

Infosys Ltd.



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Growth at the expense of margin

CMP INR 748	Target INR 761	Potential Upside 1.7%	Market Cap (INR Mn) 3,267,960	Recommendation HOLD	Sector IT Services
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Result highlights

Revenue in constant currency terms grew 11.7% yoy to USD 3,060mn in Q4 FY19 (up 2.1% qoq) which was above our estimates of \$3,031 mn. The revenue growth was supported by improvement in global IT spending environment across key verticals, especially Communications and Healthcare. Operating margin of 21.4% in Q4 FY19 was down 113 bps qoq (down 191 bps yoy) impacted by higher direct cost % of revenue.

• **By Geography:** North America remained strong with 3.7% qoq in revenue on CC basis while Europe business advanced 1.4% qoq. 4QFY19 revenue from India/rest of the world declined 9.1%/1.3% qoq, respectively.

• **By Industry:** BFSI remained under pressure with revenue on cc basis down 0.8% qoq while Retail declined 0.9% qoq. However, Communication vertical saw a robust growth of 16.6% qoq.

• **By offering:** Digital Revenues (33.8% of total business) registered a strong 9.7% qoq growth (+41% yoy) while the Core business was down 1.4% qoq on CC basis. Products and platform saw a modest 0.3% qoq growth and accounted for 5.4% of total business in 4QFY19.

MARKET DATA

Shares outs (Mn)	4,369
Equity Cap (INR Mn)	65,006
Mkt Cap (INR Mn)	3,267,960
52 Wk H/L (INR)	774/542
Volume Avg (3m K)	8,040
Face Value (INR)	5
Bloomberg Code	INFO IN

KEY FINANCIALS

Particulars (INR Crores)	FY17	FY18	FY19	FY20E	FY21E
Net Sales	68,485	70,522	82,676	90,123	97,545
EBIT	16,902	17,148	18,879	19,942	21,460
PAT	14,353	16,028	15,404	16,731	17,595
EPS	31.39	35.50	35.38	38.43	40.42
EBIT Margin	24.7%	24.3%	22.8%	22.1%	22.0%
NPM	21.0%	22.7%	18.6%	18.6%	18.0%

Source: Company, KRChoksey Research

Margin pressure more serious than expected

While topline growth (high single digits) is comforting, Infosys is struggling to arrest its margin downtrend. 4Q FY19 operating margin at 21.4% was down 113bps q/q (down 191bps y/y) and was impacted by higher direct cost % of revenue. Utilization levels (ex-Trainees) slipped to 82.3% in 4Q FY19 vs. 83.8% in 3Q FY19 while Revenue per employee stood at USD 54K in 4Q FY19 vs. USD 54.3K in previous quarter. Elevated attrition levels continue (20.4% in 4Q19 vs. 19.9% in 3QFY19 and 19.5% in 4QFY18) which further casts shadow on its margin outlook. While business mix is changing more towards product & platforms (5.4% of total revenue in 4QFY19 vs. 4.9% in 4QFY18), the benefits are yet to translate into material margin expansion. Challenges over H1B visa has also led to higher offshore attrition, especially among 3-5 years experienced employees, as employees exit due to limited mobility option to onsite.

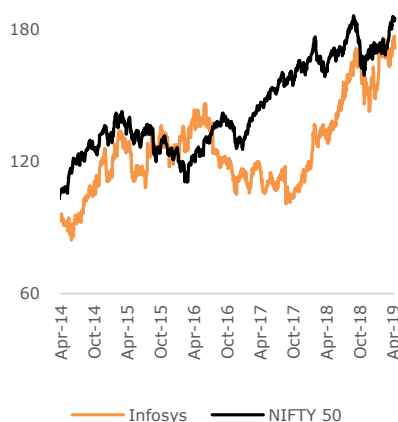
New business traction continues indicating healthy demand recovery

Infosys added 101 new clients during the quarter with large deal TCV over USD 1.5bn indicating that the deal win scenario remained healthy. Digital business remain the key growth area for Infosys (33.8% of 4QFY19 revenue vs. 31.5% in 3Q FY19) with demand primarily in the areas of cloud, data analytics and IoT. Repeat business, however, declined to 95.2% in 4Q FY19 vs. 96.6% in 3Q FY19 (and 97.6% in 4Q FY18) as new deals start contributing to top line growth.

