

## Infosys Technologies Ltd

### Q3FY11 results below expectations; US\$ guidance muted

**Infosys reported Q3FY11 below expectations.** Revenues grew 2.3% QoQ in Re and 6% Q/Q in USD terms (4.7% in CC) driven by 1) 3% Q/Q volume growth (vs. 7%QoQ expectations), 2) offshore pricing improvement of 2.6% QoQ (1.6% blended QoQ) and 3) cross currency benefits. Margins were flat QoQ despite currency headwinds, led by improvement in pricing. Overall, EPS at Rs 31/share was up 2.5% Q/Q largely inline with our expectations, but below street numbers.

**Metrics -** 1) Pricing improved 2.6% offshore (1.4% CC), 2) Reported attrition was at 17.5% flat QoQ and net addition was lower at 5,311 (7,646 in Q2), 3) Utilisation edged lower to 71% (74% in 2QFY11), 4) Europe saw a soft 3.7% CC QoQ growth, while Americas growth came off to 4.2% CC (7.5% CC in 2Q).

**Guidance soft, beating expectations remains a challenge:** The volume growth this quarter was below expectations and with cautious commentary, the management is guiding to 2% US\$ revenue growth in 4QFY11 and ~26% growth for FY11 (25% earlier). Full year rupee EPS guidance was increased only marginally to Rs 118-119/share (Rs 115-Rs 117 earlier) due to modest volume growth and rupee appreciation. We believe it might be difficult to meet the FY11 street expectations of Rs122-125, as it would imply c10% QoQ EPS growth in 4QFY11. We continue to believe that consensus estimates are already too high and there could in fact EPS downgrades.

**Takeaways:** Infosys results and management commentary highlight the macro risks and soft volume traction is a negative surprise. We believe that TCS and Wipro could see similar volume challenges and EPS growth to be largely inline with Infosys. Additionally we believe that results also indicate that earnings expectations remain high.

**Investment View:** Overall a disappointing quarter from Infosys with soft volume growth and a muted guidance for 4QFY11. While the near term demand momentum remains good, we believe that expectations are running ahead of on ground fundamentals. Further post the recent upgrades consensus estimates factor in strong volume momentum in FY12/FY13 and we believe that there is limited comfort at current valuations (P/E ) of 28x/23x on FY11E/FY12E. We do not expect any material change to our estimates and maintain our Neutral view on Infosys.

#### What's New? Target Rating Estimates

CMP	TARGET	RATING	RISK
Rs 3,377	Rs 3,200	HOLD	LOW

BSE	NSE	BLOOMBERG
500209	INFOSYSTCH	INFO IN

#### Company data

Market cap (Rs mn / US\$ mn)	1,939,008 / 42,963
Outstanding equity shares (mn)	574
Free float (%)	78.6
Dividend yield (%)	0.7
52-week high/low (Rs)	3499 / 2306
2-month average daily volume	869,260

#### Stock performance

Returns (%)	CMP	1-mth	3-mth	6-mth
Infosys	3,377	7.4	10.9	17.8
CNX IT	7,324	6.6	8.9	18.4
Sensex	19,534	0.1	(3.3)	8.9

#### Valuation matrix

(x)	FY10	FY11E	FY12E	FY13E
P/E @ CMP	31.0	27.9	23.3	20.1
P/E @ Target	29.4	26.4	22.1	19.0
EV/EBITDA @ CMP	23.9	19.5	16.0	14.0

In the interest of timeliness this report has not been edited.

#### Financial highlights

(US\$ mn)	FY10	FY11E	FY12E	FY13E
Revenue	4,804	6,143	7,527	8,910
Growth (%)	3.0	27.9	22.5	18.4
Adj net income	1,313	1,531	1,863	2,160
Growth (%)	4.8	16.6	21.6	16.0
FDEPS (Rs)	108.8	121.2	145.1	168.2
Growth (%)	6.6	11.4	19.7	16.0

#### Profitability and return ratios

(%)	FY10	FY11E	FY12E	FY13E
EBITDA margin	34.4	33.0	32.8	31.6
EBIT margin	30.4	29.8	29.8	28.8
Adj PAT margin	27.3	24.9	24.8	24.2
ROE	28.7	26.1	26.3	24.5
ROIC	51.7	51.6	49.7	46.6
ROCE	52.0	51.0	53.1	54.7





