

Stock Update

Mixed quarter, raised revenue guidance

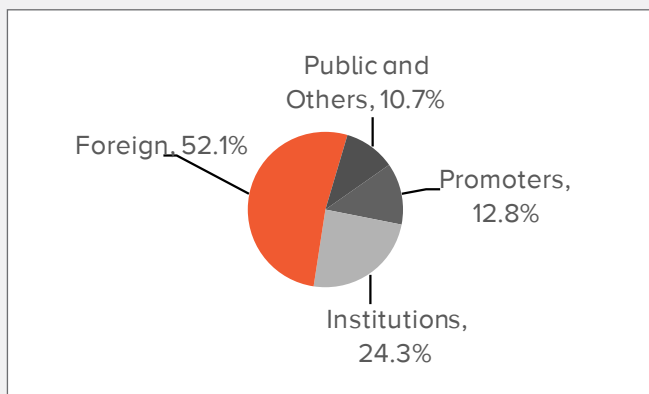
Infosys

Reco: Buy | CMP: Rs684

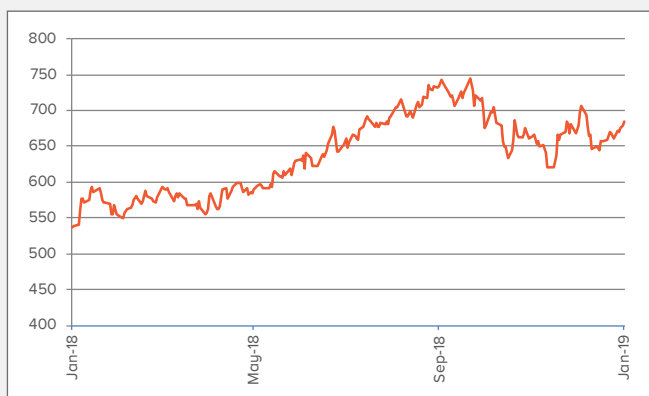
Company details

Price target:	Rs840
Market cap:	Rs298,684 cr
52-week high/low:	Rs754 / 526
NSE volume: (No of shares)	71.9 lakh
BSE code:	500209
NSE code:	INFY
Sharekhan code:	INFY
Free float: (No of shares)	380.8 cr

Shareholding pattern



Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	1.6	-1.9	5.6	33.8
Relative to Sensex	-1.7	-5.8	5.4	26.0

Key points

- ♦ **Another quarter of robust revenue performance, strong deal TCVs:** Infosys delivered yet another quarter of strong revenue growth in a seasonally weak quarter, beating street's estimates during Q3FY2019. The company reported constant currency (CC) revenue growth of 2.7% q-o-q/10.1% y-o-y (returned to double-digit growth after 10 quarters, though it includes 30 BPS incremental revenue from Fluidio's acquisition). Beat in CC revenue growth was primarily led by strong growth in financial services (3.6% q-o-q on CC), energy and utilities (7.4% q-o-q) and manufacturing (7.6% q-o-q). Europe (3.8% q-o-q) and North America (2.6% q-o-q) led the growth during the quarter. Digital revenue grew by 5% q-o-q on CC basis (31% y-o-y on USD basis), while core services revenue growth accelerated to 1.8% in Q3FY2019 (versus 0.5% in Q2FY2019). Blended realisation declined marginally by 0.1% q-o-q during the quarter, while volumes grew by 2.6% q-o-q despite furloughs. On a reported basis, U.S. revenue increased by 2.2% q-o-q to \$2,987 million, ahead of our estimates. Infosys won 14 large deals during the quarter, with TCVs of \$1.57 billion (taking total deal TCVs of \$4.7 billion in 9MFY2019), of which 30% are net new TCVs.
- ♦ **Margins below estimates owing to accelerated investments:** EBIT margin declined by 118 BPS q-o-q to 22.6% (lower than our estimates) despite rupee tailwind (+50 BPS) and operational efficiencies (+40 BPS), owing to lower utilisation (-80 BPS), catch-up in compensation (-30 BPS), increased sales investments (-30 BPS), acquisition impact (-20 BPS) and de-classification of Skava and Panaya (incurred additional depreciation expenses of \$12 million during the quarter, an impact of negative 40 BPS). Management expects Q4FY2019E margin to be impacted by rupee appreciation, continued sales investments, targeted compensation correction and transition of large deals. Given the one-time expenses (declassification of Skava and Panaya resulted in Rs. 451 crore of expenses), reported net income declined by 12% q-o-q to Rs. 3,609 crore. Adjusting the one-time expenses, net profit during the quarter declined by 1.2% q-o-q, in line with our estimates.
- ♦ **Raised revenue growth guidance, retains margin guidance:** With strong performance in 9MFY2019 (8.1% y-o-y on CC basis), acceleration in deal wins and strong demand environment in select verticals, Infosys has increased CC revenue growth guidance to 8.5-9.0% y-o-y (higher than our expectations) from 6-8%. The upward revision

