Infosys Technologies

STOCK INFO.	BLOOMBERG
BSE Sensex: 8,198	INFO IN
	REUTERS CODE
S&P CNX: 2,577	INFY.BO

Equity Shares (m)	572.5
52-Week Range	2,017/1,040
1,6,12 Rel. Perf. (%)	4/-37/-49
M.Cap. (Rs b)	677.1
M.Cap. (US$ b)	13.1

5 March 2009 — **Buy**

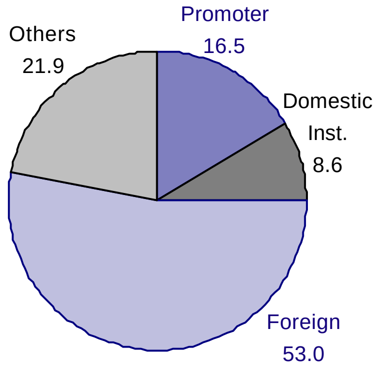
Previous Recommendation: Buy — Rs1,183

YEAR END	NET SALES (RS M)	PAT* (RS M)	EPS (RS)	EPS GR. (%)	P/E (X)	P/BV (X)	ROE (%)	ROCE (%)	EV/ SALES	EV/ EBITDA
3/07A	138,930	37,250	66.1	48.1	17.9	5.9	40.9	40.8	4.4	13.8
3/08A	166,920	45,580	79.5	20.3	14.9	4.9	36.4	36.4	3.6	11.6
3/09E	216,684	57,970	101.1	27.1	11.7	3.9	37.2	37.2	2.7	8.3
3/10E	222,651	58,979	102.7	1.6	11.5	3.2	30.5	30.5	2.5	8.1

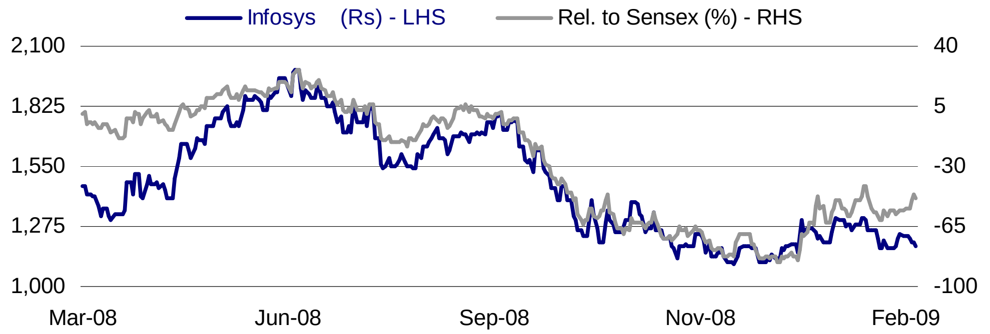
We interacted with Infosys' COO and Member of Board, Mr Shibulal and discussed several issues relating to the growth outlook for FY10. We present below our key takeaways.

- **Will provide guidance for FY10; budgets to be down 10-12%:** Infosys has confirmed that it will provide annual guidance for FY10 in its 4QFY09 earnings release. While there would be greater visibility on client budgets/spends for FY10 in the last two weeks of March, the management currently expects budgets to decline by 10-12%. IT spending cuts have spread from BFSI to almost all verticals like Manufacturing, Retail, etc. However, Infosys appears confident of growing its volumes in FY10.
- **Pricing outlook unchanged since 3Q; 4-5% decline manageable:** In the conference call post its 3QFY09 results, the management had mentioned that there was a possibility of further aggravation in pricing. However, Infosys has not seen any significant pricing deterioration since then. The management believes that it would be able to neutralize pricing decline of 4-5% over a 12-month span by using margin levers, arresting margin decline to ~100bp. The levers that it intends to use include changing time-and-material (T&M) projects to fixed-price projects (FPP), increasing offshoring, converting projects to managed services, etc.
- **Low currency hedge implies muted forex losses:** With forex hedges of US$576m, Infosys is the lowest hedged company among the large caps. It reduced its hedges drastically from US$932m in 2QFY09. Assuming stable currency rates for the rest of the quarter, rupee depreciation will be 6% QoQ. In such a scenario, Infosys will be relatively better off with lower hedges. For every 5% change in INR/US$ rate, EPS gets impacted by about 7%.
- **Valuation and view:** We believe that Infosys could guide flat to marginally negative US$ revenues for FY10, building in positive volume growth and 4-5% pricing decline. Margin management could be key driver for earnings, given its hedges and other cost measures. Our current estimates factor EPS growth of 1.6% in FY10 to Rs102.7 (will be upgrading to factor revised currency assumptions). The stock trades at 11.5x FY10E earnings. **Buy**.

