

02 Sep, 2008

Key Data	(INR)
CMP	1775
Target Price	1899

Key Data	
Bloomberg Code	INFO IN
Reuters Code	INFY.BO
BSE Code	500209
NSE Code	INFOSYSTCH
Face Value (INR)	5
Market Cap. (INR Bn.)	986.3
52 Week High (INR)	2140
52 Week Low (INR)	1212
Avg. Daily Volume (6m)	366762
Beta (Sensex)	0.71
F&O	
Market Lot	200
Turnover (Rs Bn)	2.2

Shareholding	%
Promoters	16.5
Mutual Funds / UTI	3.9
Financial Institutions / Banks	4.0
Foreign Institutional Investors	33.6
Individuals	18.7
Bodies Corporate	3.1
Non Resident Indians and others	20.2
<b>Total</b>	<b>100.0</b>

INR Bn	FY08	FY09E	FY10E
Revenues	166.9	220.0	262.1
Operating Profit	52.4	68.8	79.6
OPM (%)	31.4	31.3	30.4
PAT	46.6	58.2	67.9
PAT Margin %	27.9	26.5	25.9
EPS (Rs.)	81.5	101.8	118.7

Analyst

**Hardik Shah**

hardik.shah@acm.co.in

Tel: (022) 2858 3409

## Infosys Technologies Limited

### Background

Infosys Technologies Limited (Infosys), started in 1981, is India's second largest IT company in terms of revenues and the largest company in terms of earnings. It provides solutions that span the entire software life cycle encompassing consulting, development, maintenance, systems integration and package evaluation and implementation. Infosys, also offers software products for the banking industry and IT Enabled Services (ITES).

### Investment Rationale

- Infosys's strategy is to gradually reduce its dependence on traditional service line (i.e. application development & maintenance services-ADM) and become an end-to-end IT solution provider for its clients. The diversification is expected to benefit Infosys, as non-traditional service lines are expected to grow at a faster pace than traditional service line.
- Infosys enjoys higher margins, on account of its relatively higher billing rates and effective cost management. Going forward, we expect Infosys to maintain its lead in margin because of its non-linear growth initiatives and increased contribution of high-end services such as consulting in total revenues.
- Infosys has made an open offer of \$753 Mn in cash to acquire Axon Group Plc. (Axon); a UK based SAP consultants. If this offer goes through, it will provide Infosys an opportunity to cross-sell its services to 200 clients of Axon, diversify its geography risk by increasing share of Europe in total revenues and ability to participate in large deals in SAP area, as the combined entity will result in fifth largest SAP consultant. However, we have not considered the acquisition in financial projections as offer is yet to be approved by shareholders of Axon.

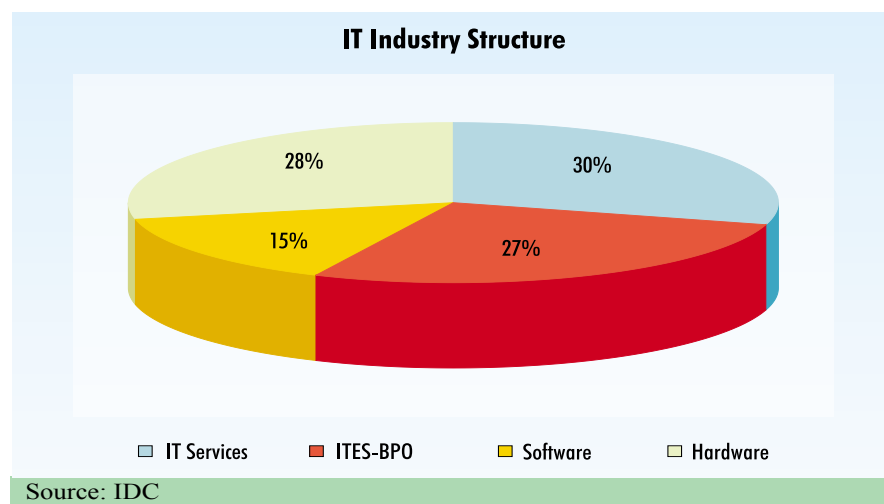
### Valuation and Recommendation

We expect, Infosys's revenue to grow at a CAGR of 25.3% over the period of FY08 -FY10E, considering the trend in offshore IT spend and Infosys's leading position in offshore market. Whereas, net profit is expected to grow at a CAGR of 20.7% over the same period, taking into account the impact of wage inflation on margins. At CMP of Rs. 1775 the stock trades at PER of 17.4x and 15.0x its FY09E and FY10E EPS of Rs.101.8 and Rs.118.7, respectively. We initiate coverage on Infosys with **HOLD** recommendation and price target of Rs.1899 based on 16x FY10E EPS of Rs 118.7.

## Industry

### IT Industry

IT industry is a generic term, which includes IT Services, ITES (IT- Enabled Services), Packaged Software and Hardware (Refer-Annexure). The size of IT industry as a whole was USD 1685 Bn in CY07 and grew at a CAGR of 7.4% over the period of CY04 to CY07. Among the four segments of IT industry; biggest segment is IT services followed by Hardware, ITES and Software.



### IT Services

IT Services, as a market, can be segmented into ‘Outsourced services’ and ‘Captive Units’ (in-house) based on execution responsibility. Independent service providers deliver ‘Outsourced services’, undertaking delivery responsibility for a price. The trend towards Outsourced services continues because of increase in demand for IT specialists.

Considering the location from where service is provided, the market can be classified into ‘Onsite’ services and ‘Off-shore’ services (i.e. services outsourced outside the home country). Offshore locations leverage their strength in availability of skilled talent at relatively lower cost to provide cost effective services. Within IT services, ‘Captives’ constitute major portion followed by ‘Onsite Services’ and ‘Offshore services’.

### IT services market structure

	CY07 (In USD Bn)	Share %
Offshore services	35	7%
Onsite services	148	30%
Outsourced services	183	37%
Captives (in-house services)	313	63%
Worldwide IT Services	496	100%

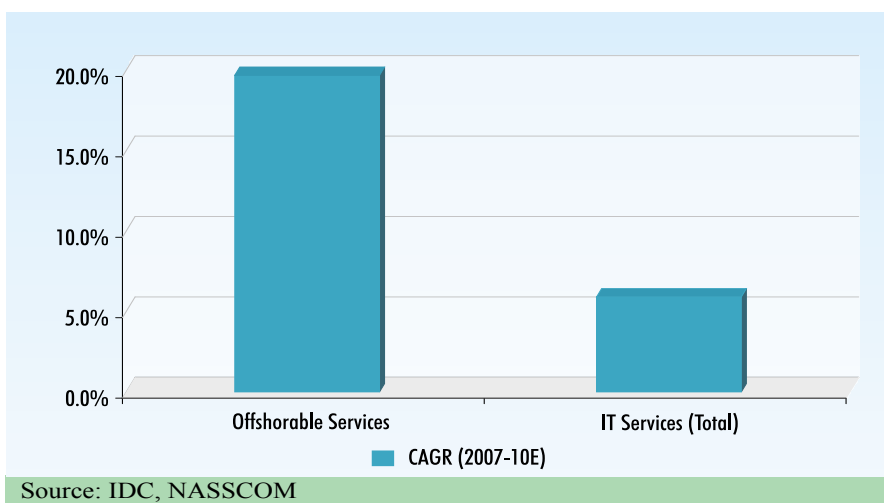
Source: NASSCOM

However, going forward, share of captives (in-house services) is expected to come down (due to increased complexity in IT services, requiring services from 3rd party), whereas that of outsourced services is expected to increase.

