



Results Flash

Infosys INFO IN

INDIA / SOFTWARE & SERVICES

TARGET INR4,000.00
CLOSE INR3,377.30
UP/DOWNSIDE +18.4%

BUY

Look beyond 3Q

- 3Q miss on muted volumes, higher taxes
- Marginal Street EPS cuts likely in the near-term, but retain BUY
- Macro data, deal flow point to a solid FY12
- Expect market to look beyond initial disappointment as in 1Q, 2Q



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Lower-than-expected 3Q results

Infosys's 3QFY11 results were marginally disappointing with USD revenue growth of 5.9% q-q (BNPP: 6.7%). The EBIT margin was 30.2%, about 50bps below our estimate, as the lower revenue would have led to fewer scale benefits. That and increased tax rates (27% vs BNPP: 25%) led to a 4% EPS miss.

But FY12 to be a "normal year"

Part of the management commentary was characteristically guarded on demand, but the company also noted that it expects a "normal year" (read 18-20% industry

growth, with Infosys aiming to grow faster) in FY12. Given this, our FY12E USD revenue growth of 26% does not look aggressive. Recall Infosys has beaten its initial revenue and EPS guidance by an average of 6% and 9%, respectively, since FY02. Management noted the company had won four USD50m-100m deals in 3Q, with another 12 USD100m-300m deals in the pipeline. We believe that all this does not add up to management's tepid 1-2% q-q 4QFY11 revenue growth guidance, which we see as conservative.

Why did revenue miss expectations?

The disappointment in revenue came from relatively muted volume growth of only 3.1% q-q, but in hindsight, it appears that the Street (and us) should have paid more heed to management's warning of weak 3Q seasonality. One extra holiday can impact q-q growth by about 1.5ppts. On the positive side, however, realizations improved 0.3% q-q in constant currency (1.5% in USD terms) on a favourable mix and the company possibly somewhat passing on cost-of-living adjustments to clients. The services revenue grew 4.7% q-q, but a strong 29.1% growth from product sales pushed the overall growth to 5.9%.

Retain 12-month positive view

Given the 3Q miss and likely 50-100bps higher FY11 tax rates, Street estimates may come down marginally. But our 12-month positive view remains. Infosys shares have suffered from high expectations on result days recently. In 1Q and 2QFY11, the stock declined over 3% on the result day, but recovered 10-14% through the quarter. Therefore, we believe the market will look beyond the 3Q results and look to improving macro data and hence a solid FY12. Risks: macro and FX uncertainty.

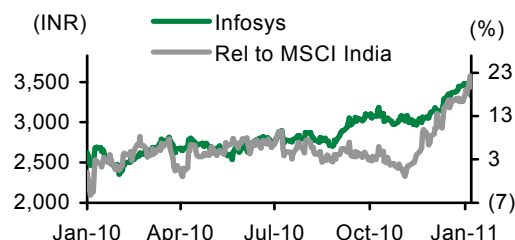
HOW WE DIFFER FROM THE STREET

	BNP	Consensus	% Diff
Target Price (INR)	4,000.00	3504	14.2
EPS 2011 (INR)	124.78	122.66	1.7
EPS 2012 (INR)	155.81	149.98	3.9
	Positive	Neutral	Negative
Market Recs.	40	19	3

KEY STOCK DATA

	2011E	2012E	2013E
YE Mar (INR m)			
Revenue	278,698	344,921	415,465
Rec. net profit	71,296	89,024	108,019
Recurring EPS (INR)	125	156	189
EPS growth (%)	14.6	24.9	21.3
Recurring P/E (x)	27.1	21.7	17.9
Dividend yield (%)	1.6	1.4	1.7
EV/EBITDA (x)	18.7	14.9	11.9
Price/book (x)	6.6	5.5	4.6
Net debt/Equity	(67.0)	(69.2)	(71.4)
ROE (%)	26.7	27.7	28.0

Mkt cap (USD m)	42,734
3m avg daily turnover (USD m)	71.8
Free float (%)	81
Major shareholder	Life Insurance Corp. Of India (AOL)
12m high/low (INR)	3,481.45/2,352.70
3m historic vol. (%)	20.8



