

Surging Ahead Profitably



Reassuring commentary on positive demand & pricing trend

The highlight of the Q4FY06 earnings call was the commentary by management on continued robust demand and incrementally positive pricing trend, in line with our recent ML CIO survey, and unlike what some of our peers feared. Notably, management showed confidence in the outlook by committing to the highest ever guidance, for FY07 revenue growth of 31% and EPS growth of 27%.

Wage-led margin concerns likely allayed

Management announced wage hikes that were in line with our expectation, of 14-15% offshore and 3% onsite, lower than hikes expected by some of our peers. Moreover, management expects to largely absorb the wage-hike by G&A cost economies and mix-related pricing improvement, which we believe is achievable.

Q4 margin decline higher than expected; Likely not secular

Infy's reported in-line Q4 revenue growth (g) of 3.6% qoq, but 2% lower than expected PAT g of 3.7%, led by higher than expected qoq EBIT margin decline of 312 bps, on Re/US\$ appreciation, higher depreciation, lower offshore and lower utilization.

Reiterate contrarian bullish stance on sector; Infy top pick

We reiterate our recent call making Infy our top pick (*Buy into results, dated Mar 31, 06*) based on a) Infy being likely one of the key beneficiaries of robust demand b) Its ability to contain wage pressure given salaries, particularly onsite, are at 10-20% higher than peers c) Superior ability to manage sector high EBIT margins not only because it runs a tight ship but also given its reluctance to take on "competitively priced large deals" d) A 7yr low relative valuation to market & fair absolute valuations of ~26x FY07EPE & a 2-yr PEG of <1.

Estimates (Mar)

(Rs)	2005A	2006A	2007E	2008E	2009
Net Income (Adjusted - mn)	18,465	24,600	32,408	41,029	---
EPS	68.24	89.29	117.00	147.85	---
EPS Change (YoY)	44.6%	30.9%	31.0%	26.4%	---
Dividend / Share	11.50	45.00	23.00	30.00	---
Free Cash Flow / Share	1.53	92.04	35.26	104.78	---
ADR EPS (US\$)	1.56	2.00	2.59	3.28	---
ADR Dividend / Share (US\$)	0.263	1.01	0.516	0.673	---

Valuation (Mar)

	2005A	2006A	2007E	2008E	2009
P/E	44.27x	33.83x	25.82x	20.43x	---
Dividend Yield	0.381%	1.49%	0.761%	0.993%	---
EV / EBITDA*	33.36x	25.20x	19.21x	14.86x	---
Free Cash Flow Yield*	0.050%	3.07%	1.18%	3.52%	---

* For full definitions of *iQmethod*SM measures, see page 16.

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Mitali Ghosh >> +91 22 5632 8661
Research Analyst
DSP Merrill Lynch (India)
mitali_b_ghosh@ml.com

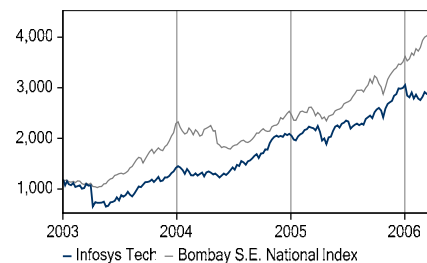
Ajay Mathrani, CFA >> +91 22 5632 8679
Research Analyst
DSP Merrill Lynch (India)
ajay_mathrani@ml.com

Prasad Deshmukh +91 22 5632 8678
Research Analyst
prasad_deshmukh@ml.com

See Team Page for Full List of Contributors

Stock Data

Price (Common / ADR)	Rs3,021 / US\$74.98
Price Objective	Rs3,700 / US\$95.00
Date Established	31-Mar-2006 / 31-Mar-2006
Investment Opinion	C-1-7 / C-1-7
Volatility Risk	HIGH / HIGH
52-Week Range	Rs1,876-Rs3,400
Market Value (mn)	US\$18,314
Shares Outstanding (mn)	273.7 / 273.7
Average Daily Volume	315,143
ML Symbol / Exchange	INFYF / BSE
ML Symbol / Exchange	INFY / NAS
Bloomberg / Reuters	INFO IN / INFY.BO
ROE (2007E)	39.4%
Net Dbt to Eqty (Mar-2006A)	-68.1%
Est. 5-Yr EPS / DPS Growth	25.0% / 25.0%
Free Float	72.0%



17 April 2006

iQprofileSM Infosys Technologies

Key Income Statement Data (Mar)

	2005A	2006A	2007E	2008E	2009
(Rs Millions)					
Sales	71,297	95,216	127,014	168,113	---
Gross Profit	33,650	44,562	58,056	75,410	---
Sell General & Admin Expense	(10,300)	(13,644)	(17,514)	(23,011)	---
Operating Profit	20,481	26,548	34,792	44,652	---
Net Interest & Other Income	1,239	1,396	2,339	3,155	---
Associates	---	---	---	---	---
Pretax Income	21,721	27,933	37,131	47,808	---
Tax (expense) / Benefit	(3,256)	(3,132)	(4,363)	(6,311)	---
Net Income (Adjusted)	18,465	24,600	32,408	41,029	---
Average Fully Diluted Shares Outstanding	271	276	277	278	---

Key Cash Flow Statement Data

Net Income (Reported)	18,465	24,600	32,408	41,029	---
Depreciation & Amortization	2,869	4,370	5,750	7,746	---
Change in Working Capital	(13,080)	7,275	(11,391)	(2,700)	---
Deferred Taxation Charge	---	---	---	---	---
Other Adjustments, Net	452	0	0	0	---
Cash Flow from Operations	8,706	36,245	26,767	46,075	---
Capital Expenditure	(8,292)	(10,888)	(17,000)	(17,000)	---
(Acquisition) / Disposal of Investments	(2,712)	625	(13,756)	(15,203)	---
Other Cash Inflow / (Outflow)	---	---	---	---	---
Cash Flow from Investing	(11,004)	(10,263)	(30,756)	(32,203)	---
Shares Issue / (Repurchase)	4,357	5,995	0	0	---
Cost of Dividends Paid	(3,520)	(14,120)	(7,161)	(9,340)	---
Cash Flow from Financing	839	(7,447)	(6,801)	(8,872)	---
Free Cash Flow	413	25,357	9,767	29,075	---
Net Debt	(29,981)	(47,890)	(50,856)	(71,059)	---
Change in Net Debt	1,460	(18,535)	10,790	(5,000)	---

Key Balance Sheet Data

Property, Plant & Equipment	15,742	22,260	33,511	42,764	---
Other Non-Current Assets	443	650	700	750	---
Trade Receivables	13,220	16,080	21,450	28,391	---
Cash & Equivalents	29,981	47,890	50,856	71,059	---
Other Current Assets	8,107	6,900	10,161	13,449	---
Total Assets	67,513	93,800	116,698	156,434	---
Long-Term Debt	0	0	0	0	---
Other Non-Current Liabilities	---	---	---	---	---
Short-Term Debt	---	---	---	---	---
Other Current Liabilities	6,560	9,340	11,431	15,130	---
Total Liabilities	14,325	23,460	20,750	28,329	---
Total Equity	53,187	70,340	95,948	128,105	---
Total Equity & Liabilities	67,512	93,800	116,698	156,434	---

iQmethodSM - Bus Performance*

Return On Capital Employed	41.7%	40.1%	38.8%	36.6%	---
Return On Equity	43.6%	40.4%	39.4%	37.0%	---
Operating Margin	28.7%	27.9%	27.4%	26.6%	---
EBITDA Margin	32.8%	32.5%	31.9%	31.2%	---

iQmethodSM - Quality of Earnings*

Cash Realization Ratio	0.5x	1.5x	0.8x	1.1x	---
Asset Replacement Ratio	2.9x	2.5x	3.0x	2.2x	---
Tax Rate (Reported)	15.0%	11.2%	11.8%	13.2%	---
Net Debt-to-Equity Ratio	-56.4%	-68.1%	-53.0%	-55.5%	---
Interest Cover	---	---	---	---	---

Key Metrics

* For full definitions of iQmethodSM measures, see page 16.

