

Healthy performance on margin, deal TCV, digital front

Infosys reported an in line performance on the revenue front while margins came in better than expectations. Key highlights of the quarter were strong large deal wins (up 3.7% QoQ to \$2.8 billion), robust growth in digital revenues (up 35.9% YoY, 9.9% QoQ) and dip in standalone attrition (fell 210 bps to 19.4%). Owing to a strong H1FY20, Infosys has raised its lower end of constant currency revenue growth guidance to 9-10% (from 8.5-10%) for FY20E while maintaining operating margin guidance of 21-23%. However, we expect growth to moderately surpass the revenue guidance.

Expect revenue growth in FY20E to surpass guided range

Infosys reported a 3.3% QoQ revenue growth in constant currency with Stater acquisition contributing ~1% to it. Infosys' Q2 performance is better than TCS. The company is expected to continue to perform healthily in coming years. Besides retail & communication, growth was all rounded across verticals. Insights from the future outlook with regard to verticals indicates: 1) financial services to be soft on the back of weakness in capital markets, European banks coupled with H2 seasonality, 2) retail is expected to be volatile led by caution in spending and 3) communication is likely to recover based on increasing deal pipeline. Infosys has guided for constant currency revenue growth in the range of 9-10% for FY20E. We believe this is a cautious stance and could moderately surpass the upper guided band mainly led by robust digital growth coupled with healthy pipeline. Hence, we expect dollar revenues to grow at 9.5% CAGR in FY19-21E.

Scope for margin expansion still on the cards

Margins came in better than our expectations at 21.7% driven by higher utilisation, lower onsite mix, operational efficiency together benefitting by 110 bps; lower visa & travel cost by another 110 bps partly offset by second leg of compensation (down 70 bps) and other costs including acquisition integration (down 30 bps). With most of its investments complete and presence of levers of utilisation, employee pyramid, onsite-offshore mix, margins are likely to see an improving trajectory from here on. Hence, we expect margins to expand to 23% in FY21E.

Valuation & Outlook

In line revenue & better-than-expected margins, accelerating deal TCV, digital growth and scope of margin expansion are key positives. Though we expect revenue growth to moderately surpass the upper guided band, the recent run up in the stock and fully priced valuations prompt us to maintain our **HOLD** rating with a revised target price of ₹ 855 (based on 19x FY21E EPS).



Particulars

Particular	Amount
Market Capitalization (₹ Crore)	343,387.6
Total Debt	-
Cash and Investments (₹ Crore)	26,195.0
EV (₹ Crore)	317,192.6
52 week H/L	847 / 600
Equity capital	2,170.0
Face value	₹ 5

Key Highlights

- In-line performance on revenue front while margins came in better than expectations
- Strong large deal wins (up 3.7% QoQ to \$2.8 billion) and robust growth in digital revenues (up 35.9% YoY & 9.9% QoQ) were key positives
- Expect margins to see improved trajectory with presence of several tailwinds
- Maintain HOLD with a revised target price of ₹ 855

Research Analyst

Devang Bhatt
devang.bhatt@icicisecurities.com

Deepti Tayal
deepti.tayal@icicisecurities.com

Key Financial Summary

₹ Crore	FY17	FY18	FY19	FY20E	FY21E	CAGR (FY19-21E)
Net Sales	50,133	70,522	82,676	90,689	100,429	10.2%
EBITDA	13,415	19,010	20,890	22,944	26,212	12.0%
EBITDA Margins (%)	27.2	27.0	25.3	25.3	26.1	
Net Profit	2,369	14,597	15,411	17,003	19,475	
EPS (₹)	47	32.3	35.4	39.1	44.8	12.5%
P/E	21.9	24.4	22.3	20.2	17.6	
RoNW (%)	25.7	22.5	23.7	24.2	25.6	
RoCE (%)	28.5	30.9	32.9	32.4	34.3	

