

Infosys Technologies

HOLD**Maintained****Rs1,230**

Walking the tightrope

Reason for report: Q3FY09 results review and earnings revision

Technology

Earnings revision

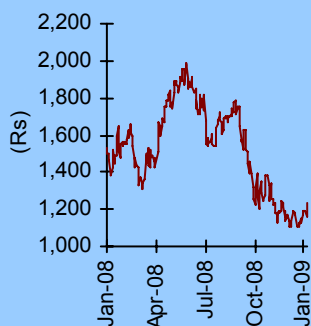
(%)	FY09E	FY10E
Sales	↑ 0.6	↑ 1.7
EBITDA	↑ 3.0	↑ 3.4
EPS	↑ 0.7	↑ 3.5

Shareholding pattern

	Jun '08	Sep '08	Dec '08
Promoters	16.5	16.5	16.5
Institutional investors	41.5	41.0	41.6
MFs and UTI	3.9	3.9	3.9
Insurance Cos.	4.0	4.5	4.7
FII	33.6	32.5	33.0
Others	42.0	42.5	41.9

Source: www.nseindia.com

Price chart



Infosys reported the first ever 3.7% decline in dollar revenues to US\$1.171bn (I-Sec: US\$1.167bn) and even missed its low-end guidance of US\$1.175-1.22bn, mainly due to cross-currency volatility (the company met constant currency guidance). Volume growth of 2% QoQ for consolidated IT services was a positive surprise (3.3% offshore growth and 1% decline in onsite). On a constant currency basis, 1.8% dip in blended pricing (onsite dip 2% and offshore 1%) surprised negatively (marginal prices could have dipped more), indicating volume growth at the cost of pricing. The management indicated that pricing will be affected in the current challenging environment if the situation worsens. Pricing pressure is being seen across sectors and pricing competition is intensifying in a bid to generate higher volumes. In line with our expectations, Q4FY09 & FY09 dollar revenue guidance was lowered to factor in cross-currency volatility and pricing dip (with FY09 constant currency growth guidance dipping 0.4% to 15.6-17.6%).

- ▶ **Maintain Infosys as sectoral outperformer.** We raise FY10E EPS 3.5% on increased rupee-dollar assumption (Rs44.8 versus Rs44.2) and higher operating leverage capability. With consistent outperformance on operating front and superior corporate governance, we maintain Infosys as our sectoral outperformer with Rs1,300 target price from Rs1,250 earlier. We remain cautious on sectoral outlook.
- ▶ **CY09 IT budgets may be finalised in mid-February '09 versus March '08 earlier.** Though overall IT budgets may be lowered in '09, offshoring budgets may increase (as seen in Q3FY09 results). However, in the current challenging environment, finalised budgets may be altered depending on economic situations.
- ▶ **Rupee depreciation leading to 199bps expansion in EBITDA margin to 35.1% (I-Sec: 33.2%).** Even SG&A dipped 180bps QoQ, compensating for the margin decline through 1.8% dip in billing rate (constant currency), indicating Infosys' focus on margin. EBITDA rose 13.2% QoQ and 45.9% YoY.
- ▶ **Healthy employee addition and large deal wins.** Infosys added 5,997 employees on a gross basis versus 4,500 guidance in Q3FY09 (23,296 YTD FY09) and increased its FY09 guidance to 27,000 from 25,000 earlier. Also, the company has made and intends to honour FY10 campus offers of 20,000. It has won four large deals in excess of US\$50mn and is currently pursuing 10 such large deals.

Market Cap	Rs704.2bn/US\$14.5bn
Reuters/Bloomberg	INFY.BO/INFO IN
Shares Outstanding (mn)	572.5
52-week Range (Rs)	1993/1101
Free Float (%)	83.5
FII (%)	33.0
Daily Volume (US\$'000)	66,000
Absolute Return 3m (%)	(12.2)
Absolute Return 12m (%)	(19.7)
Sensex Return 3m (%)	(21.0)
Sensex Return 12m (%)	(56.2)

Year to March	2008	2009E	2010E	2011E
Revenue (Rs mn)	166,920	217,268	219,739	243,811
Net Income (Rs mn)	45,684	58,393	59,275	62,665
EPS (Rs)	79.9	102.0	103.4	109.1
% Chg YoY	19.5	27.6	1.3	5.6
P/E (x)	15.4	12.1	11.9	11.3
CEPS (Rs)	90.0	114.9	118.4	125.1
EV/E (x)	12.0	8.4	8.1	6.9
Dividend Yield	2.7	2.6	2.3	2.3
RoCE (%)	36.8	37.7	30.7	26.6
RoE (%)	36.5	37.4	30.5	26.5

