

**Infosys Ltd – Acquisition of Axon Group Plc.**

CMP : Rs. 1709.0  
Accumulate  
Target - Rs. 1900.0

View Point

Infosys announces its plans to Axon Group Plc for £ 401.7 Mn. (Rs. 33.1 Bn.); the transfer of ownership being expected to get completed by November 2008, subject to scheme of arrangement being effective. Axon is a UK based SAP consultancy firm with ~2000 employees. This LSE listed company was founded in 1994 and has offices in UK, North America, Malaysia & Australia. The management of Axon has suggested the outside shareholders to accept the cash offer by Infosys of £ 6.00 per share which is at 33.1% premium to the six month average price of £ 4.51 per share. Axon services clients across 30 countries with a larger share coming in from UK & Continental Europe. Axon has contracts with Sony, Xerox, Cadbury, Unilever, etc. and also has a JV with WH Smith News.

Axon reported revenues of £ 204.5 Mn. & PAT of £ 20.2 Mn. for CY07. The operating margins of Axon at ~13-15% are lower than that of Infosys (30%+). However, Axon has had an impressive growth record of growing at 42.7% CAGR in Topline and an exciting 68.2% PAT CAGR. The RONW for CY07 stood at an attractive 25%.

Opinion :

Infosys is acquiring Axon Group Plc at ~20x its CY07 earnings and ~16.5x CY08E earnings based on Bloomberg estimates. This we believe is decent given the size, decent growth rate & return ratios for Axon. On whether the deal would be EPS accretive or otherwise, we feel that it would be EPS neutral for FY09 and would reflect a positive impact by FY10. On the face of it, the consolidated margins may marginally come down on account of the lower margins for Axon, but however, in absolute terms there would be ~ no impact on net profitability as Axon's 9-10% net margins would make up for the loss of other income by Infosys. The longer term impact would be much positive given the normal growth rates at Axon and the integration benefits, if any.

The key rationale for this acquisition is strategically strengthen Infosys' position as a globally trusted transformation partner. While the geography mix would improve further in favour of EU, there would not be much integration advantage in terms of domain expertise, as Infosys is reasonably strong in itself within the SAP practice space. Nearly 2100 Infosys consultants are implementing SAP for over 100 clients in over 20 countries. Infosys has seen its SAP practice grow at 65% CAGR over the last 3 years. Infact, 24% of its revenues are coming in from Consulting & Enterprise Solutions. So it is mainly a volume & geography play; though Infosys would like to benefit from cross selling opportunities to the Axon clients, which include some big names like Motorola, Barclays, Vodafone & GE Capital. The only concerning point, we feel is that, with ~68% of Axon's revenues coming in from implementation, and just 32% coming in from application management & consulting, the growth rates in the coming time may moderate.

While the acquisition is not making a material impact on the Infosys near-term financials, we look at this move as a very positive one. We would certainly prefer Infosys to grow on acquisitions rather than non-operating income. Also, this augers well for enhancing the corporate image, from being a organic growth play to a multi-faceted growth play. This is also a good solution to the prospective growth rates, given the higher base effect.

We maintain Accumulate on Infosys with our increased price target of Rs. 1900 (17x FY10E).

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