Information Technology

Rear View (JAS-11): Reaffirming strength

Sector Update

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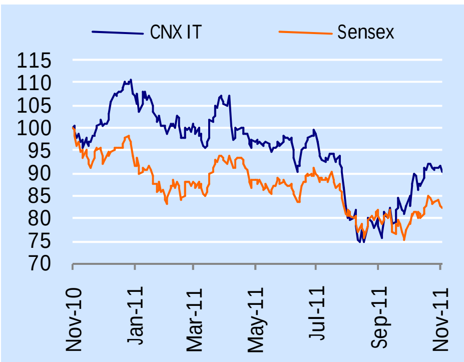
CNX IT v/s. Sensex



Source: Bloomberg

Stock Performance

(%)	**1M**	**6M**	**12M**
Sensex	**3.8**	**(7.1)**	**(17.6)**
CNX IT Index	**6.4**	**(6.5)**	**(10.0)**
eClerx Services	5.5	8.9	22.7
Geometric	(0.7)	(28.1)	(45.7)
HCL Tech.	6.0	(15.2)	6.1
Infosys Tech.	10.6	(4.4)	(9.2)
KPIT Cummins	7.1	(5.4)	(3.2)
Mphasis	2.0	(25.9)	(42.8)
MindTree	17.3	10.5	(23.0)
Patni Computer	24.4	(6.3)	(23.2)
Persistent Systems	6.8	(19.5)	(23.7)
Polaris Software	5.4	(34.2)	(17.9)
Rolta India	5.0	(44.1)	(57.5)
TCS	8.6	(0.7)	6.2
Tech Mahindra	3.9	(12.0)	(19.3)
Wipro	11.8	(13.1)	(11.2)

Performance ahead of low running expectation has set the tone for Tier-1 Indian IT Services (TCS, Infosys, Wipro, HCLT). Volume growth in mid-single digit along with margin impetus from rupee depreciation has pushed margins. The deal wins indicates little trouble for Tier-1. Moreover, better-than-expected result for global tech major and deal flow (TPI) in Q3CY11 further reaffirms strength. We remain confident 20%+USD revenue growth. **We reiterate 'BUY' on HCLT, Infosys and TCS.**

- **Performance exceeded low running expectation:** After quarters of underperformance, Wipro led the growth pack reporting 4.6% QoQ (@cc 5.5%) growth, followed by TCS 4.7% QoQ (@cc 5.2%), Infosys 4.5% QoQ (@cc 5%) and HCLT lagged with 4.1% QoQ (@cc 5.1%) growth. The volume growth for Tier-1 was 5.3% QoQ, in-line with our view of mid-single-digit growth, aided by Wipro (6.0%), TCS (5.8%), Infosys (4.4%) and HCLT (4%). However, the management tone continues to be cautious on the overall environment.

- **What surprised us? Positively 1)** Currency depreciation and operational efficiency pushed margin expansion by 22bps QoQ **2)** Rupee revenue growth was 7.5% QoQ, whereas USD revenue growth was 4.5% QoQ **3)** Blended pricing muted QoQ for Tier-1 **4)** 190 new clients added by Tier-1, strongest in the last 23 quarters **5)** Lateral hiring de-grow QoQ for the first time in last nine quarters **6)** Total employee grew by 5.5% QoQ, in-line with volume growth **7)** Onsite revenue contribution grew by 7bps, 8th consecutive quarter of uptick (excluding OND-10) **8)** Total active clients grew by 76 clients for Tier-1, strongest in last 13 quarters. **Negatively 1)** PAT Margin decline of 74bps QoQ, due to forex loss **2)** Commentary on deal pipeline continues to be cautious **3)** Top-10 clients grew by 3.8% QoQ, 4th consecutive quarter of slower than overall growth **4)** Revenue productivity (Revenue/Billed man-months) declined by -0.7% QoQ.

- **Fresher hiring for FY13:** Infosys and TCS has guided for 23k and 45 fresher hiring guidance for FY13, respectively. The guidance for Infosys looks conservative.

- **What to expect? 1)** We expect deal pipeline to improve further **2)** We expect EBITDA margin to be stable as currency fluctuates and companies absorb cost **3)** We see attrition and cost pressure easing out further.

- **Better than expected result from Accenture, Capgemini, Cognizant, and Logica:** Global IT Services majors have reported quarterly results ahead of consensus, expectation reaffirming strength in demand.

- **Remain positive on Tier-1:** We reiterate our positive stance on Tier-1. We also revise our estimates upward by 2-5% for FY12 and FY13 due to weaker rupee. ***We reiterate our 'BUY' on HCLT, Infosys and TCS and 'Accumulate' on Wipro, with a target price of Rs550, Rs3,090, Rs1,230 and Rs410, respectively.***

Exhibit 1: Pecking order – HCL Tech, Infosys and TCS

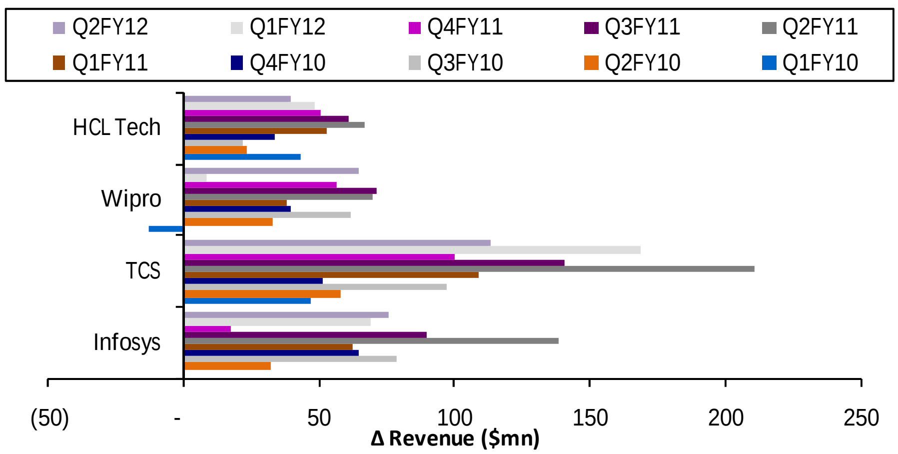
	Revenues (Rs m)		EPS (Rs)		CMP (Rs)	Target (Rs)	Rating	Upside	EPS CAGR
	2012	2013	2012	2013					
Infosys Technologies	331,186	389,543	142.9	163.3	2,775	3090	BUY	11.4%	17.0%
TCS	480,568	599,549	52.0	64.5	1,134	1230	BUY	8.4%	23.4%
Wipro	353,663	405,298	22.0	24.0	382	410	Accumulate	7.3%	12.0%
HCL Technologies	195,925	247,805	31.1	37.5	427	550	BUY	28.8%	21.3%