## Q3FY11 highlights

- ❖ Infosys reported dollar revenue growth of 5.9% QoQ for Q3FY11. Volume growth was at 3% QoQ; and pricing improved 0.5% QoQ in constant currency.
- ❖ Pricing was down 1.4% QoQ CC for offshore and up 0.2% CC QoQ for onsite projects with blended rates up 0.5% QoQ CC.
- ❖ North America grew 4.2% QoQ CC; while Europe up 3.7% in CC.
- ❖ The proportion of fixed price contracts was at 43.3% compared to 42% in the preceding quarter.
- ❖ In terms of verticals, BFSI revenues grew 7.1% QoQ in constant currency and manufacturing grew 8.6% QoQ (CC) while retail grew 5.8% (CC) and telecom declined 3.9% CC.
- ❖ Infosys added 5,311 employees (net), taking its total employee base to 127,779.
- ❖ Attrition inched up to 17.5% during the quarter from 17.1% in Q2FY11.
- ❖ Utilisation moved down to 80.5% excluding trainees and 71% including trainees.
- ❖ **EBIT margins was flat QoQ.**
- ❖ Client additions for the quarter numbered 40 versus 27 in the previous quarter.
- ❖ Net profit grew 2.5% QoQ in rupee terms and 6.1% QoQ in dollar terms.
- ❖ Cash balances totalled US\$ 3.3bn.

Fig 1 - Infosys: Quarterly P&L

Consolidated (Rs mn)	Q3FY09	Q4FY09	Q1FY10	Q2FY10	Q3FY10	Q4FY10	Q1FY11	Q2FY11	Q3FY11
<b>Sales</b>	<b>57,860</b>	<b>56,350</b>	<b>54,720</b>	<b>55,850</b>	<b>57,410</b>	<b>59,440</b>	<b>61,980</b>	<b>69,470</b>	<b>71,060</b>
<b>Gross Profit</b>	<b>27,110</b>	<b>25,900</b>	<b>25,570</b>	<b>26,220</b>	<b>27,320</b>	<b>27,600</b>	<b>27,700</b>	<b>31,930</b>	<b>32,590</b>
<b>Gross margin (%)</b>	<b>46.9</b>	<b>46.0</b>	<b>46.7</b>	<b>46.9</b>	<b>47.6</b>	<b>46.4</b>	<b>44.7</b>	<b>46.0</b>	<b>45.9</b>
Selling and marketing	2,740	2,700	2,610	2,760	3,140	3,330	3,390	3,800	3,930
General and administrative	4,060	4,290	4,280	4,130	3,800	4,050	4,560	4,980	5,030
<b>EBITDA</b>	<b>20,310</b>	<b>18,910</b>	<b>18,680</b>	<b>19,330</b>	<b>20,380</b>	<b>20,220</b>	<b>19,750</b>	<b>23,150</b>	<b>23,630</b>
<b>EBITDA margin (%)</b>	<b>35.1</b>	<b>33.6</b>	<b>34.1</b>	<b>34.6</b>	<b>35.5</b>	<b>34.0</b>	<b>31.9</b>	<b>33.3</b>	<b>33.3</b>
<b>EBIT</b>	<b>18,440</b>	<b>16,630</b>	<b>16,460</b>	<b>17,010</b>	<b>18,070</b>	<b>18,020</b>	<b>17,550</b>	<b>20,980</b>	<b>21,470</b>
Other Income	400	2,520	2,690	2,360	2,300	1,980	2,390	2,670	2,900
Depreciation	1,870	2,280	2,220	2,320	2,310	2,200	2,200	2,170	2,160
Provision for investments						(100)			
<b>PBT</b>	<b>18,840</b>	<b>19,150</b>	<b>19,150</b>	<b>19,370</b>	<b>20,370</b>	<b>20,100</b>	<b>19,940</b>	<b>23,650</b>	<b>24,370</b>
Tax	3,030	3,170	3,880	3,970	4,550	4,410	5,060	6,280	6,570
<b>Adj. PAT</b>	<b>15,810</b>	<b>15,980</b>	<b>15,270</b>	<b>15,400</b>	<b>15,820</b>	<b>16,170</b>	<b>14,880</b>	<b>17,370</b>	<b>17,800</b>
<b>NPM (%)</b>	<b>27.3</b>	<b>28.4</b>	<b>27.9</b>	<b>27.6</b>	<b>27.6</b>	<b>26.4</b>	<b>24.0</b>	<b>25.0</b>	<b>25.0</b>
<b>EPS</b>	<b>27.6</b>	<b>27.90</b>	<b>26.65</b>	<b>26.87</b>	<b>27.70</b>	<b>28.30</b>	<b>26.05</b>	<b>30.40</b>	<b>31.15</b>
<b>Q-o-Q (%)</b>									
<b>Sales</b>	<b>6.8</b>	<b>(2.6)</b>	<b>(2.9)</b>	<b>2.1</b>	<b>2.8</b>	<b>3.5</b>	<b>4.3</b>	<b>12.1</b>	<b>2.3</b>
<b>Operating profit</b>	<b>13.2</b>	<b>(6.9)</b>	<b>(1.2)</b>	<b>3.5</b>	<b>5.4</b>	<b>(0.8)</b>	<b>(2.3)</b>	<b>18.0</b>	<b>2.1</b>
<b>EBITDA</b>	<b>14.0</b>	<b>(9.8)</b>	<b>(1.0)</b>	<b>3.3</b>	<b>6.2</b>	<b>(0.3)</b>	<b>(2.6)</b>	<b>19.5</b>	<b>2.3</b>
PBT	11.9	1.6	0.0	1.1	5.2	(1.3)	(0.8)	18.6	3.0
<b>PAT</b>	<b>10.4</b>	<b>1.1</b>	<b>(4.4)</b>	<b>0.9</b>	<b>2.7</b>	<b>(0.8)</b>	<b>(5.2)</b>	<b>16.7</b>	<b>2.5</b>
<b>EPS (Rs)</b>	<b>10.4</b>	<b>1.1</b>	<b>(4.5)</b>	<b>0.8</b>	<b>3.1</b>	<b>2.2</b>	<b>(8.0)</b>	<b>16.7</b>	<b>2.5</b>
Shares outstanding	573	573	573	573	571	571	571	571	571

