

Infosys Technologies

Robust FY08 guidance reaffirms demand strength; Rupee remains the joker in pack

- **Modest 4QFY07 but with positive metrics:** Infosys reported an inline 4QFY07 exhibiting the traditional Mar-quarter weakness – revenues up 3% Q/Q (5% US\$-based) and profit up 4% Q/Q. However, metrics were quite positive with all-round growth in services, good headcount addition, attrition stable, salary hikes inline with expectations (12-15% offshore) and further increase in pricing – Y/Y 4QFY07 pricing is up 6% on blended basis.
- **Positive metrics were backed with strong FY08 US\$ guidance** of 28-30% revenue growth, 29-31% profit growth and 26-28% EPS growth. However, Rupee appreciation led to lower Rupee guidance of 23-25% revenue growth and 20-22% EPS growth.
- **Takeaways:** Positive FY08 outlook reinforces our view of strong offshore demand environment – Mr Murthy stated that "demand was better than 2000-2001 days". Secondly, we believe that the guidance should put to rest any worries on slowdown in Indian IT industry - we expect similar business traction at other top tier Indian IT companies especially TCS.
- **Estimates:** With the industry growing at ~30% and Infosys being a top-tier execution engine, we believe that the company should be able to materially beat its guidance for FY08. Our US\$ estimates remain at revenue growth of 40% and EPS growth of 37%. We expect Re-EPS of Rs 87/share, up 30% Q/Q. Rupee/US\$ remains the only joker in pack- our assumption is Rs 43/US\$.
- **Investment view:** Strong demand environment and sustained execution leads us to retain our positive view. We would advise buying at current levels with Dec-07 target of Rs 2,650/share.

Table 1: Reuters: INFY.BO/INFY.US, Bloomberg: INFO IN/INFY US

	FY06A	FY07A	FY08E	FY09E		FY06A	FY07A	FY08E	FY09E		
Sales	95,214	138,943	185,982	247,961	ROE (%)	35.7	39.1	40.4	38.9	52-Week range Rs	1,225.0-2,439.0
Operating Profit	26,550	38,326	51,768	69,248	ROIC (%)	60.4	61.7	62.9	65.9	Shares Outstg	556Mn
EBITDA	30,921	43,466	58,572	77,573	Qtr EPS (Rs)	1Q	2Q	3Q	4Q	Avg daily volume	0.3Mn
Pre Tax Profit	27,896	42,089	55,156	73,832	EPS (FY07) A	14.4	16.5	17.4	17.9	Index (Sensex)	13,114
Net profit	24,564	38,154	48,503	63,831	EPS (FY08) E	17.8	21.1	22.9	25.2	Free float	80%
EPS (Rs)	44.9	68.1	86.9	114.4	EPS (FY09) E	25.4	28.5	29.5	31.1	Avg daily value (US\$)	13.28 Mn
P/E (x)	45.5	30.0	23.5	17.9	Local	1M	3M	12M		Market Cap	US\$53.53
P/BV (x)	13.7	9.8	8.2	6.0	Abs. Perf.(%)	-2.9	-8.0	35.3		ADR	1:1
Cash	47,231	61,644	74,753	111,835	Rel. Perf.(%)	-3.9	-1.4	15.9		Ratio	US\$32.0-61.3
										52-week range	US\$53.53

Source: JPMorgan estimates, Company data.

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Overweight

Rs2,043.65

12 April 2007

Price Target: Rs2,650.00



India

eBusiness/IT Services

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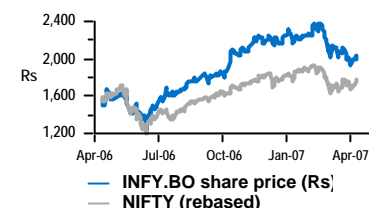
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Price Performance



YTD -1M -3M -12M

Absolute -11.1% -6.2% -8.7% 25.0%

Relative -8.5% -10.1% -6.7% 14.0%

Source: RIMES, Reuters.

