

BSE SENSEX  
18,503S&P CNX  
5,560

CMP: Rs2,792

TP: Rs3,400

Buy

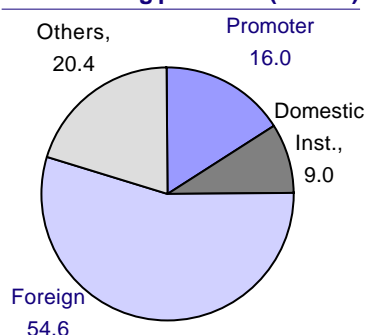


|                       |             |
|-----------------------|-------------|
| Bloomberg             | INFOIN      |
| Equity Shares (m)     | 571.2       |
| 52-Week Range (Rs)    | 3,494/2,591 |
| 1,6,12 Rel. Perf. (%) | -1/-4/-3    |
| M.Cap. (Rs b)         | 1,594.6     |
| M.Cap. (US\$ b)       | 35.4        |

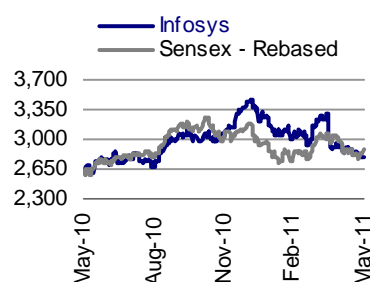
| Y/E March     | 2011  | 2012E | 2013E |
|---------------|-------|-------|-------|
| Sales (Rs b)  | 275   | 333   | 394   |
| EBITDA (Rs b) | 90    | 103   | 121   |
| NP (Rs b)     | 68    | 80    | 97    |
| EPS (Rs)      | 119.4 | 140.6 | 169.5 |
| EPS Gr. (%)   | 11.2  | 17.7  | 20.6  |
| BV/Sh. (Rs)   | 454.1 | 547.2 | 669.8 |
| P/E (x)       | 23.4  | 19.9  | 16.5  |
| P/BV (x)      | 6.1   | 5.1   | 4.2   |
| EV/EBITDA (x) | 16.1  | 13.6  | 11.1  |
| RoE (%)       | 27.8  | 28.0  | 27.8  |
| RoCE (%)      | 33.1  | 32.6  | 31.7  |

Price as on 31 May 2011

### Shareholding pattern % (Mar-11)



### Stock performance (1 year)



### Weak 4Q an anomaly; FY12 guidance conservative

**Stock correction a buying opportunity; possible upside of 22%**

- Infosys management views the weak 4Q more as an anomaly than a structural indicator of demand and relative positioning.
- We see Infosys' margin guidance as conservative and embedding the worst case. Its strong order backlog and deal pipeline provide high revenue growth visibility in FY12.
- The stock is down ~20% YTD; we recommend buying aggressively with a price target of Rs3,400 (20x FY13E EPS).

**FY12 growth in the bag provided status quo in macro scenario:** The management reiterated that macro uncertainty remains the key impediment to fundamentals. Though budgets are up 2-3% for CY11, they are getting re-evaluated every quarter and as such do not provide visibility around demand. That being said, the management's 18-20% revenue growth expectation does not embed any improvements in the macro scenario, but just status quo.

**1QFY12 trending in line with guidance, so far:** 1QFY12 is shaping up in line with the guidance of 2.6-3.6% revenue growth that the management had issued in April. Weakness in 4QFY11 was largely due to the Telecom and Insurance verticals, and some deal deferrals. Insurance weakness was seasonal and revenue should pick up in the next quarter. The Telecom pipeline has improved in 1QFY12; growth should materialize gradually through the year.

**Margin strategy unchanged; guidance embeds worst case scenario:** The management reiterated its strategy of growing faster than industry whilst maintaining its industry-high margins. This is despite guiding a 300bp margin decline in FY12. We see the margin guidance as being especially conservative, with the full impact of headwinds like currency, lower utilization and wage inflation being assumed, but no help being embedded from offsets like pricing increases, productivity improvement, scale benefits, improving subsidiary performance, increasing share of fixed bid/offshore contracts, and better business mix. The only offset that it has built in is employee pyramid management through higher influx of freshers.

**No changes in our estimates; maintain Buy:** Though Infosys new strategy and leadership changes do not necessarily signify anything revolutionary, the fact that Infosys is thinking ahead of the competition in identifying the trends that may shape the industry in the years to come and is positioning itself to take advantage of these trends early should help it to sustain its competitive advantage over peers. We believe Infosys is far ahead of the curve and competition in terms of positioning for the future. The strategy of having one-third of revenue from each of Transformation and Innovation, and just one-third of revenue from Operations is the right one, even if it may entail some investments and some sacrifice on the margins in the near term. There could be upside to our margin assumptions if we are right about our revenue growth trajectory for the company. We retain our EPS estimate for FY12 and FY13 at Rs140.6 and Rs169.5, respectively. Maintain **Buy**, with a target price of Rs3,400 (20x FY13E EPS).

**Weak 4Q an anomaly; FY12 guidance conservative**

**Stock correction a buying opportunity; possible upside of 22%**

- We met with Infosys' management. The central messaging both implicitly and literally was, "Form is temporary, class is permanent". It views the weak 4Q more as an anomaly than a structural indicator of demand and relative positioning.
- A rare volume miss relative to own 4QFY11 guidance, back-ended nature of FY12 revenue guidance, and guidance of 300bp margin decline in FY12 have made investors nervous as to whether Infosys, the long heralded leader in Indian IT is losing its mojo. Given the recent weak execution and organizational flux, investors will keep Infosys in the penalty box for sometime, and Infosys' guidance could be viewed as "realistic with some upward bias" as against "ultra conservative" as has been the case historically.
- We see Infosys' margin guidance as conservative and embedding the worst case. Its strong order backlog and deal pipeline provide high revenue growth visibility in FY12. The stock has declined ~20% YTD; we recommend buying aggressively at current levels, with an investment horizon of 12-18 months. We maintain Buy, with a price target of Rs3,400 (20x FY13E EPS).

