Stock Update

Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

L&T Infotech Ltd

Bright Q2, set to outrun peers

IT & ITES	Sharekhan code: LTI	Result Update

3R MATRIX	+	=	-
Right Sector (RS)	✓		
Right Quality (RQ)	✓		
Right Valuation (RV)		✓	

\+ Positive = Neutral - Negative

What has changed in 3R MATRIX

	Old		New
RS		↔	
RQ		↔	
RV		↔	

Reco/View	Change
Reco: **Buy**	↔
CMP: **Rs. 5,907**	
Price Target: **Rs. 6,850**	↑

↑ Upgrade ↔ Maintain ↓ Downgrade

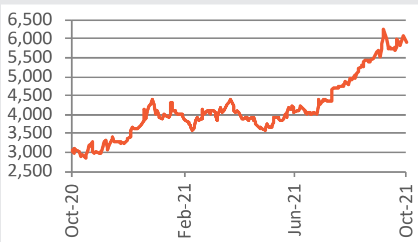
Company details

Market cap:	Rs. 1,03,475 cr
52-week high/low:	Rs. 6,498/2,828
NSE volume: (No of shares)	3.5 lakh
BSE code:	540005
NSE code:	LTI
Free float: (No of shares)	4.5 cr

Shareholding (%)

Promoters	74.1
FII	13.3
DII	4.7
Others	7.9

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	6.5	34.8	45.5	92.2
Relative to Sensex	0.9	17.3	16.7	37.7

Sharekhan Research, Bloomberg

Summary

- Q2 numbers beat our estimates on all fronts; deal TCVs and deal pipeline were robust, client metrics healthy across categories, while offshoring and net headcount addition stayed high. OCF/net profit stayed healthy at 91%.
- Strong demand is led by rising spend of transformation initiatives, spend on newer technologies and increasing opportunities on automation. The management expects strong demand to sustain at least for next three years.
- Strong hiring, investments in sales and capabilities, right market strategies and excellent execution positions LTI for sustainable growth over FY2022-FY2024E. We expect revenue/ EPS to clock 15%/16% CAGR over FY2022-24.
- We maintain a Buy on LTI with a revised PT of Rs. 6,850 given its strength in addressing digital transformation spends, robust deal wins and robust demand.

L&T Infotech (LTI) reported the strongest ever sequential constant currency (CC) revenue growth of 8.3%, led by strong double-digit growth in the BFS, manufacturing and other verticals. Reported USD revenue grew 8.3% q-o-q and 25.8% y-o-y to $509 million. EBIT margin improved 80bps q-o-q to 17.2%, ahead of our estimates, aided by SG&A leverage (up 70 bps) and higher offshoring, partially offset by lower utilisation and higher employee costs. The company signed large deal TCVs of $30 million in Europe in Q2FY2022. Strong demand is led by – (1) spend of transformation initiatives, (2) spends on new technologies and (3) higher automation to solve supply-side constraints. We believe LTI is well positioned to capture the market opportunities given superior digital competency, investments in sales and marketing (S&M), and solid executions.

Key positives

- CC revenue growth of 8.3% q-o-q was ahead of our estimate
- Deal wins, client addition, and net staff addition remained strong.
- OCF to net profit improved to 91% from 19% in Q1FY22.

Key negatives

- Attrition inched up 440 bps q-o-q to 19.6%

Management commentary

- The management reiterated demand for IT services is one of the best in a decade.
- Maintained its guidance of 14-15% net profit margin for FY2022.
- Revenue growth in H2FY22 would be stronger versus H1FY22 given strong seasonality

Revision in estimates - We revised our earnings estimates upward for FY22E/FY23E/FY24E by 1-4%

Our Call

Valuation – Strong growth prospects ahead: LTI is expected to deliver another strong year even after delivering nearly double-digit growth in FY2021, led by its strong capabilities in core modernisation, prudent client mining, strong sales and marketing practices and broad-based demand. Further, the management eyes a stable net profit margin going ahead despite investments in capability building and bolstering of sales team, aided by strong revenue growth, productivity enhancement, cost-optimisation measures, and hedging strategy. We estimate LTI to report USD revenue/EPS CAGR of 15%/16% over FY2022-FY2024E. At the CMP, the stock trades at 38x/33x its FY2023E/FY2024E earnings, which although expensive, is justified given its industry-leading revenue growth prospects with stable margins, strength in addressing transformation spending, and strong return ratios. Hence, we maintain our Buy rating on LTI with a revised price target (PT) of Rs. 6,850.

Key Risks

Rupee appreciation or/and adverse cross-currency movements and macro pressures would affect earnings.

