Visit us at www.sharekhan.com March 03, 2011

Infosys Technologies

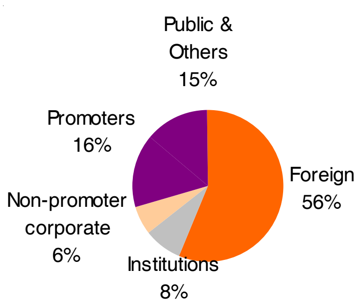
Current underperformance an opportunity to buy

Buy; CMP: Rs3,025

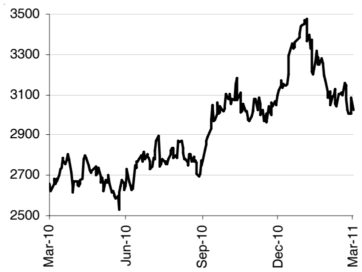
Company details

Price target:	Rs3,817
Market cap:	Rs173,674 cr
52 week high/low:	Rs3494/2510
NSE volume: (No of shares)	9.9 lakh
BSE code:	500209
NSE code:	INFOSYSTCH
Sharekhan code:	INFOSYSTCH
Free float: (No of shares)	48.2 cr

Shareholding pattern



Price chart

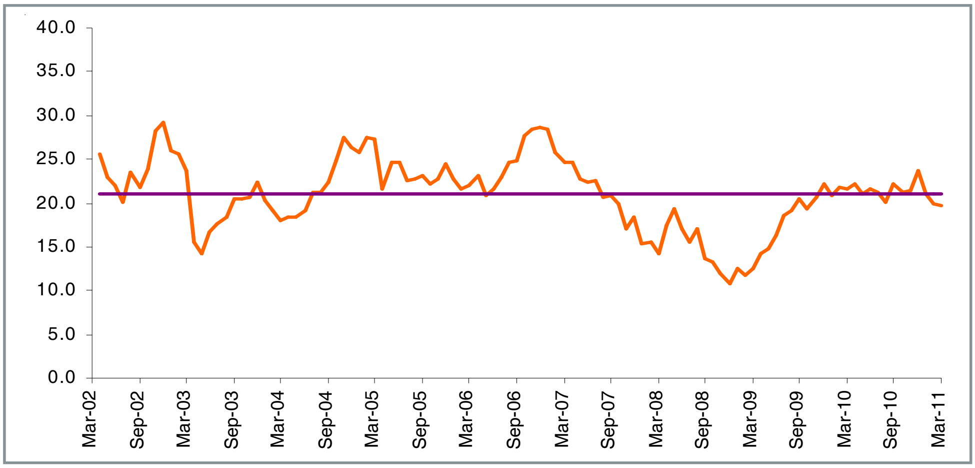


Price performance

(%)	1m	3m	6m	12m
Absolute	-0.2	1.0	12.5	20.7
Relative to Sensex	-2.6	8.5	10.6	6.0

The Infosys Technologies (Infosys) stock has underperformed the broader market over the last month and is currently trading at a discount to its average one-year forward multiple. Against the 0.9% gain in the BSE Sensex the Infosys stock has seen a fall of 2.9% in the last month. The underperformance could be on two counts: the uncertainty about the organisational change and the lag in growth in comparison to competition along with a flattish guidance for Q4FY2011. We believe that the uncertainty over the organisational change would be sorted out in the near term. With the overall demand environment improving, the growth trajectory would also be back on track (we expect the company's revenue to grow at a compounded annual growth rate [CAGR] of 24% in FY2010-13). Hence, the stock offers a good buying opportunity at the current levels.