**FY12 growth in the bag provided status quo in macro scenario**

*Guided growth of 18-20% does not embed any improvements in the macro scenario; achievable if there is status quo in the macro scenario*

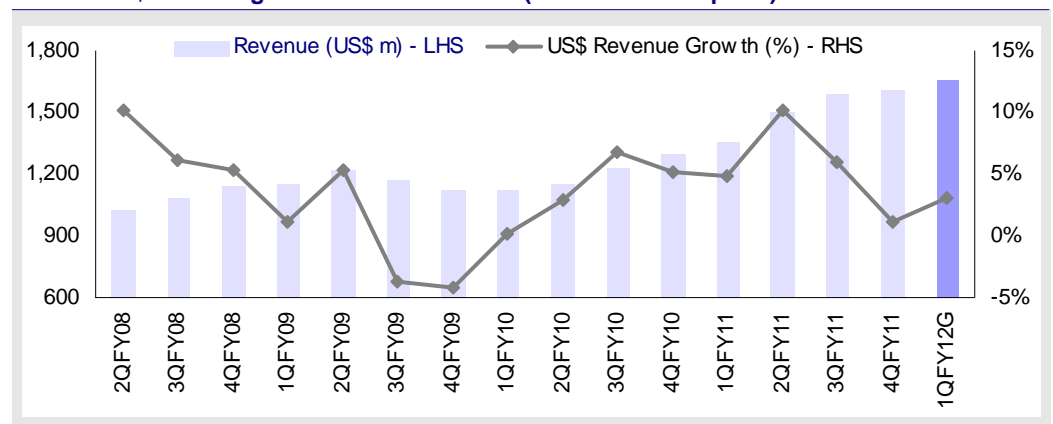
The management reiterated that macro uncertainty remains the key impediment to fundamentals. Though budgets are up 2-3% for CY11, they are getting re-evaluated every quarter and as such do not provide visibility around demand. That being said, the management's 18-20% revenue growth expectation does not embed any improvements in the macro scenario, but just status quo.

**1QFY12 trending in line with guidance, so far**

1QFY12 is shaping up in line with the guidance of 2.6-3.6% revenue growth that the management had issued in April. In our view, there were three key sources of weakness in 4QFY11: (1) Telecom revenue declined 4.8% QoQ, (2) Insurance was especially weak, even in the context of weak seasonality, with its revenue contribution declining from 8.4% in 3QFY11 to 7.2% in 4QFY11, and (3) some deals were deferred from 4QFY11 into 1QFY12 and later.

**Guided US\$ revenue growth of 2.6-3.6% QoQ (3.1% at the mid-point) for 1QFY12**

*US\$ revenue growth guidance of 2.6-3.6% QoQ for 1QFY12 implies that the growth will have to be more back-ended to meet the full-year guidance*



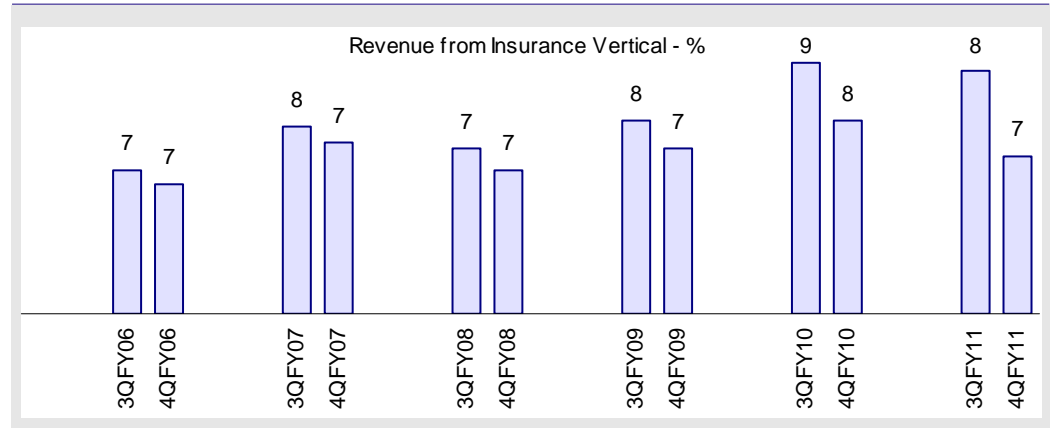
Source: Company/MOSL

*Weakness in Insurance was seasonal and revenue should pick up in the next quarter; Telecom growth should materialize gradually through the year, with pipeline having improved in 1QFY12*

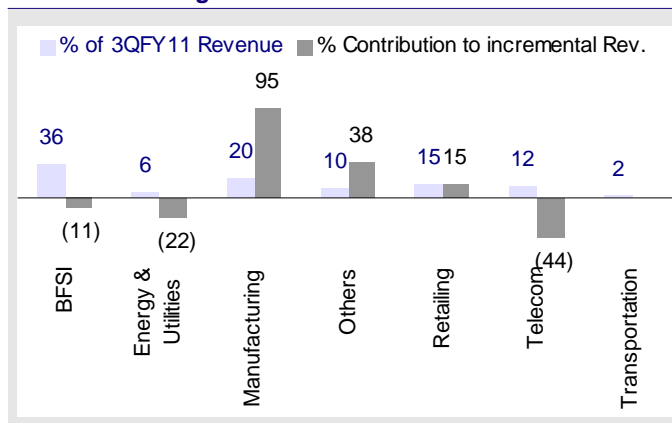
**Telecom pipeline strong:** The Telecom pipeline is now better than it has been at any point during the last few years. As the pipeline gets converted, growth will materialize, though not necessarily imminently but through FY12. While the SPs and OEMs continue to struggle, growth in Telecom vertical will hinge upon traction in accounts like Vodafone and AT&T. The deal with Vodafone, which involves the rollout of ERP across 30 countries, has been deferred by a couple of quarters. Its onset can lead to a modest revenue spike.

**4Q is usually weak for Insurance:** For Insurance, 4Q has historically been a weak quarter even vis-à-vis other verticals on a relative basis. The weakness in 4QFY11 may not imply any structural issues. The management has indicated that the Insurance vertical could see the closure of some very large deals shortly, which should also aid revenue growth.

