01 June 2015

Sector Research

India: Tier-1 IT Services

Initiation of coverage

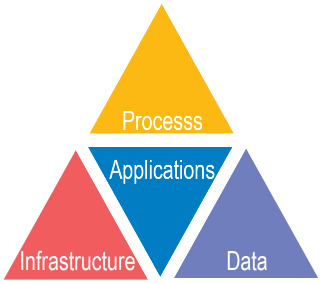
An industry in transformation

The IT services sector is in the midst of a major transformation, where technologies not only create revenue opportunities for Indian vendors, but also cannibalize existing revenues. More importantly, it is also changing the business models of companies. This duality of revenue creation & destruction will drive higher revenue volatility. We prefer stocks where risks to earnings and valuations are low. We initiate at BUY on Wipro and Infosys, with TCS, HCL Tech and Tech Mahindra at HOLD.

- **Our view of IT services business in next 10 years:** (i) IT services business is set to increasingly be driven by cost rationalization based on innovation rather than wage arbitrage; (ii) We see headcounts at companies coming down due to newer technologies over time; and (iii) IT will be all pervasive and the transfer of consumer tech innovation to enterprises will accelerate. We believe these factors will change the existing business models of vendors over time.
- **Cloud adoption to drive increasing revenue volatility…:** Just as offshore IT services players disrupted the pure onsite-based IT services players, forcing them to recalibrate their business models, adoption of the Cloud is forcing all services players to recalibrate their business models across sales and delivery. The Cloud will cannibalize every aspect of enterprise IT spend, but will also create new ones. This duality of revenue cannibalization and creation will drive increasing revenue volatility over time. Digitization, Cloud enablement and Internet of Things are key themes in the medium term.
- **…and accelerate outsourcing over time:** Tier-1 IT services together (including Cognizant) have c.90 clients, each contributing >US$100m in revenues. These are also the most mature outsourcers, implying that Cloud adoption could happen at a faster pace in these accounts. This can drive an interim uplift in spend on digitization and Cloud enablement, followed by cannibalization of existing revenue for IT services firms from these clients. It will accelerate the process of Cloud enablement and digitization of other enterprises as it will be a source of business advantage, thereby accelerating outsourcing of IT services spend, which we estimate is currently only 40% of overall spend (with the remainder in-house).
- **We prefer stocks where risks to earnings and valuations are low:** In the context of increasing volatility and a need for transformation across all companies, we prefer stocks where risks to earnings and valuations are relatively low. We score stocks on a four point framework called B.A.S.E.: (i) Broad service & client portfolio; ii) Ability to defend current margins; (iii) Scale of operations within existing clients; and (iv) Earnings growth expectations. We initiate coverage on Wipro and Infosys at BUY, with Tata Consultancy Services HCL Technologies, and Tech Mahindra at HOLD.

Company	Rec	Target
HCL Technologies	Hold	INR1008
Infosys	Buy	INR2385
Tata Consultancy Services	Hold	INR2813
Tech Mahindra	Hold	INR590
Wipro Ltd	Buy	INR677

Cloud impacts every aspect of Enterprise IT



Source: Investec Securities research

Nitin Padmanabhan
+91 (22) 6136 7400
nitin.padmanabhan@investec.co.in

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Crystal ball gazing IT services

Over the next decade: After the big shift in services delivery from a pure onsite model to an onsite-offshore model over the last decade, the industry is now in the midst of shifting to a Cloud-based model. While the last shift was driven by Tier-1 Indian IT services vendors, the current shift is being driven by Amazon, IBM, Microsoft, Google, Salesforce, Workday, SAP and Oracle among others with technologies like mobility, social media, analytics and artificial intelligence acting as catalysts.

Every time that services delivery has evolved, the business models of existing vendors have readjusted.

This shift has multiple implications from both a business model and revenue growth perspective.

Business model shifting to innovation led cost rationalization vs wage arbitrage based cost rationalization

Implications for business model:

- Requirement for fewer FTEs (full-time employees) to execute work (IT services vendors still have c.50% of revenues billed on time and material – billing per hour per employee).
- Shift to innovation-led cost rationalization versus wage arbitrage-based cost rationalization, which in turn requires a workforce with different skillsets.
- A consultative approach to selling with a close eye on customer technology road maps.
- Need for alliances and partnerships with companies that drive the Cloud ecosystem.

Duality of revenue cannibalization and creation can lead to higher revenue volatility

Implications for revenue growth:

- While we expect the Cloud to cannibalize existing IT services spend across every aspect of enterprise IT (see page 6), it will also create new revenue streams in areas like IoT (Internet of Things), analytics and other applications that leverage the Cloud.
- This duality of revenue cannibalization and creation can lead to higher volatility in revenues.

Growth over next 5 years will be driven by digitization and Cloud enablement of enterprises

IT services over the next 5 years: Digitization & Cloud enabling enterprises

While the IT services business will look significantly different 10 years from now, we expect spending on enabling legacy applications and digitizing existing landscapes over the next five years to bring revenue growth opportunities for Indian vendors. We estimate that this should help sustain 12-15% growth for Indian IT services vendors over the period.

What is Digitization?

The world is increasingly getting connected and instantaneous in terms of communication, payments, e-commerce etc. The commonality among these is that they are digital and connectable. While these are largely prevalent in the consumer space, enterprises are largely deficient. This debottlenecking of enterprises by creating digital connectable solutions is called digitization. The emergence of the Cloud, mobility, social media and artificial intelligence along with the availability of a wide variety of sensors enable the creation of this real-time digital enterprise.

Table 1: Company wise highlights on Digitization and Cloud Technology front

Company	Highlights around Digitization & Cloud
Accenture	Currently derive 20% of revenues from Digital. Portfolio growing at 20%
IBM	IBM calls the revenue mix from Cloud, analytics, and security as strategic imperatives. The portfolio is 27% of company revenues and is growing at 16%. IBM recently invested US$13bn in a separate IoT Unit.
TCS	Generated US$125mn from Cloud-based platforms in FY15. Commentary suggests strong order book for Digital services
Infosys	Using design thinking workshops with clients to generate revenues in this space. The company has also put in place multidisciplinary terms called "Super Ninjas" that can create rapid prototypes in 1-2 weeks. Cloud-based platforms generated c.US$100mn in revenues in FY15.
Wipro	Started a separate unit called Wipro Digital that works to drive growth in the business. Training and putting in place a team with multi-disciplinary capabilities called "Unicorns". R&D business well placed to benefit from growth in IoT
HCLT	Has Cloud enablement and digitalization offerings. Also investing in the engineering services space to derive growth in IoT.
Tech Mahindra	Has multiple offerings in this space including platforms and can benefit from IoT through its engineering services business.

Source: Investec Securities research

How are Tier-1 Indian IT services vendors placed?

We believe Tier-1 Indian IT services vendors have both significant opportunities and challenges, which we highlight below:

Tier-1 IT services together (including Cognizant) have c.100 clients contributing > US$100m in revenues

Opportunities:

- In the context of F500 or Global 2000 companies, Tier-1 IT taken together (including Cognizant) have c.90 clients accounting for >US$100m in revenues. This implies significant room to grow and expand with other clients.
- The top 90 clients of Tier-1 IT services vendors are also mature outsourcers. They could potentially be the fastest to shift large parts of their business to the Cloud. While this implies cannibalization of existing revenue it also means better growth in the medium term due to digitization and Cloud enablement spend.
- Re-architecting existing legacy applications of clients for the Cloud and newer spend like analytics, IoT and others that leverage the Cloud. Deutsche Bank, for instance, plans to spend US$1.1bn on digitization over the next 5 years.
- The Cloud should dramatically improve productivity for clients, thereby bringing advantages. This should drive an acceleration of IT services outsourcing by companies that haven't moved to the Cloud as they re-architect legacy systems and catch up (see page 9).

Challenges:

- Requirements for fewer FTEs (full-time employees) to execute work challenge the existing business model (IT services vendors still have c.50% of revenues billed on time and material – billing per hour per employee).
- Adjusting the existing business model without disruption.
- Managing revenue volatility as existing revenues get cannibalized.

While the above challenges indicate volatility in revenue growth, Tier-1 IT services vendors should benefit as they cater to the most mature outsourcers and can replicate those learnings to help digitize and Cloud enable newer clients to create a virtuous cycle of growth. Deflation of revenue is a continuing theme in tech since its inception; however, the increasing applicability of IT has only brought more revenue opportunities.

Bottom line: We expect Tier-1 IT services to grow at 12-15% over the next 5 years with higher revenue volatility.

Evolution of Delivery = Revenue Volatility

- **Evolution of service delivery has always driven change for incumbents**
- **Cloud is the next evolution of services delivery**
- **The Cloud will not only cannibalize existing revenue streams, but also create new ones**
- **Tech: We tend to overestimate near term and underestimate long term**

Evolution of service delivery has always driven change for incumbents

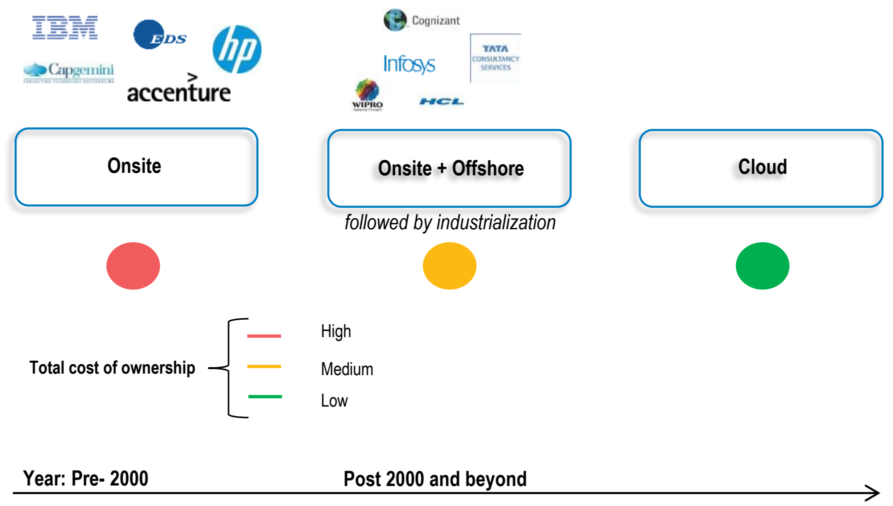
The IT services industry has seen significant change each time that services delivery evolves, requiring a readjustment of business models by incumbents. The shift from a pure onsite model to an onsite-offshore model drove the need to improve the model of onsite incumbents like IBM, Accenture and Capgemini.

The industry is now undergoing another significant evolution of IT services delivery with the emergence of the Cloud. This will drive significant change not only for the leaders of the traditional onsite model, but also the disruptors who led the offshore model – the Tier-1 Indian IT services players.

Cloud is the next evolution of IT services delivery

Figure 1 highlights the evolution of services delivery. Each stage of evolution has only led to lower total cost of ownership for the client. We highlight the key changes:

Figure 1: Change in Service Delivery and Total Cost of Ownership Overtime



Source: Investec Securities

Onsite: Services delivered at client site.

Advantages: Close proximity to client

Disadvantages: High total cost of ownership

This model was largely led by IBM, Accenture, HP and Capgemini among others

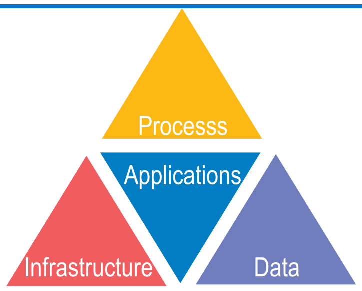
Offshore: Service delivered from low-cost locations

Advantages: a) Lower total cost of ownership; b) Can take advantage of time zone differentials; c) Scalability is high due to availability of talent

Disadvantages: Learning curve to manage offshore project teams for clients

This model was largely led by Tier-1 India-based IT services vendors which include TCS, Infosys, Wipro, Cognizant and HCL Tech. After 2009, TCS led the wave of industrialization – with delivery driven by high standardization, the re-use of tools and automation that allows higher fixed price contracts versus traditional Time & Material contracts.

Figure 2: Cloud impacts every aspect of Enterprise IT



Source: Investec Securities research

Figure 3: Exposure to different aspects of IT

BPO	Revenue FY15 ($m)	as % of revenue
TCS	1,808	11.7%
Infosys	558	6.4%
Wipro	669	9.5%
HCLT	293	5.0%
TechM	306	8.5%

IMS	Revenue FY15 ($m)	as % of revenue
TCS	2,135	14.0%
Infosys	699	8.0%
Wipro	1,893	26.7%
HCLT	2,007	34.5%
TechM	NA	NA

ADM	Revenue FY15 ($m)	as % of revenue
TCS	6,215	40.2%
Infosys	3,003	34.5%
Wipro	1,139	16.0%
HCLT	1,592	27.4%
TechM	NA	NA

EAS	Revenue FY15 ($m)	as % of revenue
TCS	2,406	15.6%
Infosys	2,831	32.5%
Wipro	NA	NA
HCLT	902	15.5%
TechM	NA	NA

Source: Investec Securities research

Cloud: While the offshore model lowers the total cost of ownership through labour arbitrage, the Cloud brings down total cost of ownership by creating efficiencies, eliminating redundancies and leveraging scale. The key benefits of the Cloud are as follows:

- Ability to pay per use (opex vs capex model) and an infrastructure that can be scaled up and down rapidly
- Lower network operation costs along with quicker and lower cost of application development
- Relatively higher reliability with a) Cloud infrastructure managed by the service provider; b) platform maintained by the platform service provider; and c) applications maintained by the application development vendor
- Enables Internet of Things (devices connected to the internet)

Cloud will cannibalize existing revenue streams, but also create new ones

The Cloud impacts every aspect of enterprise IT. Figure 2 highlights the different aspects of enterprise IT. We explain how the Cloud will cannibalize and create new revenue streams across each aspect.

1. **Process:** From a business process perspective, the Cloud can eliminate data redundancies and allows for connecting with intelligent devices that helps reduce workflows dramatically. In short, the Cloud is a key enabler to drive intelligent process automation (IPA).

   Uber is a good example of IPA. In this case, order processing and fulfilment, which would otherwise be done by people in call centres, are automated via mobile phones and the Cloud. In short, IPA is the elimination of intermediate workflows by making the end points more intelligent.

   Tier-1 IT services vendors are increasingly talking about it and building capabilities. Wipro recently talked about how it will be able to reduce FTEs for its own internal travel and expense management from 700 to 20 using a combination of mobility and intelligent software. TCS has been talking about eliminating workflows, while Infosys is institutionalizing design thinking and conducting workshops for clients that help identify problems in their businesses by keeping the client at the centre of the experience. Cognizant recently spoke about how it was able to clear a 6-month claims backlog in 3 weeks by using process automation.

   Revenue destroyer: All examples above highlight how FTEs required for managing business processes can be brought down dramatically. While this will cannibalize revenues, it will open up opportunities for players who are able to innovate and drive process disintermediation for the client.

   Revenue creator: It will also open up opportunities to Cloud, enable legacy processes and drive long-term productivity targets in a phased manner.

2. **Data:** The scalability and variability of Cloud infrastructure coupled with the ability to eliminate data redundancies by eliminating silos dramatically improves the kind of analytics that are possible with existing data. Moreover, with an increasing number of connected devices, there will be a multitude of data that can be put together and analysed.

   Revenue creator: Analytics can be a significant driver of revenue growth when combined with all existing offerings.

3 **Infrastructure:** While Indian vendors have not traditionally owned IT infrastructure for clients, they have managed clients' IT assets. Shifting to Cloud will significantly reduce the number of FTEs needed to manage IT assets.

Revenue creator: Indian IT services vendors have benefitted by gaining share from large legacy infrastructure management contracts that have been renewed. We continue to see these benefits with over US$190bn in contracts coming up for renewal in the next two years.

Revenue destroyer: However, the movement of existing Infrastructure Management Services revenues to the Cloud will impact growth.

4 **Applications:** Transitioning existing legacy applications to the Cloud will require re-architecting and extensive testing of these applications to avoid disruptions. While this will throw up new revenue opportunities, we also see cannibalization of existing revenue streams as (i) application management will now require fewer FTEs, and so will (ii) application development on the Cloud.

Revenue creator: (i) Re-architecting existing applications for the Cloud; and (ii) Migration, customization and maintenance on Cloud-based platforms

Revenue destroyer: (i) Application management will require lower FTEs; (ii) Application development on the Cloud requires lower FTEs; (iii) On-premise enterprise applications like SAP and Oracle should gradually move to the Cloud.

Tech: We tend to overestimate near term and underestimate long term

"We always overestimate the change that will occur in the next two years and underestimate the change that will occur in the next ten."

Bill Gates

In the words of Bill Gates "We always overestimate the change that will occur in the next two years and underestimate the change in the next ten." While the impact of the Cloud indicates broad-based cannibalization, we expect it to occur gradually over a period of time. Moreover, transitioning to the Cloud will involve additional spend for IT services players in the interim and companies themselves will also transform over a period. Figure 4 highlights how IT services are well placed to benefit from their presence across the Cloud value chain in the medium term.

Figure 4: Capability Map Across the Cloud Value Chain by Different Providers

Vendor Type / Cloud Offering	Strategy	Design	Implement	Support	Maintain
IT consulting companies	●	◕	○	○	○
IT services vendors	◔	◕	●	●	●
Hardware and software providers	◑	◕	◑	◔	◔
Challengers	◔	◕	◕	●	●

Capability: ● ◕ ◑ ◔ ○ (Significant → None)

Source: KPMG, Investec Securities Research

We believe the implications of increasing Cloud adoption could be as follows:

- Revenue growth could become increasingly volatile (likely determined by rate of Cloud adoption among top 20-50 clients of a company), more specifically for companies with large exposure to Infrastructure management services
- Increasing spend on Cloud-enabling the enterprise could drive positive revenue momentum, followed by the cannibalization of existing revenues
- A lower need for FTEs (over time) will inherently drive a de-humanization of IT
- Increasing spend on engineering services to build IoT devices and applications that leverage these devices on the Cloud
- Leveraging the start-up ecosystem for innovation becomes more important than ever

Core drivers will continue to support growth

- **Driver 1:** Enterprise tech is behind consumer tech vs the other way round until early 2000
- **Driver 2:** Rapid technology changes make outsourcing a more viable model
- **Driver 3:** Global shortage of ICT talent to meet the above challenges
- **Driver 4:** Labour arbitrage continues for offshore players

We believe the core drivers for the sector will continue to support growth until enterprises become Cloud ready. Re-architecting legacy applications and creating a digital enterprise are pre-requisites to Cloud enablement. Tier-1 IT services providers will continue to benefit from historic industry drivers as corporations globally transition to the Cloud.

Driver 1: Enterprise tech is behind consumer tech vs the other way round until early 2000

Enterprises have historically benefitted from innovative high end technology since inception. However, post the advent of the internet and launch of the iPhone in 2004, technological innovation has been democratized with consumers benefiting from high end technology. The rapid evolution of consumer tech and pace of innovation have left enterprises far behind. We believe the push to catch up with consumer tech will be a key driver of growth for outsourcing.

Driver 2: Rapid technology changes make outsourcing a more viable model

Rapid technological changes make training and recruitment key. Global corporations are better off outsourcing to vendors rather than constantly investing in updating in-house capabilities. IT services vendors have scale benefits and can execute far more easily. Moreover, vendors can generate use cases far more quickly and learn faster due to multiple iterations across clients. Services vendors that are able to understand and implement newer technologies faster and integrate 'best of breed' solutions for the client will benefit from higher growth rates.

Driver 3: Global shortage of ICT talent to meet the above challenges

A shortage of ICT talent makes it all the more difficult for global corporations to invest in in-house IT capabilities, which are largely seen as non-core. A few statistics below highlight how the talent shortage will continue to support growth for Indian offshore vendors.

- The EU commission estimates a shortage of 700,000 ICT professionals in the EU by 2015.
- US ICT unemployment rates currently at 2.5% vs c.8% for rest of the economy.
- Japan accounts for c.12% of global outsourced IT services spend, which is largely outsourced to Japanese IT services firms with the top 25 players accounting for 80% of the market (based on Gartner data). Despite c.23% of its population being above the age of 65, which is projected to reach 40% of the population by 2060, offshore outsourcing remains insignificant.

India continues to be a global leader in terms of availability of talent with c.1m engineers trained annually.

Driver 4: Labour arbitrage continues for offshore players

Onsite costs are still >4x offshore costs. A change over the last 10 years has been a replication of offshore capabilities by multinational corporations. Note that Accenture, IBM and Capgemini among others have significantly added offshore headcount during the period.