Source: Company Data, PL Research *(All prices as on November 11, 2011)*

Revenue – Reinforcing strength in demand

Q2FY12 witnessed one of the most volatile sessions so far as stock prices are concerned. The concern loomed as S&P downgraded US credit rating and got further compounded as visa applications declined. Due to lack of any data-points, the bears started building a de-growth scenario for FY13 if not for FY12. The bounce back in incremental revenue in Q1FY12 was deemed as one-off. However, the strength in demand is demonstrated by sustaining the incremental revenue at the same level. We believe that the companies are still operating in healthy demand environment. *We are little perturbed by dried up deal pipeline in H1CY11. Moreover, supportive nature of currency should push the operating performance. We believe due to stronger margin levers, HCLT and Infosys continue to remain our top picks. Moreover, we reiterate our 'BUY' on TCS* as well. We believe that window of opportunity for switch from TCS to Infosys was limited between Infosys and TCS result.

Exhibit 2: Demand environment looks sustainable



Source: Company Data, PL Research

Fresher Hiring Guidance FY13 – Infosys @23k, TCS @45k

Infosys' guidance for 23k fresher hiring for FY13 looks weak compared to consensus expectation of high-teen growth. However, there could be upgrade as hiring season is not over and the company could also hire talent from off-campus fresher hiring.

However, TCS' guidance of 45k fresher hiring for FY13 is in line with the expectation. The current hiring guidance of Infosys could address growth of 16-19% on upper end of spectrum, whereas on the lower end, it could address growth of 8-11% YoY for FY13. However, the similar calculation yields 25-28% YoY growth towards higher end and 14-17% YoY growth at the lower end.

However, 6-9% lower growth outlook could be catered by increasing utilization, which is 6 percentage point lower in case of Infosys. We believe TCS need to bring utilization down by 2-3 percentage point in FY13.

Exhibit 3: Infosys: Guidance sounds conservative – indicates 16-19% growth

Total Employee (post H1FY12)	**141,822**	
Volume Growth in H2FY12 (guidance)	10%	
Total Employee (post FY12)	156004	Assuming same Utilization, S&M and G&A padding
Current Utilization (excl. trainees)	***77.3%***	
Current Utilization (incl. trainees)	***70.2%***	
For FY13		
Fresher Hiring Guidance	**23,000**	**Total Number of offer given for FY13**
Fresher Mix	70%	Management guidance
Total Hiring	32,857	
For Fresher Mix	50%	To cater the growing demand
Total Hiring	46,000	
Attrition	13%	
Total Employees (post FY12)	156,004	
Employee Leaving in FY13	20,281	For simplicity assumed calculation on post FY12
Net Employee Addition (70% mix)	12,577	
Net Employee Addition (50% mix)	25,719	
FY13 Volume Growth Guidance (70% mix)	8%	
FY13 Volume Growth Guidance (50% mix)	16%	

Source: Company Data, PL Research

Exhibit 4: TCS: Guidance more realistic – in-line with our expectation

Total Employee (post H1FY12)	**214,770**	
Volume Growth in H2FY12 (guidance)	10%	
Total Employee (post FY12)	236247	Assuming same Utilization, S&M and G&A padding
Current Utilization (excl. trainees)	***83.1%***	
Current Utilization (incl. trainees)	***76.4%***	
For FY13		
Fresher Hiring Guidance	**45,000**	**Total Number of offer given for FY13**
Fresher Mix	70%	Management guidance
Total Hiring	64,286	
For Fresher Mix	50%	To cater the growing demand
Total Hiring	90,000	
Attrition	13%	
Total Employees (post FY12)	236,247	
Employee Leaving in FY13	30,712	For simplicity assumed calculation on post FY12
Net Employee Addition (70% mix)	33,574	
Net Employee Addition (50% mix)	59,288	
FY13 Volume Growth Guidance (70% mix)	14%	
FY13 Volume Growth Guidance (50% mix)	25%	

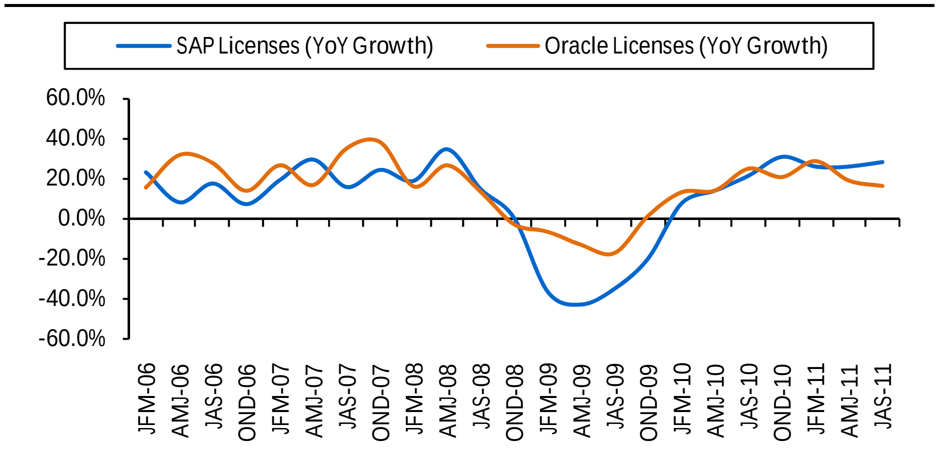
Source: Company Data, PL Research

Global Tech Majors – None indicating weakness in demand

Oracle Q1FY12 results – New Licenses revenue ahead of expectation: Oracle reported better-than-expected result. Revenue was ahead of consensus estimate (Actual: $8,398m, Consensus: $8,354m), a growth of 11% YoY. New licenses sales grew by 16% YoY to $1,498m (v/s Consensus: $1,470m). The positive surprise in New Licenses came from Application (Actual: $428m, Consensus: $405m, 23% YoY growth), whereas Technology (Database and Middleware) was in line with the expectation (Actual: $1,070m, Consensus: $1,070m, 14% YoY growth). **Healthy Guidance:** Oracle has guided for 4-8% YoY growth for revenue to $8,995-9,340m (v/s Consensus: $9,377m), touch below consensus estimate, whereas New Licenses Sale has been guided for 6-16% YoY growth to $2,120-2,320m.

