Information Technology

Mid-size: Chipping ahead of leaders

August 30, 2012

Edelweiss
Ideas create, values protect

INITIATING COVERAGE:

CMC

Tech Mahindra

Persistent Systems

Sandip Agarwal
+91 22 6623 3474
sandip.agarwal@edelcap.com

Omkar Hadkar
+91 22 6620 3147
omkar.hadkar@edelcap.com

Edelweiss Securities Limited

Executive Summary

Specialized offering, holistic client mining reward mid-caps richly

During the past couple of years, when some of the large cap players like Infosys and Wipro underperformed due to massive restructuring, client specific issues (BT in the telecom vertical) and the enduring global downturn, mid-cap and small cap players saw significant growth opportunities. In fact, such an outperformance by mid-cap players was ingrained in few internal as well as external factors; on the internal aspect, a clear approach to specialization and holistic client mining was the key driver while externally, division of large deals into smaller ones coupled with new business coming in from first time outsourcers (with small ticket sizes) pepped up the growth.

Most of the mid-cap companies have positioned themselves as specialized players in a vertical or a practice which enabled them to post a robust growth. Hexaware and NIIT Tech. made large inroads, riding on their travel and transportation expertise while MindTree and KPIT Cummins positioned themselves as specialised manufacturing and automobile players respectively. Moreover, the holistic approach to have separate teams for hunting and farming clients has reaped significant benefits post 2010 as seen by the massive revenue growth in top 10 clients for Hexaware, Geometric, Polaris and MindTree. Sustained addition to non-top 10 clients (under penetrated category) further creamed the scenario.

Fragmentation of large deals, first time outsourcers kindle prospects

On the external side, the primary reason was the fragmentation of large deals into smaller ones besides a significant rise in small deals (Source: Nasscom) from existing clients and first time outsourcers which were not suited for large vendors hence found its way to small and mid-cap specialized service providers. Another notable external factor was the budget constraint among small clients and first time outsourcers which forced them to outsource a small portion, but at the most efficient price level which suited mid-cap vendors since their pricing was cheaper than larger players.

CMC, Persistent and Tech Mahindra: Initiating coverage with 'BUY'

We consider that mid–caps like **CMC, Persistent and Tech Mahindra** can provide substantial returns due to their strategic positioning and attractive valuations. In the case of CMC, we believe the unique solutions approach coupled with hi-tech offering and TCS parentage places it in a sweet spot from both revenue growth and margin perspective. Significant room for offshoring exists, which can be a key margin driver. We sense that it will gain from the huge potential spending in the government space. We value the company at 12x our FY14 EPS of INR104, implying a target price of INR1,255 and '**BUY'** recommendation. For Persistent, we believe that investments in IP-led business (to increase IP revenues to 20%) coupled with its **`sell with'** strategy with major players like salesforce.com will be a strategic trigger going forward. We value the company at INR508, implying 10x FY14 core EPS of INR42 and INR90 cash/share and initiate with '**BUY'**. Following its merger with Mahindra Satyam (likely to be over in next few months), Tech Mahindra will have a huge base of ~500+ clients. This, coupled with TECHM's client mining capability (its average of top 10 client is USD91m) will impart a high impetus to the company over and above the significant operational leverage in terms of employee fungibility which would help enhance utilization and margin improvement. We value Tech Mahindra at INR1,005, pegging 12X FY14E EPS at INR84 (implying a target price of INR118 for Satyam – ratio of 1:8.5) and initiate with '**BUY'**.

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At a Glance

Valuation comparison for mid- cap IT companies under covergae

Company	Absolute Reco	CMP (INR)	Mcap (INR bn)	Diluted EPS (INR)		P/E(x)		EV/EBITDA(x)		ROAE (%)	
				FY13E	FY14E	FY13E	FY14E	FY13E	FY14E	FY13E	FY14E
eClerx	BUY	743	21.8	64.5	76.1	11.5	9.8	7.6	6.4	50.8	48.1
Hexaware	BUY	124	36.7	11.5	13.5	10.8	9.2	7.0	5.6	30.8	30.2
Info Edge	REDUCE	331	36.1	11.9	15.5	27.8	21.4	18.4	13.1	25.6	23.3
Infotech	BUY	176	19.6	19.9	22.2	8.8	7.9	3.4	2.9	18.0	17.4
Mphasis	HOLD	384	80.7	35.5	39.9	10.8	9.6	5.1	4.3	19.2	17.1
CMC	BUY	968	29.3	79.7	104.4	12.2	9.3	8.8	6.8	28.4	30.7
Persistent Systems	BUY	389	15.6	42.6	45.4	9.1	8.6	3.2	2.7	18.7	17.2
TECHM*	BUY	793	101.2	74.3	83.7	10.7	9.5	NA	NA	NA	NA

Source: Edelweiss research

** Merged entity*

Mid-size IT players contribute 35-37% to total export revenue

Mid-tier Indian IT players grow and flex muscle

For the past 15 years, the story of Indian IT has been one of a radical shift in market share from MNCs like IBM, HP, EDS (now part of HP), Capgemini and Accenture to India-based outsourcing companies like Infosys, TCS , Wipro , HCL Tech , Cognizant and others. Though this trend has been on a decline of late, it still provides a comfortable 25%-30% cost savings, led by the labour arbitrage. While the overall IT services market has posted a 10-year CAGR of just ~1%, Indian software services revenue has grown at 21% CAGR, largely driven by the top 5 Indian IT vendors (incl. Cognizant). We would like to note that mid-sized IT vendors, too, are joining the bandwagon and have contributed to the growth of Indian IT-BPO services exports in a meaningful way.

As per Nasscom, the Indian IT-BPO sector comprises of 5000+ service providers across verticals and service lines. While large integrated players (revenues of USD1bn+) contributed to 44%-47% of total export revenues in FY11, mid-sized IT players (revenues of USD 100mn- USD1bn) are not far away with a contribution of 35%-37% to total export revenues.

Table 1: Indian IT-BPO ecosystem - Mid-tier players gaining scale

Category	Players (nos.)	% of export revenues	% of total employees	Work focus
Large sized	8	44-47% Revenues :> USD1bn	~35%	* Comprises Indian and MNC third party players * Fully integrated players offerring full spectrum (IT services, engineering and R&D services, BPO, software products) and complex transformational deals * Large scale operations and infrastructure * Expanding their onsite/nearshore capabilities, these players have presence in over 70 countries
Mid-sized	75-80	35-37% Revenues :USD100 mn- USD1bn	~25-28%	* Includes mid-tier Indian IT and MNC firms operating in more than one vertical and offerring multiple services such as IT services, engineering and R&D services, BPO, software products * Nearshore and offshore presence in over 30-35 countries * Most of these have large scale operations and infrastructure * Dedicated GICs offering IT/BPO/ER&D services
Emerging	~300-350	9-10% Revenues :USD10mn- USD100mn	~15-20%	* Indian third-party players dominate this category accounting for nearly half of this segment * Many of the players provide full spectrum of services with specialisation in certain segments like ER&D services and niche IT services * Enhancing focus and strategy towards sub-Fortune 500/1,000 firms * Dedicated GICs offering IT/BPO/ER&D services
Small / Startups	>3,500	5-6% Revenues :USD <=10mn	~15-18%	* Smaller players focusing on specific niches in either services or verticals * Includes Indian providers and small niche GICs

Source: Nasscom

Repositioning as specialised players & holistic client mining driving growth for mid tier IT cos

On why mid-tier growth outpacing large caps

Post the 2010 downturn (when mid-cap companies suffered more than the large caps in terms of decline in revenue growth), most of the mid-cap players have undergone ***a strategic change, repositioning themselves as specialized players*** which enabled them to either match or exceed the growth of larger players. For instance, Hexaware and NIIT Tech. focused on travel and transportation, KPIT focused on automobiles, Persistent on the OPD space and MindTree on manufacturing space. Based on our interaction with IT experts and respective company managements, we believe that the above strategy of specialized offerings has enabled them not only to get invited to new RFPs in those verticals but also to ***participate in newer deals from first time outsourcers in emerging markets***. Secondly, most of the companies have adopted a ***holistic client mining approach***, reclassifying respective sales team into farming and hunting teams with a 3-tier strategy wherein top clients are being targeted for large deals while non-top clients are farmed for achieving the industry average growth. The new hunting team is assigned with the task of acquiring new businesses. We believe that the growth over the last couple years is due to the following reasons:

- Disaggregation of large deals in smaller deals and significant increase in small deals.
- Strategic positioning as a specialized player with lucid strategy for farming and hunting.
- First time outsourcers and price arbitrage aid mid-tier players as deals get smaller

Table 2: Mid-tier IT companies growth matching or exceeding peers **(USD mn)**

	FY07	FY08	FY09	FY10	FY11	FY12	YoY growth for FY10 (%)	YoY growth for FY11 (%)	YoY growth for FY12 (%)	CAGR 07-12 (%)
Mid size Indian IT players										
Infotech	120	167	194	201	261	324	3.9	29.5	24.1	21.9
Geometric	85	121	129	107	136	168	(17.6)	28.0	22.8	14.6
InfoEdge	31	54	54	49	65	78	(8.7)	31.9	21.2	20.4
MindTree	132	184	269	272	331	403	1.2	21.5	21.7	25.0
Polaris	229	273	300	286	348	428	(4.9)	22.0	22.9	13.4
KPIT Cummins	103	145	174	154	224	309	(11.7)	45.7	38.0	24.7
eClerx	19	30	42	55	76	98	30.0	37.3	29.1	38.7
Persistent Systems	70	106	128	127	170	207	(0.5)	33.7	21.8	24.3
Hexaware	187	253	263	215	231	308	(18.3)	7.7	33.3	10.5
NIIT Tech	196	234	222	209	270	328	(6.0)	29.5	21.3	10.8
Zensar	134	195	200	203	254	371	1.5	25.1	46.0	22.6
CMC	-	275	189	184	237	305	(3.0)	29.1	28.8	NA
Top 4 Indian IT players										
TCS	4,158	5,634	6,016	6,340	8,186	10,171	5.4	29.1	24.2	19.6
Infosys	3,090	4,176	4,663	4,804	6,041	6,994	3.0	25.7	15.8	17.7
Wipro	2,460	3,647	4,324	4,391	5,221	5,921	1.5	18.9	13.4	19.2
HCLT	1,266	1,763	2,085	2,574	3,320	4,035	23.5	29.0	21.5	26.1
Top 4	**10,974**	**15,221**	**17,087**	**18,108**	**22,768**	**27,120**	**6.0**	**25.7**	**19.1**	**19.8**

Source: Companies

Mega deals stable; deals of less than USD100mn tripled since FY02

Disaggregation of large deals: A potential boon for mid- sized players

While the deal activity has remained robust for last few years, there has been a significant shift in the structure of deals. As per Nasscom, the number of large (mega deals) and mid range contracts has remained stable since FY02 but those valued at USD100mn or less has seen a 300% jump since FY02. (Refer Chart 1)

This trend of deal disaggregation has also been substantiated by TPI (Refer Chart 2). Of the contracts awarded, contracts with a TCV of USD25mn-99mn have surged from 481 in 2008 to 770 in 2011 while contracts with a TCV of more than USD100mn have remained stagnant at ~224 over the same timeframe.

We believe that this trend of disaggregation has benefitted mid-sized players as it enables them to participate in newer opportunities. Going forward, we expect this trend of smaller deals to continue, forced by an uncertain macro environment where clients remain apprehensive about committing large outsourcing deals.

We believe that contracts worth at least ~USD40bn would be coming up for renewal in CY12 and CY13 each. Of this, at least 30% (at 30% discount) should go to Indian players, implying new contracts of ~USD8.4bn over a 5-year period and incremental revenue of USD1.7bn per year going forward. If the trend (of larger deals being broken down into several smaller deals) continues, mid-sized Indian IT vendors would also benefit along with their larger counter parts as they would vie for a higher deal pipeline.

Chart 1: Smaller deals rising significantly

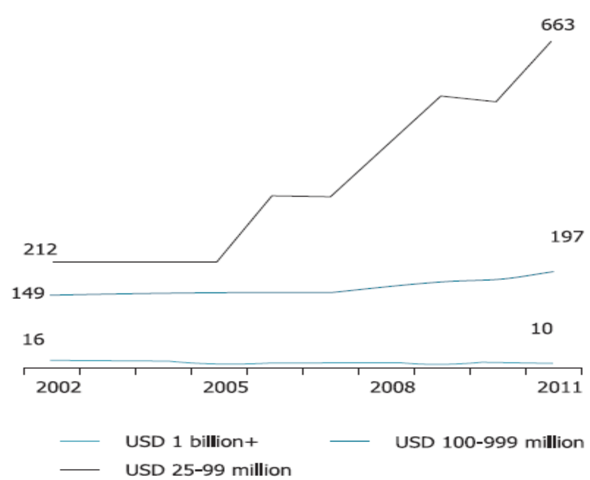
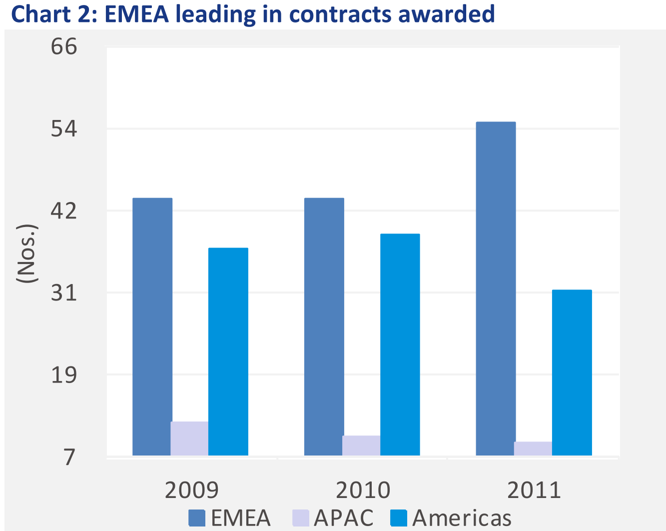


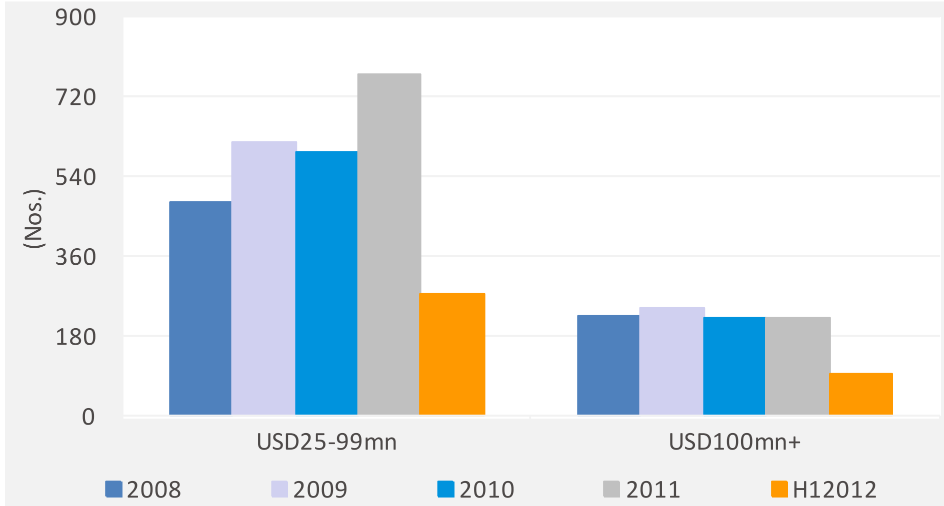
Chart 2: EMEA leading in contracts awarded



Source: Nasscom

Trend of smaller deals outpacing mega deals continues over FY08-10

Chart 3: Smaller deals in vogue than mega deals



Source: TPI

EMEA leads in contracts awarded, outpacing America consistently

Another important trend is the emergence of EMEA as the leader in contracts awarded. Based on TCV (total contract value) data published by Nasscom, out of the TCV value of USD95bn in FY11, EMEA contributed ~USD55bn or 58% of total deals (YoY growth of 25%) while Americas accounted for ~USD31bn or 33% of total deals (YoY decline of 20%). APAC contributed ~USD9bn or 10% of total deals (YoY decline of 10%).

Table3: EMEA leading geography in contracts awarded (USD bn)

Geography wise contracts	2007	2008	2009	2010	2011
EMEA	37	46	44	44	55
Americas	30	29	37	39	31
APAC	11	10	12	10	9
TCV of IT outsourcing deals	**79**	**86**	**93**	**93**	**95**

Source: Nasscom

While we are cognizant of the fact that America remains the largest contributor to revenues for mid-size Indian IT vendors, revenues from non-US (EMEA + APAC) have become a sizeable chunk on an absolute basis (refer table 4) hence the trend of higher outsourcing from this region augurs well for these companies.

While the total IT spend (IT services + BPO) rose from USD718bn in FY09 to USD758bn in FY11, the rate of growth from EMEA and APAC region was ~6% versus 4% in more mature geographies like US. We expect higher growth in EMEA and APAC region to result in high growth in global sourcing due to two reasons:

(a) Low level of outsourcing at present

(b) Presence of legacy systems which are obsolete and can save substantial costs if replaced

Non-US revenues gaining scale in mid tier IT companies

Table 4: Non-US revenues form a sizeable chunk of total revenue

(USD mn)	FY08	FY09	FY10	FY11	FY12
Infotech	90.6	96.5	106.0	116.4	138.2
Geometric	35.3	42.7	39.1	45.0	48.1
MindTree	62.6	94.0	95.2	125.9	169.2
Polaris	177.3	184.7	161.9	190.1	230.5
KPIT Cummins	64.0	77.8	60.8	72.3	94.6
eClerx	9.9	16.1	21.5	29.4	32.5
Persistent Systems	13.1	16.2	19.2	24.5	36.2
Hexaware	84.1	92.3	73.4	74.3	106.8
NIIT Tech	160.2	153.9	138.9	174.4	206.7
Zensar	97.7	86.2	80.9	92.2	104.8

YoY growth (%)	FY08	FY09	FY10	FY11	FY12
Infotech	44.6	6.5	9.9	9.8	18.7
Geometric	13.1	20.9	(8.3)	15.0	6.8
MindTree	29.3	50.1	1.2	32.3	34.3
Polaris	22.4	4.1	(12.4)	17.5	21.2
KPIT Cummins	63.6	21.5	(21.8)	19.0	30.8
eClerx	190.1	61.9	33.4	37.3	10.3
Persistent Systems	143.2	24.0	18.0	27.9	47.8
Hexaware	46.4	9.8	(20.5)	1.1	43.9
NIIT Tech	20.3	(3.9)	(9.7)	25.6	18.5
Zensar	46.9	(11.8)	(6.1)	14.0	13.6

Source: Companies

Our confidence in the growth of EMEA and APAC stems from our understanding that the global sourcing penetration in these regions is far lower than Americas. While the average penetration level in Americas is ~10%, this is as low as ~7% and ~3% in Europe and APAC in that order. This, along with rising macro uncertainty as well as cost pressures in the EMEA region, has led to higher offshoring deals particularly from Europe (mainly related to cost optimization projects).

Thus, we believe that a combination of deal disaggregation and higher offshoring from EMEA offers a significant opportunity for mid-sized Indian IT players (who have improved their domain and industry expertise than before) to drive the next leg of growth.

Positioning as specialists with lucid farming, hunting strategy

Strategy of vertical/domain specialisation driving growth

Post the 2010 downturn (when revenue growth of mid-caps suffered more than large caps), most of the mid caps clearly redefined their strategy towards **specialization and holistic client mining (a 3-tier approach)**. The specialized offering strategy has paid off primarily by enabling mid-cap players to participate in all major deals in respective verticals, up for bidding (for instance Hexaware and NIIT Tech. have been leading players in travel and transportation space while Persistent has positioned itself as a specialized OPD player whereas MindTree and KPIT have positioned themselves as specialized manufacturing and automobile players). We have seen the above strategy paying off in the past also with Tech Mahindra's focus on telecom vertical which enabled it to work with all top players in the telecom space like Cisco, BT, Verizon, AT&T and Vodafone. HCL Technologies and Cognizant experimented the same way with IMS and Healthcare space.

For the last two years, mid –tier stocks have seen a robust growth. However, we would like to note that though the growth has been broad based across client categories; some focused on gaining wallet share amongst their top ten clients while others strived to acquire new clients and mining these clients.

Focus on holistic client mining to drive growth hereon

Companies like Geometric, MindTree and Hexaware focus on mining their top ten clients while Infotech Enterprises, Polaris, KPIT Cummins and Persistent are keen on growth from beyond the top ten. Our interactions suggest that companies have fine-tuned their strategies of mining and hunting based on their client profile and scope for growth. Some of them have even benefitted by simply mining their top clients due to lower penetration levels and higher chances of growth whereas others have focused their strategies towards mining new accounts and adding new logos to gain market share. We believe that account mining involves lower selling and marketing efforts as well as resources.

Although strategies have been varying till now, going ahead, we believe that the focus of these companies continues to be more holistic growth and our interactions with these companies suggest that they will focus on increasing the wallet share among their top 20-25 clients. Most of the mid-tier stocks have identified key strategic accounts that will drive growth from here on, intensifying their efforts in to acquire/mine these accounts.

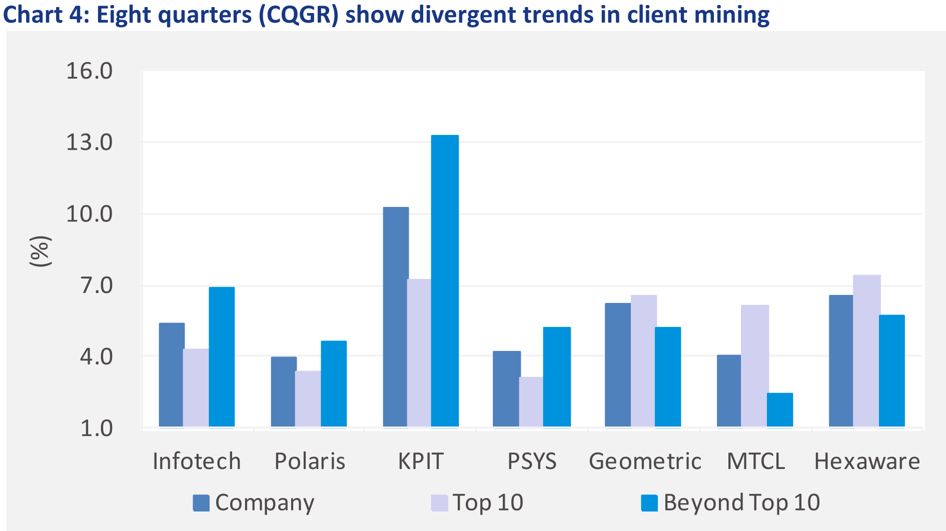
Table 5: Growth trend in Top 10 and beyond top 10 clients

Top 10 QoQ Growth (%)	Q211	Q311	Q411	Q112	Q212	Q312	Q412	Q113
Infotech	11.4	5.4	3.9	6.9	0.9	(2.3)	7.1	1.6
Geometric	9.3	12.1	2.8	0.6	10.4	1.4	5.4	11.0
MindTree	6.2	4.2	(3.1)	9.8	16.7	7.2	5.0	3.7
Polaris	5.1	5.6	9.5	4.3	14.6	2.9	(16.0)	3.9
KPIT Cummins	12.7	10.8	12.6	(0.7)	(1.9)	2.1	16.5	7.2
Persistent Systems	2.1	4.5	19.7	(2.9)	5.6	(2.0)	6.0	(6.0)
Hexaware	14.5	9.0	4.9	11.2	6.8	6.9	4.8	1.7

Beyond top 10 QoQ Growth (%)	Q211	Q311	Q411	Q112	Q212	Q312	Q412	Q113
Infotech	19.5	16.7	1.8	8.7	10.3	3.4	(4.7)	1.6
Geometric	14.7	6.8	7.9	5.5	0.4	6.4	5.4	(4.2)
MindTree	7.6	2.9	4.1	5.7	4.8	(1.2)	(1.6)	(2.3)
Polaris	7.0	7.8	7.3	3.8	5.8	(1.5)	3.0	3.9
KPIT Cummins	12.6	29.0	12.5	7.3	2.7	6.4	41.9	(0.4)
Persistent Systems	3.0	8.8	(1.2)	16.7	0.7	2.4	3.9	8.2
Hexaware	8.3	9.0	6.5	1.4	3.8	6.5	4.4	5.8

Source: Companies

Chart 4: Eight quarters (CQGR) show divergent trends in client mining



Source: Companies

Our theory of client mining focus among top ten accounts is also reflected in the surge in the average realization among mid-tier stocks compared to top 4 IT players (Refer Table 6) over the last two years. Companies like Infotech, Geometric, MindTree, KPIT Cummins, Persistent Systems and Hexaware have posted better or inline growth in average realization from their top 10 clients compared to the top 4 Indian IT players.

Table 6: Average realization for mid-size players show huge scope for growth vs. large players

Average realisation for top 10 (USD mn)	FY07	FY08	FY09	FY10	FY11	FY12
Infotech	8.2	9.8	10.9	12.1	15.0	17.5
Geometric	5.8	8.6	8.6	7.0	9.6	11.8
MindTree	-	7.5	10.6	10.9	13.1	17.3
Polaris	11.4	13.9	16.0	15.8	19.0	23.8
KPIT Cummins	8.1	10.5	11.8	9.3	11.8	14.3
Persistent Systems	3.3	4.1	4.8	5.6	8.5	10.1
Hexaware	8.8	11.9	12.6	10.6	11.1	15.7
Infosys	99.8	132.4	130.9	126.5	156.0	173.5
TCS	114.1	163.0	163.1	185.7	246.0	353.5
HCLT	53.5	70.8	72.0	71.1	89.7	101.0
Wipro	55.7	72.1	79.6	77.6	91.8	107.2

Average realisation growth YoY (%)	FY07	FY08	FY09	FY10	FY11	FY12
Infotech	55.1	19.8	11.4	10.6	24.2	17.1
Geometric	NA	49.0	(0.1)	(17.9)	36.7	22.4
MindTree	NA	NA	40.2	2.7	20.8	31.4
Polaris	NA	21.7	14.8	(1.3)	20.7	25.1
KPIT Cummins	NA	30.7	12.2	(21.2)	27.1	20.8
Persistent Systems	7.2	24.3	17.5	16.5	52.2	19.0
Hexaware	(41.8)	35.0	5.8	(15.4)	4.2	41.9
Infosys	48.3	32.7	(1.1)	(3.3)	23.4	11.2
TCS	42.5	42.9	0.0	13.9	32.5	43.7
HCLT	44.3	32.4	1.7	(1.3)	26.2	12.6
Wipro	32.0	29.4	10.3	(2.5)	18.3	16.8

Source: Companies

First time outsourcers, price arbitrage aid mid-tier as deals get smaller

While the worldwide IT services market has posted a 10 year CAGR of just ~1%, Indian software services revenue grew at 21% (CAGR), primary due to labour arbitrage or cost savings to clients. Although the price arbitrage between MNCs and Indian players is wearing thin, it would sustain given the higher offshore presence of Indian players compared to their MNC counterparts.

Based on our analysis of realization/pricing trends, we like to note that even among Indian players, there exists a price differential between the top and mid-sized players in the range of ~18%-30% (refer table 7). This can be attributed to the fact top players charge a premium for their domain expertise and track record to execute large and complex deals. Also, our channel checks and discussion with managements clearly suggest that the sudden increase in deals are being driven **by first time outsourcers who want to test check the outsourcing model with small-sized deals** and with vendors who can give them customized solutions. Such smaller deals would not invoke much interest among large cap players hence this situation is a win- win for mid-cap players.

Table 7: Pricing parity between mid-size and top Indian IT players

Realisation USD / hour	FY07	FY08	FY09	FY10	FY11	FY12	Average
Geometric	18.3	23.0	24.5	19.2	18.7	19.9	20.6
MindTree	18.4	24.8	23.9	23.1	23.4	24.8	23.1
Polaris	16.6	17.0	19.3	17.6	19.1	19.5	18.2
KPIT Cummins	19.7	20.8	25.5	20.1	22.9	25.3	22.4
eClerx	12.6	13.3	14.5	13.0	14.0	14.8	13.7
Persistent Systems	NA	NA	19.9	17.8	17.3	20.1	18.8
Hexaware	21.6	22.2	28.9	26.6	24.7	24.7	24.8
TCS	29.4	31.6	28.5	25.3	25.6	27.1	27.9
Infosys	29.6	31.0	30.7	29.4	30.3	31.9	30.5
Wipro	23.5	26.8	30.3	26.9	28.9	30.2	27.8
HCLT	38.1	31.9	32.7	35.7	35.9	36.1	35.1

Source: Companies

Mid-tiers have gained domain skills enabling better execution of complex contracts

Moreover, over the years, mid-size players have expanded both in terms of operations and domain skills, enabling better execution of contracts. They get increasingly invited to RFPs of complex deals as well. The increase in scale of mid tier players is also evident from the fact that the price differential between them and top players has been on a declining trend.

Table 8: Mid tier IT players gain scale over the last 5-6 years

(USD mn)	FY07	FY08	FY09	FY10	FY11	FY12	YoY growth for FY11 (%)	YoY growth for FY12 (%)	CAGR 07-12 (%)
Mid size Indian IT players									
Infotech	120	167	194	201	261	324	29.5	24.1	21.9
Geometric	85	121	129	107	136	168	28.0	22.8	14.6
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MindTree	132	184	269	272	331	403	21.5	21.7	25.0
Polaris	229	273	300	286	348	428	22.0	22.9	13.4
KPIT Cummins	103	145	174	154	224	309	45.7	38.0	24.7
eClerx	19	30	42	55	76	98	37.3	29.1	38.7
Persistent Systems	70	106	128	127	170	207	33.7	21.8	24.3
Hexaware	187	253	263	215	231	308	7.7	33.3	10.5
NIIT Tech	196	234	222	209	270	328	29.5	21.3	10.8
Zensar	134	195	200	203	254	371	25.1	46.0	22.6
CMC	-	275	189	184	237	305	29.1	28.8	NA
Top 4 Indian IT players									
TCS	4,158	5,634	6,016	6,340	8,186	10,171	29.1	24.2	19.6
Infosys	3,090	4,176	4,663	4,804	6,041	6,994	25.7	15.8	17.7
Wipro	2,460	3,647	4,324	4,391	5,221	5,921	18.9	13.4	19.2
HCLT	1,266	1,763	2,085	2,574	3,320	4,035	29.0	21.5	26.1
Top 4	**10,974**	**15,221**	**17,087**	**18,108**	**22,768**	**27,120**	**25.7**	**19.1**	**19.8**

Source: Companies

Price-parity to play out in favour of mid-tiers in an uncertain environment

We believe that in an uncertain environment, this price parity between the top four and mid–tier players is likely to play out in favor of mid-tier companies as clients, grappling with cost pressures, are extremely cautious. Also, the recent trend in spend shifting from CTB to RTB, and a greater focus on cost optimization projects will drive growth for mid-tier players.

Thus, we believe that mid-tier Indian IT players will stand to gain from both factors i.e. through disaggregation of deals and the pricing differential between the top four IT players and mid–tier companies.

CMC, Persistent and Tech Mahindra: Initiating coverage with 'BUY'

We consider that mid–caps like **CMC, Persistent and Tech Mahindra** can provide substantial returns due to their strategic positioning and attractive valuations. In the case of CMC, we believe the unique solutions approach coupled with hi-tech offering and TCS parentage places it in a sweet spot from both revenue growth and margin perspective. Significant room for offshoring exists, which can be a key margin driver. We sense that it will gain from the huge potential spending in the government space. We value the company at 12x our FY14 EPS of INR104, implying a target price of INR1,255 and '**BUY'** recommendation. For Persistent, we believe that investments in IP-led business (to increase IP revenues to 20%) coupled with its **`sell with'** strategy with major players like salesforce.com will be a strategic trigger going forward. We value the company at INR508, implying 10x FY14 core EPS of INR42 and INR90 cash/share and initiate with '**BUY'**. Following its merger with Mahindra Satyam (likely to be over in next few months), Tech Mahindra will have a huge base of ~500+ clients. This, coupled with TECHM's client mining capability (its average of top 10 client is USD91m) will impart a high impetus to the company over and above the significant operational leverage in terms of employee fungibility which would help enhance utilization and margin improvement. We value Tech Mahindra at INR1,005, pegging 12X FY14E EPS at INR84 (implying a target price of INR118 for Satyam – ratio of 1:8.5) and initiate with '**BUY'**.

