

Infosys ----- Maintain NEUTRAL

Expect no EPS growth in FY3/10

EPS: ▼ TP: ▼

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- Infosys' September 2008 quarter results were in line, but its guidance was below our estimates. Management reduced FY3/09 revenue growth guidance to 13-15% YoY growth (in US dollar terms), with 3% of the reduction coming from currency and 3% from the weak macro environment.
- This would result in flat QoQ top-line growth for the next two quarters. We believe that utilisation rates could drop in the next two quarters, leading to a margin decline.
- While FY3/09 EPS of US\$2.24(Rs101) seems secure, focus should shift to FY3/10. We believe that sales growth could slow down to 11% YoY in FY3/10 (despite stronger QoQ growth), with 230 bp margin decline. This should lead to EPS growth of 2% YoY.
- On the other hand, our strategist's top-down view also calls for flat earnings for index in FY3/10. Both Infosys and the index are trading at similar (12x) P/E multiple. In this environment, we think that Infosys could be a market performer.
- We reduce our EPS estimates by 4%/12% for FY09/10. We maintain our NEUTRAL rating. Our target price is Rs1,400 (previously Rs1,800).

Bbg/RIC	INFO IN / INFY.BO	Price (10 Oct 08, Rs)	1,270.05
Rating (prev. rating)	N (N)	TP (Rs) (prev. TP)	1,400 (1,800)
Shares outstanding (mn)	568.99	Est. pot. % chg. to TP	10
Daily trad vol-6m avg (mn)		52-wk range (US\$)	2124.55 - 1270.05
Daily trad val-6m avg (US\$ mn)		Mkt cap (Rs/US\$ bn)	15.1/ 15.1
Free float (%)	81.0	Performance	1M 3M 12M
Major shareholders	Promoters - 19.5%	Absolute	(27.5) (30.4) (38.0)
		Relative	(4.6) (14.2) 0.1
Year	3/07A	3/08A	3/09E 3/10E 3/11E
Revenues (US\$ mn)	3,089	4,176	4,823 5,367 6,142
EBITDA (US\$ mn)	975	1,315	1,543 1,644 1,800
Net profit (US\$ mn)	828	1,155	1,276 1,304 1,362
EPS (US\$)	1.49	2.03	2.24 2.29 2.39
- Change from prev. EPS (%)	n.a.	n.a.	-4 -12 -17
- Consensus EPS (US\$)	n.a.	n.a.	2.26 2.62 2.96
EPS growth (%)	46.2	35.9	10.3 2.1 4.4
P/E (x)	17.7	13.0	11.8 11.6 11.1
Dividend yield (%)	1.0	3.1	2.5 2.6 2.7
EV/EBITDA (x)	14.0	9.9	8.4 7.4 6.4
P/B (x)	5.3	3.7	3.5 3.0 2.5
ROE (%)	36.4	34.9	31.8 28.5 24.8
Net debt/equity (%)	net cash		

Note 1: Infosys Technologies provides consulting and software services, including business process outsourcing, program management, and supply chain solutions.

Results broadly in line

Infosys' September 2008 quarter revenues came broadly in line with our estimate of US\$1216 mn, growing 5.3% QoQ and 19% YoY. Beneficial rupee movement and seasonality helped the EBIT margin rise of 280 bp QoQ, 50 bp above our estimate. However, lower other income led to net profit missing estimates by about 5%, growing 3.9% QoQ and 17.4% YoY.

Tough macro forces a reduction in guidance

Infosys' management cut its full-year FY3/09 revenue guidance by 5% to US\$4.72-4.81 bn. Along with December 2008 quarter revenue guidance of US\$1,175-1,220 mn (0-3.4% QoQ drop), this implies flat

revenues QoQ for March 2009 quarter. The company guided full-year EPS of \$2.24.

We note that the guidance implies a fall in margins over the next two quarters. This could be due to fall in utilisation rates as revenue growth slows down while company still honours its earlier job offers.

What should we build for FY3/10?

We build a stronger QoQ growth in FY3/10 (3.1% CQGR compared to 2% CQGR in FY3/09). However, the full-year revenue growth could remain limited to 11.3% YoY.

In addition, the 12% rupee depreciation in FY3/09 could have helped margins by 400 bp. This would be lacking in FY3/10. Also, we build a 4% pricing decline. Thus, we expect a 230 bp YoY margin decline in FY3/10. Our EPS growth for FY3/10 is only 2.1%. We assume an average Rs/US\$ rate of Rs45/\$ for FY3/09 and FY3/10.

Is the stock expensive?

We are building flat EPS (~2% YoY growth) for Infosys in FY3/10. Our strategist's top-down view is for flat EPS of index in FY3/10. Both Infosys and the index are currently trading around 12x FY3/10E P/E. Hence, we find Infosys' share price reasonable.

Walks away from Axon acquisition

Infosys indicated in the call that it has communicated to Axon board its inability to increase the bid price for the company. Thus, HCL Tech should now be able to acquire Axon. We believe that this is not necessarily negative, as it: 1) conserves cash in these uncertain times and 2) the recent preannouncement of SAP and the weakness in the UK economy could imply weakness in Axon's business.

