# Larsen & Toubro Infotech Ltd ( LTINFO)

ICICI direct Research

CMP: ₹ 1663 | Target: ₹ 1950 (⬆ 17%) | Target Period: 12 months | BUY

March 26, 2019

## New alpha among its pack…

L&T Infotech (LTI) (a subsidiary of India's large conglomerate Larsen & Toubro) is among top 20 global IT service company and sixth largest Indian IT company. The key drivers of the company's growth have been winning large deals, new logos, client mining and its continuous efforts to drive the same. This is visible in LTI's financial performance wherein revenues and PAT have grown at a CAGR of 13% and 15%, respectively, over FY16-18.

### Digital transformation key growth driver

On a TTM basis, digital witnessed average growth of 40% YoY ahead of LTI's growth of 21% YoY indicating growing digital capability of the company. Even on a CQGR basis, digital revenue (in dollar terms) grew at a CQGR of 9.7% vs. the company's growth of 4.1% in the last 11 quarters. Going forward, based on global spend in digital technologies, we expect Indian IT companies to witness at least 25% growth in digital revenues. LTI with its faster adoption, strong execution capabilities, could be a major beneficiary of rising digital proportion ensuring healthy profitability over the coming years. We expect digital to grow at a CAGR of 32.4% in FY18-21E for LTI. Based on the deal pipeline and robust growth in digital revenues, we expect the company to register dollar revenue CAGR of 16.7% over FY18-21E.

### LTI to witness superior margins vis-à-vis midcap peers

LTI's overall EBITDA margins are in the 19-21% range compared to midcap peers like MindTree (14-16%), NIIT Tech (15.8-18.6%) and Persistent (14.8-19.7%). We believe this is mainly due to higher share of organic growth, digital proportion, offshore revenues and better pricing. Going forward, we expect the company to continue maintaining industry leading margins (19.3% in FY21E vs. peer average of 17.6%) mainly led by robust growth in revenues and improving share of digital revenues (from 31.8% in FY18 to ~47% in FY21E).

### Digital expertise, superior execution key to growth; BUY

We like LTI given its- 1) digital story acceleration, 2) focus on client mining, 3) healthy deal pipeline and 4) strong management foothold. Hence, we believe it is better positioned with relatively higher revenue/margin visibility. We expect LTI to witness healthy double digit revenue growth of 16.7% CAGR in FY18-21E in dollar terms with stable EBITDA margins of 19.3% and net profit margins of 15% in FY21E. Thus, we initiate coverage on the stock with a **BUY** recommendation and a target price of ₹ 1950/share based on 18x FY21E EPS. In our view, our target multiple for LTI is justified considering the robust growth trajectory implying a PEG ratio of 0.8x and strong return ratio (RoCE – 34.4% in FY21E).

LTI Let's Solve

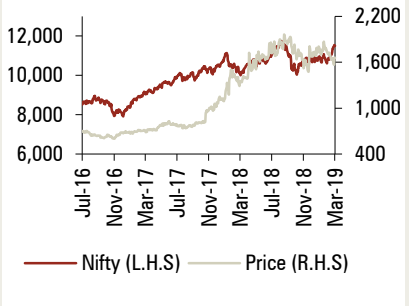
**Stock Data**

| Particular | Amount |
|---|---|
| Market Capitalisation | ₹ 28870 crore |
| Cash and Investments | ₹ 1628 crore |
| EV | ₹ 27242 crore |
| 52 week H/L | 1990 / 1301 |
| Equity Capital | ₹ 17 crore |
| Face Value | ₹ 1 |
| DII Holding (%) | 7.38 |
| FII Holding (%) | 7.84 |

**Key Highlights**

- Faster adoption and strong execution capabilities- LTI could be a major beneficiary of rising digital proportion
- Healthy deal pipeline led by consistent large deal wins
- Leading margins among midcaps

**Price Performance**

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Initiating Coverage

ICICI Securities – Retail Equity Research

**Key Financial Summary**

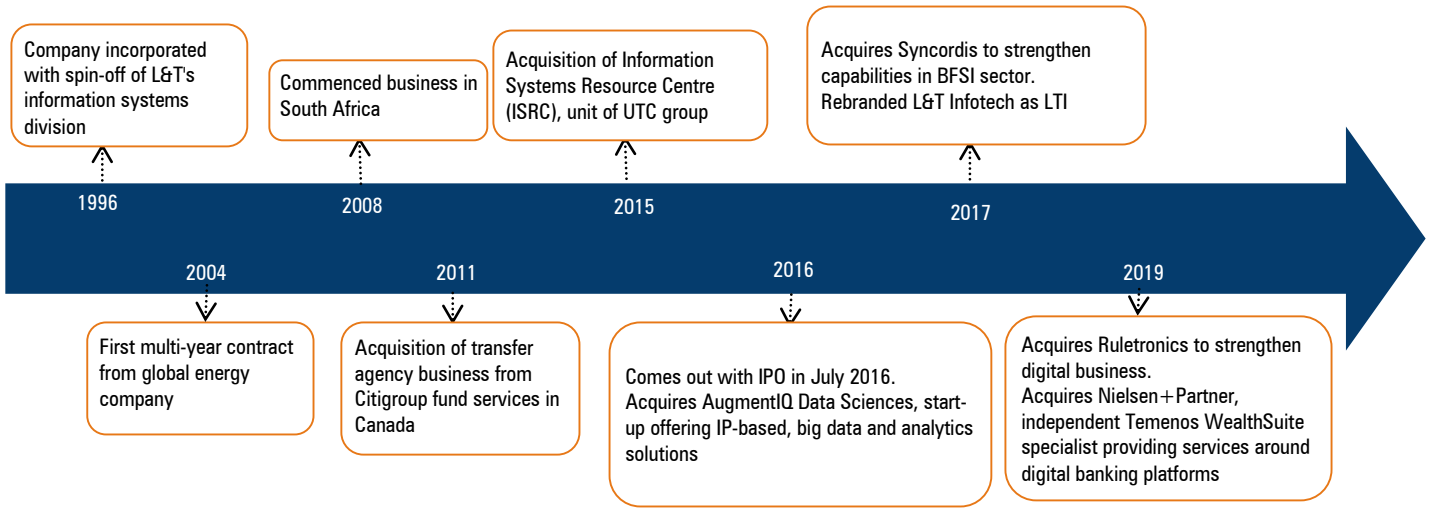
| (₹ Crore) | FY17 | FY18 | FY19E | FY20E | FY21E |
|---|---|---|---|---|---|
| Net Sales | 6,500.9 | 7,306.4 | 9,467.7 | 10,986.2 | 12,591.5 |
| EBITDA | 1,230.4 | 1,187.6 | 1,877.1 | 2,154.2 | 2,424.0 |
| EBITDA Margins (%) | 18.9 | 16.3 | 19.8 | 19.6 | 19.3 |
| Net Profit | 971.2 | 1,112.5 | 1,512.2 | 1,676.7 | 1,878.3 |
| EPS (₹) | 56.9 | 64.7 | 87.1 | 96.6 | 108.2 |
| P/E (x) | 29.2 | 25.7 | 19.1 | 17.2 | 15.4 |
| EV/EBITDA (x) | 22.4 | 22.9 | 14.3 | 12.1 | 10.4 |
| RoE (%) | 30.9 | 28.8 | 31.3 | 28.3 | 26.3 |
| RoCE (%) | 38.7 | 36.0 | 40.7 | 36.9 | 34.4 |

*Source: ICICI Direct Research, Company*

## Company Background

Incorporated in 1996, L&T Infotech (LTI) is one of India's global IT services and solutions companies. The company is among top 20 global IT service companies and sixth largest Indian IT company. LTI has operations spanning 27 countries. The company has 300 clients, 25 delivery centres, 49 sales office globally and 24,000 employees. As on Q3FY19, LTI caters to 63 Fortune 500 clients. The company leverages the strengths and heritage of promoter, Larsen & Toubro (L&T), a leading Indian conglomerate in engineering, construction, manufacturing, finance and technology.

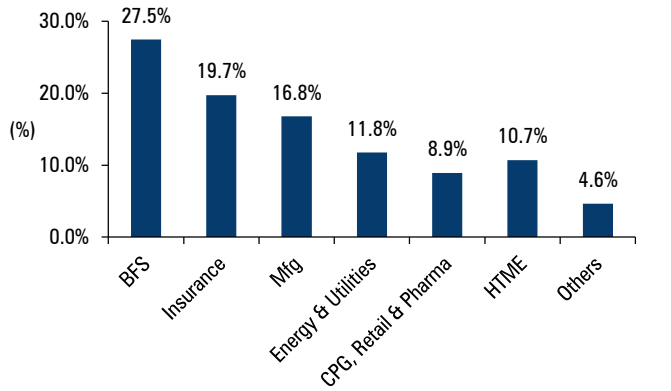
Exhibit 1: Timeline




*Source: Company, ICICI Direct Research*

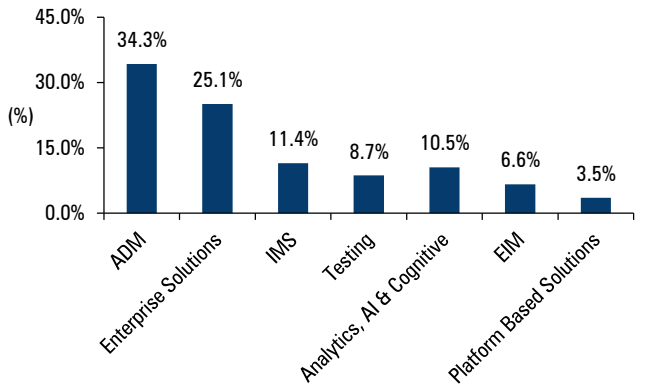
The company's services encompasses diverse industries like banking & financial services, insurance, energy & process, consumer packaged goods, retail & pharmaceuticals, media & entertainment, hi-tech & consumer electronics and automotive & aerospace. In terms of service offering, L&T Infotech offers services like application development, maintenance & outsourcing, enterprise solutions, infrastructure management services, testing, digital solutions and platform-based solutions.

