

## Company Flash

13 January 2009 | 10 pages

# Infosys Technologies (INFY.BO)

## Buy: Decent Q3; Challenging Outlook

- Better than expected Q3** — Revenues declined ~3.7% qoq to \$1,171m (CIR: \$1,167m). Volumes increased ~2% qoq while pricing declined ~1.8% (constant currency). Net profit came in at Rs16.4b (our exp: Rs15.2b) on account of better margins and a tax write back of Rs620m.
- Telecom, Top client and Europe decline largely explained by cross currency** — Sharp decline in telecom, top client and Europe can be explained by a single factor – cross currency. Assuming that bulk of revenues in Europe is in GBP/EUR, cross currency would have impacted \$-term revenues by ~12-17%. In constant currency terms, Europe/telecom would witness flat to some decline in revenues (much lower than headline numbers suggest).
- Guidance highlights challenging environment** — Infosys has guided to flattish to ~4% decline in Q4 revenues (QoQ). This highlights the challenging business environment, which remains our key concern on the sector. FY09 revenue guidance was lowered to 12-13% growth yoy (from 13-15%).
- Pricing - start of the downtrend?** — Pricing in constant currency terms was down ~1.5% onsite and ~0.2% offshore. We believe that this is the start of a downtrend – we are factoring in ~4-5% pricing decline in our FY10 estimates.
- Infosys remains our only Buy but today's up move caps near term upsides** — With a challenging demand outlook, today's up move could cap near term returns on the stock, in our view. Infosys ability to deliver superior margins should remain unparalleled. This, along with superior corporate governance, makes Infosys our only buy in the sector.

<b>Buy/Medium Risk</b>	<b>1M</b>
Price (13 Jan 09)	Rs1,220.00
Target price	Rs1,350.00
Expected share price return	10.7%
Expected dividend yield	2.5%
<b>Expected total return</b>	<b>13.1%</b>
Market Cap	Rs698,450M
	US\$14,365M

### 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)	(%)	(%)
2007A	38,560	67.76	54.6	18.0	6.1	42.3	0.9
2008A	46,590	81.26	19.9	15.0	5.1	37.2	2.7
2009E	57,888	100.93	24.2	12.1	3.9	36.6	2.5
2010E	59,518	103.77	2.8	11.8	3.2	29.8	2.5
2011E	60,320	105.17	1.3	11.6	2.7	25.0	2.6

Source: Powered by dataCentral

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

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## Other Key Points

- Net hiring was ~2,800 employees for Q3 (~3% of quarter-ago base). The company has hired ~14,500 employees over the last 12-months (~16% of base), indicating management's willingness to invest and be prepared for a recovery, whenever it happens. Management indicated that they were honoring commitments and general hiring was at a standstill.
- On the outlook for hiring, the company increased its annual target to ~27,000 new hires (gross). This implies that ~3,700 employees are expected to join in Q4.
- Pricing declined ~2% in constant currency terms. Management indicated that pricing is manageable (from "stable" in the earlier quarters) and Infosys is trying to get customers to link pricing to volumes.
- Margins increased by ~200bps QoQ – the positive impact was due to INR depreciation, lower SG&A (~180bp) partly offset by lower pricing, lower utilization and cross currency impact.
- All revenue breakups (vertical, service line, client data, geography etc.) were significantly impacted by the cross currency headwinds. Reported numbers (\$-terms) have been skewed significantly and may not provide meaningful comparisons qoq or yoy.
- In constant currency terms, BFSI was up ~4%, Manufacturing was down ~4%, retail was flat while telecom was down by ~2-3% (management commented that it was down by a couple of million dollars in constant currency terms).
- Amongst service lines, ADM and ERP/Consulting reported revenue declined ~4% each QoQ. Infrastructure Management saw ~10% QoQ growth while System Integration and Products saw ~10% and 12% QoQ growth on low bases.
- The company had forex loss of Rs2,180m (Q2: Rs1,260 loss) during the quarter. It has forex cover of \$576m as on 31 Dec'08.
- The tax provision had a reversal of Rs620m pertaining to earlier periods. Other income includes Rs330m received from Axon as inducement fees, offset partly by Rs150m for expenses towards the transaction.

