

INFOSYS

IT - SERVICES

30 OCT 2017

Quarterly Update

BUY

Target Price: Rs 1,200

Strong Q2 but seasonality to weigh on H2

Despite leadership changes, Infosys' Q2 revenue was in line with expectation. EBIT margin (24%; up 10 bps QoQ) was better driven by efficiencies which offset wage increases during the quarter. New Services (9.4% of rev; up 17% QoQ) recorded robust performance. This coupled with continued momentum in deal wins (USD 731 mn; H1: USD 1.4 bn), strong execution (utilization up 70 bps QoQ to 84.7%) and margin resilience showcase Infosys' strong execution capabilities.

Outlook: H2 is seasonally weak due to lower working days and furloughs; FY18 revenue guidance revised downwards to 5.5%-6.5% in constant currency terms (vs. earlier 6.5%-8.5%). EBIT margin maintained at 23-25%. Management highlighted its competitive position is strong in financial services, healthcare, life sciences with customer satisfaction scores improving. Hence we expect momentum to pick up in FY19.

CMP : Rs 927
Potential Upside : 29%

MARKET DATA

No. of Shares : 2,297 mn
Free Float : 87%
Market Cap : Rs 2,129 bn
52-week High / Low : Rs 1,045 / Rs 862
Avg. Daily vol. (6mth) : 5.9 mn shares
Bloomberg Code : INFO IB Equity
Promoters Holding : 13%
FII / DII : 35% / 22%

Chairman's commentary – key highlights

- ♦ **Strategy refresh** – With clients spend tilting towards digital initiative, management team is committed to software product + services model. Focus areas are: agile delivery and reskilling of employees on latest technologies; these will help target client's transformational engagement.
- ♦ **New CEO search** – is progressing well and evaluating both internal and external candidates.
- ♦ **Shareholder consultation** – one round of meetings completed and next round in Q3; findings will be shared in January.

Strong margin performance: EBIT margin improved 10 bps QoQ to 24% despite wage increases (85% of employees; impact 80 bps). Wage impact was offset by strong operational performance: reduction in onsite mix (20 bps benefit), higher utilization (30 bps), improvement in pricing (30 bps), coupled with cross currency and operating efficiencies. Q3 will see wage increases for 15% of the workforce (largely mid and senior management). **Infosys has maintained its EBIT margin guidance at 23%-25%.** Operating levers exist: higher offshore mix, onsite pyramid, project specific cost optimization measures and higher proportion of fixed price projects.

Financial summary (Consolidated)

Y/E March	FY16	FY17	FY18E	FY19E
Sales (Rs bn)	624	685	710	797
Adj PAT (Rs bn)	135	144	146	163
Con. EPS* (Rs)	-	-	64	69
EPS (Rs)	59	63	67	75
Change YOY (%)	9.4	6.4	7.1	11.6
P/E (x)	15.7	14.8	13.8	12.4
RoE (%)	24.9	22.6	22.3	24.9
RoCE (%)	34.5	31.3	30.8	34.5
EV/E (x)	10.4	9.3	9.5	8.0
DPS (Rs)	10	26	34	37

Source: *Consensus broker estimates, Company, Axis Capital

Key drivers

(Continued on page 2...)

	FY17	FY18E	FY19E
USD revenue (bn)	10,208	10,979	12,017
% change YoY	7%	8%	9%
EBIT margin (%)	24.7%	24.2%	25.1%

