

Infosys Technology (INFTEC)

Rs 2788

WHAT'S CHANGED...

PRICE TARGET Changed from Rs 3136 to Rs 3144
EPS (FY11E) Changed from Rs 117.6 to Rs 116.8
EPS (FY12E) Changed from Rs 142.6 to Rs 143.0
RATING..... Unchanged

Bracing up for strong growth ...

Infosys reported its Q1FY11 numbers that were a mix of positives like very strong volume growth (pre-economic crisis level) and negatives like dip in pricing (tail wind effect of FY10 pricing renegotiation). The company revised its annual US dollar revenue growth guidance from 16-18% to 19-21% that envisages the improving demand scenario. Also it increased its hiring target from 30,000 to 36,000 to avoid any supply side constraint in future so as to address the robust foreseen pipeline.

■ Mixed bag quarter

The company reported revenues of Rs 6198 crore with 4.3% QoQ growth that was below Street as well as our expectation (ICICIdirect.com estimate: Rs 6206 crore). In dollar terms, revenues stood at US\$1358 million (4.8% QoQ) only despite strong volume growth of 7.6% (ICICIdirect.com estimate: 6.1%) as cross-currency took away 1.2% and there was a pricing de-growth of 1.6%. Verticals like BFSI and retail pulled up growth with 9.7% (QoQ-CC) and 7.5% (QoQ-CC), respectively. Even its anchor vertical manufacturing added to growth at 2.7% (QoQ-CC) but telecom registered de-growth of 0.8% (QoQ-CC). The EBITDA margin slipped 233 bps QoQ at 31.7%. This was on the back of wage hikes given of 13% offshore and 3% onshore, 60 bps due to cross-currency impact as well as offshore pricing erosion, negating the effect of strong utilisation. The negative pricing impact was due to tail effect of renegotiations done last year and the same accounts growing at a faster pace. PAT stood lower at Rs 1488 crore (ICICIdirect.com estimate: Rs 1557 crore) due to the above and forex loss of Rs 20 crore.

Valuation

The management's new revenue guidance of US\$5.72-5.82 billion for FY11E assumes very strong US\$ against GBP and Euro of 1.50 & 1.23, respectively, which, in our view, is very conservative. On the back of the management's optimistic commentary and evident growth in demand for discretionary spend seen across verticals, we expect the company to grow at 23% CAGR over FY10-FY12E and value the stock at 22x FY12E i.e. Rs 3144. Thus, we continue to rate the stock as **BUY**.

Exhibit 1: Financial Performance

(Rs Crore)	Q1FY11	Q1FY11E	Q4FY10	Q1FY10	QoQ(Ch %)	YoY(Ch%)
Net Sales	6,197.9	6,206.0	5,944.0	5,471.9	4.3	13.3
EBITDA Margin (%)	31.7	32.7	34.0	34.1	233 bps dip	248 bps dip
Depreciation	207.0	232.1	231.0	224.0	(10.4)	(7.6)
Interest	-	-	-	-		
Other Income	239.0	280.0	252.0	269.0	(5.2)	(11.2)
Reported PAT	1,487.9	1,556.5	1,600.0	1,524.9	(7.0)	(2.4)
EPS (Rs)	26.1	27.3	28.9	26.7	(9.7)	(2.2)

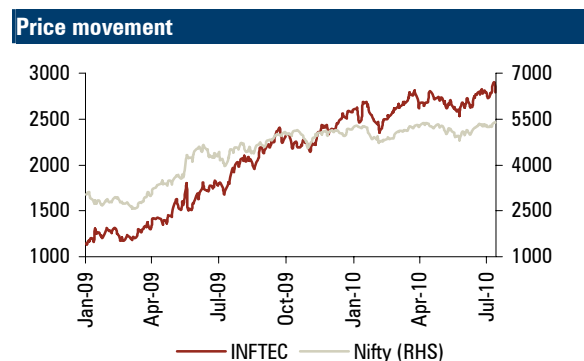
Source: Company, ICICIdirect.com Research

Rating matrix	
Rating	: Buy
Target	: Rs 3144
Target Period	: 12 months
Potential Upside	: 13%

Key Financials				
	FY09	FY10	FY11E	FY12E
Net Sales	21,693.5	22,742.0	26,502.5	31,968.5
EBITDA	7,195.5	7,852.0	8,744.6	10,369.0
EBITDA margin(%)	33.2	34.5	33.0	32.4
Net Profit	5,988.3	6,219.0	6,654.4	8,164.2
EPS	104.6	109.5	116.6	143.0

