Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Stock Update

Result Update

Infosys

Mixed quarter

IT & ITES	Sharekhan code: INFY
Reco/View: Buy ↔	CMP: Rs. 1,503 / Price Target: Rs. 1,730 ↔

↑ 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 15.39

Updated July 08, 2022

Low Risk

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

Source: Morningstar

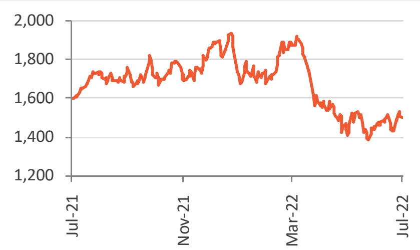
Company details

Market cap:	Rs. 6,32,342 cr
52-week high/low:	Rs. 1953 / 1367
NSE volume: (No of shares)	72.45 lakh
BSE code:	500209
NSE code:	INFY
Free float: (No of shares)	365.6 cr

Shareholding (%)

Promoters	13.1
FII	31.7
DII	18.9
Others	36.3

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	4.2	-3.8	-13.5	-6.3
Relative to Sensex	-1.5	-2.3	-10.5	-11.8

Sharekhan Research, Bloomberg

Summary

- Revenue beat led by strong volume growth and market share gains, while margins missed estimates owing to wage revision and supply-side pressures. Net headcount addition and client mining remained impressive, while deal TCVs stayed weak in Q1.
- Infosys has revised its revenue growth guidance upward by 100 bps to 14-16% in constant currency for FY2023, led by strong revenue growth in Q1, healthy deal pipeline, and higher spending on growth and efficiencies initiatives. However, it lowered its EBIT margin guidance to the lower end of 21-23% band.
- We believe Infosys is well equipped to maintain its growth leadership among large peers in the medium term, given a portfolio well aligned to growth areas, strong digital capabilities, and solid execution.
- We maintain our Buy rating on Infosys with an unchanged PT of Rs. 1,730, given strong revenue growth visibility, a set of offering portfolio that are well-aligned to clients' requirements, and market share gains.

Infosys reported a strong quarter in revenue, led by robust volume growth and market share gains, while margin missed our estimates owing to higher-than-usual wage revision and investments in talents. Q1 saw strong net headcount addition, improving client metrics, healthy growth in top accounts, and solid deal pipeline. The company reported strong constant currency (CC) revenue growth of 5.5% q-o-q and 21.4% y-o-y, ahead of our and street's expectations as well, led by broad-based growth across verticals in North America and robust growth in energy and utilities, manufacturing, and hi-tech in Europe. EBIT margin contracted by 150 bps q-o-q to 20.1%, lagged our estimates, owing to supply-side pressures and higher-than-usual wage revision, partially offset by reversal of client contractual provision and currency tailwinds. Infosys has revised upward its revenue growth guidance to 14-16% in constant currency for FY2023 versus 13-15% earlier, led by beat in Q1FY2023, healthy deal pipeline, and higher spending on growth and cost efficiencies transformation programme. However, management has lowered its EBIT margin guidance to the lower end of its earlier guided band of 21-23% for FY2023, given higher investments in talents and higher wage revision compared to historical years. Margins are expected to improve in the coming years because of rationalisation of sub-contractor costs, broadening of employee pyramid through high fresher intake, and better pricing.

Key positives

- Strong beat in revenue, led by robust growth in North America (4.5% q-o-q) and Europe (3% q-o-q)
- Net headcount addition of the past two quarters remained 15% of Q3FY2022 base
- Client metrics impressed with the number of $50 million clients increasing by 5 sequentially to 69
- Quarterly annualised attrition rate declined by 1% q-o-q in Q1.

Key negatives

- Deal wins below expectations at $1.6 billion in Q1, down 25% q-o-q
- EBIT margins lower than estimate, margin guidance to the lower end of 21-23% band.

Management Commentary

- Management cited that the demand outlook is robust, though there is weakness in some pockets such as in the mortgage sub-segment and some delay in the deal-decision making process on deals.
- The company has been gaining market share with a strong Cobalt cloud capabilities and a differentiated digital value proposition.
- Management believes that margin would improve sequentially in the remaining quarters of FY2023.

Revision in estimates – We have lowered our FY2023E/FY2024E/FY2025E EPS estimates by 1-2%, factoring in Q1FY2023 results and lower margin guidance for FY2023. However, we have raised our revenue growth, led by upward revision of revenue growth guidance.

