

INFOTECH ENTERPRISES

INR 362

Slow quarter but traction intact

BUY



In Q4FY07, Infotech Enterprises' revenues were in line, while profits were ahead of our expectations. Revenue stood at INR 1.5 bn, up 5.7% Q-o-Q, while net profit was at INR 249 mn, up 32.6% Q-o-Q. The growth in net profit was mainly on account of INR 41 mn income from the IASI JV, compared to a loss of INR 12.3 mn in the previous quarter and higher other income. Excluding that impact, net profit grew by 3.7% Q-o-Q. EBITDA margin on a Q-o-Q basis declined by 220bps, largely on account of higher employee costs (100bps), rupee appreciation (60bps), and higher lease expense (60bps).

We expect performance of the GSD segment, which has lagged company growth on account of problems in the North American geography, to improve going forward. A strong bid pipeline, improved traction from the US, and transformation of the business model in this segment infuses us with confidence. Outlook on engineering services continues to remain robust, with strong domain capability of the company in engineering solutions and industrial products space (particularly in the aerospace, rail and industrial sub-verticals) and further building expertise by investing in practices such as marine and automotive, which have started paying off. We expect the company to continue to grow 50% plus in this line of business.

We expect Infotech Enterprises' earnings to grow at a CAGR of 32.0% over FY07-09E. At CMP of INR 362, the stock trades at a P/E of 15.3x and 11.4x of our FY08E EPS of INR 23.7 and FY09E EPS of INR 31.6, respectively. We maintain our 'BUY' recommendation.

Key Highlights

- Revenue, at INR 1.5 bn, was up by 5.7% Q-o-Q and 40.3% Y-o-Y. Net profit stood at INR 248.5 mn, up 32.6% Q-o-Q and 49.8% Y-o-Y. For the purposes of comparison of core operating profit performance, Q4FY07 profit before share of profit in IASI grew 3.7% Q-o-Q (over Q3FY07).
- Employee costs as a percent of revenues rose significantly from 45.9% in Q2FY07 to 49.2% in the current quarter. This was mainly because of: (a) salary hikes of 15-17% given during the quarter to select employees; and (b) fuller impact of hiring in Q3FY07 and Q4FY07.

Financials

Year to March	Q4FY07	Q3FY07	Growth %	Q4FY06	Growth %	FY08E	FY09E
Revenue (INR mn)	1,512	1,430	5.7	1078	40.3	7,388	9,752
EBITDA (INR mn)	308	323	(4.6)	199	55.0	1,552	2,048
EBIT (INR mn)	234	257	(8.7)	151	55.7	1,316	1,718
Net profit (INR mn)	249	187	32.6	166	49.8	1,119	1,517
EPS basic (INR)	5.3	4.1	28.4	3.6	46.0	23.7	31.6
P/E (x)						15.3	11.4
EV/EBITDA (x)						14.7	10.7
Market cap/Revenue (x)						2.3	1.7

April 19, 2007

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Reuters : INFE.BO
Bloomberg : INFTC IN

Market Data

52-week range (INR) : 695 / 180
Share in issue (mn) : 46.1
M cap (INR bn/USD mn) : 16.7 / 379.2
Avg. Daily Vol. BSE/NSE ('000) : 146.9

Share Holding Pattern (%)