Company Description

Set up in 1981, Infosys is India's 2nd largest IT Services exporter with FY06 revenues of US\$2.15bn & 52715 employees. It is known for mgmt depth and corporate governance. It has a premium brand, well-diversified revenues (IT consulting to BPO, with bulk of revenues from software application dev & maintenance), industry-high revenue growth rates and margins. Key markets are North America & Europe.

Stock Data

Shares / ADR	1.00
Price to Book Value	8.7x
Market Cap (USD)	18314

Infosys Q4FY06 Result Highlights

Reassuring commentary on robust demand environment

Management reinforces our view that the demand and pricing outlook for offshore vendors is incrementally positive.

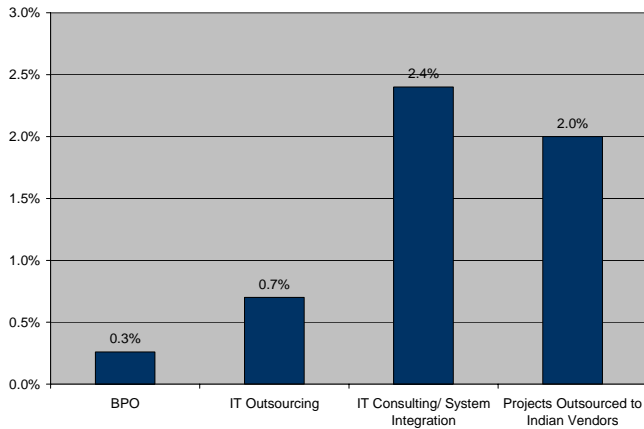
The highlight of the Q4FY06 earnings call was the commentary by management on continued robust demand and an incrementally positive pricing trend.

Our ML CIO User Survey last week also showed positive pricing trends for Indian vendors

Our March quarter ML US CIO survey (*1QCY06 CIO User Survey: Stable Outlook For '06 published last week on April 11, 2006*), published last week indicated incrementally positive pricing and demand trends for IT Consulting and offshore.

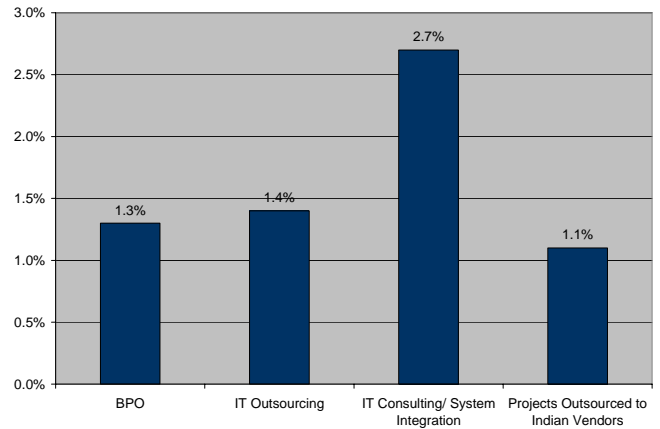
CIO respondents indicated pricing trends ticking up to 2% yoy increase for projects outsourced to Indian vendors, a significant increase from +1.1% last quarter. Pricing for consulting overall was also indicated as moving up from 2% in the Dec quarter survey to 2.4% this quarter.

Chart 1: What is current IT Services Project Pricing growth vs a year ago?



Source: ML CIO Survey March 06

Chart 2: What will be your budget growth in '06 by IT Services category?



Source: ML CIO Survey March 06

Management backs bullish commentary by committing to a robust guidance, ahead of the conservative guidance being expected by the street

Management backs up its comment on a robust outlook and committed to the highest growth guidance ever, ahead of market's expectations of a traditionally conservative guidance.

Notably, the management backed its bullish commentary on outlook by committing to a strong revenue growth guidance of 28 to 30% (US\$ terms). In Rupee terms, the guidance translates to a FY07 revenue growth of 29 to 31% and an EPS growth of 26 to 28%, smartly beating conservative EPS guidance expectations of 20-23% and is the highest growth guidance given.

The revenue **guidance for Q1** revenue is encouraging at 7% qoq while the 2% qoq EPSg is expected given the impact of wage hikes this quarter, which could knock off 100-150bps margins, to be offset partly by normalization in depreciation charge.

Management's robust guidance also likely stems from the fact that its **top 10 clients seem to show better growth prospects** as compared to the flat to declining scenario expected in 3 to 4 large clients at the same time last year. This quarter top 5 client revenues grew 10% qoq. In Q1FY06 revenues declined by 6% qoq.

Table 1: Infosys Guidance over years

Guidance at the beginning of the year	FY02	FY03	FY04	FY05	FY06	FY07
Revenue Growth	27.6%-30.6%	18.5%-21.8%	23.8%-26%	23.5%-24.5%	24.7%-26.6%	28.7%-30.7%
EPS Growth	24.1%-27.3%	15.5%-18.7%	12%-13.4%	20%	23%-24.9%	26.4%-28.4%
Actual						
Revenue Growth	37.0%	39.8%	33.3%	46.9%	33.5%	33.4% (MLE)
EPS Growth	28.0%	18.1%	30.0%	46.8%	30.9%	31.0% (MLE)

Source: Company

Table 2: Infosys Guidance for the next year

	Q4FY06	Q1FY07 Guidance	QoQ	FY06	FY07 Guidance	YoY growth	Implied Q2-Q4 Growth
Revenue Rs m	26,240	28,045	6.9%	95,210	123,500	29.7%	6.4%
EPS	24.5	25.0	2.1%	90.06	114.73	27.4%	9.3%

Source: Company

Wage hikes, in line with our expectation, lower than that being feared by some of our peers.

Wage-led margin concerns likely allayed Wage hike in-line with ML expectation

Management announced wage hikes in line with our expectation, of 14-15% (vs 13 to 15% last year) offshore and 3% onsite (similar hike last year), lower than hikes being expected by some of our peers, at upwards of 15% offshore and 5% onsite.

While employee supply and scalability continues to be one of the biggest challenges being faced by offshore vendors, we believe the wage hike fears are exaggerated, particularly for the top 3 vendors. Wage pressures are more pronounced for some of the smaller but quality broad-based IT services vendors, like Patni Computers (see our report dated Mar 23, 2006, *Patni Computer Services: Attrition pressures loom*).

