

Digital trajectory intact, revises guidance upwards

Infosys reported Q3FY20 numbers which were marginally below than expectations on operational front. Below than expected revenue was on account of 2.8% sequential dip in run the business revenues (which we believe is impacted due to furloughs). On the other hand, strong large deal wins (up 14.6% YoY to \$1.8 billion) and robust growth in digital revenues (up 39.9% YoY & 7.2% QoQ) were positive. Further, Infosys has raised its constant currency revenue growth guidance to 10-10.5% (from 9-10%) for FY20E while maintained operating margin guidance of 21%-23%. In regards to anonymous whistle-blower complaint, Infosys Audit Committee has found no evidence of financial impropriety or executive misconduct in the allegations. The Audit Committee concluded that no restatement of previously announced financial statements or other published financial information is warranted.

Deal wins, digital growth to lead to healthy growth

Infosys reported a 1% QoQ revenue growth in dollar terms with impact from 2.8% sequential decline in core business. Weakening in core business was higher compared to previous quarters and mainly seen in financial services, retail, communications and energy & utilities segments. Softness in the near term is likely to continue in BFSI in Europe & RoW and retail segment while BFSI in North America, manufacturing, lifesciences and communication is expected to do well. Further, strong momentum in digital revenues, net new wins of US\$2.3 billion (over 9 months) and healthy deal signings would support the growth trajectory. Hence, we expect dollar revenues to grow at a 9.4% CAGR in FY19-22E.

Scope for margin expansion still on the cards

Margins came in lower than our expectations at 21.9% due to an impact from lower utilisation (-40 bps) partially offset by currency benefit (+10 bps) and cost optimization along with higher offshoring (+50 bps). With 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 FY22E.

Valuation & Outlook

Highlight of the quarterly results was the clean chit given by the Audit Committee of the Board to the company in light of anonymous whistle-blower complaint. Further, healthy deal signings, digital growth and scope of margin expansion would drive the profitability. In addition, we expect valuation gap between Infosys and TCS (P/E discount of ~25% based on FY21E EPS) to narrow with improving financials. We roll over our valuations on FY22E and maintain BUY rating on the stock with a revised target price of ₹ 890 (based on 18x FY22E EPS).



Particulars

Particular	Amount
Market Capitalization (₹ Crore)	336,424.1
Total Debt	-
Cash and Investments (₹ Crore)	26,195.0
EV (₹ Crore)	310,229.1
52 week H/L	847 / 615
Equity capital	2,170.0
Face value	₹ 5

Key Highlights

- Marginally below than expectations on operational front mainly due to higher decline in core business
- Healthy large deal wins (up 14.6% YoY) and robust growth in digital revenues (up 39.9% YoY & 7.2% QoQ) were key positives
- Expect margins to see improved trajectory with presence of several tailwinds
- Maintain BUY with a revised target price of ₹ 890

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Key Financial Summary

₹ Crore	FY18	FY19	FY20E	FY21E	FY22E	CAGR (FY19-22E)
Net Sales	70,522	82,676	91,148	100,732	109,798	9.9%
EBITDA	19,010	20,890	22,696	26,392	28,767	11.3%
EBITDA Margins (%)	27.0	25.3	24.9	26.2	26.2	
Net Profit	14,597	15,411	17,087	19,695	21,553	
EPS (₹)	32.3	35.4	39.3	45.3	49.6	11.9%
P/E	23.9	21.8	19.7	17.1	15.6	
RoNW (%)	22.5	23.7	24.2	25.5	25.7	
RoCE (%)	30.9	32.9	32.2	34.5	34.7	