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INITIATING COVERAGE

CMC

In the right place at the right time

India Equity Research | IT

Edelweiss
Ideas create, values protect

CMC is a leading systems engineering and integration company in India with strong parentage in TCS. The company has significantly trimmed exposure to low-margin business and enhanced proportion of system integration and services business, leading to margin surge. We expect revenue and earnings CAGR of 25% and 44%, respectively, over FY12-14E, and prefer the company for its robust return ratios. We initiate coverage with 'BUY' and target price of INR1,255, implying 30% upside.

Solutions approach and hi-tech focus with TCS parentage an edge

CMC's unique solutions approach in the System integration space along with focus in the hi-tech space has enabled it post robust growth in an uncertain environment and also ensures revenue stickiness for future. The above coupled with TCS parentage provides it with all advantages of a large player right from capabilities in all geographies to a strong balance sheet to execute domestic projects like the passport project.

In sweet spot due to high presence in the domestic market

Rising government focus, particularly in e-governance, on faster economic development rightly places the India market in the fastest growing category in the APAC region. CMC's execution track in the domestic space which currently contributes ~35-40% of total revenues (Indian Railways' online reservation, ICR for Office of Registrar) clearly exhibits its prowess in executing complicated projects.

Focus on high margin business and offshore shift to expand margins

CMC been successful in its endeavour to exit from low margin customer service business and focus on the high margin non-equipment services business. The company also expects offshore execution to increase by at least 10% in the System Integration (SI) business which will enable margins to improve by at least 300bps.

Outlook and valuations: Long-term bet; initiate coverage with 'BUY'

We expect a robust revenue and earnings CAGR over FY12-14E, respectively, driven by strong growth in SI business and exit from loss making deals in the CS segment. We believe the stock is a long-term bet due to strong uptick expected from ***government spends, timing of which is difficult.*** We initiate coverage with **'BUY'/SO** recommendation/rating with TP of INR1,255, implying 12x our FY14E EPS of INR104.

Financials

Year to March	FY11	FY12	FY13E	FY14E
Revenues (INR mn)	10,962	14,693	18,736	23,134
Rev. growth (%)	*24.7*	*34.0*	*27.5*	*23.5*
EBITDA (INR mn)	2,225	2,243	3,211	4,181
Net profit (INR mn)	1,794	1,518	2,413	3,164
Diluted EPS (INR)	59.2	50.1	79.7	104.4
EPS growth (%)	*22.8*	*(15.4)*	*59.0*	*31.1*
Diluted P/E (x)	16.3	19.3	12.2	9.3
EV/EBITDA (x)	11.9	12.1	8.8	6.8
ROAE (%)	27.4	21.3	28.4	30.7

EDELWEISS 4D RATINGS

Absolute Rating	**BUY**
Rating Relative to Sector	Outperformer
Risk Rating Relative to Sector	Low
Sector Relative to Market	Overweight

MARKET DATA *(R: CMC.BO, B: CMC IN)*	
CMP	: INR 968
Target Price	: INR 1,255
52-week range (INR)	: 1,099 / 685
Share in issue (mn)	: 30.3
M cap (INR bn/USD mn)	: 29/ 529
Avg. Daily Vol.BSE/NSE('000)	: 37.0

SHARE HOLDING PATTERN (%)

	Current	Q4FY12	Q3FY12
Promoters %	51.1	51.1	51.1
MF's, FI's & BK's	21.1	21.5	21.1
FII's	19.1	19.3	19.3
others	8.8	8.1	8.4
** Promoters pledged shar (% of share in issue)*	:		*NIL*

RELATIVE PERFORMANCE (%)

	Sensex	Stock	Stock over Sensex
1 month	2.0	(0.4)	(2.4)
3 months	7.2	15.1	7.9
12 months	4.9	1.8	(3.0)

Sandip Agarwal
+91 22 6623 3474
sandip.agarwal@edelcap.com

Omkar Hadkar
+91 22 6620 3147
omkar.hadkar@edelcap.com

August 30, 2012

Investment Rationale

Solutions approach and hi-tech focus

Solution centric and hi-tech focus driving growth

CMC's unique solutions approach in the System integration space along with focus in the hi-tech space has enabled it post robust growth in an uncertain environment and also ensures revenue stickiness for future. The company has been working for last several years with TRW a large automotive electronic player primarily due to its unique domain capabilities and hi-tech approach. We believe that like other successful mid cap focussed players CMC's expertise has been the hi-tech space where competition has been limited which has enabled significant revenue and client stickiness. The above solutions and technology approach along with TCS parentage provides it with all advantages of a large player (inspite of being a small player) right from capabilities to offer services across geographies to a large balance sheet required to participate in huge projects like the Indian passport project

CMC has posted an average 36% growth (YoY) over the past nine quarters in the SI segment driven by robust traction in the US market, which contributes more than 70% to the vertical's revenue. The segment's PBIT margin has also been above 20% and management expects it to rise further with increase in offshore execution. We believe there is scope for at least 400bps margin improvement in this vertical, which will boost overall margin by at least 200bps over the next couple of years. CMC has been able to emerge strongly in the SI business in both revenue and margin primarily due to its arrangement with TCS. The latter's huge and experienced sales force in the international market along with CMC's strong offering in the embedded space has enabled it to report excellence.

Table 1: System integration revenues, growth and EBIT margin trend **(INR mn)**

	Q211	Q311	Q411	Q112	Q212	Q312	Q412	Q113
Revenues	1,443	1,441	1,573	1,705	2,045	2,276	2,365	2,644
YoY growth (%)	26.1	21.0	17.7	29.5	41.7	57.9	50.4	55.0
EBIT margins (%)	31.4	30.1	30.0	26.1	21.4	22.9	20.6	21.1

Source: Company

Within IT Enabled Services (ITES) too it has adopted a similar solution-centric approach for process automation and digitisation of paperwork, data migration & analysis, to name a few. In the ITES segment, share of India business has ramped up to 45%. Although this led to the segment's margin declining from 36% to 28%, the company has been able to fortify its position in the domestic IT spend.

TCS parentage provides an edge

TCS parentage an assuring factor

CMC has undergone massive change in terms of its revenue and margin profiles post takeover by TCS—from being an India-centric player in 2005 with minimal international exposure inspite of its strong technical capabilities, to executing large and complex projects. The company's international business has expanded to almost 65% in the last reported quarter. This significant surge has been possible due to its strategy of leveraging on TCS' marketing platform. CMC and TCS have an arrangement whereby contracts are won by the latter in the international market and executed by the former, for which CMC pays a marketing fee. There are also instances where the companies have executed projects jointly with a revenue sharing model, more so in case of extremely large size and complex projects like the Indian government's passport project, requiring varied skill sets and a strong capability at the project winning stage.

Domestic spend to rise as government steps up e-governance spend

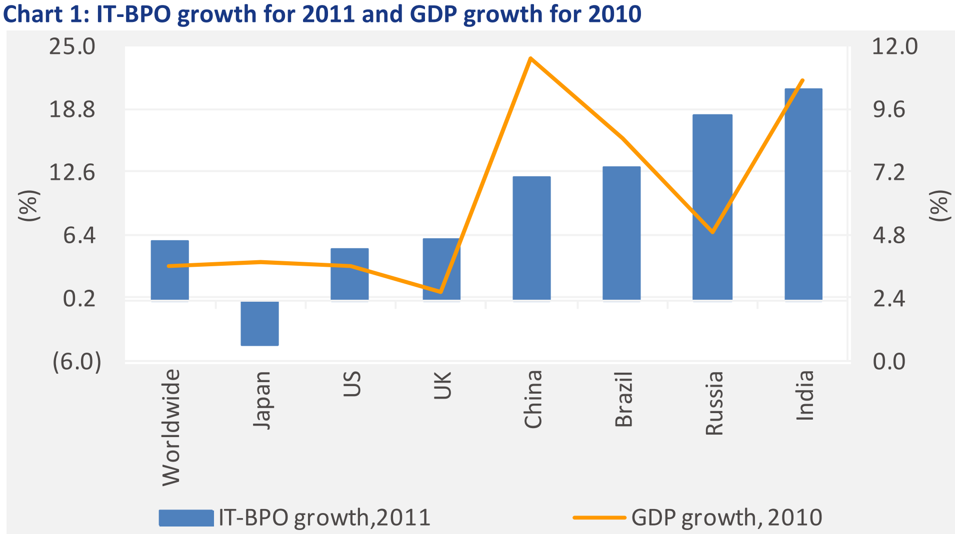
In a sweet spot to reap benefits of government's e-governance thrust

We admit that Indian IT has predominantly been known for strong exports (23% CAGR over FY04-12) in the past vis-a-vis domestic spend (18% CAGR over FY04-12). However, increasing government focus, particularly on the e-governance space for faster economic development and digitisation, rightly places the Indian market in the fastest growing category in the APAC region *(Source: Nasscom).* We expect growth in the domestic market to be stronger led by low current per capita spend vis-a-vis developed markets and significant government aim to improve the IT infrastructure. CMC's past execution track in the domestic space (Indian Railways' online reservation) and ICR for Office of Registrar clearly exhibit its prowess in executing complicated high volume projects and augurs well for future. Currently, it derives ~35-40% of revenue from the domestic market, with government projects contributing a majority (~25% of the 35-40%).

CMC has proven track record in government's IT projects

We strongly believe that India is significantly underpenetrated (going by even per capita IT spend) versus most developed nations and in our view both governments at the Centre and state levels have time and again emphasized on the importance of IT adoption and its role in streamlining key work processes like land records, e-rolls etc. The government's National e-Governance Programmes (NeGP) and Unique Identification Development (UID) programme are just a first few key steps towards digitisation. We believe UID will lay the edifice on which future IT infrastructure will be constructed. Nasscom predicts India to be the fastest growing IT services market worldwide.

Chart 1: IT-BPO growth for 2011 and GDP growth for 2010



Source: Nasscom

Also, the focus of larger peers has also increasingly shifted to emerging markets (including India) to drive growth driven by lower growth in bigger outsourcing markets like North America and Europe. Competition has intensified in India with multinationals like IBM fighting neck-to-neck to win business (IBM won telecom services deal from Bharti in FY12), while we forecast a more aggressive battle going forward in the domestic space, we believe CMC's record of executing large projects in the domestic arena will enable it to gain market share in the coming future. The online securities trading system of the Bombay Stock Exchange, Indian Railways' online reservation system, and the census project for the Registrar General of India are a few of the projects that prove CMC's execution capabilities.

The company's capability lies in execution of projects where volume/instance is high and critical. Thus, we believe, the company is firmly entrenched to gain from future projects which in our view will flow from digitisation of electoral rolls, panchayat data and digitisation of land records where volume involved will be humungous.

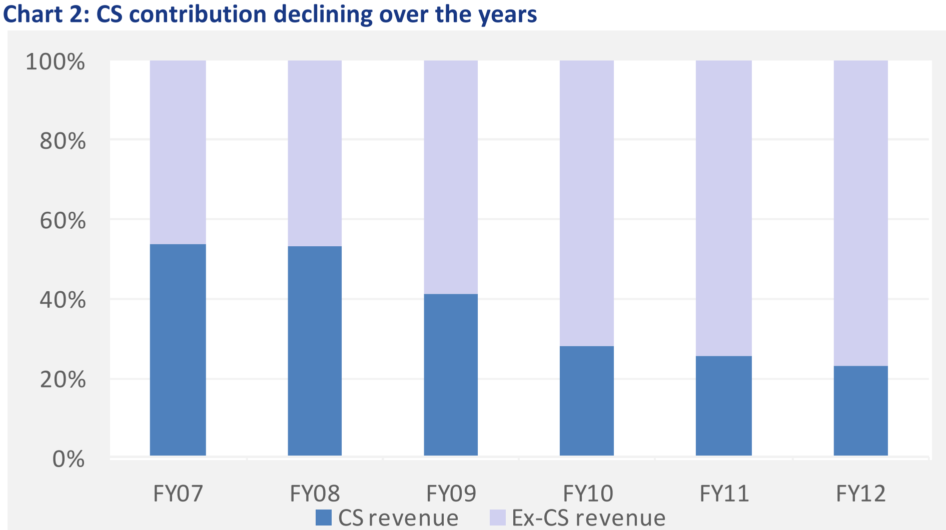
Focus on high margin business and offshore shift to expand margins

Exit from equipment business – a conscious step to shore up margins and profitability

Management, in the recently concluded earnings call (Q1FY13), cited exit from loss making deals as the reason behind sudden jump in margins in the CS segment. Traditionally, this segment (primarily hardware equipment) had accounted for as high as 54% of revenue (in FY07); but, in line with the company's vision to exit from low margin business and focus on high margin services space, the segment has seen deliberate deceleration. While the company's strategy shift led to a sharp decline in revenue in CS business, its focus on infrastructure services leading to deal wins in the domestic services space, nationwide application rollout and helpdesk services has largely compensated for the loss. While admitting that CMC has been able to trim equipment business' contribution from ~54% to total revenue in FY07 to ~23% as of FY12, we do not foresee a further decline. We believe this segment is a catalyst for the company to win large deals in the domestic space, which will come as bundled deals including some hardware and software components.

CS contribution declined from 54% (FY07) to 23% (FY12)

Chart 2: CS contribution declining over the years



Source: Company

Chart 3: Volatile CS EBIT margin trend over the years

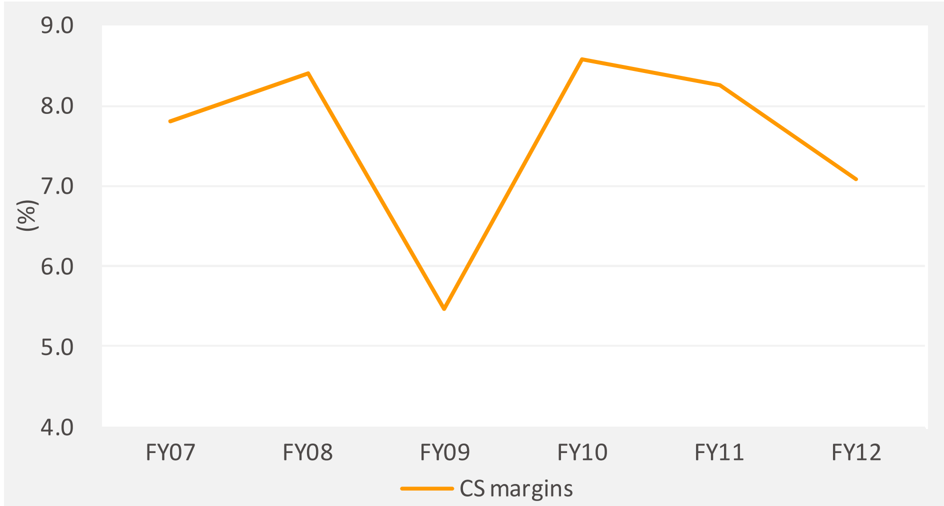


Chart 4: CS profit contribution in the overall op. profits gradually declining

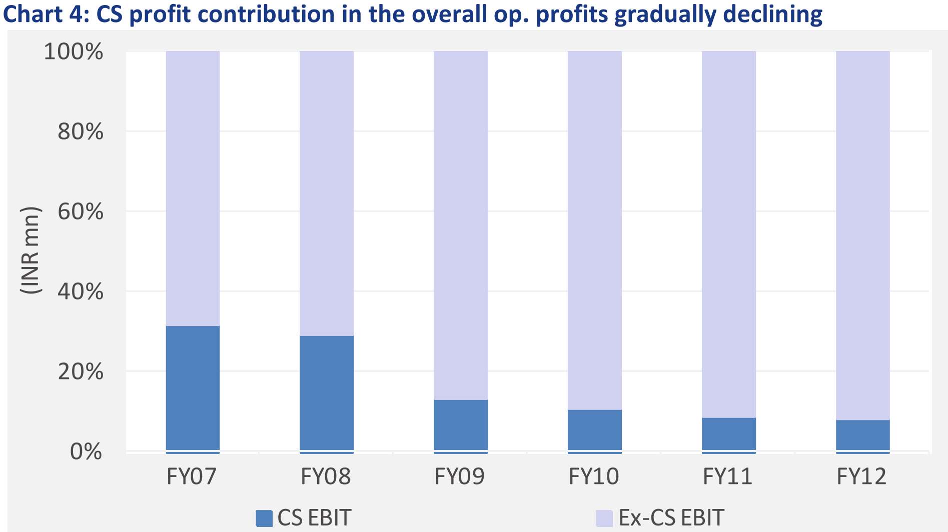
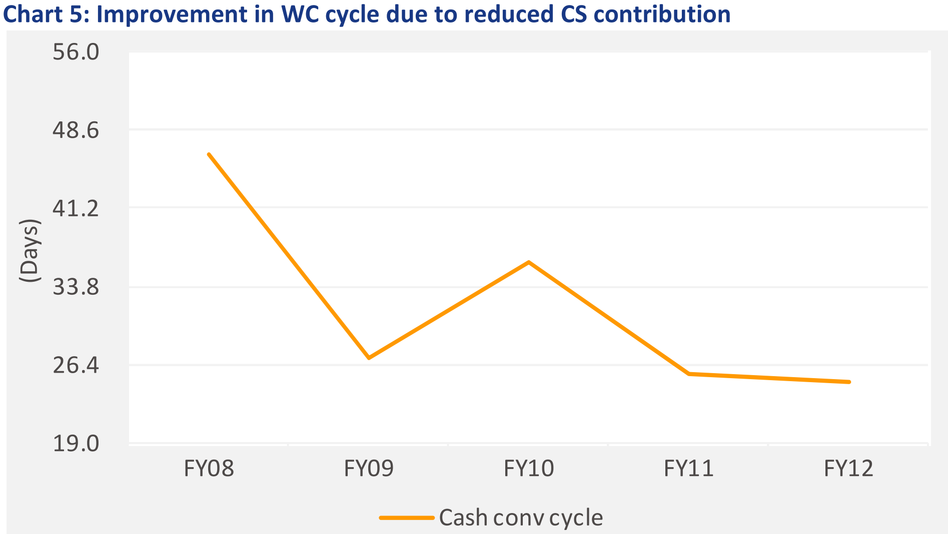


Chart 5: Improvement in WC cycle due to reduced CS contribution

Decline in CS revenues improves overall working capital cycle for the company



Source: Company

We also remain comfortable on the margin front in an uncertain environment due to CMC's differentiated strategy of hiring employees and sub-contractors. While sub-contractors are expensive in absolute terms, they permit flexibility in managing costs due to their temporary nature vis-a-vis permanent employees, who although more economical, can impact margin in an uncertain environment.

Margin to remain upwards of 16%; tax rate to cool off

Offshoring, exit from loss making deals to enable margins @ 16%

Although CMC will have to continue its low margin CS business at ~20% of total business, we believe its margin will remain upwards of 16% for the following reasons:

- **Exit from loss making deals in CS:** Management has clarified that the company has exited from loss making equipment deals in Q1FY13 and will maintain ~10% margin going forward.
- **Increase in offshore component:** CMC's current offshore execution in SI is ~26%, which will increase as projects progress and will result in decline of low margin onsite efforts. We believe there is scope for at least 10% shift in execution efforts from onshore to offshore, which will improve margin by at least 400bps in SI business and 300bps on an overall basis
- **Tax rate:** CMC expects revenue from SEZ to increase from the current 4% in the coming years, which will enable the overall tax rate to dip to 22% from 31% in FY12. Management, in its last quarter earnings call, assured that the tax rate will remain at around 22%.

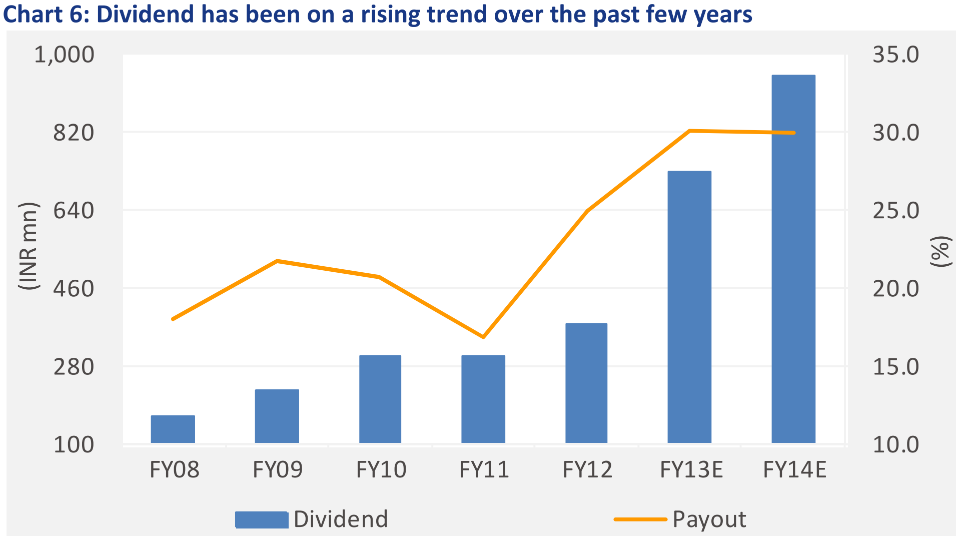
Consistently rising dividends

Dividend payout to be ~30% for FY13E/FY14E

CMC has consistently paid dividends over the years with payout ratio being in the 17-25% range. Going ahead too, the company plans to continue the policy of paying dividends. We estimate the payout ratio to be ~30% for FY13 and FY14.

Dividend continues to rise over the years

Chart 6: Dividend has been on a rising trend over the past few years



Source: Company, Edelweiss research

CMC's RoE comparable to Top 4

Industry leading RoE

CMC has, over the years, reported industry leading RoE (21-31% over FY08-12) and we believe with exit from loss making and low margin equipment business and focus on improving contribution from SI deals will lead to further improvement. We expect it to post RoE of 29% and 30% for FY13E and FY14E, respectively.

Table 2: RoE comparison with Top-4 IT companies

ROE (%)	FY08	FY09	FY10	FY11	FY12
CMC	**29.5**	**28.9**	**31.8**	**30.8**	**21.3**
Infosys	37.2	37.4	30.1	27.8	29.0
TCS	49.3	36.9	37.6	37.6	36.7
HCLT	20.2	22.0	19.2	20.9	25.7
Wipro	27.9	27.7	26.5	24.3	21.2

Source: Company, Edelweiss research

SEZ rental income to aid profitability

CMC has over 68 acres of land in Hyderabad on which it is building SEZ campus at total capex of INR4.5bn, of which INR1.3bn will be incurred in FY13 (2.5bn inFY12). This SEZ facility will have a seating capacity of 13,000, of which 2,500 is will be used by the company and balance will be leased to TCS. The company expects to earn a rental income of INR440mn in FY13E and INR550mn in FY14E. Further, this rental income is fully tax exempt as CMC is the developer of the SEZ.

Target price of INR 1,255 based on P/E of 12x FY14E earnings

Valuation

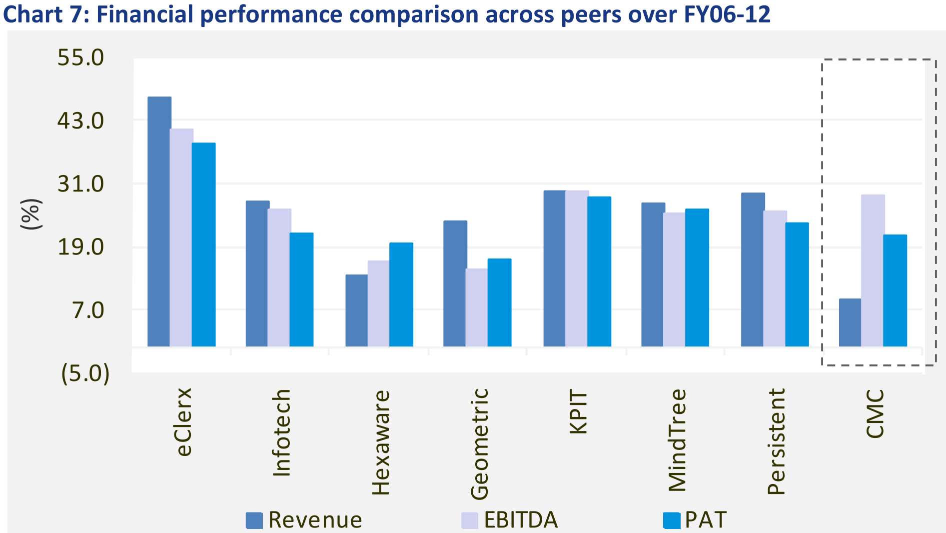
We initiate coverage of CMC with 'BUY/Sector Outperformer' recommendation/rating and value it at INR1,255 per share, implying 30% upside from the current market price of INR968 over the next 12 months. Our target price of INR1,255 is based on P/E of 12.0x FY14E EPS of INR104.4. CMC has posted revenue growth better than/in line with TCS and we believe the company's marketing arrangement with its parent will benefit it in the long run. We are forecasting a revenue growth of 14% (USD terms) for CMC's international business, in line with our FY13 and FY14 estimates for TCS.

Based on the above calculation, we arrive at an overall growth rate of 28% and 24% for FY13E and FY14E along with 17.1% and 18.1% EBITDA margin and EPS of INR80 and INR104, respectively. We expect revenue and earnings growth to be driven by strong growth in systems integration business, exit from loss making deals in the CS segment and huge domestic services opportunity. The stock, in our view, is a long-term bet due to strong uptick expected from the domestic space, which is largely expected from *government spends, timing of which is difficult.*

Comparison with other tier-II listed players

While revenue growth compared to other tier II listed players is lower for CMC, its EBITDA and PAT growth has been in line with peers. Business models are largely similar, though they cater to different markets and specialise in varied horizontals. Also, the size of these companies is comparable in terms of revenue.

Chart 7: Financial performance comparison across peers over FY06-12



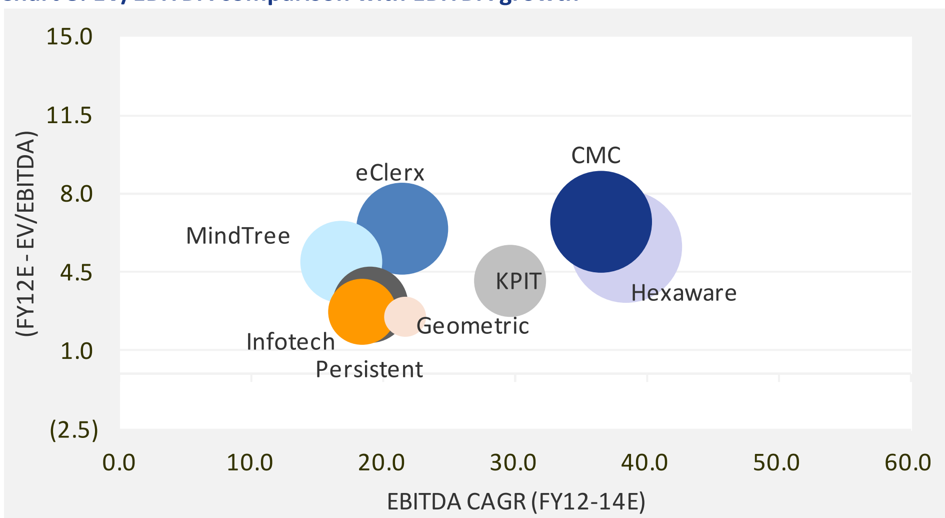
Source: Companies, Edelweiss research

Comparative valuation metrics

Table 3 Valuation comparison across mid-tier IT companies

	Price (INR)	Mkt Cap (INR mn)	EPS (INR)			P/E (x)			EV/EBITDA (x)			ROE (%) FY12	EBITDA margin (%) (FY12)
			FY12	FY13E	FY14E	FY12	FY13E	FY14E	FY12	FY13E	FY14E		
eClerx	743	21,820	53.1	64.5	76.1	14.0	11.5	9.8	9.9	7.6	6.4	55.0	56.9
Infotech	176	19,623	14.6	19.9	22.2	12.0	8.8	7.9	5.4	3.4	2.9	14.9	17.4
Hexaware	124	36,731	8.9	11.5	13.5	13.9	10.8	9.2	12.0	7.0	5.6	26.9	18.2
KPIT	124	22,068	7.5	10.8	13.1	16.5	11.5	9.5	7.2	4.3	4.1	22.1	14.5
MindTree	665	27,158	53.8	57.6	64.1	12.4	11.6	10.4	7.0	4.7	5.0	29.0	15.3
Persistent	389	15,576	35.5	42.6	45.4	11.0	9.1	8.6	5.0	3.2	2.7	17.9	23.2
CMC	**968**	**29,330**	**50.1**	**79.7**	**104**	**19.3**	**12.2**	**9.3**	**12.1**	**8.8**	**6.8**	**21.3**	**15.3**

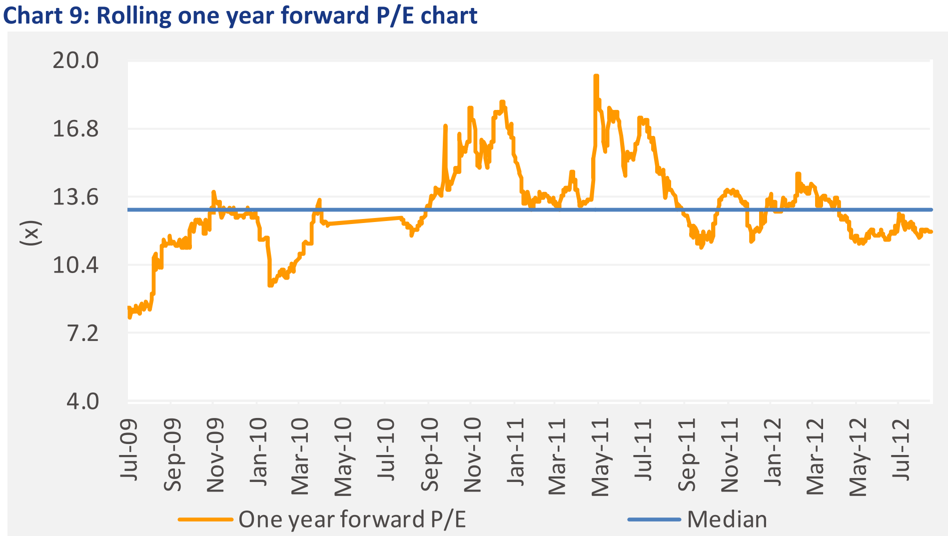
Chart 8: EV/EBITDA comparison with EBITDA growth



** Note: Size of the bubble represents current EV*

Source: Companies, Bloomberg, Edelweiss research

Chart 9: Rolling one year forward P/E chart



Source: Bloomberg,

Key Risks

Delay in government spending could impact performance

While we believe that government spending on e-governance and digitisation initiatives will scale up rapidly, the timing of the same is difficult to ascertain. Any delay or cancellation in government spending could significantly impact CMC's growth and profitability.

Sensitivity to currency movement

The proportion of export revenue has been rising and currently stands at 65%, exposing CMC to currency risk. Any significant movement in currency can impact our estimates meaningfully.

A stiffer protectionist policy in US

With the US economy going through a tough phase, there have been rising concerns of the country adopting a stiffer protectionist policy. This, to a small extent, is evident from the fact that visa rejections have jumped in recent times. Implementation of such protectionist measures for a prolonged period can materially impact our estimates.

Company Description

CMC leading player in government IT spend

CMC was incorporated on December 26, 1975, as Computer Maintenance Corporation. Government of India held 100% of equity share capital. On August 19, 1977, it was converted into a public limited company. In 1978, when IBM wound up its operations in India, CMC took over the maintenance of IBM's installations at over 800 locations around India, and subsequently, maintenance of computers supplied by other foreign manufacturers as well. In 1992, the Indian government divested 16.69% of CMC's equity to the General Insurance Corporation of India and its subsidiaries, who, in turn, sold part of their stake to the public in 1996. In 1993, the company's shares were listed on the Hyderabad Stock Exchange and the Bombay Stock Exchange (BSE). The following year, government divested 51% of CMC's equity to Tata Sons through a strategic sale and the company became part of the Tata Group. In 2004, the government divested its balance 26.5% stake in CMC to the public.

CMC is a leading systems engineering and integration company in India, offering application design, development, testing services and asset-based solutions in niche segments through turnkey projects of national importance. The company has also been expanding its service presence in international markets offering off-shoring advantages and delivering value through service level-based and project scope-based deliveries. It has 18 offices in major Indian cities and over 150 service locations.

