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Infosys

Evergreen

Stock Update

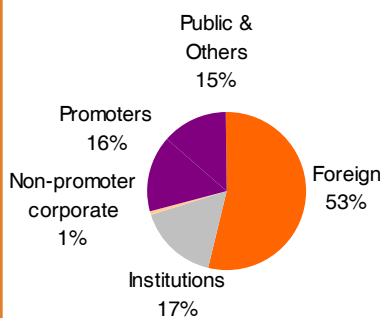
Price target revised to Rs2,440

Hold; CMP: Rs2,403

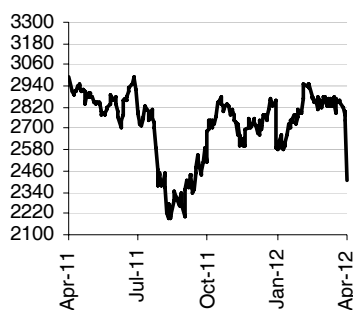
Company details

Price target:	Rs2,440
Market cap:	Rs13,7987 cr
52 week high/low:	Rs3,305/2,169
NSE volume: (No of shares)	11.28 lakh
BSE code:	500209
NSE code:	INFY
Sharekhan code:	INFY
Free float: (No of shares)	48.2 cr

Shareholding pattern



Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	-2.4	6.3	3.2	-14.1
Relative to Sensex	-1.0	-1.8	0.7	-5.9

Result highlights

- ◆ **Lackluster performance, disappointing guidance:** Infosys' has reported lackluster numbers for Q4FY2012, missing its revenue guidance (revenue declined by 1.9% quarter on quarter [QoQ] against our estimate of a 0.9% rise). For FY2013 also, the company's management has given a disappointing guidance of an 8-10% revenue (US dollar terms) growth for FY2013. The weak guidance upset the Street and the same was reflected in the 12.6% correction in the company's stock price post the announcement of the results.

For Q4FY2012, the revenues were down 1.9% to \$1,771 million, with the blended volume down 1.5% sequentially while pricing declined 1.1%. The shortfall in revenues can largely be attributed to ramp down from some clients in the banking financial services and insurance [BFSI] space in North America and due to delays in anticipated ramp ups during the quarter.

In INR terms, revenues were down 4.8% to Rs8,852 crore, whereas the EBITDA margin declined 110bps QoQ to 32.6% on account of an appreciation in the rupee (realisation down by 2.9% QoQ) coupled with a drop in the utilisation rate by 570bps to 73%. The net other income was up by 54.5% QoQ to Rs652

Results

(Rs cr)

Particulars	Q4 FY12	Q4 FY11	Q3 FY12	% YoY	% QoQ	FY 2012	FY 2011	% YoY
USD/INR	50.0	45.3	51.5	10.4	-2.9	48.2	45.5	6.0
Revenues (\$ mn)	1771	1602	1806	10.5	-1.9	6994	6041	15.8
Net sales	8852	7250	9298	22.1	-4.8	33734	27501	22.7
Direct costs	4956	4012	5052	23.5	-1.9	18871	15054	25.4
Gross profit	3896	3238	4246	20.3	-8.2	14863	12447	19.4
SG&A	1006	914	1111	10.1	-9.5	4147	3483	19.1
EBITDA	2890	2324	3135	24.4	-7.8	10716	8964	19.5
Depr & amort.	243	222	236	9.5	3.0	937	862	8.7
EBIT	2647	2102	2899	25.9	-8.7	9779	8102	20.7
Other income	652	415	422	57.1	54.5	1904	1211	57.2
PBT	3299	2517	3321	31.1	-0.7	11683	9313	25.4
Tax provision	983	699	949	40.6	3.6	3367	2490	35.2
PAT	2316	1818	2372	27.4	-2.4	8316	6823	21.9
Minority interest	0	0	0			0	0	
Net profit	2316	1818	2372	27.4	-2.4	8316	6823	21.9
Equity capital (FV Rs5/-)	286	286	286			286	286	
EPS (Rs)	40.5	31.8	41.5			145.4	119.3	21.9
Margin (%)								
GPM	44.0	44.7	45.7			44.1	45.3	
EBITDA	32.6	32.1	33.7			31.8	32.6	
EBIT	29.9	29.0	31.2			29.0	29.5	
NPM	26.2	25.1	25.5			24.7	24.8	
Tax rate	29.8	27.8	28.6			28.8	26.7	

