Stock Update

Result Update

Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Infosys Ltd

Back-to Back Weak Guidance, Downgrade to Reduce

IT & ITES	Sharekhan code: INFY
Reco/View: REDUCE ↓	CMP: **Rs. 1,449** / Price Target: **Rs. 1,300** ↓

↑ 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 13.08

Updated Jul 07, 2023

Low Risk

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

Source: Morningstar

Company details

Market cap:	Rs. 6,01,064 cr
52-week high/low:	Rs. 1,672 / 1,215
NSE volume: (No of shares)	71.3 lakh
BSE code:	500209
NSE code:	INFY
Free float: (No of shares)	359.7 cr

Shareholding (%)

Promoters	15.1
FII	35.1
DII	33.6
Others	16.2

Price chart

Price performance

(%)	1m	3m	6m	12m
Absolute	11.2	18.4	-5.0	-4.4
Relative to Sensex	4.5	5.1	-16.5	-26.3

Sharekhan Research, Bloomberg

Summary

- Infosys reported revenue at $4617 million, up 1% q-o-q/4.2% y-o-y in CC in line with our estimates of $4613 million. Sequential growth was led by Manufacturing, Hitech and Energy verticals.
- EBIT margins fell 20 bps q-o-q to 20.8% in line with our estimates. Large deal TCV wins stood at $ 2.3 bn, up 11%q-o-q /35% y-o-y.
- Management sharply downgraded the FY24 constant currency revenue guidance to 1-3.5% from earlier stated guidance of 4-7%. However, the management retained the operating margin guidance for the FY24 at 20-22%.
- Infosys has consecutively disappointed with significant revenue guidance downgrade for FY24 and is expected to underperform industry peers like TCS and HCL Tech, leading to trimming of target estimates. Thus, we have downgraded the stock to Reduce from HOLD with revised Price Target of Rs1300. At the CMP, the stock trades at 25.3x/23.5x FY24/25E EPS.

Infosys reported revenues at $4617 million, up 1% q-o-q/4.2% y-o-y in CC terms, in line with our estimates of $4613 million. Infosys reported rupee revenue at Rs 37,933 crore compared to Rs 37,441 crore, up 1.3% q-o-q. EBIT margins decreased 20 bps q-o-q to 20.8% due to a 70-bps benefit from cost optimization, including utilisation, automation, which was offset by a 90-bps impact from employee-related costs including higher variable pay promotions. Large deal TCV for the quarter stood at $2.3 billion, with net new of 56.1%. Large deal momentum continued with the company signing 16 large deals in Q1, Net profit stood at Rs. 5945 crore, down 3.0% q-o-q, missing our estimates of Rs 6128 crore. On a q-o-q basis, Manufacturing, Hi-tech, Lifesciences, Energy, Communication and Others grew 5.9%,2.7%/1.4%/1.4% and 30.8% while Retail and Financial services declined 0.7%/1.4% respectively. Headcount decreased by 6,940 q-o-q to 3,36,294 employees, Utilisation rate (including trainees) improved 78.9% % up 200 bps. LTM Attrition rate declined to 17.3% in Q1FY24, down 360 bps. Management sharply downgraded the FY24 constant currency revenue guidance to 1-3.5% from earlier stated guidance of 4-7% in constant currency on lower-than-expected volumes due to ramp downs in discretionary spends, coupled with lower mega deal volumes arising from delayed signings and longer ramp-up time due to regulatory approvals and transitions. Infosys has consecutively disappointed with a significant revenue guidance downgrade for FY24 and is expected to underperform industry peers like TCS and HCL Tech, leading to trimming of target estimates. Thus, we have downgraded the stock to Reduce from HOLD with revised target price of Rs1300, stocks trades at 25.3x/23.5x its FY24/25E EPS.

Key positives

- Large deal TCV wins at $ 2.3 bn for the quarter was strong up 11%q-o-q /35% y-o-y., The company had 1 Mega deal win in Q1
- LTM attrition fell sharply to 17.3%, declining by 360 bps q-o-q.
- Utilisation rate(including trainees) improved to 78.9% from 76.9% in Q4FY23.