Our Call

Valuation – Maintain Buy with an unchanged PT of Rs. 1,730: We believe Infosys is well equipped to maintain its growth leadership among large peers in the medium term, given a portfolio well-aligned to growth areas, strong digital capabilities, and solid execution. Infosys is expected to report USD revenue and earnings growth of 13% and 12%, respectively, over FY2022-FY2024E. At the CMP, the stock trades at 26x/23x its FY2023E/FY2024E earnings, which is justified, given strong revenue growth potential and continued market share gains. We like Infosys considering differentiated digital and cloud competencies, a strong capital-allocation policy, stability of the current leadership, and preferred partner for both growth and efficiencies transformation initiatives of clients. Hence, we maintain our Buy rating on the stock with a revised price target (PT) of Rs. 1,730.

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	FY22	FY23E	FY24E	FY25E
Revenue	1,21,641.0	1,45,125.2	1,62,330.4	1,83,789.2
OPM (%)	25.9	23.9	24.8	25.1
Adjusted PAT	22,111.0	23,858.0	27,513.3	31,714.1
% YoY growth	14.3	7.9	15.3	15.3
Adjusted EPS (Rs.)	52.6	56.9	65.6	75.6
P/E (x)	28.6	26.4	22.9	19.9
P/B (x)	4.5	4.3	3.9	3.6
EV/EBITDA (x)	19.4	17.5	15.0	12.9
RoNW (%)	29.2	29.9	31.4	33.6
RoCE (%)	33.6	36.1	39.6	42.1

Source: Company; Sharekhan estimates

Revenue beat, but margin disappointed

Infosys reported strong 5.5% constant currency (CC) sequential revenue growth after reporting weak revenue growth in Q4FY2022, exceeding our estimates. Digital revenue grew by 37.5% y-o-y on CC terms, which now constitutes 61% of its total revenue. Reported US Dollar revenue grew by 3.8% q-o-q (up 17.5% y-o-y) to $4,444 million, better than our expectations. During Q1FY2023, energy and utilities (up 7.3% q-o-q), manufacturing (up 6.5% q-o-q), communication (up 5.5% q-o-q), retail (up 5.3% q-o-q), and hi-tech (up 3.8% q-o-q) reported better growth compared to the company's overall growth rate. EBIT margin contracted by 149 bps q-o-q to 20.1%, lagged our estimates, owing to subcontractor expense (30 bps), utilisation (40 bps), and wage revision (160 bps). The above-margin headwinds were partially offset by 50 bps benefits from reversal of client contractual provision and 30 bps benefit from currency tailwinds. Net profit came at Rs. 5,362 crore (down 5.7% q-o-q, but up 3% y-o-y) and was 4.4% below of our estimates owing to margin miss and higher tax provision (28.8% versus 24.5% in Q4FY2022).

Upward revision of revenue growth guidance surprised us; However, deal TCVs stayed weak

Management cited that it does not see any weakness in IT spends except few pockets in financial services and retail sector amid adverse macro environment. Infosys has revised upward its revenue growth guidance to 14-16% in constant currency versus 13-15% earlier, which implies revenue CQGR of 1.9%-3.0% for the remaining quarters of FY2023E. The upward revision of revenue growth guidance impressed us as its large deal TCVs ($1.6 billion) continues to remain weak (down 25% q-o-q/34% y-o-y). Further, the company's LTM large deal TCVs remained at $8.6 billion in Q1FY2023 versus $15 billion in Q1FY2023. Hence, increased revenue growth guidance indicates the company would receive a large number of small and mid-sizes deals with lower tenure that are not captured in the above large deal TCVs. The company's net hiring of 21,171 employees remained strong during the quarter even after hiring 21,948 employees in Q4FY2022. This indicates strong underlying demand in the near term or anticipation of strong deal flow in the coming quarters. As H1FY2023 is expected to be stronger in terms of growth compared to H2FY2023 given front-ended revenue growth, we expect strong growth in Q2FY2023. Infosys is well placed to gain most of the benefits from cost-takeout initiatives of customers in a deteriorating macro environment.

Lowered its margin guidance for FY2023; Expect margin to improve in H2

EBIT margin declined 150 bps q-o-q due to higher-than-usual wage revisions, increased travel expenses, investments in talents, and subcontractor costs. Apart from supply-side pressure, the company witnessed further margin decline (down 2000 bps in the past seven quarters) in its manufacturing vertical. Management believes the margin decline has bottomed out and it expects gradual improvement in margins in the remaining quarters of FY2023E as it sees some stabilisation in the attrition rate. Though the LTM attrition rate increased by 70 bps q-o-q to 28.4% (one of the highest among large peers), it indicated quarterly annualised attrition declined by 100 bps on the heels of 500 bps q-o-q declined in Q4FY2022. We believe attrition would moderate in the next couple of quarters, given strong industry-wide fresher intake over the past few quarters, rising layoff in start-ups, and hiring freeze. Management has lowered its EBIT margin guidance to the lower end of its earlier guided band of 21-23%. Margins are likely to improve in 2HFY2023, aided by rationalisation of sub-contractor costs, broadening of employee pyramid through high fresher intake, and better pricing. The company sees better pricing as one of the margin levers in FY2023, as it is invoking COLA clause in projects and higher pricing during renewals.

