

Company

13 April 2010 | 10 pages

Infosys Technologies (INFY.BO)

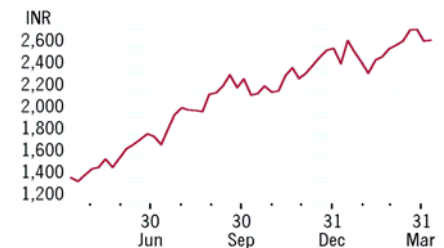
Equity

Hold: Earnings/Guidance – Good, but Is it Good Enough?

- Mixed guidance; Is it enough for further upgrades/rerating?** — Infosys guided to ~16-18% revenue growth (better than expectations) but flattish EPS of Rs107-111 (lower than expectations). While the guidance is mixed (strong top line for bulls and low margins for bears), we doubt if it is enough to drive meaningful upgrades/rerating for a stock trading at 22x FY11E EPS.
- Strong on top line; weaker on margins** — Infosys reported ~5.2% qoq revenue growth (~5.2% volume growth/10% growth in BPO/~35% qoq growth in products). Pricing declined ~70 bps (constant currency). EBITDA margin declined ~150bps (our exp: ~90bps decline). Reported net profit was Rs16b, in line. However, excluding gains on sale of investment (Rs.480m), it was lower than expectations.
- The positives** — (a) ~9% qoq growth in BFS (positive for TCS as well) (b) Good growth in package implementation/systems integration (c) 5 large transformational deals (2 of them > \$150m) signed. (d) Utilization (ex trainees) at ~76% - which is ~300bps from the highest level achieved in last 5 years. (e) M&A integration related projects still going strong (positive for TCS as well).
- The negatives** — (a) Offshore pricing declined ~170 bps qoq – is it lower price deals ramping up or a mix issue? (b) Telecom and insurance witnessed sluggish quarters (c) No special dividend (as expected by sections of the market) – dividend of Rs25 per share (against Rs23 per share yoy) (d) Wage hikes of ~15% offshore and high attrition – highlighting supply-side challenges for the sector.
- Business momentum good; Margins/valuations keep us at Hold** — Business momentum remains strong – which is likely to protect downside on the stock. However, margin pressures due to INR/wages were highlighted in the guidance – remains our key concern. We think the margin concerns and valuations (22x FY11E EPS) will limit any meaningful upside on the stock – maintain Hold. Awaiting more details in the earnings call at 1400 hrs India time.

Hold/Low Risk	2L
Price (13 Apr 10)	Rs2,685.00
Target price	Rs2,785.00
Expected share price return	3.7%
Expected dividend yield	1.3%
Expected total return	5.0%
Market Cap	Rs1,539,942M US\$34,617M

Price Performance (RIC: INFY.BO, BB: INFO IN)



Statistical Abstract

Year to	Net Profit	Diluted EPS	EPS growth	P/E	P/B	ROE	Yield
31 Mar	(RsM)	(Rs)	(%)	(x)	(x)	(%)	(%)
2008A	46,590	81.26	19.9	33.0	11.1	37.2	1.2
2009A	59,880	104.42	28.5	25.7	8.4	37.4	0.9
2010E	62,460	108.84	4.2	24.7	6.8	30.5	1.2
2011E	69,786	121.58	11.7	22.1	5.6	27.8	1.3
2012E	80,735	140.65	15.7	19.1	4.6	26.5	1.6

