

BUY

TP: Rs 1,760 | ▲ 19%

INFOSYS

| Technology & Internet

| 12 January 2023

Cobalt to drive near-term growth

- Q3 revenue growth in line at 2.4% QoQ CC, supported by vendor consolidation
- EBIT margin flat QoQ at 21.5%, marginally below our forecast; order book robust with 36% contribution from net new deal wins
- Maintain BUY and TP of Rs 1,760, set at 20.5x FY25E EPS

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Revenue robust; FY23 growth guidance raised to 16-16.5%: Despite the seasonally weak quarter, INFO reported 2.4% QoQ CC revenue growth to US\$ 4.7bn in Q3FY23. Growth was led by digital revenue (+21.7% YoY CC), whereas core services witnessed a modest uptick (+2.4%). Management indicated accelerated deal wins in core services backed by increased demand for cost efficiency programmes and automation, but is seeing weakness in the retail, hi-tech, financial (mortgage & investment bank), and telecom verticals. Manufacturing/energy, natural resources and utilities grew 36.8%/25.9% YoY CC, with strong numbers in Europe as well as the US.

Strong traction in deal TCV despite global macro weakness: Large deal TCV was up ~22% QoQ in Q3FY23 to US\$ 3.3bn (36% from net new deals), aided by a strong pickup in cost optimisation-related work, automation and digital analytics. INFO bagged 32 new contracts during the quarter, ahead of consensus expectations in a challenging time.

Net employee addition moderated to ~2.6k vs. ~10k in Q2 and is guided to achieve the ~50k mark of fresher hiring by the year-end. The emphasis on fresher hiring has significantly increased the company's bench strength and should support the cost of the employee pyramid in the long run.

Margin guidance retained in the range of 21-22%: EBIT margin was flat QoQ at 21.5% in Q3FY23, supported by forex gains (+40bps) and cost optimisation (+70bps), partly offset by SG&A and third-party expenses (-30bps). Management maintained its FY23 margin guidance at 21-22%, similar to Q2, and we believe the lower end is achievable

Maintain BUY: The stock is trading at 20.3x/17.4x FY24E/FY25E EPS. Despite INFO's cautious outlook on a few verticals, we believe its strength in managing the twin journeys of digital transformation (Cobalt) and cost takeout will drive growth leadership. We retain BUY and continue to value the stock at 20.5x FY25E EPS, translating to an unchanged TP of Rs 1,760.

Key changes

Target	Rating
◀ ▶	◀ ▶

Ticker/Price	INFO IN/Rs 1,481
Market cap	US\$ 76.3bn
Free float	3,319%
3M ADV	US\$ 101.3mn
52wk high/low	Rs 1,954/Rs 1,355
Promoter/FPI/DII	15%/36%/49%

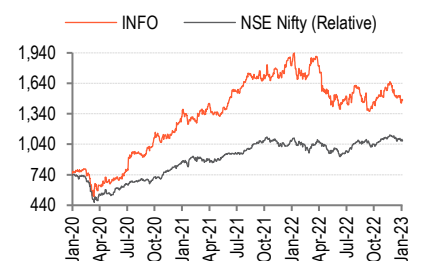
Source: NSE | Price as of 12 Jan 2023

Key financials

Y/E 31 Mar	FY22A	FY23E	FY24E
Total revenue (Rs mn)	12,16,410	14,93,753	17,29,592
EBITDA (Rs mn)	3,14,820	3,57,354	4,39,059
Adj. net profit (Rs mn)	2,21,210	2,47,056	3,07,276
Adj. EPS (Rs)	52.8	58.7	73.0
Consensus EPS (Rs)	52.8	59.5	66.3
Adj. ROAE (%)	29.0	30.6	33.5
Adj. P/E (x)	28.1	25.2	20.3
EV/EBITDA (x)	19.1	16.8	13.7
Adj. EPS growth (%)	15.9	11.3	24.4

