

Indian IT Services

1QFY10 preview: Expect quarter to be in line with guidance and consensus; Management outlook on demand recovery is key

- **We expect an in line 1QFY10 quarter, meeting management guidances and consensus estimates.** We expect volumes to be largely stable Q/Q, with a slight follow-on impact of price declines. As a result, US\$-revenues should be flat to marginally down Q/Q, with Rupee/US\$ appreciation leading to Rupee revenues being down 5-7% Q/Q. EBITDA margins should contract due to lower utilization and currency, leading to 5-15% Q/Q EBITDA declines. However, EPS performance could vary dramatically due to different hedging policies. On a company specific basis, we expect Infosys performance to be weaker than TCS/Wipro due to investments in sales and marketing and limited hedging.
- **We believe that the key in 1QFY10 results is the outlook for 2QFY10 and qualitative management commentary on demand.** We expect all companies to indicate an improving business environment, more deal closures and acceleration in ramp-ups. Further, we expect companies to indicate low-to-mid single digit revenue growth in 2QFY10, at the higher end of consensus expectations. With Infosys being the only large player providing FY10 guidance, we do not expect material change in Rupee guidance as Rupee/US\$ appreciation would offset any benefit on business improvement.
- **Investment view:** We have been fundamentally positive on the sector given our view of improving business outlook for offshore players and low consensus expectations. We expect 1QFY10 results and management commentary to confirm this trend and lead to upgrades in consensus estimates. In term of stock prices, a sharp upmove in the last few weeks could mean a near-term breather – we would be buyers in such a correction on a 9-12 month view.

Indian IT Services

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4QFY09 preview

	Date	Sales JPM Est.	Q/Q (%)	Y/Y (%)	Sales Guidance	EBITDA JPM Est.	Q/Q (%)	Y/Y (%)	PAT JPM Est.	Q/Q (%)	Y/Y (%)	PAT Guidance	EPS (Rs) JPM Est.
TCS	17-Jul-09	68,701	-5.0	6.2		16,787	-6.5	12.9	12,970	-1.3	4.3		6.6
Infosys - Cons.	10-Jul-09	52,072	-7.5	7.4	53,790-54,800	15,861	-15.9	8.4	13,525	-15.3	7.6	13,490	23.6
Wipro	22-Jul-09	64,550	-1.4	8.3		12,519	-1.1	9.7	9,384	-2.7	6.1		6.4
Wipro Global IT*		49,294	0.0	12.2	48,430-49,200	9,862	-4.0	11.8					
HCL Technologies	26-Aug-09	26,676	-6.8	23.0		5,380	-9.3	10.0	2,453	23.4	102.1		3.7
Tech Mahindra	Third week of July	9,769	-7.1	-12.5		1,938	-23.3	-28.2	1,163	-41.6	-51.9		9.5
Patni	29-Jul-09	7,631	-2.7	-2.6	7,585-7,630	1,233	-6.4	10.6	1,005	33.9	-3.1		7.8
Mphasis BFL	Second week of Aug	10,659	1.7	43.6		2,453	-12.1	101.4	1,776	-21.2	66.7		8.5
MindTree	20-Jul-09	3,129	-7.4	n.a.		620	-28.3	n.a.	513	178.8	n.a.		13.2
HCL Infosystems	Third week of Aug	29,872	-1.2	-5.3		937	-10.2	-11.9	602	3.7	-7.5		3.5
InfoEdge	Last week of July	583	1.0	-7.6		171	-11.4	-0.1	135	-2.5	3.9		4.9

Source: Company data, J.P. Morgan estimates. * - Global IT numbers are EBIT not EBITDA

See page 5 for analyst certification and important disclosures, including non-US analyst disclosures.

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Company specific estimates

1. **Infosys should see ~3% Q/Q US\$ based revenue decline** (compared to guidance of 3.7-5.4% decline) with ~270bps decline on EBIT margins due to higher SG&A, visa costs. Overall, we expect EPS of Rs 23.6/share, in-line with the guidance of Rs 23.55/share.
2. **TCS is likely to see ~1% Q/Q US\$ revenue decline** in 1QFY10 and ~50bp EBIT margin decline. Moreover, with hedging losses expected to be lower than previous quarters due to rupee appreciation, we estimate rupee EPS performance to be better on the bottom-line.
3. **Wipro Global IT should see ~2% US\$ based revenue decline**, at the high end of its guidance of US\$1,009-1,025mn, partly helped by cross-currency impact. We expect IT Services EBIT margins to decline by ~80bps due to roll-on impact of pricing cuts in March-April.
4. **HCL Technologies should report 1-2% decline in US\$ revenues**. We expect pricing to be under pressure, mainly on Axon business, which has high billing rates. We expect EBIT margins to go down by ~50bps. We expect HCL Tech to continue to report high foreign exchange losses – partly due to cash loss booked on closed hedging positions and remaining from its large forex exposure of over US\$1 billion.
5. **Tech Mahindra should have a muted quarter with ~7% Q/Q rupee based revenue decline**. We expect EBIT margins to decline by 450 bps as Tech Mahindra should see the impact of reduction in BT core business and incur transition costs from new deals with BT ramping up this quarter.
6. **We expect Patni to report in line with its guidance**. We expect revenues of US\$ 159m vs. guidance of US\$ 158-159m. On net profit, we expect PAT of US\$20.9m as compared to guidance of US\$ 26.5-27m (excluding expected forex loss of US\$10m).
7. **We expect MindTree to see revenue decline Q/Q** but hedging position should lead to a significant foreign exchange gain. As a result, we expect a sharp jump in EPS Q/Q.

