

Infosys Ltd.



RESULT UPDATE

16th April, 2018

Infosys Ltd.

Unwind Software Service !! U turn for Infosys

CMP INR 1,171	Target INR 1,184	Potential Upside 1.1%	Market Cap (INR Mn) 2,553,245	Recommendation Hold	Sector IT
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Result highlights

Revenue in dollar terms reported at \$2,805 Mn (+1.8%) qoq that was above our estimates of \$2,783 Mn. The revenue was supported by the currency tailwind of ~100 bps coupled with improvement in business verticals, especially Insurance and Energy & Utility. The operating margin for the quarter reported at 24.7% (+40 bps) qoq owing to improvement in utilization and price realization

• **By Geography:** Europe has outperformed with 3.5% qoq growth driven by increase in IT spending from regional banks. However, the growth in the US region remained subdued amidst softness in the top accounts for BFSI, which have been diverting their IT spending to captives and insourcing for last 18-24 months

• **By Industry:** Almost all the verticals have delivered a moderate growth during the quarter, wherein Telecom/Utility/Healthcare have grown by 4.7%/3.6%/3.4% qoq. However, Retail de-grew by 4% qoq on the back of store closers and e-tailers effect

• **By Services:** Infrastructure Management led the growth pack with 7.6% qoq, followed by Testing and Application development of 6.1%/2.5% qoq growth. Moreover, Digital services contributed 26.8% qoq to the overall revenues in 4QFY18

MARKET DATA

Shares outs (Mn)	2184
EquityCap (INR Mn)	10921
Mkt Cap (INR Mn)	2553245
52 Wk H/L (INR)	1220/862
Volume Avg (3m K)	5226.9
Face Value (INR)	5
Bloomberg Code	INFO IN

KEY FINANCIALS

Particulars (INR Mn)	FY16	FY17	FY18	FY19E	FY20E
Net Sales	624,410	684,850	705,220	755,027	812,484
EBITDA	170,780	186,050	190,100	200,053	211,297
PAT	134,909	143,775	160,990	156,600	174,588
EPS	59.0	62.9	70.4	68.5	76.4
OPM	25.0%	24.7%	24.3%	23.6%	23.0%
NPM	21.6%	21.0%	22.8%	20.7%	21.5%

Source: Company, KRChoksey Research

Management Laid Foundation to Drive Growth on Four Pillars

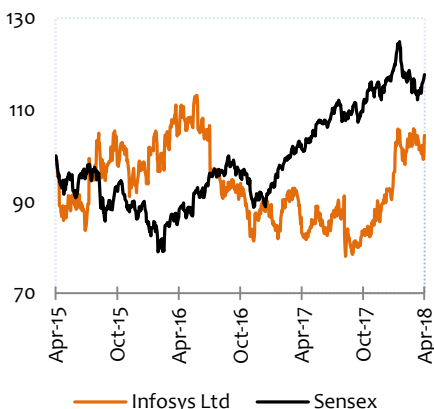
The management has set the roadmap to drive Infosys purely on four key pillars— (1) Scaling Digital Services, (2) Energizing Client Technologies, (3) Reskilling employees, and (4) Increase Localization— while dropping Panaya and Skava entirely from its ecosystem. The decision to eradicate its Cloud and eCommerce platforms is a part of realigning its existing structure and focus on investing in underdeveloped areas of digital services. The management has guided that Nia would continue to be part of Infosys and it would strengthen the digital services while Incorporating AI elements to improve the client deliveries.

Poor Guidance !! Sacrifice Margins, to Boost Digital Growth

The company has written off \$90 Mn in the investment of Panaya and registered a corresponding impairment loss of \$18 Mn during Q4 FY18, which has further narrowed its bottom-line to 20.4%. As per the guidance, the company is expected to deliver a top-line growth of 6-8% and report an operating margin within a range of 22%-24% in FY19. The management has guided that the poor margin guidance was primarily due to: (1) investments in digital services to drive further growth, (2) increase in onsite hiring, and (3) revitalizing sales for tapping market opportunities. The company's topline guidance has fallen below the industry average guidance of 7-9% for FY19, as per NASSCOM. We believe that the poor guidance has factored in the elements above to realign its existing structure, which is likely to put the pressure on product revenue and drag margins going forward.

Over the last three years, the company's operating margins reported at 25.0%/24.7%/24.3% in FY16/FY17/FY18, which have continued to de-grew owing to increase in cost per employee (Status Quo) and a decline in realization (Peer Pricing Pressure). During the quarter, the company's realization remained flat (in CC), whereas volume has increased by 1.1%, which is again putting a pressure on margins to grow. The digital services contributed 26.8% to its overall revenues in Q4FY18, which generate higher margins than the core IT services. We believe that the company's appetite to broaden its offerings on digital front through investments would pressurize its margins in the near/mid term. However, in the long-term it is likely to outweigh the drag in margins from traditional services, as the investments get materialized coupled with gradual improvement in the service offerings.

