

Company Flash

11 July 2007 | 9 pages

Infosys Technologies (INFY.BO)

1Q FY08: Numbers In Line; Revenue Guidance Slightly Lower

- In-line 1Q FY08** — Revenue of US\$928m (up 7.5% qoq) and EBITDA of Rs10.8bn (margins down ~300bp) were in line with expectations. Higher other income (driven by better forex gains and higher cash yields) and tax write-backs saw net profit at Rs10.8bn — better than expectations.
- Victim of its own success?** — Guidance was not picture-perfect and, as usual, expectations were high. The US\$ revenue guidance was raised by ~1%; the Street expected ~3%. Management comments and our interaction with sector players indicate strength in demand. 2Q has been the strongest quarter for Indian IT services – only 2Q numbers can settle the debate on demand.
- Revenue productivity up 5%+ yoy** — Realization per employee was up 6.7% yoy at onsite and 5.3% qoq at offshore. In QoQ terms, it was 1%+. Management reiterated their view of 3-4% pricing increase for renegotiations. *Pricing would not have gone up without a strong demand environment.*
- BFSI (IT Services) growth at ~7% qoq** — There has been much concern about BFSI in the recent past. BFSI (excluding product) witnessed growth of ~7% — belying concerns of any major slowdown in the vertical.
- Remains a Buy/Low Risk; lacks near-term triggers** — Revenue growth in 2Q and rupee direction are the two key factors from a stock price performance point of view. We remain positive on demand for the sector, and Infosys once again demonstrated its ability to optimize costs (~450bp margin gains on account of efficiencies/realization).

Buy/Low Risk	1L
Price (11 Jul 07)	Rs1,951.80
Target price	Rs2,440.00
Expected share price return	25.0%
Expected dividend yield	0.8%
Expected total return	25.8%
Market Cap	Rs1,114,887M US\$27,696M

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	44.5	15.4	40.4	1.2
2007A	38,560	67.76	54.6	28.8	9.8	42.3	0.6
2008E	45,916	80.17	18.3	24.3	7.5	35.1	0.8
2009E	55,825	97.47	21.6	20.0	5.8	32.5	1.0
2010E	63,356	110.62	13.5	17.6	4.6	29.0	1.2

Source: Powered by dataCentral

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See Appendix A-1 for Analyst Certification and important disclosures.

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Key Highlights

- Infosys reported revenue of US\$928m (7.5% qoq) and EBITDA of Rs10.84bn — broadly in line with our expectations.
- EBITDA margin for the quarter declined 300bps, a net impact of headwinds — stronger INR (-3.5%), wage increases (-3.8%) and higher visa costs, mitigated to a certain extent by better utilization (+1.7%), better pricing, (+1.1%) smaller consulting losses, and scale benefits.
- Volume growth for the quarter was ~7% qoq; pricing was up 1.4% qoq at onsite and 1% qoq at offshore – indicating that underlying demand remains strong. We have seen pricing going up over the last 7-8 quarters – YoY increases in onsite pricing is 6.7% and offshore pricing is 5.3%.
- The company added 3730 employees during the quarter – Of this ~1,100 employees were in Progeon while the rest were in IT and consulting. Management talked about ramping up utilization from the present 73% levels and said they were comfortable with high 70s and low 80s levels.
- Utilization excluding trainees was up 0.9% qoq, while including trainees it was up 2.6% qoq.
- Other income came significantly higher, driven by better forex gains and higher yields on cash reserves. The company had a write-back of tax provisions amounting to Rs510m.
- The company revised its US\$ revenue guidance by 1% (vs. expectation of ~3-4%) while INR EPS guidance was revised by just negative 3% (vs. expectations of negative 5-6%) in spite of 6% appreciated rupee factored in the guidance.
- The company now expects an EBITDA margin decline of 100-200bps at new factored currency rate of Rs40.58/US\$ (vs. US\$43.1 previously). The new currency assumption is ~6% stronger than assumed at end-FY07.
- At the end of Jun'07, the company had a total forex hedge position of US\$975m – hedging net receivables for the next two quarters.
- The company added 35 new clients (net add of 9 clients) while US\$1mn+ clients were up by 10 qoq. The number of US\$80m clients doubled from 4 to 8.
- The company signed three US\$50m deals during the quarter. There are 6-8 other large deals in the pipeline.

