

Moving up the pecking order

We upgrade Infosys (INFY) to BUY based on better visibility on growth, stable margin trajectory and the recent stock underperformance. Sustainable growth momentum and steady margin are premised on (1) Greater focus on large deals (77% YoY in 1H & broad-based on S&M velocity, partnerships), (2) Recovery in T25 and Large account mining, (3) Pricing lever in Digital, and (4) Completion of accelerated investment phase (localisation, innovation hubs, S&M). These are getting manifested in INFY's growth (400bps premium over sector avg. growth) and operational trajectory (EBIT% at lowest gap vs. TCS in 5-qtrs). The recent Analyst meet highlighted some key initiatives by INFY.

The stock correction and partial recovery (midway) following the whistleblower allegations (and clarifications) provide an opportunity with INFY available at its median valuations (at peak discount to TCS). Expect USD rev/EPS at 10/9% CAGR over FY19-22E and upgrade to BUY (NEU earlier) with TP of Rs 840, at 18x (unchanged) Sep-21E EPS.

Growth momentum intact

- INFY has sharpened focus to increase its share within large accounts (uptick in >USD 100mn and T25) supported by (1) Hiring of deal directors, and (2) Increased engagement with deal advisors/consultants.
- INFY is also chasing large public sector deals (APAC, Europe). Its partnership with Temasek and with Hitachi, Panasonic, Pasona in Japan are creating larger deal opportunities for the company in the APAC region.
- Senior leadership bandwidth has increased around large deals from a deal inception stage. INFY's sales teams have built industry themes in pursuit of large deals in areas of Network modernization/5G (CMT

vertical), Wealth management (BFS), S4HANA transformation (Retail), and Grid modernisation (Utilities).

Stable margin trajectory

- INFY's margin trajectory has lowered over last year (-200bps) following (1) Accelerated investments to step-up Digital (studios/delivery centers), (2) Increase in localisation, and (3) Investments in S&M (strengthening large deal/T100 teams). Automation extension to T&M contracts as compared to largely FP focus to also aid margins. We reckon that margin bottomed-out in 1QFY20 and expect a steady trajectory (21.7/22.2/22.2% for FY20/21/22E) as the investments start yielding results (resource mobilisation, better pricing in digital, automation, steady sub-con, onshore utilisations).
- INFY's cost optimisation is expected to yield USD 100-150mn benefit (+80-130bps margin impact) in FY20. Despite the onsite hiring push, the onsite effort-mix has been steady and further offshoring scope exists (on higher offshoring in core services and digital). The increase in pace of talent fulfillment (supplemented by stronger onshore delivery footprint) can optimise sub-contracting support.

Financial Summary

YE March (Rs bn)	FY18	FY19	FY20E	FY21E	FY22E
Net Revenue	705.22	826.76	911.21	1,016.30	1,141.47
EBIT	171.48	188.79	197.84	226.11	253.96
APAT	147.34	158.24	163.45	188.34	207.18
Diluted EPS (Rs)	34.6	37.2	38.4	44.3	48.7
P/E (x)	20.3	18.9	18.3	15.9	14.5
EV / EBITDA (x)	14.1	12.9	12.2	10.5	9.2
RoE (%)	22.0	24.4	25.7	28.7	28.6

Source: Company, HDFC sec Inst Research # Consolidated

INDUSTRY	IT
CMP (as on 15 Nov 2019)	Rs 704
Target Price	Rs 840
Nifty	11,895
Sensex	40,357

KEY STOCK DATA

Bloomberg	INFY IN
No. of Shares (mn)	4,258
MCap (Rs bn) / (\$ mn)	2,998/41,729
6m avg traded value (Rs mn)	7,903

STOCK PERFORMANCE (%)

	Rs 847/597		
	3M	6M	12M
Absolute (%)	(9.1)	(1.7)	7.8
Relative (%)	(17.3)	(10.4)	(6.6)

SHAREHOLDING PATTERN (%)

	Sep-19	Jun-19
Promoters	13.15	12.84
FIs & Local MFs	22.88	22.87
FPIs	33.45	34.04
Public & Others	30.52	30.25
Pledged Shares	0.00	0.00

Source : BSE

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Improved client mining (>USD 100mn, T25), Large deal focus (deal directors, consultants, senior management bandwidth), Partnerships boosting APAC wins & greater participation in large public sector deals are driving revenue momentum

Automation focus (extension to T&M), Pricing in digital, Optimising sub-con, Faster resource mobilisation (Lex platform), Improvement in onshore utilisation to support margins

Localisation initiatives

- INFY has hired 1,700 college grads overseas over the past year and has increased its localisation initiatives by launching local Digital centers across US and Europe (Romania). Investments in innovation hubs and greater client proximity are supporting the non-RFP based deals and having a positive impact on the traditional RFP-based deals.
- Infosys has opened 6 tech hubs & delivery centers in US that include (1) Phoenix-Arizona (Hi-tech, Mfg, BFS focus), (2) Hartford-Connecticut (Insurance & Healthcare, Mfg focus), (3) Indianapolis-Indiana (BFS, Mfg, Retail, Healthcare, Energy focus), (4) Raleigh-North Carolina (BFS, Life sciences focus), (5) Providence-Rhode Island and (6) Richardson-Texas (Telecom, Retail, BFS focus).

