

**BUY**

TP: Rs 2,010 | ▲ 33%

**L&T INFOTECH**

| IT Services

| 20 July 2019

## Client-specific challenges to hamper growth in FY20

**L&T Infotech (LTI) reported a sedate Q1FY20 with 1% QoQ CC revenue growth and 16% EBIT margins against our estimate of 1.5% growth and 16.9% margins. Management indicated that top account challenges have bottomed out, though revenue from another key BFS client is on the decline. We prune FY20/FY21 EPS by 6%/7% and roll forward to a new Jun'20 TP of Rs 2,010 (vs. Rs 2,100). FY20 challenges are likely to be transient and we build in a return to double-digit growth in FY21. Reiterate BUY on solid long-term business prospects.**

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**Soft operating performance:** Revenues stood at US\$ 357mn for the Jun'19 quarter, rising 1% QoQ CC vs. 1.5% estimated. EBIT margins also fell short, contracting 170bps QoQ to 16%. We highlight that the muted revenue performance stemmed from a seasonal dip in India (manufacturing) revenue; international revenue grew at a healthy 2.2% QoQ (in dollar terms). Moreover, BFS revenue increased 1.4% QoQ CC despite earlier indications of softness in the top account.

PAT at Rs 3.5bn was down 6.1% QoQ and 1.6% YoY, below our estimate due to the operational miss. Cash flow from operations stood at Rs 3.3bn with a 94% PAT to CFO conversion ratio.

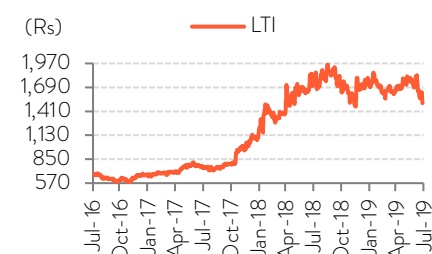
**Large deal wins continue:** LTI added yet another new client (in the insurance vertical) with a TCv of US\$ 44mn, highlighting its strong service offerings. This also marks the eighth consecutive quarter of large deal wins.

**Retain BUY:** Account-specific constraints could pose transient growth challenges in FY20, but we believe LTI has laid the foundation for structural long-term growth. Retain BUY with a revised Jun'20 TP of Rs 2,010, based on an unchanged one-year forward P/E of 20x.

Ticker/Price	LTI IN/Rs 1,516
Market cap	US\$ 3.9bn
Shares o/s	175mn
3M ADV	US\$ 4.4mn
52wk high/low	Rs 1,987/Rs 1,437
Promoter/FPI/DII	75%/8%/10%

Source: NSE

## STOCK PERFORMANCE



Source: NSE

## KEY FINANCIALS

Y/E 31 Mar	FY18A	FY19A	FY20E	FY21E	FY22E
Adj. net profit (Rs mn)	11,124	15,157	14,980	17,238	18,717
Adj. EPS (Rs)	63.5	86.5	85.5	98.4	106.8
Adj. EPS growth (%)	(8.2)	36.1	(1.1)	15.1	8.6
Adj. ROAE (%)	31.8	34.6	28.1	27.5	25.6
Adj. P/E (x)	23.9	17.5	17.7	15.4	14.2
EV/EBITDA (x)	22.0	13.9	13.9	11.3	9.8

Source: Company, BOBCAPS Research

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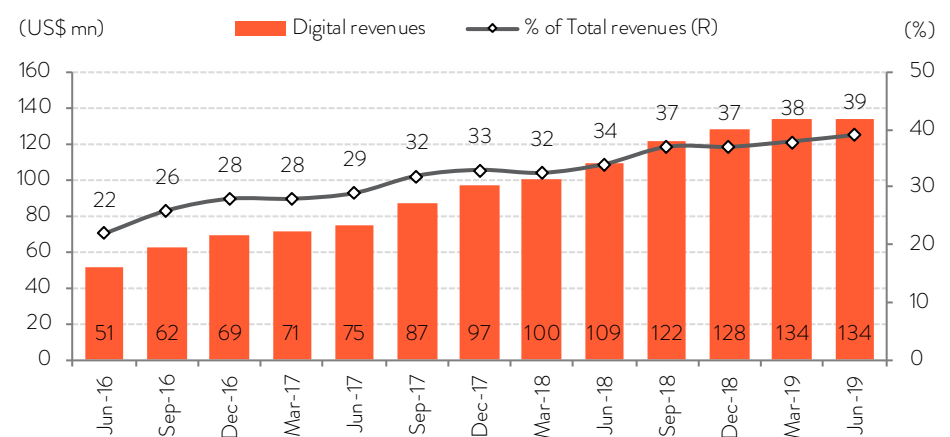
Important disclosures, including any required research certifications, are provided at the end of this report.