Points to watch for

Comments on volume ramp ups starting 2Q/3QFY10

We would watch for management commentary on how clients were ramping up for the Sep/Dec quarters. We believe that outsourcing budgets for clients have increased and clients are incrementally confident of spending their allocated budgets. This was suggested by the Accenture results showing a significant increase in outsourcing bookings. This move from high cost discretionary spending to low cost essential spending could drive revenues for Indian IT players.

Pricing pressure

While most of the pricing cuts were done within Feb-March 2009, we expect 1QFY10 to show a bit of follow-on impact of weak pricing in April. We would look for color on price stability.

Second tier performance

We believe that top-tier players would be the first beneficiaries of a stable environment as clients increase volumes to the largest vendors. Second tier players

would be secondary beneficiaries, but some do face the risk of being marginalized in vendor consolidation, which would impact revenues in FY10.

Currency movements

Rupee has appreciated by 2% on average and 5.5% on an end-to-end basis against the US\$.

Table 1: Currency movement - average

	Rs/US\$	Rs/GBP	Rs/Euro	US\$/Euro	US\$/GBP	US\$/A\$
Average 4QFY09	49.8	71.6	65.1	1.31	1.44	0.67
Average 1QFY10	48.8	75.7	66.5	1.36	1.55	0.76
Change (%)	-2.0	5.7	2.2	4.3	7.9	14.5

Source: Bloomberg.

Table 2: Currency movement: End to End

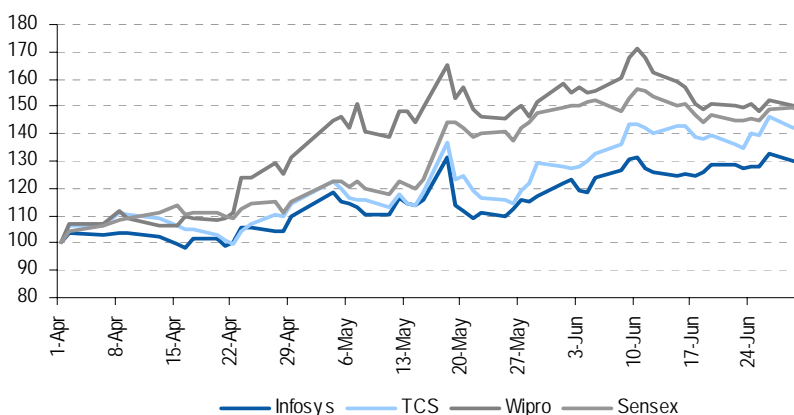
	Rs/US\$	Rs/GBP	Rs/Euro	US\$/Euro	US\$/GBP	US\$/A\$
End 4QFY09	50.7	72.7	67.2	1.33	1.43	0.69
End 1QFY10	48.0	80.0	67.6	1.41	1.67	0.81
Change (%)	-5.5	10.1	0.5	6.5	16.7	17.5

Source: Bloomberg.

Share price movement during the quarter

During 1QFY10, Infosys and TCS underperformed the Sensex by 18% / 4%. Wipro performed inline with the Sensex.

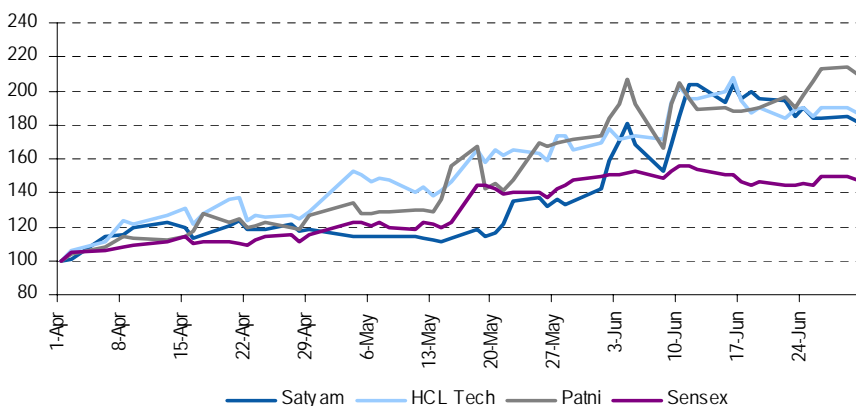
Figure 1: Movement in Tier 1 Indian IT stocks during 1QFY10



Source: Bloomberg.

