

Sector: IT & ITES
Results update

	Change
Reco: Buy	↔
CMP: Rs. 727	
Price Target: Rs. 840	↔

↑ Upgrade ↔ No change ↓ Downgrade

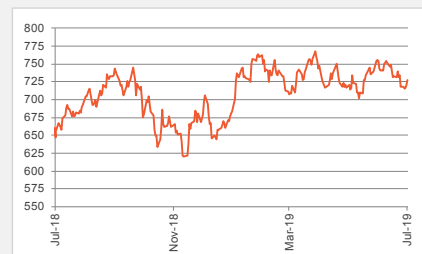
Company details

Market cap:	Rs. 312,293 cr
52-week high/low:	Rs. 773 / 600
NSE volume: (No of shares)	78.1 lakh
BSE code:	500209
NSE code:	INFY
Sharekhan code:	INFY
Free float: (No of shares)	380.8 cr

Shareholding (%)

Promoters	12.8
FII	52.1
DII	24.3
Others	10.8

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	-3.1	-1.5	7.6	12.6
Relative to Sensex	-0.5	-2.5	-0.8	4.0

Sharekhan Research, Bloomberg

Infosys delivered in-line revenue performance, with acceleration in y-o-y revenue growth (12.4%) on constant currency (CC) terms. Revenue growth was driven by strong performance in communication, financial services and North America. Further, digital business (35.7% of its total revenue) continued its strong growth momentum of 41.9% on CC terms. EBIT margin declined by 93 BPS q-o-q to 20.5%, above our estimates, owing to rupee appreciation, wage revision, visa costs and impact from Starter's acquisition. The company signed 13 deals worth \$2.71 billion (highest ever in its history). Management has raised its revenue growth guidance to 8.5-10.0% in CC from 7.5-9.5% earlier, better than our expectation of keeping guidance flat. We believe there would be steady improvement in EBIT margin from Q2FY2020E, as the company would derive benefits from the completion of investments that outlined last year. We maintain our Buy rating on the stock with a price target (PT) of Rs. 840.

Key positives

- ◆ TCV wins of \$2.71 billion (record high for Infosys) in Q1FY2020 on top of \$1.56 billion in Q4FY2019
- ◆ Raised FY2020E guidance to 8.5-10.0% in CC from 7.5-9.5% earlier
- ◆ Strong digital growth at 41.9% y-o-y
- ◆ Raised cash return plan to 85% of FCF from 70% earlier

Key negatives

- ◆ Attrition further increased to 21.5% from 18.3% owing to seasonality and involuntary attrition
- ◆ Q1FY2020 margins remained below its guided range

Our Call

Valuation – Maintain Buy with a PT of Rs. 840: We have fine-tuned our earnings estimates for FY2020E/FY2021E on account of better-than-expected margin performance, which is partially offset by change in USD/INR rate. At the CMP, the stock is trading at 19x/17x its FY2020E/FY2021E earnings estimates. With robust TCV signings, healthy deal pipeline and impressive key client metrics, we believe Infosys would catch up in revenue growth with leading peers in FY2020E and margins should see improvement from Q2FY2020E. Thus, we maintain our Buy rating on the stock with an unchanged PT of Rs. 840.

Key Risks

Rupee appreciation and/or adverse cross-currency movements, slackening pace in deal closures and/or constraint in local talent supply in the U.S. along with stringent visa regime would have an adverse impact on its earnings.

	Rs cr				
Valuation					
Particulars	FY17	FY18	FY19	FY20E	FY21E
Revenue	68,484.0	70,522.0	82,675.0	89,988.8	1,00,614.2
OPM (%)	27.2	27.0	25.3	24.5	25.0
Adjusted PAT	14,357.0	14,597.0	15,862.0	16,311.3	18,634.3
% YoY growth	6.4	1.7	8.7	2.8	14.2
Adjusted EPS (Rs.)	31.8	32.4	35.4	38.1	43.6
P/E (x)	22.8	22.5	20.5	19.1	16.7
P/B (x)	2.4	2.6	2.6	2.6	2.6
EV/EBITDA (x)	7.2	7.4	6.7	6.6	5.7
RoNW (%)	22.0	23.9	23.7	25.3	29.0
RoCE (%)	30.5	30.2	32.2	34.1	38.9

