MORNING INSIGHT

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PRIVATE CLIENT RESEARCH

OCTOBER 18, 2012

Economy News

- Banks managed to post a modest growth in credit offtake, but both loan and deposit growth was below the central bank's comfort levels. At the current levels, the annual year-on-year growth in deposits is 9%, while the y-o-y growth for loans is 15.9%, against the central bank's comfort levels of 16% and 17%, respectively. (ET)
- Bharti Airtel, Vodafone India, Idea Cellular and Bharat Sanchar Nigam Ltd face a Rs 1 trn outgo with the Telecom Commission deciding to re-farm the entire spectrum held by them in the 900 Mhz frequency band. The Commission's views will be referred to the Empowered Group of Ministers (EGoM), which is expected to meet today to take a final decision on the issue. (BL)
- Subsidised auto and cooking fuel are definitely going to become passé, if Finance Minister P. Chidambaram's statement is any indicator. "The current level of subsidy (on petroleum products) is not sustainable," he said adding that the current pricing system of petroleum product is not conducive for economic policy decisions. (BL)
- India's engineering exports dropped by 8.2 per cent year-on-year to $ 4.4 billion in September 2012 due to sluggish demand in major markets like the US and Europe. In September, last year, these exports stood at $ 4.8 billion, according to data released by the Engineering Export Promotion Council (EEPC). (BL)

Corporate News

- **Kingfisher Airlines** will continue to stay on the tarmac, as the meeting between the management and the employees failed to end the deadlock. The airline's chief said there will be an extension of the date for restarting flights (slated to resume on October 21) without giving any specific date of this further extension. (ET)
- The country's biggest coal producer **Coal India** said it achieved about 96% of its production target for the first half of 2012-13 and 97% of its sale target as heavy rains in August and September disrupted mining operations. (ET)
- **Mahindra & Mahindra** has launched the SsangYong Rexton in India. It is Mahindra & Mahindra's (M&M) first high-end sports utility vehicle. Designed and developed by SsangYong in Korea, the sports utility vehicle (SUV) is the third generation Rexton. (BL)
- The petroleum ministry has informed the Prime Minister's Office that it has not given a final nod to **RIL's** plans to raise natural gas output from the flagging KG-D6 fields as the firm has refused to allow audit of its expenditure by CAG. (BS)
- **ACC** and **Ambuja Cements** might have to shell out two per cent of sales as royalty to their Swiss parent company Holcim. **(BS)**
- Nearly a-year-and-a-half after splitting with long-time partner Honda Motor of Japan, homegrown Hero group of Munjals is close to scripting a solo ride as it will launch its first bike, sans Honda technology, next year. The two-wheeler will be built by **Hero MotoCorp's** newly-established in-house R&D set-up that will work in tandem with the company's three overseas technology partners. (ET)
- In an unprecedented move that is in contradiction with its drive towards divesting stakes in companies it owns, the central government turned acquirer, gaining control over publicly listed institutional lender **IFCI Ltd.** The government used an option to convert debentures it had issued 11 years ago when IFCI was in financial trouble to acquire control over the lender. IFCI Ltd has issued 400 million shares worth Rs 4 bn to the Government of India, making it the largest shareholder in the company. (BS)

Source: ET = Economic Times, BS = Business Standard, FE = Financial Express, BL = Business Line, ToI: Times of India, BSE = Bombay Stock Exchange

Equity

	17 Oct 12	% Chg 1 Day	% Chg 1 Mth	% Chg 3 Mths
Indian Indices				
SENSEX Index	18,611	0.2	0.6	8.3
NIFTY Index	5,660	0.2	1.1	8.5
BANKEX Index	13,036	0.1	2.9	7.0
BSET Index	5,671	(0.1)	(5.1)	8.4
BSETCG INDEX	11,046	0.6	5.1	10.7
BSEOIL INDEX	8,479	(0.5)	(3.5)	6.2
CNXMcap Index	7,862	0.0	3.9	6.9
BSESMCAP INDEX	7,132	0.3	5.7	7.1
World Indices				
Dow Jones	13,557	0.0	(0.1)	5.0
Nasdaq	3,104	0.1	(2.3)	5.5
FTSE	5,911	0.7	0.7	4.0
NIKKEI	8,807	1.2	(2.2)	2.2
HANGSENG	21,417	1.0	4.3	11.7

Value traded (Rs cr)

	17 Oct 12	% Chg - Day
Cash BSE	2,023	(30.0)
Cash NSE	10,452	(2.7)
Derivatives	133,762	(7.89)

Net inflows (Rs cr)

	16 Oct 12	% Chg	MTD	YTD
FII	(88)	(152.5)	9,548	93,328
Mutual Fund	235	1,926.7	(1,483)	(14,138)

FII open interest (Rs cr)

	16 Oct 12	% Chg
FII Index Futures	14,811	0.3
FII Index Options	51,894	2.7
FII Stock Futures	30,570	0.7
FII Stock Options	2,751	4.2