Share price performance	1 Month	3 Month	12 Month
Absolute (%)	5.8	5.5	33.6
Relative to country (%)	7.6	15.5	27.4

Sources: Bloomberg consensus; BNP Paribas estimates

Exhibit 1: Q3FY11 Actual Versus BNPP And Street

	Actuals	Change		BNPP	Var	Consensus	Var	Guidance	Var
	(INR m)	(q-q %)	(y-y %)	(INR m)	(%)	(INR m)	(%)	(INR m)	(%)
Revenue (USD m)	1,585	5.9	28.7	1,596	(0.7)	na		1,547-1,562	1.5-2.5
Revenue	71,060	2.3	23.8	71,476	(0.6)	71,803	(1.0)	68,840-69,530	2.2-3.2
EBIT	21,470	2.3	18.8	21,954	(2.2)	21,823	(1.6)		
PAT	17,800	2.5	12.5	18,583	(4.2)	18,223	(2.3)		
EPS (basic, INR)	31.15	2.4	12.3	32.54	(4.3)	31.84	(2.2)	29.37-29.89	4.2-6.0
EBIT margin (%)	30.2	1.4bps	(126bps)	30.7	(50bps)	30.4	(18bps)		
PAT margin (%)	25.0	4.6bps	(251bps)	26.0	(95bps)	25.4	(33bps)		

Sources: Infosys; Bloomberg; BNP Paribas estimates

Exhibit 2: Infosys Key Earnings Drivers And Metrics

Year-end 31 Mar	2QFY10	3QFY10	4QFY10	1QFY11	2QFY11	3QFY11
Volume, chg (%) [#]	2.3	6.1	5.2	7.6	7.2	3.1
Pricing, chg (%) [#]	0.4	1.1	(1.5)	(1.6)	3.2	1.5
Revenue growth (USD, %)	2.9	6.8	5.2	4.8	10.2	5.9
Revenue growth (constant ccy, %)	1.2	5.8	6.1	6.0	9.3	4.7
USD/INR q-q fluctuation (%) [*]	(0.9)	(3.7)	(1.5)	(0.7)	2.0	(3.5)
Revenue growth (INR, %)	2.1	2.8	3.5	4.3	12.1	2.3
EBIT margin (%)	30.5	31.5	30.3	28.3	30.2	30.2
EPS growth (%) ^{**}	0.4	3.2	(0.9)	(5.1)	16.7	2.4
Utilization, @	73.2	76.2	77.7	78.7	81.2	80.7
Offshore revenue share, (ppt)	54.0	53.9	54.0	52.0	49.8	50.7
Net headcount addition ^{***}	1,548	4,429	3,914	1,026	7646	5,311
LTM attrition (%)	10.9	11.6	13.4	15.8	17.1	17.5

[#] only IT services, ^{*} positive number indicates USD/INR depreciation and vice-versa, ^{**} excludes tax reversal gains and sale of OnMobile investment in 4QFY10, ^{***} includes support staff, @ excludes trainees
Sources: Infosys; BNP Paribas estimates

