

**ADD**

TP: Rs 730 | ▲ 12%

**INFOSYS**

| IT Services

| 21 April 2020

## Subpar operating performance, annual guidance suspended

**Infosys (INFO)** reported a lacklustre Q4FY20 operating performance marked by a miss on both revenue and margins. Deal TCV at US\$ 1.6bn was modest and carried a caveat of likely ramp-up delays. Suspended annual guidance, especially on operating margins, adds a blind spot in a crucial year for margin recovery. We trim FY21/FY22 EPS estimates by 15%/16% and revise our Mar'21 TP to Rs 730 (vs. Rs 840 earlier), set at an unchanged FY22E P/E of 18x. Retain ADD but prefer TCS and HCL Tech over INFO.

Ruchi Burde | Seema Nayak

research@bobcaps.in

**Disappointing performance:** Akin to peers, a partial Covid-19 hit in the last few weeks of March led to a 0.8% QoQ CC decline in INFO's revenue (-1.4% QoQ in dollar terms) vs. consensus estimates of 0.6% QoQ CC growth. Revenue contraction stemmed from reduction in traditional services revenue (-3.6% QoQ in dollar terms) even as digital revenue growth (+1.7% QoQ in dollar terms) was at its slowest pace since the company started this quarterly disclosure in Q1FY18. EBIT margins at 21.2% shed 80bps QoQ, rounding off FY20 at 21.3% – towards the lower end of the guided range of 21-23%.

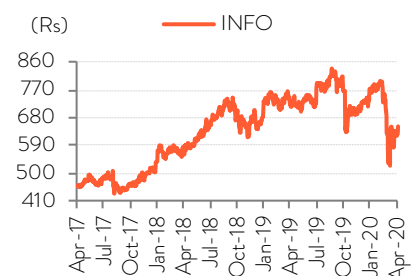
**Modest deal wins, caveat of likely ramp-up delays:** Deal win TCV at US\$ 1.6bn reflected seasonal moderation with a 9% QoQ decline, albeit up 5% YoY. New deal share increased to 56% vs. 32% in Q3, though management indicated likely ramp-up delays and the possibility of slower deal conversion during the Covid-19 turmoil.

**Suspended outlook:** As with peers such as Wipro and Cognizant, INFO has also suspended its annual outlook, both for revenue and operating margins. FY21 was to be critical for management's three-year strategic programme that aimed at recouping operating margins during the year. But Covid-led uncertainty and a suspended margin outlook have added disappointing blind spots.

Ticker/Price	INFO IN/Rs 653
Market cap	US\$ 37.1bn
Shares o/s	4,349mn
3M ADV	US\$ 88.0mn
52wk high/low	Rs 847/Rs 509
Promoter/FPI/DII	13%/35%/52%

Source: NSE

## STOCK PERFORMANCE



Source: NSE

## KEY FINANCIALS

Y/E 31 Mar	FY18A	FY19A	FY20P	FY21E	FY22E
Total revenue (Rs mn)	705,220	826,760	907,910	912,792	991,163
EBITDA (Rs mn)	190,100	208,890	222,680	229,136	255,368
Adj. net profit (Rs mn)	160,280	154,100	167,350	155,792	172,692
Adj. EPS (Rs)	36.9	35.4	39.0	36.3	40.3
Adj. EPS growth (%)	17.3	(4.0)	10.3	(6.9)	10.8
Adj. ROAE (%)	23.9	24.5	26.5	22.6	22.9
Adj. P/E (x)	17.7	18.5	16.7	18.0	16.2
EV/EBITDA (x)	13.5	12.6	11.9	11.6	10.4

Source: Company, BOBCAPS Research

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Important disclosures, including any required research certifications, are provided at the end of this report.