Management expects to largely maintain margins. We believe it does have levers and have factored in a decline of 60bps in our FY07 estimates.

Levers to offset wage hike impact on margins

Management expects to largely maintain margins. We have factored in 60bps decline in FY07 margins, which we believe is achievable, given the following.

#1. Employee pyramid effect

While the salary hike discussed above, applies to the existing staff, the addition of the engineers from campus (at least about 70% of the targeted intake of 25,000 gross additions in FY07) would likely help to dilute the impact of the wage hike.

#2. Likely scale economies in General and Administration costs

We believe Infosys could squeeze out at least 50 bps margin from its G&A costs, as it ramps up revenues.

#3. Mix-related pricing improvement

In our view, Infosys should also show some improvement in pricing based on a) ramp-up in higher margin services like testing, package implementation and consulting led development services and b) ramp-up in the proportion of business from clients acquired at higher prices in the last 4-6 quarters

#4. 'Growing large clients' as opposed to 'winning large deals which could be competitively priced'

Given the robust demand environment, management stressed its strategy of preferring to sign on customers, who may start small but can grow to a potentially large size, offering higher profitability, as compared to customers who offer large multi-year committed revenue at competitive prices.

#5. Likely reduction in losses from Infosys Consulting and Infosys China

Finally, we believe that the losses from Infosys Consulting and Infosys China should reduce over the course of FY07, with Infosys Consulting likely breaking even by the last quarter of FY07.

Table 3: FY06 - Infosys Subsidiaries Still In Investment Phase

	Rs m
Infosys Consolidated	
Revenue	95,216.0
PAT	24,599.5
Net Margin	25.8%
Infosys Subsidiaries	
Revenues	8,680.0
% of consolidated revenues	9.1%
Profit/(Loss)	580.4
Net Margin	6.7%
Progeon	
Revenue	3,780.0
% of Infy cons	14.9%
PAT	926.1
Infosys Consulting	
Revenue	1,430.0
% of Infy cons	5.6%
PAT	- 364.0
Infosys Australia	
Revenue	3,210.0
% of Infy cons	12.7%
PAT	184.2
Infosys China	
Revenue	260.0
% of Infy cons	1.0%
PAT	-165.9

Source: Company, ML Research

Q4FY06 results: Margin decline disappoints

Q4 EBIT margins below expectation but we do not see this as a secular trend.

Revenue weak, but in line

Table 4: Q4FY06 Guidance vs Actual

4QFY06	Guided	Actual
Revenue (Rs mn)	25945	26240
qoq	2%	4%
EPS (Rs.)	24.5	24.45
qoq	3%	3%

Source: Company

Infy's Q4 revenue g of 3.6% was in line with MLe and guidance. Revenue grew by 2% more than the US\$ revenue growth guidance of 4% qoq, but higher than expected Rupee appreciation knocked off about 2.5% growth in revenues, in Rupee terms. Europe, Package Implementation and Application Maintenance grew ahead of company average. The muted revenue growth this quarter reflects some amount of sluggishness in spend till New Year IT budgets kick in, but more importantly, we believe Infy's shortage of people in the Dec quarter, impacted project starts in that quarter, and revenue flow for the Mar quarter.

Table 5: Q4 and FY06 Results Snapshot (Indian GAAP Consolidated)

Year to 31 March, Rs m	Q4FY06	Q3FY06	QoQ	Q4FY05	YoY	MLe	Var%	FY 06	FY05	YoY
Operating revenues	26,240	25,320	3.6%	19,870	32.1%	26,450	-0.8%	95,210	71,300	33.5%
Software development expenses	14,220	13,270	7.2%	10,410	36.6%	13,952	1.9%	50,660	37,650	34.6%
Gross Profit	12,020	12,050	-0.2%	9,460	27.1%	12,497	-3.8%	44,550	33,650	32.4%
S&M	1,520	1,580	-3.8%	1,170	29.9%	1,719	-11.6%	6,000	4,610	30.2%
<i>As a % to sales</i>	<i>5.8%</i>	<i>6.2%</i>		<i>5.9%</i>		<i>6.5%</i>		<i>6.3%</i>	<i>6.5%</i>	
G&A	2,170	1,860	16.7%	1,630	33.1%	1,931	12.4%	7,640	5,690	34.3%
<i>As a % to sales</i>	<i>8.3%</i>	<i>7.3%</i>		<i>8.2%</i>		<i>7.3%</i>		<i>8.0%</i>	<i>8.0%</i>	
Total Expenses	17,910	16,710	7.2%	13,210	35.6%	17,603	1.7%	64,300	47,950	34.1%
EBITDA	8,330	8,610	-3.3%	6,660	25.1%	8,847	-5.8%	30,910	23,350	32.4%
Depreciation	1,440	1,170	23.1%	1,000	44.0%	1,179	22.1%	4,370	2,870	52.3%
EBIT	6,890	7,440	-7.4%	5,660	21.7%	7,668	-10.1%	26,530	20,480	29.5%
Other income	720	-50	NM	320	125.0%	361	99.4%	1,390	1,240	12.1%
Provision for Investment	0	0		0		0		10	0	
PBT	7,610	7,390	3.0%	5,980	27.3%	8,029	-5.2%	27,920	21,720	28.5%
Tax	810	830	-2.4%	850	-4.7%	1,068	-24.1%	3,130	3,260	-4.0%
PAT before minority interest	6,800	6,560	3.7%	5,130	32.6%	6,961	-2.3%	24,790	18,460	34.3%
Income from Sale of investment in Yantra				450					450	
Minority interest	70	70		0		74	-5.8%	210	0	
PAT after minority interest	6,730	6,490	3.7%	5,580	20.6%	6,887	-2.3%	24,580	18,910	30.0%
Recurring PAT	6,730	6490	3.7%	5580	20.6%	6887	-2.3%	24580	18910	30.0%
Margins			bps		bps		bps			bps
Gross Profit Margin %	45.8%	47.6%	-178	47.6%	-180	47.2%	-144	46.8%	47.2%	-40
EBITDA (%)	31.7%	34.0%	-226	33.5%	-177	33.4%	-170	32.5%	32.7%	-28
EBIT %	26.3%	29.4%	-313	28.5%	-223	29.0%	-273	27.9%	28.7%	-86
NPM (%)	25.6%	25.6%	2	28.1%	-243	26.0%	-39	25.8%	26.5%	-71
EPS (Rs)	24.5	23.9	2.3%	19.0	28.8%	25.1	-2.5%	90.1	68.8	30.9%
Tax rate(%)	10.6%	11.2%	-59	14.2%	-17.3	13.3%	-266	11.2%	15.0%	
Results Snapshot Rs. Mn	Q4FY06	Q3FY06	QoQ	Q4FY05	YoY	MLe	Var%	FY 06	FY05	QoQ
Revenue	26,240.0	25,320.0	3.6%	19,870.0	32.1%	26,449.6	-0.8%	95,210.0	71,300.0	33.5%
EBITDA	8,330.0	8,610.0	-3.3%	6,660.0	25.1%	8,847.1	-5.8%	30,910.0	23,350.0	32.4%
EBIT	6,890.0	7,440.0	-7.4%	5,660.0	21.7%	7,667.8	-10.1%	26,530.0	20,480.0	29.5%
Recurring PAT	6,730.0	6,490.0	3.7%	5,580.0	20.6%	6,886.8	-2.3%	24,580.0	18,910.0	30.0%
Gross Margin	45.8%	47.6%	-178bps	47.6%	-180bps	47.2%	-144bps	46.8%	47.2%	-40bps
EBITDA Margin	31.7%	34.0%	-226	33.5%	-177	33.4%	-170	32.5%	32.7%	-28
EBIT Margin	26.3%	29.4%	-313	28.5%	-223	29.0%	-273	27.9%	28.7%	-86
Net Margin	25.6%	25.6%	2	28.1%	-243	26.0%	-39	25.8%	26.5%	-71

