



Infosys Technologies

STOCK INFO.	BLOOMBERG
BSE SENSEX: 13,631	INFO IN
	REUTERS CODE
S&P CNX: 3,942	INFY.BO

11 January 2007

Buy

Previous Recommendation: Buy

Rs2,183

		YEAR	NET SALES	PAT*	EPS	EPS	P/E	P/BV	ROE	ROCE	EV/	EV/
		END	(RS M)	(RS M)	(RS)	GROWTH (%)	(X)	(X)	(%)	(%)	SALES	EBITDA
Equity Shares (m)	557.8	3/06A*	95,216	24,601	44.6	29.4	48.9	17.3	40.3	45.2	12.4	38.1
52-Week Range	2,401/1,225	3/07E*	140,348	37,567	67.3	50.7	32.4	11.9	43.6	49.3	8.4	26.2
1,6,12 Rel. Perf. (%)	-2/10/9	3/08E	186,543	48,787	87.4	29.9	25.0	8.6	40.0	45.5	6.1	19.6
M.Cap. (Rs b)	1,217.8											
M.Cap. (US\$ b)	27.3											

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

Volume growth remain strong; Re-US\$ rate plays spoilsport in 3QFY07: Infosys reported revenue growth of 5.9% versus expectation of 7% with a 3.8% appreciation in realized rupee-dollar rate. Volume growth remained robust at 9.7%; EBITDA margins improved 60bp due to greater revenue productivity, greater product license composition and reduction in SG&A expenses. Net profit growth lower at 5.8% (expectation of 7%) due to higher forex translation losses.

Likely 1%-2% rise in IT budgets with larger offshoring indicating strong volumes in FY08: Management is not witnessing slowdown in IT spending with upward bias in spending by 1%-2% in CY2007, with an increase in the allocation in favor of outsourcing and offshoring. This would keep volumes strong beyond FY07.

Realized rates on an uptick, pricing environment continues to improve: With likely increase in IT budgets and greater emphasis on offshoring, we expect the pricing environment to remain favorable in FY08. New clients are coming in at 3%-4% higher rates, while Infosys is witnessing rate hikes of 2%-3% with some existing clients (up from 1-2%).

Outlook and view: Following management's expectation of higher rupee appreciation in 4QFY07 as well as our expectation of decline in product license revenue growth, we have downgraded our FY07 EPS estimate to Rs67.3 from earlier estimate of Rs68.2. We have also built in more conservatism in our Rs/US\$ rate for FY08 and FY09 resulting into marginal downgrade in EPS to Rs87.4 and Rs103.6. Infosys trading at 25x FY08E and 21.1x FY09E, which does not offer room for upside based on FY08 valuation. But we believe Infosys is relatively better placed in terms of higher volume and earnings visibility ahead, hence we reiterate **Buy** for a price target of Rs2,590 based on 25x FY09E EPS.

QUARTERLY PERFORMANCE

(Rs Million)

Y/E MARCH	FY06				FY07				FY06	FY07E
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4QE		
Revenues	20,716	22,940	25,320	26,240	30,150	34,510	36,550	39,138	95,216	140,348
Q-o-Q Change (%)	4.2	10.7	10.4	3.6	14.9	14.5	5.9	7.1	33.5	47.4
Direct Expenses	11,044	12,120	13,270	14,220	16,660	18,330	19,380	20,736	50,654	75,106
Sales, General & Admin. Expenses	3,033	3,480	3,440	3,690	4,600	5,090	5,210	5,518	13,643	20,418
Operating Profit	6,638	7,340	8,610	8,330	8,890	11,090	11,960	12,883	30,918	44,823
Margins (%)	32.0	32.0	34.0	31.7	29.5	32.1	32.7	32.9	32.5	31.9
Other Income	286	440	-50	720	1,250	660	590	778	1,396	3,278
Depreciation	801	960	1,170	1,440	1,060	1,220	1,410	1,761	4,371	5,451
PBT bef. Extra-ordinary	6,123	6,820	7,390	7,610	9,080	10,530	11,140	11,900	27,943	42,650
Provision for Tax	802	690	830	810	1,060	1,230	1,300	1,392	3,132	4,982
Rate (%)	13.1	10.1	11.2	10.6	11.7	11.7	11.7	11.7	11.2	11.7
PAT bef. Minority	5,331	6,130	6,560	6,800	8,020	9,300	9,840	10,508	24,811	37,668
Minority Interest	-2	-60	-70	-70	-80	-10	-10	0	-210	-100
Extra-ordinary items	0	-10	0	0	60	0	0	0	-18	60
PAT aft. Minority and ext-ord	5,330	6,060	6,490	6,730	8,000	9,290	9,830	10,507	24,583	37,627
Q-o-Q Change (%)	3.8	13.7	7.1	3.7	18.9	16.1	5.8	6.9	33.1	53.1

