

Industry Flash

4 October 2007 | 8 pages

Indian IT Services

2Q FY08 Results Preview: Seasonally Strong Quarter

- Good revenue growth** — The 2Q of every fiscal year has traditionally been seasonally strong for Indian IT companies, and we expect a similar trend this time. The momentum is expected to continue, with strong volume growth especially for tier-I companies.
- Margins likely to improve, bottom lines expected to remain muted** — We expect margins to improve from the previous quarter (except for Satyam and HCL Tech, as they took wage hikes in 2Q) due to lower visa costs (wage hikes were implemented in 1Q). We expect QoQ net profit growth to be muted due to lower forex gains vs. 1Q.
- Infosys, Satyam expected to raise US\$ revenue guidance** — We expect Infosys/Satyam to raise US\$ revenue guidance for FY08 by 2-3% after a strong 2Q. Upgrades in EPS guidance will not be significant, in our view, due to further rupee appreciation of ~2% since the previous guidance.
- No further clarity on 2008 IT budgets** — The biggest issues facing investors today are clarity on CY08 IT budgets and the INR. We believe it is too early for companies to comment on 2008 IT budgets beyond saying "things are fine as of now". Clarity should emerge in the next few months.
- Prefer large-caps** — We maintain our large-cap bias in recognition of stronger volume growth and better margin leverage. Infosys and TCS remain our top picks. Expect strong results from Wipro and Satyam. Among the mid-cap names, we prefer Mphasis.

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Figure 1. Indian IT Large-Cap Universe

Company	RIC Code	Rating	Mkt cap (US\$m)	CMP (Rs)	TP (Rs)	P/E (x)		EV/EBITDA (x)	
						FY08E	FY09E	FY08E	FY09E
Infosys	INFY.BO	1L	28,860	2,005	2,440	25.0	20.4	20.8	16.1
TCS	TCS.BO	1L	26,668	1,081	1,460	21.0	17.3	16.9	13.6
Wipro	WIPR.BO	1L	17,390	473	650	20.2	16.5	16.3	12.8
Satyam	SATY.BO	1M	7,617	452	570	18.1	14.9	14.6	11.6
HCL Tech	HCLT.BO	1M	5,099	305	400	16.6	14.0	12.1	9.9
Patni*	PTNI.BO	1M	1,602	458	525	14.2	13.1	8.7	8.2
I-Flex	IFLX.BO	3M	3,975	1,884	2,025	38.2	27.5	26.6	18.9

Source: Powered by dataCentral Prices as on 03-Oct-07

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

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Figure 2. 2QFY08 Results Preview – Part I

