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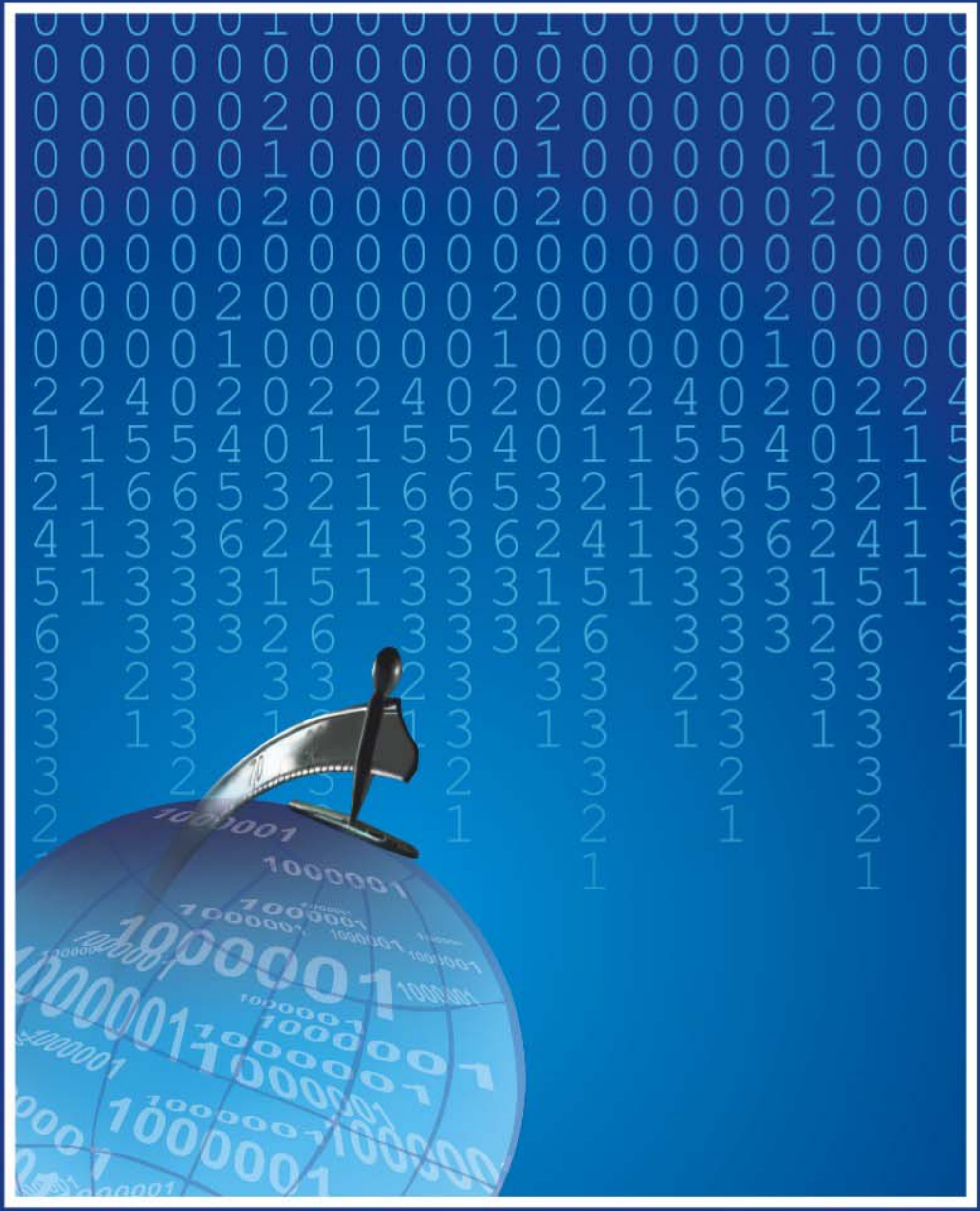
IT Result Updates - Q4FY07



Parul Inamdar
+91-22-2286 4355
parul.inamdar@edelcap.com

Viju George
+91-22-2286 4400
viju.george@edelcap.com

Kunal Sangoi
+91-22-2286 4309
kunal.sangoi@edelcap.com

Edelweiss Securities

Index

Companies	Price	Recommendation	Date
Geometric Software Solutions	117	Accumulate	May 08, 2007
HCL Technologies	302	Buy	April 17, 2007
Hexaware Technologies	174	Buy	April 24, 2007
i-flex Solutions	2,227	Buy	May 08, 2007
iGATE Global Solutions	385	Buy	April 11, 2007
Infotech Enterprises	362	Buy	April 19, 2007
Infosys Technologies	2,088	Buy	April 13, 2007
Mastek	311	Buy	April 12, 2007
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Sasken Communication	525	Buy	April 23, 2007
Satyam Computer	448	Buy	April 20, 2007
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Wipro	570	Accumulate	April 20, 2007

GEOMETRIC SOFTWARE SOLUTIONS

INR 117

Edelweiss
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Modern's consolidation dampens profits

ACCUMULATE

May 08, 2007

Parul Inamdar
+91-22-2286 4355
parul.inamdar@edelcap.com

Viju George
+91-22-2286 4400
viju.george@edelcap.com

Kunal Sangoi
+91-22-2286 4309
kunal.sangoi@edelcap.com

Geometric Software's Q4FY07 results were ahead of expectations in terms of revenues, but net profits fell short of expectations. Revenues, at INR 1.2 bn, were up 16.4% Q-o-Q, and the net profit, at INR 105 mn, was flat Q-o-Q. For FY07, the company comfortably surpassed its guidance of 35% growth in revenues and net profits, achieving 40% growth in revenues and 45% growth in net profits on an organic basis. During the quarter, Geometric completed the integration of Modern Engineering (Modern), and on a five month basis Modern has broken-even.

EBITDA margins during the quarter fell sharply to 12.6% from 16.1% in the previous quarter, on account of loss incurred at Modern in Q4 (due to revenue shortfalls). The company's strategy of focusing on direct industrial customers has met with some success with better acceptance resulting in higher traction and improving revenue contribution. Completion of Modern's integration, ongoing initiatives with regards to the go-to-market strategy, and expected turnaround of Modern in the current fiscal augur well for Geometric. reinforcing confidence in improved profitability in the coming quarters.

At CMP of INR 117, the stock trades at a P/E of 13.5x and 10.0x and EV/EBITDA of 7.4x and 5.3x on our FY08E and FY09E, respectively. We maintain our 'ACCUMULATE' recommendation on the stock.

Key Highlights

- Revenues for the quarter stood at INR 1.2 bn, up 16.4% Q-o-Q and 94.5% Y-o-Y. Net profit, at INR 105 mn, was flat Q-o-Q and declined 2% Y-o-Y.
- Gross profits stood at INR 447 mn, up 9.0% Q-o-Q and 61.0% Y-o-Y.
- EBITDA stood at INR 157 mn, down 8.8% Q-o-Q and 3.0% Y-o-Y. EBITDA margins declined by 350bps and stood at 12.6%. The reasons for margin decline were: (a) impact of consolidation of Modern Engineering, which is a low profit business (1.9% impact); (b) investment in management resources; and (c) higher expense on account of leased facility.
- Decline in EBITDA impacted profits. Also, the interest paid on loan to fund Modern acquisition impacted net profit margin and restricted net profit at INR 105 mn (flat Q-o-Q).
- Utilisation, excluding trainees, dropped to 87% from 91% in the previous quarter. Inclusive of trainees, the utilisation rate marginally increased to 86% from 85%.

Reuters	:	GEOM.BO
Bloomberg	:	GMSS IN

Market Data

52-week range (INR)	:	145 / 73
Share in issue (mn)	:	61.9
M cap (INR bn/USD mn)	:	7.2 / 750.2
Avg. Daily Vol. BSE/NSE ('000)	:	636.1

Share Holding Pattern (%)

Promoters	:	27.9
MFs, FIs & Banks	:	15.6
FIIs	:	14.7
Others	:	41.8

Financials

Year to March	Q4FY07	Q3FY07	*Growth %*	Q4FY06	*Growth %*	FY08E	FY09E
Revenue (INR mn)	1243	1067	*16.4*	639	*94.5*	6001	7922
Gross profit (INR mn)	447	410	*9.0*	278	*61.0*	2267	3027
EBITDA (INR mn)	157	172	*(8.8)*	162	*(3.0)*	1012	1371
Net profit (INR mn)	105	105	*(0.8)*	107	*(1.9)*	533	726
EPS basic (INR)	1.7	1.7	*(0.8)*	1.9	*(9.5)*	8.7	11.7
P/E (x)						13.5	10.0
EV/EBITDA (x)						7.4	5.3
Market cap/Revenues (x)						1.2	0.9

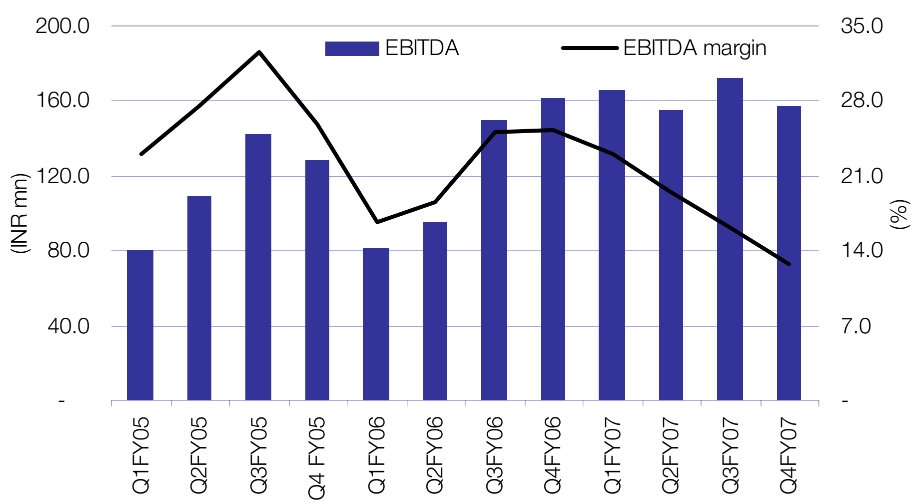
- The company's total headcount now stands at 2,512, compared to 1,931 in the previous quarter. Of the 581 net additions, 511 employees were added from Modern Engineering. Excluding that, the net addition was low, which was a planned move to focus on bench and competency based rationalization.
- The company's attrition rate stood at 18.6%. It has been successful in bringing its attrition down sequentially over the past three quarters.
- During the current quarter, the company also disclosed the client dependency for FY07. Revenue contribution from the top client was at 28%, top 5 clients was at 54%, and top 10 clients was at 68% of total FY07 revenues.
- **Guidance:** Geometric has guided for revenue growth of 50% and net profit growth of 30-35% for FY08.

FY07 guidance surpassed, but margins dwindle

Geometric had, at the start of FY07, guided to 35% growth in revenues and net profits for FY07. The company, on an organic basis, seamlessly outperformed its guidance achieving 40% growth in revenues and 45% growth in net profits. However, on account of consolidation of less profitable revenues of Modern, net profit growth was restricted to 45.2% even though revenues grew by 71.5% over FY06.

Geometric's EBITDA margins have been declining over the past four quarters and currently stand at 12.6%. We understand that for the past two quarters (Q3 and Q4FY07) the margin decline was attributed to consolidation of low margin Modern revenues. We believe lower-than-expected growth in product revenues was also a factor leading to the decrease in margins. Operating margins (EBITDA) for FY07 on an organic basis declined from 21.8% to 20.0%, mainly due to increase in employee related direct costs. The management has assured that margins are expected to stabilize at the FY07 level and will not decline further. Expected turnaround in Modern will also aid better profitability going forward.

Chart1: EBITDA margin analysis for past three years



Source: Company, Edelweiss research

Integration of new growth engine completed

Geometric, with its USD 25 mn acquisition of Modern Engineering, has added high-end engineering services such as CAE, simulation, digital manufacturing solutions, and electronic systems to its existing offerings. We understand that this will enable Geometric target OEMs and other tier 1 vendors in the automotive, aerospace, industrial products, and hi-tech sectors. The acquisition also gives Geometric presence in China and Romania.

Demand surge in extended PLM solutions

Geometric is uniquely positioned among India-based engineering firms with strength in extended Product Lifecycle Management (PLM) solutions. With offshore capabilities, strong alliance with other leading PLM vendors, and multi-platform PLM expertise, we expect Geometric to accelerate its growth trajectory capitalizing on the strong industry momentum. Currently, PLM related solutions (software services) contribute ~ 53% to total revenues. This is expected to grow in-line with traditional IT services, in our view.

Valuations

Our EPS estimate for FY08E and FY09E stand at INR 8.7 and INR 11.7, respectively. At a CMP of INR 117, the stock trades at a P/E of 13.5x and 10.0x and EV/EBITDA of 7.4x and 5.3x on our FY08E and FY09E, respectively. We maintain our **'ACCUMULATE'** recommendation on the stock.

Financials Snapshot (INR mn)

Year to March	Q4FY07	Q3FY07	*Growth %*	Q4FY06	*Growth %*	FY07	FY08E	FY09E
Total revenues	1,243	1067	*16.4*	639	*94.5*	3,831	6,001	7,922
Direct cost	796	657	*21.1*	362	*120.2*	2,347	3,735	4,895
Gross profit	447	410	*9.0*	278	*61.0*	1,484	2,267	3,027
SG & A expenses	290	238	*21.8*	116	*150.6*	834	1254	1656
EBITDA	157	172	*(8.8)*	162	*(3.0)*	650	1012	1371
Depreciation & ammortization	54	54	*0.4*	44	*23.0*	203	260	350
EBIT	103	118	*(12.9)*	118	*(12.7)*	447	752	1021
Other income	58	44	*32.7*	35	*67.9*	92	45	55
Interest	15	16	*(6.0)*	0		31	65	55
PBT	146	146	*0.0*	153	*(4.3)*	507	732	1021
Tax	22	22	*1.6*	28	*(20.9)*	68	101	161
Adjusted net profit	124	124	*(0.3)*	125	*(0.6)*	439	631	860
Minority interest	19	19	*2.5*	18	*7.5*	64	98	134
Reported net profit	105	105	*(0.8)*	107	*(1.9)*	374	533	726
Adjusted EPS basic	1.7	1.7	*(0.8)*	1.9	*(9.5)*	6.2	8.7	11.7
as % of net revenues								
Gross profit	36.0	38.4		43.4		38.7	37.8	38.2
SG & A expenses	23.3	22.3		18.1		21.8	20.9	20.9
EBITDA	12.6	16.1		25.3		17.0	16.9	17.3
Reported net profit	8.4	9.9		16.7		9.8	8.9	9.2
Tax rate	15.2	15.0		18.4		13.5	13.8	15.8

Company Description

Geometric Software Solutions caters to the fast-growing engineering services and PLM segments. It is a CMMI Level 5 company with over 20 years of experience in CAD/CAM/CAE, PDM, and MPM. Partnerships with major PLM vendors such as Dassault Systèmes, UGS PLM Solutions, and MatrixOne offer it an unique advantage of providing cost effective services on leading PLM platforms. Geometric offers services based on SolidWorks, CA TIA, ENOVIA, DELMIA, eMatrix, Teamcenter Enterprise Metaphase), Windchill, and other leading CAD/CAM/CAE/PDM software platforms. TekSoft, Inc., a subsidiary of Geometric, is a leading developer and supplier of innovative, automated CAD/CAM software solutions for the manufacturing industry.

Investment Theme

Geometric has a unique positioning among the India based engineering firms with its strengths in extended Product Lifecycle Management (PLM) solutions. It also has, with its USD 25mn acquisition of Modern engineering added high-end engineering services, which we expect will allow Geometric to target the OEMs and other tier 1 vendors. We believe that Geometric is now poised to change its positioning from a mere offshore IT services player to global PLM and engineering solutions and services provider, with specific action plans laid out and initiatives underway.

Key Risks

Key risks to our investment theme include: (a) availability of skilled manpower; (b) slowdown in engineering spending; and (c) significant appreciation of the rupee against USD, Euro, and GBP.

HCL TECHNOLOGIES

INR 302

Elevated growth and profitability prospects

BUY

HCL Technologies' (HCL Tech's) Q3FY07 results were ahead of our expectations. Revenues for the quarter were INR 15.7 bn, a growth of 7.6% Q-o-Q and 40.6% Y-o-Y. Reported net profit of INR 3.3 bn (growth of 16.0% Q-o-Q and 72.0% Y-o-Y), does not take into account the ESOP and restricted stock units (RSU) charges. After providing for those charges, the net profit growth, at 16.0% Q-o-Q and 56.1% Y-o-Y, is encouraging. EBITDA margin increased by 120bps, with improved utilisation, SG&A scale benefits, and marginally better pricing. The BPO business' strong performance, with 16.4% Q-o-Q growth and significantly improved EBITDA margins of 26.5%, is this quarter's highlight. Further, with 49 clients under multi-service delivery deals (up from 45 in Q2FY07), we see HCL Tech garnering a higher share of these clients' total spending.

The current quarter strongly indicates that HCL Tech is embarking on a higher-growth trajectory accompanied by improved profitability that seems sustainable. In our view, the independent business momentum in each of its three broad service lines (core IT software, infrastructure management, and BPO) serves to raise the consistency of delivering good quarterly growth performance, going forward. In addition, we like the fact that infrastructure management and BPO, currently contributing ~28% to revenues, are largely stable business lines. Moreover, the annuity-based revenues of these businesses are likely to minimise volatility in the company's future quarterly performance.

Factoring in HCL Tech's better-than-expected performance for the quarter and improved business outlook, we have revised our estimates; our revised EPS for FY07, FY08E, and FY09E estimates are INR 16.6, INR 20.5, and INR 25.0 respectively (up 7.8%, 5.6% and 3.6% from our earlier FY07, FY08E and FY09E estimates, respectively). At CMP of INR 302, the stock trades at a P/E of 14.7 and 12.1x for our FY08E and FY09E revised earnings, respectively. We see value in the stock at current levels and reiterate our 'BUY' recommendation.

Key Highlights

- Revenues, reported at INR 15.8 bn, up 7.6% Q-o-Q and up 40.6% Y-o-Y. Net profit stood at INR 3.0 bn, up 16.0% Q-o-Q and 56.1% Y-o-Y.
- Gross profits stood at INR 6.0 bn, up 8.8% Q-o-Q and 42.2% Y-o-Y. Gross margins improved 50bps Q-o-Q and Y-o-Y. The SG&A expenses also reduced as a percentage of revenues from 15.7% in Q2FY07 to 15.0% in Q3FY07.

Financials

Year to June	Q3FY07	Q2FY07	*Growth %*	Q3FY06	*Growth %*	FY07E	FY08E
Revenue (INR mn)	15,771	14,651	*7.6*	11,220	*40.6*	61,178	79,493
Gross profit (INR mn)	6,033	5,544	*8.8*	4,242	*42.2*	23,126	30,170
EBITDA (INR mn)	3,667	3,241	*13.1*	2,498	*46.8*	13,781	18,225
Net profit (INR mn)	3,012	2,597	*16.0*	1,929	*56.1*	10,800	13,726
Adj. EPS basic (INR)	4.6	4.0	*15.6*	3.0	*54.9*	16.6	20.5
P/E (x)						18.2	14.7
EV/EBITDA (x)						13.6	10.5
Market cap / Revenue (x)						3.2	2.5

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April 17, 2007

Hitesh Zaveri
+91-22-2286 4424
hitesh.zaveri@edelcap.com

Parul Inamdar
+91-22-2286 4355
parul.inamdar@edelcap.com

Viju George
+91-22-2286 4400
viju.george@edelcap.com

Kunal Sangoi
+91-22-2286 4309
kunal.sangoi@edelcap.com

Reuters	:	HCLT.BO
Bloomberg	:	HCLT IN

Market Data

52-week range (INR)	:	715 / 271
Share in issue (mn)	:	324.4
M cap (INR bn/USD mn)	:	198.3 / 4,736.1
Avg. Daily Vol. BSE/NSE ('000)	:	885.9

Share Holding Pattern (%)

Promoters	:	67.6
MFs, FIs & Banks	:	6.0
FIIs	:	15.9
Others	:	10.5

- Overall, these factors had a 120bps positive impact on the EBITDA margins that grew from 22.1% in Q2FY07 to 23.3% in Q3FY07. The absolute EBITDA stood at INR 3.7 bn. Improvement in realisation, utilisation, and SG&A scale benefits were among the positive contributors to the margin; the currency appreciation however affected the EBITDA margins negatively.
- Company added 26 new clients in the quarter, taking the active client count to 236 clients. Notably, 49 of these clients are multi-service delivery clients as against 45 in the previous quarter.
- HCL Tech has 147 clients, contributing to revenues in excess of USD 1 mn (145 in Q2FY07 and 131 in Q3FY06). Number of clients, contributing revenues of more than USD 20 mn, has increased from 10 as against 6 in the previous year.
- During this quarter, the company added 1,832 employees (1,273 in core software, 386 in IMS, and 173 in BPO) to its headcount. The total number of employees for HCL Tech across segments now stands at 40,149.
- Attrition for the quarter stood at 17.4% for IT services and 19.5% in BPO; in IT, the attrition has however reduced from 19.3% a year ago.
- Onsite and offsite utilisation levels for the company stood at 95.6% (95.2% in Q2FY07) and 74.8% (74.6% in Q2FY07) respectively.

- Segmental comments

  Core software

  - Revenues, at INR 11.4 bn, were up 6.4% Q-o-Q and 36.8 Y-o-Y, contributing 72.3% to the total revenues during the quarter.
  - The EBIT for this segment stood at INR 2.3 bn.
  - The EBIT margins increased from 19.5% to 20.3% Q-o-Q. EBIT grew 10.6% Q-o-Q for this segment.

  Infrastructure management services (IMS)

  - Revenues were up 6.5% Q-o-Q and 67.3% Y-o-Y, contributing 13.8% to the total revenues during the quarter (12.7% in Q2FY07).
  - The company's strategy of focusing on the fast growing IMS has yielded positive results with increasing contribution to the total revenues. At the same time, the EBIT margins have also improved marginally to reach 12%.

  BPO services

  - Revenues were up 16.4% Q-o-Q and 38.3% Y-o-Y, contributing 13.7% to the total revenues during the quarter. The quarterly revenue of the company from this segment has now increased to USD 49 mn.
  - This segment showed a strong improvement in the EBIT margins from 14.8% to 19.7% Q-o-Q on account of SG&A leverage (270bps), utilisation improvement (160bps), and realisation improvement (197bps), in-spite of negative impact of forex of 37bps and salary increments of 100bps.
  - The absolute EBIT stood at INR 250 mn from this segment, which is 11.1% of the total company EBIT.

Strong momentum in infrastructure management and BPO, and improving profitability

Infrastructure management and BPO collectively constituted ~28% of Q3FY07 revenues. The EBITDA margins for BPO are 26.5% for this quarter (EBIT at 19.7%). The company has levers to improve profitability in the infrastructure management (current EBITDA at 17.5%) with revenue growth. Implementation of a major contract in infrastructure management is delayed, which should be an additional top-line growth driver, once implementation starts. In our view, the marginal profitability for these two lines of businesses should trend up. We also like the fact that Infrastructure management and BPO are largely stable business lines with annuity-based revenues, which should help stem volatility in future quarterly performance.

Table 1: Snapshot of margins across major business segments for recent quarters

Year end June	Q3FY06	Q4FY06	Q1FY07	Q2FY07	Q3FY07
Gross margins (%)					
IT services	39.3	37.4	37.6	39.1	39.5
Infrastructure Mgmt Svcs	32.2	34.3	34.2	32.6	31.6
BPO Svcs	34.7	34.6	35.1	36.4	38.6
EBITDA margins (%)					
IT services	23.5	23.2	22.3	22.9	23.7
Infrastructure Mgmt Svcs	15.4	17.4	17.6	17.5	17.6
BPO Svcs	21.5	22.8	22.4	22.9	26.5
EBIT margins (%)					
IT services	19.8	19.8	19.2	19.5	20.3
Infrastructure Mgmt Svcs	7.7	10.5	11.7	11.9	12.0
BPO Svcs	13.6	15.0	14.6	14.8	19.7

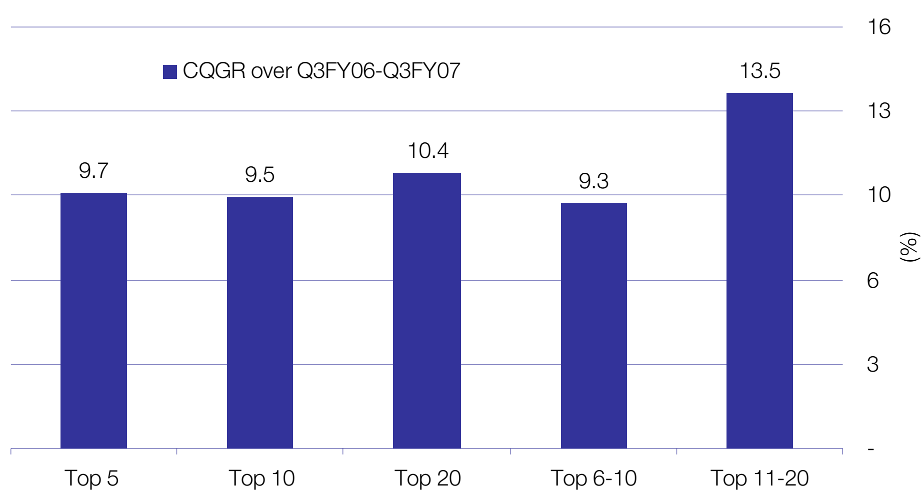
Source: Company

Multi-service client strategy paying off

HCL Tech has 49 multi-service clients, up from 45 in Q2FY07 and 34 in Q4FY06. This is reflected in the significant increase in number of USD 10 mn plus clients to 25 in Q3FY07 (versus 15 in Q4FY06). About 15% of its million dollar clients are now over USD 10 mn plus clients (versus 11% in Q4FY06).

Chart 1 depicts the traction across major clients, showing growth has been equitable and dispersed across the top-20 client base.

Chart 1: CQGR healthy in recent quarters across the top-20 clients



Source: Company

Larger deals beginning to yield greater profitability

Over the past 18 months, HCL Tech has won six multi-year, multi-service, and multi-million dollar deals. Revenues from such deals accounted for 10% of total revenues in the current quarter. The company has indicated that the expanding size of such engagements is coming at higher-than company average operating margins. While there were concerns that pursuance of large deals would suppress margins, the ramp up of these deals has not only provided a cushion, but has also enhanced the overall margin. The company has indicated that its performance on such deals has also tracked milestone targets. Two such clients are in the transition phase.

Change in estimates

We have revised our FY07E, FY08E, and FY09E estimates upward to take into account the current quarter performance, and our view that the business outlook for HCL Tech has improved. Our EPS estimates for FY07, FY08E, and FY09E stand revised upwards by 7.8%, 5.6% and 3.6%, respectively.

Table 2: Revised estimates

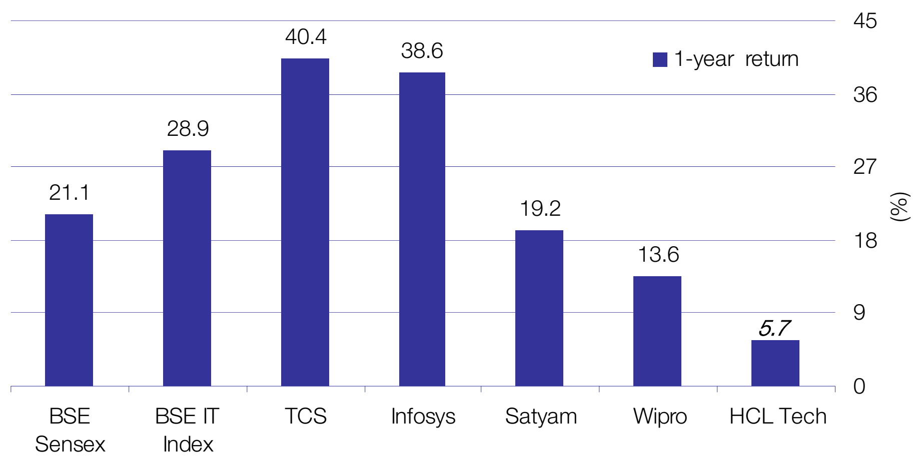
	Earlier			Revised			% change		
	FY07E	FY08E	FY09E	FY07E	FY08E	FY09E	FY07E	FY08E	FY09E
Revenue (INR mn)	60,002	76,654	96,489	61,178	79,493	99,367	2.0	3.7	3.0
Net profit (INR mn)	10,015	12,636	15,786	10,800	13,726	16,993	7.8	8.6	7.6
EPS (INR)	15.4	19.4	24.1	16.6	20.5	25.0	7.8	5.6	3.6

Source: Edelweiss research

Valuations present some near-term opportunity

HCL Tech stock has delivered one-year returns of 5.7%, a significant laggard relative to the BSE IT-index (28.9%), BSE Sensex (21.1%), and larger scale players in the Indian IT industry (See Chart 2).

Chart 2: HCL Tech's stock returns have significantly trailed that of the index and its peers



Source: Bloomberg

The business outlook for HCL Tech has improved and this reflects in our estimate for EPS CAGR of ~23% over FY07-09E. Our EPS growth rate factors in the likely stock option exercise and RSU related expenses, which drag down our estimates of reported net profit CAGR of 25.4% over FY07-09E. Due to the improved growth trajectory and higher sustainable margins, we see the stock rating (PER) moving up to the 16-18x range. At CMP of INR 302, the stock trades at a P/E of 14.7x FY08E and 12.1x FY09E and EV/EBITDA of 13.6x and 10.5x for our FY08E and FY09E revised earnings, respectively. We believe that some near-term upside potential resides on the back of upward earnings revision for FY07 and FY08, and moderate P/E expansion. We reiterate our **'BUY'** rating on the stock.

Financials snapshot (INR mn)

Year to June	Q3FY07	Q2FY07	*Growth %*	Q3FY06	*Growth %*	FY07E	FY08E	FY09E
Total revenues	15,771	14,651	*7.6*	11,220	*40.6*	61,178	79,493	99,367
Direct cost	9,738	9,107	*6.9*	6,978	*39.6*	38,052	49,323	61,806
Gross profit	6,033	5,544	*8.8*	4,242	*42.2*	23,126	30,170	37,561
SG&A expenses	2,366	2,303	*2.7*	1,744	*35.7*	9,345	11,946	15,004
EBITDA	3,667	3,241	*13.1*	2,498	*46.8*	13,781	18,225	22,556
Depreciation	659	623	*5.8*	530	*24.3*	2,514	3,124	3,915
EBIT	3,008	2,618	*14.9*	1,968	*52.8*	11,267	15,100	18,641
Other income	615	481	*27.9*	255	*141.2*	1,666	1,440	1,700
Profit before tax	3,623	3,099	*16.9*	2,223	*63.0*	12,933	16,540	20,341
Tax provision	283	206	*37.4*	277	*2.2*	1,005	1,638	2,339
Profit after tax	3,340	2,893	*15.5*	1,946	*71.6*	11,929	14,902	18,002
Share in equity investment	(3.0)	(7.0)	*(57.1)*	(6.0)	*(50.0)*	(1.0)	8.5	20.0
Minority interest	(20.0)	(23.0)	*(13.0)*	(11.0)	*81.8*	(68.0)	(40.0)	(40.0)
Adjusted net profit	3,317	2,863	*15.9*	1,929	*72.0*	11,860	14,870	17,982
Stock based sales incentives	305.0	266.0		-		1,059.1	1,144.5	989.0
Reported net profit	3,012	2,597	*16.0*	1,929	*56.1*	10,800	13,726	16,993
Adjusted EPS	4.6	4.0	*15.6*	3.0	*54.9*	16.6	20.5	25.0
as % of net revenues								
Gross profit	38.3	37.8		37.8		37.8	38.0	37.8
SG&A expenses	15.0	15.7		15.5		15.3	15.0	15.1
EBITDA	23.3	22.1		22.3		22.5	22.9	22.7
EBIT	19.1	17.9		17.5		18.4	19.0	18.8
Net profit	19.1	17.7		17.2		17.7	17.3	17.1
Tax rate	7.8	6.6		12.5		7.8	9.9	11.5

Company Description

HCL Technologies (HCL Tech) is India's fifth largest IT services company. It provides software-led IT solutions, remote infrastructure management, and BPO services, focused mainly on transformational outsourcing. The company leverages its extensive offshore infrastructure and global network of offices in 16 countries to deliver solutions across select verticals including financial services, retail and consumer, life sciences aerospace, automotive, semiconductors, telecom, and media publishing, and entertainment. The company's employee force stands at 40,149 and its revenues for the past twelve months (TTM) stood at INR 56.8 bn (USD 1.3 bn).

