

# Infosys

13 April 2012

Reuters: INFY.BO Bloomberg: INFO IN

## Dismal 1QFY13, Full-year Guidance Spoils the Show

Infosys' 4QFY12 dollar revenues and 1QFY13 as well as FY13 guidance, all of which were below expectations, suggest the environment has worsened as clients ramped down engagements on rising macro-economic uncertainty. Consequently, the stock took a 12.6% battering on the bourses. In our view, the key question is whether Infosys' poor guidance for FY13 is company-specific or an industry-wide trend. At this point, the jury is still out on this issue, which will be addressed over the next few days as other information technology (IT) firms announce their results. As regards Infosys, we slash our FY13 revenue, EBITDA and EPS estimates by 7.7%, 12.6% and 11.6%, respectively, owing to reduction in volume growth estimates. We also downgrade the PE multiple we assign to the stock to 15x (17x earlier) and thereby downgrade our target price to Rs2,438 (Rs3,125 earlier) even as we retain our Hold rating on the stock.

**Client ramp-down hurts revenue:** Infosys reported a 4.8% QoQ decline in revenue to Rs88.5bn (our estimate Rs91.1bn, consensus Rs92bn); in dollar terms revenues were US\$1,771mn, well below our estimate of US\$1,812mn, with volumes falling 0.5% QoQ (our estimate 0.9% QoQ growth) and billing rates falling 1.4% QoQ (our estimate 0.6% QoQ decline). The IT major's key vertical - Financial Services and Insurance (FSI) - showed a decline of 4.7% QoQ, which is a disconcerting sign. Unexpected client ramp-downs towards the end of the quarter led to the volume, pricing and revenue miss. The IT major missed its own revenue guidance of US\$1,806-1,810mn by a significant margin.

**Margins fall on lower capacity utilisation:** Infosys reported a 107bps QoQ fall in EBITDA margins to 32.6% (below our estimate by 71bps, below consensus estimates by 41bps) on lower capacity utilisation (70.7% including trainees, 76.4% in 3QFY12). This led to a 2.4% QoQ fall in net profit to Rs23.2bn, in line with our estimate but higher than consensus estimates by 0.6%.

**Downgrade FY13E revenue, EBITDA and EPS on lower volumes:** Infosys has guided for FY13 dollar revenue growth of just 8-10% and 1QFY13 growth of 0-1% QoQ. Whether the cautious FY13 outlook is company-specific or industry-wide remains to be seen and this will be addressed over the next few days. As regards Infosys, **we downgrade our FY13 revenue, EBITDA and EPS estimates by 7.7%, 12.6% and 11.6%, respectively, downgrade the PE multiple to 15x (17x) and also cut our target price to Rs2,438 (Rs3,125) even as we maintain Hold rating on the stock.**

**HOLD**
**Sector:** IT

**CMP:** Rs2,403

**Target Price:** Rs2,438

**Upside:** 1.4%

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**Key Data**

Current Shares O/S (mn)	574.2
Mkt Cap (Rsbn/US\$bn)	1,379/26.8
52 Wk H / L (Rs)	3,317/2,162
Daily Vol. (3M NSE Avg.)	1,214,058

**Price Performance (%)**

	1 M	6 M	1 Yr
Infosys	(16.0)	(10.9)	(27.3)
Nifty Index	(11.9)	(13.5)	(15.4)

Source: Bloomberg

Y/E March (Rsmn)	4QFY11	3QFY12	4QFY12	QoQ (%)	YoY (%)	FY11	FY12	Chg (%)
Net revenues	72,500	92,980	88,520	(4.8)	22.1	275,010	337,340	22.7
Software development expenses	40,120	50,520	49,560	(1.9)	23.5	150,540	188,710	25.4
Gross profit	32,380	42,460	38,960	(8.2)	20.3	124,470	148,630	19.4
SG&A expenses	9,140	11,110	10,060	(9.5)	10.1	34,830	41,470	19.1
EBITDA	23,240	31,350	28,900	(7.8)	24.4	89,640	107,160	19.5
Depreciation	2,220	2,360	2,430	3.0	9.5	8,620	9,370	8.7
EBIT	21,020	28,990	26,470	(8.7)	25.9	81,020	97,790	20.7
Other income	4,150	4,220	6,520	54.5	57.1	12,110	19,040	57.2
Income before income tax	25,170	33,210	32,990	(0.7)	31.1	93,130	116,830	25.4
Tax	6,990	9,490	9,830	3.6	40.6	24,900	33,670	35.2
Net profit	18,180	23,720	23,160	(2.4)	27.4	68,230	83,160	21.9
Diluted EPS (Rs)	31.8	41.5	40.5	(2.3)	27.4	119.4	145.5	21.9
Gross profit margin (%)	44.7	45.7	44.0			45.3	44.1	
EBITDA margin (%)	32.1	33.7	32.6			32.6	31.8	
EBIT margin (%)	29.0	31.2	29.9			29.5	29.0	
Net profit margin (%)	25.1	25.5	26.2			24.8	24.7	