E: M0St Estimates

Volumes remain strong; Re-US\$ rate plays spoilsport in 3QFY07

Infosys reported revenue growth of 5.9% to Rs36.5b, lower versus our expectation of Rs36.9b, with 3.8% appreciation in realized rupee-dollar rate impacting revenue realizations during the quarter. Inline with our expectation, volume growth remained strong at 9.7%, despite lower number of working days during the quarter, along with slight improvement in consolidated price realization of 0.3% QoQ. EBITDA margins were better than expected at 32.7% (our estimate: 32.3%) from 32.1% in 2QFY07, despite negative impact of 200bp of the rupee appreciation.

Greater revenue productivity, greater product license composition and reduction in SG&A expenses contributed to the improvement in EBIT margins by 80bp, 80bp and 50bp respectively. Net profit (before extra-ordinary items) was up 5.8% to Rs9.83b, lower than our expectation of Rs9.9b due to lower than expected other income, which was impacted by higher forex translation loss. Overall, 3QFY07 reported lackluster performance (despite strong operational growth) compared with the scorching growth in 1HFY07, primarily due to sharp rupee appreciation during the quarter.

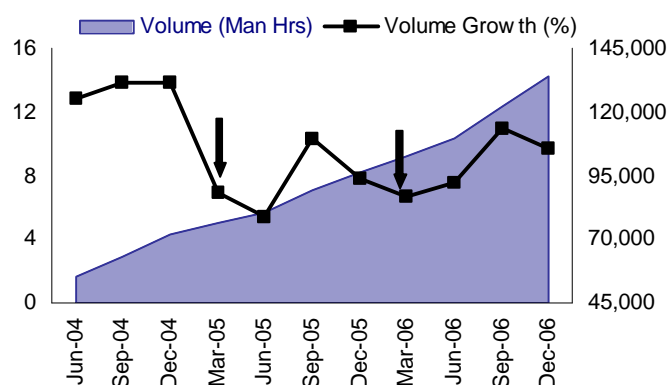
Likely 1%-2% rise in IT budgets will keep volumes strong in FY08

Management of Infosys has given guidance for 4.4%-4.6% revenue growth in dollar terms (3.5%-3.8% in rupee terms) in 4QFY07. We expect volume growth in 4QFY07 to slowdown to 8% (from 11% in 2QFY07, 9.7% in 3QFY07). However, we believe this not a concern since 4Q has historically been a slow quarter for Infosys.

Management is not witnessing slowdown in IT spending with upward bias in spending by 1-2% and with increase in allocation towards outsourcing and offshoring. We expect Infosys would be able to take advantage of the favorable trend towards offshoring given its position as a top-notch offshore IT vendor. With expansion of the service portfolio

as well as Europe expansion, Infosys' addressable pie has increased by 3%-4%, which we believe could result in higher wallet share with its existing as well as new clients. Therefore we expect robust volume growth to continue beyond FY07.

