



Infosys Technologies

STOCK INFO. BSE SENSEX: 13,384	BLOOMBERG INFO IN	13 April 2007	Buy									
S&P CNX: 3,917	REUTERS CODE INFY.BO	Previous Recommendation: Buy	Rs2,088									
Equity Shares (m)	571.2	YEAR	NET SALES	PAT*	EPS	EPS	P/E	P/BV	ROE	ROCE	EV/	EV/
52-Week Range	2,439/1,225	END	(RS M)	(RS M)	(RS)	GROWTH (%)	(X)	(X)	(%)	(%)	SALES	EBITDA
1,6,12 Rel. Perf. (%)	-4/-5/19	3/07E	138,930	37,250	65.2	46.1	32.0	10.6	42.3	46.4	8.0	25.3
M.Cap. (Rs b)	1,192.5	3/08E	180,783	48,298	84.4	29.4	24.7	7.8	36.5	41.5	6.0	19.4
M.Cap. (US\$ b)	28.0	3/09E	227,550	58,078	101.2	19.9	20.6	6.0	33.0	37.8	4.6	15.2

* PAT figures are adjusted for non recurring items

- **Robust FY08 guidance dispels concerns of slowdown in client spending:** Infosys exceeded street expectations with revenue guidance of US\$4b in FY08, a 28-30% growth. Dollar EPS growth guidance of 25.7-27.7% factors in 3% equity dilution, which implies a PAT growth of around 28.7-30.7%. We believe such guidance despite concerns of US slowdown indicates higher offshore demand going forward.
- **Multiple margin levers to help combat rupee appreciation and wage inflation in FY08:** Wage inflation and rupee appreciation are expected to impact margins by 450bp in FY08. However, management expects margins to be stable due to higher utilization, SG&A leverage and improvement in subsidiary profitability.
- **Volumes muted in 4QFY07, but top accounts perform strongly:** Rupee revenue at Rs37.72b (3.2% QoQ) was lower than guided sales of Rs37.89b-37.98b. However, dollar revenue was higher than the upper-end of its guidance at US\$863.4m. EBITDA margin was down 100bp to 31.7% due to rupee appreciation and lower utilization.
- **Outlook and view:** Considering the high end of 1QFY08 and FY08 guided sales and EPS (in rupee terms), Infosys will need to grow at CQoQ growth rate of 6.9% for sales and 9% for EPS to achieve the FY08 rupee guidance, indicating strong revenue visibility beyond 1QFY08. Following management's expectation of higher rupee appreciation in FY08, lower volume growth and equity dilution in 4QFY07, we have downgraded our EPS to Rs84.4 and Rs101.2 for FY08 and FY09 respectively. At CMP, the stock is trading at 24.7x FY08E and 20.6x FY09E. We reiterate Infosys as our top pick in the sector with a price target of Rs2,530 based on FY09E EPS (upside of 21%).

QUARTERLY PERFORMANCE									(Rs Million)	
Y/E MARCH	FY06				FY07				FY06	FY07
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q		
Revenues	20,716	22,940	25,320	26,240	30,150	34,510	36,550	37,720	95,216	138,930
Q-o-Q Change (%)	4.2	10.7	10.4	3.6	14.9	14.5	5.9	3.2	33.5	45.9
Direct Expenses	11,044	12,120	13,270	14,220	16,660	18,330	19,380	20,210	50,654	74,580
Sales, General & Admin. Expenses	3,033	3,480	3,440	3,690	4,600	5,090	5,210	5,540	13,643	20,440
Operating Profit	6,638	7,340	8,610	8,330	8,890	11,090	11,960	11,970	30,918	43,910
Margins (%)	32.0	32.0	34.0	31.7	29.5	32.1	32.7	31.7	32.5	31.6
Other Income	286	440	-50	720	1,250	660	590	1,200	1,396	3,700
Depreciation	801	960	1,170	1,440	1,060	1,220	1,410	1,450	4,371	5,140
PBT bef. Extra-ordinary	6,123	6,820	7,390	7,610	9,080	10,530	11,140	11,720	27,943	42,470
Provision for Tax	802	690	830	810	1,060	1,230	1,300	1,520	3,132	5,110
Rate (%)	13.1	10.1	11.2	10.6	11.7	11.7	11.7	13.0	11.2	12.0
PAT bef. Minority	5,331	6,130	6,560	6,800	8,020	9,300	9,840	10,200	24,811	37,360
Minority Interest	-2	-60	-70	-70	-80	-10	-10	-10	-210	-110
PAT before ext-ord	5,330	6,070	6,490	6,730	7,940	9,290	9,830	10,190	24,601	37,250
Extra-ordinary items	0	-10	0	0	60	0	0	1,250	-18	1,310
PAT aft. Minority and ext-ord	5,330	6,060	6,490	6,730	8,000	9,290	9,830	11,440	24,583	38,560
Q-o-Q Change (%)	3.8	13.7	7.1	3.7	18.9	16.1	5.8	16.4	33.1	56.9