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Table 1: Q3FY09 results review

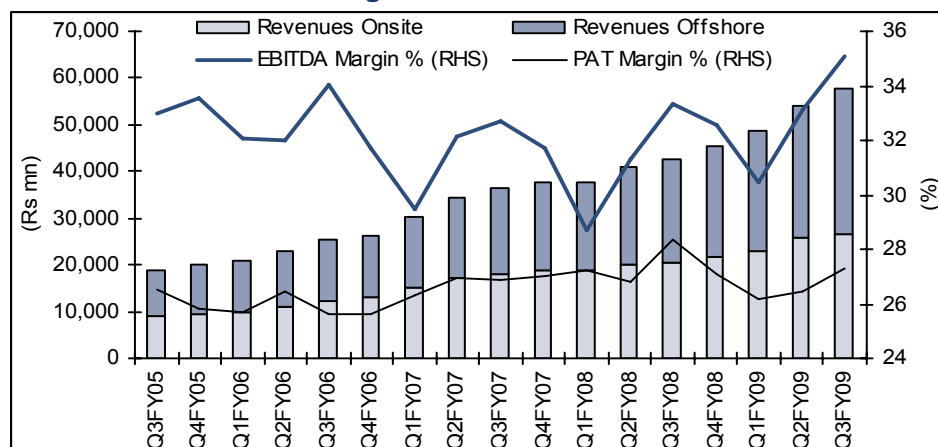
(Rs mn, year ending March 31)

	Q3FY09	Q2FY09	Q3FY08	% chg. (QoQ)	% chg. (YoY)	I-Sec estimates	% Variance
Net Sales	57,860	54,180	42,710	6.8	35.5	56,917	1.7
Cost of development	30,750	28,910	22,936	6.4	34.1	30,637	0.4
Employee expenses	26,710	24,550	19,526	8.8	36.8	25,999	2.7
Selling & marketing	2,740	3,030	2,050	(9.6)	33.7	3,017	(9.2)
General & Admin	4,060	4,300	3,490	(5.6)	16.3	4,383	(7.4)
Total Expenses	37,550	36,240	28,476	3.6	31.9	38,037	(1.3)
EBITDA	20,310	17,940	14,234	13.2	42.7	18,881	7.6
Depreciation	1,870	1,770	1,530	5.6	22.2	1,935	(3.4)
Other Income	220	660	1,580	(66.7)	(86.1)	1,166	(81.1)
Recurring pre-tax income	18,660	16,830	14,284	10.9	30.6	18,111	3.0
Extraordinary income/(expense)	780	0	196	NA	297.5	0	NA
Taxation	3,030	2,510	2,170	20.7	39.6	2,671	13.4
Minority Interest	0	0	0	NA	NA	0	NA
Reported Net Income	16,410	14,320	12,310	14.6	33.3	15,440	6.3
Recurring Net Income	15,630	14,320	12,114	9.1	29.0	15,440	1.2
Ratios (%)							
EBITDA margins	35.1	33.1	33.3			33.2	
Net profit margins	27.0	26.4	28.4			27.1	

Source: Company data, I-Sec Research

Sharp rupee depreciation, savings in SG&A led to EBITDA margin expanding 199bps to 35.1%, one of the highest margins in the past many quarters. Recurring PAT rose 9.1% QoQ to Rs15.63bn

