Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

3R MATRIX	+	=	-
Right Sector (RS)	✓		
Right Quality (RQ)	✓		
Right Valuation (RV)		✓	

\+ Positive = Neutral - Negative

What has changed in 3R MATRIX

	Old		New
RS		↔	
RQ		↔	
RV		↔	

Reco/View	Change
Reco: **Buy**	↔
CMP: **Rs. 1,132**	
Price Target: **Rs. 1,300**	↑

↑ Upgrade ↔ Maintain ↓ Downgrade

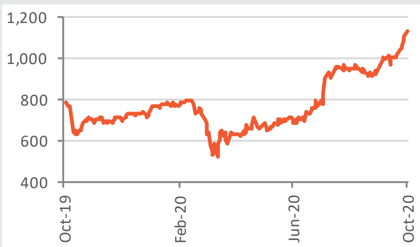
Company details

Market cap:	Rs. 482,293 cr
52-week high/low:	Rs. 1,139 / 511
NSE volume: (No of shares)	112.5 lakh
BSE code:	500209
NSE code:	INFY
Free float: (No of shares)	369.8 cr

Shareholding (%)

Promoters	13.2
FII	48.5
DII	26.3
Others	12.1

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	15.8	42.1	77.7	44.1
Relative to Sensex	11.0	31.5	45.5	37.9

Sharekhan Research, Bloomberg

Infosys

Poised to race ahead

IT & ITES	Sharekhan code: INFY	Company Update

Summary

- We maintain our Buy rating on Infosys with a revised price target to Rs. 1,300 by raising target multiple on expectation of strong results in Q2FY2021E
- We expect strong revenue growth in Q2FY2021, led by demand pick-up in both BFSI and retail verticals and ramp-up of large deals, while margin is expected to remain stable q-o-q
- COVID-19 crisis has become a catalyst for Indian IT sector, with acceleration of demand for cloud by clients; Infosys is well-placed to participate in the transformation journey of clients given its full-service model
- Infosys is currently trading at a 25x/22x its FY2022E/FY2023E EPS, at a 13%/12% discount to TCS; TCS' recent re-rating of target multiple has had a ripple-effect across the sector.

Infosys' stock price has risen 15.8% in the past one month, outperforming its largest peer TCS (despite strong performance) and broader indices by 2% and 11%, respectively. We believe Infosys could again beat the street's consensus estimates in Q2FY2021 and outperform TCS in terms of revenue growth in FY2021E. Growth in Q2 would be supported by a pick-up in demand in both BFSI and retail verticals and ramp-up of large deals. We expect margins to be stable with an upward bias in the coming quarters of FY2021E, despite pricing pressures. Margin levers are - (1) higher automation, (2) increasing offshore revenue mix, (3) pyramid rationalization, (4) reduction in subcontractor expenses and (5) cost-efficiency measures. Including the Vanguard deal, we expect Infosys would report record high deal TCVs and strong deal pipeline in Q2FY2021. Hence, we believe that Infosys may increase its guidance to 1-3% from 0-2% earlier, led by improving demand environment, anticipation of stable margin and a strong deal momentum.

The COVID-19 crisis has become a catalyst for the Indian IT sector, with acceleration of demand for cloud and cloud-enabling technologies, cyber-security, enhancement of customer experience, core modernisation and cost takeout by large global enterprises. TCS' management recently highlighted that enterprises are currently focusing on building a cloud-based foundation for operational resilience, which will shift towards building a scalable digital core and in the subsequent phases, the digital core would be utilized to innovative new business models and differentiated customer experiences. Infosys is well-placed to participate in this transformation journey given its digital capabilities, strong relationships with clients, better account mining practices and full-service model. Further, the company has recently acquired (1) Blue Acorn iCi to increase cross-technology capabilities through the convergence of customer experience, digital commerce and analytics and (2) Kaleidoscope to enhance capabilities in engineering services for medical devices, consumer and industrials markets.

Our Call

Valuation – Maintain Buy with a revised PT of Rs. 1,300: We expect Infosys would continue to outperform TCS in terms of growth in FY2021E and deliver industry-leading growth in FY2022E/FY2023E, led by continued large deal wins, enhanced digital capabilities (aided by organic investments, acquisitions and partnerships) and strong execution. Further, we believe that Infosys will be a key beneficiary in terms of acceleration of tech spends by large enterprises and vendor consolidation post COVID-19, given its full-service model and benefits from investments made over last two years. Margins are expected to remain stable. We prefer Infosys as it is one of the industry leaders with robust execution capabilities, strong balance sheet, healthy FCF generation capability and higher dividend payout. At CMP, the stock is trading at a 25x/22x its FY2022E/FY2023E EPS, at a 13%/12% discount to TCS. TCS's further re-rating of target multiple (led by its strong performance in Q2FY2021) has a ripple effect across the sector. As we are expecting a strong result from Infosys, we are assigning higher target multiple (to 25x from 22x) for Infosys that yields a revised target price of Rs. 1,300. We maintain our Buy rating on the stock.

