

Company Focus

10 October 2007 | 13 pages

Info Edge (INED.BO)

 Rating change
 Target price change

Buy: Key Takeaways from Investor Day

- Raising TP to Rs1,275 and lowering risk rating** — With Naukri continuing to hold a >50% market share, we lower our risk rating to Low and raise our 12-month TP to Rs 1,275, equating to 53x our FY09 EPS, ex-ESOP costs.
- 2QFY08 has tracked in-line** — Q2 is a seasonally softer quarter for Info Edge, but we believe the company will meet or beat our Rs491m (+55% YoY) rev and Rs62m (+29% YoY) net profit estimates.
- Naukri remains dominant: Focus is now on product innovation** — Naukri remains the #1 online recruitment site in India, with 50-55% market share by traffic. The company continues to focus on enhancing filtering functionality and introducing supplementary products, e.g., mobile, jobs fairs, professional networking site, etc., to further differentiate itself from the competition.
- Jeevansathi and 99acres continue to perform to expectations** – Fundamentals at both sites continue to perform well, with generally improving metrics. We expect Jeevansathi will be breakeven by March 2008.
- Monitoring potential risks** — We are currently monitoring two issues closely: 1) Rupee appreciation and/or subprime weakness that could affect the Indian IT services sector, which contributes ~40% of Info Edge revs; and 2) Aggressive price cutting from Naukri competitor, Timesjobs. At this point we have not seen any impact from these, but expect management to be prudently cautious on the next call.

Buy/Low Risk	1L
<i>from Buy/Medium Risk</i>	
Price (10 Oct 07)	Rs1,097.95
Target price	Rs1,275.00
<i>from Rs995.00</i>	
Expected share price return	16.1%
Expected dividend yield	0.1%
Expected total return	16.2%
Market Cap	Rs29,969M
	US\$764M

Price Performance (RIC: INED.BO, BB: INFOE IN)



Figure 1. Statistical Abstract

Year to 31 Mar	Revenues (Rs Mils.)	Net profit (Rs Mils.)	GAAP FD EPS (Rs)	Non-GAAP FD EPS (Rs)	EPS growth (%)	P/E (x)	EV/EBITDA (x)
FY06	824	133	6.09	6.37	74.6	172.2	104.9
FY07	1,396	271	11.31	11.53	80.9	95.2	79.4
FY08E	2,149	429	15.75	15.98	38.6	68.7	50.4
FY09E	2,995	648	23.77	24.10	50.8	45.6	29.2
FY10E	4,060	950	34.84	35.29	46.5	31.1	18.9

Source: Company Reports and Citi Investment Research

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¹Citigroup Global Markets Asia

Fiscal year end 31-Mar	2006	2007	2008E	2009E	2010E
Valuation Ratios					
P/E adjusted (x)	172.2	95.2	68.7	45.6	31.1
EV/EBITDA adjusted (x)	131.5	76.5	47.2	27.4	17.8
P/BV (x)	97.0	12.3	11.8	9.5	7.4
Dividend yield (%)	0.1	0.1	0.1	0.1	0.2
Per Share Data (Rs)					
EPS adjusted	6.37	11.53	15.98	24.10	35.29
EPS reported	6.09	11.31	15.75	23.77	34.84
BVPS	11.32	89.19	92.85	115.08	147.82
DPS	0.75	0.75	1.02	1.31	1.80
Profit & Loss (RsM)					
Net sales	824	1,396	2,149	2,995	4,060
Operating expenses	-626	-1,070	-1,638	-2,123	-2,762
EBIT	198	326	511	871	1,298
Net interest expense	-4	-7	0	0	0
Non-operating/exceptionals	17	76	117	96	119
Pre-tax profit	210	395	628	967	1,418
Tax	-77	-124	-198	-319	-468
Extraord./Min.Int./Pref.div.	0	0	0	0	0
Reported net income	133	271	429	648	950
Adjusted earnings	139	276	436	657	962
Adjusted EBITDA	226	372	574	963	1,429
Growth Rates (%)					
Sales	87.1	69.4	54.0	39.4	35.6
EBIT adjusted	619.1	64.7	56.7	70.6	49.0
EBITDA adjusted	483.0	65.0	54.3	67.7	48.4
EPS adjusted	74.6	80.9	38.6	50.8	46.5
Cash Flow (RsM)					
Operating cash flow	328	520	588	842	1,228
Depreciation/amortization	28	46	64	92	131
Net working capital	120	185	14	-119	-201
Investing cash flow	-153	-2,047	31	-24	-43
Capital expenditure	-61	-54	-86	-120	-162
Acquisitions/disposals	1	0	0	0	0
Financing cash flow	-10	1,621	-24	-33	-42
Borrowings	1	2	0	0	0
Dividends paid	-11	-19	-24	-33	-42
Change in cash	165	94	595	785	1,143
Balance Sheet (RsM)					
Total assets	634	2,842	3,524	4,412	5,678
Cash & cash equivalent	321	416	1,011	1,798	2,941
Accounts receivable	12	23	34	48	65
Net fixed assets	95	104	126	154	185
Total liabilities	387	708	993	1,275	1,648
Accounts payable	358	664	941	1,213	1,571
Total Debt	2	4	4	4	4
Shareholders' funds	247	2,135	2,531	3,137	4,030
Profitability/Solvency Ratios (%)					
EBITDA margin adjusted	27.4	26.7	26.7	32.2	35.2
ROE adjusted	74.6	23.2	18.7	23.2	26.8
ROIC adjusted	na	na	na	na	na
Net debt to equity	-129.2	-19.3	-39.8	-57.2	-72.9
Total debt to capital	0.7	0.2	0.2	0.1	0.1

