

Sustained Operating Margins

25th October 2017

CMP: Rs.926
Target Price: Rs.1,008
Recommendation: HOLD

Stock Info

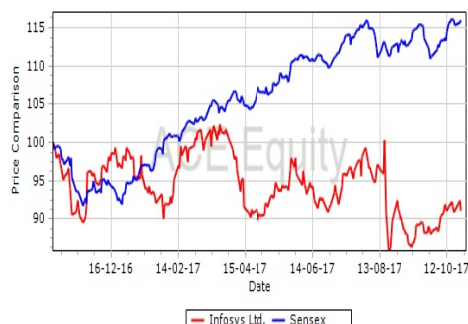
BSE Group	A
BSE Code	500209
NSE Symbol	INFOSYSTCH
Bloomberg	INFO IN
Reuters	INFY.BO
BSE Sensex	32,607
NSE Nifty	10,207

Market Info

Market Capital	Rs.2,14,712cr
Equity Capital	Rs. 1148 cr
6M Avg. Trading Vol	5,886,788
52 Wk High/ Low	1044/860
Face Value	Rs.5

Shareholding Pattern (%)	(Sep , 17)
Promoters	12.8
Domestic Institutions	22.1
Foreign Institutions	34.1
Public & Others	31.0

Price Vs Sensex Chart



Steady quarter but sustained EBIT margins of 24.2%:

- Q2 saw significant changes in the company, at the management and board level. Company responded quickly to these changes through proactive communication with all stakeholders, including clients and employees. This ensured that the impact on the business in quarter two was minimal. Revenues grew sequentially by 2.9% on reported dollar basis and 2.2% on constant currency basis.
- Operating margin for Q2 2018 is at 24.2%, which increased sequentially by 10 basis points. Reduction in onsite mix helped margins by 20 basis points, improvement in utilization helped margins by 30 basis points, while improvement in price realization helped margins by another 30 basis points. However, this was offset by higher compensation costs due to compensation review in Q2 and higher variable pay, which put together impacted margins by 80 basis points.
- Other benefits including cross currency and cost optimization was partially offset by increase in provision for AR, increase in professional charges and impact of hedges, resulting in 10 basis points improvement as compared to Q1.

Segmental Highlights:

- Financial Services, growth in Q2 was in line. Company expects seasonal softness in quarter three, driven by furloughs and spending cuts. On a mid to longer term basis, company remains optimistic about tech spend in BFSI and strong competitive position, which is reflected in large deal wins as well as pipeline.
- Manufacturing vertical is seeing some in-sourcing and cost optimization initiatives by a few clients. There is some pickup in activity in ERP space, driven by M&A in the sector in the last 12 to 18 months. High-tech companies are changing their business models to capture new sources of revenue.
- In Retail and CPG, non-discretionary spend are being impacted due to slowing growth, leading to cost pressures. On discretionary spend and new technology adoption, there is growing interest to embrace digital AI, RPA, analytics, etc. Telecom is seeing significant industry consolidation to achieve diversified product offerings and monetize the network traffic in a better way.
- Coming to digital, clients are looking at renewing their legacy landscapes and investing in customer experience, new commerce models, and in digitally connecting the enterprise. Digital experience, content management, field force management and digital marketing are some of the key trends witnessing across verticals. Retail and financial services industries are leading the transformation towards digital and are looking at consolidation of services, automation, improved customer experience and eliminating supply chain issues.
- Infosys further strengthened its digital expertise with the acquisition of Brilliant Basics, a London-based digital innovation and customer experience studio known for its world-class design thinking-led approach and experience in executing global programs. This acquisition extends digital design services network to include Europe and Middle East and enhances the capability to deliver digital innovations.

Source: Company data, Arihant Research

Key Wins :

- During the quarter, Infosys won five large deals with a Total Contract Value of \$731 million, both the TCV of deal wins and share of new deals improved over Q1 2018. For software-led offerings in quarter two, Infosys NIA, flagship 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. Working with more than 100 clients and close to 200 engagements, management sees tremendous potential for the platform and business solutions going forward.

