

Sector: IT & ITES

Result Update

	Change
Reco: Buy	↔
CMP: Rs. 831	
Price Target: Rs. 920	↑

↑ Upgrade ↔ No change ↓ Downgrade

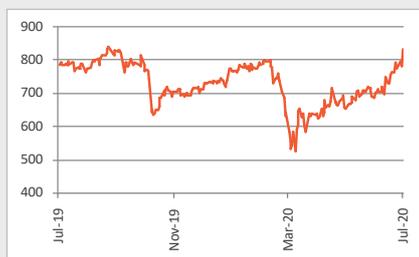
Company details

Market cap:	Rs. 354,127 cr
52-week high/low:	Rs.848 / 511
NSE volume: (No of shares)	99.3 lakh
BSE code:	500209
NSE code:	INFY
Sharekhan code:	INFY
Free float: (No of shares)	369.8 cr

Shareholding (%)

Promoters	13.2
FII	49.1
DII	24.7
Others	13.1

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	21.0	30.1	7.2	5.9
Relative to Sensex	10.8	9.6	20.0	12.4

Sharekhan Research, Bloomberg

Infosys reported better-than-expected results on all financial fronts despite supply-side constraints, with strong deal wins and free cash flow (FCF) generation. Constant currency (CC) revenue declined by 2% q-o-q, way above consensus estimates, led by limited impact of supply-side issues (10% of total revenue impact). Revenue increase on a y-o-y basis (1.5% CC) was driven by positive growth in hi-tech, life science, and financial services verticals. Further, digital CC revenue growth of 25.5% y-o-y aided growth. EBIT margin improved by 150 bps q-o-q to 22.7%, significantly exceeding our estimates, led by currency tailwinds (+70 bps), lower travel expenses (+230 bps), and lower SG&A expenses (+110 bps), which were partially offset by lower utilisation (-150 bps) and higher variable pay (-100 bps). Net profit of Rs. 4,233 crore was 9.9% ahead of our estimate, supported by higher operating margin. Surprisingly, management resumed guidance with annual revenue growth guidance of 0-2% in CC for FY2021E, while TCS's management expects flat CC revenue on y-o-y comparison by March 2021. Despite concerns relating to potential second wave of lockdown, the company expects positive growth in FY2021E because of its strong relationships with clients, traction for its digital offerings, higher localisation in the U.S., strong deal wins especially in the BFSI vertical, and healthy deal pipeline. Even as reduction of IT spending is expected during 2020, Infosys is well poised to gain share in the recessionary environment and outperform peers in terms of revenue growth in FY2021E.

Key positives

- ◆ TCV wins of \$1.7 billion in Q1FY2021, up 6% q-o-q
- ◆ EBIT margin at 22.7%, significantly exceeding our estimates
- ◆ Guided revenue growth of 0-2% and operating margin at 21-23% for FY2021E

Key negatives

- ◆ Continued softness in capital markets and payments segment
- ◆ Witnessing reduction in discretionary spending as clients' focus on preserving cash

Our Call

Valuation – Maintain Buy with a revised PT of Rs. 920: We have revised our earnings estimates upwards for FY2021E/FY2022E, factoring in strong Q1FY2021 results and impressive annual guidance on both revenue and margin for FY2021E. We believe Infosys is well positioned to deliver strong growth in FY2022E because of pent-up demand, strong digital capabilities, and market share gains. At the CMP, the stock is trading at 21x/19x its FY2021E/FY2022E earnings estimates. Infosys is one of the industry leaders with robust execution capabilities and strong balance sheet (cash balance of \$3.8 billion, which is around 8% of current market capitalisation) with healthy FCF generation capability. Hence, we maintain our Buy rating on the stock with a revised PT of Rs. 920.