Source: Company, ML Research

Table 6: Q4FY06 Revenue Breakdown by Geography

	% of revenue	QoQ	YoY
North America	65.0%	4%	34%
Europe	25.5%	6%	45%
India	1.8%	33%	19%
Rest of the World	7.7%	-8%	-6%

Source: Company, ML Research

Table 7: Q4FY06 Revenue Breakdown by Service Line

	% of revenue	QoQ	YoY
Development	20.1%	-1%	28%
Maintenance	30.8%	8%	32%
Re-engineering	4.3%	-11%	-13%
Package Implementation	17.1%	9%	48%
Consulting	3.2%	7%	3%
Testing	5.6%	6%	21%
Engineering Services	1.9%	4%	39%
Business Process Mgmt. Services	4.0%	4%	65%
Other Services	9.8%	4%	62%
Products	3.2%	-13%	24%

Source: Company, ML Research

Table 8: Q4FY06 Revenue Breakdown by Vertical

	% of revenue	QoQ	YoY
Insurance, Finance and banking	36.0%	4%	41%
Manufacturing	14.5%	7%	37%
Telecom	16.3%	7%	11%
Retailing	10.2%	3%	48%
Utilities	5.3%	4%	119%
Transportation and Logistics	3.6%	-17%	-41%
Others	14.1%	4%	50%

Source: Company, ML Research

EBIT margin decline, but likely not secular

PAT g of 3.7% was in line with guidance, helped by higher other income (year-end income in some treasury investments and lower forex loss) and lower tax (likely due to lower profitability in some onsite locations and higher tax-free dividend income). However, PAT was 2% lower than MLe, led by a higher than expected qoq EBIT margin decline of 312 bps.

While pricing moved up by 0.7% on a blended basis, EBIT margin decline was led by a 130bps impact of Rupee appreciation of 2.5%, a 90bps seasonally higher depreciation, slightly lower proportion of offshore revenues and ~70bps hit due to a 1% drop in utilization and increased hiring, as the company consciously create slack in the system. G&A costs also moved up faster than revenue growth mainly due to year-end variable compensation pay-outs.

While Q4 margin decline was higher than expected, we believe it does not suggest a secular trend given a) depreciation is a Q4 factor – companies typically write off small items of capital expenditure costing <Rs5,000 in the last quarter of the fiscal b) the company has lowered its utilization (excluding trainees) to 77%, largely achieving its target of building a larger bench, to provide slack for growth.

Forecasts maintained, at 33% rev g and 29% EPS g over FY06-08.

Forecasts Maintained

We have tweaked our numbers for FY07 and FY08 by less than 1%, to factor in the Q4 numbers. We forecast next 2-year revenue growth of 33%, EBIT margin decline of 130bps over 2 years and EPS g of 29%.

The company ended FY06 with cash and equivalents of over US\$1bn, a healthy 62 days debtor outstanding and RoE of 40%.

Reiterate contrarian bullish stance on sector; Infy top pick

We believe the Infosys management commentary and guidance will be likely significant in reassuring investors of the continued growth prospects and incrementally positive demand environment for Indian IT companies.

It strengthens our bullish stance on IT stocks, where we recently raised our rating on Infosys ADR to Buy and made Infosys local and ADR our top pick (*Buy into results dated Mar 31, 2006*).

Why Infosys is our top pick

Likely one of the key beneficiaries of robust demand

Infy will likely be a key beneficiary given its strong brand and ability to mine clients based on expanded services and client management skills. This is reflected in its track-record of superior growth and margins.

Likely one of the key beneficiaries of robust demand

Table 9: Superior Client Mining

\$10m/p.a. Revenue Clients	1Q05	2Q05	3Q05	4Q05	1Q06	2Q06	3Q06	4Q06
Infosys	27	31	37	42	43	48	51	54
Wipro	31	36	37	44	45	53	52	na
Satyam Computers	16	16	19	21	21	22	25	na
TCS	31	34	37	42	45	50	53	na

Source: Companies

Table 10: Comparison of Revenue Growth and EBIT Margins

Revenue Growth	FY02	FY03	FY04	FY05	FY06E
Infosys	37.0%	39.8%	33.3%	46.9%	33.5%
TCS	na	na	29.1%	36.6%	27.6%
Wipro Global IT	29.5%	33.1%	42.9%	39.4%	32.1%
Satyam	42.0%	17.0%	15.2%	37.5%	36.8%
EBIT Margin	FY02	FY03	FY04	FY05	FY06E
Infosys	33.7%	29.7%	28.0%	28.7%	27.9%
TCS	na	na	25.4%	26.6%	27.0%
Wipro Global IT	34.3%	27.7%	21.9%	26.4%	24.4%
Satyam	26.8%	24.4%	22.0%	21.4%	21.4%

Note: TCS numbers for FY02 and FY03 are for TCS Division and not TCS Ltd. and are hence not comparable. Satyam FY02 and FY03 unconsolidated numbers.

Source: Companies

Superior ability to maintain margins at sector high levels.

Infy prefers “large customers” to “large deals”, if the large deal is competitively priced.

7yr low relative valuation to market and fair absolute valuations.

Ability to manage margins

We believe Infosys is better poised than peers to contain wage pressure given their salaries, particularly onsite, are 10-20% higher than peers.

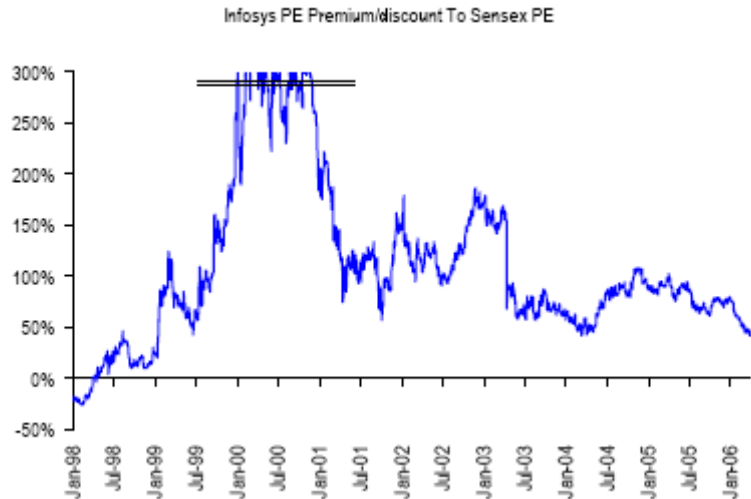
Moreover as in table 10 they have shown superior ability to manage EBIT margins which are at sector high levels of ~28%, not only because it runs a tight ship but also given its keen focus on pricing and margins.

