INFOSYS: Bellwether in Rough Weather

Disappointing numbers, lower revenue guidance, no EPS guidance for FY14, shaky management perspective summed up in what turned out to be a Black Friday for Infosys post Q4FY13 results.

For Q4FY13, Infosys witnessed 0.3% sales growth and 1.1% Pat growth on INR term sequentially. Further, on account of wage increments and cross currency impact, company's EBIT Margin declined by 210bps to 23.6% on QoQ Basis, which is an all time low margin.

In US dollar terms, Net income was at $444 mn, compared with $434 million in Q3. Revenue including that of Lodestone, the Zurich-based management consultancy firm it had acquired in September 2012, rose 1.4 percent sequentially (9.4 % YoY) to USD 1.94bn.

Lodestone has possibly come to the rescue of Infosys in the fourth quarter ended March 2013 (Q4FY13). In the fourth quarter, Infosys has only added $28 million in fresh revenue, which we largely believe has come from Lodestone.

Volume growth and Pricing Growth: Despite of 0.7% of pricing decline, company reported 1.8% volume growth against the 1.5% of third quarter. While 3rd qtr was impacted by furloughs and hurricane sandy. The onsite volume growth was 4.7% but excluding the Lodestone it was 3.7% during the quarter. Negligible volume growth also reflects the complete stagnancy in the company's operating performance.

On segmental front, its BFSI (contributes 34% of Sales) and Manufacturing (contributes 22% of Sales) registered a growth of 1% and 3% on QoQ basis, while Energy & Utilities, Communications and Services (contributes 21% of Sales) decreased by 2% (QoQ), Retail, Life science & Logistics (contributes 24% of Sales) was almost unchanged.

Geographical Revenue: Like other IT players, Infosys has been increasing its revenue exposures from Europe and searching the opportunity for acquisition of new companies. During The FY13, revenue from Europe (contribute 25% of sales) increased by 26% compare to FY12, while US revenue increased by 17% than last year.

Margin Performance: Due to wage increments and slim forex gain, Infy's EBITDA margin declined by 210bps to 23.6% on QoQ basis. Company's BFSI segment margin increased by 60 bps to 29.6%, manufacturing down by 430bps to 21.7%, Retail, Life science & Logistics down by 430bps to 25.3%. and Energy & Utilities, Communications and Services margin decreased by 210bps to 27.9% on sequential basis. PAT growth almost unchanged (QoQ) at 22.9%.

Guidance: Based on its pipeline and visibility, It expects revenues to grow by 6-10% in dollar terms (at USD~ Rs 53.4) for FY'14. However, it has not guided on margins and EPS front. Further, it indicated that it may witness headwinds in the form of wage hikes, Visa costs and further increase in investments on Margins front. The interim hike costs of USD 140 million and the Lodestone related payments will add to the costs going forward.

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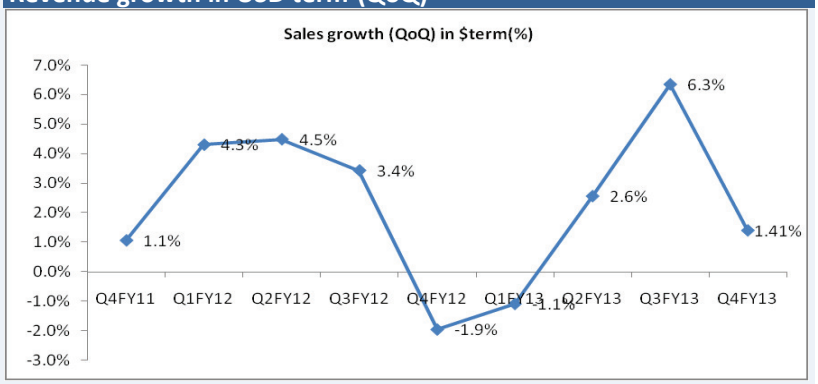
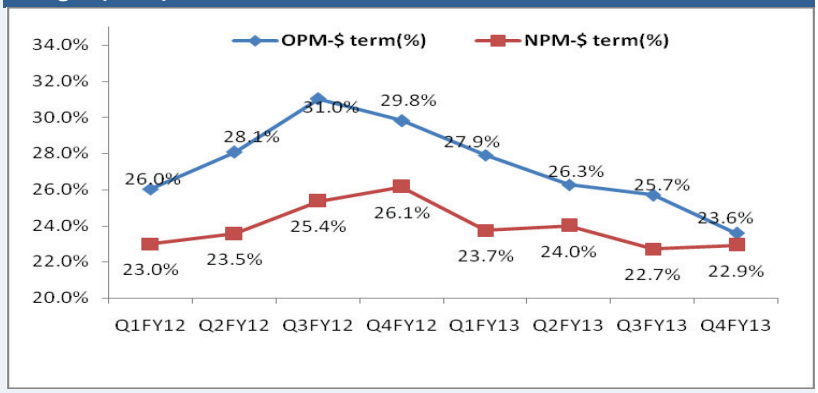
Revenue growth in USD term-(QoQ)



