

Indian IT Services

Stock Sell-off factors in macro risks, time to accumulate

Indian IT stocks have seen a sharp sell-off in the last couple of weeks since the Lehman bankruptcy and continued stress on financial institutions globally. While some investor concern is warranted, we believe the share price drop has been excessive, driven to some extent by panic and forced selling (liquidation of portfolios). First, the Indian IT outsourcing model remains intact and should in fact gain market share in a global slowdown akin to in 2001-2003. Second, Indian IT stocks are now trading close to their trough P/Es achieved in the 2001-2003 downturn, indicating high investor pessimism. Further, these estimates do not factor in recent Rupee depreciation. While near-term news flow is difficult to predict, we believe this is the right time to accumulate large Indian IT stocks on a 9-to-12-month horizon – Infosys, Satyam, and TCS are our top picks.

- **We expect Indian IT companies to gain market share in an economic slowdown, as they did in 2001-2003:** While we agree that business from some large financial institutions will be hurt, a host of other customers are likely to increase offshoring due to IT spend pressures. Even the large financial institutions should offshore a much larger proportion of their budgets over time given cost advantages.
- **Valuations for Indian IT are close to their historical troughs achieved in 2001-2003. However the crucial question today is investor belief in current consensus estimates:** With the economic uncertainty around, there might be a case to call for a 5-10% cut to current consensus estimates as pricing comes off and volume growth slows. This should be more than made up for by Rupee/US\$ depreciation. As of now, based on Bloomberg consensus, FY10E EPS growth is 15-17% for large companies, implying an FY10E P/E of 8-12x.
- **We expect 2Q FY09 earnings to be largely in line with consensus, along with in-line 3Q FY09 guidance that should allay concerns about a near-term business slowdown:** However, the FY10 outlook remains uncertain as of now. We would like to re-state that despite the recent sell-off, Indian IT stocks have performed in line with the Indian market YTD in 2008, with Infosys and Satyam outperforming the Sensex by 17% and 3% respectively.

Consensus EPS estimates and P/E values

	Price (Rs)	EPS				EPS Growth			EPS CAGR	P/E		
		FY08	FY09E	FY10E	FY11E	FY09E	FY10E	FY11E	FY08-11E	FY09E	FY10E	FY11E
Infosys	1393.3	78.6	102.0	118.6	133.0	30%	16%	12%	19%	13.7	11.8	10.5
TCS	620.0	51.3	59.7	69.2	78.0	16%	16%	13%	15%	10.4	9.0	8.0
Wipro	343.1	22.4	26.8	31.4	34.2	20%	17%	9%	15%	12.8	10.9	10.0
Satyam	293.1	25.2	32.5	37.4	40.3	29%	15%	8%	17%	9.0	7.8	7.3

Source: Bloomberg

See page 9 for analyst certification and important disclosures, including non-US analyst disclosures.

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Absolute and relative share price performance

Absolute performance	YTD	In Sep '08
Sensex	-38%	-13%
Infosys	-21%	-19%
TCS	-43%	-24%
Wipro	-35%	-21%
Satyam	-35%	-31%
HCL Tech	-41%	-19%

Relative performance	YTD	In Sep '08
Infosys	17%	-6%
TCS	-5%	-11%
Wipro	3%	-8%
Satyam	3%	-18%
HCL Tech	-3%	-6%

