Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Infosys Ltd

No bad news, is good news

IT & ITES	Sharekhan code: INFY
Reco/View: Buy ↔	CMP: Rs. 1,612 / Price Target: Rs. 1,850 ↑

↑ Upgrade ↔ Maintain ↓ Downgrade

Summary

- Revenues stood at $4,663 million, down 1% q-o-q in constant currency CC terms, beating our estimates of $4,625 million in a seasonally soft quarter.
- EBIT margin declined ~70 bps q-o-q to 20.5% in- line with our expectations of 20.3%. EBIT margin during the quarter was impacted by wage hike and McCamish cyber-attack incident but partially offset by cost optimization efforts.
- Large deal TCV stood at $3.2 billion, with 71% being net new deals. Deal win momentum remains strong with TTM TCVs up ~53% y-o-y.
- The management has tightened the revenue growth guidance for FY24 to 1.5-2% in CC terms from 1-2.5% implying muted revenue growth for Q4FY24 but has maintained the operating margin guidance for FY24 at 20% to 22%.
- Large deal signings and continuity of renewals to gain further traction as macro headwinds recede, improving earning visibility for FY25/FY26E. Hence, we maintain a Buy on Infosys with revised PT of Rs. 1850 (increase in PT reflects the roll forward to FY26E EPS) At the CMP, the stock trades at 23.3x/20x its FY25/26E EPS.

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		↔	

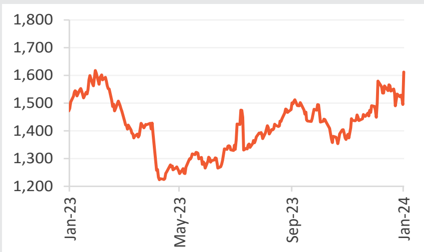
Company details

Market cap:	Rs. 6,69,125 cr
52-week high/low:	Rs. 1620 / 1215
NSE volume: (No of shares)	60.9 lakh
BSE code:	500209
NSE code:	INFY
Free float: (No of shares)	359.9 cr

Shareholding (%)

Promoters	14.9
FII	33.6
DII	35.2
Others	16.3

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	9.2	10.1	20.9	8.9
Relative to Sensex	4.9	0.8	9.9	-12.1

Sharekhan Research, Bloomberg

Infosys reported muted revenues at $4,663 million, down 1% q-o-q in CC terms but exceeded our estimates of $4,625 million in a seasonally soft quarter. Revenue in rupee terms stood at Rs 38,821 up 1.3% y-o-y. Growth was led by Manufacturing, Life sciences and Others which grew 10.6%/6.3% and 7% y-o-y respectively in constant currency but was partially offset by decline in Communication, Hi-tech and Financial services verticals. EBIT margin declined ~70 bps q-o-q to 20.5% in-line with our expectations of 20.3%. EBIT margin during the quarter was impacted by wage hike (50 bps) and McCamish cyber-attack incident (70 bps) partially offset by cost optimisation efforts (50 bps) under Project Maximus. Large deal wins TCV stood at $3.2 billion, with 71% being net new deals. Deal win momentum remains strong with TTM TCVs up ~53% y-o-y. The company tightened its FY24 revenue guidance to 1.5-2.0% from 1-2.5% implying muted revenue growth for Q4FY24.The company has retained operating margin guidance of 20-22% for FY24. Net Profit for Q3FY24 stood at Rs 6,106 crore, down 7.3% y-o-y. Attrition declined further to 170 bps to 12.9%. from 14.6% in Q2FY24 while Utilisation rate (including trainees) has improved by 130 bps to 81.7%. Net headcount additions fell by 6,101 taking the closing headcount to 322,663. Margin improvement plan is witnessing traction and the company expects to see higher benefits going ahead. We view Q3 earnings as stable in the seasonally weak quarter and expect the focus to shift to earnings improvement in FY25/26E as headwinds bottom out. We expect large deal signings and continuity of renewals to gain further traction as macro headwinds recede improving earning visibility for FY25/FY26E. Hence, we maintain a Buy on Infosys with revised PT of Rs. 1850 (Increase in PT reflects the roll-forward to FY26E EPS) At CMP, the stock trades at 23.3x/20x its FY25/26E EPS.