## Key read through for the sector

- No change in demand environment – it remains challenging. Next quarter guidance implies challenging environment to continue.
- First signs of pricing pressure visible – Infosys has been able to manage pricing much better in the past.
- Other income has translation loss of \$16m (as against gain of \$24m in Q2). This is because of cross currency movements and hence the reported other income for sector peers could be lower than what forecasts are.

Figure 1. Key Financials

Rs m	3Q08	2Q09	3Q09	QoQ	YoY
Revenue (US\$m)	1,084	1,216	1,171	-3.7%	8.0%
<b>Revenue</b>	<b>42,710</b>	<b>54,180</b>	<b>57,860</b>	<b>6.8%</b>	<b>35.5%</b>
Cost of revenue	23,250	28,910	30,750	6.4%	32.3%
Gross profit	19,460	25,270	27,110	7.3%	39.3%
Gross margin	45.6%	46.6%	46.9%	21bp	129bp
Operating expenses	5,540	7,330	6,800	-7.2%	22.7%
<b>EBITDA</b>	<b>13,920</b>	<b>17,940</b>	<b>20,310</b>	<b>13.2%</b>	<b>45.9%</b>
<b>EBITDA margin</b>	<b>32.6%</b>	<b>33.1%</b>	<b>35.1%</b>	<b>199bp</b>	<b>251bp</b>
Depreciation & amortization	1,530	1,770	1,870	5.6%	22.2%
<b>EBIT</b>	<b>12,390</b>	<b>16,170</b>	<b>18,440</b>	<b>14.0%</b>	<b>48.8%</b>
<b>EBIT margin</b>	<b>29.0%</b>	<b>29.8%</b>	<b>31.9%</b>	<b>203bp</b>	<b>286bp</b>
Other income	1,580	660	380	-42.4%	-75.9%
Profit before tax	13,970	16,830	18,820	11.8%	34.7%
Income tax expense	1,660	2,510	2,410	-4.0%	45.2%
Income from operations	12,310	14,320	16,410	14.6%	33.3%
Affiliates/Minority	0	0	0	n.a.	n.a.
Net income - recurring	12,310	14,320	16,410	14.6%	33.3%
EO income/(loss)	0	0	0	n.a.	n.a.
<b>Net profit</b>	<b>12,310</b>	<b>14,320</b>	<b>16,410</b>	<b>14.6%</b>	<b>33.3%</b>
EPS - basic	21.54	25.02	28.66	14.6%	33.1%
EPS - fully diluted	21.47	24.97	28.62	14.6%	33.3%

Source: Company Reports

Figure 2. FY09 Guidance Revisions

	Guidance		Guidance post Q1		Guidance Revision		Guidance post Q2		Guidance Revision		Guidance post Q3		Guidance Revision	
	Lower	Upper	Lower	Upper	Lower	Upper	Lower	Upper	Lower	Upper	Lower	Upper	Lower	Upper
Revenue (Rs m)	198,940	202,140	212,780	216,220	7.0%	7.0%	213,090	217,310	0.1%	0.5%	215,520	217,570	1.1%	0.1%
Revenue (US\$ m)	4,970	5,050	4,970	5,050	0.0%	0.0%	4,720	4,810	-5.0%	-4.8%	4,670	4,710	-1.1%	-2.1%
EPS - basic (Rs)	92.32	93.92	99.34	101.06	7.6%	7.6%	101.06	101.06	1.7%	0.0%	102.92	102.92	1.8%	1.8%
INR/USD assumption	40.02		43.04		7.5%		46.97		9.1%		48.71		3.7%	

