Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Infosys

Good Quarter, uncertainties persist

IT & ITES	Sharekhan code: INFY
Reco/View: Buy ↔	CMP: **Rs. 1,481** / 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 15.1

Updated Oct 08, 2022

Low Risk

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

Source: Morningstar

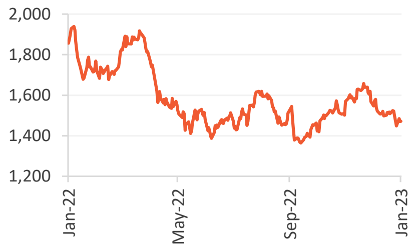
Company details

Market cap:	Rs. 6,22,990 cr
52-week high/low:	Rs. 1954 / 1356
NSE volume: (No of shares)	57.81 lakh
BSE code:	500209
NSE code:	INFY
Free float: (No of shares)	357.0 cr

Shareholding (%)

Promoters	15.2
FII	36.2
DII	32.1
Others	16.5

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	-4.3	3.6	0.5	-21.1
Relative to Sensex	-0.8	-0.4	-9.7	-19.2

Sharekhan Research, Bloomberg

Summary

- Infosys reported decent CC revenue growth of 2.4% q-o-q and 13.7 % y-o-y, 90 bps higher than our estimates, led by growth across digital business and core services. EBIT margins remained resilient at 21.5%, as cost optimisation and INR depreciation were fully offset by higher SG&A, furlough and third-party costs.
- Deal wins were strong with TCV for Q3FY22 being strongest in the past eight quarters at $3.3 billion. The management revised upward its revenue growth guidance to 16-16.5% in CC terms for FY2023 versus 15-16% earlier.
- The management expressed weakness in mortgage, investment banking, Telco, Hi-tech and Retail verticals and said clients here are looking at cost optimisation rather than digital transformation programs. Despite strong growth in Europe and North America at 13.6% and 10% q-o-q, respectively, the management has indicated that the outlook for Europe is concerning, while it is relatively better for the US.
- Given looming global headwinds, the outlook for FY24E looks uncertain and with gradual recovery in the coming quarters. However, we believe the structural growth story for the Indian IT sector remains intact. We maintain a Buy rating on Infosys with an unchanged PT of Rs. 1,730 given strong deal pipeline, its end -to-end capabilities and prowess in digital areas, analytics, automation and Cobalt cloud. We advise investors to adopt a staggered approach to invest into the stock from long term perspective.

Infosys reported CC revenue growth of 2.4% q-o-q, above our estimate of 1.5% q-o-q. USD revenue increased 2.3% q-o-q to $4,659 million which was in-line with our estimate of $4,647 million. EBIT margins stayed flat sequentially, at 21.5% , 90 bps below our estimate of 22.4%. Rupee depreciation and cost optimization helped margins to improve by 40 and 70 bps respectively but was fully offset by a 30 bps impact from an increase in SG&A expenses and 80 bps impact due to Q3 furloughs and third-party costs. Deal wins were strong with TCVs for Q3FY22 being strongest in the last eight quarters at $3.3 billion. In terms of geographies North America grew 10.5% on-year in constant currency terms, and the Europe region clocked 25.3% growth. The contribution of the rest of the world was also strong, reporting 11.9% on-year growth, although the India business underperformed other geographies, registering a 5.4% decline on-year. The attrition rate declined to 24.3% in Q3FY2023 versus 27.1% in Q2FY2023. Management revised upward its revenue growth guidance to 16-16.5% in constant currency terms for FY2023 versus 15-16% earlier, led by strong 17.8% y-o-y CC revenue growth in 9MFY23 and gains in market share. However, the management has maintained its FY23 EBIT margin guidance of 21-22%. The management expressed weakness in Mortgage, Investment banking, Telco, Hi-tech and Retail verticals and said clients here are looking at cost optimization rather than digital transformation programs. The management has indicated that the outlook for Europe is concerning, while it is relatively better for US. Given the looming global headwinds, the outlook for FY24E looks uncertain and with gradual recovery in the coming quarters. However, we believe the structural growth story for Indian IT sector remains intact. We maintain a Buy rating on Infosys with an unchanged PT of Rs. 1,730, given strong deal pipeline, its end -to-end capabilities and prowess in digital areas, analytics, automation and Cobalt cloud. We advise investors to adopt a staggered approach to invest from a long-term perspective.

