

ADD

TP: Rs 840 | ▲ 14%

INFOSYS

| IT Services

| 11 January 2020

Commentary lack new growth impetus

Infosys (INFO)'s Q3FY20 operating performance fell tad short on expectations led by operating margin miss (EBIT margins at 21.9% V/s our est. of 22.4%). Revised guidance was no surprise and imply soft starting grounds for FY21. Management commentary provided no incremental impetus to suggest improvement in growth outlook. We keep FY21/FY22 EPS estimates broadly unchanged and roll forward to a Dec'20 TP of Rs 840 (Rs 860 earlier, reset target P/E to 18x V/s 19x). Retain ADD.

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Clean chit on whistleblower allegations: Audit committee investigation report dismissed whistleblower allegations and concluded no financial impropriety or executive misconduct. This will ease overhang on the stock and render relief to multiple stakeholders.

Tad operating margin miss: While INFO's 1% QoQ cc revenue growth was inline, EBIT margins at 21.9% (up 20bps) missed street and our estimates of an QoQ improvement of 40-50bps and 70bps respectively. Operating metrics were a mixed bag, with positives from 1) onsite/offshore mix, 2) attrition, and a weak show from 1) BFSI vertical, 2) performance of top clients.

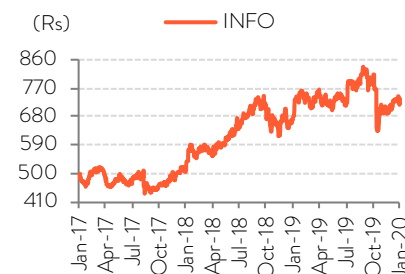
Revised guidance was no surprise: INFO now expects FY20 revenue growth of 10-10.5% YoY CC (from 9-10% guided earlier). This imply 0%-1.5% QoQ cc growth in Q4FY20 at lower and top end respectively (which is inline). Operating margin guidance unchanged at 21% to 23%.

Renewal still dominate deal wins: Deal win TCV at US\$1.8bn marked seasonal moderation (down 36% QoQ) albeit up 15% YoY. Higher share of renewals continued for 3rd consecutive quarter leading to 9mFY19 renewal deal proportion to 75% V/s 53% in 9mFY19.

Ticker/Price	INFO IN/Rs 738
Market cap	US\$ 45.3bn
Shares o/s	4,349mn
3M ADV	US\$ 121.1mn
52wk high/low	Rs 847/Rs 615
Promoter/FPI/DII	13%/35%/52%

Source: NSE

STOCK PERFORMANCE



Source: NSE

KEY FINANCIALS

Y/E 31 Mar	FY18A	FY19A	FY20E	FY21E	FY22E
Total revenue (Rs mn)	7,05,220	8,26,760	9,04,520	9,83,395	10,88,229
EBITDA (Rs mn)	1,90,100	2,08,890	2,24,386	2,53,371	2,80,381
Adj. net profit (Rs mn)	1,60,280	1,54,100	1,65,074	1,81,291	2,04,353
Adj. EPS (Rs)	36.9	35.4	38.9	42.7	48.1
Adj. EPS growth (%)	17.3	(4.0)	9.9	9.8	12.7
Adj. ROAE (%)	23.9	24.5	25.8	25.6	26.0
Adj. P/E (x)	20.0	20.9	19.0	17.3	15.3
EV/EBITDA (x)	15.4	14.4	13.5	11.9	10.5