“  
**Offshore IT services expected to grow ~3 times faster than World-wide IT services spend**  
 ”

(In USD bn)	CY07	CY11E	CAGR %
Outsourced services	183	242	7.2%
Share %	36.9%	39.0%	
Captive (in- house services)	313	378	4.8%
Share %	63.1%	61.0%	
Worldwide IT Services	496	620	5.7%
Source: IDC, NASSCOM			

Further growth in outsourced services is expected to come from offshore locations (because of the significant cost advantage in delivering services as against delivery from onsite location). Offshore IT services market is expected to grow ~3 times faster than World-wide IT Services over next 3 years (Source: IDC, NASSCOM).



### Indian IT Services market

The domestic IT market is at a nascent stage (compared with the global IT industry), as most users in India are in the initial stages of IT development. Hence, Indian IT service industry is dependent on exports for more than 3/4th of its total revenues.

### Size of Indian IT services industry

(USD in Bn)	Exports	Domestic	Total
FY03	5.5	2.4	7.9
FY07	18.1	5.6	23.7
CAGR % (FY03-FY07)	34.7%	23.6%	31.6%
Source: NASSCOM, CRIS INFAC			

### India's advantage in IT space

India is the most favored offshore location for IT Services (Source: - AT Kearny Global Services Location Index 2007) and is the leading player in Offshore IT Services market having market share of 65% in FY07 (Source: NASSCOM).

Dominance of India in offshore market is because of its financial attractiveness (i.e. cost competitiveness) as well as availability of abundant suitable talent pool in India.

- In terms of compensation cost for human resources, India has a sizeable advantage, as its costs are around 4 times lower than that in the US (which is the main client destination) and also one of the most cost competitive destinations among low cost destinations.

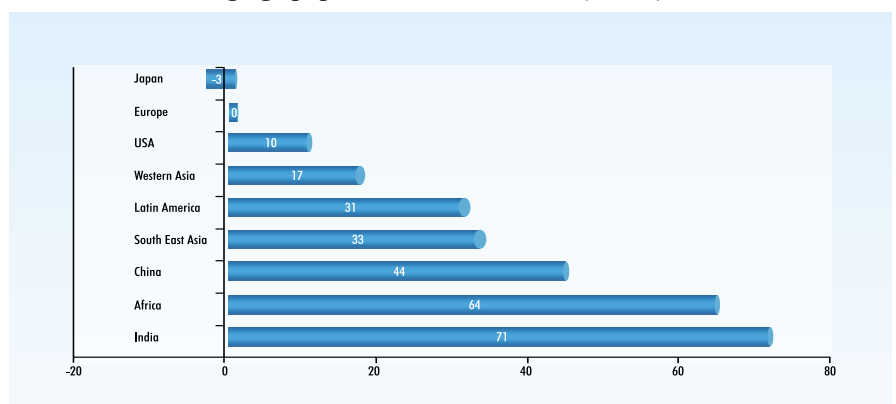
“  
**India is the most favored offshore destination and has 65% market share in Offshore IT services**  
 ”

IT managers salary p.a.: - Top 10 paying countries			IT managers salary p.a.: -Lowest 10 paying countries		
Ranking	Countries	USD	Ranking	Countries	USD
1	Switzerland	140,960	1	Vietnam	15470
2	Denmark	123,080	2	Bulgaria	22240
3	Belgium	121,170	3	Philippines	22280
4	UK	118,190	4	India	25000
5	Ireland	108,230	5	Indonesia	31720
6	US	107,500	6	China (Shanghai)	33770
7	Germany	106,730	7	Malaysia	35260
8	Canada	93,860	8	Czech Republic	35880
9	Hong Kong (China)	90,340	9	China (Beijing)	36220
10	Australia	88,850	10	Argentina	43180

Source: Mercer (2007)

- In terms of availability of talent pool, India has the largest pool of suitable offshore talent – accounting for 28 per cent of the total suitable talent pool available across all offshore destinations, outpacing the share of the next closest destination, China, by a factor of 2.4 (Source: -NASSCOM). Going forward, India is expected to be the largest contributor to the growth in the worldwide working population. This will enable India to maintain the lead in offshore IT market. Also, education skills wise India is ranked highest (Source-AT Kearney’s ‘Global Services Location Index 2007’).

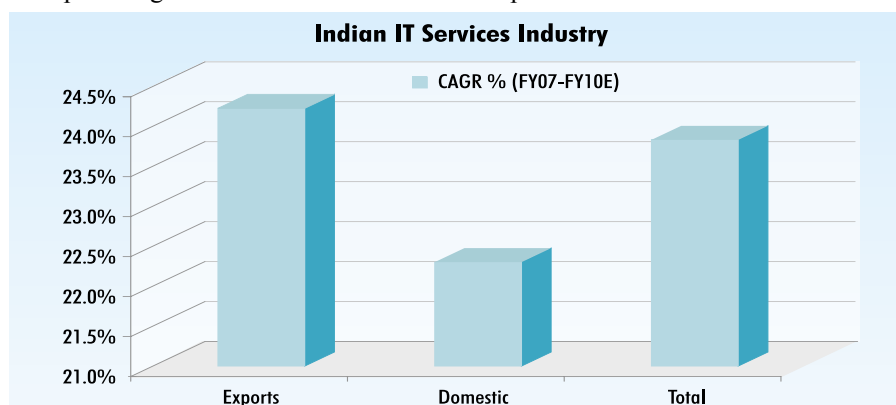
#### Addition to working age population from 2005-10 (in Mn)



Source: NASSCOM

#### Future outlook

Despite concerns of the global economy slowdown in 2008, NASSCOM expects Indian IT exports to grow at a CAGR of 24% over the period of FY07 to FY10E.



Source: NASSCOM

“  
**Indian IT vendors have  
 penetrated only 1/4th of total  
 addressable Offshore IT  
 services market**  
 ”

NASSCOM's projections of more than 20% growth in Indian IT exports, over the next 3 years is based on expectations of higher penetration by Indian companies in the total addressable offshore market.