Key Risks

Rupee appreciation and/or adverse cross-currency movements, slackening pace in deal closures would have an adverse impact on its earnings.

Valuations (Consolidated) Rs cr

Particulars	FY19	FY20	FY21E	FY22E	FY23E
Revenue	82,675.0	90,791.0	97,667.9	108,072.0	119,734.4
OPM (%)	25.3	24.5	25.2	25.1	25.2
Adjusted PAT	15,856.0	16,594.0	17,182.8	19,262.6	21,719.9
% YoY growth	*8.6*	*4.7*	*3.5*	*12.1*	*12.8*
Adjusted EPS (Rs.)	35.4	39.0	40.4	45.4	51.2
P/E (x)	32.0	29.1	28.0	24.9	22.1
P/B (x)	4.0	3.9	3.9	3.8	3.6
EV/EBITDA (x)	21.8	20.8	18.6	16.8	15.0
RoNW (%)	23.7	25.4	26.1	28.8	31.0
RoCE (%)	32.2	32.3	33.8	38.4	41.2

Source: Company; Sharekhan estimates

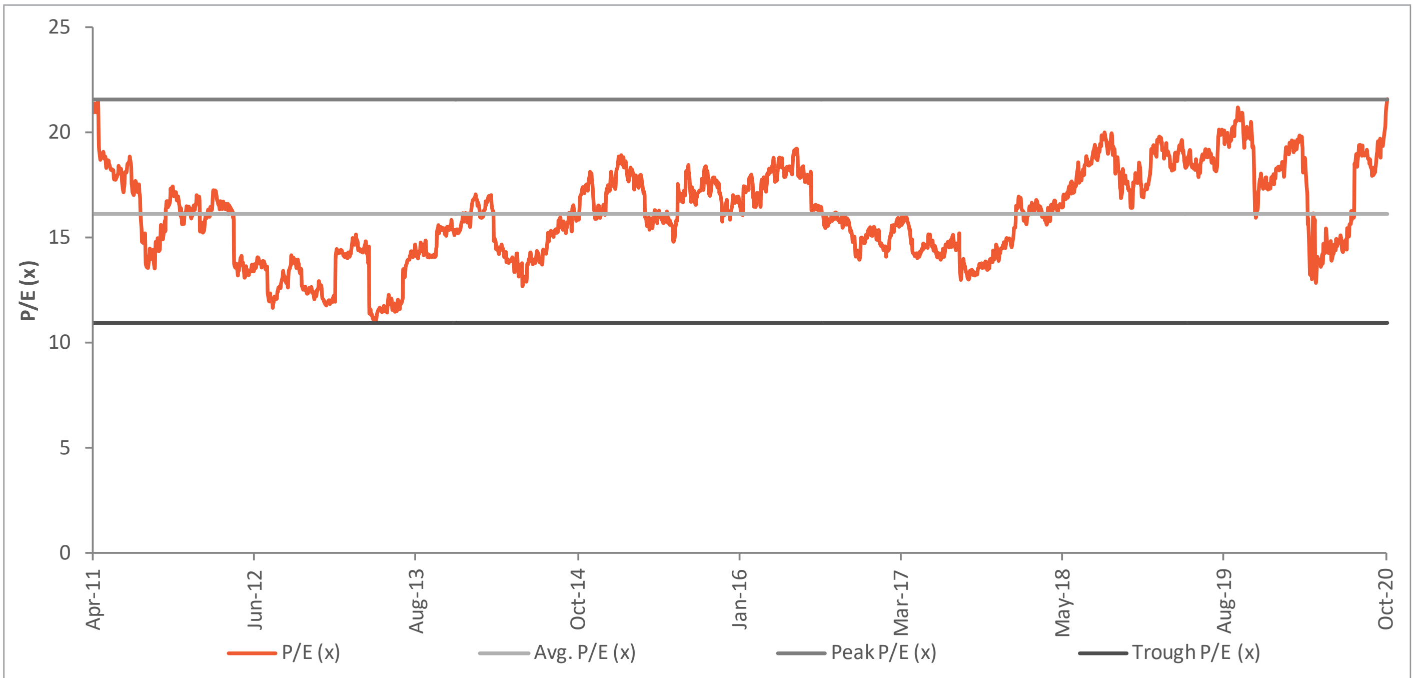
Outlook and Valuation

■ **Sector view – Expect acceleration in technology spending going forward :** Industry analysts such as Gartner estimates IT services spending would grow by 5-8% over CY2021-24E compared to average of 4.2% achieved in CY2010-19. Forecasts indicate higher demand for cloud infrastructure services, potential increase in specialised software, potential investments in transformation projects by clients and increase in online adoption across verticals. The implications from the outbreak of pandemic have accelerated the digital activities among large global enterprises, leading to increase in spending on workplace transformation and collaboration tools, cyber-security and higher cloud migration. We believe that variable cost structure of companies combined with cost-efficiency measures would help the IT companies to absorb pricing pressure.

■ **Company outlook - well positioned to capture opportunities:** 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 from the transformation journey of clients.

■ **Valuation - impressive execution:** We expect Infosys would continue to outperform TCS in terms of growth in FY2021E and deliver industry-leading growth in FY2022E/FY2023E, led by continued large deal wins, enhanced digital capabilities (aided by in-house, acquisitions and partnerships) and strong execution. Further, we believe that Infosys will be a key beneficiary in terms of acceleration of tech spends by large enterprises and vendor consolidation post COVID-19, given its full-service model and benefits from investments made over last two years. Margins are expected to remain stable. We prefer Infosys as it is one of the industry leaders with robust execution capabilities, strong balance sheet, healthy FCF generation capability and higher dividend payout. At CMP, the stock is trading at a 25x/22x its FY2022E/FY2023E EPS, at a 13%/12% discount to TCS. TCS's further re-rating of target multiple (led by its strong performance in Q2FY2021) has a ripple effect across the sector. As we are expecting a strong result from Infosys, we are assigning higher target multiple (to 25x from 22x) for Infosys that yields a revised target price of Rs. 1,300. We maintain our Buy rating on the stock.