Exhibit 2: Revenue contribution by verticals (FY18)




*Source: Company, ICICI Direct Research; *Mfg: Manufacturing, HTME: High-Tech, Media & Entertainment*

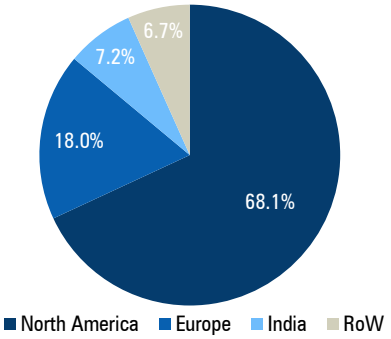
Exhibit 3: Revenue contribution by service lines (FY18)




*Source: Company, ICICI Direct Research; * ADM: Application Development Maintenance, IMS: Infrastructure Management Services, EIM: Enterprise Integration & Mobility*

In terms of geography, L&T Infotech derives 68.1% of revenue from North America, 18.0% of revenue from Europe, 7.3% of revenue from India and 6.7% from the Rest of World. L&T Infotech has an integrated global delivery model allowing it to deliver 46.3% of revenue in FY18 through onsite locations and 53.7% of revenue in FY18 through offshore locations.

Exhibit 4: Revenue contribution by geography (FY18)




*Source: ICICI Direct Research, Company*

Exhibit 5: Shareholding Pattern

| Shareholder | Q4FY18 | Q1FY19 | Q2FY19 | Q3FY19 |
|---|---|---|---|---|
| Promoter | 82.96 | 81.54 | 75.00 | 74.84 |
| FII | 6.92 | 7.98 | 9.53 | 7.84 |
| DII | 2.19 | 2.76 | 5.92 | 7.38 |
| Others | 7.93 | 7.72 | 9.55 | 9.94 |

*Source: ICICI Direct Research, Company*

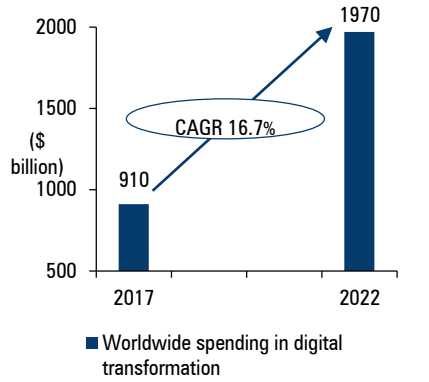
# Industry Overview

As per National Association of Software and Services Companies (Nasscom), worldwide spending on IT and related businesses grew at 2.2% CAGR to US$2395 billion in 2014-18. During the same period, the Indian IT industry market grew at a higher pace at 8.8% CAGR vs. the worldwide spending representing the increased outsourcing trend. India has a market share of 55% in global outsourcing. This, in turn, leads global outsourcing to form 21.3% of worldwide spending. As per our calculations, this has increased from 16.6% in 2014. Increasing trends in global outsourcing could indicate rising opportunities for Indian IT players as it holds a lion's share of 55%.

India's IT industry market size is US$167 billion and grew at 8.1% CAGR in FY16-18. Of this, the traditional market comprises US$142 billion and witnessed growth at 3.7% CAGR in FY16-18. The remaining market segment, which is digital, added an incremental $14 billion revenue over FY16-18 and grew at a robust 51% CAGR during the same period.

Looking from the perspective of global spending, as per industry sources IDC report, worldwide spending on technologies & services that enable the digital transformation (DX) of business practices, products and organisations is expected to reach US$1.97 trillion in 2022, at a five year CAGR of 16.7% in 2017-22. Industry spending on DX technologies is being driven by core innovation accelerator technologies with IoT and cognitive computing leading the race in terms of overall spend. From a technology perspective, of the US$1.25 trillion in worldwide DX spending in 2019, hardware and services spending will account for more than 75%. Services spending will be led by IT services ($152 billion) and connectivity services ($147 billion) over the five-year forecast period. Digital transformation related software spending may total US$288 billion in 2019 and may be the fastest growing technology category with a CAGR of 18.8% in 2017-22. Further, as per IDC, spending on cognitive & AI systems and public cloud services is forecasted to grow at a CAGR of 37.3% and 22.5%, respectively, in 2017-22. IDC predicts that, by 2020, 30% of G2000 companies will have allocated a capital budget equal to at least 10% of revenue to fuel their digital strategies.

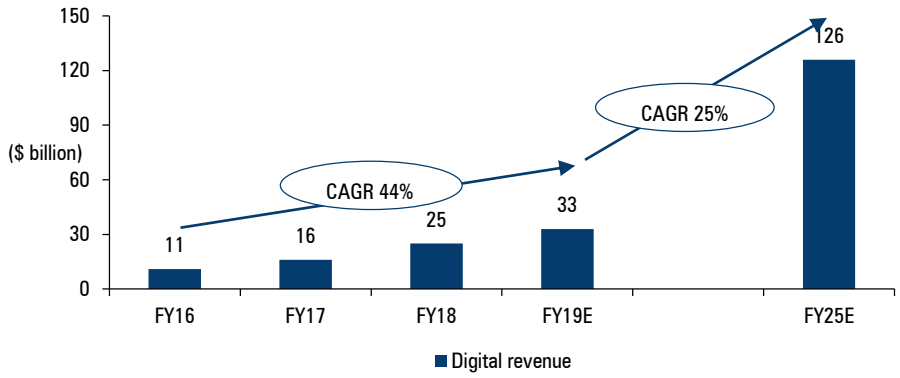
**Healthy growth projection in worldwide spending**




*Source: ICICI Direct Research, Company, 2017: Back calculated*

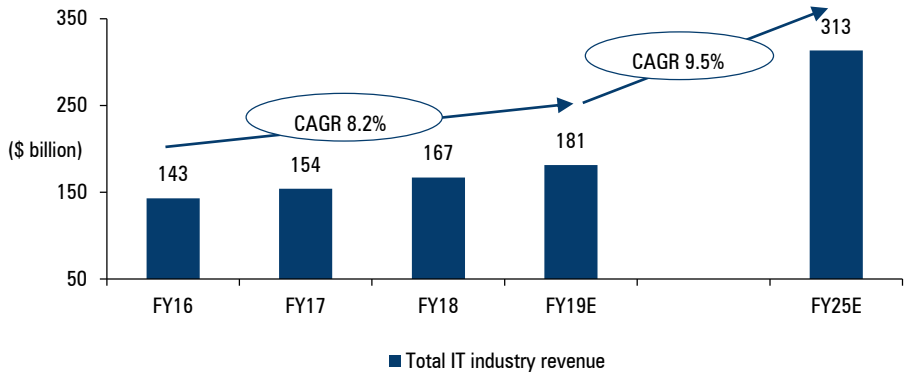
Considering the robust spend in global digital technology, Indian IT sector growth at 51% CAGR in digital revenues and taking into account the base for Tier-I Indian IT players (25-30% growth in digital), we expect digital revenues to grow in the range of 25-30% in next few years. In our base case scenario (as shown in Exhibit 9), we expect the Indian IT industry to see 9-10% growth based on 25% digital growth, 2% growth in traditional business (as seen in Tier-1 IT players). If there is acceleration in digital, the industry could mark double digit growth and accelerate further in coming years.

**Exhibit 6: Expect digital industry to grow at 25% CAGR in FY19E-25E**




*Source: ICICI Direct Research, Company, Nasscom*

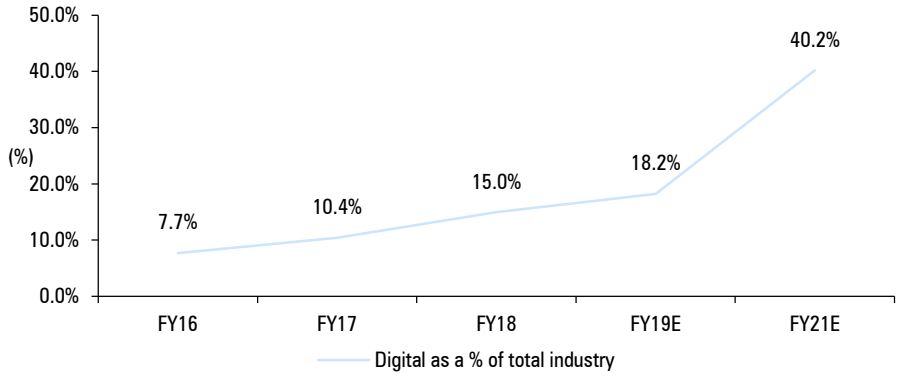
Exhibit 7: Expect industry revenue to grew at 9.5% CAGR in FY19E-25E




*Source: Company, ICICI Direct Research, Nasscom*

Based on our assumption of 25% growth in digital revenues, the share of digital services in India's IT industry is expected to double by FY21E and become 5x by FY25E. Despite this robust growth in industry digital revenues, it will still be ~40% of the total representing significant growth potential beyond FY25E.

