while Satyam witnessed a sharp decline on account of the negative impact of RSU in the quarter.

Figure 20. EBITDA Margin Trends – Last Five Quarters



Source: Company Reports

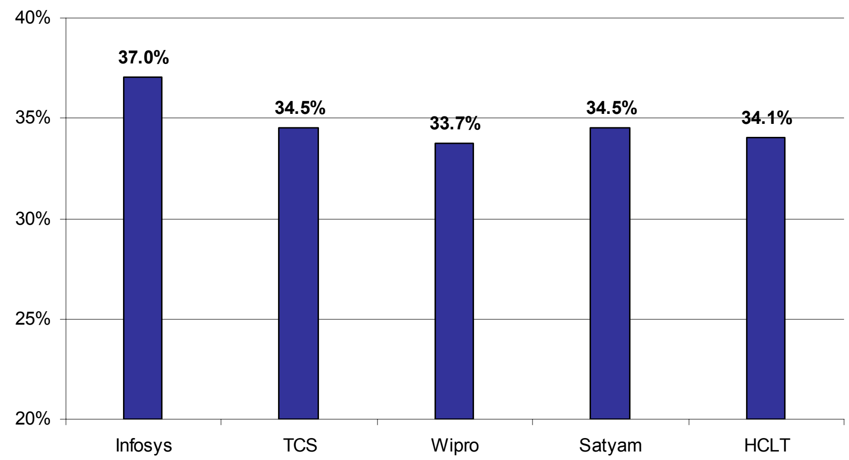
…..Outlook remains positive

Management commentary across the sector remained positive. All the companies remain positive on the pipeline and the hiring remains robust. Other data points emerging across the sector point to a relatively muted IT spending environment where growth will largely continue to be driven by market share gains.

- Hiring over trailing twelve months

Hiring over the last twelve months has been very robust, highlighting management's confidence in the pipeline going forward. Most of the large companies have added 33-37% to their employee count over the last four quarters. The campus offers made (for engineers to join in FY08) also remain positive; Wipro recently indicated that it had made 14,000 campus offers while TCS talked of 12,000 campus offers.

Figure 21. Employee Addition – over last 12 months

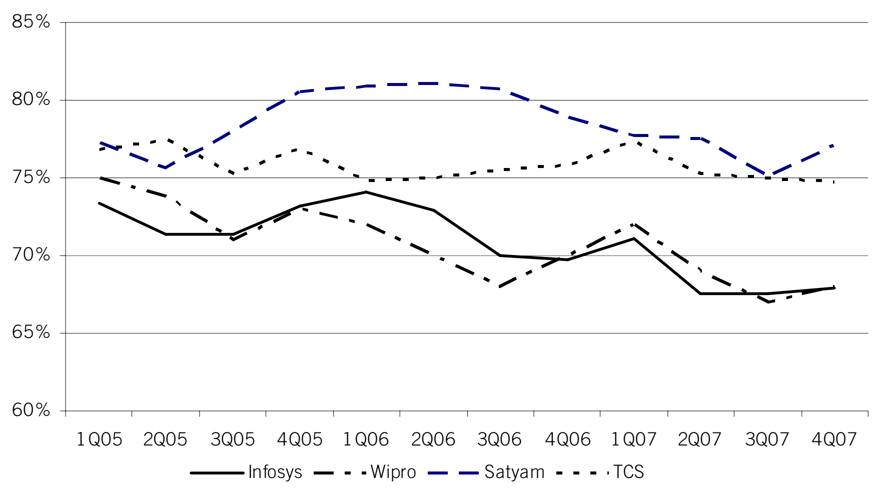


Source: Company Reports

- Utilizations have room to go up

Utilization has been flat in FY07 on a YoY basis. Most of the companies have focused on building a "strategic bench" in a favourable demand environment. Companies have room to increase utilization as utilization has been at 300-400bp higher levels in the past.

Figure 22. Utilization trends – last 12 quarters



Source: Company reports

- Accenture results solid

Accenture reported a strong Q2FY07 with revenues growing by 10% in constant currency terms. Accenture gave a very bullish outlook on management consulting (expects to double headcount over next three years). Order bookings at $5.3b were also very strong – Accenture reported record consulting bookings of $3.1b.

- IBM signings down but short term signings up

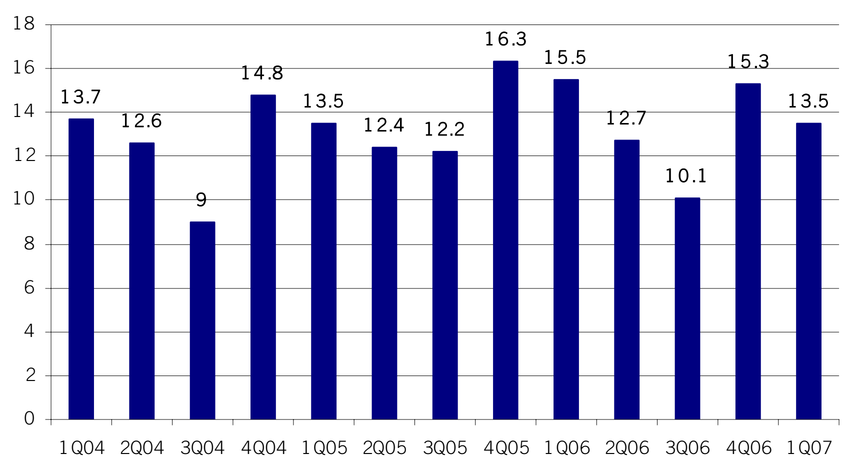
IBM's Q12007 services signings were down 10% yoy to $11.1b – however short term contract signings were up 10% yoy to $5.3b. However, IBM did indicate some kind of softening in demand towards end of March, which is a concern.

- TPI data negative, less meaningful for Indian companies

TPI data for Q1 indicated softening in demand for the sector. TPI expects Total Contract value (TCV) to decline ~19% yoy in CY07. However, Annual contract value (ACV) is expected to increase ~4% yoy, highlighting the trend of declining "mega-deals".

