Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Stock Update

Result Update

Larsen & Toubro Infotech

Decent Q4; sustaining growth momentum

IT & ITES	Sharekhan code: LTI
Reco/View: Buy ↔	CMP: **Rs. 5,486**
	Price Target: **Rs. 7,100** ↓

↑ Upgrade ↔ Maintain ↓ Downgrade

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 Feb 08, 2022

Low Risk

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

Source: Morningstar

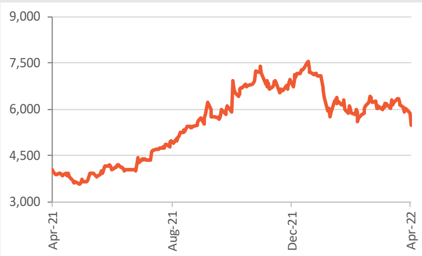
Company details

Market cap:	Rs. 96,156 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	-10.2	-20.2	-7.1	35.1
Relative to Sensex	-8.2	-13.4	1.1	16.9

Sharekhan Research, Bloomberg

Summary

- LTI's revenue growth for Q4FY22 lagged hopes as onsite volume growth declined, while EBIT margin remained in line with expectations. Deal TCVs and pipeline were strong. Q4 also saw strong logo additions and robust net hiring.
- Early investments in Cloud, new technologies and data, and strengthening of partnerships with hyperscalers & major technology vendors is yielding results in terms of capturing market opportunity.
- Conversations with clients on digital transformation, strong deal wins, a large deal pipeline, robust net headcount addition and broad-based demand indicate strong revenue growth momentum to continue in FY2023E.
- We maintain a Buy on LTI with a PT of Rs. 7,100 given its strong deal wins, consistent logo additions and broad-based demand. We expect revenue/EPS to clock 20%/19% CAGR over FY2022-24.

L&T Infotech (LTI) reported below-than-expected revenue growth owing to decline in onsite volume growth and a slowdown in the manufacturing vertical's revenue growth. Constant currency (CC) revenues grew by 3.6% q-o-q (up 29% y-o-y), led by decent strong growth in CPG, retail and pharmaceutical, energy & utilities and insurance verticals, and good client mining. Net headcount addition, closure of large deals, strong deal pipeline, consistent logo additions, moderation in quarterly annualized attrition rate and broad-based demand across industries remained impressive during the quarter. Reported USD revenue grew 3.1% q-o-q and 27.5% y-o-y to $570.4 million. EBIT margin declined by 64 bps q-o-q to 17.3%, in-line with our expectations, owing to higher employee costs and change in business mix. Except manufacturing, EBIT margins of all verticals declined sequentially. The company won four large deals with net new TCV of over $80 million. LTI believes that strong demand environment for IT services is likely to sustain given higher discretionary IT spends on business transformation initiatives.

Key positives

- It won four large deals with a net new large deal TCV of $80 million.
- Net headcount additions remained strong at 2,448;
- Highest logo addition in FY2022 since its listing
- Manufacturing vertical margin improved 186bps q-o-q

Key negatives

- Attrition inched up 150 bps q-o-q to 24%
- Onsite supply challenge given higher attrition

Management Commentary

- Strong demand environment for IT services is likely to sustain given higher discretionary IT spends on business transformation initiatives
- LTI guided for net profit margin in 14-15% for FY2023.
- The company plans fresher intake of 6,500 for FY2023.
- LTI to remain in the leaders' quadrant of the industry in terms of revenue growth in FY2023 with a stable net profit margins.

Revision in estimates – We have lowered our earnings estimates for FY23E/FY24E by 2.5-3% factoring in wage revision (290bps), inflation in developed markets and increasing travel expenses. We introduced FY2025E numbers in this note.

Our Call

Valuation – Strong growth momentum to continue: Early investments in cloud, new technologies and data and analytics and strengthening of partnerships with hyperscalers and major tech vendors is yielding results in terms of capturing market opportunities. We believe that LTI's margin would remain under pressure due to supply side challenges, higher onsite attrition and increasing discretionary expenses. Nonetheless, we estimate LTI to report strong USD revenue/EPS CAGR of 20%/19% over FY2022-FY2024E. At CMP, the stock trades at 35x/29x its FY2023E/FY2024E earnings. We continue to prefer LTI because of strong capabilities in core modernisation, resilient business model, robust client base, good client mining and strong capabilities in core modernisation. Hence, we maintain a Buy rating on LTI with a price target (PT) of Rs. 7,100.

