

Sector: IT & ITES
Result Update

	Change
Reco: Buy	↔
CMP: Rs. 738	
Price Target: Rs. 820	↑

↑ Upgrade ↔ No change ↓ Downgrade

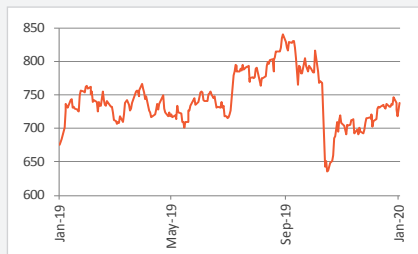
Company details

Market cap:	Rs. 314,394 cr
52-week high/low:	Rs. 847/615
NSE volume: (No of shares)	98.7 lakh
BSE code:	500209
NSE code:	INFY
Sharekhan code:	INFY
Free float: (No of shares)	369.8 cr

Shareholding (%)

Promoters	13.2
FII	49.9
DII	24.9
Others	12.1

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	1.4	-6.0	2.9	11.1
Relative to Sensex	-0.9	-13.5	-4.3	-4.0

Sharekhan Research, Bloomberg

Infosys delivered mixed performance during the quarter. While margins remained a tad below our estimates, constant currency (CC) revenue grew by 1% q-o-q/ 9.5% y-o-y, in-line with our estimates, driven by strong growth in digital business (40.8% y-o-y CC). However, core business declined 6% y-o-y versus -1.8% y-o-y in Q2FY2020. EBIT margin improved 20bps q-o-q to 21.9%, led by rupee tailwind and cost optimization, partially offset by lower utilisation. Net profit beat our estimates by 6.1%, aided by higher other income and lower tax provisions (one-time tax refund). The company signed 14 large deals worth \$1.8 billion versus \$2.8 billion / \$1.6 billion in Q2FY2020/Q3FY2019. Infosys' management increased its FY2020E revenue growth guidance band to 10-10.5% in CC from 9-10.0% earlier on the back of robust performance (11.1% y-o-y CC growth) and strong deal wins (up 56% y-o-y) during 9MFY2020, though this is the third upgrade in last three quarters. Infosys has retained EBIT margin guidance band to 21-23% for FY2020E. Clean chit to both CEO and CFO in whistleblower issue allays the concerns and removes overhang on the stock.

Key positives

- ♦ Raised the revenue growth guidance range to 10.0-10.5% in CC from 9.0-10.0% earlier
- ♦ Audit Committee finds no evidence of financial impropriety or misconduct
- ♦ TCV wins of \$7.4 billion in 9MFY2020, up 56% y-o-y
- ♦ Continued strong digital growth, up 40.8% y-o-y CC and now account for 40.6% of overall revenues
- ♦ Attrition rate has moderated to 17.6% versus 19.4% in Q2FY2020

Key negatives

- ♦ BFSI CC growth decelerated to 6.2% y-o-y in Q3FY2020 versus 10.3% y-o-y in Q2FY2020
- ♦ DSO increased by seven days

Our Call

Valuation – Maintain Buy with a revised PT of Rs. 820: We have tweaked our earnings estimates for FY2020E/FY2021E on account of increase in revenue growth guidance, though margins missed our estimates slightly. We introduced FY2022E numbers in this note. With continued robust TCV signings, a healthy deal pipeline and integrated offerings, we believe Infosys would comfortably deliver double-digit CC growth in FY2020E. At CMP, the stock is trading at 18x/17x of its FY2020E/FY2021E earnings estimates, which is currently at around 26% discount to TCS. As Infosys is expected to outperform TCS in terms of revenue growth and gaining market share in digital business among peers, we believe the discount to TCS would narrow down going ahead. Further a clean chit in whistleblower issue would remove overhang on the stock. Hence, we maintain our Buy rating on the stock with a revised PT of Rs. 820.

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. would have an adverse impact on its earnings.