Source: Company, ICICI Direct Research

Exhibit 1: Variance Analysis

	Q3FY20	Q3FY20E	Q3FY19	YoY (%)	Q2FY20	QoQ (%)	Comments
Revenue	23,092	23,205	21,400	7.9	22,629	2.0	Constant currency (CC) revenues grew 1% QoQ driven by manufacturing and lifesciences verticals
Employee expenses	14,636	14,572	13,436	8.9	14,352	2.0	
Gross Profit	8,456	8,632	7,964	6.2	8,277	2.2	
Gross margin (%)	36.6	37.2	37.2	-60 bps	36.6	4 bps	
Selling & marketing costs	1,204	1,207	1,156	4.2	1,162	3.6	
G&A expenses	1,451	1,508	1,398	3.8	1,476	-1.7	
EBITDA	5,801	5,917	5,410	7.2	5,639	2.9	
EBITDA Margin (%)	25.1	25.5	25.3	-16 bps	24.9	20 bps	
Depreciation	737	743	580	27.1	727	1.4	
EBIT	5,064	5,175	4,830	4.8	4,912	3.1	
EBIT Margin (%)	21.9	22.3	22.6	-64 bps	21.7	22 bps	EBIT margins expanded 20 bps sequentially to 21.9% due to impact from lower utilisation (-40 bps) partially offset by currency benefit (+10 bps) and cost optimization along with higher offshoring helping margins by +50 bps
Other income	827	614	753	9.8	626	32.1	
PBT	5,891	5,789	5,583	5.5	5,538	6.4	
Tax paid	1,383	1,523	1,522	-9.1	1,459	-5.2	
Reported PAT	4,466	4,224	3,610	23.7	4,037	10.6	Reported PAT came in above our estimate due to higher other income and benefit of tax refund

Key Metrics

Closing employees	243,454	241,486	225,501	8.0	236,486	2.9	Net addition of 6968 employees in the quarter
LTM attrition-standalone (%)	17.6	19.0	17.8	-20 bps	19.4	-180 bps	Attrition witnessed a dip for the second straight quarter. Sustainability of the same needs to be watched
Utilisation -ex trainees (%)	84.4	84.5	83.8	60 bps	84.9	-50 bps	
Average \$/₹	71.2	71.2	71.6	-0.6	70.5	1.0	

Source: Company, ICICI Direct Research

Exhibit 2: Change in estimates

	FY20E			FY21E			FY22E	Comments
(₹ Crore)	Old	New	% Change	Old	New	% Change	Introduced	
Revenue	90,830	91,148	0.3	100,429	100,732	0.3	109,798	Largely maintain our estimates for FY20E & FY21E and introduce FY21E estimates
EBIT	20,164	19,779	-1.9	23,099	23,168	0.3	25,254	
EBIT Margin (%)	22.2	21.7	-50 bps	23.0	23.0	0 bps	23.0	Revision in margin estimates for FY20E taking into account miss in the quarter and Q4 visibility
PAT	17,026	17,087	0.4	19,475	19,695	1.1	21,553	
EPS (₹)	39.1	39.3	0.4	44.8	45.3	1.1	49.6	

Source: Company, ICICI Direct Research

Conference Call Highlights

- **Revenue outlook:** Acquisition of Eishtec contributed \$3 million to revenues in the quarter. Taking into account 9MFY20 performance, Infosys has raised its constant currency revenue growth guidance to 10-10.5% (from 9-10%) for FY20E
- **Margin trajectory:** 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 healthy with deal signings worth ~US\$1.8 billion in the quarter, up 14.6% YoY. Out of the overall deal pipeline, 32% is net new deal wins, which improved compared to last quarter (10%). Infosys signed 14 large deals with eight in the US, five in Europe and one in RoW. Among verticals, financial services constituted 7, communication & manufacturing constituted two deals each; retail, energy & utilities, lifesciences and others bagged one deal each
- **Digital story:** Digital continues to drive the growth of the company with 39.9% YoY growth and constituting 40.6% of revenues (vs. 31.5% in Q3FY19). Further, the company continues to see traction in areas of data analytics, customer experience, cloud and IoT and continues to be the key focus areas for the company
- **Vertical commentary:** Growth from the vertical perspective was driven by manufacturing and lifesciences vertical. Manufacturing grew 3% QoQ while lifesciences grew 5.8% sequentially. Vertical based commentary indicates 1) Financial services in North America witnessed growth while was weak in Europe and RoW. Pressure is expected to continue in the near term 2) Retail too witnessed growth in North America while de-grew in Europe. Though it is expected to remain volatile based on consumer sentiments and macro 3) Momentum in existing clients led the growth in manufacturing amid weakness in auto 4) Seasonality and an insourcing by a client impacted energy & utilities revenues, though deal pipeline in the vertical looks healthy 5) Communication revenues were largely flat QoQ. Though large deal wins and increased spending in certain sub-segments points to positive outlook for the vertical
- **Client metrics:** Highlight of the quarter was addition of one client in US\$100 million bucket taking the count to 28. Number of clients remained constant in US\$50 million bucket. Twelve clients transitioned in US\$1 million category taking the total count to 705
- **Employee update:** The company hired around 6968 people on a net basis taking employee strength to 243,454. Attrition both on standalone and consolidated level witnessed sharp decline for another straight quarter. Attrition (consolidated) and attrition (standalone) declined 180 bps and 210 bps to 19.6% and 17.6%, respectively. Though sustainability of these levels need to be watched for. Utilisation (ex-trainees) dipped 50 bps sequentially to 84.4% mainly on account of quarter seasonality
- **No evidence on anonymous whistle-blower complaint:** In a detailed press release, Infosys stated that Audit Committee of Infosys has concluded the independent investigation into allegations contained in the anonymous whistle-blower complaints disclosed on October 21, 2019 and determined that the allegations are substantially without merit. The allegations regarding treasury policy, large deal approvals, revenue recognition of three large deals/ JVs and visa costs are unsubstantiated