Key negatives

- Management sharply downgraded FY24 constant currency revenue guidance to 1-3.5%
- Headcount decreased by 6,940 q-o-q to 3,36,294 employees

Management Commentary

- The management highlighted the broader and comprehensive margin expansion program. The program will work across five areas pyramid efficiency, automation and generative AI improvements in critical portfolios, reducing the indirect costs and communicating and deriving value across the portfolio.
- Management sharply trimmed the FY24 constant currency revenue guidance to 1-3.5%. However the management retained the operating margin guidance for the financial year at 20% to 22%.

Revision in estimates – We have revised our estimates downward for FY24/25E to factor the company's weak guidance for FY24.

Our Call

Valuation – Downgrade to Reduce with revised PT of Rs. 1300: Infosys has once again surprised negatively with a steep downgrade on revenue guidance for FY24, it's likely to lag industry level growth in FY24 to peers like TCS and HCL Tech. Our estimates are already on the lower side of consensus earnings, we have further trimmed down our estimates and reduced our target multiple. Thus, we have downgraded stock to Reduce from HOLD with revised target price of Rs . 1300. At the CMP, stocks trades at 25.3x/23.5x FY24/25E EPS.

Key Risks

Rupee appreciation and/or adverse cross-currency movements, Contagion effect of banking crisis and macro headwinds and possible recession in the US are likely to moderate the pace of technology spending.

Valuation (Consolidated) Rs cr

Particulars	FY22	FY23	FY24E	FY25E
Revenue	1,21,641.0	1,46,767.0	1,51,630.7	1,60,970.2
OPM (%)	25.9	23.9	23.9	24.2
Adjusted PAT	22,111.0	24,097.0	23,701.2	25,522.1
% YoY growth	14.3	9.0	-1.6	7.7
Adjusted EPS (Rs)	52.6	57.6	57.3	61.7
P/E (x)	27.5	25.1	25.3	23.5
P/B (x)	4.4	4.4	4.1	4.1
EV/EBITDA	18.6	16.9	16.1	14.9
ROE (%)	29.2	31.8	29.6	31.5
ROCE (%)	33.6	36.7	36.0	37.7

Source: Company; Sharekhan estimates

Key result highlights

- **Weak FY24 revenue guidance:** Management sharply trimmed the FY24 constant currency revenue guidance to 1-3.5% from earlier stated guidance of 4-7% in constant currency on lower-than-expected volumes due to ramp downs in discretionary spends, coupled with lower mega deal volumes arising from delayed signings and longer ramp-up time due to regulatory approvals and transitions.
- **Margin performance and guidance:** EBIT margins decreased 20 bps q-o-q to 20.8%. This was primarily due to a 70-basis point of benefit from cost optimization, including utilisation, automation, which was offset by a 90-basis point impact from employee-related costs including higher variable pay promotions. The company retained operating margin guidance for the financial year at 20% to 22%.
- **Large deal TCVs:** Large deal TCV for the quarter stood at $2.3 billion, with net new of 56.1%. Large deal momentum continued with the company signing 16 large deals in Q1. Of the 16 deals, three deals each were in Financial, Utilities Resources & Services and Communication, four in Retail, two in manufacturing, one in life sciences vertical. While 11 deals in America, four in Europe and one in ROW was the region wise deal split.
- **Vertical-wise Commentary:** Financial Services vertical witnessed continued softness in areas like mortgage, Asset Management Investment banking cards and payments. Large and super regional banking clients in US have been resilient during Q1. Large banking clients are focusing on vendor consolidation cost takeout and self-funding transformation program. The communications sector witnessed continued impact from budget cuts, delayed decision making for newer spend and slow ramp,-ups. Energy clients are seeking large scale transformation programs such as digital capabilities for energy transition and journey to net zero. Manufacturing clients are focusing on controlling the spend and awarding deals, which are focused on differentiation. Despite the volatile environment deal pipeline is strong. Areas like engineering, IoT, Supply Chain, Cloud ERP and digital are seeing increased traction.
- **Vertical-wise Performance.** On a q-o-q basis, Manufacturing, Hi-tech, Lifesciences, Energy, Communication and Others grew 5.9%,2.7%/1.4%/1.4% and 30.8% while Retail and Financial services declined 0.7%/1.4% respectively.
- **Geography-wise commentary:** Reported revenues of North America, Europe, India and ROW grew 1.1%/0.6%/5.3% and 4.6% q-o-q respectively.
- **Decline in headcount, Utilization improves:** Headcount decreased by 6,940 q-o-q to 3,36,294 employees, Utilisation rate (including trainees) improved 78.9% % up 200 bps. LTM Attrition rate declined to 17.3% in Q1FY24, down 360 bps.
- **Client metrics:** Infosys added 99 new clients versus 115 clients in Q4FY23. Revenue from the top 5, 10 and 25 clients increased by 4.5%, 2.9% and 1.1% q-o-q, respectively. The number of $50 million & $10 million increased 4 and 14 respectively.
- **Cash flow generation:** Free cash flows (FCF) stood at $699 million versus $713 million in Q4FY2023. FCF to Net profit% increased to 96.5% in Q1FY24 from 95.8% in Q4FY23. Infosys had a cash balance of $3.593 billion versus $3.807 billion in Q4FY2023.

