

# Infotech Enterprises

**BUY**
**Upgrade from HOLD**
**Rs306**
**Worst is behind**

Reason for report: Q3FY10 results review and recommendation change

**We upgrade Infotech Enterprises (Infotech) to BUY with revised target price of Rs370/share. We believe the worst is behind for Infotech on the back of increasing traction in large deals within Engineering Design (ED) – Hamilton Sundstrand deal to add 5-6% volume and another large deal in pipeline to add 2-3% volume in ED in FY11E; this would result in improving revenue visibility. Besides this, offset opportunity and ramp up in existing clients would maintain growth momentum through FY12E. Further, we are impressed by the consistency of cost efficiencies, as reflected in EBITDA margin, which has remained flat for the past four quarters despite rupee appreciating 6.4% during Q4FY09-Q3FY10. Our revised target price is based on 12x FY11E core EPS (ex treasury income) of Rs25.4 + idle net cash/share of Rs64 as at end-FY11. The stock will trade at 6.9x FY11E EV/EBITDA at our target price versus EBITDA CAGR of 12.4% over FY10-12E. Key risks to our call are: i) sharp rupee appreciation ii) lower-than-expected recovery in discretionary spend in Aerospace, Hi-Tech and Telecom iii) risks related to inorganic acquisitions.**

- ▶ **Upgrade estimates.** We upgrade FY11-12E EPS estimates 14-16% on the back of: i) consolidating acquired company Daxcon Engineering, effective mid-January '10 (CY09E expected revenues of US\$14mn, with PBT breakeven down from US\$21-22mn revenues and PBT margin at ~10% in CY08) ii) incorporating large deals (announced + in pipeline) in ED in our estimates iii) upgrading margin estimates with higher confidence on Infotech's ability to reduce margin pressure going forward. We base our revised FY11 & FY12 estimates on rupee-dollar assumption of Rs44.8 & Rs44.2 from Rs45.7 & Rs45.2 earlier respectively.
- ▶ **Good show in Q3FY10,** with 4.7% consolidated dollar revenue growth based on volume growth of 1.8% in GIS and 5.5% in ED during Q3FY10, post CQoQ growth of only 0.4% over Q1FY09-Q2FY10 (though we are surprised with the low reported dollar revenue growth despite better-than-expected volume growth as cross-currency benefits were expected to be higher for Infotech in Q3FY10). Despite rupee appreciation, EBITDA margins declined only 10bps QoQ to 21.6% in Q3FY10.
- ▶ **Acquisition of Daxcon Engineering to de-risk** Infotech's high client concentration on organic basis as well as marking its entry beyond Aerospace and Railways within ED. We will closely observe margin improvement in Daxcon, given muted management confidence about offshoring the existing business. Management estimates Daxcon to add US\$15-18mn revenue in CY10E with improving margins.

## Technology

**Target price Rs370**

### Earnings revisions

(%)	FY10E	FY11E	FY12E
Sales	↑ 2.7	↑ 7.0	↑ 7.5
EBITDA	↑ 4.0	↑ 13.7	↑ 13.8
EPS	↑ 5.3	↑ 16.3	↑ 13.7

### Target price revision

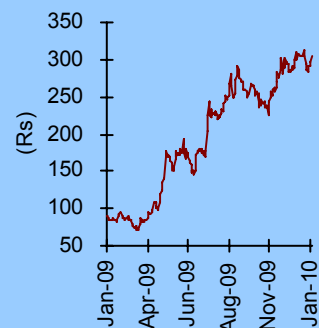
Rs370 from Rs245

### Shareholding pattern

	Mar '09	Jun '09	Sep '09
Promoters	53.5	53.4	53.4
Institutional investors	29.7	30.1	31.0
MFs and UTI	13.6	12.9	12.7
Insurance Cos.	0.0	0.0	0.0
FII	16.1	17.2	18.3
Others	16.8	16.5	15.6

