

Infosys Technologies

BUY
Maintained

Safest bet

Rs1,930

Reason for report: Q1FY08 results review and earnings revision

Infosys has upgraded its FY08E sales growth guidance 1% (in US dollars) versus consensus' and our expectations of 2% – the guidance was increased to 29-31% YoY growth from the earlier 28-30% YoY. We believe that the management is conservative due to appreciating rupee and is underplaying the likely positives expected in the coming quarters to negate any negative surprises from further rupee appreciation. FY08E EPS guidance (in rupee) has been downgraded 4% to Rs77.3-78.1 to factor in rupee appreciation assuming revised average rupee/ US dollar rate of Rs40.58 (this has accounted for further appreciation of 5.8% from the earlier guided rate and 10% from FY07 realised rate).

► **We upgrade FY08E EPS estimate 1%.** Infosys' business outlook remains robust and we expect the company to register 37.1% sales growth (US dollar) in FY08E. We have downgraded our FY08E average rupee/US dollar rate to Rs40.58 from Rs41, in line with management expectations, resulting into 1% downgrade in our FY08E sales estimates (in rupee). However, given higher-than-expected billing rates in Q1FY08, with further room for upside, we have not changed our operating margins estimates for FY08 and FY09. In order to factor in higher other income in Q1FY08 (both on treasury and forex fronts), we have raised our FY08E EPS estimates 1% to Rs81.4. With consistent growth in billing rates (CQGR: 1.5%-onsite, 1.1%-offshore for the past five quarters for IT services) and client mining (number of >US\$80mn clients increasing to eight in Q1FY08 from four in Q4FY07), we reiterate our positive outlook on demand. Infosys is our top pick in the sector with Rs2,400 price target (24% upside).

► **Q1FY08 operational results in line with expectations.** Infosys registered 7.6% QoQ revenue growth (in US dollars) to US\$929mn against i-SEC estimates of US\$931mn, with consolidated volume growth of 6.8% QoQ (IT services volume growth of 6.9%) and consolidated blended billing rates increase of 0.7%. IT services billing rates rose 1.4% for onsite and 1% for offshore. However, consolidated sales growth (in rupee) was flat versus our estimate of 0.9% increase. This was due to lower-than-expected realised rupee/US dollar rate of Rs40.58 (7% QoQ appreciation). Infosys' registered Rs10.84bn EBITDA versus i-SEC estimates of Rs10.86bn; EBITDA margin was 20bps higher than expectations.

Market Cap	Rs1,102bn/US\$27.3bn
Reuters/Bloomberg	INFY.BO/INFO IN
Shares Outstanding (mn)	571.2
52-week Range (Rs)	2439/1567
Free Float (%)	83.5
FII (%)	32.6
Daily Volume (US\$'000)	87,100
Absolute Return 3m (%)	(2.9)
Absolute Return 12m (%)	14.0
Sensex Return 3m (%)	5.2
Sensex Return 12m (%)	36.4

Year to March	FY06	FY07	FY08E	FY09E
Revenue (Rs mn)	95,216	138,930	171,918	222,980
Net Income (Rs mn)	24,601	37,250	46,517	56,820
EPS (Rs)	45.1	66.9	81.4	99.1
% Chg YoY	30.6	48.5	21.6	21.9
P/E (x)	42.8	28.8	23.7	19.5
CEPS (Rs)	52.8	75.6	87.9	108.0
EV/E (x)	34.3	23.8	19.5	14.7
Dividend Yield	1.2	0.6	0.7	0.9
RoCE (%)	40.0	41.1	36.1	33.8
RoE (%)	40.4	40.9	35.4	32.8