Source: Company Reports

Figure 3. Q4 Guidance

	Guidance		Implied growth	
	Lower	Upper	Lower	Upper
Revenue (Rs m)	54,940	56,990	-5.0%	-1.5%
Revenue (US\$ m)	1,128	1,170	-3.7%	-0.1%
EPS - basic (Rs)	26.49	26.49	-7.6%	-7.6%

Source: Company Reports

Figure 4. Key HR Metrics

	1Q08	2Q08	3Q08	4Q08	1Q09	2Q09	3Q09
IT and BPO professionals	71,018	75,313	83,011	85,013	87,816	93,624	95,910
- Billable	63,895	66,743	75,345	79,494	82,368	83,412	85,918
- Banking Business Unit	2,053	2,053	2,053	2,053	2,076	2,093	2,283
- Trainees	5,070	6,517	5,613	3,466	3,372	8,119	7,709
Sales & support	4,953	5,188	5,590	6,174	6,563	6,682	7,168
<b>Total employees</b>	<b>75,971</b>	<b>80,501</b>	<b>88,601</b>	<b>91,187</b>	<b>94,379</b>	<b>100,306</b>	<b>103,078</b>
Gross addition	7,004	8,543	11,683	5,947	7,182	10,117	5,997
Net addition	3,730	4,530	8,100	2,586	3,192	5,927	2,772
Attrition % (TTM) - Infosys SA	13.7%	14.2%	13.7%	13.4%	13.6%	12.8%	11.8%
<b>Utilization</b>							
- including trainees	70.5%	70.3%	69.4%	69.8%	68.9%	69.4%	68.5%
- excluding trainees	73.9%	77.8%	76.3%	75.4%	72.2%	73.7%	74.5%

Source: Company Reports

Figure 5. Key Execution Metrics

	1Q08	2Q08	3Q08	4Q08	1Q09	2Q09	3Q09
<b>Infosys consolidated</b>							
Billed effort (person-months)	148,359	159,203	167,381	180,478	183,604	194,073	198,932
- Onsite	39,043	40,936	42,190	44,220	44,680	46,526	46,012
- Offshore	109,316	118,267	125,191	136,258	138,924	147,547	152,920
Billed effort distribution (%)							
- Onsite	26.3%	25.7%	25.2%	24.5%	24.3%	24.0%	23.1%
- Offshore	73.7%	74.3%	74.8%	75.5%	75.7%	76.0%	76.9%
Revenue distribution (%)							
- Onsite	49.7%	48.8%	47.8%	47.5%	47.5%	47.3%	45.8%
- Offshore	50.3%	51.2%	52.2%	52.5%	52.5%	52.7%	54.2%
<b>IT Services</b>							
Billed effort distribution (person-months)	119,322	128,457	134,208	140,804	141,446	150,669	153,678
- Onsite	38,882	40,740	41,974	43,999	44,477	46,314	45,850
- Offshore	80,440	87,717	92,234	96,805	96,969	104,355	107,828
Billed effort distribution (%)							
- Onsite	32.6%	31.7%	31.3%	31.2%	31.4%	30.7%	29.8%
- Offshore	67.4%	68.3%	68.7%	68.8%	68.6%	69.3%	70.2%
Revenue distribution (%)							
- Onsite	54.1%	53.2%	52.6%	52.5%	52.7%	52.0%	50.6%
- Offshore	45.9%	46.8%	47.4%	47.5%	47.3%	48.0%	49.4%