Source: www.nseindia.com

### Price chart



Market Cap	Rs16.9bn/US\$370mn
Reuters/Bloomberg	INFE.BO/INFTEC IN
Shares Outstanding (mn)	55.2
52-week Range(Rs)	312/70
Free Float (%)	46.6
FII (%)	18.3
Daily Volume (US\$'000)	419
Absolute Return 3m (%)	28.9
Absolute Return 12m (%)	239.0
Sensex Return 3m (%)	2.4
Sensex Return 12m (%)	89.1

Year to March	FY09	FY10E	FY11E	FY12E
Revenue (Rs mn)	8,898	9,673	11,360	13,280
Net Income (Rs mn)	925	1,557	1,558	1,732
EPS (Rs)	16.7	28.2	28.2	31.4
% Chg YoY	3.5	68.3	0.0	11.2
P/E (x)	18.3	10.9	10.9	9.8
CEPS (Rs)	25.2	36.5	37.2	41.9
EV/E (x)	7.7	6.4	5.4	4.3
Dividend Yield	0.5	0.5	0.6	0.6
RoCE (%)	13.1	18.5	16.1	15.4
RoE (%)	14.3	19.3	16.5	15.8

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**Table 1: Q3FY10 results review***(Rs mn, year ending March 31)*

	Q3FY10	Q2FY10	Q3FY09	% chg. (QoQ)	% chg. (YoY)	I-Sec estimates	% Variation
<b>Net Sales</b>	<b>2,391</b>	<b>2,374</b>	<b>2,328</b>	<b>0.7</b>	<b>2.7</b>	<b>2,329</b>	<b>2.6</b>
Cost of development	1,420	1,405	1,391	1.1	2.1	1,389	2.2
Employee expenses	1,308	1,337	1,303	(2.2)	0.4	1,319	(0.9)
Travel Expenses	148	136	159	8.8	(6.6)	134	10.5
General & Admin	305	318	327	(4.1)	(6.8)	312	(2.4)
<b>Total Expenses</b>	<b>1,873</b>	<b>1,859</b>	<b>1,877</b>	<b>0.7</b>	<b>(0.2)</b>	<b>1,835</b>	<b>2.1</b>
<b>EBITDA</b>	<b>518</b>	<b>515</b>	<b>451</b>	<b>0.5</b>	<b>14.9</b>	<b>494</b>	<b>4.8</b>
Interest Expense	2	2	13	(37.5)	(88.5)	2	(37.5)
Depreciation	111	114	119	(2.6)	(7.0)	119	(6.5)
Other Income	78	45	(166)	73.8	NA	71	9.1
<b>Recurring pre-tax income</b>	<b>483</b>	<b>443</b>	<b>152</b>	<b>8.9</b>	<b>217.6</b>	<b>444</b>	<b>8.8</b>
Extraordinary income/(expense)	0	0	0			0	
Taxation	129	124	36	4.3	257.1	119	7.9
Minority Interest	0	(1)	1			(1)	(100.0)
Share of JV	25	33	30	(23.3)	(15.1)	30	(15.7)
<b>Reported Net Income</b>	<b>379</b>	<b>353</b>	<b>145</b>	<b>7.3</b>	<b>161.9</b>	<b>355</b>	<b>6.8</b>
<b>Recurring Net Income</b>	<b>379</b>	<b>353</b>	<b>145</b>	<b>7.3</b>	<b>161.9</b>	<b>355</b>	<b>6.8</b>
<b>Ratios (%)</b>							
EBITDA margins	21.7	21.7	19.4			21.2	
Net profit margins	15.9	14.9	6.2			15.2	

Source: Company data, I-Sec Research

**Table 2: Adjusted PAT growth***(Rs mn)*

	FY09	FY10E	FY11E
Sales	8,898	9,673	11,360
% to Change	32.0	8.7	17.4
EBITDA	1,785	2,090	2,302
% to sales	20.1	21.6	20.3
% to Change	46.4	17.1	10.1
<b>Reported PAT</b>	<b>925</b>	<b>1,557</b>	<b>1,558</b>
<b>% to Change</b>	<b>9.7</b>	<b>68.4</b>	<b>0.0</b>
+ / (-) MTM Loss / (Gain)	515	(185)	(1)
+ / (-) Deferred tax Dr / (Cr)	(175)	63	0
<b>Adjusted PAT</b>	<b>1,265</b>	<b>1,435</b>	<b>1,557</b>
<b>% to Change</b>	<b>50.0</b>	<b>13.4</b>	<b>8.5</b>