Valuation Rs cr

Particulars	FY21	FY22E	FY23E	FY24E
Revenue	12,369.8	15,414.6	18,188.9	21,075.4
OPM (%)	22.0	20.0	19.5	19.5
Adjusted PAT	1,881.1	2,353.5	2,697.6	3,188.4
% YoY growth	23.7	25.1	14.6	18.2
Adjusted EPS (Rs.)	110.3	134.0	153.6	181.5
P/E (x)	53.6	44.1	38.5	32.5
P/B (x)	14.3	10.8	8.4	6.7
EV/EBITDA (x)	37.9	33.5	29.1	25.2
RoNW (%)	30.5	29.0	30.3	35.8
RoCE (%)	37.2	34.6	36.4	42.2

Source: Company; Sharekhan estimates

Excellent quarterly performance

L&T Infotech (LTI) reported an excellent quarterly numbers in Q2FY2022, led by broad-based growth across verticals, strong growth in top accounts and strong demand. The company reported its best-ever sequential constant currency (CC) revenue growth of 8.3% (up 25.5% y-o-y), exceeding our estimates. Revenue growth on q-o-q was driven by strong double-digit revenue growth in BFS (up 10.6% q-o-q), manufacturing (up 12.9% q-o-q) and other (up 15% q-o-q) vertical. Reported USD revenue grew 8.3% q-o-q and 25.8% y-o-y to $509 million. EBIT margin improved 80bps q-o-q to 17.2%, ahead of our estimates, aided by SG&A leverage (up 70 bps) and higher offshoring, partially offset by lower utilisation and higher employee costs. We note that LTI had advanced its wage hike cycle from July to April for FY2022, the second wage hike (the first in January and the second in April) in a span of three months. Net profit came in at Rs. 551.7 crore (up 11.1% q-o-q and up 20.8% y-o-y) and was 1.3% ahead of our estimates, aided by beat in revenue and EBIT margin, partially offset by lower other income. Net profit margin stood at 14.6% versus 14.3% in Q1FY2022. OCF/net profit stood at 91% in Q2FY2022 versus 19%/98% in Q1FY22/Q2FY21, respectively.

Key result highlights

- **Blockbuster quarter:** LTI reported the strongest-ever sequential revenue growth of 8.9% on CC basis, led by broad-based demand across verticals, service lines, client buckets and geographies. In reported terms, USD revenue grew by 8.3% q-o-q and 25.8% y-o-y to $509 million, led by a strong growth in BFS, manufacturing, hi-tech and other vertical. With revenues of $509 million, the company's quarterly annualized revenue run-rate crossed the $2 billion mark. EBIT margin improved 80bps q-o-q to 17.2% in Q2FY2022, beating our estimates by 30bps, led by strong revenue growth.
- **Large deal in Q2:** LTI announced large deal TCV of $30 million in Europe in Q2FY2022. The management remains optimistic of reporting large deals in the coming quarters as it continues to invest in the right capabilities. Management see multiple small sized deal given higher discretionary spends on transformation projects.
- **Demand outlook and net profit margin guidance:** Management reiterated that demand for IT services is one of the best in a decade and it is likely to sustain at least for the next three years. The strong demand drivers are – (1) emergence of new business models, where clients are looking for technology partners for business transformation. These spends are discretionary in nature. Management cited that the business restructuring is comprehensive, which is leading to plethora of small-sized deals, (2) spend on new areas as ESG and cloud security have started playing a key role in business decision and strategy. Management believes Client's spend on these technologies are at the initial stages, (3) supply-side issues across industries have been creating opportunities for IT services companies as enterprises are focusing on automation to solve such issues. We believe that LTI is well poised to capture the opportunities given its investments in capability building, and sales & marketing practices as well, strengths in addressing transformation spending and solid execution. LTI added 4,084 net employees in Q2FY2022, taking total net headcount addition of 12,953 over last three quarters, to cater to the accelerated demand. The company plans to hire around 5,500 freshers in FY2022, indicates the underlying demand. Management indicated that the revenue growth in H2FY2022 would be stronger compared to 1HFY2022 on the back of strong seasonality. Growth in Europe is expected to continue on the back of deal pipeline, good demand environment and ramp-up of recent large deal wins. With healthy deal wins, sustained client mining strategies, and broad-based demand, LTI is expected to deliver another year of strong growth even after delivering nearly double-digit revenue growth in the pandemic-hit FY2021. The management reiterated that the company would remain in the leaders' quadrant of the industry in terms of revenue growth in FY2022. The management maintained its guidance of 14-15% net profit margin for FY2022.