Advances / Declines (BSE)

17 Oct 12	A	B	T	Total	% total
Advances	107	933	275	1,315	44
Declines	95	1,144	298	1,537	52
Unchanged	1	96	33	130	4

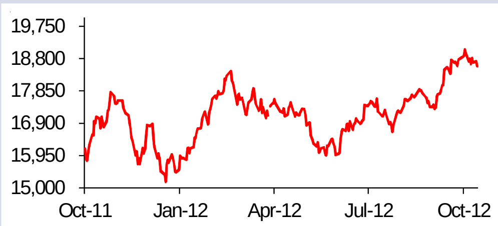
Commodity

	17 Oct 12	% Chg 1 Day	% Chg 1 Mth	% Chg 3 Mths
Crude (NYMEX) (US$/BBL)	92.1	(0.0)	(3.3)	2.5
Gold (US$/OZ)	1,751.0	0.4	(0.9)	11.1
Silver (US$/OZ)	33.2	0.9	(3.8)	22.4

Debt / forex market

	17 Oct 12	1 Day	1 Mth	3 Mths
10 yr G-Sec yield %	8.3	8.3	8.4	8.3
Re/US$	52.9	52.9	54.0	55.1

Sensex



RESULT UPDATE

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ZENSAR TECHNOLOGIES LTD

PRICE: RS.260 **RECOMMENDATION: ACCUMULATE**
TARGET PRICE: RS.305 **FY14E P/E: 5.7x**

Planned changes in revenue contributors and reduction in employees have led to a lower-than-expected 2Q. Product revenues are lower by about 21% QoQ. Services volumes were almost flat. The macro scene is uncertain but the management is positive on the pipeline and order bookings. The planned measures are targeted at improving the profitability profile of the company in the medium term. There is a short term impact, though. We view the profitability initiatives positively but will wait for the same to play out, especially as the macro scene is uncertain. Retain ACCUMULATE with a FY14 based DCF - based PT of Rs.305 (Re. 295 earlier, based on FY13E).

2QFY13 results

2Q results look disappointing. While the uncertain macro scene has had its impact, the company has made some conscious decisions to improve profitability, even at the cost of impact on short term.

Summary table

(Rs mn)	FY12	FY13E	FY14E
Sales	17,826	21,683	22,588
Growth (%)	56.6	21.6	4.2
EBITDA	2,262	2,944	2,967
EBITDA margin (%)	12.7	13.6	13.1
PBT	2,362	2,723	2,847
Net profit	1,586	1,825	1,993
EPS (Rs)	36.5	42.1	45.9
Growth (%)	20.4	15.1	9.2
CEPS (Rs)	44.2	49.7	54.2
BV (Rs/share)	132.7	169.6	209.8
Dividend / share (Rs)	4.5	5.0	5.0
ROE (%)	31.0	27.8	24.2
ROCE (%)	33.4	32.4	28.3
Net cash (debt)	(114)	1,085	2,285
NW Capital (Days)	32.2	42.6	44.8
P/E (x)	7.1	6.2	5.7
P/BV (x)	2.0	1.5	1.2
EV/Sales (x)	0.6	0.5	0.4
EV/EBITDA (x)	5.0	3.5	3.0

Source: Company, Kotak Securities - Private Client Research

Quarterly performance

(Rs.mn)	1QFY13	2QFY13	% QoQ	2QFY12	% YoY
Income	**5442.9**	**5373.1**	**-1.3**	**4090.0**	**31.4**
Expenditure	4699.5	4640.0		3566.6	
EBIDTA	**743.4**	**733.1**	**-1.4**	**523.3**	**40.1**
Depreciation	78.0	77.4		81.4	
EBIT	**665.4**	**655.7**	**-1.5**	**441.9**	**48.4**
Interest	27.1	25.7		22.5	
Other inc	193.7	-127.5		191.1	
PBT	**832.0**	**502.5**	**-39.6**	**610.5**	**-17.7**
Tax	286.6	180.8		210.0	
Minority Interest	0.0	0.0		0.0	
PAT	**545.4**	**321.7**	**-41.0**	**400.5**	**-19.7**
E.O items	0.0	0.0		0.0	
Shares (mns)	43.4	43.4		43.4	
EPS (Rs)	**12.6**	**7.4**		**9.2**	
Margins (%)					
Operating Profit	13.7	13.6		12.8	
Gross Profit	12.2	12.2		10.8	
Net Profit	10.0	6.0		9.8	

Source : Company

Volumes almost flat

- Revenues for the quarter have fallen by 1.3% QoQ in INR terms.
- This is largely on the back of a 21% fall in product revenues. Akibia sells products as a part of its IM business and the previous Akibia management had been focusing more on the same The current management of Zensar is now driving a change with more focus on integrated services (Akibia and Zensar) as compared to products.
- We had alluded to this possibility in our previous update on the company.
- The consolidated service offerings along with Akibia are getting increased acceptance from the company's clients. More than 14 clients are getting services jointly.

