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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	■	↔	■

ESG Disclosure Score

NEW

ESG RISK RATING **18.25**

Updated Apr 08, 2022

Low Risk

NEGL	LOW	MED	HIGH	SEVERE
0-10	10-20	20-30	30-40	40+

Source: Morningstar

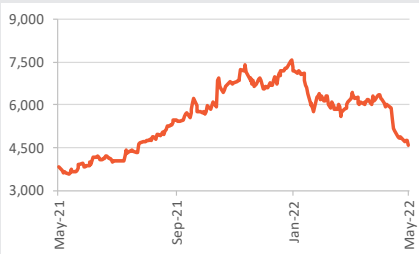
Company details

Market cap:	Rs. 80,621 cr
52-week high/low:	Rs. 7,595 / 3,525
NSE volume: (No of shares)	3.8 lakh
BSE code:	540005
NSE code:	LTI
Free float: (No of shares)	4.5 cr

Shareholding (%)

Promoters	74.1
FII	11.4
DII	7.7
Others	6.9

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	-27.4	-26.9	-32.1	20.4
Relative to Sensex	-19.4	-20.4	-23.4	8.4

Sharekhan Research, Bloomberg

Larsen & Toubro Infotech

Behold the next behemoth

IT & ITES	Sharekhan code: LTI		
Reco/View: Buy	↔	CMP: Rs. 4,596	Price Target: Rs. 6,000
↑ Upgrade	↔ Maintain	↓ Downgrade	

Summary

- L&T Infotech (LTI's) board announced the merger of Mindtree with itself at a swap ratio of 73 shares of LTI for every 100 shares of Mindtree. The proposed valuation of the merger remains fair to shareholders of both firms.
- Proposed merger to benefit combined entity in terms of large deal bids, building a huge talent pool, strengthening relationships with partner ecosystems and providing end-to-end service offerings to clients.
- With the exit of Mr. Sanjay Jalona (MD & CEO of LTI), we believe there could be some attrition in the leadership team in the near term. Further, difference in work culture could have an adverse impact on integration of workforce of both entities.
- We maintain a Buy on LTI with a revised PT of Rs. 6,000 given synergy benefits from the impending merger, minimal overlap of clients and strong growth prospects.

L&T Infotech's (LTI's) board approved a composite scheme of amalgamation of Mindtree with L&T Infotech under the Larsen & Toubro Group. The deal's swap ratio remains at 73 shares of L&T Infotech for every 100 shares of Mindtree. This was a long-awaited merger given strong revenue and cost synergies between both companies. We believe the proposed merger would benefit the combined entity in terms of large deal bids, building a huge talent pool, strengthening relationships with partner ecosystem and providing end-to-end service offerings to clients. With complementary capabilities and minimal overlap of clients and industries, the combined entity is expected to sustain industry-leading revenue growth momentum over next two years and will lead to the formation of a \$4.9 billion (\$3.5 billion in FY2022) IT Services company by FY2024.

- Merger to create next IT behemoth:** The Boards of both companies in their respective meetings approved a composite scheme of amalgamation of Mindtree with LTI. This proposed merger will bring together two fast-growing Indian mid-tier IT services companies and the combined entity will become India's sixth largest Indian IT services company in terms revenue (\$3,514 million as of FY2022). The proposed merger will take the total workforce to 81,719, while cash levels of the combined entity stands at \$991 million (will be utilized for the inorganic growth initiatives). The combined entity's pro-forma RoE remains at 30.5%, which is better than most of tier-I IT companies (except TCS).
- Strategic rationale: A perfect strategic fit:** The proposed merger has a significant revenue synergies given diversified end-to-end capabilities, bidding larger deals and minimal client overlapping, while it will drive cost efficiencies and synergies. The strategic rationale for the merger are – (1) Significant enhancement of scale and bridge the gap with large peers; (2) complimentary vertical offerings; (3) Cross selling/up-selling opportunity; (4) strong cash position; (5) diverse talent pool; (6) better geographical coverage.
- Expect to create significant revenue synergies:** The scale of the combined entity would get benefit from synergies through cross-industrial/horizontal expertise, end-to-end service offerings, increasing wallet share and accessing to a large talent pool. LTI is strong in BFSI and manufacturing, while Mindtree has strong domain capabilities in retail, travel and hospitality. We believe that complementary capabilities, minimal overlap of clients, and market share gains would position the combined entity to sustain the industry leading growth momentum going ahead.

