

## Infosys Ltd Result Synopsis

Accumulate

CMP: Rs.2296

Target: Rs. 2480

### Q413 – \$ Revenue up merely 1.4%QoQ, FY14 revenue guidance of 6-10% disappoints Volume subdued at 1.8%; pricing shrinks 70bps

Infosys reported revenues of Rs.10454cr in Q413, up merely 0.3%QoQ as subdued volume growth (1.8%) and dip in pricing (-70bps) hurt top-line growth. In USD terms, revenues grew 1.4%QoQ to 1938mn, sharply lower than expectations (+4%), consequently delivering a full year revenue growth of 5.8% YoY. Infosys has guided for FY14 revenue growth of 6-10% which is sharply lower than Nasscom's projection of 12-14% growth in FY14. The management guidance implies a quarterly growth between 0.6% QoQ at the lower end and 2% QoQ growth at the upper end. The company discontinued EPS guidance on account of lack of clarity on margins due to uncertainty of visa sanctions, pricing pressures in Business operations segment, full year impact Lodestone, competitive pressures and an uncertain environment. Net Profit for Q413 grew 1.1%QoQ to Rs.2394cr largely on account of lower tax rate (23.7% vs. 27.8%avg in last 4Qs)

Industry-wise, Banking and Finance (+2.9%QoQ) and Manufacturing (+3.8%QoQ) which account for ~50% of revenues held up, however RCL and ECU posted growth of merely 0.5% and -1.4% respectively. Service segment-wise, business operations which includes ADM services and accounts for ~62% of revenues, grew merely 0.9%.

### Margins decline sharply

EBIT margins deteriorated 213bps to 23.6%, significantly sharper than the 100bps broad range guided by the management last quarter. The company undertook on-site wage hikes (2%) during the quarter, however weak pricing and Lodestone impact, eroded margins significantly. Margins are expected to be weighed down on account of higher subcontracting costs, competitive pressures and higher contribution from Lodestone (delivers single digit margins). Lodestone margins are expected to improve as offshore capabilities are built. Infosys has upped the performance measurements to rationalize costs, however weak pricing and low utilizations have hurt margins.

We have downgraded our FY14 earnings estimate by 10.5%. We introduce FY15 estimates, and expect revenues to grow 10% and PAT by 9% CAGR over FY13-15e. We have set INR/\$ estimates for FY14 and FY15 at Rs.54.3/\$ (vs. Rs.51/\$ earlier for FY14). Infosys currently trades at 12x FY15e of Rs.190.8 and to factor in weaker margins and slower than industry growth, we lower our PE multiple to 13x (from 16x earlier) and roll forward to FY15 EPS, to arrive at our target price of Rs.2480 (from Rs.3035 earlier).

### Performance Snapshot

Description Rs.cr	Q413	Q313	QoQ (%)	YoY%
Net Sales	10454	10424	0.3	18.1
Op. Profit(excl. OI)	2462	2677	-8	-7.0
OPM (%)	23.6	25.7	(213)bps	(635)bps
PAT	2394	2369	1.1	3.4

## Revenue Profile:

### Revenue by service offering:

**Business operations** which account for 61.6% of revenues have grown 0.9%QoQ on account of healthy growth IMS and BPO. Revenue share of Application development and maintenance eroded 40bps QoQ on account of marginal performance in respective segments. Application development revenues declined 0.5%QoQ resulting in revenue share dipping to 15.5% vs. 15.8% in Q313. Revenues from Application maintenance grew 0.9% QoQ; however revenue share declined to 19.9% vs. 20% in Q313. IMS and BPO which together account for 12.4% of revenues, reported healthy growth of 5.8%, 1.4% QoQ respectively. Testing which accounts for 8.3% of revenues disappointed, growing merely 0.2%QoQ vs. 3.9% seen in Q313. Infosys expects the BPO business to sustain its momentum in the quarters ahead.

**Business transformation** segment revenue share rose to 32.7% compared to 32.6% in Q313. Consulting and system integration revenues grew 1.7%, ahead of overall revenue growth. The company remains focused on the C&SI space, however stated that discretionary spend environment remains uncertain.

**Business Innovation** segment which consists of the Products, Platforms and Solutions, recorded an increase in revenues of 5.1% QoQ. Revenues from the segment accounted for 5.7% of overall revenues and remains important focus area for Infosys. The company had 12 wins (excl. Finacle™) during the quarter and added 7 clients, consequently increasing the number of clients for products and platforms to 79. The company added over 10 engagements across Cloud service, Big Data and Security. Infosys ended the quarter with a TCV of \$685mn vs. \$603 mn earlier.

