

Equities

15 October 2010 | 10 pages

Infosys Technologies (INFY.BO)

Good 2Q; Valuations Limit Upside

- **10% qoq growth in revenues** — Infosys reported a good 2Q with revenue growth of ~10% qoq to \$1496m (our exp: \$1464b). Cross currency boosted reported growth by ~1%. Volume growth was 7.2% qoq while onsite pricing witnessed an improvement of ~2.5% qoq (partly due to mix change – management indicated). Offshore pricing was down ~0.4% qoq. EBITDA margins expanded ~170bps qoq (our exp: ~195bps) resulting in in-line net profit of Rs. 17.4b (our exp: Rs. 17.6b).
- **INR worries back – impact FY11 EPS guidance** — FY11 guidance: (a) Revenues expected to be ~\$5.95-6b, which is +24-25% qoq (earlier 19-21% qoq) (b) EBITDA margins expected to decline ~120-130 bps (earlier 150bps decline) (c) EPS now expected to be Rs. 115-117 (earlier Rs. 112-117) – growth of 5-7% yoy. EPS guidance has been impacted by the recent INR appreciation.
- **Other highlights** — (a) Europe witnesses strong growth of +18% qoq (~16% in constant currency) while US revenues were up 8% qoq (b) Consulting/ PI up ~14% qoq while testing was up 15% qoq – application development and infrastructure services were relative laggards (c) Retail up +20% qoq, energy/utilities at +16% qoq while telecom continues to lag at +4% qoq (d) 9 large deals (>\$100m TCV) won in H1, out of which 4 were in Q2.
- **Will guidance lead to meaningful EPS upgrades?** — Revenue estimates are likely to get upgraded a little post the strong performance this quarter and increases in onsite pricing. However, meaningful EPS upgrades are unlikely (consensus at Rs. 122), particularly due to the sharp recent INR appreciation.
- **Valuations limit absolute upsides** — Infosys continues to deliver well – however, at ~22x FY12E EPS, we see limited absolute upside in the stock. The stock has largely been a market performer over last 1m, 3m and YTD – CY11 IT budgets/INR movement remains a key to performance going forward.

Statistical Abstract

Year to	Net Profit	Diluted EPS	EPS growth	P/E	P/B	ROE	Yield
31 Mar	(RsM)	(Rs)	(%)	(x)	(x)	(%)	(%)
2009A	59,880	104.42	28.5	30.1	9.9	37.4	0.7
2010A	62,660	109.31	4.7	28.7	7.8	30.3	0.8
2011E	70,174	122.82	12.4	25.6	6.3	27.3	1.0
2012E	82,703	144.76	17.9	21.7	5.2	26.3	1.1
2013E	95,946	167.93	16.0	18.7	4.3	25.2	1.3

Source: Powered by dataCentral

Company Update

Hold/Low Risk	2L
Price (15 Oct 10)	Rs3,142.00
Target price	Rs3,065.00
Expected share price return	-2.5%
Expected dividend yield	1.0%
Expected total return	-1.5%
Market Cap	Rs1,794,294M
	US\$40,682M

Price Performance (RIC: INFY.BO, BB: INFO IN)



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See Appendix A-1 for Analyst Certification, Important Disclosures and non-US research analyst disclosures.