4QFY07 – In line performance

- Revenues came in at Rs 37.72 billion, up 3% Q/Q slightly below our expectation of Rs 37.89 billion. US\$ revenues were up 5% Q/Q to US\$ 863 million, inline with expectations.
- Progeon (BPO) continued to show good momentum and was up 10% Q/Q in US\$-terms. Products was down 8% Q/Q in US\$-terms – this is after strong growth in the last 3 quarters and is more of a quarterly aberration in our view.
- IT Services volumes grew 4% Q/Q, with onsite growing 4% and offshore growing 3%.
- Pricing was up both onsite and offshore up 1.7% onsite Q/Q and 1.4% offshore Q/Q. This is the fourth consecutive quarter of pricing increase from Infosys. On a Y/Y basis, pricing was up 6% onsite, 4% offshore and 6% blended.
- Top client continued its strong momentum growing to 8.5% of revenues, up 27% Q/Q in Re-terms and up 29% Q/Q in US\$-terms. Growth in top account drove growth in top 5 and top 10 as well - top 5 grew 16% Q/Q and top 10 grew 11% Q/Q.
- Onsite revenues were 54.3% of total IT services revenues broadly flat Q/Q.
- Infosys had net addition of 2,809 people with 1,843 people added in IT Services and 875 in BPO. Gross people addition was very healthy at 5,992 people indicating continued business momentum. Infosys now has 72,241 employees second highest in India after TCS.
- Infosys indicated that offshore salary hikes would be 12-15% in line with our expectations.
- Attrition was stable at 13.7%
- IT services utilization including trainees was flattish at 66.9%. However utilization excluding trainees fell significantly from 76.6% to 72.5%. This indicates building up of bench.
- Proportion of fixed price was at 27.4%, slightly down Q/Q
- Infosys added 34 clients in the quarter.
- EBITDA margins were down 100 bps Q/Q. We believe that this is largely due to Rupee appreciation, higher sales expenditure and higher bench.
- Infosys saw foreign exchange loss of Rs 50m against loss of Rs 200m in 3QFY07.
- Tax rate was at 12.9% slightly up Q/Q. However there was a reversal of tax provision of Rs 1.24 billion in 4QFY07 leading to low effective tax rate of 2.3%.
- Overall PBT grew 5% Q/Q in Re-terms and net profit grew 16% Q/Q due to tax reversal. EPS grew 15% Q/Q.
- **Total shares outstanding increased by 2% to 571.21 million shares.** We believe this is due to exercise of outstanding ESOPs – we do not anticipate any major dilution in FY08.

- Cash Balances stood at US\$1.4 billion. Receivable days were flat at 55 days.

Table 2: Infosys P&L

Consolidated Rs M	2QFY06	3QFY06	4QFY06	1QFY07	2QFY07	3QFY07	4QFY07
Sales	22,940	25,320	26,240	30,150	34,510	36,550	37,720
Gross Profit	10,820	12,050	12,020	13,490	16,180	17,170	17,510
Gross margin (%)	47.2	47.6	45.8	44.7	46.9	47.0	46.4
Selling and marketing	1,490	1,580	1,520	2,040	2,210	2,360	2,680
General and administrative	1,990	1,860	2,170	2,560	2,880	2,850	2,860
Operating profit (EBITDA)	7,340	8,610	8,330	8,890	11,090	11,960	11,970
OPM (%)	32.0	34.0	31.7	29.5	32.1	32.7	31.7
EBIT	6,380	7,440	6,890	7,830	9,870	10,550	10,520
Other Income	440	(50)	720	1,280	660	590	1,190
Depreciation	960	1,170	1,440	1,060	1,220	1,410	1,450
PBT	6,810	7,390	7,610	9,080	10,530	11,140	11,720
Tax	690	830	810	1,060.0	1,230.0	1,300.0	270.0
PAT	6,120	6,560	6,800	8,020	9,300	9,840	11,450
Extra-ord	60	70	70	20	10	10	10
Adj. PAT	6,060	6,490	6,730	8,000	9,290	9,830	11,440
NPM (%)	26.7	25.9	25.9	26.6	26.9	26.9	30.4
EPS	11.1	11.9	12.2	14.5	16.7	17.6	20.3
Q-o-Q (%)							
Sales	10.7	10.4	3.6	14.9	14.5	5.9	3.2
Gross profit	11.9	11.4	-0.2	12.2	19.9	6.1	2.0
Operating profit	10.6	17.3	(3.3)	6.7	24.7	7.8	0.1
EBIT	9.3	16.6	-7.4	13.6	26.1	6.9	-0.3
PBT	11.2	8.5	3.0	19.3	16.0	5.8	5.2
PAT	15.0	7.2	3.7	17.9	16.0	5.8	16.4
Adjusted PAT	13.9	7.1	3.7	18.9	16.1	5.8	16.4
EPS	13.5	6.4	3.0	18.5	15.7	5.4	15.2

Source: Company reports.

