Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Stock Update

Result Update

LTIMindtree Ltd

Near term headwinds, downgrade to Hold

IT & ITES	Sharekhan code: LTIM
Reco/View: Hold ↓	CMP: **Rs. 6,278** / Price Target: **Rs. 6,660** ↑

↑ 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		↓	

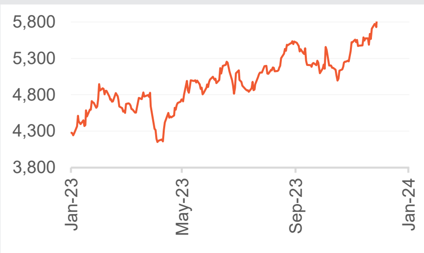
Company details

Market cap:	Rs. 1,85,764 cr
52-week high/low:	Rs. 6,443 / 4,120
NSE volume: (No of shares)	3.8 lakh
BSE code:	540005
NSE code:	LTIM
Free float: (No of shares)	9.3 cr

Shareholding (%)

Promoters	68.7
FII	8.1
DII	12.9
Others	10.4

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	2.4	20.4	22.3	46.7
Relative to Sensex	2.4	12.7	14.9	28.8

Sharekhan Research, Bloomberg

Summary

- LTIMindtree reported revenues at $1084, up 0.7%/3.5% q-o-q and y-o-y respectively in constant currency (CC), which was largely in line with our estimates of 0.9% q-o-q CC revenue growth, impacted by higher and wider than expected furloughs.
- EBIT margins declined ~60 bps q-o-q to 15.4% due to furloughs, lower working days and seasonal pass-through revenue offset by lower SG&A and operational efficiencies, missing our estimates of 15.7%. Company reported highest ever deal win of $1.5 billion.
- Management stated that the aspiration of 17-18% exit margin for FY24 will get pushed out by few quarters due to their commitment to invest in growth opportunities.
- We believe while the strong order inflows and ramp ups of deals would aid revenue growth, near term investments required for scaling up is likely to weigh on the margins and limit the earnings growth. Hence, we downgrade LTIMindtree to Hold with revised price target (PT) of a Rs 6,660 (increase in PT reflects roll forward to FY26 E EPS). At CMP, the stock trades at 32.6x/28.3x its FY25/26E EPS.

LTIMindtree's constant currency revenue growth of 0.7% q-o-q was largely in-line with our estimate of 0.9% q-o-q growth. The company reported revenue at $1084 million, up 1.2% q-o-q/ 4.6% y-o-y. Revenue in rupee terms stood at Rs. 9017 crores up 1.2 q-o-q/4.6% y-o-y. Revenue growth was led by Manufacturing and Healthcare vertical but offset by weakness in Hi-tech, Retail and BFSI vertical. The company recorded the highest ever order inflow stood at $1.5 billion for the quarter, up 21% y-o-y. EBIT margin declined ~60 bps q-o-q to 15.4% due to furloughs, lower working days and seasonal pass through revenue offset by lower SG&A and operational efficiencies, missing our estimates of 15.7%. Net profit stood at Rs.1169 crore, up 0.6%/ 16.8% q-o-q and y-o-y respectively missing our estimates of Rs. 1181 crore. Company recorded highest-ever order inflow stood of $1.5 billion, up 21% y-o-y. Net Headcount additions declined 1061 taking the total headcount to 82,471. Attrition rate declined by 100 bps q-o-q to 14.2%. Utilisation (excluding trainees) improved to 87.4%, up 80 bps q-o-q. LTIMindtree reported in-line Q3 revenue growth in a seasonally soft quarter impacted by higher and wider than expected furloughs. Order inflow was robust being highest ever, while pipeline continues to stay strong. The company's strong order inflow and healthy deal pipeline has set the stage for medium-term growth. We believe while strong order inflows and ramp ups of deals would aid revenue growth as macro headwinds recede, the near-term investments required for scaling up as utilisation is at peak levels, is likely to weigh on the margins and limit the earnings growth. Hence, we downgrade LTIMindtree to Hold with revised price target (PT) of a Rs 6,660 (increase in PT reflects roll forward to FY26E EPS). At CMP, the stock trades at 32.6x/28.3x its FY25/26E EPS.

Key positives

- Highest ever order inflow stood of $1.5 billion, up 21% y-o-y.
- LTM attrition declined by 100 bps q-o-q to 14.2%
- Utilisation (Excluding trainees) improved 80 bps q-o-q to 87.4%
- Manufacturing vertical grew 14.3% q-o-q

Key negatives

- EBIT margin declined ~60 bps q-o-q to 15.4%.
- Retail and Hitech verticals declined 3.2%/3.0% q-o-q respectively.
- Net headcount additions declined 1061 taking the total headcount to 82,471.

