Larsen & Toubro Infotech (LTINFO)

ICICI direct Research

CMP: ₹ 3105 | Target: ₹ 3570 (15%) | Target Period: 12 months | BUY

October 22, 2020

Deal pipeline continues to be healthy…

Larsen & Toubro Infotech (LTI) reported a healthy set of Q2FY21 numbers both on the revenues and margins front. Constant currency dollar revenues increased 2.3% QoQ (above our estimate of 1.5% QoQ) while margins increased 279 bps QoQ to 22.9% (above our estimate of 20.5%) mainly led by higher offshoring and increase in utilisation. Digital (41% of revenues) grew 5.8% QoQ, 18.4% YoY. The company has also won a large deal with net new TCV in excess of US$40 million in analytics.

Digital prowess, ability to win large deals key positives

LTI is expected to be a key beneficiary of recent trends of multi-year technology transformation phase. The company's ability to deliver end to end solution right from cloud migration, core modernisation, data analytics and customer experience will lead to healthy traction in revenues over the coming years. In addition, the company's ability to win large deals, effectively mine clients, adding fortune 500 clients and acquire new clients will enable the company to deliver industry leading revenue growth in coming years. The company has won US$40 million large deal and its deal pipeline is up 22% YoY. Based on the order book, expectation of a ramp up in H2FY21E, vendor consolidation opportunity and digital acceleration, we expect the company to register 7.4% YoY growth in dollar revenues in FY21E. Further, we expect LTI to register 15% YoY growth in FY22E and FY23E each led by recovery across verticals.

Cost rationalisation, offshoring to keep margins robust

The company registered healthy growth in margins, up 279 bps QoQ, led by higher utilisation, increase in offshoring, higher working days and operational efficiencies. The company plans to give wage hike in coming quarters but despite wage hike the company is confident of maintaining PAT margins in the range of 14-15% in FY21E. In addition, with operating efficiencies and offshoring, we expect the company to maintain healthy margin trajectory in FY21E and FY22E.

Valuation & Outlook

LTI is expected to be a key beneficiary of recent trends of multi-year technology transformation phase. In addition, the company's ability to win large deals, effectively mine clients, adding Fortune 500 clients and acquire new clients will enable it to deliver industry leading revenue growth in coming years. This, coupled with a healthy margin performance prompt us to revise our EPS estimates upwards. Hence, we upgrade the stock from HOLD to **BUY** with a revised target price of ₹ 3,570 (24x FY23E EPS).

LTI Let's Solve

Particulars

Particular	Amount
Market Cap	₹ 53903 crore
Total Debt	₹ 32 crore
Cash and Invests	₹ 2744 crore
EV	₹ 51191 crore
52 week H/L	3515 / 1208
Equity Capital	₹ 17 crore
Face Value	₹ 1

Key Highlights

- LTI's ability to deliver end to end solution right from cloud migration, core modernisation, data analytics and customer experience will lead to healthy traction in revenues over the coming years
- Cost rationalisation, offshoring to keep margins healthy
- Upgrade stock from HOLD to BUY

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Result Update

ICICI Securities – Retail Equity Research

Key Financial Summary

(₹ Crore)	FY19	FY20	FY21E	FY22E	FY23E	CAGR (FY20-23E)
Net Sales	9,445.8	10,878.6	12,122.7	13,964.5	16,315.8	14.5%
EBITDA	1,883.4	2,029.4	2,618.0	3,021.4	3,571.6	20.7%
EBITDA Margins (%)	19.9	18.7	21.6	21.6	21.9	
Net Profit	1,515.5	1,520.5	1,859.4	2,191.6	2,565.9	19.1%
EPS (₹)	87.3	86.6	105.9	124.8	146.2	
P/E (x)	35.6	35.9	29.3	24.9	21.2	
RoE (%)	31.0	28.1	28.3	28.0	27.5	
RoCE (%)	40.4	30.7	31.8	31.3	30.9	