FY08 Guidance and management change

FY08 guidance

Indian GAAP

Infosys has guided to revenue of Rs 170,380-173,080 million up 22.6-24.6% Y/Y and earnings of Rs 80.29-81.58 up 20-22%. We note that the weighted average number of shares during FY07 was 562.7 million. However, due to exercise of ESOPs, the share count has increased to 571.2 at end of 4QFY07, dilution of 2.6%. As a result, net profit guidance is 23-25% Y/Y ahead of revenues.

In terms of Q/Q, guidance implies 7% Q/Q revenue growth for 2Q-4Q FY08 – quite healthy.

In terms of headcount, management guided to 25,000 gross people addition similar to guidance given at beginning of FY07 despite a higher base. We would like to get better clarity on the same from management.

Table 3: Indian GAAP guidance

	1QFY08E	2QFY08E	3QFY08E	4QFY08E	FY08 guidance	Y/Y growth
Revenue Rs M	39,130	41,769	44,587	47,594	173,080	24.6%
Seq. growth (%)		6.7	6.7	6.7		
Profit Rs M	10,190	11,107	12,106	13,195	46,599	24.9%
Q/Q growth (%)		9.0	9.0	9.0		
Seq. growth (%)						
EPS Rs	17.8	19.4	21.2	23.1	81.6	21.8%
Q/Q growth (%)		9.0	9.0	9.0		

Source: JP Morgan estimates, Company reports

US GAAP

Infosys has guided to revenue of US\$3.95 - 4.02 billion up 28-30% Y/Y and EPS of US\$1.89 up 26-28%. Due to dilution in 4QFY07, we note that implied PAT growth is 29-31%.

Table 4: US GAAP guidance

	1QFY08E	2QFY08E	3QFY08E	4QFY08E	FY08 guidance	Y/Y growth
Revenue US\$ m	908	970	1,036	1,106	4020	30.0%
Seq. growth (%)		6.8	6.8	6.8		
Profit US\$ M	234	257	281	308	1080	31.3%
Q/Q growth (%)		9.6	9.6	9.6		
Seq. growth (%)						
EPS US\$	0.41	0.45	0.49	0.54	1.89	27.7%
Q/Q growth (%)		9.6	9.6	9.6		

Source: JP Morgan estimates, Company reports

1QFY08 Guidance

Indian GAAP

Infosys has guided to revenue of Rs 38,960-39,130 million up 3.3-3.7% Q/Q and EPS of Rs 17.84 down 1.5% (excluding impact of tax write-back in Q4FY07). This is due to visa costs and salary hikes of 12-15% offshore.

US GAAP

Infosys has guided to revenue of US\$ 904-908 million up 4.7-4.9% Q/Q and EPS of US\$0.41/share flat Q/Q excluding the US\$ 29 million tax reversal in 4QFY07.

Management Change

Board appointed Mr. Nandan Nilekani as Co-Chairman. They further appointed Mr Kris Gopalakrishnan as CEO and Mr Shibulal as COO. These changes are effective June 22, 2007. Mr Narayan Murthy will continue as Chairman and Chief Mentor.

Prima facie, these changes appear to us as a way of providing more visibility to all the founding members of the company. We would discuss the same with management with in more detail.

Valuation- Dec-07 price target of Rs 2,650/share

Our share price target remains Rs2,650 based on a combination of P/E multiples and DCF fair values. Our target price assumes a 1- year forward P/E multiple of 24.4x, in line with last year's average 1-year forward multiple.

Table 5: Infosys P/E multiples

	1-year forward	1-year trailing
Average P/E multiple last 1 year	24.4	33.7
Multiple used in target price (x)	24.4	33.3

Source: JPMorgan estimates, Company data.