E: MOST Estimates

Robust FY08 guidance dispels concerns of slowdown in client spending

Infosys exceeded street expectations with revenue guidance of US\$4b in FY08, a 28-30% growth (v/s expectation of dollar revenue guidance of 25-27%). Dollar EPS growth guidance of 25.7-27.7% factors in 3% equity dilution, which implies a PAT growth of around 28.7-30.7%, indicating flat margins in FY08. We believe that such guidance, despite concerns on US slowdown, indicates higher outsourcing/offshore demand going forward. This is a big positive for the industry and endorses our positive outlook for the tech sector.

Rupee revenue guidance at 22.6-24.6% is lower due to underlying rupee-dollar rates of 43.1 (versus realized Rs/US\$ rate of 44.96 in FY07, appreciation of 4.1%). The rupee EPS growth guidance at 20-22% implies 6% impact on EPS growth over dollar growth, although guided rupee appreciation is 4.1%. The management expects to maintain margins within a narrow band for FY08. Rupee appreciation and wage inflation are expected to impact margins by 150bp and 300bp respectively in FY08. We believe SG&A leverage, utilization improvements, improvement in subsidiary profitability and pricing increases are likely to reduce the pressure on margins.

Multiple margin levers to help combat rupee appreciation and wage inflation in FY08

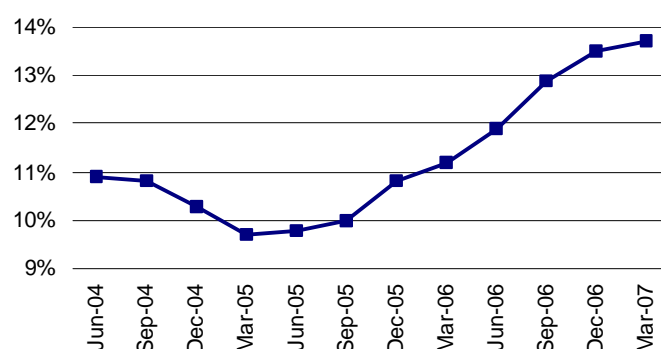
EBITDA margin declined 90bp in FY07 to 31.6%. Going forward, wage inflation and rupee appreciation continue to be the primary pressure points on margins. Given the implied appreciation of 4.2% in the FY08 guidance, the management expects a margin impact of 150-160bp due to the same. Wage increases of 13-15% offshore and 5-6% onsite (historic onsite wage hike was at 3%) would also add to margin pressure. The higher onsite wage inflation for FY08 is due to increasing demand for consulting and package implementation. Infosys is looking to affect one-time hike in certain onsite salaries in order to adjust to higher service mix, correct market discrepancies and pay scale adjustments within the company. The management is also considering 10-11% hike in the salaries offered on campus for employees joining in FY09 (which was hiked by 11%

for freshers joining in FY08). We believe that salary cost of freshers is not material cost and therefore would not impact margins materially. The combined impact of routine and one-time higher onsite wage hikes is expected to be around 300bp in FY08.

Despite the significant margin pressures due to the above reasons, the management is confident of maintaining margins within a narrow band in FY08. The primary margin levers are expected to be utilization rate improvement, SG&A leverage and improvement in subsidiary profitability. FY07 utilization rates excluding trainees were down at 75.5% versus 78% in FY06. The management expects utilization rates for FY08 at high 70s. The management has invested heavily in realignment and organization of the sales and marketing force in FY06-FY07, which has started bearing fruit in terms of client mining. Management also expects Infosys Consulting loss to decline to US\$4m in FY08 versus US\$25m in FY07, which will impact margins positively by 50bp in FY08. It also expects loss in China subsidiary to decline in FY08.