Key positives

- Large deal TCVs reported in Q3FY23 was the strongest in the last 8 quarters at $3.3 billion
- FY23 revenue growth guidance increased to 16-16.5% CC
- LTM attrition moderated by 280 bps sequentially. Attrition rate declined to 24.3% in Q3FY2023 versus 27.1% in Q2FY2023.

Key negatives

- EBIT margins was flat sequentially at 21.5% and below our estimate of 22.4%.
- Utilisation rate at 81.7% is the lowest in the past 10 quarters.

Management Commentary

- The management revised upward its revenue growth guidance to 16-16.5% in constant currency terms for FY2023 versus 15-16% earlier, led by strong 17.8% y-o-y CC revenue growth in 9MFY23 and gains in market share. However, the management has maintained its FY23 EBIT margin guidance of 21-22%.
- Management expressed weakness in Mortgage, Investment banking, telecom, Hi-tech and Retail verticals and said clients here are looking at cost optimisation rather than digital transformation programs.

Revision in estimates – We have fine-tuned our estimates for FY23/24/25 owing to macro-overhang and INR-USD reset.

Our Call

Valuation – Maintain Buy with an unchanged PT of Rs. 1,730: Given the looming global headwinds, the outlook for FY24E looks uncertain and with gradual recovery in the coming quarters. However, we believe the structural growth story for Indian IT sector remains intact. We maintain a Buy rating on Infosys with an unchanged PT of Rs. 1,730, given strong deal pipeline, its end-to-end capabilities and prowess in digital areas, analytics, automation and Cobalt Cloud. We advise investors to adopt a staggered approach to invest from a long-term perspective.

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	1,48,504.4	1,58,464.1	1,74,071.2
OPM (%)	25.9	24.0	24.1	24.7
Adjusted PAT	22,111.0	24,497.5	26,050.0	29,642.3
% YoY growth	14.3	10.8	6.3	13.8
Adjusted EPS (Rs)	52.6	58.4	62.1	70.7
P/E (x)	28.2	25.4	23.9	21.0
P/B (x)	4.5	4.2	3.9	3.7
EV/EBITDA	19.2	16.9	15.6	13.7
ROE (%)	29.2	30.5	30.1	32.4
ROCE (%)	33.6	36.8	37.4	39.9

Source: Company; Sharekhan estimates

Stock Update

Result Update

Key result highlights:

- **USD revenues in-line; CC growth above expectations:** Infosys reported CC revenue growth of 2.4% q-o-q which was above our estimate of 1.5%. USD revenue increased 2.3% q-o-q to $4,659 million which was in-line with our estimate of $4,647 million. Strong q-o-q revenue growth of 8.1%, 6.9% and 6.3% was seen in Energy/Utilities, Life sciences and Manufacturing segments, respectively. Growth rate in Hitech moderated to 1% q-o-q, whereas financial services and others declined q-o-q by 1.7% and 7.9% respectively. Digital revenues grew 21.7% y-o-y in CC terms and now constitutes 62.9% of total revenue. Management expressed weakness in Mortgage, Investment banking, Telco, Hi-tech and Retail verticals and said clients here are looking at cost optimization rather than digital transformation programs. Company did not provide FY24 revenue guidance.
- **Geography-wise commentary:** Europe and North America grew strongly 13.6% and 10% q-o-q. India declined by 15.4% q-o-q but it comprises only 2.4% of the net revenues. Outlook for Europe is concerning, and US seems relatively better.
- **Strong Large Deal TCVs signed:** Large deal TCVs for the quarter was the strongest in the last 8 quarters at $3.3 billion out of which 36% were net new. Company also signed 32 large deals which was the highest ever for a quarter. Vertical wise 7 were signed in retail, 6 each in financial services and communication, five each in energy/utilities and manufacturing, 2 in Lifesciences and 1 in Hi-tech. Geography wise 25 were signed in North America, 5 in Europe and 2 in ROW.
- **Improved FY23 revenue guidance despite challenging macros:** Management revised upward its revenue growth guidance to 16-16.5% in constant currency terms for FY2023 versus 15-16% earlier, led by strong 17.8% y-o-y CC revenue growth in 9MFY23 and gains in market share. Company's growth over the last 1-3 years has exceed industry average due to strong performance in digital areas, analytics, automation and Cobalt Cloud.
- **Maintained FY23 EBIT margin guidance:** EBIT margins stayed flat sequentially at 21.5% but was below our estimate of 22.4%. Rupee depreciation and cost optimisation helped margins to improve by 40 and 70 bps respectively but was fully offset by 30 bps impact from increase in SGA expenses and 80 bps impact due to Q3 furloughs and third-party costs. The company maintained its FY23 EBIT margin guidance of 21-22%.
- **Employee metrics:** Headcount grew by 0.5% sequentially (1,627 net hires) to 3,46,845 employees. Company added 46,000 freshers in 9MFY23 and can surpass its FY23 target of 50,000. Utilisation rate at 81.7% is the lowest in the last 10 quarters and the management expects it to improve as more freshers will be put in the workforce. Infosys did not provide FY24 guidance of its net employee addition.
- **Decline in attrition rate:** Attrition rate declined to 24.3% in Q3FY2023 versus 27.1% in Q2FY2023. Management expects attrition rate to decline going forward which will help improve the EBIT margins.
- **Strong client metric performance:** Infosys added 134 new clients (versus 103 clients in Q2FY2023). Revenue from the top 5, 10 and 25 clients increased by 6.3%, 3.8% and 2.3% q-o-q, respectively. The number of $100 million clients decreased by 1 q-o-q to 38, while $50 million and $10 million clients increased by 2 and 13 q-o-q to 79 and 294 respectively.
- **Cash flows:** Free cash flows (FCF) stood at $576 million versus $589 million in Q2FY2023. FCF to Net profit % dipped to 72% in Q3FY23 from 78.6% in Q2FY23. Infosys had cash balance of $3.9 billion versus $4.7 billion in Q2FY2023.
- **OpenAI investment:** Infosys had supported OpenAI earlier through donation. ChatGPT is increasing productivity and automation of client activities. Infosys is committed to Automation, Artificial Intelligence and Machine Learning but did not comment of further investment plans in this field.

