Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Infosys

Poised to race ahead

IT & ITES		Sharekhan code: INFY		
Reco/View: Buy	↔	CMP: **Rs. 1,813**	Price Target: **Rs. 2,050**	↔

↑ Upgrade ↔ Maintain ↓ Downgrade

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		↔	

ESG Disclosure Score NEW

ESG RISK RATING 15.77

Updated Oct 08, 2021

Low Risk

NEGL	LOW	MED	HIGH	SEVERE
0-10	10-20	20-30	30-40	40+

Source: Morningstar

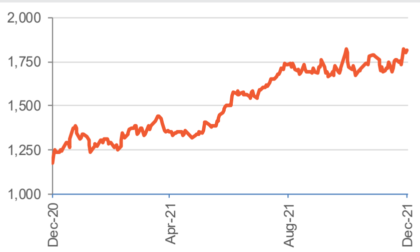
Company details

Market cap:	Rs. 7,62,254 cr
52-week high/low:	Rs. 1,848 / 1,152
NSE volume: (No of shares)	58.7 lakh
BSE code:	500209
NSE code:	INFY
Free float: (No of shares)	370.7 cr

Shareholding (%)

Promoters	13.1
FII	34.2
DII	16.6
Others	36.2

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	3.1	5.5	20.8	54.1
Relative to Sensex	6.7	10.1	13.7	30.5

Sharekhan Research, Bloomberg

Summary

- Infosys is among the best-positioned companies to benefit from strong demand backed by its strategic investments in scaling-up its digital capabilities, wining market share, and expanding presence in Europe.
- Though management cited Q3FY2022 growth will be impacted with usual seasonality, we believe strong demand environment and one-month incremental revenue from the Daimler deal will offset some of the seasonality impact.
- Margins are expected to remain under pressure in the near term due to supply-side issues, wage revision for senior employees, and weak seasonality, partially offset by strong growth in the digital business, operational efficiencies, and currency tailwinds.
- We maintain Buy on Infosys with an unchanged PT of Rs. 2,050, given strong earnings growth potential, solid execution, and strong demand.

Infosys is well placed to report industry-leading growth among Tier-IT companies in the medium term on account of broad-based traction across industries, earlier investments in emerging technology areas, gaining market share, strong growth in the digital business, and targeting a large pie of client's IT budget. Further, growth in IT spends is set to accelerate, given higher adoption of digital technologies and cloud-based services, pick-up in IT outsourcing, and new spend areas (including ESG and Cybersecurity etc). Management remains confident to capture a fair share of current multi-year technology upgrade cycle backed by breadth of offerings, timely investments in enhancing digital capabilities, new cloud-based offering, and focusing on ecosystem partnership.

- **Well poised for industry-leading growth:** Post the pandemic, strong cloud adoption and digital-transformation initiatives will support strong demand for IT services over the next 3-5 years. Infosys is among the best-positioned companies to benefit from strong demand, backed by its strategic investments in scaling up its digital capabilities, wining market share, and expanding presence in Europe. We believe Infosys would drive its growth leadership with 18.6% y-o-y growth in FY2022 and a 12.4% CAGR over FY2022-FY2024E, given broad-based demand, robust deal wins, and a healthy deal pipeline.
- **H2 growth to moderate; Expect usual seasonality in Q3:** Infosys reported strong USD revenue growth of 20.9% y-o-y in 1HFY2022. Hence, the company's growth guidance of 16.5-17.5% for FY2022 indicates moderation of growth in 2HFY2022. Though management indicated Q3FY2022 revenue growth will be impacted with usual seasonality, we believe strong demand environment and one-month incremental revenue from the Daimler deal will offset some of the seasonality impact in Q3FY2022.
- **Expect attrition rate likely to ease; Utilisation to settle at 84-86%:** Management indicated that attrition rate will remain elevated for couple of quarters before it normalises. The company expects supply-side challenges will ease in the next 2-3 quarters, given strong fresher hiring and talent-retention initiatives (including incentives such as bonuses, one-time hikes, and ESOPs, increased number of promotions, and focus on career development, among others). We believe increased intake of freshers would cool off supply-side challenges from the beginning of FY2023. Though the current utilisation of 89.2% is unsustainable, management indicated utilisation would be at 84-86% in the coming quarters versus 80-84% in pre-pandemic times.

Our Call

Valuation – Maintain Buy with a PT of Rs. 2,050: Infosys is well placed to deliver industry-leading organic growth among large peers in the medium term. Margins are expected to remain under pressure due to supply-side challenges, roll-out of wage hike for senior employees, and weak seasonality, which will be partially offset by strong growth in the digital business, operational efficiencies, and currency tailwinds. We expect Infosys to report USD revenue and earnings growth of 12.4% and 15.1%, respectively, over FY2022-FY2024E. At the CMP, the stock trades at 30x/26x its FY2023E/FY2024E earnings, which is justified, given strong growth potential, robust deal pipelines, robust execution, and improving ROCE. We like Infosys because of its superior digital capability, consistent investments on talents, stable management, a strong capital allocation policy, and a healthy balance sheet. Hence, we maintain our Buy rating on the stock with an unchanged price target (PT) of Rs. 2,050.

Key Risks

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 (Consolidated) Rs cr

Particulars	FY21	FY22E	FY23E	FY24E
Revenue	1,00,473.0	1,19,748.5	1,38,661.9	1,56,356.5
OPM (%)	27.8	26.4	26.2	26.1
Adjusted PAT	19,423.0	21,873.6	25,492.8	28,971.3
% YoY growth	*17.0*	*12.6*	*16.5*	*13.6*
Adjusted EPS (Rs.)	45.6	52.0	60.8	69.1
P/E (x)	39.7	34.9	29.8	26.2
P/B (x)	5.4	5.2	4.8	4.4
EV/EBITDA (x)	26.8	23.7	20.5	18.1
RoNW (%)	25.3	27.2	29.7	30.6
RoCE (%)	31.9	32.8	35.9	37.4