In the earnings call, management stressed its strategy of preferring to sign on customers, who may start small but can grow to a potentially large size, offering higher profitability, as compared to customers who offer large multi-year committed revenue at competitive prices.

7yr low relative valuation to market, Fair absolute valuations

Relative to market it is trading at a 7yr low, as shown below. In fact, given concerns on earnings outlook, the stock has been a significant underperformer, where the guidance concerns seem to have been overdone.

Chart 3: Infosys PE premium to Sensex



Source: Bloomberg, ML Research

Our target price is at 25x FY08E, which we believe is reasonable given the current FY07E PE of 26x, marginally ahead of its 2-yr levels of ~24x and in line with historic levels of 2-yr PEG of less than 1.

Investor friendly actions on Silver Jubilee year

Infosys has completed 25 years and to commemorate this special occasion the company declared a 1: 1 bonus share issue and a special dividend of Rs30/share. Added on to the Rs15/share regular dividend for the year, the company paid out 50% this year.

Key risks include scalability, growing competition from global vendors, exchange rate volatility and risk of the US economy slowing down.

Key Risks

Scalability

Scalability continues to be one of the biggest challenges being faced by offshore vendors. For instance the top 3 vendors alone are likely to have hired ~50,000 people in FY06. While the people availability is not yet an issue, the challenge lies in recruiting, training and maintaining corporate culture, delivery quality etc. across the organization.

We believe Infosys is one of the most process driven organizations among peers. It also has among the largest training facilities with a capacity of 4,500 people at the training institute in Mysore at any 1 point in time. Hence annually it can train over 17,000 people (Training program for engineering graduates recruited from campus is a little over 3 months). Further, it is in the process of adding a capacity of another 9,000, which should be in place by the end of FY07.

Global vendor concerns

As highlighted in our note (*Meeting With Accenture, dated Mar 01, 2006*) global vendor competition is steadily ramping up and the global vendors seem to be systematically addressing the 3 key issues 1) Likely internal resistance to change in business model 2) Managing HR cost effectively and 3) Managing profitability by offsetting the deflationary impact of an offshore revenue shift by leveraging offshore to increase volumes ("extend and defend") and lower overhead costs. Our recent ML US CIO user survey also shows that competition from global vendors is becoming more aggressive. The proportion preferring to offshore to the multi-national vendors (as opposed to a pure play Indian vendor) rose to 37% up from 34% in the Dec quarter survey. However, it is key to watch execution over 1-2 years.

Exchange rate

While the management has factored in Rs44.48/US\$ for their guidance, if the Rupee strengthens, it could impact earnings. Every 1% appreciation in the Rupee impacts EBITDA margins by 40-50bps.

US economy slowdown

Given that the US accounts for 65% of revenues, any slowdown in the US economy could result in a 2-3 quarter period of slowdown in volumes and pricing, as customers adjust to the slower environment, and possibly re-prioritize IT projects.

17 April 2006

Table 11: Summary Valuation Table

	Infosys	TCS	Wipro	Satyam	Patni	HCL Tech	Infy ADR	Wipro ADR	Saty ADR	Patni ADR
ML Ticker	INFYF	TACSF	WIPRF	SAYPF	PATIF	HCLTF	INFY	WIT	SAY	PTI
ML Rating	C-1-7	C-1-7	C-2-7	C-1-7	C-2-7	C-2-7	C-1-7	C-2-7	C-1-7	C-2-7
Currency	Rs	Rs	Rs	Rs	Rs	Rs	USD	USD	USD	USD
Current price	3021	1797	515	772	428	586	75	14	37	20
Target Price Rs	3,700	2,265		1,000			95		51	
Sales Growth FY05/CY04	46.9%	36.6%	39.9%	37.5%	24.5%	27.2%	53.1%	45.7%	43.3%	29.7%
Sales growth FY06/CY05	33.5%	27.6%	29.7%	36.8%	36.1%	28.0%	32.6%	28.8%	35.8%	35.1%
Sales Growth FY07/CY06	33.4%	40.9%	29.7%	31.2%	24.9%	26.0%	34.3%	30.5%	32.0%	25.7%
Sales Growth FY08/CY07	32.4%	30.8%	27.2%	32.6%	24.9%	24.9%	32.4%	27.2%	32.6%	24.9%
EBITDA % (FY05/CY04)	32.8%	28.3%	25.1%	24.7%	22.1%	22.9%	32.8%	25.1%	24.7%	22.1%
EBITDA % (FY06/CY05)	32.5%	29.0%	24.1%	24.3%	19.0%	22.4%	32.5%	24.1%	24.3%	19.0%
EBITDA % (FY07/CY06)	31.9%	27.2%	24.6%	23.9%	19.2%	22.2%	31.9%	24.6%	23.9%	19.2%
EBITDA % (FY08/CY07)	31.2%	27.2%	24.5%	23.3%	20.4%	21.9%	31.5%	24.8%	23.5%	20.6%
EBIT % FY05/CY04	28.7%	26.6%	22.1%	21.4%	18.6%	18.3%	28.7%	22.1%	21.4%	18.6%
EBIT % FY06/CY05	27.9%	27.0%	21.2%	21.4%	15.6%	17.7%	27.9%	21.2%	21.4%	15.6%
EBIT % FY07/CY06	27.4%	25.3%	21.8%	21.0%	14.8%	17.3%	27.4%	21.8%	21.0%	14.8%
EBIT % FY08/CY07	26.6%	25.1%	21.6%	20.2%	15.7%	17.0%	26.6%	21.6%	20.2%	15.7%
ROE % (FY05/CY04)	43.6%	93.0%	36.0%	23.9%	24.4%	17.9%	43.6%	36.0%	23.9%	24.4%
ROE % (FY06/CY05)	40.4%	67.4%	33.6%	25.7%	16.1%	20.3%	40.4%	33.6%	25.7%	16.1%
ROE % (FY07/CY06)	39.4%	53.9%	33.9%	25.5%	16.3%	22.8%	39.4%	33.9%	25.5%	16.3%
ROE % (FY08/CY07)	37.0%	46.9%	32.4%	25.9%	17.5%	24.8%	37.0%	32.4%	25.9%	17.5%
ROCE % (FY05/CY04)	50.2%	102.6%	41.1%	28.1%	22.9%	16.8%	50.2%	41.1%	28.1%	22.9%
ROCE % (FY06/CY05)	45.2%	76.7%	38.2%	29.7%	15.5%	19.4%	45.2%	38.2%	29.7%	15.5%
ROCE % (FY07/CY06)	44.7%	63.1%	39.5%	29.6%	15.0%	21.8%	44.7%	39.5%	29.6%	15.0%
ROCE % (FY08/CY07)	42.7%	56.0%	38.5%	30.5%	17.0%	23.7%	42.7%	38.5%	30.5%	17.0%
EPS Rs FY05/CY04	68.2	47.1	11.6	22.3	19.6	18.8	1.6	0.3	1.0	0.9
EPS Rs FY06E/CY05	89.3	57.3	14.3	30.3	19.5	24.7	2.0	0.3	1.4	0.9
EPS Rs FY07E/CY06E	117.0	75.3	18.8	38.3	24.6	30.0	2.7	0.4	1.8	1.1
EPS Rs FY08E/CY07E	147.8	96.4	23.3	47.9	31.3	36.1	3.4	0.5	2.2	1.4
EPS gr % FY05/CY04	45.7%	33.1%	56.6%	36.8%	7.6%	9.1%	51.9%	63.2%	42.6%	12.2%
EPS gr % FY06E/CY05	30.9%	21.6%	23.9%	36.1%	-0.2%	31.2%	30.0%	23.0%	35.1%	-0.9%
EPS gr % FY07E/CY06	31.0%	31.4%	31.0%	26.1%	25.9%	21.6%	31.9%	31.9%	27.0%	26.7%
EPS gr % FY08E/CY07	26.4%	28.1%	23.8%	25.1%	27.4%	20.1%	27.7%	25.1%	26.4%	28.7%
EPS gr % FY08-06 2 yr	29%	29.8%	27.4%	25.6%	26.6%	20.9%	30%	28%	27%	28%
5yr EPS g (FY05-10)	25.0%	24.0%	22.0%	23.0%	20.0%	20.0%	25.0%	22.0%	23.0%	20.0%
PE (FY06e/CY05 EPS)(x)	33.8	31.4	35.9	25.5	21.9	23.7	37.1	43.3	27.0	22.1
PE (FY07e/CY06e EPS)(x)	25.8	23.9	27.4	20.2	17.4	19.5	28.1	32.8	21.3	17.4
PE (FY08e/CY07e EPS)(x)	20.4	18.6	22.1	16.1	13.7	16.2	22.0	26.3	16.8	13.6
PEG (x) FY07E PE to FY06-08 EPS g	0.90	0.80	1.00	0.79	0.65	0.93	0.95	1.16	0.80	0.63
PEG (x) FY07E PE to 5-yr EPS g	1.03	0.99	1.25	0.88	0.87	0.98	1.13	1.49	0.93	0.87
EV/EBITDA (FY06) x	25.4	23.4	27.2	18.6	12.2	17.9	28.0	33.0	19.9	12.3
EV/EBITDA (FY07)x	19.3	17.5	20.2	14.1	10.0	14.4	21.1	24.4	15.0	10.0
EV/EBITDA (FY08)x	14.5	13.1	15.5	10.5	7.6	11.7	15.8	18.6	11.1	7.5
P/ BV (FY06) (x)	11.9	17.2	10.7	6.1	5.4	4.7	13.1	12.9	6.1	5.4
P/BV (FY07) (x)	8.8	10.3	8.2	4.9	4.8	4.2	9.6	9.8	4.9	4.8
P/BV (FY08) (x)	6.6	7.6	6.4	4.0	4.0	3.8	7.1	7.5	4.0	4.0