- However, the products carry relatively lower margins.
- Excluding these, revenues have risen by about 2% QoQ. However, in USD terms, they were likely flat. Volumes witnessed almost flat growth during the quarter, impacted by some project delays.
- According to the management, the company has discontinued several smaller projects (about 75projects), which were a drain on the profitability as well as on project management. This had a one-time impact on growth.
- Also, we have been indicating that, Zensar's revenue growth has been very erratic over quarters.
- Average realisations were almost stable on a sequential basis.

No major concerns at micro level, however project delays seen; Cisco to scale up

- While accepting that, the macro scene is still uncertain, the management has indicated that, it has not seen any major changes at the micro levels which may cause concern.
- There are delays and postponements in the investment banking business in BFS, but these have not impacted other businesses.
- The top clients of the company continue to scale up business along expected lines.
- While the impact is not significant, we will be cautious on future scale-ups especially in the projects-based revenues.
- Cisco, the largest client for Zensar, has continued to scale up on the revenue front. About 24% of the revenues came from this account.
- We note that, Cisco revenues had not scaled up over the past three quarters before 4QFY12 because of internal restructuring within the client.
- Cisco has recently announced further cost consolidation exercise including some employee rationalization. These initiatives may have a marginal short term impact on Zensar, if at all. On the other hand, Zensar is likely to benefit from the recent vendor rationalization exercise conducted by Cisco.
- According to the management, Cisco has rationalised its vendor base to cut costs (Zensar, TCS, Wipro and Accenture were the vendors).
- In this process, Cisco has discontinued work with one of the large Indian vendors and Zensar is expected to benefit in terms of additional revenues.
- We note that, post Akibia's acquisition, Cisco's contribution to Zensar's revenues has fallen from the higher levels of about 34% to around 24%. This was one of the factors limiting additional business from Cisco.
- The management is confident of strong growth from Cisco going ahead because of cost pressures on Cisco.
- The management maintains that, it has and will further rationalize some of the accounts which are yielding low margins. This is with a view to re-align the work force to better yielding projects.

Average realizations were almost unchanged

- Average realizations for the company were almost stable over the previous quarter.
- New contracts are coming in at higher-than-average rates. However, billing rate increases are contingent on consistent demand in the future.
- The company has not seen any pressure on billing rates from existing clients till date.

Net reduction of 318 employees

- The number of employees has come down on a sequential basis by 318.
- Zensar has consciously reduced the number of employees by about 150 as they were not able to meet the targeted performance levels. The company has also reduced the number of projects especially those, which were not yielding the desired margins.
- Utilisation levels have moved up marginally 82%.
- The management had indicated in past that, it is taking a hard look at the utilization levels and also at the performance related issues of employees.
- Zensar has been focusing on improving utilization levels and we expect the same to continue over the fiscal.
- About 50-60 employees may still be removed in due course of time.

EBIDTA margins flat QoQ

- Headline numbers show EBIDTA margins have remained stable QoQ. This is despite the 7.5% salary hikes given during the quarter.
- The benefits came in from the reduced number of employees and also the reduced contribution from the products business.
- The management expects margins to trend higher once the re-structuring of the business is completed
- The levers for margins improvement are : increased off-shore content and further cost rationalization.
- The management has indicated that, the Mckinsey restructuring initiative undertaken by the company will likely save Rs.400mn for the company in FY14, as against Rs.160mn in FY13. FY13 benefits will be offset by consultancy fees.

Future focus areas

- The management has detailed the four focus areas, which are expected to take Zensar to an aspirational revenue level of $1bn by FY16.
- These are : IM, BFSI, Healthcare and Manufacturing/Retail/ Distribution.
- IM currently brings in about 32% of the total revenues and Zensar plans to grow this into a $400mn revenue business by FY12.
- Zensar will target to grow its existing US relationships which are growing the RIMS business in European countries like UK, Germany and Benelux.
- It has also decided to penetrate the Cloud, Social Media and Mobility (CLOSOMO) markets.
- In IM, the company has already won more than $10mn worth of orders through the joint value proposition (Zensar and Akibia).
- In Cloud, the partnership with Google has already brought in 2-3 clients and Zensar will be providing cloud platforms to them.
- BFSI currently brings in 21% of revenues and the target is to get about $200mn revenues by FY16.
- The focus of Zensar will be more on Insurance, we believe, where it will likely use more platform based services.
- The company enjoys strong relationship with its clients that include UBS, Credit Suisse, Investec, Nomura etc. On the other hand, Akibia has some marquee customers like Federal Reserve Bank, JP Morgan chase etc.
- Company plans to cross sell some of its own and Akibia products across globe. This is also expected to increase the client mining - for instance Nomura is Zensar's client in Asia Pacific and Akibia's client in USA.