Source: Company, ICICI Direct Research

Exhibit 1: Variance Analysis

	Q2FY21	Q2FY21E	Q2FY20	YoY (%)	Q1FY21	QoQ (%)	Comments
Revenue	2,998.4	2,982.2	2,570.7	16.6	2,949.2	1.7	Constant currency (CC) revenues increased 2.3% QoQ mainly led by banking financial services (up 9.5% QoQ), manufacturing (5.4% QoQ) and others (up 6.7% QoQ) partially offset by Insurance (down 4.1% QoQ) and high-tech, media & entertainment (down 5.3% QoQ)
Employee expenses	1,953.7	2,004.1	1,752.5	11.5	1,991.6	-1.9	
Gross Margin	1,044.7	978.2	818.2	27.7	957.6	9.1	
Gross margin (%)	34.8	32.8	31.8	301 bps	32.5	237 bps	
Other expenses	359.1	366.8	352.4	1.9	365.6	-1.8	
EBITDA	685.6	611.4	465.8	47.2	592.0	15.8	
EBITDA Margin (%)	22.9	20.5	18.1	475 bps	20.1	279 bps	EBITDA margins expanded 279 bps QoQ due to higher utilisation (up 240 bps QoQ) and offshoring (up 270 bps QoQ to 53.5%)
Depreciation & amort	89.9	78.1	66.4	35.4	78.1	15.1	
EBIT	595.7	533.3	399.4	49.1	513.9	15.9	
EBIT Margin (%)	19.9	17.9	15.5	433 bps	17.4	244 bps	
Other income	17.4	31.0	73.9	-76.5	45.0	-61.3	
PBT	613.1	564.3	473.3	29.5	558.9	9.7	
Tax paid	156.3	143.9	113.0	38.3	142.5	9.7	
PAT	456.8	420.4	360.3	26.8	416.4	9.7	PAT was higher than our expectation mainly led by better performance at operating level

Source: Company, ICICI Direct Research

Exhibit 2: Change in estimates

	FY21E			FY22E			FY23E	Comments
(₹ Crore)	Old	New	% Change	Old	New	% Change	Introduced	
Revenue	11,902	12,123	1.9	13,408	13,965	4.2	16,316	Expect acceleration in digital technologies to drive revenue growth
EBITDA	2,364	2,618	10.7	2,718	3,021	11.2	3,572	
EBITDA Margin (%)	19.9	21.6	173 bps	20.3	21.6	136 bps	21.9	Expect margins to stabilise at 21.9% in FY23E
PAT	1,705	1,859	9.1	1,995	2,192	9.9	2,566	
EPS (₹)	97.1	105.9	9.1	113.6	124.8	9.9	146.2	

Source: Company, ICICI Direct Research

Conference Call Highlights

- **FY21E outlook:** LTI is seeing healthy traction in banking, financial services, manufacturing, CPG, retail, pharma and hi tech, media & entertainment. The company has added one Fortune 500 client in CPG, retail, pharma which will drive growth in coming quarters. In addition, LTI expect hi tech, media & entertainment to post improving growth in coming quarters. Further, the company's top client (in BFSI) continues to grow and is expected to do so in coming quarters. The company expects pricing pressure, delay in deal ramp up, large deal deferrals and new logos in the near term. LTI expects Q3FY21E revenues to surpass Q4FY20 revenues. The company's deal pipeline continues to be robust and is up 22.0% YoY. Based on the order book, expectation of a ramp up in H2FY21E, vendor consolidation opportunity and digital acceleration, the company expects FY21E revenues to exhibit industry leading growth
- **Margins:** The company registered healthy growth in margins, up 279 bps QoQ led by higher utilisation, increase in offshoring, higher working days and operational efficiencies. LTI plans to give wage hike in coming quarters but despite wage hike the company is confident of maintaining PAT margins in the range of 14-15%. In addition, with operating efficiencies, we expect the company to maintain healthy margin trajectory in FY21E and FY22E
- **Digital business:** Digital business, now comprising 42% of revenues in Q2FY21, saw an increase of 5.8% QoQ (up 18.4% YoY) in the quarter
- **Vertical commentary:** This quarter the company saw healthy growth in BFSI led healthy growth in top client. Manufacturing is seeing healthy recovery and the company added one Fortune 500 client in CPG, retail & pharma segment. The company saw a decline in hi tech and media mainly led by re prioritisation of work in one client and is expected to improve, going forward. The company expects energy & utility to remain tepid in the quarter
- **Deal wins:** The company won one large deal in the quarter of US$40 million. The deal pipeline is up 22.0% YoY. LTI added 26 new logos and expects a few more logos in the next few quarters. The company is also seeing a vendor consolidation opportunity
- **Employee details:** The company added 978 employees in Q2FY21 taking the total employee count to 32,455. The management indicated at a continuous up-tick of its fresher hiring from top colleges. LTI's attrition dipped 170 bps to 13.5% while utilisation (ex-trainees) increased 240 bps QoQ to 82.0%
- **Other highlights:** DSO days (including unbilled) declined by five days QoQ to 94. The company added two clients in the US$5 million bucket and two clients in the US$10 million bucket. Cloud has seen huge adoption across sectors. The company has added one Fortune 500 clients in the quarter taking the total to 61