SHARE PRICE PERFORMANCE

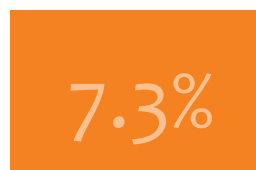


MARKET INFO

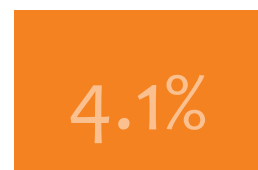
SENSEX	34193
NIFTY	10481

SHARE HOLDING PATTERN (%)

Particulars	Dec 17	Sep 17	Jun 17
Promoters	12.9	12.75	12.75
FIIIs	35	34.08	37.53
DIIIs	21.76	22.15	20.19
Others	30.34	31.02	29.53
Total	100	100	100



Revenue CAGR between FY 17 and FY 20E



PAT CAGR between FY 17 and FY 20E

ANALYST

Raghav Garg, researchho@krchoksey.com, +91-22-6696 5429
Pritesh Thakkar, pritesht.thakkar@krchoksey.com, +91-22-6696 5429

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Thomson Reuters, Factset and Capital IQ

+91-22-6696 5555 / +91-22-6691 9576
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Key Con-call Highlights : (i) In Q4 FY18, the company has bagged 10 large deals with a total contract value (TCV) of \$3 Bn : 6 in the US region, 3 in Europe and 1 in ROW (ii) As per the capital allocation policy FY19, the board has decided to payoff \$2 Bn through share buyback and a special dividend of INR 10 per share, which translates into additional payout of \$400 Mn (iii) Investment in capabilities and IPs to drive digital growth would be the core focus going forward (iv) The major Investments would be on four areas of Digital services: Cloud, IoT (Internet-of-Things), Artificial Intelligence and Modernization of Application development

Valuation and view

The management strategy to realign the organization structure and drawing its focus majorly on organic growth, is expected to plummet its topline growth and pressurize margins going forward. We have envisaged the company to generate a moderate topline growth of 7.1%/7.6% in FY19E/FY20E owing to decline in product revenue and the recent changes in the management. On the margin front we believe that the increase in investment towards scaling digital offerings, Increase localization, and escalating sub-contract expense driven by demand for onsite effort, would drag the company's operating margin to 23.6%/23.0% in FY19E/FY20E. Additionally, the company's decision to payoff \$2 Bn in the form of share buyback would further narrowed its bottom line by reducing interest income, if at all it succeeds. However, we believe the company effort to improve utilization through internal automation, increase in TCVs (\$3 Bn) and growing digital component (~26%) would provide some headroom for margins to improve and lessen the drag. **We have assigned a "HOLD" rating to the stock and we assign a multiple of 15.5x to its FY20E EPS of INR. 76.4 to arrive at a target price of INR 1,184.**

Q4 FY18 Result Snapshot

Exhibit 1: Quarterly Income Statement

INR Mn	Q4 FY18	Q3 FY17	Q-o-Q change %	Q4 FY17	Y-o-Y change %	Q4 FY18 estimates	Deviation %
Net Sales (US\$ Mn)	2,805	2,755	1.8%	2,569	9.2%	2,783	0.8%
Net Sales	180,830	177,940	1.6%	171,200	5.6%	179,478	0.8%
Less:							
Employees Remuneration & Benefits	115,540	114,500	0.9%	107,700	7.3%	115,867	(0.3%)
Administrative & Other Expenses	20,570	20,250	1.6%	21,380	(3.8%)	19,922	3.3%
Total Operating Expenditure	136,110	134,750	1.0%	129,080	5.4%	135,789	0.2%
Operating Profit	44,720	43,190	3.5%	42,120	6.2%	43,689	2.4%
Less: Depreciation	4,580	4,980	(8.0%)	4,460	2.7%	5,205	
Add: Other income	5,340	9,620	(44.5%)	7,460	(28.4%)	10,051	(46.9%)
Profit Before Tax	50,035	52,810	(5.3%)	49,580	0.9%	53,715	(6.9%)
Adjusted Profits	50,060	52,810	(5.2%)	49,580	1.0%	53,740	
Less: Total Tax	13,160	1,520	765.8%	13,300	(1.1%)	14,510	
PAT	36,875	51,290	(28.1%)	36,280	1.6%	39,205	(5.9%)
Adjusted PAT	36,900	51,290	(28.1%)	36,280	1.7%	39,230	(5.9%)
Reported Diluted EPS (Rs.)	17.0	23.6	(28.1%)	16.7	1.6%	17.2	
Adjusted Diluted EPS (Rs.)	17.0	23.6	(28.1%)	17	1.7%	17.2	(1.6%)
No of Shared Diluted (mn)	2,175	2,175		2,175		2,276	
Margin Analysis %			Change in bps		Change in bps		Deviation in bps
Operating margin	24.7%	24.3%	46	24.6%	13	24.9%	(21)
EBIDTA Margin	27.3%	27.1%	19	27.2%	6	27.6%	(33)
NPM	20.4%	28.8%	(843)	21.2%	(80)	21.4%	(98)
Adjusted NPM	20.4%	28.8%	(842)	21.2%	(79)	21.4%	(98)
Effective Tax Rate %	26.3%	2.9%	2342	26.8%	(52)	28.0%	(171)
Cost Analysis %			Change in bps		Change in bps		Deviation in bps
Employee Cost/Net Sales	63.9%	64.3%	(45)	62.9%	99	63.2%	74
SG&A/Net sales	11.4%	11.4%	(0)	12.5%	(111)	11.9%	(52)

