

IT Services Sector

CONQUERING EUROPE 2.0 – Peer pressure to drive outsourcing

INDIA | IT SERVICES | Sector Update

24 February 2015

In February 2014, we had published a report on the outsourcing opportunity for Indian IT-services companies from Europe (read [here](#)). In that report, we estimated the **total outsourcing opportunity from Europe at US\$ 52bn**. Our sample space consisted of 143 companies — top 10-12 companies (in each country/sector) by capex spend across 20 countries and 6 verticals. Our analysis had revealed that 33 of those 143 companies (23% of the total) had never outsourced their IT operations. Of the remaining 110, 66 (46%) had outsourced, but not offshored. Put together, **99 companies (70%) had never outsourced or offshored**, representing a HUGE opportunity for Indian IT vendors.

In this report, we dig deeper into the region and try to establish its major IT-outsourcing drivers over the next few years. As the EU region grapples with declining demand and ailing economies, most companies there have been struggling to remain afloat. In times like these, **peer pressure will be one of the most important factors** that will push more companies towards outsourcing.

Our analysis of the same 143 companies reveals that almost **60% of the companies that have not outsourced/offshored their IT operations are doing badly** (vs. peers who have outsourced). While there might not be a causal relationship between the two, we believe that consistent underperformance will surely force these companies to do a relative analysis, which could throw up IT outsourcing as a major avenue for saving costs.

As per our analysis, **14 of the 30 companies that have never outsourced (47%) are underperforming** their sector peers. Similarly, **41 of the 63 companies (65%) that have outsourced but not offshored their IT operations are on weaker ground**. Put together, 55 of the 93 (59%) non-outsourcing/non-offshoring companies will be forced to consider IT outsourcing as a possible avenue to improve performance. **We expect this peer comparison and resultant pressure to push non-outsourcers towards outsourcing** – leading to a strong deal pipeline for Indian IT-services companies.

In this report, **we also analyse the deal flow from Europe** since we published our last report and juxtapose it with what we had predicted. We take pride in the fact that 6 out of 17 first-time outsourcers over the last 12 months are from our list of potential outsourcers, while 8 are not part of our list because of their smaller size. **Like we foresaw, the IMS domain saw the largest number of deals awarded (36%)** – in line with our assumption that first-time outsourcers will try to test waters by outsourcing relatively low-end service such as IMS.

Almost all the top-5 IT services companies have benefitted from the opportunity in Europe; not completely in line with our hypothesis of TCS, HCL, and TechM being the bigger beneficiaries (vs. Wipro and Infosys). However, as outsourcing fever catches on, we expect the relatively stronger presence of these companies in the region to help them grab a larger share of deals at the expense of Wipro and Infosys. **In line with our premise, Indian companies continue to grab share from MNCs and have won 68% of the new deals** from the region.

We maintain that as the European region opens up to outsourcing – on the back of declining demand environment, input cost pressures and increased confidence in the delivery capabilities of the Indian companies – it will offer an unprecedented growth opportunity for the entire sector. That, coupled with revival of discretionary spending in US and increased spending on the back of adoption of SMAC technology, should hold the sector in good stead, over the next three years. We maintain our **BUY rating on Tech Mahindra, TCS and HCL Tech** and remain **NEUTRAL on Infosys and Wipro**.

Companies

TATA CONSULTANCY SERVICES

Reco	BUY
CMP, Rs	2696
Target Price, Rs	3100

INFOSYS

Reco	NEUTRAL
CMP, Rs	2265
Target Price, Rs	2000

HCL TECHNOLOGIES

Reco	BUY
CMP, Rs	1971
Target Price, Rs	2200

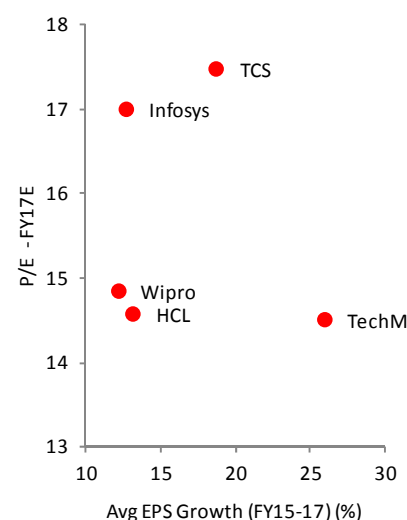
WIPRO

Reco	NEUTRAL
CMP, Rs	650
Target Price, Rs	620

TECH MAHINDRA

Reco	BUY
CMP, Rs	2780
Target Price, Rs	3320

Relative Positioning



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vsinghal@phillipcapital.in

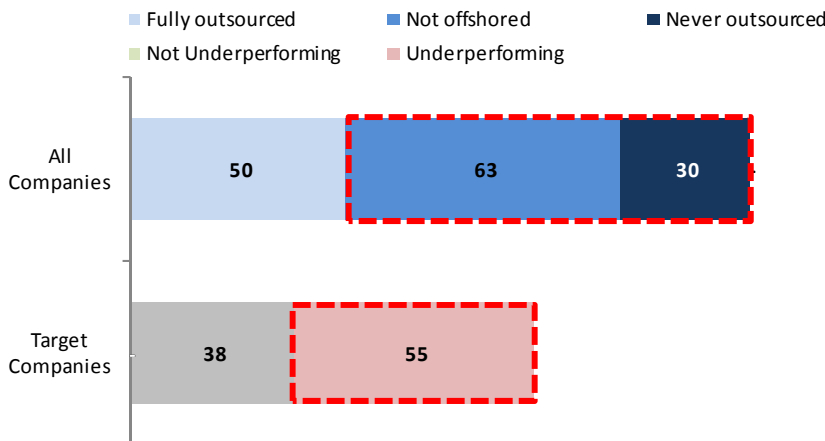
Deepan Kapadia (+ 9122 6667 9992)
dkapadia@phillipcapital.in

Key charts in the report

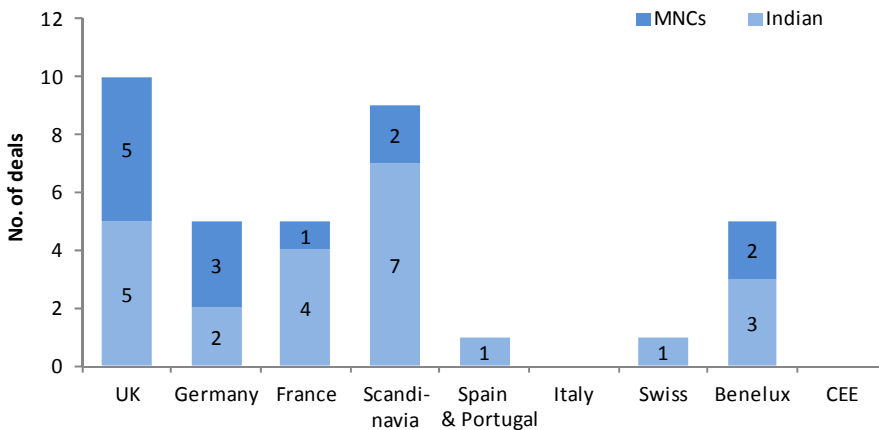
How peer pressure drove these recent first-time outsourcers



Majority of the non-outsourcing companies are underperforming their peers



Indian vendors have snatched market share from MNCs and local (EU) IT vendors like IBM, Accenture and Cap-Gemini



Source: PhillipCapital India Research

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Europe – The Next Frontier for Indian IT

Over the last few months, the IT sector has seen a surge of deals from Europe. This is a pleasant development because historically the region was reluctant to outsource. Faced with declining demand, input cost pressures, and regulatory challenges, European companies are seeking newer avenues of cutting costs – outsourcing IT is one of them.

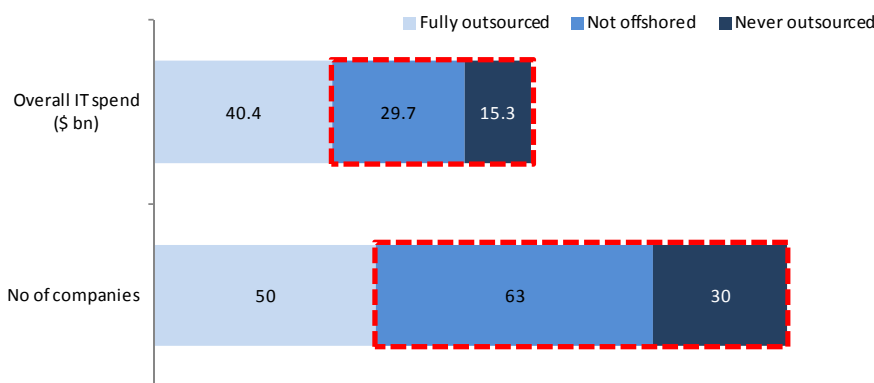
We see this opening up of European companies to outsourcing as a tremendous opportunity for Indian IT vendors. Not only will new companies join the outsourcing bandwagon, but also companies that have already outsourced their IT operations will step it up and diversify their vendor base. Powered by their lower cost models and superior delivery capabilities, we see Indian IT vendors grabbing market share from their MNC peers (especially from local vendors such as Capgemini and Atos Origin).

Over 70% of companies we analysed yet to offshore from the region

In February 2014, we had published a detailed report with a bottom-up analysis of the potential IT-outsourcing opportunity from the European region. In that report, we had analysed 143 companies (largest by capex spend) in the EU region across 20 countries and 6 verticals. Within these companies, we tried to find out how many had outsourced and how many had offshored. Our analysis had revealed that 33 companies were yet to outsource (3 companies have done so since then) and 66 companies had outsourced but not offshored (again 3 of these have done so since then). Cumulatively, 99 (70%) were yet to outsource/offshore – an extremely low level of penetration.

Quantifying this outsourcing opportunity, we had estimated the total addressable IT offshoring/outsourcing opportunity for Indian vendors would be US\$ 52bn. Of this, IT capex of US\$ 18bn would come from the never-outsourced category and US\$ 34bn from the not-offshored category.

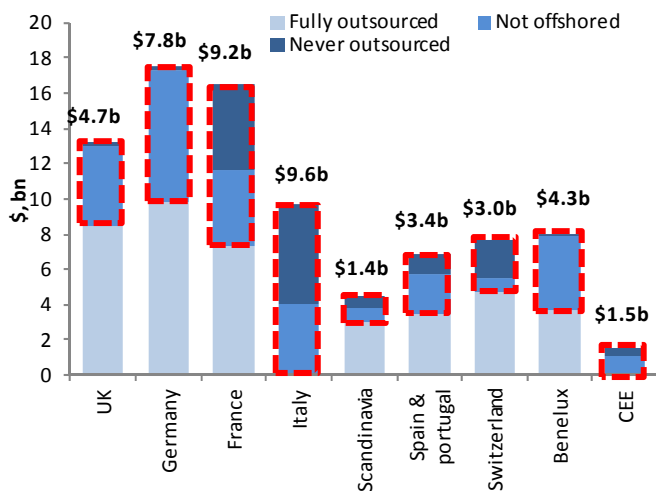
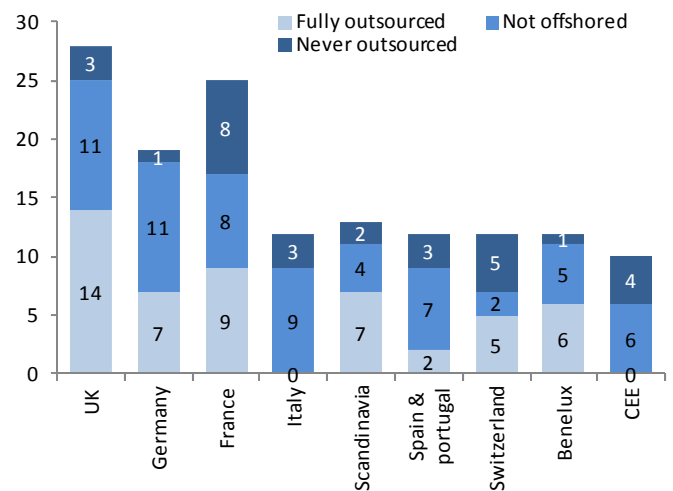
Opportunity for Indian IT companies



Source: PhillipCapital India Research

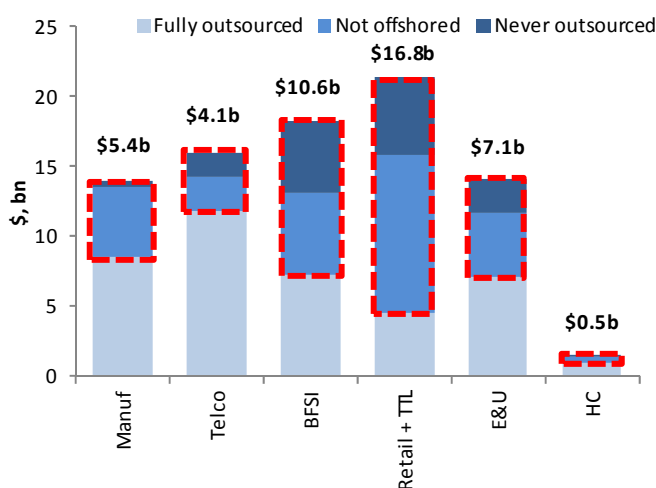
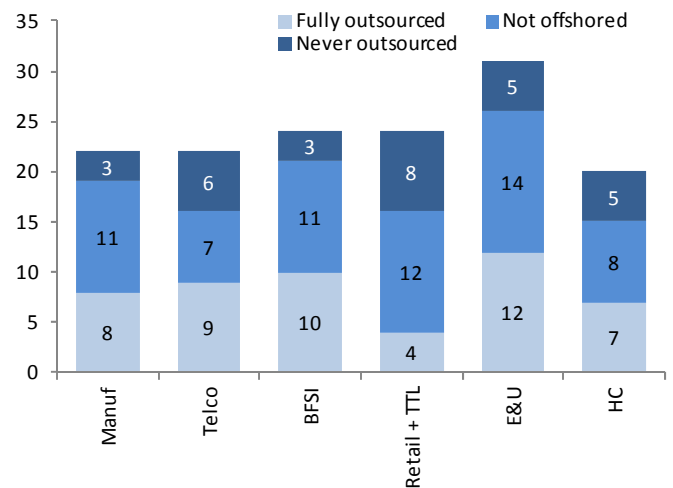
Of these 99 companies, six have joined the outsourcing bandwagon since our report. The 93 companies left on our list represent a US\$ 45bn potential IT outsourcing opportunity for Indian IT vendors.

According to our analysis, Germany and France continue to represent the largest potential with IT-spend potentials of US\$ 7.8bn and US\$ 9.2bn respectively. Companies from Italy, Spain, and Portugal continue to be reluctant to outsource due to rigid labour laws, language barriers, and negative mind set to offshoring. The total potential from Europe’s most outsourcing-friendly regions (UK, Scandinavia, Germany, France, Switzerland, and Benelux) is US\$ 30.4bn (out of the total US\$ 45bn).

Potential IT opportunity in each country

No of companies yet to outsource in each country


Source: PhillipCapital India Research

Among verticals, manufacturing, BFSI (Banking, Financial services and Institutions), and retail remain the most lucrative, with a cumulative potential IT outsourcing opportunity of US\$ 33bn. Telecom and E&U (Energy and Utilities) are widely penetrated and the potential opportunity in healthcare remains relatively small.

Potential IT opportunity in each vertical

No of companies yet to outsource in each vertical


Source: PhillipCapital India Research

In this report, we dug a little deeper and tried to find what could be the possible drivers for the 93 companies that are yet to outsource. As is true for most things in life, we found that peer pressure turns out to be one of the most important factors for companies to make that radical change.

Peer pressure to drive outsourcing further

European companies have historically been reluctant to outsource their IT operations, especially when compared with their US counterparts. While language and cultural barriers were important reasons, lack of confidence in delivery capabilities (especially from Indian vendors) was one of the primary causes. However, of late external factors have forced European companies to consider IT outsourcing, including:

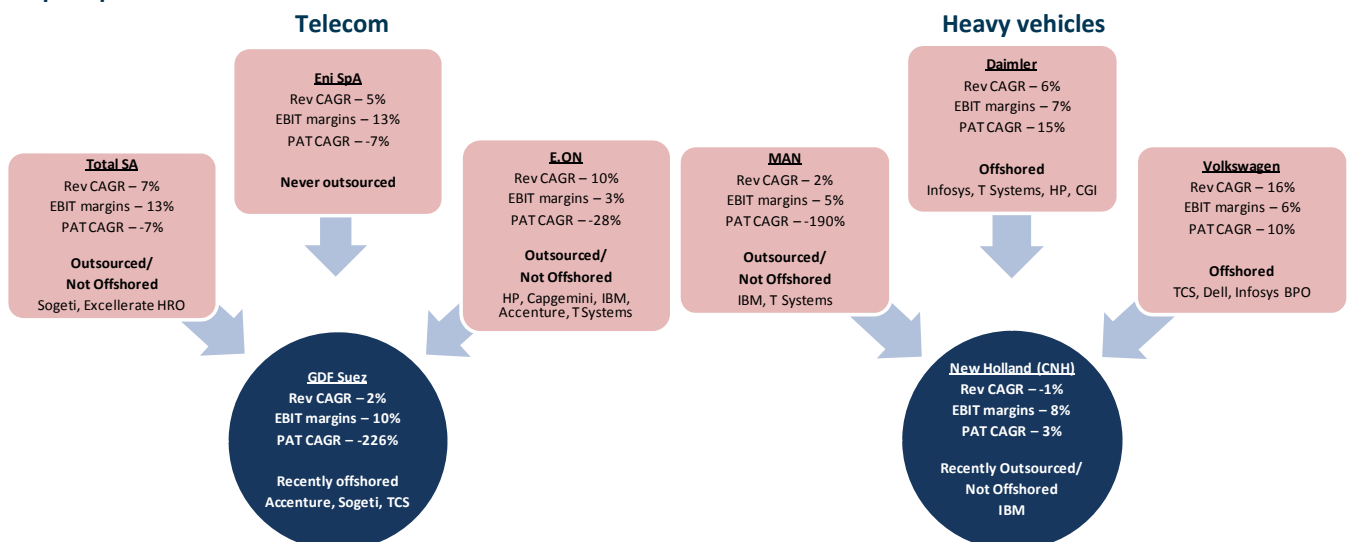
- Declining demand environment and input cost pressures
- Need to upgrade legacy systems
- Advent of new age technologies (especially SMAC – Social Mobile Analytics And Cloud)
- Enhanced confidence in delivery capabilities of the vendors

However, one more factor has emerged as an extremely important one, especially after few of the European companies chose to outsource – peer pressure.