Key Metrics

Exhibit 3: Geography wise break-up

	Q2FY20	Q3FY20	Q4FY20	Q1FY21	Q2FY21
Revenue by geography (%)					
North America	68.7	69.5	68.9	70.8	68.7
Europe	16.4	15.6	15.1	14.4	16.1
India	6.0	7.6	8.1	7.9	8.2
ROW	8.9	7.4	7.8	6.9	6.9
Growth QoQ (%)					
North America	2.0	9.7	3.0	-2.2	0.6
Europe	4.6	3.1	0.6	-9.2	15.9
India	-11.3	37.3	10.8	-7.1	7.6
ROW	6.8	-9.9	9.5	-15.8	3.6

Source: Company, ICICI Direct Research

Revenue growth across geographies in quarter and led by Europe

Exhibit 4: Vertical wise break-up

	Q2FY20	Q3FY20	Q4FY20	Q1FY21	Q2FY21
Revenue by vertical (%)					
BFS	27.1	27.8	27.6	27.7	29.9
Insurance	18.7	17.7	16.8	17.2	16.0
Manufacturing	16.4	17.5	18.0	15.8	16.2
Energy &Utilities	12.1	11.3	11.4	10.8	10.6
CPG,Retail&Pharma	11.5	11.2	11.2	11.5	11.0
HTME	10.8	10.8	11.0	11.6	10.6
Others	3.5	3.7	4.0	5.4	5.7
Growth QoQ (%)					
BFS	-0.2	11.2	3.2	-4.4	11.9
Insurance	5.4	2.6	-1.4	-2.5	-3.6
Manufacturing	10.1	15.7	6.9	-16.4	6.3
Energy & Utilities	15.4	1.2	4.8	-9.8	1.7
CPG, Retail & Pharma	5.7	5.6	3.9	-2.2	-0.9
HTME	-11.8	8.4	5.9	0.4	-5.3
Others	-22.4	14.6	12.4	28.5	9.4

Source: Company, ICICI Direct Research; HTME: High-Tech, Media & Entertainment

Growth in revenues mainly led by manufacturing, BFS

Exhibit 5: Service offering wise break-up

	Q2FY20	Q3FY20	Q4FY20	Q1FY21	Q2FY21
Revenue by service offering (%)					
ADM*	36.1	35.8	34.7	35.6	36.0
Enterprise Solutions	29.5	28.7	32.5	29.7	30.8
IMS	11.1	11.5	12.6	13.6	14.4
Analytics, AI & Cognitive	11.3	12.8	11.6	12.5	10.6
EIM	9.0	8.5	8.7	8.6	8.3
Growth QoQ (%)					
ADM	-3.3	7.5	0.7	-2.3	4.8
Enterprise Solutions	-4.4	5.5	17.7	-13.0	7.5
IMS	3.9	12.3	13.9	2.8	9.7
Analytics, AI & Cognitive	3.0	22.8	-5.8	2.6	-12.1
EIM	12.0	2.4	6.4	-5.9	0.0

*Source: Company, ICICI Direct Research; *ADM: Application Development Maintenance is now combined with testing hence certain quarters are not comparable, IMS: Infrastructure Management Services, EIM: Enterprise Integration & Mobility*

Infrastructure management services (IMS), Enterprise solution and Application Development & Maintenance (ADM) drove revenues in the quarter

