

Infosys

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Reuters: INFY.BO; Bloomberg: INFO IN

Much Improved Performance, But Priced In

Infosys' 3QFY13 revenue was better than expectations at US\$1,911mn, a growth of 6.3% QoQ (our estimate US\$1,872mn). Organic revenue growth, excluding Lodestone, was 4.2% QoQ (our estimate 1.9% QoQ). Margins were slightly below expectations (27bps below our estimate and 3bps below consensus estimates), while net profit was 2.4%/4.8% above our/consensus estimates, respectively. IT volume growth was 2% QoQ, with pricing 3.7% QoQ higher, aided by consulting revenue (up 15.6% QoQ due to Lodestone). Owing to better-than-expected revenue growth, the IT major marginally raised organic revenue guidance as against expectations of a cut (raised to 6.5% including Lodestone versus 5% earlier). Rupee EPS guidance has been raised to Rs162.80 (from Rs160.61 earlier). Thus, Infosys has performed ahead of expectations after many quarters. However, the huge 17% rally in the stock price today captures most of the upside, in our view, with the stock now trading at 15.3x FY14E EPS. We have retained our Sell rating on Infosys with a revised target price of Rs2,310 (from Rs2,120 earlier) as our target PE multiple has been raised to 13x (12x) following a 2% upgrade in FY14E dollar revenue.

Pricing drives revenue, volume below estimate: Infosys posted a 6.3% QoQ rise in dollar revenue at US\$1,911mn (our estimate US\$1,872mn); volume grew 2% QoQ (IT services), while pricing rose 3.7% QoQ on higher consulting business contribution due to Lodestone consolidation. Organic revenue growth was 4.2% QoQ (our estimate 1.9%). Excluding Lodestone, volume grew 1.5% QoQ. The company has positively surprised on the revenue front aided by deal ramp-up. For 4QFY12, the effective guidance is US\$1,990mn, implying growth of 4.1% QoQ (2.8% QoQ organic growth). From a vertical perspective, the financial services and insurance (FSI) vertical grew 6.4% QoQ, energy & utilities and communications & services (ECS) grew 8%, retail, logistics, CPG & life sciences (RCL) grew 6.5% and manufacturing (MFG) grew 4.5% QoQ.

Fall in margins restricted due to billing rate increase: Infosys reported a 64bps QoQ fall in margins at 28.5% (below our estimate by 27bps, below consensus estimates by 3bps) owing to offshore wage hike and rupee appreciation. However, the fall was cushioned owing to the increase in billing rates. Net profit was flat QoQ despite subdued other income (down 28.8% QoQ) due to a lower tax rate (25.5% versus 28.3% earlier).

Stock surge leaves little room for upside, retain Sell: While we believe Infosys' 3QFY13 revenue performance is heartening, the massive 17% surge in stock price today captures all the positives, in our view. Relatively speaking, Tata Consultancy Services now trades at a premium of 10% to Infosys, which in our view is fair. **We have retained our Sell rating on Infosys with a revised TP of Rs2,310 (Rs2,120 earlier) as our target PE multiple stands raised to 13x (12x) due to a 2% upgrade in FY14E dollar revenue.**

SELL

Sector: Information Technology

CMP: Rs2,713

Target Price: Rs2,310

Downside: 14.9%

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Key Data

Current Shares O/S (mn)	574.2
Mkt Cap (Rsbn/US\$bn)	1,557.4/28.4
52 Wk H / L (Rs)	2,981/2,061
Daily Vol. (3M NSE Avg.)	1,149,778

Price Performance (%)