Investment Theme

Industry revenues are forecasted to grow at 25-30% over FY10 and as a scale player HCL Tech is expected to gradually increase its share of the total pie. HCL Tech has been at the forefront in pursuing large deals. It has won some of the largest deals announced in the Indian IT space such as DSG International, Autodesk, Teradyne, and AXA, which provide long-term revenue visibility. HCL Tech's well-established large sized practices—BPO and infrastructure management—have substantial untapped offshoring potential. The company's leading position in both these business provides it a strong annuity base and improves consistency levels.

Key Risks

Key risks to our investment theme include: (a) sustained slowdown in the US, (b) failure in maintaining margins at current levels while pursuing large deals, (c) significant increase in salary hikes and attrition rate, creating cost pressures, and (d) any substantial appreciation of the rupee against US dollar, Euro, and GBP.

HEXAWARE TECHNOLOGIES

INR 174

Executing the right gameplan to become a major

BUY

Edelweiss
Ideas create, values protect

April 24, 2007

Parul Inamdar
+91-22-2286 4355
parul.inamdar@edelcap.com

Viju George
+91-22-2286 4400
viju.george@edelcap.com

Kunal Sangoi
+91-22-2286 4309
kunal.sangoi@edelcap.com

Reuters	:	HEXT.BO
Bloomberg	:	HEXW IN

Market Data

52-week range (INR)	:	205 / 110
Share in issue (mn)	:	132.0
M cap (INR bn/USD mn)	:	23.0 / 558.4
Avg. Daily Vol. BSE/NSE ('000)	:	324.5

Share Holding Pattern (%)

Promoters	:	25.7
MFs, FIs & Banks	:	7.1
FIIs	:	53.3
Others	:	13.9

Hexaware's revenues and net profits in Q1CY07 were in line with our expectations. Revenues came in at INR 2.6 bn, up 10.1% Q-o-Q and 50.1% Y-o-Y, while net profits stood at INR 352 mn, up 8.3% Q-o-Q and 35.2% Y-o-Y. EBITDA margin increased sequentially by 10bps during the quarter at 15.1% because of rupee appreciation and higher SG&A costs (driven by one-time expenses pertaining to consultant's fees towards company reorganization). The company has defined its growth in the coming quarters on the back of testing which has received a strong leg-up with the acquisition of FocusFrame. Its target for growing this service line is impressive and ambitious. Enterprise packages and HR IT practice also continued their strong momentum, posting Q-o-Q growth of 11.4% and 11.6%, respectively.

We are particularly impressed by the reorganization effected by the company. In our view, restructuring along verticals and horizontals with an aim to define and achieve revenue and profitability targets domain-wise are appropriate building blocks for scaling up progressively. We also expect the company to score early benefits from the FocusFrame acquisition as the company has already unified its delivery platform and positioning of the sales and marketing force. The joint go-to-market strategy has already acquired one client (in testing) and made four joint bids. Hexaware expects to achieve revenues of around USD 50 mn from testing as it strengthens its positioning in this space post the acquisition. We believe that among mid-tier Indian IT services companies, Hexaware has superior client acquisition and mining capabilities. Over time with increased size, capabilities in high-end testing solutions, added client base, and revenue sources, Hexaware is likely to further improve its growth trajectory, in our opinion.

Hexaware's current outstanding order book stands at USD 260 mn, providing strong revenue visibility. We believe that the company also has sufficient levers at its disposal to push up operating margins. At CMP of INR 174, the stock currently trades at a P/E of 15.1x and 11.8x our CY07E and CY08E earnings, respectively. We maintain our 'BUY' recommendation.

Q1CY07 result highlights

- Revenues reported at INR 2.6 bn, up 10.1% Q-o-Q and 50.1% Y-o-Y. Net profit stood at INR 352 mn, up 8.3% Q-o-Q and 35.2% Y-o-Y.
- Gross profits stood at INR 1.0 bn, up by 15.5% Q-o-Q and 52.7% Y-o-Y. Gross margins improved by an impressive 190bps Q-o-Q. The increase in gross margins was achieved by a higher utilization rate and better offshore billing rates.

Financials

Year to December	Q1CY07	Q4CY06	*Growth %*	Q1CY06	*Growth %*	CY07E	CY08E
Revenue (INR mn)	2,644	2,402	*10.1*	1,762	*50.1*	11,857	15,595
Gross profit (INR mn)	1,040	901	*15.5*	681	*52.7*	4,496	5,808
EBITDA (INR mn)	395	357	*10.7*	294	*34.6*	1,788	2,457
Net profit (INR mn)	339	325	*4.4*	260	*30.5*	1,532	2,113
Adj. EPS basic (INR)	2.6	2.5	*4.3*	2.2	*17.9*	11.3	14.4
P/E (x)						15.4	12.0
EV/EBITDA (x)						11.4	8.4
Mkt.cap/Rev. (x)						1.9	1.5

- EBITDA grew by 10.7% Q-o-Q to INR 395 mn. EBITDA margin marginally increased by 10bps Q-o-Q at 15.0%. Higher SG&A costs during the quarter prevented margin expansion. We understand the increase in these costs is mainly because of integration cost.

- Hexaware won two large orders, in excess of USD 10 mn each, during the quarter. The addition to the order book of USD 61 mn is the highest that the company has recorded in any quarter.

- The company added 20 new clients during the quarter. Its active client count now stands at 151 compared to 129 in the previous quarter and 130 a year ago. The number of clients contributing revenues in excess of USD 1 mn stands at 46 compared to 41 in the previous quarter.

- Offshore utilization for the company improved by 210bps Q-o-Q to 62.7%.

- The company's total headcount stood at 5,751 compared to 5,829 in Q4CY06. The company's total strength reduced by 78 employees.

- The company has INR 3.4 bn (USD 82 mn) as cash and cash equivalents.

Building the right DNA for growth

Hexaware recently concluded an organization-wide restructuring exercise. It has restructured to align delivery with account management. The company has now organized itself along six dimensions (horizontals/verticals) which include the current mainstream services and emerging ones as well. These include enterprise solutions, testing, business analytics/intelligence, asset management (capital markets), transportation & logistics, and HR-IT & HRO. These business segments will have independent growth and profitability mandates going forward. In our view, this reflects the mindset of a company, which has already thought through an appropriate structure flexible and powerful enough to handle growth to mark its transition to a large company over a three-four year time frame.

Early signs of integration of FocusFrame encouraging

Hexaware has already formulated a joint go-to-market strategy, which has won buy-in from the S&M force of both the companies. The company has outlined portions of work that will be driven onsite (higher-end consulting) and offshore (broader-level implementation and support). Notably, the joint selling strategy has already begun in earnest with one client win this quarter and four joint bids already submitted. Hexaware expects the acquisition to help deliver its revenue target from testing of USD 50 mn in CY07 as volume opportunity gets addressed offshore.

Testing: Poised to be a leader in its class

On the back of acquisition of FocusFrame, Hexaware's accelerated penetration in testing (ERP and customer application) is seeing strong momentum. Already, the company has marked out testing to be a USD 100 mn service line in a span of three years and has targeted USD 50 mn from this service line in CY07. Notably, eight of twenty customer wins in this quarter are for testing. We believe Hexaware is among the early and accelerated movers in this service line among companies of comparable size within the Indian IT sector.

Strong traction in HR IT and enterprise packages continues

Hexaware has built a strong brand for itself in niche areas of PeopleSoft implementation and human resources information technology services. With more than 1,000 professionals (largest in India) working in the PeopleSoft implementation practice, Hexaware is in a dominant position. Further, Oracle has also laid out plans for upgrading PeopleSoft's current version, proving higher visibility for Hexaware. The company's solution accelerator acquired through FocusFrame will enable it to implement PeopleSoft version 9 when Oracle is ready to roll out this version globally.

HR IT and enterprise packages together now contribute 40.6% of the company's total revenues in Q1CY07, in line with the contribution of 40% from these two segments over the trailing four quarters. In this quarter, the sequential growth rate from these two segments grew in double-digits in percentage terms after a relatively muted pervious quarter (Q4FY06).

Table1: Revenues from enterprise packages and HR IT continue to grow faster

	Q1CY06	Q2CY06	Q3CY06	Q4CY06	Q1CY07
Enterprise packages (INR mn)	599	674	760	795	886
Growth (%)		*12.6*	*12.7*	*4.6*	*11.4*
HR IT (INR mn)	122	145	160	168	188
Growth (%)		*19.1*	*10.3*	*5.3*	*11.6*
TOTAL	720	819	920	963	1,073
Growth (%)		*13.7*	*12.3*	*4.7*	*11.4*

Source: Company, Edelweiss research

We like Hexaware's ability to latch on to two key emerging opportunities (testing and ERP implementation) and make them count.

Superior client mining ability

A third of Hexaware's client base (of 151 clients) is Fortune 500 names. In addition, a good proportion of Hexaware's clients (46/151) are million dollar clients, which we believe is a testimony of the company's success in targeting good quality clients and growing them. Over 20% of the million-dollar client-base is also USD 5 mn plus accounts. The company has so far focused on cross-selling of horizontals to penetrate its accounts. However, we believe that to increase the proportion of USD 10 mn plus accounts further, Hexaware will have to do more with the existing clients to build annuity revenues. It should look to build more stable and stickier revenue streams such as application maintenance and verticalized solutions to deepen entrenchment within its good client base further.

Muted Q2CY07 likely

The company is likely to report sequential quarterly decline in profits in Q2CY07 mainly because of:

(a) salary hikes which take full effect for the quarter, and are likely to absorb an additional USD 3.5 mn; and

(b) visa costs, which are typically incurred in the April-June quarter of the calendar year. However, we see the revenue growth momentum continuing with Q2CY07 likely to grow at 7-8% sequentially over the current quarter. Going forward, we believe that the company's revenue growth is likely to be decent (35% in CY07 over CY06) maintaining a stable operating margin structure with an upward bias.

Valuations

We believe that Hexaware is building for the long term. Its ability to capitalize on opportunities (e.g., enterprise solutions a few years back and testing now) and restructuring to deliver longer term, instills in us the confidence that the company is readying itself to realize long-term ambitious goals. We expect Hexaware to grow its net profit by 32.2% CAGR over CY06-08E, but the dilution expected from conversion of preference shares held by General Atlantic will restrict EPS growth over CY06-08E to 26.8%. At a CMP of INR 174, the stock currently trades at a P/E of 15.1x on our CY07E earnings and 11.8x CY08E earnings. We maintain our **'BUY'** recommendation.

Financials snapshot (INR mn)

Year to December	Q1CY07	Q4CY06	*Growth %*	Q1CY06	*Growth %*	CY06	CY07E	CY08E
Total revenues	2,644	2,402	*10.1*	1,762	*50.1*	8,482	11,857	15,595
Direct costs	1,603	1,501	*6.8*	1,080	*48.4*	5,318	7,361	9,787
Gross profit	1,040	901	*15.5*	681	*52.7*	3,164	4,496	5,808
SG&A expenses	645	544	*18.7*	388	*66.4*	1,842	2,709	3,352
EBITDA	395	357	*10.7*	294	*34.6*	1,322	1,788	2,457
Depreciation	56	53	*6.8*	46	*22.6*	200	248	309
Other income	68	79	*(14.2)*	35	*96.5*	241	273	295
PBT	407	384	*6.1*	282	*44.1*	1,363	1,813	2,443
Tax	55	46	*19.1*	22	*148.8*	120	244	330
Adjusted net profit	352	338	*4.3*	260	*35.2*	1,242	1,569	2,113
Extra / Non-recurring items	-	-		-		-	-	
Preference dividend	12	12		-		34	37	-
Reported net profit	339	325	*4.4*	260	*30.5*	1,208	1,532	2,113
Adjusted EPS basic (INR)	*2.6*	*2.5*	*4.3*	2.2	*17.9*	9.5	11.3	14.4
as % of net revenues								
Direct costs	60.6	62.5		61.3		62.7	62.1	62.8
Gross margin	39.4	37.5		38.7		37.3	37.9	37.2
SG&A costs	24.4	22.6		22.0		21.7	22.8	21.5
EBITDA margin	15.0	14.9		16.7		15.6	15.1	15.8
Net profit margin	12.8	13.5		14.8		14.2	12.9	13.5
Tax rate	13.5	12.0		7.8		8.8	13.4	13.5

Company Description

Hexaware Technologies is an IT services company specializing in Enterprise solutions, Application Management and Embedded System. The company provides software services to the airlines, transportation, manufacturing, banking & financial services, insurance and healthcare verticals. Hexaware has a dominant PeopleSoft practice and is amongst the Top 20 software and services exporter from India. The company’s last twelve month revenues stood at INR 9.4 bn (USD 215 mn) and employs more than 5,700 people.

Investment Theme

Hexaware has demonstrated strong momentum and emerged strongly from the set back that it suffered on account of discontinuation from PeopleSoft ISC. Oracle’s release of PeopleSoft’ 9.0 version along with Hexaware’ dominant practice in this area (1,000+ professionals), brightens the outlook. The company has a superior client mining ability with de-risked revenue stream and focus on high potential customers as a step to accelerate the growth.

Key Risks

The key risks to our investment theme include a) sustained slowdown in US, b) wage inflation leading to higher attrition and c) appreciation of rupee against US dollar, GBP and Euro.

i-FLEX SOLUTIONS

INR 2,277

Product traction to play out longer-term

BUY

i-flex Solutions' Q4FY07 results were below expectations. Revenues reported at INR 5.8 bn were up 5.3% Q-o-Q and 26.6% Y-o-Y, while net profits at INR 776 mn were flat Q-o-Q and down 33.6% Y-o-Y. The products business at INR 3.2 bn grew 1.1% Q-o-Q, below expectations, with major contribution (78%) from implementation and AMC fees; license fees accounted for only 22% of product revenues in a seasonally strong quarter. The lower proportion of high margin license fee contribution resulted in significantly lower net profits for the quarter than our expectations. However, license fees tank is at an all-time high at USD 82.5 mn, up from USD 73.6 mn last quarter. We also note that substantial license fees have been deferred for the purpose of revenue recognition as per US GAAP (USD 31.4 mn in March 2007 versus USD 12.7 mn in March 2006) and will be recognised as revenues in the coming quarters. The services business has performed creditably in Q4FY07 with revenues from this segment, growing 10% Q-o-Q.

i-flex's product suite (through Reveleus) addresses areas such as governance, risk management, and compliance. Reveleus has won a large deal with a top-tier financial institution from the US. Financial services firms are paying greater attention to the aforementioned areas due to regulations such as Sarbens Oxley (SOX), Basel II, and Anti-Money Laundering. We believe that factors such as superior product architecture, history of successful multi-country roll outs, prestigious customer wins along with increased product portfolio from the Mantas acquisition will ensure that i-flex sustains its high growth. We remain excited on the prospects of the company in view of the quality of deals in the pipeline and the company's superior and comprehensive positioning in the financial services segment.

Adjusting for the much weaker than expected product sales for the quarter, we have revised our EPS for FY08E and FY09E downwards by ~9.6% to INR 52.4 and 6.8% to INR 67.6, respectively. Our revised estimates take into account lower than expected license fees. At a CMP of INR 2,277, the stock trades at P/E of 43.5x and 33.7x on our FY08E and FY09E revised earnings, respectively. We maintain our 'BUY' recommendation; but we note that the current valuations factor in i-flex's market leadership in the packaged banking products space.

Financials

Year to March	Q4FY07	Q3FY07	*Growth %*	Q4FY06	*Growth %*	FY08E	FY09E
Revenue (INR mn)	5,794	5,502	*5.3*	4,577	*26.6*	26,974	34,594
Gross profit (INR mn)	2,586	2,410	*7.3*	2,298	*12.5*	12,388	15,856
EBITDA (INR mn)	1,093	1,064	*2.6*	1,313	*(16.8)*	5,725	7,426
Net profit (INR mn)	777	773	*0.5*	1,169	*(33.6)*	4,347	5,580
EPS basic (INR)	9.6	9.5	*0.4*	15.5	*(38.3)*	52.4	67.6
P/E (x)						43.5	33.7
EV/EBITDA (x)						31.6	24.3
Market cap/ Revenue (x)						7.0	5.5

May 08, 2007

Parul Inamdar
+91-22-2286 4355
parul.inamdar@edelcap.com

Viju George
+91-22-2286 4400
viju.george@edelcap.com

Kunal Sangoi
+91-22-2286 4309
kunal.sangoi@edelcap.com

Reuters	:	IFLX.BO
Bloomberg	:	IFLEX IN

Market Data

52-week range (INR)	:	2,545 / 840
Share in issue (mn)	:	83.2
M cap (INR bn/USD mn)	:	189.5/4,636.7
Avg. Daily Vol. BSE/NSE ('000)	:	193.6

Share Holding Pattern (%)

Promoters	:	81.0
MFs, FIs & Banks	:	0.8
FIIs	:	0.7
Others	:	17.5

Result Highlights

- Revenues, reported at INR 5.8 bn, were up 5.3% Q-o-Q and 27.0% Y-o-Y. Net profit at INR 777 mn was almost flat Q-o-Q and down 33% Y-o-Y, which is the worst ever performance Y-o-Y at the net profit level.
- Gross margins increased 60bps Q-o-Q to 44.6%, but on a Y-o-Y basis it was down 560bps. EBITDA stood at INR 1.1 bn and the EBITDA margin was at 18.9% as against 19.3% in the previous quarter and 28.7% in the corresponding quarter last fiscal.
- The company added 30 new clients, of which, 16 were in the products business.
- The company added 522 net employees, taking the total headcount to 9,068, an increase of 32%% Y-o-Y.

Products business

- Product revenues stood at INR 3.2 bn, down 1% Q-o-Q and up 22.0% Y-o-Y. The Q4 tends to be a seasonally strong quarter for i-flex because the products business records its strongest performance typically in this quarter. In this context, the products performance in Q4FY07 growth is relatively weak.
- License fees at INR 705 mn showed a sharp decline of 11% Q-o-Q and 46% Y-o-Y, indicating that the pace of fresh deal sign-ups is not as fast as in the past and revenue recognition for the contracted deals could kick in later as the company executes its milestone projects. Deferred revenues stand at USD 31.4 mn, up from USD 12.7 Y-o-Y.
- EBITDA margin stood at 27.8%, against 31.8% in Q3FY07.
- The product revenue tank size currently stands at USD 82.5 mn, up from USD 73.6 mn in the previous quarter.
- The license fee revenue contribution to total product revenues stood at 22% (50% in Q4FY06).

Services business

- Services revenues stood at INR 2.45 bn, up 10.1% Q-o-Q and 29.3% Y-o-Y.
- The highlight in the services business was the extremely robust growth in offshore contribution, which increased 33% sequentially from Q3FY07. Offshore revenues contributed 35% to total services revenues for the quarter, marking the highest for six quarters. For FY07, offshore revenues contributed just over 30% of services revenues.
- EBITDA margins for the quarter were 23.8%, significantly up from 15.4% in the previous quarter, led by increased utilisation and number of billing days.

KPO business

- KPO revenues stood at INR 143 mn, up 32.7% Q-o-Q and 112.8% Y-o-Y.
- At the EBITDA level, this division still remains in the investment mode with a loss of INR 51.1 mn, compared with loss of INR 24.7 mn in the previous quarter.

A relatively muted Q4FY07 ends an overall good FY07

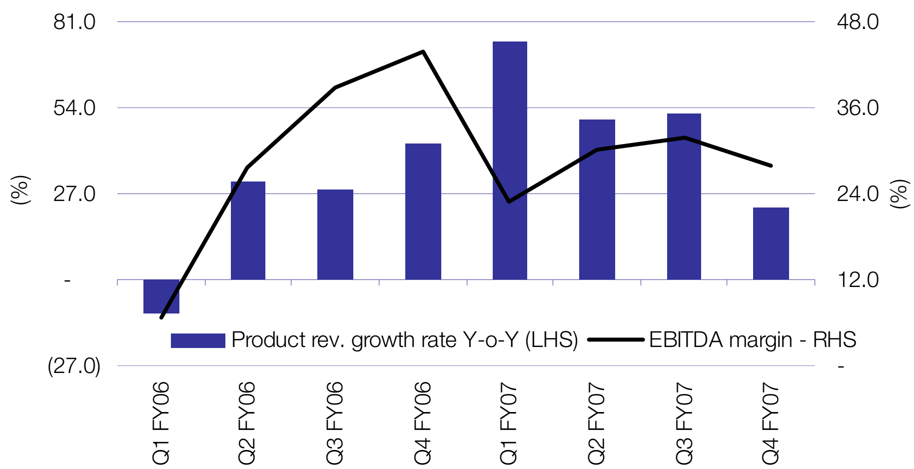
i-flex reported revenues of INR 2.0 bn and net profits of INR 277 mn in FY07, growth of 37.4% and 26.4% respectively over FY06, as per US GAAP. The net profit margin in FY07, at 13.6%, was however lower than that in FY06 at 14.8%. Organic growth amounted to about 33% of annual growth, while acquisitions contributed to the balance 4.4% growth. Products held a 56% share of the overall revenue pie, which grew to 57.2% in FY07 over FY06 (48% excluding acquisitions) . Services business grew respectably at 27.6% Y-o-Y.

Low profitability of the products business (26% in FY07 versus 33% in FY06), however, continues to cause concern.

Product squeeze in the quarter unseasonal, but long-term outlook remains buoyant

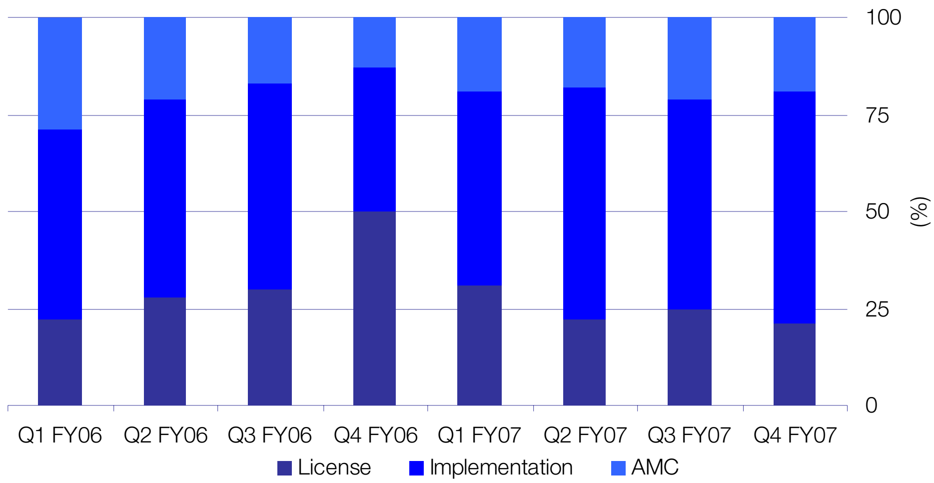
The lower than expected performance of the products business in Q4FY07, especially license fees, depressed profitability for the quarter vis-à-vis our expectations. Notably, chart 1 indicates that the products segment had a relatively weak quarter from a Y-o-Y growth and EBITDA margin perspective. In addition, chart 2 shows that the contribution from license fees (as a percentage of product sales) is also muted compared with the previous quarters, more so given that Q4 tends to be seasonally strong. Chart 3 shows that annual EBITDA margins for the products business in FY07 at 25.9% was the weakest in recent years.

Chart 1: Products had a slow quarter in Q4FY07



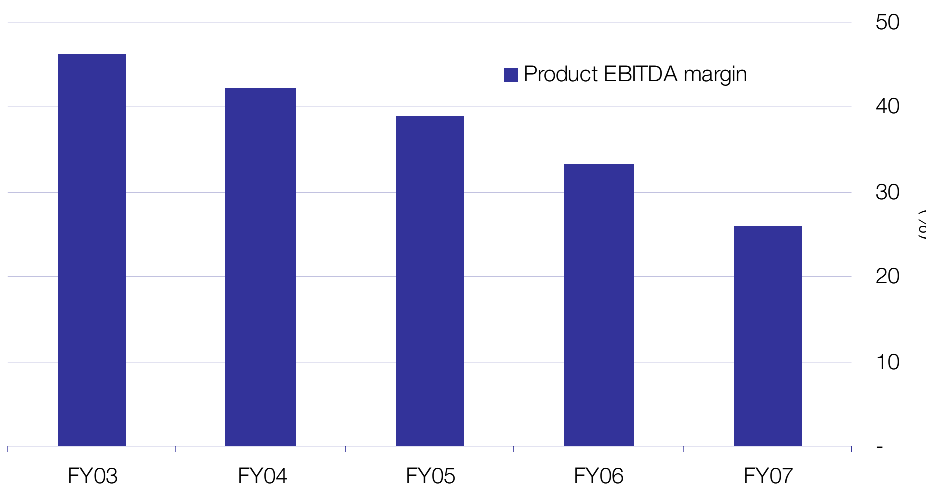
Source: Company, Edelweiss research

Chart 2: Contribution from license fees is relatively muted in Q4FY07



Source: Company, Edelweiss research

Chart 3: Product EBITDA margin (%) is the weakest in recent years



Source: Company, Edelweiss research

However, we note that deferred license fees revenues have increased to USD 31.4 mn, an increase of USD 18.7 mn from USD 12.7 mn in Q4FY06. These will be recognized as revenues in the coming quarters and have been factored in our estimates for FY08. Also, the license fees tank (conservatively estimated by the management) stood at USD 82.5 mn versus USD 73.6 in Q3FY07 and USD 65 mn in Q4FY06 (27% increase, Y-o-Y).

In the long-term, momentum in the products story remains strong and sustained. i-flex has considerably expanded the width of its product suite offerings with its acquisition of Reveleus and Mantas. Reveleus, its flagship governance, risk and compliance solution is finding resonance in the US with a significant Tier-I win in this quarter. The company indicates that with this win, Reveleus has 4 of the top 10 banks in the US as its clients. Mantas is also asserting its traction with 3 client wins in this quarter, indicating that these two entities standalone are capable of winning business on the strength of their core proposition.

Core banking solutions finding resonance in the market

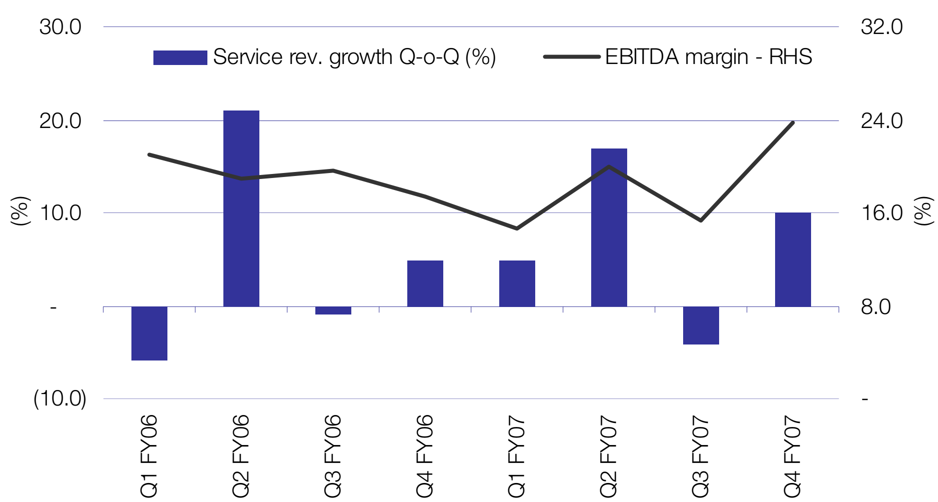
i-flex has a clearly articulated strategy centered on competitive differentiation, cost reduction, customer intimacy, and compliance adherence and management. This kind of positioning is finding acceptance and customer sign-ups are increasingly defining the trend towards core banking solutions. The company has already marked its presence in the core-banking replacement and multi-country deployment market for global financial institutions in Europe. Further, its diversified product wins for the recent quarters are indicative of its increasing traction in other markets such as Japan, Middle East, and Latin America.

However, we believe that the much opportunity resides in the core banking replacement market in the US. The US is slow to embrace non-local service providers and non-legacy systems and only a few local legacy vendors dominate this geography. i-flex has made a dent here by winning Peoplebank deal. The company has been commissioned to deploy a core retail banking platform for Peoplebank that interfaces with local payment providers, complies with regulatory norms, and measures and manages risks among other mandatory requirements. The company believes that this is a significant stepping ground and represents the very first instance of a non-local vendor replacing and redeploying a core banking platform. We believe penetration potential here will be significant in terms of adding to revenues. We expect success of i-flex's initiatives in the US playing out more significantly in FY09. In our opinion i-flex should be more stringent in its product-related expenses (especially SG&A), more so as it seeks to extend its leadership and footprint in the developed markets like the US.

Services: A decent performer with defined focus

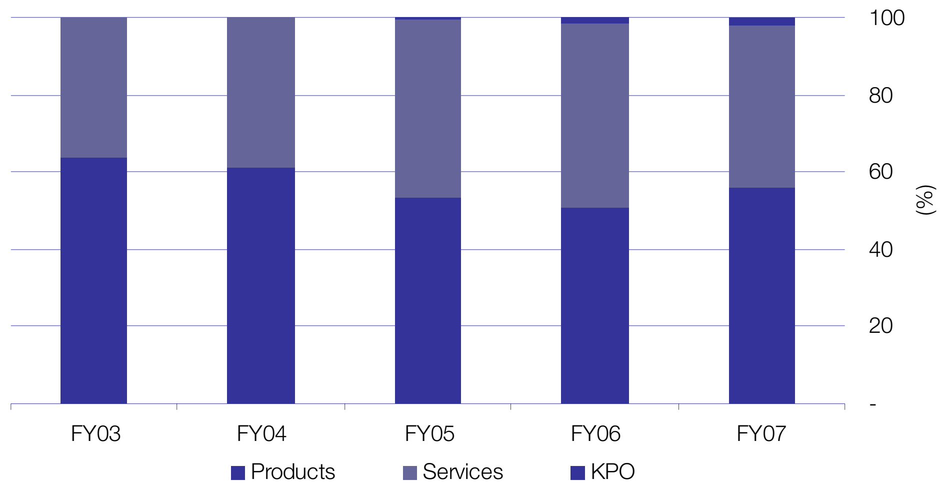
i-flex's services revenues for Q4FY07 registered a strong 10.1% growth Q-o-Q, driven primarily by increase in offshore revenues (33% growth Q-o-Q) with markedly improved EBITA (23.8% of revenues). This growth was services' strongest growth in the recent quarters, as chart 4 shows. Services registered revenues of INR 9 bn in FY07, growing ~28% over FY06, contributing ~44% to revenues in FY07 (see chart 5); EBITDA margins of 18.8% were comparable with those in the past (see chart 6).