Technology

Earnings revision

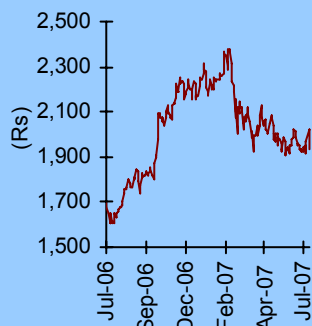
(%)	FY08E	FY09E
Sales	↓ 1.4	↓ 0.2
EBITDA	↓ 1.2	0.0
EPS	↑ 1.3	↑ 0.2

Shareholding pattern

	Sep '06	Dec '06	Mar '07
Promoters	19.3	16.9	16.5
Institutional investors	42.8	40.3	38.8
MFs and UTI	3.9	3.5	3.3
Insurance Cos.	2.8	2.9	2.9
FIs	36.2	33.9	32.6
Others	23.9	23.5	25.6

Source: www.nseindia.com

Price chart



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Table 1: Q1FY08 results review

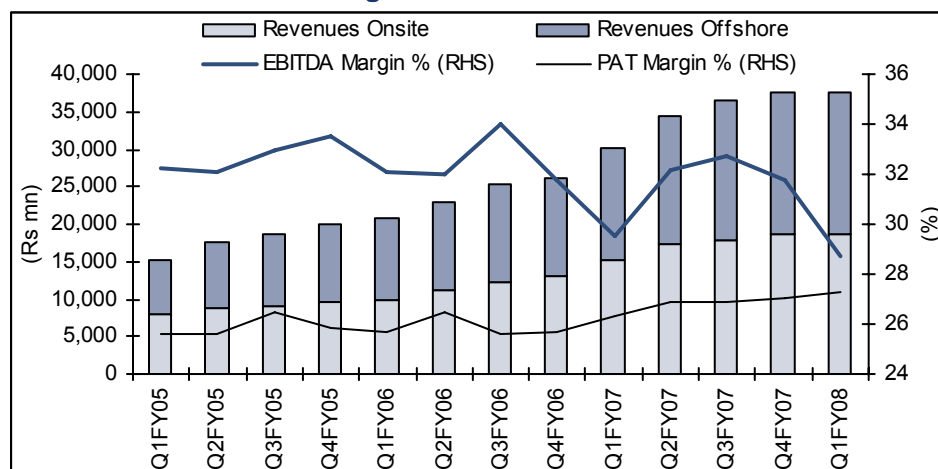
(Rs mn, year ending March 31)

	Q1FY08	Q4FY07	Q1FY06	% chg. (QoQ)	% chg. (YoY)	i-SEC Estimates	% Variance
Net Sales	37,730	37,720	30,150	0.0	25.1	38,075	(0.9)
Cost of development	21,690	20,210	16,660	7.3	30.2	21,583	0.5
Employee expenses	18,250	17,100	13,790	6.7	32.3	18,270	(0.1)
Selling & marketing	2,050	2,680	2,040	(23.5)	0.5	2,703	(24.2)
General & Admin	3,150	2,860	2,560	10.1	23.0	2,932	7.4
Total Expenses	26,890	25,750	21,260	4.4	26.5	27,218	(1.2)
EBITDA	10,840	11,970	8,890	(9.4)	21.9	10,857	(0.2)
Depreciation	1,440	1,450	1,060	(0.7)	35.8	1,409	2.2
Other Income	2,530	1,200	1,250	110.8	102.4	1,664	52.0
Recurring pre-tax income	11,930	11,720	9,080	1.8	31.4	11,112	7.4
Extraordinary income/(expense)	510	1,250	60	NA	NA	0	
Taxation	1,650	1,520	1,060	8.6	55.7	1,500	10.0
Minority Interest	0	10	80	NA	NA	0	NA
Reported Net Income	10,790	11,440	8,000	(5.7)	34.9	9,612	12.3
Recurring Net Income	10,280	10,190	7,940	0.9	29.5	9,612	7.0
Ratios (%)							
EBITDA margins	28.7	31.7	29.5			28.5	
Net profit margins	27.2	27.0	26.3			25.2	