While there has been a decline in overall demand environment in Europe over the last few years – few companies in all sectors have been able to stand tall and deliver superior results, compared to their competitors. Against that, few companies have performed miserably. We believe that their consistent underperformance will force these company managements to do a comparative analysis of their operations with their outperforming peers. We expect this exercise to throw up IT outsourcing as a possible avenue of cost-saving and enhance focus on core business operations.

To ascertain this possibility, we juxtaposed the financial performance of recent outsourcers (since our last report) vs. their peers who have already outsourced. We realised that in most cases, the recent outsourcers/offshorers were significantly underperforming peers that had already outsourced.

How peer pressure drove these recent first time outsourcers

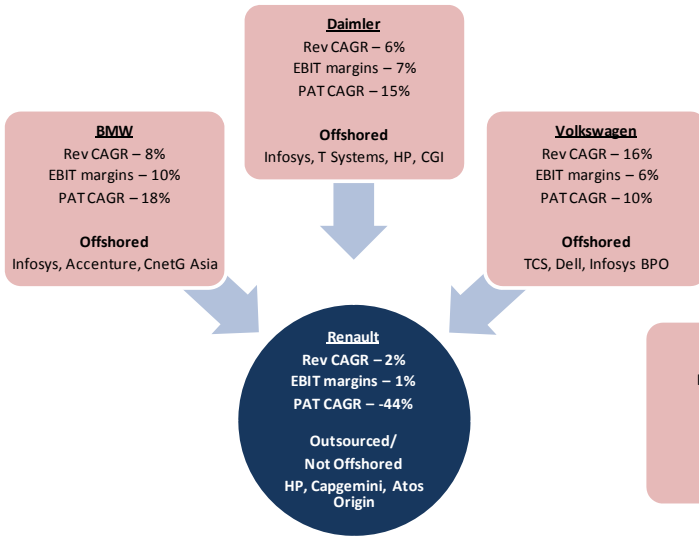


Source: PhillipCapital India Research

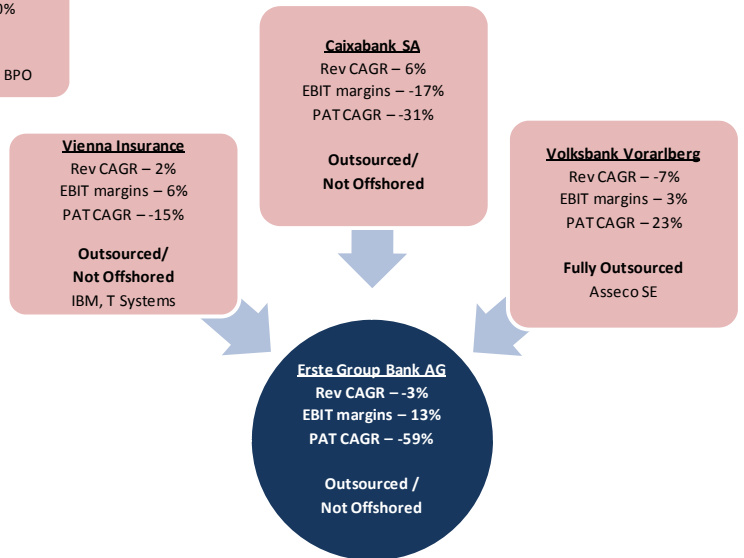
We are not suggesting that there is a strict causal relationship between a company's underperformance and its outsourcing of its IT operations. However, we do believe that in many cases if a consistently underperforming company realises that its outperforming peer has outsourced its IT operations, peer pressure will force it to consider outsourcing as an option (among other business options) to bridge the gap in performance.

Case studies – Non-outsourcers bearing the brunt

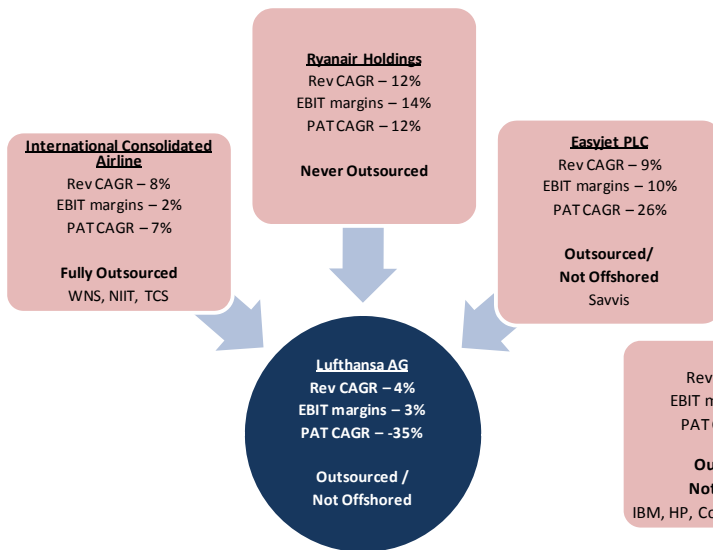
Auto manufacturing



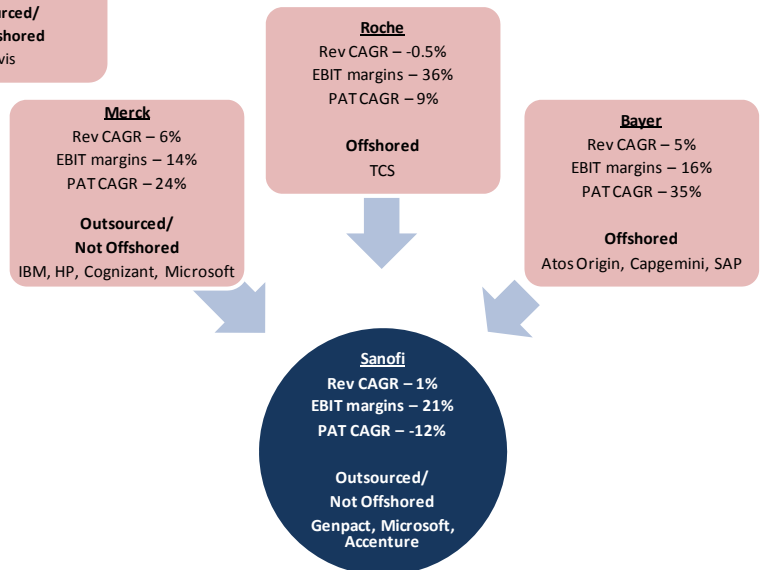
Banking & Insurance



Transportation



Healthcare

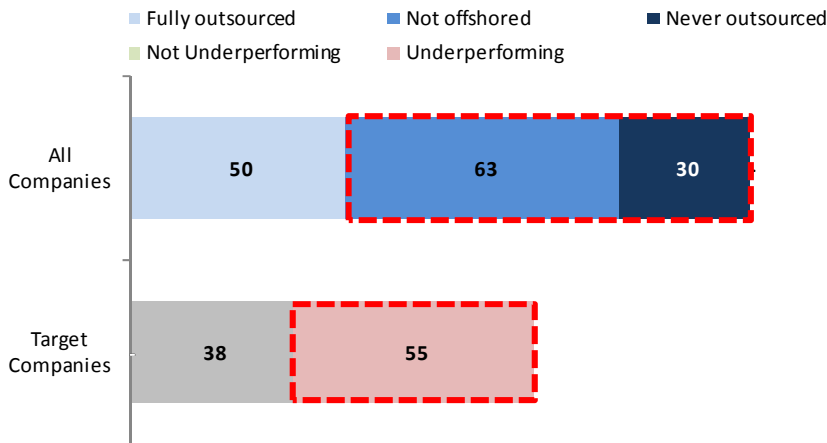


Source: PhillipCapital India Research

60% of non-outsourcers are underperforming peers

Digging deeper into our sample space of 143 companies, we tried to compare financial performance (revenue CAGR, EBITDA margins, and PAT CAGR) over the last three years with their competitors. We deduced that 55 of the 93 companies (60%), that are yet to outsource/offshore their IT operations are underperforming their sector peers who have already outsourced/offshored their IT operations.

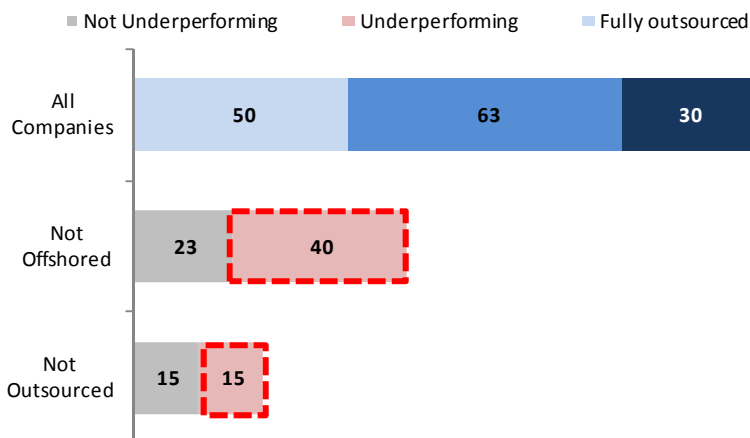
Majority of the non-outsourcing companies are underperforming their peers



Source: PhillipCapital India Research

Segregating them into outsourcing and offshoring bracket, our analysis reveals that 15 of the 30 companies (50%) that have never outsourced their IT operations are underperforming their sector peers. Similarly, 40 of the 63 companies (63%) that have outsourced but not offshored are on weaker ground.

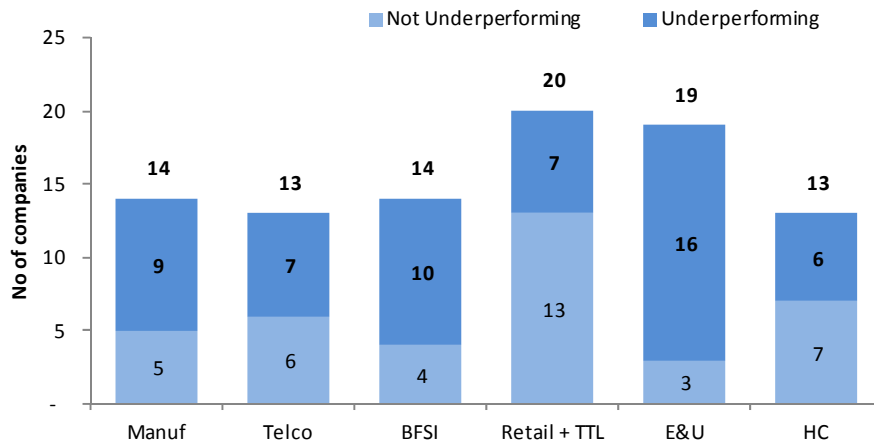
Both non-outsourcers and non-offshorers bearing the brunt



Source: PhillipCapital India Research

The highest share of non-outsourcer underperformers is in BFSI (71%) and E&U (84%). All sectors, apart from retail and healthcare, have more than 50% of the non-outsourcers underperforming their counterparts. We expect big data and mobility to drive outsourcing demand in the retail sector.

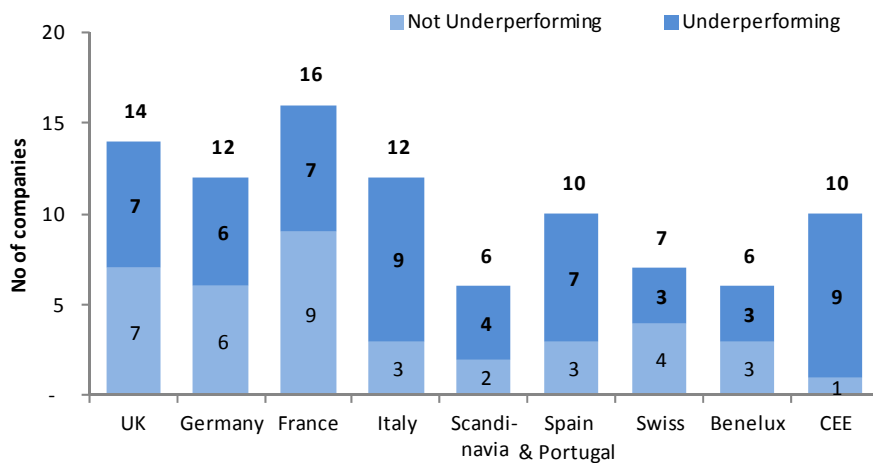
BFSI and E&U verticals have over 70% non-outsourcers underperforming



Source: PhillipCapital India Research

In almost all regions (other than France and Switzerland), more than 50% of the non-outsourcers underperformed their peers. In Italy, Spain, and CEE the underperformance appeared to have a high correlation with absence of IT outsourcing.

Italy, Spain, and CEE have most of the non-outsourcers underperforming



Source: PhillipCapital India Research

The Frontier – slowly being captured

In our last report we had highlighted that the European companies are opening up for outsourcing and taking their IT operations to low cost regions like India. Validating our thesis, 36 large deals have been awarded from the region in the last 12 months (since our report) – 23 of them going to the Indian vendors.

Total deal from Europe in the last 12 months

Date	Company	Vertical	Country	New vendors		
7-May-14	DNB	BFSI	NORWAY	HCL tech	RENEWAL	IMS
31-Jan-14	Lloyds Banking Group PLC	BFSI	UK	Communis	RENEWAL	BPO
10-Apr-14	Lloyds Banking Group PLC	BFSI	UK	Capgemini	NEW	IT outsourcing
18-Mar-14	Lansforsakringar	BFSI	Sweden	Infosys	NEW	ADM
29-May-14	Premium Credit	BFSI	UK	Tech Mahindra	NEW	ADM
26-Jun-14	REAAL NV	BFSI	Netherlands	TCS	NEW	ADM
19-Aug-14	Friends Life	BFSI	UK	TCS	RENEWAL	IMS
23-Sep-14	Ahlstrom	Diversified	Finland	Tech Mahindra	NEW	IT outsourcing
2-Jul-14	Royal Dutch Shell PLC	E&U	NETHERLANDS	HP	RENEWAL	IT outsourcing
5-Sep-14	BP PLC	E&U	UK	Infosys	RENEWAL	ADM
25-Mar-14	GDF Suez	E&U	FRANCE	TCS	NEW	IT outsourcing
25-Feb-14	Centrica PLC	E&U	UK	Avanade	NEW	IMS
12-Mar-14	Alstom Transport	E&U	France	Tech Mahindra	NEW	IT outsourcing
16-May-14	XOServe	E&U	UK	Wipro	NEW	IMS
12-Jun-14	Outokumpu	E&U	Finland	Wipro	NEW	IT outsourcing
13-May-14	Novartis	HC	SWITZERLAND	HCL tech	RENEWAL	IMS
Recent	EADS	Manufacturing	FRANCE	Cyient	RENEWAL	IT outsourcing
5-May-14	Daimler	Manufacturing	GERMANY	T Systems	RENEWAL	IT outsourcing
29-Jul-14	Daimler	Manufacturing	GERMANY	Infosys	NEW	IMS
24-Mar-14	Peugeot	Manufacturing	FRANCE	IBM	RENEWAL	IT outsourcing
4-Mar-14	Siemens AG	Manufacturing	GERMANY	Wipro	NEW	Digital
17-Mar-14	Volvo	Manufacturing	SWEDEN	Infosys	NEW	ADM
18-Mar-14	Volvo	Manufacturing	SWEDEN	Tech Mahindra	NEW	IMS
24-Apr-14	CNH Industrial NV	Manufacturing	UK	IBM	NEW	IMS
1-Mar-14	Scania AB	Manufacturing	SWEDEN	Capgemini	NEW	BPO
24-Mar-14	Public roads administration	PSU	NORWAY	IBM	NEW	Digital
2-Apr-14	FCO	PSU	UK	Capgemini	NEW	IT outsourcing
22-Oct-14	Deutsche Lufthansa AG	Retail + TTL	GERMANY	IBM	NEW	IMS
19-Aug-14	Koninklijke Vopak NV	Retail + TTL	NETHERLANDS	Ramco Systems	NEW	BPO
22-Oct-14	De Beers	Retail + TTL	Luxembourg	HCL tech	NEW	IMS
13-Feb-14	HEMA	Retail + TTL	Netherlands	Capgemini	NEW	IT outsourcing
Recent	Deutsche Telekom AG	Telco	GERMANY	Capgemini	NEW	BI & analytics
Recent	Telefonica SA	Telco	SPAIN	Cognizant	NEW	IMS
8-Aug-14	Alcatel Lucent	Telco	France	HCL tech	NEW	IT outsourcing
7-Mar-14	Thomson Reuters	Media & Ent	UK	TCS	NEW	IMS
25-Jun-14	Sanoma	Media & Ent	Finland	Wipro	NEW	IMS

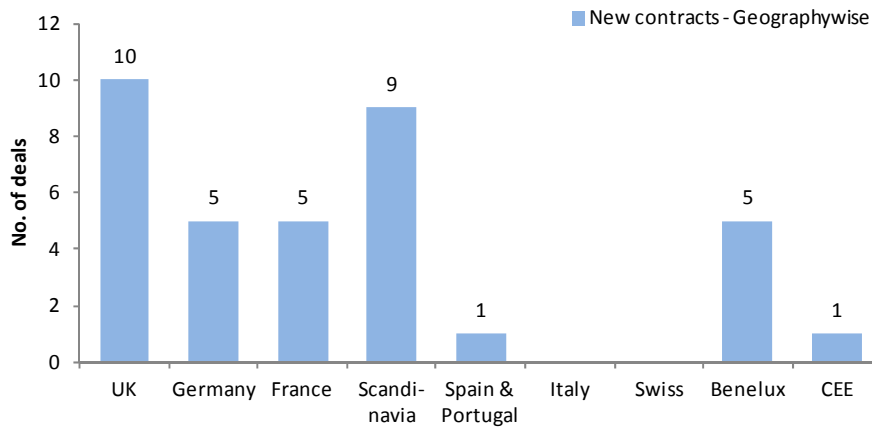
Source: Companies, PhillipCapital India Research

Out of the 36 deals:

- 17 were awarded by enterprises who outsourced and/or offshored for the first time.
- 9 were renewal deals while 27 were new contracts.
- Indian vendors bagged 23 while 13 went to MNCs (local/global) vendors such as IBM, Capgemini, and Atos Origin.

The geographical distribution of the deals is along expected lines. Most of the deals were struck in the UK (10) and Scandinavia (9) – countries that have always been more amenable to outsourcing. Germany and France announced 5 deals apiece, showing promise. Spain and CEE seemed to be joining the bandwagon, with one deal apiece.