Source: Company, ICICI Direct Research

Exhibit 1: Variance Analysis

	Q2FY20	Q2FY20E	Q2FY19	YoY (%)	Q1FY19	QoQ (%)	Comments
Revenue	22,629	22,609	20,609	9.8	21,803	3.8	Constant currency (CC) revenues grew 3.3% QoQ, in line with our estimate of 3.3% QoQ. Growth was led by digital, energy & utilities, financial services and manufacturing vertical
Employee expenses	14,352	14,379	12,818	12.0	14,098	1.8	
Gross Profit	8,277	8,230	7,791	6.2	7,705	7.4	
Gross margin (%)	36.6	36.4	37.8	-123 bps	35.3	124 bps	
Selling & marketing costs	1,162	1,289	1,088	6.8	1,174	-1.0	
G&A expenses	1,476	1,424	1,346	9.7	1,379	7.0	
EBITDA	5,639	5,517	5,357	5.3	5,152	9.5	
EBITDA Margin (%)	24.9	24.4	26.0	-107 bps	23.6	129 bps	
Depreciation	727	701	463	57.0	681	6.8	
EBIT	4,912	4,816	4,894	0.4	4,471	9.9	
EBIT Margin (%)	21.7	21.3	23.7	-204 bps	20.5	120 bps	EBIT margins expanded 120 bps sequentially to 21.7%. Uptick in margins was led by 120 bps expansion in gross margins coupled with 1% QoQ dip in sales & marketing expenses
Other income	626	733	739	-15.3	736	-14.9	
PBT	5,538	5,549	5,633	-1.7	5,207	6.4	
Tax paid	1,459	1,443	1,523	-4.2	1,365	6.9	
Reported PAT	4,037	4,106	4,110	-1.8	3,802	6.2	Reported PAT came in below our estimate due to lower other income
Key Metrics							
Closing employees	236,486	234,029	217,739	8.6	229,029	3.3	Net addition of 7457 employees in the quarter
LTM attrition-standalone (%)	19.4	21.0	19.9	-50 bps	21.5	-210 bps	Attrition witnessed a dip in this quarter. Still it is higher than industry peers and needs to be watched
Utilisation -ex trainees (%)	84.9	83.5	85.6	-70 bps	83.1	180 bps	
Average \$/₹	70.5	70.4	70.6	-0.1	69.6	1.2	

Source: Company, ICICI Direct Research

Exhibit 2: Change in estimates

(₹ Crore)	FY19			FY20E			FY21E			Comments
	Old	New	% Change	Old	New	% Change	Old	New	% Change	
Revenue	82,676	91,239	90,689	-0.6	99,911	100,429	0.5	Considering H2 seasonality and management conservative commentary, we marginally tweak our estimates		
EBIT	18,879	20,529	20,133	-1.9	22,980	23,099	0.5			
EBIT Margin (%)	22.8	22.5	22.2	-30 bps	23.0	23.0	0 bps	Revision in margin estimates for FY20E taking into account H2 visibility		
PAT	15,411	17,161	17,003	-0.9	19,346	19,475	0.7			
EPS (₹)	35.4	39.4	39.1	-0.9	44.5	44.8	0.7			

Source: Company, ICICI Direct Research

Conference Call Highlights

- **Revenue outlook:** Owing to strong H1FY20 and visibility from deal pipeline, Infosys has raised its lower end of constant currency revenue growth guidance to 9-10% (from 8.5-10%) for FY20E
- **Margin trajectory:** The company has maintained its EBIT margin guidance of 21-23% for FY20E. With most of its investments complete and presence of levers of utilisation, employee pyramid, onsite-offshore mix, margins are likely to see an improving trajectory from here on
- **TCV:** Large deal TCV was robust with deal signings worth ~US\$2.8 billion in the quarter, up 3.7% QoQ and 40% YoY. Out of the overall deal pipeline, 10% is net new deal wins, which was low compared to last few quarters (35% for H1FY20). Though the management indicated the number would increase in coming quarters. Infosys signed 13 large deals with six in the US, five in Europe and two in RoW. Among verticals, financial services, retail constituted four deals each; communication constituted two and energy & utilities, hi-tech and lifesciences bagged one deal each
- **Digital story:** Digital continues to drive the growth of the company with 35.9% YoY growth and constituting 38.3% of revenues (vs. 31% in Q2FY19). Further, the company continues to see traction in areas of data analytics, customer experience and cloud and continues to be the key focus areas for the company
- **Vertical commentary:** Growth was broad based across verticals barring retail and communication. Financial services grew 4.2% sequentially partially aided by Stater acquisition contribution. Vertical based commentary indicates 1) Weakness in capital markets and European banks to impact financial services coupled with H2 seasonality and 2) cautious spending in retail leading to delay in decision making. Volatility is expected to continue in retail. 3) Weakness in European auto impacting manufacturing. Besides that, healthy deal pipeline in Europe and America, 4) Energy & Utilities continue to do well specifically in Europe led by momentum in existing accounts and new account openings, 5) Communication looks healthy based on increasing deal pipeline, with a strong share of large deals
- **Client update:** Two clients were added in US\$50 million category while the number remained constant in US\$100 million bucket. Thirteen clients transitioned in US\$1 million category taking the total count to 693
- **Employee update:** The company hired around 14000 people on a gross basis. Thus, employee strength was at 236,486 with net addition of 7457 employees in the quarter. Attrition (consolidated) and attrition (standalone) both witnessed a dip of 170 bps and 210 bps to 21.7% and 19.4%, respectively. Although attrition witnessed a dip in this quarter, still it is higher than industry peers and needs to be watched. Utilisation (ex-trainees) increased 180 bps sequentially to 84.9% and was one of the key driver for margin expansion

