



Infosys Technologies

STOCK INFO. BLOOMBERG
BSE SENSEX: 9,977 INFO IN
REUTERS CODE
S&P CNX: 3,042 INFY.BO

16 December 2008

Buy

Rs1,123

Previous Recommendation: Buy

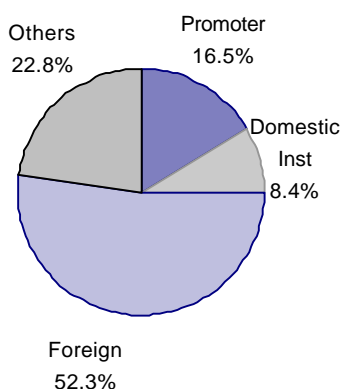
Equity Shares (m)	572.5
52-Week Range	2,017/1,040
1,6,12 Rel. Perf. (%)	-14/-5/18
M.Cap. (Rs b)	642.9
M.Cap. (US\$ b)	13.4

YEAR	NET SALES	PAT*	EPS	EPS	P/E	P/BV	ROE	ROCE	EV/	EV/
END	(RS M)	(RS M)	(RS)	GR. (%)	(X)	(X)	(%)	(%)	SALES	EBITDA
3/07A	138,930	37,250	66.1	48.1	17.0	5.6	40.9	40.8	4.1	13.1
3/08A	166,920	45,580	79.5	20.3	14.1	4.7	36.4	36.4	3.4	11.0
3/09E	218,211	58,394	101.7	27.9	11.0	3.7	37.5	37.5	2.5	7.7
3/10E	225,529	60,564	105.3	3.6	10.7	3.0	31.3	31.3	2.3	7.0

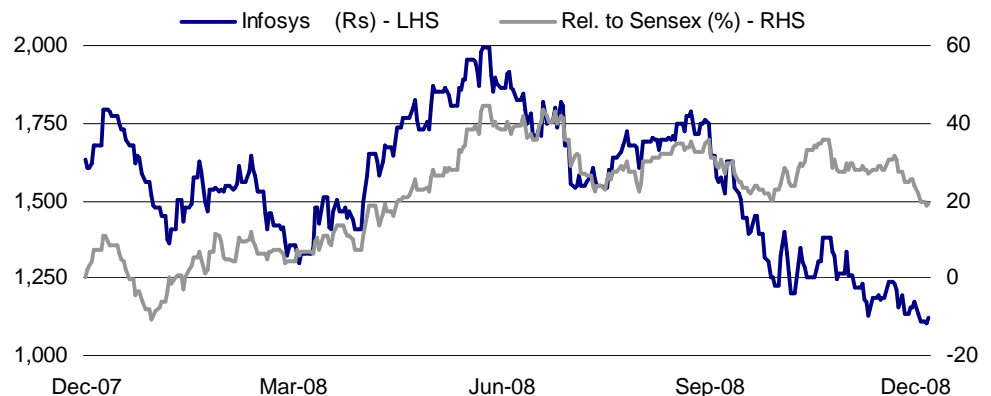
* 1:1 bonus in FY07, accordingly ratios are adjusted, PAT figures are adjusted PAT