Source: Company, KRChoksey Research

- In US\$ terms, the company reported revenues of US\$ 2,805 Mn, which was 0.8% above our estimate of US\$ 2,783 Mn
- In Rupee terms, Net sales in Q4 FY18 stood at INR 180.8 Bn, up 1.6% qoq and above our estimates
- Q4 FY18 operating margins stood at 24.7% vs our estimate of 24.9%, an increase of 46bps qoq compared to Q3 FY18 margin of 24.3%. The improvement in margin was driven by controlled employee expenditure, improved by 45 bps qoq.
- PAT margin stood at 20.4% in Q4 FY18, down 80 bps yoy.

ANALYST

Raghav Garg, researchho@krchoksey.com, +91-22-6696 5429
Pritesh Thakkar, pritesht.thakkar@krchoksey.com, +91-22-6696 5429

KRChoksey Research

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+91-22-6696 5555 / +91-22-6691 9576
www.krchoksey.com

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Exhibit 2: Profit & Loss Statement

INR Mn	FY16	FY17	FY18	FY19E	FY20E
Net Sales	624,410	684,850	705,220	755,027	812,484
Sales Growth%	17.1%	9.7%	3.0%	7.1%	7.6%
Total Revenue	624,410	684,850	705,220	755,027	812,484
Less:					
Employees Cost	390,990	432,530	451,310	489,825	531,044
SG&A	77,230	83,300	82,430	86,828	94,248
Total Operating Expenditure	468,220	515,830	533,740	576,653	625,293
EBITDA	170,780	186,050	190,100	200,053	211,297
EBITDA Growth%	14.6%	8.9%	2.2%	5.2%	5.6%
Less: Depreciation	14,590	17,030	18,620	21,679	24,106
Operating Profit	156,190	169,020	171,480	178,374	187,191
Operating Profit Growth%	12.9%	8.2%	1.5%	4.0%	4.9%
Non-operating Income	31,239	30,735	31,930	34,109	49,699
Profit Before Tax	187,429	199,755	203,410	212,483	236,890
Tax	52,520	55,980	42,420	55,883	62,302
Net Profit	134,909	143,775	160,990	156,600	174,588
Adjusted Profit	134,909	143,775	160,990	156,600	174,588
Reported Diluted EPS INR	59.0	62.9	70.4	68.5	76.4
Diluted EPS Growth%	9.4%	6.6%	12.0%	-2.7%	11.5%
Adjusted EPS	59.0	62.9	70.4	68.5	76.4
Adjusted EPS Growth%	9.4%	6.6%	12.0%	-2.7%	11.5%