Valuation summary				
	FY09	FY10	FY11E	FY12E
PE (x)	26.7	25.5	23.9	19.5
Target PE (x)	30.1	28.7	27.0	22.0
EV to EBITDA (x)	19.9	18.3	16.4	13.8
Price to book (x)	8.7	6.9	6.0	5.2
RoNW (%)	32.8	22.9	21.0	22.4
RoCE (%)	37.9	30.2	29.5	31.3

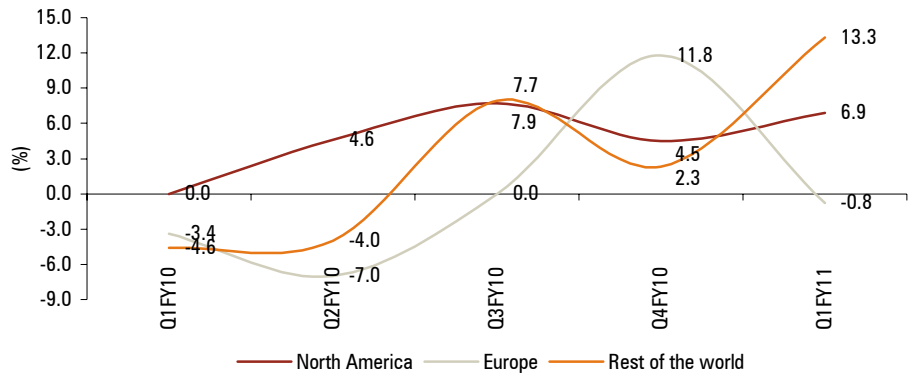
Stock data	
Market Capitalisation	Rs 159474crore
Debt (Q1FY11)	Rs 0 crore
Cash (Q1FY11)	Rs 16005 crore
EV	Rs 143269 crore
52 week H/L	2911.55/1710
Equity capital	Rs 286 Crore
Face value	Rs. 5
FII Holding (%)	36.36
DII Holding (%)	7.93



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North American markets have boosted the revenue growth for the company in the past and continue to be a growth driver. Europe dropped off this quarter after reporting growth last quarter due to subdued performance by Telecom and muted growth in Manufacturing. Also, other geographies like Australia and other Asia Pacific regions grew strongly at 13.3% (QoQ-CC)

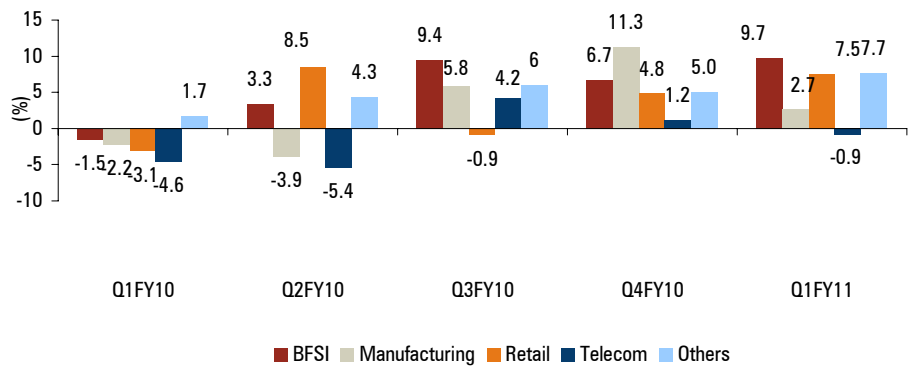
Exhibit 2: Sequential revenue growth geography wise (constant currency)



Source: Company, ICICIdirect.com Research

BFSI stood out yet again with robust 9.7% QoQ growth supplementing robust volumes in Q1FY11. A sparkling performance was posted by retail with 7.5% (QoQ-CC). Manufacturing growth was muted at 2.7% (QoQ-CC). Telecom remained weak with 0.9% (QoQ-CC) decline in revenues (QoQ-CC) because of continued tailwind effect of European exposure. The company is gaining transformational deals in verticals like Energy & Utilities.

