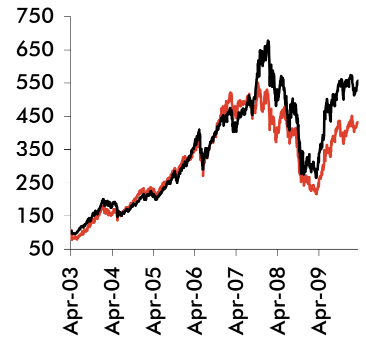
INITIATING COVERAGE

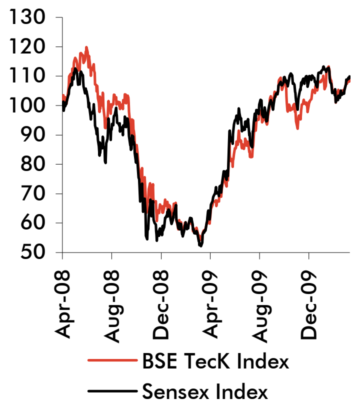
Information Technology

Riding A New Crest

Medium term IT Index & Sensex trends



Short term IT Index & Sensex trends



Source: Bloomberg, Ambit Capital Research

We are initiating coverage on the Indian IT services sector. We hold a positive outlook on the sector, which is fuelled by an improving macro scenario, setting the stage for strong offshoring demand.

- **Improving key variables set the stage for strong offshoring demand:** Our industry analysis using both the methodologies - top-down and bottom-up approaches suggests a strong demand trajectory ahead. Increased offshoring powered by cost cutting initiatives and Indian Service Providers (ISPs) increasing share of clients' wallet should drive robust growth.We see above average growth potential in:(a) verticalwise: BFSI sector (driven by M&A, risk, compliance) (b) serviceswise: Infrastructure Management Services (IMS), where India's penetration is merely 2%.
- **ISPs are breaking the mould:** Increasing convergence between business models of ISPs and MNCs, protectionist rhetoric and urgency to break the linear growth model is driving ISPs to take bolder steps to remain relevant: (a) local hires; (b) near shore presence; (c) non-linearity; and (d) opting for acquisitions. We believe these measures would help ISPs deal with the changing business landscape and hold their turf, at least for next 2-3 years.
- **Rupee appreciation poses the biggest challenge to margins:** We expect margins to decline going forward despite strong US$ revenue growth, as rupee appreciation remains the biggest challenge. We factor in margin decline of 90-165bps over FY10E-12E across our coverage universe.
- **Valuation and top picks:** We expect strong growth for tier-1 ISPs backed by strong offshoring demand and believe that the demand rush could surprise the street driving further EPS upgrade cycle ahead.

  We initiate coverage on the tier-1 ISPs with a **BUY** recommendation on Infosys (TP- Rs3,155) and TCS (TP- Rs925). We expect BFSI to be the primary growth driver going forward, particularly in FY11E. To that extent, we prefer Infosys and TCS that have higher exposure to this vertical. Further Infosys, in our view, is also better placed in terms of lower exposure to Europe (wherein the economic recovery lags the US) and higher margin levers v/s peers.

Exhibit 1: Valuation summary

FY12E	Infosys	TCS	Wipro	HCL Tech
Recommendation	**BUY**	**BUY**	**HOLD**	**HOLD**
Revenues (Rs mn)	318,564	426,493	378,406	164,513
EBITDA margin (%)	33.8	27.7	17.3	19.6
Net profit margin (%)	27.0	21.3	15.1	11.0
PE (x)	17.9	17.1	18.4	13.7
EV / EBITDA (x)	11.7	12.1	13.0	6.7
EV / Sales (x)	4.0	3.4	2.3	1.3

Source: Company, Ambit Capital Research; ^ EBIT; Valuations as on 11 March 2010.

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AMBIT
Acumen at work

IT SERVICES SECTOR

COMPANIES

Sector Outlook

Improving key variables sets stage for strong offshoring demand

- **Encouraging revival in key variables...:** Improvement in the various macro economic variables in the primary markets (US and Europe; 76% of global IT spend) are setting the stage for robust pick-up in the demand outlook for Indian IT service providers (ISP). We present a detailed insight in this report.
- **...and recovery in GDP and corporate profits bode well for IT spend**: Our top-down industry analysis approach indicates a strong correlation between IT spend - GDP (0.94x) and corporate profits (0.75x). Recovery in these variables presents a strong case for increased IT spend. Further, we note that the historical analysis of IT spend's reaction to GDP trend shows that while the IT spend has fallen more than the GDP during recessive periods, the recovery has been sharp during the business expansion cycle.
- **Europe recovery lags the US; prefer Infosys which has the lowest Europe exposure:** Recent GDP data from Eurostat has brought concerns on sustainability of Europe's recovery. The main reasons behind the tepid growth seem to be the weak labour market and patchy consumer spending. Hence, we believe that European IT spend will likely lag the US IT spend where data points on macro recovery appear relatively more encouraging.We believe that companies with higher exposure to the US might be better placed in the recovery cycle. To that extent, we prefer Infosys, which has the lowest Europe exposure (21.9% in 3QFY10).
- **Improving profit outlook for top 40 outsourcers augurs well for ISPs revenue growth:** Our bottom-up analysis points that ISPs volume growth has closely tracked the top 40 outsourcers' profit growth by ~1-2 quarters. Increasing profit expectations from these clients augurs well for the ISPs growth trajectory. Further, pick-up in SG&A expenses for these clients, a fair proxy for discretionary spending bodes well for ISPs.
- **Demand outlook improving with decision making cycles closer to normalcy:** With increasing confidence that the economy has bottomed out, companies are making exacting assessments of business models in response to the changed external environment and are becoming more amenable to offshoring. Improvement in decision-making cycles and deal closures have led to increase in the volume growth trajectory for ISPs.Further, a pick-up in discretionary spending in relatively subdued verticals, should drive strong volume growth for ISPs through FY10E-12E.

Key growth drivers: BFSI and Infrastructure Managament Services

- **Verticals perspective - BFSI to be the primary growth driver:** On the vertical front, we expect BFSI, which has led the global recovery and ISPs growth rebound, to be the primary growth driver through FY10E-12E. ISPs are benefiting from incremental work in newer areas (M&A, risk and compliance), gains from vendor consolidation wins and incremental offshoring from the relatively low adopters. Besides, pick-up in discretionary spend in lagging verticals such as Manufacturing and Telecom would improve the growth momentum through FY10E-12E.

- **ISPs services portfolio offers enough scope for expansion :** We believe that the ISPs services portfolio still has enough steam for growth as penetration in most service lines remains low. Penetration in newer services such as IMS remains as low as 2.0 %.

  Cloud computing is expected to the next big disruptive trend in services.While ISPs have been ramping up cloud services, the common perception is that they have not been creating enough visibility for their cloud computing based offerings. Our view is that: (1) ISPs are not under the threat of substantial revenue displacement unlike traditional IT vendors; (2) ISPs in the past might have been slower to adopt technologies such as ERP v/s peers like Accenture but, in our view, they are probably not very far off with regard to cloud services.

View on long term trends

- **Demographic deficits in developed countries present a compelling case for offshoring in the longer term:** Ageing population, declining fertility rates and higher life expectancy are expected to continue in developed countries, which would lead to a reduction in the working age population for these countries. In this context, India is well placed given an expected increase in the working age population (63% in 2008 to 67% in 2020).

- **Consolidation in the global technology industry - no near term impact on ISPs:** Industry consolidation trend has gained pace in the last year with big bang acquisitions (Dell-Perot and Xerox-ACS). However, we do not expect this trend to be a game-changer for ISPs in the near term. That said, ISPs should not view this trend as a mere distraction. The fact that only a few MNC players (Accenture, IBM) have achieved a dominant presence in India could motivate acquisition of a large offshore player, which could be relatively impactful.

ISPs are breaking the mould to remain relevant

- **ISPs are taking bolder steps to remain relevant:** Increasing convergence between business models of ISPs and MNCs, protectionist rhetoric and the urgency to break the linear growth model is driving ISPs to take bolder steps to remain relevant. ISPs are increasing: (a) local hires; (b) near shore presence (c) non-linearity; and (d) opting for acquisitions. We believe these measures would help ISPs deal with the changing business landscape and hold their turf, at least for the next 2-3 years.

Rupee poses the biggest challenge to margins

- **ISPs have exited the downturn with historical high margins...:** ISPs have emerged out of the downturn with margins at near historical highs. Cumulatively, ISPs have been able to increase margins by 180-350bps in 9M FY10 despite rupee appreciation, wage hikes, higher variable payout and pick-up in hiring, which proves that growth itself can be a margin lever.

- **...but margins could see a downward trend going forward as rupee appreciation remains the biggest challenge:** Going forward, we expect rupee appreciation to be the biggest risk to margins. With most of the obvious margin levers (utilisation, cost rationalisation, offshore mix) at optimum levels, non-linear growth (dependent on flawless execution) and pricing uptick (when the demand-supply gap intensifies at the client's end) could shield ISPs from an unfavourable rupee movement. We have conservatively factored US$/INR appreciation of 4.1% and 1.2% and EBITDA margin decline of 90-165 bps for our coverage universe over FY10E-12E.

Valuation and Top picks

- **Improving demand trajectory and further EPS upgrades provide scope for valuation upside:** We have a positive stance on the IT services sector and in particular the tier-1 ISPs. We believe that strong offshoring momentum powered by cost cutting initiatives and ISPs increasing share of the client's wallet in the medium-term will overshadow longer-term concerns such as industry consolidation and changing services models due to newer technology trends (which still remain relevant). Given that valuations for the tier-1 ISPs have re-rated from the trough of 6-11x to currently ~18-22x (1-year forward PE), the most obvious question that arises is: Is there a case for further upside? Our view: We expect strong growth for tier-1 ISPs backed by a robust offshoring demand and believe that the demand rush could surprise the street. Barring sharp rupee appreciation or a 'double dip' recession, we expect more positive surprises from ISPs and consistent upgrades to the consensus earnings estimates.We believe that the good times for ISPs are here to last for at least next two years.

- **Infosys and TCS are our top picks:** We initiate coverage on tier-1 ISPs with a **BUY** recommendation on Infosys (TP- Rs3,155) and TCS (TP- Rs925) and **HOLD** on Wipro (TP- Rs780) and HCL Tech (TP- Rs390). While the upcycle is expected to benefit all tier-1 IT stocks, we suggest playing individual stocks instead of adopting a 'basket approach' as some stocks, in our view, are better positioned to capture the demand upcycle. We expect BFSI to be the primary growth driver going forward, particularly in FY11E. To that extent, we prefer Infosys and TCS which have a higher exposure to this vertical. Further Infosys, in our view, is also better placed in terms of lower exposure to Europe (where the economic recovery lags the US) and higher margin levers v/s peers.

Risks to recommendation

- A ‘double dip’ recession in the US could impact IT budgets more severely than what we have presently envisaged.

- Any sharp appreciation in the rupee beyond what we have factored into our estimates would have an adverse impact on estimates.

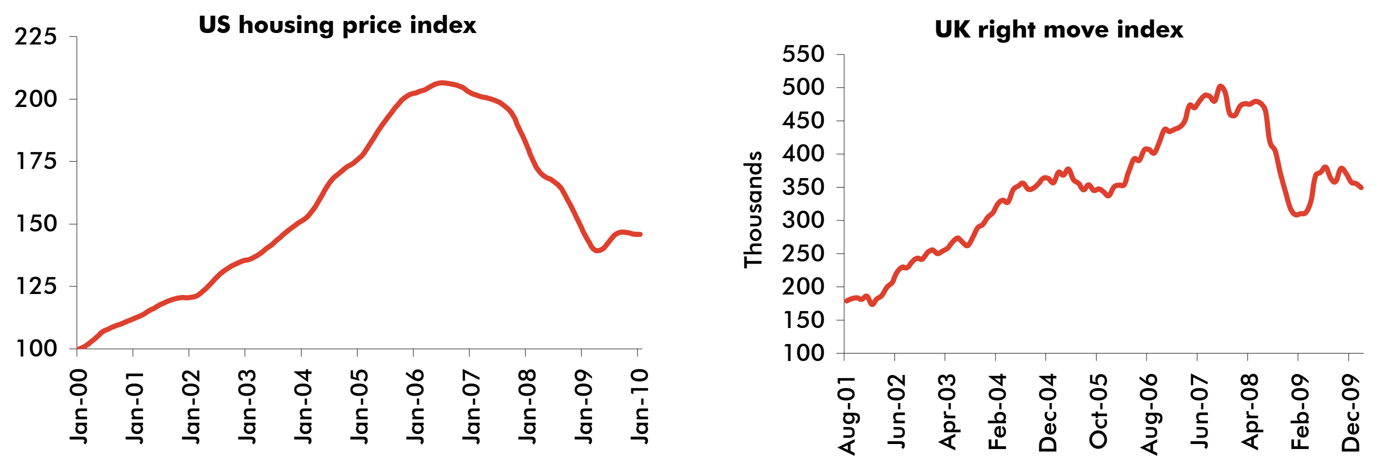
Analysis Of Key Macro Variables

This piece analyzes the key macro economic variables as IT services demand is increasingly driven by economic growth in primary markets. While the key indicators suggest that they are still not out of the woods fully, we believe that the receding negative signals suggest stability, which is sufficient for a sustainable growth trend for ISPs. Further, our analysis points to a strong correlation between IT budgets, US GDP and corporate profits. A recovery in these data points augurs well for growth in IT budgets. That said, Europe recovery lags the US and to that extent we prefer Infosys, which has the lowest Europe exposure amongst peers.

Encouraging revival in key variables

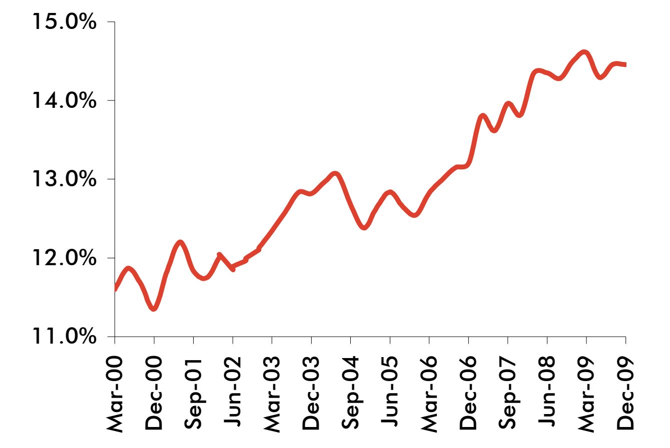
- **Improvement in macro economic variables:** Improvement in the global economic scenario has set the stage for a robust pick-up in demand outlook for the IT services sector. The extreme stimulus from various governments has brought about a rebound in the global economy. We have analysed important economic metrics in the US and Europe (primary markets account for ~76% of global IT spend; source: Nasscom), which indicate health of the global economy. Whilst some of these metrics indicate that the economy might not be out of the woods fully, they certainly point toward receding negative signals.

Exhibit 2: Housing price index in US and UK have started to look up



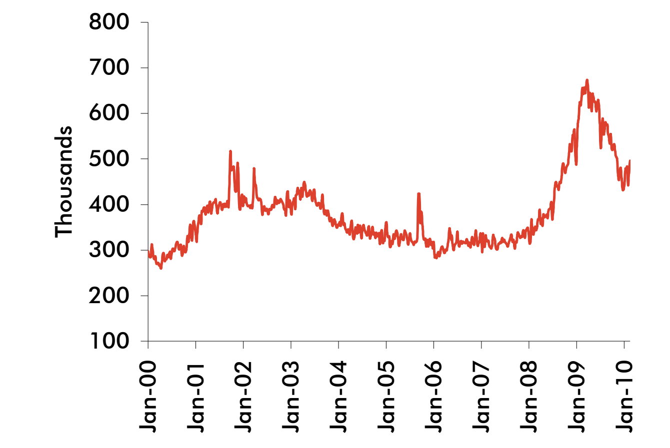
Source: Bloomberg

Exhibit 3: US vacancy rates have started to stabilise



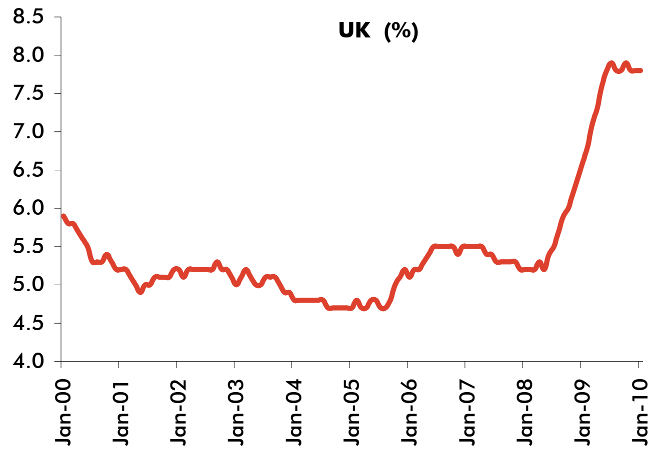
Source: U.S. Census Bureau

Exhibit 4: Initial jobless claims in the US are receding

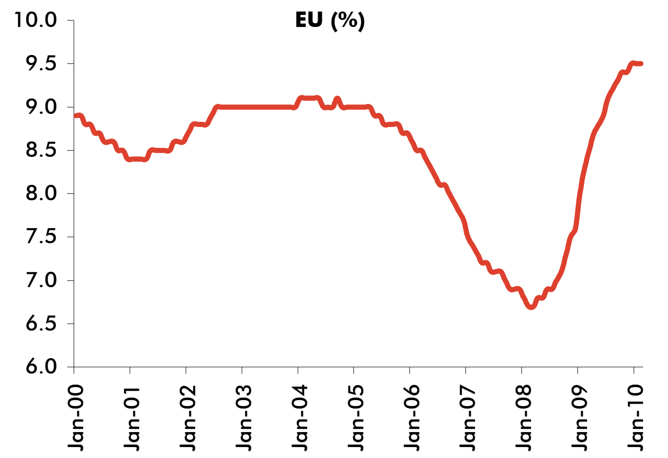


Source: Bloomberg

Exhibit 5: Unemployment in UK and EU has started stabilizing



Source: O.N.S



Source: Eurostat

Exhibit 6: Credit spreads have narrowed indicating ease in borrowing

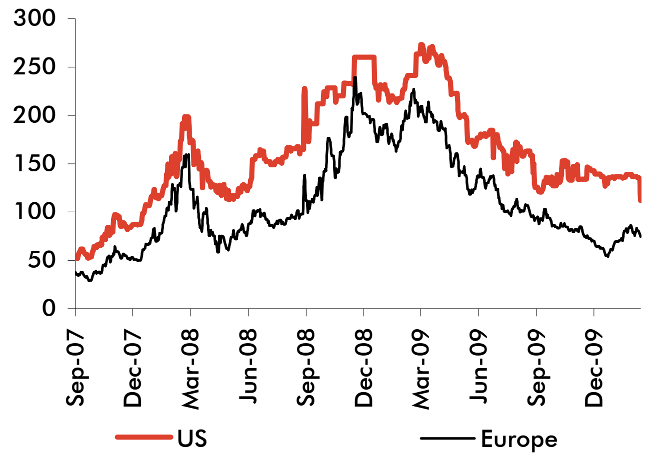
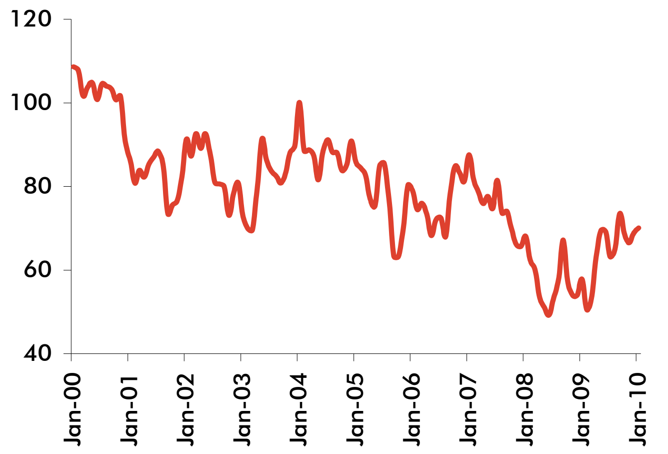
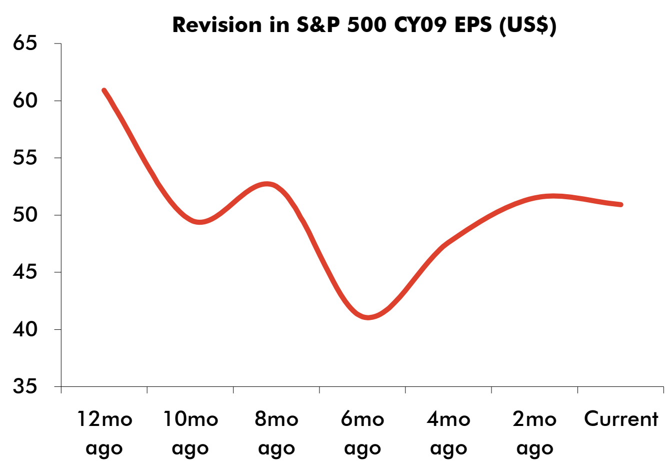


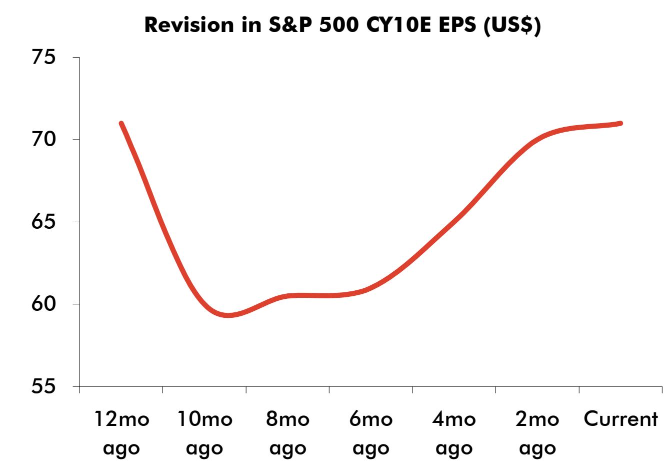
Exhibit 7: US consumer confidence has turned around



Source: Bloomberg

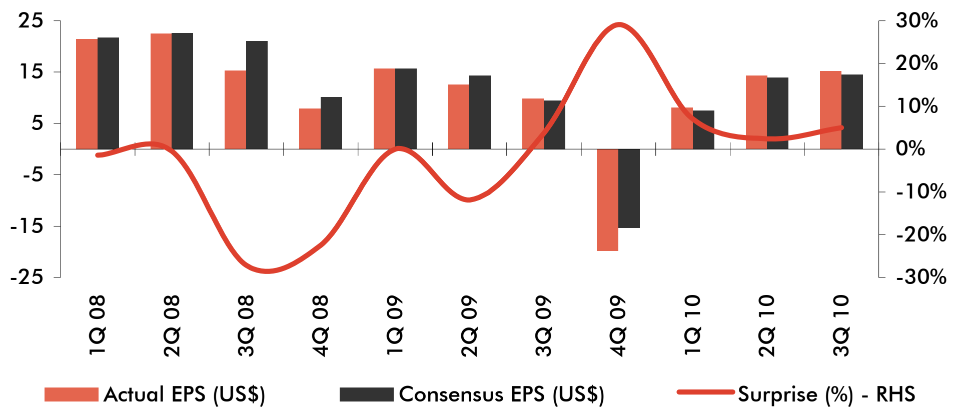
Exhibit 8: S&P 500 earnings revision momentum has picked up





Source: Reuters

Exhibit 9: S&P 500 EPS has consecutively surprised positively for last 4 qtrs



Source: Reuters

Recovery in US GDP and corporate profits augur well for IT spend growth

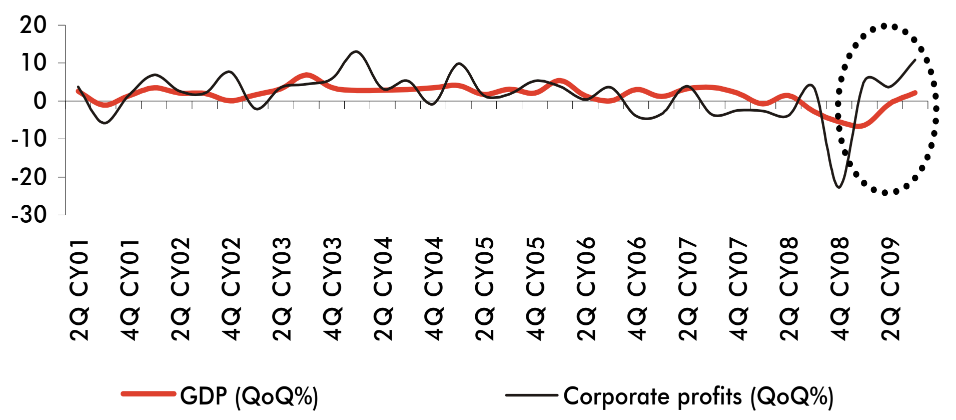
- **Strong correlation between IT spend - US GDP and corporate profits:** IT spend is closely related to client's growth & productivity and hence linked to corporate profits and GDP trends at the macro level. This is established by the strong correlation between these variables (IT budgets/GDP:0.94x; IT budgets/corporate profits:0.75x). A recovery in these data points augurs well for growth in the IT budgets.

Exhibit 10: IT budgets are closely correlated with GDP & corporate profits

(US$ bn)	2001	2002	2003	2004	2005	2006	2007	2008	Correlation to IT budgets (x)
US GDP	11,347	11,553	11,841	12,264	12,638	12,976	13,254	13,312	0.94
US Corporate profits	784	872	978	1,247	1,456	1,608	1,542	1,360	0.75
IT budgets	540	536	550	590	632	679	752	820	

Source: Bureau of Economic Analysis, Industry data, Ambit Capital Research

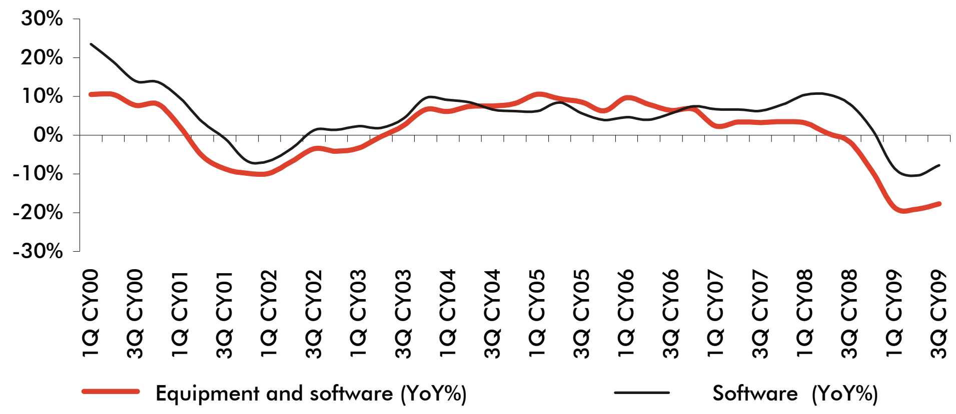
Exhibit 11: Recovery in US GDP & corporate profits augurs well for IT budgets



Source: Bureau of Economic Analysis

- **US technology capex — a fair proxy for discretionary spend, shows smart rebound:** We believe US technology capex (represented by US private fixed investment in equipment and software), is a fair proxy for discretionary spend. A rebound in this capex exudes the business confidence which augurs well for ISPs, given their higher participation in the growth budgets.

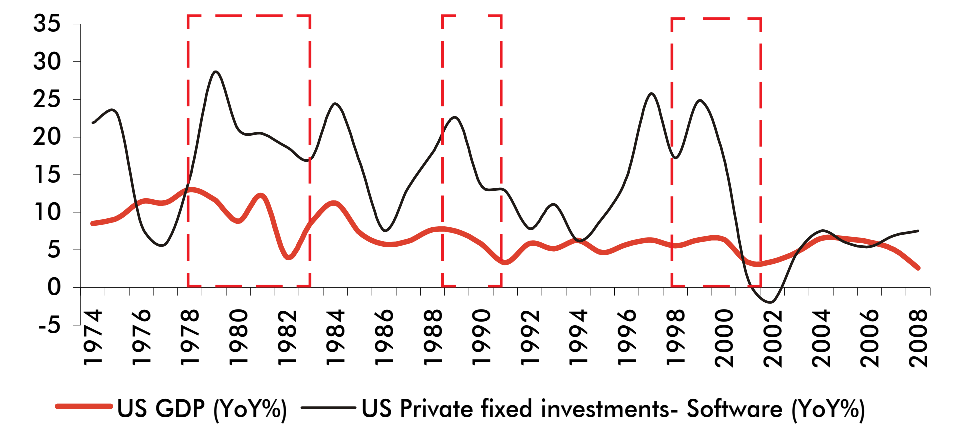
Exhibit 12: US technology capex is on a rebound



Source: Bureau of Economic Analysis

- **Recovery in IT budgets has been strong in the economic upcycle:** Our analysis indicates that the IT spend has historically fallen more than the GDP during recessive periods. However, the recovery has also been sharp in the economic upcycle (barring the 2001-2002 downturn, which was led by the technology bubble). We expect this trend to play out in the current economic upcycle as well. We have used US private fixed investment in software as a proxy for technology spend for the above analysis due to unavailability of historical data on IT budgets from industry sources.

Exhibit 13: IT spend tends to fall more than GDP during recessive periods but the recovery is sharp too



Source: Bureau of Economic Analysis

Europe IT spend recovery will likely lag the US

- **Europe data points indicate a tepid recovery; prefer Infosys which has the lowest Europe exposure:** Recent GDP data from Eurostat has brought concerns on sustainability of Europe's recovery. GDP growth for EU27 has been anemic at 0.1% in 4QCY09 vs. 0.3% in 3QCY09. The main reasons behind the tepid growth seem to be the weak labour market and patchy consumer spending. The recovery is still being supported by government stimulus programs, now under siege in countries like Greece, Spain and Portugal due to growing turbulence in financial markets about government debt. Hence, we believe that European IT spend will likely lag the US IT spend where data points on macro recovery look relatively more encouraging.

However, while UK is lagging behind the US, Continental Europe seems to be under deeper trouble. ISPs currently have a lower exposure to Continental Europe -~7% to 12% of revenues. We believe that companies with higher exposure to the US might be better placed in the recovery cycle. To that extent, we prefer Infosys which has the lowest Europe exposure (21.9% in 3QFY10).

Exhibit 14: EU GDP is witnessing a tepid recovery

CY09 GDP (QoQ%)	1Q	2Q	3Q	4Q
EU 27	-2.5	-0.2	0.3	0.1
UK	-2.6	-0.6	-0.3	0.3
France	-1.4	0.3	0.2	0.6
Germany	-3.5	0.4	0.7	0.0
Spain	-1.7	-1.0	-0.3	-0.1
Portugal	-2.0	0.6	0.6	0.0
Greece	-1.0	-0.3	-0.5	-0.8
US	-1.6	-0.2	0.6	1.4

Source:Eurostat

Exhibit 15: Infosys is better placed v/s peers due to lowest Europe exposure

3Q FY10 (% of revenue)	Europe	Continental Europe
Infosys	21.9	7-8
TCS	26.4	10.4
Wipro	26.3	11-12
HCL Tech	29.5	na

Source:Company

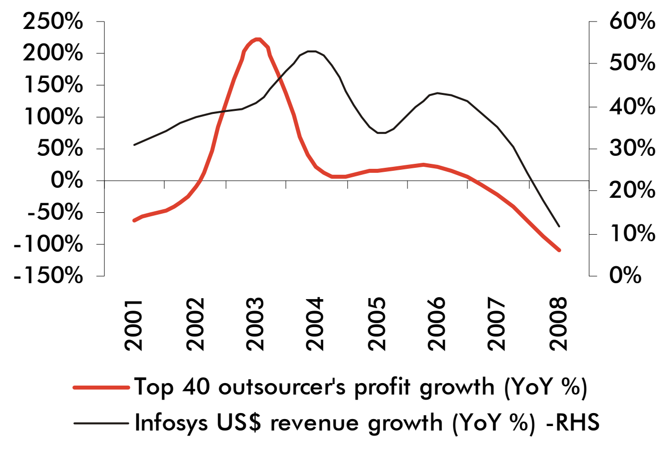
Analysis Of Client Data Points

We believe that the profit trends of the large outsourcers are key indicators for the revenue growth of ISPs. Our analysis of the top 40 customers indicates that this has been a meaningful indicator of troughs and peaks for ISPs revenue growth. An improvement in the client's profit level presents a strong case for recovery in IT budgets. Additionally, increase in client's SG&A spend could suggest a comeback phase for discretionary spending.