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) Rs cr

Particulars	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)	41.9	34.5	29.4	25.0
P/B (x)	11.8	9.0	7.0	6.6
EV/EBITDA (x)	31.3	26.2	21.1	18.4
RoNW (%)	28.5	31.7	37.2	43.7
RoCE (%)	34.5	38.0	47.4	54.2

Source: Company; Sharekhan estimates

Decent quarter

L&T Infotech (LTI) reported lower-than-expected revenue growth owing to a decline in onsite volume growth, while operating margin remained in-line with the expectations. Constant currency (CC) revenue growth of 3.6% q-o-q (up 29% y-o-y) was decent, but below than our expectations. The company reported moderation in the revenue growth sequentially after two consecutive quarters of strong sequential growth of ~9%, driven by decent revenue growth in the CPG, retail and pharma (up 7.7% q-o-q in CC terms), energy and utilities (up 4.1% q-o-q in CC terms) and insurance (up 3.8% q-o-q CC) verticals and strong client mining. Reported USD revenue grew 3.1% q-o-q and 27.5% y-o-y to $570.4 million. EBIT margin declined 64bps q-o-q to 17.3%, in-line with our expectations, owing to a 40-bps impact from higher employee costs and 60 bps impact from change in business mix and working days, partially offset by SG&A leverage. Except manufacturing, EBIT margin of all verticals declined sequentially. Net profit came in at Rs. 637.5 crore (up 4.1% q-o-q and 30.5% y-o-y) and was 1.3% below our estimates, owing to revenue miss, partially offset by higher other income. Net profit margin stood at 14.8% in Q3FY2022. OCF/net profit stood at 98% in Q4FY2022 versus 70%/131% in Q3FY22/ Q4FY21, respectively.

Key result highlights

- **Brief round-up of FY2022 performance:** LTI crossed the $2.0 billion revenue milestone in FY2022 with record growth of 25.9% in FY2022, which is the strongest since its listing. The company reported revenue of $2,102.6 million in FY2022, implying growth of 25.8% y-o-y (in CC terms). The company added incremental revenue of $433 million during FY2022, which is almost 3x of the incremental revenue of FY2021. Revenue growth during FY2022 was driven by a strong growth in BFS (37.4% y-o-y), hi-tech, media and entertainment (37.4% y-o-y), manufacturing (23.4% y-o-y), CPG, retail and pharma (16.9% y-o-y), and other (34.5% y-o-y) verticals. All the service lines grew over 20% during FY2022, with strong growth in enterprise integration and mobility (up 38% y-o-y) and analytics, AI and cognitive (up 35% y-o-y). During FY2022, the company added three clients in $50 million revenue bucket and six clients in $20 million revenue bucket. Further, the company saw the highest ever new logo addition of 100 accounts. EBIT Margin declined 250bps y-o-y to 19.5%, owing to wage revision, high costs to backfill attrition and supply-side challenges. Adjusted net profit (excluding write-back of certain earnouts payable towards an earlier acquisition in FY2021) grew by 22.2% y-o-y to Rs. 2,298.5 crore. Net cash from operating activities declined by 31% y-oy to Rs. 1,652 crore. OCF to EBITDA during FY2022 stood at 54% compared to 88%/81% in FY2021/FY2020. The company declared the final dividend of Rs. 30 per share, taking total dividend of Rs. 45 per share in FY2022 versus Rs. 40 / Rs. 27 per share in FY2021/FY2020.
- **Demand outlook and net profit margin guidance:** LTI believes that strong demand for IT services is likely to sustain given higher discretionary IT spends on business transformation initiatives. The company won 4 large deals with net new TCV of over $80 million during the quarter. Out of these four large deals, the company won three deals from its existing Fortune-500 clients and one with the new logo. The company continues to see broad-based demand in the deal pipeline across the industries and geographies. Hence, the management remains confident of reporting strong growth in FY2023E. With healthy deal wins, sustained client mining strategies, strong net hiring, healthy deal pipeline and broad-based demand, LTI is expected to maintain strong revenue growth momentum in FY2023. The management reiterated that the company would remain in the leaders' quadrant of the industry in terms of revenue growth in FY2023 with a stable net profit margin. The company's efforts to address onsite volume challenge, large deal intake, conversations with clients on digital transformation and healthy deal pipeline provide confidence of delivering strong revenue growth in FY2023E.
- **Onsite attrition:** The company reported nearly flat volume growth in onsite despite elevated attrition in the onsite location.