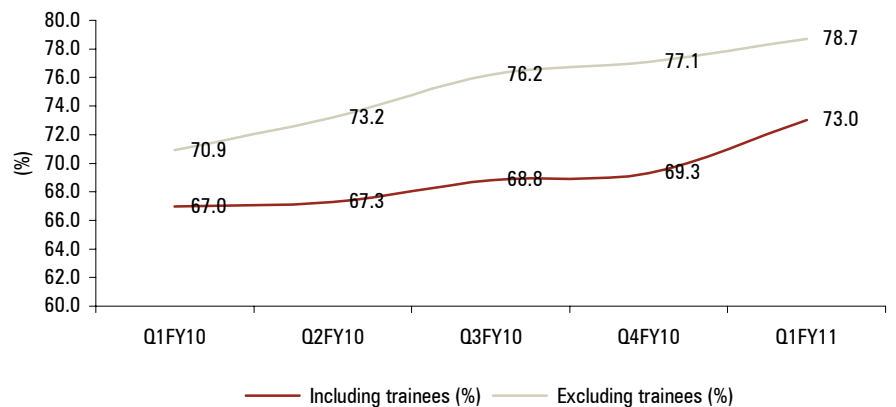
Exhibit 3: Sequential revenue growth industry wise (constant currency)



Source: Company, ICICIdirect.com Research

The company reported a 370 bps improvement in utilisation even after of hiring 5917 freshers this quarter. The management has indicated that it will maintain utilisation (excluding trainees) at 76%-77% level even on the back of hiring 36,000 people in FY11 as strong pipeline foreseen.

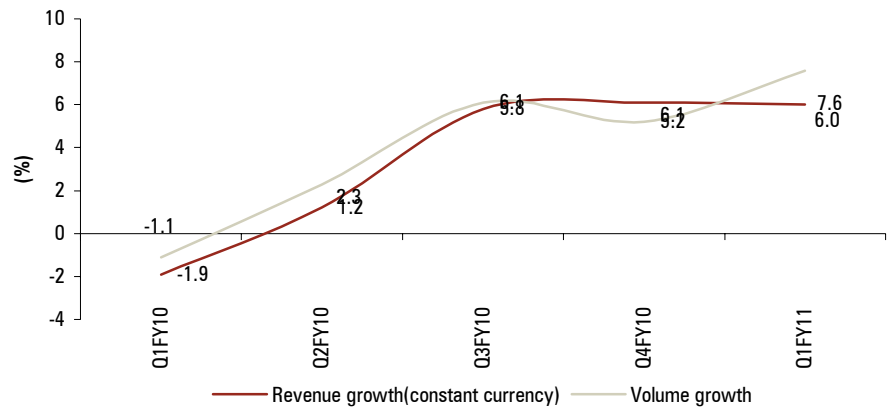
Exhibit 4: Trend in utilisation (%)



Source: Company, ICICIdirect.com Research

The company reported strong volume growth of 7.6%, first instance of above 7% growth after Q2FY08, on the back of strong growth from Retail and BFSI covering up for laggard growth in Manufacturing and de-growth in Telecom.

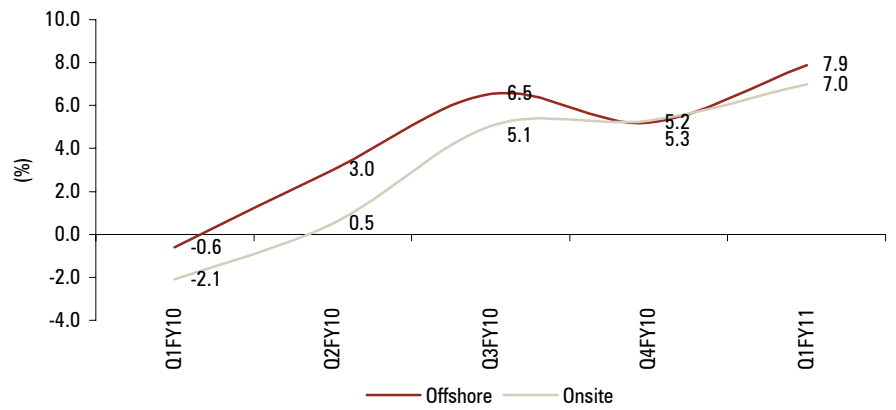
Exhibit 5: Trend in revenue and volume growth



Source: Company, ICICIdirect.com Research

Volume growth remained affirmative both offshore and onsite at 7.9% and 7.0% (QoQ-growth).