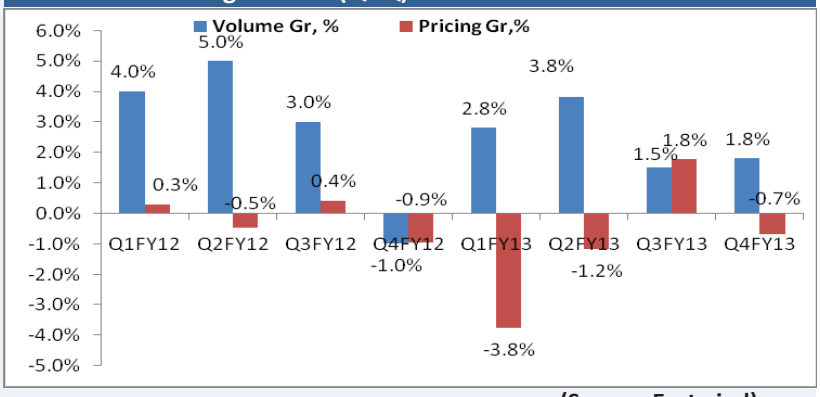
(Source: Eastwind)

Margin (QoQ)-%



(Source: Eastwind)

Volume and Pricing Growth (QoQ)-%



(Source: Eastwind)

Segment wise Margin exposures:

Segments	Q4FY12	Q1FY12	Q2FY13	Q3FY13	Q4FY13
BFSI	34.1%	31.1%	31.3%	29.1%	29.6%
Manufacturing	31.1%	30.0%	27.9%	24.7%	21.7%
Energy & Utilities	31.7%	28.4%	24.5%	30.0%	27.9%
Retail, Logist-and Life Sc-	32.9%	32.5%	31.2%	29.8%	25.3%
Overall EBITDA	**29.9%**	**28.0%**	**26.3%**	**25.7%**	**23.6%**

(Source: Eastwind)

INFOSYS LTD

Client Metrics: The Company added 56 clients during the quarter. 33 clients added in below $10mn category, 2 clients added in $90mn category. On net basis, 22 clients added. Despite of small clients' addition, company has maintained its 3.6% of revenue contribution from Top client, 14% from top-5 clients and 24% from top-10 clients as before.

Further, it has indicated that pipeline is robust and win rates are stable and better than the last year.

Headcounts Metrics: during the quarter 162 Software professionals layed off, company added more than 900 headcounts in BPO space and 300 added in sales and support team. **We expect, in near term company might be reorganize its operation as well as sales team to maintain its margin.**

Company reported 74% of utilization rate (excluding trainees) against the 73% (3QFY12), still very low across tier-1 IT space. Considering the past trend of utilization rate, we expect over employed scenario with the company. At same time, Attrition inched up to 16% from 15%(3QFY13), highest in last 8trs.

Revenue stream: What is perplexing is that despite winning big deals adding up to $960 million in the second half of FY13, the company has not seen any of this flow into the revenue stream in the fourth quarter. This implies that the deals have not been ramped up. While deals could see ramp ups in the first quarter but the management's misses so far.

