

# Infosys (INFO IN)

## Panaya acquisition – strategic, but expensive

### INDIA | IT SERVICES | Company Update

Infosys announced that it has acquired an Israel based company, Panaya Inc, for a total enterprise value (EV) of \$200mn. The acquisition is expected to be completed by March 2015. Post integration, it will be a part of Infosys platforms division, led by Abdul Razacq (former SAP executive).

**About Panaya:** Panaya Inc is American (home base of Israel) software as a service (SaaS) company that provides cloud-based quality management services for enterprise applications. Panaya with annual revenue run-rate of ~\$30-35mn generates 40% of revenues from US, 40% from EMEA and 20% from Rest of world. The company has 156 employees with a majority of them based in Israel. Its platform offers – transition and efficiency on different packaged service SAP®, Oracle® EBS, and Salesforce. Solutions include Change impact analysis, automated code remediation, collaborative test management, test-execution, and ALM acceleration enabling companies to save their IT applications life cycle costs and minimize the risks associated with system changes.

**Marquee clients list:** Panaya has 400+ active recurring customers including marquee names such as GE, Apple, Johnson & Johnson, GM, Coke, Walmart etc. and provides strong cross-selling opportunity for Infosys. The overlap with Infosys is expected to be minimum and the acquisition will enhance its existing service lines around ERP. The company also intends to use the acquisition, to further enhance its other services including ADM.

**Owned by strategic investor:** PE firms own majority stake in Panaya – Gemini Partners, Benchmark Capital, Hasso Plattner Ventures, Battery Ventures, and Israel Growth Partners. The company has raised total of \$59m over the last 8 yrs.

**Deal valuation:** The acquisition is done at EV of \$200mn at ~6x EV/sales. As per the management, the transaction is expected to be EPS accretive in 12-18 months: While the acquisition is expensive in terms of valuation, it is however, in line with the company's strategy to grow through inorganic route. The acquisition, in our opinion, is not being done to buy-out revenues, but to fill the gap in delivery capabilities of the company. We believe this acquisition is strategic fit as it augments "renew" space by automating testing for ERP and in the "new" space in the cloud technology.

**Outlook:** We expect more such acquisitions from Infosys over the next few quarters, as it explores inorganic route to enhance its delivery capabilities. While it would a step in the right direction for the company, successful integration and cross selling opportunity will be the key for the strategy to bear desired results.

Also we believe that the benefits of these acquisitions and the management's overall strategy of focusing on artificial intelligence, automation, and design thinking – will be highly back-ended. In its attempts to focus on strategic partnerships with clients, the company runs the risk of ignoring the loss of market share in its traditional business of IT outsourcing. We remain negative on the stock and believe the company will continue to underperform its peers in the near to medium term.

On our numbers, the stock is trading at 17x FY17 earnings – too high a multiple in our opinion, considering the risk to future earnings and the inadequate gap in valuation versus TCS (18x FY17 for TCS).. Our price target of Rs2000 represents 12% downside from current levels. We maintain NEUTRAL rating on the stock.

17 February 2015

## NEUTRAL

CMP RS 2282

TARGET RS 2000 (-12%)

### COMPANY DATA

O/S SHARES (MN) :	1148
MARKET CAP (RSBN) :	2607
MARKET CAP (USDBN) :	42.1
52 - WK HI/LO (RS) :	2201 / 1447
LIQUIDITY 3M (USDMN) :	113.3
PAR VALUE (RS) :	5

