

Institutional Equity Research

Infosys

IT | India

4QFY18 Result Update | April 16, 2018

CMP* (Rs)	1,169
Upside/ (Downside) (%)	10
Bloomberg Ticker	INFO IN
Market Cap. (Rs bn)	2,553
Free Float (%)	87
Shares O/S (mn)	2,184

BUY 

Target Price: Rs1,290

In Line Quarter & Guidance; Growth Investments & Cash Return – Key Positives

Infosys delivered an in-line performance in 4QFY18, with revenue rising 1.8% QoQ (0.6% QoQ in CC terms) to US\$2,805mn, almost exactly in-line with our estimate. Aided by currency, lower SG&A and offshore mix, EBIT margin rose by 46bps QoQ, while volume growth came in at 1.2% QoQ. The Management has guided for FY19E USD revenue growth at 7-9% (6-8% in CC terms), in-line with our and street expectations. However, the management guided for lower margin at 22-24%, owing to investments in business on digital, increasing localisation of US staff and re-skilling employees. The wide margin band is negative, which gives room for margins to come in at the lower end of the band. FY18 EBIT margin was at 24.3%, which implies margins could fall by 100-150bps in FY19E in the worst case scenario.

From vertical perspective, Manufacturing rose by 2.3% QoQ, while Transport & Logistics grew 21.2% QoQ, Energy & Utilities grew 3.6% QoQ and Communications rose 4.7% QoQ. Further, the outlook for BFSI remains uncertain (+1.5% QoQ USD revenue growth).

Growth Investments, Cash Return Could Support Stock

Though Infosys has guided for a lower-than-anticipated margin band for FY19E, the Management intends to invest in growth initiatives including driving digital business, increasing local US staff, re-skilling employees and beefing up sales. We believe these investments will yield the desired dividend over the medium-term. The capital return policy suggests that the Management intends to return more cash to shareholders in FY19E. Apart from paying up to 70% of free cash flow in a manner determined by the Board, Infosys will also pay out Rs130bn (US\$2bn), with Rs26bn in form of special dividend of Rs10/share, while the balance Rs104bn will be paid, as decided during the course of the year.

From other operating metrics perspective, Infosys added a gross >12,300 employees in 4QFY18, while on net basis, the total employee base increased by 2,416, taking the total head count to >204,000. Employee utilisation marginally fell to 84.7% ex-trainees (vs. 84.9% in 3QFY18), while cum-trainee utilisation declined to 80.8% (vs. 82.1% in 3QFY18).

Outlook & Valuation

We expect sentiment on the stock to get affected owing to lower margin guidance and management's intention to sell Skava and Panaya, acquired under the erstwhile Management. However, we believe this is part of the new CEO's strategy to focus purely on services, away from the 'productised business model'. Consequently, we believe this is more a case of the Infosys CEO implementing strategy to drive growth rather than looking back into past issues. We maintain our positive stance on the IT sector, aided by good IT budget growth (>6% according to Gartner, fastest growth since 2007), improvement in the US economy, strong digital growth moving the needle on total growth, with Infosys-specific factors also including decent underlying growth in key verticals and return of cash to shareholders. Infosys trades at ~4% dividend yield, while a potential buy back could drive RoE and EPS. **Hence, we retain our BUY rating on the stock, with a revised TP of Rs1,290 (Rs1,240), as we slightly raise FY20E earnings on growth leverage, even as we cut FY19E EPS 4% on higher business related investments.**

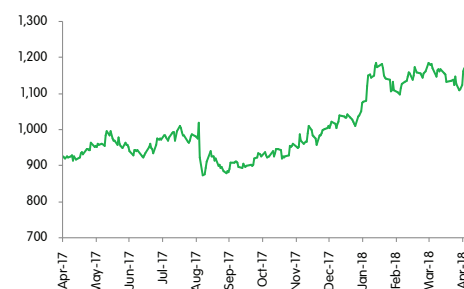
Key Financials (Rs mn)	FY17	FY18	FY19E	FY20E
Net Sales	684,850	705,220	768,709	850,415
EBIT	169,020	171,480	182,687	206,438
RPAT	143,540	160,290	161,797	183,928
Diluted EPS (Rs)	62.8	70.1	70.8	80.4
P/E (x)	18.6	16.7	16.5	14.5
EV / EBITDA (x)	13.0	12.8	12.0	10.5
RoE (%)	22.0	23.9	24.1	25.5