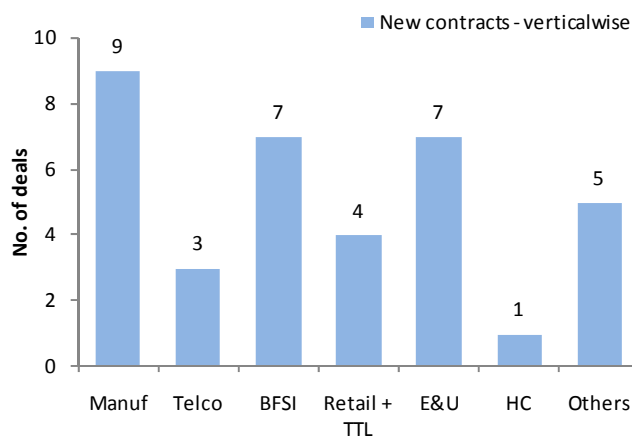
UK and Scandinavia awarded the highest number of deals in last 12 months



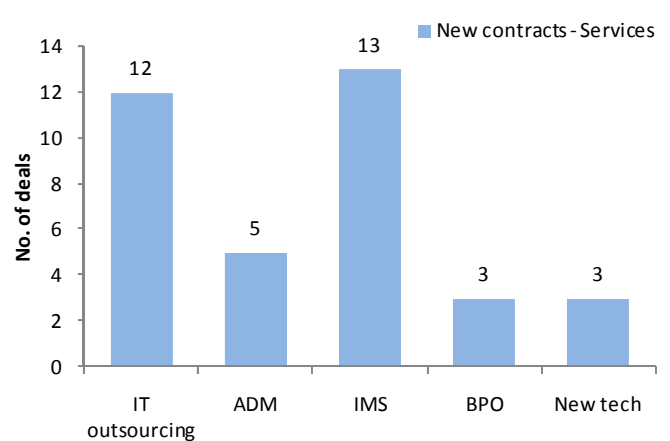
Source: Companies, PhillipCapital India Research

Amongst verticals, manufacturing and BFSI led the pack with 9 and 7 deals. E&U companies delivered a pleasant surprise, with as many as 7 deals. Telecom and retail continued to show promise.

Manufacturing, BFSI and E&U led the deals tally ...



IMS and IT outsourcing accounted for over 70% of the deals



Source: Companies, PhillipCapital India Research

Amongst services, most of the deals were for IMS (13) followed by IT outsourcing deals – ADM + Managed Services (12); 5 were pure ADM deals with most of them being renewals. Digital services (SMAC and IoT) formed a part of most, indicating increased importance for the enterprises to migrate to these platforms. Two large contracts were purely for business intelligence, analytics, and SMAC implementation.

New 'kids' joining the bandwagon

The deal flow from Europe over the last 12 months has seen many companies joining the outsourcing bandwagon. Of the total 36 large deal wins announced from the region, 17 are from either first-time outsourcers or first-time offshorers.

Companies who outsourced/offshored their IT operations for the first time in last 12 months

Company	Vertical	Country	New vendor	Change	Date
Deutsche Telekom AG	Telco	Germany	Capgemini	1st time outsourcer cum offshorer	Recent
Telefonica SA	Telco	Spain	Cognizant	1st time offshorer	Recent
EADS	Manufacturing	France	Cyient	1st time offshorer	Recent
CNH Industrial	Manufacturing	UK	IBM	1st time outsourcer/not offshored	24-Apr-14
Siemens AG	Manufacturing	Germany	Wipro	1st time offshorer	4-Mar-14
Thomson Reuters	M & E	UK	TCS	1st time offshorer	7-Mar-14
Alstom Transport	E&U	France	Tech Mahindra	1st time offshorer	12-Mar-14
Lansforsakringar	BFSI	Sweden	Infosys	1st time offshorer	18-Mar-14
GDF Suez	E&U	France	TCS	1st time offshorer	25-Mar-14
XOServe	E&U	UK	Wipro	1st time outsourcer cum offshorer	16-May-14
Premium Credit	BFSI	UK	Tech Mahindra	1st time outsourcer cum offshorer	29-May-14
Outokumpu	E&U	Finland	Wipro	1st time offshorer	12-Jun-14
Sanoma	M & E	Finland	Wipro	1st time offshorer	25-Jun-14
REAAAL NV	BFSI	Netherlands	TCS	1st time outsourcer cum offshorer	26-Jun-14
Vopak	Retail + TTL	Netherlands	Ramco Systems	1st time offshorer	19-Aug-14
Ahlstrom	Diversified	Finland	Tech Mahindra	1st time outsourcer cum offshorer	23-Sep-14
De Beers	Retail	Luxembourg	HCL tech	1st time offshorer	22-Oct-14

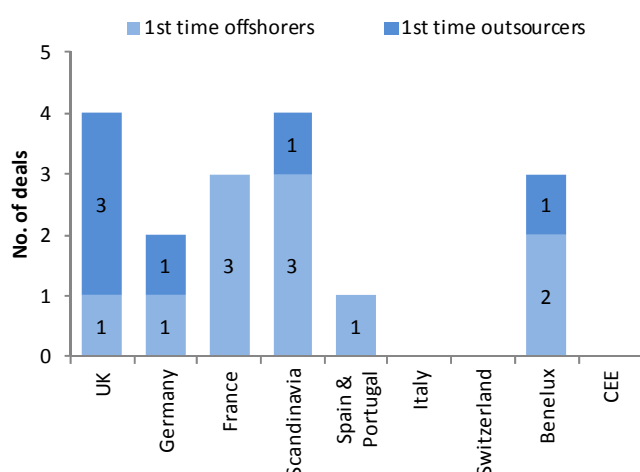
Source: Companies, PhillipCapital India Research

(Companies in grey cells are the ones that we had identified as potential outsourcers in our Feb-14 report)

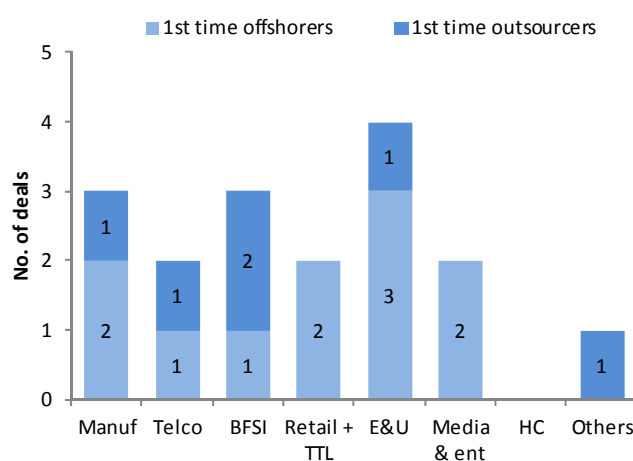
We take pride in the fact that of the 17 first timers, 6 companies are the ones whom we had identified as potential outsourcers in our February 2014 report — 5 of them have outsourced as well as offshored their IT operations. Of the 17, 8 were not on our list because they are not amongst the top-5/top-10 companies of their respective sectors, indicating that even smaller companies are moving ahead of their larger peers in terms of outsourcing initiative.

Scandinavia, UK, France, and Benelux saw majority of first timers including logos like Airbus, Alstom, Outokumpu, and De beers. Many deals came from E&U and BFSI. Retail and manufacturing saw more first-time offshorers who had an existing local or MNC onsite vendor.

Number of first timers by geography



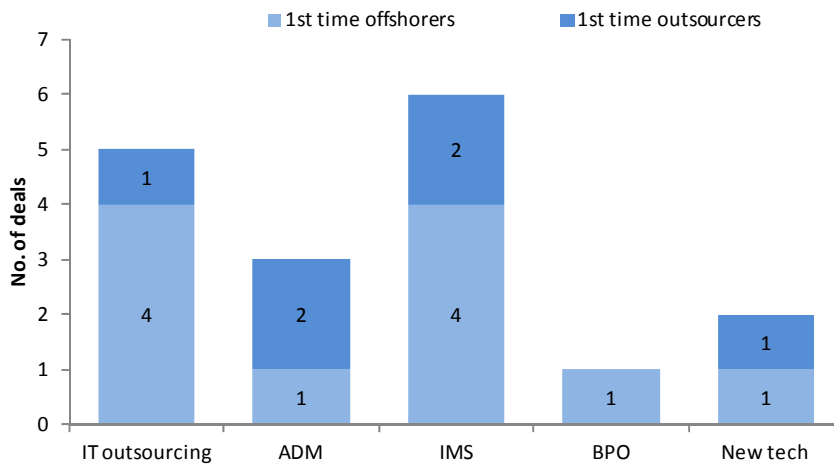
Number of first timers by vertical



Source: Companies, PhillipCapital India Research

Within service lines, IMS saw the largest number of deals (6) from first-time outsourcers, precisely along our expectations. Equally heartening was the fact that the same number of deals (5) were struck in the IT outsourcing (ADM + managed Services). The region also saw one pure-digital-solutions and one business-analytics contract awarded by a non-outsourcer.

Number of first timers by service lines



Source: Companies, PhillipCapital India Research

Lots of IMS deals

Our hypothesis of Indian IT vendors targeting infrastructure management services (low end in terms of criticality) for getting their foot in the door is clearly visible in the bifurcation of the last 12 months' deal flow.

- Out of the total 36 deals, 13 were in IMS followed by IT outsourcing (ADM + managed services).
- Of the 17 deals awarded by first-time outsourcers, 6 were for IMS.
- Of the 23 deals won by Indian-IT vendors – 10 were for IMS.

We expect this trend (of IMS dominating the deal flow from the European region) to continue – as per our hypothesis in our last report. We still hold that first-time outsourcers will try to test waters by outsourcing low-end work such as IMS initially. In those deals, Indian vendors such as HCL Tech, TCS, and Wipro should benefit and grab market share from MNC vendors such as IBM. Once they get a foot in the door through the IMS deals, these contracts will also help Indian vendors to cross sell their expertise in other domains.

DNB's deal with HCL Tech is a good example of this scenario. After signing a contract for handling IMS and banking solutions in November 2013 (TCV of US\$ 115mn), DNB awarded HCL an ADM and F&A services contract for US\$ 400mn in May 2014.

We note that most of these deals include a large portion of transformational services (including migration to cloud and implementation of SaaS platforms) signifying the importance of SMAC. We expect SMAC to drive the next wave of IT outsourcing and accordingly most IT vendors (Indian and MNC) are investing heavily into building delivery capabilities in this domain.

MNCs losing out to the Indian vendors

A secular trend has emerged over the last two years – Indian IT companies have begun capturing MNC players’ market share (from IBM and Accenture and local players such as Cap-Gemini and Atos Origin). Few examples of high-profile vendor substitution are:

- HCL Tech challenged MNCs (IBM and Capgemini) in contracts from DNB and Novartis and won.
- Infosys has recently siphoned out a large part of Daimler’s IMS contract with HP.
- TCS won IT outsourcing contract (first time offshoring company) inspite of the incumbents like Accenture and Sogeti.

Over the last 12 months (since our report), Indian vendors have won 23 of the total 36 large deals awarded from Europe.

Deals won by MNCs/local vendors over last 12 months

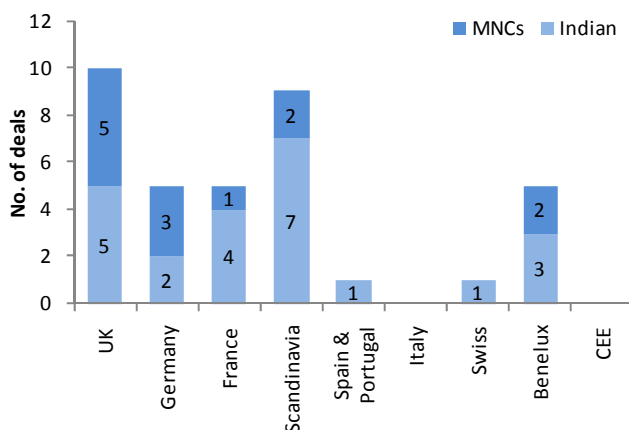
Date	Company	Vertical	Country	New vendors	Type of deal	Services
Recent	Deutsche Telekom AG	Telecom	GERMANY	Capgemini	NEW	BI & analytics
5-May-14	Daimler	Manufacturing	GERMANY	T Systems	RENEWAL	IT outsourcing
24-Mar-14	Peugeot	Manufacturing	FRANCE	IBM	RENEWAL	IT outsourcing
24-Apr-14	CNH Industrial	Manufacturing	UK	IBM	NEW	IMS
1-Mar-14	Scania AB	Manufacturing	SWEDEN	Capgemini	NEW	BPO
31-Jan-14	Lloyds Banking Group PLC	BFSI	UK	Communis	RENEWAL	BPO
10-Apr-14	Lloyds Banking Group PLC	BFSI	UK	Capgemini	NEW	IT outsourcing
22-Oct-14	Deutsche Lufthansa AG	Retail + TTL	GERMANY	IBM	NEW	IMS
13-Feb-14	HEMA	Retail	Netherlands	Capgemini	NEW	IT outsourcing
2-Jul-14	Royal Dutch Shell PLC	E&U	NETHERLANDS	HP	RENEWAL	IT outsourcing
25-Feb-14	Centrica PLC	E&U	UK	Avanade	NEW	IMS
2-Apr-14	FCO	PSU	UK	Capgemini	NEW	Digital
24-Mar-14	Public roads administration	PSU	NORWAY	IBM	NEW	Digital

Source: Companies, PhillipCapital India Research

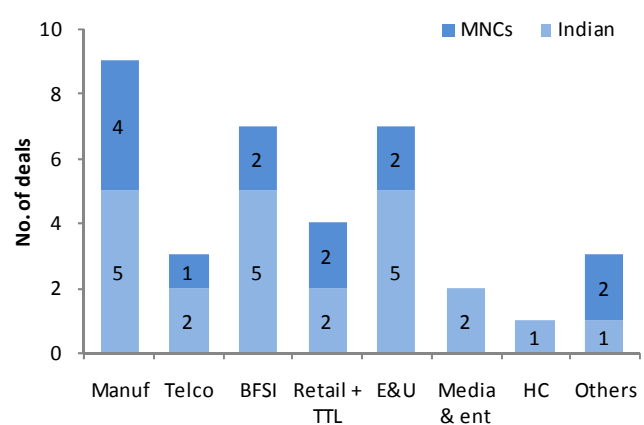
Indian vendors appear to have an upper hand in Scandinavia, Benelux, and France. Almost all Indian vendors have a strong presence in the UK, Scandinavia, and Benelux. Germans still seem to prefer MNC/local vendors.

Indian vendors have outperformed global/local players in almost all verticals, except retail in which they have equal share. Indian vendors have fared exceptionally well in BFSI, E&U, and Media verticals, grabbing over 70% market share.

Indian vs. MNC vendors – by geography



Indian vs. MNC vendors – by vertical

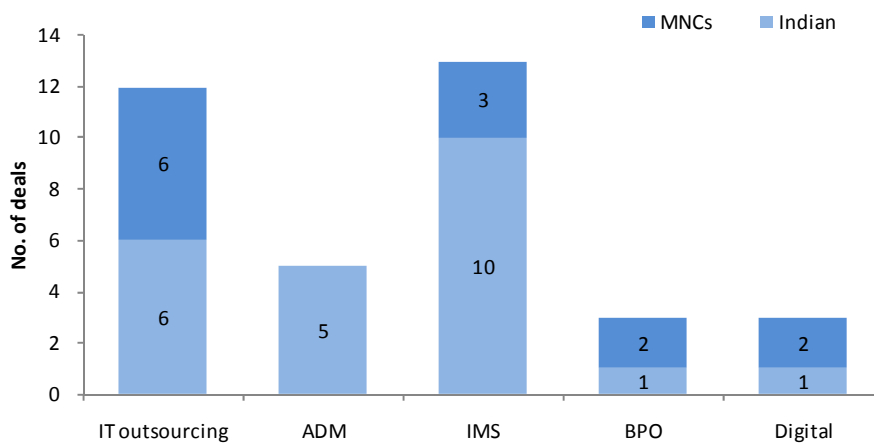


Source: Companies, PhillipCapital India Research

Classification of the deals along service lines demonstrates how Indian vendors have slowly eaten into the territory of the MNCs, especially into IBM's. Indian vendors bagged 10 out of the 13 IMS deals from the region – HCL grabbed 3 while TCS and Wipro grabbed 2 each. This validates our hypothesis that European companies will first try to test outsourcing/offshoring by giving out relatively low-end contracts such as IMS.

While the IMS argument has held true, Indian vendors remained on equal footing in ADM space and managed to grab all-five ADM contracts awarded in the region. MNCs outperformed Indian vendors in the BPO and digital space.

Indian vs. MNC vendors – by services

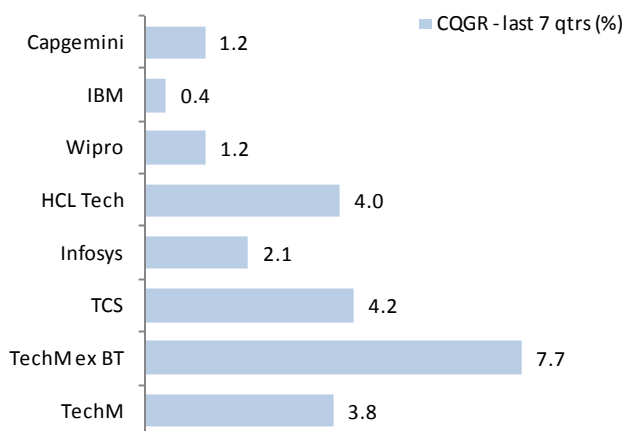


Source: Companies, PhillipCapital India Research

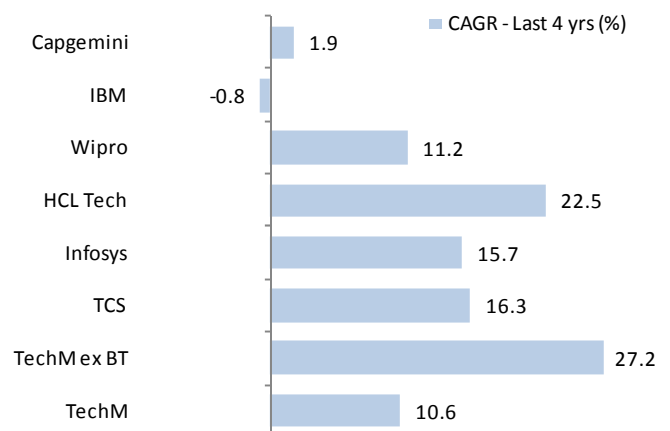
Well depicted in the historical growth

The loss of market share for MNC vendors is evident from their European-region revenue growth. Over the last four quarters, while Indian vendors (Tech Mahindra, TCS, HCL Tech) have grown at a +4% CQGR, IBM and Capgemini have reported muted CQGR of -0.3% and 1.6% respectively. Even over a longer period (last three years), all Indian vendors have grown at a CAGR of +15%, in sharp contrast to the sub-2% growth for IBM and Capgemini.

