

Sector: IT & ITES
Result Update

	Change
Reco: Buy	↔
CMP: Rs. 816	
Price Target: Rs. 880	↔

↑ Upgrade
 ↔ No change
 ↓ Downgrade

Company details

Market cap:	Rs. 350,347 cr
52-week high/low:	Rs. 847/600
NSE volume: (No of shares)	80.7 lakh
BSE code:	500209
NSE code:	INFY
Sharekhan code:	INFY
Free float: (No of shares)	369.8 cr

Shareholding (%)

Promoters	13.2
FII	51.6
DII	24.5
Others	10.7

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	-5.6	9.2	5.5	15.2
Relative to Sensex	-7.4	10.7	6.6	4.4

Sharekhan Research, Bloomberg

Infosys delivered a mixed bag results during Q2FY2020, with revenues a tad below our estimates while margins remained ahead of our estimates. Constant currency (CC) revenue grew by 3.3% q-o-q/ 11.4% y-o-y (fourth consecutive quarter of double-digit growth), driven by strong growth in financial services, energy & utilities, manufacturing, communication and life-science. Organic growth stood at 2.4% q-o-q in CC terms during the quarter, which is higher against the CC revenue growth of TCS. Digital business (38.3% of its total revenue) continued its strong growth momentum of 38.4% on CC terms. EBIT margin improved 120bps q-o-q to 21.7% despite cross-currency impact, led by improvement in utilisation, pricing in digital, absence of visa expenses, lower onsite-mix and automation. The company signed 13 large deals worth \$2.8 billion (highest ever in its history) versus \$2.7 billion / \$2.0 billion in Q1FY2020/Q2FY2019. The management has raised the bottom-end of revenue growth guidance to 9.0-10.0% in CC from 8.5-10% earlier, in-line with our expectations, though this is the second upgrade in H1FY2020. Infosys has retained EBIT margin guidance band to 21-23% for FY2020E. Though attrition rate continues to remain elevated at 21.7%, it improved 210bps q-o-q.

Key Positives

- ◆ TCV wins of \$5.6 billion in 1HFY2020, up 77% y-o-y
- ◆ Raised the lower-end revenue growth guidance range to 9.0-10.0% in CC from 8.5-10.0% earlier
- ◆ EBIT margins beat our estimates, management retained EBIT margin guidance band at 21-23% for FY2020E
- ◆ Continued strong digital growth, up 38.4% y-o-y
- ◆ Attrition rate stood at 19.4% in Q2FY2020 versus 21.5% in Q1FY2020, a reduction of 210bps q-o-q

Key Negatives

- ◆ Retail & CPG y-o-y growth decelerated to 1.1% in Q2FY2020
- ◆ Excluding starter contribution, BFSI y-o-y growth remains weak

Our call

Valuation – Maintain Buy with a PT of Rs. 880: We have tweaked our earnings estimates for FY2020E/FY2021E on account of slight miss in revenue, offset by margins beat. Operating profitability is expected to remain in the guided range in FY2020E given the absence of incremental investments that outlined last year, holding down the subcontracting expenses and operational efficiencies. With robust TCV signings, healthy deal pipeline and integrated offerings, we believe Infosys would comfortably achieve the upper-end of its revenue growth guidance. At the CMP, the stock is trading at 21x/19x of its FY2020E/FY2021E earnings estimates, which is currently at a 9% discount to TCS. As Infosys is delivering strong performance on both revenue and margin front, we believe the discount to TCS would further narrow down going ahead. Hence, we maintain our Buy rating on the stock with an unchanged PT of Rs. 880.

Key risk: Rupee appreciation and/or adverse cross-currency movements, slackening pace in deal closures and/or constraint in local talent supply in the U.S. would have an adverse impact on its earnings.