Source: Company, RSec Research

Share price (%)	1 mth	3 mth	12 mth
Absolute performance	(0.9)	8.4	26.4
Relative to Nifty	(1.6)	10.3	11.7

Shareholding Pattern (%)	27-Dec'17	Dec'17
Promoter	12.9	12.9
Public	87.1	87.1

1 Year Stock Price Performance



Note: * CMP as on April 13, 2018

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Key Conference Call Takeaways

- ▶ Digital business contributed 25.5% to Infosys' revenue in 4QFY18 (+3.6% QoQ), while on a full-year basis, the IT major earned US\$2.8bn in FY18 digital revenue,
- ▶ Infosys won US\$905mn worth of large deal TCV in 4QFY18 vs. US\$779mn in 3QFY18. For FY18, the IT major won new deals worth >US\$3bn out of which 30-32% were for new business,
- ▶ Infosys is awarding wage hike to 85% of its onsite and offshore employees from April 1, 2018. Hike for offshore employees is likely to be in mid to high single digit,
- ▶ On vertical side, Infosys is seeing good traction in Insurance, Manufacturing, Energy & Utilities and Telecom, which it expects to continue in FY19E,
- ▶ The Management is comfortable with the current utilisation rate.

Risks to the View

- ▶ Event-specific risks could impact IT budgets, cut discretionary spend and delay new deals.
- ▶ Cost escalation can lead to execution risks and margin pressure.
- ▶ Loss of existing revenue opportunities particularly on ADM and ERP side led by shifting to Cloud architecture.
- ▶ Currency risks.

Exhibit 1: Quarterly Performance (Consolidated, Rs mn)

Particulars	4QFY18	3QFY18	QoQ (%)	4QFY17	YoY (%)
Net Revenues (US\$ mn)	2,805	2,755	1.8	2,569	9.2
Net Revenues	180,830	177,940	1.6	171,200	5.6
Employee Expenses	100,540	98,690	1.9	93,090	8.0
SG&A and Other Operating Expenses	30,980	31,080	(0.3)	31,530	(1.7)
EBITDA	49,310	48,170	2.4	46,580	5.9
Depreciation	4,590	4,980	(7.8)	4,460	2.9
EBIT	44,720	43,190	3.5	42,120	6.2
Other Income	5,340	9,620	(44.5)	7,460	(28.4)
PBT	50,060	52,810	(5.2)	49,580	1.0
Minority Interest and associate profits	0	0		250	
Tax	13,160	1,520	765.8	13,300	(1.1)
APAT	36,900	51,290	(28.1)	36,030	2.4
RPAT	36,900	51,290	(28.1)	36,030	2.4

Source: Company, RSec Research

Exhibit 2: Margin Break Up

Particulars	4QFY18	3QFY18	QoQ (bps)	4QFY17	YoY (bps)
Employee Expenses % Net Revenues	55.6	55.5	14	54.4	122
SG&A and Other Expenses % Net Revenues	17.1	17.5	(33)	18.4	(128)
EBITDA Margin (%)	27.3	27.1	20	27.2	6
EBIT Margin (%)	24.7	24.3	46	24.6	13
Tax Rate (%)	26.3	2.9	2,341	26.8	(54)
APAT Margin (%)	20.4	28.8	(842)	21.0	(64)

Source: Company, RSec Research

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Exhibit 3: 4QFY18 results snapshot, comparison with RSec estimates

