COMPANY WATCH: Infosys Technologies Limited Turns 25

- **Crossed the Milestone of $2 Billion Revenue, 2 Years After Reaching the Mark of $1 Billion**
- **Financial Year 2005-06 Revenue of $2.15 billion, up 35% year-on-year**
- **Revenue to Grow 28-30% in FY'07 between $2.76 billion and $2.80 billion**
- **38 New Clients Added During Q4**
- **Net Employee Addition of 3,293 in Q4 and 15,965 in FY'06**
- **Employee-base Crossed 50,000 at the count of 52,715 Employees as on March 31, 2006**
- **Fourth Quarter Revenue at $593 million, up 30% year-on-year and 4% quarter-on-quarter**
- **Q1, FY'07 Revenue Guidance between $628 million and $633 million (up 5.9-6.75% QoQ)**
- **1:1 Bonus Issue (Stock Dividend) for all shareholders including ADS holders**
- **Earning per American Depository Share (ADS) increased to 56 cents in Q4 of 2005-06 from 47 cents in Q4 of 2004-05**
- **Silver Jubilee Special Dividend of 67 cents per ADS (Rs. 30 Per Share) and Final Dividend of 19 cents per ADS (Rs. 8.50 Per Share)**

Fourth Quarter: Above Promise, Below Expectation; Mixed Signals for the Future

You may not get a parallel example of such conservatism from a company that represents the new age Indian ambitions. Yes, we are talking about Infosys Technologies, which turned 25 this year. The company has made it a habit to deliver better performance than the guidance given earlier. For the fourth quarter ended March 31, 2006, the company has announced the revenue of $593 million against the revenue guidance of $582-$584 million. The financial year 2005-06 revenue has reached at $2.15 billion exceeding the guidance of $2.03-$2.07 billion. In fact, the second largest Indian company has done it for all the eight quarters of the last two financial years 2004-05 and 2005-06. The practice stems from the eagerness to fulfill promises and the respect for best corporate governance.

For the future, however, there are mixed signals about the pace of growth. With only 4% quarter-on-quarter growth, January-March 2006 proved to be one of the slowest quarters for Infosys. On the other hand, the company, having 50,000 plus strong employee base right now, wants to double it in next 2-3 years only. Not only this, the guidance for FY'07 given by the company is roughly 30% higher than the consensus expectations by the stock analysts.

Q4 Performance: A Tad Below Expectations

Though the company has exceeded its guidance for Q4 by achieving $593 million revenue, it couldn't reach the level of street expectations. The quarter-on-quarter increase in the revenue has been 6.08% in dollar terms, but only 3.63% in terms of rupee (from Rs. 2,532 crore to Rs. 2,624 crore) thanks to changes in rupee-dollar equations. The profit or net income also rose 6.29% in dollar terms (from $143 million in Q3 to $152 million in Q4), and only 3.7% in terms of rupee (from Rs. 649 crore in Q3 to Rs. 673 crore in Q4). The year-on-year growth, though, looks pretty impressive with revenue growing 30.33% in dollar terms and 32.06% in rupee terms. Net income also registered year-on-year growth of 19.69% in dollar terms and 20.61% in rupee terms. The lower year-on-year growth in the bottomline compared to the topline is a direct reflection of drop in the net margin. Though the operating income has increased 20.9% from $129 million in Q4 of FY'05 to $156 million in Q4 of FY'06, it has dropped 4.88% QoQ compared to Q3 of FY'06. The operating income margin in Q4 of FY'06 has dropped to 26.3% compared to 29.34% in Q3 of FY'06 and 28.35% in Q4 of FY'05. The net income margin, however, is stable at 25.63% in Q4 of FY'06 compared to 25.58% in Q3 of FY'06, but lower than 27.91% in Q4 of FY'05.

Infosys Technologies Ltd.			
Quarter ended	**31-Mar-06**	**31-Dec-05**	**QoQ Chng**
Revenue ($mln)	593	559	**6.08%**
Revenue (Rs.Cr)	2624	2532	**3.63%**
Net Income ($mln)	152	143	**6.29%**
Net Income (Rs.Cr)	673	649	**3.70%**
Quarter ended	**31-Mar-06**	**31-Mar-05**	**YoY Chng**
Revenue ($mln)	593	455	**30.33%**
Revenue (Rs.Cr)	2624	1987	**32.06%**
Net Income ($mln)	152	127	**19.69%**
Net Income (Rs.Cr)	673	558	**20.61%**
Year ended	**31-Mar-06**	**31-Mar-05**	**YoY Chng**
Revenue ($mln)	2152	1592	**35.18%**
Revenue (Rs.Cr)	9521	7130	**33.53%**
Net Income ($mln)	555	419	**32.46%**
Net Income (Rs.Cr)	2458	1891	**29.98%**

The quarter ended March 2006 could have been a quarter of stronger performance had it not been badly impacted by the rupee appreciation, higher depreciation of assets and lower utilization of workforce. All the three factors contributed to the dip in its margin. The lower utilization was caused by rapidly growing employee base; however the unutilized workforce is usually put to training for future projects enabling the company to take up new projects instantly.

