

# THE ECONOMIC TIMES

## INFOSYS DEAL

### Expect no value change in short term

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THE acquisition of US-based BPO firm McCamish Systems will boost Infosys's capability building exercise more than its financial strength in the near term. Business process outsourcing (BPO) operations constitute just 6% of Infy's total revenue. Hence, its latest shopping will not have any significant impact on future performance, apart from marginally impacting its net margin.

In 2008, McCamish had reported \$38.2 million in revenue compared with Infy's \$4.7 billion. Infy's BPO unit, Infosys BPO, has reported a revenue of \$274 million in the past four quarters. According to the management, the current revenue run rate of McCamish is close to \$27 million, which is lower than that in 2008 due to the US recession. Given the current revenue, Infy's BPO would be able to augment its revenue base by at least 10%.

The \$38-million deal may go up by another \$20 million, if McCamish meets certain operating targets in future. If these conditions are met, then Infosys BPO would pay nearly 1.5 times McCamish's 2008 sales.

It is difficult to measure the valuation in terms of operating income since McCamish had ended 2008 in operating losses due to tough business conditions in the US financial and insurance sector. According to Infosys BPO CEO and MD Amitabh Chaudhry, McCamish has historically operated at operating margin of 15%. The deal value is about seven times operating income, which is in line with the industry trend.

The deal will reduce Infosys's Rs 12,273 crore strong cash base by a tad Rs 300 crore. Considering an average return of 8% on this amount, which Infosys will have to forgo, after it pays for the deal, its net margin is likely to drop by 30-40 basis points from the current 27.6%.

Infosys would not carry on its balance sheet any accumulated losses of McCamish, according to Abraham Mathews, CFO of BPO operations. This is because, McCamish follows a pass-through taxation system wherein incomes and losses are passed through to the partners of the company. Though minuscule, the acquisition is of strategic significance. "Infosys has always focused on non-voice BPO operations, which can be expanded without significant addition to headcount. The latest acquisition will help Infosys do exactly that," said Dipen Shah, senior V-P, Kotak Securities.

In the short run, the deal is hardly likely to change Infosys's stock valuation. According to RBS's IT analyst Srinivas Seshadri, it will not have any material change in forecasts and valuations. So far, Infosys has focused on small deals such as the acquisition of BPO units of Royal Philips Electronics in 2007 worth \$28 million. These deals have provided the depth and breadth to Infy's existing business. However, what is required is the takeover strategy that can also improve scale and size of existing operations significantly.

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