

The Week Gone By

Weekly Newsletter

Parag's Views

Understanding the Representativeness Bias

The Basics:

It's common for every person to process new information, new phenomenon or some new idea through their past knowledge or experience. Many investors tend to evaluate the probabilities based on some past experience and they consider some company to be a good investment if it has performed well during some period in the past. Usually, it is the period, which is close to the present. Among many traders and investors, who are familiar to me, good past performance is a bullish sign. That's clearly erroneous, leads to serious investment mistakes and thus to significant losses, instead of wishful profit. Also, when investor tries to classify some company and when it doesn't suit to any of his categories, he tries to apply it to the category he thinks it best suits to, while it may really suit, BUT just PARTLY. Such investment mistake can drive to erroneous valuation and risk analysis.

Test:

1. Have you ever experienced a feeling of a strong wish to buy stock when you saw strong past performance?
2. If you have ever analyzed a stock analyst's track record (and if he was successful), then did you decide to follow his recommendations?

If your answer is "yes" to both questions, then you are really susceptible to representativeness bias.

Advice:

1. The strong performance in the past is not a bullish sign and doesn't indicate the same or better performance in the future (for example if some mutual funds performed well during some year only 16% of them are successful the following year). Each year is different from the previous one!
2. Do not forget the first advice.
3. Do not let representativeness bias win over your common sense! Always do your homework and do not forget to do a research before you invest your money!

Geodesic Information Systems Limited

CMP Rs. 175.0 | BUY

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Geodesic Information Systems Limited, a Information Technology company founded in April 1999. The company, a small start up company then, entered into the competitive space of Instant Messengers. It was able to excel in this competitive market with their flagship product Mundu. Geodesic has been the first Indian company to venture in the Instant Messaging market with a very innovative messenger named Mundu. Geodesic in 2005 has acquired Picopita Simputer, India, Engage Solutions, Hong Kong, and a major portion of Clangula IT of Sweden. Overall, Geodesic has seen a magnificent growth of 80% yoy with operating profit moving within 50%-60%.

Geodesic Information System has plans to change its name to Geodesic Ltd. This company cannot be classified as a typical software company as it has a different revenue mix and business model. The company has ventured into VoIP segment with its product Mundu Speak. Majority of the Geodesic's revenues are realized from the enterprise clients. The unique feature of Mundu messenger is its ability to integrate other existing messengers (AIM, ICQ, Yahoo, Google Talk and Jabber for enterprise clients) on one single IM platform. Geodesic's entry into the VoIP segment makes it enter the dynamic Telecommunications Industry in India. Geodesic recently has decided to launch low cost devices for VoIP.

Quarter gone By Q1-09

The company's Rs. 1,296.5 Mn. revenue in Q1-09 is a jump of 116% compared to last year Q1-08 and 20% increase compared to the preceding quarter. Operating Income is up 112% comparing corresponding quarter last year and 22% up comparing previous quarter. The Net profit has soared by 103% at Rs. 584.5 Mn.

The company has added 5 new Enterprise Clients across USA, Europe and Asia. Geodesic has been able to add 2,78,000 new retailer subscribers. Geodesic added a sum of 30 software engineers at Bangalore and Mumbai offices. During the quarter, one of its subsidiary, Chandamama launched its multilingual website. Earlier on 30th June 08, the 60th Anniversary Book of Chandamama was released by Mr. Amitabh Bachchan. The Anniversary book was received well and has gone for second round of printing. Farhan Ashhar, Chief Architect Net Telephony at Geodesic Information Systems said that the company is looking forward to developing low cost devices to provide IP phone services. The company already has its plans and services in place to be offered in the Indian market.

The Recent Development in the Telecom Industry to free Net Telephony is very Positive for Geodesic.

Recently TRAI's (Telecom Regulatory Authority of India) recommendation to Free Net Telephony has got Geodesic in a sweet spot. Its VoIP (Voice Over Internet Protocol) application, which is already available online can now be targeted in India. If the DoT (Department of Telecommunications) accepts the proposal then the ISP's (Internet Service Providers) will be allowed to provide VoIP services. The call rates for VoIP users is 1/6th of current charges. The calls made within the same provider can also be virtually Free.

Geodesic has recently launched its VoIP on Cell phones. The subscribers using Mundu services can use Mundu to make calls at fraction of the rates. The call made from Mundu to USA can be made at US 1.5 cents (0.60 p if \$=Rs. 40). Geodesic has list of call rates to countries around the world with specified charges mentioned on its website <http://speak.mundu.com/>. Geodesic has successfully launched these services on smart phone devices. To use VoIP service the user would require some kind of connectivity to the Internet which could be GPRS, 3G or WIMAX.

