



Infotech Enterprises

STOCK INFO.	BLOOMBERG
BSE SENSEX: 14,131	INFTC IN
	REUTERS CODE
S&P CNX: 4,084	INFE.BO

17 January 2007

Buy

Previous Recommendation: Buy

Rs342

Equity Shares (m)	45.8
52-Week Range	345/127
1,6,12 Rel. Perf. (%)	-1/70/35
M.Cap. (Rs b)	15.6
M.Cap. (US\$ b)	0.4

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
3/06A*	3,625	463	10.1	63.7	33.7	7.3	25.1	24.2	4.2	22.4
3/07E*	5,438	786	17.2	69.4	19.9	5.4	31.4	28.9	2.8	13.2
3/08E*	7,506	1,086	23.7	38.2	14.4	4.0	32.1	29.2	1.9	9.3

* 1:2 bonus and split of Rs10 share into 2 shares of Rs5 each in FY07, ratios accordingly adjusted

3QFY07 results higher on operational front, one-time JV loss upsets PAT growth: Revenue at Rs1.43b, was up 9% QoQ. Geospatial services (GS) reported better than expected 9% QoQ growth; Engineering services (ES) grew 8.9% QoQ. Operating margins improved 95bp on higher-than-expected GS growth, lowering of cost base and operational efficiencies. Net profit declined 7.4% QoQ to Rs188m.

Strong macro environment, client base in ES to continue to power growth post FY07: Strong demand growth in the macro environment with the potential market for ES in India expected to reach US\$12b-US\$16b by 2010 and US\$34b-US\$42b by 2020. We believe that the strong trend for offshoring in the ES segment would translate into strong growth in these services over the next few quarters.

Margins likely to come off highs, but may stay higher than earlier expectations: Operating margins have improved steadily with higher contributions from the ES segment. While margins are likely to come off the present high of 22.6% due to investments in new competencies, we expect margins to stay significantly higher than our earlier expectations.

Outlook and view: Given the strong business outlook in ES, expected revival in GS and the higher than anticipated margin improvement, we have upgraded our earnings estimates upwards by 1.4%, 8.5% and 11.8% to Rs17.2, Rs23.7 and Rs30.4 for FY07E, FY08E and FY09E respectively. The stock trades at 14.4x FY08E and 11.2x FY09E EPS estimates. We reiterate **Buy** for a price target of Rs455 based on 15x FY09E EPS, an upside of 33.2%.

QUARTERLY PERFORMANCE

(Rs Million)

Y/E MARCH	FY06				FY07				FY06	FY07E
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4QE		
Revenues	782	824	941	1,078	1,170	1,313	1,430	1,524	3,625	5,438
Q-o-Q Change (%)	20.0	5.3	14.2	14.6	8.6	12.2	9.0	6.5	41.0	50.0
Direct Expenses	365	394	443	495	569	621	656	708	1,696	2,554
Sales, General & Admin. Expenses	281	269	320	385	382	409	452	492	1,256	1,734
Operating Profit	136	160	178	199	219	284	323	323	673	1,149
Margins (%)	17.4	19.5	18.9	18.4	18.7	21.6	22.6	21.2	18.6	21.1
Other Income	-12	7	12	14	43	5	0	5	21	53
Depreciation	45	44	49	48	54	63	66	73	186	256
Interest	2	1	2	6	3	4	5	5	11	17
PBT bef. Extra-ordinary	78	122	139	158	206	222	252	250	498	930
Provision for Tax	11	25	21	36	42	49	52	54	93	197
Rate (%)	14.2	20.8	15.1	22.6	20.3	22.1	20.7	21.5	18.8	21.2
PAT bef. JV P/L	67	97	118	123	164	173	200	196	404	733
Q-o-Q Change (%)	-12.4	44.5	22.3	3.6	34.0	5.2	15.8	-1.9	62.2	81.2
Share of Profit from JV (IASI)	30	12	15	43	14	30	-12	22	59	53
PAT bef. Extra-ordinary	97	109	133	166	178	203	188	218	463	786
Q-o-Q Change (%)	9.0	12.0	22.2	24.6	7.1	14.1	-7.4	16.2	69.1	69.7

