

Infosys Ltd Result Synopsis**Neutral****CMP: Rs.2230****Target: Rs. 2315**

Q113 - Lackluster performance continues...**FY13 Revenue growth guidance revised from 8-10% to “at least 5%”**

Infosys saga of underperformance continues with Q113 dollar revenues declining 1.1%QoQ to \$1752mn. The management guidance of “at least 5%” from 8-10% came as a huge negative surprise, besides, weak pricing outlook added to the disappointment. Infosys revenue growth was impacted by a one-time reversal of \$15mn taken prudentially on account of cancellation of a transformation project in Europe, while \$13mn cross currency impact aggravated the pressure on revenues. In INR terms, Net sales grew 9%QoQ to Rs.9616cr while net profit contracted 1%QoQ to Rs.2289cr. Operating margins (excl. OI) shrunk to 28% compared to 29.9% despite freezing salary hikes and rupee depreciation. The weak performance coupled with the challenging business outlook, does not augur well for Infy.

We have lowered our \$ revenue expectation for FY13 to 6%, however on account of currency depreciation our INR revenue and EPS estimates are marginally revised upwards by 2.6% and 1% respectively. On account of execution challenges, pricing pressures and risks of project deferment/cancellation rising, we lower our target multiple to 13x-1yr fwd FY14EPS of Rs.178 (vs.15x) resulting in our target price of Rs.2315 (vs.Rs.2760 earlier). Downgrade to Neutral.

Volume growth silver lining, pricing slumps...

Volumes grew 2.7% compared to 1.5% de-growth seen in Q412, driven by secular growth in on-site and off-shore volumes. Utilizations (excl. trainees) remained under duress, declining to 71.6% vs. 73% in Q412. The management has guided for the volume growth of ~9.5% for the FY13 however expects pricing pressure (-3.7%) seen in Q113 to continue in the quarters ahead. Consequently the mgmt scaled its revenue guidance lower.

Client additions robust, top 5 clients’ revenue growth strong

Infy witnessed healthy pace in client additions, adding 51 clients during the Q1113. Revenue from top client declined 1%QoQ however revenues from top 2-5 clients grew 5.9%QoQ, resulting in top 5 clients revenues growing 4%QoQ. The revenue decline in the non- top 10 clients further escalated, contracting 2.3% vs. 1.8% fall seen in Q412.

Major business segments under intense pressure.

Infosys continues to witness intense pressure in key business areas thus has been underperforming both on the revenue and profitability front. B&FSI revenues which contributes 34.3% of revenues, declined 1% while Consulting and Sytem Integration revenues which is the high margin segment, dropped 5%QoQ. C&SI accounts for 29.9% of revenues. Thus with ~60% of business impacted due to macro headwinds, overall performance is likely to remain under pressure.

Revenue Profile:

Revenue by service offering:

Business operations which account for 64% of revenues have grown 1%QoQ on account of healthy growth IMS and Testing. Application development which accounts for 17.1% of revenues were flat (+0.1%) while Application Maintenance revenues, which contribute 20.9% of revenues, declined 1%QoQ. IMS which contributes 10% of segment (Bo) revenues grew 5.3% while testing services also grew 5.3%. The company attributed the robust growth to increasing client focus on infrastructure consolidation, data centre and automation. Business Process Mgmt Services revenue grew 1% QoQ as shift toward upper end of business pyramid aided revenue growth besides improved margins. Infy won 4 deals in the Business & IT services space, one above \$300mn.

Business transformation segment which accounts for 1/3rd of overall revenues, consisting of consulting and system integration services, revenue growth was disappointing, declining 4.9%. The steep decline in C&SI revenues was largely driven by the project cancellation of a transformation project of a European utilities client. Infosys won 4 deals in the transformation space. The management did indicate that the environment remains difficult and hence C&SI revenues are likely to remain under pressure.

Business Innovation segment which consists of the Products, Platforms and Solutions, recorded a decline in revenues of 2.7% QoQ. Revenues from the segment accounted for 6.1% of overall revenues and remains important focus area for Infosys. The company added 10 clients during the quarter, 3 in products and remaining in platforms. The company launched Infosys BrandEdge™, while Infosys SocialEdge™ added 10 more clients. Finacle™ added 10 clients during the quarter with 5 from EMEA and 5 from Asia Pacific region. Infosys ended the quarter with a TCV of over \$380mn.