- **Strong growth in key verticals:** During Q2FY2022, the manufacturing vertical reported strong CC revenue growth of 12.9% q-o-q (versus -6.7% in Q1FY2022), while the BFS and other verticals reported strong revenue growth of 10.6% q-o-q and 15.0% q-o-q respectively on a CC basis. The hi-tech, energy & utilities and insurance verticals reported a revenue growth of 7% q-o-q, 6.9% q-o-q and 6.1% q-o-q respectively. The company reported 2.6% q-o-q growth in CPG, retail and pharmaceutical vertical.
- **Strong growth across service offerings:** LTI's management highlighted that all its service lines grew by ~20% y-o-y in Q2FY2022. Revenue from analytics, AI & cognitive and enterprise integration & mobility reported a strong CC growth of 12.1% q-o-q (up 43.6% y-o-y) and 16.7% q-o-q (up 41.1% y-o-y) respectively. Revenue from cloud infrastructure & security services offerings grew by 2.7% q-o-q in CC terms. Revenue from ADM and testing and enterprise solutions grew by 9.2% q-o-q (up 19.3% y-o-y) and 8.1% q-o-q (up 23.6% y-o-y), respectively.
- **Strong growth across geographies:** Rest-of-the-world (RoW), North America and Europe reported strong revenue growth, registering a CC revenue growth of 11.5% q-o-q, 9.1% q-o-q and 7.5% q-o-q. Revenue in India grew by 6.6% q-o-q in CC terms after a decline of 19.9% q-o-q in Q1FY2022. Europe grew by 25.5% y-o-y.
- **Opportunities around cloud and data product businesses:** The management highlighted that two areas have emerged as new opportunity areas based on the conversion of market trends and its capabilities in new-age technologies. These are - (1) cloud business – work along with hyperscalers (AWS, Azure, and GCP) and (2) data product business with marketing platform (Mosaic and Lymbyc). The company had carved out two separate units to focus on cloud and data products. On the cloud side, the company has made significant progress, both in terms of setting up a dedicated organisation and in terms of market success.
- **Strong growth in the BFS and insurance vertical:** The BFS vertical's revenue grew by 10.6% q-o-q and 36% y-o-y in CC terms, led by higher spend on modernization projects and broad-based demand across geographies. Insurance vertical's revenue growth accelerated to 6.1% q-o-q and 10.9% y-o-y (up 5% q-o-q on CC and 0.4% y-o-y in Q1FY2022), led by strong demand. The management expects revenue growth in the insurance sector would continue on the back of new leaderships who would be driving opportunities in the marketplaces and the partnership ecosystem.
- **Manufacturing vertical revenue growth bounced back strongly:** The manufacturing vertical's revenue grew by 12.9% q-o-q and 20.8% y-o-y on a CC basis. The management indicated strong deal pipeline in this vertical given strong demand in industrial manufacturing and capital goods sector. Further, it sees strong growth across sub-segments given higher digitalization, strong demand for data and analytics for real-time decision making and change in operating models.
- **Strong traction in utilities segment:** E&U vertical's revenue grew by 6.9% q-o-q in Q2FY2022 on CC terms, led by strong growth in utilities space. Management highlighted that client budgets in this space continue to remain volatile. However, the management indicated that it sees good traction in the utilities segment.
- **Growth in CPG, retail, and pharma to pick up in subsequent quarters:** These verticals' revenue grew by 2.6% q-o-q on CC terms and increased by 15.4% y-o-y in Q2FY22. Growth was driven by spend on data-related projects as wholesaler and retailers adjust to new realities to meet customer expectations.
- **Hi-tech, media and entertainment:** Revenue in hi-tech, media and entertainment vertical grew by 7% q-o-q on CC terms and 48.4% y-o-y in CC terms.

- **Attrition rate to remain elevated for next 3-4 quarters:** The company's attrition rate (LTM basis) increased 440bps q-o-q to 19.6% despite taking proactive measures such as advancing wage revision by three months from July to April for FY2022. We note that the company had provided second wage hike in a calendar year to management the attrition in ongoing demand environment. The management stated that most of the attrition was in the 3 to 6 years experienced bracket as there had been less freshers hire over the last 3-4 years. Management expects it will take at-least 3-4 quarters to have some stability in attrition rate.
- **Pricing outlook:** The company indicated some scope for price increase in certain pockets. However, the company focuses on capturing growth opportunities in the marketplace.
- **Revenue growth accelerated in top accounts:** Revenue from top five accounts grew by 8.1% q-o-q (versus a growth of 6.6% q-o-q in Q1FY2022). Revenue from the top 10/20 accounts grew by 6.8%/7.8% q-o-q (versus growth of 5.9%/4.3% q-o-q in Q1FY2022). Revenue from other than top 20 accounts grew by 8.7% q-o-q during Q2FY2022.
- **Client metrics continued to improve across categories, led by strong demand:** LTI added 25 clients (versus 23 new clients in Q1FY2022) across all verticals in Q2FY2022. The number of clients under the $100 million client buckets remained flat q-o-q, while the number of clients under the $50 million, $20 million, $10 million and $5 million increased by 1, 3,5 and 5 clients respectively, q-o-q. On a y-o-y basis, the number of clients under the $50 million, $20 million, $10 million and $5 million category grew by 1, 5, 11 and 10, respectively.
- **OCF to net profit ratio remained healthy:** Operating cash flow stood at Rs. 504.1 crore (up 435% q-o-q and 13% y-o-y). Operating cash flow to net profit remained at 91% in Q2FY2022 versus 19% in Q1FY2022. Cash & liquid investments stood at Rs. 3,840.3 crore as compared to Rs. 4,331.4 core in Q1FY2022.
- **DSO:** Billed DSO increased by a day to 61 days. DSO including unbilled revenue remained flat at 98 days on a q-o-q basis.
- **Dividend:** LTI declared a dividend of Rs. 15/ share versus Rs. 10/share in Q1FY2022.