Note: We have factored-in MTM losses/gains and related deferred tax credit/debit only for exotic hedge cover

Source: Company data, I-Sec Research

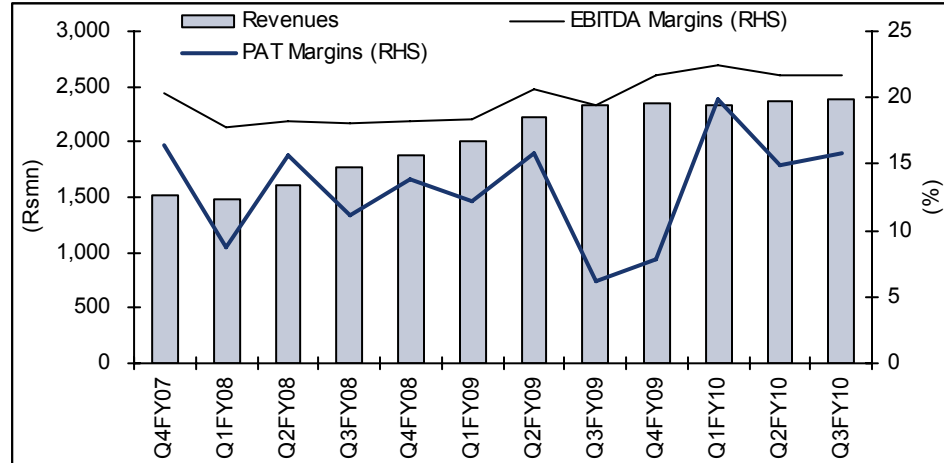
**Table 3: Valuations and target price**

	FY09	FY10E	FY11E
<b>Adjusted PAT</b>	<b>1,265</b>	<b>1,435</b>	<b>1,557</b>
Equity shares	55.2	55.2	55.2
Adjusted EPS (Rs)	22.9	26.0	28.2
P/E (x)	13.4	11.8	10.9
EPS from Treasury income post tax (A) (Rs)	3.7	2.5	2.8
Core business adjusted EPS (excluding A) (Rs)	19.2	23.4	25.4
Core business value / share (FY11 Core EPS x ~12 P/E multiple)			306
Idle net cash per share (Rs) at FY11 end			64
Target price (Rs)			370
Resulting target P/E multiple on FY11 adjusted EPS (x)			13.1

Source: Company data, I-Sec Research

**Chart 1: Revenues versus margins – EBITDA and PAT**

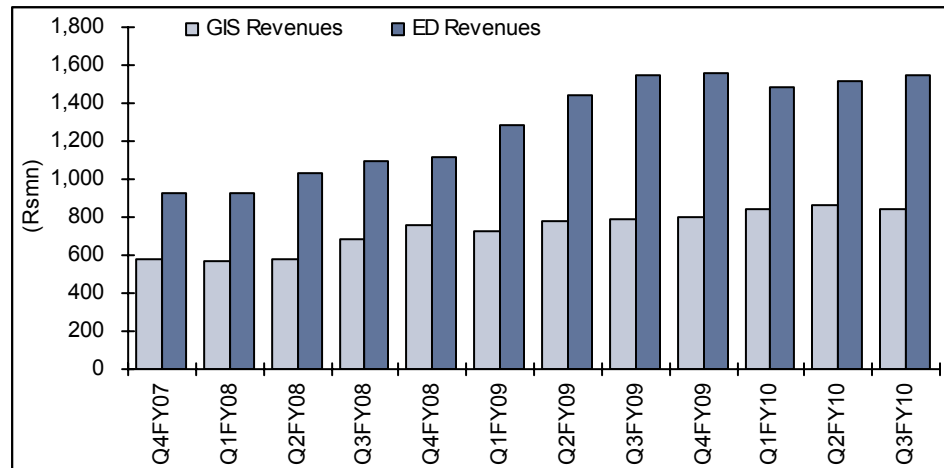
Revenues increased 0.7% QoQ in rupee terms and 4.7% QoQ in dollar terms. Infotech was able to maintain EBITDA margin, despite rupee appreciation, which was higher than our estimates of 21.2%