### Market Opportunity

(In USD Bn)	IT & Engineering Services		BPO Services	
	Current	Addressable	Current	Addressable
Offshore market	~47	~200-250	~29	~160-190

Source: NASSCOM, IDC

In non-traditional service lines (i.e. all IT Services besides Application Development & Maintenance) relatively higher growth rate is expected, as client's confidence on Indian IT Service providers has increased over the years to carry out complex projects. As a result, share of non-traditional service lines, in total IT Services exports, is expected to increase from 39% in FY06 to 48% in FY11P (Source: CRIS INFAC).

### Global IT industry and share of India in global IT spend -by service lines

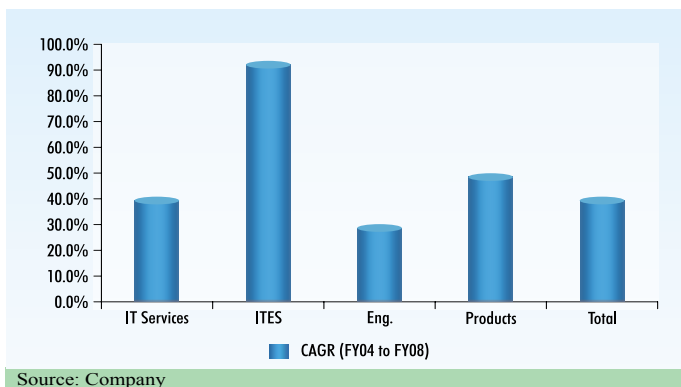
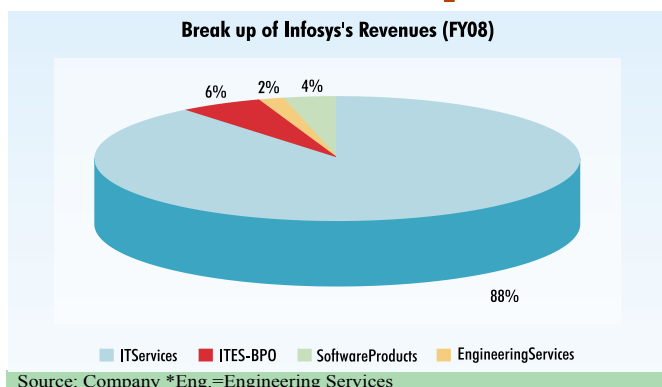
Service-lines	Worldwide IT services		India's IT services exports			
	(USD Bn)	(USD Bn)	% of World	Growth rate %		
				2003-06	2006-11P	
Custom application development	24.4	8.9	36.4%	29.4%	20.4%	
IT consulting	25.6	0.5	1.8%	63.2%	34.6%	
System integration	81.1	0.5	0.6%	55.2%	34.8%	
Network consulting and integration	30.7	0.2	0.7%	76.9%	24.4%	
Application management	22.5	2.2	9.6%	-	19.8%	
IS outsourcing	92.4	1.1	1.2%	110.5%	40.0%	
Others	55.6	3.0	5.4%	-	26.4%	
Support and training	137.8	1.7	1.2%	49.4%	24.1%	
Total	470.1	18.1	3.8%	33.9%	24.3%	

Source: NASSCOM, CRISINFAC

### Infosys

#### Business Model

Infosys derives major portion of the revenues from IT services followed by ITES-BPO, Software Products and Engineering Services. However the share of IT services segment in Infosys's total revenues has come down (from 93% in FY04 to 88% in FY08) because of relatively higher growth in other segments, especially BPO (which grew from 2% of total revenue in FY04 to 6% in FY08).



Infosys's market share in India's IT services exports is relatively high (share of captives in India's IT services exports is 2% to 3%), as compared to its market share in India's ITES exports (share of captive units in India's ITES exports is 45% to 50%).

#### Infosys's share in India's IT exports (FY08)

(In USD Bn)	India's IT exports	Infosys	Infosys's share in Indian IT exports (%)
IT services	23.1	3.72	16.1%
ITES-BPO	10.9	0.24	2.2%
Software Products & Engineering Services	6.3	0.22	3.4%

Source: NASSCOM, Company

#### IT Services

Within IT services, share of Traditional service line (ADM) in revenue is more than 50%, however with increase in focus on other service lines (Testing services, Infrastructure management and Consulting services & Package Implementation) the share of traditional service line in IT services has declined to 51% in FY08 from 54% in FY07 (inspite of 28% growth on Y-o-Y basis).

#### Breakup of revenue from IT Services

Service Lines	% of Infosys 's IT Services		Growth (%)
	FY08	FY07	Y-o-Y (in USD)
Application Development& Maintenance	51.0%	53.5%	27.8%
Consulting Services & Package Implementation	26.7%	23.5%	52.4%
Infrastructure management	5.5%	4.9%	50.5%
System Integration	3.1%	2.6%	64.5%
Testing Services	8.4%	7.7%	46.9%
Others	5.3%	7.9%	-10.5%
Total	100.0%	100.0%	34.1%

Source: Company

“  
Share of non-traditional  
service lines in revenues is  
increasing  
”

“  
**Infosys leads among offshore players in traditional service line**  
”

### 1. Traditional service line (ADM)

ADM is a key service line for Indian IT vendors accounting for nearly 58% of India’s IT Services exports in FY08, reason for the same is high offshorability of ADM services i.e. nearly 85% of the work in a typical ADM project can be delivered from offshore.

Infosys is among the strongest offshore providers in the traditional service line. According to Forrester Research (an IT services related advisory firm), in spite of not being the most price-competitive offshore provider, Infosys’s strong reputation for cultural fit among North American customers allows it to compete effectively with MNCs and offshore rivals alike. Further as per Forrester’s report, Infosys leads the ADM space among offshore players, due to its strong capabilities across every aspect of ADM.

#### Rating of top players in ADM space

Companies	(Score out of 5)		(Score out of 10)
	Current Offering	Strategy	Total
Accenture	4.68	3.83	8.51
Infosys	3.99	4.3	8.29
IBM	4.27	3.88	8.15
TCS	4.04	3.95	7.99
Cognizant	4.22	3.6	7.82

Source: Forrester \*For more details refer Annexure 2

Going forward, growth from this space is expected to be lower, considering the high penetration level reached in ADM space by Indian vendors.

### 2. Other service lines

Infosys’s strategy is to gradually reduce its dependence on traditional service line and become an end-to-end IT solution provider for its clients. In this direction, Infosys has invested in higher end service lines such as consulting, infrastructure management and system integration. As a result of this, ADM’s share in Infosys’s total revenues has declined to 45% in FY08 from 56% in FY04. Going forward, main growth driver for Infosys are expected to be testing, consulting and infrastructure management services.

- **Infrastructure management (IS)**

Infrastructure management is the biggest service line in worldwide IT Services. The market size for the same is around USD 100 Bn p.a. However, India’s penetration level in this space is only 3% (FY08), as infrastructure-outsourcing business requires IT vendors to have a large scale/size to qualify for such contracts. Tier I Indian IT vendors having attained the required size; have started winning contracts in this space in last couple of years. As a result, infrastructure outsourcing has been the fastest growing segment of Indian IT services exports over the period of FY05 to FY08.

