

Infosys Technologies

STOCK INFO. BLOOMBERG
BSE Sensex: 8,541 INFO IN
REUTERS CODE
S&P CNX: 2,590 INFY.BO

11 October 2005

Buy

Rs2,684

Previous Recommendation: Buy

Equity Shares (m) 272.1
52-Week Range 2,727/1,679
1,6,12 Rel. Perf. (%) 6/-5/10
M.Cap. (Rs b) 730.3
M.Cap. (US\$ b) 16.3

YEAR	NET SALES	PAT	EPS	EPS	P/E	P/BV	ROE	ROCE	EV/	EV/
END	(RS M)	(RS M)	(RS)	GROWTH (%)	(X)	(X)	(%)	(%)	SALES	EBITDA
3/05A	71,296	18,464	69.0	46.7	38.9	13.7	43.6	50.2	9.9	30.1
3/06E	96,520	25,281	92.8	34.5	28.9	10.2	40.9	46.0	7.1	21.9
3/07E	129,738	32,545	117.1	26.2	22.9	7.8	38.9	45.1	5.2	16.0

- Infosys has reported better than expected revenue growth of 10.5% QoQ to Rs22.9b for 2QFY06, backed by strong volume growth. Volumes grew 10.4% QoQ, driven by the BFSI, Manufacturing, Retail and Utilities verticals.
- While the top client declined 6.3% QoQ, the top 2-5 clients grew 6.8% QoQ and the top 6-10 clients grew 11.6% QoQ. The quarter saw the addition of 6,390 employees, the highest ever in the company's history. This is indicative of the accelerated growth momentum in the coming quarters.
- Despite Rupee appreciation, EBITDA margin stayed flat at 32% due to high visa costs at USD7.5m, coupled with continuing investment in new service lines, infrastructure and software. The onsite composition has also increased from 47.9% to 48.8%, adding to the pressure on margins.
- Net profit for the quarter grew 13.9% QoQ to Rs6.1b, aided by higher other income (Rs440m; 52% higher than our estimate), and lower tax provision (down 3%). There was a tax write-back of Rs200m. EPS for the quarter was Rs22.3 as against our estimate of Rs21.8.
- The company has revised its guidance for the full year, upwards. It now projects a topline of Rs93.6-93.8b against the earlier Rs85-90.5b, and an EPS of Rs89-89.4 as against the earlier Rs84.7-86. The stock is trading at 28.9x FY06E and 22.9x FY07E EPS. We maintain **Buy** with a target price of Rs2,930.

QUARTERLY PERFORMANCE

(Rs Million)

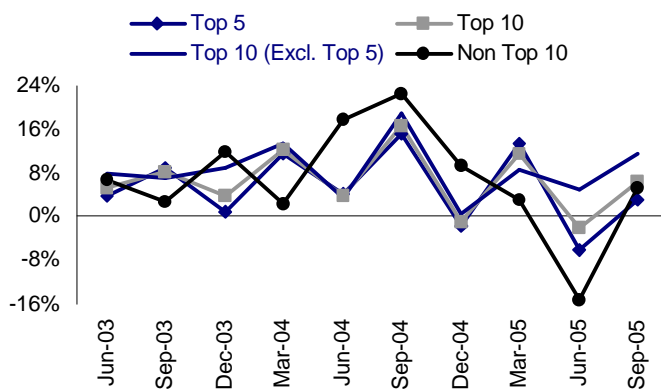
Y/E MARCH	FY05				FY06				FY05	FY06E
	1Q	2Q	3Q	4Q	1Q	2Q	3QE	4QE		
Revenues	15,174	17,493	18,756	19,873	20,716	22,940	25,327	27,537	71,296	96,520
Q-o-Q Change (%)	15.9	15.3	7.2	6.0	4.2	10.7	10.4	8.7	49.8	35.4
Direct Expenses	8,052	9,267	9,915	10,413	11,044	12,120	13,292	14,434	37,647	50,890
Sales, General & Admin. Expenses	2,229	2,616	2,662	2,793	3,033	3,480	3,698	4,020	10,300	14,232
Operating Profit	4,893	5,610	6,180	6,667	6,638	7,340	8,337	9,083	23,350	31,398
Margins (%)	32.2	32.1	32.9	33.5	32.0	32.0	32.9	33.0	32.8	32.5
Other Income	157	296	463	323	286	440	364	284	1,239	1,374
Depreciation	525	606	739	998	801	960	988	1,129	2,869	3,878
PBT bef. Extra-ordinary	4,524	5,300	5,904	5,992	6,123	6,820	7,714	8,238	21,720	28,894
Provision for Tax	641	826	934	855	802	690	1,026	1,096	3,256	3,613
Rate (%)	14.2	15.6	15.8	14.3	13.1	10.1	13.3	13.3	15.0	12.5
PAT bef. Extra-ordinary	3,883	4,474	4,970	5,137	5,321	6,130	6,688	7,142	18,464	25,281
Q-o-Q Change (%)	14.9	15.2	11.1	3.4	3.6	15.2	9.1	6.8	47.4	36.9