Attrition levels, which had been steadily increasing over the last several quarters, have increased by just 20bp during the quarter to 13.7%. Voluntary attrition remained intact at 12.2% over 3QFY07. The management is also more confident on managing supply concerns than it was in FY07 given the anticipated improvement in utilisation rates that would result in lower hires during the year. The management has guided for gross addition of 24,500 employees in FY08, which would be almost similar to the number in FY07, despite increasing base.

ATTRITION LEVELS SEEM TO BE PEAKING



Source: Company/Motilal Oswal Securities

While the management continues to be conservative on overall pricing improvement in FY08 (5% improvement in blended price realization in FY07 for IT services only), we believe that pricing improvements could continue in FY08 as well. The company has been witnessing price hikes of 3-4% in new projects and 2-3% in renewals, which we believe would translate into improved realization for FY08. In addition, the management has indicated that it has moved up the value chain for certain onsite businesses, which would also result in higher billing rates and margins.

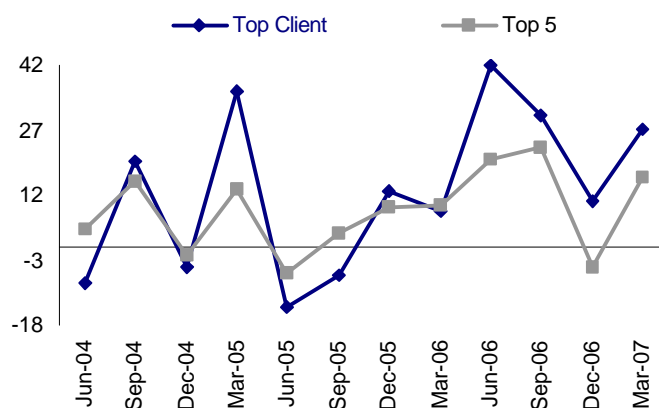
We believe all these positive levers will reduce pressure on margins arising from wage inflation and rupee appreciation. We expect margins to decline 60bp to 31% in FY08.

Volumes muted in 4Q, but top accounts perform strongly

Infosys reported a muted quarter, with volume growth of 3.8% and revenue growth of 3.2% QoQ. Revenue in rupee terms at Rs37.72b was lower than guided sales of Rs37.89b-37.98b (negative surprise). However, dollar revenue was higher than the upper-end of its guidance at US\$863.4m versus guided sales of US\$859-861m (lower than our estimate of US\$887.3m) due to higher than guided rupee appreciation of 1.9%. Lower volume growth led to lower utilizations (73% v/s 75.8% in 3QFY07 excluding trainees). EBITDA margin was down 100bp at 31.7% vs our expectation of 20bp improvement to 32.9%. Higher interest and dividend income due to larger investible surplus and higher yields (10% v/s 7% in 3QFY07) and lower forex loss resulted in higher other income of Rs1.2b. Net profit (before extra-ordinary items) was up 3.8% to Rs1.02b, lower than our expectations of Rs1.05b, due to lower revenue growth and margins. Net profit after extraordinary items was up 16.4% QoQ due to the one-time tax write back of Rs1.25b.

While overall numbers seem less than impressive, fears of slowdown have been allayed with strong FY08 guidance and top clients growing strongly during the quarter – the top client grew 29.5% QoQ, while top 5 and top 10 grew 18.5% and 13.3% QoQ respectively.

TOP CLIENTS CONTINUE ROBUST GROWTH (%)



Source: Company/Motilal Oswal Securities

In our result update for 3QFY07, we had reasoned that client churn is likely to yield higher revenue/client through a better mix of service offerings. This is evident in yet another impressive quarter of client transition to higher revenue brackets. The company also added one client into the US\$200m revenue range.

CLIENT MIX (NOS)

	MAR-06	JUN-06	SEP-06	DEC-06	MAR-07
Clients> US\$1m	221	221	232	256	275
Clients> US\$5m	81	94	97	108	107
Clients> US\$10m	54	56	61	67	71
Clients> US\$20m	26	28	29	35	36
Clients> US\$30m	19	19	20	22	25
Clients> US\$40m	14	15	16	17	16
Clients> US\$50m	9	11	12	11	12
Clients> US\$60m	0	7	8	10	11
Clients> US\$70m	4	3	6	8	9
Clients> US\$80m	0	3	3	4	4
Clients> US\$90m	1	2	3	2	4
Clients> US\$100m	0	2	2	2	3
Clients> US\$200m	0	0	0	0	1

