

ADD

TP: Rs 820 | ▲ 13%

INFOSYS

| IT Services

| 13 July 2019

Impressive deal wins; risks to operating margins ahead

Infosys (INFO) reported a largely in-line Q1FY20 operating performance, with 2.8% QoQ CC revenue growth and 20.5% EBIT margins. At US\$ 2.7bn, the company notched up its highest quarterly deal wins, which supported upbeat revenue guidance for FY20. Though strong deal wins and guidance lay the ground for healthy growth momentum, margin management could be a challenge given elevated attrition and tight staff cost control. We tweak FY20/FY21 EPS by -2%/-1%; on rollover to Jun'20, our TP remains at Rs 820.

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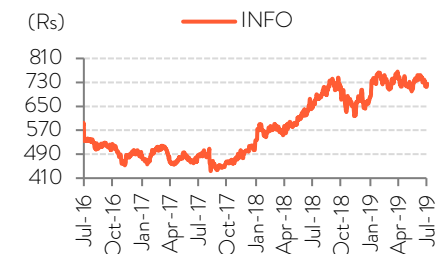
In-line operating performance: INFO reported revenues of US\$ 3.1bn (+2.3% QoQ or +2.8% QoQ CC incl. 60bps tailwinds from the Stater acquisition) – slightly softer than our estimate of 3.1% QoQ CC growth but in line with consensus. EBIT margins at 20.5% (-100bps QoQ) met expectations. BFSI performance excluding the ABN AMRO deal was weak (-0.3% QoQ in dollar terms). Among verticals, communications/energy & utility led with 4.6%/4.7% QoQ dollar revenue growth. Among geographies, North America stood out with 3% QoQ dollar growth.

Ticker/Price	INFO IN/Rs 727
Market cap	US\$ 46.1bn
Shares o/s	4,349mn
3M ADV	US\$ 84.9mn
52wk high/low	Rs 773/Rs 600
Promoter/FPI/DII	13%/35%/52%

Source: NSE

Deal wins impressive, revenue guidance revised up: Aided by the ABN AMRO contract (whose size management is yet to disclose), INFO posted its highest quarterly deal-win TCV of US\$ 2.7bn. The company raised its FY20 revenue growth guidance to 8.5-10% from 7.5-9.5% earlier (in CC terms), implying a CQGR of 1.6%/1.9% at the lower/top end of the band for the rest of FY20. EBIT margin guidance was unchanged at 21-23%.

STOCK PERFORMANCE



Source: NSE

Retain ADD: With impressive deal wins and higher guidance, INFO could well close the revenue gap with TCS in FY20, especially after a soft Q1 at TCS. But in the absence of currency tailwinds, margin management could prove thorny for INFO due to its stubbornly high attrition (vs. best-in-industry levels for TCS).

KEY FINANCIALS

Y/E 31 Mar	FY18A	FY19A	FY20E	FY21E	FY22E
Adj. net profit (Rs mn)	1,60,280	1,54,170	1,58,157	1,82,163	2,05,010
Adj. EPS (Rs)	36.9	35.4	36.3	41.8	47.1
Adj. EPS growth (%)	17.3	(4.0)	2.6	15.2	12.5
Adj. ROAE (%)	23.9	24.5	24.8	25.8	26.2
Adj. P/E (x)	19.7	20.5	20.0	17.4	15.4
EV/EBITDA (x)	15.4	14.2	13.9	11.6	10.3

Source: Company, BOBCAPS Research

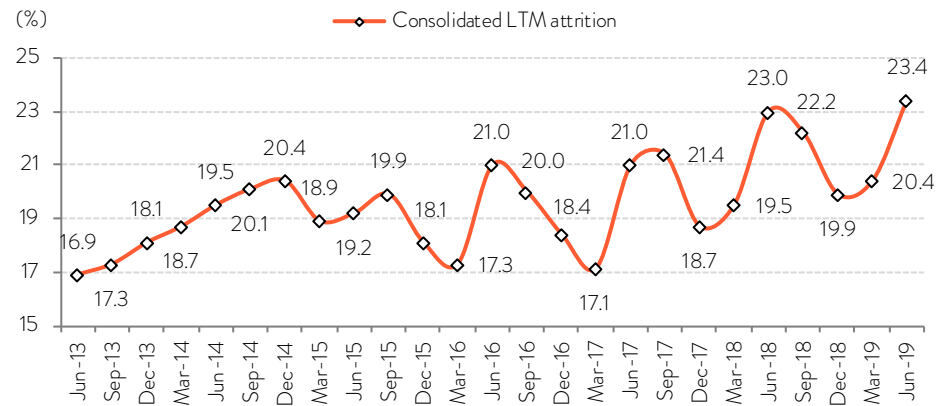
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Q1 attrition at 23.4% was among peak levels for INFO, attributed to seasonality and involuntary attrition