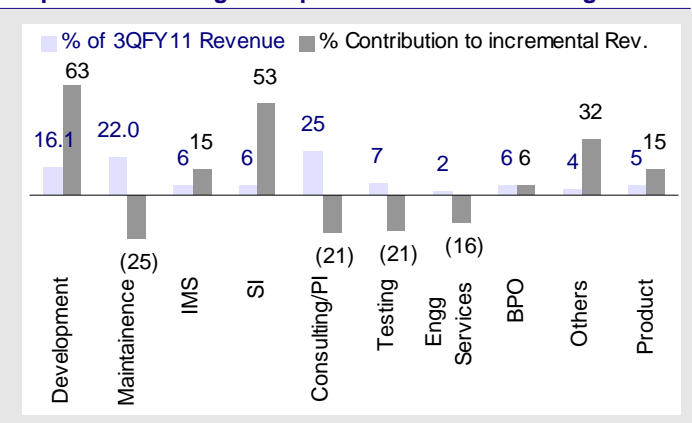
**4Q has historically been a weak quarter for Insurance, though more pronounced in FY11**



**4Q weakness pervasive across key verticals, ex-Manufacturing**



**Discretionary Services remained weak - possible explanation for higher impact of utilization on margins**



Source: Company/MOSL

*While Infosys' strategy continues to be aimed at achieving the highest margins in the industry, we do not see the margin strategy hampering growth just yet*

**Margin strategy unchanged - can afford to choose its battles for now**

The management reiterated its strategy of growing faster than the industry whilst maintaining its high margins. We do not necessarily agree with the margin philosophy for the following reasons:

- We see returns (rather than margins) as a better benchmark for capital allocation decisions
- We do not see the rationale in letting go of growth, which may come at the cost of margins but will yet be significantly value accretive

However, we do not see Infosys' margin strategy hampering its growth just yet. Given the nascence of offshoring within IT Services and that there will always be several existing/potential clients that will value Infosys' execution capabilities, strong Balance Sheet, ability to attract and retain the best talent in the industry etc; we believe that it will be able to choose its battles for now. Today Infosys can afford to let go off a GE or emerging market wireless opportunity. Whether it will be able to do so in 3-4 years, when IT offshoring matures, is questionable.

**Growth imperative for margin expansion**

*Deal activity, demand environment and deferral of some revenues from 4QFY11 to 2QFY12 give us comfort on growth, which, in turn, will take care of margins*

If our revenue growth expectations for Infosys materialize, then managing margins should not be a concern for the company. Growth should take care of margins. We can envisage a scenario where the eventual margins in FY12 may not be significantly different from FY11 on a constant currency basis. The following give us comfort on growth:

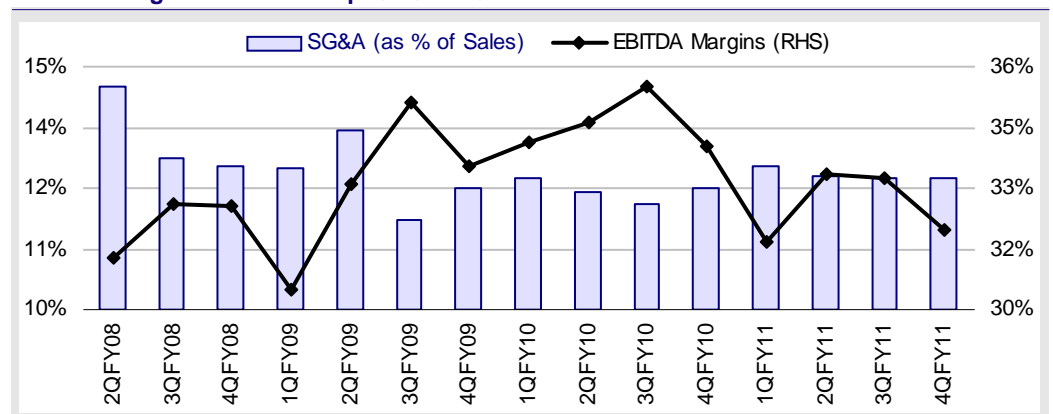
- We expect 3Q to be a seasonally stronger quarter in FY12 than was the case in FY11, driven by a material flush of budget spends this year in the quarter. In FY11, pent-up demand had ensured that budgets were spent evenly through the year, with a flush being absent in 3Q.
- Deal activity and win rates remain strong. Infosys won four transformational and six large deals during the quarter, with some deals being US\$100m+. Importantly, deal sizes have moved up from US\$30m-50m earlier to US\$80m-100m. Infosys is currently pursuing 12 deals of US\$50m-250m and has historically had a win rate of 33%.
- The demand environment generally remains strong, and we dont see any reason why Infosys should be an anomaly. Even Accenture, which is four times as big as Infosys in terms of revenue, has guided a healthy 12.5% revenue growth at the mid-point (14% at the higher end) for the year ending August 2011.
- Some of the deal deferrals from 4QFY11 should aid growth in 2QFY12.

**Margin guidance conservative; we see multiple upside drivers**

*Infosys' margin guidance embeds a worst-case scenario, which does not factor in gains from pricing, productivity improvement, scale benefits, subsidiary performance, fixed bids, etc*

We see Infosys' margin guidance as being especially conservative, with full impact of headwinds like currency, lower utilization and wage inflation being assumed, but no help being embedded from offsets like pricing increases, productivity improvement, scale benefits, improving subsidiary performance, increasing share of fixed bid/offshore contracts, and better business mix. The only offset that it has built in is employee pyramid management through higher influx of freshers. Our detailed discussion on why we believe the margin guidance to be conservative follows

**EBITDA margin declined 140bp QoQ in 4QFY11**



Source: Company/MOSL

## **FY12 margins may not be significantly different from FY11**

Better utilization (positive impact of 50-75bp), higher realization (positive impact of at least 75bp) and scale benefits (positive impact of 75-100bp) in themselves should offset 225bp of the 325bp margin decline guided by Infosys. With a little help from further pricing increases, slightly better offshore/fixed bid mix, incremental improvements in subsidiary performance and productivity improvements in fixed bid projects (which constitute ~41% of revenue), FY12 margins may actually be no different from FY11.