crore (interest income was up by 37% QoQ to Rs584 crore). The net income was down by 2.4% QoQ to Rs2,316 crore. For FY2012, the revenues were up by 22.7% year on year (YoY) to Rs33,734 crore and net income was up by 21.9% to Rs8,316 crore. During the quarter the company has added 52 new clients and won 5 large deals and 7 business transformation deals, out of which 3 deals are worth more than \$100 million.

- ♦ **Guidance disappoints, management warns of challenges ahead:** For FY2013, Infosys has guided for an 8-10% revenue growth and 4-5.7% net profit growth in US dollar terms. The revenue growth guidance fell well short of the Street's expectations and Nasscom's guidance of a 11-14% growth. Further, the company's management has also warned of an uncertain macro environment and a cautious spending pattern of clients (to be more visible in the BFSI space who are among the top clients), which has restricted its optimism on growth. Nevertheless, we believe Infosys' weak revenue guidance is more a reflection of company specific issues rather than secular sectoral concerns.
- ♦ **Valuation and view:** Client specific issues and lower than anticipated ramp up in the projects has led to Infosys missing the upper end of revenues guidance for a third consecutive quarter. The company has refrained from giving an optimistic growth forecast owing to multiple issues and an uncertain macro environment. We have downgraded our estimates for FY2013 and consequently reduced our target multiple on the stock from 17x to 15x based on FY2013 earnings estimates to factor in a lower growth and volatility in earnings. Although the stock has already corrected by 12.6% post the results, we do not see any major upside trigger for the stock in the near to medium term. We maintain our Hold rating on the stock with a revised price target of Rs2,440. We continue to maintain our preference for Tata Consultancy Services (TCS) over Infosys.
- ♦ **Management indicates at convergence of concerns, leading to lack of growth visibility:** The company's management has indicated at multiple concerns leading to lack of growth visibility. These include a ramp down from key banking and financial services (BFS) accounts in North America, slower decision making by clients and slower than anticipated ramp up in the projects. Going forward, the company's management has warned of challenges in the spending pattern by clients on account of an uncertain macro environment. As per the management, the clients' IT budgets have been finalised (which are flat to negative) but the decision making is on a month to month basis as clients are getting more cautious on the environment. This has led to a low visibility on the

spend-to-budget ratio for the coming quarters. On the discretionary side, clients remain watchful of the uncertain macro environment and are delaying decision making on new projects. Further, there has been a slowdown as well as deferment in the anticipated ramp up of regulatory and compliance related spends in the BFSI space due to extension of time line and clarifications issued by enforcing authorities as to the applicability of the regulations. Finally, on the back of the lack of visibility on the demand front, the management has decided at no wage hike for FY2013.

Key operating metrics

- ♦ Within the service offerings, this time round the company saw ramp downs in the business operations services and a slower ramp up in the discretionary projects. This is reflected in the 3.2% QoQ drop in business IT services revenues whereas there was a 0.3% fall in the consulting and package implementation services. The products, platforms and solutions (PPS) revenue grew 3% with contribution at 6.2% of revenues. Business process management (BPM) reported a strong performance with a sequential growth of 16.9%, contributing 6.2% to revenues. The growth in BPM was led by platform based business process outsourcing (BPO) services, the contribution of which has increased to 1.4% from 0.7% in the previous quarter.

