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Take Five				
Scrip	Reco Date	Reco Price	CMP	Target
◆ <b>Aban Loyd</b>	03-Mar-05	330	<b>907</b>	1,760
◆ <b>Bajaj Auto</b>	15-Nov-05	1,873	<b>2,747</b>	3,500
◆ <b>BHEL</b>	11-Nov-05	1,203	<b>1,986</b>	2,650
◆ <b>Esab India</b>	21-May-04	60	<b>329</b>	575
◆ <b>Infosys</b>	30-Dec-03	1,378	<b>3,386</b>	3,730

## Pulse Track

### ◆ **May 2006 IIP springs a positive surprise**

The index of industrial production (IIP) grew by a strong 10% year on year (yoy) for May 2006 as compared to the consensus estimates of an 8.9% growth yoy. Commendably the growth was the highest over the last eleven months and came on top of a strong 10.8% year-on-year (y-o-y) growth in May 2005.

The manufacturing sector continued its growth momentum, growing at 11.3% yoy, the highest ever over the last eleven months and again commendably over an 11.3% y-o-y growth in May 2005.

The mining production in the economy grew at 3.0% yoy and the electricity production grew at 4.7% yoy albeit on a higher base of last year.

The index of capital goods grew by a strong 20.5%, underlining the strong investment theme that the Indian economy is currently going through.

The growth in the manufacturing sector was led by a higher production of paper and printing materials, basic chemicals,

non-metallic minerals, basic metals, machineries and capital equipments and transport equipments.

	May-06	May-05	April-06	YTD 2006-07	YTD 2005-06
IIP	10.0	10.8	9.6	9.8	9.5
Mfg	11.3	11.3	10.6	10.9	10.3
Mining	3.0	5.2	3.4	3.2	4.0
Electricity	4.7	10.5	5.9	5.3	6.7
Capital goods	20.5	13.4	21.6	21.1	13.9
Consumer goods	9.1	18.4	9.0	9.0	15.9
Consumer non-durable	5.9	17.7	10.3	14.4	18.2
Consumer durables	18.3	18.6	8.6	7.2	15.2

Source: Ministry of Statistics and Programme Implementation

### April 2006 numbers revised upwards

The April 2006 growth numbers were also marginally revised upwards with the IIP at 9.56% (as compared with 9.5% announced earlier), the manufacturing index at 10.6% (10.4%) and the electricity production revised upwards to 5.9% (5.4%). However, the index of mining and the index of capital goods were revised downwards to 3.4% (4.3%) and 21.6% (24.5%) respectively.

### Key constituents of manufacturing sector

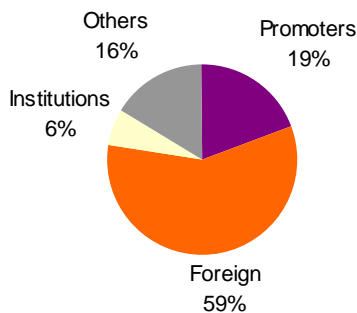
In %	Weight	Jan-06	Feb-06	y-o-y growth Mar-06	Apr-06	May-06
Beverages, tobacco and related	2.4	10.6	7.9	18.9	11.7	11.7
Textile (including wearing apparel)	2.5	15.3	15.5	-0.6	9.5	9.8
Paper and printing	2.7	3.9	-4.0	-16.8	8.3	15.8
Basic chemicals & chemicals	14.0	-1.3	2.3	3.8	12.1	12.0
Rubber, plastic, petroleum and coal	5.7	9.0	3.9	3.1	4.9	11.3
Non-metallic minerals	4.4	18.4	13.5	16.6	15.4	7.4
Basic metal and alloy industries	7.5	12.7	13.9	23.5	20.7	21.2
Machinery and equipment	9.6	17.9	13.5	8.0	13.4	15.3
Transport equipment and parts	4.0	12.5	14.7	11.9	16.3	26.7
Other manufacturing industries	2.6	37.0	20.3	34.7	36.0	29.2

Source: Ministry of Statistics and Programme Implementation

# Infosys Technologies

**Evergreen**
**Stock Update**
**Exceptional performance**
**Buy; CMP: Rs3,386**
**Company details**

Price target:	Rs3,730
Market cap:	Rs93,115 cr
52 week high/low:	Rs3,449/2,125
NSE volume: (No of shares)	10.3 lakh
BSE code:	500209
NSE code:	INFOSYSTCH
Sharekhan code:	INFOSYS
Free float: (No of shares)	22.1 cr