Infosys is trading at ~30X 1 year trailing EPS towards the lower end of band for the last couple of years. We expect multiples to move up as Infosys sustains 30%+ growth

Figure 1: One year trailing PER



Source: JPMorgan estimates, Company data.

Figure 2: One year forward PER



Source: JPMorgan estimates, Company data.

Infosys is trading at 23X 1 year forward PER.

Our DCF-based fair value estimate is Rs2,220 based on 10-year revenue CAGR of 25%, long-term EBIT margin estimate of 25%, long-term ROIC of 35%, and cost of capital of 12.5%. Our price target of Rs2,650 implies a premium of 20% to our fair value estimate. We believe that the offshore demand environment and strong EPS growth over the next 12-15 months will justify this premium.

Risks to price target: Slowdown in the macro technology spending environment, higher-than-expected wage inflation, and Rupee appreciation against the US\$.

Table 6: Infosys P&L – US GAAP (converted into Indian Rupee)

	FY02	FY03	FY04	FY05	FY06	FY07	FY08E	FY09E
Rs m								
Revenues	26,001	36,480	48,544	71,202	95,214	138,943	185,982	247,961
Gross profit	12,163	16,393	21,029	30,781	40,168	59,050	78,989	104,582
SG&A	3,407	5,602	7,587	10,310	13,618	20,724	27,221	35,334
EBIT	8,756	10,791	13,442	20,471	26,550	38,326	51,768	69,248
EBITDA	10,361	12,685	15,809	23,339	30,921	43,466	58,572	77,573
PBT	9,181	11,615	14,669	21,540	27,896	42,089	55,156	73,832
Tax	1,334	2,024	2,322	3,221	3,127	3,839	6,619	9,967
Pat before minority interest					24,769	38,250	48,538	63,865
PAT	8,085	9,823	12,475	18,319	24,564	38,154	48,503	63,831
EPS (Rs)	15.3	18.5	23.5	34.1	44.9	68.1*	86.9	114.4
Margins (%)								
Gross Margin	46.8	44.9	43.3	43.2	42.2	42.5	42.5	42.2
Operating Margin	33.7	29.6	27.7	28.8	27.9	27.6	27.8	27.9
EBITDA Margin	39.8	34.8	32.6	32.8	32.5	31.3	31.5	31.3
Net Margin	31.1	26.9	25.7	25.7	25.8	27.5	26.1	25.7
Sequential growth								
Sales	37.0	40.3	33.1	46.7	33.7	45.9	33.9	33.3
Gross profit	32.5	34.8	28.3	46.4	30.5	47.0	33.8	32.4
SG&A	28.8	64.4	35.4	35.9	32.1	52.2	31.4	29.8
EBIT	33.9	23.2	24.6	52.3	29.7	44.4	35.1	33.8
EBITDA	35.2	22.4	24.6	47.6	32.5	40.6	34.8	32.4
PAT	28.8	21.5	27.0	46.8	34.1	55.3	27.1	31.6
EPS	28.8	21.4	26.7	45.0	31.8	51.7	27.6	31.6

Source: JPMorgan estimates, Company data. * - Includes tax reversal of Rs 1.25 billion.

