

## INFOSYS TECHNOLOGIES

INR 2,183

*Currency restricts growth*

BUY

Infosys announced Q3FY07 results, which reflected healthy improvement in the operating matrix. While revenue and net profit were inline with consensus, they were below our expectations. The rupee appreciation at 3.8% for the quarter curtailed revenue growth in rupee terms—though the US dollar-denominated revenue and net profit grew by a strong 10.1% and 9.5% Q-o-Q, respectively. Improved billing rates, surge in high margin license fee revenues from its banking flagship product *Finacle*, and savings in SG&A charges buoyed the EBITDA margin. Surge in depreciation charges and lower other income curtailed PAT growth to 5.8% for the quarter.

Infosys has scored impressively in executing its strategy of taking its renowned executing engine to its large Fortune 1000 base and raising its wallet share. It has penetrated an increasing proportion of client IT budgets through services across the value chain and technology spectrum. Growth in business services such as consulting and BPO and technology-based services such as testing and infrastructure management demonstrate the company's ability to enter and proliferate large opportunities.

We maintain our forward estimates and expect the company to remain on a strong growth trajectory during the forecast period. At P/E of 32.2x and 24.1x and EV/EBITDA of 25.9x and 17.8x for FY07E and FY08E, respectively, we maintain our 'BUY' recommendation.

**Key highlights**

- Revenue stood at INR 36.6 bn (up 5.9% Q-o-Q and 44.4% Y-o-Y) and net profit was at INR 9.8 bn (up 5.8% Q-o-Q and 51.5% Y-o-Y). In dollar terms, revenue grew 10.1% and net profit by 9.5%.
- Gross profit stood at INR 17.2 bn (up 6.1% Q-o-Q and 42.5% Y-o-Y). Gross margin improved marginally by 10bps to 47.0% from 49.9%.
- S&M expenses grew by 6.8%, while G&A expenses growth declined by 1.0%. Total SG&A as a percentage of revenue stood at 14.3% of revenues, which is down by 40bps Q-o-Q and up 60bps Y-o-Y.
- Although the rupee's appreciation impacted EBIT margins by 200bps, margin on a Q-o-Q basis was up by 20bps. Improvement in billing rates and employee productivity (80bps), higher revenue share from products (80bps), and leverage from SG&A expenses (50bps) were the main contributors to surge in margin.

**Financials**

Year to March	Q3FY07	Q2FY07	Growth %	Q3FY06	Growth %	FY07E	FY08E
Revenue (INR mn)	36,550	34,510	5.9	25,320	44.4	139,815	191,100
Gross profit (INR mn)	17,170	16,180	6.1	12,050	42.5	65,227	89,665
EBITDA (INR mn)	11,960	11,090	7.8	8,610	38.9	44,862	63,687
Net profit (INR mn)	9,830	9,290	5.8	6,490	51.5	37,617	51,673
EPS basic (INR)	17.6	16.7	5.3	11.8	49.0	67.8	90.7
P/E (x)						32.2	24.1
EV/EBITDA (x)						25.9	17.8
Mkt cap / Rev (x)						8.7	6.3

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Bloomberg : INFO IN**Market Data**52-week range (INR) : 3,400 / 1,572  
Share in issue (mn) : 555.8  
M cap (INR bn/USD mn) : 1,213 / 27,339  
Avg. Daily Vol. BSE ('000) : 1,525.9**Share Holding Pattern (%)**Promoters : 19.3  
MFs, FIs & Banks : 6.7  
FIs : 36.2  
Others : 37.8