Infosys	Sep'06	Jun'07	Sep'07E	QoQ	YoY	Key things to watch for
Revenue (US\$ m)	746	928	1,017	9.6%	36.4%	* We expect 9.6% revenue growth in US\$ terms with ~96bps QoQ improvement in EBITDA margin due to wage increases and visa costs being absorbed in Q1 * Net profit (excluding extraordinary) expected to be flat primarily due to lower forex gains QoQ * Key thing to watch - change in FY08 guidance, comments on outlook for next few quarters and next year
Revenue (Rs m)	34,510	37,730	41,095	8.9%	19.1%	
EBITDA (Rs m)	11,090	10,840	12,203	12.6%	10.0%	
EBITDA margin (%)	32.1%	28.7%	29.7%	96bp	-244bp	
Net Profit (Rs m)	9,290	10,790	10,876	0.8%	17.1%	
Wipro - Global IT						
Revenue (US\$ m)	589	726	788	8.5%	33.8%	* We expect 8.5% revenue growth in US\$ terms with ~20 bps increase in EBITDA margin for Global IT business (despite wage hikes) * Our numbers do not factor in Infocrossing acquisition - Infocrossing could contribute ~\$5m to top line * At a company level, we expect 12% qoq net profit growth on account of growth in business and no forex losses in this quarter * Key thing to watch - visibility on telecom OEM clients
Revenue (Rs m)	27,173	29,413	31,839	8.2%	17.2%	
EBITDA (Rs m)	7,603	7,317	7,978	9.0%	4.9%	
EBITDA margin (%)	28.0%	24.9%	25.1%	18bp	-292bp	
Wipro - Consolidated						
Revenue (Rs m)	35,138	41,832	45,341	8.4%	29.0%	
EBITDA (Rs m)	8,526	8,129	9,229	13.5%	8.2%	
EBITDA margin (%)	24.3%	19.4%	20.4%	92bp	-391bp	
Net Profit (Rs m)	6,963	7,103	7,986	12.4%	14.7%	
TCS						
Revenue (US\$ m)	975	1,278	1,382	8.1%	41.7%	* We expect revenue traction to continue - expect 8.1% growth in US\$ terms * Expect EBITDA margins to improve ~90bp sequentially due to decline in cost per employee and lower operating costs offset by some promotions * Net profit expected to remain flattish due to lower hedging gains * Key thing to watch - outlook on pricing and volume growth
Revenue (Rs m)	44,822	52,028	55,831	7.3%	24.6%	
EBITDA (Rs m)	12,294	13,264	14,563	9.8%	18.5%	
EBITDA margin (%)	27.4%	25.5%	26.1%	59bp	-135bp	
Net Profit (Rs m)	9,915	11,855	11,953	0.8%	20.6%	
Satyam						
Revenue (US\$ m)	346	449	491	9.4%	41.9%	* Expect another strong quarter - revenue growth of 9.4% in \$ terms * We expect EBITDA margins to decline ~230bp - mainly on account of wage hikes taken during the quarter * Net profits expected to be flat qoq due to no forex losses in the quarter * Key thing to watch - Change in FY08 guidance and outlook on volumes/pricing for FY09
Revenue (Rs m)	16,019	18,302	19,828	8.3%	23.8%	
EBITDA (Rs m)	3,625	4,103	3,980	-3.0%	9.8%	
EBITDA margin (%)	22.6%	22.4%	20.1%	-234bp	-256bp	
Net Profit (Rs m)	3,198	3,783	3,770	-0.3%	17.9%	
HCL Tech						
Revenue (US\$ m)	300	396	428	8.3%	42.6%	* Expect another decent quarter - 8.3% qoq growth in revenues with all businesses growing in high single digits * We expect 105 bps decline in EBITDA margin - wage increases taken in the quarter will impact profitability * Net profit expected to decline 37% qoq on account of the very high forex gain in the previous quarter
Revenue (Rs m)	13,795	16,120	16,964	5.2%	23.0%	
EBITDA (Rs m)	2,989	3,474	3,478	0.1%	16.4%	
EBITDA margin (%)	21.7%	21.6%	20.5%	-105bp	-117bp	
Net Profit (Rs m)	2,300	4,667	2,944	-36.9%	28.0%	
Tech Mahindra						
Revenue (US\$ m)	150	211	227	7.8%	51.2%	*Expect revenue growth of 7.8% in \$ terms - BTGS contract expected to ramp up Q3 onwards *We expect net profit growth of ~4% qoq *Key things to watch - Outlook on BT and AT&T (the biggest clients) and ramp up schedule for BTGS
Revenue (Rs m)	6,976	8,763	9,186	4.8%	31.7%	
EBITDA (Rs m)	1,769	1,933	2,021	4.6%	14.3%	
EBITDA margin (%)	25.4%	22.1%	22.0%	-5bp	-335bp	
Net Profit (Rs m)	1,430	1,698	1,770	4.2%	23.8%	
Patni						
Revenue (US\$ m)	152	163	168	3.1%	11.0%	* We expect another sluggish quarter - revenue growth of 3.1% in US\$ terms * EBITDA margin reported by Patni includes the hedging gains - this quarter margins impacted by lower hedging gains * Key thing to watch - headcount addition - company had not hired any significant numbers as focus was on improving utilization and cost efficiencies
Revenue (Rs m)	6,999	6,628	6,686	0.9%	-4.5%	
EBITDA (Rs m)	1,361	1,551	1,107	-28.6%	-18.7%	
EBITDA margin (%)	19.4%	23.4%	16.6%	-684bp	-289bp	
Net Profit (Rs m)	1,024	1,348	894	-33.6%	-12.7%	
I-flex						
Revenue (US\$ m)	108	131	147	12.4%	36.0%	* We expect revenue growth of 12.4% qoq - led by product business. In services we expect 6.4% qoq growth while in products we expect 50% yoy growth (17% qoq growth) * We expect EBITDA margin improvement of ~740bp mainly on account of higher license revenues * Key thing to watch - new product wins; Oracle open offer for increase of stake in I-flex
Revenue (Rs m)	5,009	5,321	5,951	11.9%	18.8%	
EBITDA (Rs m)	970	730	1,255	72.1%	29.4%	
EBITDA margin (%)	19.4%	13.7%	21.1%	738bp	173bp	
Net Profit (Rs m)	804	416	912	119.4%	13.4%	