- **Attrition rate inches up; fresher intake rises too:** Attrition rate for the last twelve months increased 150 bps q-o-q to 24%. Management indicated that the quarterly attrition rate has started cooling off in Q3FY2022 and dropped 200bps in Q4FY2022. The drop in quarterly attrition rate is significant in domestic market. Net staff additions remained at 10,657 in FY2022, taking the headcount growth of 30% in FY2022. The company hired fresher of 5,200 in FY2022, which was higher compared to its initial target of 4,500 at the beginning of the year. The company indicated that it would hire more than 6,500 fresher in FY2023, which indicates underlying demand.
- **Strong growth in the BFS and insurance vertical:** The company's largest vertical (BFS) grew by 3.3% q-o-q and 37.3% y-o-y in CC terms, led by broad-based demand across geographies. Insurance vertical's revenue growth was at 3.8% q-o-q and 18.1% y-o-y, led by strong demand. Growth momentum would continue given large deal wins and new logo win the insurance vertical.
- **Manufacturing vertical revenue growth moderated; strong outlook remains intact:** The manufacturing vertical's revenue grew by 2.3% q-o-q and 28.4% y-o-y on a CC basis. It sees strong growth across sub-segments given higher digitalisation, strong demand for data and analytics for real-time decision making, industry 4.0 and change in operating models. The growth momentum would remain strong led by ramp-up of new logos and successful client mining.
- **Wage hikes:** The company has rolled out salary hikes for most of its employees, effective from April 2022. Management cited that the impact of wage hike would be ~290 bps.
- **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:** Revenues from top five accounts grew by 3.1% q-o-q (versus a growth of 9.0% q-o-q in Q3FY2022). Revenues from the top 10/20 accounts grew by 3%/3.7% q-o-q. Revenue from other than top 20 accounts grew by 2.5% q-o-q during Q4FY2022.
- **Client metrics continue to stay healthy, led by strong demand:** LTI added 25 clients (versus 27 new clients in Q3FY2022) across all verticals in Q4FY2022. The total F-500 logos stood at 72. Since its listing, the company added the highest number of new logos in a year in FY2022. The number of clients under the $100 million and $50 million client buckets remained flat q-o-q, while the number of clients under the $20 million and $10 million increased by 4 and 1, 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 3, 6, 9 and 11, respectively.
- **Strong large deal TCV in Q4:** The company won four large deals with a large deal TCV of $80 million in Q4FY2022. The management sees multiple small-sized deals given higher discretionary spends on transformation projects. The company won two deals in BFSI vertical, one deal in CPG and the remaining one with the government body in public healthcare space. The company's large deal pipeline continues to be at $2 billion. The company indicated that 50% of its large deal pipeline is in the late stage, while four deals are in the contracting stage. Management cited that 40% of its large deal pipeline is with new logos.
- **OCF to net profit ratio remained healthy:** Operating cash flow stood at Rs. 623.3 crore (up 45% q-o-q, but down 13% y-o-y). OCF to net profit ratio remained at 98% in Q4FY2022 versus 70% in Q3FY2022. Cash & liquid investments stood at Rs. 3,913.9 crore as compared to at Rs. 3,614.2 crore in Q3FY2022.
- **Dividend payment:** The company declared the final dividend of Rs. 30 per share, taking total dividend of Rs. 45 per share in FY2022 versus Rs. 40 / Rs. 27 per share in FY2021/FY2020. The company's dividend payout ratio stood at 41.9% for FY2022.
- **DSO:** Billed DSO decreased by 1 day to 65 days. DSO including unbilled revenue decreased by 1 day to 99 days on a q-o-q basis.

Results (Consolidated) Rs cr

Particulars	Q4FY22	Q4FY21	Q3FY22	Y-o-Y %	Q-o-Q %
Revenue ($ mn)	**570.4**	**447.4**	**553.0**	**27.5**	**3.1**
Revenue (Rs. cr)	**4,301.6**	**3,269.4**	**4,137.6**	**31.6**	**4.0**
Direct costs	3,011.1	2,223.3	2,854.7	35.4	5.5
SG&A	444.1	330.6	451.8	34.3	-1.7
EBITDA	**846.4**	**715.5**	**831.1**	**18.3**	**1.8**
Depreciation	101.9	82.6	88.5	23.4	15.1
EBIT	**744.5**	**632.9**	**742.6**	**17.6**	**0.3**
Other income (including FX)	115.1	83.9	81.1	37.2	41.9
PBT	859.6	716.8	823.7	19.9	4.4
Tax provision	222.1	171.1	211.2	29.8	5.2
Net profit	**637.5**	**545.7**	**612.5**	**16.8**	**4.1**
EPS (Rs.)	**36.3**	**31.0**	**34.9**	**16.8**	**4.0**
Margin (%)				BPS	BPS
EBITDA	19.7	21.9	20.1	-221	-41
EBIT	17.3	19.4	17.9	-205	-64
NPM	14.8	16.7	14.8	-187	2
Tax rate	25.8	23.9	25.6	197	20