- Manufacturing/Retail/Distribution (MRD) currently brings in 53% of revenues and is targeted to grow to $300mn by FY16.
- Currently 25% of the company's revenues and nearly 50% of the MRD revenues come from the hi-tech companies.
- Zensar is looking at SMEs as an area of growth and will target these through solutions and platforms.
- Within retail, the focus will be on sub-segments like apparel retail and e-tailing. The oracle and SAP expertise will lead to new customer engagements, we believe.
- Healthcare is a relatively new vertical for Zensar. It is currently focused on the ICD-10 business and has an order book of about $8mn in ICD.

Financial prospects

- We have made changes to our FY13E earnings and introduce FY14 estimates. We assume the rupee to average Rs.53.5 per USD in FY13 and 51.5 / USD in FY14.
- Services revenues in USD are expected to rise by 9% in both years, on the back of marginally lower volume growths.
- Margins are expected to fall from 2Q levels largely due to the assumed rupee appreciation and further salary hikes in FY14. Improved efficiency post restructuring should help restrict the overall impact.
- We have assumed tax at relatively lower levels of 30% in FY14 because of the expected increase in revenues from SEZs.
- Consequently, PAT is expected to rise by about 15% in FY13 and by 9% in FY14 to Rs.1.99bn, leading to an EPS of Rs.46 in FY14E.

Valuations

- Our DCF based price target is Rs.305 (Rs.295) for the stock, based on FY14E earnings.

We maintain ACCUMULATE rating on Zensar Technologies with a revised price target of Rs.305

- We view the business restructuring exercise with optimism. However, we would like to see atleast the initial gains from this, before becoming more positive on the stock. The uncertain macro may also lead to challenges.
- We, therefore, maintain **ACCUMULATE**.
- Sustained rise in margins and stable revenue growth profile may lead us to accord higher valuations to the stock.

Concerns

- A sharp appreciation in the rupee from the current levels may impact our earnings estimates for the company.
- A delayed recovery in major global economies could impact revenue growth of Zensar.

RESULT UPDATE

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HCL TECHNOLOGIES LTD (HCLT)

PRICE: RS.580 **RECOMMENDATION: BUY**
TARGET PRICE: RS.640 **FY13E P/E: 12.7x**

The improvement in margins was the highlight of the quarter for HCLT. Volume growth of 4.5% was also encouraging. The management has reiterated traction in 'Run-the-business' spends by clients, which bodes well for IMS revenues. Discretionary spends in BFSI remain a concern. Company's strategy of investing in large deals and improving margins later is yielding results, we believe. While profitability may be lower in the next two quarters as the company invests in new project renewal deals, it should ensure sustained growth in medium term. Our FY13E earnings stand revised to 45.6 (Rs.42.8 earlier), largely due to assumption of better margins. Consequently, our PT stands revised to Rs.640 (Rs.570). We maintain BUY. The company has consistently grown revenues and sustained margins over the past few quarters.

Summary table

(Rs mn)	FY11	FY12	FY13E
Sales	160,381	210,312	245,530
Growth (%)	27.6	31.1	16.7
EBITDA	27,491	40,251	50,977
EBITDA margin (%)	17.1	19.1	20.8
PBT	21,952	33,441	44,242
Net profit	16,197	24,555	32,222
EPS (Rs)	22.9	34.8	45.6
Growth (%)	30.7	51.6	31.2
CEPS (Rs)	30.0	42.8	55.5
BV (Rs/share)	119.5	152.0	193.5
Dividend / share (Rs)	4.0	6.0	4.0
ROE (%)	13.6	16.4	16.9
ROCE (%)	14.2	18.6	20.2
Net cash (debt)	2,769	6,228	25,211
NW Capital (Days)	57.0	74.5	70.6
P/E (x)	25.3	16.7	12.7
P/BV (x)	4.9	3.8	3.0
EV/Sales (x)	2.5	1.9	1.6
EV/EBITDA (x)	14.8	10.0	7.5

Source: Company, Kotak Securities - Private Client Research

1QFY13 results

(Rs mn)	4QFY12	1QFY13	QoQ (%)	1QFY12	YoY (%)
Turnover	**59190.99**	**60910.01**	**2.90**	**46513.02**	**30.95**
Expenditure	46182.00	47400.02		38564.03	
Operating Profit	**13008.99**	**13509.99**	**3.85**	**7948.99**	**69.96**
Depreciation	1524.00	1692.00		1309.00	
Gross Profit	**11484.99**	**11817.99**		**6639.99**	**77.98**
Interest	0.00	0.00		0.00	
Other Income	-423.00	-253.00		59.00	
PBT	**11061.99**	**11564.99**	**4.55**	**6698.99**	**72.64**
Tax	2525.00	2718.00		1728.00	
PAT	**8536.99**	**8846.99**	**3.63**	**4970.99**	**77.97**
Share of income	0.00	0.00		0.00	
ESOP charge	128.00	206.00		171.00	
Minority interest	-4.00	0.00		3.00	
Adj. PAT	**8412.99**	**8640.99**	**2.71**	**4796.99**	**80.13**
Shares (mns)	705.97	705.97		705.97	
EPS (Rs) *	**11.92**	**12.24**		**6.79**	
OPM (%)	21.98	22.18		17.09	
GPM (%)	19.40	19.40		14.28	
NPM (%)	14.42	14.52		10.69	