- Sub-contracting strategy to ensure fulfillment especially for shorter duration projects is expected to continue. We reckon that sub-contracting impact will remain steady following optimisation of onsite pyramid structure.

Employee training

- Key initiatives include digitising internal processes (Lex platform) that are resulting in optimising the deployment of resources and supporting re-training. The initiatives are also likely to reduce attrition further (-210bps QoQ in 2QFY20) with measures such as fast track promotions for top talent, increased leadership engagement with employees and programs for changing career streams.
- INFY has created 38 digital skill tags/certifications that are supporting employee re-training. The company has also created skill index for mid management to align performance to re-skilling.

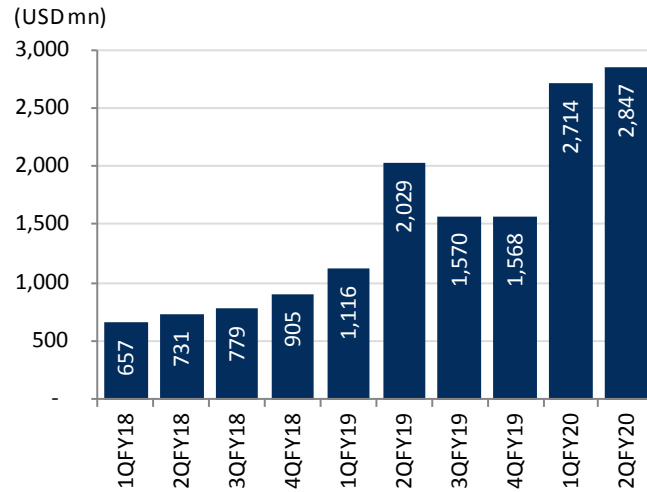
INFY's TCV of large deal wins have grown by 77% YoY in 1HFY20

Deal wins have been broad-based across verticals; BFSI, Mfg & Hi-tech verticals recorded high wins

INFY has outperformed (relatively) on large account mining over the past 2 yrs

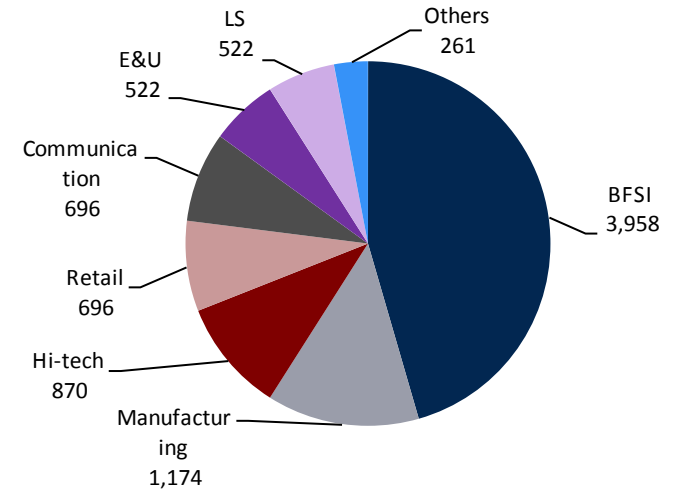
Growth acceleration in T25 accounts reflecting strength in account mining

Large Deal TCV Trend: 77% YoY In 1HFY20



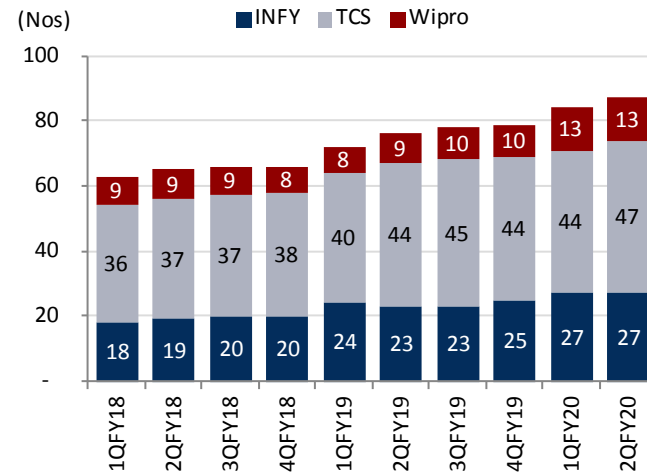
Source: Company, HDFC sec Inst Research, Includes Renewals & New deals >USD 50mn

Deal Wins By Verticals: Broad-based



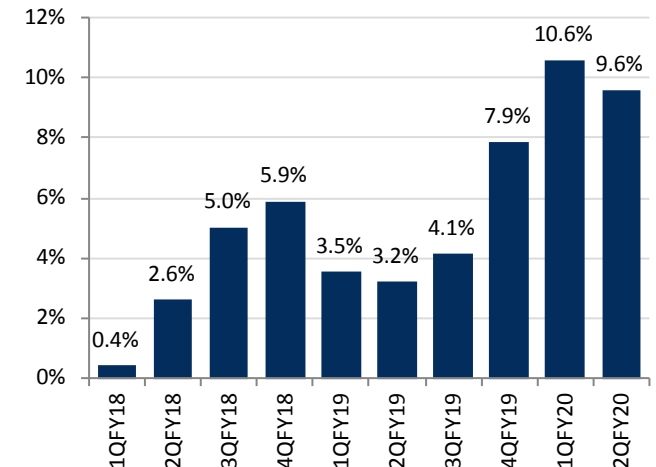
Source: Company, HDFC sec Inst Research, TTM Deals