Source: Company, Bloomberg, BOBCAPS Research

Stock performance



Source: NSE

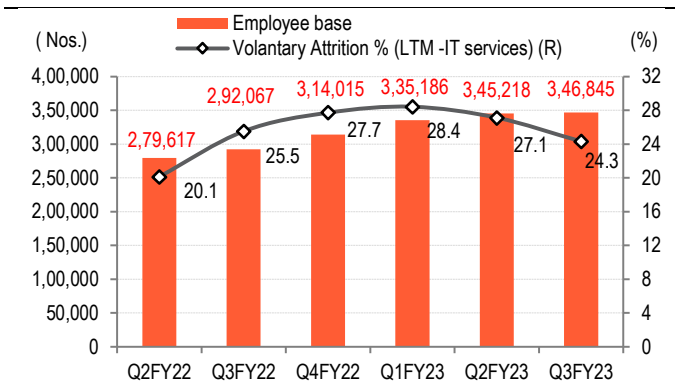


Fig 1 – Quarterly performance

(Rs mn)	Q3FY23	Q2FY23	Q3FY22	QoQ (%)	YoY (%)	Estimates	Variance (%)
US\$ Revenue (US\$ mn)	4659	4,555	4,250	2.3	9.6	4,667	(0.2)
INR Revenue	383180	365,380	318,670	4.9	20.2	384,566	(0.4)
EBIT	82420	78,7300	74,837	4.7	10.1	83,835	(1.7)
PAT	65860	61,2100	58,0870	7.6	13.4	66,145	(0.4)
EBIT Margin (%)	21.5	21.5	23.5	(4bps)	(197bps)	21.8	(29bps)
PAT Margin (%)	17.2	16.8	18.2	44bps	(104bps)	17.2	(1bps)

