



## Initiating Coverage

<b>Recommendation</b>	:	<b>Outperformer</b>
<b>CMP</b>	:	Rs 2,866
<b>Target</b>	:	<b>Rs 3,340</b>
<b>Upside Potential</b>	:	16.50%

<b>Sector</b>	:	<b>IT&amp;ITES</b>
<b>Sensex</b>	:	18469
<b>Bloomberg code</b>	:	INFO:IN
<b>Reuters Code</b>	:	INFY.BO

### AT A GLANCE

<b>Issued Equity Capital (Cr.)</b>	:	57.4
<b>Mkt. Cap (Rs. in Crs)</b>	:	164,767
<b>Major Shareholders</b>		
<b>Promoters (%)</b>	:	16.04%
<b>Free Float (%)</b>	:	83.96%

**Background:** Infosys is the 2<sup>nd</sup> largest IT Company in India with 64 offices and 63 development centers in US, India, China, Australia, Japan, Middle East, UK, Germany, France, Switzerland, Netherlands, Poland, Canada and many other countries. Infosys and its subsidiaries have 130,820 employees as on March 31, 2011 and revenue of US\$ 6 billion.

### Consistent Improvement in Market share...

Infosys ability in client mining and deeper penetration across the verticals has resulted in consistent increase in its market share. Infosys share in India's IT exports (including BPO, Engineering services and R&D software products) grew from 8.96% in FY06 to 10.46% in FY11, an increase of 149 bps.

### Deeper Client Mining...

Average Revenue per active clients grew at a CAGR of over 16% from US\$ 4.68 million in FY06 to US\$ 9.74 million in FY11. Even the percentage of repeat business from its existing clients has increased 300 bps from 95% to 98% during the same period, suggesting that Infosys expertise in deeper client mining and its ability to capture a greater share of its customers IT spend.

### De-risking its client's exposure and continues to grow...

It is commendable to appreciate Infosys effort in handling the double edge sword i.e. de-risking the client's exposure and continue to grow the revenue from its top 10 clients. This is achieved by growing the revenue base at much faster pace compared to the Top 10 client's growth.

### Consistently yielding higher return over its cost of capital...

Infosys consistently yield higher return over its cost of capital, which implies its ability to enhance and create value for shareholders.

### Valuation

We expect the revenues to grow by 20.5% and 20.6% to Rs. 33,146 crore and Rs. 39,964 crore in FY12 & FY13 respectively. We expect EBIDTA margins to decline by 130 bps from 32.6% to 31.3% in FY12 and 30.8% in FY13.

At current price the stock is trading at a multiple of 20.6X and 17.2X to its FY12E and FY13E earnings. We initiate coverage with an "Outperformer" rating with a price target of Rs. 3,340 based on 20x FY13E earning.



### ANALYST

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## Company Profile

Infosys was incorporated in Pune, in 1981 as Infosys Consultants Private Limited, and later it changed its name to Infosys Technology Limited in June 1992 and came for an Initial Public Offering in February 1993 with an IPO price of Rs. 95 per share. In March 1999, it issued ADR and listed in NASDAQ.

Today Infosys is the 2<sup>nd</sup> largest IT company in India with 64 offices and 63 development centers in US, India, China, Australia, Japan, Middle East, UK, Germany, France, Switzerland, Netherlands, Poland, Canada and many other countries. Infosys and its subsidiaries have 130,820 employees as on March 31, 2011 and revenue of US\$ 6 billion.

## SWOT Analysis

### Strength

- Excellent project and services execution capability
- Strong brand recall and long standing client relationship with 98% of revenue comes from existing clients.
- Proven Global Delivery Model and ability to scale it.
- Increasing market share in India's IT exports
- Deeper client mining yielding higher revenue per active clients.

### Weakness

- Higher attrition rate.
- Since Infosys is enjoying the highest margin compared to its peers, the increasing wage levels in the country could adversely affect the margins.