Results (Consolidated) Rs cr

Particulars	Q1FY24	Q1FY23	Q4FY23	Y-o-Y %	Q-o-Q %
Revenues ($ mn)	**4,617.0**	**4,444.0**	**4,554.0**	**3.9**	**1.4**
Net sales	**37,933.0**	**34,470.0**	**37,441.0**	**10.0**	**1.3**
Direct Costs	25,209.0	23,419.0	24,890.0	7.6	1.3
Gross Profit	**12,724.0**	**11,051.0**	**12,551.0**	**15.1**	**1.4**
SG&A	3,660.0	3,187.0	3,553.0	14.8	3.0
EBITDA	**9,064.0**	**7,864.0**	**8,998.0**	**15.3**	**0.7**
Depr & amort.	1,173.0	950.0	1,121.0	23.5	4.6
EBIT	**7,891.0**	**6,914.0**	**7,877.0**	**14.1**	**0.2**
Other Income	471.0	620.0	589.0	-24.0	-20.0
PBT	**8,362.0**	**7,534.0**	**8,466.0**	**11.0**	**-1.2**
Tax Provision	2,417.0	2,172.0	2,332.0	11.3	3.6
PAT	**5,945.0**	**5,362.0**	**6,134.0**	**10.9**	**-3.1**
Minority interest/Share of associates	-	-	6.0		
Net profit	**5,945.0**	**5,362.0**	**6,128.0**	**10.9**	**-3.0**
EO	-	-	-		
Adjusted net profit	**5,945.0**	**5,362.0**	**6,128.0**	**10.9**	**-3.0**
Equity capital (FV Rs5/-)	434.5	434.5	434.5		
EPS (Rs)	**14.4**	**12.8**	**14.8**	**12.4**	**-2.8**
Margin (%)					
GPM	33.5	32.1	33.5	148	2
EBITDA	23.9	22.8	24.0	108	-14
EBIT	20.8	20.1	21.0	74	-24
NPM	15.7	15.6	16.4	12	-69
Tax rate	28.9	28.8	27.5	8	136