Price performance

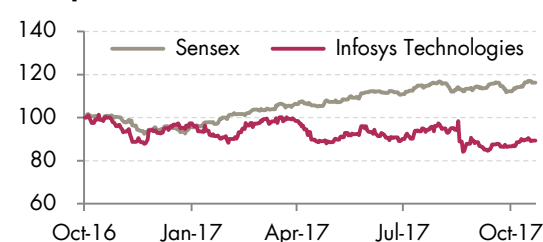


Exhibit 1: Results update

(Rs mn)	Quarter ended					12 months ended		
	Sep-17	Sep-16	% Chg	Jun-17	% Chg	FY18E	FY17	% Chg
Net sales	175,670	173,100	1.5	170,780	2.9	710,439	684,850	3.7
EBITDA	47,020	47,330	(0.7)	45,610	3.1	190,131	186,050	2.2
Other income	8,830	7,570	-	7,430	-	30,703	30,490	-
PBITD	55,850	54,900	1.7	53,040	5.3	220,834	216,540	2.0
Depreciation	4,560	4,240	-	4,500	-	18,160	17,030	-
PBT	51,290	50,660	1.2	48,540	5.7	202,674	199,510	1.6
Tax	14,030	14,600	-	13,710	-	56,536	55,980	-
Adjusted PAT	37,260	36,060	3.3	34,830	7.0	146,138	143,530	1.8
No. of shares (mn)	2,174	2,286	-	2,287	-	2,174	2,286	(4.9)
EBITDA margins (%)	26.8	27.3	(58)bps	26.7	6 bps	26.8	27.2	(1.5)bps
PBITD margins (%)	31.8	31.7	8 bps	31.1	74 bps	31.1	31.6	(1.7)bps
Rep. EPS - Annualized (Rs)	68.6	63.1	8.6	60.9	12.5	67.2	62.8	7.1

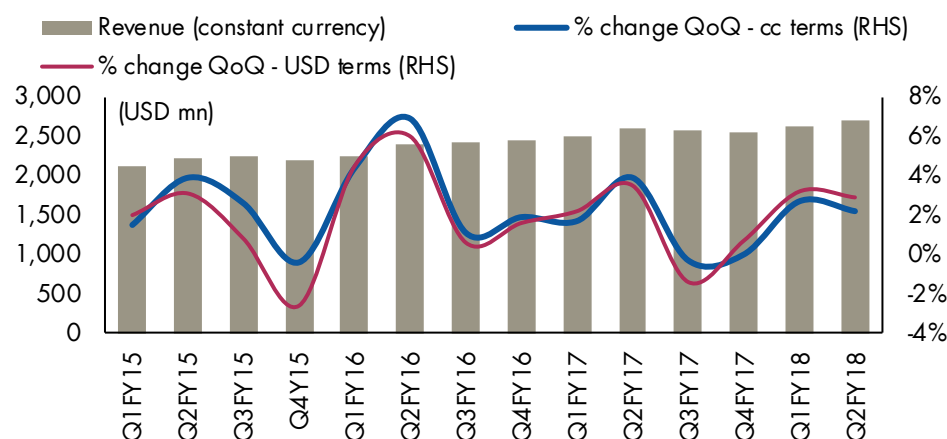
Source: Company, Axis Capital

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Other highlights

- ♦ **Vertical commentary**
 - **In BFSI (33% of revenue)**, management expects softness in Q3 due to furloughs but is optimistic on mid to long term growth prospects
 - **Manufacturing (22% of revenue)** is seeing some in-sourcing and cost optimization initiatives by a few clients
 - **Retail and CPG (14% of revenue)** non-discretionary spends are being impacted due to slow growth leading to cost pressures
- ♦ **Specific to Q2FY18**
 - USD revenue at 2,728 mn, up 2.9% QoQ (our expectation: 3.3% QoQ growth) is marginally below ours and street expectation of USD 2,740 mn/ USD 2,751 mn
 - EBIT margin 24.2% (our expectation: 23.5%) was up 10 bps QoQ
 - In constant currency terms, sequential growth: BFSI (up 2.6%), Mfg (up 1.2%), RCL (up 1.7%) and ECS (up 3.0%)
 - Gross employee additions stood at 10.5K
- ♦ **Global footprint:** Infosys opened a new office in Netherlands. To hire 10K American workers over the next 2 years; second innovation hub will be opened in North Carolina
- ♦ **New Services (9.4% of revenue)** grew 17% QoQ. These comprise of Cloud Ecosystem, Big Data and Analytics, API and Micro Services, Data and Mainframe Modernization, Cyber Security and IoT Engineering Services
- ♦ **New Software-led offerings (1.6% of revenue)** include next-generation Artificial Intelligence (AI) Platform Nia, Edge, Skava grew in-line with company growth.

