

UBS Investment Research

Indian IT Services

India

Software

Sector Comment

Highlights of the UBS India CEO/CFO forum

■ UBS India conference, 8-10 November 2011

We hosted Tata Consultancy Services (TCS), Wipro, and HCL Technologies (HCL Tech) at the UBS India CEO/CFO Forum held on 8-10 November 2011. These companies were well represented by senior management personnel who shared their views on demand, macro economic concerns, currency moves and margin issues.

■ Vendors still upbeat, investors perceive toned-down outlook

Vendor commentary on demand outlook remained positive with most vendors anticipating normal budgeting cycles and stable-to-positive budgets in 2012. However, many investors gave us feedback that there is a perceptible moderation in confidence levels from the levels seen before the September earnings season.

■ Companies plan to invest currency gains wherever possible

Most vendors plan to use margin gains from a weak Indian rupee to invest in client-facing activities, IP and platform creation and non-linear initiatives. Some vendors, like HCL Tech, expect margins to remain stable despite sharp currency depreciation due to such investments.

■ UBS view: remain cautious on demand outlook

We remain cautious on the sector due to our concerns on 2012 demand, as well as our expectations of a structural slowdown in earnings. While currency moves could support relative performance to local benchmarks, we continue to see risks to absolute stock prices. We maintain our Neutral rating on Infosys and Sell ratings on TCS, HCL Tech, Wipro, Tech Mahindra, Mahindra Satyam, Patni and Mphasis.

Valuation summary

	Price (Rs)	Mkt. Cap (US\$ bn)	Rating	Target (Rs)	Upside (%)	FY13E PE (x)	FY13E EV/EBITDA (x)	EPS CAGR FY11-14 (%)
TCS	1,130.80	44.2	Sell	1,000	-11.6%	18.0	13.4	15.7%
Infosys	2,775.60	31.7	Neutral	2,450	-11.7%	16.9	12.3	14.1%
Wipro	381.70	18.6	Sell	340	-10.9%	15.7	9.8	6.3%
HCL Tech	424.90	5.8	Sell	380	-10.6%	11.2	7.1	15.3%
Mphasis	335.70	1.4	Sell	350	4.3%	9.8	6.1	-10.4%
Patni	362.15	0.9	Sell	250	-31.0%	13.6	5.7	-10.6%
Tech Mahindra	597.15	1.5	Sell	630	5.5%	8.3	5.6	15.0%
Mahindra Satyam	75.65	1.8	Sell	70	-7.5%	11.5	5.7	NA

Note: 1) Data as at 11 November 2011. 2) October financial year-end for Mphasis; June for HCL Tech; and December for Patni.

Source: Reuters, UBS estimates

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www.ubs.com/investmentresearch

Diviya Nagarajan

Analyst

diviya.nagarajan@ubs.com

+91-22-6155 6072

We hosted TCS, Wipro, and HCL Tech at the UBS India CEO/CFO Forum held on 8-10 November 2011. Demand confidence remains high, although there seemed to be some moderation in confidence levels in the past few weeks. There was considerable discussion on currency moves, following the keynote presentation by the deputy governor of the Reserve Bank of India, Mr. Subir Gokarn. In his address, Mr Gokarn indicated that the Indian central bank viewed the recent depreciation of the Indian rupee against the US dollar as a temporary move and is unlikely to intervene at current levels.

While macroeconomy-related concerns seem to have eased, investors quizzed senior management personnel on pricing trends, investments in expanding addressable markets, margin sustenance, and hedging strategies.

Tata Consultancy Services

TCS was represented by Mr. S. Mahalingam (CFO), and Mr. Kedar Shirali (Director of Investor Relations).

- **Demand:** TCS is not seeing any decline in discretionary spending from its clients, but remains watchful on budgets in its financial services clients. The US is relatively stable, while parts of Europe (Germany, France, Nordics) also remain strong growth markets for TCS. Asia-Pacific continues to show strong demand, and so does India, although revenue tends to be lumpy due to the nature of projects.
- **Margins:** TCS is confident of maintaining margins at 27% levels ex. currency moves. TCS will continue to invest—this includes further expansion in Latin America and China, more onsite development centres, non-linear platforms, etc. If currency remains at current levels, margins are likely to improve despite such investments. The company hopes to increase contribution from non-linear models to 10% of incremental revenue by March 2012, from 3.5-4% at present.
- **Supply:** Attrition has fallen to more comfortable levels (12.5% at present) and is likely to remain manageable. Wage inflation has sustained at 10-15% in the past few years, and management expects to contain wage increases in the same band in the coming years.

