BUY

Price	**Rs1,511**
Target Price	**Rs1,822**
Investment Period	**12 months**

Stock Info

Sector	IT
Market Cap (Rs cr)	86,417
Beta	0.7
52 WK High / Low	2140 / 1212
Avg Daily Volume	294045
Face Value (Rs)	5
BSE Sensex	16,154
Nifty	4,880
BSE Code	500209
NSE Code	INFOSYSTCH
Reuters Code	INFY.BO
Bloomberg Code	INFO IN

Shareholding Pattern (%)

Promoters	16.5
MF/Banks/Indian FIs	7.1
FII/ NRIs/ OCBs	36.3
Indian Public	40.1

Abs.	**3m**	**1yr**	**3yr**
Sensex (%)	(20.2)	17.9	158.5
Infosys (%)	0.6	(29.0)	54.4

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4QFY2008 Result Update

Performance Highlights

- **Offshore volumes, currency movements drive Topline:** Infosys recorded a strong 6.3% qoq and 20.4% yoy growth in Topline during 4QFY2008. In Dollar terms, sequential growth in Topline stood at 5.4%. This quarter, offshore volumes were the key driver of the company's Topline growth. Overall offshore volumes grew by an impressive 8.8% qoq, even as blended offshore rates fell by 2.6% qoq. However, on account of Rupee depreciation during the quarter (the realised Rupee rate was higher by nearly 1% qoq), offshore revenues in Rupee terms rose by 7% qoq (Dollar growth was 6% qoq). On the other hand, onsite volumes grew by 4.8% qoq, while onsite revenues were 5.7% higher qoq. In the IT Services business, offshore volumes grew by 5% qoq and 33.5% yoy, while onsite volumes grew by 4.8% qoq and by over 25% yoy. In terms of pricing, it should be noted that after eight consecutive quarters of sequential improvement, onsite billing rates fell marginally this quarter. We believe this could be the start of a trend, given the challenges currently being faced in the business environment and is one metric that should be closely watched going forward.

- **Higher Employee costs subdue Margins:** During 4QFY2008, Infosys recorded a marginal 5bp qoq fall in EBITDA Margins on the back of higher Employee costs, which increased by 8.7% qoq and accounted for over 53% of sales (52% in 3QFY2008). Thus, despite Rupee depreciation, Infosys recorded a Margin decline. However, on a yoy basis, the company saw a strong 81bp expansion in EBITDA Margins despite a 9% fall in the realised Rupee rate, mainly due to SG&A leverage, significantly higher pricing (up 7% yoy) and higher utilisation rates. This reflects impressive Margin management by Infosys.

- **Lower Other Income, higher Taxes subdue Bottomline:** Infosys recorded a subdued 1.5% qoq rise in Bottomline during 4QFY2008 mainly due to lower Other Income (due to Forex losses of Rs45cr) and higher Taxes. However, excluding a Tax write-back of Rs50cr in the last quarter, Bottomline grew by 5.8% qoq and by 22.5% yoy.

Exhibit 1: Key Financials

Y/E March (Rs cr)	FY2007	FY2008	FY2009E	FY2010E
Net Sales	**13,893**	**16,692**	**20,708**	**24,558**
% chg	*45.9*	*20.1*	*24.1*	*18.6*
Net Profit	**3,856**	**4,659**	**5,391**	**5,802**
% chg	*56.9*	*20.8*	*15.7*	*7.6*
EBITDA Margin (%)	31.6	31.4	31.0	30.5
EPS (Rs)	**67.3**	**81.3**	**94.0**	**101.2**
P/E (x)	**22.5**	**18.6**	**16.1**	**14.9**
P/CEPS (x)	19.8	16.5	14.2	13.1
RoE (%)	42.3	37.2	34.3	29.5
RoACE (%)	37.7	38.7	36.4	34.3
P/BV (x)	7.6	6.2	4.9	3.9
EV/Sales (x)	5.8	4.8	3.7	2.9
EV/EBITDA (x)	18.4	ervice12.0	12.0	9.6

