

INFOSYS

ACCUMULATE

15-Jan-18

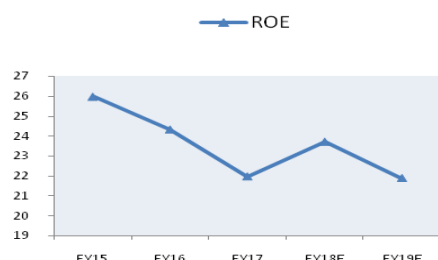
INDUSTRY - IT SOFTWARE
BLOOMBERG INFO IN
BSE Code - 500209
NSE Code - INFOSYS
NIFTY - 10681

Company Data

CMP 1078
Target Price 1233
Upside 14%

52wk Range H/L 1089/862
Mkt Capital (Rs Cr) 2,35,517
Av. Volume (.000) 377

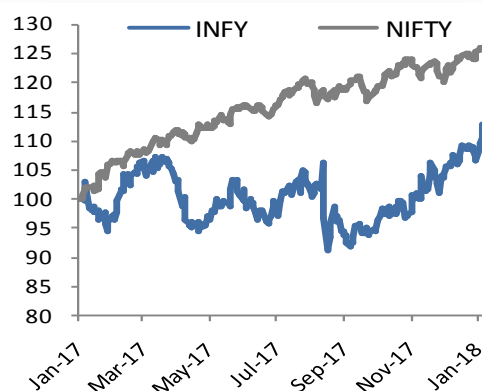
ROE Declining in 22x FY19E



	3QFY18	2QFY18	1QFY18
Promoters	12.9	12.9	12.7
Public	86.6	86.6	86.8
Others	0.5	0.5	0.5
Total	100.0	100.0	100.0

Stock Performance %

	1Mn	3Mn	1Yr
Absolute	6.2	16.0	10.7
Rel.to Nifty	2.3	10.5	-18.5



Key Highlights of the Report:

- ✓ The newly appointed CEO is in the process of evaluating 4 business dimensions, namely new geographies, client engagements, people and service portfolio, and plans to conclude this exercise by April to set strategic priorities for the company.
- ✓ Infosys 's strategy has been progressing well with 9.9% contribution from new services (Cloud Ecosystem, Big Data and Analytics, API and Micro Services, Data and Mainframe Modernization, Cyber
- ✓ Tax reversal: Infosys signed agreement with US IRS in accordance with the Advance Pricing Agreement (APA), leading to reversal of income tax provisions worth US\$225mn during the quarter. This would also lead to lower ETR going forward by 100bps. However, it would mean cash outgo of US\$233mn towards settlement of tax liabilities during the agreement covered period of 2011 and 2021.
- ✓ We value the stock at Rs1233 and recommend ACCUMULATE.

Financials/Valu	FY15	FY16	FY17	FY18E	FY19E
Net Sales	53,319	62,441	68,485	70,317	75,729
EBITDA	14,871	17,120	18,605	18,856	20,220
EBIT	17,284	18,982	19,981	20,208	20,674
PAT	12,372	13,678	14,353	15,917	15,237
EPS (Rs)	108	60	63	73	70
EPS growth (%)	-42%	-45%	5%	17%	-4%
ROE (%)	26	24	22	24	22
ROCE (%)	29	28	26	25	26
BV	444	253	302	300	340
P/B (X)	5.0	4.8	3.4	3.6	3.2
P/E (x)	20	20	16	15	15

Recent Development

Infosys signs advance pricing agreement with US Internal Revenue

- ✓ Infosys has signed an APA with the US Internal Revenue Service (IRS), reducing its tax burden in the US by one percentage point till 2021 and giving clarity on tax obligations in the country.
- ✓ Under the APA, Infosys and the IRS have agreed on the methodology to allocate revenues and compute the taxable income of the company's US operations. Infosys has to pay \$233 million in taxes, which is the difference between the taxes payable for prior periods as per the APA and the actual taxes. The reversal of the tax provisions of approximately Rs 1,432 crore will have a positive impact on the consolidated Basic EPS for the quarter ending December 31, 2017 by approximately \$0.10. Further, on account of the APA methodology, the firm expects its overall effective tax rate to be lower by about 100 basis points for future periods

