

January 15, 2018

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Rating	BUY
Price	Rs1,080
Target Price	Rs1,220
Implied Upside	13.0%
Sensex	34,844
Nifty	10,742

(Prices as on January 15, 2018)

Trading data

Market Cap. (Rs bn)	2,472.0
Shares o/s (m)	2,288.0
3M Avg. Daily value (Rs m)	4629.9

Major shareholders

Promoters	13.39%
Foreign	34.93%
Domestic Inst.	21.70%
Public & Other	29.98%

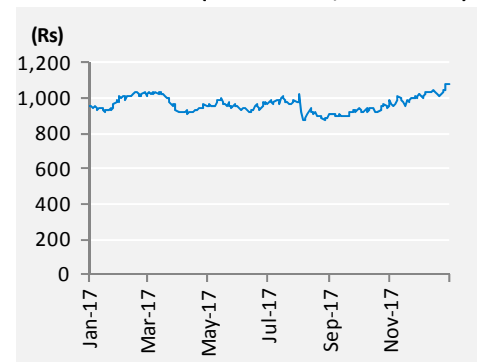
Stock Performance

(%)	1M	6M	12M
Absolute	5.6	11.1	10.8
Relative	1.4	2.3	(17.1)

How we differ from Consensus

EPS (Rs)	PL	Cons.	% Diff.
2019	70.7	69.6	1.6
2020	79.0	75.6	4.5

Price Performance (RIC: INFY.BO, BB: INFO IN)



Source: Bloomberg

Infosys' Q3FY18 results missed our estimates marginally on USD revenues, albeit were in-line at EBIT margin and adjusted PAT. Infosys continues to show steady EBIT margin lead by offshore shift in effort mix. EBIT margins at 24.3% was up 10bps QoQ (PL: 24%) led by effort mix shift in favour of offshore. Constant currency revenue growth for the quarter stood at 0.8% QoQ below our estimates (PL: 1.2%). Infosys retained its constant currency revenue growth guidance for FY18E at 5.5-6.5% for FY18E (USD revenue guidance retained at 6.5-7.5%). We estimate Infosys to deliver 7.2% USD revenue growth for FY18E (6.2% constant currency growth for FY18E). We believe constant currency revenue growth for Infosys and TCS would be in a similar range in FY18E (6-6.5% cc revenue growth). Both these vendors have maintained margin stability despite revenue growth headwinds and absence of currency tailwinds. This was driven by tepid hiring, improving utilisation rates and offshore shift in effort.

Post the completion of recent buyback, net cash on Infosys' balance sheet stands at Rs290bn (Rs133/sh which is 12.3% of Mcap). Infosys generates ~Rs120bn FCF per year. Company has a stated capital allocation policy which aims to return 70% of FCF generated to shareholders. Our view is that Infosys should continue to buyback ~4% of equity every year over the next two years (Along with maintaining current dividend payout ratio (Including dividend tax) which is at ~57% of PAT). This would lead to gradual shrinkage of net cash on the balance sheet. However, we have seen similar aggressive capital allocation strategy by global peers like Accenture and IBM (Accenture has seen gradual reduction in net cash on balance sheet over FY12-FY16 owing to higher quantum returned to shareholders, IBM has reduced shares outstanding by 19% over a 5-year period (2011-2017) through buybacks).

We expect Infosys to deliver 7.2/9.1% USD revenue growth for FY18/FY19E (7/8.6% USD revenue growth modelled earlier). Currency reset to lower levels leads us to model EBIT margin at 24.3/24.1% for FY18/FY19E (v/s 24.4/24.4% modelled earlier). Our EPS estimates are retained at Rs65/70.5/79/sh for FY18/FY19/FY20E. Led by rollover to FY20E, we raise TP by 6% to Rs1220/sh (15.5x FY20E EPS). Maintain "BUY".