### Opportunities:

- Geographic expansion in new markets
- Pursue alliance and strategic acquisitions

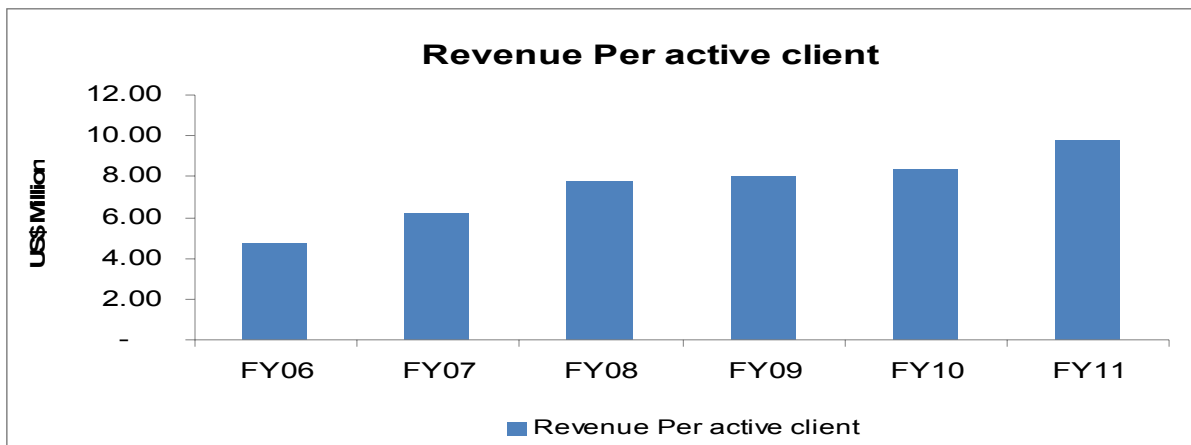
## Threat

- Rupee appreciation against the basket of currencies such as Dollar, GBP and Euro could adversely affect the earnings.
- Its revenues are highly dependent on clients primarily located in US and Europe as well as in certain industries; therefore any macro economic factors such as decrease in discretionary spending, slower economic growth in US and Europe, any regulatory change could adversely affect the earnings.
- Market is facing an intense competition for technology services from both domestic companies and MNC's and further intensity in the competition could lead in pricing war.

## Investment Rational

### Deeper Client Mining...

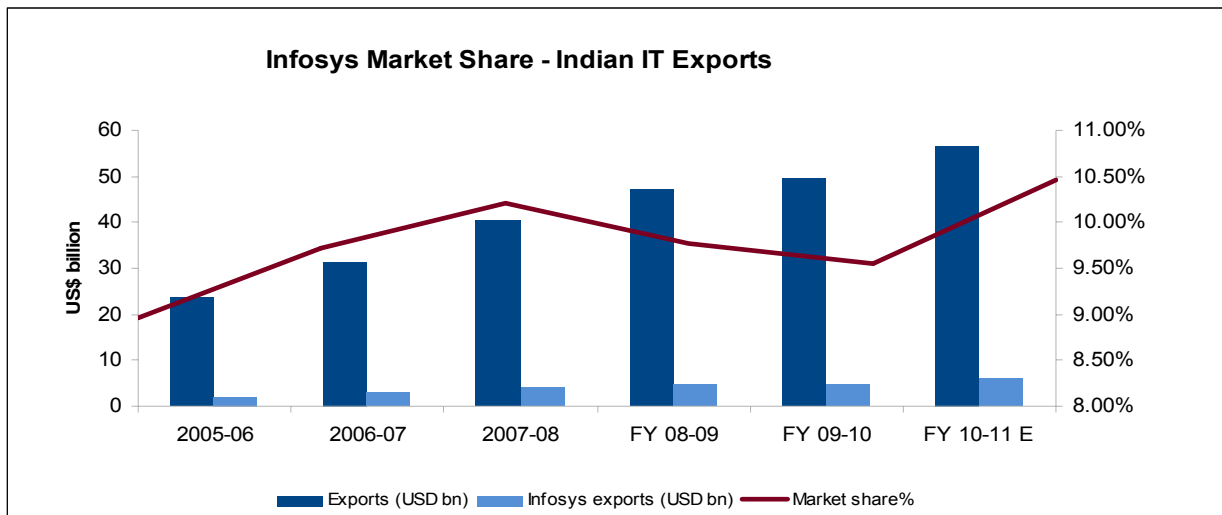
Average Revenue per active clients grew at a CAGR of over 16% from US\$ 4.68 million in FY06 to US\$ 9.74 million in FY11. Even the percentage of repeat business from its existing clients has increased 300 bps from 95% to 98% during the same period, suggesting that Infosys expertise in deeper client mining and its ability to capture a greater share of its customers IT spend.



