India Infoline

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Market Performer

Infosys Technologies Ltd (Q2 FY09)

October 13, 2008

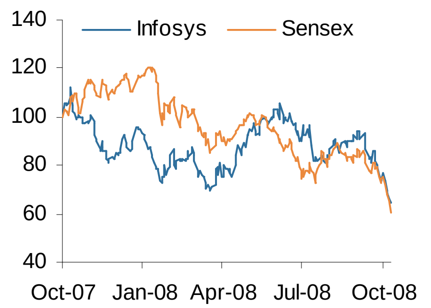
Stock data

Sensex:	10,526
CMP (Rs):	1,225
Target price (Rs):	1,259
Upside (%):	2.8
52 Week h/l (Rs):	2,140/1,040
Market cap (Rs cr)	70,070
6m Avg vol BSE&NSE ('000 nos):	2,333
No of o/s shares (mn):	572
FV (Rs):	5
Bloomberg code:	INFO IN
Reuters code:	INFY.BO
BSE code:	500209
NSE code:	INFOSYSTCH

Shareholding pattern

March 2008	(%)
Promoters	16.5
FIIs	52.7
Indian institutions	7.9
Public & others	22.9

Share price trend



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- Dollar growth above expectations; both volumes and pricing surprise on upside.
- Manufacturing vertical and Europe region drive growth; Key clients performance continues to disappoint. PI & consulting, SI and IMS lead amongst services.
- OPM expansion by 260 bps was in-line with expectations. Higher forex losses and tax provisioning suppress net profit (pre-tax reversals) growth.
- Company maintains hiring target for the year; Attrition decreases in-line with industry slowdown
- An extremely conservative FY09 guidance almost rules out any possibility of future downgrade.
- Rate Infosys as Market Performer; expect stock price to move in a narrow range over 4-6 months.

Result table

Period	Q1 FY09	Q2 FY09	QoQ	YoY
(Rs mn)	**(3)**	**(3)**	**(%)**	**(%)**
Net sales	48,540	54,180	11.6	32.0
Total Expenditure	(33,750)	(36,240)	7.4	28.4
EBIDTA	14,790	17,940	21.3	39.7
EBITDA margin (%)	30.5	33.1	-	-
Depreciation	(1,690)	(1,770)	4.7	22.9
Interest	-	-	-	-
Other income	1,170	660	(43.6)	(57.1)
PBT	14,270	16,830	17.9	30.1
Tax	(1,560)	(2,510)	60.9	29.4
Pre-Exceptional PAT	12,710	14,320	12.7	30.2
Extraordinary items	310	-	-	-
PAT	13,020	14,320	10.0	30.2
Number of shares (Mn)	572.0	572.0	-	-
EPS (Rs) - quarterly	22.8	25.0	10.0	30.2

Source: Company, India Infoline Research

Dollar growth above expectations; both volumes and pricing surprise on upside

Infosys delivered marginally higher than expected 5.3% qoq dollar revenue growth in Q2 FY09. In constant currency terms (excluding the negative impact of US$ appreciation against GBP, Euro and Aus$), the revenue growth stood at 7.1% qoq. IT services (including consulting) revenues grew by 6.2% qoq in dollar terms. Volume growth recovered sharply to 6.5% qoq (onsite – 4.1% and offshore – 7.6%) and blended pricing was essentially flattish sequentially, impacted by the cross currency movements and 70 bps offshore shift. In constant currency terms, pricing actually improved ~1.4% qoq. BPO revenues were flat qoq whereas product revenues de-grew 2.8% qoq. Overall, Infosys clocked a rupee revenue growth of 11.6% qoq benefiting from the average 6% depreciation of the rupee in Q2 FY09.

Manufacturing vertical and Europe region drive growth; Key clients performance continues to disappoint
Revenues from the manufacturing vertical grew by robust 15% qoq in dollar terms. Its share in overall revenues has increased by ~700bps over the past eight quarters to 20.1% reflecting the pivotal role it has played in compensating the declining share of the BFSI industry (lower by ~500 bps during the same period). Europe region grew far ahead of the company at 8.4% qoq in dollar terms while the growth in the US was sluggish at 3.4% qoq. Growth in the Top client (British Telecom) was disappointing at 1.3% qoq in dollar terms, especially after a significant 22.4% sequential decline in Q1 FY09. The other top nine (excluding BT in the Top 10) de-grew by 3.3% qoq.