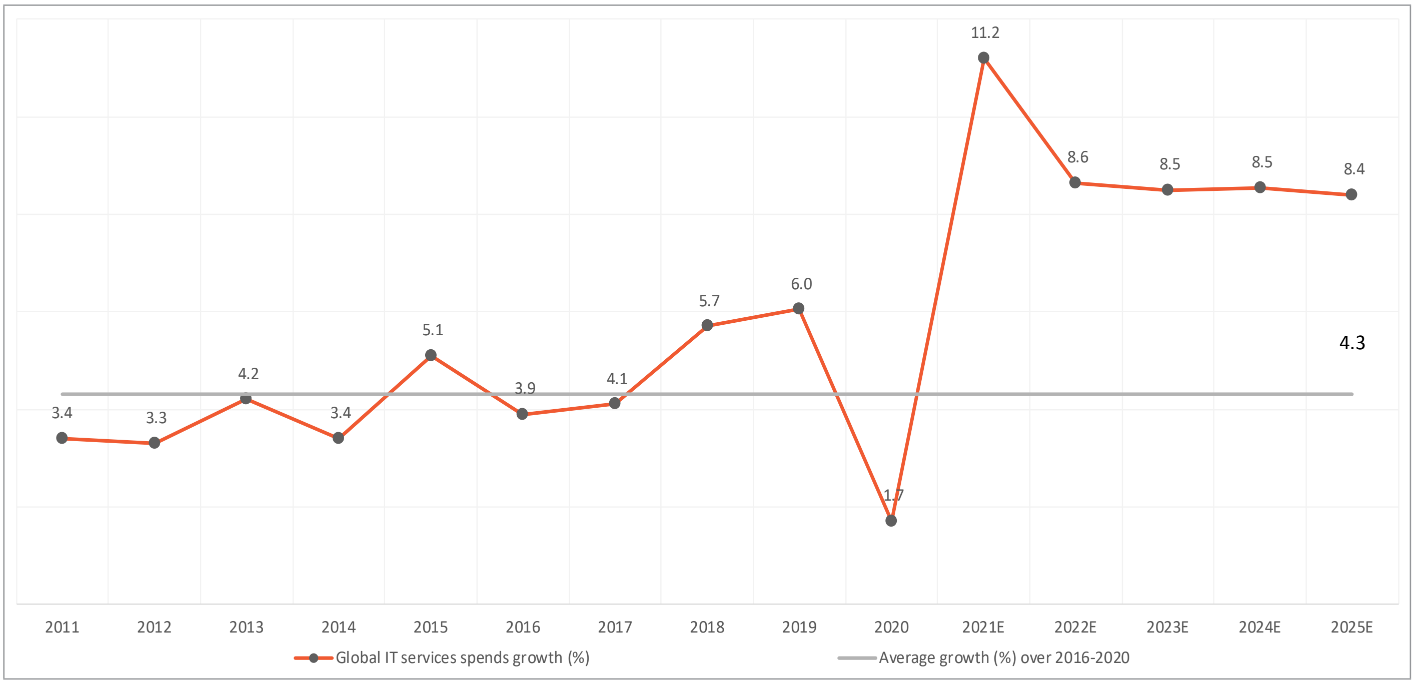
Source: Company; Sharekhan estimates

Higher digital transformation is driving global IT spends growth

The pandemic has accelerated the pace of adoption of digital technologies and cloud-based services to increase business resilience and agility, catch up with cloud-native competitors, enhance cost efficiencies, and personalising experiences for customers and employees. Further, rise in IT outsourcing, new spend areas (including ESG and Cybersecurity), and a shift of IT spends from software to services are set to accelerate IT spends. As enterprises are embarking on a multi-year technology upgrade cycle, it is estimated that enterprise technology spends are expected to increase to 5% of revenue over the next 5-10 years from 2-3% currently.

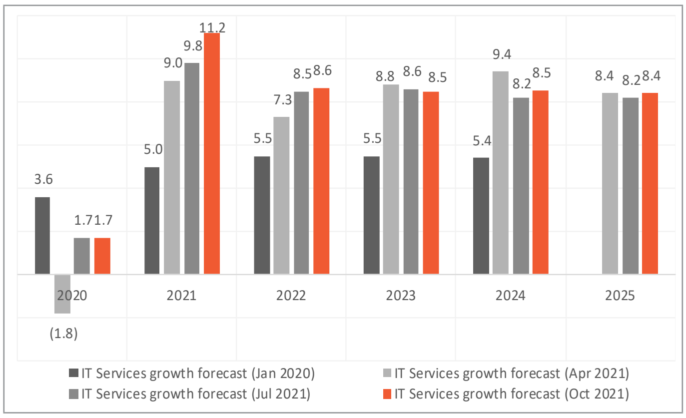
Gartner expects worldwide IT spend to rise by 9.5% y-o-y to $4.2 trillion in 2021. Of this, IT services spend would grow by 11.2% in FY2021. Further, IT services spending is likely to remain strong at an 8.5% CAGR over FY2021-FY2025, which will be significantly higher than the average growth of 4.4% during 2016-2020. Strong growth in IT services spend will be driven by increasing adoption of digital technologies. It is estimated that spends on digital technologies are likely to post a 16% CAGR over 2020-2024. We expect Indian IT services companies, including Infosys, to derive maximum benefit from higher spending on IT services, given their strong global service delivery experience, competitive cost structure, infrastructure, strong execution, talent availability, and innovation.

Global IT services spend growth to accelerate to 8.5% CAGR in 2021-25 versus 4.3% CAGR in 2016-20



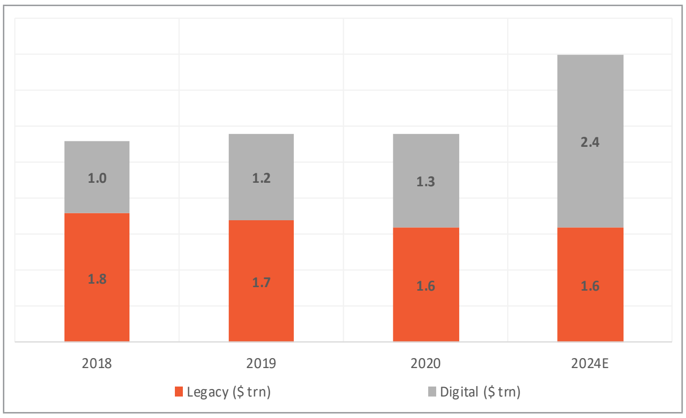
Source: Gartner, Sharekhan Research

Expected growth in IT services spending



Source: Gartner, Sharekhan Research

Spend on digital to grow at 16% CAGR over 2020-24

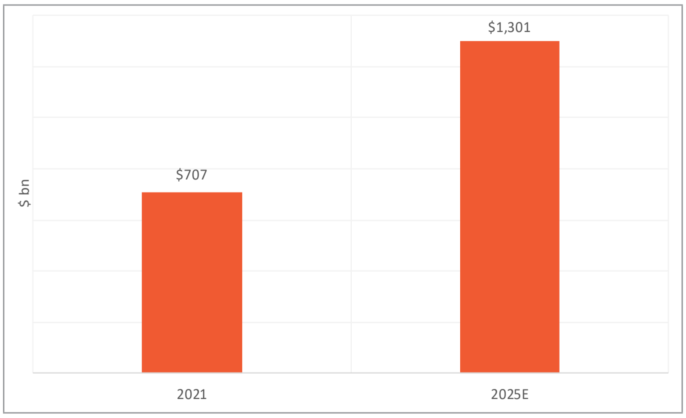


Source: Zinnov, Sharekhan Research

Cloud transformation is a multi-horizon theme

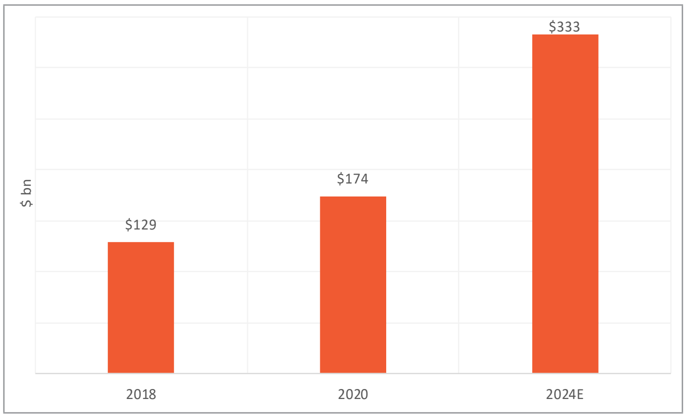
Strong cloud adoption will support robust demand over the next 3-5 years. Enterprises are currently migrating their workloads to cloud through Horizon-1 initiatives. However, in certain cases, enterprises have started moving beyond initial Horizon-1 cloud value proposition to Horizon-2 (Cloud-native application development) and Horizon-3 (integrating with cloud ecosystem) value propositions. It is estimated that 20-30% of workloads have moved to cloud and this can increase to 70-80% in the next 3-5 years. In the subsequent phases, enterprises would increase IT services spends substantially to participate in cloud-based ecosystems (including AI, data, and analytics spend) to unlock new innovations in the form of Horizon-2 and Horizon-3 transformation initiatives. Cloud adoption is estimated to be a $300–$350 billion opportunity for IT services companies.