Key result highlights:

- **Strong revenue growth:** Infosys reported strong CC revenue growth of 5.5% q-o-q and 21.4% y-o-y, exceeding our estimates, led by volume growth and market share gains. USD revenue increased 3.8% q-o-q to $4,444 million. Growth was led by broad-based growth across verticals in North America and robust growth in energy and utilities, manufacturing, and hi-tech in Europe. Manufacturing continued its strong growth momentum of 6.5% q-o-q for the last seven consecutive quarters. Digital revenue grew 37.5% y-o-y on CC terms, which now constitutes 61% of its total revenue.

- **Strong demand outlook, but it sees weakness in some pockets:** Management stated that the demand outlook is robust though there is demand slowdown in the mortgage and loan sub-segment of financial services and some slowness in the decision making on deals.
- **Client metrics remain impressive:** Infosys added 106 new clients (versus 110 clients in Q4FY2022). The number of $100 million clients remained flat sequentially at 38, while $50 million clients increased by 5 q-o-q to 69. The number of clients in the $200 million bracket increased by six on a y-o-y basis. Revenue from the top five clients increased by 14.4% q-o-q. Revenue from the top 10 and top 25 clients declined by 11.3% and 6.5% on a q-o-q basis, respectively.
- **Attrition rate inched up, but quarterly annualised attrition declined:** Attrition rate rose to 28.4% in Q1FY2023 versus 27.7% in Q4FY2022. Increased attrition rate was due to higher demand for talent across the industry and supply-side challenges. Management highlighted that quarterly annualised attrition declined by 1% q-o-q on the heels of a 5% decline in Q4FY2022. However, management remains confident to support its clients in their digital transformation journey despite ongoing supply-side concerns.
- **Strong net headcount additions:** Headcount grew by 6.7% sequentially (21,171 net hiring) to 3,35,186 employees despite strong headcount addition (21,948 net hiring) in the previous quarter. Headcount growth was substantially higher than the revenue growth rate in Q1FY2023.
- **Strong balance sheet and cash flows:** Infosys had cash balance of $4.4 billion with no debt versus $4.9 billion in Q4FY2022. Free cash flow (FCF) stood at $656 million versus $761 million in Q4FY2022. FCF conversion remained strong at 95% of net profit.
- **Acquisition of Base Life Science:** Infosys announced a definitive agreement to acquire BASE Life Science, a leading technology and consulting firm in the life sciences industry, in Europe for EUR 110 million ($111 million), including management incentives, bonuses, and retention. The transaction is valued at 4.1x EV/sales of FY2022 (June-ended year), which is reasonable given strong CAGR of 52%. Together with Infosys, BASE will further expand its portfolio of expertise into consumer health, animal health, MedTech, and genomics segments. BASE collaborates with leading software technology providers in the life sciences industry such as Veeva, IQVIA, and Salesforce. The acquisition will close in Q2FY2023.
- **Strong client mining:** Annually, the company added 10, 4, and 6 clients in the $50 million+, $100 million+, and $200 million+ revenue categories, respectively.

Results Rs cr

Particulars	Q1FY23	Q1FY22	Q4FY22	y-o-y (%)	q-o-q (%)
Revenue ($ mn)	**4,444.0**	**3,782.0**	**4,280.0**	**17.5**	**3.8**
Net sales	**34,470.0**	**27,896.0**	**32,276.0**	**23.6**	**6.8**
Direct costs	23,419.0	17,677.0	21,382.0	32.5	9.5
Gross profit	**11,051.0**	**10,219.0**	**10,894.0**	**8.1**	**1.4**
SG&A	3,187.0	2,787.0	3,048.0	14.4	4.6
EBITDA	**7,864.0**	**7,432.0**	**7,846.0**	**5.8**	**0.2**
Depreciation and amortisation	950.0	829.0	890.0	14.6	6.7
EBIT	**6,914.0**	**6,603.0**	**6,956.0**	**4.7**	**-0.6**
Other income	620.0	573.0	587.0	8.2	5.6
PBT	**7,534.0**	**7,176.0**	**7,543.0**	**5.0**	**-0.1**
Tax provision	2,172.0	1,975.0	1,848.0	10.0	17.5
Reported net profit	**5,362.0**	**5,201.0**	**5,686.0**	**3.1**	**-5.7**
EPS (Rs.)	**12.8**	**12.2**	**13.6**	**4.4**	**-5.8**
Margin (%)				**bps**	**bps**
EBITDA	22.8	26.6	24.3	-383	-150
EBIT	20.1	23.7	21.6	-361	-149
NPM	15.6	18.6	17.6	-309	-206
Tax rate (%)	28.8	27.5	24.5	131	433