	1 M	6 M	1 Yr
Infosys	18.2	9.8	(3.6)
Nifty Index	17.3	12.2	22.4

Source: Bloomberg

Y/E March (Rsmn)	3QFY12	2QFY13	3QFY13	QoQ (%)	YoY (%)	9MFY12	9MFY13	Chg (%)
Revenue	92,980	98,580	104,240	5.7	12.1	248,820	298,980	20.2
Software devt. Expenses	50,520	58,270	62,730	7.7	24.2	139,180	176,570	26.9
Gross profit	42,460	40,310	41,510	3.0	(2.2)	109,640	122,410	11.6
SG&A expenses	11,110	11,590	11,810	1.9	6.3	31,410	34,530	9.9
EBITDA	31,350	28,720	29,700	3.4	(5.3)	78,230	87,880	12.3
Depreciation	2,360	2,750	2,930	6.5	24.2	6,910	8,210	18.8
EBIT	28,990	25,970	26,770	3.1	(7.7)	71,320	79,670	11.7
Other income	4,220	7,060	5,030	(28.8)	19.2	12,520	16,850	34.6
Profit before tax	33,210	33,030	31,800	(3.7)	(4.2)	83,840	96,520	15.1
Tax	9,490	9,340	8,110	(13.2)	(14.5)	23,840	26,250	10.1
Net profit	23,720	23,690	23,690	0.0	(0.1)	60,000	70,270	17.1
Diluted EPS (Rs)	41.5	41.5	41.5	0.0	(0.1)	105.0	123.0	17.1
Gross profit margin (%)	45.7	40.9	39.8	-	-	44.1	40.9	-
EBITDA margin (%)	33.7	29.1	28.5	-	-	31.4	29.4	-
EBIT margin (%)	31.2	26.3	25.7	-	-	28.7	26.6	-
Net profit margin (%)	25.5	24.0	22.7	-	-	24.1	23.5	-

Source: Company, Nirmal Bang Institutional Equities Research

Y/E March (Rsmn)	FY10	FY11	FY12	FY13E	FY14E
Revenue	227,420	275,010	337,340	407,249	469,641
YoY (%)	4.8	20.9	22.7	20.7	15.3
EBITDA	78,520	89,640	107,160	117,411	129,804
EBITDA (%)	34.5	32.6	31.8	28.8	27.6
Adj. PAT	62,190	68,230	83,160	93,967	101,428
YoY (%)	4.1	9.7	21.9	13.0	7.9
FDEPS (Rs)	108.8	119.4	145.5	164.5	177.5
RoE (%)	28.7	27.1	27.4	26.0	23.9
RoCE (%)	25.1	23.1	22.9	21.3	19.7
P/E (x)	24.9	22.7	18.6	16.5	15.3
EV/EBITDA (x)	17.8	15.5	12.6	11.2	9.8

Source: Company, Bloomberg, Nirmal Bang Institutional Equities Research

Exhibit 1: Actuals versus our estimates, Bloomberg consensus estimates

(3QFY13)	Actuals	NBIE estimates	BBG consensus estimates	% variation from NBIE estimates	% variation from BBG consensus
Revenue (Rsmn)	104,240	101,394	100,677	2.8	3.5
EBITDA (Rsmn)	29,700	29,161	28,717	1.8	3.4
EBITDA margin (%)	28.5	28.8	28.5	(27)bps	(3)bps
Net profit (Rsmn)	23,690	23,139	22,611	2.4	4.8

Source: Company, Bloomberg, Nirmal Bang Institutional Equities Research

Key result data points

Volume and pricing – IT services and consulting

- Volume up 2% QoQ; onsite volume up 3.7% QoQ, while offshore volume up 1.3% QoQ
- Blended pricing up 3.7% QoQ; onsite rates up 3.7% QoQ, offshore rates up 2.3% QoQ
- Utilisation rate, including trainees, at 67.1%, down from 67.5% in 2QFY13
- Utilisation rate, excluding trainees, at 70.6%, down from 71.6% in 2QFY13.