SHAREHOLDING PATTERN % (DEC.08)



STOCK PERFORMANCE (1 YEAR)



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We interacted with Infosys' COO and Member of Board, Mr Shibulal and discussed several issues relating to the growth outlook for FY10. While the business environment has turned more challenging, Infosys appears confident of delivering volume growth in FY10. We see the recent currency movement as a significant earnings driver in a year where most of other parameters are headwinds. We maintain our Buy recommendation.

Will provide guidance for FY10; budgets to be down 10-12%

Post Microsoft's decision to discontinue guidance owing to unprecedented global turmoil, there was apprehension about whether Indian companies will continue to guide. Infosys has confirmed that it will provide annual guidance for FY10 in its 4QFY09 earnings release. The management expects greater visibility on client budgets/spends for FY10 in the last two weeks of March, providing the basis for the guidance. It cautioned, however, that the budgets may not be sacrosanct and could change later.

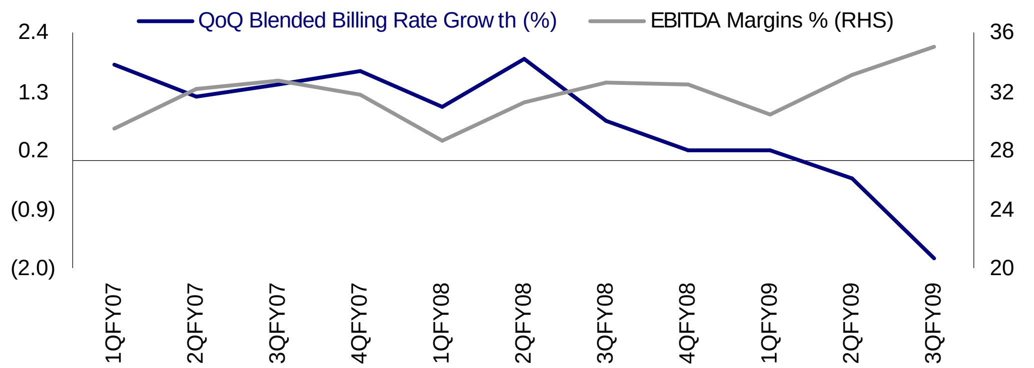
It currently expects overall budgets to decline by 10-12%, with the cuts in discretionary spending being much higher. Discretionary spending constitutes about 40% of Infosys' revenues. Non-discretionary IT spends would, however, not witness significant cuts. IT spending cuts have spread from BFSI to almost all verticals like Manufacturing, Retail, etc. However, Infosys is confident of growing its volumes in FY10.

Infosys also mentioned that the adverse impact on revenues would largely be a function of the vendor's client profile, rather than geography or industry concentration. Verticals like Utilities, Energy, Environment and Healthcare could, nevertheless, fare relatively better than others. In constant currency, BFSI grew 4.1% QoQ, while manufacturing declined 3.7% QoQ in 3QFY09.