Key financials (Y/e March)	2017	2018E	2019E	2020E
Revenues (Rs m)	684,850	706,867	775,723	842,993
Growth (%)	9.7	3.2	9.7	8.7
EBITDA (Rs m)	186,050	190,434	207,193	226,136
APAT (Rs m)	143,530	146,030	153,885	171,920
EPS (Rs)	62.7	65.0	70.7	79.0
Growth (%)	6.4	4.6	7.7	11.7
Net DPS (Rs)	25.8	30.8	33.2	37.1

Profitability & Valuation	2017	2018E	2019E	2020E
EBITDA margin (%)	27.2	26.9	26.7	26.8
RoE (%)	22.0	22.3	23.5	23.7
RoCE (%)	22.0	22.3	23.4	23.6
EV / sales (x)	3.0	3.0	2.6	2.3
EV / EBITDA (x)	11.2	11.1	9.7	8.6
PE (x)	17.2	16.5	15.3	13.7
P / BV (x)	3.6	3.9	3.4	3.1
Net dividend yield (%)	2.4	2.9	3.1	3.4

Source: Company Data; PL Research

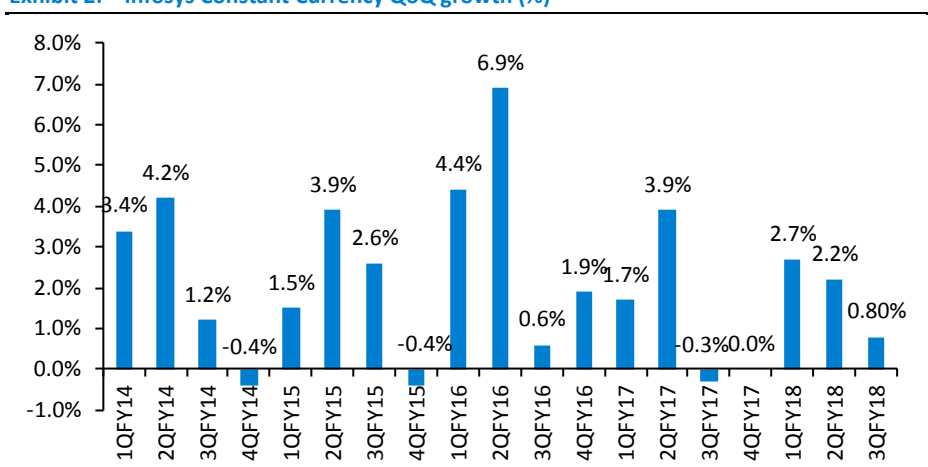
Exhibit 1: Q3FY18 Result table

(Rs mn)	Q3FY18	Q2FY18	QoQ Growth	Q2FY17	YoY Growth	Q3FY18(PLe)	Variance(PL VS ACTUAL)
Total Operating Income (US\$ mn)	2,755	2,728	1.0%	2,551	8.0%	2,758	-0.1%
Total Operating Income (Rs mn)	177,940	175,670	1.3%	172,730	3.0%	177,616	0.2%
EBIT	43,190	42,460	1.7%	43,340	-0.3%	42,627	1.3%
EBIT Margin	24.3%	24.2%	10 bps	25.1%	-82 bps	24.0%	30 bps
Pre Tax Income	52,810	51,290	3.0%	51,540	2.5%	52,190	1.2%
Tax	1,520	14,030		14,460		14,613	
<i>Tax Rate</i>	<i>2.9%</i>	<i>27.4%</i>		<i>28.1%</i>		<i>28.0%</i>	
RPAT	51,290	37,260	37.7%	37,080	38.3%	36,380	41.0%
APAT	36,970	37,260	-0.8%	37,080	-0.3%	36,380	1.6%
AEPS	16.2	16.3	-0.4%	16.2	0.1%	16.0	1.6%

