

Infosys Technology (INFTEC)

Rs 3085

WHAT'S CHANGED...

PRICE TARGET Changed from Rs 3144 to Rs 3195
EPS (FY11E) Changed from Rs 116.7 to Rs 117.6
EPS (FY12E) Changed from Rs 143.2 to Rs 145.2
RATING..... Changed from Buy to Add

Mind the growth...

Infosys reported **10.2% sequential US dollar revenue growth - a first since Q2FY08** and raised its dollar revenue growth guidance to **24-25% vs. 19-21% earlier**. Positive commentary on Europe, transformational deals signed and improved hiring targets (**40,000 heads vs. 36,000 earlier**) suggests good demand visibility. However, attrition remains a key concern.

Operating Metric Highlights

Application development grew 12% YoY and 2% QoQ and stood at 15.6% of the revenues. Consulting & system integration grew 14% and 50% QoQ vs. 0.4% and -2.2% growth in Q1FY11, respectively. Product engineering continues to see demand momentum with 31% QoQ growth on top of 22% QoQ growth in Q1FY11. From a vertical perspective, BFSI had another strong quarter with 8% QoQ growth vs. 9% QoQ in Q1FY11. Retail grew 20% QoQ as clients continue to spend top dollars before the holiday season. Geographically, Europe grew 18% QoQ and the company saw demand uptick in Germany and France. Top client revenues grew 5.7% QoQ while top 5 (excluding top 1) and top10 (excluding top 5) grew 17% and 12% QoQ. It added 27 clients in Q2FY11 and signed nine transformation deals with two having contract value of >\$200 million.

Up-tick in onsite mix good but attrition remains a concern

Infosys added 14,264 gross heads while net additions were 6,186. Noticeably, onsite effort increased 1.6 percentage points (pp) to 24.5% vs. 22.9% in Q1FY10 due to likely client ramp ups. This could translate to demand for offshore heads in sequential quarters. However, LTM attrition increased to 17.1% in Q2FY11, up 1.3 pp compared to 15.8% reported in Q1FY11. Though the absolute attrition numbers have fallen QoQ, we believe high attrition rates could pressure volume growth, going forward.

Valuation

Positive commentary from management on Europe and discretionary spending suggests good traction across verticals and service lines. Consequently, we expect revenues and net profit to grow at 23% and 15% CAGR during FY10-FY12, led by volume growth at ~22% CAGR and value the stock at 22x FY12 EPS of Rs 145 i.e. with a 12 month target price of Rs 3195 per share. We continue to recommend an **ADD** rating.

Exhibit 1: Financial Performance

(Rs crore)	Q2FY11	Q2FY11E	Q1FY11	Q2FY10	QoQ(Ch %)	YoY(Ch%)
Net Sales	6,633.2	6,633.2	6,197.9	5,585.1	7.0	18.8
EBITDA Margin (%)	33.0	33.0	31.7	34.5	249 bps up	36 bps dip
Depreciation	268.1	268.1	207.0	234.0	29.5	14.6
Interest	-	-	-	-		
Other Income	292.1	292.1	239.0	239.0	22.2	22.2
Reported PAT	1,649.3	1,649.3	1,487.9	1,535.1	10.8	7.4
EPS (Rs)	28.9	28.9	26.0	26.7	10.8	8.0

Source: Company, ICICIdirect.com Research

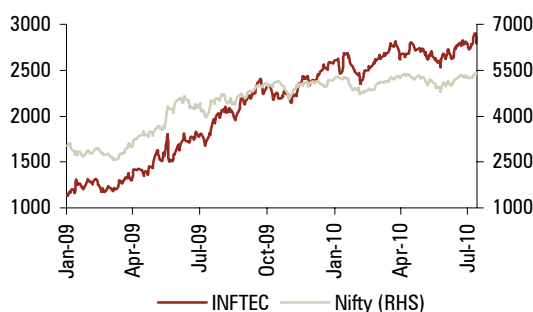
Rating matrix	
Rating	: Add
Target	: Rs 3195
Target Period	: 12 months
Potential Upside	: 4%

Key Financials				
(Rs crore)	FY09	FY10	FY11E	FY12E
Net Sales	21,693.5	22,742.0	27,386.7	32,286.9
EBITDA	7,195.5	7,852.0	9,062.5	10,681.6
EBITDA margin (%)	33.2	34.5	33.1	33.1
Net Profit	5,988.3	6,219.0	6,719.9	8,294.1
EPS (Rs)	104.6	109.5	117.6	145.2