Revenue by service offering:	% of sales	QoQ	YoY
<b>Business IT Services</b>	<b>61.6</b>	<b>0.9%</b>	
<i>Application Development</i>	15.5	-0.5%	0.4%
<i>App Maintenance</i>	19.9	0.9%	4.2%
<i>IMS</i>	7.2	5.8%	27.1%
<i>Testing</i>	8.3	0.2%	16.4%
<i>Bus. Process Mgmt Services</i>	5.2	1.4%	18.5%
<i>Products Eng Services</i>	3.2	1.4%	3.0%
<i>Others*</i>	2.3	-2.8%	-6.8%
<b>Consulting, Package Implementation &amp; Others</b>	<b>32.7</b>	<b>1.7%</b>	
<i>Consulting &amp; System Integration &amp; Others</i>	32.7	1.7%	15.1%
<b>Products, Platforms &amp; Solutions</b>	<b>5.7</b>	<b>5.1%</b>	
<i>Products</i>	4.0	4.0%	-0.5%
<i>Bus. Process Mgmt (BPM) Platform*</i>	1.3	1.4%	1.6%
<i>Others</i>	0.4	35.2%	9.4%

Source: Company and Banhem Research

## Revenue by Industry

FSI reported 2.3% sequential growth and 2.7% in constant currency. B&FS revenues grew 2.9% QoQ while Insurance fell 1.5% QoQ.

**Manufacturing** sector continues to perform relatively well, growing 3.8% sequentially and 3.9% in constant currency. The manufacturing sector accounts for 22.2% of overall revenues. Manufacturing has remained a pocket of strength, showing sustained traction. Infy expects manufacturing to be slower in H1 and pick up gradually in H2.

**Retail and Life sciences** a key investment area for the Infosys, disappointed. RCL grew 0.5% sequentially and 0.8% in constant currency terms. Life sciences and Healthcare grew 1.4% and 28.5% QoQ respectively. Transport & Logistics grew 1.4%QoQ. Retail & CPG which accounts for 64.4% of segment and 15.4% of overall revenues declined 2.4% QoQ.

**ECS** revenues declined by 1.4% sequentially and 1.0% in constant currency, as Telecom which accounts for 46.5% of (ECS) revenues, declined 1.8% QoQ. Energy and Utility which contributes 5.2% of overall revenues declined 2.3% QoQ.

Revenue by Industry	% of Sales Q413	Growth QoQ
<b>Insurance, Banking &amp; Financial Services</b>	<b>33.9</b>	<b>2.3%</b>
<i>B&amp;FS</i>	27.2	2.9%
<i>Insurance</i>	6.7	-1.5%
<b>Mfg</b>	<b>22.2</b>	<b>3.8%</b>
<b>Retail &amp; Life sciences</b>	<b>23.9</b>	<b>0.5%</b>
<i>Retail &amp; CPG</i>	15.4	-2.4%
<i>Transport &amp; Logistics</i>	1.8	1.4%
<i>Life sciences</i>	4.8	1.4%
<i>Healthcare</i>	1.9	28.5%
<b>Energy, Utilities, Communications &amp; Services</b>	<b>20.0</b>	<b>-1.4%</b>
<i>Energy &amp; Utilities</i>	5.2	-2.3%
<i>Telecom</i>	9.3	-1.8%
<i>Others</i>	5.5	1.4%

