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EQUITY RESEARCH

IT Services: 2Q Preview

Strong quarter: no material revenue growth pain; earnings surprises driven by rupee

October 4, 2011

Action: Prefer HCL Tech followed by Infosys

HCLT is our top pick within tier 1 IT on expectations of strong revenue growth (5.4% q-q), lower EBITDA margin declines despite wage hikes, on rupee depreciation and reasonable valuation comfort. At Infosys, we expect a cut in revenue growth guidance and think any fall in the stock should be used as an opportunity to add positions as we believe prices already factor in a moderation in growth. We remain cautious on TCS and CTSH on high BFSI/Europe/Client concentration exposure and lower valuation comfort. Wipro remains our least-preferred stock in tier 1 IT.

Catalyst: Stability in macroeconomic conditions and continuation of rupee depreciation trends would be potential positive triggers for IT stocks.

No material revenue growth moderation in 2Q

We expect USD revenue growth of 3.4-6.5% q-q across tier 1 IT companies, with CTSH and TCS leading on revenue growth. Infosys and Wipro should be in line with guidance. The impact of the recent economic slowdown is unlikely to be visible in results this quarter, in our view.

Likely FY12F revenue guidance cut at Infosys, EPS guidance raise

The first impact of the slowdown, in our view, would be with Infosys cutting its FY12F revenue growth guidance to 16-18% (from 18-20%) as discretionary demand tapers and cross-currency impacts hurt USD revenue growth. However, we see EPS guidance being raised to around INR135 (from INR128-130) largely driven by rupee depreciation and optimized hiring towards year-end.

Valuation: EPS up on rupee depreciation; upgrade Patni to Neutral

We revised our EPS estimates higher as we factor a new FY13F USD-INR rate of 45 vs 44 earlier. We upgrade Patni to Neutral from Reduce.

Fig. 1: Coverage summary

Company	Ticker	Rating	Mkt Cap (USDmn)	Price	Target Price	Potential up/(downside) (%)
TCS	TCS IN	NEUTRAL	41,462	1,037	1070↑	3
Infosys	INFO IN	BUY	29,703	2,533	2900↑	15
Cognizant	CTSH US	NEUTRAL	19,039	63	68	8
Wipro	WPRO IN	NEUTRAL	17,082	341	340↑	(0)
HCL Tech.	HCLT IN	BUY	5,730	409	530	30
Tech Mahindra	TECHM IN	REDUCE	1,477	574	620*	8
Mphasis	MPHL IN	REDUCE	1,474	344	335	(3)
Patni	PATNI IN	NEUTRAL↑	787	289	300↑	4

Note: * PT under review. Pricing as of 30 September
Source: Bloomberg, Nomura estimates.

Rating: *See report end for details of Nomura's rating system.*

Anchor themes

We believe it prudent to participate in the sector through companies focused on market share gains, having low client concentration and having better operating scope in the current uncertain economic environment.

Nomura vs consensus

Our revenue and EPS estimates for tier 1 IT are lower than consensus by 3-8% and 0-8%, respectively. We expect consensus numbers to come in line as the slowdown becomes more visible.

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Strong quarter: no material revenue growth moderation, positive rupee depreciation impact

We expect a strong 2QFY12 performance from tier 1 IT companies driven by a likely limited impact from current economic uncertainty on demand and an expected significant positive impact from recent rupee depreciation vs the USD (2.5% q-q on the average for 2QFY12 and 9.6% q-q on the closing rate). We expect the impact of the slowdown to start to be visible in the 3QFY12 commentaries of managements as they get greater clarity on FY13 budgets and the repercussions of the slowdown start to be seen in 4QFY12F in terms of revenue growth. Our FY13F estimates for tier 1 IT companies build low-teen revenue growths vs an average of 22% growth in FY12F.

Infosys is likely to benefit most from rupee depreciation, in our view, compared with TCS and Wipro, on account of Infosys' lower hedging levels. We estimate Infosys will beat its 2Q EPS guidance by ~20%.

USD revenue growth in 2Q FY12F is likely to be in the range of 3.4-6.5% for tier 1 players (including Cognizant), on our estimates, partly moderated by a ~40-70bp impact of adverse cross-currency moves. We expect volume growth to be in the range of 4-7%, with stable pricing. In our view, Cognizant, TCS and HCL Tech will do better on revenue growth vs the other tier 1 companies while Wipro could continuing to lag. We look for Infosys' revenue growth to be in line with its guidance for the quarter.

Margins are likely to look up on rupee depreciation, with Infosys expected to gain the most, in our view. TCS's margin positives on rupee depreciation will likely be offset somewhat by a ~70-80bp impact of promotions, while Wipro and HCL Tech's margins are expected to be depressed by wage inflation, cushioned to some extent by rupee depreciation. Typically, the sensitivity of the margins to 1% rupee depreciation is on the order of 40-50bps for Indian IT companies, based on our calculations.

Earnings are likely to be a mixed bag depending on hedging levels and timing of wage hikes. We expect Infosys to post the best q-q EPS growth of 18.6%.

Fig. 2: 2Q FY12F – Sequential performance expectations

	Revenue (US$ mn)	q-q growth (%)	EBITDA margin (%)	q-q change (bps)	Net profit (Rs mn)	q-q growth (%)
Cognizant	1,582	6.5	20.3	30	223	7.4
TCS	2,542	5.4	28.9	80	24,584	3.3
Wipro	1,456	3.4	20.0	(200)	13,179	(1.3)
Mphasis	292	6.1	18.9	390	1,898	32.7
HCL Tech	1,015	5.4	16.6	(140)	4,794	(2.1)
Infosys	1,752	4.9	30.2	110	20,418	18.6
Tech Mahindra	297	2.4	17.6	(110)	2,300	(16.8)
Patni	185	0.7	13.5	210	737	5.2

Note: Cognizant Net profit estimate is in USDmn, EBITDA margin is EBIT margin for Wipro (IT services), Revenue for Wipro is for the IT services division while Net profit is at the consolidated level, Net profit estimate for Tech Mahindra is adjusted for restructuring fee and is excluding contribution from Mahindra Satyam

Source: Nomura estimates

Key things to watch out for

- Infosys guidance: A downward revision of its FY12F USD revenue growth guidance to 16-18% (vs 18-20% earlier) looks likely to us on 1) adverse cross-currency impact on USD revenues; and 2) growth moderation, especially in discretionary segments with tail revenues of consulting engagements likely to be deferred. We expect EPS guidance to be raised to around INR135 (from INR128-130 earlier) primarily on the back of rupee depreciation and hiring optimization towards the end of the year. We believe the market would react negatively if Infosys' EPS guidance falls short of INR135.

- Overall demand commentary: We expect status quo in terms of demand commentaries by companies as: 1) a look into FY13F budgets will likely be limited; and 2) clients would have had not enough time to react to the recent macro-economic developments. We see the impact on demand largely starting to be reflected in commentaries in 3QFY12F and in revenues from 4QFY12F onwards.
- Package implementation, Europe and BFSI demand: These are the first segments in our view likely to be impacted by the current economic deterioration; we expect growth and outlooks in these segments will be keenly watched.
- Infrastructure management services (IMS) demand and corresponding deal flow: We recommend watching for growth in IMS and deal commentary by TCS and HCL Tech in particular on re-bid deals, to corroborate our view that re-bid/cost or efficiency-focussed deals are unlikely to be pushed back.
- Hiring commentary: Any curtailments in hiring and improvement in utilization expectations should be taken as corroboration of our view that revenue moderation will likely lead to cost moderation.

Infosys guidance cut – sentimentally negative, but in the price

We expect Infosys to reduce FY12F USD revenue growth guidance from 18-20% to 16-18% on account of 1) cross-currency impact being negative on USD revenue growth; and 2) growth moderation, especially in discretionary demand as tail projects post consulting engagements start to get deferred. The pick-up in discretionary demand in 2HFY12 was a key assumption in Infosys' back-ended growth guidance for FY12F, in our view.

We, however, expect the company to raise its EPS guidance to around INR135 (from INR128-130 earlier) and its EBITDA margin decline guidance to be revised to 200bps (from a 250bp decline earlier) on account of 1) rupee depreciation; and 2) hiring optimization going into 4QFY12F – especially in terms of laterals. Infosys had earlier indicated that it would be hiring 45,000 people in FY12F. This number, in our view, was ~3-4% higher than what their top-end revenue growth guidance of 20% implied. This would now be optimized for the lower growth expectations. We do not expect the company to lower its fresher hiring targets.

We see this development as a sentimental negative, but do not see a material price impact of this move as our expectations, as well as consensus, already build in no outperformance vs guidance. Any adverse stock reactions on account of this move should be used to add positions, in our view.

Fig. 3: Infosys implied 3-4Q growth rates required for 18% rev growth and INR135 EPS

Infosys	1QFY12	2QFY12F	3QFY12#	4QFY12#	FY12#
US$ revenue	1,671	1,752	1,818	1,887	7,128
q-q growth (%)	4.3	4.9	3.8	3.8	18.0
INR EPS	30.1	35.7	34.9	34.2	135.0
q-q growth (%)	-5.3	18.6	-2.2	-2.2	13.0

Note: Nomura estimates for 2QFY12. # indicates that figures are implied based on 18% revenue growth assumption and INR135 EPS for FY12F.

Source: Company, Nomura estimates

Currency moves and continuation could be a positive trigger

The rupee has depreciated significantly across all the major invoicing currencies for IT services companies, except AUD on the quarter-closing basis. In terms of cross-currency movements, the USD appreciated across EUR, GBP and AUD in 2QFY12.

Fig. 4: Movement of INR against various currencies in 2QFY12

INR has depreciated against all major currencies except the AUD

	Rates (INR)				Change (q-q)			
	USD	EUR	GBP	AUD	US$	EUR	GBP	AUD
Average	45.8	64.7	73.7	48.1	2.5%	0.5%	1.1%	1.1%
Closing	49.0	66.6	76.3	47.3	9.6%	3.0%	6.5%	-1.1%

Source: Bloomberg, Nomura research

Fig. 5: Movement of USD against various currencies in 2QFY12

USD has appreciated against all major currencies

	Rates (USD)			Change (q-q)		
	EUR	GBP	AUD	EUR	GBP	AUD
Average	1.41	1.61	1.05	-1.9%	-1.3%	-1.2%
Closing	1.34	1.56	0.97	-7.7%	-2.9%	-9.9%

Source: Bloomberg, Nomura research

Tier 1 IT companies have an EPS sensitivity of 1.5-2.2% for every 1% rupee depreciation, based on our calculations. HCL Tech has the highest and Infosys has the lowest sensitivity to the rupee depreciation. We believe that upsides of 10-16% to our FY13F EPS estimates are likely if the USD/INR rate were to be 48 in FY13F.

Fig. 6: FY13F EPS upsides at various USD/INR levels

	USD/INR of 46	USD/INR of 47	USD/INR of 48	EPS Sensitivity
Infosys	3%	7%	10%	1.5%
TCS	4%	8%	12%	1.9%
Wipro	5%	9%	14%	1.9%
HCL Tech	6%	11%	16%	2.2%

Note: We have assumed USD/INR of 44.7 for HCL Tech and 45 for the other companies, in FY13F.

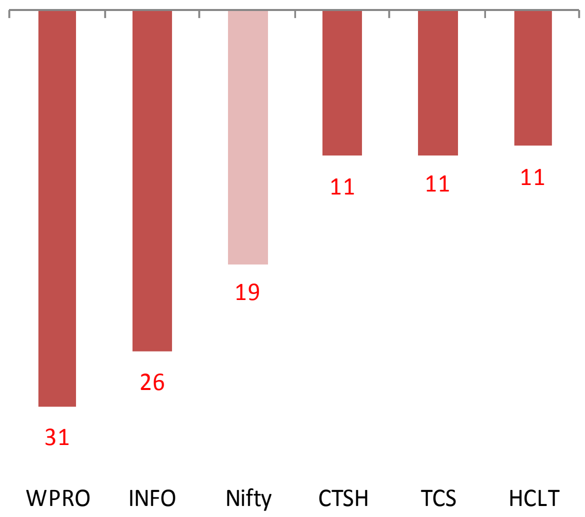
Source: Nomura estimates

Tier 1 IT stocks have corrected by 11-31% YTD

IT stocks have outperformed the Nifty by 0-9% over the past 1 month, driven by rupee depreciation. We believe continuation of USD-INR rates in excess of our assumptions of 46/ 45 for 3Q/4Q FY12F and 45 for FY13F, in the absence of material pricing declines, should be positive for stock price performance going forward, too.

Fig. 7: YTD return chart

Tier 1 stocks except Infosys and Wipro outperform Nifty

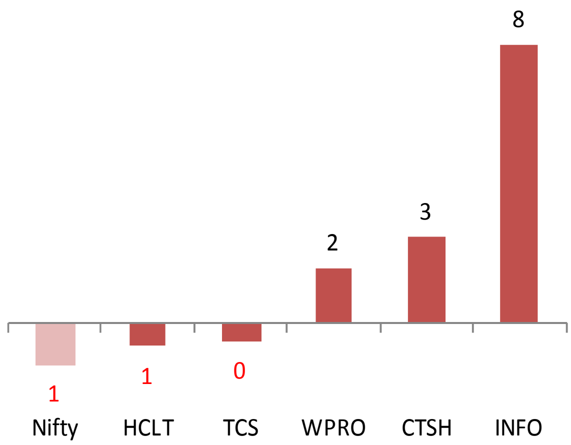


Note: YTD is up to Sep 30, 2011

Source: Bloomberg, Nomura research

Fig. 8: 1-month return chart

Tier 1 stocks outperform Nifty



Note: 1 month is month ending Sep 30, 2011

Source: Bloomberg, Nomura research

View unchanged – Demand moderation likely to be less severe than last time around, Prefer HCL Tech/Infosys

Our view remains that this downturn is not as severe as the post-Lehman crisis downturn, with the key reasons being:

- Fundamental positioning of Indian IT players is much stronger now than during the previous downturn, with participation rates in deals increasing.
- Clients are in much better shape and are not facing an existential crisis – hence while we see cuts, we do not expect them to be as sharp as those during the last downturn. Moreover, we have not seen overspending on technology in the recent past for it to be cut materially.
- Pricing is still significantly lower than pre-2008 downturn pricing levels, and we do not see material pricing cuts ahead
- We expect cost moderation to accompany growth moderation, which makes us believe there is upside to margins in FY13F.

We expect moderation in FY13F revenue growth in tier 1 IT companies as short-term decision making and macro uncertainties lead to clients' being conservative on FY13 budgets. We look for this to impact growth from 4QFY12F onwards. The other casualty, in our view, would be expectations of pricing increases in FY13F, which we think might not be possible now as the crisis has come too close to budgeting for the next year and discretionary demand could get hit. We expect this slowdown to start being reflected in FY13 revenue growth for tier 1 Indian IT companies, and we look for low-teen growth in FY13F vs an average of 22% growth in FY12F.

However, we expect positive developments on margins as companies start to react by curtailing their hiring plans, perking up utilisation, moderating wage inflation to single-digit levels or lower in FY13F (vs our earlier expectations of double-digit increases), and the possibility of push-back in wage hikes from 1Q by at least a quarter or two if demand were to moderate. In our view, this should cushion the impact of volume declines on earnings to some extent. We expect FY13F margins to be flat or better than FY12F margins. We note that continuation of the recent rupee depreciation moves would likely be an upside trigger for margins.

Fig. 9: Key assumptions for tier 1 IT companies

	US$ revenue growth (%)			EBITDA margin (%)			EPS (Rs)		
	FY12F	FY13F	CAGR (FY11-13F)	FY12F	FY13F	Change (FY11-13)	FY12F	FY13F	CAGR (FY11-13F)
TCS	25.2	12.4	18.6	28.9	29.1	-90 bps	52.3	59.4	15.4
Infosys	18.0	12.5	15.2	30.7	31.6	-100 bps	136.0	159.4	15.5
Wipro	13.0	9.8	11.4	20.6	20.4	-230 bps	22.2	24.3	6.1
Cognizant	32.6	16.5	24.3	20.6	20.5	-50 bps	2.8	3.3	17.2
HCL Tech.	23.3	14.2	18.7	16.8	16.7	10 bps	30.4	35.5	24.3

Source: Nomura estimates

We have relatively greater confidence in companies that are 1) market share gain-focused; 2) have low client concentration/BFSI and European exposure; 3) have better operational scope to cushion the potential impact of a growth slowdown; and 4) show lower future growth expectations being built into valuations. On these parameters, we like Infosys and HCL Tech (top pick), where we see 15-30% upside from current levels. We remain cautious on Cognizant and TCS, given their 1) high BFSI and/or European exposure and high client concentration; and 2) significantly higher future growth expectations being built in, which on a disappointment could potentially lead to sharp stock corrections from current levels. Wipro remains our least-preferred stock in tier 1 IT as we see the company as structurally weak, and we believe its efforts to revive growth would receive a set back in a scenario of growth moderation. We upgrade Patni to Neutral from Reduce, as we see its risk-reward turning incrementally positive, as a result of the stock correcting by 39% YTD (vs 19% in the Nifty).