Valuation summary				
	FY09	FY10	FY11E	FY12E
PE (x)	29.5	28.2	26.2	21.2
Target PE (x)	30.5	29.2	27.2	22.0
EV to EBITDA (x)	22.1	20.3	17.6	14.9
Price to book (x)	9.7	7.7	6.6	5.7
RoNW (%)	32.8	22.9	21.3	22.8
RoCE (%)	37.9	30.2	30.4	32.2

Stock data	
Market Capitalisation	Rs 176462 crore
Debt (Q2FY11)	Rs 0 crore
Cash (Q2FY11)	Rs 17388 crore
EV	Rs 159074 crore
52 week H/L	Rs 3249/2127
Equity capital	Rs 286 crore
Face value	Rs 5
FII Holding (%)	35.84
DII Holding (%)	8.16

Price movement



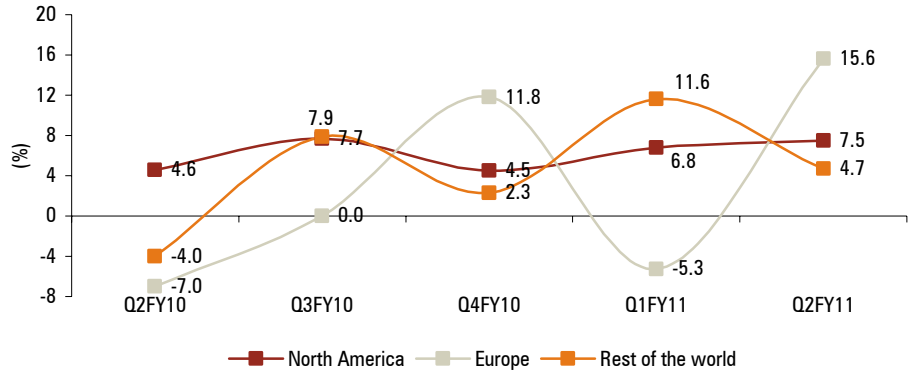
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North American markets have boosted revenue growth for the company in the past and continue to be a growth driver with 7.5% growth QoQ-CC. European markets, which dropped off last quarter, posted whopping 15.6% QoQ-CC and 18.1% QoQ on reported currency growth on the back of good traction in manufacturing and retail verticals in countries like France and Germany. Also, other geographies like Australia and other Asia Pacific regions grew at a decent 4.7% QoQ-CC

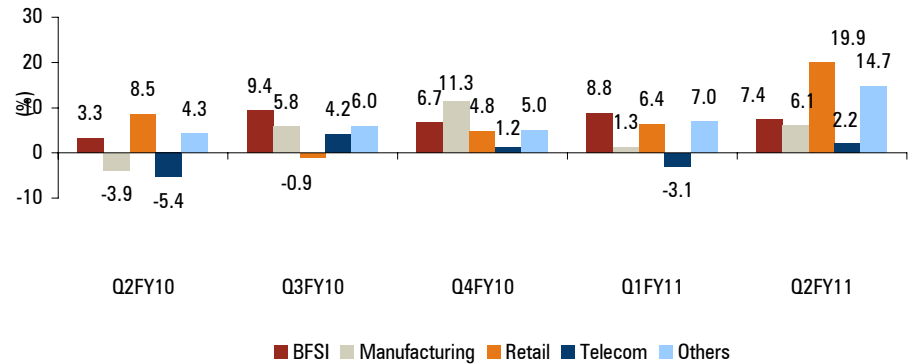
Exhibit 2: Sequential revenue growth geography wise (constant currency)



Source: Company Fact sheet-Oct 2010, ICICIdirect.com Research

BFSI stood out yet again with robust 7.4% QoQ growth supplementing robust volumes in Q2FY11. A sparkling performance was posted by retail and others with 19.9% and 14.7% QoQ-CC growth, respectively. Manufacturing growth was also healthy at 6.1% QoQ-CC. Telecom remains muted at 2.2% QoQ-CC growth and is expected to gain traction by Q4FY11. The company is gaining transformational deals in verticals like energy and utilities