Source: Powered by dataCentral

Surendra Goyal, CFA

+91-22-6631-9870
surendra.goyal@citi.com

Vishal Agarwal

+91-22-6616-2742
vishal1.agarwal@citi.com

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Other Key Highlights

- Revenues were \$1.3b, up ~5% QoQ (CIRA expectations: \$1.27b).
- EBITDA margins of 34% (CIRA expectations: 34.6%) – decline of ~150 bps sequentially. EBITDA of Rs20.2b was in line with our expectations.
- Net profit of Rs16b (CIRA expectations: Rs16b) – in line. However, this was supported by ~Rs. 480m from sale of investments. Excluding that, net profits would have been below our expectations.
- Constant currency pricing declined ~70 bps QoQ on a blended basis – onsite was flattish while offshore was down 1.5%.
- Volumes increased 5.2% sequentially on a blended basis – similar across onsite and offshore.
- Headcount increased by ~3,900 employees on a net basis.
- Manufacturing rebounded strongly with ~10% qoq growth while BFS remained strong at ~9% qoq. Telecom (large client issue) and insurance (-5% qoq) were sluggish in the quarter.
- Consulting services and package implementation as well as systems integration witnessed strong double digit growth in 4Q – highlighting return of discretionary spending. Application development and maintenance had a sluggish quarter on a sequential basis.
- Growth was largely led by the non-Top-10 clients with growth at ~8% QoQ
- FY11 guidance is for 16-18% revenue growth (\$-terms) and Rs. 107-111 on EPS (flattish yoy at the mid point). Margin decline implied in the guidance is ~150 bps yoy. Management has factored in ~550bps margin pressure on account of wages/currency out of which they should be able to offset ~400bps due to operational efficiencies.
- No major change in the hedge cover - ~\$515m at the end of Q4.

Result Tables

Figure 1. Key Financials

Rs m	4Q09	3Q10	4Q10	QoQ	YoY
Revenue (US\$ m)	1,121	1,232	1,296	5.2%	15.6%
Revenue	56,350	57,410	59,440	3.5%	5.5%
Cost of revenue	30,450	30,090	31,840	5.8%	4.6%
Gross profit	25,900	27,320	27,600	1.0%	6.6%
Gross margin	46.0%	47.6%	46.4%	-115bp	47bp
Operating expenses	6,990	6,940	7,380	6.3%	5.6%
EBITDA	18,910	20,380	20,220	-0.8%	6.9%
EBITDA margin	33.6%	35.5%	34.0%	-148bp	46bp
Depreciation & amortization	2,280	2,310	2,200	-4.8%	-3.5%
EBIT	16,630	18,070	18,020	-0.3%	8.4%
EBIT margin	29.5%	31.5%	30.3%	-116bp	80bp
Other income	2,520	2,300	2,560	11.3%	1.6%
Profit before tax	19,150	20,370	20,580	1.0%	7.5%
Income tax expense	3,020	4,550	4,410	-3.1%	46.0%
Income from operations	16,130	15,820	16,170	2.2%	0.2%
Affiliates/Minority	0	0	0	NA	NA
Net income - recurring	16,130	15,820	16,170	2.2%	0.2%
EO income/(loss)	0	0	0	NA	NA
Net profit	16,130	15,820	16,170	2.2%	0.2%
EPS - basic	28.16	27.59	28.33	2.7%	0.6%
EPS - fully diluted	28.13	27.56	28.30	2.7%	0.6%

Source: Company Reports

Figure 2. FY11 Guidance

	Guidance		Implied Growth	
	Lower	Upper	Lower	Upper
Revenue (Rs m)	247,960	252,390	9.0%	11.0%
Revenue (\$ m)	5,570	5,670	15.9%	18.0%
EPS - basic (Rs)	106.82	111.28	-2.4%	1.7%
INR/\$ assumption		44.50		

Source: Company Reports

Figure 3. 1QFY11 Guidance

	Guidance		Implied Growth	
	Lower	Upper	Lower	Upper
Revenue (Rs m)	59,190	59,630	-0.4%	0.3%
Revenue (\$ m)	1,330	1,340	2.6%	3.4%
EPS - basic (Rs)	24.34	24.79	-14.1%	-12.5%

Source: Company Reports

Figure 4. Key Client Metrics

	1Q10	2Q10	3Q10	4Q10
Active Clients	569	571	568	575
Added during the period	27	35	32	47
\$1m+ clients	330	330	336	338
\$5m+ clients	151	150	152	159
\$10m+ clients	104	96	93	97
\$20m+ clients	61	59	60	59
\$30m+ clients	45	41	41	41
\$50m+ clients	19	21	22	26
\$70m+ clients	12	11	12	12
\$100m+ clients	4	5	6	6
\$200m+ clients	1	1	2	1
Clients > 5% of revenue	0	0	0	0
Revenue - top client	4.5%	4.6%	4.7%	4.6%
Revenue - top 5 client	16.3%	16.5%	17.6%	15.8%
Revenue - top 10 client	25.8%	26.2%	27.5%	25.8%
Repeat Business	98.7%	98.0%	97.0%	95.4%
DSO - TTM (in days)	56	56	57	59