Exhibit 6: Client & human resource matrix

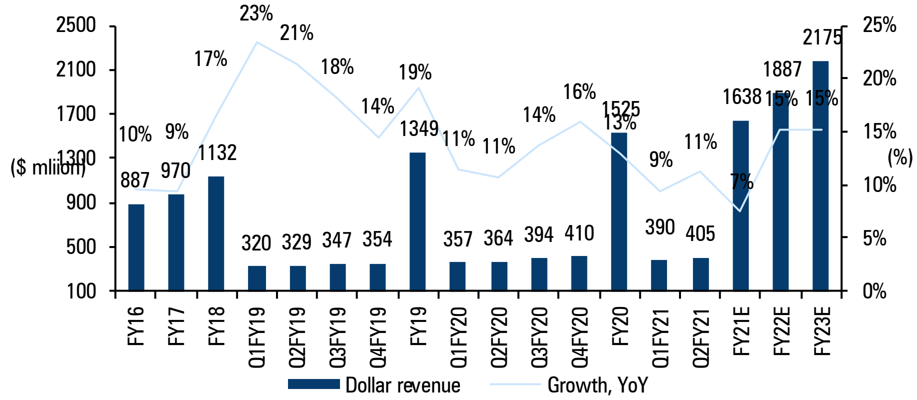
	Q2FY20	Q3FY20	Q4FY20	Q1FY21	Q2FY21
5 Million dollar +	48	48	53	59	61
10 Million Dollar +	27	28	27	30	32
20 Million dollar +	18	18	16	16	16
50 Million dollar +	6	6	6	6	6
100 Million dollar +	1	1	1	1	1
Total Headcount	30979	31419	31437	31477	32455
Utilisation	80.6	81.3	80.6	79.6	82.0
Attrition	18.4	17.7	16.5	15.2	13.5

Source: Company, ICICI Direct Research

The company added two clients in US$5 million plus category and US$10 million plus category; Utilisation increased 240 bps QoQ to 82.0%