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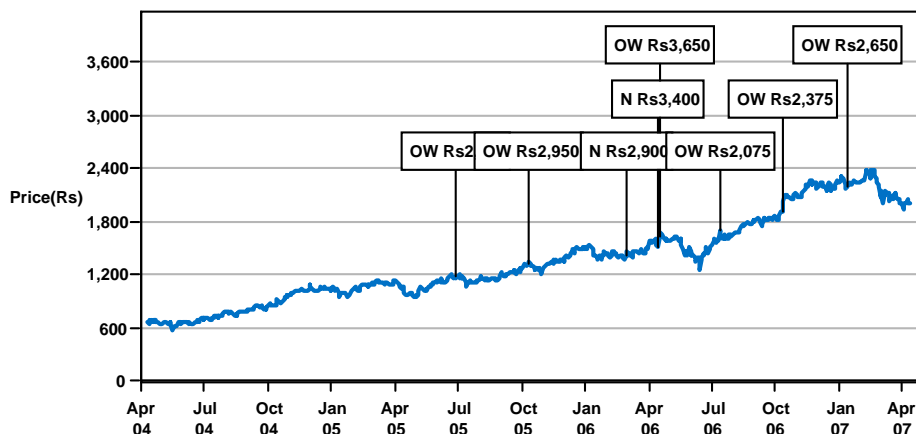
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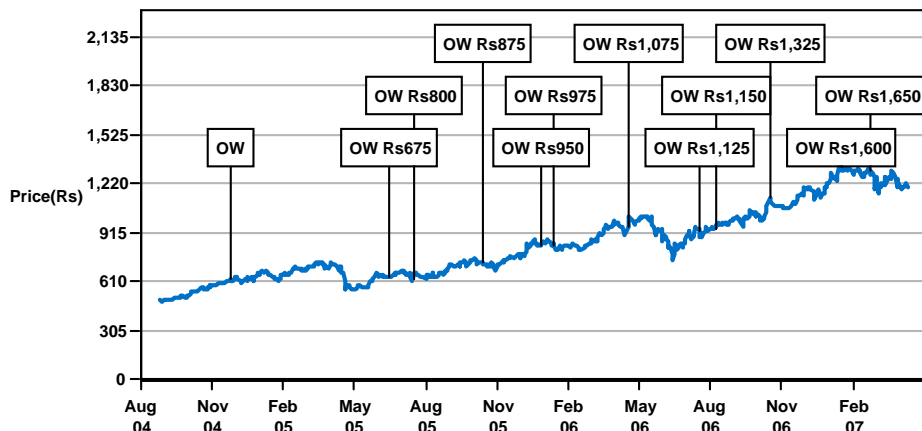
Infosys Technologies (INFY.BO) Price Chart



Date	Rating	Share Price (Rs)	Price Target (Rs)
28-Jun-05	OW	1169.10	2700.00
11-Oct-05	OW	1311.22	2950.00
01-Mar-06	N	1414.30	2900.00
14-Apr-06	N	1510.40	3400.00
17-Apr-06	OW	1615.15	3650.00
13-Jul-06	OW	1693.22	2075.00
11-Oct-06	OW	1906.00	2375.00
12-Jan-07	OW	2183.00	2650.00

Source: Reuters and JPMorgan; price data adjusted for stock splits and dividends.
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Tata Consultancy Services (TCS.BO) Price Chart



Date	Rating	Share Price (Rs)	Price Target (Rs)
24-Nov-04	OW	617.95	-
14-Jun-05	OW	635.65	675.00
16-Jul-05	OW	624.10	800.00
12-Oct-05	OW	733.95	875.00
26-Dec-05	OW	831.38	950.00
12-Jan-06	OW	835.82	975.00
18-Apr-06	OW	951.80	1075.00
19-Jul-06	OW	920.88	1125.00
08-Aug-06	OW	936.00	1150.00
17-Oct-06	OW	1130.45	1325.00
16-Jan-07	OW	1327.90	1600.00
21-Feb-07	OW	1297.20	1650.00

Source: Reuters and JPMorgan; price data adjusted for stock splits and dividends.
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IB clients*	49%	51%	38%
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IB clients*	68%	64%	53%

*Percentage of investment banking clients in each rating category.

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Revised March 30, 2007.

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Infosys Technologies: Summary of Financials

