Sharekhan by BNP PARIBAS

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Stock Update

Result Update

LTIMindtree Ltd

Weak Q3; Synergy benefits ahead

IT & ITES	Sharekhan code: LTIM
Reco/View: Buy ↔	CMP: Rs. 4,368 / Price Target: Rs. 4,965 ↓

↑ 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 Dec 08, 2022

Low Risk

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

Source: Morningstar

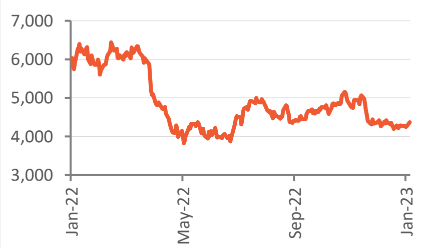
Company details

Market cap:	Rs. 1,29,205 cr
52-week high/low:	Rs. 6,600 / 3,733
NSE volume: (No of shares)	3.9 lakh
BSE code:	540005
NSE code:	LTIM
Free float: (No of shares)	9.3 cr

Shareholding (%)

Promoters	68.7
FII	9.2
DII	10.4
Others	11.7

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	2.4	-8.4	-3.0	-26.8
Relative to Sensex	0.6	-11.1	-11.7	-32.8

Sharekhan Research, Bloomberg

Summary

- For Q3FY23, LTIMindtree reported revenues of $1.05 billion, a growth of 16.3% y-o-y in CC terms, missing street estimates due to furloughs and fewer working days. EBIT margins came in at 13.9% as against 17.5% in Q2FY23. Margins were impacted due to furloughs, fewer working days , one-time merger-related integration costs, increase in employee and other operating expenses.
- In terms of verticals, manufacturing (17.5% of mix) led growth with 10.6% q-o-q growth while BFSI (37.4% of mix) and CPG & Retail (15.2% of the mix) grew 5.8% and 1.1%, respectively. The Hi-tech & Health verticals' revenues declined 4.5% & 5.1% q-o-q, respectively while in terms of geographies, North America (72.3% of mix) reported muted growth of 1.6% q-o-q while Europe & RoW reported growth of 4.5% & 4.9%, respectively. LTM attrition declined by 180 bps q-o-q to 22.3%.
- In the quarter the company had a robust order inflow of $1.25 billion. The company also stated that it has a healthy pipeline ahead and continues to see large deals in the market. Management expects synergy benefits of US$1 bn and margin expansion of 200 to 300 bps over the next four to five years.
- We expect the outlook for FY24 to be uncertain on account of global headwinds and any recovery is most likely to be gradual. Post-merger, LTIMindtree is well placed to provide cross-sell and up sell opportunities and reap significant revenue and cost synergies over the longer term .Hence, we maintain a Buy rating on LTIMindtree with revised PT of Rs. 4965 despite the muted results in a seasonally weak quarter.

For Q3FY23, LTIMindtree reported revenues of $1.05 billion, a growth of 16.3% y-o-y in CC terms missing street estimates due to furloughs and fewer working days. EBIT margins came in at 13.9% as against 17.5% in Q2FY2023. Margins were impacted to the tune of 130 bps due to furloughs and fewer working days, a 100 bps impact due to one-time merger related integration cost and an impact of 130 bps due to an increase in employee and other operating expenses. The company reported net profit at Rs 1000.7 crore. In terms of verticals, manufacturing (17.5% of mix) led the growth with 10.6% q-o-q growth while BFSI (37.4% of mix) and CPG & Retail (15.2% of the mix) grew 5.8% and 1.1%, respectively. Hi-Tech & Health declined 4.5% & 5.1% q-o-q, respectively while in terms of geographies, North America (72.3% of mix) reported muted growth of 1.6% q-o-q while Europe & RoW reported growth of 4.5% & 4.9%, respectively. In the quarter, the company had a robust order inflow of $1.25 billion. Net employee addition declined by 474 employees in Q3FY23 taking. LTM attrition reduced to 22.3% in Q3FY23 versus 24.1% in Q2FY23.The company announced an interim dividend of Rs 20 per equity share of Rs 1 each. Management expects synergy benefits of $1-bn and margin expansion of 200 to 300 bps over the next four to five years. Management stated that the merged entity is well placed to provide digital transformation to clients. We expect the outlook for FY24 to be uncertain on account of global headwinds and any recovery is most likely to be gradual. Post-merger, LTIMindtree is well-placed to provide cross-selling and up-selling opportunities and reap significant revenue and cost synergies over the longer term .Hence we maintain Buy rating on LTIMindtree with a revised PT of Rs. 4965 despite the muted results in a seasonally weak quarter.