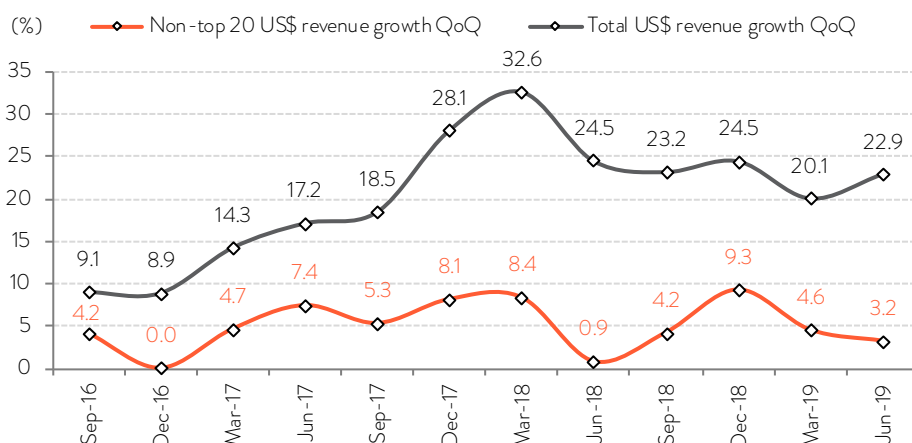
## Earnings call highlights

- FY20 outlook:** As per management, the challenges in its top account has bottomed out. While growth recovery may not be immediate, revenues from the top client are expected to be stable. However, LTI expects a revenue decline in another key BFS client from South Africa on completion of a large project (we estimate a 1% revenue impact). Management is focused on growth with stable operating margins and is confident of a recovery from Q3FY20 as large deals gather pace.
- Operating margins:** For the June ending quarter, EBIT margins saw headwinds in the form of (1) visa costs (100bps impact), (2) higher S&M expenses (100bps), and (3) adverse currency movement (20bps). These headwinds were partially countered by operational efficiencies and ~25bps of tailwinds from Ind-AS 116 adoption.
- Wage revision:** LTI will roll out employee compensation revision from Jul'19 which will have a ~170bps negative impact on operating margins in Q2FY20. Management is hopeful of recouping the margin loss from an expected reduction in visa expenses and S&M investments. The company reiterated its net margin guidance of 14-15% for FY20.
- Onsite talent supply:** LTI has applied for a significantly higher number of US visas in FY20 compared to FY19 (100bps operating margin headwinds in Q1FY20 vs. 50bps in Q1FY19). While the visa approval rate is awaited, this move highlights better preparation to tackle onsite talent supply challenges.

**FIG 1 – DIGITAL BUSINESS ACCOUNTED FOR 39% OF Q1FY20 REVENUES**



Source: Company, BOBCAPS Research

**FIG 2 – NON-TOP 20 CLIENTS CONTINUE TO GROW RAPIDLY**

Source: Company, BOBCAPS Research

**FIG 3 – LTI ADDED TWO CLIENTS TO US\$ 20MN+ REVENUE BUCKET**

Client profile	Jun'17	Sep'17	Dec'17	Mar'18	Jun'18	Sep'18	Dec'18	Mar'19	Jun'19
US\$ 100mn+	1	1	1	1	1	1	1	1	1
US\$ 50mn+	4	4	4	4	4	4	5	5	5
US\$ 20mn+	12	12	13	13	13	14	15	17	19
US\$ 10mn+	24	23	22	23	25	25	25	26	26
US\$ 5mn+	35	39	43	44	42	44	47	49	49
US\$ 1mn+	97	99	102	109	114	114	121	123	124