## Earnings call highlights

- **EBIT margins:** Q4 EBIT margin at 21.2% shed 80bps QoQ (and 30bps YoY) due to the Covid-related revenue slowdown exacerbated by lower utilisation (-90bps impact), H1B visas (-40bps) and receivables provisioning (-50bps) – these negatives were partly offset by gains of 50bps from currency depreciation and 50bps due to cost optimisation.
- **Digital business:** Q4 digital growth of 31.7% YoY has been encouraging and the business now forms 41.9% of revenue. Reinvention around digital is increasing across the board. More transition-related work is expected as automation and efficiency are important in the current work environment.
- **Deal wins:** Deal win TCV at US\$ 1.65bn was down 9% QoQ and up 5% YoY. Share of new deals increased to 56%. A total of 12 new deals were signed, of which 7 were from America and 5 from Europe. Management sees a possibility of some contracts being deferred due to the pandemic impact, but is relying on its customer relationships to carry these deals forward.
- **Covid-19 impact**
  - 93% of INFO's employees are currently working remotely which is higher than other tier-I IT players. Some supply-side constraints will persist so long as the lockdown continues.
  - INFO suffered a revenue loss of ~US\$ 30mn due to the coronavirus in Q4. Two-thirds of this stemmed from supply problems (lower utilisation due to work-from-home) and one-third came from the demand side.
  - Management has suspended revenue and margin guidance for FY21 till the situation stabilises.
  - The company has activated a programme for cost control and reduction. Steps taken include deferment of salary increase and promotions, as well as a slowdown in hiring and discretionary spend. Increased emphasis is being placed on cost saving levers of automation, pyramid optimisation and subcontracting cost reduction.
  - Near-term challenges are anticipated across verticals. BFSI will be hit by lower interest rates, decreasing net interest margins and loss of borrowers. Retail and logistics will also be significantly affected by ongoing trade disruptions, while media and entertainment will suffer from the cancellation of large events. Performance of the energy and utility vertical has been decent till now but is expected to be subdued in Q1FY21.

- Clients are showing increased interest in the areas of cloud, virtualisation and cost reduction programmes. INFO expects to gain from vendor consolidation as well.
- Per management, Covid-19 is different from the GFC because of its widespread impact across verticals. The company expects a hangover in Q1FY21.
- **Managing liquidity a top priority:** A strong balance sheet will stand INFO in good stead and the company has ample liquidity, with cash at US\$ 3.6bn as at end-Q4. Management is looking to reduce the working capital cycle, pare receivables and trim capex. A debt-free balance sheet and superior credit ratings will be helpful in managing liquidity.
- **Miscellaneous:**
  - INFO has donated Rs 1bn for dealing with the global pandemic crisis (including Rs 500mn to PM Cares Fund in India).
  - Consolidated attrition spiked 110bps QoQ and 30bps YoY to stand at 20.7% in Q4FY20, largely due to appraisals in Q3.
  - Dividend of Rs 9.5/sh was announced in Q4FY20.