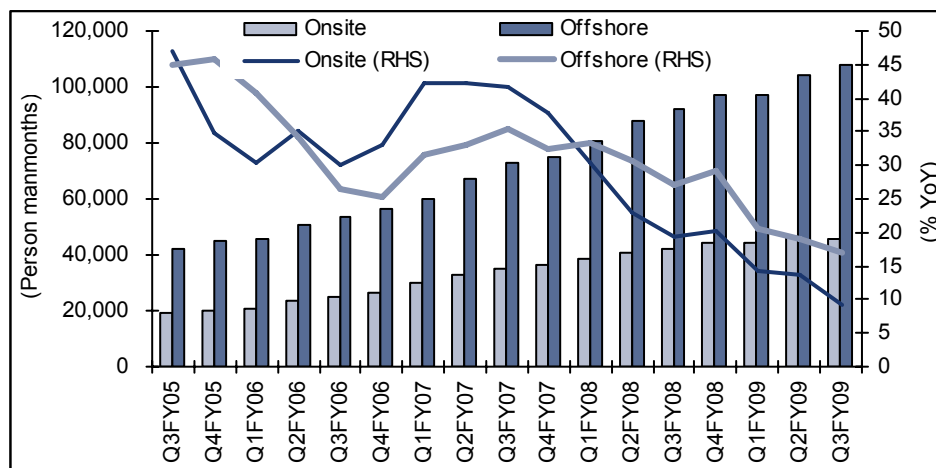
Chart 1: Revenues and margins – EBITDA and PAT



Source: Company data, I-Sec Research

Chart 2: IT services – Billed manmonths and growth (YoY)

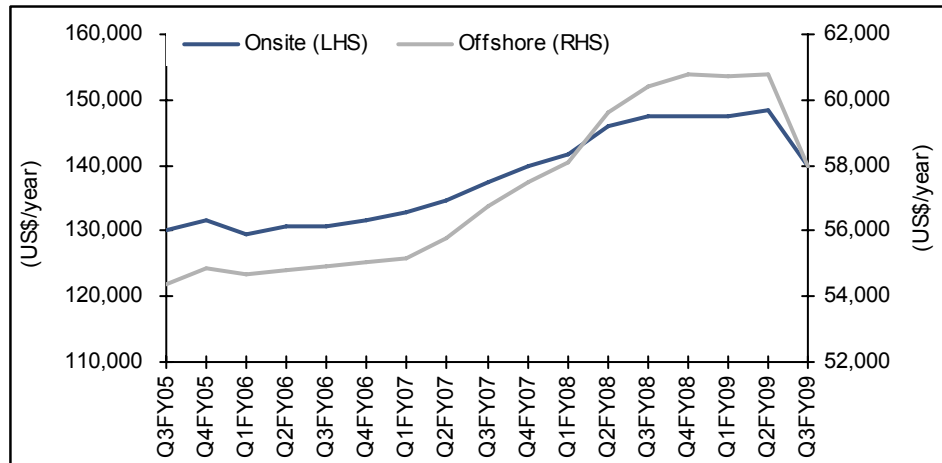
Volume growth for consolidated IT services was steady at 2% (I-Sec: 0.25% dip). Onsite volume dipped 1% QoQ and offshore volume increased 3.3% QoQ, indicating an offshore shift in troubled times



Source: Company data, I-Sec Research

Chart 3: IT services – Billing rates

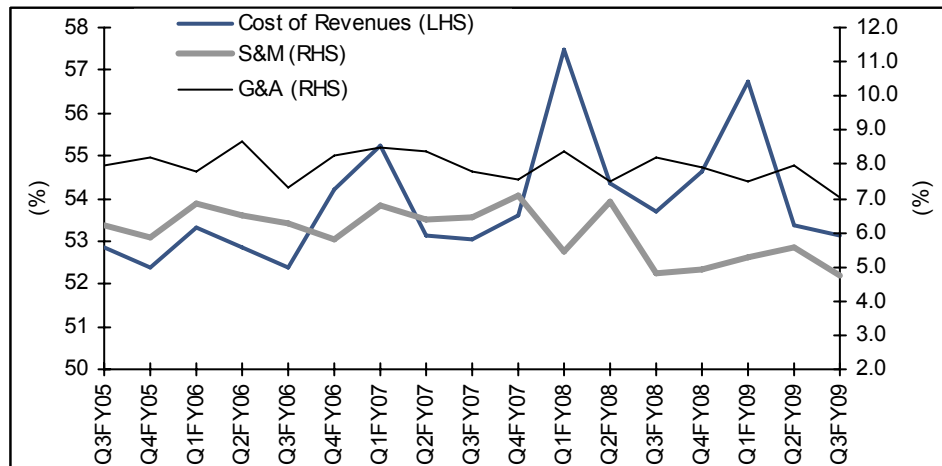
Reported onsite and offshore rates declined 5.7% and 4.4% respectively due to adverse cross-currency movements. However, dip in constant currency pricing was 1.8%