Source: Company Reports

Figure 6. Revenue Mix

	1Q08	2Q08	3Q08	4Q08	1Q09	2Q09	3Q09
<b>Geographic wise</b>							
North America	62.6%	62.6%	62.3%	60.7%	62.6%	61.5%	64.5%
Europe	26.8%	27.4%	28.6%	29.3%	27.3%	28.1%	25.5%
India	1.8%	1.0%	1.2%	1.3%	1.3%	1.3%	1.2%
RoW	8.8%	9.0%	7.9%	8.7%	8.8%	9.1%	8.8%
<b>Service line wise</b>							
Application development	21.6%	21.8%	21.5%	21.8%	21.4%	20.6%	20.8%
Application maintenance	24.4%	22.4%	24.8%	23.4%	22.0%	22.1%	21.7%
BPO	5.4%	5.2%	5.9%	6.0%	6.3%	6.0%	5.7%
Consulting & PI	23.3%	23.6%	24.0%	24.1%	23.7%	25.3%	25.1%
Infrastructure Management	5.1%	5.5%	4.5%	4.6%	5.7%	5.9%	6.5%
Product Engg Services	1.4%	1.6%	1.7%	1.8%	2.2%	2.1%	2.1%
System Integration	2.9%	2.8%	2.7%	3.0%	3.1%	3.5%	4.0%
Testing Services	7.5%	7.8%	7.4%	7.2%	7.4%	7.0%	6.5%
Others	5.1%	5.6%	3.8%	4.4%	4.3%	3.9%	3.4%
Products	3.2%	3.7%	3.7%	3.7%	3.9%	3.6%	4.2%
<b>Vertical wise</b>							
Insurance	7.0%	7.7%	7.3%	7.0%	6.8%	6.9%	7.7%
Banking & FS	29.1%	28.8%	29.5%	26.9%	27.7%	26.5%	27.2%
Manufacturing	13.6%	13.9%	14.6%	16.4%	18.4%	20.1%	19.6%
Retail	10.8%	12.5%	12.0%	11.9%	12.2%	12.1%	12.6%
Telecom	22.0%	20.6%	21.1%	22.5%	19.7%	19.0%	16.7%
Energy & Utilities	4.9%	5.3%	5.2%	5.2%	5.4%	5.5%	6.2%
Transportation & Logistics	2.3%	2.3%	2.4%	2.8%	2.4%	2.3%	2.2%
Services	7.6%	7.7%	6.0%	5.5%	5.5%	5.1%	5.4%
Others	2.7%	1.2%	1.9%	1.8%	1.9%	2.5%	2.4%

Source: Company Reports

**Figure 7. Key Client Metrics**

	1Q08	2Q08	3Q08	4Q08	1Q09	2Q09	3Q09
Active Clients	509	520	530	538	567	586	583
Added during the period	35	48	47	40	49	40	30
No. of million dollar clients	285	295	305	310	325	325	323
No. of 5mn+ dollar clients	113	122	128	141	146	151	150
No. of 10mn+ dollar clients	75	77	81	89	91	94	102
No. of 20mn+ dollar clients	40	44	45	47	53	56	58
No. of 30mn+ dollar clients	26	30	30	32	33	34	37
No. of 50mn+ dollar clients	13	16	17	18	18	20	20
No. of 70mn+ dollar clients	9	9	12	12	12	12	13
No. of 100mn+ dollar clients	3	3	4	6	6	5	4
No. of 200mn+ dollar clients	1	1	1	1	1	1	1
Clients > 5% of revenue	1	1	1	1	1	1	1
Revenue - top client	8.6%	7.9%	9.5%	10.3%	7.9%	7.6%	6.2%
Revenue - top 5 client	21.4%	19.5%	21.6%	22.0%	19.9%	18.6%	17.3%
Revenue - top 10 client	32.3%	29.9%	32.5%	32.0%	30.1%	28.0%	27.2%
Repeat Business	99.5%	97.7%	96.3%	95.0%	99.6%	99.8%	97.1%
DSO - TTM (in days)	62	61	60	72	69	60	62

Source: Company Reports

## Infosys Technologies

### Company description

Infosys is the second-largest Indian IT services company with more than 100,000 professionals, and is a leader in the offshore services space. Infosys provides business consulting, application development & maintenance and engineering services to ~600 active clients across verticals such as Banking, Financial Services, Insurance, Retail, Manufacturing and Utilities in the Americas, Europe and Asia Pacific. Infosys also sells a core banking application, Finacle, which is used by leading banks in India, Middle East, Africa and Europe. Its subsidiary, Infosys BPO, which employs more than 17,000 people, is a provider of BPO services.