Improving Trajectory Of >USD 100mn Clients (Nos)



Source: Company, HDFC sec Inst Research

Growth In T25 Accounts (YoY %)



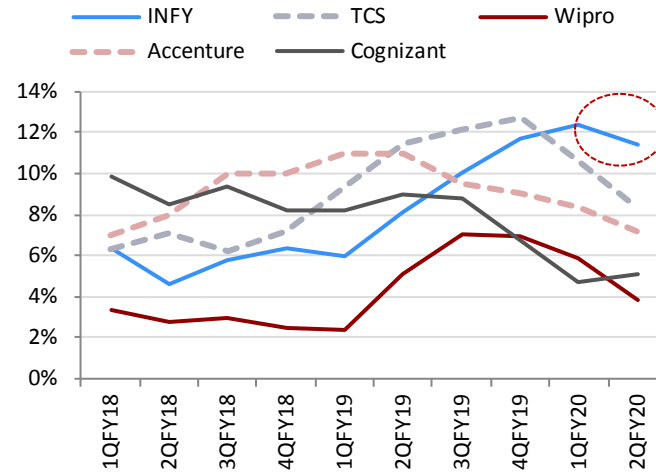
Source: Company, HDFC sec Inst Research

INFY leads peers on growth growing at 400bps premium over peers' (TCS, Wipro, Accenture, Cognizant) median growth

Recent relative outperformance in digital revenue growth

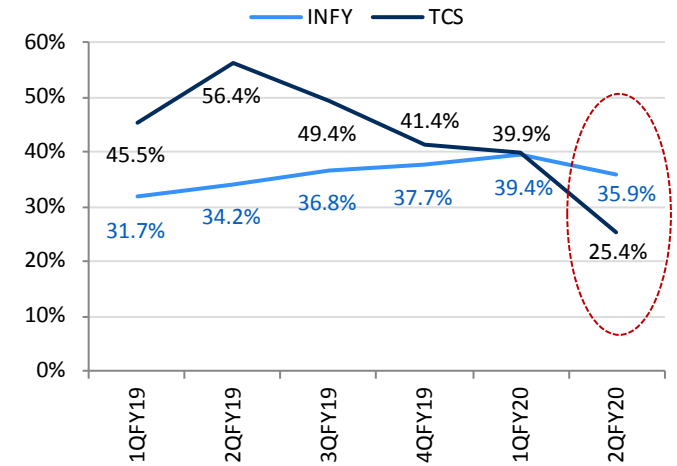
INFY's growth leadership in NorthAm and BFSI (Stater incl.) vs. peers

Revenue Trend vs. Peers (YoY % CC)



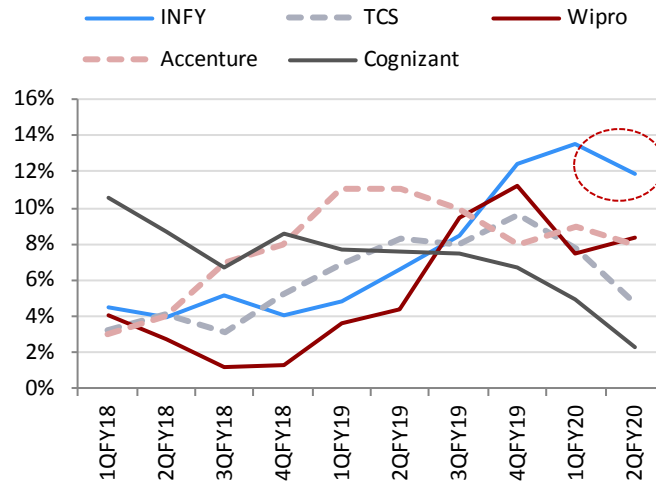
Source: Company, HDFC sec Inst Research

Growth In Digital Revenue (YoY %)



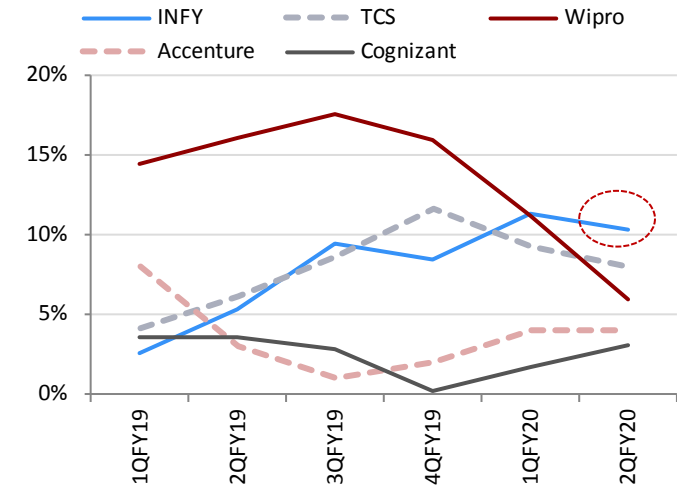
Source: Company, HDFC sec Inst Research, Trailing 6 qtrs

Growth In NorthAm (YoY %)



Source: Company, HDFC sec Inst Research

BFSI Revenue Trend vs. Peers (YoY % CC)