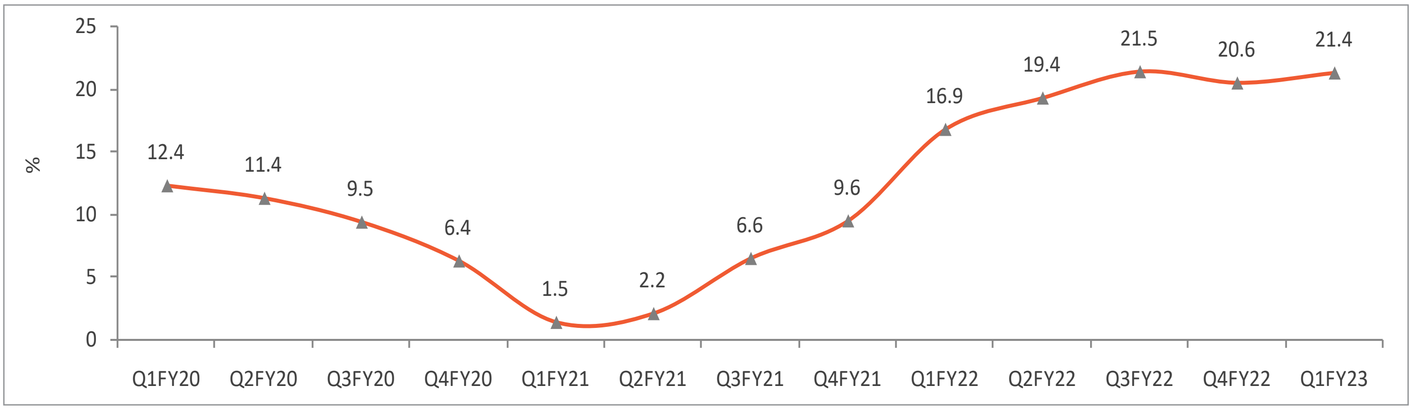
Source: Company, Sharekhan Research

Revenue mix: Geographies, industry verticals, and other operating metrics Rs cr

Particulars	Revenue ($ mn)	Contribution (%)	$ Growth (%)		CC growth (%)
			q-o-q	y-o-y	y-o-y
Revenue ($ mn)	4,444	100	3.8	17.5	21.4
Geographic mix					
North America	2,746	61.8	4.5	17.7	18.4
Europe	1,111	25.0	3.0	21.4	33.2
India	116	2.6	-15.6	5.3	5.8
Rest of world	471	10.6	7.9	11.2	17.8
Industry verticals					
Financial services	1,360	30.6	1.5	9.0	12.1
Retail	644	14.5	5.3	13.6	17.8
Communication	578	13.0	5.5	25.2	30.0
Energy, utilities, resources and services	551	12.4	7.3	20.4	24.6
Manufacturing	538	12.1	6.5	46.6	55.2
Hi tech	364	8.2	3.8	16.1	16.4
Life sciences	289	6.5	2.3	12.3	15.8
Others	120	2.7	-6.6	9.4	15.4
Service line					
Digital	2,710	61.0	7.0	32.8	37.5
Core	1,734	39.0	-0.8	-0.5	2.4
Clients Contribution					
Top client	578	13.0	14.4	35.2	-
Top 10 clients	924	20.8	11.3	30.0	-
Top 25 clients	1,613	36.3	6.5	24.0	-
Revenue per employee					
Revenue per FTE ($ K)	56.9	-	-1.4	0.5	-
Deal wins ($ mn)					
TCV	1,691	-	-25.1	-34.2	-