Source: Company data; I-Sec Research

**Chart 2: Vertical-wise revenue break-up**

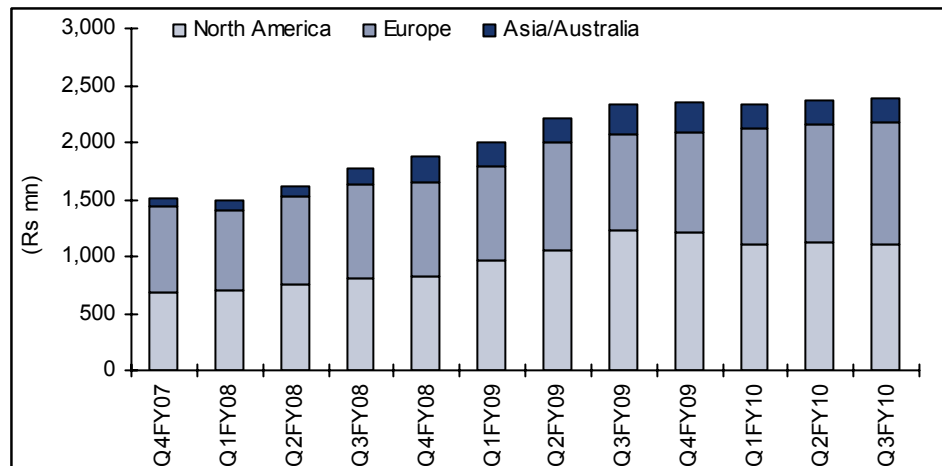
GIS and ED saw volume growth of 1.8% QoQ and 5.5% QoQ respectively. In the GIS vertical, Infotech has made strong inroads into the telecom business in the past nine months, with 57% of GIS' business being now contributed by Telecom. Management is also bullish regarding the Hi-Tech vertical within ED, with improving client relations and revenue profile



Source: Company data; I-Sec Research

**Chart 3: Geography-wise revenue break-up**

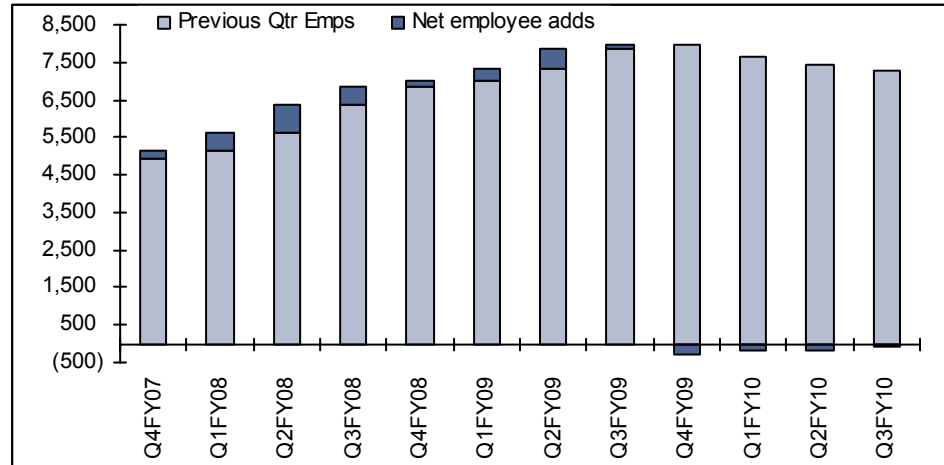
Europe and Asia/Australia grew 2.6% and 0.9% sequentially while North America dipped 1.1% QoQ