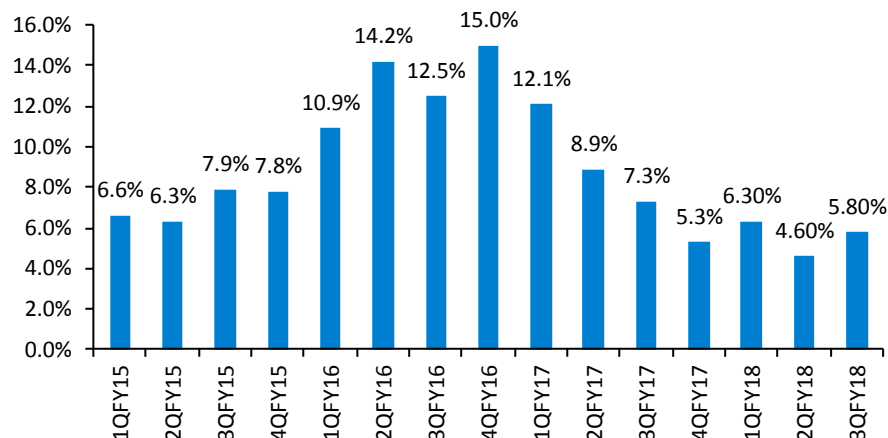
Source: Company Data, PL Research

- **Revenues in line with expectations:** Revenues stood at US\$2755m for Q3FY18, up 1% QoQ and marginally below our estimates (US\$2758m). Revenue growth was 0.8% QoQ in constant currency and below our expectations (PLe: 1.2% cc growth). Volume growth for the quarter stood at 1.6% (Onsite up 0.4% QoQ and offshore, up 2.2% QoQ). Blend pricing dropped by 0.9% in cc (Onsite down 1.1% QoQ and offshore, up 0.4% QoQ).

CC revenue growth was 0.8% for the quarter. Furloughs in Manufacturing and BFSI led to softer growth

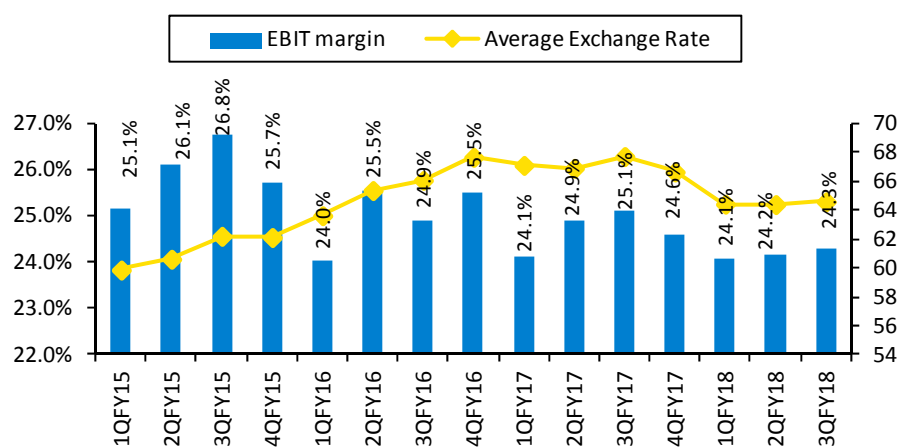
Exhibit 2: Infosys Constant Currency QoQ growth (%)


Source: Company Data, PL Research

Exhibit 3: Infosys Constant currency YoY growth (%)