Other Highlights:

- Infosys saw growth in all the four large verticals and delivered strong growth in emerging verticals like Energy and Utilities, Life Sciences, Transportation and Logistics. Volumes grew by 1.6% quarter-on-quarter, realization grew 1.3% quarter-on-quarter on reported basis and 0.7% on a constant currency basis. Both on a year-on-year basis, as well on half year basis, realization was flat in the constant currency that terms, reflecting stability in pricing environment, as well as continuous improvement in service mix towards higher value offerings. In terms of service offerings, Infosys had notably strong growth in infrastructure management, testing, and BPO services.
- New offerings in areas like cyber security, cloud, big data, IoT etc again contributed to approximately half of incremental growth in Q2, thereby improving their share further to 9.4% of revenues from 8.3% last quarter.
- Utilization excluding and including trainees, reached the all-time high levels of 84.7% and 81.8%. Onsite, offshore mix improved during the quarter by 0.7%. Revenue per FTE improved to \$52,684, which is a growth of 1.5% quarter-on-quarter and 3.3% year-on-year. Attrition increased marginally to 17.2% on a standalone basis and 21.4% on a consolidated basis.

Concall Highlights:

- Lot of headwinds in the quarter but the impact was minimal.
- Revenue grew 2.9%QoQ and 2.2% on CC terms.
- Strong growth in verticals like energy, utility, life sciences, transportation and logistics.
- Volumes grew by 1.6% QoQ.
- Realisation grew 1.3%Qoq on reported basis.
- Realisation was flat in CC terms for H1FY18 reflecting stability in pricing environment, as well as improvement in service mix towards higher value offering.
- Company has made good progress in its commitment to hire 10,000 American workers over the next two years.
- Utilization excluding & including trainee were at all time high level of 84.7% and 81.8%.
- Expanded global footprint by opening new office in Netherland.
- Operating margins at 24.2%an increase of 10 Bps.
- Capex for the quarter was \$63 million or approximately INR 406 crores.
- In H1 2018, operating cash flow increased by 8% in dollar terms and 3.6% in rupee terms.
- Reiterated operating margins in the range of 23-25% for FY 18.
- Revenue guidance to be in the range of 5.5-6.5% on CC basis.

FY18 Revenue growth guidance:

- Based on the performance in first half of the year and seasonal softness that company has typically seen in H2, management has revised their revenue guidance to 5.5% to 6.5% in constant currency terms.

Outlook:

A sustained EBIT margins even after a lot of headwinds, a lower revenue guidance of 5.5 – 6.5% on constant currency basis for the year ending March 2018 and expecting operating margins to be in the range of 23-25%, we expect management to do well in the coming quarters and have assigned a PE of 14x to its FY19E EPS of Rs 72 and have arrived at fair value of Rs 1,008 per share. At CMP Rs 926 stock trades at 13(x) its FY19E earnings. We have **HOLD** rating on the stock.

Source: Company data, Arihant Research

Financial Snapshot:

Y/E March (Rs. In Crore)	FY17	FY18E	FY19E
Net Revenue	68484	72959	78796
Growth %	10%	7%	8%
EBIT	16901	17766	19221
EBIT Margin	24.7%	24.4%	24.4%
Net Profit	14353	15094	15783
Growth %	5%	5%	5%
EPS	63	69	72
P/E	15	13	13
ROE	20.8	20.7	18.2

Quarterly Results:

Quarter Ended					
Particulars (Rs. Cr)	Q2 FY18	Q1 FY18	QoQ	Q2 FY17	YoY
Revenues	17567	17,078	2.9%	17,310	1.5%
Cost of services	10693	10,427	2.6%	10,962	-2.5%
Gross Profits	6874	6,651	3.4%	6,348	8.3%
S&M,G&A. Expenses	2628	2,540	3.5%	2,039	28.9%
EBIT	4246	4,111	3.3%	4,309	-1.5%
Other Income	883	814	8.5%	760	16.2%
Share in associate's profit/(loss)	0	(71)		(3)	
PBT	5129	4,854	5.7%	5,066	1.2%
Income tax expense	1403	1,371	2.3%	1,460	-3.9%
Net PAT	3726	3,483	7.0%	3,606	3.3%
EPS	16.3	15.2	7.0%	15.8	3.3%

