

ACCUMULATE

Price	Rs2,178
Target Price	Rs2,475
Investment Period	12 Months

Stock Info

Sector	IT
Market Cap (Rs cr)	124,899
Beta	0.6
52 WK High / Low	2415 / 1040
Avg Daily Volume	248719
Face Value (Rs)	5
BSE Sensex	16,643
Nifty	4,004
BSE Code	500209
NSE Code	INFOSYSTCH
Reuters Code	INFY.BO
Bloomberg Code	INFO@IN

Shareholding Pattern (%)

Promoters	16.5
MF/Banks/Indian FIs	12.2
FII/ NRIs/ OCBs	54.8
Indian Public	16.5

Abs.	3m	1yr	3yr
Sensex (%)	22.9	46.9	34.5
Infosys (%)	27.8	73.7	16.4

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Performance Highlights

- Top-line growth backed by improved volumes:** Infosys recorded a 2.1% qoq jump in its 2QFY2010 Top-line in Rupee terms (3.1% yoy growth). As per International Financial Reporting Standards (IFRS), the company registered a 2.9% sequential growth in Dollar Revenues (5% yoy de-growth), while in constant currency terms, the company clocked a 1.2% qoq growth (3.2% yoy de-growth). Infosys out-performed both its IFRS and Indian GAAP guidance on the Revenues and Net Profit fronts.

Onsite volumes improved marginally by 0.5% qoq (fall of 4.1% yoy), while the offshore volumes witnessed a strong improvement of 3% qoq (4.4% yoy). On the currency front, the US Dollar weakened against the Rupee by 0.6%, the British Pound by 6%, the Euro by 5%, and against the Australian Dollar by 8.9%, sequentially during the quarter. Thus, favourable cross-currency movements, coupled with the growth in volumes attributed to the growth in Infosys revenues, both in IFRS and Indian GAAP.

The company has set a positive tone for the Indian IT sector by revising Rupee/USD guidance upwards for FY2010, with revenues expected to range between Rs21,961-22,055cr, implying a yoy growth of 1.2%-1.7%, while the EPS is expected to range between Rs99.6-100, implying a yoy decline of 4.8-4.4%. Notably, at the end of 1QFY2010, this guidance (at the upper end) stood at Rs21,747cr for the top-line and the EPS guidance stood at Rs96. Infosys has also raised its gross manpower intake guidance to 20,000 from the earlier 18,000, to keep itself well equipped for seizing upcoming opportunities in the Global IT market.

- Impressive margin accretion owing to improved offshoring and pricing:** Infosys witnessed a 47bp qoq expansion in EBIDTA margins to 34.6%, with 20bp improvement attributed to cross-currency movements and the balance to strong volumes with offshore shift. Pricing increased marginally on a sequential basis, due to the cross-currency benefits.
- Lower Other Income restrains the Bottom-line:** Despite a 3.5% qoq increase in Operating Profits, the Net Profit growth during the quarter was restricted to a 0.9% qoq rise for Infosys, which was primarily on account of lower Interest income, which was down by 12.3% qoq.

Key Financials (Consolidated)

Y/E March (Rs cr)	FY2008	FY2009	FY2010E	FY2011E
Net Sales	16,692	21,693	22,413	26,215
% chg	20.1	30.0	3.3	17.0
Net Profit	4,659	5,988	5,977	6,565
% chg	20.8	28.5	(0.2)	9.8
EBITDA Margin (%)	31.4	33.2	33.0	32.1
FDEPS (Rs)	81.2	104.4	104.2	114.5
P/E (x)	26.8	20.9	20.9	19.0
P/BV (x)	9.0	6.8	5.5	4.6
RoE (%)	37.2	37.4	29.3	26.5
RoACE (%)	42.7	43.1	36.7	33.9
EV/Sales (x)	7.1	5.3	5.0	4.1
EV/EBITDA (x)	22.5	16.0	15.1	12.8

Source: Company, Angel Research

Improved offshore-mix and favourable cross-currencies aid the Top-line

In 2QFY2010, Infosys recorded a 2.1% qoq jump in its 2QFY2010 top-line, in Rupee terms (3.1% yoy growth). Under IFRS, the company registered a 2.9% sequential growth in Dollar Revenues (5% yoy de-growth), while in constant currency terms the company clocked a 1.2% qoq growth (3.2% yoy de-growth). Infosys outperformed both its IFRS and Indian GAAP guidance on the Revenues and Net Profit fronts.