E: MSt Estimates

Top clients put growth back on track

Revenue growth during 1QFY06 had been adversely impacted due to slowdown in certain large accounts. In 2QFY06, the top 2-10 clients have bounced back with the top 2-5 clients growing by 6.8% QoQ, and top 6-10 clients by 11.6% QoQ. Infosys has been witnessing a churn in its top clients, with the bottom half of the top 10 clients growing faster than the top 5. The top 5 clients have grown at 3.2% CAGR over the last 8 quarters, with sequential decline in a few quarters, while the top 5-10 clients have grown at 8.4% CAGR. We believe that this churn would improve the company's profitability over the next few quarters.

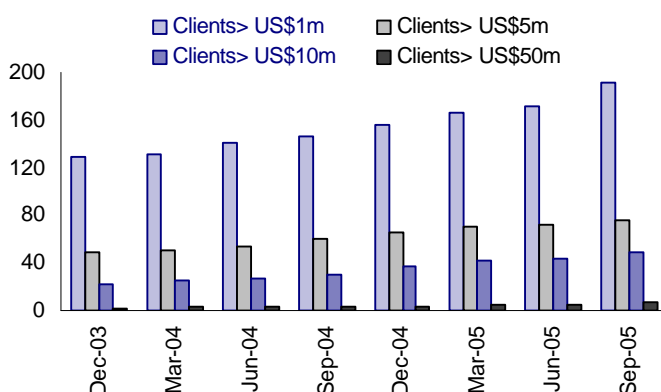
REVENUE GROWTH FROM TOP CLIENTS



Source: Company/Motilal Oswal Securities

Additionally, the number of clients has also increased, with greater number of clients transitioning to higher revenue buckets. Hence, revenue growth has been more broad-based in nature.

CLIENT BREAK-UP BY REVENUE BUCKET



Source: Company/Motilal Oswal Securities

Margins flat due to continued investments

The Rupee appreciated against the dollar during the quarter by 1% YTD and billing rates improved by 1% onsite and 0.3% offshore. However, operating margin was flat at 32%, due to high visa costs at USD7.5m, and investments in subsidiaries and infrastructure. Infosys has indicated that it would plough back any incremental appreciation in margins accruing through Rupee depreciation, economies of scale or increase in pricing into the business. It intends to create new solutions to expand offerings, hire more consultants in Infosys Consulting, and procure software packages. The company has indicated an investment of USD3-5m in hiring alone. Therefore, we do not expect significant improvement in margins in the following quarters.

Verticals also show strong growth

The company displayed robust growth across verticals. Banking grew 10.3% QoQ. Insurance, which had declined in the last two quarters, showed signs of revival with a QoQ growth of 4.1%. Manufacturing and Telecom also performed strongly with 12.4% and 7.5% QoQ growth, after declining by 1% and 7.6%, respectively in 1QFY06. Retail and Utilities grew by 21.1% and 28.7% respectively, albeit on smaller bases. Transportation & Logistics was the only vertical that declined in 2QFY06, with an 11.4% sequential decline. We believe that the broad-based revival in growth would accelerate in the coming quarters.