Source: Datastream

Valuations – Stocks close to historical troughs

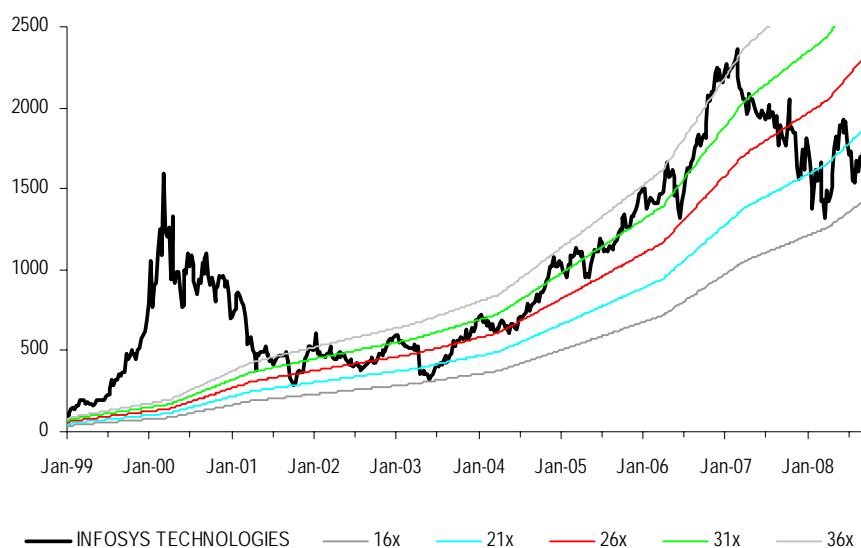
Table 1: Infosys: Consensus EPS estimates and P/E values

YE Mar.	Price (Rs)	EPS (Rs)				EPS growth			EPS CAGR FY08-11E	P/E (x)		
		FY08	FY09E	FY10E	FY11E	FY09E	FY10E	FY11E		FY09E	FY10E	FY11E
Infosys	1393.3	78.6	102.0	118.6	133.0	30%	16%	12%	19%	13.7	11.8	10.5

Source: Bloomberg

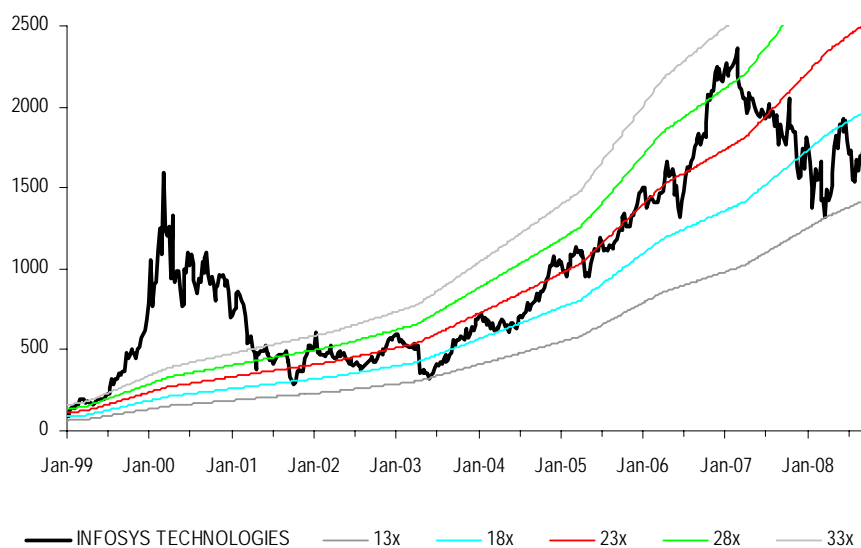
Infosys is trading at 12.7x one-year forward P/E and 15.5x one-year trailing P/E. This is below its historical trough of 13x forward P/E

Figure 1: Infosys: One-year trailing P/E



Source: Company data, Datastream, JPMorgan estimates.

Figure 2: Infosys: One-year forward P/E



Source: Company data, Datastream, J.P. Morgan estimates.

Table 2: Tata Consultancy Services: Consensus EPS estimates and P/E values

YE Mar.	Price (Rs)	EPS (Rs)				EPS growth			EPS CAGR FY08-11E	P/E (x)		
		FY08	FY09E	FY10E	FY11E	FY09E	FY10E	FY11E		FY09E	FY10E	FY11E
TCS	620.0	51.3	59.7	69.2	78.0	16%	16%	13%	15%	10.4	9.0	8.0

Source: Bloomberg

Figure 3: TCS: One-year trailing P/E

TCS is trading at 9.7x one-year forward P/E and 11.1x one-year trailing P/E

This is below its historical trough of 12x forward P/E



Source: Company data, Datastream, J.P. Morgan estimates.

Figure 4: TCS: One-year forward P/E



Source: Company data, Datastream, J.P. Morgan estimates.

