

Infosys

11 October 2013

Reuters: INFY.BO; Bloomberg: INFO IN

Consistency In Revenue Heartening; Upgrade To Buy

Infosys' 2QFY14 revenue beat expectations, for the second successive quarter, aided by volume growth and pricing. Dollar revenue grew 3.8% QoQ at US\$2,066mn, 1.3% above our estimate. Service-wise, growth was led by the bread-and-butter business operations services (BOS), up 4.4% QoQ, a reflection that the IT major is refocusing on this segment to regain its market share. Higher employee utilisation, offshore contribution and rupee depreciation offset the impact of wage hikes, leading to a small 33bps QoQ drop in EBITDA margin and almost flat EBIT margin. A lower tax rate led adjusted net profit to rise 10.6% QoQ, 7.2% above our estimate and in line with consensus estimates. Infosys has raised FY14 US dollar revenue guidance from 6%-10% to 9%-10%. This implies a 1% CQGR decline over 2QFY14-4QFY14E. Given the greater focus on BOS, better consistency, large deal wins (over US\$1bn) and a good order pipeline, we expect Infosys to beat its guidance and record strong revenue growth in FY15 as well. Led by growth and higher employee utilisation, we expect Infosys to expand its margins by over 100bps in FY15E, leading to over 22% EPS growth. We have upgraded our rating on Infosys to Buy (from Hold earlier) with a revised target price of Rs4,030 (Rs3,230 earlier) driven by a 10.5% increase in FY15E EPS and P/E multiple of 17.5x FY15E EPS (15.5x earlier).

Revenue driven by strong offshore volume growth: Infosys posted a 3.8% QoQ rise in US dollar revenue, at US\$2,066mn, 1.3% above our estimate (US\$2,039mn); volume grew 3.2% QoQ (IT services), while billing rate rose 0.6% QoQ. Onsite volume grew 0.7% QoQ, while offshore volume rose by a healthy 4.3% QoQ. Vertical-wise, manufacturing (MFG) posted an impressive growth of 6.9% QoQ, while geographically Europe grew 5.3% QoQ. From a service line perspective, the key BOS segment grew 4.4% QoQ, reflecting renewed focus on the segment in order to regain revenue market share from peers.

Rupee depreciation, higher employee utilisation offset wage hike impact: Infosys posted a small 33bps EBITDA margin decline, 113bps/95bps below our/Bloomberg consensus estimates, respectively, owing mainly to wage hikes and bonus payouts even as rupee depreciation, higher employee utilisation and pricing offset the impact. Net profit, adjusted for a one-time provision of Rs2.19bn owing to visa issues in the US, was up 10.6% QoQ (7.2% above our estimate, largely in-line with consensus estimates).

Consistency in revenue heartening, upgrade to Buy: Key positive signs have emerged over the past two quarters - a renewed focus on BOS, strong deal wins (over US\$1bn) and healthy volume growth, with this being the second successive quarter of Infosys beating revenue estimates. We expect Infosys to outperform its FY14 guidance and achieve strong revenue growth in FY15 as well. Led by growth and higher employee utilisation, we expect the IT major to expand margins by over 100bps in FY15E, leading to over 22% EPS growth.

We upgrade Infosys to Buy (from Hold earlier) with a revised TP of Rs4,030 (Rs3,230 earlier) driven by a 10.5% rise in FY15E EPS and P/E multiple of 17.5x FY15E EPS (15.5x earlier), at a 12.5% discount to our target multiple for TCS.

BUY

Sector: Information Technology

CMP: Rs3,274

Target Price: Rs4,030

Upside: 23%

Harit Shah

harit.shah@nirmalbang.com

+91-22-3926 8068

Key Data

Current Shares O/S (mn)	572.2
Mkt Cap (Rsbn/US\$bn)	1,880.3/30.8
52 Wk H / L (Rs)	3,335/2,186
Daily Vol. (3M NSE Avg.)	1,405,968

Price Performance (%)