- ✎ **Reducing FY10 US\$ revenue growth estimate to 4%:** Our recent interaction with the Infosys management has confirmed our concerns of slowing demand for IT services. Revenue visibility has deteriorated due to uncertain business environment and delays in decision making on IT spends. We are cutting our FY10 US\$ revenue growth estimates to 4% from 12% earlier, factoring ~8% volume growth and ~3% pricing de-growth. We believe that demand for IT services would pick up only in 2HFY10 and that too in the absence of significant bad news from the West.
- ✎ **Muted salary hikes, variable costs to act as margin buffers:** Lower hiring and falling attrition could lead to near zero salary hikes in FY10. We note that effective salary hikes were in low single digits in the previous slowdown. Variable pay, which forms around 30% of offshore salaries, will also act as a significant margin lever in FY10 providing a buffer of ~550bp to EBITDA margin. The impact of other cost cutting initiatives in SG&A expenditure could provide a buffer of another ~150bp. These along with increased utilization will partly offset the negative impact on margins due to billing rate decline; we expect FY10 EBIT margin to be ~35bp lower.
- ✎ **FY10 EPS cut to Rs105; maintain Buy:** We have cut our FY10 US\$ revenue growth estimate to 4% from 12% earlier to factor in deteriorating revenue visibility. We have revised our exchange rate assumption to Rs45.6/US\$ for FY09 and FY10 from Rs45.17/US\$ for FY09 and Rs44/US\$ for FY10, earlier. Our revised FY10 EPS estimate is Rs105.3 (Rs109 earlier), a growth of 4%. Our revised FY09 EPS estimate is Rs101.7 v/s Rs100.4, a marginal increase on account of revised exchange rate assumptions. We are revising our DCF-based target price to Rs1,347 (20% upside). At the target price, the stock would trade at 13x FY10E EPS. Maintain **Buy**.

SHAREHOLDING PATTERN (SEP:08)



STOCK PERFORMANCE (1 YEAR)



Reducing FY10 US\$ revenue growth estimate to 4%

Our recent interaction with the Infosys management has confirmed our concerns of slowing demand for IT services. Revenue visibility has deteriorated due to uncertain business environment and delays in decision making on IT spends. We are cutting our FY10 US\$ revenue growth estimates to 4% from 12% earlier, factoring ~8% volume growth and ~3% pricing de-growth. We believe that demand for IT services will likely pick up only in 2HFY10 and too in the event of absence of significant bad news from the west.

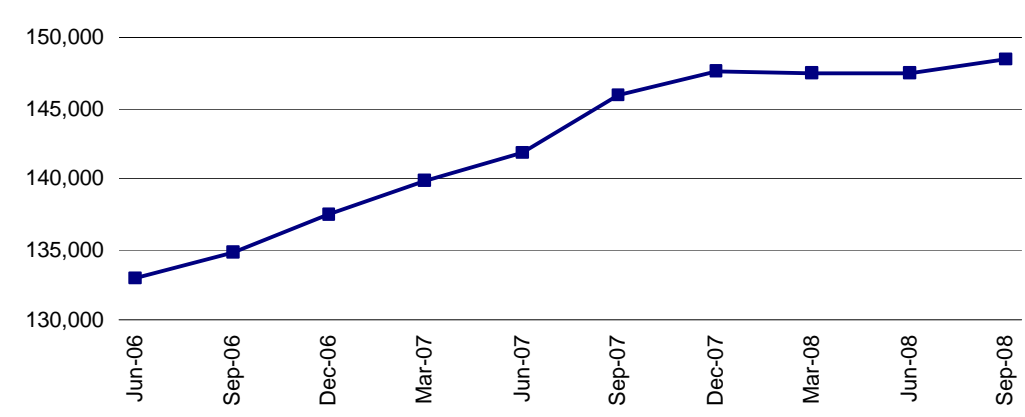
Downward bias in billing rates in near term; steep price cuts unlikely

We believe Infosys will witness increasing pricing pressure in a competitive environment and would have to accede to some of the demands to cut bill rates in order to maintain volume growth. Billing rate negotiations are likely to dominate discussions in the next two quarters, as accelerated cost containment drive is forcing clients to take a re-look even at the existing long term contracts. However, we believe the price cuts taken by Infosys will not be steep given its premium brand image and bargaining power.