Table 3: Wipro: Consensus EPS estimates and P/E values

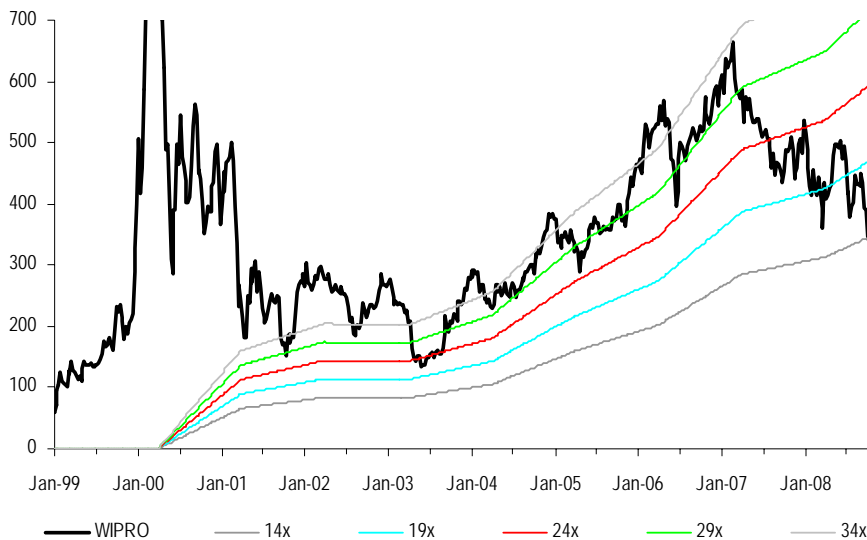
YE Mar.	Price (Rs)	EPS (Rs)				EPS growth			EPS CAGR FY08-11E	P/E (x)		
		FY08	FY09E	FY10E	FY11E	FY09E	FY10E	FY11E		FY09E	FY10E	FY11E
Wipro	343.1	22.4	26.8	31.4	34.2	20%	17%	9%	15%	12.8	10.9	10.0

Source: Bloomberg

Figure 5: Wipro: One-year trailing P/E

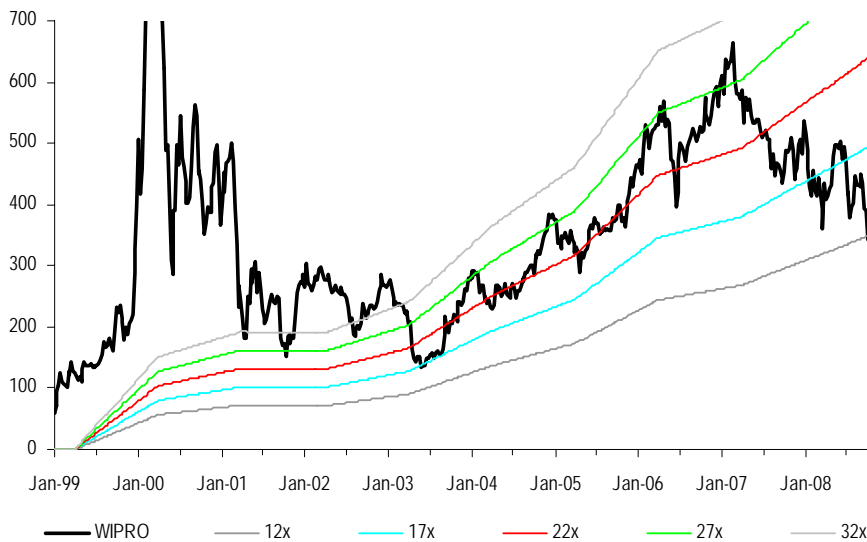
Wipro is trading at 11.8x one-year forward P/E and 14x one-year trailing P/E

Its previous historical trough was 12.7x forward P/E



Source: Company data, Datastream, J.P. Morgan estimates.

Figure 6: Wipro: One-year forward P/E



Source: Company data, Datastream, J.P. Morgan estimates.