In the TPI data, we have focused more on the >$50m and <$1b segment, which is more important from Indian companies point of view. This is broadly in line with historical trends:

Figure 23. TPI data – Broader market ex Mega deals (Contract values >US$ 50mn, <US$1bn)



Source: Company Reports

Indian companies market share coming off could be explained by no large deal announcements in the quarter – the previous quarter had witnessed the $1b announcement by Tech Mahindra. The market share data continues to be very volatile on a qoq basis.

Figure 24. India based service provider market share in new signings (contracts > US$ 50 mn)

	1Q06	2Q06	3Q06	4Q06	1Q07
Total Contract Value (New signings)	25.5	17.7	14.2	20.5	17.6
New signings by Indian service providers	1.0	1.1	0.3	3.0	0.7
Market share (Indian service providers)	4%	6%	2%	15%	4%

Source: TPI, Citigroup Investment Research

Changing estimates

We have changed our earnings estimates for companies under coverage – changes have been made to pricing, volume, and other income and tax rate assumptions.

Our new numbers factor in a currency estimate of Rs. 42.7/$ for FY08 and Rs. 41.7/$ for FY09 (which is slightly more conservative than Citi economist's estimates of Rs.43.25/$ and Rs. 42.25/$ respectively).

Top Picks

We continue to like tier1 players in the current macro environment of strong demand and challenging supply situation. Infosys and TCS remain our top picks while we also like HCL Tech amongst our large cap IT services universe.

Company Focus

HCL Technologies (HCLT.BO)

Buy: Large deal strategy paying off

Rating change ☐
Target price change ☑
Estimate change ☑

Buy/Medium Risk	1M
Price (23 Apr 07)	Rs329.05
Target price	Rs405.00
from Rs385.00	
Expected share price return	23.1%
Expected dividend yield	2.4%
Expected total return	**25.5%**
Market Cap	Rs218,385M
	US$5,250M

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	34.4	2.8	18.1	1.5
2006A	7,091	10.46	9.4	31.5	5.2	18.1	2.4
2007E	10,818	15.83	51.4	20.8	4.4	24.3	2.4
2008E	12,990	18.91	19.5	17.4	3.8	25.0	2.4
2009E	15,609	22.73	20.2	14.5	3.3	25.8	2.4

Source: Powered bv dataCentral

- Q3FY07 surprises positively — Q3FY07 surprised positively yet again with 9.6% qoq revenue growth ($ terms). Margins increased yet again to 23.3%. Over the last 4 quarters, HCL Tech's revenues ($ terms) and EBITDA (excluding non cash charges) have increased at a CQGR of 9.6% and 10.1%, respectively.

- All segments performing well — Q3 was another quarter of all-round growth – IT Services witnessed growth of 8.2% qoq, BPO grew 18.4% qoq while infrastructure services revenues increased 8.1% qoq (all $ terms).

- EBITDA margins expand again — EBITDA margins expanded by ~110 bps qoq again (after a 40bp improvement in 2Q). All segments reported improved profitability – IT services margins improved 85bp qoq while BPO margins improved 360bp qoq. Margin expansion was due to improved realizations, lower SG&A, better utilizations partly offset by currency and wage hike in BPO.

- Raising estimates; maintain Buy (1M) — We have increased our FY07 to FY09 estimates by 3-4%. HCL Tech's large deal strategy is paying off – qoq volatility has come down over the last few quarters.

Fiscal year end 30-Jun	2005	2006	2007E	2008E	2009E
Valuation Ratios					
P/E adjusted (x)	34.4	31.5	20.8	17.4	14.5
EV/EBITDA adjusted (x)	25.6	21.6	15.6	11.9	9.6
P/BV (x)	2.8	5.2	4.4	3.8	3.3
Dividend yield (%)	1.5	2.4	2.4	2.4	2.4
Per Share Data (Rs)					
EPS adjusted	9.56	10.46	15.83	18.91	22.73
EPS reported	9.56	10.46	15.83	18.91	22.73
BVPS	118.64	63.27	74.64	85.52	100.57
DPS	5.00	8.00	8.00	8.00	8.00
Profit & Loss (RsM)					
Net sales	33,694	44,007	60,968	77,387	95,447
Operating expenses	-27,527	-36,847	-50,840	-64,399	-79,470
EBIT	**6,167**	**7,161**	**10,128**	**12,988**	**15,977**
Net interest expense	1,079	578	1,804	1,679	1,976
Non-operating/exceptionals	-469	-22	-68	-74	-70
Pre-tax profit	**6,778**	**7,717**	**11,864**	**14,593**	**17,883**
Tax	-674	-626	-1,046	-1,603	-2,274
Extraord./Min.Int./Pref.div.	0	0	0	0	0
Reported net income	**6,104**	**7,091**	**10,818**	**12,990**	**15,609**
Adjusted earnings	6,104	7,091	10,818	12,990	15,609
Adjusted EBITDA	7,722	9,193	12,657	16,224	19,800
Growth Rates (%)					
Sales	31.2	30.6	38.5	26.9	23.3
EBIT adjusted	51.7	16.1	41.4	28.2	23.0
EBITDA adjusted	48.4	19.0	37.7	28.2	22.0
EPS adjusted	9.1	9.4	51.4	19.5	20.2
Cash Flow (RsM)					
Operating cash flow	**4,975**	**7,423**	**8,408**	**14,181**	**17,137**
Depreciation/amortization	1,555	2,032	2,529	3,236	3,823
Net working capital	-1,605	-1,121	-3,135	-365	-318
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**	**-2,069**	**-5,137**	**-4,940**
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**	**2,306**	**2,168**	**4,521**
Balance Sheet (RsM)					
Total assets	**46,242**	**50,445**	**61,109**	**71,257**	**84,788**
Cash & cash equivalent	19,899	18,799	22,106	25,275	30,896
Accounts receivable	6,408	9,628	13,806	17,146	21,202
Net fixed assets	6,596	8,742	10,879	14,520	18,373
Total liabilities	**8,260**	**9,780**	**12,489**	**15,464**	**19,202**
Accounts payable	6,633	8,952	11,419	14,394	18,132
Total Debt	1,308	83	75	75	75
Shareholders' funds	**37,982**	**40,665**	**48,620**	**55,794**	**65,587**
Profitability/Solvency Ratios (%)					
EBITDA margin adjusted	22.9	20.9	20.8	21.0	20.7
ROE adjusted	18.1	18.1	24.3	25.0	25.8
ROIC adjusted	40.5	33.1	38.0	40.1	42.2
Net debt to equity	-48.9	-46.0	-45.3	-45.2	-47.0
Total debt to capital	3.3	0.2	0.2	0.1	0.1