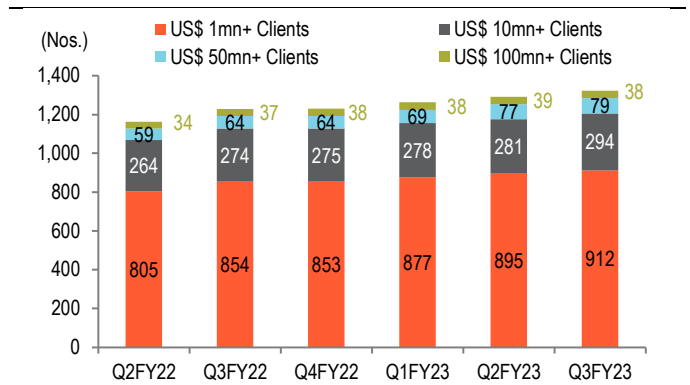
Source: Company, BOBCAPS Research

Fig 2 – Employee base & Attrition



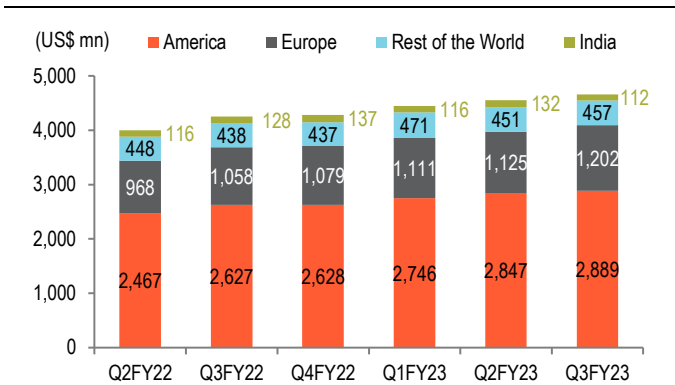
Source: Company, BOBCAPS Research

Fig 3 – Client contribution



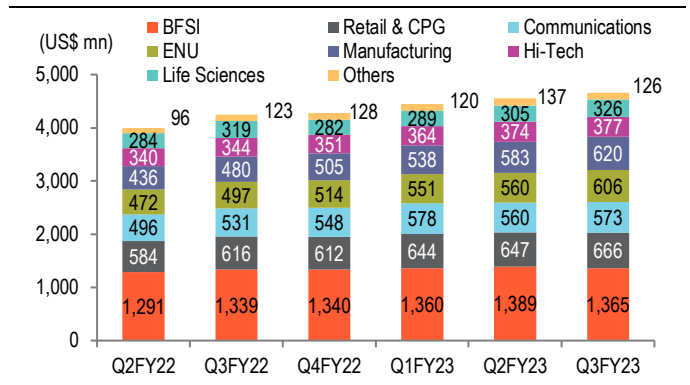
Source: Company, BOBCAPS Research

Fig 4 – Revenue contribution by geography



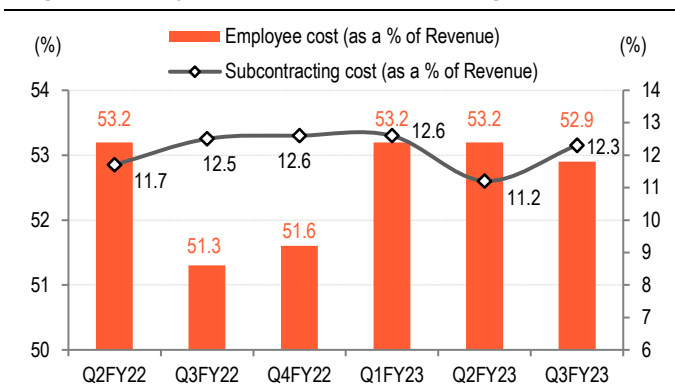
Source: Company, BOBCAPS Research

Fig 5 – Revenue contribution by vertical



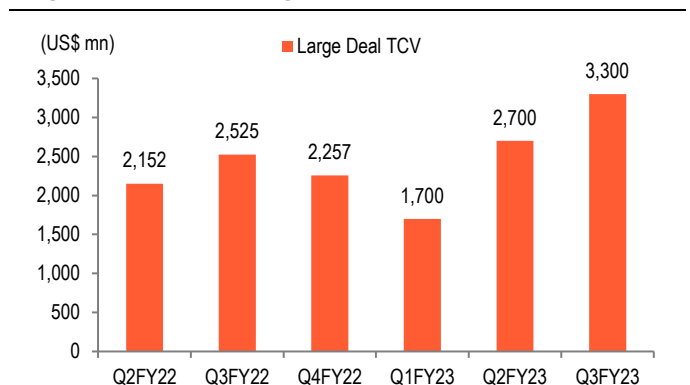
Source: Company, BOBCAPS Research

Fig 6 – Employee cost and Subcontracting cost



Source: Company, BOBCAPS Research

Fig 7 – Order book (large deal TCV)



Source: Company, BOBCAPS Research

Earnings call highlights

- INFO reported strong total contract value (TCV) of US\$ 3.3bn in Q3FY23 – the highest in the last eight quarters, of which 36% came from net new wins. The company won a total of 32 new deals that were broad-based across verticals and stemmed primarily from vendor consolidation. The deal pipeline remains healthy and larger than preceding quarters, with a higher focus on cost programmes.
- Though the third and fourth quarters are seasonally weak, impacting margins, INFO expects easing supply-side issues and lower subcontracting cost to offset pressures.
- Apart from some areas of financial services and retail, the company indicated that it is seeing a slowdown in the hi-tech and telecom verticals in the form of reduced spends towards discretionary programmes.
- Financial services growth was dragged down by investment banks and mortgage services. Retail clients are focusing on legacy modernization and supply chain transformation, with sluggishness among fashion, apparel and general merchandise retailers.
- Per management, new deal flow in the manufacturing space is steady with sustained spending on security, cloud migration, smart factories and smart products. However, macro concerns are putting pressure on traditional services in the telecom space. Hi-tech clients too are cautious on discretionary spends, and management expects some delays in deal closures.

Valuation methodology

The stock is trading at 20.3x/17.4x FY24E/FY25E EPS. Despite INFO's cautious outlook on a few verticals, we believe its strength in managing the twin journeys of digital transformation and cost takeout will drive growth leadership. We retain BUY and continue to value the stock at 20.5x FY25E EPS, translating to an unchanged TP of Rs 1,760.

Fig 8 – Peer comparison

Company	Ticker	Rating	Target Price (Rs)	Revenue CAGR FY23E-25E (%)	EPS (Rs)		ROE (%)		Target P/E (x)
					FY23E	FY24E	FY23E	FY24E	
TCS	TCS IN	HOLD	3,580	10.7	131.4	143.3	41.3	38.7	25.0
Infosys	INFO IN	BUY	1,760	14.9	58.7	73.0	30.6	33.5	20.5
HCL Tech	HCLT IN	BUY	1,240	10.4	52.0	59.8	21.7	22.3	18.7
Wipro	WPRO IN	HOLD	440	9.9	20.1	23.9	16.7	19.5	16.0
Tech Mahindra	TECHM In	HOLD	1,160	12.4	60.5	77.9	18.4	21.4	12.5

Source: Company, BOBCAPS Research

Key risks

- A further decline in interest rates would be a key downside risk to our estimates as we expect deal wins to soften due to an elongated decision-making cycle, especially in the financial services, retail, hi-tech and telecom vertical

Sector recommendation snapshot

Company	Ticker	Market Cap (US\$ bn)	Price (Rs)	Target (Rs)	Rating
HCL Technologies	HCLT IN	35.6	1,072	1,240	BUY
Infosys	INFO IN	76.3	1,481	1,760	BUY
Tata Consultancy Services	TCS IN	149.5	3,334	3,580	HOLD
Tech Mahindra	TECHM IN	10.7	1,002	1,160	HOLD
Wipro	WPRO IN	26.5	395	440	HOLD