Increasing Cloud adoption will accelerate outsourcing

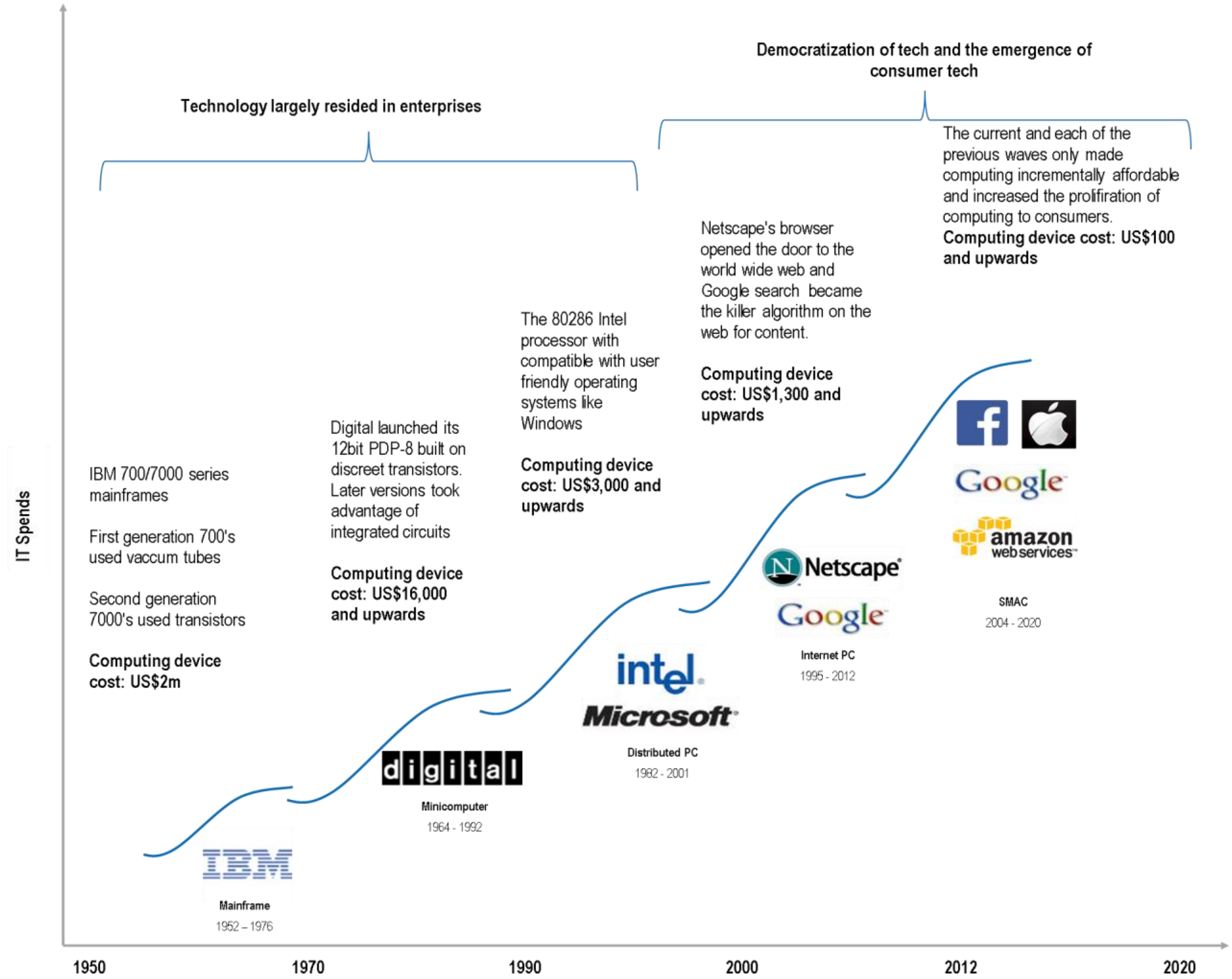
- Cloud adoption by enterprises will bring significant advantages, forcing companies that haven't to accelerate outsourcing
- Estimated outsourced spend still leave significant room for growth
- Declines in revenue growth from different IT service offerings have to a large extent historically been compensated for by newer ones

Cloud adoption by enterprises will bring significant advantages, forcing companies that haven't to accelerate outsourcing

We earlier highlighted how the Cloud will drive significant productivity for enterprises. As Cloud adoption rises and brings significant advantages, it should lead enterprises that haven't outsourced to accelerate this in an effort to quickly digitize and Cloud-enable existing applications, processes and infrastructure.

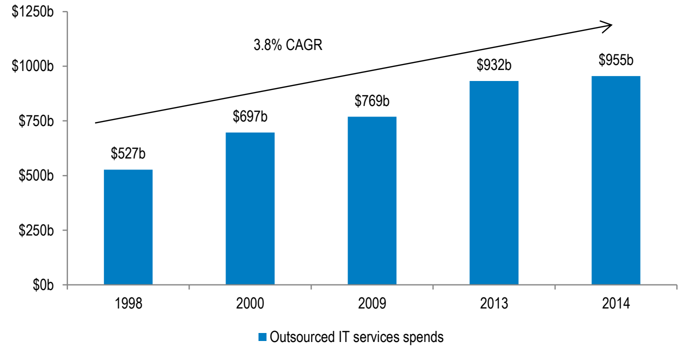
This trend is clearly visible through history as improving technology, applicability and declining total cost of ownership have only increased outsourced IT services spend. While the data only goes back to the 1950s, it is quite intuitive. Through each wave highlighted below, the number of players in the industry has only risen.

Figure 5: Declining Cost of Tech has only increased its adoption over time…



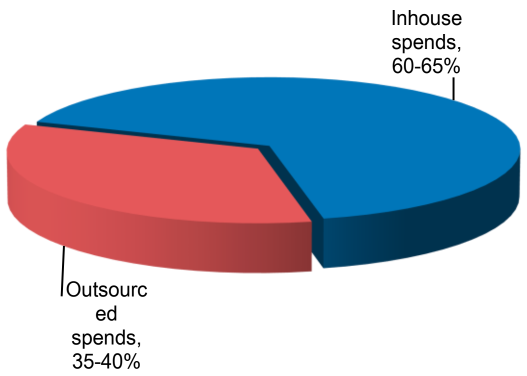
Source: Investec Securities estimates

Figure 6: … and driven higher outsourced IT service spend



Source: Gartner, Investec Securities Research

Figure 7: Broad estimates of outsourced spend are still low

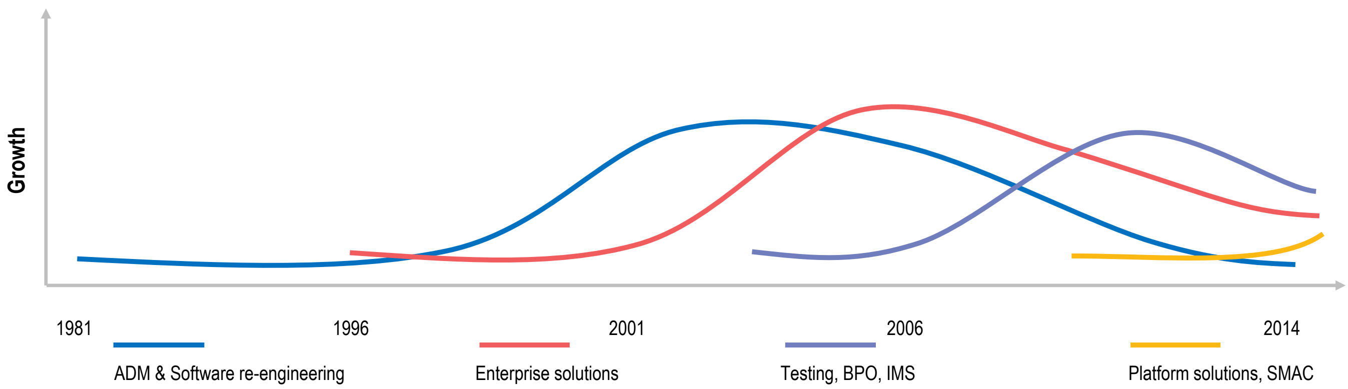


Source: Gartner, Investec Securities estimates

Declines in revenue growth from different IT service offerings have to a large extent historically been compensated for by newer ones

Figure 8 shows how declines in revenue growth from different IT services offerings have historically been offset to a large extent by newer ones. However, historically, newer service offerings have been driven by an offshore model. In the current context, the Cloud will cannibalize revenues from most of the service offerings over time, implying that growth from re-architecting legacy applications for the Cloud, migrating existing processes and infrastructure to the Cloud and investments in new areas like IoT will make up for this cannibalization. We assign a high probability to this happening as the applicability and pervasiveness of IT will increase dramatically over time, along with lower total cost of ownership.

Figure 8: : Historically growth from new services has made up for declining growth of existing ones



Source: Investec Securities research

Strategies have converged and so will growth

- Strategies of IT services players have converged over time, divergent growth rates should do too

Strategies of IT services players have converged over time, divergent growth rates should do too

Table 2 highlights how the revenue CAGR, which was largely similar for the top 4 services players since 2002, began to diverge from 2009. Divergent growth rates were largely driven by differential strategies during the period. While TCS was able to quickly adapt to the changing client priorities and HCL Tech rode the wave of infrastructure management services outsourcing, Infosys and Wipro faltered.

Table 2: Revenue CAGR

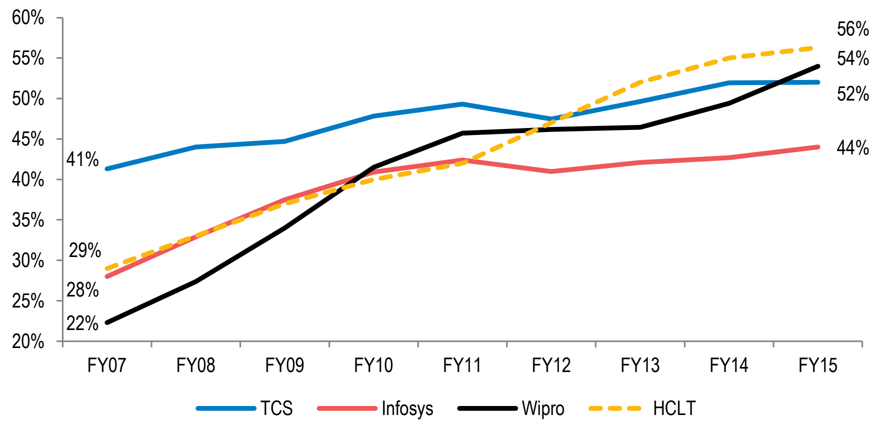
	Revenue CAGR%			
	Since 2002	Last 10 years	Last 5 years	Last 4 years
TCS	25%	21%	19%	17.2%
Infosys	24%	19%	13%	9.6%
Wipro	23%	17%	10%	8.1%
HCL Tech	25%	23%	17%	13.8%

Source: Investec Securities research

We highlight four strategies which TCS perfected that we believe Infosys and Wipro quickly caught onto. We believe a convergence of these strategies for both existing and future business should drive an increasing convergence in revenue growth over time.

1. **Lower variance vs initial estimates on cost of executing large deals vs actual costs incurred:** We believe this inherently made TCS more competitive. We note that the competition has aggressively benchmarked itself against TCS on this parameter and bridged the gap over the past 5 years. The proof is largely visible in the percentage of revenues from fixed price projects.

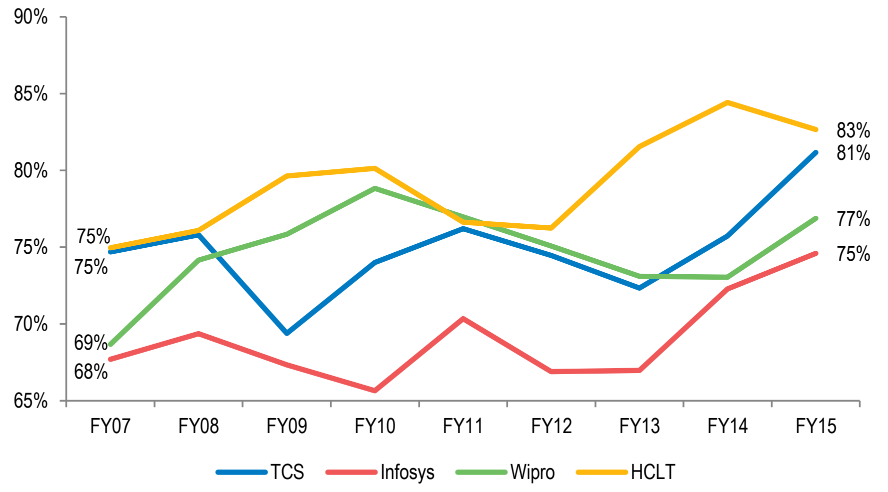
Figure 9: Revenues from fixed price contracts are increasingly converging for Tier-1 players



Source: Company, Investec Securities research

2 **Ability to operate at higher utilization rates:** The ability to operate at higher utilization rates is driven by (i) being able to match skillsets of existing resources with market demand; and (ii) higher automation and industrialized delivery.

Figure 10: Utilization rates are improving quickly for companies that lagged



Source: Investec Securities estimates

3 **Improving client experience by reducing gap between sales and delivery:** In our conversations with competitors, they have consistently highlighted how TCS was able to provide a better client experience and improve client mining by having personnel with delivery expertise and strong sales acumen to drive revenue growth from existing accounts. This not only helps drive certainty in execution, but also improves the ability to identify revenue opportunities. Infosys and Wipro have already implemented these changes by identifying and deploying key personnel within the organization. Moreover, it is also important to note that Wipro has consistently made key hires from TCS (Satishchandra Doreswamy and Abid Ali Neemuchwala) to benchmark and replicate key success factors from TCS. Infosys on the other hand hired Dr Vishal Sikka as CEO – a veteran in tech and regarded by some as a visionary.

While strategies have broadly converged with respect to driving efficiencies in the existing business, we also see a convergence in strategies on the way forward. We highlight the same below:

- Commentary on in-house artificial intelligence-based platforms to drive productivity in the existing business
- Extensive use of open source technologies to drive lower total cost of ownership for the client
- Acknowledgement of need to drive higher revenue per employee and reducing the reliance on headcount for growth
- Investments in platforms that can be a driver for growth over time

We therefore believe that with increasing convergence in strategies, overall growth rates should also begin to converge.

Critical success factors in the business

- Ability to manage the duality of IT services revenues
- Ability to view technology trends ahead of time
- Consistently drive productivity increases

Critical success factor 1: Ability to manage duality of IT services revenues

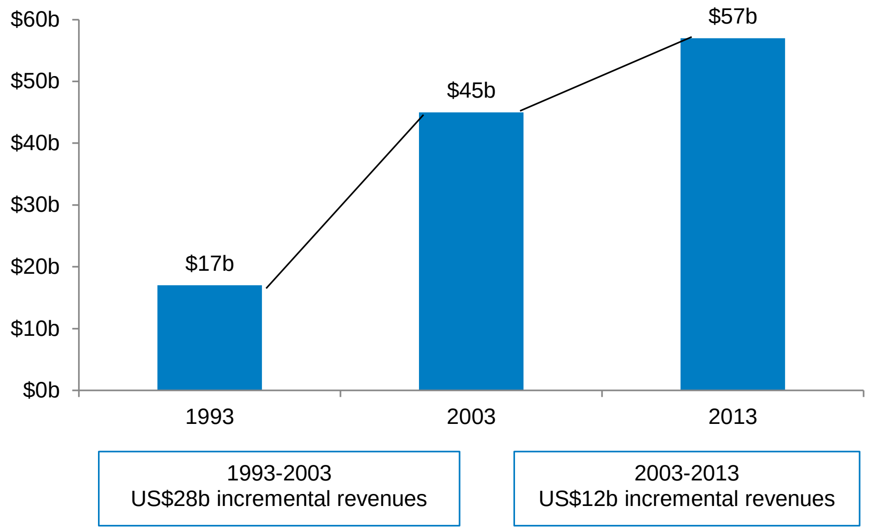
Managing the duality of IT services revenues is a key critical success factor in this business. This duality or the **revenue creation and destruction cycle** is an inherent industry characteristic driven by the evolution of technology. Over time technology becomes cheaper and productivity improvements can become dramatic, eating into existing revenue streams.

A look at IBM's services business revenue growth (see Figure 11) over the last two decades gives a reasonable view of the revenue creation and destruction cycle and how the inherent churn in the business acts as a headwind to revenue growth.

The company added US$28bn in incremental revenues from 1993 to 2003 (10% CAGR), but only added US$12bn from 2003 to 2013 (2.3% CAGR). TCS added c.75% of those revenues during that period on a much smaller base and can be attributed to a relatively lower legacy portfolio during that period).

The churn within existing revenue streams also appears dramatic for IBM. During 2003 to 2013, IBM added c.US$16bn in analytics revenues and US$4.4bn in Cloud revenues – that's US$20.5bn incremental revenues from new service lines, however, net revenue addition was only US$12bn during the period. Therefore, churn within existing revenue streams on a larger base is much higher.

Figure 11: IBM's Services Revenues over two decades

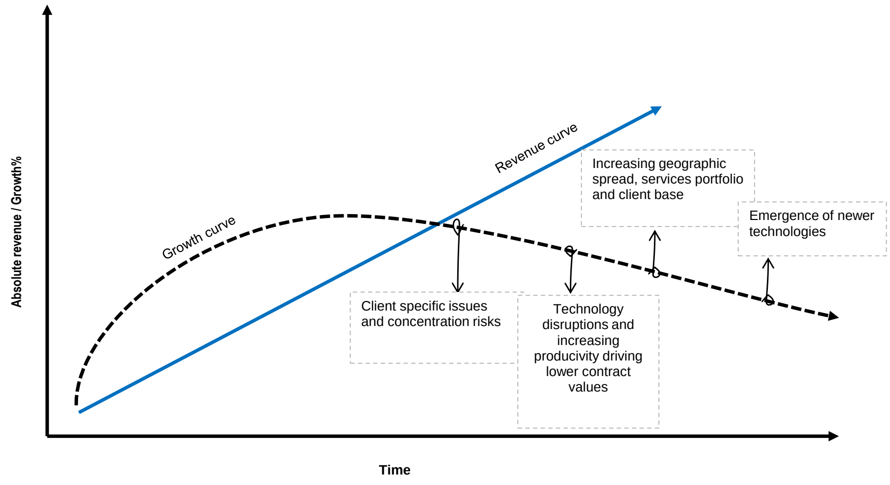


Source: Investec Securities research

We highlight the above in a schematic called the revenue creation and destruction cycle below (Figure 12).

Over time, the portfolio of revenues is subject to the force of technology changes and thereby revenue destruction (the falling cost of technology is an inherent characteristic). Therefore while the revenue curve may continue to slope upwards, the growth curve begins to slope downwards overtime.

Figure 12: The Duality of IT Services Revenue



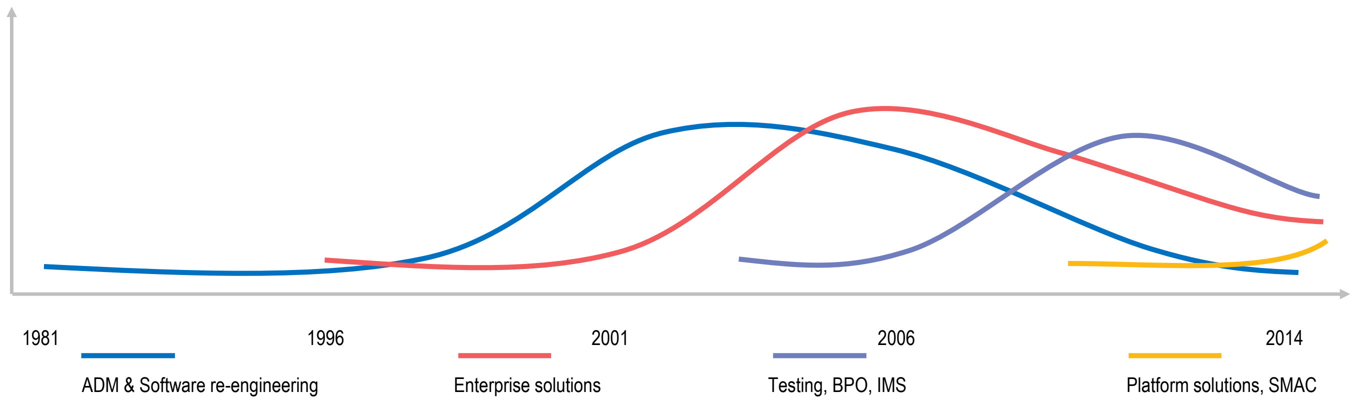
Source: Investec Securities estimates

While the fall in the growth curve cannot be eliminated, it can be reduced by taking advantage of revenue creators and managing revenue destroyers.

We highlight the key revenue creators below:

- **Expanding service offerings:** Figure 13 below highlights how growth has evolved for different service lines of IT services vendors over an extended period. The ability to add services that are able to make up for declines in others is key to sustained growth. A case in point is HCL Tech, where 55% of incremental revenues added over the past 5 years were driven by Infrastructure management services (IMS). The company will have to drive higher growth in the other revenue service line to be able to maintain growth rates as revenue growth from IMS declines.

Figure 13: Historically growth from new services has made up for declining growth of existing ones



Source: Investec Securities research

- **Expanding geographic / vertical presence / client portfolio:** The ability to invest in geographies, verticals and clients to drive new revenue streams. Penetration by Indian vendors in geographies like Continental Europe and Japan is low. We highlight examples of how Indian vendors have invested in these markets, as well as companies having invested in expanding the client portfolio and vertical presence to drive growth.

Table 3: Examples of recent geographic and vertical investments

Company	Acquisition	Geography	Description	Capability addition
TCS	IT Frontier Corporation	Japan	Increased revenue in Japan by 6x. Gives access to strong Japanese front-end capabilities	Access to geography
TCS	Alti SA	France	Among top 5 system integrators of SAP solutions in France. Quadrupled revenue in France in our view.	Geography and service capability
Infosys	Lodestone	Switzerland	Focussed on SAP implementations. Increased revenues in Switzerland by 60% and Germany by 40%. Built credible front end in both geographies.	Geography and specialist service capability
Wipro	ATCO	Canada	Deal gives a 7-10% revenue market share in the Canadian utilities market for IT services putting it among the top 5 vendors in this market for the utilities segment	Vertical presence
Tech Mahindra	LCC	US	Adds capabilities in the telecom verticals in the network design and implementation area, thereby giving TechM a bigger play to provide managed services for telcos. Also adds US$430m globally increasing wallet share with clients	Vertical presence

Source: Investec Securities research

Revenue destroyers are driven by:

- **Client and industry specific risks:** These are key risks that companies need to manage. There are many examples, including British Telecom cutting its IT services spend with Infosys from US$300m annually to c.US$70m in a short space of time and Wipro seeing its revenues from Telecom OEMs decline from c.US$434m in FY12 to c.US$50m currently. The ability to consistently add clients and successfully mine them over time helps create a portfolio that can weather such shocks better.

- **Technology itself:** The increasing adoption of "Cloud" is a good example as it will cannibalize existing revenues over time. Being a close partner to clients during these stages of evolution should give access to newer spend over time.

Investors will ultimately value companies based on their perception of a company's ability to take advantage of revenue creators and manage revenue destroyers.

Critical success factor 2: Ability to view technology trends ahead of time

We believe this is important as it gives the company enough lead time to train talent and build proof of concepts. This will help drive strong revenue growth when a technology trend begins and then becomes mainstream.