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	866	271	235,098	19.7	18.0	1.1	1.0	4.1	3.7	21.9	21.7
TCS	2,831	375	1,062,375	32.3	28.5	23.5	21.2	12.0	11.1	38.0	40.4
Wipro	378	571	215,768	21.9	20.8	6.1	5.6	3.8	3.5	15.6	15.5
Infosys	1,132	426	482,293	28.0	24.9	18.6	16.8	3.9	3.8	26.1	28.8

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 and HCLS

Source: Company Website

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Deutsche Bank Trust Co Americas	17.35
2	Life Insurance Corp of India	7.19
3	BlackRock Inc	4.55
4	Vanguard Group Inc/The	2.91
5	SBI Funds Management Pvt Ltd	2.73
6	HDFC Asset Management Co Ltd	2.05
7	ICICI Prudential Asset Management	1.78
8	Republic of Singapore	1.68
9	ICICI Prudential Life Insurance Co	1.59
10	Norges Bank	1.22

Source: Bloomberg

Understanding the Sharekhan 3R Matrix

Right Sector	
Positive	Strong industry fundamentals (favorable demand-supply scenario, consistent industry growth), increasing investments, higher entry barrier, and favorable government policies
Neutral	Stagnancy in the industry growth due to macro factors and lower incremental investments by Government/private companies
Negative	Unable to recover from low in the stable economic environment, adverse government policies affecting the business fundamentals and global challenges (currency headwinds and unfavorable policies implemented by global industrial institutions) and any significant increase in commodity prices affecting profitability.
Right Quality	
Positive	Sector leader, Strong management bandwidth, Strong financial track-record, Healthy Balance sheet/cash flows, differentiated product/service portfolio and Good corporate governance.
Neutral	Macro slowdown affecting near term growth profile, Untoward events such as natural calamities resulting in near term uncertainty, Company specific events such as factory shutdown, lack of positive triggers/events in near term, raw material price movement turning unfavourable
Negative	Weakening growth trend led by led by external/internal factors, reshuffling of key management personal, questionable corporate governance, high commodity prices/weak realisation environment resulting in margin pressure and detoriating balance sheet
Right Valuation	
Positive	Strong earnings growth expectation and improving return ratios but valuations are trading at discount to industry leaders/historical average multiples, Expansion in valuation multiple due to expected outperformance amongst its peers and Industry up-cycle with conducive business environment.
Neutral	Trading at par to historical valuations and having limited scope of expansion in valuation multiples.
Negative	Trading at premium valuations but earnings outlook are weak; Emergence of roadblocks such as corporate governance issue, adverse government policies and bleak global macro environment etc warranting for lower than historical valuation multiple.

Source: Sharekhan Research

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