Geodesic is very well placed to grow further at a rapid pace. Picopeta, a subsidiary of Geodesic has developed a hand-held computer called Simputer, which has two USB ports, Internet accessibility with most of the CDMA phones, Card Reader and Writer. The Simputer is one of the most powerful hand held computers and is now under pilot testing by the government for the traffic police and all India national Cards scheme. The Chandamama subscriptions have seen a rise of 60% after the acquisition. Geodesic's innovative approach and model has helped it come a long way.

At the CMP of Rs. 175, Geodesic is trading at < 11x its FY08 earnings. This we feel is reasonable, given the high growth rates & the inflexion point for its VoIP venture. We intend to do a more detail coverage on the company. We presently hold a very optimistic view on the company & its prospects going ahead.

Geodesic Information Systems Limited - Financials

Earnings Statement					Balance Sheet				
Particulars (Rs Mn)	FY05	FY06	FY07	FY08	Particulars (Rs Mn)	FY05	FY06	FY07	FY08
Total Revenues	432.2	967.8	1,680.5	3,164.3	Equity Capital	103.4	117.2	118.3	184.3
- Growth (%)	147.4%	123.9%	73.6%	88.3%	Preference Capital	16.5	16.5	16.5	0.0
Total Expenditure	195.7	429.1	644.3	1,249.2	Share Application	19.3	39.9	193.1	18.4
Operating Profit	236.4	538.7	1,036.3	1,915.2	Reserves	398.1	1,875.3	2,821.7	4,556.9
Other Income	7.3	36.3	76.1	138.4	Shareholders Funds	537.3	2,048.8	3,149.6	4,759.6
EBITDA	243.7	575.1	1,112.4	2,053.6	Borrowed Funds	52.8	21.6	15.2	5,067.9
Depreciation	55.1	138.1	207.5	336.2	Deferred Tax Liability	12.8	25.2	1.5	(17.9)
EBIT	188.6	437.0	904.9	1,717.4	Minority Interest	0.0	0.1	0.2	2.8
Interest	0.2	1.5	1.2	74.3	Total Liabilities	602.8	2,095.8	3,166.5	9,812.4
PBT	188.4	435.5	903.7	1,643.1	Goodwill	0.0	247.8	247.8	134.1
Tax	7.8	23.0	(8.0)	157.1	Fixed Assets	157.0	498.7	944.2	1,546.0
PAT Before MI	180.6	412.6	911.6	1,486.1	Investments	46.7	522.6	138.6	232.8
Minority Interest	0.0	0.0	0.0	0.0	Inventory	2.9	1.0	0.1	0.3
PAT after MI	180.6	412.6	911.6	1,486.1	Sundry Debtors	156.5	233.6	616.7	1,042.8
- Growth (%)	129.4%	128.5%	121.0%	63.0%	Loans & Advances	34.5	203.7	274.2	943.8
Extraordinary Items	(1.4)	(10.1)	(13.4)	(0.6)	Cash & Bank Balance	364.9	398.5	1,062.9	6,360.7