Exhibit 1: Infosys – Performance v/s guidance		
(2QFY2010)	Guidance	Performance
Indian GAAP		
Revenues (Rs cr)	5,379-5,480	5,472
EPS (Rs)	23.55	26.66
IFRS*		
Revenues (US\$ mn)	1,076-1,096	1,122
Basic EPADS (US\$)	0.48	0.55

Source: Company, Angel Research; * IFRS guidance adjusted for constant currency

In terms of its core business, Infosys witnessed a strong growth in the Infrastructure Management and System Integration services, which grew by 20.6% and 18.2% qoq, respectively, while the BPO and Products business grew by 3.7% and 4.6% qoq, respectively. However, the Development and Product Engineering Services were down by 4.3% and 2.2% qoq, respectively. Across its Verticals, Infosys witnessed a strong growth of 9% in Retail, 5.6% in Energy & Utilities, and 3.6% in BFSI.

Onsite volumes improved marginally by 0.5% qoq (fall of 4.1% yoy), while the offshore volumes witnessed a strong improvement of 3% qoq (growth of 4.4% yoy). Infosys also added 35 new clients during 2QFY2010, taking the total active clients to 571.

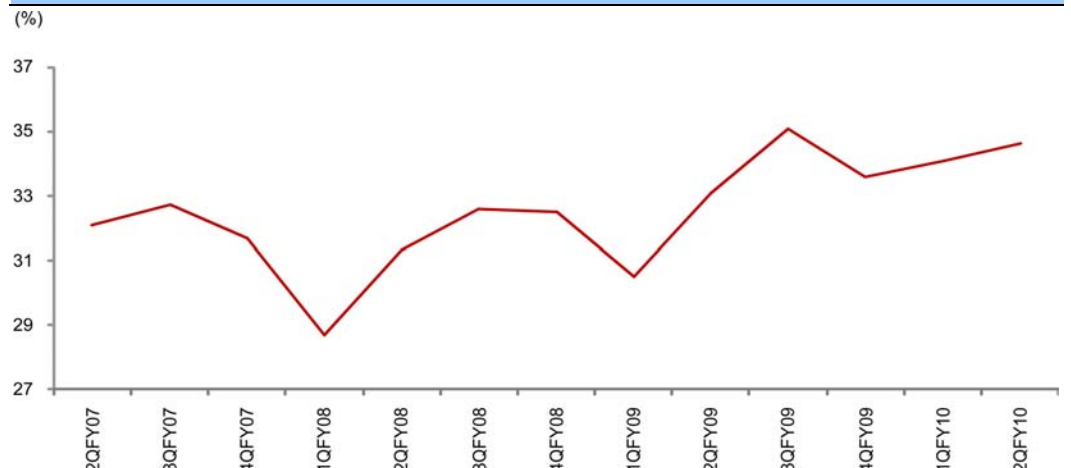
Exhibit 2: Core business					
(IT Services)	2QFY09	1QFY10	2QFY10	% chg qoq	% chg yoy
Onsite revenues (\$ mn)	572.9	518.3	527.4	1.8	(7.9)
Offshore revenues (\$ mn)	528.4	490.4	508.2	3.6	(3.8)
Onsite billing rates (US\$/hour)	73.6	69.8	70.7	1.3	(4.0)
Offshore billing rates (US\$/hour)	27.6	25.2	25.4	0.6	(7.9)
Onsite volumes (Hours, mn)	7.8	7.4	7.5	0.5	(4.1)
Offshore volumes (Hours, mn)	19.2	19.4	20.0	3.0	4.4
Realised Rupee rate per Dollar (Rs)	44.56	48.77	48.39	(0.8)	8.6

Source: Company, Angel Research

Margins soar due to an increase in offshoring and the improved pricing

During 2QFY2010, Infosys recorded a 47bp qoq (150bp increase yoy) expansion in EBITDA Margins, as against our expectations of a 96bp qoq decline. This was on account of the 50bp qoq (130bp increase yoy) shift in offshore revenues, which impacted the onsite volumes (down by 4.1% yoy) during the quarter. Cross-currency movements improved the EBITDA margins by 20bp, and the balance improvement in margins was on the back of strong offshore volumes, with a shift in the mix from onsite to offshore. This was despite the marginal increase in employee costs due to the improved qoq volumes. Pricing increased slightly on a sequential basis, due to the cross-currency benefits; however, it continued to be subdued on a yoy basis. Offshore billing rates increased by 0.6% qoq (fall of 7.9% yoy) and onsite rates by 1.3% qoq (fall of 4% yoy). In constant currency terms, however, blended pricing fell by 1% qoq. Blended utilisation during the quarter, including trainees, improved by 30bp at 67.3%, while, excluding trainees, it improved by 230bp to 73.2%, on a sequential basis.