E: MOST Estimates

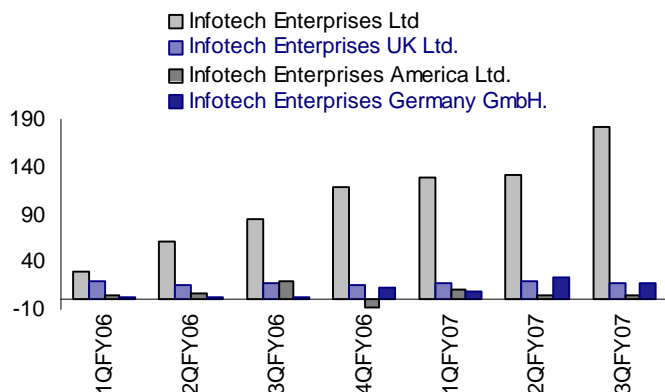
3QFY07 results higher on operational front, one-time JV loss upsets PAT growth

Infotech Enterprises reported revenue of Rs1.43b, up 9% QoQ v/s expectation of Rs1.38b. Geospatial services (GS) reported better-than-expected growth of 9% QoQ (our estimate: 0%) due to strong ramp-ups in the GE-Swisscom account. Engineering services (ES) reported yet another quarter of robust growth at 8.9%, driven by growth in clients like Alstom Transport and Boeing.

Higher than anticipated expansion in margins was a positive surprise during the quarter. Operating margins rose 95bp (v/s expectation of 190bp decline) due to higher-than-expected growth in GS, lowering of cost base due to greater addition of low-cost employees in GS (321 of a total 409) and operational efficiencies. However, management expects margins to come off the present high as it continues to invest in building new competencies. Margins are expected to hover around the 20-21% range over the next few quarters.

Tax rate was lower at 20.6% (22.1% in 2QFY07) due to changes in the transfer pricing mechanism that lower profits in overseas subsidiaries, where the tax rates are higher. Going forward, we expect the tax rate to stay at around the 21% level.

NEW TRANSFER PRICING BOOSTS INDIAN SUBSIDIARY PROFITS

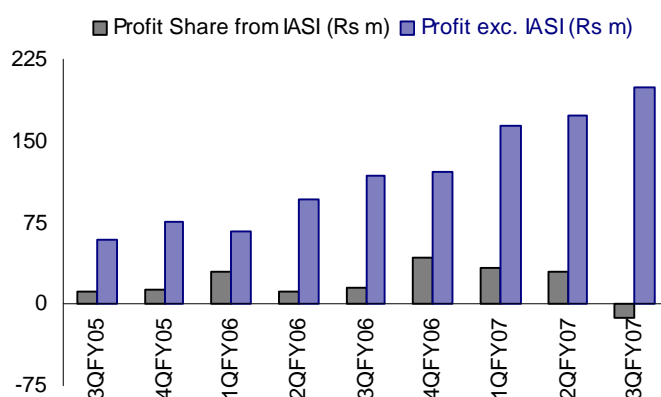


Source: Company/ Motilal Oswal Securities

IASI, the 49% subsidiary in Puerto Rico reported losses during the quarter (Rs12.3m impact on Infotech's profit)

due to one-time bonuses offered to employees and provisioning for debtors over one year. Consequently, net profit declined 7.4% QoQ to Rs188m. Excluding IASI, profits grew 15.8% QoQ. Management is hopeful of recovering the debts over the next few quarters and expects profit share from IASI to return to Rs20m levels next quarter onward.

NON IASI PROFIT GROWTH CONTINUES TO BE ROBUST



Source: Company/ Motilal Oswal Securities

Strong macro environment; client base in ES to continue to power growth post FY07

Engineering services have recorded robust growth over the past several quarters, driven by strong demand growth in the macro environment, with global spending on Engineering services expected to increase from US\$750b at present to US\$1.1t by 2020 (source: Booz Allen Hamilton Study 2006). Of this, the potential market for India is expected to touch US\$12b-US\$16b by 2010 and US\$34b-US\$42b by 2020. Automotive, Hi-Tech/telecom, Aerospace and Utilities are expected to be the fastest growing verticals within the Engineering services space.