Results (Consolidated) Rs cr

Particulars	Q2FY22	Q2FY21	Q1FY22	y-o-y (%)	q-o-q (%)
Revenue ($ mn)	**509.0**	**404.5**	**470.2**	**25.8**	**8.3**
Revenue (Rs. cr)	**3,767.0**	**2,998.4**	**3,462.5**	**25.6**	**8.8**
Direct costs	2,601.1	1,953.7	2,389.8	33.1	8.8
SG&A	432.7	359.1	424.9	20.5	1.8
EBITDA	**733.2**	**685.6**	**647.8**	**6.9**	**13.2**
Depreciation	85.0	89.9	79.5	-5.5	6.9
EBIT	**648.2**	**595.7**	**568.3**	**8.8**	**14.1**
Other income (including FX)	93.8	17.4	103.9	439.1	-9.7
PBT	742.0	613.1	672.2	21.0	10.4
Tax provision	190.3	156.3	175.4	21.8	8.5
Net profit	**551.7**	**456.8**	**496.8**	**20.8**	**11.1**
EPS (Rs.)	**31.4**	**26.0**	**28.3**	**21.0**	**11.1**
Margin (%)				**BPS**	**BPS**
EBITDA	19.5	22.9	18.7	-340	75
EBIT	17.2	19.9	16.4	-266	79
NPM	14.6	15.2	14.3	-59	30
Tax rate	25.6	25.5	26.1	15	-45

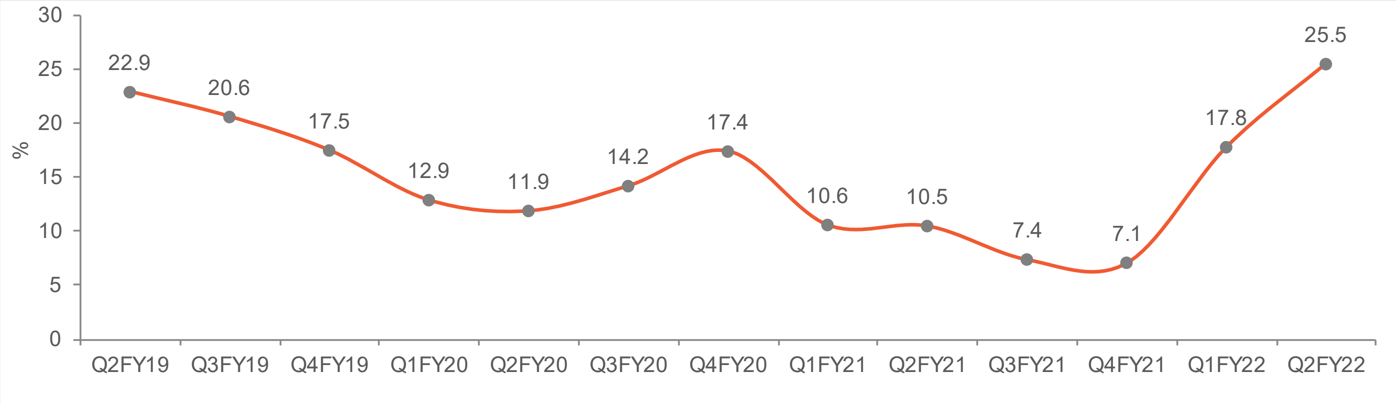
Source: Company, Sharekhan Research

Operating metrics

Particulars	Revenues	Contribution	$ Growth (%)		CC growth (%)	
	($ mn)	(%)	q-o-q	y-o-y	q-o-q	y-o-y
Revenue ($ million)	509	100	8.3	25.8	8.9	25.5
Geographic mix						
North America	344	67.5	8.9	23.6	9.1	23.3
Europe	82	16.1	5.1	25.8	7.5	25.5
ROW	50	9.8	10.6	50.4	11.5	48.5
India	34	6.6	6.6	20.4	6.6	19.5
Industry verticals						
BFS	165	32.5	9.6	36.8	10.6	36.0
Insurance	72	14.2	5.6	11.4	6.1	10.9
Manufacturing	79	15.6	12.4	20.8	12.9	20.8
Energy & Utilities	45	8.9	6.3	6.0	6.9	5.9
CPG, Retail and Pharma	51	10.1	1.9	15.3	2.6	15.4
High-Tech, Media and Entertainment	64	12.5	6.9	48.5	7.0	48.4
Others	32	6.2	14.2	38.4	15.0	38.4
Service offerings						
ADM and Testing	174	34.2	8.7	19.5	9.2	19.3
Enterprise Solutions	155	30.4	7.2	24.3	8.1	23.6
Cloud Infrastructure & Security	71	14.0	1.9	22.7	2.7	22.7
Analytics, AI and Cognitive	62	12.1	11.9	43.7	12.1	43.6
Enterprise Integration and Mobility	47	9.3	16.2	41.3	16.7	41.1