Pricing outlook unchanged since 3Q; 4-5% decline manageable

In the conference call post its 3QFY09 results, the management had mentioned that there was a possibility of further aggravation in pricing. Infosys' blended realizations in constant currency declined by 1.8% QoQ, last quarter. It continues to take a portfolio approach to client demands for pricing renegotiations. The company mentioned that there have been some instances of irrational pricing behavior by a few vendors.

MARGINS MANAGED DESPITE FALLING REALIZATIONS



3QFY09 billing rate change is in constant currency *Source: Company/MOSL*

The management believes that it would be able to neutralize pricing decline of 4-5% over a 12-month span by using margin levers, arresting margin decline to ~100bp. The levers that Infosys intends to use include changing time-and-material (T&M) projects to fixed-price projects (FPP), increasing offshoring, converting projects to managed services, etc. It can also rationalize variable salaries, which constitute about 30% of offshore salary costs.

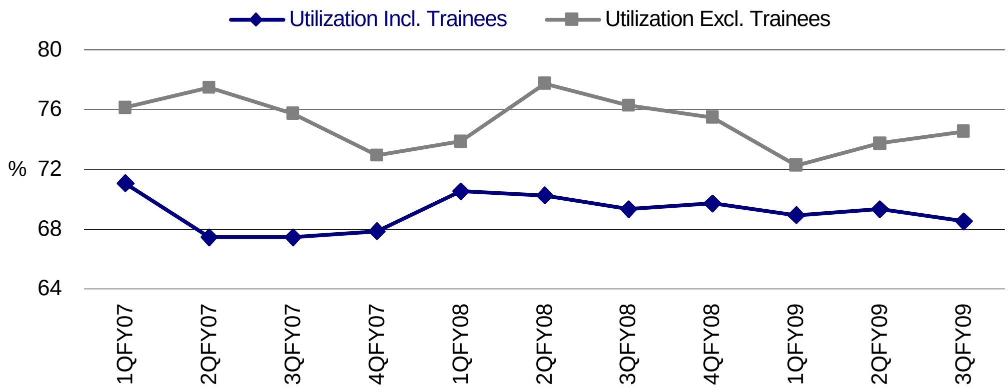
No large project cancellations; no adverse impact of vendor consolidation

Infosys has not seen large project cancellations, yet. Though a few projects have been cancelled, the magnitude is small and this would not impact revenues, materially. The company had participated in a few vendor consolidation exercises in 3QFY09, and it did not lose even in a single instance. Infosys' premium billing rates have not impacted its position adversely in such exercises. We believe its ability to come unscathed in such a tough demand environment is an indication of the high client loyalty that Infosys enjoys.

Campus recruits to join as scheduled; utilization could decline

The management expects campus recruits to join on schedule (July 2009 onwards) and is not deferring the joining dates. Infosys had made 20,000 offers and expects the acceptance rate to rise to 80-90% (from ~75% earlier). With their training period being longer, the new recruits would be billable after 27 weeks of joining as against 16 weeks earlier. Hence, most campus recruits will actually become billable by FY11. With expected addition of 27,000 employees (gross) in FY09 and 20,000 offers for FY10, utilization (including and excluding trainees) could decline, going forward. Utilization including trainees had declined by 90bp QoQ in 3QFY09 to 68.5%.