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Quarterly Performance

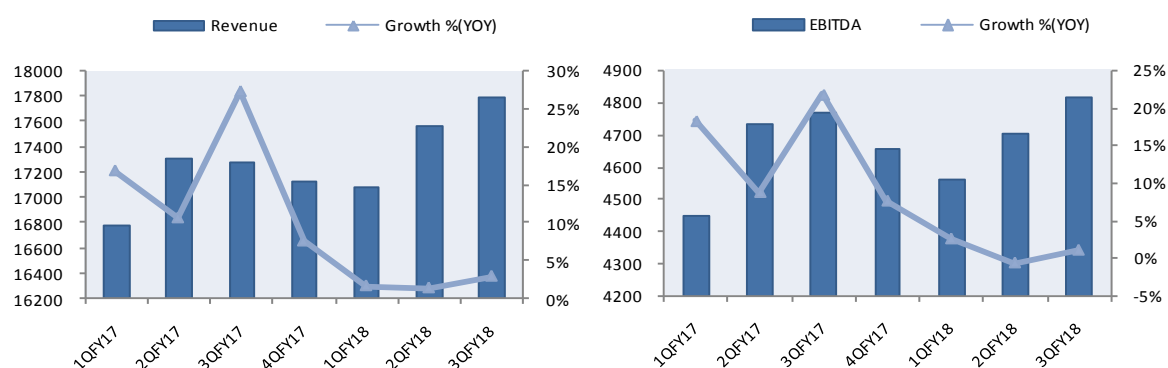
Financials	3QFY17	4QFY17	1QFY18	2QFY18	3QFY18	YoY %	QoQ%	FY16	FY17	YoY %
Net Sales / Income from	17,273	17,120	17,078	17,567	17,794	3.0%	1%	62,441	68,485	10%
Other Income	820	746	814	883	962	17%	9%	3,128	3,079	-2%
Employee Benefit	9,420	9,309	9,366	9,604	9,869	5%	3%	34,418	37,659	9%
Other Expenses	838	823	752	800	741	-12%	-7%	2,497	3,273	31%
EBITDA	4,767	4,658	4,561	4,702	4,817	1%	2%	17,120	18,605	9%
Dep and Amortisation	433	446	450	456	498	15%	9%	1,266	1,703	35%
EBIT	4,334	4,212	4,111	4,319	4,309	-1%	0%	15,854	16,902	7%
Interest	-	-	-	-	-			-	-	
PROFIT BEFORE TAX	5,154	4,958	4,925	5,129	5,281	2%	3%	18,982	19,981	5%
Tax	1,446	1,330	1,371	1,403	152	-89%	-89%	5,301	5,598	6%
Exceptional Items	-	-	71	-	-			-	-	
PROFIT AFTER TAX	3,708	3,603	3,483	3,726	5,129	38%	38%	13,678	14,353	5%

3QFY18: Revenue in line with the expectation

- ✓ Revenues for the quarter were Rs 17794 crores vs Rs 17567 crore with a sequential growth of 1.3% QOQ and 3% YOY.
- ✓ Volumes grew by 1.6% quarter-on-quarter, while realization declined by 0.9% in constant currency terms due to the impact of furloughs and lower working days.
- ✓ Revenues from new software & services increased to 11.6% compared to 11% in 2QFY18 and grew by 6.8% QoQ. Revenues contribution from Digital crossed 25% in 3QFY18.