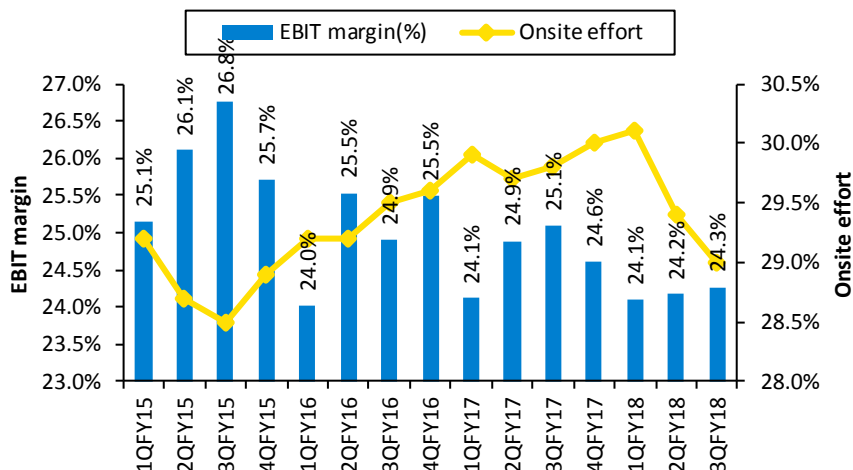
Source: Company Data, PL Research

- **Margins in line with estimates:** EBIT margin came in at 24.3%, up 10bps QoQ and above our estimates (PLe: 24.1%). Offshore shift in effort and improvement in utilisation rates appear to have aided margins for the quarter. Company has retained the EBIT margin guidance band at 23-25% for FY18E.

Exhibit 4: EBIT Margins v/s Average Exchange Rate


Source: Company Data, PL Research

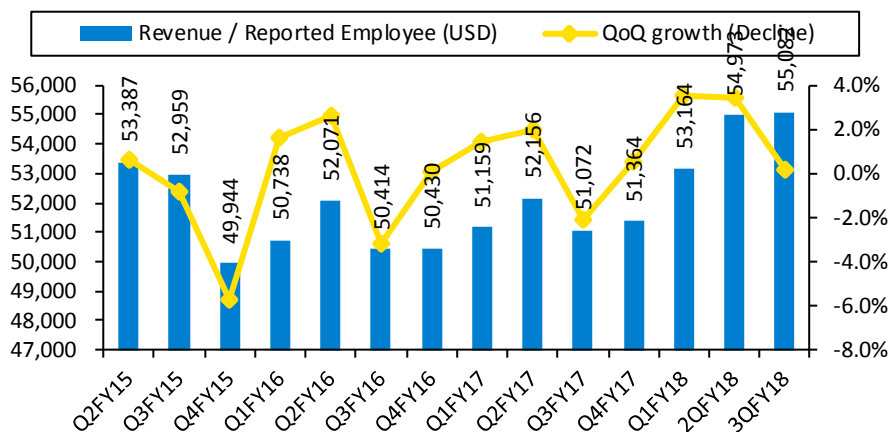
- Infosys has shown sharp mix shift in effort in favour of offshore over the past two quarters. Hence, effort mix from onsite dropped to 29%, down 40bps QoQ and 110bps over the past two quarters.

Exhibit 5: Effort mix from Onsite and EBIT Margin (%)


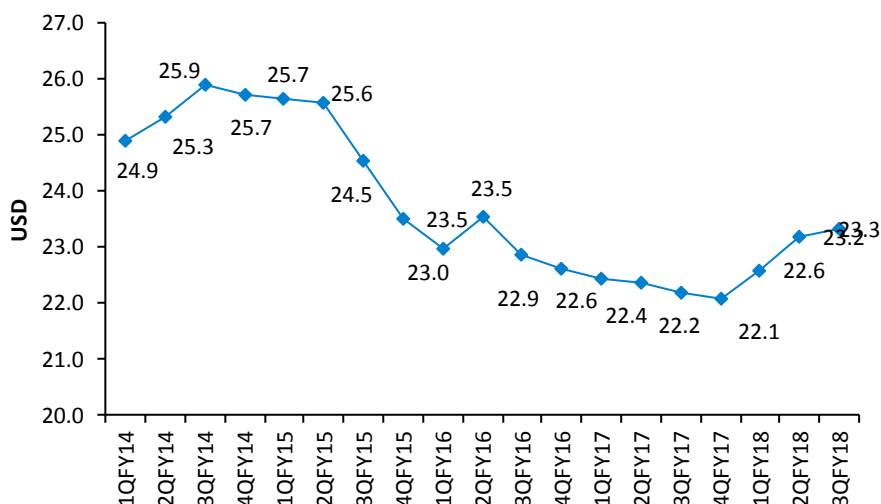
Source: Company Data, PL Research

Focus on Automation to drive revenue per reported employee

- Infosys' revenue per reported employee (Quarterly annualized) stood at USD55,082 per employee as on Q3FY18. This represents a 7.9% YoY growth. Strong focus on improving utilisation rates has aided revenue productivity of Infosys.

