HCL Technologies

Rating Change **UNDERPERFORM**

Equity | India | Computer Services
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Bank of America Merrill Lynch

RESEARCH

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A long haul, yet, Underperform

Earnings decline in FY10; Underperform

We reset our dated estimates & Price Objective established prior to Sep 08 and the Axon acquisition. While an 8% dividend yield could limit downside, we rate the stock Underperform given forecast earnings decline next year, on near term cyclical pressures, restructuring in BPO and steep margin dilution led by Axon. We forecast flattish FY11 EPS, on expiry of tax holiday. Longer term, we are positive on the strategic steps to position itself in growth markets and tighten operations. Our PO of Rs100 is at 7x FY10E EPS, at 20% discount to TCS, on relative brand and risks.

Near term earnings challenges

We forecast a modest decline in organic revs in FY09 & FY10 (Jun yr end) due to cyclical pressures, with an estimated 40-50% of revs, across enterprise solutions, R&D services & application development, being exposed to cuts in discretionary IT spending. BPO, another 10% of revs, is also in restructuring mode from voice-work to transaction processing. We forecast over 500bps margin decline over FY08-10 (prior to intangibles writeoff & stock comp) due to dilution from Axon and BPO acquisitions, hedging losses, weak European currencies & pricing cuts.

Longer term, promising strategic moves

Longer term, we believe Axon significantly boosts HCLT's position in SAP consulting, Europe, and new verticals like utilities. Also the US$1bn deal wins last quarter endorse a strengthening position in 'run the business' IT deals, though these will likely take 6 to 9 months to ramp, in our view. HCLT has also steadily improved bill-rates, utilization and lowered attrition over the last 3 years. Key upside risks: Faster than expected ramp of deals won and tax holiday extension, which could boost FY11 earnings by 15 to 20%.

Stock Data

Price	Rs109.05
Price Objective	Rs310.00 to Rs100.00
Date Established	20-Feb-2009
Investment Opinion	C-2-7 to C-3-7
Volatility Risk	HIGH
52-Week Range	Rs101.70-Rs324.50
Mrkt Val / Shares Out (mn)	US$1,461 / 668.7
Average Daily Volume	1,338,471
ML Symbol / Exchange	HCLTF / BSE
Bloomberg / Reuters	HCLT IN / HCLT.BO
ROE (2009E)	22.5%
Net Dbt to Eqty (Jun-2008A)	-7.3%
Est. 5-Yr EPS / DPS Growth	NA / NA
Free Float	NA

Estimates (Jun)

(Rs)	2007A	2008A	2009E	2010E	2011E
Net Income (Adjusted - mn)	13,673	11,381	13,122	11,302	10,814
EPS	18.82	15.38	17.18	14.30	14.42
EPS Change (YoY)	98.8%	-18.3%	11.8%	-16.8%	0.8%
Dividend / Share	8.67	9.34	9.00	8.00	8.00
Free Cash Flow / Share	10.76	12.96	13.91	15.12	12.80

Valuation (Jun)

	2007A	2008A	2009E	2010E	2011E
P/E	5.79x	7.09x	6.35x	7.62x	7.56x
Dividend Yield	7.95%	8.56%	8.26%	7.33%	7.33%
EV / EBITDA*	5.87x	4.64x	4.05x	4.58x	4.19x
Free Cash Flow Yield*	9.67%	11.85%	12.81%	13.92%	11.79%

* For full definitions of *iQmethod* SM measures, see page 20.

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iQprofile SM HCL Technologies

Key Income Statement Data (Jun)	2007A	2008A	2009E	2010E	2011E
(Rs Millions)					
Sales	60,336	76,396	98,295	100,758	107,904
Gross Profit	22,752	29,487	36,631	35,106	37,699
Sell General & Admin Expense	(9,383)	(12,568)	(17,262)	(17,974)	(18,983)
Operating Profit	10,833	13,885	14,946	12,193	14,088
Net Interest & Other Income	3,461	(2,074)	(1,303)	(607)	(366)
Associates	NA	NA	NA	NA	NA
Pretax Income	14,294	11,812	13,642	11,587	13,722
Tax (expense) / Benefit	(1,520)	(1,285)	(2,099)	(1,997)	(4,058)
Net Income (Adjusted)	13,673	11,381	13,122	11,302	10,814
Average Fully Diluted Shares Outstanding	675	683	672	670	670
Key Cash Flow Statement Data					
Net Income	12,709	10,498	11,556	9,589	9,664
Depreciation & Amortization	2,536	3,033	4,424	4,939	4,628
Change in Working Capital	(4,177)	1,716	(1,699)	(101)	(823)
Deferred Taxation Charge	NA	NA	NA	NA	NA
Other Adjustments, Net	(204)	(1,073)	831	860	772
Cash Flow from Operations	10,864	14,174	15,112	15,287	14,241
Capital Expenditure	(3,838)	(5,566)	(5,806)	(5,170)	(5,675)
(Acquisition) / Disposal of Investments	(2,049)	(33)	9,885	0	0
Other Cash Inflow / (Outflow)	4	(1,651)	(32,955)	766	117
Cash Flow from Investing	(5,883)	(7,250)	(28,877)	(4,404)	(5,558)
Shares Issue / (Repurchase)	2,267	378	0	0	0
Cost of Dividends Paid	(5,853)	(6,375)	(6,055)	(5,361)	(5,362)
Cash Flow from Financing	(3,678)	(6,384)	25,751	(5,361)	(5,362)
Free Cash Flow	7,025	8,608	9,305	10,117	8,566
Net Debt	(3,821)	(3,627)	11,044	5,652	2,138
Change in Net Debt	NA	NA	NA	NA	NA
Key Balance Sheet Data					
Property, Plant & Equipment	11,185	12,584	16,618	18,061	19,019
Other Non-Current Assets	11,198	13,938	48,831	47,723	46,236
Trade Receivables	13,087	17,894	24,574	25,189	26,976
Cash & Equivalents	3,821	3,627	16,129	21,843	24,421
Other Current Assets	28,119	27,864	23,135	23,549	23,887
Total Assets	67,410	75,908	129,287	136,366	140,539
Long-Term Debt	0	0	27,173	27,495	26,559
Other Non-Current Liabilities	1,376	5,631	7,246	7,427	7,954
Short-Term Debt	NA	NA	NA	NA	NA
Other Current Liabilities	12,427	20,924	27,523	28,212	30,213
Total Liabilities	13,803	26,555	61,941	63,134	64,726
Total Equity	53,606	49,349	67,342	73,228	75,809
Total Equity & Liabilities	67,410	75,904	129,284	136,362	140,536
iQmethod*SM - Bus Performance					
Return On Capital Employed	20.3%	22.5%	16.1%	9.6%	9.1%
Return On Equity	29.4%	22.2%	22.5%	16.1%	14.5%
Operating Margin	18.0%	18.2%	15.2%	12.1%	13.1%
EBITDA Margin	22.2%	22.1%	19.7%	17.0%	17.3%
iQmethod*SM - Quality of Earnings					
Cash Realization Ratio	0.8x	1.2x	1.2x	1.4x	1.3x
Asset Replacement Ratio	1.5x	1.8x	1.6x	1.3x	1.4x
Tax Rate (Reported)	10.6%	10.9%	15.4%	17.2%	29.6%
Net Debt-to-Equity Ratio	-7.1%	-7.3%	16.4%	7.7%	2.8%
Interest Cover	NA	NA	NA	NA	NA
Key Metrics					
Revenue Growth	37.50%	26.62%	28.66%	2.51%	7.09%
EBITDA Growth	37.42%	26.55%	14.48%	-11.55%	9.25%
EBIT Growth	38.67%	28.17%	7.64%	-18.42%	15.54%
PAT Growth	79.42%	-17.39%	10.07%	-17.02%	0.78%

* For full definitions of *iQmethod* SM measures, see page 20.