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Key takeaways from Investor Day

We hosted a series of investor meetings for Info Edge management in Hong Kong recently. Below, we discuss the key takeaways from these meetings.

Naukri: Still the dominant market leader

Focusing on product innovation

As we have maintained since the IPO, we believe Info Edge is currently the dominant player and ultimate long-term winner in the Indian online recruitment classifieds market, with an estimated 50-55% market share by traffic, compared to closest competitors' MonsterIndia (20-30% share) and Timesjobs (15-20% share).

The company is now focusing on distancing itself from the competition through product innovation.

For example, the company launched a re-vamped version of Naukri.com in September, offering an improved user experience such as enhancing filtering and "search & match" functions. This is part of the company's strategy to focus on offering not only *many* results from its 10m-strong resume database, but also *more relevant* results to its customers and clients.

Accordingly, Info Edge is developing value-added services that will enhance the filtering capability. Examples include:

- Response management tools, both automated and manual, such as the eApps tool. Users can set filters based on various parameters such as age, location, industry, etc. and shortlist candidates.
- More personalized filtering services such as the eHire service, where the company employs a team that develops the job listing on the corporate client's behalf and posts on Naukri, filters the results manually and conducts initial phone interviews to generate a shortlist of 20-30 candidates, which is then sent to the corporate client.

Info Edge is also exploring using online exams as a way of filtering candidates and has been in talks with a number of testing companies. (However, there is a trust issue with online exams, as it is difficult to ensure that the real candidate is taking the exam and not using a proxy, unless the exams are proctored.)

The company is also developing ancillary recruitment services products. For example, it recently launched its mobile product, which sends SMS on behalf of corporate clients advertising job listings.

New job fairs launched

Info Edge has decided to start holding job fairs in order to appeal to the fresh graduate market. It held its first job fair in Ahmedabad last month, which attracted 17,000 attendees over a 2-day period and has since held 3 more job fairs with overwhelming turnout: Its Pune job fair attracted 50,000 attendees while its Chennai fair attracted 53,000 attendees.

For the job fairs, the company generates revenues from the corporate recruiters. It usually engages a sponsor for the job fair, as well as a couple dozen companies that set up booths to recruit students.

Important to note, these job fairs have already reached breakeven, in our estimation, and are designed to be profitable on a stand-alone basis and are not meant as a type of marketing cost.

The company plans to continue to hold job fairs in various locations and more frequently.

Brijj.com: Professional network site launched

Info Edge launched a professional networking site, Brijj.com, in August 2007 to target the “passive jobseeker”. Professional networking sites are similar social networking sites, except that they seek to connect users to for work-related rather than entertainment or social activity.

The concept is similar to LinkedIn.com, a professional networking site that claims to be the world’s largest professional networking site with 14m users.

Expanding geographically: NaukriGulf

After launching Naukri Gulf in July 2006 to target the Middle Eastern job market, Info Edge now has 2 offices in Dubai. Naukrigulf.com is now the #2 online recruitment site in the Middle East, behind Bayt.com.

It has licenses pending in 2-3 markets and plans to open additional sales offices in these markets once the licenses are approved.

Targeting retail clients through new sales channel

Info Edge’s 500 relationship managers directly work with 3,000-4,000 of the company’s corporate clients, which represent roughly 10-15% of the company’s 27,500 clients. The remaining 85-90% of the clients are self-service and what the company considers “retail” clients that generate less than Rs20,000 revenue per annum.