	Rs cr				
Particulars	FY18	FY19	FY20E	FY21E	FY22E
Revenue	70,522.0	82,675.0	91,735.6	1,01,015.6	1,09,116.6
OPM (%)	27.0	25.3	24.7	25.0	25.2
Adjusted PAT	14,597.0	15,862.0	16,698.4	18,340.2	19,830.4
% YoY growth	1.7	8.7	5.3	9.8	8.1
Adjusted EPS (Rs.)	32.4	35.4	39.1	43.1	46.6
P/E (x)	22.8	20.8	18.9	17.1	15.9
P/B (x)	2.6	2.6	2.6	2.6	2.5
EV/EBITDA (x)	15.2	13.8	12.9	11.5	10.5
RoNW (%)	23.9	23.7	25.9	28.4	29.9
RoCE (%)	30.2	32.2	34.5	38.1	40.1

Source: Company; Sharekhan Research

Revenue in-line, margin missed slightly

Infosys delivered a mixed bag of results in Q3FY2020, with revenue performance in-line with our estimates, while EBIT margins were missed slightly. The company's CC revenue grew by 1% q-o-q and 9.5% y-o-y, in-line with our expectations. The growth was driven by strong growth in the USA (10.1% y-o-y CC) and Europe (12% y-o-y CC). Further, strong digital CC revenue growth of 40.8% y-o-y aided growth. On a reported basis, USD revenue increased by 1% q-o-q to \$3,243 million. EBIT margin improved by 22bps q-o-q to 21.9%, a tad below our estimates, led by rupee depreciation (+10 BPS) and cost optimization (+50 BPS). These margin tailwinds during the quarter were partially offset by a decline in utilisation (-40bps). Net profit of Rs. 4,457 crore (+10.9% q-o-q, 9.8% y-o-y) was 6.1% ahead of our estimate aided by improved operating profitability, higher other income and lower tax provisions of 23.6% (versus 26.5% in Q2FY2020).

Increased revenue growth guidance to 10-10.5% for FY2020E, deal wins remain strong

Infosys' management has upgraded its FY2020E revenue growth guidance band to 10-10.5% in CC from 9-10.0% earlier, which is ahead of our estimates. Given the robust performance (11.1% y-o-y CC growth) and strong deal wins (up 56% y-o-y) in 9MFY2020 along with robust deal pipeline, we believe the company would comfortably deliver the revenue growth in the guided range. Management expects softness in overall spending in BFSI vertical would continue over next couple of quarters, though it witnesses growth in financial services in the USA. Softness in both BFSI and retail vertical would moderate the growth in 2HFY2020E versus 1HFY2020. Infosys maintained EBIT margin guidance band to 21-23% for FY2020E, while margin for 9MFY2020 remained at 21.4%.

Key result highlights from earnings call

- ♦ **Audit Committee finds no evidence of financial impropriety or misconduct:** The Audit Committee conducted a thorough investigation with the assistance of two external agencies. The committee found that the allegations by the anonymous whistleblower were substantially without merit as there was no evidence of financial impropriety or executive misconduct. A clean chit in whistleblower issue is key positive for the stock.
- ♦ **Retained margin guidance:** The EBIT margin guidance was unchanged at 21-23%. Management focuses on cost optimisation and onsite pyramid rationalisation, which would help the company to report EBIT margin in the guided range in Q4FY2020E. The management highlighted that improving digital contribution (higher margin compared to traditional business) would also help in boosting margin performance going ahead.
- ♦ **Large deal wins:** Infosys has signed 14 deals during the quarter, with TCVs of \$1.8 billion (versus \$2.8 billion in Q2FY2020). The company has won seven deals in the financial services, two deals each in communication and manufacturing, one each in retail, energy and utilities and others. Geography wise, the company signed eight deals in North America, five deals in Europe and one deal in RoW. The share of new deals to overall TCVs stood at about 32% versus 10% in Q2FY2020.
- ♦ **Expect BFSI & retail, strong growth performance in rest verticals:** Four out of seven business segments i.e., communication (up 20.6% CC y-o-y), manufacturing (up 11.8% CC y-o-y), hi-tech (up 12.2% CC y-o-y) and life sciences (up 17.7% CC y-o-y) grew in double digits during the quarter. Growth in financial services decelerated to 6.2% CC y-o-y from 10.3% CC y-o-y in Q2FY2020 owing to weak seasonality, while retail vertical growth accelerated to 2.5% CC y-o-y from 1.1% CC y-o-y in Q2FY2020. Energy and utilities vertical revenue growth stood at 8.9% CC y-o-y versus 19.1% CC y-o-y in Q2FY2020.
- ♦ **Client metrics (impressive progression of clients in the \$100 million bucket):** Infosys added 84 new clients during the quarter. The number of US\$100 million increased by one on sequential basis and 5 on y-o-y basis to 28, while US\$200 million client counts doubled in last one year. Revenues from large clients i.e. top, top 10 and 25 declined at 5.3%, 0.6% and 0.1% respectively on q-o-q comparison in USD. The decline in top clients was primarily due to the higher impact of furloughs.
- ♦ **Decline in attrition rate:** There is some comfort with a decline in the attrition rate for the second consecutive quarters. The attrition rate has moderated to 17.6% from 19.4%/21.5% in Q2FY2020 and Q3FY2020. The voluntary attrition during the quarter remained lowest at 15.6%. Enhanced focus on increasing employee engagement performance has resulted in moderation of attrition rate.
- ♦ **BFSI vertical outlook:** Management continues to see weakness in BFSI vertical especially in Europe. During the quarter, financial services reported growth in North America on a sequential basis. Management expected some degree of softness would continue over the next 3-4 quarters.
- ♦ **Strong growth in Digital business:** Digital revenues grew by 40.8% y-o-y in CC and now account for 40.6% of overall revenues. Increase in demand in data and analytics, cloud, security and IOT would continue to drive growth in digital.

