Sharekhan
by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Infosys

Poised to race ahead of peers

IT & ITES	Sharekhan code: INFY	Result Update

Stock Update

Summary

- We maintain a Buy on Infosys with a revised price target of Rs. 1,650 as we expect it to clock industry-leading growth in the next couple of years.
- Q3FY21 was another stellar quarter, with revenue and margin significantly beating estimates, along with strong deal TCVs, account expansion, and robust FCF generation.
- Infosys raised revenue growth guidance to 4.5-5% in CC terms from 2-3% earlier and also revised OPM guidance upward to 24-24.5% from 23-24% for FY2021.
- Infosys is well-placed to capture opportunities from clients' transformation journeys and cost take-out initiatives given strong digital capabilities and execution track record.

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. 1,388**	
Price Target: **Rs. 1,650**	↑

↑ Upgrade ↔ Maintain ↓ Downgrade

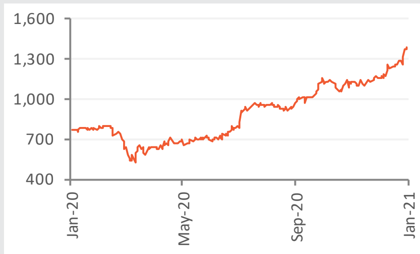
Company details

Market cap:	Rs. 591,103 cr
52-week high/low:	Rs. 1,392 / 511
NSE volume: (No of shares)	115.1 lakh
BSE code:	500209
NSE code:	INFY
Free float: (No of shares)	369.8 cr

Shareholding (%)

Promoters	13.0
FII	49.3
DII	25.8
Others	12.0

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	19.2	22.1	77.2	79.0
Relative to Sensex	12.2	0.8	39.8	61.0

Sharekhan Research, Bloomberg

Infosys reported another impressive quarter with all-round performance as revenues and margins beat our estimates, along with record high deal TCVs, lowest ever offshore mix and strong FCF generation. Constant currency (CC) revenue grew by 5.3% q-o-q and 6.6% y-o-y (beating ours as well as consensus estimates). Revenue grew strongly driven by market share gains, improving demand environment, deep client relationships, strong digital capabilities and participation in clients' transformation initiatives. EBIT margin improved 10bps q-o-q to 25.4%, exceeding our estimates. Margins improved q-o-q owing to a rise in productivity (up 100 bps), cross-currency tailwinds (up 20 bps), partially offset by transition costs and rebadging of employees expenses (-50bps), employee promotions (-20bps) and higher sub-contractor expenses (-50 bps). Net profit of Rs. 5,197 crore (up 16.6% q-o-q and 7.3% y-o-y) was 4.3% ahead of our estimates, aided by a strong beat in revenue and margins. Infosys raised its revenue growth guidance to 4.5-5% in CC terms from 2-3% earlier and also raised its OPM guidance to 24-24.5% from 23-24% for FY2021 despite a planned wage hike (effective January 1, 2021) and a seasonally soft quarter. Management upgraded its revenue growth guidance on the back of strong performance in 9MFY2021, solid deal wins, robust deal pipeline, acceleration of spends on digital transformation and improving demand environment in large verticals. The management highlighted that budget planning of clients for CY2021 is progressing normally and it expects clients would focus on their digital transformation agenda. Infosys has signed 22 large deals in Q3FY2021, with TCVs of $7,129 million (versus $3,145 million /$1,813 million in Q2FY2021/Q3FY2020). Share of new deals was 73%. Net new deals signed in Q3FY2021 were more than 1.5x of total deals singed in FY2020. Large deal win TCVs, a robust deal pipeline, strong demand for Cloud and Cloud-related technologies and increasing spends on transformation initiatives would help company to deliver strong growth in FY2022E. Given its strong digital capabilities and execution track record, Infosys is well-positioned to capture opportunities in client's growth and transformation initiatives and cost take-out initiatives as well. We believe that scaling up digital services, higher automation, increasing offshore revenue and pyramid rationalisation would help Infosys to partially offset costs that would return post normalcy.