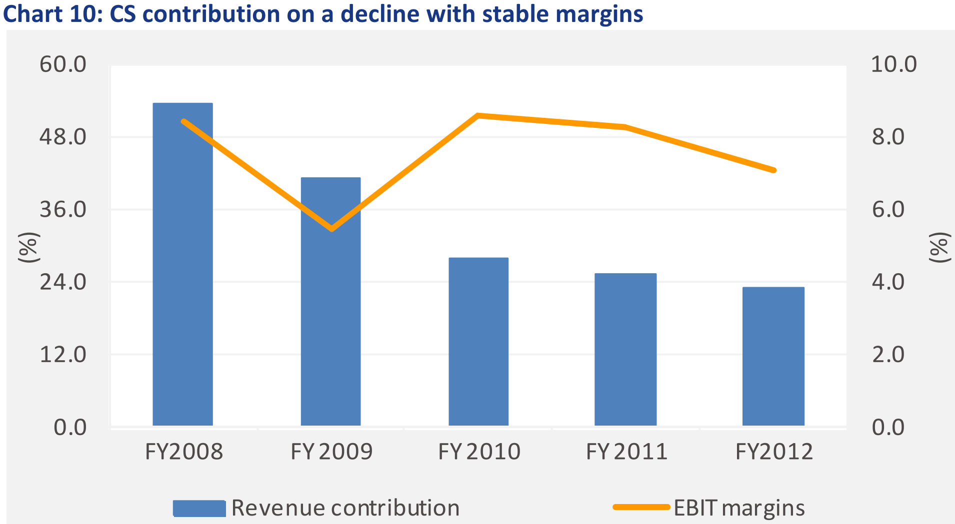
Business Segments

- **Customer Service (CS)**

CS contribution on a declining trend; margins to stabilise at current level (~10%)

The CS segment focuses on creating solutions and providing services for IT infrastructure requirements covering infrastructure architecture, design and consulting services and turnkey system integration of large network and data centre infrastructures. The scope of services includes supply of associated equipment and software. Traditionally, this segment primarily consists of hardware equipment and had accounted for as high as 54% of revenue in FY07. However, it has been deliberately decelerated in line with the management's vision to exit from low-margin business and currently its contribution stands at 23% (FY12). We expect the contribution to fall further to 20% by FY14E.

Chart 10: CS contribution on a decline with stable margins



Source: Company

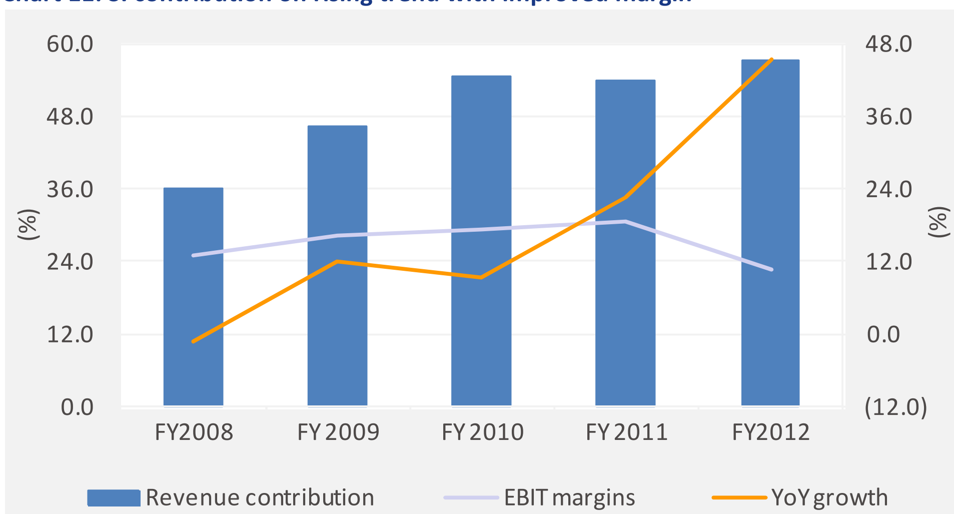
SI contribution jumped from 36% (FY07) to 57% (FY12) driving growth and margin expansion for the company

Traction continues in SI business

- **Systems Integration (SI)**

  This segment undertakes activities of deployment of solutions which includes embedded systems, software development, software maintenance and support, turnkey project implementation and systems consultancy. This segment's contribution has scaled up from 36% in FY07 to 57% in FY12 and EBIT margin has been over 20% over the same period. We believe the company has been able to emerge strongly in the SI business in both revenue growth and margin primarily due to its arrangement with TCS. The latter's huge and experienced sales force in the international market along with CMC's strong offering in the embedded space has enabled it to post robust performance over the years. We expect the traction in this segment to continue and its contribution to revenue to scale up further to 61% by FY14E.

Chart 11: SI contribution on rising trend with improved margin



Source: Company

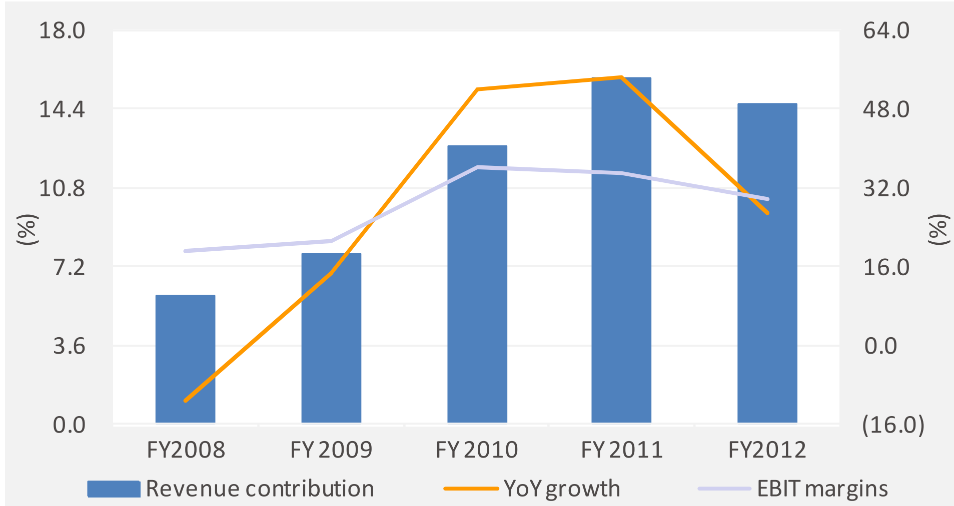
ITES drives international revenues and has contributed to overall margin expansion

- **IT Enabled Services (ITES)**

  This segment includes Business Process Outsourcing and Knowledge Process Outsourcing and has created specific business domain expertise such as on demand software services, digitisation & document management, recruitment & examination results management and legacy data migration management. Over the years, ITES has been one of the primary drivers of spurt in the company's international revenue and its contribution has increased from 8% in FY09 to 15% in FY12, while EBIT margin has expanded from 21% to 30% over the same period.

ITES contribution catapulted to 15% (FY12) from 7% (FY07)

Chart 12: ITES contribution doubled over past 5 years



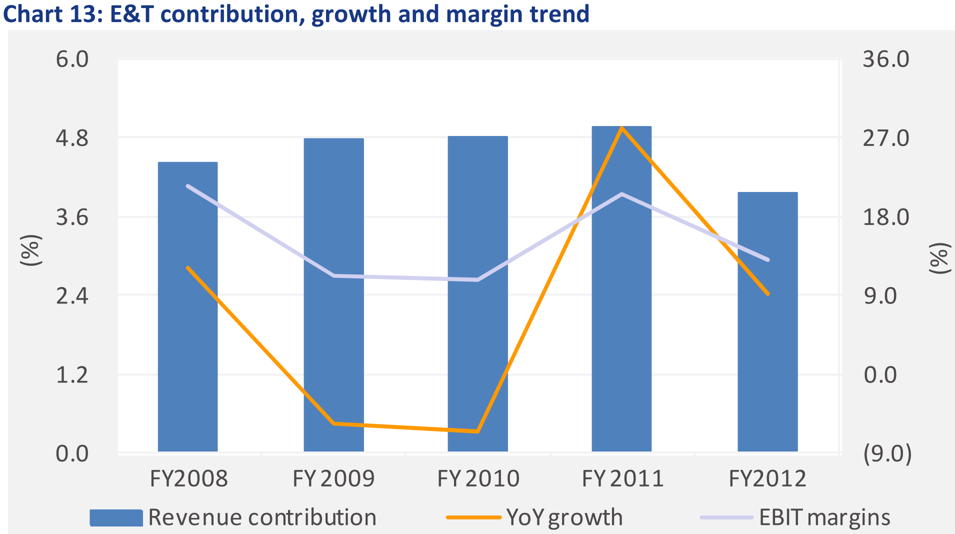
Source: Company

E&T business at nascent stage, contributes 4% to revenue

- **Education and Training (E&T)**

  This segment offers education and training solutions for corporate organisations, government institutions and individuals. Its offerings include a wide range of courses, varying from information technology, soft skills training, integrated career development programmes, skill development to vocational training programmes. In addition to training programmes for employees, it also delivers various skill enhancement programmes for experienced people from the industry. With a view to differentiate from competition, CMC has re-engineered its offerings in corporate and job enabling training segments. Currently, its contribution to revenue stands at 4% with EBIT margin of 13% (FY12).

Chart 13: E&T contribution, growth and margin trend



Source: Company

Management and BOD details

Name	Designation	Background / Previously with
S Ramadorai	Chairman	CEO of Tata Consultancy Services, 1996-2009 Continues as Vice-Chairman of TCS Chairman of other Tata companies - Tata Elxsi ,Tata Technologies & CRL Board of various other companies - HUL ,Tata Industries
Ramanathan Ramanan	Managing Director & Chief Executive Officer	Inducted as the Deputy Managing Director and COO of CMC in 2001 and became the Managing Director and CEO in 2003. Ramanan has been associated with TCS and the TATA Group since 1981.He is currently the Chairman of CMC Americas, a wholly owned subsidiary of CMC in USA
S Mahalingam	Director	Chief Financial Officer of TCS He is on the board of several subsidiaries of TCS Former Chairman of the Southern Region of Confederation of Indian Industry (CII) He was also the President of the Institute of Management Consultants of India
Kalpana Morparia	Director	She is the Chief Executive Officer, M/s J P Morgan India She has 34 years of experience with ICICI Group
Sudhakar Rao	Director	He held several key positions in the State Government of Karnataka as Chairman & Managing Director of the Karnataka Urban Infrastructure Development and Finance Corporation, Principal Secretary- Finance; Principal Secretary- Home; Principal Secretary to the Chief Minister of Karnataka; Chief Secretary of Karnataka etc. He also served the Union Government as Director in Prime Minister's Office, Jt. Secretary in the Ministry of Power; Minister(Economics) in the Embassy of India in Washington
M S Ananth	Director	Independent Director on the Boards of CPCL and UCAL Fuel Systems Fellow of Indian Institute of Chemical Engineers and the Indian National Academy of Engineering He is currently member of the Scientific Advisory Committee to the Cabinet and the National Manufacturing Competitiveness Council
Ashok Sinha	Director	Chairman and Managing Director of Bharat Petroleum Corporation (BPCL). He spent 33 years in BPCL, where he served on the Board of BPCL for 15 years – first as Director (Finance) for 10 years from 1995 and then as its Chairman and Managing Director for 5 years

Source: Company

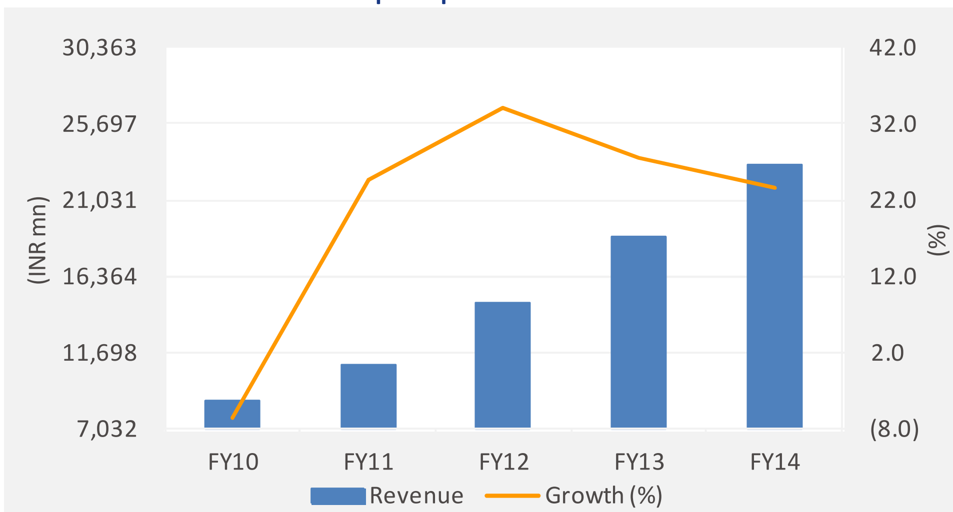
Financial Outlook

Government's e-governance focus to spur revenue, EBITDA in FY12-14

Likely to generate INR23.1bn revenue by FY14E

CMC has recorded robust growth over the past two years, with 25% and 34% revenue growth in FY11 and FY12, respectively. We expect the momentum to continue, stemming from government's increasing focus on e-governance space and initiatives to improve the IT infrastructure for faster economic development. We expect the company to post revenue and EBITDA CAGR of 25% and 37%, respectively, over FY12-14E. Based on our estimates, it will be an INR23.1bn revenue company by FY14E.

Chart 14: Revenue momentum to pick up over FY12-14



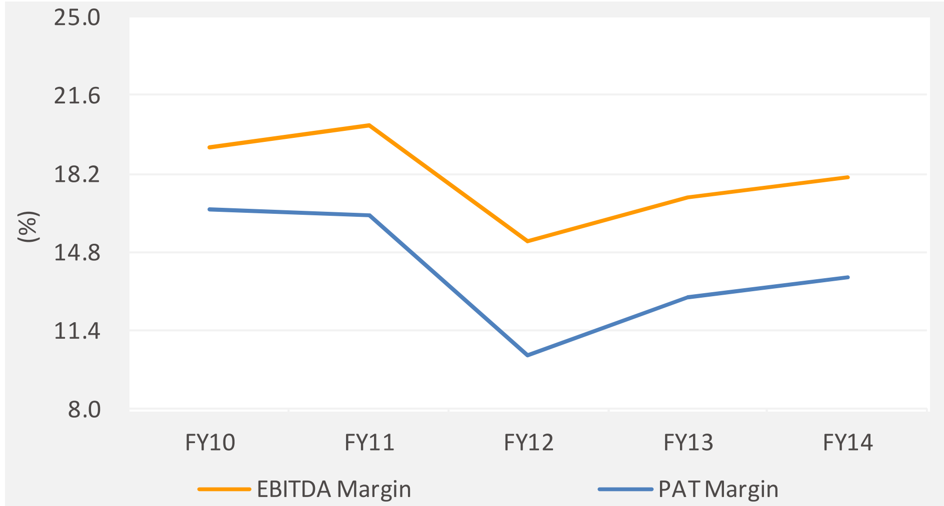
Source: Company, Edelweiss research

High margin system integration and ITES focus to boost EBITDA

EBITDA margin to surge ~270bps over FY12-14E

CMC has been consistently focused on increasing the non-equipment business and has been successful to a great extent in this regard—the low margin CS (equipment) business contribution has dipped from 54% in 2007 to 23% in 2012, and has been replaced largely by high margin (~23%) SI and ITES business (30%), which has also resulted in the company's overall margin spurting from 9% to 15% over the past few years. We expect the EBITDA margin to improve 170bps in FY13E to 17% and further 100bps to 18% in FY14E as the proportion of high margin SI and services business scales up further.

Chart 15: EBITDA and PAT margin on a rising trend

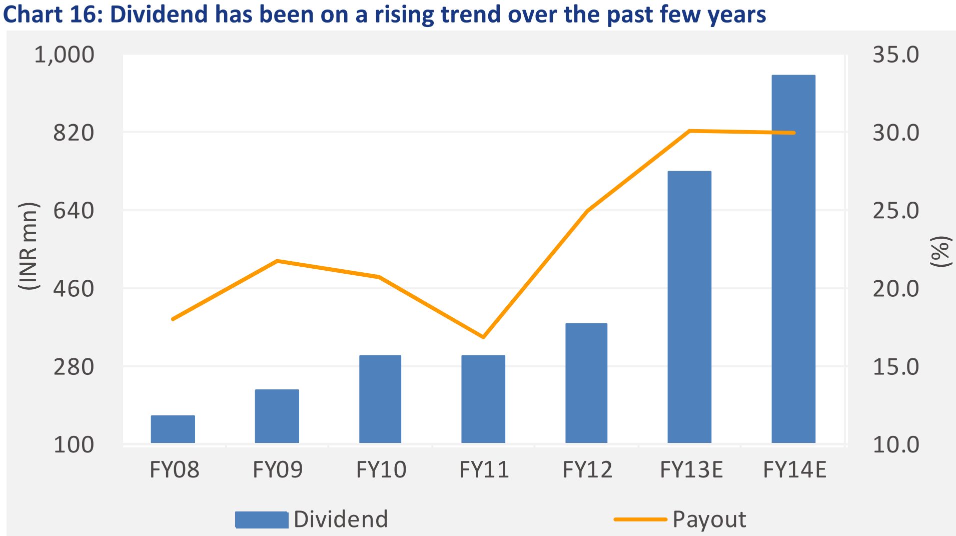


Source: Company, Edelweiss research

Consistently rising dividends

CMC has consistently paid dividends over the years with payout ratio being in the 17-25% range. Going ahead too, the company plans to continue the policy of paying dividends. We estimate the payout ratio to be ~30% for FY13 and FY14.

Chart 16: Dividend has been on a rising trend over the past few years



Source: Company, Edelweiss research

Financial Statements

Key assumptions

		FY11	FY12	FY13E	FY14E
Macro -	GDP(Y-o-Y %)	8.4	6.5	6.4	7.0
	Inflation (Avg)	9.9	8.8	7.0	6.0
	Repo rate (exit rate)	6.8	8.5	7.3	6.8
	USD/INR (Avg)	45.6	47.9	53.5	50.0
Company -	Segment growth				
	Customer Services (%)	25.3	22.9	21.2	19.8
	Systems Integration (%)	53.9	57.1	58.5	60.6
	IT enabled services (%)	15.8	14.7	14.4	14.1
	Education and Training (%)	5.0	4.0	3.4	3.1
	Materials costs (%)	11.1	11.6	8.9	8.2
	Staff costs (%)	31.5	30.0	28.1	28.0
	Sub contracting cost (%)	23.9	30.4	32.5	32.0

Income statement (INR mn)

Year to March	FY11	FY12	FY13E	FY14E
Revenues	10,962	14,693	18,736	23,134
Direct material cost	1,214	1,707	1,662	1,892
Employee cost	3,451	4,402	5,268	6,478
Subcontracting & outsourcing costs	2,623	4,461	6,080	7,403
Other costs	1,448	1,880	2,515	3,181
Total operating costs	8,737	12,450	15,525	18,954
EBITDA	2,225	2,243	3,211	4,181
Depreciation & amortization	105	214	210	292
EBIT	2,120	2,030	3,000	3,888
Interest expense	2	0	0	0
Other income	0	175	100	168
Profit before tax	2,118	2,204	3,100	4,056
Tax	324	686	687	892
Core profit	1,794	1,518	2,413	3,164
Diluted shares (mn)	30.3	30.3	30.3	30.3
EPS (INR) diluted	59.2	50.1	79.7	104.4
Dividend per share	10.0	12.5	24.0	31.3
Dividend pay out (%)	16.9	24.9	30.1	30.0

Common size metrics - as % of revenues

Year to March	FY11	FY12	FY13E	FY14E
EBITDA margin	20.3	15.3	17.1	18.1
EBIT margin	19.3	13.8	16.0	16.8
Net profit margins	16.4	10.3	12.9	13.7

Growth metrics (%)

Year to March	FY11	FY12	FY13E	FY14E
Revenues	24.7	34.0	27.5	23.5
EBITDA	30.9	0.8	43.1	30.2
Net profit	22.8	(15.4)	59.0	31.1
EPS	22.8	(15.4)	59.0	31.1

Balance sheet				(INR mn)
As on 31st March	**FY11**	**FY12**	**FY13E**	**FY14E**
Equity share capital	152	303	303	303
Reserves	6,389	7,419	8,987	11,049
Total shareholders funds	6,540	7,722	9,290	11,352
Long term provisions	251	275	302	332
Sources of funds	**6,791**	**7,996**	**9,592**	**11,685**
Goodwill and other intangible asset	3	3	3	3
Net fixed assets	961	2,581	5,005	6,212
Capital WIP	1,075	334	100	150
Non-current Investments	0	0	0	0
Long-term loans and advances	964	1,406	1,688	2,025
Deferred tax asset	88	110	110	110
Current investments	2,262	1,516	516	816
Debtors	2,521	3,821	4,620	5,768
Cash & bank balances	565	588	513	292
Short term loans and advances	553	496	546	655
Inventories	135	134	257	317
Other current assets	1,245	1,502	1,694	1,965
Total current assets	7,281	8,058	8,145	9,812
Trade payables	1,733	2,620	3,080	3,803
Other current liabilities	841	618	806	860
Short-term provisions	1,008	1,258	1,573	1,966
Total current liabilities	3,582	4,496	5,458	6,629
Net current assets	3,699	3,562	2,687	3,184
Application of funds	**6,791**	**7,996**	**9,592**	**11,685**
Book value per share (BV) (INR)	216	255	307	375
Contingent Liabilities				

Free cash flow				(INR mn)
Year to March	**FY11**	**FY12**	**FY13E**	**FY14E**
Net profit	1,794	1,518	2,413	3,164
Depreciation	105	214	210	292
Others	1	(213)	(100)	(168)
Gross cash flow	1,900	1,519	2,524	3,288
Less:Changes in working capital	302	961	454	725
Operating cash flow	1,598	558	2,070	2,563
Less: Capex	983	1,194	2,400	1,550
Free cash flow	**615**	**(636)**	**(330)**	**1,013**

Cash flow statement

Year to March	**FY11**	**FY12**	**FY13E**	**FY14E**
Cash flow from operations	1,900	1,519	2,524	3,288
Cash for working capital	(302)	(961)	(454)	(725)
Operating cashflow (A)	1,598	558	2,070	2,563
Net purchase of fixed assets	(983)	(1,194)	(2,400)	(1,550)
Net purchase of investments	(305)	859	1,000	(300)
Others	61	151	100	168
Investments cashflow (B)	(1,227)	(184)	(1,300)	(1,682)
Dividends	(351)	(352)	(845)	(1,102)
Financing cash flow (C)	(486)	(352)	(845)	(1,102)
Free cash flow	615	(636)	(330)	1,013
Exchange rate differences (D)	1	1	0	0
Change in cash (A+B+C) + (D)	**(114)**	**23**	**(75)**	**(221)**

Ratios

Year to March	**FY11**	**FY12**	**FY13E**	**FY14E**
ROAE (%)	27.4	21.3	28.4	30.7
ROACE (%)	31.2	27.4	34.1	36.5
Debtors (days)	84	79	82	82
Payable (days)	58	54	56	54
Cash conversion cycle	26	25	27	28
Current ratio	2.0	1.8	1.5	1.5
Fixed assets turnover (x)	11.4	8.3	4.9	4.1
Total asset turnover(x)	1.6	2.0	2.1	2.2
Equity turnover(x)	1.7	2.1	2.2	2.2

Valuation parameters

Year to March	**FY11**	**FY12**	**FY13E**	**FY14E**
Diluted EPS (INR)	59.2	50.1	79.7	104.4
Y-o-Y growth (%)	*22.8*	*(15.4)*	*59.0*	*31.1*
CEPS (INR)	62.7	57.2	86.6	114.1
Diluted P/E (x)	16.3	19.3	12.2	9.3
Price/BV(x)	4.5	3.8	3.2	2.6
EV/Revenues (x)	2.4	1.9	1.5	1.2
EV/EBITDA (x)	11.9	12.1	8.8	6.8
EV/EBITDA (x)+1 yr forward	11.8	8.5	6.8	
Dividend yield (%)	1.0	1.3	2.5	3.2

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INITIATING COVERAGE

TECH MAHINDRA

The big league beckons

India Equity Research | IT

Edelweiss
Ideas create, values protect

The combined entity of Tech Mahindra (TECHM) and Mahindra Satyam (MSAT) will be the fifth largest IT service provider based out of India with revenues in excess of USD2.5bn and margins in high teens. We believe that this entity will emerge as a strong contender in the current vendor consolidation environment with a diversified practice across service lines, a huge talent base and significant client relationships. The above merger will also open up newer opportunities for the company in bids where minimum past execution records are a must. We initiate coverage on TECHM with a post merger revenue growth of 7%/9% for FY13/FY14 respectively and with a target price of INR1,005, implying 12x our FY14E EPS estimate of INR83.7.

Tech Mahindra + Mahindra Satyam = A formidable combination

The merger of MSAT with TECHM creates a formidable player with TECHM's and MSAT's client base of 130 and 372 respectively, implying a client base of 500, which is similar to Tier I companies. This, combined with TECHM's impressive top client mining capabilities, (avg. Top 10 client realisation is ~USD91mn) opens up a plethora of opportunity for the combined entity to increase the wallet share among a large base of clients. This will enable significant operational synergies leading to improvement in margin.

Diversification, high non-BT growth key

TECHM on a standalone basis derives about 96% of revenues from telecom. Post the merger, the contribution of telecom will come down to 45%. Also, the geographical concentration of Europe in TECHM reduces from 45% to 35% for the combined entity. Moreover, TECHM specialized telecom play has resulted in a robust growth for the company in non-BT clients which is encouraging under current environment.

Outlook and valuations: Strong turnaround; initiate with 'BUY'

Given the significant margin performance by MSAT in the last few quarters (from 5.9% in Q211 to 21.7% in Q1FY13) combined with a modest growth by TECHM amidst uncertainty in telecom vertical gives us the comfort to forecast a revenue growth of 7%/9% for FY13E/FY14E respectively. Based on the above and coupled with a reduced client and geographical concentration, we value the company at 12x, FY14E earnings (merged entity) of INR83.7. We initiate coverage on TECHM with '**BUY/Sector Outperformer**' recommendation/ rating and a 12-month target price of INR1,005.

Financials

Year to March	FY11	FY12	FY13E	FY14E
Revenues (INR mn)	102,852	118,852	140,946	149,669
Rev. growth (%)	*1.8*	*15.6*	*18.6*	*6.2*
EBITDA (INR mn)	14,584	19,433	27,687	29,507
Net profit (INR mn)	NA	NA	17,167	19,333
Diluted EPS (INR)	NA	NA	74.3	83.7
Diluted P/E (x)	NA	NA	10.7	9.5

EDELWEISS 4D RATINGS

Absolute Rating	**BUY**
Rating Relative to Sector	Outperformer
Risk Rating Relative to Sector	Medium
Sector Relative to Market	Overweight

MARKET DATA *(R: TEML.BO, B: TECHM IN)*

CMP	: INR 793
Target Price	: INR 1,005
52-week range (INR)	: 887 / 524
Share in issue (mn)	: 127.6
M cap (INR bn/USD mn)	: 101/ 1,826
Avg. Daily Vol.BSE/NSE('000)	: 231.7

SHARE HOLDING PATTERN (%)

	Current	Q4FY12	Q3FY12
Promoters %	70.8	70.8	70.9
MF's, FI's & BK's	14.8	14.8	15.2
FII's	5.9	5.7	4.9
others	8.5	8.7	9.0

** Promoters pledged shar : NIL*
(% of share in issue)

RELATIVE PERFORMANCE (%)

	Sensex	Stock	Stock over Sensex
1 month	2.0	16.9	14.9
3 months	7.2	21.1	13.9
12 months	4.9	28.9	24.0

Sandip Agarwal
+91 22 6623 3474
sandip.agarwal@edelcap.com

Omkar Hadkar
+91 22 6620 3147
omkar.hadkar@edelcap.com

August 30, 2012

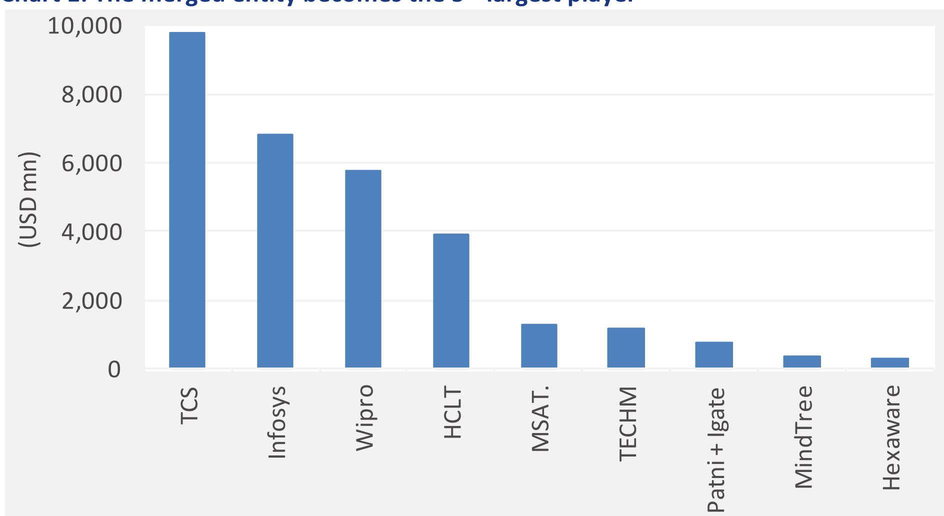
Investment Rationale

Tech Mahindra + Mahindra Satyam = A formidable combination

Merger creates 5th largest player with revenue of USD2.5bn

The merger of MSAT with TECHM creates a formidable player with combined revenues of USD2.5bn thus making it the fifth-largest player in the Indian IT services sector (ex-Cognizant). This will enable TECHM to compete with biggies of the industry and vie for larger deals which could lead to improved traction for the merged entity. Generally clients are more comfortable with larger organizations having a good track record. The close relationship between TECHM and MSAT since past three years will help better integration of functions and provide synergies to the company going forward. It will enable TECHM to diversify its portfolio vertically as well as geographically.

Chart 1: The merged entity becomes the 5th largest player



Source: Companies

Further the merger leads to reduction in top client dependency for TECHM from 36% to 17% in the combined entity. This, although, higher than Tier I players, will come down going ahead as the merged entity cross sells and up sells its services to an expanded client base.

Merger leads to sharp reduction in top client's (BT) revenue from 37% to 17%

Table 1: Top client contribution (BT) reduces significantly in merged entity

Top client (USD mn)	Q411	Q112	Q212	Q312	Q412	Q113
TCS	166	171	174	178	180	183
Infosys	75	75	80	74	73	72
Wipro	43	46	54	59	54	53
TECHM	114	116	110	101	104	101
MSAT	27	32	33	36	33	38

Top client contribution (%)	Q411	Q112	Q212	Q312	Q412	Q113
TCS	7.4	7.1	6.9	6.9	6.8	6.7
Infosys	4.7	4.5	4.6	4.1	4.1	4.1
Wipro	3.1	3.3	3.7	3.9	3.5	3.5
TECHM	41.0	40.0	37.0	35.0	37.0	36.0
MSAT	9.0	10.0	10.0	11.0	10.0	11.0
TECHM + MSAT	**19.6**	**19.0**	**17.5**	**16.5**	**17.0**	**16.2**

QoQ growth (%)	Q411	Q112	Q212	Q312	Q412	Q113
TCS		3.1	1.7	2.4	0.9	1.5
Infosys		(0.1)	6.8	(7.8)	(1.9)	(1.1)
Wipro		7.0	17.3	7.8	(8.5)	(1.4)
TECHM		1.5	(5.5)	(7.7)	3.0	(2.8)
MSAT		17.0	3.1	8.3	(7.1)	13.3
TECHM + MSAT		**6.8**	**7.0**	**8.0**	**7.3**	**7.9**

Source: Companies

The merger of MSAT with TECHM creates a strong player with TECHM's and MSAT's client base of 130 and 372 respectively (implying the combined entity's client base of 500 - similar to Tier I companies). This combined with TECHM's impressive top client mining capabilities (avg. top 10 client realisation is ~USD91mn) opens up plethora of opportunity for the combined entity to increase the wallet share among a larger base of clients.