Chart 4: Services witnessed strong growth in Q4FY07



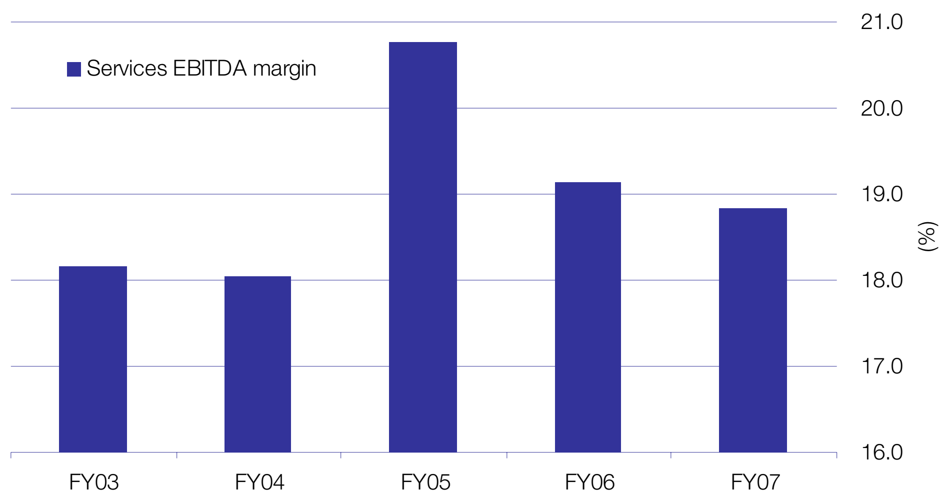
Source: Company, Edelweiss research

Chart 5: Services (including KPO) constituted 44% of i-flex's revenues in FY07



Source: Company, Edelweiss research

Chart 6: Services EBITA (%) in FY07 has been comparable with previous years



Source: Company, Edelweiss research

We believe that i-flex's services business is different from other tier-2 Indian IT services players in a few ways. First, the services business is focused on banking and financial services only. Second, it defines its focus less on larger-scale application outsourcing and more on in-demand opportunities such as MIFID and Basel-II, requiring a solution domain-led approach. Third, as many of such opportunities have a consulting and onsite implementation bias, i-flex's onsite revenues are likely to continue to account for a greater proportion of the company's services revenues. Based on all the above factors, we conclude that i-flex's services business is unlikely to embrace mainstream opportunities and build scale, though it is capable of growing 30% annually over the next two years.

* Management gets enhanced role in Oracle's scheme of things

The key members of i-flex's management team – Rajesh Hukku (Chairman and MD), R.Ravishankar (CEO, International Operations and Business Development), and Deepak Ghaisas (CEO, India Operations and CFO) are assuming elevated positions within Oracle, taking leadership of Oracle's financial services business unit. Rajesh Hukku will head this business unit with the other two also joining him to develop a unified and global strategy to manage Oracle's assets in this business unit and strategize for its growth. While we view this as testimony to i-flex's increasing visibility within Oracle and room for management to further push i-flex's joint go-to-market and product integration efforts with Oracle, this role could stretch management bandwidth going forward.

Downward revision in estimates

Adjusting for the much weaker than expected product sales for the quarter, we have revised our EPS for FY08E and FY09E downwards by ~9.6% to INR 52.4 and 6.8% to INR 67.6, respectively. Our sales estimates are revised downwards 5.7% in FY08E to INR 27 bn and 5.1% in FY09E to INR 34.6 bn. On a two-year basis, we estimate sales, net profits, and the EPS to grow at a CAGR of 39%, 42%, and 40%, respectively. Our revised estimates take into account the increase in deferred license revenues, which will flow through FY08E.

Table 1: Revised estimates

	Earlier		Revised		% change	
	FY08E	FY09E	FY08E	FY09E	FY08E	FY09E
Revenue	28,619	36,496	26,974	34,594	(5.7)	(5.2)
Net Profit	4,814	6,073	4,347	5,581	(9.7)	(8.1)
EPS	57.9	72.5	52.4	67.6	(9.6)	(6.8)

Source: Edelweiss research

Valuations

At a CMP of INR 2,277, the stock trades at P/E of 43.5x and 33.7x on our FY08E and FY09E revised earnings, respectively. The stock is trading at a forward PEG of over 1, given our CAGR earnings growth estimate of nearly 40% over FY07-09E. We maintain our **'BUY'** recommendation, but we note that the current valuations factor in i-flex's continued leadership in the packaged banking products space.

Financial snapshot (INR mn)

Year to March	Q4FY07	Q3FY07	*Growth %*	Q4FY06	*Growth %*	FY07	FY08E	FY09E
Products	3,206	3,172	*1.1*	2,619	*22.4*	11,898	14,586	18,778
Services	2,445	2,222	*10.1*	1,891	*29.3*	8,970	11,743	14,946
KPO	143	108	*32.7*	67	*112.8*	445	645	871
Total revenues	5,794	5,502	*5.3*	4,577	*26.6*	21,313	26,974	34,594
Products	1,456	1,339	*8.8*	841	*73.1*	4,856	5,612	7,379
Services	1,626	1,683	*(3.4)*	1,401	*16.1*	6,486	8,530	10,910
KPO	126	70	*79.5*	37	*243.9*	298	445	448
Direct costs	3,208	3,092	*3.8*	2,279	*40.8*	11,640	14,586	18,738
Gross profit	2,586	2,410	*7.3*	2,298	*12.5*	9,673	12,388	15,856
Products	857	824	*4.0*	627	*36.7*	3,033	3,909	4,957
Services	238	197	*20.6*	162	*46.9*	808	1,074	1,330
KPO	68	62	*9.2*	57	*19.5*	238	300	418
Corporate G & A	331	262	*26.1*	139	*138.1*	1,077	1,380	1,725
Total Overhead expenditure	1,494	1,346	*11.0*	985	*51.7*	5,156	6,662	8,430
EBITDA	1,093	1,064	*2.6*	1,313	*(16.8)*	4,518	5,725	7,426
Products	143	172	*(16.6)*	76	*88.3*	483	599	680
Services	78	61	*26.7*	56	*39.4*	247	348	440
KPO	7	8	*(0.7)*	7	*9.9*	31	46	65
Corporate	19	19	*(0.9)*	13	*43.2*	71	90	105
Total Depn & Amrtz	247	260	*(4.8)*	152	*63.0*	833	1,083	1,290
EBIT	845	805	*5.0*	1,162	*(27.2)*	3,685	4,643	6,136
Share of associate co. loss	(2)	(3)	*(36.4)*	(1)	*172.1*	(9)	(14)	(15)
Other income	26	(2)	*(1176.7)*	105	*(74.9)*	349	300	300
Profit before tax	874	806	*8.5*	1,267	*(31.0)*	4,043	4,957	6,451
Provision for tax	97	33	*196.3*	98	*(1.0)*	342	610	871
Reported net income	777	773	*0.5*	1,169	*(33.6)*	3,700	4,347	5,580
EPS basic (INR)	9.6	9.5	*0.4*	15.5	*(38.3)*	35.1	52.4	67.6
as % of revenue								
Gross profit	44.6	43.8		50.2		45.4	45.9	45.8
SG&A	25.8	24.5		21.5		24.2	24.7	24.4
EBITDA	18.9	19.3		28.7		21.2	21.2	21.5
EBIT	14.6	14.6		25.4		17.3	17.2	17.7
Reported net profit	13.4	14.0		25.5		17.4	16.1	16.1
Tax rate	11.1	4.1		7.8		8.5	12.3	13.5

Company Description

i-flex Solutions is a leading software vendor for the banking and financial services vertical. It provides technology products, custom applications and services, consulting services, IT infrastructure services, and KPO services focused specifically on the financial industry. The company's product suite comprises FLEXCUBE, DAYBREAK, Reveleus, CASTEK, and recently acquired Mantas' behaviour detection platform. Its core banking product, FLEXCUBE has been ranked world's No. 1 selling core banking solution for four years in a row since 2002 by the UK-based International Banking Systems (IBS). i-flex's services business, focused on BFSI segment, has also grown rapidly and currently contributes ~42% to the total revenues. The company employs over 9,000 people and its revenues for the past twelve months (TTM) stood at INR 20.4 bn (USD 465 mn).

Investment Theme

i-flex is a clear leader in the Indian financial services space. Its strong product portfolio has an extremely comprehensive range of solutions for the financial services industry. Besides developing a strong product suite, the company has been constantly expanding its capabilities through organic and inorganic routes. With several marquee names to its client roaster such as Citigroup, Wells Fargo, World Bank, Wachovia, the company still has a long way to go. The recent collaboration of IBM, Oracle, and i-flex aimed at combining IBM's IT architectural leadership in banks and financial institutions, Oracle's banking-specific application solutions, and i-flex's core banking and risk solutions has compelling potential. Oracle can further enhance the penetration of Flexcube as a core banking solution across its significant client base particularly in the US where Flexcube has a relatively minor presence.

Key Risks

Key risks to our investment theme include: (a) adequate availability of skilled manpower, (b) sustained slowdown in the US' BFSI segment,, and (c) significant appreciation of rupee against US dollar, Euro, and GBP.

iGATE GLOBAL SOLUTIONS

INR 385

Growth intact, minor hiccups notwithstanding

BUY

April 11, 2007

Hitesh Zaveri
+91-22-2286 4424
hitesh.zaveri@edelcap.com

Parul Inamdar
+91-22-2286 4355
parul.inamdar@edelcap.com

Viju George
+91-22-2286 4400
viju.george@edelcap.com

Kunal Sangoi
+91-22-2286 4309
kunal.sangoi@edelcap.com

iGATE's Q4FY07 results were ahead of our expectations. Revenues at INR 2.1 bn were muted (sequentially flat), but net profit of INR 226 mn, up 41.7% Q-o-Q and 379.8% Y-o-Y, was ahead of our estimates. EBITDA margins for Q4FY07 stood at 15.3%, the highest since Q3FY01. This quarter completes a strong turnaround story for the company through FY07; profits grew nearly 200% in FY07, with EBITDA margins of 11.4% in FY07 (up 180bps from the FY06 level). Most importantly, the company has established a robust clientele which we believe, is likely to sustain its growth at healthy levels going forward.

We believe that iGATE's trajectory of EBITDA margins is likely continue to exhibit an uptrend and will be sustainable in the range of 16%-18% over the next two years. This, coupled with decent outlook on the IT-services business, is likely to translate into an EPS growth of 57.1% over FY07-09.

We have revised our EPS estimates for FY08E and FY09E downwards by 8.8% and 3.3% respectively on account of weakness seen in the company's iTOPS revenue segment. At CMP of INR 385, the stock trades at a P/E of 14.2x and 9.8x for FY08E and FY09E earnings respectively. The company's valuation on EV/EBITDA and EV/revenue for FY08E continues to be attractive at 7.4x and 1.2x, respectively. At a PEG of 0.25 we see the current valuations compelling. We maintain our 'BUY' recommendation on this stock.

Key highlights of Q4FY07 and FY07

- Reported revenues (at INR 2.1 bn) are flat and below our growth estimate of 1.5% Q-o-Q. This tepidness is largely attributed to currency factors. Revenues for FY07 stood at INR 8.05 bn, up 26.6% from the FY06 level.
- Gross margins of 32.6% are up 140bps Q-o-Q and 260bps Y-o-Y, ahead of our expectations. The SG&A expenses declined by 7.5% Q-o-Q and 17.2% (as a percentage of revenues) as against 20.3% a year ago.
- EBITDA margin in Q4FY06 increased 260bps Q-o-Q and 570bps Y-o-Y, to 15.3%, averaging 11.4% in FY07 as against 9.6% in FY06. Notably, this is the highest kevel since Q3FY01. The management had guided to EBITDA margins exceeding 15% in Q4FY07, a year ago.

Reuters	:	IGAT.BO
Bloomberg	:	IGS IN

Market Data

52-week range (INR)	:	432 / 145
Share in issue (mn)	:	31.6
M cap (INR bn/USD mn)	:	12.2 / 284.2
Avg. Daily Vol. BSE ('000)	:	43.9

Share Holding Pattern (%)

Promoters	:	81.9
MFs, FIs & Banks	:	2.2
FIIs	:	5.3
Others	:	10.6

Financials

Year to March	Q4FY07	Q3FY07	*Growth %*	Q4FY06	*Growth %*	FY08E	FY09E
Revenue (INR mn)	2,101	2,107	*(0.3)*	1,674	*25.5*	9,143	11,657
Gross profit (INR mn)	684	658	*4.0*	502	*36.3*	3,036	3,998
EBITDA (INR mn)	322	267	*20.7*	161	*99.6*	1,467	1,993
Net profit (INR mn)	226	160	*41.7*	47	*379.8*	864	1,248
EPS basic (INR)	7.2	5.1	*41.8*	1.5	*377.5*	27.2	39.2
P/E (x)						14.2	9.8
EV/EBITDA (x)						7.4	4.9
Market cap / Revenue (x)						*1.3*	*1.0*

Key highlights of Q4FY07 and FY07

- EBITDA margin in Q4FY06 increased 260bps Q-o-Q and 570bps Y-o-Y, to 15.3%, averaging 11.4% in FY07 as against 9.6% in FY06. Notably, this is the highest kevel since Q3FY01. The management had guided to EBITDA margins exceeding 15% in Q4FY07 a year ago.
- The company added six new customers during this quarter. Although only 25 clients were added in FY07, 40% of these additions (10 no.s) is in the million dollar category. The company's focus is on adding strategic clients, whom it can service across multiple lines of offerings.
- The headcount increased by 793, reaching 5,945 towards the year end. The company intends to add over 1000 personnel in FY08.
- EPS, in FY07, is INR 15.8 against our estimate of INR 14.3.
- Notably, offshore effort stood at over 75% of overall effort in FY07, higher than industry standards.

Enriched revenue composition to keep IT-services' growth intact

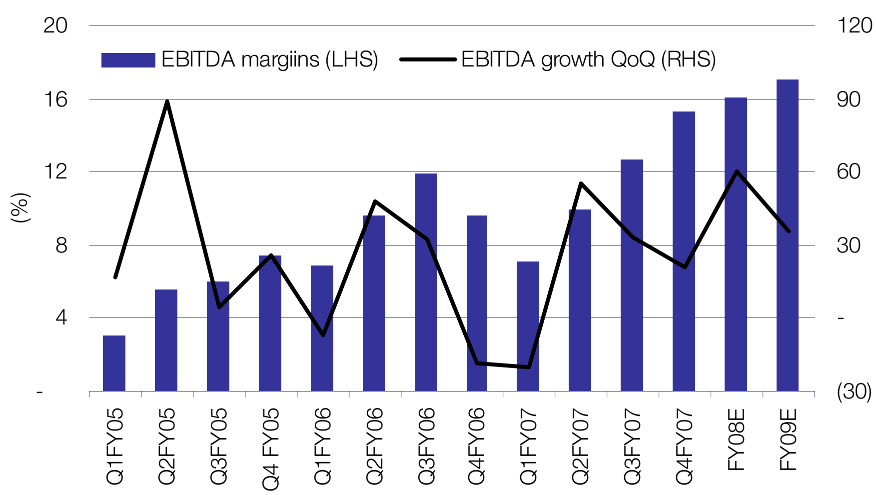
Over the last few years, iGATE is focused on its top ten clients, which has yielded desired results. Excluding revenues from GE (top client), the revenues from the other top nine clients have grown at an impressive 74.8% Y-o-Y. The offshore proportion of revenues is also increasing and currently stands at 47.5% of total revenues, the highest ever level and comparable with the best in the industry. iGATE has been focusing on getting a higher share of the client's total spend through introduction of newer services such as business intelligence, data warehousing, ERP, and infrastructure management. We believe this changing revenue composition, along with introduction of new high-margin services, will help iGATE maintain its growth rate of at least 25% in FY08 and FY09.

Uptrend in EBITDA margin to continue

We believe ongoing improvement in EBITDA is likely to continue in FY08 as well and is likely to reach a sustainable band of 16%-18%. Higher revenue share from new clients, who have been acquired at higher than the company's average billing rates, is one of the key margin drivers.

Cost rationalisation measures, including SG&A leverage and broad-basing of the employee pyramid, will also enable margin expansion. We forecast the company's EBITDA margin to expand to 16% in FY08E and 17.1% in FY09E.

Chart1: Historical and forecasted EBITDA margins and EBITDA growth (Q-o-Q)



Source: Company, Edelweiss research

Weakness in the US sub-prime mortgage market to affect traction in iTOPS

A significant proportion of iGATE's iTOPS revenues (about 10% of overall revenues) is exposed to the sub-prime mortgage market in the US. The company sees the weakness here affecting its growth in this segment, which it attributes to the rapid fall-off of two accounts. This will likely reflect in a weak Q1FY08E. We also believe that the temporary negative impact on profits is likely to be higher in Q1FY08E, given that iTOPS is relatively more profitable than IT-Services.

Estimates revision for FY08E and FY09E

We have accounted for the impact of the weakness of the sub-prime mortgage market in the US on iGATE, in our estimates for FY08 and FY09.

Our EPS for FY08E and FY09E now stands revised downwards by 8.8% and 3.9% respectively.

Table 1: Revised estimates

	Earlier		Revised		% change	
	FY08E	FY09E	FY08E	FY09E	FY08E	FY09E
Revenue (INR mn)	9,837	12,080	9,143	11,657	(7.1)	(3.5)
Net profit (INR mn)	954	1,308	864	1,248	(9.5)	(4.6)
EPS (INR)	29.8	40.8	27.2	39.2	(8.8)	(3.9)

Source: Edelweiss research

Valuations

At CMP of INR 385, the stock is valued at a P/E of 14.2x and 9.8x for FY08E and FY09E earnings, respectively. The company's valuation on EV/EBITDA and EV/revenue for FY08E continues to be attractive at 7.4x and 1.2x, respectively. Over the next two years, we estimate iGATE to earn cumulative cash profits of INR 3.1 bn,, and post a cash-earnings growth of 41.4% CAGR over FY07-09. We expect the company's EPS growth to be among the highest in our set of companies over FY07-09E. At a PEG of 0.25 we see the current valuations compelling.. We maintain our 'BUY' recommendation.

Financials snapshot (INR mn)

Year to March	Q4FY07	Q3FY07	*Growth %*	Q4FY06	*Growth %*	FY07	FY08E	FY09E
Total revenues	2,101	2,107	*(0.3)*	1,674	*25.5*	8,051	9,143	11,657
Cost of revenues	1,417	1,449	*(2.2)*	1,172	*20.9*	5,631	6,107	7,658
Gross profit	684	658	*4.0*	502	*36.3*	2,420	3,036	3,998
SG&A expenses	362	391	*(7.5)*	341	*6.3*	1,501	1,569	2,005
EBITDA	322	267	*20.7*	161	*99.6*	918	1,467	1,993
Depreciation	99	102	*(3.1)*	95	*4.5*	398	482	540
EBIT	223	165	*35.6*	67	*234.8*	521	985	1,453
Other income	11	(1)	*(885.7)*	(3)	*(479.3)*	5	18	20
Profit before interest & tax	234	163	*43.5*	64	*267.3*	526	1,003	1,473
Interest expense	7	7	*(2.8)*	8	*(12.5)*	29	16	3
Profit before tax	227	156	*45.6*	56	*307.5*	497	987	1,470
Tax provision	9	10	*(9.1)*	9	*4.7*	35	167	257
Adjusted net profit	218	146	*49.3*	47	*362.8*	462	820	1,213
Extra ordinary income/(loss)	-	-		-		(3)	-	-
Minority interest recd.	8	14		-		33	44	35
Reported net profit	226	160	*41.7*	47	*379.8*	492	864	1,248
EPS basic (INR)	7.2	5.1	*41.6*	1.5	*377.5*	15.9	27.2	39.2
as % of revenues								
Gross profit	32.6	31.2		30.0		30.1	33.2	34.3
SG&A	17.2	18.6		20.3		18.6	17.2	17.2
EBITDA	15.3	12.7		9.6		11.4	16.0	17.1
Adjusted net profit	10.4	6.9		2.8		5.7	9.0	10.4
Reported net profit	10.8	7.6		2.8		6.1	9.4	10.7
Tax rate	4.0	6.4		15.4		7.1	17.0	17.5

Company description

iGATE Global provides services in the area of e-business, Business Intelligence, Custom Solutions, Application Re-engineering and Maintenance Outsourcing. The company delivers these solutions to its clients across industry verticals such as BFS, retail & distribution, manufacturing, telecommunications among others. The company has an integrated technology and operations model (iTOPS) that is aimed at provided and integrated service offering for its clients. The company has presence in 12 countries and has development centers in the US, UK, Canada, China, Malaysia, and India. It employs over 5,945 people and its revenues for the past twelve months (TTM) stood at INR 8.1 bn (USD 177.7 mn).

Investment theme

iGATE has firmly demonstrated a turnaround, which we see lasting through FY09-FY10 period. The company is now through, with its restructuring and client rationalization exercise. The clients that have been added over the last 18 months (at higher billing rates) are now ramping up, contributing more than a third to its total revenues thereby pushing up the average realisations. iGATE is now focusing its efforts on getting a higher share of the clients total spend through introduction of newer services. These new services such as infrastructure management and testing have high potential and are scaleable. We believe this changing revenue composition along with introduction of new high margin services will benefit iGATE over the long term.

Key risks

Key risks to our investment theme include: (a) adequate availability of skilled manpower; (b) sustained slowdown in the US, as the company derives ~ 75% of its revenues from that region; and (c) significant appreciation of the rupee against USD.

INFOSYS TECHNOLOGIES

INR 2,088

Look beyond the guidance

BUY

April 13, 2007

Hitesh Zaveri
+91-22-2286 4424
hitesh.zaveri@edelcap.com

Parul Inamdar
+91-22-2286 4355
parul.inamdar@edelcap.com

Viju George
+91-22-2286 4400
viju.george@edelcap.com

Kunal Sangoi
+91-22-2286 4309
kunal.sangoi@edelcap.com

Infosys announced Q4FY07 results, which were slightly below expectations. Revenues grew by 3.2% Q-o-Q and net profits grew by 3.8% Q-o-Q (excluding a tax write back of INR 1.24 bn). EBITDA margins were lower by 100 bps largely on account of appreciation of the Rupee against the USD.

Infosys has guided for a revenue growth of 22.6%-24.6% and EPS growth of 20-22% in INR terms for FY08. This guidance factors in the impact of ESOP related equity dilution to the extent of 3%. We believe that the company will likely post strong out-performance of its guidance given the superior execution of its client mining skills through its scale and portfolio of services. Infosys currently derives a modest share of wallet of several of its clients, particularly the marquee accounts, which in our view, is primed for further penetration. Globally, offshore outsourcing of IT-spend is increasingly becoming strategic and mainstream to global corporates. The company has consistently increased its market share in the Indian IT services industry and we believe that this is likely to continue.

Our EPS estimates for FY08E and FY09E stand at INR 86.7 and INR 112.3 respectively. At INR 2,088 the stock trades at a P/E of 24.1x and 18.6x and EV/EBITDA of INR 18.6x and 13.3x our FY08E and FY09E earnings respectively. We maintain our 'BUY' rating.

Reuters	:	INFY.BO
Bloomberg	:	INFO IN

Market Data

52-week range (INR)	:	3,400 / 1,572
Share in issue (mn)	:	571.2
M cap (INR bn/USD mn)	:	1,192 / 27,828
Avg. Daily Vol. BSE ('000)	:	1,511.8

Share Holding Pattern (%)

Promoters	:	16.9
MFs, FIs & Banks	:	6.4
FIIs	:	33.9
Others	:	42.8

Key highlights

- Revenues for Q4 FY07 stood at INR 37.7 bn (up 3.2% Q-o-Q and 43.8% Y-o-Y) and net profit at INR 11.4 bn (up 16.4% Q-o-Q and 70.0% Y-o-Y). However during the quarter the company had tax write back to the tune of INR 1.24 bn, adjusting for this net profit stood at INR 10.2 bn, up 3.8% Q-o-Q and 51.6% YoY.
- Gross profits stood at INR 17.5 bn (up 2.0% Q-o-Q and 45.7% Y-o-Y). Gross margins declined by 60 bps to 46.4% from 47.0%.
- EBITDA for the quarter stood at INR 12.0 bn, up 0.1% Q-o-Q and 43.7% Y-o-Y. EBITDA margin declined by 100 bps largely on account of appreciation of the rupee and higher selling and marketing expenses. S&M stood at 7.1% of revenues as against 6.5% in the previous quarter.
- The company added gross of 5,992 employees (net 2,809 employees) in the quarter and the total employee count now stands at 72,241. Attrition during the quarter was at 13.7% compared to 13.5% in the previous quarter.

Financials

Year to March	Q4FY07	Q3FY07	*Growth %*	Q4FY06	*Growth %*	FY08E	FY09E
Revenue (INR mn)	37,720	36,550	*3.2*	26,240	*43.8*	181,253	241,578
Gross profit (INR mn)	17,510	17,170	*2.0*	12,020	*45.7*	84,886	113,542
EBITDA (INR mn)	11,970	11,960	*0.1*	8,330	*43.7*	59,691	80,300
Net profit (INR mn)	11,440	9,830	*16.4*	6,730	*70.0*	49,660	64,790
EPS basic (INR)	20.3	17.6	*15.2*	12.2	*66.2*	86.7	112.3
P/E (x)						24.1	18.6
EV/EBITDA (x)						18.6	13.3
Market cap / Revenue (x)						6.6	4.9

- The company has added 34 new clients this quarter taking the total client count to 500. Number of clients contributing over a USD 1 mn has increased from 221 a year ago to 275. At the upper end, the company has 3 clients contributing greater than USD 100 mn against none last year, which is impressive.

- Top-10 clients grew by 15.5% Q-o-Q for the quarter, which is encouraging given that there were some concerns here.

- Onsite rates went up by 1.5% Q-o-Q and the offshore rates were up by 1.75% Q-o-Q. Average onsite rate for the company now stand at USD 66.2 per hour and the offshore at USD 27.2 per hour.

- Utilisation rate including trainees remained flat at 67.9% in the current quarter (compared to 67.5 in Q3FY07).

- Guidance for FY08

  - The company has guided to revenue growth in FY08 of between 28%-30% in USD terms and 22.6%-24.6% in INR terms, FY08 EPS growth guidance of 25.7% - 27.7% in USD terms and 20-22% in INR terms.
  - The ESOP related equity dilution will have an impact on FY08 EPS to the extent of 3%, factored in the EPS guidance.
  - The guidance for Infosys BPO is USD 215 mn in FY08, growth of 44.3% over FY07 revenues of USD 149 mn.
  - The company has guided to stable operating margins in FY08 and
  - The company has assumed an average exchange rate of INR 43.1 to the USD in FY08 for guidance compared to an average of INR 45.0 in FY07.

Guidance leaves room for good out-performance

We believe that Infosys' guidance is conservative on four counts:

- Methodology of deriving data for guidance

  Infosys follows three factors in culling data to give its outlook for the coming year namely orders in hand, success-based assessment of the bid pipeline and client polling. Confirmed order book is the factor that receives maximum weightage in this process followed by a probability-weighted conversion success of the bid pipeline. This means that only that business where it has visibility from orders and pipeline at the beginning of the year get captured. The orders that it bids during the year which are won and executed within the same year are not taken into account for guidance. We believe that typically this accounts for about 4%-5% of total revenues during the fiscal.

- Philosophy of "under-promise and over-deliver"

  This is evident from table 1 below:

Table1: Infosys guidance (released in April) range for revenues and EPS FY05-07

Revenues	Guided		Actual perf.	Outperformance
FY04	23.2	25.4	33.3	31.1
FY05	23.5	24.5	46.9	91.5
FY06	24.7	26.6	33.5	26.1
FY07	28.7	30.7	45.9	49.5

EPS	Guided		Actual perf.	Outperformance
FY04	12.3	13.7	29.9	143.1
FY05	19.5	-	50.4	158.5
FY06	23.0	24.9	27.9	12.0
FY07	26.3	29.3	53.7	83.3

Source: Company

- Conservative pricing assumptions

  Infosys indicated that it has assumed the average pricing levels in Q4FY07 throughout FY08 in delivering its guidance. In our view, this is likely conservative given that Infosys has managed to realize pricing gains sequentially over the four quarters through FY07 (CQGR of 1.5% onsite, 1.1% offshore in FY07). Pricing gains flow through to the operating profit line more than volume gains.

- Pressure points on margins manageable

  Wage Inflation (12%-15% offshore and 3%-6% onsite) will likely affect margins by about 300 basis points. But we believe that this will likely be offset by (a) ability to improve utilization by 300-400 basis points (b) scale efficiencies reflected in improved SG&A leverage and (c) better yield on invested surplus (USD 1.4 bn in cash and equivalents as of March 31, 2007).

  The company has indicated that 1% appreciation of INR can impact margins to the extent of 50 bps.

Profitable penetration through diversification

Infosys' growth in recent years has been achieved on the back of (a) spotting high volume opportunity areas and building strong presence in them (e.g. BPO, ADM), (b) identifying higher-margin service lines and growing them (e.g. package implementation, consulting, testing and IMS). This broader portfolio of services enables Infosys to address its verticals more meaningfully.

For example, Infosys' growth in telecom vertical in FY07 has been particularly strong. We believe that the company has managed to penetrate one of its most significant customers in this domain through selling a portfolio of service lines such as BPO, Infrastructure Management, ADM and consulting. The ability to widen and deepen the client base through cross-selling and up-selling still leaves much scope for further penetration of the client's share of wallet.

Table 2 shows the how various service lines and verticals have fared through FY04-07. Infosys has built on its strong position in its mainstay vertical (BFS) while building market-share in telecom. Within the services mix, package implementation and testing are offering relatively higher growth, yet the incremental share of application maintenance (over FY04-07) is noteworthy. We view this as significant as application maintenance is relatively stable providing steady cash flows.

We thus believe that the revenue stream while diversified and incrementally profitable caters alike to both the offensive (growth-oriented) and defensive (cost-related) spending patterns of its clients.

Table 2: Revenue from various service lines and verticals in USD mn

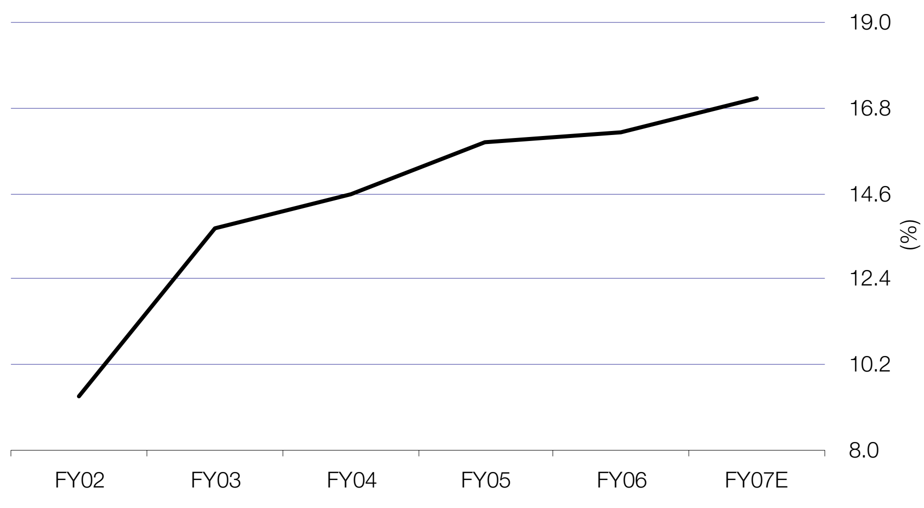
Service Lines	FY04	FY07	FY04-07 CAGR (%)	% Share of incremental revenues
Development	272	649	33.6	18.6
Maintenance	319	905	41.5	28.9
Package Implementa	154	541	52.1	19.12
Testing	56	212	56.1	7.71
BPM	17	146	105.0	6.38
Products	29	120	60.1	4.48
Others	215	516	33.9	14.84
Total	1063	3090	42.7	100.00

Verticals	FY04	FY07	FY04-07 CAGR (%)	%Share of incremental revenues
BFS	253	933	54.6	33.6
Manufacturing	157	417	38.5	12.8
Retail	124	311	35.9	9.2
Telecom	176	597	50.3	20.8
Others	354	833	33.0	23.6
Total	1063	3090	42.7	100.0

Source: Company, Edelweiss research

This successful strategy of deeper penetration across verticals from multiple service lines has resulted in Infosys' increasing market share in the Indian IT services export industry (chart 1).