(4QFY18)	Actuals	RSec estimates	% variation from RSec estimates
Revenue (US\$ mn)	2,805	2,807	(0.1)
Revenue (Rs mn)	180,830	180,497	0.2
EBIT (Rs mn)	44,720	45,147	(0.9)
EBIT margin (%)	24.7	25.0	(28) bps
Net profit (Rs mn)	36,900	40,672	(9.3)

Source: Company, RSec Research

Exhibit 4: Earlier, revised estimates

Particulars	Earlier estimates	Revised estimates		% change	Earlier estimates	Revised estimates		% change
		FY19E	FY20E			FY19E	FY20E	
Revenue (US\$ mn)	11,941	11,826	13,212	(1.0)	13,212	13,083	(1.0)	
Revenue (Rs mn)	776,167	768,709	858,765	(1.0)	858,765	850,415	(1.0)	
EBIT (Rs mn)	192,325	182,687	209,198	(5.0)	209,198	206,438	(1.3)	
EBIT margin (%)	24.8	23.8	24.4	(101) bps	24.4	24.3	(9) bps	
EPS (Rs)	73.8	70.8	78.7	(4.2)	78.7	80.4	2.2	

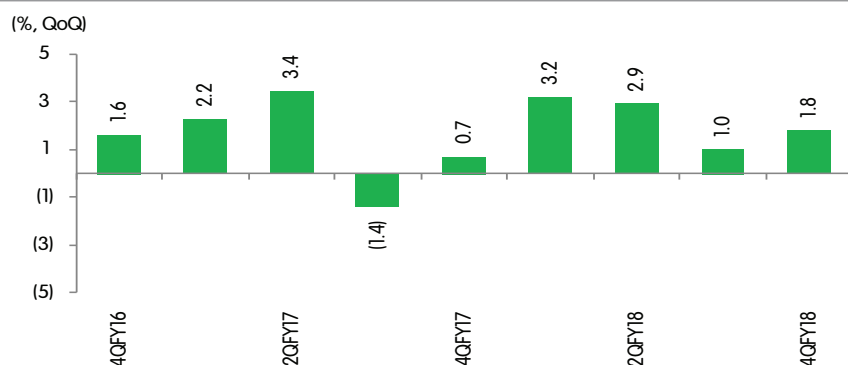
Source: RSec Research

Exhibit 5: Key Assumptions

Particulars	FY17	FY18	FY19E	FY20E
ITS volume growth (%)	10.1	6.1	7.5	10.6
ITS pricing change (%)	(2.6)	1.4	0.5	(0.3)
USD revenue growth (%)	7.4	7.2	8.1	10.6
USD/INR rate	67.09	64.47	65.00	65.00
EBIT margin (%)	24.7	24.3	23.8	24.3