Revenue from Operation trend

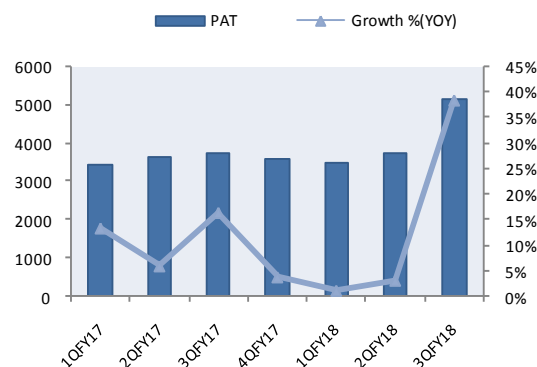
EBITDA and GROWTH trend



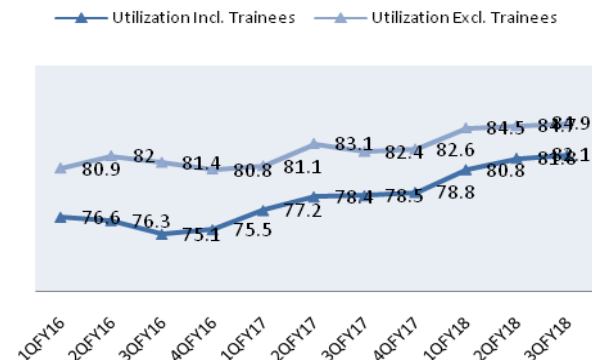
Stable operating margin

- ✓ Operating margin for the quarter to 24.3% which increased sequentially by 10bps on back of improvement in multiple operational efficiency parameters like utilization being at an all time high, onsite mix improved to 29% (vs. 29.8% in Q3FY17) and improvement in sub contracting expenses.
- ✓ Net profit grew 38 per cent to Rs 5129 crore. Net margin improved to 28.8 per cent on the back of reversed income tax on account of Advance Pricing Agreement (APA) with the US

PAT and PAT Growth trend



Utilisation including & excluding trainee



- ✓ Utilization excluding training increased further to an all-time high of 84.9% as compared to 81.9% in last year, which is a full 3% improvement. Efforts towards moderation of onsite mix has led to onsite mix decreasing to 29% in 3QFY18 which is the lowest level in last 11 quarters.
- ✓ During the quarter, on account of the conclusion of an Advance Pricing Agreement (APA) with the U.S. Internal Revenue Service (IRS), the Company has, in accordance with the APA, reversed income tax expense provision of Rs 1,432 crore which pertains to previous periods which are no longer required. Consequently, profit for 3QFY18 has increased to Rs 5129 crore. Adjusting for the provision PAT for the quarter was at Rs 3540 crore. This provision has also led to reduction of tax rate for the future by 100bps.

New services and products drove much of incremental growth

- ✓ Infosys divulge its revenue from new services and software launched from 1 April 2015.
- ✓ Infosys 's strategy has been progressing well with 9.9% contribution from new services (Cloud Ecosystem, Big Data and Analytics, API and Micro Services, Data and Mainframe Modernization)
- ✓ New software (Edge, NIA, Panaya and Skava) contributed to 1.7% of total revenue. Digital revenue constitutes 11% of total revenue

Deal wins in 3QFY18

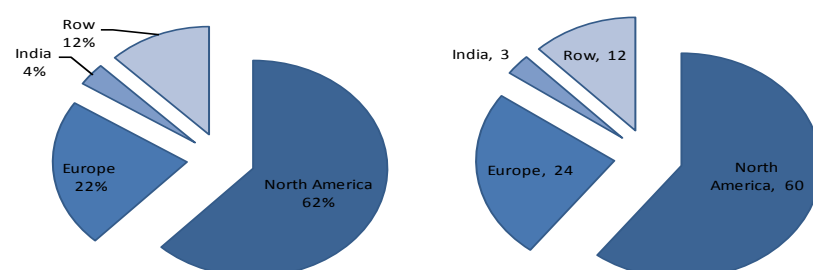
- ✓ 8 large deals with a TCV of \$779 million, both the TCV of deal wins and share of new deals improved over the period. For software-led offerings, Infosys NIA, AI and automation platform continued its positive momentum driving several deal wins.
- ✓ The platform has been leveraged across diverse business solutions, including loan on boarding, fraud management, demand sensing, predictive costing, contract compliance and procurement automation.
- ✓ The company has 200 engagements and see tremendous potential for the platform and business solutions going forward.