Source: Company; Sharekhan estimates

Revenue in-line, margin beats estimates

Infosys delivered in-line revenue growth during Q1FY2020, with CC revenue growth of 2.8% q-o-q (includes 60 BPS Stater acquisition)/12.4% y-o-y (third consecutive quarter of double-digit growth). CC revenue growth was primarily led by broad-based growth across verticals, especially strong growth in financial services (11.3% y-o-y CC) and communication (22.6% y-o-y CC). On a reported basis, USD revenue increased by 2.3% q-o-q to \$3,131 million. EBIT margin declined by 93 BPS q-o-q to 20.5%, above our estimates. Factors that contributed to q-o-q margin decline were—(1) rupee appreciation impact of 40 BPS, (2) wage revision impact of 60 BPS, (3) visa cost impact of 80 BPS and (4) Stater acquisition impact of 40 BPS. These margin headwinds during Q1FY2020 were partially offset by utilisation improvement (+70 BPS), realisation (+20 BPS) and other operational efficiencies. Lower profitability along with higher tax rate (26.4% in Q1FY2020 vs. 22.8% in Q4FY2019) resulted in a 6.7% decline in net profit during the quarter.

Strong digital and solid operating metrics, while higher attrition remains a concern

Acceleration in y-o-y revenue growth was driven by digital business and strong growth in financial services, communication and North America. Digital business (35.7% of its revenue) reported strong CC revenue growth of 41.9% in Q1FY2020. Five out of seven business segments i.e., financial services (up 11.3% CC y-o-y), communication (up 22.6% CC y-o-y), energy and utilities (up 17.7% CC y-o-y), manufacturing (up 12.8% CC y-o-y) and hi-tech (up 14.6% CC y-o-y) grew in double digits during the quarter. Retail and life science vertical growth remained soft during the quarter. On the region front, North America and Europe reported strong growth of 13.5% and 11.4% on CC terms, respectively, in Q1FY2020. Client metrics remained strong – added two large accounts under \$100 million clients bucket during the quarter. Higher attrition rate at 21.5% in Q1FY2020 versus 18.3%/20.6% in Q4FY2019/Q1FY2019 remains a concern for the company, as it has taken multiple initiatives, including bonuses to arrest the attrition rate, though management highlighted that it was due to seasonality and involuntary attrition.

Large deal momentum continued

Infosys signed 13 deals during the quarter, with TCVs of \$2.71 billion (highest ever in its history) including Stater deal from ABN AMRO. The company won three deals each in the financial services and retail verticals, two deals each in communication, energy and utilities and manufacturing verticals and one deal in life sciences. Geography wise, the company signed eight deals in North America, four deals in Europe and one deal in RoW. The share of new deals to overall TCVs stood at about 55%.

Raised revenue growth guidance, except margin recovery from Q2FY2020

Infosys' management has raised its FY2020E revenue growth guidance to 8.5-10.0% in CC from 7.5-9.5% earlier, better than our as well as street's expectation of keeping guidance flat. The company requires CQGR of 1.5-2.4% to achieve its growth guidance. Management highlighted that strong deal wins along with healthy deal pipeline and robust digital momentum provide the confidence to increase revenue guidance. Further, management believes growth would be aided by financial services (Stater's acquisition, deal wins and digital transformation in wealth management), retail (large deal wins and new logo wins), communication (ramp up of deal wins earlier) and energy (continued growth in top account and new account opening). However, management witnessed softness in capital market segment in Europe and U.S., manufacturing and healthcare vertical. On the margin front, the company maintained its FY2020E operating margin guidance at 21-23% despite lower EBIT margin (20.5%) in Q1FY2020E. We believe there would be steady improvement in EBIT margin from Q2FY2020E, as the company would derive benefits from the completion of investments that outlined last year. Further, key levers for margin expansion are utilisation, automation and onsite pyramid structure.