Source: Company data, i-SEC Research

Chart 1: Revenues and margins – EBITDA and PAT

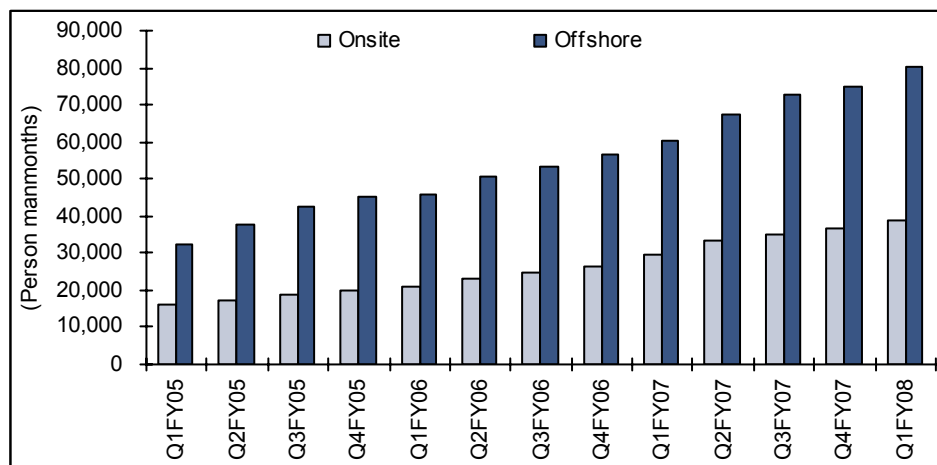
Flat QoQ revenue growth due to: i) 6.8% volume growth ii) 0.7% consolidated blended billing rate surge and iii) 7% rupee appreciation. EBITDA margin dipped 300bps due to 350bps, 250bps and 100bps impact from rupee appreciation, wage inflation & high visa cost. Savings were impacted 150bps, 100bps & 150bps due to higher utilisation rates, pricing increase and profitability improvement in subsidiaries & scale benefit



Source: Company data, i-SEC Research

Chart 2: IT services – Billed Manmonths

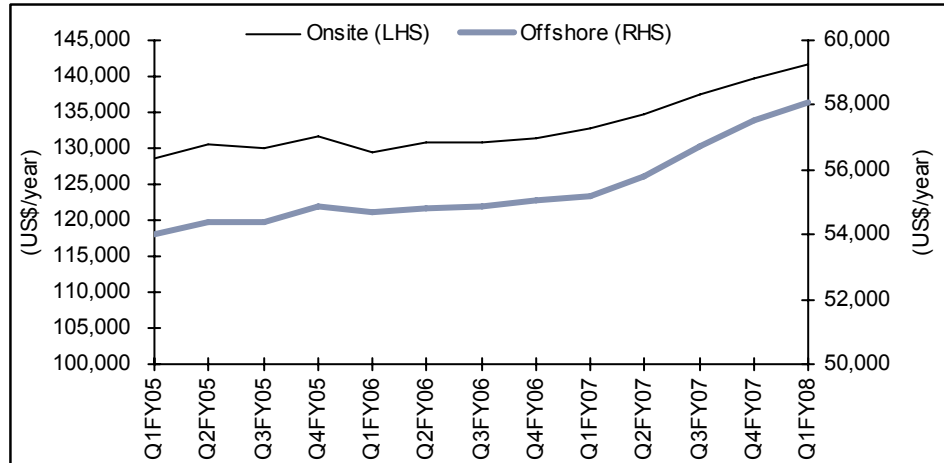
Volume growth in IT services at 6.9% – offshore volume growth of 7.2% and onsite volume growth of 6.3%