Source: Company data, I-Sec Research

Chart 4: Cost as a percentage of revenues

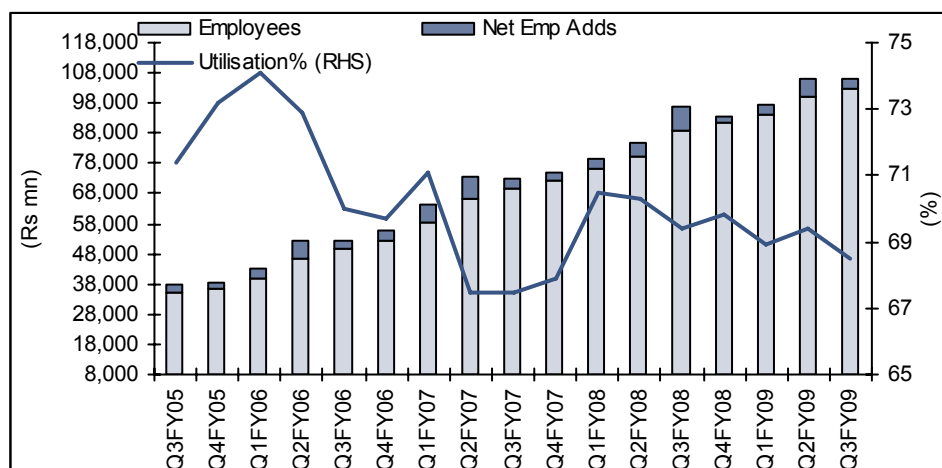
S&M and G&A expenses, as a percentage of revenues, declined 90bps each during the quarter. However, due to drop in utilisation & billing rate, the cost of revenues remained flat despite rupee depreciation



Source: Company data, I-Sec Research

Chart 5: Employee additions

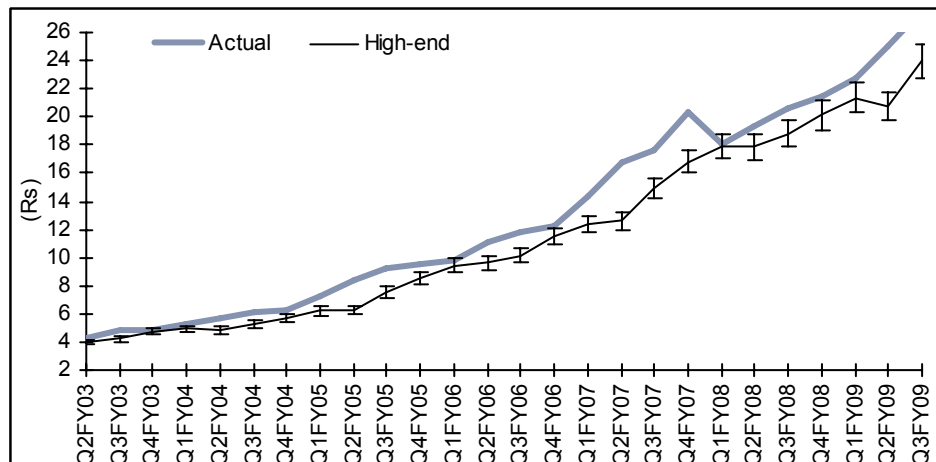
Employee adds during Q3FY09 – Net adds at 2,772 and gross at 5,997. Utilisation, including trainees, dipped 90bps to 68.5%. Infosys raised its FY09 guidance to 27,000 gross employee adds from 25,000 earlier on the back of higher BPO employee addition in March '09



Source: Company data, I-Sec Research

Chart 6: EPS guidance versus actual

Infosys' recurring EPS was at Rs27.3 versus Rs26.3 guided. Outperformance in EPS guidance was mainly due to rupee depreciation & savings from SG&A. FY09 EPS guidance, excluding tax reversals, raised to Rs101.30 (versus Rs100.51)



Source: Company data, I-Sec Research

Manufacturing declined 3.7% in constant currency terms, which is a concern. However, BFSI grew 4.1% QoQ (constant currency terms) in tough environment, which is impressive. Telecom (constant currency) declined 3.4%

Table 2: Reported QoQ revenue growth by verticals (US dollar)