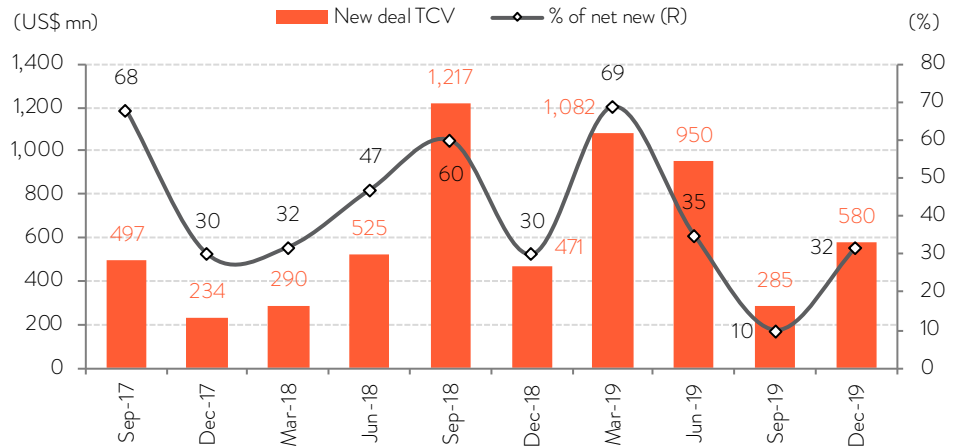
Source: Company, BOBCAPS Research

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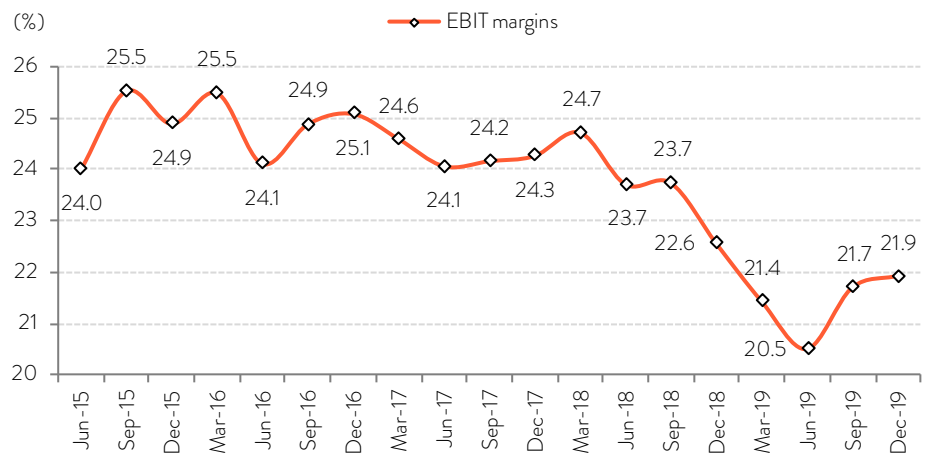