Key Metrics

Exhibit 3: Geography-wise split up

	Q2FY19	Q3FY19	Q4FY19	Q1FY20	Q2FY20	Q3FY20
<u>Revenue by geography (%)</u>						
North America	60.3	60.4	61.2	61.6	61.4	61.3
Europe	24.0	24.2	24.0	23.6	24.1	24.4
India	2.5	2.6	2.3	2.3	2.7	2.8
ROW	13.2	12.8	12.5	12.5	11.8	11.5
<u>Growth QoQ in \$ terms (%)</u>						
North America	3.7	2.4	3.8	3.0	2.2	0.9
Europe	1.9	3.1	1.6	0.6	4.7	2.3
India	-0.8	6.3	-9.4	2.3	20.4	4.8
ROW	4.0	-0.8	0.0	2.3	-3.2	-1.5

Source: Company, ICICI Direct Research

RoW was muted while growth in Europe was healthy

Exhibit 4: Vertical-wise split up

	%contribution to revenues Q3FY20	%contribution to revenues Q2FY20	Growth QoQ (%)
Revenue by verticals (%)			
Financial Services	31.5	31.9	-0.2
Retail	15.3	15.2	1.7
Communication	13.0	13.1	0.3
Energy, Utilities, Resources & Services	12.8	13.1	-1.3
Manufacturing	10.3	10.1	3.0
Hi Tech	7.6	7.6	1.0
Life Sciences	6.7	6.4	5.8
Others	2.8	2.6	11.5

Source: Company, ICICI Direct Research

Among verticals, growth was led by manufacturing and lifesciences

Exhibit 5: Client & human resource matrix

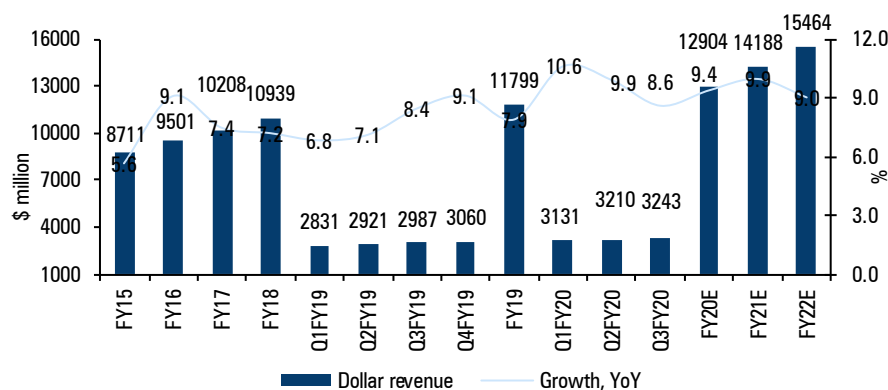
	Q2FY19	Q3FY19	Q4FY19	Q1FY20	Q2FY20	Q3FY20
<u>Client metrics</u>						
5 Million \$ clients	633	651	662	680	693	705
25 Million \$ clients	205	214	222	228	228	232
50 Million \$ clients	58	59	60	59	61	61
100 Million \$ clients	23	23	25	27	27	28
<u>Headcount, Utilization & Attrition</u>						
Total Employees	217739	225501	228123	229029	236486	243454
Utilization (Excluding trainees)	85.6	83.8	82.3	83.1	84.9	84.4
LTM Attrition (Standalone)	19.9	17.8	18.3	21.5	19.4	17.6