Verticals	Q3FY08	Q4FY08	Q1FY09	Q2FY09	Q3FY09
Banking & FS	8.7	(4.0)	4.2	0.7	(1.2)
Insurance	0.6	0.9	(1.7)	6.8	7.5
BFSI	6.9	(3.1)	3.0	1.9	0.6
Manufacturing	11.4	18.2	13.5	15.0	(6.1)
Telecom	8.7	12.2	(11.4)	1.5	(15.4)
Retailing	1.8	4.4	3.8	4.4	0.3
Utilities	4.1	5.2	5.1	7.2	8.5
Transportation & Logistics	10.7	22.8	(13.3)	0.9	(7.9)
Others	68.0	(0.3)	6.8	38.5	(7.6)
Services	(17.3)	(3.5)	1.2	(2.4)	2.0

Source: Company data, I-Sec Research

Table 3: Client mining and growth (US dollar)

Client Concentration	Q4FY08	Q1FY09	Q2FY09	Q3FY09
Active Clients	538	567	586	583
Added during quarter	40	49	40	30
No of US\$ 1mn clients	310	325	325	323
No of US\$ 5mn clients	141	146	151	150
No of US\$ 10mn clients	89	91	94	102
No of US\$ 20mn clients	47	53	56	58
No of US\$ 30mn clients	32	33	34	37
No of US\$ 40mn clients	22	25	26	26
No of US\$ 50mn clients	18	18	20	20
No of US\$ 60mn clients	13	16	16	17
No of US\$ 70mn clients	12	12	12	13
No of US\$ 80mn clients	10	12	12	11
No of US\$ 90mn clients	6	8	8	7
No of US\$ 100mn clients	4	6	5	4
Clients accounting for >5% of revenue	1	1	1	1
% revenue growth top client (US\$)	14.1	(22.4)	1.3	(21.4)
% revenue growth top 2-5 clients (US\$)	1.8	3.8	(3.5)	(2.8)
% revenue growth top-5 clients (US \$)	7.2	(8.5)	(1.6)	(10.4)
% revenue growth top 6-10 clients (US\$)	(3.4)	3.2	(3.0)	1.4
% revenue growth top 10 clients (US\$)	3.6	(4.8)	(2.1)	(6.5)
% revenue growth non top 10 clients (US\$)	6.0	4.0	8.4	(2.6)
Repeat business (%)	95.0	99.6	99.8	97.1

Source: Company data, I-Sec Research

Revenues from the top client dipped a whopping 21.4% QoQ, affected by cross-currency impact and slowing demand. Growth was muted across all client buckets

Financial Summary (Consolidated Indian GAAP)

Table 4: Profit and Loss Statement

(Rs mn, year ending March 31)

	FY08	FY09E	FY10E	FY11E
Operating Revenues (Sales)	166,920	217,268	219,739	243,811
of which Exports	164,232	213,744	215,120	242,448
of which Domestic	2,688	3,523	4,618	1,363
Operating Expenses	114,226	145,305	151,577	170,716
EBITDA	52,694	71,963	68,162	73,095
% margins	31.6	33.1	31.0	30.0
Depreciation & Amortisation	5,980	7,311	8,516	9,597
Gross Interest	0	0	0	0
Other Income	7,040	3,709	11,557	15,298
Recurring PBT	53,754	68,361	71,204	78,796
Add: Extraordinary	906	1,090	0	0
Less: Taxes	8070	9968	11929	16132
- Current tax	10,060	11,621	13,600	16,547
- Deferred tax / MAT Credit	(1,990)	(1,653)	(1,671)	(416)
Net Income (Reported)	46,590	59,483	59,275	62,665
Recurring Net Income	45,684	58,393	59,275	62,665

Source: Company data, I-Sec Research

Table 5: Balance Sheet

(Rs mn, year ending March 31)

	FY08	FY09E	FY10E	FY11E
Assets				
Total Current Assets	130,180	171,936	217,070	285,256
of which cash and deposits with FI	82,350	106,846	162,760	211,515
Total Current Liabilities & Provisions	41,910	53,241	58,155	88,642
Net Current Assets	88,270	118,695	158,915	196,614
Investments	720	1,980	1,250	1,500
of which Other Marketable	720	1,980	1,250	1,500
Net Fixed Assets	34,530	42,219	43,704	49,107
Goodwill	6,890	7,020	7,020	7,020
Capital Work-in-Progress	13,240	10,000	10,000	10,000
Total Assets	136,760	172,894	213,869	257,221
of which cash and equivalents	83,070	108,826	164,010	213,015
Liabilities				
Borrowings	0	0	0	0
Deferred Tax Liability	(1,190)	(1,134)	(1,025)	(1,441)
Minority Interest	0	0	0	0
Equity Share Capital	2,860	2,865	2,870	2,871
Face Value per share (Rs)	5	5	5	5
Reserves & Surplus*	135,090	171,164	212,024	255,790
Net Worth	137,950	174,028	214,894	258,662
Total Liabilities	136,760	172,894	213,869	257,221

