

# Infosys might not be the 'darling of the market' for some time; invest for long-term

By Kshitij Anand, ECONOMICTIMES.COM | 7 May, 2014, 03.58PM IST

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NEW DELHI: Infosys which wore the tag of IT bellwether some time back is now struggling to regain confidence of its investors. India's second largest IT exporting company has been witnessing a tepid growth in sales and profits since the past four years.

What UBS highlighted in its report on Infosys is not something new. Narayan Murthy has been saying the same thing from Day 1, that the company will take at least three years to turnaround.

The Zurich headquartered firm, UBS, downgraded Infosys to "sell" from "buy" and has also slashed its target price to Rs 2,750 from Rs 4,050, translating into a cut of 32 per cent. According to the global investment bank, a turnaround at the IT outsourcer could take longer than expected.

So going by the same logic, should retain investors 'sell' the stock at current levels?

Well, analysts on the Street are not convinced by UBS. They see potential in Infosys; but yes, in the long-term and the stock may not remain the darling of the market for quite some time to come.

"We do not agree with UBS on "Sell" on Infosys logic. Probably, the investment horizon in our investment paradigm is different from UBS's. We think in terms of 3 to 5 year holding periods or longer," said Dr. Vikas V Gupta (Head- Research & Product Development) at ArthVeda.

"With that kind of a time period, Infosys is definitely not a "Sell". Yes, there will be near-term pain. This is a classic value investor fantasy stock of a fallen angel facing temporary trouble that it is very likely to get out of in the medium term," he added.

Infosys did surprise the Street with its FY15 dollar revenue guidance of 7-9 per cent, as compared to analysts' estimates of 6-8 per cent, although sales largely remained flat. Reacting to the news, most brokerage firms revised their target prices above Rs 4,000 for a period of 12-months.

"The market got unduly excited somewhat about weak results back in April. They thought that the change in management is going to be dramatic and so will get reflected in phenomenal performance. Well, the market has come back to reality," said UR Bhat, MD, Dalton Capital Advisors.

"Basically, it (Infosys) has surrendered its leadership position quite some time back. Therefore, I do not think it will be the darling of the market for quite some time to come, unless the new management really changes things," he added.

The stock was slowly losing momentum and that was evident from the recent slide seen in the stock price from its 52-week high of Rs 3,847.20 recorded on March 3rd. And, if we compare the movement of stock price till 06 May (Rs 3,164.15), stock has plunged nearly 18 per cent since then.

UBS is right in saying that it could take a long time for the turnaround to happen. The key assumptions for downside scenario highlighted by UBS are: 1) slower than-expected revenue growth; 2) the company is unable to grow the infrastructure and BPO businesses; and 3) lower margins as a result of slower revenue growth. This scenario suggests negative earnings growth in FY16.



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"Infosys would continue to see a muted growth phase for some time not only because they have lost a few key people but mainly because their incremental revenue growth from the US has been slowing for the last many quarters," said S Ranganathan, Head of Research at LKP.

"In our view Infosys is not able to map the clients newer requirements and is losing out to peers among WITCH (Wipro, INFOSYS, TCS, COGNIZANT and HCL Technologies)," he added. We at LKP have a price target of 2900 for Infosys which is quite a downside from its price of 3165 on 6th May 2014.

UBS expects India's second largest software exporter to disappoint investor expectations in the near and medium term, leading to a valuation de-rating of the stock, UBS said in a note on Wednesday.

"The company has been in a transition mode in terms of its organisation for quite some time now and at some point of time the recurring organisational changes in the top management shall recede," says Shashank Khade, Director & Chief Equity Advisor, Entrust Family Office Investment Advisors.

"We don't agree with UBS stance on Infosys. They should not sell the stock at current levels, instead they should hold on to the stock patiently and in case the stock corrects further, it would make sense to buy into the stock further," he added.

Khade is of the view that as the new management team stabilizes and starts getting their act together, the company performance shall show an improvement. Hence de-rating in stock valuation further does not make much sense, he concludes.

As per experts, FY15 could be the year of reckoning where-in the transition within the company shall start to show results. The expectations of analysts and investing fraternity have already been toned down leaving adequate room for positive surprise.

"These kinds of transformations take time but the leadership of Narayan Murthy is in place with a very large and professional board and management team to help achieve this. It is one of the top 5 IT giants from India with a very large set of clients from Fortune 500. It is not going anywhere," assures Gupta of ArthVeda.

With recent commentary indicating the company is having trouble jumpstarting growth in its base segment as well, the buzz on the Street is that a turnaround could take longer than expected.

Let's look at what exactly turnaround means. Infosys is not a Company which is nearing business extinction or nearing bankruptcy or anything. Then why all of a sudden everybody is scared about its prospects.

It has revenues of \$8 billion+ with margins of 25 per cent and return on capital of about 25% plus. In addition, it has cash of around \$4 billion. This company is a very healthy company from all angles, highlights Gupta.

However, the only struggle is growth and the only concern is that it is not growing in line with the industry. But at the current valuations it is providing an earnings yield of 6-7 per cent which matches the post-tax fixed income returns while having the potential to find its way on the growth path through either organic or inorganic or a combination route with the \$4 billion cash hoard.

Infosys management has always followed a communication strategy of under-promising and over delivering. The management has lowered the expectations of a quick turnaround in its business prospects. And, by end of FY15, one feels the benefits of the new management team may start to flow in.

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