Note: Mar year end FY03 i.e. fiscal year ending Mar 06, has been compared with fiscal year ending Dec 05 and Jun 06: Source: Companies, ML Estimates

Financials

Table 12: Profit and Loss Statement

Year to 31 March, <i>Rs million</i>	2004	2005	2006	2007E	2008E
Operating revenues	48,530	71,297	95,216	127,014	168,113
Software development expenses	25,387	37,647	50,654	68,958	92,704
Gross Profit	23,143	33,650	44,562	58,056	75,410
Total Expenditure	32,588	47,947	64,298	86,472	115,715
EBITDA	15,942	23,350	30,918	40,541	52,399
Other income	1,234	1,239	1,396	2,339	3,154
Provision for investments	0	(1)	11	0	0
Income after other income and provisions	17,176	24,590	32,303	42,880	55,553
Interest	0	0	0	0	0
Depreciation	2,367	2,869	4,370	5,750	7,746
PBT	14,809	21,721	27,933	37,131	47,807
Tax	2,275	3,256	3,132	4,363	6,310
Recurring PAT	12,534	18,465	24,600	32,408	41,028
Extraordinary income	0	452	0	0	0
Reported PAT	12,534	18,917	24,600	32,408	41,028

Source: Company, ML Estimates

Table 13: Balance Sheet

Fiscal year end Mar 31, <i>Rs million</i>	2004	2005	2006	2007E	2008E
Liabilities					
Share capital	333	1353	1380	1380	1380
Reserves	32163	50898	68280	93527	125216
<i>Shareholders funds</i>	<i>32496</i>	<i>52251</i>	<i>69660</i>	<i>94907</i>	<i>126596</i>
Preference shares issued by subsidiary	936	935	0	0	0
Total	33432	53187	70340	95947	128104
Assets					
Gross block	16337	22873	29830	46830	63830
Less: Depreciation	8098	10308	13280	19030	26776
Net block	8238	12565	16550	27801	37054
Add : Capital work in process	2081	3177	5710	5710	5710
Investments	9455	12107	7550	25423	33643
Deferred Tax Assets	400	443	650	700	750
Debtors	6515	13220	16080	21450	28391
Cash	17215	15756	34290	23500	28500
Loan & Advances	7211	10244	12970	12115	22386
Less: Current Liabilities	5817	6560	9340	11431	15130
Less: Provisions	11864	7765	14120	9301	13181
Net Current Assets	13259	24895	39880	36314	50947
Miscellaneous	0	0	0	0	0
Total assets and liabilities	33432	53187	70340	95947	128104

Source: Company, ML Estimates

Table 14: Cash Flow

	FY04	FY05	FY06	FY07E	FY08E
Cash Flow from Operating Activities					
Profit before tax post minority and extraordinary	14809	22173	27732	36771	47340
Depreciation and amortization	2367	2869	4370	5750	7746
Change in current assets and liabilities					
Sundry Debtors and Deferred tax assets	(1359)	(6749)	(3067)	(5420)	(6991)
Loans and Advances (Excluding Treasury Investments)	625	(2975)	1207	(3261)	(3288)
Current liabilities and provisions	10603	(3356)	9135	(2710)	7579
Income taxes paid during the years	(2275)	(3256)	(3132)	(4363)	(6311)
Net cash generated by operating activities	24770	8706	36245	26767	46075
Cash Flows from Investing Activities					
Purchase of fixed assets and change in capital work in progress	(4907)	(8292)	(10888)	(17000)	(17000)
Investments in trade securities	190	0	0	0	0
Change in treasury investments	(8135)	(2712)	625	(13756)	(15203)
Net Cash used in investing activities	(12852)	(11004)	(10263)	(30756)	(32203)
Free Cash Flow From Operating Activities	19863	413	25357	9767	29075
Cash Flows from Financing Activities					
Share Capital issue	1563	4357	5995	0	(0)
Increase/ decrease in Minority Interest	0	1	679	360	468
Dividend paid	(8625)	(3098)	(12380)	(6348)	(8280)
Dividend tax	(1105)	(422)	(1740)	(813)	(1060)
Net Cash used in financing activities	(8167)	839	(7447)	(6801)	(8872)
Net (decrease)/ increase in cash	3751	(1460)	18535	(10790)	5000
Cash in the beginning of the year	13465	17216	15756	34291	23501
Cash at the end of the year	17216	15756	34291	23501	28501
Treasury Investments	11513	14225	13600	27356	42559
Cash and Cash Equivalents at the end of the period	28729	29981	47890	50856	71059