Expanded base of clients provides significant opportunities for scale up

Table 2: Active client data as of Q1FY13

Active clients (nos.)	Q1FY13
TCS	1,032
Infosys	711
Wipro	919
HCLT	536
TECHM	130
MSAT	372
TECHM + MSAT	502

Source: Companies

TECHM's average realisation from top 10 clients has scaled up significantly from USD58mn in FY07 to USD91mn in FY12, a reflection of its ability to mine and increase its wallet share among top clients. We believe that an expanded client base in the merged entity will provide an oppurtunity to replicate its client mining performance across a broader set of clients and will lead operating leverage to play out.

Table 3: TECHM's Top 10 client comparison with Tier I vendors

Top 10 Clients (USD mn)	FY07	FY08	FY09	FY10	FY11	FY12
TCS	1,141	1,630	1,631	1,857	2,460	2,846
Infosys	997	1,323	1,307	1,265	1,560	1,736
Wipro	609	788	878	867	1,017	1,174
HCLT	485	671	732	694	852	980
TECHM	583	832	864	812	919	905

Avg. realisation for Top 10 clients (USD mn)	FY07	FY08	FY09	FY10	FY11	FY12
TCS	114.1	163.0	163.1	185.7	246.0	284.6
Infosys	99.7	132.3	130.7	126.5	156.0	173.6
Wipro	60.9	78.8	87.8	86.7	101.7	117.4
HCLT	48.5	67.1	73.2	69.4	85.2	98.0
TECHM	58.3	83.2	86.4	81.2	91.9	90.5

% growth in realization per customer	FY07	FY08	FY09	FY10	FY11	FY12
TCS		42.9	0.0	13.9	32.5	15.7
Infosys		32.7	(1.2)	(3.2)	23.3	11.3
Wipro		29.5	11.4	(1.2)	17.2	15.5
HCLT		38.4	9.2	(5.2)	22.6	15.1
TECHM		42.7	3.9	(6.0)	13.2	(1.6)

Source: Companies

We believe that post merger, the combined entity will gain from the following advantages:

- Becomes 5th largest provider in terms of revenue; enables better participation in larger deals.
- Diversification: Service lines , Geographies and Client concentration
- Synergy benefits including reduced expenditure on G&A.
- Combining enterprise application development skills of MSAT with TechM strengths in other horizontals.
- Other benefits: Unified management focus and fungible talent pool

Scale advantage post merger to enable higher participation in large deals

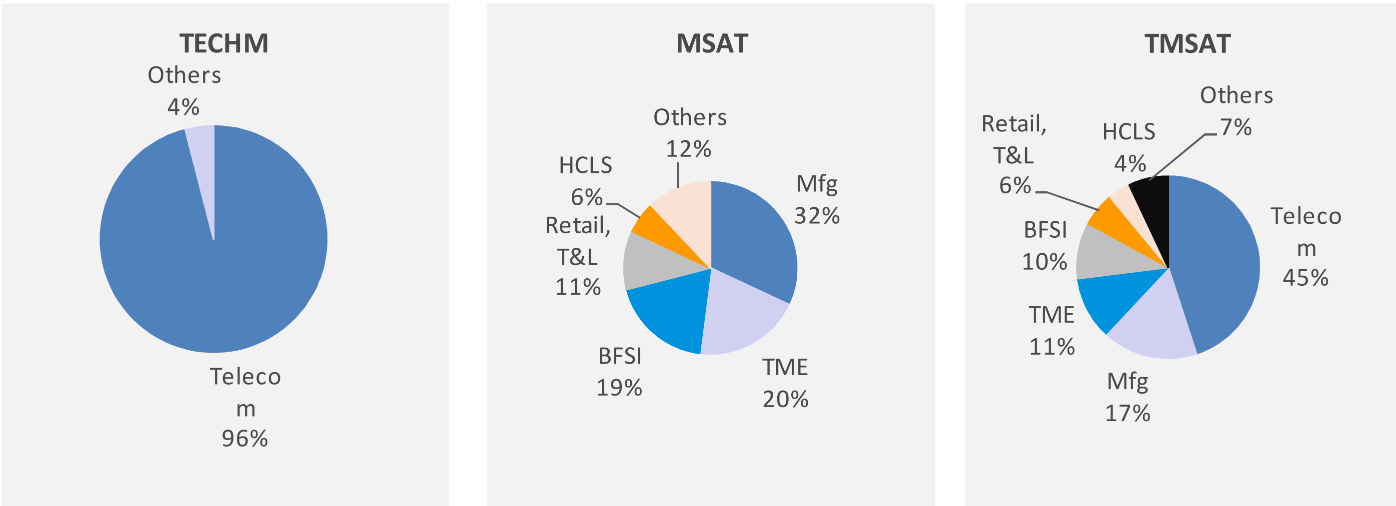
(a) 5th largest in terms of revenue; enables better participation in deals

Post the merger, TECHM will be the fifth largest in the India IT services sector (ex-Cognizant). This will enable TECHM to compete with biggies in the industry and vie for larger deals which could lead to improved traction for the merged entity (TMSAT). Being a larger organization will help TECHM to improve its utilization levels from the current ~74% to higher levels comparable to Infosys and TCS. Also, generally, clients are more comfortable in entering into deals with organizations having a scale advantage and offerrings across service lines. Hence we believe that this merger will enable TECHM to compete for larger deals and also cross sell its abilities to existing clients thereby increasing the wallet share among existing clients.

(b) Diversification: Service lines, Geographies and Client concentration

TECHM has traditionally been known for its specialization in the telecom vertical; approximately 96% of the revenue comes from this space. However, MSAT has a well diversified spread among manufacturing, BFSI, retail, Healthcare and life science (HCLS) and tech, media and entertainment (TME). Hence we believe TMSAT will have a diversified suite of offerings which will be a key positive for TECHM. Also, TECHM's dependence on telecom comes down significantly from the current 96% to ~47% in TMSAT.

Chart 2: Telecom dependency reduces in the merged entity



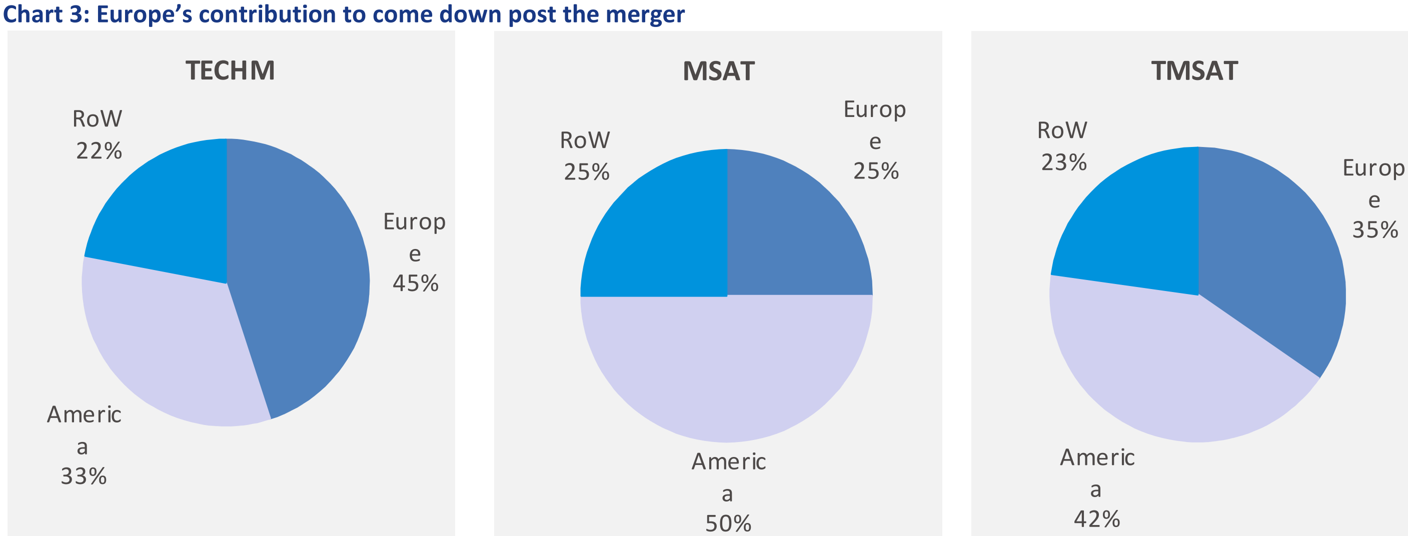
Source: Companies, Edelweiss research

Europe's contribution to dip from 45% to 35%

Merger to slash dependence on Europe

On an individual basis, TECHM has a high exposure to Europe (45% of revenues), traditionally deriving most of its business from here. The current uncertain macro environment in Europe does not bode well for TECHM hence the merger with MSAT is key for the company to reduce its dependency on Europe. MSAT generates ~50% of its business from the Americas. Therefore this merger will benefit TECHM as it reduces the company's dependence on any particular region. The share of revenue from Europe in the merged entity will come down from ~45% to 35%.

Chart 3: Europe's contribution to come down post the merger



Source: Companies, Edelweiss research

Table 4: TECHM's revenues from Europe disappoint for past several quarters **(USD mn)**

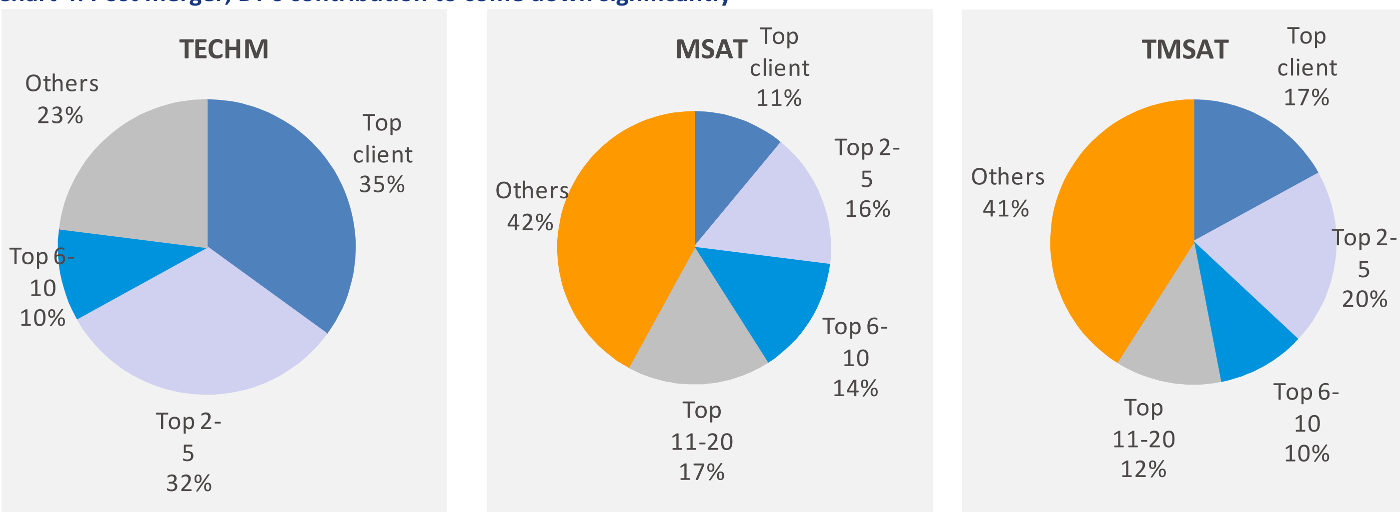
TechM revenue from Europe	Q111	Q211	Q311	Q411	Q112	Q212	Q312	Q412
Europe revenues	138.1	141.1	145.2	144.8	147.8	139.2	130.1	129.5
YoY growth	(0.6)	(2.2)	2.2	(1.8)	7.0	(1.4)	(10.4)	(10.6)

Source: Company

Reduced client concentration (BT)

The merger will significantly reduce revenue generated from BT from 35% to 17%. This is crucial for TECHM as revenue from BT holds a key risk as any ramp down in this pie could significantly impact TECHM revenue growth. Revenue share from top five clients will also come down significantly from 67% to 37%.

Chart 4: Post merger, BT's contribution to come down significantly



Source: Companies, Edelweiss research

SG&A likely to fall in line with peers post merger

(c) Synergy benefits

Post the stake buy in 2009, most of the cost synergies have already been factored in the organizational structure. However, we still believe that there is more room for improvement, particularly in SG&A expenses and utilisation levels which can be brought in line with the industry. MSAT and TECHM's SG&A as a percentage of sales is 21% and 18% respectively. We expect this to gradually come down in line with its peers. Also a unified management and a larger size of the merged entity will provide TECHM the platform for pricing power and help improve its margins going forward. Moreover, we believe that the merger will give MSAT the opportunity to win back some of the clients it lost post the 2009 incident.

Table 5: SG&A of both TECHM & MSAT higher than peers; scope exists to reduce it further (%)

	Q1FY11	Q2FY11	Q3FY11	Q4FY11	Q1FY12	Q2FY12	Q3FY12	Q4FY12
TechM	15.5	11.9	14.3	16.2	15.2	16.7	15.5	17.5
Satyam	20.7	20.5	22.6	21.3	20.3	23.7	22.9	21.2
INFO	12.8	12.6	12.6	12.6	12.8	13.3	11.9	11.4
TCS	16.9	16.3	16.5	16.6	17.5	17.5	17.1	18.3
HCLT	14.5	15.4	15.2	14.7	13.9	14.4	14.5	14.2
WPRO	12.8	12.9	13.3	13.1	12.6	12.3	13.2	13.5

Source: Companies

(d) Combining ERP skills of MSAT, strengths of TECHM in other horizontals

Complementary skill sets to lead to significant benefits in merged entity

MSAT has a diversified portfolio with exposures to various verticals like manufacturing (34% of revenue), BFSI (19%), retail (11%), tech, media and entertainment (21%) as well as healthcare and life-sciences (7%) whereas TECHM has end to end solutions for the telecom vertical and is the industry leader in this vertical. Hence the merger entity will have a diversified portfolio with a good spread of revenue from different verticals. MSAT has a very strong foothold in enterprise solutions for clients which could also benefit TECHM. The skill sets of two companies are complimentary in nature hence the merger provides TECHM with a great opportunity to integrate MSAT's horizontal expertise in its key vertical i.e. telecom. It can also provide better services to its clients as well as clients of MSAT.

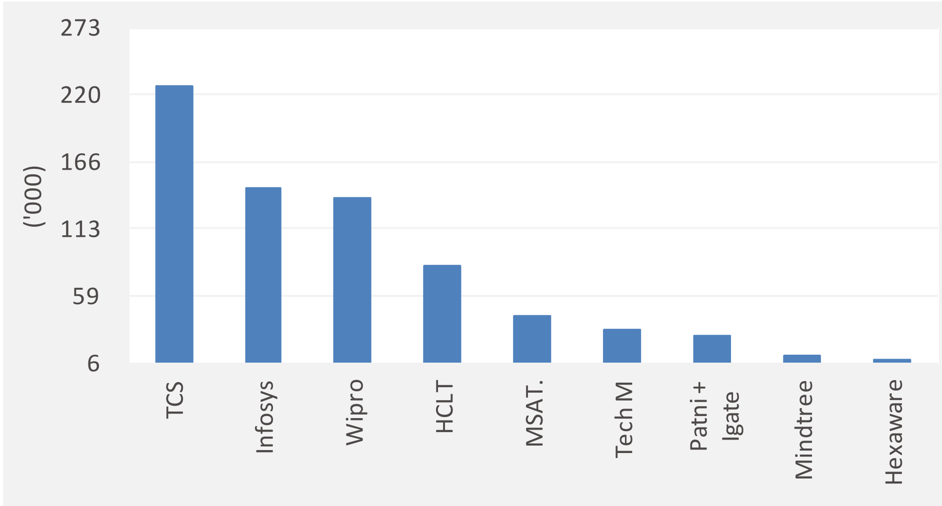
(e) Other benefits: Unified management focus, fungible talent pool

Fifth largest talent pool, enabling better fungibility and utilisation improvement

TECHM took a 43% stake in erstwhile Satyam Computer Services in April 2009 post the 2009 debacle. Since then, both TECHM and MSAT have been working under different management teams. However, with the merger getting approved, going forward, we expect a better performance from these companies as a combined entity, as the management team can work in tandem to grow the business under one roof. Already, the integration of sales team has been done. We believe that once the integration process is complete, which would not be too tough given that MSAT has been TECHM's associate for around three years now, business from both companies could benefit from better utilization of resources and a unified management focus. However, we would like to point out that risks from the integration remain, particularly on the top management.

The merger will catapult TECHM as thefifth largest company (excl. Cognizant) in the IT services space. This provides TECHM with a readymade pool of talent and scale to bid for larger deals and compete with the likes of HCLT and Wipro. Clients are generally more comfortable giving larger deals to companies having larger and diverse talent pools and a proven track record. This merger will provide TECHM the opportunity to enhance its ability to win larger deals and compete with the likes of Infosys and TCS.

Chart 5: Merged entity to have the 5th largest talent pool



Source: Companies

(f) Merged entity to be net cash company

While TECHM on a standalone basis has debt on its books MSAT has been a net cash company and post the merger the TECHM will be able to reduce or payoff its debt and still the merged entity will be net cash company (refer Table 6)

Table 6: Merged entity to be a net cash company **(INR mn)**

FY12 ending position	Cash & equivalents	Investments	Debt	Net cash
TECHM	2,418	1,605	11,266	(7,243)
MSAT	28,519	972	234	29,257
TECHM + MSAT				22,014

Source: Companies

MSAT's all-round vertical presence to drive growth for merged entity

MSAT's presence in Manufacturing, BFSI, retail to drive growth

As mentioned earlier, the exposure of telecom and BT in the merged entity reduces to 45% and 17% from 96% and 37% in TECHM. While the merger does reduce vertical and client concentration in the merged entity, significant exposure to telecom and BT still remains a risk particularly when IT spend in telecom vertical has seen pressure, especially in the equipment manufacturer space. However, MSAT's presence in verticals like BFSI, manufacturing, retail, media and healthcare will not only offset a decline in BT and muted growth in telecom vertical, but also drive growth for the merged entity (TMSAT).

Non-BT revenues to aid growth

We remain positive on the overall growth of TMSAT and expect it to post USD revenue growth of 7% and 9% for FY13 and FY14, respectively after factoring in 2% decline in BT revenue for FY13 and 8%/10% growth in non- BT revenues for FY13 and FY14 in the merged entity. We have been conservative in our estimates for non-BT revenues despite a 21% CAGR in last four years due to the overall weakness in the telecom vertical.

Our confidence stems from the fact that we expect the total Indian IT exports revenue to jump from the current USD69bn to USD98bn, implying a CAGR of 12.2% from FY12 to FY15E. This surge will be driven by market share gains (though at a slower pace) in both high growth verticals like healthcare, utilities and retail (from current 14.4% to 22.5%) and churns in more matured verticals like BFSI followed by a tepid growth in telecom (partly compensated by an increase in media spends).

Table 7: Indian IT BPO exports forecast **(USD bn)**

Vertical-wise breakup (Indian IT-BPO exports)	2009	2010	2011	2012	2013E	2014E	2015E	3Yr-CAGR (%)
BFSI	19	20	24	28	31	33	35	7.4
Telecom & media	9	10	12	13	13	16	17	9.4
Manufacturing	8	8	9	11	13	15	17	16.2
Retail	4	5	6	7	8	9	11	17.5
Healthcare	1	2	3	3	4	5	6	26.0
Travel &Transport	2	2	2	2	3	3	3	15.0
Const. & Utilities	2	2	2	2	3	3	4	24.0
Total	**47**	**50**	**59**	**69**	**77**	**87**	**98**	**12.2**

Source: Nasscom, Edelweiss research

Even as TECHM is struggling for growth over the past few quarters owing to pressure from its top client BT, MSAT has seen a continuous traction due to its diverse vertical presence. Over the past few quarters, it has posted a decent performance in its key verticals like manufactring, BFSI and media. The growth has been comparable to the top 4 Indian players.

Table 8: Comparison of MSAT's vertical wise revenue and growth with peers

BFSI (USD mn)	Q112	Q212	Q312	Q412	Q113
TCS	1,044	1,098	1,120	1,117	1,173
Infosys	592	616	638	607	601
Wipro	376	399	411	408	400
HCLT	250	252	259	251	257
MSAT	54	63	68	63	65

QoQ growth (%)	Q112	Q212	Q312	Q412	Q113
TCS	5.8	5.2	1.9	(0.2)	5.0
Infosys	3.4	4.2	3.4	(4.7)	(1.1)
Wipro	0.5	6.1	3.0	(0.6)	(2.1)
HCLT	4.5	0.5	2.8	(2.7)	2.2
MSAT	**(0.6)**	**15.3**	**8.9**	**(7.6)**	**3.0**

Manufacturing (USD mn)	Q112	Q212	Q312	Q412	Q113
TCS	323	346	354	368	379
Infosys	339	353	368	377	385
Wipro	277	280	286	293	294
HCLT	270	291	301	304	307
MSAT	102	106	104	106	116

QoQ growth (%)	Q112	Q212	Q312	Q412	Q113
TCS	11.7	7.0	2.4	3.9	3.0
Infosys	3.8	4.0	4.5	2.4	2.2
Wipro	0.5	0.9	2.3	2.5	0.2
HCLT	8.0	7.8	3.7	0.8	0.9
MSAT	**5.3**	**3.1**	**(1.5)**	**2.2**	**9.5**

Retail (USD mn)	Q112	Q212	Q312	Q412	Q113
TCS	280	306	318	331	360
Infosys	269	272	275	280	296
Wipro	211	216	224	236	227
HCLT	76	85	90	90	93
MSAT	38	36	36	37	38

QoQ growth (%)	Q112	Q212	Q312	Q412	Q113
TCS	11.3	9.2	4.1	4.1	8.8
Infosys	15.8	1.2	0.8	1.9	5.8
Wipro	(4.0)	2.5	3.7	5.4	(3.9)
HCLT	(4.4)	12.0	5.6	0.2	3.0
MSAT	**14.8**	**(5.5)**	**(1.5)**	**2.2**	**3.0**

Source: Companies

Table 9: Comparison of vertical wise revenue and growth of MSAT (contd.)

Healthcare (USD mn)	Q112	Q212	Q312	Q412	Q113
TCS	125	134	137	140	145
Infosys	80	98	107	97	89
Wipro	144	144	151	154	153
HCLT - Life Science	76	76	88	95	117
Cognizant	386	430	458	467	484
MSAT	22	23	20	20	24

QoQ growth (%)	Q112	Q212	Q312	Q412	Q113
TCS	5.5	6.7	2.4	2.4	3.0
Infosys	4.3	21.9	9.0	(8.6)	(8.3)
Wipro	(2.4)	0.5	4.4	2.0	(0.4)
HCLT - Life Science	4.0	0.1	15.4	8.5	22.3
Cognizant	10.9	11.2	6.4	2.1	3.7
MSAT	**(7.9)**	**3.1**	**(15.6)**	**2.2**	**20.2**

Media (USD mn)	Q112	Q212	Q312	Q412	Q113
TCS	53	53	57	58	60
HCLT	68	68	65	70	72
MSAT	64	69	62	70	72

QoQ growth (%)	Q112	Q212	Q312	Q412	Q113
TCS	2.8	(0.1)	7.3	2.4	3.0
Infosys	13.3	(0.3)	(4.0)	7.3	3.0
MSAT	**10.8**	**8.3**	**(10.9)**	**12.9**	**3.0**

Source: Companies

We believe that this momentum to continue and TMSAT would benefit from this as mature verticals like manufacturing and BFSI will contribute 17% and 10% respectively and growth verticals like media, retail and healthcare will contribute 11%, 6% and 3% respectively to revenueus.

Table 10: Vertical wise contribution in merged entity

Contribution (%)	Satyam	TECHM	TMSAT
Manufacturing	32.0		17.0
TME (Technology, Media & Entertainment)	20.3		10.8
BFSI	19.0		10.1
Retail, T&L	11.2		6.0
Healthcare & Life Sciences	6.5		3.5
Others	11.0	3.1	7.3
Telecom service provider		80.7	37.8
Telecom equipment provider		6.6	3.1
BPO		9.7	4.5

Source: Companies, Edelweiss research

Target price of INR1,005 based on P/E of 12x FY14E earnings of merged entity

Valuation

We initiate coverage of TECHM with 'BUY' rating and value it at INR1,005 per share, implying 27% upside from the current market price of INR793 over the next 12 months. Our target price is based on 12x, FY14E earnings (merged entity) of INR83.7.

Given the significant EBITDA margin performance by MSAT in the last few quarters (from 5.9% in Q211 to 21.7% in the last quarter) combined with a modest growth by TECHM amidst uncertainty in telecom vertical gives us the comfort to forecast a revenue growth of 7%/9% % for FY13E/FY14E respectively for the merged entity. Also, we expect EBITDA margin to be ~20% for the merged entity. Based on the above and coupled with a reduced client and geographical concentration, we value the company at 12x, FY14E earnings (merged entity) of INR83.5.

Our confidence in the merged entity also stems from TECHM's impressive top client mining capabilities, (avg. Top 10 client realisation is ~USD91mn) which opens up a plethora of opportunity to increase the wallet share for the combined entity with an expanded client base of over 500.

Peer comparison

Table 11: Comparison with Top 4 IT players

Company	CMP	Mcap	Diluted EPS (INR)		P/E(x)		JSD revenue growth (%		EBITDA margin (%)		PAT growth	
	(INR)	(INR bn)	FY13E	FY14E	FY13E	FY14E	FY13E	FY14E	FY13E	FY14E	FY13E	FY14E
Infosys	2,393	1,374	165.9	184.9	14.4	12.9	6.3	11.3	31.4	32.6	14.0	11.5
TCS	1,367	2,676	68.6	75.1	19.9	18.2	14.5	15.7	28.9	28.6	26.4	9.6
Wipro	369	908	27.2	27.6	13.6	13.4	5.6	11.8	11.1	10.7	20.0	1.7
HCL Tech	547	379	38.7	41.9	14.1	13.0	12.9	14.5	18.1	17.0	12.1	8.2
TECHM*	793	101	74.3	83.7	10.7	9.5	6.7	9.3	19.6	19.7	6.5	11.3

Source: Companies, Edelweiss research

**Note: Merged entity*

Key Risks

Delay in telecom spend raises a concern

While we have factored in a relatively lower growth for the telecom vertical, further pressure or delays in IT spend in the vertical (particularly in the equipment provider space) can impact estimates meaningfully as the vertical will contribute ~45% of revenues in the merged entity.

High exposure to BT, Europe may impact growth

BT's revenue in the combined entity stands at ~17% which is high from a top client perspective (top client revenue for Tier I stocks ranges from 4%-7%) even though its revenue has been on a declining trend for the last three years. We have factored in 2% decline for FY13 and flat revenue growth for FY14. Any further decline in BT revenues can impact our estimates.

With more than 35% of revenue in the merged entity coming from Europe, the company's performance can be affected if the recovery is not sustainable in the geography. Any cut back in spending in this geography could impact the revenue growth.

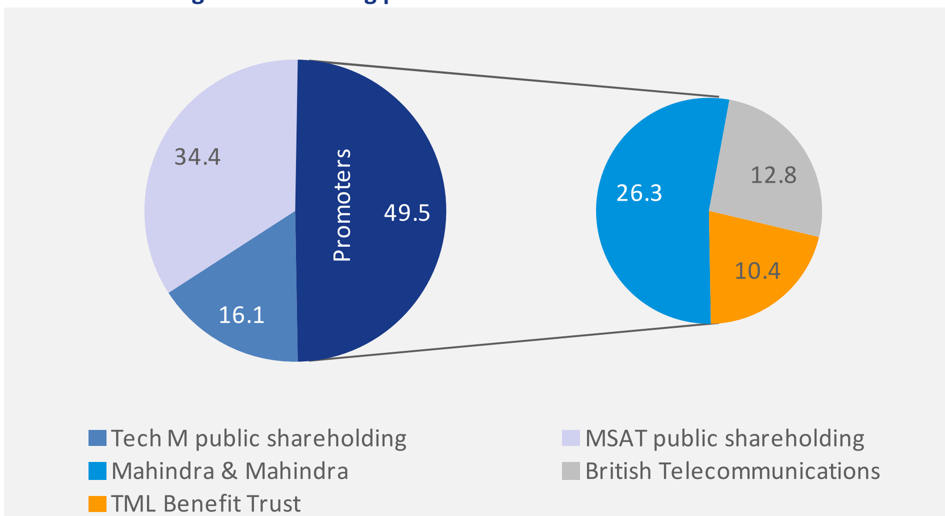
Legal, tax litigations cloud the outlook

Post the scam in 2009, there were a number of claims and litigations against MSAT. While most of them have been settled, few remain. Recently, MSAT completed an out of court settlement with Aberdeen US of USD12mn. Aberdeen US had earlier claimed compensation of ~ USD68mn. Aberdeen UK has filed a claim for USD150mn plus penal interest. Another claim is from the Raju group of companies for INR12.5bn. Similarly there are tax litigations to the tune of INR6.17bn (bank guarantee provided by the company for the same) and INR17bn (provision of INR5bn made for the same). These claims and litigations if go against the company could reduce the cash position significantly.

Shareholding pattern post merger

The boards of directors of both TECHM and MSAT have approved the merger ratio of 17:2 (2 shares of TECHM for every 17 shares of MSAT). TECHM will issue 103.4mn shares to MSAT shareholders as 10.4% of MSAT will be transferred to a trust, to be held as treasury stock, while the remaining shares will be cancelled. This will increase the base of Tech Mahindra's share capital to INR2308mn.

Chart 6: Post merger shareholding pattern



Source: Company

Financial Statements

Key assumptions

		FY11	FY12	FY13E	FY14E
Macro -	GDP(Y-o-Y %)	8.4	6.5	6.4	7.0
	Inflation (Avg)	9.9	8.8	7.0	6.0
	Repo rate (exit rate)	6.8	8.5	7.3	6.8
	USD/INR (Avg)	45.6	47.9	53.5	50.0
Company -	BT growth (%)			(2.0)	0.0
	Non-BT growth (%)			8.0	10.0
	Other verticals growth (%)			6.6	9.1

Income statement (INR mn)

Year to March	FY11	FY12	FY13E	FY14E
Revenues	102,852	118,852	140,946	149,669
Cost of revenues	69,971	76,371	88,391	93,648
Gross profit	32,881	42,482	52,554	56,020
SG&A expenses	18,297	23,048	24,868	26,514
EBITDA	14,584	19,433	27,687	29,507
Depreciation & amortization	3,282	3,191	3,778	3,994
EBIT	11,302	16,242	23,909	25,512
Interest expense	1,096	1,531	0	0
Other income	3,568	4,918	2,100	3,447
Foreign exchange gain/(loss)	548	665	0	0
Profit before tax	14,322	20,295	26,009	28,959
Tax	1,893	2,290	6,842	7,626
Core profit	12,429	18,005	19,167	21,333
Extraordinary income/(loss)	(6,411)	1,094	(2,000)	(2,000)
Profit after tax	6,018	19,099	17,167	19,333
Diluted shares (mn)	NA	NA	231	231
EPS (INR) diluted	NA	NA	74.3	83.7
Diluted P/E (x)	NA	NA	11.2	10.0

Common size metrics - as % of revenues

Year to March	FY11	FY12	FY13E	FY14E
Cost of revenues	68.0	64.3	62.7	62.6
Gross margin	32.0	35.7	37.3	37.4
SG&A expenses	17.8	19.4	17.6	17.7
EBITDA margin	14.2	16.4	19.6	19.7
EBIT margin	11.0	13.7	17.0	17.0
Net profit margins	5.9	16.1	12.2	12.9

Growth metrics (%)

Year to March	FY11	FY12	FY13E	FY14E
Revenues	1.8	15.6	18.6	6.2
EBITDA	(8.2)	33.3	42.5	6.6
EBIT	(8.9)	43.7	47.2	6.7
PBT	22.3	41.7	28.2	11.3
Net profit	23.7	44.9	6.5	11.3
EPS	NA	NA	NA	12.6

TECH MAHINDRA – BT pain to continue

High telecom & BT exposure impact in an uncertain environment

High telecom, BT exposure impacting growth

TECHM has been one of the leaders in providing end to end solution to the IT needs of the telecom vertical and derives ~96% of its revenue from the telecom vertical. Its top client British Telecom (BT) contributes 37% to revenues. However, this high concentration is impacting its growth as the IT spend in telecom is witnessing pressure and this is furter aggravated by the fact that BT too is facing a slowdown.