Source: Company data, i-SEC Research

Chart 3: IT services – Billing rates

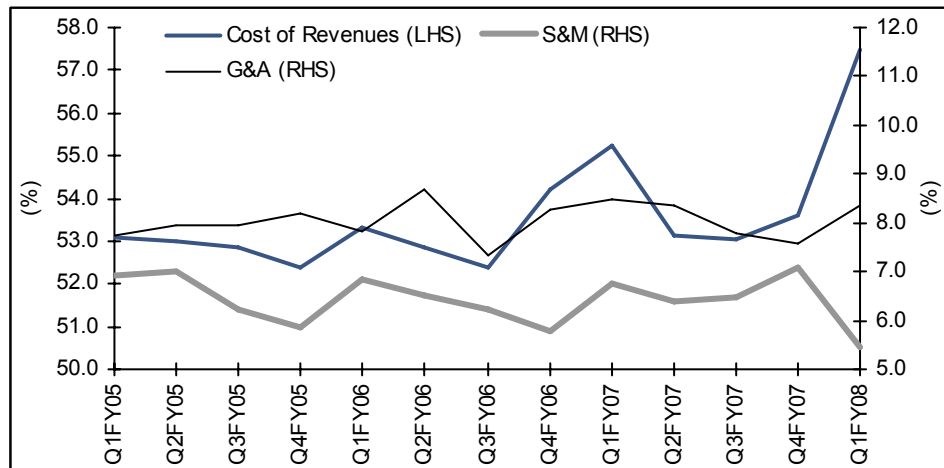
Billing rates for IT services rose – Onsite: 1.4%, offshore: 1%. This is the sixth consecutive quarter of billing rate expansion



Source: Company data, i-SEC Research

Chart 4: Costs as a percentage of revenues

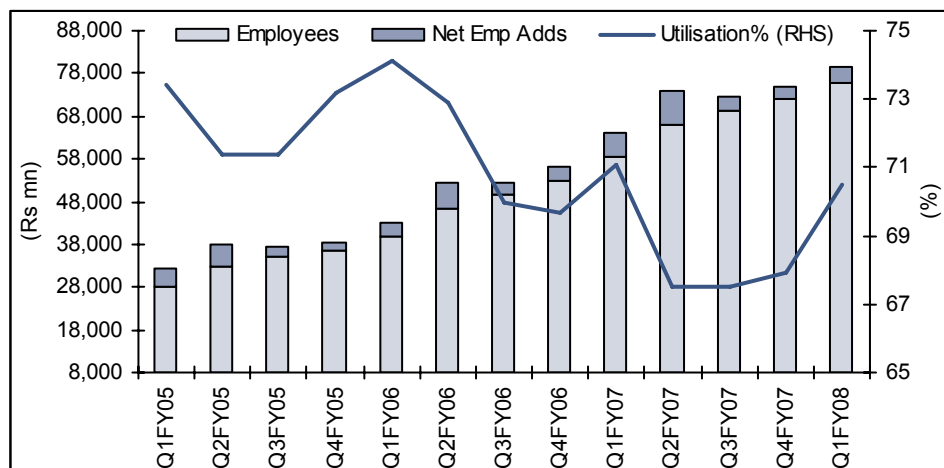
Cost of revenues increased 390bps due to wage inflation and sharp rupee appreciation. Sales & marketing expenses dipped 170bps due to savings in subsidiary and variable pay