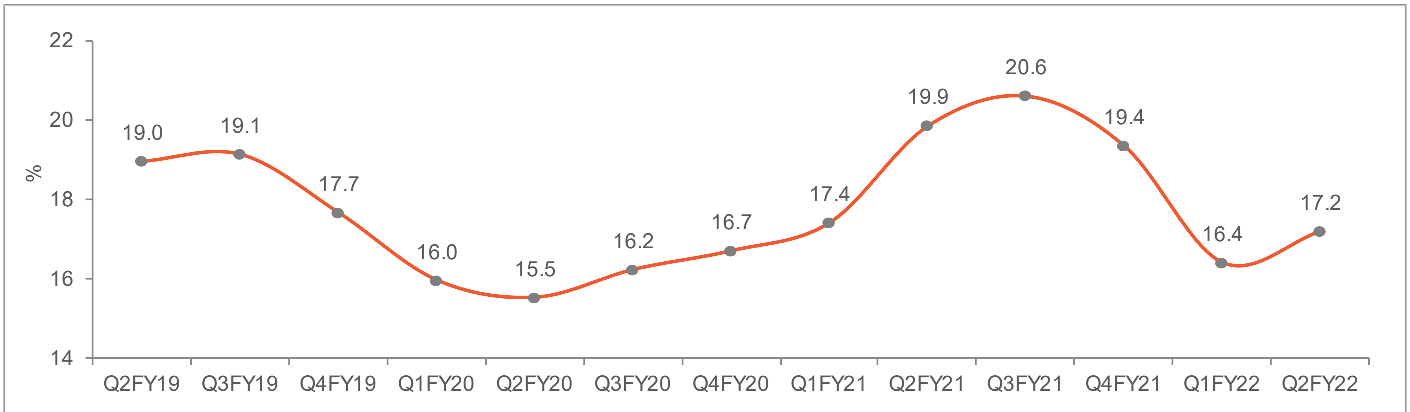
Source: Company, Sharekhan Research

LTI' constant-currency revenue growth trend (y-o-y)