Valuation

	Rs cr				
Particulars	FY17	FY18	FY19	FY20E	FY21E
Revenue	68,484.0	70,522.0	82,675.0	90,854.4	1,00,637.3
OPM (%)	27.2	27.0	25.3	24.8	25.0
Adjusted PAT	14,357.0	14,597.0	15,862.0	16,438.5	18,295.9
% YoY growth	6.4	1.7	8.7	3.6	11.3
Adjusted EPS (Rs.)	31.8	32.4	35.4	38.5	43.0
P/E (x)	25.6	25.2	23.0	21.2	19.0
P/B (x)	2.7	2.9	2.9	2.9	2.9
EV/EBITDA (x)	16.9	16.9	15.4	14.4	12.9
RoNW (%)	22.0	23.9	23.7	25.5	28.5
RoCE (%)	30.5	30.2	32.2	34.4	38.2

Source: Company; Sharekhan Research

Revenue miss, margin beat estimates

Infosys delivered a mixed bag of results in Q2FY2020, with revenue performance a tad below our estimates, while EBIT margins beat. The company's revenue grew by 3.3% q-o-q (includes inorganic revenue initiatives) and 11.4% y-o-y, a tad below our estimates. Organic revenue during the quarter grew by 2.4% in CC, which is higher than its largest peer. Except retail (15.2% of its total revenue), most of the key verticals grew double-digit on y-o-y basis during Q2FY2020. On a reported basis, USD revenue increased by 2.5% q-o-q to \$3,210 million. EBIT margin improved by 120bps q-o-q to 21.7%, ahead of our estimates, led by 110 bps tailwind from improving utilisation, lower onsite-mix and other cost optimisation measures and 110 bps tailwind from absence of visa expenses. These margin tailwinds during the quarter were partially offset by wage hike for middle management (70 bps) and other costs (30bps). Net profit of Rs. 4,019 crore (+5.8% q-o-q, -2.2% y-o-y) was 1.4% ahead of our estimate aided by improved profitability.

Restricted to raise upper-end of growth guidance owing to weak seasonality

Infosys' management has upgraded the lower-end of its FY2020E revenue growth guidance band to 9-10.0% in CC from 8.5-10.0% earlier, which is in-line with our estimates. Assuming the cross-currency impact for full-year at current exchange rates, this revised guidance requires around -0.6% to 0.7% CQGR for the remaining quarters of FY2020E. Despite robust performance (11.9% y-o-y CC growth) in H1FY2020, the management restricted itself in raising the top-end of the growth guidance given weak seasonality in H2, softness in capital markets and European banks and weakness in retail vertical.

Key result highlights from earnings call

Retained margin guidance: EBIT margin guidance was unchanged at 21-23%. Management focuses on cost and operational parameters, which would help the company to report EBIT margin in the guided range in H2FY2020. Further, the margin is expected to be benefited from the absence of incremental investments that was outlined in FY2019. Management highlighted that improving digital contribution (higher margin compared to traditional business) would also help in boosting margin performance going ahead. The compensation increase of title-holder would have minimal impact on the margin in Q3FY2020.

Large deal wins: Infosys signed 13 deals during the quarter, with TCVs of \$2.8 billion (highest ever in its history). The company won four deals each in the financial services and retail verticals, two deals in communication, one each in energy and utilities, hi-tech and life sciences. Geography wise, the company signed six deals in North America, five deals in Europe and two deals in RoW. The share of new deals to overall TCVs stood at about 10%.

Key verticals: Six out of seven business segments i.e., financial services (up 10.3% CC y-o-y), communication (up 19.2% CC y-o-y), energy and utilities (up 19.1% CC y-o-y), manufacturing (up 16.9% CC y-o-y), hi-tech (up 11.7% CC y-o-y) and life sciences (up 10.9% CC y-o-y) grew in double digits during the quarter.

Client metrics: Infosys added 96 new clients during the quarter. The number of \$100 million remained flat on sequential basis, while \$50 million increased by two to 61. Revenues from large clients i.e. top 10 and 25 also grew at 8.8% and 9.6% respectively on y-o-y comparison in USD.