Critical success factor 3: Proactively improve productivity in existing projects

The ability to consistently deliver productivity benefits helps create new revenue from clients over time. An inability to do this would result in sharp revenue declines over time due to the evolution of technology itself.

Our preferred picks

The IT services sector is undergoing a phase of evolution driven by technology. We argue that while the evolution of technology has a perceived effect of revenue deflation for IT services firms, it has not been the case throughout the history of IT services as the falling cost of technology has only increased its applicability and pervasiveness.

However, evolution of technology will drive revenue volatility as it disrupts not only the entire ecosystem but businesses of clients as well. We use a framework (B.A.S.E) that scores stocks based on historic performance and expectations and helps drive our call on valuation premiums / discounts to arrive at our call.

The B.A.S.E framework covers:

i) **Broad service and client portfolio (30% weighting):** We believe this is a key determinant as it helps companies to manage revenue creators and destroyers better (explained on pages 13-14). TechM scores low on this metric as 45% of its revenues are derived from the top 10 clients. Moreover, the scale of operations across services is also not as large vs peers. Wipro's client portfolio has been a key cause of underperformance in the past. While we believe it is largely over and drives our BUY case on the stock, we give it a relatively lower score versus TCS and Infosys. HCLT gets a lower score versus TCS and Infosys as significant growth has come from a single vertical in the past and an inability to drive the rest of the business could be a source of risk.

ii) **Ability to defend current margins (20% weighting):** We rank all companies (except TechM) equally on this metric as we believe the opportunities and challenges to manage margins are equally spread. TechM however has room to improve margins post recent headwinds.

iii) **Scale of operations within existing clients (30% weighting):** We believe this is important in the current context of digitization, as having a large share implies better understanding of the client landscape and the ability to gain from digitization spends. We look at the number of clients contributing >US$100m to vendor revenues to arrive at this score. Note that this could be a little subjective if another vendor were to get a higher share of digitization spend within these clients. While TechM lost versus HCLT due to a higher client concentration, it gains in terms of being able to leverage these clients for higher digitization spends.

iv) **Earnings growth expectation (20% weighting):** We expect earnings growth of 41% for TechM in FY17E as we believe the company will continue to gain share in the telecom space, assuming the two big telco transactions proposed in the UK go through. As a result, Tech Mahindra gets the highest score. We expect all other players to show less than half the earnings growth and thus halve the score for all other players.

Table 5: Clients contributing >US$100m in revenues

Company	No.
TCS	24.00
Infosys	15.00
Wipro	11.00
HCL Tech	7.00
Tech Mahindra	10-11

Source: Company, Investec Securities estimates

Table 4: Earnings growth expectation

Earnings growth expectation	FY17E
TCS	15%
Infosys	16%
Wipro	15%
HCL Tech	16%
Tech Mahindra	41%

Source: Investec Securities estimates

Table 6: TCS, followed by Infosys and Wipro perform well on this framework

	TCS	Infosys	Wipro	HCLT	TechM
Broad services & client portfolio	●	●	◕	◕	◔
Ability to defend current margins	◕	◕	◕	◕	◕
Scale of operations within existing client landscapes	●	◕	◑	◔	◑
Earnings growth expectation	◑	◑	◑	◑	◕
Weighted average scores	**3.4**	**3.1**	**2.5**	**2.2**	**2.1**

Source: Investec Securities research

This framework aims to cover most opportunities and challenges and highlight the order of preference ignoring valuations. However, it is difficult to cover risks from share gains by competition on existing client revenues. Moreover, we expect revenue volatility given the duality of revenue cannibalization and creation.

Valuation methodology

Based on the framework, we value TCS at a FY17E PE of 20x (between the mean of the five-year forward PE and 1 standard deviation above it) and ascribe a discount to all other stocks vs TCS. We value Infosys at a 10% discount to TCS, Wipro at 20%, HCLT at 25% and TechM at 30%.

TCS: Valuation premiums leave little upside

- **Legacy portfolio on a larger base hurts:** While opportunities for growth remain high, legacy spend on a much larger portfolio inherently hurts growth rates. We highlight this in Figure 12 on page 14, where cannibalization of the legacy portfolio inherently hurts the growth curve on a larger base. We model revenue growth of 11.5%/14.5% for FY16E/FY17E in USD terms (with revenues of c.US$20b in FY17E).
- **Strategies of peers converging:** Over the past few years we have seen the actions of peers like Wipro and Infosys closely benchmarked with TCS (*see Strategies have converged and so will growth* section on page 11), so growth rates should also converge. With increasing convergence in growth rates, we also see valuation premiums versus peers declining. We initiate coverage at HOLD with a TP of Rs2,813.

Infosys: Expect revenue growth to converge with TCS by FY17E

- **New leadership delivering:** Infosys has had new leadership over the last 9 months, the benefits of which are already visible with attrition rates falling and margins improving.
- **Highest ever headcount additions drive comfort:** Company guidance for 10-12% growth in constant currency USD terms is predicated on a strong deal pipeline (Infosys' headcount net additions in Q4FY15 were the highest in the last 14 quarters and are higher than at TCS).
- **Improving discretionary spend to aid growth:** Most vendors expect an improvement in discretionary spend through FY16 and Infosys has the highest leverage to discretionary spend with c.32% of its revenues from Consulting & SI.
- **We expect revenue growth convergence with TCS in FY17E:** We expect revenue growth rates for Infosys to converge with TCS by FY17E, leading to P/E multiples converging over time. We initiate coverage on Infosys at BUY with a TP of Rs2,385.

Wipro: Headwinds abate

- **Headwinds abate:** We see the revenue growth differential vs TCS declining for Wipro as two key portfolio exposures that explain most of the differential may no longer represent headwinds: (i) The Telecom OEM segment, which accounted for US$434m in revenues for FY12 now contribute less than US$50m (estimated for FY15); and (ii) Wipro lost c.US$100m in revenues in FY15 due to spending cuts by energy companies (Wipro has the largest exposure in this space). While headwinds from the telecom OEM segment are largely over, growth from energy companies should improve going forward as oil prices have improved.
- **Poised to deliver:** Wipro has undergone a significant revamp over the last four years and core operational parameters like utilization, the proportion of fixed

price contracts and improving large deal traction indicate the benefits of these actions.

- Valuations are also below mean levels, making risk-reward more favourable. We initiate coverage at BUY with a target price of Rs677, based on a 20% discount to TCS' target PE multiple of 20x.

HCL Tech: Investing to diversify from IMS led growth

- **IMS growth declining:** The Infrastructure management services (IMS) space has been the biggest growth driver for HCL Tech (c.44% of incremental revenues over the last 6 years and 55% over the last 3 years). Growth in this segment has already declined from a peak of 61% in FY10 to 19.3% in FY15 on a LTM basis. High attrition rates of 27% do not help in meeting the emerging requirement for skillsets in order to achieve growth.
- **New investments need to aid growth:** The company is investing in its engineering services practice to benefit from emerging opportunities in IoT and creating offerings around the digitization of enterprises (margins declined by 150bps last quarter due to these investments).
- We initiate coverage at HOLD with a TP of Rs1008. Our target P/E multiple implies a 25% discount to TCS.

Tech Mahindra: Yet to graduate

- **Client concentration restricts valuations:** While TechM has graduated to a Tier-1 services player in terms of revenues, the company still has Tier-2 characteristics with its top 10 clients accounting for 45% of its revenues. We don't see this changing anytime soon. So while factors below highlight the case for strong growth, risks to growth due to concentration restrict valuation multiples.
- **TechM could benefit from telco consolidation in the UK:** Assuming the proposed acquisitions of EE by BT and O2 by Hutchison in the UK are completed, TechM is likely to benefit as a large vendor for both acquirers, more so for BT. Both firms expect regulatory approval in a year, which could potentially see TechM serving two of the three UK mobile operators with a combined subscriber market share of 79%.
- **Non-telecom business seeing higher deal traction:** 76% of the large deals announced by TechM in the last four quarters are non-telecom (total TCV of large deals in the past 4 quarters is US$957m).
- We initiate coverage at HOLD with a TP of Rs590.

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Table 7: Revenue Growth & one year forward P/E valuations

	FY08	FY09	FY10	FY11	FY12	FY13	FY14	FY15	
Revenue growth %									**Period CAGR**
TCS	37.7%	6.0%	5.2%	29.1%	24.2%	13.7%	16.2%	15.0%	17.9%
Infosys	35.2%	11.6%	3.0%	25.8%	15.8%	5.8%	11.5%	5.6%	13.8%
Wipro	54.0%	18.3%	1.4%	19.4%	13.4%	5.0%	6.4%	7.0%	14.7%
HCLT	35.2%	16.2%	23.9%	31.1%	17.1%	12.9%	14.4%	11.2%	19.9%
Tech Mahindra	44.4%	5.1%	-0.7%	15.5%	2.6%	127.8%	17.7%	18.6%	24.2%
Average growth% (ex-TechM)	**40.5%**	**13.0%**	**8.3%**	**26.3%**	**17.6%**	**9.3%**	**12.1%**	**9.7%**	
Average P/E									**Period Avg.**
TCS	20.3	11.3	13.5	19.0	18.2	15.4	16.8	21.5	17.0
Infosys	19.5	13.8	18.7	22.1	17.6	14.2	15.2	17.1	17.3
Wipro	17.7	10.6	14.1	17.2	14.5	11.9	13.7	15.9	14.4
HCLT	16.8	8.4	15.8	15.3	9.9	8.7	12.5	15.7	12.9
Tech Mahindra	26.5	7.8	15.8	11.1	7.2	7.6	11.2	17.4	13.1
Average P/E (ex-TechM)	**18.6**	**11.0**	**15.5**	**18.4**	**15.1**	**12.5**	**14.5**	**17.6**	**15.4**

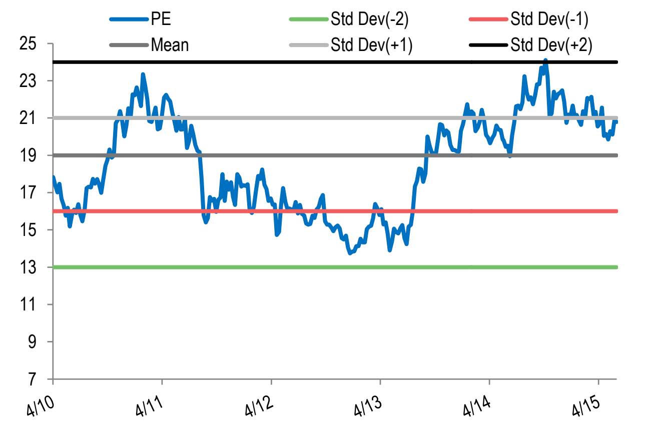
Source: Bloomberg, Investec Securities estimates

Table 8: Revenue Growth and one year P/E Valuation (Global peers))

	2007	2008	2009	2010	2011	2012	2013	2014	
Revenue growth %									**Period CAGR**
IBM Corp	8.05	4.90	(7.60)	4.30	7.06	(2.25)	(5.88)	(5.67)	-0.7%
Accenture PLC	17.69	18.00	(8.47)	(0.33)	18.44	8.87	2.07	4.87	4.5%
Cognizant Technology	49.94	31.88	16.42	40.07	33.29	20.02	20.37	16.05	19.1%
Cap Gemini SA	13.03	0.08	(3.89)	3.89	11.45	5.89	(1.68)	4.77	2.2%
Average growth%	**22.18**	**13.71**	**(0.88)**	**11.98**	**17.56**	**8.13**	**3.72**	**5.01**	
Average P/E									**Period Avg.**
IBM Corp	15.1	9.4	12.9	12.9	14.0	12.7	11.3	9.5	12.2
Accenture PLC	20.8	15.5	12.5	13.7	15.5	16.0	17.2	18.0	16.2
Cognizant Technology	29.5	12.5	24.9	30.4	23.0	21.4	24.9	21.9	23.6
Cap Gemini SA	14.1	8.8	26.0	19.1	9.2	14.5	17.5	16.2	15.7
Average P/E %	**19.9**	**11.6**	**19.1**	**19.0**	**15.4**	**16.2**	**17.7**	**16.4**	**16.9**

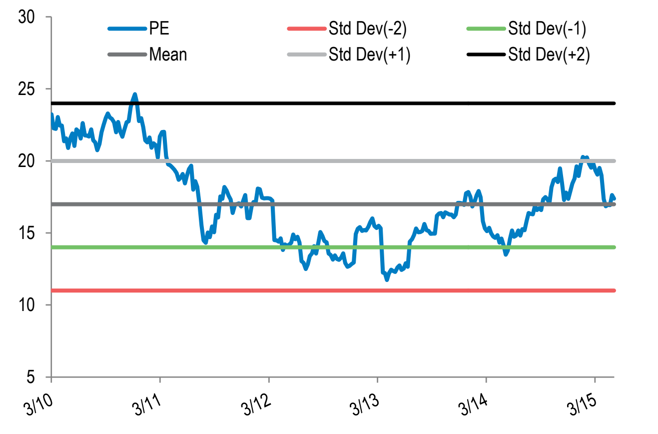
Source: Bloomberg

Figure 14: TCS P/E band



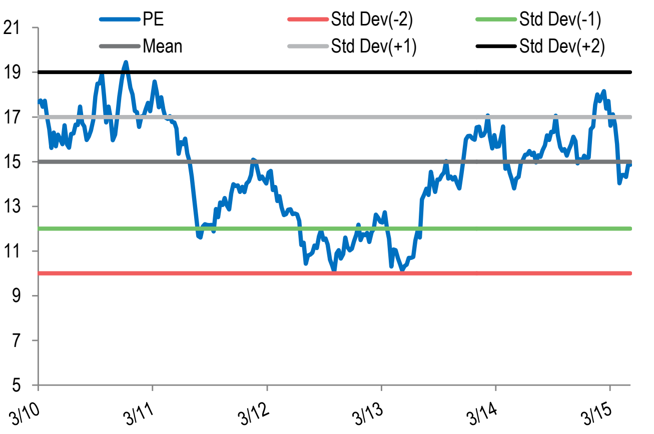
Source: Bloomberg, Investec Securities research

Figure 15: Infosys P/E band



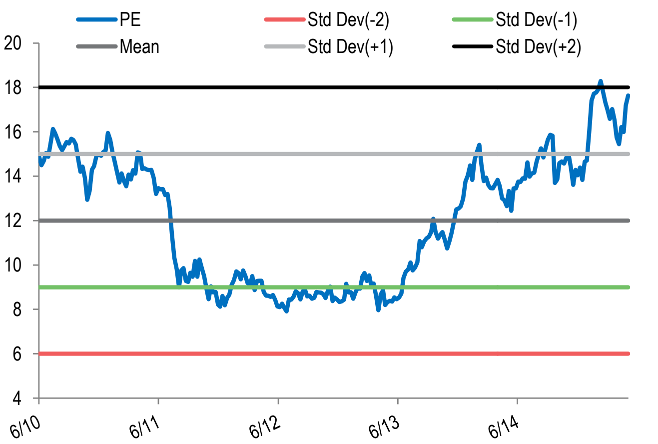
Source: Bloomberg, Investec Securities research

Figure 16: Wipro P/E band



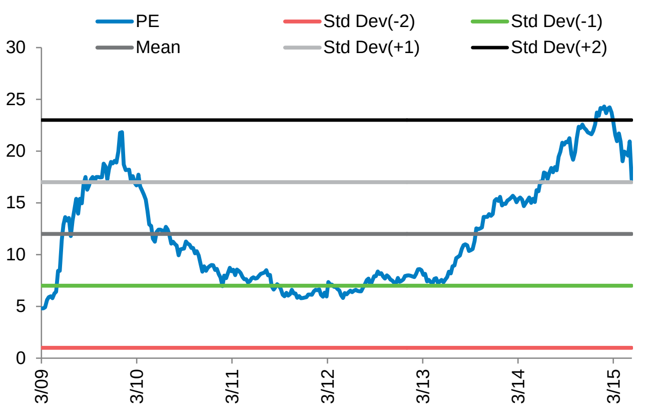
Source: Bloomberg, Investec Securities research

Figure 17: HCL Tech P/E band



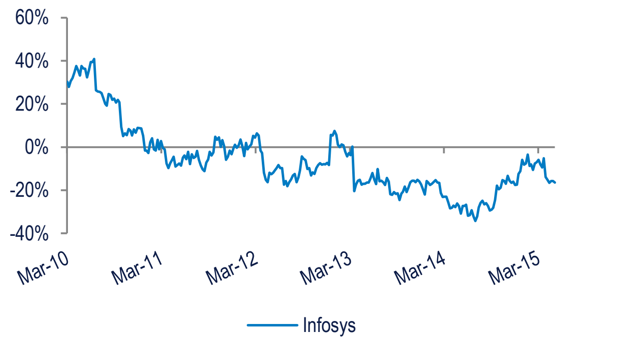
Source: Bloomberg, Investec Securities research

Figure 18: Tech Mahindra P/E band



Source: Bloomberg, Investec Securities research

Figure 19: Premium / Discount – Infosys vs TCS

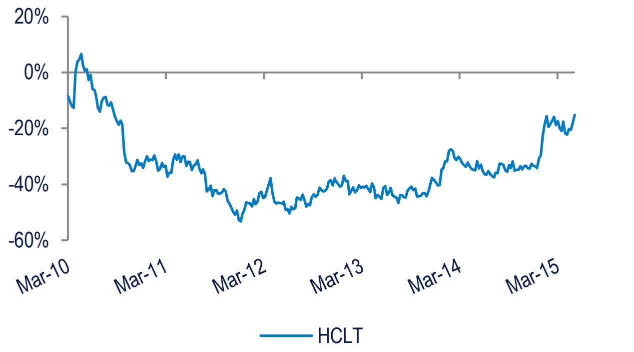


Source: Investec Securities estimates

Figure 20: Premium / Discount – Wipro vs TCS

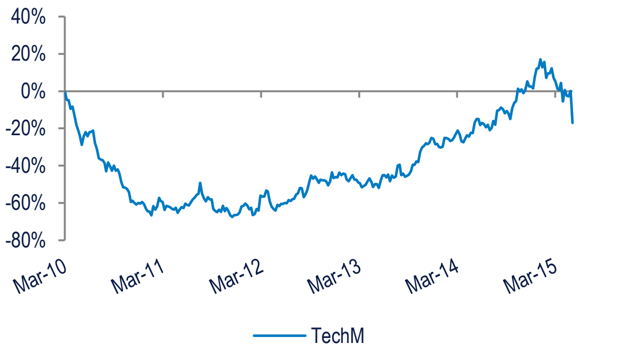
Source: Investec Securities estimates

Figure 21: Premium / Discount – HCL Tech vs TCS



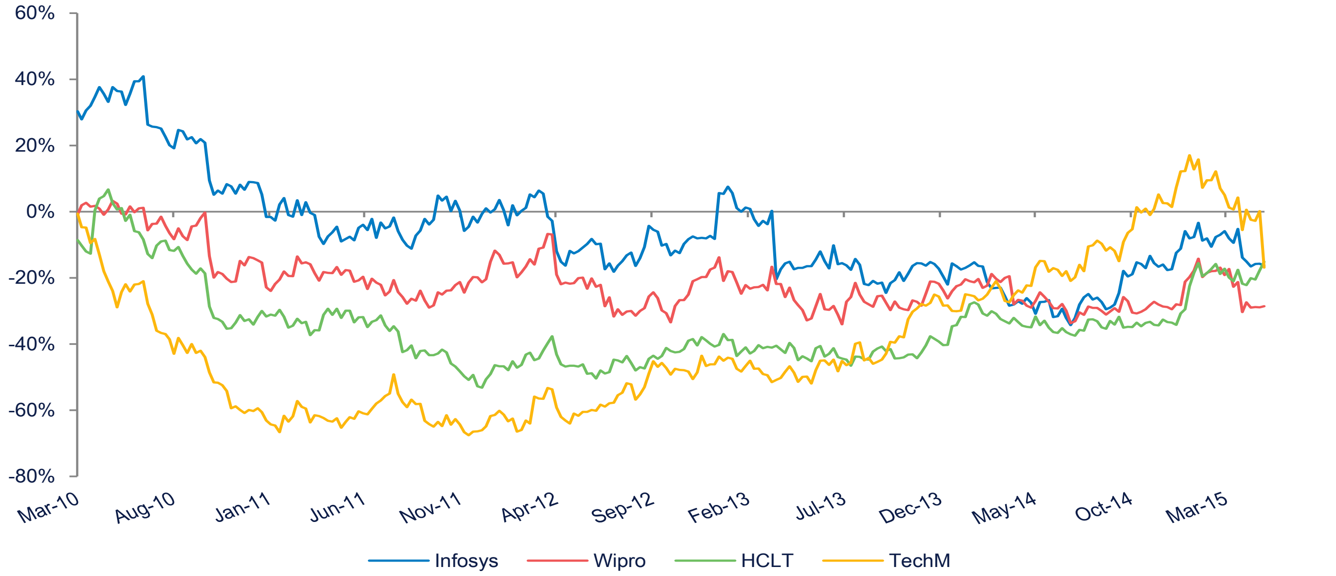
Source: Investec Securities estimates

Figure 22: Premium / Discount – Tech Mahindra vs TCS



Source: Investec Securities estimates

Figure 23: Premium / Discount – Infosys, Wipro, HCL Tech, TechM vs.TCS



Source: Investec Securities estimates

Investec

HCL Technologies (HCLT.NS)

India | Technology

HOLD

Price: INR975.30

Target: INR1008.00

Forecast Total Return: 5.1%

Market Cap: INR1,371bn

EV: INR1,356bn

Average daily volume: 203k

Investing to diversify from IMS led growth

The Infrastructure Management Services (IMS) space has been the biggest growth driver for HCL Tech, contributing c.44% of incremental revenues over the last six years. This segment will be the biggest hit as clients migrate to the Cloud. While HCL Tech is already taking steps with offerings around digitization, applications modernization and engineering services (driven by trends like IoT), we worry about the pace of cannibalization in the IMS business. We initiate at HOLD with a TP of Rs1008.

