

Merger Overhang Ends, LTI CEO resigns, KMP Attrition holds key

Three years after Larsen and Toubro Ltd. acquired Mindtree, the overhang of an impending merger of its two I.T subsidiaries, LTI and Mindtree, is now finally reached its conclusion, with LTI proposing to merge with Mindtree in a share swap deal, wherein **shareholders of Mindtree will be issued 73 shares of LTI for every 100 shares held in Mindtree**, taking parent L&T ownership to 68.7% in combined entity post-merger. Combined entity expected to result in Revenue scale of \$3.5Bn, and total market cap of \$18.7bn (ahead of TechM).

LTI CEO resigns, more KMP may follow

LTI CEO, Sanjay Jalona resigned on the same evening, which indicates that Debashis Chatterjee would potentially run the merged entity as CEO. We believe there would be some cultural hit to LTites as Sanjay was aggressive leader with go getter personality and empowered its team to achieve industry leading growth throughout his tenure. LTI prospered under its unique culture and gained enormously as it functioned as separate unit versus being in fold of LT (was hived off into separate entity). Sanjay was an external CEO and brought in best practices and scalability talent from his learnings from Infosys where he was running \$2bn business unit till 2015. Mindtree also had suffered at the cost of management transition from founders to LT group, which resulted in massive KMP attrition (18 KMP/title holders in first twelve month of being acquired). Now again some more attrition may happen and thus would be key metrics to match out hereon.

Is there any synergy? Is timing ideal?

We don't see any clear known synergies either from cost or revenue perspective that can be easily identified. Off course, there could be some cross-sell opportunities due to complimentary capabilities/offerings and also some cost optimisation due to overlaps which in our view were already been leveraged ever since LT group bought Mindtree. Management highlighted that the combined entity will be able to attract larger size deals of \$100mn plus which if it does could be positive. We know this was due and any potential gyrations are unavoidable but in our view timing could have been better. In our view, ideal time could have been when demand environment would have normalized (8-9% industry growth). As by announcing it now the growth momentum may take unnecessary hit and also may end up losing lots of key talent to competition as many of them may like to avoid any uncertainties or culture shift.

DART View

At current market prices, arbitrage is only 0.6%. Business metrics (Client Contribution Mix, Utilization, Attrition, Onsite mix) and valuations for both entities are similar, and therefore we do not foresee a re-rating. On the contrary we think the event may have some risk of potential slowdown on the growth performance in near term and thus we tone down our target multiples for both the names. We retain REDUCE rating on Mindtree with TP of Rs3,420, and has now downgraded LTI to REDUCE rating with TP of Rs. 4,820 – valuing both the entities at 28x FY24E earnings.

| Company | TP | Rating |
|----------|-------|--------|
| LTI | 4,820 | Reduce |
| Mindtree | 3,420 | Reduce |

Rahul Jain

VP - Research

+9122 40969771

rahulj@dolatcapital.com

Pranav Mashruwala

Associate

+9122 40969773

pranavm@dolatcapital.com

Few KTAs from the merger call:

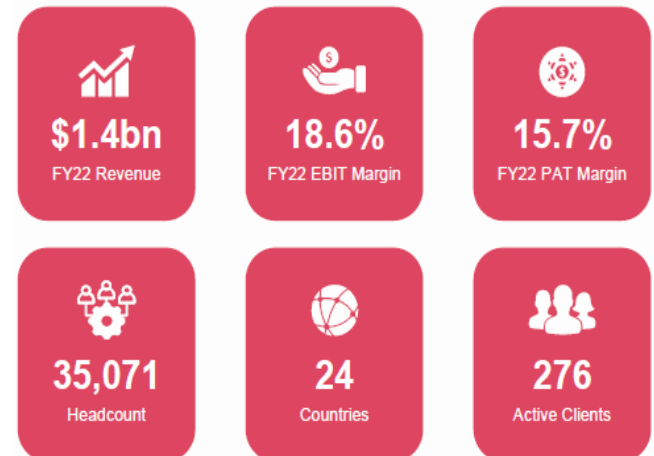
- **Expected Synergies:** On the Revenue front, management expects that combined entity will be even well-equipped to compete with Tier-1 players. A diversified service portfolio, with more focus on end-to-end offerings, is better positioned to win contract bids over competitors. 760+ of combined active clients will have 30-40% more cross-selling opportunities. Access to larger cash pool will help build IPs as well as be ready for any M&A opportunities. There is minimal overlap between clients of both entities.
- **Deal Winning Capability:** Despite the merger the commentary on outlook for FY23E remain intact individually for both the entity. Mindtree re-iterated its emphasis on continuing on industry leading growth, sustaining EBITDA margin of 20%+ (20.9% for FY22), and overall profitable growth. LTI's Sudhir Chaturvedi (President Sales - LTI) also assured for its leader quadrant growth performance in FY23E.