Exhibit 3: EBITDA Margin trend



Source: Company, Angel Research

Bottom-line growth restrained due to lower other income

Infosys reported a restricted 0.9% qoq rise in its Bottom-line for 2QFY2010, mainly due to a lower interest income of Rs195cr (vis-à-vis Rs226cr in 1QFY2010). However, the other income was up by over 250% yoy, from Rs66cr in 2QFY2009 to Rs236cr in 2QFY2010, on account of a huge forex loss of Rs126cr that was reported in 2QFY2009. The tax rate remained flat qoq at 20.5% in 2QFY2010, even though higher as compared to the 15% in 2QFY2009.

Gross addition of 6,069 employees in 2QFY2010; strong net additions

Infosys added a gross of 6,069 employees in 2QFY2010, while net additions were up by 1,548 employees, vis-à-vis a negative 945 in 1QFY2010. The company has 105,453 employees on its rolls (103,905 in the last quarter). The attrition rate stood at 10.9%, which improved from 11.1% in 1QFY2010 on a trailing 12-month (TTM) basis.

Infosys upgrades both its Rupee and its IFRS guidance

The company had downgraded its revenue guidance at the end of 1QFY2010 to Rs21,416-21,747cr, implying a yoy decline of 1.3% to a yoy growth of 0.3%, and an EPS ranging between Rs94.59-96, implying a yoy decline of 5.4-3.7%. However, at the end of 2QFY2010 Infosys has revised its guidance upwards for FY2010 in Rupee terms, with revenues expected to range between Rs21,961-22,055cr, implying a yoy growth of 1.2%-1.7%, while the EPS is expected to range between Rs99.6-100, implying a yoy decline of 4.8-4.4%.

Exhibit 4: Upgraded guidance

(FY2010)	Guidance in 1QFY2010	Revised guidance in 2QFY2010
Indian GAAP		
Revenues (Rs cr)	21,416-21,747	21,961-22,055
EPS (Rs)	94.59-96	99.6-100
IFRS		
Revenues (US \$bn)	4.45-4.52	4.6-4.62
Basic EPADS (US \$)	1.97-2	2.09-2.1

Source: Company, Angel Research

Infosys also upgraded its IFRS guidance, as it now expects revenues of US \$4.6-4.62bn, implying a yoy decline of 1-1.3%, as against US \$4.45-4.52bn guided at the end of 1QFY2010. On the other hand, EPADS is expected to be in the range of US \$2.09-2.1, implying a yoy decline of 6.7-7.1%, as against a range of US \$1.97-2 earlier.

The company expects to announce salary hikes of 8% offshore and 2% onsite, across the board, and would also increase its investments on the sales and marketing front in H2FY2010. These moves would impact the FY2010E EBIDTA margins by over 150bp yoy. However, this would be offset by strong margin improvements witnessed by the company in H1FY2010.

Cross-currency movements and the appreciating Rupee would be another caveat to Infosys' FY2010 guidance. However, the company has a strong hedged position of US \$699mn and follows a short-term (for two months) hedging policy, which works in containing the adverse currency movements. Thus, only if the Rupee appreciates below Rs45 to the US Dollar, would there be a major concern to the given EPS guidance of Rs100 for FY2010E.

Exhibit 5: Service Line break-up

Service Lines	2QFY2009	1QFY2010	2QFY2010	% chg	% chg
	Rs cr	Rs cr	Rs cr	qoq	yoy
Application Development & Maintenance	2,313	2,326	2,279	(2.0)	(1.5)
<i>Development</i>	1,116	1,056	1,011	(4.3)	(9.4)
<i>Maintenance</i>	1,197	1,270	1,268	(0.1)	5.9
Business Process Management	325	334	346	3.7	6.5
Consulting and Package Implementation	1,371	1,335	1,329	(0.4)	(3.0)
Infrastructure Management	320	361	436	20.6	36.3
Testing Services	379	339	346	2.1	(8.7)
Product Engineering Services	114	131	128	(2.2)	12.9
Systems Integration	190	208	246	18.2	29.6
Others	211	219	246	12.3	16.3
Total services	5,223	5,253	5,356	2.0	2.5
Products	195	219	229	4.6	17.4
Total revenues	5,418	5,472	5,585	2.1	3.1