Service offerings: BPM revenues report growth (%)					
Particulars	Q4FY12	Q4FY11	Q3FY12	YoY %	QoQ %
Appl Dev	16.9	16.1	17.1	16.0	-3.1
Appl Maint	20.9	22.0	21.8	5.0	-6.0
ADM	37.8	38.1	38.9	9.7	-4.7
BPM	6.2	5.6	5.2	22.4	16.9
Consulting & Package Impl.	31.1	31.7	30.6	8.5	-0.3
IMS	6.2	6.1	6.1	12.4	-0.3
Prod engg.	3.4	2.4	3.6	56.6	-7.4
Testing	7.8	7.3	7.9	18.1	-3.2
Others	3.1	3.3	2.9	3.8	4.8
Products	4.4	5.4	4.8	-9.9	-10.1

Source: Company and Sharekhan Research

Business IT services revenues fall (%)					
Particulars	Q4FY12	Q4FY11	Q3FY12	YoY %	QoQ %
Business IT services	62.7	61.9	63.5	12.0	-3.2
Business transformation	31.1	31.7	30.6	8.5	-0.3
Products, platforms and solutions	6.2	6.4	5.9	7.1	3.0

Source: Company and Sharekhan Research

- ♦ Amongst the industry verticals, BFSI is seeing ramp downs in North America involving one of the top accounts. There has been a slowdown and delay in the anticipated ramp up on regulatory and compliance related spends due to

extension of time line and clarifications as to the enforceability of the regulations. This has led to a 3.7% drop in the revenues from the BFS vertical. In Insurance there has been a delay in the ramp up in few large deals that the company had signed earlier with some programs shelved or deferred leading to a 8.6% Q-o-Q fall in the revenues from the insurance vertical. The transportation and healthcare & life sciences segment saw a drop in revenues on the back of a strong previous quarter. The manufacturing vertical saw a Q-o-Q growth of 2.4% while retail grew by 1.9%. Manufacturing is seeing a stable demand environment whereas retail is slow.

Industry verticals: BFSI sees ramp downs (%)

Particulars	Q4FY12	Q4FY11	Q3FY12	YoY %	QoQ %
Insurance	6.9	7.2	7.4	5.9	-8.6
Banking	27.4	28.5	27.9	6.3	-3.7
BFSI	34.3	35.7	35.3	6.2	-4.7
Manufacturing	21.3	20.4	20.4	15.4	2.4
Retail	15.8	14.5	15.2	20.5	1.9
Telecom	10.1	11.9	9.8	-6.2	1.1
Energy & Utilities	6.1	5.8	6.0	16.3	-0.3
Transportation	1.6	2.1	2.0	-15.8	-21.6
Life sciences and Healthcare	5.5	4.8	5.9	26.7	-8.6
Others	5.3	4.8	5.4	22.1	-3.8

Source: Company and Sharekhan Research

- ♦ The revenue from the top client declined by 1.9% QoQ whereas the top six to ten clients reported a 7.1% drop in revenues.

Revenue from the top client down 1.9% QoQ (%)

Particulars	Q4FY12	Q4FY11	Q3FY12	YoY %	QoQ %
Top client	4.1	4.7	4.1	-3.6	-1.9
Top 5 clients	15.4	15.4	15.0	10.5	0.7
Top 10 clients	24.4	24.9	24.5	8.3	-2.3
Others than top 10	75.6	75.1	75.5	11.3	-1.8

Source: Company and Sharekhan Research

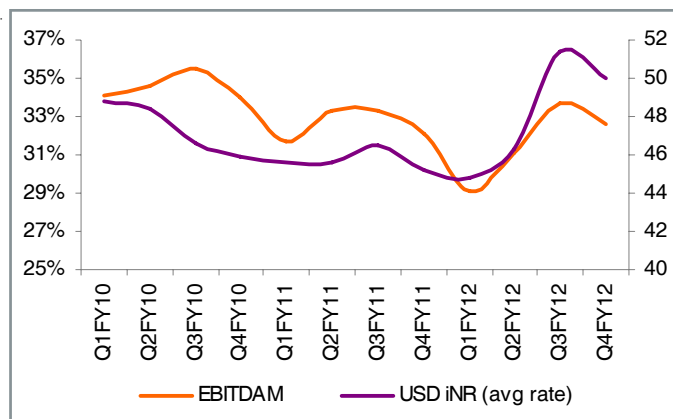
- ♦ Among the geographies, North America reported a 3.9% fall in revenues with contribution down to 62.4%. In North America, the company saw ramp downs from BFSI clients. The revenues from Europe were marginally up contributing 23.1% to the company's total revenues. The company added five new clients in the European geography. In terms of demand environment the management believes that business is relatively steady in Europe as against North America. Revenues from the rest of world were up 5.7%.