	1 M	6 M	1 Yr
Infosys	5.0	12.3	29.3
Nifty Index	3.1	9.0	6.8

Source: Bloomberg

Y/E March (Rsmn)	2QFY13	1QFY14	2QFY14	QoQ (%)	YoY (%)	1HFY13	1HFY14	Chg (%)
Revenue	98,580	112,670	129,650	15.1	31.5	194,740	242,320	24.4
Software development expenses	58,270	70,000	80,500	15.0	38.1	113,840	150,500	32.2
Gross profit	40,310	42,670	49,150	15.2	21.9	80,900	91,820	13.5
SG&A expenses	11,590	12,840	15,250	18.8	31.6	22,720	28,090	23.6
EBITDA	28,720	29,830	33,900	13.6	18.0	58,180	63,730	9.5
Depreciation	2,750	3,190	3,340	4.7	21.5	5,280	6,530	23.7
EBIT	25,970	26,640	30,560	14.7	17.7	52,900	57,200	8.1
Other income	7,060	5,770	5,100	(11.6)	(27.8)	11,820	10,870	(8.0)
Exceptional items	-	-	(2,190)	-	-	-	(2,190)	-
Profit before tax	33,030	32,410	33,470	3.3	1.3	64,720	65,880	1.8
Tax	9,340	8,670	9,400	8.4	0.6	18,140	18,070	(0.4)
Net profit	23,690	23,740	24,070	1.4	1.6	46,580	47,810	2.6
Diluted EPS (Rs)	41.5	41.5	42.1	1.4	1.6	81.5	83.7	2.6
Gross profit margin (%)	40.9	37.9	37.9	-	-	41.5	37.9	-
EBITDA margin (%)	29.1	26.5	26.1	-	-	29.9	26.3	-
EBIT margin (%)	26.3	23.6	23.6	-	-	27.2	23.6	-
Net profit margin (%)	24.0	21.1	18.6	-	-	23.9	19.7	-

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 1: Financial summary

Y/E March (Rsmn)	FY11	FY12	FY13	FY14E	FY15E
Revenue	275,010	337,340	403,520	509,080	575,181
YoY (%)	20.9	22.7	19.6	26.2	13.0
EBITDA	89,640	107,160	115,580	135,591	160,040
EBITDA (%)	32.6	31.8	28.6	26.6	27.8
Adj. PAT	68,230	83,160	94,210	107,772	131,544
YoY (%)	9.7	21.9	13.3	14.4	22.1
FDEPS (Rs)	119.4	145.5	164.9	188.6	230.2
RoE (%)	27.1	27.4	25.7	24.7	25.3
RoCE (%)	23.1	22.9	21.0	20.6	20.4
P/E (x)	27.4	22.5	19.9	17.4	14.2
EV/EBITDA (x)	19.1	15.6	14.2	11.8	9.6

Source: Company, Bloomberg, Nirmal Bang Institutional Equities Research

Exhibit 2: Actual performance versus our estimates, Bloomberg consensus estimates

(2QFY14)	Actual	NBIE estimates	BBG consensus estimates	% variation from NBIE estimates	% variation from BBG consensus
Revenue (Rsmn)	129,650	126,568	127,209	2.4	1.9
EBITDA (Rsmn)	33,900	34,524	34,468	(1.8)	(1.6)
EBITDA margin (%)	26.1	27.3	27.1	(113)bps	(95)bps
Adj. net profit (Rsmn)	26,260	24,490	26,326	7.2	(0.3)

Source: Company, Bloomberg, Nirmal Bang Institutional Equities Research

Key result data points

Volume and pricing – IT services and consulting

- Total volume up 3.2% QoQ; on-site volume up 0.7% QoQ, while offshore volume up 4.3% QoQ
- Blended pricing up 0.6% QoQ; on-site rate up 1.4% QoQ, while offshore rate up 1.7% QoQ
- Employee utilisation rate, including trainees, at 73.1%, up from 70.7% in 1QFY14
- Employee utilisation rate, excluding trainees, at 77.5%, up from 74.3% in 1QFY14.

Exhibit 3: IT service volume details

Hours worked (mn)	2QFY13	1QFY14	2QFY14	Chg. QoQ (%)	Chg. YoY (%)
On-site	11.9	13.7	13.8	0.7	15.7
Offshore	30.4	31.9	33.3	4.3	9.6
Total	42.3	45.6	47.1	3.2	11.3

Source: Company

Service lines (US\$ terms)

- **Business operation services: Up 4.4% QoQ at US\$1,269mn, of which:**
 - Application development: Up 5.7% QoQ
 - Application maintenance: Down 2.7% QoQ
 - Testing services: Up 3.8% QoQ
 - Infrastructure management: Up 6.7% QoQ
 - Product engineering services: Up 7% QoQ
 - Business process management: Up 3.8% QoQ
- **Consulting and systems integration: Up 2.8% QoQ at US\$688mn**
- **Products, platforms & solutions: Up 1.8% QoQ at US\$109mn, of which:**
 - Product revenue: Up 3.8% QoQ
 - BPM platform: Up 3.8% QoQ.