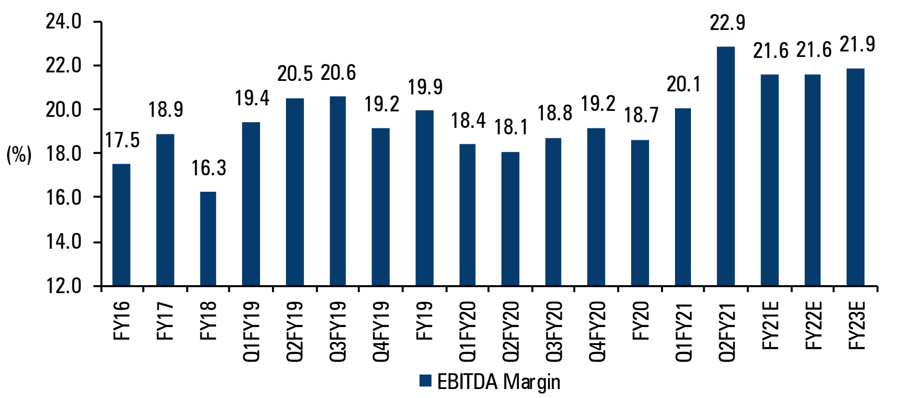
Financial story in charts

Exhibit 7: Dollar revenues may grow at 12.6% CAGR in FY20-23E



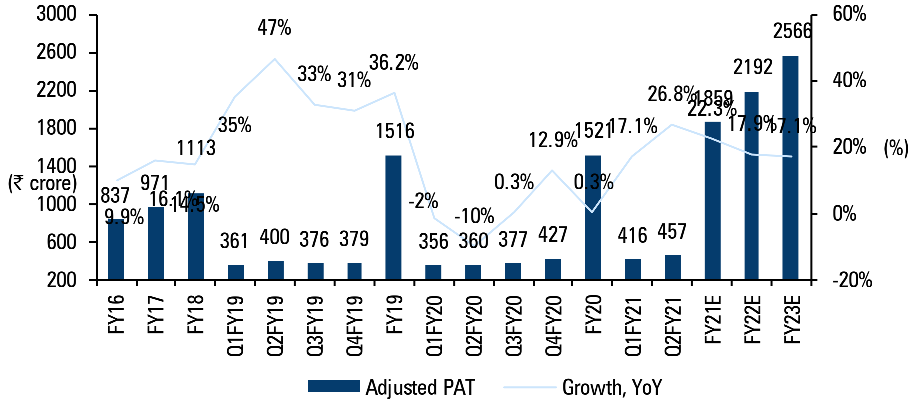
Source: Company, ICICI Direct Research

Exhibit 8: Revise our margin estimates



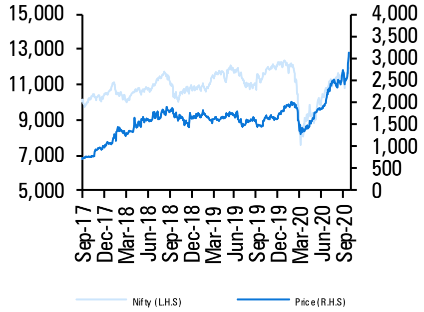
Source: Company, ICICI Direct Research

Exhibit 9: PAT trend



Source: Company, ICICI Direct Research

Exhibit 10: Three-year chart



Source: Company, ICICI Direct Research

Financial summary

Exhibit 11: Profit and loss statement ₹ crore

(Year-end March)	FY20	FY21E	FY22E	FY23E
Total Revenues	**10,879**	**12,123**	**13,965**	**16,316**
Growth (%)	15.2	11.4	15.2	16.8
Employee costs	7,359	7,965	9,142	10,623
Total Operating Expenditure	8,849	9,505	10,943	12,744
EBITDA	**2,029**	**2,618**	**3,021**	**3,572**
Growth (%)	7.8	29.0	15.4	18.2
Depreciation & Amortization	273	315	363	424
Other Income (net)	247	176	244	244
PBT before Exceptional Items	2,003	2,479	2,903	3,392
Growth (%)	(1.2)	23.8	17.1	16.8
Tax	482	620	711	826
PAT before Exceptional Items	1,521	1,859	2,192	2,566
PAT	**1,521**	**1,859**	**2,192**	**2,566**
Growth (%)	0.3	22.3	17.9	17.1
Diluted EPS	86.6	105.9	124.8	146.2
EPS (Growth %)	(0.8)	22.3	17.9	17.1

Source: Company, ICICI Direct Research

Exhibit 12: Cash flow statement ₹ crore

(Year-end March)	FY20	FY21E	FY22E	FY23E
PBT	2,003	2,479	2,903	3,392
Add: Depreciation	273	315	363	424
(Inc)/Dec in current assets	(592)	(264)	(391)	(500)
Inc/(Dec) in current liabilities	360	123	183	233
CF from operations	**1,644**	**1,976**	**2,288**	**2,649**
(Inc)/dec in other investments	(357)	(689)	(664)	(628)
(Inc)/dec in Fixed Assets	(243)	(275)	(316)	(370)
Other investing cash flow	6	5	8	12
CF from investing Activities	**(652)**	**(959)**	**(972)**	**(986)**
Issue of equity	-	-	-	-
Inc/(dec) in loan funds	(178)	(0)	0	0
Dividend paid & dividend tax	(568)	(701)	(920)	(1,078)
Others	(4)	-	-	-
CF from Financial Activities	**(890)**	**(701)**	**(920)**	**(1,078)**
Net cash flow	102	316	395	586
Effect of exchange rate change	9	-	-	-
Opening cash	415	525	841	1,236
Closing cash	**525**	**841**	**1,236**	**1,823**

Source: Company, ICICI Direct Research

Exhibit 13: Balance sheet ₹ crore

(Year-end March)	FY20	FY21E	FY22E	FY23E
Liabilities				
Equity	17	17	17	17
Reserves & Surplus	5,387	6,545	7,816	9,304
Networth	5,404	6,562	7,834	9,322
Long term Liabilties & provisioi	1,089	1,212	1,395	1,628
Total Debt	32	32	32	32
Source of funds	**6,526**	**7,807**	**9,261**	**10,983**
Assets				
Net fixed assets	1,211	1,192	1,171	1,147
Net intangible assets	132	109	84	54
Goodwill	637	637	637	637
Other non current assets	517	576	664	775
Unbilled revenue	442	493	567	663
Debtors	2,312	2,577	2,968	3,468
Current Investments	2,219	3,019	3,819	4,619
Cash & Cash equivalents	525	841	1,236	1,823
Other current assets	831	926	1,067	1,246
Trade payables	695	774	892	1,042
Current liabilities	1,604	1,788	2,059	2,406
Application of funds	**6,526**	**7,807**	**9,261**	**10,983**