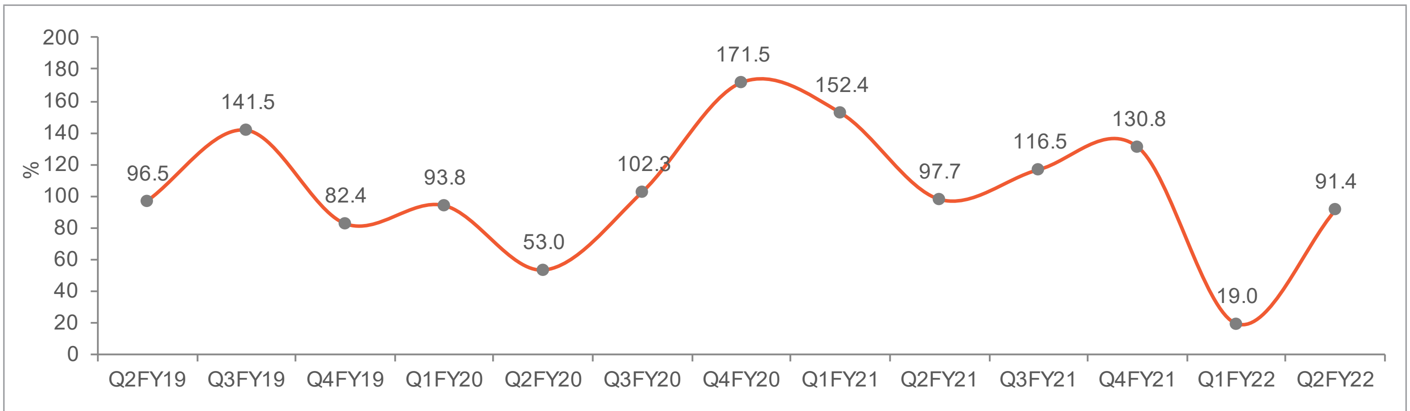
Source: Company, Sharekhan Research

EBIT margin (%) trend



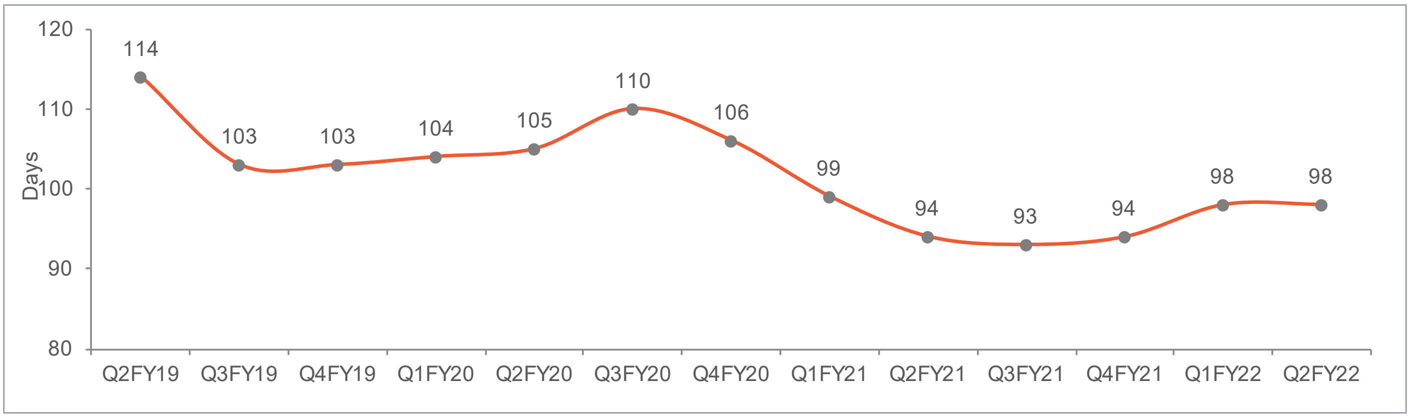
Source: Company, Sharekhan Research

CFO as a % of net profit



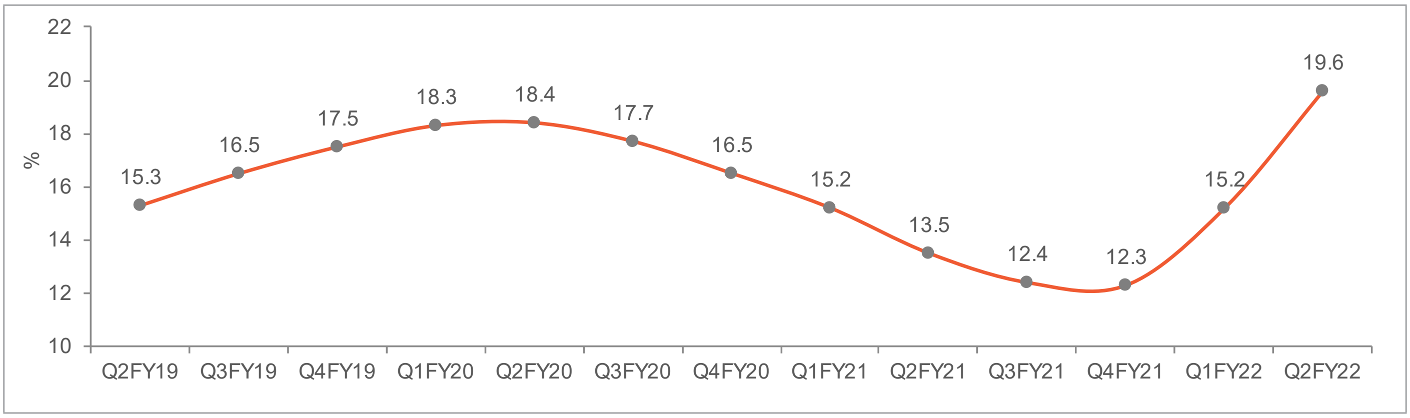
Source: Company, Sharekhan Research

DSO (including unbilled) trend



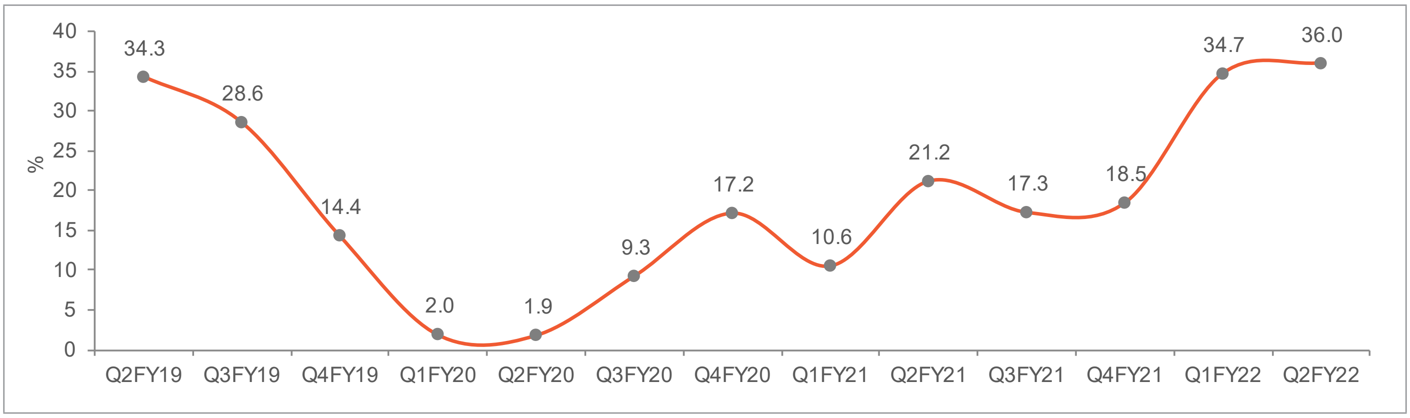
Source: Company, Sharekhan Research

Attrition rate (%)



Source: Company, Sharekhan Research

BFS CC revenue growth (y-o-y) trend



Source: Company, Sharekhan Research

Outlook and Valuation

■ Sector view - Expect acceleration in technology spending going forward

With the outbreak of the COVID-19 pandemic, the need for business continuity, operational resilience and the switch to digital transactions has led to a strong demand for IT services. Industry analysts such as Gartner estimate that IT services spending would grow by 7-9% over CY2021-CY2024E as compared to the average