Source: Company, KRChoksey Research

Exhibit 3 : Balance Sheet

INR Mn	FY16	FY17	FY18	FY19E	FY20E
Liabilities					
Equity Capital	11,440	11,440	10,880	10,880	10,880
Reserves & Surplus	566,820	678,380	612,410	678,182	751,509
Equity	578,260	689,820	623,290	689,062	762,389
Net Worth	578,260	689,820	623,290	689,062	762,389
Net Deferred tax liability/(Asset)	1,260	3,600	8,610	8,610	8,610
Total Loans	0	0	0	0	0
Capital Employed	579,520	693,420	631,900	697,672	770,999
Assets					
Gross Block	160,900	183,320	201,790	216,790	231,790
Less: Depreciation	74,530	52,942	100,630	122,309	146,415
Net Block	86,370	130,378	101,160	94,481	85,375
Capital WIP & Intangibles	55,030	57,930	44,850	35,905	36,767
Investments	18,170	64,820	57,560	57,560	57,560
Others-Assets	74,310	65,650	95,160	39,118	43,612
Current Assets					
Sundry Debtors	113,300	123,220	131,420	134,457	144,689
Cash and Bank Balance	302,630	179,208	184,436	290,929	339,096
Loans and Advances	73,520	105,900	83,270	92,868	99,123
Total Current Assets	491,550	514,772	477,460	608,858	680,406
Less: Current Liabilities & Provisions					
Sundry Creditors	3,860	3,670	6,940	3,160	3,426
Provisions	18,530	4,050	4,920	4,471	4,984
Other Current Liabilities	123,520	132,410	132,430	130,620	124,310
Total Current Liabilities& Provisions	145,910	140,130	144,290	138,250	132,720
Capital Applied	579,520	693,420	631,900	697,672	770,999

Source: Company, KRChoksey Research

ANALYST

Raghav Garg, researchho@krchoksey.com, +91-22-6696 5429
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Exhibit 4: Ratio Analysis

INR Mn	FY16	FY17	FY18	FY19E	FY20E
EBITDA Margin(%)	25.0%	24.7%	24.3%	23.6%	23.0%
Tax/PBT(%)	28.0%	28.0%	20.9%	26.3%	26.3%
Net Profit Margin(%)	21.6%	21.0%	22.8%	20.7%	21.5%
RoE(%)	22.7%	21.5%	22.8%	22.3%	22.5%
RoCE(%)	22.6%	21.4%	22.6%	22.1%	22.2%
Current Ratio(x)	3.4x	3.7x	3.3x	4.4x	5.1x
Dividend Payout(%)	47.9%	47.7%	63.2%	58.0%	58.0%
Book Value Per Share(Rs.)	253.0	301.8	272.7	301.5	333.6
Financial Leverage Ratios					
Debt/Equity(x)	0.0x	0.0x	0.0x	0.0x	0.0x
Growth Indicators%					
Growth in Gross Block(%)	14.1%	13.9%	10.1%	7.4%	6.9%
Sales Growth(%)	17.1%	9.7%	3.0%	7.1%	7.6%
EBITDA Growth(%)	12.9%	8.2%	1.5%	4.0%	4.9%
Net Profit Growth(%)	9.4%	6.6%	12.0%	(2.7%)	11.5%
Diluted EPS Growth(%)	9.4%	6.6%	12.0%	(2.7%)	11.5%
Turnover Ratios					
Debtors (Days of net sales)	66	66	68	65	65

Source: Company, KRChoksey Research

Exhibit 5: Free Cash Flow Analysis

INR Mn	FY16	FY17	FY18	FY19E	FY20E
EBITA	156,190	169,020	171,480	178,374	187,191
Less: Adjusted Taxes	43,766	47,367	35,761	46,912	49,231
NOPLAT	112,424	121,653	135,719	131,462	137,960
Plus: Depreciation	14,590	17,030	18,620	21,679	24,106
Less: Increase in Working Capital	10,184	110,439	(27,723)	27,714	29,724
Operating Cash flow	116,829	28,244	182,061	125,427	132,343
Less: Net Capex	19,310	65,088	(3,978)	6,055	15,862
Less: Increase in Net Other Assets	6,660	32,194	5,930	(51,816)	4,830
Total FCF	90,859	(69,038)	180,109	171,187	111,651

Source: Company, KRChoksey Research

Infosys Ltd.

Infosys Ltd.				Rating Legend	
Date	CMP (INR)	TP (INR)	Recommendation	Our Rating	Upside
16-Apr-18	1,171	1,184	HOLD	Buy	More than 15%
15-Jan-18	1079	1,187	ACCUMULATE	Accumulate	5% – 15%
14-July-17	972	1,158	BUY	Hold	0 – 5%
13-Apr-17	931	1,060	ACCUMULATE	Reduce	-5% – 0
13-Jan-17	971	1,074	ACCUMULATE	Sell	Less than – 5%
18-Oct-16	1,022	1,123	ACCUMULATE		

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Visit us at www.krchoksey.com
Kisan Ratilal Choksey Shares and Securities Pvt. Ltd
Registered Office:
1102, Stock Exchange Tower, Dalal Street, Fort, Mumbai – 400 001.
Phone: +91-22-6633 5000; Fax: +91-22-6633 8060.
Corporate Office:
ABHISHEK, 5th Floor, Link Road, Andheri (W), Mumbai – 400 053.
Phone: +91-22-6696 5555; Fax: +91-22-6691 9576.