Revenue by service offering:	% of sales	QoQ	YoY
Business IT Services	64.0	1.0%	
<i>Application Development</i>	17.1	0.1%	11.4%
<i>App Maintainance</i>	20.9	-1.1%	-1.7%
<i>IMS</i>	6.6	5.3%	17.3%
<i>Testing</i>	8.3	5.3%	16.0%
<i>Bus. Process Mgmt Services</i>	4.9	1.0%	-4.9%
<i>Products Eng Services</i>	3.5	1.8%	14.7%
<i>Others*</i>	2.7	-1.1%	1.1%
Consulting, Package Implementation & Others	29.9	-4.9%	
<i>Consulting & System Integration & Others</i>	29.9	-4.9%	-1.1%
Products, Platforms & Solutions	6.1	-2.7%	
<i>Products</i>	4.5	1.2%	-1.7%
<i>Bus. Process Mgmt (BPM) Platform*</i>	1.3	-8.1%	NA
<i>Others</i>	0.3	-26%	4.8%

*Reported under "Business IT Services" in previous quarters; Source: Company and Banham Research

Revenue by Industry

FSI reported 1% sequential decline and 0.4% in constant currency. B&FS revenues were flat QoQ while Insurance fell 5% QoQ. The management outlined that the B&FS sector remains under pressure and witnessing instances of price re-negotiations and attempt to offset investments in new systems & initiatives by squeezing expenditure on day-to-day IT applications.

Manufacturing sector continues to perform relatively well, growing 2.5% sequentially and 3.1% in constant currency. The mfg sector accounts for 22% of overall revenues. The mgmt remains confident of the sector, however cautioned that in the event of further deterioration in the FSI environment, manufacturing could be impacted with 6 month lag.

Retail and Life sciences remains a key investment area for the Infosys, rebounded this quarter after a weak Q412. RCL grew 2.3% sequentially and 2.6% in constant currency terms. Life sciences and Healthcare recorded a decline of 6% and 13.4% QoQ respectively. Transport & Logistics grew 5.1%QoQ. Retail & CPG which accounts for 71% of segment and 16.9% of overall revenues grew 5.8% sequentially. The strong performance of retail and life science segment is a positive.

ECS revenues declined by 8.2% sequentially and 7.3% in constant currency, as Telecom which accounts for half of segment (ECS) revenues, declined 1.1%. Energy and Utility which contributes 4.6% of overall revenues declined 25.4%, on account of the project cancellation during the quarter.

Revenue by Industry	% of Sales Q412	Growth QoQ
Insurance, Banking & Financial Services	34.3	-1.1%
<i>B&FS</i>	27.7	0.0%
<i>Insurance</i>	6.6	-5.4%
Mfg	22.0	2.2%
Retail & Life sciences	23.7	2.4%
<i>Retail & CPG</i>	16.9	5.8%
<i>Transport & Logistics</i>	1.7	5.1%
<i>Life sciences</i>	3.7	-6.1%
<i>Healthcare</i>	1.4	-13.4%
Energy, Utilities, Communications & Services	20.0	-8.0%
<i>Energy & Utilities</i>	4.6	-25.4%
<i>Telecom</i>	10.1	-1.1%
<i>Others</i>	5.3	-1.1%