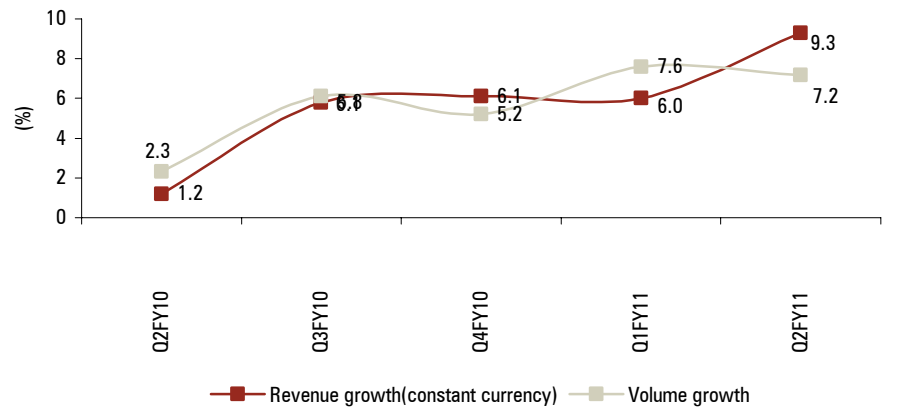
Exhibit 3: Sequential revenue growth industry wise (constant currency)



Source: Company Fact sheet-Oct 2010, ICICIdirect.com Research

The company reported strong volume growth of 7.2% on the back of strong growth from retail, energy & utilities with BFSI covering up for growth lagging in telecom

Exhibit 4: Trend in revenue and volume growth



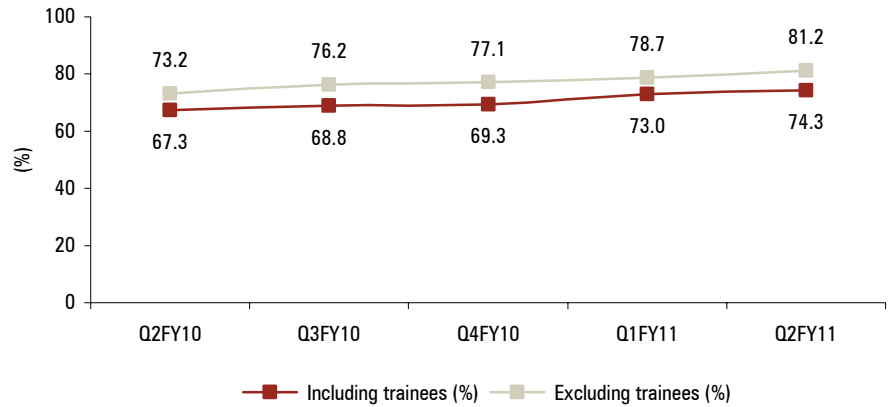
Source: Company Fact sheet-Oct 2010, ICICIdirect.com Research

The company reported a 130 bps improvement in utilisation even after net addition of 7,646 employees this quarter. The management has indicated that it will maintain utilisation (excluding trainees) at 77-78% level even on the back of hiring 40,000 people in FY11 as a strong pipeline is foreseen

Volume growth remained affirmative both offshore and onsite at 5.5% and 11.4% (QoQ)

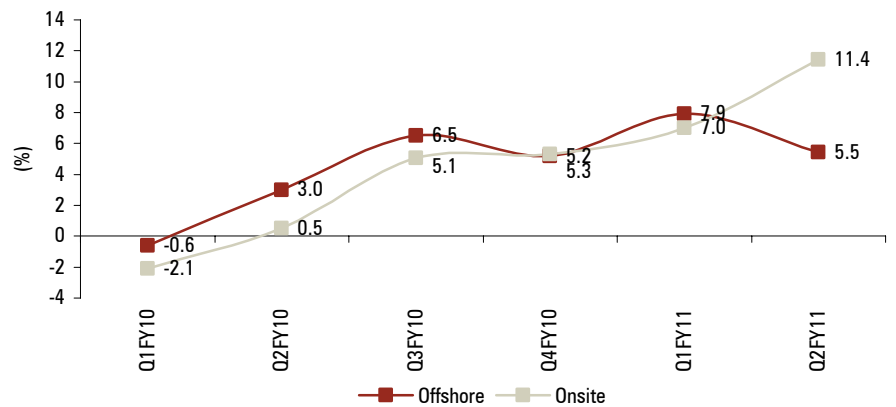
The EBITDA margin bounced back by 190 bps QoQ on the back of favourable cross currency impact of 80 bps coupled with a change in business mix with growth in revenues from consulting and package implementation, which commands a higher margin

Exhibit 5: Trend in utilisation (%)