Source: Company, Nirmal Bang Institutional Equities Research

Y/E March (Rsmn)	FY10	FY11	FY12	FY13E	FY14E
Revenues	227,420	275,010	337,340	393,985	439,450
YoY (%)	4.8	20.9	22.7	16.8	11.5
EBITDA	78,520	89,640	107,160	126,470	137,667
EBITDA (%)	34.5	32.6	31.8	32.1	31.3
Adj. PAT	62,190	68,230	83,160	92,859	103,164
YoY (%)	4.1	9.7	21.9	11.7	11.1
FDEPS (Rs)	108.8	119.4	145.5	162.5	180.6
RoE (%)	28.7	27.1	27.4	25.3	23.6
RoCE (%)	25.1	23.1	22.9	22.5	20.6
P/E (x)	24.4	22.3	18.3	16.4	14.7
EV/EBITDA (x)	17.4	15.2	12.3	10.1	8.8

Source: Company, Bloomberg, Nirmal Bang Institutional Equities Research

### Exhibit 1: Actuals versus our, Bloomberg consensus estimates

(4QFY12)	Actuals	NBIE estimates	BBG consensus estimates	% variation from NBIE estimates	% variation from BBG consensus
Revenues (Rsmn)	88,520	91,111	92,036	(2.8)	(3.8)
EBITDA (Rsmn)	28,900	30,358	30,391	(4.8)	(4.9)
EBITDA margin (%)	32.6	33.3	33.0	(71bps)	(41bps)
Net profit (Rsmn)	23,160	23,188	23,031	(0.1)	0.6

Source: Company, Bloomberg, Nirmal Bang Institutional Equities Research

### Exhibit 2: Performance versus guidance

(4QFY12)	Guidance	Performance	% out-performance*
Revenues (US\$mn)	1,806-1,810	1,771	(2.2)
EPADS (US\$)	0.81	0.81	0.0
Revenues (Rsbm)	93.91-94.12	88.52	(5.9)
EPS (Rs)	42.12	40.54	(3.8)

Source: Company, Nirmal Bang Institutional Equities Research;

\* From the upper end of the guidance

## Key result data points

### Volumes and pricing - consolidated

- Volumes down 0.5% QoQ; onsite volumes down 1.3% QoQ, offshore volumes down 0.3% QoQ
- Blended pricing down 1.4% QoQ; onsite billing rates down 0.5% QoQ and offshore rates down 1.8% QoQ
- Utilisation rate, including trainees, at 67.2%, well below the 69.9% level in 3QFY12
- Utilisation rate, excluding trainees, at 73%, well below the 77.4% level in 3QFY12

### Volumes and pricing – IT services and consulting

- Volumes down 1.5% QoQ; onsite volumes down 2.1% QoQ, while offshore volumes down 1.2% QoQ
- Blended pricing down 1.1% QoQ; onsite rates down 0.2% QoQ, offshore rates down 1.7% QoQ
- Utilisation rate, including trainees, at 64.2%, down from 67.6% in 3QFY12
- Utilisation rate, excluding trainees, at 70.7%, down from 76.4% in 3QFY12

### Exhibit 3: IT service volume details – Ramp-downs lead to decline

Hours worked (mn)	4QFY11	3QFY12	4QFY12	QoQ (%)	YoY (%)
Onsite	10.1	11.4	11.2	(2.1)	11.0
Offshore	25.9	28.8	28.5	(1.2)	10.1
<b>Total</b>	<b>35.9</b>	<b>40.3</b>	<b>39.7</b>	<b>(1.5)</b>	<b>10.3</b>

Source: Company

## Service lines (US\$ terms)

- **Business operation services – Down 3.4% QoQ to US\$1,110mn, of which:**
- Application development: Down 3.1% QoQ
- Application maintenance: Down 6% QoQ
- Testing services: Down 3.2% QoQ
- Infrastructure management: Down 0.3% QoQ
- Product engineering services: Down 7.4% QoQ
- Business process management: Up 7% QoQ
- **Consulting and systems integration – Down 0.3% QoQ to US\$551mn**
- **Products, platforms & solutions – Up 3% QoQ at US\$110mn, of which:**
- Product revenues: Up 4.4% QoQ
- BPM platforms: Up 1.4% QoQ
- Others: Up 0.4% QoQ.

