

## INFOTECH ENTERPRISES

INR 342



*One-off items drag the bottomline, shield strong performance* **BUY**

Infotech Enterprises announced strong Q3FY07 results. While revenue was ahead of our expectations, net profit was impacted by two one-off items appearing in its 49% owned affiliate IASI. Revenue stood at INR 1.4 bn, up 9.0% Q-o-Q, while net profit, at INR 187 mn, was down 7.5% Q-o-Q. Excluding the IASI share, the PAT before minority interest grew by 15.8% Q-o-Q. During the quarter, the IASI JV had two one-time adjustments: (a) provision for debtors, outstanding for more than 365 days; and (b) bonus payment to IASI employees on achieving USD 25 mn of revenues. The EBITDA margin for the company expanded by 100bps, contributed by higher utilisation and lower employee costs.

The GSD segment improved after two quarters of tepid performance. We understand that the GSD segment is undergoing business transformation, but the strong order intake of GBP 6 mn (USD 11.8 mn) from Europe and a healthy deal pipeline makes the outlook positive. Engineering services continues to have strong traction, and the company has invested in building newer practices and domains which will enhance growth going forward. Marine engineering practice, which acquired two new clients, and avionics are expected to make more meaningful contribution to revenues only after two more quarters.

We have revised our FY07E earnings downward by ~ 3% to INR 17.6, factoring in the unexpected loss from the IASI JV. We maintain our FY08E EPS of INR 24.0. At CMP of INR 342, the stock trades at a P/E of 19.4x and 14.3x for FY07E and FY08E earnings, respectively. We reiterate our 'BUY' recommendation.

#### Key highlights

- Revenue, at INR 1.4 bn, was up by 9.0% Q-o-Q and 52.0% Y-o-Y. Net profit stood at INR 187 mn, down 7.5% Q-o-Q and up 40.8% Y-o-Y.
- Employee costs as a percent of revenues dipped from 47.3% in Q2FY07 to 45.9% in the current quarter. This was mainly on account of higher employee addition in the GSD vertical.
- EBITDA stood INR 323 mn, up by 13.8% Q-o-Q. EBITDA margin increased 100bps to 22.6%. This increase is on top of a 290bps increase in the previous quarter. However, management has stated that margins will stabilize at ~ 20% levels on account of continuing investments in developing newer practices.
- The company added eight new customers during the quarter (five in GSD and three in the EMI vertical).

#### Financials

Year to March	Q3FY07	Q2FY07	Growth %	Q3FY06	Growth %	FY07E	FY08E
Revenue (INR mn)	1,430	1,313	9.0	941	52.0	5,436	7,379
EBITDA (INR mn)	323	284	13.8	178	81.2	1,152	1,561
EBIT (INR mn)	257	221	16.3	129	98.9	897	1,266
Net profit (INR mn)	187	203	(7.5)	133	40.8	811	1,149
EPS basic (INR)	4.1	4.4	(6.6)	2.9	41.3	17.6	24.0
P/E (x)						19.4	14.3
EV/EBITDA (x)						16.8	9.2
Mkt cap/Rev. (x)						2.9	2.1

January 17, 2007

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#### Market Data

52-week range (INR) : 358 / 127  
Share in issue (mn) : 45.9  
M cap (INR bn/USD mn) : 15.7 / 354.3  
Avg. Daily Vol. BSE/NSE ('000) : 150.0

#### Share Holding Pattern (%)

Promoters : 28.8  
MFs, FIs & Banks : 17.4  
FIs : 16.5  
Others : 37.3

- The company's headcount addition was strong, with 409 employees (net) being added in the quarter, taking the total head count to 4,953. The company is targeting a headcount of 5,300-5,400 by the end of the current fiscal.
- The annualized attrition for the quarter stood at 14%, much lower than its peers.
- During the current quarter, IASI (Puerto Rico based JV) took one-time charges relating to provision for debtors and one-time bonus payments resulting in a loss of INR 12 mn for Infotech.

