

Outperformance continues

Revising earnings upwards, upgrading PO to Rs400

Based on a robust operating performance in Q3FY07 and sustainable EBITDA margin expansion, we have revised Infotech's FY08 and FY09 earnings estimates upwards by 10 and 9% respectively. Based on this we have upgraded our PO to Rs400 (17% potential upside from current levels) at a target PE of 16x FY08E and at a target PEG of 0.5 for FY08E to FY07-09E growth.

Sustainable EBITDA margin improvement

EBITDA margin expanded by 100bps driven by utilization (150bps impact). Given room for further improvement in utilization, increasing proportion of EMI revenue and scale benefits we believe these improvements are sustainable.

One-off charges in IASI behind us

IASI (Infotech Aerospace Services Inc) is a 49% Puerto Rican subsidiary of Infotech Enterprises with Pratt and Whitney (51% stake). There were a couple of one-off provisions in IASI regarding a one-time bonus to employees for reaching USD25mn revenue mark and a one-time provision of ~USD0.7mn towards receivables. Adjusting for these charges IASI operations were profitable.

GSD growth picks up, EMI sustains growth

GSD growth picked up (grew 9% qoq) ahead of our expectations, post two flat quarters driven by strong order intake of GBP6mn in Europe, ramp-up in clients like Swisscom, and growth in US operations. EMI grew by a robust 9% qoq driven by a ramp up in existing clients like Bombardier and Alstom.

Key risks

1) Non-annuity revenues in GIS, 2) Increasing competition from large Indian IT vendors, 3) Rupee appreciation and industry-wide wage inflation.

Estimates (Mar)

(Rs)	2005A	2006A	2007E	2008E	2009E
Net Income (Adjusted - mn)	274	503	822	1,137	1,413
EPS	6.20	11.02	18.01	24.90	30.95
EPS Change (YoY)	201.3%	77.8%	63.3%	38.3%	24.3%
Dividend / Share	0.375	0.563	0.625	0.750	0.800
Free Cash Flow / Share	1.14	0.174	(3.46)	7.91	12.36

Valuation (Mar)

	2005A	2006A	2007E	2008E	2009E
P/E	55.12x	31.00x	18.98x	13.72x	11.04x
Dividend Yield	0.110%	0.165%	0.183%	0.219%	0.234%
EV / EBITDA*	32.84x	22.95x	13.24x	9.55x	7.47x
Free Cash Flow Yield*	0.322%	0.051%	-1.01%	2.32%	3.62%

* For full definitions of *iQmethod*SM measures, see page 8.



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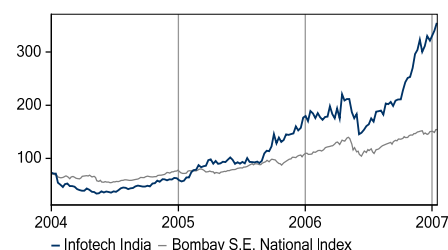
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Stock Data

Price	Rs341.70
Price Objective	Rs400.00
Date Established	17-Jan-2007
Investment Opinion	C-1-7
Volatility Risk	HIGH
52-Week Range	Rs126.67-Rs373.50
Mrkt Val / Shares Out (mn)	US\$352 / 45.7
Average Daily Volume	82,912
ML Symbol / Exchange	IFKFF / BSE
Bloomberg / Reuters	INFTC IN / INFE.BO
ROE (2007E)	33.2%
Net Dbt to Eqty (Mar-2006A)	-15.1%
Est. 5-Yr EPS / DPS Growth	24.0% / 18.0%
Free Float	NA



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Refer to important disclosures on page 9 to 10. Analyst Certification on page 7. Price Objective Basis/Risk on page 7.