The Higher-than-expected Guidance May Actually be an Easy Target:

The company has given revenue guidance between $628 million and $633 million compared to revenue of $593 million achieved in the last quarter. This would translate into a sequential quarter growth between 5.9% and 6.75%, and year-on-year growth between 31.9% and 33.0%, which is pretty decent by any benchmark. The company expects its EPS to be between 56 cents and 57 cents in Q1 of FY'07 compared to 56 cents in Q4 of FY'06. The annual EPS is expected to reach between $2.57 and $2.61 in Q1 of FY'07 compared to $2.04 in Q4 of FY'06.

The company hopes that its margins would remain stable in the financial year 2006-07. It may have based its FY'07 guidance on the hope that the margins would remain intact during the financial year and the growth in revenue would add to the bottom line. The margin remaining stable will depend on two crucial factors: rupee-dollar equation and hike in billing rates. It is expected that the Indian companies may now find the situation favourable to hike the billing rates even for the existing clients. They have already been signing deals with new clients at 3-4% higher rates compared to existing clients. The impact on the margin, however, may depend on the timing of such hikes. As far as the rupee-dollar equation is concerned, the fluctuations in the conversion rate may impact either way.

Again, the fact that Infosys has based its guidance on the premise that the margin would remain stable is a reflection of its conservative approach only. Since the margins have been under pressure for some time now, the possibility of an improvement in the margin is much more than the possibility of margin coming down further. So, outpacing the guidance would be easier for Infosys, considering that it is said to be higher than the street expectations. Not surprising, old story for Infosys!

The Army of 100,000 soldiers: Just Wait for 2-3 Years

Infosys has announced that it plans to hire 25,000 new employees in the financial year 2006-07 (roughly 50% of the current base of 52,715 employees). And this can't be termed as an ambitious target. It has already recruited 22,868 people (net addition 15,965) during the FY'06. Going by the current rate of hiring, it may actually cross the mark of 100,000 employees in the next 2-3 years. While it signals the growth potential observed by the company, it is also in response to the competition posed from all corners: the large MNCs, Tata Consultancy Services—India's largest IT consulting, services and business process outsourcing company, and the mid-size Indian players. No wonder Infosys has decided to move its Director and CFO (Chief Financial Officer) T.V. Mohandas Pai from the position of CFO to take the responsibility of human resource development (HRD), education and research, and administration. He continues to be a member of the board. The importance of the move may be gauged by the comment in an analysis published in the business daily "The Financial Express" saying, "When an army moves a high-profile general to a frontline position, you know that key battles are imminent."

Just have a look at the competition. Even though Infosys might have recruited 22,868 people in FY'06, it falls short of the employee addition by the largest Indian IT company Tata Consultancy Services (TCS) that has grossed about 25,000 new employees during the same period. So, the biggest has become bigger. IBM on the other hand has reached the employee base of 40,000 in India and the figure could easily cross 60,000 by the end of fiscal 2006-07. The recent offer by Electronic Data Systems (EDS) to acquire majority stake in MphasiS BFL Ltd. would place the mid-sized MphasiS in the big league suddenly, if the deal concludes successfully. Other mid-size IT services companies of India are also making their presence felt in the global market. With the increased attrition rate of 11.2% in Q4 of FY'06 compared to 9.7% in Q4 of FY'05, Infosys faces the challenge of acquiring skilled workforce in significantly large numbers and training the new recruits as well as keeping them away from the desperate poachers. It would be interesting to note the impact of the new role that Mohandas Pai assumes on the attrition figures of Infosys in the coming quarters.

Looking for a Merger of the BPO Subsidiary Progeon:

The top management of Infosys confirmed to the media that it intends to buy out the stake of Citigroup in its subsidiary Progeon. The company expects to conclude the talks with Citigroup by the end of April-June 2006 quarter. Once the deal concludes, Infosys will have almost 100% stake in Progeon. Media reports have suggested that Infosys may merge the BPO arm into itself, and rename it removing the word Progeon.

The BPO subsidiary has posted revenue of $24.4 million in Q4 of FY'06 compared to $14.5 million in the corresponding quarter of the previous fiscal, registering a growth of 69%. The quarter-on-quarter growth in the revenue is 8.4%. The annual revenue for FY'06 is $85.4 million, almost double of $42.9 million in FY'05. Infosys management expects Progeon to grow 45%-50% in FY'07. The major challenge for Progeon, however, is to curb the high attrition rate of 40%.

Bonus Shares: The Mega-Multiplier Effect

Infosys has a history of issuing bonus shares. The 1:1 bonus declared along with the quarterly results is the fifth bonus issue by the company. If an investor had bought one share of Infosys before the bonus issued in 1994, and had held the original as well as bonus shares through out these years, his one share would have converted into 64 shares. The earliest stock price of Infosys available at the Bombay Stock Exchange website is dated March 19, 1996 on which the stock was traded at Rs. 470. It wouldn't be mathematically correct to take that price as the base price prior to all the bonus issues. For a rough calculation, however, if we take that price as the base, the seed investment of Rs. 470 would now have converted in to the mega tree of more than Rs. 1.93 lakh ($4345).

Year	**Bonus Ratio (bonus:held)**	**After Bonus**
2006	1:1	64
2004	3:1	32
1999	1:1	8
1997	1:1	4
1994	1:1	2
Pre-bonus		1