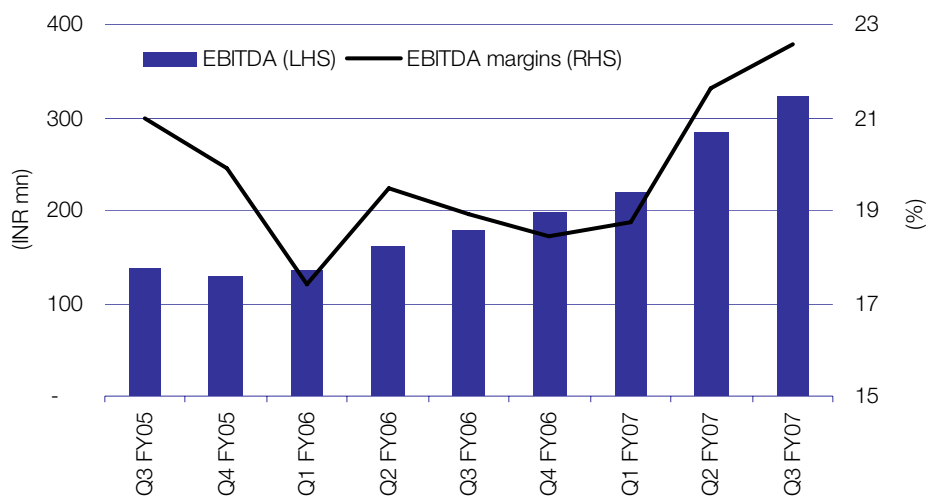
#### \* Investments in new practices and domains

Infotech has, since the past two quarters, focused on expanding its presence in the engineering space and entered the marine engineering and avionics space. The company also stated that it acquired two new clients in the marine engineering space during the current quarter. The new practices are expected to make some meaningful contribution to revenues after two more quarters. We believe, the company's strategy to diversify its service offerings and cash in on the offshore opportunity available in the marine and avionics space will drive future growth.

#### \* Steady improvement in EBITDA margins

The company's EBITDA margin continued to increase and was at 22.6%, compared to 18.9% a year ago. Ramp up from top 10 clients, price hikes from two of the large clients helped the company boost the EBITDA margin over the past twelve months. Infotech has guided that it expects the EBITDA margin to remain at ~ 20% level in the foreseeable future on account of investments to be made for developing new practices. We, however, expect the company to earn 21% plus margins based on factors such as a strong demand environment in engineering IT, increase in bill rates from large deals which have annual hike clauses, and benefits of achieving scale.

Chart 1: EBITDA and EBITDA margins over Q3FY05-Q3FY07



Source: Company, Edelweiss research

#### \* Revision in earnings

We have revised our FY07E earnings downward by ~ 3% to INR 17.6, factoring in the unexpected loss from the IASI JV. We maintain our FY08E EPS of INR 24.0.

Table 1: Revised estimates

	Earlier		Revised		% change	
	FY07E	FY08E	FY07E	FY08E	FY07E	FY08E
Revenue	5,410	7,379	5,436	7,379	0.5	-
Net profit	850	1,149	811	1,149	(4.6)	(0.0)
EPS	18.1	24.0	17.6	24.0	(2.8)	(0.0)

Source: Edelweiss research

## \* Valuations

Infotech has been performing steadily over the past many quarters. With increasing traction in the GSD division and a strong pipeline in the EMI segment, we expect the company to sustain its growth trajectory over the next two-three years. We remain positive about the prospects of the engineering IT space, which will sustain higher growth trajectory after lagging growth in enterprise IT. We expect Infotech, one of the leading players in the offshore world, to benefit from this trend. At CMP of INR 342, the stock trades at a P/E of 19.4x and 14.3x for FY07E and FY08E earnings, respectively. We reiterate our 'BUY' recommendation.