Infosys is one of the leading offshore players in infrastructure management space and has been able to distinct itself as a leader (as per Forrester) in the Infrastructure management space within a span of 5 years of entering this space. Infosys executes ~75% of its work at offshore centers in infrastructure outsourcing space, as against Indian industry’s average of ~50%, enabling Infosys to offer better prices to its clients.

Going forward, infrastructure outsourcing will be a key growth driver for Infosys considering the huge opportunity in this space and its cost advantage against the peers. Also these projects offer non-linear growth opportunity, as they are not typically time based or fixed contract based, providing scope for higher margins.

“  
**Market potential for offshore players in IS is ~\$50 Bn**  
”

“  
**Infosys enjoys cost advantage in IS because of its higher than average offshore revenue mix**  
”



**Market potential for India in IT testing services is \$4.2 Bn**



**Plans to introduce 3 platforms in this fiscal year**



- **Testing Services**

The worldwide software testing market is expected to be more than \$13 billion by 2010, out of which 45-50 percent (approximately \$6 billion) is expected to be outsourced (Source: Gartner). India has the potential to corner 70% share of the outsourced testing market (Source: NASSCOM). In FY08, India's export revenues from testing was only \$0.4 Bn (Source: NASSCOM), offering huge opportunity to India based service providers.

Infosys is one of India's leading players in testing services, deriving 8% of its total revenues (in FY08) from this space. It has registered a CAGR of 57% (in USD) in testing services over the period of F06 to FY08, as against growth of 39% (in USD) for the company as whole over the same period. Testing space is expected to drive growth for Infosys in coming years, considering the opportunity in the space and Infosys's leading position.

- **Consulting Services**

To move up the value chain, IT companies need to invest in account managers who mine the existing clients and excellent sales professionals who can win potential million dollar clients. Apart from these sales and marketing costs, IT vendors also have to undertake brand building exercise to shift their positioning from pure service providers to business transformation agents. Infosys has made a conscious effort on this front and has invested around Rs.1, 710 Mn in its consulting subsidiary. Infosys has more than 2000 consultants; contributing ~8% (including consulting in ERP space) of its total revenue. IT Consulting services will enable Infosys to differentiate itself from plain vanilla offshore players and help in becoming trusted transformational partner for its clients.

### **IT Enabled Services (ITES)**

ITES space is as large as IT services space, offering huge opportunity to grow for Indian players. As per CRISIL Research, Indian ITES industry will grow at a CAGR of 22% to touch \$29.7 billion by 2012-13. However, margins are likely to be under pressure going forward, as average wage hike in ITES industry is expected to remain high because of scarcity of suitable talent pool (Source-Hewitt).

ITES has been one of the fastest growing segments for Infosys, registering a CAGR of 77% (in USD) over the period of FY05 to FY08. Transaction processing constitutes ~80% of Infosys's ITES business and ~20% is voice business.

Infosys's strategy is to have Global Delivery Model (GDM) rather than India centric model. It has 6 centers outside India (3 centers in Asia, 2 in Continental Europe and 1 in Latin America) beside 5 centers in India. Infosys is developing new platforms and is planning to introduce three new platforms in this fiscal year. These platforms offer non-linear growth opportunity, as companies get paid based on output rather than get paid based on fixed or time & material basis, providing scope for higher margins. Considering recent trends of combining IT services contracts with ITES contracts (Source: TPI), vendors such as Infosys providing end-to-end IT solutions stands to gain from the same.

### **Inorganic route for growth in niche areas**

#### **Proposed acquisition of Axon Group Plc**

- **Summary of the transaction:** -Infosys has made an open offer of \$753 mn in cash to acquire Axon Group Plc. (Axon); a U.K. based listed company. Acquisition is through scheme of arrangement and deal is expected by management to close in November 2008. However, if Axon shareholders vote in favor of another buyer and that deal is completed before January 31, 2009, Axon would pay Infosys an inducement fee of one per cent of the consideration payable by Infosys for Axon shares.



“  
**Axon is debt free company  
having cash balance of Rs.2.1  
Bn**  
”

“  
**ERP is expected to grow at  
double the pace of IT services  
over period of 2007-10E**  
”

“  
**After acquisition Infosys will be  
the leading SAP consultant in  
India**  
”

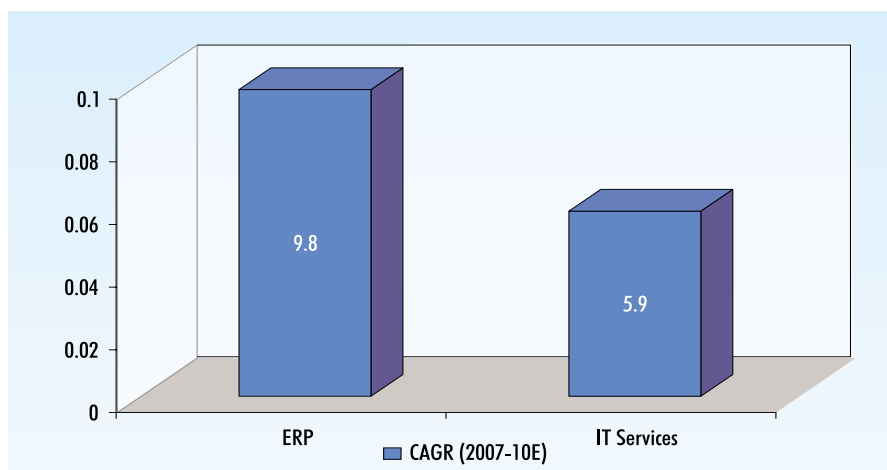
- **About Axon:** - Axon, incorporated in 1994, is one of the leading SAP consultants in Europe. It has around 200 clients; located in 30 countries. Axon has an employee base of around 2000 employees situated in U.K., U.S.A, Malaysia and Australia.
- **Axon’s historical financial performance:** - Axon has reported CAGR of 43% and 68% in revenues and PAT, respectively, over the period of CY03 to CY07 (as per International Financial Reporting Standards-IFRS). Its operating margins (OPM) and PAT margins (PATM) stood at 17.9% and 9.9% in CY07, as against Infosys OPM and PATM of 31.4% and 27.9%, respectively, in FY08.

**Financial highlights of Axon**

(In Mn-INR)	CY07*
Revenues	16,899.0
**As % of Infosys’s revenues	10.1%
PAT	1,670.4
**As % of Infosys’s PAT	3.6%
Debt outstanding	0
Cash and cash equivalents	2091.3
Source: Company	
*Average exchange rate for INR/GBP= 82.65 ** Infosys’s FY08 financials are considered	

• **Rationale for the deal**

**ERP is a high growth segment:** With increase in demand for Enterprise Resource Planning-ERP (SAP, Oracle and Microsoft are dominant players in ERP) as a tool for business transformation, demand for the same is expected to grow at around double the pace for IT services as a whole (refer chart given hereunder).