Company Description

HCL Tech is one of India's leading IT services exporters offering offshore IT Services. It was set up in 1999 by Shiv Nadar, who remains a majority shareholder and Chairman/Chief Strategy Officer. HCL has diversified revs from R&D services to include enterprise solutions, Business Process Outsourcing and Infra Mgmt Services and from technology to include manufacturing, banking, lifesciences, media and retail. HCL has adopted an aggressive acquisition strategy compared to peers..

Investment Thesis

HCLT's organic growth being driven by its leading position in infrastructure management services. However, strong deal wins overshadowed by likely near term challenges in engineering and R&D services, enterprise solutions and restructuring in BPO from voice work to platform based BPO. The US$690m Axon acquisition in the SAP space, a long term positive, but dilutes margins significantly over the next 4-8 quarters, resulting in earnings decline. Reasonable dividend yield could limit downside.

Stock Data

Price to Book Value	1.1x

Will take time to deliver

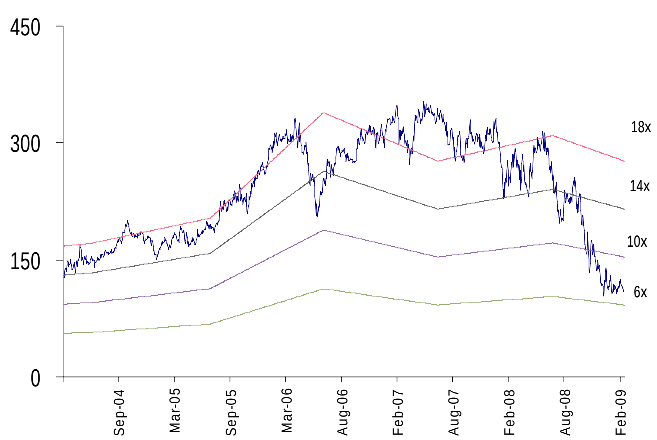
Reset PO and EPS estimates; Underperform

We reset our dated estimates & Price Objective established prior to Sep 08 and the Axon acquisition. While an 8% dividend yield could limit downside, we rate the stock Underperform given forecast 17% decline in GAAP earnings (Re) and 14% decline in non GAAP earnings, reflecting near term cyclical pressures, restructuring in BPO and steep margin dilution led by Axon. Further, earnings are expected to remain flattish in FY11 due to a steep jump in tax rate from 16% to 28% post expiry of tax holiday. Longer term, we are positive on the strategic steps to position itself in growth markets and tighten operations.

Our PO of Rs100 is at 7x FY10E EPS, at 20% discount to TCS, on weaker brand and risks to earnings, in line with the average YTD discount. Though the stock has underperformed the BSE Sensex by 20% in the last six months, we are unable to see any potential catalysts to rerate the stock, given poor earnings outlook next year, risks to integration of Axon and poor visibility overall with respect to recovery in IT spend.

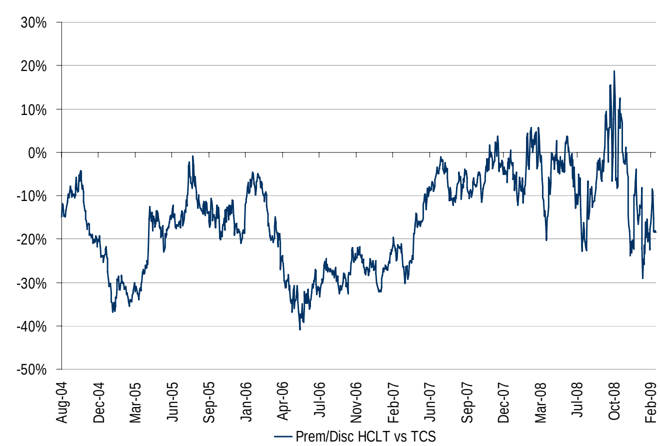
Key upside risks: Faster than expected ramp of deals won and tax holiday extension, which could boost FY11E earnings by 15% to 20%.

Chart 1: HCLT P/E Band



Source: Banc of America Securities – Merrill Lynch Research

Chart 2: HCL Discount vs TCS



Source: Banc of America Securities – Merrill Lynch Research

Near-term earnings challenges

We forecast a modest decline in organic revs in FY09 & FY10 (Jun yr end) due to cyclical pressures, with an estimated 40-50% of revs across enterprise solutions, R&D services & application development, being exposed to cuts in discretionary IT spending. BPO, another 10% of revs, is also in restructuring mode from voice-work to transaction processing. We forecast over 500bps margin decline over FY08-10 (prior to intangibles writeoff & stock comp) due to dilution from Axon and BPO acquisitions, hedging losses, weak European currencies & pricing cuts.

Longer term, promising strategic moves

Longer term, we believe Axon significantly boosts HCLT’s position in SAP consulting, Europe, and new verticals like utilities. Also the US$1bn deal wins last quarter endorse a strengthening position in ‘run the business’ IT deals, though these will likely take 6 to 9 months to ramp, in our view.

Relative valuations – Unfavorable on earnings growth

While HCLT stands out on dividend yield, it compares unfavorably to peers on margins, RoE and growth and we rate it Underperform. Our Underperform on Wipro is a relative call vs peers Infosys and TCS, where though it is reasonably valued, we believe risk to estimates is higher than in peers, given higher management stability at peers, lower exposure to technology, banking and retail on a combined basis and more encouraging hiring indicators. We prefer Wipro to HCLT, given its better earnings growth outlook. At a 26% discount to Infosys, we rate TCS a Buy, and it is our top pick. We believe Infosys stock is fairly priced, given the premium it commands on high transparency and tight management, but see limited upside potential given lack of catalysts, and rate it Neutral. We remain bearish on the sector and believe stocks could correct near term with downside risk to earnings on anecdotal evidence of steep price cuts and IT budget cuts.

Table 1: SUMMARY VALUATION TABLE

	TCS	Wipro	Infosys	HCL Tech
ML Code	TACSF	WIPRF	INFYF	HCLTF
ML Rating	C-1-7	C-3-7	C-2-7	C-3-7
Price	490	220	1,209	109
Target Price Rs	550	225	1,300	100
Market Cap in mn $	9,980	6,716	14,418	1,522
EPS				
EPS Rs FY08	50.11	22.5	79.2	15.4
EPS Rs FY09E	53.12	25.6	100.8	17.2
EPS Rs FY10E	56.82	25.9	103.2	14.3
EPS Rs FY11E	61.67	29.0	110.8	14.4
EPS gr % FY08	19.8%	10.3%	21.0%	-18.3% *
EPS gr % FY09E	6.0%	13.9%	27.4%	11.8%
EPS gr % FY10E	7.0%	1.0%	2.4%	-16.8%
EPS gr % FY11E	8.5%	11.9%	7.3%	0.8%
*HCLT's EPS fell 8.5% in FY08 and would be flattish in FY09, if we adjust the loss on cancellation of forex contracts in FY08. Even apart from the cancellation, large hedging related forex gains/losses have impacted HCLT's FY08 and FY09 EPSg.				
2 yr EPS gr % FY09-11	7.7%	6.3%	4.8%	-8.4%
PE (FY09e EPS)(x)	9.2	8.6	12.0	6.3
PE (FY10e EPS)(x)	8.6	8.5	11.7	7.6
PE (FY11e EPS)(x)	7.9	7.6	10.9	7.6
EV/Sales FY10 E	1.3	1.0	2.3	0.7
EV/EBITDA (FY10E)x	5.4	5.4	7.4	3.9
EBIT % FY08	23.2%	17.3%	27.8%	16.9%
EBIT % FY09E	23.8%	16.9%	29.5%	14.3%
EBIT % FY10E	22.0%	15.8%	27.1%	11.2%
EBIT % FY11E	21.1%	15.7%	26.0%	12.2%
ROE (FY09e) (x)	35.2%	28.8%	36.0%	22.5%
ROE (FY10e) (x)	28.3%	23.9%	28.6%	16.1%
ROE (FY11e) (x)	24.2%	22.5%	24.9%	14.5%
Dividend Yield FY08	3.1%	2.7%	2.8%	8.5%
Dividend Yield FY09E	3.3%	3.2%	2.1%	8.3%
Dividend Yield FY10E	3.5%	3.4%	2.1%	7.3%
Dividend Yield FY11E	3.8%	3.6%	2.1%	7.3%
PE ex cash FY09	8.8	8.3	10.9	6.2
PE ex cash FY10	7.8	7.7	10.2	7.1
PE ex cash FY11	6.6	6.4	9.0	6.8