Figure 2: Movement in Tier 2 Indian IT stocks during 1QFY10

Tier-2 Indian IT firms have outperformed the index, HCL Tech by 39% and Patni by 63%.



Source: Bloomberg.

Table 3: Valuation

Year ending March		Rating	PT (Rs)	Mkt Cap		EPS			PER			EPS CAGR
Company	Ticker			Price	US\$ M	FY09	FY10E	FY11E	FY09	FY10E	FY11E	FY09-11E
TCS	TCS IN	OW	550	391	15,928	26.4	30.3	35.0	14.8	12.9	11.2	15.0
Infosys	INFO IN	OW	1,850	1,778	21,221	102.0	106.5	126.8	17.4	16.7	14.0	11.5
Wipro Limited	WPRO IN	OW	400	378	11,544	25.7	26.9	29.7	14.7	14.0	12.7	7.4
Satyam Computers	SCS IN	OW	100	71	1,445	10.6	3.9	11.1	6.7	18.3	6.4	2.2
HCL Tech	HCLT IN	N	130	185	2,590	17.0	15.7	22.6	10.9	11.8	8.2	15.4
Tech MH	TECHM IN	OW	900	730	1,854	71.1	49.6	82.0	10.3	14.7	8.9	7.4
Patni	PATNI IN	OW	200	259	691	34.1	26.9	28.8	7.6	9.6	9.0	-8.1
Mphasis-BFL	MPHL IN	OW	525	387	1,686	14.1	38.4	38.8	27.4	10.1	10.0	65.6
Mid-caps												
Mindtree	MTCL IN	OW	425	475	376	7.9	43.3	52.6	60.4	11.0	9.0	158.7
NIIT Ltd	NIIT IN	UW	30	63	217	5.0	4.1	5.9	12.6	15.4	10.8	8.3
HCL Infosystems	HCLI IN	OW	120	116	415	14.0	15.4	17.9	8.3	7.6	6.5	13.0
Info Edge	INFOE IN	UW	300	615	350	21.9	18.3	20.5	28.1	33.6	30.0	-3.1
OnMobile	ONMB IN	UW	200	435	525	14.4	15.8	19.4	30.1	27.6	22.4	15.9

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

Dated as of 30 June, 2009.

Companies Recommended in This Report (all prices in this report as of market close on 30 June 2009)

HCL Infosystems (HCLI.BO/Rs115.95/Overweight), HCL-Technologies (HCLT.BO/Rs185.00/Neutral), Info Edge India (INED.BO/Rs620.00/Underweight), Infosys Technologies (INFY.BO/Rs1,776.90/Overweight), MindTree Ltd. (MINT.BO/Rs468.75/Overweight), Mphasis Ltd (MBFL.BO/Rs385.55/Overweight), NIIT Ltd (NIIT.BO/Rs61.45/Underweight), OnMobile Global Limited (ONMO.BO/Rs432.80/Underweight), Patni Computer (PTNI.BO/Rs258.95/Overweight), Satyam Computer Services (SATY.BO/Rs70.90/Overweight), Tata Consultancy Services (TCS.BO/Rs389.70/Overweight), Tech Mahindra Ltd. (TEML.BO/Rs732.40/Overweight), Wipro Ltd. (WIPR.BO/Rs377.65/Overweight)