Key Metrics

Exhibit 3: Geography-wise split up

	Q1FY19	Q2FY19	Q3FY19	Q4FY19	Q1FY20	Q2FY20
Revenue by geography (%)						
North America	60.0	60.3	60.4	61.2	61.6	61.4
Europe	24.3	24.0	24.2	24.0	23.6	24.1
India	2.6	2.5	2.6	2.3	2.3	2.7
ROW	13.1	13.2	12.8	12.5	12.5	11.8
Growth QoQ in \$ terms (%)						
North America	1.9	3.7	2.4	3.8	3.0	2.2
Europe	-1.1	1.9	3.1	1.6	0.6	4.7
India	-6.3	-0.8	6.3	-9.4	2.3	20.4
ROW	1.7	4.0	-0.8	0.0	2.3	-3.2

Source: Company, ICICI Direct Research

Growth led by North America and Europe wherein Stater acquisition aided growth in Europe. Growth in RoW expected to revert in coming quarters

Exhibit 4: Vertical-wise split up

	% contribution to revenues Q2FY20	% contribution to revenues Q1FY20	Growth QoQ (%)
Revenue by verticals (%)			
Financial Services	31.9	31.4	4.2
Retail	15.2	15.8	-1.4
Communication	13.1	13.8	-2.7
Energy, Utilities, Resources & Services	13.1	13.0	3.3
Manufacturing	10.1	9.6	7.9
Hi Tech	7.6	7.7	1.2
Life Sciences	6.4	6.1	7.6
Others	2.6	2.6	-74.7

Source: Company, ICICI Direct Research

Among verticals, growth was led by energy & utilities, financial services, manufacturing and lifesciences

Exhibit 5: Client & human resource matrix

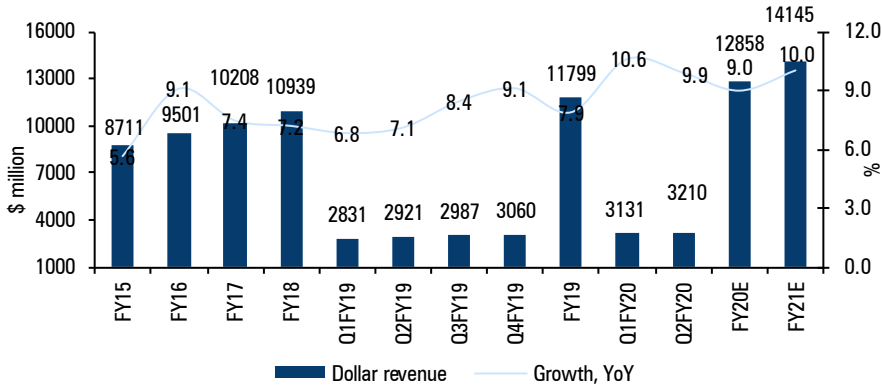
	Q1FY19	Q2FY19	Q3FY19	Q4FY19	Q1FY20	Q2FY20
Client metrics						
5 Million \$ clients	627	633	651	662	680	693
25 Million \$ clients	200	205	214	222	228	228
50 Million \$ clients	56	58	59	60	59	61
100 Million \$ clients	24	23	23	25	27	27
Headcount, Utilization & Attrition						
Total Employees	209905	217739	225501	228123	229029	236486
Utilization (Excluding trainees)	85.7	85.6	83.8	82.3	83.1	84.9
LTM Attrition (Standalone)	20.6	19.9	17.8	18.3	21.5	19.4