Results

	Rs cr				
Particulars	Q1FY20	Q1FY19	Q4FY19	y-o-y (%)	q-o-q (%)
Revenue (\$ mn)	3,131.0	2,831.0	3,060.0	10.6	2.3
Net sales	21,803.0	19,128.0	21,539.0	14.0	1.2
Direct costs	14,098.0	11,852.0	13,752.0	19.0	2.5
Gross profit	7,705.0	7,276.0	7,787.0	5.9	-1.1
SG&A	2,553.0	2,303.0	2,638.0	10.9	-3.2
EBITDA	5,152.0	4,973.0	5,149.0	3.6	0.1
Depreciation & amortisation	681.0	436.0	531.0	56.2	28.2
EBIT	4,471.0	4,537.0	4,618.0	-1.5	-3.2
Other income	696.0	456.0	665.0	52.6	4.7
PBT	5,167.0	4,993.0	5,283.0	3.5	-2.2
Tax provision	1,365.0	1,381.0	1,205.0	-1.2	13.3
Reported net profit	3,802.0	3,612.0	4,074.0	5.3	-6.7
Adjusted net profit	3,802.0	3,612.0	4,074.0	5.3	-6.7
EPS (Rs.)	8.8	8.3	9.4	6.3	-5.8
Margin (%)				BPS	BPS
EBITDA	23.6	26.0	23.9	-237	-28
EBIT	20.5	23.7	21.4	-321	-93
NPM	17.4	18.9	18.9	-145	-148

Source: Company; Sharekhan Research

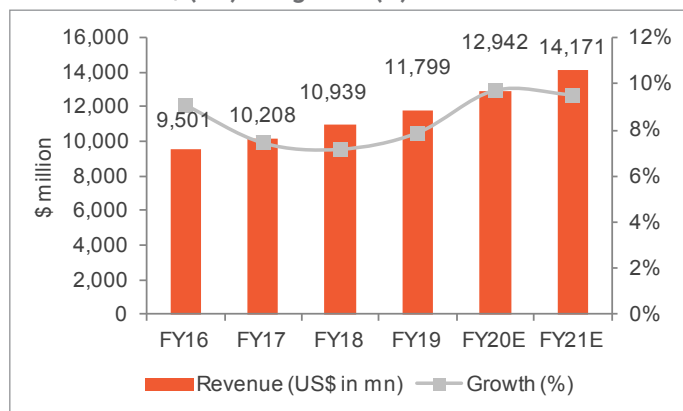
Revenue mix: Geographies, industry verticals and other operating metrics

Particulars	Revenues	Contribution	\$ Growth (%)		CC growth (%)
	(\$ mn)	(%)	q-o-q	y-o-y	y-o-y
Revenue (\$ mn)	3,131	100	2.3	10.6	12.4
Geographic mix					
North America	1,929	61.6	3.0	13.5	13.5
Europe	739	23.6	0.6	7.4	11.4
India	72	2.3	2.3	-2.2	1.2
Rest of world	391	12.5	2.3	5.5	11.0
Industry verticals					
Financial services	983	31.4	1.7	9.2	11.3
Retail	495	15.8	1.7	5.3	6.9
Communication	432	13.8	4.6	20.2	22.6
Energy, utilities, resources & services	407	13.0	4.7	15.9	17.7
Manufacturing	301	9.6	-1.8	10.6	12.8
Hi tech	241	7.7	2.3	15.1	14.6
Life sciences	191	6.1	4.0	2.2	4.3
Others	81	2.6	2.3	-0.8	-1.1
Service line					
Digital	1,119	35.7	8.1	39.4	41.9
Core	2,012	64.3	-0.6	-0.8	0.6
Clients Contribution					
Top client	100	3.2	-0.8	-4.3	-
Top 10 clients	626	20.0	3.9	15.2	-
Top 25 clients	1,093	34.9	2.0	10.6	-
Revenue per employee					
Revenue per FTE (\$ K)	54.1	-	0.0	0.0	-
Deal wins (\$ mn)					
TCV	2,714	-	73.1	143.2	-