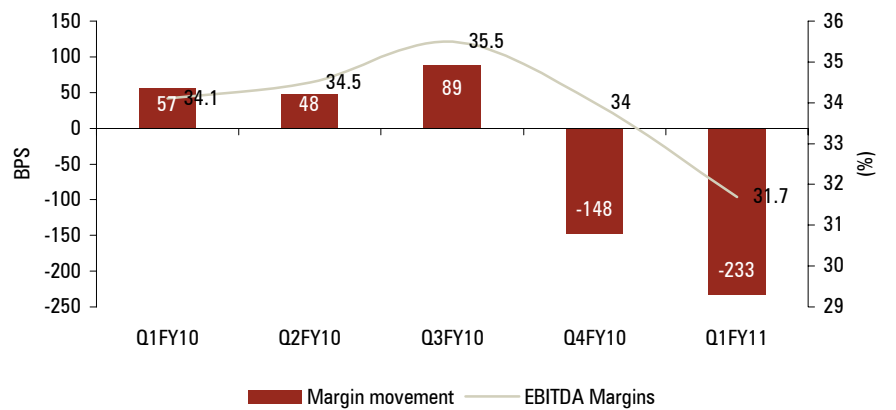
Exhibit 6: Trend in volume growth



Source: Company, ICICIdirect.com Research

The EBITDA margins slipped 233bps (QoQ) due to 60 bps negative impact of cross-currency, offshore pricing de-growth on portfolio level, wage hike impact negating the positive effect of strong utilisation of 78.7% (excluding trainees).

Exhibit 7: Trend in EBITDA margin



Source: Company, ICICIdirect.com Research

Client addition stood decent at 38. 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 been migrated to higher segments. The company added 13 new clients in BFSI and 5 new clients from European region.

Exhibit 8: Client pyramid

Client Metrics	Q1FY10	Q2FY10	Q3FY10	Q4FY10	Q1FY11
Top client(% of revenue)	4.5	4.6	4.7	4.6	4.9
Client addition	27	35	32	47	38
Active client	569	571	568	575	590
USD \$1-5 million	179	180	184	179	171
USD \$5-10 million	47	54	59	62	67
USD\$10-20 million	43	37	33	38	43
USD\$20-50 million	42	38	38	33	34
USD\$50-100 million	15	16	16	20	18
USD \$100 -200 million	3	4	4	5	7
USD\$200 million plus	1	1	2	1	1

Source: Company, ICICIdirect.com Research

The attrition rate posted a blip shooting up to 15.8% from 13.4% in Q4FY10. This is primarily due to 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 to hire 36,000 employees for FY11 to avoid any supply constraint. This number has been raised on the back of improving pipeline, infact they will hire 14,000 in Q2FY11 itself.

Exhibit 9: Employee metrics

	Q1FY10	Q2FY10	Q3FY10	Q4FY10	Q1FY11
Gross Addition	3538	6069	8719	9313	8859
Net Addition	-945	1548	4429	3914	1026
Lateral Employees	390	1064	1420	2041	2942
Attrition	11.1	10.9	11.6	13.4	15.8

Source: Company, ICICIdirect.com Research

Valuation

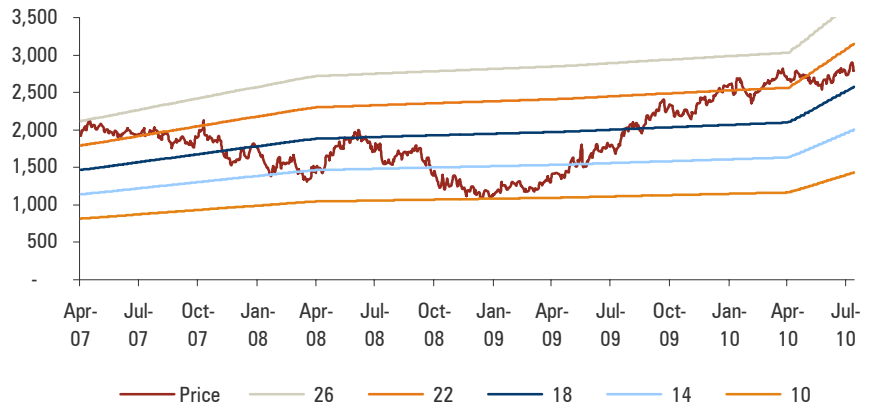
The company has revised the guidance from 16-18% YoY growth to strong growth of 19-21% YoY with annual revenue for FY11 outlined at US\$5.72- 5.81billion, which highlights the fact that demand as well as visibility has improved significantly for the company. The guidance given by the company is based on clients feedback which implies that discretionary spend is returning back in full swing and revenue productivity is also posting improvement. This gives us confidence of 23% CAGR kind of volume driven growth for the company over FY10-FY12E.