Risk to our sector call is rupee appreciation beyond assumed levels or breakage of pricing discipline leading to pricing declines in FY13F. Upside sector risks to our estimates are return of macro stability and continuation of current rupee depreciation trends (with our FY13F estimates currently factoring in USD-INR rate of 45).

Earnings estimates revised up on rupee depreciation

We are revising our FY12F estimates for companies under coverage assuming average USD-INR rates for 2Q and changing our assumptions for 3Q and 4Q to a USD-INR rate of 46 and 45 (vs 44.5 earlier). We revise our FY13F USD-INR assumptions to 45 (from 44 earlier). We raise our target prices marginally for Infosys, TCS, Wipro and Patni by 2-3%.

Fig. 10: Estimate changes across companies

	US$ revenue (% change)		EBITDA margin (bps change)		Diluted EPS (% change)	
	FY12F	FY13F	FY12F	FY13F	FY12F	FY13F
TCS	0	0	-10 bps	10 bps	0	2
Infosys	-1	-1	0 bps	10 bps	1	2
Wipro	0	-1	60 bps	60 bps	2	3
HCL Tech	-1	0	30 bps	-10 bps	3	1
Patni	0	-4	60 bps	50 bps	6	3

Source: Nomura estimates

Scenario analysis: What if the US and Europe slip back into recession?

As the markets have been signaling that risks to our baseline forecasts are on the downside, our global economics team have considered a bear case economic scenario, most obviously triggered by a market meltdown, but the fragile state of the advanced economies leaves them vulnerable to unforeseen shocks or policy errors. For details, see Global Weekly Economic Monitor, 12 August 2011, and Global market turbulence: Implications for Asia, 9 August 2011.

The bear case scenario assumes:

- The US and Euro area slip back into recession, with US GDP averaging -1% saar in 2H11 and Euro GDP averaging -3% before recovering to around 2% growth in 2012.
- The CRB commodity price index falls 15% between now and year-end, but starts rising back again through 2012 reaching current levels by end-2012.

If there is a market meltdown and recessions in the US and euro area, we have no doubt that initially many economies in the region would be hit hard again in an echo of the global financial crisis, as non-linear effects start to kick in, notably financial decelerator effects, multiplier effects of weakening exports on domestic capex and jobs, and capital flight. However, less disturbing this time around are the two factors that there is less leverage in the financial system (less room for capital flight) and less chance of Asian trade finance drying up, as the world's central banks have most likely learnt the need to provide ample USD liquidity through FX swap arrangements.

In this scenario, we find Hong Kong, Singapore, Malaysia and Taiwan to be among the most vulnerable. But, as in 2009, we would expect that, over time, powerful tailwinds would develop, allowing Asia to bounce back before other regions. These tailwinds include a likely further decline in commodity prices and the ample room Asia has to ease monetary and fiscal policies – more so than any other region. In our bear case scenario, we would expect the Fed to resort to further quantitative easing, which once again would likely precipitate strong net capital inflows into Asia, attracted by stronger growth, superior fundamentals and higher interest rates relative to other regions.

What if things get even worse than we can foresee? Although our global economics team does not see such a situation as plausible at the moment, they have run an extreme-case scenario analysis to provide some perspective. This extreme scenario assumes:

- US GDP averaging about -4% saar in 2H11 and Euro GDP averaging -6.5% before recovering to around 1% growth in 2012.
- CRB commodity price index falls 40% between now and year-end, and stays at the lower level through 2012.

The table below summarises both the official bear case and the hypothetical extreme case scenarios.

Fig. 11: Real GDP growth forecasts: baseline and downside scenarios

	2011F			2012F		
	Base case	Bear case	Extreme case	Base case	Bear case	Extreme case
Australia	2.2	1.5	0.9	4.6	3.5	3.3
China	9.5	9.0	8.5	8.6	8.8	6.0
Hong Kong	5.4	4.4	3.4	4.5	4.0	1.2
India	7.7	7.0	6.5	7.9	7.6	7.0
Indonesia	6.5	6.0	4.8	7.0	6.8	4.0
Malaysia	4.7	4.0	1.0	5.1	4.8	-0.4
New Zealand	2.2	1.8	1.4	3.5	3.5	3.3
Philippines	5.1	4.7	3.3	5.7	5.3	2.4
Singapore	5.6	4.3	1.5	5.3	5.1	-1.8
South Korea	3.5	2.5	1.5	5.0	5.0	2.5
Taiwan	4.5	3.6	2.4	5.0	4.9	0.9
Thailand	4.1	3.5	0.6	4.7	4.5	-0.5
Vietnam	6.4	6.0	4.5	6.9	6.5	4.2
Asia ex Japan, Aus, NZ	7.9	7.2	6.4	7.6	7.6	5.1

Source: CEIC and Nomura Global Economics. Units: % y-o-y

The global bear case does not look bad for much of Asia and in fact is marginally better than the base case for China in 2012 because we would expect a V-shape rebound for the region thanks to the likely decline in commodity prices and the ample room Asia has to ease monetary and fiscal policies. We would also expect the Fed to resort to further quantitative easing, which once again would likely precipitate strong net capital inflows into Asia. In the extreme case, however, even these strengths will be tested.

What does this mean for our companies?

In the above mentioned bear case scenario, we have assumed a 1% pricing cut in the quarter ending March 2012, followed by a 4% cut in the quarter ending June 2011. Under the extreme scenario, we have assumed a 2% pricing cut in the quarter ending March 2012, followed by an 8% cut in the quarter ending June 2011.

Fig. 12: Earnings and Price target sensitivity

	Base case	Bear case	Downside %	Extreme case	Downside %
Infosys					
FY12F EPS	136	135	-1%	134	-1%
FY13F EPS	159	142	-11%	123	-23%
12-m target price	2900	2300	-21%	1780	-39%
TCS					
FY12F EPS	52	52	-1%	52	-1%
FY13F EPS	59	51	-14%	43	-28%
12-m target price	1070	830	-22%	610	-43%
HCL Tech					
FY12F EPS	30	29	-5%	27	-10%
FY13F EPS	35	27	-25%	18	-50%
12-m target price	530	360	-32%	210	-60%
Wipro					
FY12F EPS	22	22	-1%	22	-1%
FY13F EPS	24	21	-13%	18	-25%
12-m target price	340	270	-21%	200	-41%
Cognizant					
FY12F EPS	3.3	3.1	-4%	3.0	-7%
FY13F EPS	3.8	3.7	-4%	3.5	-9%
12-m target price	68	60	-12%	50	-26%
Patni					
FY12F EPS	28	21	-26%	13	-52%
FY13F EPS	30	21	-30%	12	-59%
12-m target price	300	180	-40%	90	-70%

Source: Nomura estimates

Cognizant CTSH.OQ CTSH US

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No slowdown impact likely in FY11F

Revenue outperformance moderation and BFSI exposure could weigh on valuations

October 4, 2011

Rating Remains	**Neutral**
Target price Remains	USD 68.00
Closing price September 30, 2011	USD 62.70
Potential upside	+8.45%

3Q FY11F: Expect Cognizant to post revenue growth ahead of peers

We expect Cognizant to report 6.5% q-q revenue growth in 3Q FY11F. EBIT margins are likely improve slightly by 10bps q-q. Management commentary on Europe and demand will likely be keenly watched.

Action: Maintain Neutral; wait for better entry points to build in the risks

Cognizant has traded at a premium to its Indian IT peers on: 1) double-digit revenue growth outperformance; and 2) margin predictability. We believe both will continue, but that the growth outperformance gap should narrow. This, coupled with risks on high BFSI exposure and client concentration, could weigh on the stock's valuation, in our view, leading to a moderation in Cognizant's premium valuation. We would wait for better entry points and remain Neutral.

Expect moderation in FY12F growth; FY11F not at risk, in our view

We expect Cognizant to continue to outperform its peer group on revenue growth despite moderation in our FY12F expectation to 16.5%, while keeping our FY11F expectation intact at 32.6%. We expect USD revenue CAGR of 24%, flattish EBIT margins and EPS CAGR of 17% over FY10-12F.

Catalysts: Economic stability, higher growth

Valuation: Maintain TP of USD68 based on 20x 1-year forward

31 Dec	FY10		FY11F		FY12F		FY13F
Currency (USD)	Actual	Old	New	Old	New	Old	New
Revenue (mn)	4,592	6,089	6,089	7,094	7,094	8,547	8,547
Reported net profit (mn)	734	875	875	1,021	1,021	1,203	1,203
Normalised net profit (mn)	734	875	875	1,021	1,021	1,203	1,203
Normalised EPS	2.44	2.88	2.88	3.34	3.34	3.92	3.92
Norm. EPS growth (%)	33.7	18.0	18.0	16.2	16.2	17.4	17.4
Norm. P/E (x)	26.4	N/A	22.4	N/A	19.2	N/A	16.3
EV/EBITDA (x)	17.4	13.2	13.2	11.0	11.0	8.8	8.8
Price/book (x)	5.3	N/A	4.3	N/A	3.5	N/A	2.9
Dividend yield (%)	na	N/A	na	N/A	na	N/A	na
ROE (%)	23.5	21.9	21.9	20.7	20.7	19.9	19.9
Net debt/equity (%)	net cash	net cash	net cash	net cash	net cash	net cash	net cash

Source: Nomura estimates

Key company data: *See page 2 for company data and detailed price/index chart.*
Rating: *See report end for details of Nomura's rating system.*

Anchor themes

We believe it prudent to participate in the sector through companies focused on market share gains, having low client concentration and better operating scope in the current uncertain economic environment.

Nomura vs consensus

Our TP is around 15% lower than Bloomberg consensus on expectations of a moderation of valuation premiums as growth outperformance narrows and growth moderates.

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Key data on Cognizant

Income statement (USDmn)

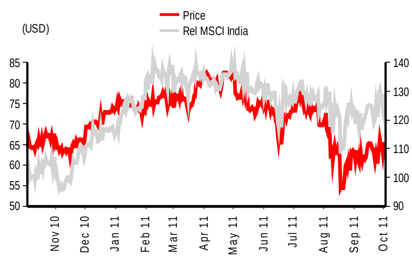
Year-end 31 Dec	FY09	FY10	FY11F	FY12F	FY13F
Revenue	**3,279**	**4,592**	**6,089**	**7,094**	**8,547**
Cost of goods sold	-1,906	-2,725	-3,579	-4,180	-5,048
Gross profit	**1,373**	**1,868**	**2,510**	**2,913**	**3,498**
SG&A	-709	-949	-1,290	-1,509	-1,848
Employee share expense	-46	-57	-90	-99	-111
Operating profit	**618**	**862**	**1,130**	**1,305**	**1,539**
EBITDA	**708**	**966**	**1,252**	**1,454**	**1,719**
Depreciation	-89	-104	-121	-149	-179
Amortisation					
EBIT	618	862	1,130	1,305	1,539
Net interest expense	16	26	39	46	54
Associates & JCEs					
Other income	3	-9	4	0	0
Earnings before tax	**637**	**879**	**1,173**	**1,352**	**1,593**
Income tax	-102	-145	-298	-331	-390
Net profit after tax	**535**	**734**	**875**	**1,021**	**1,203**
Minority interests					
Other items					
Preferred dividends					
Normalised NPAT	**535**	**734**	**875**	**1,021**	**1,203**
Extraordinary items					
Reported NPAT	**535**	**734**	**875**	**1,021**	**1,203**
Dividends	0	0	0	0	0
Transfer to reserves	**535**	**734**	**875**	**1,021**	**1,203**
Valuation and ratio analysis					
FD normalised P/E (x)	35.3	26.4	22.4	19.2	16.3
FD normalised P/E at price target (x)	38.3	28.7	24.3	20.9	17.7
Reported P/E (x)	34.4	25.7	21.8	18.8	16.0
Dividend yield (%)	na	na	na	na	na
Price/cashflow (x)	30.5	29.1	38.2	23.3	19.7
Price/book (x)	6.9	5.3	4.3	3.5	2.9
EV/EBITDA (x)	25.0	17.4	13.2	11.0	8.8
EV/EBIT (x)	28.6	19.5	14.7	12.2	9.9
Gross margin (%)	41.9	40.7	41.2	41.1	40.9
EBITDA margin (%)	21.6	21.0	20.6	20.5	20.1
EBIT margin (%)	18.9	18.8	18.6	18.4	18.0
Net margin (%)	16.3	16.0	14.4	14.4	14.1
Effective tax rate (%)	16.0	16.5	25.4	24.5	24.5
Dividend payout (%)	0.0	0.0	0.0	0.0	0.0
Capex to sales (%)	3.5	4.2	4.0	4.1	3.4
Capex to depreciation (x)	1.3	1.9	2.0	1.9	1.6
ROE (%)	23.2	23.5	21.9	20.7	19.9
ROA (pretax %)	34.8	40.1	42.4	40.1	39.8
Growth (%)					
Revenue	16.4	40.1	32.6	16.5	20.5
EBITDA	19.7	36.4	29.6	16.2	18.2
EBIT	19.7	39.3	31.1	15.5	17.9
Normalised EPS	22.8	33.7	18.0	16.2	17.4
Normalised FDEPS	23.3	33.6	18.2	16.3	17.9
Per share					
Reported EPS (USD)	1.82	2.44	2.88	3.34	3.92
Norm EPS (USD)	1.82	2.44	2.88	3.34	3.92
Fully diluted norm EPS (USD)	1.78	2.37	2.80	3.26	3.84
Book value per share (USD)	9.05	11.92	14.51	17.82	21.67
DPS (USD)	0.00	0.00	0.00	0.00	0.00

Source: Nomura estimates

Notes

We expect revenue growth of 32.6%/16.5% in FY11/12F

Price and price relative chart (one year)



(%)	1M	3M	12M
Absolute (USD)	-1.2	-14.5	-2.7
Absolute (USD)	-1.2	-14.5	-2.7
Relative to index	-0.5	-1.8	16.8
Market cap (USDmn)	19,074.3		
Estimated free float (%)	99.0		
52-week range (USD)	/		
3-mth avg daily turnover (USDmn)	227.95		
Major shareholders (%)			
Fidelity	8.4		
Waddell & Reed Financial	5.0		

Source: Thomson Reuters, Nomura research

Cashflow (USDmn)

Year-end 31 Dec	FY09	FY10	FY11F	FY12F	FY13F
EBITDA	708	966	1,252	1,454	1,719
Change in working capital	56	-99	-270	-48	-139
Other operating cashflow	-144	-200	-469	-564	-585
Cashflow from operations	**620**	**666**	**513**	**842**	**995**
Capital expenditure	-116	-193	-242	-290	-290
Free cashflow	**504**	**473**	**271**	**552**	**705**
Reduction in investments	3	151	0	0	0
Net acquisitions					
Reduction in other LT assets	-59	-41	-3	0	0
Addition in other LT liabilities	0	0	0	0	0
Adjustments					
Cashflow after investing acts	**449**	**583**	**268**	**552**	**705**
Cash dividends	0	0	0	0	0
Equity issue	170	227	-35	7	1
Debt issue					
Convertible debt issue					
Others	18	17	43	46	54
Cashflow from financial acts	**188**	**244**	**8**	**54**	**55**
Net cashflow	**637**	**827**	**276**	**606**	**761**
Beginning cash	763	1,399	2,226	2,503	3,109
Ending cash	1,399	2,226	2,503	3,109	3,869
Ending net debt	-1,399	-2,226	-2,503	-3,109	-3,869

Source: Nomura estimates

Notes

Strong cash flow generation to continue

Balance sheet (USDmn)

As at 31 Dec	FY09	FY10	FY11F	FY12F	FY13F
Cash & equivalents	1,399	2,226	2,503	3,109	3,869
Marketable securities	0	0	0	0	0
Accounts receivable	709	1,014	1,340	1,508	1,845
Inventories	0	0	0	0	0
Other current assets	199	278	281	285	336
Total current assets	**2,308**	**3,518**	**4,124**	**4,902**	**6,050**
LT investments	151	0	0	0	0
Fixed assets	482	570	691	832	942
Goodwill	192	224	224	224	224
Other intangible assets	76	85	88	88	88
Other LT assets	130	185	356	589	784
Total assets	**3,338**	**4,583**	**5,483**	**6,635**	**8,089**
Short-term debt					
Accounts payable	55	75	132	149	182
Other current liabilities	592	855	858	965	1,182
Total current liabilities	**647**	**931**	**990**	**1,114**	**1,364**
Long-term debt					
Convertible debt					
Other LT liabilities	38	68	78	78	78
Total liabilities	**685**	**999**	**1,068**	**1,192**	**1,441**
Minority interest					
Preferred stock	0	0	0	0	0
Common stock	668	850	850	850	850
Retained earnings	1,965	2,699	3,574	4,595	5,798
Proposed dividends					
Other equity and reserves	20	36	-9	-2	0
Total shareholders' equity	**2,653**	**3,584**	**4,415**	**5,443**	**6,647**
Total equity & liabilities	**3,338**	**4,583**	**5,483**	**6,635**	**8,089**
Liquidity (x)					
Current ratio	3.57	3.78	4.16	4.40	4.44
Interest cover	na	na	na	na	na
Leverage					
Net debt/EBITDA (x)	net cash	net cash	net cash	net cash	net cash
Net debt/equity (%)	net cash	net cash	net cash	net cash	net cash
Activity (days)					
Days receivable	71.7	68.5	70.6	73.5	71.6
Days inventory	0.0	0.0	0.0	0.0	0.0
Days payable	9.1	8.7	10.6	12.3	11.9
Cash cycle	62.7	59.8	60.0	61.2	59.7

Source: Nomura estimates

Notes

Cash levels continue to increase

3Q results likely to be ahead of peers

We expect Cognizant to report 6.5% q-q revenue growth in 3Q FY11F, ahead of peers Infosys (5%) and TCS (5.7%) in the quarter. The CoreLogic India acquisition (which was announced on July 26, 2011) would add USD5mn to 3Q revenue, according to management. We expect the EBIT margin to show a slight improvement of 10bps q-q.

