



## Q2FY2009 IT earnings preview

*With cross currency headwind, the focus will be on dollar term guidance*

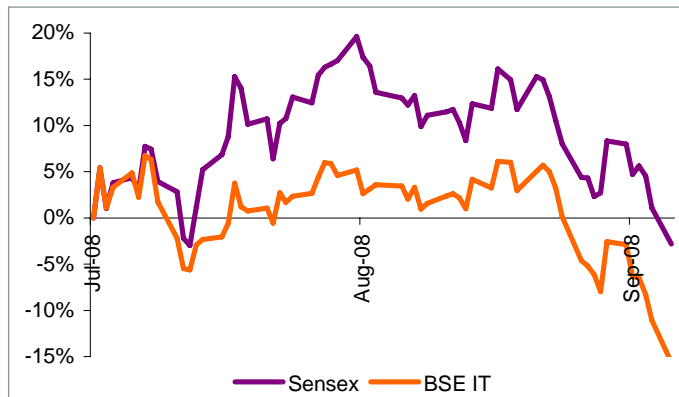
- ♦ The top line of frontline information technology (IT) companies is expected to grow in the range of 5.6-9.3% quarter on quarter (qoq) in Q2FY2009. The revenue growth would be primarily driven by the depreciation of the rupee against the US Dollar, which is likely to boost the top line growth by 4-4.5% on a sequential basis. In dollar terms, the revenues of these companies are expected to grow in the range of 1.5-5.2% on a sequential basis backed by a moderate volume growth and flat pricing.
- ♦ On the margin front, Satyam Computer Services' (Satyam's) operating profit margin (OPM) is expected to decline by 200 basis points sequentially during the quarter on account of the wage hike implemented during the quarter. HCL Technologies (HCL Tech) and Wipro have also given wage hikes to a part of their work force. Hence, we expect their OPMs to decline by 60 to 70 basis points qoq during the quarter. On the other hand, Infosys Technologies (Infosys) and Tata Consultancy Services (TCS) are expected to show healthy improvement in their margins, as these companies had already given wage hikes to their employees in the previous quarter. Furthermore, the depreciating rupee is also likely to have a favorable impact on the OPM of these companies.
- ♦ On hedging front, Infosys and Satyam are going to benefit from the depreciation of the rupee during the quarter, as their hedge position were lower at the end of Q1FY2009. On the other hand, Wipro and HCL Tech had higher hedge position. In case of TCS, the forex losses would be limited on account of higher portion of options in its hedge position.
- ♦ The US Dollar has appreciated by 8.5% and 8.9% against the Euro and Great Britain Pound (GBP) respectively at the end of the quarter. This is likely to have an adverse impact on the financial performance of IT companies under the US GAAP, as IT companies bill 25-30% of their revenues in GBP and Euro. This has led to concerns that some of the frontline IT companies may not meet their Q2FY2009 revenue guidance in dollar terms and, in fact, may have to revise downwards their full-year FY2009 revenue guidance. However, this seems to be already discounted in the current valuations.
- ♦ Apart from the possible revision in US dollar term guidance, the street would be keenly watching the management commentary on indicators such as demand environment, pricing scenario and any revision in hiring targets.

IT stocks have significantly under-performed the benchmark indices during the period July 2008-September 2008 on account of worsening condition of the US economy (due to financial crisis), distinct signs of a slowdown in Europe (supposedly an alternative region for IT companies to offset the US slowdown) and cross currency headwinds.

### Quarterly estimates

(Rs crore)	Net sales			Net profit			EPS (Rs)	OPM (%)
	Q2FY09	% qoq	% yoy	Q2FY09	% qoq	% yoy		
Infosys Tech	5308	9.3	29.3	1393	9.6	26.6	24.4	33.0
Guidance	5229-5278						23.52-23.95	
Satyam computer	2845	8.5	40.0	538	-1.8	31.4	8.0	22.2
Guidance	2743-2769						7.71-7.78	
HCL Tech	2350	8.4	37.5	307.4	118.0	-0.1	4.6	22.8
Wipro (Cons)	6296	5.6	33.2	829	1.8	2.0	5.7	15.7
Wipro (Global IT services)	4736							
Guidance (Global IT services)	\$1089 mn							
TCS	6799	6.1	20.5	1435	15.4	15.1	14.7	24.1

## Sensex v/s BSE IT



Going forward, the forthcoming earning results and the management's commentary on the below-mentioned points will be the key to the share price performance of IT companies.

## Revenue guidance in US Dollar term

Infosys and Satyam are expected to revise their rupee-term guidance on account of the depreciation of the rupee against the US Dollar. However, the street would keenly watch if Infosys and Satyam are able to meet their Q2FY2009 revenue guidance in dollar terms and also if they are able to maintain their FY2009 dollar term guidance given the significant appreciation of the US Dollar against the GBP and Euro and against the backdrop of worsening US economy. As the street seems to be already discounting this impact, the sentiments towards IT stocks will improve if the frontline IT companies beat their Q2FY2009 guidance and maintain their FY2009 guidance.