Exhibit 1: Overview of LTI



Source: Company

Exhibit 2: Overview of Mindtree



Source: Company

LTI has been strong in BFSI, while CMT and Travel has been Mindtree's Forte; Combined entity expected to play out larger deal wins across key verticals.

Exhibit 3: While Verticals will be Strengthened with renewed scale, Other Complementary Verticals provide adequate Diversification for scaling up to next level

FY22 Revenue Split by Vertical (%; \$mn)

| LTI Let's Solve | | | Mindtree Welcome to possible | | | Proforma (As-is) | | |
|----------------------|----------------|-------------------|--------------------------------------|----------------|-------------------|--------------------------------------|----------------|-------------------|
| | Revenue (\$mn) | Revenue Share (%) | | Revenue (\$mn) | Revenue Share (%) | | Revenue (\$mn) | Revenue Share (%) |
| BFSI | \$974 | 47% | BFSI | \$251 | 18% | BFSI | \$1,225 | 35% |
| Hi-Tech & Media | \$255 | 12% | Communications, Media & Technology | \$614 | 43% | Communications, Media & Technology | \$869 | 25% |
| CPG, Retail & Pharma | \$216 | 10% | CPG, Retail, Mfg | \$334 | 24% | Mfg, CPG, Retail, Healthcare | \$906 | 26% |
| Manufacturing | \$339 | 16% | Healthcare | \$17 | 1% | Energy & Utilities | \$187 | 5% |
| Energy & Utilities | \$187 | 9% | Travel, Transportation & Hospitality | \$195 | 14% | Travel, Transportation & Hospitality | \$195 | 5% |
| Others | \$131 | 6% | | | | Others | \$131 | 4% |
| Total | \$2,102 | 100% | Total | \$1,411 | 100% | Total | \$3,513 | 100% |

Source: Company

Combined and Deeper Presence in Key Geographies to aid Market Share Gains

Exhibit 4: Diversification Benefits will be across Geographies

| LTI Let's Solve | | | Mindtree Welcome to possible | | | Proforma (As-is) | | |
|--------------------|----------------|-------------------|---------------------------------|----------------|-------------------|------------------|----------------|-------------------|
| | Revenue (\$mn) | Revenue Share (%) | | Revenue (\$mn) | Revenue Share (%) | | Revenue (\$mn) | Revenue Share (%) |
| Americas | \$1,398 | 67% | Americas | \$1,044 | 74% | Americas | \$2,442 | 69% |
| Europe | \$340 | 16% | Europe | \$254 | 18% | Europe | \$594 | 17% |
| RoW | \$364 | 17% | RoW | \$113 | 8% | RoW | \$477 | 14% |
| Total | \$2,102 | 100% | Total | \$1,411 | 100% | Total | \$3,513 | 100% |

Source: Company

View: We do not see any meaningful synergies coming out of the transactions and rather on the contrary we think the event may have some risk of potential slowdown on the growth performance in near term and thus we tone town our target multiples for both the names. We retain REDUCE rating on Mindtree with TP of Rs3,420, and has now downgraded LTI to REDUCE rating with TP of Rs. 4,820 – valuing both the entities at 28x FY24E earnings.

Profit and Loss Account

| (Rs Mn) | FY21A | FY22A | FY23E | FY24E |
|--|----------------|----------------|----------------|----------------|
| Revenue | 123,698 | 156,687 | 189,389 | 219,000 |
| Total Expense | 96,447 | 126,102 | 153,168 | 177,296 |
| COGS | 82,193 | 108,567 | 131,661 | 151,954 |
| Employees Cost | 0 | 0 | 0 | 0 |
| Other expenses | 14,254 | 17,535 | 21,507 | 25,343 |
| EBIDTA | 27,251 | 30,585 | 36,221 | 41,703 |
| Depreciation | 3,325 | 3,549 | 4,167 | 4,599 |
| EBIT | 23,926 | 27,036 | 32,054 | 37,104 |
| Interest | 0 | 0 | 0 | 0 |
| Other Income | 1,955 | 3,939 | 3,027 | 3,497 |
| Exc. / E.O. items | 0 | 0 | 0 | 0 |
| EBT | 25,881 | 30,975 | 35,081 | 40,601 |
| Tax | 6,500 | 7,989 | 8,946 | 10,353 |
| RPAT | 19,360 | 22,969 | 26,116 | 30,228 |
| Minority Interest | 21 | 17 | 20 | 20 |
| Profit/Loss share of associates | 0 | 0 | 0 | 0 |
| APAT | 19,360 | 22,969 | 26,116 | 30,228 |