Source: Company, BOBCAPS Research

**FIG 4 – LARGE DEAL WINS CONTINUE**

Quarter	Large deal wins
<b>Jun-19</b>	Opened a new logo in insurance vertical with large deal TCV of US\$ 44mn  <b>2 large deals with net new TCV of US\$ 100mn+</b>
<b>Mar-19</b>	<ul style="list-style-type: none"> <li>Deal 1: Multi-year multi-million-dollar deal for transforming global application operations of an engineering equipment manufacturer</li> <li>Deal 2: New logo opening with a large IT transformation deal in the insurance vertical</li> </ul>
<b>Dec-18</b>	Secured large deal for a payments company in the Nordic region as primary IT partner post vendor consolidation
<b>Sep-18</b>	Secured a large deal for a global pharma company with net new TCV of US\$ 55mn
<b>Jun-18</b>	<b>1 large deal with net new TCV of US\$ 50mn</b> <ul style="list-style-type: none"> <li>Multi-year multi-million-dollar deal in ERP, data and analytics with global consumer and pharmaceutical conglomerate</li> </ul> <b>2 large deals with combined net new TCV of US\$ 50mn+ (one with Exxon which is a new logo addition and the other from an existing banking client)</b>
<b>Mar-18</b>	<ul style="list-style-type: none"> <li>Deal 1: ExxonMobil selected LTI to digitise Geoscience content by leveraging automation. This deal is in collaboration with L&amp;T Technology</li> <li>Deal 2: Bagged from one of the company's existing large BFS clients</li> </ul>

Source: Company, BOBCAPS Research

**FIG 5 – JUN'19 QUARTER PERFORMANCE**

(Rs mn)	Q1FY19	Q2FY19	Q3FY19	Q4FY19	Q1FY20	YoY (%)	QoQ (%)	FY19
<b>Revenues (US\$ mn)</b>	<b>319.9</b>	<b>328.5</b>	<b>346.9</b>	<b>353.8</b>	<b>356.5</b>	<b>11.4</b>	<b>0.8</b>	<b>1,349.1</b>
<b>Revenue</b>	<b>21,557</b>	<b>23,312</b>	<b>24,729</b>	<b>24,860</b>	<b>24,849</b>	<b>15.3</b>	<b>(0.0)</b>	<b>94,458</b>
<b>Operating Expenditure</b>	<b>17,367</b>	<b>18,522</b>	<b>19,639</b>	<b>20,095</b>	<b>20,270</b>	<b>16.7</b>	<b>0.9</b>	<b>75,623</b>
Cost of revenues	13,977	15,124	16,125	16,417	16,625	18.9	1.3	61,643
as % of sales	64.8	64.9	65.2	66.0	66.9	-	-	65.3
SG&A expenses	3,390	3,398	3,514	3,678	3,645	7.5	(0.9)	13,980
as % of sales	15.7	14.6	14.2	14.8	14.7	-	-	14.8
<b>EBITDA</b>	<b>4,190</b>	<b>4,790</b>	<b>5,090</b>	<b>4,765</b>	<b>4,579</b>	<b>9.3</b>	<b>(3.9)</b>	<b>18,835</b>
Depreciation	378	367	355	371	611	61.6	64.7	1,471
<b>EBIT</b>	<b>3,812</b>	<b>4,423</b>	<b>4,735</b>	<b>4,394</b>	<b>3,968</b>	<b>4.1</b>	<b>(9.7)</b>	<b>17,364</b>
Other Income	1,036	943	288	648	812	-	-	2,915
<b>PBT</b>	<b>4,848</b>	<b>5,366</b>	<b>5,023</b>	<b>5,042</b>	<b>4,780</b>	<b>(1.4)</b>	<b>(5.2)</b>	<b>20,279</b>
Total Tax	1,236	1,363	1,268	1,255	1,225	(0.9)	(2.4)	5,122
<b>Reported PAT</b>	<b>3,612</b>	<b>4,003</b>	<b>3,755</b>	<b>3,787</b>	<b>3,555</b>	<b>(1.6)</b>	<b>(6.1)</b>	<b>15,157</b>
<b>Reported EPS</b>	<b>20.6</b>	<b>22.6</b>	<b>21.6</b>	<b>21.6</b>	<b>20.3</b>	<b>(1.5)</b>	<b>(6.1)</b>	<b>86.4</b>
<b>Margins (%)</b>						<b>(bps)</b>	<b>(bps)</b>	
EBITDA	19.4	20.5	20.6	19.2	18.4	(101)	(74)	19.9
EBIT	17.7	19.0	19.1	17.7	16.0	(171)	(171)	18.4
EBT	22.5	23.0	20.3	20.3	19.2	(325)	(105)	21.5
PAT	16.8	17.2	15.2	15.2	14.3	(245)	(93)	16.0
Effective Tax rate	25.5	25.4	25.2	24.9	25.6	13	74	25.3

Source: Company, BOBCAPS Research

## Valuation methodology

We prune our FY20/FY21 EPS estimates by 6%/7% as we pencil in lower revenue growth in light of client-specific challenges and also moderate our operating margin assumptions on higher delivery costs. We introduce FY22 EPS at Rs 106.8 with dollar revenue growth pegged at 11.7% and net margins at 14.7%.