Results Rs cr

Particulars	Q3FY23	Q3FY22	Q2FY23	Y-o-Y %	Q-o-Q %
Revenues ($ mn)	**4,659.0**	**4,250.0**	**4,555.0**	**9.6**	**2.3**
Net sales	**38,318.0**	**31,867.0**	**36,538.0**	**20.2**	**4.9**
Direct Costs	25,436.0	20,516.0	24,383.0	24.0	4.3
Gross Profit	**12,882.0**	**11,351.0**	**12,155.0**	**13.5**	**6.0**
SG&A	3,515.0	2,968.0	3,253.0	18.4	8.1
EBITDA	**9,367.0**	**8,383.0**	**8,902.0**	**11.7**	**5.2**
Depr & amort.	1,125.0	899.0	1,029.0	25.1	9.3
EBIT	**8,242.0**	**7,484.0**	**7,873.0**	**10.1**	**4.7**
Other Income	689.0	459.0	518.0	50.1	33.0
PBT	**8,931.0**	**7,943.0**	**8,391.0**	**12.4**	**6.4**
Tax Provision	2,345.0	2,121.0	2,365.0	10.6	-0.8
PAT	**6,586.0**	**5,822.0**	**6,026.0**	**13.1**	**9.3**
Minority interest/Share of associates	-	13.0	5.0		
Net profit	**6,586.0**	**5,822.0**	**6,021.0**	**13.1**	**9.4**
EO	-	-	-		
Adjusted net profit	**6,586.0**	**5,822.0**	**6,021.0**	**13.1**	**9.4**
Equity capital (FV Rs5/-)	434.5	434.5	434.5		
EPS (Rs)	**15.7**	**13.9**	**14.4**	**13.3**	**9.4**
Margin (%)					
GPM	33.6	35.6	33.3	-200	35
EBITDA	24.4	26.3	24.4	-186	8
EBIT	21.5	23.5	21.5	-198	-4
NPM	17.2	18.3	16.5	-108	71
Tax rate	26.3	26.7	28.2	-45	-193