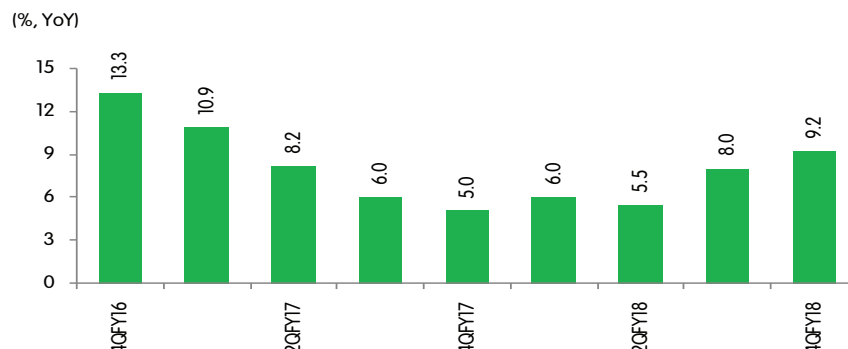
Source: Company, RSec Research

Exhibit 6: QoQ USD revenue growth trend



Source: Company, RSec Research

Exhibit 7: YoY USD revenue growth trend



Source: Company, RSec Research

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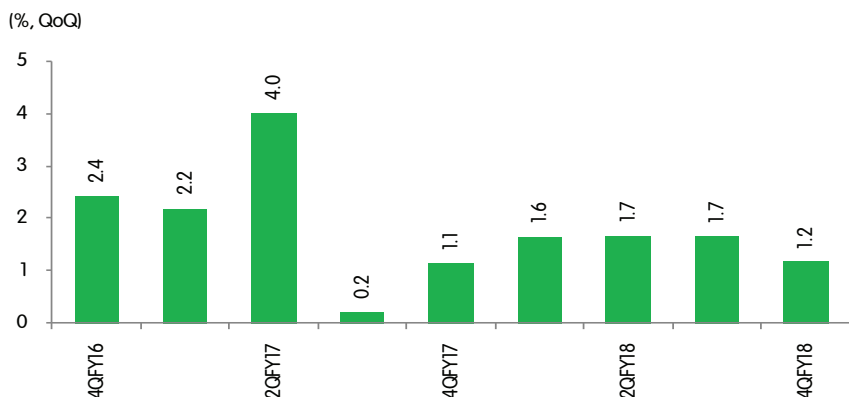
Target Price: Rs1,290

Exhibit 8: EBIT margin trend



Source: Company, RSec Research

Exhibit 9: Volume growth trend



Source: Company, RSec Research

Exhibit 10: Vertical break-up

(% of revenue)	2QFY17	3QFY17	4QFY17	1QFY18	2QFY18	3QFY18	4QFY18
BFSI	33.1	33.3	33.5	33.3	33.4	33.1	33.0
Insurance	5.7	6.1	6.1	6.2	6.4	6.8	6.8
Banking and Financial Services	27.4	27.2	27.4	27.1	27.0	26.3	26.2
Manufacturing	22.5	22.5	22.4	22.2	22.0	21.8	21.9
Retail, Logistics, CPG & Life Sciences	23.5	23.5	22.7	22.7	22.6	22.7	22.4
Retail & CPG	14.9	14.6	14.1	14.2	13.8	14.1	13.3
Transport & Logistics	1.9	2.0	2.0	1.9	2.0	2.1	2.5
Life Sciences	4.5	4.6	4.6	4.6	4.8	4.6	4.7
Healthcare	2.2	2.3	2.0	2.0	2.0	1.9	1.9
Energy & Utilities, Comm. & Services	20.9	20.7	21.4	21.8	22.0	22.4	22.7
Energy & Utilities	4.8	5.0	5.0	5.2	5.5	5.8	5.9
Communication & Services	9.4	9.1	9.9	10.4	10.4	10.5	10.8
Others	6.7	6.6	6.5	6.2	6.1	6.1	6.0
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Source: Company, RSec Research

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Exhibit 11: Vertical growth

(QoQ, %)	2QFY17	3QFY17	4QFY17	1QFY18	2QFY18	3QFY18	4QFY18
BFSI	4.4	(0.8)	1.3	2.6	3.2	0.1	1.5
Insurance	5.3	5.5	0.7	4.9	6.2	7.3	1.8
Banking and Financial Services	4.2	(2.1)	1.4	2.1	2.5	(1.6)	1.4
Manufacturing	2.1	(1.4)	0.3	2.3	2.0	0.1	2.3
Retail, Logistics, CPG & Life Sciences	0.4	(1.4)	(2.7)	3.2	2.5	1.4	0.5
Retail & CPG	(0.6)	(3.4)	(2.7)	3.9	0.0	3.2	(4.0)
Transport & Logistics	3.4	3.8	0.7	(2.0)	8.3	6.0	21.2
Life Sciences	(1.0)	0.8	0.7	3.2	7.4	(3.2)	4.0
Healthcare	8.4	3.1	(12.4)	3.2	2.9	(4.1)	1.8
Energy & Utilities, Comm. & Services	7.0	(2.3)	4.1	5.1	3.8	2.8	3.2
Energy & Utilities	5.6	2.7	0.7	7.3	8.8	6.5	3.6
Communication & Services	3.4	(4.5)	9.6	8.4	2.9	2.0	4.7
Others	13.6	(2.9)	(0.8)	(1.6)	1.2	1.0	0.1
Total	3.4	(1.4)	0.7	3.2	2.9	1.0	1.8