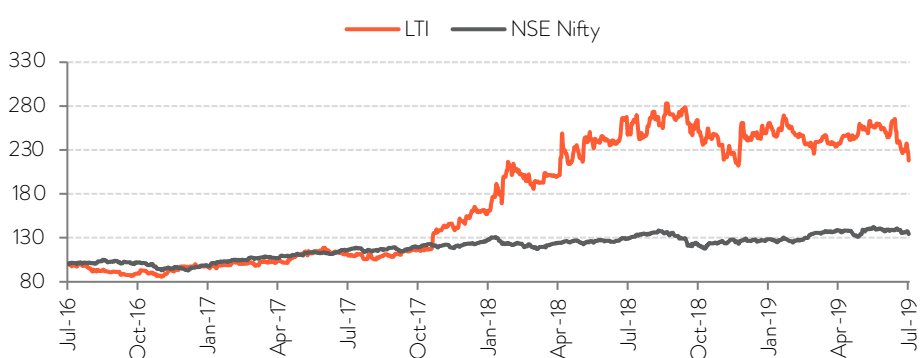
In our view, the challenges in FY20 will be transient in nature even as the building blocks for long-term growth remain intact, especially considering LTI's impressive sales engine and systematic investments to enhance the service portfolio. We reiterate BUY and roll forward to a revised Jun'20 target price of Rs 2,010 (from Rs 2,100 earlier), based on an unchanged one-year forward P/E multiple of 20x.

**FIG 6 – REVISED ESTIMATES**

(Rs mn)	FY20E			FY21E			FY22E
	Old	New	Change (%)	Old	New	Change (%)	New
Revenues (US\$ mn)	1,510	1,462	(3.2)	1,713	1,624	(5.2)	1,814
YoY growth (%)	11.9	8.4	-	13.5	11.1	-	11.7
Revenues	1,05,697	1,01,136	(4.3)	1,19,942	1,13,699	(5.2)	1,27,010
EBITDA	20,268	18,803	(7.2)	23,602	22,374	(5.2)	24,993
EBITDA margins (%)	19.2	18.6	-	19.7	19.7	-	19.7
Net profits	15,985	14,980	(6.3)	18,439	17,238	(6.5)	18,717
EPS (Rs)	91.2	85.5	(6.2)	105.2	98.4	(6.5)	106.8

Source: BOBCAPS Research

**FIG 7 – RELATIVE STOCK PERFORMANCE**



Source: NSE

## Key risks

- **Currency risk:** A sharp fluctuation in exchange rates may materially impact the company's operating profits.
- **Leadership flux:** LTI has suffered from a leadership flux in the past (prior to FY14) – a repeat of this situation would pose a risk to our thesis.

- **Inability to sustain large deal momentum:** Steady large deal wins are critical for the company to sustain its strong growth traction. An inability to do so may derail growth.
- **Client concentration risk:** Top 5/10 clients account for ~35%/48% of LTI's revenue. Any prolonged weakness in top client revenue would pose a downside risk to our estimates.
- **Benchmarking clause:** Some of LTI's client contracts contain benchmarking clauses (22% of revenues in FY16) and most favoured customer provisions (29% of revenues in FY16) – if triggered, they could result in lower contractual revenues and profitability in future.

## FINANCIALS

### Income Statement

Y/E 31 Mar (Rs mn)	FY18A	FY19A	FY20E	FY21E	FY22E
<b>Total revenue</b>	<b>73,064</b>	<b>94,458</b>	<b>1,01,136</b>	<b>1,13,699</b>	<b>1,27,010</b>
EBITDA	11,875	18,835	18,803	22,374	24,993
EBIT	10,312	17,364	16,285	19,532	21,818
Net interest income/(expenses)	0	0	0	0	0
Other income/(expenses)	4,102	2,915	3,830	3,606	3,306
Exceptional items	0	0	0	0	0
EBT	14,414	20,279	20,115	23,138	25,123
Income taxes	3,290	5,122	5,135	5,900	6,406
Extraordinary items	0	0	0	0	0
Min. int./Inc. from associates	0	0	0	0	0
<b>Reported net profit</b>	<b>11,124</b>	<b>15,157</b>	<b>14,980</b>	<b>17,238</b>	<b>18,717</b>
Adjustments	0	0	0	0	0
<b>Adjusted net profit</b>	<b>11,124</b>	<b>15,157</b>	<b>14,980</b>	<b>17,238</b>	<b>18,717</b>