Source: Company, Angel Research

Topline grows 20% in FY2008 driven by volumes, pricing

During FY2008, Infosys recorded a decent 20.1% yoy growth in Topline, driven by strong volume growth and a positive trend in pricing. Overall, consolidated volumes grew by nearly 33% yoy offshore and by 23% yoy onsite. Offshore billing rates rose by an impressive 4.5% yoy, while onsite billing rates rose at an even stronger pace of 6.2% yoy. This led to total revenues, in Dollar terms, powering ahead by an impressive 35% yoy. However, on account of the steep appreciation of the Rupee witnessed over the course of the fiscal, consolidated revenues, in Rupee terms, grew by a more modest 20% yoy. The realised Rupee rate for FY2008 stood at Rs39.97 per Dollar compared to Rs44.96 in FY2007, a fall of over 11% yoy. In fact, Infosys lost over Rs2,000cr in Topline and Rs1,000cr in Bottomline on account of the adverse currency movements seen during the fiscal.

In the IT Services Business, offshore volumes clocked strong growth of 30% yoy, while onsite volumes grew by 23% yoy. Billing rates were fairly robust, with offshore rates increasing by 6% yoy and onsite rates moving up by 7% yoy. Thus, overall IT Services revenues grew by over 34% yoy in Dollar terms.

Exhibit 2: Offshore volumes drive IT Services Business

IT Services	FY2007	FY2008	*% chg yoy*
Onsite revenues ($ mn)	1,532.2	2,011.9	*31.3*
Offshore revenues ($ mn)	1,291.7	1,780.0	*37.8*
Onsite billing rates (US$/hour)	67.7	72.3	*6.9*
Offshore billing rates (US$/hour)	25.6	27.1	*6.1*
Onsite volumes (Hours, mn)	22.6	27.8	*22.9*
Offshore volumes (Hours, mn)	50.5	65.6	*29.9*

Source: Company, Angel Research

We believe the primary reason for the strong rise in Infosys' billing rates is the ever-increasing proportion of non-ADM work in its Topline. In FY2008, ADM services contributed less than 50% of total consolidated Topline. These services contributed a little over 45% to total revenues, down from 48% in FY2007. In terms of incremental revenues, ADM services accounted for just 32.5% of total incremental revenues in FY2008. Thus, this clearly reflects Infosys' conscious focus at increasing the higher-end component of revenues by driving services like consulting, package implementation, systems integration and infrastructure management.

In 4QFY2008 however, onsite billing rates fell marginally on a sequential basis, even as offshore rates grew by 0.5% qoq. This fall in onsite rates has come after eight consecutive quarters of sequential increase. This is a metric that we would track closely going ahead. With the US economy slipping into a recession, pricing is likely to come under pressure, as clients demand more value for every Dollar spent. Hence, whether the sequential fall in onsite rates is just a one-off phenomenon or is likely to persist is something that would take the next two quarters to judge. Infosys will thus have to keep focussing on improving revenue productivity and bettering its business mix to keep rates strong, as this (pricing) is a key lever that any IT company has to protect its Margins.

Exhibit 3: Billing rates – Fall in onsite rates in 4QFY2008, a trend or one-off case?

	FY2007				FY2008				*% chg$*
	1Q	**2Q**	**3Q**	**4Q**	**1Q**	**2Q**	**3Q**	**4Q**	
Newer service lines*	50.2	51.4	52.3	53.7	54.0	55.8	53.7	54.8	*4.6*
Onsite billing rates**	65.9	66.9	68.2	69.4	70.3	72.4	**73.2**	**73.1**	*11.0*
Offshore billing rates**	25.0	25.3	25.7	26.1	26.4	27.0	27.4	27.6	*10.1*

*Source: Company, Angel Research; * As a percentage of sales, excluding ADM; ** In US $ per hour; $ This is the point-to-point change of 4QFY2008 over 1QFY2007.*

Newer Services drive growth

Infosys has been consciously focusing on reducing its dependence on plain-vanilla ADM services and has steadily diversified into higher-value solutions like consulting, package implementation, systems integration and infrastructure management. Hence, it has been able to more effectively tap into the IT budgets of its clients by offering them a wider range of services and solutions. In FY2008 also, this trend was visible, with services like Consulting and Package Implementation grew by 36% yoy), Infrastructure Management

(34% yoy), Systems Integration (46% yoy) and Testing (31% yoy) all growing at a considerably faster pace than ADM, which grew by just 13.6% yoy. ADM, in FY2008, contributed around 45% to total revenues.