Key positives

- Attrition declined further by 170 bps to 12.9%. from 14.6% in Q2FY24
- Utilisation rate(including trainees) improved by 130 bps to 81.7% from 80.4% in Q2FY24

Key negatives

- The company tightened CC revenue growth guidance to 1.5-2% from 1 -2.5% growth for FY24
- Net Headcount fell by 6,101 taking the total headcount to 322,663

Management Commentary

- Digital programs continue to be fewer, while cost optimization and automation continue to see higher demand . Generative AI is seeing lot of interest and traction.
- The management has tightened the revenue growth guidance for FY24 to 1.5% to 2% growth in constant currency but has maintained the operating margin guidance for FY24 at 20- 22%.

Revision in estimates – We have fine-tuned estimates to factor Q3FY24 performance

Our Call

Valuation – Maintain Buy with revised price target of Rs 1,850: We view Q3 earnings as stable in a seasonally weak quarter and expect focus to shift to earnings improvement in FY25/26E as headwinds bottom out. We expect the large deal signings and continuity of renewals to gain further traction as macro headwinds recede improving earning visibility for FY25/FY26E. We expect Sales/ PAT CAGR of 9.3%/11.4% respectively over FY23-26E. Hence, we maintain a Buy on Infosys with revised PT of Rs. 1850 (Increase in PT reflects the roll forward to FY26E EPS) At CMP, the stock trades at 23.3x/20x its FY25/26E EPS.

Key Risks

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

Valuation (Consolidated) Rs cr

Particulars	FY23	FY24E	FY25E	FY26E
Revenue	1,46,767.0	1,53,752.8	1,70,169.6	1,91,492.9
OPM (%)	23.9	24.0	24.8	25.4
Adjusted PAT	24,097.0	24,432.4	28,650.6	33,297.3
% YoY growth	9.0	1.4	17.3	16.2
Adjusted EPS (Rs)	57.6	59.0	69.3	80.5
P/E (x)	28.0	27.3	23.3	20.0
P/B (x)	4.9	4.6	4.3	3.9
EV/EBITDA	18.9	17.7	15.3	13.1
ROE (%)	31.8	30.3	33.7	35.5
ROCE (%)	36.7	36.6	39.9	43.2

Source: Company; Sharekhan estimates

Key result highlights:

- **Muted revenues:** Infosys reported CC revenue decline of -1% q-o-q and y-o-y, above our estimates of 1.8% q-o-q CC revenue decline. USD revenues fell by 1.2% q-o-q /0.1% y-o-y to $ 4,663 million. Revenue in rupee terms stood at Rs 38,821 up 1.3% y-o-y. Growth was led by Manufacturing, Life sciences and Others but offset by decline in Communication, Hi-tech and Financial services verticals
- **Margin performance:** EBIT margins declined ~70 bps q-o-q to 20.5% in line with our expectations of 20.3%, impacted by wage hike (70 bps) and McCamish cyberattack incident (50 Bps) which was partially offset by cost optimization measures through Project Maximus.
- **Large deal TCVs:** Large deal wins TCV were strong at $3.2 billion, with 71% being net new up ~4% y-o-y. Large deal comprised of one mega deal. Deal win momentum remains strong with TTM TCVs up ~53% y-o-y.
- **Vertical-wise performance:** Lifesciences/ others and Manufacturing grew 6.3%/7% and 10.6% y-o-y respectively in cc while Financial Services/ Hitech and Communication declined 5.9%/5.1% and 8.0% y-o-y respectively in cc terms. Retail and Energy, Utilities Resources and services was flat.
- **Geography-wise performance:** Growth was led by Rest of the World and Europe, which grew 7.8% and 5 % y-o-y in CC terms, while India and North America declined 4.9% and 1% y-o-y respectively in CC terms.
- **Headcount continues to fall, utilisation improves:** Attrition declined further by 170 bps to 12.9%. from 14.6% in Q2FY24 . Utilization rate(including trainees) improved by 130 bps to 81.7% from 80.4% in Q2FY24. Net Headcount fell by 6101 taking the total headcount to 322,663. The company does not see any immediate campus requirement but in case volumes are required they have a very strong off campus program in place.
- **Client metrics:** The company added 88 clients versus 100 clients in Q2FY24. Revenue from the top 5, Top 10 and 25 clients declined by 0.4% 0.7% and 2.3% q-o-q respectively. The company added one client in $100 million+ and two clients in $50 million + categories.
- **Cash flow generation:** Free cash flow (FCF) stood at $665 million versus $670 million in Q2FY24 .FCF to Net profit ratio improved to 90.6% 89.2% in Q2FY24. Consolidated cash and investments stood at $3.9 billion versus $4.17 billion in Q2FY24.