Table 4: Satyam: Consensus EPS estimates and P/E values

YE Mar.	Price (Rs)	EPS				EPS Growth			EPS CAGR FY08-11E	P/E		
		FY08	FY09E	FY10E	FY11E	FY09E	FY10E	FY11E		FY09E	FY10E	FY11E
Satyam	293.1	25.2	32.5	37.4	40.3	29%	15%	8%	17%	9.0	7.8	7.3

Source: Bloomberg

Figure 7: Satyam: One-year trailing P/E



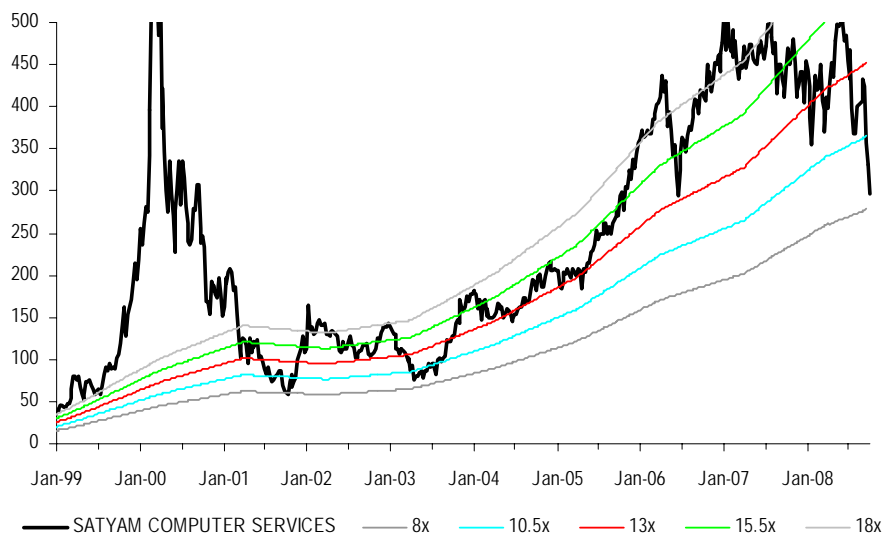
Source: Company data, Datastream, J.P. Morgan estimates.

Satyam is trading at 8.5x one-year forward P/E and 10.2x one-year trailing P/E

This is below its recent trough of 12x forward P/E and FY03 trough of ~10x forward P/E

Satyam has net cash of Rs69/share based on its June-08 reported balance sheet

Figure 8: Satyam: One-year forward P/E



Source: Company data, Datastream, J.P. Morgan estimates.

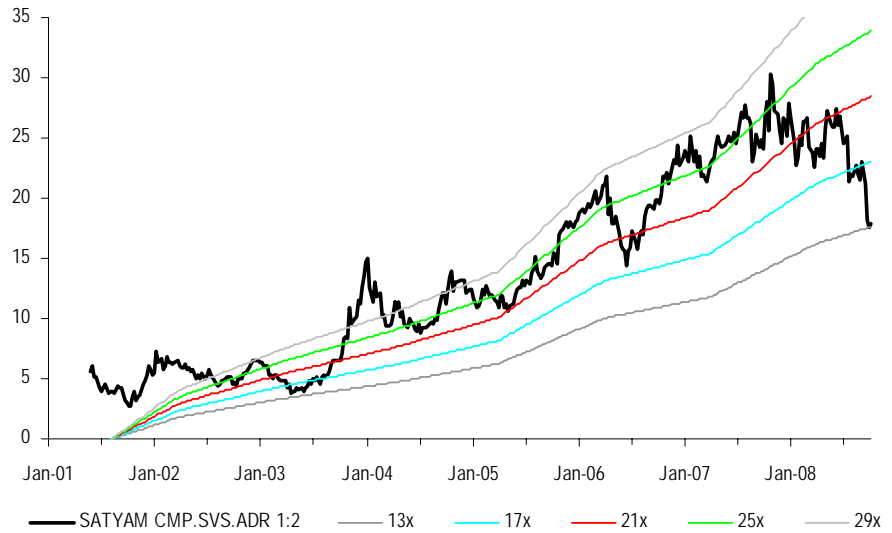
Even ADR P/Es are at trough valuations

Figure 9: Infosys: ADR one-year forward P/E



Source: Company data, Datastream, J.P. Morgan estimates.