FIG 1 – ATTRITION REMAINS AN AREA OF CONCERN

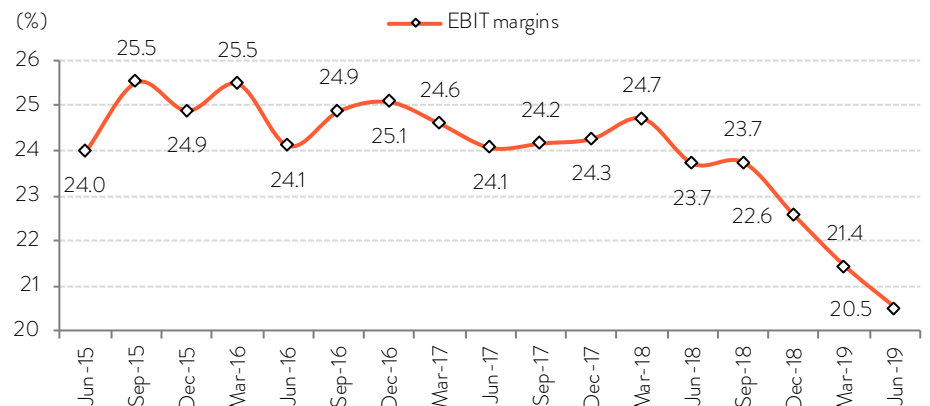


Source: Company, BOBCAPS Research

Wages revised for 85% of headcount in Q1 (-60bps margin impact: moderate vs. -100bps impact last year)

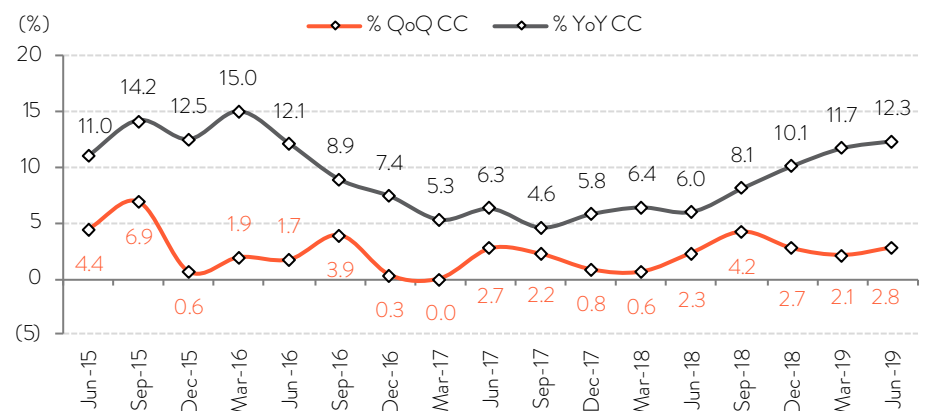
Margin management strategy will be tested as INFO looks to balance wage revision costs and employee attrition

