

February 26, 2010

Industry View
In-Line

India IT Services

Budget: No FY11e EPS Impact; FY12e Remains Uncertain Due to DTC

Quick Comment: We believe budget provisions are unlikely to have any material impact on FY11e earnings for India IT stocks. However, impact on FY12e tax rates will depend on provisions in the Direct Tax code (DTC) for treatment of MAT credit entitlement.

MAT (Minimum Alternate Tax) has been increased to 18% from 15% earlier. Our discussions with companies indicate that this is unlikely to have any EPS impact in FY11e. Increase in MAT would have some cash flow impact and is shown as Loan and Advances, as companies can claim credit entitlement over the next eight years.

Clarity needed on DTC: If DTC (likely to be effective from April 2011) **does not allow MAT credit** to be carried forward, effective tax rate on offshore profits for all India IT companies could increase to 18% in FY12e. We note that MAT applies to the offshore profits and does not depend on the effective tax rate of the consolidated entity. We believe there would be no EPS impact on offshore profits even in FY12e if MAT credit is allowed to be carried forward.

SEZ tax exemption has been granted with retroactive effect in the budget. Though this was always the intent, corrections have been made to section 10AA (7) over last two years. In our view, key beneficiary would be **Infosys**, which has been providing for higher SEZ taxes over the last few years. Based on our calculations, all other things remaining same, theoretically Infosys could get a tax reversal of Rs2-3bn in FY11e (~ 3-4% on FY11e EPS). TCS and Wipro should have no impact.

Lower Tax Surcharge: Surcharge on income tax has been lowered to 7.5% from 10% earlier. We estimate that this could have a negligible positive impact (~0.5%) on FY11e EPS.

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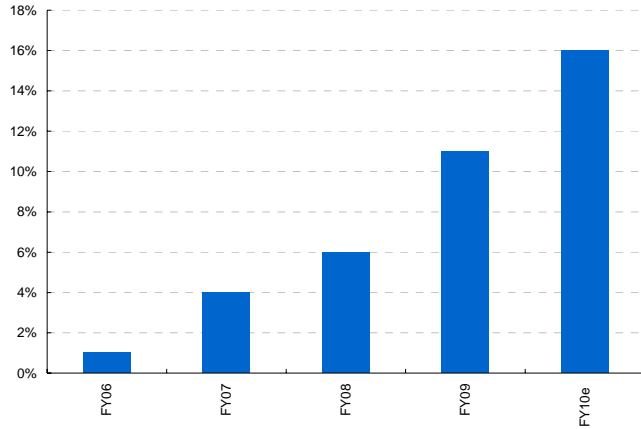
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Other highlights: License sales for pre-packaged IT software have been exempted from service tax subject to specified conditions. Indian IT companies have limited presence in this space and may not benefit from this exemption

Exhibit 1

Infosys: Trends in Revenues from SEZs (%)



Source: Company data, Morgan Stanley Research SEZ = Special Economic Zone

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Industry Coverage: India Software

Company (Ticker)	Rating (as of)	Price* (02/25/2010)
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Infosys Technologies (INFY.BO)	E (01/14/2010)	Rs2,601.6
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