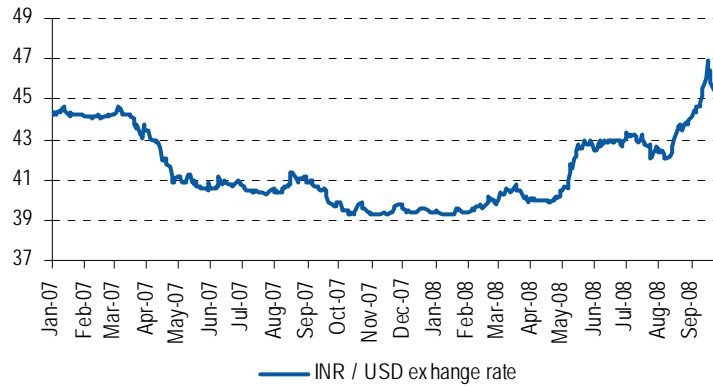
Figure 10: Satyam: ADR one-year forward P/E



Source: Company data, Datastream, J.P. Morgan estimates.

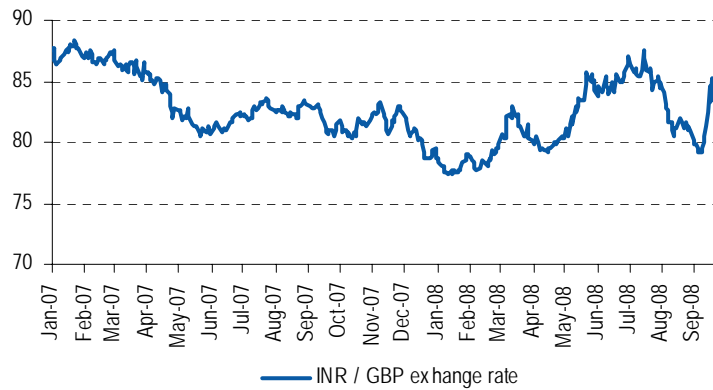
Rupee movement against major currencies

Figure 11: INR USD exchange rate



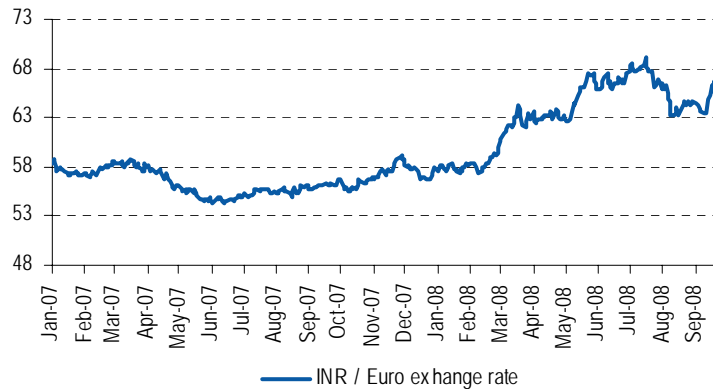
Source: Datastream

Figure 12: INR GBP exchange rate



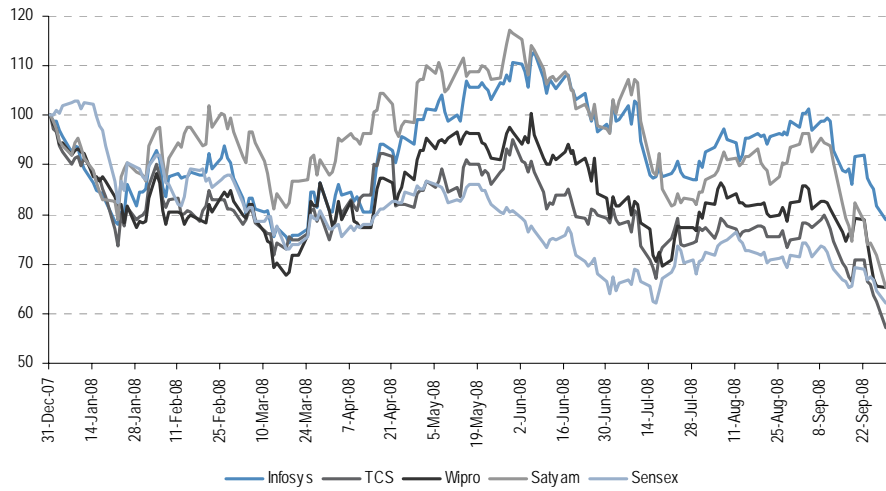
Source: Datastream

Figure 13: INR Euro exchange rate



Source: Datastream

Figure 14: Share price performance of top-tier Indian IT companies (re-based to 100)