Promoters : 28.7
MFs, FIs & Banks : 23.0
FIIIs : 11.6
Others : 36.7

- ♦ The higher employee costs weighed on EBITDA margins (20.4%) for Q4FY07, which declined 220bps from those in Q3FY07. EBITDA, at INR 308 mn, declined 4.6% Q-o-Q.
- ♦ However, management has stated that margins will stabilize at ~ 20-22% levels in FY08E. We believe that shift of the revenue mix in favor of the higher margin EMI business segment will support EBITDA margins higher than 20% in FY08E.
- ♦ In the current quarter, most of the company's revenue increase has come from Europe, which accounted for 50.3% of revenues in Q4FY07. We believe that traction in Europe will continue to be healthy in FY08, given the relatively healthy demand in this geography for GSD and EMI. Several key clients that drove the company's growth in FY07 are from Europe.
- ♦ The company's net headcount addition for the quarter was 188, taking the total headcount to 5,131. On a Y-o-Y basis, the company's headcount has gone up by 29.0%. The headcount in GSD division grew by 21.9% Y-o-Y, while in the EMI division the headcount went up by 39%. The company has indicated that it will add 1,500 people (30%) to its headcount in FY08, which is encouraging.
- ♦ Attrition for the quarter stood at 13%, down from 14% in the previous quarter. This is particularly impressive compared to peers.

* Impressive performance in FY07

In FY07, Infotech once again delivered strong performance. Revenues stood at INR 5.45 bn (USD 120 mn), a growth of 49.7% over FY06. Adjusted net profits of INR 836 mn (15.4% of sales) in FY07 showed an impressive 65% growth over FY06, while EBITDA margin increased to 20.9% (versus 18.6%). The revenue growth in FY07 was powered by EMI services, which grew at 69%, while the GSD service line's growth was relatively tepid at 27%. The company hired 1,153 employees during the year, which constitutes a 29% increase in employee strength over FY06 levels.

* Investments in growing new services to pay off soon

Significant spend in the engineering space resides in the automotive engineering segment. The automotive industry is passing through a phase of rapid and constant changes in design requirements and OEMs and their suppliers are under constant pressure to bring superior products, and at faster time-to-market. This has led to opening up of opportunities for engineering services firms, which Infotech has been focusing on to grow. Infotech has already acquired four customers in this area and has built a team of 40 engineers. The company has also entered the marine engineering space recently and has been able to bag four customers.

We remain positive on the direction that the company is taking towards new areas for growth. Moreover, we particularly note the quality of customers and their potential, which seems comforting.

* Strong traction from existing clients to drive growth

Infotech has, in FY06, won multi-year deals which are in the early middle stage of ramp-up. This has led to strong growth in the engineering segment. We see this phenomenon continuing going forward, as further scale-up happens.

Table 1: Q-o-Q growth in different client category

Growth in average realization	Q1 FY 06	Q2 FY 06	Q3 FY 06	Q4 FY06	Q1 FY 07	Q2 FY 07	Q3 FY 07	Q4 FY07
Top 5 (%)	23.4	7.3	8.0	7.6	14.0	12.4	5.8	2.1
Top 10 (%)	19.3	6.2	16.0	10.0	14.2	16.9	7.1	5.2
Customers 6-10 (%)	0.2	(0.2)	64.4	19.8	14.9	33.1	10.9	14.2

Source: Company, Edelweiss research

*** M&A: Could be an upside risk to numbers**

Infotech has been continuously scouting for acquisitions to rapidly expand its presence in emerging areas of growth. Any closure of a deal in this regard will be a likely upside to our estimates, which is highly probable. The company currently has cash and cash equivalents of INR 740 mn.

*** Valuations**

The engineering services space continues to show relatively greater acceptance of outsourcing and in-turn offshoring. We see Infotech among the key leading players operating in the industrial products space of engineering services and further diversifying in the marine and avionics sub-vertical. Given the strong domain knowledge, long-term relationships with marquee clients along with improving traction for the GSD division, we expect the company to continue to post healthy growth rates going forward.

We expect the company's revenues and EPS to grow at a CAGR of 34% and 32%, respectively, over FY07-09E. At CMP of INR 362, the stock trades at a P/E of 15.3x and 11.4x of our FY08E EPS of INR 23.7 and FY09E EPS of INR 31.6, respectively. We expect the stock returns to largely track the earnings growth going forward. We maintain our **'BUY'** recommendation.

