

Company Focus

17 September 2008 | 11 pages

Info Edge (INED.BO)

Downgrade to Hold: Slowing Non-IT Sectors Put Estimates at Risk

Change in opinion ✓
Rating change ✓
Target price change ✓
Estimate change ✓

- **Downgrading to Hold (2L) and cutting TP to Rs860** — With the Indian economy continuing to slow, which is weakening recruiting demand from non-IT sectors (~65% of revs), we believe that it will be increasingly challenging for Info Edge to meet Street FY09E (we are modeling well below the Street). Accordingly, until Street estimates are reduced, we adopt a more cautious stance: Downgrade to Hold (2L), trim 2QFY09E-FY11E, and cut our TP to Rs860.
- **Slowing Indian economy sapping growth from key non-IT sectors** — Naukri is the primary rev/earnings driver, and non-IT related industries account for ~65% of demand. Through the first 6 months of CY08, demand from non-IT sectors has been strong, helping to offset slowing IT Services demand. However, we believe that as the Indian economy has continued to slow, demand from non-IT has slowed significantly, putting estimates at risk.
- **IT sector rebound likely pushed-out** — As is well known, the Indian IT Services sector, contrary to its optimism in FYQ1, was much more cautious about its near-term outlook in the most recent quarter. This naturally is a concern for Info Edge, which generates ~27% of revs from this sector. That said, we believe that Naukri continues to dominate the landscape, and that any slowing in growth is purely macro-related, with no slippage seen vs. the competition.
- **Street too high; trimming our estimates as well** — We believe the Street is currently too high for the current quarter/fully year/next year. Although we were previously below the Street, we trim our current & next year revs estimates (but keep FY09E earnings unchanged, reflecting leverage in the model).

Hold/Low Risk	2L
<i>from Buy/Low Risk</i>	
Price (16 Sep 08)	Rs780.05
Target price	Rs860.00
<i>from Rs1,000.00</i>	
Expected share price return	10.2%
Expected dividend yield	0.2%
Expected total return	10.4%
Market Cap	Rs21,292M
	US\$455M

Price Performance (RIC: INED.BO, BB: INFOE IN)



Statistical Abstract

Year to	Net Profit	Diluted EPS	EPS growth	P/E	P/B	ROE	Yield
31 Mar	(RsM)	(Rs)	(%)	(x)	(x)	(%)	(%)
2007A	276	11.53	80.8	67.7	8.7	23.2	0.1
2008A	573	21.03	82.5	37.1	7.9	23.8	0.2
2009E	648	23.72	12.8	32.9	6.5	21.8	0.2
2010E	776	28.44	19.9	27.4	5.3	21.4	0.2
2011E	1,058	38.76	36.3	20.1	4.3	23.8	0.5

Source: Powered by dataCentral

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

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¹Citigroup Global Markets Asia

Fiscal year end 31-Mar	2007	2008	2009E	2010E	2011E
Valuation Ratios					
P/E adjusted (x)	67.7	37.1	32.9	27.4	20.1
EV/EBITDA adjusted (x)	54.2	29.1	20.1	15.0	9.6
P/BV (x)	8.7	7.9	6.5	5.3	4.3
Dividend yield (%)	0.1	0.2	0.2	0.2	0.5
Per Share Data (Rs)					
EPS adjusted	11.53	21.03	23.72	28.44	38.76
EPS reported	11.31	20.33	23.17	28.04	38.23
BVPS	89.19	98.34	119.89	146.23	179.93
DPS	0.75	1.34	1.29	1.45	3.88
Profit & Loss (RsM)					
Net sales	1,396	2,189	2,764	3,615	4,819
Operating expenses	-1,077	-1,610	-1,963	-2,622	-3,362
EBIT	319	579	801	993	1,457
Net interest expense	0	0	0	0	0
Non-operating/exceptionals	76	207	141	149	100
Pre-tax profit	395	786	942	1,142	1,557
Tax	-124	-231	-309	-377	-514
Extraord./Min.Int./Pref.div.	0	0	0	0	0
Reported net income	271	554	632	765	1,043
Adjusted earnings	276	573	648	776	1,058
Adjusted EBITDA	365	634	894	1,151	1,682
Growth Rates (%)					
Sales	69.4	56.9	26.2	30.8	33.3
EBIT adjusted	61.2	81.4	38.3	24.0	46.7
EBITDA adjusted	62.0	73.7	40.8	28.8	46.1
EPS adjusted	80.8	82.5	12.8	19.9	36.3
Cash Flow (RsM)					
Operating cash flow	520	850	733	1,191	1,481
Depreciation/amortization	46	56	93	158	225
Net working capital	185	158	-213	-80	-200
Investing cash flow	-2,047	-592	-142	-140	-189
Capital expenditure	-54	-326	-276	-289	-289
Acquisitions/disposals	0	2	0	0	0
Financing cash flow	1,621	-24	-43	-41	-46
Borrowings	2	1	0	0	0
Dividends paid	-19	-24	-43	-41	-46
Change in cash	94	235	547	1,010	1,246
Balance Sheet (RsM)					
Total assets	2,842	3,707	4,433	5,516	6,915
Cash & cash equivalent	415	486	987	1,877	3,123
Accounts receivable	23	36	44	58	77
Net fixed assets	104	382	565	696	761
Total liabilities	708	1,025	1,161	1,524	2,004
Accounts payable	664	976	1,113	1,472	1,874
Total Debt	4	4	4	4	4
Shareholders' funds	2,135	2,682	3,273	3,992	4,912
Profitability/Solvency Ratios (%)					
EBITDA margin adjusted	26.2	29.0	32.3	31.8	34.9
ROE adjusted	23.2	23.8	21.8	21.4	23.8
ROIC adjusted	na	na	na	na	na
Net debt to equity	-19.3	-17.9	-30.0	-46.9	-63.5
Total debt to capital	0.2	0.2	0.1	0.1	0.1