**Shareholding pattern**

**Price chart**

**Price performance**

(%)	1m	3m	6m	12m
Absolute	13.0	0.2	7.4	38.3
Relative to Sensex	3.9	9.1	-5.4	-6.5

**Result highlights**

- Infosys Technologies reported an impressive revenue growth of 14.9% quarter on quarter (qoq) and 45.5% year on year (yoy) to Rs3,015 crore during the first quarter ended June 2006. The sequential growth in the revenues was driven by the cumulative impact of a robust growth in the volumes (8.5%), higher billing rates (blended rates up by 1.8%), rupee depreciation (by 3.2%) and a growth of 21% and 33% in the business process outsourcing (BPO) and the banking product business respectively.
- The operating profit margin (OPM) declined by 230 basis points sequentially on the back of an adverse impact of the salary hikes (3.3%) and increased cost of visa charges (1.3%). On the other hand, the favourable foreign exchange (forex) movement resulted in a positive impact of around 2.3% on the margins at the operating level. The decline in the operating margins was higher than the expectations of a 70-80-basis-point decline as per the consensus estimates. That is because the management invested aggressively in additional visas and in building the sales & marketing infrastructure (sales, general and administration [SG&A] expenses stood at 15.3% of the revenues as against 14.1% in Q4FY2006).
- The other income jumped by 77.8% qoq and by 347.9% yoy to Rs128 crore. The other income was driven by the positive net forex impact of Rs52 crore (instead of an expected loss), arising from the huge translation gains of around Rs80 crore.

**Result table**

Rs (cr)

Particulars	Q1FY07	Q1FY06	Q4FY06	% yoy chg	% qoq chg
Net revenue	3,015.0	2,071.6	2,624.0	45.5	14.9
Software development expenses	1,666.0	1,104.4	1,422.0	50.9	17.2
Gross profit	1,349.0	967.2	1,202.0	39.5	12.2
Selling and marketing expenses	204.0	141.5	152.0	44.2	34.2
Total expenditure	2,126.0	1,407.7	1,791.0	51.0	18.7
Operating profit	889.0	663.9	833.0	33.9	6.7
Other income	128.0	28.6	72.0	347.9	77.8
Provision for investments	3.0	0.1	0.0		
PBDT	1,014.0	692.4	905.0	46.5	12.0
Depreciation/Amortisation	106.0	80.1	144.0	32.3	-26.4
PBT	908.0	612.3	761.0	48.3	19.3
Provision for taxation- current	106.0	80.2	81.0	32.2	30.9
Profit after tax	802.0	532.1	680.0	50.7	17.9
Exceptional item net of tax	6.0	0.0	0.0		
Minority interest	8.0	0.2	7.0	-	14.3
<b>RPAT</b>	<b>800.0</b>	<b>532.0</b>	<b>673.0</b>	<b>50.4</b>	<b>18.9</b>
Equity capital	137.6	135.7	137.5		
Basic EPS (in Rs)	28.9	19.6	24.5		
GPM (%)	44.7	46.7	45.8		
OPM (%)	29.5	32.0	31.7		

- ♦ The earnings growth was also boosted by lower depreciation charges as a percentage of sales. The depreciation stood at 3.5% of the revenues as compared to its expected range of 4-4.5%. Consequently, the consolidated earnings grew by 18.9% qoq and by 50.4% yoy to Rs800 crore (Rs794 crore after excluding one-time items), much higher than the consensus estimates.
- ♦ In addition to the much higher-than-expected performance in Q1, the steep upward revision in the annual growth guidance is also encouraging. The consolidated revenues are guided to grow by 40.2-40.7% to Rs13,350-13,400 crore, up from Rs12,254-12,446 crore indicated in the beginning of the fiscal. The earning per share is guided to grow by 38.3-39.6% to Rs124.5-125.7 as compared to Rs113.9-115.6 given earlier.
- ♦ In terms of the guidance for Q2, the revenues and earnings are guided to grow sequentially by 8-8.8% and 2-3% respectively.
- ♦ At the current market price the scrip trades at 25.7x FY2007 and 20.9x its FY2008 estimated earnings. We maintain our Buy call on the stock with a revised target price of Rs3,730.