Analysis of client data also points to a revival

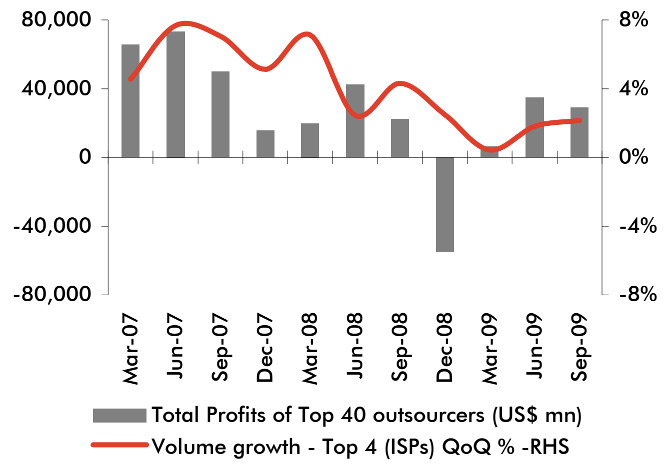
- **Volume growth has tracked top 40 outsourcers' revenue growth by 2 quarters:** We have used Infosys' volume growth data (due to availability and consistency in historical data) as the benchmark and we find that it has closely tracked the top 40 outsourcers' profit growth by ~1-2 quarters. Consensus estimates indicate further pick-up in the revenue and profit growth rate for these customers, which we believe signals the ISPs' strong growth trajectory for FY11E/12E.

Exhibit 16: Infosys' revenue growth has closely followed top 40 outsourcers profit growth



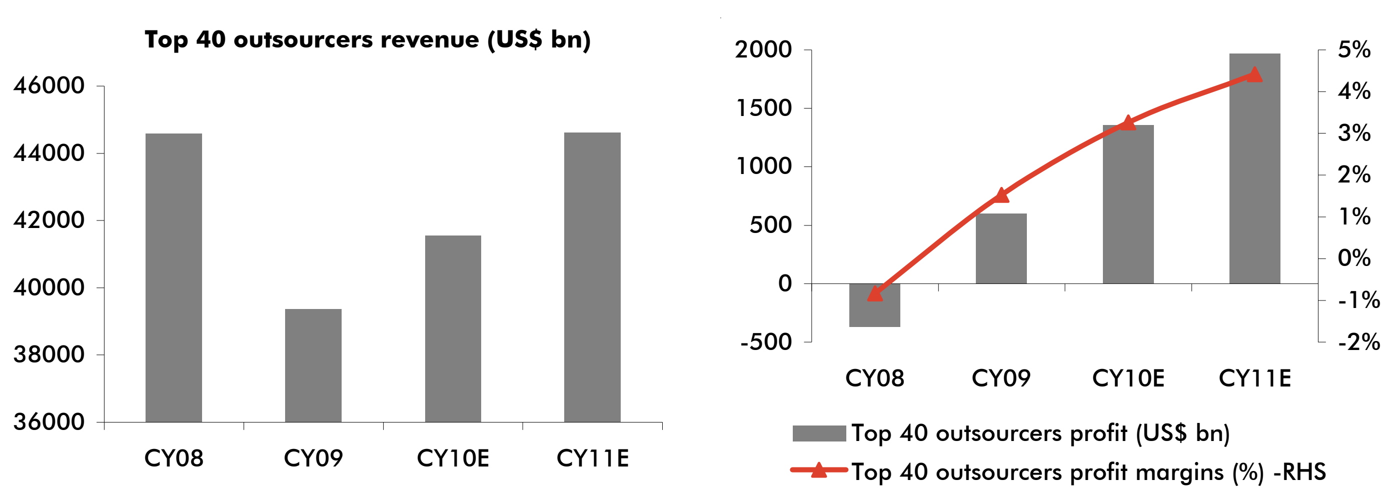
Source: Bloomberg, Company

Exhibit 17: Quarterly trend of top 40 outsourcers' profit v/s volume growth of top 4 ISPs



Source: Bloomberg, Company, Ambit Capital Research

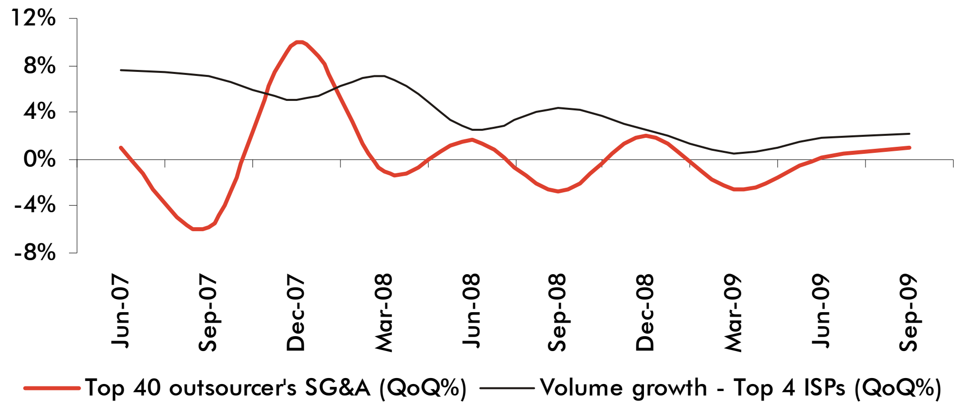
Exhibit 18: Estimates for top 40 outsourcers' projects a recovery which charts a positive revenue trajectory for ISPs



Source: Bloomberg

- **Pick up in SG&A spend for top 40 outsourcers indicates uptick in discretionary spend trend for ISPs:** We have analysed the trend in sales, general & administration (SG&A) expenses for the top 40 outsourcers, which indicates an upturn. While this does not directly imply an uptick in the technology budgets, as IT spend typically constitutes only a portion, (some also gets accounted under the business functions), it suggests a pick-up in the discretionary spending trend.

Exhibit 19: Client's SG&A spend pick-up suggests upturn in discretionary spending



Source: Company, Bloomberg

Robust Offshoring Demand

With increasing confidence that the economy has bottomed out, companies are making exacting assessments of business models in response to the changed external environment and are becoming more amenable to offshoring. Improvement in decision-making cycles and deal closures have led to increase in the volume growth trajectory for ISPs. However uptick in discretionary spend has been feeble, and has picked up marginally in BFSI and Retail till now. A further pick-up in discretionary spend across these verticals and other lagging verticals would drive the volume trajectory for FY11E/12E.

Setting the stage for robust offshoring demand

- **Better macro environment has improved decision-making cycles and deal closures:** The improved economic parameters have translated into better business confidence that has consummated into relatively quicker client decision-making cycles and deal closures.

  At the height of economic instability, clients were looking for stop-gap adjustments for their business models and strategies that would yield immediate cost savings - reducing headcount and divesting businesses. The indecisive phase had resulted in a freeze on discretionary spend, pressure on volumes and billing rates during the trough of the downturn. Improvement in the macro variables has brought the decision making cycles close to normalcy.

- **Faster decision-making cycles rather than budget flush is leading to volume uptick for ISPs:** Our interaction with company managements also indicates that while pipelines are improving, they are also progressing relatively quickly towards deal signings. All the tier-1 ISPs have witnessed strong volume growth in 3QFY10 after 2-3 quarter decline. While there could be some element of budget flush, we believe that it is primarily the faster decision-making cycles which has resulted in strong volume uptick for ISPs.

  We believe further pick-up in discretionary spending particularly in relatively subdued verticals and return of client confidence to spend approved budgets, should drive volume growth for ISPs. We have built in volume CAGR of 18.5-22.0% for our coverage universe over FY10E-12E.

Growth Trajectory Improving For Global IT Companies And ISPs

- The Technology index has outperformed the S&P500 by a significant margin of 61%. EPS upgrades for the technology sector within the S&P500 has been the highest at 9.1%. Global technology companies have turned positive on their business outlook. The recent key highlights from the global technology bigwigs are presented in exhibit 22.

Exhibit 20: Technology has outperformed S&P500 by 61% in CY09

S&P 500 Sector Price Performances and Rankings -- 2000-2009

	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
Best	U +51.7	CD +1.9	CS -6.3	IT +46.5	E +22.7	E +29.1	E +58.3	E +32.4	CS -17.7	IT +61.0
|	HC +35.5	M +1.0	M -7.7	CD +36.1	U +13.6	U +12.8	U +31.0	M +20.0	HC -24.5	M +46.9
|	F +23.4	I -7.0	E -13.3	M +34.8	TS +9.9	HC +4.9	F +20.5	U +15.8	U -31.5	CD +40.7
|	CS +14.5	CS -8.3	F -16.4	I +29.7	I +9.9	F3.7	TS +19.7	IT +15.5	TS -33.6	S&P +24.7
|	E +13.2	F -10.5	HC -20.0	F +27.9	S&P +9.0	S&P +3.0	M +18.1	CS +11.6	CD -34.7	I +19.1
to	I +4.5	E -12.3	S&P -23.4	S&P +26.4	CD +6.1	M +2.2	S&P +13.6	I +9.8	E -35.9	HC +18.6
|	S&P -10.1	HC -12.9	CD -24.4	E +22.4	M +4.7	CS +1.3	CS +13.0	TS +8.5	S&P -38.5	F +15.1
|	M -17.7	S&P -13.0	I -27.6	U +21.1	F +2.2	IT +0.4	I +11.2	HC +5.4	I -41.5	CS +12.6
|	CD -20.7	TS -13.7	U -33.0	HC +13.3	CS +0	I +0.4	HC +10.5	S&P +3.5	IT -43.7	E +12.2
|	TS -39.7	IT -26.0	TS -35.9	CS +9.2	IT -3.9	CD -7.4	CD +8.4	CD -14.3	M -47	U +8.4
Worst	IT -41	U -32.5	IT -37.6	TS +3.3	HC -5.8	TS -9.1	IT +8.1	F -20.8	F -56.9	TS +3.7

CD = Consumer Discretionary　F = Financials　IT = Info. Tech.　U = Utilities
CS = Consumer Staples　HC = Health Care　M = Materials　S&P = S&P 500
E = Energy　I = Industrials　TS = Telecom Services

Source: S&P

Exhibit 21: EPS upgrades have been the highest for the technology sector

Particulars	CY10 operating EPS change
S&P 500	2.7%
Consumer Discretionary	5.2%
Consumer Staples	0.4%
Energy	0.3%
Financials	3.8%
Health Care	0.1%
Industrials	2.1%
Information Technology	9.1%
Materials	-1.6%
Telecommunication Services	-2.8%
Utilities	0.2%

Source: S&P

Exhibit 22: Commentary from the global IT companies

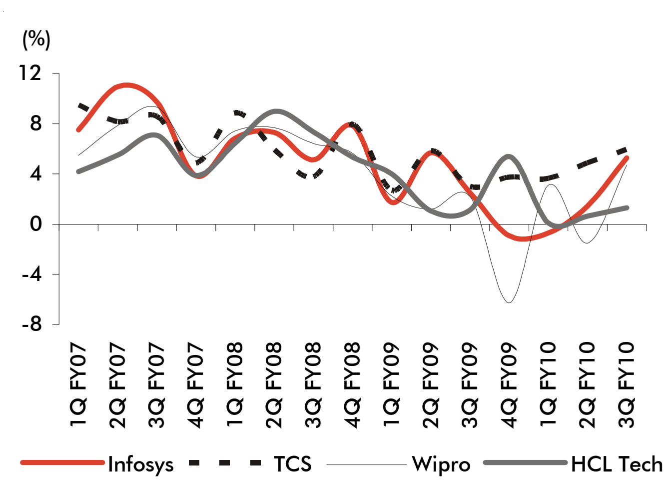
Company	Comments
Oracle	▪ 2Q FY10 revenue growth of 4% YoY and PAT growth at 12% YoY in US$ terms. ▪ New software license revenue, a closely-watched metric for the trend in discretionary spending grew by 2% following several quarters of decline. ▪ Oracle has typically been more conservative in its public pronouncements. The optimistic note in the management commentary "We are definitely seeing customers back buying. We are really seeing a recovery" adds to the comfort.
SAP	▪ 4Q CY09 revenue decline of 9% YoY and PAT decline of 12% YoY in Euro terms. ▪ Expects CY10 revenue growth at 4 to 8% YoY vs. decline of 3% YoY in CY09 ▪ "There is a lot of pent-up demand at the high end of the market" ▪ "One of the best demand indicators is pre-sales as they get increasingly involved on the customer site.Our pre-sales team has been busier now than they have been in the past, so we are actually encouraged by that" ▪ "Witnessing more pipeline activity and real increase seen in the smaller sized deals". ▪ "Financial services is doing very well for us"
Microsoft	▪ Customers are coming out with RFPs, issuing them, and taking them through to conclusion. ▪ "I think what's happening in the enterprise is good news in the sense that most enterprises are saying that whereas previously I might have waited for what we call the SP1 or SP2 version of the product to come out before considering implementation, they're actually willing to go with the current release".
Accenture	▪ Management pointed to a increase in smaller sized deals which remains a sweet spot for Indian vendors ▪ Consulting space has seen a good build up particularly in the financial services space.
Intel	▪ PC inventories remain at healthy levels v/s the demand expected in the next couple of quarters. ▪ Majority of the demand is consumer driven and corporate spending is still coasting around the water.

Source: Company, Industry data

ISPs strong 3QFY10 volume growth removes any doubts of a demand revival

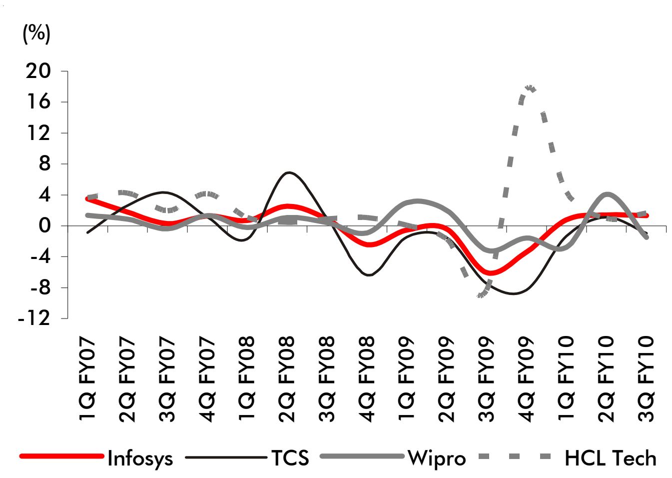
- **Strong volume led growth in 3Q FY10:** ISPs' 3QFY10 revenue growth has been strong surpassing guidance and expectations by a huge margin. All the tier 1-ISPs registered positive QoQ volume growth for the first time in the last four quarters despite a seasonally weak quarter. Pricing realisation remained primarily stable, barring Wipro, which was due to the impact of lower number of working days (-3.5% onsite; -0.5% offshore) getting reflected in the pricing.

Exhibit 23: Strong volume growth in 3QFY10



Source: Company

Exhibit 24: Pricing has stabilised in 3QFY10



Source:Company

- **Top 10 clients lead the growth:** Strong performance in top 10 clients across the ISPs (except HCL Tech) was the highlight of 3QFY10. An all-round improvement in the client base (top 10-20) will further drive growth, as the economy continues to stabilise.

Exhibit 25: Strong growth in top 10 clients led ISPs 3Q FY10 revenue growth

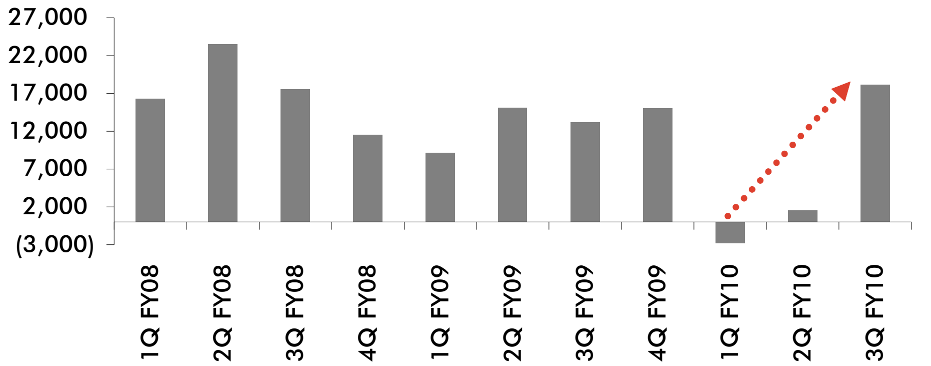
	1Q FY09	2Q FY09	3Q FY09	4Q FY09	1Q FY10	2Q FY10	3Q FY10
Top 10 client revenue (QoQ%)							
Infosys	-4.8	-2.1	-6.4	-5.7	-3.7	4.5	12.1
TCS	-2.2	-1.9	-7.9	-1.2	7.5	7.3	10.0
Wipro	4.0	1.5	-1.9	-7.3	3.2	-1.3	4.7
HCL Tech	1.5	-1.7	-3.7	1.2	-2.5	-2.3	-0.4
Ex- top client revenue (QoQ%)							
Infosys	4.0	8.4	-2.6	-3.8	1.4	2.4	4.9
TCS	1.7	5.2	-5.0	-4.2	1.7	2.6	4.8
Wipro	3.4	4.6	-0.6	-4.3	-2.4	4.3	6.0
HCL Tech	6.0	1.7	2.2	20.5	14.1	7.4	5.4

Source: Company

Optimism reflected in companies hiring plans

- **Upward revision in hiring plans and a comeback of lateral hiring:** Trend in employee addition, which remains a good proxy for future demand, has been strong in 3QFY10. Net addition has increased by 37.6% YoY. Further, management's hiring outlook has turned positive: (a) TCS has mentioned about 'aggressive' hiring and is targeting 30,000 hires in FY11E; (b) Wipro which has followed just-in-time hiring has mentioned that it will honour all the pending 7,500 trainee offers by June 2010 (c) Infosys has revised its gross hiring target upward yet again by 20% to 24,000 for FY10E. The remarkable point here is, lateral hiring has picked up after a long hiatus, clearly reflecting the improved business confidence.

Exhibit 26: Trend in net employee addition



Source: Company, Ambit Capital Research

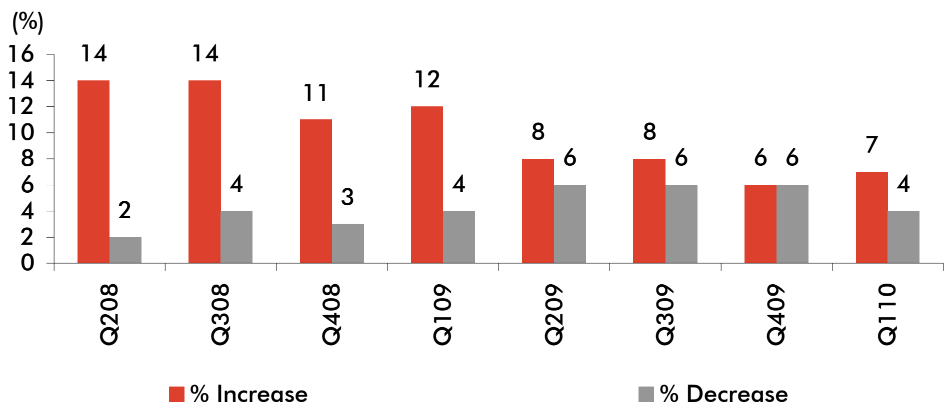
- **Recruitment agencies and industry surveys share the optimism:** Our recent interaction with top recruitment agencies corroborates the optimism seen in the companies hiring plans. According to our channel checks, hiring has picked up strongly in Bangalore and NCR while Chennai, which was subdued on relative basis is starting to pick up. Further, according to Naukri Job Speak (job index by Naukri.com), IT-Software hiring index has moved up by 10% in January 2010 on a MoM basis, reinforcing the comeback of recruitment drives.

- **Technology sector hiring expected to pick up in the US:** The optimism in hiring is not just restricted to technology sector in India but is evident even in the US. A recent survey by Robert Half Technology (a global staffing and consulting firm), indicates that US IT hiring is expected to pick up in 1QCY10 and CIOs are increasingly optimistic, as they begin with new CY10 budgets. The highlights from the survey that paint a relatively positive picture for the IT industry, are presented below.

- 42% of CIOs are confident that their companies will invest in IT projects in 1QCY10
- Net 3% increase in hiring activity is the strongest forecast since 1Q CY09.
- 19% respondents mentioned it was most challenging to find skilled IT professionals in networking, followed by security (13%) and applications development (10%).

- **Survey indicates that 43% CIOs' find their IT departments understaffed:** We believe that several companies have already cut technology staff levels too deeply, making it challenging for IT departments to keep pace with the business expansion demands. According to the survey, 43% of CIOs believe that their IT departments are understaffed versus their respective workload. We believe that considering the clients' unfaltering focus on cost take-outs and unwillingness to take on fixed commitments, such jobs would naturally become amenable to offshoring.

Exhibit 27: Intent to hire IT Staff has been the highest since 1QCY09

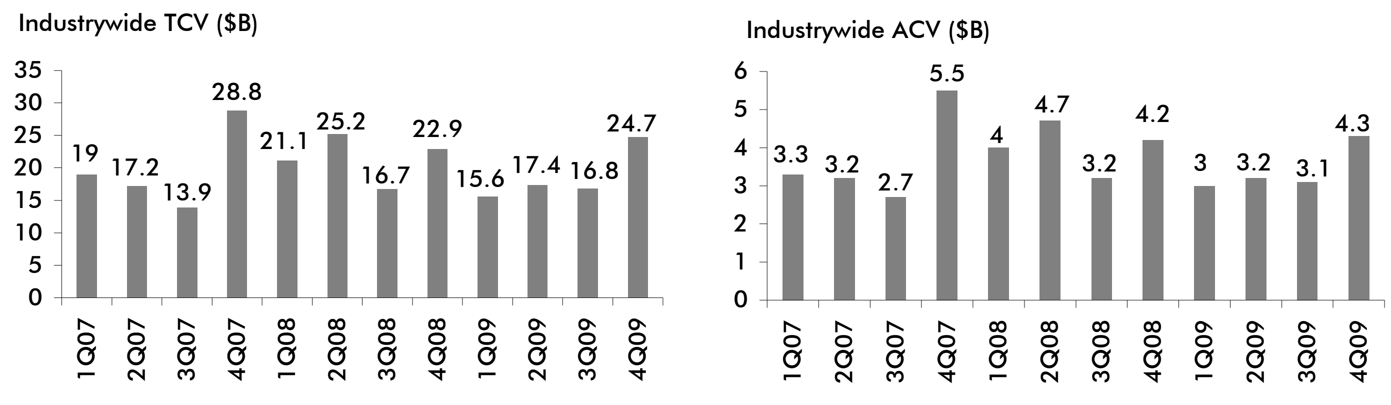


Source: Robert Half Technology

TPI data points confirm the revival

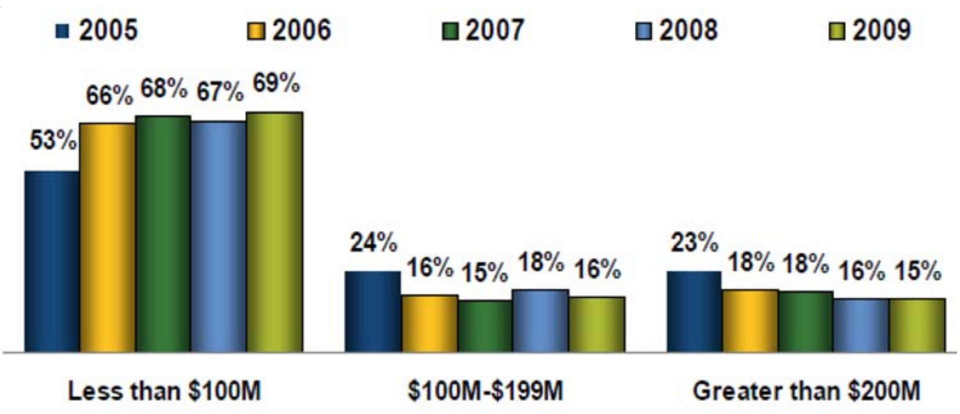
- The recent 4QCY09 TPI index data (offshore advisory firm) indicates that the market for large deals had bottomed out in 1HCY09 and witnessed a smart rebound in 2HCY09. The three large verticals, Financial Services, Manufacturing, Telecom and Media showed strong increases in 2HCY09. Further, industry shift towards smaller deal sizes continue, which is the sweet spot for tier-1 ISPs.

Exhibit 28: 4Q CY09 TCV and ACV are the best since 2QCY08



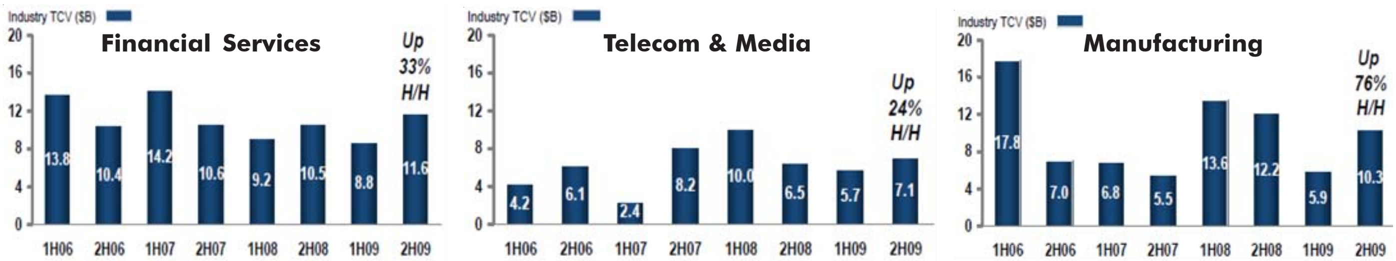
Source: TPI

Exhibit 29: Shift towards smaller deal sizes is a positive for ISPs



Source: TPI

Exhibit 30: Large verticals have staged a smart rebound in 2HCY09



Source: TPI

What Are The Key Growth Drivers?

On the vertical front we expect BFSI, which has led the global recovery and ISPs' growth rebound, to be the primary growth driver through FY11E-12E. ISPs are benefiting from - incremental work in newer areas (M&A risk and compliance), gains from vendor consolidation wins and incremental offshoring from relatively low adopters.

Amongst other large verticals, Manufacturing and Telecom are showing encouraging signs of a revival driven by cost cutting, capex revival and return of confidence to spend the approved IT budgets. Pick-up in discretionary spend in these verticals should further aid the growth momentum in FY11E/12E.

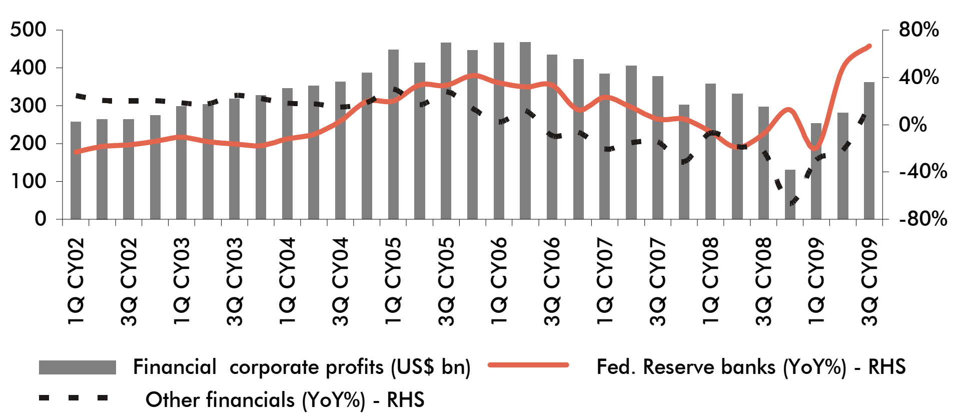
On the services front, we believe the ISPs' services portfolio still has enough steam for growth, as penetration in most service lines remains low. Penetration in newer services such as Infrastructure management services (IMS) remains at merely 2.0 %.

BFSI to be the primary growth driver

- **Global BFSI outlook improving:** BFSI sector has historically been the most mature in leveraging technology and forms the largest pie of the global IT spend (17.3% of total IT budgets). While the 'Great Recession' led by the BFSI sector saw a near systemic collapse in the banking system, a collaborative pull led by various governments has successfully averted the disaster.

  The global financial sector has been witnessing stability and corporate profits from US financial firms have witnessed a sharp rebound. Disclosure from Citigroup indicates that the TARP capital has been used to fund new initiatives and expand the flow of credit. This is also evident in the improving consumer lending patterns. Further, large US banks are repaying the TARP (Troubled Asset Relief Program) funds, which is a tangible sign of the banks financial health and removes them from the shield of government control.

Exhibit 31: Corporate profits of financial firms has witnessed a strong rebound



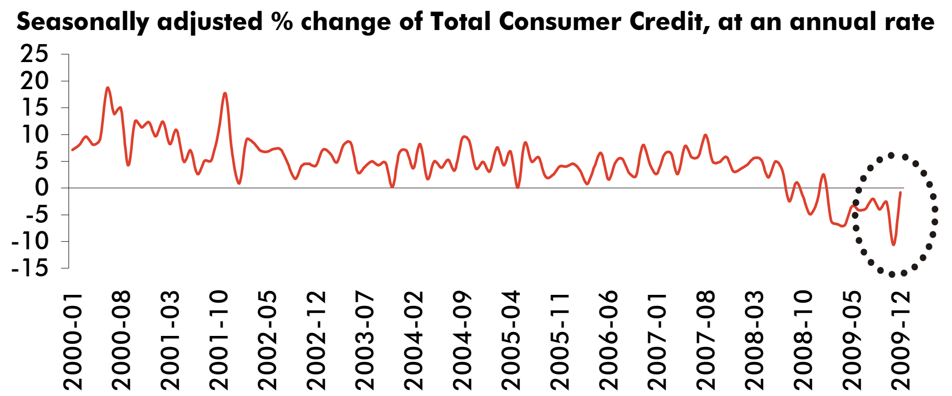
Source: Bureau of Economic Analysis

Exhibit 32: Large banks are paying back TARP funds

Goldman Sachs
Morgan Stanley
American Express Co
Bank of New York Mellon Corp
Northern Trust Corp
State Street Corp.
U.S. Bancorp
BB&T Corp
Capital One Financial Corp
Bank of America
Wells Fargo
Citigroup

Source: Industry data

Exhibit 33: Stimulus packages have contained decline in consumer lending



Source: Fed reserve

Exhibit 34: Aggregate TARP capital initiatives by Citigroup

Particulars	(US$ bn)
Supplier financing	2.0
U.S Prime residential mortgage securities	7.5
Conforming mortgage securities	10.0
Auto loans	0.3
Corporate loan securitization	1.5
Municipals	9.0
Residential mortgage loans	1.4
Cards	5.8
Business and personal loans	4.1
Trade receivables financing	3.0
Non-conforming mortgage loans	8.2
Student loans	1.0
Total as on 30th Sept 2009	**53.8**

Source: Citigroup

- **BFSI revenues returning to normalised pace for ISPs:** BFSI revenue for ISPs has witnessed recovery wherein growth levels are close to the pre-crisis levels. ISPs have been successful in increasing their share of wallet with the clients by garnering incremental work in newer areas such as M&A, risk and compliance etc. In fact, BFSI is witnessing an early recovery in discretionary spend as well, an area where other large verticals such as Telecom and Manufacturing remain subdued.