Clients more receptive towards alternative pricing models

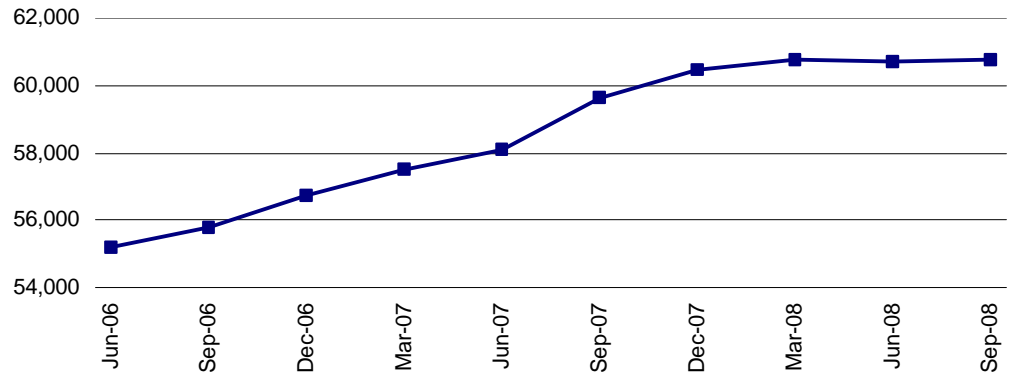
Infosys is witnessing greater traction in innovative pricing models like outcome-based, ticket-based, output-based billing etc. These pricing models, which are non-linear, involve transfer of project risk to the vendors and provide more flexibility and scalability. Given that cost minimization for the client has taken prominence over perceived process control, these modes of billing are gaining prominence and are expected to contribute ~5% of revenues in FY10. This would lower the impact of price cuts on margins.

PER CAPITA REVENUE PRODUCTIVITY – ONSITE (US\$)



Source: Company/MOSL

PER CAPITA REVENUE PRODUCTIVITY - OFFSHORE (US\$)



Source: Company/MOSL

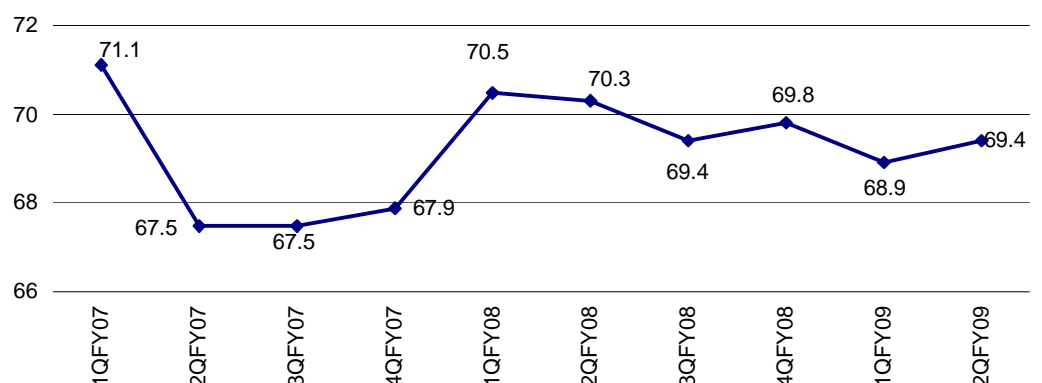
Manpower hiring freeze; to honor past commitments

Infosys management clarified that its statement on hiring freeze implied honoring its commitment for hiring 25,000 gross employees in FY09. The decision on the hiring number for FY10 will be taken only when revenue visibility improves. Infosys gave 18,000 campus offers (scheduled to join in the next fiscal) and might align the joining dates in line with demand visibility. With attrition expected to ease, improved utilization levels, and growing focus on non-linear pricing model, the management believes it can manage FY10 topline growth with less than proportionate hiring.

Utilization to drop in 2HFY09 and improve only in FY10

Infosys hired ~17,000 employees in 1HFY09 and is on track for hiring 25,000 employees in FY09. Incremental hiring coupled with lack of incremental volumes on account of delayed decision making would cast a pressure on utilization rate in 2HFY09. Utilization rate of Infosys has stagnated at ~70% for the last six quarters. We model utilization of ~69% (incl. trainees) in 2HFY09. Lower hiring YoY in FY10 coupled with higher volumes driven by lower pricing norms would lead to improved utilization in FY10. This would, in turn, enable margin protection in FY10. We model utilization of ~73% in FY10.

