

January 11, 2007

Stock Rating
Overweight

Industry View
Attractive

Infosys Technologies

F3Q07 Results: Initial Comments

Quick Comment: Infosys' F3Q07 numbers were reasonably strong, especially in the backdrop of the 3.8% rupee appreciation against the US\$ that the company effectively recorded during the quarter. Revenue rose 10% QoQ in US\$ terms and EBITDA margin rose a surprising 60 bps sequentially. Net income numbers were well ahead of guidance and slightly ahead of consensus estimates. F4Q07 guidance is muted – 4% QoQ revenue growth and 1.4% earnings growth (the company had guided for 5% revenue growth and 0.5% earnings growth for F3Q07).

What's New: Infosys reported 6% QoQ revenue and net income growth, while EBITDA margin expanded by 60 bps and EBIT margin by 30 bps. The company indicated that the rupee appreciation would have negatively affected margins by about 200 bps. Offshore and onsite pricing went up 1.7% and 1.9% QoQ – or up 3.3%/5.1% YoY. F2007 guidance has been revised up marginally.

Implications: While the element of positive surprise has been a lot lower than that in the prior two quarters (and which was in a way expected as well), we think that the stock and the sector continue to be well placed for 2007. Overall fundamentals remain strong for offshore outsourcing and any improvement in pricing could be a strong driver of consensus earnings, as well as the stock price.

We will follow these initial comments with a more detailed note and updated estimates. Other key quarterly highlights, financials and operating metrics are detailed on the following pages.

Key Ratios and Statistics

Reuters: **INFY.BO** Bloomberg: **INFO IN**

India Software

Shr price, close (Jan 10, 2007)	Rs2,168.75
Mkt cap, curr (mn)	US\$27,221
52-Week Range	Rs2,401.00-1,225.00

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Key F3Q07 Highlights

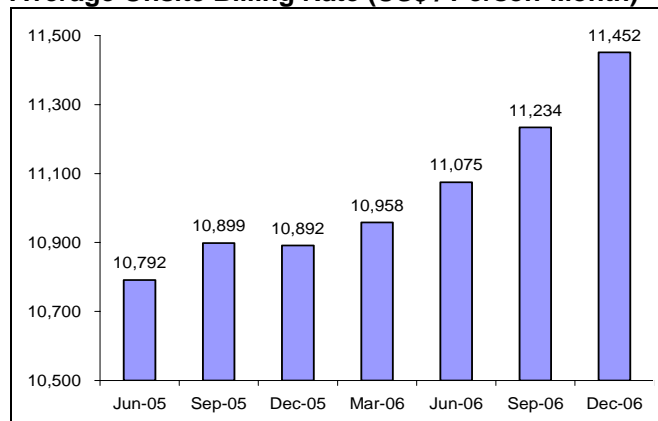
- Overall volumes rose 7% QoQ in F3Q07, compared to 11% and 9% growth in the preceding two quarters.
- Onsite pricing improved marginally by 1.9% and offshore pricing was up 1.7%. Offshore pricing has gradually climbed up for six quarters in a row now and onsite prices for four quarters (Exhibit 1 & 2).
- The rupee appreciated on average by 3.8% for Infosys during the quarter. We understand that the company has US\$360 million of forward cover outstanding.
- EBIT margin improved by 30 bps sequentially and EBITDA by 60 bps. We believe that the rupee appreciation hurt margins by about 200 bps. Pricing and increased product

revenue helped margins by 80 bps each. G&A savings were 50 bps.

- The company added 3,282 employees (net) during the quarter to take the total to 69,432. Attrition continued to move higher, up from 12.9% to 13.5%. We understand that the attrition increase, net of involuntary attrition, was about 0.2%.
- The company added 43 new clients in the quarter (versus 45 in F2Q07) and the net addition was 12 (versus seven).
- Management has guided for 4% QoQ revenue growth and 1.4% earnings growth for F4Q07. It has assumed an average exchange rate of Rs44.11/US\$. F2007 basic EPS guidance has been revised up marginally to Rs66.63.

Exhibit 1

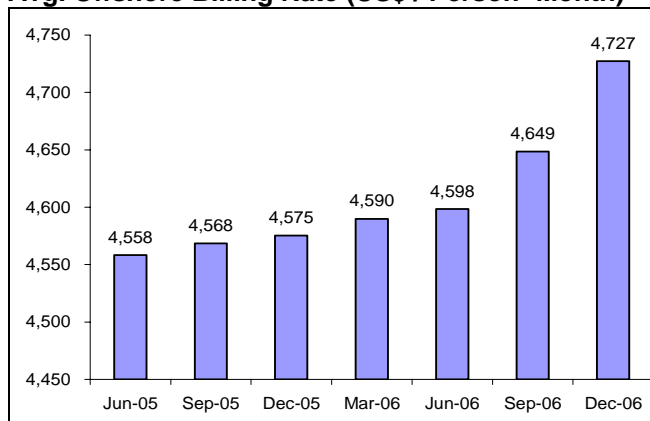
Average Onsite Billing Rate (US\$ / Person-Month)