CQGR of European revenues in the last 7 quarters



CAGR of European revenues in the last 3 years



Source: Companies, PhillipCapital India Research

Indian vendors – Honours shared equally

In terms of deals won by Indian vendors, all top-5 Indian IT vendors performed equally well – grabbing 4 deals each (of the total 23 deals won by Indian vendors). They won most of these deals from the UK (where Indian vendors have historically been strong) and Scandinavia (which is opening up to Indian vendors in a big manner). Deals from German, France, and Spain remained rare.

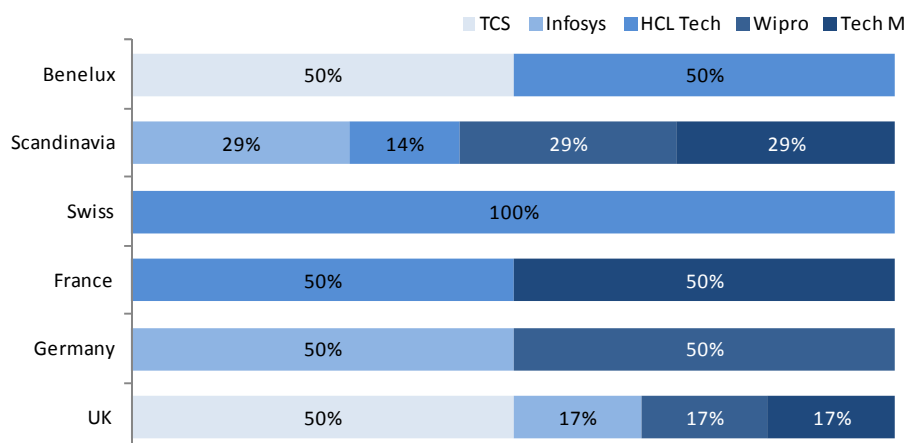
Deal wins by Indian IT firms in Europe over the last 12 months

Date	Company	Vertical	Country	Vendor	Services	Contract
Recent	Telefonica SA	Telco	SPAIN	Cognizant	IMS	NEW
Recent	EADS	Manuf	FRANCE	Cyient	IT outsourcing	Renewal
7-May-14	DNB	FS	Norway	HCL tech	IMS	Renewal
16-May-14	Novartis	HC & LS	Swiss	HCL tech	IMS	Renewal
8-Aug-14	Alcatel Lucent	Telco	France	HCL tech	IT outsourcing	NEW
22-Oct-14	De Beers	Retail	Luxembourg	HCL tech	IMS	NEW
17-Mar-14	Volvo Cars	Manuf	Sweden	Infosys	ADM	NEW
18-Mar-14	Lansforsakringar	FS	Sweden	Infosys	ADM	NEW
22-Jul-14	Daimler AG	Manuf	Germany	Infosys	IMS	NEW
4-Sep-14	BP	E&U	UK	Infosys	ADM	Renewal
19-Aug-14	Vopak	Retail	NETHERLANDS	Ramco Systems	BPO	NEW
7-Mar-14	Thomson Reuters	M & E	UK	TCS	IMS	NEW
25-Mar-14	GDF Suez	E&U	France	TCS	IT outsourcing	NEW
26-Jun-14	REAAL NV	FS	Netherlands	TCS	ADM	NEW
19-Aug-14	Friends Life	FS	UK	TCS	IMS	Renewal
12-Mar-14	Alstom Transport	E&U	France	Tech Mahindra	IT outsourcing	NEW
18-Mar-14	Volvo Cars	Manuf	Sweden	Tech Mahindra	IMS	Extension
29-May-14	Premium Credit	FS	UK	Tech Mahindra	ADM	NEW
23-Sep-14	Ahlstrom	Diversified	Finland	Tech Mahindra	IT outsourcing	NEW
4-Mar-14	Siemens	Manuf	Germany	Wipro	Digital	NEW
16-May-14	XOServe	E&U	UK	Wipro	IMS	NEW
12-Jun-14	Outokumpu	E&U	Finland	Wipro	IT outsourcing	NEW
25-Jun-14	Sanoma	M & E	Finland	Wipro	IMS	NEW

Source: Companies, PhillipCapital India Research

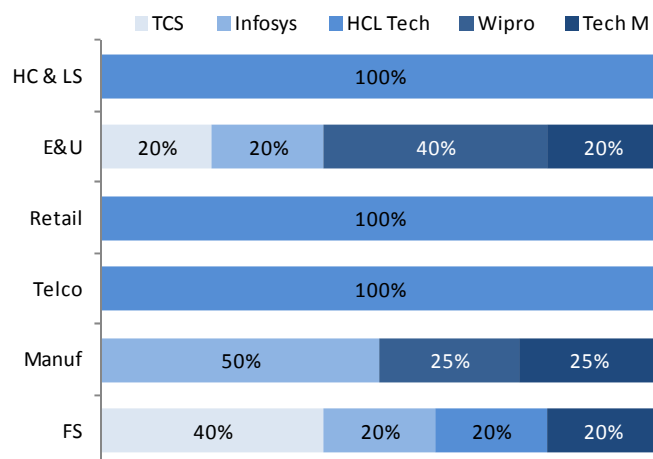
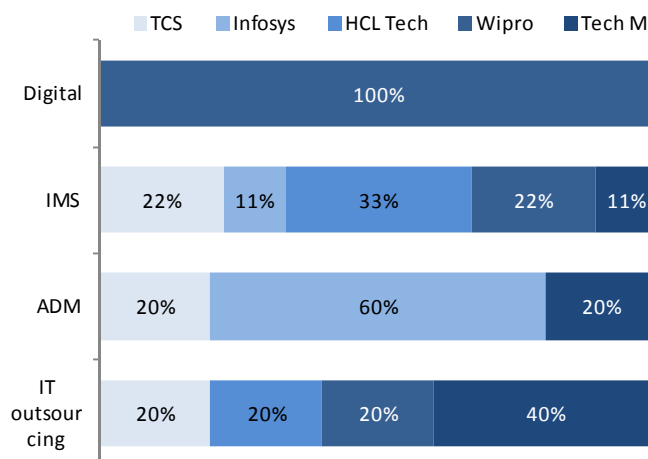
Geographically, almost all vendors got a deal apiece from UK and Scandinavia. While TCS and HCL Tech managed to penetrate France, Infosys and Wipro got lucky in Germany. HCL Tech grabbed the only deal awarded from Switzerland – a traditionally strong region for the company.

Share of deals won from each region over the last 12 months



Source: Companies, PhillipCapital India Research

Almost all vendors got a deal apiece from BFSI and E&U verticals. Deal flow from E&U was a particularly pleasant surprise, as it has traditionally not outsourced much and Indian vendors do not have strong presence in that domain. Retail and telecom awarded only one deal each – grabbed by HCL Tech and Cognizant respectively. Infosys and Wipro wiped out manufacturing space – winning 3 out of 4 deals from the vertical.

Share of deal wins – by verticals

Share of deal wins – by horizontals


Source: Companies, PhillipCapital India Research

Amongst service lines, HCL Tech continued to dominate IMS – winning 3 out of 9 deals awarded. Almost all companies won deals for IMS implementation and almost all fared well in IT outsourcing (ADM + managed services) contracts – with TechM grabbing 2 out of 6. Infosys performed exceptionally well in its stronghold ADM winning 3 out of 5 deals. Wipro captured the only pure-digital contract from Europe.

So overall, almost all Indian vendors fared equally well in capturing deals. This is not entirely in line with our hypothesis, which was that TCS, TechM, and HCL Tech would benefit at the expense of Wipro and Infosys. Wipro, which has been the weakest of players in the region, has seen an exceptionally strong deal flow in the last 12 months, from across the globe including Europe.

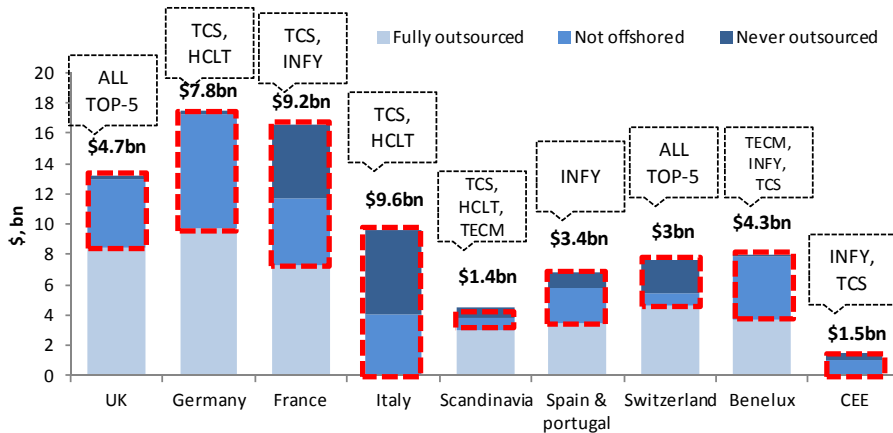
However, as the outsourcing fever catches on, we expect that the relatively stronger presence of TCS in the region will help it to grab a larger share of deals at the expense of others. HCL Tech should benefit from the surge in IMS deals from the region over the next few years. TechM should benefit from its strong presence in retail – a domain which offers one of the biggest IT outsourcing opportunities and where TechM has a strong presence (courtesy Satyam).

A mammoth opportunity beckons

Italy, France, and Germany present the biggest opportunity

In terms of geography, the biggest opportunities lie in Germany and France with a total IT capex outlay of US\$ 17bn. We believe that TCS, HCL Tech, and Infosys should be the largest beneficiaries of this opportunity since they have a strong foothold in these countries. TechM should benefit from opportunities arising out of Benelux and the UK, especially in telecom and manufacturing.

The potential opportunity and its likely beneficiaries – by geography

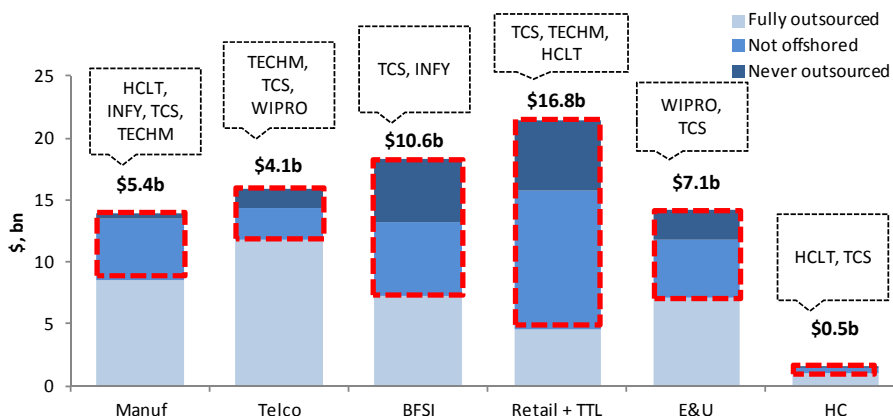


Source: PhillipCapital India Research

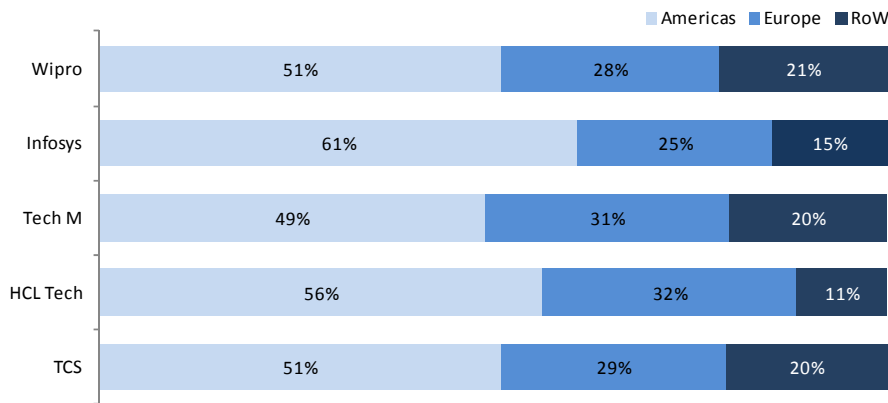
Put together, Retail + TTL and BFSI are bigger than all others are

Manufacturing and retail (including TTL (Travel Transportation and Logistics)) should drive the next wave of growth for IT spends from Europe (IT capex outlay expected at US\$ 16.8bn). TCS, TechM, and HCL Tech should be the major beneficiaries. All companies (except Wipro) are expected to gain from strong IT spends in manufacturing (US\$ 10bn). Wipro should be a major beneficiary of spends from E&U (US\$ 7bn).

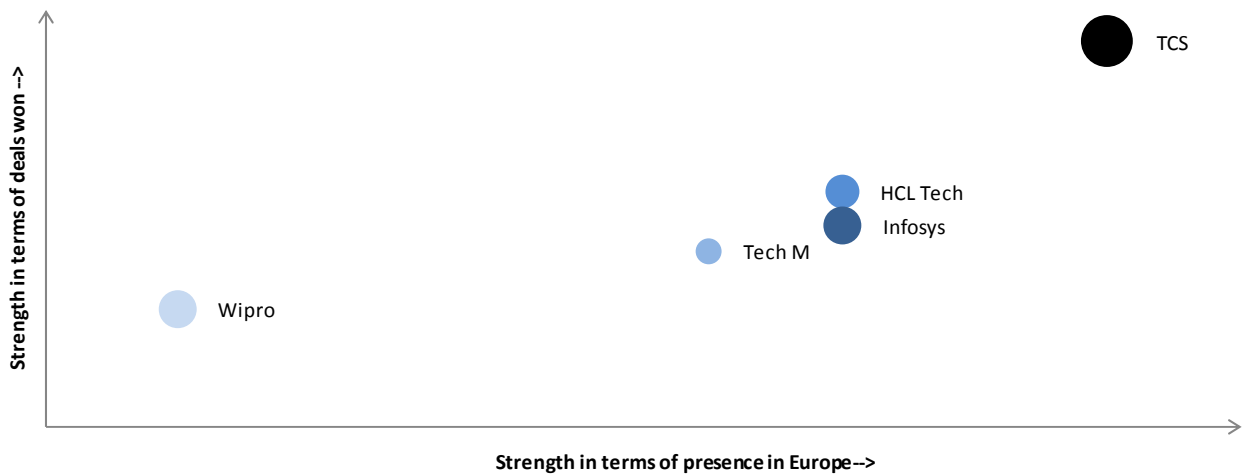
The potential opportunity and its likely beneficiaries – by vertical



Source: PhillipCapital India Research

Europe forms close to third of the revenues for top-5 Indian IT services companies


Source: Companies, PhillipCapital India Research

Relative positioning in the EU region


Source: PhillipCapital India Research

Valuation snapshot

Companies	At CMP	MCAP Rs bn	Revenue Growth			EBITDA Margins			EPS			EPS Growth		
			FY15E	FY16E	FY17E	FY15E	FY16E	FY17E	FY15E	FY16E	FY17E	FY15E	FY16E	FY17E
TCS	2,696	5,281	16.6	16.1	16.1	28.8	28.5	28.1	110	133	155	12.9	20.4	17.0
Infosys	2,265	2,589	7.2	12.1	14.1	27.5	27.2	27.5	106	117	135	13.8	10.3	15.1
Wipro	650	1,605	6.4	9.1	10.7	22.9	22.6	22.3	35	40	44	10.7	13.1	11.3
HCL Tech	1,971	1,392	13.0	14.5	15.2	24.9	24.9	24.7	107	120	137	19.0	12.1	14.2
Tech Mahindra	2,780	660	17.1	27.9	19.7	19.3	19.5	20.3	123	156	195	-3.5	27.1	24.8

Companies	At CMP	MCAP Rs bn	ROE			PE			PB			EV/EBITDA		
			FY15E	FY16E	FY17E	FY15E	FY16E	FY17E	FY15E	FY16E	FY17E	FY15E	FY16E	FY17E
TCS	2,696	5,281	39.1	37.6	35.7	24.5	20.3	17.4	9.6	7.7	6.2	19.1	16.4	14.2
Infosys	2,265	2,589	21.7	21.0	21.1	21.4	19.4	16.8	4.6	4.1	3.6	15.1	13.1	11.1
Wipro	650	1,605	21.3	20.8	20.1	18.5	16.4	14.7	3.9	3.4	3.0	13.5	12.1	10.7
HCL Tech	1,971	1,392	30.6	28.0	26.5	18.4	16.4	14.4	5.6	4.6	3.8	14.1	12.0	10.3
Tech Mahindra	2,780	660	22.8	23.6	23.7	22.6	17.8	14.2	5.2	4.2	3.4	14.6	11.4	8.9

Source: PhillipCapital India Research

Europe – Who's who of the outsourcing opportunity

The who's who of potential targets in each country

UK	Germany	France	Italy	Switzerland
Vodafone Group PLC	Volkswagen AG	Societe Generale SA	<i>Exor SpA</i>	Nestle SA
Lloyds Banking Group PLC	Deutsche Telekom AG	Orange SA	Fiat SpA	<i>Glencore Xstrata PLC</i>
BP PLC	Deutsche Post AG	<i>Christian Dior SA</i>	Telecom Italia SpA	Credit Suisse Group AG
RBS Group PLC	Daimler AG	<i>Louis Vuitton SA</i>	<i>Eni SpA</i>	<i>Cie Financiere Richemont SA</i>
BT Group PLC	Deutsche Lufthansa AG	Total SA	Enel SpA	UBS AG
ICA Group	Siemens AG	L'Oreal SA	UniCredit SpA	ABB Ltd
Kingfisher PLC	BMW AG	<i>Vivendi SA</i>	Luxottica Group SpA	Swisscom AG
Marks & Spencer Group PLC	Allianz SE	BNP Paribas SA	Finmeccanica SpA	<i>Swatch Group AG/The</i>
Barclays PLC	E.ON SE	EADS	Mediaset SpA	Novartis AG
CNH Industrial NV	Henkel AG & Co KGaA	Peugeot SA	Saipem SpA	Roche Holding AG
BHP Billiton PLC	Adidas AG	Renault SA	<i>Snam SpA</i>	<i>Galenica AG</i>
Firstgroup PLC	Continental AG	GDF Suez	Terna Rete Elettrica Nazionale	<i>Actelion Ltd</i>