UTILIZATION INCLUDING TRAINEES (%)



Source: Company/MOSL

Muted salary hikes, variable costs to act as margin buffers

Lower hiring and falling attrition could lead to near zero salary hikes in FY10. We note that effective salary hikes were in low single digit in the previous slowdown. Variable pay, which forms around 30% of offshore salaries, will also act as a significant margin lever in FY10 providing a buffer of ~550bp to EBITDA margin. The impact of other cost cutting initiatives in SG&A expenditure could provide a buffer of another ~150bp. The company is rationalizing its general expenses like travel, communication, staff welfare etc, and is also likely to witness flat selling and marketing expenses in FY10 given the increased focus on existing relationships than building new ones.

FY10 EPS cut to Rs105; maintain Buy

We have cut our FY10 US\$ revenue growth estimate to 4% from 12% earlier to factor in deteriorating revenue visibility. Our estimate factors in ~8% volume growth and ~3% pricing de-growth. We believe the negative impact on margins due to billing rate decline will be partly offset by increased utilization and muted wage hikes; we expect FY10 EBIT margin to be ~35bp lower. We have revised our exchange rate assumption to Rs45.6/US\$ for FY09 and FY10 from Rs45.17/US\$ for FY09 and Rs44/US\$ for FY10, earlier. Our revised FY10 EPS estimate is Rs105.3 (Rs109 earlier), a growth of 4%. Our revised FY09 EPS estimate is Rs101.7 v/s Rs100.4, a marginal increase on account of revised exchange rate assumptions. We are revising our DCF-based target price to Rs1,347 (20% upside). At the target price, the stock would trade at 13x FY10E EPS. Maintain **Buy**.

INCOME STATEMENT						(RS MILLION)					
Y/E MARCH	2006	2007	2008	2009E	2010E	Y/E MARCH	2006	2007	2008	2009E	2010E
Sales	95,216	138,930	166,920	218,211	225,529	Basic (Rs)					
Change (%)	33.5	45.9	20.1	30.7	3.4	EPS	44.6	66.1	79.5	101.7	105.3
Software Develop. Exp.	50,654	74,580	92,070	117,705	122,383	Cash EPS	105.1	75.2	89.9	115.4	118.8
Selling and Mktg. Exp.	6,005	9,290	9,160	12,202	13,004	Book Value	252.8	199.7	240.6	302.0	371.5
Administration Exp.	7,639	11,150	13,310	17,026	17,438	DPS	44.9	11.5	33.2	35.8	31.6
						Payout %(Incl.Div.Taxes)	100.6	17.4	41.7	35.2	30.0
EBITDA	30,918	43,910	52,380	71,279	72,704	Valuation (x)					
% of Net Sales	32.5	31.6	31.4	32.7	32.2	P/E	25.2	17.0	14.1	11.0	10.7
Depreciation	4,371	5,140	5,980	7,849	7,724	Cash P/E	10.7	14.9	12.5	9.7	9.5
Other Income	1,396	3,700	7,040	4,898	8,879	EV/EBITDA	8.7	13.1	11.0	7.7	7.0
						EV/Sales	2.8	4.1	3.4	2.5	2.3
PBT	27,943	42,470	53,440	68,328	73,859	Price/Book Value	4.4	5.6	4.7	3.7	3.0
Tax	3,132	5,110	7,860	9,933	13,295	Dividend Yield (%)	4.0	1.0	3.0	3.2	2.8
Rate (%)	11.2	12.0	14.7	14.5	18.0	Profitability Ratios (%)					
Minority Interest	210	110	0	0	0	RoE	40.4	40.9	36.4	37.5	31.3
Adjusted PAT	24,601	37,250	45,580	58,394	60,564	RoCE	40.2	40.8	36.4	37.5	31.3
Extraordinary Items	18	-1,310	-1,010	-310	0	Turnover Ratios					
Reported PAT	24,583	38,560	46,590	58,704	60,564	Debtors (Days)	56	53	63	63	63
Change (%)	30.0	56.9	20.8	26.0	3.2	Fixed Asset Turnover (x)	6.6	6.4	5.6	6.1	5.5