FINANCIAL STATEMENTS

Infosys

Profit and Loss (INR m)					
Year Ending Mar	2009A	2010A	2011E	2012E	2013E
Revenue	216,930	227,420	278,698	344,921	415,465
Cost of sales ex depreciation	(117,650)	(120,710)	(150,167)	(187,048)	(225,770)
Gross profit ex depreciation	99,280	106,710	128,532	157,872	189,695
Other operating income	0	0	0	0	0
Operating costs	(27,330)	(28,100)	(34,984)	(42,770)	(50,271)
Operating EBITDA	71,950	78,610	93,547	115,102	139,424
Depreciation	(7,610)	(9,050)	(8,767)	(9,961)	(11,274)
Goodwill amortisation	0	0	0	0	0
Operating EBIT	64,340	69,560	84,780	105,141	128,150
Net financing costs	4,730	9,430	10,872	13,557	15,875
Associates	0	0	0	0	0
Recurring non operating income	0	0	0	0	0
Non recurring items	0	0	0	0	0
Profit before tax	69,070	78,990	95,651	118,699	144,025
Tax	(9,190)	(16,810)	(24,355)	(29,675)	(36,006)
Profit after tax	59,880	62,180	71,296	89,024	108,019
Minority interests	0	0	0	0	0
Preferred dividends	0	0	0	0	0
Other items	0	480	0	0	0
Reported net profit	59,880	62,660	71,296	89,024	108,019
Non recurring items & goodwill (net)	0	0	0	0	0
Recurring net profit	59,880	62,660	71,296	89,024	108,019
Per share (INR)					
Recurring EPS *	103	109	125	156	189
Reported EPS	105	110	125	156	189
DPS	23.49	25.14	54.56	46.76	56.74
Growth					
Revenue (%)	30.0	4.8	22.5	23.8	20.5
Operating EBITDA (%)	37.4	9.3	19.0	23.0	21.1
Operating EBIT (%)	38.7	8.1	21.9	24.0	21.9
Recurring EPS (%)	29.5	6.2	14.6	24.9	21.3
Reported EPS (%)	28.3	5.0	13.7	24.9	21.3
Operating performance					
Gross margin inc depreciation (%)	42.3	42.9	43.0	42.9	42.9
Operating EBITDA margin (%)	33.2	34.6	33.6	33.4	33.6
Operating EBIT margin (%)	29.7	30.6	30.4	30.5	30.8
Net margin (%)	27.6	27.6	25.6	25.8	26.0
Effective tax rate (%)	13.3	21.3	25.5	25.0	25.0
Dividend payout on recurring profit (%)	22.9	23.1	43.7	30.0	30.0
Interest cover (x)	-	-	-	-	-
Inventory days	0.0	0.0	0.0	0.0	0.0
Debtor days	58.6	57.5	52.8	52.2	50.7
Creditor days	60.7	30.4	0.7	0.9	0.8
Operating ROIC (%)	68.3	68.6	81.4	86.9	93.0
Operating ROIC – WACC (%)	55.3	55.6	68.5	74.0	80.1
ROIC (%)	66.6	58.3	60.8	66.4	72.8
ROIC – WACC (%)	53.6	45.4	47.9	53.5	59.8
ROE (%)	37.4	29.6	26.7	27.7	28.0
ROA (%)	28.3	22.7	21.0	22.0	22.5

* Pre exceptional, pre-goodwill and fully diluted

Sources: Infosys; BNP Paribas estimates

Translates to a 27.9%, 25.6% and 20.5% y-y growth in USD revenue for FY11, FY12 and FY13, respectively, on our estimates

Modelling EBIT margin to remain stable as higher volumes provide cost efficiencies

Infosys

Cash Flow (INR m)					
Year Ending Mar	2009A	2010A	2011E	2012E	2013E
Recurring net profit	59,880	62,660	71,296	89,024	108,019
Depreciation	7,610	9,050	8,767	9,961	11,274
Associates & minorities	0	0	0	0	0
Other non-cash items	(880)	(460)	1,320	0	0
Recurring cash flow	66,610	71,250	81,383	98,985	119,293
Change in working capital	(4,600)	(400)	(11,778)	(6,504)	(6,939)
Capex - maintenance	0	0	0	0	0
Capex - new investment	(13,270)	(6,750)	(12,076)	(14,832)	(16,619)
Free cash flow to equity	48,740	64,100	57,529	77,649	95,736
Net acquisitions & disposals	(100)	(1,730)	(20)	0	0
Dividends paid	(24,940)	(15,740)	(19,581)	(31,247)	(37,915)
Non recurring cash flows	2,480	(36,530)	16,680	0	0
Net cash flow	26,180	10,100	54,608	46,402	57,821
Equity finance	640	890	120	0	0
Debt finance	0	0	0	0	0
Movement in cash	26,820	10,990	54,728	46,402	57,821

Per share (INR)

Recurring cash flow per share	116	125	143	173	209
FCF to equity per share	85.14	112	101	136	168

Balance Sheet (INR m)