Key positives

- Deal TCVs of $7.13 billion, up 2.3x q-o-q; higher share of new deals to total TCVs provides revenue visibility
- Raised FY2021E guidance for both revenues and margins
- FCF conversion at 109.0% of net profit.

Key negatives

- Attrition inched up to 10%

Our Call

Valuation – Maintain Buy with a revised PT of Rs. 1,650: We have raised our earnings estimates for FY2021E/FY2022E/FY2023, factoring in strong Q3FY2021 results and strong deal wins. We expect Infosys would continue to deliver industry-leading numbers in FY2022E/FY2023E, led by continued large deal wins, enhanced digital capabilities (aided by organic investments, acquisitions and partnerships) and strong execution. 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 27x/24x its FY2022E/FY2023E EPS, at a discount to TCS. Hence, we maintain our Buy rating on the stock with a revised PT of Rs. 1,650.

Key risk

Rupee appreciation and/or adverse cross-currency movements, slackening pace in deal closures and/or constraints in local talent supply in the US would affect earnings.

Valuation Rs cr

Particulars	FY19	FY20	FY21E	FY22E	FY23E
Revenue	82,675.0	90,791.0	100,482.7	113,314.3	127,473.9
OPM (%)	25.3	24.5	27.8	27.7	27.6
Adjusted PAT	15,856.0	16,594.0	19,445.4	22,198.6	25,003.5
% YoY growth	8.6	4.7	17.2	14.2	12.6
Adjusted EPS (Rs.)	35.4	39.0	45.7	52.3	58.9
P/E (x)	39.2	35.6	30.4	26.5	23.5
P/B (x)	4.9	4.8	4.3	3.8	3.4
EV/EBITDA (x)	27.0	25.7	20.2	17.7	15.4
RoNW (%)	23.7	25.4	27.8	28.1	28.1
RoCE (%)	32.2	32.3	35.5	36.1	36.4

Source: Company; Sharekhan estimates

Beat on all fronts

Infosys reported another strong quarter with all-round performance as revenue and margins beat our estimates. Besides, the company clocked record high deal TCVs and strong FCF. CC revenue grew by 5.3% q-o-q (above our as well as consensus estimates) and 6.6% y-o-y. Revenue growth was driven by strong growth in lifesciences, BFSI, retail, energy & utilities and manufacturing verticals. Digital revenue growth of 31.3% y-o-y (in cc terms) also aided growth. On a reported basis, US Dollar revenue grew by 6.2% q-o-q to $3,516 million. EBIT margin improved 10bps q-o-q to 25.4% despite rebadging of employees and deal transition costs, exceeding our estimates. Sequential margin improvement was driven by productivity (+100 bps), cross-currency tailwinds (+20 bps), partially offset by transition costs and rebadging of employees expenses (-50bps), employee promotions (-20 bps) and higher sub-contractor expenses (-50 bps). Net profit of Rs. 5,197 crore (up 16.6% q-o-q and 7.3% y-o-y) was 4.3% ahead of our estimates, aided by better-than-expected revenue and margins.

Guidance raised; deal wins remains strong

Infosys raised its revenue growth guidance to 4.5-5% in CC terms from 2-3% earlier and also revised its operating margin guidance upward to 24-24.5% from 23-24% for FY2021 despite planned wage hike (effective from January 1, 2021) and a seasonally soft quarter. The management upgraded its revenue growth guidance on the back of strong performance in 9MFY2021, solid deal wins, a robust deal pipeline, acceleration of spends on digital transformation and improving demand environment in large verticals. Digital business contributes 50.1% of its total revenue, registered a strong growth of over 31.3% y-o-y in Q3FY2021. The management highlighted that budget planning of clients for CY2021 is progressing normally and it expects clients would focus on their digital transformation agenda. The company has added new logos in the sub-verticals (mortgages, regional banks, wealth and retirement services) of BFSI verticals during the quarter. The management stated that the growth momentum in financial services would continue led by opportunities around vendor consolidation and captive monetization. Large deal wins remained strong at $7,129 million and share of net new deals remained at 73%, which provide strong revenue visibility in FY2022E. The management remains optimistic that its earlier investment in digital capabilities would position the company to capture opportunities in clients' growth and transformation initiatives and cost take-out initiatives as well.