Source: Company, ICICI Direct Research

One client added in US\$100 million category

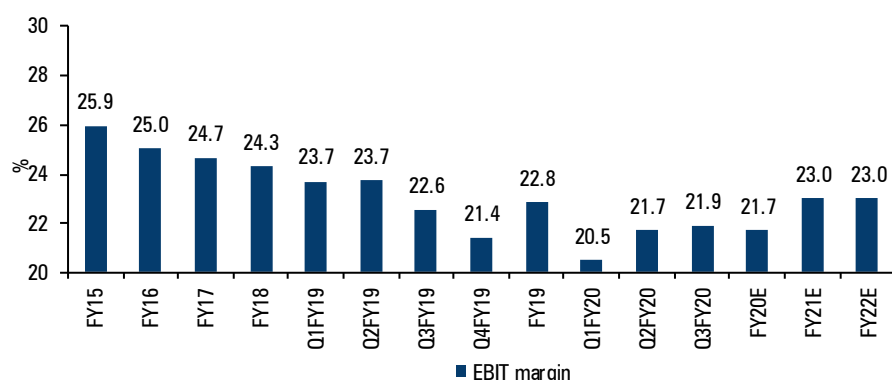
Financial story in charts

Exhibit 6: Dollar revenues may grow at 9.4% CAGR in FY19-22E



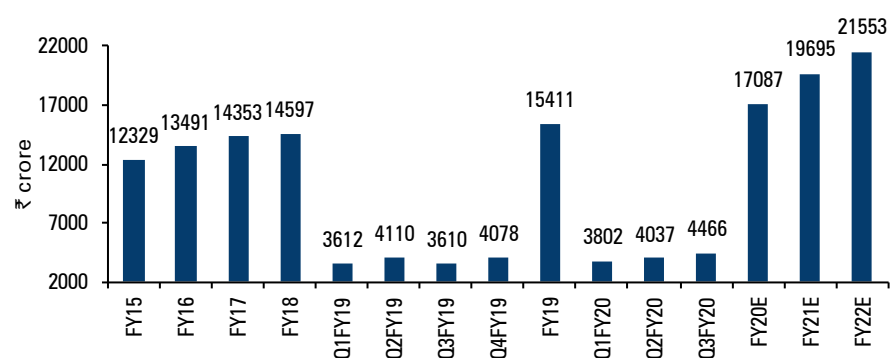
Source: Company, ICICI Direct Research

Exhibit 7: Change in margin estimates for FY20E



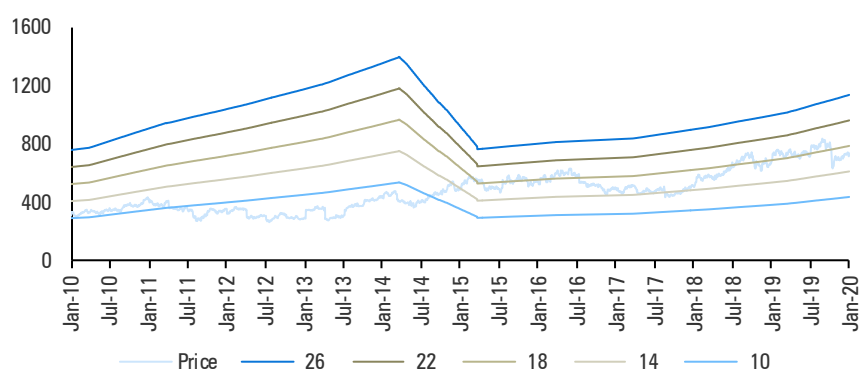
Source: Company, ICICI Direct Research

Exhibit 8: PAT trend



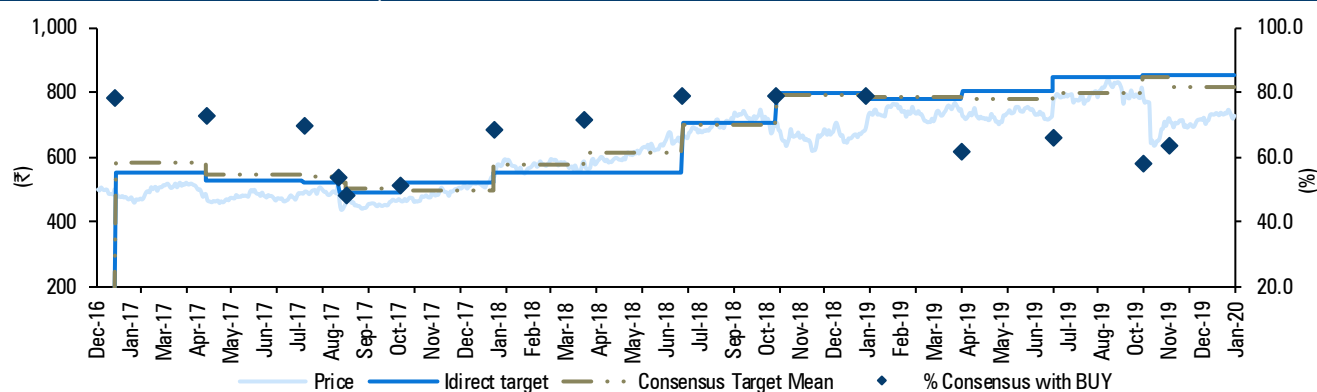
Source: Company, ICICI Direct Research

Exhibit 9: One year forward rolling PE



Source: Company, ICICI Direct Research

Exhibit 10: Recommendation History vs. Consensus



Source: Bloomberg, Company, ICICI Direct Research

Exhibit 11: Top 10 Shareholders

Rank	Name	Latest Filing Date	% O/S Position (m)	Change (m)
1	DEUTSCHE BANK TRUST	3-Sep-19	17.5%	745.7
2	LIFE INSURANCE CORP	3-Sep-19	6.0%	254.7
3	BLACKROCK	31-May-19	5.0%	211.3
4	Gopalakrishnan Senap	3-Sep-19	3.2%	137.2
5	VANGUARD GROUP	30-Nov-19	3.0%	126.6
6	HDFC ASSET MANAGEMEN	31-Dec-19	2.6%	108.7
7	SBI FUNDS MANAGEMENT	3-Sep-19	2.5%	104.6
8	ICICI PRUDENTIAL ASS	30-Nov-19	2.3%	98.2
9	REPUBLIC OF SINGAPOR	3-Sep-19	1.9%	80.5
10	Murthy Rohan	3-Sep-19	1.4%	60.8

Source: Bloomberg, ICICI Direct Research

Exhibit 12: Shareholding Pattern

(in %)	Jun-19	Sep-19	Dec-19
Promoter	13.04	13.15	13.15
Public	86.49	86.39	86.40
Others	0.47	0.45	0.44
Total	100.00	100.00	100.00

Source: Company, ICICI Direct Research

Financial summary

Exhibit 13: Profit and loss statement ₹ crore				