Figure 1: Infosys Sep-08 results summary

(US\$ mn)	2Q08	1Q09	2Q09	YoY %	QoQ %	CS Est	% Diff
Net sales	1,022	1,155	1,216	19.0%	5.3%	1,220	-0.3%
Gross profit	430	458	526	22.2%	14.8%	501	5.0%
Gross Margin	42.1%	39.7%	43.3%			41.1%	
EBIT	281	308	359	27.7%	16.5%	353	1.6%
EBIT margin	27.5%	26.7%	29.5%			29.0%	
EBITDA	320	352	405	26.5%	14.9%	397	1.9%
EBITDA margins	31.3%	30.5%	33.3%			32.6%	
Other income	38	28	15			40	-61.3%
Pre-tax income	319	336	374	17.3%	11.4%	393	-4.7%
Net income	271	306	318	17.4%	3.9%	335	-4.9%
Net margin	26.6%	26.5%	26.2%			27.4%	
EPS	0.48	0.54	0.56	17.1%	3.9%	0.59	-4.9%

Source: Company data, Credit Suisse estimates.

Figure 2: Summary operating metrics

	Jun-07	Sep-07	Dec-07	Mar-08	Jun-08	Sep-08
Headcount (qtr end)	75,971	80,501	88,601	91,187	94,379	100,306
Attrition	13.7%	14.2%	13.7%	13.4%	13.6%	12.8%
Utilisation (ex. trainees)	73.9%	78.4%	76.3%	74.5%	70.9%	72.8%
Volume growth (QoQ)	6.9%	7.7%	4.5%	4.9%	0.5%	6.5%
Pricing improvement						
Onsite	1.4%	2.9%	1.1%	0.0%	0.0%	0.6%
Offshore	1.0%	2.6%	1.3%	0.5%	0.0%	0.1%

Source: Company data, Credit Suisse estimates.

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Companies Mentioned (Price as of 09 Oct 08)

Infosys Technologies Ltd. (INFY.BO, Rs1270.05, NEUTRAL, TP Rs1400.00, MARKET WEIGHT)

HCL Technologies (HCLT.BO, Rs189.15, UNDERPERFORM, TP Rs190.00, MARKET WEIGHT)

Axon Group (AXO.L, 6.50 p)

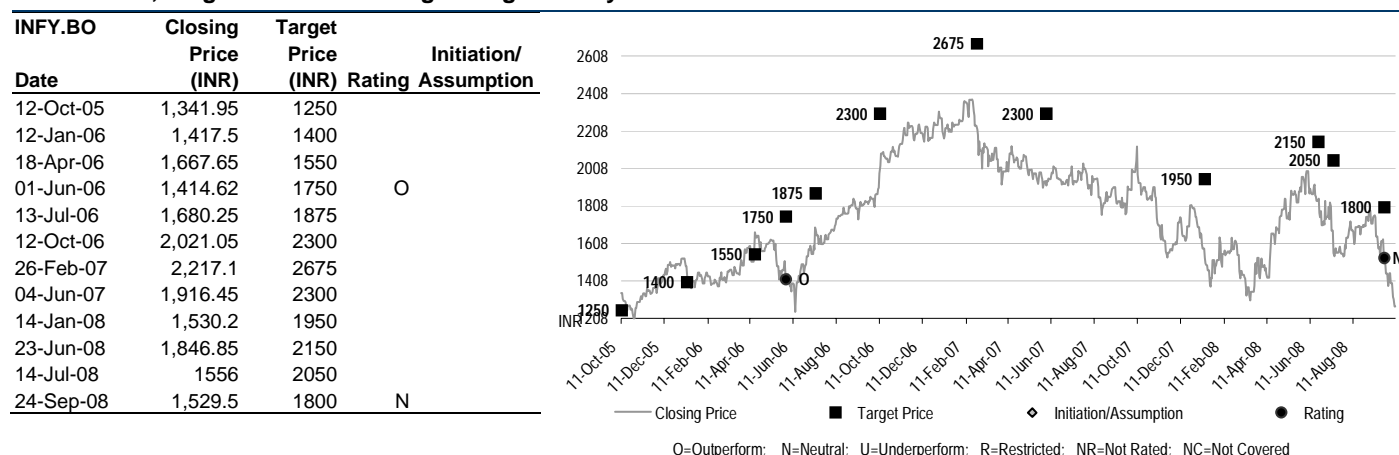
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3-Year Price, Target Price and Rating Change History Chart for INFY.BO



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Price Target: (12 months) for (INFY.BO)

Method: Our target price of Rs1,400 for Infosys is based on discounted cash flow (DCF) method. We assume a 21% near-term growth rate, 16% medium-term growth and 3% terminal growth. We use a weighted average cost of capital (WACC) of 14.2% to arrive at our target price.

Risks: Risks to our Rs1,400 target price for Infosys Technologies include: 1) a weaker economic environment in the US leading to slower IT services spending; 2) stronger competition by global vendors in the offshore arena; 3) large clients of the company shifting a greater proportion of their work to their in-house centres; 4) greater-than-expected wage inflation; and 5) adverse currency movements.

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