Infotech is currently present in the Aerospace, Automotive and Transportation verticals. We believe this presence will enable the company to leverage the stated potential expansion in market opportunity due to greater outsourcing. Aerospace, in particular, would be a fast growth area for Infotech, given its deep domain expertise in this segment.

CONSISTENT HIGH GROWTH IN EMI

	3QFY06	4QFY06	1QFY07	2QFY07	3QFY07
EMI Revenue (Rs m)	519	606	689	816	888
% Growth	17.7	16.7	13.6	18.5	8.9

Source: Company/ Motilal Oswal Securities

Infotech's strong relationships with marquee clients such as Pratt & Whitney, Bombardier, Boeing etc. are likely to result in greater offshoring from these players. Given Infotech's excellent track record in client mining, we expect to see strong growth in ES from top clients. Going by the strong trend in favor of offshoring in the Engineering services segment, management is confident of maintaining high single digit to double digit growth in ES over the next few quarters.

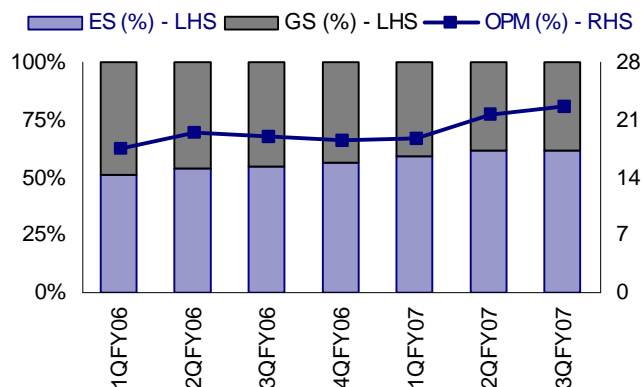
GS restructuring to continue in the US; expect growth from Europe

GS continues to undergo restructuring, with the US subsidiary (VARGIS) still under losses. The company is presently trying to exit low-margin, high-onsite centric business (primarily in the government domain) and enter higher-margin businesses wherein it can leverage its offshore capabilities. Whilst management has stated that losses have reduced from last quarter levels, we expect that it would take a few more quarters for the restructuring exercise to be completed. However, GS is expected to perform better in Europe and management is confident of achieving 25% YoY growth in FY08 in this segment. We expect GS to perform better in FY08E compared with the current year and anticipate considerable ramp-ups post FY08.

Margins likely to come off highs, but likely to stay higher than earlier expectation

Operating margins have improved steadily over the past few quarters, with rising contribution from the ES segment, where the margins are 4-5% higher than the GS segment. In addition, efficiencies of scale and higher realizations from top clients such as Bombardier and Pratt & Whitney (3-5% on existing business) also helped push up margins.

HIGH GROWTH IN EMI DRIVING MARGINS



Source: Company/ Motilal Oswal Securities

Going forward, we expect margins to come off the present high of 22.6% as the company plans to continue investments in developing new competencies, notably in the Marine and Avionics segments. The anticipated revival in lower margin GS business is also likely to bring down margins from the current levels. In FY08, we expect salary hikes to be the single largest negative factor on margins. However, on the back of better-than-expected performance over 9mFY07, and improvement in GS profitability post FY07, we expect margins to stay significantly higher than our earlier expectations (20.6% and 19.7% v/s 19.2% and 18.5% in FY08E and FY09E respectively).

Outlook and view

Given the strong business outlook in engineering services, expected revival in GS revenue growth and the higher than anticipated margin improvement, we have upgraded our earnings estimates upwards by 1.4%, 8.5% and 11.8% to Rs17.2, Rs23.7 and Rs30.4 for FY07E, FY08E and FY09E respectively. The stock trades at 14.4x FY08E and 11.2x FY09E EPS estimates. Infotech continues to remain amongst our top picks in the mid cap IT space, given the high revenue visibility and presence in a high growth domain. We reiterate **Buy** on our price target of Rs455 based on 15x FY09E EPS, an upside of 33.2% from current level.

