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Brokerages divided on IT sector outlook in '08

Expect firms to sign non-dollar deals, go for inorganic growth

BS REPORTER
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Information Technology stocks, which lagged the benchmark equity indices in 2007, offer huge opportunity for contrarian investors as valuations of software services companies such as Infosys, Tata Consultancy Services, Satyam Computers and Wipro have hit a multi-year low, according to leading brokerage houses.

Concerns of a US slowdown, appreciating rupee and wage hike will continue to impact the sector's performance in 2008, they say. The brokerage houses, who participated in the Business Standard poll for 2008 outlook on stock markets, are divided on the prospects of the sector in the new year. Most participants including Angel Broking, Kotak Securities, Morgan Stanley and SBI Caps Securities see good buying opportunity in IT stocks at current valuations. Others like Motilal Oswal Financial Services, Avendus Capital, India Infoline and Relegare Securities are, however, not bullish on the sector in 2008.

Some brokerage houses expected the domestic software companies to diversify their product offering across different countries, sign non-dollar contracts and even go for inorganic growth to sustain growth in the coming year.

"In our opinion, the IT sector will make a comeback in 2008. However, the exact time of the year is difficult to de-

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- The IT Index on BSE saw a negative growth of 15 per cent in 2007 against 40% rise in the Sensex
- The appreciation rupee, which rose 12% against the US dollar during the year, has hit the IT companies hardest
- The top four IT stocks -- Infosys, TCS, Wipro and Satyam -- have shed 11-20% over the year



termine," said Dipen Shah, vice-president (private client group) of Kotak Securities.

The bellwether Sensex index of Bombay Stock Exchange rose nearly 40 per cent in 2007 while the IT Index saw a negative growth of 15 per cent during the same period as the appreciating rupee and rising wages put pressure on profit margins of the IT companies. A large chunk of revenues of Indian software makers are dollar-denominated. The rupee appreciated by about 12 per cent this year against the US dollar.

"We doubt that the IT sector will be able to bring in the returns that it has given to its investors in the past. Factors

Such as the current US economic scenario, high base effect of Indian companies, wage inflation pressures, rupee appreciation, increasing global competition and cutting down of tax concessions will lead to less than 20 per cent growth in the next three years," said Amar Ambani, vice-president of India Infoline.

Nandan Chakraborty, head of research at Enam Securities, said the volume growth for the IT companies will remain strong next year, though concerns of US slowdown and rupee appreciation could continue to weigh on the minds of investors. "However, strong underperformance and relative under-ownership may re-

sult in a short-term uptrend. The sector will remain volatile and hence the entry and the exit points (for investors) will be crucial," he said.

Top four IT stocks -- Infosys (down 20 per cent, or Rs 470 a share, since January to Rs 1804), TCS (down Rs 151.55 a share, or 12.13 per cent to Rs 1097), Satyam Computers (down Rs 54.35, or 11 per cent, to Rs 454) and Wipro (down Rs 75.8, or 12.39 per cent since January to Rs 535.70) have all let down the investors this year, which saw most of the other stocks including capital goods, infrastructure and banking stocks doing extremely well.

"Even after factoring in the 12 per cent rupee appreciation this year, the large caps in this space trade at a 16 times earnings multiple, which is well below its average multiple. With the profit abilities of these companies intact, we believe that the current valuations discount the concerns fairly well. Thus, 2008 would be a year for IT," said Lalit Thakkar, director (research) of Angel Broking.

Amurag Tripathi, EVP (equities), Almondz Global Securities, said, "The IT companies have been successful in growing at over 20 per cent year-on-year for several years, controlling costs and maintaining dollar margins. Their future performance will depend on their capability to diversify their product offerings across different countries, signing of non-dollar contracts and forex risk management."

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