Source: CSEC Research

## Consistent Improvement in Market share...

Infosys ability in client mining and deeper penetration across the verticals has resulted in consistent increase in its market share. Infosys share in India's IT exports (including BPO, Engineering services and R&D software products) grew from 8.96% in FY06 to 10.46% in FY11 increase of 149 bps.

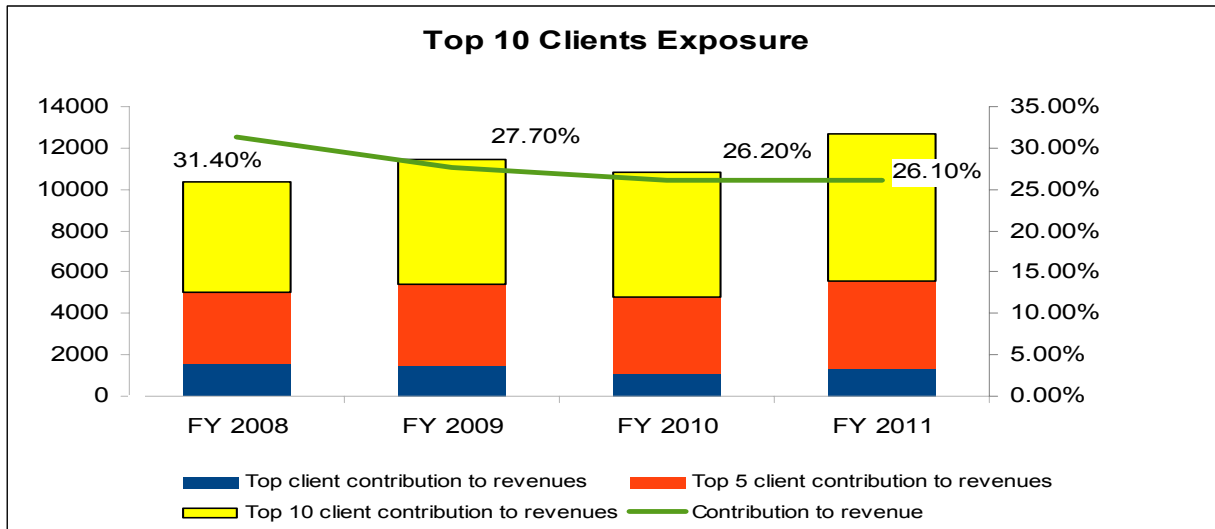


Source: NASSCOM, CSEC Research

## De-risking its client's exposure and continues to grow...

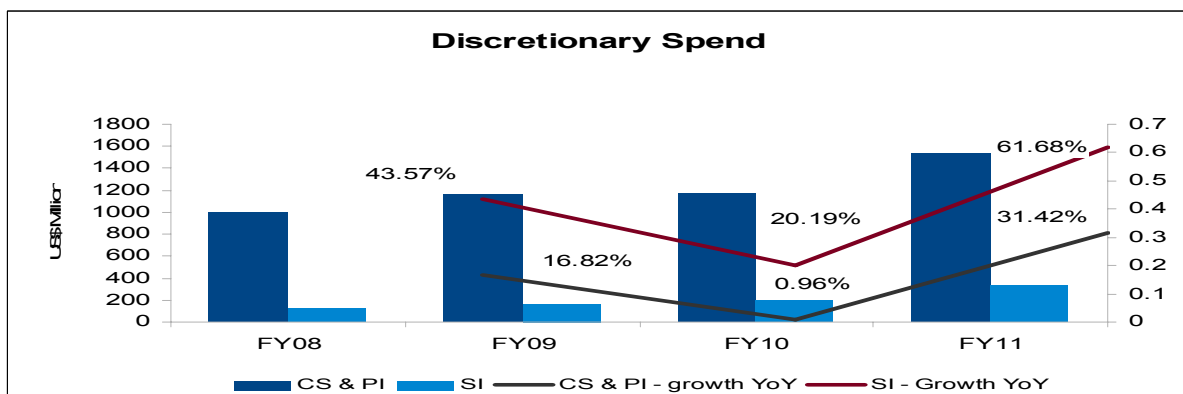
It is commendable to appreciate Infosys effort in handling the double edge sword i.e. de-risking the client's exposure and continue to grow the revenue from its top 10 clients. This is achieved by growing the revenue base much faster compared to the Top 10 client's growth.