Table 1: TECHM the second largest player despite slowdon in telecom and top client BT

Telecom revenues (USD mn)	FY06	FY07	FY08	FY09	FY10	FY11	FY12
TCS	416	703	982	982	906	1,161	1,297
Infosys	354	597	900	841	774	779	715
Wipro	559	715	721	778	765	890	928
HCLT	-	285	390	425	497	585	617
TECHM	280	648	935	985	977	1,127	1,157
Total	**1,610**	**2,948**	**3,929**	**4,012**	**3,918**	**4,543**	**4,714**

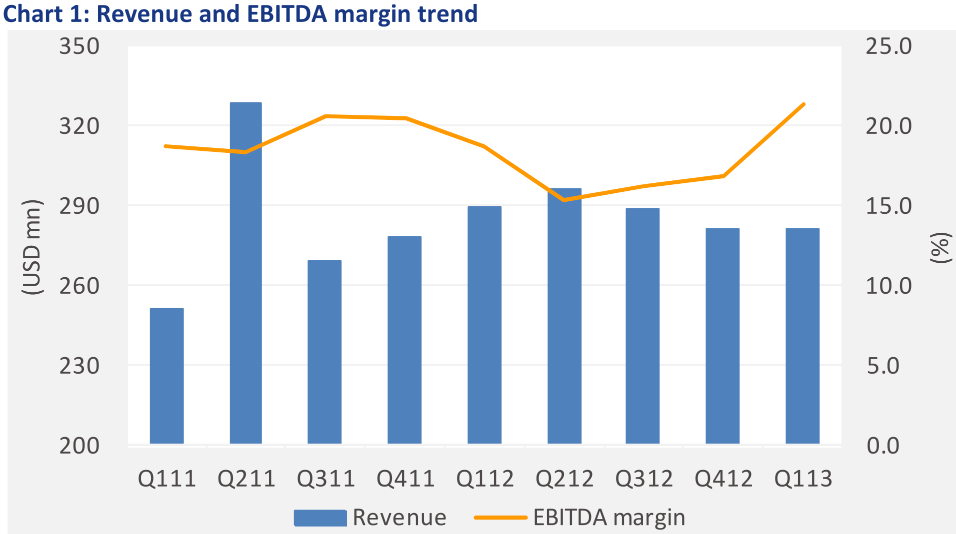
Growth YoY (%)	FY06	FY07	FY08	FY09	FY10	FY11	FY12
TCS	188.3	68.9	39.6	0.0	(7.8)	28.2	11.7
Infosys	20.2	68.5	50.8	(6.6)	(8.0)	0.6	(8.3)
Wipro	158.1	27.9	0.9	8.0	(1.7)	16.4	4.3
HCLT			37.1	8.9	16.8	17.9	5.3
TECHM	34.1	131.3	44.2	5.4	(0.8)	15.4	2.7

Source: Companies

Revenue declining largely owing to BT

Although, growth has been impacted in the last few quarters, what remains key is that it is not losing market share to peers and the domain expertise in the telecom vertical will enable it to scale its non-BT revenues.

Chart 1: Revenue and EBITDA margin trend



Source: Company

Table 2: TECHM maintaining market share despite slowdown impacting growth

Telecom market share (%)	FY06	FY07	FY08	FY09	FY10	FY11	FY12
TCS	25.9	23.9	25.0	24.5	23.1	25.6	27.5
Infosys	22.0	20.3	22.9	21.0	19.8	17.2	15.2
Wipro	34.7	24.2	18.4	19.4	19.5	19.6	19.7
HCLT	-	9.7	9.9	10.6	12.7	12.9	13.1
TECHM	**17.4**	**22.0**	**23.8**	**24.5**	**24.9**	**24.8**	**24.7**

Source: Companies

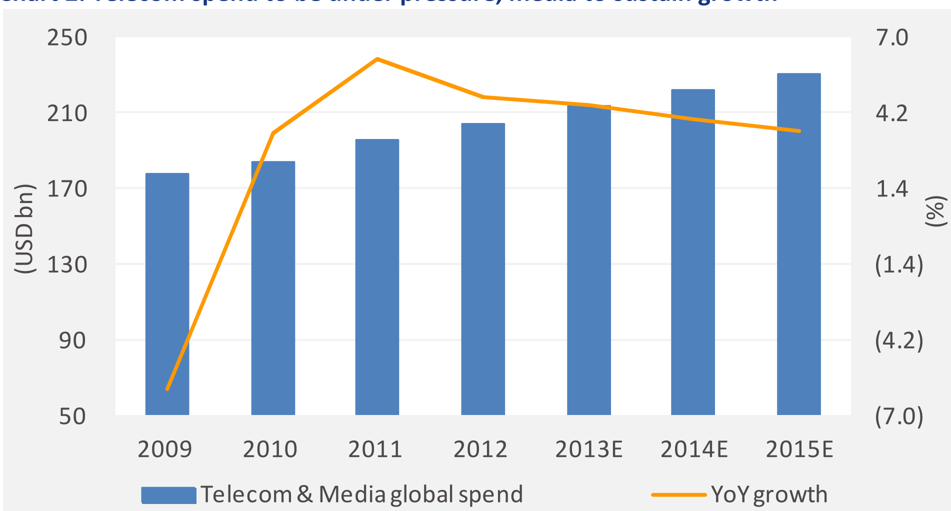
Telecom revenue to remain under pressure with export revenue growing to USD16.8bn in FY15E from USD12.8bn inFY12

Pain in telecom vertical to continue

In the telecom vertical, primary revenue contributors (equipment manufacturers) have not been able to post any growth as most of their clients (service providers) have either completed their capital expenditure plans (as most infrastructure is already built) or they want to shift to the operating model due to economic slowdown and shifting of focus to fast growing economies in the Asia region.

The vertical's current addressable market along with media spend is ~USD204bn. Indian players have ~6.3% share and it is primarily in the low-end maintenance and business process work, which is also under threat due to protectionist, near-shore and customer preference issues. Further, we believe that Indian vendors will face a tough competition from MNCs in this space due to a strong presence of players like IBM hence forecast a market share of 7.3% (currently 6.3%) by FY15, propelling the total export revenue from the current USD12.8bn to ~USD16.8bn by FY15E.

Chart 2: Telecom spend to be under pressure, media to sustain growth



Source: Nasscom, Edelweiss research

Non-BT revenue posted CAGR of 21% over FY08-12; to drive growth in FY13-14

Non BT revenues: A silver lining

BT revenue has consistently declined over the last four years, impacting the overall growth of the company. However,over these years, the company has been successful in scaling up its Non-BT revneus from INR339mn in FY08 to INR726mn in FY12, posting a CAGR of 21%. This has not only helped it offset the decline in BT revenues but also post an overall growth for the company.

Table 3: Non-BT revenue driving growth for the last four years

USD mn	FY05	FY06	FY07	FY08	FY09	FY10	FY11	FY12
Total revenue	209	280	648	935	985	977	1127	1157
BT revenue	168	192	415	596	567	472	460	431
Non- BT revenue	41	89	233	339	418	504	666	726

YoY growth (%)	FY05	FY06	FY07	FY08	FY09	FY10	FY11	FY12
Total revenue		34.1	131.3	44.2	5.4	(0.8)	15.4	2.7
BT revenue		14.0	116.4	43.7	(4.8)	(16.7)	(2.5)	(6.4)
Non- BT revenue		116.8	163.6	45.3	23.2	20.7	32.1	8.9

Contribution (%)	FY05	FY06	FY07	FY08	FY09	FY10	FY11	FY12
BT revenue	80.5	68.4	64.0	63.7	57.6	48.4	40.9	37.3
Non- BT revenue	19.5	31.6	36.0	36.3	42.4	51.6	59.1	62.7

Source: Company

Discretionary spend in telecom verticle to benefit

Telecom companies spend on IT mostly to 'run the business' and not change the business. On the back of a challenging macro environment, most of the telecom companies have stayed away from the discretionary spend. However, going forward, we believe new innovations like cloud, mobility and social media will induce more of discretionary IT spend in the telecom vertical. Being the market leader in the telecom vertical,TECHM is bound to benefit from this hence best positioned to make the most of this oppurtunity.

Table 4: Operating metrics for TECHM

	FY07	FY08	FY09	FY10	FY11	FY12
Vertical / Segment wise (%)						
Telecom service provider	NA	NA	NA	86.3	87.0	80.7
Telecom equipment provider	NA	NA	NA	5.5	5.1	6.6
BPO	NA	NA	NA	5.7	6.3	9.7
Others	NA	NA	NA	2.4	1.6	3.1
Geography-wise (%)						
America	18.6	19.5	24.9	29.3	30.0	33.0
Europe	72.7	73.5	67.4	58.6	50.5	47.3
ROW	8.7	7.0	7.7	12.1	19.5	19.7
Revenues break-up (%)						
Offshore	61.4	56.5	60.2	61.7	65.0	62.0
Onsite	38.6	43.5	39.8	38.3	35.0	38.0
Client Data (%)						
Top	64.0	63.7	57.6	48.4	40.9	37.3
Top 5	83.1	83.9	81.0	74.9	73.4	68.7
Top 10	89.9	89.0	87.7	83.2	81.6	78.2
Employees (Nos.)						
Software professionals	**17181**	**18430**	**20,060**	**24,405**	**26,282**	**24,833**
BPO	1755	3445	3,769	8,067	11,011	14,792
Sales & Support	813	1009	1,143	1,052	1,040	1,138
Total	19,749	22,884	24,972	33,524	38,333	40,763
Utilization (%)						
Including trainees	68.8	68.0	69.9	73.0	73.5	72.5
Attrition (%)					**29.0**	**20.0**

Source: Company

MAHINDRA SATYAM - Rising like a phoenix

Growth phase in the offing

Done with transformation and consolidation; growth phase to begin

Post the disclosure of revenue and earnings scam in 2009, the company has witnessed a successful transformation under the new management team led by Chairman Mr. Vineet Nayyar and CEO Mr. C. P. Gurnani. The turnaround can be summed up in three phases. First being the phase of saving the company from a collapse. This phase was the most critical one as the employee and client confidence was at the lowest ebb and the company saw an exodus of sales team and clients and a multitude of legal issues. The management in this phase altered the organisation structure, closed down loss making operations and right sized the organization.The second phase was the phase of consolidation wherein the management focused its efforts on rebuilding the organization, particularly the sales team and retaining key talent. We believe the management's efforts in the first two phase have fructified and initial results are being seen in the growth rate. We believe the management is on track to achieve its third phase objective of growing in line with the industry.

On track to deliver

The company has posted growth in line with top four players barring Q3FY12, an indication of growing client confidence in it. This coupled with the significant margin expansion bears testimony to the management's continued focus on profitable growth

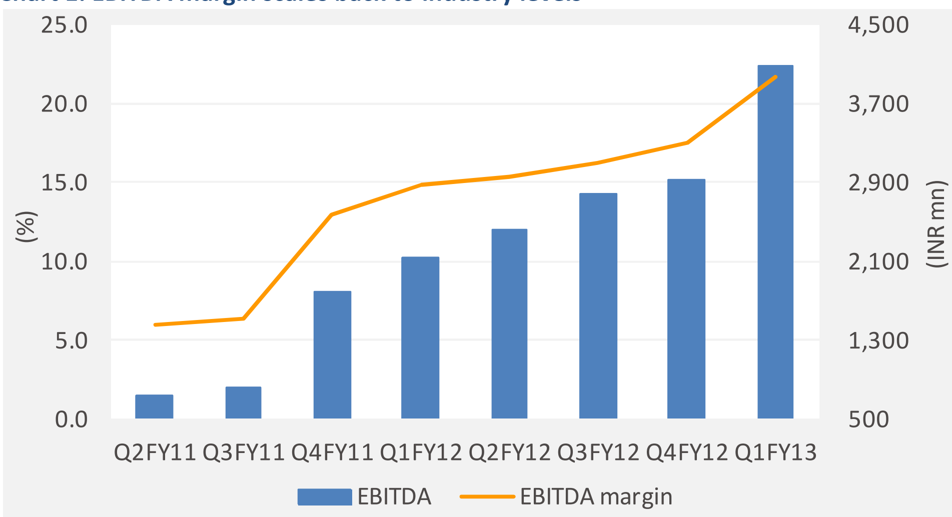
MSAT's growth matching peers in recent quarters

Table 1: Growth in line with Top 4 in last two quarters

Growth (QoQ) (%)	Q112	Q212	Q312	Q412	Q113
TCS	7.5	4.7	2.4	2.4	3.0
Infosys	4.3	4.5	3.4	(1.9)	(1.1)
Wipro	0.5	4.6	2.3	2.0	(1.4)
HCLT	5.3	4.1	2.0	2.5	3.0
Mahindra Satyam	**5.3**	**3.1**	**(1.5)**	**2.2**	**3.0**

Source: Companies

Chart 1: EBITDA margin scales back to industry levels



Source: Company

Pyramid rationalisation and offshore shift to drive margin upwards

Further margin expansion possible (ex- currency)

EBITDA margin has seen a significant expansion from 5.9% in Q2FY11 to 21.7% in Q1FY13 largely on the back of cost optimisation in the first phase, and through broadening of pyramid and increasing offshore shift in the second phase. The Q1FY13 also saw a margin expansion of 420bps to 21.7% of which 300bps was due to currency while balance was due to opeartional efficiencies. We believe the company still has levers like pyramid rationalisation, utilisation improvement and SG&A leverage which will enable it to improve margin (ex – currency) as it forays into the next leg of growth.

Table 2: Pyramid rationalisation the key margin driver for the company

Employee experience profile	Q4FY11	Q1FY12	Q2FY12	Q3FY12	Q4FY12	Q1FY13
0-3 years (%)	18-21	21.0	24.0	28.0	32.0	33.8
3 years and above (%)	79-82	79.0	76.0	72.0	68.0	66.3

Table 3: Offshore component rising gradually

Location wise Revenue Break-up	Q4FY11	Q1FY12	Q2FY12	Q3FY12	Q4FY12	Q1FY13
Onsite (%)	57.0	56.0	52.0	51.0	52.0	52.0
Offshore (%)	43.0	44.0	48.0	49.0	48.0	48.0

Source: Company

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INITIATING COVERAGE

PERSISTENT SYSTEMS

Value pick

India Equity Research | IT

Edelweiss
Ideas create, values protect

Persistent Systems (Persistent) is a credible offshore services provider in the niche and growing outsourced product development (OPD) space. Strong domain expertise, marquee client base, sound management and healthy balance sheet are its key strengths. The company will ride the next growth wave on back of surge in spending in new technology areas and growth in traditional OPD market. We initiate coverage with 'BUY' and a target price of INR508, implying 30% upside.

Investing in new technologies to fuel next leg of growth

Persistent has consistently invested in creation of IP-led solutions and has invested in cloud computing, enterprise collaboration, analytics, enterprise mobility, which promises significant growth opportunities. On an ongoing basis, 4-6% of the staff is dedicated to building intellectual property (IP), imparting it an 18-24 month edge over competition.

Revitalising and strengthening front-end sales and marketing force

The company is investing in mining its large client relationships by strenghtening its front-end hunting force and imparting executive responsibility for its top accounts. It has forged partnerships with various ISVs to leverage their sales channels and adopted a "**sell-with**" approach. This will help it develop relationships with the client's ecosystem and generate incremental revenue without additional selling expenses.

Focus on IP-led revenue to aid margin sustenance

Persistent has been consistently increasing its revenue from IP-led business with a stated goal of reaching up to 20% of its expanded revenue base. Typically, this business' gross margin is ~50% versus the company's 40%. Focus on this business will enable margin sustenance in the long run. Scale up in IP-led revenue could be upside risk to target price.

Outlook and valuations: Equipped for growth; initiate with 'BUY'

We believe Persistent is poised to capture high growth opportunities, and forecast revenue and EBITDA CAGR of 17% and 18%, over FY12-14. This, coupled with sound management and transparent governance, bolsters our confidence in the company. We value the stock at INR 508/share based on P/E of 10x FY14E core EPS of INR41.8 and INR90 cash per share. We initiate coverage on the stock with **'BUY/SO'** recommendation.

Financials

Year to March	FY11	FY12	FY13E	FY14E
Revenues (INR mn)	7,758	10,003	12,347	13,763
Rev. growth (%)	*29.1*	*28.9*	*23.4*	*11.5*
EBITDA (INR mn)	1583	2324	3189	3258
Net profit (INR mn)	1,398	1,418	1,704	1,815
Diluted EPS (INR)	34.9	35.5	42.6	45.4
EPS growth (%)	*8.8*	*1.6*	*20.1*	*6.5*
Diluted P/E (x)	11.2	11.0	9.1	8.6
EV/EBITDA (x)	7.1	5.0	3.2	2.7
ROAE (%)	18.7	17.9	18.7	17.2

EDELWEISS 4D RATINGS

Absolute Rating	**BUY**
Rating Relative to Sector	Outperformer
Risk Rating Relative to Sector	Low
Sector Relative to Market	Overweight

MARKET DATA *(R: PERS.BO, B: PSYS IN)*

CMP	: INR 389
Target Price	: INR 508
52-week range (INR)	: 410 / 290
Share in issue (mn)	: 40.0
M cap (INR bn/USD mn)	: 15 / 280
Avg. Daily Vol.BSE/NSE('000)	: 27.5

SHARE HOLDING PATTERN (%)

	Current	Q4FY12	Q3FY12
Promoters %	39.0	39.0	38.9
MF's, FI's & BK's	31.6	30.8	27.0
FII's	1.9	2.2	5.8
others	27.5	28.1	28.2

** Promoters pledged shar : NIL*
(% of share in issue)

RELATIVE PERFORMANCE (%)

	Sensex	Stock	Stock over Sensex
1 month	2.0	4.0	2.0
3 months	7.2	12.2	4.9
12 months	4.9	20.1	15.2

Sandip Agarwal
+91 22 6623 3474
sandip.agarwal@edelcap.com

Omkar Hadkar
+91 22 6620 3147
omkar.hadkar@edelcap.com

August 30, 2012

Table 1: Business summary

		Key verticals	
	Infrastructure & Systems	**Telecom & Wireless**	**Life sciences & Healthcare**
Traditional offerings			
Offshore product development	• Offers product development service throughout the lifecycle of the product • Partners with vendors to develop connectors		
End-of-life product sustenance services	• Acquires IP of end-of-life or non strategic product; shares risk-reward with ISV and provides sustenance services		
Focus area - next gen technologies			
Cloud computing	• Works with ISVs in developing platforms (PaaS) • Provides enterprises and ISVs migration, testing and consulting services for cloud adoption		
Collaboration services	• Builds products that leverage technologies across search, email and messaging, web 2.0 and text mining and analytics • Managing content and facilitating social networking		
Enterprise mobility	• Product development services to OEM to develop proprietory platforms and application store (for OEM and TSPs) • Ready to integrate frameworks; providing consulting and professional services		
BI and Analytics	• Analytical application development, data management and BI services		
Rationale for India' OPD market growth	• "Cloud enabled" software products • Shrinking product lifecycle, declinging budget and reducing time to market • New emerging markets like Europe as outsourcing increases from these regions • New application development for mobile products and application stores i.e. for mobile platforms • Mature talent, domain expertise, project management practices and scalable delivery model		
Key clients	• IBM, Wells Fargo, Oracle, Intuit, Salesforce.com, Yahoo and Microsoft among others		
Competitors	• Internal captives centres (Microsoft India, Google India, etc) • Traditional IT players (L&T Infotech, Mindtree, Wipro, HCLT) • Pure play OPD players (Global Logic, Symphony, Aditi Technologies, Aspire Systems)		
Competitive advantage / differentiation	• Owning the complete product roadmap and experience in building end-to-end products (3,000+ product releases) • Early investments to build tools and solutions in new technolgies gives it an edge • Long term client relationships and references that are key in services business		
Revenue model	• T&E (time and expense) - 80% contribution • FPP (fixed price project) - 11% contribution • SLA based/ revenue sharing/ risk reward (IP based) - 9% contribution		

Source: Edelweiss research

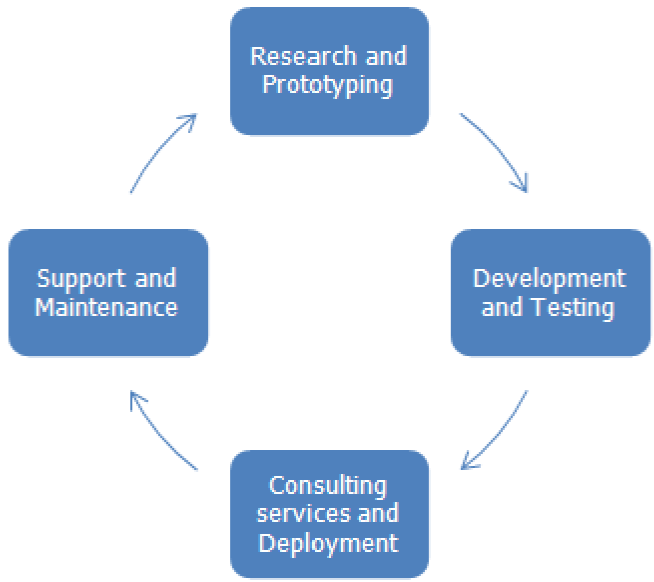
Investment Rationale

Well placed pure play OPD player addressing full cycle

Strong OPD player with offerings spanning across different stages of PLM

Persistent is a pure play in the OPD space, catering to telecom, life science & healthcare, infrastructure and systems verticals. The company has a strong and marquee client base (IBM, Wells Fargo, Microsoft, Yahoo, Intuit, Salesforce.com, among others) with long-term relationships and service offerings addressing each stage of the product development lifecycle starting from conceptulisation-to-design-to-development-to-implementaion and finally maintenance. This domain expertise not only aids customers reduce their time-to-market, but also enables the company broaden dialogue with prospective clients.

Fig. 1: Addressing the full product lifecycle



Source: Edelweiss research

OPD industry on fast growth track with drivers in place

Indian OSPD industry expected to touch USD1.4bn by FY13E

The OPD market includes software development services sourced by global software companies for product development through their captive units or outsourced relationships in India. As per IDC forecast, worldwide offshore R&D/product engineering services is expected to touch USD65.7bn, implying 21% CAGR over CY10-13E. An increasing number of companies is adopting the outsourcing model, either through captive or third-party OPD players not only for lower costs, but also for quick time-to-market, and Indian vendors have focused efforts to develop proprietary time-to-market accelerators that can be easily integrated, customised, and deployed.

With the share of outsourcing maintained at 23-24% of total R&D spending, the offshore R&D industry is expected to surge 1.5x by 2013E (*source: NASSCOM*). India is expected to be a key beneficiary of the accelerating outsourcing trend as it has a large pool of manpower with the necessary skill sets. NASSCOM estimates the Indian OSPD industry to be USD1.2bn in FY12, ~10% of the offshore R&D market.

Chart 1: Offshore OSPD industry revenue on the rise

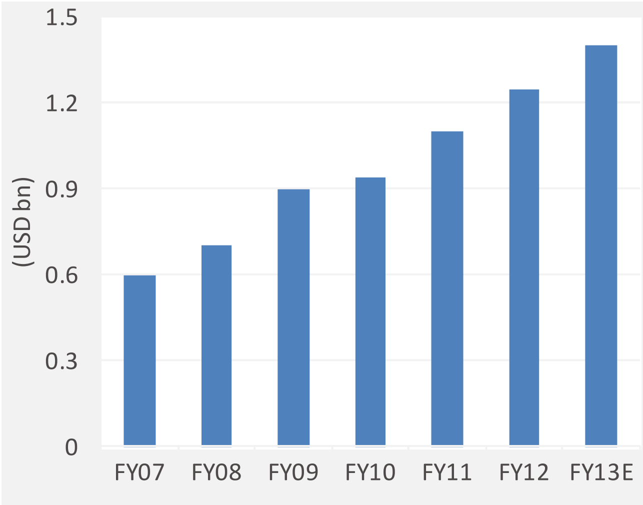
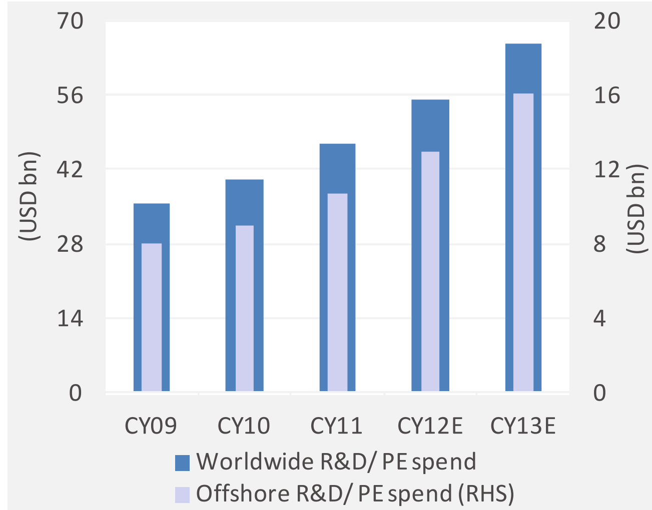


Chart 2: Global R&D/ PE and offshore R&D/ PE spending up



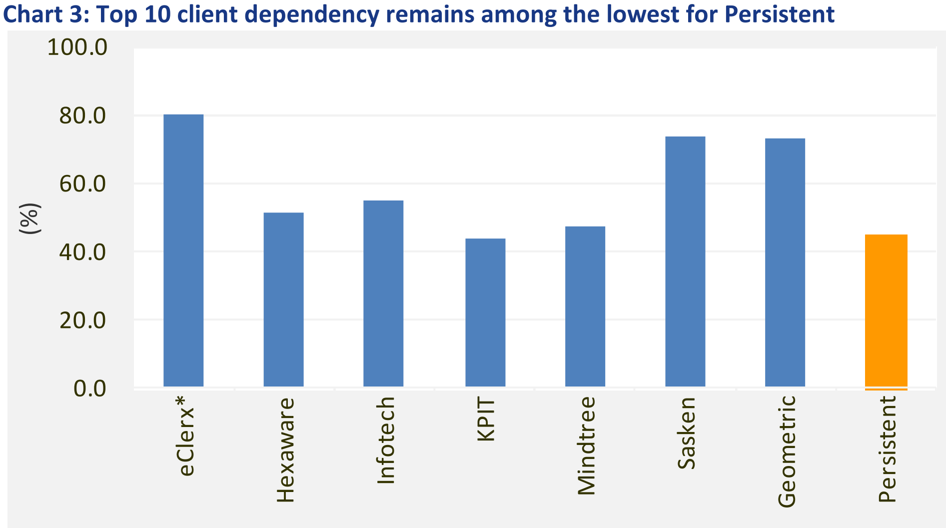
Source: Nasscom, IDC, Edelweiss research

Well established long-term relationships will aid growth to scale to next level

Long-standing engagements with marquee clientele

Persistent has built long-term client relationships through successful execution and strong client references. Its established relationships with clients are reflected in the fact that of its top 10 customers, seven-eight have been in the list over the past five years; also, via high repeat business (over 90% in FY12). The company has a well-diversified client portfolio with lower dependence on top 10 clients, who contribute 45% to total revenue (lower than most mid-cap IT companies).

Chart 3: Top 10 client dependency remains among the lowest for Persistent



Source: Companies, Edelweiss research

**Note: Eclerx: contribution from Top 5 clients*

"Sell-with" approach, technology specialist group and geography based core sales team will collectively focus on client mining

Revitalising and strengthening front-end sales and marketing arm

The company is investing in mining its large client relationships. Persistent has strenghtened its front-end hunting and imparted executive responsibility for farming top 25 accounts. This is crucial as the company plans to scale up to the next level from USD207mn currently. It has stuctured its sales into two groups— **technology specialists** (focussed on new initiatives) and **other core sales** (following a geographic approach) that are responsible for targeted sales. In our view, these investments impart the company strong growth visibility of 12-15% plus over the next two-three years. Further, the company has planned to increase its S&M expenses from current 6.2% to 8.0% of revenue, an indication of Persistent's focus of increasing the wallet share in existing clients and also vie for new clients.

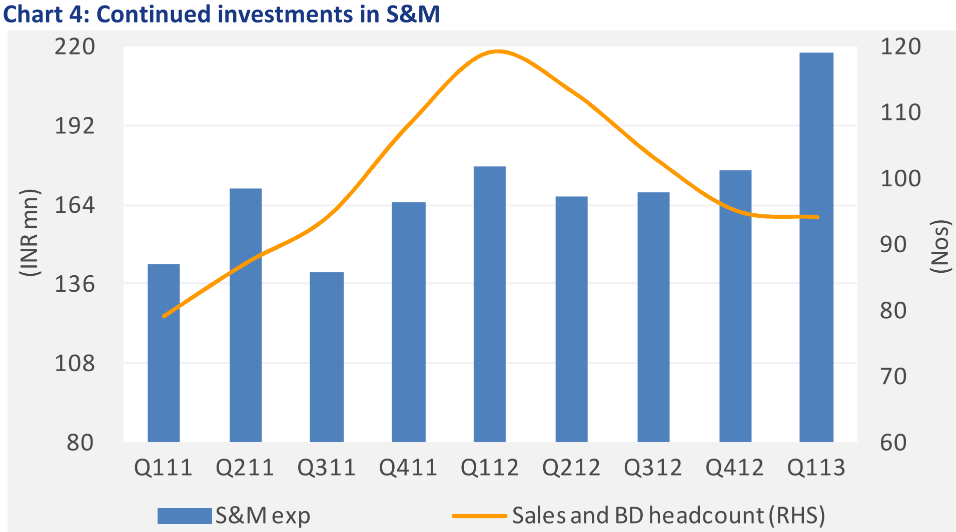
"Sell-with" approach adds additional dimension in sales effort: Persistent follows a "sell-with" approach, i.e., it partners with clients (software product companies) to sell its framework/solutions/services to enterprises. This way, it not only develops relationships with the client's ecosystem, but also generates incremental revenue without incurring any selling expenses.

Table 2: Ramping up investments in S&M to capture new opportunities, mine clients

	Cloud builder	Cloud platform	Remarks
Partnership	Salesforce.com	Force.com platform	Builds SaaS applications and products on Force.com
			It has 18 plus on-going Salesforce.com projects
			Clients include - BMC, Eviant, Areva, Pitney Boses
	VMware	VMforce	Persistent is a part of the VMforce partner programme and it helps ISVs and enterprises for migration to VMforce cloud
	Microsoft	Azure	It has a structured process for migrating existing SaaS or cloud applications seamlessly while minimising development costs
			Experience of migrating 30 plus customers

Source: Company, Edelweiss research

Chart 4: Continued investments in S&M



Source: Company, Edelweiss research

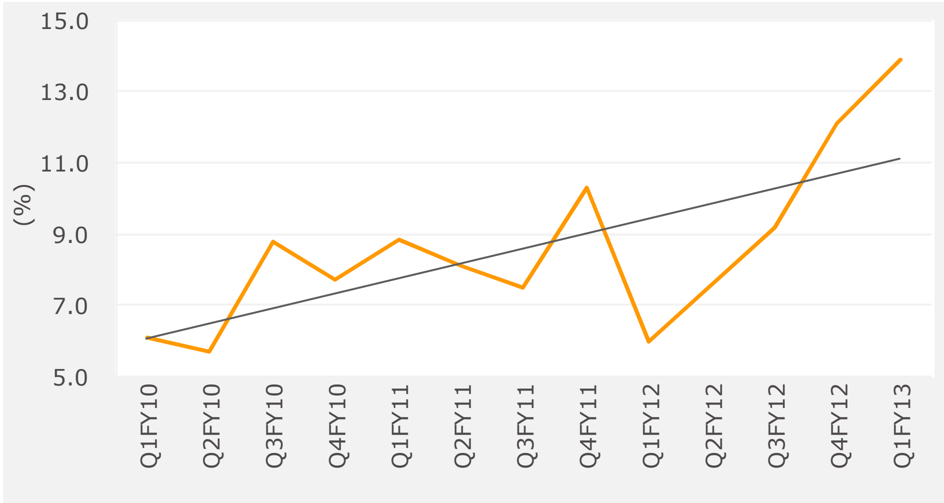
Consistent investments in IP-led solutions give an edge

Focus on new initiatives gives edge over competition and fuels growth

The company has been consistently investing in creation of IP-led solutions for its clients. As a policy, on an ongoing basis, 4-5% of its staff is dedicated to building value-added products and services (including connectors, accelerators and other components). Further, Persistent now generates revenue from these IP-based solutions on a revenue-sharing basis (Q1FY13 – 13.9% of total) from earlier one-time licence based. It has also been investing in cloud computing, analytics, enterprise mobility, and enterprise collaboration which could offer huge growth opportunities in the coming years. Revenues from projects in these new initiatives form 40% of total. It has invested in cloud computing technologies 18-24 months ago to build the necessary tools and systems that will aid consulting/planning and migration to the cloud platform.

