

Infosys Technologies

 BSE code: 500209
 NSE code: INFOSYSTCH

CMP: Rs 1,930
Target: Rs 2,466
BUY

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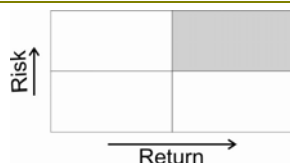
Company data

Particulars	
Market cap (Rs bn / US\$ bn)	1,102 / 27.3
Outstanding equity shares (mn)	571.2
52-week high/low (Rs)	3,400 / 1,572
2-month average daily volume	310,144

Financial snapshot

Particulars	FY07	FY08E	FY09E
Sales (Rs bn)	138.9	170.8	214.9
Growth (%)	45.6	22.9	25.9
Adj net profit (Rs bn)	38.2	46.7	58.7
Growth (%)	55.2	22.2	25.9
FDEPS (Rs)	68.5	81.5	102.3
Growth (%)	52.3	19.0	25.6
P/E (x)	28.2	23.7	18.9
RoE (%)	23.6	19.7	15.4

Risk-return profile



Shareholding pattern

(%)	Jun-07	Mar-07
Promoters	20.5	20.5
FIs	39.3	40.2
Banks & FIs	8.6	7.7
Public	31.6	31.6

Stock performance

Returns (%)	CMP	1-mth	3-mth	6-mth
Infosys	1,930	(2.5)	(3.1)	(11.6)
Sensex	14,911	5.5	13.7	6.1
BSE IT	4,869	(2.9)	1.3	(6.9)

Infosys' Q1FY08 results have been above our expectations at net profit levels. Revenue growth, however, was lower than anticipated due to slower volume growth. Net profit was bolstered by higher other income and a tax write-back. Even after excluding the tax write-backs of Rs 510mn and Rs 1,250mn that occurred in Q1FY08 and Q4FY07 respectively, the net profit grew by 1% sequentially against our expectation of a 4.6% decline.

In line with our expectations, the company raised its dollar guidance for FY08. However, the magnitude of revision was less than anticipated, resulting in higher downward revision in the rupee guidance. Our evaluation of Q1FY08 results and FY08 guidance suggest a conservative management outlook. We view further rupee appreciation as the most significant risk to our estimates. We maintain our Buy recommendation on Infosys with a March 2008 target of Rs 2,466.

Actual vs estimated performance

(Rs mn)	Actual	Estimated	% Variance
Net sales	37,755.0	38,254.0	(1.3)
EBIDTA	10,865.0	11,121.0	(2.3)
PAT	10,700.0	9,723.0	10.0
EPS (Rs)	18.9	17.0	11.2

Source: Company, Religare Research

Q1FY08 financial performance

(Rs mn)	Q1FY08	Q4FY07	% Chg QoQ	Q1FY07	% Chg YoY
Revenue	37,755	37,785	(0.1)	30,155	25.2
Cost of revenue	21,690	20,210	-	16,660	-
Gross profit	16,065	17,575	(8.6)	13,495	19.0
S&M expenses	2,050	2,680	-	2,040	-
G&A expenses	3,150	2,860	-	2,560	-
EBITDA	10,865	12,035	(9.7)	8,895	22.1
EBITDA margin (%)	28.8	31.9	-	29.5	-
Depreciation	1,467	1,615	-	1,128	-
Amortisation	81	44	-	-	-
Operating profit	9,317	10,377	(10.2)	7,767	19.9
OPM (%)	24.7	27.5	-	25.8	-
Other income	2,522	1,226	105.8	1,325	90.4
Profit before taxes	11,839	11,603	2.0	9,092	30.2
Provision for taxes*	1,139	263	-	1,051	-
Profit after taxes	10,700	11,340	(5.6)	8,041	33.1
Minority interest	-	-	-	91	-
Net profit	10,700	11,340	(5.6)	7,950	34.6
Net profit margin (%)	28.3	30.0	-	26.4	-
Basic EPS	18.9	20.2	(6.3)	14.4	31.6

Source: Company, Religare Research *Includes tax write-back of Rs 510mn and Rs 1,250mn for Q1FY08 and Q4FY07