Cognizant hedges 50-60% of its revenue and takes hedges for 2-3 years ahead on a rolling basis. For 3Q-4QFY11F, the company has hedged at an average USD/INR of ~48.1. We do not expect any material benefits to 3QFY11F margins from the rupee depreciation.

Fig. 13: 3QFY12 expectations

	3QFY11F	3QFY10	y-y (%)	2QFY11	q-q (%)
Revenue (US$ mn)	1,582	1,217	30.0	1,485	6.5
EBIT margin (%)	18.3	18.8	-50bp	18.2	10bp
PAT (US$ mn)	223	204	9.7	208	7.4
Diluted EPS (US$)	0.72	0.66	8.7	0.67	7.1

Source: Company data, Nomura estimates

Maintain Neutral and TP of USD68

We remain Neutral on Cognizant on anticipated moderation in growth differentials vs other market-share gain-focused Indian IT peers such TCS/HCL Tech. Given our caution on Cognizant's BFSI exposure and concentrated services and geographical profile, we would wait for better entry points in the stock. Our target price of USD68 is based on 20x one-year rolling forward EPS of USD3.4.

Valuation methodology

We value Cognizant at 20x our one-year forward earnings per share estimate of USD3.4, which is at a 10% discount to its long-term average to reflect higher risk in the macro environment and risks related to higher BFSI exposure.

Risks to valuation

The key risks include: 1) a faster-than-anticipated demand slowdown; 2) breakage of pricing discipline in the industry; and 3) rupee appreciation.

HCL Technologies HCLT.NS HCLT IN

SOFTWARE & SERVICES

NOMURA
EQUITY RESEARCH

Strong deal pipeline

Excessive pessimism in valuations; revenue surety provides comfort

October 4, 2011

Rating Remains	**Buy**
Target price Remains	INR 530
Closing price September 30, 2011	INR 409
Potential upside	+29.5%

1QFY12: revenue growth of 5.4%, margin decline of 140bps expected

We expect HCL Tech to deliver US dollar revenue growth of 5.4% q-q in 1Q FY12F along with a 140bp decline in EBITDA margin from wage hikes and fresher recruitment, cushioned by rupee depreciation. Management commentary on the deal pipeline and win-rates will be keenly watched.

Action: Top pick in IT for highest absolute return potential

HCL Tech's market share gain focus and lower margin expectations should aid in competing better in a growth slowdown scenario, in our view. We derive comfort from revenue surety on strong deal wins/pipeline exhibited by: 1) USD2.7bn worth of TCV signed in BFSI/manufacturing in FY11; 2) about USD2bn worth of deals in BFSI in the pipeline; and 3) anticipated strong deal decision making in the Dec-11 quarter with a record-high pipeline. Valuations seem to be building in a worst-case scenario of severe pricing cuts, which we believe is unlikely. In our view, its valuations and best-in-class earnings growth provide comfort for implied upside of ~30% from current levels. HCL Tech remains our top pick in IT.

Catalyst: Decision making on deals in line with expectations in the Dec-11 quarter and an absence of pricing cuts

Valuation: Reiterate Buy and TP of INR530 based on 15x FY13F

We expect a USD revenue CAGR of 19% and EPS CAGR of 24% over FY11-13F. Our estimates are marginally revised upwards for rupee depreciation. We retain our TP of INR530, based on 15x FY13F earnings.

30 Jun	FY11		FY12F		FY13F		FY14F
Currency (INR)	Actual	Old	New	Old	New	Old	New
Revenue (mn)	158,555	195,254	198,655	220,283	223,363	260,932	260,026
Reported net profit (mn)	16,010	20,775	21,311	24,731	24,999	28,197	27,255
Normalised net profit (mn)	16,010	20,775	21,311	24,731	24,999	28,197	27,255
Normalised EPS	23.47	30.19	30.97	35.80	36.19	40.71	39.35
Norm. EPS growth (%)	34.2	28.6	31.9	18.6	16.9	13.7	8.7
Norm. P/E (x)	17.8	N/A	13.5	N/A	11.5	N/A	10.6
EV/EBITDA (x)	11.3	9.0	8.7	7.5	7.4	6.2	6.5
Price/book (x)	3.3	N/A	2.8	N/A	2.4	N/A	2.0
Dividend yield (%)	1.8	N/A	2.0	N/A	2.0	N/A	2.0
ROE (%)	20.7	22.7	23.2	22.9	23.0	22.1	21.3
Net debt/equity (%)	19.0	9.1	9.2	net cash	net cash	net cash	net cash

Source: Nomura estimates

Key company data: *See page 2 for company data and detailed price/index chart.*
Rating: *See report end for details of Nomura's rating system.*

Anchor themes

We believe it prudent to participate in the sector through companies focused on market share gains, having low client concentration and better operating scope in the current uncertain economic environment.

Nomura vs consensus

Our FY13F earnings estimate is in line with Bloomberg consensus.

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Key data on HCL Technologies

Income statement (INRmn)

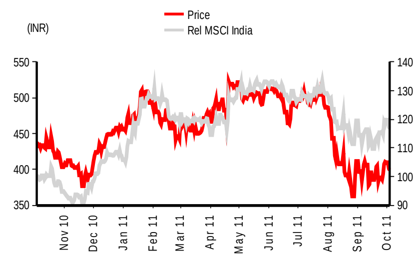
Year-end 30 Jun	FY10	FY11	FY12F	FY13F	FY14F
Revenue	**125,650**	**158,555**	**198,655**	**223,363**	**260,026**
Cost of goods sold	-87,391	-113,318	-141,635	-160,087	-189,618
Gross profit	**38,259**	**45,237**	**57,019**	**63,276**	**70,408**
SG&A	-18,466	-23,935	-29,442	-32,303	-37,195
Employee share expense					
Operating profit	**19,793**	**21,302**	**27,577**	**30,973**	**33,213**
EBITDA	**24,802**	**26,221**	**33,286**	**37,239**	**40,494**
Depreciation	-5,009	-4,919	-5,710	-6,266	-7,281
Amortisation					
EBIT	19,793	21,302	27,577	30,973	33,213
Net interest expense	0	0	-1,291	-1,088	-905
Associates & JCEs					
Other income	-5,302	-544	1,755	2,581	3,089
Earnings before tax	**14,491**	**20,758**	**28,041**	**32,466**	**35,397**
Income tax	-2,724	-4,748	-6,730	-7,467	-8,141
Net profit after tax	**11,767**	**16,010**	**21,311**	**24,999**	**27,255**
Minority interests	0	0	0	0	0
Other items	-1	0	0	0	0
Preferred dividends					
Normalised NPAT	**11,766**	**16,010**	**21,311**	**24,999**	**27,255**
Extraordinary items	372	0	0	0	0
Reported NPAT	**12,138**	**16,010**	**21,311**	**24,999**	**27,255**
Dividends	-3,153	-6,000	-6,444	-6,464	-6,485
Transfer to reserves	**8,985**	**10,010**	**14,867**	**18,534**	**20,771**
Valuation and ratio analysis					
FD normalised P/E (x)	23.9	17.8	13.5	11.5	10.6
FD normalised P/E at price target (x)	31.0	23.1	17.5	14.9	13.7
Reported P/E (x)	22.7	17.4	13.2	11.3	10.4
Dividend yield (%)	1.0	1.8	2.0	2.0	2.0
Price/cashflow (x)	15.7	18.5	12.6	10.0	10.0
Price/book (x)	3.9	3.3	2.8	2.4	2.0
EV/EBITDA (x)	12.2	11.3	8.7	7.4	6.5
EV/EBIT (x)	15.3	13.9	10.5	8.9	7.9
Gross margin (%)	30.4	28.5	28.7	28.3	27.1
EBITDA margin (%)	19.7	16.5	16.8	16.7	15.6
EBIT margin (%)	15.8	13.4	13.9	13.9	12.8
Net margin (%)	9.7	10.1	10.7	11.2	10.5
Effective tax rate (%)	18.8	22.9	24.0	23.0	23.0
Dividend payout (%)	26.0	37.5	30.2	25.9	23.8
Capex to sales (%)	6.1	5.4	5.0	4.4	4.1
Capex to depreciation (x)	1.5	1.7	1.7	1.6	1.5
ROE (%)	19.1	20.7	23.2	23.0	21.3
ROA (pretax %)	15.6	15.7	18.4	18.8	18.5
Growth (%)					
Revenue	18.5	26.2	25.3	12.4	16.4
EBITDA	10.9	5.7	26.9	11.9	8.7
EBIT	10.7	7.6	29.5	12.3	7.2
Normalised EPS	-2.6	34.2	31.9	16.9	8.7
Normalised FDEPS	-4.0	34.3	32.2	16.9	8.7
Per share					
Reported EPS (INR)	18.05	23.47	30.97	36.19	39.35
Norm EPS (INR)	17.49	23.47	30.97	36.19	39.35
Fully diluted norm EPS (INR)	17.09	22.97	30.36	35.48	38.59
Book value per share (INR)	104.61	123.63	144.16	170.48	200.01
DPS (INR)	4.01	7.52	8.00	8.00	8.00

Source: Nomura estimates

Notes

We expect USD revenue growth of 23%/14% in FY12/13F.

Price and price relative chart (one year)



(%)	1M	3M	12M
Absolute (INR)	-0.4	-17.3	-2.8
Absolute (USD)	-6.3	-24.5	-10.8
Relative to index	0.2	-4.6	16.7
Market cap (USDmn)	5,729.8		
Estimated free float (%)	25.0		
52-week range (INR)	528.4/360		
3-mth avg daily turnover (USDmn)	10.91		
Major shareholders (%)			
Shiv Nadar	65.2		

Source: Thomson Reuters, Nomura research

Cashflow (INRmn)

Year-end 30 Jun	FY10	FY11	FY12F	FY13F	FY14F
EBITDA	24,802	26,221	33,286	37,239	40,494
Change in working capital	-3,156	-5,335	-1,536	536	-667
Other operating cashflow	-3,757	-5,500	-8,949	-8,860	-10,795
Cashflow from operations	**17,889**	**15,386**	**22,801**	**28,915**	**29,033**
Capital expenditure	-7,633	-8,598	-9,905	-9,845	-10,560
Free cashflow	**10,256**	**6,788**	**12,896**	**19,070**	**18,473**
Reduction in investments	-5,278	449	0	0	0
Net acquisitions	2,203	1,244	0	0	0
Reduction in other LT assets	0	0	0	0	0
Addition in other LT liabilities	0	0	0	0	0
Adjustments					
Cashflow after investing acts	**7,181**	**8,481**	**12,896**	**19,070**	**18,473**
Cash dividends	-3,153	-6,000	-6,444	-6,464	-6,485
Equity issue	4,524	3,967	6	3	-6
Debt issue	-3,139	-5,392	-2,439	-2,981	-2,549
Convertible debt issue					
Others	-4,930	-544	465	1,493	2,184
Cashflow from financial acts	**-6,698**	**-7,969**	**-8,413**	**-7,949**	**-6,856**
Net cashflow	**483**	**512**	**4,483**	**11,121**	**11,617**
Beginning cash	4,203	4,686	5,198	9,681	20,802
Ending cash	4,686	5,198	9,681	20,802	32,418
Ending net debt	21,946	16,042	9,119	-4,982	-19,147

Source: Nomura estimates

Notes

We expect improvement in cash flow generation going forward

Balance sheet (INRmn)

As at 30 Jun	FY10	FY11	FY12F	FY13F	FY14F
Cash & equivalents	4,686	5,198	9,681	20,802	32,418
Marketable securities	19,733	17,211	17,211	17,211	17,211
Accounts receivable	30,496	34,065	42,680	47,989	55,866
Inventories	0	0	0	0	0
Other current assets	8,845	12,546	15,226	16,907	20,111
Total current assets	**63,760**	**69,020**	**84,798**	**102,909**	**125,606**
LT investments	707	2,780	2,780	2,780	2,780
Fixed assets	18,486	22,165	26,360	29,939	33,218
Goodwill	43,122	41,878	41,878	41,878	41,878
Other intangible assets					
Other LT assets	9,640	10,392	12,612	14,005	16,658
Total assets	**135,715**	**146,235**	**168,428**	**191,511**	**220,140**
Short-term debt					
Accounts payable	31,329	33,763	42,051	47,496	56,622
Other current liabilities	7,386	6,887	8,358	10,439	11,727
Total current liabilities	**38,715**	**40,650**	**50,409**	**57,935**	**68,349**
Long-term debt	26,632	21,240	18,801	15,820	13,271
Convertible debt					
Other LT liabilities	0	0	0	0	0
Total liabilities	**65,347**	**61,890**	**69,210**	**73,755**	**81,620**
Minority interest	0	0	0	0	0
Preferred stock	0	0	0	0	0
Common stock					
Retained earnings	70,368	84,345	99,218	117,755	138,520
Proposed dividends					
Other equity and reserves					
Total shareholders' equity	**70,368**	**84,345**	**99,218**	**117,755**	**138,520**
Total equity & liabilities	**135,715**	**146,235**	**168,428**	**191,511**	**220,140**
Liquidity (x)					
Current ratio	1.65	1.70	1.68	1.78	1.84
Interest cover	na	na	21.4	28.5	36.7
Leverage					
Net debt/EBITDA (x)	0.88	0.61	0.27	net cash	net cash
Net debt/equity (%)	31.2	19.0	9.2	net cash	net cash
Activity (days)					
Days receivable	83.6	74.3	70.7	74.1	72.9
Days inventory	0.0	0.0	0.0	0.0	0.0
Days payable	133.7	104.8	98.0	102.1	100.2
Cash cycle	-50.0	-30.5	-27.3	-28.0	-27.3

Source: Nomura estimates

Notes

Cash levels are increasing

Deal win momentum will be keenly watched

We expect HCL Tech to deliver US dollar revenue growth of 5.4% q-q in 1Q FY12F along with a 140bps decline in EBITDA margin from wage hikes and fresher recruitment. The wage hikes impact should be cushioned by rupee depreciation. Management commentary on deal pipeline and win-rates will be keenly watched, we expect. Management has indicated a higher-than-ever pipeline for the Dec-11 quarter.

Fig. 14: 1QFY12 expectations

	1QFY12F	1QFY11	y-y (%)	4QFY11	q-q (%)
Revenue (US$ mn)	1,015	804	26.3	963	5.4
Revenue (Rs mn)	46,498	36,116	28.7	43,035	8.0
EBITDA margin (%)	16.6	15.6	100bp	18.0	-140bp
PAT (Rs mn)	4,794	3,004	59.6	4,896	-2.1
Diluted EPS (Rs)	6.8	4.3	58.0	7.0	-2.2

Source: Company data, Nomura estimates

Adjusting estimates for rupee depreciation

We have adjusted our USD revenue estimates slightly lower on the back of USD appreciation against the GBP and EUR. Rupee revenue estimates are higher on rupee depreciation against the USD. Our EPS estimates for FY12F are higher by 3% largely on upward revision in rupee/USD rates for the remaining three quarters of FY12 and for the full year FY13. We model for 23% and 14% USD revenue growth in FY12F and FY13F, respectively, margin improvement of 20bps over FY11-13F and an earnings CAGR of 24% over FY11-13F.