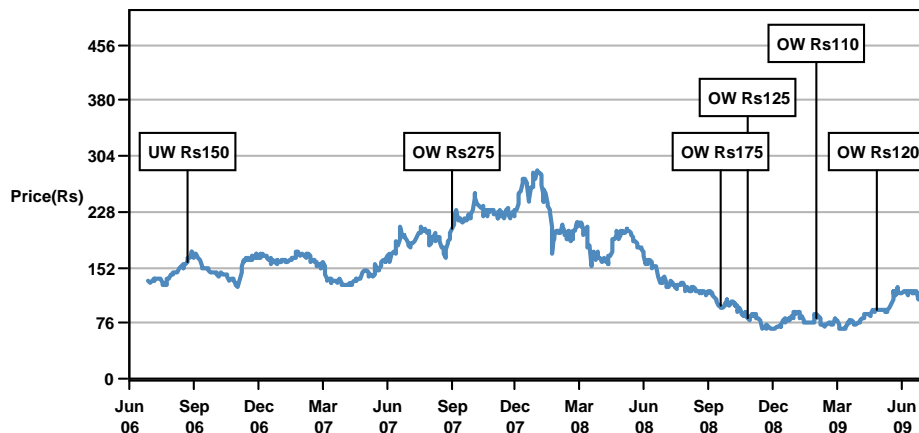
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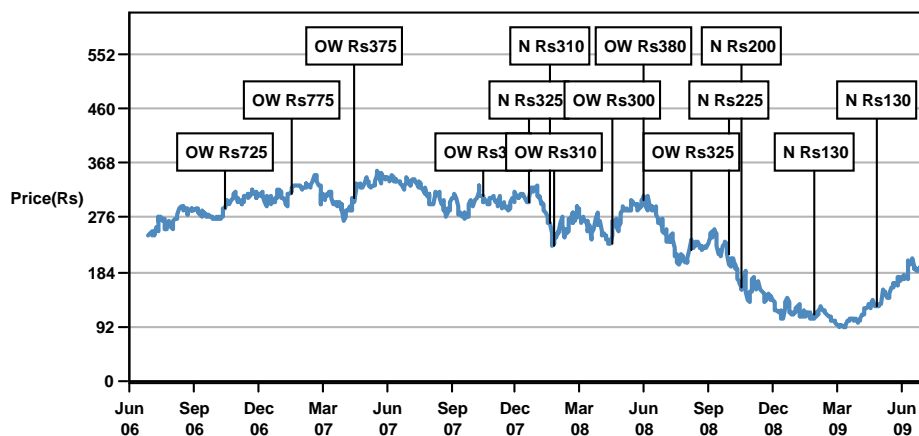
HCL Infosystems (HCLI.BO) Price Chart



Date	Rating	Share Price (Rs)	Price Target (Rs)
23-Aug-06	UW	160.45	150.00
03-Sep-07	OW	205.85	275.00
16-Sep-08	OW	100.25	175.00
25-Oct-08	OW	81.95	125.00
30-Jan-09	OW	83.80	110.00
26-Apr-09	OW	93.95	120.00

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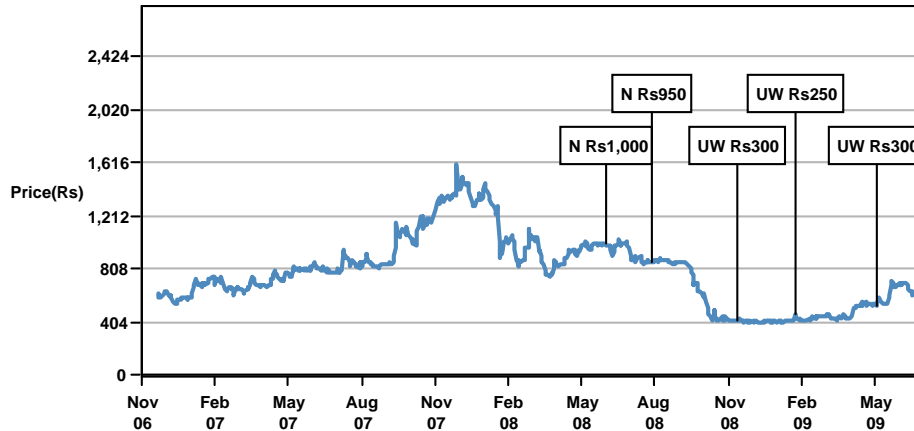
HCL-Technologies (HCLT.BO) Price Chart



Date	Rating	Share Price (Rs)	Price Target (Rs)
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
16-Oct-08	N	158.20	200.00
28-Jan-09	N	112.50	130.00
26-Apr-09	N	126.75	130.00

Source: Reuters and J.P. Morgan; price data adjusted for stock splits and dividends.
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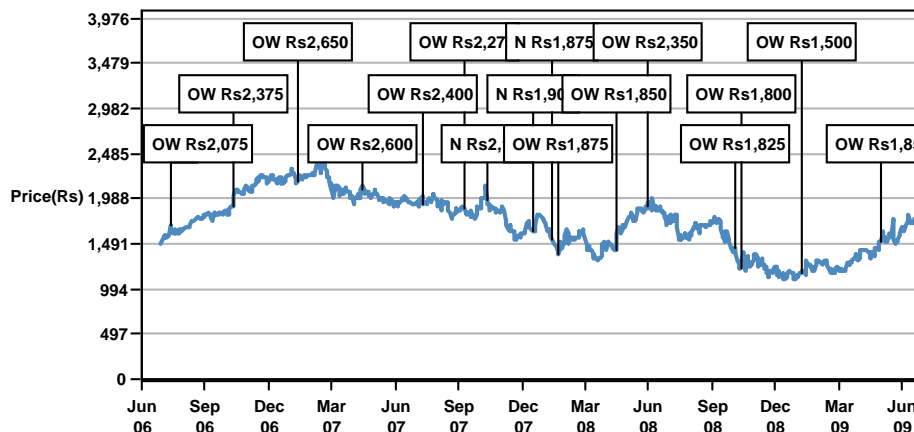
Info Edge India (INED.BO) Price Chart