Source: Company data, i-SEC Research

Chart 5: Employee additions

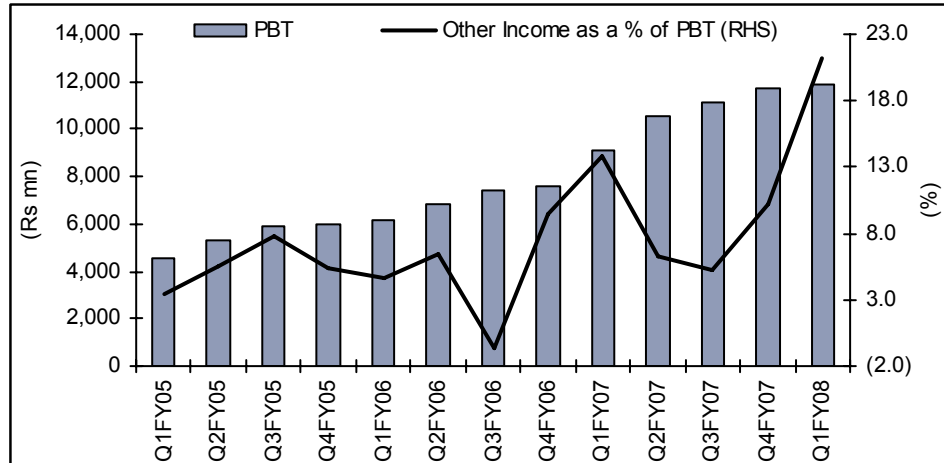
Net employee additions were muted at 3,730 versus 5,694 in Q1FY07 due to postponement in joining dates of freshers from Q1FY08 to Q2FY08 on account of delay in the expansion of Mysore campus



Source: Company data, i-SEC Research

Chart 6: Other Income as percentage to PBT

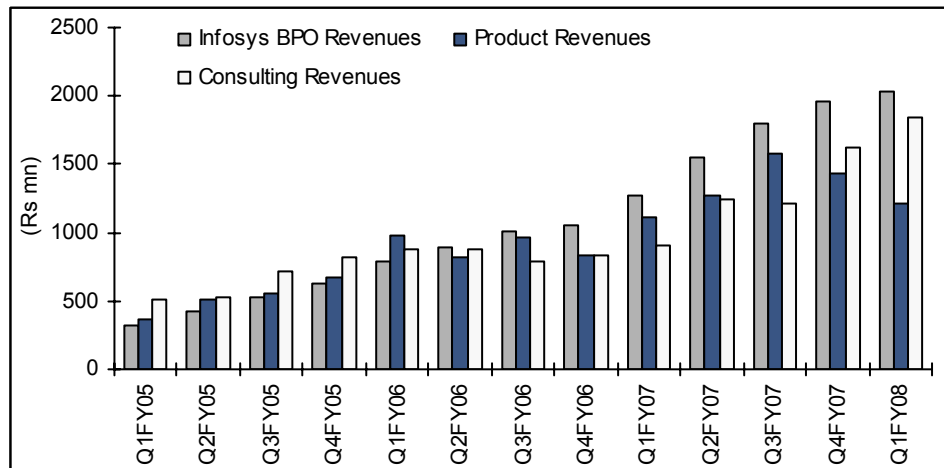
Other income as a percentage to PBT increased significantly on the back of rising treasury yields (11% in Q1FY08) and mark-to-market hedging gains



Source: Company data, i-SEC Research

Chart 7: Revenues – Progeon, product and consulting

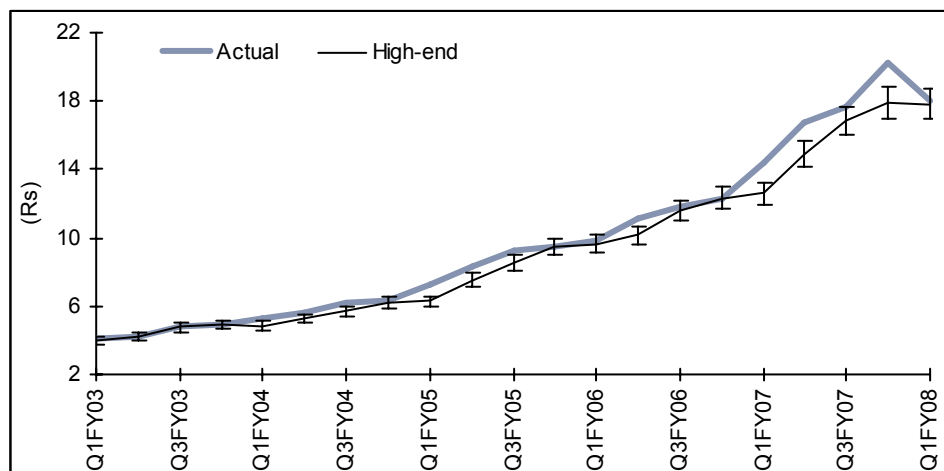
Progeon's revenues grew 11.7% QoQ (US dollar); however, PAT margin dipped 300bps due to rupee appreciation and wage inflation. Consulting revenues continued to grow at a robust 22.6% (37% growth in Q4FY07). Product revenues declined 9.4% QoQ (US dollar)