Note : Mar year end FY09 i.e fiscal year ending Mar 09 fir TCS, Infosys and Wipro, has been compared with fiscal year ending Jun 09 for HCL

Longer term - promising strategic moves

#1. Axon: Quality acquisition, but will take time to deliver

High growth area

Axon was integrated with HCL effective Dec 16, 08, contributing US$17.8m (~5% of core software revs) during the qtr. On a run-rate of about US$100m per quarter i.e. about US$400m/yr, Axon would form close to 20% of HCLT's total revenues.

This would take Enterprise Application Services to about 25% of FY10E revenues up from the erstwhile 11%. EAS including consulting, integration and maintenance of software packages like SAP and Oracle, is a high growth area. We believe companies are increasingly moving from custom application building to leveraging packages like SAP to improve efficiency of cost reduction programs, business processes and business strategies. Axon brings transformation and consulting capabilities along with efficient implementation skills which complement HCL's application and infrastructure capabilities and strong offshore delivery.

Over 2003-07, Axon reported a revenue CAGR of 43% (including inorganic revenues) and PAT CAGR of 68%. GAAP EBIT margin expanded 700bps over CY05-07 to 15% & non-GAAP margins by 450bps to 17.9%. Bill rate is 2 to 3x that of Indian vendors' onsite rate.

In H12008, Axon reported GBP124m of rev, 28% growth yoy (all organic), operating margin dropped to 13.4% from 15% in 2007 (GAAP), likely due to integration of acquisition in the US. PAT was GBP10.8m, up 29% yoy.

Strengthens position in Europe/adds new verticals and marquee clients

Axon adds about 2,000 employees (including 350 in Malaysia) & **clients like BP, Xerox, TXU Energy, helping to add capability in verticals like public sector, utility, consumer goods and travel which are complementary to HCL's verticals**.

As per the update on the 2Q (Dec qrt) management conference call, there has been no attrition in senior and middle level management so far, four new deals have been won by HCL-Axon and there has been no loss of existing customers. No transfer of work to offshore locations yet.

Axon derived over 60% revenues from Europe and should help grow the relatively under-penetrated European market and take up European revenues from the current 28% to about 38%. **This will increase exposure to the currently weak European currencies.**

Key risks

Axon has grown through a number of acquisitions and hence organic growth rate needs to be watched, apart from usual integration related challenges such as employee retention.

Also, **in the last couple of quarters Enterprise Application Services have been facing cyclical pressures**, as software license sales themselves are under pressure. We believe at least half of EAS revenues would be implementation in nature and would be exposed to cuts in discretionary spending. Therefore though HCLT has stated that the joint funnel for HCL-Axon is a robust USD1.2bn, we believe deal closures could take time.

#2. Business Process Outsourcing: Work-in-progress

Inorganic growth initiatives towards platform BPO/new verticals

HCLT is in the process of transforming its BPO unit from voice related work to non-voice-related platform BPO and has made 3 acquisitions last year to acquire platforms and add vertical capabilities in banking, insurance and telecom expense management for corporates. Historically it has had high revenue concentration, mainly in the telecom services vertical.

It acquired **Liberata Financial Services,** which provides services in the life and pension insurance space, a new vertical for HCLT BPO, in August 2008.

Further it acquired **Control Point Solutions** in Sep 2008, a leading provider of voice, data and wireless Telecommunications Expense Management (TEM) services.

Earlier in Feb. 2008, HCLT acquired CapitalStream (CS), which has products that help commercial loan origination and straight through processing systems and customers like National Bank of Canada, Scotiabank, Bank of the West, Bank of America, M&I Bank as well as mid-sized banks and finance companies. Clients are primarily US based. They have installations in 20% of the largest banks in North America. It had margins of about 5%.

These acquisitions have resulted in a significant dip in margins from about 14% in 1QFY09 to about 9% in 2Q, with likely risk of further decline, before recovery. In fact, in FY08 BPO had reported EBIT margins of almost 21%, which we found difficult to understand and also believed to be unsustainable. We believe they increased utilization by cutting back on people but also hardly grew revenues sequentially.

High revenue concentration risks

BPO revenues are highly concentrated in one UK telecom customer, where we believe it has been facing pressure.

While we believe the two acquisitions and move towards transaction processing and platform BPO may help, execution will be key**. It will likely take 3 to 4 quarters before HCLT finishes modifying the platforms and wins work on these platforms**. For example in Liberata, HCLT is investing in modifying the platform to be able to handle open book insurance business.

#3. Focus on 'Run the business' results in bumper wins

HCL reported strong new deal wins in the Dec 08 quarter, bagging twenty deals worth ~US$1bn from customers like Xerox, Nokia, Viacom, Singapore Airlines, Deutsche Bank, Microsoft and Cisco. These include 3 deals of over US$100m and 5 deals of over US$50m each. We believe HCLT's focus on integrated IT infrastructure management and application maintenance services to address 'run the business' requirements of clients' IT departments gives it a competitive edge.

The company stated that the bulk of these deals are from vendor consolidation efforts. HCLT derives over 16% of revenues from remote infrastructure management services, reflecting the focus of the company. Infra services revenues have grown at 60% in the last 3 years, FY05-08, and are expected to continue to lead the growth for the company.

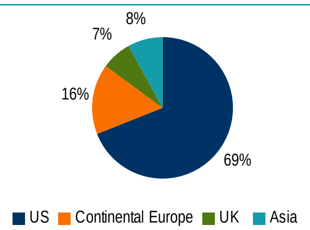
Table 2: HCL won three deals worth US$100m+ and US$1bn in total

Deal Size	Client Industry	Areas of Engagement
$350 mil, 7 years	Publishing	Oracle ASM, Mainframe
$100 mil, 6 years	Copiers	Infrastructure / Disaster Recovery
$145 mil, 5 years	Phone maker	User a/c mgmt, Remote desktop mgmt
$50 mil, 5 years	SCM Software	Legacy Modernization
$50 mil, 5 years	Media	E-commerce
$50 mil, 5 years	Data centre / Networking	Infrastructure, Oracle appl, Storage

Source: Company

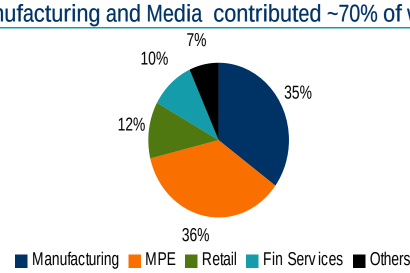
It inked deals worth $1.27 bn in H1FY09; predominantly in North America and traction in continental Europe. Amongst the verticals, manufacturing and media, publishing and entertainment verticals contributed ~70% of deal wins. 69% of the deal value won was against global MNCs.