Source: Company, Angel Research

Exhibit 6: Vertical split

Industry Verticals (Rs cr)	2QFY2009	1QFY2010	2QFY2010	% chg	% chg
				qoq	yoy
BFSI	1,810	1,806	1,871	3.6	3.4
<i>Insurance</i>	374	389	413	6.4	10.6
<i>Banking & Financial Services</i>	1,436	1,417	1,458	2.9	1.5
Manufacturing	1,089	1,122	1,078	(3.9)	(1.0)
Retail	656	722	787	9.0	20.1
Telecom	1,029	925	905	(2.2)	(12.1)
Energy & Utilities	298	312	330	5.6	10.6
Transportation & logistics	125	126	128	2.1	3.1
Services	276	268	279	4.1	1.1
Others	135	192	207	7.9	52.6
Total revenues	5,418	5,472	5,585	2.1	3.1

Source: Company, Angel Research

Exhibit 7: Geographical break-up

Geographies (Rs cr)	2QFY2009	1QFY2010	2QFY2010	% chg	% chg
				qoq	yoy
North America	3,332	3,540	3,681	4.0	10.5
Europe	1,522	1,352	1,296	(4.1)	(14.9)
India	70	49	67	36.1	(4.8)
Rest of the world	493	531	542	2.1	9.9
Total revenues	5,418	5,472	5,585	2.1	3.1

Source: Company, Angel Research

Exhibit 8: Client contribution

Particulars (Rs cr)	2QFY2009	1QFY2010	2QFY2010	% chg qoq	% chg yoy
Top client	412	246	257	4.3	(37.6)
% of revenues	7.6	4.5	4.6	-	-
Top 5 clients	1,008	892	922	3.3	(8.6)
% of revenues	18.6	16.3	16.5	-	-
Top 10 clients	1,517	1,412	1,463	3.6	(3.5)
% of revenues	28.0	25.8	26.2	-	-

Source: Company, Angel Research

Exhibit 9: 2QFY2010 Performance (Consolidated)

Y/E March (Rs cr)	FY2010 2Q	FY2010 1Q	% chg (qoq)	FY2009 2Q	% chg (yoy)	1HFY2010	1HFY2009	% chg
Net Revenues	5,585	5,472	2.1	5,418	3.1	11,057	10,272	7.6
Software Development Expenses	2,963	2,915	1.6	2,891	2.5	5,878	5,645	4.1
Gross Profit	2,622	2,557	2.5	2,527	3.8	5,179	4,627	11.9
SG&A Expenses	689	689	0.0	733	(6.0)	1,378	1,354	1.8
Operating Profit (EBITDA)	1,933	1,868	3.5	1,794	7.7	3,801	3,273	16.1
Other Income	236	269	(12.3)	66	257.6	505	183	176.0
Depreciation	232	222	4.5	177	31.1	454	346	31.2
Provision for Investments	0	0	-	0	-	0	0	-
Income before Income Taxes	1,937	1,915	1.1	1,683	15.1	3,852	3,110	23.9
Tax	397	388	2.3	251	58.2	785	376	108.8
Minority Interest	-	-	-	-	-	-	-	-
Extraordinary Items	-	-	-	-	-	-	-	-
Net Income	1,540	1,527	0.9	1,432	7.5	3,067	2,734	12.2
Diluted EPS (Rs)	26.8	26.6	0.8	25.0	7.4	53.5	47.7	12.1
Gross Profit Margin (%)	46.9	46.7	-	46.6	-	46.8	45.0	-
EBITDA Margin (%)	34.6	34.1	-	33.1	-	34.4	31.9	-
Net Profit Margin (%)	27.6	27.9	-	26.4	-	27.7	26.6	-

Source: Company, Angel Research

Outlook and Valuation

Although there has been an increased exuberance in the IT environment as compared to the previous couple of quarters, the global economy has not yet completely recovered. However, the signals of recovery would start to strengthen once the IT clients globally start to fix up their budgetary spends for CY2010. Until then, the outlook would remain that of cautious optimism. However, with some deals flowing in (Infosys clinched the British Petroleum deal) and with some signs of improving demand for IT services visible, the company plans to grab the upcoming opportunities, both in the International and domestic markets. This explains in part the raised guidance on gross employee addition from the earlier 18,000 to the current 20,000.

We have raised our FY2011E Net sales estimate from the earlier Rs25,754cr to Rs26,215cr, and our EPS estimate from Rs112.5 to Rs114.5, factoring in marginally better volumes. Thus, we expect Infosys to record a CAGR of 9.9% in its Top-line over FY2009-11E, while the Bottom-line is estimated to post a CAGR of 4.7%, over the mentioned period. At the CMP of Rs2,178, the stock is trading at 19x its FY2011E EPS. **We recommend an Accumulate on the stock, with a Target Price of Rs2,475.**



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