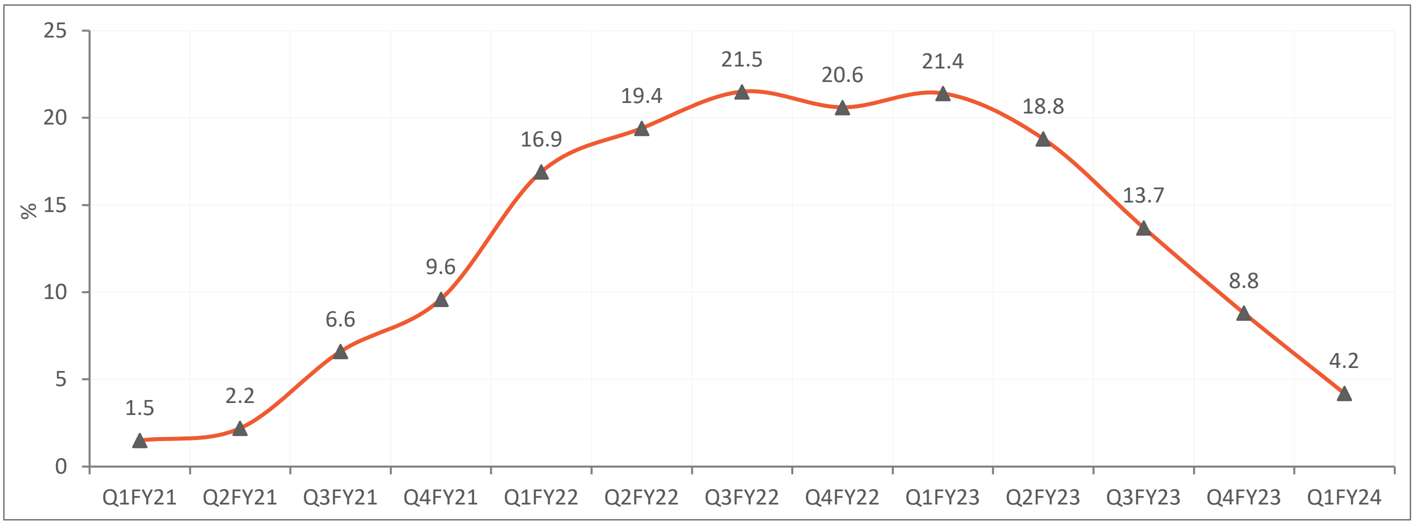
Source: Company; Sharekhan Research

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)	4,617	100	1.4	3.9	4.2
Geographic mix					
North America	2,807	60.8	1.1	2.2	2.1
Europe	1,237	26.8	0.6	11.4	10.1
India	125	2.7	5.3	7.9	13.7
Rest of world	448	9.7	4.6	-4.9	-0.5
Industry verticals					
Financial services	1,297	28.1	-1.4	-4.6	-4.2
Retail	669	14.5	-0.7	3.9	4.0
Communication	540	11.7	0.5	-6.5	-5.6
Energy, utilities, resources & services	596	12.9	1.4	8.1	8.6
Manufacturing	651	14.1	5.9	21.1	20.7
Hi tech	374	8.1	2.7	2.6	2.3
Life sciences	332	7.2	1.4	15.1	13.9
Others	157	3.4	18.9	30.8	32.9
Service line					
Service	4,349	94.2	1.9	4.4	-
Products and platforms	268	5.8	-9.8	-4.3	-
Total	4,617	0.0	1.4	3.9	4.2
Clients Contribution					
Top 5 clients	619	13.4	4.5	7.1	-
Top 10 clients	942	20.4	2.9	1.9	-
Top 25 clients	1,597	34.6	1.1	-1.0	-
Deal wins ($ mn)					
TCV	2,285	-	10.1	35.1	-