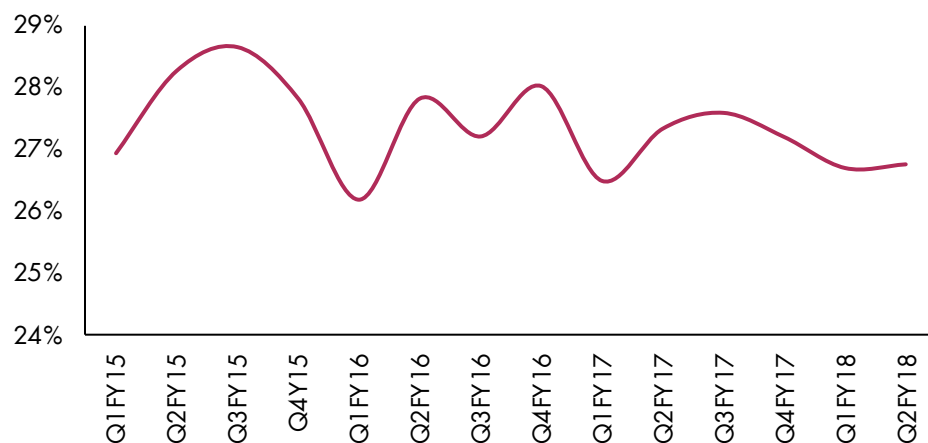
Estimates and valuations: We expect Infosys to deliver USD revenue growth of 8%/9% in FY18/FY19 with EBIT margin of 24% and 25%. Our TP stands at Rs 1,200; implies 29% upside from CMP of Rs 927. Maintain **BUY**. The stock trades at 14x/12x FY18/19 EPS of Rs 67/ Rs 75.

Exhibit 2: Revenue - Absolute in cc terms and % change QoQ (cc and USD terms)