Infact the company’s main vertical like BFSI is growing at a scorching pace followed by retail. Manufacturing, which was the worst affected during recession and is one of its anchor vertical is now showing secular trend of growth. Though some concerns about telecom in Europe looms but the company sees opportunity in this space also as it is now witnessing leading indicator i.e. network related spend inching up. This is expected to follow with system related spend and expect Europe to follow US’s growth path in two quarters time frame. The company is investing in Germany and France and has bagged one major deal in France as well as two small deals in Germany. As such it lacks direct exposure to troubled economies like Spain, Portugal, and Greece etc. Also it doesn’t foresee any cascading effect to impact its clients in Germany and France.

Considering the above facts, we believe the company will have robust double digit volume growth of 23.5% over FY10-FY12 as against only 6.7% in FY10. Thus, we value the company at 22x FY12 EPS of Rs142.9 i.e. with 12 month target price of Rs 3144 per share and continue to hold **BUY** rating.

The stock is trading at 23.9x FY11 and 19.5x FY12 EPS of Rs116.6 and Rs143 respectively

Exhibit 10: One year forward PE(x) chart



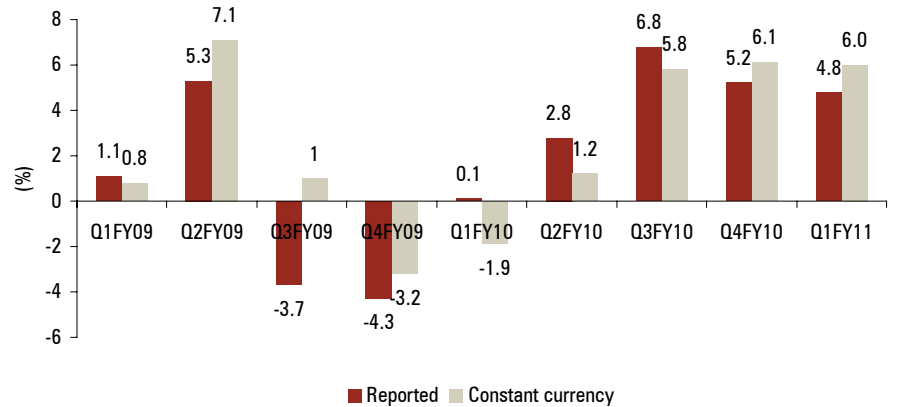
Source: Company, ICICIdirect.com Research

Risk & Concern

The cross currency volatility has proved to be a spoil sport with US\$ appreciation of 4.5% and 8.6% against GBP and Euro, respectively, resulting in lower dollar realisation. We have assumed US\$/INR of 45.0 and 44.0 for FY11 and FY12. Any steep appreciation of the rupee against US\$ will result in downside risks to our estimates.

The US\$ appreciation against GBP and Euro by 4.5% and 8.6%, respectively, has resulted in reported QoQ growth being lower at 4.8% as against constant currency growth of 6.0%.