These self-service clients may not have fully monetized in the past as sales efforts were not concentrated on them. Info Edge plans to develop a separate sales team that will be incentivized differently than the relationship managers targeting the larger companies. The need to create a separate sales team targeting smaller retail corporates versus larger corporates is due to the incentive scheme for the sales force, as a material portion of the sales force’s compensation is variable and benchmarked against sales generated. As a result, the sales force is generally more inclined to target the larger clients rather than smaller retail clients in order to meet their quota.

As discussed above, this new retail sales channel is one of the ways that Info Edge is reacting against more aggressive competition from Timesjobs.

Jeevansathi and 99acres: Still in investment mode

Jeevansathi should break even by end-FY08

Info Edge's matrimonial website Jeevansathi remains the #3 player in the Indian online matrimonial market and is on track to break even by end-FY08 (ending March). The site now has 1.7m registered users, with 2,500 profiles added daily.

However, we should stress that March 08 is not a deadline set in stone, as the company expressed it would be willing to trade off margins for growth, if it had to choose to spend more – hence not breaking even – in order to take advantage of growth opportunity, as profitability will naturally follow scale and revenues because the company has control of its costs.

In terms of key metrics, Jeevansathi has seen encouraging improvement in key metrics such as higher percentage of conversion from free to paid users and average bill per paying customer. Currently, approximately 10% of its free users convert to paying users (within 1 year of registration), compared to only 6% a year ago. The average revenue per paying user is now approximately Rs1,400 compared to Rs1,000 a year ago.

99acres gaining traction in burgeoning real estate market

Info Edge management remained confident of the huge opportunity in the Indian real estate market. The company elaborated that the real estate market in India has a number of characteristics different from other markets, and which create demand for real estate markets:

1. Fragmented, unorganized market;
2. Opaque prices and information not easily available; and
3. Market is dominated by local real estate agents, who are not required to register with any association. There are no national level players.

Real estate related advertising is currently concentrated on print, and is actually the largest category of advertisers in print.

While the company has initially focused on the residential market, it is increasingly looking at the commercial and industrial markets as the site is gaining traffic. Since launching in September 2005, 99acres now has 55,000 property listings covering 23 cities across India.

Because 99acres has been gaining traffic, it is now approaching larger real estate developers (e.g., Unitec), which have much larger marketing budgets. Previously, the company initially focused on obtaining listings from real estate agents, then to smaller developers as traffic grew.

Currently, 60% of 99acres' listings are free, as the company offers a free 1-month trial to attract traffic and users. 99acres generates revenues from developers, builders and brokers that are seeking to sell or lease properties.

Exploring new businesses: Education services

Info Edge is also exploring new markets that present significant revenue opportunity. One such market is the educational services market, which the company has expressed a desire to enter in its 1QFY08 results call in July. The education services sector is the 2nd largest advertiser group, behind real estate, on print media in India.

The company plans to launch an education services portal that will serve as a platform for education services providers to market their products, though plans have not been finalized yet.

We believe that the education services market actually has synergies with the company's core recruitment services business.

Monitoring Potential Risks: Increased uncertainty in the near term?

While we remain bullish on Info Edge's dominant market positioning and growth prospects longer term, we note three issues that create more uncertainty for the company in the nearer term:

1. Potential impact of Indian IT services corporate clients to rupee appreciation;
2. Exposure of Indian IT services corporate clients to the US subprime mortgage market; and
3. Increased price competition and activity from #2 competitor Timesjobs.

Info Edge generates 40% of revs from IT Services

The IT services sector is currently Info Edge's largest revenue contributor by sector. We estimate the sector directly contributes approximately 32% of the company's revenues, without taking into account that the company derives 15-20% of its revenues from placement agencies, many of which act on behalf of IT services companies. Assuming that half of the placement agency revenue is from IT services, we estimate that approximately 40% of Info Edge's revenues are generated from IT services companies.

Because the IT services sector generates a significant portion of the company's revenues, Info Edge's financial performance is directly related to the health of the IT services companies.

In the nearer term, we see two issues that could negatively affect IT services companies – namely rupee appreciation and subprime mortgage market weakness – and hence could ultimately negatively affect demand for Info Edge's services.

While the company has not yet seen secular slowdown in IT services' recruitment spend, it has started to see some clients delaying or temporarily halting their hiring plans. Overall, this has not affected Info Edge's revenue growth materially, and the company remains on a strong growth trajectory.