Exhibit 6: Revenue per reported employee Quarterly Annualized (USD) and Growth (YoY)


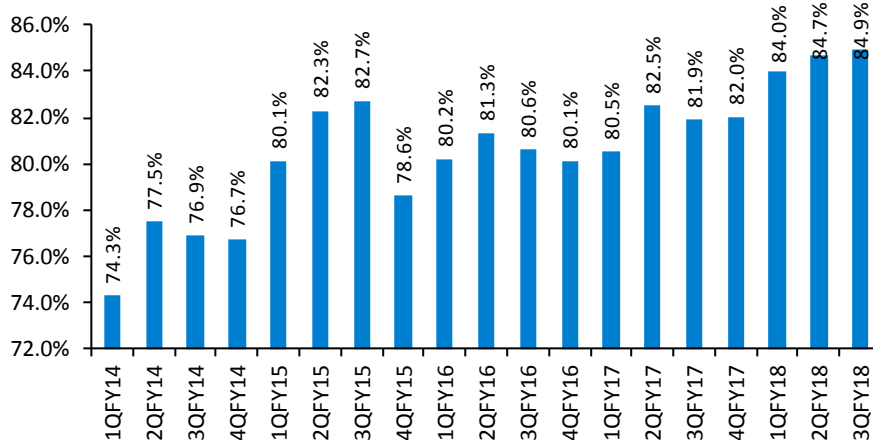
Source: Company Data, PL Research * Revenue per reported employee is quarterly annualized

Exhibit 7: Infosys Offshore Billing Rates per hour (USD)


Source: Company Data, PL Research

Utilisation continues to show steady improvement

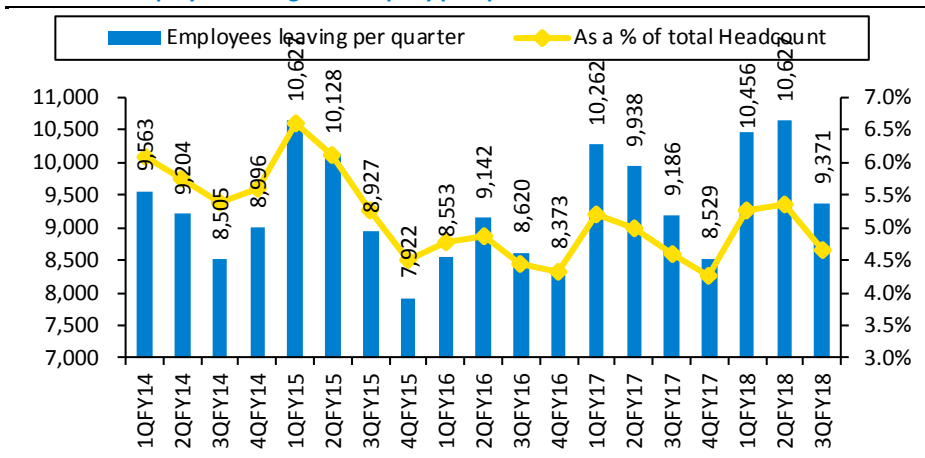
- IT services utilisation (excluding trainees) came in at 84.9% for Q3FY18, up 20bps QoQ. Infosys has been maintaining utilisation rates above 80% for the past nine consecutive quarters.

Exhibit 8: IT Service Utilisation (excluding trainees)


Source: Company Data, PL Research

- **Attrition moderates:** Exit headcount for the quarter came in at 201,691, with net addition of 3251 employees. Employees leaving the company during the quarter came in at 9371 for Q3FY18 (v/s 9186 in Q3FY17). This represents a quarterly annualised attrition of 18.7% for Q3FY18 for the consolidated entity (IT services + BPO) (v/s 21.4% in Q2FY18).