Source: Company, RSec Research

Exhibit 12: Service line break-up

(% of revenue)	2QFY17	3QFY17	4QFY17	1QFY18	2QFY18	3QFY18	4QFY18
Business Operations Services	62.8	62.0	61.9	62.0	62.3	61.9	62.7
Application Development	15.6	15.5	15.3	15.4	15.6	15.4	15.5
Application Maintenance	18.1	17.0	16.8	16.7	16.0	16.2	15.6
Infrastructure Management	8.4	8.6	8.5	8.4	9.0	8.8	9.3
Testing Services	9.2	9.1	9.0	9.3	9.4	9.4	9.8
Business Process Management	4.9	4.9	5.1	5.0	5.1	5.3	5.4
Product Engineering Services	3.7	3.9	4.0	4.1	4.1	4.0	4.0
Others	2.9	3.0	3.2	3.1	3.1	2.8	3.1
Consulting & Systems Integration	32.1	32.4	32.6	32.6	32.5	32.8	32.4
Products, Platforms & Solutions	5.1	5.6	5.5	5.4	5.2	5.3	4.9
Product Revenues	3.0	3.2	3.1				
BPM Platforms	1.7	1.9	1.9				
Others	0.4	0.5	0.5				
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Source: Company, RSec Research

Exhibit 13: Service line growth

(QoQ, %)	2QFY17	3QFY17	4QFY17	1QFY18	2QFY18	3QFY18	4QFY18
Business Operations Services	4.1	(2.6)	0.5	3.4	3.4	0.3	3.1
Application Development	12.1	(2.0)	(0.6)	3.9	4.2	(0.3)	2.5
Application Maintenance	(4.0)	(7.4)	(0.5)	2.6	(1.4)	2.3	(2.0)
Infrastructure Management	4.7	1.0	(0.5)	2.0	10.3	(1.3)	7.6
Testing Services	4.6	(2.5)	(0.4)	6.6	4.0	1.0	6.1
Business Process Management	3.4	(1.4)	4.8	1.2	5.0	5.0	3.7
Product Engineering Services	9.3	3.9	3.3	5.8	2.9	(1.5)	1.8
Others	11.1	2.0	7.4	(0.0)	2.9	(8.8)	12.7
Consulting & Systems Integration	3.4	(0.5)	1.3	3.2	2.6	1.9	0.6
Products, Platforms & Solutions	(4.1)	8.3	(1.1)	1.3	(0.9)	2.9	(5.9)
Product Revenues	3.4	5.2	(2.4)				
BPM Platforms	(16.3)	10.2	0.7				
Others	3.4	23.3	0.7				
Total	3.4	(1.4)	0.7	3.2	2.9	1.0	1.8

Source: Company, RSec Research

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Exhibit 14: Geographic break-up

(% of revenue)	2QFY17	3QFY17	4QFY17	1QFY18	2QFY18	3QFY18	4QFY18
North America	61.5	62.0	62.3	61.1	60.6	60.4	59.4
Europe	22.5	22.2	22.1	22.4	23.2	24.4	24.8
India	3.4	3.4	3.2	3.6	3.3	3.0	2.8
Rest of the World	12.6	12.4	12.4	12.9	12.9	12.2	13.0
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Source: Company, RSec Research

Exhibit 15: Geographic growth

(QoQ, %)	2QFY17	3QFY17	4QFY17	1QFY18	2QFY18	3QFY18	4QFY18
North America	2.6	(0.6)	1.2	1.2	2.1	0.7	0.1
Europe	1.2	(2.7)	0.3	4.6	6.6	6.2	3.5
India	30.3	(1.4)	(5.2)	16.1	(5.7)	(8.2)	(5.0)
Rest of the World	6.0	(3.0)	0.7	7.4	2.9	(4.5)	8.5
Total	3.4	(1.4)	0.7	3.2	2.9	1.0	1.8