Fig. 15: Earnings revisions

	New		Old		Change (%)	
	FY12F	FY13F	FY12F	FY13F	FY12F	FY13F
Revenue (US$ mn)	4,373	4,993	4,401	5,006	-0.6	-0.3
US$/INR rate	45.4	44.7	44.4	44.0	2.4	1.7
Revenue (Rs bn)	198.7	223.4	195.3	220.3	1.7	1.4
EBITDA margin (%)	16.8	16.7	16.4	16.8	30 bps	-10 bps
Tax Rate (%)	24.0	23.0	24.0	23.0	0 bps	0 bps
Diluted EPS (Rs)	30.4	35.5	29.6	35.1	2.6	1.1

Source: Nomura estimates

Current valuations build in extreme pessimism; reiterate Buy

We believe a key risk which is being built into the current price is pricing cuts. HCL Tech, on account of its lower margins, has the highest sensitivity to pricing cuts on earnings in our coverage universe. We believe the stock is building in the possibility of a ~5% pricing cut, which we consider unlikely due to the following:

- HCL Tech pricing is already lower than the peer group's pricing by ~10%; and
- HCL Tech's lower margin expectations; implying that in the case of pricing pressure, the risks would be higher for peers.

Notwithstanding its high-beta nature and the possibility of a liquidity-related fall, we reiterate HCL Tech as our top pick in the IT sector and maintain our Buy, with a TP of INR530 on best-in-class EPS CAGR of ~24% over FY11-13F. Our TP is based on 15x FY13F earnings, in line with its average historical valuation to reflect higher economic uncertainty and increased risk perception.

Valuation methodology

Our target price of INR530 is based on 15x our FY13F earnings forecast of INR35.5, which is in line with its historical average valuation.

Risk to valuation

The key risks are: 1) worse-than-expected slowdown and breakage of pricing discipline; 2) failure to exhibit stability in margins; 3) rupee appreciation; and 4) client-specific issues.

Infosys INFY.NS INFO IN

SOFTWARE & SERVICES

NOMURA
EQUITY RESEARCH

Revenue guidance could disappoint

High probability of cut in revenue guidance; we see upside to EPS guidance

October 4, 2011

Rating Remains	**Buy**
Target price Increased from 2800	INR 2900
Closing price September 30, 2011	INR 2533
Potential upside	+15%

Action: Possible negative reaction to guidance cut; accumulate on declines

We expect 2QFY12 results to be in line with guidance on USD revenues (4.9% q-q), to surprise positively on EBITDA margins (est +110bps q-q) and come in ahead of guidance on EPS (est INR35.7 vs guidance of INR30.2) driven by rupee depreciation. We see disappointments on a cut in FY12F revenue guidance, which we think is highly probable given: 1) project delays/deferrals and discretionary spending curtailments; and 2) adverse cross-currency movements. Infosys has significant operational scope to tide over demand moderation and we find comfort in valuations which are already factoring in a possibility of guidance downgrade and growth moderation to the low-teen levels in FY13F. Reiterate Buy.

Expect FY12F revenue guidance cut and EPS guidance raise

We expect a cut in USD revenue growth guidance from 18-20% to 16-18% on: 1) growth moderation; and 2) cross-currency impacts. We think EPS guidance is likely to be raised to around INR135 from INR128-130 earlier on: 1) rupee depreciation; and 2) cost curtailments in a growth moderation environment. Expect 3QFY12F revenue growth to be guided at 3-4% q-q.

Catalyst: Keeping revenue growth guidance unchanged would be a positive trigger

Valuation: Raise TP to INR2,900, reiterate Buy

We raise our TP to INR2,900 (vs INR2,800 earlier) based on 18x FY13F earnings on a marginal improvement in earnings on rupee depreciation. Maintain Buy on better operational scope and comfort on valuations.

31 Mar	FY11		FY12F		FY13F		FY14F
Currency (INR)	Actual	Old	New	Old	New	Old	New
Revenue (mn)	275,010	320,668	323,533	356,086	360,746	422,102	417,485
Reported net profit (mn)	68,230	76,794	77,720	89,712	91,089	103,707	101,553
Normalised net profit (mn)	68,230	76,794	77,720	89,712	91,089	103,707	101,553
Normalised EPS	119.45	134.46	136.08	157.05	159.46	181.53	177.76
Norm. EPS growth (%)	11.1	12.6	13.9	16.8	17.2	15.6	11.5
Norm. P/E (x)	21.2	N/A	18.6	N/A	15.9	N/A	14.3
EV/EBITDA (x)	14.4	12.7	12.6	10.7	10.5	9.0	9.2
Price/book (x)	5.3	N/A	4.6	N/A	3.9	N/A	3.2
Dividend yield (%)	2.4	N/A	1.6	N/A	1.6	N/A	1.8
ROE (%)	27.1	26.3	26.6	26.2	26.5	25.2	24.6
Net debt/equity (%)	net cash	net cash	net cash	net cash	net cash	net cash	net cash

Source: Nomura estimates

Key company data: *See page 2 for company data and detailed price/index chart.*
Rating: *See report end for details of Nomura's rating system.*

Anchor themes

We believe it is prudent to participate in the sector through companies focused on market share gains, having low client concentration and better operating scope in the current uncertain economic environment.

Nomura vs consensus

Our target price is in line with Bloomberg consensus.

Research analysts

India Technology/Services & Software

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Key data on Infosys

Income statement (INRmn)

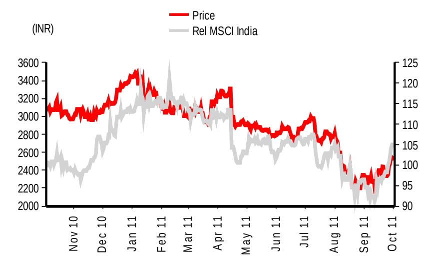
Year-end 31 Mar	FY10	FY11	FY12F	FY13F	FY14F
Revenue	**227,420**	**275,010**	**323,533**	**360,746**	**417,485**
Cost of goods sold	-128,855	-158,298	-191,730	-210,031	-249,714
Gross profit	**98,565**	**116,712**	**131,803**	**150,715**	**167,771**
SG&A	-29,005	-35,692	-41,806	-46,338	-53,401
Employee share expense					
Operating profit	**69,560**	**81,020**	**89,997**	**104,377**	**114,370**
EBITDA	**78,610**	**89,640**	**99,200**	**114,046**	**124,460**
Depreciation	-9,050	-8,620	-9,202	-9,670	-10,091
Amortisation					
EBIT	69,560	81,020	89,997	104,377	114,370
Net interest expense					
Associates & JCEs					
Other income	9,430	12,110	17,023	18,716	21,034
Earnings before tax	**78,990**	**93,130**	**107,020**	**123,093**	**135,404**
Income tax	-17,650	-24,900	-29,300	-32,004	-33,851
Net profit after tax	**61,340**	**68,230**	**77,720**	**91,089**	**101,553**
Minority interests	0	0	0	0	0
Other items					
Preferred dividends					
Normalised NPAT	**61,340**	**68,230**	**77,720**	**91,089**	**101,553**
Extraordinary items	1,320	0	0	0	0
Reported NPAT	**62,660**	**68,230**	**77,720**	**91,089**	**101,553**
Dividends	-16,724	-40,096	-26,737	-26,737	-26,737
Transfer to reserves	**45,936**	**28,134**	**50,983**	**64,351**	**74,816**
Valuation and ratio analysis					
FD normalised P/E (x)	23.6	21.2	18.6	15.9	14.3
FD normalised P/E at price target (x)	26.1	23.4	20.6	17.6	15.8
Reported P/E (x)	23.1	21.2	18.6	15.9	14.3
Dividend yield (%)	1.0	2.4	1.6	1.6	1.8
Price/cashflow (x)	24.1	28.1	20.7	19.6	18.9
Price/book (x)	6.3	5.3	4.6	3.9	3.2
EV/EBITDA (x)	17.2	14.4	12.6	10.5	9.2
EV/EBIT (x)	19.4	15.9	13.9	11.5	10.0
Gross margin (%)	43.3	42.4	40.7	41.8	40.2
EBITDA margin (%)	34.6	32.6	30.7	31.6	29.8
EBIT margin (%)	30.6	29.5	27.8	28.9	27.4
Net margin (%)	27.6	24.8	24.0	25.3	24.3
Effective tax rate (%)	22.3	26.7	27.4	26.0	25.0
Dividend payout (%)	26.7	58.8	34.4	29.4	26.3
Capex to sales (%)	4.0	4.5	4.1	3.2	3.4
Capex to depreciation (x)	1.0	1.4	1.4	1.2	1.4
ROE (%)	30.3	27.1	26.6	26.5	24.6
ROA (pretax %)	47.4	51.4	59.1	63.2	62.2
Growth (%)					
Revenue	4.8	20.9	17.6	11.5	15.7
EBITDA	9.3	14.0	10.7	15.0	9.1
EBIT	8.1	16.5	11.1	16.0	9.6
Normalised EPS	4.7	11.1	13.9	17.2	11.5
Normalised FDEPS	4.7	11.2	13.9	17.2	11.5
Per share					
Reported EPS (INR)	109.84	119.45	136.08	159.46	177.76
Norm EPS (INR)	107.52	119.45	136.08	159.46	177.76
Fully diluted norm EPS (INR)	107.40	119.42	136.03	159.42	177.76
Book value per share (INR)	404.03	478.01	545.03	657.57	788.46
DPS (INR)	25.06	60.00	40.01	40.01	46.80

Source: Nomura estimates

Notes

We expect USD revenue growth of 18%/13% in FY12/13F

Price and price relative chart (one year)



(%)	1M	3M	12M
Absolute (INR)	8.1	-13.0	-17.0
Absolute (USD)	1.8	-20.6	-23.8
Relative to index	8.8	-0.3	2.5
Market cap (USDmn)	29,703.0		
Estimated free float (%)			
52-week range (INR)	3499/2161.5		
3-mth avg daily turnover (USDmn)	84.29		
Major shareholders (%)			
N R Narayana Murthy	4.5		
Nandan M Nilekani	3.4		

Source: Thomson Reuters, Nomura research

Cashflow (INRmn)

Year-end 31 Mar	FY10	FY11	FY12F	FY13F	FY14F
EBITDA	78,610	89,640	99,200	114,046	124,460
Change in working capital	-1,470	-11,490	42	-8,118	-14,162
Other operating cashflow	-17,070	-26,680	-29,300	-32,004	-33,851
Cashflow from operations	**60,070**	**51,470**	**69,942**	**73,924**	**76,448**
Capital expenditure	-9,060	-12,240	-13,260	-11,600	-14,000
Free cashflow	**51,010**	**39,230**	**56,682**	**62,324**	**62,448**
Reduction in investments	-37,120	35,450	930	0	0
Net acquisitions					
Reduction in other LT assets			0	0	0
Addition in other LT liabilities	0	0	0	0	0
Adjustments	90	0	0	0	
Cashflow after investing acts	**13,980**	**74,680**	**57,612**	**62,324**	**62,448**
Cash dividends	-16,724	-40,096	-26,737	-26,737	-26,737
Equity issue	2,014	14,406	-12,730	0	0
Debt issue					
Convertible debt issue					
Others	9,340	12,110	17,023	18,716	21,034
Cashflow from financial acts	**-5,370**	**-13,580**	**-22,445**	**-8,021**	**-5,703**
Net cashflow	**8,610**	**61,100**	**35,167**	**54,303**	**56,745**
Beginning cash	96,950	105,560	166,660	201,827	256,130
Ending cash	105,560	166,660	201,827	256,130	312,875
Ending net debt	-105,560	-166,660	-201,827	-256,130	-312,875

Source: Nomura estimates

Notes

Strong cash flow generation to continue

Balance sheet (INRmn)

As at 31 Mar	FY10	FY11	FY12F	FY13F	FY14F
Cash & equivalents	105,560	166,660	201,827	256,130	312,875
Marketable securities	37,120	1,670	740	740	740
Accounts receivable	34,940	58,960	66,479	74,126	85,785
Inventories	0	0	0	0	0
Other current assets	41,870	24,390	26,459	30,051	38,288
Total current assets	**219,490**	**251,680**	**295,506**	**361,047**	**437,688**
LT investments	0	0	0	0	0
Fixed assets	53,550	57,170	61,228	63,158	67,067
Goodwill					
Other intangible assets					
Other LT assets	2,000	3,780	3,780	3,780	3,780
Total assets	**275,040**	**312,630**	**360,513**	**427,985**	**508,535**
Short-term debt					
Accounts payable	23,430	18,600	24,584	27,036	32,112
Other current liabilities	21,120	21,000	24,646	25,315	25,973
Total current liabilities	**44,550**	**39,600**	**49,230**	**52,350**	**58,085**
Long-term debt					
Convertible debt					
Other LT liabilities	0	0	0	0	0
Total liabilities	**44,550**	**39,600**	**49,230**	**52,350**	**58,085**
Minority interest	0	0	0	0	0
Preferred stock	0	0	0	0	0
Common stock	2,860	2,860	2,860	2,860	2,860
Retained earnings	227,630	270,170	308,423	372,774	447,590
Proposed dividends					
Other equity and reserves					
Total shareholders' equity	**230,490**	**273,030**	**311,283**	**375,634**	**450,450**
Total equity & liabilities	**275,040**	**312,630**	**360,513**	**427,985**	**508,535**
Liquidity (x)					
Current ratio	4.93	6.36	6.00	6.90	7.54
Interest cover	na	na	na	na	na
Leverage					
Net debt/EBITDA (x)	net cash	net cash	net cash	net cash	net cash
Net debt/equity (%)	net cash	net cash	net cash	net cash	net cash
Activity (days)					
Days receivable	57.5	62.3	71.0	71.1	69.9
Days inventory	0.0	0.0	0.0	0.0	0.0
Days payable	61.6	48.5	41.2	44.9	43.2
Cash cycle	-4.1	13.9	29.7	26.3	26.7

Source: Nomura estimates

Notes

Cash & equivalents continues to rise

Valuations factoring guidance cut

We expect 2QFY12 results to be in line with guidance on USD revenues (4.9% q-q), to surprises positively on EBITDA margins (est. +110bps q-q) and come ahead of guidance on EPS (est. INR35.7 vs guidance of INR30.2) driven by rupee depreciation. We see disappointments on a cut in FY12F revenue guidance likely due to 1) project delays/ deferrals and discretionary spending curtailments; and 2) adverse cross-currency movements. Infosys has significant operational scope to tide over demand moderation, and we find comfort in valuations which are already factoring in a possibility of a guidance downgrade. We would use any declines as an opportunity to accumulate.

Fig. 16: 2QFY12 expectations

	2QFY12F	2QFY11	y-y (%)	1QFY12	q-q (%)
Revenue (US$ mn)	1,752	1,496	17.1	1,671	4.9
Revenue (Rs mn)	80,247	69,470	15.5	74,850	7.2
EBITDA margin (%)	30.2	33.3	-310bp	29.1	110bp
PAT (Rs mn)	20,418	17,370	17.5	17,220	18.6
Diluted EPS (Rs)	35.7	30.4	17.5	30.1	18.6

Source: Company data, Nomura estimates

Key things to watch out for

- 3QFY12F and FY12F guidance: Infosys keeping the revenue growth guidance unchanged versus our expectation of a cut from 18-20% to 16-18% would be a positive catalyst for the stock, in our view.
- Any material change in hiring plans or utilization targets to counter the moderation in growth would be another metric which will be keenly watched.

Change of estimates

We have revised our FY12F USD revenue growth estimates lower by ~100bps to 18% (vs 19.1% earlier) incorporating the impact of adverse cross-currency movements and the continuation of the trend of project delays/deferrals going into 2HFY12F. Our INR revenue expectations are higher largely driven by rupee depreciation. Our FY13F estimates are largely unchanged.

We expect USD revenue growth of 18%/12.5% in FY12/13F, EBITDA margin decline of 100bps and an EPS CAGR of 15.5% over FY11-13F.

Fig. 17: Earnings revisions

	New		Old		Change (%)	
	FY12F	FY13F	FY12F	FY13F	FY12F	FY13F
Revenue (US$ mn)	7,126	8,017	7,195	8,093	-1.0	-0.9
US$/INR rate	45.4	45.0	44.6	44.0	1.8	2.3
Revenue (Rs bn)	323.5	360.7	320.7	356.1	0.9	1.3
EBITDA margin (%)	30.7	31.6	30.7	31.5	0 bps	10 bps
Tax Rate (%)	27.4	26.0	27.4	26.0	0 bps	0 bps
Diluted EPS (Rs)	136.0	159.4	134.4	157.0	1.2	1.5

Source: Nomura estimates

Maintain Buy, TP raised to INR2900

We continue to derive greater comfort from Infosys' lower exposure to slowdown-prone segments such as BFSI/Europe, better operational scope to counter growth moderation impact and greater valuation comfort on lower future growth expectations being built into valuations. Near-term stock movement might, however, remain sluggish on guidance moderation and continued outperformance by TCS on revenue growth, in our view.