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Company Focus

Infosys Technologies (INFY.BO)

Buy: Weak quarter; Strong guidance; Remains our top pick

Rating change ☐
Target price change ☑
Estimate change ☑

Buy/Low Risk	1L
Price (23 Apr 07)	Rs2,067.55
Target price	Rs2,580.00
from Rs2,660.00	
Expected share price return	24.8%
Expected dividend yield	0.8%
Expected total return	**25.6%**
Market Cap	Rs1,181,005M
	US$28,393M

Price Performance (RIC: INFY.BO, BB: INFO IN)

Statistical Abstract

Year to 31 Mar	Net Profit (RsM)	Diluted EPS (Rs)	EPS growth (%)	P/E (x)	P/B (x)	ROE (%)	Yield (%)
2006A	24,599	43.82	27.5	47.2	16.3	40.4	1.1
2007A	38,560	67.76	54.6	30.5	10.3	42.3	0.6
2008E	47,688	83.26	22.9	24.8	7.7	36.2	0.8
2009E	59,030	103.07	23.8	20.1	5.8	33.7	1.0
2010E	69,102	120.65	17.1	17.1	4.6	30.5	1.2

Source: Powered by dataCentral

- Quarter was below expectation; guidance in line — 4QFY07 results were below our expectations with 5% revenue growth (US$ terms) qoq. However, more importantly, guidance was strong at ~28-30% top line growth (US$ terms) and EPS growth of ~20-22%.

- Strong statement on demand; top client grows 30% qoq — We believe that the 28-30% revenue growth guidance (US$ terms) is testimony of strong demand. Management talked of low single-digit growth in IT budgets and increasing momentum for offshoring. Its top client grew 30% qoq and the top five grew 18.5% qoq – belying concerns about top clients like BT and ABN Amro – and it won multi-million dollar orders from ABN AMRO in 4Q07.

- Another quarter of solid pricing — For FY07, onsite pricing was up 4.4% while offshore pricing was up 2.7% (Q4 saw an increase of 1.8% in onsite and 1.4% offshore). This trend was supported by peers as well.

- BFSI weakness in Q4 the only concern — BFSI revenues were almost flat qoq – in our view, the key concern as far as Q4 results were concerned. However, management indicated that outlook continues to remain strong.

- Infosys is our top pick — Infosys completed a solid FY07 and the guidance reinforces the positive outlook going forward. Infosys remains the best at client mining and cost optimization. Management commentary should also address investor concerns on demand which have resurfaced over the past month or so.

Fiscal year end 31-Mar	2006	2007	2008E	2009E	2010E
Valuation Ratios					
P/E adjusted (x)	47.2	30.5	24.8	20.1	17.1
EV/EBITDA adjusted (x)	37.1	25.7	19.6	15.3	12.1
P/BV (x)	16.3	10.3	7.7	5.8	4.6
Dividend yield (%)	1.1	0.6	0.8	1.0	1.2
Per Share Data (Rs)					
EPS adjusted	43.82	67.76	83.26	103.07	120.65
EPS reported	43.82	67.76	83.26	103.07	120.65
BVPS	126.60	199.99	268.73	353.62	452.40
DPS	22.50	11.50	16.00	20.00	24.00
Profit & Loss (RsM)					
Net sales	95,216	138,930	181,094	227,797	280,823
Operating expenses	-68,669	-100,160	-131,263	-165,512	-203,874
EBIT	**26,547**	**38,770**	**49,831**	**62,285**	**76,949**
Net interest expense	1,396	3,720	4,653	6,355	9,042
Non-operating/exceptionals	-11	-20	0	0	0
Pre-tax profit	**27,932**	**42,470**	**54,484**	**68,639**	**85,991**
Tax	-3,132	-5,110	-6,796	-9,609	-16,889
Extraord./Min.Int./Pref.div.	-201	1,200	0	0	0
Reported net income	**24,599**	**38,560**	**47,688**	**59,030**	**69,102**
Adjusted earnings	24,599	38,560	47,688	59,030	69,102
Adjusted EBITDA	30,918	43,910	56,737	70,808	86,819
Growth Rates (%)					
Sales	33.5	45.9	30.3	25.8	23.3
EBIT adjusted	29.6	46.0	28.5	25.0	23.5
EBITDA adjusted	32.4	42.0	29.2	24.8	22.6
EPS adjusted	27.5	54.6	22.9	23.8	17.1
Cash Flow (RsM)					
Operating cash flow	**31,118**	**29,100**	**40,889**	**55,683**	**65,606**
Depreciation/amortization	4,371	5,140	6,907	8,524	9,870
Net working capital	3,549	-9,410	-9,053	-5,516	-4,324
Investing cash flow	**-10,890**	**-20,590**	**-19,456**	**-16,201**	**-20,271**
Capital expenditure	-10,890	-20,590	-19,456	-16,201	-20,271
Acquisitions/disposals	0	0	0	0	0
Financing cash flow	**-7,447**	**5,000**	**-9,004**	**-11,256**	**-13,507**
Borrowings	0	0	0	0	0
Dividends paid	-12,360	-6,432	-9,004	-11,256	-13,507
Change in cash	**12,782**	**13,510**	**12,429**	**28,226**	**31,828**
Balance Sheet (RsM)					
Total assets	**93,800**	**134,090**	**177,302**	**232,079**	**297,307**
Cash & cash equivalent	34,290	58,710	75,792	110,373	151,243
Accounts receivable	16,080	24,360	31,753	39,942	49,240
Net fixed assets	22,260	37,710	50,259	57,936	68,338
Total liabilities	**23,460**	**21,500**	**26,028**	**33,030**	**42,664**
Accounts payable	9,340	14,690	18,128	22,598	27,466
Total Debt	0	0	0	0	0
Shareholders' funds	**70,340**	**112,590**	**151,274**	**199,048**	**254,644**
Profitability/Solvency Ratios (%)					
EBITDA margin adjusted	32.5	31.6	31.3	31.1	30.9
ROE adjusted	40.4	42.3	36.2	33.7	30.5
ROIC adjusted	88.8	83.6	67.8	65.1	63.3
Net debt to equity	-48.7	-52.1	-50.1	-55.5	-59.4
Total debt to capital	0.0	0.0	0.0	0.0	0.0