FIG 2 – IN ABSENCE OF CURRENCY TAILWINDS, MARGIN RECOVERY THROUGH FY20 TO BE CHALLENGING IN VIEW OF ELEVATED ATTRITION



Source: Company, BOBCAPS Research

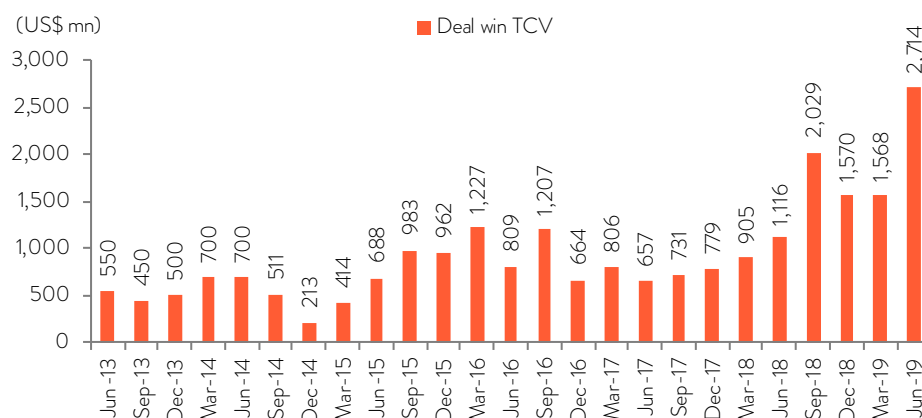
FIG 3 – JUN'19 QUARTER REVENUE GROWTH AIDED BY STATER CONSOLIDATION (~60BPS QOQ TAILWINDS)



Source: Company, BOBCAPS Research

Record quarterly deal-win TCV of US\$ 2.7bn aided by ABN AMRO contract

FIG 4 – IMPRESSIVE LARGE DEAL WINS IN JUN'19 QUARTER



Source: Company, BOBCAPS Research

Other earnings call takeaways

- Q1 trends:** We note similar trends between INFO and TCS's Jun'19 quarter performance in that both players had strong deal wins, continued digital business growth, and a soft BFSI & retail showing. Management commentary on capital market and European bank weakness was also a common factor.
- Operating margins:** INFO's Q1FY20 operating margins were affected by headwinds from (1) adverse currency movement (-40bps QoQ), (2) compensation revisions (-60bps), (3) visa costs (-80bps), and (4) the Stater acquisition from ABN Amro (-30bps QoQ). These headwinds were partially neutralised by increases in utilisation (+70bps QoQ), higher realisations and other cost efficiencies (+20bps), and minor gains due to IFRS-16 adoption (+10bps).
- Margin levers:** Management is counting on levers such as utilisation improvement, rationalising the onsite-offshore role mix, and overhead efficiency measures for operating margin recovery through FY20.
- Localisation:** INFO has achieved its American worker hiring target of 10,000 locals set in Mar'17. As part of this localisation initiative, the company has onboarded ~2,500 fresh graduates in North America. Management indicated high scalability of the onsite pyramid and gradual evolution into a hub delivery model (nearshore large delivery centres) as the localisation initiative progresses.
- Digital revenue:** Digital revenue accounted for 35.7% of overall revenues, up 8.1% QoQ in dollar terms. We note YoY growth acceleration for the third consecutive quarter at 39% in dollar terms.
- Capital allocation:** The company revised its capital allocation policy, with a target to return up to ~85% of free cash flows (vs. 70% earlier) to shareholders cumulatively over a five-year period.

FIG 5 – JUN'19 QUARTER PERFORMANCE

(Rs mn)	Q1FY19	Q2FY19	Q3FY19	Q4FY19	Q1FY20	QoQ (%)	YoY (%)
Revenues (US\$ mn)	2,831	2,921	2,987	3,060	3,131	2.3	10.6
Revenue	1,91,280	2,06,090	2,14,000	2,15,390	2,18,030	1.2	14.0
Operating expenditure	1,41,550	1,52,520	1,59,900	1,63,900	1,66,510	1.6	17.6
Cost of revenues	1,18,520	1,28,180	1,34,360	1,37,520	1,40,980	2.5	19.0
as % of sales	62.0	62.2	62.8	63.8	64.7	-	-
SG&A expenses	23,030	24,340	25,540	26,380	25,530	(3.2)	10.9
as % of sales	12.0	11.8	11.9	12.2	11.7	-	-
EBITDA	49,730	53,570	54,100	51,490	51,520	0.1	3.6
Depreciation	4,360	4,630	5,800	5,310	6,810	28.2	56.2
EBIT	45,370	48,940	48,300	46,180	44,710	(3.2)	(1.5)
Other Income	7,260	7,390	7,530	6,650	7,360	-	-
PBT	52,630	56,330	55,830	52,830	52,070	(1.4)	(1.1)
Total Tax	13,810	15,230	15,220	12,050	13,650	13.3	(1.2)
Adjusted PAT	38,820	41,100	40,610	40,780	38,420	(5.8)	(1.0)
(Profit)/loss from JV's/Ass/MI	0	0	0	0	0	-	-
APAT after MI	38,820	41,100	40,610	40,780	38,420	(5.8)	(1.0)
Extra ordinary items	(2,700)	0	(4,510)	0	0	-	-
Reported PAT	36,120	41,100	36,100	40,780	38,420	(5.8)	6.4
Reported EPS	8.3	9.4	8.3	9.4	9.3	(0.4)	12.2
Margins (%)						(bps)	(bps)
EBITDA	26.0	26.0	25.3	23.9	23.6	(28)	(237)
EBIT	23.7	23.7	22.6	21.4	20.5	(93)	(321)
EBT	27.5	27.3	26.1	24.5	23.9	(65)	(363)
PAT	18.9	19.9	16.9	18.9	17.6	(131)	(126)
Effective Tax rate	26.2	27.0	27.3	22.8	26.2	341	(2.5)