SAP Q3FY11 results – Licenses sale surged ahead of consensus expectation: License revenue was €841m (28%, @cc 32% YoY) (including Sybase acquisition, but integration happened on July 26, 2010, so organic revenue to a large extent) against street expectation of €746m. Software and software related services revenue (SSRS) grew (14%, @cc 18% YoY) to €2.69bn, above street estimates of €2.57bn.

Exhibit 5: SAP and Oracle: Stable at 20%+ YoY growth

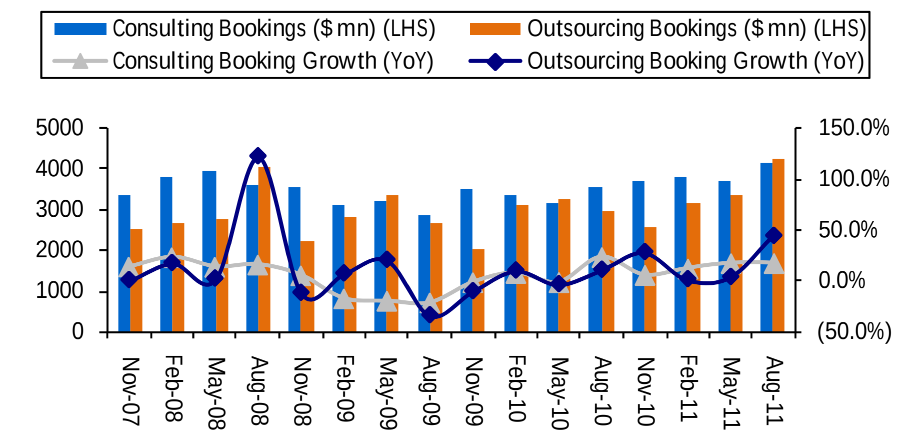


Source: Company Data, PL Research, Oracle (October year end), SAP (December year end)

Microsoft Q1FY12 results – in-line quarter: Total revenue was touch ahead of street estimate at $17.33bn (Cons: $17.25bn), 7.3% YoY growth, that comprises of in-line revenues from Windows (Actual: $4.87bn v/s Cons: $4.89bn), Business Division that was slightly ahead (Actual: $5.62bn v/s Cons: $5.46bn), Server and Tools (Actual: $4.25bn v/s Cons $4.36bn) a little lower, Entertainment Device was inline (Actual: $1.96bn v/s Cons: $1.91bn) and a slight miss in smallest segment i.e. online revenue (Actual: $625m v/s Cons: $640m). **Corporate spending surprised positively:** According to the CFO, Mr. Peter Kevin, "We had another quarter for Office, SharePoint, Exchange, and Lync and saw growing demand for our public and private cloud services, including Office 365, Dynamic CRM Online, and Window Azure". Business division delivered the strongest positive surprise.

Accenture Q4FY11 results - Ahead of analysts' expectation: Accenture reported Q4FY11 revenues of $6.7bn (+23% YoY; +14% in cc), above consensus' expectation of $6.5bn estimate. Operating margin of 13.8% was in line with the consensus. EPS of $0.91 was $0.02 above the analysts' expectation. Bookings finished at $8.4bn, driven by strength in both, Consulting and Outsourcing bookings. Consulting: revenues were at $3.9bn (+16% in cc). Bookings are at $4.16bn, 9% higher than consensus. Outsourcing: Revenue was at $2.8bn (+13% in cc). Bookings are at $4.28bn. **FY12 guidance – visible strength:** For FY12, management guided for (1) constant currency revenue growth of 7%-10% YoY (unchanged); (2) operating margin of 13.7-13.9%; (3) EPS of $3.80-$3.88 (+12%-14% YoY) v/s the consensus of $3.77; (4) bookings of $28-$31bn. (4) The management said "Our clients continue to take steps to adjust to this new environment and this continues to drive demand for our services" and also highlighted "The visibility that we have right now (on budgets) is very good based on the first few months….".

Exhibit 6: Accenture Bookings: Strength in demand environment



Source: Company Data, PL Research

Capgemini Q3CY11 results – Another quarter of outperformance: Capgemini reported Q3CY11 revenues of €2,378m (13% YoY growth, Organic Growth: 5.2% YoY), consensus estimates of €2,319m. The beat was led by Technology Services (+7.2%); offset softness in outsourcing growth (+2.7% vs. 8.2% in Q2CY11). **North America and Manufacturing growth strong:** The key market for Indian Outsourcer North America has grown 5% YoY for Capgemini, whereas UK grew by 1.3% YoY for them due softness in public sector growth. Manufacturing was up by 18.8% YoY for Q3CY11 compared to 5.7% YoY growth for Financial Services likely to be impacted due to softness in demand from capital market. **Strong Bookings:** Capgemini Q3CY11bookings at €2,208m grew 6% YoY with the cyclical activities reporting a 6.4% increase in bookings on an average. The Q3CY11 group book-to-bill ratio was 0.93, while P&C book to bill was 0.98. **Reiterated guidance:** Despite a stronger-than-expected Q3CY11 results, the company retained CY11 revenue guidance to achieve 9%-10% YoY growth. The guidance implies Q4CY11E revenue growth of -1.5% to 2.2%, which according to us is slightly conservative.

Exhibit 7: Book-to-Bill: Indicates stable environment

Booking (€ mn)	Q3CY10	Q2CY11	Q3CY11	YoY (Growth)
Project & Consulting	1,279	1,921	1,438	12%
Outsourcing Solution	897	862	770	-14%
Total	2,176	2,783	2,208	1%
Book-to-Bill	96%	129%	98%	

Source: Company Data, PL Research

Atos Q3CY11 results – Beaten Street expectation: Atos Origin, French IT Services major, reported Q3CY11 results on Wednesday. Revenues ahead of consensus with overall revenues growing by 72.9% YoY (excluding the impact of the SIS acquisition and the changes in exchange rates the underlying business declined by 0.3% YoY) to €2,093m ahead of consensus at €2,072m. **Management guided for robust pipeline:** Overall Q3'11 book-to-bill was 96% (101% in Q2'11 and 90% in Q3'10), which is ahead of the normal 90% (4 year avg), at €2,014m. The cyclical businesses were at 103%, while the recurring businesses were at 93%. The full backlog was stable at €14.0bn. The management also guided to FY11 book-to-bill of over 100%, driven by the robust pipeline and expected renewals in Q4CY11. **North America and UK Strong:** On an organic basis, North America was the fastest growing geography, with revenues growing by 7.7% YoY to €125m, driven by the managed services and Siemens. UK was also robust with revenues growing by 4.3% YoY due to better volumes from clients acquired from SIS. **Retained Guidance:** Managed Services increased by 2.1% (YoY). Consulting remained weak and declined by 9.2% to €136m. Then Atos never had strong Consulting practice. Atos retained its FY11 guidance of revenues of around €6.8bn and adjusted operating margins of 6.2%.