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Slowing Non-IT Sectors Put Estimates at Risk

CY1H demand was largely supported by non-IT Sectors...

Due to recent strength from non-IT sectors, Info Edge's exposure to the IT Services industry continues to decline, representing 27% of total revs in 1Q09, compared with 30% in FY08.

Recall that on the FY1Q conference call, Info Edge management maintained a cautious tone regarding near-term demand due to growing uncertainty in demand from both IT and non-IT services sectors, with the latter having sustained robust growth previously in the year. Regarding the later, Naukri enjoyed strong demand in CY1H from non-IT (65% of revs), especially the broadly defined infrastructure sector (oil & gas, real estate, construction, etc.).

Despite increasing uncertainty, the company maintained their FY09 revenue YoY growth guidance of 35-50%, but noted that they may look to revisit this guidance depending on how 2Q performs. At this point, although most key metrics (traffic, resumes/number of users, market share, etc) remain very strong, we believe the deceleration in the demand environment is such that the company will like grow only in the low 20% YoY in the current quarter.

... But this demand has slowed in the most recent quarter, putting estimates at risk

Unfortunately, non-IT sector demand, which help support overall growth the past 2 quarters, is slowing as the Indian economy weakens

Our call today is that since that conference call, demand from non-IT services sectors has weakened as the Indian economy has continued to slow. As a result, we believe it will be challenging for the company to meet the upper-end of its guidance, and that current Street estimates are likely to prove to be high. Accordingly, we expect that Street estimates will have to come down, which, coupled with slowing demand, is an obvious negative for the stock.

We see continued uncertainty for India IT Services industry

We believe that IT companies appear to be more cautious regarding expansion, in part reflecting the more issues in June such as rising oil prices, inflation and political instability.

The worst fears seem to be coming true for the Indian IT Services sector

According to CIR's India IT Services Analyst Surendra Goyal, despite most Indian IT Services companies expecting a reacceleration in growth in 2QFY09, the near- to medium-term outlook for the Indian IT Services sector appears to be more difficult than previously expected, with a more challenging macro environment leading to delays in decision making and pricing pressures. If the deterioration persists, FY10 budgets could be decided in this more difficult context. For more, see *Indian IT Services: Worst Fears Coming True; What Do Trough Valuations Suggest?*,

<https://www.citigroupgeo.com/pdf/SAP20247.pdf>

Relatively speaking, larger companies (e.g. Infosys, TCS) are expected to weather the difficulty better as they are able to gain market share.

2Q India IT Services hiring trends remain weak

While hiring demand from IT Services sector also continues to soften

Info Edge's observations of more cautious expansion plans by IT Services companies have also been echoed by Goyal. According to his checks, the major IT Services companies have moderated hiring.