Source: Company, HDFC sec Inst Research, Trailing 6 qtrs

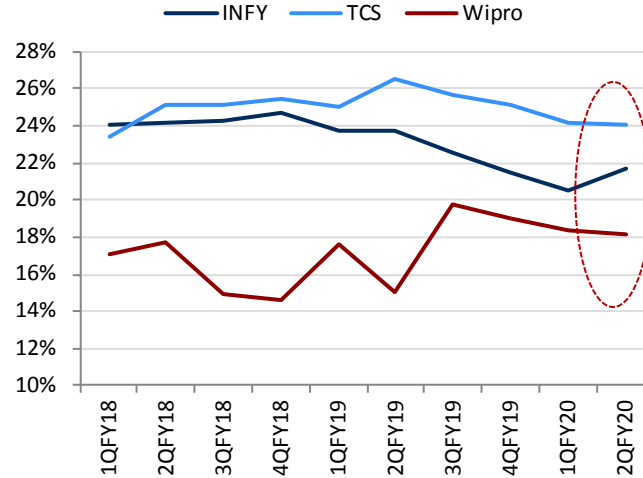
Margin trajectory improving on a relative basis, INFY's margin gap to TCS at -230bps is lowest in 5-qtrs

Steady onsite-offshore mix despite accelerated local hiring

Attrition at elevated levels but expected to moderate following multiple interventions (improved trajectory in 2Q)

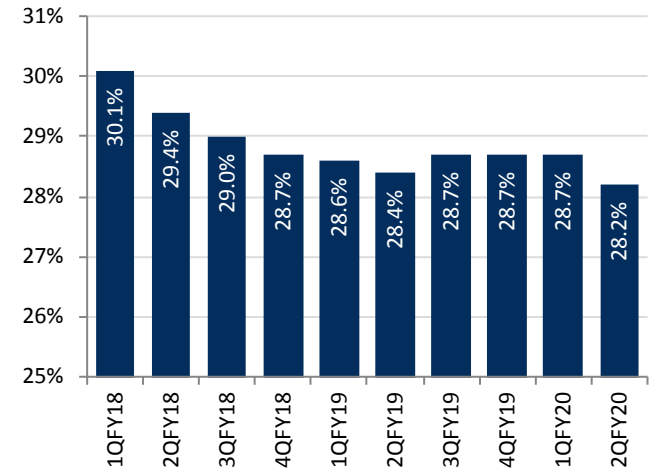
SG&A% has been steady despite accelerated investments reflecting strong cost management

EBIT Margin Trend vs. Peers (%)



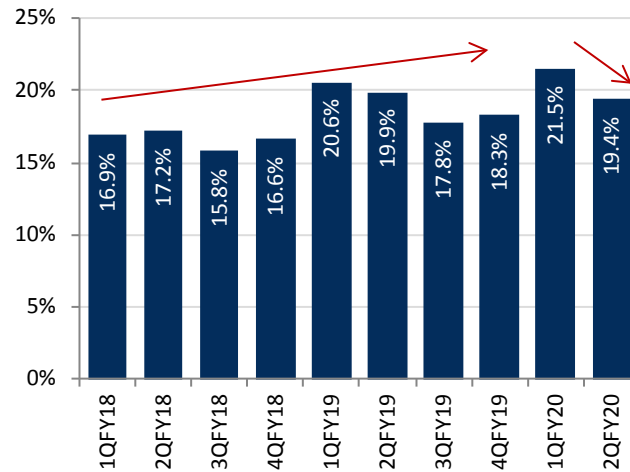
Source: Company, HDFC sec Inst Research

Onsite-Offshore Effort Mix Steady (%)



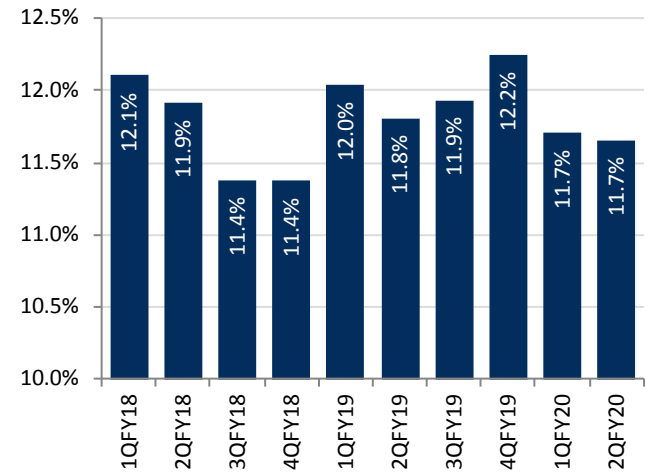
Source: Company, HDFC sec Inst Research

Attrition Trend (%)



Source: Company, HDFC sec Inst Research

Steady SG&A%



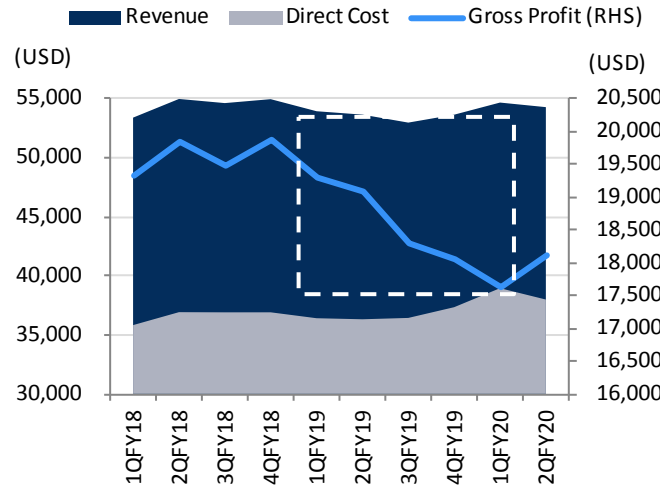
Source: Company, HDFC sec Inst Research, SG&A % of revenue