VOLUME GROWTH TREND REMAINS STRONG; 4Q SEASONALLY WEAK



Source: Company/ Motilal Oswal Securities

EMPLOYEE PROFILE (NOS)

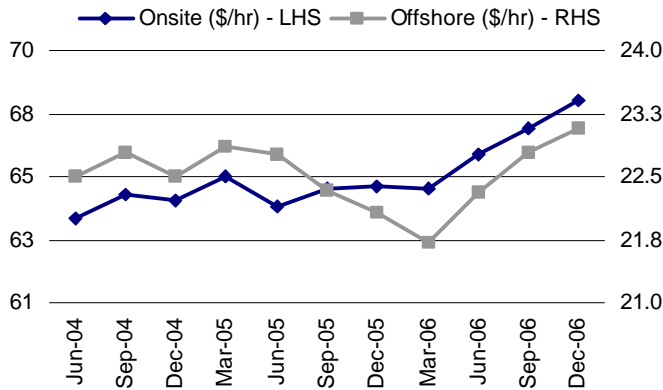
	SEP-05	DEC-05	MAR-06	JUN-06	SEP-06	DEC-06
Billable	38,541	39,494	42,604	48,438	53,873	58,073
Banking Prod.	1,351	1,677	1,863	1,817	1,809	1,967
Trainees	3,549	5,313	5,028	4,351	6,284	5,353
Total Software	43,441	46,484	49,495	54,606	61,966	65,393
Lateral addition	1,166	927	1,620	2,140	2,560	1,676
% of total Net add.	18.2	28.7	49.2	37.6	33.1	51.1
% of total Gross add.	14.5	18.1	31.3	26.4	23.7	27.6

Source: Company/ Motilal Oswal Securities

Realized rates on an uptick, pricing environment continues to improve

Pricing continues to improve, with new clients coming in at 3%-4% higher rates. The company is also renegotiating rates with some of its existing clients, and is currently witnessing rate hikes of 2%-3% (up from 1%-2% until a few months ago). With the anticipated increase in IT budgets and greater emphasis on offshoring, we expect the pricing environment to remain favorable for Indian offshore vendors in FY08, which will ease of the margin pressure due to wage inflation and continuing rupee appreciation.

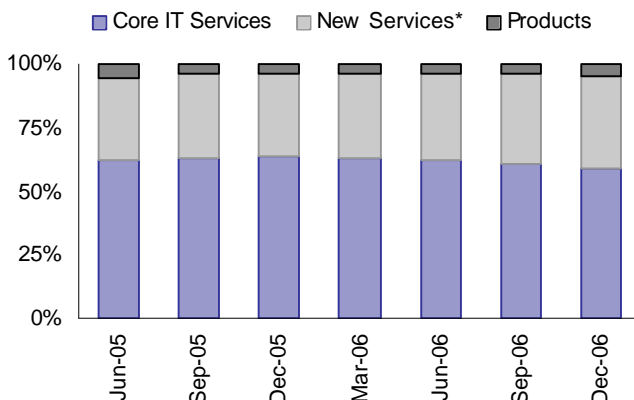
REALIZED BILLING RATES CONTINUE TO RISE



Source: Company/ Motilal Oswal Securities

Consolidated IT services onsite realizations improved by 1.9% QoQ while offshore realizations improved by 1.7% QoQ. Billing rate increase during the quarter is primarily due to higher growth in package implementation, higher growth in high margin Europe territory as well as higher contribution from fixed price projects. The share of new service lines increased to 33% (31.9% in the previous quarter), while product business grew by 23% QoQ to touch 4.3% of revenue (3.7% in the previous quarter). We expect new service lines to contribute a greater share to overall revenue over the next few quarters. On the products front, management expects growth to be in a broad band of 5%-20% over next few quarters.

NEW SERVICE LINES AND PRODUCTS CONTINUE TO GAIN SHARE



* Includes BPO, Testing, Consulting and Package Implementation
Source: Company/ Motilal Oswal Securities

Client transition rates impressive despite client churn in top 5 category

While the top client grew 10.72% QoQ to 6.9% of total revenue (up from 6.6% in 2QFY07), the top 2-5 clients declined 11.7% QoQ. This was due to the exit of a top client (with revenue >US\$90m) from the Top 5 list during the quarter. However, Infosys claims this as a quarterly aberration with an expectation of ramp up in future.

REVENUE GROWTH FROM CLIENTS



Source: Company/ Motilal Oswal Securities

Despite this, client transition rate has improved during the quarter largely at lower revenue brackets indicating further mining opportunity with increasing deal size.