Key positives

- LTM attrition reduced to 22.3% in Q3FY23 versus 24.1% in Q2FY23
- In the quarter the company reported a robust order inflow of $1.25 billion

Key negatives

- EBIT margins stood at 13.9% in Q3FY2023 as against 17.5% in Q2FY2023
- Net employee addition declined by 474 employees in Q3FY23 taking total headcount to 86462.
- Utilization excluding trainees was at 82.9% compared to 83.5% in Q2FY23.

Management Commentary

- The management stated that the merged entity is well placed to provide digital transformation to its clients. The company is witnessing high caution with respect to client spending, however there have been no cancellations till date. Some clients have deferred some projects and are taking relatively longer to make decisions. The overall focus on longer term transformation remains intact across all sectors.
- The company also indicated it is not seeing any major issues in Banking, Insurance, Energy verticals barring a few pockets of weakness as far as client spending is concerned. LTIMindtree added that it has seen some weakness in the Hi-tech vertical as well as real estate piece of Travel & Hospitality (TTH) vertical.
- Management expects synergy benefits of US$1 bn and margin expansion of 200 to 300 bps over the next four to five years. The company also stated that it has a healthy pipeline ahead and continues to see large deals in the market.

Revision in estimates – We have fine-tuned our estimates for FY23/24/25 owing to macro overhang and INR-USD reset.

Our Call

Valuation – Maintain Buy with a revised PT of Rs. 4965: We expect the outlook for FY24 to be uncertain on account of global headwinds and any recovery is most likely to be gradual. Post-merger, LTIMindtree is well-placed to provide cross-selling and up-selling opportunities and reap significant revenue and cost synergies over the longer term .Hence, we maintain Buy rating on LTIMindtree with a revised PT of Rs. 4965 despite the muted results in a seasonally weak quarter.

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	26,109	33,162	36,115	41,006
OPM (%)	20.1%	18.1%	19.5%	19.8%
Adjusted PAT (Rs cr)	3,948	4,322	5,259	6,119
% YoY growth		*9.5*	*21.7*	*16.4*
Adjusted EPS (Rs)	133.5	146.1	177.8	206.9
P/E (x)	32.7	29.9	24.6	21.1
P/B (x)	8.9	7.3	5.9	5.2
EV/EBITDA	21.2	14.4	7.2	3.1
ROE (%)	30.2	26.7	26.6	26.3
ROCE (%)	34.9	34.1	33.5	33.2

Source: Company; Sharekhan estimates

Key result highlights

- **Weak Revenue and EBIT margins:**

  For Q3FY23 LTIMindtree reported revenue of US$1.05bn, constant currency growth of 1.9% QoQ while dollar revenue growth was 2.4% QoQ. LTIMindtree in USD terms while in rupee terms revenue was at 8,620 crore, up 4.8% QoQ missing street estimates due to furloughs and fewer working days. EBIT margins came in at 13.9% in Q3FY2023 as against 17.5% in Q2FY2023. Margins were impacted to the tune of 130 bps due to furloughs and fewer working days, a 100 bps impact due to one-time merger related integration cost and an impact of 130 bps due to increase in employee and other operating expenses.