Chart 1: Infosys' market share in the Indian IT services export industry



Source: Company, Nasscom

Sustaining track record of impressive client mining

Infosys' growth through FY04-FY07 has come on the back of comparable growth in major accounts (top-10) and outside them (non top-10). Table 3 shows the progression of the average client account size for both top-10 and non top-10 categories indexed to FY04. This demonstrates Infosys' track record of growing the overall client base and not just select accounts.

Table 3: Progress of average size of the client through FY04-07 (indexed to FY04)

	FY04	FY05	FY06	FY07
Top-10	100	136	169	254
Non top-10	100	141	192	244

Source: Company, Edelweiss research

Notably, the proportion of the significant clients (USD 1mn plus) of the overall client base is increasing over time (chart 2). Also, we note Infosys is increasingly demonstrating the ability to grow clients from one revenue milestone to another. This is seen by the fact that currently 67% of the USD 5 mn plus clients are also USD 10 mn plus clients (compared to 50% in Q1FY05). In FY07, Infosys' top client contributed over USD 200 mn, yet contributed only about 7% of total revenues. Currently the company has 3 clients that contribute over USD 100 mn of revenue in a year. Also the company's now has 275 clients that contribute USD 1 mn plus revenues of the total clients base of 500.

Chart 2: USD 1mn plus clients as a proportion of total client base

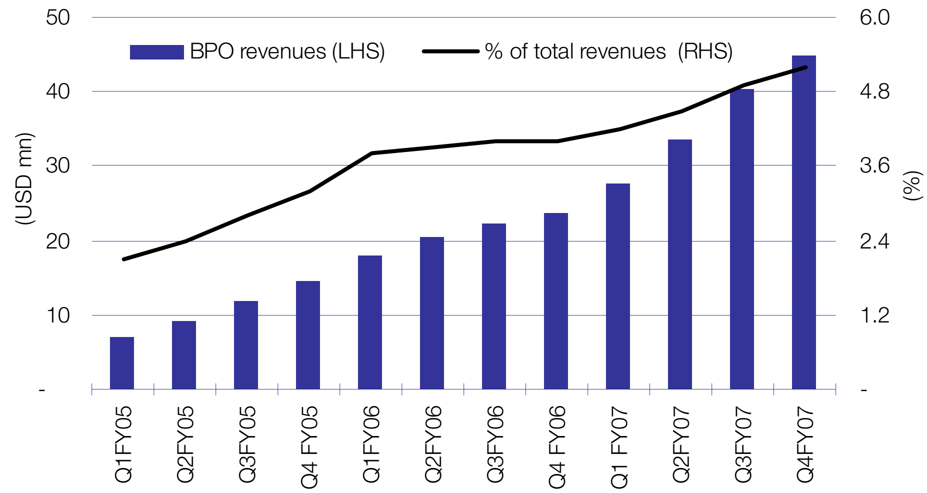
Source: Company, Edelweiss research

Notably, Infosys indicated that currently it is simultaneously pursuing about 10-12 deals of over USD50 mn size.

BPO is robustly growing with industry-leading profitability

Infosys' BPO business, with a limited operating history, has already achieved meaningful size. The revenue contribution has now increased to USD 44.9 mn during the current quarter and USD 147 mn for FY07. In the current quarter, revenue was up 11.6% Q-o-Q and 89.2% Y-o-Y. Notably, net profit margins for Infosys BPO stood at about 23%, comparable with IT services. The revenue composition in this division is increasingly value-added on the back of penetration in finance and accounting and knowledge services (for example, financial research covering equity and fixed income). We expect this business to continue to grow over 50% in FY08.

Chart 3: BPO growth through the quarters (FY05-FY07)



Source: Company, Edelweiss research

Valuations

Infosys now has over 275 customers billing over a million dollars a year. The company has demonstrated superior mining skills and we expect the million dollar customers, who largely belong to the Fortune 1000 space, to be a potent source of growth.

We remain positive on the theme of outsourcing taking centre stage and offshoring growing in adoption. Infosys, as a leading vendor in the offshore world, will continue to benefit from the same. We believe that Infosys will likely outperform significantly its guidance in FY08 and have factored this in our EPS estimates for FY08. Our EPS estimates for FY08E and FY09E stand at INR 86.7 and INR 112.3 respectively. At INR 2,088 the stock trades at a P/E of 24.1x and 18.6x and EV/EBITDA of INR 18.6x and 13.3x our FY08E and FY09E earnings respectively. We maintain our **'BUY'** rating.

Financials snapshot								(INR mn)
Year to March	Q4FY07	Q3FY07	*Growth %*	Q4FY06	*Growth %*	FY07	FY08E	FY09E
Total revenues	37,720	36,550	*3.2*	26,240	*43.8*	138,930	181,253	241,578
Software dev expenses	20,210	19,380	*4.3*	14,220	*42.1*	74,580	96,367	128,036
Gross profit	17,510	17,170	*2.0*	12,020	*45.7*	64,350	84,886	113,542
Selling & marketing exp	2,680	2,360	*13.6*	1,520	*76.3*	9,290	11,058	14,640
General & admin exp	2,860	2,850	*0.4*	2,170	*31.8*	11,150	14,138	18,601
Overhead expenditure	5,540	5,210	*6.3*	3,690	*50.1*	20,440	25,195	33,241
EBITDA	11,970	11,960	*0.1*	8,330	*43.7*	43,910	59,691	80,300
Depreciation	1,450	1,410	*2.8*	1,440	*0.7*	5,140	6,525	8,455
EBIT	10,520	10,550	*(0.3)*	6,890	*52.7*	38,770	53,166	71,845
Other expense	(10)	-		-		20	-	-
Other income	1,190	590	*101.7*	720	*65.3*	3,720	4,340	4,900
PBT	11,720	11,140	*5.2*	7,610	*54.0*	42,470	57,506	76,745
Tax	270	1,300	*(79.2)*	810	*(66.7)*	3,860	7,801	11,819
Adjusted net profit	11,450	9,840	*16.4*	6,800	*68.4*	38,610	49,705	64,926
Extra ordinary income	-	-		-				
Minority Interest	(10)	(10)	*0.0*	(70)		(110)	(45)	(136)
Reported net profit	11,440	9,830	*16.4*	6,730	*70.0*	38,500	49,660	64,790
EPS basic (INR)	20.3	17.6	*15.2*	12.2	*66.2*	69.2	86.7	112.3
as % of net revenues								
Gross profit	46.4	47.0		45.8		46.3	46.8	47.0
Selling & marketing exp	7.1	6.5		5.8		6.7	6.1	6.1
Admin exp	7.6	7.8		8.3		8.0	7.8	7.7
EBITDA	31.7	32.7		31.7		31.6	32.9	33.2
Adjusted net profit	30.4	26.9		25.9		27.8	27.4	26.9
Reported net profit	30.3	26.9		25.6		27.7	27.4	26.8
Tax rate	2.3	11.7		10.6		9.1	13.6	15.4

Company Description

Infosys is the second-largest IT services company in India providing consulting and IT services to clients globally. It is also among the fastest growing IT services organization in the world and a leader in the offshore services space with a pioneer in Global delivery model. Infosys provides business consulting, application development and maintenance and engineering services to over 488 active clients spread across Banking, Financial Services, Insurance, Retail, Manufacturing, and Utilities verticals and 29 countries. The company has also its own proprietary core banking software - *Finacle* used by some of the leading banks in India, Middle East, Africa and Europe. Infosys also has a BPO arm, Progeon which employs more than 10,500 people. Infosys' IT services employee force stands at 72,241 and its revenues for the last twelve months (TTM) stood at INR 138.9 bn (USD 3.1 bn).

Investment Theme

Infosys is known for its excellent project execution skills, which makes it the most preferred tier 1 vendor. With rapidly increasing numbers of service lines and domain capabilities, Infosys has readied itself for multiple possible points of initiating and growing client engagements. The company has also demonstrated its ability to engage with larger client organisations and winning increasing proportion of their wallet share. Infosys' growth over the last three to four years reflect its abilities to benefit from the improving macro environment, as reflected in its above-peer group growth in its offshore revenues, key verticals and service lines.

Key Risks

Key risks to our investment theme include –

- sustained slowdown in US,
- Reduction in the number of H1B visas granted by US will have an adverse impact,
- Significant increase in the salary hikes and attrition rate creating cost pressures, and d) Any substantial appreciation of rupee against US dollar, Euro and GBP.

INFOTECH ENTERPRISES

INR 362

Slow quarter but traction intact

BUY

In Q4FY07, Infotech Enterprises' revenues were in line, while profits were ahead of our expectations. Revenue stood at INR 1.5 bn, up 5.7% Q-o-Q, while net profit was at INR 249 mn, up 32.6% Q-o-Q. The growth in net profit was mainly on account of INR 41 mn income from the IASI JV, compared to a loss of INR 12.3 mn in the previous quarter and higher other income. Excluding that impact, net profit grew by 3.7% Q-o-Q. EBITDA margin on a Q-o-Q basis declined by 220bps, largely on account of higher employee costs (100bps), rupee appreciation (60bps), and higher lease expense (60bps).

We expect performance of the GSD segment, which has lagged company growth on account of problems in the North American geography, to improve going forward. A strong bid pipeline, improved traction from the US, and transformation of the business model in this segment infuses us with confidence. Outlook on engineering services continues to remain robust, with strong domain capability of the company in engineering solutions and industrial products space (particularly in the aerospace, rail and industrial sub-verticals) and further building expertise by investing in practices such as marine and automotive, which have started paying off. We expect the company to continue to grow 50% plus in this line of business.

We expect Infotech Enterprises' earnings to grow at a CAGR of 32.0% over FY07-09E. At CMP of INR 362, the stock trades at a P/E of 15.3x and 11.4x of our FY08E EPS of INR 23.7 and FY09E EPS of INR 31.6, respectively. We maintain our 'BUY' recommendation.

Key Highlights

- Revenue, at INR 1.5 bn, was up by 5.7% Q-o-Q and 40.3% Y-o-Y. Net profit stood at INR 248.5 mn, up 32.6% Q-o-Q and 49.8% Y-o-Y. For the purposes of comparison of core operating profit performance, Q4FY07 profit before share of profit in IASI grew 3.7% Q-o-Q (over Q3FY07).

- Employee costs as a percent of revenues rose significantly from 45.9% in Q2FY07 to 49.2% in the current quarter. This was mainly because of: (a) salary hikes of 15-17% given during the quarter to select employees; and (b) fuller impact of hiring in Q3FY07 and Q4FY07.

Financials

Year to March	Q4FY07	Q3FY07	*Growth %*	Q4FY06	*Growth %*	FY08E	FY09E
Revenue (INR mn)	1,512	1,430	*5.7*	1078	*40.3*	7,388	9,752
EBITDA (INR mn)	308	323	*(4.6)*	199	*55.0*	1,552	2,048
EBIT (INR mn)	234	257	*(8.7)*	151	*55.7*	1,316	1,718
Net profit (INR mn)	249	187	*32.6*	166	*49.8*	1,119	1,517
EPS basic (INR)	5.3	4.1	*28.4*	3.6	*46.0*	23.7	31.6
P/E (x)						15.3	11.4
EV/EBITDA (x)						14.7	10.7
Market cap/Revenue (x)						2.3	1.7

Edelweiss
Ideas create, values protect

April 19, 2007

Parul Inamdar
+91-22-2286 4355
parul.inamdar@edelcap.com

Viju George
+91-22-2286 4400
viju.george@edelcap.com

Kunal Sangoi
+91-22-2286 4309
kunal.sangoi@edelcap.com

Reuters	:	INFE.BO
Bloomberg	:	INFTC IN

Market Data

52-week range (INR)	:	695 / 180
Share in issue (mn)	:	46.1
M cap (INR bn/USD mn)	:	16.7 / 379.2
Avg. Daily Vol. BSE/NSE ('000)	:	146.9

Share Holding Pattern (%)

Promoters	:	28.7
MFs, FIs & Banks	:	23.0
FIIs	:	11.6
Others	:	36.7

- The higher employee costs weighed on EBITDA margins (20.4%) for Q4FY07, which declined 220bps from those in Q3FY07. EBITDA, at INR 308 mn, declined 4.6% Q-o-Q.
- However, management has stated that margins will stabilize at ~ 20-22% levels in FY08E. We believe that shift of the revenue mix in favor of the higher margin EMI business segment will support EBITDA margins higher than 20% in FY08E.
- In the current quarter, most of the company's revenue increase has come from Europe, which accounted for 50.3% of revenues in Q4FY07. We believe that traction in Europe will continue to be healthy in FY08, given the relatively healthy demand in this geography for GSD and EMI. Several key clients that drove the company's growth in FY07 are from Europe.
- The company's net headcount addition for the quarter was 188, taking the total head count to 5,131. On a Y-o-Y basis, the company's headcount has gone up by 29.0%. The headcount in GSD division grew by 21.9% Y-o-Y, while in the EMI division the headcount went up by 39%. The company has indicated that it will add 1,500 people (30%) to its headcount in FY08, which is encouraging.
- Attrition for the quarter stood at 13%, down from 14% in the previous quarter. This is particularly impressive compared to peers.

Impressive performance in FY07

In FY07, Infotech once again delivered strong performance. Revenues stood at INR 5.45 bn (USD 120 mn), a growth of 49.7% over FY06. Adjusted net profits of INR 836 mn (15.4% of sales) in FY07 showed an impressive 65% growth over FY06, while EBITDA margin increased to 20.9% (versus 18.6%). The revenue growth in FY07 was powered by EMI services, which grew at 69%, while the GSD service line's growth was relatively tepid at 27%. The company hired 1,153 employees during the year, which constitutes a 29% increase in employee strength over FY06 levels.

Investments in growing new services to pay off soon

Significant spend in the engineering space resides in the automotive engineering segment . The automotive industry is passing through a phase of rapid and constant changes in design requirements and OEMs and their suppliers are under constant pressure to bring superior products, and at faster time-to-market. This has led to opening up of opportunities for engineering services firms, which Infotech has been focusing on to grow. Infotech has already acquired four customers in this area and has built a team of 40 engineers. The company has also entered the marine engineering space recently and has been able to bag four customers.

We remain positive on the direction that the company is taking towards new areas for growth. Moreover, we particularly note the quality of customers and their potential, which seems comforting.

Strong traction from existing clients to drive growth

Infotech has, in FY06, won multi-year deals which are in the early middle stage of ramp-up. This has led to strong growth in the engineering segment. We see this phenomenon continuing going forward, as further scale-up happens.

Table 1: Q-o-Q growth in different client category

Growth in average realization	Q1 FY 06	Q2 FY 06	Q3 FY 06	Q4 FY06	Q1 FY 07	Q2 FY 07	Q3 FY 07	Q4 FY07
Top 5 (%)	23.4	7.3	8.0	7.6	14.0	12.4	5.8	2.1
Top 10 (%)	19.3	6.2	16.0	10.0	14.2	16.9	7.1	5.2
Customers 6-10 (%)	0.2	(0.2)	64.4	19.8	14.9	33.1	10.9	14.2

Source: Company, Edelweiss research

M&A: Could be an upside risk to numbers

Infotech has been continuously scouting for acquisitions to rapidly expand its presence in emerging areas of growth. Any closure of a deal in this regard will be a likely upside to our estimates, which is highly probable. The company currently has cash and cash equivalents of INR 740 mn.

Valuations

The engineering services space continues to show relatively greater acceptance of outsourcing and in-turn offshoring. We see Infotech among the key leading players operating in the industrial products space of engineering services and further diversifying in the marine and avionics sub-vertical. Given the strong domain knowledge, long-term relationships with marquee clients along with improving traction for the GSD division, we expect the company to continue to post healthy growth rates going forward.

We expect the company's revenues and EPS to grow at a CAGR of 34% and 32%, respectively, over FY07-09E. At CMP of INR 362, the stock trades at a P/E of 15.3x and 11.4x of our FY08E EPS of INR 23.7 and FY09E EPS of INR 31.6, respectively. We expect the stock returns to largely track the earnings growth going forward. We maintain our 'BUY' recommendation.

Financials snapshot (INR mn)

Year to March	Q4FY07	Q3FY07	*Growth %*	Q4FY06	*Growth %*	FY07	FY08E	FY09E
Total revenues	1,512	1,430	*5.7*	1,078	*40.3*	5,425	7,388	9,752
Employee cost	744	656	*13.4*	495	*50.4*	2,589	3,499	4,661
Travel expenses	137	126	*9.1*	98	*39.6*	482	645	800
Cost of purchases	146	168	*(13.4)*	161	*(9.5)*	617	872	1,170
Operating & admin expenses	178	158	*12.5*	126	*41.2*	604	820	1,073
Total expenditure	1,204	1,108	*8.7*	879	*36.9*	4,292	5,836	7,704
EBITDA	308	323	*(4.6)*	199	*55.0*	1,134	1,552	2,048
Depreciation & ammortization	74	66	*11.7*	48	*52.8*	256	300	410
EBIT	234	257	*(8.7)*	151	*55.7*	878	1,316	1,718
Other income	19	0	*9150.0*	14	*32.1*	67	64	80
Interest expense	2	5	*(52.1)*	6	*(62.9)*	14	13	15
Extra ordinary item	-	-		-		-	-	-
PBT	251	252	*(0.6)*	158	*58.3*	930	1,303	1,703
Tax	44	53	*(17.1)*	36	*21.5*	187	265	366
Adjusted net profit	207	200	*3.7*	123	*69.1*	744	1,037	1,337
Share of IASI profit	41	(12)	*(436.6)*	43	*(4.6)*	93	82	180
Reported net profit	249	187	*32.6*	166	*49.8*	836	1,119	1,517
EPS basic (INR)	5.3	4.1	*28.4*	3.6	*46.0*	18.1	23.7	31.6
as % of net revenues								
Employee cost	49.2	45.9		45.9		47.7	47.4	47.8
Travel expenses	9.1	8.8		9.1		8.9	8.7	8.2
Cost of purchases	9.6	11.8		14.9		11.4	11.8	12.0
Operating & admin expenses	11.8	11.1		11.7		11.1	11.1	11.0
EBITDA	20.4	22.6		18.4		20.9	21.0	21.0
EBIT	15.5	18.0		14.0		16.2	17.8	17.6
Reported net profit	16.4	13.1		15.4		15.4	15.2	15.6
Tax rate	17.4	20.8		22.6		20.1	20.4	21.5

Company Description

Infotech Enterprises (Infotech) is a 5,100 plus employee software services company with competencies in: (a) GIS services catering to utility, transportation, and government segments; (b) engineering design services for engineering, manufacturing, and industrial products verticals; and (c) software services to clients in both the verticals—data & technology services, engineering design, and IT services. The company has grown its revenues and net profits at a CAGR of 45.3% and 74.8%, respectively, over FY05-07. The company's past twelve months revenues stood at INR 5.4 bn (USD 120.3 mn).

Investment Theme

Outsourcing of engineering services is expected to reach USD 38-50 bn by 2020E compared with USD 2 bn now, as per a Nasscom, Booz Allen Hamilton study. As one of the leading offshore engineering services firm for manufacturing industry, Infotech is poised to grab the increasing opportunities. The company has strong domain knowledge and complete solution capability in the GIS segment along with healthy pipeline of deals. The company's skills in the areas of mapping and designing across diverse segments and in a variety of end user IT environments give it an edge. We expect Infotech's revenues and net profits to grow at a CAGR of 42.7% and 50.8%, respectively, over FY06-08E.

Key Risks

Key risks to our investment theme include:

(a) Adequate availability of skilled manpower.

(b) Slowdown in engineering spending

(c) Significant appreciation of rupee against the USD, Euro, and GBP.

MASTEK

INR 311

Status quo

BUY

Mastek's Q3FY07 results were in line with our expectations. Revenue and adjusted net profit grew to INR 2.1 bn and INR 270.7 mn (growth of 2.5% and 8.9% Q-o-Q), respectively. Reported net profit included an additional amount of INR 164.8 mn realized by the company's sale of 50.1% stake in the DCJV to Deloitte. Our adjusted net profit excludes this one-time gain. EBITDA margin weakened to 17.3% on account of higher operating costs. Mastek added four new accounts in the insurance space, which we view as encouraging. The order book during the quarter declined to INR 3.0 bn (from INR 4.1 bn in the preceding quarter). However we see the order book strengthening in the coming quarter based on the strong bid pipeline and management comments. The management has guided to consolidated revenues of INR 1.96–2.0 bn and net profit of INR 230-240 mn. We believe that the relatively higher profitability for the coming quarter reflects the exit from the lower-margin DCJV.

Our EPS forecasts are INR 37.2 and INR 43.7 for FY08 and FY09, respectively. At CMP of INR 308, the stock currently trades at a P/E of 8.3x and 7.0x and EV/EBITDA of 4.0x and 3.1x on our FY08E and FY09E earnings, respectively. We maintain our 'BUY' recommendation.

Key highlights

- Revenue at INR 2.1 bn was up 2.5% Q-o-Q and 19.2% Y-o-Y. Net profit stood at INR 402.6 mn, up 84.3% Q-o-Q and 132.6% Y-o-Y. However, the net profit included the one extra-ordinary income of INR 164.8 mn on sale of stake to Deloitte. Excluding that, the net profit grew by 8.9% Q-o-Q.

- EBITDA stood at INR 365 mn, down 1.5% Q-o-Q and up 13.3% Y-o-Y. EBITDA margin declined by 70bps to 17.3% on account of increase in operating costs. As the low margin revenue stream of the Deloitte JV has phased out, we expect gradual increase in the company's operating margins.

- Mastek's order book stood at INR 3.0 bn in the current quarter, compared to INR 4.1 bn in the previous quarter. Decline in order book is on account of two factors. One, completion of projects during the current quarter and second, orders in DCJV excluded (previous quarter order book contained INR 250 mn of orders in the DCJV).

- The company added four new clients during the quarter and the active client count now stands at 41. This addition is the highest in the past nine quarters.

Financials

Year to June	Q3FY07	Q2FY07	*Growth %*	Q3FY06	*Growth %*	FY08E	FY09E
Revenue (INR mn)	2,115	2,064	*2.5*	1,774	*19.2*	8,860	10,111
EBITDA (INR mn)	365	371	*(1.5)*	322	*13.3*	1,658	1,840
Rep. net profit (INR mn)	403	218	*84.3*	173	*132.6*	1,050	1,241
EPS basic (INR)	14.2	7.7	*82.9*	6.2	*127.7*	37.2	43.7
P/E (x)						8.3	7.0
EV/EBITDA (x)						4.0	3.1
Market cap / Rev. (x)						1.0	0.9

Edelweiss
Ideas create, values protect

April 12, 2007

Parul Inamdar
+91-22-2286 4355
parul.inamdar@edelcap.com

Viju George
+91-22-2286 4400
viju.george@edelcap.com

Kunal Sangoi
+91-22-2286 4309
kunal.sangoi@edelcap.com

Reuters	:	MAST.BO
Bloomberg	:	MAST IN

Market Data

52-week range (INR)	:	419 / 270
Share in issue (mn)	:	28.4
M cap (INR bn/USD mn)	:	8.8 / 206.1
Avg. Daily Vol. BSE ('000)	:	64.0

Share Holding Pattern (%)

Promoters	:	40.6
MFs, FIs & Banks	:	13.5
FIIs	:	29.4
Others	:	16,5

- Onsite utilization at 92.4% was marginally higher compared to 92.1% in the previous quarter. Offshore utilization declined to 78.5% from 79.8% in the previous quarter.
- The total headcount now stands at 3,141, compared to 3,568 in the previous quarter. This is on account of non-inclusion of 485 employees (as of December 2006) of the DCJV. Excluding that, the headcount increased by 58.
- US geography saw improved traction and ramp up from existing clients. Revenues from the region grew by 26.6% Q-o-Q contributing 22% to total revenues.
- The revenue guidance for the next quarter (Q4FY07) stands at of INR 1,960-2,000 mn and net profit of INR 230–240 mn, which is positive. This is on the back of quarterly loss of revenues of ~ INR 250 from the Deloitte JV.

Delay in ramp-up from partnership with Euriware

Mastek has indicated that its traction from the partnership with Euriware is delayed and will likely be seen only in FY08. This will likely close out FY07 at a lower level than before, given that the company had earlier indicated Euro 4-5 mn to be generated from this partnership in the current financial year (FY07).

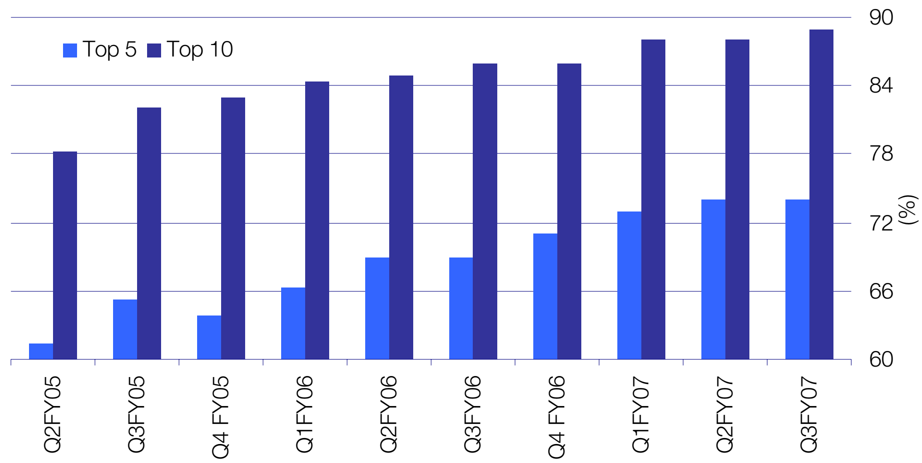
Broad-basing of segment exposure required

We are concerned over Mastek's concentrated exposure to two segments, viz., the healthcare segment for the government and insurance. NHS, Mastek's healthcare client in the UK (33% of YTDFY07 revenues), will likely ramp down to completely phase out its development related portion (which is ~ 68%) by FY08. The company's healthy growth from clients in the insurance domain in the US will partly offset this, but we believe that the company will need to find newer sources of revenue opportunities.

Heavy dependence on key clients a concern

Revenue contribution from its top 10 clients over the past eight quarters has increased from 82% to 89% in the current quarter, while from the top 5 clients the contribution has moved from 65% to 74%. Slow client addition and inability to mine the client base outside the top 10 remain an area of concern.

Chart 1: Revenue contribution of top clients



Source: Company, Edelweiss research

Actively scouting for acquisitions

With an improved cash position following the sale of its stake in DCJV, the company, with cash reserves of INR 1.56 bn, believes that it is well-positioned to make acquisitions. The company has articulated its preference for acquiring companies in the US of size USD10-20 mn with recognized IP in the insurance domain, which it believes will complement its presence in this segment. We also believe that acquisitions could materialize in the near future to give the required leg-up to growth in FY08E and FY09E.

Valuation

We expect Mastek to post CAGR EPS growth of 19% for FY07-09E. We believe that there exists potential to deliver higher profit growth going forward if Mastek can address the following: (a) Its relative inability to find newer revenue opportunities to broad-base growth; and (b) weaker-than-expected ramp-up of key accounts and partnerships (including Euriware). We maintain our EPS forecast of INR 37.2 and INR 43.7 for FY08 and FY09, respectively. At CMP of INR 308, the stock currently trades at a P/E of 8.3x and 7.0x and EV/EBITDA of 4.0x and 3.1x on our FY08E and FY09E earnings, respectively. We maintain our **'BUY'** recommendation.

Financials snapshot (INR mn)

Year to June	Q3FY07	Q2FY07	*Growth %*	Q3FY06	*Growth %*	FY07E	FY08E	FY09E
Total revenues	2,115	2,064	*2.5*	1,774	*19.2*	8,117	8,860	10,111
Staff costs	1,301	1,246	*4.4*	1,071	*21.4*	5,010	5,377	6,097
Programming charges	109	77	*41.5*	67	*62.7*	318	286	374
Travel & conveyance	113	115	*(1.8)*	102	*11.0*	441	498	576
Other costs	228	255	*(10.7)*	212	*7.5*	957	1,041	1,223
Total operating expenditure	1,750	1,693	*3.4*	1,452	*20.6*	6,726	7,201	8,271
EBITDA	365	371	*(1.5)*	322	*13.3*	1,391	1,658	1,840
Depreciation	74	76	*(1.9)*	71	*4.7*	313	428	475
EBIT	291	295	*(1.5)*	251	*15.8*	1,078	1,230	1,365
Other income	33	34	*(1.5)*	21	*58.1*	120	98	120
Interest	2	4	*(36.1)*	1	*64.3*	9	16	8
PBT	322	325	*(1.1)*	271	*18.8*	1,189	1,313	1,477
Tax	59	76	*(21.9)*	71	*(17.1)*	218	197	236
PAT bef. minority interest	263	250	*5.2*	200	*31.6*	970	1,116	1,241
Losses in equity affiliates	-	20	*(100.0)*	7	*(100.0)*	28	-	-
Minority interest	25	12	*116.4*	20	*26.1*	71	66	-
Extra-ordinary income	165					165		
Net profit	403	218	*84.3*	173	*132.6*	1,036	1,050	1,241
EPS basic (INR)	14.2	7.7	*82.9*	6.2	*127.7*	30.7	37.2	43.7
As % of net revenues								
Total operating expenditure	82.7	82.0		81.8		82.9	81.3	81.8
EBITDA	17.3	18.0		18.2		17.1	18.7	18.2
EBIT	13.8	14.3		14.2		13.3	13.9	13.5
Net profit	19.0	10.6		9.8		12.8	11.9	12.3
Tax rate	18.3	23.2		26.3		18.4	15.0	16.0

** FY07E EPS excludes the extra-ordinary profit of INR 165 mn on sale of stake in Deloitte JV*

Company description

Mastek is software solutions and integration services provider and is among the top 20 IT software and service exporters from India. The company provides enterprise solutions to insurance, government, and financial services organizations worldwide. Mastek has a differentiated position in its insurance practice with its well adopted solution framework Elixir. This *Elixir* platform has business layer to cater to the requirements of various insurance types such as life, health and pension. With its principal offshore delivery facility based at Mumbai, India, Mastek operates across US, Europe, Japan and Asia Pacific regions. The company's last twelve month revenues stood at INR 8.0 bn (USD 187.6 mn) and employs more than 3,100 people.

Investment theme

Mastek's *Elixir* platform caters to the requirements in the insurance practice types such as life, health and pensions. Apart from this, it also handles multiple operational activities such as claim processing, underwriting and policy administration. With increased traction in the insurance vertical and Mastek's efforts to establish tie ups with large BPO companies, we believe it *(Elixir)* has the potential to become an important source of growth and margin improvement. Mastek's experience in executing / negotiating government contracts has led the company take its 'e-governance' solutions to the US markets. A success in its endeavor in this region will have higher than proportionate impact on its margins.

Key risks

The key risks to our investment theme include a) slowdown in UK geography; b) high dependence on the top 5 clients, any reduction in its spending will affect the company's growth, c) wage inflation leading to higher attrition and c) appreciation of rupee against GBP and Euro.