Exhibit 35: ISPs have witnessed a rebound in BFSI revenues

BFSI revenue (QoQ %)	1Q 08	2Q 08	3Q 08	4Q 08	1Q 09	2Q 09	3Q 09	4Q 09	1Q 10	2Q 10	3Q 10
Infosys	5.0	11.3	6.9	-3.1	3.0	1.9	0.7	-9.5	0.0	4.5	10.3
TCS	11.2	12.7	7.9	0.5	-2.5	1.8	-5.8	-1.3	5.9	6.5	6.3
Wipro	9.3	10.6	8.0	7.4	5.6	7.7	-2.0	-4.9	-0.1	0.8	6.2
HCL Tech	14.0	8.4	9.3	2.3	-0.1	0.9	1.2	-5.2	13.1	10.0	2.6

Source: Company

- **ISPs benefiting from increased offshoring and vendor consolidation:** Sceptics were concerned of ISPs' scope for increasing share within BFSI clients given their maturity towards offshoring. However, anecdotal evidence suggests that ~30-40% of large banks that had adopted offshoring but had some reservations, have made the choice to increase offshoring spend driven by stringent cost control measures. Further ISPs have benefited from the vendor consolidation wins, the full benefit of which can be witnessed in FY11E.

- **Priority shift within IT spend with newer spend areas emerging:** Banks are seen deploying higher spend on more strategic areas such as risk and compliance, audit and post-merger related system integration projects. Industry conversations indicate that spending on customer loyalty and multi-channel customer experience related spend have also been assuming greater priority in the IT spend plans.

Exhibit 36: Areas where BFSI clients are spending

Post merger integration due to increasing industry consolidation
Risk and compliance spurred by new regulations
Process and platform consolidation given increased scrutiny on cost & control matters
Improving customer experience to cross-sell/ up-sell and improved customer insight

Source: Industry data

However, the large transformational deals which incorporate more business driven changes such as 'differentiated positioning' etc. are still elusive from the deal landscape. Such deals also require higher consulting capabilities and deeper domain knowledge for which ISPs are honing their skills. The other change point is that as ISPs pursue transformational deals increasingly, the buyer changes from the typical CIO to CxO. This implies that ISPs must adapt to a sales approach that requires greater selling based on a business perspective rather than just technology. The fact that ISPs have recognised this change is driving them to adapt to these changes.

- **ISPs benefiting from industry consolidation:** Post the consolidation witnessed in the global BFSI landscape, most banks have started integrating their software applications, consolidating data centers and other trading platforms into a single entity (e.g. BOA-ML, Citigroup, JP Morgan). Tier-1 ISPs have been well placed in vendor consolidation exercises and have had favourable outcomes in most of the post-merger integration related RFPs.

We would like to highlight that post-merger technology integration work is typically more complex and has essentially been the domain of MNC players given their higher exposure to business consulting. However, ISPs have been able to win several projects in this area with deal sizes ranging from US$50-US$75mn. Infosys is currently working on six M&A related deals, Wipro on two and TCS, several. ISPs were well placed to win deals of such profiles as:

- In this downturn, ISPs had built formidable relationships with the large banks versus the last downturn (2001-2002).
- From the perspective of large banks, ISPs possessed a successful record of working on a diverse range of services and technologies. Given this, banks were open to offshoring not just for cost arbitrage (although that remains the primary motive) but also for more complex work.

The 'Volcker rule' and the possible ramifications

- **The 'Volcker rule' has brought regulatory risks to the forefront:** With the Obama government seeking to repair the US financial system, regulatory risks have come to the forefront. Obama's recent proposal to "restrict the size and scope of financial institutions to rein in excesses and protect taxpayers" was not taken positively by the US markets. Although finer details are awaited, the proposal focuses on eliminating hedge funds, private equity funds and proprietary trading unrelated to customers, at banks.
- **The apparent question that emerges is: How does this proposal impact Indian IT vendors?** While the enactment itself remains in doubt, it is even more difficult to determine the potential ramifications of the proposal. That said, we believe that the 'Volcker rule' is more to do with the spirit rather than the letter and regulatory concerns are unlikely to subside soon.

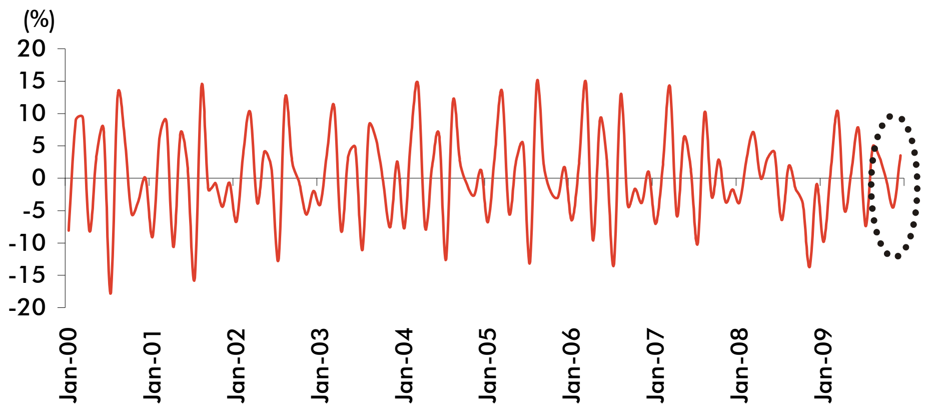
  We believe that any sweeping change in the regulatory environment could introduce uncertainty in the short term impacting any new incremental IT spend. This, in our view, could be a near term risk for the ISPs; but to reiterate 'only if it becomes a law'. That said, any regulatory impact is also bound to have a huge technological change in the medium term and, in our view, will likely benefit the ISPs, as investments into newer technologies and incremental pressure to increase profits, drive IT offshoring.

Other large verticals - Telecom and Manufacturing show improving trends

Manufacturing (16.8%) and Telecom (12.7%) are the two large verticals in terms of global IT spend after BFSI. Though both have lagged in the recovery cycle; for most ISPs, both have shown return to growth in 3QFY10. While discretionary spend in both these verticals remains subdued presently, return of confidence and cost cutting initiatives would drive newer spend.

- Cost cutting appears to be a strong theme across the sub-verticals (process, discrete, resources, aerospace, automotive) within Manufacturing. Further, there is increased buoyancy (except auto, which has undergone a structural change) arising from the need for internal consolidation of the IT landscape, back office functions and supply chain optimisation. Even Continental Europe, which has not been as open to offshoring, has been mandating the increasing use of GDM (global delivery model) in their IT spend plan.

Exhibit 37: Rebound in manufacturing sales indicates pick up in real economy



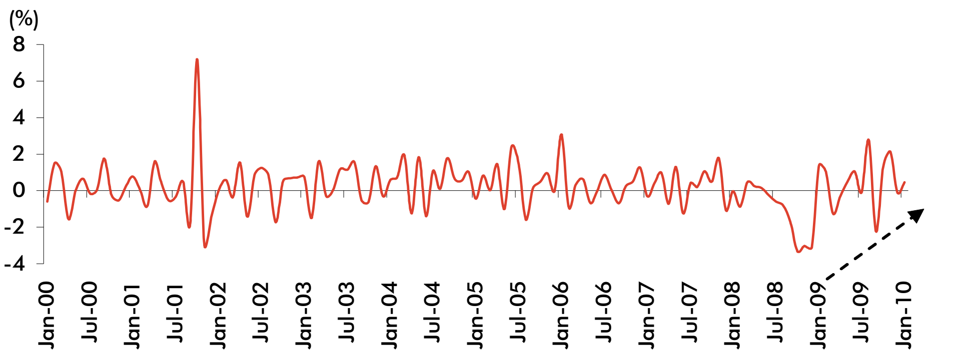
Source: U.S. Census Bureau

- ISPs' exposure in Telecom is primarily restricted to telecom service providers (TSPs) except Wipro. Capex cutback by TSPs and lack of confidence in spending approved budgets impacted ISPs' telecom growth in the downturn.The return of confidence and capex cycles is now driving release of newer projects, leading to ISPs growth in 3Q FY10.

Retail is a classic example of lesser mature vertical taking to incremental offshoring

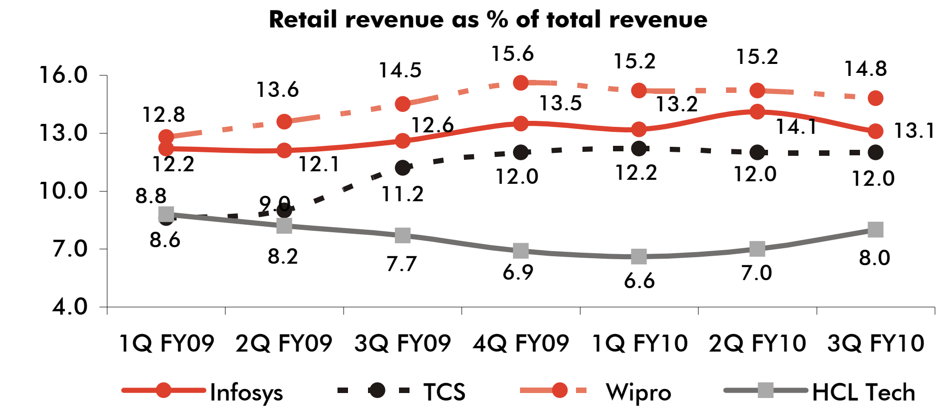
- **Retail has performed well primarily due to higher offshoring:** US retail sales has picked up suggesting improved consumer spending patterns . Retail (9.5% of global IT spend) is a relatively less mature vertical in terms of offshore adoption - more skewed towards in-sourcing and reluctancy to offshore as they are directly linked to the end consumers. However, it is a classic example of how the downturn has pushed this vertical towards higher offshore adoption. Aggressive cost cutting initiatives, investment into front-end systems, e-commerce initiatives and vendor consolidation wins by some of the large retail firms has been driving ISPs growth. Retail as a percentage of revenues has increased by 100-350bps for ISPs (except HCL Tech) since 1QFY09. Offshore revenue mix for Infosys' retail vertical has grown from ~35% (pre-downturn levels) to 40% currently which reflects the increased client confidence on offshoring.

Exhibit 38: US retail sales have shown a rebound



Source: U.S. Census Bureau

Exhibit 39: ISPs retail revenue mix has been growing well

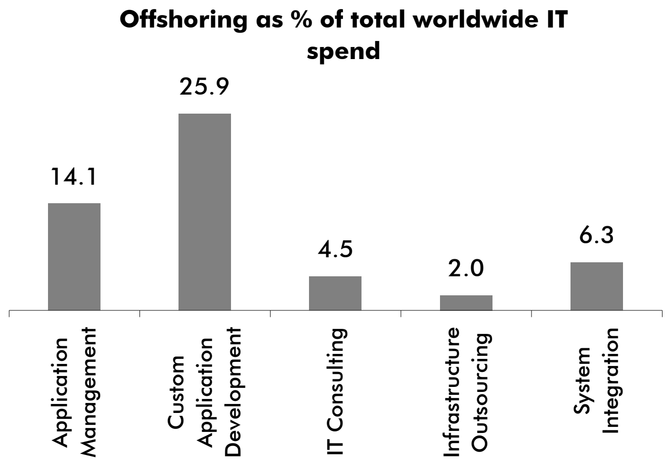


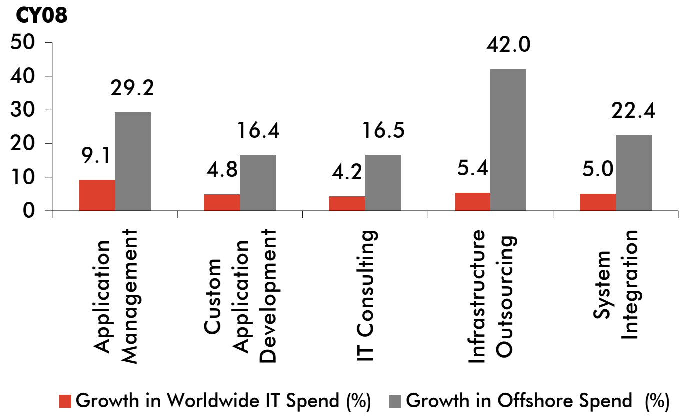
Source: Company

Services perspective

- **Services portfolio offers scope for greater market penetration:** We believe that the ISPs services portfolio still has enough steam for growth as penetration in most service lines remains low. Offshoring within Application management — widely regarded a mature service offering — is still only 14.1% of overall spending. Infrastructure services — a high spend area — is at a negligible 2.0 % of total spend. We believe ISPs have enough scope for expansion, especially within the newer service lines such as Infrastructure outsourcing, which also holds a potential for higher offshore delivery mix.

Exhibit 40: ISPs services portfolio has enough scope for growth





Source: NASSCOM Strategic Review

Cloud computing - ISPs are in the race as well

Cloud computing which has become the buzzword is touted as the next big disruptive technology wave. While cloud computing is expected to become a dominant software delivery model, it is still at a nascent stage.

- **What is cloud computing?** In simple terms, cloud computing is a service to the user, the cloud is IT- that is delivered by virtualised resources, independent of the location. The advantage to the client is:The ability to host large amounts of data without sunk costs, faster deployment and better capacity planning.
- **What is the opportunity size?** According to IDC, cloud services form US$16bn out of the US$383bn spent on IT services (4.5%) which is expected to go up to US$42bn by 2012 (8.5%).
- **Where do ISPs stand?** While ISPs have been watchful of the cloud adoption trend, the common perception is that they have not been creating enough visibility for their cloud based offerings. ISPs,in our view, have adopted a 'follower' approach but that is not to say that they have not been investing into cloud strategies. In fact most ISPs have options ready for this space. Our channel checks suggest that one of the tier-1 ISPs derives ~US$75 mn from cloud based offerings currently. Our view is that:
  - Firstly, traditional IT vendors such as IBM have large investments in IT infrastructure and are under far higher revenue displacement due to cloud computing. Moreover, cloud will not give a significant advantage to the vendors offering infrastructure. ISPs being asset light, do not have any such risks.
  - Secondly, while ISPs, in the past, may have been slower to adopt technologies such as ERP v/s peers like Accenture; in our view, they are probably not very far off with regard to cloud services. ISPs realise the need to be in the cloud play and have options ready for this space.

Exhibit 41: Cloud computing key areas

Type	Meaning	Market size (US$ bn) by 2012
Infrastructure as a Service	Computer infrastructure accessible via web	11
Platform as a Service	Development in the cloud (web)	10
Software as a Service	Application is hosted by provider and accessible via web	21
Total market for cloud computing by 2012		**42**

Source: Ambit Capital Research

View On Long Term Trends

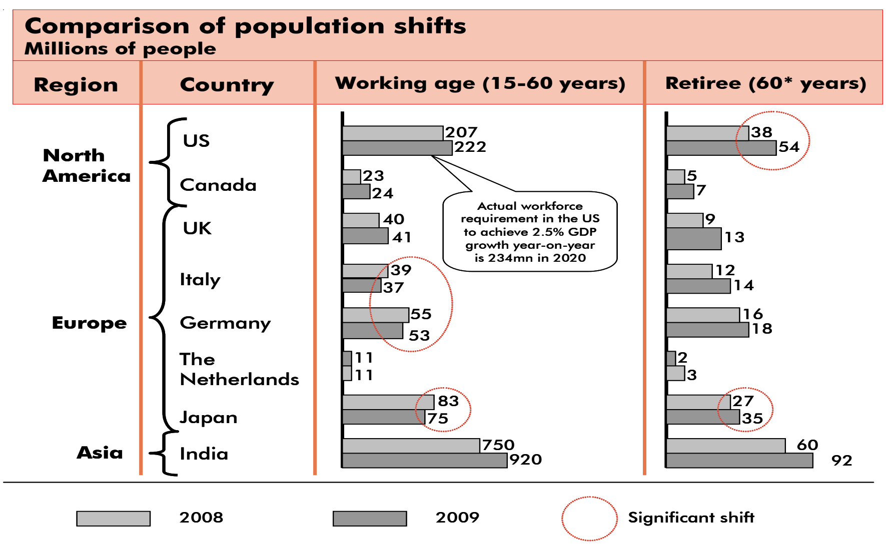
This write-up presents our view on two dominant long term trends which are emerging and could be impactful for offshoring. We believe that demographic shifts in the developed countries could be a secular driver for offshoring. The other dominant trend is the consolidation witnessed in the global technology space (Dell-Perot, Xerox-ACS). While the big-bang acquisitions are not likely to impact ISPs in the near term, it has brought uncertainty into the picture where - today's competitor is visible but tomorrow's is not. The possibility of a large offshore player getting acquired however could be more impactful.

Demographic shifts present a compelling case for offshoring

- **Skill shortages in developed countries:** Demographic shifts in the developed countries, in our view, could be the long term secular driver for offshoring (although less relevant in the current scenario with widespread joblessness). The clients (in developed countries) need for talent pools are accentuated by: (1) falling fertility rates; (2) increasing life expectancy; and (3) ageing workforce. Hence companies would not merely face the challenge of reducing total cost of ownership but deal with workforce shortages ahead.

- **India's demographic situation remains a secular driver for offshoring:** According to the US Labor Market Review, the proportion of the US working age population is expected to decline from 68% in 2008 to 63% in 2018. With the ageing of the baby-boom generation, (defined as persons born between 1946 and 1964), the older age cohorts are expected to make up a much larger share of the labor force. In 2008, the baby-boom cohort was 44 to 62 years of age. By 2018, almost all the baby boomers will be in the 55-years-and-older age group. Other developed countries such as Japan, Germany and Italy have a more severe problem. Even China is expected to have declining working population (72% in 2008 v/s 70% in 2020). In this context, India is well placed given an expected increase in working age population (63% in 2008 to 67% in 2020).

Exhibit 42: US and other developed countries workforce is ageing



Source: Nasscom McKinsey

- **Graduate enrolment in computer sciences in the US is declining while India's engineering output is growing in double digits:** Data from US National Science Foundation suggests that while the overall US graduate enrolments have been growing, computer sciences enrolments have been declining for four consecutive years. This compares with India's situation where India's engineering output has grown at a 13.5% CAGR over FY04-09E.

Exhibit 43: US graduate enrolments in IT is declining

Graduate enrolment (YoY %)	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
Total Science & Engineering	0.0	-0.9	-1.1	-1.4	-0.3	1.6	0.0	3.3	6.0	4.9	1.3	1.4	2.6
Science	1.0	0.3	-0.4	-1.2	-0.1	1.5	-0.6	2.8	5.2	4.5	2.5	2.4	2.8
Computer sciences	-5.7	-2.0	3.5	3.9	5.7	11.7	11.5	10.2	5.9	-2.8	-6.9	-4.1	-0.7
Engineering (incl.all streams)	-3.3	-5.2	-3.7	-2.0	-1.1	1.7	2.4	5.2	9.3	6.4	-3.0	-2.4	2.1

Source: National Science Foundation

Exhibit 44 : India's engineering graduate output has been growing in double digits

Total engineering output (Nos.)	FY04	FY05	FY06	FY07	FY08	FY09E
Graduate engineering	240,000	271,300	323,600	372,400	392,400	451,700
YoY%	(0.3)	13.0	19.3	15.1	5.4	15.1
Technology graduate	141,500	159,900	190,400	219,000	233,100	268,622
YoY%	(0.4)	13.0	19.1	15.0	6.4	15.2

Source: Nasscom

Consolidation in the global technology industry: Today's competitor is obvious but not tomorrow's

- **Industry consolidation accelerating:** The global IT services landscape has witnessed a spate of acquisitions, with the large ones such as Dell-Perot and Xerox-ACS stepping up the trend of large hardware companies making the leap into IT services business. Besides, barring IBM, Accenture and HP-EDS, none of the other MNC players have been able to achieve a dominant offshore presence. These players could also be looking at acquisitions to increase their offshore presence.

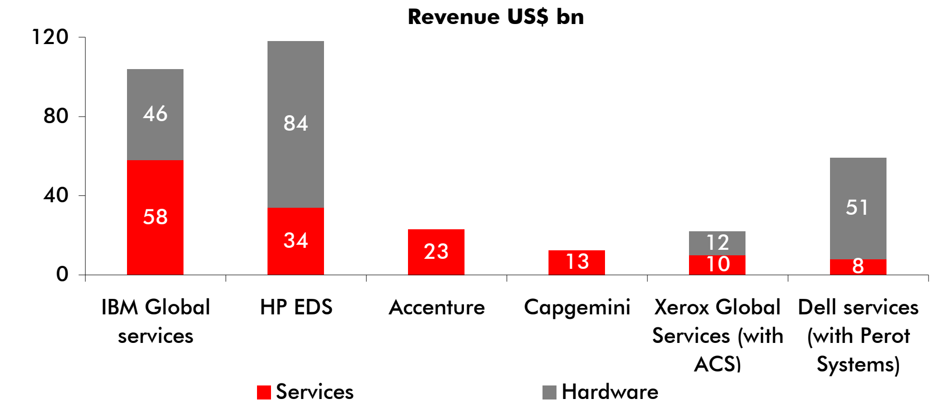
Reasons why hardware companies chose to enter the IT services space:

- Significant revenue and margin pressure and need to diversify revenue and product lines
- Potential opportunities to cross-sell into each company's respective customer base

However, several challenges accompany these deals:

- Culture is one of the greater unknowns of any merger - a services firm's culture is far different from that of a product company.
- Integrating the sales organisations is a challenging task.
- Managing the pressure to sell the parent company's products

Exhibit 45: Changing IT services landscape



Source: Company, Industry data

How does this impact Indian IT services?

- **No near term impact on ISPs ...:** While the big-bang acquisitions in CY09 have propelled acquirers into the big league of services business (with reasonable offshore delivery capability), we do not expect the trend to be a game-changer for ISPs. Currently, Perot is more focused on healthcare (48% of revenue) and the government (25% of revenue) vertical; ISPs are currently not very large in these businesses and hence it does not threaten their current turf. ACS has a stronger presence in BPO space (79% of revenue) and does not have a dominant India presence.

- **... but ISPs should not view this trend as mere distraction:** Consequently, while the acquisitive moves lend credibility to the offshoring model (Perot has a reasonable offshore presence and so did EDS when it was acquired), the underlying changes in the technology landscape should not be viewed as mere distractions.We reckon that while 'today's competitor is obvious, tomorrow's is not'. An example, Dell-Perot's combined services revenue would be ~US$8bn, which is still far lower when compared to biggies such as IBM, HP-EDS. Dell might be motivated to acquire a large offshore player to increase its services presence. In such a circumstance, acquisition of a large credible offshore player (such as Cognizant/HCL Tech) cannot be ruled out and such a move will have a wide-ranging impact on ISPs.

Exhibit 46: While Perot has a reasonable India presence, ACS is smaller

	No. of employees (total)	India presence	% of total
Perot Systems	23,000	8,000	34.8
Affiliated Computer Systems (ACS)	67,000	5,000	7.5

Source: Company, Industry data.

ISPs Are Breaking The Mould

Increasing convergence between business models of ISPs and MNCs, protectionist rhetoric and the urgency to break the linear growth model is driving ISPs to take bolder steps to remain relevant. ISPs have taken to increasing: (a) local hires (b) near shore presence; (c) non-linearity; and (d) opting for acquisitions. We believe that these measures would help ISPs to deal with the changing business landscape and hold their turf, at least for the next 2-3 years.

Increasing local hires

- **ISPs are getting more serious about hiring locals:** With increasing convergence between the business models of ISPs and MNCs coupled with the protectionist rhetoric, ISPs have opted to go 'more local'. ISPs are hiring locals, both in the delivery and front-end sales teams. Hiring locals could give them a better understanding of the nuances of customer markets, especially in difficult/culturally sensitive geographies (Continental Europe, China, LATAM) and verticals (government) where ISPs are increasing focus.
    - Infosys has set an objective to increase its local workforce from ~5% currently to ~15%. Infosys is targeting to hire ~1,000 locals in the delivery organisation by Dec 2010, while a majority of the 200 targeted sales hires are expected to be locals.
    - Wipro has also embarked upon globalisation of its workforce and intends to increase local employees from ~21% to ~50% of its onsite workforce over the medium term.
- **Localisation is not easy, but the time is ripe for ISPs:** While localisation of workforce has its advantages, it is easier said than done. ISPs might have to deal with HR issues that typically emerge with a multicultural workforce. While the share of local employees is expected to be a smaller pie even after the local hiring efforts, it still entails a far-reaching mindset change on the part of ISPs. However, we believe that ISPs who have been shying from 'going local' for long also due to the inability to attract local talent have understood the need of time and are better placed to deal with these changes than ever before.

Recent announcements made by ISPs for senior positions

- Wipro recently appointed Ms.Martha Bejar as President, global sales and operations, Mr. Mark Fleming as the head of telecom, media & technology vertical, Mr.Ralf Reich as the head for Germany. Wipro's France (Mr. Christophe Martinoli) and Japan & China (Mr. Horoshi Alley) geographies are already headed by non-Indians.
- Infosys' Australia (Mr.Jackie Korhonen) geography is already headed by a local and so is the recently appointed Germany head. The search for a local head is on for France and the newly formed government subsidiary.
- TCS counts Mr.John Lenzen (global head of marketing), Mr.Gabriel Rozman (global head of emerging markets) and Ms.Carol Wilson (hi-tech solutions head) amongst the local heads. We have presented a case study of how Mr. Rozman's efforts has brought success for TCS in LATAM.

Exhibit 47: Case study on TCS' success in the LATAM markets

We believe that TCS' success story in LATAM makes a classic case study of how getting local heads can make a winning proposition.

When TCS tried penetrating the Latin American (LATAM) market in 2001, it was no cake walk. Although, TCS was a reasonably known brand in North America, it had to struggle to break into the LATAM market when it started off. Despite having an impeccable reputation and competitive pricing, the Latin Americans were not taking TCS seriously. The LATAM clients were willing to pay more to US IT firms who would in turn outsource to India. TCS appointed Mr. Gabriel Rozman in 2001 (a Uruguay native with over 30 years of consulting experience in E&Y) as the Head of IberoAmercia. Mr. Rozman started TCS´operations in Uruguay in 2002 with 15 employees. From thereon, TCS has traversed a long way and currently employs ~7,000 locals across LATAM, which forms 62% of TCS' non-Indian staff.

Mr.Rozman's multicultural skills helped change the mindset and make clients feel confident and comfortable in dealing directly with an Indian firm. TCS went on to win large contracts - Banco Pichincha (US$140 mn) and Social Security Institute of Mexico (US$200 mn) deal from the LATAM market. Mr. Rozman is currently the head for Emerging Markets.

Source: Industry data, Ambit Capital Research

Increasing near shore presence

- ISPs have been increasing their near shore presence by opening more delivery centres in these locations. This has multi-advantages - cultural proximity, favourable time and language compatibility with the sourcing nations. TCS has been the most aggressive in pursuing the near shore strategy; it has the largest number of delivery centres in LATAM (10) v/s Infosys (3) and Wipro (2) which have been increasing their presence recently.

Increasing non-linearity

- Non-linear growth has been an oft-discussed topic particularly as scalability concerns emerge with the ISPs' headcount reaching considerable proportions. However, we discern a sense of imperativeness in the recent non-linear initiatives made by the ISPs. Tier-1 ISPs expect to take on the non-linearity drive through platforms, accelerators, solutions, IP-based services, frameworks, software as a service (SAAS) and newer pricing models (if managed well could lead to non-linearity).

  However, some of these such as newer pricing models are largely unchartered territories for ISPs and infuse higher risks into the business model. For instance, in case of outcome based pricing, there are enough variables in the environment that can impact the outcome and the outcome itself can be measured only after a period of time. In such a scenario, ISPs would be hedging themselves; only a portion of the fees (~10-20%) would be tied to the end result and the remaining would get billed through traditional models.

Acquisitions

- ISPs have till date been shy of big-bang acquisitions. While Wipro and TCS have been more active on the acquisition front in the pecking order, Infosys has largely stuck to the organic growth mantra. That said, Infosys' bidding for Axon in 2008 (although it failed to consummate and was later acquired by HCL Tech) shows that even the company which has been the most conservative is warming up to the idea of larger acquisitions.

  Nevertheless, IT services is a primarily people-driven business and cultural issues remain the topmost priority for the acquiring entities. Further, acquiring some of the large onsite IT services companies could have a meaningful margin dilutive effect for the ISPs. Hence, we would expect ISPs to stick to the strategy of niche acquisitions. That said, increasing cash on books, competitive intensity and sense of urgency to fill portfolio gaps could drive them to turn more active on the acquisition front.

Exhibit 48: Recent acquisitions by ISPs

Particulars	Deal size (US$ mn)
HCL Tech	
Control Point Solutions	21
Liberata Solutions	2
Capital Stream	40
Axon Group	658
Wipro	
Gallagher Financial Systems	na
Citi Technology Services	127
TCS	
Citigroup Global Services	505

Source: Company, Industry data.

Margin Issues

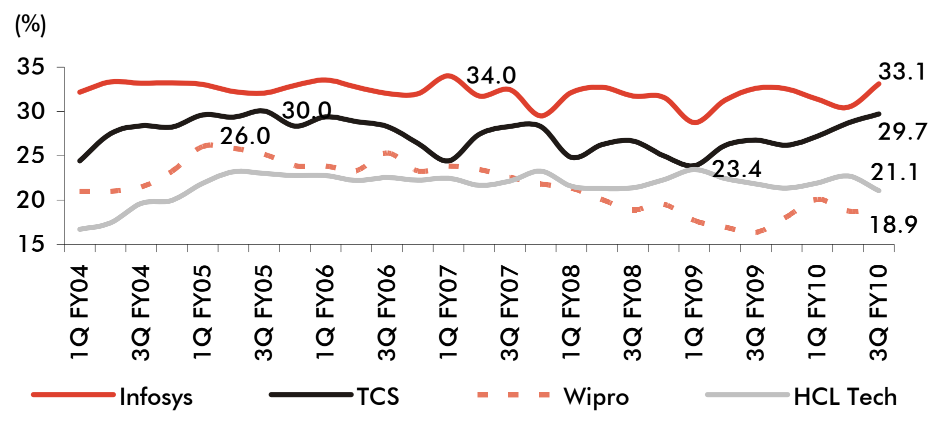
ISPs have emerged from the downturn with margins at near historical highs. Cumulatively, ISPs (except HCL Tech) have been able to increase margins by 180-350 bps in 9MFY10 despite rupee appreciation, wage hikes, higher variable payout and pick-up in hiring, which proves the extent to which growth itself can become a margin lever.

However, going forward we expect rupee appreciation could be the biggest risk to margins. With most of the obvious margin levers (utilisation, cost rationalisation, offshore mix) at optimum levels for most ISPs, non-linear growth (dependent on flawless execution) and pricing uptick (when the demand-supply gap intensifies at the client's end) could shield ISPs from an unfavourable rupee movement. We have factored an US$/INR appreciation of 4.1% (FY11E) and 1.2% (FY12E) and EBITDA margin decline of 90-165bps for our coverage universe over FY10E-12E.