Cloud spending ($ bn) to grow at 17% CAGR



Source: IDC, Sharekhan Research

Data analytics to grow at 18% CAGR over 2020-24E



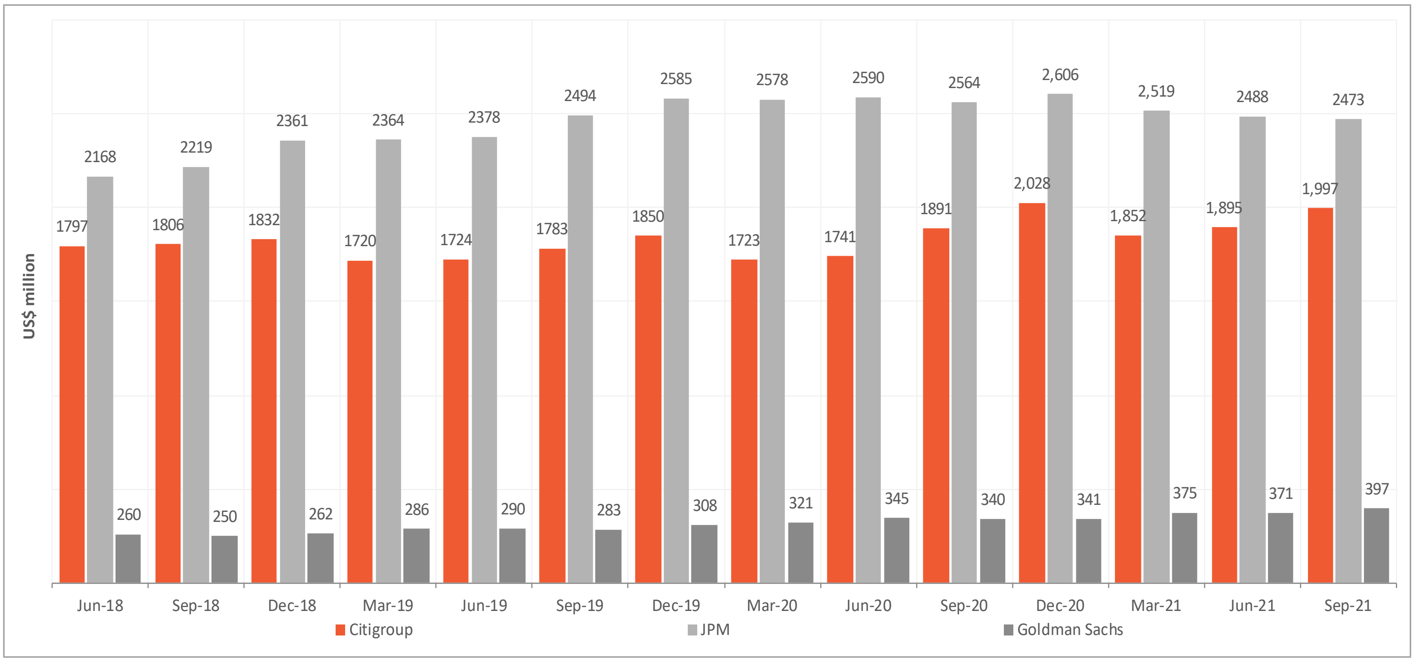
Source: Industry research, Sharekhan Research

Infosys is engaged with its clients to redesign the core and build new cloud-first capabilities to create seamless experiences in public, private, and hybrid cloud, across PaaS, SaaS, and IaaS landscapes. Last year, Infosys had launched its integrated cloud offering, Infosys Cobalt, which has been gaining traction among customers, as it helps in driving value for clients. Infosys Cobalt capabilities are resonating well with clients, given its strong capabilities, diversified vertical and geographical presence, and strong partner ecosystem with hyperscalers and downstream players.

Strong spending outlook of BFSI firms to bode well for Infosys

Large global BFS firms, which are the highest spender on technologies, are the laggards in terms of cloud adoption among other major industries, given the concerns over security and confidentiality. Post the pandemic, BFS firms have been investing on online channels because of higher customer experience, cost-efficiency agendas, gaining market share, and intense competition from fintech firms. BFS firms are now investing on data and analytics, AI and ML, automation, applications with micro services and APIs, cyber security, regulatory compliance requirements, etc. We believe tech spending among BFS firms would remain strong in the medium terms as these financial institutions focus on legacy modernisation and digital-transformation initiatives.

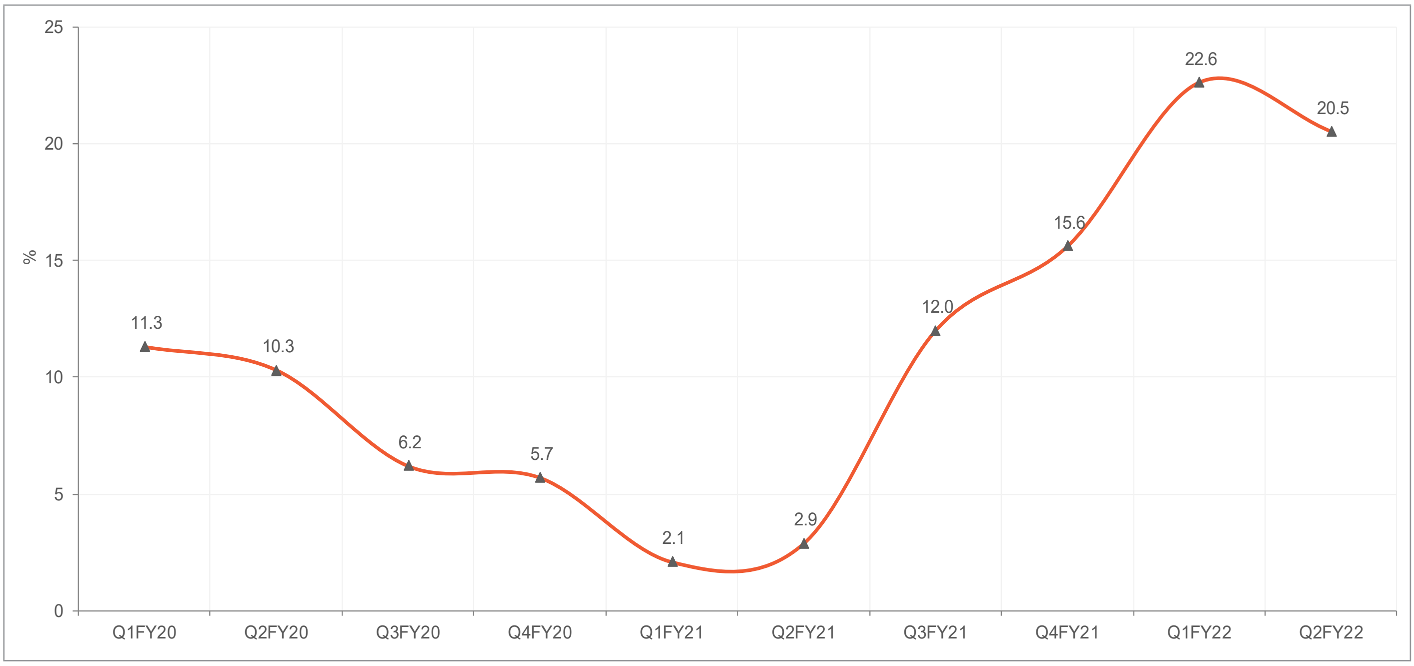
Technology spends by large US banks remained strong