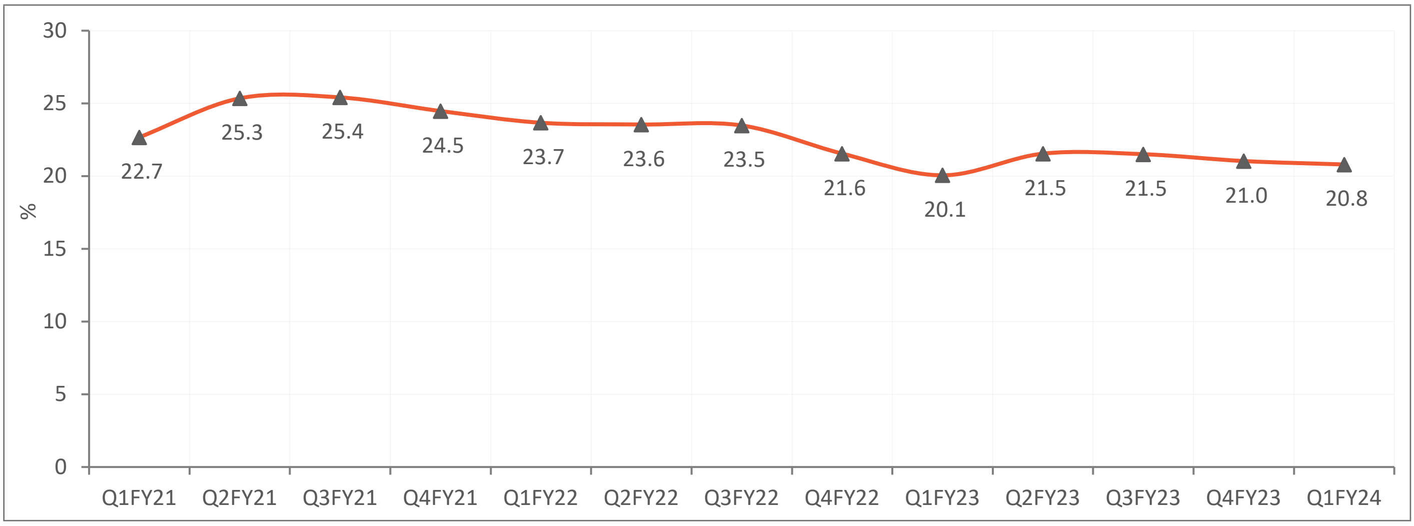
Source: Company; Sharekhan Research

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



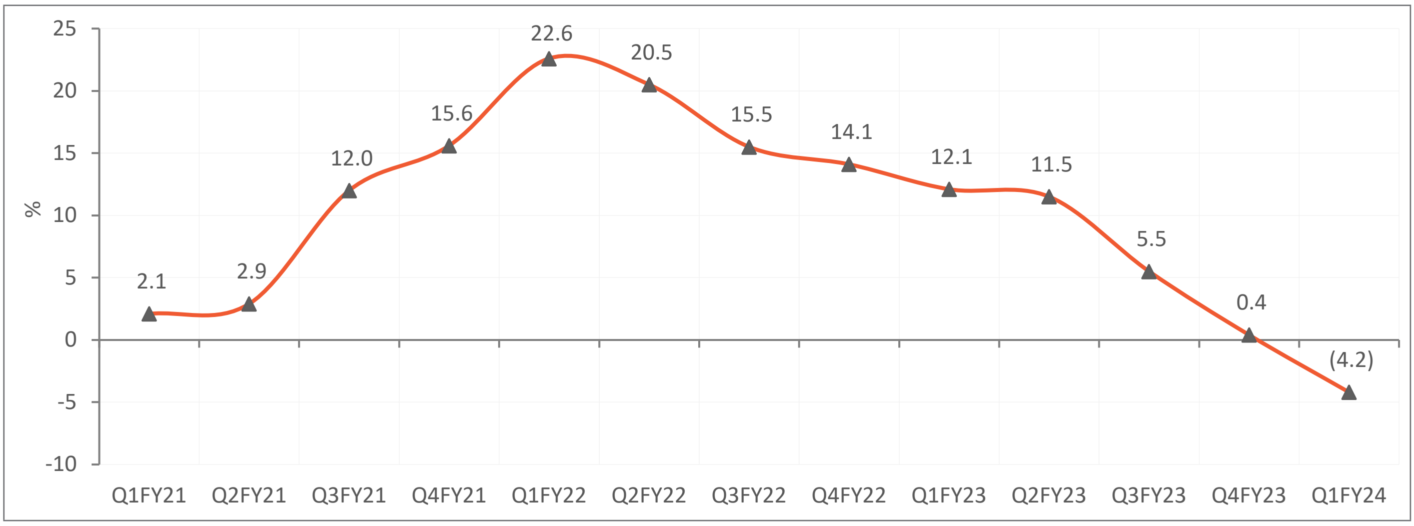
Source: Company; Sharekhan Research

EBIT margin trend (%)