MphasiS

INR 325

Edelweiss
Ideas create, values protect

Benefits from EDS handsomely flowing in

BUY

May 7, 2007

Parul Inamdar
+91-22-2286 4355
parul.inamdar@edelcap.com

Viju George
+91-22-2286 4400
viju.george@edelcap.com

Kunal Sangoi
+91-22-2286 4309
kunal.sangoi@edelcap.com

MphasiS' Q4FY07 results were positive and ahead of our expectations. Revenues grew 10.2% Q-o-Q to INR 3.4 bn, while net profits surged 27.4% Q-o-Q to INR 456 mn (29.6% Y-o-Y). Operating profits before depreciation (EBITDA) at INR 647 mn also registered good sequential growth of 9.9% Q-o-Q. Revenue Y-o-Y growth (34.6%) is the highest in the last four quarters, while Y-o-Y growth of 29.6% in net profit reverses three quarters of Y-o-Y profit decline over the corresponding quarters last fiscal. Additionally, net profit margin, at 13.5% for Q4FY07, has been significantly higher than profitability (as a percentage of revenues) in the earlier three quarters of FY07. SG&A expenses at 16.2% of sales showed a flattish trend over Q3FY07, though S&M expenses sequentially shot up 24%, offset by G&A that grew only 3% Q-o-Q. Net profit growth was also aided by the lower tax provision (effective tax rate of 4.5%), though we expect effective tax rates in the range of 12-15% in FY08.

We are positive on the buoyant revenues of USD 9 mn for the quarter (~ 12%), derived by MphasiS from EDS' internal work. Revenues from this channel, which were non-existent in Q1FY07, have been doubling every quarter through Q4FY07. We are particularly pleased about the quality of pipeline that MphasiS has established and is building with EDS. We believe the pipeline of such deals is strong and is likely to yield more revenues of this kind in the coming quarters.

MphasiS' results do not include the EDS (India) numbers, as the approval for the legal merger is still pending in the high court. But operationally, the merger has already taken effect and synergy benefits have started to accrue in an encouraging fashion.

We estimate MphasiS' EPS on a consolidated basis to grow at a CAGR of 30.4% over FY07-09E. At INR 325, the stock trades at a P/E of 23.5x and 18.6x on our FY08E and FY09E earnings, respectively. We maintain our 'BUY' recommendation.

Key Highlights

- Revenues were reported at INR 3.4 bn, up 10.2% Q-o-Q and 34.6% Y-o-Y and net profit at INR 456 mn was up 27.4% Q-o-Q and 29.6% Y-o-Y.
- IT services witnessed strong volume growth of 9.7%, but the rupee appreciation restricted the growth to 4.8% Q-o-Q. On the BPO side, the revenue growth was impressive at 23.6% (driven by higher volumes and better pricing).

Reuters	:	BFLS.BO
Bloomberg	:	MPHL IN

Market Data

52-week range (INR)	:	340 / 121
Share in issue (mn)	:	164.1
M cap (INR bn/USD mn)	:	53.4 / 1,306.8
Avg. Daily Vol. BSE/NSE ('000)	:	1,111.8

Share Holding Pattern (%)

Promoters	:	50.6
MFs, FIs & Banks	:	9.9
FIIs	:	11..5
Others	:	28.1

Financials

Year to March	Q4FY07	Q3FY07	*Growth %*	Q4FY06	*Growth %*	FY08E	FY09E
Revenue (INR mn)	3,372	3,060	*10.2*	2,505	*34.6*	15,367	19,034
Gross profit (INR mn)	1,193	1,077	*10.8*	885	*34.8*	5,394	6,762
EBITDA (INR mn)	647	588	*9.9*	513	*26.1*	2,950	3,728
Net profit (INR mn)	456	358	*27.4*	352	*29.6*	1,953	2,348
Adj. EPS basic (INR)	2.8	2.2	*26.7*	2.2	*27.9*	11.9	14.1
P/E (x) *						27.4	23.1
P/E (x) **						23.5	18.6
EV/EBITDA (x)						17.4	13.6
Market cap / Revenue (x)						3.5	2.8

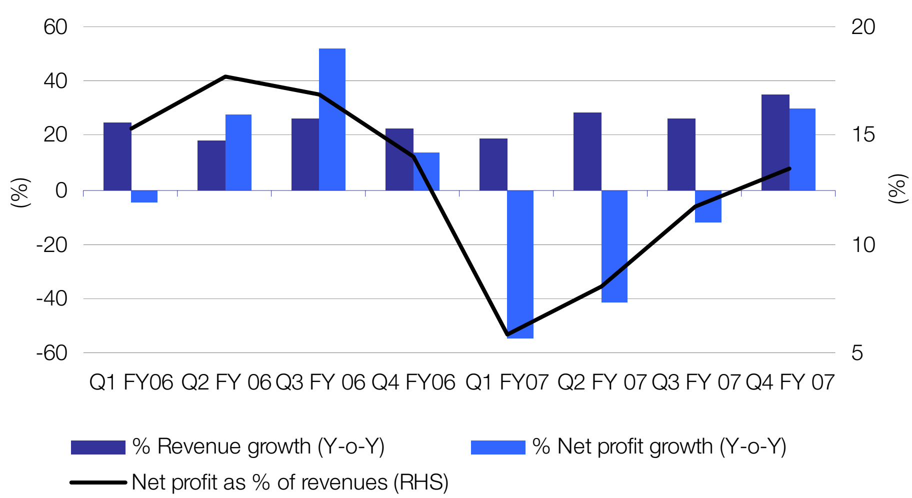
** MphasiS consolidated* *** MphasiS including EDS (India)*

- Gross profits stood at INR 1,193 mn (up 10.8% Q-o-Q), with a 20bps improvement in gross margin. EBITDA stood at INR 647 mn, up 9.9% Q-o-Q and 26.1% Y-o-Y. EBITDA margins remained stable at 19.2%.
- Lower forex loss of INR 26 mn (INR 60 mn loss in Q3) also aided growth in net profits.
- During the quarter, MphasiS added 1,808 employees, the highest addition till date, taking the company's total headcount to 14,679 (5,191 in IT services and 9,485 in BPO).
- The total headcount including EDS (India) stood at 20,249. Further, the management intends to add another 8,000-10,000 employees in CY07, which is indicative of the strong momentum that the company is witnessing.
- Seven new clients were added during the quarter (six in IT and one in BPO). The total number of active clients the company serves stands at 350+, with 60 clients in the BO space.
- Number of clients in the IT services, contributing revenues in excess of USD 1 mn and USD 10 mn stood at 36 and 5 respectively. In BPO, the company has 17 clients with USD 1 mn plus of revenue contribution and 4 clients with USD 10 mn plus revenues.
- The strong growth in the BPO business is particularly on account of the internal work of EDS that is being transitioned offshore. The revenue contribution on this account stood at USD 9 mn for the quarter (grown from USD 4 mn in Q3 and USD 2 mn in Q2).
- Other factors contributing to better performance in the BPO business are: a) turnaround in the domestic BPO, which is ~18-20% of BPO revenues, b) change in the revenue mix – more of back office services like F&A and HR.

A good Q4FY07 rounds off a difficult FY07, marking the end of integration throes

Chart 1, shows that MphasiS' financial performance suffered during most of FY07, but picked up in the last quarter of the fiscal. Quarterly net profits have been particularly volatile through this period, partly explained by the costs of consummating the integration. We believe that Q4FY07 quarter marks the end of a difficult period of transition for MphasiS, as it works through the integration with EDS.

Chart 1: MphasiS' quarterly profit performance through FY07 has been volatile and lags behind the corresponding quarters in FY06



Source: Company, Edelweiss research

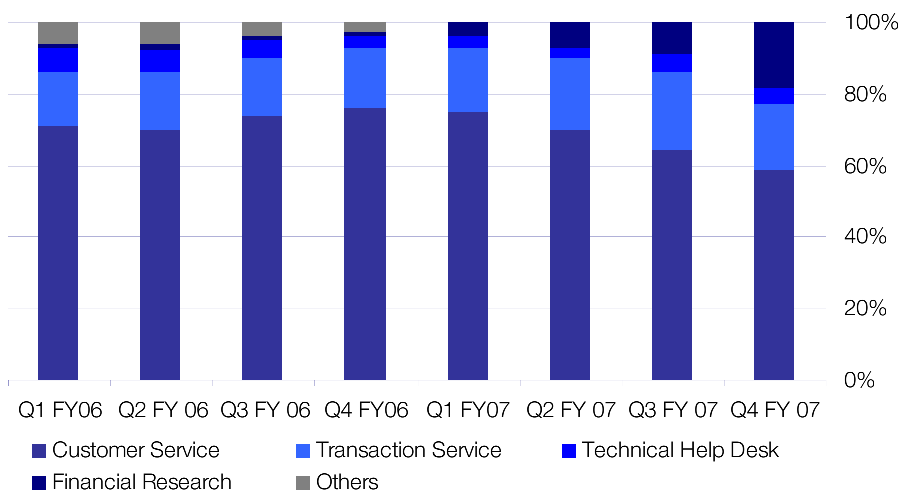
For FY07, MphasiS reported revenues and net profits of INR 12.0 bn and INR 1.2 bn, up 27% and down 20% from FY06, respectively. Profitability, as a percentage of revenues, in FY07 significantly declined to 10% of revenues versus 15.9% in FY06. However, we note that profitability surged to 13.5% of revenues in Q4FY07. Even if MphasiS merely maintains Q4FY07 levels of net profits through FY08 at no further sequential growth, it will have already posted 53% earnings growth in FY08. Hence, we believe that MphasiS without EDS (India) is on course for a well-above 50% earnings growth in FY08 over FY07, admittedly, off a depressed base in FY07.

EDS brings to MphasiS both enhanced quantity and quality of growth in BPO

EDS has already significantly started contributing to MphasiS in two ways: (a) contracts bagged through joint efforts, where customer lead-in may have been provided by EDS and (b) contracts awarded directly to MphasiS by EDS as a client. Notably, the surge in MphasiS' revenues and profitability in its BPO division in Q4FY07 is largely on account of significant traction from EDS, with over 550 personnel engaged in higher-value services such as F&A, HR, back-end processing, and credit card processing. EDS is helping MphasiS manage the shift away from customer interaction-based processes towards knowledge services. This is set to continue with transaction and knowledge-based services expected to account for an increasing share of the BPO pie (39% in Q4FY07).

Chart 2 shows how MphasiS has consistently managed its revenue mix away from customer service.

Chart 2: Increasing contribution from financial research and transaction services



Source: Company, Edelweiss research

The domestic BPO business during the quarter registered an increase in margins, contributing to the profitability. However, the company indicated that profitability in the BPO division in Q1FY08 could be relatively soft, given the likely ramp down of two accounts and salary revisions to be effective during the coming quarter.

Enhanced profile with EDS to aid bidding for significantly larger deals and building good quality pipeline in IT Services

MphasiS is able to leverage its newly acquired EDS parentage for:

- Better pricing of services realised because of EDS' superior brand.

- Gaining better momentum in chasing larger deals with multi-year and multi-service offerings with a good bias towards annuity-based revenues. Till date, MphasiS was almost completely absent from credibly addressing this space owing to its project-oriented execution, as opposed to large-scale application outsourcing.
- Accelerating the progress towards a multi-service shop. RelQ, acquired by EDS, is a specialist testing company and EDS is driving synergies between RelQ's IPs in testing with MphasiS' nascent presence here to bolster the latter's strength. Notably, MphasiS indicated its intention of almost doubling its investment in testing, taking it over 1,300 professionals by FY08 versus 700 as of today. Also, EDS will help drive traction in infrastructure management through addressing areas such as remote desktop management, data centre management, and remote data management. This practice currently has about 600 professionals but MphasiS will invest to grow this practice with over 1,000 professionals by FY08.

EDS is now substantially better-positioned to address the large-deal space, entailing a significant offshore component post the acquisition of its majority stake in MphasiS. MphasiS has already won a large-deal client in the retail vertical this quarter, which follows its one large-deal win in the telecom vertical last quarter.

We see MphasiS-EDS collectively making a better attempt at a portfolio of deals, including the large multi-year ones as well as the high-end project-oriented types such as solution architecting (MphasiS' mainstay).

* Robust people addition plans, further provide comfort

MphasiS and EDS together hired over 2,300 professionals in Q4FY07, ahead of their earlier upper-end indications of about 2,000. Notably, they together intend to hire about 8,000-10,000 professionals in FY08, a 40%-50% addition to the existing manpower base. We believe that these combined people addition plans for FY08 are amongst the most aggressive in percentage terms within the sector.

This provides additional comfort and room for conservatism to our revenue growth estimates of near 30% in FY08 for MphasiS.

* A developed fresher training program, but entry-level intake still low compared to peers

We believe relative absence of a sound training and orientation program for fresher's or entry-level professionals at MphasiS restrained its ability to lower or optimise its delivery costs. This was a significant problem, given a major proportion of MphasiS' professional base comprises mid-level professionals.

However, with the establishment of MphasiS' fresher training institute in Mangalore and more long-term application outsourcing work in prospect, we believe that MphasiS' can now include a greater proportion of entry-level professionals in its recruitment mix. This should help control incremental cost of delivery over the medium-to-long term.

The company has indicated that it can absorb an entry-level professional intake of about 20% in FY08. We note that this proportion is significantly higher compared with its peers such as Hexaware that is targeting a 50:50 mix of 'entry-level to experienced intake' in FY08. Hence, we believe that MphasiS has still significant progress to make towards broadening its employee pyramid.

Expanding offerings for broad basing revenues

At 60% of revenues, BFSI segment accounts for a major portion of the company's revenues. We understand, much of this comes from application development and maintenance/ support services (ADM). ADM services account for most of the IT services revenues (90% in current quarter), which the company is now looking at diversifying. We have noted that the company is currently making investments in developing high growth practices such as infrastructure management, testing, and business intelligence. We see the broad basing of the revenues as these services grow. Developing these practices will involve its own investments as well as time, before they start yielding the desired results. In our view, the pressure created by investments in developing these services will however be eased by consistent improvement in the billing rates and the lower cost of delivery.

Proforma consolidated earnings

Table 1 lays out our proforma consolidated financials for EDS-MphasiS based on current and estimated financials of EDS. We note that post consolidation; EDS (India) will likely add INR 1.9 in FY08E and ~ INR 3.4 in FY09E).

Table 1: Proforma consolidation is EPS accretive

	MphasiS consolidated			EDS (India)			Combined		
	FY07	FY08E	FY09E	FY07	FY08E	FY09 E	FY07	FY08E	FY09 E
Revenues (INR mn)	11,958	15,367	19,035	5,700	7,410	9,633	17,658	22,777	28,668
EBITDA (INR mn)	2,035	2,950	3,729	1055*	1,352	1,782	3,090	4,302	5,511
Net profits (INR mn)	1,199	1,953	2,349	590	889	1,252	1,789	2,842	3,601
Shares o/s (mn)	164.1	164.5	166.5				173.4	205.3	205.3
EPS (INR)	7.3	11.9	14.1				10.3	13.8	17.5
PE (x)	44.5	27.4	23.1				31.5	23.5	18.6

** estimated no.*

Source: Edelweiss research

Valuations

We remain positive on the long term prospects of the company, given significant changes in the company's profile post merger with EDS. We see higher proportion of revenues flowing in the coming quarters from the clients pursued through EDS along with improvement in the billing rates. At a CMP of INR 325, the stock trades at a P/E of 23.5x and 18.6x for FY08E and FY09E, respectively. We maintain our **'BUY'** recommendation.

Financials snapshot (INR mn)

Year to March	Q4FY07	Q3FY07	*Growth %*	Q4FY06	*Growth %*	FY07	FY08E	FY09E
Total revenues	3,372	3,060	*10.2*	2,505	*34.6*	11,958	15,367	19,034
Cost of revenues	2,179	1,982	*9.9*	1,620	*34.5*	7,954	9,972	12,272
Gross profit	1,193	1,077	*10.8*	885	*34.8*	4,003	5,394	6,762
General & admin exp	283	276	*2.6*	218	*29.9*	1,067	1,273	1,589
Selling expenses	263	213	*23.7*	154	*70.9*	902	1,171	1,445
EBITDA	647	588	*9.9*	513	*26.1*	2,035	2,950	3,728
Depreciation	163	161	*1.2*	140	*16.3*	631	902	1,170
EBIT	483	427	*13.2*	372	*29.8*	1,403	2,048	2,558
Other income	(6)	(50)	*(88.2)*	22	*(126.9)*	(69)	174	140
Profit before tax	478	378	*26.5*	394	*21.2*	1,335	2,222	2,698
Tax provision	22	20	*10.2*	43	*(48.5)*	136	269	349
Net profit	456	358	*27.4*	352	*29.6*	1,199	1,953	2,348
Adjusted EPS basic (INR)	2.8	2.2	*26.7*	2.2	*27.9*	7.3	11.9	14.1
as % of net revenues								
Gross profit	35.4	35.2		35.3		33.5	35.1	35.5
General & admin exp	8.4	9.0		8.7		8.9	8.3	8.3
Selling expenses	7.8	7.0		6.2		7.5	7.6	7.6
EBITDA	19.2	19.2		20.5		17.0	19.2	19.6
Net profit	13.5	11.7		14.0		10.0	12.7	12.3
Tax rate	4.6	5.3		10.8		10.2	12.1	13.0

Company Description

MphasiS is a tier II and one of top 10 IT integrated software services vendor in India. The company provides IT services, mainly focused on banking, financial services, and insurance segments. It has one of the largest BPO practice in India, providing voice and transaction-based services. In June 2006, Electronic Data Systems (EDS) bought a majority stake in MphasiS and now, the total holding stands at 50.6%. The company's last twelve month revenues stood at INR 11.1 bn (USD 249.8 mn), with employee strength of 4,300 plus in IT services and 8,400 plus in BPO services. Combined with EDS (India), the company's employee strength stands at 20,249.

Investment Theme

We believe, with EDS as the owner, the issues such as size and scale, market access, pricing power, and enhanced capabilities in offshore delivery will add substantial business for MphasiS, going forward. Incremental business for MphasiS is likely to come from – direct working with EDS' clients, serving EDS' clients through sub-contracting arrangement with EDS, and servicing EDS' itself (doing internal work in the HR and F&A area).

Key Risks

Key risks to our investment theme include – a) sustained slowdown in the US, b) supply side constraints such as salary hikes and attrition, and c) appreciation of rupee against US dollar, GBP, and Euro.

PATNI COMPUTER SYSTEMS

INR 474

Tepid quarter

ACCUMULATE

Edelweiss
Ideas create, values protect

April 30, 2007

Parul Inamdar
+91-22-2286 4355
parul.inamdar@edelcap.com

Viju George
+91-22-2286 4400
viju.george@edelcap.com

Kunal Sangoi
+91-22-2286 4309
kunal.sangoi@edelcap.com

Patni's Q1CY07 results were below our and street's expectations in terms of revenues, but marginally exceeded expectations at the net profit level. Revenue, at INR 6.8 bn, declined 0.6% Q-o-Q and 18.2% Y-o-Y. This is the company's second successive quarter of sequential revenue decline and the slowest annual growth for any quarter. Net profit stood at INR 1.3 bn, down 10.4% from the last quarter and up 89.7% Y-o-Y. However, this was supported by higher other income of INR 365 mn. EBITDA, at INR 1.3 bn, showed a sharp sequential quarterly decline of 13.9%, and EBITDA margins declined significantly by 290bps to 18.7%. We believe that Patni should have an optimal cost structure, given its size and profile. Its SG&A expenditure as percentage of sales, at 26.8% for the quarter, remains significantly high relative to peers.

Patni has issued a moderate revenue and muted profit guidance for Q2CY07; revenue and net profit are guided at USD 163.0 mn (Q-o-Q growth of 4.5% in USD terms) and USD 22.5 mn (4.5% decline Q-o-Q) respectively. Patni has guided to decline in profit in Q2CY07 on account of salary hikes coming into effect. Attrition rate, reported at 29.1%, remains a challenge demanding immediate attention. The company's response to that has been to provide above industry average offshore salary increases (18%-20% offshore and 3%-5% onsite), which we believe could put pressure on margins going forward.

We believe that Patni's 2-year forward earnings growth profile (11.3% over CY06-CY08E, adjusted for extraordinary charges in CY06) compares unfavourably with the other companies in our coverage universe. At CMP of INR 474, the stock currently trades at a P/E of 14.9x and 12.9x, and EV/EBITDA of 9.7x and 6.9x on our CY07E and CY08E earnings, respectively. In our view, current valuations limit reasonable upsides from present levels. We maintain our 'ACCMULATE' rating on the stock.

Reuters	:	PTNI.BO
Bloomberg	:	PATNI IN

Market Data

52-week range (INR)	:	511 / 251
Share in issue (mn)	:	137.9
M cap (INR bn/USD mn)	:	65.4 / 1,590.8
Avg. Daily Vol. BSE ('000)	:	395.2

Share Holding Pattern (%)

Promoters	:	44.1
MFs, FIs & Banks	:	3.4
FIIs	:	20.6
Others	:	31.9

Result Highlights

- Revenues stood at INR 6.8 bn (USD 156 mn), down 0.6% Q-o-Q and up merely 18.2% Y-o-Y. The net profits stood at INR 1.3 bn, down 10.4% Q-o-Q, but up 89% Y-o-Y. The decline was lower than our expectation; largely on account of higher other income.
- Staff cost remained flattish during the quarter at INR 3.8 bn; it stood at 54.5% of revenues compared with 54.2% in the previous quarter.
- EBIT for the quarter stood at INR 1.3 bn, down 13.9% Q-o-Q and up 55.9% Y-o-Y. The EBIT margin reduced by 280bps at 18.7%, mainly on account of higher SG&A expenses.

Financials

Year to December	Q1CY07	Q4CY06	*Growth %*	Q1CY06	*Growth %*	CY07E	CY08E
Revenues (INR mn)	6,796	6,840	*(0.6)*	5,750	*18.2*	29,787	36,479
EBITDA (INR mn)	1,269	1,474	*(13.9)*	1,007	*26.1*	5,223	6,858
Net profit (INR mn)	1,339	1,495	*(10.4)*	706	*89.7*	4,516	5,167
EPS basic (INR)*	9.7	10.8	*(10.5)*	5.1	*89.0*	31.7	36.6
P/E (x)						14.9	12.9
EV/EBITDA (x)						9.7	6.9
Market cap/ Revenue (x)						2.2	1.8

** Excluding extra-ordinary charges*

- Other income for the quarter stood at INR 365 mn as against INR 159 mn in the previous quarter. The other income for the quarter included USD 1.1 mn of write back of provision made for the forex loss, that is one time
- Utlisation during the quarter decreased 72.8% from 73.7% in Q4CY06.
- Client addition remained strong with 26 new clients during the quarter; the total active client count now stands at 252.
- The number of clients contributing revenues of more than USD 1 mn stands at 74, remaining flat over the previous quarter. Number of clients contributing revenues in excess of USD 10 mn stand at 14 compared to 8 a year ago.
- Nearly 292 employees were added during the quarter, taking the total headcount to 13,096.
- The company's attrition rate, reported at 29.1% during the quarter on a LTM basis, continued to be highest the industry. This remained a major concern for the company, leading it to give highest salary increases, effective since Q2CY07. The hikes are to be in the range of 18-20% and 3- 5% for offshore and onsite employees respectively, and are expected to adversely impact operating margins to the extent of 3- 3.2%.
- The company has guided to revenues of USD 163 mn (up 4.5% Q-o-Q) and net income of USD 22.5 - 23.0 mn for Q2CY07.

Sharp decline in telecom vertical dragging down overall growth

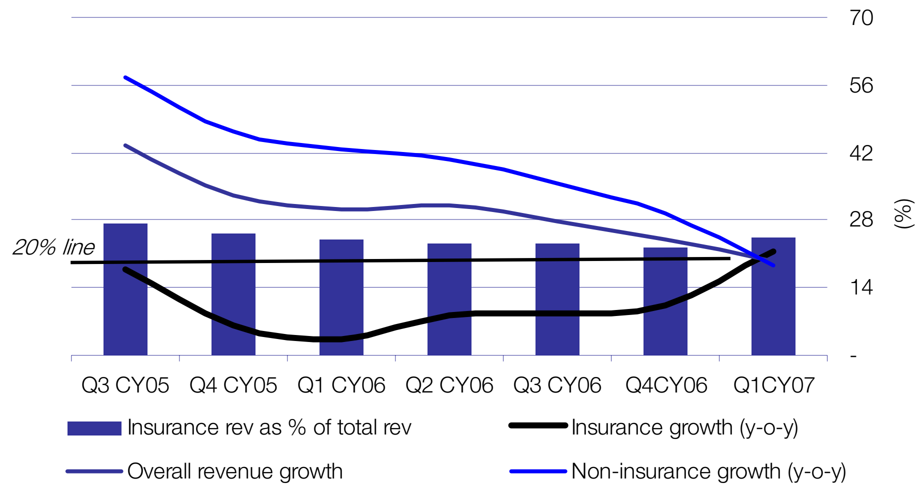
Patni has lost a significant account in its telecom vertical because of rationalization of that client's outsourced spend. This has resulted in a sharp revenue decline of 23.4% (over Q4CY06) in the company's telecom vertical. Notably, this lost revenue stream was almost entirely ADM. This renders instability to the company's overall service portfolio, given its under-penetration in other service lines such as enterprise solutions and embedded technologies where growth has been erratic, though significant, in some quarters.

Insurance makes a comeback, but broad-based revenue growth lagging

Patni's mainstay vertical insurance revived in this quarter with a 9.7% sequential growth rate (22% growth rate Y-o-Y). The insurance vertical has been witnessing a slowdown in growth over the last four–six quarters and the reversal of tepidness in Q1CY07 is encouraging. Maturing accounts and a stable client list, without much addition of new clients, has caused the growth rate to decline. Non-insurance revenue growth that used to compensate earlier for slow insurance growth has come off due to the decline in revenues from telecom.

Banking and financial services vertical, which has been a strong revenue growth driver for Patni's peers, has failed to become an engine of consistent growth for Patni, causing concern. Patni has never had a quarter when both insurance and non-insurance businesses have grown over 20% on a Y-o-Y basis (see Chart 1). We believe that all-round growth for Patni is difficult to come by in the near term.

Chart 1: Insurance grows at 22% Y-o-Y, but non-insurance's Y-o-Y growth falls below 20%

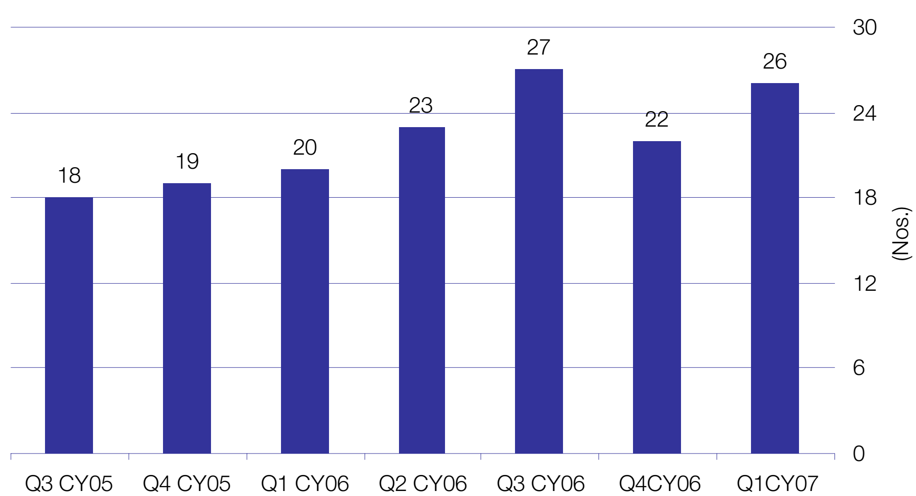


Source: Company, Edelweiss research

* Need to shore up multi-service delivery capability and develop multi-geographic strategies

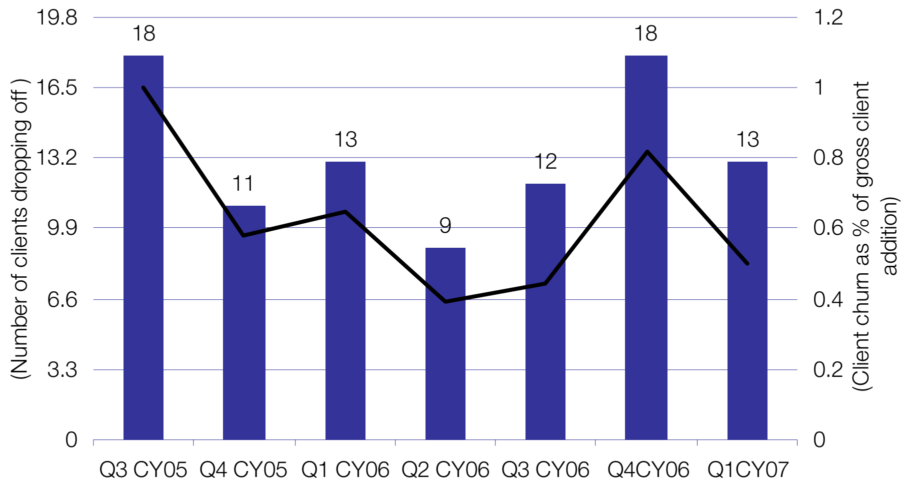
We believe that one of the factors that limits Patni's ability to create more significant accounts (USD 10 mn plus) is its over-reliance on ADM (contributed 70% to revenues over the last four quarters). While many of its peers in the domestic market are leveraging on the potential in areas such as enterprise application, product engineering, and infrastructure management, Patni is yet to demonstrate consistent growth even on a small base. The onus of growth currently seems to be on the consistent performance of a few accounts, which can unravel, as the ramp-down in one of the key telecom clients has shown. We note that only 14 clients (5.5% of active client base) are USD 10 mn plus accounts on a trailing twelve month (TTM) basis. However, the pace of new client addition seems intact (as seen in chart 2), but the net addition to the active client list indicates high customer churn (chart 3). We believe that this points to the need for better client retention and offtake strategies.

Chart 2: The pace of quarterly client addition is reasonably healthy



Source: Company, Edelweiss research

Chart 3: A significant percentage of the clients drop out as % of gross client additions



Source: Company, Edelweiss research

Also, Patni derives a significant proportion of its revenues from the Americas (80% over the last four quarters), and hence is exposed to fluctuations in the INR against the USD besides slowdown in the US.

✻ Need for better optimisation of the high SG&A spend

Patni incurred SG&A spend amounting to 26.8% of revenues in Q1CY07, which has gone up 260bps from Q4CY06. We believe that given the imperative to diversify accounts across geographies and better farming of active accounts, rationalising S&M may be unwarranted. However, we believe that there exists significant potential to optimise the existing SG&A by directing it towards better account management practices and greater involvement of the senior delivery personnel in helping mine them farther. There needs to be more focus on driving improvement in sales and account management related metrics such as:

- Number of USD million accounts created (across million dollar categories)
- Average client account size per sales personnel
- Multiplicity of levels of relationship with key accounts
- Stringent strategic review of top 20% accounts (about 50 in number) for multi-service penetration and account profitability net of specific account-related investments
- Peer benchmarking: The current annualised productivity of the sales force, at USD 3.8 mn, seems low relative to peers.

Thus, we believe that while investments in S&M are likely be maintained, the quality of the spend needs to improve. Also, the company needs to work on identifying and examining the scope of rationalising G&A that are non-sales related.

✻ Outlook on margins is damp

The company is focusing primarily on improving in utilisation rates and broadening the employee pyramid (to include a greater proportion of freshers in the entry mix) to manage margins in CY07. Utilisation improvement is a relatively weak driver of operating margins and improvement may not coincide with the broadening of the pyramid, given the time (3-4 months) freshers would need to be productive and start billing. We would like to see improvement in billing rates and faster shift to offshore-based revenues, which are more potent contributors to margin improvement. The company has indicated only marginal improvements on both these counts.