Exhibit 9: Employee leaving the company per quarter

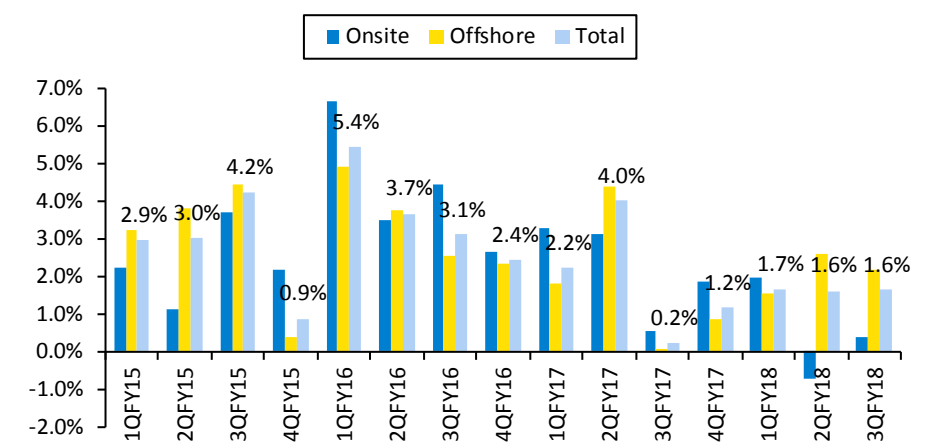


Source: Company Data, PL Research

Key Metrics

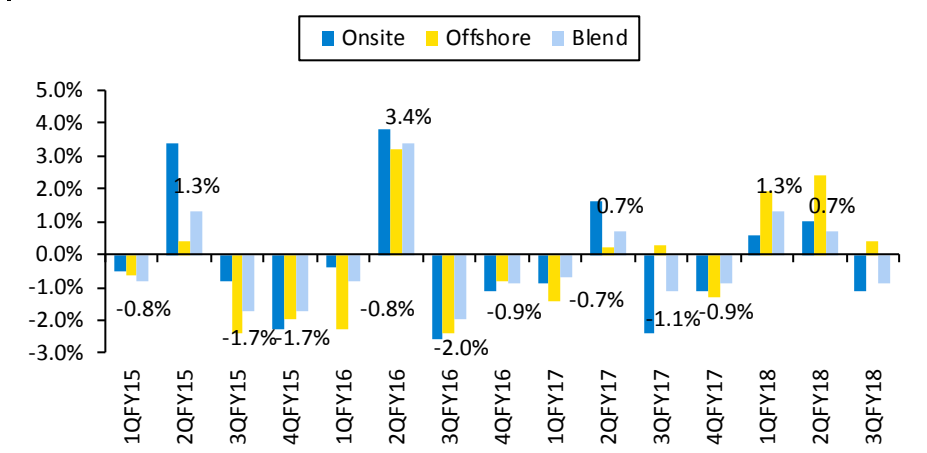
Volume growth for the quarter improved and grew by 1.6% for the quarter

Exhibit 10: Volume growth (QoQ)



Source: Company Data, PL Research

Exhibit 11: Pricing Growth/(decline) in constant currency



Source: Company Data, PL Research

- **Steady TCV wins:** TCV wins for 3QFY18 stood at USD779mn. However, this predominantly includes renewals.