INFY's Direct cost per employee increased by 7% over 1QFY19-1QFY20, while revenue productivity increased by 1.4% resulting in 8.8% lower Gross Profit per employee

Improvement in Revenue productivity (digital bill rate, large deals ramps) and steady Direct cost per unit (completion of accelerated investment phase) will support margins

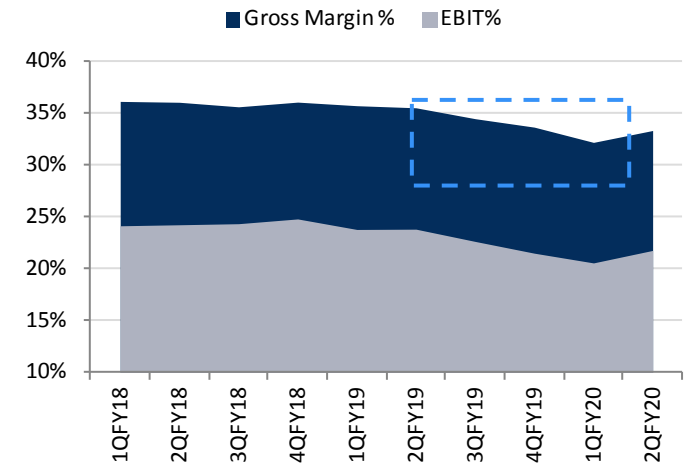
INFY at peak discount to TCS' valuations (at 28% vs. avg. of 15% discount) and at its 5/10-yr valuations

Unit Metrics Of Gross Profit Impacted By Increase in Direct Cost (USD)



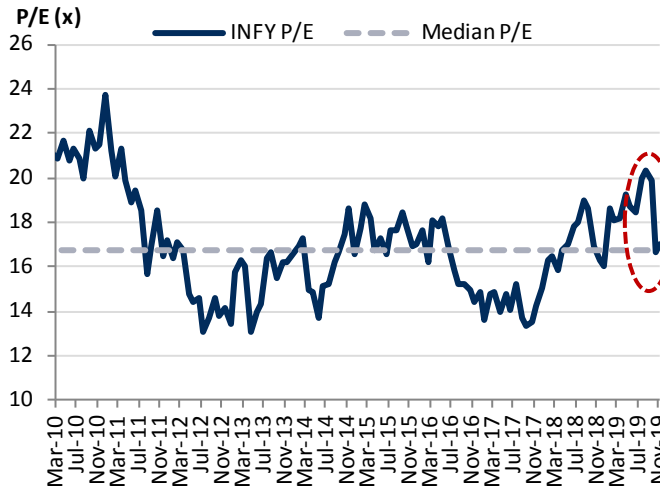
Source: Company, HDFC sec Inst Research

Gross Margin Led Impact On EBIT Margin (%)



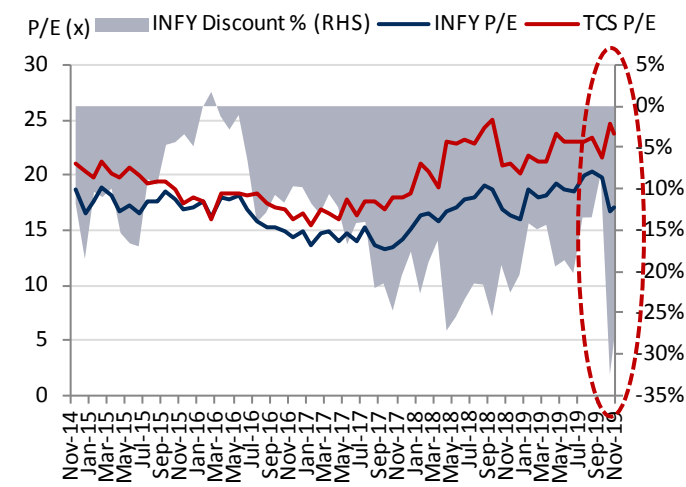
Source: Company, HDFC sec Inst Research

INFY Valuations At Historical Median (P/E)



Source: Bloomberg, HDFC sec Inst Research, 10 Years Trend

INFY At Peak Discount To TCS Valuations



Source: Bloomberg, HDFC sec Inst Research, 5 Years Trend

Our EPS est ahead of consensus by 2.5/3.2% for FY21/22E, respectively

Key risk include any adverse outcome from the investigation conducted by the independent law firm pertaining the whistleblower allegations, even as the Chairman re-iterated the sound governance policies