Exhibit 8: Share of digital in India's IT industry expected to grow 5x by FY25E




*Source: Company, ICICI Direct Research, Nasscom*

Exhibit 9: Sector growth sensitivity to digital and legacy growth

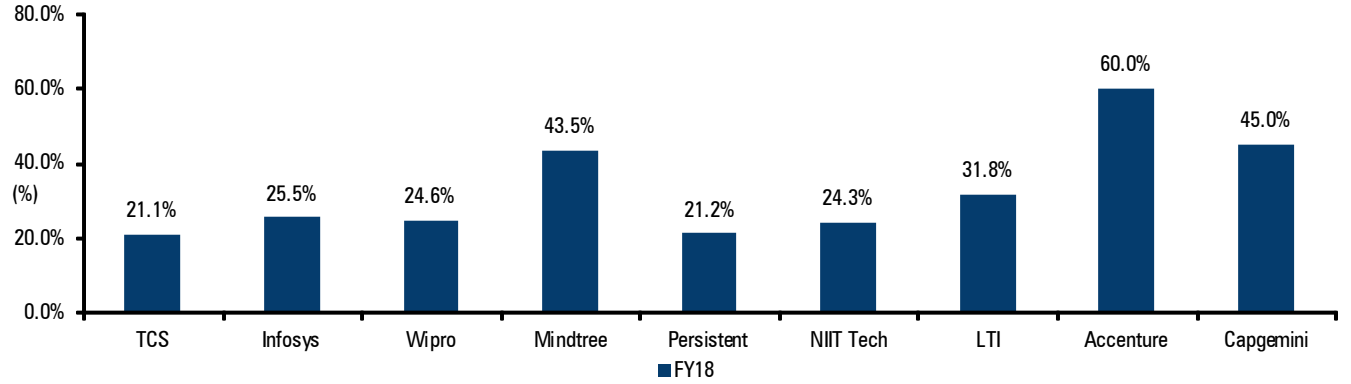
| Digital growth | 20% | 22% | 25% | 30% | 35% | 40% | 45% |
|---|---|---|---|---|---|---|---|
| **Legacy Growth** | | | | | | | |
| **-3%** | 4.6 | 5.3 | 6.2 | 7.9 | 9.5 | 11.2 | 12.8 |
| **-1%** | 5.9 | 6.6 | 7.6 | 9.2 | 10.9 | 12.5 | 14.2 |
| **2%** | 7.9 | 8.6 | 9.6 | 11.2 | 12.9 | 14.5 | 16.2 |
| **3%** | 8.6 | 9.3 | 10.3 | 11.9 | 13.6 | 15.2 | 16.9 |
| **4%** | 9.3 | 9.9 | 10.9 | 12.6 | 14.2 | 15.9 | 17.5 |
| **5%** | 10.0 | 10.6 | 11.6 | 13.3 | 14.9 | 16.6 | 18.2 |
| **6%** | 10.6 | 11.3 | 12.3 | 13.9 | 15.6 | 17.2 | 18.9 |

*Source: ICICI Direct Research, Company*

Further, the stepping up of digital is expected to present significant opportunities for Indian IT service providers as they continue to scale up through reskilling of employees in emerging technologies and filling the capability gap. Indian IT companies have seen an uptick in hiring in 9MFY19 over 9MFY18. Looking at our IT coverage universe, digital contribution continues to inch upwards and contributed an average of ~24% for large cap (TCS, Infosys, Wipro) and ~30% for midcap (MindTree, Persistent, NIIT Tech). Digital is becoming mainstream and gaining acceleration as witnessed in the ~30-50% YoY growth for our coverage IT universe. Further, digital revenues in Capgemini also witnessed healthy growth of ~45% YoY.

Hence, we believe companies that are frontrunners to improve their digital capabilities and are winning large deals in the digital segment, would be the prime beneficiaries.

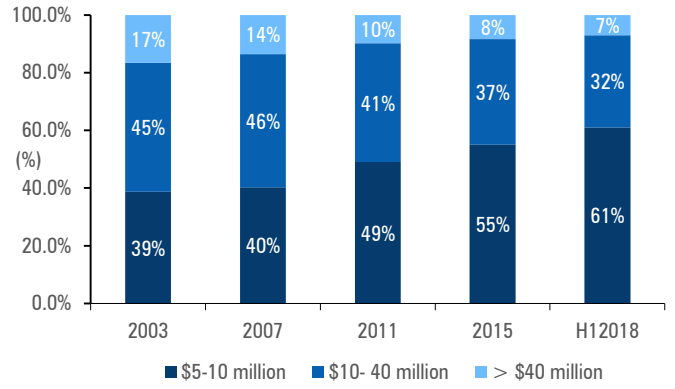
Exhibit 10: Further scope for Indian IT players to increase their digital proportion compared to global peers




*Source: ICICI Direct Research, Company, Company's website- Accenture (Year ending August 2018), Capgemini (CY18)*

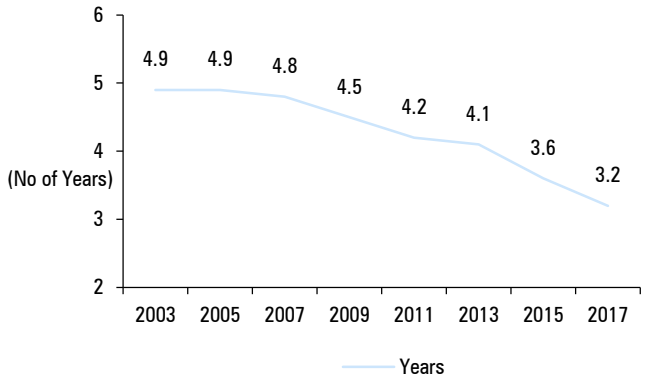
With the acceleration of digital in the overall revenue pie, deal contract sizes and duration of contracts have reduced mainly on the back of faster technology evolution and niche digital offerings. As per Crisil, the share of deals with annual contract value (ACV) of $5-10 million have increased from~39% in 2003 to 61% in H1FY18. On the other hand, contract duration of five years in 2003 has come down to three years in 2017 and is now trending towards one to two years contracts. The lower deal sizes augur well for mid-size Indian IT players as they have the scale and capabilities to cater to them.

Exhibit 11: Rise in digital based deals leads to lower ACV




*Source: ICICI Direct Research, Company, Crisil*

Exhibit 12: Trend towards lower duration contracts



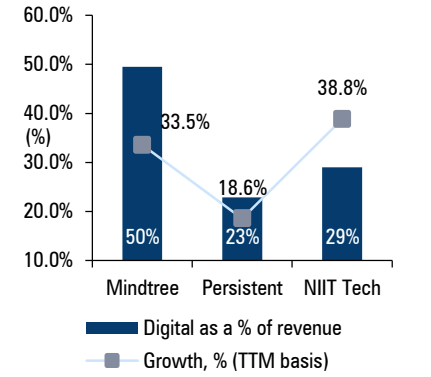

*Source: ICICI Direct Research, Company, Crisil*

# Investment Rationale

## Digital key driver of LTI's revenue momentum

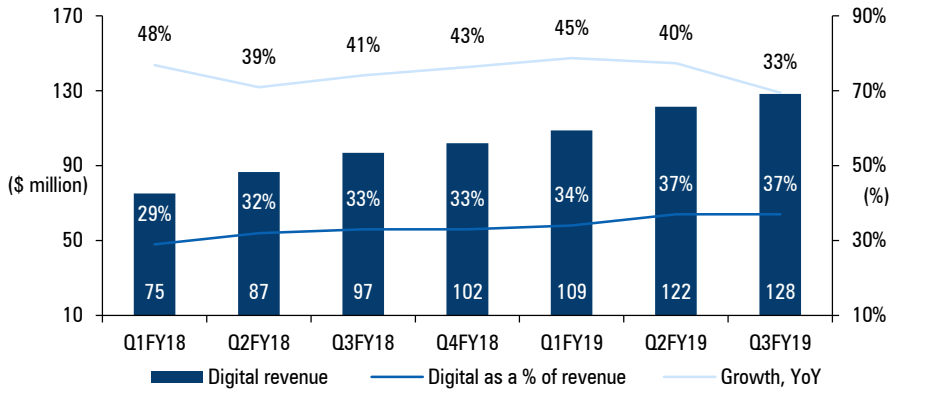
On a TTM basis, digital has witnessed average growth of 40% YoY ahead of the company's growth of 21.2% YoY indicating growing digital capability of the company. Even on a CQGR basis, digital revenue (in dollar terms) grew at a CQGR of 9.7% vs. LTI's growth of 4.1% over the last 11 quarters. Digital revenue contribution was at 37% during Q3FY19 (vs. 22% in Q1FY17). This has been the key driver for LTI's growth. As per the management, digital will not just be a 'set of capabilities' for LTI but will be a 'way of working'. Accordingly, it has strategised to strengthen its digital offering and focuses on following 1) digital embed (outcome based approach using emerging technologies), 2) digitising the core, 3) pivot on platforms (platform based approach) and 4) service as a product (improving customer experience). Further, LTI has inched up its efforts in hiring from top institutes like IITs and NITs for better employable skills. The company's relentless focus on digital solutions is visible compared to its industry peers. Among Indian IT players, only MindTree comes close with 49.5% contribution by digital revenues while rest players digital contribution is in the range of 21-30%.