Reported PAT	179.1	402.5	898.2	1,485.5	Other C.A. (Deposits)	5.5	0.0	0.0	0.0
					Current Liabilities	166.0	32.7	135.2	596.4
					Net Current Assets	398.2	804.2	1,818.6	7,751.2
					Misc. Exp.	1.0	22.6	17.3	148.2
					Total Assets	602.8	2,095.8	3,166.5	9,812.4
Ratio Analysis					Cash Flow				
Particulars	FY05	FY06	FY07	FY08	Particulars (Rs Mn)	FY05	FY06	FY07	FY08
OPM (%)	54.7%	55.7%	61.7%	60.5%	Opening Cash & Bank	81.6	364.9	398.5	1,062.9
EBITDA (%)	56.4%	59.4%	66.2%	64.9%	Profit After Tax	179.1	402.5	898.2	1,485.5
PBIT (%)	43.6%	45.0%	53.8%	51.9%	Invnt Income	(7.3)	(36.3)	(76.1)	(138.4)
PAT (%)	41.8%	42.6%	54.2%	47.0%	Interest Paid	0.2	1.5	1.2	74.3
Interest Cover (x)	1,047.6	296.7	772.1	23.1	Misc. Exp W/Off	0.1	5.6	5.7	11.9
EPS (Rs.)	3.5	7.0	15.4	16.1	Depreciation	55.1	138.1	207.5	336.2
P/E (x)	50.1	24.9	11.4	10.9	Deferred Taxation	2.2	12.1	(23.7)	(19.2)
P/BV (x)	16.9	5.1	3.3	3.5	Others	(5.0)	(309.5)	(23.5)	(30.2)
BVPS (Rs.)	10.4	34.6	52.9	50.0	Change in Working Cap	79.2	(372.4)	(350.1)	(634.8)
Market Cap (Rs. Mn.)	9,045.8	10,253.3	10,354.0	16,126.8	CF - Operating Activities	303.7	(158.5)	639.2	1,085.2
M Cap/Sales (x)	20.9	10.6	6.2	5.1	Change in Fixed Assets	(112.5)	(444.8)	(629.8)	(934.6)
EV (Rs. Mn.)	8,686.9	9,353.8	9,167.7	14,601.2	Change in Investments	72.9	(475.9)	384.0	(94.2)
EV/EBITDA (x)	35.6	16.3	8.2	7.1	Investment Income	7.3	36.3	76.1	138.4
EV/Sales (x)	20.1	9.7	5.5	4.6	CF - Investing Activities	(32.4)	(884.4)	(169.8)	(890.4)
ROCE (%)	31.3%	20.9%	28.6%	17.5%	Increase in Equity	(22.8)	1,135.8	230.0	205.8
RONW (%)	33.7%	20.4%	29.1%	32.2%	Changes in Pref Cap	0.0	0.0	0.0	(16.5)
Debt/Equity Ratio (x)	0.1	0.0	0.0	1.1	Changes in Borrowings	52.4	(31.1)	(6.4)	5,052.7
Inventory T/o Days	2.5	0.4	0.0	0.0	Interest Paid	(0.2)	(1.5)	(1.2)	(74.3)
Debtors T/o Days	132.1	88.1	134.0	120.3	Dividend Paid	(17.4)	(26.7)	(27.5)	(64.8)
Advances T/o Days	29.1	76.8	59.6	108.9	CF - Financing Activities	11.9	1,076.4	194.9	5,103.0
Creditors T/o Days	140.2	6.6	20.4	40.3	Net Change in Cash	283.3	33.6	664.4	5,297.8
WrkgCap(Ex-Cash)T/oDays	28.1	153.0	164.1	160.4	Closing Cash & Bank Bal	364.9	398.5	1,062.9	6,360.7
Fixed Assets T/o (Gross)	1.7	1.4	1.7	1.9					
DPS (Rs.)	0.3	0.4	0.4	0.6					
Dividend Payout (%)	8.5%	5.7%	2.6%	3.7%					
Dividend Yield (%)	0.2%	0.2%	0.2%	0.3%					