Although our FY09 estimates are unchanged, we are cutting our FY10E, our rating to Hold, and trimming our TP to Rs860

Specifically, Tier 1 IT Services company hiring demand is slowing down with most companies deferring campus recruits joining dates (except Infosys). In engineering campuses, offers made are down 20-30% YoY, with most companies talking about using "just in time hiring" as and when visibility is better. Tier II IT Services hiring plans are even worse...

Downgrade to Hold; Reducing target price to Rs860

We are lowering our TP to Rs860 from Rs1,000, and cutting our rating to Hold (2L). Our new TP is based on an FY10E P/E of 30x (which is unchanged), off our new lower FY10 earnings estimates (see below).

FY09 revenue estimates cut

Having significantly reduced our estimates on 25 July, we are currently modeling materially below the Street.

Specifically, for 2QFY09E, Citi/Street revs are Rs636m/Rs722m & net profit is Rs131m/Street Rs158m.

For 3QFY09, Citi/Street revs are Rs684m/Rs791m & net profit of Rs157m/Rs189m.

For FY09, Citi/Street revs are Rs2,764m/Rs3,038m & net profit of Rs632m/Rs694m

Significantly, at this point, we believe our estimates are conservative enough (at least for the next 2 quarters), and hence our estimates are unchanged.

Trimming FY10 estimates further

In an attempt to keep ahead of the slowing demand, which we expect will soften further into the next fiscal year, we are proactively trimming our FY2010E, which were already below the Street.

Specifically, we are cutting our revenue estimates from Rs4053m (+37.1%) to Rs3,615m (+30.8% YoY) and our net profit goes from Rs900m (+42% YoY) to Rs765m (+21.0% YoY).

The Street is currently at Rs4241m and Rs998m, respectively.

Figure 1. Info Edge – Earnings Estimates Changes

	Revenues (Rs Mils.)			Proforma FD EPS (Rs)			Net Profit (Rs Mils.)	
	Old	New	% Chg	Old	New	% Chg	Old	New
FY09E	2,937	2,764	-5.9%	23.41	23.72	1.3%	630	632
FY10E	3,961	3,615	-8.7%	32.98	28.44	-13.8%	888	765
FY11E	6,898	4,819	-30.1%	44.82	38.76	-13.5%	1,207	1,043

Source: CIR Estimates

Figure 2. Info Edge – Consolidated Income Statement (Rs in Millions)

Year to 31 Mar	FY07	1Q	2Q	3Q	4Q	FY08	1Q	2QE	3QE	4QE	FY09E	FY10E	FY11E
Recruitment services	1,277	423	468	488	582	1,964	558	562	600	716	2,435	3,144	4,150
Other verticals	119	43	58	60	68	225	73	74	84	97	328	471	669
Revenues	1,396	465	526	548	650	2,189	631	636	684	812	2,764	3,615	4,819
<i>YoY change</i>	<i>69.4%</i>	<i>66.7%</i>	<i>65.7%</i>	<i>51.0%</i>	<i>49.0%</i>	<i>56.9%</i>	<i>35.6%</i>	<i>20.9%</i>	<i>24.9%</i>	<i>25.0%</i>	<i>26.2%</i>	<i>30.8%</i>	<i>33.3%</i>
Cost of services (network and others)	58.99	13.38	15.63	14.15	17.37	60.53	19.33	19.71	20.53	21.12	80.69	106.68	144.57
Gross profit	1,337	452	510	534	633	2,129	612	616	664	791	2,683	3,508	4,674
Personnel expenses	487	158	170	198	201	727	240	227	226	227	920	1,190	1,484
Administrative and other costs	479	170	174	177	227	748	201	200	211	242	854	1,156	1,494
Advertising and promotion	300	111	108	108	154	481	121	123	129	153	526	712	940
Admin and others	179	59	66	69	73	267	80	78	82	89	329	444	554
Employees stock option plan comp	5	5	5	5	5	19	4	4	4	4	15	11	14
Total expenses	971	333	349	379	433	1,494	445	431	440	474	1,790	2,357	2,993
EBITDA	365	119	162	154	200	634	167	185	223	318	894	1,151	1,682
Depreciation & amortization	46	12	13	14	16	56	16	23	23	30	93	158	225
Operating profit	319	107	149	140	184	579	151	162	200	287	801	993	1,457
Other income	76	54	59	54	40	207	40	34	34	34	141	149	100
Interest and financial charges	(0)	(0)	(0)	(0)	(0)	(0)	(0)	-	-	-	(0)	-	-
Profit before tax	395	161	208	194	224	786	191	196	234	321	942	1,142	1,557
Tax	(124)	(44)	(56)	(63)	(68)	(231)	(62)	(65)	(77)	(106)	(309)	(377)	(514)
Net profit	271	116	151	131	156	554	130	131	157	215	632	765	1,043

