9 January 2018

Update | Sector: Technology

Infosys

BSE SENSEX	S&P CNX
34,443	10,637

Infosys

CMP: INR1,041 TP: INR1,200 (+15%) Buy

APA agreement with US to bring down tax rate

Stock Info

Bloomberg	INFO IN
Equity Shares (m)	2,285.6
52-Week Range (INR)	1046 / 862
1, 6, 12 Rel. Per (%)	0/-1/-22
M.Cap. (INR b)	2,391.9
M.Cap. (USD b)	37.1
Avg Val, INRm	5007
Free float (%)	87.3

Financials Snapshot (INR b)

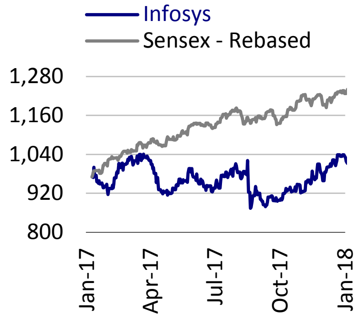
Y/E Mar	2017	2018E	2019E
Sales	684.9	707.6	772.0
EBITDA	186.1	188.3	202.6
PAT	143.8	145.0	150.1
EPS (INR)	62.8	64.7	69.0
EPS Gr. (%)	6.4	3.1	6.6
BV/Sh. (INR)	302	260.1	325.2
RoE (%)	22.0	21.8	22.3
RoCE (%)	22.0	21.8	22.3
P/E (x)	16.6	16.1	15.1
P/BV (x)	3.5	4.0	3.2

Shareholding pattern (%)

As On	Sep-17	Jun-17	Sep-16
Promoter	12.8	12.8	12.8
DII	22.1	20.2	18.0
FII	34.6	38.0	40.1
Others	30.6	29.0	29.2

FII Includes depository receipts

Stock Performance (1-year)



The Development: Infosys (INFO) has announced an Advanced Pricing Agreement (APA) with the US Internal Revenue Service (IRS), under which both companies have agreed on a methodology to allocate revenues and compute taxable income of the company's US operations. The agreement covers a 10-year period from FY11-21.

The impact: Three-fold impact as a consequence of the APA would be:

- INFO will reverse tax provisions of ~USD225m that were made in the previous period and are no longer required. This is the P&L impact and will be seen in 3QFY18 earnings, driving EPS higher by INR6.7 (10.4% on FY18E base).
- INFO is expected to pay out USD233m due to the differences in payable taxes for the prior period and actual taxes paid. This is the cash flow impact that will play out over the next few quarters (exact period not specified).
- INFO's overall effective tax rate is expected to decline by 100bp up till FY21 as a consequence of the agreement. This drives a marginal upgrade of 1.4% to our future earnings estimates.

What is APA?

- An advance pricing agreement (APA) is an ahead-of-time agreement between a taxpayer and a tax authority on an appropriate transfer pricing methodology (TPM) for a set of transactions at issue over a fixed period of time. It allows the taxpayer and the tax authority to avoid future transfer pricing disputes by entering into a prospective agreement.
- For most taxpayers, certainty regarding their transfer prices is the single-most important benefit gained through the APA process. Transfer pricing examinations are often time-consuming and expensive. The APA process generally takes substantially less time to complete than a transfer pricing examination followed by a dispute resolution mechanism, which can easily last three to four years.

Valuation and view

- For INFO, we expect USD revenue CAGR of 8% and EPS CAGR of 7.1% over FY17-20E. Lower earnings CAGR is a function of a 90bp decline in profitability and slight strengthening of the INR.
- However, we do not expect INFO's performance to lag peers materially, especially after the company having swiftly addressed the heightened issues around governance with the appointment of Mr Nilekani to the Board and Mr Salil Parekh as the CEO.
- Our price target of INR1,200 discounts forward earnings by 16x, implying an upside of 15%. Maintain **Buy**.

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Financials and Valuations

Income Statement							(INR Million)
Y/E March	**2014**	**2015**	**2016**	**2017**	**2018E**	**2019E**	**2020E**
Sales	**501,330**	**533,190**	**624,410**	**684,850**	**707,619**	**771,996**	**849,064**
Change (%)	24.2	6.4	17.1	9.7	3.3	9.1	10.0
Software Develop. Exp.	307,670	318,140	376,390	415,500	434,031	476,341	522,746
Selling and Mktg. Exp.	26,250	29,400	34,310	35,910	36,121	39,779	45,000
Administration Exp.	31,070	36,630	42,920	47,390	49,195	53,253	60,074
EBITDA	**136,340**	**149,020**	**170,790**	**186,050**	**188,272**	**202,623**	**221,243**
% of Net Sales	27.2	27.9	27.4	27.2	26.6	26.2	26.1
Depreciation	13,740	10,690	14,590	17,030	18,212	18,904	19,157
Other Income	26,690	34,270	31,250	30,790	31,458	24,770	31,961
PBT	**149,290**	**172,600**	**187,450**	**199,810**	**201,518**	**208,489**	**234,048**
Tax	40,620	49,290	52,520	55,980	56,497	58,377	65,533
Rate (%)	27.2	28.6	28.0	28.0	28.0	28.0	28.0
Minority Interest	0	10	0	0	0	0	0
Adjusted PAT	**108,670**	**123,300**	**134,930**	**143,830**	**145,022**	**150,112**	**168,514**
Extraordinary Items	2,190	0	0	0	-14,571	0	0
Reported PAT	**106,480**	**123,300**	**134,930**	**143,830**	**159,593**	**150,112**	**168,514**
Change (%)	13.0	15.8	9.4	6.6	11.0	-5.9	12.3