**Digital revenue contribution by peers**




*Source: Company, ICICI Direct Research*

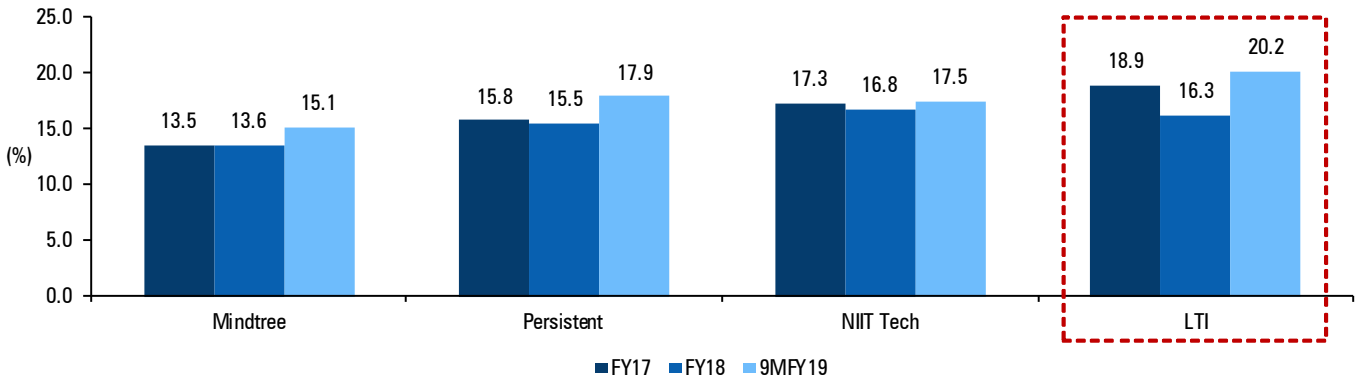
**Exhibit 13: Digital going strong, growth of 40% YoY on TTM basis for LTI**




*Source: Company, ICICI Direct Research*

For LTI, we believe digital revenues come in at higher margins. This is on account of the fact that the company's overall EBITDA margins are in the 19-21% range compared to midcap peers like MindTree (14-16%), NIIT Tech (15.8-18.6%) and Persistent (14.8-19.7%). Going forward, as the pure-play legacy business decelerates, there is expected to be a sharp uptick in digital contribution with emerging technologies becoming the trend of doing business. We believe that as the share of digital revenues increases, margins could see an upward bias.

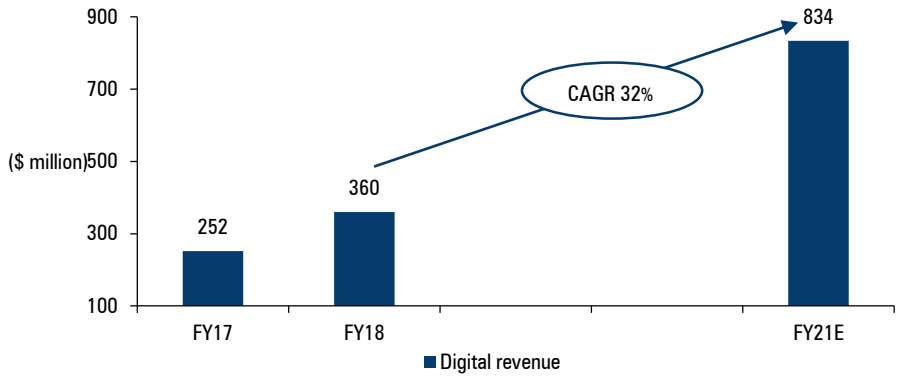
**Exhibit 14: Higher EBITDA margins for LTI implies digital revenues coming in at higher margins**




*Source: ICICI Direct Research, Company*

Going forward, based on the global spend on digital technologies, we expect Indian IT companies to witness at least 25% growth in digital revenues. LTI, with its faster adoption and strong execution capabilities, could be a major beneficiary of rising digital proportion ensuring healthy profitability in the coming years. We expect digital to grow at 32% CAGR in FY18-21E for LTI.

Exhibit 15: Digital revenues expected to grow at 32.4% CAGR during FY18-21E




*Source: ICICI Direct Research, Company*

## Healthy pipeline provides better revenue visibility

The company alluded to its growth engines as winning large deals, new logos, client mining and its continuous efforts in driving the same. The same can be witnessed in the improving metrics under which LTI has added 12 large deals with net new TCV of $575 million in 10 quarters and 73 new logos opened in the last 12 months.

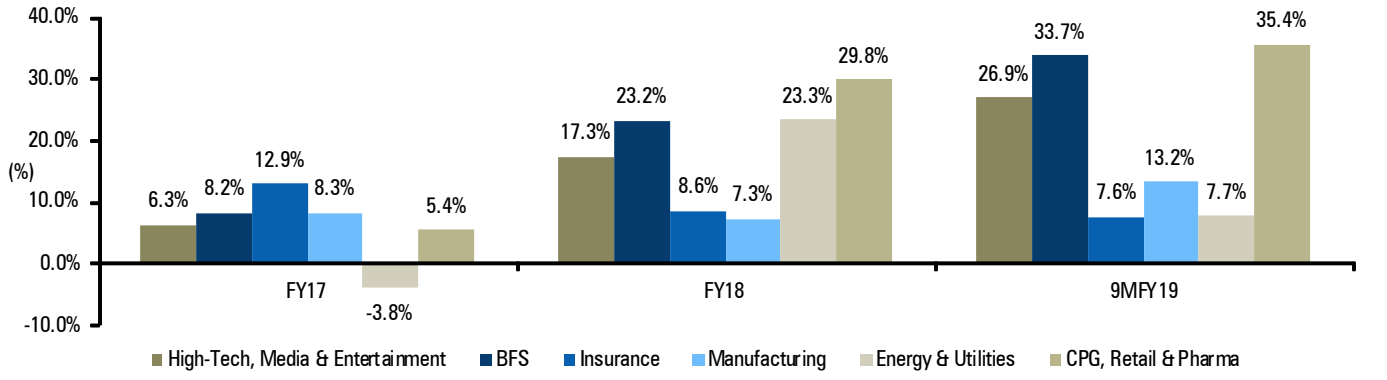
Further, the company has an overall deal pipeline of US$2 billion. Of this, the large deal pipeline accounts for US$1 billion (backed by 28 large deals). In addition, the pipeline has 43% of projects in digital technology, 32% is net new deals and 36% is in the proposal stage. The positive in the deal pipeline is that the company is winning deals across verticals viz. in banking & financial services (multi-year deal to provide end-to-end application, development & maintenance services for leading African bank), life sciences (more than $55 million TCV from data analytics) and oil & gas (AI based digitisation for American major). A healthy deal total contract value (TCV) enhances the revenue growth visibility for the coming years.

Further, the company crossing the US$1 billion revenue threshold would support LTI in greater deal participation. Based on the deal pipeline and digital revenue growth, we believe the company could clock double digit revenue growth, going forward.

## CPG, retail & pharma, high-tech, media & entertainment to lead growth for company

LTI's largest vertical revenue contributor banking & financial services (BFS) and insurance (46.9% of revenue) has been seeing growth momentum (5.5% CQGR over last 10 quarters), unlike peers. During the same period, mid-size IT peers have grown in the range of 1.5-4% CQGR. This is mainly driven by the company's focus on building fortes in sub segments within verticals like wealth management, risk and compliance. Four out of top five clients of LTI are from the BFSI vertical, with Citibank being the largest client for LTI, contributing 14.5% of overall revenue and 30.7% to BFSI revenues (FY17). Tightness of budgets and delay in decision making by top client would impact top client growth and thereby BFSI for LTI in FY20E. However, insurance is anticipated to perform well in FY20E based on the deal pipeline and new logos. In the long run, LTI's capabilities and high focus on niche segments would bode well as the demand environment improves with increased spending in BFSI.