Spain & Portugal	Scandinavia	Benelux	Central & Eastern Europe
Telefonica SA	Ericsson Telekom	Royal Dutch Shell PLC	Erste Group Bank AG
Banco Santander SA	<i>Hennes & Mauritz AB</i>	Unilever NV	OMV AG
Banco Bilbao Vizcaya Argentaria	Telenor ASA	Delhaize Group SA	OPAP SA
<i>Inditex SA</i>	Statoil ASA	Heineken NV	<i>Telekom Austria AG</i>
Repsol SA	TeliaSonera AB	Koninklijke KPN NV	<i>Hellenic Telecom Organization</i>
Banco Espirito Santo SA	DNB ASA	KBC Groep NV	Vienna Insurance
Portugal Telecom SGPS SA	Volvo AB	ArcelorMittal	<i>Andritz AG</i>
Iberdrola SA	Tele2 AB	Belgacom SA	Voestalpine AG
Endesa SA	Scania AB	ING Groep NV	CEZ AS
<i>Gas Natural SDG SA</i>	Novo Nordisk A/S	<i>SES SA</i>	<i>Komercni Banka AS</i>
<i>Galp Energia SGPS SA</i>	Vestas Wind Systems A/S	Koninklijke Vopak NV	
Grifols SA	<i>Meda AB</i>	UCB SA	

Never Outsourced
Not offshored

The who's who of potential targets in each vertical

Telecom	Manufacturing	BFSI
Deutsche Telekom AG	Volkswagen AG	<i>Exor SpA</i>
Telefonica SA	Daimler AG	Societe Generale SA
Vodafone Group PLC	Fiat SpA	Lloyds Banking Group PLC
Orange SA	Siemens AG	Banco Santander SA
Ericsson	BMW AG	RBS Group PLC
Telecom Italia SpA	EADS	BNP Paribas SA
<i>Vivendi SA</i>	Peugeot SA	Allianz SE
BT Group PLC	Renault SA	Credit Suisse Group AG
Telenor ASA	Continental AG	UniCredit SpA
Koninklijke KPN NV	Volvo AB	UBS AG
TeliaSonera AB	CNH Industrial NV	KBC Groep NV
Swisscom AG	BAE Systems PLC	DNB ASA

Retail, TTL & CPG	E&U	Healthcare & Life Sciences
Deutsche Post AG	Royal Dutch Shell PLC	Novartis AG
<i>Christian Dior SA</i>	BP PLC	Bayer AG
<i>Louis Vuitton SA</i>	<i>Glencore Xstrata PLC</i>	Roche Holding AG
Deutsche Lufthansa AG	Total SA	Sanofi
L'Oreal SA	E.ON SE	GlaxoSmithKline PLC
ICA Group	<i>Eni SpA</i>	Celesio AG
<i>Inditex SA</i>	GDF Suez	AstraZeneca PLC
Henkel AG & Co KGaA	Enel SpA	Novo Nordisk A/S
Nestle SA	Electricite de France	Merck KGaA
Unilever NV	Statoil ASA	Shire PLC
Delhaize Group SA	RWE AG	UCB SA
Heineken NV	BHP Billiton PLC	Grifols SA

Never Outsourced
Not offshored

Source: PhillipCapital India Research

TCS (TCS IN)

Concerns overdone; Stock undervalued

INDIA | IT SERVICES | Company Update

24 February 2015

Burdened with high expectations

TCS's stock has underperformed its peers in recent, particularly post 2Q and 3QFY15 results – primarily on the back of high expectations. The company had missed the consensus revenue estimates by \$25-30mn in the two quarters – forming a miniscule 0.2% of the total \$18bn topline it is expected to achieve in FY15. Notwithstanding the minor blips, we expect the company to report log-term sustainable industry leading growth (organic basis) and the stock to catch up with its peers, in near future.

All-around superior performance to continue

TCS has consistently outperformed all its peers across almost all parameters – it has posted dollar revenue CAGR of 18% over the last 5 years with a 300bps margin expansion. We expect this growth momentum to continue – its well-diversified revenue profile (across verticals, horizontals, and geographies) will help deliver growth that is ahead of peers and the industry average. We also find TCS much ahead in its ability to capitalise on a pick up in discretionary spend in the US and other geographies.

TCS is currently reaping the benefits of the investments it has made over the last 5-7 years. It has consistently been the highest spender on S&M (19% of sales/year) vs. Infosys' and Wipro's 13-14%. It has established significant presence in geographies such as Japan, Australia, Middle East, and Asia-Pacific – regions that can translate into huge opportunity once US and Europe reach significant levels of penetration.

Much ahead of peers in adopting new technology and delivery models

TCS was one of the first few companies to realise the potential of the SMAC domain and has already invested heavily in this segment. Like all Indian IT services companies, it continues to invest in building delivery capabilities in the digital space. It has also been the most active in migrating from linear T&M to non-linear delivery models. While its IMS practice contributes only 15% to its topline, it is bigger than Wipro and HCL Tech.

TCS – Strong presence in Europe

TCS has a much stronger presence in the EU region than most of its peers. Over 29% of its revenues come from here and they have posted a CQGR of 4.2% over the last seven quarters. It remains in a leading position in all big economies (UK, Germany, France, Switzerland) and has also penetrated economies such as Scandinavia, Italy, and Benelux, which are opening up to outsourcing.

Additionally, TCS has surmounted the language barrier issue (that other companies still face) and has a strong presence in countries such as France and Germany. Its acquisition of Alti (a France-based consulting services company) to gain a foothold in the region shows its earnestness in capitalising the EU opportunity.

Valuations appear expensive, but justified

TCS is currently trading at 20x FY16 and 17.5x FY17 earnings. The stock has given handsome returns in CY14 (25%), but has lagged its peers over the last six months (10%) on valuation concerns and scepticism about its ability to meet high expectations. This is highlighted in the sharp correction in its stock price after its 2QFY15 results (where it missed consensus revenue expectations only by US\$ 25-30mn, just 0.2% of its annual revenue).

However, we find these fears overdone and expect the company to continue to meet expectations and outperform the industry and its peers. The stock is a safe haven with the least concerns (vs. peers) about its growth potential or margin profile. We expect robust 20% earnings CAGR over the next three years, significantly outperforming its peers.

We continue to value the stock at 20x FY17 earnings. Our price target of Rs 3,100 represents a 15% upside from current levels. We maintain BUY.

BUY (Maintain)

CMP RS 2696

TARGET RS 3100 (+15%)

COMPANY DATA

O/S SHARES (MN) :	1959
MARKET CAP (RSBN) :	5239
MARKET CAP (USDBN) :	84.2
52 - WK HI/LO (RS) :	2834 / 1970
LIQUIDITY 3M (USDMN) :	51.7
PAR VALUE (RS) :	1

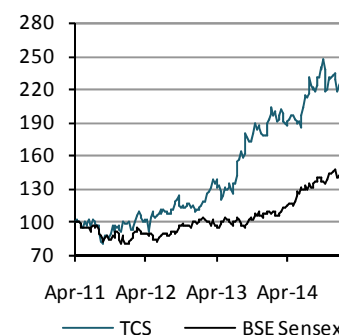
SHARE HOLDING PATTERN, %

PROMOTERS :	73.9
FII / NRI :	16.8
FI / MF :	4.7
NON PROMOTER CORP. HOLDINGS :	0.4
PUBLIC & OTHERS :	4.2

PRICE PERFORMANCE, %

	1MTH	3MTH	1YR
ABS	7.0	2.7	23.9
REL TO BSE	5.5	-1.5	-18.5

PRICE VS. SENSEX



Source: Phillip Capital India Research

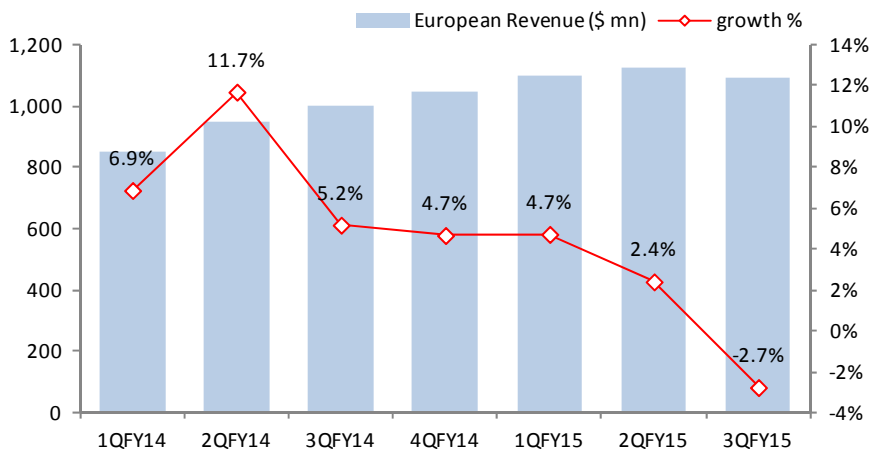
KEY FINANCIALS

Rs mn	FY15E	FY16E	FY17E
Net Sales	959.4	1,128.0	1,310.0
EBIDTA	275.9	321.5	367.7
Net Profit	215.8	259.8	304.0
EPS, Rs	110.2	132.6	155.2
PER, x	24.5	20.3	17.4
EV/EBIDTA, x	19.1	16.4	14.2
P/BV, x	9.6	7.7	6.2
ROE, %	39.1	37.6	35.7

Source: PhillipCapital India Research Est.

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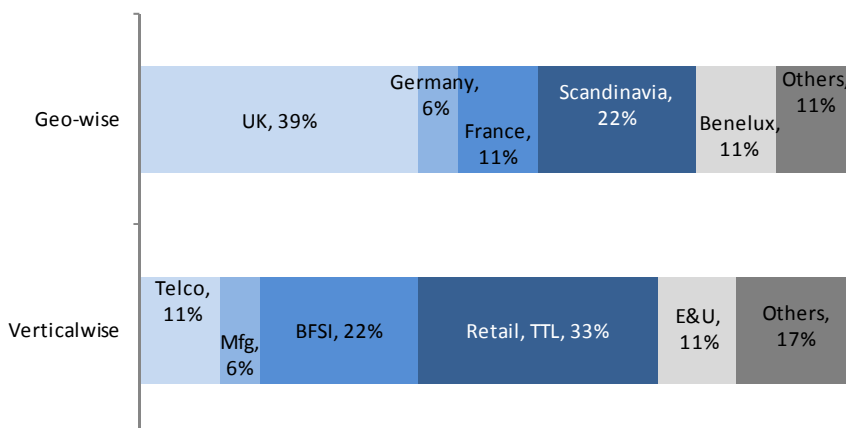
European revenues and qoq growth %


Source: Company, PhillipCapital India Research

Recent deal wins from Europe

Date	Companies	Country	Sector	Major Service opted
19-Aug-14	Friends Life	Britain	BFSI	IT outsourcing
26-Jun-14	REAAL NV	Netherlands	BFSI	ADMS
25-Mar-14	GDF Suez	France	E&U	BPO
07-Mar-14	Thomson Reuters	Britain	BFSI	IMS
20-Feb-14	Diageo	Britain	CPG	IMS
29-Jan-14	TNT Express	Netherlands	TTL	ADMS
12-Dec-13	Improvement Services	Britain	PSU	Front end IT
28-Nov-13	Npower, UK subsidiary of RWE	Britain	E&U	IT outsourcing
26-Nov-13	Keler, Hungarian CSD	Hungary	PSU	PPS
21-Oct-13	Bombardier Transportation	Germany	TTL	IMS
10-Sep-13	Scandinavian Airlines	Scandinavia	TTL	Digital + IMS
3-Sep-13	DNB, Norway	Norway	BFSI	IMS
25-Mar-13	Norway Post	Norway	TTL	Transformational
17-Jan-13	Nokia - partnership	Finland	Telecom	IT outsourcing
13-Dec-12	Mitchell's & Butler's	Britain	CPG	BPO
29-Nov-12	UK Home Office	Britain	PSU	AMS
29-Mar-12	TDC - Danish Telecom	Denmark	Telecom	IT outsourcing
7-Feb-12	Europcar Info Services	France	Manufacturing	IT outsourcing

Source: BSE Archives

Deal win share in Europe – by region and vertical


Source: Company, PhillipCapital India Research

Financials

Income Statement

Y/E Mar, Rs mn	FY14	FY15e	FY16e	FY17e
Net sales	818,094	959,420	1,128,032	1,309,987
Growth, %	29.9	17.3	17.6	16.1
Employee expenses	-422,065	-518,347	-615,722	-720,295
Other Operating expenses	-144,707	-165,123	-190,773	-222,033
EBITDA (Core)	251,322	275,950	321,537	367,659
Growth, %	39.0	9.8	16.5	14.3
Margin, %	30.7	28.8	28.5	28.1
Depreciation	-13,243	-18,376	-19,201	-21,434
EBIT	238,079	257,573	302,336	346,225
Growth, %	40.0	8.2	17.4	14.5
Margin, %	29.1	26.8	26.8	26.4
Interest paid	0	0	0	0
Other Non-Operating Income	15,809	27,406	38,405	52,095
Pre-tax profit	253,888	284,798	340,739	398,318
Tax provided	-60,712	-66,663	-78,370	-91,613
Profit after tax	193,176	218,135	262,369	306,705
Others (Minorities, Associates)	-2,089	-2,367	-2,568	-2,696
Net Profit	191,087	215,768	259,801	304,009
Growth, %	37.1	12.9	20.4	17.0
Net Profit (adjusted)	191,087	215,768	259,801	304,009
Wtd avg shares (m)	1,959	1,959	1,959	1,959

	FY14	FY15e	FY16e	FY17e
US\$ Revenue (US\$ mn)	13,443	15,669	18,194	21,129
Growth, %	16.2	16.6	16.1	16.1
Re / US\$ (rate)	60.9	61.2	62.0	62.0

Balance Sheet

Y/E Mar, Rs mn	FY14	FY15e	FY16e	FY17e
Cash & bank	14,688	9,158	23,427	64,067
Marketable securities at cost	0	0	0	0
Debtors	182,304	209,699	246,793	285,443
Inventory	0	0	0	0
Other current assets	221,122	248,842	301,997	349,292
Total current assets	418,114	467,699	572,217	698,802
Investments	34,489	6,847	29,347	59,347
Net fixed assets	236,522	246,356	286,363	327,689
Non-current assets	0	0	0	0
Total assets	689,125	720,903	887,927	1,085,837
Total current liabilities	110,751	137,515	161,051	190,906
Non-current liabilities	18,117	21,821	24,523	28,142
Total liabilities	128,868	159,335	185,573	219,048
Paid-up capital	1,957	1,957	1,957	1,957
Reserves & surplus	551,395	550,016	688,235	849,974
Minorities	6,905	9,594	12,162	14,858
Shareholders' equity	560,257	561,567	702,354	866,790
Total equity & liabilities	689,125	720,903	887,927	1,085,837

Source: Company, PhillipCapital India Research Estimates

Cash Flow

	FY14	FY15e	FY16e	FY17e
Pre-tax profit	253,888	284,798	340,739	398,318
Depreciation	13,243	18,376	19,201	21,434
Chg in working capital	-91,200	-24,785	-64,011	-52,470
Total tax paid	-60,712	-66,663	-78,370	-91,613
Other operating activities	0	0	0	0
Cash flow from operating activities	115,219	211,726	217,559	275,669
Capital expenditure	-54,800	-28,211	-59,208	-62,760
Chg in investments	-14,086	27,642	-22,500	-30,000
Chg in marketable securities	0	0	0	0
Other investing activities	0	0	0	0
Cash flow from investing activities	-68,886	-569	-81,708	-92,760
Free cash flow	60,419	183,516	158,351	212,910
Equity raised/(repaid)	0	0	0	0
Debt raised/(repaid)	-1,037	137	0	0
Dividend (incl. tax)	-73,328	-183,334	-121,582	-142,270
Other financing activities	26,033	-33,813	0	0
Cash flow from financing activities	-50,077	-216,688	-121,582	-142,270
Net chg in cash	-3,744	-5,530	14,269	40,640

Valuation Ratios

	FY14	FY15e	FY16e	FY17e
Per Share data				
EPS (INR)	97.6	110.2	132.6	155.2
Growth, %	37.0	12.9	20.4	17.0
Book NAV/share (INR)	282.5	281.8	352.4	434.9
CFPS (INR)	50.8	94.1	91.5	114.1
DPS (INR)	32.0	80.0	53.1	62.1
Return ratios				
Return on assets (%)	31.9	30.9	32.6	31.1
Return on equity (%)	34.5	39.1	37.6	35.7
Return on capital employed (%)	38.2	37.6	40.0	37.8
Turnover ratios				
Asset turnover (x)	1.8	1.8	1.9	1.9
Sales/Total assets (x)	1.4	1.4	1.4	1.3
Sales/Net FA (x)	3.8	4.0	4.2	4.3
Working capital/Sales (x)	0.4	0.3	0.3	0.3
Receivable days	81.3	79.8	79.9	79.5
Liquidity ratios				
Current ratio (x)	3.8	3.4	3.6	3.7
Quick ratio (x)	3.8	3.4	3.6	3.7
Dividend cover (x)	3.0	1.4	2.5	2.5
Total debt/Equity (%)	0.2	0.3	0.2	0.2
Net debt/Equity (%)	(2.4)	(1.4)	(3.2)	(7.4)
Valuation				
PER (x)	27.6	24.5	20.3	17.4
PEG (x) - y-o-y growth	0.7	1.9	1.0	1.0
Price/Book (x)	9.5	9.6	7.7	6.2
Yield (%)	1.2	3.0	2.0	2.3
EV/Net sales (x)	6.4	5.5	4.7	4.0
EV/EBITDA (x)	21.0	19.1	16.4	14.2
EV/EBIT (x)	22.1	20.5	17.4	15.1

Infosys (INFOIN)

Attempting a DNA change

INDIA | IT SERVICES | Company Update

24 February 2015

Attempting a mammoth transformation

The newly appointed CEO of Infosys, Dr Vishal Sikka, is trying to implement a mammoth transformation in the company. He has laid down a strategy with artificial intelligence, automation, and design thinking as the corner stones. With this strategy, Infosys intends to increase its partnership with clients at strategic level.