**FIG 1 – MAR'20 QUARTER PERFORMANCE**

(Rs mn)	Q4FY20	Q4FY19	YoY (%)	Q3FY20	QoQ (%)	FY20	FY19	YoY (%)
<b>Revenues (in US\$ mn)</b>	<b>3,197</b>	<b>3,060</b>	<b>4.5</b>	<b>3,243</b>	<b>(1.4)</b>	<b>12,781</b>	<b>11,799</b>	<b>8.3</b>
<b>Revenue</b>	<b>2,32,670</b>	<b>2,15,390</b>	<b>8.0</b>	<b>2,30,920</b>	<b>0.8</b>	<b>9,07,910</b>	<b>8,26,760</b>	<b>9.8</b>
Operating Expenditure	1,75,910	1,63,900	7.3	1,72,910	1.7	6,85,230	6,17,870	10.9
Cost of revenues	1,47,520	1,37,520	7.3	1,46,360	0.8	5,78,380	5,18,580	11.5
as % of sales	63.4	63.8	-	63.4	-	63.7	62.7	-
SG&A expenses	28,390	26,380	7.6	26,550	6.9	1,06,850	99,290	7.6
as % of sales	12.2	12.2	-	11.5	-	11.8	12.0	-
<b>EBITDA</b>	<b>56,760</b>	<b>51,490</b>	<b>10.2</b>	<b>58,010</b>	<b>(2.2)</b>	<b>2,22,680</b>	<b>2,08,890</b>	<b>6.6</b>
Depreciation	7,490	5,310	41.1	7,360	1.8	28,930	20,100	43.9
<b>EBIT</b>	<b>49,270</b>	<b>46,180</b>	<b>6.7</b>	<b>50,650</b>	<b>(2.7)</b>	<b>1,93,750</b>	<b>1,88,790</b>	<b>2.6</b>
Other Income	6,140	6,650	-	8,270	-	28,030	28,830	(2.8)
PBT	55,410	52,830	4.9	58,920	(6.0)	2,21,780	2,17,620	1.9
Total Tax	11,610	12,050	(3.7)	13,830	(16.1)	53,680	56,310	(4.7)
Adjusted PAT	43,800	40,780	7.4	45,090	(2.9)	1,68,100	1,61,310	4.2
(Profit)/loss from JV's/Ass/MI	0	0	-	0	-	0	0	-
APAT after MI	43,800	40,780	7.4	45,090	(2.9)	1,68,100	1,61,310	4.2
Extra ordinary items	0	0	-	0	-	0	(7,210)	-
<b>Reported PAT</b>	<b>43,800</b>	<b>40,780</b>	<b>7.4</b>	<b>45,090</b>	<b>(2.9)</b>	<b>1,68,100</b>	<b>1,54,100</b>	<b>9.1</b>
Reported EPS	10.2	9.4	8.8	10.5	(3.0)	39	35	10.0
<b>Margins (%)</b>			<b>(bps)</b>		<b>(bps)</b>			<b>(bps)</b>
EBITDA	24.4	23.9	49	25.1	(73)	24.5	25.3	(74)
EBIT	21.2	21.4	(26)	21.9	(76)	21.3	22.8	(149)
EBT	23.8	24.5	(71)	25.5	(170)	24.4	26.3	(189)

(Rs mn)	Q4FY20	Q4FY19	YoY (%)	Q3FY20	QoQ (%)	FY20	FY19	YoY (%)
PAT	18.8	18.9	(11)	19.5	(70)	18.5	19.5	(100)
Effective Tax rate	21.0	22.8	(185.6)	23.5	(252)	24.2	25.9	(167)

Source: Company, BOBCAPS Research

## FIG 2 – MAR'20 OPERATING METRICS

(In US\$ terms)	Q4FY20 (% Contr. to Revenue)	QoQ (%)	YoY (%)
TCV of deal wins (in US\$ mn)	1,646	(9.2)	5.0
Digital Revenues	41.9	1.7	29.5
<b>Revenue by Geography</b>			
North America	61.6	(0.9)	5.2
Europe	24.4	(1.4)	6.2
India	2.6	(8.5)	18.1
ROW	11.4	(2.3)	(4.7)
<b>Revenue by Industry Groups</b>			
BFSI	31.3	(2.0)	3.5
Retail	15.5	(0.1)	1.8
Communications	13.0	(1.4)	0.6
Energy, Utilities, Resources and Services	12.9	(0.6)	6.1
Manufacturing	10.1	(3.3)	5.5
Hi Tech	7.9	2.5	7.2
Life Sciences	6.4	(5.8)	11.4
Others	2.9	2.1	16.5
<b>Client concentration</b>			
Top Client	3.1	1.9	(1.9)
Top 10 Clients	18.7	(2.5)	(0.8)
Non-Top 10 Clients	81.3	(1.2)	5.8
<b>(%)</b>			
<b>Onsite-Offshore effort split</b>			
Onsite	27.6	27.7	28.7
Offshore	72.4	72.3	71.3
<b>Utilization measures (IT Services and Consulting)</b>			
Including trainees	79.0	80.4	78.9
Excluding trainees	83.5	84.4	82.3