Balance Sheet

| (Rs Mn) | FY21A | FY22A | FY23E | FY24E |
|-------------------------------|---------------|---------------|----------------|----------------|
| Sources of Funds | | | | |
| Equity Capital | 175 | 175 | 175 | 175 |
| Minority Interest | 37 | 57 | 77 | 97 |
| Reserves & Surplus | 72,859 | 87,971 | 103,549 | 121,483 |
| Net Worth | 73,034 | 88,146 | 103,724 | 121,658 |
| Total Debt | 414 | 519 | 519 | 519 |
| Net Deferred Tax Liability | (511) | (444) | (444) | (444) |
| Total Capital Employed | 72,974 | 88,278 | 103,876 | 121,830 |

Applications of Funds

| | | | | |
|---|---------------|---------------|----------------|----------------|
| Net Block | 16,911 | 18,698 | 20,006 | 20,157 |
| CWIP | 403 | 4,374 | 4,374 | 3,874 |
| Investments | 38,130 | 38,644 | 41,144 | 43,894 |
| Current Assets, Loans & Advances | 51,101 | 62,428 | 77,158 | 95,432 |
| Inventories | 0 | 0 | 0 | 0 |
| Receivables | 20,835 | 28,335 | 33,727 | 39,000 |
| Cash and Bank Balances | 6,759 | 3,949 | 10,461 | 21,646 |
| Loans and Advances | 757 | 0 | 0 | 0 |
| Other Current Assets | 22,750 | 30,144 | 32,970 | 34,786 |
| Less: Current Liabilities & Provisions | 33,571 | 35,866 | 38,807 | 41,528 |
| Payables | 8,277 | 8,028 | 9,751 | 11,287 |
| Other Current Liabilities | 25,294 | 27,838 | 29,055 | 30,241 |
| <i>sub total</i> | | | | |
| Net Current Assets | 17,530 | 26,562 | 38,352 | 53,904 |
| Total Assets | 72,974 | 88,278 | 103,876 | 121,830 |

E – Estimates

Important Ratios

| Particulars | FY21A | FY22A | FY23E | FY24E |
|---|---------|---------|---------|---------|
| (A) Margins (%) | | | | |
| Gross Profit Margin | 33.6 | 30.7 | 30.5 | 30.6 |
| EBIDTA Margin | 22.0 | 19.5 | 19.1 | 19.0 |
| EBIT Margin | 19.3 | 17.3 | 16.9 | 16.9 |
| Tax rate | 25.1 | 25.8 | 25.5 | 25.5 |
| Net Profit Margin | 15.7 | 14.7 | 13.8 | 13.8 |
| (B) As Percentage of Net Sales (%) | | | | |
| COGS | 66.4 | 69.3 | 69.5 | 69.4 |
| Employee | 0.0 | 0.0 | 0.0 | 0.0 |
| Other | 11.5 | 11.2 | 11.4 | 11.6 |
| (C) Measure of Financial Status | | | | |
| Gross Debt / Equity | 0.0 | 0.0 | 0.0 | 0.0 |
| Interest Coverage | | | | |
| Inventory days | 0 | 0 | 0 | 0 |
| Debtors days | 61 | 66 | 65 | 65 |
| Average Cost of Debt | 0.0 | 0.0 | 0.0 | 0.0 |
| Payable days | 24 | 19 | 19 | 19 |
| Working Capital days | 52 | 62 | 74 | 90 |
| FA T/O | 7.3 | 8.4 | 9.5 | 10.9 |
| (D) Measures of Investment | | | | |
| AEPS (Rs) | 110.2 | 130.8 | 148.7 | 172.1 |
| CEPS (Rs) | 129.2 | 151.0 | 172.4 | 198.3 |
| DPS (Rs) | 40.0 | 55.0 | 60.0 | 70.0 |
| Dividend Payout (%) | 36.3 | 42.1 | 40.4 | 40.7 |
| BVPS (Rs) | 415.8 | 501.9 | 590.6 | 692.7 |
| RoANW (%) | 30.5 | 28.5 | 27.2 | 26.8 |
| RoACE (%) | 31.0 | 28.5 | 27.2 | 26.8 |
| RoAIC (%) | 42.1 | 35.9 | 36.1 | 38.3 |
| (E) Valuation Ratios | | | | |
| CMP (Rs) | 4593 | 4593 | 4593 | 4593 |
| P/E | 41.7 | 35.1 | 30.9 | 26.7 |
| Mcap (Rs Mn) | 807,839 | 807,839 | 807,839 | 807,839 |
| MCap/ Sales | 6.5 | 5.2 | 4.3 | 3.7 |
| EV | 801,494 | 804,409 | 797,896 | 786,712 |
| EV/Sales | 6.5 | 5.1 | 4.2 | 3.6 |
| EV/EBITDA | 29.4 | 26.3 | 22.0 | 18.9 |
| P/BV | 11.0 | 9.2 | 7.8 | 6.6 |
| Dividend Yield (%) | 0.9 | 1.2 | 1.3 | 1.5 |
| (F) Growth Rate (%) | | | | |
| Revenue | 13.7 | 26.7 | 20.9 | 15.6 |
| EBITDA | 34.3 | 12.2 | 18.4 | 15.1 |
| EBIT | 36.2 | 13.0 | 18.6 | 15.8 |
| PBT | 29.2 | 19.7 | 13.3 | 15.7 |
| APAT | 27.4 | 18.6 | 13.7 | 15.7 |
| EPS | 27.6 | 18.7 | 13.7 | 15.7 |