We believe our estimates of low-teen growth in FY13F build in moderation in growth expectations. We maintain our Buy rating and raise our target price to INR2,900, based on 18x FY13F earnings. This TP upgrade is largely driven by marginal upgrades to our FY13F earnings driven by rupee depreciation. Our methodology is unchanged.

Our FY13F estimates are based on a USD-INR rate of 45 (vs spot rates of 49+). Better-than-assumed currency rates could provide upside to our earnings estimates. Infosys' EPS sensitivity is ~1.5% for 1% rupee depreciation, on our estimates.

Valuation methodology

We value Infosys at 18x our FY13F earnings forecast of INR159.4, which is at a 10% discount to its long-term average valuation. We believe the discount is justified on heightened economic uncertainties, increased risk aversion and an impending slowdown.

Risks to our valuation

The key risks are: 1) worse-than-expected slowdown and breakage of pricing discipline in the industry; 2) rupee appreciation; 3) client-specific issues; and 4) an adverse ruling in its pending B1 visa violation case in the US.

Patni Computer Systems PTNI.NS PATNI IN

SOFTWARE & SERVICES

NOMURA
EQUITY RESEARCH

Upgrade to Neutral on better risk reward

Weak revenue outlook in the price; downside protected by delisting trigger

October 4, 2011

Rating Up from Reduce	**Neutral**
Target price Increased from 290	INR 300
Closing price September 30, 2011	INR 289
Potential upside	+3.8%

Action: Weak revenue outlook in the price; upgrade to Neutral

Patni has corrected by 39% (vs 19% correction for the Nifty) YTD and is now trading at 10x FY12F EPS. Post this correction, we see limited downside given: 1) likely sequential margin and EPS improvement for the next few quarters primarily on the back of G&A savings; 2) a cash balance of INR130 per share (~45% of market cap); and 3) Igate's expressed preference for a delisting, which could result in shares being acquired at a premium to current prices. Upgrade Patni to Neutral.

Not a Buy yet, as revenue and governance concerns remain

Patni's revenue growth will be sluggish, in our view, (we model 6.6% CAGR over FY10-12F) as margin improvement seems to be the primary focus of management. Also, we still have concerns on allocation of costs and revenues to Patni under a common Igate-Patni front-end.

Catalyst: Change in delisting plans, improvement in revenue growth

An Igate decision to cut its stake instead of delisting could lead to valuation multiple de-rating. Any sign of Patni breaking out from the sub-4% sequential revenue growth pattern could lead to a re-rating in the stock.

Valuation: Raise TP to INR300 based on 10x 1-yr forward earnings

Our diluted EPS estimates are higher by 6%/3% to INR25.4/28.3 in FY11/12F on 1) rupee depreciation; and 2) higher G&A savings, despite cut in FY13F revenue estimates.

31 Dec	FY10		FY11F		FY12F		FY13F
Currency (INR)	Actual	Old	New	Old	New	Old	New
Revenue (mn)	31,689	33,330	33,777	36,433	35,780	40,210	39,526
Reported net profit (mn)	6,016	2,664	2,850	3,731	3,840	4,195	4,050
Normalised net profit (mn)	5,677	3,257	3,443	3,731	3,840	4,195	4,050
Normalised EPS	43.29	24.45	25.86	27.93	28.75	31.40	30.32
Norm. EPS growth (%)	17.8	-43.5	-40.3	14.2	11.2	12.4	5.5
Norm. P/E (x)	6.8	N/A	11.4	N/A	10.2	N/A	9.7
EV/EBITDA (x)	5.6	6.9	6.5	4.8	4.7	3.8	3.8
Price/book (x)	1.2	N/A	0.6	N/A	0.5	N/A	0.5
Dividend yield (%)	25.5	N/A	1.2	N/A	1.2	N/A	1.2
ROE (%)	18.5	5.4	5.8	5.5	5.6	5.8	5.6
Net debt/equity (%)	net cash	net cash	net cash	net cash	net cash	net cash	net cash

Source: Nomura estimates

Key company data: *See page 2 for company data and detailed price/index chart.*
Rating: *See report end for details of Nomura's rating system.*

Anchor themes

We believe it prudent to participate in the sector through companies focused on market share gains, having low client concentration and better operating scope in the current uncertain economic environment.

Nomura vs consensus

Our FY12F earnings are 14% lower than Bloomberg consensus; we think consensus margin expectations are higher than ours.

Research analysts

India Technology/Services & Software

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Key data on Patni Computer Systems

Income statement (INRmn)

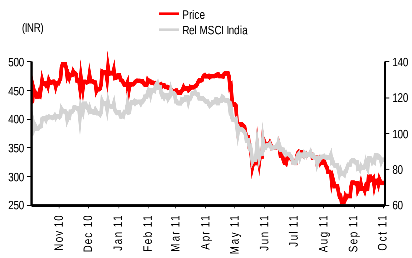
Year-end 31 Dec	FY09	FY10	FY11F	FY12F	FY13F
Revenue	**31,620**	**31,689**	**33,777**	**35,780**	**39,526**
Cost of goods sold	-20,597	-20,836	-23,763	-25,653	-28,889
Gross profit	**11,024**	**10,853**	**10,014**	**10,127**	**10,637**
SG&A	-5,716	-5,837	-7,024	-6,086	-6,292
Employee share expense					
Operating profit	**5,307**	**5,016**	**2,990**	**4,041**	**4,345**
EBITDA	**6,576**	**6,299**	**4,874**	**5,951**	**6,322**
Depreciation	-1,269	-1,283	-1,883	-1,910	-1,976
Amortisation					
EBIT	5,307	5,016	2,990	4,041	4,345
Net interest expense					
Associates & JCEs					
Other income	482	1,816	1,797	1,292	1,279
Earnings before tax	**5,789**	**6,831**	**4,788**	**5,333**	**5,624**
Income tax	-1,072	-1,154	-1,345	-1,493	-1,575
Net profit after tax	**4,718**	**5,677**	**3,443**	**3,840**	**4,050**
Minority interests					
Other items					
Preferred dividends					
Normalised NPAT	**4,718**	**5,677**	**3,443**	**3,840**	**4,050**
Extraordinary items	1,063	338	-593	0	0
Reported NPAT	**5,781**	**6,016**	**2,850**	**3,840**	**4,050**
Dividends	-453	-9,667	-467	-469	-469
Transfer to reserves	**5,328**	**-3,651**	**2,383**	**3,371**	**3,581**
Valuation and ratio analysis					
FD normalised P/E (x)	7.9	6.8	11.4	10.2	9.7
FD normalised P/E at price target (x)	7.9	6.9	11.4	10.2	9.7
Reported P/E (x)	6.4	6.3	13.5	10.0	9.5
Dividend yield (%)	1.2	25.5	1.2	1.2	1.2
Price/cashflow (x)	7.9	11.1	na	10.4	11.0
Price/book (x)	1.1	1.2	0.6	0.5	0.5
EV/EBITDA (x)	5.4	5.6	6.5	4.7	3.8
EV/EBIT (x)	6.7	7.0	10.6	6.9	5.5
Gross margin (%)	34.9	34.2	29.6	28.3	26.9
EBITDA margin (%)	20.8	19.9	14.4	16.6	16.0
EBIT margin (%)	16.8	15.8	8.9	11.3	11.0
Net margin (%)	18.3	19.0	8.4	10.7	10.2
Effective tax rate (%)	18.5	16.9	28.1	28.0	28.0
Dividend payout (%)	7.8	160.7	16.4	12.2	11.6
Capex to sales (%)	3.5	2.3	8.2	3.9	3.8
Capex to depreciation (x)	0.9	0.6	1.5	0.7	0.8
ROE (%)	19.4	18.5	5.8	5.6	5.6
ROA (pretax %)	15.2	13.7	5.6	5.6	6.0
Growth (%)					
Revenue	-1.2	0.2	6.6	5.9	10.5
EBITDA	19.5	-4.2	-22.6	22.1	6.2
EBIT	24.4	-5.5	-40.4	35.1	7.5
Normalised EPS	24.1	17.8	-40.3	11.2	5.5
Normalised FDEPS	23.5	15.6	-39.8	11.4	5.5
Per share					
Reported EPS (INR)	45.02	45.87	21.40	28.75	30.32
Norm EPS (INR)	36.74	43.29	25.86	28.75	30.32
Fully diluted norm EPS (INR)	36.52	42.21	25.42	28.31	29.86
Book value per share (INR)	262.84	239.07	500.87	528.14	558.46
DPS (INR)	3.53	73.71	3.51	3.51	3.51

Source: Nomura estimates

Notes

We look for USD revenue growth of 6.3%/6.5% in FY11/12F.

Price and price relative chart (one year)



(%)	1M	3M	12M
Absolute (INR)	-0.2	-10.9	-30.4
Absolute (USD)	-6.1	-18.7	-36.1
Relative to index	0.4	1.7	-10.9
Market cap (USDmn)	787.0		
Estimated free float (%)	35.0		
52-week range (INR)	509.5/250		
3-mth avg daily turnover (USDmn)	1.37		
Major shareholders (%)			
Igate	82.4		

Source: Thomson Reuters, Nomura research

Cashflow (INRmn)

Year-end 31 Dec	FY09	FY10	FY11F	FY12F	FY13F
EBITDA	6,576	6,299	4,874	5,951	6,322
Change in working capital	-1,794	-800	-6,764	-356	-812
Other operating cashflow	-71	-1,989	-1,975	-1,812	-1,957
Cashflow from operations	**4,712**	**3,510**	**-3,865**	**3,783**	**3,553**
Capital expenditure	-1,122	-716	-2,780	-1,400	-1,500
Free cashflow	**3,590**	**2,794**	**-6,645**	**2,383**	**2,053**
Reduction in investments	-5,892	4,276	0	0	0
Net acquisitions	0	0	0	0	0
Reduction in other LT assets	-569	-32	-28,100	0	0
Addition in other LT liabilities	0	0	0	0	0
Adjustments					
Cashflow after investing acts	**-2,872**	**7,039**	**-34,745**	**2,383**	**2,053**
Cash dividends	-453	-9,667	-467	-469	-469
Equity issue	2,636	1,249	32,969	469	469
Debt issue	358	223	3,685	290	541
Convertible debt issue					
Others	482	1,816	1,797	1,292	1,279
Cashflow from financial acts	**3,023**	**-6,379**	**37,984**	**1,582**	**1,821**
Net cashflow	**151**	**660**	**3,239**	**3,965**	**3,873**
Beginning cash	2,716	2,867	3,527	6,766	10,731
Ending cash	2,867	3,527	6,766	10,731	14,604
Ending net debt	-2,867	-3,527	-6,766	-10,731	-14,604

Source: Nomura estimates

Notes

The significant increase in LT assets and equity issue in FY11F is on account of revaluation of Patni assets post the Igate acquisition that closed in 2QFY11.

Balance sheet (INRmn)

As at 31 Dec	FY09	FY10	FY11F	FY12F	FY13F
Cash & equivalents	2,867	3,527	6,766	10,731	14,604
Marketable securities	16,983	12,707	12,707	12,707	12,707
Accounts receivable	5,835	6,825	7,958	8,430	9,313
Inventories	0	0	0	0	0
Other current assets	1,133	1,510	7,093	7,514	8,300
Total current assets	**26,819**	**24,569**	**34,524**	**39,382**	**44,924**
LT investments	0	0	0	0	0
Fixed assets	6,671	6,103	7,000	6,490	6,014
Goodwill					
Other intangible assets					
Other LT assets	7,230	8,428	36,528	36,846	37,229
Total assets	**40,719**	**39,101**	**78,052**	**82,719**	**88,167**
Short-term debt					
Accounts payable	267	267	463	490	541
Other current liabilities	5,674	6,239	5,996	6,505	7,311
Total current liabilities	**5,940**	**6,506**	**6,459**	**6,996**	**7,853**
Long-term debt	0	0	0	0	0
Convertible debt					
Other LT liabilities	1,025	1,242	4,889	5,179	5,720
Total liabilities	**6,965**	**7,748**	**11,348**	**12,175**	**13,573**
Minority interest	0	0	0	0	0
Preferred stock	0	0	0	0	0
Common stock	258	261	267	267	267
Retained earnings	33,496	31,092	66,437	70,277	74,326
Proposed dividends					
Other equity and reserves					
Total shareholders' equity	**33,754**	**31,353**	**66,704**	**70,544**	**74,594**
Total equity & liabilities	**40,719**	**39,101**	**78,052**	**82,719**	**88,167**
Liquidity (x)					
Current ratio	4.51	3.78	5.35	5.63	5.72
Interest cover	na	na	na	na	na
Leverage					
Net debt/EBITDA (x)	net cash	net cash	net cash	net cash	net cash
Net debt/equity (%)	net cash	net cash	net cash	net cash	net cash
Activity (days)					
Days receivable	70.8	72.9	79.9	83.8	81.9
Days inventory	0.0	0.0	0.0	0.0	0.0
Days payable	6.0	4.7	5.6	6.8	6.5
Cash cycle	64.8	68.2	74.3	77.0	75.4

Source: Nomura estimates

Notes

Cash levels are increasing

Upgrade to Neutral on better risk reward

Patni has corrected by 39% (vs 19% correction for the Nifty) YTD and is now trading at 10x FY12F EPS. Post this correction, we see limited downside given: 1) likely sequential margin and EPS improvement for the next few quarters primarily on the back of G&A savings; 2) a cash balance of INR130 per share (~45% of market cap); and 3) Igate's expressed preference for a delisting, which could result in Patni shares being acquired at a premium to current prices. We upgrade Patni to Neutral.

We increase our target price to INR300 (from INR290 earlier) based on 10x one-year rolling forward earnings (unchanged). The 10x multiple that we use to value Patni is a discount of ~45% to our valuation of Infosys and in line with the 40-50% historical discount at which the stock has traded. We believe the stock warrants a lower multiple on uncertainty of revenue and cost allocation to Patni under the common front-end and less confidence in revenue synergies from the Igate- Patni combination.

~600bp margin improvement likely over next 3 quarters

Patni is likely to see EBITDA margin improvement of 590bps over the next three quarters, in our view, on account of the following factors

- Higher Utilization: Management expects attrition (which was 23% (LTM) in 2QFY11) to fall below 20% in 3Q. With lower attrition, Patni is looking to optimize the bench strength and run at higher utilization rates. Management is looking to increase utilization to about 79-80% (from 76% reported in 2QFY11) latest by end of FY12.
- Increase share of fixed-price contracts: Management is starting to convert the time and materials (T&M) contracts to fixed-price and outcome-based contracts, which should aid in margin improvement, in our view. In fixed-price contracts, as the project matures, the staff strength and experience level can be progressively be brought lower which should lead to higher gross margins. Patni currently has many T&M contracts where there is no flexibility to substitute employees that the management is trying to negotiate. (54% of Patni's revenues is based on T&M contracts).
- SG&A synergies: Management has raised its SG&A savings estimate (from the initially anticipated figure of USD25mn) to USD30mn in the combined entity within one year of the transaction closing (ie, by May 2012). We estimate that about 70% of this saving would flow into Patni, which implies about 260bps in margin improvement in FY12F over FY11F.
- Employee pyramid optimization: Patni employees' average years of experience is 6-7 years, compared with about 3.5 years at Igate, which management is looking to correct by: 1) not making any new hires and using the natural attrition to bring down the average age; and 2) bringing on board fresh graduates from the 4,500 campus offers that Patni had extended.