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Fiscal year end 31-Mar	2009	2010	2011E	2012E	2013E
Valuation Ratios					
P/E adjusted (x)	30.1	28.7	25.6	21.7	18.7
EV/EBITDA adjusted (x)	23.8	21.3	17.9	14.8	12.4
P/BV (x)	9.9	7.8	6.3	5.2	4.3
Dividend yield (%)	0.7	0.8	1.0	1.1	1.3
Per Share Data (Rs)					
EPS adjusted	104.42	109.31	122.82	144.76	167.93
EPS reported	104.42	109.31	122.82	144.76	167.93
BVPS	318.71	403.77	495.52	604.35	730.37
DPS	23.50	25.00	31.00	36.00	42.00
Profit & Loss (RsM)					
Net sales	216,930	227,420	270,390	323,134	377,585
Operating expenses	-152,590	-157,860	-188,530	-226,736	-265,962
EBIT	64,340	69,560	81,860	96,398	111,623
Net interest expense	4,730	9,910	11,088	14,218	16,736
Non-operating/exceptionals	0	0	0	0	0
Pre-tax profit	69,070	79,470	92,947	110,616	128,358
Tax	-9,190	-16,810	-22,774	-27,913	-32,413
Extraord./Min.Int./Pref.div.	0	0	0	0	0
Reported net income	59,880	62,660	70,174	82,703	95,946
Adjusted earnings	59,880	62,660	70,174	82,703	95,946
Adjusted EBITDA	71,950	78,610	90,743	107,270	124,142
Growth Rates (%)					
Sales	30.0	4.8	18.9	19.5	16.9
EBIT adjusted	38.7	8.1	17.7	17.8	15.8
EBITDA adjusted	37.4	9.3	15.4	18.2	15.7
EPS adjusted	28.5	4.7	12.4	17.9	16.0
Cash Flow (RsM)					
Operating cash flow	50,670	57,270	66,961	73,490	85,279
Depreciation/amortization	7,610	9,050	8,883	10,872	12,519
Net working capital	-12,020	-1,470	-1,008	-5,867	-6,451
Investing cash flow	-13,380	-9,060	-17,131	-22,283	-23,442
Capital expenditure	-13,380	-9,060	-17,131	-22,283	-23,442
Acquisitions/disposals	0	0	0	0	0
Financing cash flow	-15,290	-12,390	-20,022	-20,557	-23,984
Borrowings	0	2,320	-2,320	0	0
Dividends paid	-13,456	-14,294	-17,702	-20,557	-23,984
Change in cash	22,000	35,820	29,808	30,650	37,853
Balance Sheet (RsM)					
Total assets	221,260	277,360	332,054	405,630	487,290
Cash & cash equivalent	96,950	105,560	146,456	191,324	245,912
Accounts receivable	36,720	34,940	41,910	51,701	60,414
Net fixed assets	53,540	53,550	61,798	73,209	84,132
Total liabilities	38,720	46,870	49,092	60,523	70,220
Accounts payable	20,040	23,430	28,854	36,287	42,022
Total Debt	0	0	0	0	0
Shareholders' funds	182,540	230,490	282,962	345,108	417,070
Profitability/Solvency Ratios (%)					
EBITDA margin adjusted	33.2	34.6	33.6	33.2	32.9
ROE adjusted	37.4	30.3	27.3	26.3	25.2
ROIC adjusted	73.1	62.0	65.3	66.0	65.4
Net debt to equity	-53.1	-45.8	-51.8	-55.4	-59.0
Total debt to capital	0.0	0.0	0.0	0.0	0.0

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Key Highlights

- Revenues were \$1.5b, up ~10% QoQ (CIRA expectations: \$1.46b).
- EBITDA margin of 33.3% (CIRA expectations: 33.6%), an increase of ~170bps sequentially. This was primarily on account of higher utilization, pricing improvements and favorable currency.
- Net profit of Rs17.4b (CIRA expectations: Rs17.6b) was inline with expectations.
- Constant currency realizations improved on a blended basis – onsite realizations improved ~250bps while offshore declined ~40bps QoQ. Management attributed this to the change in mix with services like Consulting/Package Implementation showing strong growth this quarter and the fact that new transformational deals are coming at better realizations.
- IT volumes increased ~7.2% sequentially on a blended basis – offshore volumes increased ~5% qoq while onsite showed a strong growth of ~11% qoq.
- Headcount increased by 7,646 employees on a net basis. Management has raised full-year hiring guidance – now expecting to add ~40,000 employees in the year (against 36,000 earlier).
- Growth was led by Retail and Insurance segments where revenues increased by ~20% and ~11% qoq respectively. Telecom was relatively slow at ~4%. BFS witnessed a growth of 7% qoq.
- Management indicated that M&A related spends are now below peak levels.
- In terms of Service lines, growth was led by Consulting & Package Implementation and Testing at ~14% and ~15% qoq while application development was sluggish at ~2% qoq. Products had a decline of ~2% qoq but good growth of 33% yoy.
- BPO business recovered with revenue growth of ~8% qoq; net margins expanded sharply to ~13% (~8% last quarter).
- Top- 5 and Top-10 clients grew ~13% QoQ each.
- Attrition increased by ~130bps on a LTM basis, however, management indicated that absolute number of employees leaving the company declined in Q2 vs Q1.
- FY11 guidance now implies ~24-25% revenue growth (\$-terms) and Rs115-117 on EPS. Margin decline implied in the guidance is ~120-130bps YoY, which has been lowered from the previous levels of ~150bps.
- Infosys announced a special dividend of Rs. 30 per share.