Source: IDC, Gartner \*ERP=Enterprise Resource Planning

**Will be the leading SAP consulting service provider in India :** After this acquisition, Infosys will be the largest offshore player in SAP and will be the fifth largest service provider globally. The acquisition will enable Infosys to participate in large transformational projects in SAP.

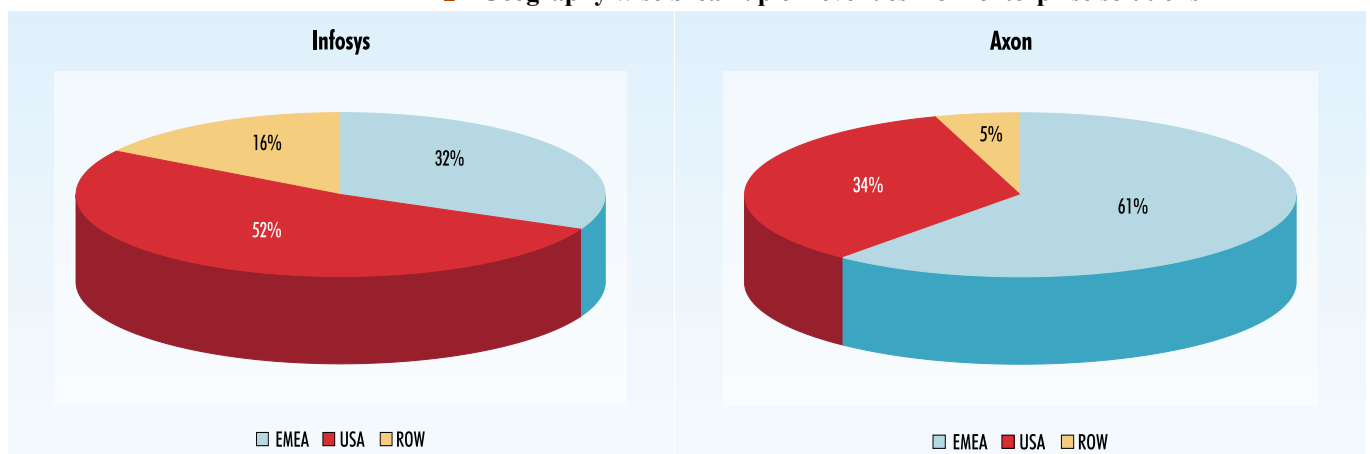
Provider	Total no. of SAP consultants	Ranking
Accenture	21700	1
IBM Global Services	16350	2
Deloitte	5246	3
Capgemini	5000	4
Satyam	4300	5
CSC	3853	6
TCS	3735	7
BearingPoint	3540	8
Wipro	3186	9
HCL	2800	10
<b>Infosys (before acquisition)</b>	<b>2375</b>	<b>11</b>
Cognizant	2048	12
Fujitsu	1600	13
Intelligroup	1300	14
Neoris	1200	15
Softtek	1046	16
<b>Infosys (after acquisition)</b>	<b>4375</b>	<b>5</b>

Source: Forrester Wave: SAP Implementation Providers

**Cross-selling of services:** As per Infosys’s management, there is only small overlap between clients of Axon and Infosys. This provides Infosys an opportunity to cross sell its services to clients of Axon.

**Geographical diversification:** In Enterprise solutions space, Infosys is concentrated in US, whereas Axon is deriving major portion of total revenues from Europe. Hence, the acquisition will, to some extent, de-risk Infosys’s model by increasing share of Europe in total revenues.

**Geography wise break up of revenues from enterprise solutions**



Source: Company

“  
**Infosys enjoys the highest margins among Tier I Indian IT companies**  
”

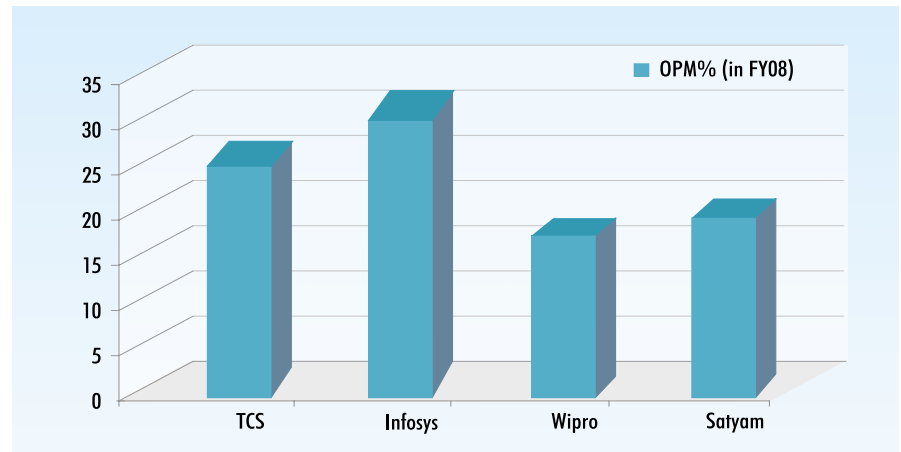
**Key strength areas of the company**

**One of the best infrastructure and processes in place to deliver world-class services**

- Infosys has established one of the world’s largest training facilities in Mysore capable of training 15,200 employees annually.
- In FY08, Infosys’s ‘Education and Research’ department won the ASTD (American Society for Training and Development) BEST award. Infosys’s training programs for entry-level employees are benchmarked against US institutes i.e. after its training programs an Indian engineering student would be equivalent, skill wise, as that of US graduate in computer science.

Infosys’s focus on improving the skill level of its employees has enabled it to charge relatively higher billing rate as compared to its Indian peers resulting in Industry leading margins.

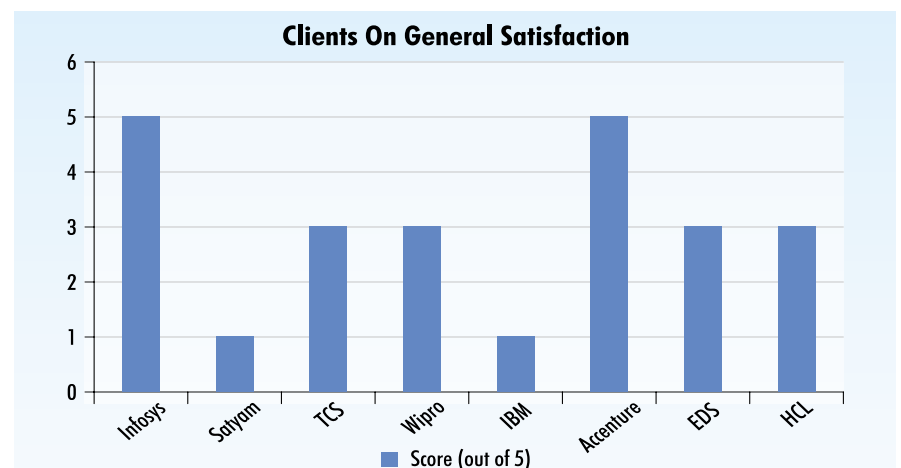
**Comparison of margins of Tier I Indian IT companies**



Source: Company

**Service delivery excellence**

Infosys’s ability to culturally fit with its clients, ability to deliver improvements in services on continuous basis, business domain competencies and performance against ‘Service Level Agreement’ (SLA) has earned it full score from the clients on general satisfaction (Source: Forrester).