Figure 1. Key Financials

Rs mn	1Q07	4Q07	1Q08	QoQ	YoY
Revenue (US\$ m)	660	863	928	7.5%	40.6%
Revenue	30,150	37,720	37,730	0.0%	25.1%
Cost of revenue	16,660	20,210	21,690	7.3%	30.2%
Gross profit	13,490	17,510	16,040	-8.4%	18.9%
Gross margin	44.7%	46.4%	42.5%	-391bp	-223bp
Operating expenses	4,600	5,540	5,200	-6.1%	13.0%
EBITDA	8,890	11,970	10,840	-9.4%	21.9%
EBITDA margin	29.5%	31.7%	28.7%	-300bp	-76bp
Depreciation and amortization	1,060	1,450	1,440	-0.7%	35.8%
EBIT	7,830	10,520	9,400	-10.6%	20.1%
EBIT margin	26.0%	27.9%	24.9%	-298bp	-106bp
Other income	1,280	1,190	2,530	112.6%	97.7%
Profit before tax	9,080	11,720	11,930	1.8%	31.4%
Income tax expense	1,060	1,520	1,140	-25.0%	7.5%
Income from operations	8,020	10,200	10,790	5.8%	34.5%
Affiliates/Minority	-20	1,240	0	-100.0%	-100.0%
Net income - recurring	7,940	10,190	10,790	5.9%	35.9%
EO income/(loss)	60	1,250	0	n.a.	n.a.
Net profit	8,000	11,440	10,790	-5.7%	34.9%
EPS - basic	14.36	18.11	18.89	4.3%	31.5%
EPS - fully diluted	14.03	17.79	18.82	5.8%	34.2%

Source: Company Reports

Figure 2. Annual Guidance

Infosys FY08 guidance	Guidance		Revised guidance		Guidance revision	
	Lower	Upper	Lower	Upper	Lower	Upper
Revenue (Rs m)	170,380	173,080	162,380	164,330	-4.7%	-5.1%
Revenue (\$ m)	3,950	4,020	4,000	4,050	1.3%	0.7%
EPS (Rs)	80.29	81.58	78.20	79.00	-2.6%	-3.2%
INR/USD assumption		43.10		40.58		-5.8%

Source: Company Reports

Figure 3. Quarterly Guidance

Infosys 2Q08 guidance	Guidance		Implied growth	
	Lower	Upper	Lower	Upper
Revenue (Rs m)	39,520	39,930	4.7%	5.8%
Revenue (\$ m)	974	984	5.0%	6.0%
EPS (Rs)	18.88	18.88	-0.1%	-0.1%

Source: Company Reports

Figure 4. Key HR Metrics

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

Source: Company Reports

Figure 5. Key Execution Metrics

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

Source: Company Reports

Figure 6. Revenue Mix

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

Source: Company Reports

Figure 7. Key Client Metrics

	1Q07	2Q07	3Q07	4Q07	1Q08
Active Clients	469	476	488	500	509
Added during the quarter	38	45	43	34	35
No. of million dollar clients	221	232	256	275	285
No. of 5mn+ dollar clients	94	97	108	107	113
No. of 10mn+ dollar clients	56	61	67	71	75
No. of 20mn+ dollar clients	28	29	35	36	40
No. of 30mn+ dollar clients	19	20	22	25	26
No. of 40mn+ dollar clients	15	16	17	16	18
No. of 50mn+ dollar clients	11	12	11	12	13
No. of 70mn+ dollar clients	3	6	8	9	9
No. of 90mn+ dollar clients	2	3	2	4	4
Revenue - top client	5.8%	6.6%	6.9%	8.5%	8.6%
Revenue - top 5 client	19.5%	21.0%	18.9%	21.3%	21.4%
Revenue - top 10 client	31.7%	32.9%	31.0%	33.4%	32.3%
Repeat Business	97.0%	95.2%	94.7%	93.3%	99.5%
DSO - TTM (in days)	65	65	63	64	62

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 thesis

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 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

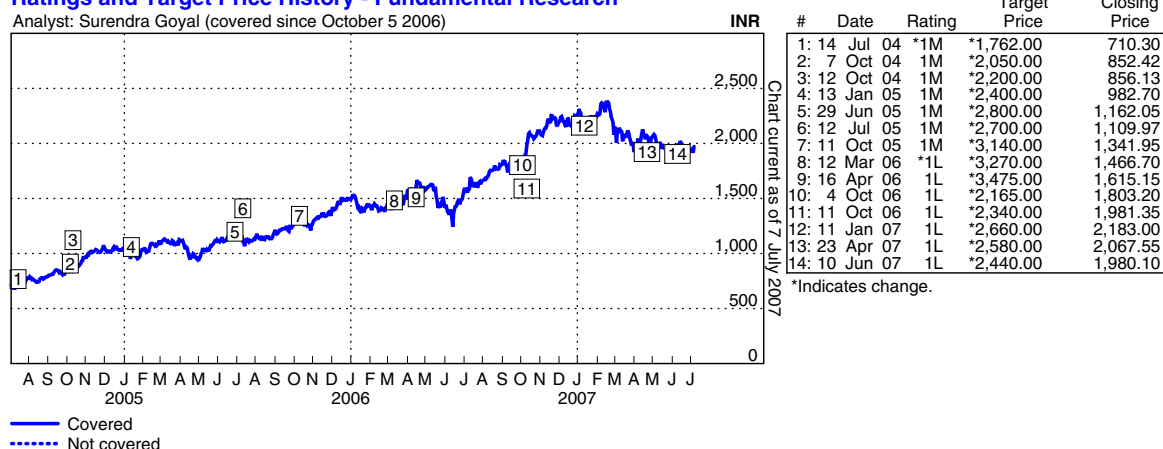
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Analyst: Surendra Goyal (covered since October 5 2006)



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