Focus on sustainability of margins as and when situation normalises

Infosys surprised positively margins beating expectations for the last three consecutive quarters on the back of cost deferrals in terms of wage hikes and recruitment freeze, lower administration expenses (including travel expenses) and higher offshore revenue mix. Though work-from-home efficiencies and automation would aid to margin improvement in FY2022/FY2023, investments in technology, communications and security are expected to offset improvement to some extent. We believe that scaling up digital services, higher automation, increasing offshore revenue and onsite pyramid rationalisation would help Infosys to partially offset costs that would return once the situation normalises.

Key conference call highlights

- **Exceptionally strong quarter in seasonally weak quarter:** Infosys reported exceptionally strong quarter across multiple dimensions. This was driven by market share gains, improving demand environment, deep relationship with clients, strong digital capabilities and participating digital and cloud transformation journeys of large enterprises. Q3FY2021 results were strong across multiple dimensions such as digital revenue growth, record-high deal wins, account expansion and strong cash collection.
- **Guidance raised:** The management has revised upward its FY2021E annual revenue growth guidance to 4.5-5% from 2-3% earlier in CC terms. A higher guidance was led by strong 9MFY2021 numbers, solid deal wins, healthy deal pipeline and material improvement in demand environment in its large verticals. The management also improved its FY2021E EBIT margin guidance to 24-24.5% (versus 23-24% earlier), better than our expectations.

- **Work-from-home mode continues:** The management highlighted that majority of its delivery centers are operating in BCP mode and 97% of its employees across the globe have been on the WFH mode.
- **Vertical-wise performance:** The BFSI, high-tech and lifesciences reported double-digit growth y-o-y. The hi-tech (up 17.4% CC y-o-y versus 24.4% in Q2FY2021), lifesciences (up 11% CC y-o-y versus 7.4% in Q2FY2021), financial services (up 12% CC y-o-y versus 2.9% in Q2FY2021) reported strong growth during the quarter. While manufacturing (-4.1% CC y-o-y) reported muted growth, retail, energy and utilities, and communication vertical reported positive revenue growth.
- **Strong growth in digital business:** Digital business' revenue grew by 31.3% y-o-y in CC terms as against a 25.4% y-o-y growth in Q2FY2020. Digital business revenue contributed 50.1% to total revenue versus 47.3% in Q2FY2021. The increase in demand in data and analytics, cloud, security, cost efficiency, and IoT would continue to drive growth in the digital space. The management highlighted acceleration of spends in digital transformation (especially cloud migration and deployment and cloud applications) and core modernisation.
- **Client metrics and strong growth in top accounts:** Infosys added 139 new clients during the quarter due to acquisitions. The number of $100 million clients declined by one on a q-o-q basis to 29, while $50 million clients remained flat on a q-o-q basis. The number of clients in the $10 million bracket increased by four q-o-q to 246. Revenue from top five clients increased by 1.5% q-o-q. Revenue from top 10 and top 25 clients accelerated to 5% and 7.4% on a q-o-q basis.
- **Record-high deal wins:** Infosys signed 22 large deals in Q3FY2021, with TCVs of $7,129 million (versus $3,145 million /$1,813 million in Q2FY2021/Q3FY2020). A large deal signed during the quarter will help Infosys continue expanding its strong presence in Continental Europe. The share of new deals was 73%. The net new deals signed in Q3FY2021 are more than 1.5x of total deals signed in FY2020. Overall deal TCVs for 9MFY2021 remained over $12 billion and the net new large deal value was over $8 billion. Out of 22 large deals, the company won 12 deals in financial services, four deals in manufacturing, three deals in communication and one deal each in retail, high-tech and other segments. Geography-wise, the company signed 13 deals in North America, seven deals in Europe and two deals from the Rest of World geographies. The share of new deals to overall TCVs stood at about 73% versus 86% in Q2FY2021.
- **Attrition rate:** Attrition rose to 10% versus 7.8% in Q2FY2021. This is significantly lower compared to its comfortable band of 13-14%. The management expects attrition rate would rise when market opens up.
- **Wage hike:** The management highlighted that it would roll out annual wage hike to its staffs, effective from January 1, 2020. The company expanded its promotion cycle across all levels in this quarter.
- **Localisation:** Infosys highlighted that the localisation push in the US helped manage visa restrictions and regulatory changes better and has made the business model more resilient. The company has hired around 13,000 US workers till date and plans to hire additional 12,000 workers over the next two years. The company indicated that it plans to hire 25,000 US workers over next 5 years.
- **Headcount:** Headcount remained at 249,312, with a net addition of 9104 employees. Sub-contracting costs increased by 40 bps q-o-q with a significant increase in revenues.
- **Higher utilisation and higher offshore mix:** Utilisation increased sequentially during the quarter to 86.3% from 83.6% in Q2FY2021. The offshore mix was lowest ever at 25.2%.
- **Strong balance sheet and cash flows:** Infosys had a cash balance of $4.5 billion with no debt versus $4.6 billion in Q2FY2021. Increased focus on cash collections resulted in $772 million of FCF during the quarter versus $674 million in Q2FY2021. FCF grew by 15% y-o-y during the quarter. FCF conversion remained strong at 109% of net profit.