Source: Forrester Wave: Global IT Infrastructure Outsourcing

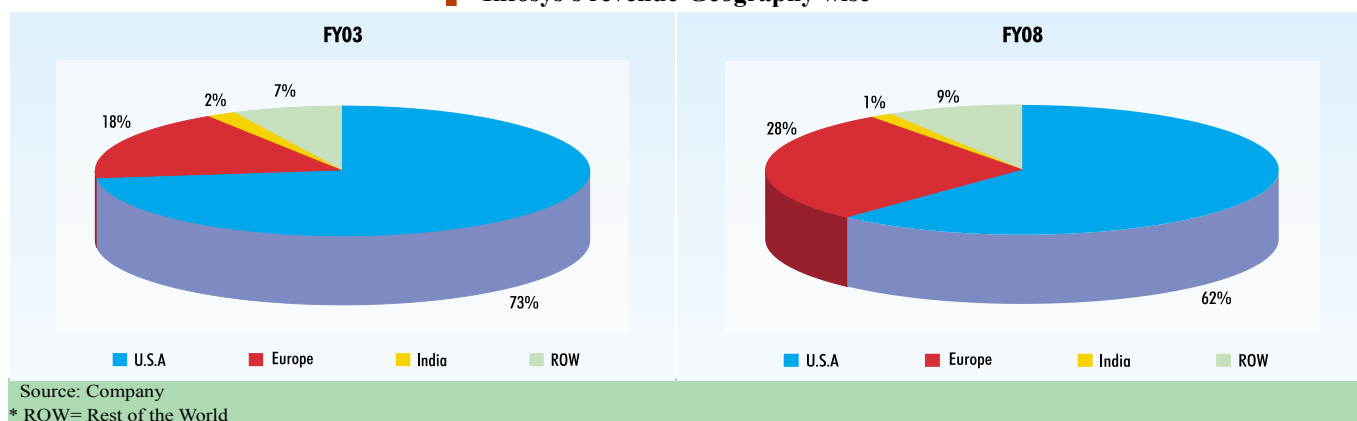
\*For more details refer Annexure 3

### Concerns

#### Geography concentration

Geography wise, major portion of Infosys's total revenues comes from the U.S. i.e. 62% (FY08). Considering the same, it is susceptible to adverse economic conditions and events that may unfold in the U.S. However to counter this, management is actively pursuing clients in Europe and Rest of the World (ROW) and thereby share of the US based customers has reduced from 73% in FY03 to 62% in FY08.

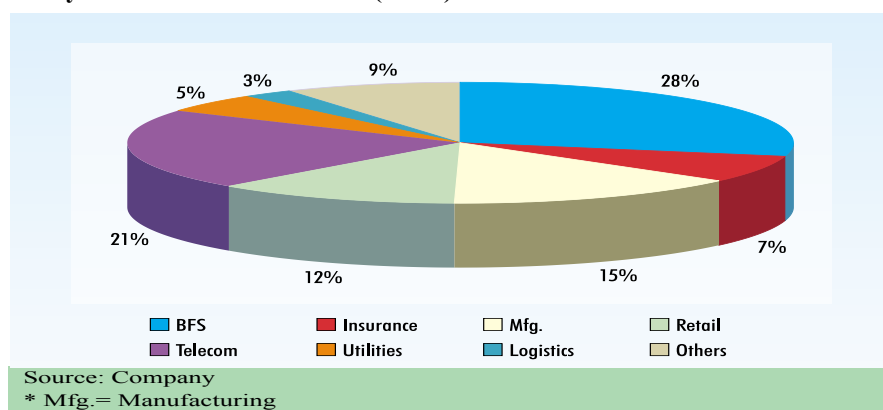
#### Infosys's revenue-Geography wise



#### Vertical concentration

Vertically (i.e. industry-wise), Infosys is dependent on Banking and Financial Services (BFS) sector for major portion of its total revenue, followed by Telecom, manufacturing, retail, insurance, utilities and logistics.

#### Infosys's Revenue-Vertical wise (FY08)



Due to credit market losses in U.S., financial companies have cut their IT spending in CY08. However, so far, none of Infosys's clients in financial sector have reduced their IT spending with it.

#### Wage inflation

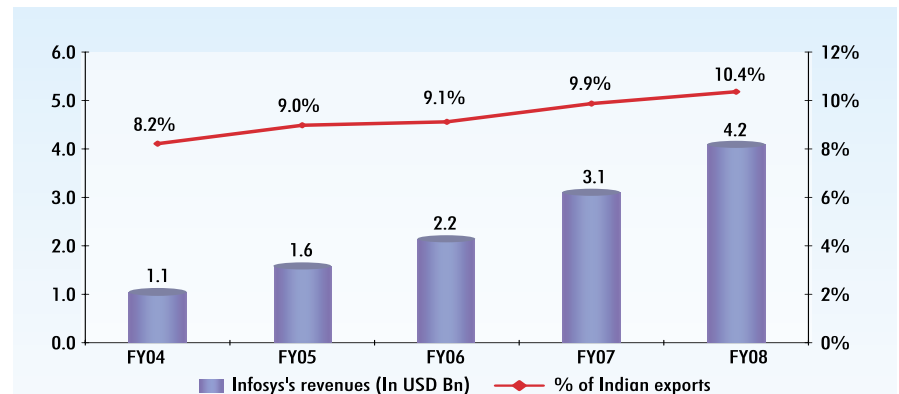
Due to mismatch between demand and supply for skilled IT professionals in India, the competition for hiring and retaining IT personnel is intense. Therefore in order to attract and retain such personnel, management may have to offer higher incentives as compared to its competitors, which will directly impact its profitability.

#### Foreign exchange fluctuation risk

As over 98% of Infosys's revenues comes from exports, it is exposed to currency fluctuations, which directly impacts its operating margin to the extent of ~50 bps for each percentage appreciation of the rupee. We have considered average USD rate of Rs.43/- for FY09 and Rs.42/- for FY10 in our projections. Forward and option contracts outstanding at the end of June 2008 was ~\$811 Mn.

