

August 26, 2008

|                |                  |
|----------------|------------------|
| Rating         | Market Performer |
| Price          | Rs1,703          |
| Target Price   | Rs1,837          |
| Implied Upside | 7.9%             |
| Sensex         | 14,450           |

(Prices as on August 25, 2008)

**Trading Data**

|                            |       |
|----------------------------|-------|
| Market Cap. (Rs bn)        | 948.3 |
| Shares o/s (m)             | 556.9 |
| Free Float                 | 83.5% |
| 3M Avg. Daily Vol ('000)   | 362.7 |
| 3M Avg. Daily Value (Rs m) | 624.6 |

**Major Shareholders**

|                 |       |
|-----------------|-------|
| Promoters       | 16.5% |
| Foreign         | 33.6% |
| Domestic Inst.  | 27.0% |
| Public & Others | 22.9% |

**Stock Performance**

|          |     |      |       |
|----------|-----|------|-------|
| (%)      | 1M  | 6M   | 12M   |
| Absolute | 9.9 | 2.5  | (6.6) |
| Relative | 8.6 | 21.3 | (6.8) |

Price Performance (RIC: INFY.BO, BB: INFO IN)



Source: Bloomberg

- **Deal terms:** Infosys has entered into an agreement to buy London-based SAP consulting company Axon Group in an all cash acquisition valued at GBP 407.1m. The deal, which is expected to be completed by Nov. 2008, will add about 2000 employees of Avon to Infosys rolls.
- **Consideration:** Infosys has valued Axon at 1.99x CY07 revenues. The consideration implies a premium of 19% to last quoted price of Axon (as of Friday closing price) which amounts to a premium of GBP 84m in absolute terms. The all cash nature of the deal implies Infosys will dip into its cash reserves (Rs 61.45bn as of June 30,2008) to pay the deal consideration of about Rs 33.1bn .
- **Revenue impact:** Given that Infosys anticipates the deal to be completed by Nov. 2008, we expect consolidation for three months only (in Q4 FY09). Incremental revenue from the deal in FY09 is expected to be in range of Rs 4387m in Q4 FY09 with neutral impact on margins and EPS. We expect the deal to be EBITDA margin dilutive in both FY09 and FY10 notwithstanding enhanced offshoring efforts and other streamlining of Axon's processes by Infosys.
- **Valuation:** The Axon acquisition ought to strengthen Infosys fast growing SAP practice and enable it to increase its win rate in large size transformational deals going forward. We expect Infosys to report revenue growth of 32.74% and 30.67% in FY2009 and 2010 respectively. The acquisition while being a good fit in the long-term would be viewed as a bit expensive in the near-term. The acquisition will be EPS neutral in FY2009 and marginally EPS accretive in FY2010 (Rs 122.5 v/s Rs 121.6). At the CMP of Rs1,703, it quotes at 14.0x FY10E consolidated earnings. We maintain Market Performer rating with a target price of Rs1,837 (15x FY10E earnings).

**Key financials (Y/e March)**

|                   | FY09    | Old FY10 | New FY09 | New FY10 |
|-------------------|---------|----------|----------|----------|
| Revenues (Rs m)   | 217,185 | 268,039  | 221,572  | 289,535  |
| EBITDA (Rs m)     | 63,146  | 77,054   | 63,827   | 80,923   |
| Margin (%)        | 29.1    | 28.7     | 28.8     | 27.9     |
| PAT (Rs m)        | 59,431  | 70,394   | 59,351   | 70,917   |
| Margin (%)        | 27.4    | 26.3     | 26.8     | 24.5     |
| EPS (Rs)          | 103.1   | 121.6    | 103.0    | 122.5    |
| PE (x)            | 16.5    | 14.0     | 16.5     | 13.9     |
| Target Price (Rs) |         |          |          | 1,837    |

Source: Company Data; PL Research

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## Axon: Profile

Axon Group is a London based SAP consulting company with a market cap of GBP 323m. Axons annual report labels it as one of the worlds largest independent SAP services provider employing about 2000 consultants. Axon derives about 60% of its revenues from Europe (mainly UK) and 34% from US. Its major operating segments are Business Consulting which forms about 19% of its revenues while its Solutions segment forms about 70% revenues.

While Axon has reported impressive growth rates over the last few years, analyst consensus estimates expect growth to moderate given the tough macro environment.

### Axon summary financials

GBP Mn

| Y/e Dec            | 2004 | 2005 | 2006  | 2007  | 2008E | 2009E |
|--------------------|------|------|-------|-------|-------|-------|
| Revenue            | 60.2 | 87.9 | 137.5 | 204.5 | 242.8 | 270.8 |
| <i>YoY gr. (%)</i> | —    | 46.0 | 56.4  | 48.7  | 18.7  | 11.5  |
| EBITDA             | 6.1  | 10.1 | 18.6  | 30.5  | 39.21 | 42.05 |
| <i>YoY gr. (%)</i> | —    | 11.5 | 13.5  | 14.9  | 16.1  | 15.5  |
| PAT                | 4.7  | 5.1  | 11.3  | 20.2  | 22.06 | 23.8  |
| <i>YoY gr. (%)</i> | —    | 5.8  | 8.2   | 9.9   | 9.1   | 8.8   |

Source: Bloomberg

## Business Impact

Currently Infosys employs about 2100 SAP consultants servicing over 100 clients across the globe. The acquisition of Axon will add over 2000 consultants to Infosys' SAP practice making it one of the largest SAP vendors globally. Further, management indicates minimal overlap of SAP clients providing opportunity for cross selling/upselling of services by the combined entity. Currently Infosys derives around 24% revenues from Consulting and Package Implementation which post acquisition is expected to move up to 25.6% in FY09E and 29.6% in FY10E. Given that over 60% of Axon's revenues are derived from Europe, we expect Infosys consolidated revenues from Europe to move from the current 28% to 28.6% and 30.4% in FY09 and FY 10 respectively (assuming similar revenue profile for Infosys-standalone- to continue).