Industry verticals (US\$ terms)

- Financial services and insurance: Up 2.8% QoQ at US\$690mn
- Manufacturing: Up by a robust 6.9% QoQ at US\$479mn; **the stand-out performer yet again; on a YoY basis, growth was over 20%, signifying strong traction and good order book**
- Retail, logistics, CPG and life sciences: Up 1.4% QoQ at US\$499mn
- Energy and utilities, communications and services: Up 4.7% QoQ at US\$398mn.

Geographies (US\$ terms)

- **North America: Up 3.9% QoQ at US\$1,271mn – strong growth from the largest geography**
- **Europe: Up 5.3% QoQ at US\$495mn – the outperformer for the quarter**
- India: Down 3.8% QoQ at US\$50mn; **revenue adversely impacted by cross-currency movements**
- Rest of the world: Up 1.6% QoQ at US\$250mn.

Employee data

- Gross addition of 12,168 employees, net addition of 2,964; total employee base at 160,227
- Standalone attrition rate rises to 17.3% (16.9% in 1QFY14).

Valuation

Infosys' better-than-expected performance in 2QFY14 is a positive sign, and is the second successive quarter of its revenue beating expectations. Volume growth was impressive, with offshore volume growth particularly strong - a positive factor for profitability. This is likely to continue, with project starts over the past few quarters beginning to move offshore as the execution progresses, with this also being part of Infosys' strategy to combat margin headwinds ahead of the US Immigration Bill getting passed in a few months from now. Strong deal wins worth US\$1bn and a strong order pipeline lead to improved revenue visibility. We expect this to enable the IT major to comfortably surpass its revised revenue guidance for FY14 and also drive strong revenue growth in FY15. European customers are also opening up to Indian IT firms, as witnessed by the strong 5.3% QoQ growth for the quarter, which could boost growth further. The renewed focus on the key BOS segment to regain market share is also a positive move.

While the management continues to be cautious regarding the overall business environment, we believe key positive signs over the past few quarters, as stated above, should enable Infosys to post strong revenue growth (13.1% in FY14E, 15.5% in FY15E) and start to match/exceed industry growth, thereby regaining revenue market share. This was the third successive double-digit YoY increase in on-site volume (15.7% in 2QFY14, 20.0% in 1QFY14 and 16.0% in 4QFY13, from 8.4% in 3QFY13). Offshore volume growth trajectory also improved, at nearly 10.0% YoY (8.9% YoY in 1QFY14 and 8.5% YoY in 4QFY13, from 6.6% YoY in 3QFY13). These factors, along with a strong rise in the employee utilisation rate (utilisation rate, including trainees, at its highest level since 3QFY11) imply steady growth ramp-up. All these factors should drive revenue going forward.

As regards margins, we believe the company's focus on re-investing margin gains back into the business - into sales activities and employee benefits - is a positive feature, which should drive revenue growth and offset any margin headwinds. Apart from this, improved revenue productivity (2QFY14 was the third successive quarter of YoY increase in revenue/employee) and higher employee utilisation rate are also two key margin levers, which we believe - along with growth - should boost margins by over 100bps in FY15E.

We also believe margins have hit the bottom this quarter, and expect a combination of improved revenue growth, higher employee utilisation and revenue productivity to drive upside in this metric, thereby boosting earnings growth at over 22% YoY in FY15E. The improved consistency and better revenue visibility are factors that will enable the IT major to sustain its higher valuation. We have raised our revenue/EPS estimates for FY15 by 6.3%/10.5%, respectively, to account for the outperformance in 2QFY14.

We have upgraded our rating on Infosys to Buy (from Hold earlier) with a revised target price of Rs4,030 (Rs3,230 earlier) owing to the rise in our EPS estimates and a higher P/E multiple of 17.5x FY15E EPS (15.5x FY15E EPS earlier) due to greater consistency likely, going forward. This is at a 12.5% discount to our multiple for TCS, which we believe is appropriate.