Source : Company

CC growth of 2.9% - largely volume-led

- Revenues grew by 2.9% in CC terms.
- While the software services revenues grew by 0.2%, IMS reported a strong 10.3% rise on a CC basis. BPO also reported a strong 4.8% CC growth. The overall CC growth was better than our estimates.
- While IMS has reported second successive quarter of more than 9% CC growth, BPO has reported strong growth after a long time. These indicate that, the spending on run-the-business initiatives is showing traction as clients focus on these spends only.
- The discretionary spends have remained sluggish and that is reflected in the 0.2% rise in software services business. Within that, enterprise services have seen a 2% de-growth QoQ.

- The CC revenue growth was led by volumes, which grew by 4.5% at the company level. This is encouraging and also much better than the growth reported by Infosys. Volume growth in 4QFY12 was 3.4% QoQ.
- The overall client profile has improved for HCLT. There has been an increase in clients in all brackets except in the $50mn and $100mn brackets.
- This indicates that, the newer accounts are likely scaling up faster whereas the larger accounts are also sustaining momentum. All the Top 10 clients of the company are in the Fortune 500 / Global 500 list.
- HCLT has also been penetrating deeper into its clients by offering diverse services.
- US and Europe geographies grew at a fast pace with CC growth of 4% and 2.7% QoQ, respectively.
- HCLT has been focusing more on these geographies and has de-focused on ROW. This is yielding results with the focus geographies growing even in the backdrop of an uncertain environment.
- Europe revenues have grown consistently at a CQGR of more than 4% for the past 5 quarters, which is surprising, in the backdrop of a slowdown in that geography.
- We understand that, the cost pressures are pushing European companies to outsource and off-shore more, in turn helping Indian vendors.
- The management has indicated that, companies in the Financials Services space in Europe have initiated the vendor consolidation process and are opening up to appointing new vendors.
- Within verticals, growth came from new verticals like retail, healthcare and media/entertainment, which reported CC growth of 7% to 14%. Telecom continued to suffer with a 3% drop in CC revenues.
- The US BFSI segment is witnessing increased pressure because of the changing composition of profitability of the institutions. Companies in this sector have been reporting dismal performance on the revenue front.
- Due to this, there is a churn in the vendors to these companies and also pressure on realisations. Clients are looking at reducing spends on run-the-business initiatives, while increasingly looking at new business models to increase revenues (support change-the-business spends).
- HCLT has participated increasingly in the CTB market and has won several deals. US revenues grew by 3.6% on a CC basis.
- Within services, Infrastructure services and BPO contributed to growth, while SW services revenues were almost flat QoQ.
- The growth in IMS and BPO indicates that, clients are more inclined to spend on run-the-business initiatives and less on change-the-business.
- While 4QFY12 had seen Enterprise services performing well, we believe that, run-the-business spends will continue to witness more traction till the macro scene remains uncertain. Enterprise services reported a 2% de-growth in 1Q.
- HCLT has been aggressively pursuing run-the-business spends and has won deals in the past few quarters.

Macro scene - headwinds persist

- In line with other companies, HCLT management has indicated that, the headwinds against the sector persist in the form of uncertain global economic scene, which is creating uncertainties in client spends.
- The new spending was down by about 20% in 1HCY12 as compared to the year-ago period. The BFSI segment is witnessing more softness because of the structural change in the financial health of companies there.
- Moreover, with the supply scene getting more competitive, the management assigns low probability to billing rate increases. Average realisations were flat in 1Q.
- However, it has indicated that, the churn ratio in project re-bidding is unusually high and this provides an opportunity to HCLT to win larger projects.
- The restructuring or churn spend is at about 30%, we understand. The companies are looking at squeezing more benefits in the RTB budgets which is also leading to vendor churn.
- The benefits from the RTB savings are now being directed to CTB. This is with a view to develop different business models and increasing revenues or revenue streams.
- To that extent, CTB is witnessing some spending but remains stressed overall.
- HCLT plans to bring in more efficiency in the RTB side of clients business and help clients divert the same to CTB, we understand.
- According to the management, 2H is expected to see a more than 100% rise in the deals coming up for renewals and that provides a big opportunity for the company.
- In OND quarter, about $30bn worth of deals are coming up for renewals. Within this, Europe's contribution is expected to be higher than US.