### Impact on Infosys' revenue profile

(Rs m)

|                               | Package Implementation |        |        | Europe |        |        |
|-------------------------------|------------------------|--------|--------|--------|--------|--------|
|                               | FY2008                 | FY2009 | FY2010 | FY2008 | FY2009 | FY2010 |
| Infosys                       | 39,727                 | 52,124 | 64,329 | 46,905 | 60,812 | 75,051 |
| Axon                          | -                      | 4,387  | 21,496 | -      | 2,632  | 12,898 |
| Infosys-Axon                  | 39,727                 | 56,511 | 85,826 | 46,905 | 63,444 | 87,949 |
| <i>% of combined revenues</i> | 23.8                   | 25.5   | 29.6   | 28.1   | 28.6   | 30.4   |

Source: Company Data, PL Research

## Financial Impact

As a result of the acquisition, we expect consolidated Infosys revenue to grow 32.7% YoY in FY09 to Rs 221.5bn (v/s Rs 217.2bn earlier @ 30.1% YoY gr). The marginal change in estimates is owing to consolidation done for a single quarter only. In FY10, we expect consolidated revenue to grow a handsome 30.6% to Rs 289.5bn (v/s 23.4% gr to Rs 268bn earlier). We expect the deal to be EBITDA margin dilutive in both FY09 and FY10 notwithstanding enhanced offshoring efforts and other streamlining of processes by Infosys.

## Valuation

Infosys has valued Axon at 1.99x CY07 revenues. The consideration implies a premium of 19% to last quoted price of Axon (as of Friday closing price) which amounts to a premium of GBP 84m in absolute terms. Assuming the CMP to be broadly indicative of fair value of the stock, we believe it would be challenging for Infosys to extract synergies from the deal much in excess of the premium paid, given the tough operating macro environment and Axon's dependence on SAP based revenues which typically include a significant element of discretionary spending. Having said that, we expect the acquisition to strengthen Infosys fast growth in SAP practice and enable it to increase its win rate in large size transformational deals going forward.

We expect Infosys to report revenue growth of 32.74% and 30.67% in FY2009 and 2010 respectively. The acquisition will be EPS neutral in FY2009 (Rs 103.0 v/s Rs 103.1) and marginally EPS accretive in FY2010 (Rs 122.5 v/s Rs 121.6). The acquisition while being a good fit in the long-term would be viewed as a bit expensive in the near-term. At the CMP of Rs1,703, it quotes at 14.0x FY10E consolidated earnings. We maintain Market Performer rating with a target price of Rs1,837 (15x FY10E earnings).

### Key financials

| Y/e March         | FY07        | FY08        | FY09E       | FY10E       |
|-------------------|-------------|-------------|-------------|-------------|
| Revenues (Rs m)   | 138,930     | 166,920     | 217,185     | 268,039     |
| <i>Growth (%)</i> | <i>45.9</i> | <i>20.1</i> | <i>30.1</i> | <i>23.4</i> |
| EBITDA (Rs m)     | 43,910      | 52,380      | 69,936      | 85,654      |
| PAT (Rs m)        | 38,620      | 46,590      | 59,431      | 70,394      |
| EPS (Rs)          | 67.6        | 81.3        | 103.1       | 121.6       |
| <i>Growth (%)</i> | <i>48.8</i> | <i>20.2</i> | <i>26.9</i> | <i>17.9</i> |
| Net DPS (Rs)      | 11.7        | 33.3        | 24.0        | 28.0        |

Source: Company Data; PL Research

### Profitability & valuation

| Y/e March                     | FY07        | FY08        | FY09E       | FY10E       |
|-------------------------------|-------------|-------------|-------------|-------------|
| <i>EBITDA margin (%)</i>      | <i>31.6</i> | <i>31.4</i> | <i>32.2</i> | <i>32.0</i> |
| <i>RoE (%)</i>                | <i>42.3</i> | <i>37.2</i> | <i>37.2</i> | <i>33.9</i> |
| <i>RoCE (%)</i>               | <i>42.3</i> | <i>37.2</i> | <i>37.2</i> | <i>33.9</i> |
| EV / sales (x)                | 6.6         | 5.4         | 4.0         | 3.1         |
| EV / EBITDA (x)               | 20.9        | 17.3        | 12.5        | 9.8         |
| PE (x)                        | 25.2        | 21.0        | 16.5        | 14.0        |
| P / BV (x)                    | 8.7         | 7.1         | 5.4         | 4.2         |
| <i>Net dividend yield (%)</i> | <i>0.7</i>  | <i>2.0</i>  | <i>1.4</i>  | <i>1.6</i>  |

Source: Company Data; PL Research



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#### PL's Recommendation Nomenclature

|                              |                                      |                            |  |
|------------------------------|--------------------------------------|----------------------------|--|
| <b>BUY</b>                   | : > 15% Outperformance to BSE Sensex | <b>Outperformer (OP)</b>   | : 5 to 15% Outperformance to Sensex        |
| <b>Market Performer (MP)</b> | : -5 to 5% of Sensex Movement        | <b>Underperformer (UP)</b> | : -5 to -15% of Underperformance to Sensex |
| <b>Sell</b>                  | : <-15% Relative to Sensex           |                            |  |
| <b>Not Rated (NR)</b>        | : No specific call on the stock      | <b>Under Review (UR)</b>   | : Rating likely to change shortly          |

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