Revenue by industry	2QFY16	3QFY16	4QFY16	1QFY17	2QFY17	3QFY17	4QFY17	1QFY18	2QFY18	3QFY18
Banking and Financial	4243	4377	4522	4551	4686	4663	4655	4594	4718	4643
Manufacturing	1827	1756	1748	1844	1853	1893	1918	1863	1916	1955
Energy & Utilities,	3336	3410	3635	3719	3864	3885	3963	3957	4122	4241
Retail & CPG	2582	2576	2727	2861	2833	2821	2710	2695	2742	2837
Life Sciences , Healthcare	2036	2102	2083	2004	2089	2196	2148	2170	2301	2375
Hi-Tech	1214	1198	1327	1322	1339	1250	1211	1235	1254	1256
Others	397	483	508	481	646	565	515	564	514	487
Total	15635	15902	16550	16782	17310	17273	17120	17078	17567	17794

Segment Performance

- ✓ FSI grew by 0.3% sequentially and 0.1% in constant currency .Growth in financial services was impacted in Q3FY18 due to higher than normal furloughs, budget cuts in few large clients and transition underway in some large deals.But the management expects good traction and stability in spending. Deal pipeline is strong for FY19.
- ✓ Strong performance witnessed in insurance led by growth from top clients and ramp up of lot deals won in previous quarters. MFG & Hi-Tech grew by 0.1% sequentially and declined by 0.1% in constant currency . Growth in manufacturing vertical in 3QFY18 was flat due to furloughs in the US and offset by growth in European business.
- ✓ Retail and CPG verticals delivered a strong performance in 3QFY18 driven by new opportunity conversions leading to higher volumes especially in the CPG sector
- ✓ Telecom sector is witnessing growing interest in cyber security, artificial intelligence, 5G and cloud computing.

Geography Performance



- ✓ Growth across geographies was dominated by Europe which grew by 5.9% sequentially and 4.7% in constant currency. This was followed by Rest of the world grew by 4.6% sequentially and 4.0% in constant. Growth in North America grew by 0.7% sequentially and 0.7% in constant currency and India declined by 5.9% sequentially which was lower than that of company average

✓ **Retained Guidance for FY18**

Company has retained its revenue growth of 5.5%-6.5% in CC for FY18, against earlier expectation of 6.5%- 8.5% guidance
Company has also retained its EBIT margin guidance of 23%-25% for FY18

Concall Highlights For 3QFY18

- ✓ Strategy update from New CEO: The newly appointed CEO is in the process of evaluating 4 business dimensions, namely new geographies, client engagements, people and service portfolio, and plans to conclude this exercise by April to set strategic priorities for the company.
- ✓ Deal wins: The company announced 8 large deal wins in Q3FY18 with TCV of deal wins at US\$779mn. The TCV of deal wins in 9MFY18 was US\$2,167mn, down 19% yoy.
- ✓ Tax reversal: Infosys signed agreement with US IRS in accordance with the Advance Pricing Agreement (APA), leading to reversal of income tax provisions worth US\$225mn during the quarter. This would also lead to lower ETR going forward by 100bps. However, it would mean cash outgo of US\$233mn towards settlement of tax liabilities during the agreement covered period of 2011 and 2021.
- ✓ Performance-based variable payments were made during the quarter. Payouts were higher than previous years.
- ✓ Infosys has retained its near term EBIT margin range of 23-25%. Management is counting on onsite/offshore role mix optimization as operating profit margin lever, as current Utilization excluding training increased further to an all-time high of 84.9 which is a full 3% improvement. Efforts towards moderation of onsite mix has led to onsite mix decreasing to 29% in 3QFY18 which is the lowest level in last 11 .
- ✓ Vertical Performance: Growth in financial services was impacted in Q3FY18 due to higher than normal furloughs, budget cuts in few large clients and transition underway in some large deals. But the management expects good traction and stability in spending. Deal pipeline is strong for FY19. MFG & Hi-Tech grew by 0.1% sequentially and declined by 0.1% in constant currency . Telecom sector is witnessing growing interest in cyber security, artificial intelligence, 5G and cloud computing. New software (Edge, NIA, Panaya and Skava) contributed to 1.7% of total revenue. Digital revenue constitutes 11% of total revenue.
- ✓ Growth across geographies was dominated by Europe which grew by 5.9% sequentially and 4.7% in constant currency. This was followed by Rest of the world grew by 4.6% sequentially and 4.0% in constant. Growth in North America grew by 0.7% sequentially and 0.7% in constant currency and India declined by 5.9% sequentially which was lower than that of company average.

View and Valuation

Infosys in last few quarters was undergoing financial performance pressure, shareholders' expectations pressure, Peer Pressure and Management pressure. Vishal Sikka's resignation we believe has been one of the major pivot point for Infosys. Businesses are not built in days but it is management's strategy that works over years that build up a company. But recently with appointment of new CEO Salil Parekh, we believe Infosys will show some positivity and stability in top management.