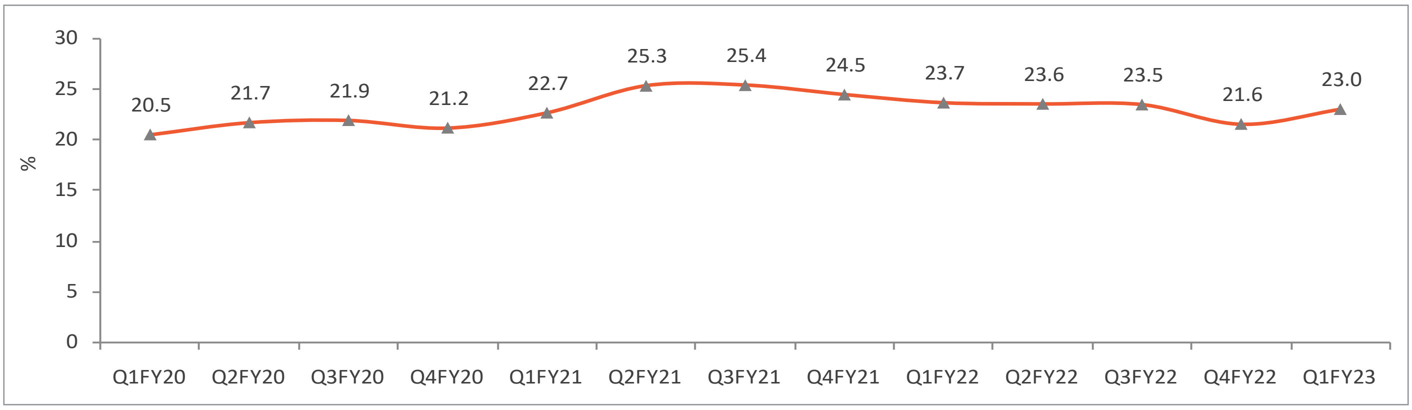
Source: Company, Sharekhan Research

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



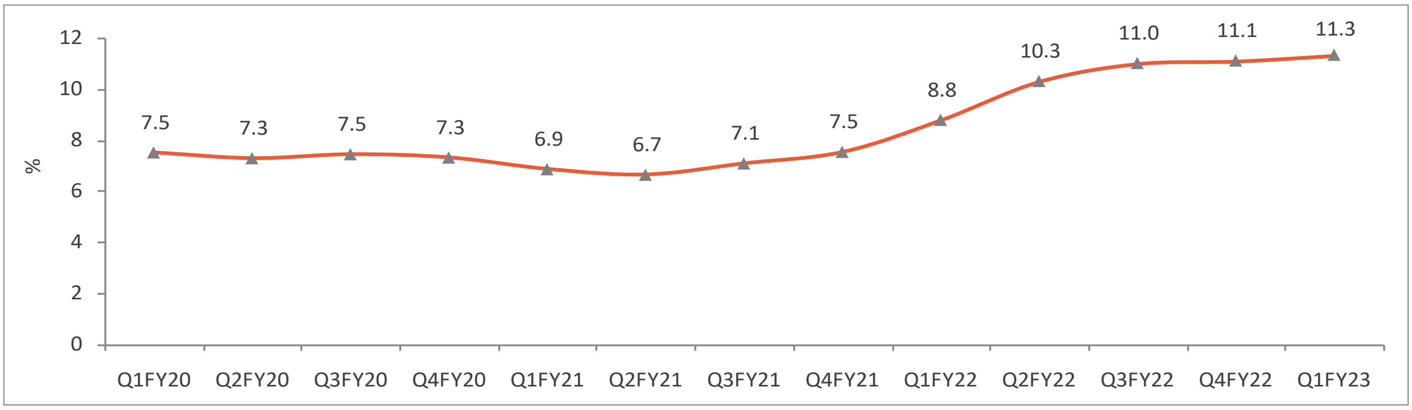
Source: Company, Sharekhan Research

EBIT margin trend (%)