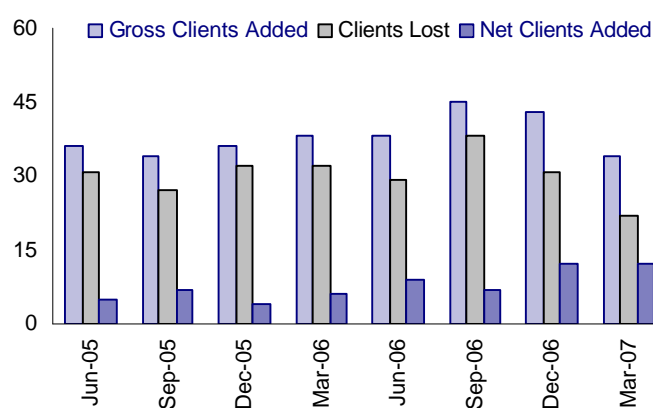
Source: Company/ Motilal Oswal Securities

The continuous migration of clients to higher revenue band validates Infosys' strategy of organic growth within existing clients. In addition, it also gives strength to the argument that Infosys is now being able to participate in business transformation of its clients, which would in turn increase customer stickiness and dependence on the vendor. We expect Infosys to increasingly position itself as a transformation partner to its clients, which would greatly enhance revenue visibility and productivity from its customer base.

Organic revenue growth in FY08 is likely to be robust on back of deepening of client engagements, leading to greater revenue per client and better margin management on account of higher revenue visibility. IT spending by its clients is expected to remain strong, even in the BFSI domain, where the fear of a meltdown is the highest.

Other operational metrics also indicate strong growth trend

CLIENT ADDITION REMAINS STRONG



Source: Company/ Motilal Oswal Securities

EMPLOYEE ADDITION ALSO HEALTHY

EMPLOYEE PROFILE (NOS)	MAR-06	JUN-06	SEP-06	DEC-06	MAR-07
Billable	42,604	48,438	53,873	58,073	61,917
Banking Product	1,863	1,817	1,809	1,967	2,053
Trainees	5,028	4,351	6,284	5,353	4,186
Total Software	49,495	54,606	61,966	65,393	68,156
Lateral Addition	1,620	2,140	2,560	1,676	1,647
% of Total Net Addition	49.2	37.6	33.1	51.1	58.6
% of Total Gross Addition	31.3	26.4	23.7	27.6	27.5
Sales & Support	3,220	3,803	4,184	4,039	4,085
Total Employees	52,715	58,409	66,150	69,432	72,241

Source: Company/ Motilal Oswal Securities

NEW SERVICE LINES CONTINUE TO OUTPACE ADM

REVENUE MIX	MAR-06	JUN-06	SEP-06	DEC-06	MAR-07
Core IT	14,983	16,763	18,808	19,554	19,916
Change (%)	2.9	11.9	12.2	4.0	1.9
New Service Lines *	7,846	9,015	11,009	12,098	13,277
Change (%)	7.2	14.9	22.1	9.9	9.7

* Consulting, Package Implementation, BPO, Testing

Source: Company/ Motilal Oswal Securities

Outlook and view

The robust earning guidance for FY08 would serve to dispel doubts on continued growth for the industry as a whole in FY08. Infosys has guided for dollar revenue growth of 4.7%-5.2% with EPS decline of 1.5% for 1QFY08 (however 1QFY08 EPS is likely to be on an expanded equity capital on account of ESOP exercise in 4QFY07, which implies a flat recurring PAT QoQ in 1QFY08). Considering the high end of 1QFY08 and FY08 guided sales and EPS (in rupee terms), Infosys will need to grow at CQoQ growth rate of 6.9% for sales and 9% on EPS to achieve the FY08 rupee guidance, indicating strong revenue visibility beyond 1QFY08. This indicates that management does not anticipate US slowdown to impact growth beyond 1QFY08. Given the conservatism usually built into Infosys' guidance, we believe FY08 could be another year of strong performance for the company.

Following management's expectation of higher rupee appreciation in FY08, lower volume growth and equity dilution in 4QFY07, we have downgraded our EPS by 3.3% and 2.2% to Rs84.4 and Rs101.2 from earlier expectation of Rs87.2 and Rs103.4 for FY08 and FY09 respectively. However, we note that current Rs/\$ rate is around 42.5 versus our estimate of average rate of Rs43.1 for FY08 and Rs42 for FY09. Therefore, any further sharp appreciation in the rupee from current levels could result in downside risk to our EPS estimates.