Source: Company, BOBCAPS Research

FIG 6 – JUN'19 QUARTER OPERATING METRICS

Particulars	Q1FY20 (% Contr. to Revenue)	QoQ (%)	YoY (%)
TCV of deal wins (US\$ mn)	2,714	73.1	143.2
Digital revenues	35.7	8.1	39.0
Revenue breakup by Geography (in US\$ terms)			
North America	61.6	3.0	13.5
Europe	23.6	0.6	7.4
India	2.3	2.3	(2.2)
ROW	12.5	2.3	5.5
Revenue breakup by Vertical (in US\$ terms)			
BFSI	31.4	(0.3)	7.1
Retail	15.8	1.7	5.3
Communications	13.8	4.6	20.2
Energy, Utilities, Resources and Services	13.0	4.7	15.9
Manufacturing	9.6	(1.8)	10.6
Hi Tech	7.7	2.3	15.1
Life Sciences	6.1	4.0	2.2
Others	2.6	2.3	(0.8)
Client concentration			
Top Client	3.2	(0.8)	(4.3)
Top 10 Clients	20.0	3.9	15.2
Non-Top 10 Clients	80.0	1.9	9.5
(%)	Q1FY20	Q4FY19	Q1FY19
Onsite-Offshore effort split			
Onsite	28.7	28.7	28.6
Offshore	71.3	71.3	71.4
Utilisation measures (IT Services and Consulting)			
Including trainees	80.3	78.9	81.5
Excluding trainees	83.1	82.3	85.7

Source: Company, BOBCAPS Research

Valuation methodology

Post the Q1FY20 results, we lower our FY20/FY21 EPS estimates marginally by 2%/1%. Our revised estimates build in 9%/9.2% YoY dollar revenue growth and 21.2%/22.7% EBIT margins for these two years. We introduce FY22 EPS at Rs 47.1 as we estimate 10.7% dollar revenue growth and 23% EBIT margins.

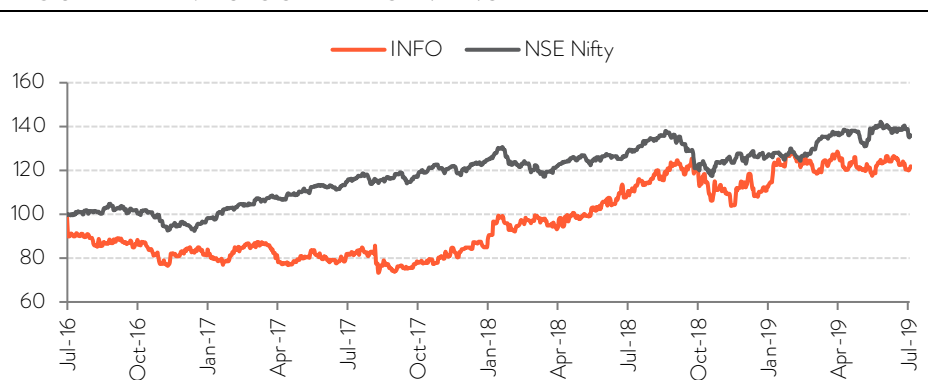
We continue to value INFO at an unchanged P/E multiple of 19x, which is one standard deviation above the stock's five-year average 12-month forward P/E. On rolling valuations forward, we have an unchanged Jun'20 target price of Rs 820. Retain ADD.