BFSI vertical outlook: Management continues to see weakness in BFSI vertical especially in capital market and European banks. The recent reduction interest rate in major geographies could have an adverse impact on revenues of large banks, which would impact their tech spending

Results

	Rs cr				
Particulars	Q2FY20	Q2FY19	Q1FY20	y-o-y (%)	q-o-q (%)
Revenue (\$ mn)	3,210.0	2,921.0	3,131.0	9.9	2.5
Net sales	22,629.0	20,609.0	21,803.0	9.8	3.8
Direct costs	14,352.0	12,817.0	14,098.0	12.0	1.8
Gross profit	8,277.0	7,792.0	7,705.0	6.2	7.4
SG&A	2,638.0	2,434.0	2,553.0	8.4	3.3
EBITDA	5,639.0	5,358.0	5,152.0	5.2	9.5
Depreciation & amortisation	727.0	464.0	681.0	56.7	6.8
EBIT	4,912.0	4,894.0	4,471.0	0.4	9.9
Other income	584.0	739.0	696.0	-21.0	-16.1
PBT	5,496.0	5,633.0	5,167.0	-2.4	6.4
Tax provision	1,459.0	1,523.0	1,365.0	-4.2	6.9
Reported net profit	4,037.0	4,110.0	3,802.0	-1.8	6.2
Adjusted net profit	4,019.0	4,110.0	3,798.0	-2.2	5.8
EPS (Rs.)	9.5	9.5	8.8	0.0	7.0
Margin (%)				BPS	BPS
EBITDA	24.9	26.0	23.6	-108	129
EBIT	21.7	23.7	20.5	-204	120
NPM	17.8	19.9	17.4	-218	34

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)	3,210	100	2.5	9.9	11.4
Geographic mix					
North America	1,971	61.4	2.2	11.9	11.9
Europe	774	24.1	4.7	10.4	14.6
India	87	2.7	20.4	18.7	17.9
Rest of world	379	11.8	-3.2	-1.8	1.9
Industry verticals					
Financial services	1,024	31.9	4.2	8.9	10.3
Retail	488	15.2	-1.4	-0.6	1.1
Communication	421	13.1	-2.7	17.0	19.2
Energy, utilities, resources & services	421	13.1	3.3	17.0	19.1
Manufacturing	324	10.1	7.9	15.6	16.9
Hi tech	244	7.6	1.2	11.4	11.7
Life sciences	205	6.4	7.6	9.9	10.9
Others	83	2.6	2.5	-1.5	0.3
Service line					
Digital	1,230	38.3	9.9	35.9	38.4
Core	1,980	61.7	-1.6	-1.8	-0.7
Clients Contribution					
Top client	103	3.2	2.5	-9.8	-
Top 10 clients	616	19.2	-1.6	8.8	-
Top 25 clients	1,111	34.6	1.6	9.6	-
Revenue per employee					
Revenue per FTE (\$ K)	54.4	-	-	-	-
Deal wins (\$ mn)					
TCV	2,847	-	4.9	40.3	-