**Financials**

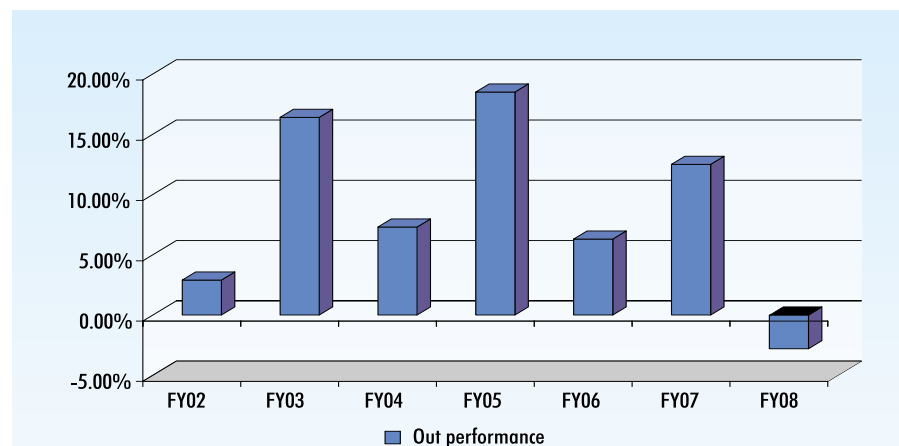
Infosys’s revenue grew at a CAGR of 40.9% (in USD) whereas Indian IT-BPO export grew at a CAGR of 32.9% (in USD) over the period of FY04 to FY08. As a result, Infosys’s share in Indian IT-BPO export grew from 8.2% in FY04 to 10.4% in FY08.



Source: Company

Infosys has guided for growth of 27.5% in revenues on lower side and 29.5% on upper side for FY09 in Indian Rupee (INR) term, considering conversion rate of 1 USD=INR 43.04. As per the management, they have ~70% visibility in respect of the guidance for FY09. In past, Infosys has outperformed the guidance by an average of ~8% over the period of FY02 to FY08, except in FY08 due to 11% INR appreciation against USD. Considering the management’s guidance, expected trend in the global IT spend and Infosys’s business model, we expect Infosys’s revenue to grow at a CAGR of 22% in USD terms and 25% in INR terms over the period of FY08 to FY10E.

**Performance of actuals v/s guidance**

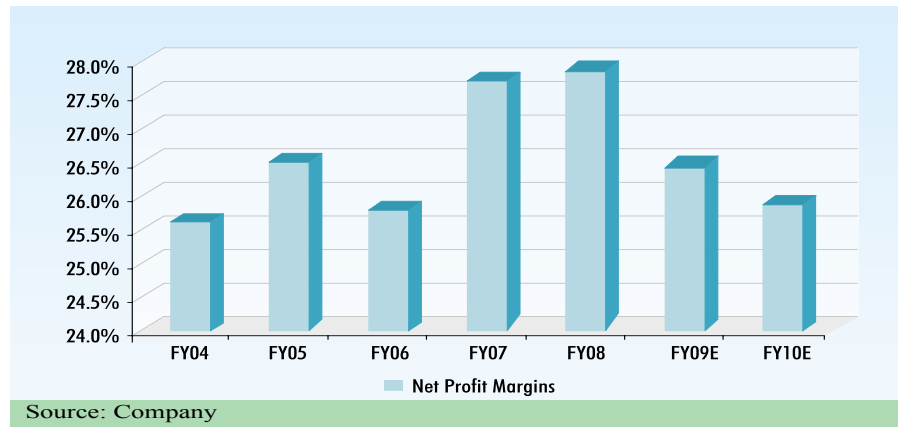


Source: Company

\*Out performance= Actual -Guidance

Infosys’s net profit margin has improved from 25.6% in FY04 to 27.9% in FY08; inspite of wage inflation pressure on margins; due to increase in per-capita revenues, economies of scale benefits and increase in offshore mix in the total revenues. However, going forward we expect Infosys’s margins to be under pressure, as IT vendors may not be able to pass on wage hike to their clients because of global economic slowdown.

Infosys's EPS guidance for FY09 is in the range of Rs.99.34 -Rs.101.06. We expect, growth in net profit at a CAGR of 21% over the period of FY08 to FY10E, resulting in EPS of Rs.101.8 in FY09 and Rs.118.7 in FY10.



### Valuation and Recommendation

We expect, Infosys's revenue to grow at a CAGR of 25.3% over the period of FY08 -FY10E, considering the trend in offshore IT spend and Infosys's leading position in offshore market. Whereas, net profit is expected to grow at a CAGR of 20.7% over the same period, taking into account the impact of wage inflation on margins. At CMP of Rs. 1775 the stock trades at PER of 17.4x and 15.0x its FY09E and FY10E EPS of Rs.101.8 and Rs.118.7, respectively. We initiate coverage on Infosys with **HOLD** recommendation and price target of Rs.1899 based on 16x FY10E EPS of Rs 118.7.

Profit and loss statement					INR Bn
INR Bn	FY06	FY07	FY08	FY09E	FY10E
<b>Revenue</b>	<b>95.2</b>	<b>138.9</b>	<b>166.9</b>	<b>220.0</b>	<b>262.1</b>
<b>Expenditure:</b>					
Software development & business process management expenses	50.7	74.6	92.1	121.6	148.7
Selling & Marketing expenses	6.0	9.3	9.2	12.1	13.9
General & Administration expenses	7.6	11.2	13.3	17.5	19.9
<b>Total Expenditure</b>	<b>64.3</b>	<b>95.0</b>	<b>114.5</b>	<b>151.2</b>	<b>182.5</b>
<b>Operating Profit</b>	<b>30.9</b>	<b>43.9</b>	<b>52.4</b>	<b>68.8</b>	<b>79.6</b>
Other income	1.4	3.7	7.0	6.6	8.1
Depreciation	4.4	5.1	6.0	7.5	8.8
<b>Profit before Taxes</b>	<b>27.9</b>	<b>42.5</b>	<b>53.4</b>	<b>67.7</b>	<b>78.9</b>
Income tax expense	3.1	3.9	6.9	9.5	11.1
Profit before minority Interest and exceptional item	33.5	48.9	58.6	73.3	85.6
<b>Net Profit</b>	<b>24.6</b>	<b>38.6</b>	<b>46.6</b>	<b>58.2</b>	<b>67.9</b>