## Cross currency headwinds pose risk to US Dollar term guidance

The US dollar has on an average appreciated by 3.8% against the GBP and 3.6% against the Euro during the quarter. This is likely to adversely affect the financial performance of IT companies under the US GAAP, as these companies bill 25-30% of their revenues in GBP and Euro.

## Cross currency rates

	End of period rates		Average rates	
	30-Jun-08	30-Sep-08	30-Jun-08	30-Sep-08
USD/GBP	1.99	1.81	1.97	1.89
% change		-8.9		-3.8
USD/EUR	1.57	1.44	1.56	1.50
% change		-8.5		-3.6

## Hedge position

Infosys and Satyam are going to benefit from the depreciation of the rupee during the quarter, as their hedge position were lower at the end of Q1FY2009. On the other

hand, Wipro and HCL Tech had higher hedge position. In case of TCS, the forex losses would be limited on account of higher portion of options in its hedge position.

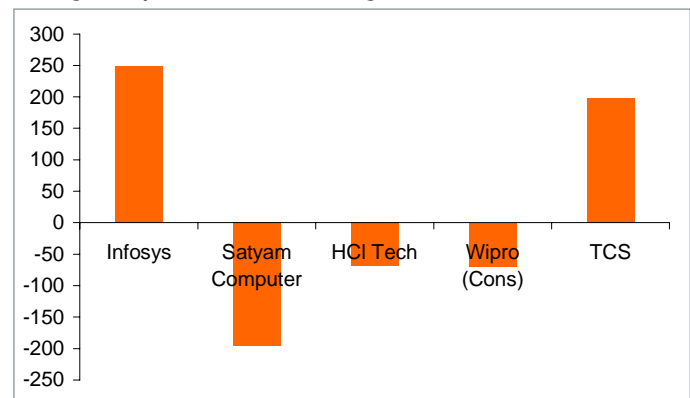
## Hedge position

(\$ in mn)	Infosys	TCS	Wipro	Satyam	HCL Tech
As on Q4FY08	762	2,900	2,750	1,130	2,750
As on Q1FY09	811	2,300	2,600	675	1,850

## OPM to decline significantly for Satyam on account of wage hike

Satyam's OPM is expected to decline by 200 basis points sequentially during the quarter on account of wage hike (12-14% for offshore employees, 3-4% for onshore employees) during the quarter. The negative impact of the wage hike is likely to be partially offset by the depreciation of the rupee during the quarter. HCL Tech and Wipro have given wage hikes only to a part of their work force. Hence, we expect their OPMs to decline by 60 to 70 basis points during the quarter. On the other hand, Infosys and TCS are expected to show healthy improvement in their margin as these companies had already given the wage hike in the previous quarter. Further, the depreciation in the rupee is also likely to have a favorable affect on the OPM of these companies.

## Divergence performance on margin front



## Negative global and domestic cues during the quarter

The quarter witnessed negative cues both from global and domestic markets.

## Global cues

- The condition of US economy is getting worse on account of deepening financial crisis. Close on the heels of a bailout of the mortgage giants Freddie Mac and Fannie Mae, the 158-year-old investment bank Lehman Brothers has filed for bankruptcy and Merrill Lynch has sold itself to the Bank of America. The negative news continued to flow with events such as American International Group selling its assets to the US Federal Reserve, Citi

Group's buying out Wachovia's banking operations and JP Morgan Chase acquiring the distressed loan portfolio of Washington Mutual. Such depressing events can result not only in client specific issues, but can also cast a question mark on the overall demand environment for IT companies.

- ♦ The European region, which was initially touted as an important region to offset the likely slowdown in the business from the US geography, is also showing distinct signs of an impending slowdown.

### Domestic cues

There have been considerable media reports mentioning that frontline IT companies are deferring their recruitment plans. The number of campus visits by IT companies have also decreased this year. Even, the joining dates for the campus-recruited employees have been postponed. In fact, a media report mentions that TCS is reducing its FY2009 hiring target by 20%.

### Valuation

Given the continuous flow of negative news during the quarter, the sentiments towards IT stocks remained weak and these stocks have grossly under-performed the broader markets. In fact, the street seems to be already discounting in a possible downward revision in the revenue growth guidance in dollar terms. We would keenly watch key indicators like hiring targets (and campus offers for the next year) and management's confidence in growth outlook and subsequently review our estimates. We maintain our Buy recommendation on Infosys, TCS and Satyam and Hold recommendation on Wipro and HCL Tech.

### Valuation table

Company	EPS (Rs)			P/E (x)		
	FY08	FY09	FY10	FY08	FY09	FY10
Infosys	79.3	101.3	111.7	18.3	14.4	13.0
TCS	51.3	58.6	67.3	13.1	11.5	10.0
Wipro	22.1	26.7	31.1	15.8	13.1	11.2
Satyam	25.2	32.2	37.2	12.7	9.9	8.6
HCL Tech	15.1	20.8	23.6	13.6	9.9	8.7

The author doesn't hold any investment in any of the companies mentioned in the article.

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