We see this strategy as a huge 'vector transformation' for the company – changing the direction of its business, with a high magnitude. It involves a complete DNA alteration for the workforce – where the management wants its employees to migrate from low-end mundane work to high-end design work. While this might appear to be the right strategy, we remain sceptical of its implementation.

We fear that a transformation of this magnitude is extremely difficult to implement in a company as large as Infosys with over 150,000 employees. It would involve huge investments (in terms of time, effort, and money), and a complete change in the mind-set of a large part of its workforce. While on one end, it runs the risk of ignoring its existing bread-butter business (IT outsourcing) – on the other hand, it could potentially alienate large section of its workforce, leading to workforce integration issues.

In addition, by the management's own admission, the strategy will only yield back-ended results, which will be insignificant to begin with. While clients might start to appreciate Infosys' involvement in strategic business decisions, deals or projects with that scope of work will take lot longer to accrue. In this period (near to medium term), we believe it will continue to underperform its peers.

Time is a luxury Infosys does not have

The biggest risk that we see with strategy is what happened with Infosys 3.0. In its attempt to focus on strategic partnerships with clients, it runs the risk of ignoring the loss of market share in its traditional business of IT outsourcing. Competitors (TCS, HCL Tech, Tech Mahindra) are highly aggressive companies and Infosys needs 2x their speed/aggression to regain lost market share from them.

While the management has taken steps (higher incentives and performance-linked bonuses for its sales and marketing team), we believe more needs to be done to address its slide in deal wins. It has historically been the lowest spender on S&M (13% vs. 19% of revenues for TCS) amongst the top-4. Correcting this might lead to better deal wins over the long term, but will also dilute margins in near to medium-term.

Decent presence in the EU, especially in some underpenetrated regions

Infosys has a decent presence in the EU (though inferior to TCS and HCL Tech). The region currently accounts for 25% of its revenues, with a CQGR of 2.1% over the last seven quarters. While it remains strong in the UK, France, and Switzerland, it has also made better inroads in relatively underpenetrated regions such as Spain, Benelux, and CEE.

Risk-reward profile looks unfavourable; recommend NEUTRAL

We remain negative on the stock and believe the company will continue to underperform its peers in the near to medium term. The dealflow, as reported by the company, has also been dismal. The company has reported total large dealwins of \$1.5bn in 9M FY15 – as compared to \$2.2bn in FY14. The necessary impetus for a higher growth in FY16 clearly seems to be missing.

Infosys currently trades at 19.5x FY16 and 17x FY17 earnings – too high a multiple in our opinion, considering the risk to future earnings and the inadequate gap in valuation versus TCS (17.5x FY17 for TCS). We continue to value the company at 15x FY17 earnings (5% discount to HCL Tech). Our price target of Rs 2,000 represents 12% downside from current levels. We maintain NEUTRAL.

NEUTRAL (Maintain)

CMP RS 2265

TARGET RS 2000 (-12%)

COMPANY DATA

O/S SHARES (MN) :	1148
MARKET CAP (RSBN) :	2623
MARKET CAP (USDBN) :	42.2
52 - WK HI/LO (RS) :	2335 / 1447
LIQUIDITY 3M (USDMMN) :	115
PAR VALUE (RS) :	5

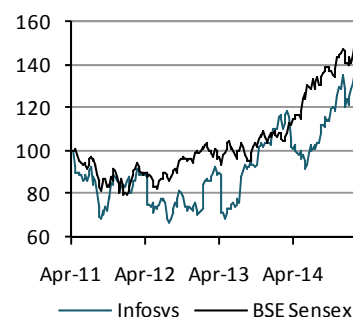
SHARE HOLDING PATTERN, %

PROMOTERS :	13.1
FII / NRI :	60.3
FI / MF :	15.3
NON PROMOTER CORP. HOLDINGS :	0.9
PUBLIC & OTHERS :	10.5

PRICE PERFORMANCE, %

	1MTH	3MTH	1YR
ABS	7.6	8.2	23.0
REL TO BSE	6.1	4.1	-19.3

PRICE VS. SENSEX



Source: Phillip Capital India Research

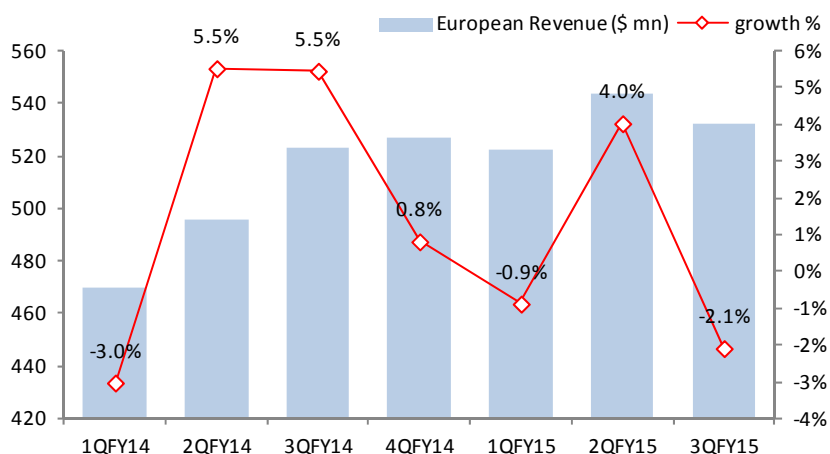
KEY FINANCIALS

Rs mn	FY15E	FY16E	FY17E
Net Sales	540.8	614.6	701.2
EBIDTA	148.8	166.9	192.7
Net Profit	119.4	133.8	154.0
EPS, Rs	104.4	117.0	134.7
PER, x	21.7	19.4	16.8
EV/EBIDTA, x	15.1	13.1	11.1
P/BV, x	4.6	4.1	3.6
ROE, %	21.4	21.0	21.1

Source: PhillipCapital India Research Est.

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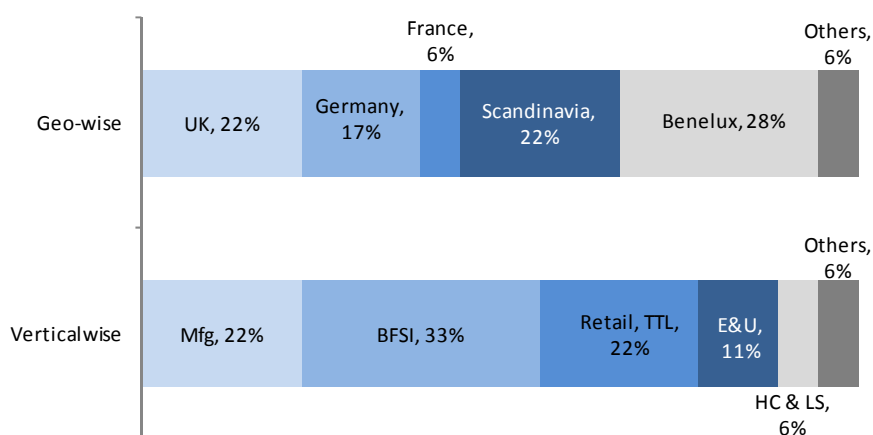
European revenues and qoq growth %


Source: Company, PhillipCapital India Research

Recent deal wins from Europe

Date	Companies	Country	Sector	Major Service opted
18-Feb-15	ABN AMRO	Netherlands	BFSI	ADM
11-Feb-15	IGA Gruppen	Sweden	Retail	ADM, IMS
04-Sep-14	BP	Britain	E&U	ADM
22-Jul-14	Daimler AG	Germany	Manufacturing	IMS
18-Mar-14	Lansforsakringar	Sweden	BFSI	ADM
17-Mar-14	Volvo Cars	Sweden	Manufacturing	ADM
13-Feb-14	Royal Philips Electronics	Netherlands	Manufacturing	BPO
28-Jan-14	TNT express	Netherlands	TTL	ADM
30-Sep-13	RBS	Britain	BFSI	Transformational
12-Sep-13	Akzo Nobel	Netherlands	Retail	Transformational
16-Apr-13	Queens University, Belfast	Britain	PSU	BPO
2-Apr-13	RWE Supply	Germany	E&U	Transformational
14-Mar-13	BMW	Germany	Manufacturing	IMS + BI
7-Mar-13	Accor	France	Retail	PPS
16-Oct-12	Nykredit Bank, Denmark	Denmark	BFSI	PPS
26-Jun-12	Zuno Bank	Austria	BFSI	PPS
22-Mar-12	ING Belgium	Belgium	BFSI	PPS
13-Mar-12	GlaxoSmithKline(GSK)	Britain	HC & LS	IT outsourcing

Source: BSE Archives

Deal win share in Europe – by region and vertical


Source: Company, PhillipCapital India Research

Financials

Income Statement

Y/E Mar, Rs mn	FY14	FY15e	FY16e	FY17e
Net sales	501,330	540,838	614,565	701,205
Growth, %	24	7.9	13.6	14.1
Employee expenses	-307,670	-326,733	-372,980	-423,699
Other Operating expenses	-59,510	-65,267	-74,659	-84,846
EBITDA (Core)	134,150	148,838	166,926	192,659
Growth, %	16.1	10.9	12.2	15.4
Margin, %	26.8	27.5	27.2	27.5
Depreciation	-13,740	-10,876	-13,278	-14,361
EBIT	120,410	137,961	153,647	178,298
Growth, %	15.5	14.6	11.4	16.0
Margin, %	24.0	25.5	25.0	25.4
Forex gains/losses	2,300	2,079	0	0
Other Non-Operating Income	24,390	28,976	34,715	38,557
Pre-tax profit	147,100	169,016	188,363	216,855
Tax provided	-40,620	-49,651	-54,608	-62,868
Profit after tax	106,480	119,365	133,755	153,987
Others (Minorities, Associates)	0	0	0	0
Net Profit	106,480	119,365	133,755	153,987
Growth, %	13.0	12.1	12.1	15.1
Net Profit (adjusted)	106,480	119,365	133,755	153,987
Wtd avg shares (m)	1,143	1,143	1,143	1,143

	FY14	FY15e	FY16e	FY17e
US\$ Revenue (US\$ mn)	8,249	8,846	9,912	11,310
Growth, %	11.5	7.2	12.1	14.1
Re / US\$ (rate)	60.8	61.1	62.0	62.0

Balance Sheet

Y/E Mar, Rs mn	FY14	FY15e	FY16e	FY17e
Cash & bank	290,060	345,085	394,617	455,754
Marketable securities at cost	0	0	0	0
Debtors	83,510	100,817	116,178	134,478
Inventory	0	0	0	0
Loans & advances	56,620	65,352	77,531	89,774
Total current assets	430,190	511,253	588,326	680,005
Investments	29,940	38,680	46,180	53,680
Net fixed assets	103,860	117,554	128,275	137,914
Non-current assets	0	0	0	0
Total assets	566,680	669,677	764,972	873,789
Total current liabilities	91,380	110,706	127,016	144,901
Non-current liabilities	0	0	0	0
Total liabilities	91,380	110,706	127,016	144,901
Paid-up capital	2,860	2,860	2,860	2,860
Reserves & surplus	472,440	556,110	635,096	726,029
Minorities	0	0	0	0
Shareholders' equity	475,300	558,970	637,956	728,889
Total equity & liabilities	566,680	669,677	764,972	873,789

Source: Company, PhillipCapital India Research Estimates

Cash Flow

	FY14	FY15e	FY16e	FY17e
Pre-tax profit	147,100	169,016	188,363	216,855
Depreciation	13,740	10,876	13,278	14,361
Chg in working capital	5,810	-6,712	-11,231	-12,658
Total tax paid	-40,960	-49,151	-54,608	-62,868
Other operating activities	0	0	0	0
Cash flow from operating activities	125,690	124,029	135,802	155,690
Capital expenditure	-29,480	-24,570	-24,000	-24,000
Chg in investments	-12,710	-8,740	-7,500	-7,500
Chg in marketable securities	0	0	0	0
Other investing activities	0	0	0	0
Cash flow from investing activities	-42,190	-33,310	-31,500	-31,500
Free cash flow	96,210	99,459	111,802	131,690
Equity raised/(repaid)	0	0	0	0
Debt raised/(repaid)	0	0	0	0
Dividend (incl. tax)	-84,236	-50,524	-54,769	-63,054
Other financing activities	55,086	14,829	0	0
Cash flow from financing activities	-29,150	-35,695	-54,769	-63,054
Net chg in cash	54,350	55,025	49,532	61,137

Valuation Ratios

	FY14	FY15e	FY16e	FY17e
Per Share data				
EPS (INR)	93.2	104.4	117.0	134.7
Growth, %	13.0	12.1	12.1	15.1
Book NAV/share (INR)	415.9	489.1	558.2	637.8
CFPS (INR)	88.6	83.2	88.5	102.5
DPS (INR)	63.0	37.8	41.0	47.2
Return ratios				
Return on assets (%)	20.7	19.3	18.6	18.8
Return on equity (%)	22.4	21.4	21.0	21.1
Return on capital employed (%)	24.4	23.1	22.3	22.5
Turnover ratios				
Asset turnover (x)	3.4	3.3	3.3	3.4
Sales/Total assets (x)	1.0	0.9	0.9	0.9
Sales/Net FA (x)	5.2	4.9	5.0	5.3
Working capital/Sales (x)	0.1	0.1	0.1	0.1
Receivable days	60.8	68.0	69.0	70.0
Liquidity ratios				
Current ratio (x)	4.7	4.6	4.6	4.7
Quick ratio (x)	4.7	4.6	4.6	4.7
Dividend cover (x)	1.5	2.8	2.9	2.9
Net debt/Equity (%)	(61.0)	(61.7)	(61.9)	(62.5)
Valuation				
PER (x)	24.3	21.7	19.4	16.8
PEG (x) - y-o-y growth	1.9	1.8	1.6	1.1
Price/Book (x)	5.4	4.6	4.1	3.6
Yield (%)	2.8	1.7	1.8	2.1
EV/Net sales (x)	4.6	4.1	3.6	3.0
EV/EBITDA (x)	17.1	15.1	13.1	11.1
EV/EBIT (x)	19.1	16.3	14.3	12.0

HCL Tech (HCLT IN)

Clears litmus test – Not acidic anymore!

INDIA | IT SERVICES | Company Update

24 February 2015

Delivering robust performance, consistently

HCL Tech's stellar performance in Dec-14 quarter amounts to it passing the litmus test, in our opinion. For long the stock had remained undervalued, inspite of consistence performance both on growth and margins front. But in Dec-14 quarter, a seasonally weak quarter marred with huge cross currency impact, the company delivered broad-based 4.0% QoQ growth (6.2% in CC terms) – far ahead of TCS, Infosys and Wipro. We expect various concerns with the company to gradually fade away now, leading to significant rerating and outperformance by the stock.

IMS continues to deliver for the company; concerns overdone

The key driver behind HCL's strong growth has been its superior performance in the IMS space. The company has captured a large market share in the domain, even from strong contenders such as IBM. Its IMS division has seen a CQGR of 6.3% over the last seven quarters and accounts for 52% of its incremental revenues.

We find the concerns about HCL's lopsided growth (driven only by IMS) largely overdone. During times when discretionary spend has been dismal, IMS has enabled the company to get multiple new clients. Its bundling of other services along with IMS has led to deeper client penetration and significant margin expansion. Its enterprise software business, too, has picked up in the last three quarters (reporting 3% CQGR) and is likely to hold the company in good stead, if and when discretionary spend revives.

Margin guidance over the next two years limits the rerating potential

HCL Tech's management has guided a 300-400bps decline in operating margins over the next two years on the back of investment in building delivery capabilities in the digital space. We believe all companies will be investing heavily in delivery and S&M in the digital space. However, their margin contraction might not be as high as HCL Tech's – this limits the upside potential of the stock to some extent.

Significant presence in Europe, second only to TCS

HCL has a much stronger presence in the EU region than most of its peers (inferior only to TCS). Over 31% of its revenues come from this geography, posting a CQGR of 4% over the last seven quarters. It is in a strong position in the UK, Germany, Scandinavia, and Switzerland, but it is yet to win a large deal in Spain, Benelux, and CEE.

HCL Tech has benefitted immensely from its expertise in IMS. It has been able to beat the likes of IBM and Accenture in IMS contracts from EU and we expect it to expand its offerings by bundling its enterprise services with IMS. Its expertise in the IMS domain means it will be the biggest beneficiary, if our hypothesis – that first-time outsourcers from Europe will try to test waters by outsourcing low-end work like IMS – plays out.

Valuation gap not justified in our opinion; recommend BUY

HCL currently trades at 16.5x FY16 and 14.5x FY17 earnings – at a significant discount to TCS and Infosys. While its discount to TCS is justified, we believe it has delivered significantly better results than Infosys (growth and margins) and warrants an equal multiple, if not higher. Over the last twelve quarters, it has delivered robust topline growth (3.5% CQGR) and 1000bps margin expansion (from 16.5% in FY11 to 26% in FY14). Its operating margins are now at 26% (same as Infosys') – it has bridged a gap of 1100bps in the last 11 quarters. Its return ratios are also far superior to all peers (except TCS).

We expect a significant rerating of the stock on the back of robust revenue growth driven by its dominant position in IMS and strong presence in the EU region. We upgrade our valuation for the stock to 16x FY17 earnings (5% premium to Infosys, earlier 15x). Our price target of Rs 2,200 represents 12% upside from current levels. We maintain BUY.

