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Shareholding (%)

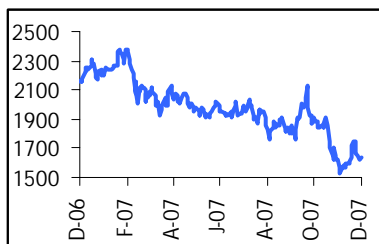
Promoters	16.5
FII's	32.8
MFs	2.9
FIs/Banks	3.6
Others	44.2

Share price performance

52-week high/low (Rs)	2415/1517		
	-1m	-3m	-12m
Abs (%)	1.2	-11.5	-24.0
Rel* (%)	4.4	-32.2	-73.2

*to Nifty

Stock chart



Valuations force an upgrade

We had downgraded Infosys Technologies Limited (Infosys) from 'Buy' to 'Reduce' post Q1FY08 results (July 11, 2007) due to stretched valuations and the expectation of a slowdown in net profit growth, from a CAGR of 40.8% during FY05-07 to 18.6% during Fy07-09E. The stock has underperformed the indices by 46% since our recommendation change and has also given a negative return of 15% (see chart 1).

However, our recent meeting with the management of Infosys suggests that the extent of fall in the stock price may be unwarranted. Though there is still some uncertainty on the IT budgets, we believe that the current stock price factors in the same.

Infosys has historically quoted at a one-year forward PER band of 26-28x. However with the growth slowing down we do not believe that it should quote at its historic PER. However at the current FY08E, Fy09E, and FY10E PER of 20.2x, 17.3x, and 16.3x respectively, the stock in our opinion offer some upside. Therefore, we upgrade Infosys from a 'Reduce' to 'Buy', with a target price of Rs1,838 (12% upside). Our target price is based on the average PEG of its global peers. At our target price the stock would be quoting at FY08E and FY09E PER of 22.7x and 19.4x respectively.

Buy

Rs1,639

19 December 2007

Market cap

Rs bn 938
US\$ bn 24

Avg 3m daily volume

2,169,488

Avg 3m daily value

USD mn 97

Shares outstanding (mn)

572

Reuters/Bloomberg

INFY.BO/INFO.IN

NSE/BSE

INFOSYSTCH

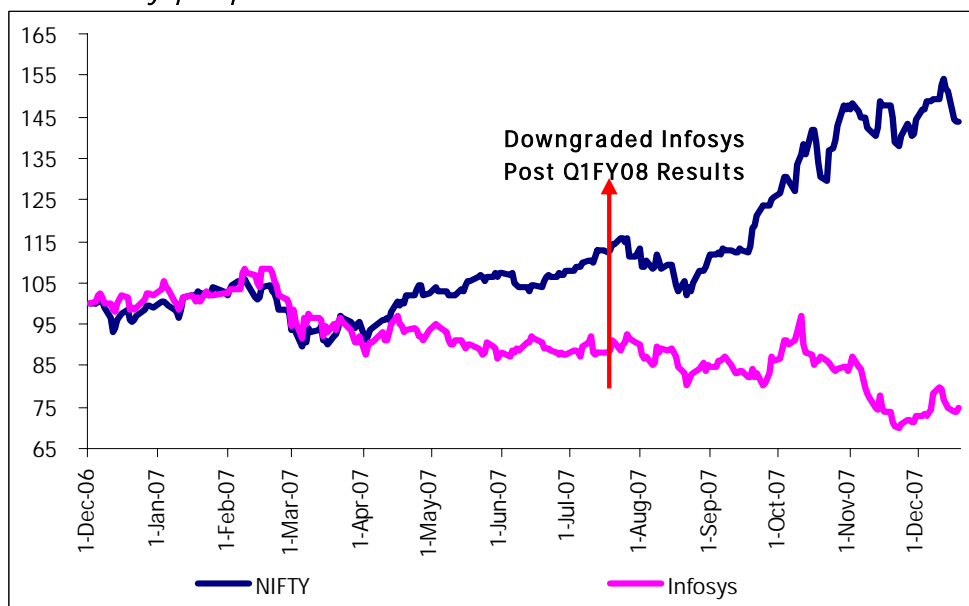
Sensex

19,092

Nifty

5,715

Chart 1. Infosys price performance



Source: IISL research

The key takeaways from the meetings were:

- ▲ Infosys indicated that till now none of its clients had guided for any slowdown in the IT budgets; the company, however, pointed out that the final decision for CY08 IT budgets had been deferred by a month. Infosys now expects to have visibility on the IT budgets by the end of January 2008.
- ▲ Infosys plans to increasingly focus on the consulting and package implementation business; the company intends to grow its consulting revenues from the current 5% (Q2FY08) to around 11% in the next 3-4 years. Enhanced focus on this business would help the company in securing downstream revenues and in increasing average realisations; this is because, the consulting (at USD200-250 per hour) and package implementation work comes at higher billing rates.
- ▲ Infosys is eyeing acquisitions in the consulting space either in France or Germany. Though it is looking at a deal size of USD 50-200mn for the acquisition, the company is also not averse to acquire a company for USD 1bn. The company, however, does not intend to take debt or dilute equity for financing the acquisitions. Infosys also denied the recent rumours of it acquiring CapGemini, terming that it would have been a 'disaster' if that would have happened.
- ▲ In order to tap the Indian IT market, Infosys has set up a unit in the country. However, the unit is still in a nascent stage and the company is currently studying the market.
- ▲ Currently, Infosys has 60% of its employees in 0-3 years experience bracket. The company plans to maintain the same ratio, going forward, and reduce its per capita employee cost.
- ▲ Some of Infosys' peers in the IT services space have indicated that there could be some moderation in salary increases, going forward. Infosys, however, expects the salary increase to be in the range of 12-15% in FY09E, same as during the past few years.
- ▲ To reduce its per capita employee cost and widen its employee base, Infosys is recruiting BSC and other graduates in the testing and Infrastructure Management Services (IMS) segments. The company expects to increase its employee base in this segment (currently 3-4%), going forward.

Valuations

Infosys has given negative returns of 27.9% in CY07, first time in the past six years that it has given a negative return in the calendar year. Though the stock has fallen by 15% since we downgraded it to **'Reduce'** from a **'Buy'**, we believe that the extent of the fall is unwarranted. Currently, the stock is quoting at FY08E, FY09E, and FY10E PER of 20.2x, 17.3x, and 16.3x respectively. We, therefore, upgrade the stock to **'Buy'**, with a price target of Rs 1,838. Our target price is based on the average PEG of its global peers. At this price, the stock would be quoting at FY08E and FY09E PER of 22.7x and 19.4x respectively.

Table 1. Peer Comparison

	PE			EPS CAGR		PEG	
	FY07	FY08	FY09	FY07	FY08	FY09	
IBM	17.4	15.0	13.1	15.2%	1.15	0.99	0.86
Accenture	20.5	17.5	16.1	12.9%	1.58	1.36	1.24
Cognizant	48.9	32.4	24.9	40.2%	1.22	0.81	0.62
CSC	13.7	12.3	11.2	10.2%	1.34	1.21	1.10
Logica CMG	11.2	10.9	8.9	12.7%	0.89	0.86	0.70
Average					1.23	1.04	0.90
Infosys	24.3	20.2	17.3	18.6%	1.31	1.09	0.93

Source: IISL research, Bloomberg

Financials

Profit & Loss

Rs mn	FY06	FY07	FY08E	FY09E	FY10E
Net Sales	95,216	138,931	167,507	205,410	243,491
<i>yoy</i>	33.5%	45.9%	20.6%	22.6%	18.5%
<i>Software Development exp</i>	50,654	74,580	91,778	115,024	140,525
<i>% of revenue</i>	53.2%	53.7%	54.8%	56.0%	57.7%
Gross Profit	44,562	64,351	75,728	90,386	102,966
<i>GPM</i>	46.8%	46.3%	45.2%	44.0%	42.3%
<i>Selling & Mktg exp</i>	6,005	9,290	10,400	12,437	13,636
<i>% of revenue</i>	6.3%	6.7%	6.2%	6.1%	5.6%
<i>G&A Expenses</i>	7,639	11,150	12,850	14,891	17,352
<i>% of revenue</i>	8.0%	8.0%	7.7%	7.2%	7.1%
EBIDTA	30,918	43,911	52,479	63,058	71,977
<i>yoy</i>	32.4%	42.0%	19.5%	20.2%	14.1%
<i>EBIDTA %</i>	32.5%	31.6%	31.3%	30.7%	29.6%
<i>Depreciation</i>	4,371	5,140	6,143	8,814	10,615
EBIT	26,547	38,771	46,335	54,245	61,362
<i>Interest</i>	-	-	-	-	-
<i>Other Income</i>	2,171	3,320	7,613	9,276	11,543
PBT	28,719	42,091	53,948	63,520	72,905
<i>(-) Tax</i>	3,132	3,860	7,442	9,210	15,310
<i>Tax rate</i>	10.9%	9.2%	13.8%	14.5%	21.0%
PAT	25,587	38,231	46,506	54,310	57,595
<i>Exceptional items</i>	-	60	-	-	-
<i>Minority interest</i>	210	110	-	-	-
PAT after Minority Int.	25,377	38,181	46,506	54,310	57,595