- **As growth in IMS is declining…:** IMS contributed c.44% of HCLT's incremental revenues over the past six years and 55% in the last three. However, revenue growth has declined from a peak of 61% in FY10 to 19.3% on an LTM basis in constant currency. We believe this is likely driven by i) renewals post five years coming in at lower total contract values; and ii) cannibalization of existing revenues as clients shift to the Cloud. Also, note that competitive intensity has increased significantly in this business, evidenced by improving growth in this segment for peers.
- **…HCLT is investing to drive growth in other areas:** HCLT is making investments i) to drive growth from emerging opportunities like IoT for its engineering services business; and ii) in the digitization of client landscapes for Cloud enablement. The company expects EBIT margins to be in the 21-22% range as it continues to invest in these areas.
- **High attrition rates worrying as emerging areas require niche talent:** HCLT hired over 100 senior level technical & enterprise architects to create new propositions for IoT and digitization. HCLT will need to continue such hiring as it invests in this space, however, high attrition rates (27% annualized on a consolidated basis) are a concern. HCLT will need to bring down attrition to be able to cater to new demand.
- **Valuation:** We initiate coverage on HCLT at HOLD with a target price of Rs1,008. Our target multiple implies a 10% discount to Infosys and is in line with Wipro as we remain cautious on declining revenue growth in IMS and the company's ability to expand in newer areas given high attrition rates. Current valuation also offers little support as the stock trades at 14.5x FY17E.

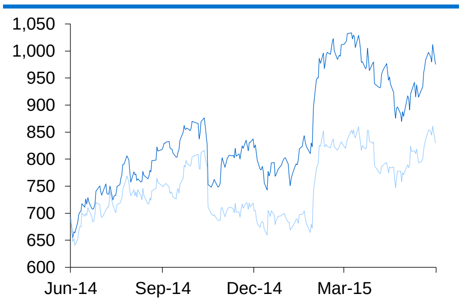
Nitin Padmanabhan
+91 (22) 6136 7400
nitin.padmanabhan@investec.co.in

Financials and valuation — Year end: 30 June

	2013A	2014A	2015E	2016E	2017E
Revenue (INRm)	257,580	329,170	370,180	423,930	487,423
EBITDA (INRm)	57,540	86,660	88,983	99,144	113,817
EBITA (INRm)	-	-	-	-	-
PBT (normalised) (INRm)	52,360	79,160	93,449	104,211	121,524
Net Income (normalised) (INRm)	40,220	63,680	73,213	81,284	94,789
EPS (norm. cont.) – FD (INR)	28.5	45.2	51.9	57.6	67.2
FCFPS - FD (INR)	28.5	43.8	25.9	42.1	48.2
DPS (INR)	5.9	11.0	14.5	17.4	20.3
PE (normalised) (x)	34.2	21.6	18.8	16.9	14.5
EV/sales (x)	5.3	4.1	3.7	3.2	2.8
EV/EBITDA (x)	23.6	15.6	15.2	13.7	11.9
FCF yield (%)	2.9	4.5	2.7	4.3	4.9
Dividend yield (%)	0.6	1.1	1.5	1.8	2.1

Source: Company accounts/Investec Securities estimates

Price Performance



	1m	3m	12m
Price	10.9	(3.6)	37.6
Price rel to India S&P BSE 500 - BSE	7.6	0.2	14.9

Source: FactSet

Company Background

HCL Tech is the fourth largest India-based IT services company. The company has over 100,000 employees and provides services including Application Development & Maintenance, Enterprise Application Services (EAS), Infrastructure Management Services (IMS) and Engineering and R&D services to multiple industry segments. The company has grown at a 20% CAGR over the past five years, largely led by strong growth in Infrastructure management services. The company now believes there could be a similar opportunity in Engineering and R&D services.

Source: Investec Securities estimates

Catalysts

Positive:

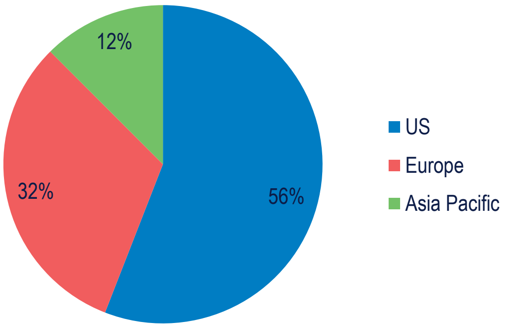
- Large deal wins in Engineering and R&D services could lead to acceleration in revenue growth
- Weakening INR vs USD can lead to better-than-expected margins. (1% change in INR = 25bps margin change)

Negative:

- Cannibalization of IMS revenue due to clients transitioning to the Cloud

Source: Investec Securities estimates

Figure 1: Revenue Exposure by Geography



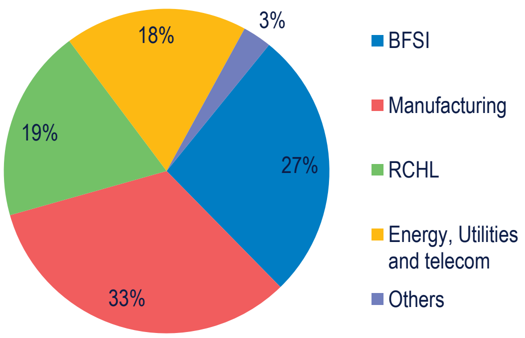
Source: Company, Investec Securities estimates

Table 1: Revenue Trends by Geography

In US$ m	FY10	FY11	FY12	FY13	FY14
US	1,603	1,980	2,365	2,671	2,996
-Growth %	*24%*	*24%*	*19%*	*13%*	*12%*
Europe	739	952	1,131	1,358	1,694
-Growth %	*21%*	*29%*	*19%*	*20%*	*25%*
Asia Pacific	363	613	655	657	669
-Growth %	*30%*	*69%*	*7%*	*0%*	*2%*

Source: Company, Investec Securities estimates

Figure 2: Revenue Exposure by Business Vertical



Source: Company, Investec Securities estimates

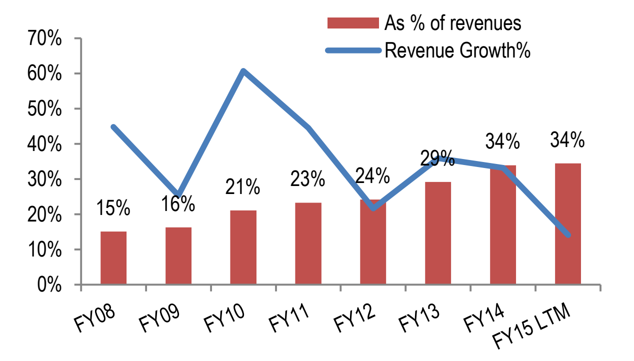
Table 2: Revenue Trends by Business Vertical

In US$ m	FY10	FY11	FY12	FY13	FY14
BFSI	694	905	1,019	1,175	1,438
-Growth %	*23%*	*30%*	*13%*	*15%*	*22%*
MFG.	724	972	1,202	1,313	1,765
-Growth %	*9%*	*34%*	*24%*	*9%*	*34%*
RCHL[1]	407	592	735	963	1,028
-Growth %	*38%*	*45%*	*24%*	*31%*	*7%*
Energy / Utilities & telecom	513	628	639	689	973
-Growth %	*20%*	*22%*	*2%*	*8%*	*41%*
Media & Publishing	198	243	276	321	-
-Growth %	*67%*	*23%*	*14%*	*16%*	*-100%*
Others	168	205	282	225	154
-Growth %	*46%*	*22%*	*38%*	*-20%*	*-32%*

[1] Retail, CPG, Healthcare, Life Sciences, Logistics / transportation
[2]Company merged reporting of this metric with manufacturing & telecom

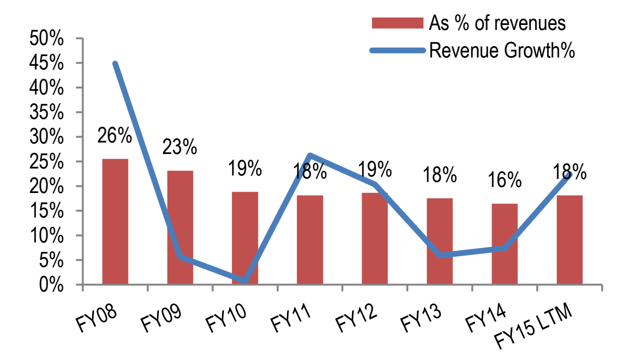
Source: Company, Investec Securities estimates

Figure 3: Declining growth rates in IMS needs to be made up by…



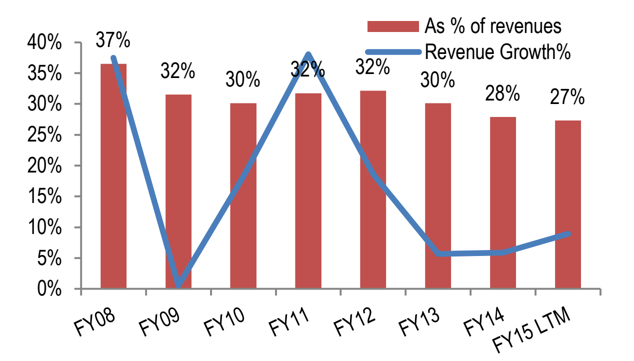
Source: Company, Investec Securities estimates

Figure 4: …improving growth in engineering services



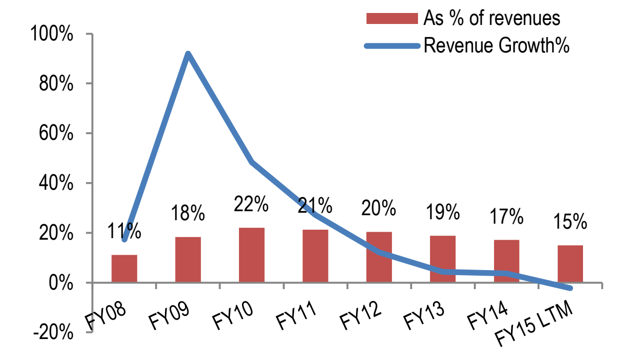
Source: Company, Investec Securities estimates

Figure 5: Growth in ADM has improved marginally…



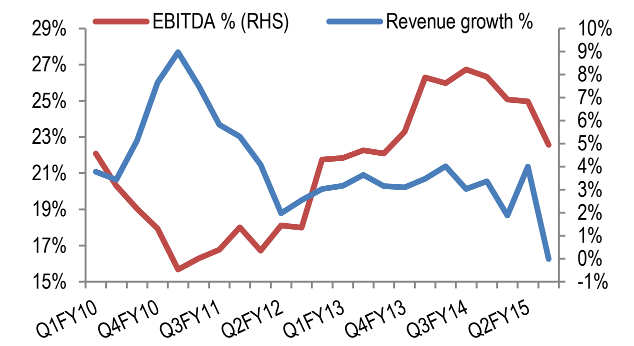
Source: Company, Investec Securities estimates

Figure 6: …while enterprise solutions continues to see growth rates decline



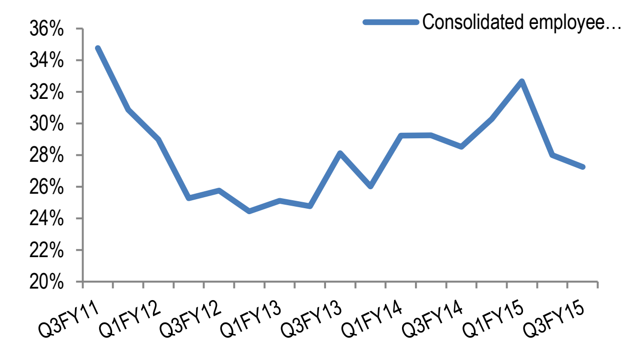
Source: Company, Investec Securities estimates

Figure 7: Investment led margin decline has led to improving growth in the past



Source: Company, Investec Securities estimates

Figure 8: Attrition continue to remain significantly higher than industry



Source: Company, Investec Securities estimates

Summary Financials (INRm)

Year end: 30 June

Income Statement	2013	2014	2015E	2016E	2017E
Revenue	**257,580**	**329,170**	**370,180**	**423,930**	**487,423**
EBITDA	**57,540**	**86,660**	**88,983**	**99,144**	**113,817**
Depreciation and amortisation	(6,740)	(7,330)	(4,428)	(5,077)	(5,802)
Operating profit	**50,800**	**79,330**	**84,555**	**94,066**	**108,015**
Other income	1,560	(170)	8,894	10,145	13,510
Net interest	0	0	0	0	0
Share-based-payments	0	0	0	0	0
PBT (normalised)	**52,360**	**79,160**	**93,449**	**104,211**	**121,524**
Impairment of acquired intangibles	0	0	0	0	0
Non-recurring items/exceptionals	0	0	0	0	0
PBT (reported)	**52,360**	**79,160**	**93,449**	**104,211**	**121,524**
Taxation	(12,140)	(15,480)	(20,236)	(22,926)	(26,735)
Minorities & preference dividends	0	0	0	0	0
Discontinued/assets held for sale	0	0	0	0	0
Net Income (normalised)	40,220	63,680	73,213	81,284	94,789
Attributable profit	40,220	63,680	73,213	81,284	94,789
EPS (reported)	28.5	45.2	51.9	57.6	67.2
EPS (norm., cont.) – FD (INR)	28.5	45.2	51.9	57.6	67.2
EPS (norm., cont., IAS19R adj.) – FD	-	-	-	-	-
DPS (INR)	5.9	11.0	14.5	17.4	20.3
Average number of group shares - FD (m)	1,410	1,410	1,410	1,410	1,410
Average number of group shares (m)	1,410	1,410	1,410	1,410	1,410
Total number of shares in issue (m)	1,403	1,403	1,403	1,403	1,403

Cash Flow	2013	2014	2015E	2016E	2017E
Operating profit	50,800	79,330	84,555	94,066	108,015
Depreciation & amortisation	6,740	7,330	4,428	5,077	5,802
Other cash and non-cash movements	2,389	(2,490)	3,408	(24)	(24)
Change in working capital	(1,756)	(2,132)	(23,044)	(3,272)	(3,518)
Operating cash flow	**58,173**	**82,038**	**69,347**	**95,847**	**110,275**
Interest	-	-	-	-	-
Tax paid	(12,140)	(15,480)	(20,236)	(22,926)	(26,735)
Dividends from associates and JVs	-	-	-	-	-
Cash flow from operations	**46,033**	**66,558**	**49,111**	**72,921**	**83,539**
Maintenance capex	(5,814)	(4,850)	(12,661)	(13,566)	(15,598)
Free cash flow	**40,219**	**61,708**	**36,450**	**59,355**	**67,942**
Expansionary capex	0	0	0	0	0
Exceptionals and discontinued operations	0	0	0	0	0
Other financials	(21,782)	(46,365)	1,632	8,307	11,546
Acquisitions	2,517	0	0	0	0
Disposals	0	0	0	0	0
Net share issues	0	0	0	0	0
Dividends paid	(8,045)	(13,000)	(27,954)	(28,531)	(33,271)
Change in net cash	**12,909**	**2,343**	**10,128**	**39,135**	**46,233**
Net cash/(debt)	360	2,703	12,831	51,966	98,199
FCFPS - FD (INR)	28.5	43.8	25.9	42.1	48.2

Balance Sheet	2013	2014	2015E	2016E	2017E
Property plant and equipment	27,283	31,470	38,563	47,555	57,855
Intangible assets	49,581	51,490	50,244	49,740	49,236
Investments and other non current assets	59,525	109,400	118,691	120,549	122,521
Cash and equivalents	7,321	10,210	17,081	56,216	102,449
Other current assets	86,733	102,304	127,297	143,970	162,070
Total assets	**230,443**	**304,874**	**351,876**	**418,031**	**494,131**
Total debt	(6,961)	(7,507)	(4,250)	(4,250)	(4,250)
Preference shares	0	0	0	0	0
Other long term liabilities	(15,151)	(14,620)	(14,070)	(14,070)	(14,070)
Provisions & other current liabilities	(65,423)	(81,967)	(88,063)	(101,465)	(116,047)
Pension deficit and other adjustments	0	0	0	0	0
Total liabilities	**(87,535)**	**(104,094)**	**(106,383)**	**(119,785)**	**(134,367)**
Net assets	**142,908**	**200,780**	**245,492**	**298,246**	**359,764**
Shareholder's equity	142,908	200,780	245,492	298,246	359,764
Minority interests	0	0	0	0	0
Total equity	**142,908**	**200,780**	**245,492**	**298,246**	**359,764**
Net working capital	83,077	97,417	138,291	156,637	176,558
NAV per share (INR)	101.8	143.1	174.9	212.5	256.4

Source: Company accounts, Investec Securities estimates

Calendarised Valuation

Year end: 30 June

	2013	2014	2015E	2016E
Calendar PE (x)	26.4	20.1	17.8	15.6
Calendar Price/NAVPS (x)	8.0	6.1	5.0	4.2
EV/sales (x)	4.6	3.9	3.4	3.0
EV/EBITDA (x)	18.8	15.4	14.4	12.7
FCF yield (%)	3.7	3.6	3.5	4.6
Dividend yield (%)	0.9	1.3	1.6	1.9

Source: Company accounts, Investec Securities estimates

Ratios and Metrics

Year end: 30 June

Ratios and metrics	2013	2014	2015E	2016E	2017E
Revenue growth (y-on-y) (%)	22.5	27.8	12.5	14.5	15.0
EBITDA growth (y-on-y) (%)	43.0	50.6	2.7	11.4	14.8
Net income (normalised) growth (yoy)	59.2	58.3	15.0	11.0	16.6
EPS (normalised) growth (y-on-y) (%)	59.2	58.3	15.0	11.0	16.6
FCFPS growth (y-on-y) (%)	127.9	53.4	(40.9)	62.8	14.5
NAVPS growth (y-on-y) (%)	33.2	40.5	22.3	21.5	20.6
DPS growth (y-on-y) (%)	0.6	84.3	32.7	19.4	16.6
Interest cover (x)	-	-	-	-	-
Net debt/EBITDA (x)	(0.0)	(0.0)	(0.1)	(0.5)	(0.9)
Net debt/equity (%)	(0.3)	(1.3)	(5.2)	(17.4)	(27.3)
Net gearing (%)	(0.3)	(1.4)	(5.5)	(21.1)	(37.5)
Dividend cover (x)	4.8	4.1	3.6	3.3	3.3
EBITDA margin (%)	22.3	26.3	24.0	23.4	23.4
Operating profit margin (%)	-	-	-	-	-
ROE (%)	28.1	31.7	29.8	27.3	26.3
ROCE (%)	30.8	35.6	32.1	29.7	28.6
NWC/revenue (%)	32.3	29.6	37.4	36.9	36.2
Tax rate (normalised) (%)	-	-	-	-	-
Tax rate (reported) (%)	23.2	19.6	21.7	22.0	22.0

Source: Company accounts, Investec Securities estimates

Target Price Basis

Relative valuation (25% discount to TCS)

Key Risks

Faster than expected cannibalization in existing business and currency risks

Infosys (INFY.NS)

India | Software & Computer Services

BUY

Price: INR2049.90

Target: INR2385.00

Forecast Total Return: 19.2%

Market Cap: INR2,354bn

EV: INR1,996bn

Average daily volume: 178k

All the right moves …

Infosys has had new leadership in place over the last 9 months – the benefits of which are already visible, with attrition rates falling and margins improving. While we would not rule out medium-term volatility, we believe the new leadership understands technology cycles well and has a strong balance sheet to help manoeuvre and achieve growth and margins. We believe P/E multiples will re-rate as the revenue growth gap to TCS begins to narrow and margins improve. We initiate coverage at BUY with a target price of Rs2385.

- **All the right moves:** In the past 2 years Infosys has made all the right moves that appear to be in line with best practice in the industry. These include (i) 100 senior partners from Lodestone Consulting will jointly manage large accounts (Cognizant model of consulting-driven account management); (ii) 150 people from delivery with sales acumen will manage accounts (a practice by TCS that has been highlighted by competition to reduce the gap between sales and delivery); (iii) institutionalized deal hunting through design thinking workshops for clients (have won multiple mega deals already) and many other initiatives.
- **Speed of execution in the last 9 months has been comforting:** The change in mood among employees in the past 9 months has been significant and is visible in attrition coming down from 10,627 employees in Q1FY15 to 7,922 in Q2FY15. The company has made two acquisitions and one strategic investment during this period. We see multiple initiatives on client account management, new client acquisition and delivery that will continue to aid growth and margins on an ongoing basis. The company also has a 40bps cushion on margins as the deferred payments for Lodestone come to an end in Q3FY15.
- **The Infosys BUY case:** We expect the benefits from actions over the past nine months to be visible in FY16E, and FY17E should see growth improve even further as all actions begin to drive momentum. We model 6.4%/13.3% growth in USD terms for FY16E/FY17E. Margins are also fairly defensible as we will continue to see utilization rates improve to make up for pricing pressure. However, we believe investors will need to contend with some volatility in revenue growth due to the consulting & SI business. We initiate coverage at BUY with a target price of Rs2385 (18x P/E, which is a 10% discount to TCS).