Exhibit 16: Broad based growth among verticals



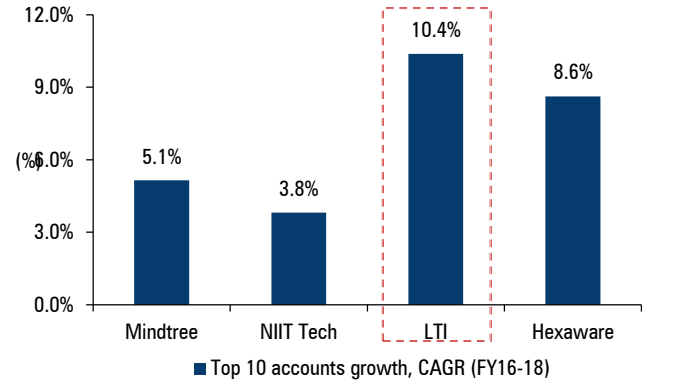

*Source: ICICI Direct Research, Company*

Other than BFSI, verticals like CPG, retail & pharma; high-tech, media & entertainment and energy & utilities also witnessed healthy growth over the last 10 quarters and grew at 7.8%, 4.8% and 4.2%, respectively. This is despite energy & utilities segmented being impacted by a decline in oil prices. Going ahead, the management foresees CPG, retail & pharma and high-tech, media & entertainment to lead growth for the company. We expect these verticals to grow in double digits in coming years.

## Strong execution, better account mining key driving force

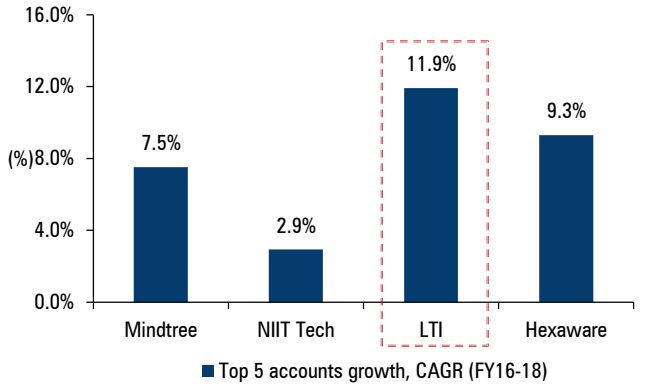
LTI's strong focus on client mining has been one of the main driving forces behind the momentum on the revenue front. Top 10 clients witnessed a CAGR of 10.4% in FY16-18 and 17.7% YoY in 9MFY19. Further, ~42% of incremental growth in revenue is driven by top 10 client. The growth rate is higher and consistent compared to its most peers in Indian IT industry. On growth comparison with mid-size Indian IT players, LTI witnessed healthy growth in top five and top 10 accounts (depicted in the exhibit below).

Exhibit 17: Healthy growth in top 10 for LTI vs. peers




*Source: Company, ICICI Direct Research*

Exhibit 18: Healthy growth in top five for LTI vs. peers




*Source: Company, ICICI Direct Research*

LTI has crafted certain strategies for mining top accounts. LTI's strategy called 'ADEA', which aims at instilling analytics and digital in every account and 'Minecraft' (aimed at mining the top 50 accounts) has led to 17.3% CAGR in non-top 20 clients. It has a dedicated client manager for its top 50 accounts. This, along with its strategy of targeted account list (TAL) is seeing signs of success as indicated from -LTI has added 12 (out of 63) Fortune 500 customers since listing and 73 new logos in the last 12 months. In addition, LTI refers top 250 MSAs and customers as a 'pot of gold' and focuses on mining these accounts. This implies significant growth opportunities from client mining perspective thereby indicating robust potential in revenue growth over the long term.

Further, the number of clients with US$1 million+ revenue has increased from 84 in Q1FY16 to 121 currently. Going up the client bucket, LTI has one account in the US$100 million+ revenue category and five accounts in the US$50 million+. Looking at history trends when Indian IT players reached the threshold of US$1 billion (Infosys in 2004, HCL Tech in 2007), we believe LTI's performance is more or less on par with the tier-1 players when the respective players reached the US$1 billion threshold. Further, based on past data, we believe LTI would also witness significant acceleration in client growth post the achievement of US$1 billion revenue mark in 2018.

Exhibit 19: Well poised to join tier-I league, going forward

| Infosys | | | | HCL Tech | | | | LTI | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| (March end) | 2003 | 2004 | 2005 | (June end) | 2006 | 2007 | 2008 | (March end) | 2016 | 2017 | 2018 |
| Revenue ($ million) | 754 | 1063 | 1592 | Revenue ($ million) | 976 | 1390 | 1879 | Revenue ($ million) | 887 | 970 | 1132 |
| | | | | | | | | | | | |
| Active clients | 345 | 393 | 438 | Active clients | 219 | 242 | 279 | Active clients | 258 | 261 | 300 |
| $100 mn + | - | - | - | $100 mn + | 1 | 2 | 2 | $100 mn + | 1 | 1 | 1 |
| $50 mn + | 0 | 3 | 5 | $50 mn + | 2 | 3 | 3 | $50 mn + | 3 | 4 | 4 |
| $20 mn + | 9 | 12 | 19 | $20 mn + | 6 | 13 | 16 | $20 mn + | 10 | 11 | 13 |
| $10 mn + | 16 | 25 | 42 | $10 mn + | 15 | 26 | 34 | $10 mn + | 17 | 23 | 23 |
| $1 mn + | 115 | 131 | 166 | $1 mn + | 133 | 156 | 201 | $1 mn + | 85 | 96 | 109 |

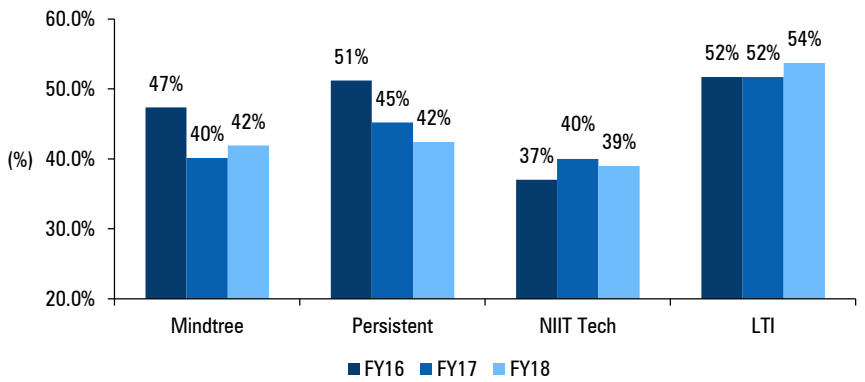
*Source: ICICI Direct Research, Company*

## Organic growth, higher offshore to drive superior margin

LTI witnessed a strong growth trajectory in the recent past, which can be validated by the fact that the company's revenues (in dollar terms) grew at an average quarterly growth of 4.2% in last 10 quarters. This growth has largely been organic. In FY13-18, rupee revenue growth of 13.7% CAGR is encouraging as it has largely been organic (13.4%). The company has done selective acquisitions (three acquisitions between 2014 and 2017) to bridge capability gaps. Further, LTI has higher offshore revenue component (53.7% in FY18) compared to its midcap peers (39-40%). The higher offshore component leads to better gross margins. Taking into consideration consistent offshore proportion of revenues and growing revenue per employee, we believe the company has the ability to deliver projects at better pricing power. In addition, relatively higher revenue per employee (US$50100) implies improving productivity mainly on the back of automation, bodes well for LTI.

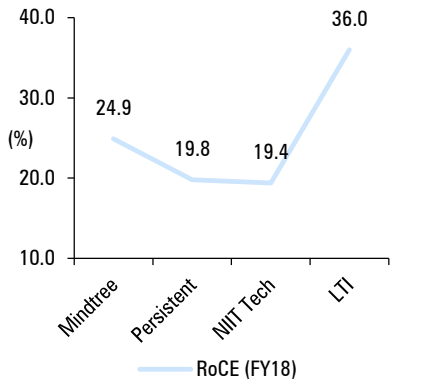
This has enabled the company to deliver higher EBITDA margins in the range of 19-21% vis-à-vis its midcap IT peers as MindTree (14-16%), NIIT Tech (16-18%) and Persistent (15-19%). A playing out of these factors is visible in healthy return ratios of RoE (~30% for LTI vs. midcap at 15-20%) and RoCE (~30% for LTI vs. midcap at 20-25%), indicating LTI's execution strategy in the right direction.

Exhibit 20: Higher offshore proportion in LTI provides edge in margins



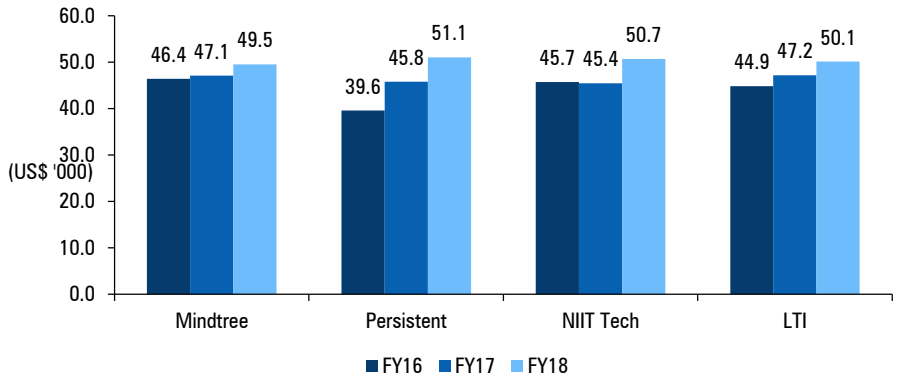

*Source: Company, ICICI Direct Research*

Peer comparison- RoCE




*Source: Company, ICICI Direct Research*

Exhibit 21: Increasing revenue per employee implies improving productivity




*Source: Company, ICICI Direct Research*

Even going forward, we expect LTI to continue to deliver industry leading margin vis-à-vis midcap peers led by robust growth in revenues and improving share of digital revenues. In turn, this is expected to result in healthy return ratios (RoE and RoCE of ~25-35%).