BALANCE SHEET						(RS MILLION)					
Y/E MARCH	2006	2007	2008	2009E	2010E	Y/E MARCH	2006	2007	2008	2009E	2010E
Share Capital	1,380	2,860	2,859	2,865	2,873	Net Worth	69,660	112,550	137,950	173,364	213,611
Share Premium	15,430	27,680	28,511	29,253	30,187	Minority Interest	680	40	0	0	0
Reserves	52,850	82,010	106,580	141,245	180,551	Loans	0	0	0	0	0
Capital Employed	70,340	112,590	137,950	173,364	213,611	Capital Employed	70,340	112,590	137,950	173,364	213,611
Gross Block	29,830	46,420	54,390	66,390	81,390	Gross Block	29,830	46,420	54,390	66,390	81,390
Less : Depreciation	13,280	18,360	19,860	27,709	35,433	Less : Depreciation	13,280	18,360	19,860	27,709	35,433
Net Block	16,550	28,060	34,530	38,681	45,957	Net Block	16,550	28,060	34,530	38,681	45,957
CWIP	5,710	9,650	13,240	12,000	15,000	CWIP	5,710	9,650	13,240	12,000	15,000
Investments	7,550	250	720	1,020	1,320	Investments	7,550	250	720	1,020	1,320
Curr. Assets	63,990	96,130	131,370	165,491	198,877	Curr. Assets	63,990	96,130	131,370	165,491	198,877
Debtors	16,080	24,360	32,970	42,358	35,496	Debtors	16,080	24,360	32,970	42,358	35,496
Cash & Bank Balance	34,290	58,710	69,500	97,308	132,012	Cash & Bank Balance	34,290	58,710	69,500	97,308	132,012
Loans & Advances	12,970	12,140	27,710	24,661	29,466	Loans & Advances	12,970	12,140	27,710	24,661	29,466
Other Current Assets	650	920	1,190	1,164	1,902	Other Current Assets	650	920	1,190	1,164	1,902
Current Liab. & Prov	23,460	21,500	41,910	43,828	47,543	Current Liab. & Prov	23,460	21,500	41,910	43,828	47,543
Creditors	7,320	11,540	16,240	20,228	18,081	Creditors	7,320	11,540	16,240	20,228	18,081
Other liabilities	2,020	3,150	2,880	4,626	3,132	Other liabilities	2,020	3,150	2,880	4,626	3,132
Provisions	14,120	6,810	22,790	18,974	26,330	Provisions	14,120	6,810	22,790	18,974	26,330
Net Current Assets	40,530	74,630	89,460	121,662	151,334	Net Current Assets	40,530	74,630	89,460	121,662	151,334
Misc. Expenses	0	0	1	1	1	Misc. Expenses	0	0	1	1	1
Application of Funds	70,340	112,590	137,950	173,364	213,611	Application of Funds	70,340	112,590	137,950	173,364	213,611