Change In Estimates

Particulars	Earlier estimates	Revised estimates	% change
	FY20E	FY20E	
Revenue (USD mn)	12,933	12,964	0.2
Revenue (Rsbn)	908.98	911.21	0.2
EBIT (Rsbn)	196.51	197.84	0.7
EBIT margin (%)	21.6	21.7	9bps
EPS (Rs)	38.2	38.4	0.6
	FY21E	FY21E	% change
Revenue (USD mn)	14,171	14,214	0.3
Revenue (Rsbn)	1,013.23	1,016.30	0.3
EBIT (Rsbn)	223.44	226.11	1.2
EBIT margin (%)	22.1	22.2	20bps
EPS (Rs)	43.8	44.3	1.1

Source: HDFC sec Inst Research

Assumptions

Particulars	FY16	FY17	FY18	FY19	FY20E	FY21E	FY22E
ITS volume growth (%)	14.5	10.2	6.0	11.1	8.8	8.2	8.4
ITS pricing change (%)	(4.7)	(2.7)	1.5	(2.6)	1.1	1.2	1.7
USD revenue growth (%)	9.1	7.4	7.2	7.9	9.9	9.6	10.0
USD/INR rate	65.69	67.09	64.47	70.07	70.29	71.50	73.00
EBIT margin (%)	25.0	24.7	24.3	22.8	21.7	22.2	22.2

Source: HDFC sec Inst Research

Peer Set Comparison

Company	MCap (Rs bn)	CMP (Rs)	TP (Rs)	RECO	EPS (Rs)				P/E (x)				RoE (%)			
					FY18	FY19	FY20E	FY21E	FY18	FY19	FY20E	FY21E	FY18	FY19	FY20E	FY21E
TCS	8,161	2,175	1,975	NEU	68.8	83.9	85.5	92.9	31.6	25.9	25.4	23.4	30.1	36.1	35.3	37.1
Infosys	2,996	704	840	BUY	34.6	37.2	38.4	44.3	20.3	18.9	18.3	15.9	22.0	24.4	25.7	28.7
Wipro	1,502	253	230	NEU	13.5	15.1	16.8	18.0	18.8	16.7	15.0	14.0	16.5	17.3	17.8	17.7
HCL Tech	1,551	1,144	1,250	BUY	64.7	74.6	74.0	83.0	17.7	15.3	15.5	13.8	25.3	26.0	22.2	21.7
TechM	743	752	850	BUY	43.2	48.9	47.6	52.9	17.4	15.4	15.8	14.2	21.5	22.0	20.2	20.6
Tier-1 IT Median									18.8	16.7	15.8	14.2	22.0	24.4	22.2	21.7
LTI	294	1,691	1,845	BUY	66.9	87.3	83.7	95.5	25.3	19.4	20.2	17.7	33.2	34.6	27.5	27.1
Mphasis	169	907	1,180	BUY	45.4	57.6	59.3	67.5	20.0	15.7	15.3	13.4	14.6	20.0	20.0	20.3
LTTS	148	1,422	1,705	BUY	45.5	68.0	74.0	88.4	31.2	20.9	19.2	16.1	27.7	32.0	28.4	28.5
Mindtree	114	693	760	NEU	32.3	44.1	36.4	47.9	21.4	15.7	19.1	14.5	21.4	24.9	17.3	22.9
Hexaware *	100	336	445	BUY	16.7	19.6	21.4	24.5	20.1	17.2	15.7	13.7	26.6	26.5	24.5	24.2
Cyient	45	397	485	NEU	38.6	43.6	39.3	42.1	10.3	9.1	10.1	9.4	18.1	19.5	16.5	16.2
Zensar	43	188	240	BUY	10.6	14.3	15.5	18.1	17.7	13.2	12.1	10.4	15.1	17.6	16.6	17.0
Persistent	50	652	670	BUY	42.3	47.8	44.6	48.2	15.4	13.6	14.6	13.5	16.0	15.7	14.1	14.7
Tata Elxsi	49	793	680	NR	38.5	46.6	38.6	45.1	20.6	17.0	20.6	17.6	37.0	34.5	23.7	24.0
Sonata	32	305	395	BUY	18.6	24.0	27.0	30.7	16.4	12.7	11.3	9.9	31.0	35.1	34.3	34.5
Intellect	19	145	288	BUY	3.5	7.7	4.6	8.7	41.0	19.0	31.3	16.8	6.7	11.1	5.8	10.0
eClerx	16	435	495	NR	74.0	61.7	53.6	54.6	5.9	7.0	8.1	8.0	24.1	17.6	14.4	14.9
Majesco	11	410	677	BUY	(1.5)	18.3	19.6	28.8	NM	22.4	20.9	14.2	NM	8.4	7.8	10.6
HGS	13	620	760	NR	96.5	84.6	85.3	101.2	6.4	7.3	7.3	6.1	10.5	8.5	11.2	11.8
Mastek	8	317	505	BUY	27.7	40.4	38.3	42.7	11.5	7.9	8.3	7.4	13.7	16.1	12.9	13.0
Tier-2 IT Median									18.8	14.5	15.6	12.6	21.1	21.5	18.3	19.3

Company	MCap (USD bn)	CMP (USD)	TP	RECO	EPS (USD)				P/E (x)				RoE (%)			
					FY18	FY19E	FY20E	FY21E	FY18	FY19E	FY20E	FY21E	FY18	FY19E	FY20E	FY21E
Accenture	132	196	NA	NR	5.6	6.5	7.8	8.6	35.3	30.4	25.1	22.9	41.7	42.0	34.9	35.0
Cognizant	35	63	NA	NR	2.5	3.6	4.0	4.3	24.8	17.5	15.9	14.7	14.1	19.0	19.0	20.4
Capgemini^	18	106	NA	NR	4.9	4.4	6.5	7.2	21.6	24.2	16.1	14.8	11.5	10.1	13.4	13.6
Global IT Median									27.3	24.0	19.1	17.4	22.4	23.7	22.4	23.0