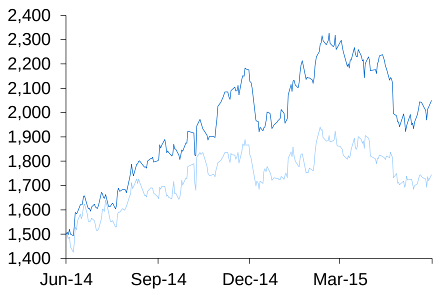
Nitin Padmanabhan
+91 (22) 6136 7400
nitin.padmanabhan@investec.co.in

Financials and valuation — Year end: 31 March

	2013A	2014A	2015A	2016E	2017E
Revenue (INRm)	403,523	501,330	533,173	584,379	665,830
EBITDA (INRm)	115,348	134,800	148,984	162,369	190,073
EBITA (INRm)	104,058	121,070	138,294	150,049	176,131
PBT (normalised) (INRm)	127,648	147,760	172,554	181,975	211,792
Net Income (normalised) (INRm)	93,978	107,140	123,264	130,112	151,431
EPS (norm. cont.) – FD (INR)	82.2	93.8	107.9	113.9	132.5
FCFPS - FD (INR)	66.1	82.6	74.4	67.7	77.7
DPS (INR)	17.6	31.7	44.5	56.9	66.3
PE (normalised) (x)	24.9	21.9	19.0	18.0	15.5
EV/sales (x)	4.9	4.0	3.7	3.4	3.0
EV/EBITDA (x)	17.3	14.8	13.4	12.3	10.5
FCF yield (%)	3.2	4.0	3.6	3.3	3.8
Dividend yield (%)	0.9	1.5	2.2	2.8	3.2

Source: Company accounts/Investec Securities estimates

Price Performance



	1m	3m	12m
Price	5.5	(9.6)	39.4
Price rel to India S&P BSE 500 - BSE	2.4	(6.0)	16.4

Source: FactSet

Company background

Infosys is the third largest offshore IT services vendor after TCS and Cognizant. The company derives the highest proportion of revenues from consulting and system integration (c.33%) among Indian vendors. Infosys saw a transition from a promoter-driven company to non-promoter leadership in August 2014. The company also has a strong core banking product called Finacle and multiple platform offerings. The company has articulated a vision of achieving US$20bn revenues by 2020 with 30% margins.

Catalysts

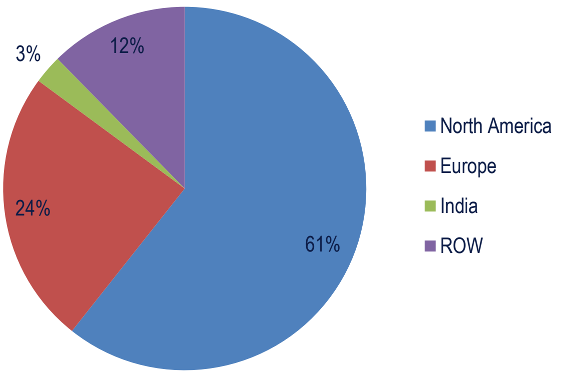
Positive catalysts:

- Higher than expected growth due to improving discretionary spend
- Weakening INR vs USD can lead to better-than-expected margins (1% change in INR = 25bps margin change)

Negative catalysts:

- Lower-than-expected growth due to cannibalization of existing revenues and loss of market share to competition
- Pricing pressure/cut in spending by top 20 clients

Figure 1: Revenues by Geography



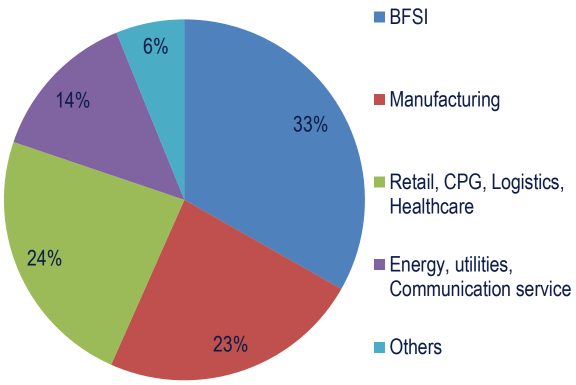
Source: Company, Investec Securities estimates

Table 1: Revenue Trends by Geography

in US$ m	FY10	FY11	FY12	FY13	FY14	FY15
N. America	3,164	3,944	4,468	4,604	5,004	5,357
- Growth%	*7%*	*25%*	*13%*	*3%*	*9%*	*7%*
Europe	1,106	1,301	1,531	1,712	2,016	2,097
- Growth%	*-10%*	*18%*	*18%*	*12%*	*18%*	*4%*
India	57	133	155	152	210	209
- Growth%	*-6%*	*133%*	*17%*	*-2%*	*38%*	*-1%*
ROW	477	663	839	930	1,019	1,048
- Growth%	*12%*	*39%*	*27%*	*11%*	*10%*	*3%*

Source: Company, Investec Securities estimates

Figure 2: Revenues by Business Vertical



Source: Company, Investec Securities research

Table 9: Revenues Trends by Business Vertical

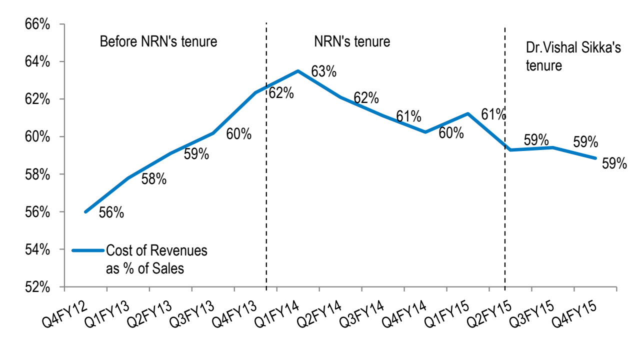
in US$ m	FY10	FY11	FY12	FY13	FY14	FY 15
BFSI	1,634	2,166	2,453	2,508	2,765	2,894
- Growth%	*3%*	*33%*	*13%*	*2%*	*10%*	*5%*
MFG.	952	1,185	1,438	1,628	1,887	2,041
- Growth%	*4%*	*24%*	*21%*	*13%*	*16%*	*8%*
RCLH[1]	978	1,239	1,602	1,770	2,006	2,051
- Growth%	*4%*	*27%*	*29%*	*11%*	*13%*	*2%*
Energy & Utilities	1,057	1,146	1,126	1,098	1,110	1,189
- Growth%	*-5%*	*8%*	*-2%*	*-2%*	*1%*	*7%*
Others	183	305	376	394	480	536
- Growth%	*57%*	*67%*	*23%*	*5%*	*22%*	*12%*

[1] Retail, CPG, Logistics, Healthcare & Life Sciences

Source: Company, Investec Securities research

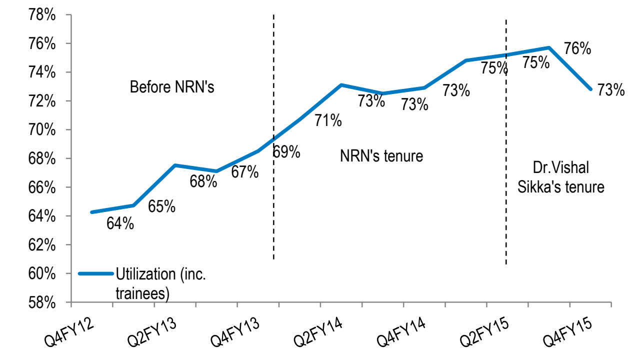
Investec

Figure 3: Falling costs…



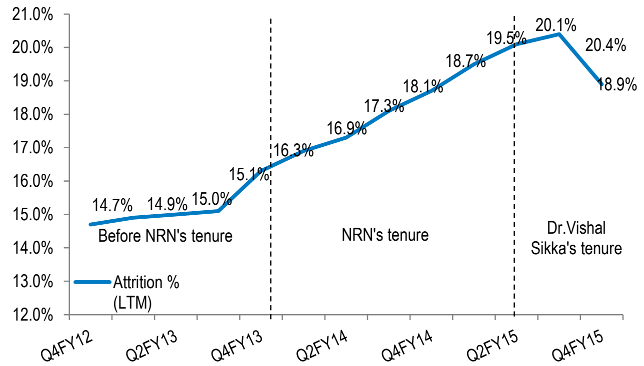
Source: Company, Investec Securities research

Figure 4: ...Improving Utilization Rates...



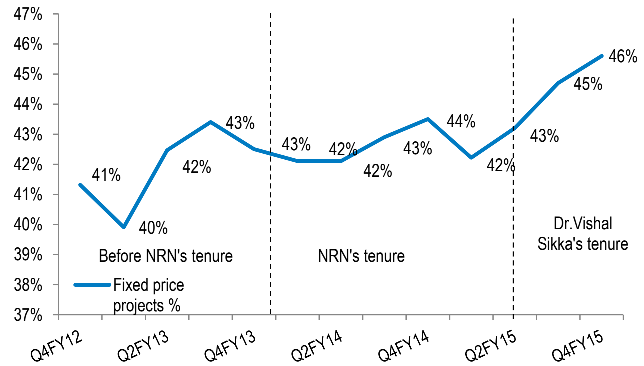
Source: Company, Investec Securities research

Figure 5: ...& falling attrition highlight improving operational performance



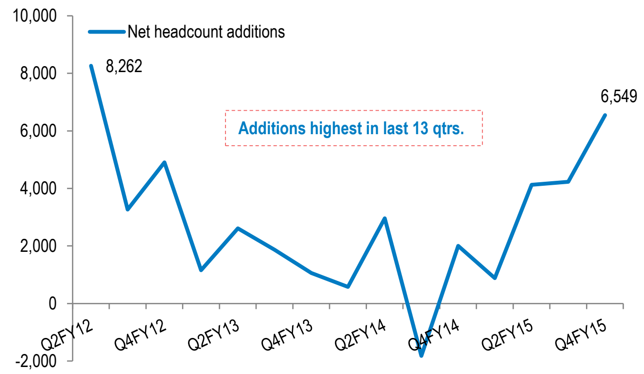
Source: Company, Investec Securities research

Figure 6: Increasing Fixed Price projects…



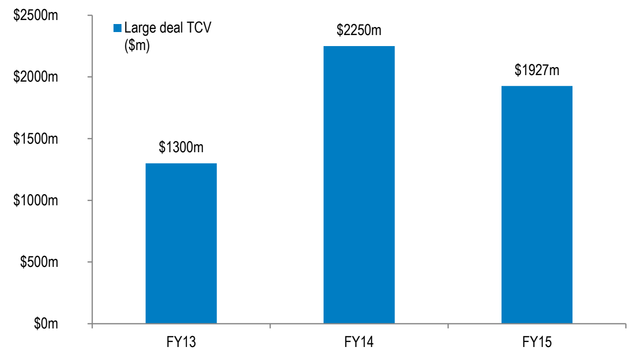
Source: Company, Investec Securities research

Figure 7: ...& headcount additions = increasing competitiveness



Source: Company, Investec Securities research

Figure 8: Large deals ≥ US$ 50mn; hence may not be accurate reflection



Source: Company, Investec Securities research

Summary Financials (INRm) Year end: 31 March

Income Statement	2013	2014	2015	2016E	2017E
Revenue	**403,523**	**501,330**	**533,173**	**584,379**	**665,830**
EBITDA	**115,348**	**134,800**	**148,984**	**162,369**	**190,073**
Depreciation and amortisation	11,290	13,730	10,690	12,320	13,942
Operating profit	**104,058**	**121,070**	**138,294**	**150,049**	**176,131**
Other income	23,590	26,690	34,260	31,926	35,661
Net interest	0	0	0	0	0
Share-based-payments	0	0	0	0	0
PBT (normalised)	**127,648**	**147,760**	**172,554**	**181,975**	**211,792**
Impairment of acquired intangibles	-	-	-	-	-
Non-recurring items/exceptionals	-	-	-	-	-
PBT (reported)	**127,648**	**147,760**	**172,554**	**181,975**	**211,792**
Taxation	33,670	40,620	49,290	51,863	60,361
Minorities & preference dividends	0	0	0	0	0
Discontinued/assets held for sale	0	0	0	0	0
Net Income (normalised)	93,978	107,140	123,264	130,112	151,431
Attributable profit	93,978	107,140	123,264	130,112	151,431
EPS (reported)	82.2	93.8	107.9	113.9	132.5
EPS (norm., cont.) – FD (INR)	82.2	93.8	107.9	113.9	132.5
EPS (norm., cont., IAS19R adj.) – FD	-	-	-	-	-
DPS (INR)	17.6	31.7	44.5	56.9	66.3
Average number of group shares - FD (m)	1,143	1,143	1,143	1,143	1,143
Average number of group shares (m)	1,143	1,143	1,143	1,143	1,143
Total number of shares in issue (m)	1,143	1,143	1,143	1,143	1,143

Cash Flow	2013	2014	2015	2016E	2017E
Operating profit	104,058	121,070	138,294	150,049	176,131
Depreciation & amortisation	(11,290)	(13,730)	(10,690)	(12,320)	(13,942)
Other cash and non-cash movements	33,392	40,100	48,041	12,320	13,942
Change in working capital	(9,760)	(520)	(11,310)	(12,690)	(17,591)
Operating cash flow	**127,690**	**160,650**	**175,026**	**149,679**	**172,482**
Interest	-	-	-	-	-
Tax paid	(32,910)	(38,780)	(67,510)	(51,863)	(60,361)
Dividends from associates and JVs	-	-	-	-	-
Cash flow from operations	**94,780**	**121,870**	**107,516**	**97,816**	**112,122**
Maintenance capex	(19,280)	(27,450)	(22,470)	(20,453)	(23,304)
Free cash flow	**75,500**	**94,420**	**85,046**	**77,363**	**88,818**
Expansionary capex	0	0	0	0	0
Exceptionals and discontinued operations	-	-	-	-	-
Other financials	(18,680)	(21,810)	21,294	31,663	35,374
Acquisitions	(13,190)	0	(12,820)	0	0
Disposals	-	-	-	-	-
Net share issues	10	0	0	0	0
Dividends paid	(31,230)	(31,430)	(49,350)	(66,145)	(81,103)
Change in net cash	**12,410**	**41,180**	**44,170**	**42,896**	**43,102**
Net cash/(debt)	218,320	259,500	303,670	346,566	389,669
FCFPS - FD (INR)	66.1	82.6	74.4	67.7	77.7

Balance Sheet	2013	2014	2015	2016E	2017E
Property plant and equipment	84,440	100,440	122,160	130,293	139,655
Intangible assets	3,680	3,420	6,380	6,380	6,380
Investments and other non current assets	22,260	36,500	62,090	62,337	62,610
Cash and equivalents	218,320	259,500	303,670	346,566	389,669
Other current assets	134,810	170,690	169,220	188,565	213,653
Total assets	**463,510**	**570,550**	**663,520**	**734,141**	**811,967**
Total debt	0	0	0	0	0
Preference shares	0	0	0	0	0
Other long term liabilities	(2,680)	(3,870)	(2,060)	(2,060)	(2,060)
Provisions & other current liabilities	(63,097)	(91,380)	(113,830)	(120,485)	(127,982)
Pension deficit and other adjustments	0	0	0	0	0
Total liabilities	**(65,777)**	**(95,250)**	**(115,890)**	**(122,545)**	**(130,042)**
Net assets	**397,733**	**475,300**	**547,630**	**611,597**	**681,925**
Shareholder's equity	397,733	475,300	547,630	611,597	681,925
Minority interests	0	0	0	0	0
Total equity	**397,733**	**475,300**	**547,630**	**611,597**	**681,925**
Net working capital	165,003	189,200	180,500	208,939	247,618
NAV per share (INR)	348.0	415.9	479.2	535.2	596.7

Source: Company accounts, Investec Securities estimates

Calendarised Valuation

Year end: 31 March

	2013	2014	2015	2016E
Calendar PE (x)	22.5	19.6	18.3	16.0
Calendar Price/NAVPS (x)	5.1	4.4	3.9	3.5
EV/sales (x)	4.2	3.8	3.5	3.1
EV/EBITDA (x)	15.4	13.7	12.6	10.9
FCF yield (%)	3.8	3.7	3.4	3.7
Dividend yield (%)	1.4	2.0	2.6	3.1

Source: Company accounts, Investec Securities estimates

Ratios and Metrics

Year end: 31 March

Ratios and metrics	2013	2014	2015	2016E	2017E
Revenue growth (y-on-y) (%)	19.6	24.2	6.4	9.6	13.9
EBITDA growth (y-on-y) (%)	7.6	16.9	10.5	9.0	17.1
Net income (normalised) growth (yoy)	12.8	14.0	15.0	5.6	16.4
EPS (normalised) growth (y-on-y) (%)	12.8	14.0	15.0	5.6	16.4
FCFPS growth (y-on-y) (%)	11.5	25.1	(9.9)	(9.0)	14.8
NAVPS growth (y-on-y) (%)	18.9	19.5	15.2	11.7	11.5
DPS growth (y-on-y) (%)	(25.5)	79.8	40.6	27.9	16.4
Interest cover (x)	ns	ns	ns	ns	ns
Net debt/EBITDA (x)	(1.9)	(1.9)	(2.0)	(2.1)	(2.1)
Net debt/equity (%)	(54.9)	(54.6)	(55.5)	(56.7)	(57.1)
Net gearing (%)	(121.7)	(120.3)	(124.5)	(130.8)	(133.3)
Dividend cover (x)	4.7	3.0	2.4	2.0	2.0
EBITDA margin (%)	28.6	26.9	27.9	27.8	28.5
Operating profit margin (%)	25.8	24.1	25.9	25.7	26.5
ROE (%)	23.6	22.5	22.5	21.3	22.2
ROCE (%)	26.0	25.3	25.2	24.5	25.8
NWC/revenue (%)	40.9	37.7	33.9	35.8	37.2
Tax rate (normalised) (%)	(26.4)	(27.5)	(28.6)	(28.5)	(28.5)
Tax rate (reported) (%)	(26.4)	(27.5)	(28.6)	(28.5)	(28.5)

Source: Company accounts, Investec Securities estimates

Target Price Basis

Relative valuation. P/E multiple at 10% discount to TCS target multiple of 20x

Key Risks

Client specific issues and faster than expected revenue cannibalization of legacy business

Tata Consultancy Services (TCS.NS)

India | Software & Computer Services

HOLD

Price: INR2628.20

Target: INR2813.00

Forecast Total Return: 8.9%

Market Cap: INR5,148bn

EV: INR5,066bn

Average daily volume: 89k

Valuation premiums imply little upside

TCS has managed the technology transitions of the past two decades extremely well, in our view. This is clearly visible in the market share gains the company has achieved compared with other vendors over the last 5 years. We expect TCS to continue trading at a premium as long as the perception of its ability to manage these transitions versus peers does not diminish. We see peers catching up quickly, meaning valuation premiums could decline over time. We initiate on TCS at HOLD with a TP of Rs2813.

- **Has been the leader in this ongoing phase of industrialization:** TCS accounted for 31% incremental revenue market share over the past 5 years (the highest vs Tier-1 Indian vendors including Cognizant). Competitors believe TCS i) has been the best at institutionalizing the use of tools, accelerators and re-using code; ii) has the narrowest gap between sales and delivery; and iii) is able to proactively invest in clients and customers to drive high growth across the portfolio.
- **Methodically invested in geographies, clients and service lines:** TCS has multiple initiatives across the portfolio that should aid growth in the near term and over the longer term. The JV with Mitsubishi in Japan is a good example – an initiative which started a good 2-3 years ago. The JV puts TCS amongst the top 28 vendors in Japan, which is a highly concentrated market (the top 30 vendors account for 80% of the market). TCS now has a stronger front-end in Japan and we believe it has a high probability of successfully driving an offshoring + industrialization effort in the region. Acquisitions like CGSL (Citi Global Services Limited) and Alti are other good examples.
- **Margins to remain in narrow band:** TCS has consistently invested excess margins to drive growth (see page 3). We thus model flattish margins over the next two years (adjusted for one-off bonus to employees of Rs26bn in FY15).
- **Competition catching up quickly and should restrict valuation premiums:** TCS is a good example of the benefits of successfully managing technology transitions and the significant revenue and margins that come with them. However, we see peers catching up quickly, which should restrict expansion in valuation premiums. We initiate coverage at HOLD with a target price of Rs2813 based on a five-year average P/E multiple of 20x.

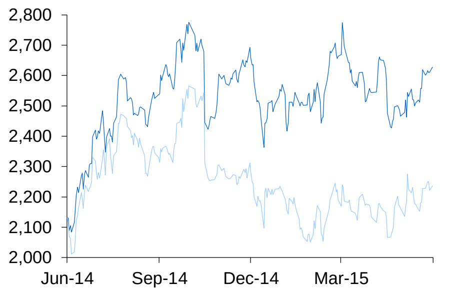
Nitin Padmanabhan
+91 (22) 6136 7400
nitin.padmanabhan@investec.co.in

Financials and valuation — Year end: 31 March

	2013A	2014A	2015A	2016E	2017E
Revenue (INRm)	629,895	818,094	946,484	1,087,367	1,243,359
EBITDA (INRm)	180,876	251,325	246,667	312,575	357,819
EBITA (INRm)	170,084	238,082	227,969	294,090	336,682
PBT (normalised) (INRm)	180,903	253,978	259,365	315,229	361,841
Net Income (normalised) (INRm)	139,059	191,176	196,489	239,858	275,517
EPS (norm. cont.) – FD (INR)	71.1	97.6	106.7	122.4	140.6
FCFPS - FD (INR)	45.9	65.7	94.5	81.3	89.0
DPS (INR)	25.0	23.8	75.0	49.0	56.2
PE (normalised) (x)	37.0	26.9	24.6	21.5	18.7
EV/sales (x)	8.0	6.2	5.4	4.7	4.1
EV/EBITDA (x)	28.0	20.2	20.5	16.2	14.2
FCF yield (%)	1.7	2.5	3.6	3.1	3.4
Dividend yield (%)	1.0	0.9	2.9	1.9	2.1

Source: Company accounts/Investec Securities estimates

Price Performance



	1m	3m	12m
Price	6.5	(1.3)	22.6
Price rel to India S&P BSE 500 - BSE	3.4	2.5	2.4

Source: FactSet

Company Background

TCS is India's largest and the world's 10th largest IT services company providing end-to-end IT services. The company was founded in 1968 by Tata Sons to provide punch card services to its sister company TISCO (now Tata Steel). In the past 10 years, TCS grew revenues at a 20% CAGR on the back of strong growth across verticals (in USD terms). TCS is the largest provider of IT services from India to Banking, Financial Services and Insurance companies globally. The company also has significant scale across all other sectors.