Income statement						Ratio Analysis					
INR in millions, year-end Mar	FY05A	FY06A	FY07A	FY08E	FY09E	% , year-end Mar	FY05A	FY06A	FY07A	FY08E	FY09E
Revenues	71,202	95,214	138,943	185,982	247,961	Gross Margin	43.2	42.2	42.5	42.5	42.2
Cost of Goods Sold	40,421	55,046	79,893	106,993	143,379	EBITDA margin	32.8	32.5	31.3	31.5	31.3
Gross Profit	30,781	40,168	59,050	78,989	104,582	Operating Margin	28.8	27.9	27.6	27.8	27.9
SG&A Expenses	10,310	13,618	20,724	27,221	35,334	Net Margin	25.7	25.8	27.5	26.1	25.7
Operating Profit (EBIT)	20,471	26,550	38,326	51,768	69,248	SG&A/Sales	14.5	14.3	14.9	14.6	14.2
EBITDA	23,339	30,921	43,466	58,572	77,573						
Interest Income	1,069	1,346	3,763	3,388	3,637	Sales growth	46.7	33.7	45.9	33.9	33.3
Interest Expense	-	-	-	-	-	Operating Profit Growth	52.3	29.7	44.4	35.1	33.8
Investment Income (Exp.)	-	-	-	-	-	Net profit growth	46.8	34.1	55.3	27.1	31.6
Non-Operating Income (Exp.)	-	-	-	-	-	EPS (Reported) growth	45.0	31.8	51.7	27.6	31.6
Earnings before tax	21,540	27,896	42,089	55,156	73,832						
Tax	-3,221	-3,127	-3,839	-6,619	-9,967	Interest coverage (x)	n.m.	n.m.	n.m.	n.m.	n.m.
Net Income (Reported)	18,319	24,564	38,154	48,503	63,831	Net debt to total capital	n.m.	n.m.	n.m.	n.m.	n.m.
						Net debt to equity	n.m.	n.m.	n.m.	n.m.	n.m.
INR											
EPS (Reported)	34.1	44.9	68.1	86.9	114.4	Asset Turnover	111.9	103.3	103.3	121.3	120.8
BPS	101.3	148.7	207.9	249.0	339.0	ROE	36.4	35.7	37.3	40.4	38.9
DPS	9.2	22.5	5.0	15.0	19.0	ROIC	64.7	60.4	60.5	62.9	65.9
Shares Outstanding (mn)	541	551	571	558	558	ROCE	34.9	34.4	34.8	38.6	37.1
									1.1		
Balance sheet						Cash flow statement					
INR in millions, year-end Mar	FY05A	FY06A	FY07A	FY08E	FY09E	INR in millions, year-end Mar	FY05A	FY06A	FY07A	FY08E	FY09E
Cash and cash equivalents	30,097	47,231	61,644	74,753	111,835	Net Income	18,319	24,564	38,154	48,503	63,831
Accounts receivable	13,255	16,101	24,719	32,551	41,971	Depr. & Amortisation	2,869	4,371	5,140	6,804	8,325
Deferred Tax Assets	87	45	88	127	164	Change in working capital	-6,183	-1,125	-4,039	-10,199	-10,305
Others	2,931	3,925	5,425	8,634	11,133	Other	0	0	0	0	0
Current assets	46,370	67,301	91,875	116,065	165,103	Cash flow from operations	15,005	27,810	39,255	45,108	61,851
LT investments	0	0	0	0	0	Capex	-8,354	-10,871	-15,529	-9,460	-11,180
Net fixed assets	15,398	21,899	32,288	29,533	32,388	Disposal/ (purchase)	-453	-1,106	-7,338	0	0
Others	1,837	2,944	10,281	7,783	7,783	Cash flow from investing	-8,806	-11,978	-22,867	-9,460	-11,180
Total assets	63,605	92,144	134,444	153,381	205,274	Free cash flow	6,651	16,939	23,726	35,648	50,671
Liabilities						Equity raised/ (repaid)	105	14,030	1,402	-1,180	-1,494
ST loans	1,006	-	175	-	-	Debt raised/ (repaid)	68	-1,006	175	0	0
Payables	44	134	263	253	336	Other	2	673	-848	0	0
Others	6,605	9,188	15,181	14,199	15,767	Dividends paid	-5,014	-12,394	-2,705	-9,548	-12,094
Total current liabilities	7,655	9,321	15,619	14,452	16,103	Cash flow from financing	-4,840	1,302	-1,976	-10,727	-13,588
Long term debt	0	0	0	0	0	Net change in cash	1,359	17,135	14,412	24,921	37,083
Other liabilities	219	892	44	43	43	Beginning cash	28,738	30,097	47,231	49,832	74,753
Total liabilities	7,874	10,213	15,663	14,495	16,146	Ending cash	30,097	47,231	61,644	74,753	111,835
Shareholders' equity	55,731	81,930	118,781	138,885	189,128						

Source: JPMorgan estimates, Company data.