Result Tables

Figure 1. Key Financials

Rs m	2Q10	1Q11	2Q11	QoQ	YoY
Revenue (US\$ m)	1,154	1,358	1,496	10.2%	29.6%
Revenue	55,850	61,980	69,470	12.1%	24.4%
Cost of revenue	29,630	34,430	37,540	9.0%	26.7%
Gross profit	26,220	27,550	31,930	15.9%	21.8%
Gross margin	46.9%	44.4%	46.0%	151bp	-98bp
Operating expenses	6,890	7,950	8,780	10.4%	27.4%
EBITDA	19,330	19,600	23,150	18.1%	19.8%
EBITDA margin	34.6%	31.6%	33.3%	170bp	-129bp
Depreciation & amortization	2,320	2,050	2,170	5.9%	-6.5%
EBIT	17,010	17,550	20,980	19.5%	23.3%
EBIT margin	30.5%	28.3%	30.2%	188bp	-26bp
Other income	2,360	2,390	2,670	11.7%	13.1%
Profit before tax	19,370	19,940	23,650	18.6%	22.1%
Income tax expense	3,970	5,060	6,280	24.1%	58.2%
Net profit	15,400	14,880	17,370	16.7%	12.8%
EPS - basic	26.87	26.06	30.41	16.7%	13.2%
EPS - fully diluted	26.83	26.04	30.40	16.7%	13.3%

Source: Company Reports

Figure 2. FY11 Guidance

	Guidance		Guidance post Q1		Guidance revision		Guidance post Q2		Guidance revision	
	Lower	Upper	Lower	Upper	Lower	Upper	Lower	Upper	Lower	Upper
Revenue (Rs m)	247,960	252,390	264,410	268,850	6.6%	6.5%	269,510	271,650	1.9%	1.0%
Revenue (\$ m)	5,570	5,670	5,720	5,810	2.7%	2.5%	5,950	6,000	4.0%	3.3%
EPS - basic (Rs)	106.82	111.28	112.21	116.73	5.0%	4.9%	115.07	117.07	2.5%	0.3%
INR/\$ assumption		44.50		46.45		4.4%		44.50		-4.2%

Source: Company Reports

Figure 3. 3Q Guidance

	Guidance		Implied Growth	
	Lower	Upper	Lower	Upper
Revenue (Rs m)	68,840	69,530	-0.9%	0.1%
Revenue (\$ m)	1,547	1,562	3.4%	4.4%
EPS - basic (Rs)	29.37	29.89	-3.4%	-1.7%

Source: Company Reports

Figure 4. Key Client Metrics

	1Q10	2Q10	3Q10	4Q10	1Q11	2Q11
Active Clients	569	571	568	575	590	592
Added during the period	27	35	32	47	38	27
\$1m+ clients	330	330	336	338	341	337
\$5m+ clients	151	150	152	159	170	173
\$10m+ clients	104	96	93	97	103	113
\$20m+ clients	61	59	60	59	60	66
\$30m+ clients	45	41	41	41	43	48
\$50m+ clients	19	21	22	26	26	27
\$70m+ clients	12	11	12	12	13	15
\$100m+ clients	4	5	6	6	8	10
\$200m+ clients	1	1	2	1	1	2
Clients > 5% of revenue	0	0	0	0	0	0
Revenue - top client	4.5%	4.6%	4.7%	4.6%	4.9%	4.7%
Revenue - top 5 client	16.3%	16.5%	17.6%	15.8%	15.4%	15.8%
Revenue - top 10 client	25.8%	26.2%	27.5%	25.8%	26.1%	26.7%
Repeat Business	98.7%	98.0%	97.0%	95.4%	99.4%	98.4%
DSO - TTM (in days)	56	56	57	59	60	63