## Industry verticals (US\$ terms)

- Financial services and insurance (FSI): Down 4.7% QoQ to US\$607mn; **this was a major disappointment during the quarter and a result of unexpected ramp-down by clients in areas such as regulatory compliance**
- Manufacturing (MFG): Up 2.2% QoQ at US\$377mn
- Retail, logistics, CPG & life sciences (RCL): Down 2.9% QoQ to US\$406mn
- Energy and utilities, communications and services (ECS): Down 0.3% QoQ to US\$381mn.

## Geographies (US\$ terms)

- US: Down 4.1% QoQ to US\$1,104mn; **a disappointing performance this quarter**
- Europe: Up by just 0.2% QoQ at US\$409mn
- India: Down 2.7% QoQ to US\$36mn
- Rest of the world: Up 5.7% QoQ at US\$222mn

## Employee data

- Gross addition of 10,676 employees, net addition at 4,727; total employee base at 149,994
- Standalone attrition rate declines to 14.7% (15.4% in 3QFY12)
- Infosys expects to hire total 35,000 people in FY13, including 13,000 in its BPO business
- **The IT major will not give salary hikes in FY13 owing to the uncertain macro-economic environment - a clear sign of the issues the company is facing with regard to revenue visibility and its intention to also protect its margin profile, something that it has always been known to focus on**
- This is similar to FY10, a year in which Infosys did not give salary hikes in April, but did so in October, as the economic situation improved; **we are not convinced that Infosys will have the luxury of awarding salary hikes in October this year as the macro-economic situation appears unlikely to improve anytime soon.**

## 1QFY13, FY13 dollar revenue and FY13 rupee EPS guidance well below expectations

- Infosys has guided for FY13 dollar revenue growth of just 8-10% at US\$7,553-7,692mn, as compared with expectations of 11-14% growth; the IT major's 1QFY13 guidance is also very disappointing at just 0-1% QoQ growth to US\$1,771-1,789mn, clearly suggesting the impact of client ramp-down towards the end of the quarter, apart from general delays in IT budget finalisation
- Earnings per American Depositary Share (EPADS) guidance came in at US\$3.12-3.17, implying growth of just 4-5.7%
- On the rupee side, FY13 revenue growth guidance was 13.9-16% at Rs384.31-391.36bn, taking a rate of Rs50.88/\$ (closing rate as on 30 March 2012), while the rupee EPS guidance came in at a disappointing Rs158.76-161.41 despite the rupee tailwind.

### Exhibit 4: FY13 guidance – Below expectations

(FY13)	Guidance	% growth over FY12*
Revenues (US\$mn)	7,553-7,692	10.0
EPADS (US\$)	3.12-3.17	5.7
Revenues (Rsbn)	384.31-391.36	16.0
EPS (Rs)	158.76-161.41	10.9

Source: Company; \* From the upper end of the guidance

### Exhibit 5: 1QFY13 guidance – Not too enthusing either

(1QFY13)	Guidance	% growth over 4QFY12*
Revenues (US\$mn)	1,771-1,789	1.0
EPADS (US\$)	0.73	(9.9)
Revenues (Rsbn)	90.11-91	1.8-2.8
EPS (Rs)	36.89	(9.0)

Source: Company; \* From the upper end of the guidance

## Valuation

Infosys has guided for FY13 dollar revenue growth of just 8-10% YoY and 1QFY13 growth of just 0-1% QoQ. Whether Infosys' cautious FY13 outlook is a company-specific issue or an industry-wide one remains to be seen and this will be addressed over the next few days, as and when other top-tier IT companies announce their results. At this point, the jury is still out regards this particular issue. As regards Infosys, **we downgrade FY13 revenue, EBITDA and EPS estimates by 7.7%, 12.6% and 11.6%, respectively, downgrade the PE multiple to 15x (17x) and reduce our TP to Rs2,438 (Rs3,125) even as we maintain a Hold rating on the stock.** Infosys' historical premium to the market has been mainly owing to its strong revenue and earnings predictability and the ability to consistently beat its guidance. Clearly, these two factors have been diluted significantly, partly owing to the highly uncertain macro-economic environment and we believe this is the key reason for the stock's valuation getting de-rated, something we do not expect to reverse anytime soon.

## Rating History

Date	Rating	CMP	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

## Disclaimer

### Stock Ratings Absolute Returns

BUY > 15%

HOLD 0-15%

SELL < 0%

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