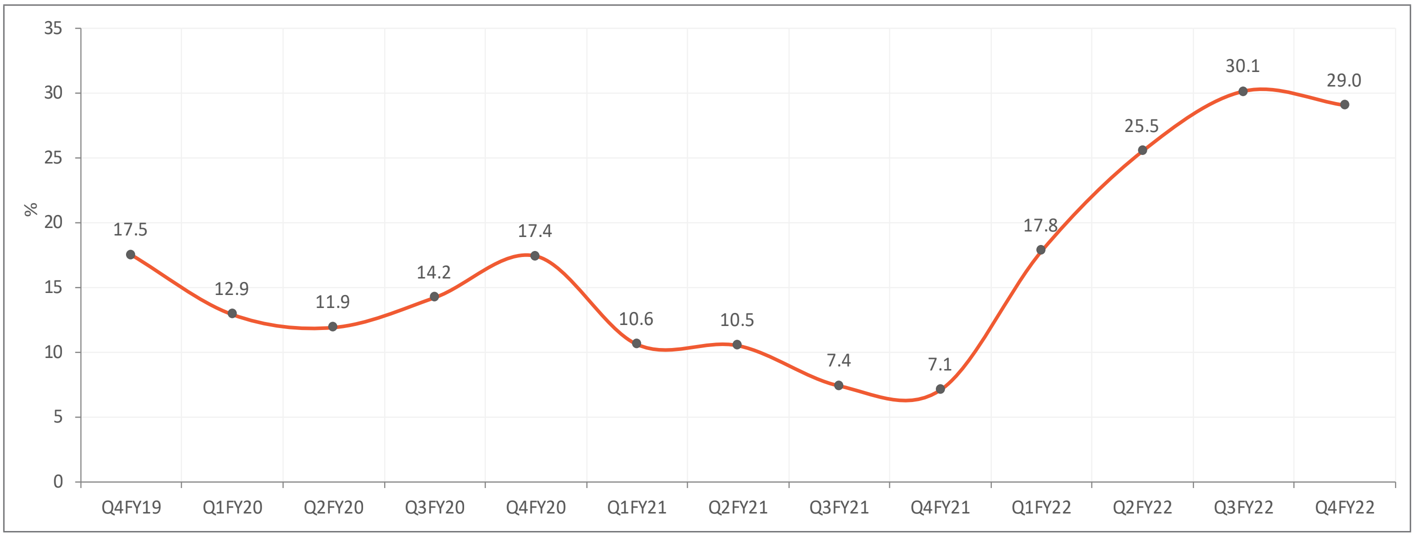
Source: Company; Sharekhan Research

Operating metrics

Particulars	Revenues	Contribution	$ Growth (%)		CC growth (%)	
	($ million)	(%)	Q-o-Q %	Y-o-Y %	Q-o-Q %	Y-o-Y %
Revenue ($ million)	570	100	3.1	27.5	3.6	29.0
Geographic mix						
North America	374	65.6	2.5	26.3	2.6	26.3
Europe	92	16.2	5.8	25.3	8.2	32.6
ROW	47	8.3	-0.3	25.5	-0.3	26.6
India	56	9.9	6.0	42.1	6.4	45.0
Industry verticals						
BFS	187	32.7	2.8	35.5	3.3	37.3
Insurance	76	13.4	3.7	17.6	3.8	18.1
Manufacturing	96	16.8	1.9	26.5	2.3	28.4
Energy & Utilities	50	8.8	3.6	23.0	4.1	24.3
CPG, Retail and Pharma	59	10.3	7.0	21.9	7.7	24.2
High-Tech, Media and Entertainment	67	11.7	2.0	27.1	2.2	27.8
Others	36	6.3	2.7	30.6	3.3	32.9
Service offerings						
ADM and Testing	188	33.0	1.4	26.1	1.8	27.6
Enterprise Solutions	176	30.8	1.3	21.6	2.0	23.3
Cloud Infrastructure & Security	78	13.7	7.3	15.9	8.0	17.3
Analytics, AI and Cognitive	73	12.8	4.5	46.8	4.7	47.9
Enterprise Integration and Mobility	55	9.7	8.0	51.8	8.4	53.5