FIG 1 – 9MFY20 NEW DEAL TCV DOWN 18% YOY



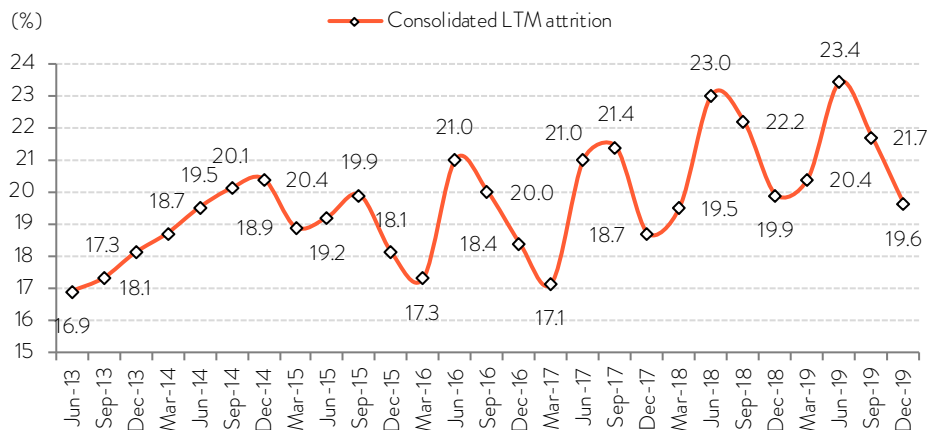
Source: Company, BOBCAPS Research

FIG 2 – 20BPS QOQ EBIT MARGIN IMPROVEMENT WAS SHORT ON EXPECTATIONS



Source: Company, BOBCAPS Research

FIG 3 – ATTRITION EASED FOR 2ND QUARTER IN ROW



Source: Company, BOBCAPS Research

FIG 4 – DEC'19 QUARTER RESULT SUMMARY

(Rs mn)	Q1FY19	Q2FY19	Q3FY19	Q4FY19	Q1FY20	Q2FY20	Q3FY20	YoY (%)	QoQ (%)	9mFY19	9mFY20	YoY (%)
Revenues (US\$ mn)	2,831	2,921	2,987	3,060	3,131	3,210	3,243	8.6	1.0	8,739	9,584	9.7
Revenue	1,91,280	2,06,090	2,14,000	2,15,390	2,18,030	2,26,290	2,30,920	7.9	2.0	6,11,370	6,75,240	10.4
Operating Expenditure	1,41,550	1,52,520	1,59,900	1,63,900	1,66,510	1,69,900	1,72,910	8.1	1.8	4,53,970	5,09,320	12.2
Cost of revenues	1,18,520	1,28,180	1,34,360	1,37,520	1,40,980	1,43,520	1,46,360	8.9	2.0	3,81,060	4,30,860	13.1
as % of sales	62.0	62.2	62.8	63.8	64.7	63.4	63.4	-	-	62.3	63.8	-
SG&A expenses	23,030	24,340	25,540	26,380	25,530	26,380	26,550	4.0	0.6	72,910	78,460	7.6
as % of sales	12.0	11.8	11.9	12.2	11.7	11.7	11.5	-	-	11.9	11.6	-
EBITDA	49,730	53,570	54,100	51,490	51,520	56,390	58,010	7.2	2.9	1,57,400	1,65,920	5.4
Depreciation	4,360	4,630	5,800	5,310	6,810	7,270	7,360	26.9	1.2	14,790	21,440	45.0
EBIT	45,370	48,940	48,300	46,180	44,710	49,120	50,650	4.9	3.1	1,42,610	1,44,480	1.3
Other Income	7,260	7,390	7,530	6,650	7,360	6,260	8,270	-	-	22,180	21,890	(1.3)
PBT	52,630	56,330	55,830	52,830	52,070	55,380	58,920	5.5	6.4	1,64,790	1,66,370	1.0
Total Tax	13,810	15,230	15,220	12,050	13,650	14,590	13,830	(9.1)	(5.2)	44,260	42,070	(4.9)
Adjusted PAT	38,820	41,100	40,610	40,780	38,420	40,790	45,090	11.0	10.5	1,20,530	1,24,300	3.1
(Profit)/loss from JV's/Ass/MI	0	0	0	0	0	0	0	-	-	0	0	-
APAT after MI	38,820	41,100	40,610	40,780	38,420	40,790	45,090	11.0	10.5	1,20,530	1,24,300	3.1
Extra ordinary items	(2,700)	0	(4,510)	0	0	0	0	-	-	(7,210)	0	-
Reported PAT	36,120	41,100	36,100	40,780	38,420	40,790	45,090	24.9	10.5	1,13,320	1,24,300	9.7
Reported EPS	8.3	9.4	8.3	9.4	8.8	9.4	10.5	26.7	11.2	26	29	10.4
Margins (%)								(bps)	(bps)			(bps)
EBIDTA	26.0	26.0	25.3	23.9	23.6	24.9	25.1	(16)	20	25.7	24.6	(117)
EBIT	23.7	23.7	22.6	21.4	20.5	21.7	21.9	(64)	23	23.3	21.4	(193)
EBT	27.5	27.3	26.1	24.5	23.9	24.5	25.5	(57)	104	27.0	24.6	(232)
PAT	18.9	19.9	16.9	18.9	17.6	18.0	19.5	266	150	19.7	18.4	(131)
Effective Tax rate	26.2	27.0	27.3	22.8	26.2	26.3	23.5	(378.9)	(287)	26.9	25.3	(157)

Source: Company, BOBCAPS Research

FIG 5 – DEC'19 QUARTER OPERATING METRICS

	Q3FY20 (% Contr. to Revenue)	QoQ (%)	YoY (%)
TCV of deal wins (in US\$ mn)	1,813	(36.3)	15.5
Digital Revenues	40.6	7.1	39.9
Revenue breakup-Geography			
North America	61.3	0.9	10.2
Europe	24.4	2.3	9.5
India	2.8	4.8	16.9
ROW	11.5	(1.5)	(2.5)
Revenue by industry groups			
BFSI	31.5	(0.2)	5.2
Retail	15.3	1.7	1.3
Communications	13.0	0.3	18.6
Energy, Utilities, Resources and Services	12.8	(1.3)	8.6
Manufacturing	10.3	3.0	10.7
Hi Tech	7.6	1.0	13.0

	Q3FY20 (% Contr. to Revenue)	QoQ (%)	YoY (%)
Life Sciences	6.7	5.8	17.3
Others	2.8	8.8	8.6
Client concentration			
Top Client	3.0	(5.3)	(4.2)
Top 10 Clients	18.9	(0.6)	6.9
Non Top 10 Clients	81.1	1.4	9.0
	Q3FY20	Q2FY20	Q3FY19
Onsite-Offshore Effort Split			
Onsite	27.7	28.2	28.7
Offshore	72.3	71.8	71.3
Utilization measures (IT Services and Consulting)			
Including trainees	80.4	81.6	79.8
Excluding trainees	84.4	84.9	83.8

Source: Company, BOBCAPS Research

Valuation methodology

In our view Infosys management commentary provided no incremental impetus to suggest improvement in growth outlook. Management reiterated challenging outlook for BFSI and retail vertical (accounting for ~47% of revenues). Manufacturing, Communication and Hi Tech are likely to be growth supportive. Auto vertical is soft patch in manufacturing while couple of client specific issue linger in Energy vertical.