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Company Focus

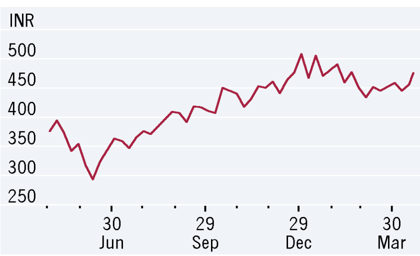
Satyam Computers Services (SATY.BO)

Buy: Ambitious Guidance; Delivery the key

Rating change ☐
Target price change ☑
Estimate change ☑

Buy/Medium Risk	1M
Price (23 Apr 07)	Rs480.65
Target price	Rs590.00
from Rs582.00	
Expected share price return	22.8%
Expected dividend yield	1.7%
Expected total return	**24.4%**
Market Cap	Rs320,688M
	US$7,710M

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	31.9	7.2	26.2	0.7
2007A	14,047	20.81	38.0	23.1	5.5	27.9	0.7
2008E	17,471	25.89	24.4	18.6	4.6	27.6	1.7
2009E	20,925	31.01	19.8	15.5	3.8	27.6	2.1
2010E	23,384	34.65	11.8	13.9	3.3	26.1	2.5

Source: Powered bv dataCentral

- In-line results; good guidance — Satyam delivered in-line Q4 results – topline was up 9.5% qoq to $406m (est. $402m) while EBITDA at Rs. 4.1b was flat qoq and lower than our expectation of Rs.4.3b. Satyam guided to a strong FY08 with topline growth of 28-30% and EPS growth of 27-29% ($ terms).

- Q4FY07 results - key points — Gross margins were down 220bp SG&A resulted in EBITDA margin decline of ~160bp qoq. Lower higher other income and lower tax rate (despite higher other income) resulted in net income of Rs.3.9b (against our expectation of Rs.3.6b).

- Pricing in line with sector trend — Satyam witnessed an improvement in blended pricing of ~70bp qoq and guided to a 2-3% increase in realizations in FY08. This is in line with sector trends where we have witnessed pricing improvement for all the leading companies in the sector.

- Attrition moving down a positive — Attrition moved down again in the quarter; Attrition in the last twelve months fell to 15.7% as against 17.3% at the end of Q3. On a quarterly annualized basis, attrition fell to 13%, which was one of the positive highlights of the quarter.

- Ambitious guidance of flat margins in FY08 — Satyam has talked about flat margins for FY08. With full impact of RSU, rupee appreciation and wage hikes, it is an ambitious target in our view. Levers like pricing, employee pyramid, offshorization, improvement in profitability of subsidiaries would all need to fall in place to achieve that.

- Maintain Buy/Medium Risk — Satyam's guidance positively surprised the market – the guidance is in line with Infosys guidance for FY08. Delivery qoq becomes critical as Satyam has set itself a very high benchmark in terms of investor expectations.

Fiscal year end 31-Mar	2006	2007	2008E	2009E	2010E
Valuation Ratios					
P/E adjusted (x)	31.9	23.1	18.6	15.5	13.9
EV/EBITDA adjusted (x)	25.2	18.6	14.5	11.5	9.3
P/BV (x)	7.2	5.5	4.6	3.8	3.3
Dividend yield (%)	0.7	0.7	1.7	2.1	2.5
Per Share Data (Rs)					
EPS adjusted	15.09	20.81	25.89	31.01	34.65
EPS reported	15.09	20.81	25.89	31.01	34.65
BVPS	66.53	87.41	104.91	125.40	147.36
DPS	3.50	3.50	8.00	10.00	12.00
Profit & Loss (RsM)					
Net sales	47,926	64,851	84,069	106,190	130,157
Operating expenses	-37,637	-50,958	-66,883	-84,982	-104,748
EBIT	**10,289**	**13,893**	**17,186**	**21,208**	**25,409**
Net interest expense	1,113	1,674	2,531	2,921	3,460
Non-operating/exceptionals	-1	0	0	0	0
Pre-tax profit	**11,401**	**15,566**	**19,717**	**24,130**	**28,869**
Tax	-1,509	-1,520	-2,246	-3,205	-5,485
Extraord./Min.Int./Pref.div.	87	1	0	0	0
Reported net income	**9,979**	**14,047**	**17,471**	**20,925**	**23,384**
Adjusted earnings	9,979	14,047	17,471	20,925	23,384
Adjusted EBITDA	11,662	15,377	19,155	23,632	28,225
Growth Rates (%)					
Sales	36.1	35.3	29.6	26.3	22.6
EBIT adjusted	36.3	35.0	23.7	23.4	19.8
EBITDA adjusted	34.3	31.9	24.6	23.4	19.4
EPS adjusted	36.9	38.0	24.4	19.8	11.8
Cash Flow (RsM)					
Operating cash flow	**7,689**	**10,541**	**14,321**	**17,094**	**20,084**
Depreciation/amortization	1,373	1,484	1,969	2,423	2,816
Net working capital	-2,685	-2,925	-2,588	-3,333	-2,655
Investing cash flow	**-1,292**	**-2,462**	**-990**	**-2,219**	**-2,176**
Capital expenditure	-3,167	-4,135	-3,521	-5,141	-5,636
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**	**7,378**	**7,433**	**8,979**
Balance Sheet (RsM)					
Total assets	**51,371**	**68,951**	**83,070**	**99,656**	**118,677**
Cash & cash equivalent	31,117	39,914	47,292	54,725	63,704
Accounts receivable	11,684	17,432	20,269	25,311	31,024
Net fixed assets	5,573	8,223	9,775	12,493	15,313
Total liabilities	**8,157**	**11,425**	**14,026**	**17,128**	**21,696**
Accounts payable	4,370	5,745	7,566	9,557	11,714
Total Debt	1,027	1,479	1,479	1,479	1,479
Shareholders' funds	**43,214**	**57,526**	**69,044**	**82,528**	**96,982**
Profitability/Solvency Ratios (%)					
EBITDA margin adjusted	24.3	23.7	22.8	22.3	21.7
ROE adjusted	26.2	27.9	27.6	27.6	26.1
ROIC adjusted	81.0	78.0	72.1	69.7	63.1
Net debt to equity	-69.6	-66.8	-66.4	-64.5	-64.2
Total debt to capital	2.3	2.5	2.1	1.8	1.5