Source: Sharekhan Research

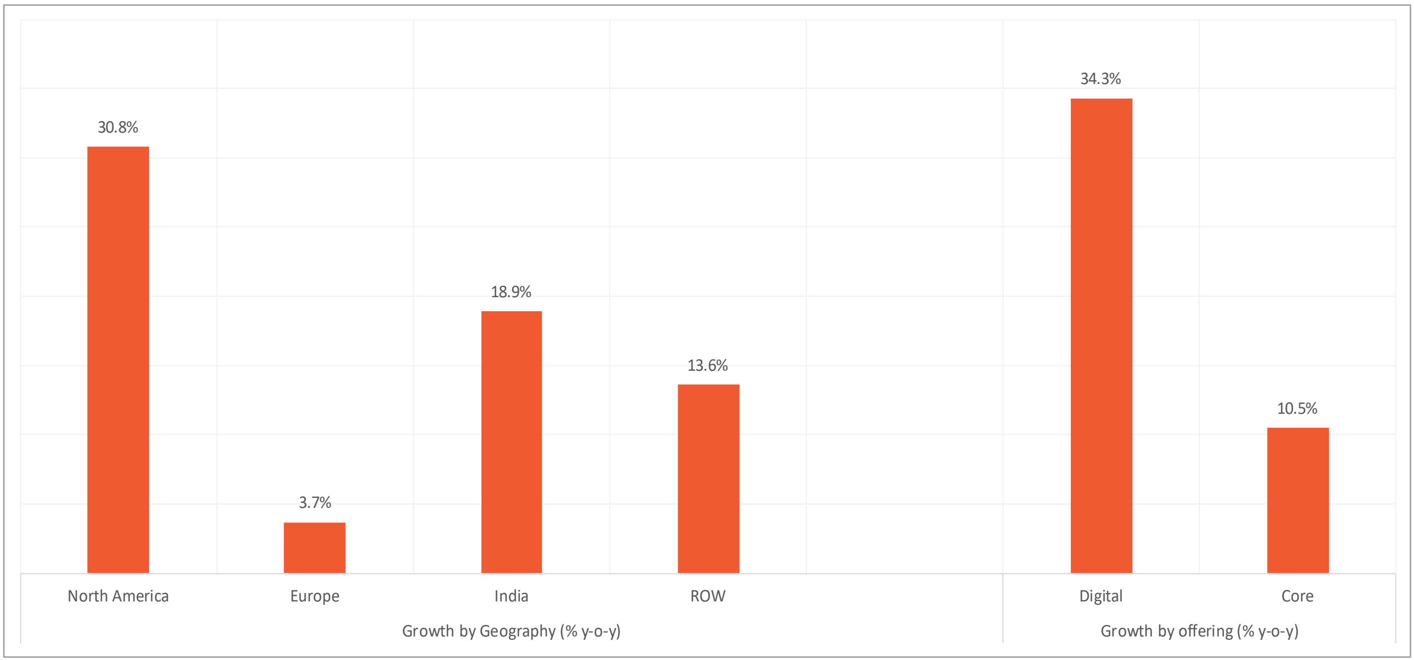
Infosys' investments in building capability at the sub-vertical level areas such as regional banking, retirement services, and payments are providing differentiation in large transformation programmes. The company's financial services vertical has been reporting industry-leading growth for the past several quarters because of strong demand in sub-verticals such as banking, mortgages, wealth, and retirement services in the US. Revenue growth of Infosys' BFSI vertical has been accelerating over the past three quarters. Infosys reported strong USD revenue growth of 3.5% q-o-q and 21.8% y-o-y in its BFSI vertical in Q2FY2022. Given Infosys' deep domain expertise, robust delivery capabilities, transformation solutions across sub-segments of BFS, and strong tech spends by BFS firms, we believe Infosys would sustain its strong growth momentum in its BFSI vertical.

Infosys' BFSI constant-currency revenue growth trend (% y-o-y)