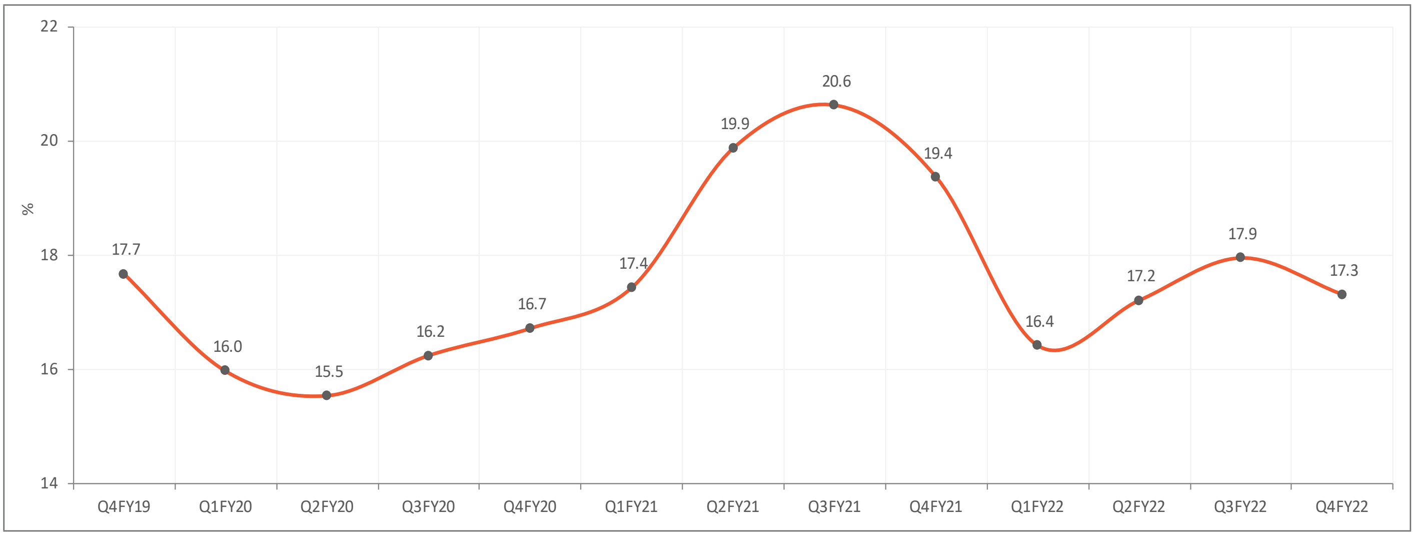
Source: Company; Sharekhan Research

LTI' CC revenue growth trend (y-o-y)