Source: Company and Banham Research

## Revenues by Geography

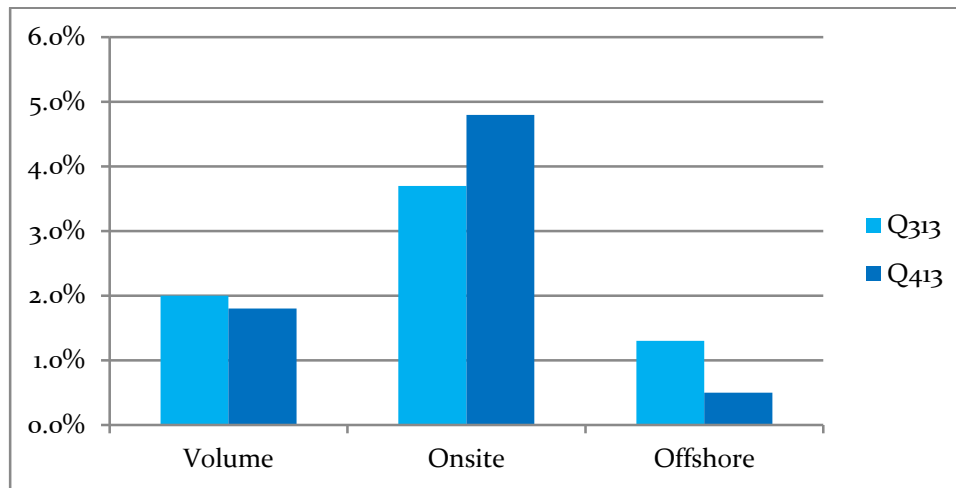
Revenue share from North America declined 80bps QoQ to 60.2%. Revenue contribution from Europe rose 100bps QoQ to 25% on account of traction in business. Revenues from NA grew 0.1% QoQ while Europe revenues grew 5.7% QoQ (6.5%ccy). India revenue contribution grew to 2.4% from 2.2% in Q313 while revenues grew 10%QoQ. ROW revenue share declined marginally to 12.4% while revenues fell 1.5% sequentially and 0.9% in constant currency.

## Revenues by Project Type

The share of fixed price projects declined 110bps QoQ to 40.2% while Time and Material project rose to 59.8% vs. 58.7% in Q313.

## Pricing and Volume Growth

Infosys posted volume growth of 1.8% versus 2.0% in Q313. Onsite efforts grew 4.8% QoQ vs. 3.7% in Q313 while offshore efforts grew 0.5% vs. 1.3% seen in the Q313 quarter. Pricing declined 70bps QoQ.



Source: Company, Banham Research

## Client additions:

### **Client additions healthy**

Infosys added 56 clients during the quarter, in-line trend seen in recent quarters. The company has won 5 deals along with Lodestone. Although client additions remained healthy and management remains confident of pipeline, Infosys is witnessing pressure in terms of sustained delay in ramp ups in existing projects.

Number of clients active rose to 798 from 776 at end of Q313. Revenue concentration was stable, with Top client, Top 5 and Top 10 clients accounting for 3.6%, 14.7% and 24% respectively. Share of Repeat business dropped to 96.5% from 97.5% in Q313.

**View:**

Infosys after a robust quarter has definitely surprised negatively in terms of downward shift in confidence, business outlook, margins, and attrition pressures. The extremely sluggish outlook of 6-10 percent and discontinuance of EPS guidance clearly reflects the uncertainty within the management on its revenues and profitability. The delay in ramp-ups in existing deals and sluggishness in discretionary spend has hit revenue visibility for the company.

Infosys has acknowledged its facing headwinds on pricing on account of competitive intensity and clients focus on extracting best possible terms. This is contrary to its outlook of stable pricing environment at the end of Dec-quarter. We believe the difficult choice of high revenue growth or high margins has resulted in increased uncertainty for Infosys.

Attrition pressures which seemed to have ebbed for Infosys have risen again in the fourth quarter despite the wage hikes and promotions announced. Attrition rate has risen 120 bps to 16.3%. The QoQ increase in average attrition (TTM) which had decelerated from 3.4% in Q113 to 0.5% in Q313 has now risen by 7.7%. This has resulted in increased pressure on the management to award pay hikes in-line with industry. Thus the combination of deteriorating pricing, higher staff costs, higher sub-contracting costs on account of tighter US visa rules are expected to hurt margins.

**We have downgraded our FY14 earnings estimate by 10.5%. We introduce FY15 estimates, and expect revenues to grow 10% and PAT by 9% CAGR over FY13-15e. We have set INR/\$ estimates for FY14 and FY15 at Rs.54.3/\$ (vs. Rs.51/\$ earlier for FY14). Infosys currently trades at 12x FY15e of Rs.190.8 and to factor in weaker margins and slower than industry growth, we lower our PE multiple to 13x (from 16x earlier) and roll forward to FY15 EPS, to arrive at our target price of Rs.2480 (from Rs.3035 earlier).**