Source: Company data, i-SEC Research

Chart 8: EPS guidance versus actual

Infosys outperformed its EPS guidance despite a sharp 7% rupee appreciation in Q1FY08 on the back of higher forex gain to partly offset EBITDA loss



Source: Company data, i-SEC Research

Table 2: QoQ revenue growth by verticals (US dollar)

BFSI back on track with 5% growth along with continued robust growth in other focussed verticals

(%)	Q2FY07	Q3FY07	Q4FY07	Q1FY08
Verticals				
Banking &FS	17.9	11.2	0.4	5.8
Insurance	8.1	24.9	2.4	1.8
BFSI	16.0	13.7	0.8	5.0
Manufacturing	9.0	0.7	6.0	13.4
Telecom	20.6	6.6	25.8	8.1
Retailing	4.8	28.5	8.2	7.6
Utilities	17.1	6.2	(6.5)	9.8
Transportation & Logistics	(7.6)	(18.4)	(5.4)	37.5
Others	23.4	(3.9)	(25.6)	0.2
Services	(0.1)	18.7	0.1	3.5

Source: Company data, i-SEC Research

Table 3: Client mining and growth (US dollar)

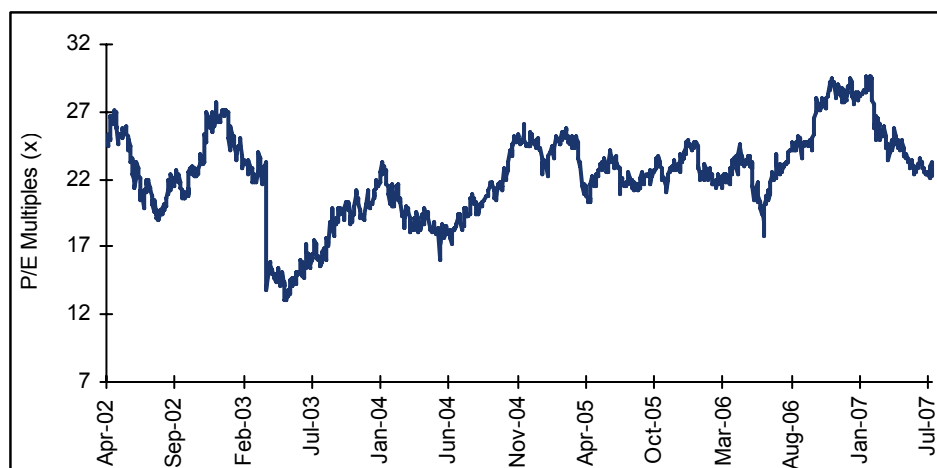
Progression of clients to the next higher billing bucket continued during the quarter with the number of clients in US\$80mn+ billing bucket doubling to eight. Top-5 clients continued to show good growth; decline in top 6-10 being a quarterly aberration