Source: Company Reports

Figure 5. Revenue Mix

	1Q10	2Q10	3Q10	4Q10	1Q11	2Q11
Geographic wise						
North America	64.7%	65.9%	66.6%	66.1%	67.3%	65.8%
Europe	24.7%	23.2%	21.9%	22.5%	20.3%	21.8%
India	0.9%	1.2%	1.2%	1.4%	1.7%	2.1%
RoW	9.7%	9.7%	10.3%	10.0%	10.7%	10.3%
Service line wise						
Application development	19.3%	18.1%	17.8%	16.8%	16.9%	15.6%
Application maintenance	23.2%	22.7%	24.5%	22.8%	23.9%	23.5%
BPO	6.1%	6.2%	5.9%	6.2%	5.7%	5.6%
Consulting & PI	24.4%	23.8%	23.3%	26.0%	24.9%	25.8%
Infrastructure Management	6.6%	7.8%	7.1%	7.2%	6.9%	6.2%
Product Engg Services	2.4%	2.3%	2.4%	1.8%	2.1%	2.5%
System Integration	3.8%	4.4%	4.1%	4.5%	4.2%	5.7%
Testing Services	6.2%	6.2%	6.5%	6.6%	7.3%	7.6%
Others	4.0%	4.4%	4.5%	3.1%	3.4%	3.3%
Products	4.0%	4.1%	3.9%	5.0%	4.7%	4.2%
Vertical wise						
Insurance	7.1%	7.4%	8.5%	7.7%	8.4%	8.5%
Banking & FS	25.9%	26.1%	26.1%	27.1%	27.7%	26.9%
Manufacturing	20.5%	19.3%	19.3%	20.2%	19.5%	18.9%
Retail	13.2%	14.1%	13.1%	13.0%	13.2%	14.4%
Telecom	16.9%	16.2%	16.2%	15.3%	14.1%	13.3%
Energy & Utilities	5.7%	5.9%	6.1%	5.8%	6.0%	6.3%
Transportation & Logistics	2.3%	2.3%	1.8%	1.8%	1.8%	1.8%
Services	4.9%	5.0%	5.1%	4.9%	4.8%	5.2%
Others	3.5%	3.7%	3.8%	4.2%	4.5%	4.7%

Source: Company Reports

Figure 6. Key HR Metrics

	1Q10	2Q10	3Q10	4Q10	1Q11	2Q11
IT and BPO professionals	96,334	97,594	103,476	106,864	108,495	115,972
- Billable	88,061	87,798	89,086	93,254	95,863	99,667
- Banking Business Unit	2,664	2,800	4,345	4,730	5,029	5,178
- Trainees	5,609	6,996	10,045	8,880	7,603	11,127
Sales & support	7,571	7,859	6,406	6,932	6,327	6,496
Total employees	103,905	105,453	109,882	113,796	114,822	122,468
Gross addition	3,538	6,069	8,719	9,313	8,859	14,264
Net addition	-945	1,548	4,429	3,914	1,026	7,646
Attrition% (TTM) - SA	11.1%	10.9%	11.6%	13.4%	15.8%	17.1%
Utilization						
- including trainees	67.0%	67.3%	68.8%	69.3%	73.0%	74.3%
- excluding trainees	70.9%	73.2%	76.2%	77.1%	78.7%	81.2%