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Company Focus

Tata Consultancy Services (TCS.BO)

Buy: Size matters

Rating change ☐
Target price change ☑
Estimate change ☑

Buy/Low Risk	**1L**
Price (23 Apr 07)	Rs1,246.10
Target price	Rs1,550.00
from Rs1,560.00	
Expected share price return	24.4%
Expected dividend yield	1.1%
Expected total return	**25.5%**
Market Cap	Rs1,219,447M
	US$29,317M

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	41.9	20.9	64.3	0.5
2007A	40,608	41.50	39.7	30.0	13.7	55.1	0.9
2008E	52,432	53.58	29.1	23.3	9.5	48.4	1.1
2009E	63,063	64.44	20.3	19.3	7.0	41.6	1.3
2010E	73,238	74.84	16.1	16.7	5.3	36.2	1.4

Source: Powered by dataCentral

- Revenues in-line; margins flat qoq — Revenue for the quarter was $1.18b (as against our expectation of $1.19b). EBITDA margins were flat qoq at 28.3% as against our expectation of 40bp improvement. Net profit was helped by a one-off other income due to sale of stake in Sitel – net profit for the quarter was Rs11.73b.

- Strong hiring trend indicates momentum — TCS indicated that demand scenario remains robust. Over FY07, TCS has added 36% to its employee strength. TCS has also made offers to 12,000 candidates for next year and guided to gross addition greater than FY07 (~32,000 employees).

- Demand strong; rupee the wildcard — Management reiterated its view that demand remains strong across geographies and service lines. While we remain positive on the prospects of the sector – the sharp rupee appreciation over the blast few days remains a big risk to earnings and stock price performance.

- TCS remains another top Buy — With its size and leadership position in various verticals and horizontals, we expect TCS to be one of the biggest beneficiaries of the offshore trend.

Fiscal year end 31-Mar	2006	2007	2008E	2009E	2010E
Valuation Ratios					
P/E adjusted (x)	41.9	30.0	23.3	19.3	16.7
EV/EBITDA adjusted (x)	32.8	23.7	18.2	15.0	12.2
P/BV (x)	20.9	13.7	9.5	7.0	5.3
Dividend yield (%)	0.5	0.9	1.1	1.3	1.4
Per Share Data (Rs)					
EPS adjusted	29.71	41.50	53.58	64.44	74.84
EPS reported	29.71	41.50	53.58	64.44	74.84
BVPS	59.69	90.98	130.56	179.00	234.70
DPS	6.75	11.50	14.00	16.00	18.00
Profit & Loss (RsM)					
Net sales	132,454	186,333	241,339	297,124	362,767
Operating expenses	-98,318	-139,888	-181,858	-225,667	-276,781
EBIT	**34,136**	**46,445**	**59,482**	**71,458**	**85,986**
Net interest expense	190	1,236	1,769	2,717	3,837
Non-operating/exceptionals	16	44	45	45	45
Pre-tax profit	**34,342**	**47,725**	**61,296**	**74,220**	**89,868**
Tax	-4,989	-6,700	-8,625	-10,917	-16,390
Extraord./Min.Int./Pref.div.	-279	-417	-240	-240	-240
Reported net income	**29,074**	**40,608**	**52,432**	**63,063**	**73,238**
Adjusted earnings	29,074	40,608	52,432	63,063	73,238
Adjusted EBITDA	36,946	50,629	64,735	77,665	93,158
Growth Rates (%)					
Sales	36.2	40.7	29.5	23.1	22.1
EBIT adjusted	26.9	36.1	28.1	20.1	20.3
EBITDA adjusted	29.8	37.0	27.9	20.0	19.9
EPS adjusted	39.1	39.7	29.1	20.3	16.1
Cash Flow (RsM)					
Operating cash flow	**22,978**	**41,834**	**43,757**	**41,859**	**62,240**
Depreciation/amortization	2,810	4,184	5,253	6,208	7,172
Net working capital	-8,995	-2,139	-12,398	-24,934	-14,573
Investing cash flow	**-7,012**	**-12,025**	**-12,387**	**-17,455**	**-21,500**
Capital expenditure	-7,012	-12,025	-12,387	-11,445	-14,587
Acquisitions/disposals	0	0	0	2,717	3,837
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**	**17,670**	**8,746**	**23,125**
Balance Sheet (RsM)					
Total assets	**85,626**	**130,880**	**172,952**	**219,811**	**282,191**
Cash & cash equivalent	3,965	22,605	41,804	59,038	91,553
Accounts receivable	32,790	42,857	53,095	62,396	76,181
Net fixed assets	15,072	22,912	30,046	35,283	42,698
Total liabilities	**25,655**	**40,234**	**43,575**	**43,029**	**50,906**
Accounts payable	0	0	0	0	0
Total Debt	979	1,184	0	0	0
Shareholders' funds	**59,972**	**90,646**	**129,377**	**176,782**	**231,285**
Profitability/Solvency Ratios (%)					
EBITDA margin adjusted	27.9	27.2	26.8	26.1	25.7
ROE adjusted	64.3	55.1	48.4	41.6	36.2
ROIC adjusted	72.4	69.3	70.5	62.8	56.8
Net debt to equity	-5.0	-23.6	-32.3	-33.4	-39.6
Total debt to capital	1.6	1.3	0.0	0.0	0.0