DOMAIN-WISE REVENUES

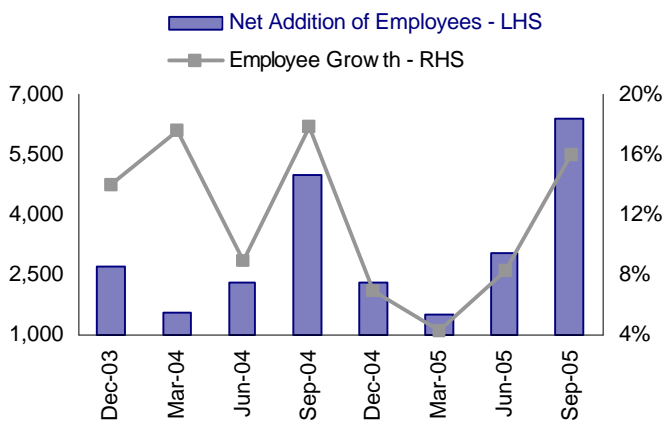
	2Q FY06	% CHG QOQ	% CHG YOY	1Q FY06	2Q FY05
Banking & FS (Rs m)	6,377	10.3	44.1	5,780	4,426
Banking & FS (%)	27.8			27.9	25.3
Insurance (Rs m)	1,812	4.1	5.7	1,740	1,714
Insurance (%)	7.9			8.4	9.8
Manufacturing (Rs m)	3,097	12.4	20.4	2,755	2,572
Manufacturing (%)	13.5			13.3	14.7
Telecom (Rs m)	3,831	7.5	18.4	3,563	3,236
Telecom (%)	16.7			17.2	18.5
Retailing (Rs m)	2,409	21.1	44.9	1,989	1,662
Retailing (%)	10.5			9.6	9.5
Utilities (Rs m)	986	28.7	94.4	766	507
Utilities (%)	4.3			3.7	2.9
Trans.&Logistics (Rs m)	1,285	-11.4	-2.1	1,450	1,312
Trans. & Logistics (%)	5.6			7.0	7.5
Others (Rs m)	872	20.2	-57.8	725	2,064
Others (%)	3.8			3.5	11.8

Source: Company/Motilal Oswal Securities

Employee addition at historical high

Infosys recruited 8,026 employees in 2QFY06, with a net employee addition of 6,930, the highest ever addition in a single quarter. Of the recruits, 6,860 were freshers, in line with the company's strategy of hiring more freshers. It plans to add 7,700 people in the second half of the year, amounting to a net addition of 5,000-5,400 employees. The high employee addition figures are indicative of the expected business momentum in the coming quarters.

EMPLOYEE ADDITION



Source: Company/Motilal Oswal Securities

Core IT business picks up speed

After three successive quarters of faster growth from the new service lines (Consulting, Package Implementation, Testing, BPO), core IT Services (development, maintenance, re-engineering) seem to have caught up,

reporting 10.5% QoQ growth, as against 10.7% growth in the new service lines. The company has been trying to grow the core IT business using the new service lines as value drivers, thereby driving volumes in the traditional ADM business.

Despite lower than average growth, prospects for Progeon look promising

After averaging 24.5% sequential growth over the past seven quarters, Progeon reported slower growth at 13.7% QoQ. However, business momentum remains stout, with net employee additions of 553, and the company guiding revenues of USD80m for the full year, implying a 100% YoY growth.

Valuation and view

Infosys' results for 2QFY06 were encouraging, with flat margins being the only disappointment. As we had predicted in our 1QFY06 Results Update, 2QFY06 has seen top clients pick up speed and boost topline growth. Core verticals such as Telecom and Manufacturing saw a revival in their respective growth rates during the quarter, which also bodes well for the quarters to follow. Employee addition plans for the rest of the year also indicate a positive trend in volume growth, with ramp-ups beginning in the ABN Amro deal during the second half of the year. We remain positive on the company and maintain **Buy** with a price target of Rs2,930.