Exhibit 8: Book-to-Bill- Steady improvement

Book-to-Bill	Atos	Cyclical Business	Reccuring Business
Q3CY11	96%	103%	93%
Q3CY10	90%	102%	83%

Source: Company Data, PL Research

Cognizant – Another quarter of beat: Cognizant reported Q3CY11 revenue of US$1.6bn, up 7.8% QoQ ahead of the guidance of US$1.57bn (5.7% QoQ), and consensus estimate of (US$1.58bn). **Realization improvement already in result:** According to the management, realization improvement of 5-6% in CY11 is already in the price and does not expect any realization improvement in Q4CY11. Moreover, realization could be under pressure in CY12. **Guidance revised up by 0.8%:** Revenue guidance for CY11 has been increased by 0.8% to at least US$6.11bn, yielding 33% YoY growth compared to 26% YoY growth guidance at the beginning of CY11. CTSH provided Q4CY11 revenue guidance of "at least" $1.66bn (+26.7% YoY, 3.7% QoQ at the lower end of the range) is lower than Infosys' 3.2-5.4% QoQ and 2-4% QoQ growth guidance for Wipro.

TPI: Q3CY11 bounce back – in-line with expectation

In-line with the expectation, the IT contract (TCV) has surged in Q3CY11. After a complete washout in terms of deal-flow in H1CY11, Q3CY11 bounce-back was a sigh of relief. TCV in the global market jumped 31% QoQ and 41% YoY to $25.1bn, largely driven by mega deals related to M&A. We believe as the resume of Indian IT companies get stronger with M&A integration work during 2008-10. M&A related deal flow could only improve deal pipeline for Tier-1 Indian IT. According to TPI and Tier-1 management, deal funnel for Q4CY11 is shaping well and likely to improve and only get better. As Europe looks toward austerity measures, Indian IT Vendors provide a better alternative for companies in Europe. The new contracts have been driven by first time outsourcers from Continental Europe. We expect restructuring deals that grew by 132% QoQ and 44% YoY to $12bn in Q3CY11 to only get better as clients from EMEA region look for Indian IT vendors.

Some of the key highlights from TPI

1) Global Market TCV @ $25.1bn (31% QoQ, 41% YoY), at an all-time Q3 high 2) Mega Deal (acquisition related) TCV $7.2bn (220% QoQ, 60% YoY) 3) ITO TCV $18.5bn (51% QoQ, 51% YoY) 4) Telecom & Media TCV witnessed sharp jump in CY11 with YTD TCV @ $11.1bn (CY10 TCV $8.8bn) 5) HCLT and TCS continues to dominate all the regions (Americas, EMEA and APAC), ranked in top 15 along with Accenture, HP and IBM 6) Non-US outsourcing market witnessed steady growth despite wild swing in economic outlook, contribution of the US in outsourcing market declined from ~40% (CY04) to ~25% (CY11) 7) Q3CY11 TCV was up primarily the result of single acquisition related mega deal, excluding deal Q3 performance was atypical

Exhibit 9: Broader Market – Growth in Q3 at all time high

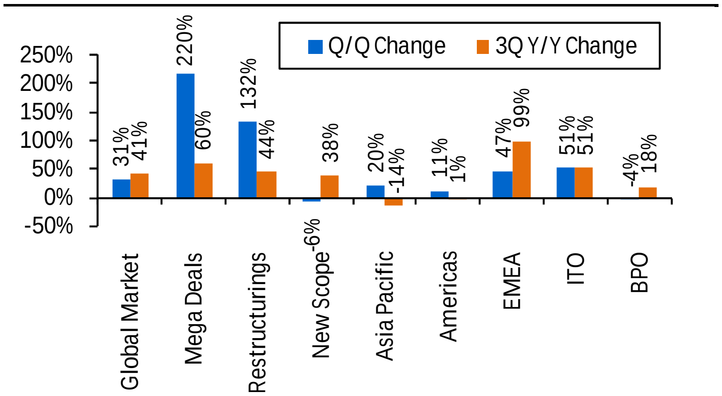


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Exhibit 10: Q3CY11 TCV compared to the 5 most recent Q3s

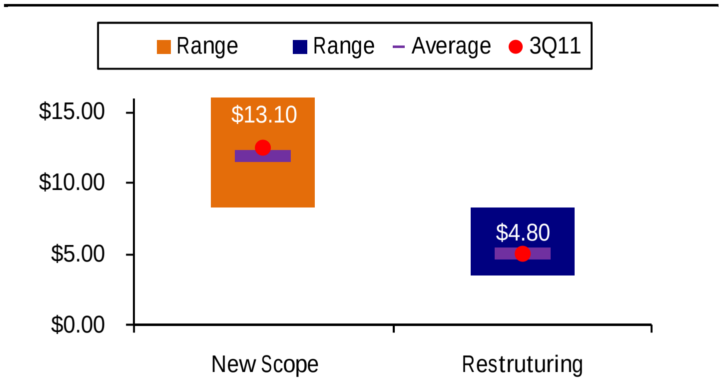

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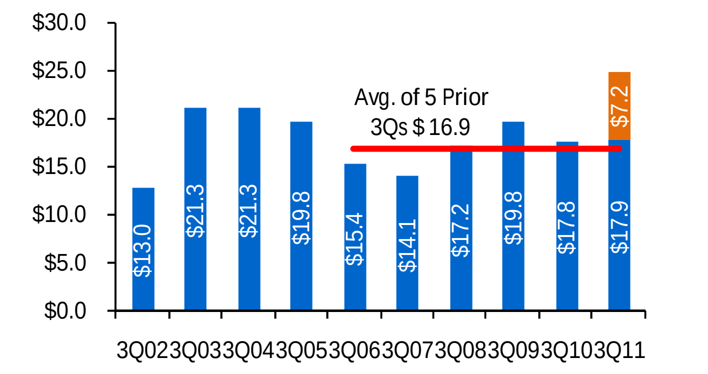
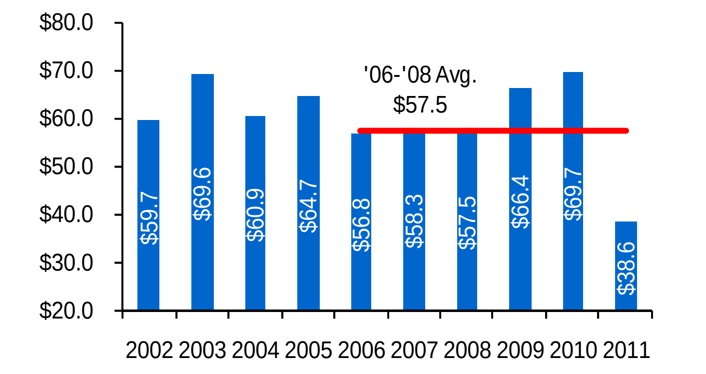
Exhibit 11: Broader Market Q3s Comparison – driven by 1 mega deal