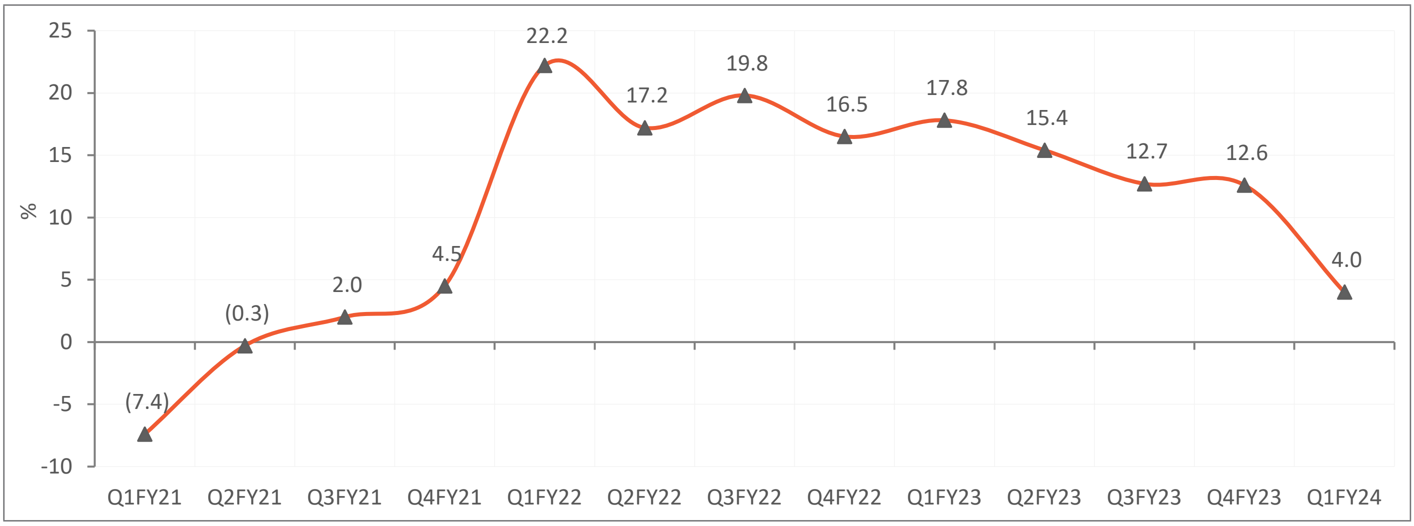
Source: Company; Sharekhan Research

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



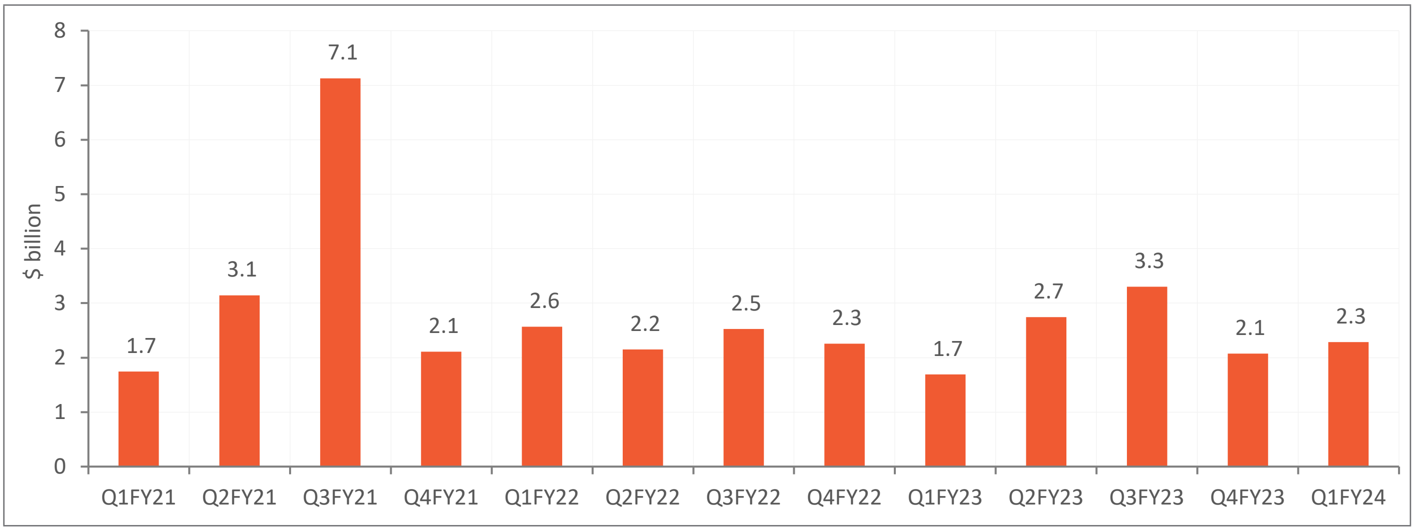
Source: Company; Sharekhan Research

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



Source: Company; Sharekhan Research

TCV of deal wins ($ bn)



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.