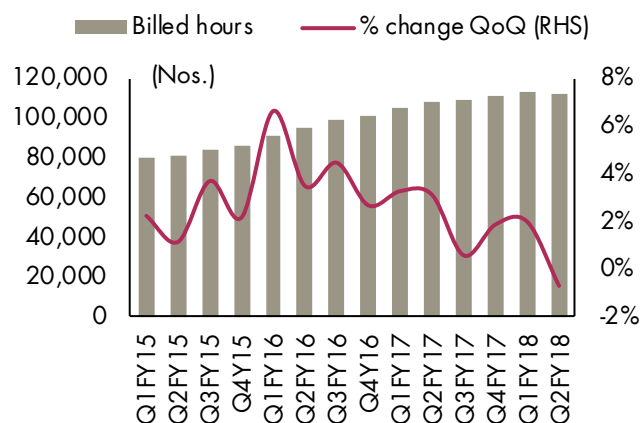
Source: Company, Axis Capital

Exhibit 3: EBITDA margin trend



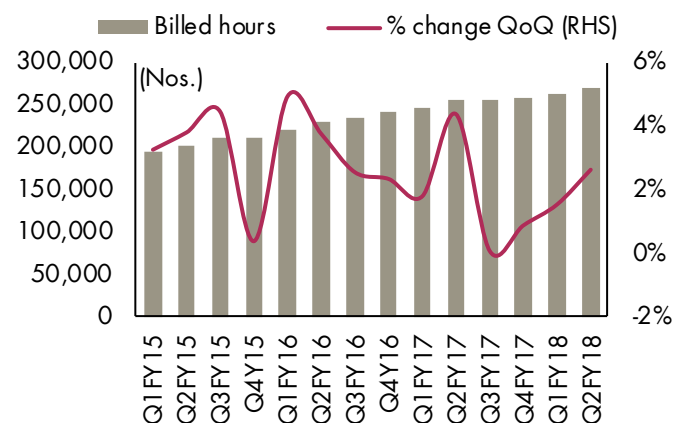
Source: Company, Axis Capital

Exhibit 4: Onsite volumes witness uptick

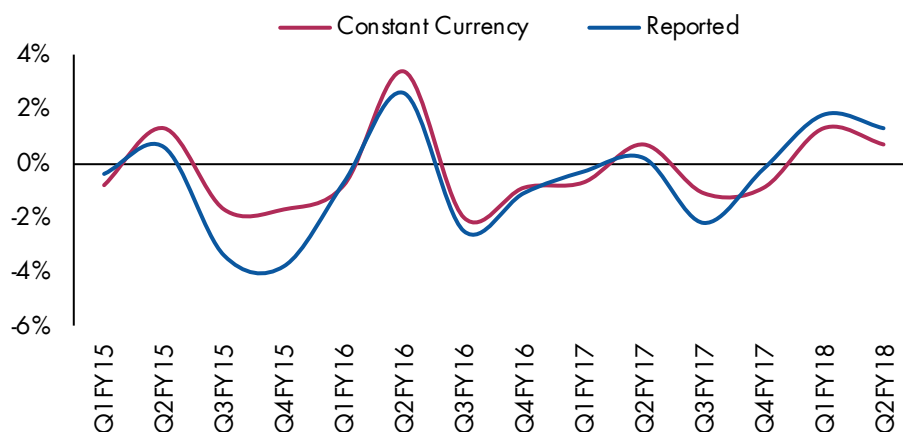


Source: Company, Axis Capital

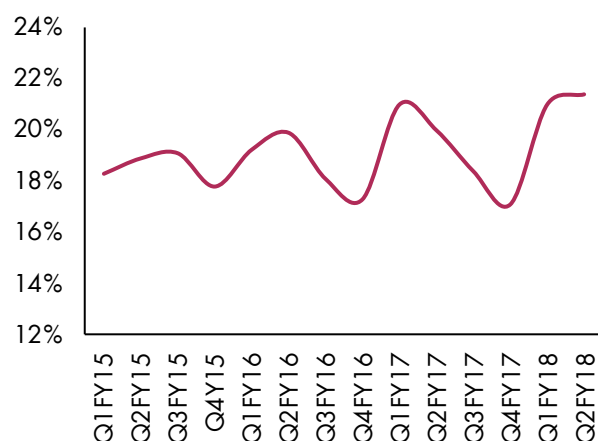
Exhibit 5: Offshore



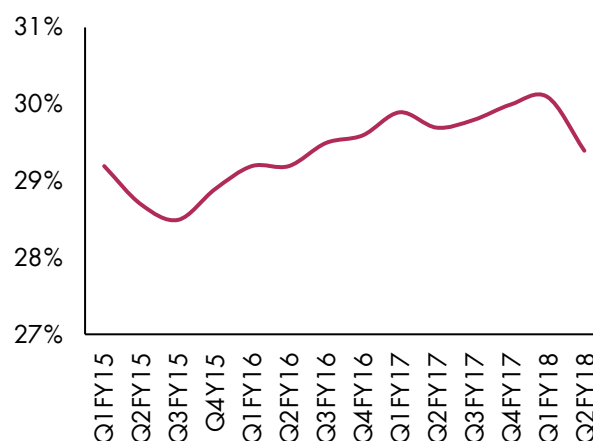
Source: Company, Axis Capital

Exhibit 6: Blended pricing trends (% change QoQ)