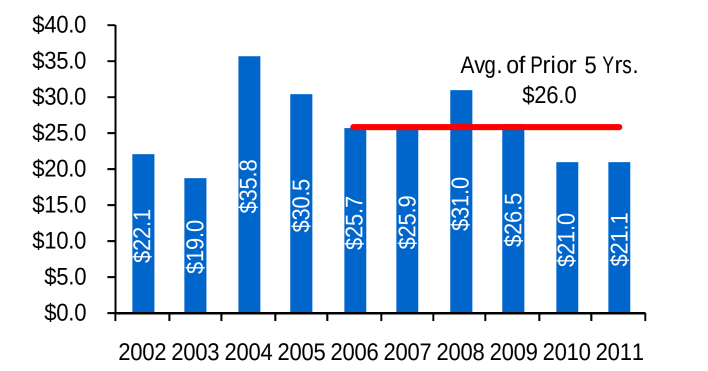
Source: TPI, PL Research

Exhibit 12: ITO YTD: Q4 TCV will have to be high to pull the average



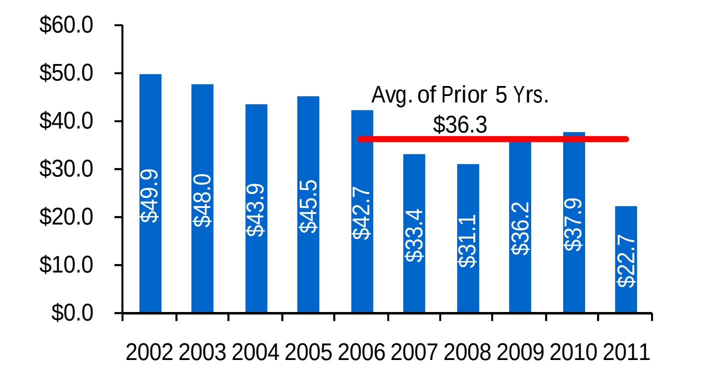
Source: TPI, PL Research

Exhibit 13: BPO YTD: Still at par with 2010 TCV



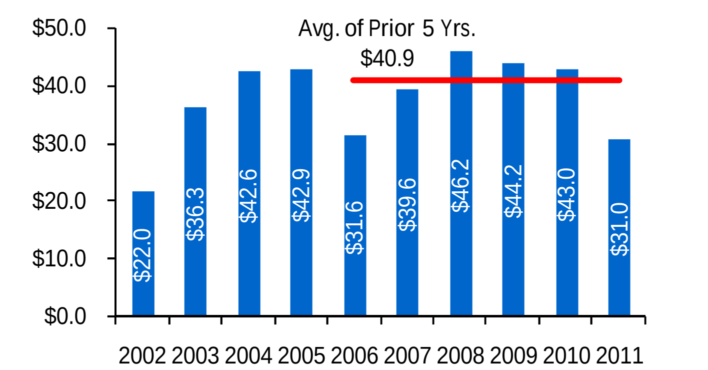
Source: TPI, PL Research

Exhibit 14: America YTD: QYTD TCV is just 60% of 2010



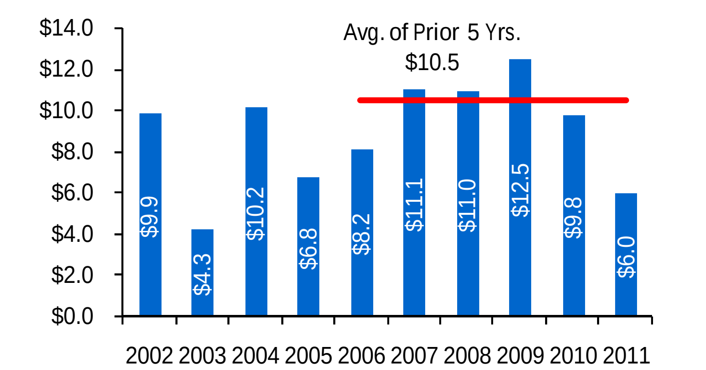
Source: TPI, PL Research

Exhibit 15: EMEA YTD: Anticipate Q4 activity to pull 2011 upto average



Source: TPI, PL Research

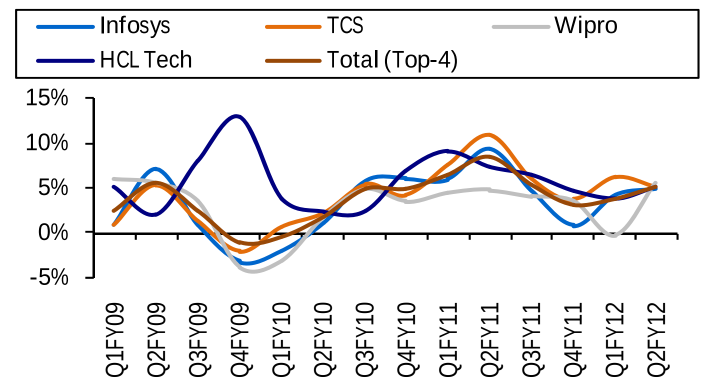
Exhibit 16: APAC YTD: An average Q4 TCV should pull 2011 to CY avg.



