

## Company Flash

11 October 2007 | 9 pages

# Infosys Technologies (INFY.BO)

## Buy: Operationally Strong 2Q

- In-line 2Q FY08** — Revenue was US\$1,022m (vs. our estimate of US\$1,017m) and net profit Rs11bn (Rs10.9bn). The EBITDA margin surprised on the upside: a sharp ~250bp expansion was led by pricing increases. But higher tax rate resulted in in-line net profits.
- FY08 guidance raised** — Infosys raised its guidance again. Revenue guidance (US\$ terms) was raised to US\$4.16-4.17bn (+34.6-35% yoy) and EPS guidance was upped marginally to Rs79.5-79.9 (+~19% yoy).
- Strong pricing** — The pricing trend remains positive, up ~2% sequentially (on a blended basis). YoY, onsite pricing is up ~8% and offshore pricing +~7%.
- Volume growth muted again; hiring guidance raised** — Volume growth in 2Q was 7.7% qoq, lower than our estimate. Hiring was slow in the quarter at ~4,500 employees; management attributed this to delayed infrastructure ramp-up. Management raised its FY08 hiring guidance to ~30,000 (~1,500 from Philips acquisition) from ~26,500.
- Clarity on 2008 IT budgets the key** — Key investor concerns continue to be (1) INR appreciation and (2) clarity over 2008 IT budgets. Infosys' management indicated on CNBC that as of now they do not see any slowdown in IT spending. Clarity on IT budgets should emerge only over the next few months. Infosys trades at ~20x FY09E EPS.

<b>Buy/Low Risk</b>	<b>1L</b>
Price (11 Oct 07)	Rs1,978.55
Target price	Rs2,440.00
Expected share price return	23.3%
Expected dividend yield	0.8%
<b>Expected total return</b>	<b>24.1%</b>
Market Cap	Rs1,130,167M
	US\$28,875M

### Price Performance (RIC: INFY.BO, BB: INFO IN)



### Statistical Abstract

Year to	Net Profit	Diluted EPS	EPS growth	P/E	P/B	ROE	Yield
31 Mar	(RsM)	(Rs)	(%)	(x)	(x)	(%)	(%)
2006A	24,599	43.82	27.5	45.2	15.6	40.4	1.1
2007A	38,560	67.76	54.6	29.2	9.9	42.3	0.6
2008E	46,004	80.24	18.4	24.7	7.6	35.1	0.8
2009E	56,389	98.35	22.6	20.1	5.8	32.8	1.0
2010E	64,658	112.77	14.7	17.5	4.6	29.4	1.2

Source: Powered by dataCentral

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### Other key details

- Forward cover at the end of the quarter was US\$1.4bn (vs. US\$925m at the end of the previous quarter).
- Infosys has made 18,000 offers to campus engineers for next year.
- BFSI spend indicators do not indicate any slowdown as per Infosys's head of BFSI.
- Infosys BPO had a mixed quarter – revenue growth was slow at ~7% qoq at US\$53m but margins improved ~300bp qoq and attrition fell to ~35%.
- Philips BPO deal done in this quarter was the largest deal in the history of Infosys (revenue of ~US\$250m). Infosys also talked about another large (sub US\$100m) deal in the transportation space in Canada.
- Infosys management indicated that 12-14 large deals were in the pipeline, of which ~70% were US\$100m+ in size.

Figure 1. Key Financials (Rs mn)