(Year-end March)	FY19	FY20E	FY21E	FY22E
Total operating Income	82,676	91,148	100,732	109,798
Growth (%)	17.2	10.2	10.5	9.0
COGS (employee expenses)	51,857	57,970	63,260	68,953
Admin expenses	5,454	5,742	5,742	6,258
S&M expenses	4,475	4,740	5,339	5,819
Total Operating Expenditure	61,786	68,452	74,340	81,031
EBITDA	20,890	22,696	26,392	28,767
Growth (%)	9.9	8.6	16.3	9.0
Depreciation	2,011	2,917	3,223	3,514
Other Income	2,883	3,311	3,811	4,272
PBT	21,041	23,090	26,979	29,525
Total Tax	5,630	6,003	7,284	7,972
PAT	15,411	17,087	19,695	21,553
Growth (%)	5.6	10.9	15.3	9.4
EPS (₹)	35.4	39.3	45.3	49.6
Growth (%)	9.5	10.9	15.4	9.4

Source: Company, ICICI Direct Research

Exhibit 14: Cash flow statement ₹ crore				
(Year-end March)	FY19	FY20E	FY21E	FY22E
Profit after Tax	15,411	17,087	19,695	21,553
Add: Depreciation	2,011	2,917	3,223	3,514
(Inc)/dec in Current Assets	(3,720)	(1,393)	(2,917)	(1,661)
Inc/(dec) in CL and Provisions	3,128	1,520	2,179	1,119
Taxes paid	(6,832)	(6,003)	(7,284)	(7,972)
CF from operating activities	15,844	16,820	18,369	20,253
(Inc)/dec in Investments	1,369	3,311	3,811	4,272
(Inc)/dec in Fixed Assets	(2,445)	(3,500)	(3,000)	(3,000)
CF from investing activities	(1,578)	(189)	811	1,272
Dividend paid & dividend tax	(13,705)	(11,588)	(13,064)	(14,665)
Others	6	-	-	-
CF from financing activities	(14,512)	(11,588)	(13,064)	(14,665)
Net Cash flow	(246)	5,042	6,116	6,860
Exchange difference	(57)	-	-	-
Opening Cash	19,818	19,568	24,610	30,727
Closing Cash	19,568	24,610	30,727	37,586