Exhibit 4: Our earlier estimates, revised estimates

Particulars	Earlier estimates	Revised estimates	Chg (%)
FY14E			
Revenue (US\$mn)	8,220	8,367	1.8
Revenue (Rsmn)	498,589	509,080	2.1
EBITDA margin (%)	27.0	26.6	(33)bps
EPS (Rs)	182.2	188.6	3.5
FY15E			
Revenue (US\$mn)	9,089	9,663	6.3
Revenue (Rsmn)	541,105	575,181	6.3
EBITDA margin (%)	26.9	27.8	94bps
EPS (Rs)	208.4	230.2	10.5

Source: Nirmal Bang Institutional Equities Research

Rating track

Date	Rating	Market price	Target price (Rs)
2 June 2011	Hold	2,812	2,900
1 July 2011	Sell	2,907	2,900
12 July 2011	Hold	2,794	2,875
12 August 2011	Sell	2,374	2,298
23 September 2011	Sell	2,354	2,338
30 September 2011	Sell	2,550	2,354
12 October 2011	Sell	2,681	2,378
23 November 2011	Hold	2,651	2,746
21 December 2011	Hold	2,667	2,755
2 January 2012	Buy	2,765	3,210
12 January 2012	Buy	2,588	3,125
30 March 2012	Hold	2,791	3,125
13 April 2012	Hold	2,403	2,438
17 May 2012	Hold	2,371	2,464
29 June 2012	Hold	2,472	2,473
12 July 2012	Sell	2,265	2,129
10 September 2012	Sell	2,493	2,323
4 October 2012	Sell	2,579	2,363
12 October 2012	Sell	2,396	2,120
7 January 2013	Sell	2,350	2,120
11 January 2013	Sell	2,713	2,310
9 April 2013	Sell	2,833	2,685
12 April 2013	Sell	2,295	2,084
28 May 2013	Sell	2,364	2,084
3 June 2013	Sell	2,412	2,084
9 July 2013	Sell	2,468	2,400
12 July 2013	Hold	2,804	2,860
7 October 2013	Hold	3,015	3,230

Disclaimer

Stock Ratings Absolute Returns

BUY > 15%

HOLD 0-15%

SELL < 0%

This report is published by Nirmal Bang's Institutional Equities Research desk. Nirmal Bang has other business units with independent research teams separated by Chinese walls, and therefore may, at times, have different or contrary views on stocks and markets. This report is for the personal information of the authorised recipient and is not for public distribution. This should not be reproduced or redistributed to any other person or in any form. This report is for the general information for the clients of Nirmal Bang Equities Pvt. Ltd., a division of Nirmal Bang, and should not be construed as an offer or solicitation of an offer to buy/sell any securities.

We have exercised due diligence in checking the correctness and authenticity of the information contained herein, so far as it relates to current and historical information, but do not guarantee its accuracy or completeness. The opinions expressed are our current opinions as of the date appearing in the material and may be subject to change from time to time without notice.

Nirmal Bang or any persons connected with it do not accept any liability arising from the use of this document or the information contained therein. The recipients of this material should rely on their own judgment and take their own professional advice before acting on this information. Nirmal Bang or any of its connected persons including its directors or subsidiaries or associates or employees or agents shall not be in any way responsible for any loss or damage that may arise to any person/s from any inadvertent error in the information contained, views and opinions expressed in this publication.

['Access our reports on Bloomberg Type NBIE <GO>'](#)

Team Details:			
Name		Email Id	Direct Line
Rahul Arora	CEO	rahul.arora@nirmalbang.com	+91 22 3926 8098 / 99
Hemindra Hazari	Head of Research	hemindra.hazari@nirmalbang.com	+91 22 3926 8017 / 18
Sales and Dealing:			
Neha Grover	AVP Sales	neha.grover@nirmalbang.com	+91 22 3926 8093
Ravi Jagtiani	Dealing Desk	ravi.jagtiani@nirmalbang.com	+91 22 3926 8230, +91 22 6636 8833
Pradeep Kasat	Dealing Desk	pradeep.kasat@nirmalbang.com	+91 22 3926 8100/8101, +91 22 6636 8831
Michael Pillai	Dealing Desk	michael.pillai@nirmalbang.com	+91 22 3926 8102/8103, +91 22 6636 8830
Umesh Bharadia	Dealing Desk	umesh.bharadia@nirmalbang.com	+91-22-39268226

Nirmal Bang Equities Pvt. Ltd.

Correspondence Address

B-2, 301/302, Marathon Innova,
 Nr. Peninsula Corporate Park
 Lower Parel (W), Mumbai-400013.
 Board No. : 91 22 3926 8000/1
 Fax. : 022 3926 8010