Profit and Loss statement

Particulars (Rs. In Crore)	FY17	FY18 E	FY19 E
Income	68,484	72,959	78,796
Software development expenses	43,253	44,294	47,278
Gross Profit	25,231	28,665	31,518
Sales and development expenses	3,591	4,601	4,334
General and administrative expenses	5,239	6,297	7,964
EBIT	16,901	17,766	19,221
EBIT Margin	24.7	24.4	24.4
Interest	0	0	0
Other Income	3,050	2,846	2,700
PBT	19,951	20,613	21,921
Tax	5,598	5,519	6,138
PAT	14,353	15,094	15,783
Growth (%)	5%	5%	5%
EPS	63	69	72

Balance Sheet

Particulars (Rs. In Crore)	FY17	FY18 E	FY19 E
Shareholder's funds			
Share Capital*	1,144	1,092	1,092
Reserves & Surplus	67,838	71,944	85,625
Total	68,982	73,036	86,717
Minority Interest	0	0	0
Total Non Current Liabilities	360	177	189
Total Current Liabilities	14,013	16,365	11,517
Total Liabilities	83,355	89,578	98,423
Net Block	15,344	18,029	19,002
Capital Work-in-Progress	800	1,324	1,489
Total Non Current Assets	29,650	34,416	38,982
Cash and bank balance	22,625	22,269	22,026
Total Current Assets	53,705	55,162	59,442
Total Assets	83,355	89,578	98,423

Cash Flow Statement

Particulars (Rs. In Crore)	FY17	FY18 E	FY19 E
Profit After taxes	14,353	15,094	15,783
Add:- Depreciation	1,703	1,914	1,227
Change in Working Capital	-1,972	-5,218	-5,108
Cash generated from operations	17,184	14,542	15,273
Taxes paid	-5,653	-5,519	-6,138
Net cash flow from operating activities	11,531	9,022	9,135
Purchase of fixed assets and Capital Expenditure	-2,760	-4,000	-3,500
Others	-11,782	2,155	1,968
Net cash flow from investing activities	-14,542	-1,845	-1,532
Proceeds long term borrowings	0	812	500
Dividend paid, including dividend tax	-6,939	-8,310	-8,310
Net cash used in financing activities	-6,939	-7,498	-7,810
Exchange fluctuations	-122	-35	-35
Net Cash Flow	-9,950	-321	-207
Opening Cash balance	32,697	22,625	22,269
Closing Cash balance	22,625	22,269	22,026

Particulars	FY17	FY18 E	FY19 E
EPS	62.8	69.1	72.3
Book Value	301.8	334.4	397.1
DPS	30	40	40
Payout %	48	58	55
Dividend Yield %	3.2	4.3	4.3
P/E	14.8	13.4	12.8
EBIT Margin	24.7%	24.4%	24.4%
PBT Margin	29%	28%	28%
PAT Margin	21%	21%	20%
Debt/Equity	0.0	0.0	0.0
Current Ratio	3.83	3.37	5.16
ROE	20.8	20.7	18.2
ROCE	25.2	24.6	21.3

Arihant Research Desk

E. research@arihantcapital.com
T. 022-42254800

Head Office

#1011, Solitaire Corporate park ,
Building No. 10, 1st Floor,
Andheri Ghatkopar Link Road
Chakala, Andheri (E).
Mumbai – 400093
Tel: (91-22) 42254800
Fax: (91-22) 42254880

Registered Office

Arihant House
E-5 Ratlam Kothi
Indore - 452003, (M.P.)
Tel: (91-731) 3016100
Fax: (91-731) 3016199

Stock Rating Scale

	Absolute Return
BUY	>20%
ACCUMULATE	12% to 20%
HOLD	5% to 12%
NEUTRAL	-5% to 5%
REDUCE	<-5%

Research Analyst Registration No.

INH000002764

Contact

SMS: 'Arihant' to 56677

Website

www.arihantcapital.com

Email Id

research@arihantcapital.com

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ARIHANT capital markets Ltd.

1011, Solitaire Corporate park , Building No. 10, 1st Floor,
Andheri Ghatkopar Link Road Chakala, Andheri (E) Mumbai - 400093
Tel. 022-42254800 Fax. 022-42254880
www.arihantcapital.com