Revenues from North America drop whereas Europe is flat (%)

Particulars	Q4FY12	Q4FY11	Q3FY12	YoY %	QoQ %
North America	62.4	63.7	63.7	8.3	-3.9
Europe	23.1	22.1	22.6	15.6	0.2
India	2.0	2.7	2.1	-18.1	-6.6
Rest of world	12.5	11.5	11.6	20.2	5.7

Source: Company and Sharekhan Research

Margins down 110bps sequentially; management expects margins to decline by 50-100bps in FY2013 (without considering wage hikes)

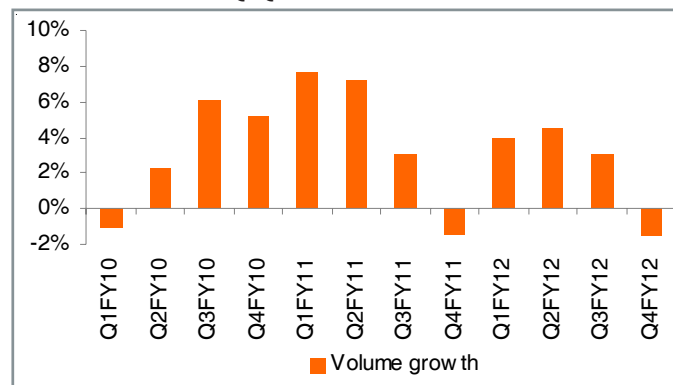


Guidance for Q1FY2013 and FY2013

Particulars	Q1FY13	FY13
Revenues (\$ mln)	1771 - 1789	7553 - 7692
QoQ %	0.0 - 1.0	
YoY %	6.0 - 7.1	8.0 - 10.0
Revenues (Rs cr)	9011 - 9100	38431 - 39136
QoQ %	1.8 - 2.8	
YoY %	20.4 - 21.6	13.9 - 16.0
EPS (Rs)	36.89	158.76 - 161.41
QoQ %	-9.0	
YoY %	22.4	9.1 - 10.9

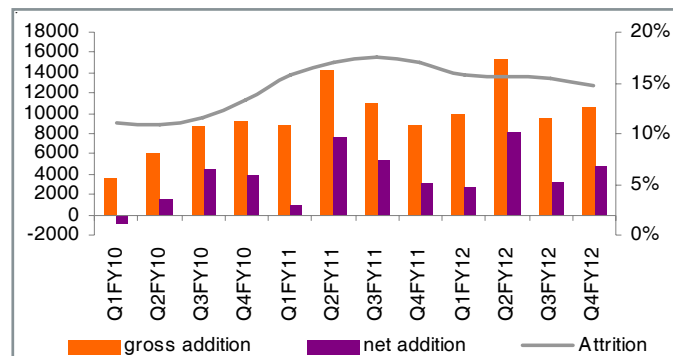
Assumed rates: USD/INR: 50.88, Euro/USD:1.33, GBP/USD:1.60, AUD/USD: 1.04