GROWTH IN CORE IT SERVICES REVENUES HAS BOUNCED BACK

	DEC-03	MAR-04	JUN-04	SEP-04	DEC-04	MAR-05	JUN-05	SEP-05
Core IT	7,868.6	8,569.0	9,498.8	10,985.8	11,347.4	11,904.0	11,745.9	12,984.0
Change (%)	7.0	8.9	10.9	15.7	3.3	4.9	-1.3	10.5
New service lines	3,211.7	3,576.0	3,914.8	4,583.2	5,270.5	5,703.6	6,152.6	6,813.2
Change (%)	20.4	11.3	9.5	17.1	15.0	8.2	7.9	10.7

Source: Company/Motilal Oswal Securities

PROGEON: REVENUE TREND

	DEC-03	MAR-04	JUN-04	SEP-04	DEC-04	MAR-05	JUN-05	SEP-05
Revenue (Rs m)	210.0	256.4	318.6	419.8	525.2	635.9	787.2	894.7
Change (%)	23.4	22.1	24.3	31.8	25.1	21.1	23.8	13.7

Source: Company/Motilal Oswal Securities

KEY METRICS

	2Q	% CHG	% CHG	1Q	2Q
	FY06	QOQ	YOY	FY06	FY05
Volume Data - Person Months Billed					
Onsite	23,486	11.0	35.3	21,165	17,358
Offshore	65,334	10.2	44.0	59,306	45,375
Blended	88,820	10.4	41.6	80,471	62,733
Revenue - IT Services					
Onsite (Rs m)	11,113	12.7	28.0	9,856	8,683
Onsite (%)	48.8			47.9	49.8
Offshore (Rs m)	10,084	10.8	28.2	9,098	7,864
Offshore (%)	51.2			52.1	50.2
Utilization					
Including Trainees	72.9			74.1	71.4
Excluding Trainees	79.1	2.1	-2.3	77.5	81.0
Billing Rates - Derived					
Onsite	52.7	0.3	-0.4	52.5	52.9
Offshore	22.3	-5.8	-20.1	23.6	27.8
Employee Base					
Employees	46,196	6,390	13,247	39,806	32,949
Net Empl. Addition	6,390	3,334	1,380	3,056	5,010
Gross Empl. Addition	8,026	3,489	1,948	4,537	6,078
Billable Software					
Professionals	38,541	3,930	13,564	34,611	24,977
Laterals	1,166	37	114	1,129	1,052
Freshers	6,860	3,452	1,834	3,408	5,026
Attrition Rate (%)	10.0	0.2	-0.8	9.8	10.8
Client Performance					
Active Clients	450			443	431
Client Addition	34			36	32
Clients Dropped	27			31	20
Repeat Business	96.5			98.7	96.3
Client Concentration					
Top Client (Rs m)	1,009	-6.3	4.9	1,077	962
Top Client (%)	4.4			5.2	5.5
Top 2-5 Clients (Rs m)	3,074	6.8	9.1	2,880	2,816
Top 5 Clients (%)	17.8			19.1	21.6
Top 6- 10 Clients (Rs m)	2,936	11.6	28.1	2,631	2,292
Top 10 Clients (%)	30.6			31.8	34.7
Remain. Clients (Rs m)	15,920	12.7	39.4	14,128	11,423
Remaining Clients (%)	69.4			68.2	65.3
Client Evaluation					
> US\$1m	191			172	146
> US\$5m	76			73	60
> US\$10m	48			43	31
> US\$20m	23			22	16
> US\$30m	16			14	10
> US\$40m	11			8	7
> US\$50m	6			5	3
> US\$60m	4			4	0
> US\$70m	2			3	0
> US\$80m	1			1	0
> US\$90m	1			1	0