#### Encouraging volume growth and pricing trend

The volume growth of 8.5% sequentially was driven by a growth of 12.5% in the onsite volumes and a growth of 6.6% in the offshore volumes. The robust growth in the onsite volumes was boosted by the commencement of some large orders and the ramp-up in the business from a few of its large clients. The top ten clients have grown at a healthy rate of 17.5% on a sequential basis, with the revenues from its largest client growing at a staggering rate of 41.8% qoq to Rs175 crore.

The pricing environment was also favourable with the blended rate increasing by 1.8%, with a sequential improvement of 1.1% and 0.2% in the onsite and offshore billing rates respectively. The management indicated that the new clients are being added with billing rates higher by 2-3% as compared to the average billing rates of the existing clients. Moreover, in some of the existing clients also, the company has been able to extract higher billing rates.

#### Operating margin slides by 230 basis points

The operating profit margin (OPM) declined by 230 basis points sequentially on the back of an adverse impact of 3.3% due to the annual hike in salaries and the additional \$8 million (\$11 million spent in Q1 as compared to \$3 million in Q4FY2006) depressed the OPM by 1.3%. On the other hand, the favourable forex movement resulted in a positive impact of around 2.3% on the margins at the operating level.

The decline in the operating margins was higher than the expectations of a 70-80-basis-point decline as per the consensus estimates. That is because the management invested aggressively in additional visas and in building the sales & marketing infrastructure (sales, general and administration [SG&A] expenses stood at 15.3% of revenues as against 14.1% in Q4FY2006).

For the full year, the company expects the OPM to remain in the indicated band of 32-33%. Thus, the OPM is expected to improve considerably in the second half of this fiscal.

#### Huge jump in other income

The other income stood at Rs128 crore, up 77.8% qoq and 348% yoy. The company surprised with a positive net forex impact of Rs52 crore (as compared to the expectations of a marginal net forex loss due to the mark-to-market provisions on the forward contracts). The mark-to-market losses of Rs28 crore on the forex hedges were more than nullified by the translation gains of Rs80 crore. The interest income on the bank deposit and the other investments contributed Rs76 crore (including Rs6 crore of profit from the sale of investment in the liquid mutual funds).

The company had a forex hedge of \$381 million at the end of the quarter at an average rate of Rs45.87 per dollar, which includes options (range barrier) worth \$280 million.

#### Gain of 2% in depreciation charges

The depreciation charges of Rs106 crore amounted to 3.5% of the revenues as compared to 5.5% of the revenues in Q4FY2006, which resulted in a gain of 2% in the profit before tax (PBT) margin. The depreciation charges were surprisingly lower than the range of 4-4.5% indicated by the management for the full year.

#### Impressive guidance upgrade

The steep upward revision in the annual growth guidance was far ahead of the street expectations. The consolidated revenues are guided to grow by around 40.5% to Rs13,350-13,400 crore, up from Rs12,254-12,446 crore indicated in the beginning of the fiscal. The earning per share is guided to grow by around 39% to Rs124.5-125.7 as compared to Rs113.9-115.6 given earlier.

#### Other highlights

##### *Employee addition was healthy*

Infosys added 5,694 employees during the quarter, an increase of 10.8% over its base at the end of March 2006. The total consolidated staff strength stood at 58,409 at the end of June 2005. The company indicated that it aims to add around 7,000 employees in Q2FY2007 and another 10,000 in the second half of this fiscal.

On the flip side, the attrition rate of 11.9% (as against 11.2% in Q4) is a concerning factor, considering the aggressive salary hikes given this fiscal.

#### *Performance of subsidiaries*

The four subsidiaries (Infosys China, Infosys Consulting, Infosys Australia and Progeon) reported cumulative revenues of Rs148 crore and a net loss of around Rs5 crore. While Progeon and Infosys Australia are profitable, the other two subsidiaries are in an investment phase and continue to make losses. The management indicated that the profitability in its consulting business and in the China subsidiary would occur in another 2-3 quarters.

Progeon, its BPO subsidiary, reported a revenue growth of Rs128 crore and a net profit of Rs20 crore during the first quarter. It also reported a healthy employee addition of around 1,000 associates (taking the total headcount to over 8,000) during the quarter.