	2Q07	1Q08	2Q08	QoQ	YoY
<b>Revenue (US\$ m)</b>	<b>746</b>	<b>928</b>	<b>1,022</b>	<b>10.1%</b>	<b>37.0%</b>
<b>Revenue</b>	<b>34,510</b>	<b>37,730</b>	<b>41,060</b>	<b>8.8%</b>	<b>19.0%</b>
Cost of revenue	18,330	21,690	22,310	2.9%	21.7%
Gross profit	16,180	16,040	18,750	16.9%	15.9%
Gross margin	46.9%	42.5%	45.7%	315bp	-122bp
Operating expenses	5,090	5,200	5,910	13.7%	16.1%
<b>EBITDA</b>	<b>11,090</b>	<b>10,840</b>	<b>12,840</b>	<b>18.5%</b>	<b>15.8%</b>
<b>EBITDA margin</b>	<b>32.1%</b>	<b>28.7%</b>	<b>31.3%</b>	<b>254bp</b>	<b>-86bp</b>
Depreciation and amortization	1,220	1,440	1,440	0.0%	18.0%
<b>EBIT</b>	<b>9,870</b>	<b>9,400</b>	<b>11,400</b>	<b>21.3%</b>	<b>15.5%</b>
<b>EBIT margin</b>	<b>28.6%</b>	<b>24.9%</b>	<b>27.8%</b>	<b>285bp</b>	<b>-84bp</b>
Other income	660	2,530	1,540	-39.1%	133.3%
Profit before tax	10,530	11,930	12,940	8.5%	22.9%
Income tax expense	1,230	1,140	1,940	70.2%	57.7%
Income from operations	9,300	10,790	11,000	1.9%	18.3%
Affiliates/Minority	-10	0	0	n.a	n.a
Net income - recurring	9,290	10,790	11,000	1.9%	18.4%
EO income/(loss)	0	0	0	n.a.	n.a.
Net profit	9,290	10,790	11,000	1.9%	18.4%
EPS - basic	16.75	18.89	19.26	1.9%	15.0%
EPS - fully diluted	16.36	18.82	19.19	2.0%	17.3%

Source: Company Reports

Figure 2. 3Q FY08 Guidance

Infosys 3Q08 guidance	Guidance		Implied growth	
	Lower	Upper	Lower	Upper
Revenue (Rs m)	42,380	42,580	3.2%	3.7%
Revenue (\$ m)	1,073	1,078	5.0%	5.5%
EPS - basic (Rs)	20.11	20.11	4.4%	4.4%

Source: Company Reports

Figure 3. FY08 Guidance Revision

Infosys FY08 guidance	Guidance		Guidance post 1Q08		Guidance revision		Guidance post 2Q08		Guidance revision	
	Lower	Upper	Lower	Upper	Lower	Upper	Lower	Upper	Lower	Upper
Revenue (Rs m)	170,380	173,080	162,380	164,330	-4.7%	-5.1%	165,880	166,480	2.2%	1.3%
Revenue (\$ m)	3,950	4,020	4,000	4,050	1.3%	0.7%	4,160	4,170	4.0%	3.0%
EPS - basic (Rs)	80.29	81.58	78.20	79.00	-2.6%	-3.2%	79.49	79.88	1.6%	1.1%
INR/USD assumption		43.10		40.58		-5.8%		39.50		-2.7%

Source: Company Reports

Figure 4. Performance vs. Guidance

Infosys - 2Q08	Actual	Guidance		Outperformance vs. guidance	
		Lower	Upper	Lower	Upper
Revenue (Rs m)	41060	39,520	39,930	3.9%	2.8%
Revenue (\$ m)	1022	974	984	4.9%	3.9%
EPS - basic (Rs)	19.26	18.88	18.88	2.0%	2.0%

Source: Company Reports

Figure 5. Performance vs. Expectation

Infosys - 2Q08	Actual	Expectations Citi	Outperformance Citi
Revenue (Rs m)	41,060	41,095	-0.1%
Revenue (\$ m)	1,022	1,017	0.5%
Net profit(Rs m)	11,000	10,876	1.1%
EPS - basic (Rs)	19.26	19.04	1.1%

Source: Company Reports, Citi Estimates

Figure 6. Key HR Metrics

	1Q07	2Q07	3Q07	4Q07	1Q08	2Q08
IT and BPO professionals	54,606	61,966	65,293	68,156	71,018	75,313
- Billable	48,438	53,873	58,073	61,917	63,895	66,743
- Banking Business Unit	1,817	1,809	1,967	2,053	2,053	2,053
- Trainees	4,351	6,284	5,253	4,186	5,070	6,517
Sales & support	3,803	4,184	4,039	4,085	4,953	5,188
<b>Total employees</b>	<b>58,409</b>	<b>66,150</b>	<b>69,332</b>	<b>72,241</b>	<b>75,971</b>	<b>80,501</b>
Gross addition	8,097	10,795	6,062	5,990	7,004	8,543
Net addition	5,694	7,741	3,282	2,809	3,730	4,530
Attrition % (TTM) - Infosys stand alone	11.9%	12.9%	13.5%	13.7%	13.7%	14.2%
<b>Utilization</b>						
- including trainees	71.1%	67.5%	67.5%	67.9%	70.5%	70.3%
- excluding trainees	76.1%	77.5%	75.8%	73.0%	73.9%	77.8%