Source: Company data; I-Sec Research

**Chart 4: Employee additions**

Infotech had 81 net employee deletions in the quarter – 135 deletions in GIS and 10 in Support, although it added 64 employees in ED. The company plans 500 employee additions in the next quarter – 150 of these via Daxcon and 175 each to be hired in the UTG and EMI verticals

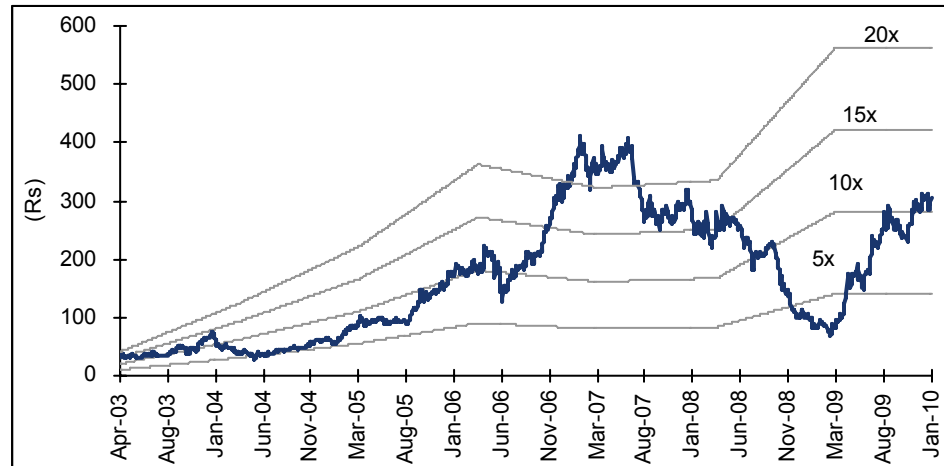


Source: Company data, I-Sec Research

**Chart 5: Rolling P/E bands**

Three-year average P/E stands at 12.7x; five-year average P/E is 11.7x

Our target price is based on ~12x FY11E core EPS

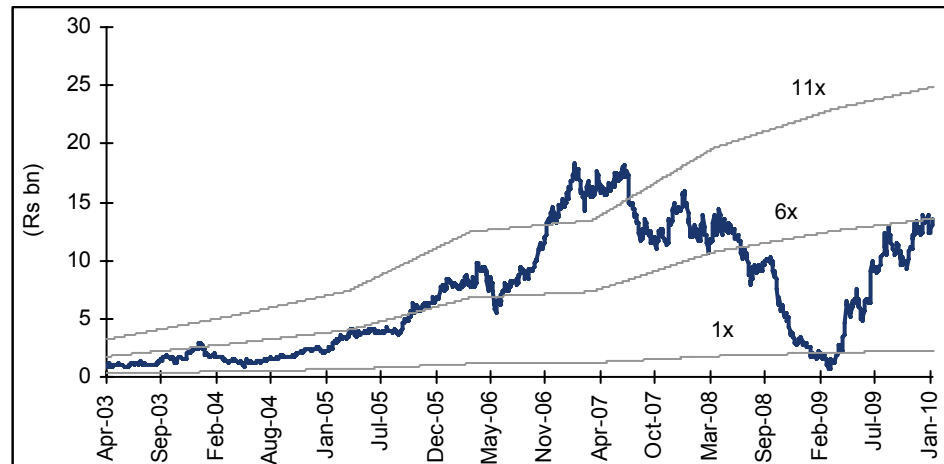


Source: Company data, I-Sec Research

**Chart 6: Rolling EV/EBITDA bands**

Three-year average EV/EBITDA stands at 6.5x; five-year average EV/EBITDA is 6.6x

Our target price of Rs370/share discounts FY11E EBITDA by 6.9x



Source: Company data, I-Sec Research

## Financial Summary (Indian GAAP Consolidated)

### Table 4: Profit and Loss Statement

(Rs mn, year ending March 31)