Catalysts

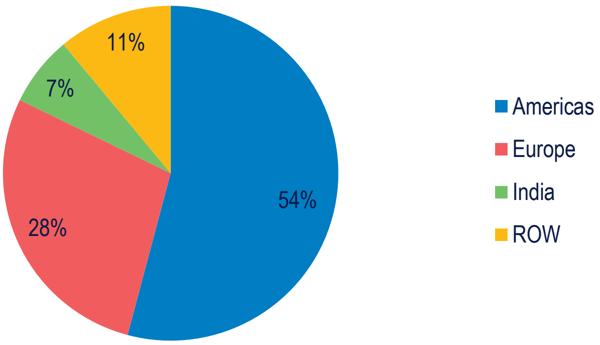
Positive:

- Large deal closures in Insurance, Telecom and Energy & Utilities as these are areas of current weakness
- Weakening INR vs USD can lead to better-than-expected margins. (1% change in INR = 30bps margin change)

Negative:

- Pricing pressure/cut in spending by top 20 clients
- Adverse cross currency movements

Figure 1: Revenue Exposure by Geography



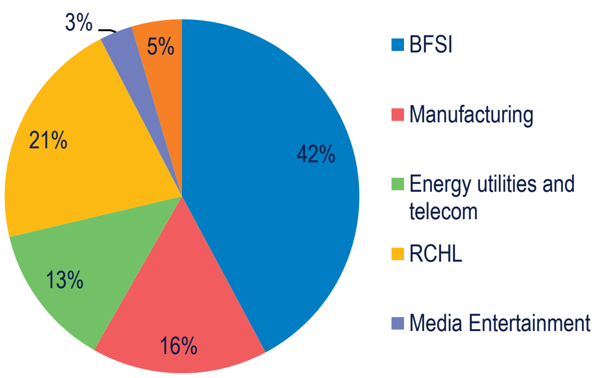
Source: Company, Investec Securities estimates

Table 1: Revenue Trend by Geography

In US$ m	FY10	FY11	FY12	FY13	FY14	FY15
Americas	3,663	4,702	5,735	6,498	7,437	8,336
- Growth%	*8%*	*28%*	*22%*	*13%*	*14%*	*12%*
Europe	1,686	2,032	2,576	3,065	3,850	4,367
- Growth%	*-5%*	*21%*	*27%*	*19%*	*26%*	*13%*
India	536	751	876	899	909	1,001
- Growth%	*14%*	*40%*	*17%*	*3%*	*1%*	*10%*
ROW	453	701	984	1,105	1,251	1,750
- Growth%	*16%*	*55%*	*40%*	*12%*	*13%*	*40%*

Source: Company, Investec Securities estimates

Figure 2: Revenue Exposure by Vertical



Source: Company, Investec Securities estimates

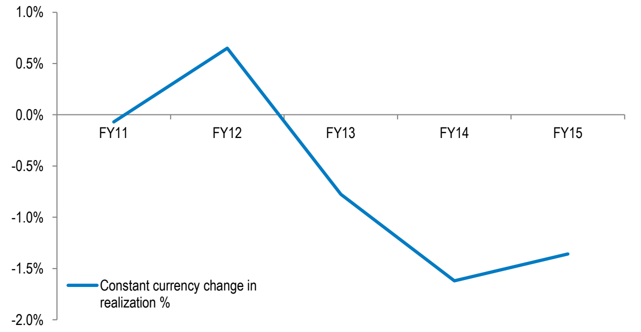
Table 2: Revenue Trend by Business Vertical

in US$ m	FY10	FY11	FY12	FY13	FY14	FY15
BFSI	2,848	3,627	4,380	4,983	5,770	6,303
- Growth%	12%	27%	21%	14%	16%	*9%*
MFG.	782	1,007	1,391	1,634	1,872	2,402
- Growth%	-24%	29%	38%	17%	15%	*28%*
Energy/ Utilities	985	1,329	1,483	1,566	1,778	1,993
- Growth%	-5%	35%	12%	6%	14%	*12%*
RCHL	1,196	1,607	2,152	2,559	3,099	3,090
- Growth%	1%	34%	34%	19%	21%	*0%*
Media & Ent.	120	175	221	248	310	417
- Growth%	5%	46%	26%	12%	25%	*35%*
Others	407	441	543	576	614	707
- Growth%	238%	8%	23%	6%	7%	*15%*

Source: Company, Investec Securities estimates

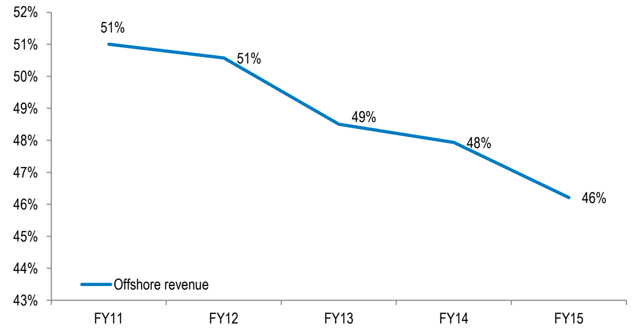
Investec

Figure 3: Declining constant currency realization (-3% for the period)



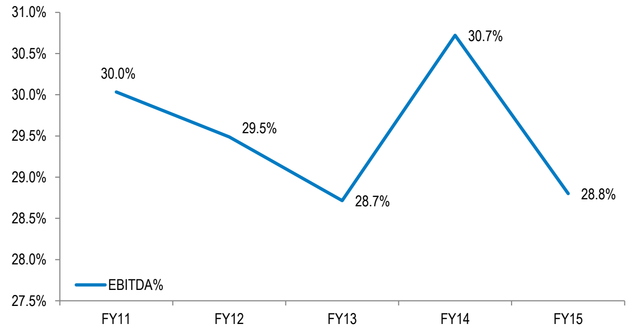
Source: Company, Investec Securities estimates

Figure 4: …despite lower offshore mix



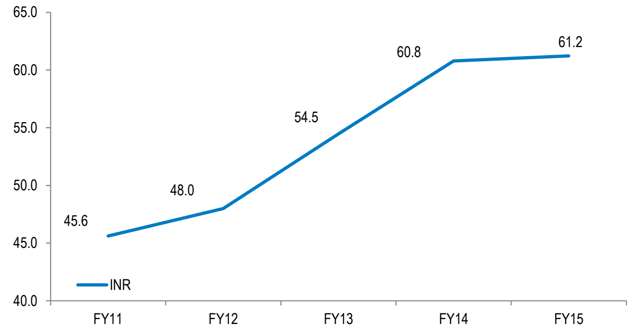
Source: Company, Investec Securities estimates

Figure 5: …leading to a 120bps margin decline



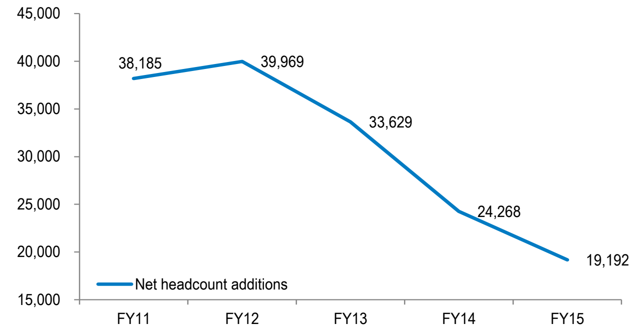
Source: Company, Investec Securities estimates

Figure 6: …despite a 34% INR depreciation



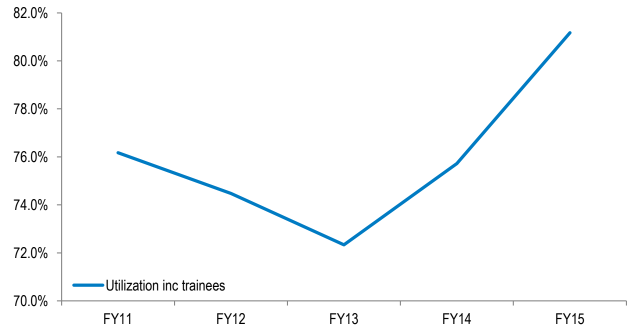
Source: Company, Investec Securities estimates

Figure 7: Declining headcount additions…



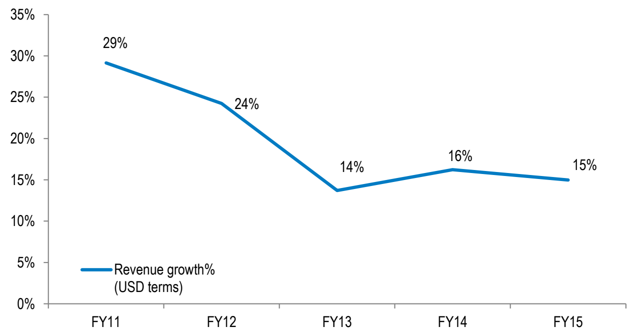
Source: Company, Investec Securities estimates

Figure 8: …on the back of improving utilization…



Source: Company, Investec Securities estimates

Figure 9: …and lower growth



Source: Company, Investec Securities estimates

Summary Financials (INRm) Year end: 31 March

Income Statement	2013	2014	2015	2016E	2017E
Revenue	**629,895**	**818,094**	**946,484**	**1,087,367**	**1,243,359**
EBITDA	**180,876**	**251,325**	**246,667**	**312,575**	**357,819**
Depreciation and amortisation	(10,792)	(13,243)	(18,698)	(18,485)	(21,137)
Operating profit	**170,084**	**238,082**	**227,969**	**294,090**	**336,682**
Other income	10,819	15,896	31,397	21,139	25,160
Net interest	0	0	0	0	0
Share-based-payments	0	0	0	0	0
PBT (normalised)	**180,903**	**253,978**	**259,365**	**315,229**	**361,841**
Impairment of acquired intangibles	-	-	-	-	-
Non-recurring items/exceptionals	-	-	-	-	-
PBT (reported)	**180,903**	**253,978**	**259,365**	**315,229**	**361,841**
Taxation	40,350	60,713	60,829	74,079	85,033
Minorities & preference dividends	1,494	2,089	2,048	1,292	1,292
Discontinued/assets held for sale	0	0	0	0	0
Net Income (normalised)	139,059	191,176	196,489	239,858	275,517
Attributable profit	139,059	191,176	196,489	239,858	275,517
EPS (reported)	71.1	97.6	100.3	122.4	140.6
EPS (norm., cont.) – FD (INR)	71.1	97.6	106.7	122.4	140.6
EPS (norm., cont., IAS19R adj.) – FD	-	-	-	-	-
DPS (INR)	25.0	23.8	75.0	49.0	56.2
Average number of group shares - FD (m)	1,957	1,959	1,959	1,959	1,959
Average number of group shares (m)	1,957	1,959	1,959	1,959	1,959
Total number of shares in issue (m)	1,957	1,959	1,959	1,959	1,959

Cash Flow	2013	2014	2015	2016E	2017E
Operating profit	170,084	238,082	227,969	294,090	336,682
Depreciation & amortisation	10,792	13,243	18,698	18,485	21,137
Other cash and non-cash movements	43,755	87,007	(43,738)	(1,292)	(1,292)
Change in working capital	(68,132)	(118,402)	69,956	(43,010)	(50,917)
Operating cash flow	**156,500**	**219,930**	**272,884**	**268,273**	**305,610**
Interest	-	-	-	-	-
Tax paid	(40,350)	(60,713)	(60,829)	(74,079)	(85,033)
Dividends from associates and JVs	-	-	-	-	-
Cash flow from operations	**116,150**	**159,217**	**212,055**	**194,194**	**220,577**
Maintenance capex	(26,401)	(30,605)	(27,007)	(35,000)	(46,200)
Free cash flow	**89,748**	**128,612**	**185,048**	**159,194**	**174,377**
Expansionary capex	0	0	0	0	0
Exceptionals and discontinued operations	-	-	-	-	-
Other financials	(34,839)	(78,450)	(23,243)	21,132	25,160
Acquisitions	0	0	0	0	0
Disposals	-	-	-	-	-
Net share issues	0	0	0	0	0
Dividends paid	(57,371)	(54,551)	(158,479)	(112,334)	(129,034)
Change in net cash	**(2,462)**	**(4,389)**	**3,325**	**67,993**	**70,502**
Net cash/(debt)	16,109	11,720	15,045	83,038	153,540
FCFPS - FD (INR)	45.9	65.7	94.5	81.3	89.0

Balance Sheet	2013	2014	2015	2016E	2017E
Property plant and equipment	115,580	143,441	152,830	171,029	197,772
Intangible assets	1,427	1,772	2,193	2,193	2,193
Investments and other non current assets	147,332	255,685	284,341	286,295	288,669
Cash and equivalents	18,432	14,688	18,622	86,615	157,117
Other current assets	235,997	273,540	291,550	364,843	452,801
Total assets	**518,768**	**689,125**	**749,536**	**910,974**	**1,098,552**
Total debt	(2,323)	(2,969)	(3,577)	(3,577)	(3,577)
Preference shares	(1,000)	0	0	0	0
Other long term liabilities	(13,677)	(15,738)	(16,831)	(17,701)	(18,759)
Provisions & other current liabilities	(85,716)	(110,162)	(145,226)	(176,591)	(214,948)
Pension deficit and other adjustments	0	0	0	0	0
Total liabilities	**(102,716)**	**(128,869)**	**(165,634)**	**(197,869)**	**(237,284)**
Net assets	**416,052**	**560,257**	**583,902**	**713,106**	**861,268**
Shareholder's equity	409,490	553,355	574,767	703,971	852,134
Minority interests	6,562	6,902	9,135	9,135	9,135
Total equity	**416,052**	**560,257**	**583,902**	**713,106**	**861,268**
Net working capital	279,951	330,372	300,674	387,123	487,283
NAV per share (INR)	212.6	286.0	298.1	364.0	439.6

Source: Company accounts, Investec Securities estimates

Calendarised Valuation

Year end: 31 March

	2013	2014	2015	2016E
Calendar PE (x)	28.9	25.2	22.2	19.3
Calendar Price/NAVPS (x)	9.8	8.9	7.6	6.2
EV/sales (x)	6.6	5.5	4.8	4.2
EV/EBITDA (x)	21.7	20.4	17.1	14.6
FCF yield (%)	2.3	3.3	3.2	3.3
Dividend yield (%)	0.9	2.4	2.1	2.1

Source: Company accounts, Investec Securities estimates

Ratios and Metrics

Year end: 31 March

Ratios and metrics	2013	2014	2015	2016E	2017E
Revenue growth (y-on-y) (%)	28.8	29.9	15.7	14.9	14.3
EBITDA growth (y-on-y) (%)	25.5	38.9	(1.9)	26.7	14.5
Net income (normalised) growth (yoy)	30.7	37.5	2.8	22.1	14.9
EPS (normalised) growth (y-on-y) (%)	30.7	37.4	9.4	14.7	14.9
FCFPS growth (y-on-y) (%)	61.8	43.2	43.9	(14.0)	9.5
NAVPS growth (y-on-y) (%)	25.9	34.5	4.2	22.1	20.8
DPS growth (y-on-y) (%)	48.0	(5.0)	215.3	(34.7)	14.9
Interest cover (x)	ns	ns	ns	ns	ns
Net debt/EBITDA (x)	(0.1)	(0.0)	(0.1)	(0.3)	(0.4)
Net debt/equity (%)	(3.9)	(2.1)	(2.6)	(11.6)	(17.8)
Net gearing (%)	(4.0)	(2.1)	(2.6)	(13.2)	(21.7)
Dividend cover (x)	2.8	4.1	1.4	2.5	2.5
EBITDA margin (%)	28.7	30.7	26.1	28.7	28.8
Operating profit margin (%)	27.0	29.1	24.1	27.0	27.1
ROE (%)	34.0	34.5	34.2	34.1	32.3
ROCE (%)	39.4	41.2	37.9	40.2	38.2
NWC/revenue (%)	44.4	40.4	31.8	35.6	39.2
Tax rate (normalised) (%)	(22.3)	(23.9)	(23.5)	(23.5)	(23.5)
Tax rate (reported) (%)	(22.3)	(23.9)	(23.5)	(23.5)	(23.5)

Source: Company accounts, Investec Securities estimates

Target Price Basis

20x PE; between the mean of the five-year forward PE and 1 standard deviation above it

Key Risks

Client specific issues and faster than expected revenue cannibalization of legacy business

Tech Mahindra (TEML.NS)

India | Software & Computer Services

HOLD

Price: INR552.60
Target: INR590.00
Forecast Total Return: 7.9%

Market Cap: INR531bn
EV: INR445bn
Average daily volume: 280k

Yet to graduate …

Tech Mahindra graduated to a Tier-1 services provider following the merger with Mahindra Satyam in terms of revenues, however, Tier-2 characteristics still remain with c.45% of its revenues from its top 10 clients (vs c.20% for Tier-1 peers). While TechM could benefit from the likely consolidation of telcos in the UK in FY17, near-term headwinds on the portfolio and margins make FY16E a wash-out from an earnings perspective, in our view. We initiate coverage with a HOLD rating and TP of Rs590.

- **TechM could benefit from telco consolidation in the UK:** The proposed acquisition of EE by BT and O2 by Hutchison in the UK could benefit TechM. TechM is a large vendor for both prospective acquirers, although more so for BT. Both firms expect regulatory approvals within a year, after which TechM could gain wallet share in two of the three mobile operators in the UK with a combined subscriber market share of 79%.
- **Expanded service portfolio through acquisitions to aid growth:** TechM acquired Light Bridge Communications (revenue of US$430m) and Sofgen (revenue of US$45m) in 2014. We expect the benefits of synergies from cross-selling opportunities and cost rationalization to play out in FY16E. Both acquisitions are expected to be EPS accretive, however, we are more bullish on TechM's ability to cross sell with existing clients.
- **Non-telecom business seeing higher deal traction:** 76% of the large deals announced by TechM in the last four quarters are non-telecom deals (the total TCV of large deals in the last 4 quarters is US$910m). So, while we expect near-term softness in telecoms, this should be compensated for by the non-telecom business, and we are sanguine about growth picking up in 2H16E.
- **Margin dilution from acquisitions in FY16E, but should improve in FY17E:** We are not worried about margin dilution from acquisitions in FY16E. We believe this should be more than offset by better revenue growth in FY17E and consequently better margins due to synergy benefits.
- **Valuation:** Despite forecasting strong growth for FY17E (17.6% in US$), upside potential is limited due to inherent risks (highlighted in our B.A.S.E framework). We initiate at HOLD with a target price of Rs590/share (representing a 30% discount to our TCS target PE multiple of 20x).

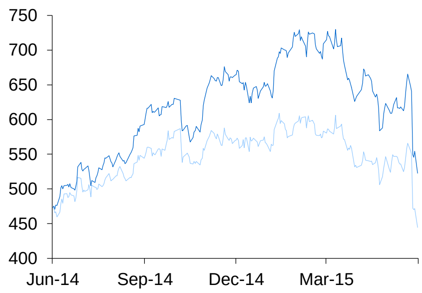
Nitin Padmanabhan
+91 (22) 6136 7400
nitin.padmanabhan@investec.co.in

Financials and valuation — Year end: 31 March

	2013A	2014A	2015A	2016E	2017E
Revenue (INRm)	141,320	186,313	224,779	266,386	313,329
EBITDA (INRm)	30,631	41,837	41,144	44,530	59,635
EBITA (INRm)	26,735	36,616	35,065	36,156	49,934
PBT (normalised) (INRm)	27,934	36,948	35,774	36,787	51,825
Net Income (normalised) (INRm)	19,554	30,287	26,278	26,359	37,411
EPS (norm. cont.) – FD (INR)	22.0	34.1	29.6	29.7	42.2
FCFPS - FD (INR)	7.7	7.7	14.5	23.8	32.0
DPS (INR)	0.3	2.4	6.0	6.1	8.6
PE (normalised) (x)	25.1	16.2	18.7	18.6	13.1
EV/sales (x)	3.1	2.4	2.0	1.7	1.4
EV/EBITDA (x)	14.5	10.6	10.8	10.0	7.5
FCF yield (%)	1.4	1.4	2.6	4.3	5.8
Dividend yield (%)	0.1	0.4	1.1	1.1	1.6

Source: Company accounts/Investec Securities estimates

Price Performance



	1m	3m	12m
Price	(16.2)	(26.3)	9.1
Price rel to India S&P BSE 500 - BSE	(18.6)	(23.4)	(8.9)

Source: FactSet

Company Background

Tech Mahindra, part of the USD16.5bn Mahindra Group, is the largest IT service provider in the telecom space among India listed vendors. The company was founded in 1986 to provide information technology, networking technology solutions and business support services to the global telecommunications industry. However, following the merger with Mahindra Satyam, the combined entity today has a diversified services portfolio catering to multiple industries, with a total headcount of over 103,000 employees.