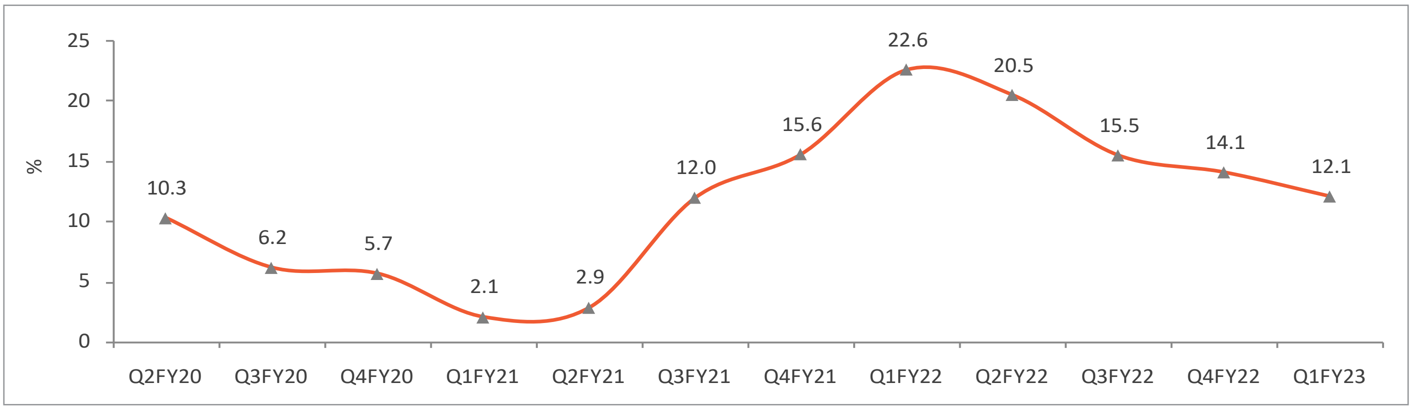
Source: Company, Sharekhan Research

Subcontracting costs as a % of revenue



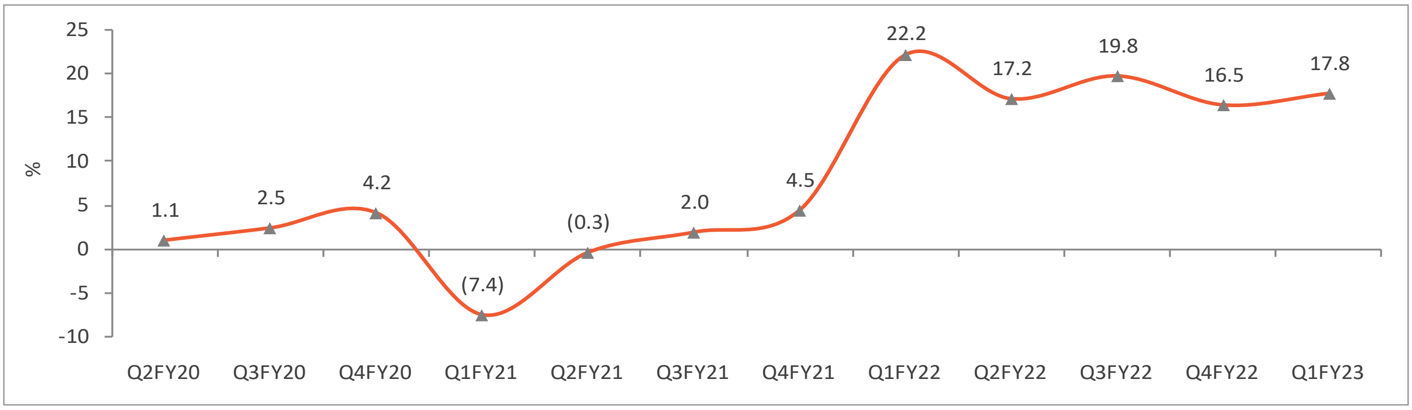
Source: Company, Sharekhan Research

BFSI revenue growth trends (y-o-y CC)



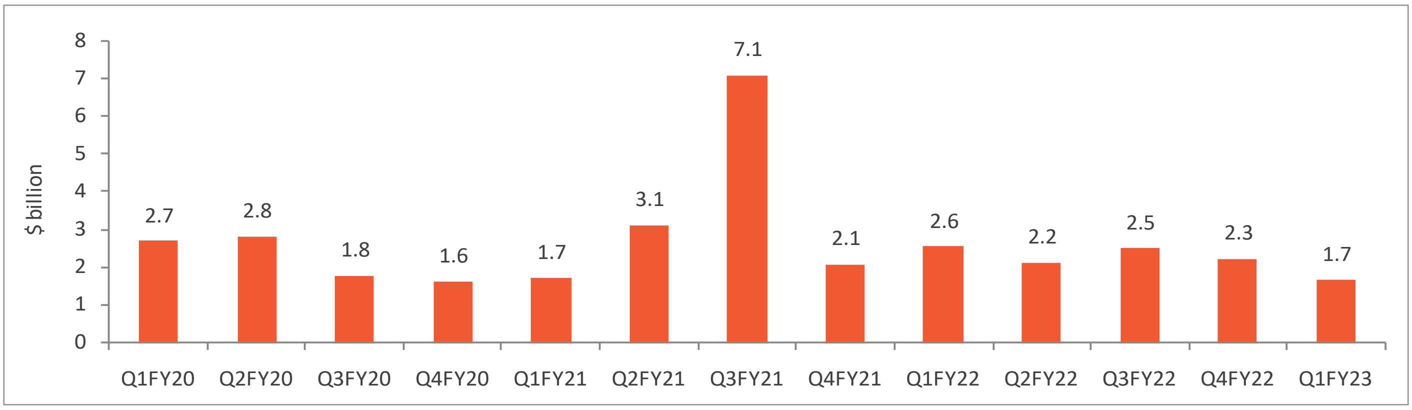
Source: Company, Sharekhan Research

Retail revenue growth trend (y-o-y CC)