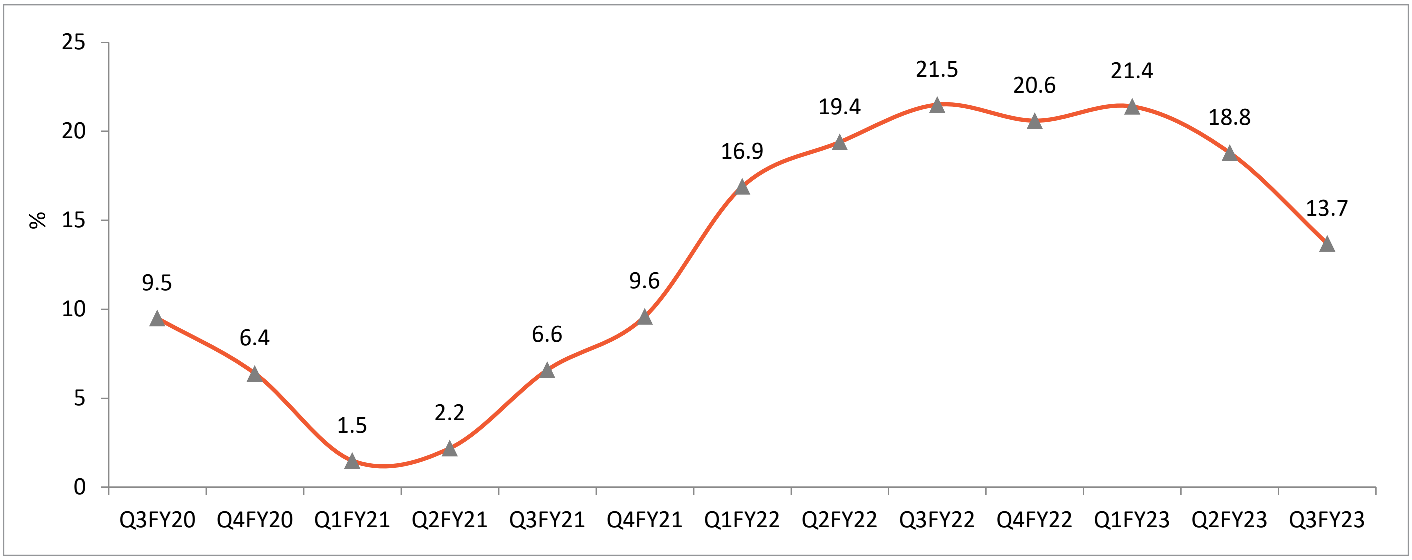
Source: Company; Sharekhan Research

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

Particulars	Revenues	Contribution	$ Growth (%)		CC growth (%)
	($ mn)	(%)	Q-o-Q %	Y-o-Y %	Y-o-Y %
Revenues ($ mn)	4,659	100	2.3	9.6	13.7
Geographic mix					
North America	2,889	62.0	1.5	10.0	10.5
Europe	1,202	25.8	6.8	13.6	25.3
India	112	2.4	-15.4	-12.3	-5.4
Rest of world	457	9.8	1.3	4.3	11.9
Industry verticals					
Financial services	1,365	29.3	-1.7	2.0	5.5
Retail	666	14.3	3.0	8.1	12.7
Communication	573	12.3	2.3	7.9	12.7
Energy, utilities, resources & services	606	13.0	8.1	21.8	25.9
Manufacturing	620	13.3	6.3	29.0	36.8
Hi tech	377	8.1	1.0	9.6	10.4
Life sciences	326	7.0	6.9	2.3	5.0
Others	126	2.7	-7.9	2.1	8.1
Service line					
Service	4,362	93.6	2.2	9.9	-
Products and platforms	297	6.4	3.5	5.9	-
Total	4,659	100.0	2.3	9.6	13.7
Digital	2,930	62.9	4.0	17.8	21.7
Core	1,729	37.1	-0.5	-1.9	2.4
Clients Contribution					
Top 5 clients	610	13.1	6.3	19.7	-
Top 10 clients	955	20.5	3.8	11.3	-
Top 25 clients	1,645	35.3	2.3	7.8	-
Revenue per employee					
Revenue per FTE ($ K)	54.2	-	-2.3	-6.4	-
Deal wins ($ mn)					
TCV	3,300	-	20.3	30.7	-