Source: Company Reports and Citi Investment Research estimates

Figure 3. 2Q FY08 Results Preview – Part II

Mphasis	Sep'06	Jun'07	Sep'07E	QoQ	YoY	Key things to watch for
Revenue (US\$ m)	92	130	140	7.7%	52.1%	* Expect another decent quarter with ~8% qoq revenue growth
Revenue (Rs m)	4,263	5,316	5,668	6.6%	32.9%	* EBITDA margins expected to improve ~40bp qoq
EBITDA (Rs m)	745	977	1,062	8.7%	42.6%	* Net profit expected to increase ~25% qoq as the company had a forex loss in Q1FY08
EBITDA margin (%)	17.5%	18.4%	18.7%	36bp	127bp	* Key thing to watch - new deals from EDS partnership and status on ramp of existing deals
Net Profit (Rs m)	366	513	639	24.5%	74.8%	
Hexaware						
Revenue (US\$ m)	49	64	66	3.4%	36.4%	* We expect another sluggish quarter - we forecast revenue growth of ~3% qoq
Revenue (Rs m)	2,250	2,616	2,675	2.2%	18.9%	* We expect margins to improve marginally by ~30bp qoq
EBITDA (Rs m)	361	321	336	4.7%	-7.0%	* Key thing to watch - hiring during the quarter and any large deal announcements
EBITDA margin (%)	16.0%	12.3%	12.5%	29bp	-349bp	
Net Profit (Rs m)	347	261	278	6.5%	-19.8%	
KPIT Cumm.						
Revenue (US\$ m)	25	31	35	11.9%	40.0%	* We expect a strong quarter - 12% qoq growth in US\$ terms
Revenue (Rs m)	1,140	1,353	1,472	8.8%	29.1%	* We expect some improvement in margins of ~35bp qoq
EBITDA (Rs m)	179	215	239	11.2%	33.4%	* Key thing to watch - Ability to achieve FY08 guidance
EBITDA margin (%)	15.7%	15.9%	16.2%	35bp	53bp	
Net Profit (Rs m)	123	127	143	12.8%	15.8%	
Sasken						
Revenue (US\$ m)	25	31	34	7.1%	32.3%	* We expect some ramp up in the handset side of the services business - expect 7% qoq growth (\$ terms)
Revenue (Rs m)	1,175	1,284	1,359	5.8%	15.6%	* Margins expected to improve~375bp after the sharp fall in Q1 and cost optimization efforts undertaken by management
EBITDA (Rs m)	220	99	156	57.3%	-29.3%	* Key thing to watch - visibility on telecom OEM clients; management update on new and existing design-ins/ design wins
EBITDA margin (%)	18.7%	7.7%	11.5%	375bp	-727bp	
Net Profit (Rs m)	119	64	84	31.8%	-29.2%	
NIIT Ltd						
Revenue (US\$ m)	44	55	67	20.7%	51.5%	* Seasonally strongest quarter - we expect revenue growth of 32% yoy in Rupee terms
Revenue (Rs m)	2,031	2,254	2,687	19.2%	32.3%	* Growth to led by individual business - we expect 40% revenue and 96% operating profit growth in this business
EBITDA (Rs m)	239	145	360	148.6%	50.8%	* Key thing to watch - progress on ElementK integration and its profitability; revenue uptick in new businesses; clarity on stake sale in NIIT Tech
EBITDA margin (%)	11.8%	6.4%	13.4%	698bp	165bp	
Net Profit (Rs m)	162	154	246	59.7%	51.8%	
Educomp Sol						
Revenue (Rs m)	197	275	357	29.8%	81.0%	*Growth momentum to continue - we expect 81% yoy growth in revenues
EBITDA (Rs m)	93	134	180	34.3%	93.9%	*EBITDA margins expected to improve further by ~330bp yoy
EBITDA margin (%)	47.0%	48.6%	50.3%	171bp	333bp	*Key thing to watch - outlook on the new school business
Net Profit (Rs m)	51	60	101	69.2%	99.1%	

Source: Company Reports and Citi Investment Research estimates

Figure 4. Results Schedule

Company	Date
Infosys	11-Oct
TCS	15-Oct
Sasken	15-Oct
HCL Tech	17-Oct
KPIT	17-Oct
Hexaware	18-Oct
Tech Mahindra	19-Oct
Wipro	19-Oct
Satyam	23-Oct