	FY09	FY10E	FY11E	FY12E
<b>Operating Revenues (Sales)</b>	<b>8,898</b>	<b>9,673</b>	<b>11,360</b>	<b>13,280</b>
of which Exports	8,898	9,673	11,360	13,280
of which Domestic	0	0	0	0
<b>Operating Expenses</b>	<b>7,112</b>	<b>7,582</b>	<b>9,058</b>	<b>10,639</b>
<b>EBITDA</b>	<b>1,785</b>	<b>2,090</b>	<b>2,302</b>	<b>2,641</b>
% margins	20.1	21.6	20.3	19.9
Depreciation & Amortisation	466	457	497	581
Gross Interest	40	8	4	4
Other Income	(295)	338	202	244
<b>Recurring PBT</b>	<b>984</b>	<b>1,964</b>	<b>2,003</b>	<b>2,299</b>
Add: Extraordinaries	0	0	0	0
Less: Taxes	140	531	577	707
- Current tax	140	531	577	707
- Deferred tax	0	0	0	0
Less: Minority Interest	(0)	(5)	(5)	(6)
Add: Share of JV	80	119	126	134
<b>Net Income (Reported)</b>	<b>925</b>	<b>1,557</b>	<b>1,558</b>	<b>1,732</b>
<b>Adjusted Net Income</b>	<b>1,265</b>	<b>1,435</b>	<b>1,557</b>	<b>1,732</b>

Source: Company data, I-Sec Research

### Table 5: Balance sheet

(Rs mn, year ending March 31)

	FY09	FY10E	FY11E	FY12E
<b>Assets</b>				
Total Current Assets	6,564	6,751	8,461	10,117
of which cash and deposits	3,334	3,538	4,548	5,417
Total Current Liabilities & Provisions	2,105	1,966	2,275	2,515
<b>Net Current Assets</b>	<b>4,459</b>	<b>4,785</b>	<b>6,186</b>	<b>7,602</b>
<b>Investments</b>	<b>402</b>	<b>622</b>	<b>748</b>	<b>793</b>
of which Strategic/Group	402	622	748	793
<b>Net Fixed Assets</b>	<b>2,424</b>	<b>3,062</b>	<b>3,316</b>	<b>3,484</b>
Goodwill	272	801	801	801
<b>Capital Work-in-Progress</b>	<b>584</b>	<b>450</b>	<b>150</b>	<b>150</b>
<b>Total Assets</b>	<b>7,870</b>	<b>8,919</b>	<b>10,400</b>	<b>12,029</b>
of which cash and equivalents	3,334	3,538	4,548	5,417
<b>Liabilities</b>				
<b>Borrowings</b>	<b>195</b>	<b>0</b>	<b>0</b>	<b>0</b>
<b>Other liabilities</b>	<b>(31)</b>	<b>(48)</b>	<b>(32)</b>	<b>(16)</b>
Minority Interest	3	(1)	(7)	(13)
Equity Share Capital	276	276	276	276
Face Value per share (Rs)	5	5	5	5
Preference Share Capital	0	0	0	0
Reserves & Surplus*	7,427	8,692	10,162	11,781
<b>Net Worth</b>	<b>7,703</b>	<b>8,969</b>	<b>10,438</b>	<b>12,057</b>
<b>Total Liabilities</b>	<b>7,870</b>	<b>8,919</b>	<b>10,400</b>	<b>12,029</b>

\*excluding revaluation reserves

Source: Company data, I-Sec Research

### Table 8: Quarterly trend

(Rs mn, year ending March 31)

	Mar-09	Jun-09	Sep-09	Dec-09
Net sales	2,350	2,326	2,374	2,391
% growth (YoY)	25.4	15.9	7.2	2.7
EBITDA	509	524	515	518
Margin (%)	21.7	22.5	21.7	21.7
Other income	(275)	163	45	78
Extraordinaries Inc / (Loss)	0	0	0	0
Reported Net Income	186	462	353	379

Source: Company data, I-Sec Research

### Table 6: Cashflow statement

(Rs mn, year ending March 31)