Exhibit 4: Service line mix – Newer services driving growth

(Rs cr)	FY2007	FY2008	% chg yoy
ADM	**6,669**	**7,578**	***13.6***
Application Development	*3,209*	*3,622*	*12.9*
Application Maintenance	*3,459*	*3,956*	*14.4*
Business Process Management	653	951	*45.7*
Consulting and Package Implementation	2,931	3,973	*35.5*
Infrastructure Management	611	818	*33.8*
Testing Services	959	1,252	*30.6*
Product Engineering Services	222	267	*20.1*
Systems Integration	320	467	*46.3*
Others	986	785	*(20.5)*
Total services	**13,351**	**16,091**	***20.5***
Products	542	601	*10.9*
Total revenues	**13,893**	**16,692**	***20.1***

Source: Company, Angel Research

BFSI, the Achilles' heel?

Infosys recorded a considerably slower growth in its key BFSI vertical in FY2008 (under 15% yoy). This was after recording an outstanding 52% yoy growth in this vertical in FY2007. With the US economy in the doldrums, going ahead, at least in the short term, growth in this vertical seems uncertain. Management has alluded to a 'collective pause' in spending by BFSI clients. With BFSI contributing by far the maximum to Infosys' revenues (nearly 36% in FY2008), this factor could restrict revenue growth if an up-tick is not seen. The company has said, however, that no projects have as yet been cancelled. However, management has also alluded to some project cancellations being seen in the Retail vertical. Thus, in the medium term, the outlook for these two verticals (BFSI and Retail) seems to be cautious. This is the case, even as Retail was the fastest-growing vertical for Infosys in FY2008 (growth of 44% yoy).

Apart from Retail, it was the Telecom (growth of 31% yoy) and Manufacturing (30% yoy) verticals that were the key growth drivers for Infosys in FY2008. Infosys has said that it expects the growth in Telecom to sustain going into FY2009. With British Telecom (BT), it's largest client, set to spend significant sums of money on transformational projects like 21CN (21^{st} Century network, a next-generation Internet Protocol-enabled (IP-enabled) network, upgrading from the current Public Switched Telephone Network-based (PSTN) system), Infosys seems well set to reap the benefits, given its top-class execution skills and better positioning in the event of vendor consolidation.

Exhibit 5: Vertical split – BFSI sluggish, a matter of concern

(Rs cr)	FY2007	FY2008	% chg yoy
BFSI	**5,196**	**5,959**	***14.7***
Insurance	*1,000*	*1,202*	*20.1*
Banking & Financial Services	*4,196*	*4,757*	*13.4*
Manufacturing	1,876	2,437	*29.9*
Retail	1,389	2,003	*44.2*
Telecom	2,681	3,522	*31.4*
Energy & Utilities	736	868	*17.9*
Transportation & Logistics	333	401	*20.1*
Services	1,125	1,002	*(11.0)*
Others	556	317	*(42.9)*
Total revenues	**13,893**	**16,692**	***20.1***

Source: Company, Angel Research

Europe drives the geographies

Infosys saw its European geography grow by 28% yoy and the share of Europe in total revenues has risen to over 28% in FY2008. The US geography, on the other hand, grew by a relatively subdued 18% yoy, with it's share declining to 62% in FY2008 (63.3% in FY2007). Thus, Infosys is clearly focussing on expanding its geographical base to reduce dependence on the US. The company is also looking at growing in emerging geographies and regions like the Middle East, China, Australia, Latin America and Canada.

Margins held within a range; an admirable performance in a difficult year

Infosys recorded a marginal 23bp yoy fall in EBITDA Margins in FY2008, which we believe, is an excellent performance, given that the Rupee appreciated by over 11% yoy during the fiscal. This was on account of SG&A leverage and scale benefits, improved pricing, higher utilisation rates, higher offshore and a better service mix. Infosys' blended billing rates rose by around 4% yoy, while the offshore component of total consolidated revenues rose by around 150bp yoy. Overall utilisation rates rose to nearly 76% excluding trainees (75.5% in FY2007). Thus, the company utilised all its levers of Margin defence to protect its Profitability. The company has an almost-obsessive focus on maintaining Margins, which is apparent from the premium billing rates that it commands.