Source: Company Reports

Figure 5. Indian IT Services: Valuation Comparison

Company	RIC Code	Rating	Mkt cap (US\$ m)	CMP (Rs)	TP (Rs)	P/E (x)		EV/EBITDA (x)		EV/Sales(x)		P/BV (x)		Div.Yield (%)	
						FY08E	FY09E	FY08E	FY09E	FY08E	FY09E	FY08E	FY09E	FY08E	FY09E
Infosys	INFY.BO	1L	28,860	2,005	2,440	25.0	20.4	20.8	16.1	6.3	5.0	7.7	5.9	0.8%	1.0%
TCS	TCS.BO	1L	26,668	1,081	1,460	21.0	17.3	16.9	13.6	4.5	3.6	8.4	6.2	1.3%	1.5%
Wipro	WIPR.BO	1L	17,390	473	650	20.2	16.5	16.3	12.8	3.4	2.7	5.7	4.7	2.1%	2.5%
Satyam	SATY.BO	1M	7,617	452	570	18.1	14.9	14.6	11.6	3.2	2.5	4.4	3.7	1.8%	2.2%
HCL Tech	HCLT.BO	1M	5,099	305	400	16.6	14.0	12.1	9.9	2.4	2.0	3.6	3.1	2.6%	2.6%
I-Flex	IFLX.BO	3M	3,975	1,884	2,025	38.2	27.5	26.6	18.9	5.6	4.2	7.7	6.0	0.0%	0.0%
Tech Mahindra	TEML.BO	1H	4,027	1,318	1,920	20.7	14.4	17.0	12.0	3.6	2.5	9.2	5.5	0.2%	0.2%
Patni*	PTNI.BO	1M	1,602	458	525	14.2	13.1	8.7	8.2	1.8	1.5	2.4	2.1	0.8%	1.1%
Educomp	EDSO.BO	3H	1,288	2,967	2,380	76.6	43.7	45.0	24.8	21.4	10.4	28.7	17.3	0.1%	0.1%
Mphasis	MBFL.BO	1M	1,193	288	400	23.6	15.1	10.1	7.1	1.9	1.3	5.0	3.9	1.0%	1.0%
NIIT	NIIT.BO	3M	612	148	153	25.3	16.0	23.5	14.6	2.5	2.1	5.6	4.3	0.7%	0.7%
Hexaware*	HEXT.BO	1M	438	121	155	13.4	11.7	9.3	8.0	1.3	1.1	2.1	1.9	1.5%	2.0%
Sasken	SKCT.BO	1M	231	321	505	16.1	9.8	10.0	5.6	1.2	0.9	2.0	1.7	1.6%	3.1%
KPIT	KPIT.BO	1M	232	121	154	16.6	11.8	10.2	7.7	1.6	1.2	3.7	2.8	0.4%	0.6%

Source: Powered by dataCentral; Prices as on 03-Oct-07; * CY07/CY08 for Dec year-end companies