Wipro

Wipro was represented by Mr. Aravind Viswanathan (Head - Investor Relations).

- **Demand:** Revenue acceleration likely to be slow and steady, rather a sudden spike in sequential growth rates. The organizational realignment is complete and is likely to yield results in the next few quarters. Wipro has not seen any meaningful impact on demand due to macroeconomic uncertainty till date. Clients remain cautious, but the deal pipeline remains strong. The only point of stress, if any, could come from large investment banks in Europe.

- **Supply:** Entry level supply is not an issue, contrary to some media reports about low acceptance ratios for Wipro's campus offers. Attrition has also come off recent highs, easing supply pressures. Wipro's management is not too worried about visa-related issues—the company has not seen any significant increase in rejection rates for visa applications, although regulatory scrutiny has increased.

HCL Technologies

HCL Technologies was represented by Mr. Anil Chanana (CFO), Mr. Anant Gupta (President) and Mr. Sanjay Mendiratta (Head – Investor Relations).

- **Demand:** HCL Tech is getting invited to more pre-Request For Proposal (RFP) deals, which indicates that the company is able to demonstrate thought leadership and provide relevant solutions to their clients. The company expects to see strong revenue traction in areas such as global risk compliance. Management hopes to close several large deals in the December quarter, which is likely to help the company report strong revenue growth.
- **Margins:** Margins are likely to remain at 14% (EBIT) despite currency depreciation as the company plans to invest margin gains back into the business. Management denied that HCL Tech was more willing to offer price cuts to clients (as stated in recent media reports), and cited investments in internal projects and IP creation as reasons for margins not benefitting from currency gains.
- **Supply:** HCL Tech has started hiring more at the entry level, which is expected to bring down per capita cost and improve margins.

■ Statement of Risk

We believe a sharp decline in IT spending or currency appreciation could result in downward revisions in earnings estimates.

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UBS 12-Month Rating	Rating Category	Coverage ¹	IB Services ²
Buy	Buy	59%	35%
Neutral	Hold/Neutral	35%	33%
Sell	Sell	6%	14%
UBS Short-Term Rating	Rating Category	Coverage ³	IB Services ⁴
Buy	Buy	less than 1%	0%
Sell	Sell	less than 1%	20%

1:Percentage of companies under coverage globally within the 12-month rating category.

2:Percentage of companies within the 12-month rating category for which investment banking (IB) services were provided within the past 12 months.

3:Percentage of companies under coverage globally within the Short-Term rating category.

4:Percentage of companies within the Short-Term rating category for which investment banking (IB) services were provided within the past 12 months.

Source: UBS. Rating allocations are as of 30 September 2011.

UBS Investment Research: Global Equity Rating Definitions

UBS 12-Month Rating	Definition
Buy	FSR is > 6% above the MRA.
Neutral	FSR is between -6% and 6% of the MRA.
Sell	FSR is > 6% below the MRA.
UBS Short-Term Rating	Definition
Buy	Buy: Stock price expected to rise within three months from the time the rating was assigned because of a specific catalyst or event.
Sell	Sell: Stock price expected to fall within three months from the time the rating was assigned because of a specific catalyst or event.

KEY DEFINITIONS

Forecast Stock Return (FSR) is defined as expected percentage price appreciation plus gross dividend yield over the next 12 months.

Market Return Assumption (MRA) is defined as the one-year local market interest rate plus 5% (a proxy for, and not a forecast of, the equity risk premium).

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UBS Securities India Private Ltd: Diviya Nagarajan.

Company Disclosures

Company Name	Reuters	12-mo rating	Short-term rating	Price	Price date
HCL Technologies	HCLT.BO	Sell	N/A	Rs426.55	09 Nov 2011
Infosys Ltd ^{16, 18a}	INFY.BO	Neutral	N/A	Rs2,832.10	09 Nov 2011
Mahindra Satyam ¹⁶	SATY.BO	Sell	N/A	Rs73.00	09 Nov 2011
Mphasis Limited	MBFL.BO	Sell	N/A	Rs334.15	09 Nov 2011
Patni Computer Systems ¹⁶	PTNI.BO	Sell	N/A	Rs358.50	09 Nov 2011
Tata Consultancy Services Ltd.	TCS.BO	Sell	N/A	Rs1,123.00	09 Nov 2011
Tech Mahindra ⁵	TEML.BO	Sell	N/A	Rs601.60	09 Nov 2011
Wipro Ltd. ^{16, 18b}	WIPR.BO	Sell	N/A	Rs376.60	09 Nov 2011

Source: UBS. All prices as of local market close.

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