With recent quarterly result, deal wins, strong growth in Digital business (25% of total revenue) has filled us with confidence for growth in near future. Despite soft revenue in BFSI segment in 3QFY18, the management is confident of demand revival as discretionary spend in the vertical will pick-up in CY18. Also the management is executing well on its strategy with 50% of the incremental revenues coming from new services like Cloud Ecosystem, Big Data and Analytics, API and Micro Services, Data and Mainframe Modernization etc which grew 7% QoQ has made us optimistic for future growth.

We value the stock with target price of Rs1233(15x FY20EPS) and recommend ACCUMULATE.

Operating Metrics

By Geography (%)	2QFY16	3QFY16	4QFY16	1QFY17	2QFY17	3QFY17	4QFY17	1QFY18	2QFY18	3QFY18
North America	63	63	62	62	62	62	62	61	61	60
Europe	23	23	23	23	23	22	22	22	23	24
India	2	3	3	3	3	3	3	4	3	3
Rest of the world	12	12	12	12	13	12	12	13	13	12
Revenues by Client	2QFY16	3QFY16	4QFY16	1QFY17	2QFY17	3QFY17	4QFY17	1QFY18	2QFY18	3QFY18
Banking & Financial	33	34	33	33	33	33	34	33	33	33
Manufacturing & Hi-Tech	24	23	23	23	23	23	22	22	22	22
Retail & Life Sciences	25	24	25	24	24	24	23	23	23	23
Energy, Utilities,	19	19	20	20	21	21	21	22	22	22
Revenues by Service	2QFY16	3QFY16	4QFY16	1QFY17	2QFY17	3QFY17	4QFY17	1QFY18	2QFY18	3QFY18
Business IT Services	62	61	62	62	63	62	62	62	62	62
Application Development	14	14	14	14	16	16	15	15	16	15
Application Maintenance	20	19	20	20	18	17	17	17	16	16
Infrastructure	9	8	8	8	8	9	9	8	9	9
Testing Services	9	9	9	9	9	9	9	9	9	9
Product Engineering	3	3	3	4	4	4	4	4	4	4
Business Process	5	5	5	5	5	5	5	5	5	5
Others	3	3	3	3	3	3	3	3	3	3
Consulting,Package Imp	33	34	33	32	32	32	33	33	33	33
Products& Platforms	5	5	5	6	5	6	6	5	5	5
Products	3	3	3	3	3	3	3	0	0	0
Platforms	1	2	2	2	2	2	2	0	0	0
Others	1	0	0	0	0	1	1	0	0	0
Client Data	2QFY16	3QFY16	4QFY16	1QFY17	2QFY17	3QFY17	4QFY17	1QFY18	2QFY18	3QFY18
Active	1,011	1,045	1,092	1,126	1,136	1,152	1,162	1,164	1,173	1,191
Added during the period	82	75	89	95	78	77	71	59	72	79
Top client	4	4	4	4	4	3	3	3	3	3
Top 5 clients	14	14	14	14	13	12	12	N/A	N/A	N/A
Top 10 clients	23	23	22	22	22	20	20	20	20	19
Utilization	2QFY16	3QFY16	4QFY16	1QFY17	2QFY17	3QFY17	4QFY17	1QFY18	2QFY18	3QFY18
Utilization Incl. Trainees	76	75	76	77	78	79	79	81	82	82
Utilization Excl. Trainees	82	81	81	81	83	82	83	85	85	85
Attrition	2QFY16	3QFY16	4QFY16	1QFY17	2QFY17	3QFY17	4QFY17	1QFY18	2QFY18	3QFY18
Attrition rate (% LTM)	14	13	13	16	16	15	14	15	17	16