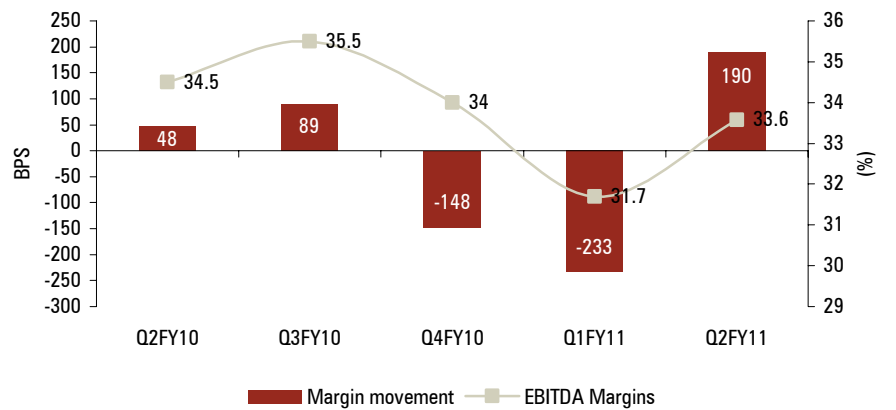
Source: Company Fact sheet-Oct 2010, ICICIdirect.com Research

Exhibit 6: Trend in volume growth



Source: Company Fact sheet-Oct 2010, ICICIdirect.com Research

Exhibit 7: Trend in EBITDA margin



Source: Company Fact sheet-Oct 2010, ICICIdirect.com Research

Client addition was decent at 27. The client pyramid has shown improvement across various segments with two clients scaling up from US\$50-100 million to US\$100-200 million. Also, many US\$1-5 million clients have migrated to higher segments. The company added 13 new clients in BFSI and five new clients from the European region

Exhibit 8: Client pyramid

Client Metrics	Q2FY10	Q3FY10	Q4FY10	Q1FY11	Q2FY11
Top client(% of revenue)	4.6	4.7	4.6	4.9	4.7
Client addition	35	32	47	38	27
Active client	571	568	575	590	592
US\$1-5 million	180	184	179	171	164
US\$5-10 million	54	59	62	67	60
US\$10-20 million	37	33	38	43	47
US\$20-50 million	38	38	33	34	39
US\$50-100 million	16	16	20	18	17
US\$100 -200 million	4	4	5	7	8
US\$200 million plus	1	2	1	1	2

Source: Company Factsheet-Oct 2010, ICICIdirect.com Research

The attrition rate posted a blip shooting up to 17.1% from 13.4% in Q4FY10. This was primarily due to the narrowing demand-supply gap as well as close to 950 people moving out due to higher studies. The management expects it to normalise by the end of this year. The company has indicated its intent hire 36,000 employees in FY11 to avoid any supply constraint. This number has been raised on the back of an improving pipeline. They will hire 14,000 in Q2FY11 itself

Exhibit 9: Employee Metrics

	Q2FY10	Q3FY10	Q4FY10	Q1FY11	Q2FY11
Gross Addition	6069	8719	9313	8859	14264
Net Addition	1548	4429	3914	1026	7646
Lateral Employees	1064	1420	2041	2942	4138
Attrition	10.9	11.6	13.4	15.8	17.1

Source: Company Fact sheet-Oct 2010, ICICIdirect.com Research

Valuation

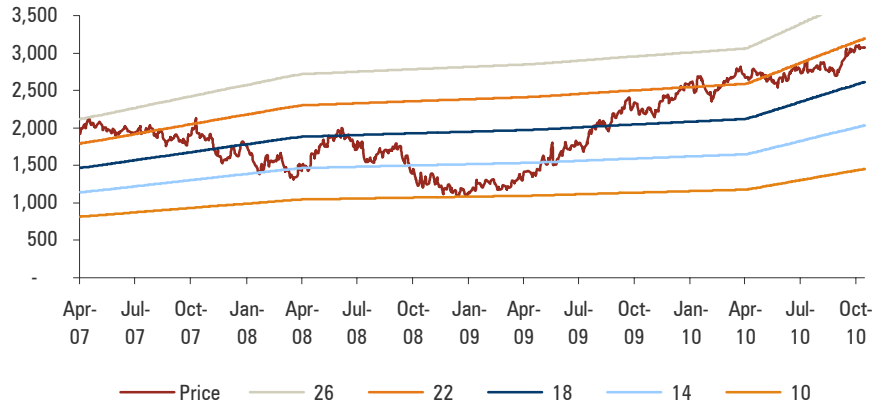
Infosys revised its YoY US\$ revenue growth guidance to 24-25% from 19-21% with annual revenue run-rate of US\$5.95-6.00 billion. This implies improved demand visibility for the company. The guidance given by the company is based on client feedback, which implies that discretionary spend is returning to full swing and revenue productivity is also posting an improvement. This gives us confidence of 23% CAGR volume driven growth for the company over FY10-FY12E.