Source: Company; Sharekhan Research

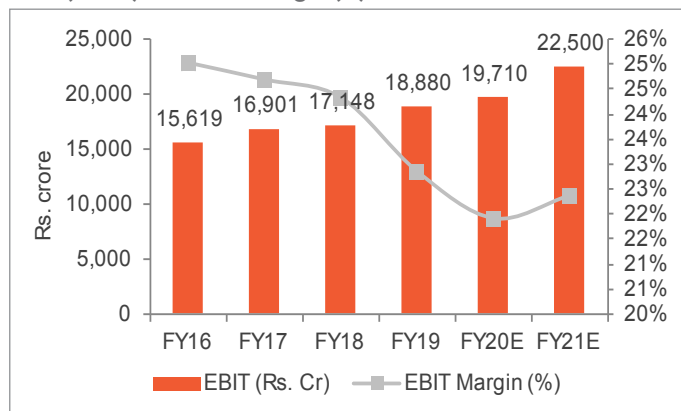
Financials in charts

Revenue in US\$ (mn) and growth (%)



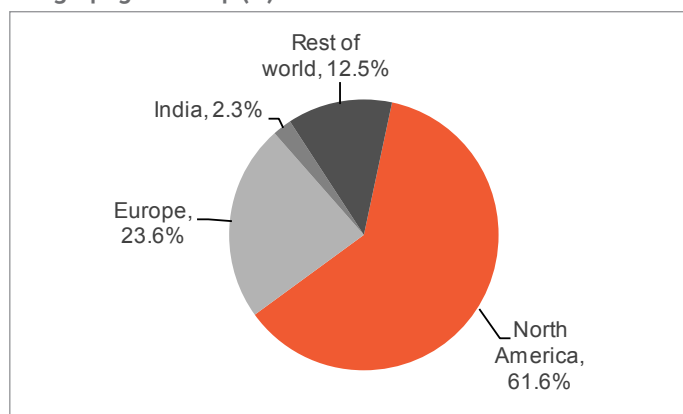
Source: Company, Sharekhan Research

EBIT (Rs. cr) and EBIT margin (%)



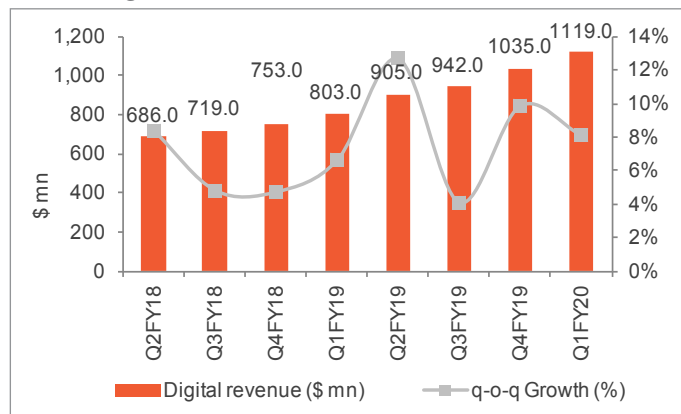
Source: Company, Sharekhan Research

Geography break-up (%)