Key Risks

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

Valuation

Particulars	FY18	FY19	FY20	FY21E	FY22E
Revenue	70,522.0	82,675.0	90,791.0	97,366.0	107,255.8
OPM (%)	27.0	25.3	24.5	25.0	25.2
Adjusted PAT	14,597.0	15,856.0	16,594.0	17,026.2	18,925.2
% YoY growth	1.7	8.6	4.7	2.6	11.2
Adjusted EPS (Rs.)	32.4	35.4	39.0	40.1	44.6
P/E (x)	25.7	23.5	21.3	20.8	18.6
P/B (x)	2.9	2.9	2.9	2.9	2.8
EV/EBITDA (x)	17.2	15.7	15.0	13.6	12.2
RoNW (%)	23.9	23.7	25.4	25.9	28.5
RoCE (%)	30.2	32.2	32.3	33.5	37.9

Source: Company; Sharekhan estimates

Strong beat in tough times

Infosys reported better-than-expected results on all financial fronts with strong TCVs of large deals and FCF generation. The company's CC revenue declined by 2% q-o-q (way above consensus estimates) and increased by 1.5% y-o-y. Total revenue impact during the quarter was contributed by supply-side constraints (10% of total impact) and the remaining by demand side. Revenue increase on a y-o-y basis was driven by strong growth in hi-tech and life sciences vertical. Financial services vertical's revenue grew by 2.1% y-o-y on CC basis during the quarter. Further, digital CC revenue growth of 25.5% y-o-y aided growth. On a reported basis, USD revenue declined by 2.4% q-o-q to \$3,121 million. EBIT margin improved by 150 bps q-o-q to 22.7%, significantly exceeding our estimates. Margin improvement during the quarter was driven by currency tailwinds (+70 bps), lower travel expenses (+230 bps), and lower SG&A expenses (+110 bps), partially offset by lower utilisation (-150 bps) and higher variable pay (-100 bps). Net profit of Rs. 4,233 crore (-2% q-o-q, +11.5% y-o-y) was 9.9% ahead of our estimates, aided by strong improvement in operating margin.

Guidance reinstated; deal wins remains strong

Infosys' management resumed its annual revenue growth guidance despite concerns relating to potential second wave of infections in the view of COVID-19. Surprisingly, management has guided FY2021E revenue growth of 0-2% in CC, while TCS's management expects flat CC revenue on y-o-y comparison in Q4FY2021. Further, the company expects operating margin to remain at 21-23% (EBIT margin was 21.3% in FY2020). Even as reduction of IT spending is expected during 2020, Infosys is well positioned to gain share in the recessionary environment and outperform peers in terms of revenue growth. Management indicated faster recovery in volume and deal in financial services vertical especially in USA and APAC during the quarter, though it continues to see softness in capital market and payment sector. However, deal wins momentum remains strong across the vertical, given strong demand for digital transformation, cloud, work transformation, cost efficiency, automation, and cyber security. Given strong relationship with clients, superior digital capabilities, and strong local presence in key markets, Infosys is well positioned to deliver strong growth in FY2022E due to pent-up demand and market share gains.