Results

	Rs cr				
Particulars	Q3FY20	Q3FY19	Q2FY20	y-o-y (%)	q-o-q (%)
Revenue (\$ mn)	3,243.0	2,987.0	3,210.0	8.6	1.0
Net sales	23,092.0	21,400.0	22,629.0	7.9	2.0
Direct costs	14,637.0	13,436.0	14,352.0	8.9	2.0
Gross profit	8,455.0	7,964.0	8,277.0	6.2	2.2
SG&A	2,655.0	2,554.0	2,638.0	4.0	0.6
EBITDA	5,800.0	5,410.0	5,639.0	7.2	2.9
Depreciation & amortisation	736.0	580.0	727.0	26.9	1.2
EBIT	5,064.0	4,830.0	4,912.0	4.8	3.1
Other income	785.0	302.0	584.0	159.9	34.4
PBT	5,849.0	5,132.0	5,496.0	14.0	6.4
Tax provision	1,383.0	1,522.0	1,459.0	-9.1	-5.2
Reported net profit	4,457.0	3,610.0	4,019.0	23.5	10.9
Adjusted net profit	4,457.0	3,610.0	4,019.0	23.5	10.9
EPS (Rs.)	10.5	9.3	9.5	12.5	11.2
Margin (%)				BPS	BPS
EBITDA	25.1	25.3	24.9	-16	20
EBIT	21.9	22.6	21.7	-64	22
NPM	19.3	16.9	17.8	243	154

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)	3,243	100	1.0	8.6	9.5
Geographic mix					
North America	1,988	61.3	0.9	10.2	10.1
Europe	791	24.4	2.3	9.5	12.0
India	91	2.8	4.8	16.9	18.4
Rest of world	373	11.5	-1.5	-2.5	0.2
Industry verticals					
Financial services	1,022	31.5	-0.2	5.2	6.2
Retail	496	15.3	1.7	1.3	2.5
Communication	422	13.0	0.3	18.6	20.6
Energy, utilities, resources & services	415	12.8	-1.3	8.6	8.9
Manufacturing	334	10.3	3.0	10.7	11.8
Hi tech	246	7.6	1.0	13.0	12.2
Life sciences	217	6.7	5.8	17.3	17.7
Others	91	2.8	8.8	8.6	11.5
Service line					
Digital	1,318	40.6	7.2	39.9	40.8
Core	1,925	59.4	-2.8	-5.9	-5.0
Clients Contribution					
Top client	97	3.0	-5.3	-4.2	-
Top 10 clients	613	18.9	-0.6	6.9	-
Top 25 clients	1,109	34.2	-0.1	9.5	-
Revenue per employee					
Revenue per FTE (\$ K)	54.4	-	-	-	-
Deal wins (\$ mn)					
TCV	1,813	-	-36.3	15.5	-