Exhibit 12: TCV and number of deal wins

USD mn	4QFY15	1QFY16	2QFY16	3QFY16	4QFY16	1QFY17	2QFY17	3QFY17	4QFY17	1QFY18	2QFY18	3QFY18
TCV	213	414	688	983	350	757	810	1,209	664	657	731	779

Source: Company Data, PL Research

Exhibit 13: Financial summary

	FY15	FY16	FY17	FY18E	FY19E	FY20E
Total revenues USD mn	8,711	9,501	10,208	10,941	11,934	12,969
Growth (%)	5.6%	9.1%	7.4%	7.2%	9.1%	8.7%
Average exchange rate	61.2	65.7	67.1	64.6	65.0	65.0
Total Revenues (Rs mn)	533,190	624,410	684,850	706,867	775,723	842,993
Growth (%)	6.4%	17.1%	9.7%	3.2%	9.7%	8.7%
EBIDTA	149,028	170,780	186,050	190,434	207,193	226,136
EBIT	138,338	156,190	169,020	171,467	187,024	206,748
PAT	123,328	134,900	143,530	146,030	153,885	171,920
Margins						
EBIDTA Margins (%)	28.0%	27.4%	27.2%	26.9%	26.7%	26.8%
EBIT Margin (%)	25.9%	25.0%	24.7%	24.3%	24.1%	24.5%
PBT(%)	32.4%	30.0%	29.2%	29.0%	27.7%	28.5%
NPM	23.1%	21.6%	21.0%	20.7%	19.8%	20.4%
Tax Rate	28.6%	28.0%	28.0%	21.5%	28.5%	28.5%
Diluted EPS	54	59	63	64.7	70.7	79.0
EPS Growth (%)	15.8%	9.4%	6.4%	3.1%	9.2%	11.7%
P/E	17.1	15.7	14.7	16.7	15.3	13.7
P/S	4.0	3.4	3.1	3.3	3.0	2.8
EV/EBIDTA	12.1	10.4	9.3	10.8	9.7	8.6
ROE (%)	24.1%	23.2%	22.0%	22.3%	23.5%	23.7%
ROCE (%)	24.1%	23.2%	22.0%	22.3%	23.5%	23.7%
DPS	22.4	24.4	25.9	30.4	33.2	37.1
Dividend Payout Ratio (Including dividend tax)	49.8%	49.7%	49.6%	56.8%	56.8%	56.8%
Dividend Yield (%)	2.1%	2.3%	2.4%	2.8%	3.1%	3.4%
Consolidated Balance sheet (Rs mn)						
Net Cash on Balance Sheet	330,520	391,540	389,770	295,530	349,727	407,872
Net Cash Per Share	145	171	171	136	161	187
Net Cash per share as a % of stock price	15.6%	18.5%	18.4%	12.6%	14.9%	17.4%
Consolidated Cash flow (Rs mn)						
Cash flow from Operations	107,520	122,430	140,630	141,689	163,640	177,834
Capex+ acquisitions	35,290	34,700	27,600	22,000	22,000	22,000
Free cash flow from operations	72,230	87,730	113,030	119,689	141,640	155,834
FCF /EBIDTA	48.5%	51.4%	60.8%	62.9%	68.4%	68.9%
FCF Yield (%)	3.4%	4.1%	5.3%	5.1%	6.0%	6.6%

Source: Company Data, PL Research

Income Statement (Rs m)

Y/e March	2017	2018E	2019E	2020E
Net Revenue	684,850	706,867	775,723	842,993
Software development Expenses	415,500	433,589	477,982	517,383
Gross Profit	269,350	273,279	297,741	325,610
RM Cost	—	—	—	—
Other Expenses	83,300	82,845	90,548	99,473
EBITDA	186,050	190,434	207,193	226,136
Depr. & Amortization	17,030	18,967	20,169	19,389
Other Income	30,790	33,590	28,200	33,700
Profit before Tax	199,810	219,377	215,224	240,448
Total Tax	55,980	43,996	61,339	68,528
Profit after Tax	143,830	175,380	153,885	171,920
Ex-Od items / Min. Int.	300	(14,320)	—	—
Adj. PAT	143,530	146,030	153,885	171,920
Avg. Shares O/S (m)	2,288.0	2,224.9	2,176.0	2,176.0
EPS (Rs.)	62.7	65.6	70.7	79.0

Cash Flow Abstract (Rs m)