Source: BOBCAPS Research, NSE | Price as of 12 Jan 2023

Financials

Income Statement

Y/E 31 Mar (Rs mn)	FY21A	FY22A	FY23E	FY24E	FY25E
Total revenue	10,04,730	12,16,410	14,93,753	17,29,592	19,71,116
EBITDA	2,79,350	3,14,820	3,57,354	4,39,059	5,02,757
Depreciation	32,680	34,770	39,015	45,520	38,178
EBIT	2,46,670	2,80,050	3,18,339	3,93,539	4,64,578
Net interest inc./(exp.)	16,150	16,570	17,227	19,079	20,271
Other inc./(exp.)	19,960	21,050	20,547	21,699	23,511
Exceptional items	0	0	0	0	0
EBT	2,66,630	3,01,100	3,38,886	4,15,238	4,88,090
Income taxes	72,050	79,640	91,830	1,07,962	1,26,903
Extraordinary items	0	0	0	0	1
Min. int./Inc. from assoc.	590	250	0	0	0
Reported net profit	1,93,990	2,21,210	2,47,056	3,07,276	3,61,186
Adjustments	0	0	0	0	1
Adjusted net profit	1,93,990	2,21,210	2,47,056	3,07,276	3,61,187

Balance Sheet

Y/E 31 Mar (Rs mn)	FY21A	FY22A	FY23E	FY24E	FY25E
Accounts payables	0	0	0	0	1
Other current liabilities	3,08,910	4,11,740	4,29,710	4,50,168	4,86,028
Provisions	7,130	9,750	10,231	11,847	13,501
Debt funds	0	0	0	0	1
Other liabilities	0	0	0	0	0
Equity capital	21,240	20,980	20,980	20,980	20,980
Reserves & surplus	7,46,580	7,36,370	8,34,760	9,57,133	11,00,975
Shareholders' fund	7,67,820	7,57,350	8,55,740	9,78,113	11,21,955
Total liab. and equities	10,83,860	11,78,840	12,95,681	14,40,127	16,21,486
Cash and cash eq.	2,47,140	1,74,720	2,64,334	3,86,644	5,44,225
Accounts receivables	1,92,940	2,26,980	2,37,363	2,46,408	2,48,415
Inventories	0	0	0	0	0
Other current assets	75,270	1,15,680	1,18,682	1,23,204	1,24,207
Investments	1,47,990	2,12,640	2,12,640	2,12,640	2,12,640
Net fixed assets	2,65,680	2,63,040	2,74,025	2,78,505	2,90,327
CWIP	47,940	48,230	48,230	48,230	48,230
Intangible assets	0	0	0	0	1
Deferred tax assets, net	10,980	12,660	12,660	12,660	12,660
Other assets	1,43,860	1,73,120	1,75,976	1,80,067	1,89,011
Total assets	10,83,860	11,78,840	12,95,681	14,40,127	16,21,485

Cash Flows

Y/E 31 Mar (Rs mn)	FY21A	FY22A	FY23E	FY24E	FY25E
Cash flow from operations	2,27,791	1,00,360	2,67,733	3,35,514	4,01,415
Capital expenditures	(41,570)	(21,610)	(50,000)	(50,000)	(50,000)
Change in investments	(28,798)	(42,580)	0	0	0
Other investing cash flows	19,960	18,980	20,547	21,699	23,511
Cash flow from investing	(50,408)	(45,210)	(29,453)	(28,301)	(26,489)
Equities issued/Others	0	210	0	0	0
Debt raised/repaid	0	0	0	0	1
Interest expenses	0	(1,260)	0	0	0
Dividends paid	(1,16,733)	(1,26,520)	(1,48,666)	(1,84,903)	(2,17,344)
Other financing cash flows	0	0	0	0	1
Cash flow from financing	(1,16,733)	(1,27,570)	(1,48,666)	(1,84,903)	(2,17,342)
Chg in cash & cash eq.	60,650	(72,420)	89,614	1,22,310	1,57,584
Closing cash & cash eq.	2,47,140	1,74,720	2,64,334	3,86,644	5,44,225

Per Share

Y/E 31 Mar (Rs)	FY21A	FY22A	FY23E	FY24E	FY25E
Reported EPS	45.5	52.8	58.7	73.0	85.8
Adjusted EPS	45.5	52.8	58.7	73.0	85.8
Dividend per share	22.8	26.3	29.4	36.5	42.9
Book value per share	180.2	179.9	203.3	232.4	266.5