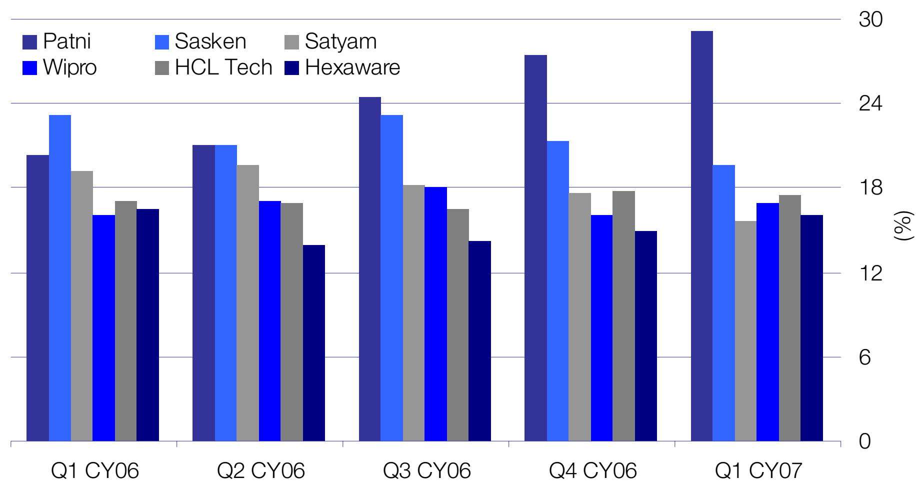
The other factor that could offer room for margin management is better cost management in SG&A expenses. However, we expect limited leverage to be obtained from cost management in SG&A and believe the company will have to invest in this area in the coming quarters to fund growth, especially as it builds its campus in Pune.

Facing attrition challenges

Patni is facing serious problems on the employee front. The attrition rate of 29%, reported by the company in the current quarter, is the highest amongst the peer group. The company has indicated that it will give hikes of 18-20% offshore and 3-5% onsite in the coming quarter. However, note that similar hikes were given in Q2CY06 and despite being highest in the industry, these hikes failed to keep Patni's attrition under control.

We also note that attrition reported by Patni is based on trailing twelve months basis. As we can see from the chart 4 (below), over the last four quarters attrition has been constantly inching up, indicating that the current quarter attrition is significantly higher compared with previous quarters in absolute terms. In our quarterly discussion with the management, we have not seen any soft or hard measures being taken to curb this attrition like issuance of restricted stock units (RSUs). We remain particularly concerned about high attrition in 3-6 year employee experience bracket.

Chart 4: Patni's attrition rate vis-à-vis peers



Source: Companies

Valuations limit meaningful near-term upsides given earnings outlook

We would look for more effective measures to address challenges in the areas of revenue growth, diversification of the revenue growth, margins, and attrition. Our EPS growth estimates of 11.3% (CY06-CY08E) factors in these near-term growth challenges. This outlook on earnings growth is fairly muted compared with other companies' in our coverage universe.

Our EPS estimates for CY07E and CY08E stand at INR 31.7 and 36.6 respectively. At CMP of INR 474, the stock currently trades at a P/E of 14.9x and 12.9x and EV/EBITDA of 9.7x and 6.9x on our CY07E and CY08E earnings, respectively. In our view, current valuations limit reasonable upsides from the present levels. We maintain our 'ACCUMULATE' rating on the stock.

Financials snapshot (INR mn)

Year to December	Q1CY07	Q4CY06	*Growth %*	Q1CY06	*Growth %*	CY06	CY07E	CY08E
Total revenues	6,796	6,840	*(0.6)*	5,750	*18.2*	26,080	29,787	36,479
Staff costs	3,707	3,709	*(0.1)*	3,224	*15.0*	14,447	17,093	20,720
SG & A	1,820	1,658	*9.8*	1,519	*19.8*	6,219	7,472	8,901
EBITDA	1,269	1,474	*(13.9)*	1,007	*26.1*	5,414	5,223	6,858
Depreciation *	-	-		193		600	690	1,020
EBIT	1,269	1,474	*(13.9)*	814	*55.9*	4,814	4,533	5,838
Other income	365	159	*129.9*	148	*146.2*	613	815	702
Interest	31	(6)	*(599.8)*	34	*(11.4)*	179	31	-
PBT	1,604	1,639	*(2.1)*	928	*72.9*	5,247	5,317	6,540
Tax	264	204	*29.8*	222	*19.2*	2,568	801	1,373
Prior period adjustment	-	(60)		-		232	-	-
Net profit	1,339	1,495	*(10.4)*	706	*89.7*	2,448	4,516	5,167
EPS basic (INR)**	9.7	10.8	*(10.5)*	5.1	*89.0*	29.6	31.7	36.6
as % of net revenues								
Staff costs	54.5	54.2		56.1		55.4	57.4	56.8
SG &A	26.8	24.2		26.4		23.8	25.1	24.4
EBITDA	18.7	21.5		17.5		20.8	17.5	18.8
EBIT	18.7	21.5		14.2		18.5	15.2	16.0
PBT	23.6	24.0		16.1		20.1	17.9	17.9
Net profit	19.7	21.9		12.3		9.4	15.2	14.2
Tax rate	16.5	12.4		23.9		48.9	15.1	21.0

** Current quarter and previous quarter depreciation nos. are included in SG&A as the breakup is not available*

*** Excluding extra-ordinary charges for CY06*

Company Description

Incorporated in 1978, Patni is one of the oldest and sixth-largest IT solution providers from India. The company provides IT services which is mainly focused on the banking, financial services, manufacturing and telecom verticals. The company's service gamut includes ADM, enterprise solutions, embedded technology service and product engineering services among others catering to more than 252 clients in various verticals. GE is Patni's largest customer and contributes ~ 11% to its total revenues. The company's last twelve months (TTM) revenue stood at INR 27.1 bn (USD 658 mn) and employs over 13,000 people.

Investment Theme

Over the last two years, Patni has been able to reduce its dependence on large clients and de-risk its revenue stream over a larger client base. The company has entered into newer domain / service line through differentiated offerings and built a profitable business. Patni's strong focus on providing end-to-end product engineering services across verticals and diversified client base provides a strong revenue growth opportunity.

Key Risks

Key risks to our investment theme include – a) attrition and increasing staff costs, b) slowdown in US as the company revenues mainly are US based c) slowdown in BFSI segment and d) appreciation of rupee against US dollar.

ROLTA INDIA

INR 385

Edelweiss
Ideas create, values protect

Strong quarter again; distinctive positioning auguring well BUY

April 23, 2007

Parul Inamdar
+91-22-2286 4355
parul.inamdar@edelcap.com

Viju George
+91-22-2286 4400
viju.george@edelcap.com

Kunal Sangoi
+91-22-2286 4309
kunal.sangoi@edelcap.com

Rolta's Q3FY07 results have exceeded our expectations on both top line and bottom line fronts. Revenues were at INR 1.9 bn (up 10.4% Q-o-Q and 30.8% Y-o-Y) and net profits were at INR 455 mn (up 11.2% Q-o-Q and 37.9% Y-o-Y). The company reported improved traction from all its service lines viz., GIS, EDA, and eSolutions. Commendably, Rolta reported better EBITDA margins due to lower sales and marketing expenses in the quarter.

Rolta has a number of beneficial factors operating in conjunction. These include:

(a) A robust order book of INR 7.5 bn (USD 173 mn), executable over the next 18-24 months, which is its highest ever, representing a sequential quarterly growth of 9%. In addition, it has bid for projects worth INR 15 bn (USD 345 mn).

(b) Two JVs with high-revenue potential over the medium-to-long term. Business solutions provided by the JVs cater to both domestic and export markets. Rolta stands to significantly gain by way of technology transfers.

(c) A strong operating environment present in the GIS and engineering IT space. Rolta, with its unique turnkey solutions capabilities and track record of executing large-sized projects, seems to be emphatically exploiting the current operating environment.

(d) High profitability of operations. Rolta enjoys industry-leading EBITDA margins of over 40%, which the company believes will be sustained going forward.

We estimate a three-year EPS CAGR of 41.5% over FY06-09E. The stock has already delivered 44% returns since our initiating coverage report (*'Sailing on strong winds'*, dated January 8, 2007). We continue to remain positive about returns over the next 9-12 months, which we believe will be led primarily by earnings growth rate accompanied by moderate P/E expansion. We believe its one-year forward P/E is likely to be in the 14-16x range compared to its present P/E of 12.5x for FY08E. We maintain our 'BUY' recommendation.

Reuters	:	ROLT.BO
Bloomberg	:	RLTA IN

Market Data

52-week range (INR)	:	387 / 124
Share in issue (mn)	:	80.1
M cap (INR bn/USD mn)	:	30.8 / 737.3
Avg. Daily Vol. BSE/NSE ('000)	:	1,388.7

Share Holding Pattern (%)

Promoters	:	40.7
MFs, FIs & Banks	:	0.6
FIIs	:	30.7
Others	:	28.0

Result highlights

- Rolta's Q3FY07 results were ahead of our expectations by 3.6% and 4.7% on revenue and net profit fronts, respectively. Revenues were reported at INR 1.9 bn (USD 42.7 mn), up 10.4% Q-o-Q and 30.8% Y-o-Y. Net profits stood at INR 455 mn, up 11.2% Q-o-Q and 37.9% Y-o-Y.

- Gross profits for the quarter stood at INR 926 mn, up 10.5% Q-o-Q. The gross margins marginally increased by 10bps Q-o-Q to 49.9%.

Financials

Year to June	Q3FY07	Q2FY07	*Growth %*	Q3FY06	*Growth %*	FY08E	FY09E
Revenue (INR mn)	1,856	1,681	*10.4*	1,419	*30.8*	10,010	13,664
Gross profit (INR mn)	926	838	*10.5*	723	*28.0*	4,964	6,750
EBITDA (INR mn)	782	677	*15.6*	582	*34.4*	3,979	5,384
Net profit (INR mn)	455	409	*11.2*	330	*37.9*	2,477	3,400
EPS basic (INR)	5.7	5.1	*11.0*	5.2	*9.6*	30.7	41.9
P/E (x)						12.5	9.2
EV/EBITDA (x)						7.0	4.8
Mkt. cap / Revenue (x)						3.1	2.3

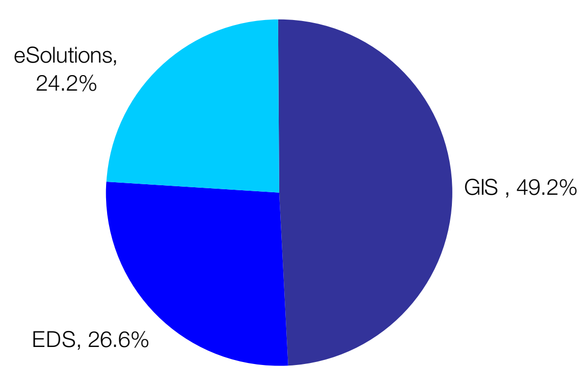
- EBITDA stood at INR 782 mn, up 15.6% Q-o-Q and 34.4% Y-o-Y. EBITDA margins rose by 190bps Q-o-Q to 42.1%. Expansion in EBITDA margins was mainly driven by lower SG&A expenses. The absolute amount of SG&A expense declined from INR 161 mn in Q2FY07 to INR 144 mn in the current quarter. This was mainly because the previous quarter had included advertising and marketing expenses pertaining to the Thales JV and additionally, because of expenses relating to participation in conferences.
- The company added a net of 200 technical professionals during the quarter, taking its total technical headcount to 3,056. The company's total headcount, including sales and support staff, now stands at 3,800 plus. The company stated that it intends to ramp up the headcount to 5,000 over the next 12 months.
- In the S&W JV the company intends to close FY07 with a headcount of 350, and further ramp up to 1,000 by June 2008.
- Rolta's order book, as at the end of the quarter, stood at an impressive INR 7.52 bn.
- More encouraging is the pipeline of deals that Rolta is currently pursuing, which stands at a robust INR 15 bn. This is a strong indicator of the increased traction for the company in various service offerings.
- The company's attrition rate remained in high single digit, which is impressive compared to its peers, which have ~ 14-18%.
- The company has USD 27 mn in cash and cash equivalents as at the end of the quarter.

Robust order book along with a strong pipeline

With tremendous opportunities in all the business segments that the company is present in, we believe Rolta is uniquely positioned with its inter-related skills and service portfolio. This has begun to reflect in the company's strong order book, which, as at the end of the quarter, stood at a robust INR 7.5 bn (USD 173 mn). This is well balanced across the company's three business segments (see Chart 1). This confirmed order book executable over the next 12-15 months exceeds our FY07 revenue estimates of INR 7 bn and has been consistently rising through the quarters (chart 2).

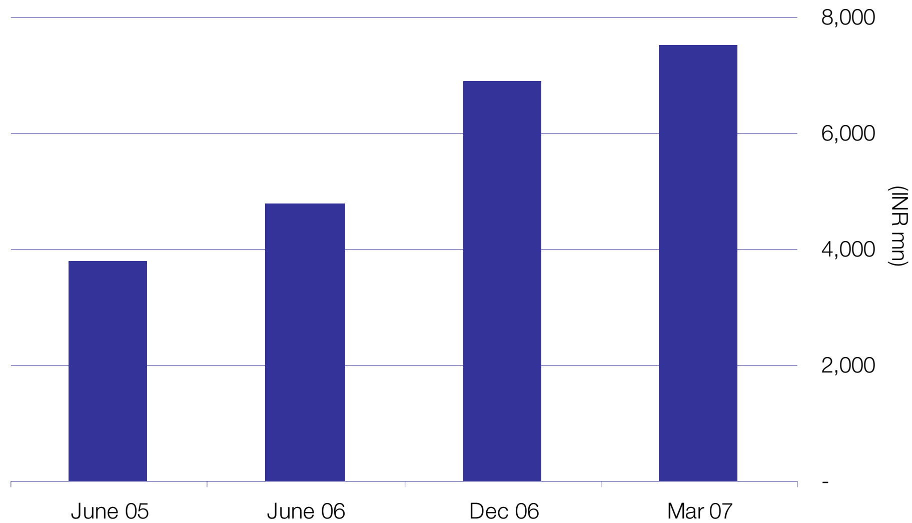
Rolta has also indicated that its order pipeline stands at over INR 15 bn (USD 345 mn). The company's success rate of converting the pipeline into wins has been high at nearly 60-70%. We also note that it has been bidding at rates which are higher by more than 5-7% than the average billing rates.

Chart1: Order book (March 2007) is well balanced across all three business segments



Source: Company, Edelweiss research

Chart 2: Cumulative order book steadily increasing through the quarters



Source: Company, Edelweiss research

JVs on track

Rolta has indicated that its Thales JV is proceeding as per the company's plan and will be incorporated shortly. In addition, the company's JV with S&W (Stone & Webster) is in the ramp-up stage as the company expects to take the personnel strength in this JV to 1,000 by FY08 from 260 currently.

Rolta has not spelt out any near-term revenue targets for the Thales JV, though it has stated its intention to realize cumulative revenues of USD 500 mn over five years from this venture.

Uptrend in billing rates another positive

Rolta has effected a significant increase in its billing rates recently. It has indicated that its billing rates have gone up by 10-15% on a like-to-like basis over the past three years. With increasing offshore contribution, this contributes to maintaining its industry-leading EBITDA margins.

Increase in higher value orders

We believe that one factor that contributes to Rolta's higher realizations is the enlarging size of the average contract size. It is especially so in its GIS and EDA divisions, which account for over 85% of the company's revenues. The company has broadly indicated that it is winning more multi-million dollar deals of USD 5 mn plus and a few even exceeding USD 10 mn.

Debtor days a concern, now being mitigated

Government business constitutes substantial portion of Rolta's total revenues. These government projects involve development of CAD/CAM/GIS solutions and technologically intensive IT services, payments for which are based on completion of milestones as well as the total project. We understand that the company is increasingly focussing on international markets and private domestic clients. Higher debtor days for the company are also a result of higher fixed price projects, which have various milestones and retentions. During the current quarter, debtor days stood at more than six months, which have dipped from 223 days in FY06 (254 days in FY05). Going forward, the company plans to reduce the same to ~ 180 days by the end of FY07 as government's share of Rolta's business comes down as a percentage of sales.

Acquisitions another potential upside

Rolta currently has USD 27 mn in cash as of March 31, 2007. The company has serious M&A plans and we note the company's philosophy will revolve around enhancing its existing capabilities and any acquisition it makes will be EPS accretive. We believe that Rolta is well positioned to enhance its stature through the inorganic route as well. We believe the company is poised to improve its growth momentum via organic and inorganic means through FY07-09E. Inorganic growth will provide further upside to our estimates, which factor in strong organic growth only.

Valuations

Rolta is well positioned in the buoyant macro environment, considering its leadership position in GIS and engineering services. We expect the company to achieve strong organic growth through FY09E. In addition, the Thales (51% share) and Stone & Webster JVs are expected to contribute significantly through FY09E, which will shift the company's growth trajectory to 38-40%.

Currently, our EPS stands at INR 30.7 and INR 41.9 for FY08E and FY09E, respectively, a CAGR of 38.7% over FY07-09E. At INR 385, the stock trades at a P/E of 12.5x and 9.2x on our FY08E and FY09E earnings, respectively. The stock has already delivered 44% returns since our initiating coverage report (*'Sailing on strong winds'*, dated January 8, 2007). We continue to remain positive about returns over the next 9-12 months, which we believe will be led primarily by earnings growth rate accompanied by moderate P/E expansion. We believe its one-year forward P/E is likely to be in the 14-16x range, compared to its present P/E band of 10-13x. We maintain our 'BUY' recommendation.

Financials snapshot (INR mn)

Year to June	Q3FY07	Q2FY07	*Growth %*	Q3FY06	*Growth %*	FY07E	FY08E	FY09E
Total revenues	1,856	1,681	*10.4*	1,419	*30.8*	7,081	10,010	13,664
Software dev expenses	930	843	*10.3*	696	*33.6*	3,545	5,046	6,914
Gross profit	926	838	*10.5*	723	*28.0*	3,536	4,964	6,750
SG&A	144	161	*(10.5)*	142	*1.9*	651	985	1,366
EBITDA	782	677	*15.6*	582	*34.4*	2,884	3,979	5,384
Depreciation	279	239	*16.8*	175	*59.7*	1,007	1,100	1,240
EBIT	502	437	*14.9*	407	*23.5*	1,877	2,879	4,144
Other expense	1	0		47	*(98.4)*	7	5	-
Other income	9	23	*(60.9)*	9	*(1.2)*	87	56	65
PBT	511	460	*11.0*	369	*38.4*	1,957	2,930	4,209
Tax	55	50	*9.3*	39	*43.4*	217	381	602
Adjusted net profit	455	409	*11.2*	330	*37.9*	1,740	2,549	3,607
Minority Interest	-	-	-	-		-	(72)	(207)
Reported net profit	455	409	*11.2*	330	*37.9*	1,740	2,477	3,400
EPS basic (INR)	5.7	5.1	*11.0*	5.2	*9.6*	21.8	30.7	41.9
as % of net revenues								
Gross profit	49.9	49.8		51.0		49.9	49.6	49.4
SG&A	7.8	9.6		10.0		9.2	9.8	10.0
EBITDA	42.1	40.2		41.0		40.7	39.8	39.4
Adjusted net profit	24.5	24.4		23.3		24.6	25.5	26.4
Reported net profit	24.5	24.4		23.3		24.6	24.7	24.9
Tax rate	10.8	11.0		10.4		11.1	13.0	14.3

Company Description

Rolta is one of the leading providers of geospatial information services (GIS) and engineering design & automation (EDA) services. In GIS, Rolta provides and develops digital map-based solutions servicing customers in segments like defence, environmental protection, utilities, emergency services, and public planning. In EDA, Rolta focuses on computer-aided plant design and mechanical engineering solutions. The company provides a combination of software skills and component manufacturing services through its EDA group. It also provides security and IT infrastructure, software development, testing, gaming services through its eSolutions group. The company's past twelve months (TTM) revenues stood at INR 6.5 bn (USD 150 mn) and it employs over 3,800 people including its joint ventures.

Investment Theme

Outsourcing of engineering services is expected to reach USD 38-50 bn by 2020 compared to USD 2 bn now, as per the Nasscom, Booz Allen Hamilton study. As one of the leading offshore engineering services firm for manufacturing industry, Rolta is well poised to grab the increasing opportunities. The company has entered into two high potential JVs which are likely to raise its traction in high growth verticals such as power, energy, and defence. Its 50:50 JV with Stone & Webster is pursuing engineering design opportunities in high growth refinery, petrochemicals, and energy sectors in India. Its 51:49 JV with Thales, the French defence and aerospace major, aims at targeting Indian and international defence spend in the area of high-tech warfare.

Key Risks

Key risks to our investment theme include: (a) adequate availability of skilled manpower; (b) substantial proportion of revenues from non-annuity sources; and (c) large proportion of revenues from domestic market.

SASKEN COMMUNICATION TECHNOLOGIES INR 525

On a platform for profitable growth BUY

Sasken's Q4FY07 results were below our expectations. Revenues were reported at INR 1.4 bn, up 3.3% Q-o-Q and net profits at INR 117 were down 1.4% Q-o-Q. Revenues from the services business grew by 2% in USD terms for the quarter, while it remained flat in INR terms. EBITDA margins for the services business declined by 220 bps at 20.7% largely on account of appreciation of the rupee against US dollar. Product revenues increased by 110% Q-o-Q at INR 87 mn with increased contribution from customization and royalty revenues.

The growth in the services business for the quarter was below our expectation. However we note that the network infrastructure clients which contribute ~ 40-50% of Sasken' services revenues are coming of the consolidation phase, leading to postponement of their R&D spent budgets, in turn leading to slow growth for Sasken on the services side. We see the growth from this business segment to pick up as budget rationalization happens in the coming quarters. We also believe that the company has increased opportunity on the network operator and handset manufacturers, as the R&D expenses for them come under cost pressure. We estimate the Services business to grow by 32.2% in coming fiscal - FY08.

On the products side, Sasken achieved a significant milestone with its Application framework 'E-series' being adopted by Lenovo Mobile. Also, the royalty revenues of INR 19 mn recognised during the quarter, is the highest ever for the company for any quarter. With higher number of handset shipments expected beginning April 07, we see increased visibility in this revenue segment.

At a CMP of INR 525, the stock currently trades at a P/E of 15.2x and 11.9x and EV/EBITDA of 9.6x and 7.4x on our FY08E and FY09E earnings, respectively. We reiterate our 'BUY' recommendation.

Result highlights

- Revenues were reported at INR 1.4 bn, up 3.3% QoQ and 73.5% YoY and the net profits stood at INR 117mn (down from INR 119 mn in Q3FY07). However the net profit reported includes the high depreciation charge (explained below – product segment).
- EBITDA for the quarter stood at INR 210 mn up 8.2% QoQ and 100% YoY. The EBITDA margins for the company increased to 15.5% from 14.8% QoQ. Higher contribution from the products helped the margins improve.

Financials

Year to March	Q4FY07	Q3FY07	*Growth %*	Q4FY06	*Growth %*	FY08E	FY09E
Revenue (INR mn)	1,354	1,310	*3.3*	781	*73.5*	6,915	9,234
EBITDA (INR mn)	210	194	*8.2*	105	*99.9*	1,635	2,134
Net profit (INR mn)	117	119	*(1.4)*	63	*86.3*	970	1,244
EPS basic (INR)	4.1	4.2	*(2.1)*	2.3	*83.2*	34.6	44.2
P/E (x)						15.2	11.9
EV/EBITDA (x)						9.6	7.4
Mkt. cap / Revenue (x)						2.1	1.6

Edelweiss
Ideas create, values protect

April 23, 2007

Parul Inamdar
+91-22-2286 4355
parul.inamdar@edelcap.com

Viju George
+91-22-2286 4400
viju.george@edelcap.com

Kunal Sangoi
+91-22-2286 4309
kunal.sangoi@edelcap.com

Reuters	:	SKCT.BO
Bloomberg	:	SACT IN

Market Data

52-week range (INR)	:	624 / 240
Share in issue (mn)	:	28.5
M cap (INR bn/USD mn)	:	15.0 / 358.4
Avg. Daily Vol. BSE ('000)	:	136.8

Share Holding Pattern (%)

Promoters	:	26.4
MFs, FIs & Banks	:	5.1
FIIs	:	19.2
Others	:	49.3

Services

- Services revenues remained flat for the quarter at INR 1.3 bn, while the products revenues showed a strong jump of 110% QoQ at INR 87.3 mn.
- The growth in the services revenues was impacted by two factors – 1) appreciation of the rupee, and 2) The spent of the network OEMs (such as Alcatel, Lucent) has stagnated as the segment is still coming out of consolidation and have not yet finalized their budgets.
- EBITDA for the services business declined by 9.6% QoQ at INR 262 mn. EBITDA margins fell by 220 bps to reach 20.7% for the quarter. This sharp decline in the margins is largely on account of the appreciation of rupee.
- Though the growth in the services business for the quarter has been flat, we see it as a quarterly aberration. We see the growth reviving in the coming quarters and believe the growth in the range of 30-35% going forward.

Products

- Revenues from the products stood at INR 87.3 mn up 110% QoQ and 97% YoY. The products continued to make losses at EBITDA level, which was negative INR 52.3 mn.
- The company had two new, Design-Ins during the quarter, one for the Application Framework and other for the Multimedia Subsystem, which is positive.
- Importantly, with one of the design-ins in the 'E-series', the company has started to depreciated the product capitalization expense. The impact of the same has been felt in current quarter with depreciation for the quarter increasing from INR 61 mn in Q3FY07 to INR 103 mn.
- The R&D expenses have also increased from INR 50 mn to INR 74 mn, impacting the profits.

Other highlights

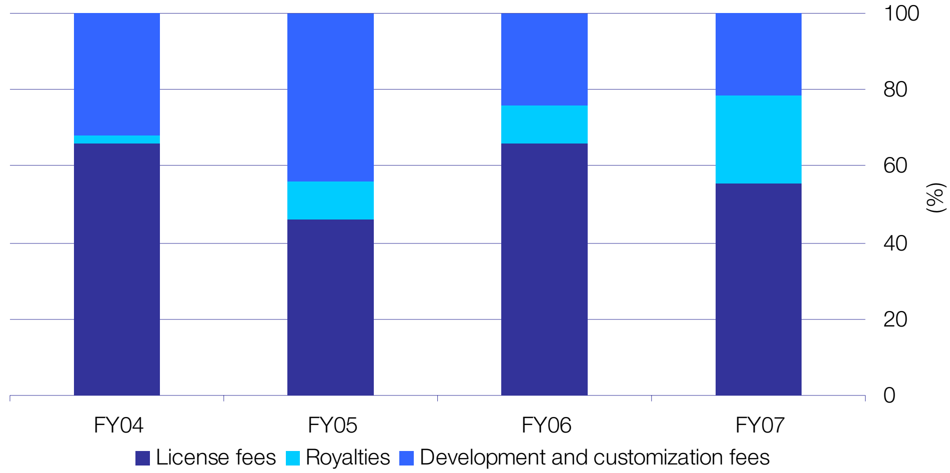
- New customer additions were 6 and the total number of active customers now stands at 84.
- The company added a gross of 290 employees (net 107) in the current quarter taking the total headcount to 3,611. On a YoY basis the headcount of the company has grown by 40%. Services headcount constitutes 83% of the overall employees.
- Notably, the attrition rate for the company declined to 19.6% from 21.3% in the previous quarter.
- The company gained INR 38.8 mn (compared to INR 15.9 mn in Q3FY07) due to foreign exchange fluctuations. The current hedge position of the company stands at USD 53.9 mn.

Encouraging outlook on the products business

Sasken's products business continued to achieve the milestone, and announced two platform Design-Ins. One of them is a significant win for its Application framework 'E-series' that has been adopted by Lenovo Mobile. This is the first design-in in the 'E-series' range of product that offers solutions for rich media phones. Our interactions with the management suggest that it takes 6-9 months for a Design-In to get converted in a Design-Win. We expect the first shipment of phones on this platform in the second half of FY08 (i.e. Q3FY08 onward).

Royalty revenues recognised during the current quarter stood at INR 19 mn, which is the highest ever for the company in any quarter. With higher number of handset shipments expected beginning April 07 and onwards (refer table 1), we see increased visibility on this account.

Chart 1: Product revenue break-up over last four years



Source: Company

Table 1: Products—Milestone targets and status

Milestones	Application Framework	Wireless Protocol Stacks (2.5G)	Wireless Protocol Stacks (3G)	Multimedia Subsystems 3G
No. of Platform Design-ins as of date	1- Lenovo Mobile (April 2007)	5	2	4 -> 5 (April 2007)
No. of Phone Models Launched (Design-wins) as of date	None	None	None	3 -> 4
<u>Tentative</u> Phone Shipments Schedule	First shipments in Q3/ Q4FY08	First shipments in Q2FY08	Global Tier 1- end Q2/ early Q3FY08	NTT DoCoMo FOMA N903i (NEC)- Shipping
			Global Tier 2- Q3FY08	NTT DoCoMo FOMA N903iX (PMC)- SHIPPED April 19, 2007
				Global Tier 1 - May 2007
				Wistron - Q1FY08

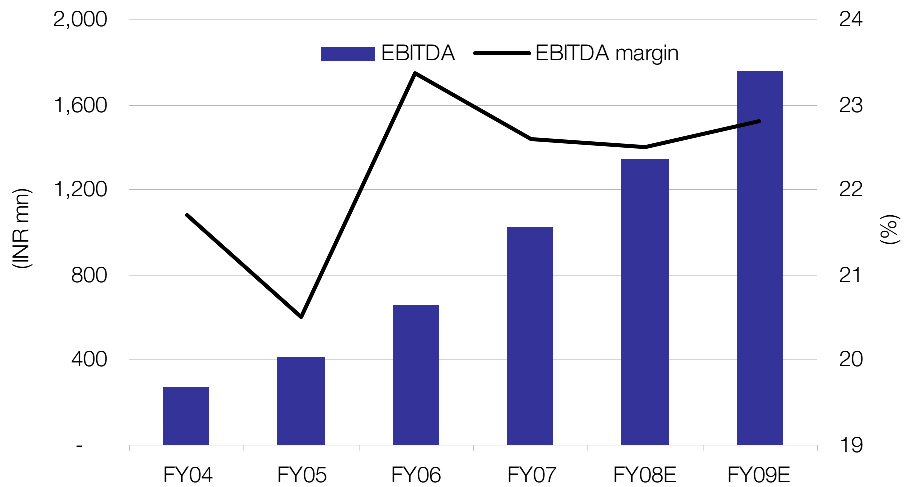
Source: Company

Strong growth opportunities on the services side

The services growth during the current quarter was below our expectation. In USD terms the revenues grew by meager 2% QoQ. Sasken derives major portion of its services revenues from the network infrastructure vendors (NIVs). These companies are under constant pressure to reduce their R&D related expenses, which has created opportunity for companies like Sasken that have strong expertise in outsourced R&D. Sasken has been able to capitalize on this opportunity and has build revenue stream of ~40-50% (of services revenues) from these vendors. With the NIVs coming off the consolidation phase, the R&D related spend is however getting delayed, in turn affecting Sasken. Prioritization of technologies, the methodology of maintenance and rationalization of R&D budgets, are some other functions that have lead to higher that expected time for R&D spent. However, we see the growth from this segment to pick-up in the coming quarters.

We also see higher opportunity for Sasken on the network operator as well as the network handset manufacturer side for its services business, which comes from the Sasken Finland Oy (formerly Botnia). We remain positive on Sasken's services business going forward and expect a CAGR of 30.4% over FY07-09E. Also the margins in the services business are expected to increase going forward based on the improvement in the billing rates of ~ 2.5%, and also as the company executes more number of fixed price projects. EBITDA margins in the services business are expected to be in the range 22-24% compared to earlier 21-23% range.

Chart 2: EBITDA and EBITDA margins in the services business



Source: Company, Edelweiss research

Valuations

Our EPS estimate for Sasken stands at INR 34.6 and INR 44.2 for FY08E and FY09E, respectively backed by increased contribution expected from the high margin product related royalty revenues. At a CMP of INR 525, the stock currently trades at a P/E of 15.2x and 11.9x and EV/EBITDA of 9.6x and 7.4x on our FY08E and FY09E earnings, respectively. We reiterate our 'BUY' recommendation.