We believe Infosys has made changes in the senior management to increase focus on client relationship/ experience and improving competitiveness. We note that in the recent past, Infosys has lost various large BFSI deals to Wipro, TCS, Cognizant, and HCL Tech despite BFSI being the highest contributor to revenue (37% in 4QFY07, down from 38.6% in 3QFY07, resulting in just 0.8% QoQ growth in BFSI revenue in dollar terms in 4QFY07).

At CMP, the stock is trading at 24.7x FY08E and 20.6x FY09E, which looks attractive on FY09 basis. We believe Infosys is relatively better placed in terms of higher volume and earning visibility, therefore we reiterate Infosys as our top pick in the sector with a price target of Rs2,530 based on FY09E EPS (upside of 21%).

Infosys Technologies: an investment profile

Company description

Infosys is the second largest IT company in India with revenues of more than US\$3b and employing over 72,000 people. It provides IT / ITES services to 500 clients and is a preferred vendor for a majority of the Fortune 500/Global 1000 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 a preferred vendor for most clients.
- ✎ Differentiates itself by innovating offshore delivery of services in various forms.
- ✎ Sustained competitive advantage enables it to maintain 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 losing out on large outsourcing deals.
- ✎ Higher mix of freshers in overall employee base could impact quality of services.

COMPARATIVE VALUATIONS

		INFOSYS	TCS	WIPRO
P/E (x)	FY08E	24.7	22.9	22.1
	FY09E	20.6	19.0	18.5
P/BV (x)	FY08E	7.8	9.3	6.0
	FY09E	6.0	6.7	4.7
EV/Sales (x)	FY08E	6.0	4.8	3.8
	FY09E	4.6	3.7	2.9
EV/EBITDA (x)	FY08E	19.4	17.7	16.6
	FY09E	15.2	14.0	13.0

SHAREHOLDING PATTERN (%)

	DEC.06	SEP.06	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

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, a 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 28% and 25% in revenue and adjusted profit respectively, over FY07-FY09E
- ✎ Valuations at 20.6x FY09E still offer room for upside
- ✎ Maintain **Buy** with a target of Rs2,530, a 21% upside.

Sector view

- ✎ Various CIO surveys indicate increasing share of offshore spending in IT budgets. Any slowdown in the US economy could impact discretionary spending.
- ✎ Indian offshore vendors are gaining market share from MNCs.
- ✎ We prefer large companies, as bulk of volumes are going to them; niche players are benefiting due to lack of offshore competition.

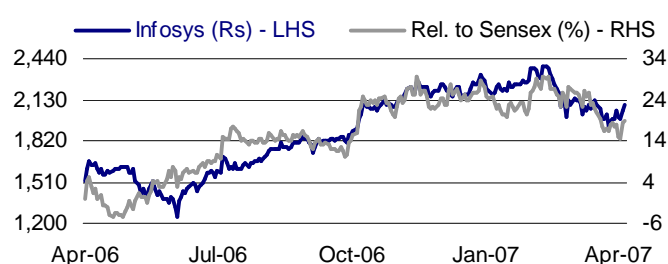
EPS: MOST FORECAST VS CONSENSUS (RS)

	MOST FORECAST	CONSENSUS FORECAST	VARIATION (%)
FY08	84.4	86.7	-2.6
FY09	101.2	109.6	-7.7

TARGET PRICE AND RECOMMENDATION

CURRENT PRICE (RS)	TARGET PRICE (RS)	UPSIDE (%)	RECO.
2,088	2,530	21.2	Buy

STOCK PERFORMANCE (1 YEAR)



INCOME STATEMENT						(Rs Million)					
Y/E MARCH	2005	2006	2007	2008E	2009E						
Sales	71,296	95,216	138,930	180,783	227,550						
Change (%)	49.8	33.5	45.9	30.1	25.9						
Software Develop. Exp.	37,647	50,654	74,580	99,312	128,574						
Selling and Mktg. Exp.	4,610	6,005	9,290	11,527	13,653						
Administration Exp.	5,690	7,639	11,150	13,819	16,725						
EBITDA	23,350	30,918	43,910	56,126	68,599						
% of Net Sales	32.8	32.5	31.6	31.0	30.1						
Depreciation	2,869	4,371	5,140	6,830	8,874						
Other Income	1,239	1,396	3,700	5,643	6,800						
PBT	21,720	27,943	42,470	54,939	66,525						
Tax	3,256	3,132	5,110	6,639	8,444						
Rate (%)	15.0	11.2	12.0	12.1	12.7						
Minority Interest		210	110	2	3						
Adjusted PAT	18,464	24,601	37,250	48,298	58,078						
Extraordinary Items	-452	18	-1,310	0	0						
Reported PAT	18,916	24,583	38,560	48,298	58,078						
Change (%)	51.0	30.0	56.9	25.3	20.2						