BUY (Maintain)

CMP RS 1971

TARGET RS 2200 (+12%)

COMPANY DATA

O/S SHARES (MN) :	703
MARKET CAP (RSBN) :	1405
MARKET CAP (USDBN) :	22.6
52 - WK HI/LO (RS) :	2057 / 1247
LIQUIDITY 3M (USDMMN) :	30.1
PAR VALUE (RS) :	2

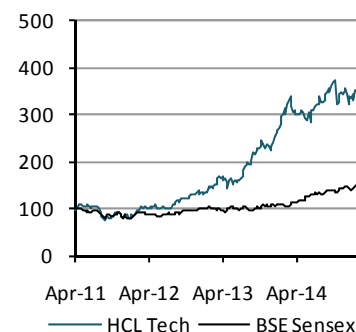
SHARE HOLDING PATTERN, %

PROMOTERS :	61.4
FII / NRI :	29.8
FI / MF :	3.7
NON PROMOTER CORP. HOLDINGS :	2.2
PUBLIC & OTHERS :	2.9

PRICE PERFORMANCE, %

	1MTH	3MTH	1YR
ABS	19.7	21.4	36.8
REL TO BSE	18.1	17.2	-5.5

PRICE VS. SENSEX



Source: Phillip Capital India Research

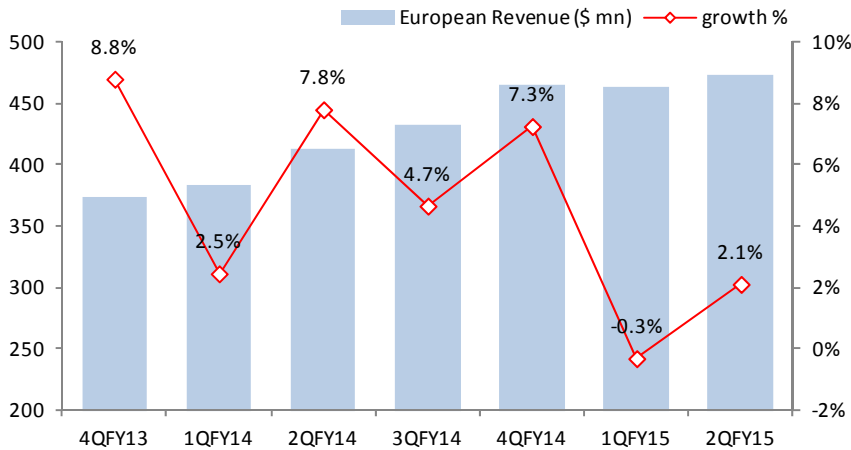
KEY FINANCIALS

Rs mn	FY15E	FY16E	FY17E
Net Sales	374.3	429.8	495.0
EBIDTA	93.1	107.0	122.0
Net Profit	75.7	84.8	96.9
EPS, Rs	107.2	120.1	137.2
PER, x	18.4	16.4	14.4
EV/EBIDTA, x	13.8	11.7	10.0
P/BV, x	5.6	4.6	3.8
ROE, %	30.6	28.0	26.5

Source: PhillipCapital India Research Est.

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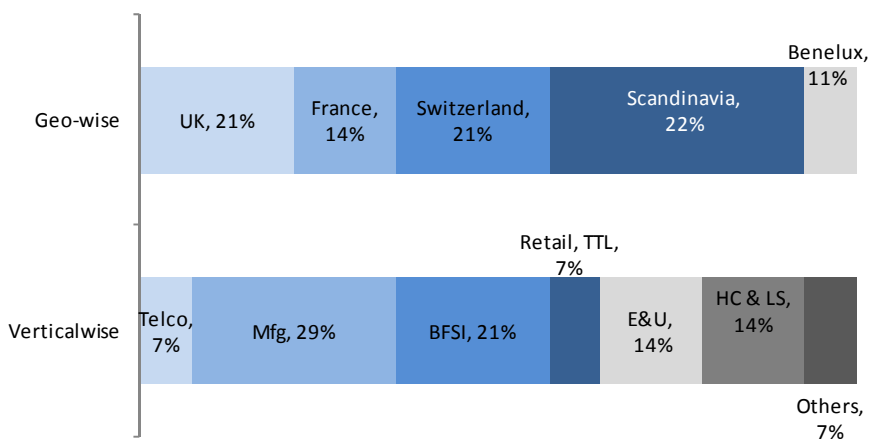
European revenues and qoq growth %


Source: Company, PhillipCapital India Research

Recent deal wins from Europe

Date	Companies	Country	Sector	Major Service opted
22-Oct-14	De Beers	Luxembourg	Retail	IMS
08-Aug-14	Alcatel Lucent	France	Telecom	ER&D
16-May-14	Novartis	Swiss	HC & LS	IMS
07-May-14	DNB	Norway	BFSI	IT outsourcing
31-Dec-13	Student Loan Co	Britain	PSU	IT outsourcing
26-Nov-13	DNB	Norway	BFSI	IT outsourcing
10-Sep-13	Anglo American PLC	Britain	E&U	IMS
24-Jun-13	Vestas Wind Systems	Denmark	Manufacturing	ADM
16-May-13	Husqvarna Group	Sweden	Manufacturing	IMS
11-Feb-13	Saint Gobain	France	Manufacturing	IMS
30-Jan-13	Cobham PLC	Britain	Manufacturing	IT outsourcing
14-Mar-12	UBS	Swiss	BFSI	Transformational
13-Feb-12	Statoil	Norway	E&U	IMS
15-Jan-12	Novartis	Swiss	HC & LS	IMS

Source: BSE Archives

Deal win share in Europe – by region and vertical


Source: Company, PhillipCapital India Research

Financials

Income Statement

Y/E Mar, Rs mn	FY14	FY15e	FY16e	FY17e
Net sales	329,180	374,283	429,792	494,954
Growth, %	28	14	15	15
Employee expenses	-202,170	-235,569	-271,956	-312,432
Other Operating expenses	-40,350	-45,607	-50,796	-60,505
EBITDA (Core)	86,660	93,108	107,040	122,016
Growth, %	50.6	7.4	15.0	14.0
Margin, %	26.3	24.9	24.9	24.7
Depreciation	-7,320	-4,757	-5,680	-6,328
EBIT	79,340	88,352	101,361	115,688
Growth, %	56.2	11.4	14.7	14.1
Margin, %	24.1	23.6	23.6	23.4
Other Non-Operating Income	5,730	8,223	6,708	7,809
Forex Gains\ (Losses)	-5,890	-267	0	0
Pre-tax profit	79,180	96,307	108,069	123,497
Tax provided	-15,480	-20,635	-23,235	-26,552
Profit after tax	63,700	75,672	84,834	96,945
Others (Minorities, Associates)	0	0	0	0
Net Profit	63,700	75,672	84,834	96,945
Growth, %	58.7	18.8	12.1	14.3
Net Profit (adjusted)	63,700	75,672	84,834	96,945
Wtd avg shares (m)	707	706	706	706

	FY14	FY15e	FY16e	FY17e
US\$ Revenue (US\$ mn)	5,360	6,055	6,932	7,983
Growth, %	14.4	13.0	14.5	15.2
Re / US\$ (rate)	61.4	61.8	62.0	62.0

Balance Sheet

Y/E Mar, Rs mn	FY14	FY15e	FY16e	FY17e
Cash & bank	10,206	15,819	25,241	31,938
Marketable securities at cost	89,792	104,590	124,590	156,590
Debtors	77,086	92,289	107,154	123,399
Inventory	0	0	0	0
Other current assets	21,245	25,666	30,556	35,863
Total current assets	198,329	238,364	287,541	347,790
Investments	156	120	1,120	1,620
Net fixed assets	106,419	120,801	136,837	153,897
Non-current assets	0	0	0	0
Total assets	304,904	359,285	425,498	503,307
Total current liabilities	81,966	94,873	108,037	124,117
Non-current liabilities	22,124	16,814	14,814	13,640
Total liabilities	104,090	111,687	122,852	137,757
Paid-up capital	1,341	1,341	1,341	1,341
Reserves & surplus	199,474	246,257	301,305	364,210
Minorities	0	0	0	0
Shareholders' equity	200,814	247,598	302,646	365,550
Total equity & liabilities	304,904	359,285	425,498	503,307

Source: Company, PhillipCapital India Research Estimates

Cash Flow

	FY14	FY15e	FY16e	FY17e
Pre-tax profit	79,180	96,307	108,069	123,497
Depreciation	7,320	4,757	5,680	6,328
Chg in working capital	-950	-6,717	-6,590	-5,473
Total tax paid	-15,480	-20,635	-23,235	-26,552
Other operating activities	0	0	0	0
Cash flow from operating activities	70,070	73,711	83,923	97,800
Capital expenditure	-14,485	-19,139	-21,715	-23,389
Chg in investments	421	36	-1,000	-500
Chg in marketable securities	-47,301	-14,798	-20,000	-32,000
Other investing activities	0	0	0	0
Cash flow from investing activities	-61,365	-33,901	-42,715	-55,889
Free cash flow	55,585	54,572	62,208	74,412
Equity raised/(repaid)	0	0	0	0
Debt raised/(repaid)	13	-5,310	-2,000	-1,174
Dividend (incl. tax)	-17,996	-26,565	-29,786	-34,041
Other financing activities	12,163	-2,323	0	0
Cash flow from financing activities	-5,820	-34,198	-31,786	-35,215
Net chg in cash	2,885	5,613	9,422	6,697

Valuation Ratios

	FY14	FY15e	FY16e	FY17e
Per Share data				
EPS (INR)	90.1	107.2	120.1	137.2
Growth, %	58.4	18.9	12.1	14.2
Book NAV/share (INR)	284.2	350.8	428.6	517.5
CFPS (INR)	91.0	92.8	109.4	127.4
DPS (INR)	21.8	32.2	36.1	41.2
Return ratios				
Return on assets (%)	23.8	22.8	21.6	20.9
Return on equity (%)	31.7	30.6	28.0	26.5
Return on capital employed (%)	32.8	31.1	29.2	27.8
Turnover ratios				
Asset turnover (x)	2.8	2.8	2.8	2.8
Sales/Total assets (x)	1.2	1.1	1.1	1.1
Sales/Net FA (x)	3.2	3.3	3.3	3.4
Working capital/Sales (x)	0.0	0.1	0.1	0.1
Receivable days	85.5	90.0	91.0	91.0
Liquidity ratios				
Current ratio (x)	2.4	2.5	2.7	2.8
Quick ratio (x)	2.4	2.5	2.7	2.8
Dividend cover (x)	4.1	3.3	3.3	3.3
Total debt/Equity (%)	11.0	6.8	4.9	3.7
Net debt/Equity (%)	5.9	0.4	(3.4)	(5.0)
Valuation				
PER (x)	21.9	18.4	16.4	14.4
PEG (x) - y-o-y growth	0.4	1.0	1.4	1.0
Price/Book (x)	6.9	5.6	4.6	3.8
Yield (%)	1.1	1.6	1.8	2.1
EV/Net sales (x)	4.0	3.4	2.9	2.5
EV/EBITDA (x)	15.2	13.8	11.7	10.0
EV/EBIT (x)	16.6	14.6	12.4	10.5

Wipro (WPRO IN)

Out of the woods?

INDIA | IT SERVICES | Company Update

24 February 2015

Strongest ever deal flow in the first nine months

Wipro has announced a historically large number of deal wins in the first nine months of FY15. The total TCW of the large deals announced, including the ATCO acquisition, is close to US\$ 3bn. To put this number into perspective, it had won large deals worth a TCW of US\$ 1.2bn and US\$ 1.6bn in FY13 and FY14 respectively.

Also, an analysis of the deal wins reveals, that the company has captured deals from across the globe – US, EU, Japan, Australia, Middle East, and India. Almost all deals are in upcoming verticals such as healthcare, CPG, media, and E&U – none in the traditional BFSI and manufacturing space; 5 deals are in transformational and digital services spaces.

Muted guidance remains a concern

The robust deal flow leads us to believe that it might be turning the corner and should be able to catch up with the industry growth rate over the next few quarters. However, its guidance for 4QFY15 remained modest at 1-3% QoQ growth in IT services. Even accounting for the weakness in E&U segment (16% of revenues for Wipro) and lag of 4-6 months from deal win to execution, the revenue for 4QFY15 should have been much better than what the management has guided for.

Weak presence in Europe to hamper growth

Wipro has a relatively weaker presence in the EU vs. its peers. While the region currently accounts for 28% of its revenues, it has seen a CQGR of only 1.2% over the last seven quarters – much lower than peers. Its deal win record from EU over the last eight quarters has been dismal. This may stand in the way of its benefitting from the region opening up.

Amongst geographies, it has a significant presence only in the UK, which would still be inferior to that of TCS and HCL Tech. In most of the other geographies, it has failed to penetrate or win a large deal over the last three years.

Growth concerns will inhibit rerating

Wipro's business has shown signs of a turnaround over the last three quarters along with the strongest ever deal flow over the last nine months. However, like the last quarter, its 4QFY15 guidance does not allay concerns of it being able to catch up with its peers in terms of growth. We see the continued modest guidance as a sign of Wipro facing execution issues or losing a large part of its existing business to competitors.

Wipro's stock has borne the brunt of its lacklustre performance and guidance. The stock has significantly underperformed the broader index and peers. It currently trades at FY17 P/E of 15x – at a discount to all other companies in the top-5 bracket. We believe, for the stock to merit a rerating, the management needs to deliver more, and more importantly, deliver consistently.

We continue to value the company at 14x FY17 earnings (10% discount to Infosys). Our price target of Rs 620 represents 5% downside from current levels. We maintain NEUTRAL.

NEUTRAL (Maintain)

CMP RS 650

TARGET RS 620 (-5%)

COMPANY DATA

O/S SHARES (MN) :	2469
MARKET CAP (RSBN) :	1605
MARKET CAP (USDBN) :	25.8
52 - WK HI/LO (RS) :	671 / 475
LIQUIDITY 3M (USDMN) :	18.2
PAR VALUE (RS) :	2

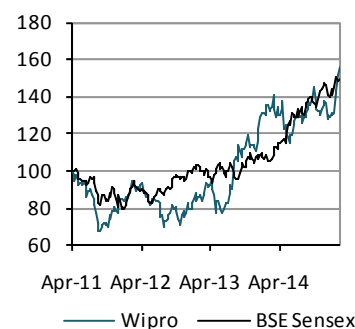
SHARE HOLDING PATTERN, %

PROMOTERS :	73.4
FII / NRI :	12.7
FI / MF :	4.7
NON PROMOTER CORP. HOLDINGS :	3.3
PUBLIC & OTHERS :	5.9

PRICE PERFORMANCE, %

	1MTH	3MTH	1YR
ABS	10.1	13.6	15.0
REL TO BSE	8.6	9.5	-27.4

PRICE VS. SENSEX



Source: Phillip Capital India Research

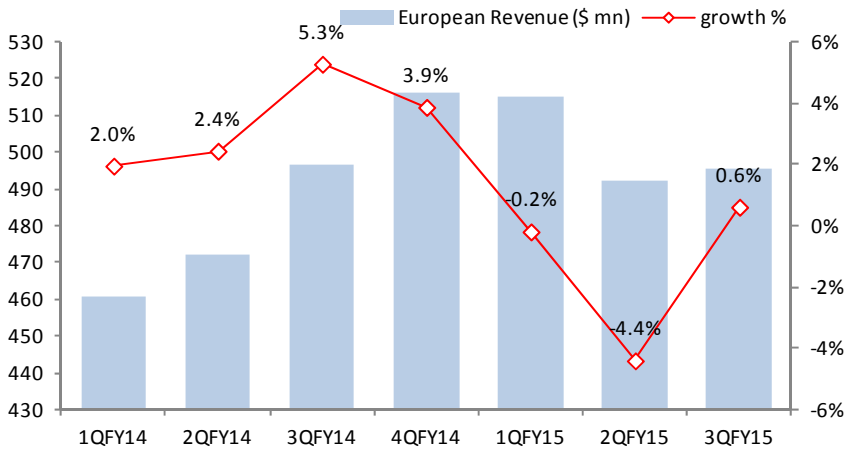
KEY FINANCIALS

Rs mn	FY15E	FY16E	FY17E
Net Sales	472.9	522.1	578.1
EBIDTA	108.5	117.9	129.1
Net Profit	86.5	97.9	109.0
EPS, Rs	35.1	39.6	44.1
PER, x	18.5	16.4	14.7
EV/EBIDTA, x	13.5	12.1	10.7
P/BV, x	3.9	3.4	3.0
ROE, %	21.3	20.8	20.1

Source: PhillipCapital India Research Est.

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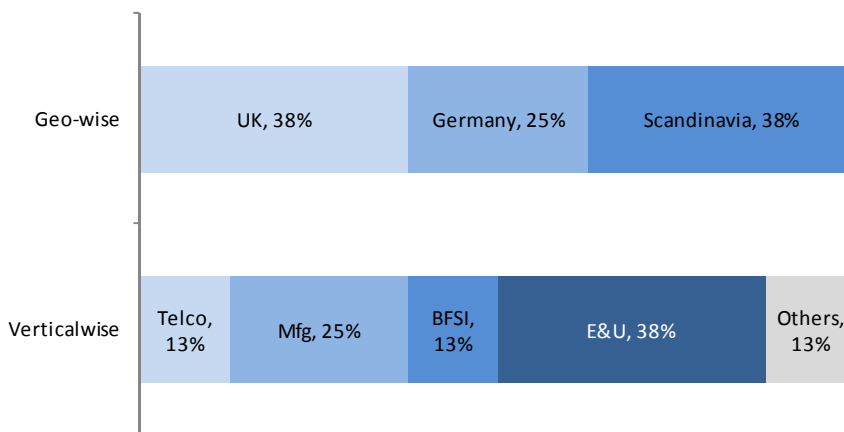
European revenues and qoq growth %


Source: Company, PhillipCapital India Research

Recent deal wins from Europe

Date	Companies	Country	Sector	Major Service opted
25-Jun-14	Sanoma	Finland	M & E	IMS
12-Jun-14	Outokumpu	Finland	E&U	ADM + IMS
16-May-14	XOServe	Britain	E&U	Transformational
04-Mar-14	Siemens	Germany	Manufacturing	Digital
25-Feb-14	Carillion PLC	Britain	E&U	Outsourcing
3-Sep-13	Deutsche Bank	Germany	BFSI	Outsourcing
10-Dec-12	Telenor	Norway	Telecom	IMS
24-Jul-12	Royal Philips Electronics	Britain	Manufacturing	Transformational

Source: BSE Archives

Deal win share in Europe – by region and vertical


Source: Company, PhillipCapital India Research

Financials

Income Statement

Y/E Mar, Rs mn	FY14	FY15e	FY16e	FY17e
Net sales	434,269	472,943	522,143	578,062
Growth, %	16.0	8.9	10.4	10.7
Employee expenses	-284,899	-310,736	-342,106	-377,993
Other Operating expenses	-49,428	-53,737	-62,166	-70,955
EBITDA (Core)	99,942	108,469	117,871	129,113
Growth, %	25.2	8.5	8.7	9.5
Margin, %	23.0	22.9	22.6	22.3
Depreciation	-10,590	-12,731	-13,278	-13,983
EBIT	89,352	95,738	104,594	115,130
Growth, %	27.7	7.1	9.2	10.1
Margin, %	20.6	20.2	20.0	19.9
Interest paid	0	0	0	0
Other Non-Operating Income	11,653	16,014	21,454	25,219
Pre-tax profit	101,005	111,752	126,047	140,348
Tax provided	-22,601	-24,791	-27,730	-30,877
Profit after tax	78,404	86,961	98,317	109,472
Others (Minorities, Associates)	-438	-492	-460	-512
Net Profit	77,966	86,469	97,857	108,960
Growth, %	17.5	10.9	13.2	11.3
Net Profit (adjusted)	77,966	86,469	97,857	108,960
Wtd avg shares (m)	2,462	2,467	2,469	2,469