In absolute term the revenues grew at CAGR of 10.34% from Rs. 5,287.89 crore FY08 to Rs. 7,104.02 crore in FY11, and the revenue contribution has shrunk to the tune of 530 bps from 31.4% in 2008 to 26.1% in FY11.



### Increasing discretionary spends...

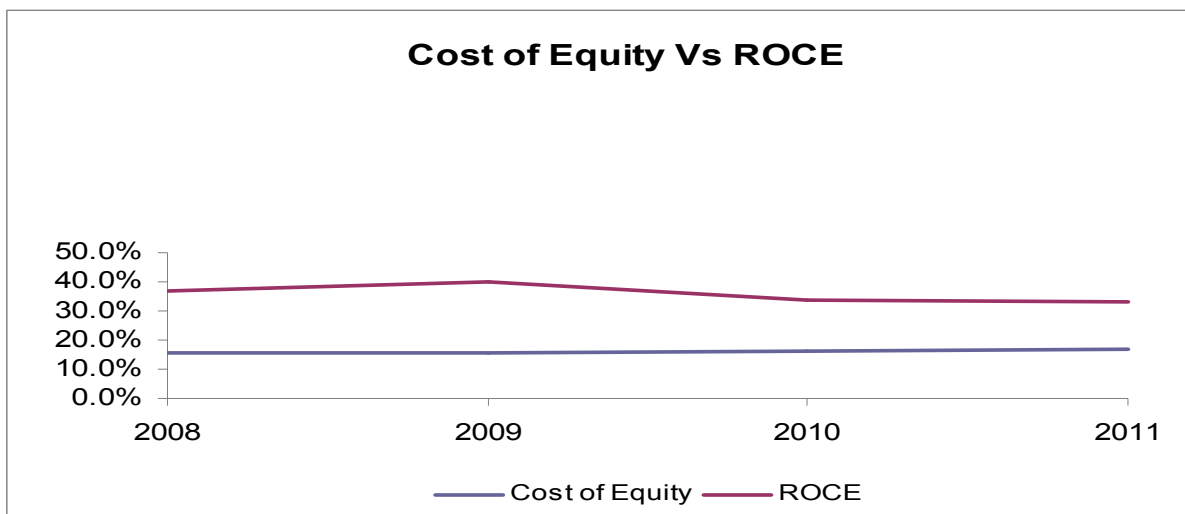
Among services, Consulting Services and Package Implementation (CS&PI) registered a strong growth of 31.42% YoY from US\$1,172 million in FY10 to US\$1,540 million in FY11, indicating the return of discretionary spending by clients. System Integration (SI), another service line that indicates discretionary spending, also grew strongly, up 61.68% YoY from US\$201 million in FY10 to US\$326 million in FY11. The management indicated that it is getting strong on transformational space and the company has won 4 transformational projects which are US\$30 million plus and it has also won 6 large engagements which are US\$ 100 million plus deals during this quarter.



## Consistently yielding higher return over its cost of capital...

We calculated cost of capital using Capital Asset Pricing Model (CAPM), since Infosys is a debt free company; its Cost of Capital is equal to Cost of Equity (Re). We assumed average market return as 18.57% (Average Nifty annual return for the period January, 2000 to April, 2011) and we used GS-10 year bond yields as the risk free rate.

Infosys consistently yield higher return over its cost of capital, which implies, its ability to enhance and creates value for shareholders.



Source: CSEC Research

## Financial Overview

### Revenue to Grow at CAGR of 20.7%...

We have estimated the revenue to grow at a CAGR of 20.7% from Rs. 22,742 crore in FY10 to Rs. 39,964 in FY 13 on account of improving global economic scenario thus leading to higher discretionary spending.

We have factored a volume growth of 16.7% in FY12 and 19.3% for FY13 and we have assumed the revenue productivity (blended) to increase by 5.5% in FY12 against the management's flattish guidance.