Source: HDFC sec Inst Research, Bloomberg, *Dec YE, ^CMP and EPS in EUR terms, NR is Not Rated and TP implies Fair Value

Consolidated Income Statement

YE March (Rs bn)	FY18	FY19	FY20E	FY21E	FY22E
Net Revenues (US \$mn)	10,939	11,799	12,964	14,214	15,637
<i>Growth (%)</i>	<i>7.2</i>	<i>7.9</i>	<i>9.9</i>	<i>9.6</i>	<i>10.0</i>
Net Revenues	705.22	826.76	911.21	1,016.30	1,141.47
<i>Growth (%)</i>	<i>3.0</i>	<i>17.2</i>	<i>10.2</i>	<i>11.5</i>	<i>12.3</i>
Software development	432.69	518.58	582.88	651.37	733.98
SG&A expense	82.43	99.29	102.29	107.86	119.93
EBITDA	190.10	208.89	226.05	257.07	287.55
Depreciation	18.62	20.10	28.20	30.96	33.59
EBIT	171.48	188.79	197.84	226.11	253.96
<i>EBIT (%)</i>	<i>24.3</i>	<i>22.8</i>	<i>21.7</i>	<i>22.2</i>	<i>22.2</i>
<i>EBIT Growth (%)</i>	<i>1.5</i>	<i>10.1</i>	<i>4.8</i>	<i>14.3</i>	<i>12.3</i>
Other Income	33.11	21.61	27.04	32.79	30.58
Interest	-	-	1.66	1.68	1.68
PBT	204.59	210.40	223.22	257.22	282.86
Tax (incl deferred)	42.42	56.31	59.19	68.16	74.96
RPAT	162.17	154.03	163.45	188.34	207.18
E/o (adj for tax)	14.83	(4.21)	-	-	-
APAT	147.34	158.24	163.45	188.34	207.18
<i>APAT Growth (%)</i>	<i>2.7</i>	<i>7.4</i>	<i>3.3</i>	<i>15.2</i>	<i>10.0</i>
EPS	34.6	37.2	38.4	44.3	48.7
<i>EPS Growth (%)</i>	<i>2.7</i>	<i>7.4</i>	<i>3.3</i>	<i>15.2</i>	<i>10.0</i>

Source: Company, HDFC sec Inst Research

Consolidated Balance Sheet

YE March (Rs bn)	FY18	FY19	FY20E	FY21E	FY22E
SOURCES OF FUNDS					
Share Capital - Equity	10.88	21.70	21.21	21.21	21.21
Reserves	638.35	627.78	602.60	667.52	741.41
Total Shareholders' Funds	649.23	649.48	623.81	688.73	762.62
Minority Interest	0.01	0.58	0.58	0.58	0.58
Lease liability	-	-	38.32	38.32	38.32
Net Deferred Taxes	(7.41)	(7.00)	(7.00)	(7.00)	(7.00)
Long Term Provisions & Others	6.44	4.22	4.22	4.22	4.22
TOTAL SOURCES OF FUNDS	648.27	647.28	659.93	724.85	798.74
APPLICATION OF FUNDS					
Net Block	101.16	114.79	146.22	150.34	157.41
CWIP	16.06	13.88	13.88	13.88	13.88
Goodwill & Other Intangible Assets	24.58	42.31	43.02	43.90	44.94
Other Non-current Assets	88.94	89.97	90.22	90.52	90.89
Total Non Current Assets	232.90	262.34	294.72	300.03	308.51
Cash & Equivalents	317.65	306.90	274.90	326.22	381.76
Debtors	131.42	148.27	163.42	182.26	204.71
Other Current Assets	104.11	116.15	130.71	141.85	155.12
Total Current Assets	235.53	264.42	294.12	324.11	359.82
Creditors	6.94	16.55	18.24	20.34	22.85
Other Current Liabilities & Provns	130.87	169.83	185.58	205.17	228.51
Total Current Liabilities	137.81	186.38	203.82	225.52	251.36
Net Current Assets	97.72	78.04	90.31	98.59	108.46
TOTAL APPLICATION OF FUNDS	648.27	647.28	659.93	724.85	798.74

Source: Company, HDFC sec Inst Research

Consolidated Cash Flow

YE March (Rs bn)	FY18	FY19	FY20E	FY21E	FY22E
Reported PBT	204.59	210.40	223.22	257.22	282.86
Non-operating & EO items	(21.70)	(13.77)	(19.87)	(24.10)	(22.48)
Interest expenses	-	-	1.66	1.68	1.68
Depreciation	18.62	20.10	28.20	30.96	33.59
Working Capital Change	0.84	(4.53)	(23.36)	(14.70)	(12.33)
Tax paid	(68.29)	(68.32)	(59.19)	(68.16)	(74.96)
OPERATING CASH FLOW (a)	134.06	143.88	150.67	182.89	208.37
Capex	(19.98)	(24.45)	(24.01)	(35.08)	(40.66)
Free cash flow (FCF)	114.08	119.43	126.65	147.81	167.71
Investments	0.59	0.77	-	-	-
Non-operating income	21.70	13.77	19.87	24.10	22.48
INVESTING CASH FLOW (b)	2.31	(9.91)	(4.15)	(10.98)	(18.18)
FCFE	114.08	119.43	124.99	146.13	166.03
Share capital Issuance	0.05	0.06	-	-	-
Dividend/Buyback	(205.10)	(145.18)	(188.63)	(123.42)	(133.29)
FINANCING CASH FLOW (c)	(205.05)	(145.12)	(190.29)	(125.10)	(134.97)
NET CASH FLOW (a+b+c)	(68.68)	(11.15)	(43.77)	46.81	55.22
Closing Cash & Equivalents	317.65	306.90	274.90	326.22	381.76