IP revenues have been consistently on the rise

Chart 5: Increasing proportion of IP-based revenue (though fluctuating)



Source: Company, Edelweiss research

Lead in cloud services compared to peers with…

(A) Forerunner in **cloud services:** With 600 plus technical experts providing services involving consulting, cloud platform development & deployment, migration & management, Persistent clearly has a lead of about 18-24 months over other players. In addition, nurturing partnerships is among the most critical aspects to benefit from cloud opportunity that the company seems to have successfully built. It has partnered with cloud providers such as Salesforce.com, VMware, Microsoft, and Amazon web services, which has enabled it to be the preferred vendor for clients who would look to migrate to the above cloud providers for cloud deployment and integration activities.

…expertise in executing projects and platform partnerships in place

Fig 2: Persistent has strong cloud practice

Source: Edelweiss research

Significant opportunities in new areas such as enterprise mobility and analytics

(B) **Enterprise mobility:** Proliferation of new high tech devices such as tablets (iPad, Galaxy Tab, etc), smartphones, connected TV has created a number of opportunities for enterprise and application service providers. With video becoming the new voice, the industry is at a tipping point as multiple connected devices see huge adoption. This has thrown up significant opportunities to create and maintain several applications on multiple platforms i.e., iOS, Android, Blackberry OS, the Nokia platform (Qt/Symbian/Meego) etc. Application downloads based on the pay-per-use business model are growing at a scorching pace, compelling OEMs, ISVs and enterprises to adopt mobility solutions faster. Persistent's offerings in this area: (a) product development services to OEMs to develop proprietary platform; (b) ready-to-integrate solutions that can reduce time-to-market significantly; (c) integration and support to mobility platform for ISVs for various communication channels; and (d) working with enterprises to implement the enterprise-wide mobility platform.

(C) **Collaboration:** The rise of social networking and collective intelligence the collaboration phenomenon is fast moving into the enterprise. This trend is transforming people from content readers into publishers, making it imperative for enterprises to understand consumer requirements and patterns. Persistent has been working with product companies (start ups, larger ISVs, and enterprise) to build products that leverage technologies across search, email and messaging, text mining and analytics social networking and web 2.0. It provides platform integration, content integration connectors, integrated workspace portal, and consulting within this area. The company is working with Cisco in the go-to-market strategy for deploying collaboration solutions using Cisco Quad (Cisco's collaborative software) and it also works extensively on the Microsoft Sharepoint platform for its clients.

(D) **BI and analytics:** Software is getting richer and complex along with changing trends in the business. Applications have become collaborative and social, which creates huge demand for business intelligence (BI) and analytical solutions. Commonly used software tools are unable to capture, manage and process that within quick time. This has led to enterprises rapidly shifting focus on acquiring strategic, tactical and operational insights and making special efforts to understand their customers, products, business processes, and operations. BI and data analytics tools are often used as door openers as it helps making a mark in decision-making environment, particularly in new logos and is growing rapidly in the current environment. Persistent has a 400 plus member team, including seven PhDs who focus on developing solutions in this space. Currently, this segment contributes ~15-16% to total revenue.

Tuck-in acquisition strategy to continue

Persistent's key rationale behind acquistions has been addiing capabilities to its portfolio of offerings. It will continue to look for tuck-in acqusitions that will add technical expertise. Over the past five years, the company has made four acquisitions. Two of them are end-of-life or non-strategic products from ISVs; it shares risk-rewards with the ISV, as it monetises intellectual property rights and provides product sustenancec services.

Table 3: Acquisition history

Date	Company	Rationale	Deal value	Other details
2012-13	Openwave Location Business	Will strengthen product maintenance & support business	USD 6mn	
2011-12	Agilent Technologies' software marketing & development business	Will enhance its capabilities in healthcare and lifse science segment	NA	
2010-11	Infospectrum	Presence in Europe and gets addition of new verticals (aerospace,defence, complex manufacturing, maritime, transportation and logistics, satellite imaging and geographic information systems)	USD 6mn (all cash deal, consideration to be paid over 18 months)	Deal ~1x of revenues and margin profile similar to Persistent (~18 % NPM)
2009-10	Paxonix	Paxonix provides web-based branding and packaging process solutions that accelerate speed to market	NA	Acquired certain assets of Paxonix, a subsidiary of MeadWestvaco Corporation
2007-08	Metrikus (India)	Acquisition brought on board BI solutions expertise and a development centre in Hyderabad	NA	
2005-06	ControlNet (India)	Acquisition gives entry in embedded systems and application specific integrated circuit design (ASIC) space	USD 2 mn	

Source: Company, Edelweiss research

Healthy balance sheet with net cash reserve of INR3.4bn

Strong balance sheet with zero debt

We like the company for its strong debt free balance sheet. Further, utlisation of funds is mostly fixed assets which form 44% of total funds. As of FY12, Persistent has owned built-up capacityof ~1.16mn sq ft and seating capacity of 8,400 people. It has its own facilities in Pune, Goa, Nagpur and Grenoble (France). The company has been debt free and has cash balance of INR3,596mn (Q1FY13), transalting into INR90/share or 23% of market cap. We believe this augurs well for the company if it plans to go for another acquistion which can give an impetus to growth.

Table 4: Cash trend over the years

(INR mn)	FY07	FY08	FY09	FY10	FY11	FY12
Cash	113	113	165	1,918	886	1,375
Inv	247	692	880	1,562	2,500	2,038
	360	**805**	**1,046**	**3,479**	**3,387**	**3,413**

Source: Company

Target price of INR508 based on P/E of 10x FY14E operating earnings plus INR90 cash/share

Valuation

We initiate coverage of Persistent with 'BUY/Sector Outperformer' recommendation/rating and value it at INR508 per share, implying 30% upside from the current market price of INR389 over the next 12 months. Our target price is based on its intrinsic P/E of 10.0x FY14E operating EPS of INR41.8 plus cash per share of INR90. Further, we note that going forward there could be upgrades in consensus estimates led by margin expansion as the proportion of IP-led business rises. Our EPS estimates (lower than consensus by over 6%) factor the expected operating margin decline in FY14.

Table 5: Share value calculation based on multiple to operating EPS

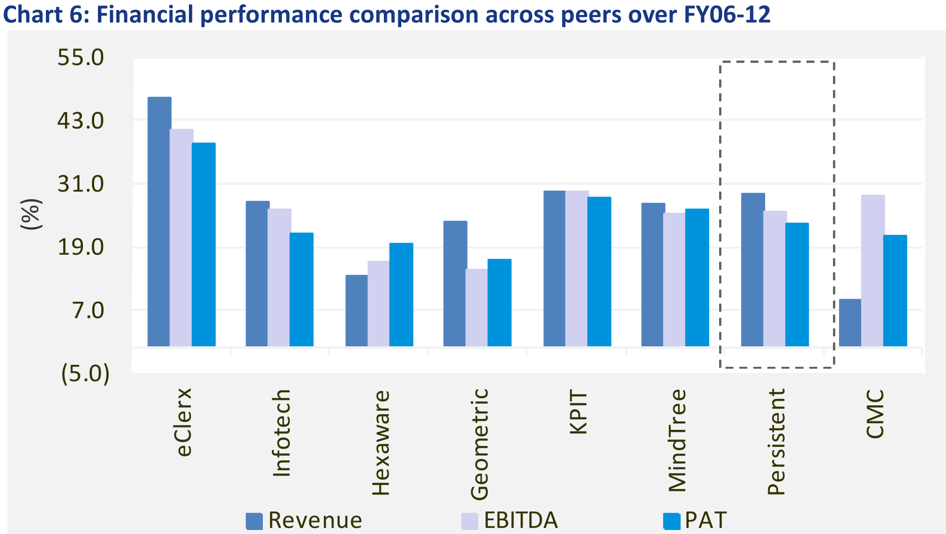
Operating EPS for FY14E (INR)	41.8
Target P/E multiple	10.0
Operating value (per share) (INR)	418
Cash per share (INR)	90
Value per share (INR)	**508**

Source: Edelweiss research

Comparison with other tier-II listed players

We compare Persistent with other tier-II IT services players (Hexaware, Infotech, KPIT, MindTree, Geometric, among others) for our valuation and financial analysis. The business models are largely similar, though they cater to different markets and specialise in varied horizontals. Also, the size of these companies is comparable in terms of revenue.

Chart 6: Financial performance comparison across peers over FY06-12



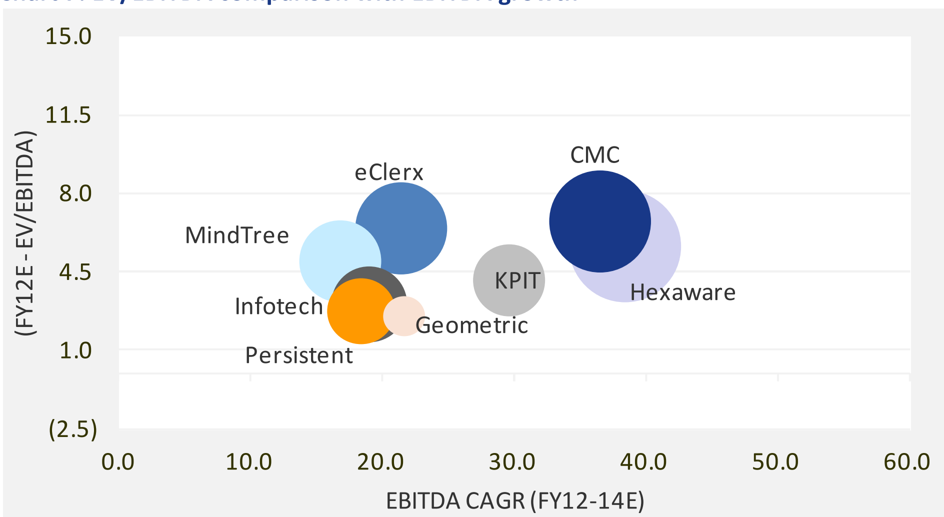
Source: Companies, Edelweiss research

Comparative valuation metrics

Table 6: Valuation comparison across mid-tier IT companies

	Price	Mkt cap	EPS (INR)			P/E (x)			EV/EBITDA (x)			ROE (%)	EBITDA margin
	(INR)	(INR mn)	FY12	FY13E	FY14E	FY12	FY13E	FY14E	FY12	FY13E	FY14E	FY12	(%) (FY12)
eClerx	743	21,820	53.1	64.5	76.1	14.0	11.5	9.8	9.9	7.6	6.4	55.0	56.9
Infotech	176	19,623	14.6	19.9	22.2	12.0	8.8	7.9	5.4	3.4	2.9	14.9	17.4
Hexaware	124	36,731	8.9	11.5	13.5	13.9	10.8	9.2	12.0	7.0	5.6	26.9	18.2
Geometric	107	6,685	10.5	11.3	14.3	10.1	9.4	7.5	3.4	3.1	2.5	29.3	13.8
KPIT	124	22,068	7.5	10.8	13.1	16.5	11.5	9.5	7.2	4.3	4.1	22.1	14.5
MindTree	665	27,158	53.8	57.6	64.1	12.4	11.6	10.4	7.0	4.7	5.0	29.0	15.3
CMC	968	29,330	50.1	79.7	104	19.3	12.2	9.3	12.1	8.8	6.8	21.3	15.3
Persistent	**389**	**15,576**	**35.5**	**42.6**	**45.4**	**11.0**	**9.1**	**8.6**	**5.0**	**3.2**	**2.7**	**17.9**	**23.2**

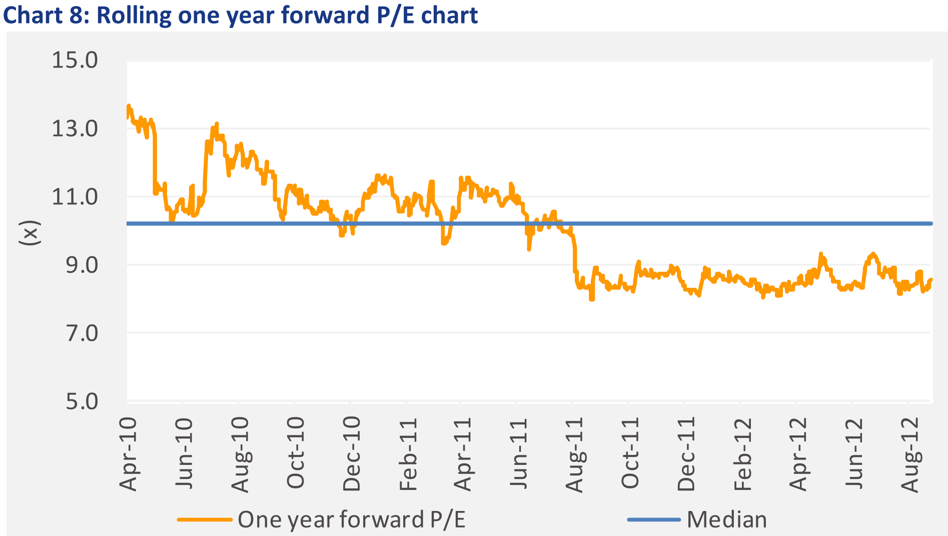
Chart 7: EV/EBITDA comparison with EBITDA growth



** Note: Size of the bubble represents current EV*

Source: Bloomberg, Companies, Edelweiss research

Chart 8: Rolling one year forward P/E chart



Source: Bloomberg

Key Risks

High sensitivity to USD movement

Majority of Persistent's revenues are invoiced in USD, exposing it to USD/INR movements. The sensitivity to the movement is high given high offshore proportion of revenue. Though the company, as a policy, hedges 50% of its receivables for the following 12 months, significant appreciation of INR against USD will impact its financials materially.

Aggressive competition from captives and lack of pricing power

Persistent primarily competes with captive centers of its client companies. Any aggressive stance from captives on pricing or cutback in R&D spending by clients could lead to reduced business opportunity for a third party vendor like Persistent. Also, due to constant benchmarking with captives, Persistent's pricing hike endeavours will always face resistance.

High exposure to US, Canada geographies, limited industry exposure

With more than 80% of revenue coming from the US, the company's performance can be affected if recovery is not sustainable in the geography and in case its economy enters a double-dip recession. Persistent caters to only three industries—infrastructure & systems (68% of revenue), telecom (21%), and life science & healthcare (11%), and. Any cut back in spending in these industries could lower the company's volumes and revenue growth.

Volatility in IP-led business

While the company has stated its intent of increasing IP-led revenue from the current 13.9% to 20.0%, there could be quarterly volatility in the proportion of revenue from this business. Any significant upside or downside in contribution from this segment can have a positive or negative impact on our estimates.

Company Description

Persistent was incorporated in 1990-91 by Dr. Anand Deshpande and Mr. S. P. Deshpande as a boutique company primarily focused on database internals. Currently, it is one of the leading outsourced product development (OPD) companies in India. It offers a wide range of services from database internals to data management, data warehousing, data analytics etc., and across various stages of the product life cycle. The company has successfully delivered more than 3,000 product releases in the past five years on behalf of its customers. It has deep domain expertise and over 6,200 highly skilled software professionals working currently. The company has significant domain expertise in telecom, life science & healthcare, and infrastructure & systems. Persistent derives more than 83% of revenue from the US and Canada and is fairly diversified with regards to its dependency on top 10 clients who contribute ~48% to total revenue. With over two decades of experience in the OPD space, long-term client relationships, investments in new technology areas, and strengthening recovery globally, Persistent is well poised.

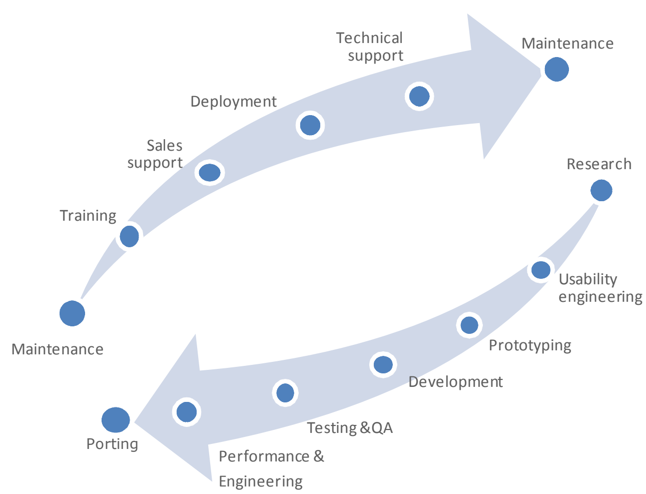
Positioning across clients as technology specialist

The company is one of the pure plays in the OPD space focusing on telecom, life science & healthcare, infrastructure & systems verticals in particular. With service offerings from concept to design to engineering/ development to maintenance and support, it enables the customer to introduce the product faster to the market, which is critical. Strong domain expertise not only helps customers reduce their time-to-market, but also enables the company to broaden dialogue with prospective clients.

Persistent follows technology specialist approach

Persistent positions itself as a technology specialist having invested in building capability in new technology areas and in-house developed IP. Further, having worked with clients in these new technologies on architecture, standards, and working knowledge it is equipped to provide consulting on functional expertise to its existing and prospective clients and then procuring downstream activities of product development.

Fig. 3: Addressing the full product lifecycle



Source: Company, Edelweiss research

Early entry in cloud technology gives a head start

Expertise of working with clients in latest technologies gives an edge

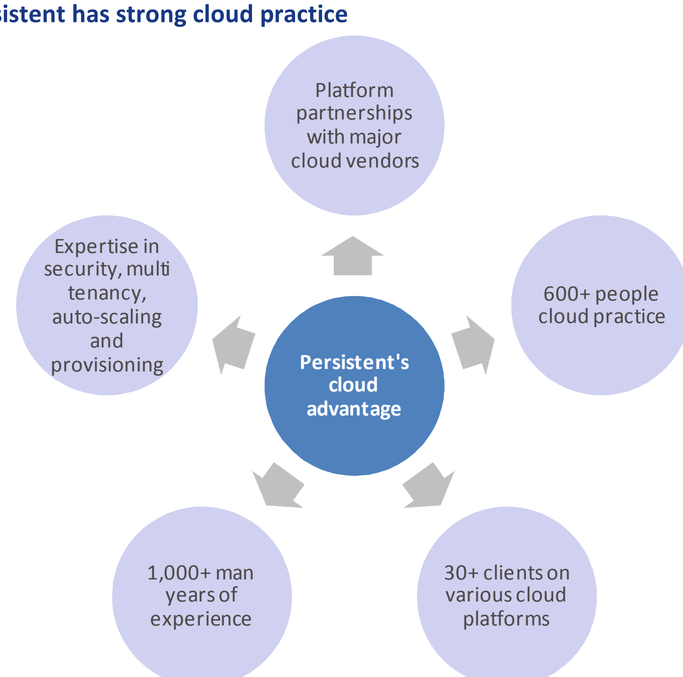
(A) **Forerunner in cloud services**

Cloud is naturally not a technology by itself, but rather an approach to deliver software services that harness the twin power of virtualisation and economies of scale. The most significant advantage of adoption to a cloud is availability on infinite infrastructure and resource capacity with no initial commitments and infrastructure costs. This has led to significant demand from software companies to redesign their products to operate with a high degree of multi-tenancy.

Persistent's expertise in this area emanates from its working with large software product companies. It has in-depth understanding of the underlying cloud technology, with a strong SaaS technology foundation. It works with ISVs in developing platforms as well as connectors of platforms and existing applications. It also assists ISVs and enterprise towards migrating and testing their existing on-premise applications on the cloud computing platform.

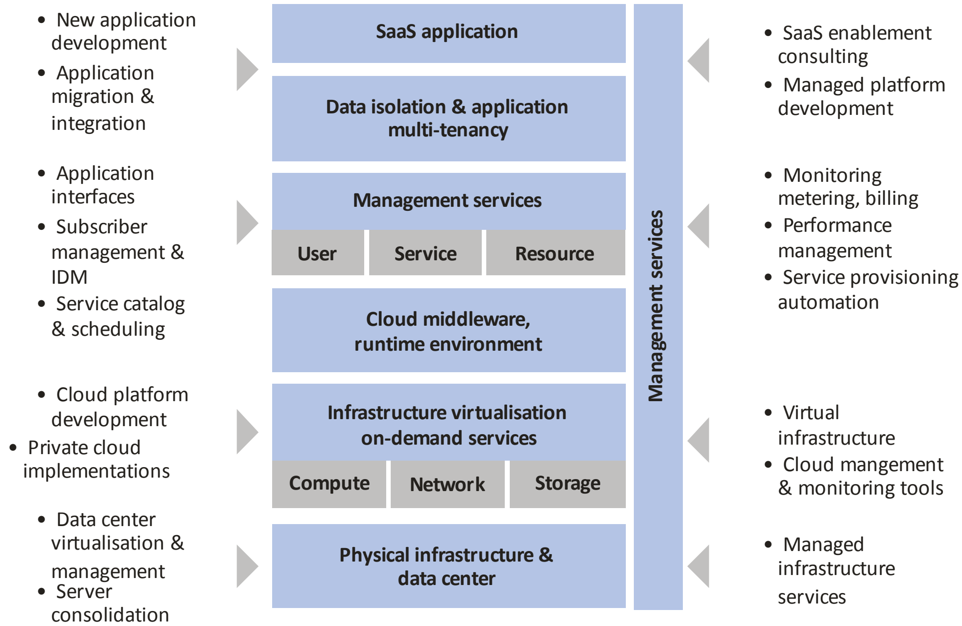
With 600 plus technical experts, providing services that involve consulting, cloud platform development and deployment, migration and management, the company clearly has a lead of about 18-24 months over other players as far as cloud services are concerned.

Fig. 4: Persistent has strong cloud practice



Source: Edelweiss research

Fig. 5: Persistent's cloud offerings for ISVs



Source: Company, Edelweiss research

Partnerships in place with major cloud providers

In addition, nurturing partnerships is among the most critical aspects to benefit from the cloud opportunity that Persistent seems to have successfully built. It has partnered with cloud providers such as Salesforce.com, VMware, Microsoft and Amazon web services, which has enabled it to be preferred vendor for clients looking to migrate to the above cloud providers for cloud deployment and integration activities.

Table 7: Persistent has forged strategic partnerships for its cloud offerings

	Cloud builder	Cloud platform	Remarks
Partnership	Salesforce.com	Force.com platform	Builds SaaS applications and products on Force.com
			It has 18 plus on-going Salesforce.com projects
			Clients include - BMC, Eviant, Areva, Pitney Boses
	VMware	VMforce	Persistent is a part of the VMforce partner programme and it helps ISVs and enterprises for migration to VMforce cloud
	Microsoft	Azure	It has a structured process for migrating existing SaaS or cloud applications seamlessly while minimising development costs
			Experience of migrating 30 plus customers

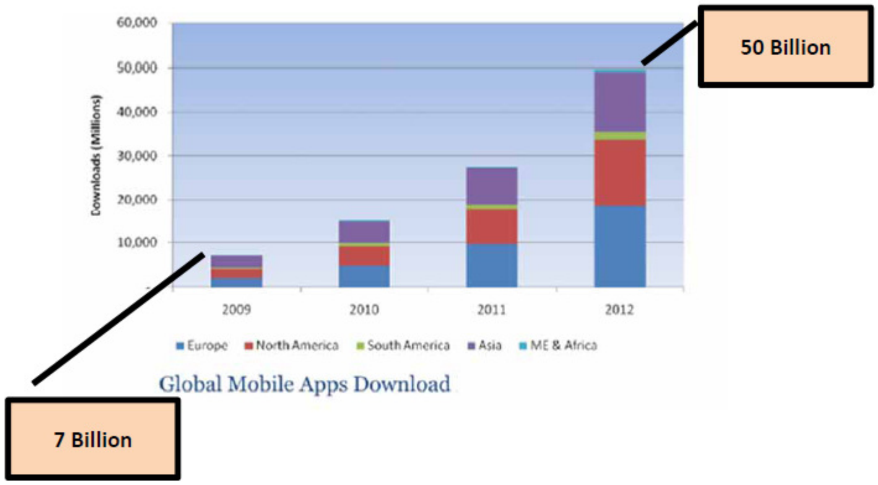
Source: Edelweiss research

(B) **Enterprise mobility**

Proliferation of new hi-tech devices such as tablets (iPad, Galaxy Tab, etc), smartphones, connected TV has created a number of opportunities for enterprise and application service providers. With video becoming the new voice, the industry is at a tipping point as multiple connected devices gain ground. This has thrown up significant opportunities to create and maintain several applications on multiple platforms i.e., iOS, Android, Blackberry OS, the Nokia platform (Qt/Symbian/Meego), etc. Application downloads based on the pay-per-use business model are growing at a scorching pace, compelling OEMs, ISVs, and enterprises to adopt mobility solutions faster.

Significant surge in application downloads …

Chart 9: No. of application downloads has grown multi-fold across regions



Source: Company reports

… has led to opportunities in various areas

What does Persistent do in this area?

(a) Product development services (OPD) services to OEMs to develop proprietary platform (e.g., Wave for Samsung on Android OS) and application store (e.g., Samsung apps).

(b) Persistent has created its own IP by developing a portable framework such as Skype framework, STAMP framework, and iPAF that are ready to integrate solutions that can reduce time-to-market significantly.

(c) Integration and support to mobility platform ISVs for various communication channels.

(d) Working with enterprises to implement enterprise-wide mobility platform.

Stockpile of information driving need for BI and data analytics

Fig. 6: Persistent's services and product stack in mobility area

Consulting services		
Mobility strategy & technology consulting	Workshops and training	ROI calculation

Professional services					
Deployment	Testing	Support	Maintenance	Managed services	Performance engineering

Mobility services	Middleware services	Embedded services
• Enterprise mobility services Multi-platform engineering services • Usability engineering services Enabling & managing app. Store	• Skype integration services • Qt integration services • WebKit customisation &	• Android dev. for embedded systems • Embedded solutions design and development

Persistent IP's		
Skype Framework	STAMP Framework	iPAF Framework

Source: Company reports, Edelweiss research

(C) **Collaboration**

The rise of social networking and collective intelligence phenomenon is fast moving into the enterprise. This trend is transforming people from content readers into publishers, making it imperative for enterprises to understand consumer requirements and patterns. Persistent has been working with product companies (start ups, larger ISVs and enterprise) to build products that leverage technologies across search, email and messaging, text mining and analytics social networking and web 2.0. It provides platform integration, content integration connectors, integrated workspace portal and consulting within this area. Persistent is engaged with Cisco in go-to-market strategy for deployment of collaboration solutions using Cisco Quad (Cisco's collaborative software) and also works extensively on Microsoft Sharepoint platform for its clients.

(D) **BI and analytics**

Software is getting richer and complex along with the changing trends in business. Applications have become collaborative and social, which creates huge demand for business intelligence (BI) and analytical solutions. Commonly used software tools are unable to capture, manage, and process that within quick time. This has led to enterprises rapidly shifting their focus on acquiring strategic, tactical and operational insights and taking special efforts to understand their customers, products, business processes, and operations. BI and data analytics tools are often used as door openers as they help make a mark in decision-making environment particularly in new logos and is seeing rapid growth in the current environment. Persistent has a 400 plus member team, including seven PhDs who focus on developing solutions in this space. Currently, this segment contributes ~15-16% to total revenue.

Fig. 7: Service portfolio in BI and analytics space

Business Intelligence Services	Data Management Services	Analytic Services	Large Data Analytics
BI Consultancy (Business analyst)	Data migration services	Text analytics	Hadoop setup & maintenance
Data integration/ Data warehousing (DWH)	Data connectors	Statistical modelling (using SPSS/SAS)	Hadoop/Map reduce programming
Reporting/ Dashboards/ Alerts	Master data management	Telecom churn/analytics	Analytical application development
BI Tool Integration for ISV		Web analytics/Usage analytics	

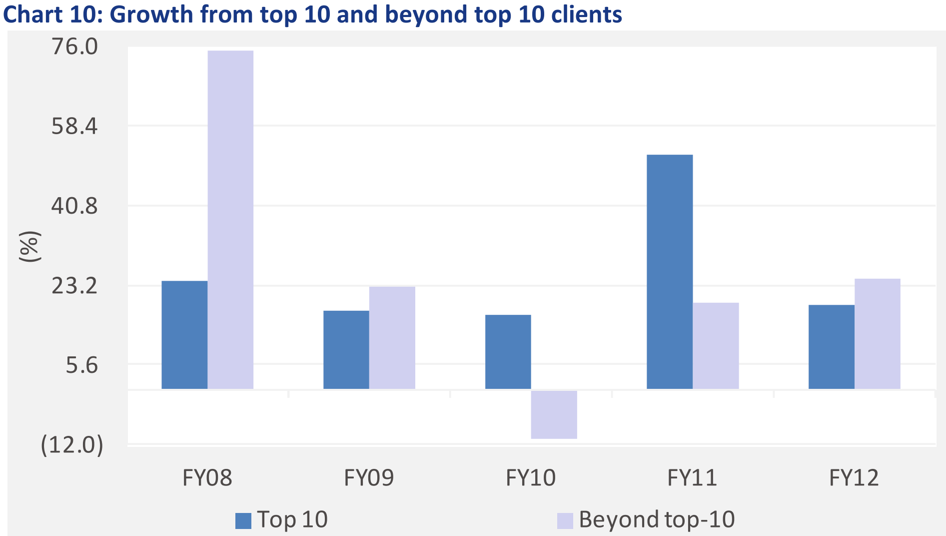
Source: Company reports, Edelweiss research

Client base includes marquee logos

Mining existing large clients key for next phase of growth

Persistent has built an impressive clientele—marquee names such as IBM, Microsoft, Intel, Oracle, Wells Fargo, Intuit and Salesforce.com, among others—garnered through successful execution and strong references. The strength of its relationships is reflected from the fact that seven-eight of its top 10 clients have remained in the top list since the past six years. Also, 42% of its revenue comes from clients with whom Persistent has a relationship for more than five years.

Chart 10: Growth from top 10 and beyond top 10 clients



Source: Company, Edelweiss research

Pricing model dominated by low risk T&M and moving towards IP led

The company continues to adopt newer pricing models aligned to market trends and customer needs. Persistent's pricing method continues to be dominated by the low risk time and expense (T&E - 80%), followed by fixed price (11%) and currently small, but growing IP-based (revenue sharing/ risk reward revenue; 9%).

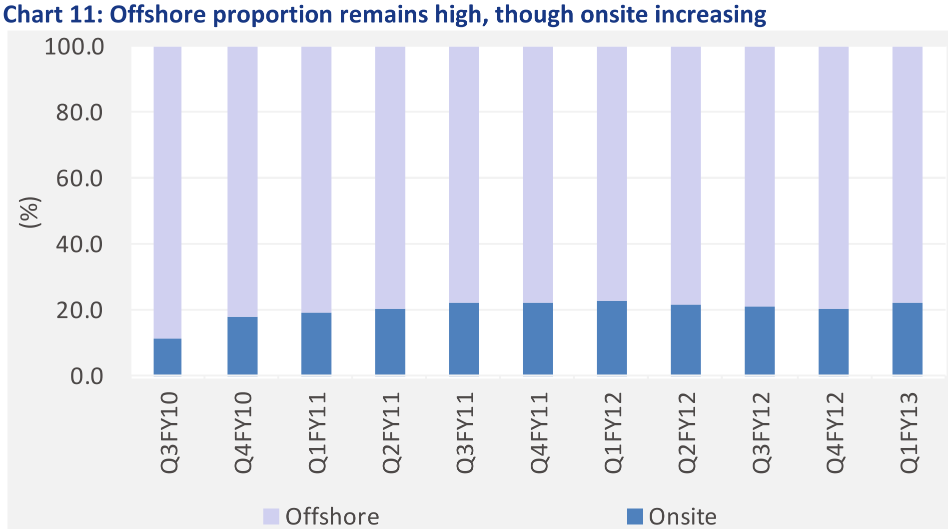
Table 8: Billing remains predominantly T&M based with increasing IP proportion

Revenue model	% of total revenue	Execution specialities
Time and expense (T&E)	79.7	Dedicated team extends customer engineering onsite team (where necessary) with primary offshore execution Flexible - ramp up and ramp down suitable for on-going co-development and quality assessment
Fixed price (FPP)	11.4	Clear requirements and change management process, initial onsite presence for requirements phase Flexible - on tap experts available on short term assignment suitable for performance/usability engineering, POCs, QA automation, migration/porting, fixed requirements projects
Revenue sharing/ risk reward (IP driven)	8.8	Complete product ownership for maintenance, roadmap ownership, and upgrades Teams - onsite/offshore as appropriate at Persistent Systems discretion, possible customer contracts assignment including SLAs suitable for new as well as mature / end of life products launching new products together in new markets, roadmap extensions

Source: Company, Edelweiss research

Also, compared to traditional IT services, execution for product development primarily is offshore (contributing ~95% of total effort). Persistent's offshore:onsite mix continues to be 80:20 for revenue, from 87:13 in FY11 as it scales its initiatives in new technology areas and increases onsite presence.