Volumes down 1.5% QoQ



Source: Company and Sharekhan Research

Headcount metrics: Management indicates at adding 35,000 headcounts in FY2013



Source: Company and Sharekhan Research

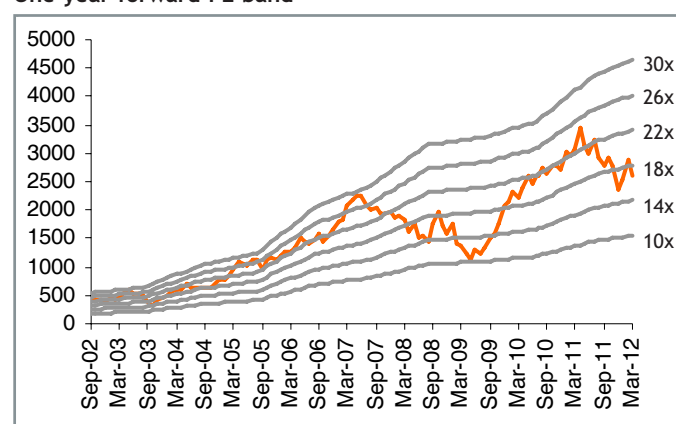
Other highlights

- ◆ The cash and cash equivalents at the end of the quarter increased to Rs20,591 crore from Rs19,495 crore at the end of Q3FY2012.
- ◆ The company's total hedge at the end of Q4FY2012 stood at \$889 million against \$852 million at the end of the previous quarter. The company has maintained its hedging policy of covering the next two quarters' receivables.
- ◆ The DSO days were down to 60 days from 61 days in the previous quarter.
- ◆ **Employees:** The company added 10,676 employees on a gross basis and 4,906 employees on a net basis, taking the total headcount to 149,994 employees. The attrition rate on the last-twelve-month basis was down 70bps to 14.7%. The utilisation of the employees including trainees was down by 270bps to 67.2% and that excluding the trainees dropped by 440bps to 73%. For FY2013, the company has guided at a gross employee addition of 35,000 people including 13,000 in the BPM business and 1,200 local hires in North America.
- ◆ **Clients:** The company added 52 new clients during the quarter including 5 clients in Europe. Of the new clients 12 are Fortune 500 companies of which 4 are in North America. The total active clients increased to 694 clients at the end of Q4FY2012. The number of clients contributing annual revenue of more than \$60 million increased to 28 from 27 at the end of Q4FY2012.
- ◆ **Large deals:** The company signed five large deals and seven business transformational deals in the quarter including three large deals in North America. Three of the large deals are more than \$100 million each.
- ◆ **Valuation and view:** Client specific issues and lower than anticipated ramp up in the projects has led to Infosys missing the upper end of revenues guidance for a third consecutive quarter. The company has refrained from giving an optimistic growth forecast owing to multiple issues and an uncertain macro environment. We have

downgraded our estimates for FY2013 and consequently reduced our target multiple on the stock from 17x to 15x based on FY2013 earnings estimates to factor in a lower growth and volatility in earnings. Although the stock has already corrected by 12.6% post the results, we do not see any major upside trigger for the stock in the near to medium term. We maintain our Hold rating on the stock with a revised price target of Rs2,440. We continue to maintain our preference for Tata Consultancy Services (TCS) over Infosys.

Valuation				Rs (cr)
Particulars	FY11	FY12	FY13E	FY14E
Total revenue	27,501.0	33,734.0	38,528.8	43,696.9
EBITDA margin (%)	32.6	31.8	30.7	30.5
Net profit	6835.0	8316.0	9125.8	10483.6
EPS (Rs)	119.5	145.4	159.5	183.3
PER (x)	20.1	16.5	15.1	13.1
EV/EBITDA (x)	13.6	10.9	9.3	7.8
RoE (%)	27.9	29.0	26.4	25.2
RoCE (%)	37.7	40.5	36.6	33.8
Dividend yield (%)	1.0	0.6	0.7	0.8

One-year forward PE band



Source: Bloomberg

Estimates variance

Particulars	Sharekhan Old Estimates	Sharekhan New Estimates	Consensus estimates	Var (%) Sharekhan New vs Sharekhan old	Var (%) Sharekhan New vs Consensus
Rs/USD	49.5	49.8	50.6	0.6	-1.5
Revenues (\$ mln)	7959.1	7735.9	7859.0	-2.8	-1.6
YoY grth (%)	12.6	10.6	13.8		
Revenues (Rs cr)	39403.5	38528.8	39741.7	-2.2	-3.1
Net profit (Rs cr)	9605.8	9125.8	9711.4	-5.0	-6.0
YoY grth (%)	13.8	9.7	15.5		
EPS (Rs)	167.9	159.5	169.1	-5.0	-5.7

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