Financials snapshot (INR mn)

Year to March	Q4FY07	Q3FY07	*Growth(%)*	Q4FY06	*Growth(%)*	FY07	FY08E	FY09E
Services	1,267	1,269	*(0.2)*	736	*72.0*	4,523	5,982	7,686
Products	87	42	*110.0*	44	*97.4*	227	934	1,548
Total revenues	1,354	1,310	*3.3*	781	*73.5*	4,751	6,915	9,234
Cost of revenues	828	827	*0.2*	514	*61.2*	2,962	3,797	5,494
R & D expenses	74	50	*47.1*	22	*232.0*	196	225	396
SG & A	242	239	*1.1*	139	*73.3*	838	1,259	1,210
EBITDA	210	194	*8.2*	105	*99.9*	755	1,635	2,134
EBITDA - services	262	290	*(9.6)*	179	*46.3*	1,022	1,346	1,752
EBITDA - products	(52)	(96)	*(45.6)*	(74)	*(29.5)*	(267)	290	381
Depreciation	103	61	*68.4*	48	*112.0*	266	341	460
EBIT	107	133	*(19.3)*	57	*89.5*	489	1,294	1,673
Other income	47	31	*52.1*	17	*175.9*	98	18	28
Interest expense	11	10	*1.0*	0	*2,988.2*	45	78	65
PBT	144	154	*(6.2)*	73	*96.3*	542	1,234	1,636
Tax	27	35	*(22.6)*	11	*155.7*	101	264	393
Net profit	117	119	*(1.4)*	63	*86.3*	441	970	1,244
EPS basic (INR)	4.1	4.2	*(2.1)*	2.3	*83.2*	15.7	34.6	44.2
as % of net revenues								
Cost of revenue	61.2	63.1		65.8		62.3	54.9	59.5
SG &A	17.8	18.2		17.9		17.6	18.2	13.1
EBITDA	15.5	14.8		13.5		15.9	23.7	23.1
EBIT	7.9	10.2		7.3		10.3	18.7	18.1
PBT	10.7	11.7		9.4		11.4	17.8	17.7
Net profit	8.6	9.1		8.1		9.3	14.0	13.5
Tax rate	18.8	22.8		14.5		18.6	21.4	24.0

Company Description

Sasken is a communication software design and development company focused on the wireless and broadband software space. It offers a hybrid model of services and products, and works with network OEMs, semiconductor vendors, terminal devices OEMs, and operators across the world. It provides embedded communication software across the entire communication value chain, application software services for service providers and planning, deploying and managing wireless networks. The company's past twelve months (TTM) revenues stood at INR 4.8 bn (USD 104.4 mn) and it employs over 3,600 people at its offices in India, China, Finland, Germany, Japan, Mexico, Sweden, UK, and the US.

Investment Theme

Sasken's services business has a well-aligned portfolio, capturing a gamut of outsourced embedded R&D spends across the telecom value chain. The company is getting increasing traction with emerging leaders in the network original equipment manufacturer (OEM) space that accounts for nearly two thirds of the outsourced R&D spend. Sasken's product suite now stands adopted on eleven platforms and is likely to witness a surge in revenues post first half of FY08. Through the platforms of its silicon partners, Sasken's products are set to be launched by leading global handset vendors. The company will stand to earn licensing and sub-licensing fees, apart from royalty income from this opportunity.

Key Risks

The key risks to our investment theme include: (a) slowdown in telecom spending; (b) product revenues linked to success of handsets (consumer product); and (c) significant appreciation of the rupee against the US dollar, GBP, and Euro.

SATYAM COMPUTER SERVICES

INR 448

Edelweiss
Ideas create, values protect

Back on track after a strong quarter

BUY

April 20, 2007

Hitesh Zaveri
+91-22-2286 4424
hitesh.zaveri@edelcap.com

Parul Inamdar
+91-22-2286 4355
parul.inamdar@edelcap.com

Viju George
+91-22-2286 4400
viju.george@edelcap.com

Kunal Sangoi
+91-22-2286 4309
kunal.sangoi@edelcap.com

Satyam's Q4FY07 results were ahead of our expectations. Revenues, came in at INR 17.8 bn, up 7.1% Q-o-Q and 35.4% Y-o-Y while net profit, at INR 3.9 bn, was up 16.7% Q-o-Q and 38.3% Y-o-Y. Higher other income and lower depreciation have contributed to the better-than-expected profits. EBITDA margins at 23.1% (down by 160 bps Q-o-Q) resulted in a flat EBITDA over Q3FY07.

A steady pace of client addition over the past several quarters with an increasing number of clients being migrated in the USD 1-5 mn category augurs well for the company. The company has increased its million dollar client base by over 20% and its USD 10 mn plus client base by 30% in FY07 over FY06. Though the growth rate in the top 5-client category has been slightly volatile over the past three-four quarters, the top 6-10 client category has been ramping up well for the company. The company's focus on consulting and enterprise business solutions and engineering solutions is paying off, with both registering double-digit growth.

Satyam has issued positive guidance for FY08 for revenues and EPS growth of 28-30% and 27-29% respectively in USD terms as per US GAAP, revenues and EPS growth of 20-22% and 18-20% respectively as per consolidated Indian GAAP. The difference is due to the assumption of a 6% Rupee assumption factored in.

At INR 448, the stock trades at a P/E of 16.9x and 13.6x on our FY08E and FY09E earnings respectively. We maintain our 'BUY' recommendation.

Q4FY07 result highlights

- Revenues grew 7.1% Q-o-Q at INR 17.8 bn while net profit grew 16.7% Q-o-Q at INR 3.9 bn.
- However the net income has been mainly boosted by higher other income - INR 704 mn compared to INR 102 mn and lower depreciation
- EBITDA margins have declined by 160 bps Q-o-Q at 23.1%. EBITDA in absolute INR has been flat relative to Q3FY07.
- The company added 1,265 people during the quarter taking the total headcount to 35,670
- Attrition rate for the company has come down from 17.6% to 15.7%, which is commendable.
- 35 new clients have been added during the quarter and the active client count now stands at 538
- The billing rates for the quarter have increased Q-o-Q by 0.7% for offshore, 0.6% for onsite.

Reuters	:	SATY.BO
Bloomberg	:	SCS IN

Market Data

52-week range (INR)	:	890 / 396
Share in issue (mn)	:	667.2
M cap (INR bn/USD mn)	:	298.9 / 7,103.2
Avg. Daily Vol. BSE/NSE('000)	:	3,926.1

Share Holding Pattern (%)

Promoters	:	9.1
MFs, FIs & Banks	:	11.3
FIIs	:	48.2
Others	:	31.4

Financials

Year to March	Q4FY07	Q3FY07	*Growth %*	Q4FY06	*Growth %*	FY08E	FY09E
Revenue (INR mn)	17,792	16,611	*7.1*	13,136	*35.4*	83,334	106,442
EBITDA (INR mn)	4,102	4,100	*0.1*	3,345	*22.6*	19,751	24,999
EBIT (INR mn)	3,748	3,706	*1.1*	2,973	*26.1*	17,826	22,537
Net profit (INR mn)	3,936	3,372	*16.7*	2,847	*38.3*	15,528	19,316
EPS basic (INR)	6.0	5.1	*16.3*	4.4	*36.3*	25.8	31.9
PE (x)						18.4	14.9
EV/EBITDA (x)						13.7	10.3
Mkt. cap / Rev. (x)						3.8	3.0

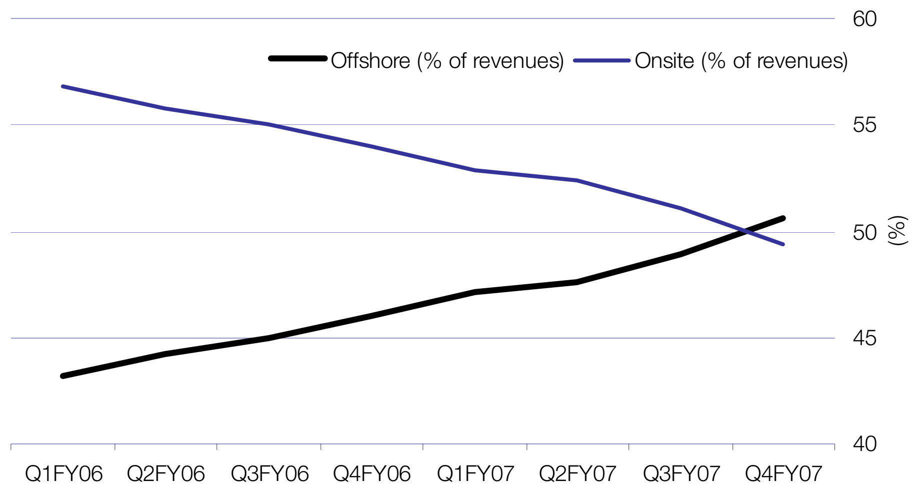
Guidance for FY08 positive

In USD terms, guidance for revenue growth in FY08 is 28-30% and that for EPS 27-29%. However in INR terms the company is factoring in 6% rupee appreciation and hence revenue guidance is at 20-22% and EPS growth at 18-20%.

Offshore revenues on an uptrend backed by consistent double-digit volume growth

Satyam has been consistently increasing its offshore revenues, leading to a healthier revenue mix—from 43.2% in Q1FY06 to 50.6% now, exceeding the contribution from onsite for the first time (see chart 1). While offshore revenues have been increasing at a CQGR of 10.8% through the four quarters in FY07, onsite revenues have increased at a CQGR of 5.8%, and the company's revenues have increased at a CQGR of 8.1% over the same period. This period has seen 11% CQGR offshore volume growth through quarters.

Chart 1: Increasing offshore contribution consistently through the quarters



Source: Company, Edelweiss research

The company indicated that further shift to offshore will continue through FY08. We believe that this is one of the key levers that the company has to sustain its margins in FY08. A 1% shift in revenues to offshore has a beneficial impact on margins to the extent of 30-35 bps.

Scope of client mining can improve

Satyam is increasing the share of revenues from the non-top 10 clients. However, there is significant scope to further build stronger top 10 client mining capabilities. The top client has shown anemic growth in FY07. Over the past 4 quarters, while the non-top 10 clients have grown at a CQGR of 8%, the top 5 and top 10 clients have grown at 5.7% and 8.4%, respectively (see table 1). However, within the top 10, it is the top 6-10 client category that has been growing relatively better at 13.6%.

Table 1: Top 6-10 clients are showing stronger traction than the rest (CQGR in FY07)

	Contribution to revenues (%)	Contribution per client (avg) (%)
Top client	1.0	1.0
Top 2-5	7.8	8.4
Top 6-10	13.6	13.6
Non-Top 10	8.0	4.3

Source: Company, Edelweiss research

* Traditional dominance in enterprise applications will drive value growth

Satyam with over 8000 professionals in its ERP practice is among the most significant Indian vendors addressing the enterprise solutions space (package implementation). The company has diversified in a balanced way between the SAP ecosystem and the Oracle System thus benefiting from deployment drivers operating for both of these globally eminent software service providers.

Enterprise Solutions and Consulting contribute significantly to Satyam's revenues (42.6% in Q4FY07) and has been growing CQGR of 10% in FY07. This accounts for about 50% of the incremental revenues for Satyam in FY07 over FY06. At USD 605 mn for FY07 this is ahead of Infosys' package implementation practice (USD 541 mn in FY07) and also of TCS (USD 525 mn in FY07). In addition, its revenues in this practice for Q4FY07 have been ahead of its closest peers.

The outlook for this segment is bright and we believe that Satyam should continue to lead the growth in this segment within the industry.

* Getting a toehold in the large deals

With its breakthrough win of a USD 200 mn engagement with AMD, Satyam has announced its entry in the mega multi-million multi-year contract club. Satyam has indicated that it has won three large deals in FY07 as against two in FY06 (size not specified).

Satyam is growing its infrastructure management practice as this is emerging as an essential component in several large deals. However, the company has also mentioned that several large deals in the fray cut across geographies and services without any bias towards any specific vertical(s). It is currently pursuing about 10-15 of them.

However, alternatively we believe that Satyam can further strengthen focus on its mid-tier clients (those ranked between 20 and 50 in the revenue pecking order) to achieve growth. Several of them could be potentially USD 50 mn plus accounts.

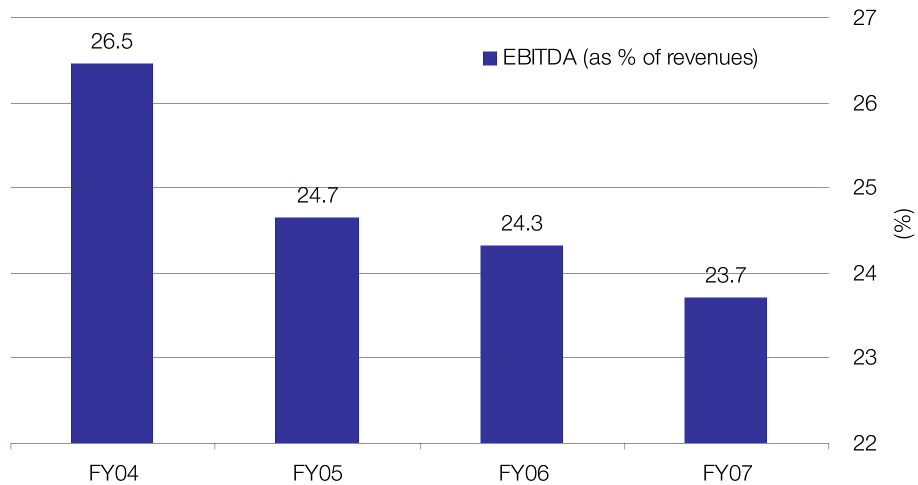
* Reining in attrition

Satyam historically has had annualized attrition in excess of 18% through the quarters (19.2% in FY06). The company has done an admirable job of keeping the quarterly attrition down to 13% in Q4FY07. The company has paid particular attention to implementing better employee retention such as job rotation (exposure to different technologies and domains) which has had the beneficial impact of stemming voluntary departures of mid-level professionals. The company has also emerged as the number 2 employer in India in the Hewitt "Best Employers in India" survey.

* Ability to maintain margins will be watched

Satyam's performance over the years on maintaining EBITDA margins has been less encouraging (see chart 2).

Chart 2: Satyam's EBITDA margins have been trending down



Source: Company, Edelweiss research

- The company has indicated various levers to maintain margins in FY08 which include
  - Broadening of the employee pyramid. We believe that the mix of addition of entry-level professionals to lateral professionals could be 50:50 in FY08 at a gross level as against a 45:55 addition mix in FY07
  - Improving profitability of the subsidiaries which can improve EBIT margins upto 50 bps
  - Further shift offshore. A feasible 1.5% revenue shift to offshore can beneficially impact margins to the tune of 50 bps.
  - Productivity improvements emanating from several factors such as a greater The company has already factored in the adverse impact of a 12%-15% offshore salary hike and 3%-5% onsite salary hike and a further 2% appreciation of the INR versus the USD.

- Guidance is pleasing to markets

  We believe that Satyam's FY08 guidance sends two positive messages namely its
  - ability to grow revenues at near-top growth rates in the industry comparable with Tier-1 players such as Infosys, Wipro and TCS.
  - confidence in sustaining margins in FY08 versus FY07. Given that operating margins in Q4FY07 have trended down and are lower than the overall margins in FY07, the company indicates that it expects to improve margins to operate at FY07 levels in FY08. This is after deduction of non-cash charges towards RSUs.

- Outperformance of guidance is getting stronger over time

  We observe that Satyam's degree of out-performance relative to its stated guidance is getting stronger through the years. Table 2 shows that the strength of outpeformance is more pronounced at the EPS growth level.

Table 2: Satyam has been outperforming guidance more strongly with time in terms of growth delivered

Under Indian GAAP

Revenues	Guided		Actual perf.	Outperformance
FY04	15.0	17.0	15.2	(10.6)
FY05	28.0	30.0	37.5	25.0
FY06	26.0	28.0	36.1	29.0
FY07	25.2	27.3	35.3	29.3

EPS	Guided		Actual perf.	Outperformance
FY04	41.8	45.0	47.7	6.0
FY05	24.5	26.6	37.5	41.0
FY06	20.0	22.0	36.2	64.5
FY07	18.0	20.0	40.0	100.0

Source: Company, Edelweiss research

This gives us further confidence that Satyam will likely outperform its guidance for FY08 factored in our estimates.

* Valuations

We believe that the focused approach that the company has adopted in pursuing large deals will enable it to ramp up growth in the future. Satyam is focusing on achieving operational efficiency going forward. We have EPS of INR 26.5 for FY08E, a growth of 23.9% over FY07 and INR 32.8 for FY09E (24% growth over FY08E). Our EPS CAGR stand at 23.8% over FY07-09E. At INR 448, the stock trades at a P/E of 16.9x and 13.6x on our FY08E and FY09E earnings respectively. We maintain our 'BUY' recommendation.

Financials snapshot (INR mn)

Year to March	Q4FY07	Q3FY07	*Growth %*	Q4FY06	*Growth %*	FY07	FY08E	FY09E
Total revenues	17,792	16,611	*7.1*	13,136	*35.4*	64,851	83,334	106,442
Employee cost	10,763	9,674	*11.3*	7,500	*43.5*	38,579	49,116	62,902
Operating & admin expenses	2,927	2,838	*3.1*	2,291	*27.8*	10,894	14,467	18,541
Total expenditure	13,689	12,511	*9.4*	9,791	*39.8*	49,474	63,583	81,443
EBITDA	4,102	4,100	*0.1*	3,345	*22.6*	15,377	19,751	24,999
Depreciation	354	394	*(10.1)*	372	*(4.8)*	1,484	1,925	2,462
EBIT	3,748	3,706	*1.1*	2,973	*26.1*	13,893	17,826	22,537
Other income	704	102	*592.2*	289	*143.7*	1,833	1,652	1,972
Interest	74	32	*129.7*	17	*349.7*	159	74	40
PBT	4,378	3,776	*16.0*	3,246	*34.9*	15,566	17,752	22,497
Tax	442	403	*9.7*	397	*11.3*	1,520	2,231	3,181
Adjusted net profit	3,936	3,372	*16.7*	2,848	*38.2*	14,046	15,521	19,316
Minority interest				2	*(100.0)*	(1)	(7)	-
Reported net profit	3,936	3,372	*16.7*	2,847	*38.3*	14,047	15,528	19,316
EPS basic (INR)	6.0	5.1	*16.3*	4.4	*36.3*	21.4	25.8	31.9
% of revenues								
Employee cost	60.5	58.2		57.1		59.5	58.9	59.1
Operating & admin expenses	16.4	17.1		17.4		16.8	17.4	17.4
EBITDA	23.1	24.7		25.5		23.7	23.7	23.5
EBIT	21.1	22.3		22.6		21.4	21.4	21.2
Reported net profit	22.1	20.3		21.7		21.7	18.6	18.1
Tax rate	10.1	10.7		12.2		9.8	12.6	14.1

** Q3FY06 and FY06 nos. exclude Sify stake sale profit*

Company Description

Satyam is the fourth-largest IT services company in India. It offers a range of IT services catering to verticals such as manufacturing, banking & financial services and insurance, telecom-infrastructure-media-entertainment-semiconductors (TIMES), and healthcare, among others. Satyam has the largest ERP practice amongst offshore vendors, having competencies in implementation of enterprise packages such as Oracle, SAP, PeopleSoft, and JD Edwards. Satyam's presence spans 55 countries, across six continents. Currently ~ 42% of its revenues were contributed by the ERP practice. The company has a client base of 620 across the globe and employs over 35,670 professionals across IT and BPO services. The number of associates including the subsidiaries and joint ventures stood at 39,552.

Investment Theme

Satyam has, over the past 8-12 quarters, successfully de-risked its revenues and achieved success in growing relationships with other than the top 15-20 accounts. Recent initiatives at Satyam include growing practices such as engineering and infrastructure segments, which have huge untapped potential. Satyam has recognized the need to focus on large deals and formed strategic deals group (SDG) to pursue and filter large deal opportunities. We believe Satyam can benefit with recent initiatives and enhance its revenues by cross-selling services to existing and new clients.

Key Risks

Key risks to our investment theme include: (a) a slowdown in US IT spending; (b) supply side constraints—salary hikes and attrition; and (d) appreciation of rupee against US dollar.

TATA CONSULTANCY SERVICES

INR 1,250

Big, and looking even bigger

BUY

Tata Consultancy Services' (TCS) Q4FY07 results were in line with our expectations. Revenues came in at INR 51.5 bn, up 5.9% Q-o-Q, and net profit was at INR 11.7 bn, up 6.2% Q-o-Q. On Y-o-Y basis, revenue and net profit growth stood at 37.9% and 44.9%, respectively.

TCS closed FY07 with revenues of USD 4.3 bn and net income of USD 950 mn, a growth of 41% and 43%, respectively, in USD terms. The company crossed the USD 2 bn and USD 1 bn revenue mark from North America and Europe, respectively, attesting to its scale and geographic spread. TCS' existing realizations have room for expansion.

Recent services such as business intelligence, remote infrastructure management, BPO, and assurance services are seeing strong traction. We expect these services to continue to lead healthy growth in FY08E. We believe that TCS has sufficient levers to sustain margins in FY08E given the continuing trend towards offshore and improving realizations on account of pricing and productivity gains.

Our EPS forecasts of INR 55.4 in FY08 and INR 69.7 in FY09 imply an EPS CAGR of 28.4% over 2007-09. At the CMP of INR 1,250 the stock trades at a P/E of 22.6x and 17.9x for our FY08E and FY09E earnings respectively. We reiterate our 'BUY' recommendation on the stock.

Key Highlights

Q4FY07 Result Highlights

- Revenues were reported at INR 51.5 bn, up 5.9% Q-o-Q and 37.9% Y-o-Y, and net profits stood at INR 11.7 bn, up 6.2% Q-o-Q and 44.9% Y-o-Y.
- Gross margins were up 20bps Q-o-Q and 40bps Y-o-Y to 47.2%. The increase in the margin is attributed to the improvement in the utilization level and improved realizations.
- EBITDA for the quarter stood at INR 14.6 bn, up 5.9% Q-o-Q and 43.7% Y-o-Y. EBITDA margins remained stable at 28.3% Q-o-Q, but were up 110bps Y-o-Y.
- The employee headcount increase continued to remain strong. In the current quarter the company added gross 8,613 employees and net 5,991 employees. The company's total headcount now stands at 89,491.

Financials

Year to March	Q4FY07	Q3FY07	*Growth %*	Q4FY06	*Growth %*	FY08E	FY09E
Revenue (INR mn)	51,464	48,605	*5.9*	37,328	*37.9*	245,591	317,507
EBITDA (INR mn)	14,568	13,753	*5.9*	10,137	*43.7*	69,020	88,922
Net profit (INR mn)	11,728	11,047	*6.2*	8,094	*44.9*	54,213	68,198
EPS (INR)	12.0	11.3	*6.1*	8.3	*44.9*	55.4	69.7
P/E (x)						22.6	17.9
EV/EBITDA (x)						17.4	13.3
Mkt. cap/ Rev.						5.0	3.9

Edelweiss
Ideas create, values protect

April 17, 2007

Hitesh Zaveri
+91-22-2286 4424
hitesh.zaveri@edelcap.com

Parul Inamdar
+91-22-2286 4355
parul.inamdar@edelcap.com

Viju George
+91-22-2286 4400
viju.george@edelcap.com

Kunal Sangoi
+91-22-2286 4309
kunal.sangoi@edelcap.com

Reuters	:	TCS.BO
Bloomberg	:	TCS IN

Market Data

52-week range (INR)	:	2,099 / 900
Share in issue (mn)	:	978.6
M cap (INR bn/USD mn)	:	1,223 / 29,197
Avg. Daily Vol. BSE/NSE ('000)	:	1,342.1

Share Holding Pattern (%)

Promoters	:	81.7
MFs, FIs & Banks	:	2.9
FIIs	:	7.1
Others	:	8.3

- Attrition for the quarter stood at 11.3%, up from 10.8% in the previous quarter. However, the attrition in IT-services remained low at 10.6%, which is the best in the sector. BPO attrition stood at 20.2%.
- Utilization rate (excluding trainees) improved during the quarter to 79.6% from 78.2% in Q3FY07. Including trainees, utilization for the company stood at 74.7% during the current quarter compared to 75.0% in Q3FY07.
- During the current quarter the company added 43 new clients and the active client count now stands at 780, compared to 754 in the previous quarter. TCS has 297 customers contributing revenues of USD 1 mn plus, against 288 in Q3FY07 and 256 in Q4FY06. Clients with revenue contribution of over USD 50 mn have grown from nine in Q4FY06 to 14 in Q4FY07, which is particularly impressive.
- Offshore revenue contribution (41.3%) remained mainly in line with the previous quarter (41.6%).

Highlights of FY07

- TCS closed FY07 with revenues of USD 4.3 bn and net income of USD 950 mn, a growth of 41% and 43%, respectively, in USD terms.
- North American revenues crossed USD 2 bn and those from Europe crossed the USD 1 bn revenue mark.
- The company closed 12 deals of value USD 50 mn and above during the year.
- Customer addition for the year stood at 218, headcount increased by 34.6% to reach 89,500.

Confident and optimistic outlook

We sensed the management's optimism and confidence in its commentary on the current demand environment and on the traction for the company's full-service model. Muted growth seen in the current quarter with regard to North America and revenues from ADM were put down to being a quarterly phenomenon only, as momentum continues to be strong all around.

Bigger deals increasingly becoming the mainstay

TCS has closed 12 deals of over USD 50 mn in FY07. It is currently pursuing 10 deals of above USD 50 mn. The company also indicated that at least five among them are upwards of USD 100 mn in size. We believe that large-size deals will be the mainstay going forward for the company given its full-services model.

The company has indicated that it has won a follow-up order from ABN Amro Bank which is in excess of USD 50 mn.

Levers for sustaining operating margins in FY08 exist

We believe that TCS will sustain its margins on the back of:

(a) Improved overall pricing

Headroom exists to derive even greater price hikes (5-10%) from new clients. We believe that there is a meaningful differential between TCS and Infosys pricing and headroom to narrow this gap exists.

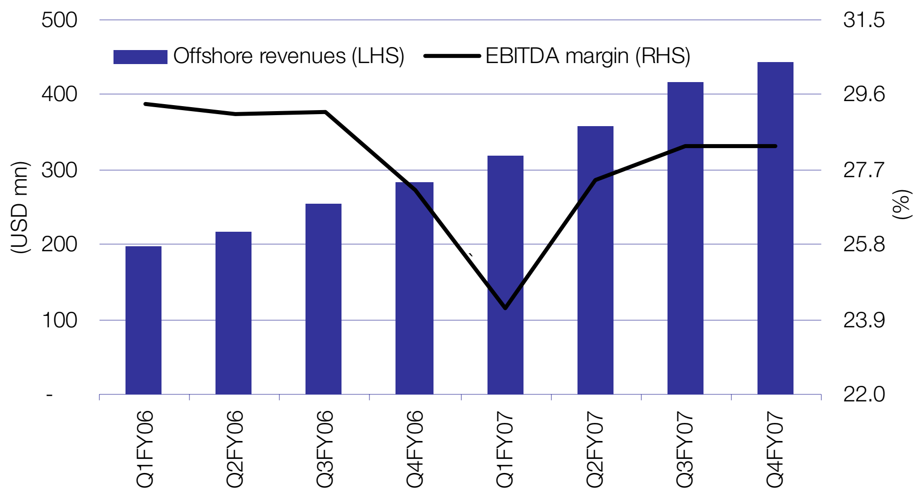
(b) Productivity improvements

TCS draws on its significant repository of project knowledge and frameworks spanning verticals and services to deliver accelerated solutions. In our view, this is an additional margin accretive factor and potentially provides a further upside of between 50bps and 60bps in FY08E.

(c) Continuing shift towards offshore

As traction builds in infrastructure management, assurance, and BPO and momentum is maintained in the traditional application maintenance offering, we believe that there will be a slight sequential marginal shift towards offshore that should support margins. EBITDA margins have shown an upward trend through FY07 supported by increasing offshore revenues (see chart 1).

Chart 1: Offshore revenues and EBITDA margins through FY07



Source: Company, Edelweiss research

(d) Incremental growth in products in banking products business

TCS has indicated that it has recorded banking product revenues of about USD 120 mn in FY07 with 51 client wins during the fiscal. The outlook for the banking products business seems buoyant. The company has bagged a significant order from the Bank of China and a significant portion of that project is product-related revenues. Our estimates show that decent growth in banking products could offer between 50bps and 100bps leverage in operating margins.

These factors should help offset margin pressures that arise on account of wage inflation (12-15% offshore and 3-5% onsite) and sustain margins.

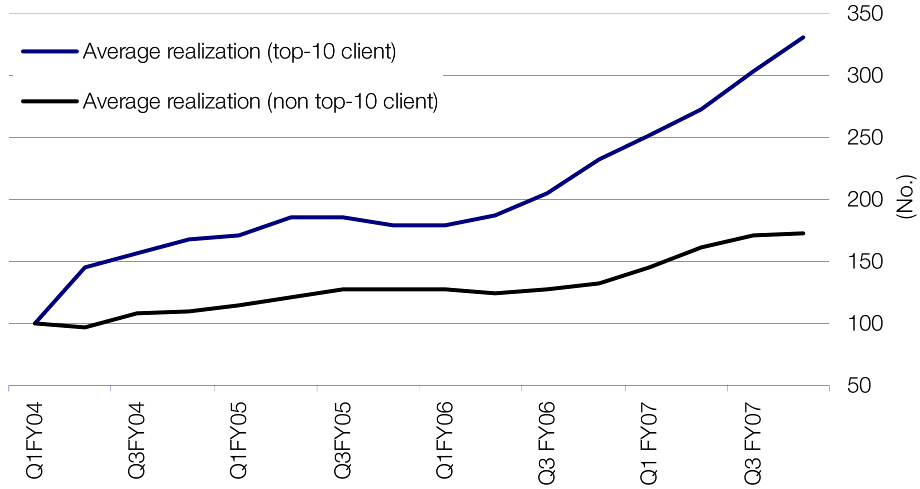
Continued appreciation of INR versus the USD beyond a range could have a dampening impact on margins.

* Making large accounts even larger with cross selling

TCS is continuously increasing its contribution from service lines such as business intelligence, infrastructure services, assurance services, and BPO which contributed nearly 25% of revenues in Q4FY07, significantly up from 15.8% in FY06. This growing revenue stream enables the company to further cross sell into existing customers, thus making big customers even bigger. The company has marked out remote infrastructure management as an offering that is driving new client acquisition as well as large deal pipeline.

TCS' initiatives in further consolidating its share of revenues from its major clients can be seen from chart 2 that maps out the growth of the average realization per client in the top-10 category versus that for the non-top 10 clients. The size is indexed to Q1FY04 levels for purposes of comparison.

Chart 2: Progress of average size of the client through FY04-07 (indexed to FY04)



Source: Company, Edelweiss research

Growth broad-based across verticals and services

Tables 1 and 2 show how various service lines and verticals have fared through FY04-07. The BFSI vertical has garnered 44% of incremental revenues from 2004 maintaining its traditional dominance, while telecom and retail are the new growth verticals. We believe that growth in these verticals is powered by an array of services such as BI, infrastructure management, assurance services, and BPO, which we have mentioned earlier (see table 2).