Chart 11: Offshore proportion remains high, though onsite increasing



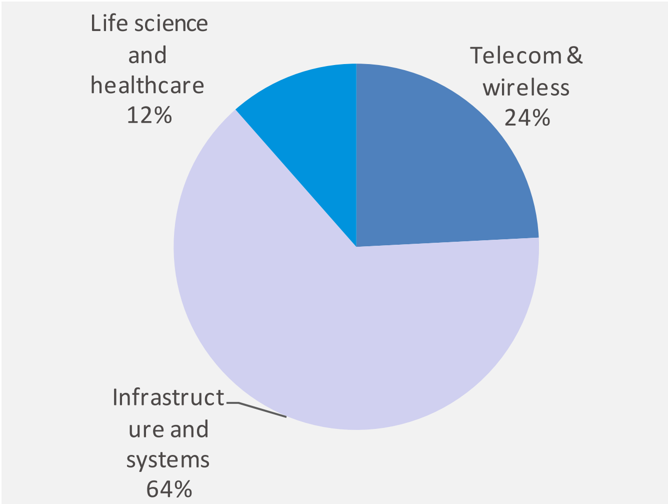
Source: Company, Edelweiss research

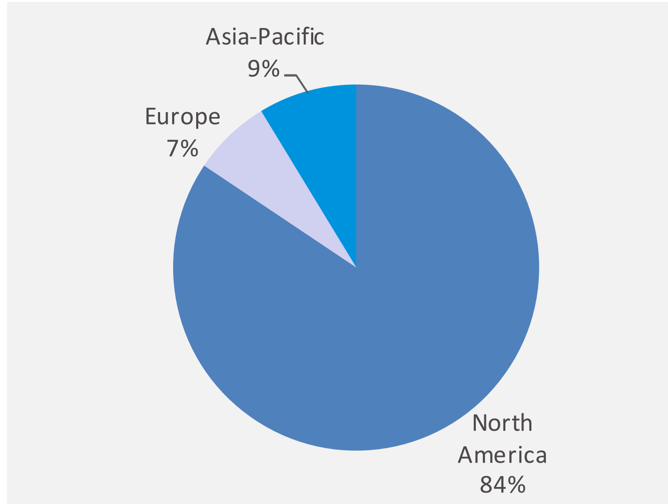
High dependence on US and infrastructure & systems segment

Infrastructure & systems key client segment; US major geography

Since Persistent is a pure OPD play primarily catering to ISVs, infrastructure & systems is the largest vertical with two-third revenue contribution. Telecom & wireless is the second largest client segment as new application, platform development, and mobility gain traction in this segment. The life science & healthcare segment currently contributes 11.5% to revenue. Within the life sciences vertical, Persistent's presence involves lab automation, data warehousing techniques, workflow management system, among other services. The company offers point solutions for specific customised needs and also royalty-based products in the life sciences domain that aid it generate IP revenue. In terms of geography, US remains dominant with 84% revenue generation.

Chart 12: Vertical-wise and geography-wise revenue break-up





Source: Company, Edelweiss research

Table 9: Operating metrics for Persistent Systems

	FY08	FY09	FY10	FY11	FY12
Segments (%)					
Telecom & Wireless	25.6	20.9	22.9	20.6	21.4
Infrastructure and systems	80.6	65.0	66.0	68.6	67.5
Life science and healthcare	15.0	14.1	11.1	10.8	11.1
Geography-wise (%)					
North America	87.6	87.3	84.9	85.6	82.5
Europe	8.7	8.6	8.2	5.9	7.3
Asia-Pacific	3.7	4.0	6.8	8.5	10.2
Revenue Mix (%)					
Onsite	11.2	14.2	12.7	21.1	21.4
Offshore	88.8	85.8	87.3	78.9	78.6
Revenue by contract type					
Time & Material	86.8	80.5	77.3	78.6	79.7
Fixed Bid	11.2	14.3	15.5	12.6	11.4
IP driven	2.0	5.2	7.2	8.7	8.8
Existing & repeat business					
Repeat Business	87.4	90.3	91.3	93.7	90.3
New business	12.6	9.7	8.7	6.3	9.7
Revenue concentration (%)					
Top	8.3	9.3	11.0	16.0	19.6
Top 5	27.0	26.4	33.3	38.7	45.6
Top 10	38.5	37.4	43.8	49.8	48.7
Employees (nos.)					
Technical	NA	3,900	4,321	5,950	6,223
Sales & Business Development	NA	38	71	108	95
Rest	NA	245	270	302	310
Total	**3,867**	**4,183**	**4,662**	**6,360**	**6,628**
Utilisation rate (%)	**NA**	**72.6**	**72.6**	**73.9**	**73.7**
Investment in IP led work (%)	**NA**	**5.1**	**4.7**	**4.1**	**5.2**
Attrition rate (%)	**21.2**	**13.6**	**13.7**	**19.6**	**18.3**

Source: Company

Management Overview

Strong management background

Persistent benefits from a qualified and experienced management team in the software product industry. Key members of the team have commendable credentials with a strong and accomplished work experience that has helped the company build a strong foundation and thought leadership.

Table 10: Management background

Name	Designation	Qualification	Background / Previously with
Dr. Anand Deshpande	Chairman and Managing Director	B.Tech (Hons.) in Computer Science from IIT,Kharagpur; M.S. and Phd. (Computer Science)	Worked at Hewlett-Packard Laboratories as a member of the technical staff
Hari Haran	President, Persistent Systems and Head- Global Sales & Marketing	B.Tech from IIT,Kharagpur; MBA from University of Louisiana; M.S. in Computer Science; Executive Management Education at Wharton, Lucent Senior Leadership Development Programme	He has worked as Senior VP – Worldwide Field Operations in Openwave Systems prior to joing Persistent. Prior experience in AGS Consultants, AT & T Network Systems, Lucent Technologies,etc
Nitin Kulkarni	Executive Director and Chief Operating Officer	M.E (Electronics) from VNIT, Nagpur University	Worked in Infosys as AVP and Development Center Head prior to joining Persistent. Has also worked with Siemens and NELCO
Ranganath Puranik	Executive Vice President and Head, New Business Initiatives and Portfolio	MBA from Kellogg School of Management; B.E. - Electronics & Communication	Prior to joining Persistent, he was Senior VP at Sasken. He has worked with Motorola & GE for over 15 years
Rohit Kamat	Chief Financial Officer	Bcom (Hons), C.A., C.S., ICWA	Prior to joining Persistent, he has worked in companies such as Tata Unisys, L & T Infotech and Syntel Software
Dr. R. Venkateswaran	Chief Technology Officer	M.Tech in Computer Science from IIT, and Doctorate (Computer Science)	Prior to joining Persistent he served as Researcher at Bell Labs and was a part of CTO - CIO office at Lucent Technologies
Vivek Sadhale	Company Secretary and Head – Legal and Investor Relations	Bcom; Bachelor of Law; ICWA; C.S.	He has earlier worked with Siemens, Bombay Dyeing and Kirloskar Pneumatic
Sameer Bendre	Chief People Officer	B.E (Electronics); Executive MBA (IIM A)	Prior to Persistent he was an entrepreneur running his own industry Nagpur Motors manufacturing electric motors

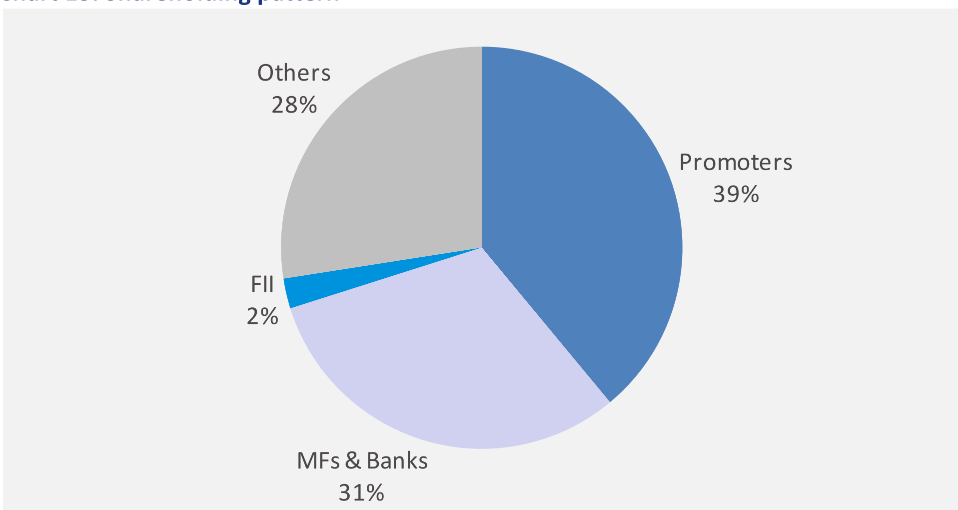
Source: Company

Table 11: Brief history and milestones

1990-91	Incorporated on May 30, 1990
1998-99	Started operations at Panini' premises at Pune
2000-01	Investment by Intel 64 LLC Set up Persistent Systems (wholly owned subsidiary) in US
2001-02	Started operations at Bhageerath' premises at Pune
2003-04	Set up a branch office at Edinburgh, Scotland, UK Development center at Nagpur became operational
2004-05	Set up a branch office at Tokyo, Japan
2005-06	Acquired Goa based ControlNet (India) Started operations at Pingala-Aryabhata' premises at Pune Joint investment by Norwest and Gabriel Investment by Intel Mauritius
2007-08	Converted into a public limited company Signed an asset purchase and sale agreement with Metrikus (India) Opened branch office at a)Rotterdam (The Netherlands) and b)Ottawa and Vancouver (Canada) Formed a wholly owned subsidiary, Persistent Systems Pte. in Singapore
2008-09	Received an ISO27001:2005 Certification for Pune (except Hinjewadi), Nagpur and Goa Set up a branch office at Quebec, Canada Formed a wholly owned subsidiary, Persistent Systems and Solutions in Pune
2009-10	Acquired certain assets of Paxonix through the wholly owned subsidiary (Persistent Systems, Inc.) Received DIN EN ISO 9001:2008 certification for the software design, development, testing, support, enhancement services for the ChemLMS Product Initial Public Offering
2010-11	Acquisition of OPD business of Infospectrum Acquired Agilent technologies' software marketing and development business
2011-12	Acquires Openwave's Location Business

Source: Company

Chart 13: Shareholding pattern



Source: BSE

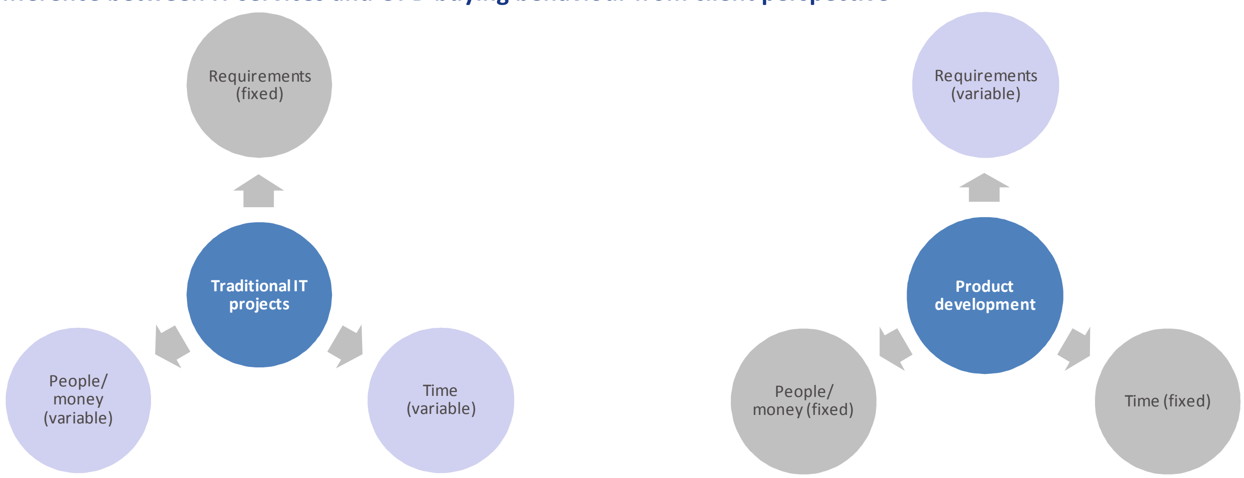
Industry Overview

OPD, being time critical, is different from traditional IT services

In IT services, projects start with well-defined requirements and vendors use time and money as variables to arrive at a reasonable cost estimate for the project. After completion, the project goes into maintenance mode.

In product development, requirements are less clearly defined. Instead, most product developers are given a product's ship-date which is typically determined by external factors. Once the ship-dates are identified, budgets for the product are frozen. In product development projects, all requirements can never be completely fulfilled in a particular version. As a result, most product companies plan multiple product versions. Every team member must contribute not only to building features for the current release, but also contribute enhancements and feedback for future releases of the product.

Fig. 8: Difference between IT services and OPD buying behaviour from client perspective



Source: Company, Edelweiss research

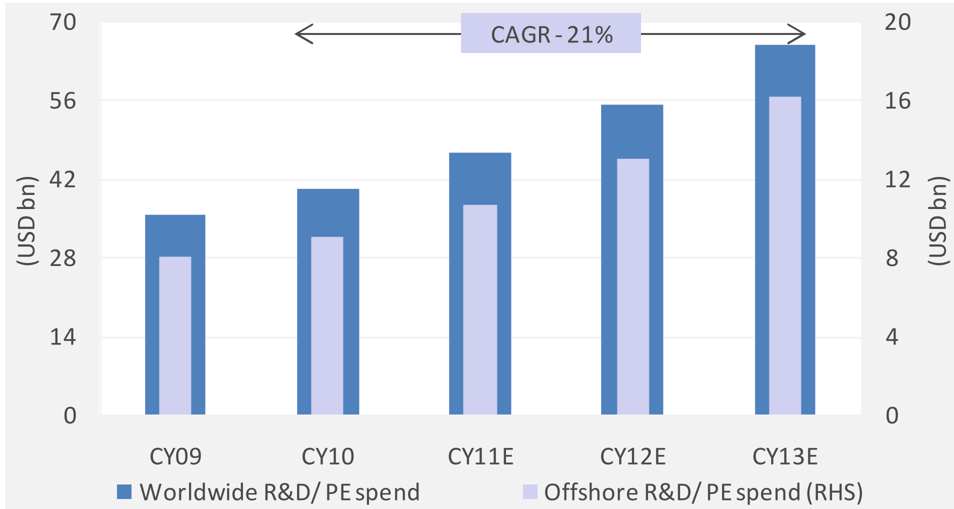
With drivers in place OPD industry on fast growth track

Indian OPD industry to touch USD1.4bn by 2013

The OPD market includes software development services sourced by global software companies for product development through their captive units or outsourced relationships in India. As per IDC forecast worldwide offshore R&D/product engineering services is expected to reach USD 65.7 bn, implying a 21% CAGR over CY10-13E. An increasing number of companies is adopting the outsourcing model, either through captive or third-party OPD players not only for lower costs, but also for quick time-to-market and Indian vendors have focussed efforts to develop proprietary time–to-market accelerators that can be easily integrated, customised, and deployed. With share of outsourcing maintained at 23-24% of total R&D spending, the offshore OPD industry is expected to surge 1.5x by 2013. India is expected to be a key beneficiary of the accelerating trend of outsourcing as it has a large pool of manpower with the desired skill sets. NASSCOM estimates the Indian OSPD industry to be USD 1.2 bn in FY12, ~10% of the offshore R&D market, likely to increase to USD 1.4bn by CY13.

Offshore R&D/ PE likely to post 21% CAGR over CY10-13E

Chart 14: Offshore R&D/ PE on solid growth path



Source: IDC, Edelweiss research

Fig. 9: Key dynamics of OPD market

Market size	Rationale for outsourcing	Competition
• Worldwise R&D/PE market at USD 40bn CY10 • Offshore OPD market at USD 0.9bn CY10	• Shrinking product lifecycle and declining budget • Mature talent with strong domain expertise and project management practices • Reducing time to market • Reduce risk of engineering failure and thereby costs • Scaleable delivery model and easy exit strategy	• Internal captives • Pure play OPD vendors • Traditional IT players • Small fragmented players

Source: Nasscom, Edelweiss research

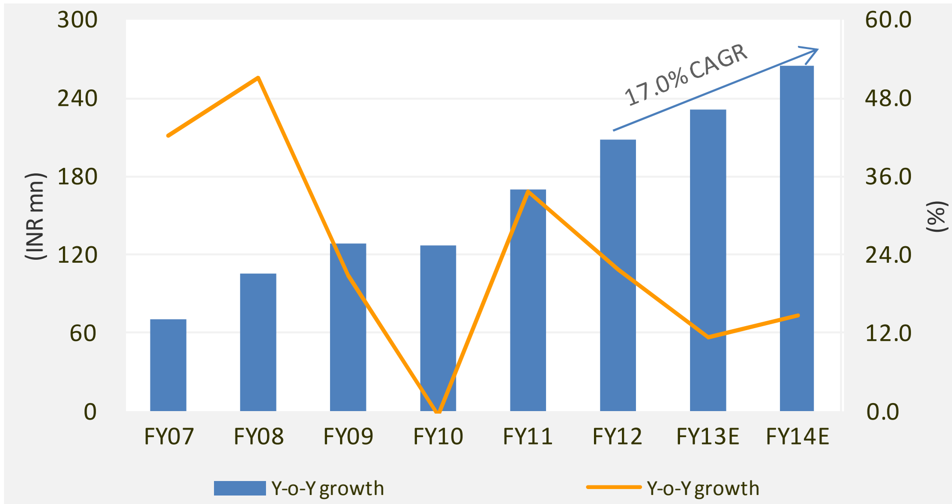
Financial Outlook

New initiatives, IP-led revenue, client mining focus to spur EBITDA

Persistent has recorded above-industry growth in the past few years, with 26% revenue CAGR over FY07-12. We expect this growth momentum to continue and the company to post revenue and EBITDA CAGR of 17% and 19%, respectively, over FY12-14E. Impetus on new initiatives, increasing contribution from IP revenues, and increased focus on client mining are likely to drive the next leg of growth. Based on our estimates, Persistent will be an USD265mn revenue company by FY14.

Likely to generate USD265mn revenue by FY14E

Chart 15: Revenue momentum to be sustained over FY12-14



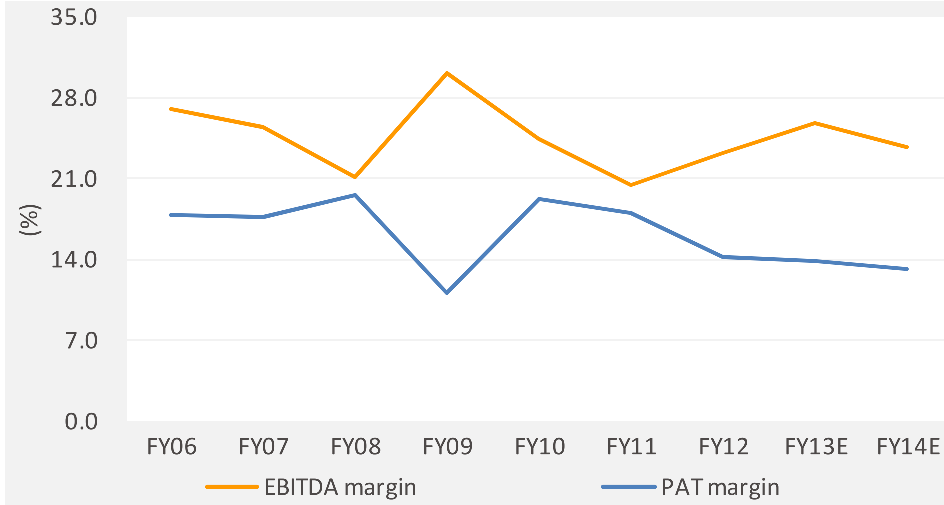
Source: Company, Edelweiss research

Margin to expand in FY13, but drop in FY14

Persistent has industry-leading margin in the mid-tier IT space over the past few years. However, going forward, we believe rising cost of talent and investments made to scale up will impact EBITDA margin. But these costs are likely to be offset by rising proportion of IP-led revenue which is high margin oriented. We expect EBITDA margin to expand 260bps to 25.8% in FY13E versus 23.2% in FY12. However, our FY14 USD/INR assumption of 52/USD versus 53.5/USD for FY13 leads to margin contraction in FY14. We like to note that every 1% change in USD/INR leads to ~30-35bps impact on Persistent's EBITDA margin. Increased contribution from high-margin IP-based revenue (management expects to increase IP revenue contribution to ~20% in next 3-5 years from 9% in FY12) will cushion the rising wage inflation could also lead to upside risk to our margin assumption.

EBIDTA margin likely to decline 220bps in FY14E largely owing currency

Chart 16: EBITDA and PAT margin to settle at a new normal



Source: Company, Edelweiss research

FCF set to rise

The company has been generating strong FCF over the years, baring FY12 where a tax jump from 7% (FY11) to 28% and a capex of INR1.5bn led to negative FCF. However, with major capex out of the way and increasing proportion of IP-led revenue will lead to higher FCF going ahead.

Table 12: FCF set to surge over FY13-14E

(INR mn)	FY07	FY08	FY09	FY10	FY11	FY12	FY13E	FY14E
Net cashflow from operations	852	1,002	698	1,611	1,575	1,436	2,149	2,391
Capex	617	485	474	475	970	1,504	834	850
FCF	**235**	**517**	**224**	**1,136**	**605**	**(68)**	**1,315**	**1,541**

Source: Company

Financial Statements

Key assumptions

		FY11	FY12	FY13E	FY14E
Macro -	GDP(Y-o-Y %)	8.4	6.5	6.4	7.0
	Inflation (Avg)	9.9	8.8	7.0	6.0
	Repo rate (exit rate)	6.8	8.5	7.3	6.8
	USD/INR (Avg)	45.6	47.9	53.5	50.0
Company -	USD revenue growth (%)	33.7	21.8	11.3	14.7
	Billing rates (USD/hr) - Onsite	71.8	72.0	72.7	72.7
	Billing rates (USD/hr) - Offshore	20.7	21.6	22.3	22.3

Income statement (INR mn)

Year to March	FY11	FY12	FY13E	FY14E
Revenues	7,758	10,003	12,347	13,763
Cost of revenues	4,723	5,922	7,053	8,216
Gross profit	3,036	4,081	5,294	5,547
SG&A expenses	1,453	1,757	2,105	2,289
EBITDA	1,583	2,324	3,189	3,258
Depreciation & amortization	423	611	838	932
EBIT	1,160	1,713	2,351	2,326
Other income	171	272	210	203
Forex gain/(loss)	173	(16)	(196)	(8)
Profit before tax	1,504	1,969	2,365	2,521
Tax	106	551	661	706
Core profit	1,398	1,418	1,704	1,815
Profit after tax	1,398	1,418	1,704	1,815
Diluted shares (mn)	40.1	40.0	40.0	40.0
EPS (INR) diluted	34.9	35.5	42.6	45.4
Dividend per share	5.8	6.3	6.5	6.8
Dividend pay out (%)	18.3	19.7	17.1	16.7

Common size metrics - as % of revenues

Year to March	FY11	FY12	FY13E	FY14E
Cost of revenues	60.9	59.2	57.1	59.7
Gross margin	39.1	40.8	42.9	40.3
SG&A expenses	18.7	17.6	17.0	16.6
EBITDA margin	20.4	23.2	25.8	23.7
EBIT margin	14.9	17.1	19.0	16.9
Net profit margins	18.0	14.2	13.8	13.2

Growth metrics (%)

Year to March	FY11	FY12	FY13E	FY14E
Revenues	29.1	28.9	23.4	11.5
EBITDA	8.2	46.8	37.2	2.2
EBIT	2.8	47.7	37.2	(1.0)
PBT	21.2	30.9	20.1	6.6
Net profit	21.5	1.4	20.2	6.5
EPS	8.8	1.6	20.1	6.5

Balance sheet				(INR mn)
As on 31st March	**FY11**	**FY12**	**FY13E**	**FY14E**
Equity share capital	400	400	400	400
Reserves	7,071	8,005	9,421	10,933
Total shareholders funds	7,471	8,405	9,821	11,333
Minority interest	0	0	0	0
Long term borrowings	0	7	7	7
Long term provisions	62	71	78	86
Sources of funds	**7,533**	**8,483**	**9,905**	**11,426**
Net fixed assets	2,261	3,197	3,470	3,389
Capital WIP	553	528	250	250
Non-current investments	0	123	123	123
Deferred tax assets (net)	60	107	107	107
Long term loans and advances	149	147	162	178
Other non-current assets	114	2	2	2
Current investments	2,500	1,915	2,515	3,815
Trade receivables	1,582	2,033	2,402	2,677
Cash and bank balances	886	1,375	2,004	2,138
Short term loans and advances	771	535	642	707
Other current assets	226	182	204	230
Total Current Assets	5,966	6,040	7,767	9,567
Trade payables	406	289	372	415
Other current liabilities	429	590	744	830
Short term provisions	736	781	859	945
Total current liabilities	1,570	1,660	1,976	2,190
Net current assets	4,396	4,379	5,791	7,378
Application of funds	**7,533**	**8,483**	**9,905**	**11,426**
Book value per share (BV) (INR)	186	210	245	283

Free cash flow				(INR mn)
As on 31st March	**FY11**	**FY12**	**FY13E**	**FY14E**
Net profit	1,398	1,418	1,704	1,815
Depreciation	423	611	838	932
Others	(294)	12	(210)	(203)
Gross cash flow	1,527	2,041	2,332	2,544
Less:Changes in working capital	(48)	604	190	161
Operating cash flow	1,575	1,436	2,142	2,383
Less: Capex	970	1,504	834	850
Free cash flow	**605**	**(68)**	**1,308**	**1,533**

Cash flow statement

As on 31st March	FY11	FY12	FY13E	FY14E
Cash flow from operations	1,527	2,041	2,332	2,544
Cash for working capital	48	(604)	(190)	(161)
Operating cashflow (A)	1,575	1,436	2,142	2,383
Net purchase of fixed assets	(970)	(1,504)	(834)	(850)
Net purchase of investments	(1,684)	182	(600)	(1,300)
Others	125	331	210	203
Investments cashflow (B)	(2,529)	(992)	(1,224)	(1,947)
Dividends	(280)	(233)	(292)	(302)
Proceeds from issue of equity	(45)	0	3	0
Proceeds/repayment from loan	0	7	0	0
Interest paid & other items	(387)	(15)	0	0
Financing cash flow (C)	(712)	(241)	(289)	(302)
Change in cash (A+B+C) + (D)	**(1,666)**	**203**	**630**	**134**

Ratios

Year to March	FY11	FY12	FY13E	FY14E
ROAE (%)	18.7	17.9	18.7	17.2
ROACE (%)	23.0	29.9	34.3	31.5
Debtors (days)	74	66	66	67
Payable (days)	19	13	10	10
Cash conversion cycle	55	53	56	57
Current ratio	3.8	3.6	3.9	4.4
Fixed assets turnover (x)	3.4	3.7	3.7	4.0
Total asset turnover(x)	1.0	1.2	1.3	1.3
Equity turnover(x)	1.0	1.3	1.4	1.3

Valuation parameters

Year to March	FY11	FY12	FY13E	FY14E
Diluted EPS (INR)	34.9	35.5	42.6	45.4
Y-o-Y growth (%)	*8.8*	*1.6*	*20.1*	*6.5*
CEPS (INR)	48.3	53.0	66.3	71.7
Diluted P/E (x)	11.2	11.0	9.1	8.6
Price/BV(x)	2.1	1.9	1.6	1.4
EV/Revenues (x)	1.5	1.2	0.8	0.6
EV/EBITDA (x)	7.1	5.0	3.2	2.7
EV/EBITDA (x)+1 yr forward	4.9	3.6	3.2	-
Dividend Yield %	1.5	1.6	1.7	1.7

COMPANY UPDATE

ECLERX SERVICES

Outlook improving

India Equity Research| IT

Edelweiss
Ideas create, values protect

We recently interacted with eClerx Services' (eClerx) management to get a business update and outlook going forward. Our key inference was that demand is on an uptick and the pipeline is better than it was a quarter ago; hence, the company expects growth to pick up in the organic business in Q2FY13, and expects H2FY13 to be better than H1FY13. The improving outlook and robust growth from Agilyst give us the confidence to build in 24%/22% USD revenue growth for FY13E/FY14E, respectively. At 12x FY14E EPS we maintain 'BUY' with a revised TP of INR915.

Initial signs of demand pick up

Management reiterated that macro economic uncertainty and downsizing on the client front continues to impact demand as clients are unwilling to commit. However, it stated that the demand scenario has picked up and eClerx expects Q2FY13 to be better than Q1FY13, and maintained its stance of H2FY13 to be better than H1FY13. For FY13, the company expects growth in high single digit or low double digits on organic basis. We have built in organic growth of 9% and 15% growth from Agilyst leading to an overall growth of 24% for FY13E and 22% growth in FY14E.

Agilyst margin only a tad lower than eClerx: A positive

Post the acquisition of Agilyst, the Street was concerned as it had expected the company's margin to be half of eClerx, which could have diluted overall margin. However, Q1FY13 numbers laid to rest these concerns as Agilyst's OPM is ~30%+, only marginally lower than eClerx's (35%-37%). We expect the margin to improve as consolidation will lead to operating leverage playing out.

Outlook and valuations: Gearing up for growth; maintain 'BUY'

With margin concerns abating, the stock has run up 20% post Q1FY13 result. This, coupled with an improved demand outlook in the organic business makes us confident of eClerx posting robust growth. We value the company at 12x our FY14E EPS of INR76.1, and hence we maintain **'BUY/SO'** recommendation/ rating with a revised target price of INR915

Financials

Year to March	FY11	FY12	FY13E	FY14E
Revenues (INR mn)	3,421	4,729	6,463	7,659
Growth (%)	*33.1*	*38.2*	*36.7*	*18.5*
EBITDA (INR mn)	1,346	1,898	2,462	2,800
Net profit (INR mn)	1,224	1,598	1,944	2,293
Diluted EPS (INR)	40.7	53.1	64.5	76.1
EPS growth (%)	*64.3*	*30.5*	*21.6*	*18.0*
Diluted P/E (x)	18.3	14.0	11.5	9.8
EV/EBITDA (x)	14.5	9.9	7.6	6.4
ROAE (%)	55.9	55.0	50.8	48.1

EDELWEISS 4D RATINGS

Absolute Rating	**BUY**
Rating Relative to Sector	Outperformer
Risk Rating Relative to Sector	Medium
Sector Relative to Market	Overweight

MARKET DATA *(R: ECLE.BO, B: ECLX IN)*

CMP	: INR 743
Target Price	: INR 915
52-week range (INR)	: 844 / 570
Share in issue (mn)	: 29.4
M cap (INR bn/USD mn)	: 22/ 392
Avg. Daily Vol.BSE/NSE('000)	: 27.7

SHARE HOLDING PATTERN (%)

	Current	Q4FY12	Q3FY12
Promoters %	54.5	54.8	54.8
MF's, FI's & BK's	13.0	12.4	10.5
FII's	20.3	21.7	23.5
others	12.1	11.1	11.2

** Promoters pledged shar : NIL*
(% of share in issue)

PRICE PERFORMANCE (%)

	Stock	Nifty	EW Technology Index
1 month	7.2	2.2	5.7
3 months	19.0	7.4	4.3
12 months	2.6	6.3	27.0

Sandip Agarwal
+91 22 6623 3474
sandip.agarwal@edelcap.com

Omkar Hadkar
+91 22 6620 3147
omkar.hadkar@edelcap.com

August 30, 2012

Company Description

Incorporated in 2000, eClerx is one of the first KPOs to be listed in India and provides data analytics and customized process solutions to global enterprise clients from its offshore delivery centers in India. The company provides business solutions leveraging the cost effective combination of people, process and technology. These provide clients with benefits beyond cost reduction by designing solutions that incorporate talent management, process improvements, better reporting and metrics. It currently offers services to clients in the financial services, retail and manufacturing industries. eClerx's TTM revenues stood at USD103mn and employs over 5,545 people.