It has to be noted that even last year the management has guided a flattish productivity, however they reported a 3.5% growth on YoY basis and given the fact that the business environment is much better than previous year and even management has indicated that, they are now in the position to claim Cost of Living Allowance (COLA) increase from their clients. Hence, we believe 5.5% growth in revenue productivity is achievable.

### Operating margin to decline...

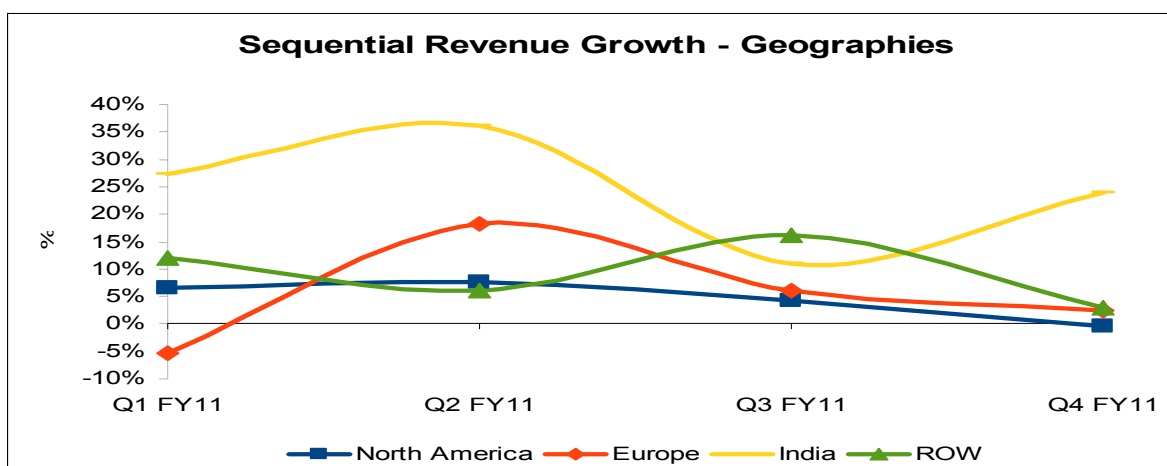
We estimated Profit After Tax (PAT) to grow from Rs. 6,218 crore in FY10 to Rs. 9,546 crore in FY13 at a CAGR of 15.1%, a lower growth compared to the revenue has factored the pressure in margin front on account of increasing wage and tax levels. We have estimated the EBIDTA margins to decline from 32.6% in FY11 to 31.3% and 30.8% in FY12 & 13 respectively and we have assumed the tax rate at 27.5% for FY12&13 compared to 26.7% in FY11.

### Healthy Balance sheet...

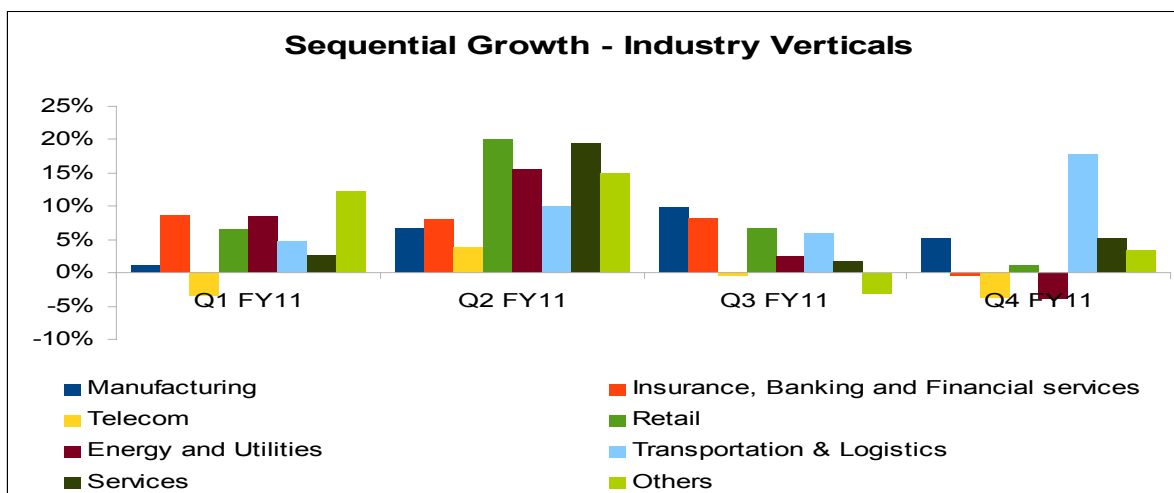
Infosys a zero debt company has got one of the strongest balance sheet in the industry, which we estimate to grow at CAGR of 18% from Rs. 23,049 crore in FY10 to Rs.37,818 crore in FY13 and fixed asset turnover continue to increase from 4.7x in FY10 to 5.4x in FY11. However increasing debtor days (incl. Unbilled revenue) is a concern to worry, which has gone up from 70 days in FY10 to 78 days in FY11.