Amongst services, growth led by few services - PI & consulting, SI and IMS
System integration (SI), package implementation (PI) & consulting and IMS registered robust growth of 18.9%, 12.4% and 9% respectively in dollar terms. ADM grew by 3.6% qoq while the growth in other services was essentially flattish except the product revenues which de-grew qoq.

OPM expansion by 260 bps was in-line with expectations
On expected lines, OPM improved by 260 bps qoq to 33.1% in Q2 FY09. The key margin tailwinds were rupee depreciation (~250 bps), lower visa charges, higher utilization and improvement in profitability of subsidiaries (especially Infosys BPO). The SG&A% increased qoq from 12.8% to 13.5% as the company chose to invest some portion of the margins benefits. The utilization (including trainees) improved ~100bps qoq to 69.2%. Operating profit growth was robust at 21.3% qoq in rupee terms.

Higher forex losses and tax provisioning suppress net profit (pre-tax reversals) growth
Higher forex losses (Rs1.26bn v/s Rs800mn in Q1 FY09) and tax provisioning (14.9% v/s 10.7% in Q1 FY09) lead to a lower net profit (pre-tax reversals) growth of 12.7% qoq in rupee terms. Including the tax reversal of Rs310mn in the previous quarter, the sequential growth stood at 10% qoq.

Company maintains hiring target for the year; Attrition decreases in-line with industry slowdown
Infosys added net 5,927 (gross 10,117) people, 6.3% of Q1 FY09 base, during the quarter. The additions mainly comprised campus recruits to whom offers were made in the last fiscal. Increase in BPO headcount was negligible at 43 in Q2 FY09. More importantly, company has maintained the gross hiring target of 25,000 people for the year, indicating material addition in the remaining two quarters. Attrition for the stand-alone company retreated by 80 bps qoq to 12.8%.

An extremely conservative FY09 guidance almost rules out any possibility of future downgrade
Factoring a 3% impact of the dollar appreciation against other business currencies and another 3% impact of possible volume slippages from any further deterioration in operating environment, Infosys downgraded its FY09 revenue growth guidance in dollar terms to 13-15%. Resultantly, the expected growth in earnings was downgraded to 10% yoy. The cut in the guidance was far higher than street's expectations. To achieve the full year numbers, Infosys just has to maintain revenue and profits at the Q2 FY09 level in the remaining two quarters. In rupee terms, there was a marginal increase in the revenue growth (27.7%-30.2%) and EPS (Rs101.1) guidance for FY09 purely due to the rupee depreciation. Company expects full-year OPM within 40-50bps of FY08 OPM of 31.4%. For Q3 FY09, company expects flat or marginal de-growth in revenues qoq and a modest increase in profits.

Rate Infosys as Market Performer; expect stock price to move in a narrow range over 4-6 months
Before entering into the result season, we had downgraded Infosys's FY10 EPS by ~6% to factor in a very difficult business environment ie lower volume growth and sharper pricing cuts. Therefore, the new conservative FY09 guidance only marginally changes our FY10 EPS estimate to Rs104.9, which implies a ~5% growth yoy. We reckon that a further downgrade in the annual guidance is unlikely given the minimal growth required. Moreover, the company has still not witnessed any client specific issues (deferment in committed volumes, rampdowns, pricing cuts, etc). This should limit any further material downside in stock price and lend stability over the next 4-6 months.

Projected financials

y/e Mar, Rs mn	FY06	FY07	FY08	FY09E	FY10E
Revenues	95,210	138,930	166,920	215,449	231,117
yoy growth (%)	33.5	45.9	20.1	29.1	7.3
EBITDA	30,911	43,910	52,380	68,688	69,337
EBITDA margin (%)	32.5	31.6	31.4	31.9	30.0
PAT	24,581	38,560	46,590	57,250	60,021
PAT	24,581	38,560	46,590	57,250	60,021
yoy growth (%)	30.0	56.9	20.8	22.9	4.8
EPS (Rs)	44.6	67.4	81.5	100.1	104.9
P/E (x)	27.5	18.2	15.1	12.3	11.7
P/BV (x)	9.7	6.2	5.0	3.9	3.1
EV/EBITDA (x)	20.3	14.6	16.3	13.3	10.8
ROE (%)	40.0	42.3	36.9	36.5	28.0
ROCE (%)	45.5	46.5	43.2	42.3	33.2

Source: Company, India Infoline Research