Source: Company Reports

Figure 5. Revenue Mix

	1Q10	2Q10	3Q10	4Q10
Geographic wise				
North America	64.7%	65.9%	66.6%	66.1%
Europe	24.7%	23.2%	21.9%	22.5%
India	0.9%	1.2%	1.2%	1.4%
RoW	9.7%	9.7%	10.3%	10.0%
Service line wise				
Application development	19.3%	18.1%	17.8%	16.8%
Application maintenance	23.2%	22.7%	24.5%	22.8%
BPO	6.1%	6.2%	5.9%	6.2%
Consulting & PI	24.4%	23.8%	23.3%	26.0%
Infrastructure Management	6.6%	7.8%	7.1%	7.2%
Product Engg Services	2.4%	2.3%	2.4%	1.8%
System Integration	3.8%	4.4%	4.1%	4.5%
Testing Services	6.2%	6.2%	6.5%	6.6%
Others	4.0%	4.4%	4.5%	3.1%
Products	4.0%	4.1%	3.9%	5.0%
Vertical wise				
Insurance	7.1%	7.4%	8.5%	7.7%
Banking & FS	25.9%	26.1%	26.1%	27.1%
Manufacturing	20.5%	19.3%	19.3%	20.2%
Retail	13.2%	14.1%	13.1%	13.0%
Telecom	16.9%	16.2%	16.2%	15.3%
Energy & Utilities	5.7%	5.9%	6.1%	5.8%
Transportation & Logistics	2.3%	2.3%	1.8%	1.8%
Services	4.9%	5.0%	5.1%	4.9%
Others	3.5%	3.7%	3.8%	4.2%

Source: Company Reports

Figure 6. Key HR Metrics

	1Q10	2Q10	3Q10	4Q10
IT and BPO professionals	96,334	97,594	103,476	106,864
- Billable	88,061	87,798	89,086	93,254
- Banking Business Unit	2,664	2,800	4,345	4,730
- Trainees	5,609	6,996	10,045	8,880
Sales & support	7,571	7,859	6,406	6,932
Total employees	103,905	105,453	109,882	113,796
Gross addition	3,538	6,069	8,719	9,313
Net addition	-945	1,548	4,429	3,914
Attrition% (TTM) - SA	11.1%	10.9%	11.6%	13.4%
Utilization				
- including trainees	67.0%	67.3%	68.8%	69.3%
- excluding trainees	70.9%	73.2%	76.2%	77.1%

Source: Company Reports

Figure 7. Key Execution Metrics

	1Q10	2Q10	3Q10	4Q10
Infosys consolidated				
Billed effort (person-mths)	195,725	198,511	208,980	218,687
- Onsite	44,458	44,804	46,925	49,347
- Offshore	151,267	153,707	162,055	169,340
Billed effort distribution (%)				
- Onsite	22.7%	22.6%	22.5%	22.6%
- Offshore	77.3%	77.4%	77.5%	77.4%
Revenue distribution (%)				
- Onsite	46.4%	46.0%	46.1%	46.0%
- Offshore	53.6%	54.0%	53.9%	54.0%
IT Services				
Billed effort distribution (person-mths)	149,961	153,388	162,755	171,232
- Onsite	44,231	44,435	46,686	49,183
- Offshore	105,730	108,953	116,069	122,049
Billed effort distribution (%)				
- Onsite	29.5%	29.0%	28.7%	28.7%
- Offshore	70.5%	71.0%	71.3%	71.3%
Revenue distribution (%)				
- Onsite	51.4%	50.9%	50.9%	51.5%
- Offshore	48.6%	49.1%	49.1%	48.5%

Source: Company Reports

Infosys Technologies

Company description

Infosys is the second-largest Indian IT services company with more than 100,000 professionals, and is a leader in the offshore services space. Infosys provides business consulting, application development & maintenance and engineering services to ~570 active clients across verticals such as Banking, Financial Services, Insurance, Retail, Manufacturing and Utilities in the Americas, Europe and Asia Pacific. Infosys also sells a core banking application, Finacle, which is used by leading banks in India, the Middle East, Africa and Europe. Its subsidiary, Infosys BPO, which employs more than 16,000 people, is a provider of BPO services.