Source: Company, BOBCAPS Research

## Valuation methodology

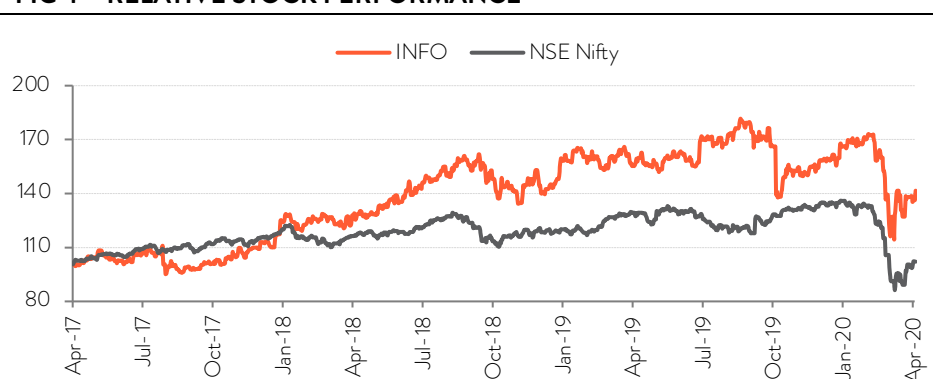
We cut FY21/FY22 EPS estimates by 15%/16% as we moderate revenue growth and margin assumptions amid Covid-19. We now expect a 4.8% YoY dollar revenue decline for FY21 and growth recovery to 8.6% in FY22. Our Mar'21 target price stands revised to Rs 730 from Rs 840 earlier, set at an unchanged FY22E P/E multiple of 18x. Retain ADD but prefer TCS and HCL Tech over INFO.

**FIG 3 – REVISED ESTIMATES**

(Rs mn)	FY21E			FY22E		
	Old	New	Change (%)	Old	New	Change (%)
Revenues (US\$ mn)	14,048	12,171	(13.4)	15,546	13,216	(15.0)
YoY revenue growth (%)	920.0	(4.8)	-	1070.0	8.6	-
Revenues	9,83,395	9,12,792	(7.2)	10,88,229	9,91,163	(8.9)
EBITDA	2,53,371	2,29,136	(9.6)	2,80,381	2,55,368	(8.9)
EBITDA margins (%)	25.8	25.1	-	25.8	25.8	-
EBIT margins (%)	22.6	21.1	-	22.9	21.9	-
Net profits	1,81,291	1,55,792	(14.1)	2,04,353	1,72,692	(15.5)
EPS (Rs)	42.7	36.3	(14.9)	48.1	40.3	(16.3)

Source: BOBCAPS Research

**FIG 4 – RELATIVE STOCK PERFORMANCE**



Source: NSE

## Key risks

Downside risks to our estimates are:

- a more pronounced adverse impact of Covid-19, 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	FY20P	FY21E	FY22E
<b>Total revenue</b>	<b>705,220</b>	<b>826,760</b>	<b>907,910</b>	<b>912,792</b>	<b>991,163</b>
EBITDA	190,100	208,890	222,680	229,136	255,368
Depreciation	18,620	20,100	28,930	36,303	38,211
EBIT	171,480	188,790	193,750	192,833	217,157
Net interest income/(expenses)	26,130	21,550	16,120	20,581	19,407
Other income/(expenses)	32,400	28,830	28,030	20,581	19,407
Exceptional items	(1,180)	(7,210)	0	0	0
EBT	202,700	210,410	221,780	213,413	236,564
Income taxes	42,420	56,310	53,680	57,622	63,872
Extraordinary items	0	0	0	0	0
Min. int./Inc. from associates	0	0	750	0	0
<b>Reported net profit</b>	<b>160,280</b>	<b>154,100</b>	<b>167,350</b>	<b>155,792</b>	<b>172,692</b>
Adjustments	0	0	0	0	0
<b>Adjusted net profit</b>	<b>160,280</b>	<b>154,100</b>	<b>167,350</b>	<b>155,792</b>	<b>172,692</b>