Source: Datastream

Table 5: Absolute and relative share price performance

Absolute performance	YTD	In Sep '08
Sensex	-38%	-13%
Infosys	-21%	-19%
TCS	-43%	-24%
Wipro	-35%	-21%
Satyam	-35%	-31%
HCL Tech	-41%	-19%

Relative performance	YTD	In Sep '08
Infosys	17%	-6%
TCS	-5%	-11%
Wipro	3%	-8%
Satyam	3%	-18%
HCL Tech	-3%	-6%

Source: Datastream

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HCL-Technologies (HCLT.BO/Rs195.80/Neutral), Infosys Technologies (INFY.BO/Rs1,391.95/Overweight), Satyam Computers (SATY.BO/Rs292.55/Overweight), Tata Consultancy Services (TCS.BO/Rs619.65/Overweight), Wipro Ltd. (WIPR.BO/Rs343.10/Overweight)

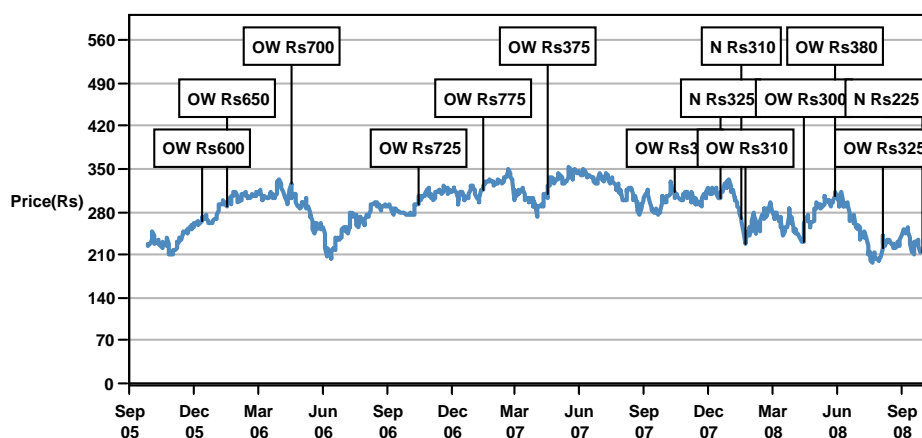
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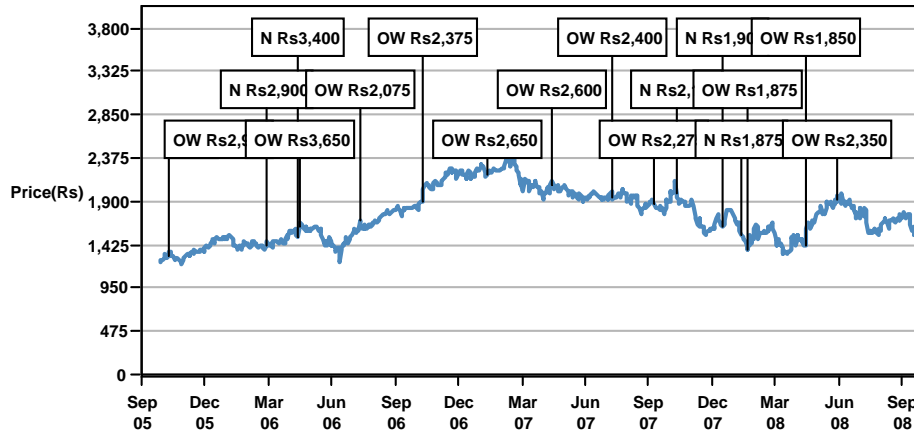
HCL-Technologies (HCLT.BO) Price Chart