Source: Company Reports and CIR Estimates

Figure 3. Relative Valuation Comparisons

Company	RIC	Rating	Price Crcy	Price 16 Sep 08	Market cap US\$m	P/E (x)			EV/EBITDA (x)			PEG
						07/FY08E	08/FY09E	09/FY10E	07/FY08E	08/FY09E	09/FY10E	
China Internet												
51job	JOBS.O	2M	USD	11.05	311	16.2	19.3	13.0	7.0	7.3	4.0	1.1
Alibaba	1688.HK	3M	HKD	8.70	5,421	36.9	26.8	23.4	45.0	33.0	24.9	0.8
Baidu	BIDU.O	1M	USD	266.49	9,084	100.9	58.7	36.4	89.2	43.6	24.6	1.0
Ctrip	CTRP.O	1L	USD	37.06	2,563	38.0	29.1	21.3	40.9	29.0	19.4	0.9
eLong	LONG.O	3M	USD	7.10	180	NM	NM	NM	NM	NM	1.4	0.1
Focus Media	FMCN.O	1L	USD	24.84	3,123	18.2	16.1	10.1	15.0	11.1	6.5	0.4
Global Sources	GSOL.O	2L	USD	11.05	516	15.1	17.4	12.8	12.4	7.6	5.1	0.8
Sina	SINA.O	1L	USD	37.75	2,094	33.9	22.4	17.6	27.7	19.3	11.9	0.6
Tencent	0700.HK	1L	HKD	56.05	12,708	59.4	36.7	28.4	50.6	25.6	19.9	0.9
Average						41.1	27.5	20.1	36.8	21.2	13.1	0.7
China Online Gaming												
Giant Interactive	GA.N	3H	USD	7.70	1,992	10.5	10.5	8.9	6.6	5.6	3.5	0.7
GigaMedia	GIGM.O	1M	USD	8.71	468	12.8	11.2	7.5	9.5	7.3	4.1	0.4
NetEase	NTES.O	1M	USD	22.24	2,701	15.8	13.1	13.3	12.4	6.8	5.7	1.5
Perfect World	PWRD.O	1M	USD	23.30	1,301	24.3	13.2	10.2	21.6	9.6	6.3	0.4
Shanda	SNDA.O	1L	USD	27.23	1,971	14.1	11.4	11.1	9.6	6.1	4.7	1.0
The9	NCTY.O	3H	USD	17.51	523	11.5	7.9	9.3	3.4	1.8	1.3	0.9
Average						15.5	11.9	10.2	11.9	7.1	4.9	0.8
India Internet												
Info Edge	INED.BO	2L	INR	780.05	455	37.1	32.9	27.4	32.8	22.2	14.4	0.9
Northgate Technologies	NOTC.BO	1M	INR	262.30	196	12.5	10.5	8.0	7.0	5.2	3.4	0.5
Korea Internet												
CJ Internet	037150.KQ	2H	KRW	12,300	242	10.8	9.5	9.2	2.5	2.0	1.5	0.8
NCSOft	036570.KS	1M	KRW	43,200	763	20.7	30.5	16.5	9.4	10.5	7.1	2.5
Neowiz Games	095660.KQ	1S	KRW	20,150	167	11.9	9.2	6.9	NA	3.6	2.5	NA
NHN	035420.KQ	3H	KRW	140,000	5,811	23.1	17.9	17.1	15.6	12.3	11.1	0.6
Average						16.6	16.8	12.4	9.1	7.1	5.6	1.3
US Internet												
Amazon	AMZN.O	1H	USD	78.73	33,533	70.1	52.7	41.1	36.0	26.4	19.5	1.7
eBay	EBAY.O	2H	USD	22.81	29,666	14.9	12.9	11.4	8.1	6.9	5.9	1.0
Expedia	EXPE.O	1H	USD	16.05	4,601	13.1	11.2	9.8	6.4	5.9	4.6	0.7
Google	GOOG.O	1H	USD	442.93	139,278	28.4	22.8	18.7	20.9	15.3	12.1	1.1
IAC/InterActive Corp	IACI.O	2H	USD	16.46	2,303	13.2	12.6	11.1	1.0	0.9	0.5	1.3
Monster	MNST.O	1H	USD	16.65	2,064	11.7	12.1	9.7	5.6	5.8	4.1	0.8
Orbitz	OWW.N	2S	USD	6.23	519	NM	NM	52.4	8.0	9.3	6.9	0.2
Priceline	PCLN.O	1H	USD	83.36	3,242	20.2	15.1	12.5	13.3	8.0	5.9	0.7
Yahoo	YHOO.O	2H	USD	19.26	26,690	40.8	46.6	37.8	18.1	17.5	13.6	7.2
Average						26.5	23.2	22.7	13.0	10.7	8.1	1.6