Source: Company and Banham Research

Revenues by Geography

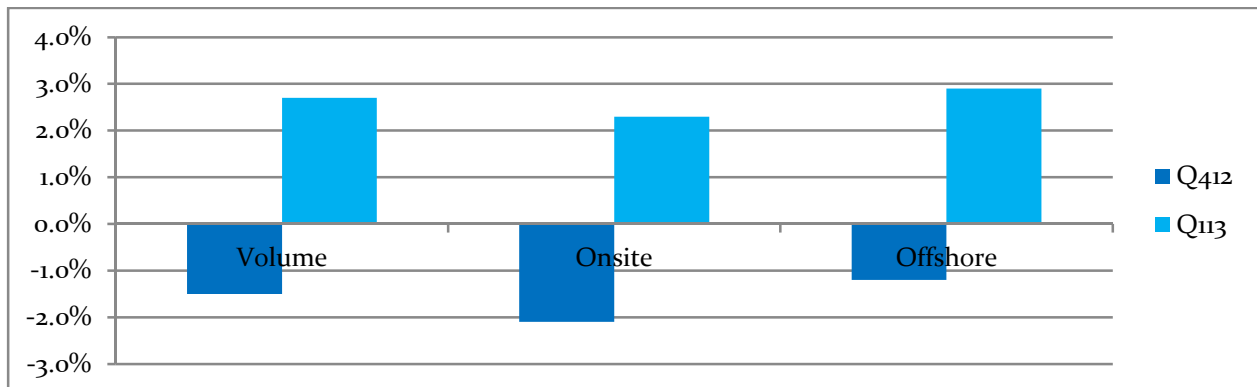
Revenue share from North America rebounded 170bps QoQ to 64.10% at expense of Europe. Revenue contribution from Europe dipped 170bpsQoQ to 21.4% due to the one-off reversal of revenue from the cancelled project. The company remains confident of business sustaining from Europe. Revenues from NA grew 1.6% QoQ (1.7%ccy) while Europe revenues declined 8.1% QoQ (7.2%ccy). India revenue contribution remained constant at 2.0% while revenues declined 4.3%QoQ. ROW revenue share remained constant at 12.5% while revenues fell -1.0%QoQ (2.2%ccy).

Revenues by Project Type

The share of fixed price projects declined 140bps QoQ to 38% while Time and Material project grew to 62.0% vs. 60.6% in Q412.

Pricing and Volume Growth

Infosys positively surprised with volumes growing 2.7%. Onsite efforts grew 2.3% QoQ vs. -2.1% in Q412 while offshore efforts grew 2.9% vs. -1.2%QoQ seen in the Mar-12 quarter. Pricing declined 3.7%QoQ (3.2% ccy).



Source: Company, Banham Research

Client additions:

Infosys continued to witness robust client additions, acquiring 51 new clients in Q113 compared to 52 clients in the Q4FY12. Infy added 4 large deals during the quarter with 1 in \$300mn plus category. Infy won 4 transformation deals during the quarter. Number of clients active rose to 711 from 694 at end of Mar-12 quarter. Client concentration remained largely stable, with Top client, Top 5 and Top 10 clients accounting for 4.1%, 16.2% and 25.3% respectively. Share of Repeat business grew sharply to 99.1% from 96.0% in Q412.

Guidance:

Infosys further downgraded its full year revenue guidance to atleast 5% from of 8-10% to \$7.343bn from \$7.553bn-7.692bn earlier. The company discontinued its policy of giving quarterly guidance on account of lack of visibility.

Infosys has guided for FY13 EPS of at least Rs.166.46 from between Rs.158.76-161.41, translating to YoY growth of 14.4%. Infy has now assumes INR/USD rate of Rs.55 compared to Rs.50.88 earlier.

	FY13	FY13	Q113	Q113
Rupee Guidance	Guidance	Revised	Guidance	Actual
Revenues	Rs.38431-39136cr	Rs.40364cr	Rs.9011-9100cr	9616
YoY	13.9-16.0%	19.7%	20.4-21.6% 1.79-2.80% QoQ	28.5% 8.6%
EPS	158.76-161.41	166.46	36.89	40.06
YoY	9.1-10.9%	14.4%	22.4%	32.90%
Rs./\$	50.88	55.00	50.88	54.8
Dollar Guidance				
Revenues	\$7.553-7.692bn	\$7.343bn	\$1.771-1.789mn	\$1752
YoY	8-10%	5.0%	6.0-7.1% 0-1%QoQ	4.8%
EPADS	\$3.12-3.17	\$3.03	\$0.73	\$0.73
YoY	4-5.7%	1.0%	9.0%	9.0%

Source: Company, Banhem Research

View:

Infosys management seems to be a victim of its own legacy of delivering high quality growth and hence has not been able to scale up its revenues in the current environment wherein projects are scarce while competition has moved several notches higher. Given the high margins enjoyed by Infy, the risks of price re-negotiations are higher. Hence ability of Infosys to negotiate without increasing risks of deferment or cancellations of projects would be tested.

The management has acknowledged the issue of vendor consolidation especially in the commoditized services like ADM, IMS etc. Infosys ability to sustain projects at relatively higher margins with low degree of service differentiation seems to be at risk.

Infosys faces increasing risk of attrition moving higher, given the freeze on wage hikes. The management has given over 20,000 promotions to lower the resentment and has decided to review its decision in second half (Oct) of this year. Attrition rate inched higher to 14.9% vs. 14.7% seen at end of Q412. Hence the risk of further deterioration in margin remains.