of 3.6% achieved over CY2010-CY2020. Forecasts indicate higher demand for cloud infrastructure services, a potential increase in specialised software, potential investments in transformation projects by clients and increased online adoption across verticals.

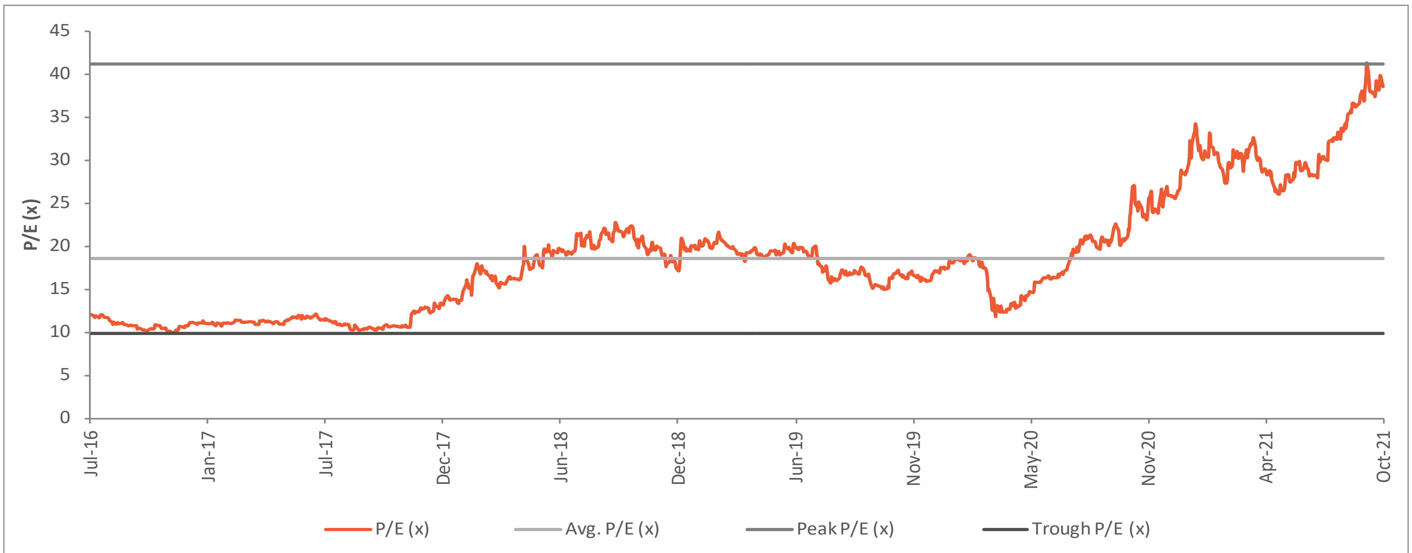
■ Company outlook - Superior execution likely to drive outperformance

We believe that LTI's prudent strategies along with an efficient sales force would lead to market share gains in large accounts and new deal wins. Hence, we expect LTI to deliver industry-leading revenue growth in the long term on account of consistent large deal wins and deal pipeline, higher digital mix, prudent account mining strategies and a marquee client base. Further, LTI's sharp focus on bringing new-age disruptive technologies along with leveraging platforms (in-house and external) would help it transform the core business of enterprises on a large scale.