of guidance indicates the signs of progress of its strategies. Infosys outlined investments of 100 BPS at the beginning of FY2019 into sales, digital competencies, localisation and employee reskilling; and now management does not see any incremental investments in these areas in the medium term. Management has retained its margin guidance band at 22-24%, despite EBIT margin of 23.3% in 9MFY2019. Margin is expected to remain under pressure in Q4FY2019 on account of continued investments.

- ♦ **Digital momentum to continue albeit flat client budget:** Management mentioned that the client's budget for CY2019 would be flat on a y-o-y basis. On the vertical front, BFSI is expected to continue its growth momentum on account of market share gains in top accounts, adoption of new technologies among large banking clients, ramp-up of large deals and new logo wins, though management indicated slowdown in buy-side firms owing to drop in AUM. Digital revenue is expected to maintain its strong momentum given robust demand for cloud, SaaS, digital studio, analytics and IoT. Given strong deal wins, strengthening relationships with large clients and continued digital momentum, we believe Infosys is well positioned to catch up with leaders on revenue growth in FY2020E.

- ♦ **Approved buyback of worth Rs. 8,260 crore:** Infosys announced buyback of Rs. 8,260 crore (approximately \$1.1 billion) under the open market route at a price of Rs. 800 per share (a 17% premium to the last closing price of Rs. 684). Effectively, the company will buyback around 10.3 crore shares, represents 2.4% of total outstanding shares. Along this share buyback, the company has announced a special dividend, which would result in payout of approximately Rs. 2,107 crore (\$302 million). Management had announced its intention of \$2 billion additional payout in FY2019, of which \$400 million has been paid as special dividend.

- ♦ **Valuation: Maintain Buy with a PT of Rs. 840:** We have tweaked our earnings estimates for FY2019E/FY2020E/FY2021E, factoring in lower-than-expected margin that is being largely offset with increased revenue guidance in FY2019E and improving business visibility. At the CMP, the stock is trading at 16.4x/15.1x its FY2020/FY2021E earnings estimates. With robust TCV signings and improving business visibility, we believe Infosys is gradually catching up in revenue growth with TCS. Hence, we believe the discount with TCS will gradually reduce going forward. Thus, we maintain our Buy rating on the stock with an unchanged price target (PT) of Rs. 840.

Valuations

	Rs cr				
Particulars	FY17	FY18	FY19E	FY20E	FY21E
Total revenue	68,484.0	70,522.0	82,898.9	92,563.3	1,01,387.5
EBITDA margin (%)	24.7	24.3	23.3	23.9	24.0
Net profit	14,357.0	14,597.0	16,106.1	18,430.6	20,091.7
EPS (Rs.)	33.0	33.6	36.0	42.4	46.2
P/E (x)	20.7	20.4	19.0	16.1	14.8
EV/EBITDA (x)	6.7	6.9	6.4	5.6	5.0
RoE (%)	22.0	23.9	25.4	31.3	33.2
RoCE (%)	30.5	30.2	35.0	41.8	44.7

Results

	Rs cr				
Particulars	Q3FY19	Q3FY18	Q2FY19	YoY (%)	QoQ (%)
Revenue (\$ mn)	2,987.0	2,755.0	2,921.0	8.4	2.3
Net sales	21,400.0	17,794.0	20,609.0	20.3	3.8
Direct costs	13,436.0	10,952.0	12,817.0	22.7	4.8
Gross profit	7,964.0	6,842.0	7,792.0	16.4	2.2
SG&A	2,554.0	2,025.0	2,434.0	26.1	4.9
EBITDA	5,410.0	4,817.0	5,358.0	12.3	1.0
Depreciation & amortisation	580.0	498.0	464.0	16.5	25.0
EBIT	4,830.0	4,319.0	4,894.0	11.8	-1.3
Other income	302.0	962.0	739.0	-68.6	-59.1
PBT	5,132.0	5,281.0	5,633.0	-2.8	-8.9
Tax provision	1,522.0	152.0	1,523.0	901.3	-0.1
Reported net profit	3,610.0	5,129.0	4,110.0	-29.6	-12.2
Adjusted net profit	4,060.0	5,129.0	4,110.0	-20.8	-1.2
EPS (Rs)	9.3	11.8	9.5	-20.8	-1.2
Margin (%)				BPS	BPS
EBITDA	25.3	27.1	26.0	-179	-72
EBIT	22.6	24.3	23.7	-170	-118
NPM	16.9	28.8	19.9	-1,196	-307