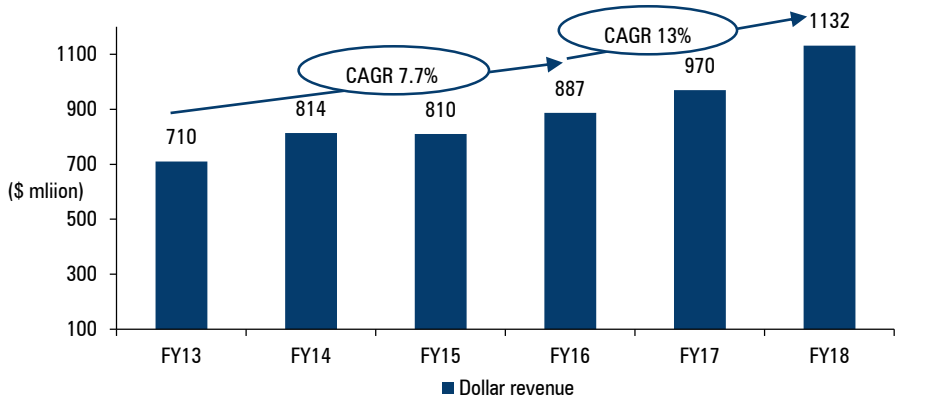
## Strategic changes in management leads to robust financial performance

LTI has seen significant transition post induction of new CEO.

Current CEO Sanjay Jalona (who took over as CEO and MD in August 2015) has revived the leadership team with several top tier hiring. Notable among these are (1) Aftab Ullah, COO (ex-Capgemini and BofA Indian captive), (2) Sudhir Chaturvedi, President, Sales (ex NIIT Tech, ex Infosys), (3) Rohit Kedia, Head of Manufacturing vertical (ex-Infosys) and (4) Siddharth Bothra, Head of Consumer, Media and Hi Tech verticals (yet again an ex-Infosys hire). In addition to top tier hiring, the company has undergone a significant restructuring from a pure delivery led organisation to a more sales focused organisation. The organisation witnessed a significant replacement at the sales level and also inculcated a consulting mindset among its sales workforce.

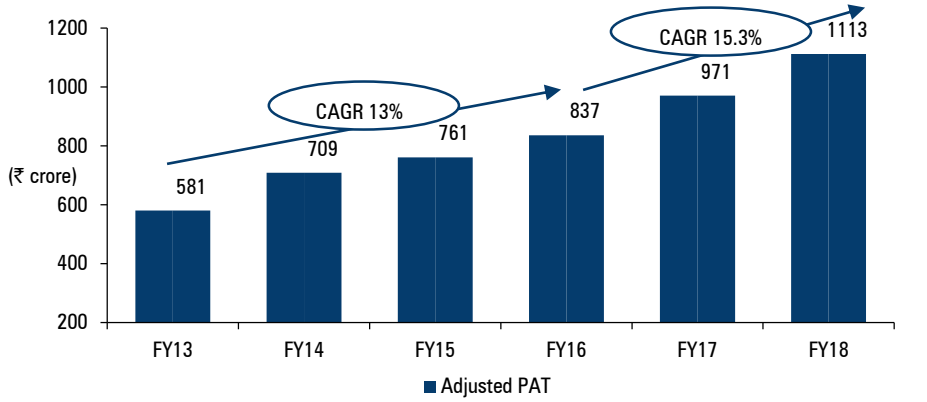
Additionally, LTI increased its focus on client servicing, increased interaction with industry analyst (which helped it in increasing visibility in leadership quadrants) and marketing & branding of the company. Further, in order to increase focus on large deal wins the company employed deal advisors (people who have experience in sourcing large deals right from sourcing to transition) and deal consultant. In addition, LTI has also set up customer success teams within each industry vertical and large deals team (best talent in the organisation) to pursue and win large deals. This has enabled the company to win new logos, large deals and mine its clients effectively helping it to stay ahead of competition. The same can also be witnessed in financial growth in FY16-18 (FY16 as the new CEO was inducted in August 2015) as the company's dollar revenue has grown at a CAGR of 13.0% vs. 7.7% from FY13-16 with PAT growth of 15.3% in FY16-18 vis-à-vis 12.9% in FY13-16.

Exhibit 22: Improving growth in FY16-18 with change in management




*Source: ICICI Direct Research, Company*

Exhibit 23: Improving profitability in FY16-18 vs. FY13-16



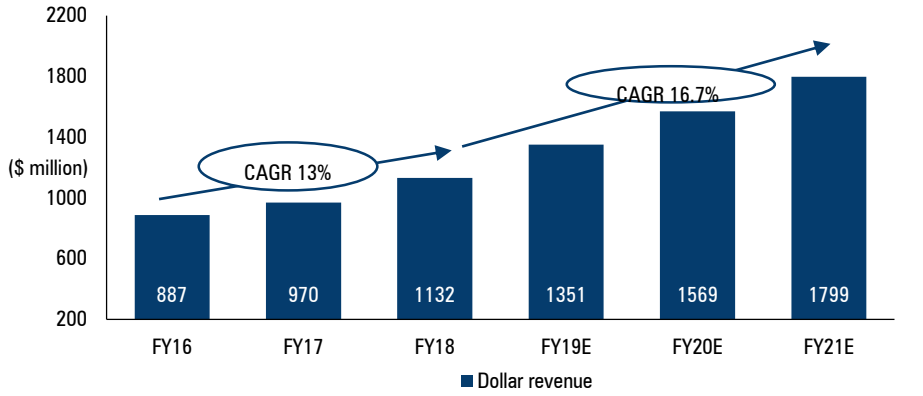

*Source: ICICI Direct Research, Company*

# Financials

## Revenue to grow at 16.7% CAGR in FY18-21E

Historically, the topline has grown at a CAGR of 7.7% in FY13-16. Post the management change led by Sanjay Jalona as MD & CEO in 2015, the company saw healthy double digit growth at 13.0% CAGR in FY16-18 and entered the billion dollar club with revenues of US$1.1 billion. In 9MFY19, LTI reached a revenue of $995 million (growth of 21% YoY over 9MFY18). We believe it will grow at 19.3% YoY in FY19E. Going ahead, continued momentum in insurance, CPG, media, uptick in digital revenues and incremental revenues from recent two acquisitions (~US$13 million in FY20E) would bode well for the company's growth. Consequently, we build in dollar revenues CAGR of 16.7% to $1799 million in FY18-21E.

Exhibit 24: Expect revenues to grow at 16.7% CAGR in FY18-21E

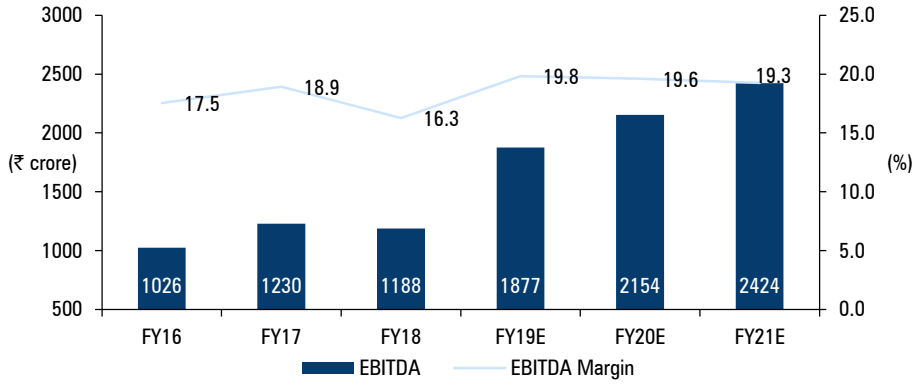



*Source: ICICI Direct Research, Company*

## Margin to remain steady

LTI reported EBITDA margins of 16.3% in FY18. The same expanded 430 bps since then to 20.6% in Q3FY19. Margin expansion was driven by SG&A optimisation and improvement in utilisation (excluding trainees) (from 80.4% in FY18 to 83% in Q3FY19). Going ahead, factors like onsite-offshore mix, digital led growth and operational efficiency would support margins. Further, the company follows a relatively longer duration hedging cycle (12-36 months), which provides better stability to the margin profile. However, we believe investments required for growth in terms of enhancing capabilities, peaking of utilisation lever, recruitment of freshers from higher institutions and localisation would keep EBITDA margins in the narrow range of 19%. Hence, we expect EBITDA margins of 19.3% in FY21E.