We expect Progeon's revenues to grow by 75% to Rs607 crore in FY2007. Moreover, the OPM would also improve in the coming quarters, as the impact of the recent salary hikes would get diluted over the year. Moreover, the company had taken a one-time expense related to stock options in the first quarter.

#### *Growth engines*

Infosys witnessed a robust growth in the three key industry verticals of banking, financial services and insurance (BFSI), telecom and manufacturing. In terms of service offering, application development and testing were the fastest growing services in the last quarter. The management expects the package implementation also to grow at higher than average growth rates in the current fiscal.

The management indicated that the global spend on IT services is expected to increase by 5-6% in the current calendar year, largely due to an increase in the discretionary spending. What is more heartening is the fact that offshore outsourcing to India is estimated to grow at a much higher rate of 30% and Infosys with its strong brand and scale of operations is likely to be one of the key beneficiaries of the trend. The company is also actively pursuing large deals and is one of the bidders in 10-12 large multi-million dollar outsourcing deals.

In terms of overall profitability, the company expects the billing rates to remain stable with an upward bias. Moreover, the improvement in the performance of the subsidiaries and the higher proportion of the offshore business would also cushion any adverse impact of cost pressures on the margins.

#### **Valuation**

At the current market price the scrip trades at 25.7x FY2007 and 20.9x its FY2008 estimated earnings. We maintain our Buy call on the stock with a revised target price of Rs3,730 (23x FY2008 earnings per share).

#### **Earning table**

Particulars	FY2005	FY2006	FY2007E	FY2008E
Net profit (Rs cr)	1,847.0	2,458.0	3,673.0	4,602.0
No of shares (cr)	27.0	27.6	27.9	28.4
EPS(Rs)	68.4	89.2	131.7	162.1
% yoy chg		30.4	47.6	23.1
PER	49.5	38.0	25.7	20.9
PBV	17.5	13.4	9.5	7.0
EV/EBIDTA	38.5	29.1	20.2	15.3
EV/Sales	12.6	9.4	6.6	4.8
ROCE	40.8	39.7	41.9	38.9
RONW	35.3	35.3	36.8	33.6

The author doesn't hold any investment in any of the companies mentioned in the article.

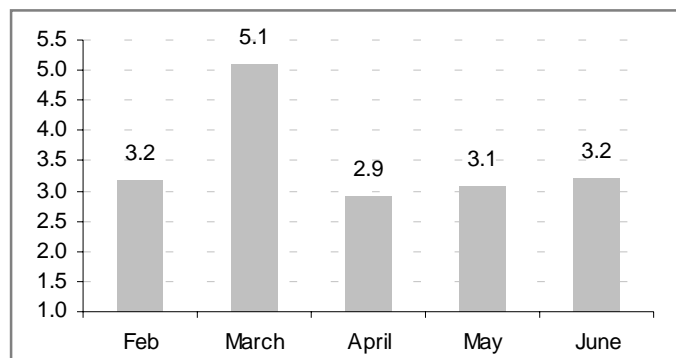
# Telecom

## Sector Update

### Bharti reigns supreme

India added a total of 4.9 million new cellular users in June, a rise of 4.7%, to take the country's total cellular subscriber base to 109.4 million. Falling handset costs and pre-paid packages fuelled the strong growth of cellular subscribers during the month. The addition of 3.21 million users in the month has taken the GSM subscriber base to 78.5 million. On the CDMA front, 1.7 million new users were added in June, growing by 5.7% over May 2006.

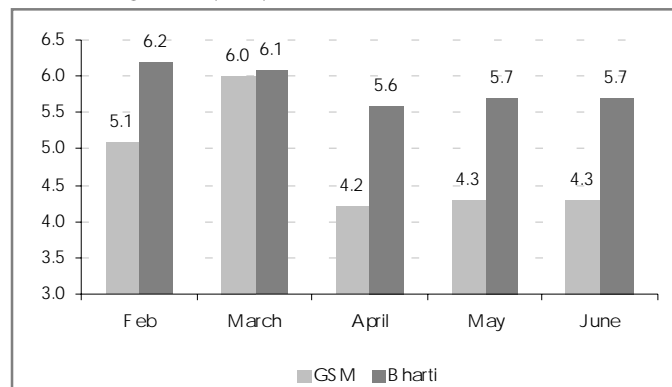
GSM subscribers additions (in million)



### Bharti continues to shine

Bharti Airtel continued to lead in the GSM arena as it added 1.2 million users in June, taking its total subscriber base to 23.1 million. Bharti continued to grow ahead of the industry by clocking a growth of 5.5%, well ahead of the 4.3% growth reported by the overall GSM category for the month. Consequently, it increased its overall market share to 21.1%. Bharat Sanchar Nigam Ltd (BSNL) managed to add just 0.3 million users during the month, taking its user base to 18.3 million. Among the other GSM players, Idea grew by 5.5%, adding 0.47 million new users in June, taking its total user base to 8.5 million.