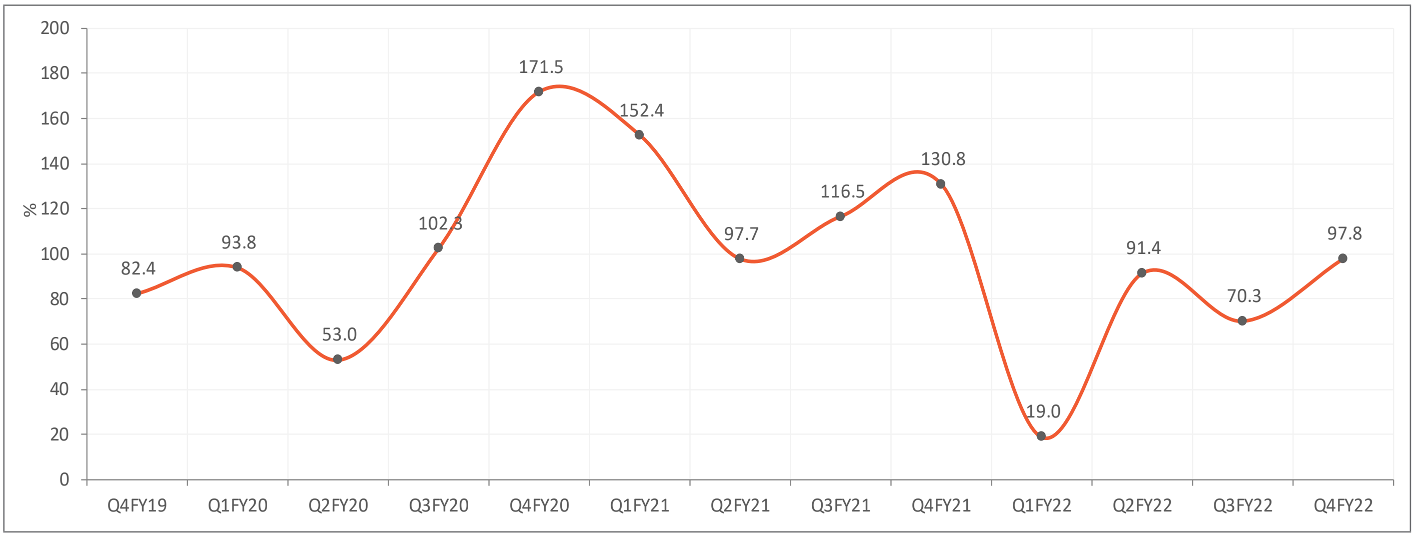
Source: Sharekhan Research

EBIT margin trend (%)



