

IT Services Takeaways – Mar-2013 INFY Call

Alert: INFY's Disappointing FY14 Revenue Guide and Lack of Margin, EPS Guide Likely to Hurt IT Services Sector

Results: FY14 guide of "at least" 6%-10% incl Lodestone and 4%-8% organic. 4Q-FY13 revenues of \$1938 mil (Citi \$1,970 mil), representing ~1.4% reported sequential rev growth (const currency 1.7%; volumes ~1.8% seq). EBITDA margins at ~26.5% (Citi 27.9%) - down ~200 bps sequential due to onsite wage hikes, promotions, Lodestone integration etc. Europe grew 6.5% seq while US was almost flat seq in constant currency. By vertical Financial Svcs grew +2.7% seq, Manufacturing +3.9% seq, Retail CPG Logistics +0.8% seq.

Given the magnitude of the "miss" versus expectations, the tone of the 2am ET India call was surprisingly confident about INFY itself making a revenue recovery, while at the same time expressing concern about the macro environment. Over the past 12 months, INFY has gradually moved towards giving less guidance than before – it shelved quarterly guidance first and is now shelving margin and EPS guidance – one clear interpretation of this latest step, taken in conjunction with its recent "refocusing" on revenue growth is that investors will worry about industry pricing. Our view is INFY will likely lose any legacy pricing premium as it successfully defends and grows its turf – but given how ingrained fiscal discipline is at the company, we are unlikely to see an undisciplined approach.

Our CIO survey has indicated for the past 3-4 quarters that INFY is turning around its client relationships (% of CIOs using INFY was declining but has increased over the past year) and INFY's wallet share is also rising. Of course, our survey tends to be directional and it does not predict magnitude – so INFY's FY14 revenue guide of "at least" 6%-10% (incl 2% contribution from Lodestone) and confidence is actually consistent with our CIO survey. The market reaction today seems to be a partially justified reversal from uber-bullish sentiment following INFY's decent Dec-12 report.

Eventually, the conclusions from recent data (Infosys earnings, Our CIO survey, Accenture earnings, ISG/TPI data on industry contract values) are reasonably consistent. (i) No material deferrals or cancellations but some project ramps are likely slower than expected. (ii) Contract signings / Decision making is happening, especially for larger / transformational / strategic work but smaller / add-on / unscheduled work is just not happening – in other words, one of the sources of historical upside is off the table. (iii) Vendor consolidation is a major trend. (iv) Incumbency is still important but not as powerful as before. (v) Many business models seem to be tending towards what CTSH and ACN saw years ago – growth is king. We do believe that CTSH can maintain its growth premium over others.

(INFY.BO; Rs2,347.10; 1; S. Goyal); (CTSH.O; US\$77.66; 1); (ACN.N; US\$77.78; 1)

■ Industry Overview

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See Appendix A-1 for Analyst Certification, Important Disclosures and non-US research analyst disclosures.

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Infosys

Valuation

Our Rs3,450 target price for Infosys is based on 18x Sep'14E EPS, in line with the 5-year average 12-month forward earnings. Our estimates continue to assume a certain PE premium to the market; this is justified, in our view, given the strong FCF and ROIC for Infosys vs. the overall market. We believe PE remains the most appropriate valuation measure given Infosys' profitability record and higher earnings visibility.

Risks

The key downside risks to our investment thesis on Infosys are: (1) any significant appreciation of the rupee against the USD/EUR/GBP; (2) pressure on billing rates; and (3) a prolonged slowdown in the US economy. If any of these risk factors has a greater downside impact than we anticipate, the share price will likely have difficulty attaining our target price.

Accenture Ltd

Valuation

Our \$82.50 (rounded) one-year target price is based on the implied value derived from our price-to-earnings (P/E) valuation model plus the approximately \$8.00 in cash per share currently on the company's balance sheet. Our P/E model yields an implied value of \$74.50 per share by applying our 14x-16x multiple-range to our \$4.69 fiscal year 2014 GAAP EPS estimate. We believe our target multiple range of 14x-16x is appropriate as 1) the range is in line with ACN's recent comparable company P/E of 15X the 2012 estimate; and (ii) it is in line with ACN's 2-year historical P/E based on FactSet.