Source: Company, ML Estimates

Table 15: Key Ratios

	2004	2005	2006	2007E	2008E
Gross Margin	47.7%	47.2%	46.8%	45.7%	44.9%
EBITDA Margin	32.9%	32.8%	32.5%	31.9%	31.2%
Net margin	25.8%	25.9%	25.8%	25.5%	24.4%
EPS (Rs)	47.2	68.20	89.29	117.0	147.9
CEPS (Rs)	56.1	78.8	105.2	137.8	175.8
DPS (Rs) *	32.5	11.5	45.0	23.0	30.0
Pay out ratio (%) ex					
Special Dividend	15.65	16.78	16.71	19.59	20.18
ADR EPS	1.03	1.52	2.02	2.68	3.43
CEPS/ADR	1.22	1.76	2.38	3.16	4.08
Dividend/ADR	0.16	0.26	1.02	0.53	0.70
Book-value (Rs)	122	193	253	343	456
RONW (%)	41.0	43.6	40.4	39.4	37.0

Source: Company, ML Estimates; Note*: FY04 and FY06 DPS include 1-time special dividend of Rs25 and Rs30 respectively

Price Objective Basis & Risk

Our 1-yr PO of Rs3,700 is at 25x 1-yr forward (FY08E) earnings lower than the current 1-yr forward FY07E PE of 26x, and at a target PEG of less than 1. Our ADR PO is at US\$95, based on a 10% premium to the local, in line with the current premium and below its 1-yr average of ~20% and current premium of peers at 10-20%.

Risks are 1) Growing competition from western systems integrators like Accenture 2) Ability to scale rapidly and manage growth 3) Industry wide risks of US economy slowdown and Rupee/USD appreciation.

Satyam Computers

Our PO of Rs1,000 is at 21x 1-year rolling forward (FY08E) earnings at a 15% discount to our multiple for Infosys, which we believe is justified given Infosys' higher growth, margins, RoE and more diversified revenue base. Our ADR PO of US\$51 is at a 10% premium to the local, in line with Infosys current premium to local.

Key company specific risks are high concentration of revenues from enterprise solutions, higher than expected attrition and the risk of large deals having a lower profitability than the company average, especially during the initial transition phase. Prominent industry wide risks are that of a slowdown in the US economy and risk of Rupee/USD appreciation.

Tata Consultancy Services

Our Rs2,265 PO is at a target PE of 23.5x 1-year forward (FY08E) earnings. We believe the target PE of 23.5x is reasonable at a little over 5% discount to Infosys' target PE, given TCS' shorter track record as a listed company and likely greater volatility in quarterly profits given a higher proportion of fixed price projects.

Risks are 1) Growing competition from western systems integrators 2) maturity of top 10 clients and a high revenue base 3) ability to scale and manage growth 4) higher than expected wage pressure and 5) industry wide risks primarily of US slowdown and also risk of Rupee/USD appreciation.

Analyst Certification

I, Mitali Ghosh, hereby certify that the views expressed in this research report accurately reflect my personal views about the subject securities and issuers. I also certify that no part of my compensation was, is, or will be, directly or indirectly, related to the specific recommendations or view expressed in this research report.

Special Disclosures

In accordance with the SEBI (Foreign Institutional Investors) Regulations and with guidelines issued by the Securities and Exchange Board of India (SEBI), foreign investors (individuals as well as institutional) that wish to transact the common stock of Indian companies must have applied to, and have been approved by SEBI and the Reserve Bank of India (RBI). Each investor who transacts common stock of Indian companies will be required to certify approval as a foreign institutional investor or as a sub-account of a foreign institutional investor by SEBI and RBI. Certain other entities are also entitled to transact common stock of Indian companies under the Indian laws relating to investment by foreigners. Merrill Lynch reserves the right to refuse copy of research on common stock of Indian companies to a person not resident in India. American Depository

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iQmethodSM Measures Definitions

Business Performance	Numerator	Denominator
Return On Capital Employed	NOPAT = (EBIT + Interest Income) * (1 - Tax Rate) + Goodwill	Total Assets – Current Liabilities + ST Debt + Accumulated Goodwill
Return On Equity	Amortization	Amortization
Operating Margin	Net Income	Shareholders' Equity
Earnings Growth	Operating Profit	Sales
Free Cash Flow	Expected 5-Year CAGR From Latest Actual	N/A
	Cash Flow From Operations – Total Capex	N/A
Quality of Earnings		
Cash Realization Ratio	Cash Flow From Operations	Net Income
Asset Replacement Ratio	Capex	Depreciation
Tax Rate	Tax Charge	Pre-Tax Income
Net Debt-To-Equity Ratio	Net Debt = Total Debt, Less Cash & Equivalents	Total Equity
Interest Cover	EBIT	Interest Expense
Valuation Toolkit		
Price / Earnings Ratio	Current Share Price	Diluted Earnings Per Share (Basis As Specified)
Price / Book Value	Current Share Price	Shareholders' Equity / Current Basic Shares
Dividend Yield	Annualised Declared Cash Dividend	Current Share Price
Free Cash Flow Yield	Cash Flow From Operations – Total Capex	Market Cap. = Current Share Price * Current Basic Shares
Enterprise Value / Sales	EV = Current Share Price * Current Shares + Minority Equity + Net Debt + Sales	Other LT Liabilities
EV / EBITDA	Enterprise Value	Basic EBIT + Depreciation + Amortization

iQmethodSM is the set of Merrill Lynch standard measures that serve to maintain global consistency under three broad headings: Business Performance, Quality of Earnings, and valuations. The key features of iQmethod are: A consistently structured, detailed, and transparent methodology. Guidelines to maximize the effectiveness of the comparative valuation process, and to identify some common pitfalls.

iQdatabaseSM is our real-time global research database that is sourced directly from our equity analysts' earnings models and includes forecasted as well as historical data for income statements, balance sheets, and cash flow statements for companies covered by Merrill Lynch.