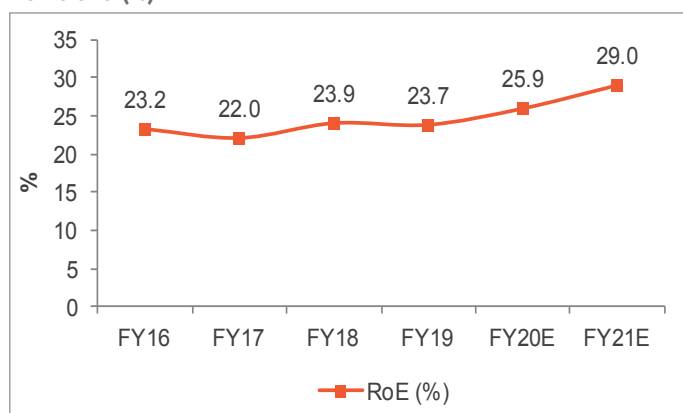
Source: Company, Sharekhan Research

Trend in digital revenue



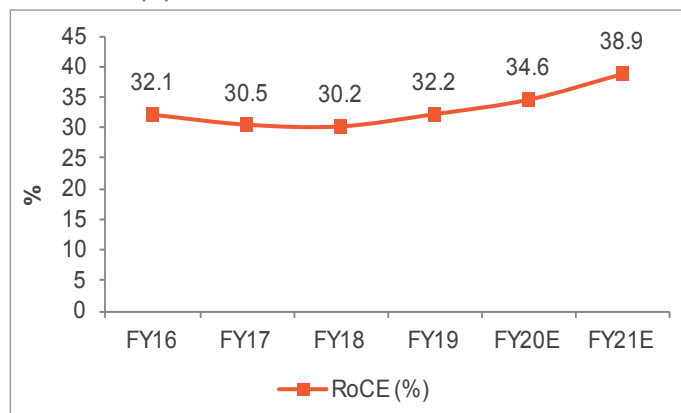
Source: Company, Sharekhan Research

RoE trend (%)



Source: Company, Sharekhan Research

RoCE trend (%)



Source: Company, Sharekhan Research

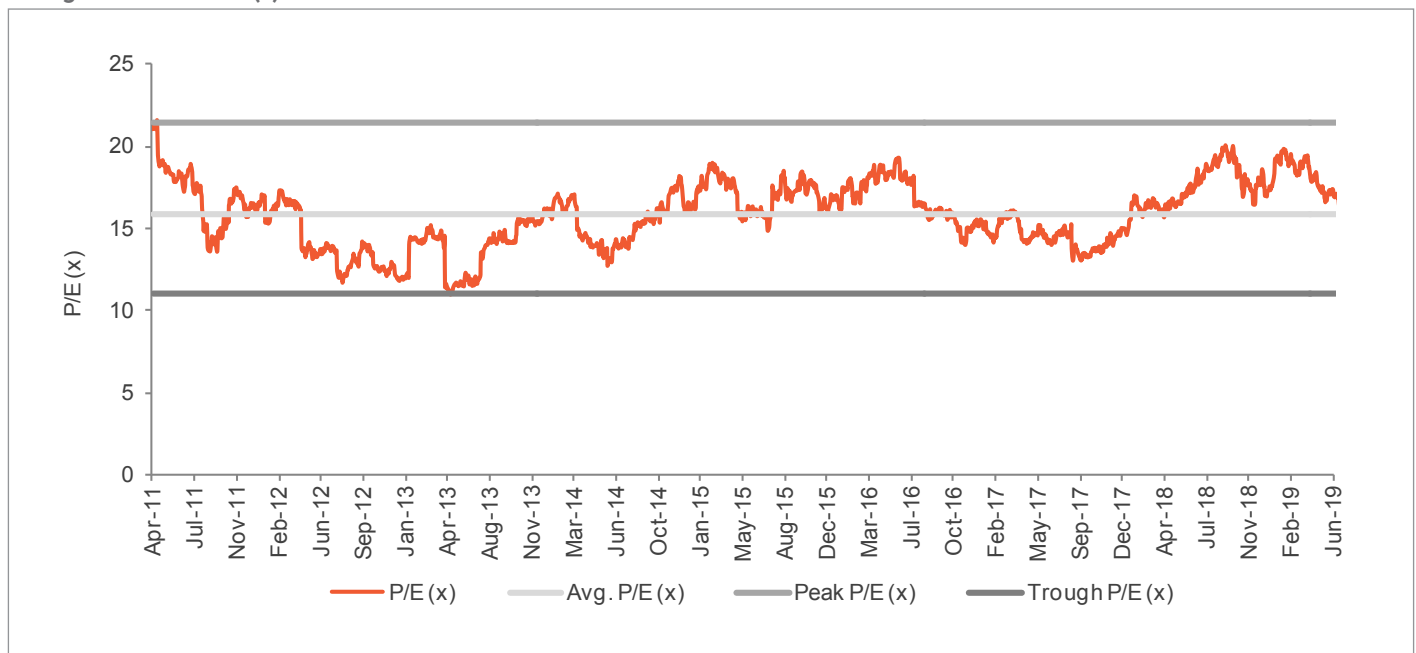
Outlook

Growth for Indian IT is expected to accelerate from current 6-7% as demand for digital services grows rapidly. India will continue to remain the preferred destination for talent supply and create a gradual shift of digital business from onsite. As a result, Infosys has aggressively invested in digital technologies to capture the large portion of upcoming digital spends. With recent strong deal wins, Infosys' revenue momentum is expected to catch up with leading peers going ahead. We expect Infosys' revenue growth momentum to sustain on account of investments in sale resources, enhancing capabilities in digital and robust deal wins, while profitability would be impacted in FY2020E owing to higher visa rejection, initiatives to control attrition rate and constraint in talent supply.