Key Ratios

	FY06	FY07	FY08E	FY09E	FY10E
EPS (Rs)	45.0	67.3	81.1	94.7	100.5
CEPS (Rs)	53.1	76.3	91.8	110.1	119.0
Mkt Cap (Rs bn)	894.8				
Book value (Rs)	128	197	265	347	435
Divd. per share (Rs)	23	13	13	13	13
ROCE	43.0%	42.4%	35.0%	30.9%	27.4%
ROE	40.3%	42.3%	35.2%	31.0%	25.7%
Valuation at Rs.	1,639.4				
PE (x)	36.4	24.3	20.2	17.3	16.3
P/EBIT	33.7	24.2	20.3	17.3	15.3
Cash PE (x)	30.9	21.5	17.9	14.9	13.8
Price / Book Value (x)	12.8	8.3	6.2	4.7	3.8
Div. Yield	1.4%	0.8%	0.8%	0.8%	0.8%
Mcap / Sales	0.0	0.0	0.0	0.0	0.0
EV / Sales (x)	8.8	6.2	4.8	3.7	3.0
EV / EBDITA (x)	27.6	20.0	15.9	12.6	10.5

Balance Sheet

Rs mn	FY06E	FY07E	FY08E	FY09E	FY10E
Equity Capital	1,380	2,860	2,860	2,860	2,860
Reserves	68,280	109,690	149,030	196,172	246,601
Net Worth	69,660	112,550	151,890	199,032	249,461
Total Borrowings	-	-	-	-	-
Minority interest	680	40	40	40	40
Preference shares issued	-	-	-	-	-
Total Liabilities	70,340	112,590	151,930	199,072	249,501
Gross block	29,830	46,420	61,175	78,675	98,675
Less: Acc. depn.	13,280	18,360	24,503	33,317	43,933
Net block	16,550	28,060	36,672	45,358	54,743
CWIP	5,710	9,650	5,000	5,000	5,000
Investments	7,550	250	465	571	676
Deferred tax assets	650	920	920	920	920
Current Assets	63,340	95,211	143,766	190,014	238,885
Debtors	16,080	24,360	27,918	34,235	40,582
Cash	34,290	58,711	103,708	143,639	186,163
Loans & Advances	12,970	12,140	12,140	12,140	12,140
Current Liabilities	23,460	21,500	34,897	42,794	50,727
Net curr. assets	39,880	73,711	108,869	147,220	188,158
Total Assets	70,340	112,590	151,930	199,072	249,501

Cash Flow

Rs mn	FY06	FY07	FY08E	FY09E	FY10E
Net profit before tax	27,914	42,471	53,948	63,520	72,905
Deprn & w/o	4,371	5,140	6,143	8,814	10,615
Tax paid	(4,800)	(4,460)	(7,442)	(9,210)	(15,310)
Change in WC	(1,200)	(4,880)	9,839	1,579	1,587
Others	(2,190)	(3,170)	4,650	-	-
Operating Cash Flow	24,095	35,101	67,139	64,703	69,797
Capex	(10,900)	(15,100)	(14,760)	(17,500)	(20,000)
Others	6,670	4,150	(215)	(105)	(106)
Investing Cash Flow	(4,230)	(10,950)	(14,975)	(17,605)	(20,106)
Dividend Paid	(4,030)	(15,320)	(7,167)	(7,167)	(7,167)
Proceeds from issue of st	5,740	12,160	-	-	-
Others	-	-	-	-	-
Financing Cash Flow	1,710	(3,160)	(7,167)	(7,167)	(7,167)
Effect of exchange diff	90	(70)	0	0	0
Net inc/(dec) in cash	21,670	20,921	44,997	39,931	42,524
Opening cash	18,174	39,844	60,765	105,762	145,693
Closing cash	39,844	60,765	105,762	145,693	188,218

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