Y/e March	2017	2018E	2019E	2020E
C/F from Operations	140,630	141,689	163,640	177,834
C/F from Investing	(170,670)	(22,000)	(22,000)	(22,000)
C/F from Financing	(69,390)	(212,979)	(87,442)	(97,690)
Inc. / Dec. in Cash	(99,430)	(93,290)	54,197	58,144

Key Financial Metrics

Y/e March	2017	2018E	2019E	2020E
Growth				
Revenue (%)	9.7	3.2	9.7	8.7
EBITDA (%)	8.9	2.4	8.8	9.1
PAT (%)	6.4	1.7	5.4	11.7
EPS (%)	6.4	4.6	7.7	11.7
Profitability				
EBITDA Margin (%)	27.2	26.9	26.7	26.8
PAT Margin (%)	21.0	20.7	19.8	20.4
RoCE (%)	22.0	22.3	23.4	23.6
RoE (%)	22.0	22.3	23.5	23.7
Balance Sheet				
Net Debt : Equity	(0.6)	(0.5)	(0.5)	(0.5)
Net Wrkng Cap. (days)	—	—	—	—
Valuation				
PER (x)	17.2	16.5	15.3	13.7
P / B (x)	3.6	3.9	3.4	3.1
EV / EBITDA (x)	11.2	11.1	9.7	8.6
EV / Sales (x)	3.0	3.0	2.6	2.3
Earnings Quality				
Eff. Tax Rate	28.0	20.1	28.5	28.5
Other Inc / PBT	15.4	16.4	13.1	14.0

Source: Company Data, PL Research.

Balance Sheet Abstract (Rs m)

Y/e March	2017	2018E	2019E	2020E
Shareholder's Funds	689,430	621,922	688,365	762,595
Total Debt	—	—	—	—
Other Liabilities	3,600	3,600	3,600	3,600
Total Liabilities	693,030	625,522	691,965	766,195
Net Fixed Assets	117,160	120,193	122,024	124,635
Goodwill	44,280	44,280	44,280	44,280
Investments	—	—	—	—
Net Current Assets	460,740	387,808	450,420	520,039
Cash & Equivalents	389,770	295,530	349,727	407,872
Other Current Assets	211,100	215,624	236,454	252,672
Current Liabilities	140,130	123,345	135,761	140,504
Other Assets	71,240	73,240	75,240	77,240
Total Assets	693,420	625,522	691,965	766,195

Quarterly Financials (Rs m)

Y/e March	Q4FY17	Q1FY18	Q2FY18	Q3FY18
Net Revenue	171,200	170,780	175,670	177,940
EBITDA	46,580	45,610	47,020	48,170
% of revenue	27.2	26.7	26.8	27.1
Depr. & Amortization	4,460	4,500	4,560	4,980
Net Interest	(7,460)	(8,140)	(8,830)	(9,620)
Other Income	7,460	8,140	8,830	9,620
Profit before Tax	49,580	49,250	51,290	52,810
Total Tax	13,300	13,710	14,030	1,520
Profit after Tax	36,280	35,540	37,260	51,290
Adj. PAT	36,280	35,540	37,260	36,970

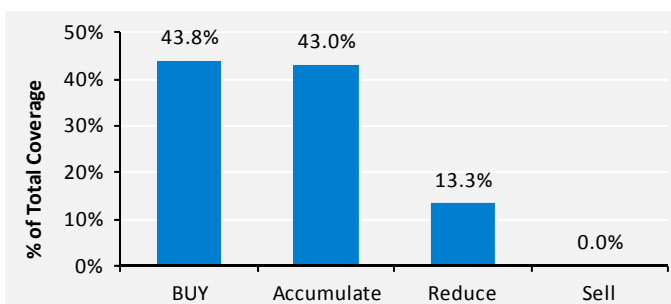
Source: Company Data, PL Research.

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Sell	: Over 15% underperformance to Sensex over 12-months
Trading Buy	: Over 10% absolute upside in 1-month
Trading Sell	: Over 10% absolute decline in 1-month
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