Risks

The key risks to our investment thesis on ACN include the following:

- (1) More than half of Accenture's revenue base (consulting) is susceptible to the changes in the discretionary spending environment.
- (2) Currency fluctuations can cause the top- and bottom-line results to fluctuate because almost half of Accenture's revenues are generated outside the U.S.
- (3) Accenture is not immune to problem contracts – this can cause fluctuations in its margin performance from quarter to quarter.
- (4) Accenture might use its significant cash balance to grow via acquisitions, which could create integration risk.
- (5) Accenture's response to the threat from offshore outsourcing (i.e., the build-out of its Global Delivery Network) does have risks, such as the possible cannibalization of revenues and margin risk. However, Accenture does appear to be executing well so these risks have moderated in our opinion.

If the impact on the company from any of these factors proves to be greater than we anticipate, it may prevent the stock from achieving our target price. Conversely, if the impact on the company from any of these factors proves to be significantly less than we anticipate, the stock may exceed our target price.

Cognizant

Valuation

Our \$90 target price is based on our price-to-earnings (P/E) valuation model plus the ~\$9.00 of net cash and investments per share on the company's balance sheet. Our P/E-based model yields an implied \$81 (rounded) valuation based on our 20x-22x target multiple range applied to our 2013 GAAP EPS estimate of \$4.07. We forecast CTSH to grow net income by an average of ~20% over the next three years, so a multiple in line to slightly above its growth rate is reasonable in our opinion.

Risks

The key risks to our investment thesis on Cognizant Technology Solutions include the following:

1. Normal IT services vendor risks such as timing and magnitude of budgets; Contract ramps; Pricing pressure are par for the course.
2. Normal offshore services risks including exchange rate volatility; the threat of political backlash against offshore outsourcing; wage inflation in India; supply-side constraints, including visa limits and infrastructure development in India should be considered.
3. Though Cognizant does not trade on the Indian market, most of its comparables do, and the company does respond to moves in the Indian market, both up and down.
4. Senior management's compensation is heavily impacted by stock option grants. Based on the historical performance of the stock, senior management has and may in the future exercise significant amounts of options.

If any of these risk factors has a greater downside impact than we anticipate, the share price will likely have difficulty attaining our target price. Conversely, if the impact of any of these risks is less than we anticipate, the stock could exceed our target price.

Appendix A-1

Analyst Certification

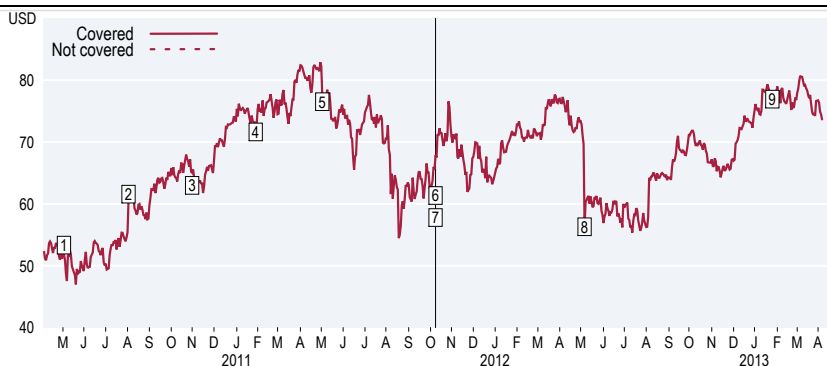
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Ratings and Target Price History Fundamental Research

Analyst: Ashwin Shirvaikar, CFA



	Date	Rating	Target Price	Closing Price
1	4-May-10	1M	*62.00	51.80
2	3-Aug-10	1M	*74.00	60.62
3	1-Nov-10	1M	*76.00	65.04

* Indicates change

	Date	Rating	Target Price	Closing Price
4	28-Jan-11	1M	*85.00	71.63
5	3-May-11	1M	*88.00	77.52
6	8-Oct-11	Stock rating system changed		