Result highlights

Q1FY08 results: Key takeaways

Parameters	Comments
Volume growth	The onsite-offshore effort mix remained unchanged during the quarter. The volumes in Q1FY08 grew by 6.9% over Q4FY07 resulting in dollar revenue growth of 7.5% during the same period.
Pricing	Blended pricing improved by 1%; onsite and offshore billing rates rose 1.6% and 1.1% QoQ respectively. New clients are coming in at a premium of 3-4% over existing rates.
Onsite-Offshore mix	Revenue mix from onsite and offshore locations remained stable as compared to Q4FY07 at 49.7% and 50.3% respectively.
Employee addition	A gross addition of 7,000 employees was made during the quarter. The company plans to add 11,700 employees in Q2FY08, a good proportion of which would be fresh graduates. It has also increased the employee addition target for FY08 from 24,500 to 26,000.
Attrition rate	After consistently increasing for four sequential quarters, the attrition rate remained stable at 13.7% on LTM basis.
Salary hikes	Salaries of offshore employees were increased by 13-15% whereas onsite salaries grew by 3-5%. Salary hikes resulted in a 250bps QoQ decline in the EBITDA margin.
Clients & deals	The company witnessed sustained growth momentum in client additions, with 35 clients added during the quarter. Three deals of over US\$ 50mn each were bagged during the quarter.
Geographical mix	There were no significant changes in the geographical mix of revenues. The contribution from Europe improved marginally by 20bps QoQ.
Utilisation levels	Utilisation including trainees increased by 300bps QOQ to 70.5%. Utilisation remains the single largest margin lever for sustaining EBITDA margins.
Client growth	After leading growth for the last few quarters, the top-10 clients grew by 4% sequentially. Other clients grew faster at 9.3% over Q4FY07. The top client grew 8.8% QoQ.
Services metrics	Consulting and Testing services witnessed the strongest growth at 22.5% and 10.5% QoQ respectively. New services introduced in the last five years now contribute ~44% of total revenue.
Vertical metrics	Growth in the BFSI segment is back on track, at 4.9% QoQ. Telecom and Utilities witnessed higher-than-company growth rates at 8% and 9.8% respectively over Q4FY07.

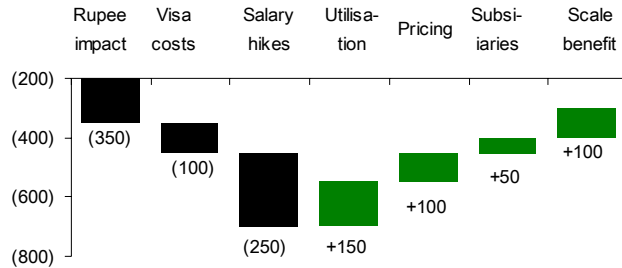
Source: Company, Religare Research

EBITDA margin contracts 300bps

The EBITDA margin declined 350bps QoQ as the rupee appreciated by 7% during the quarter. Higher visa expenses and salary hikes of 13-15% for offshore employees and 3-5% for onsite employees pulled the margin down a further 350bps. However, an improvement in blended pricing, utilisation rates and better performance from subsidiaries restricted the margin decline to only 300bps QoQ.

Rupee appreciation, higher visa expenses and salary hikes put a squeeze on the EBITDA margin

EBITDA margin decline (bps)



Source: Company' Religare Research

Utilisation rates – a key margin lever

We believe the level of employee utilisation is the most important margin lever available with the company. Infosys has invested in setting up a strategic bench of human resources which resulted in a dip in net utilisation rates from 82.4% in FY04 to 75.5% in FY07. In Q1FY08, the gross and net utilisation rates improved by 260bps and 90bps respectively. We expect the net utilisation rate to improve further to ~78% in FY09, thus protecting margins against a stronger rupee.

Raised FY08 dollar revenue growth guidance from 28-30% to 29-31%, lower than expected

FY08 guidance revised

As expected, Infosys revised its dollar guidance for FY08 upwards, while lowering its rupee guidance to factor in the strong currency appreciation. However, the quantum of dollar guidance revision was lower than expected, resulting in a higher-than-anticipated decline in rupee guidance. We had anticipated a 33-34% upward revision in the dollar revenue growth guidance, whereas Infosys has now guided for 29-31% growth in FY08.