### **The drags**

Infosys has guided a contraction of ~325bp in FY12 operating margin, on account of the following: [1] unfavorable currency movements - a potential 100bp headwind to margins, and [2] wage inflation, which could drag margins down by another 100bp, after considering the cushion provided by employee pyramid management.

#### **■ Currency - any guess is as good as ours**

The management has guided that unfavorable currency movement would result in a 100bp negative impact on FY12 margin. We would not like to hazard a guess on currency movements during the year. Continued appreciation of the Rupee eats into the industry competitiveness and is something that the industry will have to deal with. That being said, if the exchange rate remains at the current Rs45/US\$, there will be an upside of Rs2.7 to our FY12 EPS estimate.

#### **■ Wage inflation - employee pyramid management to help**

The net impact of wage inflation on Infosys' FY12 margin would be 100bp, with employee pyramid management helping to offset the 300bp impact of a 10-12% offshore and 2-3% onsite wage hike by 200bp.

### **The offsets**

We expect wage inflation pressures to be offset by: [1] higher utilization on better than guided growth, [2] higher realization - while Infosys' commentary has remained guarded on pricing uptick, it has witnessed an increase in realization in each of the last three quarters, and [3] operational leverage - driven by scale benefits from potential volume growth of 18-20%.

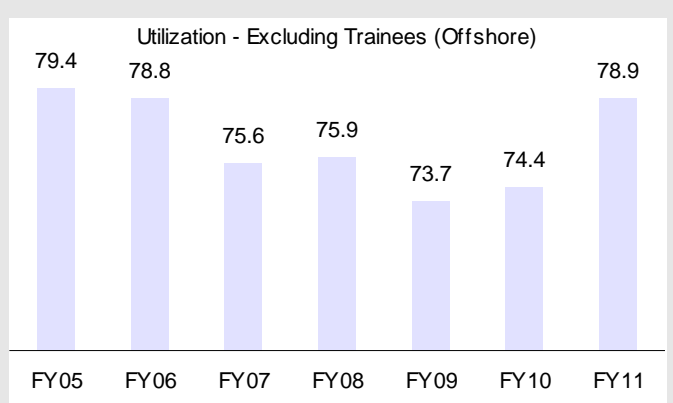
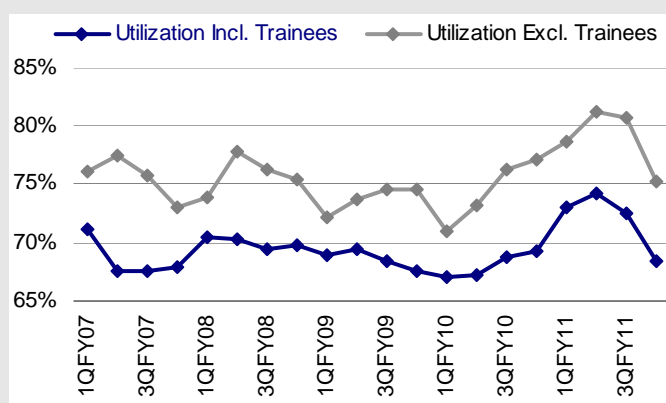
#### **■ Utilization - expect it to be higher than guidance**

In FY11, Infosys' utilization ex-trainees had jumped to 78.9% from a 4-year average of 74.9%. Utilization including trainees had jumped to 72% v/s an average of 68.8% over FY07-10. 4QFY11 levels of 75.2% (ex-trainees) and 68.4% (including trainees) were more consistent with the long-term averages. We agree that Infosys was running a little hot with utilization ex-trainees at ~81% in the last two quarters. Slightly lower utilization makes sense for the following reasons:

1. Infosys' peak utilization during FY11 after accounting for travel, leave, training, etc works out to 86-87%, leaving little room for error.
2. High utilization eventually leads to some disruption in service and delivery levels, especially at a time when the industry is dealing with high attrition. It also limits the ability of an organization to capture any unforeseen demand.
3. The opportunity cost of not having an employee on board and available is significantly higher than the loss because of the employee having to remain on the bench for longer.

**4QFY11 utilization lower than recent highs**

**FY11 utilization level was uncomfortably high (%)**



Management is comfortable at three percentage-point higher utilization than 4QFY11 level

For FY12, the management has guided a moderation in utilization from FY11 level

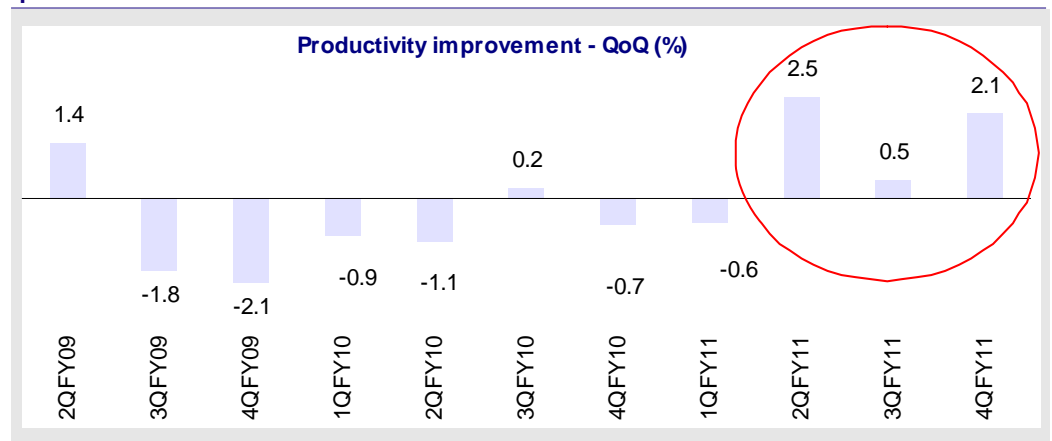
Source: Company/MOSL

While Infosys has guided to a lower utilization level for FY12 v/s FY11, we believe that the utilization will actually be higher. This is in turn driven by our belief that revenue growth for the year will be higher than the company's guided range of 18-20%. Higher revenue growth should lead to better absorption of resources, resulting in ~50-75bp addition to Infosys' margin guidance for the year. The management has also stated that it would be comfortable operating at a utilization rate of up to 78%.