## Financials snapshot

								(INR mn)
Year to March	Q3FY07	Q2FY07	Growth %	Q3FY06	Growth %	FY06	FY07E	FY08E
Total revenues	1,430	1,313	9.0	941	52.0	3,625	5,436	7,379
Employee cost	656	621	5.7	443	48.1	1,696	2,557	3,501
Travel expenses	126	116	7.9	88	43.1	328	478	620
Cost of purchases	168	147	14.2	110	52.5	459	653	871
Operating & admin expenses	158	145	9.0	122	29.6	469	596	826
Total expenditure	1,108	1,029	7.6	763	45.2	2,952	4,284	5,818
EBITDA	323	284	13.8	178	81.2	673	1,152	1,561
Depreciation & amortization	66	63	4.8	49	34.6	186	255	360
EBIT	257	221	16.3	129	98.9	487	897	1,266
Other income	0	5	(96.2)	12	(98.3)	21	54	65
Interest expense	5	4	11.6	2	166.7	11	16	15
PBT	252	222	13.8	139	80.9	498	935	1,251
Tax	53	49	7.1	21	148.8	93	197	244
Adjusted net profit	200	173	15.6	118	68.8	404	739	1,007
Share of IASl profit	(12)	30	(141.1)	15	(183.1)	101	72	142
Reported net profit	187	203	(7.5)	133	40.8	505	811	1,149
EPS basic (INR)	4.1	4.4	(6.6)	2.9	41.3	11.1	17.6	24.0
as % of net revenues								
Employee cost	45.9	47.3		47.1		46.8	47.0	47.5
Travel expenses	8.8	8.9		9.3		9.0	8.8	8.4
Cost of purchases	11.8	11.2		11.7		12.7	12.0	11.8
Operating & admin expenses	11.1	11.0		13.0		12.9	11.0	11.2
EBITDA	22.6	21.6		18.9		18.6	21.2	21.2
EBIT	18.0	16.8		13.7		13.4	16.5	17.2
Reported net profit	13.1	15.4		14.1		13.9	14.9	15.6
Tax rate	20.8	22.1		15.1		18.8	21.1	19.5

## Company description

Infotech Enterprises is a 4900+ employee software services company with competencies a) GIS services catering to Utility, Transportation and Government segments b) Engineering design services for Engineering, Manufacturing and Industrial products verticals and c) Software services to clients in both the verticals. Data & Technology services, engineering design and IT services. The provides solutions company specializes in software services and solutions for manufacturing, utilities, telecommunications, transportation, retail, financial services, geotechnical and local government markets. The company has grown its revenues and net profits at a CAGR of 39.1% and 136.7% respectively over FY04-06. The company's last twelve months (TTM) revenues stood at INR 5.0 bn (USD 112.4 mn).

## Investment theme

Outsourcing of engineering services are expected to increase to USD is expected to reach USD 38-50 bn by 2020 as compared to USD 2 bn now, as per the Nasscom, Booz Allen Hamilton study. As one of the leading offshore engineering services firm for manufacturing industry, Infotech is well poised to grab the increasing opportunities. The company has strong domain knowledge and complete solution capability in the GIS segment along with healthy pipeline of deals. The company's skills in the areas of mapping and designing across diverse segments and in a variety of end-user IT environments give it an edge. We expect Infotech's revenues and net profits to grow at a CAGR of 42.7% and 50.8%, respectively over FY06-08E.

## Risks to investment theme

Key risks to the investment to our investment theme include – a) adequate availability of skilled manpower, b) slowdown in engineering spending c) significant appreciation of rupee against US dollar, Euro and GBP

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<b>Buy</b>	Expected to appreciate more than 20% over a 12-month period	<b>Reduce</b>	Expected to depreciate up to 10% over a 12-month period
<b>Accumulate</b>	Expected to appreciate up to 20% over a 12-month period	<b>Sell</b>	Expected to depreciate more than 10% over a 12-month period
<b>Trading Buy</b>	Expected to appreciate more than 10% over a 45-day period	<b>Trading Sell</b>	Expected to depreciate more than 10% over a 45-day period

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