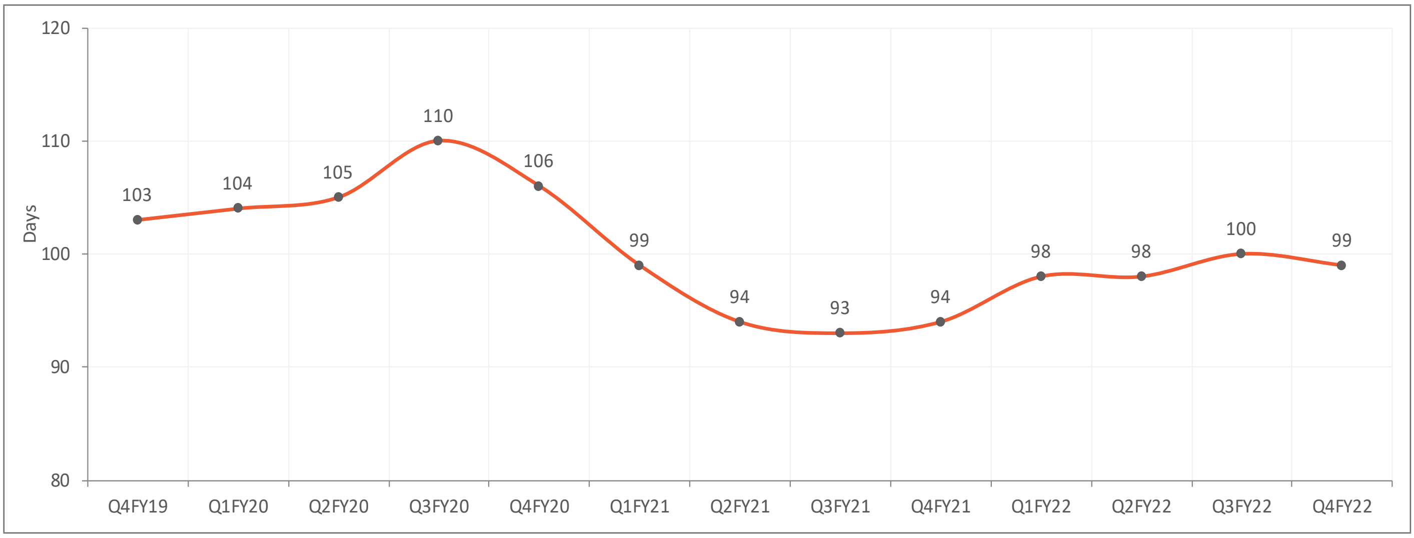
Source: Sharekhan Research

CFO as a % of net profit



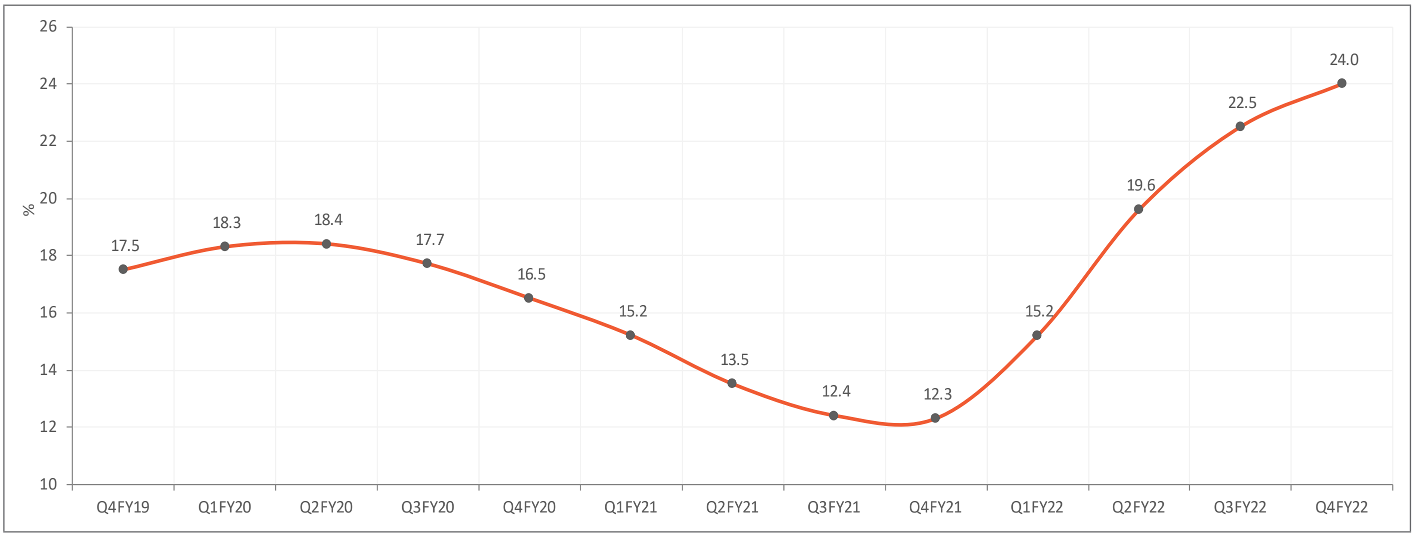
Source: Sharekhan Research

DSO (including unbilled) trend



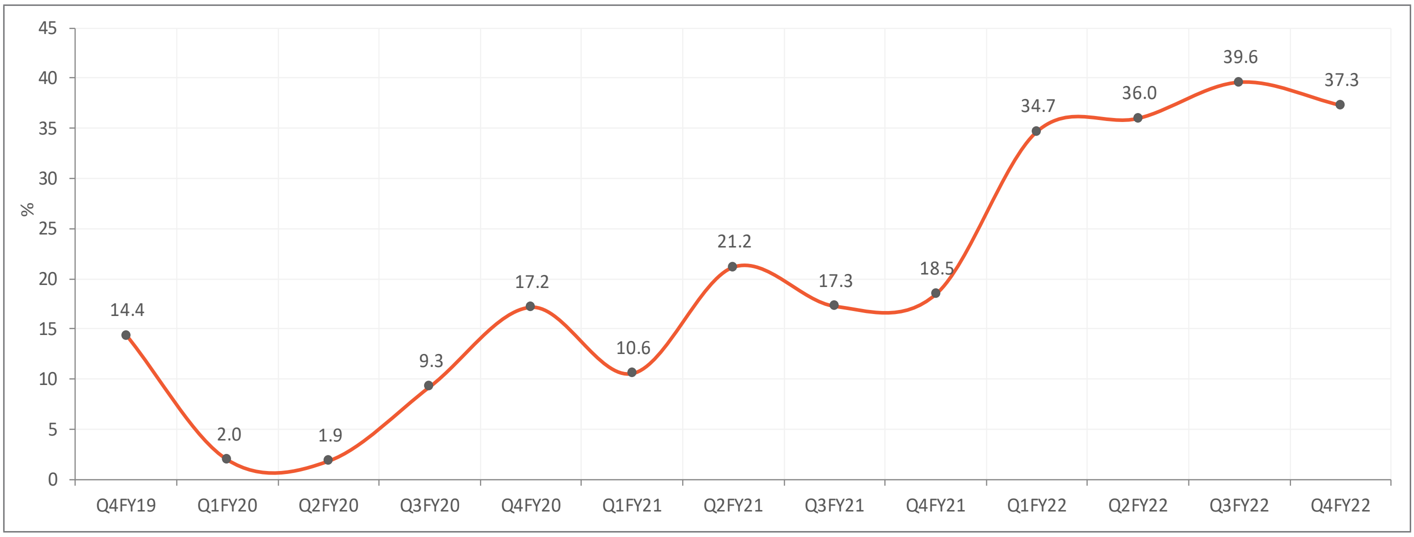
Source: Sharekhan Research

Attrition rate (%)



Source: Sharekhan Research

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



Source: Sharekhan Research

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.