Table 1: Revenue CAGR progress over 2004-07 from verticals in INR mn

	FY04	FY07	FY04-07 (CAGR)	% share of incremental rev.
BFSI	28,491	78,611	40.3	43.5
Manufacturing	14,245	28,648	26.2	12.5
Telecom	11,396	31,502	40.3	17.5
Life Sciences & Heathcare	2,422	8,098	49.5	4.9
Retail & Distribution	4,772	13,154	40.2	7.3
Transportation	3,134	6,072	24.7	2.6
Energy & Utility	1,994	4,541	31.6	2.2
Others	4,772	15,708	48.8	9.5
Total	71,227	186,334	37.8	100.0

Source: Company, Edelweiss research

Table 2: Several services demonstrate healthy growth in recent quarters

(INR mn)	Q1FY06	Q4FY07	CQGR (%)
Application dev. & maint.	17,649	26,401	6.9
Business intelligence	2,214	5,043	14.7
Engineering and industrial services	2,007	2,779	5.6
Inftrastructure services	1,210	3,088	16.9
Enterprise solutions	4,161	6,330	7.2
Global consulting	738	1,801	16.0
Asset leveraged solutions	797	1,595	12.3
Assurance services	354	1,338	24.8
Business process outsourcing	384	3,088	41.6
Total	29,513	51,464	9.7

Source: Company, Edelweiss research

* Valuations

We forecast TCS to post healthy EPS growth of 28.4% over FY07-09E. Our FY08 EPS forecast of INR 55.4 requires an EPS CQGR of 5.8% through FY08, relatively undemanding in our view.

At the CMP of INR 1,250 the stock trades at a P/E of 22.6x and 17.9x for our FY08E and FY09E earnings, respectively. We reiterate our **'BUY'** recommendation on the stock.

Financial snapshot (INR mn)

Year to March	Q4FY07	Q3FY07	*Growth %*	Q4FY06	*Growth %*	FY07	FY08E	FY09E
Total revenues	51,464	48,605	*5.9*	37,328	*37.9*	186,334	245,591	317,507
Cost of revenues	27,177	25,758	*5.5*	19,850	*36.9*	99,886	128,097	167,124
Gross profit	24,287	22,847	*6.3*	17,479	*39.0*	86,447	117,494	150,383
SG&A	9,587	8,989	*6.6*	7,234	*32.5*	35,385	47,264	59,711
R&D	133	105	*26.8*	107	*23.5*	432	1,210	1,750
EBITDA	14,568	13,753	*5.9*	10,137	*43.7*	50,630	69,020	88,922
Depreciation and amortization	1,395	1,080	*29.2*	861	*62.0*	4,184	6,030	7,007
EBIT	13,173	12,673	*3.9*	9,276	*42.0*	46,446	62,990	81,916
Other income	898	300	*199.5*	16	*5,351.7*	1,943	720	1,080
PBT	14,070	12,972	*8.5*	9,293	*51.4*	48,389	63,710	82,996
Tax	2,188	1,828	*19.7*	896	*144.2*	6,700	8,975	14,109
Adjusted net profit	11,882	11,144	*6.6*	8,397	*41.5*	41,688	54,735	68,886
Minority interest	(158)	(115)	*37.9*	(103)	*53.3*	(417)	(522)	(689)
Equity in net earnings of affiliates	4	17	*(79.1)*	33	*(89.2)*	44	-	-
Extraordinary income/expense	-	-		(232)		-	-	-
Reported net profit	11,728	11,047	*6.2*	8,094	*44.9*	41,315	54,213	68,198
EPS - basic	12.0	11.3	*6.1*	8.3	*44.9*	42.2	55.4	69.7
as % of net revenues								
Gross profit	47.2	47.0		46.8		46.4	47.8	47.4
SG&A	18.6	18.5		19.4		19.0	19.2	18.8
EBITDA	28.3	28.3		27.2		27.2	28.1	28.0
Adjusted net profit	23.1	22.9		22.5		22.4	22.3	21.7
Reported net profit	22.8	22.7		21.7		22.2	22.1	21.5
Tax rate	15.6	14.1		9.6		13.8	14.1	17.0

Company Description

TCS is India's largest and among the oldest IT companies which commenced operations in 1968. It provides a comprehensive range of IT services to industries such as banking and financial services, insurance, manufacturing, telecommunications, retail and transportation. With presence in 34 countries, TCS is positioned to deliver its services seamlessly. TCS has a large diversified client base (780 active clients) which includes seven of the Fortune Top 10 companies. TCS' employee force stands at 89,491 and its revenues for the last twelve months (TTM) stood at INR 186.3 bn (USD 4.3 bn).

Investment Theme

As India's largest and most experienced IT services firm, TCS is well positioned to benefit from the growing demand for offshore IT services. TCS is a serious contender for winning large deals as it has more experience than any of its peers in implementing large, complex, mission critical projects. TCS has multiple margin levers at its disposal, which we believe, will sustain its margins, shielding it from continued pressures on account of wage increases across the industry. These drivers include transition to offshore, leveraging fixed price business, and higher client mining.

Key Risks

Key risks to our investment theme include – a) sustained slowdown in US, b) maintaining the margins while pursuing large deals, c) Significant increase in the salary hikes and attrition rate creating cost pressures, and d) Any substantial appreciation of rupee against US dollar, Euro and GBP.

WIPRO

INR 570

Closing out FY07 well, signs for a good FY08 ACCUMULATE

April 20, 2007

Hitesh Zaveri
+91-22-2286 4424
hitesh.zaveri@edelcap.com

Parul Inamdar
+91-22-2286 4355
parul.inamdar@edelcap.com

Viju George
+91-22-2286 4400
viju.george@edelcap.com

Kunal Sangoi
+91-22-2286 4309
kunal.sangoi@edelcap.com

Wipro's Q4FY07 results were ahead of our expectations. Revenues were reported at INR 43.3 bn, up 9.4% Q-o-Q and 41.9% Y-o-Y; net profit stood at INR 8.6 bn, up 15.6% Q-o-Q and 44.2% Y-o-Y. Revenues from all the segments have posted a healthy performance - Global IT business in USD terms grew by 7.8% Q-o-Q and 34.1% Y-o-Y to USD 690.7 mn (as against guidance of USD 685 mn). The Indian and Asia Pac IT business in INR terms reported a significant growth of 15.8% Q-o-Q and 47.2% Y-o-Y on top of an already strong Q3FY07 performance (growth of 34.7% Q-o-Q and 74.2% Y-o-Y). The BPO segment recorded healthy sequential growth rates, which in our view is encouraging as it arrests a period of relatively tepid sequential growth performance in recent quarters. EBIT margins for the quarter at 19.2% were down 60 bps from Q3FY07 largely due to higher spend on SG&A.

We expect the company to maintain its growth momentum backed by

- Good outlook in many of the company's key verticals, notably technology (telecom service providers in particular), financial services, retail and utilities
- Strong traction seen in the new services lines such as infrastructure management and testing services and
- Ability to integrate the umbrella of acquisitions and drive profitability from them.

We remain encouraged by the company's ability to capitalize on faster-growing segments such as package implementation and testing and robustly grow such services at over 50% CAGR over the last three years. In addition, factors such as improved profitability of the acquired entities, 3-4% improved billing rates in the contracts that are being renewed, and improving bulge mix of the employee pyramid are all aiding the company in arresting the decline in the margins.

The guidance for revenues of global IT-Services in Q1FY08 of USD 711 mn seems relatively muted (2.9% growth Q-o-Q over Q4FY06) but management has indicated that growth is likely to be relatively back-ended through FY08.

At CMP of INR 570, the stock trades at P/E of 22.1x and 17.8x and EV/EBITDA of 16.8x and 12.9x for our FY08E and FY09E earnings, respectively. We maintain our 'ACCUMULATE' rating on the stock.

Reuters	:	WIPR.BO
Bloomberg	:	WPRO IN

Market Data

52-week range (INR)	:	690 / 383
Share in issue (mn)	:	1,459.0
M cap (INR bn/USD mn)	:	824.0 / 19,581.5
Avg. Daily Vol. BSE/NSE ('000)	:	1,353.4

Share Holding Pattern (%)

Promoters	:	79.6
MFs, FIs & Banks	:	2.0
FIIs	:	5.1
Others	:	13.3

Financials

Year to March	Q4FY07	Q3FY07	*Growth %*	Q1FY06	*Growth %*	FY08E	FY09E
Revenue (INR mn)	43,345	39,636	*9.4*	30,542	*41.9*	196,038	245,508
Gross profit (INR mn)	13,528	12,276	*10.2*	9,482	*42.7*	62,461	79,135
EBITDA (INR mn)	9,449	8,945	*5.6*	7,055	*33.9*	44,810	56,407
EBIT (INR mn)	8,344	7,849	*6.3*	6,181	*35.0*	39,814	50,562
Net profit (INR mn)	8,614	7,450	*15.6*	5,975	*44.2*	37,072	46,133
EPS basic (INR)	6.0	5.2	*15.3*	4.2	*42.4*	25.8	32.0
P/E (x)						22.1	17.8
EV/EBITDA (x)						16.6	12.7
Market cap / Rev. (x)						4.2	3.3

Q4 FY07 result highlights

- Total revenues at INR 43.3 bn were up 9.4% QoQ and 41.9% YoY. Net profits grew at INR 8.6 bn were up 15.6% QoQ and 44.2% YoY.
- Global IT revenues stood at USD 690.7 mn, up 7.8% QoQ as against the guidance of USD 685 mn. The company has guided to revenues of USD 711 mn (2.9% QoQ) for the next quarter, which is muted.
- BPO during the quarter showed strong growth of 12.5% QoQ at USD 59.6 mn.
- Gross profit margins improved by 20 bps QoQ to 31.2%. EBIT during the quarter grew by 6.3% QoQ and 35.0% YoY. The EBIT margins declined during the quarter by 60 bps at 19.2%. This is on account of higher spent in the SG&A, which increased from 10.7% of revenues in Q3 to 11.7% in the current quarter.
- The company added 44 new clients during the current quarter, and now that active client count stands at 620. The no. of USD 1 mn clients for the company stand at 262 compared to 253 in the previous quarter and 221 a year ago.
- Wipro added 1,642 people in the current quarter (1,041 in IT services and 601 in BPO) taking the total headcount to 67,818 (50,354 – IT and 17,464 – BPO)
- Attrition for the quarter inched up at 16.9% from 16.0% in the earlier quarter.

FY07 highlights

- Wipro ended the year FY07 with revenues of INR 150 bn, up 41%. Global IT services and products account for 74% at INR 111 bn and grew at 38% YoY. Adjusted net profits for FY07 at INR 29.2 bn grew at 43.9% over FY06. EBIT margins for Global IT-Services and products for FY07 stood at 23.8% versus 24% in FY06.
- Acquisitions contributed about 5% of the total revenues in Global IT and products and stripping out acquisitions the Global IT business grew at 33%.
- The overall EBIT margins for the acquisition is ~ 4.2%, which is currently margin dilutive but on an improving trend.

Snapshot of financial performance over FY04-FY07

Table 1 gives a snapshot of the financial performance of Wipro over FY04-07 relative to its peers Infosys and TCS indexed to FY04. We believe the company has grown revenues and profits comparably with its direct peers. Table 1 also provides a snapshot of comparative size metrics indexed to Infosys (we set Infosys as 100 and indexing absolute size of revenues and profits of TCS and Wipro to Infosys base).

Table 1: Comparing Wipro's progress on revenues and profits over FY04-07 with its peers

Revenues

				Indexing to Infosys	
	FY04	FY07	CAGR (04-07)	FY04	FY07
Wipro	100	256	36.7	120	108
Infosys	100	286	42.0	100	100
TCS	100	262	37.8	147	134
Wipro*	100	255	36.7	90	80

Profits

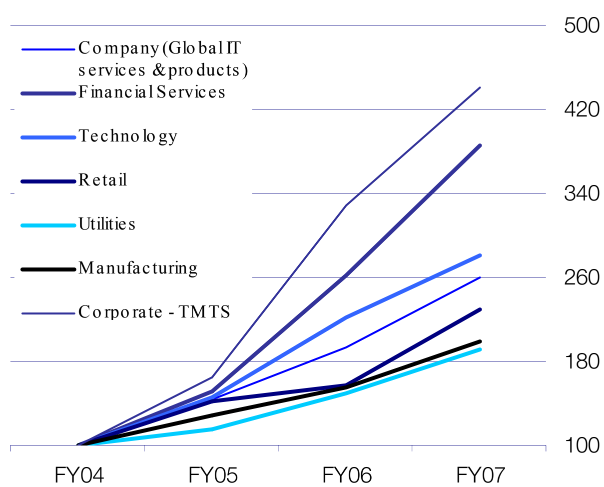
				Indexing to Infosys	
	FY04	FY07	CAGR (04-07)	FY04	FY07
Wipro	100	284	41.6	82	75
Infosys	100	310	45.9	100	100
TCS	100	252	36.2	132	107

Source: Company, Edelweiss research   ** applicable to Global IT services and products only*

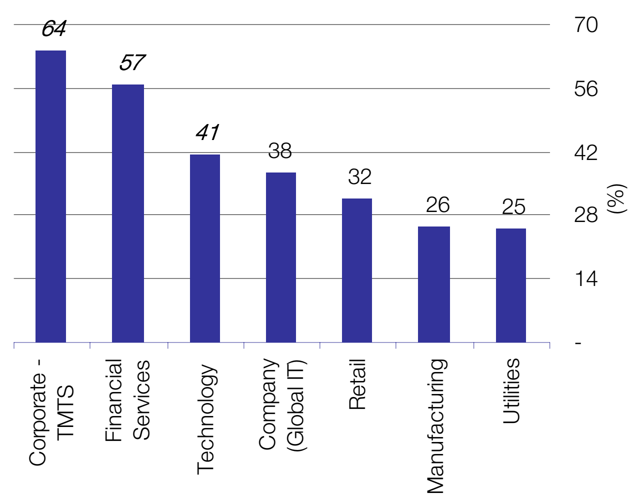
Notably, during this period the company has been able to establish several growth engines that will likely power growth ahead. The company has creditably substantially managed to close the perceived gap in the in key mainstream enterprise application areas by its ability to realize growth in faster-growing opportunities such as package implementation and testing.

Charts 1 and 2 break down the components of this growth over FY04-07 by verticals and horizontals. The performance of Financial Services, Technology and general corporate (technology, media, transportation and services) has all grown ahead of 40% CAGR over 2004-2007 and remained above-company-average.

Chart 1: Growth of verticals indexed to their 2004 levels

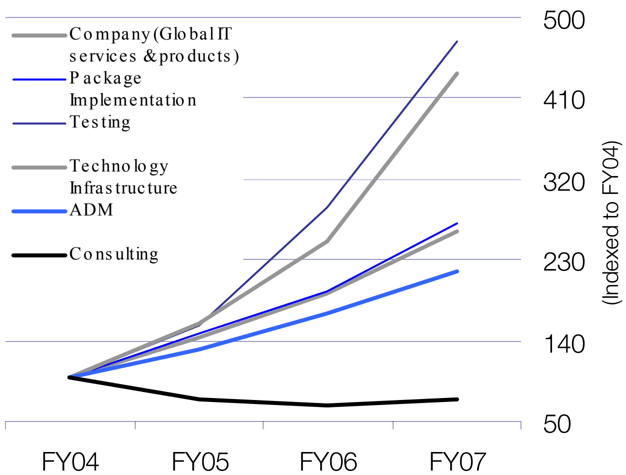


Growth of verticals as CAGR (2004-2007): Corporate, financial services and technology outperform

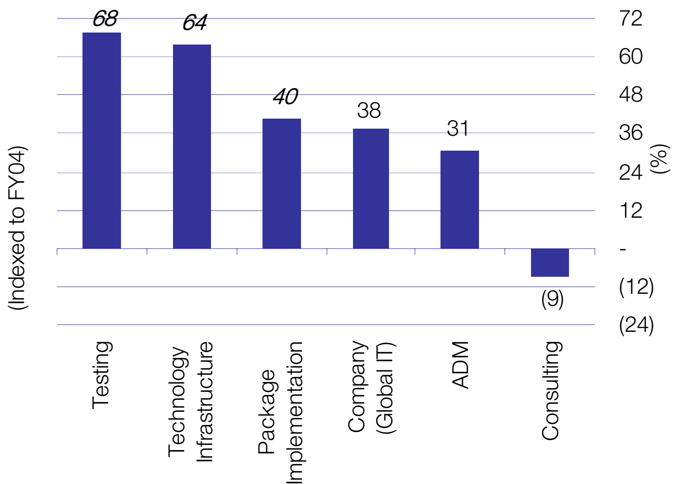


Source: Company, Edelweiss research

Chart 2: Growth of services indexed to their 2004 levels



Growth of services as CAGR (2004-2007): Testing and Infrastructure Management lead the pack



Source: Company, Edelweiss research

We believe that this deeper vertical penetration has been enabled by significant growth in the emerging service areas such as package implementation (64% CAGR), testing (64%), and technology infrastructure (40%) as chart 2 illustrates. Consulting has been the only significant laggard.

Acquisitions delivering their goals

Wipro has consummated six acquisitions in Global IT services and products, one in domestic services and two joint venture partnerships. Revenues from acquisitions have grown over 14% sequentially over Q3FY07 and at about INR 6 bn in FY07 now account for close to 6% of Global IT services and products by revenues. Notably, acquisitions are profitable (net profit level) and their continually improving profitability will likely be one of the margin levers during FY08.

More significantly, Wipro, armed with the confidence of integrating multiple acquisitions into its fold, is prepared to make larger ticket-size acquisitions that can add to or sharpen domain competencies and/ or bolster its consulting skills.

Pursuing multiple mega deals that are sector and geography agnostic

Wipro has indicated that it is in the fray pursuing 10-15 mega deals that cut across geographies such as US, Europe and Asia. Moreover, these deals are spread across service lines such as BPO, technology infrastructure and multiple service-line deals. We believe that Wipro has relatively better credentials in larger deals containing a significant component of infrastructure management given its strengths and record of accomplishment here.

Client mining is good but could be further better for the top-10 clients

Table 2 lays out the progress of client categories of Wipro compared to Infosys. We would draw attention to the superior manner in which Infosys has mined its major accounts (top-10) over time. Infosys' per client realization in the top-10 category is more than 50% greater than it is for Wipro in FY07 while that in the non-top 10 category is about 40% higher. We recognize that establishing comparisons on the ability to mine the average non top-10 account relative to Infosys may not be wholly appropriate given Wipro's acquisition strategy versus Infosys' organic growth strategy.

Table 2: Examining Wipro's per client average realization over FY04-07 relative to Infosys

		FY04	FY07
Wipro	Top-10	100	197
	Non top-10	100	184
Infosys	Top-10	100	255
	Non top-10	100	245

Average client size (US$mn)

		FY04	FY07
Wipro	Top-10	31.0	61.0
	Non top-10	1.7	3.0
Infosys	Top-10	39.3	99.7
	Non top-10	1.8	4.3

Source: Company, Edelweiss research

Interestingly, Table 3 shows that TCS, Infosys and Wipro fare very comparably when it comes to mining clients across various slabs. In FY07 all three

- have comparable number of USD 1 mn plus clients,
- are comparable in terms of number of USD 20 mn plus accounts, USD 5 mn plus accounts as a % of million dollar clients and
- fare equally well on a more significant mining benchmark measure such as USD 10 mn plus accounts as a % of clients billing in excess of USD 5 mn.

Table 3: Infosys, Wipro and TCS fare equally on million dollar client metrics (FY04-07)

	FY04	FY05	FY06	FY07
Number of USD 1 mn+ clients				
Wipro	132	168	221	262
Infosys	131	166	221	275
TCS	258	274	288	297
Number of USD 20 mn+ clients				
Wipro	12	19	29	40
Infosys	12	19	26	36
TCS	31	33	32	37
USD 5mn+ clients as % of USD 1 mn+ clients				
Wipro	33	45	37	41
Infosys	39	43	37	39
TCS	38	38	40	40
USD 10 mn+ clients as % of USD 5 mn+ clients				
Wipro	56	57	67	68
Infosys	49	59	67	66
TCS	67	67	65	63

Source: Company, Edelweiss research

We believe that the difference between Wipro and the other two companies lies in two aspects namely that

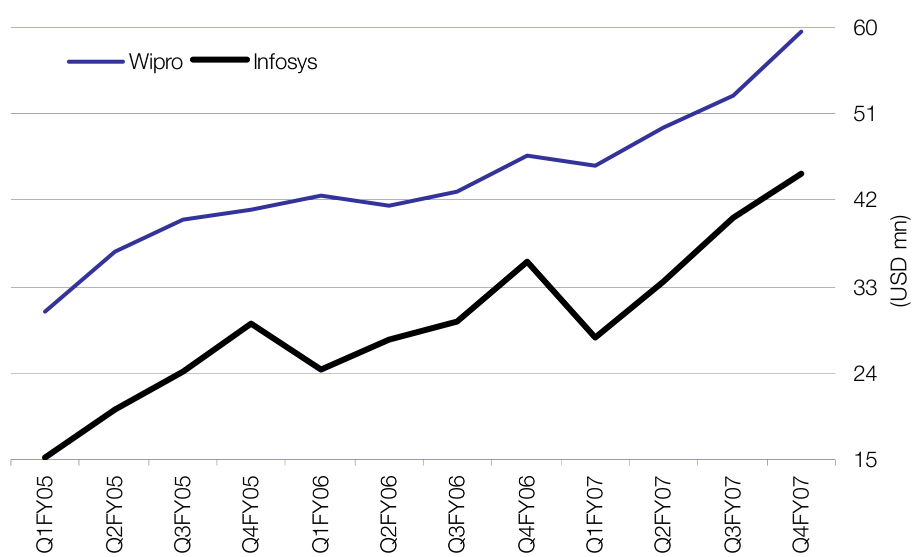
- Wipro has a greater proportion of sub-optimal clients (below USD 1 mn) that comprise almost 60% of its overall client base, which for Infosys is 45%. As we pointed out earlier, we attribute this to Wipro's acquisition strategy.
- Infosys and TCS have many more clients in the USD 50 mn plus category than Wipro. We believe that of late, Infosys has had more success in scaling up accounts to mega sizes upwards of USD 50 mn (to beyond the USD 100 mn).

BPO hits higher sustainable margin band powered by value migration

Wipro's BPO division posted revenues of USD 207 mn for FY07 marked by improving profitability. Gross margins stood at 34% for FY07, a significant improvement over 26% in FY06. Wipro's restructuring of its BPO business by rationalizing its exposure to voice and technical support seems substantially complete with focus now on enriching its business mix to include a greater proportion of vertically-oriented solutions and business based on transaction-based pricing. Q4FY07 EBIT margins for Wipro's BPO at between 22%-24%, represents a significant uptick over levels seen through FY06 and FY07. Notably, the company indicated that and revenues have grown 50% over FY05-07 with comparable headcount in FY05, (17,464 personnel in BPO in FY07). With the rationalization in this line of business now complete, focus will be on growth and achieving industry growth at the minimum.

In FY07, Wipro's BPO is still ahead of Infosys' BPO in revenues by 40% despite the latter's higher sequential growth through the quarters (see chart 3).

Chart 3: Traction of Wipro's BPO business versus Infosys through FY05-07 (in USD mn)



Source: Company, Edelweiss research

Initial investments bearing fruits in growing newer high-opportunity services ahead of competition

Early investments in other new service lines such as Testing and Infrastructure management have provided it with a head-start over its peers. In Infrastructure management, for example, Wipro, with a quarterly USD 80 mn in revenue, is ahead of its peers with only TCS close behind (USD 70 mn in Q4FY07). In testing too, Wipro is by far the leader in product testing related to the telecom/embedded space. In Q4FY07, revenue from both RIMS and Testing exhibited a robust, 82.3% and 48.3% Y-o-Y growths, respectively.

We regard Wipro's ability to uncover new segments of faster growth across verticals as best-in-class. The company is gearing up to serve as a one stop integrated end-to-end solutions provider.

Guidance for Q1FY08 muted but not a concern

Wipro has guided to revenues in global IT services and products of USD 711 mn in Q1FY08 (3% growth Q-o-Q). This seems muted but we believe that this should be seen in the context of two factors:

- Wipro has had stronger quarters after the first quarter of the fiscal. Guidance for later quarters especially Q3 and Q4 tends to be healthier.
- Wipro had guided to comparable revenue growth (about 4%) for Q1 of the fiscal in the last two years.

Moreover, the company assumes this to be completely organic growth and impact of any acquisition in the first fiscal would be over and above this.

Client traction on a good wicket

The company's account management initiatives give us a sense of confidence. With an active customer base of 620, net additions to its client roster stood at 111. The client addition shows a good balance between the enterprise and technology domains. For Q4FY07, the company added 44 clients, divided equally between the enterprise and technology domains (22 each). Some of the key clients in the telecom equipment vendor space are not scaling up as per expectations. The company has indicated that this is largely because of the consolidation being witnessed in the Telecom Equipment vendor space, which largely dominates this bucket of its clientele. Post this consolidation, these clients too should start ramping up.

Valuations

We believe Wipro's initiatives and focused expansion will help it to consistently post healthy performance. We expect the company to grow its EPS by 26% CAGR over FY07-09E. At CMP of INR 570, the stock trades at P/E of 22.1x and 17.8x and EV/EBITDA of 16.8and 12.9x for our FY08E and FY09E earnings, respectively. We maintain our 'ACCUMULATE' rating on the stock.

Financials snapshot (INR mn)

Year to March	Q4FY07	Q3FY07	*Growth %*	Q4FY06	*Growth %*	FY07	FY08E	FY09E
Global IT	30,357	28,873	*5.1*	22,892	*32.6*	110,922	142,850	178,911
India and AsiaPac IT	7,800	6,734	*15.8*	5,297	*47.2*	23,888	32,234	41,260
Consumer care & lighting	2,107	1,931	*9.1*	1,483	*42.1*	7,559	9,656	11,781
Others	3,081	2,099	*46.8*	870	*254.1*	7,063	11,297	13,556
Revenues	43,345	39,636	*9.4*	30,542	*41.9*	149,431	196,038	245,508
Global IT	19,873	19,041	*4.4*	15,193	*30.8*	72,991	92,786	116,325
India and AsiaPac IT	6,091	5,250	*16.0*	4,269	*42.7*	18,555	25,048	31,664
Consumer care & lighting	1,347	1,260	*6.9*	933	*44.3*	4,905	6,142	7,540
Others	2,506	1,809	*38.5*	665	*276.9*	5,749	9,602	10,845
Total direct cost	29,817	27,360	*9.0*	21,060	*41.6*	102,200	133,577	166,374
Gross profit	13,528	12,276	*10.2*	9,482	*42.7*	47,231	62,461	79,135
SG&A	5,083	4,261	*19.3*	3,212	*58.3*	16,812	21,917	27,742
R&D	63	76	*(17.2)*	61	*3.7*	268	380	450
Amortization	38	90	*(58.1)*	28	*34.4*	269	350	380
EBIT	8,344	7,849	*6.3*	6,181	*35.0*	29,882	39,814	50,562
Depreciation	1,067	1,006	*6.1*	846	*26.2*	3,931	4,646	5,465
EBITDA	9,449	8,945	*5.6*	7,055	*33.9*	34,082	44,810	56,407
Other income	835	770	*8.5*	425	*96.5*	2,888	2,490	3,100
Foreign exchange gain / (loss)	(9)	(211)	*(96.0)*	212	*(104.0)*	(236)	-	-
Earnings before tax and minority int.	9,170	8,408	*9.1*	6,818	*34.5*	32,535	42,304	53,662
Tax	596	1,080	*(44.8)*	898	*(33.7)*	3,723	5,707	8,049
Adj. net income	8,575	7,328	*17.0*	5,920	*44.8*	28,812	36,597	45,613
Extraordinary item	-	-		-		39	-	-
Equity in earnings of affiliates	39	121	*(67.7)*	55	*(28.8)*	318	475	520
Reported net income	8,614	7,450	*15.6*	5,975	*44.2*	29,169	37,072	46,133
EPS basic (INR)	6.0	5.2	*15.3*	4.2	*42.4*	20.4	25.8	32.0
% of revenue								
Gross profit	31.2	31.0		31.0		31.6	31.9	32.2
SG&A	11.7	10.7		10.5		11.3	11.2	11.3
EBITDA	21.8	22.6		23.1		22.8	22.9	23.0
EBIT	19.2	19.8		20.2		20.0	20.3	20.6
Reported net profit	19.9	18.8		19.6		19.5	18.9	18.8
Tax rate	6.5	12.8		13.2		11.4	13.5	15.0

Company Description

Wipro is India's leading Indian company with business interests in IT and BPO services exports, domestic hardware, consumer lighting and consumer care. It has one of the widest range of services, including systems integration; IT enabled services, package implementation, software application development and maintenance, and R&D services. Wipro is the first P CMM Level 5 and SEI CMM Level 5 certified IT services company in the world. It has more than 590 clients spanning the BFSI, Manufacturing, Retail, Utilities and Telecom verticals. Its IT services exports team has more than 54,500 employees and BPO operation has around 18,000 employees and its revenues for the last twelve months (TTM) stood at INR 149.4 bn (USD 3.3 bn).

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Investment Theme

Industry revenues are forecasted to grow at 25-30% over FY10 and as a dominant player Wipro is expected to gradually increase its share of the total pie. Wipro recently has been at the forefront in its 'string of pearls' acquisition strategy. Early investments in new service lines such as BPO, Infrastructure management, Testing, and so on highlight the company's endeavor to be looked upon as a one stop end to end integrated solutions provider. Successful transition in the BPO business from voice to non-voice business is a good example of this focus. Being the leader in infrastructure-management and testing services too opens up good opportunities for the company, who along with its peers is in pursuit of the multiple mega offshoring deals in the industry. We expect Wipro's presence in significant long term potential domains will enable it to grow its revenues and net profits at a CAGR of 28.2% and 25.8%, respectively over FY07-09E.

Key Risks

Key risks to our investment theme include – a) sustained economic slowdown in US, b) maintaining the margins while pursuing large deals, c) Significant increase in the salary hikes and attrition rate creating cost pressures, and d) Any substantial appreciation of rupee against US dollar, Euro and GBP.

Edelweiss Securities
14th Floor, Express Towers,
Nariman Point, Mumbai – 400 021
Board: (91-22) 2286 4400
Email*: research@edelcap.com*

Naresh Kothari – 2286 4246	Head, Institutional Equities
Vikas Khemani – 2286 4206	Head, Institutional Equities

INDIA RESEARCH			SECTOR
Shriram Iyer	-	2286 4256	Head – Research
Gautam Roy	-	2286 4305	Airlines, Textile
Ashutosh Goel	-	2286 4287	Automobiles, Auto Components
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Prakash Kapadia	-	4097 9843	Mid Caps
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Nimish Mehta	-	2286 4295	Pharmaceuticals, Agrochemicals
Manika Premsingh	-	4019 4847	Economist
Sunil Jain	-	2286 4308	Alternative & Quantitative
Yogesh Radke	-	2286 4328	Alternative & Quantitative

INSTITUTIONAL SALES		
Nischal Maheshwari	-	2286 4205
Rajesh Makharia	-	2286 4202
Shabnam Kapur	-	2286 4394
Balakumar V	-	(044) 4263 8283
Ashish Agrawal	-	2286 4301
Nikhil Garg	-	2286 4282
Swati Khemani	-	2286 4266
Neha Shahra	-	2286 4276
Priya Ramchandran	-	2286 4389
Anubhav Kanodia	-	2286 4361
Tushar Mahajan	-	2286 4439
Harsh Biyani	-	2286 4419
Nirmal Ajmera	-	2286 4258
Ankit Doshi	-	2286 4671
Dipesh Shah	-	2286 4434

Email addresses: firstname.lastname@edelcap.com **e.g.** naresh.kothari@edelcap.com *unless otherwise specified*

RATING INTERPRETATION

Buy	Expected to appreciate more than 20% over a 12-month period	Reduce	Expected to depreciate up to 10% over a 12-month period
Accumulate	Expected to appreciate up to 20% over a 12-month period	Sell	Expected to depreciate more than 10% over a 12-month period
Trading Buy	Expected to appreciate more than 10% over a 45-day period	Trading Sell	Expected to depreciate more than 10% over a 45-day period