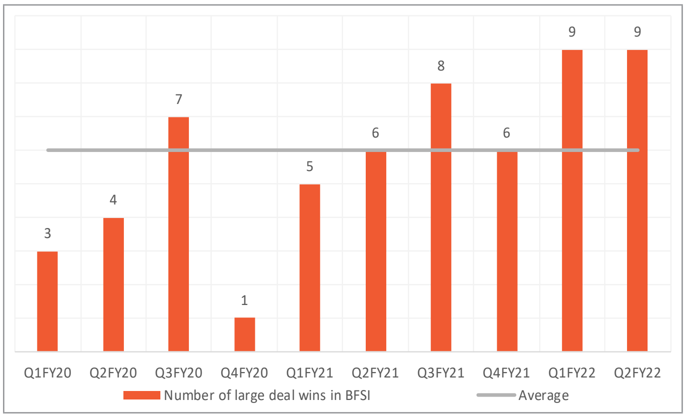
Source: Sharekhan Research

Q2FY2022: BFSI USD revenue growth y-o-y across geographies and offerings



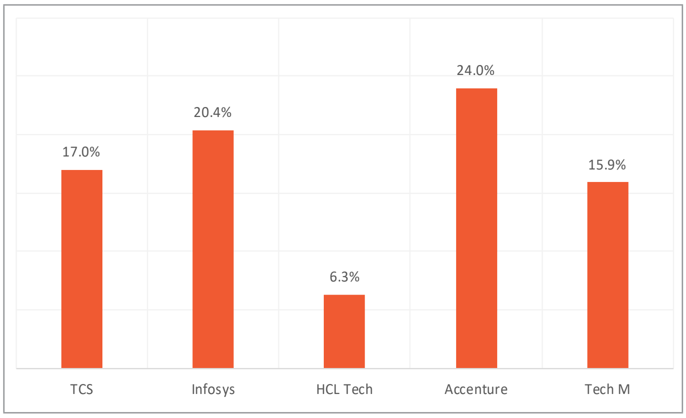
Source: Sharekhan Research

Number of BFSI deal wins by Infosys



Source: Company, Sharekhan Research

Infosys BFSI is one of the fast growing among peers in Q2

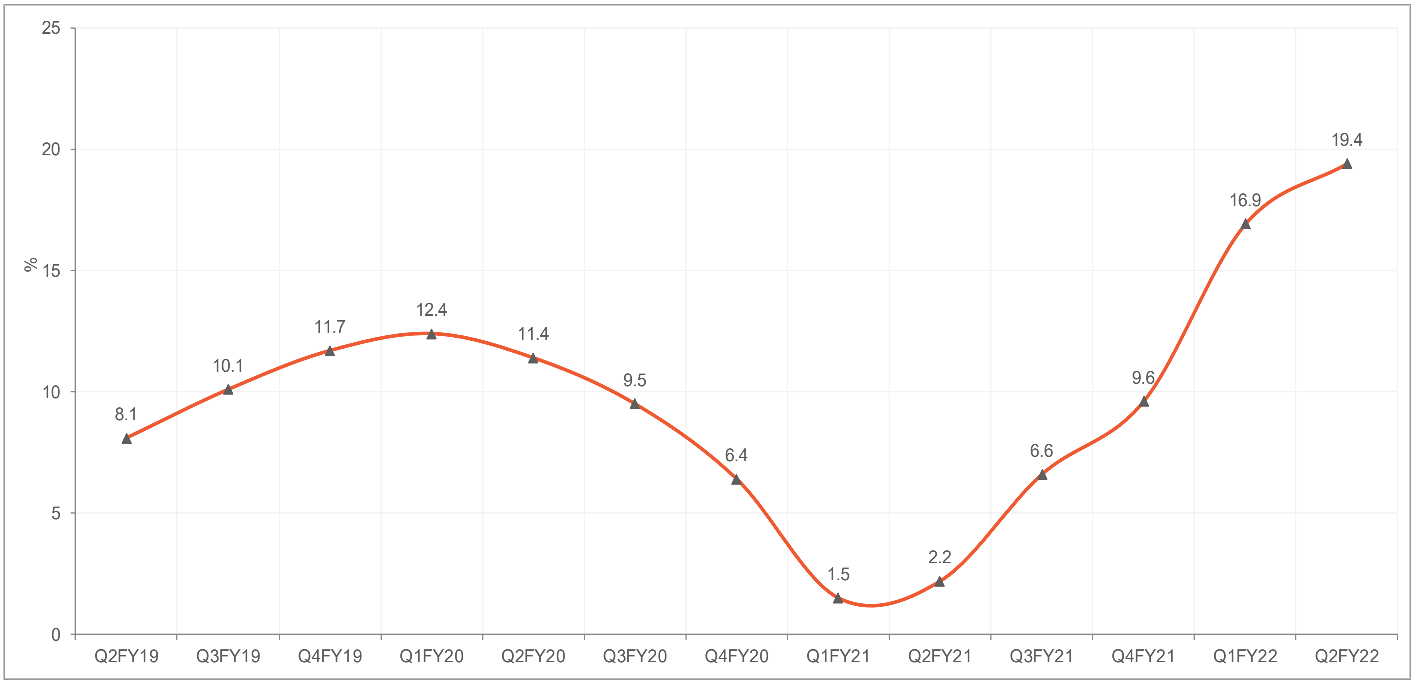


Source: Company, Sharekhan Research

Growth to decelerate in 2HFY2022; Incremental revenue from Daimler deal to aid its Q3 growth

Management has reiterated its earlier commentary on the outlook as it has not witnessed any incremental changes in demand so far during the quarter. Infosys reported strong USD revenue growth of 20.9% y-o-y in 1HFY2022, which is on track to achieve industry-leading organic growth among Tier-I companies. Growth guidance of 16.5-17.5% for FY2022 indicates moderation of revenue growth in 2HFY2022. Management indicated that Q3FY2021 revenue growth (6.2% q-o-q in USD terms) was abbreviated. It believes normalcy has returned and Q3FY2022 revenue growth will be impacted with usual seasonality. However, strong demand environment and one-month incremental revenue from the Daimler deal will offset some of the seasonality impact (including furloughs and lower billing days) in Q3FY2022. Further, the company's digital revenue has posted a 7.7% CQGR since Q1FY2018, and its contribution has increased from 23.9% in Q1FY2018 to 56.1% of total revenue in Q2FY2022.

Infosys' CC revenue growth trend (y-o-y)