Key result highlights from earnings call

- ♦ **Strong performance in multiple areas:** Infosys' Q1FY2021 results were strong across multiple dimensions such as strong digital revenue growth, large deal wins, healthy improvement in operating margin, strong cash collection, which led to health cash flows, and reduction in attrition.
- ♦ **Reinstated guidance:** Given strong Q1FY2021 results and strong client relationships, management has reinstated the annual guidance for both revenue and EBIT margin for FY2021. Management has provided FY2021E annual revenue growth guidance of 0-2% on CC and operating margin to be at 21-23%.
- ♦ **Strong growth in digital business:** Digital revenue grew by 25.5% y-o-y in CC as against 31.7% y-o-y growth in Q4FY2020. Digital business revenue contributes 44.5% to total revenue versus 41.9% in Q4FY2020. The increase in demand in data and analytics, cloud, security, cost efficiency, and IOT would continue to drive growth in digital.
- ♦ **Vertical performance:** Five out of eight verticals, i.e. hi-tech (up 13.4% CC y-o-y), life sciences (up 7.7% CC y-o-y), financial services (up 2.1% CC y-o-y), and others (24.4% CC y-o-y) reported positive revenue growth on a y-o-y basis during the quarter. While manufacturing (up 0.3% CC y-o-y), energy and utilities (-0.2% CC y-o-y), and communication (-0.7% CC y-o-y) reported muted growth on a y-o-y basis. Growth in financial services decelerated to 2.1% CC y-o-y in Q1FY2021 from 5.7% CC y-o-y in Q4FY2020, while the retail vertical's revenue declined to 7.4% CC y-o-y in Q1FY2021 from 4.2% CC y-o-y revenue growth in Q4FY2020. Revenue in energy and utilities vertical declined to 0.2% CC y-o-y in Q1FY2021 versus 7.3% CC y-o-y growth in Q4FY2020.
- ♦ **Large deal wins:** Infosys has signed 15 large deals during the quarter, with TCVs of \$1.74 billion (versus \$1.65 billion/\$2.7 billion in Q4FY2020/Q1FY2020). Out of 15 large deals, the company won five deals in financial services, three deals each in retail, energy and utilities, and hi-tech and one deal in manufacturing. Geography wise, the company signed 13 deals in North America and two deals in Europe. The share of new deals to overall TCVs stood at about 19% versus 66% in Q4FY2020.
- ♦ **Client metrics and strong growth in top account:** Infosys added 110 new clients during the quarter. The number of \$100 million clients dropped by three on a q-o-q basis to 25, while \$50 million clients declined by one on a q-o-q basis. The number of \$10 million increased by two q-o-q to 236. Revenue from large clients increased by 7.1% q-o-q during the quarter, while revenue from top 10 and top 25 clients remained flat on a q-o-q basis.
- ♦ **Lower impact of supply-side challenges:** Infosys helped clients to run their operations seamlessly by enabling remote work support. The company's supply enablement lowered the impact of COVID-19 compared to what was estimated at the beginning of the year.
- ♦ **Lower utilisation:** Utilisation dropped sequentially during the quarter to 81.2% from 83.5% in Q4FY2020, primarily owing to supply-side constraints in view of COVID-19. Onsite utilisation remained steady during the quarter despite drop in the beginning of the quarter.
- ♦ **Attrition rate:** Attrition rate was down to 11.7% versus 18.2% in Q4FY2020. There is significant improvement in the attrition rate during the quarter. This is significantly lower compared to its comfortable band of 13-14%.
- ♦ **Strong balance sheet and cash flows:** Infosys had cash balance of \$3.8 billion with no debt. Increased focus on cash collections resulted in \$728 million of FCF during the quarter. FCF grew by 22.8% q-o-q and 50.1% y-o-y during the quarter.
- ♦ **Higher localisation helped mitigate risks:** Infosys' early investments in localisation initiatives in the U.S. helped the company to minimise supply-side issues during the period of travel restrictions. As majority workforce in the U.S. is local, it helped the company to better manage the evolving visa regulations in the U.S.

Results

Particulars	Rs cr				
	Q1FY21	Q1FY20	Q4FY20	y-o-y (%)	q-o-q (%)
Revenue (\$ mn)	3,121.0	3,131.0	3,197.0	-0.3	-2.4
Net sales	23,665.0	21,803.0	23,267.0	8.5	1.7
Direct costs	14,947.0	14,098.0	14,752.0	6.0	1.3
Gross profit	8,718.0	7,705.0	8,515.0	13.1	2.4
SG&A	2,597.0	2,553.0	2,839.0	1.7	-8.5
EBITDA	6,121.0	5,152.0	5,676.0	18.8	7.8
Depreciation & amortisation	756.0	681.0	749.0	11.0	0.9
EBIT	5,365.0	4,471.0	4,927.0	20.0	8.9
Other income	427.0	696.0	569.0	-38.6	-25.0
PBT	5,792.0	5,167.0	5,496.0	12.1	5.4
Tax provision	1,520.0	1,365.0	1,161.0	11.4	30.9
Reported net profit	4,233.0	3,802.0	4,321.0	11.3	-2.0
Adjusted net profit	4,233.0	3,802.0	4,321.0	11.3	-2.0
EPS (Rs.)	10.0	8.8	10.2	13.0	-2.1
Margin (%)				bps	bps
EBITDA	25.9	23.6	24.4	224	147
EBIT	22.7	20.5	21.2	216	149
NPM	17.9	17.4	18.6	45	(68)