Source: Company, ICICI Direct Research

Two clients added in US\$50 million category

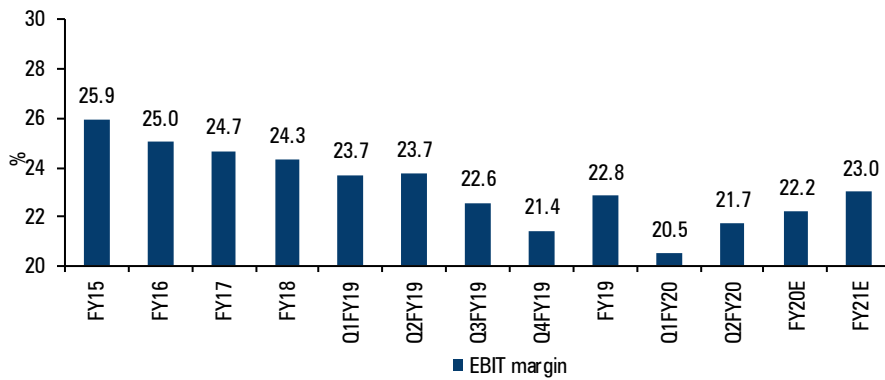
Financial story in charts

Exhibit 6: Dollar revenues may grow at 9.5% CAGR in FY19-21E



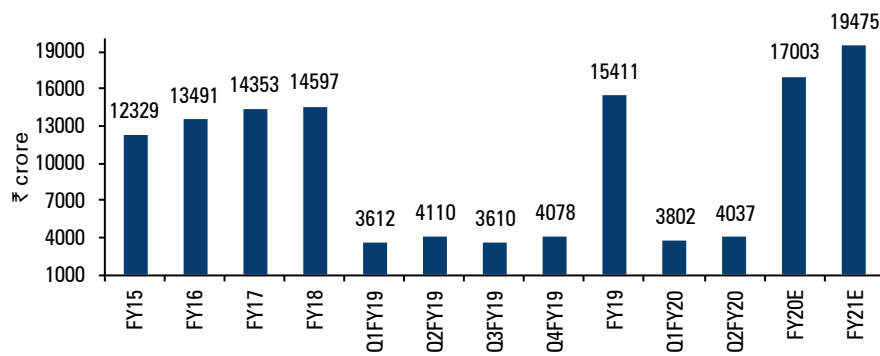
Source: Company, ICICI Direct Research

Exhibit 7: Change in margin estimates for FY20E



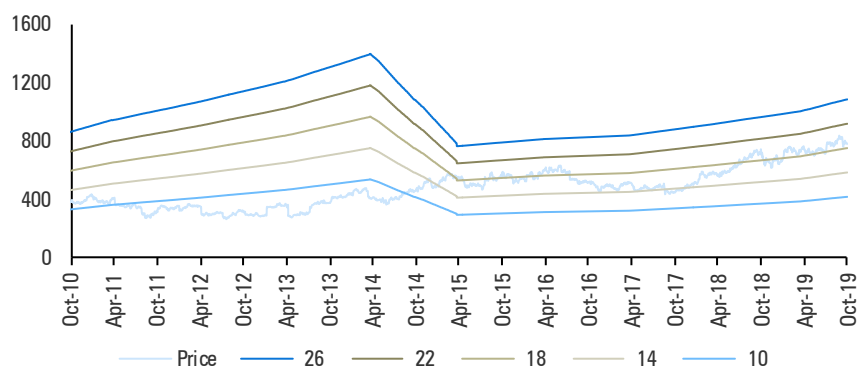
Source: Company, ICICI Direct Research

Exhibit 8: PAT trend



Source: Company, ICICI Direct Research

Exhibit 9: One year forward rolling PE



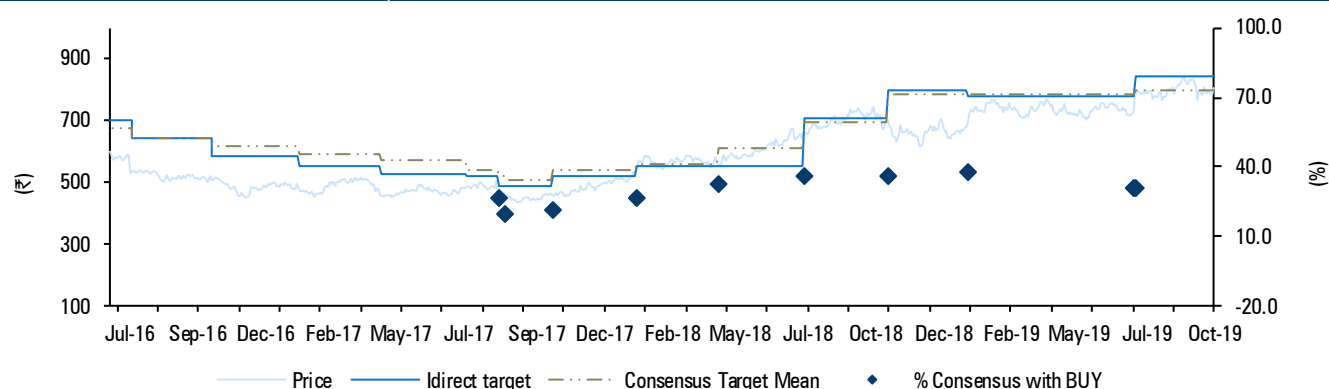
Source: Company, ICICI Direct Research

Exhibit 10: Valuation

	Sales	Growth	EPS	Growth	PE	EV/EBITDA	RoNW	RoCE
	(₹ cr)	(%)	(₹)	(%)	(x)	(x)	(%)	(%)
FY17	68,485	9.7	31.4	6.4	25.1	16.7	20.8	28.8
FY18	70,522	3.0	32.3	3.0	24.4	16.7	22.5	30.9
FY19	82,676	17.2	35.4	9.5	22.3	15.2	23.7	32.9
FY20E	90,689	9.7	39.1	10.3	20.2	13.6	24.2	32.4
FY21E	100,429	10.7	44.8	14.7	17.6	11.7	25.6	34.3

Source: Company, ICICI Direct Research

Exhibit 11: Recommendation History vs. Consensus



Source: Bloomberg, Company, ICICI Direct Research

Exhibit 12: Top 10 Shareholders

Rank	Name	Latest Filing Date	% O/S	Position (m)	Change (m)