Management Commentary

- Despite higher than anticipated seasonality in Q3, the company's strong order inflow and healthy deal pipeline has set the stage for medium-term growth.
- Q4 is expected to remain similar to the Q3, with continued challenging macroeconomic environment and delays in client decision making.
- Discretionary book is not getting refreshed as before and hence company is falling back on long term cost take out deals for growth.
- Most anticipated merger synergies are playing out well with a 30% increase in the overall pipeline except for macro headwind impact on discretionary spends.

Revision in estimates – We have revised our estimates to factor Q3FY24 performance and the soft near-term outlook.

Our Call

Valuation – Downgrade to Hold with revised PT of Rs. 6,660: The company's strong order inflow and healthy deal pipeline has set the stage for medium-term growth. We expect sales/PAT CAGR of 10.5%/14.2% over FY23-26E. However, we believe while the strong order inflows and ramp ups of deals would assist in picking up growth momentum as macro headwinds recede, with utilisation at peak levels the near term investments required for scaling up is likely to weigh on the margins and limit the earnings growth. Hence, we downgrade LTIMindtree to Hold with revised price target (PT) of a Rs 6,660 (increase in PT reflects roll forward to FY26E EPS). At CMP, the stock trades at 32.6x/28.3x its FY25/26E EPS.

Key Risks

Rupee appreciation and/or adverse cross-currency movements. Contagion effect of banking crisis, macro headwinds and a possible recession in the US are likely to moderate the pace of technology spending.

Valuation (Consolidated) Rs cr

Particulars	FY22	FY23	FY24E	FY25E	FY26E
Total Revenue	26,109	33,183	35,782	39,870	44,783
EBITDA margin %	20.1%	18.4%	18.3%	18.9%	19.1%
Adjusted Net Profit	3,948	4,408	4,766	5,701	6,568
% YoY growth		*11.7*	*8.1*	*19.6*	*15.2*
EPS (Rs)	133.4	149.0	161.1	192.6	222.0
PER (x)	47.0	42.1	39.0	32.6	28.3
P/BV (x)	12.8	10.4	8.7	7.6	6.7
EV/EBITDA	32.0	23.4	16.3	10.9	9.6
ROE (%)	30.2	27.2	24.3	24.9	25.3
ROCE (%)	34.9	34.6	31.3	31.4	33.7

Source: Company; Sharekhan estimates

Key result highlights

- **Revenue growth:** Revenues stood at $1084, up 0.7%/3.5% q-o-q and y-o-y respectively in constant currency (CC) which was largely in line with our estimates of 0.9% q-o-q CC revenue growth. Revenue in rupee terms stood at Rs. 9017 crores up 1.2 q-o-q/4.6% y-o-y. Revenue growth was led by Manufacturing and Healthcare vertical but offset by weakness in Hi-tech, Retail and BFSI vertical. Company registered highest ever order inflow stood at $1.5 billion for the quarter, up 21% y-o-y.

- **Margins:** EBIT margin fell ~60 bps to 15.4% owing to furloughs, furloughs, lower working days, and seasonal pass-through revenue (-200bps) offset by SG&A benefit (+80bps) and operational efficiencies (+60 bps). Management stated that the aspiration of 17-18% exit margin will get pushed out by few quarters due to their commitment to invest in growth opportunities.

- **Vertical-wise performance:** In terms of verticals, Manufacturing and Healthcare vertical was up 14.3% /0.8% q-o-q respectively while Hi-tech, Retail and BFSI vertical which declined 3.0%/3.2% and 1.7% q-o-q respectively. The company continues to see challenges in BFS while insurance remains resilient. Company is seeing demand for services related to data in the travel, transport, and hospitality vertical.

- **Geography-wise performance:** In terms of geographies, North America/Europe declined 0.2%/4.5%, respectively while ROW grew 14.1% q-o-q, respectively.

- **People Metrics:** LTM attrition declined by 100 bps q-o-q to 14 .2%. Net additions declined 1061 q-o-q taking the total headcount to 82,471. Utilisation (excluding trainees) improved to 87.4% up 80bps q-o-q. The company onboarded 500 plus freshers this quarter and plan to continue hiring on a relatively real time basis. The company has trained over 10,000 employees on Gen AI to stay ahead in the ever- evolving AI landscape.

- **Client Metrics:** LTIMindtree added 23 new clients while the number of active clients increased to 739 from 737. Client additions in $50 million+, $20 million+ and $10 million+ category declined by -2/-1 and -1 q-o-q respectively while $5 million + category increased by 3 q-o-q. Top 5, Top 10, Top 20 and Top 40 client revenues grew 3.4%/3.7%/2.3% and 2.3% q-o-q respectively .

- **Strong Cash Conversion:** The operating cash flow to PAT was 155.7% in Q3FY24 versus 92.1% in Q2FY24 on account of strong collections. Free cash flow to PAT has shown a strong improvement to 143.7% in Q3FY24 versus to 75.1% in Q2FY24.