Exhibit 2: IT service volume details

Hours worked (mn)	3QFY12	2QFY13	3QFY13	QoQ (%)	YoY (%)
Onsite	11.3	11.9	12.4	3.7	9.9
Offshore	27.8	30.4	30.7	1.3	10.7
Total	39.0	42.3	43.1	2.0	10.4

Source: Company

Service lines (US\$ terms)

- **Business operation services: Up 2.1% QoQ at US\$1,183mn, of which:**
 - Application development: Down 1.2% QoQ
 - Application maintenance: Down 0.6% QoQ
 - Testing services: Up 3.9% QoQ
 - Infrastructure management: Up 7.9% QoQ
 - Product engineering services: Up 0.1% QoQ
- **Business process management: Up 17.7% QoQ – Led by a strong India business performance (India geography up 43.3% QoQ, though on a low base, led by traction in the government space)**
- **Consulting and systems integration: Up 15.6% QoQ at US\$623mn – Aided by Lodestone impact of US\$39mn; nonetheless even excluding Lodestone, this segment grew 8.3% QoQ**
- **Products, platforms & solutions: Up 6.3% QoQ at US\$105mn, of which:**
 - **Product revenue: Up 9.1% QoQ – it could be noted that this comes after a 13.4% QoQ decline, indicating the lumpy nature of the business**
 - BPM platforms: Up 6.3% QoQ

Industry verticals (US\$ terms)

- FSI: Up 6.4% QoQ at US\$644mn
- MFG: Up 4.5% QoQ at US\$415mn
- RCL: Up 6.5% QoQ at US\$460mn
- ECS: Up 8% QoQ at US\$392mn

Geographies (US\$ terms)

- North America: Up 1.6% QoQ at US\$1,165mn
- **Europe: Up 16.8% QoQ at US\$459mn – aided by Lodestone; however, even excluding Lodestone, Europe grew 6.9% QoQ, a healthy performance**
- India: Up 43.3% QoQ at US\$43mn
- Rest of the World: Up 7.5% QoQ at US\$244mn

Employee data

- Gross addition of 8,390 employees, net addition at 1,868; total employee base at 155,629
- Standalone attrition rate rises slightly to 15.1% (15.0% in 2QFY13)

Exhibit 3: Earlier, revised guidance for FY13 – Lodestone aids revenue growth

(FY13E)	Earlier guidance	Revised guidance	Chg (%)
Revenue (US\$mn)	7,343	7,450	1.5
EPADS (US\$)	2.97	2.97	0.0
Revenue (Rsbn)	395.82	407.46	2.9
EPS (Rs)	160.61	162.80	1.4

Source: Company

Valuation

While we believe Infosys' 3QFY13 revenue performance is heartening, the massive 17% surge in the stock price today captures all the positives, in our view. Relatively speaking also, Tata Consultancy Services now trades at a premium of 10% to Infosys, which in our view is fair. **We have retained our Sell rating on Infosys with a revised TP of Rs2,310 (Rs2,120 earlier) as our target PE multiple stands raised to 13x (12x) due to a 2% upgrade in FY14E dollar revenue.**

Rating history

Date	Rating	Market price	Target price (Rs)
2 June 2011	Hold	2,812	2,900
1 July 2011	Sell	2,907	2,900
12 July 2011	Hold	2,794	2,875
12 August 2011	Sell	2,374	2,298
23 September 2011	Sell	2,354	2,338
30 September 2011	Sell	2,550	2,354
12 October 2011	Sell	2,681	2,378
23 November 2011	Hold	2,651	2,746
21 December 2011	Hold	2,667	2,755
2 January 2012	Buy	2,765	3,210
12 January 2012	Buy	2,588	3,125
30 March 2012	Hold	2,791	3,125
13 April 2012	Hold	2,403	2,438
17 May 2012	Hold	2,371	2,464
29 June 2012	Hold	2,472	2,473
12 July 2012	Sell	2,265	2,129
10 September 2012	Sell	2,493	2,323
4 October 2012	Sell	2,579	2,363
12 October 2012	Sell	2,396	2,120
7 January 2013	Sell	2,350	2,120

Disclaimer

Stock Ratings Absolute Returns

BUY > 15%

HOLD 0-15%

SELL < 0%

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