ISPs have upped margins through the downturn

- The current downturn has taught the street not to underestimate the margin management skills of tier-1 ISPs. They have emerged from the downturn with margins at near historical highs. Margins for ISPs (except HCL Tech) has increased by 180-350 bps in 9MFY10 despite rupee appreciation, wage hikes, higher variable payout and pick-up in hiring. This shows the extent to which growth itself can become a margin lever.

Exhibit 49: ISPs have emerged from the downturn with EBITDA margins at near historical highs

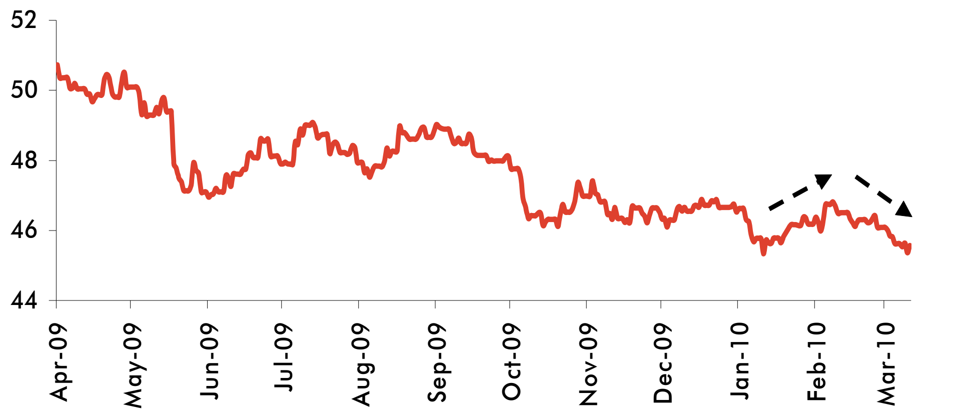


Source: Company data. Note: Wipro - Consolidated EBIT margins, prior to 2QFY10 represents US GAAP.

Rupee appreciation — biggest risk to margins

- **Rupee remains a wildcard:** While FY09 witnessed sharp rupee depreciation (27%), which cushioned an otherwise forgettable year, the rupee been playing a truant in 9MFY10. While rupee has appreciated by 8.3% in 9M FY10, it has been volatile in 4Q FY10E. Rupee has been consistently appreciating post-budget after a stint of depreciation. We have factored in rupee appreciation of 4.1% in FY11E and 1.2% in FY12E. A 1% rupee appreciation would dent EBITDA margins by 40-50bps and EPS by 1.3-3.0% for our coverage universe.

Exhibit 50: Rupee has been volatile in 4Q FY10E



Source: Bloomberg

Exhibit 51: Hedging details

Particulars	Infosys	TCS	Wipro	HCL Tech
Impact of 1% movement in US$/INR on EPS (%)	1.4	1.5	1.4	3.0
Hedges (US$ mn)	699	~1,000	~1,800	645
Hedge period (upto)	2 qtrs	2 yrs	4 yrs	2 yrs
% of net FY11E forex exposure	19	20	50	33
Accounting policy	Mark-to-market	Cash flow hedge	Cash flow hedge	Cash flow hedge

Source: Company, Ambit Capital Research

- **Despite geographic diversification, ISPs stakes in US remains dominant:** Although ISPs' invoicing portfolio stands more diversified compared with the past, they still have a large part of their fortunes linked to the US$. On an average, 59% of revenue for ISPs is derived from the US.

Exhibit 52: Despite diversification ISPs revenue mix from US remains dominant

	FY06		9M FY10	
Revenue mix (%)	US	ex-US	US	ex-US
Infosys	64.8	35.2	65.7	34.3
TCS	57.3	42.7	52.7	47.3
Wipro	65.2	34.8	58.4	41.6
HCL Tech	60.1	39.9	58.2	41.8

Source: Company

Obvious margin levers are at optimum levels

- **Obvious margin levers are already at optimum levels for most ISPs:** While ISPs have been exceptional at margin management, we believe that they have exercised most of the obvious levers (utilisation, cost rationalisation, offshore mix). We remain confident of a demand upsurge for the Indian IT sector through FY10E-12E. However, rupee appreciation and other obvious expenses which typically follow growth viz. wage hikes, increased variable payout, promotions, advance hiring as against a just-in-time approach, higher lateral hiring would impact margins going forward.

- **We have built-in EBITDA decline of 90-165 bps across our coverage universe; primarily due to our assumptions of US$/INR:** Nevertheless, we believe that a sharp rupee appreciation would pose the biggest margin management challenge. The other margin negatives such as wage hikes (11-13% hikes have become a legacy with the Indian IT industry) and lateral hiring (situation will correct itself in FY12E), in our view, are less of a concern. We expect margins to decline by ~90-165 bps for our coverage universe over FY10E-12E primarily on the back of our US$/INR assumptions.

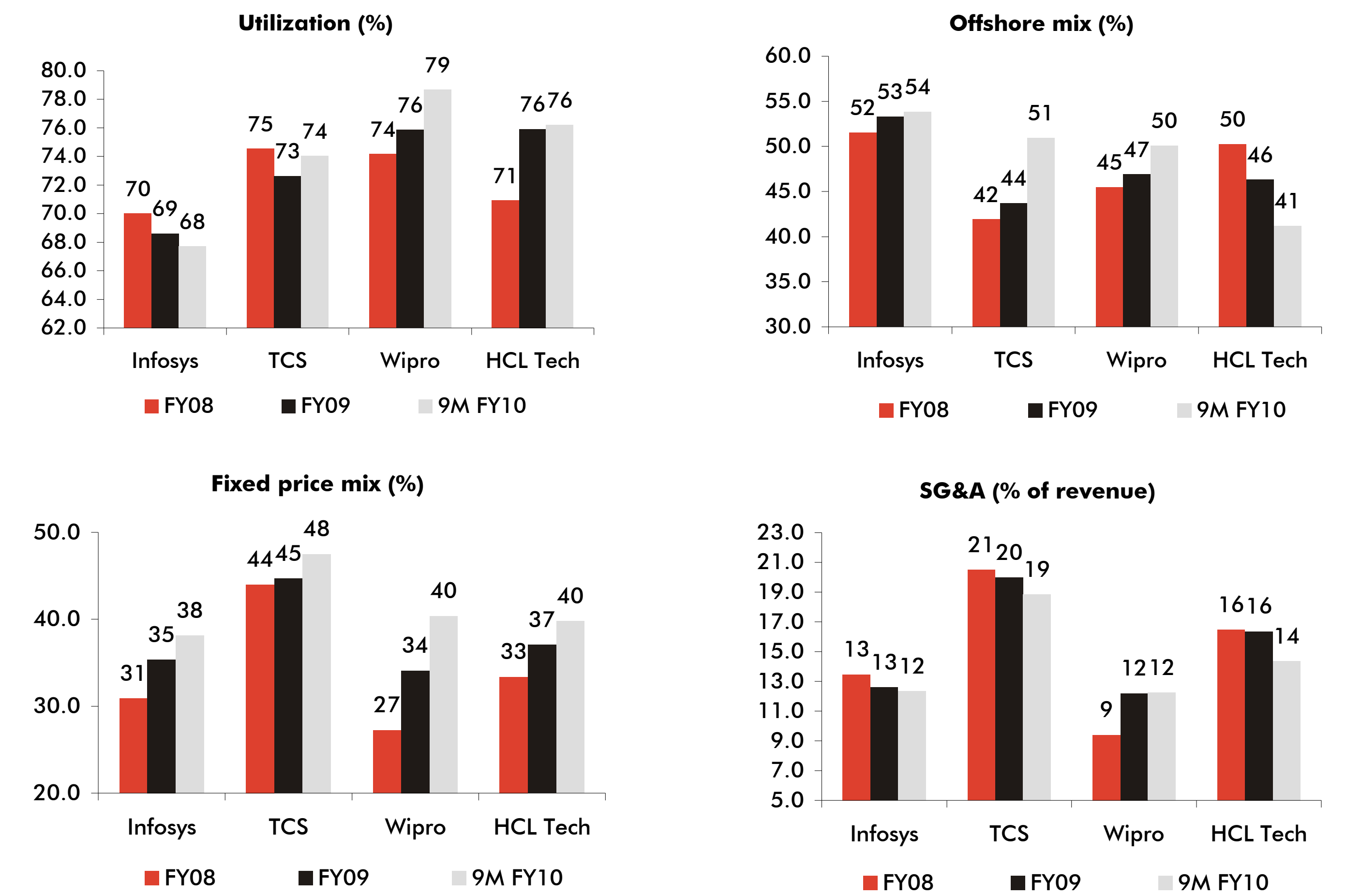
Levers which could shield against rupee appreciation

While productivity gains and growth itself can become margin levers, non-linear growth and pricing can turn out to be the not-so-obvious levers.

- **Non-linear growth:** New engagement models including newer pricing models and higher platform-based selling could provide margin upsides if executed well.

- **Pricing:** Pricing realisation decline in FY09 was lower than expected (4-5% YoY v/s estimate of 8-9%). Companies are still finding their feet and pricing remains largely stable although there are no signs of pricing uptick presently. Pricing could see a gradual upward move, as the situation improves and demand-supply gap at the clients' end intensifies. A 1% upmove in pricing would benefit margins by 65-70bps. Further, pricing realisation is also a function of business mix - ISPs moving up the value chain to target higher transformational deals could help them garner higher margins. However, we have conservatively assumed stable pricing levels over FY10E-12E.

Exhibit 53: Most of the obvious margin levers are at optimum levels



Source: Company

Valuation And Top Picks

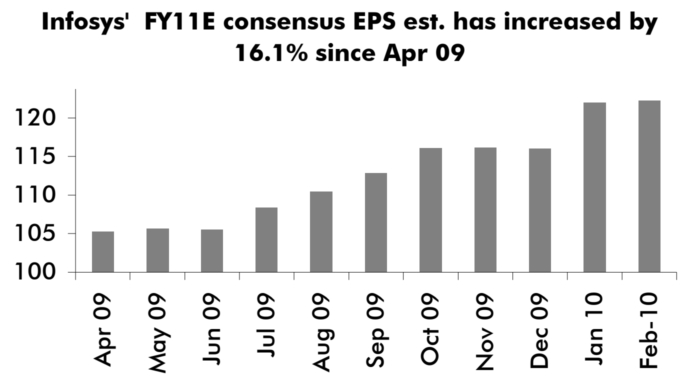
Demand rush could surprise the street

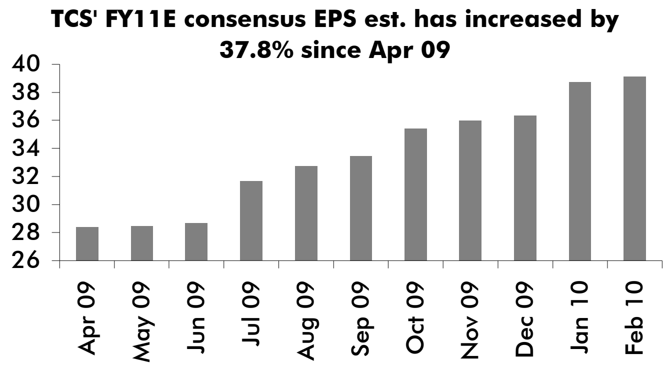
- We have a positive stance on the IT services sector and in particular the tier-1 ISPs. We believe that strong offshoring momentum powered by cost cutting initiatives and ISPs increasing share of client's wallet in the medium-term will overshadow longer-term concerns such as industry consolidation and changing services model due to newer technology trends (which still remain relevant). Given that valuations for the tier-1 ISPs have re-rated from the trough of 6-11x to currently ~18-22x (1-year forward PE), the most obvious question that arises is: Is there a case for further upside? Our view: We expect strong growth for tier-1 ISPs backed by a robust offshoring demand and believe that the demand rush could surprise the street. We believe that the good times for ISPs are here to last for at least next two years.

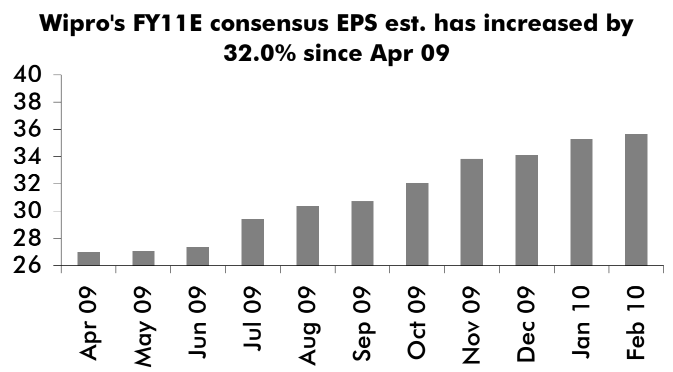
We expect a further EPS upgrade cycle

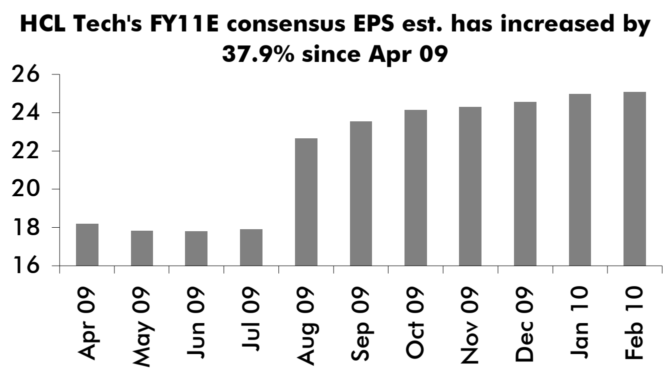
- While tier-1 ISPs have seen sharp earnings upgrade of close to 16-38% since April 2009, we see further fundamental triggers for an EPS upgrade cycle driven by higher offshoring momentum, increasing discretionary spend in relatively subdued verticals, stronger pick-up in ex-top 10 clients and gains from vendor consolidation wins getting reflected in FY11E/12E. Barring a sharp rupee appreciation or a 'double dip' recession, we expect more positive surprises from ISPs and consistent upgrades to the consensus earnings estimates.

Exhibit 54: ISPs earnings have got upgraded by 16-38% since April 2009









Source: Reuters

Current prices present a good entry opportunity

- 3QFY10 was a teaser where ISPs demonstrated their ability to outperform the already raised revenue growth expectation. However, stocks have not outperformed much given the concerns over protectionism re-emerging, new US banking reforms and questions on sustainability of the good performance. We believe that the concerns on protectionism and regulation are overrated. In our view, the demand rush could surprise the street and current prices present a good entry opportunity for investors.

Exhibit 55: Despite strong 3QFY10 results ISPs outperformance to the street has not been significant presenting a good entry opportunity for investors

(%)	Infosys	TCS	Wipro	HCL Tech
Outperformance to Sensex in CY09	50.2	125.6	97.7	126.0
Outperformance to Sensex YTD	4.8	7.5	6.5	-0.8

Source: Bloomberg

Infosys and TCS are our top picks

We initiate coverage on the tier-1 ISPs with a **BUY** recommendation on Infosys (TP- Rs3,155) and TCS (TP- Rs925) and **HOLD** on Wipro (TP- Rs780) and HCL Tech (TP- Rs390). While the upcycle is expected to benefit all tier-1 IT stocks, we suggest playing individual stocks instead of adopting a 'basket approach' as some stocks, in our view, are better positioned to capture the demand upcycle. We expect BFSI to be the primary growth driver going forward, particularly in FY11E. To that extent, we prefer Infosys and TCS which have a higher exposure to this vertical. Further Infosys, in our view, is also better placed in terms of lower exposure to Europe (where the economic recovery lags the US) and higher margin levers v/s peers. We have valued the tier-1 ISPs using a PE multiple approach.

- We have valued Infosys at 21x FY12E EPS which is at a 5% premium to its historic 5-year average of 20x. We believe that this premium is justified as we are in a demand upcycle with further earnings surprises on the horizon. We believe Infosys is best placed amongst peers on both revenue and margin outperformance.

- We have valued TCS at 20x FY12E EPS which is at a 5% discount to Infosys. TCS has traded at a average discount of ~10% to Infosys since listing. However, we believe a 5% discount is justified given that TCS has demonstrated strong revenue performance and margin management skills that we believe are sustainable.

- We have valued Wipro at 20x FY12E EPS which is at a 5% discount to Infosys. We believe that this is justified as although Wipro will be a strong beneficiary of the offshoring trend given its fine execution skills and well diversified services portfolio, lower BFSI exposure and fewer margin levers and would reduce the scope of financial outperformance to Infosys.

- We have valued HCL Tech at 15x TTM March-2012 EPS which is at a 30% discount to Infosys. It has historically traded at 30-40% discount to Infosys. We are assigning a 30% discount, which is at the lower end of the historical range. We believe that the Axon acquisition has made HCL Tech a serious contender in the PI space — if the integration runs through its trial period successfully and the real benefits of acquisition i.e. downstream revenues come through in the medium term, it could be an interesting stock to look at. That said, we expect performance in the near term, particularly in FY11E, to be lower versus peers due to lower visibility on pick-up in PI revenues, subdued BPO revenues and lower margin levers.

Risks to recommendation

- A double dip recession in the US could impact IT budgets more severely than what we have presently envisaged.
- Any sharp appreciation in the rupee beyond what we have factored into our estimates would have an adverse impact on estimates.

COMPANIES

- Infosys Technologies
- Tata Consultancy Services
- Wipro
- HCL Technologies

Infosys Technologies

BUY

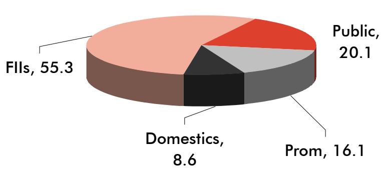
Price	Rs2,684
Target Price	**%Upside**
Rs3,155	18↑
Market Capitalisation	
Rs1,539,569mn	(US$33,764mn)
52 week range H/L (Rs)	2,710/ 1,215
Shares o/s (mn)	**Daily vol (mn)**
573.54	1.17
Reuters	**Bloomberg**
INFY.BO	INFO IN

Perfm(%)	**1M**	**3M**	**12M**	**YTD**
Absolute	7.5	9.4	124.3	3.0
Rel. to Sensex	1.1	9.0	6.6	4.8

BSE Sensex	**Nifty**
17,168	5,133

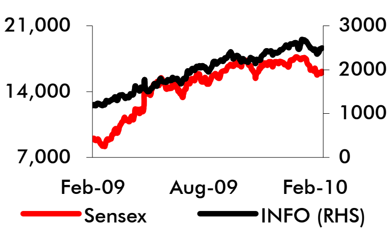
Source: Bloomberg

Shareholding pattern (%)



Source: Bloomberg

Price performance



Source: Bloomberg

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AMBIT
Acumen at work

King Of All Times

- **Strong BFSI-led rebound:** The BFSI vertical has led Infosys' strong volume revival. Infosys' lower exposure to failed banks and strong client footprint has helped it win a majority of the vendor consolidation exercises. Going forward, we expect it to benefit from uptick in discretionary spend within the BFSI vertical, with more transformational projects coming its way.
- **Problem client witnessing stability:** While Infosys' FY09 performance was plagued by sharp decline in BT, management mentioned that the account has bottomed out. In fact, the normalcy seen in the account has not been witnessed in the last two years. Newer wins in the Telecom vertical such as Telstra, France Telecom should enable increased ramp-ups in FY11E/12E.
- **Excellent client mining skills:** Infosys has the best account mining skills helping it garner a higher share of clients' IT spend in the demand upcycle. Further, the highest number of US$>1mn clients lends higher earnings visibility.
- **Preparing for the next leg of growth:** Infosys' serious thrust toward non-linearity, iRACE - bold HR measures, and a new-found urgency to penetrate the domestic market, suggests that it has been working seriously on its business strategy to remain relevant.
- **Best placed in margin management:** Infosys has the highest margin levers in its kitty versus peers, more so on the utilisation metric which becomes the key margin lever with increasing volume visibility. However, we expect margin decline of 90bps over FY10E-12E (lowest amongst peers) primarily due to US$/INR depreciation.
- **Initiate with a BUY and target price of Rs3,155:** We initiate coverage on Infosys with a target price of Rs3,155 which implies a 21x target PE multiple on FY12E EPS and upside potential of 18%.

Exhibit 1: Key Financials

Y/E March, Rs mn	FY08	FY09	FY10E	FY11E	FY12E
Net Sales	166,920	216,930	227,104	266,527	318,564
Sales growth (YoY %)	20.1	30.0	4.7	17.4	19.5
EBITDA	52,380	71,950	78,686	90,549	107,568
EBITDA (%)	31.4	33.2	34.6	34.0	33.8
Adjusted Net Profit	45,380	58,800	62,434	69,102	86,161
EPS (Rs)	81.5	104.5	109.0	120.6	150.3
EPS Growth (YoY %)	18.9	28.3	4.2	10.6	24.6
ROCE (%)	37.0	40.2	34.2	32.7	32.8
ROE (%)	37.2	37.4	30.7	28.1	29.0
PE (x)	33.0	25.7	24.6	22.3	17.9
Price/Book Value (x)	11.0	8.4	6.9	5.7	4.7
EV/EBITDA (x)	27.3	19.5	17.3	14.6	11.7

Source: Company, Ambit Capital Research

Company financial snapshot

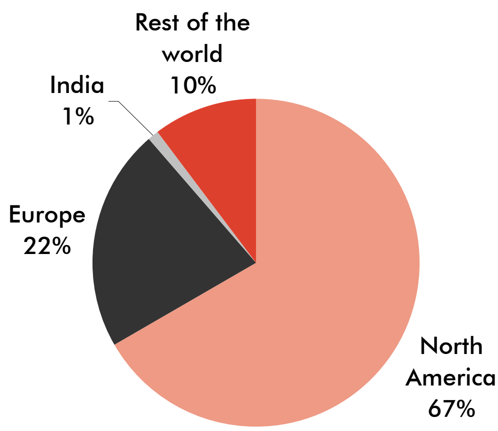
Profit and loss (Rsmn)

	FY10E	FY11E	FY12E
Net Sales	227,104	266,527	318,564
Operating Exp	148,419	175,978	210,996
EBITDA	78,686	90,549	107,568
Depreciation	9,274	9,924	10,194
Other income	9,528	11,512	14,523
PBT	78,940	92,137	111,897
Tax	16,506	23,035	25,736
PAT	62,434	69,102	86,161

Profit and loss ratios

	FY10E	FY11E	FY12E
EBITDA Margin (%)	34.6	34.0	33.8
PAT Margin (%)	27.5	25.9	27.0
P/E (X)	24.6	22.3	17.9
EV/ EBITDA (X)	17.3	14.6	11.7

Revenue mix Geo-wise



Source:: Company, Ambit Capital Research

Balance sheet (Rsmn)

	FY10E	FY11E	FY12E
Total Assets	272,116	329,176	402,066
Fixed Assets	54,496	57,572	59,378
Current Assets	164,890	201,604	257,688
Other Assets	52,730	70,000	85,000
Total Liabilities	272,116	329,176	402,066
Total Net Worth	223,890	268,737	324,655
Total Debt	-	-	-
Current Liabilities	48,227	60,439	77,411
Minority Interest	-	-	-

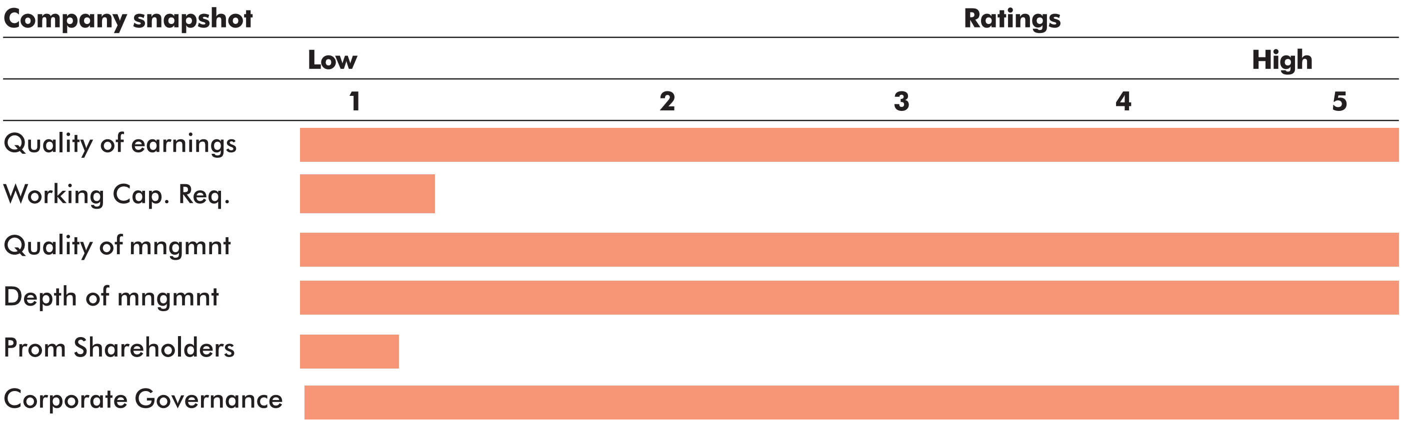
Balance sheet ratios (%)

	FY10E	FY11E	FY12E
RoE	30.7	28.1	29.0
RoCE	34.2	32.7	32.8
P/BV (X)	6.9	5.7	4.7

Cash flow (Rsmn)

	FY10E	FY11E	FY12E
Net profit	62,434	69,102	86,161
Depreciation	9,274	9,924	10,194
Incr (decr) in net working capital	878	(6,380)	5,438
Others	(9526)	(11512)	(14523)
Cash flow from operating activities	63,059	61,134	87,270
Incr (decr) in investments	(43,202)	(5,758)	(477)
Incr (decr) in capital expenditure	(10,230)	(13,000)	(12,000)
Cash flow from investing activities	(53,432)	(18,758)	(12,477)
Issuance of equity	180	-	-
Dividend paid	(18,822)	(23,085)	(27,249)
Cash flow from financing activities	(18,642)	(23,085)	(27,249)
Net change in cash	(9,015)	19,291	47,544
Opening cash balance	96,950	87,936	107,227
Closing cash balance	87,936	107,227	154,771

Company snapshot



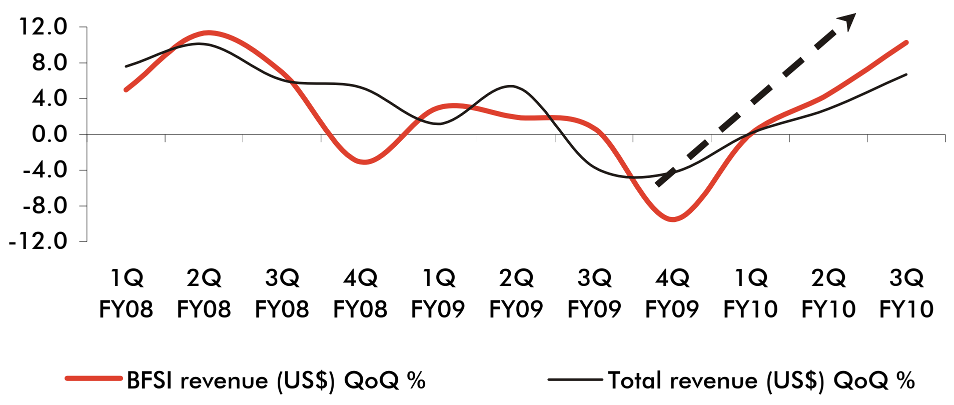
Investment Highlights

Strong BFSI-led rebound

- A pick-up in the BFSI vertical (4.8% CQGR; 33.7% of revenue) has primarily led Infosys' rebound in 9MFY10. Infosys' lower exposure to failed banks and strong client footprint has helped it win a majority of the vendor consolidation exercises.

  Infosys is currently working on 6 M&A integration deals with sizes ranging from US$50-US$75mn and tenures of between 18-24 months. Besides these mandates are end-to-end services, typically involving front end consulting, IT strategy, platform and infrastructure consolidation, which places the company in a better position to capture the maintenance and upgrade related spend at a later stage. Going forward, we believe Infosys would continue to benefit from the uptick in discretionary spend within the BFSI vertical, with more transformational projects coming its way.

Exhibit 2: BFSI leading the recovery



Source: Company

Problem client witnessing stability

- FY09 saw Infosys grappling not only with problems from BFSI clients but also with BT (its top client at the time). BT took a 'slash and burn' approach for its IT budgets and had asked for rate reduction to the extent of ~35% from contractors. Infosys which has stood by its stance of profitable growth decided to move away from the account instead of making upfront payments, which competitors chose to offer. Consequently, for Infosys, BT revenue declined 16.0% YoY in FY09 and reduced from 9.1% of revenue in FY08 to 6.9% in FY09. However, with BT no longer a large proportion of revenues, the account doesnot have as much impact on Infosys' growth prospects. That said, management mentioned that the account is witnessing stability . In fact the normalcy seen in the account is something which has not been experienced in the last two years. Further, newer wins in the Telecom vertical such as Telstra, France Telecom are ramping up well and should drive growth in FY11E/12E.

Exhibit 3: BT account is witnessing stability

	FY08				FY09				FY10		
(US$,QoQ %)	**1Q**	**2Q**	**3Q**	**4Q**	**1Q**	**2Q**	**3Q**	**4Q**	**1Q**	**2Q**	**3Q**
Top client -BT revenue	8.8	1.1	27.6	14.1	-22.4	1.3	-21.4	-12.0	-21.1	Top client changed	
% of total revenue	8.6	7.9	9.5	10.3	7.9	7.6	6.2	5.7	4.5	to Bank of America	
Telecom revenue	8.1	3.1	8.7	12.2	-11.4	1.5	-15.3	-4.3	1.2	-1.3	6.8
Total revenue	7.6	10.1	6.1	5.2	1.2	5.3	-3.7	-4.3	0.1	2.9	6.7

Source: Company, Ambit Capital Research

Excellent client mining skills

- Infosys has by far the best client mining skills amongst ISPs, which is demonstrated in its highest revenue per client (US$8.2mn in 9MFY10). With clients easing their strings on IT budgets, Infosys' strong foothold in client accounts would help it garner a higher share. Further, its highest share of >US$1mn clients gives it higher earnings visibility v/s peers.

Exhibit 4: Infosys has the highest revenue per client

US$ mn	FY03	FY04	FY05	FY06	FY07	FY08	FY09	9MFY10
Infosys	2.4	2.9	3.7	4.8	6.4	8.0	8.1	8.2
TCS	2.1	3.8	4.4	4.4	5.5	6.8	6.4	6.8
Wipro	2.5	2.9	3.7	3.8	4.1	4.5	4.8	5.2

Source: Company

Exhibit 5: Infosys has the highest % of clients in >US$1mn bracket

% of clients contributing >US$1 mn	FY05	FY06	FY07	FY08	FY09	9M FY10
Infosys	37.9	48.0	55.0	57.6	56.5	59.2
TCS	41.5	34.2	38.1	39.6	41.1	45.7
Wipro	39.9	44.7	42.3	39.1	49.5	48.4

Source: Company

Preparing for the next leg of growth

With the changing competitive landscape and increasing commoditisation of core ADM services, Infosys has been working on its business model to remain relevant and at the same time protect its premium pricing positioning. Infosys' serious initiatives on the non-linearity front and bold HR measures suggest a preparedness for the next phase of growth.

- **A serious thrust for the non-linearity drive:** While currently non-linearity largely remains impervious (~9% currently including Finacle), Infosys targets to derive ~33% of revenue from non-linearity in the medium term by:
  - Development and monetisation of Intellectual Properties (filed for 204 patents in last 3 years)
  - Product and platform development (focused on both vertical and horizontal) and
  - Offering newer pricing models to clients (eg:outcome based, output based). Management mentioned that it has won 144 new deals of ~US$165mn involving newer engagement models in 1HFY10 and has active opportunities for 115 new deals worth US$568mn.