E: MOST Estimates

RATIOS *						(RS MILLION)					
Y/E MARCH	2006	2007	2008	2009E	2010E	Y/E MARCH	2006	2007	2008	2009E	2010E
Basic (Rs)						Basic (Rs)					
EPS	44.6	66.1	79.5	101.7	105.3	EPS	44.6	66.1	79.5	101.7	105.3
Cash EPS	105.1	75.2	89.9	115.4	118.8	Cash EPS	105.1	75.2	89.9	115.4	118.8
Book Value	252.8	199.7	240.6	302.0	371.5	Book Value	252.8	199.7	240.6	302.0	371.5
DPS	44.9	11.5	33.2	35.8	31.6	DPS	44.9	11.5	33.2	35.8	31.6
Payout %(Incl.Div.Taxes)	100.6	17.4	41.7	35.2	30.0	Payout %(Incl.Div.Taxes)	100.6	17.4	41.7	35.2	30.0
Valuation (x)						Valuation (x)					
P/E	25.2	17.0	14.1	11.0	10.7	P/E	25.2	17.0	14.1	11.0	10.7
Cash P/E	10.7	14.9	12.5	9.7	9.5	Cash P/E	10.7	14.9	12.5	9.7	9.5
EV/EBITDA	8.7	13.1	11.0	7.7	7.0	EV/EBITDA	8.7	13.1	11.0	7.7	7.0
EV/Sales	2.8	4.1	3.4	2.5	2.3	EV/Sales	2.8	4.1	3.4	2.5	2.3
Price/Book Value	4.4	5.6	4.7	3.7	3.0	Price/Book Value	4.4	5.6	4.7	3.7	3.0
Dividend Yield (%)	4.0	1.0	3.0	3.2	2.8	Dividend Yield (%)	4.0	1.0	3.0	3.2	2.8
Profitability Ratios (%)						Profitability Ratios (%)					
RoE	40.4	40.9	36.4	37.5	31.3	RoE	40.4	40.9	36.4	37.5	31.3
RoCE	40.2	40.8	36.4	37.5	31.3	RoCE	40.2	40.8	36.4	37.5	31.3
Turnover Ratios						Turnover Ratios					
Debtors (Days)	56	53	63	63	63	Debtors (Days)	56	53	63	63	63
Fixed Asset Turnover (x)	6.6	6.4	5.6	6.1	5.5	Fixed Asset Turnover (x)	6.6	6.4	5.6	6.1	5.5
Leverage Ratio (x)						Leverage Ratio (x)					
Debt/Equity Ratio(x)	0.0	0.0	0.0	0.0	0.0	Debt/Equity Ratio(x)	0.0	0.0	0.0	0.0	0.0

* 1:1 bonus in FY07, accordingly ratios are adjusted

CASH FLOW STATEMENT						(RS MILLION)					
Y/E MARCH	2006	2007	2008	2009E	2010E	Y/E MARCH	2006	2007	2008	2009E	2010E
CF from Operations	29,428	42,790	52,260	66,579	67,550	CF from Operations	29,428	42,790	52,260	66,579	67,550
Cash for Working Capital	3,549	-9,410	-3,770	-4,420	5,771	Cash for Working Capital	3,549	-9,410	-3,770	-4,420	5,771
Net Operating CF	32,977	33,380	48,490	62,159	73,321	Net Operating CF	32,977	33,380	48,490	62,159	73,321
Net Purchase of FA	-10,890	-20,590	-16,040	-10,760	-18,000	Net Purchase of FA	-10,890	-20,590	-16,040	-10,760	-18,000
Net Purchase of Invest.	4,558	7,300	-470	-300	-300	Net Purchase of Invest.	4,558	7,300	-470	-300	-300
Net Cash from Invest.	-6,332	-13,290	-16,510	-11,060	-18,300	Net Cash from Invest.	-6,332	-13,290	-16,510	-11,060	-18,300
Proceeds from Equity & oth	6,010	11,840	1,060	749	942	Proceeds from Equity & oth	6,010	11,840	1,060	749	942
Proceeds from LTB/STB	0	0	0	0	0	Proceeds from LTB/STB	0	0	0	0	0
Dividend Payments	-14,120	-7,510	-22,250	-24,039	-21,258	Dividend Payments	-14,120	-7,510	-22,250	-24,039	-21,258
Cash Flow from Fin.	-8,110	4,330	-21,190	-23,291	-20,317	Cash Flow from Fin.	-8,110	4,330	-21,190	-23,291	-20,317
Net Cash Flow	18,535	24,420	10,790	27,808	34,704	Net Cash Flow	18,535	24,420	10,790	27,808	34,704
Opening Cash Balance	15,755	34,290	58,710	69,500	97,308	Opening Cash Balance	15,755	34,290	58,710	69,500	97,308
Add: Net Cash	18,535	24,420	10,790	27,808	34,704	Add: Net Cash	18,535	24,420	10,790	27,808	34,704
Closing Cash Balance	34,290	58,710	69,500	97,308	132,012	Closing Cash Balance	34,290	58,710	69,500	97,308	132,012



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Disclosure of Interest Statement

Infosys Technologies

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|---|----|
| 1. Analyst ownership of the stock | No |
| 2. Group/Directors ownership of the stock | No |
| 3. Broking relationship with company covered | No |
| 4. Investment Banking relationship with company covered | No |

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