With expectations raised post Q3FY13 earnings, Infy had closed some of the valuation gap with TCS, and was supossed to build on to this momentum. This reversal in fortunes has one again brought to the limelight the issue of "company specific" v/s "Industry specific" and majority opinions now vouch for the former. Company's earning guidance(6-10%) lagging behind the NASSCOM 12-14% industry growth guidance lends credence to this camp.

All gloom and doom for Infosys? In the midst of all doomsday scenario being projected, it will be prudent to highlight the positives that still exist for the company. Infy looks reasonably placed when it comes to a rise in discretionary spending in FY14 considering its high exposure to consulting - 32% of revenue, accentuated further by Lodestone acquisition. Management continues to be on the lookout for acquisitions, though it is easier said than done. A strong operating cash flow keeps boosting the cash levels, which stood at Rs21800cr (Cash/share at Rs 380) as on March, 2013, thus providing a credible warchest.A recessionary Europe is expected to dole out newer opportunities and could provide fresh impetus to client additions.

Outlook: We had anticipated some turnaround in fortunes in Q3FY13 which duly happened, while not being exactly gung-ho about fortunes in Q4FY13. The extent of miss in Q4FY13 however worries us. An overbearing TCS and the nimble footed peers in Cognizant, HCLTECH, iGate have snatched market share from Infosys. Going forward, Infosys will need a significant rise in overall IT spending, early-mover advantage in some newer geographies plus effect of current (and future) acquisitions kicking in to start delivering. We have been maintaining a NEUTRAL view on Infosys for the last 1 year, precisely for many of the reasons outlined above. At a CMP of Rs 2295 it trades at 13.8x FY14E earnings.

Employee Metrics

	FY06	FY07	FY08	FY09	FY10	FY11	FY12	FY13
Total Employees ©	52715	72241	91187	104850	113796	130820	149994	156688
Net additions	15965	19526	18946	13663	8946	17024	19174	6694
Attrition	11%	14%	13%	11%	13%	17%	15%	16%
Utilization(ex-trainee)	78.1%	77.1%	76.9%	73.9%	74.2%	79.6%	75.9%	73.2%

(Source: Eastwind)

Client Metrics

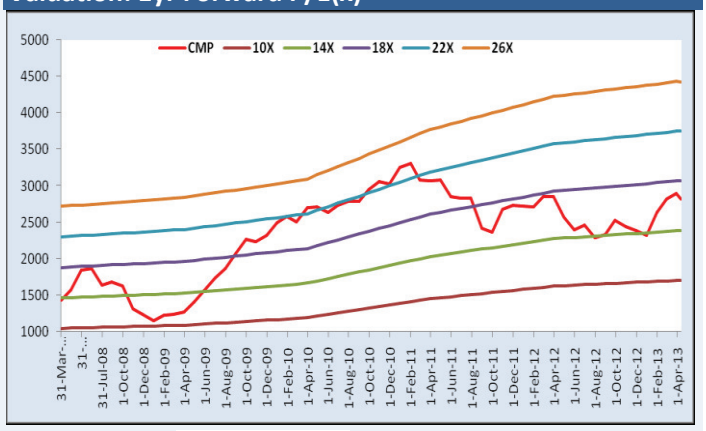
Year	FY06	FY07	FY08	FY09	FY10	FY11	FY12	FY13
Active Clients	460	500	538	579	575	620	694	798
New added	144	160	170	156	141	139	172	235
Revenue/Client,Cr	21	28	31	37	40	44	49	54
Contribution to Revenue By								
Top Client	4.4%	7.0%	9.1%	6.9%	4.6%	4.7%	4.3%	3.6%
Top 5 Clients	17.8%	19.4%	20.9%	18.0%	16.4%	15.4%	15.5%	14.7%
Top 10 Clients	30.3%	31.4%	31.4%	27.7%	26.2%	25.7%	24.6%	24.0%

(Source: Eastwind)

Cash Per Share-INR

(Source: Eastwind)

Valuation: 1yr Forward P/E(x)



(Source: Eastwind)