Investment Theme

eClerx is a strongly differentiated play in India's burgeoning KPO space and stands out by virtue of its business model. The company has built a strong and relatively uncontested position in specific high opportunity segments such as data analytics & management and process improvement solutions thus positioning itself as an established provider of specialised services. It inks multi-year annuity contracts facilitated by ongoing engagements, which has helped the company forge a predictable revenue stream leading to attractive profitability. Strong financial track record marked by significant profitability and return ratios, strong execution and management are eClerx's distinctive factors. We expect eClerx's earnings growth at 18% CAGR over FY12-14E.

Key Risks

- Supply side pressures could affect client servicing and margins.
- Volatility in exchange rates could impact the company's financials meaningfully.
- Process automation and adverse regulations could impact the existing business.

Financial Statements

Key assumptions

		FY11	FY12	FY13E	FY14E
Macro -	GDP(Y-o-Y %)	8.4	6.5	6.4	7.0
	Inflation (Avg)	9.9	8.8	7.0	6.0
	Repo rate (exit rate)	6.8	8.5	7.3	6.8
	USD/INR (Avg)	45.5	48.4	52.3	50.0
Company -	Revenue growth (%)	38.3	29.1	24.0	21.9
	Net addition (nos.)	795	747	1,340	1,300
	Pricing growth (%)	0.8	4.5	(6.7)	0.0

Income statement **(INR mn)**

Year to March	FY11	FY12	FY13E	FY14E
Revenues	3,421	4,729	6,463	7,659
Cost of revenues	1,477	2,039	2,842	3,480
Gross profit	1,945	2,690	3,622	4,179
Total SG&A expenses	599	793	1,160	1,379
EBITDA	1,346	1,898	2,462	2,800
Depreciation & amortization	91	129	166	196
EBIT	1,255	1,769	2,296	2,604
Other income	240	223	184	317
Exceptionals	103	0	21	0
Profit before tax	1,392	1,992	2,458	2,921
Tax	168	394	514	628
Core profit	1,224	1,598	1,944	2,293
Profit after tax	1,224	1,598	1,944	2,293
Net profit after minority interest	1,224	1,598	1,944	2,293
Diluted shares (mn)	30	30	30	30
EPS (INR) diluted	40.7	53.1	64.5	76.1
Dividend per share	22.6	17.6	33.5	35.6
Dividend pay out (%)	53.0	32.0	50.0	45.0

Common size metrics - as % of revenues

Year to March	FY11	FY12	FY13E	FY14E
Cost of revenues	43.2	43.1	44.0	45.4
Gross margin	56.8	56.9	56.0	54.6
SG&A expenses	17.5	16.8	17.9	18.0
EBITDA margin	39.3	40.1	38.1	36.6
EBIT margin	36.7	37.4	35.5	34.0
Net profit margins	35.8	33.8	30.1	29.9

Growth metrics (%)

Year to March	FY11	FY12	FY13E	FY14E
Revenues	33.1	38.2	36.7	18.5
EBITDA	34.1	41.0	29.7	13.8
EBIT	34.4	41.0	29.8	13.5
PBT	68.1	43.1	23.4	18.8
Net profit	66.5	30.5	21.6	18.0
EPS	64.3	30.5	21.6	18.0

Balance sheet				(INR mn)
As on 31st March	**FY11**	**FY12**	**FY13E**	**FY14E**
Equity share capital	292	299	298	298
Share premium account	667	696	684	684
Reserves	1,425	2,437	3,244	4,330
Total shareholders funds	2,384	3,432	4,226	5,312
Long term provisions	25	45	68	101
Deferred tax liability	(7)	(8)	(8)	(8)
Sources of funds	**2,402**	**3,470**	**4,286**	**5,406**
Net fixed assets	305	444	558	672
Capital WIP	65	45	60	100
Long term Loans & Advances	63	79	79	87
Current Investments	278	999	1,450	1,550
Cash & bank balances	1,515	1,687	1,330	2,127
Debtors	659	422	1,240	1,427
Short term Loans and advances	223	296	325	358
Other current assets	412	636	699	769
Total current assets	3,088	4,039	5,044	6,231
Sundry creditors	103	161	241	362
Provisions	969	926	1,137	1,207
Other liabilities	48	51	76	114
Total current liabilities	1,119	1,137	1,454	1,683
Net current assets	1,969	2,902	3,589	4,547
Application of funds	**2,402**	**3,470**	**4,286**	**5,406**
Book value per share (BV) (INR)	79	114	140	176

Free cash flow				(INR mn)
Year to March	**FY11**	**FY12**	**FY13E**	**FY14E**
Net profit	1,224	1,598	1,944	2,293
Add : Non cash charges				
Depreciation	91	129	166	196
Others	(74)	(139)	(164)	(301)
Gross cash flow	1,242	1,588	1,946	2,188
Less:Changes in working capital	324	(183)	571	35
Operating cash flow	918	1,771	1,375	2,153
Less: Capex	240	221	295	350
Free cash flow	**678**	**1,550**	**1,080**	**1,803**

Cash flow statement

Year to March	FY11	FY12	FY13E	FY14E
Cash flow from operations	1,242	1,588	1,946	2,188
Cash for working capital	(324)	183	(571)	(35)
Operating cashflow (A)	918	1,771	1,375	2,153
Net purchase of fixed assets	(240)	(221)	(295)	(350)
Net purchase of investments	496	0	(451)	(100)
Others	76	139	164	301
Investments cashflow (B)	332	(82)	(582)	(149)
Dividends	(335)	(598)	(1,137)	(1,207)
Proceeds from issue of equity	25	37	(13)	0
Proceeds from LTB/STB	-	-	-	0
Financing cash flow (C)	(310)	(562)	(1,150)	(1,207)
Exchange rate differences (D)	1	-	-	0
Change in cash (A+B+C) + (D)	941	1,127	(357)	797

Ratios

Year to March	FY11	FY12	FY13E	FY14E
ROAE (%)	55.9	55.0	50.8	48.1
ROACE (%)	118.2	77.0	86.5	77.8
Debtors (days)	35	42	47	64
Payable (days)	11	10	11	14
Cash conversion cycle	24	32	36	49
Current ratio	2.8	3.6	3.5	3.7
Fixed assets turnover (x)	11.2	12.6	12.9	12.5
Total asset turnover(x)	1.4	1.6	1.7	1.6
Equity turnover(x)	1.4	1.6	1.7	1.6

Valuation parameters

Year to March	FY11	FY12	FY13E	FY14E
Diluted EPS (INR)	40.7	53.1	64.5	76.1
Y-o-Y growth (%)	*64.3*	*30.5*	*21.6*	*18.0*
CEPS (INR)	45.8	59.6	72.8	85.8
Diluted P/E (x)	18.3	14.0	11.5	9.8
Price/BV(x)	9.4	6.5	5.3	4.2
EV/Revenues (x)	5.7	4.0	2.9	2.3
EV/EBITDA (x)	14.5	9.9	7.6	6.4
EV/EBITDA (x)+1 yr forward	10.3	7.7	6.7	
Dividend yield (%)	3.0	2.4	4.5	4.8

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COMPANY UPDATE

HEXAWARE TECHNOLOGIES

Heading towards the big league

India Equity Research| IT

Edelweiss
Ideas create, values protect

We recently interacted with the management of Hexaware Technologies (HEXA) to get an update on the outlook and future plans of the company. The management indicated that the momentum stays on and is on track to achieve 20% growth in CY12 (industry leading growth) in an uncertain environment. Ramp up of large deal wins and a healthy pipeline (chasing four large deals) give us the confidence of 20% growth for CY13. We re-iterate our positive outlook on the company as it continues to deliver profitable growth. We maintain 'BUY' with a TP of INR150.

Momentum intact; large deals, healthy pipeline to inspire growth

The company indicated that it is on course to achieve its annual revenue guidance of atleast 20% YoY growth for CY12 which we believe is commendable in this uncertain environment. This coupled with ramping of large deals won and a healthy pipeline gives us the confidence of 20%+ growth in CY13 too. Despite wage hikes in Q2CY12, margins improved 50bps to 22.9% and it is confident of maintaining these levels in CY12, using levers like pyramid rationalisation, offshore shift and SG&A leverage.

Holistic client mining driving growth

Post the slowdown in FY09, the company adopted a three pronged approach to client mining. For the top ten clients, it focused on getting large deals which enabled growth to be better than the industry. Beyond top, it focused on maximizing growth in few clients and minimizing decline in others. Thus, growth in this bucket was in line with the industry. Third was scaling up of revenues from new clients. This strategy has delivered robust returns as further execution of this will drive growth for the company.

Outlook and valuations: Poised for growth; maintain 'BUY'

As Hexaware executes complex and larger projects due to its continuous investments in newer technology areas, it will build a strong case for itself which will drive growth from hereon. Further implementation of the client mining strategy will lead to profitable growth. Currently, the stock is trading at P/E of 10.8x and 9.2x our CY12E and CY13E earnings, respectively. We maintain **'BUY /SO'.**

Financials

Year to December	CY10	CY11	CY12E	CY13E
Revenues (INR mn)	10,545	14,505	19,586	23,328
Rev. growth (%)	*1.5*	*37.6*	*35.0*	*19.1*
EBITDA (INR mn)	938	2,646	4,393	5,067
Net profit (INR mn)	1,077	2,668	3,458	4,060
Diluted EPS (INR)	3.6	8.9	11.5	13.5
EPS growth (%)	*(19.6)*	*145.8*	*28.9*	*17.4*
Diluted P/E (x)	34.1	13.9	10.8	9.2
EV/EBITDA (x)	33.4	12.0	7.0	5.6
ROAE (%)	9.4	26.9	30.8	30.2

EDELWEISS 4D RATINGS

Absolute Rating	**BUY**
Rating Relative to Sector	Outperformer
Risk Rating Relative to Sector	Medium
Sector Relative to Market	Overweight

MARKET DATA *(R: HEXT.BO, B: HEXW IN)*

CMP	: INR 124
Target Price	: INR 150
52-week range (INR)	: 134 / 71
Share in issue (mn)	: 296.3
M cap (INR bn/USD mn)	: 37/ 661
Avg. Daily Vol.BSE/NSE('000)	: 1,787.5

SHARE HOLDING PATTERN (%)

	Current	Q4FY12	Q3FY12
Promoters %	27.9	28.0	28.2
MF's, FI's & BK's	8.7	9.5	9.4
FII's	43.4	42.1	41.4
others	20.0	20.4	21.0

** Promoters pledged shar : NIL*
(% of share in issue)

PRICE PERFORMANCE (%)

	Stock	Nifty	EW Technology Index
1 month	6.0	2.2	5.7
3 months	0.9	7.4	4.3
12 months	62.7	6.3	27.0

Sandip Agarwal
+91 22 6623 3474
sandip.agarwal@edelcap.com

Omkar Hadkar
+91 22 6620 3147
omkar.hadkar@edelcap.com

August 30, 2012

Company Description

Hexaware Technologies (Hexaware) is an IT-services company, specialised in offering enterprise solutions, application management, and embedded system. The company provides software services to banking and financial services, insurance, travel & transportation, emerging segments (manufacturing and healthcare) verticals. Hexaware has a dominant PeopleSoft practice and is amongst the Top 20 software and services exporter from India. The company's last twelve month revenues stood at INR17.4bn (USD342mn) and it employees 8,733 people.

Investment Theme

Over the past one year Hexaware has focused on improving operational efficiencies and re-aligned itself vertically from earlier horizontal sales-based approach. Further, strengthening of the sales force with 16 new recruits and new deal wins reported in the past six months are likely to result in improving revenue traction going forward. In addition, high US and BFSI exposure should aid growth in an improving macro environment. We see Hexaware fundamentally strengthened with the recent initiatives and with a healthy cash position it is well poised to explore inorganic growth opportunities as well.

Key Risks

- Double dip recession in its major market US and prolonged slowdown in Europe.
- Appreciation of INR against USD, EUR, and GBP.
- Inadequate availability of manpower.

Financial Statements

Key assumptions

		CY10	CY11	CY12E	CY13E
Macro -	GDP(Y-o-Y %)	8.4	6.5	6.4	7.0
	Inflation (Avg)	9.9	8.8	7.0	6.0
	Repo rate (exit rate)	6.8	8.5	7.3	6.8
	USD/INR (Avg)	6.8	47.9	53.5	50.0
Company -	USD revenue growth (%)	7.7	33.3	20.1	20.4
	Net addition (nos.)	1,335	1,845	1,236	1,466

Income statement **(INR mn)**

Year to December	CY10	CY11	CY12E	CY13E
Revenues	10,545	14,505	19,586	23,328
Cost of revenues	6,915	8,939	11,722	14,061
Gross profit	3,630	5,566	7,864	9,266
Total SG&A expenses	2,692	2,920	3,471	4,199
EBITDA	938	2,646	4,393	5,067
Depreciation & Amortization	242	248	303	350
EBIT	696	2,398	4,090	4,717
Other income	249	677	238	488
Profit before tax	945	3,075	4,328	5,206
Tax	92	407	870	1,145
Core Profit	853	2,668	3,458	4,060
Diluted shares (mn)	296.6	299.0	300.6	300.6
EPS (INR) diluted	3.6	8.9	11.5	13.5
Dividend per share	2.0	4.0	4.5	5.0
Dividend (%)	200.4	199.6	225.0	250.0
Dividend pay out (%)	54.0	43.8	38.5	36.4

Common size metrics - as % of revenues

Year to December	CY10	CY11	CY12E	CY13E
Cost of revenues	65.6	61.6	59.8	60.3
Gross margin	34.4	38.4	40.2	39.7
G&A expenses	25.5	20.1	17.7	18.0
SG&A expenses	25.5	20.1	17.7	18.0
EBITDA margin	8.9	18.2	22.4	21.7
EBIT margin	6.6	16.5	20.9	20.2
Net profit margins	8.1	18.4	17.7	17.4

Growth metrics (%)

Year to December	CY10	CY11	CY12E	CY13E
Revenues	1.5	37.6	35.0	19.1
EBITDA	(53.6)	182.1	66.0	15.4
EBIT	(60.3)	244.5	70.5	15.4
PBT	(34.6)	225.4	40.7	20.3
Net profit	(36.5)	212.8	29.6	17.4
EPS	(19.6)	145.8	28.9	17.4

Balance sheet				(INR mn)
As on 31st December	CY10	CY11	CY12E	CY13E
Equity share capital	291	587	591	591
Share premium account	4,774	4,522	4,522	4,522
Reserves	4,590	5,053	7,159	9,495
Total shareholders funds	9,655	10,162	12,272	14,608
Borrowings	112	-	-	-
Deferred tax liability	13	32	32	32
Sources of funds	**9,780**	**10,194**	**12,304**	**14,641**
Goodwill and other intangible asset	1,160	1,377	1,377	1,377
Gross fixed assets	3,469	4,292	5,313	6,227
Less: Accumulated depreciation	1,519	1,697	2,000	2,350
Net fixed assets	1,950	2,594	3,312	3,877
Capital WIP	969	813	488	244
Investments	397	229	800	1,500
Deferred tax asset	182	195	195	195
Cash & bank balances	4,356	4,377	5,303	6,530
Debtors	1,919	2,993	3,649	4,218
Loans and advances	1,632	1,946	1,400	1,500
Total current assets	7,907	9,317	10,352	12,248
Sundry creditors	1,475	2,891	3,240	3,700
Provisions	1,309	1,440	980	1,100
Total current liabilities	2,785	4,331	4,220	4,800
Working capital	5,123	4,986	6,132	7,448
Application of funds	**9,780**	**10,194**	**12,304**	**14,641**
Book value per share (BV) (INR)	33	35	42	49

Free cash flow				
Year to December	CY10	CY11	CY12E	CY13E
Net profit	1,077	2,668	3,458	4,060
Depreciation	242	248	303	350
Others	(634)	(925)	(238)	(488)
Gross cash flow	685	1,991	3,523	3,922
Less:Changes in working capital	563	578	21	90
Operating cash flow	122	1,413	3,501	3,832
Less: Capex	(542)	629	696	670
Free cash flow	**665**	**784**	**2,806**	**3,162**

Cash flow statement				(INR mn)
Year to December	**CY10**	**CY11**	**CY12E**	**CY13E**
Cash flow from operations	685	1,991	3,523	3,922
Cash for working capital	(563)	(578)	(21)	(90)
Operating cashflow (A)	122	1,413	3,501	3,832
Net purchase of fixed assets	542	(629)	(696)	(670)
Net purchase of investments	872	168	(571)	(700)
Investments cashflow (B)	1,414	(461)	(1,267)	(1,370)
Dividends	(233)	(1,243)	(1,551)	(1,724)
Proceeds from issue of equity	32	37	5	-
Proceeds from LTB/STB	(48)	(212)	-	-
Interest paid & other items	(26)	(22)	238	488
Financing cash flow (C)	(275)	(1,439)	(1,308)	(1,236)
Exchange rate differences (D)	(26)	94	-	-
Change in cash (A+B+C) + (D)	**1,236**	**(394)**	**926**	**1,226**

Ratios

Year to December	CY10	CY11	CY12E	CY13E
ROAE (%)	9.4	26.9	30.8	30.2
ROACE (%)	8.3	24.8	38.1	38.3
Debtors (days)	60	62	62	62
Payable (days)	60	55	57	54
Cash conversion cycle	(0)	7	5	7
Current ratio	2.8	2.2	2.5	2.6
Fixed assets turnover (x)	5.5	6.4	6.6	6.5
Total asset turnover(x)	1.1	1.5	1.7	1.7
Equity turnover(x)	1.2	1.5	1.7	1.7

Valuation parameters

Year to December	CY10	CY11	CY12E	CY13E
Diluted EPS (INR)	3.6	8.9	11.5	13.5
Y-o-Y growth (%)	(19.6)	145.8	28.9	17.4
CEPS (INR)	3.8	10.0	12.7	14.9
Diluted P/E (x)	34.1	13.9	10.8	9.2
Price/BV(x)	3.7	3.6	3.0	2.5
EV/Revenues (x)	3.0	2.2	1.6	1.2
EV/EBITDA (x)	33.4	12.0	7.0	5.6
EV/EBITDA (x)+1 yr forward	11.8	7.2	6.0	
Dividend yield (%)	1.6	3.2	3.6	4.0

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COMPANY UPDATE

INFOTECH ENTERPRISES

Prospects to brighten

India Equity Research| IT

Edelweiss
Ideas create, values protect

We recently met Infotech Enterprises (Infotech) management to get an impression on the outlook of the company. The key message that we inferred from our discussion was that the environment has improved considerably compared to the previous quarter and the company remains confident of achieving a growth higher than the industry. Further, Infotech aspires to maintain margins at 18% levels. We remain confident of the margin improvement on a YoY basis and expect revenue momentum to pick up from Q2 onwards. At 8x FY14E earnings, we deem valuations as attractive thus maintain 'BUY' with a TP of INR220.

Growth momentum to pick up from Q2FY13 onwards

While the revenue growth has been sluggish for the past three quarters, we expect the momentum to pick up due to a ramp-up in projects that were delayed in Q1FY13. The management too indicated that the momentum is much better than that in the previous quarter. In the Q1 concall, the management had indicated 14% plus USD revenue growth for FY13 in CC. While we expect growth to be driven by Engineering segment, it remains confident of UT&C segment too, due to improving deal pipeline.

Operating margins sustainable in 17%-18% range

Margin dipped 670bps in FY11 due to salary hikes, lower price realizations and consolidation of low margin acquisitions (Wellsco, Daxcon and TTM). The management, being cognizant of this margin concern, has taken various initiatives like broadening of the pyramid, offshore shift and bringing in operational efficiencies which have led to margins improving to ~18.7% in Q1FY13. As the growth traction improves focus on operational tightening further, margin improvement will continue. We believe its EBITDA margin is sustainable in the 17%-18% range.

Outlook and valuations: On right track; maintain 'BUY'

As the momentum returns and Infotech delivers on its stated strategy and improves cash generation and return ratios, valuations will improve from current P/E of 8.0x FY14EPS which is lower than its historic range of 10-11x. We re-iterate our **'BUY'** recommendation with target of INR220.

Financials

Year to March	FY11	FY12	FY13E	FY14E
Revenues (INR mn)	11,880	15,531	19,732	22,163
Revenue growth (%)	*24.6*	*30.7*	*27.0*	*12.3*
EBITDA (INR mn)	1,804	2,705	3,646	3,826
Net profit (INR mn)	1,397	1,614	2,217	2,459
Diluted EPS (INR)	12.5	14.6	19.9	22.1
EPS growth (%)	*(18.7)*	*16.6*	*36.0*	*10.9*
Diluted P/E (x)	14.0	12.0	8.8	8.0
EV/EBITDA (x)	8.4	5.4	3.5	3.1
ROAE (%)	14.4	14.9	18.0	17.3

EDELWEISS 4D RATINGS

Absolute Rating	**BUY**
Rating Relative to Sector	Outperformer
Risk Rating Relative to Sector	High
Sector Relative to Market	Overweight

MARKET DATA *(R: INFE.BO, B: INFTC IN)*

CMP	: INR 176
Target Price	: INR 220
52-week range (INR)	: 199 / 100
Share in issue (mn)	: 111.5
M cap (INR bn/USD mn)	: 20/ 353
Avg. Daily Vol.BSE/NSE('000)	: 136.2

SHARE HOLDING PATTERN (%)

	Current	Q4FY12	Q3FY12
Promoters %	22.4	22.8	22.9
MF's, FI's & BK's	9.1	9.1	6.9
FII's	23.4	23.3	25.4
others	45.1	44.7	44.9

** Promoters pledged shar*: *NIL*
(% of share in issue)

PRICE PERFORMANCE (%)

	Stock	Nifty	EW Technology Index
1 month	2.7	2.2	5.7
3 months	3.0	7.4	4.3
12 months	45.4	6.3	27.0

Sandip Agarwal
+91 22 6623 3474
sandip.agarwal@edelcap.com

Omkar Hadkar
+91 22 6620 3147
omkar.hadkar@edelcap.com

August 30, 2012

Company Description

Infotech is a 9,978 plus employee software services company with competencies in: (a) UT&C services (catering to utility, transportation, and government segments); (b) engineering design services (for engineering, manufacturing, and industrial products verticals); and (c) software services (to clients in data and technology services, engineering design, and IT services. The company's past twelve month revenues stood at INR16.6bn (USD330mn).

Investment Theme

Outsourcing of engineering services is expected to reach USD 38-50 bn by FY20E compared with USD 2 bn now, as per a Nasscom-Booz Allen Hamilton study. As one of the leading offshore engineering services firms for the manufacturing industry, Infotech is poised to grab the increasing opportunities. The company has strong domain knowledge and complete solution capability in the GIS segment along with healthy pipeline of deals. The company's skills in the areas of mapping and designing across diverse segments and in a variety of end-user IT environments give it an edge.

Key Risks

- Significant appreciation of INR against USD, EUR, and GBP.
- Inadequate availability of skilled manpower.
- Sustained slowdown in engineering services spending.

Financial Statements

Key assumptions

		FY11	FY12	FY13E	FY14E
Macro -	GDP(Y-o-Y %)	8.4	6.5	6.4	7.0
	Inflation (Avg)	9.9	8.8	7.0	6.0
	Repo rate (exit rate)	6.8	8.5	7.3	6.8
	USD/INR (Avg)	45.6	47.9	53.5	50.0
Company -	USD revenue growth (%)	29.5	24.1	14.2	15.4
	Net addition (nos.)	1,074	623	1,364	1,000

Income statement **(INR mn)**

Year to March	FY11	FY12	FY13E	FY14E
Revenues	11,880	15,531	19,732	22,163
Cost of revenues	7,368	9,462	11,804	13,550
Gross profit	4,512	6,069	7,929	8,613
S&M expenses	1,192	1,362	1,759	1,995
G&A expenses	1,517	2,003	2,523	2,793
Total SG&A expenses	2,709	3,365	4,282	4,787
EBITDA	1,804	2,705	3,646	3,826
Depreciation & amortization	486	494	540	580
EBIT	1,318	2,210	3,106	3,246
Interest expense	15	14	0	0
Other income	296	168	112	297
Profit before tax	1,598	2,365	3,219	3,543
Tax	270	835	1,082	1,134
Core profit	1,328	1,530	2,136	2,409
Minority int. and others - paid/(recd.)	(69)	(100)	(99)	(50)
Net profit after minority interest	1,397	1,614	2,217	2,459
Dividend per share	1.3	2.5	4.0	4.5
Dividend (%)	25.0	50.0	80.0	90.0
Dividend pay out (%)	9.9	17.3	20.1	20.4

Common size metrics - as % of revenues

Year to March	FY11	FY12	FY13E	FY14E
Gross margin	38.0	39.1	40.2	38.9
EBITDA margin	15.2	17.4	18.5	17.3
EBIT margin	11.1	14.2	15.7	14.6
Net profit margins	11.2	9.8	10.8	10.9

Growth metrics (%)

Year to March	FY11	FY12	FY13E	FY14E
Revenues	24.6	30.7	27.0	12.3
EBITDA	(13.4)	50.0	34.8	4.9
Net profit	(15.7)	15.2	39.7	12.8
EPS	(18.7)	16.6	36.0	10.9

Balance sheet				(INR mn)
As on 31st March	**FY11**	**FY12**	**FY13E**	**FY14E**
Equity share capital	556	557	557	557
Share premium account	3,651	3,667	3,662	3,662
Reserves	6,086	7,350	9,047	10,920
Total shareholders funds	10,293	11,575	13,266	15,139
Loan Funds	33	34	34	34
Long term Provisions	420	493	542	597
Sources of funds	**10,746**	**12,102**	**13,843**	**15,770**
Net fixed assets	3,320	3,268	3,428	3,648
Capital WIP	74	198	220	350
Non current Investments	579	244	100	100
Long term loans and adv/other receivables	635	735	808	889
Other non-current assets	25	0	0	0
Deferred tax asset	15	30	30	30
Current Investments	334	222	900	1,000
Cash & bank balances	3,507	4,560	5,843	6,839
Debtors	2,567	3,675	4,325	4,918
Short term Loans and advances	373	353	423	508
Other current assets	414	719	791	870
Total current assets	7,196	9,529	12,282	14,135
Trade payables	459	847	1,018	1,222
Short term provisions	273	689	1,571	1,636
Other liabilities	364	365	436	524
Total current liabilities	1,096	1,901	3,026	3,382
Working capital	6,100	7,628	9,257	10,753
Application of funds	**11,080**	**12,325**	**14,743**	**16,770**
Book value per share (BV) (INR)	93	104	119	136

Free cash flow				
Year to March	**FY11**	**FY12**	**FY13E**	**FY14E**
Net profit	1,397	1,614	2,217	2,459
Depreciation	486	494	540	580
Others	(166)	(133)	(211)	(347)
Gross cash flow	1,717	1,975	2,546	2,692
Less:Changes in working capital	689	733	101	547
Operating cash flow	1,028	1,242	2,445	2,145
Less: Capex	647	790	722	930
Free cash flow	**381**	**452**	**1,723**	**1,215**

Cash flow statement				(INR mn)
Year to March	**FY11**	**FY12**	**FY13E**	**FY14E**
Cash flow from operations	1,717	1,975	2,546	2,692
Cash for working capital	(689)	(733)	(101)	(547)
Operating cashflow (A)	1,028	1,242	2,445	2,145
Net purchase of fixed assets	(647)	(790)	(722)	(930)
Net purchase of investments	839	316	(421)	197
Others	0	0	99	50
Investments cashflow (B)	192	(474)	(1,044)	(683)
Dividends	(130)	(324)	(162)	(521)
Proceeds from issue of equity	24	17	(5)	0
Proceeds from LTB/STB	(31)	21	0	0
Interest paid & other items	(10)	(7)	0	0
Financing cash flow (C)	(322)	(584)	(279)	(521)
Free cash flow	381	452	1,723	1,215
Change in cash (A+B+C) + (D)	898	184	1,122	941

Ratios

Year to March	FY11	FY12	FY13E	FY14E
ROAE (%)	14.4	14.9	18.0	17.3
ROACE (%)	25.1	19.6	23.2	20.7
Debtors (days)	79	73	74	76
Payable (days)	14	15	17	18
Cash conversion cycle	65	58	57	58
Current ratio	6.6	5.0	4.1	4.2
Fixed assets turnover (x)	3.6	4.7	5.9	6.3
Total asset turnover(x)	1.1	1.3	1.5	1.4
Equity turnover(x)	1.2	1.4	1.6	1.6

Valuation parameters

Year to March	FY11	FY12	FY13E	FY14E
Diluted EPS (INR)	12.5	14.6	19.9	22.1
Y-o-Y growth (%)	*(18.7)*	*16.6*	*36.0*	*10.9*
CEPS (INR)	16.9	19.1	24.9	27.3
Diluted P/E (x)	14.0	12.0	8.8	8.0
Price/BV(x)	1.9	1.7	1.5	1.3
EV/Revenues (x)	1.3	0.9	0.6	0.5
EV/EBITDA (x)	8.4	5.4	3.5	3.1
EV/EBITDA (x)+1 yr forward	5.6	4.0	3.3	
Dividend yield %	0.7	1.4	2.3	2.6

NOTES:

NOTES:

Company	Absolute reco	Relative reco	Relative risk	Company	Absolute reco	Relative reco	Relative Risk
ECLERX SERVICES	BUY	SO	M	HCL Technologies	BUY	SO	H
Hexaware Technologies	BUY	SO	M	Info Edge	REDUCE	SU	M
Infosys	BUY	SO	L	Infotech Enterprises	BUY	SO	H
Mphasis	HOLD	SP	M	Tata Consultancy Services	HOLD	SP	L
Wipro	HOLD	SP	L				

ABSOLUTE RATING

Ratings	Expected absolute returns over 12 months
Buy	More than 15%
Hold	Between 15% and - 5%
Reduce	Less than -5%

RELATIVE RETURNS RATING

Ratings	Criteria
Sector Outperformer (SO)	Stock return > 1.25 x Sector return
Sector Performer (SP)	Stock return > 0.75 x Sector return
	Stock return < 1.25 x Sector return
Sector Underperformer (SU)	Stock return < 0.75 x Sector return

Sector return is market cap weighted average return for the coverage universe within the sector

RELATIVE RISK RATING

Ratings	Criteria
Low (L)	Bottom 1/3rd percentile in the sector
Medium (M)	Middle 1/3rd percentile in the sector
High (H)	Top 1/3rd percentile in the sector

Risk ratings are based on Edelweiss risk model

SECTOR RATING

Ratings	Criteria
Overweight (OW)	Sector return > 1.25 x Nifty return
Equalweight (EW)	Sector return > 0.75 x Nifty return
	Sector return < 1.25 x Nifty return
Underweight (UW)	Sector return < 0.75 x Nifty return

Edelweiss Securities Limited, Edelweiss House, off C.S.T. Road, Kalina, Mumbai – 400 098.
Board: (91-22) 4009 4400, Email: *research@edelcap.com*

Vikas Khemani	Head Institutional Equities	vikas.khemani@edelcap.com	+91 22 2286 4206
Nischal Maheshwari	Co-Head Institutional Equities & Head Research	nischal.maheshwari@edelcap.com	+91 22 4063 5476
Nirav Sheth	Head Sales	nirav.sheth@edelcap.com	+91 22 4040 7499

Coverage group(s) of stocks by primary analyst(s): IT

ECLERX SERVICES, HCL Technologies, Hexaware Technologies, Infosys, Info Edge, Infotech Enterprises, Mphasis, Tata Consultancy Services, Wipro

Recent Research

Date	Company	Title	Price (INR)	Recos
06-Aug-12	**Cognizant**	Good show; positive vibes for Indian IT; *Global Pulse*		Not Rated
31-Jul-12	**Hexaware Technologies**	Good show continues; *Result Update*	114	Buy
25-Jul-12	**Info Edge**	Moderate hiring impacts growth; *Result Update*	340	Reduce

Distribution of Ratings / Market Cap

Edelweiss Research Coverage Universe

	Buy	Hold	Reduce	Total
Rating Distribution* * 1 stocks under review	104	60	18	183

	> 50bn	Between 10bn and 50 bn	< 10bn
Market Cap (INR)	114	58	11

Rating Interpretation

Rating	Expected to
Buy	appreciate more than 15% over a 12-month period
Hold	appreciate up to 15% over a 12-month period
Reduce	depreciate more than 5% over a 12-month period

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Edelweiss Securities Limited, Edelweiss House, off C.S.T. Road, Kalina, Mumbai 400 098
Tel: +91 22 4009 4400. Email: research@edelcap.com