- **iRACE - the race for tomorrow:** Infosys has introduced a significant change in its organisation structure with iRACE (effective October 2009), which calls for a transition into ability+role based organisation v/s a plain role based one. While this program has introduced changes in: span of control, career streams; the most far-reaching change has been in the delivery organisation where technical employees will need to spend a minimum of 8 years (v/s 5-6 years earlier) before getting into the project manager cadre. This move was spurred by the need to increase the technical depth especially in light of changing customer expectation. While this might affect ~8% of employees, the interim hike could be assuaging in the near term. Our channel checks suggest that while iRACE is highly suitable from the organization's perspective, it has not been as well received by the employees given that it has increased the overall number of lattices. We would not be surprised if some changes to the program are made to strike a balance in the future.

- **Domestic market - late but successful:** Infosys' entry in the domestic market has been relatively late versus peers. It had set up its India business unit only during the last organisational rejig in October 2007. However, it has been able to create a niche for itself in the technology-intensive projects. Out of the four Mission Mode Programs (27 planned under the National e-Governance plan) which are under implementation, Infosys has won two. It has set serious targets to achieve 40:40:20 revenue mix from US:Europe:ROW in the medium term (v/s 63:23:14 currently).

Strong S&M investment - places it better in the demand upturn

- Infosys has strategically increased its sales and marketing (S&M) focus during the downturn. Infosys has added: (a) 204 people in FY09, which was the highest addition in the last 5 years. (b) 68 people until 3QFY10, which takes the sales and marketing headcount to 815.

  While Infosys is known for its exceptional client mining skills, we believe that Infosys' focus on strengthening its sales force (particularly in the client acquisition profiles), during the downturn was impressive as it emphasises that the company remained unfazed by the short-term pain and cost control did not come at the cost of business investments. We believe Infosys' strong S&M investments would enable the company to partake increasingly in clients IT budgets in the demand upcycle.

Exhibit 6: Infosys has expanded its sales force significantly since FY08

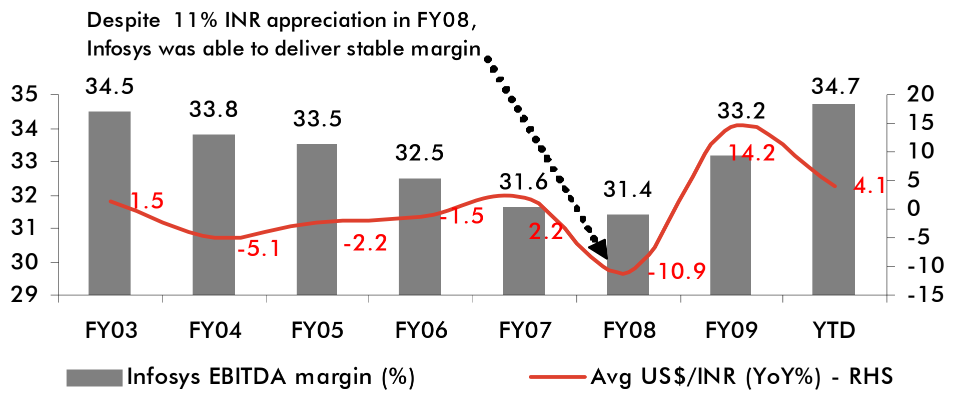
(Nos)	FY05	FY06	FY07	FY08	FY09	3Q FY10
Sales and marketing personnel	308	404	486	543	747	815
Net addition	33	96	82	57	204	68

Source: Company

Best placed in margin management

- Infosys has the highest margins in the industry. While Infosys' margin story has always been debated, we believe its margin resilience stands unmatched - Infosys has overcome the downturn with the highest margins seen since FY02. A look at the past suggests Infosys has been able to manage margins well enough even during years of strong rupee appreciation.

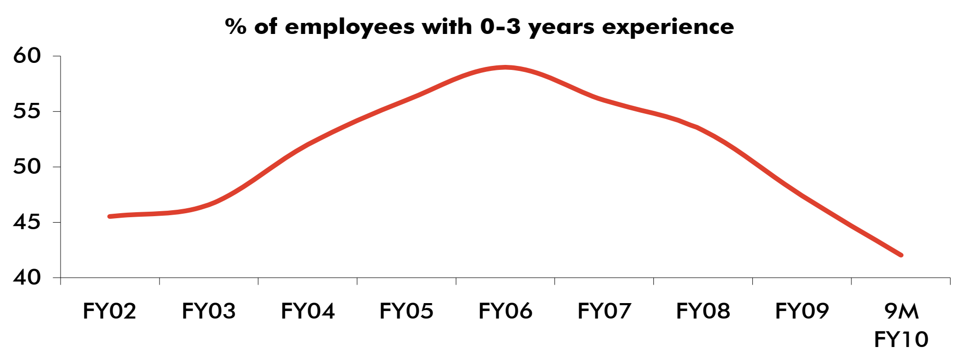
Exhibit 7: Infosys has demonstrated margin resilience even in years of strong US$/INR appreciation



Source: Bloomberg, Company

- Infosys, in our view, has the highest margin levers in its kitty versus peers. However, we expect EBITDA margins to decline marginally by 90bps during FY10E-12E (lowest decline amongst peers). This is due to our assumptions of: (a) rupee appreciation of 4.1% and 1.2%; and (b) wage hike of 10% and 12%; in FY11E and FY12E respectively.
  - **Lowest utilisation amongst peers:** Infosys currently has the lowest utilisation rates amongst peers at 68.8% (including trainees). With improving volume visibility, utilisation becomes the key margin lever. Infosys has had utilisation levels of 74% in the past. This in itself could provide a margin buffer of 180 bps- (assuming 1% increase would contribute 35 bps to margins).
  - **Lowest proportion of employees with <3 years experience since FY02:** Currently Infosys' proportion of employees with <3 years experience is at a 8-year low of 42%. We believe that the current employee pyramid presents ample scope for broadening.

Exhibit 8: Employee pyramid presents further scope for broadening



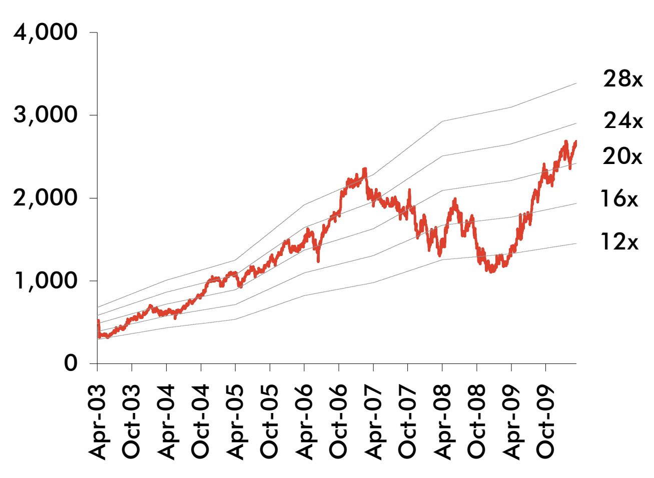
Source: Company, Ambit Capital Research

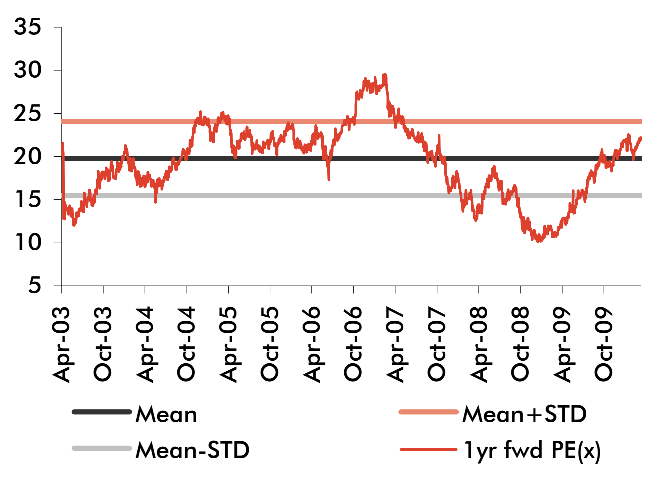
- **First to give pay hikes; might work to its advantage in FY11E:** Infosys has been the first to announce wage hikes (effective October 2009): 8% offshore and 2% onsite. While wage hikes would have a negative impact on margins, we are not overly worried and in fact, read it as a strong signal of business confidence. Besides, Infosys being the first player doling out increments might work to its advantage in FY11E for: people management and option to declare a relatively lower hike v/s peers in FY11E .

Valuation

- **Initiate with a BUY; target price of Rs3,155:** We initiate coverage on Infosys with a BUY recommendation and March-2011 target price of Rs3,155. Our target price implies an upside potential of 18% from current levels.The stock currently trades at 22.3x and 17.9x on FY11E and FY12E EPS. We have valued Infosys on historic PE multiple basis. We choose to assign a target PE multiple of 21x on FY12E EPS which is at a 5% premium above the 5-year historic average of 20x. Infosys has broadly traded in the range of 12-28x (1-year forward PE) across the business cycle and around 20-25x during the demand upcycle. We believe that a premium of 5% over the historic average PE is justified given that we are in a demand upcycle with further earnings surprises on the horizon.
- Infosys has historically enjoyed valuation premium to the market (during business expansion cycle) and peers. We believe that Infosys' premium to peers is justified given our assumptions of: (a) industry leading revenue growth and margins in FY11E and FY12E; (b) strong free cash flow generation and high ROCE.
- Assumptions in our estimates include: (a) US$ revenue CAGR of 21.7%; (b) EBITDA CAGR of 16.9%; over FY10E-12E. We believe that US$ revenue growth would be an important metric to consider as the EPS CAGR of 17.4% would appear lower. This is due to our assumptions of: (a) rupee appreciation of 4.1% and 1.2% in FY11E and FY12E respectively; and (b) tax rate of 25% in FY11E and 23% in FY12E v/s 20.5% currently.

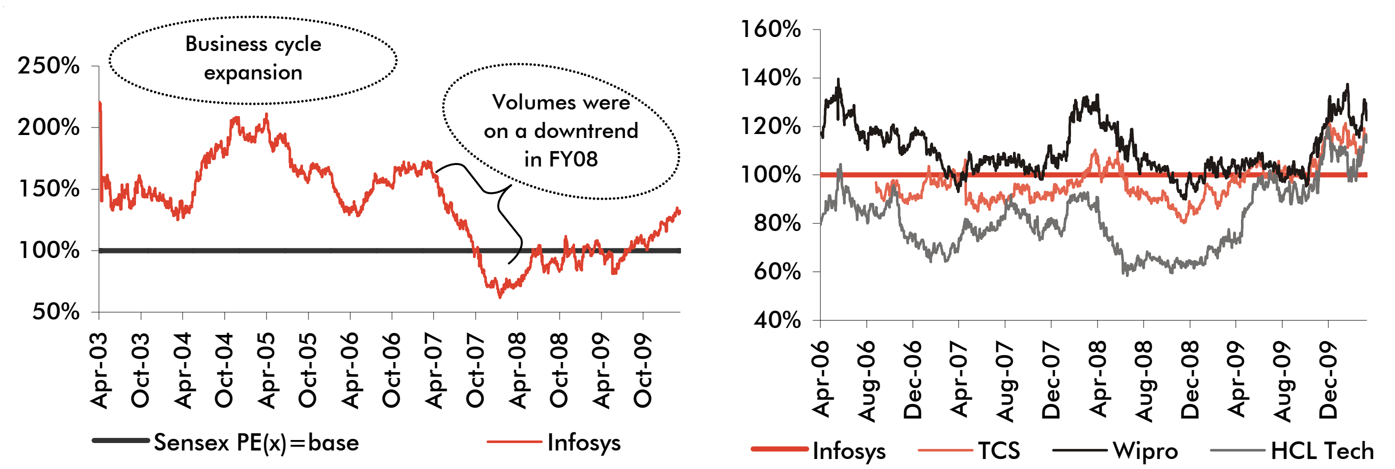
Exhibit 9: Infosys - 1-year forward PE band





Source: Company, Ambit Capital Research

Exhibit 10: Infosys - premium/ discount to Sensex and peers



Source: Company, Ambit Capital Research

Exhibit 11: Financial assumptions

	FY10E	FY11E	FY12E
US$ revenue growth (YoY %)	2.7	22.4	21.0
Volume growth (YoY %)	6.2	22.0	22.2
Realization growth (YoY %)	-3.3	0.3	-1.0
US$/INR (Appreciation)/ Depreciation (%)	1.9	-4.1	-1.2
EBITDA margin (%)	34.6	34.0	33.8
EPS(YoY %)	4.2	10.6	24.6

Source: Company, Ambit Capital Research

Exhibit 12: Comparison to consensus

Infosys (Rs mn)	Bloomberg estimate		Ambit Capital estimate		Difference to consensus	
	FY11E	FY12E	FY11E	FY12E	FY11E	FY12E
Sales	262,235	310,023	266,527	318,564	1.6%	2.8%
EBITDA	90,484	105,368	90,549	107,568	0.1%	2.1%
Profit	69,946	81,810	69,102	86,161	-1.2%	5.3%
EPS (Rs)	121.9	142.2	120.6	150.3	-1.1%	5.7%

Source: Bloomberg, Ambit Capital Research

Financials

Exhibit 13: Profit & Loss statement

Y/E March, Rs mn	FY08	FY09	FY10E	FY11E	FY12E
Net sales	**166,920**	**216,930**	**227,104**	**266,527**	**318,564**
Growth (%)	20.1	30.0	4.7	17.4	19.5
EBITDA	**52,380**	**71,950**	**78,686**	**90,549**	**107,568**
EBITDA (%)	31.4	33.2	34.6	34.0	33.8
Growth (%)	19.3	37.4	9.4	15.1	18.8
Depreciation & amortisation	5,980	7,610	9,274	9,924	10,194
EBIT	46,400	64,340	69,412	80,626	97,374
Other non-operational income/expense (net)	7,040	4,730	9,528	11,512	14,523
PBT	53,440	69,070	78,940	92,137	111,897
Taxes	8,060	10,270	16,506	23,035	25,736
Extraordinary (income)/expense (net)/ Minority Interest	-1,210	-1,080	0	0	0
Net profit	**46,590**	**59,880**	**62,434**	**69,102**	**86,161**
Margin (%)	27.9	27.6	27.5	25.9	27.0
Diluted share capital (mn)	572.0	573.4	571.2	571.2	571.2
EPS (Rs)	**81.5**	**104.5**	**109.0**	**120.6**	**150.3**
Growth (%)	18.9	28.3	4.2	10.6	24.6

Exhibit 14: Balance sheet

Y/E March, Rs mn	FY08	FY09	FY10E	FY11E	FY12E
Share capital	2,860	2,860	2,870	2,870	2,870
Reserves & surplus	135,090	179,680	221,020	265,867	321,785
Networth	137,950	182,540	223,890	268,737	324,655
Sources of funds	**137,950**	**182,540**	**223,890**	**268,737**	**324,655**
Fixed assets	54,390	70,930	82,930	94,930	106,930
Less: Depreciation/amortisation	19,860	24,160	33,434	43,358	53,552
Net block	34,530	46,770	49,496	51,572	53,378
CWIP	13,240	6,770	5,000	6,000	6,000
Investments	720	0	52,730	70,000	85,000
Current assets	131,370	167,720	164,890	201,604	257,688
Sundry debtors	32,970	36,720	34,211	46,112	49,894
Cash & bank balance	69,500	96,950	87,935	107,227	154,770
Other current assets	1,190	1,260	2,860	2,860	2,860
Loans & advances	27,710	32,790	39,883	45,405	50,164
Current liabilities & provisions	41,910	38,720	48,227	60,439	77,411
Current liabilities	16,180	16,660	18,183	21,248	24,136
Provisions and others	25,730	22,060	30,043	39,191	53,274
Net current assets	89,460	129,000	116,663	141,165	180,277
Application of funds	**137,950**	**182,540**	**223,890**	**268,737**	**324,655**

Source: Company, Ambit Capital Research

Exhibit 15: Cash flow statement

Y/E March, Rs mn	FY08	FY09	FY10E	FY11E	FY12E
Net profit	46,590	59,880	62,434	69,102	86,161
Depreciation/amortisation	5,980	7,610	9,274	9,924	10,194
(Inc)/dec in working capital	-11,180	-4,730	878	-6,380	5,438
Others	-150	-9,640	-9,526	-11,512	-14,523
Net cash from operations (a)	**41,240**	**53,120**	**63,059**	**61,134**	**87,270**
(Inc)/dec in investments	-7,370	11,120	-43,202	-5,758	-477
Capex	-14,940	-13,250	-10,230	-13,000	-12,000
Cash flow from inv. (b)	**-22,310**	**-2,130**	**-53,432**	**-18,758**	**-12,477**
Inc/(dec) in capital	580	640	180	0	0
Dividends paid + dividend tax	-8,350	-24,940	-18,822	-23,085	-27,249
Financial cash flow (c)	**-7,770**	**-24,300**	**-18,642**	**-23,085**	**-27,249**
Net inc/dec in cash (a+b+c)	11,160	27,450	-9,015	19,291	47,544
Opening cash balance	58,340	69,500	96,950	87,936	107,227
Closing cash balance	**69,500**	**96,950**	**87,936**	**107,227**	**154,771**

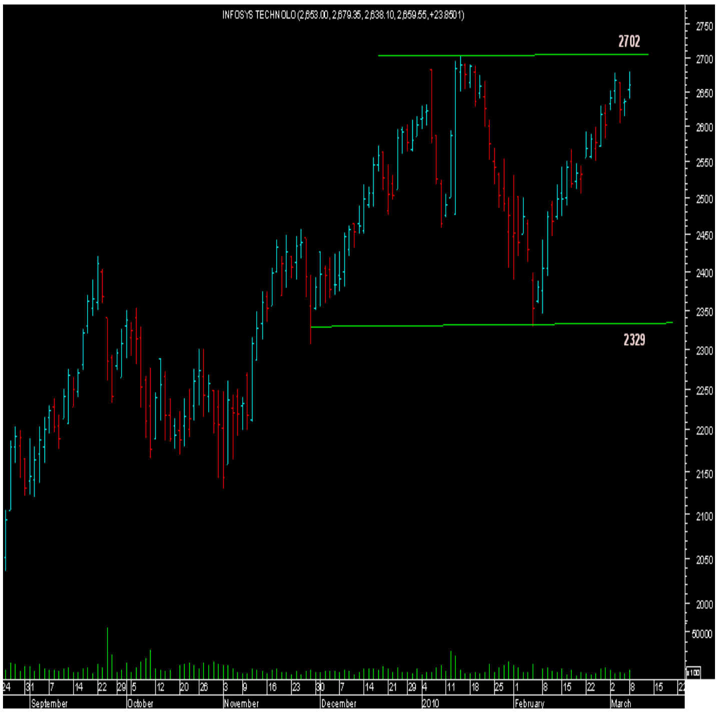
Exhibit 16: Key ratios

Y/E March	FY08	FY09	FY10E	FY11E	FY12E
ROCE (%)	37.0	40.2	34.2	32.7	32.8
ROE (%)	37.2	37.4	30.7	28.1	29.0
Valuation ratios (x)					
PER	33.0	25.7	24.6	22.3	17.9
PBV	11.0	8.4	6.9	5.7	4.7
EV/EBITDA	27.3	19.5	17.3	14.6	11.7
EV/Sales	8.6	6.5	6.0	5.0	4.0
Turnover ratios (no.)					
Debtor days	63	59	57	55	55
Creditor days	30	28	28	27	26

Source: Company, Ambit Capital Research

Technical View: Infosys Technologies - Wait for break out

Exhibit 17: Daily Chart



Source: MetaStock

- Infosys for the past two months is trading in 2329 to 2702 band.
- We expect the range bound move in this broad band would continue in the medium term.
- The Weekly MACD is in sell mode and daily is curving downward signaling correction is on the cards.
- Currently the stock is trading at upper end of the trading band and therefore could witness selling pressure.
- On break above 2702 the stock could witness fresh buying and then could target 2890, but on not doing so the stock could see severe beating down from 2702 levels.
- We advise to wait for a breakout or buy on decline to 2500 as the risk reward ratio is also not favorable at current market price.

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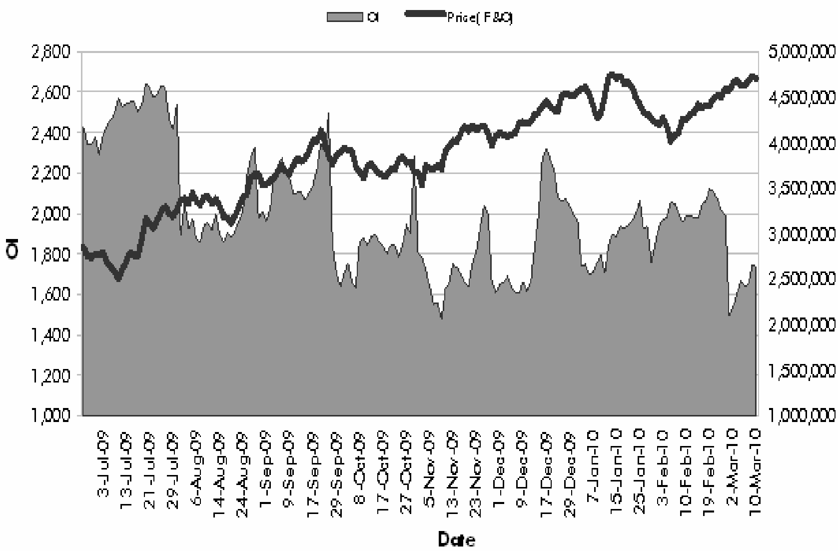
Derivatives View: Infosys Technologies

Exhibit 18: OI & price (F&O)



Source: Ambit Capital Research

- Open interest activity has been on a decline in Infosys over the last few months. The stock has stiff resistance around 2700 on the way up. A break out above those levels should lead the stock towards 2950-3000 levels. Very strong support for the stock lies at around 2400 levels. Any dip towards those levels should be used to buy into the stock. levels.

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INITIATING COVERAGE

Tata Consultancy Services

BUY

`Financials' To Drive Performance

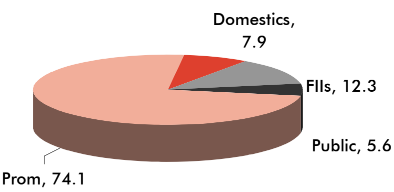
Price	Rs792
Target Price	**%Upside**
Rs925	17↑
Market Capitalisation	
Rs1,549,336mn	(US$34,008mn)
52 week range H/L (Rs)	816/225
Shares o/s (mn)	**Daily vol (mn)**
1,957.22	2.25
Reuters	**Bloomberg**
TCS.BO	TCS IN

Perfm(%)	**1M**	**3M**	**12M**	**YTD**
Absolute	6.6	12.4	242.4	5.6
Rel. to Sensex	0.3	12.1	62.7	7.4

BSE Sensex	**Nifty**
17,168	5,133

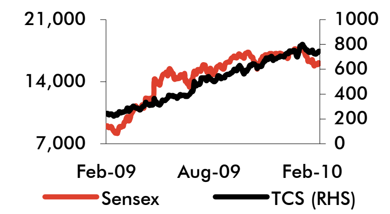
Source: Bloomberg

Shareholding pattern (%)



Source: Bloomberg

Price performance



Source: Bloomberg

- **Primary gainer of the BFSI revival:** TCS has been the biggest gainer of the BFSI recovery in 9MFY10. Despite having a higher exposure to failed banks during the BFSI industry consolidation phase, TCS has not only been able to retain clients but also gain incremental volumes from the vendor consolidation wins.
- **Leadership in Emerging markets:** Versus peers, TCS derives the highest revenue (US$345mn; 21.1% of revenue in 3QFY10) from Emerging markets, placing it in the best position to capture the incremental spend ensuing from these fast-growing markets.
- **Developing into a truly global company:** TCS has been the most aggressive in ramping up its near-shore model with 10 delivery centres in LATAM and ~7,000 employees. Not surprisingly, TCS has the largest share of non-Indian nationals in its workforce - 7.4% versus close to 5% for peers.
- **Early starter in non-linear initiatives:** TCS has been an early starter in pursuing non-linear initiatives ahead of peers. While peers have started focusing seriously on various non-linear growth models, we believe that TCS' formal SBU model and the early advantage gives it an edge.
- **Margins to decline ahead:** While TCS has always been under the scanner for its margin management capabilities, it has positively surprised the street in cost management. In fact, TCS has exited 3QFY10 with the best margins since 2QFY06. However, going forward, we expect margins to decline 120bps over FY10E-12E primarily due to our assumptions of US$/INR appreciation.
- **Initiate with a BUY, target price of Rs925:** We initiate coverage on TCS with a BUY recommendation and target price of Rs925, implying a target PE multiple of 20x, which is at a 5% discount to Infosys.Our target price implies a upside of 17%.

Exhibit 1: Key Financials

Y/E March, Rsmn	FY08	FY09	FY10E	FY11E	FY12E
Net Sales	228,614	278,129	301,894	355,341	426,493
Sales growth (YoY %)	22.7	21.7	8.5	17.7	20.0
EBITDA	59,397	71,781	87,338	100,043	118,229
EBITDA (%)	26.0	25.8	28.9	28.2	27.7
Adjusted Net Profit	50,191	51,721	68,049	78,713	90,747
EPS (Rs)	25.6	26.4	34.8	40.2	46.4
EPS Growth (YoY %)	23.1	3.0	31.6	15.7	15.3
ROCE (%)	46.0	43.4	41.6	37.9	35.9
ROE (%)	46.3	36.2	37.0	33.3	30.5
PE (x)	31.0	30.0	22.8	19.7	17.1
Price/Book Value (x)	12.6	9.9	7.6	6.0	4.8
EV/EBITDA (x)	25.7	21.3	17.2	14.7	12.1

Source: Company, Ambit Capital Research

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Company financial snapshot

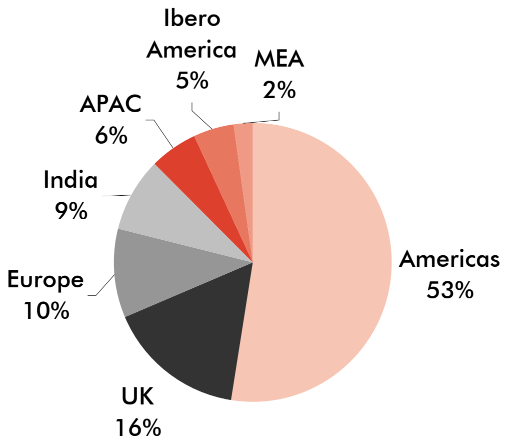
Profit and loss (Rsmn)

	FY10E	FY11E	FY12E
Net Sales	301,894	355,341	426,493
Operating Exp	214,557	255,298	308,264
EBITDA	87,338	100,043	118,229
Depreciation	7,262	7,818	8,956
Other income	1,091	4,967	9,098
PBT	81,166	97,193	118,370
Tax	12,164	17,495	26,633
Minority interest (MI)	952	986	990
Earnings in equity affiliates	(2)	-	-
PAT	68,049	78,713	90,747

Profit and loss ratios

	FY10E	FY11E	FY12E
EBITDA Margin (%)	28.9	28.2	27.7
PAT Margin (%)	22.5	22.2	21.3
P/E (x)	22.8	19.7	17.1
EV/ EBITDA (x)	17.2	14.7	12.1

Revenue mix Geo-wise



Source:: Company, Ambit Capital Research

Balance sheet (Rsmn)

	FY10E	FY11E	FY12E
Total Assets	273,988	345,286	424,958
Fixed Assets	41,896	51,078	59,122
Current Assets	113,690	171,938	228,934
Other Assets	78,419	82,287	96,919
Investments	39,983	39,983	39,983
Total Liabilities	273,988	345,286	424,958
Total Net Worth	203,894	259,583	323,787
Total Debt	2,962	2,962	2,962
Current Liabilities	59,299	73,922	88,401
Minority Interest	4,050	5,036	6,025
Other liabilities	3,782	3,782	3,782

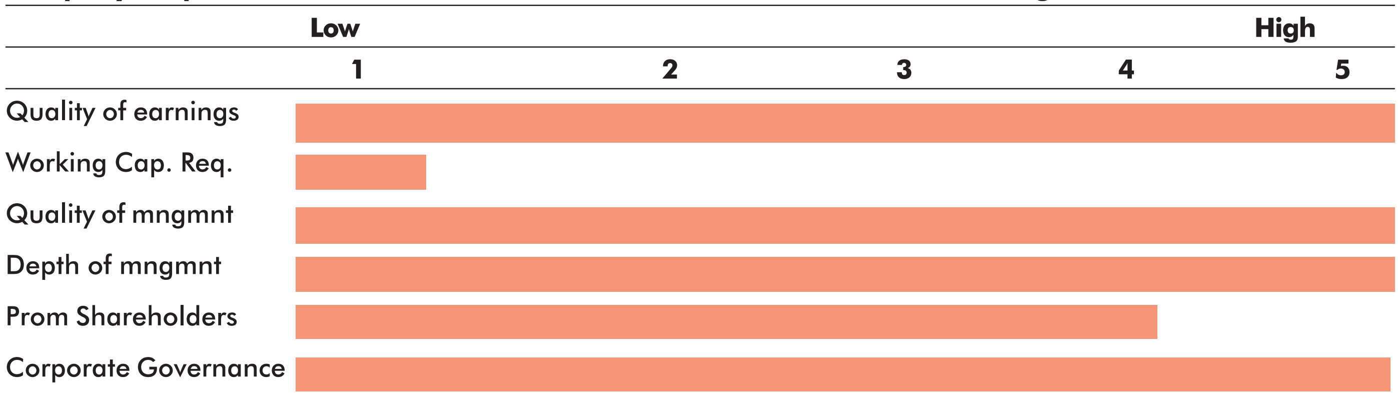
Balance sheet ratios (%)

	FY10E	FY11E	FY12E
RoE	37.0	33.3	30.5
RoCE	41.6	37.9	35.9
P/BV (x)	7.6	6.0	4.8

Cash flow (Rsmn)

	FY10E	FY11E	FY12E
Net profit	68,049	78,713	90,747
Depreciation/amortisation	7,262	7,818	8,956
(Inc)/dec in working capital	4,699	(21,931)	(2,454)
Others	(15,537)	(6,888)	(21,469)
Net cash from operations (a)	64,472	57,711	75,780
(Inc)/dec in investments	(22,726)	-	-
Capex	(11,663)	(17,000)	(17,000)
Others	1,091	4,967	9,098
Cash flow from inv. (b)	(33,298)	(12,033)	(7,902)
Dividends paid + dividend tax	(20,700)	(23,023)	(26,544)
Inc/dec in loans	(4,951)	-	-
Financial cash flow (c)	(25,651)	(23,023)	(26,544)
Net inc/dec in cash (a+b+c)	5,523	22,655	41,335
Opening cash balance	13,440	18,963	41,619
Closing cash balance	18,963	41,619	82,953

Company snapshot **Ratings**



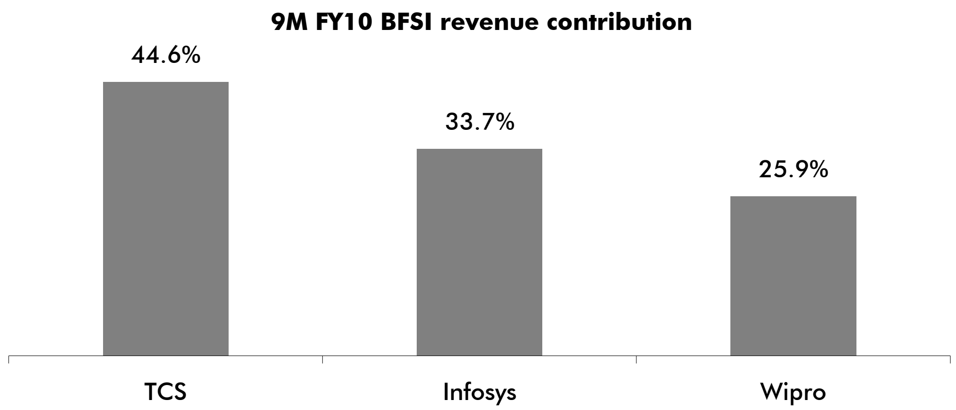
Investment Highlights

Primary gainer of the BFSI revival

- TCS has been the biggest gainer of the BFSI recovery in 9MFY10 amongst the tier-1 IT pack. The company has surprised the street positively on the revenue front for last three quarters in a row. While TCS' highest exposure to the BFSI vertical (44.6% of revenue in 9MFY10) saw its growth slip early in the downcycle resulting in the lowest revenue growth in FY09 amongst peers, it has also been the first to recover and deliver the strongest growth in the recovery phase in 9M FY10.