**■ Realization - 3% increase assuming pricing/mix at levels similar to 4QFY11**

If realization remains at 4QFY11 levels all through FY12, in line with Infosys' guidance, FY12 realization would be 3% higher than FY11. A large part of this increase (2%) is cross currency related, where the margin fall through would be limited. However, we still believe that the eventual impact of a 3% blended realization increase would be at least a 75bp addition to Infosys' FY12 margin. In addition, as we have shown later in the report, pricing tends to be much better than Infosys' guidance whenever revenue growth has exceeded their guidance. Also, to provide some context, Infosys has been indicating no more than a stable pricing scenario over the past few quarters as well but saw pricing increases of 2.5%, 0.5% and 2.1% QoQ during 2Q, 3Q and 4QFY11 respectively.

**Despite muted commentary on pricing, productivity increased for the third consecutive quarter**



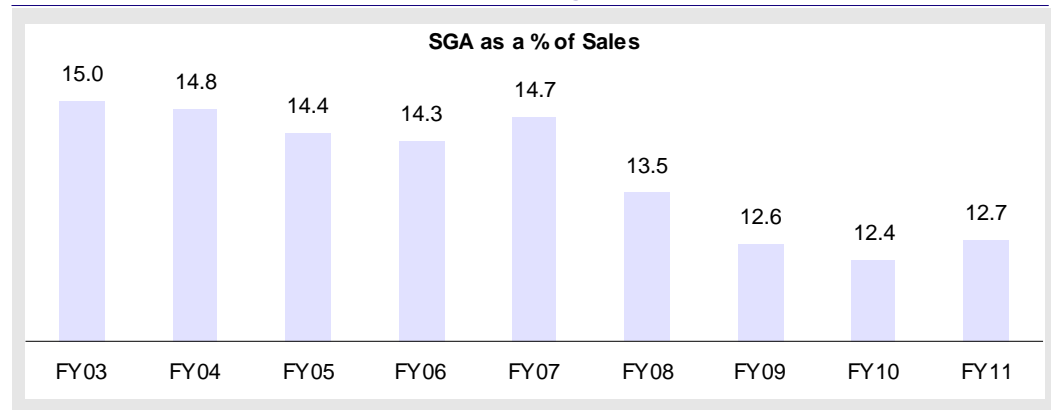
Source: Company/MOSL



### ■ Scale benefits - to continue providing margin cushion

A 16% volume growth in FY12 (Infosys' estimate; our estimate is higher) should provide better absorption of fixed costs and thus drive some operating leverage. Even if we assume fixed costs as being 10% of aggregate costs for Infosys (after adjusting some parts of the semi variable costs to fixed), a 16% growth should push operating margin up by ~100bp. We expect volume growth to be higher than 16%, which should drive a modestly higher leverage in margins, as well.

### Scale benefits will continue to provide some margin cushion



Source: Company/MOSL

*Performance on pricing and utilization has been much better than guidance when growth has been higher than expected - the two underpinnings of higher margin expectation for FY12, as well*

### Focus on management action rather than management commentary

We believe that investors should focus more on what Infosys is doing rather than on what the management is saying. Though commentary on demand continues to be peppered with caution about the uncertain global macro scenario, we believe that Infosys' internal growth and margin expectations are higher than the management guidance. We derive comfort from the following:

- Infosys is recruiting 45,000 employees on a gross basis in FY12 in a scenario of declining attrition (expected at ~13% in FY12), which implies volume growth of 19% v/s 16% guided at the mid-point (after assuming decline in utilization from ~78% in FY11 to ~75% in FY12).
- Infosys is guiding to a much lower utilization levels in FY12 (~75% now as against prior comfort level of high 70's/low 80's earlier and a level of 78.9% in FY11). This does not fit in with a scenario of declining attrition and demand uncertainty. To us, its comfort with lower utilization implies that the company wants to be prepared to take advantage of any upside surprises in demand. We believe that the management anticipates higher probability of demand surprising on the upside than on the downside.
- Infosys has a track record of surpassing its guidance. We juxtaposed its guidance on various parameters related to growth and margins over the last two years v/s actual performance. We found that the actual performance has been markedly different than the guidance in the case of a significant number of metrics. Especially, pricing and utilization have been much better than guidance when growth has been higher than expected, the two underpinnings of our better margin expectation for FY12 as well.

**Guidance v/s actual performance**

|                          |  | FY10                         |  |
|--------------------------|--|------------------------------|--|
|                          | Guidance   | Impact on OPM                | Actual   |
| Revenue Growth/(Decline) | (-3 to -7%)  | -                            | 3%   |
| Pricing                  | 5.7% decline Y-o-Y (assuming 4Q pricing remaining through the full year) | Headwind of 3%               | Actual Decline 3%...or a 1.5% impact on OPM  |
| Utilization              | Expected to go down  | Headwind of 5% alongwith S&M | Actual utilization was higher at 74.4% vs 73.7% (vs. 70.9% in Q1FY10)                                    |
| Re/\$                    | 50.72  | Benefit of 4.5%              | 47.3 --> implying an actual benefit of just 75bps  |
| S&M                      | Expected to go up  | (negative impact)            | SGA actually declined 20bps  |
| Wage Inflation           | Not to give any hikes in the year  | -                            | None Given   |
| Total Impact on OPM      | (-300bp)   |                              | Actually increased by 90bps (Apart from the factors above, Offshore mix movement helped margins as well) |

|                          |  | FY11  |  |
|--------------------------|--|---|--|
|                          | Guidance   | Impact on OPM   | Actual   |
| Revenue Growth/(Decline) | +16-18%  |   | 25.70%   |
| Pricing                  | Increase of 1.4% (assuming Q4FY10 pricing remaining stable through FY11)                   | Tailwind of ~70bps+   | up 3.5% --> tailwind of 150bps+  |
| Utilization              | to go up by ~2% from 74.5% in FY10 --> comfortable with utilization of high 70's, low 80's | positive impact on margins by 100bps                              | 78.9% --> implying positive impact should have been ~250bps  |
| Re/\$                    | Assumed 44.5 --> appreciation of 6.2%  | negative Impact of 250bp  | 45.5 --> implying impact should not have been more than 150bp  |
| S&M                      | No specific commentary   | Minimal impact on account of employee pyramid management (~100bp) | SGA increased by 30bps   |
| Wage Inflation           | Offshore wage inflation of 14%, onsite of 2-3% --> expected to impact by 300bps standalone |   | In-line wage increase, but higher proportion of laterals within GA   |
| Total Impact on OPM      | (-150bp)   |   | (-110bp) --> can be explained by higher lateral adds, and 3% shift in onsite:offshore mix in favor of onsite |