Source: Company, RSec Research

Exhibit 16: Onsite-offshore contribution (IT services + consulting)

(% of revenue)	2QFY17	3QFY17	4QFY17	1QFY18	2QFY18	3QFY18	4QFY18
Onsite revenue	57.0	56.5	56.7	56.6	55.6	54.8	54.6
Offshore revenue	43.0	43.5	43.3	43.4	44.4	45.2	45.4
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Source: Company, RSec Research

Exhibit 17: Onsite-offshore growth (IT services + consulting)

(QoQ, %)	2QFY17	3QFY17	4QFY17	1QFY18	2QFY18	3QFY18	4QFY18
Onsite revenue	4.3	(2.9)	1.3	3.2	1.2	(0.5)	1.8
Offshore revenue	4.1	(0.7)	0.4	3.8	5.3	2.8	2.7
Total	4.2	(2.0)	0.9	3.5	3.0	1.0	2.2

Source: Company, RSec Research

Exhibit 18: Headcount, attrition, utilisation data

(Nos.)	2QFY17	3QFY17	4QFY17	1QFY18	2QFY18	3QFY18	4QFY18
Total headcount	199,829	199,763	200,364	198,553	198,440	201,691	204,107
Gross additions	12,717	9,120	9,130	8,645	10,514	12,622	12,329
Lateral additions	5,752	4,000	3,967	N.A.	N.A.	N.A.	N.A.
Net additions	2,779	(66)	601	(1,811)	(113)	3,251	2,416
Consolidated LTM attrition (%)	18.6	18.9	18.9	19.2	19.6	18.7	19.8
Quarterly annualised attrition (%)	19.9	18.4	17.0	21.1	21.4	18.6	19.4
Utilisation including trainees (%)	77.7	77.8	78.2	80.2	81.8	82.1	80.8
Utilisation excluding trainees (%)	82.5	81.9	82.0	84.0	84.7	84.9	84.7

Source: Company, RSec Research

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Profit & Loss Statement

Y/E March (Rs mn)	FY17	FY18	FY19E	FY20E
Net Revenues (US\$ mn)	10,208	10,939	11,826	13,083
Growth (%)	7.4	7.2	8.1	10.6
Net Revenues	684,850	705,220	768,709	850,415
Growth (%)	9.7	3.0	9.0	10.6
Employee Expenses	376,590	388,930	429,660	474,861
SG&A and Other Operating Expenses	122,210	126,180	136,477	148,772
EBITDA	186,050	190,110	202,572	226,783
EBITDA (%)	27.2	27.0	26.4	26.7
EBITDA Growth (%)	8.9	2.2	6.6	12.0
Depreciation	17,030	18,630	19,885	20,345
EBIT	169,020	171,480	182,687	206,438
Other Income	30,800	31,930	27,439	29,367
PBT	199,820	203,410	210,126	235,805
Tax (incl deferred)	55,980	42,410	48,329	51,877
Minority Interest and associate profit	(300)	0	0	0
RPAT	143,540	161,000	161,797	183,928
RPAT Growth (%)	6.4	12.2	0.5	13.7
EPS	62.8	70.1	70.8	80.4
EPS Growth (%)	6.4	11.7	0.9	13.7