Date	Rating	Share Price (Rs)	Price Target (Rs)
02-Jun-08	N	992.10	1000.00
29-Jul-08	N	859.80	950.00
12-Nov-08	UW	412.10	300.00
23-Jan-09	UW	453.00	250.00
05-May-09	UW	527.30	300.00

Source: Reuters and J.P. Morgan; price data adjusted for stock splits and dividends.
 Initiated coverage Jun 02, 2008. This chart shows J.P. Morgan's continuing coverage of this stock; the current analyst may or may not have covered it over the entire period.
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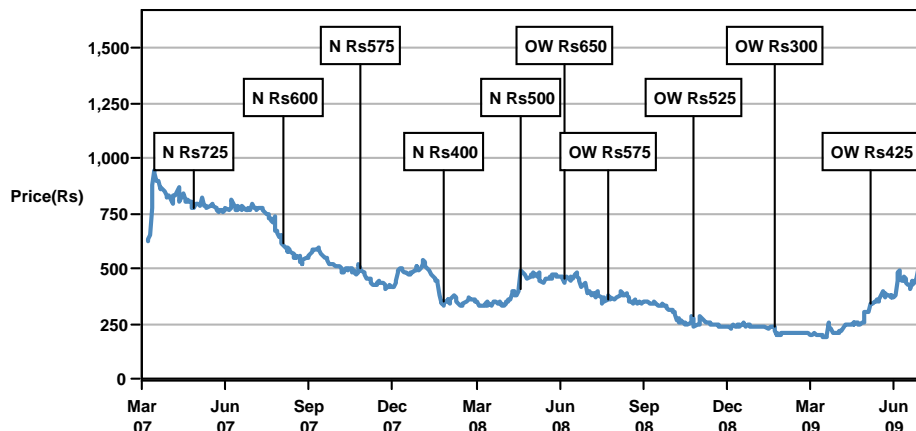
Infosys Technologies (INFY.BO) Price Chart



Date	Rating	Share Price (Rs)	Price Target (Rs)
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
02-Oct-08	OW	1453.90	1825.00
11-Oct-08	OW	1226.70	1800.00
06-Jan-09	OW	1174.45	1500.00
01-May-09	OW	1507.30	1850.00

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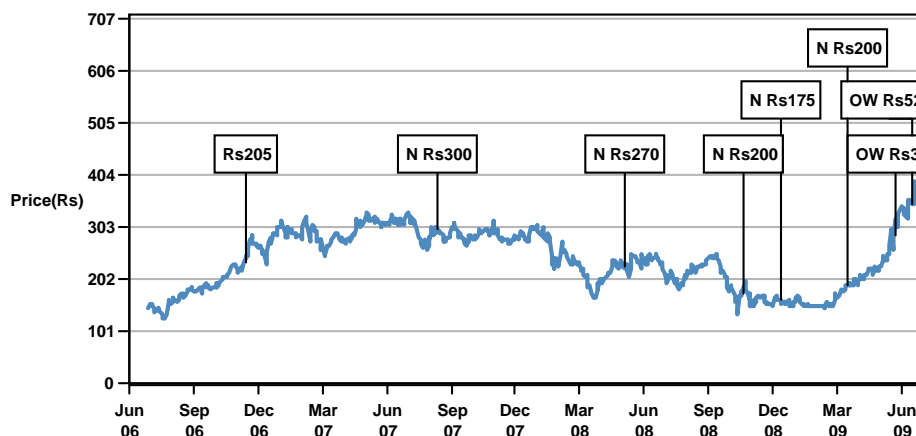
MindTree Ltd. (MINT.BO) Price Chart



Date	Rating	Share Price (Rs)	Price Target (Rs)
26-Apr-07	N	776.65	725.00
02-Aug-07	N	618.40	600.00
26-Oct-07	N	502.00	575.00
24-Jan-08	N	350.80	400.00
17-Apr-08	N	408.30	500.00
04-Jun-08	OW	451.60	650.00
21-Jul-08	OW	354.85	575.00
22-Oct-08	OW	283.85	525.00
20-Jan-09	OW	237.55	300.00
05-May-09	OW	343.45	425.00