## Operating Metrics Highlights...

During the year System Integration (SI), Testing and products grew at 62%, 47.36% and 46.71% respectively on back of strong discretionary spending. From a vertical perspective Retail, BFSI and Energy & Utilities showing good traction and it exhibited a YoY growth of 34.26%, 32.41% and 30% respectively. Geographically the contribution from India increased from 1.2% in FY10 to 2.2% in FY11 and revenue from North America grew at 24.8%, Europe grew at 17.5% and RoW grew at 38% in constant currency terms on a yearly basis.



Source: Company, CSEC Research



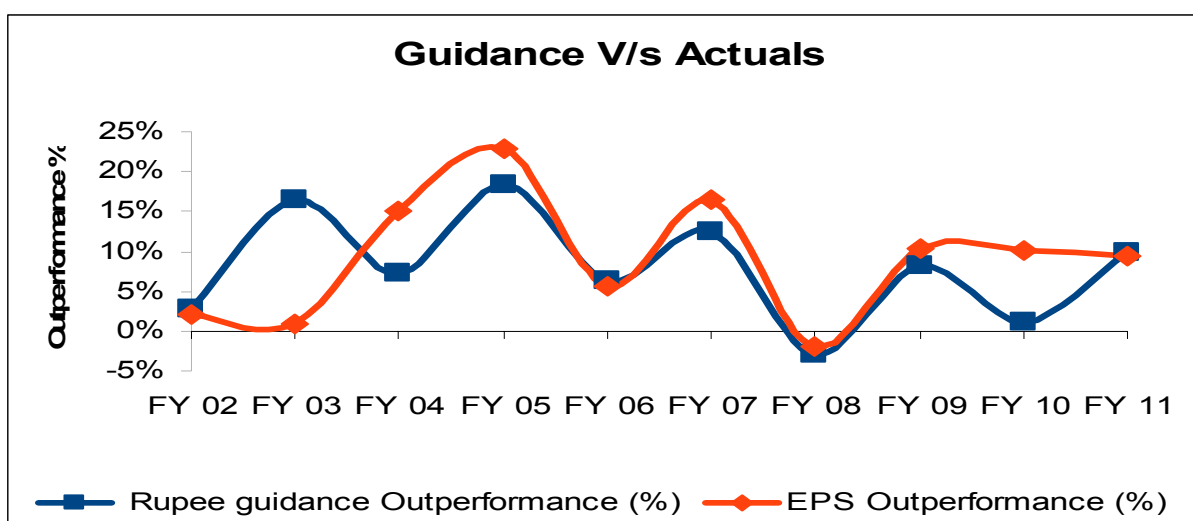
Source: Company, CSEC Research



On a net level company has added 17,024 employees in FY11 compared to only 8,946 in FY10 and on utilization front (excluding trainees) showed a slight improvement to the tune of 80 bps from 74.4% in FY10 to 75.2% in FY11.

### Guidance v/s actual...

Management has guided a revenue growth of 18 – 20% for FY12 in dollar terms (US\$7.12 bn – US\$7.25bn) assuming Rupee-dollar equation at 44.50, it translates into a revenue growth of 15.4% - 17.3% in rupee terms (Rs.31,721 crore – Rs. 32,258 crore). On the EPS front it has guided a single digit YoY growth of 5.4% to 7.4% to Rs. 126 – 128.