Our Call

Valuation – A perfect fit: With extremely complementary capabilities and minimal overlap of clients, the combined entity is well poised to benefit in terms of winning large deals, strengthening relationship across partner ecosystems and increasing wallet share. At CMP, the stock trades at 29x/25x its FY2023E/FY2024E earnings estimates. Though we continue to prefer LTI given its resilient business model, robust client base, and good client mining, the sudden exit of Mr. Sanjay Jalona could lead to certain attrition in the senior management team in the near-term. Given anticipation of higher attrition in the top management of LTI and possibilities of integration issues, we lower our target multiple for LTI. We maintain a Buy on LTI with a revised price target (PT) of Rs. 6,000.

Key Risks

Rupee appreciation or/and adverse cross-currency movements, slower-than-expected technology spends by customers and a loss of any large clients would affect earnings.

Valuation (Consolidated)

Particulars	Rs cr			
	FY22	FY23E	FY24E	FY25E
Revenue	15,668.7	19,414.3	23,204.5	26,477.0
OPM (%)	19.5	18.8	19.6	19.7
Adjusted PAT	2,298.5	2,794.7	3,280.8	3,852.5
% YoY growth	22.2	21.6	17.4	17.4
Adjusted EPS (Rs.)	130.8	159.0	186.7	219.2
P/E (x)	35.1	28.9	24.6	20.9
P/B (x)	11.8	9.0	7.0	6.6
EV/EBITDA (x)	25.5	21.3	17.1	15.0
RoNW (%)	28.5	31.7	37.2	43.7
RoCE (%)	34.5	38.0	47.4	54.2

Source: Company; Sharekhan estimates

Event: L&T Infotech and Mindtree announce a merger:

The Boards of L&T Infotech and Mindtree in their respective meetings held on May 06, 2022, approved a composite scheme of amalgamation of Mindtree with L&T infotech under the L&T Group. This proposed merger will bring together two fast growing Indian mid-tier IT services companies and the combined entity will become India's sixth-largest Indian IT services company in terms revenue (\$3,514 million). As per the deal, the swap ratio remains at 73 shares of L&T Infotech for every 100 shares of Mindtree. Post the merger, the promoter i.e. Larsen & Toubro Limited will hold 68.73% of L&T Infotech. The combined entity will be named as "LTIMindtree" to leverage advantages of both the brands. The group announced that Mr. Debashis Chatterjee (Current CEO of Mindtree) will lead the combined entity, while Mr. Sanjay Jalona (L&T Infotech's MD and CEO) resigned due to personal reasons. The merger is subject to approval of stock exchanges, the shareholders of both the entities, creditors, NCLT approval, RoC filling and other regulatory approvals. The management expects the transaction is likely to close within the next 9-12 months.

Financial implications: The combined entity's pro-forma revenue remains at \$3,513 million, which will enable tier status upgrade and bid for large deals. The EBIT margin of the combined entity is at 17.8%. The net profit stands at Rs. 3,951 crore. The derived EPS is at Rs. 133.5. The proposed merger will take the total workforce to 81,719. The cash and investments of the combined entity stands at \$991 million.