Margins higher than estimates

- The surprising part of the results was the improvement in margins, which rose marginally over the previous quarter as against expectations of a drop.
- HCLT gave salary hikes in 1Q and this was expected to bring down margins in 1Q.
- However, the company has been able to sustain margins on the back of higher off-shore content in SW services revenues (150bps higher) and increased utilization rates.
- The off-shore content increased as large deals won in the past two quarters scaled up and more work started getting off-shored.
- We understand that, margins may moderate from 2Q as the company invests in the renewal bids coming up over the next two quarters.
- However, if the company is able to subsequently improve profitability, it will bode well from the PAT growth perspective as well as valuations.
- Low margins were a cause of concern for us. The sustenance of margins in a narrow band over the past few quarters and the sharp improvement in past two quarters do lead to some comfort on this front.

Future prospects

- We have suitably modified our earnings estimates for FY13E.
- Revenues are expected to rise by 17% in FY13E, largely on the back of volumes and rupee.
- Margins are expected to rise as compared to FY12. While the expected rupee appreciation, salary increments and initially lower utilization levels may impact margins, higher off-shore content, better profitability in BPO business, mix change and cost optimization should help sustain profitability.
- We have assumed the rupee at Rs.52.6 / USD in FY13.
- We expect the company to report an EPS of Rs.45.6 (Rs.42.8.) in FY13E. This is after assuming a further equity dilution due to ESOPs.

Valuations

We maintain BUY on HCL Technologies with a revised price target of Rs.640

- We value HCLT at a marginal discount to Infosys' valuations due to the relatively lower profitability. This leads us to a PT of Rs.640 based on FY13 earnings estimates.
- The company has consistently grown revenues and sustained margins over the past few quarters. We maintain BUY based on valuations.

Concerns

- A delayed recovery in major user economies may impact our projections.
- A sharp acceleration in the rupee from our assumed levels may impact our earnings estimates for the company.

RESULT UPDATE

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INFOTECH ENTERPRISES LTD (IEL)

PRICE: RS.195 **RECOMMENDATION: BUY**
TARGET PRICE: RS.221 **FY14E P/E: 8.7x**

Infotech's results were broadly in line with estimates on the EBIDTA front. Volumes grew by 3.9% as compared to 2% in 1Q. Some of the client-specific issues, which had impacted the company, have started getting addressed towards the end of the quarter. EBIDTA margins were maintained QoQ as the leverage on salary hikes was set off by higher contribution from onsite projects in US and some one-time costs. The business outlook is largely positive subject to few sub-sectors like telecom and railways which are facing challenges on some fronts. The management has maintained its guidance of achieving FY13 revenue growth at the lower end of the 11-14% band set by Nasscom. We tweak our earnings estimates for FY13 and introduce FY14 estimates. FY14E earnings stand at Rs.22.5 per share. We increase our PT to Rs.221 (v/s Rs.205), based on FY14 estimates. Maintain BUY. Expected cash of Rs.58 per share by FY14 end, may provide cushion to the stock.

Summary table

(Rs mn)	FY12	FY13E	FY14E
Sales	15,531	19,096	20,860
Growth (%)	30.7	22.9	9.2
EBITDA	2,704	3,500	3,551
EBITDA margin (%)	17.4	18.3	17.0
PBT	2,365	3,268	3,389
Net profit	1,630	2,366	2,498
EPS (Rs)	14.7	21.3	22.5
Growth (%)	16.7	45.2	5.6
CEPS (Rs)	19.1	26.4	27.6
BV (Rs/share)	104.3	122.5	141.9
Dividend / share (Rs)	2.5	3.0	3.0
ROE (%)	14.9	18.8	17.0
ROCE (%)	21.6	26.0	23.0
Net cash (debt)	4,449	5,145	6,797
NW Capital (Days)	84.4	88.1	89.0
P/E (x)	13.3	9.2	8.7
P/BV (x)	1.9	1.6	1.4
EV/Sales (x)	1.1	0.9	0.7
EV/EBITDA (x)	6.4	4.7	4.2

Source: Company, Kotak Securities - Private Client Research

2QFY13 results

(Rs mn)	2QFY13	1QFY13	QoQ (%)	2QFY12	YoY (%)
Income	**4771.2**	**4563.8**	**4.5**	**3726.0**	**28.1**
Expenditure	3879.5	3712.0		3140.2	
EBDITA	**891.7**	**851.8**	**4.7**	**585.8**	**52.2**
Depreciation	144.5	134.2		123.0	
EBIT	**747.2**	**717.6**	**4.1**	**462.8**	
Interest	4.6	0.5		4.9	
Other income	-43.2	178.8		-13.8	
PBT	**699.4**	**895.9**	**-21.9**	**444.1**	**57.5**
Tax	226.2	292.3		153.5	
PAT	**473.2**	**603.6**	**-21.6**	**290.6**	**62.8**
Sh of profit	29.9	61.6		17.3	
MI	0.0	0.0		-0.5	
Adj PAT	503.1	665.2	-24.4	307.4	63.7
EPS (Rs)	**4.53**	**5.99**		**2.77**	
Margins (%)					
EBDITA	18.7	18.7		15.7	
EBIT	15.7	15.7		12.4	
PAT	9.9	13.2		7.8	