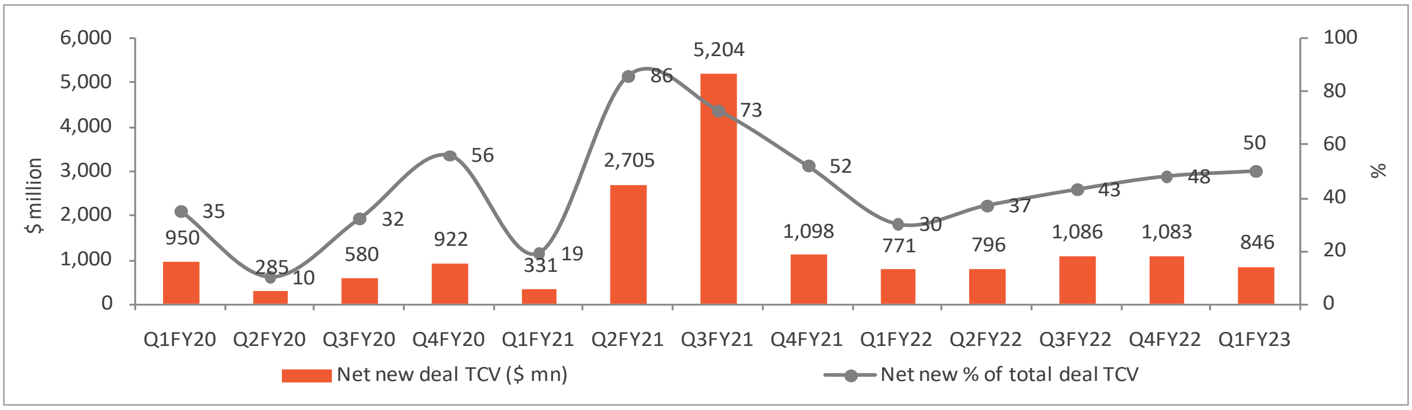
Source: Company, Sharekhan Research

TCV of deal wins ($ bn)



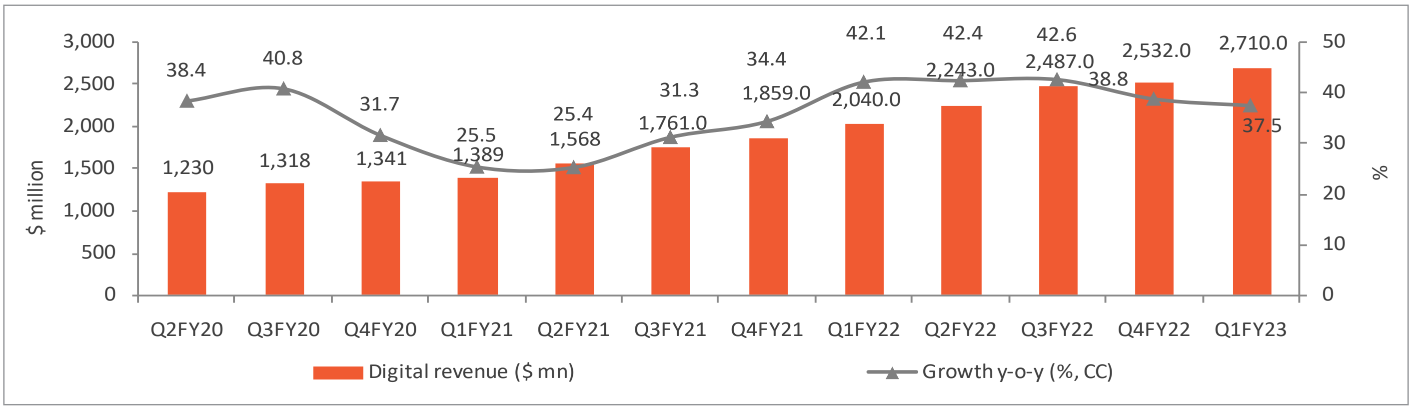
Source: Company, Sharekhan Research

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



Source: Company, Sharekhan Research

Digital revenue ($ mn) and growth (%)



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 2011-2020. Consulting (+11%) and application implementation and managed services (+9%) are expected to grow faster than BPO (+7%) and infra implementation and managed services (+4%) in CY2022E. 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.