The company saw demand uptick across verticals led by retail and BFSI. Telecom continues to be weak while manufacturing, its anchor vertical and the worst affected during the recession, is showing signs of secular growth. Infosys saw good traction in Germany and France and does not have direct exposure to troubled economies like Spain, Portugal and Greece.

We expect Infosys' revenues and net profit to grow at 23% and 15% CAGR during FY10-FY12, led by volume growth of ~22% CAGR as against only 6.7% in FY10. Thus, we value the stock at 22x FY12 EPS of Rs 145 i.e. with a 12 month target price of Rs 3195 per share and continue to recommend an **ADD** rating.

The stock is trading at 26.2x FY11E and 21.2x FY12E EPS of Rs 117.6 and Rs 145.2, respectively

Exhibit 10: One year forward PE(x) chart

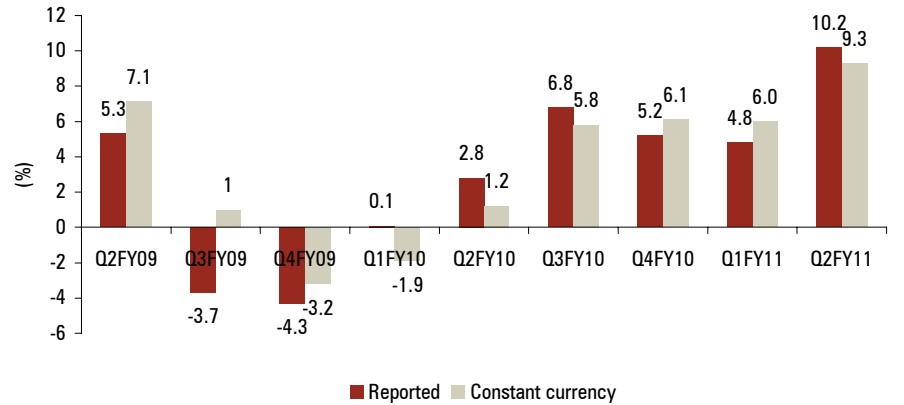


Source: NSE, ICICIdirect.com Research

Risk & Concern

Though the pound, euro and Australian dollar created tailwinds in Q2FY11, cross currency volatility remains a key concern. Noticeably, Infosys guided Q3FY11 revenue at an average rupee/\$ rate of 44.5. Were the rate to remain at these levels for the remainder of the year, the average rupee/\$ rate could be 45.3 vs. 47.3 for FY10 or an appreciation of ~4%, which could impact operating margins by ~100 bps. Incremental appreciation from these levels would create downside risks to our estimates.

Exhibit 11: Impact of cross currency volatility (QoQ revenue growth)