UTILIZATION WOULD CONTINUE TO BE STRESSED

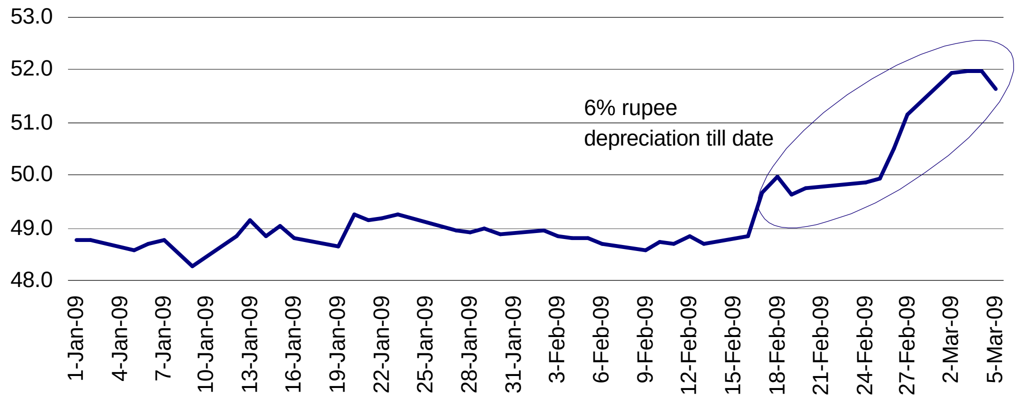


Source: Company/MOSL

Low currency hedge implies muted forex losses

With forex hedges of US$576m, Infosys is the lowest hedged among the large caps. It reduced its hedges drastically from US$932m in 2QFY09. Assuming stable currency rates for the rest of the quarter, rupee depreciation will be 6% QoQ. In such a scenario, Infosys will be relatively better off with lower hedges. Our estimates currently factor average currency rate of Rs45.6/US$ for FY10, yielding an EPS of Rs102.7. For every 5% change in the INR/US$ rate, Infosys' EPS gets impacted by about 7%.

REDUCED HEDGES TO CURTAIL FOREX LOSSES DUE TO RUPEE DEPRECIATION (INR/USD)



Source: Company/MOSL

Valuation and view

We believe that Infosys could guide flat to marginally negative US$ revenues for FY10, building in positive volume growth and 4-5% pricing decline. While some horizontals like ERP and consulting are likely to suffer, a comprehensive services portfolio would enable Infosys to tide through the crisis. Margin management could be key driver for earnings, given its hedges and other cost measures. Our current estimates factor EPS growth of 1.6% in FY10 to Rs102.7 (will be upgrading to factor revised currency assumptions). The stock trades at 11.5x FY10E earnings. We maintain **Buy**.

INCOME STATEMENT					(RS MILLION)
Y/E MARCH	2006	2007	2008	2009E	2010E
Sales	**95,216**	**138,930**	**166,920**	**216,684**	**222,651**
Change (%)	*33.5*	*45.9*	*20.1*	*29.8*	*2.8*
Software Develop. Exp.	50,654	74,580	92,070	118,517	126,578
Selling and Mktg. Exp.	6,005	9,290	9,160	11,137	11,126
Administration Exp.	7,639	11,150	13,310	16,036	15,403
EBITDA	**30,918**	**43,910**	**52,380**	**70,995**	**69,544**
% of Net Sales	*32.5*	*31.6*	*31.4*	*32.8*	*31.2*
Depreciation	4,371	5,140	5,980	7,462	7,624
Other Income	1,396	3,700	7,040	4,370	10,005
PBT	**27,943**	**42,470**	**53,440**	**67,903**	**71,925**
Tax	3,132	5,110	7,860	9,932	12,947
Rate (%)	*11.2*	*12.0*	*14.7*	*14.6*	*18.0*
Minority Interest	210	110	0	0	0
Adjusted PAT	**24,601**	**37,250**	**45,580**	**57,970**	**58,979**
Extraordinary Items	18	-1,310	-1,010	-930	0
Reported PAT	**24,583**	**38,560**	**46,590**	**58,900**	**58,979**
Change (%)	*30.0*	*56.9*	*20.8*	*26.4*	*0.1*