Average vs current one-year forward PE (x)



Change in leadership

Infosys would see a change in leadership with S Gopalakrishnan stepping down as the chief executive officer (CEO). Mr Gopalakrishnan might replace NR Narayana Murthy as the chairman of Infosys. Mr Murthy is scheduled to step down as chairman in August 2011 as he attains the age of 65 years. As has been the past trend, S Shibulal, the last of the founder members, would be replacing Mr Gopalakrishnan as the CEO of the company. The company's history shows that the chief operating

Valuation table

Particulars	FY09	FY10	FY11E	FY12E	FY13E
Total revenue (Rs cr)	21,693.0	22,742.0	27,802.1	34,565.5	43,155.6
EBITDA margin (%)	33.2	34.6	33.0	33.2	33.0
Net profit	5988.0	6266.0	6945.3	8822.3	10954.1
EPS (Rs)	104.5	109.2	121	153.7	190.8
PER (x)	28.9	27.7	25.0	19.7	15.9
CEPS (Rs)	117.8	124.9	136.3	173.6	215.6
RoE (%)	36.7	30.1	27.2	28.3	28.6
RoCE (%)	43.1	38.0	36.6	38.0	38.5

officer (COO) goes on to become the CEO of the company—Mr Nilekani and Mr Gopalakrishnan were promoted as the CEO after their stint as the COO of the company.

Non-founder member to lead in coming years...

Mr Shibulal would be the last of the founder members and his replacement would see the first non-founder member becoming the CEO of the company. The media is speculating on a non-Indian CEO: Stephen Pratt, currently CEO and managing director, Infosys Consulting. He was the founder member of Infosys Consulting and was listed amongst the top 25 consultants in the world in 2003 and 2005. There are other Indian candidates who have been heading the vertical businesses: Ashok Vemuri, senior vice president (VP), Banking & Capital Markets and Strategic Global Sourcing; BG Srinivas, senior VP, Manufacturing, Product engineering, Product life cycle and Engineering solutions; and Subhash Dhar, senior VP, Communications, media & entertainment, Global sales alliances and marketing, and Independent valuation solutions amongst others whom the company has groomed over the years.

Infosys already works on an industry verticalised structure. The company has over the years created a pool of leaders who are capable of managing small/medium-sized companies. The company follows a procedure to select a leader from the pool of aspirants to fill in higher positions internally before going for a non-Infosys leader. Further, the company also plans to create more business units, making them profit centres and promoting leaders to head these units, in a way creating leaders for the future.

What changes could happen…

Infosys has been working on a verticalised structure in line with the broad industry structure. The company last saw a change in the structure in October 2007, when it had realigned its vertical structure into six vertical industry business units, five horizontal business units embedded within the verticals and created a ten-member executive council. Also, the company has talked about a strategy that includes business transformation, strategic global sourcing and new engagement models.

The business re-structuring could see the following changes:

- *Focused unit on large transformational deals:* Infosys has lagged Tata Consultancy Services (TCS) in terms of large transformational deals. TCS has been announcing large deals quarter over quarter whereas Infosys has had fewer large deal wins in the last few quarters at least after the meltdown. The company could create a unit to focus on large transformational deals.
- *More focus on European geography:* Infosys has lagged its competitors in the European geography. It has been focusing on Europe and has maintained that its ultimate target is that the contribution of the USA, Europe and the Rest of world would be 40:40:20. It has elected heads for a few countries in the European continent. It could be working on a structure where Europe could become a separate business unit.
- *Increased focus on new engagement models:* The company has identified seven themes for growth going forward: (1) digital consumers, (2) emerging economies, (3) sustainable tomorrow, (4) new commerce, (5) healthcare economy, (6) smarter organisation, and (7) pervasive computing. Hence there could be a change in the organisational structure to re-align to these seven themes.

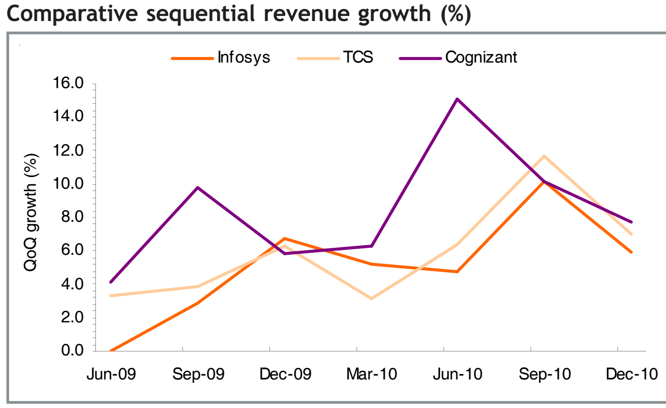
We believe that the uncertainty over the organisational change would be sorted out in the near term and that it would not have much of an impact on the performance of the stock, as the company would not take any major steps that would adversely affect its growth opportunities.