BALANCE SHEET						(Rs Million)					
Y/E MARCH	2005	2006	2007	2008E	2009E						
Share Capital	1,353	1,380	2,859	2,867	2,873						
Share Premium	8,999	15,430	27,680	28,715	29,408						
Reserves	41,900	52,850	82,010	120,702	167,228						
Net Worth	52,251	69,660	112,549	152,284	199,509						
Preference Capital	935	0	0	0	0						
Minority Interest	0	680	40	42	45						
Loans	0	0	0	0	0						
Capital Employed	53,188	70,340	112,589	152,326	199,553						
Gross Block	22,873	29,830	46,420	64,420	84,420						
Less : Depreciation	10,308	13,280	18,360	25,190	34,064						
Net Block	12,565	16,550	28,060	39,230	50,356						
CWIP	3,177	5,710	9,650	5,000	5,000						
Investments	12,108	7,550	250	10,000	15,000						
Curr. Assets	39,664	63,990	96,130	131,479	182,280						
Debtors	13,220	16,080	24,360	28,637	38,693						
Cash & Bank Balance	15,756	34,290	58,710	71,590	114,340						
Loans & Advances	10,244	12,970	12,140	27,632	22,429						
Other Current Assets	444	650	920	3,621	6,818						
Current Liab. & Prov	14,326	23,460	21,500	33,382	53,081						
Creditors	5,354	7,320	11,540	12,730	17,818						
Other liabilities	1,207	2,020	3,150	3,177	4,787						
Provisions	7,766	14,120	6,810	17,475	30,476						
Net Current Assets	25,338	40,530	74,630	98,097	129,199						
Application of Funds	53,187	70,340	112,590	152,327	199,554						

E: M OSt Estimates

RATIOS *					
Y/E MARCH	2005	2006	2007	2008E	2009E
Basic (Rs)					
EPS	34.5	44.6	65.2	84.4	101.2
Cash EPS	40.7	52.5	76.5	96.3	116.6
Book Value	97.6	126.4	197.0	266.1	347.5
DPS	6.4	22.5	11.4	14.3	17.2
Payout %(Incl.Div.Taxes)	20.6	57.4	19.5	19.9	19.9
Valuation (x)					
P/E		46.8	32.0	24.7	20.6
Cash P/E		39.7	27.3	21.7	17.9
EV/EBITDA		36.5	25.3	19.4	15.2
EV/Sales		11.8	8.0	6.0	4.6
Price/Book Value		16.5	10.6	7.8	6.0
Dividend Yield (%)		1.1	0.5	0.7	0.8
Profitability Ratios (%)					
RoE	44.6	40.3	42.3	36.5	33.0
RoCE	50.2	45.2	46.4	41.5	37.8
Turnover Ratios					
Debtors (Days)	68	62	64	58	62
Fixed Asset Turnover (x)	3.1	3.2	3.0	2.8	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	2007	2008E	2009E						
CF from Operations	23,450	30,190	44,370	52,187	63,353						
Cash for Working Capital	-9,755	-9,856	-5,840	-14,336	7,478						
Net Operating CF	13,696	20,334	38,530	37,851	70,830						
Net Purchase of FA	-8,298	-10,890	-14,960	-13,350	-20,000						
Net Purchase of Invest.	-1,059	6,660	4,010	-4,107	1,800						
Net Cash from Invest.	-9,357	-4,230	-10,950	-17,457	-18,200						
Proceeds from Equity & other	4,408	6,460	12,160	1,044	698						
Proceeds from LTB/STB	0	0	0	0	0						
Dividend Payments	-10,206	-4,030	-15,320	-8,558	-10,579						
Cash Flow from Fin.	-5,798	2,430	-3,160	-7,514	-9,881						
Free Cash Flow	21,187	605	23,241	12,560	33,893						
Net Cash Flow	-1,459	18,534	24,420	12,880	42,749						
Opening Cash Balance	17,215	15,756	34,290	58,710	71,590						
Add: Net Cash	-1,459	18,534	24,420	12,880	42,749						
Closing Cash Balance	15,756	34,290	58,710	71,590	114,339						

N O T E S



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