Results Rs cr

Particulars	Q3FY24	Q3FY23	Q2FY24	YoY %	QoQ %
Revenues ($ mn)	**4,663.0**	**4,659.0**	**4,718.0**	**0.1**	**-1.2**
Net sales	**38,821.0**	**38,318.0**	**38,994.0**	**1.3**	**-0.4**
Direct Costs	26,077.0	25,436.0	25,865.0	2.5	0.8
Gross Profit	**12,744.0**	**12,882.0**	**13,129.0**	**-1.1**	**-2.9**
SG&A	3,607.0	3,515.0	3,689.0	2.6	-2.2
EBITDA	**9,137.0**	**9,367.0**	**9,440.0**	**-2.5**	**-3.2**
Depreciation & amort.	1,176.0	1,125.0	1,166.0	4.5	0.9
EBIT	**7,961.0**	**8,242.0**	**8,274.0**	**-3.4**	**-3.8**
Other Income	658.0	689.0	494.0	-4.5	33.2
PBT	**8,619.0**	**8,931.0**	**8,768.0**	**-3.5**	**-1.7**
Tax Provision	2,506.0	2,345.0	2,553.0	6.9	-1.8
PAT	**6,113.0**	**6,586.0**	**6,215.0**	**-7.2**	**-1.6**
Minority interest/Share of associates	7.0	-	-		
Net profit	**6,106.0**	**6,586.0**	**6,215.0**	**-7.3**	**-1.8**
EO	-	-	-		
Adjusted net profit	**6,106.0**	**6,586.0**	**6,215.0**	**-7.3**	**-1.8**
Equity capital (FV Rs5/-)	434.5	434.5	434.5		
EPS (Rs)	**14.8**	**15.7**	**15.0**	**-6.0**	**-1.8**
Margin (%)					
GPM	32.8	33.6	33.7	-79	-84
EBITDA	23.5	24.4	24.2	-91	-67
EBIT	20.5	21.5	21.2	-100	-71
NPM	15.7	17.2	15.9	-146	-21
Tax rate	29.1	26.3	29.1	282	-4