Source : Company

Volume growth at 3.9%

- Revenues grew by 4.5%, largely on the back of higher volumes, which were up by about 3.9%, as against 2% for 1QFY13.
- In 1Q, volume growth was impacted by the suspension of work in one of the large accounts in the European rail client. For another client in the same segment (London Underground) in Europe, work was pushed back to 2Q because of the Olympics.
- According to the company, the scale ups have started but only partially. To that extent, the company has been impacted by the slower spending by clients.
- We have been concerned due to the relatively higher proportion of projects-based business in Infotech.

- Infotech bagged 17 new accounts during the quarter of which, 9 were in the ENGG vertical and the balance in UTC (Utilities, Telecom and Content).
- In the Engineering vertical, Aerospace and HTH (Heavy Equipment, Transportation, Hi-tech) saw volume growth of 1.5% and 2.8%, respectively.
- The vertical continued to execute on the large orders. The aerospace business has seen stability in order execution because of the longevity of the projects. The order bookings and customer acquisitions have also been decent with 2 'must-have' accounts during the quarter.
- The rail signaling business had been challenged, more so in Europe with suspension and push-back of contracts. This has started to recover towards the end of the quarter and is expected to further improve, going ahead.
- The hi-tech business continues to be cyclically strong and is expected to remain so till the fiscal end.
- The heavy engineering business has seen recovery after seeing some challenges in 1H, with ramp-ups in three accounts.
- Within ENGG, aerospace contributes about 55% of revenues, rail transportation 20%, heavy engineering 15% and hitech, the balance.
- In the UTC vertical, Utilities and Content reported volume growth of 8.2% and 5.2%, respectively. Strong traction is seen in the utilities business and the company has witnessed some revival even in the telecom network planning segment, which is encouraging. US business accounts for more than 50% of the UT business.
- The telecom business is stressed, especially the equipment manufacturers.
- The content business saw good scale up in the commercial geospatial business. The top 2 clients in this business are scaling up.
- The projects-based nature of UTC revenues makes the revenue trajectory volatile.
- Within this vertical, more than 40% of revenues come from telecom, 30% from content engineering and the balance from utilities.

Average realisations flat

- Infotech has indicated that, average realisations were marginally lower and that, it has not witnessed any major pricing renegotiations during the quarter.
- We view this positively but would watch the future quarters closely in the backdrop of the macro uncertainties.

EBIDTA margins maintained QoQ

- EBITDA margins for the quarter were maintained at the previous quarter levels.
- While the salary increments had impacted margins by about 370bps in 1Q, the 2Q margins were impacted by higher proportion of onsite revenues in USA. There were also some one-off items which impacted margins to some extent.
- The company also had added net 464 employees in 1Q and it further added 295 in 2Q.

"Other income' and tax

- Infotech reported a forex loss of about 105mn during the quarter, largely due to translation losses (Rs.90mn).
- The company provided tax at the rate of 32% of PBT. Management expects the same to remain at around 33% in FY13.

Earnings estimates changed

- We have changed our FY13 earnings expectations to accommodate the 2Q results changed currency scenario. We also introduce FY14 estimates.
- For FY13, we have assumed the exchange rate at Rs.53.5 / USD and for FY14E at Rs.51.5 / USD.
- For FY13, we expect revenues to grow at 23%, led by volume growth of about 12%. For FY14, volume growth is expected to be about 12%.
- Margins are expected to fall YoY in FY14, largely due to the assumed rupee appreciation and also salary hikes. Better utilisation of resources and efficiency gains may limit losses.
- PAT is expected to rise by about 6% only in FY14, largely due to currency fluctuations. Infotech is already a high tax paying company.
- EPS for FY13E works out to Rs.21.3 and that for FY14E at 22.5.
- We expect the company to have net cash of about Rs.6.8bn by FY14 end, which works out to Rs.58 per share.

Valuations

- Infotech has managed to deepen engagement for clients like UTC, P&W, Bombardier, Tele-Atlas & Swisscom over the recent quarters and enjoys relationships with marquee clients in its verticals.
- Management continues to see opportunities in the higher thrust which aerospace companies (Bombardier, etc are major clients) are giving to efficient and light engine design skill sets- areas where IEL has domain expertise and existing impressive client roster.
- However, margins have scope for improvement. These reflect the challenges of a mid-tier company.

We maintain BUY on Infotech Enterprises with a price target of Rs.221

- We accord a suitable discount to Infotech as compared to the valuations of larger companies and arrive at a PT of Rs.221. We will become more positive after seeing a sustained improvement in the margins.
- We maintain **BUY** looking at the near 13% upside from the current levels.