Chart 3: US contributed 69% of new deals; traction in Continental Europe



Source: Company, Banc of America Securities – Merrill Lynch Research

Chart 4: Manufacturing and Media contributed ~70% of wins

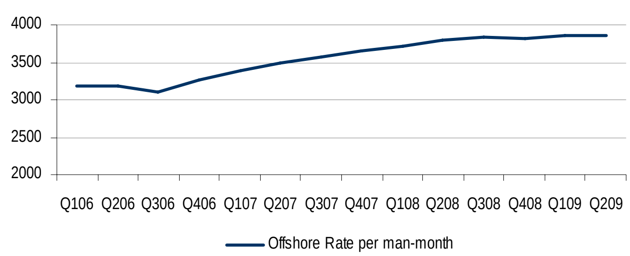


Source: Company, Banc of America Securities – Merrill Lynch Research

#4. Steady improvement in tightening operations

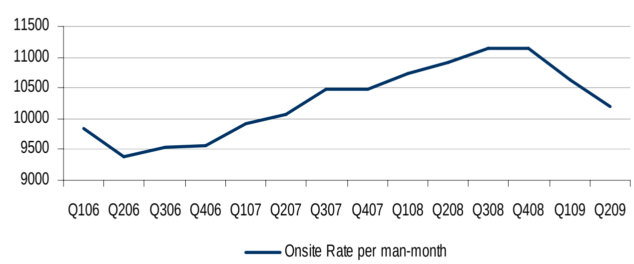
Over the last 3 years, HCLT has steadily improved bill-rates, utilization and lowered attrition. It has also grown the proportion of fixed price contracts as it tries to move to non-linear pricing models.

Chart 5: Steady Increase in Offshore Bill Rate



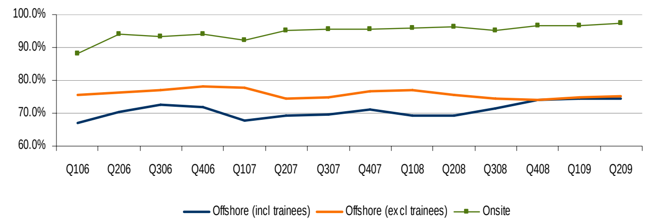
Source: Company, Banc of America Securities – Merrill Lynch Research

Chart 6: Onsite Billing declined this qtr after a steady climb



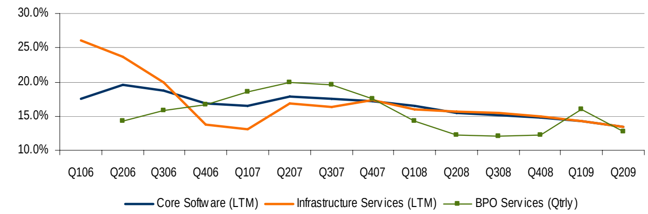
Source: Company, Banc of America Securities – Merrill Lynch Research

Chart 7: Improvement in Utilization Rates



Source: Company, Banc of America Securities – Merrill Lynch Research

Chart 8: Declining Trend in Attrition



Source: Company, Banc of America Securities – Merrill Lynch Research Note: Attrition excludes involuntary attrition

HCL Tech has grown its infrastructure services offering and R&D services offering rapidly, and post Axon and the BPO acquisitions it should see momentum in enterprise solutions, when the market recovers and in BPO, after the investment in platforms is behind.

Table 3: Rev contribution by Service Mix

	Q1FY06	Q1FY07	Q1FY08	Q1FY09
Enterprise Application Services	15.2%	13.7%	11.8%	10.9%
Engineering and R&D Services	24.1%	24.0%	24.8%	26.3%
Custom Application (Industry Solutions)	37.3%	36.2%	35.5%	35.8%
Infrastructure Services	10.0%	13.2%	15.1%	15.7%
BPO Services	13.4%	12.8%	12.8%	11.3%

Source: Company, Banc of America Securities – Merrill Lynch Research

HCLT is also focusing on growing non-linear revs, as reflected in a growing proportion of fixed price revs.

Table 4: Increase in Fixed Price Projects

	Q1FY06	Q1FY07	Q1FY08	Q1FY09
Time & Material	72.6%	70.8%	68.8%	64.0%
Fixed Price Projects	27.4%	29.2%	31.2%	36.0%

Source: Company, Banc of America Securities – Merrill Lynch Research

HCLT is diversifying revenues into newer verticals like retail, media, life sciences and now with Axon, it should get a foothold in utilities, public sector, consumers.

Table 5: Revenue Contribution by Vertical

	Q2FY06	Q1FY07	Q1FY08	Q1FY09
Banking, FS & Insurance	25.6%	22.8%	28.7%	27.5%
Hi-tech - Manufacturing	34.2%	31.3%	30.0%	30.7%
Telecom	17.3%	16.9%	16.3%	16.5%
Retail	5.7%	12.0%	8.7%	8.2%
Media Publishing & Entertainment	6.1%	5.9%	5.5%	5.6%
Life Sciences	3.4%	3.5%	5.2%	5.9%
Others	7.8%	7.6%	5.6%	5.6%

Source: Company, Banc of America Securities – Merrill Lynch Research

Financial Summary and Outlook

Our discussion below is on US GAAP, USD estimates.

Total USD revenues forecast to grow 13% in FY09, 1% in FY10 and 11% in FY11, led by infrastructure services and inorganic revs from Axon and the 2 BPO acquisitions.

We forecast a 3% and 7% decline in organic revs in FY09 & FY10 (Jun yr end) due to cyclical pressures, with an estimated 40-50% of revs across enterprise solutions, R&D services & application development, being exposed to cuts in discretionary IT spending. BPO, another 10% of revs, is also in restructuring mode from voice-work to transaction processing. We forecast over 500bps margin decline over FY08-10 (prior to intangibles writeoff & stock comp) due to dilution from Axon and BPO acquisitions, hedging losses, weak European currencies & pricing cuts.

Further, we expect Axon, which would form an estimated 20% of total revs, to face cyclical pressures as well, given the softness in SAP consulting and implementation.

Margins are expected to decline due to the Axon acquisition, pricing pressure and the cashflow hedges impacting rate realized. Axon EBIT margin (prior to amortization of intangibles) was at 13.4% in H1 vs HCLT's 19%. Non GAAP EBIT margin (prior to intangibles amortization and stock comp) is expected to fall from about 18% in FY08 to13% in FY10. GAAP EBIT margin is expected to fall steeply by nearly 600bps to 11.2%. We expect it to recover 100bps to 12.2% as intangibles hit and hedging losses decline.

GAAP EBIT (USD terms) thereby is expected to decline by 5% in FY09, fall 21% in FY10 and rebound 21% in FY11.

GAAP net profit (USD terms) growth is flattish in FY09E (adjusting for the loss on cancellation of forex hedges in FY08), falls 18% in FY10E (due to lower margins offset by absence of mark to market forex losses) and is flattish again in FY11E, impacted by the jump in tax rate from 16% to 28%, on anticipated expiry of tax holiday.