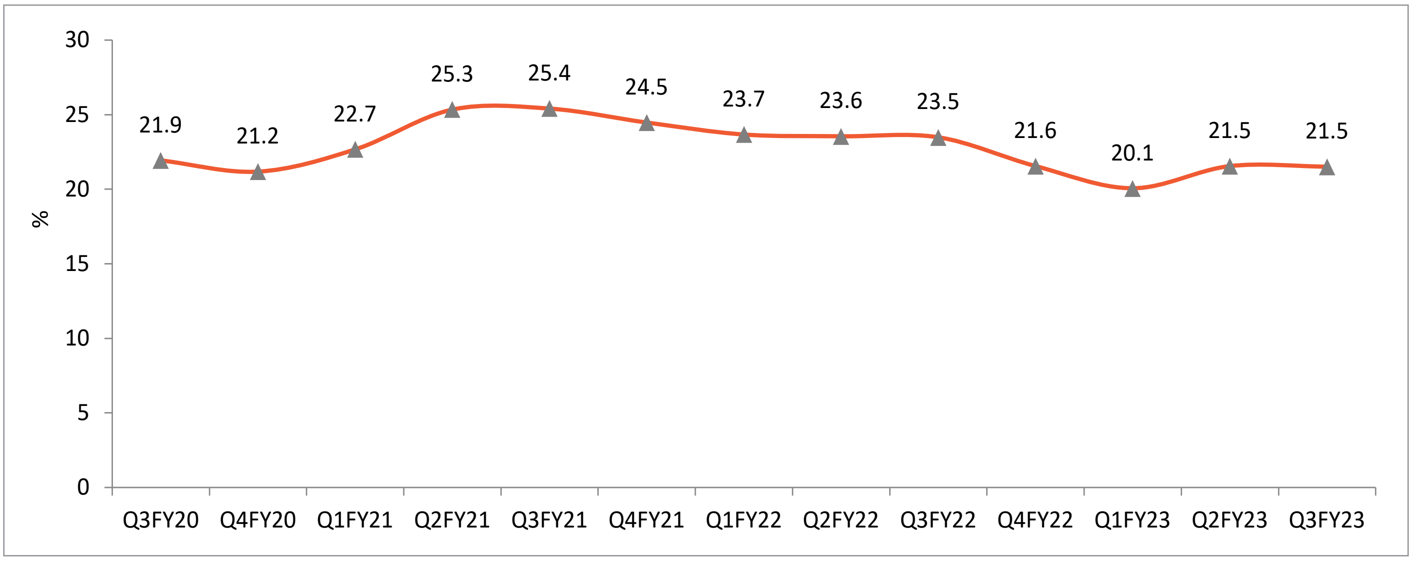
Source: Company; Sharekhan Research

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



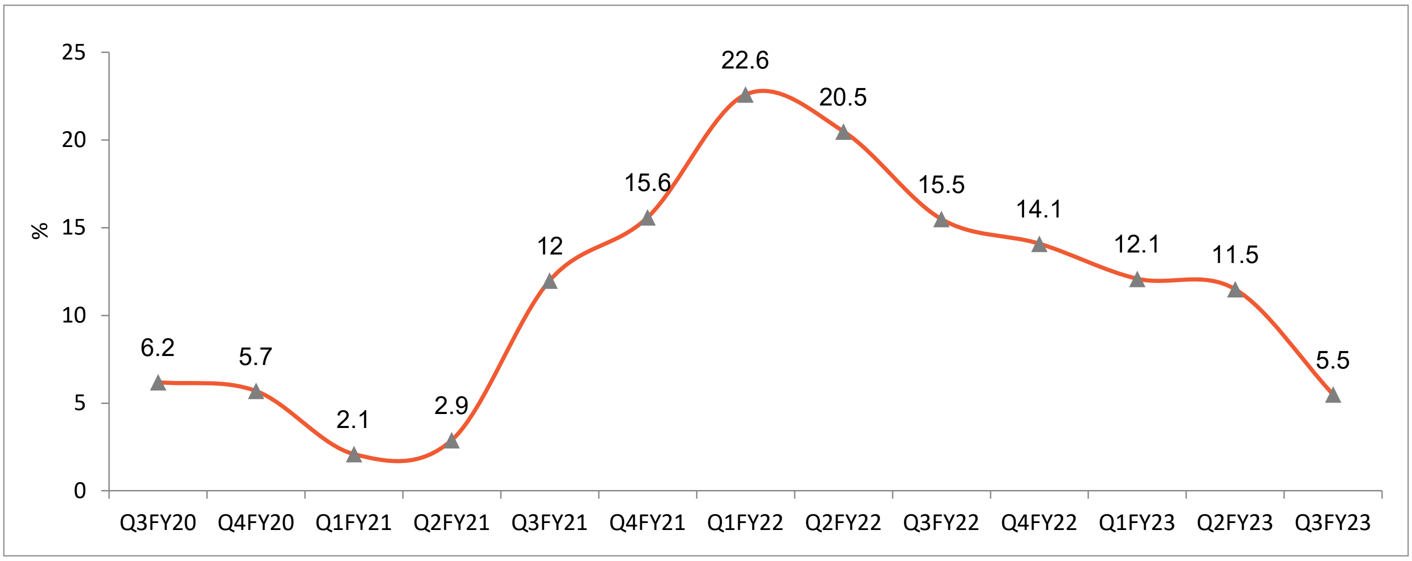
Source: Company, Sharekhan Research

EBIT margin trend (%)