- ◆ Infosys added gross 6,062 employees (net 3,282) in the quarter taking the total employee count to 69,432. Attrition during the quarter was at 13.5%, compared to 12.9% in the previous quarter. The attrition figure also includes involuntary attrition, excluding which, the like-to-like attrition rate has marginally increased by 20bps to 12.2%.
- ◆ Utilisation rate including trainees remained flat at 67.5% in the current quarter.
- ◆ The company has added 43 new clients in the current quarter, taking the total client count to 488.
- ◆ The number of clients contributing revenues of over USD 1 mn has increased from 206 a year ago to 256, while the number of clients contributing revenues over USD 5 mn has gone up from 78 to 108 over the past twelve months. The company has 11 clients contributing over USD 50 mn, against seven clients a year ago. It also has two clients contributing greater than USD 100 mn, against none in the previous year.
- ◆ Billing rate for the quarter continued its upward trend with onsite rates increasing by 1.9% Q-o-Q and offshore rates were up by 1.7%. Infosys' billing rates have now seen upward movement for four consecutive quarters, which is particularly impressive. We expect this trend to continue as the rates negotiated with new clients as well as the existing clients are at 3-5% higher than the company's average rates.

#### \* Improved revenue composition

During the quarter, the company's BFSI vertical crossed a milestone of quarterly run rate of USD 1 bn. Infosys has invested in growing multiple BFSI sub-segments—mortgage, securities, risk management, payment solutions, and consumer banking—which are large in size. Each sub-segment has a huge potential which the company has been able to tap and develop its expertise in.

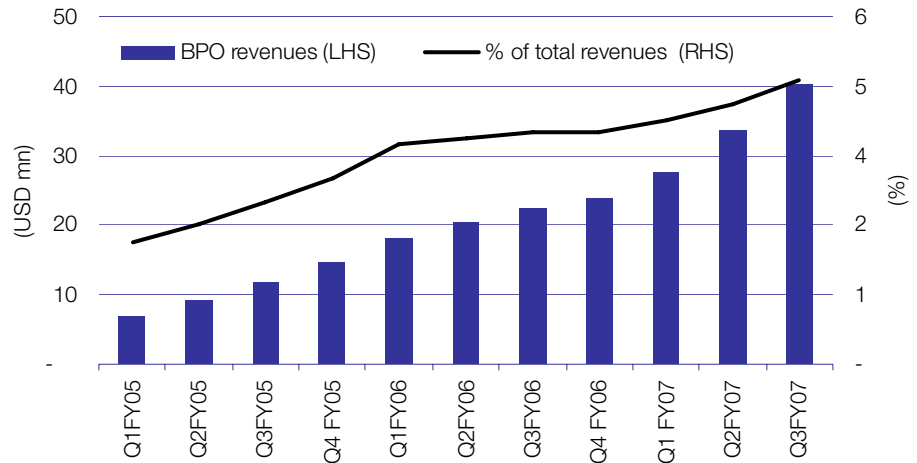
This quarter also saw product revenue contribution increasing to 4.3% of revenue. The higher license fee booked in the products revenue also provided cushion to margins during the quarter. We remain positive on its products business, which under its flagship core banking product *Finacle* is getting higher recognition in the global banking space.

Enterprise solutions and testing services led growth with 15.9% and 13.3% Q-o-Q growth, respectively. Over the past four quarters, package implementation and testing services have grown at a CAGR of 12.7% and 16.9%, respectively, increasing their contribution to the total revenue.

#### \* Strong growth in BPO continues

Infosys' BPO business, even though a small proportion of total revenues, has achieved meaningful size. The revenue contribution has now increased to USD 40 mn during the current quarter and its headcount now stands at 10,351. In the current quarter, revenue was up 19.8% Q-o-Q and 79.9% Y-o-Y. The number of total clients served stands at 23 and the company also acquired a Fortune 10 client for handling its procurement process. We expect the BPO business to sustain strong revenue momentum along with maintaining its healthy net margins.