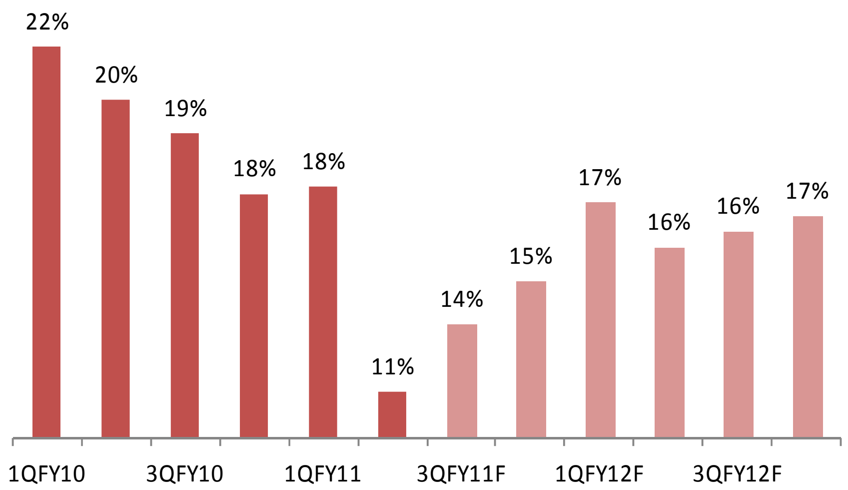
25% EBITDA margin target looks unrealistic

We think management's goal of reaching 25% EBITDA by June 2013 looks unrealistic. On our estimates, Patni would move up to 16.0% EBITDA by FY13F, an improvement of 160bps over FY11-13F. The key reasons why we believe the 25% target may not be achieved are:

- Patni's SG&A expenditure as a percentage of sales is unlikely to fall below 15%, in our view. This is so because a high level of sales investments will have to be maintained: 1) to target newer clients and break dependence on the top 10 clients who contribute about 50% of revenues; and 2) to target bigger deals (in the USD20-50mn range) on which the combined Patni-Igate entity would be eligible to bid. Patni's SG&A as a percentage of sales has been 16-22% over the last three years. We model for SG&A at 16.5%/15.4% of revenues in FY12/13F.
- Gross margin expansion would likely be very difficult as: 1) Patni would have to pay higher-than-industry rates to attract quality talent at the lateral level; 2) pricing increases look very unlikely in the current environment; and 3) to tide over double-digit

wage hikes (made necessary by high inflation in India) every year, Patni will have to grow at above-industry rates, which we do not think is possible in the near term.

Fig. 18: Patni EBITDA margin trajectory and estimates



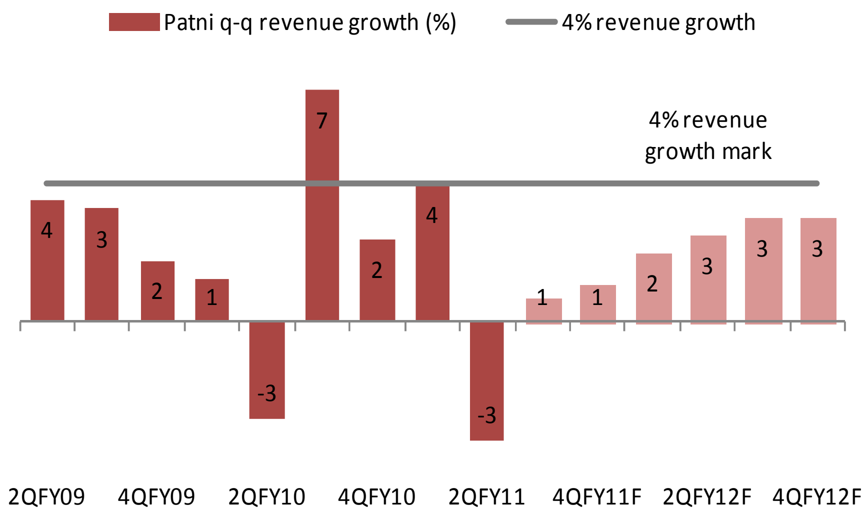
Source: Company, Nomura estimates

Not a Buy until revenue growth traction improves

We think the primary focus of management is stabilizing the combined entity which is going through a major integration exercise currently. To that extent, we believe management attention will be more towards maintaining existing business and exploiting the operational synergies between the two companies. Igate's extremely high debt burden also necessitates that margin improvement gets top priority in order to meet interest servicing. Indeed the June 2013 25% EBITDA margin target given to senior management (with no short-term revenue targets), also suggests to us that sequential revenue growth will remain sub 4% in the near term. Patni has beaten 4% sequential growth only once over the last 14 quarters. We are modelling for 6.3%/6.5% USD revenue growth in FY11/12F.

Our estimates also tie in with management commentary on demand, as CEO Phaneesh Murthy expects growth for Igate in FY12F to be a little ahead of FY11F growth. He also expects industry growth to be in the 8-10% range for 2012F, compared with the 16-18% that NASSCOM expects for 2011F. Patni has grown slower than the industry in the past 3 years, and we do not see this scenario changing going forward.

Fig. 19: Patni sequential revenue growth trajectory and estimates



Source: Company data, Nomura research

Potential delisting an upside trigger, but timing big uncertainty

18-25% upside to the stock from current levels if Patni were to announce a delisting, going by the same valuation multiple that Igate originally acquired Patni, or by the floor price mandated by SEBI.

Igate owns 82% of Patni and will have to either scale back to 75% to meet the minimum public shareholding requirement (of 25%) or delist Patni from the stock exchanges. Key points to highlight here are:

- The promoters (Igate) have expressed their preference to delisting Patni rather than paring its stake and continuing to leave Patni listed on the Indian exchanges. According to SEBI regulations, Igate has until May 12, 2012 to reduce its stake to 75%.
- Igate CEO has in various interviews suggested using USD200-300mn to buyback the 18% minority stake, suggesting an offer price range of INR370-560 per share for Patni stock. Based on our latest interaction, management is currently factoring ~USD250mn (about INR460/share) for a buyback in view of the recent correction in Patni's stock.
- According to Igate management, the delisting option would be considered only if Patni's stock price remains 'low'. If Patni's stock price runs up, then management would be willing to sell a 7% stake in the secondary market and comply with the 25% minimum public shareholding norms.
- Management is looking at finalizing its option post November regarding either delisting or selling shares in secondary market. November marks six months post completion of the Igate acquisition. Until November, Igate would be forced to pay the same price as the acquisition price (INR503.5/share) if it were to pursue a delisting.
- We believe Igate will at best pay the acquisition price (INR503.5/share) to buyout the remaining shareholders. In this scenario, the best case return for shareholders comes out to be 74%, on our estimates.
- Igate acquired Patni at 13.5x one-year forward earnings; assuming Igate would buy-back the remaining stake at the same valuation multiple then the offer price today works out to be INR360/share on our estimates. At this price, the implied upside from current levels is ~25%.
- The floor price for a potential delisting (see section on delisting procedure below) will work out to be INR340/share – at which the implied upside from current levels is ~18%.

Procedure for delisting

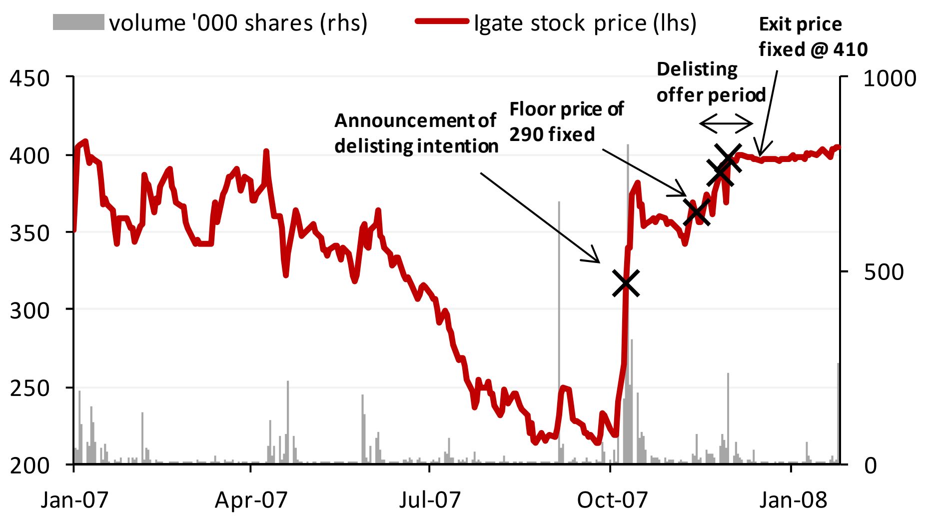
The steps for delisting shares according to SEBI regulations (2009) are:

- Shareholder approval: The delisting offer should be approved by the public shareholders (via postal ballot) and votes cast by the public shareholders in favour of the delisting proposal should be at least 2 times of numbers cast against it.
- Reverse book-building: The delisting offer price is discovered through a reverse-book-building process, where the floor price is fixed as the higher of the average of the weekly high and low of the closing prices of the equity shares of the company during the twenty-six weeks or two weeks preceding the date on which the recognised stock exchanges were notified of the board meeting in which the delisting proposal was considered.
- Final offer price: The final offer price is determined as the price at which the maximum number of equity shares is tendered by the public shareholders. If the final price is accepted, then, the promoter shall accept all shares tendered where the corresponding bids placed are at the final price or at a price which is lesser than the final price.
- Criteria for successful delisting: The delisting will be deemed successful only if the shareholding of the promoter taken together with the shares accepted through eligible bids at the final price, reaches the higher of (a) 90% of the total issued shares (excluding the shares which are held by a custodian and against which depository receipts have been issued overseas); or (b) the aggregate percentage of pre-offer promoter shareholding and 50% of the offer size.

Flashback: Igate Global Solutions delisting (in 2007)

We present the stock price chart and chronology of events preceding the delisting of Igate Global Solutions in 2007. We highlight that Patni CEO Phaneesh Murthy was the then CEO of Igate Global Solutions. Igate Corp, which is currently the promoter of Patni, was also the promoter of Igate Global Solutions.

Fig. 20: Igate Global Solutions delisting history



Source: BSE, Nomura research

Fig. 21: Timeline of events leading to the delisting of Igate Global Solutions

Date	Event
09-Oct-07	iGate Corporation announces its intention to delist its offshore subsidiary, iGATE Global Solutions, Ltd. ("iGS") from the Bombay Stock Exchange, the National Stock Exchange, and the Bangalore Stock Exchange, subject to the approval of the iGS shareholders and regulatory approval.
14-Nov-07	iGate delisting offer approved by the shareholders of iGate Global solutions. The floor price for the iGate delisting offer was fixed at Rs 288.90 per share which is the 6 months average closing price of iGate Global Solutions. The reverse book building process will open on 26 November 2007 and close on 29 November 2007.
04-Dec-07	The discovered price / exit price has been arrived at Rs 410/- per equity share as per the Reverse Book Building Process. iGATE Corporation has accepted the exit price of Rs 410/- (Rupees Four Hundred and Ten Only) per equity share of the Company.

Source: BSE, Nomura research

3QFY11 preview: Patni's margins likely to expand on absence of one-offs

Fig. 22: 3QFY11F results expectation

	3QFY11F	3QFY10	y-y (%)	2QFY11	q-q (%)
Revenue (US$ mn)	185	179	3.5	184	0.7
Revenue (Rs mn)	8,476	7,967	6.4	8,221	3.1
EBIT margin (%)	7.0	15.3	-830bp	5.9	120bp
PAT (Rs mn)	737	1,281	-42.4	701	5.2
Diluted EPS (Rs)	5.4	9.6	-43.2	5.2	5.2

Source: Company data, Nomura estimates

Reducing revenue growth forecasts in FY12F; upward revisions to FY11/12F EPS estimates

We have reduced our FY12F revenue estimates on the back of weak macroeconomic conditions and expected moderation in demand. Our margin assumptions are higher to factor; 1) higher estimated G&A savings projected by management; 2) employee pyramid optimization benefits; and 3) rupee depreciation.

Fig. 23: Earnings revisions

	New		Old		Change (%)	
	FY11F	FY12F	FY11F	FY12F	FY11F	FY12F
Revenue (US$ mn)	746	795	748	826	-0.2	-3.7
US$/INR rate	45.3	45.0	44.6	44.1	1.6	2.0
Revenue (Rs bn)	33.8	35.8	33.3	36.4	1.3	-1.8
EBIT margin (%)	8.9	11.3	8.3	10.8	60 bps	50 bps
Tax Rate (%)	28.1	28.0	28.1	28.0	0 bps	0 bps
Diluted EPS (Rs)	25.4	28.3	24.0	27.5	5.7	2.9

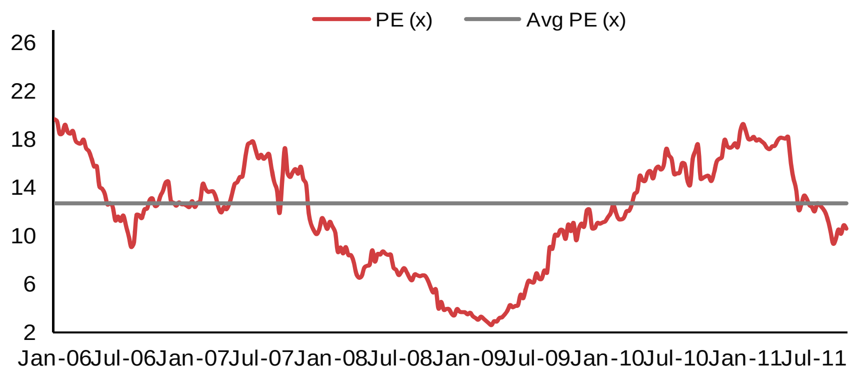
Source: Nomura estimates

Valuation Methodology Our revised PT of INR300 is based on 10x one-year rolling forward earnings (INR30). The 10x multiple that we use to value Patni is a discount of ~45% to the multiple we use to value Infosys and in line with the historical average at which Patni has traded.

Risks to our call

Upside risks to our call: 1) earlier-than-anticipated merger with Igate and realisation of integration benefits; and 2) higher-than-anticipated revenue growth. Downside risks to our call are 1) margin expansion lower than what we expect and 2) Igate deciding not to do a buyback.

Fig. 24: Patni P/E and avg P/E trend



Source: Bloomberg, Nomura estimates

Tata Consultancy Services TCS.NS TCS IN

SOFTWARE & SERVICES

NOMURA
EQUITY RESEARCH

Growth momentum to continue in 2Q

Cautious on high BFSI/Europe exposure and greater dependence on top clients

October 4, 2011

Rating Remains	**Neutral**
Target price Increased from 1050	INR 1070
Closing price September 30, 2011	INR 1037
Potential upside	+3.18%

2QFY12F: 5%+ revenue growth; forex losses to weigh on earnings

We expect TCS to report USD revenue growth of 5.4% q-q in 2Q FY12F. EBTIDA margins are likely to improve by 80bps q-q on better rupee realisation and SG&A leverage. Forex losses could depress the positive impact of rupee depreciation on earnings. Management commentary on demand and pipeline will be key things to watch for, as we sense some moderation in management optimism over the past few quarters.

Action: High BFSI/Europe exposure a risk; remain NEUTRAL

We see the key risk at TCS being its high Banking, Financial Services and Insurance (BFSI) and Europe exposure. These were the first segments to be hit in the previous downturn, and we expect a repeat of the same scenario. Valuations still appear to build in higher-than-peer-group optimism on future growth given strong management commentary and superior results of late, which could be at risk in a growth moderation scenario. We maintain our Neutral rating, despite continuation of growth momentum in the near term. Amongst Tier-1 stocks, we prefer Infosys and HCL Tech.

Catalysts: Economic uncertainty shifting to individual clients and management commentary turning less upbeat on demand

Valuation: Raising TP to INR1,070; remain Neutral

We have raised our EPS estimates marginally on rupee depreciation. This leads to our TP being raised to INR1,070 (from INR1,050), based on 18x FY13F earnings. We remain cautious on TCS on its high BFSI/Europe and client concentration, coupled with lesser comfort on valuations.

31 Mar	FY11	FY12F		FY13F		FY14F	
Currency (INR)	Actual	Old	New	Old	New	Old	New
Revenue (mn)	373,245	456,075	465,259	508,381	518,526	599,605	596,807
Reported net profit (mn)	87,166	102,023	102,340	113,929	116,175	130,773	128,225
Normalised net profit (mn)	87,166	102,023	102,340	113,929	116,175	130,773	128,225
Normalised EPS	44.54	52.13	52.29	58.21	59.36	66.82	65.51
Norm. EPS growth (%)	27.0	17.0	17.4	11.7	13.5	14.8	10.4
Norm. P/E (x)	23.3	N/A	19.8	N/A	17.5	N/A	15.8
EV/EBITDA (x)	18.0	15.0	14.8	13.2	12.9	11.4	11.6
Price/book (x)	8.0	N/A	6.4	N/A	5.2	N/A	4.3
Dividend yield (%)	1.3	N/A	1.6	N/A	1.8	N/A	1.8
ROE (%)	37.6	35.7	35.8	32.3	32.8	30.3	29.6
Net debt/equity (%)	net cash	net cash	net cash	net cash	net cash	net cash	net cash

Source: Nomura estimates

Key company data: *See page 2 for company data and detailed price/index chart.*
Rating: *See report end for details of Nomura's rating system.*

Anchor themes

We believe it's prudent to participate in the sector through companies focused on market share gains, having low client concentration and better operating scope in the current uncertain economic environment.

Nomura vs consensus

Our FY13F earnings forecast is ~3% lower than Bloomberg consensus, as we factor in higher risk for growth amid the economic uncertainty and high BFSI/Europe exposure.