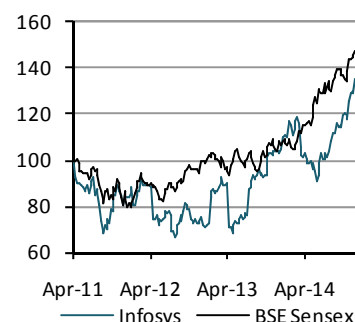
### SHARE HOLDING PATTERN, %

PROMOTERS :	15.9
FII / NRI :	59.4
FI / MF :	14.1
NON PROMOTER CORP. HOLDINGS :	0.6
PUBLIC & OTHERS :	9.7

### PRICE PERFORMANCE, %

	1MTH	3MTH	1YR
ABS	-5.1	2.6	13.7
REL TO BSE	0.4	0.2	-16.4

### PRICE VS. SENSEX



Source: Phillip Capital India Research

### KEY FINANCIALS

Rs mn	FY15	FY16E	FY17E
Net Sales	540.8	614.6	701.2
EBIDTA	148.8	166.9	192.7
Net Profit	119.4	133.8	154.0
EPS, Rs	104.4	117.0	134.7
PER, x	21.8	19.5	16.9
EV/EBIDTA, x	15.2	13.3	11.2
P/BV, x	4.7	4.1	3.6
ROE, %	21.4	21.0	21.1

Source: PhillipCapital India Research Est.

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## Financials

### Income Statement

Y/E Mar, Rs mn	FY14	FY15E	FY16E	FY17E
<b>Net sales</b>	<b>5,01,330</b>	<b>5,40,838</b>	<b>6,14,565</b>	<b>7,01,205</b>
Growth, %	24	7.9	13.6	14.1
Employee expenses	-3,07,670	-3,26,733	-3,72,980	-4,23,699
Other Operating expenses	-59,510	-65,267	-74,659	-84,846
<b>EBITDA (Core)</b>	<b>1,34,150</b>	<b>1,48,838</b>	<b>1,66,926</b>	<b>1,92,659</b>
Growth, %	16.1	10.9	12.2	15.4
Margin, %	26.8	27.5	27.2	27.5
Depreciation	-13,740	-10,876	-13,278	-14,361
<b>EBIT</b>	<b>1,20,410</b>	<b>1,37,961</b>	<b>1,53,647</b>	<b>1,78,298</b>
Growth, %	15.5	14.6	11.4	16.0
Margin, %	24.0	25.5	25.0	25.4
Forex gains/losses	2,300	2,079	0	0
Other Non-Operating Income	24,390	28,976	34,715	38,557
<b>Pre-tax profit</b>	<b>1,47,100</b>	<b>1,69,016</b>	<b>1,88,363</b>	<b>2,16,855</b>
Tax provided	-40,620	-49,651	-54,608	-62,868
<b>Profit after tax</b>	<b>1,06,480</b>	<b>1,19,365</b>	<b>1,33,755</b>	<b>1,53,987</b>
Others (Minorities, Associates)	0	0	0	0
<b>Net Profit</b>	<b>1,06,480</b>	<b>1,19,365</b>	<b>1,33,755</b>	<b>1,53,987</b>
Growth, %	13.0	12.1	12.1	15.1
<b>Net Profit (adjusted)</b>	<b>1,06,480</b>	<b>1,19,365</b>	<b>1,33,755</b>	<b>1,53,987</b>
Wtd avg shares (m)	1,143	1,143	1,143	1,143

	FY14	FY15E	FY16E	FY17E
<b>US\$ Revenue (\$ mn)</b>	<b>8,249</b>	<b>8,846</b>	<b>9,912</b>	<b>11,310</b>
Growth, %	11.5	7.2	12.1	14.1
Re / US\$ (rate)	60.8	61.1	62.0	62.0

### Balance Sheet

Y/E Mar, Rs mn	FY14	FY15E	FY16E	FY17E
Cash & bank	2,90,060	3,45,085	3,94,617	4,55,754
Marketable securities at cost	0	0	0	0
Debtors	83,510	1,00,817	1,16,178	1,34,478
Inventory	0	0	0	0
Loans & advances	56,620	65,352	77,531	89,774
Total current assets	4,30,190	5,11,253	5,88,326	6,80,005
Investments	29,940	38,680	46,180	53,680
Net fixed assets	1,03,860	1,17,554	1,28,275	1,37,914
Non-current assets	0	0	0	0
<b>Total assets</b>	<b>5,66,680</b>	<b>6,69,677</b>	<b>7,64,972</b>	<b>8,73,789</b>
Total current liabilities	91,380	1,10,706	1,27,016	1,44,901
Non-current liabilities	0	0	0	0
Total liabilities	91,380	1,10,706	1,27,016	1,44,901
Paid-up capital	2,860	2,860	2,860	2,860
Reserves & surplus	4,72,440	5,56,110	6,35,096	7,26,029
Minorities	0	0	0	0
Shareholders' equity	4,75,300	5,58,970	6,37,956	7,28,889
<b>Total equity &amp; liabilities</b>	<b>5,66,680</b>	<b>6,69,677</b>	<b>7,64,972</b>	<b>8,73,789</b>