CLIENT TRANSITION RATE (%)

	DEC-05	MAR-06	JUN-06	SEP-06	DEC-06
> US\$1m	10.3	7.4	8.5	8.5	9.1
> US\$5m	10.9	7.1	12.8	11.3	12.6
> US\$10m	20.9	14.8	18.8	20.1	19.7
> US\$20m	11.3	7.4	12.1	11.3	16.0
> US\$30m	9.7	7.9	8.1	7.5	9.2
> US\$40m	22.5	10.6	10.8	10.0	14.8
> US\$50m	8.0	23.7	13.4	12.5	3.1
> US\$60m	0.0	6.3	-4.0	0.0	3.7
> US\$70m	0.0	14.8	0.0	13.2	17.3
> US\$80m	6.4	0.0	0.0	0.0	0.0
> US\$90m	0.0	0.0	6.1	5.6	-5.5

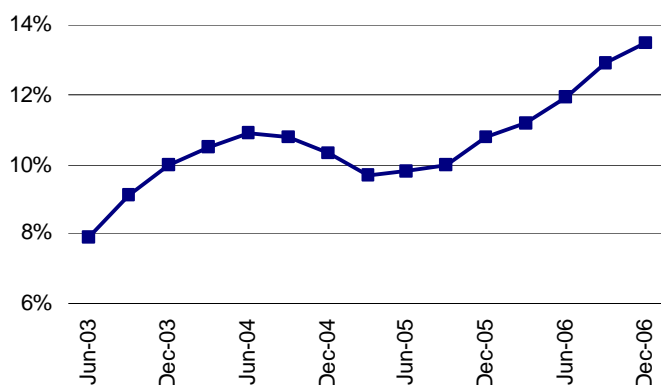
Source: Company/ Motilal Oswal Securities

Expect margins to improve in 4QFY07, FY08 could see pressure due to wage inflation and rupee appreciation

EBITDA margins have risen to 32.7% (our estimate: 32.3%) from 32.1% in 2QFY07. Productivity gains, better service mix, higher product license sales and reduction in G&A expenses have contributed to an improvement in margins by 60bp. Management expects 4QFY07 EPS growth at 1.5% versus revenue growth of 3.5%-3.8% with expectation of 0.9% appreciation in the rupee and some ESOP dilution.

4QFY07 margins are likely to be impacted by absence of higher product license revenues. However, we expect better utilization rates (utilisation rates excluding trainees declined QoQ to 75.8% in 3QFY07 from 77.5% in 2QFY07) and further G&A leverage to result in improvement in 4QFY07 margins. However, with increasing attrition levels and continued tightness in supply at the middle management level, we expect margins to come under pressure in FY08. Attrition levels increased to 13.5% during the quarter, with 12.2% voluntary attrition (12% in 2QFY07) and 1.3% involuntary attrition (0.9% in 2QFY07). The increase in involuntary attrition is due to stricter passing norms for trainees, which resulted in trainee level attrition increasing to 5% from 2% in the previous quarter.

ATTRITION LEVEL CONTINUE TO TOUCH NEW HIGHS



Source: Company/ Motilal Oswal Securities

However, the absolute number of attrition has remained constant despite increase in employees in 3QFY07. Management is confident of keeping attrition levels under control. Hence it currently believes that a 13%-15% offshore wage hike would suffice for FY08. But increasing competition for resources from Indian peers and MNCs could result in a supply crunch in the 3-5 year experience bracket, thereby driving up salaries in this space. Whilst competition from Indian IT vendors is routine, the recent commitment of MNC firms such as IBM and EDS, to increase headcount in India, could add to supply side woes. We expect supply concerns to rear its head in FY08 together with continuing rupee appreciation and anticipate margin decline of 50bp in FY08.

Outlook

Infosys has guided for dollar revenue growth of 4.4%-4.6% in 4QFY07 with rupee revenue growth of 3.5%-3.8% for 4QFY07. On EPS front, Infosys expects lower growth at 1.5% due to some ESOP dilution and expected rupee appreciation in 4QFY07. The company's guidance is based on revised assumption of rupee/dollar rate at 44.11 in 4QFY07 (v/s 44.5 in 3QFY07).