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Key data on Tata Consultancy Services

Income statement (INRmn)

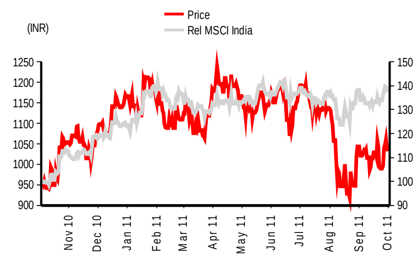
Year-end 31 Mar	FY10	FY11	FY12F	FY13F	FY14F
Revenue	**300,289**	**373,245**	**465,259**	**518,526**	**596,807**
Cost of goods sold	-163,805	-205,865	-258,981	-288,212	-342,886
Gross profit	**136,484**	**167,380**	**206,278**	**230,314**	**253,921**
SG&A	-56,975	-62,609	-80,403	-89,785	-102,950
Employee share expense					
Operating profit	**79,509**	**104,771**	**125,875**	**140,529**	**150,971**
EBITDA	**86,800**	**111,985**	**134,531**	**150,758**	**162,171**
Depreciation	-7,291	-7,214	-8,656	-10,229	-11,200
Amortisation					
EBIT	79,509	104,771	125,875	140,529	150,971
Net interest expense					
Associates & JCEs					
Other income	2,255	5,324	8,362	10,825	14,861
Earnings before tax	**81,764**	**110,095**	**134,237**	**151,354**	**165,832**
Income tax	-12,088	-21,739	-30,774	-34,055	-36,483
Net profit after tax	**69,676**	**88,356**	**103,464**	**117,299**	**129,349**
Minority interests	-1,019	-1,190	-1,124	-1,124	-1,124
Other items	-10	0	0	0	0
Preferred dividends					
Normalised NPAT	**68,647**	**87,166**	**102,340**	**116,175**	**128,225**
Extraordinary items	0	0	0	0	0
Reported NPAT	**68,647**	**87,166**	**102,340**	**116,175**	**128,225**
Dividends	-45,797	-32,058	-38,927	-43,507	-43,507
Transfer to reserves	**22,850**	**55,108**	**63,412**	**72,668**	**84,718**
Valuation and ratio analysis					
FD normalised P/E (x)	29.6	23.3	19.8	17.5	15.8
FD normalised P/E at price target (x)	29.9	23.6	20.1	17.7	16.0
Reported P/E (x)	29.6	23.3	19.8	17.5	15.8
Dividend yield (%)	1.9	1.3	1.6	1.8	1.8
Price/cashflow (x)	68.8	17.4	23.6	18.8	17.8
Price/book (x)	9.7	8.0	6.4	5.2	4.3
EV/EBITDA (x)	23.3	18.0	14.8	12.9	11.6
EV/EBIT (x)	25.4	19.2	15.8	13.8	12.5
Gross margin (%)	45.5	44.8	44.3	44.4	42.5
EBITDA margin (%)	28.9	30.0	28.9	29.1	27.2
EBIT margin (%)	26.5	28.1	27.1	27.1	25.3
Net margin (%)	22.9	23.4	22.0	22.4	21.5
Effective tax rate (%)	14.8	19.7	22.9	22.5	22.0
Dividend payout (%)	66.7	36.8	38.0	37.4	33.9
Capex to sales (%)	3.6	4.5	4.1	3.7	3.4
Capex to depreciation (x)	1.5	2.3	2.2	1.9	1.8
ROE (%)	37.5	37.6	35.8	32.8	29.6
ROA (pretax %)	33.3	36.3	37.2	36.9	36.2
Growth (%)					
Revenue	8.0	24.3	24.7	11.4	15.1
EBITDA	20.9	29.0	20.1	12.1	7.6
EBIT	20.4	31.8	20.1	11.6	7.4
Normalised EPS	33.6	27.0	17.4	13.5	10.4
Normalised FDEPS	33.6	27.0	17.4	13.5	10.4
Per share					
Reported EPS (INR)	35.07	44.54	52.29	59.36	65.51
Norm EPS (INR)	35.07	44.54	52.29	59.36	65.51
Fully diluted norm EPS (INR)	35.07	44.54	52.29	59.36	65.51
Book value per share (INR)	107.49	130.31	163.06	200.19	243.47
DPS (INR)	20.00	14.00	17.00	19.00	19.00

Source: Nomura estimates

Notes

We expect USD revenue growth of 26%/13% for FY12/13F

Price and price relative chart (one year)



(%)	1M	3M	12M
Absolute (INR)	-0.5	-12.4	11.9
Absolute (USD)	-6.3	-20.1	2.7
Relative to index	0.2	0.3	31.4
Market cap (USDmn)	41,461.7		
Estimated free float (%)	23.0		
52-week range (INR)	1247/869		
3-mth avg daily turnover (USDmn)	49.23		
Major shareholders (%)			
Tata Sons Ltd	73.8		

Source: Thomson Reuters, Nomura research

Cashflow (INRmn)

Year-end 31 Mar	FY10	FY11	FY12F	FY13F	FY14F
EBITDA	86,800	111,985	134,531	150,758	162,171
Change in working capital	-44,271	27,556	-16,736	-7,506	-10,378
Other operating cashflow	-13,035	-22,929	-31,898	-35,179	-37,607
Cashflow from operations	**29,494**	**116,612**	**85,897**	**108,073**	**114,186**
Capital expenditure	-10,932	-16,934	-19,078	-19,200	-20,000
Free cashflow	**18,561**	**99,678**	**66,819**	**88,873**	**94,186**
Reduction in investments	-20,546	-53,005	-13,874	0	0
Net acquisitions					
Reduction in other LT assets	5,706	-3,266	-2,412	-5,885	-6,980
Addition in other LT liabilities	0	0	0	0	0
Adjustments	1,160	-1,946	-624	-570	-570
Cashflow after investing acts	**4,882**	**41,461**	**49,909**	**82,418**	**86,636**
Cash dividends	-45,797	-32,058	-38,927	-43,507	-43,507
Equity issue	30,864	-11,354	811	0	0
Debt issue	4,605	1,919	2,050	1,666	2,236
Convertible debt issue	0	0	0	0	0
Others	2,255	5,322	8,362	10,825	14,861
Cashflow from financial acts	**-8,073**	**-36,171**	**-27,705**	**-31,016**	**-26,410**
Net cashflow	**-3,191**	**5,290**	**22,204**	**51,402**	**60,226**
Beginning cash	13,440	10,249	15,539	37,743	89,146
Ending cash	10,249	15,539	37,743	89,146	149,372
Ending net debt	-10,249	-15,539	-37,743	-89,146	-149,372

Source: Nomura estimates

Notes

Cash flow generation remains strong

Balance sheet (INRmn)

As at 31 Mar	FY10	FY11	FY12F	FY13F	FY14F
Cash & equivalents	10,249	15,539	37,743	89,146	149,372
Marketable securities	37,799	90,821	104,695	104,695	104,695
Accounts receivable	70,109	95,497	117,706	132,746	152,933
Inventories	0	0	0	0	0
Other current assets	59,762	14,485	17,224	19,425	22,379
Total current assets	**177,919**	**216,342**	**277,369**	**346,013**	**429,379**
LT investments	17	0	0	0	0
Fixed assets	41,706	51,996	62,988	72,529	81,899
Goodwill	32,415	33,791	33,845	33,845	33,845
Other intangible assets	0	0	0	0	0
Other LT assets	22,488	25,754	28,166	34,051	41,031
Total assets	**274,546**	**327,883**	**402,368**	**486,437**	**586,154**
Short-term debt					
Accounts payable	50,996	58,663	66,875	76,611	89,373
Other current liabilities					
Total current liabilities	**50,996**	**58,663**	**66,875**	**76,611**	**89,373**
Long-term debt					
Convertible debt					
Other LT liabilities	9,110	11,029	13,079	14,745	16,981
Total liabilities	**60,106**	**69,692**	**79,954**	**91,355**	**106,354**
Minority interest	4,056	3,147	3,274	3,274	3,274
Preferred stock	1,000	1,000	1,000	1,000	1,000
Common stock	1,957	1,957	1,957	1,957	1,957
Retained earnings	207,427	252,087	316,183	388,851	473,569
Proposed dividends					
Other equity and reserves					
Total shareholders' equity	**210,384**	**255,044**	**319,140**	**391,808**	**476,526**
Total equity & liabilities	**274,546**	**327,883**	**402,368**	**486,437**	**586,154**
Liquidity (x)					
Current ratio	3.49	3.69	4.15	4.52	4.80
Interest cover	na	na	na	na	na
Leverage					
Net debt/EBITDA (x)	net cash	net cash	net cash	net cash	net cash
Net debt/equity (%)	net cash	net cash	net cash	net cash	net cash
Activity (days)					
Days receivable	88.4	81.0	83.9	88.1	87.4
Days inventory	0.0	0.0	0.0	0.0	0.0
Days payable	125.6	97.2	88.7	90.9	88.3
Cash cycle	-37.2	-16.2	-4.8	-2.7	-1.0

Source: Nomura estimates

Notes

Cash levels are on the rise

Limited room for disappointment

We expect TCS to report USD revenue growth of 5.4% q-q in 2Q FY12F. EBTIDA margins are likely to improve by 80bps q-q on better rupee realisation and SG&A leverage. The full impact of rupee depreciation benefits on earnings could be depressed by forex losses on hedges. We expect TCS to outperform on revenue growth in this quarter, but Infosys to perform better on margins and earnings growth over TCS.

Management commentary on demand and pipeline will be key things to watch for, as we sense some moderation in management optimism over the past few quarters. We believe Street expectations are running high and the stock could correct on disappointment on any front – revenue growth/margin or commentary.

Fig. 25: 2QFY12F expectation

	2QFY12F	2QFY11	y-y (%)	1QFY12	q-q (%)
Revenue (US$ mn)	2,542	2,004	26.9	2,412	5.4
Revenue (Rs bn)	116	93	25.4	108	7.8
EBITDA margin (%)	28.9	29.9	-100bp	28.1	80bp
PAT (Rs bn)	24.6	21.3	15.6	23.8	3.3
Diluted EPS (Rs)	12.6	10.9	15.6	12.2	3.3

Source: Nomura estimates

Adjusting our estimates for rupee depreciation

We are raising our EPS estimates for FY12/13F by 0.3%/2% largely on an upward revision in rupee/USD rates for the remaining two quarters of FY12 and for FY13F from the USD/INR assumption of 44 for FY13 to 45 levels.

Fig. 26: Earnings revisions

	New		Old		Change (%)	
	FY12F	FY13F	FY12F	FY13F	FY12F	FY13F
Revenue (US$ mn)	10,248	11,523	10,234	11,554	0.1	-0.3
US$/INR rate	45.4	45.0	44.6	44.0	1.9	2.3
Revenue (Rs bn)	465.3	518.5	456.1	508.4	2.0	2.0
EBITDA margin (%)	28.9	29.1	29.0	29.0	-10 bps	10 bps
Tax Rate (%)	22.9	22.5	22.9	22.5	0 bps	0 bps
Diluted EPS (Rs)	52.3	59.4	52.1	58.2	0.3	2.0

Source: Nomura estimates

Maintain Neutral; raising TP to INR1,070

We remain cautious on the stock on account of:

- High BFSI and Europe exposure, which we see as the segments most susceptible to a slowdown;
- High client dependence (the top-five clients contribute 22% of revenue, compared with 16% at Infosys), which could be an issue if clients face financial shocks;
- Risk of disappointment is higher, given continued positive demand commentary, which seems to be reflected in the stock still building in high future growth value (55% of EV) vs. its historical average (~32%), compared with a converse scenario at its peers like Infosys and Wipro. This could lead to a sharper correction at TCS, vs. the underperformance seen at Infosys, where greater caution has already been built in to prices, in our view.

We are raising our TP marginally to INR1,070 (from INR1,050) based on marginal increases to our earnings estimates driven by rupee depreciation.

Valuation methodology

Our TP of INR1,070 is based on 18x our FY13F earnings forecast of INR59.4. Our target multiple is in line with the stock's historical average, reflecting heightened economic uncertainty and risk on its high BFSI and Europe exposure.

Risks to our valuation

The key risks include: 1) faster-than-anticipated slowdown and breakage of pricing discipline in the industry; 2) rupee appreciation; 3) client-specific issues; and 4) deterioration in management commentary from the current position of no issues on demand.

Wipro WIPR.NS WPRO IN

SOFTWARE & SERVICES

NOMURA
EQUITY RESEARCH

Another quarter lagging peers

Economic uncertainty could delay any revival; maintain Neutral

October 4, 2011

Rating Remains	**Neutral**
Target price Increased from 330	INR 340
Closing price September 30, 2011	INR 341
Potential downside	-0.3%

2QFY12: 3% revenue growth, 200bp margin decline expected

We expect Wipro's IT Services business to post USD revenue growth of 3.4% q-q (1.3% organic growth), which would be near the higher end of its guidance (2-4%). EBIT margins in IT services are likely to dip by 200bps q-q on the partial impact of wage hikes and the SAIC acquisition. We think there could be disappointment if Wipro guides for less than 3% q-q growth in 3Q.

Action: Downturn a setback to revival efforts; maintain Neutral

We believe the economic uncertainty and impending growth moderation have come at the wrong time for Wipro, which is trying to restructure and close the growth gap with its peers. We see economic uncertainty setting back Wipro's revival efforts, adding to the high risks to growth in FY13F on account of: 1) weak near-term deal flow; and 2) slow decision-making reducing the possibility of a near-term revival. Wipro remains our least-preferred tier-1 Indian IT stock, as we believe it has the slowest earnings and revenue growth outlook among peers and lacks immediate triggers.

Catalysts: Continued underperformance on growth and pricing cuts

Valuation: Raise TP to INR340 based on 14x FY13F EPS

We expect Wipro to deliver a CAGR of 11% in revenue growth and 6% in EPS over FY11-13F. The 14x multiple is a ~20% discount to our target multiple for Infosys and TCS, justified given the lag in revenue revival and below par earnings growth.

31 Mar	FY11	FY12F		FY13F		FY14F	
Currency (INR)	Actual	Old	New	Old	New	Old	New
Revenue (mn)	310,542	352,470	355,184	383,071	387,480	440,992	439,349
Reported net profit (mn)	52,977	53,196	54,488	58,177	59,723	62,389	61,881
Normalised net profit (mn)	52,435	53,196	54,488	58,177	59,723	62,389	61,881
Normalised EPS	21.52	21.81	22.34	23.85	24.49	25.58	25.37
Norm. EPS growth (%)	13.9	1.3	3.8	9.4	9.6	7.2	3.6
Norm. P/E (x)	15.9	N/A	15.3	N/A	14.0	N/A	13.5
EV/EBITDA (x)	12.7	12.4	12.1	11.1	10.8	9.9	10.1
Price/book (x)	3.5	N/A	3.0	N/A	2.6	N/A	2.3
Dividend yield (%)	1.8	N/A	1.8	N/A	1.8	N/A	2.1
ROE (%)	24.3	20.7	21.1	19.7	20.0	18.4	18.1
Net debt/equity (%)	net cash	net cash	net cash	net cash	net cash	net cash	net cash

Source: Nomura estimates

Key company data: *See page 2 for company data and detailed price/index chart.*
Rating: *See report end for details of Nomura's rating system.*

Anchor themes

We believe it prudent to participate in the sector through companies focused on market share gains, having low client concentration and better operating scope in the current uncertain economic environment.

Nomura vs consensus

We are 5% lower than the Bloomberg consensus earnings estimate for FY13; we expect Street estimates to be cut as growth revival expectations get reset lower.