Revised FY08 guidance

Guidance parameters	New		Old	
	Value	Growth (%)	Value	Growth (%)
Dollar guidance				
Revenue (US\$ bn)	4.0 - 4.1	29.0 - 31.0	3.9 - 4.0	28.0 - 30.0
Earnings per ADS (US\$)	1.92 - 1.94	25.5 - 26.8	1.86 - 1.89	25.7 - 27.7
Rupee guidance				
Guidance exchange rate	Rs 40.6/US\$	-	Rs 43.1/US\$	-
Revenue	162.4 - 164.3	16.9 - 18.3	170.4 - 173.1	22.6 - 24.6
EPS	78.2 - 79.0	13.0 - 14.1	80.3 - 81.6	20.0 - 22.0

Source: Company

Potential upsides from billing rates not factored into the guidance

Guidance implies conservative revenue CQGR of 5.8%

Our evaluation of the Q1FY08 results and FY08 guidance suggest a conservative management outlook. To achieve the fresh guidance for the fiscal, the company will have to grow at an implied compounded quarterly growth rate (CQGR) of ~5.8% QoQ in revenues and ~7% QoQ in EPS. This is much lower than the growth in the corresponding year-ago period (9.4% and 14.2% respectively), which was recorded despite an increasing base.

For Q2FY08, the management has given a revenue and EPS growth guidance of 6% and ~5% respectively. Seasonally, Q2 and Q3 are the strongest quarters for the company. Moreover, the management has not factored in any kind of upsides from billing rates. The company has been witnessing a steady increase in offshore as well as onsite billing rates in the last five consecutive quarters. We estimate that blended billing rates will improve 3.5% in FY08.

CQGR for Q2FY08-Q4FY08

Strong revenue CQGR trend in preceding years despite increasing base

(%)	FY05A	FY06A	FY07A	FY08 Guided
In US\$ terms				
Revenue	10.7	7.6	9.4	5.8
EADS	15.2	7.6	14.2	7.0
In rupee terms				
Revenue	9.5	8.2	7.8	5.7
EPS	13.5	7.6	12.0	6.2

Source: Company, Religare Research

FY08 guidance to be surpassed comfortably provided the rupee doesn't play spoilsport

Growth momentum to return to form in FY09

In the absence of further significant appreciation of the rupee against the US dollar, we expect Infosys to surpass its FY08 guidance comfortably. In dollar terms, we expect the company's revenue to grow 35% over FY07 to reach US\$ 4.2bn against the guidance of US\$ 4.1bn. Our rupee estimates are at an average exchange rate of Rs 41/US\$ as against Rs 40.6/US\$ used by the management in its guidance. We expect the revenue and EPS in rupee terms to grow by ~23% and ~19% respectively versus the guided growth range of 16.9 - 18.3% and 13 - 14.1%.

Valuation

Sensitivity of EPS estimates to exchange rate

We have realigned our estimates for Infosys assuming an average exchange rate of Rs 41/US\$ for FY08. However, in the table below we provide the sensitivity of our EPS estimates to further rupee appreciation.

EPS sensitivity

Avg exchange rate (Rs/US\$)	FY08 EPS (Rs)	FY09 (Rs)
41.0	81.5	102.3
40.5	80.0	99.9
40.0	78.6	97.5
39.0	75.7	92.6
38.0	72.8	87.8

Source: Religare Research

Earnings growth to bounce back in FY09; Maintain Buy

Stock may underperform in the short term; Maintain Buy

We expect Infosys' earnings to clock a CAGR of ~22% over FY07-FY09. At the current market price of Rs 1,930, the company is trading at 23.7x and 18.9x on expected FY08 and FY09 earnings of Rs 81.5 and Rs 102.3. The current pessimism in the stock price has resulted in contraction of the P/E multiple at which the company has traded historically. Due to the lower growth rate anticipated in FY08 and the impact of a strengthening rupee, the stock may remain an underperformer in the short term. We expect the growth rate in earnings to bounce back to ~25% in FY09 in the absence of the high rupee appreciation witnessed in FY08.

We maintain our Buy recommendation on the stock with a March 2008 target price of Rs 2,466. At this price the stock would trade at 30x and 24x on FY08E and FY09E.

Financials

Profit and Loss statement

(Rs bn)	FY06	FY07	FY08E	FY09E
Revenues	95.4	138.9	170.8	214.9
Growth (%)	33.9	45.6	22.9	25.9
EBITDA	31.1	43.9	52.8	67.4
Growth (%)	33.3	41.2	20.2	27.8
Depreciation	4.5	5.6	7.0	8.4
EBIT	26.6	38.3	46.0	59.1
Growth (%)	30.1	44.2	20.0	28.5
Interest	-	-	-	-
Other income	1.4	3.8	7.8	9.9
EBT	27.9	42.1	53.7	68.9
Growth (%)	27.1	50.7	27.7	28.2
Tax	3.1	3.8	7.1	10.2
Effective tax rate	11.1	9.0	13.2	14.8
Adj net income	24.6	38.2	46.7	58.7
Growth (%)	31.2	55.2	22.2	25.9
Shares outstanding (mn)	547.1	557.5	574.2	574.2
FDEPS (Rs)	45.0	68.5	81.5	102.3
DPS (Rs)	12.1	12.3	13.7	16.0
CEPS (Rs)	53.2	78.5	93.5	116.9