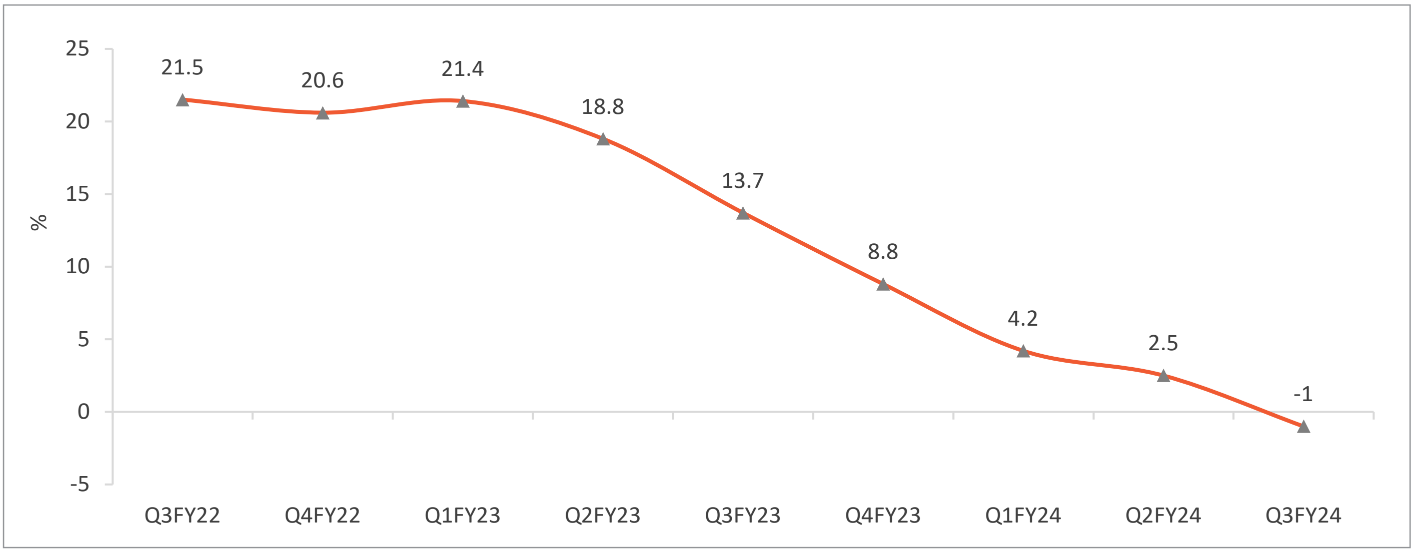
Source: Company, Sharekhan Research

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)	4,663	100	-1.2	0.1	-1.0
Geographic mix					
North America	2,751	59.0	-4.6	-4.8	-4.9
Europe	1,315	28.2	5.2	9.4	5.0
India	112	2.4	-15.3	0.1	-1.0
Rest of world	485	10.4	7.1	6.2	7.8
Industry verticals					
Financial services	1,296	27.8	-0.1	-5.0	-5.9
Retail	681	14.6	-5.1	2.2	0.4
Communication	532	11.4	-1.2	-7.2	-8.0
Energy, utilities, resources & services	616	13.2	2.7	1.6	0.3
Manufacturing	695	14.9	3.0	12.1	10.6
Hi tech	359	7.7	-2.4	-4.9	-5.1
Life sciences	354	7.6	-3.7	8.7	6.3
Others	135	2.9	-13.1	7.5	7.0
Clients Contribution					
Top 5 clients	625	13.4	-0.4	2.4	-
Top 10 clients	933	20.0	-0.7	-2.4	-
Top 25 clients	1,571	33.7	-2.3	-4.5	-
Deal wins ($ mn)					
TCV	3,241	-	-57.8	-1.8	-