**Keeping estimates unchanged; maintain Buy**

We see the formulation of the new strategy and leadership changes by Infosys as steps in the right direction. Though the redefined vision does not necessarily signify anything revolutionary, the fact that Infosys is thinking ahead of the competition in identifying the trends that may shape the industry in the years to come and is positioning itself to take advantage of these trends early should help it to sustain its competitive advantage over peers.

We believe Infosys is far ahead of the curve and competition in terms of positioning for the future. The strategy of having one-third of revenue from each of Transformation and Innovation, and just one-third of revenue from Operations is the right one, even if it may entail some investments and some sacrifice on the margins in the near term. Eventually, if Infosys is successful, its margin profile will be far better than it is currently. Margins on initiatives like Cloud, Analytics, Social Media, Products and IP would be ~50% higher than the margins on traditional IT services.



See our update dated 4 May 2011



Traditional IT services are fast getting commoditized, with the pricing and margins on Application Development and Maintenance (ADM) being significantly lower today than they were five years ago. Though companies can seek comfort in chasing volumes in commoditized services for now, made possible given the nascence of offshoring within IT services, the eventual winners will be companies that think and act ahead. Infosys is the value leader in the space and we would prefer it that way (instead of necessarily chasing low-end volumes, just for the sake of growth).

We are retaining our EPS estimates for FY12 and FY13 at Rs140.6 and Rs169.5, respectively. We believe there could be upside to our margin assumptions if we are right about the revenue growth trajectory for the company. We maintain our **Buy** rating, with a target price of Rs3,400 (20x FY13E EPS).

## Financials and Valuation

## Income Statement

(Rs Million)

| Y/E March              | 2008           | 2009           | 2010           | 2011           | 2012E          | 2013E          |
|------------------------|----------------|----------------|----------------|----------------|----------------|----------------|
| <b>Sales</b>           | <b>166,920</b> | <b>216,930</b> | <b>227,420</b> | <b>275,010</b> | <b>333,234</b> | <b>394,154</b> |
| Change (%)             | 20.1           | 30.0           | 4.8            | 20.9           | 21.2           | 18.3           |
| Software Develop. Exp. | 92,070         | 117,650        | 120,710        | 150,620        | 186,666        | 222,767        |
| Selling and Mktg. Exp. | 9,160          | 11,040         | 11,840         | 15,320         | 20,085         | 22,861         |
| Administration Exp.    | 13,310         | 16,290         | 16,260         | 19,510         | 23,648         | 27,591         |
| <b>EBITDA</b>          | <b>52,380</b>  | <b>71,950</b>  | <b>78,610</b>  | <b>89,560</b>  | <b>102,834</b> | <b>120,936</b> |
| % of Net Sales         | 31.4           | 33.2           | 34.6           | 32.6           | 30.9           | 30.7           |
| Depreciation           | 5,980          | 7,610          | 9,050          | 8,540          | 9,432          | 10,514         |
| Other Income           | 7,040          | 4,730          | 9,430          | 12,110         | 15,154         | 19,580         |
| <b>PBT</b>             | <b>53,440</b>  | <b>69,070</b>  | <b>78,990</b>  | <b>93,130</b>  | <b>108,556</b> | <b>130,002</b> |
| Tax                    | 8,060          | 10,270         | 17,650         | 24,900         | 28,225         | 33,150         |
| Rate (%)               | 15.1           | 14.9           | 22.3           | 26.7           | 26.0           | 25.5           |
| <b>Adjusted PAT</b>    | <b>45,380</b>  | <b>58,800</b>  | <b>61,340</b>  | <b>68,230</b>  | <b>80,332</b>  | <b>96,851</b>  |
| Extraordinary Items    | -1,210         | -1,080         | -1,320         | 0              | 0              | 0              |
| Reported PAT           | 46,590         | 59,880         | 62,660         | 68,230         | 80,332         | 96,851         |
| Change (%)             | 20.8           | 28.5           | 4.6            | 8.9            | 17.7           | 20.6           |

## Balance Sheet

(Rs Million)

| Y/E March                       | 2008           | 2009           | 2010           | 2011           | 2012E          | 2013E          |
|---------------------------------|----------------|----------------|----------------|----------------|----------------|----------------|
| Share Capital                   | 2,860          | 2,860          | 2,860          | 2,860          | 2,860          | 2,860          |
| Reserves                        | 135,090        | 179,680        | 227,630        | 256,900        | 310,165        | 380,286        |
| Net Worth                       | 137,950        | 182,540        | 230,490        | 259,760        | 313,025        | 383,146        |
| <b>Capital Employed</b>         | <b>137,950</b> | <b>182,540</b> | <b>230,490</b> | <b>259,760</b> | <b>313,025</b> | <b>383,146</b> |
| Gross Block                     | 54,390         | 70,930         | 78,390         | 85,010         | 102,160        | 114,960        |
| Less : Depreciation             | 19,860         | 24,160         | 28,930         | 32,660         | 46,272         | 56,786         |
| Net Block                       | 34,530         | 46,770         | 49,460         | 52,350         | 55,888         | 58,174         |
| CWIP                            | 13,240         | 6,770          | 4,090          | 5,250          | 4,350          | 4,350          |
| Investments                     | 720            | 0              | 37,120         | 1,440          | 10,780         | 10,780         |
| <b>Curr. Assets</b>             | <b>131,370</b> | <b>167,720</b> | <b>184,370</b> | <b>253,890</b> | <b>300,114</b> | <b>374,952</b> |
| Debtors                         | 37,790         | 44,220         | 43,350         | 46,530         | 67,550         | 79,899         |
| Cash & Bank Balance             | 69,500         | 96,950         | 105,560        | 150,950        | 191,851        | 245,925        |
| Loans & Advances                | 22,890         | 25,290         | 33,460         | 53,200         | 37,563         | 45,978         |
| Other Current Assets            | 1,190          | 1,260          | 2,000          | 3,210          | 3,150          | 3,150          |
| <b>Current Liab. &amp; Prov</b> | <b>41,910</b>  | <b>38,720</b>  | <b>44,550</b>  | <b>53,170</b>  | <b>58,107</b>  | <b>65,110</b>  |
| Current Liabilities             | 19,120         | 20,040         | 23,430         | 26,770         | 33,155         | 39,316         |
| Provisions                      | 22,790         | 18,680         | 21,120         | 26,400         | 24,952         | 25,794         |
| <b>Net Current Assets</b>       | <b>89,460</b>  | <b>129,000</b> | <b>139,820</b> | <b>200,720</b> | <b>242,007</b> | <b>309,842</b> |
| <b>Application of Funds</b>     | <b>137,950</b> | <b>182,540</b> | <b>230,490</b> | <b>259,760</b> | <b>313,025</b> | <b>383,146</b> |