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Powered by: dataCentral

Company Focus

Wipro (WIPR.BO)

Buy: Telecom business visibility near term concern

Rating change ☐
Target price change ☑
Estimate change ☑

Buy/Low Risk	**1L**
Price (23 Apr 07)	Rs567.00
Target price	Rs685.00
from Rs730.00	
Expected share price return	20.8%
Expected dividend yield	1.8%
Expected total return	**22.6%**
Market Cap	Rs827,039M
	US$19,883M

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	40.3	10.2	29.9	0.9
2007A	29,271	20.26	43.9	28.0	8.0	32.5	1.1
2008E	36,282	25.12	24.0	22.6	6.6	32.3	1.8
2009E	44,972	31.13	24.0	18.2	5.3	32.7	2.1
2010E	52,260	36.18	16.2	15.7	4.4	31.3	2.6

Source: Powered by dataCentral

- 4QFY07 results in line — Wipro reported in-line 4Q FY07 results – revenues of US$691m and EBIT of Rs7.1bn for Global IT Services were in line with our expectations. Consolidated net profit at Rs.8.6bn (est. Rs7.7bn) was higher than expectation due to higher other income and a lower tax rate.

- Guidance muted — Wipro guided to US$711m revenues for 1Q FY08, implying growth of 3% qoq for Global IT Services. While 1Q guidance has historically been weak (avg. 5.4% qoq for the last four years), the guidance this time around looks even more muted.

- Pricing trend in line with sector — Wipro witnessed ~200bp improvement in offshore pricing and ~70bp improvement in onsite pricing in 4Q, in line with sector trends. All the large companies have reported ~60-200bp improvement in pricing on a sequential basis for 4Q.

- BPO back to robust growth trajectory — BPO delivered a solid quarter after a long time; revenue growth was 12.4% qoq and EBIT margins improved to 25%, up 280bp qoq.

- Telecom OEM business visibility low — Over the past few quarters, Wipro's growth has been impacted by restructuring/M&A at a couple of large clients in the Telecom OEM space. Management indicated that visibility on this part of the business is still low.

- Maintain Buy/Low Risk; Telecom business visibility a trigger — Wipro's stock performance has been impacted by the poor performance and low visibility form its telecom OEM business. Increasing visibility on that business is the key trigger to watch.

Fiscal year end 31-Mar	2006	2007	2008E	2009E	2010E
Valuation Ratios					
P/E adjusted (x)	40.3	28.0	22.6	18.2	15.7
EV/EBITDA adjusted (x)	31.5	22.9	18.2	14.2	11.5
P/BV (x)	10.2	8.0	6.6	5.3	4.4
Dividend yield (%)	0.9	1.1	1.8	2.1	2.6
Per Share Data (Rs)					
EPS adjusted	14.08	20.26	25.12	31.13	36.18
EPS reported	14.08	20.26	25.12	31.13	36.18
BVPS	55.69	71.12	86.55	106.07	127.70
DPS	5.00	6.00	10.00	12.00	15.00
Profit & Loss (RsM)					
Net sales	106,107	149,431	190,909	242,746	302,955
Operating expenses	-84,135	-119,423	-153,736	-195,334	-245,524
EBIT	**21,972**	**30,009**	**37,173**	**47,412**	**57,431**
Net interest expense	1,277	2,667	4,165	4,766	5,817
Non-operating/exceptionals	288	318	366	420	483
Pre-tax profit	**23,537**	**32,993**	**41,704**	**52,599**	**63,731**
Tax	-3,265	-3,723	-5,421	-7,627	-11,472
Extraord./Min.Int./Pref.div.	-2	0	0	0	0
Reported net income	**20,270**	**29,271**	**36,282**	**44,972**	**52,260**
Adjusted earnings	20,270	29,271	36,282	44,972	52,260
Adjusted EBITDA	25,137	34,208	42,412	53,670	65,151
Growth Rates (%)					
Sales	30.4	40.8	27.8	27.2	24.8
EBIT adjusted	23.0	36.6	23.9	27.5	21.1
EBITDA adjusted	23.0	36.1	24.0	26.5	21.4
EPS adjusted	24.3	43.9	24.0	24.0	16.2
Cash Flow (RsM)					
Operating cash flow	**18,906**	**36,050**	**28,131**	**40,388**	**46,493**
Depreciation/amortization	3,165	4,200	5,239	6,257	7,720
Net working capital	-3,723	5,029	-9,225	-6,076	-7,671
Investing cash flow	**-9,847**	**-18,325**	**-6,351**	**-10,131**	**-11,938**
Capital expenditure	-7,741	-12,964	-10,516	-14,897	-17,755
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**	**7,514**	**13,136**	**13,154**
Balance Sheet (RsM)					
Total assets	**100,266**	**146,102**	**162,568**	**198,249**	**237,364**
Cash & cash equivalent	39,186	52,060	59,574	72,710	85,864
Accounts receivable	20,593	28,467	35,567	45,224	56,441
Net fixed assets	17,777	26,541	31,818	40,458	50,492
Total liabilities	**21,502**	**44,634**	**39,084**	**46,915**	**55,171**
Accounts payable	4,146	7,060	6,152	7,688	9,206
Total Debt	705	3,781	3,781	3,781	3,781
Shareholders' funds	**78,764**	**101,468**	**123,483**	**151,335**	**182,194**
Profitability/Solvency Ratios (%)					
EBITDA margin adjusted	23.7	22.9	22.2	22.1	21.5
ROE adjusted	29.9	32.5	32.3	32.7	31.3
ROIC adjusted	55.1	56.9	52.9	53.3	50.6
Net debt to equity	-48.9	-47.6	-45.2	-45.5	-45.1
Total debt to capital	0.9	3.6	3.0	2.4	2.0

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

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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 400 clients across verticals, and a workforce of 32,000.