Source: Company, CSEC Research

It is a common practice for Infosys to give a conservative guidance and outperform it, and looking at the history starting from FY02, Infosys has missed its guidance in both revenue and EPS only once in FY08 by 2.8% and 1.9% respectively. On an average it has outperformed the revenue and EPS guidance by around 8% and 9% respectively. For FY12 we have assumed Revenue and EPS to outperform the mid-point of the guidance by 3.6% and 9.6% respectively.

## Management Change...

Infosys has recently made one of the biggest changes since its inception in its Board, which is as follows:

- N.R. Narayana Murthy appointed as Chairman Emeritus
- K.V. Kamath, one of the independent directors of the company, named as the new Chairman of the Board. He will be the first outsider to head the company's board.
- S. Gopalakrishnan, one of the Co-Founders and Chief Executive Officer, named as the Executive Co-Chairman of the Board.
- S.D. Shibulal, one of the Co-Founders and Chief Operating Officer, named as the Chief Executive Officer and Managing Director of the company.

These appointments are effective from August 21, 2011. The Board of Directors also approved the proposal of changing the company's name from Infosys Technologies to Infosys Limited. The company intends to seek shareholders' approval on the proposal at the ensuing annual general meeting on June 11, 2011. In our opinion we appreciate the move of appointing K.V. Kamath as a Chairman, given the fact that 35.8% of revenues come from BFSI and we feel Shibulal, replacing Krish is more cosmetic and not going to have any material impact on the earnings.

## Rupee impact...

During this financial year, rupee depreciated against USD by 2.02%, against euro by 7.57% and against GBP by 8.36%. Management expects rupee to appreciate in the near term and factored the same in its guidance at Rs. 44.5 and any sharp appreciation than these level will affect its guidance adversely.

## Sensitivity analysis...

On a base case, we have assumed the exchange rate for FY12 & FY13 as 44.56 & 44.5 respectively. To analyze the impact of exchange rate on our EPS estimate, we have done a sensitivity analysis using various exchange rates ranging from Rs. 42.5 – 45.5. Our sensitivity analysis indicates the FY13 EPS estimate could vary in a range between Rs.147 to Rs.177.2 ceasing the downside risk from current level.

## Sensitivity of FY13 EPS to the Exchange Rate

Figures in Rs.Crore

Average Exchange Rate	45.5	45	44.5	44	43.5	43	42.5
Net Sales	40,862	40,413	39,964	39,515	39,066	38,617	38,168
Growth %	23.3	21.9	20.6	19.2	17.9	16.5	15.2
Software Development Exp.	22,558	22,526	22,494	22,461	22,429	22,396	22,364
SG&A	5,205	5,185	5,165	5,145	5,125	5,105	5,085
EBIDTA	13,099	12,702	12,306	11,909	11,513	11,116	10,719
% of Sales	32.1	31.4	30.8	30.1	29.5	28.8	28.1
Depreciation	1,123	1,123	1,123	1,123	1,123	1,123	1,123
Other Income	1,984	1,984	1,984	1,984	1,984	1,984	1,984
PBT	13,960	13,563	13,167	12,770	12,373	11,977	11,580
Tax	3,839	3,730	3,621	3,512	3,403	3,294	3,185
Minority Interest	0	0	0	0	0	0	0
Extraordinary Items	0	0	0	0	0	0	0
<b>Reported PAT</b>	<b>10,121</b>	<b>9,833</b>	<b>9,546</b>	<b>9,258</b>	<b>8,971</b>	<b>8,683</b>	<b>8,396</b>
Adj. PAT	10,121	9,833	9,546	9,258	8,971	8,683	8,396
EPS (Rs.)	177.2	172.1	167.1	162.1	157	152	147
P/E – 1yr forward	20	20	20	20	20	20	20
<b>Price Per Share</b>	<b>3544</b>	<b>3442</b>	<b>3342</b>	<b>3242</b>	<b>3140</b>	<b>3040</b>	<b>2940</b>

Source: CSEC Research

## Valuation and Recommendations

We have seen a raise in discretionary IT spending by clients in FY11 and it has reflected through a surge in company's deal pipeline, during last quarter it has bagged four transformational deals of size of US\$30 million plus and six large deals of US\$150 million plus and we believe the same to continue in FY12. We are optimistic on demand scenario and also on the business outlook of Infosys.