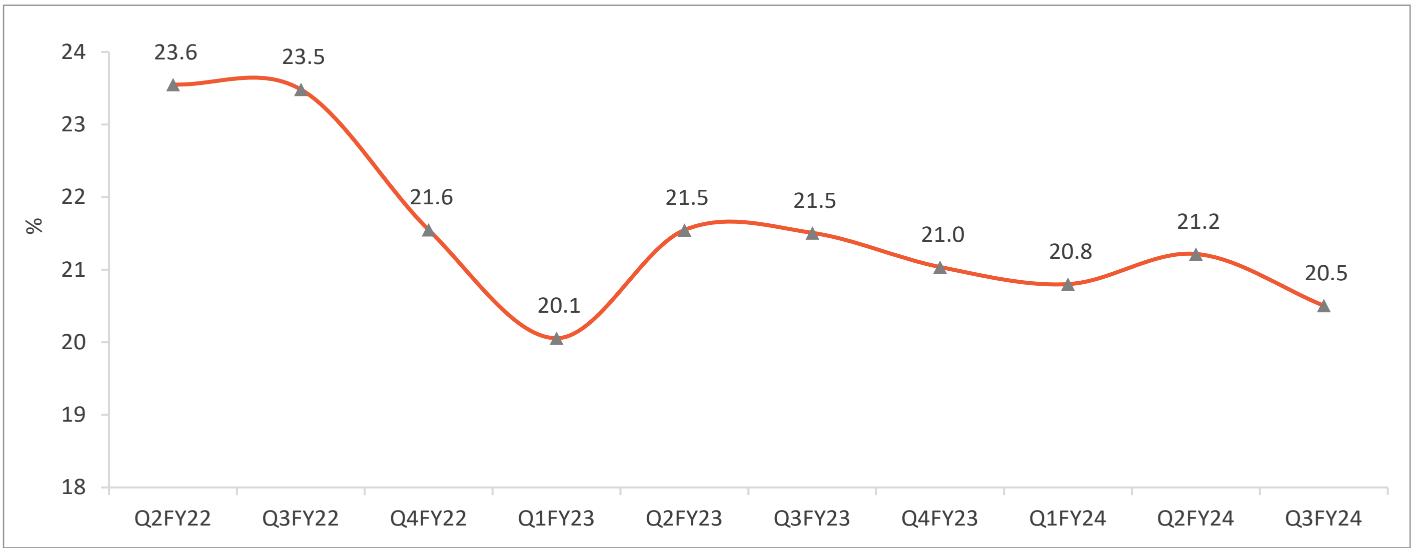
Source: Company, Sharekhan Research

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



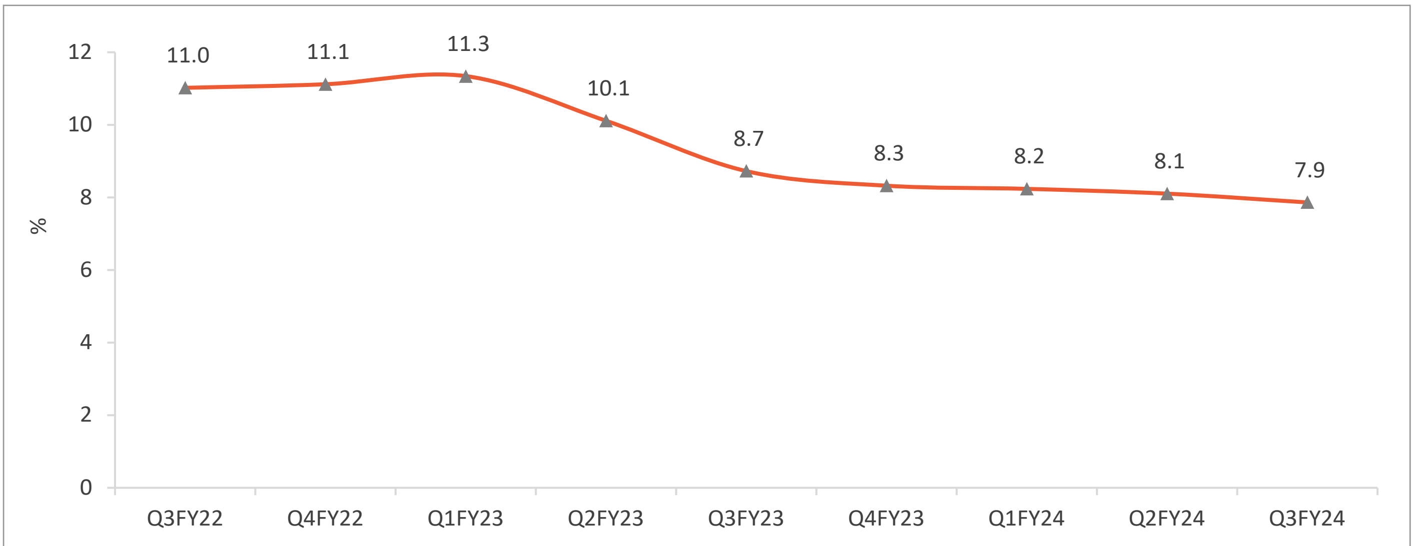
Source: Company, Sharekhan Research

EBIT margin trend (%)