Infosys Ltd – Acquisition of Axon Group Plc.

CMP : Rs. 1709.0
Accumulate
Target - Rs. 1900.0

View Point

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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).

Local Equity Market						Top Gainers & Losers of the Week			
INDICES	30-Aug-08	Week Ago	% Chng	Month Ago	% Chng	Top Gainers		Aug 30, 08	% Chng
Sensex	14,564.53	14,401.49	1.13	14,355.75	1.45	Archies Ltd.		118.30	29.36
Nifty	4,360.00	4,327.45	0.75	4,332.95	0.62	Lumax Industries Ltd.		164.05	21.20
CNX Nifty Junior	7,138.30	6,956.50	2.61	6,936.80	2.90	Educomp Solutions Ltd.		3,770.85	18.05
S&P CNX500	3,489.05	3,459.75	0.85	3,456.70	0.94	Donear Industries Ltd.		44.25	12.60
CNX Midcap 200	5,698.95	5,647.50	0.91	5,536.95	2.93	Zandu Pharmaceutical Works Ltd.		17,377.40	12.57
CNX IT	3,926.80	3,829.40	2.54	3,752.85	4.64	Blue Star Infotech Ltd.		68.50	11.93
International Equity Market						Bank of Baroda		283.50	11.35
INDICES	30-Aug-08	Week Ago	% Chng	Month Ago	% Chng	Moser Baer India Ltd.		101.80	11.01
DJIA	11,543.55	11,628.06	(0.73)	11,378.02	1.45	Top Losers			
Nasdaq	2,367.52	2,414.71	(1.95)	2,325.55	1.80	Electrosteel Castings Ltd.		31.85	(12.14)
S&P 500	1,282.83	1,292.20	(0.73)	1,267.38	1.22	Indo Rama Synthetics Ltd.		23.35	(11.72)
FTSE 100	5,636.60	5,505.60	2.38	5,411.90	4.15	Micro Inks Ltd.		189.95	(10.61)
Nikkei 225	13,072.87	12,666.04	3.21	13,376.81	(2.27)	Hindalco Industries Ltd.		122.40	(9.10)
Hang Seng	21,261.89	20,392.06	4.27	22,731.10	(6.46)	Adani Enterprises Ltd.		588.50	(7.97)
HSCEI	11,664.43	10,916.50	6.85	12,506.74	(6.73)	Alstom Projects India Ltd.		379.85	(7.80)
MSCI Indices						Shree Renuka Sugars Ltd.		117.30	(7.67)
MSCI Indices	30-Aug-08	Week Ago	% Chng	Month Ago	% Chng	Triveni Engineering & Industries Ltd.		96.30	(7.40)
The World Index	1,344.86	1,337.53	0.55	1,351.91	(0.52)	Sectoral Performance			
Emerging Market	956.25	956.22	0.00	1,029.81	(7.14)	Sectors	Week	Month	3 Months
EM Asia	362.17	359.71	0.68	390.21	(7.19)	Printing And Publishing	5.11	8.10	(11.45)
EM India	409.67	410.64	(0.24)	426.11	(3.86)	Banks	4.09	7.27	(10.81)
Commodities						Refractories	3.24	17.52	(6.88)
Commodities	30-Aug-08	Week Ago	% Chng	Month Ago	% Chng	Computers - Hardware	3.00	5.49	(19.98)
GOLD (\$/oz)	831.15	823.05	0.98	914.07	(9.07)	Textile Products	2.67	(2.50)	(18.79)
SILVER (\$/oz)	13.61	13.36	1.87	17.75	(23.32)	Bearings	2.47	6.80	(5.18)
ALUMINIUM (\$/t)	2,714.00	2,790.00	(2.72)	2,979.00	(8.90)	Pesticides And Agrochemicals	2.40	12.00	4.64
COPPER (\$/t)	7,510.00	7,660.00	(1.96)	8,055.00	(6.77)	Abrasives	2.33	5.29	15.68
CRUDE - BRENT (\$/bbl)	114.05	113.92	0.11	125.11	(8.84)	Automobiles - 2 And 3 Wheelers	2.19	3.24	0.57
CRUDE - WTI (\$/bbl)	115.46	114.59	0.76	124.51	(7.27)	Diesel Engines	2.13	(0.59)	(13.23)
Transportation						Paints	2.08	1.25	(6.56)
Transportation	30-Aug-08	Week Ago	% Chng	Month Ago	% Chng	Finance - Housing	2.04	3.25	(5.53)
World SCALE	95.00	70.00	35.71	160.00	(40.63)	Computers - Software	1.59	2.75	(12.27)
BALTIC FREIGHT INDEX	6,809.00	7,147.00	(4.73)	8,341.00	(18.37)	Construction	1.43	2.22	(24.21)
Forex						Gas	1.42	6.02	(0.56)
FOREX	30-Aug-08	Week Ago	% Chng	Month Ago	% Chng	Personal Care	1.31	7.18	(3.84)
USD	43.94	43.43	1.18	42.57	3.21	Pharmaceuticals	1.22	2.08	0.16
GBP	80.04	80.51	(0.58)	84.30	(5.05)	Cigarettes	1.19	2.57	(7.93)
EURO	64.48	64.28	0.32	66.30	(2.74)	Travel And Transport	1.03	4.24	(0.23)
YEN	40.39	39.47	2.33	39.38	2.56	Finance	1.00	2.19	(14.10)
Global Listings						Inflation (%)			
Scripts	30-Aug-08	Week Chng	Month Chng	Premium/D iscount	Share per ADR/GDR	10 year G-Sec Bond Yield			
Infosys ADR	41.28	6.24	0.04	6.75%	1				
Wipro ADR	11.58	4.49	0.18	21.13%	1				
ICICI Bank ADR	31.02	1.24	0.01	2.25%	2				
Satyam ADR	22.26	0.28	0.17	22.61%	2				
HDFC Bank ADR	90.49	6.65	0.04	4.04%	3				
MTNL ADR	4.66	(6.05)	0.03	3.10%	2				
Dr. Reddy ADR	13.66	0.07	0.04	3.52%	1				
Reliance GDR	96.30	-	(0.01)	0.70%	2				
ITC GDR	4.20	(2.09)	(0.02)	0.93%	1				
Ranbaxy GDR	11.00	(2.24)	(0.07)	-5.19%	1				
L & T GDR	58.00	(3.83)	(0.02)	0.87%	1				

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