17 January 2007

*iQprofile*SM Infotech Enterprises Ltd

Key Income Statement Data (Mar)	2005A	2006A	2007E	2008E	2009E
(Rs Millions)					
Sales	2,571	3,625	5,453	7,473	9,910
Gross Profit	1,347	1,929	2,885	3,723	4,553
Sell General & Admin Expense	(878)	(1,257)	(1,720)	(2,109)	(2,488)
Operating Profit	302	486	915	1,333	1,704
Net Interest & Other Income	37	10	40	13	11
Associates	NA	NA	NA	NA	NA
Pretax Income	339	497	954	1,346	1,715
Tax (expense) / Benefit	(90)	(94)	(203)	(296)	(394)
Net Income (Adjusted)	274	503	822	1,137	1,413
Average Fully Diluted Shares Outstanding	44	46	46	46	46

Key Cash Flow Statement Data

Net Income (Reported)	274	503	822	1,137	1,413
Depreciation & Amortization	167	186	250	282	362
Change in Working Capital	(112)	(288)	(497)	(560)	(717)
Deferred Taxation Charge	NA	NA	NA	NA	NA
Other Adjustments, Net	(42)	(36)	(79)	2	6
Cash Flow from Operations	287	365	497	861	1,064
Capital Expenditure	(237)	(357)	(654)	(500)	(500)
(Acquisition) / Disposal of Investments	3	0	0	0	0
Other Cash Inflow / (Outflow)	(69)	(79)	54	(25)	0
Cash Flow from Investing	(303)	(436)	(600)	(525)	(500)
Shares Issue / (Repurchase)	11	100	0	0	0
Cost of Dividends Paid	(20)	(26)	(24)	(27)	(28)
Cash Flow from Financing	(23)	114	(87)	(41)	(48)
Free Cash Flow	50	8	(158)	361	564
Net Debt	(326)	(321)	(177)	(469)	(986)
Change in Net Debt	24	5	144	(293)	(516)

Key Balance Sheet Data

Property, Plant & Equipment	327	683	1,089	1,330	1,490
Other Non-Current Assets	390	312	261	264	242
Trade Receivables	872	1,223	1,853	2,539	3,367
Cash & Equivalents	340	385	195	489	1,006
Other Current Assets	114	266	139	155	155
Total Assets	2,044	2,869	3,537	4,777	6,259
Long-Term Debt	14	65	18	20	20
Other Non-Current Liabilities	NA	NA	NA	NA	NA
Short-Term Debt	NA	NA	NA	NA	NA
Other Current Liabilities	465	680	686	829	940
Total Liabilities	479	745	704	849	960
Total Equity	1,564	2,123	2,832	3,928	5,300
Total Equity & Liabilities	2,044	2,868	3,537	4,777	6,259

*iQmethod*SM - Bus Performance*

Return On Capital Employed	13.7%	18.9%	26.4%	28.8%	27.1%
Return On Equity	19.1%	27.3%	33.2%	33.6%	30.6%
Operating Margin	11.8%	13.4%	16.8%	17.8%	17.2%
EBITDA Margin	18.3%	18.5%	21.4%	21.6%	20.8%

*iQmethod*SM - Quality of Earnings*

Cash Realization Ratio	1.0x	0.7x	0.6x	0.8x	0.8x
Asset Replacement Ratio	1.4x	1.9x	2.6x	1.8x	1.4x
Tax Rate (Reported)	26.5%	18.9%	21.3%	22.0%	23.0%
Net Debt-to-Equity Ratio	-20.8%	-15.1%	-6.2%	-11.9%	-18.6%
Interest Cover	NM	44.2x	NM	NM	NM

Key Metrics

Sales Growth	37.2%	41.0%	50.4%	37.0%	32.6%
EBITDA GROWTH	60.9%	43.1%	73.4%	38.6%	27.9%
EBIT Growth	254.9%	60.8%	88.1%	45.7%	27.9%
Net Income Growth	204.3%	83.8%	63.3%	38.3%	24.3%

* For full definitions of *iQmethod*SM measures, see page 8.

Company Description

Infotech is a mid-tier Indian IT services company providing geographical information system (GSI) services to utility, transportation, & government (UTG) segments, engineering design services to engineering, manufacturing, & industrial (EMI) product segments, & software services to both these segments. It has leadership positions in offshore GIS data conversion services for UTG segment & offshore mechanical design services for the EMI segment.