Infosys has upgraded its FY07 guidance with expectation of dollar revenues at US\$3.09b versus earlier guided revenues of US\$3.03-3.04b (revised growth of 43.6% versus earlier growth expectation of 40.6%-41.1%). On the EPS front, the company expects EPS of Rs66.63 versus earlier expectation of Rs66.

Following management's expectation of higher rupee appreciation in 4QFY07 as well as expectation of decline in product license revenues, we have downgraded our FY07 EPS estimate to Rs67.3 from earlier estimate of Rs68.2. We have also built in more conservatism in our Rs/US\$ rate for FY08 and FY09 resulting into marginal downgrade in EPS to Rs87.4 and Rs103.6 from earlier expectation of Rs87.5 and Rs104 for FY08 and FY09 respectively.

Valuation and view

We believe that robust volume and earnings visibility will continue for Infosys beyond FY07 considering: (1) No slowdown in IT spending witnessed with upward bias in spending of 1-2%; (2) Budget towards outsourcing and offshoring continues to grow; (3) New clients are added at 3-4% higher billing rates and witnessing 2-3% higher billing rates in some of existing clients (earlier claimed 1-2%); (4) High margin Europe geography is expected to outperform; (5) Increasing engagement in large deals (in 3QFY07 Infosys won 3-5 large deals with >US\$50m size, engaged

in 6-7 deals worth >US\$100m in 3QFY07 which are expected to close in coming quarters (6) Currently Infosys expects FY08 offshore wage inflation likely to be similar to FY07 at 13-15%.

At CMP it is trading at 25x FY08E and 21.1x FY09E, which does not offer upside based on FY08 valuation. However, we believe that Infosys is relatively better placed in terms of higher volume and earning visibility beyond FY08. We maintain **Buy** with a price target of Rs2,590 based on 25x FY09E EPS.

Infosys Technologies: an investment profile

Company description

Infosys is the second largest IT company in India with revenues of more than US\$2b and employing nearly 70,000 people. It provides IT / ITES services to more than 485 clients. It is the preferred vendor for a majority of the Fortune 500/Global 1,000 companies. Its top clients include DHL, Telstra, American Express, Goldman Sachs, Cisco, Fidelity and Bank of America.

Key investment arguments

- Excellent project execution skills make it the preferred vendor for most clients. Differentiates itself by innovating offshore delivery of services in various forms
- Sustained competitive advantage to enable it to maintain its leadership position

Key investment risks

- Rapid hiring could hurt margins if demand declines
- Weak R&D services and infrastructure management services practice could result in it losing out on large outsourcing deals
- Higher mix of freshers in overall employee base could impact quality of services

Recent developments

- Ranked top ADM service provider in terms of Delivery Model, Industry Focus, Schedule Compliance and Agility in a client survey conducted by Performance Monitor LLC, provider of fact-based research and advisory focused on monitoring the field performance of professional services firms.
- Became the first Indian company to enter the NASDAQ-100 Index on 9 December 2006.

Valuation and view

- CAGR of 40% and 40.8% in revenues and adjusted profit respectively over FY06-FY08E.
- Valuations at of 21.1x FY09E still offer room for upside.
- We maintain **Buy** for a price target of Rs2,590, upside of 19%.

Sector view

- Various CIO surveys indicate increasing share of offshore in IT budgets. However, any slowdown in the US economy could impact discretionary spending.
- Indian offshore vendors gaining market share in competition with MNCs
- We prefer large companies; niche players are benefiting due to lack of offshore competition

COMPARATIVE VALUATIONS

		INFOSYS	TCS	WIPRO
P/E (x)	FY07E	32.4	30.7	32.1
	FY08E	25.0	24.0	24.7
P/BV (x)	FY07E	11.9	13.9	8.7
	FY08E	8.6	9.6	6.6
EV/Sales (x)	FY07E	8.4	6.7	5.7
	FY08E	6.1	5.0	4.2
EV/EBITDA (x)	FY07E	26.2	24.7	25.1
	FY08E	19.6	18.6	18.3

EPS: MOST FORECAST VS CONSENSUS (RS)