Results (Consolidated) Rs cr

Particulars	Q3FY24	Q3FY23	Q2FY24	YoY (%)	QoQ (%)
Revenues In USD (mn)	**1,084**	**1,047**	**1,076**	**3.5**	**0.8**
Revenues In INR	**9,017**	**8,620**	**8,905**	**4.6**	**1.2**
Direct Costs	5,633	5,472	5,681	2.9	-0.8
Other Expenses	1,148	1,019	921	12.7	24.5
Sub contracting cost	652	754	672	-13.6	-3.0
EBITDA	**1,585**	**1,375**	**1,631**	**15.3**	**-2.8**
Depreciation & amortization	199	178	208	11.7	-4.4
EBIT	**1,386**	**1,197**	**1,423**	**15.8**	**-2.6**
Finance Costs	61	38	47	60.2	29.1
Other Income	220	152	143	44.6	53.3
PBT	**1,545**	**1,311**	**1,519**	**17.9**	**1.7**
Tax Provision	375	310	357	21.1	5.2
Net profit	**1,169**	**1,001**	**1,162**	**16.8**	**0.6**
Adjusted net profit	1,169	1,001	1,162	16.8	0.6
EPS (Rs)	**39.2**	**40.1**	**38.9**	**-2.3**	**0.8**
Margin (%)					
EBITDA	17.6	15.9	18.3	163	-74
EBIT	**15.4**	**13.9**	**16.0**	**149**	**-61**
NPM	13.0	11.6	13.0	136	-8
Tax rate	24.3	23.6	23.5	66	80

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)	1,084	100	0.8	3.5	0.7	3.1
Geographic mix						
North America	788	72.7	-0.2	4.1		
Europe	157	14.5	-4.5	0.8		
ROW	139	12.8	14.1	3.5		
Industry verticals						
BFSI	386	35.6	-1.7	-1.4		
Hi-tech, Media & Entertainment	248	22.9	-3.0	0.5		
Manufacturing & Resource	220	20.3	14.3	20.1		
Retail, CPG, Travel, Transportation & Hospitality	159	14.7	-3.2	0.1		
Health, Life Sciences & Public Services	70	6.5	0.8	6.8		

Source: Company; Sharekhan Research

Outlook and Valuation

Sector View – Macro heading winds bottoming out coupled with better earnings visibility

We anticipate growth momentum to return in FY25 aided by lower base coupled with easing sector headwinds. Though, IT sector has already outperformed the Nifty last year, we expect overall outperformance in CY24 as well driven by receding headwinds and better earnings visibility

Company Outlook – Superior execution likely to drive outperformance

We believe that LTIM'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 LTIM 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, LTIM'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 – Downgrade to Hold with revised PT of Rs. 6,660

The company's strong order inflow and healthy deal pipeline has set the stage for medium-term growth. We expect sales/PAT CAGR of 10.5%/14.2% over FY23-26E. However, we believe while the strong order inflows and ramp ups of deals would assist in picking up growth momentum as macro headwinds recede, with utilisation at peak levels the near term investments required for scaling up is likely to weigh on the margins and limit the earnings growth. Hence, we downgrade LTIMindtree to Hold with revised price target (PT) of a Rs 6,660 (increase in PT reflects roll forward to FY26E EPS). At CMP, the stock trades at 32.6x/28.3x its FY25/26E EPS.

Peer valuation

Particulars	CMP (Rs / Share)	O/S Shares (Cr)	MCAP (Rs Cr)	P/E (x)		EV/EBITDA (x)		P/BV (x)		RoE (%)	
				FY24E	FY25E	FY24E	FY25E	FY24E	FY25E	FY24E	FY25E
LTIM	6,278	30	152586	39.0	31.3	16.3	10.5	8.7	7.6	24.3	25.9
Infosys	1,640	415	6,80,322	27.8	23.7	18.0	15.6	4.6	4.4	30.3	33.7
TCS	3,884	366	14,21,450	30.5	27.5	21.2	18.9	13.5	13.2	47.5	48.5

Source: Company, Sharekhan estimates

About company

L&T Infotech (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. 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 LTIMindtree 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 LTIMindtree to deliver above-industry average revenue growth.

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.

Additional Data

Key management personnel

Debashis Chatterjee	MD & CEO
Nachiket Deshpande	WTD & COO
Sudhir Chaturvedi	WTD & President, Markets
Vinit Teredesai	CFO

Source: Company Website

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Life Insurance Corp of India	3.54
2	UTI Asset Management Co Ltd	1.71
3	Vanguard Group Inc	1.23
4	BlackRock Inc	1.06
5	SBI Funds Management Ltd	0.79
6	Aditya Birla Sun Life Asset Manage	0.58
7	Axis Asset Management Co Ltd	0.52
8	Tata Asset Management Pvt Ltd	0.47
9	ICICI Prudential Asset Management	0.42
10	Norges Bank	0.42

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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