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## Financials and Valuation

### Ratios

| Y/E March               | 2008  | 2009  | 2010  | 2011  | 2012E | 2013E |
|-------------------------|-------|-------|-------|-------|-------|-------|
| <b>Basic (Rs)</b>       |       |       |       |       |       |       |
| EPS                     | 79.2  | 102.5 | 107.4 | 119.4 | 140.6 | 169.5 |
| Cash EPS                | 89.8  | 116.1 | 123.1 | 134.2 | 156.9 | 187.7 |
| Book Value              | 241.2 | 319.1 | 403.0 | 454.1 | 547.2 | 669.8 |
| DPS                     | 33.2  | 23.5  | 25.1  | 60.3  | 40.0  | 40.0  |
| Payout % (excl.div.tax) | 41.9  | 22.9  | 23.3  | 50.5  | 28.4  | 23.6  |

### Valuation (x)

|                    |      |      |      |      |      |      |
|--------------------|------|------|------|------|------|------|
| P/E                | 35.3 | 27.2 | 26.0 | 23.4 | 19.9 | 16.5 |
| Cash P/E           | 31.1 | 24.0 | 22.7 | 20.8 | 17.8 | 14.9 |
| EV/EBITDA          | 29.1 | 20.8 | 18.5 | 16.1 | 13.6 | 11.1 |
| EV/Sales           | 9.1  | 6.9  | 6.4  | 5.3  | 4.2  | 3.4  |
| Price/Book Value   | 11.6 | 8.7  | 6.9  | 6.1  | 5.1  | 4.2  |
| Dividend Yield (%) | 1.2  | 0.8  | 0.9  | 2.2  | 1.4  | 1.4  |

### Profitability Ratios (%)

|      |      |      |      |      |      |      |
|------|------|------|------|------|------|------|
| RoE  | 36.2 | 36.7 | 29.7 | 27.8 | 28.0 | 27.8 |
| RoCE | 37.0 | 40.2 | 33.7 | 33.1 | 32.6 | 31.7 |

### Turnover Ratios

|                          |     |     |     |     |     |     |
|--------------------------|-----|-----|-----|-----|-----|-----|
| Debtors (Days)           | 83  | 74  | 70  | 62  | 74  | 74  |
| Fixed Asset Turnover (x) | 5.6 | 5.5 | 4.9 | 5.6 | 6.4 | 7.3 |

### Cash Flow Statement

(Rs Million)

| Y/E March                    | 2008           | 2009           | 2010           | 2011           | 2012E          | 2013E          |
|------------------------------|----------------|----------------|----------------|----------------|----------------|----------------|
| CF from Operations           | 52,300         | 67,420         | 70,880         | 75,560         | 89,824         | 107,365        |
| Cash for Working Capital     | -3,770         | -12,020        | -1,470         | -14,300        | -446           | -13,761        |
| <b>Net Operating CF</b>      | <b>48,530</b>  | <b>55,400</b>  | <b>69,410</b>  | <b>61,260</b>  | <b>89,378</b>  | <b>93,604</b>  |
| Net Purchase of FA           | -16,040        | -13,380        | -9,060         | -12,590        | -12,070        | -12,800        |
| Net Purchase of Invest.      | -470           | 720            | -37,030        | 35,680         | -9,340         | 0              |
| <b>Net Cash from Invest.</b> | <b>-16,510</b> | <b>-12,660</b> | <b>-46,090</b> | <b>23,090</b>  | <b>-21,410</b> | <b>-12,800</b> |
| Proceeds from Equity         | 1,010          | 440            | 2,014          | 1,170          | -337           | 0              |
| Dividend Payments            | -22,240        | -15,730        | -16,724        | -40,130        | -26,730        | -26,730        |
| <b>Cash Flow from Fin.</b>   | <b>-21,230</b> | <b>-15,290</b> | <b>-14,710</b> | <b>-38,960</b> | <b>-27,067</b> | <b>-26,730</b> |
| <b>Net Cash Flow</b>         | <b>10,790</b>  | <b>27,450</b>  | <b>8,610</b>   | <b>45,390</b>  | <b>40,901</b>  | <b>54,074</b>  |
| Opening Cash Bal.            | 58,710         | 69,500         | 96,950         | 105,560        | 150,950        | 191,851        |
| Add: Net Cash                | 10,790         | 27,450         | 8,610          | 45,390         | 40,901         | 54,074         |
| <b>Closing Cash Bal.</b>     | <b>69,500</b>  | <b>96,950</b>  | <b>105,560</b> | <b>150,950</b> | <b>191,851</b> | <b>245,925</b> |

E: MOSL Estimates

# Our recent releases on Infosys

Annual report update | 20 May 2011

Infosys 3.0 update | 4 May 2011

Management meet update | 28 March 2011

**Infosys Technologies**  
CMP: Rs2,851 TP: Rs3,400 Buy

**Future-proofing the organization**  
Transforming to Infosys 3.0, remains our top IT pick

- Infosys' annual report for FY11 discusses its new brand positioning and its organizational restructuring. We see the focus on the new strategy and leadership changes as steps in the right direction.
- Return ratios continue to moderate due to upside cap on the balance sheet. Infosys has increased its payout ratio from under 20% in the last two years to ~60%.
- The expiry of STPI benefits will not cause a material impact on valuation. The company has begun production at three more SEZ units.
- We retain Infosys as our top pick in the IT sector.