Source: Company, ICICI Direct Research

Exhibit 14: Key ratios ₹ crore

(Year-end March)	FY20	FY21E	FY22E	FY23E
Per share data (₹)				
EPS	86.6	105.9	124.8	146.2
Cash Per Share	30.2	48.1	70.7	104.3
BV	307.8	373.8	446.2	531.0
DPS	28.0	40.1	52.7	61.6
Operating Ratios (%)				
EBITDA Margin	18.7	21.6	21.6	21.9
PBT Margin	18.4	20.5	20.8	20.8
PAT Margin	14.0	15.3	15.7	15.7
Turnover Ratios				
Debtor days	78	78	78	78
Creditor days	23	23	23	23
Return Ratios (%)				
RoE	28.1	28.3	28.0	27.5
RoCE	30.7	31.8	31.3	30.9
RoIC	46.4	58.3	63.2	69.3
Valuation Ratios (x)				
P/E	35.9	29.3	24.9	21.2
EV / EBITDA	25.2	19.1	16.2	13.3
Market Cap / Sales	5.0	4.4	3.9	3.3
Solvency Ratios				
Current Ratio	1.6	1.6	1.6	1.6
Quick Ratio	1.4	1.4	1.4	1.4

Source: Company, ICICI Direct Research

Exhibit 15: ICICI Direct coverage universe (IT)

Company	Cmp (₹)	TP (₹)	Rating	Mcap (₹ Cr)	EPS (₹)				P/E (x)				RoCE (%)				RoE (%)			
					FY20	FY21E	FY22E	FY23E	FY20	FY21E	FY22E	FY23E	FY20	FY21E	FY22E	FY23E	FY20	FY21E	FY22E	FY23E
HCL Tech (HCLTEC)	871	960	Buy	2,36,386	40.8	45.2	52.2	59.3	21	19	17	15	23.0	23.6	24.5	24.7	21.6	20.5	20.7	20.4
Infosys (INFTEC)	1,148	1,350	Buy	4,89,618	38.9	45.9	49.2	56.4	30	25	23	20	30.8	33.5	33.3	35.3	25.2	27.2	26.9	28.4
TCS (TCS)	2,675	3,300	Buy	10,03,763	86.2	87.2	103.8	118.0	31	31	26	23	43.5	44.5	49.0	52.9	37.5	37.1	42.3	45.6
Tech M (TECMAH)	845	765	Buy	81,716	45.9	44.0	51.0		18	19	17		19.1	16.4	17.4		18.5	16.0	16.7	
Wipro (WIPRO)	344	435	Buy	1,96,679	16.6	18.1	19.8	22.2	21	19	17	15	19.3	21.0	22.4	24.5	17.4	18.6	19.9	21.9
Mindtree (MINCON)	1,356	1,680	Buy	22,340	38.3	58.8	68.0	76.3	35	23	20	18	23.0	29.7	30.0	29.6	20.0	25.5	25.4	24.6
LTI (LTINFC)	3,105	3,570	Buy	53,903	86.6	105.9	124.8	146.2	36	29	25	21	30.7	31.8	31.3	30.9	28.1	28.3	28.0	27.5
Coforge (NIITEC)	2,518	2,200	Buy	15,256	71.4	75.3	94.4		35	33	27		23.0	24.7	26.0		18.5	19.4	21.2	
Infoedge (INFEDG)	3,479	3,555	Hold	44,738	26.8	27.8	33.4		130	125	104		18.0	10.6	12.0		13.5	7.9	8.9	
Teamlease (TEASER)	2,259	2,205	Buy	3,868	20.5	48.2	62.8		110	47	36		15.0	12.7	14.1		6.5	12.9	14.5	

Source: Company, ICICI Direct Research

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Buy: >15%

Hold: -5% to 15%;

Reduce: -15% to -5%;

Sell: <-15%

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