Subscriber growth (in %): GSM and Bharti



Reliance Communication Venture added 1.03 million subscribers recording a growth of 4.8% month on month. The company's CDMA subscriber base grew by 4.5% to 20.2 million while its GSM subscriber base grew by 7.5% over May 2006. Tata Tele-services reported a good growth by adding 0.8 million subscribers in June, a growth of 8.3% over the previous month, taking its total user base to 10.4 million in June 2006.

June cellular subscribers (in million)

Company	Total Subscribers		% chg	Additions in June	Market share (%)
	Jun 06	May 06			
Bharti	23.1	21.9	5.5	1.2	21.1
Reliance	22.5	21.5	4.8	1.0	20.6
BSNL	18.3	18.0	1.6	0.3	16.7
Hutch	17.6	16.8	4.5	0.8	16.0
Tata Tele	10.4	9.6	8.3	0.8	9.5
<b>Total</b>	<b>109.4</b>	<b>104.5</b>	<b>4.7</b>	<b>4.9</b>	

Source: COAI, AUSPI, Sharekhan Research

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## Evergreen

HDFC Bank  
 Infosys Technologies  
 Reliance Industries  
 Tata Consultancy Services

## Apple Green

Aditya Birla Nuvo  
 Associated Cement Companies  
 Bajaj Auto  
 Balrampur Chini Mills  
 Bharat Bijlee  
 Bharat Heavy Electricals  
 Corporation Bank  
 Crompton Greaves  
 Godrej Consumer Products  
 Elder Pharmaceuticals  
 Grasim Industries  
 Hindustan Lever  
 Hyderabad Industries  
 ICICI Bank  
 Indian Hotel Company  
 ITC  
 Mahindra & Mahindra  
 Marico Industries  
 Maruti Udyog  
 MRO-TEK  
 Lupin  
 Nicholas Piramal India  
 Omax Auto  
 Ranbaxy Laboratories  
 Satyam Computer Services  
 Sintex Industries  
 SKF India  
 State Bank of India  
 Sundaram Clayton  
 Tata Motors  
 Tata Tea  
 Unichem Laboratories  
 Wipro

## Cannonball

Cipla  
 Gateway Distriparks  
 International Combustion (India)  
 JK Cements  
 Madras Cement  
 Shree Cement  
 Transport Corporation of India

## Emerging Star

3i Infotech  
 Aarvee Denims and Exports  
 Aban Loyd Chiles Offshore  
 Alok Industries  
 Alphageo India  
 Cadila Healthcare  
 KSB Pumps  
 Marksans Pharma  
 Navneet Publications (India)  
 New Delhi Television  
 Orchid Chemicals & Pharmaceuticals  
 ORG Informatics  
 Solelectron Centum Electronics  
 Television Eighteen India  
 Thermax  
 Tube Investments of India  
 TVS Motor Company  
 UTI Bank  
 Welspun Gujarat Stahl Rohren  
 Welspun India

## Ugly Duckling

Ashok Leyland  
 Deepak Fertilisers & Petrochemicals Corporation  
 Genus Overseas Electronics  
 HCL Technologies  
 ICI India  
 Jaiprakash Associates  
 JM Financial  
 KEI Industries  
 Nelco  
 NIIT Technologies  
 Punjab National Bank  
 Ratnamani Metals and Tubes  
 Sanghvi Movers  
 Saregama India  
 Selan Exploration Technology  
 Subros  
 Sun Pharmaceutical Industries  
 Surya Pharmaceuticals  
 UltraTech Cement  
 Union Bank of India  
 Universal Cables  
 Wockhardt

## Vulture's Pick

Esab India  
 Orient Paper and Industries  
 WS Industries India

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