1. Rupee appreciation affects IT services' margins

The appreciation of the rupee against the US dollar has negatively affected the margins of IT services companies, especially small, private ones. YTD, the rupee has appreciated by 12% against the US dollar.

Rupee appreciation affects smaller IT services companies more

The smaller companies have been affected more because their margins are lower and the material appreciation in the rupee significantly cuts into their profitability. While Info Edge has not seen a sector-wide cutback in hiring plans, anecdotal evidence suggests that some of these companies have started to reassess their hiring plans and are putting on halt their recruitment for the next couple of quarters. Some are also revisiting the appropriate mix for new hires, e.g., mid-career vs. fresh graduates, which affects the recruitment service they use. Companies use Naukri mostly for mid-career hires rather than for fresh graduates, as they are usually hired from job fairs or campus recruitment. As noted above, however, Info Edge recently launched a job fair's initiative, with excellent early traction.

Larger IT services firms such as Infosys and Wipro have been less affected because 1) their margins are higher and their ability to absorb rupee appreciation is greater; and 2) these companies have more sophisticated financial departments, which hedge against exchange rate risk.

That larger IT services companies are less affected by rupee appreciation is positive for Info Edge, as the company generates the bulk of its revenues from the larger players. We estimate that 60% of Info Edge's revenues are generated by its top 10 corporate clients. Moreover, a significant portion (~40%) of revenue growth comes from up-selling services to repeat customers.

Material Rupee appreciation expected

CIR Indian Economist Rohini Malkani expects rupee appreciation over the long term based on the following factors:

- India's strong growth, which is expected to be ~9% in the next few years; and
- India's growing current account deficit, which was at US\$4.7bn in 1QFY08 and which is expected to increase to US\$14.7bn in FY08 from US\$9.6bn in FY07. Over 70% of the increase in non-oil imports is due to capital goods and industrial raw materials.

Specifically, Rohini expects the rupee to appreciate to an average exchange rate against the US dollar of 40.2 in 2007, 38.0 in 2008, 36.0 in 2009 and 35.0 in 2010.

2. US subprime market turbulence could affect IT services demand

The impact of the US subprime market meltdown has flowed down to the Indian IT services companies, especially the larger public companies (e.g., Infosys, TCS, Wipro), many of which generate business from the mortgage market. These companies have seen some cutback in contracts from US mortgage lenders, and as a result, may have had to re-evaluate their hiring plans.

Anecdotes from Quadrangles suggest that while mortgage-related candidates were heavily in demand 15 months ago, there is now an oversupply of these candidates.

In contrast to the impact from the appreciating rupee, subprime weakness affects larger IT services players more than smaller ones, as the larger companies generate more revenues from US clients.

3. Intensifying competition from Timesjobs

Naukri's #2 competitor, Timesjobs (under the Times of India Group), has been increasingly active in substantially undercutting Naukri in order to grab market share. This could have an impact on the lower end of the market, which is more price sensitive. In general, Timesjobs' prices are 15-20% lower than Naukri, which is an important differential for the lower end of the market.

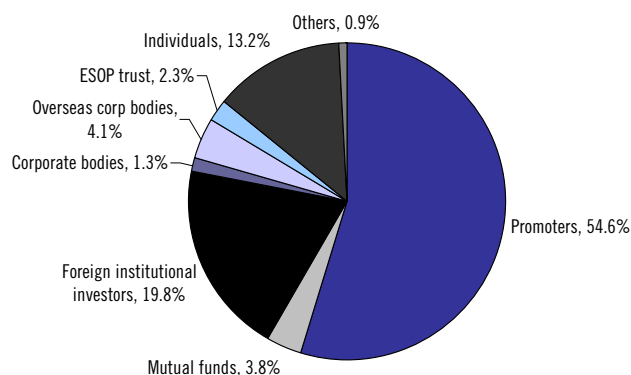
Info Edge is reluctant to cut the prices of its core products, as this would undermine their brand positioning and hurt their relationship with existing clients. Instead, to counter this, Info Edge has developed 3 strategies:

1. Introduce stripped-down versions of its core products. For example, full access to its core resume database costs Rs200,000 p.a. The company will start to introduce pared down versions of its database, offering by product or geography.
2. Introduce pay-per-use products to appeal to smaller companies that do not need access to that many resumes per day. The pay-per-use products may restrict access to say, 200 resumes per day rather than unlimited access.
3. Develop a separate sales channel targeting the lower-revenue, retail corporate clients, which is discussed in further detail below.

Info Edge currently does not have plans to increase its marketing in response to Timesjobs, but does not rule this out if there is a prolonged increase in marketing by Timesjobs or when it sees an impact on its business.

