

Infosys 2Q: Strong quarter, Positive guidance

First Look

Breaking news, market events and company announcements

October 12, 2011

Rating Remains	Buy
Target price Remains	INR 2900
Closing price October 10, 2011	INR 2590

Strong quarter, Guidance positive; Reiterate BUY

Infosys 2QFY12 results were operationally better than expected. The key highlight of the result were: 1) no cut in revenue guidance in constant currency (vs Street and our expectations of a cut); and 2) EPS guidance raise of 10%+ was higher than our expectation on a better rupee forecast and better operational performance. Our estimates are under review. There may be a shift in preference from TCS (TCS IN) to Infosys as: 1) we expect Infosys to outperform TCS on operational results this quarter; 2) we see higher risks at TCS on high BFSI/Europe/Client concentration exposure; and 3) we are more comfortable with the valuations at Infosys. Reiterate Buy.

Q2 results: Operationally better than expected, PAT lower on other income

- US\$ revenue growth of 4.5% q-q - marginally below estimates of 4.9%
- In constant currency terms, revenue growth was 5% q-q, volume growth was 4.5% q-q and constant currency (cc) pricing improved by 1% q-q (3.5% increase in offshore pricing).
- EBIT margin improvement of 210bps q-q to 28.2, above our estimate of +130bps.
- PAT at Rs19bn is below our estimate of Rs20.4bn and in line with consensus estimates of Rs18.9bn. Infosys other income of Rs3.8bn was lower than our estimate of Rs6.2bn.

Guidance: No change in constant currency guidance

- FY12 US\$ revenue growth guidance cut to 17-19% (vs 18-20% earlier). In constant currency terms the original guidance of 18-20% is to remain as the cut is on account of the USD appreciating against the EUR and GBP. Management has maintained its pricing and volume assumptions for FY12. Our expectation was for a reduction in revenue growth guidance to 16-18%.
- EPS guidance raised to Rs143-145 for FY12 (vs expectations of Rs135 and earlier guidance of Rs128-130). Infosys has used USD/INR rate of 49 for guidance (vs 44.5 earlier).
- Q3 US\$ revenue growth guidance at 3.2-5.4% q-q. We were estimating the company to guide for 3-4% q-q growth for Q3.
- Q3 EPS guidance of Rs39.2 at the top end implies 17.5% q-q.

Positive highlights of the results

- 3.5% q-q increase in offshore pricing in cc terms
- Strong growth in US region at 6.3% q-q
- Strong growth in business operations - up 6% q-q (last qtr 4.3%); Street perceptions of Infosys underperforming TCS in this segment is likely to improve, in our view
- Quarterly annualized attrition coming down 80bps q-q to 21.2%
- Strong headcount growth of 6.2% with improvement in utilization too

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See Appendix A-1 for analyst certification, important disclosures and the status of non-US analysts.

- BPO profitability back on track at 14% from 10% (net profit margin)
- Telecom turning positive 2.5% q-q growth, key reason for the underperformance against TCS in FY11.

Hiring guidance maintained

- Net headcount increased by 8262 (6.2% q-q)
- Hiring guidance of 45,000 for FY12 maintained

Segmental growth

- North America (6.2% q-q) and ROW (5.8% q-q) drove growth across geographies.
- Industry segment growth was broad based and between 3.5-5.5% q-q with Retail leading.

Fig. 1: Infosys 2QFY12: Actual vs Expected

Key parameters	2QFY12		1QFY12	q-q (%)	2QFY11	y-y (%)
	Actual	Est.				
Revenues (US\$ mn)	1,746	1,752	1,671	4.5%	1,496	16.7%
Revenues (Rs mn)	80,990	80,247	74,850	8.2%	69,470	16.6%
EBITDA (Rs mn)	25,160	24,229	21,750	15.7%	23,150	8.7%
EBITDA (%)	31.1%	30.2%	29.1%	200bp	33.3%	-230bp
PAT (Rs mn)	19,060	20,418	17,220	10.7%	17,370	9.7%
Diluted EPS (Rs)	33.4	35.7	30.1	10.7%	30.4	9.7%

Source: Company, Nomura research

Fig. 2: Infosys 3QFY12 and full year FY12 guidance

	3QFY12F	FY12F	FY12F-Old
Revenue (Rs bn)	88.26-90.12	335.01-340.88	317.77-323.11
Sequential growth (%)	9.0%-11.3%	21.8%-24.0%	15.5%-17.5%
EPS (Rs)	38.51-39.20	143.02-145.26	128.2-130.08
Annual growth (%)	23.6%-25.8%	19.7%-21.6%	7.3%-8.9%
Revenue (US\$ bn)	1.802-1.840	7.08-7.20	7.13-7.25
Sequential growth (%)	3.2%-5.4%	17.1%-19.1%	18%-20%
EPS (US\$)	0.79-0.80	3.02-3.06	2.88-2.92