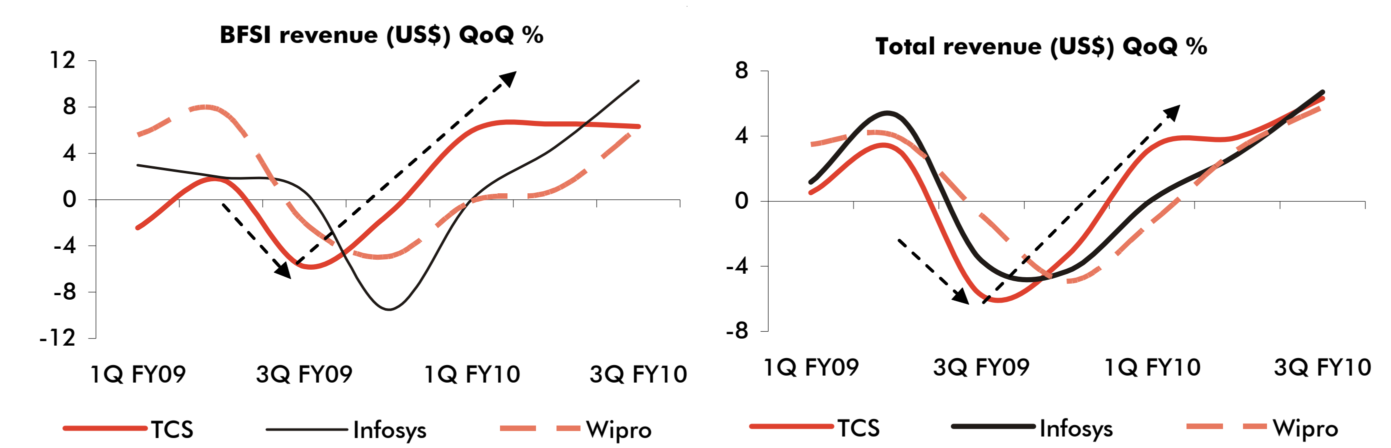
  We understand that during the BFSI industry consolidation phase TCS had the maximum exposure, to both the target and acquiring banks within the top 10 BFSI clients. However, TCS played its cards right and not only managed to retain clients but has been a winner in most vendor consolidation exercises even where the client was the target bank (e.g.: BOA-ML). Our channel checks suggest that incremental volumes from BOA-ML, JP Morgan, Citigroup and Barclays have driven most of the BFSI volume growth for TCS. We expect BFSI to remain the primary growth driver for TCS in FY11E.

Exhibit 2: TCS' higher BFSI exposure was advantageous in the recovery cycle



Source: Company

Exhibit 3: TCS' early recovery in BFSI propped overall growth levels



Source: Company

- **Products revenue has been strong:** TCS' product business (TCS BaNCS) has witnessed strong growth of 20.2% CQGR in 9MFY10. In fact, the products business has contributed 18.2% of incremental growth in the BFSI segment for 9MFY10. Strong growth in products business also corroborates the discretionary spend uptick witnessed in the BFSI space.

Exhibit 4: Products contributed 18% of incremental growth to BFSI in 9MFY10

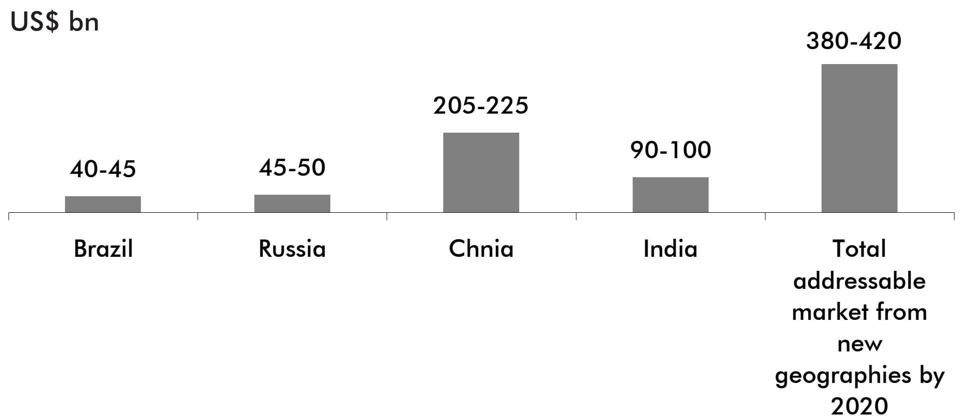
	FY09				FY10		
Particulars	**1Q**	**2Q**	**3Q**	**4Q**	**1Q**	**2Q**	**3Q**
Asset Leveraged Solutions (QoQ %)	-18.2	-8.6	-2.7	-36.6	27.9	27.9	6.3
BFSI (QoQ %)	-2.5	1.8	-5.8	-1.3	5.9	6.5	6.3
Contribution to BFSI growth (%)	-72.6	-40.3	-3.5	-215.6	23.0	25.3	7.1

Source: Company, Ambit Capital Research

Leadership in Emerging markets

- TCS' leadership in Emerging markets places it in a sweet spot with majority of the long-term incremental growth in IT spend expected to be driven by these markets. According to Nasscom-McKinsey Perspective 2020, the addressable spend from Emerging countries is expected to be US$380-420bn by 2020. Versus peers, TCS derives the highest revenue (US$345mn; 21.1% of revenue in 3QFY10) from Emerging markets, placing it in the best position to capture the incremental spend ensuing from these markets.

Exhibit 5: Emerging markets IT spend expected to be US$380-420bn by 2020



Source: Nasscom-McKinsey

Exhibit 6: TCS derives the highest revenues from Emerging markets

Particulars	1Q FY09	2Q FY09	3Q FY09	4Q FY09	1Q FY10	2Q FY10	3Q FY10
TCS							
Emerging markets revenue (US$ mn)	294	309	276	271	293	300	345
QoQ (%)	-5.8	4.8	-10.6	-1.8	8.2	2.3	15.0
% of revenue	19.3	19.6	18.6	18.9	19.8	19.5	21.1
Infosys							
Emerging markets revenue (US$ mn)	117	126	117	124	119	126	142
QoQ (%)	2.2	8.4	-7.4	6.2	-4.5	5.9	12.6
% of revenue	10.1	10.4	10	11.1	10.6	10.9	11.5
Wipro							
Emerging markets revenue (US$ mn)	113	124	127	122	134	144	169
QoQ (%)	0.6	9.9	1.8	-3.3	9.7	7.1	17.5
% of revenue	10.6	11.2	11.5	11.7	13.0	13.5	15.0

Source: Company

Developing into a truly global company

- The sheer number of people in TCS - 149,654 (incl. subsidiaries) coupled with the lowest attrition rates in industry (11.5% in 3Q FY10) speaks of TCS' excellent process and human resource management capabilities. Even in the recent downturn, TCS was the largest recruiter in the private sector globally with gross addition of 48,595 employees in FY09. The company has been the most aggressive in ramping up its near shore model with 10 delivery centers and ~7,000 employees in LATAM. Not surprisingly, TCS has the largest share of non-Indian nationals in its workforce - 7.4% versus peers which have close to 5%.

Exhibit 7: Non-Indian nationals constitute 7.4% of the total headcount

	FY05	FY06	FY07	FY08	FY09	3Q FY10
Non-Indian nationals (Nos.)	1,448	4,084	8,216	10,005	11,484	11,074
% of total headcount	3.2%	6.1%	9.2%	9.0%	8.0%*	7.4%

Source: Company, Ambit Capital Research; Note: The proportion of non-Indian nationals declined in FY09 primarily due to the CGSL acquisition (12,500 employees who were mainly offshore).*

Early starter in non-linear initiatives

- TCS has been an early starter in pursuing non-linear initiatives ahead of peers. Under the organisational rejig in February 2008, TCS' non-linear growth initiatives gained sharper focus with a formal strategic business unit (SBU) structure. While peers have started focusing seriously on various non-linear growth models, we believe that TCS' formal SBU model and the early advantage gives it an edge.
  - **Asset leveraged solutions:** Acquistion of FNS in FY06 gave TCS reasonable presence in the core banking products space and was instrumental in TCS' large deal wins such as the Bank of China (US$100mn) deal. Asset leveraged solutions currently contribute 3.2% to revenue. Apart from financial services, TCS is currently building frameworks and solutions for government and life sciences verticals.

- **Platform-based BPO:** TCS made a meaningful debut in the platform-based BPO business through its UK Life & Pension BPO subsidiary - Diligenta, built on the £486mn Pearl deal won in 2006. The core to this deal was TCS migrating Pearl's ~12 separate policy platforms to its own benefits adminstration platform, which would introduce cross-selling opportunities and cost effeciences. This was a complex process and has taken nearly four years. The all-new platform is expected to go live by May 2010. We would keenly watch the wins in this space as a large client win is essential: (i) to prove scalability of the platform; and (ii) is crucial for the required turnaround in Diligenta's declining profits. TCS has also launched new platforms in Finance & Accounting, Human Resource Outsourcing, while it is currently working on newer ones such as Procurement & Analytics.

Exhibit 8: Diligenta's turnaround depends on the success of new platform

Diligenta performance (Rs mn)	FY07	FY08	FY09
Revenue	6,369	5,625	5,269
% of consol. revenue	3.4	2.5	1.9
YoY %		(11.7)	(6.3)
PAT	(270)	(242)	(409)
YoY %		(10.4)	(68.9)

Source: Company

- **Small and medium business (SMB) intiative:** TCS launched 'IT-as-a-service' for the SMB vertical in India in 2008 which is based on 'pay per use' and 'build-as-you-grow' model. Once TCS attains reasonable success in India, it plans to launch the offering in other markets.

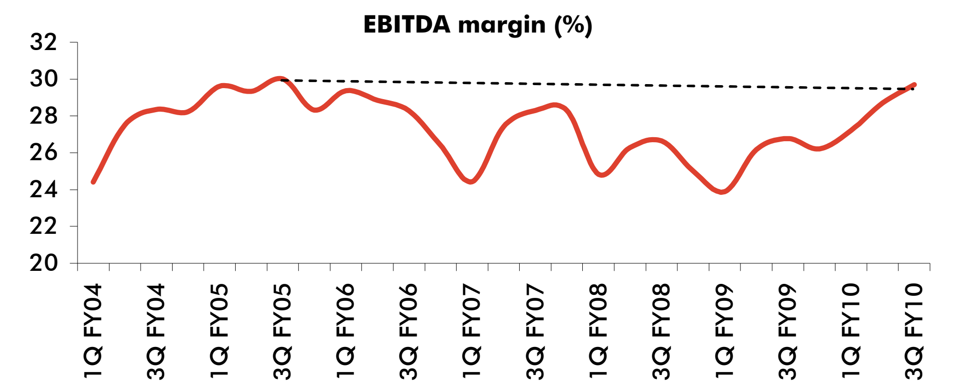
Margins to see a downtrend ahead

- **Positively surprised on margin management capabilities but further improvement not sustainable:** While TCS has always been under the scanner for its margin management capabilities, the company has positively surprised the street on its cost management and ability to push work offshore. In fact, TCS has exited 3QFY10 with the best margins since 2QFY06.

  Sharp focus on cost rationalisation and strong offshore transition (+360bps in 9MFY10) has led to stellar margin performance. That said, scope for margin leverage remains low with utilisation at a historical high of 77.2% (including trainees) as on 3QFY10. Further, SG&A costs have remained stagnant for the last few quarters and most other obvious margin levers seem to be at optimum levels.

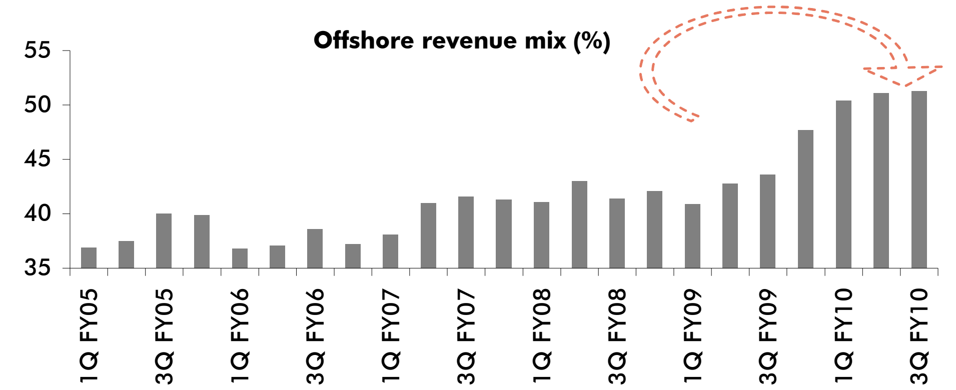
  We believe that turnaround in Diligenta (dependant on the success of client adds for the new platform), higher productivity and higher volume visibility should partially offset the negative impact of rupee appreciation. We expect margins to decline by 120bps over FY10E-12E. We have built in rupee appreciation of 4.1% and 1.2% for FY11E and FY12E respectively.

Exhibit 9: TCS' margins have been the highest since 3QFY05



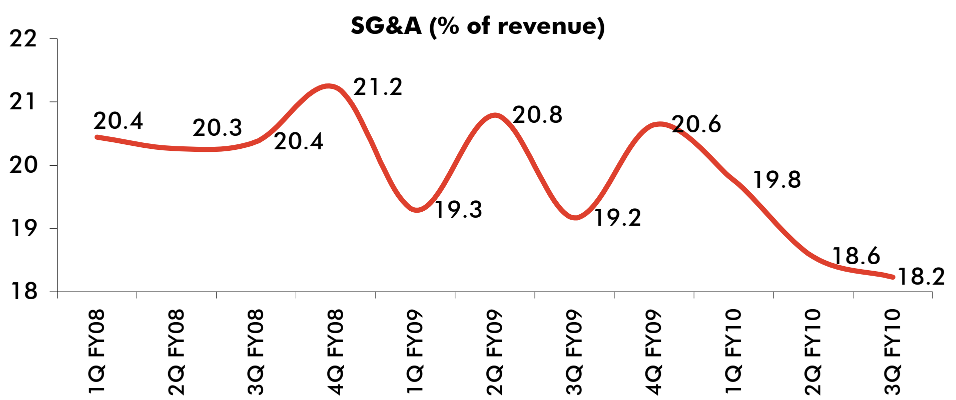
Source: Company

Exhibit 10: Strong offshore transition has helped margins …



Source: Company

Exhibit 11: … and so has stringent cost rationalisation



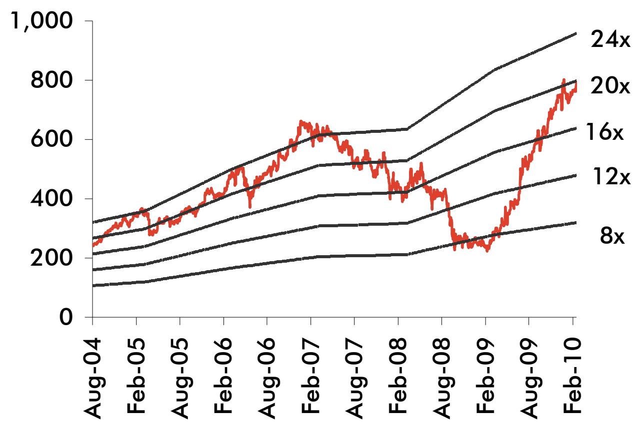
Source: Company

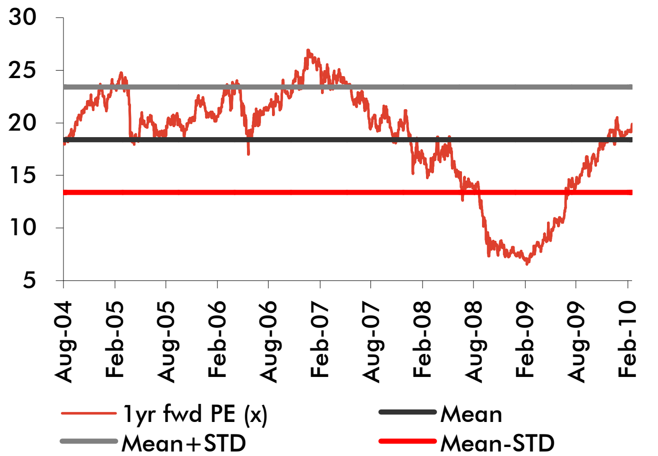
Valuation

- **Initiate with a BUY; target price of Rs925:** We initiate coverage on TCS with a BUY recommendation and March-2011 target price of Rs925. Our target price implies an upside potential of 17% from current levels.The stock currently trades at 19.7x and 17.1x on FY11E and FY12E EPS. We have valued TCS on a relative PE multiple basis. We choose to assign a target PE multiple of 20x on FY12E EPS, which is at a 5% discount to Infosys. TCS has traded at a average discount of ~10% to Infosys since listing. However, we believe a 5% discount is justified given that TCS has demonstrated strong revenue performance and margin management skills that we believe are sustainable.

  Our assumptions factor in: (a) US$ revenue CAGR of 22.2% (b) EBITDA CAGR of 16.3%; over FY10E-12E. We believe that US$ revenue growth would be an important metric to consider as the EPS CAGR of 15.5% would appear lower. This is due to our assumptions of: (a) Rupee appreciation of 4.1% and 1.2% over FY11E and FY12E respectively. (b) Tax rate increase to 18% in FY11E and to 23% in FY12E v/s 15% currently.

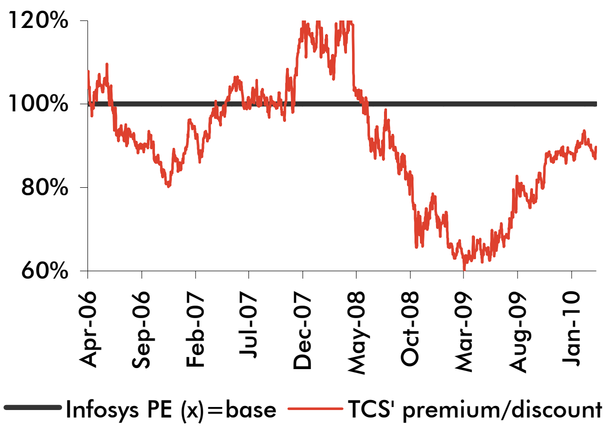
Exhibit 12: TCS — 1 year forward PE band

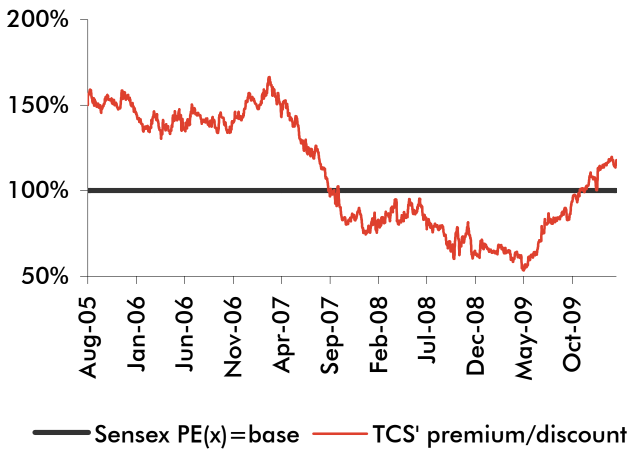




Source: Bloomberg

Exhibit 13: TCS — premium/discount to Infosys and Sensex





Source: Bloomberg

Exhibit 14: Financial assumptions

	FY10E	FY11E	FY12E
US$ revenue growth (YoY %)	5.8	22.8	21.5
Volume growth (YoY %)	18.4	22.1	21.6
Realization growth (YoY %)	-11.0	0.2	-0.8
US$/INR (Appreciation)/ Depreciation (%)	2.6	-4.1	-1.2
EBITDA margin (%)	28.9	28.2	27.7
EPS (YoY %)	31.6	15.7	15.3

Source: Company, Ambit Capital Research

Exhibit 15: Comparison to consensus

TCS (Rs mn)	Bloomberg estimate		Ambit Capital estimate		Difference to consensus	
	FY11E	FY12E	FY11E	FY12E	FY11E	FY12E
Sales	349,101	410,967	355,341	426,493	1.8%	3.8%
EBITDA	99,506	116,651	100,043	118,229	0.5%	1.4%
Profit	77,530	87,473	78,713	90,747	1.5%	3.7%
EPS (Rs)	39.4	44.4	40.2	46.4	2.1%	4.4%

Source: Bloomberg, Ambit Capital Research

Financials

Exhibit 16: Profit & Loss statement

Y/E March, Rs mn	FY08	FY09	FY10E	FY11E	FY12E
Net sales	**228,614**	**278,129**	**301,894**	**355,341**	**426,493**
Growth (%)	22.7	21.7	8.5	17.7	20.0
EBITDA	**59,397**	**71,781**	**87,338**	**100,043**	**118,229**
EBITDA (%)	26.0	25.8	28.9	28.2	27.7
Growth (%)	17.1	20.9	21.7	14.5	18.2
Depreciation & ammortisation	5,746	5,766	7,262	7,818	8,956
EBIT	53,651	66,015	80,075	92,226	109,272
Other non-operational income/ expense (net)	4,450	-4,672	1,091	4,967	9,098
PBT	58,101	61,343	81,166	97,193	118,370
Taxes	7,494	9,012	12,164	17,495	26,633
Extraordinary (income)/expense (net)	293	0	0	0	0
Equity in net earnings of affiliates	8	-7	-2	0	0
Minority interest	424	603	952	986	990
Adjusted net profit	**50,484**	**51,721**	**68,049**	**78,713**	**90,747**
Margin (%)	22.1	18.6	22.5	22.2	21.3
Diluted share capital (mn)	1,957.2	1,957.2	1,957.2	1,957.2	1,957.2
EPS (Rs)	**25.6**	**26.4**	**34.8**	**40.2**	**46.4**
Growth (%)	23.1	3.0	31.6	15.7	15.3

Exhibit 17: Balance sheet

Y/E March, Rs mn	FY08	FY09	FY10E	FY11E	FY12E
Share capital	979	979	1,957	1,957	1,957
Reserves & surplus	122,841	155,567	201,937	257,626	321,829
Networth	123,820	156,545	203,894	259,583	323,787
Minority Interest	2,300	3,098	4,050	5,036	6,025
Loans	7,098	7,913	2,962	2,962	2,962
Others (net)	756	2,745	3,782	3,782	3,782
Sources of funds	**133,974**	**170,301**	**214,688**	**271,363**	**336,556**
Fixed assets	36,664	51,386	61,386	76,386	91,386
Less: Depreciation/amortisation	14,699	20,229	27,491	35,308	44,265
Net block	21,965	31,157	33,895	41,077	47,121
CWIP	8,250	6,338	8,001	10,001	12,001
Investments	26,475	17,257	39,983	39,983	39,983
Other Long Term Assets	25,165	62,353	78,419	82,287	96,919
Current assets	93,170	109,750	113,690	171,938	228,934
Sundry debtors	53,903	60,463	60,295	79,895	86,029
Cash & bank balance	10,352	13,440	18,963	41,619	82,953
Other current assets	28,915	35,847	34,431	50,424	59,952
Current liabilities & provisions	41,050	56,553	59,299	73,922	88,401
Current liabilities	7,395	10,340	7,856	11,614	14,092
Provisions and others	33,655	46,213	51,443	62,308	74,309
Net current assets	52,119	53,196	54,390	98,014	140,532
Application of funds	**133,974**	**170,301**	**214,688**	**271,363**	**336,556**

Source: Company, Ambit Capital Research

Exhibit 18: Cash flow statement

Y/E March, Rs mn	FY08	FY09	FY10E	FY11E	FY12E
Net profit	50,191	51,721	68,049	78,713	90,747
Depreciation/amortisation	5,746	5,766	7,262	7,818	8,956
(Inc)/dec in working capital	-11,699	-1,012	4,699	-21,931	-2,454
Others	-3,880	-5,060	-15,537	-6,888	-21,469
Net cash from operations (a)	**40,358**	**51,415**	**64,472**	**57,711**	**75,780**
(Inc)/dec in investments	-13,311	10,413	-22,726	0	0
Capex	-12,340	-10,644	-11,663	-17,000	-17,000
Others	-1,795	-36,754	1,091	4,967	9,098
Cash flow from inv. (b)	**-27,445**	**-36,985**	**-33,298**	**-12,033**	**-7,902**
Inc/(dec) in capital	986	0	0	0	0
Dividends paid + dividend tax	-14,884	-16,029	-20,700	-23,023	-26,544
Inc/dec in loans	-268	-378	-4,951	0	0
Others	-37	-56	0	0	0
Financial cash flow (c)	**-14,202**	**-16,463**	**-25,651**	**-23,023**	**-26,544**
Net inc/dec in cash (a+b+c)	-1,289	-2,033	5,523	22,655	41,335
Opening cash balance	12,291	10,352	13,440	18,963	41,619
Effect of foreign exchange	-650	5,121	0	0	0
Closing cash balance	**10,352**	**13,440**	**18,963**	**41,619**	**82,953**

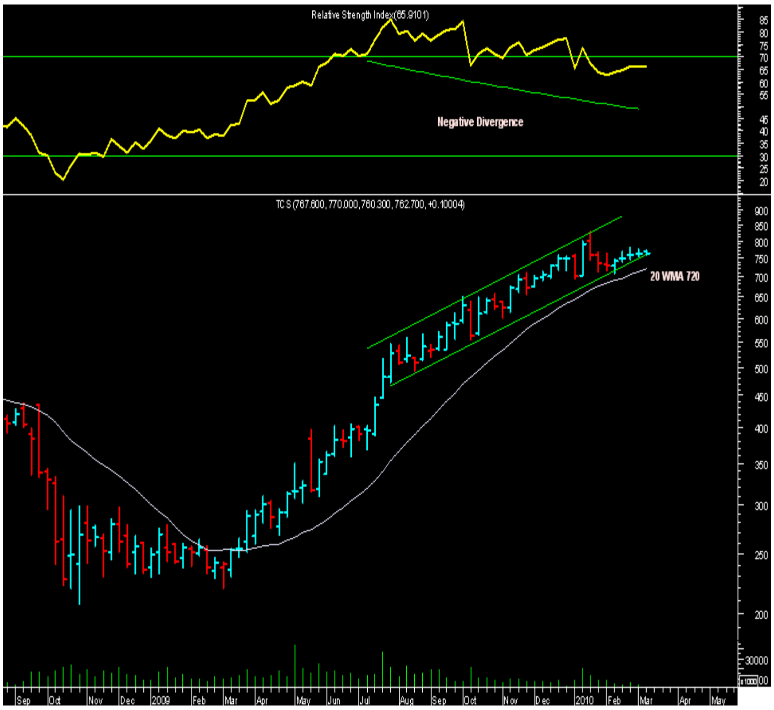
Exhibit 19: Key ratios

Y/E March	FY08	FY09	FY10E	FY11E	FY12E
ROCE (%)	46.0	43.4	41.6	37.9	35.9
ROE (%)	46.3	36.2	37.0	33.3	30.5
Valuation ratios (x)					
PER	31.0	30.0	22.8	19.7	17.1
PBV	12.6	9.9	7.6	6.0	4.8
EV/EBITDA	25.7	21.3	17.2	14.7	12.1
EV/Sales	6.7	5.5	5.0	4.2	3.4
Turnover ratios (no.)					
Debtor days	86	79	73	82	74
Creditor days	11	12	11	10	11

Source: Company, Ambit Capital Research

Technical View: TCS - Short

Exhibit 20: Weekly Chart



Source: MetaStock

- TCS is witnessing negative divergence on weekly chart.
- The RSI is drifting down and prices are moving up, this ignorance could face sharp fall in coming days.
- We remain cautious for next couple of months and expect TCS to correct till its 20WMA (weekly moving average) which is at 720.
- On the upside resistance for the stock is at 815.

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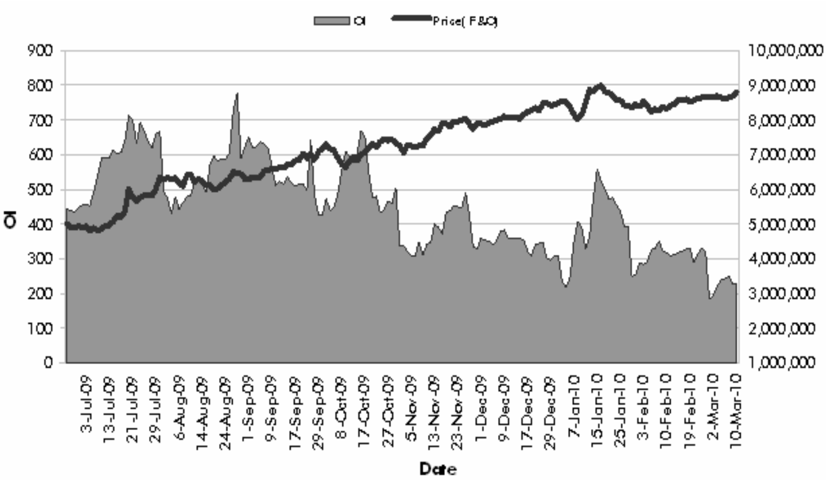
Derivatives View: TCS

- In line with Infosys, TCS too has seen significant decline in Open Interest activity over the last few months. 700 would be a good entry point into the stock. Resistance on the way up is at 800 levels a break above which would mean the stock looking to target 900 levels.

Exhibit 21: OI & price (F&O)



Source: Ambit Capital Research

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Wipro

HOLD

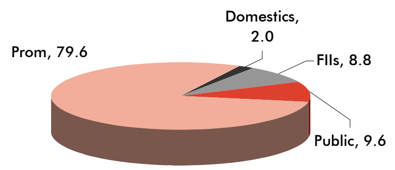
Price	Rs713
Target Price	**%Upside**
Rs780	9↑
Market Capitalisation	
Rs1,041,698mn	(US$22,866mn)
52 week range H/L (Rs)	753/208
Shares o/s (mn)	**Daily vol (mn)**
11,468.01	1.44
Reuters	**Bloomberg**
WIPR.BO	WPRO IN

Perfm(%)	1M	3M	12M	YTD
Absolute	8.2	10.1	244.9	4.4
Rel. to Sensex	1.8	9.8	63.9	6.3

BSE Sensex	Nifty
17,168	5,133

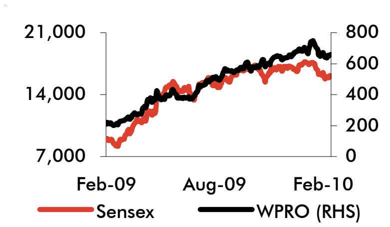
Source: Bloomberg

Shareholding pattern (%)



Source: Bloomberg

Price performance



Source: Bloomberg

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AMBIT
Acumen at work

Fewer Catalysts Ahead

- **Strong presence in emerging verticals ….:** Wipro's strong presence in emerging verticals such as Energy & Utilities (9% of revenue in 9MFY10) and Healthcare (8.3% of revenue), which are expected to be the primary growth drivers in the longer term, should work to its advantage.
- **.. and Emerging markets offers a potent combination:** Wipro has been a strong contender in the domestic market and has been in the forefront of deal wins. With the domestic market opportunity expected to increase to US$90 bn by 2020, Wipro appears well-positioned in the longer term.
- **Diversified services base:** Wipro has been able to successfully build a diversified services portfolio across verticals with strong positioning in IMS and largest presence in Testing services. Ex-ADM service lines contributed 60.6% to revenue in 9M FY10 (Infosys: 58.1%; TCS: 50.9%).
- **Lower BFSI exposure was beneficial in FY09…:** Wipro's lower exposure to BFSI worked to its advantage in FY09 (US$ revenue YoY - Wipro:18.5%, Infosys:11.8%, TCS:5.6%) when financial services growth plunged, led by the credit crisis.
- **… but going forward we do not expect financial outperformance:** While the stronger presence in emerging verticals will help faster growth, the lower BFSI exposure, expected to be the primary growth driver particularly for FY11E, will not lead to a repeat of the financial outperformance witnessed in FY09.
- **Low margin levers:** Factors such as: (a) little scope for leverage on utilisation; (b) increasing investments into data centers in IMS; and (c) advance hiring might lead to relative underperformance on the margin front v/s peers.
- **Initiating with a HOLD and target price of Rs780:** We initiate coverage on Wipro with a target price of Rs780, implying a target PE multiple of 20x on FY12E EPS. Our target price implies an upside of 9%.