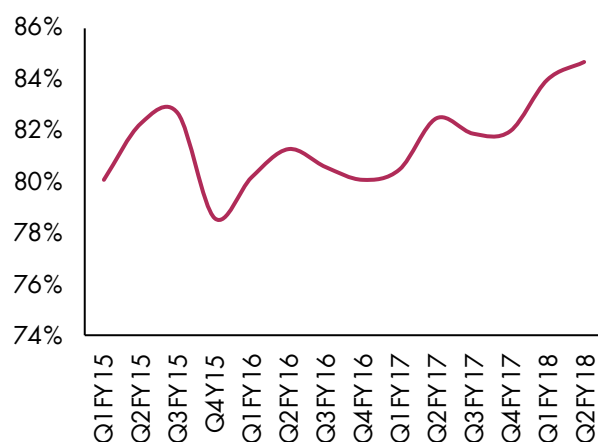
Source: Company, Axis Capital

Exhibit 7: Attrition rate


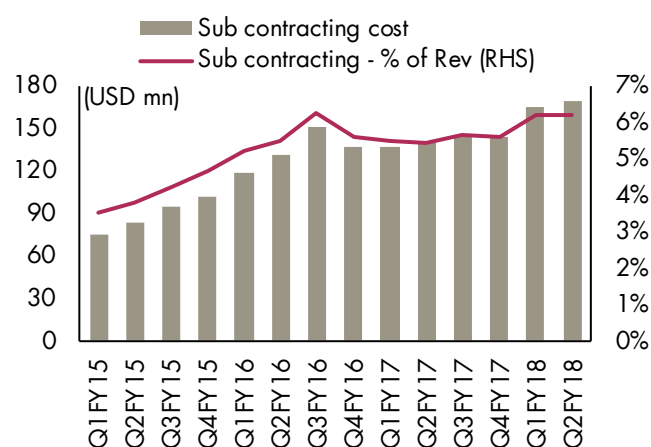
Source: Company, Axis Capital

Exhibit 8: Onsite efforts mix


Source: Company, Axis Capital

Exhibit 9: Utilization rate at highest levels


Source: Company, Axis Capital

Exhibit 10: Sub-contracting cost steady


Source: Company, Axis Capital

Exhibit 11: Client mining

	Q2FY16	Q3FY16	Q4FY16	Q1FY17	Q2FY17	Q3FY17	Q4FY17	Q1FY18	Q2FY18
1 mn USD clients	542	555	558	574	577	591	598	606	620
5 mn USD clients	258	261	268	268	277	275	282	279	286
10 mn USD clients	169	171	177	180	186	195	189	190	186
25 mn USD clients	85	89	88	87	89	90	91	97	100
50 mn USD clients	50	51	52	52	54	54	56	56	55
75 mn USD clients	31	28	31	31	30	32	31	31	31
100 mn USD clients	14	13	14	17	18	18	19	18	19

Source: Company, Axis Capital

Exhibit 12: Performance across verticals

	Q2FY16	Q3FY16	Q4FY16	Q1FY17	Q2FY17	Q3FY17	Q4FY17	Q1FY18	Q2FY18
Revenue share %									
FSI (Financial Services and Insurance)	32.8%	33.5%	32.8%	32.8%	33.1%	33.3%	33.5%	33.3%	33.4%
Manufacturing	23.8%	22.8%	22.7%	22.8%	22.5%	22.5%	22.4%	22.2%	22.0%
RCL (Retail, Logistics, CPG and Life Sciences)	24.6%	24.3%	24.5%	24.2%	23.5%	23.5%	22.7%	22.7%	22.6%
ECS (Energy & Utilities, Communications and Services)	18.8%	19.4%	20.0%	20.2%	20.9%	20.7%	21.4%	21.8%	22.0%
% change QoQ in cc terms									
FSI (Financial Services and Insurance)	6.4%	3.1%	0.2%	1.7%	5.2%	0.2%	0.5%	2.0%	1.9%
Manufacturing	5.8%	-3.2%	0.8%	2.4%	2.1%	-0.5%	0.0%	1.5%	4.1%
RCL (Retail, Logistics, CPG and Life Sciences)	8.2%	-0.1%	2.7%	0.7%	1.2%	-0.4%	-3.1%	2.6%	2.3%
ECS (Energy & Utilities, Communications and Services)	7.8%	4.6%	4.9%	2.4%	7.3%	-0.8%	2.8%	4.9%	-5.1%