Source: Company, Nomura research

Fig. 3: Infosys FY12 guidance and implied 4Q sequential growth rate

Lower end	1QFY12A	2QFY12A	3QFY12	4QFY12	FY12
US\$ revenue	1,671	1,746	1,802	1,861	7,080
q-q growth (%)	4.3	4.5	3.2	3.3	17.2
INR EPS	30.1	33.4	38.5	41.0	143.0
q-q growth (%)	-5.3	10.7	15.4	6.5	19.7
Higher end	1QFY12A	2QFY12A	3QFY12	4QFY12	FY12
US\$ revenue	1,671	1,746	1,840	1,943	7,200
q-q growth (%)	4.3	4.5	5.4	5.6	19.2
INR EPS	30.1	33.4	39.2	42.6	145.3
q-q growth (%)	-5.3	10.7	17.5	8.6	21.6

Source: Company, Nomura research

Appendix A-1

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Issuer name	Ticker	Price	Price date	Stock rating	Sector rating	Disclosures
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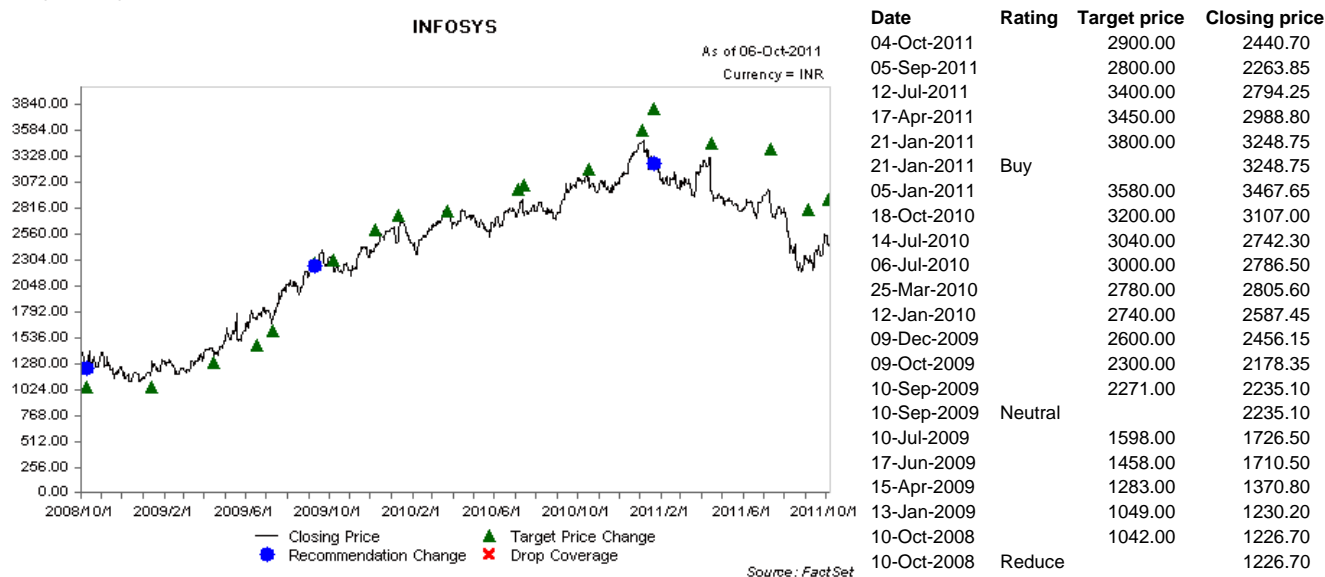
Previous Rating

Issuer name	Previous Rating	Date of change
Infosys	Neutral	21-Jan-2011

Infosys (INFO IN)

INR 2590 (10-Oct-2011) Buy (Sector rating: Not rated)

Rating and target price chart (three year history)



For explanation of ratings refer to the stock rating keys located after chart(s)

Valuation Methodology We value Infosys at 18x our FY13F earnings forecast of INR159.4, which is at a 10% discount to its long-term average valuation. We believe the discount is justified on heightened economic uncertainties, increased risk aversion and an impending slowdown. Our target price is INR2,900.

Risks that may impede the achievement of the target price The key risks are: 1) worse-than-expected slowdown and breakage of pricing discipline in the industry; 2) rupee appreciation; 3) client-specific issues; and 4) an adverse ruling in its pending B1 visa violation case in the US.

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Explanation of Nomura's equity research rating system for Asian companies under coverage ex Japan published from 30 October 2008 and in Japan from 6 January 2009

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