Higher Other Income aids Bottomline growth

Infosys recorded a 21% yoy growth in Bottomline in FY2008, which was marginally higher than the Topline growth, despite the slight fall seen in Margins. This was on account of higher Other Income (up 89% yoy) due to higher interest on its deposits. The company held a significant sum of money as cash and bank balances over the year and this led to the sharp rise in interest earned (as much as 250% yoy). However, there was a significant increase in Taxes paid (up 78% yoy). Excluding the tax write-backs of Rs121cr in FY2008, the effective tax rate stood at around 15% in FY2008.

Client data remains strong; adds one US $300mn client in FY2008

Infosys' client metrics continued to impress. The number of clients in the US $1mn-plus revenue basket now stands at 310 (305 in 3QFY2008, 275 in FY2007). In fact, the number of clients in most of the revenue buckets has increased. Infosys has mined its top client, BT, to the extent of over US $300mn, reflecting the ever-increasing depth and scale of its engagement with the UK-based telecom major. BT contributed over 10% to Infosys' revenues in 4QFY2008 and over 9% in FY2008. Thus, this is a metric that the company will need to carefully assess, given its increasing dependence on one client for revenues. Infosys added a gross of 170 clients during FY2008 and its active client base now stands at 538.

Infosys' management has mentioned that in a 'dip-stick survey' of its 'Top-100' clients, 76% have said that IT budgets are either flat or slightly down from last year. However, they also expect to spend a greater amount of their budgets on the offshore delivery model, which is a heartening feature for the company. Nonetheless, given the shenanigans being currently witnessed in the US economy and the turmoil and uncertainty in the global economy, this is an area under close watch.

Hedges at US $760mn

Infosys' outstanding hedges now stand at US $760mn. The company has said that it expects the Rupee to depreciate in the short-term, given spiraling crude oil prices, which will result in a higher trade deficit and lead to a fall in the value of the domestic currency. However, if the Rupee appreciates, it could adversely impact the company.

To grow revenues by 19-21% yoy, EPS by 16-18% yoy in FY2009

Management has guided for revenues to be in the range of Rs19,894 - 20,214cr in FY2009, while EPS is expected to range between Rs92.3 - 93.9. This signifies a decent growth outlook for the fiscal. However, it should be noted that this assumption has been made with the Rupee expected at Rs40.02 per Dollar. If the domestic currency were to appreciate against the greenback, the company could find it difficult to beat its estimates by a wide margin. In fact, in 4QFY2007 and 1QFY2008, it may be recalled that due to the highly volatile currency movements seen, the company actually missed its guidance. Thus, if a similar thing were to happen this time round, a repeat might be witnessed.

Another point to be noted is that the guidance for 1QFY2009 is relatively muted, with Topline expected to grow by less than 1% qoq, while EPS is expected to be lower by 5% qoq. Thus, the guidance assumes significant back-ended growth. To meet its FY2009 revenue guidance at the upper end, Infosys will need to record a compounded quarterly growth rate (CQGR) of over 6.5% over the next three quarters, which we believe is fairly ambitious. On the EPS front, the company will need to record a CQGR of over 8% over the next three quarters, even more ambitious.

Nonetheless, it must also be noted that the company has not assumed any pricing-related improvements in its guidance. It has also not taken any large deal wins into this number. Infosys is in negotiations for around 12-15 large deals and thus, any significant deal win would enable it to beat its guidance.

To add a gross 25,000 employees in FY2009; 18,000 campus offers made

Infosys intends to add a gross of 25,000 employees in FY2009 and has already made around 18,000 campus offers. It expects 14-15,000 of these offers to be accepted and of the balance, lateral hires are expected to be around 6,500. This is a relatively muted figure. We believe this could be a sign of things to come in future, as the company will need to focus on revenue productivity and non-linear growth going ahead, given the increasingly difficult business environment that it is facing. Even though it may be a little early to read too much into these numbers, we believe that a purely headcount-based business model is unsustainable and that a greater proportion of revenues will need to come from non-linear initiatives. A positive feature during FY2008 was that the attrition levels reduced to 13.4% (13.7%).