Date	Rating	Share Price (Rs)	Price Target (Rs)
13-Dec-05	OW	263.62	600.00
18-Jan-06	OW	290.15	650.00
19-Apr-06	OW	325.58	700.00
16-Oct-06	OW	292.30	725.00
16-Jan-07	OW	314.90	775.00
17-Apr-07	OW	308.75	375.00
16-Oct-07	OW	312.95	360.00
19-Dec-07	N	300.50	325.00
18-Jan-08	N	267.60	310.00
23-Jan-08	OW	228.60	310.00
15-Apr-08	OW	230.20	300.00
29-May-08	OW	306.80	380.00
05-Aug-08	OW	220.10	325.00
29-Sep-08	N	212.95	225.00

Source: Reuters and J.P. Morgan; price data adjusted for stock splits and dividends.
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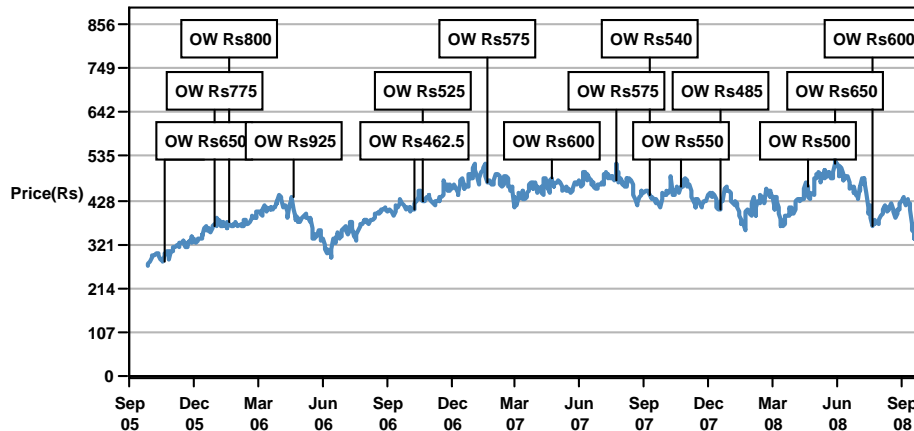
Infosys Technologies (INFY.BO) Price Chart



Date	Rating	Share Price (Rs)	Price Target (Rs)
11-Oct-05	OW	1311.22	2950.00
01-Mar-06	N	1414.30	2900.00
14-Apr-06	N	1510.40	3400.00
17-Apr-06	OW	1615.15	3650.00
13-Jul-06	OW	1693.22	2075.00
11-Oct-06	OW	1906.00	2375.00
12-Jan-07	OW	2183.00	2650.00
16-Apr-07	OW	2087.60	2600.00
12-Jul-07	OW	1929.70	2400.00
10-Sep-07	OW	1871.50	2275.00
12-Oct-07	N	1976.00	2150.00
18-Dec-07	N	1621.95	1900.00
14-Jan-08	N	1530.20	1875.00
23-Jan-08	OW	1377.55	1875.00
15-Apr-08	OW	1422.45	1850.00
29-May-08	OW	1912.65	2350.00

Source: Reuters and J.P. Morgan; price data adjusted for stock splits and dividends.
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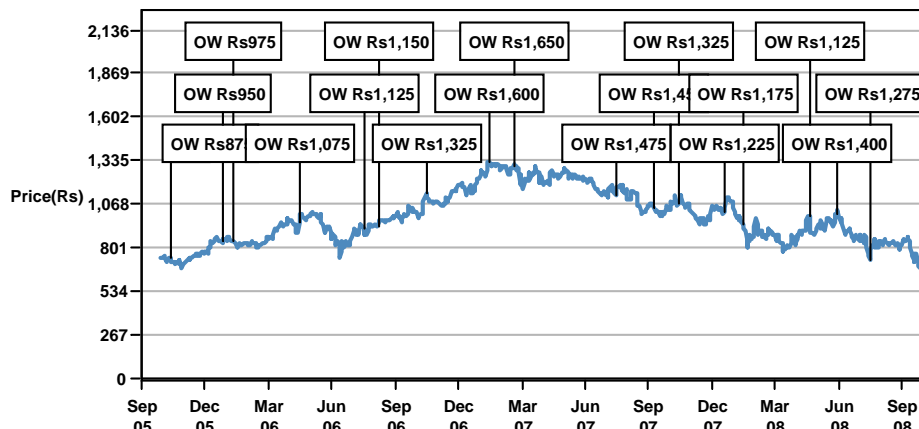
Satyam Computers (SATY.BO) Price Chart