(No. of clients)	Q2FY07	Q3FY07	Q4FY07	Q1FY08
Client Concentration				
Active Clients	476	488	500	509
Added during quarter	45	43	34	35
No of US\$ 1mn clients	232	256	275	285
No of US\$ 5mn clients	97	108	107	113
No of US\$ 10mn clients	61	67	71	75
No of US\$ 20mn clients	29	35	36	40
No of US\$ 30mn clients	20	22	25	26
No of US\$ 40mn clients	16	17	16	18
No of US\$ 50mn clients	12	11	12	13
No of US\$ 60mn clients	8	10	11	11
No of US\$ 70mn clients	6	8	9	9
No of US\$ 80mn clients	3	4	4	8
No of US\$ 90mn clients	3	2	4	4
No of US\$ 100mn clients	2	2	3	3
Clients accounting for >5% of revenue	1	1	1	1
% revenue growth top client (US\$)	28.5	15.1	29.5	8.8
% revenue growth top 2-5 clients (US\$)	18.7	(8.2)	12.2	7.6
% revenue growth top-5 clients (US \$)	21.6	(0.9)	18.5	8.1
% revenue growth top 6-10 clients (US\$)	10.1	12.0	5.2	(3.1)
% revenue growth top 10 clients (US\$)	17.2	3.8	13.3	4.0
% revenue growth non top 10 clients (US\$)	10.9	13.2	1.5	9.4
Repeat business (%)	95.2	94.7	93.3	99.5

Source: Company data, i-SEC Research

Chart 9: One-year rolling forward P/E

We believe that Infosys is likely to surprise positively going forward. With revised Rs/US dollar rate at Rs40.58 for FY08E, we believe Infosys is one of the safest bet in the sector with limited downside



Source: Company data, i-SEC Research

Financial Summary (Consolidated Indian GAAP)

Table 4: Profit and Loss Statement

(Rs mn, year ending March)

	FY06	FY07	FY08E	FY09E
Operating Revenues (Sales)	95,216	138,930	171,918	222,980
of which Exports	93,548	136,732	169,230	219,456
of which Domestic	1,668	2,198	2,688	3,523
Operating Expenses	64,298	95,020	119,765	156,652
EBITDA	30,918	43,910	52,153	66,327
% margins	32.5	31.6	30.3	29.7
Depreciation & Amortisation	4,371	5,140	6,539	8,362
Other Income	1,396	3,700	7,730	7,722
Recurring PBT	27,943	42,470	53,344	65,687
Add: Extraordinaries	(18)	1,310	0	0
Less: Taxes	3132	5110	6827	8868
- Current tax	3,290	5,380	9,602	12,152
- Deferred tax	(158)	(270)	(2,775)	(3,284)
Less: Minority Interest	210	110	0	0
Net Income (Reported)	24,583	38,560	46,517	56,820
Recurring Net Income	24,601	37,250	46,517	56,820

Source: Company data, i-SEC Research

Table 5: Balance Sheet

(Rs mn, year ending March)

	FY06	FY07	FY08E	FY09E
Assets				
Total Current Assets	63,340	95,210	126,321	176,131
of which cash and deposits	34,290	58,710	82,420	115,140
Total Current Liabilities & Provisions	23,460	21,500	31,458	52,233
Net Current Assets	39,880	73,710	94,862	123,898
Investments	7,550	250	5,000	10,000
of which Strategic/Group	20	0	0	0
of which Other Marketable	7,530	250	5,000	10,000
Net Fixed Assets	16,550	28,060	41,521	50,659
Intangibles	0	0	0	0
Goodwill	410	5,890	5,890	5,890
Capital Work-in-Progress	5,710	9,650	5,000	5,000
Total Assets	69,690	111,670	146,383	189,558
of which cash and equivalents	41,820	58,960	87,420	125,140
Liabilities				
Borrowings	0	0	0	0
Deferred Tax Liability	(650)	(920)	(3,695)	(6,980)
Minority Interest	680	40	40	40
Equity Share Capital	1,380	2,860	2,862	2,870
Face Value per share (Rs)	5	5	5	5
Preference Share Capital	0	0	0	0
Reserves & Surplus*	68,280	109,690	147,177	193,628
Net Worth	69,660	112,550	150,039	196,497
Total Liabilities	69,690	111,670	146,383	189,558