Merger valuation remains fair to both shareholders

Mindtree's share outstanding (no in cr)	16.5
Number of LTI's share to be received	12.0
Share price of LTI (May 06, 2022)	4593
Implied value of Mindtree (Rs. crore)	55,268
Net debt (Rs. crore)	(3,046)
Implied market cap of Mindtree	58,314
Current Market cap of Mindtree	55,627
Premium to current market cap	5%

Source: Company; Sharekhan Research

Merger rationale: A perfect strategic fit

This is a long-awaited merger over last three years and would benefit the combined entity in terms of bidding for the large deal, building large talent pool, strengthening relationships with partner ecosystem and providing end-to-end service offerings to its clients. Further, we expect the proposed merger will drive cost efficiencies and synergies in the areas of SG&A, infrastructure and alignment in geographies and delivery centres. The strategic rationale for the merger are – (1) significant enhancement of scale and bridge the gap with large peers – this proposed merger will increase the competitiveness of the merged entity with the large peers. This would result in winning larger deals and higher market share. Further, end-to-end service offerings and strong domain expertise would enable the company increase the wallet share among existing customers; (2) complimentary vertical offerings – BFSI remains the largest vertical for LTI, while CMT (communication, media and technology) is the largest revenue contributor to Mindtree. The proposed merger would create three large industry verticals (BFSI, CMT, manufacturing) for the combined entity. We believe the diversified domain capability and expanded service offerings portfolio will enable the merged entity to bid larger contracts, command higher pricing and improve execution; (3) cross selling opportunity – the combined entity will have higher cross-selling/up-selling opportunities given minimal overlapping of clients. The number of clients of the combined entity stand at 760, which includes many Fortune 500 clients. Further, LTI's service offering portfolio can be complimented with Mindtree's expertise in customer experience and salesforce; (4) strong cash position – this would enable the combined entity to fill the gaps in the capabilities through inorganic route; (5) diverse talent pool – the combined entity will be benefiting from the wider range of talent pool (81,719 staffs), which would help in pyramid balancing and utilisation of resource; (6) better geographical coverage – the merger will enhance presence in many countries and rationalise exposure where both companies are present.

Merger is expected to create significant revenue synergies

Proposed merger would significantly enhance scale for combined business, which would help the combined entity to unlock the synergies through cross-industrial/horizontal expertise, end-to-end service offerings, increasing wallet share with existing customers, strengthening relationship across partner ecosystems and talent pools. LTI has reported strong revenue growth (17% CAGR over FY2020-FY2022) over last couple of

years (including nearly double-digit growth in the pandemic year of FY2021) and it expects to remain in the leaders' quadrant of the industry in terms of revenue growth in FY2023 with stable net profit margins. On the other hand, over the last two years, Mindtree's revenue has grown at a CAGR of ~14% despite high exposure to the worst impacted verticals during pandemic, led by 31.1% y-o-y growth in FY2022 and it is setting stage for another year of industry leading growth in FY2023. Post-merger, the strong growth momentum is likely to continue given little business overlap. LTI is strong in BFSI and manufacturing, while Mindtree has strong domain capabilities in retail, travel and hospitality. Both the companies have strong capabilities in communication, media and technology vertical. The diversified revenue profile and joint go-to-market strategies for large deals would also create new avenues for the workforce of both entities, which would drive the integration of workforces with synergies. Hence, we believe that complementary capabilities, minimal overlap of clients and industries, diversified revenue profile, smooth integration of workforce of both entities and market share gains would position the combined entity to sustain the industry leading growth momentum going ahead.

Exit of Mr. Sanjay Jalona could create minor hiccups



Sanjay Jalona, CEO and MD of LTI, had joined the company in 2015. Since then, the company has been progressing well almost in all fronts. Early investments in digital capabilities and talents, partnerships with Hyperscalers and cloud native data companies, and tuck-in acquisitions enabled the company to report industry leading growth (15% CAGR over FY2016-FY2022) over last seven years. We believe the top management's continuous focus on growth accounts, invest accounts, new logo addition and consistency in large deal wins helped the company to deliver industry-leading growth. Further, the company's client mining remained strong with an addition of 5/14 clients in \$50 mn/\$20 mn revenue bracket over FY2017-2022. Under the leadership of Mr. Jalona, the company hired many senior leaders from tier-I IT companies. With his exit, attrition is expected to inch up among senior leaders. The could have an adverse impact on its project execution in the near-term.