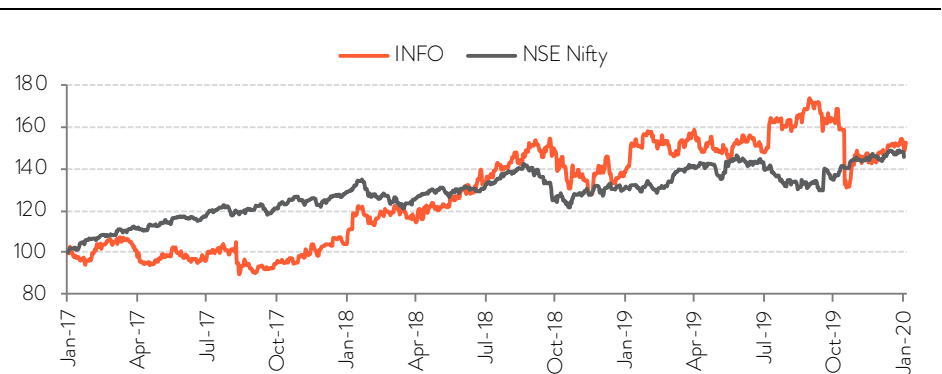
Moreover 18% YoY decline in new deal wins in 9mFY20 further undermine growth visibility. Q4FY20 implied guidance hint at softer start to FY21E (compared to FY20). We build 10%/11.1% dollar revenue and EPS CAGR over FY20-22. We keep FY21/22E EPS largely unchanged (4.6% FY20 EPS increase bakes in higher other income and lower taxes beside margins operational tweak). Retain ADD with revised TP of Rs840 (set at target 18x P/E V/s 19x earlier factoring in moderation in growth traction). Beyond reset of valuations for clear title on whistleblower allegations, stock performance hinges on operating margin improvement clarity (over FY18 to FY20 - EBIT margin difference between Infosys and TCS has increased from 50bps to ~280bps). Prefer TCS and HCL Tech over Infosys.

FIG 6 – REVISED EARNINGS

(Rs mn)	FY20E			FY21E			FY22E		
	Old	New	Change (%)	Old	New	Change (%)	Old	New	Change (%)
Revenues (US\$ mn)	12,825	12,859	0.3	13,975	14,048	0.5	15,465	15,546	0.5
YoY revenue growth (%)	8.7	9.0	-	9.0	9.2	-	10.7	10.7	-
Revenues	8,91,741	9,04,520	1.4	9,78,255	9,83,395	0.5	10,82,541	10,88,229	0.5
EBITDA	2,18,425	2,24,386	2.7	2,52,046	2,53,371	0.5	2,78,916	2,80,381	0.5
EBITDA margins (%)	24.5	24.8	-	25.8	25.8	-	25.8	25.8	-
EBIT margins (%)	21.4	21.6	-	22.7	22.6	-	23.0	22.9	-
Net profits	1,57,751	1,65,074	4.6	1,81,264	1,81,291	0.0	2,04,072	2,04,353	0.1
EPS (Rs)	37.2	38.9	4.6	42.7	42.7	0.0	48.1	48.1	0.1

Source: BOBCAPS Research

FIG 7 – RELATIVE STOCK PERFORMANCE



Source: NSE

Key risks

Downside risks to our estimates are:

- a more pronounced adverse impact of global trade tensions, Brexit and other negative external events, leading to weaker-than-expected demand;
- more stringent visa regulations;
- below-expected operating margins for new engagements/renewals; and
- leadership changes.