IPO lockup expires in November

The one-year IPO lockup expires on November 21, when senior management and VCs will be eligible to sell. We expect this to have minimal impact on the share price, as liquidity is low and a limited number of shares should come on the market (~5% of total), mostly from VCs rather than senior management.

Figure 2. Info Edge Shareholding Structure

Source: Company Reports

Note: As of 30 June 2007.

The promoters consist of Info Edge's senior management, namely CEO Sanjeev Bikhchandani, CFO Ambarish Raghuvanshi and COO Hitesh Oberoi. Mr. Bikhchandani owns 43-44% of the company.

Info Edge

Company description

Info Edge operates India's leading online recruitment and classifieds portal – Naukri.com, which was launched in 1997. The company was incorporated in 1995. In addition to online recruitment, the company generates revenue through an executive search agency named Quadrangle, as well as a matrimony portal (Jeevansathi.com) and a property portal (99acres.com). Info Edge has been listed on the Bombay Stock Exchange since November 2006.

Investment strategy

We rate Info Edge shares as Buy/Low Risk (1L) with a target price of Rs1,275. Info Edge's naukri.com is India's leading online recruitment classifieds portal, a service that is well suited to the early stages of the India Internet market, in our view. Naukri contributes ~90% of the company's revenues, and upside exists through the company's operation of matrimony sites and a real estate site that stands to benefit from rising adoption of the Internet in the country. This could enable Info Edge to become one of the dominant Internet players in India. Over FY07-10E, we forecast a revenue CAGR of 43% and a net profit CAGR of 45%.

Valuation

Our target price of Rs1,275 is based on 53x our FY09E EPS (YE March), adjusted for ESOP costs, and implies a PEG of 1.4x. Our target multiple is set at a 40-60% premium to our China and Global Internet peer groups, given the scarcity premium applied to the stock (being the only pure-play Internet company currently listed in India) and a market positioning that we see as delivering a 45% earnings CAGR in net profit over FY07-10E.

Risks

Under our quantitative risk-rating system, a default Speculative rating would be applied to Info Edge shares given that the stock has been publicly traded for less than a year. However, in light of the company's track record of profitability and its market leadership, we believe a Low Risk rating is more appropriate.

Downside risks that could prevent the shares from reaching our target price include: 1) any slowdown in the Indian economy or specifically, IT services sector, that would directly impact employment and recruiting demand; 2) increasing competition; 3) increased churn of posted resumes; 4) lack of policies against online fraud; and 5) greater and more prolonged losses from new verticals.

Appendix A-1

Analyst Certification

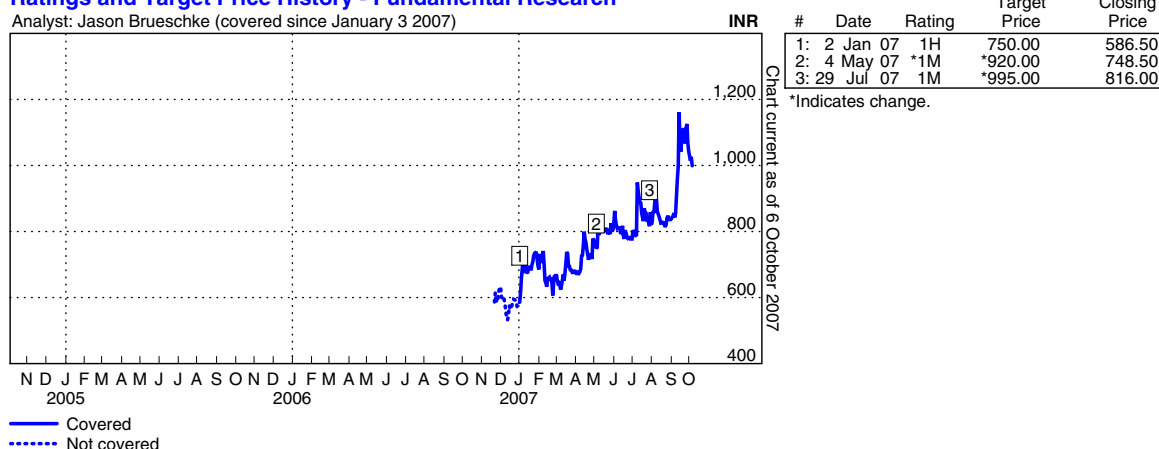
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Info Edge (INED.BO)

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Analyst: Jason Brueschke (covered since January 3 2007)



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