Infotech Enterprises: an investment profile

Company description

Infotech is a niche IT-services vendor specializing in Engineering services and Geospatial services. It employs over 4,800 people, of which 2,250 are employed in its Engineering services division. Its key clients include Pratt & Whitney, Tele Atlas, Bombardier and Alstom Transport.

Key investment arguments

- ☞ Credible tier-2 Indian IT services vendor with niche offerings.
- ☞ One of the largest Indian It vendors in geospatial services and aerospace engineering design.

Key investment risks

- ☞ Geospatial services is currently being restructured in order to increase the annuity component of revenue in this business. Any delay in the same could impact revenue growth
- ☞ Despite higher than industry wage hikes, salaries continue to remain below industry average, which is likely to result in greater wage pressure post FY07.

Recent developments

- ☞ Entered into an agreement with IBM to provide PLM and engineering design services for its clients.
- ☞ JV with Pratt & Whitney in Puerto Rico opened a new facility to cater to defense related contracts for the US government.

Valuation and view

- ☞ Revenue CAGR of 43.9% and earnings CAGR of 53.2% over FY06-FY08E.
- ☞ Valuations at 14.4x FY08E and 11.2x FY09E earnings are attractive.
- ☞ Maintain **Buy** with target price of Rs455.

Sector view

- ☞ Various CIO surveys indicate increasing share of offshore spending in IT budgets.
- ☞ Indian offshore vendors gaining market share in competition with MNCs.
- ☞ Prefer large companies as bulk of volumes going to them while niche players benefit due to lack of offshore competition in their segments.

COMPARATIVE VALUATIONS

		INFOTECH	HEXAWARE	GEOMETRIC
P/E (x)	FY07E	19.9	20.7	19.2
	FY08E	14.4	16.7	13.2
P/BV (x)	FY07E	5.4	3.5	4.8
	FY08E	4.0	3.0	3.4
EV/Sales (x)	FY07E	2.8	2.6	2.8
	FY08E	1.9	2.0	3.0
EV/EBITDA (x)	FY07E	13.2	16.3	2.2
	FY08E	9.3	13.1	1.6

SHAREHOLDING PATTERN (%)

	DEC.06	SEP.05	DEC.05
Promoter	16.9	19.3	19.6
Domestic Inst	6.4	6.7	5.4
Foreign	56.5	53.8	57.8
Others	20.2	20.2	17.3

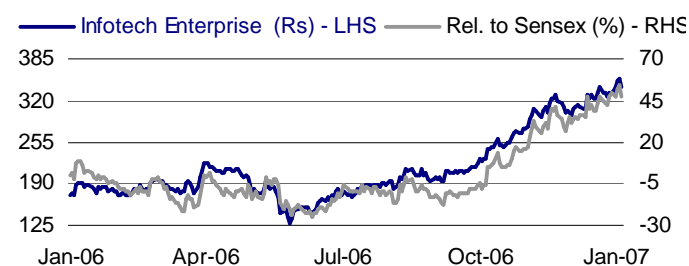
EPS: MOST FORECAST VS CONSENSUS (RS)

	MOST FORECAST	CONSENSUS FORECAST	VARIATION (%)
FY07	17.2	18.0	-4.4
FY08	23.7	23.3	1.7

TARGET PRICE AND RECOMMENDATION

CURRENT PRICE (RS)	TARGET PRICE (RS)	UPSIDE (%)	RECO.
342	455	33.2	Buy

STOCK PERFORMANCE (1 YEAR)



INCOME STATEMENT					
(Rs Million)					
Y/E MARCH	2005	2006	2007E	2008E	2009E
Sales	2,571	3,625	5,438	7,506	10,078
Change (%)	37.2	41.0	50.0	38.0	34.3
Software Develop. Exp.	1,234	1,696	2,554	3,844	5,483
SG&A	867	1,256	1,734	2,115	2,614
EBITDA	470	673	1,149	1,547	1,982
% of Net Sales	18.3	18.6	21.1	20.6	19.7
Depreciation	167	186	256	375	484
Interest	2	11	17	23	20
Other Income	39	21	53	90	111
PBT	339	498	930	1,239	1,589
Tax	90	93	197	257	327
Rate (%)	26.6	18.8	21.2	20.7	20.6
PAT	249	404	733	983	1,261
Share of Profit from JV (IASI)	25	59	53	104	129
Adjusted PAT	274	463	786	1,086	1,391
Change (%)	204.1	69.2	69.7	38.2	28.0
Reported PAT	274	505	806	1,086	1,391
Change (%)	204.1	84.5	59.6	34.8	28.0