Source: Company, Investec Securities research

Catalysts

Positive:

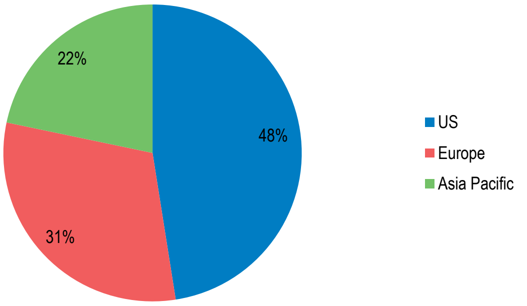
- Margin improvement expected from Q2FY16E
- Improvement in non-telecom business going forward
- Consolidation in telecom industry
- Weakening INR vs USD expected to improve margins. (1% change in INR = 18bps margin change)

Negative:

- Cut in spending by top 20 clients

Source: Investec Securities research

Figure 1: Revenue Exposure by Geography



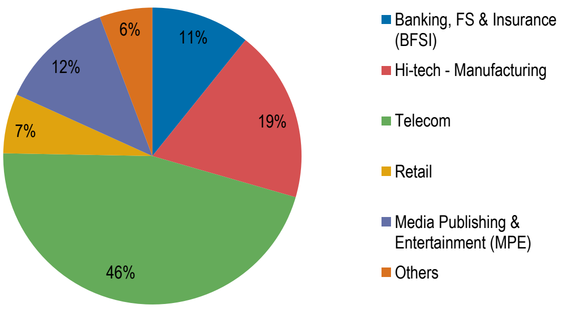
Source: Company, Investec Securities research

Table 1: Revenue Trends by Geography

Revenue by Geography (USD mn)	FY2013	FY2014	FY2015
US	1156.4	1404.8	1740.6
-Growth%		*21.5%*	*23.9%*
Europe	888.7	985.2	1127.5
-Growth%		*10.9%*	*14.4%*
Asia Pacific	587.5	700.2	795.1
-Growth%		*19.2%*	*13.6%*

Source: Company, Investec Securities research

Figure 2: Revenue Exposure by Business Vertical



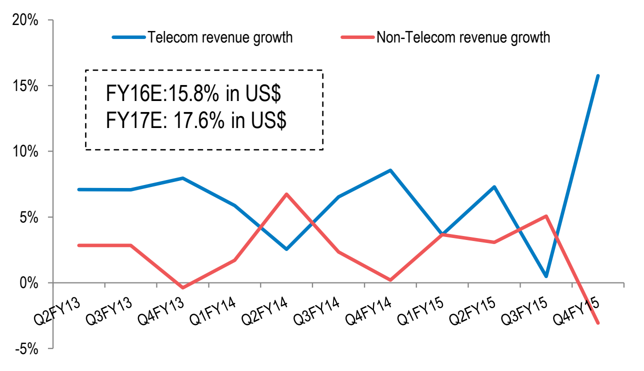
Source: Company, Investec Securities research

Table 2: Revenue Trends by Business Vertical

Revenue by Industry (USD mn)	FY2013	FY2014	FY2015
Banking, FS & Insurance (BFSI)	282.6	295.0	355.5
-Growth%		*4.4%*	*20.5%*
Hi-tech - Manufacturing	493.5	580.4	660.2
-Growth%		*17.6%*	*13.7%*
Telecom	1206.3	1527.0	1918.5
-Growth%		*26.6%*	*25.6%*
Retail	171.2	201.4	225.3
-Growth%		*17.7%*	*11.9%*
Media Publishing & Entertainment (MPE)	328.5	308.5	285.2
-Growth%		*-6.1%*	*-7.6%*
Others	150.7	185.9	219.6
-Growth%		*23.4%*	*18.2%*

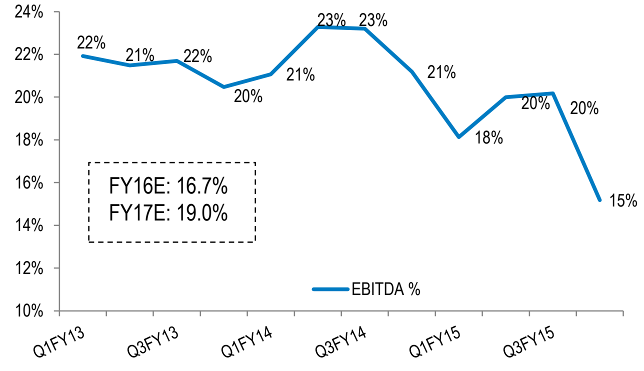
Source: Company, Investec Securities research

Figure 3: Portfolio Diversification has helped reduce volatility



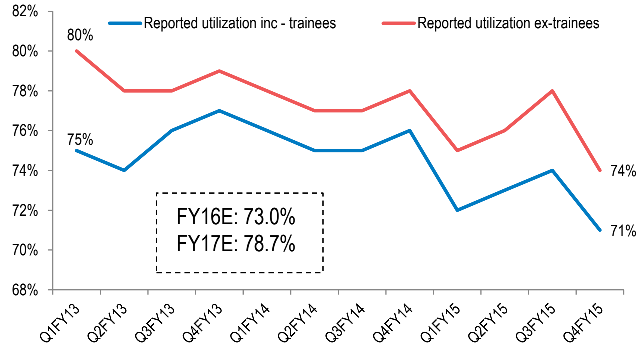
Source: Investec Securities research / Company accounts

Figure 4: EBITDA Margins to improve…



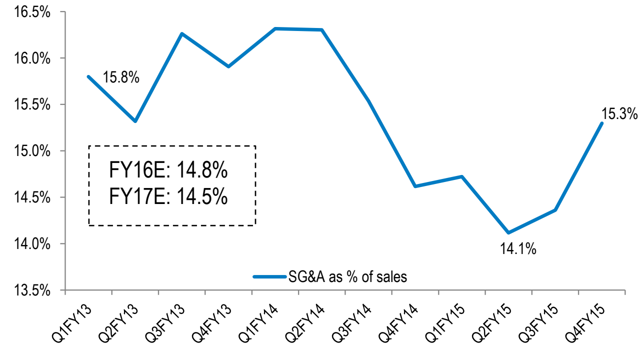
Source: Investec Securities research / Company accounts

Figure 5: …as utilization improves going forward



Source: Investec Securities research / Company accounts

Figure 6: …and acquisition related integration spends decline



Source: Investec Securities research / Company accounts

Table 10: Acquisitions so far: most have been acquired at <1x sales

Date		Cost	Annual revenues	Margins	Remarks	Other data points
Nov, 2014	**Light Bridge Communications Corporation (LCC)**	$240m	$430m	8%	1) Will help address rapidly growing market opportunity in telecom network upgrade cycle, 2) With networks increasingly IP-based and virtual, software will play a key role in the future, 3) Will augment investments already made in the network services business, 4) LCC's network engineering and field services will enable providing a full range of network services for both CSPs and ecosystem partners	Client base of 400
Oct, 2014	**Sofgen holdings**	$30m	$45m	8%	1) Delivers solutions in and around core banking (has 2nd largest pool of Avaloq consultants in the world and is Temenos' most prolific partner); 2) Specializes in private wealth, commercial and retail banking (8 of the top 10 wealth & private banks globally), 3) Niche consulting firm based out of Geneva (founded in 1999)	Client base of 20
Feb, 2014	**BASF Business Services Gmbh**	NA	NA	NA	All 60 employees of the BASF entity will move to Tech Mahindra as a part of the transaction. The entity's third party customers will also move to Tech Mahindra	The entity will provide IT services, supply chain operations and BPM services to the BASF group
Nov, 2013	**Mahindra Engineering Services**	4.26m shares of TechM	$40m	27%	Provides engineering services for automotive, off-highway equipment, aerospace and marine industries, and has over 40 clients globally. Some of its marquee clients include Honda, Renault-Nissan, Bentley, McLaren, GM, Navistar and Mercedes Benz and Volvo Construction Equipment	The company has 1300 employees
Feb, 2013	**Complex IT**	$30m	$48m	Mid teens	Acquired 51% stake with an upfront payment of US$6.5m. Will pay out remaining US$23m over 18-24 months. Can buy remaining stake in the future	Complex IT provides SAP implementation services in Brazil
Sept, 2012	**Hutchison Global Services**	$67m	$170m	Mid teens	$850m of committed revenues over five years. Customer contact centre with 11,500 people (Voice, Email & Chat). Can service new customers through the BPO	60% of revenues from UK, 35% from Australia and 5% from Ireland. 5 year deal structure guarantees margins. Deal effective 4th Sept
Sept, 2012	**Comviva**	$44m	$70m	Mid teens	VAS provider grown at 15-18% CAGR in the last 3 years with 130 customers. Acquired 51% in the company. US$21m paid upfront; US$12m guaranteed payment; US$11m earn-out	Top 10 clients account for 85% of revenues and Bharti Airtel is the top client. Caller ring back tones is 30% of the business. Current employee base of 1,500 people
Mar, 2012	**Vcustomer**	$27m	$16m	Mid teens	BPO focussed on retail and consumer technology. Acquired 100% of the International operations	

Source: Investec Securities research

Summary Financials (INRm)

Year end: 31 March

Income Statement	2013	2014	2015	2016E	2017E
Revenue	**141,320**	**186,313**	**224,779**	**266,386**	**313,329**
EBITDA	**30,631**	**41,837**	**41,144**	**44,530**	**59,635**
Depreciation and amortisation	(3,896)	(5,221)	(6,079)	(8,374)	(9,702)
Operating profit	**26,735**	**36,616**	**35,065**	**36,156**	**49,934**
Other income	2,121	1,129	1,006	2,244	3,503
Net interest	(922)	(797)	(297)	(1,612)	(1,612)
Share-based-payments	-	-	-	-	-
PBT (normalised)	**27,934**	**36,948**	**35,774**	**36,787**	**51,825**
Impairment of acquired intangibles	-	-	-	-	-
Non-recurring items/exceptionals	(1,600)	3,466	286	0	0
PBT (reported)	**26,334**	**40,414**	**36,060**	**36,787**	**51,825**
Taxation	(6,479)	(9,791)	(9,472)	(9,749)	(13,734)
Minorities & preference dividends	(301)	(336)	(310)	(680)	(680)
Discontinued/assets held for sale	0	0	0	0	0
Net Income (normalised)	19,554	30,287	26,278	26,359	37,411
Attributable profit	19,554	30,287	26,278	26,359	37,411
EPS (reported)	22.0	34.1	29.6	29.7	42.2
EPS (norm., cont.) – FD (INR)	22.0	34.1	29.6	29.7	42.2
EPS (norm., cont., IAS19R adj.) – FD	-	-	-	-	-
DPS (INR)	0.3	2.4	6.0	6.1	8.6
Average number of group shares - FD (m)	887	887	887	887	887
Average number of group shares (m)	887	887	887	887	887
Total number of shares in issue (m)	887	887	887	887	887

Cash Flow	2013	2014	2015	2016E	2017E
Operating profit	26,735	36,616	35,065	36,156	49,934
Depreciation & amortisation	3,896	5,221	6,079	8,374	9,702
Other cash and non-cash movements	(15,442)	5,762	8,306	6,762	8,089
Change in working capital	(316)	(16,151)	(8,617)	(4,623)	(6,884)
Operating cash flow	**10,977**	**26,227**	**34,754**	**38,295**	**51,140**
Interest	1,030	799	299	1,612	1,612
Tax paid	(3,410)	(10,941)	(10,725)	(9,749)	(13,734)
Dividends from associates and JVs	(49)	(156)	(354)	0	0
Cash flow from operations	**8,548**	**15,929**	**23,974**	**30,158**	**39,018**
Maintenance capex	(1,747)	(9,138)	(11,132)	(9,057)	(10,653)
Free cash flow	**6,801**	**6,791**	**12,842**	**21,101**	**28,365**
Expansionary capex	0	0	0	0	0
Exceptionals and discontinued operations	0	0	0	0	0
Other financials	3,795	13,575	2,835	632	1,891
Acquisitions	(6,122)	(894)	(13,642)	0	0
Disposals	0	0	0	0	0
Net share issues	71	497	582	0	0
Dividends paid	(593)	(1,359)	(5,496)	(6,786)	(6,807)
Change in net cash	**3,952**	**18,610**	**(2,879)**	**14,947**	**23,449**
Net cash/(debt)	15,063	33,673	30,794	45,741	69,190
FCFPS - FD (INR)	7.7	7.7	14.5	23.8	32.0

Balance Sheet	2013	2014	2015	2016E	2017E
Property plant and equipment	19,859	22,121	27,717	28,457	29,370
Intangible assets	5,054	845	1,006	949	987
Investments and other non current assets	23,558	31,011	47,231	47,231	47,231
Cash and equivalents	6,537	33,149	24,049	38,996	62,445
Other current assets	83,097	72,270	98,478	106,125	117,512
Total assets	**138,105**	**159,396**	**198,481**	**221,758**	**257,545**
Total debt	(8,526)	(524)	(6,745)	(6,745)	(6,745)
Preference shares	0	0	0	0	0
Other long term liabilities	(2,242)	(3,757)	(440)	(440)	(440)
Provisions & other current liabilities	(57,458)	(61,857)	(67,206)	(70,230)	(74,733)
Pension deficit and other adjustments	0	0	0	0	0
Total liabilities	**(68,226)**	**(66,138)**	**(74,391)**	**(77,415)**	**(81,918)**
Net assets	**69,879**	**93,258**	**124,091**	**144,343**	**175,627**
Shareholder's equity	68,536	91,820	122,490	142,062	172,667
Minority interests	1,344	1,438	1,601	2,281	2,961
Total equity	**69,879**	**93,258**	**124,091**	**144,343**	**175,627**
Net working capital	(44,541)	(45,299)	(47,792)	(46,194)	(43,813)
NAV per share (INR)	78.7	105.1	139.8	162.7	197.9

Source: Company accounts, Investec Securities estimates

Calendarised Valuation

Year end: 31 March

	2013	2014	2015	2016E
Calendar PE (x)	17.7	18.0	18.7	14.1
Calendar Price/NAVPS (x)	5.6	4.2	3.5	2.9
EV/sales (x)	2.6	2.1	1.8	1.5
EV/EBITDA (x)	11.4	10.8	10.2	7.9
FCF yield (%)	1.4	2.3	3.9	5.4
Dividend yield (%)	0.3	0.9	1.1	1.4

Source: Company accounts, Investec Securities estimates

Ratios and Metrics

Year end: 31 March

Ratios and metrics	2013	2014	2015	2016E	2017E
Revenue growth (y-on-y) (%)	20.8	31.8	20.6	18.5	17.6
EBITDA growth (y-on-y) (%)	56.9	36.6	(1.7)	8.2	33.9
Net income (normalised) growth (yoy)	6.1	54.9	(13.2)	0.3	41.9
EPS (normalised) growth (y-on-y) (%)	6.1	54.9	(13.2)	0.3	41.9
FCFPS growth (y-on-y) (%)	-	(0.1)	89.1	64.3	34.4
NAVPS growth (y-on-y) (%)	-	33.5	33.1	16.3	21.7
DPS growth (y-on-y) (%)	-	628.5	146.7	1.0	41.9
Interest cover (x)	29.0	45.9	118.1	22.4	31.0
Net debt/EBITDA (x)	(0.5)	(0.8)	(0.7)	(1.0)	(1.2)
Net debt/equity (%)	(21.6)	(36.1)	(24.8)	(31.7)	(39.4)
Net gearing (%)	(27.5)	(56.5)	(33.0)	(46.4)	(65.0)
Dividend cover (x)	66.0	14.0	4.9	4.9	4.9
EBITDA margin (%)	21.7	22.5	18.3	16.7	19.0
Operating profit margin (%)	18.9	19.7	15.6	13.6	15.9
ROE (%)	28.5	33.0	21.5	18.6	21.7
ROCE (%)	35.5	37.7	28.1	24.9	28.3
NWC/revenue (%)	(31.5)	(24.3)	(21.3)	(17.3)	(14.0)
Tax rate (normalised) (%)	23.2	26.5	29.1	35.9	29.6
Tax rate (reported) (%)	24.6	24.2	26.3	26.5	26.5

Source: Company accounts, Investec Securities estimates

Target Price Basis

Relative valuation; 30% discount to TCS target multiple of 20x

Key Risks

Client concentration (top 10 clients account for 45% of revenues)

Wipro Ltd (WIPR.NS)

India | Software & Computer Services

BUY

Price: INR565.75

Target: INR677.00

Forecast Total Return: 21.4%

Market Cap: INR1,397bn

EV: INR1,273bn

Average daily volume: 135k

Key headwinds abate…

Wipro has undergone a significant revamp over the last four years with core operational parameters such as utilization, proportion of fixed price contracts and improving large deal traction illustrating the benefits of these actions. However, challenges within its existing portfolio in the form of client-specific spending cuts have kept revenue growth in check. We highlight the larger challenges for Wipro versus peers and why we believe they could fade in the medium term. We initiate coverage at BUY with a price target of Rs677.

- **Large scale portfolio issues mostly over:** Portfolio issues have consistently hurt Wipro's ability to achieve industry level growth. The extent of exposure to Telecom OEMs and Energy companies has been unique to Wipro (highest among peers). The run down by telecom OEMs have hurt IT services revenue CAGR by c.2.5% since FY12 (revenues declined from US$434m in FY12 to c.S$50m currently. The Energy space impacted FY15 revenue growth by 1.5% (lost revenues of US$100m YoY). While headwinds from the telecom OEM segment are largely over, revenues from the energy space should begin to drive growth from mid-FY16 as we believe large oil & gas companies will begin to offshore in an effort to cut costs.
- **Large deal wins and strategy on new business gives comfort:** Wipro has seen a significant acceleration in large deal wins over the past year – ATCO (US$1.2b), Takeda (US$400m), Corning (US$175m), ABB (US$450m), and Levis (US$143m) to name a few. This highlights the increasing competitiveness and momentum in the sales engine built over the past few years.
- **Margins defensible – we see an upward bias:** With most of the large revenue headwinds largely over, we believe Wipro's ability to defend margins can only improve. Moreover, there are gains from the increasing automation Wipro has undertaken over the past few years through integrated offerings like ServiceNxT. Moreover, the company has benchmarked best practices with TCS to bring down total cost of ownership.
- **Valuations imply favourable risk reward:** We believe Wipro's current valuation reflects the impact of depressed revenues from factors that might not be as relevant going forward. We initiate at BUY with a TP of Rs677 based on a 20% discount to TCS' target PE multiple of 20x.

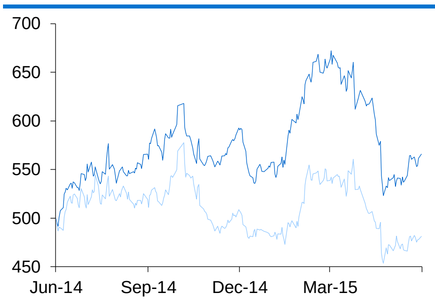
Nitin Padmanabhan
+91 (22) 6136 7400
nitin.padmanabhan@investec.co.in

Financials and valuation — Year end: 31 March

	2013A	2014A	2015A	2016E	2017E
Revenue (INRm)	374,256	434,317	470,467	502,109	556,876
EBITDA (INRm)	76,772	96,613	104,609	111,834	127,884
EBITA (INRm)	67,346	86,023	91,778	97,289	112,429
PBT (normalised) (INRm)	78,596	101,035	111,675	117,036	134,304
Net Income (normalised) (INRm)	66,696	78,433	87,051	90,937	104,354
EPS (norm. cont.) – FD (INR)	27.0	31.8	35.3	36.9	42.3
FCFPS - FD (INR)	23.4	23.4	24.7	29.4	36.9
DPS (INR)	7.0	7.9	12.0	9.4	10.8
PE (normalised) (x)	20.9	17.8	16.0	15.3	13.4
EV/sales (x)	3.4	2.9	2.7	2.5	2.3
EV/EBITDA (x)	16.6	13.2	12.2	11.4	10.0
FCF yield (%)	4.1	4.1	4.4	5.2	6.5
Dividend yield (%)	1.2	1.4	2.1	1.7	1.9

Source: Company accounts/Investec Securities estimates

Price Performance



	1m	3m	12m
Price	5.1	(13.6)	12.0
Price rel to India S&P BSE 500 - BSE	1.9	(10.2)	(6.4)

Source: FactSet

Company Background

Wipro is the third largest India-based IT services vendor with over 155,000 employees. The company had other large consumer, lighting and infrastructure engineering businesses which it demerged in April 2013. Those listed now comprise an IT services business (93% of revenues and 99.5% of EBIT) and the remaining IT products business. Wipro has the highest proportion of revenues from Energy & Utilities and Healthcare & Life Sciences vs peers.