1	Deutsche Asset Management Americas	3-Sep-19	17.6%	745.7	-0.5
2	Life Insurance Corporation of India	3-Sep-19	6.0%	254.7	3.4
3	Gopalakrishnan (Sudha)	3-Sep-19	3.2%	137.2	0.0
4	The Vanguard Group, Inc.	31-Aug-19	3.0%	126.3	1.0
5	HDFC Asset Management Co., Ltd.	3-Sep-19	3.0%	125.7	1.7
6	SBI Funds Management Pvt. Ltd.	3-Sep-19	2.5%	104.6	-1.5
7	BlackRock Institutional Trust Company, N.A.	30-Sep-19	2.4%	101.1	-0.2
8	GIC Private Limited	3-Sep-19	1.9%	80.5	-4.4
9	ICICI Prudential Asset Management Co. Ltd.	3-Sep-19	1.7%	71.1	-3.2
10	Murty (Rohan)	3-Sep-19	1.4%	60.8	0.0

Source: Reuters, ICICI Direct Research

Exhibit 13: Recent Activity

Buys			Sells		
Investor name	Value	Shares	Investor name	Value	Shares
Capital Research Global Investors	256.6m	24.2m	APG Asset Management N.V.	-58.0m	-5.4m
Life Insurance Corporation of India	38.3m	3.4m	GIC Private Limited	-50.2m	-4.4m
HDFC Asset Management Co., Ltd.	19.6m	1.7m	Reliance Nippon Life Asset Management Limited	-43.1m	-3.8m
Canara Robeco Asset Management Company Ltd.	13.4m	1.2m	ICICI Prudential Asset Management Co. Ltd.	-37.1m	-3.2m
The Vanguard Group, Inc.	11.8m	1.0m	Stewart Investors	-24.1m	-2.3m