FINANCIALS

Income Statement

Y/E 31 Mar (Rs mn)	FY18A	FY19A	FY20E	FY21E	FY22E
Total revenue	7,05,220	8,26,760	9,04,520	9,83,395	10,88,229
EBITDA	1,90,100	2,08,890	2,24,386	2,53,371	2,80,381
Depreciation	18,620	20,100	28,655	31,156	31,156
EBIT	1,71,480	1,88,790	1,95,732	2,22,215	2,49,226
Net interest income/(expenses)	26,130	21,550	17,638	26,129	30,711
Other income/(expenses)	32,400	28,830	27,328	26,129	30,711
Exceptional items	(1,180)	(7,210)	0	0	0
EBT	2,02,700	2,10,410	2,23,060	2,48,344	2,79,936
Income taxes	42,420	56,310	57,376	67,053	75,583
Extraordinary items	0	0	0	0	0
Min. int./Inc. from associates	0	0	610	0	0
Reported net profit	1,60,280	1,54,100	1,65,074	1,81,291	2,04,353
Adjustments	0	0	0	0	0
Adjusted net profit	1,60,280	1,54,100	1,65,074	1,81,291	2,04,353

Balance Sheet

Y/E 31 Mar (Rs mn)	FY18A	FY19A	FY20E	FY21E	FY22E
Accounts payables	0	0	0	0	0
Other current liabilities	1,44,740	1,68,940	1,90,817	2,07,456	2,29,572
Provisions	4,920	5,230	7,434	8,083	8,944
Debt funds	0	0	0	0	0
Other liabilities	0	0	0	0	0
Equity capital	10,880	21,700	21,700	21,700	21,700
Reserves & surplus	6,38,360	5,85,160	6,50,873	7,23,072	8,04,455
Shareholders' fund	6,49,240	6,06,860	6,72,573	7,44,772	8,26,155
Total liabilities and equities	7,98,900	7,81,030	8,70,824	9,60,310	10,64,671
Cash and cash eq.	1,98,180	1,65,060	2,23,391	2,84,484	3,46,567
Accounts receivables	1,31,420	1,36,990	1,63,557	1,77,819	1,96,776
Inventories	0	0	0	0	0
Other current assets	42,610	46,550	47,085	51,190	56,648
Investments	1,21,630	1,24,990	1,24,990	1,24,990	1,24,990
Net fixed assets	1,46,010	1,49,560	1,47,634	1,44,478	1,44,822
CWIP	0	0	0	0	0
Intangible assets	0	0	0	0	0
Deferred tax assets, net	12,820	13,000	13,000	13,000	13,000
Other assets	1,46,230	1,44,880	1,51,166	1,64,348	1,81,868
Total assets	7,98,900	7,81,030	8,70,824	9,60,310	10,64,671

Source: Company, BOBCAPS Research

Cash Flows

Y/E 31 Mar (Rs mn)	FY18A	FY19A	FY20E	FY21E	FY22E
Net income + Depreciation	1,10,630	1,74,200	1,93,729	2,12,447	2,35,509
Interest expenses	(23,600)	(28,830)	(27,328)	(26,129)	(30,711)
Non-cash adjustments	0	0	0	0	0
Changes in working capital	840	16,350	(9,307)	(14,262)	(18,956)
Other operating cash flows	43,780	(98,005)	73,287	0	0
Cash flow from operations	1,31,650	63,715	2,30,380	1,72,056	1,85,842
Capital expenditures	(19,980)	(23,650)	(26,729)	(28,000)	(31,500)
Change in investments	21,810	0	0	0	0
Other investing cash flows	43,500	28,830	27,328	26,129	30,711
Cash flow from investing	45,330	5,180	600	(1,871)	(789)
Equities issued/Others	50	(9,313)	(73,287)	0	0
Debt raised/repaid	0	0	0	0	0
Interest expenses	0	0	0	0	0
Dividends paid	(2,05,100)	(92,730)	(99,333)	(1,09,092)	(1,22,970)
Other financing cash flows	0	0	0	0	0
Cash flow from financing	(2,05,050)	(1,02,043)	(1,72,620)	(1,09,092)	(1,22,970)
Changes in cash and cash eq.	(28,070)	(33,148)	58,359	61,093	62,083
Closing cash and cash eq.	1,98,180	1,65,032	2,23,391	2,84,484	3,46,567

Per Share

Y/E 31 Mar (Rs)	FY18A	FY19A	FY20E	FY21E	FY22E
Reported EPS	36.9	35.4	38.9	42.7	48.1
Adjusted EPS	36.9	35.4	38.9	42.7	48.1
Dividend per share	43.5	21.5	19.5	21.4	24.1
Book value per share	149.3	139.3	158.4	175.4	194.6

Valuations Ratios

Y/E 31 Mar (x)	FY18A	FY19A	FY20E	FY21E	FY22E
EV/Sales	4.2	3.6	3.3	3.1	2.7
EV/EBITDA	15.4	14.4	13.5	11.9	10.5
Adjusted P/E	20.0	20.9	19.0	17.3	15.3
P/BV	4.9	5.3	4.7	4.2	3.8