	2Q	% CHG	% CHG	1Q	2Q
	FY06	QOQ	YOY	FY06	FY05
Revenue by Project Type					
Fixed price (Rs m)	6,083	12.2	23.6	5,421	4,920
Fixed price (%)	28.7			28.6	29.7
Time & Material (Rs m)	15,113	11.7	29.8	13,533	11,646
Time & Material (%)	71.3			71.4	70.3
Revenue by Domain					
Banking & FS (Rs m)	6,377	10.3	44.1	5,780	4,426
Banking & FS (%)	27.8			27.9	25.3
Insurance (Rs m)	1,812	4.1	5.7	1,740	1,714
Insurance (%)	7.9			8.4	9.8
Manufacturing (Rs m)	3,097	12.4	20.4	2,755	2,572
Manufacturing (%)	13.5			13.3	14.7
Telecom (Rs m)	3,831	7.5	18.4	3,563	3,236
Telecom (%)	16.7			17.2	18.5
Retailing (Rs m)	2,409	21.1	44.9	1,989	1,662
Retailing (%)	10.5			9.6	9.5
Utilities (Rs m)	986	28.7	94.4	766	507
Utilities (%)	4.3			3.7	2.9
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Trans. & Logistics (%)	5.6			7.0	7.5
Others (Rs m)	872	20.2	-57.8	725	2,064
Others (%)	3.8			3.5	11.8
Revenue by Geography					
North America (Rs m)	6,377	10.3	44.1	5,780	4,426
North America (%)	27.8			27.9	25.3
Europe (Rs m)	1,812	4.1	5.7	1,740	1,714
Europe (%)	7.9			8.4	9.8
India (Rs m)	3,097	12.4	20.4	2,755	2,572
India (%)	13.5			13.3	14.7
RoW (Rs m)	3,831	7.5	18.4	3,563	3,236
RoW (%)	16.7			17.2	18.5
Revenue by Service Offering					
Development (Rs m)	4,565	13.6	4.0	4,019	4,391
Development (%)	19.9			19.4	25.1
Maint., incl. Y2K (Rs m)	6,905	9.6	35.2	6,298	5,108
Maint., incl. Y2K (%)	30.1			30.4	29.2
Re-engineering (Rs m)	1,078	2.1	-5.2	1,057	1,137
Re-engineering (%)	4.7			5.1	6.5
Package imple. (Rs m)	3,625	15.1	37.2	3,149	2,641
Package imple. (%)	15.8			15.2	15.1
Consulting (Rs m)	872	0.2	66.1	870	525
Consulting (%)	3.8			4.2	3.0
Testing (Rs m)	1,422	5.6	42.6	1,347	997
Testing (%)	6.2			6.5	5.7
Engg. Services (Rs m)	436	16.9	24.6	373	350
Engg. Services (%)	1.9			1.8	2.0
Other Services (Rs m)	2,317	25.7	63.5	1,844	1,417
Other Services (%)	10.1			8.9	8.1
BPO (Rs m)	895	13.7	113.1	787	420
BPO (%)	3.9			3.8	2.4
Products (Rs m)	826	-15.2	62.8	974	507
Products (%)	3.6			4.7	2.9
New Service Lines	6,813	10.7	48.7	6,153	4,583
Rest	16,127	10.7	24.9	14,563	12,910

Source: Motilal Oswal Securities

Infosys Technologies: an investment profile

Company description

Infosys is the second largest IT company in India with revenues of more than US\$1b and employing over 40,000 people. It provides IT as well as BPO services to more than 450 clients. It is the preferred vendor for a majority of the Fortune 500/Global 1,000 companies. Its top clients include DHL, Telstra, American Express, Goldman Sachs, Cisco, Fidelity and Bank of America.