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 a 29% revenue CAGR and 30% EPS CAGR for FY06-09. The stock has underperformed the Sensex for the past two quarters. A forecast dividend yield of 2.4% and high cash per share of Rs30 should limit the downside for this stock.

Valuation

Our 12-month target price is Rs405 based on 18x FY09E EPS (vs. 19x average FY08E-09E EPS previously). We value HCL Tech relative to Satyam, which is similar to HCL Tech in terms of revenue. We expect a 30% 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.

Infosys Technologies

Company description

Infosys is the second-largest IT services company in India with more than 66,000 professionals. It is also among the fastest-growing IT services organization in the world, and is a leader in the offshore services space. Infosys provides business consulting, application development and maintenance and engineering services to more than 475 active clients across verticals such as Banking, Financial Services, Insurance, Retail, Manufacturing, and Utilities in the Americas, Europe and Asia Pacific. Infosys sells a core banking application, Finacle, which is used by leading banks in India, the Middle East, Africa and Europe. Its subsidiary, Infosys BPO (formerly Progeon), which employs more than 11,000 people, is a provider of BPO services. It launched a subsidiary in April 2004, Infosys Consulting, which provides high-end IT consulting services.

Investment thesis

We rate Infosys as Buy/Low Risk (1L). We are positive on the stock from a fundamental 12-month view. Offshore IT outsourcing has now become a mainstream option, and we think scale and scalability, along with an ability to move up the value chain, are key criteria for successful offshore IT vendors. In this respect, Infosys appears well positioned and continues to gain ground given its strong branding and industry-leading sales force. Infosys should see above-industry average volume growth along with modest pricing improvement. We expect Infosys to deliver a revenue CAGR of 26.4% and EPS CAGR of 22.6% for FY07-10. Unlike many other high-growth firms in other industries, Infosys continues to generate solid FCF, and its RoE of 40%+ continues to be well above its cost of capital.

Valuation

Our target price of Rs2,580 is based on 25x FY09E EPS (vs. 28x average FY08-FY0E EPS previously). This is close to the midpoint of the last one-year trading band of 20-28x 1-year forward earnings and factors in some deceleration in growth. We are now forecasting 23% earnings growth (on a high base of FY07) with some upside potential from pricing improvement and/or rupee depreciation. This is also supported by comparing it with global peers and the broader Indian market. The 25x multiple was also derived from a P/E band analysis of Infosys' trading pattern. During slowdowns in tech and offshore IT services, Infosys has traded at an average one-year rolling P/E of 25.1x with a low of 13x. Our estimates continue to assume a certain P/E premium to the market; this is justified, in our view, given the strong FCF, ROIC and growth rates for Infosys vs. the overall market. We believe P/E remains the most appropriate valuation measure given Infosys' profitable record and high earnings visibility.

Risks

We rate Infosys shares as Low Risk, which is consistent with our quantitative risk-rating system that tracks historical share price volatility. The key downside risks to the shares reaching our target price include: (1) any significant appreciation of the rupee against the US dollar/euro/pound; (2) pressure on billing rates (as Infosys continues to enjoy a 10-15% premium in its billing rates); (3) a sharp slowdown in the US economy; and (4) limited H1B visa quotas.

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 a 26.1% revenue CAGR and an 18.5% EPS CAGR over FY07-10E.

Valuation

Our 12-month target is Rs590, based on 19x FY09E earnings (vs. 21x average FY08-09E EPS previously). 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 an 18.5% 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.

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 Rs1,550 is based on a P/E of 24x FY09E EPS (vs. 26x FY08-09E average EPS previously), derived from a 4% discount (cutting the discount from 7% to account for better growth rates) 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 to 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 a 27% revenue CAGR and a 22% EPS CAGR over FY07-10E. For the global IT business, we expect a 25% revenue CAGR.

Valuation

Our 12-month target price of Rs685 is based on 22x FY09E EPS — a 12% discount to our target multiple for Infosys. Our previous target price was based on 26x average FY08-09E EPS, an 8% discount to Infosys. We have increased the discount to factor in slower growth for Wipro. 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 strong 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 to 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.

Appendix A-1

Analyst Certification

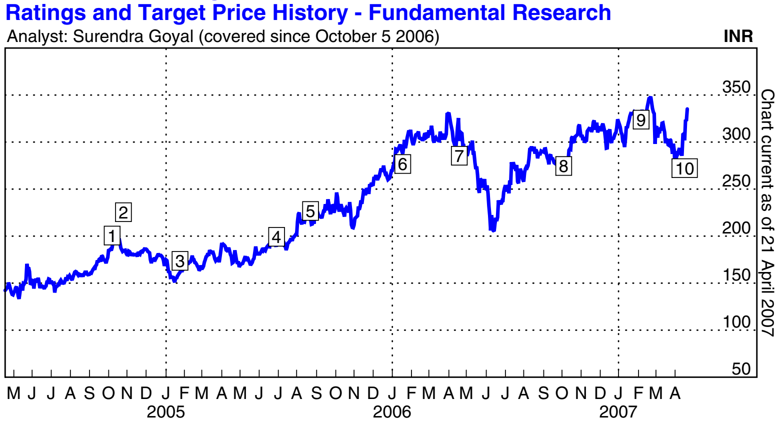
We, Surendra Goyal, CFA and Hitesh Shah, research analysts and the authors of this report, hereby certify that all of the views expressed in this research report accurately reflect our personal views about any and all of the subject issuer(s) or securities. We also certify that no part of our compensation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

IMPORTANT DISCLOSURES

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

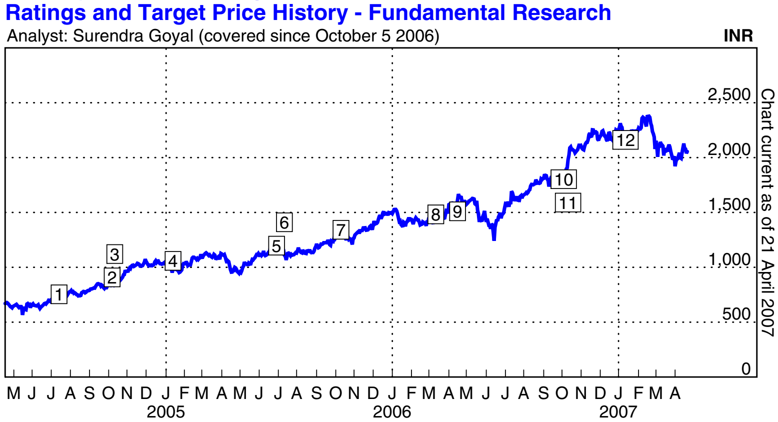
*Indicates change.