Key assumptions

- We assume that the deals won this quarter will take at least 6 months to ramp up.
- We assume BPO will take at least another 4 quarters for the transformation to be completed, and revenue growth and margins to turn.
- The Axon deal was funded by US$116m contribution from HCL and a 1-yr bridge loan of US$585m. The company will decide the future course of loan component through a combination of take-out financing and internal funding, depending on its cash flow generation and other capex requirements closer to Dec. 09.
- Tax rate is expected to go to a high 28% in FY11, assuming tax holiday for Software Technology Parks expires.
- Our revenue estimates bake in the company's guidance for US$120m and US$26m cashflow hedge related loss for FY10 and FY11. Cashflow hedge related notional loss is US$60m for H2FY09E.

Table 6: Annual P&L Statement

($ millions, US GAAP)	2006	2007	2008	2009E	2010E	2011E
Revenues	976	1,390	1,879	2,116	2,144	2,377
Direct costs	613	866	1,154	1,328	1,397	1,546
Gross Profits	363	524	725	789	747	830
SG&A	146	216	309	372	382	418
EBITDA	216	308	416	417	365	412
Depreciation	43	58	75	77	83	90
Amortization	0	0	0	19	22	12
EBIT	174	250	342	322	259	310
EBIT (excl amortization & stock comp charges)	174	250	342	340	281	322
Adjust : Non-cash stock option expense	15	24	24	19	20	20
Adjust : Amortization expense	0	0	0	19	22	12
EBIT (GAAP)	159	226	318	302	239	290
Other Income, net	20	23	42	40	5	9
Provision for tax	14	35	32	45	42	89
Minority int/Eq inv	0	-2	-1	0	0	0
Net income (before forex gains)	180	236	351	317	222	230
Forex gains	-8	79	-71	-50	0	0
Net income (after forex gains)	172	315	280	267	222	230
Net income (excl post tax amortisation & stock comp)	172	315	280	282	240	238
Adjust : Post tax stock option expense	15	22	22	18	18	17
Adjust : Post-tax amortization expense	0	0	0	16	18	8
Net income (GAAP)	158	293	258	249	204	213

Source: Company, Banc of America Securities – Merrill Lynch Research

Table 7: Key Ratios

(Using US$ nos)	2006	2007	2008	2009E	2010E	2011E
Rev growth	28.1%	42.4%	35.2%	12.6%	1.3%	10.9%
Gross profit growth	28.5%	44.4%	38.4%	8.7%	-5.3%	11.2%
EBITDA growth	24.9%	42.3%	35.1%	0.2%	-12.6%	13.1%
EBIT growth (gaap)*	36.5%	42.6%	40.5%	-4.8%	-20.8%	21.3%
EBIT growth (non-gaap)	24.4%	43.6%	36.9%	-0.4%	-17.4%	14.5%
Net income growth (gaap)*	36.0%	85.8%	-11.8%	-3.6%	-18.0%	4.3%
Net income growth (non-gaap)	24.7%	82.9%	-11.1%	0.9%	-14.9%	-0.9%
Gross Margin	37.2%	37.7%	38.6%	37.3%	34.8%	34.9%
EBITDA Margin	22.2%	22.2%	22.1%	19.7%	17.0%	17.3%
EBIT Margin (gaap)*	16.2%	16.3%	16.9%	14.3%	11.2%	12.2%
EBIT Margin (non-gaap)	17.8%	18.0%	18.2%	16.1%	13.1%	13.5%
Net Margin (gaap)*	16.1%	21.1%	13.7%	11.8%	9.5%	9.0%
Net Margin (non-gaap)	17.6%	22.7%	14.9%	13.3%	11.2%	10.0%
EPS (dil, gaap)*	0.23	0.43	0.38	0.37	0.30	0.32
EPS (dil, non gaap)	0.25	0.47	0.41	0.42	0.36	0.36
DPS	0.19	0.20	0.23	0.17	0.15	0.15
Payout Ratio (%)	84.2%	46.1%	60.7%	52.4%	55.9%	55.5%
ROE	19.7%	29.8%	22.9%	20.0%	14.8%	14.3%
ROA	15.9%	23.8%	16.4%	11.5%	7.8%	7.7%
CEPS	0.3	0.6	0.5	0.5	0.5	0.5
BV	1.3	1.8	1.8	2.2	2.3	2.5

*Note : While our gaap numbers include stock compensation charges, the company does not include these charges in its quarterly release

Source: Company, Banc of America Securities – Merrill Lynch Research

Table 8: Annual P&L Statement

(INR millions, converted at avg $/Rs rate from US$ US GAAP P&L)	2006	2007	2008	2009E	2010E	2011E
Revenues	43,882	60,336	76,396	98,295	100,758	107,904
Direct costs	27,572	37,584	46,909	61,663	65,651	70,205
Gross Profits	16,311	22,752	29,487	36,631	35,106	37,699
SG&A	6,582	9,383	12,568	17,262	17,974	18,983
EBITDA	9,728	13,369	16,919	19,369	17,132	18,716
Depreciation	1,916	2,536	3,033	3,564	3,924	4,102
Amortization	0	0	0	859	1,015	526
EBIT	7,812	10,833	13,885	14,946	12,193	14,088
EBIT (excl amortization & stock comp charges)	7,812	10,833	13,885	15,805	13,208	14,614
Adjust : Non-cash stock option expense	685	1,020	972	901	940	908
Adjust : Amortization expense	0	0	0	859	1,015	526
EBIT (GAAP)	7,127	9,813	12,914	14,044	11,253	13,180
Other Income, net	919	986	1,708	1,848	253	406
Provision for tax	632	1,520	1,285	2,099	1,997	4,058
Minority int/Eq inv	-22	-65	-28	12	0	0
Net income (before forex gains)	8,077	10,234	14,280	14,707	10,449	10,436
Forex gains	-338	3,439	-2,899	-2,320	0	0
Net income (after forex gains)	7,739	13,673	11,381	12,387	10,449	10,436
Net income (excl post tax amortization & stock comp)	7,739	13,673	11,381	13,122	11,302	10,814
Adjust : Post tax stock option expense	656	964	882	831	860	772
Adjust : Post-tax amortization expense	0	0	0	735	852	379
Net income (GAAP)	7,083	12,709	10,498	11,556	9,589	9,664

Source: Company, Banc of America Securities – Merrill Lynch Research

Table 9: Key Ratios

(Using INR nos)	2006	2007	2008	2009E	2010E	2011E
Rev growth	30.5%	37.5%	26.6%	28.7%	2.5%	7.1%
Gross profit growth	30.9%	39.5%	29.6%	24.2%	-4.2%	7.4%
EBITDA growth	27.3%	37.4%	26.6%	14.5%	-11.6%	9.2%
EBIT growth (gaap)*	39.1%	37.7%	31.6%	8.8%	-19.9%	17.1%
EBIT growth (non-gaap)	26.8%	38.7%	28.2%	13.8%	-16.4%	10.6%
Net income growth (gaap)*	38.58%	79.42%	-17.39%	10.1%	-17.0%	0.8%
Net income growth (non-gaap)	27.05%	76.68%	-16.76%	15.3%	-13.9%	-4.3%
Gross Margin	37.2%	37.7%	38.6%	37.3%	34.8%	34.9%
EBITDA Margin	22.2%	22.2%	22.1%	19.7%	17.0%	17.3%
EBIT Margin (gaap)*	16.24%	16.26%	16.90%	14.3%	11.2%	12.2%
EBIT Margin (non-gaap)	17.8%	18.0%	18.2%	16.1%	13.1%	13.5%
Net Margin (gaap)*	16.1%	21.1%	13.7%	11.8%	9.5%	9.0%
Net Margin (non-gaap)	17.6%	22.7%	14.9%	13.3%	11.2%	10.0%
EPS (dil, gaap)*	10.4	18.8	15.4	17.2	14.3	14.4
EPS (dil, non gaap)	11.3	20.2	16.7	19.5	16.9	16.1
DPS	8.7	8.7	9.3	9.0	8.0	8.0
Payout Ratio (%)	77%	43%	56%	49%	51%	51%
ROE	19.8%	29.4%	22.2%	22.5%	16.1%	14.5%
ROA	16.1%	23.4%	15.9%	12.8%	8.5%	7.8%
CEPS	14.1	24.0	21.1	23.7	21.4	21.7
BV per share	57.9	79.2	72.2	100.1	109.2	113.0