Source: ACMIIL Research and Company

Balance sheet					INR Bn
INR Bn	FY06	FY07	FY08	FY09E	FY10E
<b>SOURCES OF FUNDS</b>					
Share Capital	1.4	2.9	2.9	2.9	2.9
Reserves and Surplus	68.3	109.7	135.1	173.5	218.3
<b>Shareholders fund</b>	<b>69.7</b>	<b>112.6</b>	<b>138.0</b>	<b>176.4</b>	<b>221.2</b>
Minority interest	0.7	0.0	0.0	0.0	0.0
<b>FUNDS EMPLOYED</b>	<b>70.3</b>	<b>112.6</b>	<b>138.0</b>	<b>176.4</b>	<b>221.2</b>
<b>APPLICATION OF FUNDS</b>					
<b>ASSETS</b>					
Gross Block	29.8	46.4	54.4	67.9	80.4
Less: - Accumulated Depreciation	13.3	18.4	19.9	27.3	36.2
<b>Net Block</b>	<b>16.6</b>	<b>28.1</b>	<b>34.5</b>	<b>40.6</b>	<b>44.2</b>
Capital Work-in-Progress	5.7	9.7	13.2	14.7	17.2
Investments	7.6	0.3	0.7	0.7	0.7
Deferred tax asset (net)	0.7	0.9	1.2	1.2	1.2
Current assets, loans & advances	63.3	95.2	130.2	161.6	198.5
Less: Current Liabilities & provisions	23.5	21.5	41.9	42.5	40.7
<b>Net current asset</b>	<b>39.9</b>	<b>73.7</b>	<b>88.3</b>	<b>119.2</b>	<b>157.8</b>
<b>FUNDS UTILIZED</b>	<b>70.3</b>	<b>112.6</b>	<b>138.0</b>	<b>176.4</b>	<b>221.2</b>

Source: ACMIIL Research and Company

Cash flow statement					INR Bn
INR Bn	FY06	FY07	FY08	FY09E	FY10E
Profit before taxes	27.9	42.5	53.4	67.7	78.9
Operating cash flow before working capital changes	30.1	44.4	52.4	68.6	79.6
Cash generated from operations	28.9	39.4	46.3	53.5	63.3
Taxes paid	-4.8	-4.5	-5.5	-9.5	-11.1
<b>Net cash provided by operating activities</b>	<b>24.1</b>	<b>35.0</b>	<b>40.8</b>	<b>44.0</b>	<b>52.2</b>
<b>Net cash used in investing activities</b>	<b>-4.2</b>	<b>-11.2</b>	<b>-11.2</b>	<b>-8.4</b>	<b>-6.9</b>
<b>Net cash used in financing activities</b>	<b>1.7</b>	<b>-3.2</b>	<b>-7.8</b>	<b>-19.8</b>	<b>-23.1</b>
Net increase in cash and cash equivalents	21.6	20.6	21.9	15.8	22.2
Cash and cash equivalents at beginning of the year	17.9	39.6	60.1	82.4	98.2
Exchange difference on translation of foreign currency cash and cash equivalents	0.1	-0.1	0.4	0.0	0.0
<b>Cash and cash equivalents at end of the year</b>	<b>39.6</b>	<b>60.1</b>	<b>82.4</b>	<b>98.2</b>	<b>120.4</b>

Source: ACMIIL Research and Company

Ratios					
Particulars	FY06	FY07	FY08	FY09E	FY10E
<b>Profitability Ratios</b>					
Operating profit margin (%)	32.5%	31.6%	31.4%	31.3%	30.4%
PAT Margin (%)	25.8%	27.8%	27.9%	26.5%	25.9%
RONW (%)	35.3%	34.3%	33.8%	33.0%	30.7%
ROCE (%)	40.1%	37.8%	38.7%	38.4%	35.7%
<b>Per Share</b>					
Earnings (Rs.)	43.0	67.4	81.5	101.8	118.7
<b>Capital Structure Ratios</b>					
Debt/Equity	-	-	-	-	-
Current Ratio	2.7	4.4	3.1	3.8	4.9
<b>Turnover Ratios</b>					
Debtors Turnover (x)	5.9	5.7	5.1	5.0	5.0
Fixed Asset Turnover (x)	3.2	3.0	3.1	3.2	3.3
<b>Growth Ratios</b>					
Revenue	33.5%	45.9%	20.1%	31.8%	19.2%
Operating profit	32.4%	42.1%	19.3%	31.3%	15.8%
Net profit	29.9%	56.9%	20.8%	25.0%	16.5%

Source: ACMIIL Research and Company



### ANNEXURE

#### 1. Terminology's meaning

##### IT-Enabled Services

Business processes and services performed or provided from a location different to that of the user, and delivered over the telecom networks or the Internet, are referred to as IT-Enabled Services. The aim of out locating these processes and services is the improved quality and productivity and lower costs. Some examples of IT-enabled services are call centers and BPO.

##### IT services

IT services refer to the entire range of services required to meet the information technology needs of an organization. The aim of IT services is the creation, management and optimization of various information technology tools, in order to improve a firm's business and technical expertise. Examples of IT services functions are application development and maintenance, software installation and support, systems integration, network infrastructure management and IT training.

##### Software

Software is a general term for the various types of programs used to operate computers and related devices. Software can be divided into application software (programs that perform tasks, which the users use directly) and system software (which includes operating systems and other programs that support the application software).

#### 2. Evaluation criteria-For Application Outsourcing (Source: Forrester)

CURRENT OFFERING	MARKET PRESENCE
Technical approach	Customer base
Engagement approach	Financial performance
Functional approach	Engagement profile
Client reference score	
Complementary capabilities	

#### 3. Client reference scores- Categories (Source: Forrester)

Price competitiveness
Cultural fit
Performance against budget
Performance against SLAs
Accuracy of project estimation
Effectiveness of work order processes
Quality of release management skills
Expectations management
Governance
Transition management
Flexible contract terms
Technical competency
Vertical industry/business domain competencies
Account management
Responsiveness
Quality of SLAs
Ability to capture knowledge
Ability to improve quality of apps under management
Ability to delivery year-over-year improvements
Scalability of resources

## Notes:

### HNI Sales:

Raju Mewawalla, Tel: +91 22 2858 3220

### Institutional Sales:

Bharat Patel, Tel: +91 22 2858 3730

Kirti Bagri, Tel: +91 22 2858 3731

Himanshu Varia, Tel: +91 22 2858 3732



**investmentz.com**  
*Online trading & more*

#### Disclaimer:

This report is based on information that we consider reliable, but we do not represent that it is accurate or complete and it should not be relied upon such. ACMIIL or any of its affiliates or employees shall not be in any way responsible for any loss or damage that may arise to any person from any inadvertent error in the information contained in the report. ACMIIL and/or its affiliates and/or employees may have interests/positions, financial or otherwise in the securities mentioned in this report. To enhance transparency we have incorporated a Disclosure of Interest Statement in this document. This should however not be treated as endorsement of the views expressed in the report

Disclosure of Interest	Infosys Technologies Limited
1. Analyst ownership of the stock	NO
2. Broking Relationship with the company covered	NO
3. Investment Banking relationship with the company covered	NO
4. Discretionary Portfolio Management Services	NO

This document has been prepared by the Research Desk of Asit C Mehta Investment Intermediates Ltd. and is meant for use of the recipient only and is not for circulation. This document is not to be reported or copied or made available to others. It should not be considered as an offer to sell or a solicitation to buy any security. The information contained herein is from sources believed reliable. We do not represent that it is accurate or complete and it should not be relied upon as such. We may from time to time have positions in and buy and sell securities referred to herein.