■ Valuation - Superior execution justifies premium valuation

LTI is expected to deliver another strong year even after delivering nearly double-digit growth in FY2021, led by its strong capabilities in core modernisation, prudent client mining, strong sales and marketing practices and broad-based demand. Further, the management eyes a stable net profit margin going ahead despite investments in capability building and bolstering of sales team, aided by strong revenue growth, productivity enhancement, cost-optimisation measures, and hedging strategy. We estimate LTI to report USD revenue/ EPS CAGR of 15%/16% over FY2022-FY2024E. At the CMP, the stock trades at 38x/33x its FY2023E/FY2024E earnings, which although expensive, is justified given its industry-leading revenue growth prospects with stable margins, strength in addressing transformation spending, and strong return ratios. Hence, we maintain our Buy rating on LTI with a revised price target (PT) of Rs. 6,850.

One-year forward P/E (x) band



Source: Sharekhan Research

Peer comparison

Company	CMP (Rs / Share)	O/S Shares (Cr)	MCAP (Rs Cr)	P/E (x)		EV/EBITDA (x)		P/BV (x)		RoE (%)	
				FY22E	FY23E	FY22E	FY23E	FY22E	FY23E	FY22E	FY23E
Persistent	4,126	8	31,534	48.6	35.9	35.1	26.0	9.9	8.5	21.7	25.4
TCS	3,647	370	13,49,192	34.4	30.0	24.5	21.3	15.2	14.8	44.5	49.9
LTI	5,907	18	1,03,475	44.1	38.5	33.5	29.1	10.8	8.4	29.0	30.3

Source: Company; Sharekhan Research

About company

Promoted by Larsen & Toubro (L&T) in 1996, LTI is the sixth largest ($1,670 million in FY2021) IT services company in India in terms of export revenue and is among the top-20 IT service providers globally. With operations in 27 countries, LTI provides technology consulting and digital solutions to around 289 clients across the globe. LTI provides services to 72 of the Fortune Global 500 companies. The company has 23 delivery centres and 43 sales offices, with employee strength of over 42,380+. LTI's vertical focus is heavily towards banking and financial services, insurance, and manufacturing, which together contribute ~62% to total revenue.

Investment theme

A multitude of factors such as strong execution capabilities, a dynamic sales team, accelerating revenue contribution from its digital business, leverage of domain experience, solid top account mining, and healthy deal wins have been helping LTI to outpace the average industry growth rate. Further, the gradual increase in digital deal sizes along with high volume digital deals and migration of the legacy business has helped the company grow at a rapid pace compared to its peers. We believe the sharpened focus on large account mining and new client additions augurs well for LTI to deliver above-industry average revenue growth.

Key Risks

1) Rupee appreciation or/and adverse cross-currency movements; 2) any hostile regulatory visa norms could affect employee expenses; and 3) macro pressure would hit growth in key verticals.

Additional Data

Key management personnel

A. M. Naik	Founder Chairman
S. N. Subrahmanyan	Non-Executive Vice Chairman
Sanjay Jalona	CEO & MD
Sudhir Chaturvedi	President sales

Source: Company

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	UTI Asset Management Co Ltd	1.91
2	UTI Flexi Cap Fund	1.83
3	Blackrock Inc	0.93
4	Wasatch advisors Inc	0.89
5	Invesco Limited	0.86
6	Vanguard Group	0.80
7	Aditya Birla Sun life Asset management	0.50
8	ICICI Prudential Asset Management	0.38
9	Government Pension Investment Fund japan	0.19
10	Mirae Asset Global Investments	0.18

Source: Bloomberg

Understanding the Sharekhan 3R Matrix

Right Sector	
Positive	Strong industry fundamentals (favorable demand-supply scenario, consistent industry growth), increasing investments, higher entry barrier, and favorable government policies
Neutral	Stagnancy in the industry growth due to macro factors and lower incremental investments by Government/private companies
Negative	Unable to recover from low in the stable economic environment, adverse government policies affecting the business fundamentals and global challenges (currency headwinds and unfavorable policies implemented by global industrial institutions) and any significant increase in commodity prices affecting profitability.
Right Quality	
Positive	Sector leader, Strong management bandwidth, Strong financial track-record, Healthy Balance sheet/cash flows, differentiated product/service portfolio and Good corporate governance.
Neutral	Macro slowdown affecting near term growth profile, Untoward events such as natural calamities resulting in near term uncertainty, Company specific events such as factory shutdown, lack of positive triggers/events in near term, raw material price movement turning unfavourable
Negative	Weakening growth trend led by led by external/internal factors, reshuffling of key management personal, questionable corporate governance, high commodity prices/weak realisation environment resulting in margin pressure and detoriating balance sheet
Right Valuation	
Positive	Strong earnings growth expectation and improving return ratios but valuations are trading at discount to industry leaders/historical average multiples, Expansion in valuation multiple due to expected outperformance amongst its peers and Industry up-cycle with conducive business environment.
Neutral	Trading at par to historical valuations and having limited scope of expansion in valuation multiples.
Negative	Trading at premium valuations but earnings outlook are weak; Emergence of roadblocks such as corporate governance issue, adverse government policies and bleak global macro environment etc warranting for lower than historical valuation multiple.

Source: Sharekhan Research

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