- **Performance across geographies and Verticals**

  In terms of verticals, manufacturing (17.5% of mix) led the growth with 10.6% q-o-q growth while BFSI (37.4% of mix) and CPG & Retail (15.2% of the mix) grew 5.8% and 1.1%, respectively. Revenues of the Hi-Tech & Health verticals declined 4.5% & 5.1% q-o-q, respectively while in terms of geographies, North America (72.3% of mix) reported muted growth of 1.6% q-o-q while Europe & RoW reported growth of 4.5% & 4.9%, respectively.

- **Management commentary on Verticals**

  The company's BFSI segment revenues grew 22% y-o-y. The continued revenue momentum was backed by significant deal wins including new logos, rate increases and a growing pipeline of large deals. The insurance business has hit $100 million run rate annually. Hi-tech, Media and communication grew by 9% YoY. The strong growth momentum which was witnessed earlier in the year decelerated on account of furloughs. Manufacturing and resources business grew 8.8% YoY. The growth in Manufacturing was a result of improved outsourcing pipeline and deal wins mainly in automotive sector. Retail CPG, Travel, transportation and Hospitalization grew 10.7% yoy. Within retail and CPG clients are being cautious because of high inflation however they continue to invest in digital and data platforms to drive their digital transformation journeys. Travel, transportation and Hospitalisation business witnessed robust growth .Health, Life Sciences & Public Services business grew by 11.9% y-o-y. Health and life-sciences grew 22.3% was partially offset by the project specific softness in public services portfolio.

- **Headcount addition & attrition**

  Net employee additions declined by 474 employees in Q3FY23 taking total headcount to 86,462. LTM attrition reduced to 22.3% in Q3FY23 versus 24.1% in Q2FY23.

- **DSO**

  Billed DSO increased by 5 days to 61 days and DSO including unbilled revenue decreased by 5 days to 90 days on a q-o-q basis.

Results (Consolidated) Rs cr

Particulars	Q3FY23	Q3FY22	Q2FY23	Y-o-Y %	Q-o-Q %
Revenues In USD (mn)	**1,046.7**	**918.4**	**1,021.7**	**14.0**	**2.4**
Revenues In INR	**8,620.0**	**6,880.7**	**8,227.8**	**25.3**	**4.8**
Direct Costs	6,155.5	4,660.4	5,690.4	32.1	8.2
SG&A	1,089.7	794.0	901.8	37.2	20.8
EBITDA	**1,374.8**	**1,426.3**	**1,635.6**	**-3.6**	**-15.9**
Depreciation & amortization	178.1	151.8	195.9	17.3	-9.1
EBIT	**1,196.7**	**1,274.5**	**1,439.7**	**-6.1**	**-16.9**
Forex gain/(loss)	49.0	107.1	19.8	-54.2	147.5
Other Income	102.8	59.0	141.3	74.2	-27.2
Other income (including FX)	151.8	166.1	161.1	-8.6	-5.8
PBT	**1,348.5**	**1,440.6**	**1,600.8**	**-6.4**	**-15.8**
Tax Provision	309.9	359.1	374.0	-13.7	-17.1
PAT	**1,000.7**	**1,050.1**	**1,189.0**	**-4.7**	**-15.8**
Adjusted net profit	**1,000.7**	**1,050.1**	**1,189.0**	**-4.7**	**-15.8**
EPS (Rs)	33.9	34.9	40.2	-2.8	-15.7
Margin (%)					
EBITDA	15.9	20.7	19.9	-478	-393
EBIT	13.9	18.5	17.5	-464	-362
NPM	11.6	15.3	14.5	-365	-284
Tax rate	23.0	24.9	23.4	-195	-38