Exhibit 25: Expect steady margins in FY20E, FY21E

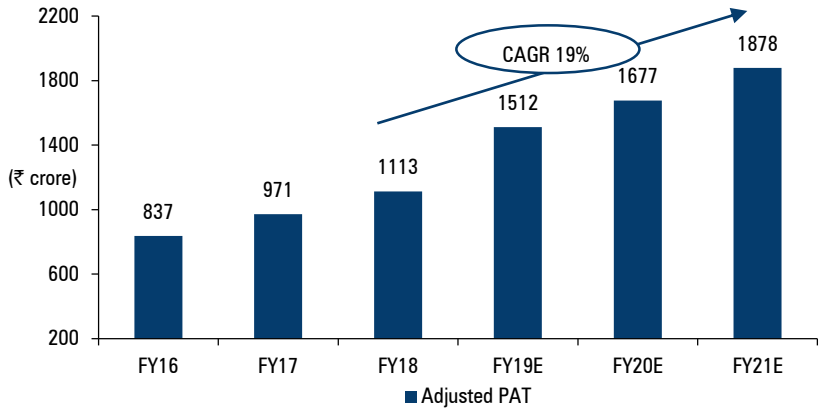



*Source: ICICI Direct Research, Company*

## PAT to grow at 19% CAGR in FY18-21E

Taking into account the blend of strong revenue performance, the company's hedging policy and steady margin performance, we expect PAT to grow at a CAGR of 19% in FY18-21E. This, in turn, is expected to lead to healthy return ratios with RoE, RoCE of 26%, 34%, respectively, in FY21E.

Exhibit 26: PAT expected to increase 19% CAGR during FY18-21E

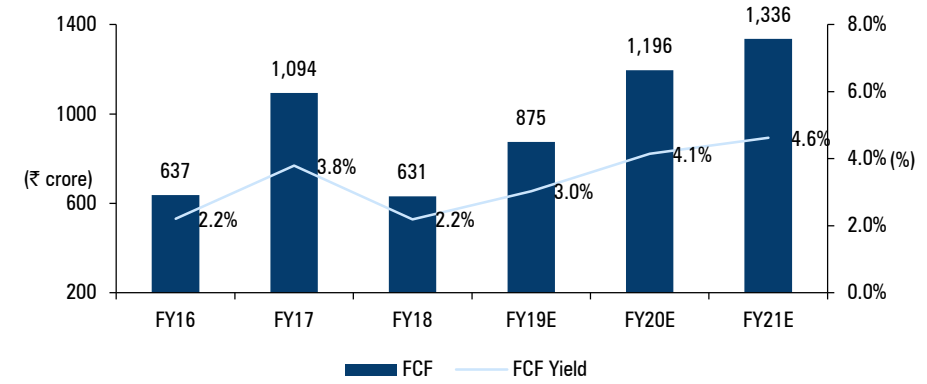



*Source: Company, ICICI Direct Research*

## FCF may improve in FY18-21E

LTI has been generating healthy FCF with FCF yield in the 1.5-3.5% range. With improving operating profitability (from FY18) and minimum capex requirements, we expect the FCF of the company to witness an improvement in FY18-21E leading the FCF yield to increase from 2.2% in FY18 to 4.6% in FY21E.

Exhibit 27: FCF to witness improvement in FY18-21E




*Source: Company, ICICI Direct Research*

# Risks and Concerns

## Attrition at key man level may impact growth momentum

The company saw certain changes in key management position in the last two to three years. Current CEO Sanjay Jalona joined LTI in 2015 from Infosys wherein he served as EVP and Global Head of high-tech, manufacturing & engineering services at Infosys. His joining LTI was followed by a series of new additions in the leadership team (CFO, COO, head of verticals, etc). This has added strength to the company, visible in the fact that the company's revenue grew in healthy double digits of 13% CAGR in FY16-18 compared to 7.7% CAGR in FY13-16. A higher attrition at the top level could adversely impact the current growth momentum.

## Higher offshore presence, changes in US policies to impact margins

The company has a higher offshore presence (53.7% of overall revenues in FY18) compared to peers. A shift in mix towards more onsite will have an adverse impact on margins. In addition, supply constraints in the US due to curbs in H1B visa and rising pressure on IT companies to hire local talent could also impact margins adversely. We believe LTI is catching up in terms of increasing local hiring (that we factor in our estimates). However, an aggressive attempt to increase local talent and rising attrition in onsite regions could have an adverse impact on the company's financials.

## Higher exposure to enterprise solutions, energy vertical

The company had exposure to certain revenue segments, which remained under pressure due to industry specific concern. Enterprise solutions (27.8% of revenue) have been under pressure due to higher on-premise component in the segment. However, new age ERPs now form ~33% of enterprise solutions, which is a positive. Similarly, energy and utilities, now comprising 10.8% of revenue (vs. 13.9% in Q1FY16), have faced pressure due to a decline in oil prices.

## High client concentration may impact growth

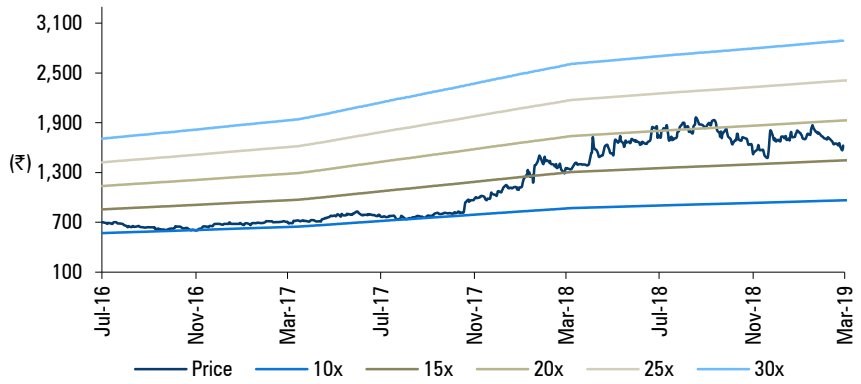
Client concentration is relatively higher in the top buckets with top five, top 10 and top 20 clients constituting 34.5%, 48.4% and 64.3% of revenues, respectively, in Q3FY19. Any client specific issue within top 20 accounts could impact our assumptions of steady financial performance for the company. On the other hand, high client concentration opens up opportunities of cross selling new services and gain market share. Also, the company's effort in mining top 50 accounts puts less risk on the table.

## Valuation

We like LTI given - 1) acceleration of its digital story, 2) its relentless focus on client mining reflected in growth in top clients and significant opportunity ahead, 3) its healthy deal pipeline presenting potential for revenue growth and 4) its strong management foothold. Hence, we believe LTI is better positioned with relatively higher revenue, margin visibility. We expect it to witness healthy double digit revenue growth at 16.7% CAGR in FY18-21E in dollar terms with stable EBITDA margins of 19.3% and net profit margins of 15.0% in FY21E. Thus, we initiate coverage on the stock with a **BUY** recommendation and target price of ₹ 1950/share based on 18x FY21E EPS.

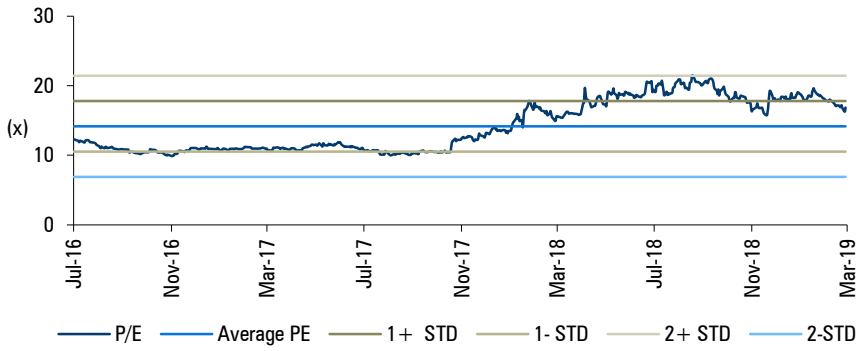
In terms of PE multiple, LTI has traded at an average PE multiple of 14x since its listing in July 2016. Currently, it is trading at 15x FY21E EPS. We value LTI at ₹ 1950/share, implying 18x FY21E EPS. In our view, this is justified considering the robust growth trajectory implying a PEG ratio of 0.8x and strong return ratio (RoCE – 34.4% and RoIC – 60.2% in FY21E).

Exhibit 28: One year forward PE band




*Source: ICICI Direct Research, Company*

Exhibit 29: Average one year forward PE multiple




*Source: ICICI Direct Research, Company*

We expect LTI to witness better revenue growth (16.7% CAGR in FY18-21E) compared to its industry mid-size peers with a margin profile better than peers. A healthy deal pipeline, higher offshore proportion, strength in client mining and acceleration in digital based revenues leads the company to witness profitability focused growth.