Source: Investec Securities research

Catalysts

Positive:

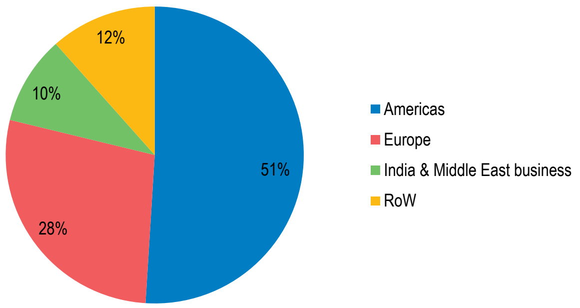
- Relatively lower impact of large-scale ramp-downs, that are unique to Wipro's portfolio
- Weakening INR vs USD can lead to better-than-expected margins (1% change in INR = 25bps margin change)

Negative:

- Lower-than-expected growth due to cannibalization of existing revenues and loss of market share to competition
- Pricing pressure/cut in spending by top 20 clients

Source: Investec Securities research

Figure 1: Revenue Exposure by Geography



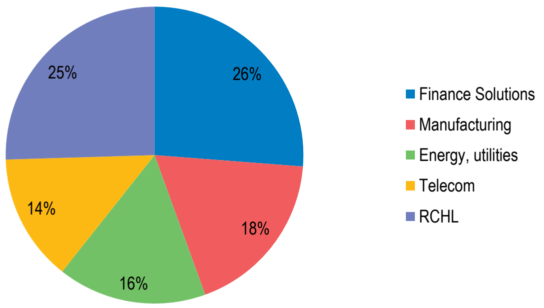
Source: Company, Investec Securities research

Table 1: Revenue Trend by Geography

US$ mn	FY11	FY12	FY13	FY14	FY15
Americas	2884	3097	3166	3299	3610
- Growth%		*7%*	*2%*	*4%*	*9%*
Europe	1415	1676	1780	1945	1970
- Growth%		*18%*	*6%*	*9%*	*1%*
India & Middle East	469	548	546	569	684
- Growth%		*17%*	*0%*	*4%*	*20%*
RoW	452	599	724	805	818
- Growth%		*32%*	*21%*	*11%*	*2%*

Source: Company, Investec Securities research

Figure 2: Revenue Exposure by Business Vertical



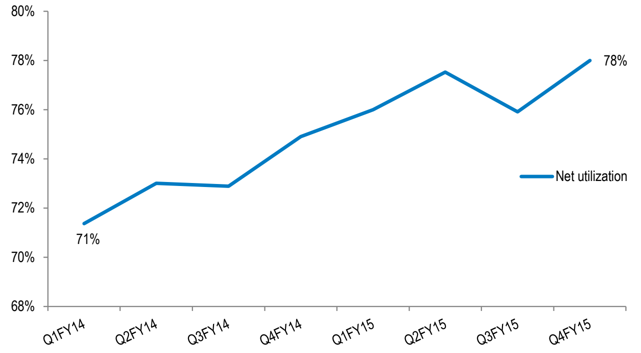
Source: Company, Investec Securities research

Table 2: Revenue Trend by Business Vertical

US$ mn	FY11	FY12	FY13	FY14	FY15
Finance Solutions	1407	1594	1662	1756	1857
- Growth%		*13%*	*4%*	*6%*	*6%*
Manufacturing	1069	1136	1184	1235	1292
- Growth%		*6%*	*4%*	*4%*	*5%*
Energy, utilities	496	782	924	1059	1146
- Growth%		*58%*	*18%*	*15%*	*8%*
Telecom	890	928	900	912	982
- Growth%		*4%*	*-3%*	*1%*	*8%*
RCHL	1358	1480	1548	1656	1804
- Growth%		*9%*	*5%*	*7%*	*9%*

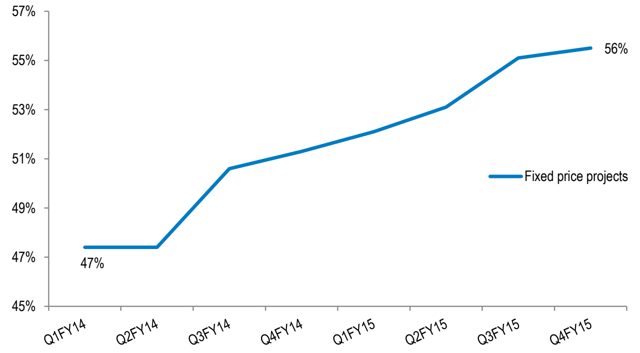
Source: Company, Investec Securities research

Figure 24: Improving efficiency through higher utilization



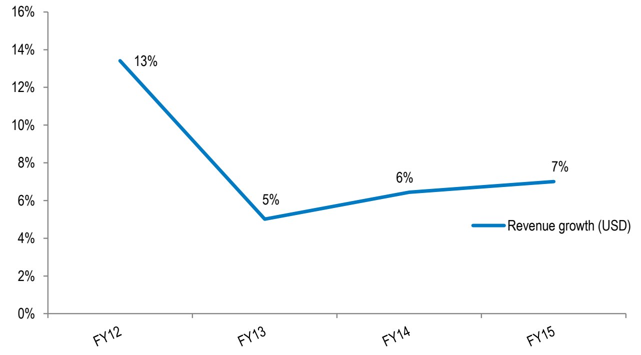
Source: Company, Investec Securities research

Figure 25: Improving fixed price projects indicates higher maturity



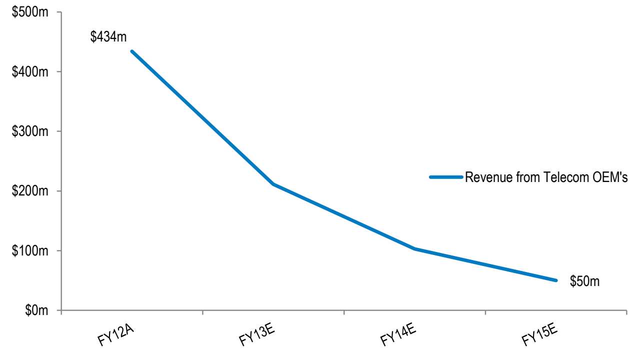
Source: Company, Investec Securities research

Figure 26: Revenue growth has been impacted by …



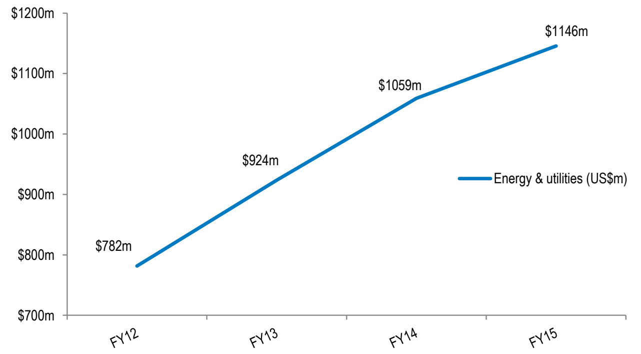
Source: Company, Investec Securities research

Figure 27: … run down by telecom OEM customers over the period



Source: Company, Investec Securities estimates

Figure 28: … and US$100m decline by energy customers in FY15



Source: Company, Investec Securities research

Summary Financials (INRm)

Year end: 31 March

Income Statement	2013	2014	2015	2016E	2017E
Revenue	**374,256**	**434,317**	**470,467**	**502,109**	**556,876**
EBITDA	**76,772**	**96,613**	**104,609**	**111,834**	**127,884**
Depreciation and amortisation	9,426	10,590	12,831	14,544	15,455
Operating profit	**67,346**	**86,023**	**91,778**	**97,289**	**112,429**
Other income	13,943	17,903	23,496	23,202	25,042
Net interest	(2,693)	(2,891)	(3,599)	(3,455)	(3,167)
Share-based-payments	5,012	0	0	0	0
PBT (normalised)	**78,596**	**101,035**	**111,675**	**117,036**	**134,304**
Impairment of acquired intangibles	-	-	-	-	-
Non-recurring items/exceptionals	0	0	0	0	0
PBT (reported)	**78,596**	**101,035**	**111,675**	**117,036**	**134,304**
Taxation	16,912	22,602	24,624	26,099	29,950
Minorities & preference dividends	-	-	-	-	-
Discontinued/assets held for sale	-	-	-	-	-
Net Income (normalised)	66,696	78,433	87,051	90,937	104,354
Attributable profit	66,696	78,433	87,051	90,937	104,354
EPS (reported)	27.0	31.8	35.3	36.9	42.3
EPS (norm., cont.) – FD (INR)	27.0	31.8	35.3	36.9	42.3
EPS (norm., cont., IAS19R adj.) – FD	-	-	-	-	-
DPS (INR)	7.0	7.9	12.0	9.4	10.8
Average number of group shares - FD (m)	2,466	2,466	2,466	2,466	2,466
Average number of group shares (m)	2,466	2,466	2,466	2,466	2,466
Total number of shares in issue (m)	2,466	2,466	2,466	2,466	2,466

Cash Flow	2013	2014	2015	2016E	2017E
Operating profit	67,346	86,023	91,778	97,289	112,429
Depreciation & amortisation	(9,426)	(10,590)	(12,831)	(14,544)	(15,455)
Other cash and non-cash movements	82,035	102,920	125,184	131,580	149,759
Change in working capital	2,822	(10,788)	(27,028)	(21,541)	(16,110)
Operating cash flow	**84,857**	**92,132**	**98,156**	**110,039**	**133,649**
Interest	-	-	-	-	-
Tax paid	(16,912)	(22,602)	(24,624)	(26,099)	(29,950)
Dividends from associates and JVs	-	-	-	-	-
Cash flow from operations	**67,945**	**69,530**	**73,532**	**83,940**	**103,699**
Maintenance capex	(10,145)	(11,786)	(12,661)	(11,421)	(12,667)
Free cash flow	**57,800**	**57,744**	**60,871**	**72,519**	**91,032**
Expansionary capex	0	0	0	0	0
Exceptionals and discontinued operations	-	-	-	-	-
Other financials	(36,144)	3,203	(21,150)	(2,641)	(2,266)
Acquisitions	(2,271)	0	0	0	0
Disposals	-	-	-	-	-
Net share issues	9	3,913	7,187	0	0
Dividends paid	(17,080)	(23,273)	(29,490)	(27,057)	(31,200)
Change in net cash	**2,314**	**41,587**	**17,418**	**42,821**	**57,566**
Net cash/(debt)	21,022	62,609	80,027	122,848	180,414
FCFPS - FD (INR)	23.4	23.4	24.7	29.4	36.9

Balance Sheet	2013	2014	2015	2016E	2017E
Property plant and equipment	105,281	114,871	122,284	122,656	123,059
Intangible assets	1,714	1,936	7,931	7,931	7,931
Investments and other non current assets	25,332	30,811	33,326	34,510	35,818
Cash and equivalents	84,838	114,201	158,940	195,164	246,698
Other current assets	222,565	240,485	277,552	300,307	325,385
Total assets	**439,730**	**502,304**	**600,033**	**660,568**	**738,891**
Total debt	(63,816)	(51,592)	(78,913)	(72,316)	(66,285)
Preference shares	0	0	0	0	0
Other long term liabilities	(9,153)	(10,053)	(13,669)	(14,523)	(15,447)
Provisions & other current liabilities	(81,778)	(95,773)	(97,823)	(100,221)	(110,497)
Pension deficit and other adjustments	-	-	-	-	-
Total liabilities	**(154,747)**	**(157,418)**	**(190,405)**	**(187,060)**	**(192,228)**
Net assets	**284,983**	**344,886**	**409,628**	**473,508**	**546,663**
Shareholder's equity	283,812	343,499	407,982	471,862	545,017
Minority interests	1,171	1,387	1,646	1,646	1,646
Total equity	**284,983**	**344,886**	**409,628**	**473,508**	**546,663**
Net working capital	194,259	206,708	243,153	276,227	299,742
NAV per share (INR)	115.5	139.8	166.1	192.0	221.6

Source: Company accounts, Investec Securities estimates

Calendarised Valuation

Year end: 31 March

	2013	2014	2015	2016E
Calendar PE (x)	18.5	16.4	15.5	13.8
Calendar Price/NAVPS (x)	4.2	3.5	3.1	2.6
EV/sales (x)	3.1	2.8	2.6	2.4
EV/EBITDA (x)	13.9	12.4	11.6	10.2
FCF yield (%)	4.1	4.3	5.0	6.2
Dividend yield (%)	1.4	1.9	1.8	1.9

Source: Company accounts, Investec Securities estimates

Ratios and Metrics

Year end: 31 March

Ratios and metrics	2013	2014	2015	2016E	2017E
Revenue growth (y-on-y) (%)	(0.3)	16.0	8.3	6.7	10.9
EBITDA growth (y-on-y) (%)	9.0	25.8	8.3	6.9	14.4
Net income (normalised) growth (yoy)	19.1	17.6	11.0	4.5	14.8
EPS (normalised) growth (y-on-y) (%)	19.1	17.6	11.0	4.5	14.8
FCFPS growth (y-on-y) (%)	69.0	(0.1)	5.4	19.1	25.5
NAVPS growth (y-on-y) (%)	(0.4)	21.0	18.8	15.6	15.4
DPS growth (y-on-y) (%)	16.7	13.5	51.0	(21.9)	15.3
Interest cover (x)	25.0	29.8	25.5	28.2	35.5
Net debt/EBITDA (x)	(0.3)	(0.6)	(0.8)	(1.1)	(1.4)
Net debt/equity (%)	(7.4)	(18.2)	(19.5)	(25.9)	(33.0)
Net gearing (%)	(8.0)	(22.2)	(24.3)	(35.0)	(49.3)
Dividend cover (x)	3.9	4.0	2.9	3.9	3.9
EBITDA margin (%)	20.5	22.2	22.2	22.3	23.0
Operating profit margin (%)	18.0	19.8	19.5	19.4	20.2
ROE (%)	23.5	22.8	21.3	19.3	19.1
ROCE (%)	22.8	23.5	21.0	19.5	19.7
NWC/revenue (%)	51.9	47.6	51.7	55.0	53.8
Tax rate (normalised) (%)	-	-	-	-	-
Tax rate (reported) (%)	(21.5)	(22.4)	(22.0)	(22.3)	(22.3)

Source: Company accounts, Investec Securities estimates

Target Price Basis

Relative valuation; 20% discount to TCS target P/E multiple of 20x

Key Risks

Likely senior leadership changes over the next two years

Investec

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	Expected total return 12m performance	Count	All stocks % of total	Count	Corporate stocks % of total
Buy	greater than 10%	165	54%	82	50%
Hold	0% to 10%	105	35%	16	15%
Sell	less than 0%	34	11%	0	0%

Source: Investec Securities estimates

Stock ratings for Indian stocks — Stock ratings for research produced by Investec Bank plc

	Expected total return 12m performance	Count	All stocks % of total	Count	Corporate stocks % of total
Buy	greater than 15%	15	68%	0	0%
Hold	5% to 15%	5	23%	0	0%
Sell	less than 5%	2	9%	0	0%

Source: Investec Securities estimates

Stock ratings for African* stocks — Stock ratings for research produced by Investec Securities Limited

	Expected total return 12m performance	Count	All stocks % of total	Count	Corporate stocks % of total
Buy	greater than 15%	24	38%	5	21%
Hold	5% to 15%	24	38%	4	17%
Sell	less than 5%	16	25%	3	19%

Source: Investec Securities estimates

*For African countries excluding South Africa, ratings are based on the 12m implied US dollar expected total return (ETR). This is derived from the expected local currency (LCY) ETR by making assumptions on the 12month forward exchange rates for the respective currencies. For South African stocks, ratings are based on the ETR in rand terms.

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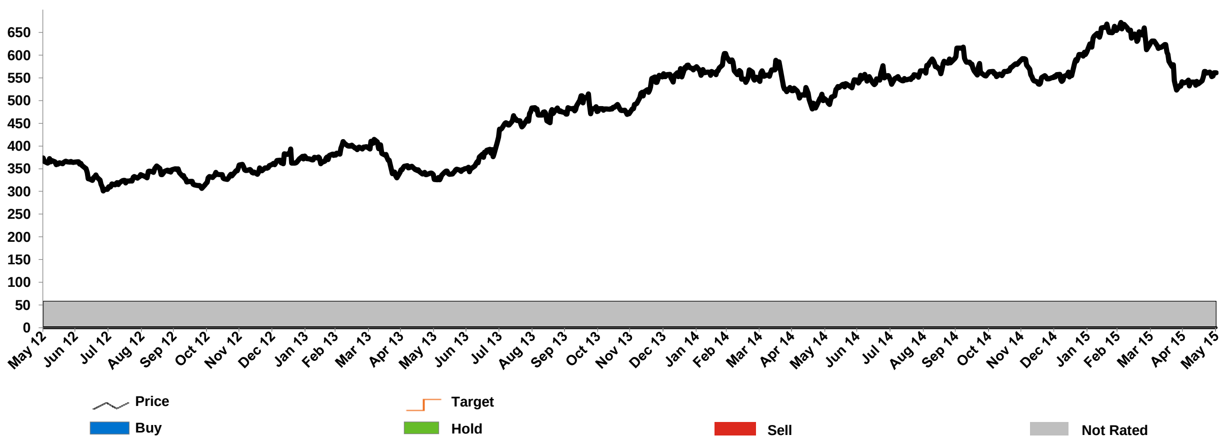

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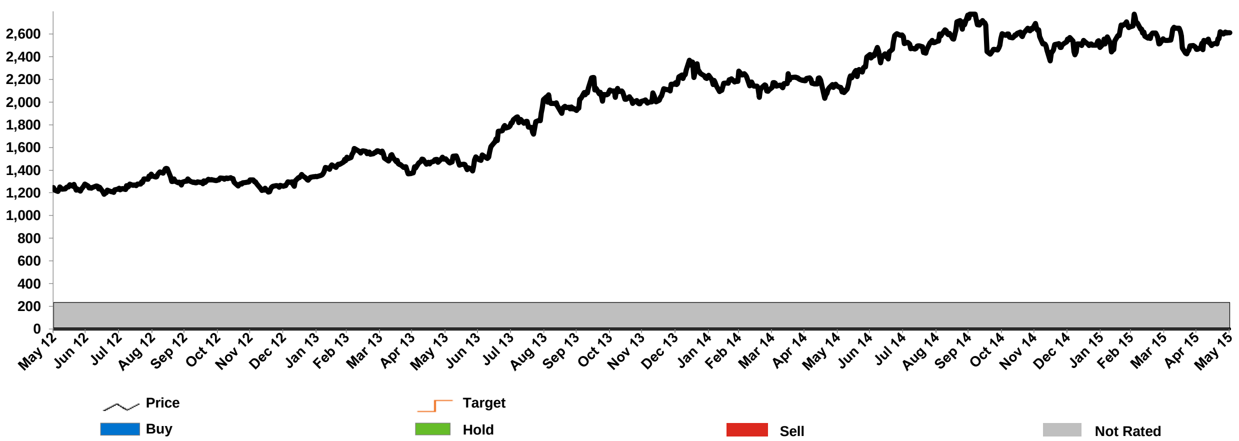

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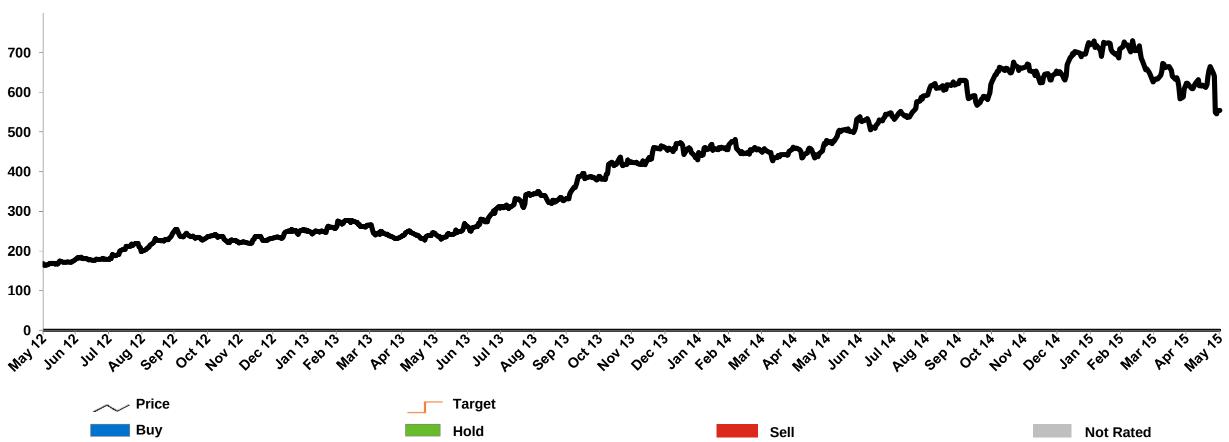

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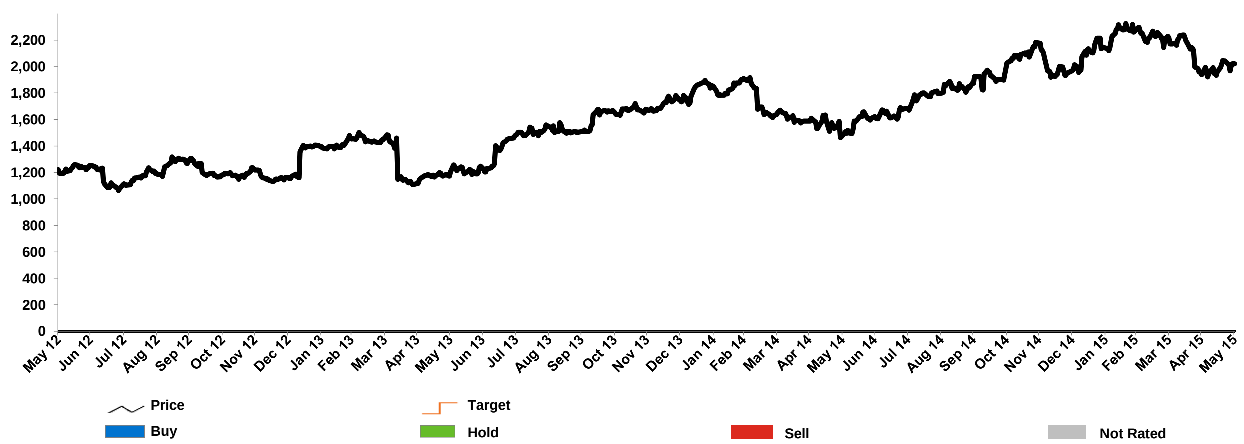
Infosys (INFY.NS) – Rating Plotter as at 01 Jun 2015



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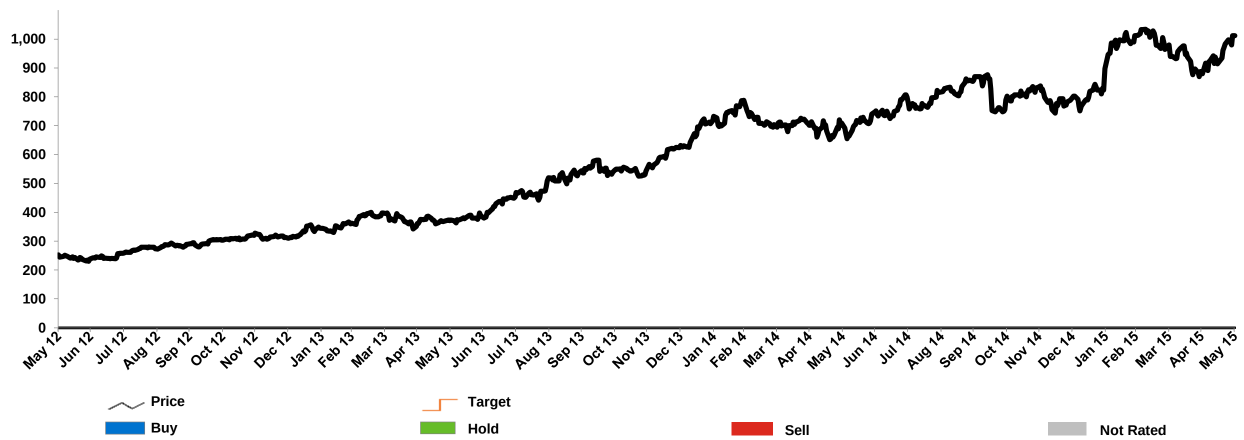

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Registered Office Address:
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Key Global Contacts

United Kingdom

Andrew Fitchie
+44 (0)20 7597 5084
andrew.fitchie@investec.co.uk

South Africa

Leon van Heerden
+27 11 286 7941
leon.vanheerden@investec.co.za

Analyst(s)

Nitin Padmanabhan
+91 (22) 6136 7400
nitin.padmanabhan@investec.co.in