Source: Company Reports, Citi Investment Research estimates

Info Edge

Company description

Info Edge operates India's leading online recruitment and classifieds portal Naukri.com, which was launched in 1997. The company was incorporated in 1995. In addition to online recruitment, it generates revenue through an executive search agency named Quadrangle, as well as a matrimony portal (Jeevansathi.com) and a property portal (99acres.com). It also has a recently launched education portal, Shiksha.com. Info Edge has been listed on the Bombay Stock Exchange since November 2006.

Investment strategy

We rate Info Edge shares Hold/Low Risk (2L) with a target price of Rs860. Info Edge's naukri.com is India's leading online recruitment classifieds portal, a service that is well suited to the early stages of the India Internet market, in our view. We believe risk-reward is very favorable at current levels given the significant pull-back in share price that has already reflected concern over softening Indian IT Services demand and an expected improving growth outlook going into 2HFY09 and FY10.

Valuation

Our target price of Rs860 is based on 30x FY10E EPS (YE March), adjusted for ESOP costs. Our valuation base year is FY10, as we believe FY09 will be impacted by near-term demand uncertainty, which should be resolved by FY10. Our target multiple is in line with the implied target PEGs for regional peers and is off a 23% earnings CAGR over FY08-11E. We use a P/E-based valuation methodology as it is the most commonly used valuation method for high-growth Internet stocks.

Risks

Our quantitative risk-rating system, which tracks 260-day historical share price volatility, rates Info Edge Low Risk. Downside risks that could prevent the shares from reaching our target price include: 1) any slowdown in the US/global or domestic economy, especially in the IT Services sector, that would directly impact employment and recruiting demand; 2) increasing competition; and 3) greater and more prolonged losses from new verticals.

Upside risks include stronger-than-expected demand from the Indian IT Services industry, from a milder US slowdown than expected, as well as a more benign competitive landscape.

Appendix A-1

Analyst Certification

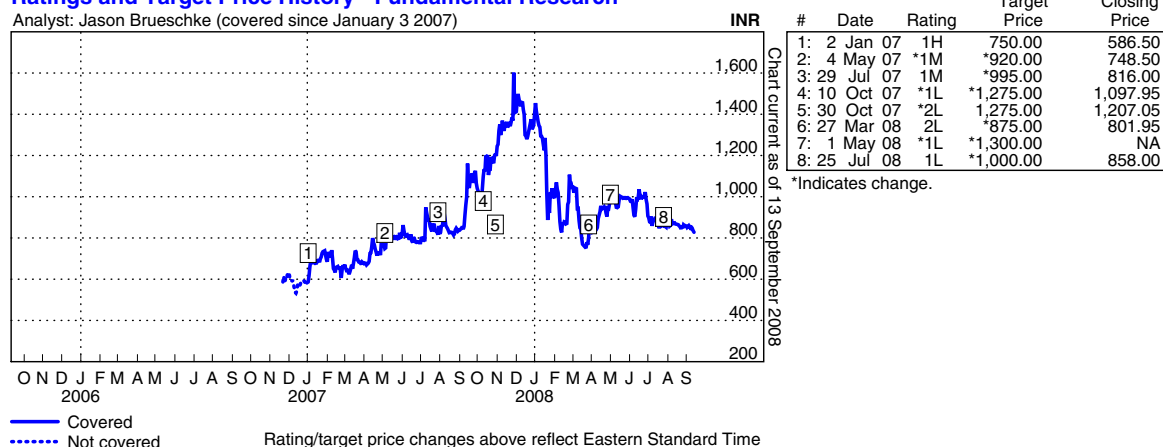
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Analyst: Jason Brueschke (covered since January 3 2007)



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