	FY14	FY15e	FY16e	FY17e
US\$ Revenue (US\$ mn)	7,254	7,719	8,422	9,324
Growth, %	4.6	6.4	9.1	10.7
Re / US\$ (rate)	60.4	61.8	62.0	62.0

Balance Sheet

Y/E Mar, Rs mn	FY14	FY15e	FY16e	FY17e
Cash & bank	114,201	124,610	144,360	170,589
Marketable securities at cost	60,557	82,985	102,985	122,985
Debtors	85,392	93,293	102,998	114,029
Inventory	2,293	2,332	2,432	2,534
Other current assets	92,243	100,931	112,475	123,943
Total current assets	354,686	404,151	465,250	534,079
Investments	0	0	0	0
Net fixed assets	116,807	135,392	143,014	149,931
Non-current assets	30,811	32,160	35,506	39,308
Total assets	502,304	571,703	643,770	723,318
Total current liabilities	136,456	139,421	146,402	153,442
Non-current liabilities	20,962	23,843	24,960	26,241
Total liabilities	157,418	163,264	171,362	179,683
Paid-up capital	4,932	4,937	4,937	4,937
Reserves & surplus	338,567	401,892	465,401	536,116
Minorities	1,387	1,610	2,070	2,582
Shareholders' equity	344,886	408,439	472,408	543,635
Total equity & liabilities	502,304	571,703	643,770	723,318

Source: Company, PhillipCapital India Research Estimates

Cash Flow

	FY14	FY15e	FY16e	FY17e
Pre-tax profit	101,005	111,752	126,047	140,348
Depreciation	10,590	12,731	13,278	13,983
Chg in working capital	-40,297	-15,013	-17,714	-19,362
Total tax paid	-22,601	-24,791	-27,730	-30,877
Other operating activities	0	0	0	0
Cash flow from operating activities	48,697	84,680	93,881	104,093
Capital expenditure	-20,402	-31,316	-20,900	-20,900
Chg in investments	0	0	0	0
Chg in marketable securities	8,614	-22,428	-20,000	-20,000
Other investing activities	0	0	0	0
Cash flow from investing activities	-11,788	-53,744	-40,900	-40,900
Free cash flow	28,295	53,364	72,981	83,193
Equity raised/(repaid)	3,913	5,599	0	0
Debt raised/(repaid)	10,955	2,881	1,117	1,281
Dividend (incl. tax)	-23,051	-28,823	-34,348	-38,245
Other financing activities	859	86	0	0
Cash flow from financing activities	-7,546	-20,527	-33,231	-36,964
Net chg in cash	29,363	10,409	19,750	26,229

Valuation Ratios

	FY14	FY15e	FY16e	FY17e
Per Share data				
EPS (INR)	31.7	35.1	39.6	44.1
Growth, %	27.0	10.7	13.1	11.3
Book NAV/share (INR)	139.5	164.9	190.5	219.1
CFPS (INR)	26.3	27.5	31.1	33.9
DPS (INR)	8.0	10.0	11.9	13.2
Return ratios				
Return on assets (%)	16.6	16.2	16.2	16.0
Return on equity (%)	22.7	21.3	20.8	20.1
Return on capital employed (%)	23.7	21.8	21.2	20.5
Turnover ratios				
Asset turnover (x)	2.3	2.2	2.1	2.2
Sales/Total assets (x)	0.9	0.9	0.9	0.8
Sales/Net FA (x)	3.9	3.8	3.8	3.9
Receivable days	71.8	72.0	72.0	72.0
Inventory days	1.9	1.8	1.7	1.6
Liquidity ratios				
Current ratio (x)	2.6	2.9	3.2	3.5
Quick ratio (x)	2.6	2.9	3.2	3.5
Dividend cover (x)	4.0	3.5	3.3	3.3
Total debt/Equity (%)	17.9	16.4	14.2	12.4
Net debt/Equity (%)	(15.3)	(14.2)	(16.5)	(19.1)
Valuation				
PER (x)	20.5	18.5	16.4	14.7
PEG (x) - y-o-y growth	0.8	1.7	1.3	1.3
Price/Book (x)	4.7	3.9	3.4	3.0
Yield (%)	1.2	1.5	1.8	2.0
EV/Net sales (x)	3.4	3.1	2.7	2.4
EV/EBITDA (x)	14.9	13.5	12.1	10.7
EV/EBIT (x)	16.6	15.3	13.6	12.0

Tech Mahindra (TECHM IN)

Continuously bridging the gap...

INDIA | IT SERVICES | Company Update

24 February 2015

On track to achieve its 'stretch goal' of US\$ 5bn revenue by CY15

TechM's acquisition of Lightbridge Communications Corp (LCC) in Dec-14 – a US-headquartered network-services-management (NSM) company – takes it closer to its 'stretch goal' of US\$ 5bn in revenues by CY15. LCC is expected add US\$ 450mn to TechM's topline in CY15. With TechM's enhanced delivery capabilities in the NSM space and robust growth from retail and manufacturing, we expect it to achieve its target with relative ease. We also expect the company to report industry leading USD revenue growth of 28% and 20% in FY16 and FY17 respectively – overtaking TCS in terms of organic growth too.

Domain expertise in telecom to drive growth momentum

TechM's acquisition of LCC has enriched its telecom portfolio even further. It was always one of the preferred IT vendors for telecom companies. With LCC, it has further raised the entry barrier. NSM should open up an almost US\$40bn market for the company.

Over the last few quarters, TechM has been able to add key clients (AT&T, Verizon) to its portfolio. We expect it to grab a good chunk of deals in the telecom space, which will see higher momentum driven by regulatory changes and new technology. Its strategy to bundle its communications and networking services with enterprise Solutions should reap rich dividends (as it has for HCL Tech).

Satyam's expertise to boost growth in manufacturing and retail

After its integration with Satyam, TechM has transformed into a full-range IT service provider with a significant presence in all key geographies and verticals. We expect the combined entity to benefit from TechM's expertise in telecom and Satyam's presence in manufacturing and retail.

Strong presence in Europe to boost growth

Tech Mahindra has a strong presence in EU along with TCS and HCL Tech. Over 31% of its revenues come from this geography with a CQGR of 3.8% over the last seven quarters (7.7% excluding BT). It has a strong presence in Scandinavia, Germany, and Benelux. It has made significant inroads into telecom, manufacturing, and retail – the last two being Satyam's key strengths.

We expect TechM to benefit from its strong presence in telecom, as telecom companies from the EU region open up to outsourcing. Its bundling of network solutions with enterprise solutions should also lead to the expansion of its service offerings and a stronger presence in the region.

Industry-leading growth to drive further rerating

TechM is currently trading at 14.5x FY17 P/E, at par with HCL Tech and Wipro. Our hypothesis of the company breaking into the top-4 bracket of the Indian IT services sector, thereby expanding the bracket to top-5 has played out handsomely.

We still maintain our positive stance on the company and expect it to benefit from its domain expertise in telecom, aided by growth in manufacturing and retail. We expect TechM to report an industry-leading dollar-revenue CAGR of 24% over the next three years, leading to 26% earnings CAGR over the same period.

We continue to value the stock at 17x FY17 P/E (*premium to Infosys, Wipro and HCL Tech, but discount to TCS*). Our price target of Rs 3,320 represents 19% upside from the current levels. We maintain BUY.

BUY (Maintain)

CMP RS 2780

TARGET RS 3320 (+19%)

COMPANY DATA

O/S SHARES (MN) :	240
MARKET CAP (RSBN) :	674
MARKET CAP (USDBN) :	10.8
52 - WK HI/LO (RS) :	2998 / 1678
LIQUIDITY 3M (USDMN) :	24.8
PAR VALUE (RS) :	10

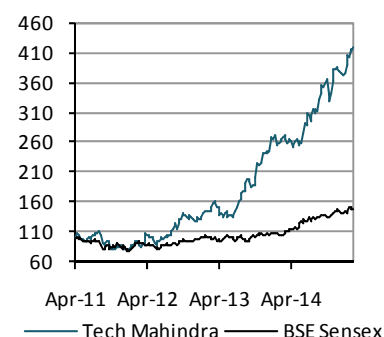
SHARE HOLDING PATTERN, %

PROMOTERS :	36.7
FII / NRI :	39.0
FI / MF :	11.2
NON PROMOTER CORP. HOLDINGS :	2.0
PUBLIC & OTHERS :	10.8

PRICE PERFORMANCE, %

	1MTH	3MTH	1YR
ABS	0.3	3.8	53.3
REL TO BSE	-1.3	-0.3	10.9

PRICE VS. SENSEX



Source: Phillip Capital India Research

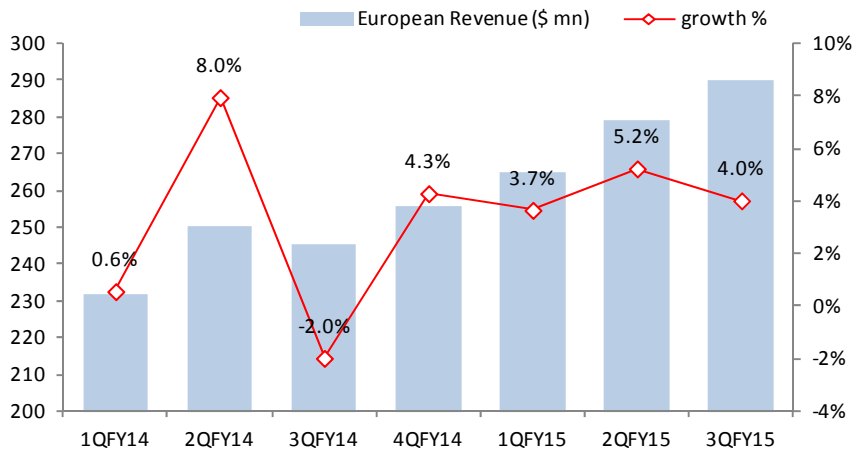
KEY FINANCIALS

Rs mn	FY15E	FY16E	FY17E
Net Sales	222.5	287.8	344.5
EBIDTA	42.9	56.0	70.0
Net Profit	27.2	37.1	46.3
EPS, Rs	115.2	156.4	195.2
PER, x	22.3	17.8	14.2
EV/EBIDTA, x	14.5	11.4	8.9
P/BV, x	5.2	4.2	3.4
ROE, %	21.4	23.6	23.7

Source: PhillipCapital India Research Est.

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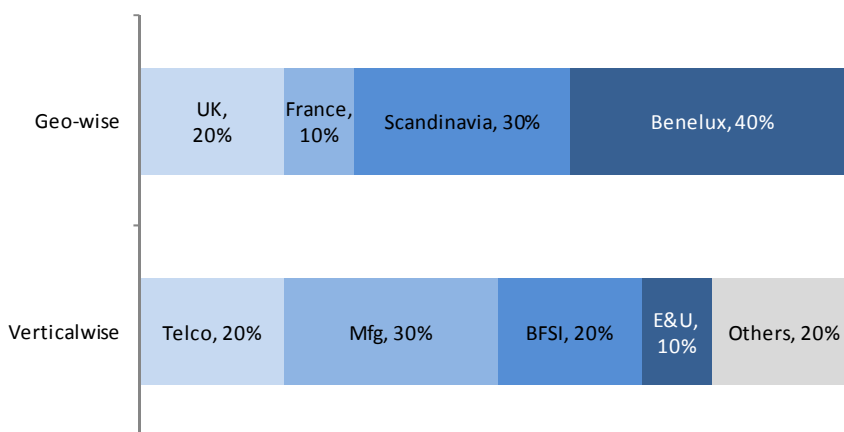
European revenues and qoq growth %


Source: Company, PhillipCapital India Research

Recent deal wins in Europe

Date	Companies	Country	Sector	Major Service opted
23-Sep-14	Ahlstrom	Finland	Diversified	ADMS+IMS
29-May-14	Premium Credit	Britain	BFSI	ADMS + SI
18-Mar-14	Volvo Car Group	Sweden	Manufacturing	IMS
12-Mar-14	Alstom Transport	France	E&U	ER&D
27-Jan-14	Cambridge University Press	Britain	Others	SAP
13-Sep-13	Volvo	Sweden	Manufacturing	ADM
5-Aug-13	BASE Company - Belgium	Belgium	Telecom	MS
24-Jul-13	UBS Fund Services	Luxembourg	BFSI	ERP & SAP
6-Jun-13	Bridgestone Europe	Belgium	Manufacturing	IMS
5-Sep-12	KPN, Dutch	Netherlands	Telecom	ADM

Source: BSE archives

Deal win share in Europe – by region and vertical


Source: Company, PhillipCapital India Research

Financials

Income Statement

Y/E Mar, Rs mn	FY14	FY15e	FY16e	FY17e
Net sales	188,313	222,451	287,791	344,484
Growth, %	31.4	18.1	29.4	19.7
Employee expenses	-117,001	-147,596	-194,543	-232,332
Other Operating expenses	-29,476	-31,957	-37,217	-42,140
EBITDA (Core)	41,836	42,897	56,031	70,011
Growth, %	36.6	2.5	30.6	25.0
Margin, %	22.2	19.3	19.5	20.3
Depreciation	-5,221	-5,794	-7,868	-9,812
EBIT	36,615	37,104	48,163	60,200
Growth, %	37.0	1.3	29.8	25.0
Margin, %	19.4	16.7	16.7	17.5
Interest paid	-797	-153	-351	-351
Other Non-Operating Income	1,129	2,755	2,541	3,008
Pre-tax profit	38,147	39,705	50,353	62,856
Tax provided	-7,524	-10,400	-13,092	-16,343
Profit after tax	30,623	29,305	37,261	46,514
Others (Minorities, Associates)	-336	114	-148	-185
Net Profit	30,287	29,419	37,113	46,329
Growth, %	37.5	(6.7)	36.7	24.8
Net Profit (adjusted)	29,087	27,153	37,113	46,329
Wtd avg shares (m)	232	236	237	237

	FY14	FY15e	FY16e	FY17e
US\$ Revenue (US\$ mn)	3,098	3,629	4,642	5,556
Growth, %	17.7	17.1	27.9	19.7
Re / US\$ (rate)	60.8	61.3	62.0	62.0

Balance Sheet

Y/E Mar, Rs mn	FY14	FY15e	FY16e	FY17e
Cash & bank	33,202	32,819	23,257	38,355
Debtors	43,486	57,898	74,904	87,773
Inventory	98	305	394	472
Other current assets	11,617	10,665	14,192	16,988
Total current assets	112,084	132,160	152,172	190,777
Investments	14,876	19,876	24,876	29,876
Gross fixed assets	44,864	53,864	77,264	86,264
Less: Depreciation	-18,920	-24,714	-32,581	-42,393
Add: Capital WIP	2,662	2,662	2,662	2,662
Net fixed assets	28,606	31,812	47,345	46,533
Total assets	159,396	187,678	228,223	271,016
Current liabilities	32,746	40,437	47,970	52,195
Provisions	16,807	14,591	14,883	15,267
Total current liabilities	49,553	55,029	62,853	67,462
Non-current liabilities	4,281	4,281	6,681	6,681
Total liabilities	53,834	59,310	69,534	74,143
Paid-up capital	2,335	2,335	2,335	2,335
Reserves & surplus	101,789	124,709	154,881	192,881
Minorities	1,438	1,324	1,472	1,657
Shareholders' equity	105,562	128,369	158,689	196,873
Total equity & liabilities	159,396	187,678	228,223	271,016

Cash Flow

	FY14	FY15e	FY16e	FY17e
Pre-tax profit	38,147	39,705	50,353	62,856
Depreciation	5,221	5,794	7,868	9,812
Chg in working capital	-12,879	-12,768	-22,041	-19,282
Total tax paid	-7,273	-12,616	-12,800	-15,959
Other operating activities	-1,200	0	0	0
Cash flow from operating activities	22,016	20,115	23,379	37,426
Capital expenditure	-8,914	-9,000	-23,400	-9,000
Chg in investments	-483	-5,000	-5,000	-5,000
Chg in marketable securities	0	0	0	0
Other investing activities	0	0	0	0
Cash flow from investing activities	-9,397	-14,000	-28,400	-14,000
Free cash flow	13,102	11,115	-21	28,426
Equity raised/(repaid)	29	-15	0	0
Debt raised/(repaid)	-8,002	0	2,400	0
Dividend (incl. tax)	-5,432	-6,483	-6,941	-8,329
Other financing activities	-399	0	0	0
Cash flow from financing activities	-14,046	-6,498	-4,541	-8,329
Net chg in cash	-1,427	-383	-9,562	15,097

Valuation Ratios

	FY14	FY15e	FY16e	FY17e
Per Share data				
EPS (INR)	125.3	115.2	156.4	195.2
Growth, %	37.0	(8.1)	35.8	24.8
Book NAV/share (INR)	448.5	538.8	662.5	822.7
CFPS (INR)	95.1	73.6	87.8	145.0
DPS (INR)	20.0	23.5	25.0	30.0
Return ratios				
Return on assets (%)	20.9	16.9	18.0	18.7
Return on equity (%)	27.9	21.4	23.6	23.7
Return on capital employed (%)	30.7	24.3	25.2	25.3
Turnover ratios				
Asset turnover (x)	3.0	2.8	2.7	2.6
Sales/Total assets (x)	1.3	1.3	1.4	1.4
Sales/Net FA (x)	7.0	7.4	7.3	7.3
Working capital/Sales (x)	0.2	0.2	0.2	0.2
Receivable days	84.3	95.0	95.0	93.0
Liquidity ratios				
Current ratio (x)	2.3	2.4	2.4	2.8
Quick ratio (x)	2.3	2.4	2.4	2.8
Dividend cover (x)	6.3	4.9	6.3	6.5
Total debt/Equity (%)	0.5	0.4	1.9	1.5
Net debt/Equity (%)	(31.4)	(25.4)	(12.9)	(18.1)
Valuation				
PER (x)	21.3	22.3	17.8	14.2
PEG (x) - y-o-y growth	0.4	(5.1)	0.7	0.6
Price/Book (x)	6.2	5.2	4.2	3.4
Yield (%)	0.7	0.8	0.9	1.1
EV/Net sales (x)	3.3	2.8	2.2	1.8
EV/EBITDA (x)	14.6	14.5	11.4	8.9
EV/EBIT (x)	16.7	16.8	13.3	10.4

Source: Company, PhillipCapital India Research Estimates

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