DuPont Analysis

Y/E 31 Mar (%)	FY18A	FY19A	FY20E	FY21E	FY22E
Tax burden (Net profit/PBT)	79.1	73.2	74.0	73.0	73.0
Interest burden (PBT/EBIT)	118.2	111.5	114.0	111.8	112.3
EBIT margin (EBIT/Revenue)	24.3	22.8	21.6	22.6	22.9
Asset turnover (Revenue/Avg TA)	86.4	104.7	109.5	107.4	107.5
Leverage (Avg TA/Avg Equity)	1.2	1.3	1.3	1.3	1.3
Adjusted ROAE	23.9	24.5	25.8	25.6	26.0

Source: Company, BOBCAPS Research | Note: TA = Total Assets

Ratio Analysis

Y/E 31 Mar	FY18A	FY19A	FY20E	FY21E	FY22E
YoY growth (%)					
Revenue	3.0	17.2	9.4	8.7	10.7
EBITDA	2.2	9.9	7.4	12.9	10.7
Adjusted EPS	17.3	(4.0)	9.9	9.8	12.7
Profitability & Return ratios (%)					
EBITDA margin	27.0	25.3	24.8	25.8	25.8
EBIT margin	24.3	22.8	21.6	22.6	22.9
Adjusted profit margin	22.7	18.6	18.2	18.4	18.8
Adjusted ROAE	23.9	24.5	25.8	25.6	26.0
ROCE	29.6	31.0	32.6	35.7	38.7
Working capital days (days)					
Receivables	66	59	61	63	63
Inventory	0	0	0	0	0
Payables	101	93	97	100	99
Ratios (x)					
Gross asset turnover	4.6	5.6	6.1	6.7	7.5
Current ratio	3.5	2.8	3.0	3.1	3.3
Net interest coverage ratio	6.6	8.8	11.1	8.5	8.1
Adjusted debt/equity	(0.3)	(0.3)	(0.3)	(0.4)	(0.4)

Source: Company, BOBCAPS Research

Disclaimer

Recommendations and Absolute returns (%) over 12 months

BUY – Expected return >+15%

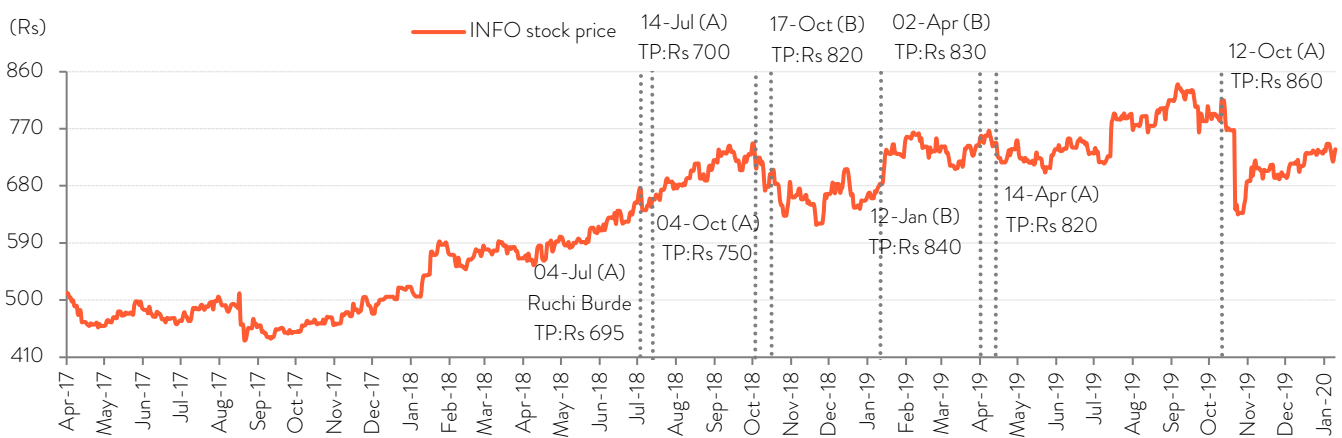
ADD – Expected return from >+5% to +15%

REDUCE – Expected return from -5% to +5%

SELL – Expected return <-5%

Note: Recommendation structure changed with effect from 1 January 2018 (Hold rating discontinued and replaced by Add / Reduce)

HISTORICAL RATINGS AND TARGET PRICE: INFOSYS (INFO IN)



B – Buy, A – Add, R – Reduce, S – Sell

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