Balance Sheet							(INR Million)
Y/E March	**2014**	**2015**	**2016**	**2017**	**2018E**	**2019E**	**2020E**
Share Capital	2,860	5,720	11,440	11,440	10,875	10,875	10,875
Reserves	472,440	541,910	606,350	677,990	630,311	696,346	770,273
Net Worth	**475,300**	**547,630**	**617,790**	**689,430**	**641,186**	**707,221**	**781,148**
Capital Employed	**475,300**	**547,630**	**617,790**	**689,430**	**641,186**	**707,221**	**781,148**
Gross Block	140,790	178,360	208,370	227,210	264,278	292,278	320,278
Less : Depreciation	55,250	64,220	74,510	85,810	111,622	130,526	149,682
Net Block	**85,540**	**114,140**	**133,860**	**141,400**	**152,656**	**161,752**	**170,595**
CWIP	18,320	14,400	18,930	19,650	17,110	17,110	17,110
Investments	45,230	24,130	21,050	167,070	22,920	22,920	22,920
Curr. Assets	**421,460**	**510,850**	**580,050**	**505,040**	**612,160**	**684,348**	**767,872**
Debtors	111,620	125,580	143,590	159,700	168,665	184,010	202,380
Cash & Bank Balance	259,500	303,670	326,970	226,250	336,065	382,343	435,669
Loans & Advances	43,780	76,230	104,130	113,690	102,590	113,155	124,984
Other Current Assets	6,560	5,370	5,360	5,400	4,840	4,840	4,840
Current Liab. & Prov	**95,250**	**115,890**	**136,100**	**143,730**	**163,659**	**178,910**	**197,350**
Current Liabilities	56,180	70,180	79,760	83,640	96,755	106,075	116,964
Provisions	39,070	45,710	56,340	60,090	66,904	72,835	80,386
Net Current Assets	**326,210**	**394,960**	**443,950**	**361,310**	**448,500**	**505,439**	**570,522**
Application of Funds	**475,300**	**547,630**	**617,790**	**689,430**	**641,186**	**707,221**	**781,148**

E: MOSL Estimates

Financials and Valuations

Ratios

Y/E March	2014	2015	2016	2017	2018E	2019E	2020E
Basic (INR)							
EPS	**46.6**	**53.9**	**59.0**	**62.8**	**64.7**	**69.0**	**77.5**
Cash EPS	53.6	58.6	65.4	70.3	66.2	77.7	86.3
Book Value	208.0	239.6	270.3	301.5	260.1	325.2	359.2
DPS	15.8	18.5	24.7	25.7	29.7	34.0	38.0
Payout % (excl.div.tax)	33.1	34.3	41.9	40.9	50.5	49.2	49.0
Valuation (x)							
P/E	22.4	19.3	17.6	16.6	16.1	15.1	13.4
Cash P/E	19.4	17.8	15.9	14.8	15.7	13.4	12.1
EV/EBITDA	15.2	13.8	11.9	10.7	11.7	9.2	8.2
EV/Sales	4.1	3.8	3.3	2.9	3.1	2.4	2.1
Price/Book Value	5.0	4.3	3.9	3.5	4.0	3.2	2.9
Dividend Yield (%)	1.5	1.8	2.4	2.5	2.9	3.3	3.6
Profitability Ratios (%)							
RoE	24.9	24.1	23.2	22.0	21.8	22.3	22.6
RoCE	24.9	24.1	23.2	22.0	21.8	22.3	22.6
Turnover Ratios							
Debtors (Days)	81	86	84	85	87	87	87
Fixed Asset Turnover (x)	6.6	5.7	5.3	5.2	5.0	5.1	5.3

Cash Flow Statement (INR Million)

Y/E March	2014	2015	2016	2017	2018E	2019E	2020E
CF from Operations	122,250	135,180	149,530	160,820	178,365	169,016	187,671
Cash for Working Capital	390	-25,770	-24,275	-18,040	22,064	-10,660	-11,758
Net Operating CF	**122,640**	**109,410**	**125,255**	**142,780**	**200,429**	**158,356**	**175,913**
Net Purchase of FA	-27,450	-35,370	-37,278	-25,290	-26,928	-28,000	-28,000
Free Cash Flow	**95,190**	**74,040**	**87,977**	**117,490**	**173,501**	**130,356**	**147,913**
Net Purchase of Invest.	-22,580	21,100	3,287	-132,201	144,150	0	0
Net Cash from Invest.	**-50,030**	**-14,270**	**-33,991**	**-157,491**	**117,222**	**-28,000**	**-28,000**
Proceeds from Equity	0	0	0	0	0	1	1
Others	13,020	-123	0	0	0	0	0
Dividend Payments	-44,450	-50,847	-68,403	-71,168	-88,481	-89,333	-99,842
Cash Flow from Fin.	**-31,430**	**-50,970**	**-68,403**	**-71,168**	**-88,481**	**-89,332**	**-99,841**
Net Cash Flow	**41,180**	**44,170**	**22,861**	**-85,879**	**229,170**	**41,025**	**48,072**
Opening Cash Bal.	**218,320**	**259,500**	**303,670**	**326,531**	**240,652**	**469,821**	**510,846**
Add: Net Cash	41,180	44,170	22,861	-85,879	229,170	41,025	48,072
Closing Cash Bal.	**259,500**	**303,670**	**326,531**	**240,652**	**469,821**	**510,846**	**558,918**

E: MOSL Estimates

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