At current price the stock is trading at a multiple of 20.6X and 17.2X to its FY12E and FY13E earnings. We initiate coverage with an **"Outperformer"** rating with a price target of Rs. 3,340 based on 20x FY13E earning.

## Risk & Concerns

- Rupee appreciation against the basket of currencies such as Dollar, GBP and Euro could adversely affect the earnings.
- Its revenues are highly dependent on clients primarily located in US and Europe as well as in certain industry verticals; therefore any macro economic factors such as decrease in discretionary spending, slower economic growth in US & Europe and any regulatory change could adversely affect the earnings.
- Market is facing an intense competition for technology services from both domestic companies and MNC's and further intensity in the competition could lead in pricing war.

## Financial Statements

Income Statement		(Rs. Crore)				
Particulars	FY09	FY10	FY11	FY12E	FY13E	
Net Sales	21,693	22,742	27,501	33,146	39,964	
Growth %		4.8	20.9	20.5	20.6	
Software Development Exp.	11,765	12,071	15,054	18,532	22,494	
SG&A	2,733	2,810	3,479	4,250	5,165	
% of Sales	12.6	12.4	12.7	12.8	12.9	
EBIDTA	7,195	7,861	8,968	10,364	12,306	
% of Sales	33.2	34.6	32.6	31.3	30.8	
Depreciation	761	905	854	943	1,123	
Other Income	473	943	1,211	1,550	1,984	
PBT	6,907	7,899	9,325	10,971	13,167	
Tax	919	1,681	2,490	3,017	3,621	
Minority Interest	0	0	0	0	0	
Extraordinary Items	0	48	0	0	0	
Reported PAT	5,988	6,266	6,835	7,954	9,546	
Adj. PAT	5,988	6,218	6,835	7,954	9,546	

Balance Sheet		(Rs. Crore)				
Particulars	FY09	FY10	FY11	FY12E	FY13E	
Share Capital	286	286	286	286	286	
Reserves	17,968	22,763	25,690	30,982	37,532	
Net worth	18,254	23,049	25,976	31,267	37,818	
<b>Total Source of Fund</b>	<b>18,254</b>	<b>23,049</b>	<b>25,976</b>	<b>31,267</b>	<b>37,818</b>	
Net Block	4,677	4,946	5,235	5,697	6,179	
CWIP	677	409	525	525	525	
Investments	0	3,712	144	144	144	
DTA (Net)	126	200	321	450	321	
Net Current Assets	12,774	13,782	19,751	24,452	30,649	
<b>Total Application of Funds</b>	<b>18,254</b>	<b>23,049</b>	<b>25,976</b>	<b>31,267</b>	<b>37,818</b>	

Cash flow Statement			(Rs. Crore)		
Particulars	FY09	FY10	FY11	FY12E	FY13E
Net Cash from Operations	6,140	5,703	4,349	5,493	7,400
Net Cash from Investments	-341	-3,483	3,475	142	376
Net Cash from Financing	-2,161	-1,481	-3,372	-4,013	-2,662
Effect of Exchange rate	76	-31	45	45	45
Net Increase in Cash	3,714	708	4,497	1,667	5,158
Closing Balance of Cash	9,695	10,556	15,095	16,762	21,921
FCF	4,813	5,028	3,087	4,085	5,791

Ratios		FY09	FY10	FY11	FY12E	FY13E
Gross Margin%		45.8	46.9	45.3	44.1	43.7
EBIDTA%		33.2	34.6	32.6	31.3	30.8
PBT %		31.8	34.7	33.9	33.1	32.9
PAT %		27.6	27.6	24.9	24.0	23.9
ROE%		37.4	30.3	27.9	27.8	27.6
RoCE%		40.2	33.7	33.1	32.9	32.4
Debtors (Days)		74	70	78	78	78
EPS (Rs.)		104.5	109.7	119.6	139.2	167.1
CEPS (Rs.)		117.8	125.6	134.6	155.7	186.7
DPS (Rs.)		23.5	25.1	60.3	40.0	45.0
Fixed asset turnover (x)		5.3	4.7	5.4	6.1	6.7

**Cholamandalam Securites Limited**

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STOCK RATINGS : Outperformer:>15% upside over the next 12 months; Marketperformer: trade within a +/-15% range over the next 12 months; underperformer:>15% downside over the next 12 months.