Source: Company, PhillipCapital India Research Estimates

### Cash Flow

Y/E Mar, Rs mn	FY14	FY15E	FY16E	FY17E
Pre-tax profit	1,47,100	1,69,016	1,88,363	2,16,855
Depreciation	13,740	10,876	13,278	14,361
Chg in working capital	5,810	-6,712	-11,231	-12,658
Total tax paid	-40,960	-49,151	-54,608	-62,868
Other operating activities	0	0	0	0
<b>Cash flow from operating activities</b>	<b>1,25,690</b>	<b>1,24,029</b>	<b>1,35,802</b>	<b>1,55,690</b>
Capital expenditure	-29,480	-24,570	-24,000	-24,000
Chg in investments	-12,710	-8,740	-7,500	-7,500
Chg in marketable securities	0	0	0	0
Other investing activities	0	0	0	0
<b>Cash flow from investing activities</b>	<b>-42,190</b>	<b>-33,310</b>	<b>-31,500</b>	<b>-31,500</b>
Free cash flow	96,210	99,459	1,11,802	1,31,690
Equity raised/(repaid)	0	0	0	0
Debt raised/(repaid)	0	0	0	0
Dividend (incl. tax)	-84,236	-50,524	-54,769	-63,054
Other financing activities	55,086	14,829	0	0
<b>Cash flow from financing activities</b>	<b>-29,150</b>	<b>-35,695</b>	<b>-54,769</b>	<b>-63,054</b>
<b>Net chg in cash</b>	<b>54,350</b>	<b>55,025</b>	<b>49,532</b>	<b>61,137</b>

### Valuation Ratios

	FY14	FY15E	FY16E	FY17E
<b>Per Share data</b>				
EPS (INR)	93.2	104.4	117.0	134.7
Growth, %	13.0	12.1	12.1	15.1
Book NAV/share (INR)	415.9	489.1	558.2	637.8
CFPS (INR)	88.6	83.2	88.5	102.5
DPS (INR)	63.0	37.8	41.0	47.2
<b>Return ratios</b>				
Return on assets (%)	20.7	19.3	18.6	18.8
Return on equity (%)	22.4	21.4	21.0	21.1
Return on capital employed (%)	24.4	23.1	22.3	22.5
<b>Turnover ratios</b>				
Asset turnover (x)	3.4	3.3	3.3	3.4
Sales/Total assets (x)	1.0	0.9	0.9	0.9
Sales/Net FA (x)	5.2	4.9	5.0	5.3
Working capital/Sales (x)	0.1	0.1	0.1	0.1
Receivable days	60.8	68.0	69.0	70.0
<b>Liquidity ratios</b>				
Current ratio (x)	4.7	4.6	4.6	4.7
Quick ratio (x)	4.7	4.6	4.6	4.7
Dividend cover (x)	1.5	2.8	2.9	2.9
Net debt/Equity (%)	(61.0)	(61.7)	(61.9)	(62.5)
<b>Valuation</b>				
PER (x)	24.5	21.8	19.5	16.9
PEG (x) - y-o-y growth	1.9	1.8	1.6	1.1
Price/Book (x)	5.5	4.7	4.1	3.6
Yield (%)	2.8	1.7	1.8	2.1
EV/Net sales (x)	4.6	4.2	3.6	3.1
EV/EBITDA (x)	17.3	15.2	13.3	11.2
EV/EBIT (x)	19.2	16.4	14.4	12.1

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