Source: Company; Sharekhan Research

Operating metrics Rs cr

Particulars	Revenues ($ mn)	Contribution (%)	$ Growth (%)		CC growth (%)	
			Q-o-Q %	Y-o-Y %	Q-o-Q %	Y-o-Y %
Revenues ($ mn)	1,047	100	2.4	14.0	1.9	16.3
Geographic mix						
North America	757	72.3	1.6	19.6	0.0	0.0
Europe	156	14.9	4.6	0.5	0.0	0.0
ROW	134	12.8	4.9	2.7	0.0	0.0
Industry verticals						
BFSI	391	37.4	5.8	21.8	0.0	0.0
Manufacturing	183	17.5	10.6	9.0	0.0	0.0
Retail, CPG, Travel, Transportation & Hospitalilty	159	15.2	1.1	11.0	0.0	0.0
High-Tech, Media & Entertainment	247	23.6	-4.4	8.9	0.0	0.0
Health, Life Sciences & Public Services	66	6.3	-5.1	11.9	0.0	0.0

Source: Company; Sharekhan Research

Outlook and Valuation

■ Sector View – Persisting multiple global headwinds turning outlook for FY24E uncertain

Owing to multiple global headwinds the outlook for FY24E looks uncertain, and the recovery could be gradual in the coming quarters. Hence, concerns relating to macro headwinds are unlikely to abate anytime soon thus restricting any material outperformance for Indian IT companies.

■ 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 – Maintain Buy with a revised PT of Rs. 4965

We expect the outlook for FY24 to be uncertain on account of global headwinds and any recovery is most likely to be gradual. Post-merger, LTIMindtree is well-placed to provide cross-selling and up-selling opportunities and reap significant revenue and cost synergies over the longer term .Hence, we maintain Buy rating on LTIMindtree with a revised PT of Rs. 4965 despite the muted results in a seasonally weak quarter.

Peer valuation

Particulars	CMP (Rs / Share)	O/S Shares (Cr)	MCAP (Rs Cr)	P/E (x)		EV/EBITDA (x)		P/BV (x)		RoE (%)	
				FY23E	FY24E	FY23E	FY24E	FY23E	FY24E	FY23E	FY24E
LTIMindtree	4368	30	1,29,215	29.9	24.6	14.4	7.2	7.3	5.9	26.7	26.6
Infosys	1,548	404	6,24,690	26.5	24.9	17.6	16.3	4.4	4.1	30.5	30.1
TCS	3,414	356	12,14,805	29.7	27.3	20.4	18.8	12.7	11.2	44.7	43.6

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 77 of the Fortune Global 500 companies. The company has 23 delivery centres and 43 sales offices, with employee strength of over 48,000+. LTI's vertical focus is heavily towards banking and financial services, insurance, and manufacturing, which together contribute ~62% to total revenue. LTI and Mindtree Ltd (Mindtree), on May 06, 2022, announced the proposal to merge Mindtree into LTI through a scheme of amalgamation as approved by the respective boards of the companies. L&T Infotech (LTI) and Mindtree have merged into LTIMindtree in Nov 2022, becoming the country's fifth largest provider of IT services by market capitalisation and sixth largest IT company 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 and/or adverse cross-currency movements, 2) constraint in local talent supply in the US would have an adverse impact on its earnings and 3) macro headwinds and possible recession in the US are likely to moderate the pace of technology spending.

Additional Data

Key management personnel

A. M. Naik	Founder Chairman
S. N. Subrahmanyan	Non-Executive Vice Chairman
Nachiket Deshpande	COO
Sudhir Chaturvedi	President sales

Source: Company Website

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	UTI Asset Management Co Ltd	1.87
2	Vanguard Group Inc	0.99
3	Aditya Birla Sun life Asset management	0.96
4	Blackrock Inc	0.88
5	Axis Asset Management Co Ltd	0.84
6	UTI International Singapore pte	0.44
7	Tata Asset Management Pvt Ltd	0.39
8	Wasatch advisors Inc	0.39
9	Norges Bank	0.36
10	Mirae Asset Global Investment Co	0.31

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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