Source: Company



## Guidance

### Rupee

- ❖ **FY11:** Infosys has guided for revenue of Rs 274bn–275bn, a growth of 20.5–20.8% YoY, and EPS of Rs 118.7–118.9, a growth of 8.9–9.1% YoY. Excluding the impact of a one-time sale of its investment in OnMobile, EPS growth is expected to be between 9.7–9.9%.
- ❖ **Q4FY11:** The management has guided towards revenue of Rs 71.6bn–72.3bn, implying a 0.7–1.7% growth QoQ, and EPS of Rs 31.06–31.28 up -0.3%-0.4% QoQ.

**Fig 2 - Infosys : Rupee guidance**

(Rs mn)	Q1FY11	Q2FY11	Q3FY11	Q4FY11E	FY11E	% Chg YoY
Revenue	<b>61,980</b>	<b>69,470</b>	71,060	72,300	274,810	<b>21</b>
QoQ growth (%)	4.3%	12.1%	2.3%	1.7%		
Profit	<b>14,886</b>	17,370	17,800	17,880	67,926	<b>9</b>
QoQ growth (%)	-8%	16.7%	2.5%	0.4%		

Source: Company

### US dollar

- ❖ **FY11:** Infosys has guided for revenue of US\$ 6.04bn–6.06bn, a growth of 25.7–26.1% YoY, and EPS of US\$ 2.6–2.61, a growth of 13–13.5% YoY. Excluding the OnMobile investment sale, EPS growth is expected to be between 14–14.5%.
- ❖ **Q4FY11:** For Q4FY11, revenues are guided to be in the range of US\$ 1,601mn–1,617mn, up 1–2% QoQ, with an EPS of US\$ 0.69–0.7, flat–1.4% QoQ.

**Fig 3 - Infosys: US\$ guidance**

(US\$ mn)	Q1FY11	Q2FY11	Q3FY11	Q4FY11E	FY11E	% Chg YoY
Revenue	1,358	1,496	1,585	1,617	6,060	26
QoQ growth (%)	4.8%	10.2%	5.9%	2.0%		
Profit	326	374	397	400	1,491	13
QoQ growth (%)	-6.7%	14.9%	6.1%	0.7%		