Source: Banc of America Securities – Merrill Lynch Research

2Q Results Summary

- 2Q revenues grew 8.1% qoq (0.8% organically) in constant currency terms to US$511.5mn. Volume growth at 2.4% was similar to the top 3 vendors. Onsite realization was down 1.2%, another trend also shown by the top 3, while offshore realization increased 1.5%.
- EBIT margin remained flat q/q with negative impact of acquisitions (-93 bps) and fewer working days (-144 bps) being offset by efficiency gains (114 bps) and positive forex impact (114 bps).
- Other income and tax provisions showed a jump this qtr due to movement of funds from mutual funds to fixed deposits.
- Hedging loss during the quarter was US$29mn, while the outstanding hedge position at quarter end was US$1.9bn at average booked rate of Rs41.05. The company expects a hedge loss of US$210mn over next 7 qtrs.

Table 10: Q2 Profit & Loss Statement

$ Million	Q209	Q109	QoQ	Q208	YoY
Revenues	511.5	504.7	1.3%	461.0	11.0%
Direct costs	307.5	305.9	0.5%	285.7	7.6%
Gross Profits	204.0	198.8	2.6%	175.3	16.4%
SG&A	89.0	85.6	4.0%	76.7	16.0%
EBITDA	115.0	113.2	1.6%	98.6	16.6%
Dep and Amortisation	19.9	19.3	3.1%	18.4	8.2%
EBIT	95.1	93.9	1.3%	80.2	18.6%
Other Income, net	24.8	11.9	108.1%	12.3	101.3%
Provision for tax	14.0	9.4	49.4%	9.0	56.0%
Minority int/Eq inv	0.0	0.3	-113.3%	-0.5	-92.0%
Net income (before forex gains)	105.8	96.7	9.4%	83.0	27.4%
Forex gains	-29.1	-20.8	40.1%	1.5	-2042.7%
Net income (after forex gains)	76.6	75.9	1.0%	84.5	-9.3%
Non-recurring items	0.0	0.0	n/m	0.0	n/m
Recurring net-income	76.6	75.9	1.0%	84.5	-9.3%

Source: Company, Banc of America Securities – Merrill Lynch Research

Table 11: Q2 FY09 Growth Rates (US GAAP)

Growth	QoQ	YoY
Revenues	1.3%	11.0%
Gross Profit	2.6%	16.4%
EBITDA	1.6%	16.6%
EBITA	1.3%	18.6%
PAT (before forex gains)	9.4%	27.4%
PAT (after forex gains)	1.0%	-9.3%

Source: Company, Banc of America Securities – Merrill Lynch Research

Table 12: Q2 FY09 Margins (US GAAP)

Margins	Q209	Q109	QoQ (bps)	Q208	YoY (bps)
Gross	39.9%	39.4%	49	38.0%	186
EBITDA	22.5%	22.4%	5	21.4%	109
EBIT	18.6%	18.6%	-1	17.4%	120
PAT (before forex gains)	20.7%	19.2%	152	18.0%	268
PAT (after forex gains)	15.0%	15.0%	-6	18.3%	-335
Effective Tax Rate	11.7%	8.9%	286	9.8%	193

Source: Company, Banc of America Securities – Merrill Lynch Research

Table 13: Revenue Growth and Margin Movement during Quarter

Revenue Growth (qoq)	%	EBIT Margin (qoq)	Bps
Overall	1.4%	Overall	6
Volume-IT Services	2.8%	Acquisitions	-93
Acquisition	7.3%	Lesser no of days	-144
Hedge accounting	0.2%	Efficiency gains	114
Exchange rate	-6.7%	Forex	129
Lower no of working days	-1.8%		
Reduction in BPO vol	-0.4%		

Source: Company, Banc of America Securities – Merrill Lynch Research

Core software services

Volume in core software services increased 1.1%, increasing revenues q/q by 3.6% on an organic basis. Axon contributed 4.8% to core software revenues. EBIT margin improved by 90 bps during the quarter helped by efficiency gains (130 bps) and favorable forex movement (210 bps), offset by the Axon acquisition (-70 bps) and lesser no of working days (-180 bps).

Table 14: Core Software - Revenue Growth and Margin Movement during Quarter

Revenue Growth (qoq)	-1.4%	EBIT Margin (qoq)	90
Volume	1.1%	Acquisitions	-70
Acquisition-Axon	4.8%	Lesser no of days	-180
Hedge accounting	0.2%	Efficiency gains	130
Exchange rate	-5.0%	Forex	210
Lower no of working days	-2.2%		
Mix change/ Others	-0.4%		

Source: Company, Banc of America Securities – Merrill Lynch Research

Table 15: Q2 Core Software Performance

Core Software Services	Q209	Q109	QoQ	Q208	YoY
Revenues	363.4	368.5	-1.4%	334.9	8.5%
Direct costs	210.9	216	-2.4%	203.8	3.5%
Gross Profits	152.5	152.5	0.0%	131.1	16.3%
SG&A	62.8	65.1	-3.5%	58.9	6.6%
EBITDA	89.7	87.4	2.6%	72.2	24.2%
Dep and Amortisation	12.9	12.8	0.8%	11.5	12.2%
EBIT	76.8	74.6	2.9%	60.7	26.5%
Margins	Q209	Q109	QoQ (bps)	Q208	YoY (bps)
Gross	42.0%	41.4%	58	39.1%	282
EBITDA	24.7%	23.7%	97	21.6%	312
EBIT	21.1%	20.2%	89	18.1%	301

Source: Company, Banc of America Securities – Merrill Lynch Research

Infrastructure services

Infrastructure continued to show strong growth with 12.8% increase in volumes during the quarter. EBIT margin increased 40 bps helped by forex movement.

Table 16: Infrastructure - Revenue Growth and Margin Movement during Quarter

Revenue Growth (qoq)	7.0%	EBIT Margin (qoq)	40
Volume	12.8%	Cost increase	-150
One-time non effort based	1.9%	Forex	190
Exchange rate	-7.7%		

Source: Company, Banc of America Securities – Merrill Lynch Research

Table 17: Q2 Infrastructure Performance

Infrastructure Services	Q209	Q109	QoQ	Q208	YoY
Revenues	84.5	79.0	7.0%	70.6	19.7%
Direct costs	56.4	53.2	6.0%	48.9	15.3%
Gross Profits	28.1	25.8	8.9%	21.7	29.5%
SG&A	11.6	10.8	7.4%	9.8	18.4%
EBITDA	16.5	15.0	10.0%	11.9	38.7%
Dep and Amortisation	3.9	3.4	14.7%	3.4	14.7%
EBIT	12.6	11.6	8.6%	8.5	48.2%
Margins	Q209	Q109	QoQ (bps)	Q208	YoY (bps)
Gross	33.3%	32.7%	60	30.7%	252
EBITDA	19.5%	19.0%	54	16.9%	267
EBIT	14.9%	14.7%	23	12.0%	287

Source: Company, Banc of America Securities – Merrill Lynch Research

BPO

BPO revenues grew a strong 11.3% during the quarter (27.6% on constant currency) helped by the acquisitions of Liberata and Control Point. Liberata contributed $15.9 mil of revs while Control Point contributed $6.6 mil for the quarter. EBIT margin declined to 9% in the quarter, largely impacted by the two acquisitions.