Source: Reuters and J.P. Morgan; price data adjusted for stock splits and dividends.
 Initiated coverage Apr 26, 2007. This chart shows J.P. Morgan's continuing coverage of this stock; the current analyst may or may not have covered it over the entire period.
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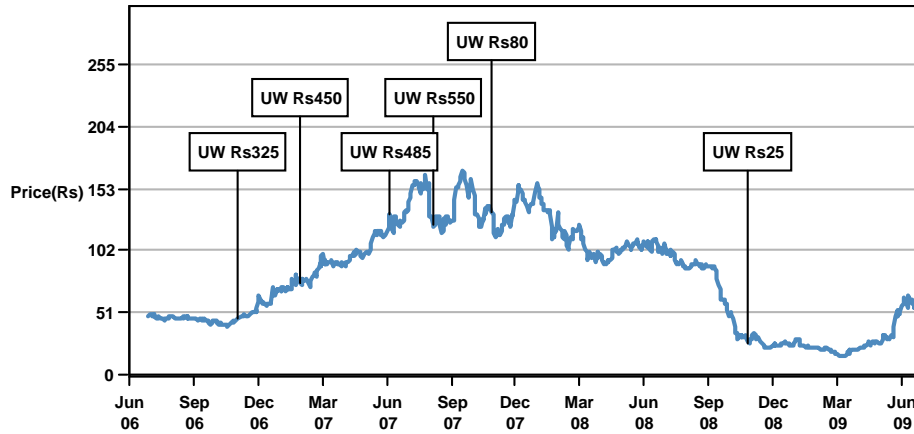
Mphasis Ltd (MBFL.BO) Price Chart



Date	Rating	Share Price (Rs)	Price Target (Rs)
13-Aug-07	N	299.85	300.00
05-May-08	N	227.40	270.00
20-Oct-08	N	173.95	200.00
11-Dec-08	N	159.90	175.00
16-Mar-09	N	188.30	200.00
22-May-09	OW	285.40	375.00
16-Jun-09	OW	347.35	525.00

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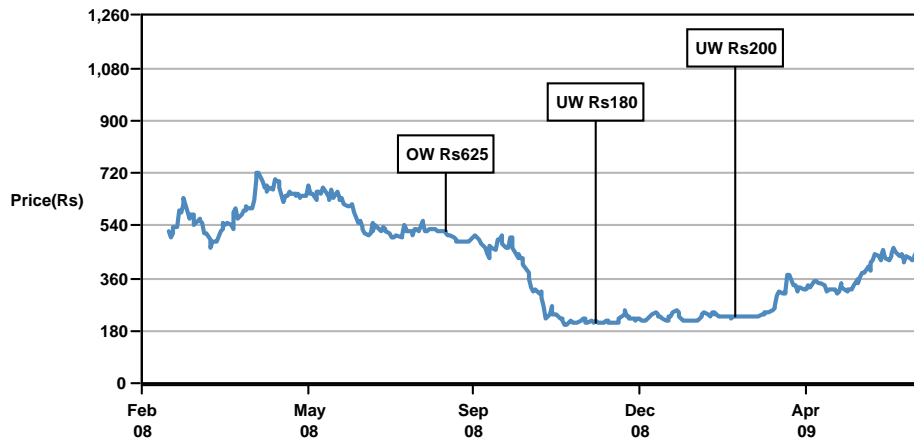
NIIT Ltd (NIIT.BO) Price Chart



Date	Rating	Share Price (Rs)	Price Target (Rs)
02-Nov-06	UW	45.55	325.00
30-Jan-07	UW	75.33	450.00
06-Jun-07	UW	132.45	485.00
06-Aug-07	UW	123.61	550.00
29-Oct-07	UW	134.25	80.00
26-Oct-08	UW	25.90	25.00

Source: Reuters and J.P. Morgan; price data adjusted for stock splits and dividends.
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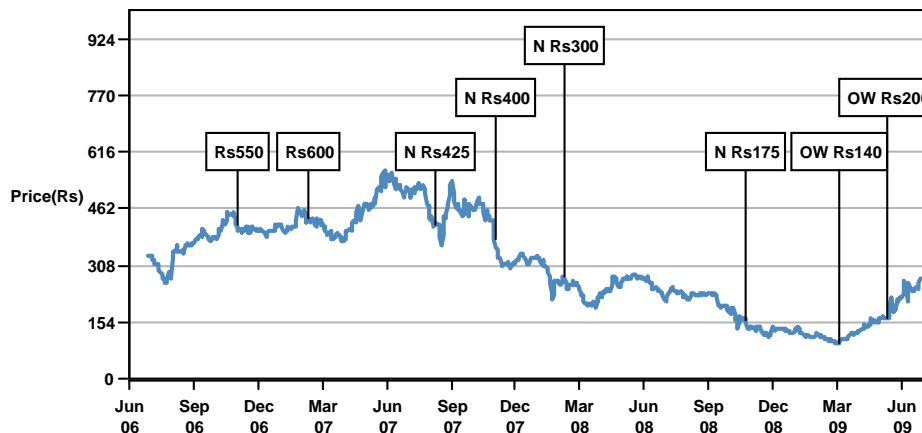
OnMobile Global Limited (ONMO.BO) Price Chart



Date	Rating	Share Price (Rs)	Price Target (Rs)
20-Aug-08	OW	520.00	625.00
26-Nov-08	UW	208.25	180.00
27-Feb-09	UW	228.25	200.00