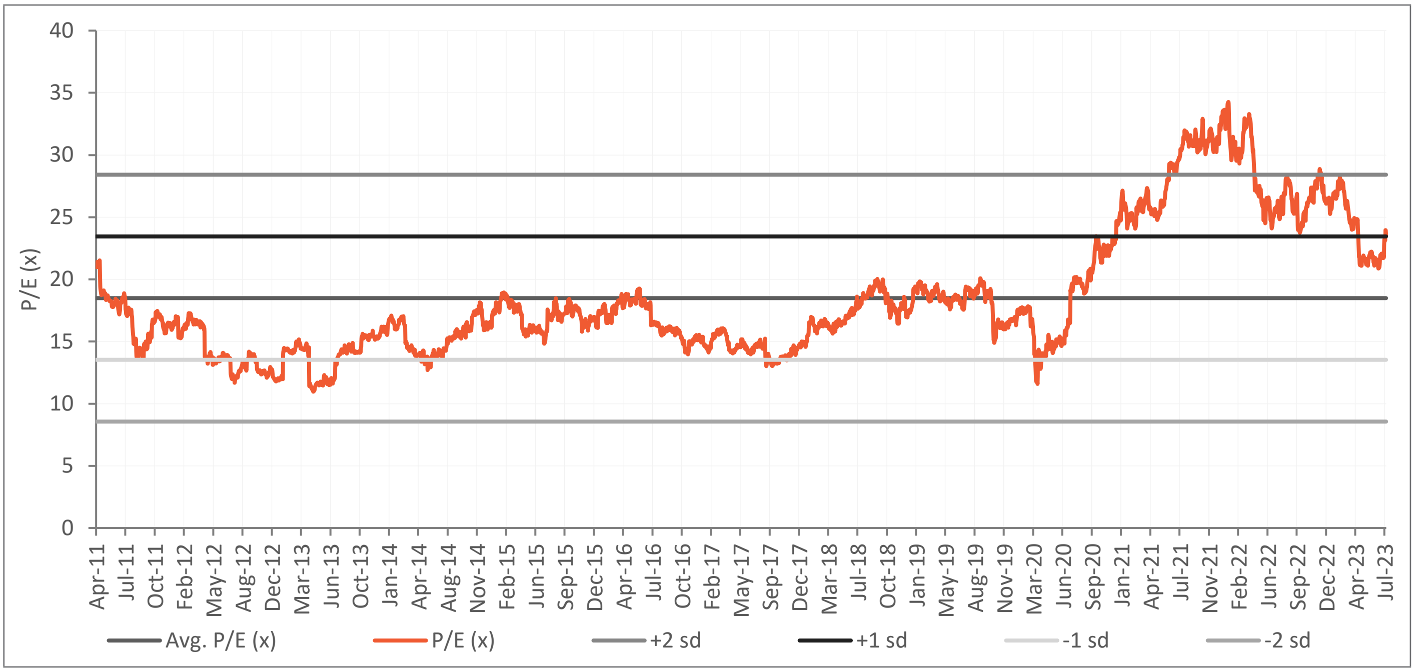
■ Company Outlook – Well-positioned to capture opportunities

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 – Downgrade to Reduce with revised PT of Rs. 1300

Infosys has once again surprised negatively with a steep downgrade on revenue guidance for FY24, its likely to lag industry level growth in FY24 to peers like TCS and HCl Tech. Our estimates are already on the lower side of consensus earnings, we have further trimmed down our estimates and reduced our target multiple. Thus, we have downgraded stock to Reduce from HOLD with revised target price of Rs1300. At the CMP the stocks trades at 25.3x/23.5x its FY24/25E EPS.

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

Rupee appreciation and/or adverse cross-currency movements, Contagion effect of banking crisis and macro headwinds and possible recession in the US are likely to moderate the pace of technology spending.

Additional Data

Key management personnel

Nandan M. Nilekani	Co-founder and Non-Executive Chairman
Salil Parekh	Chief Executive Officer
Nilanjan Roy	Chief Financial Officer

Source: Company Website

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Deutsche Bank Trust Co Americas	12.19
2	Life Insurance Corp of India	7.19
3	SBI Funds Management Ltd	4.17
4	BlackRock Inc	2.82
5	Vanguard Group Inc/The	2.79
6	ICICI Prudential Asset Management	2.54
7	Republic of Singapore	2.29
8	NATIONAL PENSION SYSTEM	1.56
9	UTI Asset Management Co Ltd	1.53
10	HDFC Asset Management Co Ltd	1.51

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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