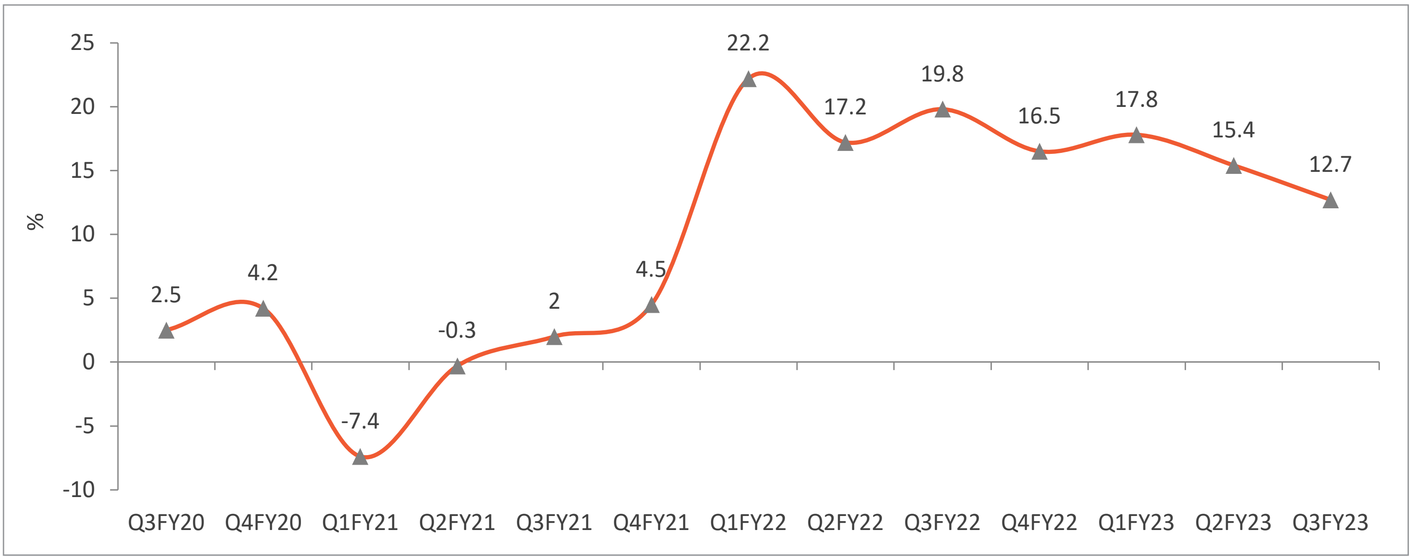
Source: Company, Sharekhan Research

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



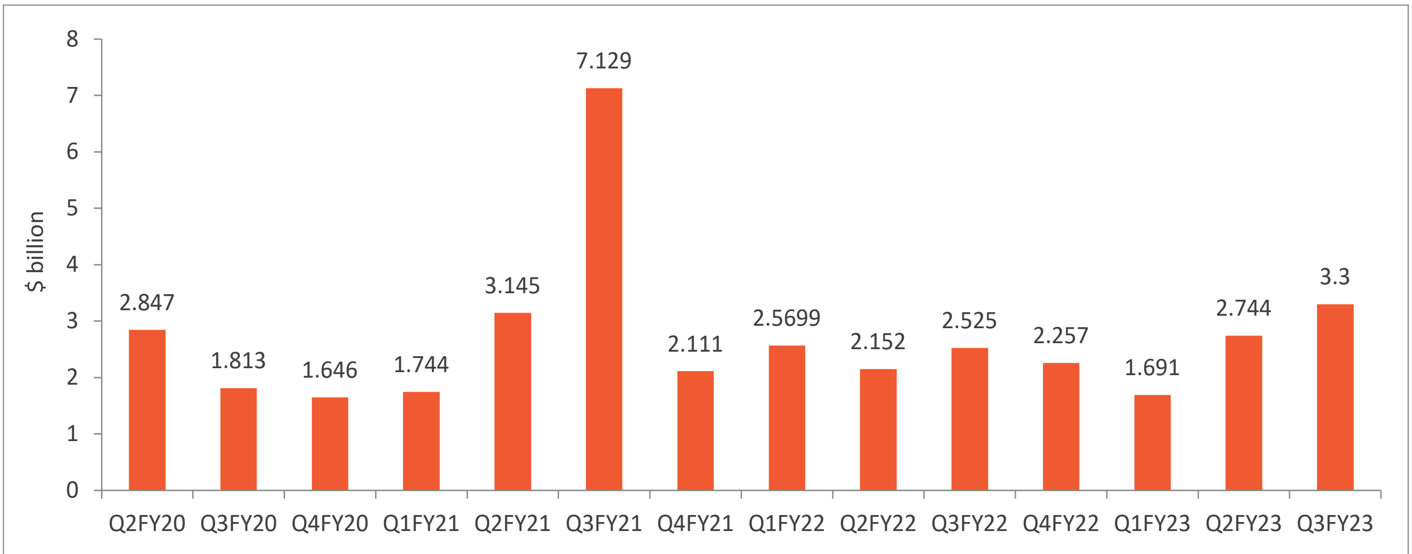
Source: Company, Sharekhan Research

Retail revenue growth trend



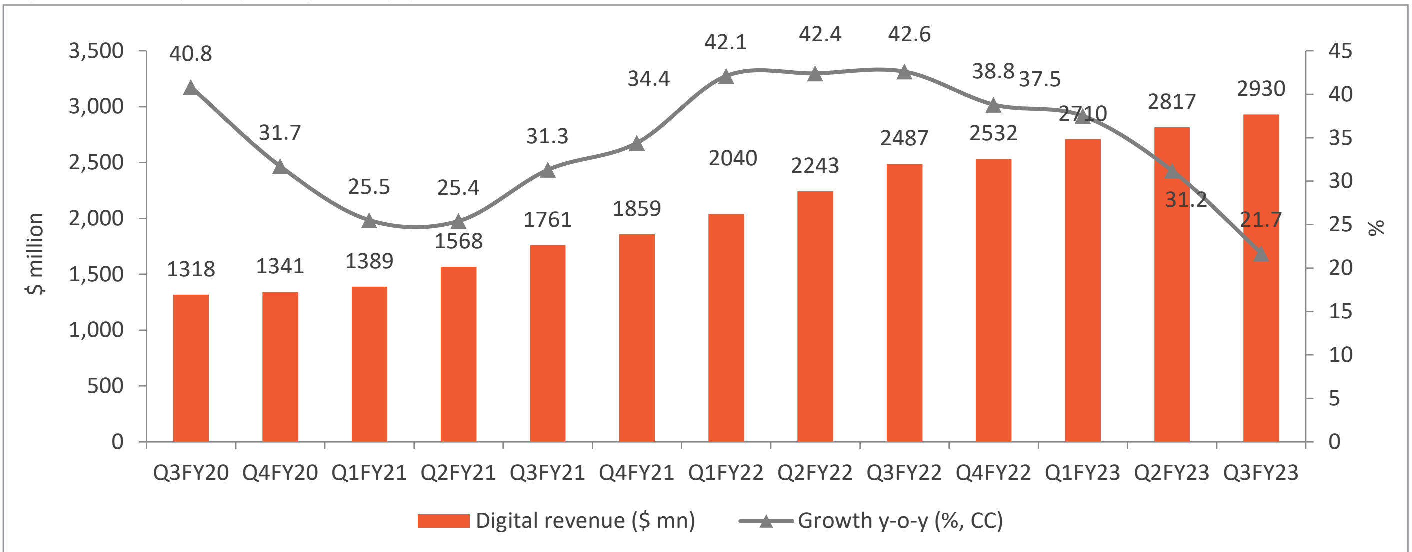
Source: Company, Sharekhan Research

TCV of deal wins ($ bn)



Source: Company, Sharekhan Research

Digital revenue ($ mn) and growth (%)



Source: Company, Sharekhan Research

Outlook and Valuation

■ Sector view - Persisting multiple global headwinds turning outlook for FY24E uncertain

Owing to multiple global headwinds the outlook for FY24E looks uncertain, and the recovery could be gradual in the coming quarters. Hence, concerns relating to macro headwinds are unlikely to abate anytime soon thus restricting any material outperformance for Indian IT companies.