Date	Rating	Share Price (Rs)	Price Target (Rs)
20-Oct-05	OW	278.72	650.00
30-Dec-05	OW	365.70	775.00
20-Jan-06	OW	374.12	800.00
21-Apr-06	OW	435.78	925.00
10-Oct-06	OW	406.15	462.50
23-Oct-06	OW	425.00	525.00
21-Jan-07	OW	472.35	575.00
22-Apr-07	OW	480.65	600.00
23-Jul-07	OW	477.85	575.00
10-Sep-07	OW	442.25	540.00
24-Oct-07	OW	461.75	550.00
18-Dec-07	OW	405.90	485.00
22-Apr-08	OW	458.95	500.00
29-May-08	OW	514.40	650.00
21-Jul-08	OW	367.10	600.00

Source: Reuters and J.P. Morgan; price data adjusted for stock splits and dividends.
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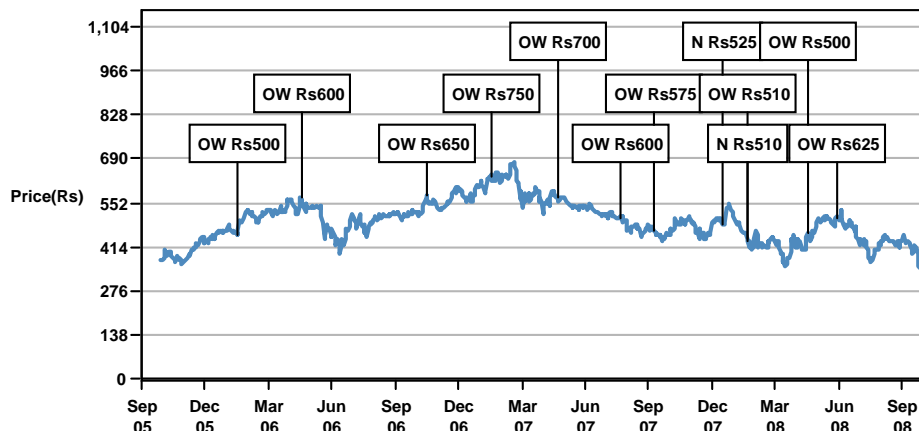
Tata Consultancy Services (TCS.BO) Price Chart



Date	Rating	Share Price (Rs)	Price Target (Rs)
12-Oct-05	OW	733.95	875.00
26-Dec-05	OW	835.90	950.00
12-Jan-06	OW	835.82	975.00
17-Apr-06	OW	951.80	1075.00
19-Jul-06	OW	920.88	1125.00
08-Aug-06	OW	936.00	1150.00
16-Oct-06	OW	1130.45	1325.00
15-Jan-07	OW	1325.30	1600.00
21-Feb-07	OW	1297.20	1650.00
16-Jul-07	OW	1127.90	1475.00
10-Sep-07	OW	1046.95	1450.00
15-Oct-07	OW	1073.65	1325.00
20-Dec-07	OW	1021.35	1225.00
16-Jan-08	OW	938.25	1175.00
21-Apr-08	OW	992.55	1125.00
29-May-08	OW	1009.70	1400.00
17-Jul-08	OW	727.35	1275.00

Source: Reuters and J.P. Morgan; price data adjusted for stock splits and dividends.
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Wipro Ltd. (WIPR.BO) Price Chart



Date	Rating	Share Price (Rs)	Price Target (Rs)
18-Jan-06	OW	449.25	500.00
19-Apr-06	OW	570.15	600.00
18-Oct-06	OW	574.70	650.00
17-Jan-07	OW	636.85	750.00
23-Apr-07	OW	567.00	700.00
22-Jul-07	OW	505.05	600.00
10-Sep-07	OW	466.95	575.00
17-Dec-07	N	484.60	525.00
21-Jan-08	N	439.80	510.00
23-Jan-08	OW	428.85	510.00
18-Apr-08	OW	459.20	500.00
29-May-08	OW	506.15	625.00

Source: Reuters and J.P. Morgan; price data adjusted for stock splits and dividends.
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IB clients*	51%	52%	41%
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IB clients*	75%	70%	60%

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