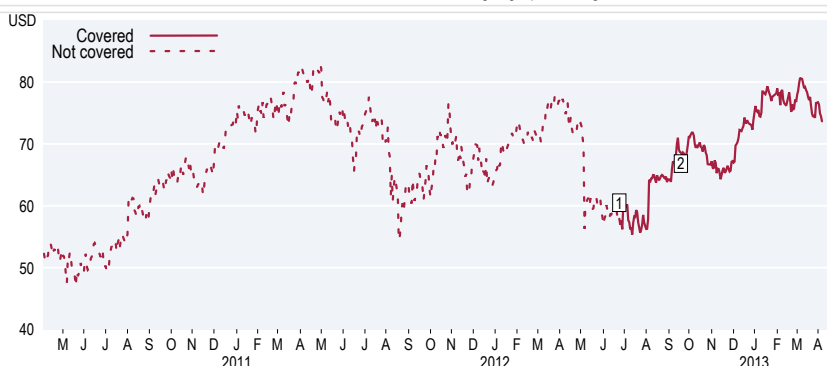
	Date	Rating	Target Price	Closing Price
7	8-Oct-11	*1	88.00	65.62
8	7-May-12	1	*79.00	56.30
9	25-Jan-13	1	*90.00	77.63

Rating/target price changes above reflect Eastern Standard Time

Cognizant (CTSH)

Ratings and Target Price History Best Ideas Research Relative Call (3 Month)

Analyst: Ashwin Shirvaikar, CFA



	Date	Rating	Target Price	Closing Price
1	25-Jun-12	*ADD MP	-	57.90

* Indicates change

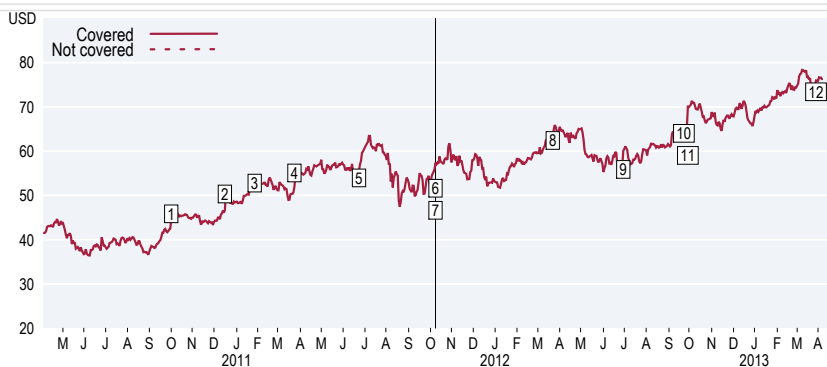
	Date	Rating	Target Price	Closing Price
2	19-Sep-12	*REM MP	-	68.61

Rating/target price changes above reflect Eastern Standard Time

Accenture Ltd (ACN)

Ratings and Target Price History Fundamental Research

Analyst: Ashwin Shirvaikar, CFA



	Date	Rating	Target Price	Closing Price
1	1-Oct-10	1H	*53.00	44.38
2	16-Dec-10	1H	*55.00	46.67
3	27-Jan-11	*1M	*60.00	52.36
4	24-Mar-11	1M	*64.00	51.96

* Indicates change

	Date	Rating	Target Price	Closing Price
5	23-Jun-11	1M	*66.00	55.69
6	8-Oct-11	Stock rating system changed		
7	8-Oct-11	*1	66.00	55.92
8	22-Mar-12	1	*73.00	63.52

	Date	Rating	Target Price	Closing Price
9	29-Jun-12	1	*70.00	60.09
10	24-Sep-12	1	*75.00	65.78
11	28-Sep-12	1	*76.00	70.03
12	28-Mar-13	1	*82.50	75.97

Rating/target price changes above reflect Eastern Standard Time

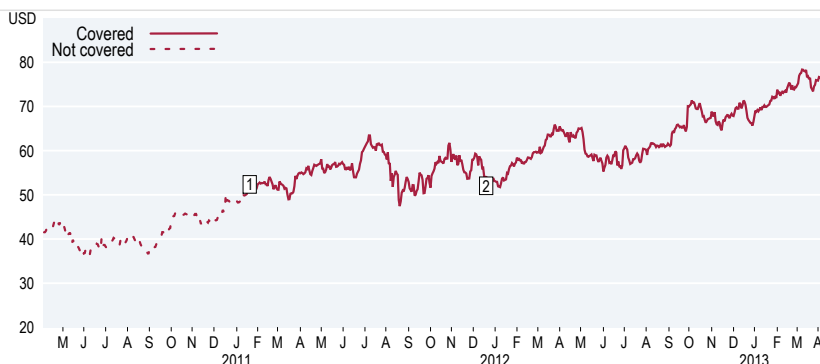
Accenture Ltd (ACN)

Ratings and Target Price History

Best Ideas Research

Relative Call (3 Month)