Investment strategy

We rate Infosys shares as Hold/Low Risk (2L) for valuation reasons. We are positive on the company's fundamentals. Offshore IT outsourcing has become a mainstream option, and we think that scale and scalability, along with an ability to move up the value chain, are key criteria for successful offshore vendors. In this respect, Infosys appears well positioned and continues to gain ground given its strong branding and industry-leading sales force. We expect Infosys to deliver a revenue CAGR of ~11% (\$ terms) and an earnings CAGR of ~9% for FY09-12E. Unlike other high-growth firms in other industries, Infosys continues to generate solid FCF and its RoE of ~30% remains well above its cost of capital.

Valuation

Our Rs2,785 target price is based on 23x-24x FY11E EPS. This is around the mid-point of the last 3-year trading band of 11x-30x 12-month forward earnings and factors in some deceleration in growth. Our estimates continue to assume a certain P/E premium to the market; this is justified, in our view, given the strong FCF and ROIC for Infosys vs. the overall market. We believe P/E remains the most appropriate valuation measure given Infosys' profitability record and higher earnings visibility.

Risks

We rate Infosys Low Risk given its superior branding, management quality and cost optimization abilities. This is in line with our quantitative risk-rating system, which tracks 260-day historical share price volatility. Key downside risks to our target price include: 1) any significant appreciation of the rupee against the USD/EUR/GBP; 2) pressure on billing rates (as Infosys still continues to enjoy a 10-15% premium in its billing rates); 3) a prolonged slowdown in the US economy; and 4) limited H1B visas. Key upside risks include: 1) any significant depreciation of the rupee against the USD/EUR/GBP; and 2) a pickup in the US/Global economy.

Appendix A-1

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Infosys Technologies (INFY.BO)

Ratings and Target Price History

Fundamental Research

Analyst: Surendra Goyal, CFA

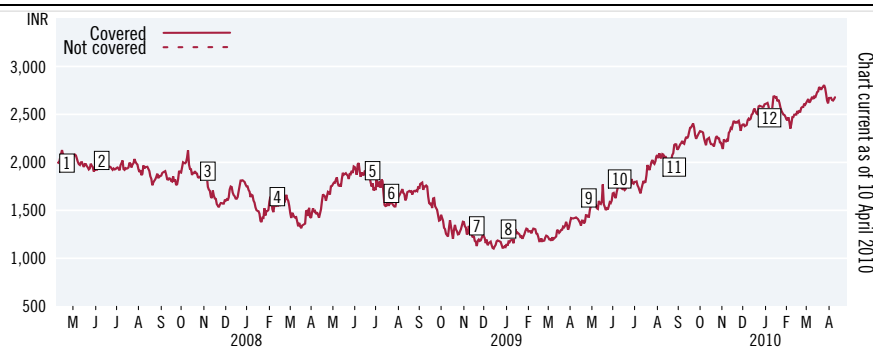


Chart current as of 10 April 2010

	Date	Rating	Target Price	Closing Price
1	23-Apr-07	1L	*2,580.00	2,067.55
2	10-Jun-07	1L	*2,440.00	1,951.05
3	7-Nov-07	1L	*2,190.00	1,743.85
4	13-Feb-08	*1M	*2,060.00	1,549.15

	Date	Rating	Target Price	Closing Price
5	26-Jun-08	1M	*2,175.00	1,781.85
6	23-Jul-08	1M	*1,910.00	1,603.70
7	20-Nov-08	1M	*1,420.00	1,127.25
8	4-Jan-09	1M	*1,350.00	1,130.95

	Date	Rating	Target Price	Closing Price
9	28-Apr-09	*1L	*1,650.00	1,431.55
10	10-Jun-09	1L	*2,060.00	1,803.25
11	26-Aug-09	*2L	*2,290.00	2,181.35
12	7-Jan-10	2L	*2,785.00	2,525.25

* Indicates change

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