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	q-o-q	
Revenue (\$ mn)	3,121		100		-2.4	-0.3	1.5	
Geographic mix								
North America	1,919		61.5		-2.5	-0.5	0.0	
Europe	749		24.0		-4.0	1.4	4.4	
India	91		2.9		8.9	25.7	32.8	
Rest of world	362		11.6		-0.7	-7.5	-2.0	
Industry verticals								
Financial services	983		31.5		-1.8	0.0	2.1	
Retail	446		14.3		-9.9	2.6	-7.4	
Communication	418		13.4		0.6	-0.1	-0.7	
Energy, utilities, resources & services	399		12.8		-3.1	5.4	-0.2	
Manufacturing	296		9.5		-8.2	5.8	0.3	
Hi tech	272		8.7		7.5	7.3	13.4	
Life sciences	209		6.7		2.2	9.5	7.7	
Others	97		3.1		4.4	18.8	24.4	
Service line								
Digital	1,389		44.5		3.6	24.1	25.5	
Core	1,732		55.5		-6.7	-13.9	-11.8	
Clients Contribution								
Top client	106		3.4		7.1	5.9		
Top 10 clients	602		19.3		0.8	-3.8		
Top 25 clients	1,080		34.6		-0.9	-1.2		
Revenue per employee								
Revenue per FTE (\$ K)	53.5		-		0.0	0.0		
Deal wins (\$ mn)								
TCV	1,744		-		6.0	-35.7		

Source: Company; Sharekhan Research

Outlook

The COVID-19 outbreak is causing supply disruption and will lead to material deterioration of the demand environment and cut in discretionary spending, request for rate concession, and postponement of large deal wins. However, Infosys provides services to a large number of Fortune 500/Global 500 clients and these have a strong balance sheet and are able to hold on better in the economic downturn. Further, Infosys has aggressively invested in digital technologies in the past couple of years to capture the large portion of upcoming digital spends. Given strong relationships with clients and robust execution capabilities, Infosys is well positioned to capitalise on opportunities as and when clients boost their technology spends. The company has surprised us with providing annual revenue growth guidance of 0-2% for FY2021E despite forecast of decline in IT services spends worldwide in 2020.

Valuation

Best performance among peers: We have revised our earnings estimates upwards for FY2021E/FY2022E, factoring in strong Q1FY2021 results and impressive annual guidance on both revenue and margin fronts for FY2021E. We believe Infosys is well positioned to deliver strong growth in FY2022E because of pent-up demand, strong digital capabilities, and market share gains. At the CMP, the stock is trading at 21x/19x its FY2021E/FY2022E earnings estimates. Infosys is one of the industry leaders with robust execution capabilities and strong balance sheet (cash balance of \$3.8 billion, which is around 8% of current market capitalisation) with healthy FCF generation capability. Hence, we maintain our Buy rating on the stock with a revised PT of Rs. 920.

One-year forward P/E (x) band



Source: Sharekhan Research

Peer comparison

Particulars	CMP (Rs / Share)	O/S Shares (Cr)	MCAP (Rs Cr)	P/E (x)		EV/EBIDTA (x)		P/BV (x)		RoE (%)	
				FY21E	FY22E	FY21E	FY22E	FY21E	FY22E	FY21E	FY22E
HCL Tech	615	271	166,945	16.9	14.6	5.1	4.6	3.0	2.7	18.4	19.4
TCS	2,234	375	838,114	27.9	24.6	20.4	18.4	10.1	9.9	35.9	40.6
Wipro	263	570	150,261	16.4	15.0	4.5	3.9	2.6	2.4	13.9	14.0
Infosys	831	424	354,127	20.8	18.6	13.6	12.2	2.9	2.8	25.9	28.5

Source: Company, Sharekhan estimates

About company

Founded in 1981, Infosys is the second largest (\$12,780 million in FY2020) IT services company in India in terms of export revenue with 2.25 lakh number of head count. 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 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 the 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	17.36
2	Life Insurance Corp of India	6.62
3	BlackRock Inc	4.55
4	Vanguard Group Inc/The	3.02
5	SBI Funds Management Pvt Ltd	2.56
6	HDFC Asset Management Co Ltd	2.09
7	ICICI Prudential Asset Management	2.03
8	Republic of Singapore	1.64
9	ICICI Prudential Life Insurance Co	1.54
10	UTI Asset Management Co Ltd	1.22

Source: Bloomberg

Sharekhan Limited, its analyst or dependant(s) of the analyst might be holding or having a position in the companies mentioned in the article.

Sharekhan

by BNP PARIBAS

Know more about our products and services

For Private Circulation only

Disclaimer: This document has been prepared by Sharekhan Ltd. (SHAREKHAN) and is intended for use only by the person or entity to which it is addressed to. This Document may contain confidential and/or privileged material and is not for any type of circulation and any review, retransmission, or any other use is strictly prohibited. This Document is subject to changes without prior notice. This document does not constitute an offer to sell or solicitation for the purchase or sale of any financial instrument or as an official confirmation of any transaction. Though disseminated to all customers who are due to receive the same, not all customers may receive this report at the same time. SHAREKHAN will not treat recipients as customers by virtue of their receiving this report.