Source: Reuters, ICICI Direct Research

Exhibit 14: Shareholding Pattern

(in %)	Mar-19	Jun-19	Sep-19
Promoter	12.84	13.04	13.15
Public	86.69	86.49	86.39
Others	0.47	0.47	0.45
Total	100.00	100.00	100.00

Source: Company, ICICI Direct Research

Financial summary

Exhibit 15: Profit and loss statement				
	₹ crore			
(Year-end March)	FY18	FY19	FY20E	FY21E
Total operating Income	70,522	82,676	90,689	100,429
Growth (%)	3.0	17.2	9.7	10.7
COGS (employee expenses)	43,267	51,857	57,315	63,170
Admin expenses	4,684	5,454	5,713	5,724
S&M expenses	3,560	4,475	4,716	5,323
Total Operating Expenditure	51,511	61,786	67,744	74,217
EBITDA	19,010	20,890	22,944	26,212
Growth (%)	2.2	9.9	9.8	14.2
Depreciation	1,863	2,011	2,811	3,113
Other Income	3,193	2,883	3,001	3,398
PBT	20,270	21,041	23,134	26,497
Total Tax	4,241	5,630	6,130	7,022
PAT	14,597	15,411	17,003	19,475
Growth (%)	1.7	5.6	10.3	14.5
EPS (₹)	32.3	35.4	39.1	44.8
Growth (%)	3.0	9.5	10.3	14.7

Source: Company, ICICI Direct Research

Exhibit 16: Cash flow statement				
	₹ crore			
(Year-end March)	FY18	FY19	FY20E	FY21E
Profit after Tax	14,597	15,411	17,003	19,475
Add: Depreciation	1,863	2,011	2,811	3,113
(Inc)/dec in Current Assets	(1,899)	(3,720)	(1,253)	(1,960)
Inc/(dec) in CL and Provisions	1,793	3,128	1,438	1,748
Taxes paid	(6,829)	(6,832)	(6,130)	(7,022)
CF from operating activities	14,559	15,844	16,999	18,978
(Inc)/dec in Investments	5,374	1,369	3,001	3,398
(Inc)/dec in Fixed Assets	(1,998)	(2,445)	(3,500)	(3,000)
CF from investing activities	3,111	(1,578)	(499)	398
Dividend paid & dividend tax	(7,464)	(13,705)	(11,744)	(13,581)
Others	5	6	-	-
CF from financing activities	(20,505)	(14,512)	(11,744)	(13,581)
Net Cash flow	(2,835)	(246)	4,755	5,795
Exchange difference	81	(57)	-	-
Opening Cash	22,625	19,818	19,568	24,323
Closing Cash	19,818	19,568	24,323	30,118

Source: Company, ICICI Direct Research

Exhibit 17: Balance sheet				
	₹ crore			
(Year-end March)	FY18	FY19	FY20E	FY21E
Equity Capital	2,258	2,170	2,170	2,170
Reserve and Surplus	62,666	62,836	68,095	73,989
Total Shareholders funds	64,924	65,006	70,265	76,159
Employee benefit obligations	48	44	44	44
Debt	-	-	-	-
Deferred Tax Liability	541	672	672	672
Other non current liabilities	272	378	378	378
Total Liabilities	65,785	66,100	71,359	77,253
Assets				
Property, plant and equipment	12,143	13,356	14,045	13,931
Goodwill	2,211	3,540	3,540	3,540
Intangibles	247	691	691	691
Available for sale assets	5,756	4,634	4,634	4,634
Other assets	9,516	9,639	9,639	9,639
Cash	19,818	19,568	24,323	30,118
Current Investments	6,407	6,627	6,627	6,627
Trade receivables	13,142	14,827	16,264	18,011
Unbilled revenue	4,261	5,374	4,988	5,524
Prepayment & O.fin.assets	6,373	6,146	6,348	6,026
Other current assets	16	336	336	336
Total Current Assets	50,017	52,878	58,886	66,642
Trade payables	694	1,655	1,815	2,010
Unearned revenue	2,295	2,809	3,081	3,412
OCL & provisions	11,116	14,174	15,179	16,401
Total Current Liabilities	14,105	18,638	20,076	21,824
Net Current Assets	35,912	34,240	38,811	44,818
Application of Funds	65,785	66,100	71,359	77,253