Quarterly (Rs.cr)	Q413	Q313	QoQ	YoY
<b>Revenues</b>	<b>10454</b>	<b>10424</b>	<b>0.3%</b>	<b>18.1%</b>
COS	6802	6566	3.6%	30.8%
Gross Profit	3652	3858	-5.3%	0.0%
<b>GPM (%)</b>	<b>34.9%</b>	<b>37.0%</b>	<b>-208bps</b>	<b>-633bps</b>
Selling & Mkt	518	541	-4.3%	14.6%
Admin	672	640	5.0%	21.3%
Total Opex	1190	1181	0.8%	18.3%
Op profit	2462	2677	-8.0%	-7.0%
<b>OPM (%)</b>	<b>23.6%</b>	<b>25.7%</b>	<b>-213bps</b>	<b>-635bps</b>
other income	674	503	34.0%	3.4%
PBT	3136	3180	-1.4%	-4.9%
Tax	742	811	-8.5%	-24.5%
Tax Rate	23.7%	25.50%	-184bps	-614bps
<b>PAT</b>	<b>2394</b>	<b>2369</b>	<b>1.1%</b>	<b>3.4%</b>

Quarterly (\$ mn)	Q413	Q313	QoQ	YoY
<b>Revenues</b>	<b>1938</b>	<b>1911</b>	<b>1.4%</b>	<b>9.4%</b>
COS	1261	1203	4.8%	21.1%
Gross Profit	677	708	-4.4%	-7.3%
<b>GPM (%)</b>	<b>34.9%</b>	<b>37.0%</b>	<b>-212bps</b>	<b>-629bps</b>
Selling & Mkt	96	99	-3.0%	5.5%
Admin	124	118	5.1%	11.7%
Total Opex	220	217	1.4%	8.9%
Op profit	457	491	-6.9%	-13.4%
<b>OPM (%)</b>	<b>23.6</b>	<b>25.7</b>	<b>-211bps</b>	<b>-623bps</b>
other income	125	92	35.9%	-4.6%
PBT	582	583	-0.2%	-11.7%
Tax	138	149	-7.4%	-29.6%
Tax Rate	23.7%	25.6%	-185ps	-603bps
<b>PAT</b>	<b>444</b>	<b>434</b>	<b>2.3%</b>	<b>-4.1%</b>

All figures in Rs.cr

P/L	FY11	FY12	FY13	FY14e	FY15e
Revenues	27501	33734	40352	43385	48591
Cost of sales	15054	18871	24151	26161	29300
Gross Profit	12447	14863	16201	17224	19291
<b>GPM (%)</b>	<b>45.3%</b>	<b>44.1%</b>	<b>40.1%</b>	<b>39.7%</b>	<b>39.7%</b>
Selling & Mktg	1512	1757	2034	2268	2541
Admin exp	1971	2390	2609	2835	3090
Total Opex	3483	4147	4643	5103	5631
EBITDA	8964	10716	11558	12120	13660
<b>EBITDA Margin</b>	<b>32.6%</b>	<b>31.8%</b>	<b>28.6%</b>	<b>27.9%</b>	<b>28.1%</b>
Depreciation	862	937	1129	1236	1360
EBIT	8102	9779	10429	10884	12300
Other Income	1211	1904	2359	2586	2845
Interest	0	0	0	0	0
PBT	9313	11683	12788	13470	15145
Tax	2490	3367	3367	3772	4241
Tax Rate	26.7%	28.8%	26.3%	28.0%	28.0%
<b>PAT</b>	<b>6823</b>	<b>8316</b>	<b>9421</b>	<b>9699</b>	<b>10904</b>
EPS	119.42	145.54	164.87	169.73	190.83

Balance sheet	FY11	FY12	FY13	FY14e	FY15e
<b>Assets</b>					
Cash and Cash Eq	16666	20591	21832	30022	36864
Other Current Assets	7023	9655	13481	11942	12807
Non Current Assets	7574	8102	11038	10981	11116
<b>Total Assets</b>	<b>31263</b>	<b>38348</b>	<b>46351</b>	<b>52945</b>	<b>60787</b>
<b>Liabilities</b>					
Equity	286	286	286	286	286
Net worth	27303	33461	39797	46183	53432
Liabilities	3960	4887	6554	6763	7354
<b>Total Liabilities</b>	<b>31263</b>	<b>38348</b>	<b>46351</b>	<b>52945</b>	<b>60787</b>

Cash Flow	FY11	FY12	FY13	FY14e	FY15e
Cash from Operations	5,907	8,212	9478	10984	11921
Cash from Investments	2,231	-2061	-5051	528	-1425
Cash from Financing	-3,641	-2,321	-3211	-3322	-3654
Net Chg in cash	4,497	3830	1216	8190	6842

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**RATINGS**

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

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