BALANCE SHEET					(RS MILLION)
Y/E MARCH	2006	2007	2008	2009E	2010E
Share Capital	1,380	2,860	2,859	2,868	2,876
Share Premium	15,430	27,680	28,511	29,562	30,496
Reserves	52,850	82,010	106,580	141,361	179,638
Net Worth	**69,660**	**112,550**	**137,950**	**173,790**	**213,010**
Minority Interest	680	40	0	0	0
Loans	0	0	0	0	0
Capital Employed	**70,340**	**112,590**	**137,950**	**173,790**	**213,010**
Gross Block	29,830	46,420	54,390	66,390	78,390
Less : Depreciation	13,280	18,360	19,860	27,322	34,946
Net Block	**16,550**	**28,060**	**34,530**	**39,068**	**43,444**
CWIP	5,710	9,650	13,240	12,000	15,000
Investments	7,550	250	720	1,020	1,320
Curr. Assets	**63,990**	**96,130**	**131,370**	**161,062**	**198,089**
Debtors	16,080	24,360	32,970	41,831	43,570
Cash & Bank Balance	34,290	58,710	69,500	85,167	114,409
Loans & Advances	12,970	12,140	27,710	32,962	38,287
Other Current Assets	650	920	1,190	1,104	1,823
Current Liab. & Prov	**23,460**	**21,500**	**41,910**	**39,360**	**44,842**
Creditors	7,320	11,540	16,240	15,817	15,903
Other liabilites	2,020	3,150	2,880	4,574	3,085
Provisions	14,120	6,810	22,790	18,969	25,854
Net Current Assets	**40,530**	**74,630**	**89,460**	**121,702**	**153,246**
Misc. Expenses	0	0	1	1	1
Application of Funds	**70,340**	**112,590**	**137,950**	**173,790**	**213,010**

E: MOSL Estimates

RATIOS *					(RS MILLION)
Y/E MARCH	2006	2007	2008	2009E	2010E
Basic (Rs)					
EPS	**44.6**	**66.1**	**79.5**	**101.1**	**102.7**
Cash EPS	105.1	75.2	89.9	114.1	115.9
Book Value	252.8	199.7	240.6	303.0	370.8
DPS	22.5	11.5	33.2	35.9	30.8
Payout %(Incl.Div.Taxes)	50.3	17.4	41.7	35.6	30.0
Valuation (x)					
P/E		17.9	14.9	11.7	11.5
Cash P/E		15.7	13.2	10.4	10.2
EV/EBITDA		13.8	11.6	8.3	8.1
EV/Sales		4.4	3.6	2.7	2.5
Price/Book Value		5.9	4.9	3.9	3.2
Dividend Yield (%)		1.0	2.8	3.0	2.6
Profitability Ratios (%)					
RoE	40.4	40.9	36.4	37.2	30.5
RoCE	40.2	40.8	36.4	37.2	30.5
Turnover Ratios					
Debtors (Days)	56	53	63	63	70
Fixed Asset Turnover (x)	6.6	6.4	5.6	6.0	5.6
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	2006	2007	2008	2009E	2010E
CF from Operations	29,428	42,790	52,260	66,449	65,884
Cash for Working Capital	3,549	-9,410	-3,770	-16,662	-1,582
Net Operating CF	**32,977**	**33,380**	**48,490**	**49,787**	**64,301**
Net Purchase of FA	-10,890	-20,590	-16,040	-10,760	-15,000
Net Purchase of Invest.	4,558	7,300	-470	-300	-300
Net Cash from Invest.	**-6,332**	**-13,290**	**-16,510**	**-11,060**	**-15,300**
Proceeds from Equity & oth	6,010	11,840	1,060	1,059	942
Proceeds from LTB/STB	0	0	0	0	0
Dividend Payments	-14,120	-7,510	-22,250	-24,120	-20,702
Cash Flow from Fin.	**-8,110**	**4,330**	**-21,190**	**-23,060**	**-19,759**
Net Cash Flow	**18,535**	**24,420**	**10,790**	**15,666**	**29,242**
Opening Cash Balance	**15,755**	**34,290**	**58,710**	**69,500**	**85,166**
Add: Net Cash	18,535	24,420	10,790	15,666	29,242
Closing Cash Balance	**34,290**	**58,710**	**69,500**	**85,166**	**114,409**

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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