Concerns

- A sharp appreciation in the rupee from our assumed levels will impact earnings estimates negatively for the company.
- A delayed recovery in major user economies could impact revenue growth of Infotech.

Bulk deals

Trade details of bulk deals

Date	Scrip name	Name of client	Buy/ Sell	Quantity of shares	Avg. price (Rs)
17-Oct	8k Miles Soft	Shah Niraj Nagindas (HUF)	S	104,961	27.85
17-Oct	8k Miles Soft	Pallasanna Krishna Subramanian HUF	S	93,750	27.85
17-Oct	Aarey Drugs	Mukesh Bhogibhai Darji	B	74,788	59.90
17-Oct	Aarey Drugs	Rameshchandra Pranshankar Mehta	S	100,000	60.00
17-Oct	Aishwarya Tele	MV Tradecom Pvt. Ltd	B	181,341	10.08
17-Oct	Aishwarya Tele	G Rama Manohar Reddy	S	200,000	10.09
17-Oct	Ashutosh Paper	Shakuntala Devi	S	35,304	69.89
17-Oct	Binayak Tex	Dilipkumar Pacheriwala	B	5,000	350.00
17-Oct	Binayak Tex	Gitadevi Hariprasad Garodia	S	5,000	350.00
17-Oct	Comfort Com	Narayan Securities Ltd	S	60,000	19.02
17-Oct	Devika Prot	Pravin S Rajpurohit	B	100,000	9.29
17-Oct	Devika Prot	Kiran M Joshi	S	101,000	9.29
17-Oct	Devika Prot	Parikh Shilpa Mihir	S	81,000	9.30
17-Oct	Devika Prot	Parikh Dhruman Mihir	B	81,200	9.29
17-Oct	Farry Inds	Tien Trading Pvt. Ltd	S	64,261	21.65
17-Oct	Farry Inds	Ceeplast Trading Co Pvt Ltd	B	25,000	21.65
17-Oct	Finalysis Cred	Sagar Bothra	S	30,000	61.10
17-Oct	Fineotex Chem	Shah Pathik	S	65,851	36.25
17-Oct	Globsyn Info	Harish Pande (HUF)	B	50,000	8.50
17-Oct	Globsyn Info	IFCI Limited	S	52,000	8.50
17-Oct	High Str Fila	Ravindra Jamad	B	5,000	49.00
17-Oct	Infodrive	Saheli Trading Pvt. Ltd	B	257,982	9.36
17-Oct	Jaihind Syn	Arcadia Share & Stock Brokers	B	25,000	6.25
17-Oct	Jaihind Syn	Dinesh Jayntalal Doshi	S	25,000	6.25
17-Oct	Pasupati Fin	Orion Investmart Pvt Ltd	B	40,000	23.93
17-Oct	Pasupati Fin	Narayan Dass Rathi	B	27,000	23.95
17-Oct	Pasupati Fin	Charishma Engineering Ltd	S	50,000	23.93
17-Oct	Rcl Retail	Guiness Securities Ltd	S	70,000	10.39
17-Oct	Rcl Retail	ABM Finlease Pvt. Ltd	S	110,000	10.33
17-Oct	Rcl Retail	Saravanan Marimuthu	B	70,000	10.32
17-Oct	Riga Sugar-$	Amandeep Singh	B	79,741	21.80
17-Oct	Riga Sugar-$	Future Zone Entertainment Pvt	S	125,925	21.78
17-Oct	Shreychem	Kishor Valji Gohil	B	35,000	74.24
17-Oct	SR Inds	Dinesh Chand Garg(Huf)	S	88,010	6.09
17-Oct	SR Inds	AVN Corporate Research	B	86,719	6.09
17-Oct	Suryanagri Fin	Chimanlal Jaigopal Shah	S	50,000	41.00
17-Oct	Transgene Bio	Persistent Commodities Tradlink	S	608,713	9.59
17-Oct	TV18 Broadcast	SBI Life Equity Fund	B	1,934,000	27.50
17-Oct	TV18 Broadcast	Templeton Mutual Fund Ac Franklin India Prima Plus	S	1,899,981	27.50
17-Oct	Vision Cinemas	Srinivas Karrothi	B	284,344	9.62
17-Oct	Vision Cinemas	Vijaykumar Bandulal Bhandari	S	150,000	9.54

Source: BSE

Gainers & Losers

Nifty Gainers & Losers

	Price (Rs)	chg (%)	Index points	Volume (mn)
Gainers				
HDFC	753	1.2	4.2	3.0
L&T	1,626	1.3	3.5	1.3
ITC Ltd	288	0.6	3.1	2.9
Losers				
Reliance Ind	805	(0.9)	(3.8)	4.8
TCS	1,283	(1.0)	(2.1)	0.8
Ambuja Cement	203	(3.0)	(1.5)	4.9

Source: Bloomberg

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