*excluding revaluation reserves

Source: Company data, I-Sec Research

Table 8: Quarterly trends

(Rs mn, year ending March 31)

	Mar-08	Jun-08	Sep-08	Dec-08
Net sales	45,420	48,540	54,180	57,860
% growth (YoY)	20.4	28.7	32.0	35.5
Recurring EBITDA	14,780	14,790	17,940	20,310
Margin (%)*	32.5	30.5	33.1	35.1
Other income	1,390	1,170	660	220
Extraordinary Inc / (Loss)	200	310	0	780
Recurring Net Income	12,290	12,710	14,320	15,630

Source: Company data, I-Sec Research

Table 6: Cash Flow Statement

(Rs mn, year ending March 31)

	FY08	FY09E	FY10E	FY11E
Operating Cash flow before W Cap changes	52,830	73,672	69,942	73,095
Working Capital Inflow / (Outflow)	(11,590)	(10,205)	3,453	(5,487)
Capex	(14,940)	(11,760)	(10,000)	(15,000)
Free Cash flow	26,300	51,707	63,395	52,608
Cash Flow from other Invest Act (Ex Capex)	3,740	2,449	12,287	15,048
Proceeds from Issue of Share Capital	580	565	662	166
Inc/(Dec) in Borrowings	0	0	0	0
Dividend paid	(8,350)	(29,135)	(20,430)	(19,067)
Others	0	(1,090)	0	0
Increase/(Decrease) in Cash	22,270	24,496	55,914	48,754

Source: Company data, I-Sec Research

Table 7: Key Ratios

(Year ending March 31)

	FY08	FY09E	FY10E	FY11E
Per Share Data (Rs)				
EPS(Basic Recurring - Wtd Avg)	79.9	102.0	103.4	109.1
Fully Diluted Recurring EPS	79.4	101.5	103.1	108.9
Recurring Cash EPS	90.0	114.9	118.4	125.1
Dividend per share (DPS)	33.3	32.5	28.4	28.4
Book Value per share (BV)	241.2	303.8	374.4	450.4
Growth Ratios (%)				
Operating Income (Sales)	20.1	30.2	1.1	11.0
EBITDA	20.0	36.6	(5.3)	7.2
Recurring Net Income	22.6	27.8	1.5	5.7
Diluted Recurring EPS	22.6	27.8	1.5	5.7
Diluted Recurring CEPS	22.1	27.8	3.3	5.8
Valuation Ratios (x)				
P/E	15.4	12.1	11.9	11.3
P/CEPS	13.7	10.7	10.4	9.8
P/BV	5.1	4.0	3.3	2.7
EV / EBITDA	12.0	8.4	8.1	6.9
EV / Sales	3.8	2.8	2.5	2.1
EV / FCF	24.1	11.7	8.7	9.6
Operating Ratio				
Software Development Expenses/Sales (%)	55.0	54.3	57.0	58.0
SG&A/Sales (%)	13.5	12.6	12.0	12.0
Other Income / PBT (%)	13.1	5.4	16.2	19.4
Effective Tax Rate (%)	15.0	14.6	16.8	20.5
NWC / Total Assets (%)	49.4	52.5	58.4	56.8
Fixed Asset Turnover (x) on average	5.3	5.7	5.1	5.3
Receivables (days) on average	63	62	64	63
Payables (days) on average	44	45	41	43
D/E Ratio (x)	0.0	0.0	0.0	0.0
Return/Profitability Ratio (%)				
Recurring Net Income Margins	27.4	26.9	27.0	25.7
RoIC (Based on Avg)	73.0	92.0	85.5	104.6
RoCE (Based on Avg)	36.8	37.7	30.7	26.6
RoNW (Based on Avg)	36.5	37.4	30.5	26.5
Dividend Payout Ratio	49.7	38.0	32.2	30.4
Dividend Yield	2.7	2.6	2.3	2.3
EBITDA Margins	31.6	33.1	31.0	30.0

Source: Company data, I-Sec Research

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