Source: TPI, PL Research

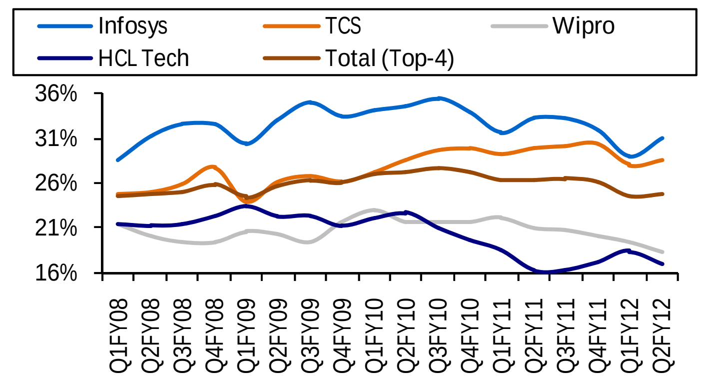
Operating metrics comparison top-4 (TCS, INFO, WPRO and HCLT)

Exhibit 17: Growth @cc QoQ: Similar performance across tier-1



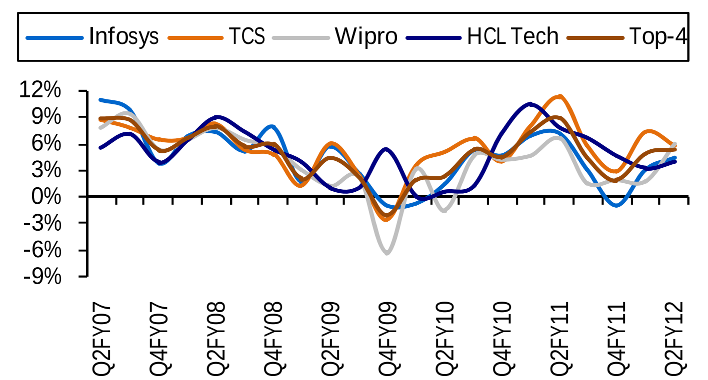
Source: Company Data, PL Research

Exhibit 18: EBITDA margin: Infosys and HCLT best placed with levers



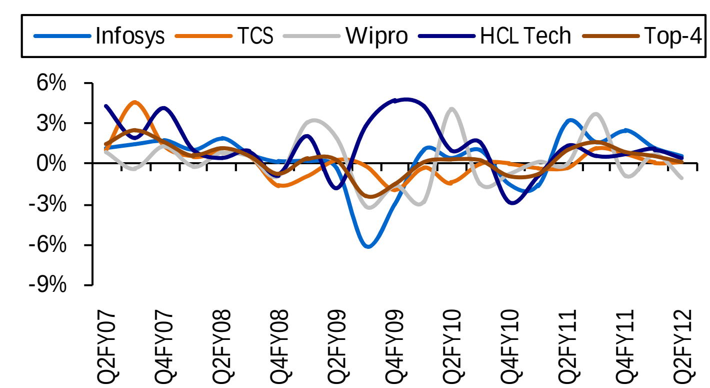
Source: Company Data, PL Research

Exhibit 19: Volume Growth QoQ – Steady after bounce back



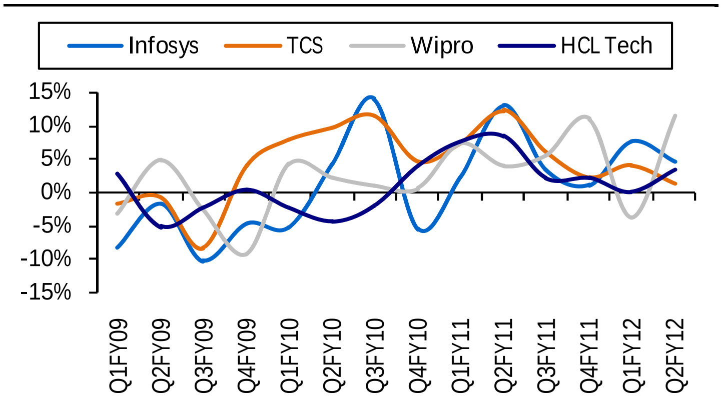
Source: Company Data, PL Research

Exhibit 20: Pricing QoQ – Muted



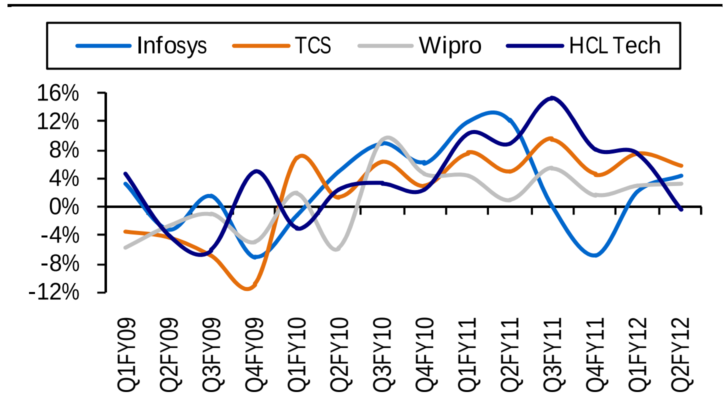
Source: Company Data, PL Research

Exhibit 21: Top 5 Clients– Much needed growth for Wipro



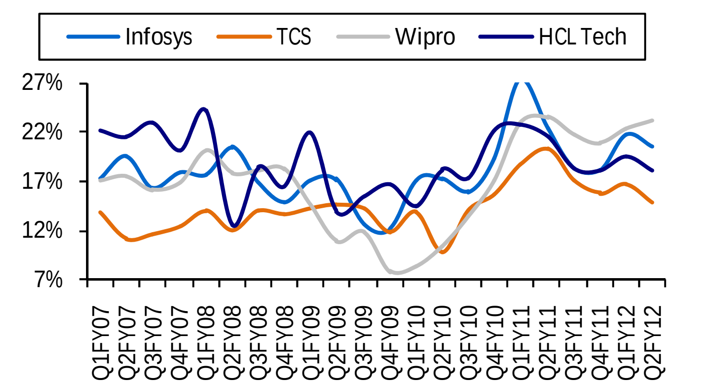
Source: Company Data, PL Research

Exhibit 22: Top 6-10 – Disappointing performance for most tier-1



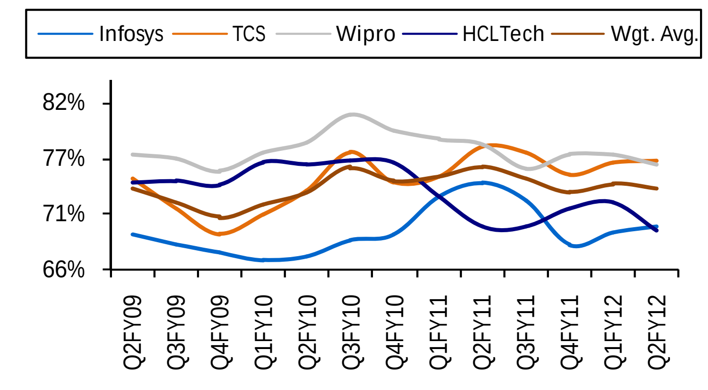
Source: Company Data, PL Research

Exhibit 23: Attrition Annualized – Coming down steadily



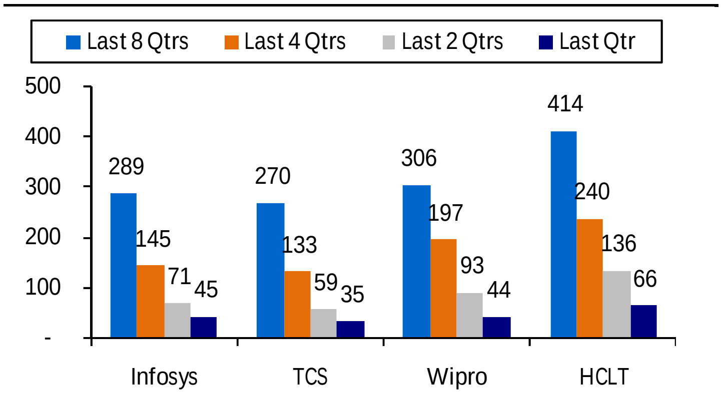
Source: Company Data, PL Research

Exhibit 24: Steady Utilization (incl. trainees): hiring in-line with growth



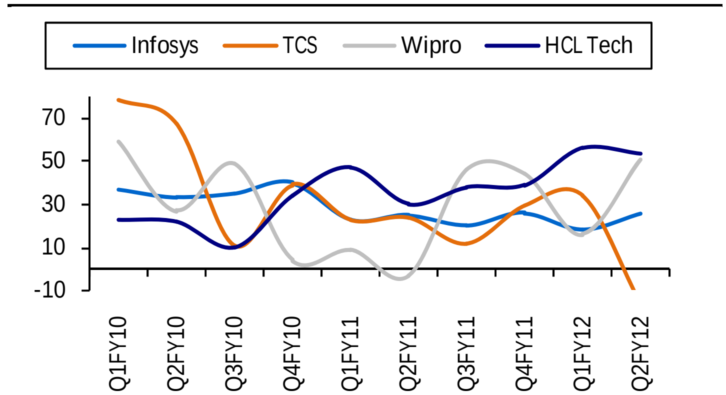
Source: Company Data, PL Research

Exhibit 25: Clients Addition – HCL Tech outperformed in all the bracket



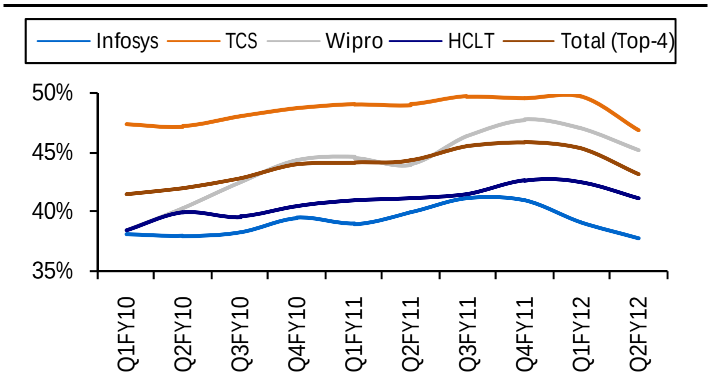
Source: Company Data, PL Research

Exhibit 26: Client Attrition – Check on client attrition



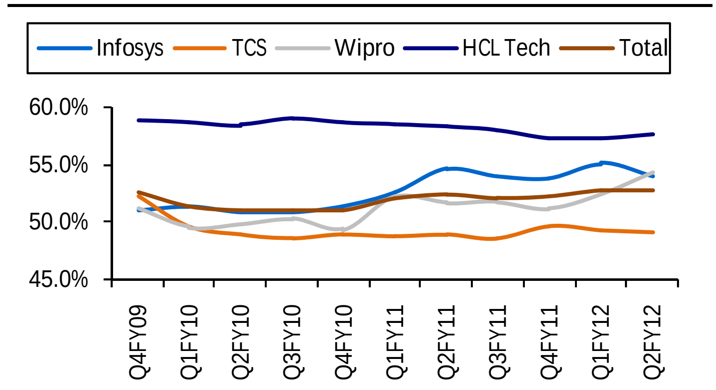
Source: Company Data, PL Research

Exhibit 27: FPP – Witnessing secular decline as client opt for T&M



Source: Company Data, PL Research

Exhibit 28: Onsite – Wipro onsite ramping up fast