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



Source: Company, ICICIdirect.com Research

ICICIdirect.com Coverage Universe

Infosys				Sales (Rs Cr)	EPS (Rs)	PE (x)	EV/EBITDA (x)	RoNW(%)	RoCE(%)
Idirect Code	INFTEC	CMP(Rs)	2788.0 FY09	21693.5	104.6	26.7	20.1	32.8	37.9
		Target(Rs)	3136.5 FY10	22742.1	109.5	25.5	18.4	26.9	34.2
Mcap(crore)	159194.8	Upside(%)	12.5 FY11E	26342.6	117.6	23.7	16.6	24.7	32.9
			FY12E	31438.3	142.6	19.6	14.0	25.3	33.7
TCS				Sales (Rs Cr)	EPS (Rs)	PE (x)	EV/EBITDA (x)	RoNW(%)	RoCE(%)
Idirect Code	TCS	CMP(Rs)	774.9 FY09	27813.3	26.4	29.3	20.0	33.2	39.6
		Target(Rs)	926.4 FY10	30027.9	35.1	22.1	16.5	37.4	42.2
Mcap(crore)	151663.428	% Upside	19.6 FY11E	34179.4	40.1	19.3	14.5	33.0	37.0
			FY12E	40130.0	44.1	17.6	12.8	29.1	33.8
HCL Technologies				Sales (Rs Cr)	EPS (Rs)	PE (x)	EV/EBITDA (x)	RoNW(%)	RoCE(%)
Idirect Code	HCLTEC	CMP(Rs)	360.7 FY09	10630.5	19.0	19.0	10.6	22.5	14.9
		Target(Rs)	438.7 FY10E	12338.6	18.8	19.2	9.7	20.1	15.5
Mcap(crore)	24477.3155	Upside(%)	21.6 FY11E	14024.3	25.1	14.4	9.2	22.7	14.4
			FY12E	16594.5	30.7	11.8	7.4	23.0	16.5
Tech Mahindra				Sales (Rs Cr)	EPS (Rs)	PE (x)	EV/EBITDA (x)	RoNW(%)	RoCE(%)
Idirect Code	TECHM	CMP(Rs)	764.6 FY09	4464.8	77.4	9.9	8.7	52.2	65.6
		Target(Rs)	822 FY10	4625.4	53.6	14.3	9.4	25.3	27.3
Mcap(crore)	9481.04	Upside(%)	7.5 FY11E	4848.7	65.4	11.7	9.8	26.3	24.5
			FY12E	5401.8	62.3	12.3	8.8	20.4	24.4
Wipro				Sales (Rs Cr)	EPS (Rs)	PE (x)	EV/EBITDA (x)	RoNW(%)	RoCE(%)
Idirect Code	WIPRO	CMP(Rs)	405.6 FY09	25699.5	26.7	15.2	18.5	28.6	23.3
		Target(Rs)	485.9 FY10	27141.3	31.4	12.9	16.1	26.5	22.4
Mcap(crore)	99343.608	Upside(%)	19.8 FY11E	31186.7	24.2	16.7	13.9	24.3	21.4
			FY12E	36649.4	24.9	16.3	12.1	22.6	21.3
Patni Computers				Sales (Rs Cr)	EPS (Rs)	PE (x)	EV/EBITDA (x)	RoNW(%)	RoCE(%)
Idirect Code	PATCOM	CMP(Rs)	514.2 CY09	3146.1	45.0	11.4	7.4	16.5	13.4
		Target(Rs)	594.1 CY10E	3347.3	44.1	11.7	6.6	14.6	13.5
Mcap(crore)	6632.535	Upside(%)	15.6 CY11E	3846.8	46.5	11.1	5.8	13.5	13.5
			CY12E	4278.0	49.1	10.5	5.3	12.6	13.2
Rolta				Sales (Rs Cr)	EPS (Rs)	PE (x)	EV/EBITDA (x)	RoNW(%)	RoCE(%)
Idirect Code	ROLIND	CMP(Rs)	182.3 FY09	1372.8	18.2	10.0	8.6	22.7	15.7
		Target(Rs)	225.1 FY10E	1551.3	16.5	11.0	6.8	17.7	13.3
Mcap(crore)	2938.7	Upside(%)	23.5 FY11E	1786.5	18.4	9.9	5.8	17.9	14.6
			FY12E	2087.3	22.5	8.1	4.9	18.4	16.4
Mastek				Sales (Rs Cr)	EPS (Rs)	PE (x)	EV/EBITDA (x)	RoNW(%)	RoCE(%)
Idirect Code	MASTEK	CMP(Rs)	292.6 FY09	942.6	52.5	5.6	4.0	31.3	24.4
		Target(Rs)	303.4 FY10E	709.7	28.0	10.4	6.6	14.3	12.0
Mcap(crore)	788.3	Upside(%)	3.7 FY11E	736.0	31.5	9.3	5.6	14.5	15.0
			FY12E	829.1	33.7			13.8	15.5
NIIT				Sales (Rs Cr)	EPS (Rs)	PE (x)	EV/EBITDA (x)	RoNW(%)	RoCE(%)
Idirect Code	NIIT	CMP(Rs)	69.5 FY09	1168.5	4.2	16.4	12.5	15.8	16.5
		Target(Rs)	73.8 FY10	1199.3	4.3	16.3	9.5	14.2	18.0
Mcap(crore)	1146.6	Upside(%)	6.3 FY11E	1337.8	5.7	12.3	7.7	17.3	20.5
			FY12E	1496.3	6.7	10.4	6.8	18.2	21.7

Source: Company, ICICIdirect.com Research

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