	MOST FORECAST	CONSENSUS FORECAST	VARIATION (%)
FY07	67.3	67.5	-0.3
FY08	87.4	87.6	-0.3

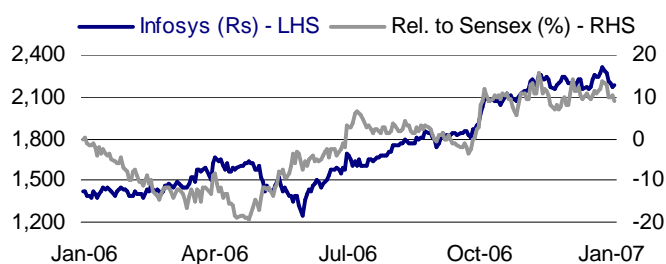
TARGET PRICE AND RECOMMENDATION

CURRENT PRICE (RS)	TARGET PRICE (RS)	UPSIDE (%)	RECO.
2,183	2,590	18.6	Buy

SHAREHOLDING PATTERN (%)

	SEP.06	JUN.06	SEP.05
Promoter	19.3	19.4	19.7
Domestic Inst	6.7	7.2	4.7
Foreign	53.8	53.9	58.5
Others	20.1	19.5	17.1

STOCK PERFORMANCE (1 YEAR)



INCOME STATEMENT					
(Rs Million)					
Y/E MARCH	2005	2006	2007E	2008E	2009E
Sales	71,296	95,216	140,348	186,543	234,671
Change (%)	49.8	33.5	47.4	32.9	25.8
Software Develop. Exp.	37,647	50,654	75,106	102,309	132,344
Selling and Mktg. Exp.	4,610	6,005	9,076	11,566	14,080
Administration Exp.	5,690	7,639	11,343	14,177	17,131
EBITDA	23,350	30,918	44,823	58,491	71,116
% of Net Sales	32.8	32.5	31.9	31.4	30.3
Depreciation	2,869	4,371	5,451	7,664	10,560
Other Income	1,239	1,396	3,278	4,647	6,326
PBT	21,720	27,943	42,650	55,474	66,882
Tax	3,256	3,132	4,982	6,685	9,029
Rate (%)	15.0	11.2	11.7	12.1	13.5
Minority Interest		210	100	2	3
Adjusted PAT	18,464	24,601	37,567	48,787	57,850
Extraordinary Income	-452	18	-60	0	0
Reported PAT	18,916	24,583	37,627	48,787	57,850
Change (%)	51.0	30.0	53.1	29.7	18.6

BALANCE SHEET					
(Rs Million)					
Y/E MARCH	2005	2006	2007E	2008E	2009E
Share Capital	1,353	1,380	2,792	2,792	2,792
Share Premium	8,999	15,430	19,610	19,610	19,610
Reserves	41,900	52,850	80,453	118,683	164,003
Net Worth	52,251	69,660	102,855	141,084	186,404
Preference Capital	935	0	0	0	0
Minority Interest	0	680	0	2	5
Loans	0	0	0	0	0
Capital Employed	53,188	70,340	102,855	141,086	186,409
Gross Block	22,873	29,830	49,940	67,940	87,940
Less : Depreciation	10,308	13,280	18,711	26,375	36,936
Net Block	12,565	16,550	31,229	41,565	51,004
CWIP	3,177	5,710	5,000	5,000	5,000
Investments	12,108	7,550	21,920	40,000	60,000
Curr. Assets	39,664	63,990	66,038	93,356	118,324
Debtors	13,220	16,080	23,909	30,776	38,661
Cash & Bank Balance	15,756	34,290	22,671	34,711	48,183
Loans & Advances	10,244	12,970	18,608	26,908	30,352
Other Current Assets	444	650	850	961	1,128
Current Liab. & Prov	14,326	23,460	21,332	38,833	47,918
Creditors	5,354	7,320	8,830	15,702	15,159
Other liabilities	1,207	2,020	1,729	3,967	3,173
Provisions	7,766	14,120	10,774	19,164	29,586
Net Current Assets	25,338	40,530	44,706	54,523	70,406
Application of Funds	53,187	70,340	102,855	141,087	186,410