### Investment strategy

We rate Infosys shares as Buy / Medium Risk (1M). We are positive on the fundamentals of the company. Offshore IT outsourcing has now become a mainstream option, and we think that scale and scalability, along with an ability to move up the value chain, are key criteria for successful offshore vendors. In this respect, Infosys appears well positioned and continues to gain ground given its strong branding and industry-leading sales force. We expect Infosys to deliver revenue CAGR of ~9% (US\$ terms) and earnings CAGR of ~9% for FY08-11E. Unlike many other high-growth firms in other industries, Infosys continues to generate solid FCF and its RoE of 30%+ continues to be well above its cost of capital.

### Valuation

Our target price of Rs1,350 is based on 13x FY10E EPS. This is close to the lower end of the last three-year trading band of 11-30x 12-month forward earnings and factors in some deceleration in growth. Our estimates continue to assume a certain P/E premium to the market; this is justified, in our view, given the strong FCF and ROIC for Infosys vs. the overall market. We believe P/E remains the most appropriate valuation measure given Infosys' profitability record and higher earnings visibility.

### Risks

Although our quantitative risk-rating system suggests High Risk, we rate Infosys shares as Medium Risk given the superior branding, management quality and cost optimization abilities. The key downside risks are: (1) any significant appreciation of the rupee against the USD/EUR/GBP; (2) pressure on billing rates (as Infosys still continues to enjoy a 10-15% premium in its billing rates); (3) a prolonged slowdown in the US economy; and (4) limited H1B visas. Any of these risk factors could impede the shares from reaching our target price.

# Appendix A-1

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Analyst: Surendra Goyal, CFA  
Covered since October 5 2006

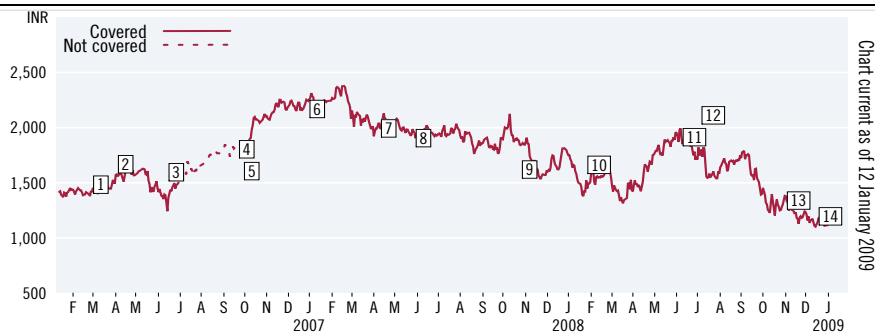


Chart current as of 12 January 2009

Date	Rating	Target Price	Closing Price
1 13-Mar-06	*1L	*1,635.00	1,466.70
2 17-Apr-06	1L	*1,737.50	1,615.15
3 27-Jun-06	Coverage suspended		
4 4-Oct-06	1L	*2,165.00	1,803.20
5 11-Oct-06	1L	*2,340.00	1,981.35

Date	Rating	Target Price	Closing Price
6 11-Jan-07	1L	*2,660.00	2,183.00
7 23-Apr-07	1L	*2,580.00	2,067.55
8 10-Jun-07	1L	*2,440.00	1,951.05
9 7-Nov-07	1L	*2,190.00	1,743.85
10 13-Feb-08	*1M	*2,060.00	1,549.15

Date	Rating	Target Price	Closing Price
11 26-Jun-08	1M	*2,175.00	1,781.85
12 23-Jul-08	1M	*1,910.00	1,603.70
13 20-Nov-08	1M	*1,420.00	1,127.25
14 4-Jan-09	1M	*1,350.00	1,130.95

\* Indicates change

Rating/target price changes above reflect Eastern Standard Time

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