Table 18: BPO - Revenue Growth and Margin Movement during Quarter

Revenue Growth (qoq)	11.3%	EBIT Margin (qoq)	-460
Acquisition	33.6%	Acquisitions	-330
Hedge accounting	0.2%	Lesser no of days	-140
Exchange rate	-16.3%	Efficiency gains	20
Lower no of working days	-2.2%	Forex	-10
Volume-billed FTE	-4.0%		

Source: Company, Banc of America Securities – Merrill Lynch Research

Table 19: BPO Performance

BPO Services	Q209	Q109	QoQ	Q208	YoY
Revenues	63.6	57.2	11.2%	55.4	14.8%
Direct costs	40.2	36.7	9.5%	33.0	21.8%
Gross Profits	23.4	20.5	14.1%	22.4	4.5%
SG&A	14.5	9.7	49.5%	8.0	81.3%
EBITDA	8.9	10.8	-17.6%	14.4	-38.2%
Dep and Amortisation	3.2	3.1	3.2%	3.4	-5.9%
EBIT	5.7	7.7	-26.0%	11.0	-48.2%
Margins	Q209	Q109	QoQ (bps)	Q208	YoY (bps)
Gross	36.8%	35.8%	95	40.4%	-364
EBITDA	14.0%	18.9%	-489	26.0%	-1200
EBIT	9.0%	13.5%	-450	19.9%	-1089

Source: Company, Banc of America Securities – Merrill Lynch Research

Enterprise application services showed a q/q growth of 20% in constant currency. However on an organic basis (ie excluding Axon), it showed a net decline. Infrastructure continued to show a strong growth trajectory while BPO numbers were bumped up by Liberata and Control Point acquisitions.

Table 20: Growth by service line (USD terms)

	% of Revenue	QoQ	YoY	QoQ (c/c)
Enterprise Application Services	12.5%	16.2%	24.9%	20.4%
Engineering and R&D Services	25.7%	-1.0%	14.5%	0.1%
Custom Application (Industry Solutions)	32.9%	-6.9%	-0.5%	1.1%
Infrastructure Services	16.5%	6.5%	19.7%	14.8%
BPO Services	12.4%	11.2%	14.7%	27.5%

Source: Company, Banc of America Securities – Merrill Lynch Research

BFSI and Telecom showed leading growth in the qtr possibly due to the contributions of the three recent acquisitions

Table 21: Growth by vertical (USD terms)

	% of Revenue	QoQ	YoY	QoQ (c/c)
Banking, FS & Insurance (BFSI)	27.5%	1.3%	4.5%	13.1%
Hi-tech - Manufacturing	30.5%	0.7%	18.7%	1.4%
Telecom	15.7%	-3.6%	8.2%	7.6%
Retail	7.7%	-4.8%	-2.9%	4.4%
Media Publishing & Entertainment (MPE)	5.5%	-0.5%	3.4%	2.4%
Life Sciences	5.8%	-0.4%	14.9%	2.5%
Others	7.4%	33.9%	39.2%	37.8%

Source: Company, Banc of America Securities – Merrill Lynch Research

Continental Europe gained traction with deal wins of $200 mil during the quarter. Europe grew 15% during the qtr helped by Axon and Liberata

Table 22: Growth by geography (USD terms)

	% of Revenue	QoQ	YoY	QoQ (c/c)
US	59.8%	5.8%	20.6%	5.8%
Europe	27.1%	-4.3%	1.2%	14.7%
Asia Pacific	13.1%	-4.5%	-5.0%	3.7%

Source: Company, Banc of America Securities – Merrill Lynch Research

Growth shown by non top-10 clients (last twelve months basis)

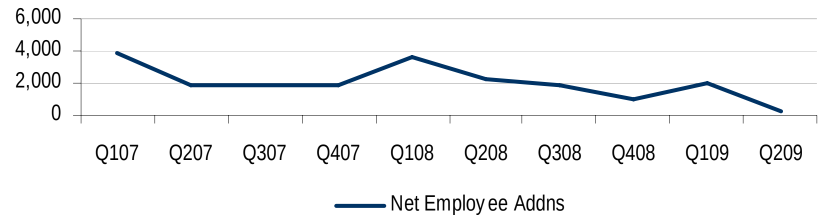
Table 23: Client Growth (USD terms)

	Sep-07	Dec-07	Mar-08	Jun-08	Sep-08	Dec-08	Mar-09	Jun-09	Sep-09
Top 5 Clients	13.0%	7.8%	6.7%	6.9%	6.2%	8.6%	3.0%	1.7%	-0.6%
Top 6-10 Clients	6.9%	9.6%	15.6%	13.7%	12.8%	8.4%	5.1%	3.0%	-4.3%
Top 11-20 Clients	16.6%	8.7%	14.2%	7.6%	8.6%	4.9%	5.3%	3.2%	7.6%
Non top 20 Clients	67.5%	5.7%	4.4%	-23.6%	72.5%	3.3%	5.2%	-28.7%	4.4%

Source: Company, Banc of America Securities – Merrill Lynch Research

Net addition was a low 243 in the quarter. Management expects hiring to pick up in the next quarter with a ramp-up in some of the recent deal wins

Chart 9: Low Net Employee Addition



Source: Company, Banc of America Securities – Merrill Lynch Research

Table 24: Annual Balance Sheet

($ millions)	2006	2007	2008	2009E	2010E	2011E
Liabilities & Stockholders' Equity						
Total Current Liabilities	195	286	515	593	600	665
Long term debt	2	0	0	585	585	585
Other Liabilities	16	32	139	156	158	175
Total Liabilities	213	318	653	1,334	1,343	1,426
Minority Interest	2	4	1	1	1	1
Total Stockholders Equity	881	1,231	1,212	1,449	1,557	1,669
Total Liabilities and Stockholders Equity	1,096	1,553	1,867	2,783	2,901	3,095
Assets						
Cash & Cash Eq	66	88	89	347	465	538
Account receivables, net	209	301	440	529	536	594
Treasury Investments	343	473	483	270	270	270
Other current assets	78	175	203	228	231	256
Total current assets	695	1,037	1,215	1,374	1,502	1,658
Property & equipment net	190	258	310	358	384	419
Intangible assets net	182	198	223	900	879	867
Investment in equity investee	2	2	2	2	2	2
Other assets	26	58	118	149	134	149
Total Assets	1,096	1,553	1,867	2,783	2,901	3,096