The information contained herein is obtained from publicly available data or other sources believed to be reliable and SHAREKHAN has not independently verified the accuracy and completeness of the said data and hence it should not be relied upon as such. While we would endeavour to update the information herein on reasonable basis, SHAREKHAN, its subsidiaries and associated companies, their directors and employees ("SHAREKHAN and affiliates") are under no obligation to update or keep the information current. Also, there may be regulatory, compliance, or other reasons that may prevent SHAREKHAN and affiliates from doing so. This document is prepared for assistance only and is not intended to be and must not alone be taken as the basis for an investment decision. Recipients of this report should also be aware that past performance is not necessarily a guide to future performance and value of investments can go down as well. The user assumes the entire risk of any use made of this information. Each recipient of this document should make such investigations as it deems necessary to arrive at an independent evaluation of an investment in the securities of companies referred to in this document (including the merits and risks involved), and should consult its own advisors to determine the merits and risks of such an investment. The investment discussed or views expressed may not be suitable for all investors. We do not undertake to advise you as to any change of our views. Affiliates of Sharekhan may have issued other reports that are inconsistent with and reach different conclusions from the information presented in this report.

This report is not directed or intended for distribution to, or use by, any person or entity who is a citizen or resident of or located in any locality, state, country or other jurisdiction, where such distribution, publication, availability or use would be contrary to law, regulation or which would subject SHAREKHAN and affiliates to any registration or licensing requirement within such jurisdiction. The securities described herein may or may not be eligible for sale in all jurisdictions or to certain category of investors. Persons in whose possession this document may come are required to inform themselves of and to observe such restriction.

The analyst certifies that the analyst has not dealt or traded directly or indirectly in securities of the company and that all of the views expressed in this document accurately reflect his or her personal views about the subject company or companies and its or their securities and do not necessarily reflect those of SHAREKHAN. The analyst further certifies that neither he or its associates or his relatives has any direct or indirect financial interest nor have actual or beneficial ownership of 1% or more in the securities of the company at the end of the month immediately preceding the date of publication of the research report nor have any material conflict of interest nor has served as officer, director or employee or engaged in market making activity of the company. Further, the analyst has also not been a part of the team which has managed or co-managed the public offerings of the company and no part of the analyst's compensation was, is or will be, directly or indirectly related to specific recommendations or views expressed in this document. Sharekhan Limited or its associates or analysts have not received any compensation for investment banking, merchant banking, brokerage services or any compensation or other benefits from the subject company or from third party in the past twelve months in connection with the research report.

Either SHAREKHAN or its affiliates or its directors or employees / representatives / clients or their relatives may have position(s), make market, act as principal or engage in transactions of purchase or sell of securities, from time to time or may be materially interested in any of the securities or related securities referred to in this report and they may have used the information set forth herein before publication. SHAREKHAN may from time to time solicit from, or perform investment banking, or other services for, any company mentioned herein. Without limiting any of the foregoing, in no event shall SHAREKHAN, any of its affiliates or any third party involved in, or related to, computing or compiling the information have any liability for any damages of any kind.

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

For any queries or grievances kindly email igc@sharekhan.com or contact: myaccount@sharekhan.com

Registered Office: Sharekhan Limited, 10th Floor, Beta Building, Lodha iThink Techno Campus, Off. JVLR, Opp. Kanjurmarg Railway Station, Kanjurmarg (East), Mumbai – 400042, Maharashtra. Tel: 022 - 61150000. Sharekhan Ltd.: SEBI Regn. Nos.: BSE / NSE / MSEI (CASH / F&O / CD) / MCX - Commodity: INZ000171337; DP: NSDL/CDSL-IN-DP-365-2018; PMS: INP000005786; Mutual Fund: ARN 20669; Research Analyst: INH000006183;

Disclaimer: Client should read the Risk Disclosure Document issued by SEBI & relevant exchanges and the T&C on www.sharekhan.com; Investment in securities market are subject to market risks, read all the related documents carefully before investing.