Source: Company Data, PL Research

HCL Tech, Infosys and TCS remain best pick in the sector

We believe that improving GDP growth scenario in the US (the major exposed geography for tier-1 Indian IT) and currency depreciation due to global uncertainty and weak fiscal situation of India would provide much needed impetus for tier-1 at operating level. We expect that the slowdown in Europe would open the opportunity for tier-1 Indian IT companies. **We revise our revenue estimates upward for FY12-13 for Tier-1 names for new currency assumption. We retained our multiple for the companies.**

Exhibit 29: Revise FY12 and FY13 estimates upward

Coverage Company		Revenue				EPS				EBITDA Margin		
		FY11	FY12	FY13	*CAGR*	FY11	FY12	FY13	*CAGR*	FY11	FY12	FY13
TCS	New	373,245	480,568	599,549	*27%*	42.4	52.0	64.5	*23%*	30.0	28.7	28.3
	Old	373,245	476,080	591,062	*26%*	42.4	51.1	60.4	*19%*	30.0	28.5	27.8
	Revision	*NA*	*0.9%*	*1.4%*		*NA*	*1.6%*	*6.7%*		*NA*	*17.7*	*44.6*
Infosys	New	275,010	331,186	389,543	*19%*	119.3	142.9	163.3	*17%*	32.6	32.1	30.4
	Old	275,010	329,386	385,214	*18%*	119.3	141.5	159.9	*16%*	32.6	31.9	30.1
	Revision	*NA*	*0.5%*	*1.1%*		*NA*	*0.9%*	*2.1%*		*NA*	*14.2*	*30.9*
Wipro	New	310,542	353,663	405,298	*14%*	21.6	22.0	24.0	*5%*	21.1	19.8	19.3
	Old	310,542	353,663	405,298	*14%*	21.6	22.0	24.0	*5%*	21.1	19.8	19.3
	Revision	*NA*	*0.0%*	*0.0%*		*NA*	*0.0%*	*0.0%*		*NA*	*0.0*	*0.0*
HCL Tech	New	160,342	195,925	247,805	*24%*	25.5	31.1	37.5	*21%*	17.1	16.5	15.8
	Old	160,342	195,925	247,805	*24%*	25.5	31.1	37.5	*21%*	17.1	16.5	15.8
	Revision	*NA*	*0.0%*	*0.0%*		*NA*	*0.0%*	*0.0%*		*NA*	*0.0*	*0.0*