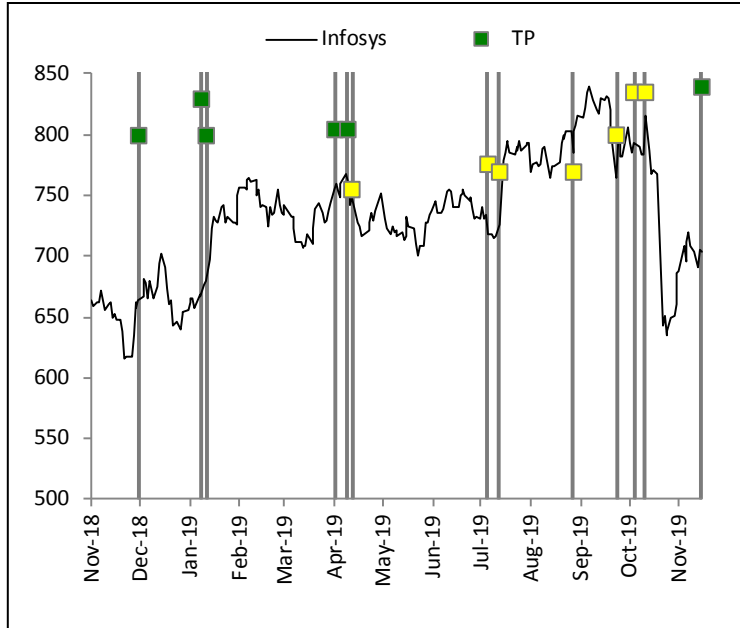
Source: Company, HDFC sec Inst Research

Key Ratios

	FY18	FY19	FY20E	FY21E	FY22E
PROFITABILITY (%)					
EBIT Margin	24.3	22.8	21.7	22.2	22.2
APAT Margin	23.0	18.6	18.0	18.6	18.2
RoE	22.0	24.4	25.7	28.7	28.6
RoIc or Core RoCE	43.1	41.2	40.1	42.4	45.8
RoCE	22.1	24.4	25.0	27.2	27.2
EFFICIENCY					
Tax Rate (%)	20.7	26.8	26.5	26.5	26.5
Fixed Asset Turnover (x)	3.4	3.4	2.9	3.2	3.4
Debtors (days)	68	65	65	65	65
Other Current assets (days)	54	51	52	51	50
Payables (days)	4	7	7	7	7
Other Current liabilities (days)	68	75	74	74	73
Cash Conversion Cycle (days)	51	34	36	35	35
Net Debt/EBITDA (x)	(0.7)	(0.7)	(0.6)	(0.6)	(0.6)
Net Debt/Equity (x)	(0.2)	(0.2)	(0.2)	(0.2)	(0.2)
Interest Coverage (x)	N.A.	N.A.	119	135	151
PER SHARE DATA					
EPS (Rs/sh)	34.6	37.2	38.4	44.3	48.7
CEPS (Rs/sh)	38.1	41.0	44.0	50.4	55.3
DPS (Rs/sh)	16.8	21.5	23.0	25.0	27.0
BV (Rs/sh)	149.1	149.2	143.3	158.2	175.2
VALUATION					
P/E	20.3	18.9	18.3	15.9	14.5
P/BV	4.7	4.7	4.9	4.4	4.0
EV/EBITDA	14.1	12.9	12.2	10.5	9.2
OCF/EV (%)	5.0	5.4	5.5	6.8	7.9
FCF/EV (%)	4.3	4.4	4.6	5.5	6.3
FCFE/mkt cap (%)	3.8	4.0	4.2	4.9	5.5
Dividend Yield (%)	2.4	3.1	3.3	3.6	3.8

Source: Company, HDFC sec Inst Research

RECOMMENDATION HISTORY



Date	CMP	Reco	Target
30-Nov-18	661	BUY	800
8-Jan-19	670	BUY	830
12-Jan-19	684	BUY	800
1-Apr-19	742	BUY	805
09-Apr	767	BUY	805
13-Apr-19	748	NEU	755
5-Jul-19	718	NEU	775
13-Jul-19	727	NEU	770
27-Aug-19	803	NEU	770
22-Sep-19	805	NEU	800
4-Oct-19	786	NEU	835
12-Oct-19	816	NEU	835
18-Nov-19	704	BUY	840

Rating Definitions

- BUY : Where the stock is expected to deliver more than 10% returns over the next 12 month period
- NEUTRAL : Where the stock is expected to deliver (-)10% to 10% returns over the next 12 month period
- SELL : Where the stock is expected to deliver less than (-)10% returns over the next 12 month period

Disclosure:

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