Source: Company; Sharekhan Research

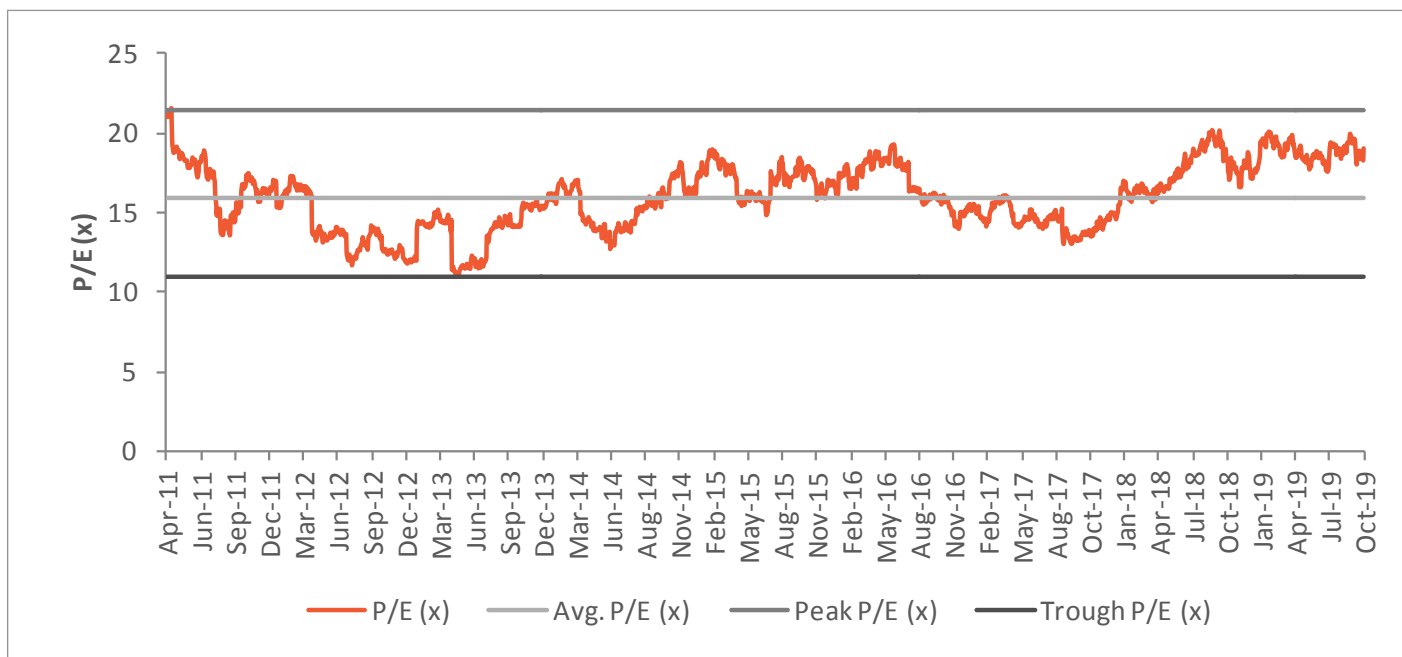
Outlook

Growth for the Indian IT sector 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. 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 in FY2020E is expected to remain in the guided range of 21-23% on account of lower investments on sales & marketing and operational efficiencies.

Valuation

Robust TCV signings, a healthy deal pipeline and integrated offerings would lead Infosys to comfortably achieve the upper-end of revenue growth guidance. At CMP, the stock is trading at 21x/19x of its FY2020E/FY2021E earnings estimates, which is currently at a 9% discount to TCS. With strong performance on both the revenue and margin front, we believe the discount to TCS would further narrow down going ahead. Hence, we maintain our Buy rating on the stock with an unchanged PT of Rs. 880. We have tweaked our earnings estimates for FY2020E/FY2021E on account of slight miss in revenue, offset by margins beat. Operating profitability is expected to remain in the guided range in FY2020E given absence of incremental investments that outlined last year, holding down the subcontracting expenses and operational efficiencies.

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)		RoE (%)	
				FY20E	FY21E	FY20E	FY21E	FY20E	FY21E	FY20E	FY21E
HCL Tech	1,080	136	1,47,383	14.5	13.1	9.1	8.3	3.2	2.8	23.0	22.8
TCS	1,987	375	7,45,618	22.8	20.7	16.8	15.1	7.5	6.9	34.7	34.7
Tech M	722	96	69,583	15.0	12.9	9.7	7.8	3.1	2.7	19.3	19.8
Wipro	239	603	1,44,422	14.6	13.1	9.3	8.0	2.9	2.6	17.9	18.1
Infosys	816	426	3,50,347	21.2	19.0	14.4	12.9	2.9	2.9	25.5	28.5

Source: Company, Sharekhan estimates

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 has 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; and 4) increasing attrition rate

Additional Data

Key management personnel

Management	Designation
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

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
	Deutsche Bank Trust Co Americas	17.5
	Life Insurance Corp of India	6.0
	BlackRock Inc	5.0
	Gopalakrishnan Senapathy	3.2
	Vanguard Group Inc/The	3.1
	HDFC Asset Management Co Ltd	3.0
	SBI Funds Management Pvt Ltd	2.5
	Republic of Singapore	1.9
	ICICI Prudential Asset Management	1.7
	Murthy Rohan	1.4

Source: Bloomberg

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