Calculation of target price

Particulars	Mindtree	LTI	LTIMindtree
USD revenue in mn (FY2024E)	1,931	3,014	4,945
Net profit (FY2024E)	2,250	3,281	5,530
Target P/E (x)			32
Equity value			1,77,359
Shares Outstanding (cr)			29.6
Target price			6,000

Source: Company; Sharekhan Research

Proforma headline number of LTIMindtree

	 LTI Let's Solve	+	 Mindtree Welcome to possible	=	Proforma (As-is)
FY22					
Revenue (\$mn)	\$2,102		\$1,411		\$3,513
EBIT (\$mn; %) ⁽¹⁾	\$363 17.3%		\$262 18.6%		\$625 17.8%
PAT (\$mn; %) ⁽¹⁾	\$308 14.7%		\$222 15.7%		\$530 15.1%
Cash & Investments (\$mn) ⁽¹⁾	\$516		\$475		\$991
Employees	46,648		35,071		81,719

Source: Company

Complementary industry capabilities

FY22 Revenue Split by Vertical (%; \$mn)

	Revenue (\$mn)	Revenue Share (%)		Revenue (\$mn)	Revenue Share (%)		Revenue (\$mn)	Revenue Share (%)
LTI Let's Solve			Mindtree Welcome to possible			Proforma (As-is)		
BFSI	\$974	47%	BFSI	\$251	18%	BFSI	\$1,225	35%
Hi-Tech & Media	\$255	12%	Communications, Media & Technology	\$614	43%	Communications, Media & Technology	\$869	25%
CPG, Retail & Pharma	\$216	10%	CPG, Retail, Mfg	\$334	24%	Mfg, CPG, Retail, Healthcare	\$906	26%
Manufacturing	\$339	16%	Healthcare	\$17	1%	Energy & Utilities	\$187	5%
Energy & Utilities	\$187	9%	Travel, Transportation & Hospitality	\$195	14%	Travel, Transportation & Hospitality	\$195	5%
Others	\$131	6%				Others	\$131	4%
Total	\$2,102	100%	Total	\$1,411	100%	Total	\$3,513	100%

Source: Company

Diversified and balanced operations across geographies

FY22 Revenue Split by Geography (%; \$mn)

	Revenue (\$mn)	Revenue Share (%)		Revenue (\$mn)	Revenue Share (%)		Revenue (\$mn)	Revenue Share (%)
LTI Let's Solve			Mindtree Welcome to possible			Proforma (As-is)		
Americas	\$1,398	67%	Americas	\$1,044	74%	Americas	\$2,442	69%
Europe	\$340	16%	Europe	\$254	18%	Europe	\$594	17%
RoW	\$364	17%	RoW	\$113	8%	RoW	\$477	14%
Total	\$2,102	100%	Total	\$1,411	100%	Total	\$3,513	100%

Source: Company

Stronger relationships across partner ecosystem

LTI Let's Solve							Other Select Partners
	Silver Partner	Premier Partner	Premier Partner	Gold Partner	Crest Partner	Elite Partner	
Mindtree Welcome to possible							Other Select Partners
	Platinum Partner	Advanced Partner	Premier Partner	Gold Partner	Summit Partner	Elite Partner	

Source: Company

Outlook and Valuation

■ Sector View – Expect acceleration in technology spending going forward

With the outbreak of COVID-19, 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 8-8.5% in the next four years as compared to the average of 4.2% achieved over last 10 years. 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.