### Balance Sheet

Y/E 31 Mar (Rs mn)	FY18A	FY19A	FY20E	FY21E	FY22E
Accounts payables	0	0	0	0	0
Other current liabilities	12,960	15,291	16,372	18,406	20,561
Provisions	2,123	2,402	2,572	2,891	3,230
Debt funds	0	0	0	0	0
Other liabilities	132	56	56	56	56
Equity capital	171	171	171	171	171
Reserves & surplus	38,439	48,772	57,439	67,413	78,243
Shareholders' fund	38,610	48,943	57,610	67,584	78,414
<b>Total liabilities and equities</b>	<b>53,825</b>	<b>66,692</b>	<b>76,610</b>	<b>88,937</b>	<b>1,02,260</b>
Cash and cash eq.	3,633	4,150	11,651	19,366	27,802
Accounts receivables	22,327	23,845	18,011	20,248	22,618
Inventories	0	0	0	0	0
Other current assets	7,121	10,878	12,746	14,329	16,007
Investments	12,643	17,402	17,402	17,402	17,402
Net fixed assets	5,281	8,031	8,041	8,041	8,041
CWIP	0	0	0	0	0
Intangible assets	0	0	0	0	0
Deferred tax assets, net	2,821	2,386	2,386	2,386	2,386
Other assets	0	0	6,373	7,165	8,003
<b>Total assets</b>	<b>53,826</b>	<b>66,692</b>	<b>76,610</b>	<b>88,937</b>	<b>1,02,260</b>

Source: Company, BOBCAPS Research

**Cash Flows**

Y/E 31 Mar (Rs mn)	FY18A	FY19A	FY20E	FY21E	FY22E
Net income + Depreciation	9,106	11,876	17,498	20,080	21,892
Interest expenses	134	87	(1,263)	(2,034)	(2,574)
Non-cash adjustments	0	0	0	0	0
Changes in working capital	(3,760)	(3,060)	(1,156)	(2,259)	(2,393)
Other operating cash flows	2,958	5,048	0	0	0
<b>Cash flow from operations</b>	<b>8,438</b>	<b>13,951</b>	<b>15,079</b>	<b>15,788</b>	<b>16,925</b>
Capital expenditures	(982)	(1,531)	(2,528)	(2,842)	(3,175)
Change in investments	(2,501)	(3,769)	0	0	0
Other investing cash flows	(1,041)	(2,191)	1,263	2,034	2,574
<b>Cash flow from investing</b>	<b>(4,524)</b>	<b>(7,491)</b>	<b>(1,265)</b>	<b>(809)</b>	<b>(601)</b>
Equities issued/Others	3	3	0	0	0
Debt raised/repaid	0	0	0	0	0
Interest expenses	(1,045)	(1,447)	0	0	0
Dividends paid	(3,034)	(4,499)	(6,312)	(7,264)	(7,887)
Other financing cash flows	0	0	0	0	0
<b>Cash flow from financing</b>	<b>(4,076)</b>	<b>(5,943)</b>	<b>(6,312)</b>	<b>(7,264)</b>	<b>(7,887)</b>
<b>Changes in cash and cash eq.</b>	<b>(162)</b>	<b>517</b>	<b>7,501</b>	<b>7,715</b>	<b>8,436</b>
<b>Closing cash and cash eq.</b>	<b>3,633</b>	<b>4,150</b>	<b>11,651</b>	<b>19,366</b>	<b>27,802</b>

**Per Share**

Y/E 31 Mar (Rs)	FY18A	FY19A	FY20E	FY21E	FY22E
Reported EPS	63.5	86.5	85.5	98.4	106.8
Adjusted EPS	63.5	86.5	85.5	98.4	106.8
Dividend per share	21.5	28.0	29.9	34.4	37.4
Book value per share	220.5	279.2	328.8	385.7	447.5

**Valuations Ratios**

Y/E 31 Mar (x)	FY18A	FY19A	FY20E	FY21E	FY22E
EV/Sales	3.6	2.8	2.6	2.2	1.9
EV/EBITDA	22.0	13.9	13.9	11.3	9.8
Adjusted P/E	23.9	17.5	17.7	15.4	14.2
P/BV	6.9	5.4	4.6	3.9	3.4