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Important Disclosures

INFYF Price Chart



B : Buy, N : Neutral, S : Sell, PO : Price objective, NA : No longer valid

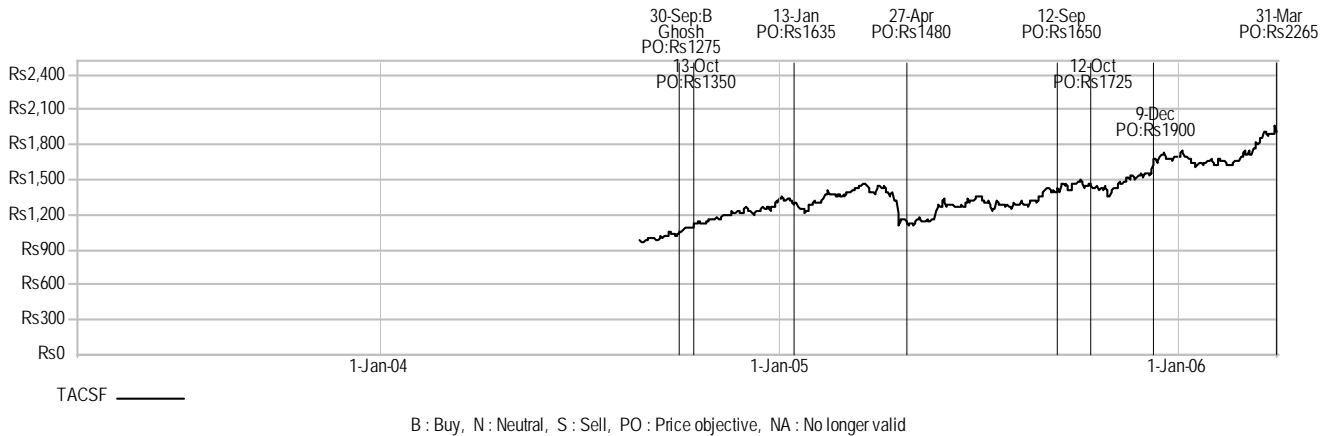
The Investment Opinion System is contained at the end of the report under the heading "Fundamental Equity Opinion Key". Dark Grey shading indicates the security is restricted with the opinion suspended. Light Grey shading indicates the security is under review with the opinion withdrawn. Chart current as of March 31, 2006.

INFY Price Chart



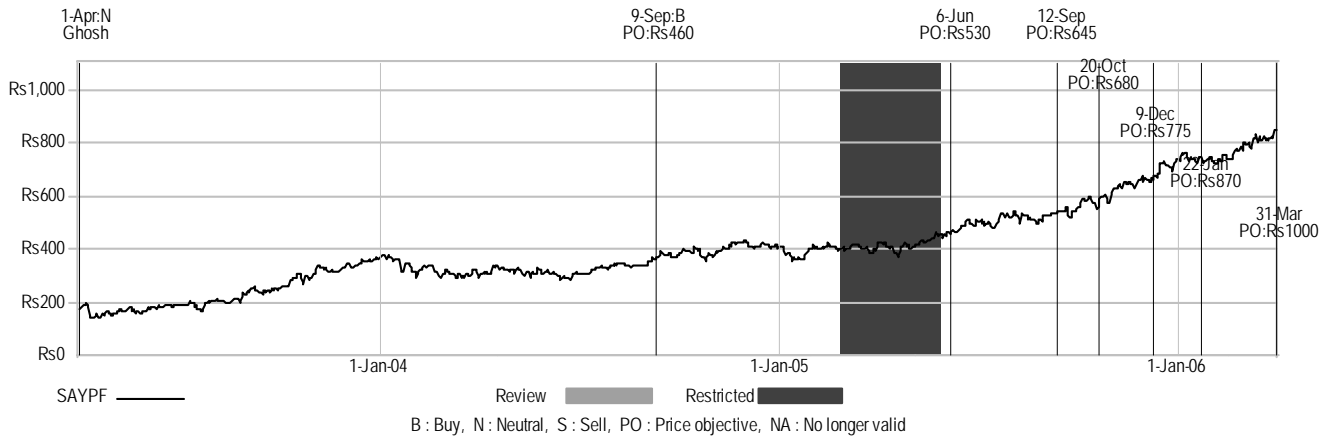
The Investment Opinion System is contained at the end of the report under the heading "Fundamental Equity Opinion Key". Dark Grey shading indicates the security is restricted with the opinion suspended. Light Grey shading indicates the security is under review with the opinion withdrawn. Chart current as of March 31, 2006.

TACSF Price Chart



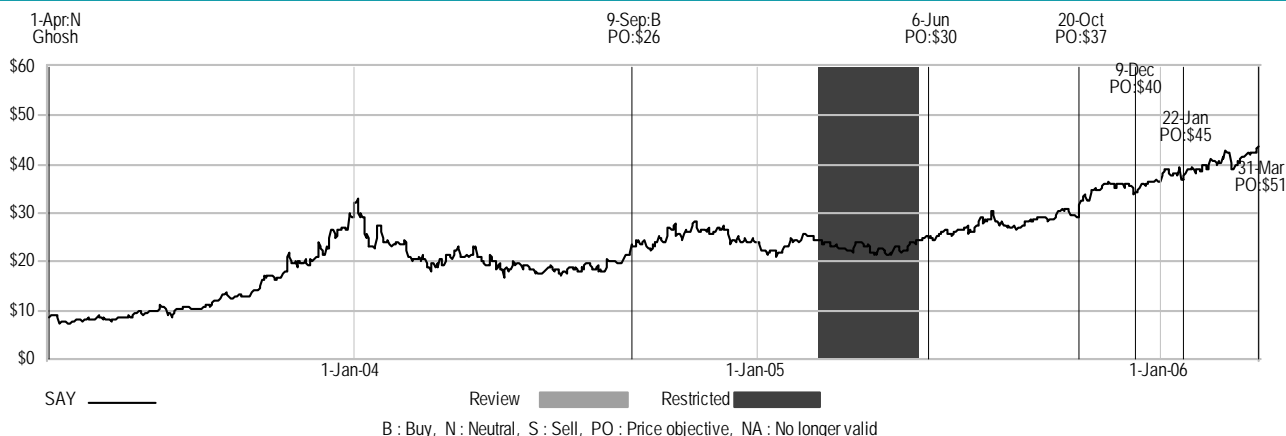
The Investment Opinion System is contained at the end of the report under the heading "Fundamental Equity Opinion Key". Dark Grey shading indicates the security is restricted with the opinion suspended. Light Grey shading indicates the security is under review with the opinion withdrawn. Chart current as of March 31, 2006.

SAYPF Price Chart



The Investment Opinion System is contained at the end of the report under the heading "Fundamental Equity Opinion Key". Dark Grey shading indicates the security is restricted with the opinion suspended. Light Grey shading indicates the security is under review with the opinion withdrawn. Chart current as of March 31, 2006.

SAY Price Chart



The Investment Opinion System is contained at the end of the report under the heading "Fundamental Equity Opinion Key". Dark Grey shading indicates the security is restricted with the opinion suspended. Light Grey shading indicates the security is under review with the opinion withdrawn. Chart current as of March 31, 2006.

Investment Rating Distribution: Technology Group(as of 31 Mar 2006)

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	94	39.33%	Buy	22	23.40%
Neutral	135	56.49%	Neutral	20	14.81%
Sell	10	4.18%	Sell	2	20.00%

Investment Rating Distribution: Global Group(as of 31 Mar 2006)

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	1145	40.29%	Buy	393	34.32%
Neutral	1474	51.86%	Neutral	430	29.17%
Sell	223	7.85%	Sell	44	19.73%

* Companies in respect of which MLPF&S or an affiliate has received compensation for investment banking services within the past 12 months.

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Team Page

Mitali Ghosh >>

Research Analyst
DSP Merrill Lynch (India)
mitali_b_ghosh@ml.com

+91 22 5632 8661

Ajay Mathrani, CFA >>

Research Analyst
DSP Merrill Lynch (India)
ajay_mathrani@ml.com

+91 22 5632 8679

Prasad Deshmukh

Research Analyst
prasad_deshmukh@ml.com

+91 22 5632 8678

Tien Yu Sieh >>

Research Analyst
Merrill Lynch (Hong Kong)
tienyu_sieh@ml.com

+852 2536 3025