Stock Data

Price to Book Value 5.5x

Strong operating quarter

Based on Infotech's strong Q3FY07 operating performance, we have revised earnings estimates for FY08 and 09 by 10% and 9% respectively. We have upgraded our target price to Rs400 at a target PE of 16x FY08E and a target PEG of 0.55 for FY08E PE to FY07-09E growth.

Quarter update

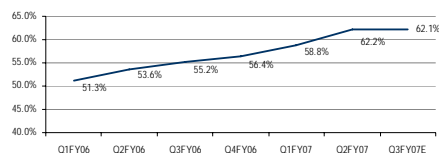
Infotech reported a strong operating performance, with revenue growing 9% qoq and 52% yoy. EBITDA margin expansion of about 100bps was driven by improved utilization. PAT before IASI profit increased 16% qoq, beating our expectations, though PAT after considering IASI impact declined due to the one-time provisions in IASI.

Table 1: Q3FY07 results

P&L (INR mn)	Q3FY07	Q2FY07	QoQ	Q3FY06	YoY	MLe	ML Var
Geospatial Design Solution (GSD) Revenues	543.0	498.3	9.0%	422.9	28.4%	518.2	4.8%
Engineering Manufacturing and Industrial Products (EMI) Revenues	888.9	815.9	8.9%	519.2	71.2%	881.2	0.9%
Inter Vertical Sales	1.5	1.4	7.1%	1.5	0.0%	2.9	-48.0%
Revenues from software sales	1430.4	1312.8	9.0%	940.6	52.1%	1396.5	2.4%
Expenditure							
Personnel cost	656.0	620.6	5.7%	442.9	48.1%	671.8	-2.4%
Travel	125.5	116.3	7.9%	87.7	43.1%	127.9	-1.9%
Purchases- Services/Products	168.2	147.3	14.2%	110.3	52.5%	169.4	-0.7%
Other expenses	158.1	145.0	9.0%	122.0	29.6%	152.3	3.8%
Total	1107.8	1029.2	7.6%	762.9	45.2%	1121.4	-1.2%
EBIDTA	322.6	283.6	13.8%	177.7	81.5%	275.1	17.3%
Depreciation	65.8	62.8	4.8%	48.9	34.6%	64.1	2.7%
EBIT	256.8	220.8	16.3%	128.8	99.4%	211.1	21.7%
Other Income	0.2	5.2	-96.2%	12.1	-98.3%	1.0	
Interest	4.8	4.3	11.6%	1.8	166.7%	4.0	20.0%
PBT	252.2	221.7	13.8%	139.1	81.3%	208.1	21.2%
Taxation	52.2	49.0	6.5%	21.1	147.4%	43.7	19.5%
Net Profit	200.0	172.7	15.8%	118.0	69.5%	164.4	21.7%
Share of IASI profit	-12.3	29.9	-141.1%	14.8	-183.1%	32.5	-137.8%
PAT incl. sh of IASI rmgn	187.7	202.6	-7.4%	132.8	41.3%	196.9	-4.7%
Margins %			bps		bps		bps
EBIDTA	22.6%	21.6%	95	18.9%	366	19.7%	285
PBT	17.6%	16.9%	74	14.8%	284	14.9%	273
PAT	13.1%	15.4%	-231	14.1%	-100	14.1%	-98
Tax rate	20.7%	22.1%	-140	15.2%	553	21.0%	-30

Source: Company

Chart 1: EMI proportion of revenue improving

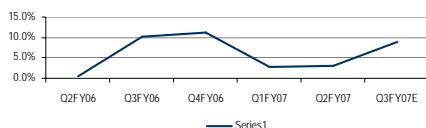


Source: Company

Margin improvement sustainable

Infotech's EBITDA margin this quarter improved 100bps, largely as a result of higher utilization. We believe these margin levels are sustainable given increasing scale of operations, further room to improve utilization (currently at 71% in GSD and 75% in EMI), and increasing revenue visibility due to higher proportion of EMI revenue helping Infotech better manage allocation of resources. Infotech's stated stand is to try to maintain margins at about 20% by investing in the development of newer practices like Marines and Avionics.