Financials Snap Shot

Income Statement				
Rs in Crores				
Y/E March	FY16	FY17E	FY18E	FY19E
Revenue from Operation	62,441	68,485	70,317	75,729
Change (%)	17%	10%	3%	8%
Other Operating Income	-	-	-	-
EBITDA	17,120	18,605	18,856	20,220
Change (%)	15%	9%	1%	7%
Margin (%)	27%	27%	27%	27%
Depr & Amor.	1,266	1,703	1,871	1,969
EBIT	18,982	19,981	20,208	20,674
Int. & other fin. Cost	-	-	-	-
Other Income	3,128	3,079	2,800	2,400
EBT	18,982	19,981	20,208	20,674
Exp Item	-	-	71	-
Tax	5,301	5,598	4,219	5,437
Minority Int & P/L share of Ass.	(3)	(30)	-	-
Reported PAT	13,681	14,383	15,917	15,237
Adjusted PAT	13,678	14,353	15,917	15,237
Change (%)	11%	5%	11%	-4%
Margin(%)	22%	21%	23%	20%

Balance Sheet				
Rs in Crores				
Y/E March	FY16	FY17E	FY18E	FY19E
Share Capital	1,144	1,144	1,088	1,088
Reserves	60,600	67,838	64,210	72,901
Networth	61,744	68,982	65,298	73,989
Debt	-	-	-	-
Other Non Cur Liab	367	360	360	360
Total Capital Employed	62,111	69,342	65,658	74,349
Net Fixed Assets (incl CWIP)	10,582	11,892	13,091	14,274
Non Cur Investments	1,714	6,382	6,382	6,382
Other Non Cur Asst	1,357	1,059	1,059	1,059
Non Curr Assets	20,526	22,209	23,408	24,591
Current investments	75	9,970	9,970	9,970
Debtors	11,330	12,322	12,652	13,625
Cash & Bank	32,697	22,625	17,438	24,050
Other Curr Assets	2,158	2,536	2,604	2,804
Other financial assets	5,190	5,980	5,980	5,980
Short-term loans and advances	303	272	279	301
Curr Assets	51,753	53,705	48,923	56,730
Creditors	386	367	377	406
Provisions	512	405	416	448
Other Curr Liab	2,629	3,007	3,087	3,325
Other financial liabilities	6,302	6,349	6,349	6,349
Income tax liabilities	3,410	3,885	3,885	3,885
Curr Liabilities	13,239	14,013	14,114	14,413
Net Curr Assets	38,514	39,692	34,809	42,318
Total Assets	75,350	83,355	79,772	88,762

Key Ratios				
Y/E March	FY16	FY17E	FY18E	FY19E
ROE	24	22	24	22
ROCE	28	26	25	26
Asset Turnover	1	1	1	1
Current Ratio	4	4	3	4
Debt/Equity	-	-	-	-
DPS	29	30	26	26
Payable Days	2	2	2	2
Debtor Days	66	66	66	66
Earnings Per Share	60	63	73	70
Book Value Per Share	253	302	300	340
P/E	20	16	15	15
Price / Book Value	5	3	4	3
EV/EBITDA	14	11	12	10
EV/Sales	4	3	3	3
Div Payout%	49%	48%	35%	37%
EPS GROWTH	-45%	5%	17%	-4%

Cash Flow Statement				
Rs in Crores				
Y/E March	FY16	FY17E	FY18E	FY19E
PBT	13,489	14,353	20,208	20,674
(inc)/Dec in Working Capital	(1,946)	(2,156)	(276)	(631)
Non Cash Op Exp	4,350	4,987	1,661	2,053
Int Paid (+)	-	-	-	-
Tax Paid	(5,865)	(5,653)	(4,219)	(5,437)
others	-	-	-	-
CF from Op. Activities	10,028	11,531	17,374	16,659
(inc)/Dec in FA & CWIP	(2,723)	(2,760)	(3,197)	(3,152)
Free Cashflow	7,305	8,771	14,177	13,507
others	1,822	(11,782)	-	-
CF from Inv. Activities	(901)	(14,542)	(3,197)	(3,152)
inc/(dec) in NW	-	-	(13,000)	-
inc/(dec) in Debt	-	-	-	-
Int. Paid	-	-	-	-
Div Paid (inc tax)	(6,813)	(6,939)	(6,545)	(6,545)
others	-	-	-	-
CF from Fin. Activities	(6,813)	(6,939)	(19,545)	(6,545)
Inc(Dec) in Cash	2,314	(9,950)	(5,187)	6,612
Add: Opening Balance	30,383	32,575	22,625	17,438
Closing Balance	32,697	22,625	17,438	24,050



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