**DuPont Analysis**

Y/E 31 Mar (%)	FY18A	FY19A	FY20E	FY21E	FY22E
Tax burden (Net profit/PBT)	77.2	74.7	74.5	74.5	74.5
Interest burden (PBT/EBIT)	139.8	116.8	123.5	118.5	115.2
EBIT margin (EBIT/Revenue)	14.1	18.4	16.1	17.2	17.2
Asset turnover (Revenue/Avg TA)	148.9	156.8	141.2	137.4	132.9
Leverage (Avg TA/Avg Equity)	1.4	1.4	1.3	1.3	1.3
Adjusted ROAE	31.8	34.6	28.1	27.5	25.6

Source: Company, BOBCAPS Research | Note: TA = Total Assets



**Ratio Analysis**

Y/E 31 Mar	FY18A	FY19A	FY20E	FY21E	FY22E
<b>YoY growth (%)</b>					
Revenue	12.4	29.3	7.1	12.4	11.7
EBITDA	(3.4)	58.6	(0.2)	19.0	11.7
Adjusted EPS	(8.2)	36.1	(1.1)	15.1	8.6
<b>Profitability &amp; Return ratios (%)</b>					
EBITDA margin	16.3	19.9	18.6	19.7	19.7
EBIT margin	14.1	18.4	16.1	17.2	17.2
Adjusted profit margin	15.2	16.0	14.8	15.2	14.7
Adjusted ROAE	31.8	34.6	28.1	27.5	25.6
ROCE	32.8	43.4	35.8	41.4	44.1
<b>Working capital days (days)</b>					
Receivables	85	89	76	61	62
Inventory	0	0	0	0	0
Payables	12	11	11	11	11
<b>Ratios (x)</b>					
Gross asset turnover	13.6	14.2	12.6	14.1	15.8
Current ratio	2.2	2.2	2.6	2.9	3.1
Net interest coverage ratio	NA	NA	NA	NA	NA
Adjusted debt/equity	(0.1)	(0.1)	(0.2)	(0.3)	(0.4)

Source: Company, BOBCAPS Research

## Disclaimer

### Recommendations and Absolute returns (%) over 12 months

**BUY** – Expected return >+15%

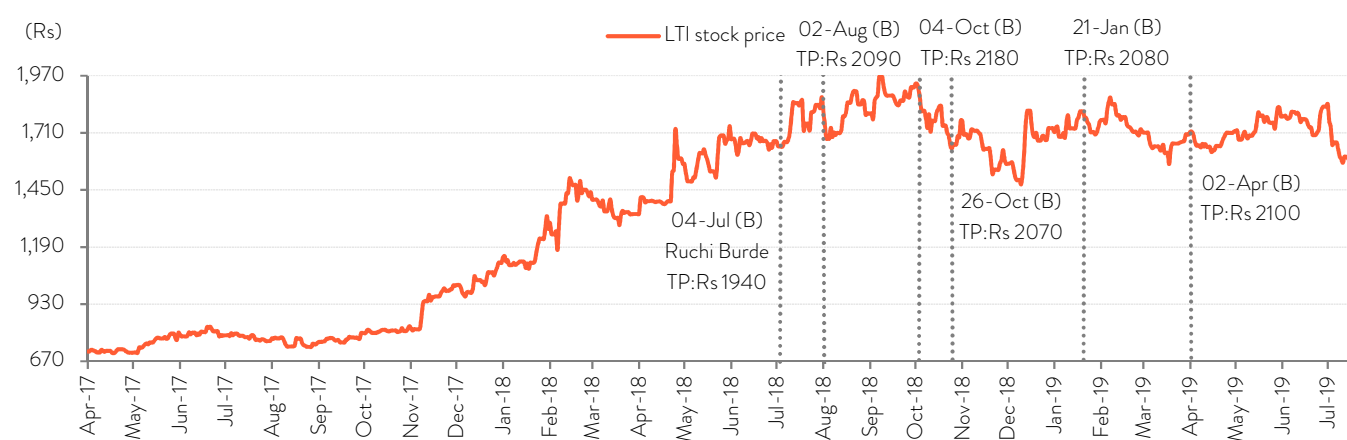
**ADD** – Expected return from >+5% to +15%

**REDUCE** – Expected return from -5% to +5%

**SELL** – Expected return <-5%

**Note:** Recommendation structure changed with effect from 1 January 2018 (Hold rating discontinued and replaced by Add / Reduce)

### HISTORICAL RATINGS AND TARGET PRICE: L&T INFOTECH (LTI IN)



B – Buy, A – Add, R – Reduce, S – Sell

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