Chart 2: GSD growth picks up after two flat quarters



Source: Company

GSD shows strong growth, pipeline robust

Geospatial Solutions Design (GSD) growth that remained flat for the past two quarters picked up (grew 9% qoq) with a strong order intake of GBP6mn in Europe. Ramp-up in existing clients like Swisscom and growth in US operations (post two muted quarters consecutively) drove this growth. We were expecting increased traction in GSD in Q4FY07. Moreover, the company mentioned a strong pipeline in the GSD business, with large-sized deals up for bidding in Q4.

EMI growth on track

Engineering, Manufacturing and Industrial products (EMI) grew a robust 9% qoq driven by a ramp-up in existing clients like Bombardier and Alstom. Management indicated towards a high single digit to low double digit EMI growth sequentially in FY08. The company is taking steps to beef up its training engine.

Profit decline in IASI behind us

IASI (Infotech Aerospace Services Inc) is a 49% Puerto Rican subsidiary of Infotech Enterprises along with Pratt and Whitney (51% stake). It caters to four North American defense industry clients, including Pratt and Whitney itself.

This quarter IASI reported a loss, with Infotech's share being Rs12.3mn. This loss was an outcome of one-time provisions mentioned below:

1. Provision for a one time bonus to IASI employees for IASI's revenues reaching USD25mn in CY06, within its 3 years of operations. Infotech management indicated that this will not be a recurring charge.
2. IASI for the first time provided for receivables this quarter, as a good governance practice. Hence there was a one time provision of ~USD0.7mn. This was towards all the receivables outstanding for more than 365 days. Infotech management believes that a large portion of this provision stands a chance of getting reversed in the next 2-3 quarters.

Also, on the consolidated level Infotech has no debtors outstanding for over 365 days and debtors outstanding for more than 180 days too have come down this quarter by ~Rs40mn. Hence we do not expect any such one-off charge at the consolidated level.

Revising earnings, upgrading PO to Rs400

Based on a robust operating performance in Q3FY07 and sustainable EBITDA margin expansion, we have revised our FY08 and FY09 earnings estimates upward by 10 and 9% respectively. Based on this we have upgraded our PO to Rs400 at a target PE of 16x FY08E and target PEG for FY08E to FY07-09E growth at 0.5.

Table 2: Estimate revisions

	New			Old			Change		
	FY07	FY08	FY09	FY07	FY08	FY09	FY07	FY08	FY09
Revenue	5,453.0	7,472.9	9,909.9	5,367.3	7,230.2	9,600.2	1.6%	3.4%	3.2%
EBITDA	1,165.0	1,614.5	2,065.7	1,090.0	1,427.8	1,855.4	6.9%	13.1%	11.3%
EBITDA Margin	21.4%	21.6%	20.8%	20.3%	19.7%	19.3%	105bps	186bps	152bps
PAT	822.1	1,136.8	1,413.3	822.3	1,036.9	1,300.0	0.0%	9.6%	8.7%
EPS	18.0	24.9	31.0	18.0	22.7	28.5	0.0%	9.6%	8.7%

Source: Merrill Lynch Estimates

Financials

Table 3: Profit and loss statement

Year to March	FY05	FY06	FY07E	FY08E	FY09E
Total Revenues	2,571.3	3,625.0	5,453.0	7,472.9	9,909.9
Personnel Expenses	1,223.9	1,696.5	2,567.9	3,749.6	5,356.5
Operating & Admin Expenses	877.7	1,256.5	1,720.1	2,108.8	2,487.7
Total operating expenses	2,102	2,953	4,288	5,858	7,844
EBIDTA	469.7	672.0	1,165.0	1,614.5	2,065.7
Other Income	39.5	21.3	55.3	29.1	31.2
Interest expense, net	2.5	11.0	15.6	16.0	20.0
Depreciation & Amortization	167.3	185.7	250.3	281.9	361.8
EBIT	302.4	486.3	914.7	1,332.6	1,703.9
Profit before Tax	339	497	954	1,346	1,715
Provision for Tax	90.1	94.0	203.4	296.1	394.5
Profit after tax	249.3	402.6	751.0	1,049.7	1,320.7
Share of IASI profit	25	101	71	87	93
Profit after tax incl share above	274	503	822	1,137	1,413