Results highlights Rs cr

Particulars	Q3FY21	Q3FY20	Q2FY21	y-o-y (%)	q-o-q (%)
Revenue ($ mn)	**3,516.0**	**3,243.0**	**3,312.0**	**8.4**	**6.2**
Net sales	**25,927.0**	**23,092.0**	**24,570.0**	**12.3**	**5.5**
Direct costs	15,952.0	14,637.0	14,916.0	9.0	6.9
Gross profit	**9,975.0**	**8,455.0**	**9,654.0**	**18.0**	**3.3**
SG&A	2,561.0	2,655.0	2,571.0	-3.5	-0.4
EBITDA	**7,414.0**	**5,800.0**	**7,083.0**	**27.8**	**4.7**
Depreciation and amortisation	825.0	736.0	855.0	12.1	-3.5
EBIT	**6,589.0**	**5,064.0**	**6,228.0**	**30.1**	**5.8**
Other income	562.0	785.0	522.0	-28.4	7.7
PBT	**7,151.0**	**5,849.0**	**6,750.0**	**22.3**	**5.9**
Tax provision	1,936.0	1,383.0	1,892.0	40.0	2.3
Reported net profit	**5,197.0**	**4,466.0**	**4,845.0**	**16.4**	**7.3**
Adjusted net profit	**5,197.0**	**4,466.0**	**4,845.0**	**16.4**	**7.3**
EPS (Rs.)	**12.2**	**10.5**	**11.4**	**16.5**	**7.2**
Margin (%)				**bps**	**bps**
EBITDA	28.6	25.1	28.8	348	(23)
EBIT	25.4	21.9	25.3	348	7
NPM	20.0	19.3	19.7	70	33

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)	3,516	100	6.2	8.4	6.6
Geographic mix					
North America	2,166	61.6	7.7	8.9	8.8
Europe	844	24.0	4.8	6.6	1.3
India	91	2.6	-8.0	0.7	4.3
Rest of world	415	11.8	4.4	11.2	6.1
Industry verticals					
Financial services	1,164	33.1	9.8	13.9	12.0
Retail	517	14.7	4.7	2.6	2.0
Communication	436	12.4	4.5	-0.1	0.8
Energy, utilities, resources and services	440	12.5	7.9	5.4	4.9
Manufacturing	327	9.3	8.5	5.8	-4.1
Hi tech	288	8.2	-4.3	7.3	17.4
Life sciences	250	7.1	10.8	14.9	11.0
Others	95	2.7	-10.4	4.5	2.7
Service line					
Digital	1,761	50.1	12.3	33.6	31.3
Core	1,755	49.9	0.6	-8.8	-10.3
Clients Contribution					
Top client	380	10.8	1.5	3.6	-
Top 10 clients	650	18.5	5.0	6.1	-
Top 25 clients	1,217	34.6	7.4	9.7	-
Revenue per employee					
Revenue per FTE ($ K)	54.3	-	1.5	-0.2	-
Deal wins ($ mn)		-	-		-
TCV	7,129	-	126.7	293.2	-

Source: Company; Sharekhan Research

Outlook and Valuation

■ Sector View – Technology spending to accelerate 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 COVID-19 outbreak 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 the variable cost structure of companies combined with cost-efficiency measures would help IT companies absorb pricing pressures.

