

NOT RATED**INFOSYS**

| IT Services

| 19 July 2024

Better-than-expected showing

- Revenue comes in 100bps higher than expected as US BFS surprised positively. INFO sees volume growth for the first time in many quarters
- EBIT margin surprises too. India-related one-off on revenue (50bps) and on EBIT margin (40bps) spoils the positive picture a tad
- The revenue guidance of 3-4% in CC looks conservative. We will be re-initiating coverage on the IT services sector shortly

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Conservative revenue guidance: INFO's revenue guidance of 3-4% in constant currency (CC) looks conservative. Seems to imply no QoQ growth in 3Q and 4Q (assuming 3.5% QoQ growth in 2QFY25). The discretionary demand pick-up is only in selective areas of US Banking and Financial Services (BFS) – mortgages, cards, capital markets and payments. The stock has rallied 25% since 1 June 2024.

Strong revenue show in 1Q: Infosys delivered a strong 1Q on the revenue front with 3.6% growth QoQ against consensus expectation of 2.5%. EBIT margin was better than expected at 21.1%, which was higher than the consensus number of 20.7%.

Raises revenue growth guidance: Against consensus it raised its guidance of revenue growth to 3-4% compared to 1-3% that it had announced three months ago. There is also an inorganic element in the new guidance due to the in-tech acquisition.

EBIT margin guidance retained: INFO's EBIT margin guidance has been kept the same at 20-22%. The headwinds for margins in coming days will be compensation increase (quantum and timing not indicated) and transition costs connected with ramp up large projects.

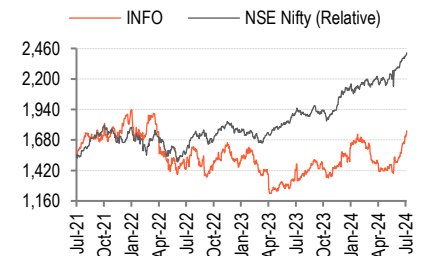
US BFS drives growth: The pickup in revenue growth has been driven by the US BFS business, which grew by 7.9% QoQ in CC terms after six quarters of successive declines.

Revenue and margin one-offs: There were one-offs in both the revenue and the margin lines. 50bps in the revenue line and 40bps in the margin line due to India-related business.

Ticker/Price	INFO IN/Rs 1,758
Market cap	US\$ 88.6bn
Free float	86%
3M ADV	US\$ 158.4mn
52wk high/low	Rs 1,738/Rs 1,305
Promoter/FPI/DII	15%/36%/49%

Source: NSE | Price as of 18 Jul 2024

Stock performance



Source: NSE



- When the 1-3% guidance was given for FY25 at the beginning of the year neither the one-off impact of revenue from an Indian client nor the in-tech acquisition-related revenue was considered. Both combined would roughly add 100bps to INFO's revenue guidance.
- The company indicated that US BFS spending picked up in specific areas like mortgages, cards, capital markets and payments.
- While INFO indicated that it is building in stronger 1H seasonality into its guidance, the revenue guidance for FY25 seems conservative because it implies 1-1.5% CQGR at the lower and upper end of guidance.
- The 100bps positive QoQ EBIT margin expansion has been on the back of the following – absence of one-offs QoQ in margins (100bps), Project Proximus benefits (80bps), benefit from the Indian client one-off (40bps). The 220bps tailwind was offset by 120bps coming from higher variable pay, higher leave costs, etc. Project Maximus benefits came from value-based pricing, higher utilisation, higher offshoring, use of automation, etc.
- While INFO's management mentioned lower interest rates a couple of times for the demand to pick up potentially, it could not say whether it would be the start of rate cuts or specific levels of fed funds rate that would trigger the demand pick-up.
- On the BFS pick-up, the company indicated that INFO's capabilities in cloud – the Cobalt suite of services or in Gen AI – using Topaz played a role in gain share. So, it is unclear if this is a broad-based pick-up across various vendors.
- The company clocked a large deal of a total contract value (TCV) of US\$ 4.1bn with 58% being net new and this came in at the higher end of market expectations.
- INFO stated that outside of US BFS, the discretionary spending picture looks quite like what it was over the last three to four quarters.
- TCV to revenue conversion picked up in BFS but not at the levels it was before the slowdown hit.
- Outside of US BFS – which accelerated – most other sectors are expected to grow slower than in FY24.

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Note: Recommendation structure changed with effect from 21 June 2021

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