Source: Company, Religare Research

Cash flow statement

(Rs bn)	FY06	FY07	FY08E	FY09E
Net income	24.6	38.2	46.7	58.7
Depreciation	4.5	5.6	7.0	8.4
Other adjustments	0.0	(0.0)	(0.5)	-
Changes in WC	(7.8)	(5.0)	(4.2)	(4.1)
Operating cash flow	21.4	38.8	49.0	63.0
Capital expenditure	(8.5)	(16.3)	(14.5)	(11.3)
Investments	4.6	-	0.2	-
Other investing inc/(exp)	(0.3)	-	0.1	-
Investing cash flow	(4.2)	(16.3)	(14.1)	(11.3)
Free cash flow	17.2	22.5	34.9	51.7
Issue of equity	6.5	-	0.0	-
Issue/repay debt	-	-	-	-
Dividends paid	(7.5)	(7.7)	(8.9)	(10.3)
Others	-	-	-	-
Financing cash flow	(1.0)	(7.7)	(8.9)	(10.3)
Beg. cash & cash eq	30.5	46.7	61.4	86.6
Chg in cash & cash eq	16.2	14.8	25.9	41.4
Closing cash & cash eq	46.7	61.4	86.6	128.0

Source: Company, Religare Research

Recommendation history

Date	Event	Target (Rs)	Reco
16-Apr-07	Results Update	2,583	Buy
9-Jul-07	Sector Update	2,466	Buy
12-Jul-07	Results Update	2,466	Buy

Source: Religare Research

Balance sheet

(Rs bn)	FY06	FY07	FY08E	FY09E
Cash and bank bal	39.4	61.4	86.6	128.0
Accounts receivable	16.0	24.7	31.2	37.6
Inventories	-	-	-	-
Others current assets	11.5	5.8	7.9	9.5
Current assets	66.9	91.9	125.7	175.1
LT investments	-	-	-	-
Net fixed assets	21.8	32.3	40.4	43.9
Other assets	2.9	10.3	9.4	9.4
Total assets	91.6	134.5	175.4	228.3
Payables	7.3	12.3	14.9	17.9
Others	2.0	3.3	4.2	5.0
Current liabilities	9.3	15.6	19.0	22.9
LT debt	-	-	-	-
Other liabilities	0.9	0.0	-	-
Equity capital	1.4	2.9	2.9	2.9
Reserves	80.0	116.0	153.6	202.5
Net Worth	81.4	118.9	156.4	205.4
Total liabilities	91.6	134.5	175.4	228.3
BVPS (Rs)	148.8	213.2	272.4	357.7

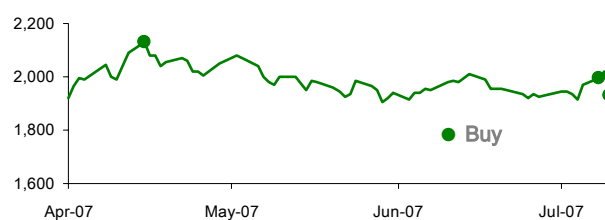
Source: Company, Religare Research

Financial ratios

	FY06	FY07	FY08E	FY09E
EBITDA margin (%)	32.6	31.6	30.9	31.4
EBIT margin (%)	27.8	27.6	26.9	27.5
Net profit margin (%)	25.8	27.5	27.3	27.3
FDEPS growth (%)	29.0	52.3	19.0	25.6
Receivables (days)	61.2	65.0	66.7	63.9
Inventory (days)	-	-	-	-
Payables (days)	28.0	32.3	31.8	30.4
Current ratio (x)	7.2	5.9	6.6	7.6
Interest coverage (x)	-	-	-	-
Debt/equity ratio (x)	-	-	-	-
ROE (%)	30.2	32.1	29.8	28.6
ROCE (%)	29.9	32.1	29.8	28.6
ROAE (%)	26.9	28.4	26.6	25.7
EV/Sales (x)	10.9	7.5	6.1	4.8
EV/EBITDA (x)	33.4	23.6	19.7	15.4
P/E (x)	42.9	28.2	23.7	18.9
P/BV (x)	13.0	9.1	7.1	5.4
P/CEPS (x)	36.2	24.6	20.6	16.5

Source: Company, Religare Research

Stock performance



Source: Religare Research

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