Analyst: Ashwin Shirvaikar, CFA



	Date	Rating	Target Price	Closing Price
[1]	20-Jan-11	*ADD MP	-	51.14

* Indicates change

	Date	Rating	Target Price	Closing Price
[2]	20-Dec-11	*REM MP	-	54.24

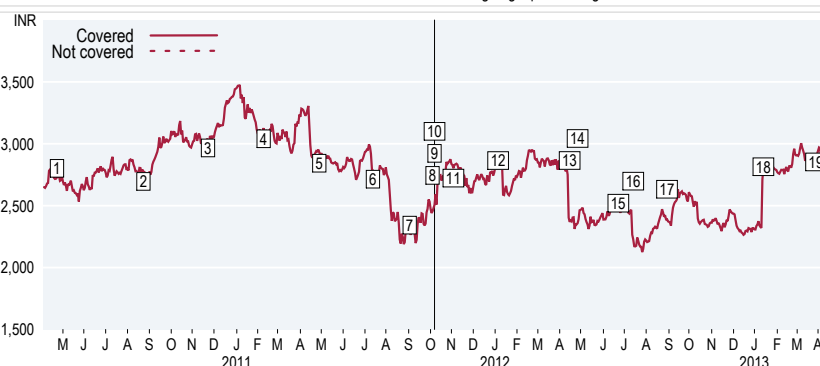
Rating/target price changes above reflect Eastern Standard Time

Infosys (INFY.BO)

Ratings and Target Price History

Fundamental Research

Analyst: Surendra Goyal, CFA



	Date	Rating	Target Price	Closing Price
[1]	23-Apr-10	2L	*2,935.00	2,728.10
[2]	24-Aug-10	2L	*3,065.00	2,765.50
[3]	23-Nov-10	2L	*3,220.00	3,013.30
[4]	9-Feb-11	2L	*3,430.00	3,127.00
[5]	28-Apr-11	2L	*3,230.00	2,931.55
[6]	13-Jul-11	2L	*3,125.00	2,784.20
[7]	2-Sep-11	2L	*2,570.00	2,315.55

* Indicates change

	Date	Rating	Target Price	Closing Price
[8]	5-Oct-11	2L	*2,650.00	2,454.30
[9]	7-Oct-11	Stock rating system changed		
[10]	7-Oct-11	*2	2,650.00	2,507.05
[11]	3-Nov-11	2	*2,890.00	2,802.15
[12]	5-Jan-12	2	*3,110.00	2,838.90
[13]	16-Apr-12	2	*2,700.00	2,369.35
[14]	26-Apr-12	*1	*2,750.00	2,358.20

	Date	Rating	Target Price	Closing Price
[15]	22-Jun-12	1	*2,825.00	2,475.10
[16]	13-Jul-12	1	*2,550.00	2,227.80
[17]	30-Aug-12	1	*2,710.00	2,391.00
[18]	14-Jan-13	1	*3,035.00	2,807.25
[19]	28-Mar-13	1	*3,450.00	2,889.90

Rating/target price changes above reflect Eastern Standard Time

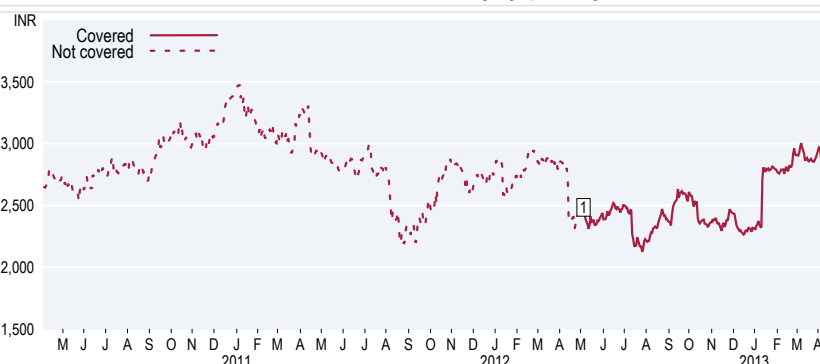
Infosys (INFY.BO)

Ratings and Target Price History

Best Ideas Research

Relative Call (3 Month)

Analyst: Surendra Goyal, CFA



	Date	Rating	Target Price	Closing Price
[1]	4-May-12	*ADD MP	-	2,441.15

* Indicates change

Rating/target price changes above reflect Eastern Standard Time

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