Source: Company Data, Morgan Stanley Research

Exhibit 2

Avg. Offshore Billing Rate (US\$ / Person- Month)



Source: Company Data, Morgan Stanley Research

Exhibit 3

Consolidated Quarterly Financials (Rs Mn)

Quarter Ending	Mar-06	QoQ	YoY	Jun-06	QoQ	YoY	Sep-06	QoQ	YoY	Dec-06	QoQ	YoY
Revenue	26,240	4%	32%	30,150	15%	46%	34,510	14%	50%	36,550	6%	44%
Cost of Goods	14,220	7%	37%	16,660	17%	51%	18,330	10%	51%	19,380	6%	46%
Gross Profit	12,020	0%	27%	13,490	12%	39%	16,180	20%	50%	17,170	6%	42%
<i>Gross Margins (%)</i>	<i>45.81%</i>	<i>-178 bps</i>	<i>-179 bps</i>	<i>44.74%</i>	<i>-106 bps</i>	<i>-194 bps</i>	<i>46.88%</i>	<i>214 bps</i>	<i>-28 bps</i>	<i>46.98%</i>	<i>9 bps</i>	<i>-61 bps</i>
SG&A	3,690	7%	32%	4,600	25%	52%	5,090	11%	46%	5,210	2%	51%
EBIDTA	8,330	-3%	25%	8,890	7%	34%	11,090	25%	51%	11,960	8%	39%
<i>EBIDTA Margins (%)</i>	<i>31.7%</i>	<i>-226 bps</i>	<i>-180 bps</i>	<i>29.5%</i>	<i>-226 bps</i>	<i>-256 bps</i>	<i>32.1%</i>	<i>265 bps</i>	<i>14 bps</i>	<i>32.7%</i>	<i>59 bps</i>	<i>-128 bps</i>
Depreciation	1,440	23%	44%	1,060	-26%	32%	1,220	15%	27%	1,410	16%	21%
Operating Profit	6,890	-7%	22%	7,830	14%	34%	9,870	26%	55%	10,550	7%	42%
<i>Operating Margins (%)</i>	<i>26.26%</i>	<i>-313 bps</i>	<i>-227 bps</i>	<i>25.97%</i>	<i>-29 bps</i>	<i>-221 bps</i>	<i>28.60%</i>	<i>263 bps</i>	<i>79 bps</i>	<i>28.86%</i>	<i>26 bps</i>	<i>-52 bps</i>
Other Income	720	-1540%	123%	1,280	78%	348%	660	-48%	50%	590	-11%	-1280%
Extraordinary	-			(30)								
PBT	7,610	3%	27%	9,080	19%	48%	10,530	16%	55%	11,140	6%	51%
Tax	810	-2%	-5%	1,060	31%	32%	1,230	16%	78%	1,300	6%	57%
<i>Tax rate (%)</i>	<i>10.6%</i>	<i>-59 bps</i>	<i>-363 bps</i>	<i>11.7%</i>	<i>103 bps</i>	<i>-142 bps</i>	<i>11.7%</i>	<i>1 bps</i>	<i>155 bps</i>	<i>11.7%</i>	<i>-1 bps</i>	<i>44 bps</i>
PAT	6,800	4%	32%	8,020	18%	51%	9,300	16%	52%	9,840	6%	50%
Minority Interest	70			80			10			10		
Profit after minority interest	6,730	4%	31%	7,940	18%	49%	9,290	17%	53%	9,830	6%	51%
Extraordinary	-			60								
PAT after extraordinary items	6,730	4%	31%	8,000	19%	50%	9,290	16%	53%	9,830	6%	51%