Source: Reuters and J.P. Morgan; price data adjusted for stock splits and dividends.
 Initiated coverage Aug 20, 2008. This chart shows J.P. Morgan's continuing coverage of this stock; the current analyst may or may not have covered it over the entire period.
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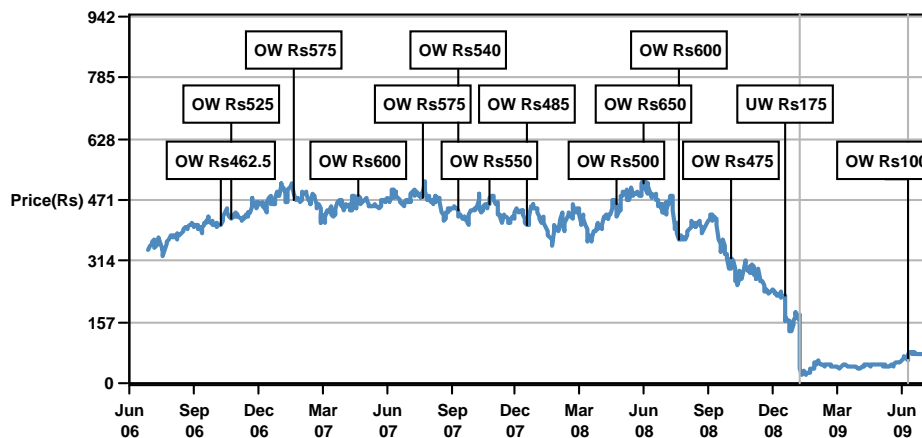
Patni Computer (PTNI.BO) Price Chart



Date	Rating	Share Price (Rs)	Price Target (Rs)
08-Aug-07	N	420.65	425.00
02-Nov-07	N	377.45	400.00
07-Feb-08	N	278.65	300.00
23-Oct-08	N	157.95	175.00
05-Mar-09	OW	95.05	140.00
12-May-09	OW	164.65	200.00

Source: Reuters and J.P. Morgan; price data adjusted for stock splits and dividends.
 Initiated coverage Aug 07, 2007. This chart shows J.P. Morgan's continuing coverage of this stock; the current analyst may or may not have covered it over the entire period.
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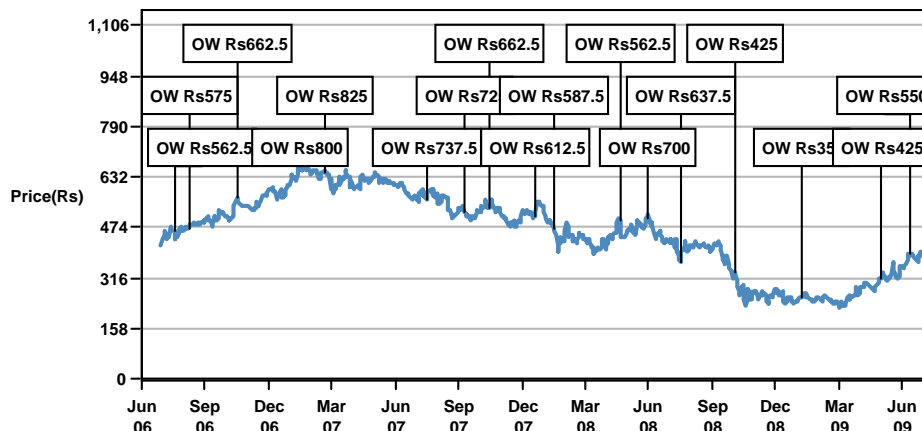
Satyam Computer Services (SATY.BO) Price Chart



Date	Rating	Share Price (Rs)	Price Target (Rs)
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
02-Oct-08	OW	318.75	475.00
17-Dec-08	UW	226.50	175.00
10-Jun-09	OW	66.85	100.00

Source: Reuters and J.P. Morgan; price data adjusted for stock splits and dividends.
 Break in coverage Jan 07, 2009 - Jun 10, 2009. This chart shows J.P. Morgan's continuing coverage of this stock; the current analyst may or may not have covered it over the entire period.
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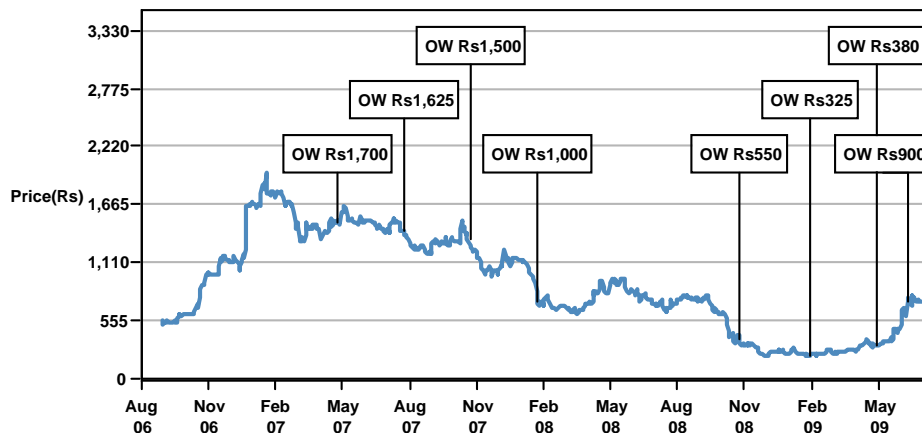
Tata Consultancy Services (TCS.BO) Price Chart