Exhibit 1: Key Financials

Y/E March, Rsmn	FY08	FY09	FY10E	FY11E	FY12E
Net Sales	197,428	254,564	274,389	318,434	378,406
Sales growth (YoY %)	32.1	28.9	7.8	16.1	18.8
EBIT	33,714	41,387	51,345	57,866	65,492
EBIT (%)	17.1	16.3	18.7	18.2	17.3
Adjusted Net Profit	32,241	34,412	45,766	51,210	56,999
EPS (Rs)	22.1	23.5	31.2	34.9	38.8
EPS Growth (YoY%)	11.9	6.5	32.7	11.8	11.2
ROCE (%)	29.1	25.1	27.9	26.2	25.7
ROE (%)	27.9	24.6	26.4	23.6	21.8
PE (x)	32.3	30.3	22.8	20.4	18.4
Price/Book Value (x)	8.0	6.9	5.3	4.4	3.7
EV/EBITDA (x)	29.7	24.0	18.4	15.8	13.0

Source: Company, Ambit Capital Research

Company financial snapshot

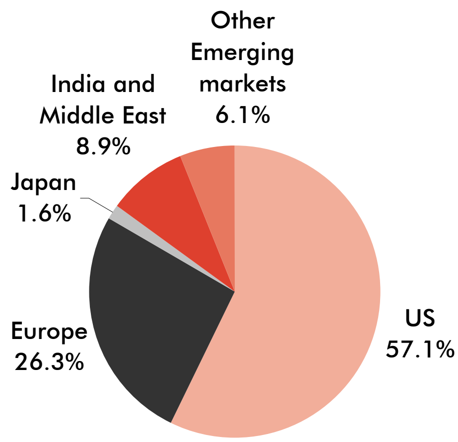
Profit and loss (Rsmn)

	FY10E	FY11E	FY12E
Net Sales	274,389	318,434	378,406
Operating Exp	223,044	260,569	312,914
EBITDA	51,345	57,866	65,492
Other income	2,492	4,000	6,000
PBT	53,838	61,866	71,492
Tax	8,546	11,136	15,013
Earnings in equity affiliates	474	480	520
PAT	45,766	51,210	56,999

Profit and loss ratios

	FY10E	FY11E	FY12E
EBITDA Margin (%)	18.7	18.2	17.3
PAT Margin (%)	16.7	16.1	15.1
P/E (x)	22.8	20.4	18.4
EV/ EBITDA (x)	18.4	15.8	13.0

Revenue mix Geo-wise



Source:: Company, Ambit Capital Research

Balance sheet (Rsmn)

	FY10E	FY11E	FY12E
Total Assets	340,035	397,588	479,047
Fixed Assets	53,356	55,484	55,754
Current Assets	177,406	230,124	307,796
Other Assets	58,406	58,406	58,406
Investments	50,867	53,573	57,091
Total Liabilities	340,035	397,588	479,047
Total Net Worth	195,910	237,542	284,868
Total Debt	19,836	17,852	16,067
Current Liabilities	123,896	141,801	177,719
Minority Interest	393	393	393

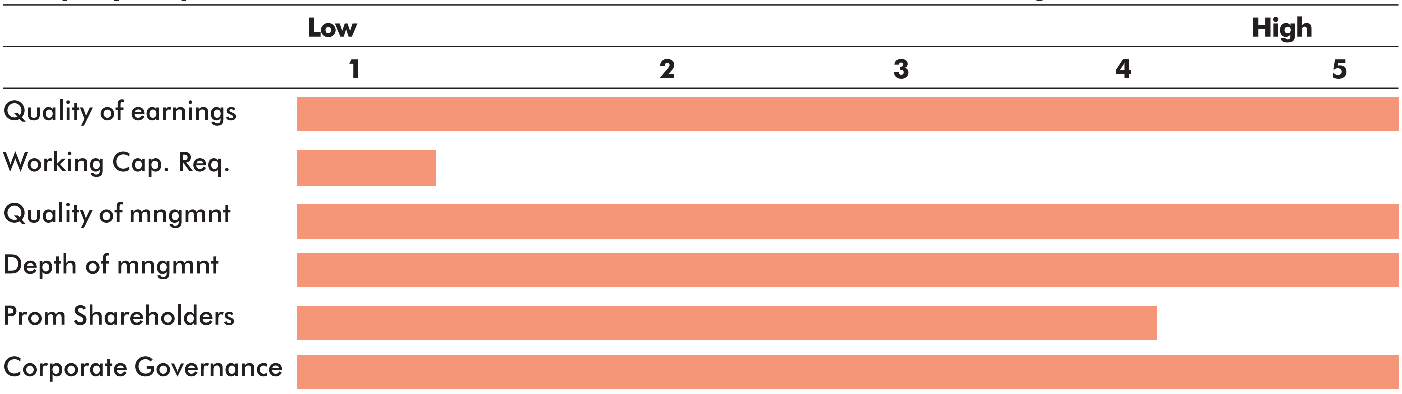
Balance sheet ratios (%)

	FY10E	FY11E	FY12E
RoE	26.4	23.6	21.8
RoCE	27.8	26.2	25.7
P/BV (x)	5.3	4.4	3.7

Cash flow (Rsmn)

	FY10E	FY11E	FY12E
Net profit	45,766	51,210	56,999
(Inc)/dec in working capital	(1,432)	(1,879)	14,795
Others	6,341	5,871	5,731
Net cash from operations (a)	50,674	55,203	77,524
(Inc)/dec in investments	(23,658)	-	-
Capex	(12,000)	(12,000)	(12,000)
Others	8,852	1,294	2,482
Cash flow from inv. (b)	(26,806)	(10,706)	(9,518)
Inc/(dec) in capital	393	719	633
Dividends paid + dividend tax	(6,859)	(10,297)	(10,306)
Inc/dec in loans	241	(1,984)	(1,785)
Others	6,428	-	-
Financial cash flow (c)	203	(11,561)	(11,458)
Net inc/dec in cash (a+b+c)	24,072	32,935	56,548
Opening cash balance	49,117	73,189	106,124
Closing cash balance	73,189	106,124	162,672

Company snapshot **Ratings**



Investment Highlights

Strong presence in emerging verticals ....

- Wipro has a strong presence in emerging verticals such as Energy and Utilities (9% of revenue in 9MFY10) and Healthcare (8.3% of revenue). These verticals are expected to be the primary growth drivers in the longer term. According to Nasscom-McKinsey, by 2020, the addressable markets for these verticals would be US$115-135bn. Wipro's strong presence in these verticals should work to its advantage.

Exhibit 2: Wipro has a strong presence in emerging verticals

Revenue (US$ mn) 9M FY10	Wipro	Infosys	TCS	HCL Tech
Energy & Utilities	289	207	139	137 ^
% of total revenue	9.0	5.9	3.0	7.2
Healthcare & Services	267	na	273	126
% of total revenue	8.3	na	5.9	6.7

Source: Company; Note: ^ Includes public sector, trailing 9 months.

... and domestic markets offers a potent combination

- Wipro has been a strong contender in the domestic market (India/ME contributed 8.3% of revenue in 9M FY10) and has been in the forefront of deal wins. With domestic markets expected to be a strong growth driver (addressable market expected to increase from US$26bn to US$90bn by 2020; CAGR of 11%), Wipro appears well positioned in the longer term.

Exhibit 3: Wipro - recent domestic deal wins

Company	Deal particulars	Deal value (Rs bn)
Unitech Wireless	Integrate the Telco's operations with the use	25
	of ERP and host all its data centers	
Life Insurance Corporation (LIC)	Upgrade LIC's front-end IT application programmes	2
Employees State Insurance	Modernisation and automation of the entire healthcare	
	benefits administration corporation	118
Punjab and Sind bank	Enable the bank to centralise its banking operations	1
Delhi International Airport Limited (DIAL)	To provide world class IT Infrastructure and services for IGIA, New Delhi	na

Source: Industry data

Diversified services base

- Wipro has been able to successfully build a diversified services portfolio across verticals with strong positioning in infrastructure management services (IMS) and largest presence in Testing services. Ex-ADM service lines contributed 60.6% to revenue in 9M FY10 (Infosys: 58.1%; TCS: 50.9%). Wipro's acquisition of Infocrossing (deal size US$600 mn; Price/Sales of 2.6x) helped it gain a strong foothold in the fledgling IMS space. Infocrossing was a striking departure from the 'only-services' model, as it gave the ability of data hosting services and also offered an entry point for winning more downstream application-driven projects.

Exhibit 4: Largest presence in IMS and Testing services

Revenue (US$ mn) 9MFY10	Wipro	Infosys	TCS	HCL Tech
Infrastructure management services	675	251	390	361 ^
% of total revenue	20.9	7.2	8.4	19.1
Testing	382	221	222	na
% of total revenue	11.9	6.3	4.8	na

Source: Company. Note: ^trailing 9 months.

Organisation restructuring working well

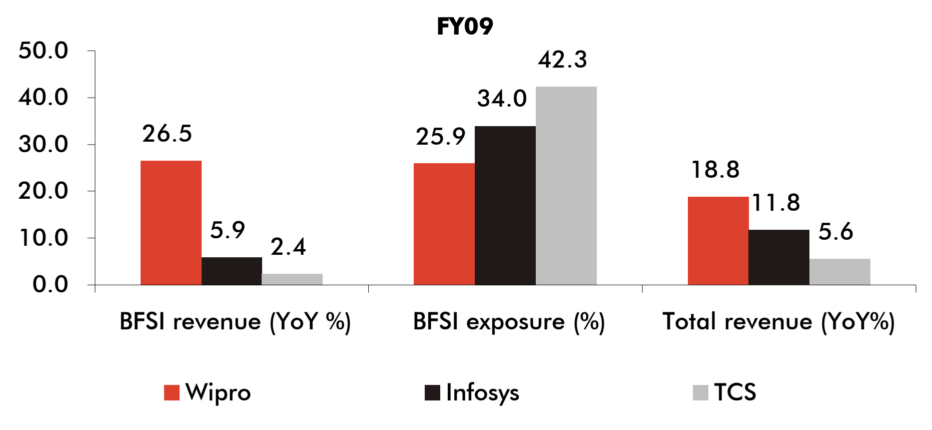
- Wipro underwent organisation restructuring in FY08 wherein a joint CEO system with clear responsibilities came into force. While there was initial skepticism about success of this model, the last two years has seen the collective leadership model being fruitful with a clearer strategic direction emerging.

  Besides, during the same time Wipro instituted a global programs group (headed by T.K. Kurien then and now by Mr.Ramakanth Desai) which focuses on large transformational deals and typically targets the CxO budgets v/s CIO budgets. While Wipro was known to be lagging in its large deal capabilities versus peers, we believe that the sharper focus rendered by a separate team (~40 people), formalised large deal process and strong IMS capability has catapulted it into the league of a meaningful competitor.

Lower BFSI exposure was beneficial in FY09...

- While Wipro's lower exposure to BFSI and higher exposure to Telecom OEM (v/s telecom service providers) drove its underperformance from FY05 to FY08, this same profile worked to its advantage in FY09 when financial services growth plunged, led by the credit crisis. Besides, during FY09, Wipro restructured its R&D services unit, which catered primarily to Telecom OEM and Hi-tech clients to include Automotive, Aerospace, which softened the blow during the downturn.

Exhibit 5: Lower exposure to BFSI worked to Wipro's advantage in FY09



Source: Company

... but financial outperformance unlikely ahead

- BFSI which has led the recovery is expected to be the primary growth driver going forward for FY11E/12E. We believe that while Wipro's stronger presence in emerging verticals will help faster growth, its lower exposure to BFSI and slower recovery in the Telecom OEM space will partly pull down the overall growth rates. That said, we do not expect the company to post the kind of underperformance which it did in FY05-08 as: (a) Wipro has relatively beefed its presence within BFSI since then; and (b) Telecom OEM was coming off a higher base in FY05.

Low margin levers

- Wipro delivered a big surprise on the margin front and improved EBIT margins (IT Services) by 140bps since Jun-09. This was achieved by its just-in-time hiring policy, stringent cost rationalisation and sharp increase in the fixed price revenue contribution. However, going forward, we believe that margin concerns emanating primarily from the risk of rupee appreciation are looming large on the horizon.

  With: (a) little scope for leverage on utilisation from the current historic high level (80.7%, excluding IFOX in 3QFY10); and (b) increasing investments into data centers in IMS (as Infocrossing is already operating at close to full capacity), which although positive in the medium term, might have near-term margin pressure; and (c) need to turn aggressive on hiring given the just-in-time hiring pursued until 2QFY10, might lead to relative underperformance of margins v/s peers. We have built in EBIT margin decline of 140bps over FY10E-12E.

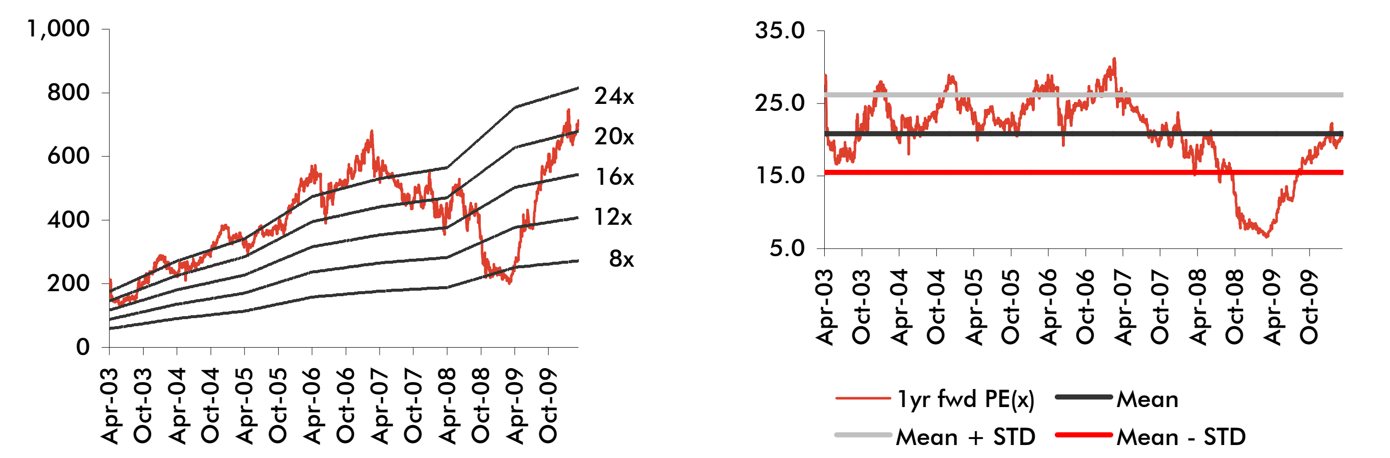
Valuation

- **Initiate with a HOLD; target price of Rs780:** We initiate coverage on Wipro with a HOLD recommendation and March-2011 target price of Rs780. Our target price implies an upside potential of 9% from current levels. The stock currently trades at 20.4x and 18.4x on FY11E and FY12E EPS. We have valued Wipro on a relative PE multiple basis. We choose to assign a target PE multiple of 20x on FY12E EPS, which is at a 5% discount to Infosys.

  Wipro has broadly traded at a 35% premium to 40% discount to Infosys. Valuation multiples for Wipro have converged to ~5% discount from the lows of 40% in Feb-09, given Wipro's financial outperformance since FY09. We believe that the current discount of 5% is justified as although Wipro will be a strong beneficiary of the offshoring trend given its fine execution skills and well-diversified portfolio, lower margin levers and lower exposure to BFSI would reduce the scope of its financial outperformance to Infosys.

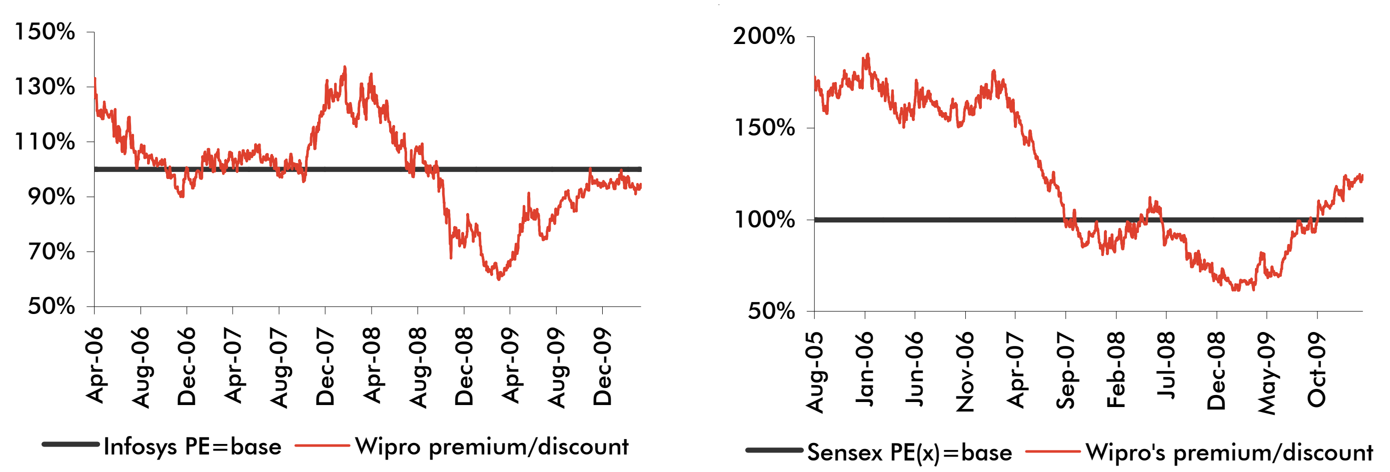
  Assumptions in our estimates include: (a) US$ revenue (IT Services) CAGR of 20.0%; (b) EBIT CAGR of 12.9%; over FY10E-12E. We believe that US$ revenue growth would be an important metric to consider as the EPS CAGR of 11.5% would appear lower. This is due to our assumption of: (a) rupee appreciation of 4.0% and 1.3% in FY11E and FY12E; (b) tax rate increase to 18% in FY11E and 21% in FY12E respectively v/s 16.3% currently.

Exhibit 6: Wipro — 1-year forward PE band



Source: Bloomberg

Exhibit 7: Wipro — premium/discount to Infosys and Sensex



Source: Bloomberg

Exhibit 8: Financial assumptions

	FY10E	FY11E	FY12E
US$ revenue growth^ (YoY %)	1.9	20.5	19.6
Volume growth* (YoY %)	2.6	21.5	18.9
Realization growth* (YoY %)	-3.0	-1.0	0.3
US$/INR (Appreciation)/ Depreciation (%)	3.6	-4.0	-1.3
EBIT margin (%)	19.0	18.0	17.1
EPS (YoY %)	32.7	11.8	11.2

*Source: Company, Ambit Capital Research, Note:^ IT Services; *IT services excl. India/ME/IFOX*

Exhibit 9: Comparison to consensus

Wipro (Rs mn)	Bloomberg estimate		Ambit Capital estimate		Difference to consensus	
	FY11E	FY12E	FY11E	FY12E	FY11E	FY12E
Sales	317,174	369,924	318,434	378,406	0.4%	2.3%
EBITDA	68,060	77,721	61,866	71,492	-9.1%	-8.0%
Profit	52,297	58,194	51,210	56,999	-2.1%	-2.1%
EPS (Rs)	35.7	39.7	34.9	38.8	-2.3%	-2.2%

Source: Bloomberg, Ambit Capital Research

Financials

Exhibit 10: Profit & Loss statement

Y/E March, Rs mn	FY08	FY09	FY10E	FY11E	FY12E
Net sales	**197,428**	**254,564**	**274,389**	**318,434**	**378,406**
Growth (%)	32.1	28.9	7.8	16.1	18.8
EBIT	**33,714**	**41,387**	**51,345**	**57,866**	**65,492**
Margin (%)	17.1	16.3	18.7	18.2	17.3
Other non-operational income	2,167	-1,816	2,492	4,000	6,000
PBT	35,881	39,571	53,838	61,866	71,492
Taxes	3,873	5,422	8,546	11,136	15,013
Extraordinary (income)/expense (net)	0	0	0	0	0
Minority interest/Income from equity investees	233	263	474	480	520
Adjusted net profit	**32,241**	**34,412**	**45,766**	**51,210**	**56,999**
Margin (%)	16.3	13.5	16.7	16.1	15.1
Diluted share capital (mn)	1,462	1,465	1,466	1,467	1,468
EPS (Rs)	**22.1**	**23.5**	**31.2**	**34.9**	**38.8**
Growth (%)	11.9	6.5	32.7	11.8	11.2

Exhibit 11: Balance sheet

Y/E March, Rs mn	FY08	FY09	FY10E	FY11E	FY12E
Share capital	2,923	2,930	2,931	2,934	2,936
Reserves & surplus	126,444	147,252	192,978	234,608	281,933
Networth	129,367	150,182	195,910	237,542	284,868
Minority Interest	114	235	393	393	393
Loans	15,223	19,595	19,836	17,852	16,067
Sources of funds	**144,704**	**170,012**	**216,139**	**255,787**	**301,328**
Intangible assets	51,436	67,106	58,406	58,406	58,406
Fixed assets	63,574	81,251	93,251	105,251	117,251
Less: Depreciation/amortisation	23,752	31,389	39,895	49,766	61,497
Net block	39,822	49,862	53,356	55,484	55,754
Investments	18,508	25,038	50,867	53,573	57,091
Current assets	113,533	148,542	177,406	230,124	307,796
Inventories	7,172	8,686	9,424	11,593	13,382
Sundry debtors	38,908	46,217	51,511	60,160	70,468
Cash & bank balance	39,270	49,117	73,189	106,124	162,672
Other current assets	28,183	44,522	43,283	52,248	61,274
Current liabilities & provisions	78,595	120,536	123,896	141,801	177,719
Current liabilities	13,082	18,017	31,599	20,747	41,457
Provisions and others	65,513	102,519	92,297	121,054	136,262
Net current assets	34,938	28,006	53,510	88,323	130,077
Application of funds	**144,704**	**170,012**	**216,139**	**255,787**	**301,328**

Source: Company, Ambit Capital Research. Note: Prior to FY09 financials are in US GAAP; rest in IFRS

Exhibit 12: Cash flow statement

Y/E March, Rs mn	FY08	FY09	FY10E	FY11E	FY12E
Net profit	32,241	34,412	45,766	51,210	56,999
(Inc)/dec in working capital	-13,256	-341	-1,432	-1,879	14,795
Others	5,283	2,758	6,341	5,871	5,731
Net cash from operations (a)	**24,268**	**36,829**	**50,674**	**55,203**	**77,524**
(Inc)/dec in investments	18,451	-1,030	-23,658	0	0
Capex	-14,194	-16,234	-12,000	-12,000	-12,000
Others	-32,639	-10,429	8,852	1,294	2,482
Cash flow from inv. (b)	**-28,382**	**-27,693**	**-26,806**	**-10,706**	**-9,518**
Inc/(dec) in capital	749	440	393	719	633
Dividends paid + dividend tax	-5,404	-6,829	-6,859	-10,297	-10,306
Inc/dec in loans	35,589	6,419	241	-1,984	-1,785
Others	68	18	6,428	0	0
Financial cash flow (c)	**31,002**	**48**	**203**	**-11,561**	**-11,458**
Net inc/dec in cash (a+b+c)	26,888	9,184	24,072	32,935	56,548
Opening cash balance	12,412	39,270	49,117	73,189	106,124
Effect of foreign exchange	-30	663	0	0	0
Closing cash balance	**39,270**	**49,117**	**73,189**	**106,124**	**162,672**

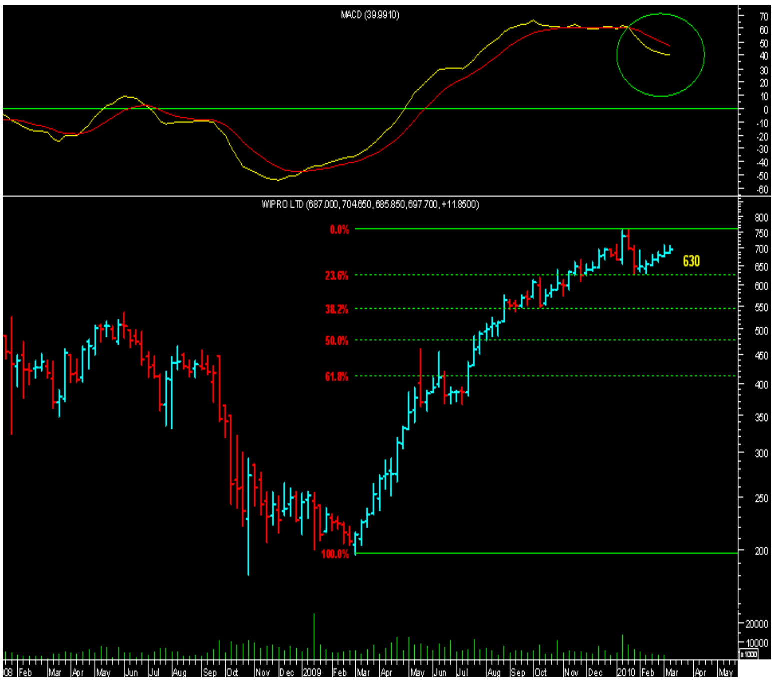
Exhibit 13: Key ratios

Y/E March	FY08	FY09	FY10E	FY11E	FY12E
ROCE (%)	29.1	25.1	27.9	26.2	25.7
ROE (%)	27.9	24.6	26.4	23.6	21.8
Debt-equity ratio (x)	0.1	0.1	0.1	0.1	0.1
Valuation ratios (x)					
PER	32.3	30.3	22.8	20.4	18.4
PBV	8.0	6.9	5.3	4.4	3.7
EV/EBITDA	29.7	24.0	18.4	15.8	13.0
EV/Sales	5.1	3.9	3.5	2.9	2.3
Turnover ratios (no.)					
Debtor days	55	53	65	64	63
Inventory days	13	12	13	13	13
Creditor days	22	22	33	30	30

Source: Company, Ambit Capital Research.Note: Prior to FY09 financials are in US GAAP; rest in IFRS

Technical View: Wipro - Buy on decline

Exhibit 14: Weekly Chart



Source: MetaStock

- The momentum oscillators of Wipro on daily chart are in buy mode but on weekly chart all the indicators are stretched and in sell mode.
- Wipro has very strong support at 630 levels and we expect that would be a good level to buy the stock.
- Therefore we advise buy on decline approach at 630 which is the 23.8% retracement of the rise.
- The upside breakout or resistance level is at 735.

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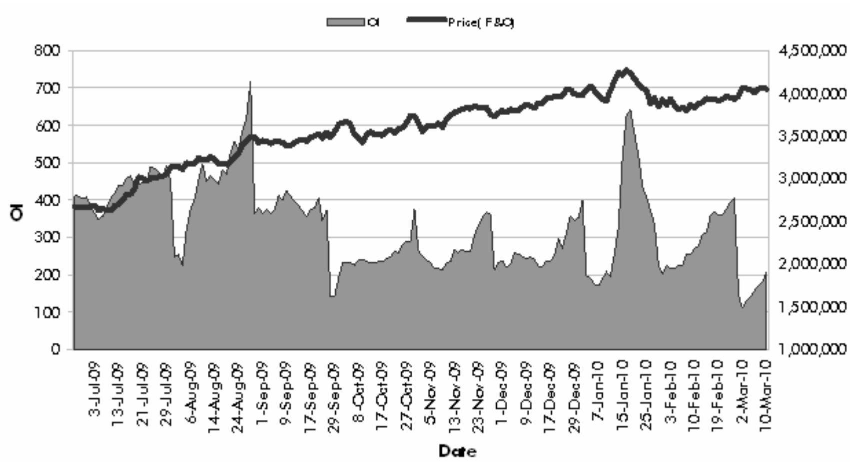
Derivatives View: Wipro

- In line with other IT peers, this stock too has seen significant decline in open interest levels over the last few months. Expect the stock to trade range bound in the 650 to 750 range for the next few weeks.

Exhibit 15: OI & price (F&O)



Source: Ambit Capital Research

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HCL Technologies

HOLD

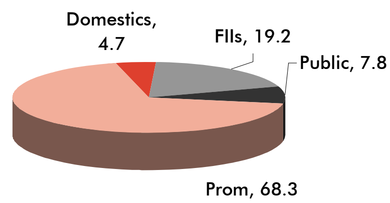
Price	Rs361
Target Price Rs390	**%Upside** 8↑
Market Capitalisation Rs243,509mn	(US$5,345mn)
52 week range H/L (Rs)	388/89
Shares o/s (mn) 675.38	**Daily vol (mn)** 1.22
Reuters HCLT.BO	**Bloomberg** HCLT IN

Perfm(%)	1M	3M	12M	YTD
Absolute	3.5	3.9	295.8	(2.9)
Relative	(2.7)	3.6	88.1	(1.2)

BSE Sensex 17,168	**Nifty** 5,133

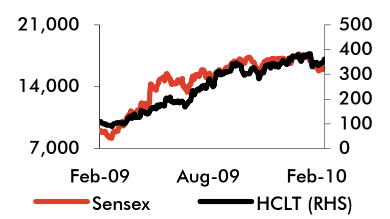
Source: Bloomberg

Shareholding pattern (%)



Source: Bloomberg

Price performance



Source: Bloomberg

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AMBIT Acumen at work

Near Term Growth Likely Muted

- **Infrastructure services to remain key growth driver:** Infrastructure management services (IMS) has been the biggest organic revenue growth driver for HCL Tech and has in effect contributed 57.1% to incremental growth in 1HFY10. HCL Tech has been closing the gap with peers in IMS. Its strong foothold and ability to win large deals in this space will ensure that IMS remains a key growth driver going forward.
- **Axon integration has provided the much-needed impetus ...:** HCL Tech's lagging performance in package implementation (PI) prompted it to acquire Axon in CY08. Our apprehension notwithstanding HCL Tech has done a commendable job of retaining Axon's senior management and managing a smooth transition.
- **...but weak near term outlook remains subdued for PI:** We note SAP's licence sales data is yet to start growing. Since implementation revenues follow with a 2-3Q lag, we expect PI revenues to remain subdued in FY11E.
- **BPO revenues to remain subdued in FY11E:** HCL Tech's efforts to restructure the BPO business has taken longer than expected. The Control Point and Liberata acquisitions are not expected to grow for the next 3-4 quarters while the Voice business is expected to continue its decline.
- **Margin issues loom large:** We expect margins to decline by 160bps over FY10E-12E on the back of BPO investments and peak utilisation rates.
- **Initiate with a HOLD and target price of Rs390:** We initiate coverage on HCL Tech with a HOLD recommendation and target price of Rs390, implying a target PE multiple of 15x which is at 30% discount to Infosys. Our target price implies a upside of 8% from the current levels.