Valuations Ratios

Y/E 31 Mar (x)	FY21A	FY22A	FY23E	FY24E	FY25E
EV/Sales	6.0	4.9	4.0	3.5	3.0
EV/EBITDA	21.7	19.1	16.8	13.7	11.7
Adjusted P/E	32.5	28.1	25.2	20.3	17.3
P/BV	8.2	8.2	7.3	6.4	5.6

DuPont Analysis

Y/E 31 Mar (%)	FY21A	FY22A	FY23E	FY24E	FY25E
Tax burden (Net profit/PBT)	72.8	73.5	72.9	74.0	74.0
Interest burden (PBT/EBIT)	108.1	107.5	106.5	105.5	105.1
EBIT margin (EBIT/Revenue)	24.6	23.0	21.3	22.8	23.6
Asset turnover (Rev./Avg TA)	99.9	107.5	120.7	126.4	128.8
Leverage (Avg TA/Avg Equity)	1.4	1.5	1.5	1.5	1.5
Adjusted ROAE	27.2	29.0	30.6	33.5	34.4

Ratio Analysis

Y/E 31 Mar	FY21A	FY22A	FY23E	FY24E	FY25E
YoY growth (%)					
Revenue	10.7	21.1	22.8	15.8	14.0
EBITDA	25.4	12.7	13.5	22.9	14.5
Adjusted EPS	16.7	15.9	11.3	24.4	17.5
Profitability & Return ratios (%)					
EBITDA margin	27.8	25.9	23.9	25.4	25.5
EBIT margin	24.6	23.0	21.3	22.8	23.6
Adjusted profit margin	19.3	18.2	16.5	17.8	18.3
Adjusted ROAE	27.2	29.0	30.6	33.5	34.4
ROCE	36.3	37.3	39.5	40.6	41.2
Working capital days (days)					
Receivables	69	63	57	51	46
Inventory	0	0	0	0	0
Payables	144	146	135	124	116
Ratios (x)					
Gross asset turnover	3.9	4.6	5.6	6.3	6.9
Current ratio	2.1	1.6	1.8	2.0	2.2
Net interest coverage ratio	15.3	16.9	18.5	20.6	22.9
Adjusted debt/equity	(0.3)	(0.2)	(0.3)	(0.4)	(0.5)

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

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Recommendation scale: Recommendations and Absolute returns (%) over 12 months

BUY – Expected return >+15%

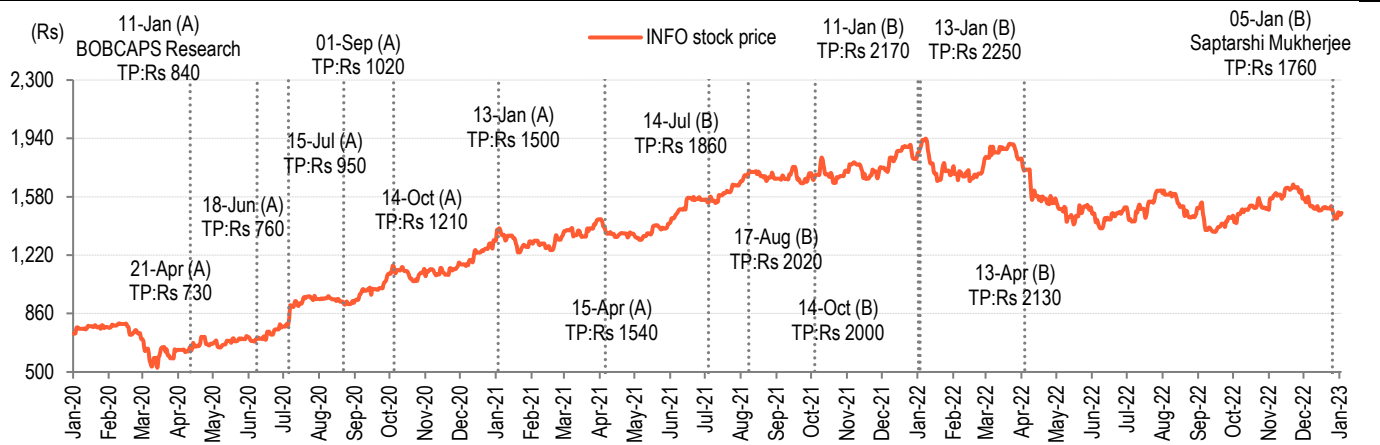
HOLD – Expected return from -6% to +15%

SELL – Expected return <-6%

Note: Recommendation structure changed with effect from 21 June 2021

Our recommendation scale does not factor in short-term stock price volatility related to market fluctuations. Thus, our recommendations may not always be strictly in line with the recommendation scale as shown above.

Ratings and Target Price (3-year history): INFOSYS (INFO IN)



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

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