Source: Company Fact sheet-Oct 2010, ICICIdirect.com Research

ICICIdirect.com Coverage Universe

TCS				Sales (Rs Cr)	EPS (Rs)	PE (x)	EV/EBITDA (x)	RoNW(%)	RoCE(%)
Idirect Code	TCS	CMP(Rs)	951.0 FY09	27813.3	26.4	36.0	24.6	33.2	39.6
		Target(Rs)	960.0 FY10	30027.9	35.1	27.1	20.4	37.4	42.2
Mcap(Rs. crore)	186129.7	% Upside	0.9 FY11E	34915.2	40.4	23.5	17.4	33.2	38.2
			FY12E	41641.7	46.0	20.7	15.0	30.0	35.3
HCL Technologies				Sales (Rs Cr)	EPS (Rs)	PE (x)	EV/EBITDA (x)	RoNW(%)	RoCE(%)
Idirect Code	HCLTEC	CMP(Rs)	431.3 FY09	10630.5	19.0	22.7	12.6	22.5	14.9
		Target(Rs)	445.0 FY10	12564.5	18.9	22.8	11.4	20.2	15.6
Mcap(Rs. crore)	29272.3	Upside(%)	3.2 FY11E	15041.2	24.8	17.4	10.4	22.5	14.9
			FY12E	17347.3	31.9	13.5	8.5	23.8	16.7
Tech Mahindra				Sales (Rs Cr)	EPS (Rs)	PE (x)	EV/EBITDA (x)	RoNW(%)	RoCE(%)
Idirect Code	TECHM	CMP(Rs)	752.4 FY09	4464.8	77.4	9.7	8.7	52.2	65.6
		Target(Rs)	790 FY10	4625.4	53.6	14.0	9.4	25.3	27.3
Mcap(Rs. crore)	9329.8	Upside(%)	5.0 FY11E	4735.8	49.9	15.1	12.1	21.4	20.1
			FY12E	5246.8	48.8	15.4	11.2	17.5	19.9
Wipro				Sales (Rs Cr)	EPS (Rs)	PE (x)	EV/EBITDA (x)	RoNW(%)	RoCE(%)
Idirect Code	WIPRO	CMP(Rs)	473.5 FY09	25699.5	15.9	29.7	22.5	28.6	23.3
		Target(Rs)	474.0 FY10	27141.3	18.9	25.1	19.1	26.5	22.4
Mcap(Rs. crore)	115974.4	Upside(%)	0.1 FY11E	31305.4	22.0	21.5	16.5	24.8	22.5
			FY12E	36515.5	24.8	19.1	14.4	22.8	21.6
Patni Computers				Sales (Rs Cr)	EPS (Rs)	PE (x)	EV/EBITDA (x)	RoNW(%)	RoCE(%)
Idirect Code	PATCOM	CMP(Rs)	463.4 CY09	3146.1	45.0	10.3	6.2	16.5	13.4
		Target(Rs)	516.0 CY10E	3191.2	41.6	11.1	5.7	14.0	13.0
Mcap(Rs. crore)	5977.9	Upside(%)	11.4 CY11E	3613.3	40.6	11.4	5.3	12.1	12.6
			CY12E	3962.9	42.7	10.9	5.0	11.4	11.9
Rolta				Sales (Rs Cr)	EPS (Rs)	PE (x)	EV/EBITDA (x)	RoNW(%)	RoCE(%)
Idirect Code	ROLIND	CMP(Rs)	169.2 FY09	1372.8	18.2	9.3	8.4	22.7	15.7
		Target(Rs)	209.0 FY10	1532.7	15.9	10.7	6.7	17.0	12.9
Mcap(Rs. crore)	2727.5	Upside(%)	23.5 FY11E	1743.0	18.3	9.3	5.8	17.7	14.5
			FY12E	2042.1	23.2	7.3	4.9	19.0	16.6
ICSA				Sales (Rs Cr)	EPS (Rs)	PE (x)	EV/EBITDA (x)	RoNW(%)	RoCE(%)
Idirect Code	INNCOM	CMP(Rs)	126.7 FY09	1100.4	32.6	3.9	4.4	26.3	23.6
		Target(Rs)	150.0 FY10	1230.4	27.5	4.6	4.3	18.3	17.2
Mcap(Rs. crore)	601.8	Upside(%)	18.4 FY11E	1338.1	27.5	4.6	4.0	15.6	18.2
			FY12E	1522.8	32.1	3.9	3.5	15.5	18.8
Mastek				Sales (Rs Cr)	EPS (Rs)	PE (x)	EV/EBITDA (x)	RoNW(%)	RoCE(%)
Idirect Code	MASTEK	CMP(Rs)	229.7 FY09	942.6	52.5	4.4	2.9	31.3	24.4
		Target(Rs)	208.0 FY10	713.8	25.2	9.1	5.4	12.8	10.4
Mcap(Rs. crore)	618.8	Upside(%)	(9.4) FY11E	621.3	-7.1	-32.4	-111.3	0.1	-1.6
			FY12E	685.0	6.4	36.1	12.7	3.1	2.4
NIIT				Sales (Rs Cr)	EPS (Rs)	PE (x)	EV/EBITDA (x)	RoNW(%)	RoCE(%)
Idirect Code	NIIT	CMP(Rs)	66.3 FY09	1168.5	4.2	15.6	11.6	15.8	16.5
		Target(Rs)	77 FY10	1199.3	4.3	15.6	8.8	14.2	18.0
Mcap(Rs. crore)	1094.6	Upside(%)	15.5 FY11E	1264.1	5.5	12.0	7.9	16.8	18.5
			FY12E	1420.6	6.6	10.1	6.5	18.5	20.6

Source: Company, ICICIdirect.com Research

RATING RATIONALE

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