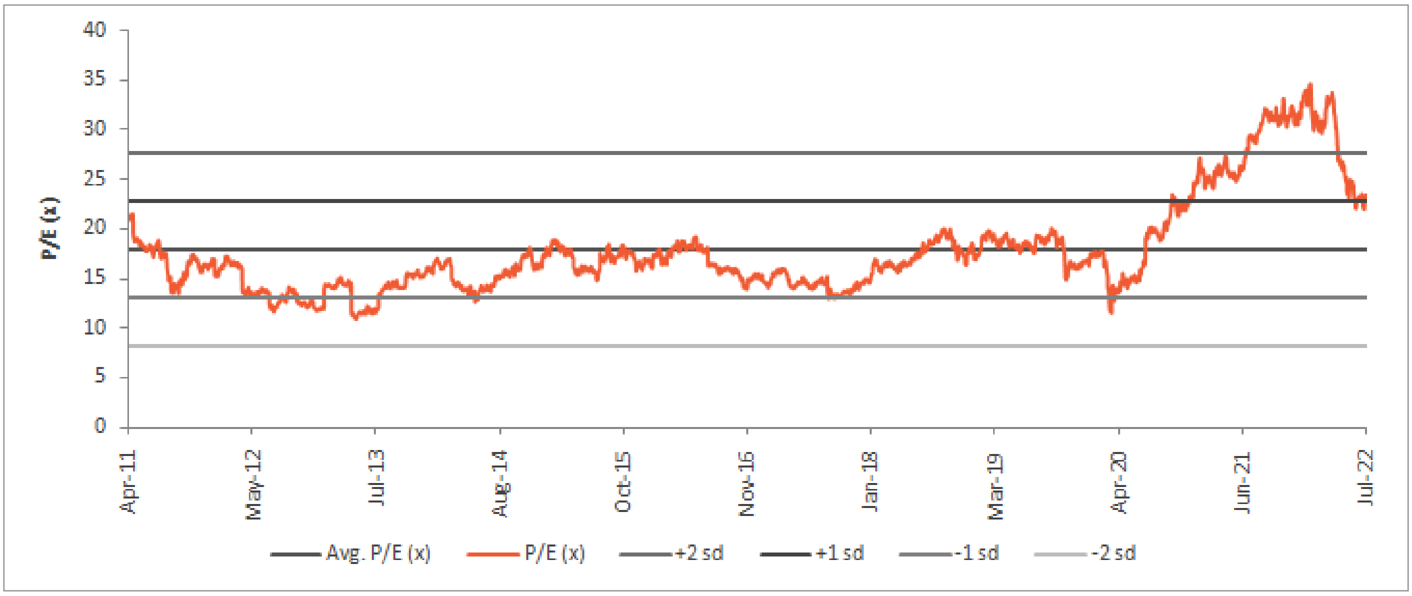
Company outlook - Well positioned to capture opportunities

Infosys services a large number of Fortune 500/Global 500 clients who have strong balance sheets 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 an unchanged PT of Rs. 1,730

We believe Infosys is well equipped to maintain its growth leadership among large peers in the medium term, given a portfolio well-aligned to growth areas, strong digital capabilities, and solid execution. Infosys is expected to report USD revenue and earnings growth of 13% and 12%, respectively, over FY2022-FY2024E. At the CMP, the stock trades at 26x/23x its FY2023E/FY2024E earnings, which is justified, given strong revenue growth potential and continued market share gains. We like Infosys considering differentiated digital and cloud competencies, a strong capital-allocation policy, stability of the current leadership, and preferred partner for both growth and efficiencies transformation initiatives of clients. Hence, we maintain our Buy rating on the stock with a revised PT of Rs. 1,730.

One-year forward P/E (x) band



Source: Sharekhan Research

About company

Founded in 1981, Infosys is the second largest ($16,311 million in FY2022) IT services company in India in terms of export revenue with headcount of 3.14 lakh employees. BFSI accounts for the largest chunk of revenue (~31% 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 59.2% 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
Nilanjan Roy	Chief Financial Officer
Ravi Kumar S	President, Deputy COO
Mohit Joshi	President, Head – BFSI and HCLS

Source: Company

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Deutsche Bank Trust Co Americas	14.2
2	Life Insurance Corp of India	6.2
3	BlackRock Inc.	4.61
4	SBI Funds Management Pvt. Ltd.	3.57
5	The Vanguard Group Inc.	3.09
6	Republic of Singapore	2.28
7	ICICI Prudential Asset Management	2.17
8	UTI Asset Management Co Limited	1.33
9	HDFC Asset Management Co Limited	1.32
10	Government Pension Fund – Global	1.24

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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