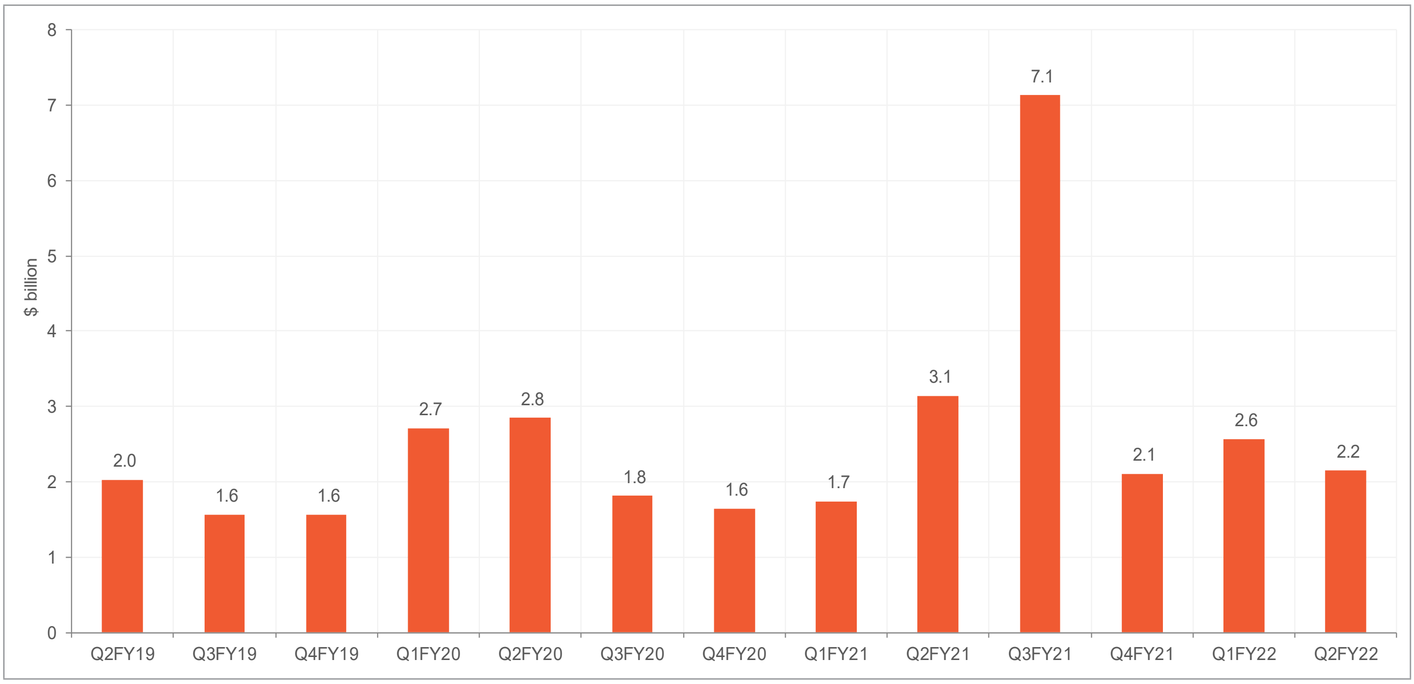


Source: Sharekhan Research

Deal wins to remain healthy

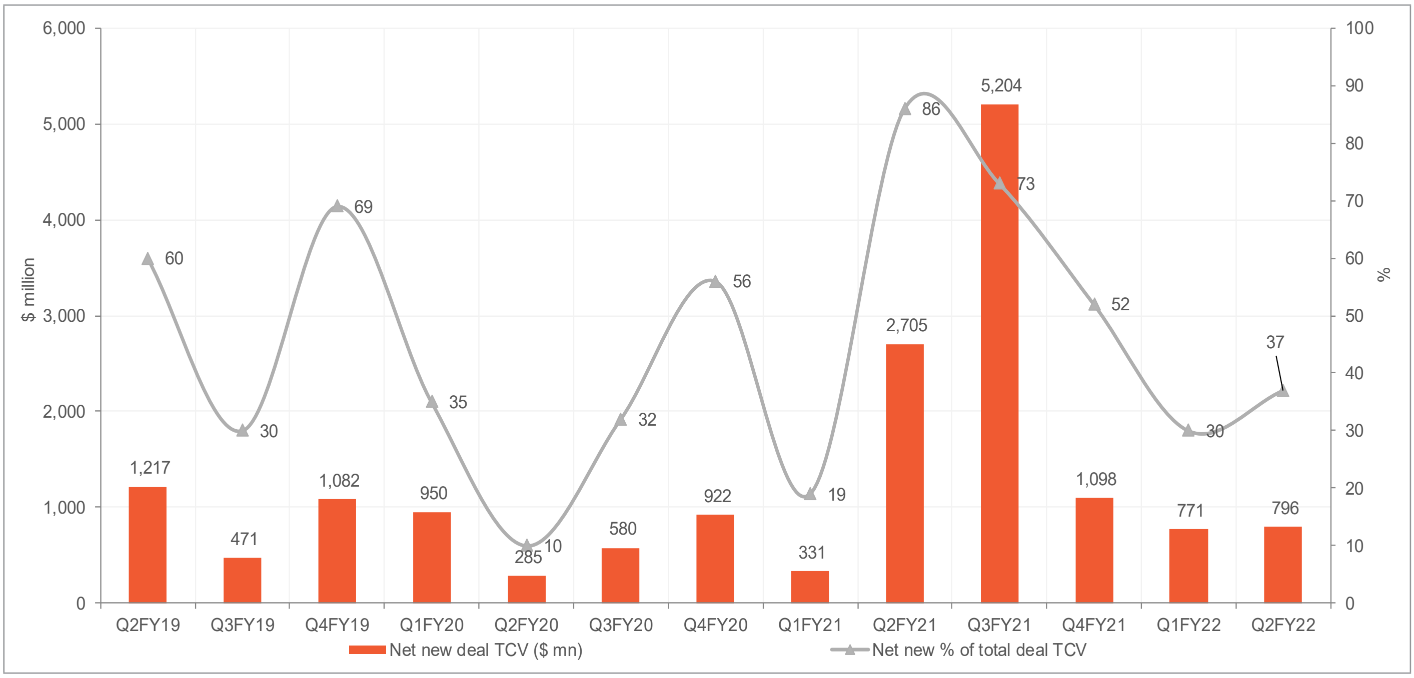
Infosys signed large deal TCVs of $2.2 billion in Q2FY2022, which declined 16%/32% q-o-q/y-o-y because of a large number of small-sized deals that were not included in large deals (> $50 million) and short-cycled programmes. Note that the company had won a large deal from Vanguard in Q2FY2021. Infosys won 22 large deals and added 117 new logos during Q2FY2022. Management indicated that the deal pipeline (comprising both large and small deals) remains strong because of its strong participation in clients' deal transformation journey. We believe sustained demand strength and steady conversion of the deal pipeline would drive deal win momentum going forward.

TCV of deal wins ($ bn)



Source: Sharekhan Research

Net new deal TCV ($ mn) and % of total deal TCV



Source: Company; Sharekhan Research

Expect attrition rate to ease going ahead

Attrition rate inched up to 20.1% on a TTM basis in Q2FY2022. Increased attrition rate was due to higher demand for talent across the industry. Management indicated that attrition rate will remain elevated for couple of quarters before it normalises. Management expects supply-side challenges will ease in the next 2-3 quarters, given strong fresher hiring across the industry and its initiatives (incentives such as bonuses, one-time hikes and ESOPs, increased number of promotions, and focus on career development, among others) to retain the talents. Over the past 3-4 quarters, the company has been relying on subcontractors to bridge the supply gap that resulted in higher subcontracting expense as a percentage of revenue (increased 345 bps y-o-y to 10.3% in Q2FY2022). Infosys plans to hire 45,000 freshers globally in FY2022 (on-boarded 25,000 freshers in 1HFY2022), which is 10,000 higher than its previous target of 35,000. Increased intake of freshers is expected to cool off supply-side challenges in the beginning of FY2023.

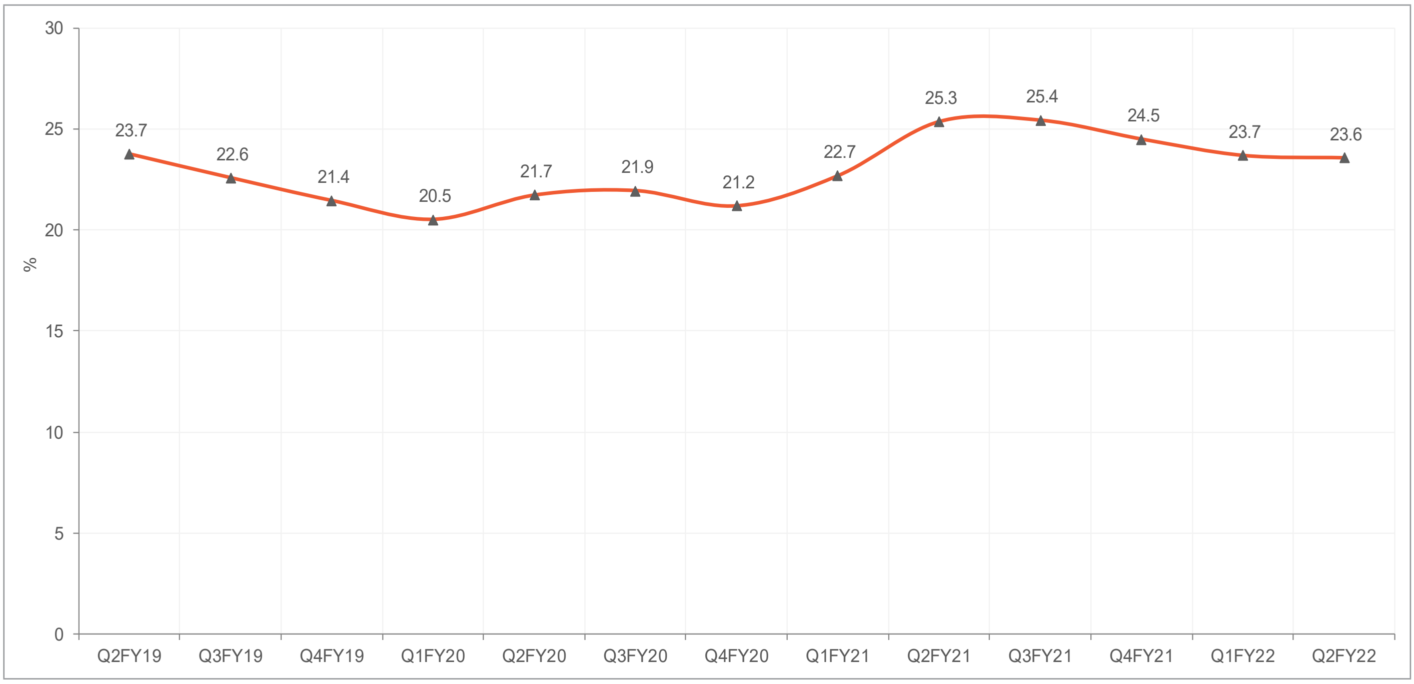
Focus on capability-based acquisitions

Infosys focuses on a three-pronged strategy for M&A activities such as (1) strengthen digital services capability, (2) deepen vertical expertise, and (3) expand geographical presence. The company's recent acquisition of Global Enterprise International Malaysia Sdn. Bhd. would help the company expand its presence in Malaysia and provide services to clients in South East Asia region.