Balance Sheet

Y/E March (Rs mn)	FY17	FY18	FY19E	FY20E
SOURCES OF FUNDS				
Share Capital - Equity	11,440	10,880	10,880	10,880
Reserves	678,380	638,350	683,653	735,153
Total Shareholders' Funds	689,820	649,230	694,533	746,033
Deferred Tax Liabilities	2,070	5,410	5,410	5,410
Long Term Provisions & Others	1,530	3,200	3,200	3,200
Trade Payables	3,670	6,940	1,551	1,709
Other Current Liabilities & Provns	136,460	134,110	132,274	145,115
Total Current Liabilities	140,130	141,050	133,825	146,823
TOTAL SOURCES OF FUNDS	833,550	798,900	836,978	901,476
APPLICATION OF FUNDS				
Net Block	97,510	101,160	104,336	109,504
CWIP	19,650	20,270	20,270	20,270
Goodwill & Other Intangible Assets	44,280	24,580	24,580	24,580
Investments	64,530	57,560	57,560	57,560
LT Loans & Advances, Others	65,130	82,340	82,340	82,340
Deferred Tax Assets	5,400	12,820	12,820	12,820
Total Non Current Assets	296,500	298,730	301,906	307,074
Debtors	123,220	131,420	147,424	163,093
Cash & Bank	226,250	198,180	217,567	256,751
Current Investments	99,700	64,070	64,070	64,070
Other Current Assets	87,880	106,500	106,011	110,488
Total Current Assets	537,050	500,170	535,072	594,402
TOTAL APPLICATION OF FUNDS	833,550	798,900	836,978	901,476

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Cash Flow Statement

Y/E March (Rs mn)	FY17	FY18	FY19E	FY20E
PAT	143,540	160,290	161,797	183,928
Non-operating & EO items	(300)	0	0	0
Depreciation	17,030	18,630	19,885	20,345
Working Capital Change	(13,550)	9,730	(22,740)	(7,149)
Cash Flow from Operations (a)	146,720	188,650	158,942	197,124
Capex	(38,220)	(22,900)	(23,061)	(25,512)
Investments	(46,360)	6,970	0	0
Cash Flow from Investing (b)	(84,580)	(15,930)	(23,061)	(25,512)
Share capital Issuance	0	(560)	0	0
Dividend	(69,390)	(69,390)	(116,494)	(132,428)
Cash Flow from Financing (c)	(69,390)	(69,950)	(116,494)	(132,428)
NET CASH FLOW (a+b+c)	(7,250)	102,770	19,387	39,184
EO items, others	(93,470)	(130,840)	0	0
Closing Cash Balance	226,250	198,180	217,567	256,751
Free Cash Flow	108,500	165,750	135,881	171,612

Key Ratios

Y/E March	FY17	FY18	FY19E	FY20E
Profitability (%)				
EBITDA Margin	27.2	27.0	26.4	26.7
APAT Margin	21.0	22.7	21.0	21.6
RoE	22.0	23.9	24.1	25.5
RoIC or Core RoCE	24.0	25.3	25.3	27.7
RoCE	18.6	20.3	20.9	22.4
Efficiency				
Tax Rate (%)	28.0	20.8	23.0	22.0
Fixed Asset Turnover (x)	3.1	2.9	2.9	2.9
Debtors + Unbilled rev. (days)	85	90	90	90
Payables (days)	3	5	1	1
Cash Conversion Cycle (days)	82	85	89	89
Net Debt/EBITDA (x)	(1.8)	(1.4)	(1.4)	(1.4)
Net Debt/Equity (x)	(0.5)	(0.4)	(0.4)	(0.4)
Interest Coverage (x)	N.A.	N.A.	N.A.	N.A.
Per Share Data (Rs)				
EPS	62.8	70.1	70.8	80.4
CEPS	71.1	79.3	80.5	90.5
DPS	25.6	27.6	43.0	48.9
BV	305.6	287.6	307.6	330.5
Valuation				
P/E	18.6	16.7	16.5	14.5
P/BV	3.8	4.1	3.8	3.5
EV/EBITDA	13.0	12.8	12.0	10.5
OCF/EV (%)	6.1	7.7	6.6	8.3
FCF/EV (%)	4.5	6.8	5.6	7.2
FCFE/mkt cap (%)	4.1	6.3	5.1	6.5
Dividend Yield (%)	2.2	2.4	3.7	4.2

Institutional Equity Research

Infosys

IT | India

CMP* (Rs)	1,169
Upside/ (Downside) (%)	10
Bloomberg Ticker	INFO IN

BUY 

Target Price: Rs1,290

Rating Guides

Rating	Expected absolute returns (%) over 12 months
BUY	>10%
HOLD	-5% to 10%
REDUCE	>-5%

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