Year Ending Mar	2009A	2010A	2011E	2012E	2013E
Working capital assets	56,530	50,710	65,552	75,174	86,881
Working capital liabilities	(38,720)	(31,930)	(37,955)	(41,911)	(47,259)
Net working capital	17,810	18,780	27,597	33,264	39,622
Tangible fixed assets	53,540	44,390	47,389	52,260	57,604
Operating invested capital	71,350	63,170	74,985	85,523	97,226
Goodwill	0	8,290	8,240	8,240	8,240
Other intangible assets	0	560	520	520	520
Investments	0	0	0	0	0
Other assets	1,260	13,600	15,562	16,398	16,978
Invested capital	72,610	85,620	99,307	110,682	122,965
Cash & equivalents	(109,930)	(158,570)	(195,968)	(242,370)	(300,191)
Short term debt	0	0	0	0	0
Long term debt *	0	0	0	0	0
Net debt	(109,930)	(158,570)	(195,968)	(242,370)	(300,191)
Deferred tax	0	1,140	10	10	10
Other liabilities	0	2,320	2,560	2,560	2,560
Total equity	182,540	240,730	292,705	350,482	420,586
Minority interests	0	0	0	0	0
Invested capital	72,610	85,620	99,307	110,682	122,965

* includes convertibles and preferred stock which is being treated as debt

Per share (INR)

Book value per share	319	422	513	614	736
Tangible book value per share	319	406	497	598	721

Financial strength

Net debt/equity (%)	(60.2)	(65.9)	(67.0)	(69.2)	(71.4)
Net debt/total assets (%)	(49.7)	(57.4)	(58.8)	(61.4)	(63.8)
Current ratio (x)	4.3	6.6	6.9	7.6	8.2
CF interest cover (x)	-	-	-	-	-

Valuation	2009A	2010A	2011E	2012E	2013E
Recurring P/E (x) *	32.9	31.0	27.1	21.7	17.9
Recurring P/E @ target price (x) *	39.0	36.7	32.1	25.7	21.2
Reported P/E (x)	32.3	30.7	27.1	21.7	17.9
Dividend yield (%)	0.7	0.7	1.6	1.4	1.7
P/CF (x)	29.0	27.0	23.7	19.5	16.2
P/FCF (x)	39.7	30.1	33.5	24.8	20.1
Price/book (x)	10.6	8.0	6.6	5.5	4.6
Price/tangible book (x)	10.6	8.3	6.8	5.6	4.7
EV/EBITDA (x) **	25.5	22.8	18.7	14.9	11.9
EV/EBITDA @ target price (x) **	30.5	27.4	22.5	17.9	14.4
EV/invested capital (x)	25.1	20.7	17.4	15.2	13.2

* Pre exceptional, pre-goodwill and fully diluted

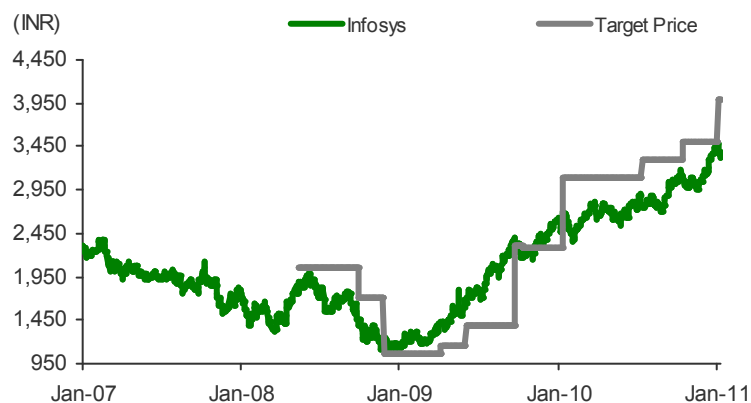
** EBITDA includes associate income and recurring non-operating income

Sources: Infosys; BNP Paribas estimates

High cash balance likely to be used for niche acquisitions going forward especially after the company announced a special dividend at the end of 2QFY11

HISTORY OF CHANGE IN INVESTMENT RATING AND/OR TARGET PRICE

Infosys Technologies (INFO IN)



Abhiram Eleswarapu started covering this stock from 12 May 2008

Price and TP are in local currency

Valuation and risks: Downside risks to our DCF-based TP are: Unexpected macro weakness leading to reversal in the current spending rebound in major verticals such as financial services telecom and manufacturing; and a stronger USD/INR

Sources: Bloomberg, BNP Paribas

DISCLAIMERS & DISCLOSURES**ANALYST(S)**

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