Source: Company; Sharekhan Research

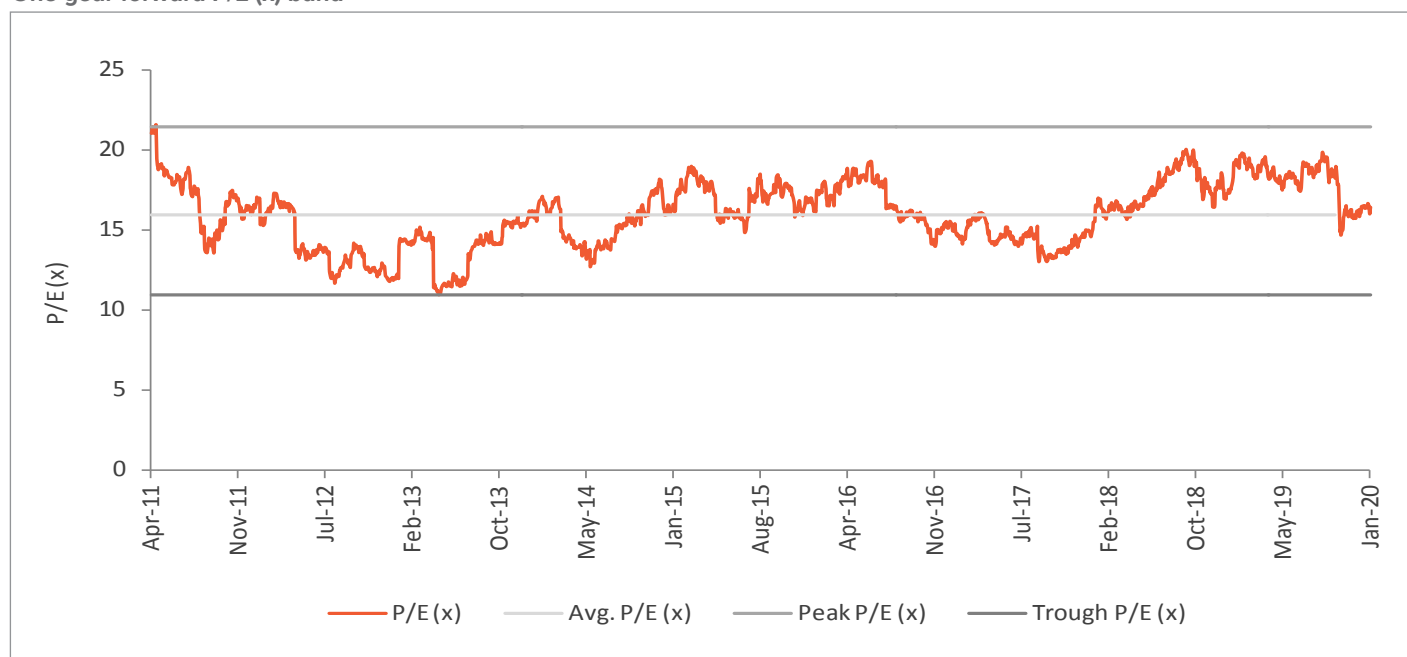
Outlook

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 would be impacted owing to higher visa rejection, initiatives to control attrition rate and constraint in talent supply. Infosys' efforts to energize growth through investments in digital capabilities have been reaping results, with enhanced participation in large deals and consequent uptick in TCVs of deal wins.

Valuation

We have tweaked our earnings estimates for FY2020E/FY2021E on account of increase in revenue growth guidance, though margins missed our estimates slightly. We introduced FY2022E numbers in this note. With continued robust TCV signings, a healthy deal pipeline and gain in digital share, we believe Infosys would comfortably deliver double-digit CC growth in FY2020E. At CMP, the stock is trading at 18x/17x of its FY2020E/ FY2021E earnings estimates, which is currently at around 26% discount to TCS. As Infosys is expected to outperform TCS in terms of revenue growth and gaining market share in digital business, we believe the discount to TCS would narrow down going ahead. Further a clean chit in whistleblower issue would remove overhang on the stock. Hence, we maintain our Buy rating on the stock with a revised PT of Rs. 820.

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	581	1,57,464	271	15.5	13.9	9.6	8.6	1.7	1.5	23.1	23.0
Infosys	738	3,14,394	426	18.9	17.1	12.9	11.5	2.6	2.6	25.9	28.4
TCS	2,214	8,30,722	375	25.4	23.2	18.9	17.0	8.4	7.7	34.6	34.5
Wipro	252	1,43,822	571	15.0	13.6	9.2	8.0	3.1	2.8	17.8	17.4

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 (~31.5% 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 40.6% 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

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 (%)
1	Deutsche Bank Trust Co Americas	17.51
2	Life Insurance Corp of India	5.98
3	BlackRock Inc	4.96
4	Vanguard Group Inc/The	2.97
5	HDFC Asset Management Co Ltd	2.55
6	SBI Funds Management Pvt Ltd	2.46
7	ICICI Prudential Asset Management	2.31
8	Republic of Singapore	1.89
9	ICICI Prudential Life Insurance Co	1.35
10	UTI Asset Management Co Ltd	1.19

Source: Bloomberg

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Compliance Officer: Mr. Joby John Meledan; Tel: 022-61150000; email id: compliance@sharekhan.com;

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