Key investment arguments

- Excellent project execution skills make it the preferred vendor for most clients
- Differentiates itself by innovating offshore delivery of services in various forms
- Sustained competitive advantage to enable it to maintain its leadership position

Key investment risks

- Rapid hiring could hurt margins if demand declines
- Weak R&D services and infrastructure management services practice could result in it losing out on large outsourcing deals
- Higher mix of freshers in overall employee base could impact quality of services

Recent developments

- Ranked No.10 on Businessweek IT 100.
- Completed sponsored ADS issue with acceptance ratio of 8.7%
- Signed a landmark US\$250m deal with ABN Amro to start in 4QFY06

Valuation and view

- Revenue and earnings growth of 35% and 37% respectively in FY06E
- Valuations at 28.9x FY06E earnings are quite attractive, strong growth and likely revenues of US\$2.2b in FY06
- Reiterate **Buy** with a target price of Rs2,930

Sector view

- Various CIO surveys indicate increasing share of offshore spending in IT budgets
- Indian offshore vendors gaining market share in competition with MNCs
- We prefer large companies, as bulk of volumes are going to them; niche players are benefiting due to lack of offshore competition

COMPARATIVE VALUATIONS

		INFOSYS	TCS	WIPRO
P/E (x)	FY06E	28.9	25.7	29.4
	FY07E	22.9	21.2	23.0
P/BV (x)	FY06E	10.2	12.2	7.4
	FY07E	7.8	8.4	5.5
EV/Sales (x)	FY06E	7.1	5.8	4.9
	FY07E	5.2	4.6	3.7
EV/EBITDA (x)	FY06E	21.9	19.8	20.6
	FY07E	16.0	15.9	14.8

SHAREHOLDING PATTERN (%)

	JUN.05	MAR.05	JUN.04
Promoters	19.8	21.8	22.0
Domestic Institutions	4.8	4.8	6.1
FII's/FDIs	58.1	52.4	48.4
Others	17.3	21.0	23.5

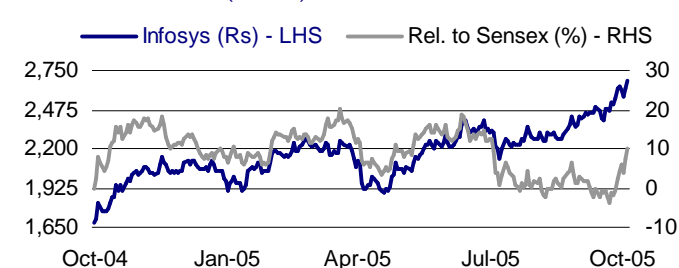
EPS: INQUIRE FORECAST VS CONSENSUS (RS)

	INQUIRE FORECAST	CONSENSUS FORECAST	VARIATION (%)
FY06	92.8	90.4	2.7
FY07	117.1	116.2	0.8

TARGET PRICE AND RECOMMENDATION

CURRENT PRICE (RS)	TARGET PRICE (RS)	UPSIDE (%)	RECO.
2,684	2,930	9.2	Buy

STOCK PERFORMANCE (1 YEAR)



INCOME STATEMENT					
(Rs Million)					
Y/E MARCH	2003	2004	2005	2006E	2007E
Sales	36,227	47,609	71,296	96,520	129,738
Change (%)	39.1	31.4	49.8	35.4	34.4
Software Develop. Exp.	18,133	24,953	37,647	50,890	68,547
Selling and Mktg. Exp.	2,670	3,351	4,610	6,447	8,715
Administration Exp.	2,703	3,469	5,690	7,785	10,534
Provisions	238	0	0	0	0
EBITDA	12,483	15,837	23,350	31,398	41,942
% of Net Sales	34.5	33.3	32.8	32.5	32.3
Depreciation	1,890	2,309	2,869	3,878	5,160
Other Income	996	1,274	1,239	1,374	1,401
PBT	11,590	14,801	21,720	28,894	38,183
Tax	2,010	2,270	3,256	3,613	5,638
Rate (%)	17.3	15.3	15.0	12.5	14.8
PAT	9,580	12,531	18,464	25,281	32,545
Net Income	9,580	12,531	18,464	25,281	32,545
Change (%)	18.6	30.8	47.3	36.9	28.7