Source: Company Reports

**Figure 7. Key Execution Metrics**

	1Q07	2Q07	3Q07	4Q07	1Q08	2Q08
<b>Infosys consolidated</b>						
Billed effort (person-months)	109,818	121,845	133,711	138,852	148,359	159,203
- Onsite	30,051	33,346	35,368	36,752	39,043	40,936
- Offshore	79,767	88,499	98,343	102,100	109,316	118,267
Billed effort distribution (%)						
- Onsite	27.4%	27.4%	26.5%	26.5%	26.3%	25.7%
- Offshore	72.6%	72.6%	73.5%	73.5%	73.7%	74.3%
Revenue distribution (%)						
- Onsite	50.5%	50.3%	49.2%	49.8%	49.7%	48.8%
- Offshore	49.5%	49.7%	50.8%	50.2%	50.3%	51.2%
<b>IT Services</b>						
Billed effort distribution (person-months)	90,198	100,292	107,679	111,587	119,322	128,457
- Onsite	29,861	33,146	35,175	36,584	38,882	40,740
- Offshore	60,337	67,146	72,504	75,003	80,440	87,717
Billed effort distribution (%)						
- Onsite	33.1%	33.0%	32.7%	32.8%	32.6%	31.7%
- Offshore	66.9%	67.0%	67.3%	67.2%	67.4%	68.3%
Revenue distribution (%)						
- Onsite	54.4%	54.4%	54.0%	54.3%	54.1%	53.2%
- Offshore	45.6%	45.6%	46.0%	45.7%	45.9%	46.8%

Source: Company Reports

**Figure 8. Revenue Mix**

	1Q07	2Q07	3Q07	4Q07	1Q08	2Q08
<b>Geographic wise</b>						
North America	64.0%	63.7%	63.2%	62.6%	62.6%	62.6%
Europe	26.2%	25.8%	26.8%	26.6%	26.8%	27.4%
India	1.4%	1.6%	1.8%	1.5%	1.8%	1.0%
RoW	8.4%	8.9%	8.2%	9.3%	8.8%	9.0%
<b>Service line wise</b>						
Development	21.3%	21.4%	20.1%	21.3%	19.6%	20.2%
Maintenance	29.9%	29.2%	29.8%	28.4%	29.5%	27.9%
Re-engineering	2.6%	2.3%	2.1%	1.5%	2.0%	1.6%
Package implementation	16.5%	17.0%	17.9%	18.4%	18.4%	18.7%
Consulting	3.0%	3.6%	3.3%	4.3%	4.9%	5.0%
Testing	6.2%	6.8%	7.0%	7.3%	7.5%	7.8%
Engineering services	1.8%	1.6%	1.5%	1.6%	1.4%	1.6%
Business process management	4.2%	4.5%	4.9%	5.2%	5.4%	5.2%
Other services	10.8%	9.9%	9.1%	8.2%	8.1%	8.3%
Products	3.7%	3.7%	4.3%	3.8%	3.2%	3.7%
<b>Vertical wise</b>						
Insurance	7.0%	6.7%	7.6%	7.4%	7.0%	7.7%
Banking & FS	29.4%	30.7%	31.0%	29.6%	29.1%	28.8%
Manufacturing	14.5%	14.0%	12.8%	12.9%	13.6%	13.9%
Retail	9.7%	9.0%	10.5%	10.8%	10.8%	12.5%
Telecom	17.7%	18.9%	18.3%	21.9%	22.0%	20.6%
Energy & Utilities	5.4%	5.6%	5.4%	4.8%	4.9%	5.3%
Transportation & Logistics	3.3%	2.7%	2.0%	1.8%	2.3%	2.3%
Services	8.7%	7.7%	8.3%	7.9%	7.6%	7.7%
Others	4.3%	4.7%	4.1%	2.9%	2.7%	1.2%