Source: Company Reports

Figure 7. Key Execution Metrics

	1Q10	2Q10	3Q10	4Q10	1Q11	2Q11
Infosys consolidated						
Billed effort (person-mths)	195,725	198,511	208,980	218,687	233,756	250,439
- Onsite	44,458	44,804	46,925	49,347	53,519	61,396
- Offshore	151,267	153,707	162,055	169,340	180,237	189,043
Billed effort distribution (%)						
- Onsite	22.7%	22.6%	22.5%	22.6%	22.9%	24.5%
- Offshore	77.3%	77.4%	77.5%	77.4%	77.1%	75.5%
Revenue distribution (%)						
- Onsite	46.4%	46.0%	46.1%	46.0%	48.0%	50.2%
- Offshore	53.6%	54.0%	53.9%	54.0%	52.0%	49.8%
IT Services						
Billed effort distribution (person-mths)	149,961	153,388	162,755	171,232	184,279	197,478
- Onsite	44,231	44,435	46,686	49,183	52,630	58,650
- Offshore	105,730	108,953	116,069	122,049	131,649	138,828
Billed effort distribution (%)						
- Onsite	29.5%	29.0%	28.7%	28.7%	28.6%	29.7%
- Offshore	70.5%	71.0%	71.3%	71.3%	71.4%	70.3%
Revenue distribution (%)						
- Onsite	51.4%	50.9%	50.9%	51.5%	52.6%	54.7%
- Offshore	48.6%	49.1%	49.1%	48.5%	47.4%	45.3%

Source: Company Reports

Infosys Technologies

Valuation

Our Rs3,065 target price for Infosys is based on 22x Dec'11E EPS. This is around the mid-point of the last 3-year trading band of 11x-30x 12-month forward earnings and factors in some deceleration in growth. Our estimates continue to assume a certain PE premium to the market; this is justified, in our view, given the strong FCF and ROIC for Infosys vs. the overall market. We believe PE remains the most appropriate valuation measure given Infosys' profitability record and higher earnings visibility.

Risks

We rate Infosys Low Risk which is inline with our quantitative risk-rating system, which tracks 260-day historical share price volatility. Key downside risks to our target price include: (1) any significant appreciation of the rupee against the USD/EUR/GBP; (2) pressure on billing rates (as Infosys still continues to enjoy a 10-15% premium in its billing rates); and (3) a prolonged slowdown in the US economy. Key upside risks include: (1) any significant depreciation of the rupee against the USD/EUR/GBP; and (2) a pickup in the US/global economy leading to better than expected spends.

Appendix A-1

Analyst Certification

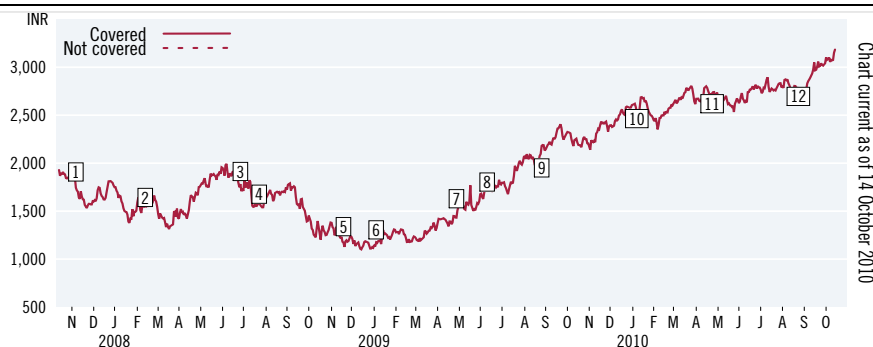
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IMPORTANT DISCLOSURES

Infosys Technologies (INFY.BO)

Ratings and Target Price History Fundamental Research

Analyst: Surendra Goyal, CFA



	Date	Rating	Target Price	Closing Price
1	7-Nov-07	1L	*2,190.00	1,743.85
2	13-Feb-08	*1M	*2,060.00	1,549.15
3	26-Jun-08	1M	*2,175.00	1,781.85
4	23-Jul-08	1M	*1,910.00	1,603.70

	Date	Rating	Target Price	Closing Price
5	19-Nov-08	1M	*1,420.00	1,172.00
6	4-Jan-09	1M	*1,350.00	1,130.95
7	28-Apr-09	*1L	*1,650.00	1,431.55
8	10-Jun-09	1L	*2,060.00	1,803.25

	Date	Rating	Target Price	Closing Price
9	26-Aug-09	*2L	*2,290.00	2,181.35
10	7-Jan-10	2L	*2,785.00	2,525.25
11	23-Apr-10	2L	*2,935.00	2,728.10
12	24-Aug-10	2L	*3,065.00	2,765.50

* Indicates change

Rating/target price changes above reflect Eastern Standard Time

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Data current as of 30 Sep 2010

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