Source: Company, Merrill Lynch Estimates

Table 4: Balance Sheet

As at 31st March, Rs mn	FY05	FY06	FY07E	FY08E	FY09E
Share Capital	147	152	228	228	228
Reserves & Surplus	1,417	1,971	2,604	3,700	5,072
Shareholders funds	1,564	2,123	2,832	3,928	5,300
Debt	14	65	18	20	20
Source of funds	1,578	2,188	2,850	3,948	5,320
Gross Fixed Assets	1,324	1,811	2,446	2,946	3,446
Accumulated depreciation	860	1,014	1,264	1,546	1,908
Net Fixed Assets	463	798	1,182	1,400	1,539
Capital WIP	141	11	30	30	30
Investments	100	179	125	150	150
<i>Current Assets:</i>					
Inventories	2	1	4	5	5
Sundry Debtors	872	1,223	1,853	2,539	3,367
Cash & Cash equivalents	340	385	195	489	1,006
Loans & Advances	112	265	135	150	150
<i>Current Liabilities</i>	<i>358</i>	<i>525</i>	<i>400</i>	<i>425</i>	<i>425</i>
<i>Provisions</i>	<i>108</i>	<i>156</i>	<i>286</i>	<i>404</i>	<i>515</i>
<i>Provisions as % of PBT</i>	<i>0</i>	<i>0</i>	<i>0</i>	<i>0</i>	<i>0</i>
Working Capital	861	1,194	1,500	2,354	3,588
Deferred Tax asset	13	8	13	13	13
Application of funds	1,578	2,189	2,850	3,948	5,320

Source: Company, Merrill Lynch Estimates

Table 5: Cash flow statement

Year to March, Rs mn	FY05	FY06	FY07E	FY08E	FY09E
PAT	273.9	503.3	822.1	1,136.8	1,413.3
Depreciation	167.3	185.7	250.3	281.9	361.8
Interest	2.5	11.0	15.6	16.0	20.0
(Inc) / Dec in Working capital	(111.8)	(287.6)	(496.6)	(559.8)	(717.1)
Others	(44.9)	(47.1)	(94.9)	(13.7)	(13.9)
Net cash from operations	287.0	365.2	496.5	861.2	1,064.1
Investments	(68.9)	(79.0)	53.8	(25.0)	-
Capital expenditure	(236.9)	(357.3)	(654.3)	(500.0)	(500.0)
Acquisitions / JV	3.0				
Others					
Net cash from investing	(302.7)	(436.3)	(600.4)	(525.0)	(500.0)
Free Cash Flow	50.2	8.0	(157.7)	361.2	564.1
Issue of equity	10.7	99.8	-	-	-
Inc / (Dec) in Debt	(11.7)	50.6	(46.6)	2.0	-
Dividends	(19.9)	(25.6)	(24.5)	(27.5)	(27.7)
Interest	(2.5)	(11.0)	(15.6)	(16.0)	(20.0)
Others					
Net cash from financing	(23.4)	113.8	(86.7)	(41.5)	(47.7)
Exchange differences	3.9	2.9	-	-	-
(Dec) / Inc in cash	(35.2)	45.6	(190.6)	294.7	516.4
Cash balance at the beginning	374.8	339.6	385.2	194.6	489.3
Cash balance at the end	339.6	385.2	194.6	489.3	1,005.8