Source: Company, ICICI Direct Research

Exhibit 18: Key ratios				
(Year-end March)	FY18	FY19	FY20E	FY21E
Per share data (₹)				
EPS	32.3	35.4	39.1	44.8
Cash EPS	36.5	40.0	45.5	52.0
BV	144	149	161	175
DPS	43.5	21.5	22.4	25.9
Cash Per Share	44	45	56	69
Operating Ratios (%)				
EBIT Margin	24.3	22.8	22.2	23.0
PBT Margin	28.7	25.4	25.5	26.4
PAT Margin	20.7	18.6	18.7	19.4
Debtor days	68	65	65	65
Unbilled revenue	20	21	21	19
Creditor days	4	7	7	7
Return Ratios (%)				
RoE	22.5	23.7	24.2	25.6
RoCE	30.9	32.9	32.4	34.3
RoIC	43.3	47.3	49.8	57.0
Valuation Ratios (x)				
P/E	24	22	20	18
EV / EBITDA	17	15	14	12
EV / Net Sales	4	4	3	3
Market Cap / Sales	5	4	4	3
Price to Book Value	5	5	5	5
Solvency Ratios				
Debt/EBITDA	-	-	-	-
Debt / Equity	-	-	-	-
Current Ratio	3	2	2	2
Quick Ratio	3	2	2	2

Source: Company, ICICI Direct Research

Exhibit 19: ICICI Direct coverage universe (IT)

Sector / Company	CMP			M Cap (₹ Cr)	EPS (₹)			P/E (x)			EV/EBITDA (x)			RoCE (%)			RoE (%)		
	(₹)	TP(₹)	Rating		FY19	FY20E	FY21E	FY19	FY20E	FY21E	FY19	FY20E	FY21E	FY19	FY20E	FY21E	FY19	FY20E	FY21E
HCL Tech (HCLTEC)	1,089	1,150	Hold	143,444	74.7	73.7	83.7	14.2	14.4	12.6	9.8	8.8	7.6	26.5	25.7	26.4	24.5	21.7	22.0
Infosys (INFTEC)	789	855	Hold	343,388	35.4	39.1	44.8	22.3	20.2	17.6	15.2	13.6	11.7	32.9	32.4	34.3	23.7	24.2	25.6
MindTree (MINCON)	735	635	Reduce	11,313	45.9	37.7	48.8	15.0	18.3	14.1	9.7	10.0	7.8	29.8	24.4	27.8	22.8	17.0	19.5
L&T Intotech (LTINFO)	1,490	1,710	Hold	26,301	87.3	84.1	96.8	17.4	18.0	15.6	12.8	12.1	10.1	40.4	33.0	32.2	31.0	25.1	24.4
NIIT Tech (NIITEC)	1,396	1,345	Hold	8,125	65.7	74.3	83.9	20.1	18.3	16.0	11.1	9.3	7.9	24.2	23.5	23.8	19.9	19.8	19.7
TCS (TCS)	2,023	2,005	Hold	739,500	83.8	86.2	95.5	23.4	22.8	20.6	17.7	16.6	14.8	43.8	42.6	43.9	34.4	33.4	34.4
Tech M (TECMAH)	723	720	Buy	55,655	47.7	45.8	51.7	13.0	13.5	12.0	7.6	7.6	6.5	23.6	21.1	21.2	21.2	17.9	17.8
Wipro (WIPRO)	245	315	Buy	160,796	14.9	16.3	19.7	17.9	16.4	13.6	11.1	10.2	8.1	17.8	17.1	18.8	15.8	15.7	17.3

Source: Company, ICICI Direct Research

RATING RATIONALE

ICICI Direct endeavors to provide objective opinions and recommendations. ICICI Direct assigns ratings to its stocks according to their notional target price vs. current market price and then categorizes them as Buy, Hold, Reduce and Sell. The performance horizon is two years unless specified and the notional target price is defined as the analysts' valuation for a stock

Buy: > 15%

Hold: -5% to 15%;

Reduce: -15% to -5%;

Sell: < -15%



Pankaj Pandey

Head – Research

pankaj.pandey@icicisecurities.com

**ICICI Direct Research Desk,
ICICI Securities Limited,
1st Floor, Akruiti Trade Centre,
Road No 7, MIDC,
Andheri (East)
Mumbai – 400 093
research@icicidirect.com**

ANALYST CERTIFICATION

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