Financials snapshot

(INR mn)

Year to March	Q4FY07	Q3FY07	Growth %	Q4FY06	Growth %	FY07	FY08E	FY09E
Total revenues	1,512	1,430	5.7	1,078	40.3	5,425	7,388	9,752
Employee cost	744	656	13.4	495	50.4	2,589	3,499	4,661
Travel expenses	137	126	9.1	98	39.6	482	645	800
Cost of purchases	146	168	(13.4)	161	(9.5)	617	872	1,170
Operating & admin expenses	178	158	12.5	126	41.2	604	820	1,073
Total expenditure	1,204	1,108	8.7	879	36.9	4,292	5,836	7,704
EBITDA	308	323	(4.6)	199	55.0	1,134	1,552	2,048
Depreciation & ammortization	74	66	11.7	48	52.8	256	300	410
EBIT	234	257	(8.7)	151	55.7	878	1,316	1,718
Other income	19	0	9150.0	14	32.1	67	64	80
Interest expense	2	5	(52.1)	6	(62.9)	14	13	15
Extra ordinary item	-	-		-		-	-	-
PBT	251	252	(0.6)	158	58.3	930	1,303	1,703
Tax	44	53	(17.1)	36	21.5	187	265	366
Adjusted net profit	207	200	3.7	123	69.1	744	1,037	1,337
Share of IASI profit	41	(12)	(436.6)	43	(4.6)	93	82	180
Reported net profit	249	187	32.6	166	49.8	836	1,119	1,517
EPS basic (INR)	5.3	4.1	28.4	3.6	46.0	18.1	23.7	31.6
as % of net revenues								
Employee cost	49.2	45.9		45.9		47.7	47.4	47.8
Travel expenses	9.1	8.8		9.1		8.9	8.7	8.2
Cost of purchases	9.6	11.8		14.9		11.4	11.8	12.0
Operating & admin expenses	11.8	11.1		11.7		11.1	11.1	11.0
EBITDA	20.4	22.6		18.4		20.9	21.0	21.0
EBIT	15.5	18.0		14.0		16.2	17.8	17.6
Reported net profit	16.4	13.1		15.4		15.4	15.2	15.6
Tax rate	17.4	20.8		22.6		20.1	20.4	21.5

Company Description

Infotech Enterprises (Infotech) is a 5,100 plus employee software services company with competencies in: (a) GIS services catering to utility, transportation, and government segments; (b) engineering design services for engineering, manufacturing, and industrial products verticals; and (c) software services to clients in both the verticals—data & technology services, engineering design, and IT services. The company has grown its revenues and net profits at a CAGR of 45.3% and 74.8%, respectively, over FY05-07. The company's past twelve months revenues stood at INR 5.4 bn (USD 120.3 mn).

Investment Theme

Outsourcing of engineering services is expected to reach USD 38-50 bn by 2020E compared with USD 2 bn now, as per a Nasscom, Booz Allen Hamilton study. As one of the leading offshore engineering services firm for manufacturing industry, Infotech is poised to grab the increasing opportunities. The company has strong domain knowledge and complete solution capability in the GIS segment along with healthy pipeline of deals. The company's skills in the areas of mapping and designing across diverse segments and in a variety of end user IT environments give it an edge. We expect Infotech's revenues and net profits to grow at a CAGR of 42.7% and 50.8%, respectively, over FY06-08E.

Key Risks

Key risks to our investment theme include:

- (a) Adequate availability of skilled manpower.
- (b) Slowdown in engineering spending
- (c) Significant appreciation of rupee against the USD, Euro, and GBP.

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RATING INTERPRETATION

Buy	Expected to appreciate more than 20% over a 12-month period	Reduce	Expected to depreciate up to 10% over a 12-month period
Accumulate	Expected to appreciate up to 20% over a 12-month period	Sell	Expected to depreciate more than 10% over a 12-month period
Trading Buy	Expected to appreciate more than 10% over a 45-day period	Trading Sell	Expected to depreciate more than 10% over a 45-day period

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