To give 11-13% hike in offshore salaries and 4-5% onsite salary hikes in FY2009

Infosys will give its offshore staff a hike of 11-13% in FY2009, slightly down from 12-15% seen in FY2008. The onsite staff will get a hike of 4-5%. The offshore salary hikes could be a sign of further moderation going ahead and we believe this is necessary to keep costs in line with revenues, going ahead.

Margins to be contained within a 50-100bp range in FY2009

In its Margin outlook, Management has mentioned that it expects Margins to stay in a range of 50-100bp in FY2009, despite absorbing the impact of salary hikes.

Tax rate to increase to 20-22% in FY2010 if STPI scheme not extended

Management has said that it expects the tax rate in FY2009 to be 15-16%, while in FY2010, if the STPI scheme is not extended, the tax rate could rise to 20-22%. We have factored the same in our estimates.

‘Special Dividend’ of Rs20 per share announced; pay-out ratio raised to 30%

Infosys has announced a ‘Special Dividend’ of Rs20 per share to celebrate the achievement of hitting US $1bn in Net Profits. This is in addition to a final dividend of Rs7.25 per share. This takes the total dividend for FY2008 to Rs33.25 per share (dividend yield of 2.2%). The company has also raised its dividend pay-out ratio to 30% of Net Profits effective FY2009 from the earlier 20%. This signifies a more liberal policy of rewarding shareholders, given the significant amount of cash on the company’s balance sheet.

Outlook and Valuation

Infosys has performed in line with our Topline estimates in FY2008, while on the Bottomline front, there has been a slight under-performance to the tune of 0.4%. EBITDA Margins were higher than our estimates by 18bp. Going ahead, we expect Infosys to record a CAGR growth in Topline of 21.3% over FY2008-10E, while Bottomline would grow at a considerably slower CAGR of 11.6%. We expect a downward trend in EBITDA Margins, which are expected to touch 30.5% by FY2010E vis-à-vis 31.4% in FY2008. We have modeled for a 22% tax rate in FY2010E, assuming that the STPI scheme is discontinued. We have also assumed 5% annual appreciation of the Rupee against the Dollar. At the CMP of Rs1,511, the stock is trading at 14.9x FY2010E EPS. **We maintain a Buy on the stock, with a 12-month Target Price of Rs1,822.**

Exhibit 6: FY2008 Performance

Y/E March (Rs cr)	FY2008 4Q	FY2008 3Q	% chg (qoq)	FY2007 4Q	% chg (yoy)	FY2008	FY2007	% chg
Net Revenues	**4,542**	4,271	***6.3***	**3,772**	***20.4***	**16,692**	13,893	***20.1***
Software Development Expenses	2,482	2,325	*6.8*	2,021	*22.8*	9,207	7,458	*23.5*
Gross Profit	**2,060**	1,946	***5.9***	1,751	*17.6*	**7,485**	6,435	***16.3***
SG&A Expenses	582	554	*5.1*	554	*5.1*	2,247	2,044	*9.9*
Operating Profit (EBITDA)	**1,478**	1,392	***6.2***	1,197	*23.5*	**5,238**	4,391	***19.3***
Other Income	139	158	*(12.0)*	119	*16.8*	704	372	*89.2*
Depreciation	157	153	*2.6*	145	*8.3*	598	514	*16.3*
Provision for Investments	0	0		(1)		0	2	
Income before Income Taxes	**1,460**	1,397	***4.5***	1,172	*24.6*	**5,344**	4,247	***25.8***
Tax	211	166	*27.1*	27	*681.5*	685	386	*77.5*
Minority Interest	0	0		1		0	11	
Extraordinary Items	0	0		0		0	6	
Net Income	**1,249**	1,231	***1.5***	**1,144**	***9.2***	**4,659**	3,856	***20.8***
Diluted EPS (Rs)*	**21.8**	20.6	***5.7***	**17.8**	***22.4***	**81.3**	67.6	***20.2***
Gross Profit Margin (%)	45.4	45.6		46.4		44.8	46.3	
EBITDA Margin (%)	32.5	32.6		31.7		31.4	31.6	
Net Profit Margin (%)	27.5	28.8		30.3		27.9	27.8	

*Source: Company, Angel Research; * Diluted EPS calculated excluding extraordinary and one-time items*

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