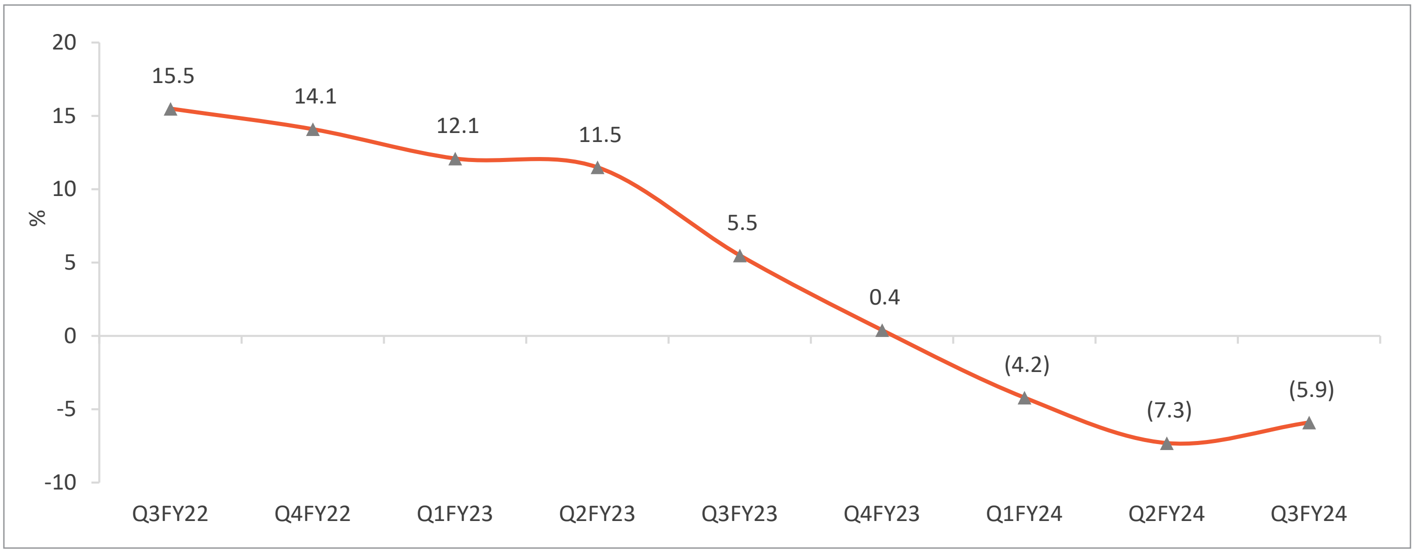
Source: Company, Sharekhan Research

Subcontracting costs as a % of revenue



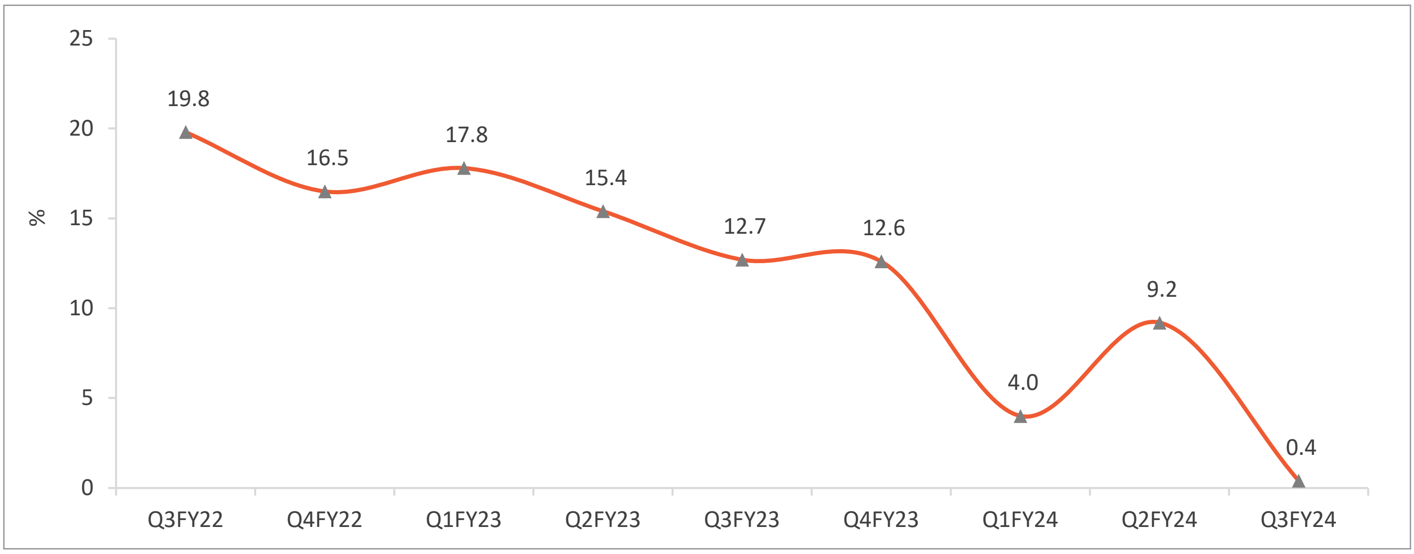
Source: Company, Sharekhan Research

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



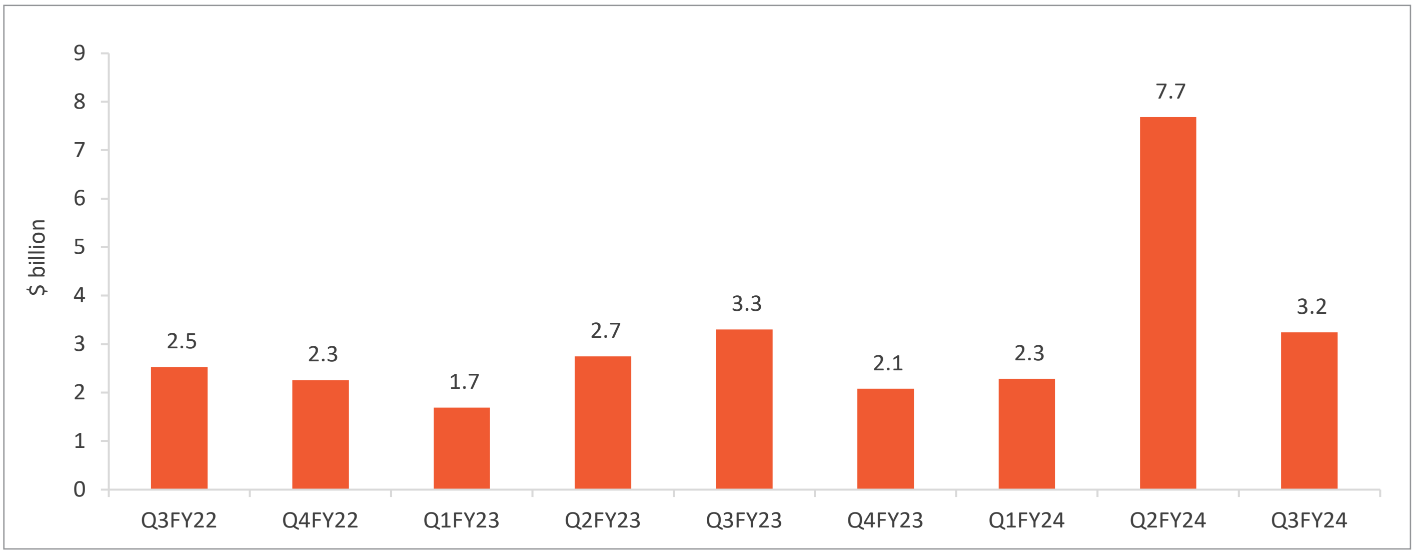
Source: Company, Sharekhan Research

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



Source: Company, Sharekhan Research

TCV of deal wins ($ bn)



Source: Company, Sharekhan Research

Outlook and Valuation

■ Sector view - Macro heading winds bottoming out coupled with better earnings visibility

We anticipate growth momentum to return in FY25 aided by lower base coupled with easing sector headwinds. Though, IT sector has already outperformed Nifty last year, we expect overall outperformance in CY24 as well driven by receding headwinds and better earnings visibility.