Exhibit 30: Peer comparison- Growth

| Players | Market Cap (₹ crore) | Revenue (₹ crore) | | | | CAGR FY18-21E (%) | EBITDA Margin (%) | | | | PAT (₹ crore) | | | | CAGR FY18-21E (%) |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | | FY18 | FY19E | FY20E | FY21E | | FY18 | FY19E | FY20E | FY21E | FY18 | FY19E | FY20E | FY21E | |
| LTI | 28870 | 7306 | 9468 | 10986 | 12591 | 19.9% | 16.3 | 19.8 | 19.6 | 19.3 | 1113 | 1512 | 1677 | 1878 | 19.1% |
| Mindtree | 15419 | 5463 | 7011 | 7851 | 8637 | 16.5% | 13.6 | 15.3 | 15.6 | 15.6 | 570 | 739 | 846 | 934 | 17.9% |
| NIIT Tech | 8064 | 2991 | 3683 | 4141 | 4555 | 15.0% | 16.8 | 17.7 | 18.0 | 18.0 | 280 | 416 | 469 | 526 | 23.4% |
| Persistent Systems | 5128 | 3034 | 3408 | 3682 | 3966 | 9.3% | 15.5 | 17.8 | 17.6 | 17.6 | 323 | 362 | 398 | 427 | 9.7% |
| **Average** | **14370** | **4698.6** | **5892.2** | **6665.0** | **7437.4** | **15.2%** | **15.5** | **17.6** | **17.7** | **17.6** | **571.5** | **757.5** | **847.4** | **941.3** | **17.5%** |

*Source: ICICI Direct Research, Company*

Comparing LTI with its peers, we highlight that LTI is trading at a relatively better valuation multiple of 15x FY21E EPS while it is available at an industry average PEG multiple of 0.8x on earnings growth of 19% in FY18-21E.

Exhibit 31: Peer comparison- Valuation

| Players | P/E | | | | RoCE | | | | RoE | | | | Current PEG |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | FY18 | FY19E | FY20E | FY21E | FY18 | FY19E | FY20E | FY21E | FY18 | FY19E | FY20E | FY21E | |
| LTI | 25.7 | 19.1 | 17.2 | 15.4 | 36.0 | 40.7 | 36.9 | 34.4 | 28.8 | 31.3 | 28.3 | 26.3 | 0.8 |
| Mindtree | 27.4 | 20.9 | 18.2 | 16.5 | 24.9 | 29.4 | 29.6 | 28.9 | 20.8 | 23.4 | 23.3 | 22.5 | 0.9 |
| NIIT Tech | 28.6 | 19.2 | 17.1 | 15.2 | 19.4 | 24.8 | 24.6 | 24.3 | 15.8 | 20.5 | 20.2 | 19.9 | 0.7 |
| Persistent Systems | 15.8 | 14.2 | 12.9 | 12.0 | 19.8 | 20.8 | 20.4 | 19.7 | 15.2 | 15.2 | 15.0 | 14.4 | 1.2 |
| **Average** | **24.4** | **18.3** | **16.4** | **14.8** | **25.0** | **28.9** | **27.9** | **26.8** | **20.2** | **22.6** | **21.7** | **20.8** | **0.9** |

*Source: ICICI Direct Research, Company*

# Financial Summary

## Exhibit 32: Profit & Loss Statement

| (Year-end March) | FY18 | FY19E | FY20E | FY21E |
|---|---|---|---|---|
| Total Revenues | 7,306 | 9,468 | 10,986 | 12,591 |
| Growth (%) | 12.4 | 29.6 | 16.0 | 14.6 |
| Employee costs | 4,376 | 5,541 | 6,515 | 7,536 |
| Total Operating Expenditure | 6,119 | 7,591 | 8,832 | 10,168 |
| EBITDA | 1,188 | 1,877 | 2,154 | 2,424 |
| Growth (%) | (3.5) | 58.1 | 14.8 | 12.5 |
| Depreciation & Amortization | 156 | 145 | 165 | 189 |
| Other Income | 410 | 312 | 276 | 303 |
| Interest | - | - | - | - |
| PBT before Exceptional Items | 1,442 | 2,043 | 2,266 | 2,538 |
| Growth (%) | 16.6 | 41.7 | 10.9 | 12.0 |
| Tax | 329 | 531 | 589 | 660 |
| PAT before Exceptional Items | 1,113 | 1,512 | 1,677 | 1,878 |
| PAT | 1,113 | 1,512 | 1,677 | 1,878 |
| Growth (%) | 14.5 | 35.9 | 10.9 | 12.0 |
| Diluted EPS | 64.7 | 87.1 | 96.6 | 108.2 |
| EPS (Growth %) | 13.6 | 34.7 | 10.9 | 12.0 |

*Source: Company, ICICI Direct Research*

## Exhibit 33: Balance Sheet

| (Year-end March) | FY18 | FY19E | FY20E | FY21E |
|---|---|---|---|---|
| **Liabilities** | | | | |
| Equity | 17 | 17 | 17 | 17 |
| Reserves & Surplus | 3,843 | 4,822 | 5,907 | 7,124 |
| Networth | 3,860 | 4,839 | 5,925 | 7,141 |
| Long term Liabilities & provisions | 145 | 184 | 212 | 241 |
| Total Debt | - | - | - | - |
| Source of funds | 4,006 | 5,025 | 6,138 | 7,383 |
| | | | | |
| **Assets** | | | | |
| Net fixed assets | 252 | 246 | 241 | 235 |
| Net intangible assets | 159 | 152 | 146 | 139 |
| Goodwill | 276 | 276 | 276 | 276 |
| Other non-current assets | 501 | 646 | 750 | 860 |
| Unbilled revenue | 837 | 1,084 | 1,258 | 1,442 |
| Debtors | 1,396 | 1,808 | 2,098 | 2,405 |
| Current Investments | 1,264 | 1,764 | 2,464 | 3,164 |
| Cash & Cash equivalents | 363 | 281 | 336 | 504 |
| Other current assets | 334 | 433 | 502 | 575 |
| Trade payables | 389 | 502 | 582 | 667 |
| Current liabilities | 987 | 1,165 | 1,351 | 1,549 |
| Application of funds | 4,006 | 5,025 | 6,138 | 7,383 |

*Source: Company, ICICI Direct Research*

## Exhibit 34: Cash Flow Statement

| (Year-end March) | FY18 | FY19E | FY20E | FY21E |
|---|---|---|---|---|
| PBT | 1,442 | 2,043 | 2,266 | 2,538 |
| Add: Depreciation | 156 | 145 | 165 | 189 |
| (Inc)/Dec in current assets | (576) | (412) | (290) | (307) |
| Inc/(Dec) in current liabilities | 200 | 39 | 27 | 29 |
| CF from operations | 844 | 1,007 | 1,349 | 1,511 |
| (Inc)/Dec in other investments | (250) | (426) | (552) | (510) |
| (Inc)/Dec in Fixed Assets | (98) | (132) | (153) | (176) |
| Other investing cash flow | 2 | 2 | 2 | 4 |
| CF from investing Activities | (461) | (556) | (703) | (682) |
| Issue of equity | 0 | - | - | - |
| Inc/(Dec) in loan funds | (41) | - | - | - |
| Dividend paid & dividend tax | (353) | (533) | (591) | (662) |
| Others | (14) | - | - | - |
| CF from Financial Activities | (408) | (533) | (591) | (662) |
| Net cash flow | (24) | (82) | 55 | 168 |
| Effect of exchange rate changes | 8 | - | - | - |
| Opening cash | 380 | 363 | 281 | 336 |
| Closing cash | 363 | 281 | 336 | 504 |

*Source: ICICI Direct Research, Company*

## Exhibit 35: Key Ratios

| (Year-end March) | FY18 | FY19E | FY20E | FY21E |
|---|---|---|---|---|
| Per share data (₹) | | | | |
| EPS | 64.7 | 87.1 | 96.6 | 108.2 |
| Cash Per Share | 21.1 | 16.2 | 19.4 | 29.1 |
| BV | 224.4 | 278.7 | 341.3 | 411.3 |
| DPS | 21.5 | 26.2 | 29.0 | 32.5 |
| Operating Ratios (%) | | | | |
| EBITDA Margin | 16.3 | 19.8 | 19.6 | 19.3 |
| PBT Margin | 19.7 | 21.6 | 20.6 | 20.2 |
| PAT Margin | 15.2 | 16.0 | 15.3 | 14.9 |
| Turnover Ratios | | | | |
| Debtor days | 70 | 70 | 70 | 70 |
| Creditor days | 19 | 19 | 19 | 19 |
| Return Ratios (%) | | | | |
| RoE | 28.8 | 31.3 | 28.3 | 26.3 |
| RoCE | 36.0 | 40.7 | 36.9 | 34.4 |
| RoIC | 43.4 | 58.1 | 59.6 | 60.2 |
| Valuation Ratios (x) | | | | |
| P/E | 25.7 | 19.1 | 17.2 | 15.4 |
| EV / EBITDA | 22.9 | 14.3 | 12.1 | 10.4 |
| Market Cap / Sales | 4.0 | 3.0 | 2.6 | 2.3 |
| Solvency Ratios | | | | |
| Current Ratio | 1.9 | 2.0 | 2.0 | 2.0 |
| Quick Ratio | 1.3 | 1.3 | 1.3 | 1.3 |

*Source: ICICI Direct Research, Company*

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Hold: Up to +/-10%;

Sell: -10% or more;


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