Revenue mix: Geographies, industry verticals and other operating metrics

Particulars	Revenues	Contribution	\$ Growth (%)		CC growth (%)
	(\$ mn)	(%)	q-o-q	y-o-y	q-o-q
Revenues (\$ mn)	2,987	100	2.3	8.4	2.7
Geographic mix					
North America	1,804	60.4	2.4	8.4	2.6
Europe	723	24.2	3.1	7.5	3.8
India	78	2.6	6.3	-6.0	5.2
Rest of world	382	12.8	-0.8	13.8	0.8
Industry verticals					
Financial services	971	32.5	3.2	7.4	3.6
Retail	490	16.4	-0.2	9.8	-0.1
Communication	355	11.9	-1.1	4.0	-0.5
Energy, utilities, resources & services	382	12.8	6.4	15.6	7.4
Manufacturing	302	10.1	7.6	14.1	7.6
Hi tech	218	7.3	-0.5	9.9	0.6
Life sciences	185	6.2	-0.9	1.9	0.0
Others	84	2.8	-1.3	-5.1	-1.3
Service line					
Service	2,823	94.5	1.8	8.2	2.2
Digital	875	29.3	3.7	30.7	4.3
Core	1,948	65.2	1.0	0.4	1.3
Products and platforms	152	5.1	2.3	4.3	12.1
Digital	66	2.2	7.1	32.5	12.0
Core	99	3.3	12.5	2.2	12.1
Total	2,987	100.0	2.2	8.4	2.7
Digital	942	31.5	4.1	31.0	5.0
Core	2,045	68.5	1.4	0.4	1.8
Clients Contribution					
Top client	102	3.4	-10.9	8.4	-
Top 10 clients	574	19.2	1.2	8.4	-
Top 25 clients	1,013	33.9	-0.1	4.1	-
Revenue per employee					
Revenue per FTE (\$ K)	54.3	-	0.0	0.0	-
Deal wins (\$ mn)					
TCV	1,570	-	-22.6	101.5	-

Client metrics

Particulars	Q4FY17	Q1FY18	Q2FY18	Q3FY18	Q4FY18	Q1FY19	Q2FY19	Q3FY19
Number of active clients	1,162	1,164	1,173	1,191	1,204	1,214	1,222	1,251
New clients added	71	59	72	79	73	70	73	101
Repeat business (%)	96.2	99.4	98.7	98.3	97.6	99.5	98.2	96.6
DSO	68	68	71	70	67	66	66	67
\$1 mn clients +	598	606	620	630	634	627	633	651
\$10 mn clients +	189	190	186	198	198	200	205	214
\$50 mn clients +	56	56	55	56	57	56	58	59
\$100 mn clients +	19	18	19	20	20	24	23	23

Realization matrices

Particulars	Q4FY17	Q1FY18	Q2FY18	Q3FY18	Q4FY18	Q1FY19	Q2FY19	Q3FY19
Billing rate (\$/manyar)								
Onsite	1,42,870	1,44,555	1,47,349	1,46,023	1,48,359	1,48,063	1,47,767	1,47,176
Offshore	46,661	47,728	48,975	49,260	49,753	48,559	48,947	48,262
Blended	75,492	76,833	77,865	77,351	78,133	75,163	74,051	73,262
Billing rate (q-o-q) - reported								
Onsite	-0.5	1.2	1.9	-0.9	1.6	-0.2	-0.2	-0.4
Offshore	-0.4	2.3	2.6	0.6	1.0	-2.4	0.8	-1.4
Blended	-0.2	1.8	1.3	-0.6	1.0	-1.3	-0.1	-0.5
Billing rate (q-o-q) - CC								
Onsite	-1.1	0.6	1.0	-1.1	0.4	1.1	0.8	0.0
Offshore	-1.3	1.9	2.4	0.4	-0.2	-1.1	1.7	-1.0
Blended	-0.9	1.3	0.7	-0.9	-0.2	0.0	0.9	-0.1

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