Infosys lagging competition…

Over the last couple of years, Infosys has lagged competition, mainly TCS, in terms of growth and share of revenues. The competition is getting intense with Cognizant Technology Solutions also gaining market share (though to some extent due to a lagging Wipro).

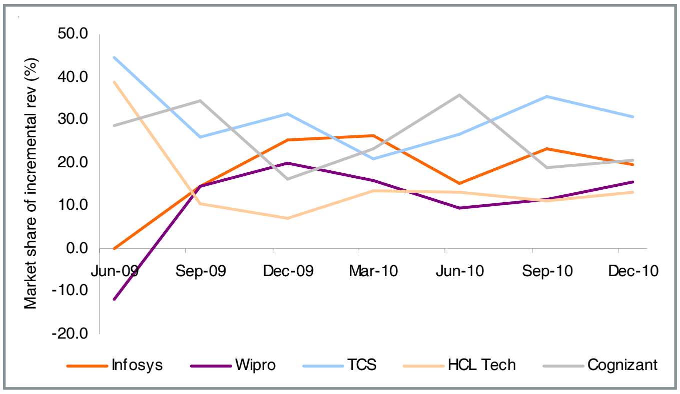
Infosys has lagged its information technology (IT) counterparts in terms of growth. In terms of growth, over the last seven quarters, Infosys has beaten TCS and Cognizant only in one quarter.

Comparative sequential revenue growth (%)



The lower sequential growth compared to competition means that the share of Infosys in the incremental revenues over the last seven quarters has also been decreasing.

Market share of incremental revenues (%)



However, we believe that with the demand environment improving, the company though tagged conservative is agile on the market orientation front, with focus on newer engagement models which would be the growth drivers for the future. The company is well placed to register a growth higher than the industry average in the coming years. We expect Infosys to register a revenue CAGR of 24% over FY2010-13.

Valuation and view

The Infosys stock has underperformed the broader market over the last month and is currently trading at a discount to its average one-year forward multiple. Against the 0.9% gain in the BSE Sensex the Infosys stock has seen a fall of 2.9% in the last month. The underperformance could be on two counts: the uncertainty about the organisational change and the lag in growth in comparison to competition along with a flattish guidance for Q4FY2011. We believe that the uncertainty over the organisational change would be sorted out in the near term. With the overall demand environment improving the growth trajectory would also be back on track (we expect the company's revenue to grow at a CAGR of 24% in FY2010-13). Hence, the stock offers a good buying opportunity at the current levels.

At the current market price of Rs3,025, the stock trades at 19.7x and 15.9x its FY2012E and FY2013E earnings respectively. We maintain a Buy recommendation on the stock with a price target of Rs3,817, valuing the company at 20x FY2013E earnings.

The author doesn't hold any investment in any of the companies mentioned in the article.

Sharekhan
Your guide to the financial jungle

Sharekhan Ltd, Regd Add: 10th Floor, Beta Building, Lodha iThink Techno Campus, Off. JVLR, Opp. Kanjurmarg Railway Station, Kanjurmarg (East), Mumbai – 400 042, Maharashtra. Tel: 022 - 61150000. BSE Cash-INB011073351; F&O-INF011073351; NSE – INB/INF231073330; CD - INE231073330; MCX Stock Exchange: CD - INE261073330 DP: NSDL-IN-DP-NSDL-233-2003; CDSL-IN-DP-CDSL-271-2004; PMS INP000000662; Mutual Fund: ARN 20669. Sharekhan Commodities Pvt. Ltd.: MCX-10080; (MCX/TCM/CORP/0425); NCDEX -00132; (NCDEX/TCM/CORP/0142)