Valuation

We have fine-tuned our earnings estimates for FY2020E/FY2021E on account of better-than-expected margin performance, which will partially offset change in USD/INR rate. At the CMP, the stock is trading at 19x/17x its FY2020E/FY2021E earnings estimates. With robust TCV signings, healthy deal pipeline and impressive key client metrics, we believe Infosys would catch up in revenue growth with leading peers in FY2020E and margins should see improvement from Q2FY2020E. Thus, we maintain our Buy rating on the stock with an unchanged PT of Rs. 840.

One-year forward P/E (x) band



Source: Sharekhan Research

Peer valuation

Particulars	CMP (Rs / Share)	O/S Shares (Cr)	MCAP (Rs Cr)	P/E (x)		EV/EBIDTA (x)		P/BV (x)		RoCE (%)	
				FY20E	FY21E	FY20E	FY21E	FY20E	FY21E	FY20E	FY21E
HCL Tech	1,024	136	1,38,815	13.0	11.6	8.9	7.9	3.0	2.7	24.4	24.2
Wipro	2,108	375	7,90,984	23.4	21.4	17.6	15.8	8.0	7.2	35.6	35.4
TCS	259	603	1,56,279	15.5	14.0	10.2	9.1	2.1	1.9	17.4	17.5
Tech M	667	96	64,174	12.5	11.6	9.2	8.4	2.8	2.5	21.2	20.0
Infosys	727	429	312,293	19.1	16.7	13.4	11.7	2.6	2.6	25.3	29.0

Source: Company, Sharekhan Research

About company

Founded in 1981, Infosys is the second largest (\$11,799 million in FY2019) IT services company in India in terms of export revenue with 2.25 lakh number of headcounts. BFSI accounts for the largest chunk of revenue (~32.5% of total revenue), followed by retail, energy and utilities and manufacturing. Region wise, North America and Europe continue to be the mainstay. Digital revenue continued to have strong growth momentum in the past few quarters and now contributes 33.8% to total revenue.

Investment theme

Infosys has accelerated deal wins momentum through engagement with deal advisors, consulting firms and private equity players. Effectively, the strong large deal trajectory provides better revenue growth visibility. Further, revitalisation of sales and investment in digital competencies have certainly helped the company to drive its digital business. Sharp focus on execution and augmentation of digital capabilities through investments can bring Infosys back on its high growth trajectory. 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 coming years.

Key Risks

1) Regulatory visa norms could have an impact on employee expenses; 2) any instability in leadership; additional exits at senior management level; 3) rupee appreciation and/or adverse cross-currency movements; 4) increasing attrition rate; and 5) issue in certain industry pockets owing to macro uncertainties could impact revenue growth.

Additional Data

Key management personnel

Nandan M. Nilekani	Co-founder and Non-Executive Chairman
Salil Parekh	Chief Executive Officer
U.B. Pravin Rao	Chief Operating Officer (COO)
Nilanjan Roy	Chief Financial Officer
Ravi Kumar S	President, Deputy COO
Mohit Joshi	President, Head – BFSI & HCLS

Source: Company Annual Report

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Deutsche Bank Trust Co Americas	17.1
2	Life Insurance Corp of India	6.2
3	BlackRock Inc	4.8
4	Gopalakrishnan Senapathy	3.1
5	Vanguard Group Inc/The	3.0
6	HDFC Asset Management Co Ltd	2.9
7	SBI Funds Management Pvt Ltd	2.3
8	Republic of Singapore	2.0
9	ICICI Prudential Asset Management	1.7
10	Murthy Rohan	1.4

Source: Bloomberg

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