Source: Company, ICICI Direct Research

Exhibit 15: Balance sheet ₹ crore				
(Year-end March)	FY19	FY20E	FY21E	FY22E
Equity Capital	2,170	2,170	2,170	2,170
Reserve and Surplus	62,836	68,334	74,965	81,853
Total Shareholders funds	65,006	70,504	77,135	84,023
Employee benefit obligations	44	44	44	44
Debt	-	-	-	1
Deferred Tax Liability	672	672	672	672
Other non current liabilities	378	378	378	378
Total Liabilities	66,100	71,598	78,229	85,118
Assets				
Property, plant and equipment	13,356	13,939	13,716	13,202
Goodwill	3,540	3,540	3,540	3,540
Intangibles	691	691	691	691
Available for sale assets	4,634	4,634	4,634	4,634
Other assets	9,639	9,639	9,639	9,639
Cash	19,568	24,610	30,727	37,586
Current Investments	6,627	6,627	6,627	6,627
Trade receivables	14,827	16,346	18,065	19,691
Unbilled revenue	5,374	5,013	6,548	6,039
Prepayment & O.fin.assets	6,146	6,380	6,044	6,588
Other current assets	336	336	336	336
Total Current Assets	52,878	59,313	68,347	76,867
Trade payables	1,655	1,825	2,016	2,198
Unearned revenue	2,809	3,097	3,422	3,730
OCL & provisions	14,174	15,237	16,898	17,528
Total Current Liabilities	18,638	20,158	22,337	23,456
Net Current Assets	34,240	39,155	46,009	53,411
Application of Funds	66,100	71,598	78,229	85,118

Source: Company, ICICI Direct Research

Exhibit 16: Key ratios				
(Year-end March)	FY19	FY20E	FY21E	FY22E
Per share data (₹)				
EPS	35.4	39.3	45.3	49.6
Cash EPS	40.0	46.0	52.7	57.7
BV	149	162	177	193
DPS	21.5	22.1	24.9	28.0
Cash Per Share	45	57	71	86
Operating Ratios (%)				
EBIT Margin	22.8	21.7	23.0	23.0
PBT Margin	25.4	25.3	26.8	26.9
PAT Margin	18.6	18.7	19.6	19.6
Debtor days	65	65	65	65
Unbilled revenue	21	21	21	21
Creditor days	7	7	7	7
Return Ratios (%)				
RoE	23.7	24.2	25.5	25.7
RoCE	32.9	32.2	34.5	34.7
RoIC	47.3	49.0	56.7	61.7
Valuation Ratios (x)				
P/E	22	20	17	16
EV / EBITDA	15	13	11	10
EV / Net Sales	4	3	3	3
Market Cap / Sales	4	4	3	3
Price to Book Value	5	5	4	4
Solvency Ratios				
Debt/EBITDA	-	-	-	0
Debt / Equity	-	-	-	0
Current Ratio	2	2	2	2
Quick Ratio	2	2	2	2

Source: Company, ICICI Direct Research

Exhibit 17: 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)	583	600	Hold	152,663	37.3	38.4	42.8	15.1	14.7	13.2	10.5	9.3	7.9	26.9	25.3	24.7	24.5	21.4	20.6
Infosys (INFTEC)	773	890	Buy	336,424	35.4	39.3	45.3	21.8	19.7	17.1	14.9	13.4	11.3	32.9	32.2	34.5	23.7	24.2	25.5
MindTree (MINCON)	834	690	Hold	11,953	45.9	33.7	45.8	15.9	21.6	15.9	10.3	10.9	8.5	29.8	22.1	26.5	22.8	15.3	18.6
L&T Intotech (LTINFO)	1,824	2,025	Buy	30,033	87.3	89.3	103.6	19.8	19.4	16.7	14.8	13.4	11.2	40.4	34.5	33.6	31.0	26.5	25.8
NIIT Tech (NIITEC)	1,757	1,415	Hold	8,931	65.7	73.6	83.2	22.1	20.3	17.7	12.4	10.6	9.2	25.2	23.5	23.8	19.5	19.2	19.2
TCS (TCS)	2,203	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)	784	900	Buy	70,424	47.7	47.6	54.9	16.4	16.4	14.3	9.9	9.8	8.3	23.6	21.2	21.9	21.2	18.5	18.7
Wipro (WIPRO)	255	300	Buy	150,558	14.9	17.2	20.5	16.7	14.5	12.2	10.2	9.9	7.9	17.8	18.7	20.0	15.8	18.0	19.1

Source: Company, ICICI Direct Research

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Reduce: -15% to -5%;

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