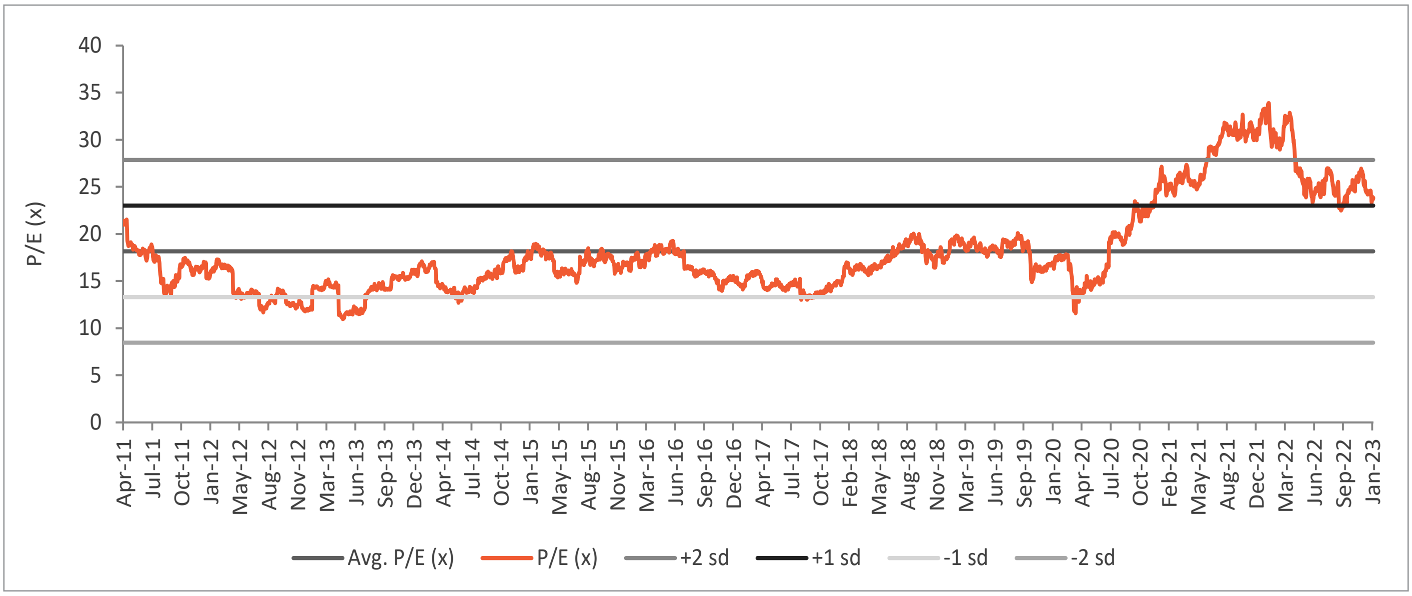
■ Company outlook - Well-positioned to capture opportunities

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

Given the looming global headwinds, the outlook for FY24E looks uncertain and with gradual recovery in the coming quarters. However, we believe that the structural growth story for Indian IT sector remains intact. We maintain a Buy rating on Infosys with an unchanged PT of Rs. 1,730, given the strong deal pipeline, its end-to-end capabilities and prowess in digital areas, analytics, automation and Cobalt cloud. We advise investors to adopt a staggered approach to invest from a long-term perspective.

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	Deutsch Bank Trust Co Americas	13.6
2	Life insurance Corp Of India	6.56
3	BlackRock Inc	4.63
4	SBI Funds Management LTD	3.85
5	Gopalakrishnan Senapathy	3.28
6	Vanguard Group Inc	2.75
7	Republic Of Singapore	2.33
8	ICICI Prudential Asset Management Co Ltd	2.09
9	Murthy Rohan	1.45
10	UTI ASSET MANAGEMENT CO LTD	1.44

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

Know more about our products and services

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Compliance Officer: Ms. Binkle Oza; Tel: 022-61150000; email id: complianceofficer@sharekhan.com;

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

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