FIG 7 – REVISED ESTIMATES

(Rs mn)	FY20E			FY21E			FY22E
	Old	New	Change (%)	Old	New	Change (%)	New
Revenues (US\$ mn)	12,878	12,855	(0.2)	14,066	14,041	(0.2)	15,538
YoY revenue growth (%)	9.1	9.0		9.2	9.2		10.7
Revenues	8,98,324	8,89,015	(1.0)	9,84,626	9,82,900	(0.2)	10,87,682
EBITDA	2,20,306	2,16,164	(1.9)	2,49,737	2,53,243	1.4	2,80,240
EBITDA margins (%)	24.5	24.3		25.4	25.8		25.8
EBIT margins (%)	22.1	21.2		23.1	22.7		23.0
Net profits	1,60,960	1,58,157	(1.7)	1,84,173	1,82,163	(1.1)	2,05,010
EPS (Rs)	36.9	36.3	(1.7)	42.3	41.8	(1.1)	47.1

Source: BOBCAPS Research

FIG 8 – 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	8,89,015	9,82,900	10,87,682
EBITDA	1,90,100	2,08,890	2,16,164	2,53,243	2,80,240
EBIT	1,71,480	1,88,790	1,88,815	2,23,468	2,50,464
Net interest income/(expenses)	26,130	21,620	23,675	26,070	30,371
Other income/(expenses)	32,400	28,900	26,305	26,070	30,371
Exceptional items	(1,180)	(7,210)	0	0	0
EBT	2,02,700	2,10,480	2,15,120	2,49,538	2,80,836
Income taxes	42,420	56,310	56,963	67,375	75,826
Extraordinary items	0	0	0	0	0
Min. int./Inc. from associates	0	0	0	0	0
Reported net profit	1,60,280	1,54,170	1,58,157	1,82,163	2,05,010
Adjustments	0	0	0	0	0
Adjusted net profit	1,60,280	1,54,170	1,58,157	1,82,163	2,05,010

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	1,87,546	2,07,351	2,29,456
Provisions	4,920	5,230	7,307	8,079	8,940
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	6,48,146	7,20,692	8,02,337
Shareholders' fund	6,49,240	6,06,860	6,69,846	7,42,392	8,24,037
Total liabilities and equities	7,98,900	7,81,030	8,64,698	9,57,822	10,62,433
Cash and cash eq.	1,98,180	1,65,060	2,22,613	2,79,958	3,40,933
Accounts receivables	1,31,420	1,36,990	1,60,753	1,77,730	1,96,677
Inventories	0	0	0	0	0
Other current assets	42,610	46,550	46,278	51,165	56,619
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	1,48,489	1,46,714	1,48,438
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	1,48,575	1,64,265	1,81,777
Total assets	7,98,900	7,81,030	8,64,698	9,57,822	10,62,433

Source: Company, BOBCAPS Research

Cash Flows

Y/E 31 Mar (Rs mn)	FY18A	FY19A	FY20E	FY21E	FY22E
Net income + Depreciation	1,10,630	1,74,270	1,85,506	2,11,938	2,34,786
Interest expenses	(23,600)	(28,900)	(26,305)	(26,070)	(30,371)
Non-cash adjustments	0	0	0	0	0
Changes in working capital	840	16,350	(6,503)	(16,976)	(18,947)
Other operating cash flows	43,780	(98,005)	73,287	0	0
Cash flow from operations	1,31,650	63,715	2,25,984	1,68,892	1,85,468
Capital expenditures	(19,980)	(23,650)	(26,279)	(28,000)	(31,500)
Change in investments	21,810	0	0	0	0
Other investing cash flows	43,500	28,900	26,305	26,070	30,371
Cash flow from investing	45,330	5,250	26	(1,930)	(1,129)
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)	(92,772)	(95,171)	(1,09,616)	(1,23,365)
Other financing cash flows	0	0	0	0	0
Cash flow from financing	(2,05,050)	(1,02,085)	(1,68,457)	(1,09,616)	(1,23,365)
Changes in cash and cash eq.	(28,070)	(33,120)	57,553	57,346	60,974
Closing cash and cash eq.	1,98,180	1,65,060	2,22,613	2,79,958	3,40,933