Source: Company Data, Morgan Stanley Research

Exhibit 4

Infosys Technologies: Operating Metrics

Quarter Ending	Dec-04	Mar-05	Jun-05	Sep-05	Dec-05	Mar-06	Jun-06	Sep-06	Dec-06
Geographical:									
North America	66.6%	63.9%	63.6%	65.4%	65.0%	65.0%	64.0%	63.7%	63.2%
Europe	22.1%	23.3%	23.9%	23.7%	24.9%	25.5%	26.2%	25.8%	26.8%
India	2.1%	2.0%	2.4%	1.5%	1.4%	1.8%	1.4%	1.6%	1.8%
Others	9.2%	10.8%	10.1%	9.4%	8.7%	7.7%	8.4%	8.9%	8.2%
Revenue:									
Offshore as a Proportion to Total	51.0%	51.9%	52.1%	51.2%	51.4%	50.7%	49.5%	49.7%	50.8%
Onsite as a Proportion to Total	49.0%	48.1%	47.9%	48.8%	48.6%	49.3%	50.5%	50.3%	49.2%
Industry Verticals (% of Revenues):									
BFSI	35.2%	33.8%	36.3%	35.7%	36.0%	36.0%	36.4%	37.4%	38.6%
Manufacturing	14.3%	14.0%	13.3%	13.5%	14.1%	14.5%	14.5%	14.0%	12.8%
Telecom	18.1%	19.4%	17.2%	16.7%	15.8%	16.3%	17.7%	18.9%	18.3%
Retailing	9.4%	9.1%	9.6%	10.5%	10.3%	10.2%	9.7%	9.0%	10.5%
Others	23.0%	23.7%	23.6%	23.6%	23.8%	23.0%	21.7%	20.7%	19.8%
Client Concentration:									
Gross Clients Added	38	37	36	34	36	38	38	45	43
Total Clients	434	438	443	450	454	460	469	476	488
Net Clients Added	3	4	5	7	4	6	9	7	12
Top client's contribution to revenue	4.9%	6.3%	5.2%	4.4%	4.5%	4.7%	5.8%	6.6%	6.9%
Top 5 clients' contribution to revenue	19.8%	21.2%	19.1%	17.8%	17.6%	18.6%	19.5%	21.0%	18.9%
Top 10 clients' contribution to revenue	32.1%	33.8%	31.8%	30.6%	29.9%	31.0%	31.7%	32.9%	31.0%
Repeat Business	95.0%	92.9%	98.7%	96.5%	93.2%	92.1%	97.0%	95.2%	94.7%
Client Size:									
\$1 Mn clients	156	166	172	191	206	221	221	232	256
\$ 5 Mn clients	65	71	73	76	78	81	94	97	108
\$ 10 Mn clients	37	42	43	48	51	54	56	61	67
\$ 20 Mn clients	18	19	22	23	25	26	28	29	35
\$ 30 Mn clients	10	11	14	16	18	19	19	20	22
\$ 40 Mn clients	7	8	8	11	14	14	15	16	17
\$ 50 Mn clients	4	5	5	6	7	9	11	12	11
Billing Rates (US\$/Person-Month):									
Onsite Billing Rate	10833	10975	10792	10899	10892	10958	11075	11,234	11,452
Offshore Billing	4533	4575	4558	4568	4575	4590	4598	4,649	4,727
Blended Billing Rate	6483	6533	6517	6569	6574	6623	6742	6,825	6,924
Utilization Rates:									
Including Trainees	70.4%	72.7%	72.8%	71.6%	67.6%	67.7%	70.6%	67.4%	66.6%
Excluding Trainees	79.3%	76.1%	76.3%	78.6%	77.6%	75.9%	76.1%	79.3%	76.6%
Contract Type:									
Fixed Price	32.2%	29.4%	28.6%	28.7%	28.4%	27.0%	26.9%	26.2%	27.7%
Time & Materials	67.8%	70.6%	71.4%	71.3%	71.6%	73.0%	73.1%	73.8%	72.3%
DSO	58	68	59	59	57	62	65	65	63
Employees:									
IT and Consulting employees	31807	32784	35067	40903	43726	45694	50397	56374	59081
Infosys BPO	3422	3966	4739	5293	5696	7021	8012	9776	10351
No of Employees	35229	36750	39806	46196	49422	52715	58409	66150	69432
Attrition Rates	10.3%	9.7%	9.8%	10.0%	10.8%	11.2%	11.9%	12.9%	13.5%

Source: Company Data, Morgan Stanley Research



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Industry Coverage:India Software

Company (Ticker)	Rating (as of)	Price (01/10/2007)
Anantha Narayan		
HCL Technologies (HCLT.BO)	E (01/30/2004)	Rs589.45
Hexaware Technologies Limited (HEXT.BO)	O (06/22/2006)	Rs186.15
i-flex Solutions Ltd. (IFLX.BO)	E (10/31/2005)	Rs1,950.05
Infosys Technologies (INFY.BO)	O (04/17/2006)	Rs2,168.75
Mphasis BFL Group (MBFL.BO)	E (03/15/2004)	Rs283.10
Patni Computer Systems (PTNI.BO)	O (08/08/2005)	Rs402.35
Polaris Software Lab Ltd. (POLS.BO)	U (08/08/2005)	Rs190.95
Satyam Computer Services (SATY.BO)	O (03/18/2002)	Rs464.35
Tata Consultancy Services (TCS.BO)	O (09/29/2004)	Rs1,234.10
Wipro Ltd. (WIPR.BO)	E (03/22/2002)	Rs590.60

Stock Ratings are subject to change. Please see latest research for each company.