Source: Company Reports

**Figure 9. Key Client Metrics**

	1Q07	2Q07	3Q07	4Q07	1Q08	2Q08
Active Clients	469	476	488	500	509	520
Added during the quarter	38	45	43	34	35	48
No. of million dollar clients	221	232	256	275	285	295
No. of 5mn+ dollar clients	94	97	108	107	113	122
No. of 10mn+ dollar clients	56	61	67	71	75	77
No. of 20mn+ dollar clients	28	29	35	36	40	44
No. of 30mn+ dollar clients	19	20	22	25	26	30
No. of 30mn+ dollar clients	19	20	22	25	26	30
No. of 40mn+ dollar clients	15	16	17	16	18	22
No. of 70mn+ dollar clients	7	8	10	11	11	11
No. of 90mn+ dollar clients	3	3	4	4	8	9
Clients accounting for > 5% of revenue	1	1	1	1	1	1
Revenue - top client	5.8%	6.6%	6.9%	8.5%	8.6%	7.9%
Revenue - top 5 client	19.5%	21.0%	18.9%	21.3%	21.4%	19.5%
Revenue - top 10 client	31.7%	32.9%	31.0%	33.4%	32.3%	29.9%
Repeat Business	0.97	0.952	0.947	0.933	0.995	0.977
DSO - TTM (in days)	65	65	63	64	62	61

Source: Company Reports

## Infosys Technologies

### Company description

Infosys is the second-largest IT services company in India with more than 66,000 professionals. It is also among the fastest-growing IT services organization in the world, and is a leader in the offshore services space. Infosys provides business consulting, application development and maintenance and engineering services to more than 475 active clients across verticals such as Banking, Financial Services, Insurance, Retail, Manufacturing, and Utilities in the Americas, Europe and Asia Pacific. Infosys sells a core banking application, Finacle, which is used by leading banks in India, the Middle East, Africa and Europe. Its subsidiary, Infosys BPO (formerly Progeon), which employs more than 11,000 people, is a provider of BPO services. It launched a subsidiary in April 2004, Infosys Consulting, which provides high-end IT consulting services.

### Investment strategy

We rate Infosys as Buy/Low Risk (1L). We are positive on the stock from a fundamental 12-month view. Offshore IT outsourcing has now become a mainstream option, and we think scale and scalability, along with an ability to move up the value chain, are key criteria for successful offshore IT vendors. In this respect, Infosys appears well positioned and continues to gain ground given its strong branding and industry-leading sales force. Infosys should see above-industry average volume growth along with modest pricing improvement. We expect Infosys to deliver revenue CAGR of 24.5% and EPS CAGR of 19.1% for FY07-10. Unlike many other high-growth firms in other industries, Infosys continues to generate solid FCF, and its RoE of 40%+ continues to be well above its cost of capital.

## Valuation

Our target price of Rs2,440 is based on 25x FY09E EPS. This is close to the midpoint of the last one-year trading band of 20-28x 1-year forward earnings and factors in some deceleration in growth. We are now forecasting 19% earnings growth (on a high base of FY07) with some upside potential from pricing improvement and/or rupee depreciation. This is also supported by comparing it with global peers and the broader Indian market. The 25x multiple was also derived from a P/E band analysis of Infosys' trading pattern. During slowdowns in tech and offshore IT services, Infosys has traded at an average one-year rolling P/E of 25.1x with a low of 13x. Our estimates continue to assume a certain P/E premium to the market; this is justified, in our view, given the strong FCF, ROIC and growth rates for Infosys vs. the overall market. We believe P/E remains the most appropriate valuation measure given Infosys' profitable record and high earnings visibility.

## Risks

We rate Infosys shares as Low Risk, which is consistent with our quantitative risk-rating system that tracks historical share price volatility. The key downside risks to the shares reaching our target price include: (1) any significant appreciation of the rupee against the US dollar/euro/pound; (2) pressure on billing rates (as Infosys continues to enjoy a 10-15% premium in its billing rates); (3) a sharp slowdown in the US economy; and (4) limited H1B visa quotas.

# Appendix A-1

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Analyst: Surendra Goyal, CFA (covered since October 5 2006)



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