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Key data on Wipro

Income statement (INRmn)

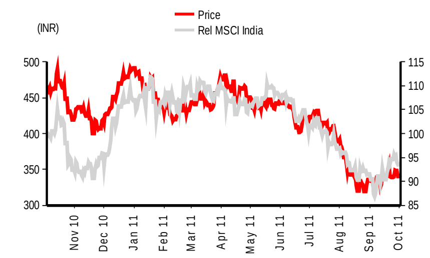
Year-end 31 Mar	FY10	FY11	FY12F	FY13F	FY14F
Revenue	**271,957**	**310,542**	**355,184**	**387,480**	**439,349**
Cost of goods sold	-186,430	-212,930	-251,916	-274,323	-318,342
Gross profit	**85,527**	**97,612**	**103,268**	**113,157**	**121,007**
SG&A	-33,299	-40,389	-44,522	-48,581	-55,142
Employee share expense					
Operating profit	**52,228**	**57,223**	**58,746**	**64,576**	**65,865**
EBITDA	**60,059**	**65,434**	**68,328**	**74,263**	**76,848**
Depreciation	-7,831	-8,211	-9,582	-9,687	-10,984
Amortisation	0	0	0	0	0
EBIT	52,228	57,223	58,746	64,576	65,865
Net interest expense					
Associates & JCEs					
Other income	2,653	5,164	8,847	9,773	11,182
Earnings before tax	**54,881**	**62,387**	**67,593**	**74,349**	**77,046**
Income tax	-9,294	-10,256	-13,350	-14,870	-15,409
Net profit after tax	**45,587**	**52,131**	**54,244**	**59,479**	**61,637**
Minority interests	-185	-344	-196	-196	-196
Other items	530	648	440	440	440
Preferred dividends					
Normalised NPAT	**45,932**	**52,435**	**54,488**	**59,723**	**61,881**
Extraordinary items	0	542	0	0	0
Reported NPAT	**45,932**	**52,977**	**54,488**	**59,723**	**61,881**
Dividends	-10,092	-17,118	-17,128	-17,128	-17,128
Transfer to reserves	**35,840**	**35,859**	**37,360**	**42,595**	**44,753**
Valuation and ratio analysis					
FD normalised P/E (x)	18.2	15.9	15.3	14.0	13.5
FD normalised P/E at price target (x)	17.6	15.4	14.9	13.6	13.1
Reported P/E (x)	18.0	15.7	15.3	13.9	13.4
Dividend yield (%)	1.1	1.8	1.8	1.8	2.1
Price/cashflow (x)	32.9	17.3	21.3	15.7	15.6
Price/book (x)	4.2	3.5	3.0	2.6	2.3
EV/EBITDA (x)	13.9	12.7	12.1	10.8	10.1
EV/EBIT (x)	16.0	14.5	14.1	12.4	11.8
Gross margin (%)	31.4	31.4	29.1	29.2	27.5
EBITDA margin (%)	22.1	21.1	19.2	19.2	17.5
EBIT margin (%)	19.2	18.4	16.5	16.7	15.0
Net margin (%)	16.9	17.1	15.3	15.4	14.1
Effective tax rate (%)	16.9	16.4	19.7	20.0	20.0
Dividend payout (%)	22.0	32.3	31.4	28.7	27.7
Capex to sales (%)	4.2	3.2	4.1	4.0	3.9
Capex to depreciation (x)	1.5	1.2	1.5	1.6	1.5
ROE (%)	26.8	24.3	21.1	20.0	18.1
ROA (pretax %)	20.9	19.9	17.6	17.6	16.7
Growth (%)					
Revenue	5.9	14.2	14.4	9.1	13.4
EBITDA	15.8	8.9	4.4	8.7	3.5
EBIT	16.3	9.6	2.7	9.9	2.0
Normalised EPS	18.4	13.9	3.8	9.6	3.6
Normalised FDEPS	18.2	14.1	3.8	9.6	3.6
Per share					
Reported EPS (INR)	18.89	21.74	22.34	24.49	25.37
Norm EPS (INR)	18.89	21.52	22.34	24.49	25.37
Fully diluted norm EPS (INR)	18.75	21.39	22.20	24.34	25.22
Book value per share (INR)	80.66	98.37	113.46	130.92	149.27
DPS (INR)	3.62	6.01	6.00	6.00	7.02

Source: Nomura estimates

Notes

We expect US$ revenue growth of 13%/10% in the IT services division for FY12/13F

Price and price relative chart (one year)



(%)	1M	3M	12M
Absolute (INR)	1.7	-18.4	-24.2
Absolute (USD)	-4.3	-25.5	-30.4
Relative to index	2.3	-5.7	-4.7

Market cap (USDmn)	17,082.0
Estimated free float (%)	19.0
52-week range (INR)	500/310.2
3-mth avg daily turnover (USDmn)	12.92
Major shareholders (%)	
Azim H Premji	79.2

Source: Thomson Reuters, Nomura research

Cashflow (INRmn)

Year-end 31 Mar	FY10	FY11	FY12F	FY13F	FY14F
EBITDA	60,059	65,434	68,328	74,263	76,848
Change in working capital	-25,743	-7,066	-15,894	-6,486	-7,953
Other operating cashflow	-8,949	-9,952	-13,106	-14,626	-15,165
Cashflow from operations	**25,367**	**48,416**	**39,329**	**53,151**	**53,730**
Capital expenditure	-11,495	-9,847	-14,510	-15,687	-16,984
Free cashflow	**13,872**	**38,569**	**24,819**	**37,464**	**36,747**
Reduction in investments	-14,552	-19,510	-8,781	0	0
Net acquisitions	1,823	-556	-7,037	0	
Reduction in other LT assets	-13	-11,875	-3,262	-2,860	-3,251
Addition in other LT liabilities					
Adjustments	0	542	0	0	
Cashflow after investing acts	**1,130**	**7,170**	**5,739**	**34,604**	**33,496**
Cash dividends	-10,092	-17,118	-17,128	-17,128	-17,128
Equity issue	13,328	7,963	-262	0	0
Debt issue	8,742	-6,916	8,781	0	-452
Convertible debt issue					
Others	2,653	5,164	8,847	9,773	11,182
Cashflow from financial acts	**14,631**	**-10,907**	**238**	**-7,355**	**-6,399**
Net cashflow	**15,761**	**-3,737**	**5,978**	**27,248**	**27,097**
Beginning cash	49,117	64,878	61,141	67,119	94,367
Ending cash	64,878	61,141	67,119	94,367	121,464
Ending net debt	-2,367	-8,339	-6,636	-33,884	-61,434

Source: Nomura estimates

Notes

Free cash flow generation expected to be largely flattish

Balance sheet (INRmn)

As at 31 Mar	FY10	FY11	FY12F	FY13F	FY14F
Cash & equivalents	64,878	61,141	67,119	94,367	121,464
Marketable securities	30,420	49,282	57,953	57,953	57,953
Accounts receivable	67,636	85,776	99,100	108,110	122,582
Inventories	7,926	9,707	10,704	11,677	13,241
Other current assets	34,654	26,408	33,617	37,596	42,119
Total current assets	**205,514**	**232,314**	**268,492**	**309,704**	**357,359**
LT investments	2,345	2,993	3,103	3,103	3,103
Fixed assets	53,458	55,094	60,022	66,022	72,022
Goodwill	57,813	58,369	65,406	65,406	65,406
Other intangible assets					
Other LT assets	10,798	22,673	25,935	28,795	32,046
Total assets	**329,928**	**371,443**	**422,957**	**473,030**	**529,936**
Short-term debt					
Accounts payable	62,966	67,575	73,211	80,688	93,294
Other current liabilities	0	0	0	0	0
Total current liabilities	**62,966**	**67,575**	**73,211**	**80,688**	**93,294**
Long-term debt	62,511	52,802	60,483	60,483	60,030
Convertible debt					
Other LT liabilities	7,902	10,695	11,795	11,795	11,795
Total liabilities	**133,379**	**131,072**	**145,488**	**152,966**	**165,119**
Minority interest	437	691	751	751	751
Preferred stock	0	0	0	0	0
Common stock	2,936	4,908	4,911	4,911	4,911
Retained earnings	193,176	234,772	271,807	314,402	359,155
Proposed dividends					
Other equity and reserves					
Total shareholders' equity	**196,112**	**239,680**	**276,718**	**319,313**	**364,066**
Total equity & liabilities	**329,928**	**371,443**	**422,957**	**473,030**	**529,936**
Liquidity (x)					
Current ratio	3.26	3.44	3.67	3.84	3.83
Interest cover	na	na	na	na	na
Leverage					
Net debt/EBITDA (x)	net cash	net cash	net cash	net cash	net cash
Net debt/equity (%)	net cash	net cash	net cash	net cash	net cash
Activity (days)					
Days receivable	87.5	90.2	95.3	97.6	95.8
Days inventory	15.2	15.1	14.8	14.9	14.3
Days payable	135.1	111.9	102.3	102.4	99.7
Cash cycle	-32.5	-6.6	7.8	10.1	10.4

Source: Nomura estimates

Notes

Cash levels likely to rise

3Q revenue growth guidance will be test of revival effort

We expect Wipro's IT Services business to post USD revenue growth of 3.4% q-q (including incremental US$30mn contribution from the SAIC acquisition, which was effective June 10) accompanied by a 200bp decline in the IT services EBIT margin in 2Q FY12F. The margin decline is likely on account of the 1) two-month impact of the salary hike (effective from June 1); and 2) dilution on account of the SAIC acquisition (~9 weeks revenues to flow in 2Q). Our estimate for organic revenue growth in the quarter is 1.3% q-q, near the higher end of management guidance for the quarter (0-2% growth).

Wipro's 3Q FY12 revenue growth guidance will likely be keenly watched to ascertain results of its revival effort. Guidance of less than 3% q-q growth, in our view, would be taken negatively.

Fig. 27: 2QFY12 expectations

	2QFY12F	2QFY11	y-y (%)	1QFY12	q-q (%)
IT Services Revenue (US$ mn)	1,456	1,273	14.4	1,408	3.4
IT Services Revenue (Rs mn)	66,683	57,471	16.0	64,046	4.1
IT Services EBIT margin (%)	20.0	22.2	-220bp	22.0	-200bp
PAT (Rs mn)	13,179	12,849	2.6	13,349	-1.3
Diluted EPS (Rs)	5.4	5.3	2.2	5.4	-1.3

Source: Company data, Nomura estimates

Marginal changes to EPS on rupee adjustment

We have marginally reduced our FY12/13F USD revenue estimates to adjust for the cross-currency impact of GBP and EUR depreciation against the USD. Our rupee revenue estimates are higher on account of rupee depreciation against the USD. We have slightly increased our margin estimates partly as we believe there will be some wage cost moderation along with the moderation in demand and partly due to rupee depreciation.

Fig. 28: Earnings revisions

	New		Old		Change (%)	
	FY12F	FY13F	FY12F	FY13F	FY12F	FY13F
IT services revenue (US$ mn)	5,902	6,477	5,924	6,524	-0.4	-0.7
IT services revenue (Rs bn)	268.9	291.5	266.2	287.1	1.0	1.5
IT services EBIT margin (%)	20.6	20.4	20.0	19.8	60 bps	60 bps
Cons. revenue (Rs bn)	355.2	387.5	352.5	383.1	0.8	1.2
Tax Rate (%)	19.7	20.0	19.7	20.0	0 bps	0 bps
Diluted EPS (Rs)	22.2	24.3	21.7	23.7	2.4	2.7

Source: Nomura estimates

Limited upside triggers, Maintain Neutral

We raise our target price to INR340 (from INR330) and maintain our Neutral rating on Wipro, as we believe Wipro's efforts at reducing its lag relative to its peers are at further risk due to economic uncertainties and anticipated deal decision-making delays. Further, we see Wipro having to raise its efforts to gain lost momentum as HCL Tech did during the last downturn, which could limit upside to margins. Wipro remains our least-preferred stock in tier 1 IT.

Valuation methodology

We value Wipro at 14x our FY13F EPS forecast of INR24.3, which is at a ~20% discount to our target multiple for Infosys and TCS. The discount, in our view, is justified given the lag in revenue revival and below par earnings growth.

Risks to valuation

The key risks include: 1) worse-than-anticipated demand slowdown and breakage of pricing discipline; 2) rupee appreciation; and 3) client-specific issues.

Appendix A-1

Analyst Certification

We, Ashwin Mehta and Pinku Pappan, hereby certify (1) that the views expressed in this Research report accurately reflect our personal views about any or all of the subject securities or issuers referred to in this Research report, (2) no part of our compensation was, is or will be directly or indirectly related to the specific recommendations or views expressed in this Research report and (3) no part of our compensation is tied to any specific investment banking transactions performed by Nomura Securities International, Inc., Nomura International plc or any other Nomura Group company.

Issuer Specific Regulatory Disclosures

Mentioned companies

Issuer name	Ticker	Price	Price date	Stock rating	Sector rating	Disclosures
Cognizant	CTSH US	USD 61.35	03-Oct-2011	Neutral	Not rated	123
HCL Technologies	HCLT IN	INR 401	03-Oct-2011	Buy	Not rated	
Infosys	INFO IN	INR 2476	03-Oct-2011	Buy	Not rated	123
Mphasis	MPHL IN	INR 336	03-Oct-2011	Reduce	Not rated	
Patni Computer Systems	PATNI IN	INR 274	03-Oct-2011	Neutral	Not rated	
Tata Consultancy Services	TCS IN	INR 1043	03-Oct-2011	Neutral	Not rated	
Tech Mahindra	TECHM IN	INR 554	03-Oct-2011	Reduce	Not rated	
Wipro	WPRO IN	INR 330	03-Oct-2011	Neutral	Not rated	

Disclosures required in the U.S.

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Previous Rating

Issuer name	Previous Rating	Date of change
Cognizant	Buy	02-Nov-2010
HCL Technologies	Neutral	10-Sep-2009
Infosys	Neutral	21-Jan-2011
Mphasis	Buy	01-Mar-2011
Patni Computer Systems	Reduce	03-Oct-2011
Tata Consultancy Services	Buy	22-Dec-2009
Tech Mahindra	Neutral	15-Aug-2011
Wipro	Buy	13-Oct-2010

Rating and target price changes

	Ticker	Old stock rating	New stock rating	Old target price	New target price
Infosys	INFO IN	Buy	Buy	INR 2800	INR 2900
Patni Computer Systems	PATNI IN	Reduce	Neutral	INR 290	INR 300
Tata Consultancy Services	TCS IN	Neutral	Neutral	INR 1050	INR 1070
Wipro	WPRO IN	Neutral	Neutral	INR 330	INR 340

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STOCKS

A rating of '**Buy**', indicates that the analyst expects the stock to outperform the Benchmark over the next 12 months.
A rating of '**Neutral**', indicates that the analyst expects the stock to perform in line with the Benchmark over the next 12 months.
A rating of '**Reduce**', indicates that the analyst expects the stock to underperform the Benchmark over the next 12 months.
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SECTORS

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A '**Neutral**' stance, indicates that the analyst expects the sector to perform in line with the Benchmark during the next 12 months.
A '**Bearish**' stance, indicates that the analyst expects the sector to underperform the Benchmark during the next 12 months.
Benchmarks are as follows: **United States**: S&P 500; **Europe**: Dow Jones STOXX 600; **Global Emerging Markets (ex-Asia)**: MSCI Emerging Markets ex-Asia.

Explanation of Nomura's equity research rating system for Asian companies under coverage ex Japan published from 30 October 2008 and in Japan from 6 January 2009

STOCKS

Stock recommendations are based on absolute valuation upside (downside), which is defined as (Target Price - Current Price) / Current Price, subject to limited management discretion. In most cases, the Target Price will equal the analyst's 12-month intrinsic valuation of the stock, based on an appropriate valuation methodology such as discounted cash flow, multiple analysis, etc.
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Explanation of Nomura's equity research rating system in Japan published prior to 6 January 2009 (and ratings in Europe, Middle East and Africa, US and Latin America published prior to 27 October 2008)

STOCKS
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A rating of '2' or '**Buy'**, indicates that the analyst expects the stock to outperform the Benchmark by 5% or more but less than 15% over the next six months.
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A '**Bearish'** stance, indicates that the analyst expects the sector to underperform the Benchmark during the next six months.
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Explanation of Nomura's equity research rating system for Asian companies under coverage ex Japan published prior to 30 October 2008

STOCKS
Stock recommendations are based on absolute valuation upside (downside), which is defined as (Fair Value - Current Price)/Current Price, subject to limited management discretion. In most cases, the Fair Value will equal the analyst's assessment of the current intrinsic fair value of the stock using an appropriate valuation methodology such as Discounted Cash Flow or Multiple analysis etc. However, if the analyst doesn't think the market will revalue the stock over the specified time horizon due to a lack of events or catalysts, then the fair value may differ from the intrinsic fair value. In most cases, therefore, our recommendation is an assessment of the difference between current market price and our estimate of current intrinsic fair value. Recommendations are set with a 6-12 month horizon unless specified otherwise. Accordingly, within this horizon, price volatility may cause the actual upside or downside based on the prevailing market price to differ from the upside or downside implied by the recommendation.
A '**Strong buy'** recommendation indicates that upside is more than 20%.
A '**Buy'** recommendation indicates that upside is between 10% and 20%.
A '**Neutral'** recommendation indicates that upside or downside is less than 10%.
A '**Reduce'** recommendation indicates that downside is between 10% and 20%.
A '**Sell'** recommendation indicates that downside is more than 20%.
SECTORS
A '**Bullish'** rating means most stocks in the sector have (or the weighted average recommendation of the stocks under coverage is) a positive absolute recommendation.
A '**Neutral'** rating means most stocks in the sector have (or the weighted average recommendation of the stocks under coverage is) a neutral absolute recommendation.
A '**Bearish'** rating means most stocks in the sector have (or the weighted average recommendation of the stocks under coverage is) a negative absolute recommendation.

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A Target Price, if discussed, reflect in part the analyst's estimates for the company's earnings. The achievement of any target price may be impeded by general market and macroeconomic trends, and by other risks related to the company or the market, and may not occur if the company's earnings differ from estimates.

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