Expect margin to stay under pressure in Q3

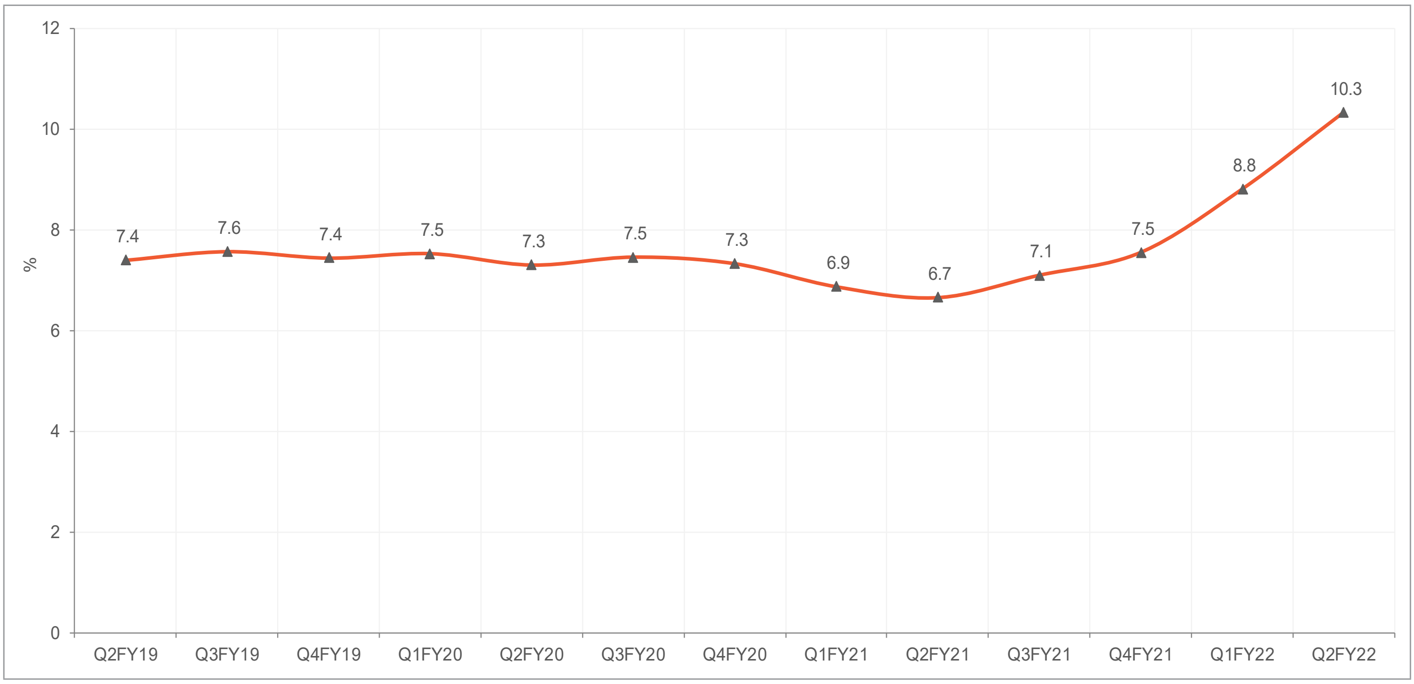
Infosys reported better-than-expected margin performance in Q2FY2022 despite wage revision, higher costs related to recruitments, and increased sub-contracting expenses, aided by strong revenue growth and currency tailwinds. Though margins are expected to remain under pressure due to supply-side challenges, roll-out of wage hike for senior employees, and weak seasonality, we believe strong growth in digital services, higher offshore revenue mix, structural pricing improvement, and currency tailwinds would offset these headwinds to a large extent. Further, management indicated the company focuses on value-added selling, higher pricing in new bookings, and bringing the right level of Cost of Living Adjustments (COLA) during renewals to offset higher talent costs, but with a lag. Though the current utilisation of 89.2% (excluding trainees) in Q2FY2022 is unsustainable, management cited that utilisation would stay at 84-86% going ahead versus 80-83% before pre-pandemic times. Management has maintained its EBIT margin guidance at 22-24%.

EBIT margin trend (%)



Source: Company; Sharekhan Research

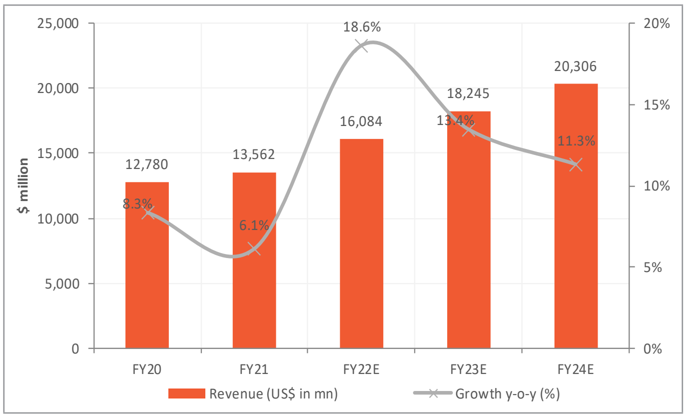
Subcontracting costs as % of revenue



Source: Company; Sharekhan Research

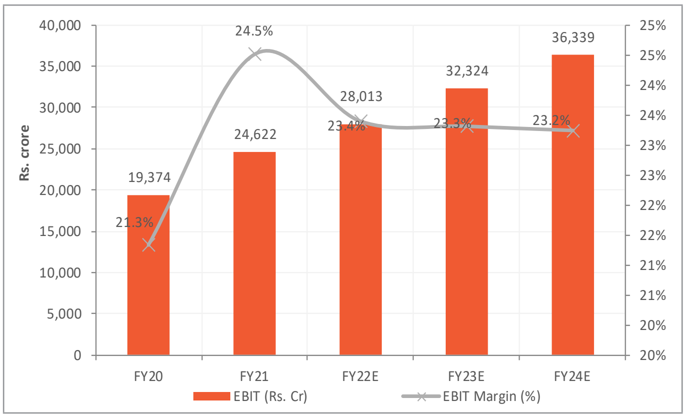
Financials in charts

Revenue in US$ (mn) and growth (%)



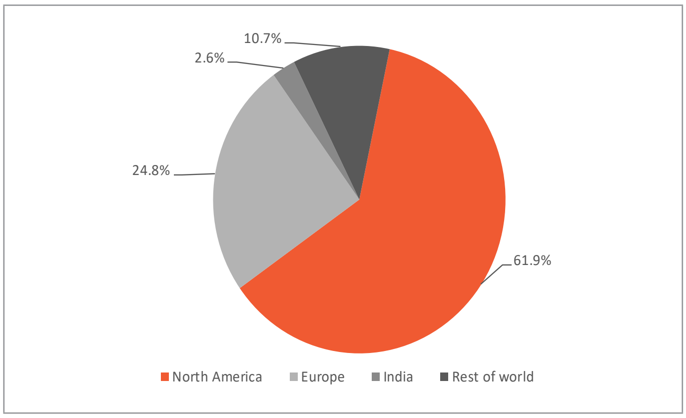
Source: Company, Sharekhan Research

EBIT (Rs. cr) and EBIT margin (%)



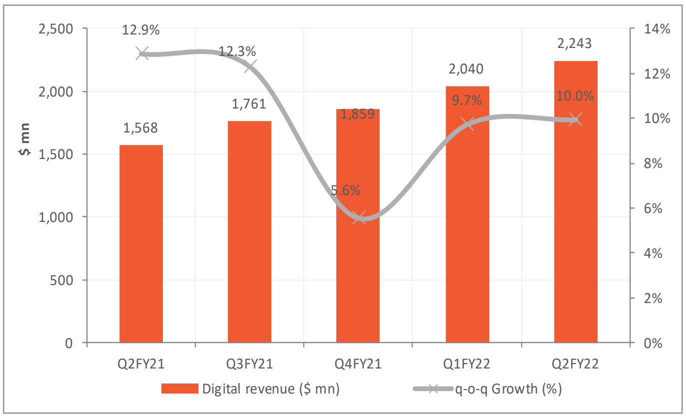
Source: Company, Sharekhan Research

Geography break-up (%)