On the positive side, Infosys has continued to secure robust client additions, witness healthy client additions in P&P space, sustained traction in BPO operations, and uptick in repeat business. We believe the company seems focused on its objectives however slower adjustments to economic environment, has hurt revenue growth.

Overall we believe Infosys has cornered itself with rigid focus on margins, resulting in lesser flexibility in dealing with current environment. We believe the underperformance could continue in the quarters ahead.

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Quarterly (Rs.cr)	Q113	Q412	QoQ	YoY
Revenues	9616	8852	8.6%	28.5%
COS	5810	5199	11.8%	26.9%
Gross Profit	3806	3653	4.2%	30.9%
GPM (%)	39.6%	41.3%	-169bps	73bps
Selling & Mkt	469	452	3.8%	17.8%
Admin	644	554	16.2%	15.4%
Total Opex	1113	1006	10.6%	16.4%
Op profit	2693	2647	1.7%	38.0%
OPM (%)	28.0%	29.9%	-190bps	190bps
other income	476	652	-27.0%	7.4%
PBT	3169	3299	-3.9%	32.3%
Tax	880	983	-10.5%	30.8%
Tax Rate	27.77%	29.80%	-200bps	-33bps
PAT	2289	2316	-1.2%	32.9%

Quarterly (\$ mn)	Q113	Q412	QoQ	YoY
Revenues	1752	1771	-1.1%	4.8%
COS	1059	1041	1.7%	3.6%
Gross Profit	693	730	-5.1%	6.8%
GPM (%)	39.6%	41.2%	-170bps	73bps
Selling & Mkt	86	91	-5.5%	-3.4%
Admin	118	111	6.3%	-5.6%
Total Opex	204	202	1.0%	-4.7%
Op profit	489	528	-7.4%	12.4%
OPM (%)	27.9%	29.8%	-190bps	190bps
other income	87	131	-33.6%	-12.1%
PBT	576	659	-12.6%	7.9%
Tax	160	196	-18.4%	6.7%
Tax Rate	27.8%	29.7%	-200bps	670bps
PAT	416	463	-10.2%	8.3%

All figures in Rs.cr

P/L	FY10	FY11	FY12	FY13e	FY14e
Revenues	22742	27501	33734	39663	41859
Cost of sales	12078	15054	18871	22767	23818
Gross Profit	10664	12447	14863	16896	18041
GPM (%)	46.9%	45.3%	44.1%	42.6%	43.1%
Selling & Mktg	1184	1512	1757	2095	2152
Admin exp	1628	1971	2390	2977	3141
Total Opex	2812	3483	4147	5072	5294
EBITDA	7852	8964	10716	11824	12748
EBITDA Margin	34.5%	32.6%	31.8%	29.8%	30.5%
Depreciation	942	862	937	1137	1168
EBIT	6910	8102	9779	10687	11580
Other Income	990	1211	1904	2483	2551
Interest	0	0	0	0	0
PBT	7900	9313	11683	13170	14131
Tax	1681	2490	3367	3688	3957
Tax Rate	21.3%	26.7%	28.8%	28.0%	28.0%
PAT	6219	6823	8316	9483	10174
EPS	108.89	119.42	145.54	165.96	178.06

Balance sheet	FY10	FY11	FY12	FY13e	FY14e
Assets					
Cash and Cash Eq	12111	16666	20591	26739	33612
Other Current Assets	8779	7023	9655	10105	10658
Non Current Assets	6722	7574	8102	8460	8830
Total Assets	27612	31263	38348	45304	53100
Liabilities					
Equity	286	286	286	286	286
Networth	24073	27303	33461	40131	47509
Liabilities	3539	3960	4887	5173	5591
Total Liabilities	27612	31263	38348	45304	53100

Cash Flow	FY10	FY11	FY12	FY13e	FY14e
Cash from Operations	6,873	5,907	8,212	10439	11120
Cash from Investments	-4,388	2,231	-2061	-1653	-1475
Cash from Financing	-1,480	-3,641	-2,321	-2639	-2,772
Net Chg in cash	1,005	4,497	3830	6148	6873

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RATINGS

Buy	Accumulate	Neutral	Reduce	Sell
>15%	+5>15%	+5%/-5%	-5%<-15%	>-15%

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