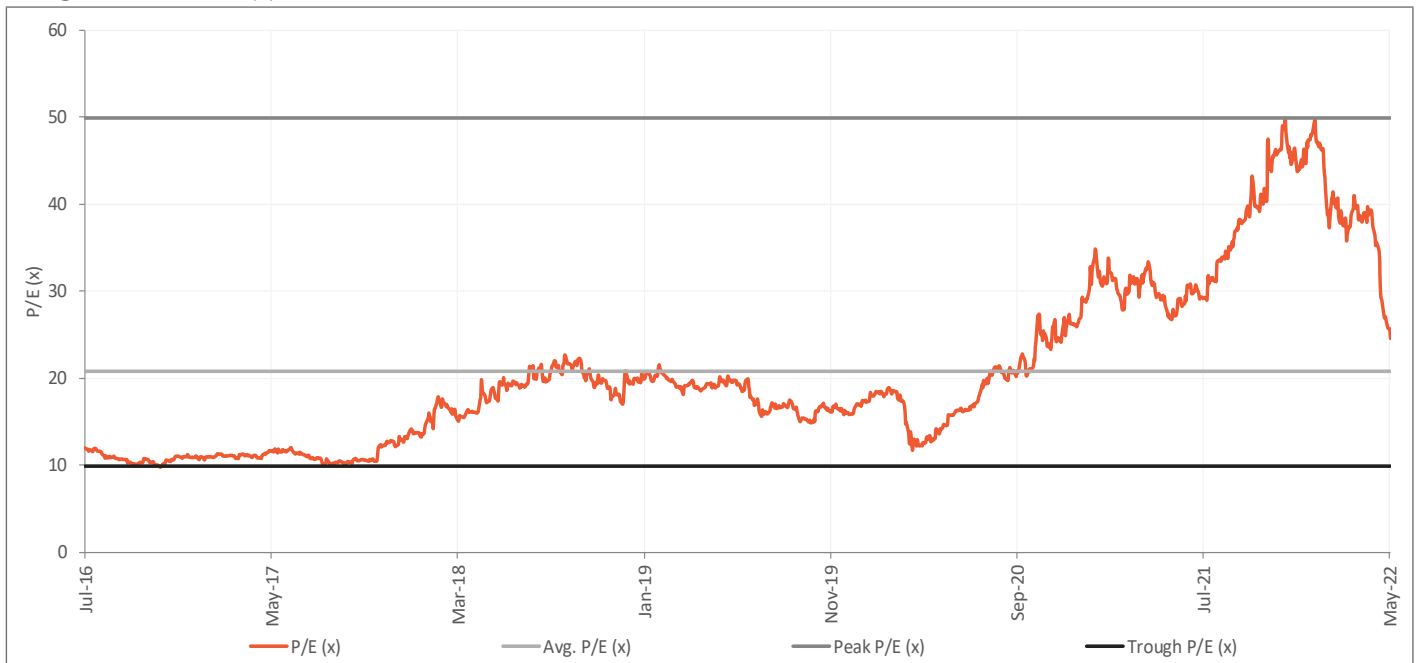
■ Company Outlook – Superior execution likely to drive outperformance

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 and leveraging of platforms (in-house and external) would help it transform the core business of enterprises on a large scale.

■ Valuation – Highly complementary capabilities between two entities

With extremely complementary capabilities and minimal overlap of clients, the combined entity is well poised to benefit in terms of winning large deals, strengthening relationship across partner ecosystems and increasing wallet share. At CMP, the stock trades at 29x/25x its FY2023E/FY2024E earnings estimates. Though we continue to prefer LTI given resilient business model, robust client base, and good client mining, the sudden exit of Mr. Sanjay Jalona could lead to certain attrition in the senior management team in the near term. Given anticipation of higher attrition in the top management of LTI and possibilities of integration issues, we lower our target multiple for LTI. We maintain a Buy on LTI with a revised price target (PT) of Rs. 6,000.

One-year forward P/E (x) band



Source: Sharekhan Research

About company

Promoted by Larsen & Toubro (L&T) in 1996, LTI is the sixth largest (\$2,102 million in FY2022) 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 46,000+. LTI's vertical focus is heavily towards banking and financial services, insurance, and manufacturing, which together contribute ~63% 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. Subrahmanyam	Non-Executive Vice Chairman
Sanjay Jalona	CEO & MD
Sudhir Chaturvedi	President sales

Source: Company Website

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	St James's Place PLC	5.41
2	UTI Asset Management Co Ltd	1.88
3	Blackrock Inc	0.96
4	Wasatch advisors Inc	0.83
5	Vanguard Group	0.83
6	Invesco Limited	0.71
7	Aditya Birla Sun life Asset management	0.64
8	Axis Asset Management	0.53
9	Norges Bank	0.46
10	ICICI Prudential Asset Management	0.40

Source: Bloomberg

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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 deteriorating 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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