	FY09	FY10E	FY11E	FY12E
<b>Operating Cash flow before W Cap changes</b>	<b>1,312</b>	<b>1,643</b>	<b>1,736</b>	<b>1,927</b>
Working Capital Inflow / (Outflow)	268	(111)	(239)	(389)
Capex	(1,272)	(961)	(450)	(750)
<b>Free Cash flow</b>	<b>308</b>	<b>571</b>	<b>1,046</b>	<b>788</b>
<b>Cash Flow from other Invest Act (Ex Capex)</b>	<b>2,023</b>	<b>(219)</b>	<b>(126)</b>	<b>(45)</b>
Proceeds from Issue of Share Capital	32	0	0	0
Inc/(Dec) in Borrowings	(221)	(195)	0	0
Dividend paid	(79)	(97)	(107)	(113)
Interest paid	(40)	(8)	(4)	(4)
<b>Others (Interest Received)</b>	<b>118</b>	<b>153</b>	<b>201</b>	<b>244</b>
<b>Increase/(Decrease) in Cash</b>	<b>2,140</b>	<b>205</b>	<b>1,010</b>	<b>869</b>

Source: Company data, I-Sec Research

### Table 7: Key ratios

(Year ending March 31)

	FY09	FY10E	FY11E	FY12E
<b>Per Share Data (Rs)</b>				
EPS(Basic Recurring)	16.7	28.2	28.2	31.4
Adjusted EPS	22.9	26.0	28.2	31.4
Fully Diluted Recurring EPS	16.2	27.4	27.4	30.4
Recurring Cash EPS	25.2	36.5	37.2	41.9
Dividend per share (DPS)	1.5	1.6	1.7	1.7
Book Value per share (BV)	139.5	162.3	188.9	218.3
<b>Growth Ratios (%)</b>				
Operating Income (Sales)	32.0	8.7	17.4	16.9
EBITDA	46.4	17.1	10.1	14.7
Recurring Net Income	9.7	68.4	0.0	11.2
Diluted Recurring EPS	5.7	68.4	0.0	11.2
Diluted Recurring CEPS	10.8	44.8	2.0	12.6
<b>Valuation Ratios (x)</b>				
P/E	18.3	10.9	10.9	9.8
P/E (Based on Adjusted EPS)	13.4	11.8	10.9	9.8
P/CEPS	12.2	8.4	8.2	7.3
P/BV	2.2	1.9	1.6	1.4
EV / EBITDA	7.7	6.4	5.4	4.3
EV / Sales	1.5	1.4	1.1	0.9
EV / FCF	44.7	23.4	11.8	14.6
<b>Operating Ratio</b>				
Employee Cost/Sales (%)	55.0	56.0	57.2	58.3
SG&A/Sales (%)	21.5	18.7	20.0	19.3
Other Income / PBT (%)	(29.9)	17.2	10.1	10.6
Effective Tax Rate (%)	14.2	27.0	28.8	30.7
NWC / Total Assets (%)	44.7	44.0	48.8	52.3
Fixed Asset Turnover (x) on avg	4.0	3.5	3.6	3.9
Receivables (days) on average	98	97	92	95
Payables (days) on average	57	68	65	64
D/E Ratio (x)	0.0	0.0	0.0	0.0
<b>Return/Profitability Ratio (%)</b>				
Recurring Net Income Margins	14.2	14.8	13.7	13.0
RoIC (Based on Avg)	28.5	31.5	26.3	27.1
RoCE (Based on Avg)	13.1	18.5	16.1	15.4
RoNW (Based on Avg)	14.3	19.3	16.5	15.8
Dividend Payout Ratio	10.5	6.8	7.3	6.5
Dividend Yield	0.5	0.5	0.6	0.6
EBITDA Margins	20.1	21.6	20.3	19.9

Source: Company data, I-Sec Research

*I-Sec investment ratings (all ratings relative to Sensex over next 12 months)*

**BUY:** +10% outperformance; **HOLD:** -10% to +10% relative performance; **SELL:** +10% underperformance

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