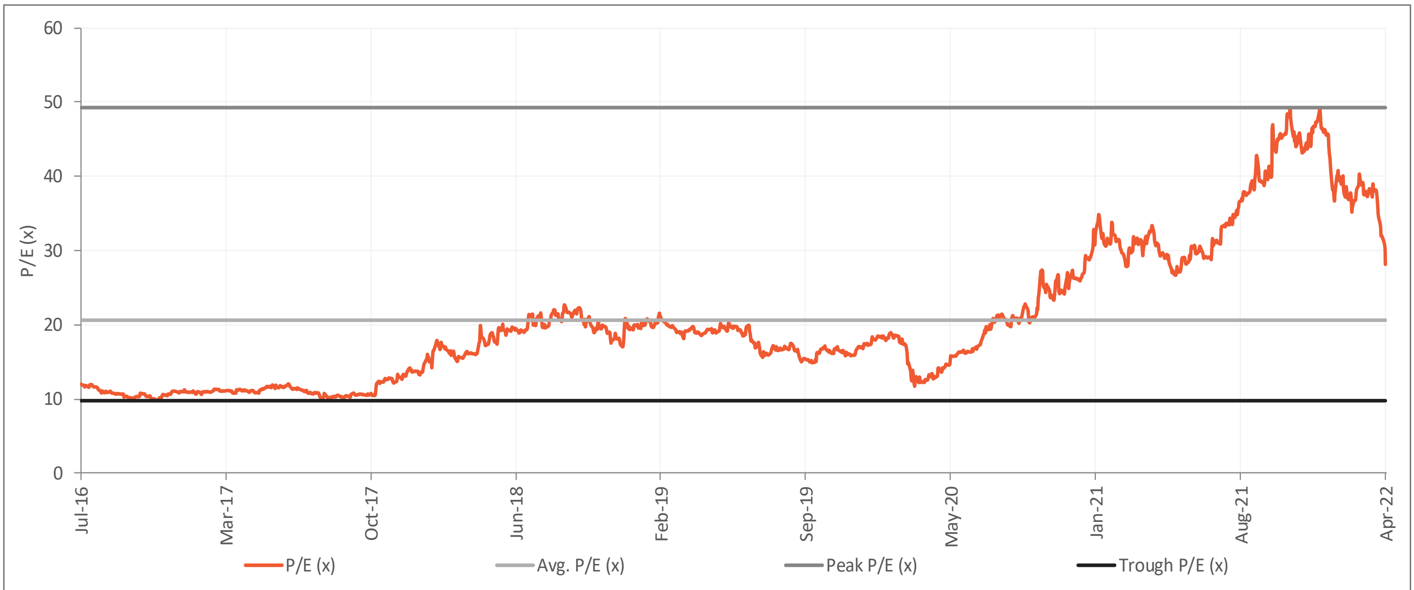
■ Company Outlook – Superior execution likely to drive outperformance

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 – Strong growth momentum to continue

Early investments in cloud, new technologies and data and analytics and strengthening of partnerships with hyperscalers and major tech vendors is yielding results in terms of capturing market opportunities. We believe that LTI's margin would remain under pressure due to supply side challenges, higher onsite attrition and increasing discretionary expenses. Nonetheless, we estimate LTI to report strong USD revenue/EPS CAGR of 20%/19% over FY2022-FY2024E. At CMP, the stock trades at 35x/29x its FY2023E/FY2024E earnings. We continue to prefer LTI because of strong capabilities in core modernisation, resilient business model, robust client base, good client mining and strong capabilities in core modernisation. Hence, we maintain a Buy rating on LTI with a price target (PT) of Rs. 7,100.

One-year forward P/E (x) band



Source: Sharekhan Research

Peer valuation

Particulars	CMP (Rs / Share)	O/S Shares (Cr)	MCAP (Rs Cr)	P/E (x)		EV/EBIDTA (x)		P/BV (x)		RoE (%)	
				FY23E	FY24E	FY23E	FY24E	FY23E	FY24E	FY23E	FY24E
Infosys	1,564	421	6,57,913	26.2	22.9	17.7	15.3	4.4	4.0	30.9	31.9
TCS	3,474	366	12,71,264	29.1	25.7	20.1	17.6	12.9	11.2	46.3	46.7
LTI	5,486	18	96,156	34.5	29.4	26.2	21.1	9.0	7.0	31.7	37.2

Source: Company, Sharekhan estimates

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. Subrahmanyan	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	5.35
2	UTI Asset Management Co Ltd	1.88
3	UTI Flexi Cap Fund	1.81
4	Wasatch advisors Inc	1.40
5	Blackrock Inc	0.95
6	Vanguard Group	0.81
7	Invesco Limited	0.71
8	Aditya Birla Sun life Asset management	0.64
9	Axis Asset Management Co Ltd/India	0.53
10	Norges Bank	0.46

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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by BNP PARIBAS

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