### Balance Sheet

Y/E 31 Mar (Rs mn)	FY18A	FY19A	FY20P	FY21E	FY22E
Accounts payables	0	0	0	0	0
Other current liabilities	144,740	168,940	263,520	192,562	209,095
Provisions	4,920	5,230	5,720	7,502	8,147
Debt funds	0	0	0	0	0
Other liabilities	0	0	0	0	0
Equity capital	10,880	21,700	21,220	21,220	21,220
Reserves & surplus	638,360	585,160	637,220	699,264	768,039
Shareholders' fund	649,240	606,860	658,440	720,484	789,259
<b>Total liabilities and equities</b>	<b>798,900</b>	<b>781,030</b>	<b>927,680</b>	<b>920,548</b>	<b>1,006,500</b>
Cash and cash eq.	198,180	165,060	186,490	170,834	226,892
Accounts receivables	131,420	136,990	184,870	187,560	203,664
Inventories	0	0	0	0	0
Other current assets	42,610	46,550	71,210	62,520	67,888
Investments	121,630	124,990	87,920	87,920	87,920
Net fixed assets	146,010	149,560	250,530	244,227	239,766
CWIP	0	0	41,680	41,680	41,680
Intangible assets	0	0	0	0	0
Deferred tax assets, net	12,820	13,000	17,440	17,440	17,440
Other assets	146,230	144,880	129,220	150,048	162,931
<b>Total assets</b>	<b>798,900</b>	<b>781,030</b>	<b>927,680</b>	<b>920,548</b>	<b>1,006,500</b>

Source: Company, BOBCAPS Research

### Cash Flows

Y/E 31 Mar (Rs mn)	FY18A	FY19A	FY20P	FY21E	FY22E
Net income + Depreciation	110,630	174,200	196,280	192,095	210,903
Interest expenses	(23,600)	(28,830)	(28,030)	(20,581)	(19,407)
Non-cash adjustments	0	0	0	0	0
Changes in working capital	840	16,350	38,190	(84,004)	(17,177)
Other operating cash flows	43,780	(98,005)	49,198	0	0
<b>Cash flow from operations</b>	<b>131,650</b>	<b>63,715</b>	<b>255,638</b>	<b>87,510</b>	<b>174,319</b>
Capital expenditures	(19,980)	(23,650)	(88,220)	(30,000)	(33,750)
Change in investments	21,810	0	0	0	0
Other investing cash flows	43,500	28,830	28,030	20,581	19,407
<b>Cash flow from investing</b>	<b>45,330</b>	<b>5,180</b>	<b>(60,190)</b>	<b>(9,419)</b>	<b>(14,343)</b>
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	(205,100)	(92,730)	(100,703)	(93,748)	(103,917)
Other financing cash flows	0	0	0	0	0
<b>Cash flow from financing</b>	<b>(205,050)</b>	<b>(102,043)</b>	<b>(173,990)</b>	<b>(93,748)</b>	<b>(103,917)</b>
<b>Changes in cash and cash eq.</b>	<b>(28,070)</b>	<b>(33,148)</b>	<b>21,458</b>	<b>(15,656)</b>	<b>56,058</b>
<b>Closing cash and cash eq.</b>	<b>198,180</b>	<b>165,032</b>	<b>186,490</b>	<b>170,834</b>	<b>226,892</b>

### Per Share

Y/E 31 Mar (Rs)	FY18A	FY19A	FY20P	FY21E	FY22E
Reported EPS	36.9	35.4	39.0	36.3	40.3
Adjusted EPS	36.9	35.4	39.0	36.3	40.3
Dividend per share	43.5	21.5	19.5	18.2	20.2
Book value per share	149.3	139.3	153.5	168.0	184.0

### Valuations Ratios

Y/E 31 Mar (x)	FY18A	FY19A	FY20P	FY21E	FY22E
EV/Sales	3.6	3.2	2.9	2.9	2.7
EV/EBITDA	13.5	12.6	11.9	11.6	10.4
Adjusted P/E	17.7	18.5	16.7	18.0	16.2
P/BV	4.4	4.7	4.3	3.9	3.6