Source: Company Data, PL Research

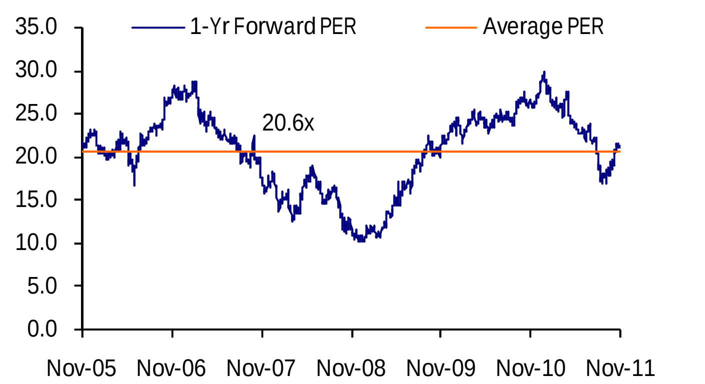
We retain our positive stance on tier-1 Indian IT Services companies. Moreover, we reiterate our bullish stance on **HCL Tech, Infosys and TCS** going into CY12. We reiterate our '**BUY'** recommendation on Infosys, TCS and HCL Tech and '**Accumulate'** on Wipro with a target price of **Rs3090**, **Rs1230**, **Rs550** and **Rs410**, respectively.

Exhibit 30: ....hence revising target price upward

Coverage Company	CMP	Ratings	Old TP (Rs)	Multiple	New TP (Rs)	Upside	Revision
TCS	1,134	BUY	1,140	19	1,230	8.4%	8%
Infosys	2,775	BUY	3,040	19	3,090	11.4%	2%
Wipro	382	Accumulate	410	17	410	7.3%	0%
HCL Tech	427	BUY	550	16	550	28.8%	0%

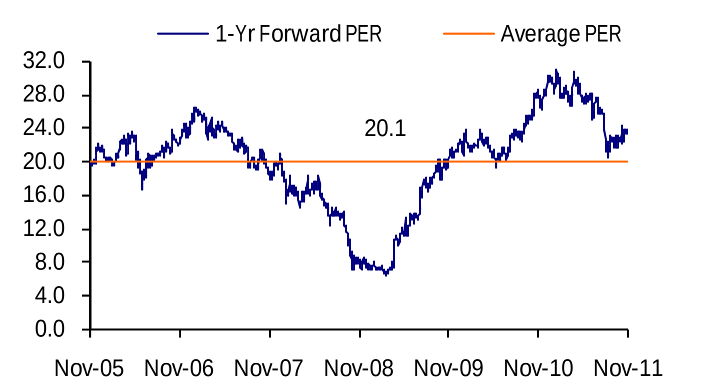
Source: PL Research

Exhibit 31: Infosys



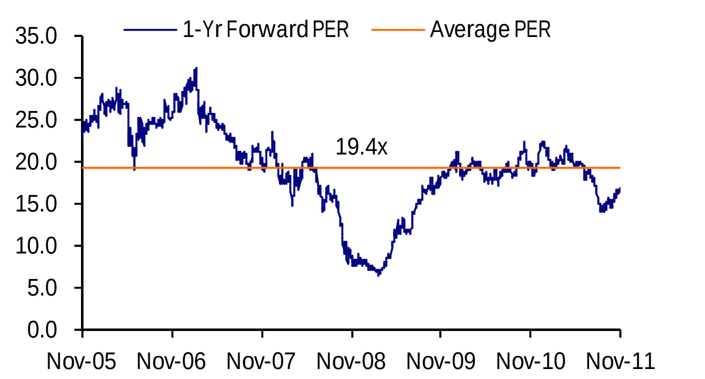
Source: Company Data, Bloomberg, PL Research

Exhibit 32: TCS



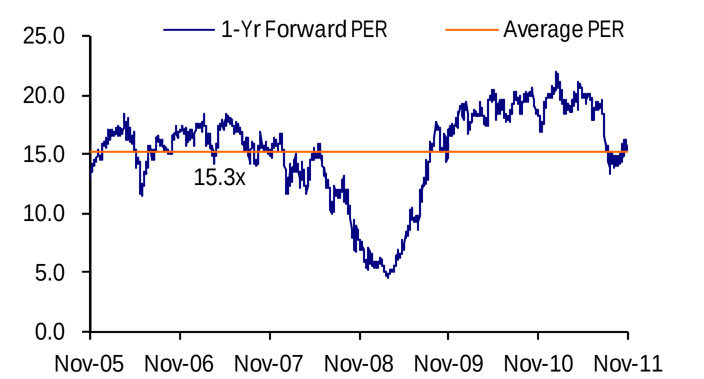
Source: Company Data, Bloomberg, PL Research

Exhibit 33: Wipro



Source: Company Data, Bloomberg, PL Research

Exhibit 34: HCL Tech



Source: Company Data, Bloomberg, PL Research

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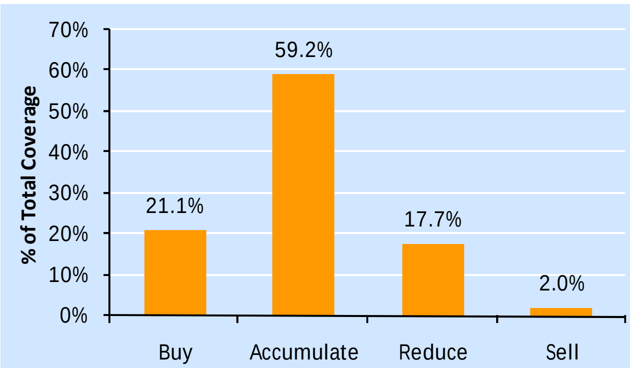

PL's Recommendation Nomenclature

BUY	:	Over 15% Outperformance to Sensex over 12-months	**Accumulate**	:	Outperformance to Sensex over 12-months
Reduce	:	Underperformance to Sensex over 12-months	**Sell**	:	Over 15% underperformance to Sensex over 12-months
Trading Buy	:	Over 10% absolute upside in 1-month	**Trading Sell**	:	Over 10% absolute decline in 1-month
Not Rated (NR)	:	No specific call on the stock	**Under Review (UR)**	:	Rating likely to change shortly

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