Exhibit 1: Key Financials

Y/E June, Rsmn	FY08	FY09	FY10E	FY11E	FY12E
Net sales	76,396	106,084	123,172	137,838	164,513
Sales growth (YoY %)	26.6	38.9	16.1	11.9	19.4
EBITDA	16,941	23,238	26,171	28,103	32,245
EBITDA (%)	22.2	21.9	21.2	20.4	19.6
Profit (after ESOP charges)	10,271	11,973	12,583	16,161	18,154
EPS (after ESOP charges) (Rs)	15.4	17.8	18.6	23.8	26.5
EPS growth (YoY %)	-18.3	15.6	4.5	27.4	11.4
ROCE (%)	24.5	21.7	18.7	23.1	24.9
ROE (%)	22.0	23.0	21.6	23.5	22.4
PE (x)	23.5	20.3	19.4	15.2	13.7
Price/Book value (x)	4.6	4.1	3.7	3.2	2.7
EV/EBITDA (x)	12.7	10.8	9.2	8.1	6.7

Source: Company, Ambit Capital Research

Company financial snapshot

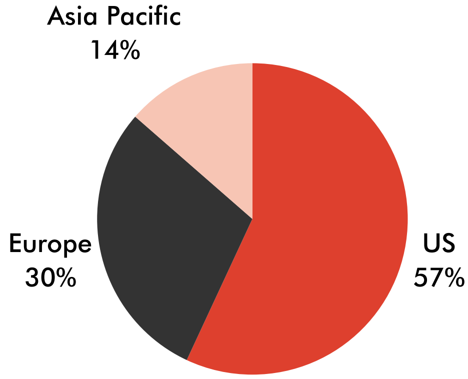
Profit and loss (Rsmn)

	FY10E	FY11E	FY12E
Net Sales	123,172	137,838	164,513
Operating Exp	97,001	109,735	132,267
EBITDA	26,171	28,103	32,245
Depreciation	5,585	6,153	7,316
Other income	(4,063)	(556)	551
PBT	16,524	21,394	25,481
Tax	3,088	4,493	6,625
Minority interest (MI)	(35)	(62)	(91)
PAT (before ESOP charges)	13,471	16,964	18,947
ESOP charges	888	804	793
PAT (after ESOP charges)	12582	16160	18154

Profit and loss ratios

EBITDA Margin (%)	21.2	20.4	19.6
PAT Margin (%) (after ESOP)	10.2	11.7	11.0
P/E (x) (after ESOP)	18.6	23.8	26.5
EV/ EBITDA (x)	9.2	8.1	6.7

Revenue mix Geo-wise



Source:: Company, Ambit Capital Research

Balance sheet (Rsmn)

	FY10E	FY11E	FY12E
Total Assets	133,639	151,007	177,186
Fixed Assets	25,304	28,554	29,481
Current Assets	47,676	64,057	91,460
Other Assets	45,285	43,021	40,870
Investments	15,375	15,375	15,375
Total Liabilities	133,639	151,007	177,186
Total Net Worth	66,200	77,898	91,258
Total Debt	22,328	18,979	16,132
Current Liabilities	45,095	54,114	69,780
Minority Interest	16	16	16

Balance sheet ratios (%)

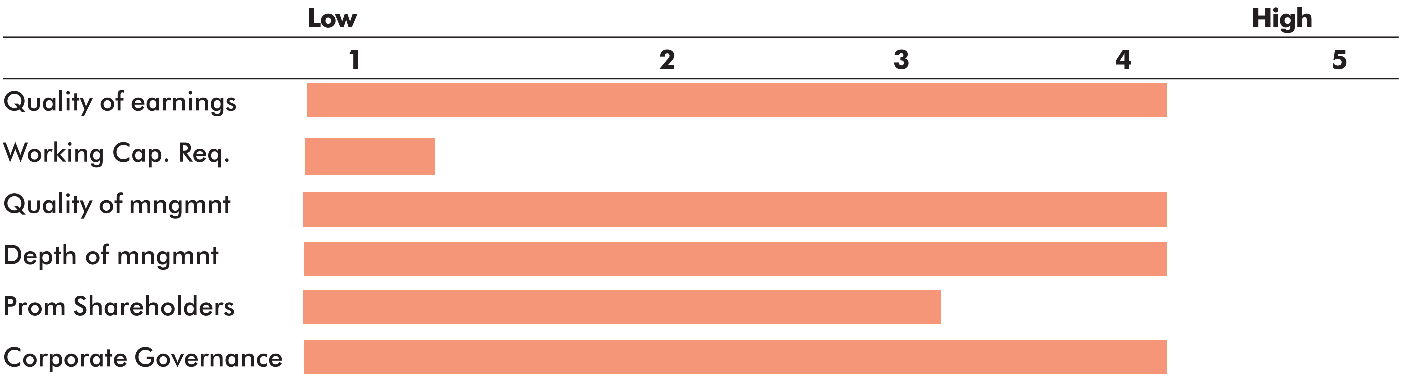
RoE	21.6	23.5	22.4
RoCE	18.7	23.1	24.9
P/BV (X)	3.7	3.2	2.7

Cash flow (Rsmn)

	FY10E	FY11E	FY12E
Net profit	12,583	16,161	18,154
Depreciation/amortisation	5,585	6,153	7,316
(Inc)/dec in working capital	1,341	(3,346)	(9,694)
Others	7,805	8,167	8,951
Net cash from operations (a)	27,314	27,135	24,726
(Inc)/dec in investments	(209)	-	-
Capex	(6,000)	(6,000)	(6,000)
Others	(5,101)	(4,813)	(2,418)
Cash flow from inv. (b)	(11,310)	(10,813)	(8,418)
Inc/(dec) in capital	(278)	313	20
Dividends paid + dividend tax	(6,267)	(4,738)	(4,776)
Inc/dec in loans	22,432	(3,349)	(2,847)
Others	(29,875)	0	(0)
Financial cash flow (c)	(13,988)	(7,774)	(7,602)
Net inc/dec in cash (a+b+c)	2,016	8,548	8,707
Opening cash balance	4,203	6,219	14,767
Closing cash balance	6,219	14,767	23,473

Company snapshot

Ratings



Investment Highlights

Infrastructure services to remain key driver...

- HCL Tech which was highly concentrated in the R&D services space during the 2001 downturn has been able to find its mainstay in remote infrastructure management services. IMS has been the biggest driver of organic revenue and has contributed 57.1% to HCL Tech's incremental growth in 1HFY10. HCL Tech has been closing the gap with peers in IMS.

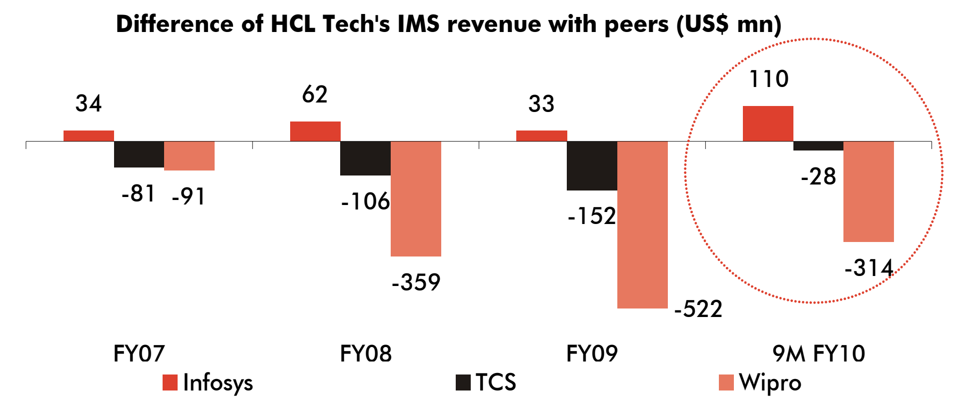
  RIM services is a relatively large and untapped market. According to Nasscom, offshoring represents only US$6-7bn of the total addressable market potential of US$96-104bn; penetration of merely ~6%. HCL Tech's strong foothold and ability to win large deals in this space will ensure that it remains a key growth driver going forward. We expect IMS revenue to grow at 30% and 28% in FY11E and FY12E respectively, faster than the company's average.

Exhibit 2: IMS has been a key growth driver for HCL Tech

US$ mn	FY06	FY07	FY08	FY09	1HFY10
Total revenue (YoY %)	30.8	41.9	35.3	16.2	26.7
Infrastructure services revenue (YoY %)	72.1	65.7	44.7	25.7	55.3

Source: Company

Exhibit 3: HCL Tech has been closing the gap with peers in IMS

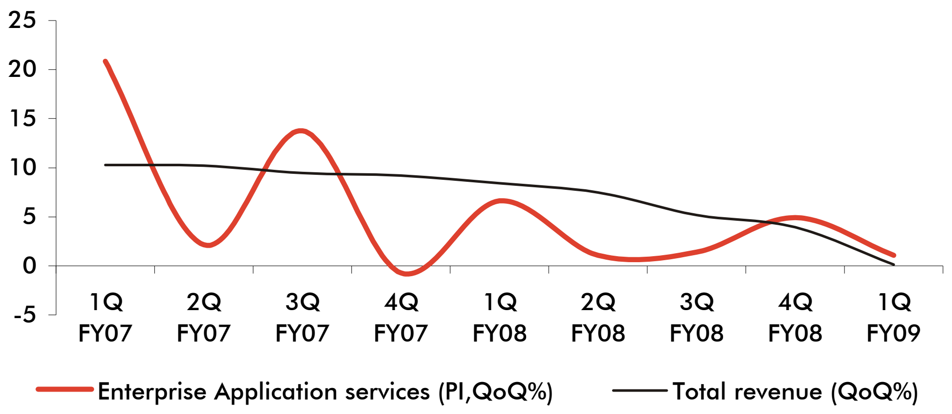


Source: Company. Note: Since HCL Tech has June YE v/s March for peers, we have calculated HCL Tech's revenues on a March ending basis for purposes of comparison.

Axon provided the much-needed impetus ...

- HCL Tech's presence in the rest of the services apart from IMS has not been as strong; more so in the package implementation (PI) space. While peers PI revenues grew strongly - Infosys at 10% and TCS at 7.8% CQGR over June 2006-March 2008, HCL Tech's PI business grew by only 5.4% over the same period. Hence, HCL Tech took an aggressive step of making a large acquisition to strengthen its position in this space with the UK-based Axon (deal size £441mn, Price/Sales of 2.2x). Despite our apprehensions of Axon's integration, HCL Tech has done a commendable job until now of retaining senior management and managing a smooth transition.

Exhibit 4: PI was not a strong point for HCL Tech, prompting it to acquire Axon

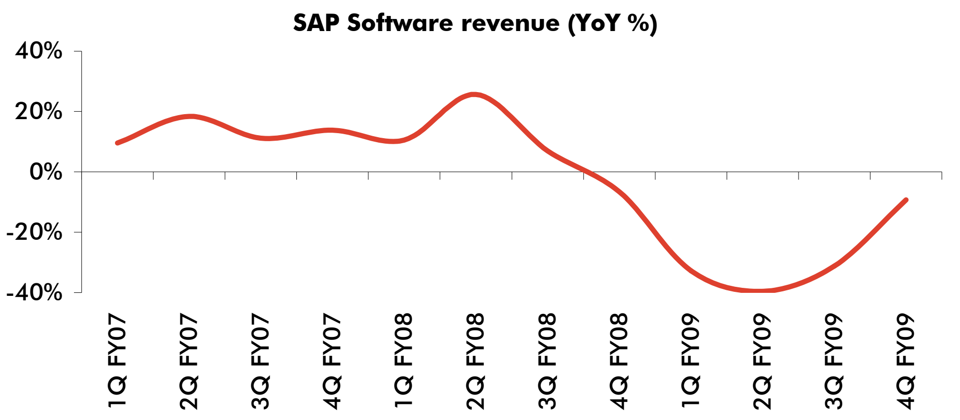


Source: Company

… but near term outlook remains subdued for PI business

- HCL Tech's PI revenues have not grown much post the Axon acquisition in December 2008, as the global economy nosedived and PI being a relatively higher discretionary service, was impacted. While 2QFY10 saw PI growth bouncing back to 5.8% QoQ after two quarters of underperformance, this was partially driven by short-term consulting projects, which were released in the last quarter of the CY09 IT budgets. We understand that SAP's licence sales data is yet to start growing. Since implementation revenues usually follow with a 2-3Q lag, we expect PI revenues to remain subdued in FY11E.

Exhibit 5: SAP's licence sales is yet to start growing



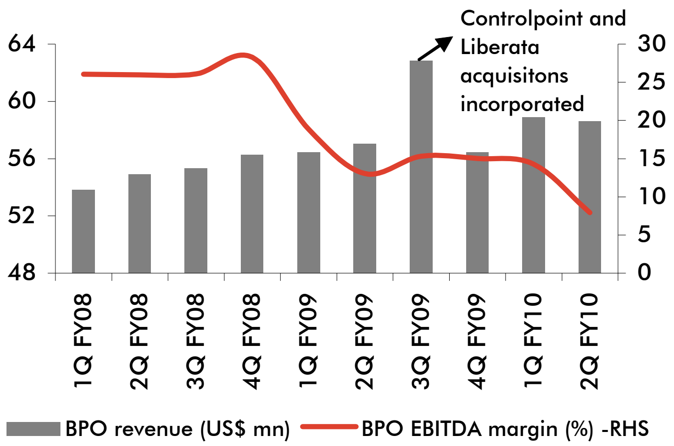
Source: Company

BPO business to remain subdued in FY11E

- HCL Tech's BPO business has been under restructuring for some time now. The company has been trying to diversify away from the Voice business using the inorganic route (Control Point, Liberata acquisitions in CY08) to increase its non-voice presence and have a footprint in the platform-based BPO solutions market. HCL Tech targets to increase the non-voice mix from 39% of BPO revenue to 60% in the medium term.

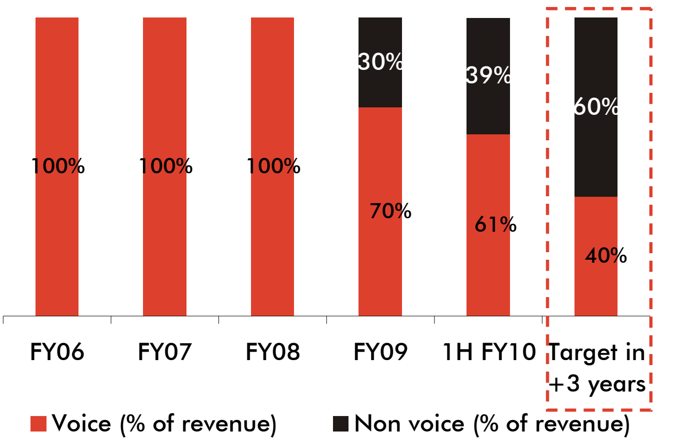
However, the BPO restructuring has taken longer than expected and acquisitions have not been able to support growth levels. HCL Tech invested US$4mn in 2QFY10 to boost the acquired platforms. BPO margins slipped to single digits at 7.9% in 2QFY10 v/s 14.3% in 1QFY10. The Control Point and Liberata acquisitions (~US$30mn in revenue together on a quarterly basis) are not expected to grow for the next 3-4 quarters while the Voice business is expected to continue declining. We expect the weakness in BPO business to continue through FY11E.

Exhibit 6: BPO revenues remain muted while margins have nosedived



Source: Company

Exhibit 7: Efforts to diversify from voice to non-voice will take time



Source: Company

Margin issues loom large

- We expect HCL Tech's margins to slip from hereon on the back of BPO investments and peak utilisation rates (76.4% in 2QFY10, including trainees). Further, even by management's admission, HCL Tech does not have any of the traditional levers to control margins; and growth remains the only expected lever. We have built in a margin decline of 165 bps over FY10E-12E.

Valuation

- **Initiate with a HOLD; target price of Rs390:** We initiate coverage on HCL Tech with a HOLD recommendation and March-2011 target price of Rs390. Our target price implies an upside potential of 8% from current levels. We have valued HCL Tech on a relative PE multiple basis.The stock currently trades at 15.2x and 13.7x on FY11E and FY12E EPS. We choose to assign a target PE multiple of 15x on TTM March-2012 EPS, which is at a 30% discount to Infosys.

  HCL Tech has broadly traded in the range of 14-18x (one-year forward PE). It has historically traded at 30-40% discount to Infosys. However, we are assigning a 30% discount to Infosys' target PE, which is at the lower end of the historical range. We believe that the Axon acquisition has made HCL Tech a serious contender in the PI space - should the integration run through the trial period successfully and the real benefits of acquisition i.e. downstream revenues come through in the medium term, HCL Tech could be an interesting stock to consider. That said, we expect near-term performance, particularly in FY11E, to be lower versus peers due to lower visibility on pick-up in PI revenues, subdued BPO revenues and lower margin levers.

  Assumptions to our estimates include: (a) US$ revenue CAGR of 18.8%; (b) EBITDA CAGR of 10.9%; over FY10E-12E. We believe that US$ revenue growth would be an important metric to consider as the EPS CAGR of 19.1% would be impacted by our assumptions of: (a) rupee appreciation of 4.1% and 1.3% in FY11E and FY12E respectively; (b) tax rate increase to 21% in FY11E and 26% in FY12E v/s 18.7% currently and (c) lower forex losses.

Exhibit 8: HCL Tech — 1-year forward PE band

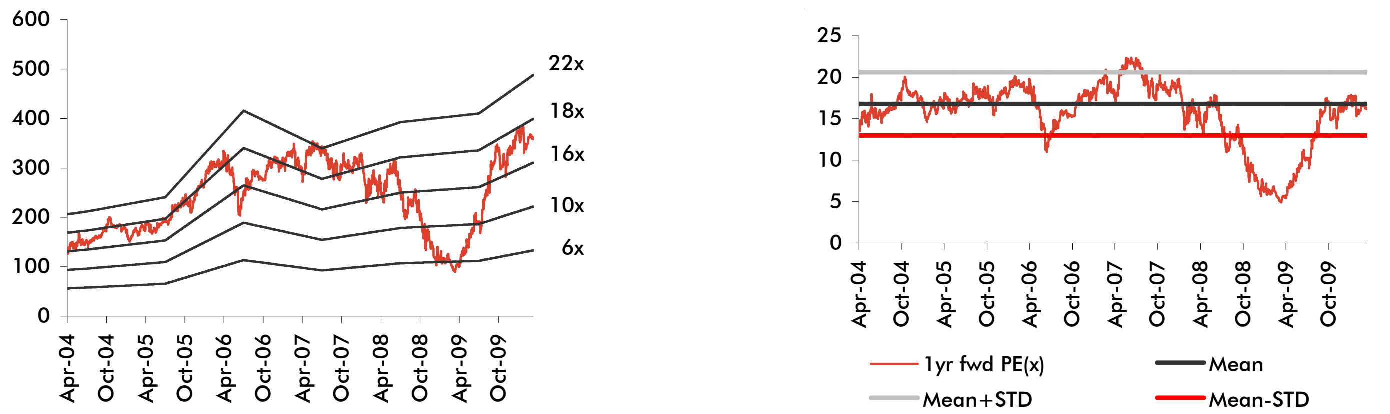
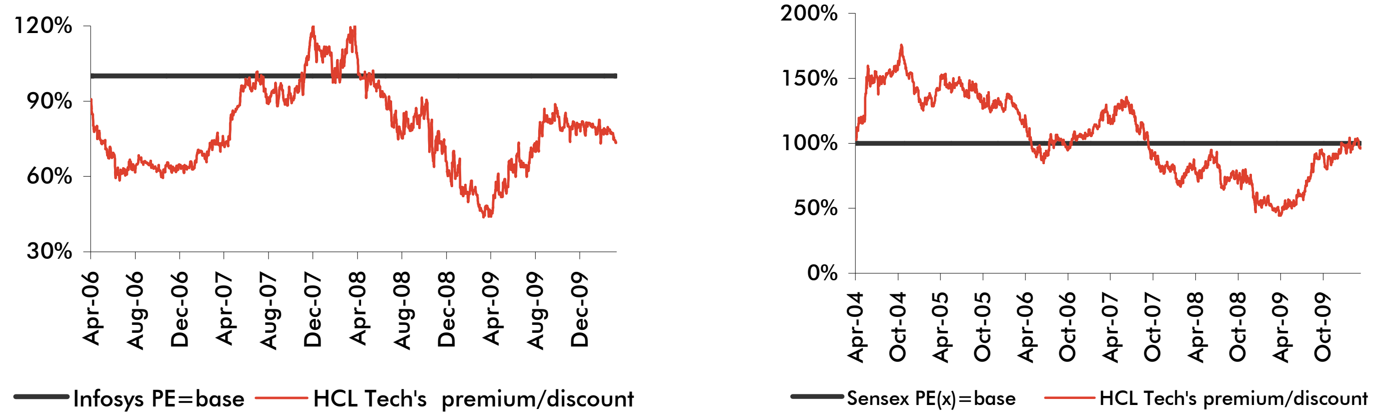


Exhibit 9: HCL Tech's discount/premium to Infosys and Sensex



Source: Bloomberg

Exhibit 10: Financial assumptions

	FY10E	FY11E	FY12E
US$ revenue growth (YoY %)	21.2	16.7	20.9
Volume growth^ (YoY %)	6.9	16.2	20.8
Realization growth^ (YoY %)	11.2	-1.6	-0.7
US$/INR (Appreciation)/ Depreciation (%)	-4.2	-4.1	-1.3
EBITDA margin (%)	21.2	20.4	19.6
EPS (YoY %)	4.5	27.4	11.4

Source: Company, Ambit Capital Research, Note: ^IT Services

Exhibit 11: Comparison to consensus

HCL Tech (Rs mn)	Bloomberg estimate		Ambit Capital estimate		Difference to consensus	
	FY11E	FY12E	FY11E	FY12E	FY11E	FY12E
Sales	139,460	161,258	137,838	164,513	-1.2%	2.0%
EBITDA	29,081	33,219	28,103	32,245	-3.4%	-2.9%
Profit	17,392	19,652	16,161	18,154	-7.1%	-7.6%
EPS (before ESOP, Rs)	25.6	28.7	24.9	27.6	-2.5%	-3.8%

Source: Bloomberg, Ambit Capital Research

Financials

Exhibit 12: Profit & Loss statement

Y/E June, Rs mn	FY08	FY09	FY10E	FY11E	FY12E
Net sales	**76,396**	**106,084**	**123,172**	**137,838**	**164,513**
Growth (%)	26.6	38.9	16.1	11.9	19.4
EBITDA	**16,941**	**23,238**	**26,171**	**28,103**	**32,245**
EBITDA (%)	22.2	21.9	21.2	20.4	19.6
Growth (%)	26.7	37.2	12.6	7.4	14.7
Depreciation & amortisation	3,032	4,494	5,585	6,153	7,316
EBIT	13,909	18,744	20,586	21,950	24,930
Interest expense	0	-740	-1,005	-854	-726
Other non-operational income	-1,370	-4,197	-5,067	-1,410	-175
Pre tax profit	12,539	15,287	16,524	21,394	25,481
Taxes	1,272	2,543	3,088	4,493	6,625
Minority interest	19	-26	-35	-62	-91
Adjusted net profit (before ESOP charges)	11,248	12,770	13,471	16,964	18,947
Margin (%)	14.7	12.0	10.9	12.3	11.5
ESOP charges	977	797	888	804	793
Adjusted net profit (after ESOP charges)	**10,271**	**11,973**	**12,583**	**16,160**	**18,154**
Margin (%)	13.4	11.3	10.2	11.7	11.0
Diluted share capital (mn)	683	692	706	713	680
EPS (before ESOP charges) (Rs)	16.9	19.0	20.0	24.9	27.6
Growth (%)	-17.2	12.6	4.9	24.9	10.8
EPS (after ESOP charges) (Rs)	**15.4**	**17.8**	**18.6**	**23.8**	**26.5**
Growth (%)	-18.3	15.6	4.5	27.4	11.4

Exhibit 13: Balance sheet

Y/E June, Rs mn	FY08	FY09	FY10E	FY11E	FY12E
Share capital	1,331	1,342	1,350	1,361	1,372
Reserves & surplus	50,846	57,291	64,850	76,537	89,887
Networth	52,177	58,633	66,200	77,898	91,258
Minority Interest	57	16	16	16	16
Loans		29,771	22,328	18,979	16,132
Sources of funds	**52,234**	**88,420**	**88,544**	**96,893**	**107,406**
Intangible assets	9,585	45,325	45,285	43,021	40,870
Fixed assets	26,149	33,188	39,188	45,188	51,188
Less: Depreciation/amortisation	12,832	17,326	22,521	28,674	35,989
Net block	13,317	15,862	16,668	16,514	15,199
Investments	20,879	15,160	15,375	15,375	15,375
Deferred tax assets/(liability)	148	857	1,450	1,728	3,333
Current assets	31,493	41,985	47,676	64,057	91,460
Sundry debtors	18,940	27,083	28,260	32,162	39,051
Cash & bank balance	3,840	4,203	6,219	14,767	23,474
Other current assets	8,713	10,699	13,196	17,128	28,935
Current liabilities & provisions	28,252	39,377	46,545	55,842	73,113
Current liabilities	14,756	27,479	31,300	36,066	46,674
Provisions and others	13,497	13,687	15,246	19,776	26,440
Net current assets	3,241	2,608	1,130	8,215	18,347
Others (net)	5,064	8,608	8,636	12,040	14,282
Application of funds	**52,234**	**88,420**	**88,544**	**96,893**	**107,406**

Source: Company, Ambit Capital Research

Exhibit 14: Cash flow statement

Y/E June, Rs mn	FY08	FY09	FY10E	FY11E	FY12E
Net profit	10,271	11,973	12,583	16,161	18,154
Depreciation/amortisation	3,032	4,494	5,585	6,153	7,316
(Inc)/dec in working capital	1,713	-5,750	1,341	-3,346	-9,694
Others	-641	-619	7,805	8,167	8,951
Net cash from operations (a)	**14,375**	**10,098**	**27,314**	**27,135**	**24,726**
(Inc)/dec in investments	-32	14,714	-209	0	0
Capex	-5,558	0	-6,000	-6,000	-6,000
Others	-1,648	-48,760	-5,101	-4,813	-2,418
Cash flow from inv. (b)	**-7,239**	**-34,046**	**-11,310**	**-10,813**	**-8,418**
Inc/(dec) in capital	378	223	-278	313	20
Dividends paid + dividend tax	-6,366	-7,187	-6,267	-4,738	-4,776
Inc/dec in loans	0	0	22,432	-3,349	-2,847
Others	-386	29,860	-29,875	0	0
Financial cash flow (c)	**-6,374**	**22,897**	**-13,988**	**-7,774**	**-7,602**
Net inc/dec in cash (a+b+c)	268	-1,052	2,016	8,548	8,707
Opening cash balance	3,573	5,254	4,203	6,219	14,767
Closing cash balance	**3,840**	**4,203**	**6,219**	**14,767**	**23,473**

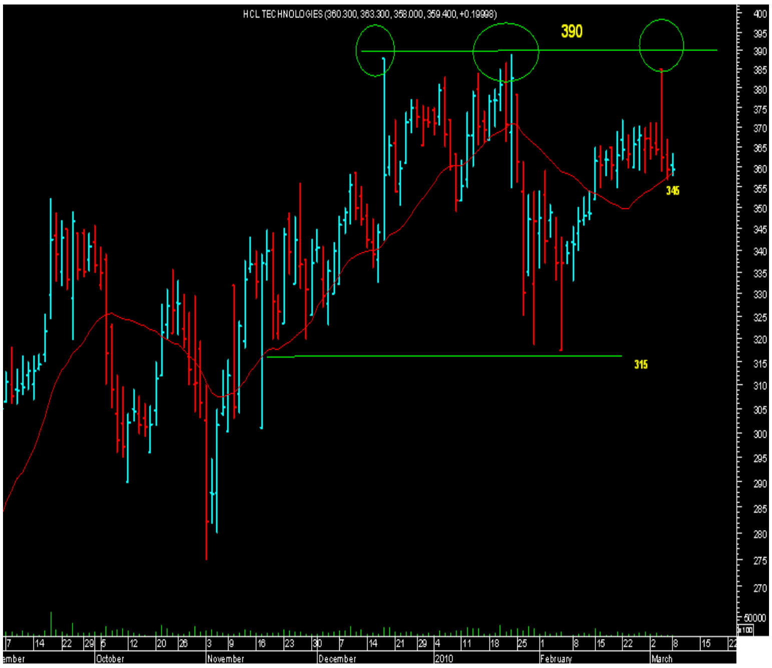
Exhibit 15: Key ratios

Y/E June	FY08	FY09	FY10E	FY11E	FY12E
ROCE (%)	24.5	21.7	18.7	23.1	24.9
ROE (%)	22.0	23.0	21.6	23.5	22.4
Debt-equity ratio (x)	0.0	0.5	0.3	0.2	0.2
Valuation ratios (x)					
PER	23.5	20.3	19.4	15.2	13.7
PBV	4.6	4.1	3.7	3.2	2.7
EV/EBITDA	12.7	10.8	9.2	8.1	6.7
EV/Sales	2.8	2.4	2.0	1.7	1.3
Turnover ratios (no.)					
Debtor days	75	79	82	80	79
Inventory days	0	0	0	0	0
Creditor days	5	6	7	7	7

Source: Company, Ambit Capital Research

Technical View: HCL Technologies - Sell on rise

Exhibit 16: Daily Chart



Source: MetaStock

- HCL Tech has formed a Triple Top at 390 levels.
- The momentum indicators are in neutral zone but drifting downward.
- On breaking below 20DMA which is at 345, the next strong support is at 315.
- We would use any rise as a selling opportunity.

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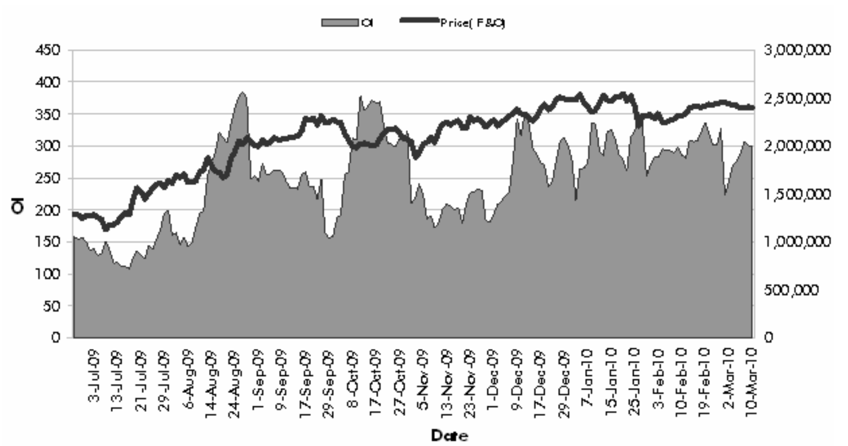
Derivatives View: HCL Technologies

- The stock has been broadly trading in a range for the last few months. Expect the range to continue for some more time with 330 on the way down and 380 on the way up being important support and resistance levels respectively.

Exhibit 17: OI & price (F&O)



Source: Ambit Capital Research

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Explanation of investment rating

Investment Rating	Expected return (over 12-Month period from date of initial rating)
Buy	>15%
Hold	5% to 15%
Sell	<5%

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