Digital growth to come at a high cost ; conservative guidance

On the guidance front, management expects top line growth of 7.5%-9.5% for FY20 while EBIT margin guidance of 21%-23% is essentially a cut by 100bps. We believe this is a conservative approach by the management primarily due to: (1) investments in digital services (and training) to drive growth, (2) H1-B visa fallout and increase in onsite hiring and wage revision; and (3) Business development costs on digital and localization to tap emerging market opportunities. In our view, the company's digital growth is clearly coming at a higher cost base and margin contraction is the key risk to investment.

SHARE PRICE PERFORMANCE

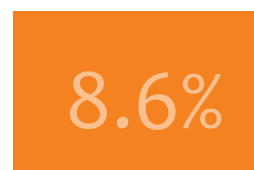


MARKET INFO

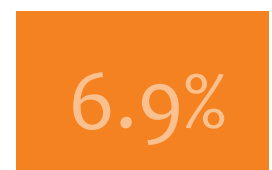
SENSEX	38,767
NIFTY	11,643

SHARE HOLDING PATTERN (%)

Particulars	Dec 18	Sep 18	Jun 18
Promoters	12.82	12.82	12.90
FIIIs	34.46	35.05	34.87
DIIIs	22.40	22.01	22.37
Others	30.32	30.12	29.86
Total	100	100	100



Revenue CAGR between FY19 and FY21E



PAT CAGR between FY19 and FY21E

ANALYST

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Key Concall Highlights: (i) Management indicated at weakness in BFSI vertical led by M&A activities and leadership changes (at regional banks and Insurance). Challenges were also highlighted for manufacturing vertical in Europe. Management indicated that weakness in Healthcare/Life Sciences is expected to play out in FY20 (ii) In terms of capital allocation, the board has decided to pay a final dividend of INR 10.5 per share taking total FY19 DPS to INR 21.5 per share (which includes a special dividend of INR 4.0 per share and interim dividend of INR 7.5 per share) (iii) Share buyback plan started in March, 2019 of which INR 1546 cr. worth of shares have been bought back out of the total buyback size of INR 8,260 cr. indicating that only c.19% of cash were used. (iv) Wage revision for 85% of employees in 1QFY20 and remaining 15% of workforce in 2QFY20; with an average 6% and 1.5% increment for offshore and onsite employees, respectively.

Valuation and view

We expect the company to generate a topline growth of 9.0%/8.2% in FY20E/FY21E owing to the strong digital business growth supported by a revival in global IT spending (expected to increase 3.5%/2.8% in CY20E/21E). We expect contribution from the new business (deal wins with TCV of USD 1.6bn in 4QFY19) and Stater acquisition to drive top line growth. Partially offsetting this growth will be a weakness in its core business revenue. On the margin front, we expect investments towards scaling digital offerings and increased localization to continue to negatively impact the operating margin in FY20E. However, we expect the company's buy back plan (~80% allocated capital left unutilized) to act as a support for the stock price. **Infosys is currently trading at a P/E multiple of 19.5x/18.5x on FY20E/FY21E earnings. We conservatively apply a P/E multiple of 19.8x to the FY20 estimated EPS of INR 38.4 to arrive at a revised target price of INR 761 per share, an upside of 2% over the CMP. Accordingly, we reiterate our HOLD rating.**

KEY FINANCIALS

Exhibit 1: Profit & Loss Statement

INR Crores	FY 17	FY 18	FY 19	FY 20E	FY 21E
Revenues	68,485	70,522	82,676	90,123	97,545
Cost of sales	43,253	45,131	53,868	59,547	64,575
Gross profit	25,232	25,391	28,808	30,576	32,970
Selling and marketing expenses	3,591	3,558	4,475	4,867	5,267
Administrative expenses	4,739	4,685	5,454	5,768	6,243
Opex	8,330	8,243	9,929	10,635	11,510
Operating profit	16,902	17,148	18,879	19,942	21,460
D&A	1,703	1,863	2,011	2,163	2,171
EBITDA	18,605	19,011	20,890	22,105	23,630
Other income, net	3,079	3,193	2,883	3,000	3,000
Pretax Income	19,951	20,270	21,041	22,942	24,460
Adjusted Pretax Income	19,951	20,270	21,041	22,942	24,460
Income tax expense	5,598	4,242	5,631	6,194	6,849
Minority interest	-	-	60	160	160
Net profit	14,353	16,028	15,404	16,731	17,595
Adjusted Net profit	14,353	16,028	15,404	16,731	17,595
Diluted EPS (INR)	31.4	35.5	35.4	38.4	40.4
Adjusted Diluted EPS (INR)	31.4	35.5	35.4	38.4	40.4
No. of Shares (mn) - Diluted	4,573	4,515	4,353	4,353	4,353