Source: Company, Merrill Lynch Estimates

Table 6: Key ratios

Year to 31st March	FY05	FY06	FY07E	FY08E	FY09E
Growth (%)					
Revenues	37.2	41.0	50.4	37.0	32.6
Net profit	204.3	83.8	63.3	38.3	24.3
EBIDTA	60.9	43.1	73.4	38.6	27.9
Gross Fixed Assets	8.9	36.8	35.1	20.4	17.0
Capital Employed	18.4	38.7	30.2	38.5	34.7
Per share data					
EPS (Rs)	6.2	11.0	18.0	24.9	31.0
CFPS (Rs)	10.0	15.1	23.5	31.1	38.9
BVPS (Rs)	35.4	46.5	62.0	86.0	116.1
CPS (Rs)	5.2	2.6	1.3	7.4	18.7
Profitability (%)					
EBITDA margin	18.3	18.5	21.4	21.6	20.8
Net Profit margin	10.7	13.9	15.1	15.2	14.3
ROE	19.1	27.3	33.2	33.6	30.6
Turnover (times)					
Debtor days	124	123	124	124	124
Total Assets	1.6	1.7	1.9	1.9	1.9
Net fixed assets	5.5	4.5	4.6	5.3	6.4

Source: Company, Merrill Lynch Estimates

Price Objective Basis & Risk

Our PO of Rs400 is set at 16x FY08E EPS at a 2-yr PEG of 0.5, given a 31% EPS CAGR over FY07-09E, lower than the 0.7-1.2 range for peers.

Key risks: 1) Non-annuity revenues in GIS, 2) Increasing competition from large Indian IT vendors, 3) Threat of captive in engineering services, and 4) Rupee appreciation and industry-wide wage inflation.

Analyst Certification

I, Mitali Ghosh, hereby certify that the views expressed in this research report accurately reflect my personal views about the subject securities and issuers. I also certify that no part of my compensation was, is, or will be, directly or indirectly, related to the specific recommendations or view expressed in this research report.

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17 January 2007

***iQmethod*SM Measures Definitions**

Business Performance	Numerator	Denominator
Return On Capital Employed	$\text{NOPAT} = (\text{EBIT} + \text{Interest Income}) * (1 - \text{Tax Rate}) + \text{Goodwill Amortization}$	Total Assets – Current Liabilities + ST Debt + Accumulated Goodwill
Return On Equity	Net Income	Shareholders' Equity
Operating Margin	Operating Profit	Sales
Earnings Growth	Expected 5-Year CAGR From Latest Actual	N/A
Free Cash Flow	Cash Flow From Operations – Total Capex	N/A
Quality of Earnings		
Cash Realization Ratio	Cash Flow From Operations	Net Income
Asset Replacement Ratio	Capex	Depreciation
Tax Rate	Tax Charge	Pre-Tax Income
Net Debt-To-Equity Ratio	Net Debt = Total Debt, Less Cash & Equivalents	Total Equity
Interest Cover	EBIT	Interest Expense
Valuation Toolkit		
Price / Earnings Ratio	Current Share Price	Diluted Earnings Per Share (Basis As Specified)
Price / Book Value	Current Share Price	Shareholders' Equity / Current Basic Shares
Dividend Yield	Annualised Declared Cash Dividend	Current Share Price
Free Cash Flow Yield	Cash Flow From Operations – Total Capex	Market Cap. = Current Share Price * Current Basic Shares
Enterprise Value / Sales	$\text{EV} = \text{Current Share Price} * \text{Current Shares} + \text{Minority Equity} + \text{Net Debt} + \text{Sales} + \text{Other LT Liabilities}$	
EV / EBITDA	Enterprise Value	Basic EBIT + Depreciation + Amortization

*iQmethod*SM is the set of Merrill Lynch standard measures that serve to maintain global consistency under three broad headings: Business Performance, Quality of Earnings, and validations. The key features of *iQmethod* are: A consistently structured, detailed, and transparent methodology. Guidelines to maximize the effectiveness of the comparative valuation process, and to identify some common pitfalls.

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Important Disclosures

Investment Rating Distribution: Technology Group (as of 31 Dec 2006)

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	104	41.94%	Buy	19	18.27%
Neutral	128	51.61%	Neutral	24	18.75%
Sell	16	6.45%	Sell	2	12.50%

Investment Rating Distribution: Global Group (as of 31 Dec 2006)

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	1306	42.74%	Buy	406	31.09%
Neutral	1509	49.38%	Neutral	446	29.56%
Sell	241	7.89%	Sell	53	21.99%

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