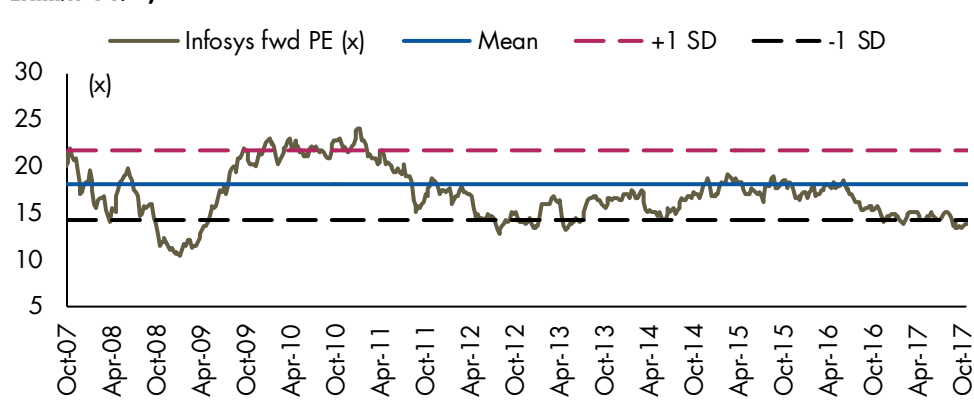
Source: Company, Axis Capital

Exhibit 13: Performance across geographies

	Q2FY16	Q3FY16	Q4FY16	Q1FY17	Q2FY17	Q3FY17	Q4FY17	Q1FY18	Q2FY18
Revenue share %									
North America	63.3%	62.5%	61.9%	62.0%	61.5%	62.0%	62.3%	61.1%	60.6%
Europe	22.9%	23.2%	23.4%	23.0%	22.5%	22.2%	22.1%	22.4%	23.2%
India	2.3%	2.8%	3.0%	2.7%	3.4%	3.4%	3.2%	3.6%	3.3%
ROW	11.5%	11.5%	11.7%	12.3%	12.6%	12.4%	12.4%	12.9%	12.9%
% change QoQ in cc terms									
North America	6.2%	-0.5%	0.6%	2.4%	2.7%	-0.6%	1.2%	1.3%	1.9%
Europe	8.3%	3.9%	3.6%	0.3%	0.3%	1.0%	-1.6%	3.1%	4.1%
India	12.1%	24.3%	11.1%	-8.2%	28.7%	-1.5%	-1.3%	6.9%	2.3%
RoW	7.1%	-0.3%	3.2%	4.9%	5.2%	-0.1%	-6.9%	11.2%	-5.1%

Source: Company, Axis Capital

Exhibit 14: P/E valuation



Source: Bloomberg, Axis Capital

Financial summary (Consolidated)

Profit & loss (Rs bn)

Y/E March	FY16	FY17	FY18E	FY19E
Net sales	624	685	710	797
Other operating income	-	-	-	-
Total operating income	624	685	710	797
Cost of goods sold	(376)	(416)	(434)	(482)
Gross profit	248	269	276	314
<i>Gross margin (%)</i>	<i>40</i>	<i>39</i>	<i>39</i>	<i>39</i>
Total operating expenses	(77)	(83)	(86)	(95)
EBITDA	171	186	190	220
<i>EBITDA margin (%)</i>	<i>27</i>	<i>27</i>	<i>27</i>	<i>28</i>
Depreciation	(15)	(17)	(18)	(20)
EBIT	156	169	172	200
Net interest	-	-	-	-
Other income	31	30	31	28
Profit before tax	187	200	203	227
Total taxation	(53)	(56)	(57)	(64)
<i>Tax rate (%)</i>	<i>28</i>	<i>28</i>	<i>28</i>	<i>28</i>
Profit after tax	135	144	146	163
Minorities	-	-	-	-
Profit/ Loss associate co(s)	-	-	-	-
Adjusted net profit	135	144	146	163
<i>Adj. PAT margin (%)</i>	<i>22</i>	<i>21</i>	<i>21</i>	<i>20</i>
Net non-recurring items	-	-	-	-
Reported net profit	135	144	146	163