BALANCE SHEET					
(Rs Million)					
Y/E MARCH	2003	2004	2005	2006E	2007E
Share Capital	331	333	1,353	1,353	1,353
Share Premium	3,388	4,609	8,999	8,999	8,999
Reserves	24,887	27,554	41,900	61,034	85,667
Net Worth	28,606	32,496	52,251	71,385	96,018
Preference Capital		936	935	935	935
Capital Employed	28,607	33,431	53,188	72,320	96,953
Gross Block	12,733	16,337	22,873	34,873	47,873
Less : Depreciation	5,772	8,098	10,308	14,186	19,346
Net Block	6,962	8,238	12,565	20,687	28,527
CWIP	766	2,081	3,177	1,000	1,000
Investments	332	9,455	12,108	3,000	3,000
Curr. Assets	27,580	31,340	39,664	66,266	89,555
Debtors	5,121	6,515	13,220	13,222	17,772
Cash & Bank Balance	13,362	17,215	15,756	40,196	56,338
Loans & Advances	8,728	7,211	10,244	12,293	14,752
Other Current Assets	368	400	444	555	693
Current Liab. & Prov	7,032	17,682	14,326	18,633	25,129
Creditors	2,366	4,499	5,354	7,850	10,584
Other liabilities	787	1,310	1,207	1,238	1,285
Provisions	3,880	11,872	7,765	9,545	13,260
Net Current Assets	20,547	13,658	25,338	47,633	64,426
Application of Funds	28,607	33,431	53,188	72,320	96,953

E: MOST Estimates

RATIOS					
Y/E MARCH	2003	2004	2005	2006E	2007E
Basic (Rs)					
EPS*	36.2	47.0	69.0	92.8	117.1
Cash EPS*	43.3	55.4	79.7	107.0	135.7
Book Value	108.0	121.9	195.2	262.0	345.5
DPS	6.8	32.4	12.9	20.4	25.8
Payout %(Incl.Div.Taxes)	18.7	78.0	21.1	24.3	24.3
Valuation (x)					
P/E		57.1	38.9	28.9	22.9
Cash P/E		48.4	33.7	25.1	19.8
EV/EBITDA		44.4	30.1	21.9	16.0
EV/Sales		14.8	9.9	7.1	5.2
Price/Book Value		22.0	13.7	10.2	7.8
Dividend Yield (%)		12	0.5	0.8	1.0
Profitability Ratios (%)					
RoE	38.8	41.0	43.6	40.9	38.9
RoCE	46.9	47.7	50.2	46.0	45.1
Turnover Ratios					
Debtors (Days)	52	50	68	50	50
Fixed Asset Turnover (x)	2.8	2.9	3.1	2.8	2.7
Leverage Ratio (x)					
Debt/Equity Ratio(x)	0.0	0.0	0.0	1.0	2.0

CASH FLOW STATEMENT					
(Rs Million)					
Y/E MARCH	2003	2004	2005	2006E	2007E
CF from Operations	11,469	14,840	21,333	29,159	37,706
Cash for Working Capital	1,605	-10,773	13,095	-2,256	513
Net Operating CF	9864	25614	8238	31415	37193
Net Purchase of FA	-2,511	-4,918	-7,633	-9,823	-13,000
Net Purchase of Invest.	112	-7,113	-3,574	9,108	0
Net Cash from Invest.	-2399	-12031	-11207	-716	-13000
Proceeds from Pvt. Place.	135	0	5,409	0	0
Proceeds from LTB/STB	0	0	0	0	0
Dividend Payments	-1,960	-9,730	-3,900	-6,259	-8,050
Cash Flow from Fin.	-1825	-9730	1509	-6259	-8050
Free Cash Flow	5,390	7,478	20,695	605	21,592
Net Cash Flow	5640	3853	-1459	24440	16142
Opening Cash Balance	7,722	13,362	17,215	15,756	40,196
Add: Net Cash	5,640	3,853	-1,459	24,440	16,142
Closing Cash Balance	13,362	17,215	15,756	40,196	56,338

N O T E S

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