Chart 1: BPO revenues and its % contribution



Source: Company, Edelweiss research

**\* Infrastructure management services focus**

Infrastructure management services (IMS), over the long term, is expected to become a large business opportunity for offshore IT vendors. In the IMS space, Infosys is clear that it will focus only on infrastructure operation management services and will not go into deals that involve infrastructure ownerships. The company wants to pursue asset light infrastructure which will typically not involve taking over the client’s people and infrastructure. Though the management is pursuing several large deals, it has stated intentions of protecting its billing rates and not getting locked in at lower price points.

**\* Valuations**

Infosys now has over 250 customers billing over a million dollars a year. The company has demonstrated superior mining skills and we expect the million dollar customers, who largely belong to the Fortune 1000 space, to be a potent source of growth.

We remain positive on the theme of outsourcing taking a centre stage and offshoring growing in adoption. Infosys, as a leading vendor in the offshore world, will continue to benefit from the same. At a P/E of 32.2x and 24.1x and EV/EBITDA of 25.9x and 17.8x for our FY07E and FY08E earnings, respectively, we see maintain our **‘BUY’** recommendation.

Financials snapshot								(INR mn)
Year to March	Q3FY07	Q2FY07	Growth %	Q3FY06	Growth %	FY06	FY07E	FY08E
Total revenues	36,550	34,510	5.9	25,320	44.4	95,216	139,815	191,100
Software dev expenses	19,380	18,330	5.7	13,270	46.0	50,654	74,588	101,435
Gross profit	17,170	16,180	6.1	12,050	42.5	44,562	65,227	89,665
Selling & marketing exp	2,360	2,210	6.8	1,580	49.4	6,005	9,087	12,048
General & admin exp	2,850	2,880	(1.0)	1,860	53.2	7,639	11,278	13,930
Overhead expenditure	5,210	5,090	2.4	3,440	51.5	13,643	20,366	25,978
EBITDA	11,960	11,090	7.8	8,610	38.9	30,918	44,862	63,687
Depreciation	1,410	1,220	15.6	1,170	20.5	4,371	5,380	7,048
EBIT	10,550	9,870	6.9	7,440	41.8	26,547	39,482	56,639
Other expense	-	-	-	-	-	11	30	-
Other income	590	660	(10.6)	(50)	(1280.0)	1,396	3,210	2,850
PBT	11,140	10,530	5.8	7,390	50.7	27,932	42,662	59,489
Tax	1,300	1,230	5.7	830	56.6	3,132	4,935	7,377
Adjusted net profit	9,840	9,300	5.8	6,560	50.0	24,801	37,727	52,113
Extra ordinary income	-	-	-	-	-	-	-	-
Minority Interest	(10)	(10)	0.0	(70)	-	(202)	(110)	(440)
Reported net profit	9,830	9,290	5.8	6,490	51.5	24,599	37,617	51,673
EPS basic (INR)	17.6	16.7	5.3	11.8	49.0	45.1	67.8	90.7
<b>as % of net revenues</b>								
Gross profit	47.0	46.9	-	47.6	-	46.8	46.7	46.9
Selling & marketing exp	6.5	6.4	-	6.2	-	6.3	6.5	6.3
Admin exp	7.8	8.3	-	7.3	-	8.0	8.1	7.3
EBITDA	32.7	32.1	-	34.0	-	32.5	32.1	33.3
Adjusted net profit	26.9	26.9	-	25.9	-	26.0	27.0	27.3
Reported net profit	26.9	26.9	-	25.6	-	25.8	26.9	27.0
Tax rate	11.7	11.7	-	11.2	-	11.2	11.6	12.4

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<b>Buy</b>	Expected to appreciate more than 20% over a 12-month period	<b>Reduce</b>	Expected to depreciate up to 10% over a 12-month period
<b>Accumulate</b>	Expected to appreciate up to 20% over a 12-month period	<b>Sell</b>	Expected to depreciate more than 10% over a 12-month period
<b>Trading Buy</b>	Expected to appreciate more than 10% over a 45-day period	<b>Trading Sell</b>	Expected to depreciate more than 10% over a 45-day period

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