### DuPont Analysis

Y/E 31 Mar (%)	FY18A	FY19A	FY20P	FY21E	FY22E
Tax burden (Net profit/PBT)	79.1	73.2	75.5	73.0	73.0
Interest burden (PBT/EBIT)	118.2	111.5	114.5	110.7	108.9
EBIT margin (EBIT/Revenue)	24.3	22.8	21.3	21.1	21.9
Asset turnover (Revenue/Avg TA)	86.4	104.7	106.3	98.8	102.9
Leverage (Avg TA/Avg Equity)	1.2	1.3	1.4	1.3	1.3
Adjusted ROAE	23.9	24.5	26.5	22.6	22.9

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

**Ratio Analysis**

Y/E 31 Mar	FY18A	FY19A	FY20P	FY21E	FY22E
<b>YoY growth (%)</b>					
Revenue	3.0	17.2	9.8	0.5	8.6
EBITDA	2.2	9.9	6.6	2.9	11.4
Adjusted EPS	17.3	(4.0)	10.3	(6.9)	10.8
<b>Profitability &amp; Return ratios (%)</b>					
EBITDA margin	27.0	25.3	24.5	25.1	25.8
EBIT margin	24.3	22.8	21.3	21.1	21.9
Adjusted profit margin	22.7	18.6	18.4	17.1	17.4
Adjusted ROAE	23.9	24.5	26.5	22.6	22.9
ROCE	29.6	31.0	32.1	27.6	28.5
<b>Working capital days (days)</b>					
Receivables	66	59	65	74	72
Inventory	0	0	0	0	0
Payables	101	93	115	122	100
<b>Ratios (x)</b>					
Gross asset turnover	4.6	5.6	4.5	3.7	4.1
Current ratio	3.5	2.8	2.1	2.9	3.0
Net interest coverage ratio	6.6	8.8	12.0	9.4	11.2
Adjusted debt/equity	(0.3)	(0.3)	(0.3)	(0.2)	(0.3)

Source: Company, BOBCAPS Research



## Disclaimer

### Recommendations and Absolute returns (%) over 12 months

**BUY** – Expected return >+15%

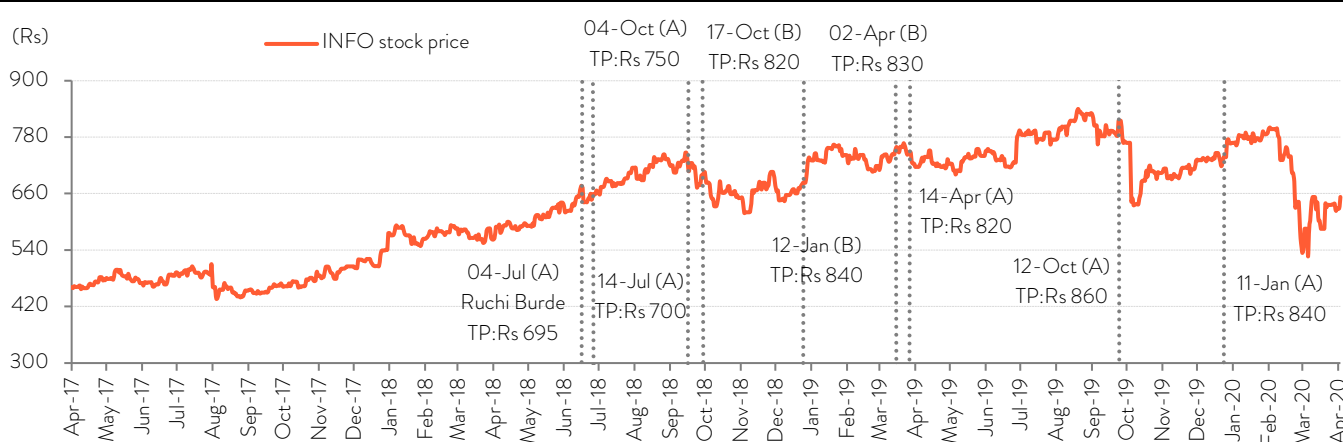
**ADD** – Expected return from >+5% to +15%

**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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