Per Share

Y/E 31 Mar (Rs)	FY18A	FY19A	FY20E	FY21E	FY22E
Reported EPS	36.9	35.4	36.3	41.8	47.1
Adjusted EPS	36.9	35.4	36.3	41.8	47.1
Dividend per share	43.5	21.5	18.2	20.9	23.6
Book value per share	149.3	139.3	153.7	170.4	189.1

Valuations Ratios

Y/E 31 Mar (x)	FY18A	FY19A	FY20E	FY21E	FY22E
EV/Sales	4.2	3.6	3.4	3.0	2.6
EV/EBITDA	15.4	14.2	13.9	11.6	10.3
Adjusted P/E	19.7	20.5	20.0	17.4	15.4
P/BV	4.9	5.2	4.7	4.3	3.8

DuPont Analysis

Y/E 31 Mar (%)	FY18A	FY19A	FY20E	FY21E	FY22E
Tax burden (Net profit/PBT)	79.1	73.2	73.5	73.0	73.0
Interest burden (PBT/EBIT)	118.2	111.5	113.9	111.7	112.1
EBIT margin (EBIT/Revenue)	24.3	22.8	21.2	22.7	23.0
Asset turnover (Revenue/Avg TA)	86.4	104.7	108.0	107.9	107.7
Leverage (Avg TA/Avg Equity)	1.2	1.3	1.3	1.3	1.3
Adjusted ROAE	23.9	24.5	24.8	25.8	26.2

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	7.5	10.6	10.7
EBITDA	2.2	9.9	3.5	17.2	10.7
Adjusted EPS	17.3	(4.0)	2.6	15.2	12.5
Profitability & Return ratios (%)					
EBITDA margin	27.0	25.3	24.3	25.8	25.8
EBIT margin	24.3	22.8	21.2	22.7	23.0
Adjusted profit margin	22.7	18.6	17.8	18.5	18.8
Adjusted ROAE	23.9	24.5	24.8	25.8	26.2
ROCE	29.6	31.0	31.2	35.9	38.7
Working capital days (days)					
Receivables	66	59	61	63	63
Inventory	0	0	0	0	0
Payables	101	93	97	99	99
Ratios (x)					
Gross asset turnover	4.6	5.6	6.0	6.7	7.4
Current ratio	3.5	2.8	3.0	3.1	3.3
Net interest coverage ratio	6.6	8.7	8.0	8.6	8.2
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%

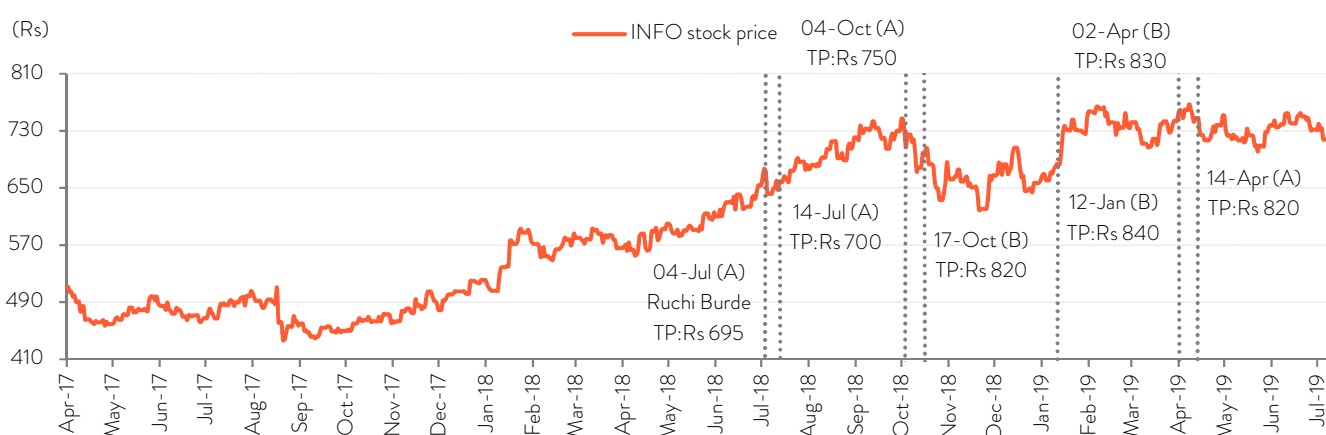
ADD – Expected return from >+5% to +15%

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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