E: M0St Estimates

RATIOS *					
Y/E MARCH	2005	2006	2007E	2008E	2009E
Basic (Rs)					
EPS	34.5	44.6	67.3	87.4	103.6
Cash EPS	40.7	52.5	77.2	101.1	122.5
Book Value	97.6	126.4	184.2	252.7	333.8
DPS	6.4	22.5	12.8	16.6	19.7
Payout %(Incl.Div.Taxes)	20.6	57.4	21.7	21.7	21.7
Valuation (x)					
P/E		48.9	32.4	25.0	21.1
Cash P/E		41.6	28.3	21.6	17.8
EV/EBITDA		38.1	26.2	19.6	15.6
EV/Sales		12.4	8.4	6.1	4.7
Price/Book Value		17.3	11.9	8.6	6.5
Dividend Yield (%)		10	0.6	0.8	0.9
Profitability Ratios (%)					
RoE	44.6	40.3	43.6	40.0	35.3
RoCE	50.2	45.2	49.3	45.5	40.8
Turnover Ratios					
Debtors (Days)	68	62	62	60	60
Fixed Asset Turnover (x)	3.1	3.2	2.8	2.7	2.7
Leverage Ratio (x)					
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	2005	2006	2007E	2008E	2009E
CF from Operations	23,450	30,190	40,041	51,917	62,254
Cash for Working Capital	-9,755	-9,856	-7,872	915	-3,561
Net Operating CF	13,696	20,334	32,169	52,832	58,694
Net Purchase of FA	-8,298	-10,890	-19,420	-18,000	-20,000
Net Purchase of Invest.	-1,059	6,660	-11,092	-13,433	-13,674
Net Cash from Invest.	-9,357	-4,230	-30,512	-31,433	-33,674
Proceeds from Equity & other	4,408	6,460	2,899	0	0
Proceeds from LTB/STB	0	0	0	0	0
Dividend Payments	-10,206	-4,030	-16,175	-9,359	-11,549
Cash Flow from Fin.	-5,798	2,430	-13,277	-9,359	-11,549
Free Cash Flow	21,187	605	23,241	8,123	40,788
Net Cash Flow	-1,459	18,534	-11,619	12,041	13,471
Opening Cash Balance	17,215	15,756	34,290	22,671	34,711
Add: Net Cash	-1,459	18,534	-11,619	12,041	13,471
Closing Cash Balance	15,756	34,290	22,671	34,711	48,183



For more copies or other information, contact

Institutional: Navin Agarwal. **Retail:** Manish Shah, Mihir Kothari

Phone: (91-22) 39825500 Fax: (91-22) 22885038. E-mail: inquire@motilaloswal.com

Motilal Oswal Securities Ltd, 3rd Floor, Hoechst House, Nariman Point, Mumbai 400 021

This report is for the personal information of the authorized recipient and does not construe to be any investment, legal or taxation advice to you. Motilal Oswal Securities Limited (*hereinafter referred as MOST*) is not soliciting any action based upon it. This report is not for public distribution and has been furnished to you solely for your information and should not be reproduced or redistributed to any other person in any form.

The report is based upon information that we consider reliable, but we do not represent that it is accurate or complete, and it should not be relied upon such. MOST or any of its affiliates or employees shall not be in any way responsible for any loss or damage that may arise to any person from any inadvertent error in the information contained in this report. MOST or any of its affiliates or employees do not provide, at any time, any express or implied warranty of any kind, regarding any matter pertaining to this report, including without limitation the implied warranties of merchantability, fitness for a particular purpose, and non-infringement. The recipients of this report should rely on their own investigations.

MOST and/or its affiliates and/or employees may have interests/ positions, financial or otherwise in the securities mentioned in this report. To enhance transparency, MOST has incorporated a Disclosure of Interest Statement in this document. This should, however, not be treated as endorsement of the views expressed in the report.

Disclosure of Interest Statement

Infosys Technologies

- | | |
|---|----|
| 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 |

This information is subject to change without any prior notice. MOST reserves the right to make modifications and alternations to this statement as may be required from time to time. Nevertheless, MOST is committed to providing independent and transparent recommendations to its clients, and would be happy to provide information in response to specific client queries.