Source: Company, Banc of America Securities – Merrill Lynch Research

Table 25: Annual Cash Flow Statement

($ millions)	2006	2007	2008	2009E	2010E	2011E
CASH FLOWS FROM OPERATING ACTIVITIES						
Net income	144	294	280	267	222	230
Depreciation and Amortization	43	58	75	95	105	102
Loss / (Profit) on Sale of Investment Securities	-16	0	-28	0	0	0
Others	8	-5	-20	0	0	0
Accounts Receivable	-68	-76	-152	-89	-7	-58
Other Assets	-3	-76	9	-26	-3	-25
Current Liabilities	57	56	186	78	8	65
Changes in assets and liabilities, net	-13	-96	42	-37	-2	-18
Net cash provided by operating activities	166	250	349	325	325	314
CASH FLOWS FROM INVESTING ACTIVITIES						
Purchase of Property and Equipment (net)	-84	-88	-137	-125	-110	-125
(Purchase) / Sale of Investments	73	-47	-1	213	0	0
Others	9	0	-41	-13	16	3
Net cash used in investing activities	-3	-136	-178	-622	-94	-122
Free Cash Flow From Operating Activities	82	162	212	200	215	189
CASH FLOWS FROM FINANCING ACTIVITIES						
Proceeds from Issuance of Employees Stock Options	20	52	9	0	0	0
Dividend	-133	-135	-157	-130	-114	-118
Others	-39	-2	-10	685	0	0
Net cash provided by (used in) financing activities	-152	-85	-157	554	-114	-118
Effect of Exchange Rate on Cash and Cash Equivalents	1	6	-12	0	0	0
Net Increase/ (decrease) in Cash and Cash Equivalents	11	30	13	258	118	73
CASH						
Opening Cash	41	52	88	89	347	465
Closing Cash	52	88	89	347	465	538
Treasury Investments	343	473	483	270	270	270
Closing Cash and Investments	395	561	572	617	735	808

Source: Company, Banc of America Securities – Merrill Lynch Research

Price objective basis & risk

HCL (HCLTF)

Our PO is set at Rs100 at 7x FY10E GAAP PE, at 20% discount to TCS, given relative brands reflected in likely lower prices and margins and higher risk profile. Key risks are integration of the over US$700m worth of acquisitions made in late CY2008 in SAP consulting and BPO and exposure to engineering & R&D services and now enterprise solutions, both exposed to cuts in discretionary IT spending. Faster than expected ramp of the US$1bn deals won recently or extension of tax holiday beyond Mar 10 provide upside risk to estimates.

Infosys Tech (INFYF / INFY)

Our PO of Rs1,300 (US$30 for ADR) is at about13x FY10E PE, in line with trough valuations seen in 2001. Risks are steeper and longer than anticipated global slowdown in the US economy, greater competition from global and Indian vendors, and Rupee appreciation. Upside risks to estimates stem from any large deal wins or lower-than-expected Rupee.

Tata Consultancy (TACSF)

Our PO of Rs550 is set at an FY10E PE of 9.5x, which is based on a 20% discount to Infosys' target PE. This is higher than the range of 5 to 10%, to factor in higher exposure to the banking vertical and absence of track record as a listed company during the last trough. Risks are steeper and longer than anticipated global slowdown, greater competition from global and Indian vendors, and Rupee appreciation.

Wipro (WIPRF / WIT)

Our PO of Rs225 is set at about 9x FY10E PE, in line with current 30% discount to Infy target PE. Risks: Any impact of recent management churn in May 08, over 60% revs from the vulnerable verticals of technology, banking and retail/transportation and quarterly lumpiness of infrastructure management services business. Industry specific risks are increasing competition from global vendors, risk of Rupee appreciation and sharper than expected macro slowdown. Upside risk to estimates from any large deal wins or stronger-than-expected Rupee.

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India - Software & IT Services Coverage Cluster

Investment rating	Company	ML ticker	Bloomberg symbol	Analyst
BUY				
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	Educomp Solu	EUSOF	EDSL IN	Pratish Krishnan
	Infotech India	IFKFF	INFTC IN	Prasad Deshmukh
	MphasiS Ltd	MPSSF	MPHL IN	Pratish Krishnan
	Rolta India	RLTAF	RLTA IN	Prasad Deshmukh
	Rolta India-GDR	XLROF	RTI LI	Prasad Deshmukh
	Tata Consultancy	TACSF	TCS IN	Mitali Ghosh
	Tech Mahindra	TMHAF	TECHM IN	Pratish Krishnan
	WNS (Holdings) L	WNS	WNS US	Mitali Ghosh
NEUTRAL				
	Genpact Ltd	G	G US	Mitali Ghosh
	Infosys Tech	INFYF	INFO IN	Mitali Ghosh
	Infosys Tech - A	INFY	INFY US	Mitali Ghosh
UNDERPERFORM				
	ExlService Holdi	EXLS	EXLS US	Mitali Ghosh
	Firstsource	FSSOF	FSOL IN	Mitali Ghosh
	HCL	HCLTF	HCLT IN	Mitali Ghosh
	Hexaware Tech	XFTCF	HEXW IN	Pratish Krishnan
	KPIT Cummins Inf	KPTCF	KPIT IN	Prasad Deshmukh
	Mastek	MSKDF	MAST IN	Prasad Deshmukh
	Patni	PATIF	PATNI IN	Mitali Ghosh
	Patni Computer	PTI	PTI US	Mitali Ghosh
	Sasken Communic	SKNCF	SACT IN	Pratish Krishnan
	Subex Ltd	SBXSF	SUBX IN	Pratish Krishnan
	Subex Ltd-GDR Regs	XZSUF	SUBX LI	Pratish Krishnan
	Wipro	WIPRF	WPRO IN	Mitali Ghosh
	Wipro	WIT	WIT US	Mitali Ghosh

iQmethod SM Measures Definitions

Business Performance	Numerator	Denominator
Return On Capital Employed	NOPAT = (EBIT + Interest Income) * (1 - Tax Rate) + Goodwill Amortization	Total Assets – Current Liabilities + ST Debt + Accumulated Goodwill Amortization
Return On Equity	Net Income	Shareholders' Equity
Operating Margin	Operating Profit	Sales
Earnings Growth	Expected 5-Year CAGR From Latest Actual	N/A
Free Cash Flow	Cash Flow From Operations – Total Capex	N/A
Quality of Earnings		
Cash Realization Ratio	Cash Flow From Operations	Net Income
Asset Replacement Ratio	Capex	Depreciation
Tax Rate	Tax Charge	Pre-Tax Income
Net Debt-To-Equity Ratio	Net Debt = Total Debt, Less Cash & Equivalents	Total Equity
Interest Cover	EBIT	Interest Expense
Valuation Toolkit		
Price / Earnings Ratio	Current Share Price	Diluted Earnings Per Share (Basis As Specified)
Price / Book Value	Current Share Price	Shareholders' Equity / Current Basic Shares
Dividend Yield	Annualised Declared Cash Dividend	Current Share Price
Free Cash Flow Yield	Cash Flow From Operations – Total Capex	Market Cap. = Current Share Price * Current Basic Shares
Enterprise Value / Sales	EV = Current Share Price * Current Shares + Minority Equity + Net Debt + Other LT Liabilities	Sales
EV / EBITDA	Enterprise Value	Basic EBIT + Depreciation + Amortization

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Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	51	50.50%	Buy	10	21.74%
Neutral	20	19.80%	Neutral	3	17.65%
Sell	30	29.70%	Sell	3	12.00%

Investment Rating Distribution: Technology Group (as of 01 Jan 2009)

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	68	35.79%	Buy	4	6.35%
Neutral	49	25.79%	Neutral	9	23.68%
Sell	73	38.42%	Sell	12	18.18%

Investment Rating Distribution: Global Group (as of 01 Jan 2009)

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	1297	38.46%	Buy	314	26.81%
Neutral	859	25.47%	Neutral	210	28.23%
Sell	1216	36.06%	Sell	229	20.71%

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Investment rating	Total return expectation (within 12-month period of date of initial rating)	Ratings dispersion guidelines for coverage cluster*
Buy	≥ 10%	≤ 70%
Neutral	≥ 0%	≤ 30%
Underperform	N/A	≥ 20%

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