**Infosys 3.0 - transforming into a business solutions company.** The annual report discusses Infosys 3.0. It is a rebranding of the company that essentially marks its transition from a technology solutions company to a business solutions company, essentially helping clients build a business for themselves. In keeping with this shift, the Board has decided to change the name of the company from Infosys Technologies Limited to Infosys Limited. Further, the transition Infosys has undertaken with its banking industry verticals, alongside the addition of an new vertical (Public Services and Healthcare), and three new services.

**Return ratios continue to moderate, despite sharp uptick in payout ratio.** Infosys' P/E ratio has increased to 30x from 25x in FY10 and 28x in FY09, respectively. The payout ratio in FY11 increased to ~60% after having been at a low 25% in the two previous years. The below is a list of acquisitions that Infosys has made in the last 10% of Infosys' total investments of cash since a US\$2.5b.

**Great talent is always short in supply, not the other way.** Human talent is the core of Infosys' success. "Cost-effective analysis of talent" that Infosys has used to identify and recruit the best talent in the industry has been a key to its success. This is a key to its success. This is a key to its success. This is a key to its success.

**No material impact on expiry of STPI benefits; begin production at three more SEZs.** Infosys' 0.08% of Infosys' revenue came from the SEZs in Maharashtra, Chennai and 13.34% of its revenue came from other SEZs, which were eligible for tax breaks. Based on 75-80% of its revenue from other SEZs, which were eligible for tax breaks. Based on 75-80% of its revenue from other SEZs, which were eligible for tax breaks.

**Valuation and view:** Infosys is our top pick in the IT sector. We expect the company to post US\$ revenue CAGR of 21% and an EPS CAGR of 19% over FY11-13. The stock trades at 30x P/E and 160x P/BV. We recommend Buy, with a price target of Rs3,400 (30x FY13E EPS), an upside of 19%.

**Infosys Technologies**  
CMP: Rs2,911 TP: Rs3,400 Buy

**Infosys 3.0 - Positioning for the future**  
Leadership changes to help bring focus back to external environment

With the launch of Infosys 3.0, Infosys aims to become more relevant to customers by helping them build tomorrow's enterprise. Along with the changes in leadership, the company has created the Infosys 3.0 framework, and added one critical, the services that have been reorganized into three categories. We believe the change in a step in the right direction, as Infosys continues to move ahead of competition, positioning itself to be a leader in the industry that will shape the industry in the future.

**Infosys 3.0 framework launched** Infosys has launched Infosys 3.0, under which it will focus on three key areas: (1) building a strong foundation for the business, (2) building a strong foundation for the business, (3) building a strong foundation for the business.

**Leadership changes announced** Infosys has announced the resignation of its former CEO and now Chairman of Infosys, Mr. S. D. Subramanian, and the appointment of Mr. S. D. Subramanian as Chairman of Infosys. Mr. S. D. Subramanian will continue to be responsible for the company's operations until 31st August 2011. Mr. S. D. Subramanian will be replaced by Mr. S. D. Subramanian.

**Leadership for Infosys 3.0**

**Shareholding pattern (as at 31st Mar 2011)**

**Stock performance (1 year)**

**Infosys Technologies**  
CMP: Rs3,140 Buy

**Status quo post management interaction; estimates unchanged**  
Seasonality impacts QoFY11; sanguine on discretionary up-64

Infosys gave a good commentary on its performance in FY12, especially on pricing, which is expected to be a key driver. This is a contrast to the company's performance in FY11, which was impacted by a sharp decline in price. We believe the company's performance in FY12, especially on pricing, which is expected to be a key driver. This is a contrast to the company's performance in FY11, which was impacted by a sharp decline in price.

**Seasonality impacts QoFY11; sanguine on discretionary up-64**  
Infosys continues to be positive on the long term demand environment. Though it mentioned a modest QoFY11 guidance of 1-2% sequential growth due to seasonality. Among the positive takeaways from the interaction were:

- The business momentum is becoming more broad based across verticals and geographies, and
- The expectation is under-spending in discretionary areas, like implementation and consulting over the past couple of years, will correct over the next 12 months.

**Commentary on pricing guarded, in contrast to peers**  
Infosys gave a good commentary on its performance in FY12, especially on pricing, which is expected to be a key driver. This is a contrast to the company's performance in FY11, which was impacted by a sharp decline in price. We believe the company's performance in FY12, especially on pricing, which is expected to be a key driver. This is a contrast to the company's performance in FY11, which was impacted by a sharp decline in price.

**EBIT margin expected to remain stable; levels to absorb ~10% wage inflation**  
EBIT margin is expected to stay stable at about 30%, because gains from leverage like employee benefits, scale benefits, tax benefits and better subsidiary margin performance will be needed to be offset. This will help improve the company's performance in FY12, especially on pricing, which is expected to be a key driver. This is a contrast to the company's performance in FY11, which was impacted by a sharp decline in price.

**Expect 18-20% US dollar revenue growth guidance in FY12; maintain Buy**  
We are modeling revenue growth of ~18% in QoFY11, better than the company's guidance, though we expect QoFY11 growth to be in the range of 15-20%. We expect Infosys to give FY12 US dollar revenue growth of 18-20%, which is better than the industry's 15-20% revenue growth. We believe Infosys will be able to absorb wage inflation of ~10% in FY12 without impact to its margin structure, since it has a similar conservative stance on pricing as its peers.



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|---|------------------------|
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| 2. Group/Directors ownership of the stock               | No                     |
| 3. Broking relationship with company covered            | No                     |
| 4. Investment Banking relationship with company covered | No                     |

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