Figure 6. Price Performance

	Price 3-Oct-07	Performance						
		1W	1M	3M	6M	12M	YTD	
Infosys	INFY.BO	2,005	9.9%	7.7%	3.0%	2.1%	10.3%	-10.5%
TCS	TCS.BO	1,081	3.9%	2.1%	-4.1%	-10.0%	6.6%	-11.3%
Wipro	WIPR.BO	473	4.0%	-0.5%	-8.2%	-11.5%	-9.0%	-21.8%
Satyam	SATY.BO	452	4.8%	0.5%	-4.1%	-1.5%	10.0%	-6.6%
HCL Tech	HCLT.BO	305	2.6%	-1.8%	-9.1%	9.5%	10.2%	-6.0%
Patni	PTNI.BO	458	-3.5%	-14.4%	-11.3%	21.3%	18.8%	9.6%
Educomp	EDSO.BO	2,967	4.8%	2.3%	31.5%	198.7%	315.7%	210.4%
TechM	TEML.BO	1,318	-0.3%	0.2%	-7.7%	-1.7%	112.8%	-21.1%
I-Flex	IFLX.BO	1,884	1.5%	-6.8%	-27.2%	-8.7%	31.4%	-3.3%
Mphasis	MBFL.BO	288	1.1%	-4.4%	-11.8%	6.3%	50.1%	-5.1%
Sasken	SKCT.BO	321	-5.5%	-15.6%	-37.5%	-32.4%	-19.3%	-40.1%
Hexaware	HEXT.BO	121	-2.8%	-0.6%	-27.5%	-27.0%	-27.9%	-39.2%
KPIT Cummins	KPIT.BO	121	1.8%	-0.3%	-12.4%	-6.7%	30.2%	-13.2%
Moser Baer	MOSR.BO	316	-2.4%	4.4%	-5.2%	61.4%	124.1%	53.9%
NIIT Ltd	NIIT.BO	148	0.2%	15.7%	4.3%	64.7%	240.2%	110.7%
Aptech	APTA.BO	400	7.9%	28.3%	25.4%	85.4%	205.7%	147.8%
NIIT Tech	NIIT.BO	363	7.8%	4.6%	2.6%	27.8%	190.6%	79.0%
iGate	IGAT.BO	218	-0.3%	0.1%	-28.8%	-41.0%	20.2%	-37.1%
Mastek	MAST.BO	305	0.1%	16.2%	4.8%	0.7%	-11.9%	-17.8%
CMC	CMC.BO	995	0.3%	-12.0%	-15.9%	-14.4%	77.6%	47.5%
Infotech Ent	INFE.BO	268	1.2%	-5.1%	-33.5%	-22.2%	27.6%	-16.6%
Geometric s/w	GEOM.BO	95	-0.2%	-5.0%	-24.3%	-3.1%	-11.8%	-20.3%
Geodesic	GEIS.BO	187	-7.4%	-18.5%	-6.5%	24.0%	78.4%	55.8%
Aztec	AZTC.BO	64	-0.8%	-15.0%	-26.6%	-46.4%	-50.3%	-61.1%
HCL Infosystems	HCLI.BO	249	12.5%	21.0%	36.4%	92.9%	72.7%	56.4%
BSE Sensex	.BSESN	17,890	5.7%	16.0%	20.8%	41.7%	44.7%	29.8%
BSE IT Index	.BSEIT	4,789	6.4%	3.9%	-1.8%	0.5%	9.8%	-9.2%

Source: DataStream

Figure 7. INR Movement

	1QFY08	2QFY08	Change (diff)	Change (%)
INR/USD				
Period end	40.70	39.81	0.89	-2.2%
Average	41.26	40.54	0.72	-1.7%
INR/GBP				
Period end	81.70	81.52	0.18	-0.2%
Average	81.92	81.93	-0.01	0.0%
INR/Euro				
Period end	55.06	56.82	-1.76	3.2%
Average	55.61	55.70	-0.09	0.2%

Source: Bloomberg

Figure 8. Hedge Position (at the end of Jun'07)

	Forex Cover (US\$ m) - Jun'07			Revenue (Jun'07) US\$ mn	Hedge as a % of quarterly revenue
	Forwards	Options	Total		
Infosys	719	204	923	928	99%
TCS	2,500	-	2,500	1,278	196%
Wipro	675	75	750	726	103%
Satyam	297	446	743	449	166%
HCL Tech	1,160	-	1,160	396	293%

Source: Company Reports

Figure 9. Infosys 2Q08 Guidance

	Guidance		Implied growth	
	Lower	Upper	Lower	Upper
Revenue (Rs m)	39,520	39,930	4.7%	5.8%
Revenue (\$ m)	974	984	5.0%	6.0%
EPS (Rs)	18.88	18.88	-0.1%	-0.1%

Source: Company Reports; Company guidance based on exchange rate of Rs 40.58/US\$.

Figure 10. Satyam 2Q08 Guidance

	Guidance		Implied growth	
	Lower	Upper	Lower	Upper
Revenue (Rs m)	19,170	19,260	4.7%	5.2%
Revenue (\$ m)	477	479	5.5%	6.0%
EPS (Rs)	5.36	5.41	-5.4%	-4.6%

Source: Company Reports; Company guidance based on exchange rate of Rs 40.50/US\$.

Figure 11. Patni 3Q07 Guidance

	Guidance		Implied growth	
	Lower	Upper	Lower	Upper
Revenue (\$ m)	167	168	2.2%	2.9%
Net profit (US\$ m)	18.50	19.00	-44.3%	-42.8%

Source: Company Reports; Company guidance excludes forex gain/loss and is based on exchange rate of Rs 40.80/US\$.

Appendix A-1

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