Source: Company data, i-SEC Research

*excluding revaluation reserves; # = not written off

Table 8: Quarterly trends

(Rs mn, year ending March)

	Sep-06	Dec-06	Mar-07	Jun-07
Net sales	34,510	36,550	37,720	37,730
% growth (YoY)	50.4	44.4	43.8	25.1
EBITDA	11,090	11,960	11,970	10,840
Margin (%)	32.1	32.7	31.7	28.7
Other income	660	590	1,200	2,530
Add: Extraordinaries	0	0	1,250	510
Net profit	9,290	9,830	10,190	10,280

Source: Company data, i-SEC Research

Table 6: Cash Flow Statement

(Rs mn, year ending March)

	FY06	FY07	FY08E	FY09E
Operating Cash flow before	30,190	44,370	52,153	66,327
Working Cap changes				
Working Capital Inflow/ Outflow	(9,856)	(5,840)	(7,916)	(9,493)
Capex	(10,890)	(14,960)	(15,350)	(17,500)
Free Cash flow	9,444	23,570	28,887	39,335
Cash Flow from other Invest Act (Ex Capex)	6,660	4,010	2,980	2,722
Proceeds from Issue of Share Capital	6,460	12,160	223	941
Inc/(Dec) in Borrowings	0	0	0	0
Divided paid	(4,030)	(15,320)	(8,381)	(10,277)
Increase/(Decrease) in Cash	18,534	24,420	23,710	32,720

Source: Company data, i-SEC Research

Table 7: Key Ratios

(Rs mn, year ending March)

	FY06	FY07	FY08E	FY09E
Per Share Data (in Rs)				
EPS(Basic Rec. - wgh Avg)	45.1	66.9	81.4	99.1
Fully Diluted Recurring EPS	42.8	64.8	80.9	98.8
Recurring Cash EPS	52.8	75.6	87.9	108.0
Dividend per share (DPS)	22.5	11.4	13.8	16.8
Book Value per share (BV)	126.4	197.0	262.1	342.4
Growth Ratios (%)				
Operating Income (Sales)	33.5	45.9	23.7	29.7
EBITDA	32.4	42.0	18.8	27.2
Recurring Net Income	33.2	51.4	24.9	22.1
Diluted Recurring EPS	33.4	51.3	24.9	22.1
Diluted Recurring CEPS	35.8	46.1	19.4	23.1
Valuation Ratios (x)				
P/E	42.8	28.8	23.7	19.5
P/CEPS	36.6	25.5	21.9	17.9
P/BV	15.3	9.8	7.4	5.6
EV / EBITDA	34.3	23.8	19.5	14.7
EV / Sales	11.1	7.5	5.9	4.4
EV / FCF	112.3	44.3	35.1	24.8
Operating Ratio				
Software Development Expenses/Sales (%)	53.2	53.7	55.7	56.8
SG&A/Sales (%)	14.3	14.7	14.0	13.5
Other Income / PBT (%)	5.0	8.7	14.5	11.8
Effective Tax Rate (%)	11.2	12.0	12.8	13.5
NWC / Total Assets (%)	42.8	55.4	53.3	51.2
Fixed Asset Turnover (x) on average	6.5	6.2	4.9	4.8
Receivables (days) on average	56.2	53.1	52.5	53.0
Payables (days) on average	36.0	36.2	35.5	34.2
D/E Ratio (x)	0.0	0.0	0.0	0.0
Return/Profitability Ratio (%)				
Recurring Net Income Margins	25.8	26.8	27.1	25.5
RoIC (Based on Avg)	90.2	83.8	68.5	74.8
RoCE (Based on Avg)	40.0	41.1	36.1	33.8
RoNW (Based on Avg)	40.4	40.9	35.4	32.8
Dividend Payout Ratio	57.4	19.5	19.9	19.9
Dividend Yield	1.2	0.6	0.7	0.9
EBITDA Margins	32.5	31.6	30.3	29.7

Source: Company data, i-SEC Research

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