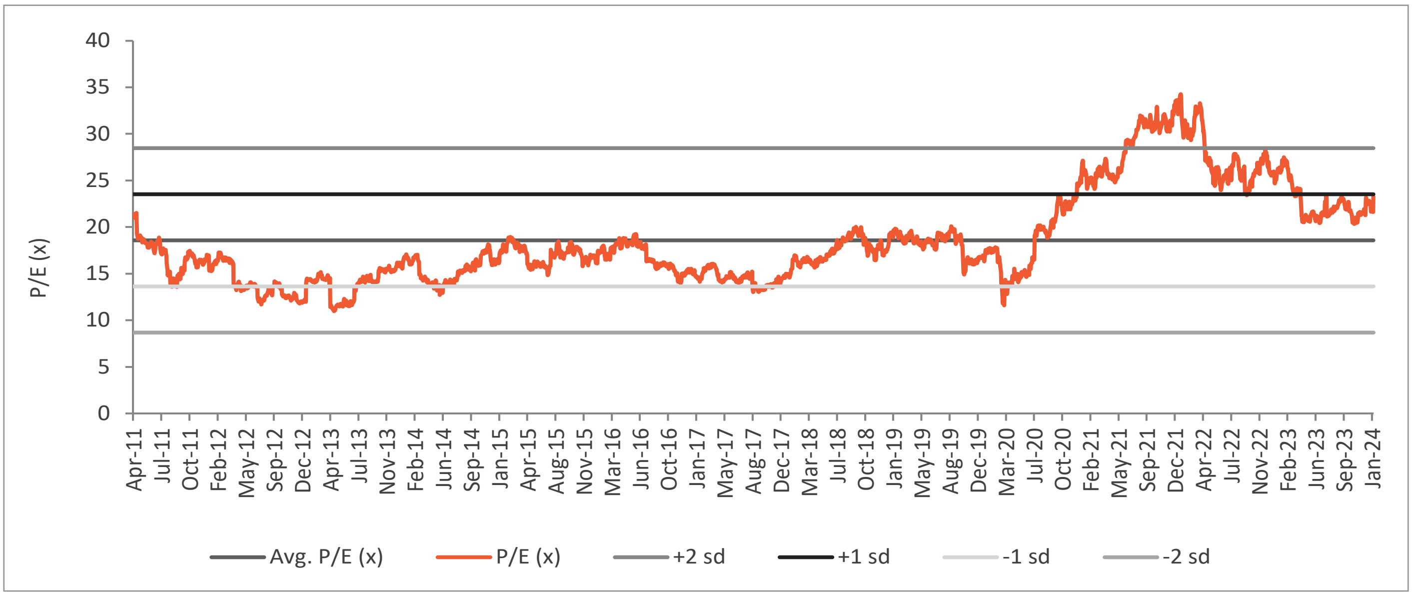
■ Company outlook - Well-positioned to capture opportunities

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 revised price target of Rs 1850

We view Q3 earnings as stable in a seasonally weak quarter and expect focus to shift to earnings improvement in FY25/26E as headwinds bottom out. We expect the large deal signings and continuity of renewals to gain further traction as macro headwinds recede improving earning visibility for FY25/FY26E. We expect Sales/ PAT CAGR of 9.3%/11.4% respectively over FY23-26E. Hence, we maintain a Buy on Infosys with revised PT of Rs. 1850 (Increase in PT reflects the roll forward to FY26E EPS) At CMP, the stock trades at 23.3x/20x its FY25/26E 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

1) Rupee appreciation and/or adverse cross-currency movements. 2)The contagion effect of banking crisis, macro headwinds and 3) 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

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Deutsche Bank Trust Co Americas	10.74
2	Life Insurance Corp of India	8.38
3	SBI Funds Management Ltd	4.35
4	Vanguard Group Inc	3.35
5	BlackRock Inc	3.19
6	ICICI Prudential Asset Management	2.56
7	Republic of Singapore	2.3
8	NATIONAL PENSION SYSTEM	1.62
9	UTI Asset Management Co Ltd	1.55
10	HDFC 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

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