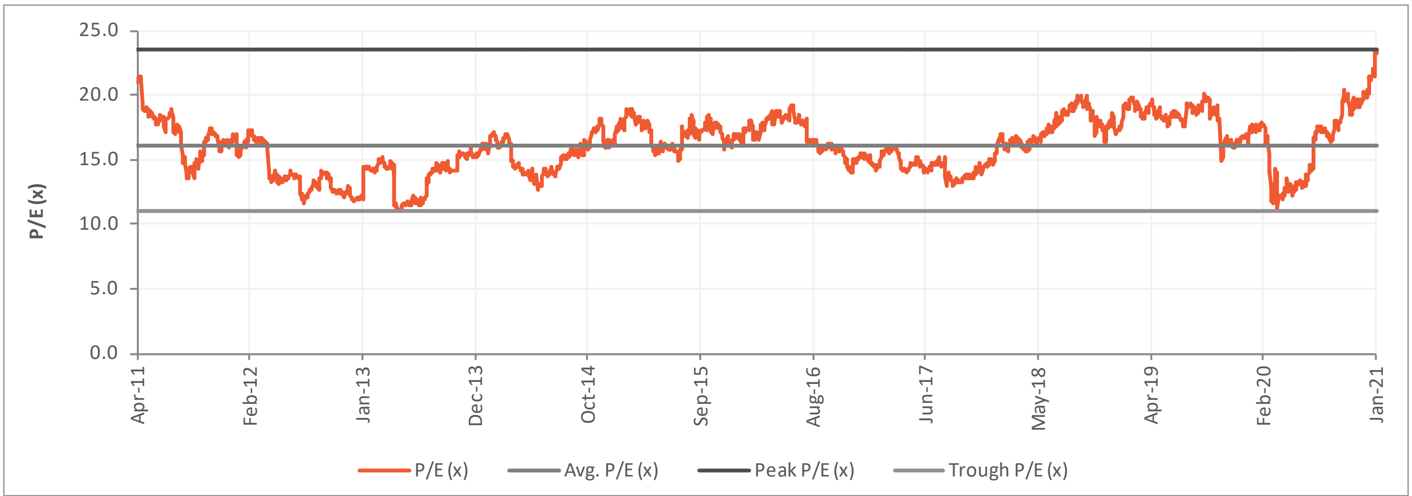
■ Company Outlook – Well-positioned to capture opportunities

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 amid the economic downturn. Further, Infosys has aggressively invested in digital technologies in the past couple of years to capture a large portion of upcoming digital spends. Given strong relationships with clients and robust execution capabilities, Infosys is well-positioned to capitalise on opportunities from clients' transformation journeys.

■ Valuation – Valuation gap with TCS to narrow

We have raised our earnings estimates for FY2021E/FY2022E/FY2023, factoring in strong Q3FY2021 results and strong deal wins. We expect Infosys would continue to deliver industry-leading numbers in FY2022E/FY2023E, led by continued large deal wins, enhanced digital capabilities (aided by organic investments, acquisitions and partnerships) and strong execution. 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 27x/24x its FY2022E/FY2023E EPS, at a discount to TCS. Hence, we maintain our Buy rating on the stock with a revised PT of Rs. 1,650.

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	1,056	271	286,427	23.2	21.3	14.8	13.8	5.0	4.5	22.7	22.1
TCS	3,159	375	1,185,303	35.0	30.2	24.3	21.1	13.2	12.1	38.4	41.8
Wipro	459	572	262,191	24.2	22.1	16.5	15.0	4.6	4.1	17.2	17.6
Infosys	1,388	426	591,103	30.4	26.5	20.2	17.7	4.3	3.8	27.8	28.1

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

Sharekhan

by BNP PARIBAS

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