Source: Company, KRChoksey Research

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Exhibit 2: Balance Sheet

INR Crores	FY17	FY18	FY19	FY20E	FY21E
Assets					
Cash and equivalents	2,263	1,982	1,957	2,946	3,954
Available-for-sale financial assets/current investments	997	641	663	663	663
Trade receivables	1,232	1,314	1,483	1,631	1,761
Unbilled Revenues	365	426	537	537	537
Other Current Assets	514	639	648	648	648
Total current assets	5,371	5,002	5,288	6,425	7,563
Property, plant and equipment	1,172	1,214	1,336	1,267	1,294
Goodwill	365	221	354	354	354
Intangible assets	78	25	69	69	69
Other non current assets	1,351	1,527	1,427	1,427	1,427
Total non-current assets	2,965	2,987	3,186	3,117	3,144
Total Assets	8,336	7,989	8,474	9,542	10,707
Liabilities and equity					
Trade payables	37	69	166	168	182
Unearned revenue	178	230	281	281	281
Other Current liabilities	1,187	1,112	1,417	1,417	1,417
Total current liabilities	1,401	1,411	1,864	1,867	1,880
Non-current liabilities	36	86	109	109	109
Total liabilities	1,437	1,497	1,973	1,976	1,990
Share capital	114	109	217	217	217
Share premium	236	19	40	40	40
Retained earnings	6,506	6,124	5,885	6,948	8,098
Others	43	241	353	353	353
Total Equity holders of the company	6,898	6,492	6,495	7,558	8,708
Non-controlling interests	-	0	6	7	9
Total Equity	6,898	6,492	6,501	7,566	8,717
Total liabilities and equity	8,336	7,989	8,474	9,542	10,707

Source: Company, KRChoksey Research

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Exhibit 3: Free Cash Flow Analysis

INR Crores	FY17	FY18	FY19	FY20E	FY21E
Net Cash Generated From Operations	1,406	1,456	1,584	1,746	1,862
Net Cash Flow from/(used in) Investing Activities	(1,707)	311	(158)	(225)	(244)
Net Cash Flow from Financing Activities	(694)	(2,051)	(1,451)	(532)	(609)
Net Inc/Dec in cash equivalents	(995)	(284)	(25)	989	1,009
Opening Balance	3,270	2,263	1,987	1,957	2,946
Closing Balance Cash and Cash Equivalents	2,263	1,987	1,957	2,946	3,954

Source: Company, KRChoksey Research

Exhibit 4: Ratio Analysis

Key Ratio	FY17	FY18	FY19	FY20E	FY21E
EBIT Margin (%)	24.7%	24.3%	22.8%	22.1%	22.0%
Tax rate (%)	28.1%	20.9%	26.8%	27.0%	28.0%
Net Profit Margin (%)	21.0%	22.7%	18.6%	18.6%	18.0%
RoE (%)	20.8%	0.0%	23.7%	22.1%	20.2%
RoCE (%)	24.4%	26.1%	28.6%	26.0%	24.3%
Current Ratio (x)	3.83x	3.55x	2.84x	3.44x	4.02x
EPS (INR per share)	31.39	35.50	35.38	38.43	40.42

Source: Company, KRChoksey Research

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Infosys Ltd.				Rating Legend	
Date	CMP (INR)	TP (INR)	Recommendation	Our Rating	Upside
15-Apr-19	748	761	HOLD	Buy	More than 15%
16-Apr-18	1,171	1,184	HOLD	Accumulate	5% – 15%
15-Jan-18	1079	1,187	ACCUMULATE	Hold	0 – 5%
14-July-17	972	1,158	BUY	Reduce	-5% – 0
13-Apr-17	931	1,060	ACCUMULATE	Sell	Less than – 5%
13-Jan-17	971	1,074	ACCUMULATE		
18-Oct-16	1,022	1,123	ACCUMULATE		

ANALYST CERTIFICATION:

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