Covered
Not covered

Infosys Technologies (INFY.BO)

Ratings and Target Price History - Fundamental Research

Analyst: Surendra Goyal (covered since October 5 2006)



#	Date	Rating	Target Price	Closing Price
1:	14 Jul 04	*1M	*1,762.00	710.30
2:	7 Oct 04	1M	*2,050.00	852.42
3:	12 Oct 04	1M	*2,200.00	856.13
4:	13 Jan 05	1M	*2,400.00	982.70
5:	29 Jun 05	1M	*2,800.00	1,162.05
6:	12 Jul 05	1M	*2,700.00	1,109.97
7:	11 Oct 05	1M	*3,140.00	1,341.95
8:	12 Mar 06	*1L	*3,270.00	1,466.70
9:	16 Apr 06	1L	*3,475.00	1,615.15
10:	4 Oct 06	1L	*2,165.00	1,803.20
11:	11 Oct 06	1L	*2,340.00	1,981.35
12:	11 Jan 07	1L	*2,660.00	2,183.00

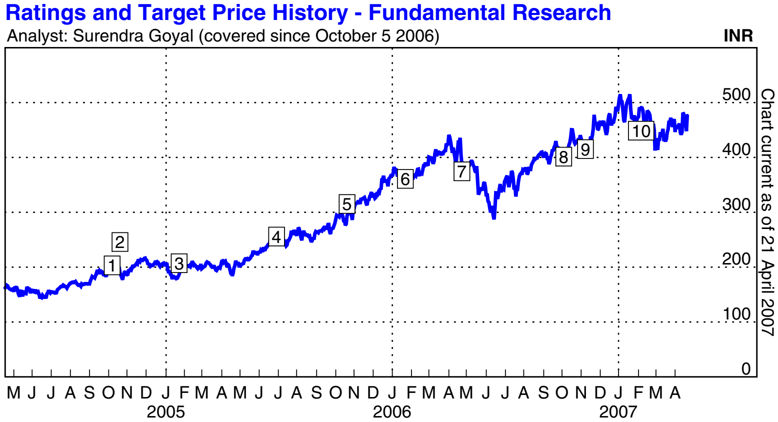
*Indicates change.

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

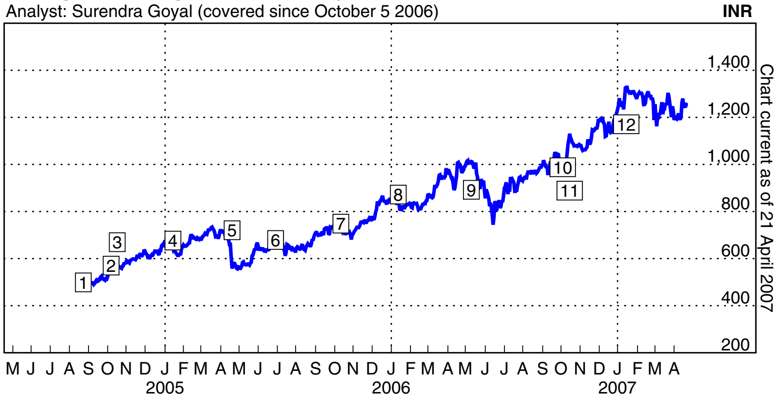
*Indicates change.

Covered
Not covered

Tata Consultancy Services (TCS.BO)

Ratings and Target Price History - Fundamental Research

Analyst: Surendra Goyal (covered since October 5 2006)



Covered
Not covered

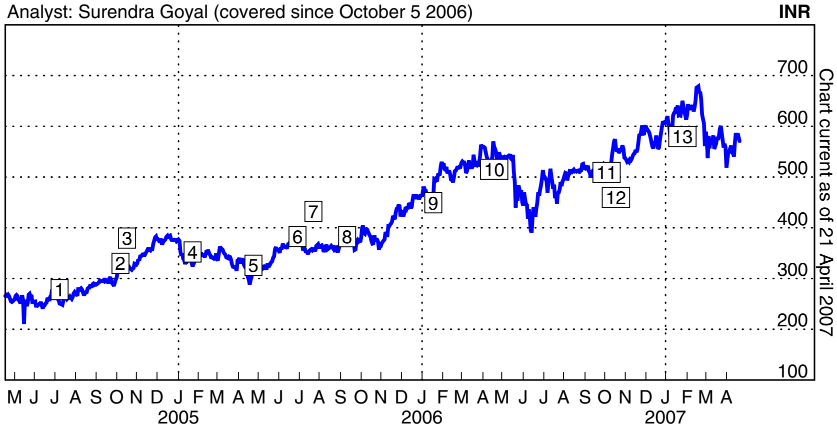
#	Date	Rating	Target Price	Closing Price
1:	24 Aug 04	1M	1,050.00	NA
2:	7 Oct 04	1M	*1,285.00	548.38
3:	16 Oct 04	1M	*1,350.00	568.85
4:	14 Jan 05	1M	*1,600.00	648.47
5:	20 Apr 05	1M	*1,440.00	557.83
6:	29 Jun 05	1M	*1,580.00	666.63
7:	12 Oct 05	1M	*1,740.00	NA
8:	12 Jan 06	1M	*2,000.00	839.13
9:	10 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

*Indicates change.

Wipro (WIPR.BO)

Ratings and Target Price History - Fundamental Research

Analyst: Surendra Goyal (covered since October 5 2006)



Covered
Not covered

#	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

*Indicates change.

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% 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%
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