Balance sheet (Rs bn)

Y/E March	FY16	FY17	FY18E	FY19E
Paid-up capital	11	11	11	11
Reserves & surplus	567	678	610	678
Net worth	578	690	621	689
Borrowing	-	-	-	-
Other non-current liabilities	1	4	4	4
Total liabilities	580	693	624	692
Gross fixed assets	207	228	256	287
Less: Depreciation	(75)	(86)	(104)	(124)
Net fixed assets	132	142	152	163
Add: Capital WIP	10	14	14	14
Total fixed assets	141	155	166	177
Other Investment	-	19	-	-
Debtors	113	123	132	142
Cash & bank	327	226	150	209
Loans & advances	77	88	92	100
Current liabilities	172	140	157	176
Net current assets	345	297	217	275
Other non-current assets	74	73	73	73
Total assets	580	693	624	692

Source: Company, Axis Capital

Cash flow (Rs bn)

Y/E March	FY16	FY17	FY18E	FY19E
Profit before tax	187	200	203	227
Depreciation & Amortisation	15	17	18	20
<i>Chg in working capital</i>	<i>(13)</i>	<i>(53)</i>	<i>3</i>	<i>2</i>
Cash flow from operations	137	107	168	185
<i>Capital expenditure</i>	<i>(30)</i>	<i>(25)</i>	<i>(29)</i>	<i>(31)</i>
Cash flow from investing	(45)	(170)	(29)	(31)
<i>Equity raised/ (repaid)</i>	<i>4</i>	<i>39</i>	<i>(130)</i>	<i>-</i>
<i>Debt raised/ (repaid)</i>	<i>-</i>	<i>-</i>	<i>-</i>	<i>-</i>
<i>Dividend paid</i>	<i>(68)</i>	<i>(71)</i>	<i>(85)</i>	<i>(95)</i>
Cash flow from financing	(64)	(32)	(215)	(95)
Net chg in cash	28	(95)	(77)	59

Key ratios

Y/E March	FY16	FY17	FY18E	FY19E
OPERATIONAL				
FDEPS (Rs)	59	63	67	75
CEPS (Rs)	65	70	76	84
DPS (Rs)	10	26	34	37
Dividend payout ratio (%)	17	41	50	50
GROWTH				
Net sales (%)	17	10	4	12
EBITDA (%)	15	9	2	16
Adj net profit (%)	9	6	2	12
FDEPS (%)	9	6	7	12
PERFORMANCE				
RoE (%)	24.9	22.6	22.3	24.9
RoCE (%)	34.5	31.3	30.8	34.5
EFFICIENCY				
Asset turnover (x)	3.0	2.6	2.4	2.6
Sales/ total assets (x)	0.9	0.9	0.9	1.0
Receivable days	66	66	68	65
FINANCIAL STABILITY				
Current ratio (x)	3.0	3.1	2.4	2.6
VALUATION				
PE (x)	15.7	14.8	13.8	12.4
EV/ EBITDA (x)	10.4	9.3	9.5	8.0
EV/ Net sales (x)	2.9	2.5	2.5	2.2
PB (x)	3.7	3.1	3.2	2.9
Dividend yield (%)	1.1	2.8	3.6	4.0

Source: Company, Axis Capital

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SELL	Less than -10%

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