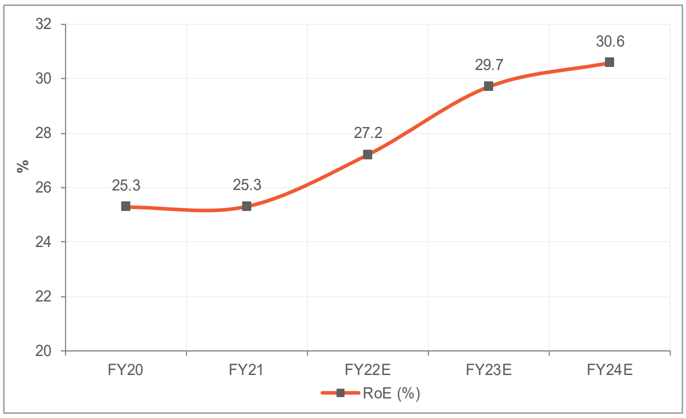
Source: Company, Sharekhan Research

Digital revenue ($ mn) and growth (%)



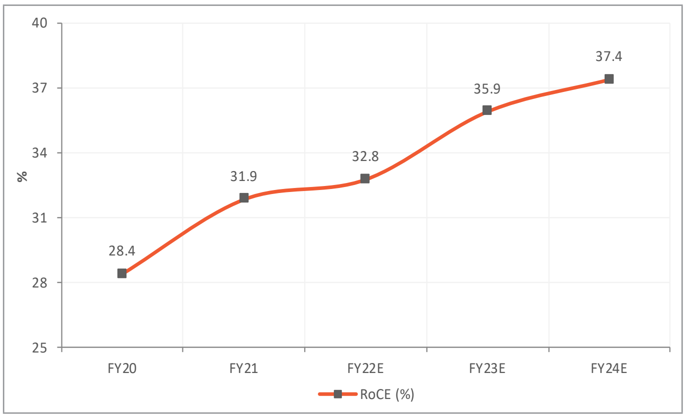
Source: Company, Sharekhan Research

RoE trend (%)



Source: Company, Sharekhan Research

RoCE trend (%)



Source: Company, Sharekhan Research

Outlook and Valuation

■ Sector view – Technology spending to accelerate going forward

We believe the need for business continuity, operational resilience, and the switch to digital transactions have led to strong demand for IT services post the pandemic. Industry analysts such as Gartner estimate that IT services spending would grow by 8-8.5% in the next four years as compared to the average of 4.3% achieved over 2016-20. Forecasts indicate higher demand for cloud infrastructure services, a potential increase in specialised software, potential investments in transformation projects by clients, and increased online adoption across verticals.

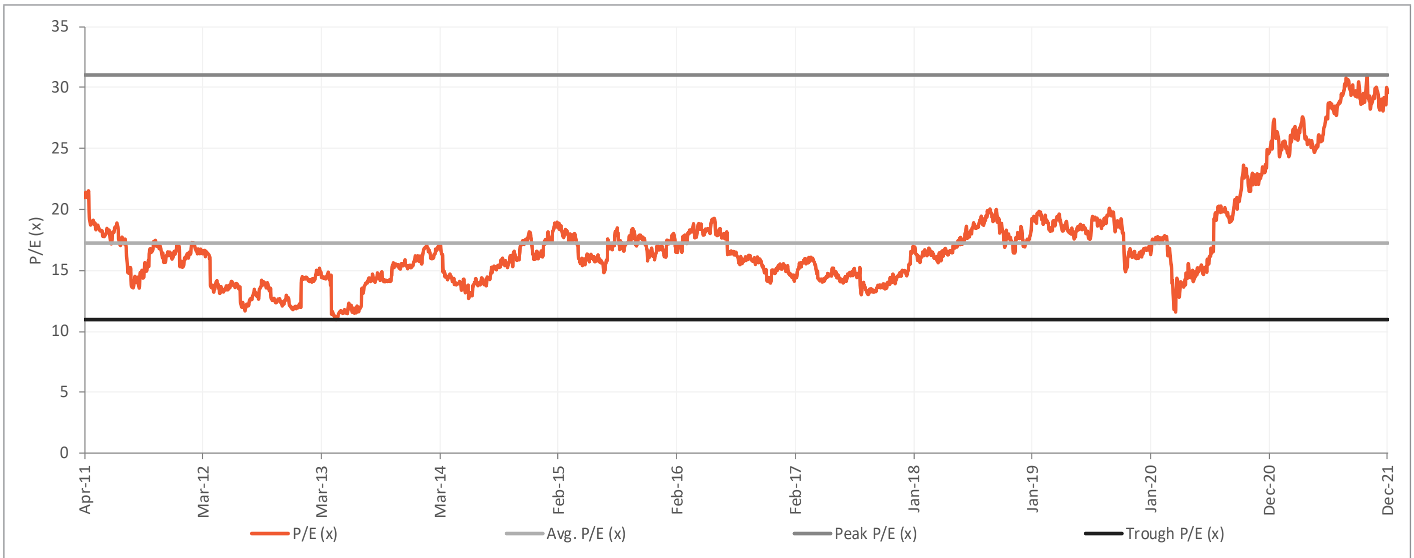
■ Company outlook – Well positioned to capture opportunities

Infosys services a large number of Fortune 500/Global 500 clients who 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 – Maintain Buy with a PT of Rs. 2,050

Infosys is well placed to deliver industry-leading organic growth among large peers in the medium term. Margins are expected to remain under pressure due to supply-side challenges, roll-out of wage hike for senior employees, and weak seasonality, which will be partially offset by strong growth in the digital business, operational efficiencies, and currency tailwinds. We expect Infosys to report USD revenue and earnings growth of 12.4% and 15.1%, respectively, over FY2022-FY2024E. At the CMP, the stock trades at 30x/26x its FY2023E/FY2024E earnings, which is justified, given strong growth potential, robust deal pipelines, robust execution, and improving ROCE. We like Infosys because of its superior digital capability, consistent investments on talents, stable management, a strong capital allocation policy, and a healthy balance sheet. Hence, we maintain our Buy rating on the stock with an unchanged PT of Rs. 2,050.

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 (%)	
				FY22E	FY23E	FY22E	FY23E	FY22E	FY23E	FY22E	FY23E
HCL Tech	1,205	271	3,27,064	23.9	21.1	15.9	14.3	5.2	4.8	21.5	23.1
TCS	3,608	370	13,34,784	34.1	29.7	24.2	21.1	15.0	14.6	44.5	49.9
Wipro	691	548	3,78,609	31.0	27.4	20.8	18.1	6.6	5.9	19.2	20.6
Infosys	1,813	421	7,62,254	34.9	29.8	23.7	20.5	5.2	4.8	27.2	29.7

Source: Company, Sharekhan estimates

About company

Founded in 1981, Infosys is the second largest ($13,562 million in FY2021) IT services company in India in terms of export revenue with headcount of 2.7 lakh employees. BFSI accounts for the largest chunk of revenue (~32% of total revenue), followed by retail, energy and utilities, and communication. Region wise, North America and Europe continue to be the mainstay. Digital revenue continued to have a strong growth momentum in the past few quarters and now contributes 56.1% 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	5.50
3	BlackRock Inc	4.55
4	SBI Funds Management Pvt Ltd	2.79
5	Vanguard Group Inc/The	2.64
6	Republic of Singapore	1.68
7	ICICI Prudential Asset Management	1.25
8	UTI Asset Management Co Limited	1.19
9	Government Pension Fund – Global	1.13
10	HDFC Asset Management Co Ltd	1.11

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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