Source: Company



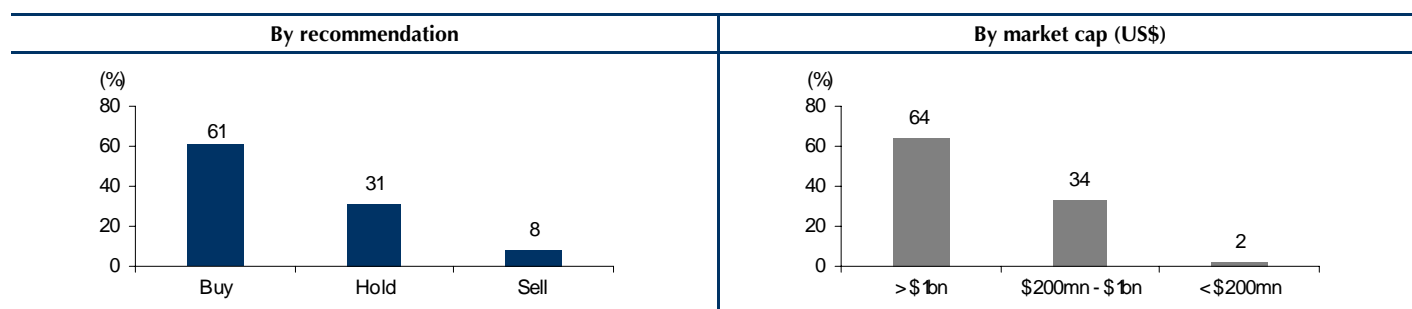
Fig 4 - Infosys : Quarterly metrics

	Q3FY09	Q4FY09	Q1FY10	Q2FY10	Q3FY10	Q4FY10	Q1FY11	Q2FY11	Q3FY11
Top client (%)	6.2	5.7	4.5	4.6	4.7	4.6	4.9	4.7	4.6
Top 5 (%)	17.3	17.2	16.3	16.5	17.6	15.8	15.4	15.8	15.4
Top 10 (%)	27.2	26.8	25.8	26.2	27.5	25.8	26.1	26.7	25.7
Non-top 10	72.8	73.2	74.2	73.8	72.5	74.2	73.9	73.3	74.3
Fixed Price (%)	38.4	40.5	40.7	40.4	40.6	41.9	41.1	39.9*	41.2
Time & Materials (%)	61.6	59.5	59.3	59.6	59.4	58.1	58.9	60.1	58.8
New clients added	30	37	27	35	32	47	38	27	40
Repeat business (%)	97.1	95.9	98.7	98.0	97.0	95.4	99.4	98.4	97.6
Total active clients	583	579	569	569	568	575	590	592	612
Clients lost	33	41	37	35	33	40	23	25	20
<b>Clients</b>									
>US\$ 1mn	323	327	330	330	336	338	341	337	350
>US\$ 5mn	150	151	151	151	152	159	170	173	180
>US\$ 10mn	102	101	104	104	93	97	103	113	121
>US\$ 20mn	58	59	61	61	60	59	60	66	68
>US\$ 30mn	37	39	45	45	41	41	43	48	47
>US\$ 40mn	26	30	30	30	33	33	34	37	39
>US\$ 50mn	20	20	19	19	22	26	26	27	29
>US\$ 60mn	17	16	15	15	14	16	17	18	22
>US\$ 70mn	13	12	12	12	12	12	13	15	17
>US\$ 80mn	11	10	11	11	9	10	11	12	12
>US\$ 90mn	7	7	6	6	7	8	10	11	11
>US\$ 100mn	4	4	4	4	6	6	8	10	11
>US\$ 200mn	1	1	1	1	2	1	1	2	2
>US\$ 300mn	1	1	0	0	0	0	0	0	0
Attrition (%)	11.8	11.1	11.1	10.9	11.6	13.4	15.8	17.1	17.5
Application development and maintenance (%)	43	41	43	41	42	40	41	39	38
Application development (%)	21	19	19	18	18	17	17	16	16
Application maintenance (%)	22	22	23	23	25	23	24	24	23
Business Process Management (%)	6	6	6	6	6	6	6	6	6
Consulting Services and Package Implementation (%)	25	25	24	24	23	26	25	26	26
Infrastructure Management (%)	7	7	7	8	7	7	7	6	6
Product Engineering Services (%)	2	3	2	2	2	2	2	3	3
System Integration (%)	4	4	4	4	4	5	4	6	6
Testing Services (%)	7	6	6	6	7	7	7	8	8
Others (%)	3	4	4	4	5	3	3	3	3
Product revenues (%)	4	4	4	4	4	5	5	4	5
BFSI (%)	34.9	33.0	33.0	33.5	34.6	34.8	36.1	<b>35.4</b>	36.2
Manufacturing (%)	19.6	20.8	20.5	19.3	19.3	20.2	19.5	18.9	19.6
Telecom (%)	16.7	16.7	16.9	16.2	16.2	15.3	14.1	13.3	12.5
Retailing (%)	12.6	13.5	13.2	14.1	13.1	13.0	13.2	14.4	14.5
Energy & Utilities (%)	6.2	5.9	5.7	5.9	6.1	5.8	6.0	6.3	6.1
Transportation & logistics (%)	2.2	2.3	2.3	2.3	1.8	1.8	1.8	1.8	1.8
Services (%)	5.4	5.0	4.9	5.0	5.1	4.9	4.8	5.2	5.0
Others (%)	2.4	2.8	3.5	3.7	3.8	4.2	4.5	4.7	4.3

Source: Company \* incl. products



### Coverage Profile



### Recommendation interpretation

Recommendation	Expected absolute returns (%) over 12 months
Buy	More than 15%
Hold	Between 15% and -5%
Sell	Less than -5%

Recommendation structure changed with effect from March 1, 2009

Expected absolute returns are based on share price at market close unless otherwise stated. Stock recommendations are based on absolute upside (downside) and have a 12-month horizon. Our target price represents the fair value of the stock based upon the analyst's discretion. We note that future price fluctuations could lead to a temporary mismatch between upside/downside for a stock and our recommendation.

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