Date	Rating	Share Price (Rs)	Price Target (Rs)
19-Jul-06	OW	460.44	562.50
08-Aug-06	OW	468.00	575.00
16-Oct-06	OW	565.22	662.50
15-Jan-07	OW	662.65	800.00
21-Feb-07	OW	648.60	825.00
16-Jul-07	OW	563.95	737.50
10-Sep-07	OW	523.48	725.00
15-Oct-07	OW	536.82	662.50
20-Dec-07	OW	510.68	612.50
16-Jan-08	OW	469.12	587.50
21-Apr-08	OW	496.28	562.50
29-May-08	OW	504.85	700.00
17-Jul-08	OW	363.68	637.50
02-Oct-08	OW	335.50	425.00
06-Jan-09	OW	257.50	350.00
01-May-09	OW	311.60	425.00
11-Jun-09	OW	390.88	550.00

Source: Reuters and J.P. Morgan; price data adjusted for stock splits and dividends. This chart shows J.P. Morgan's continuing coverage of this stock; the current analyst may or may not have covered it over the entire period.
 J.P. Morgan ratings: OW = Overweight, N = Neutral, UW = Underweight.

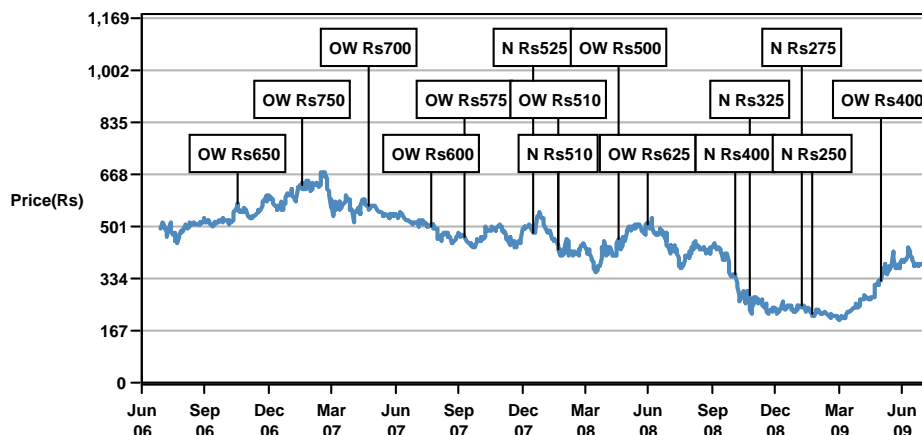
Tech Mahindra Ltd. (TEML.BO) Price Chart



Date	Rating	Share Price (Rs)	Price Target (Rs)
24-Apr-07	OW	1499.15	1700.00
24-Jul-07	OW	1417.10	1625.00
22-Oct-07	OW	1329.45	1500.00
23-Jan-08	OW	727.05	1000.00
24-Oct-08	OW	376.10	550.00
28-Jan-09	OW	215.90	325.00
28-Apr-09	OW	328.35	380.00
10-Jun-09	OW	744.20	900.00

Source: Reuters and J.P. Morgan; price data adjusted for stock splits and dividends. Initiated coverage Apr 24, 2007. This chart shows J.P. Morgan's continuing coverage of this stock; the current analyst may or may not have covered it over the entire period.
 J.P. Morgan ratings: OW = Overweight, N = Neutral, UW = Underweight.

Wipro Ltd. (WIPR.BO) Price Chart



Date	Rating	Share Price (Rs)	Price Target (Rs)
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
02-Oct-08	N	349.10	400.00
23-Oct-08	N	279.25	325.00
06-Jan-09	N	245.65	275.00
22-Jan-09	N	219.75	250.00
01-May-09	OW	330.50	400.00

Source: Reuters and J.P. Morgan; price data adjusted for stock splits and dividends.
 This chart shows J.P. Morgan's continuing coverage of this stock; the current analyst may or may not have covered it over the entire period.
 J.P. Morgan ratings: OW = Overweight, N = Neutral, UW = Underweight.

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IB clients*	54%	54%	42%
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IB clients*	75%	73%	57%

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