BALANCE SHEET					
(Rs Million)					
Y/E MARCH	2005	2006	2007E	2008E	2009E
Share Capital	147	152	229	229	229
Share Premium	463	558	558	558	558
Reserves	954	1,413	2,097	3,107	4,394
Net Worth	1,564	2,124	2,885	3,894	5,181
Secured Loans	14	65	283	269	256
Deferred Tax Liability	-13	-8	-9	-9	-10
Capital Employed	1,565	2,180	3,159	4,153	5,427
Gross Block	1,324	1,811	2,461	2,961	3,661
Less : Depreciation	860	1,014	1,270	1,645	2,129
Net Block	463	797	1,191	1,316	1,532
CWIP	141	11	50	75	100
Investments	100	178	178	178	178
Curr. Assets	1,326	1,874	2,738	3,934	5,514
Debtors	872	1,223	1,800	2,163	3,175
Cash & Bank Balance	340	385	558	1,266	1,708
Loans & Advances	12	265	375	500	625
Other Current Assets	2	1	5	5	5
Current Liab. & Prov	465	680	997	1,350	1,897
Current Liabilities	358	525	767	1,023	1,438
Provisions	108	156	231	327	460
Net Current Assets	861	1,194	1,740	2,584	3,616
Capital Employed	1,565	2,180	3,160	4,153	5,427

E: MOST Estimates

RATIOS*					
Y/E MARCH	2005	2006E	2007E	2008E	2009E
Basic (Rs)					
EPS*	6.2	10.1	17.2	23.7	30.4
Cash EPS*	10.0	14.2	22.8	32.0	41.0
Book Value	35.4	46.5	63.1	85.1	113.3
DPS	0.5	0.8	1.3	1.5	2.0
Payout %(Incl.Div.Taxes)	8.1	7.4	7.3	6.3	6.6
Valuation (x)					
P/E		33.7	19.9	14.4	11.2
Cash P/E		24.0	15.0	10.7	8.3
EV/EBITDA		22.4	13.2	9.3	7.1
EV/Sales		4.2	2.8	1.9	1.4
Price/Book Value		7.3	5.4	4.0	3.0
Dividend Yield (%)		0.2	0.4	0.4	0.6
Profitability Ratios (%)					
RoE	19.1	25.1	31.4	32.1	30.7
RoCE	18.8	24.2	28.9	29.2	28.7
Turnover Ratios					
Debtors (Days)	143	140	145	122	115
Fixed Asset Turnover (x)	5.5	4.5	4.6	5.7	6.6
Leverage Ratio (x)					
Debt/Equity Ratio(x)	0.0	0.0	0.1	0.1	0.0

* 12 bonus and split of Rs 10 share into 2 shares of Rs 5 each in FY07, adj. Ratios

CASH FLOW STATEMENT					
(Rs Million)					
Y/E MARCH	2005	2006E	2007E	2008E	2009E
CF from Operations	421	612	1,022	1,403	1,785
Cash for Working Capital	-121	-288	-374	-135	-590
Net Operating CF	300	325	648	1,268	1,195
Net Purchase of FA	-237	-357	-689	-525	-725
Net Purchase of Invest.	-107	48	-43	44	63
Net Cash from Invest.	-344	-310	-732	-481	-662
Proceeds from Equity.	1	5	77	0	0
Proceeds from LTB/STB	8	51	218	-14	-13
Dividend Payments	0	-25	-39	-65	-77
Cash Flow from Fin.	9	30	256	-78	-91
Free Cash Flow	63	-33	-41	743	470
Net Cash Flow	-35	45	172	709	443
Opening Cash Balance	375	340	385	557	1,266
Add: Net Cash	-35	45	172	709	443
Closing Cash Balance	340	385	557	1,266	1,709



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Infotech Enterprises

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

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