Cash Flow

| (Rs Mn) | FY21A | FY22A | FY23E | FY24E |
|--------------|----------|----------|---------|---------|
| CFO | 23,996 | 16,520 | 22,014 | 27,182 |
| CFI | (16,560) | (9,594) | (8,325) | (7,200) |
| CFF | (5,088) | (10,458) | (7,177) | (8,797) |
| FCFF | 21,331 | 7,964 | 16,189 | 22,732 |
| Opening Cash | 5,252 | 7,594 | 3,949 | 10,461 |
| Closing Cash | 7,594 | 3,949 | 10,461 | 21,646 |

E – Estimates

Profit and Loss Account

| (Rs Mn) | FY21A | FY22A | FY23E | FY24E |
|--|---------------|----------------|----------------|----------------|
| Revenue | 79,678 | 105,253 | 125,840 | 143,779 |
| Total Expense | 63,111 | 83,297 | 100,564 | 115,346 |
| COGS | 51,132 | 63,278 | 76,060 | 87,128 |
| Employees Cost | 0 | 0 | 0 | 0 |
| Other expenses | 11,979 | 20,019 | 24,504 | 28,218 |
| EBIDTA | 16,567 | 21,956 | 25,276 | 28,433 |
| Depreciation | 2,596 | 2,420 | 2,708 | 3,144 |
| EBIT | 13,971 | 19,536 | 22,569 | 25,289 |
| Interest | 504 | 502 | 442 | 342 |
| Other Income | 1,517 | 3,073 | 2,389 | 2,115 |
| Exc. / E.O. items | 0 | 0 | 0 | 0 |
| EBT | 14,984 | 22,107 | 24,516 | 27,062 |
| Tax | 3,879 | 5,578 | 6,251 | 6,901 |
| RPAT | 11,105 | 16,529 | 18,264 | 20,161 |
| Minority Interest | 0 | 0 | 0 | 0 |
| Profit/Loss share of associates | 0 | 0 | 0 | 0 |
| APAT | 11,105 | 16,529 | 18,264 | 20,161 |

Balance Sheet

| (Rs Mn) | FY21A | FY22A | FY23E | FY24E |
|-------------------------------|---------------|---------------|---------------|---------------|
| Sources of Funds | | | | |
| Equity Capital | 1,647 | 1,648 | 1,647 | 1,647 |
| Minority Interest | 0 | 0 | 0 | 0 |
| Reserves & Surplus | 41,543 | 53,091 | 64,763 | 78,002 |
| Net Worth | 43,190 | 54,739 | 66,410 | 79,649 |
| Total Debt | 0 | 0 | 0 | 0 |
| Net Deferred Tax Liability | (351) | 161 | 161 | 161 |
| Total Capital Employed | 42,839 | 54,900 | 66,571 | 79,810 |

Applications of Funds

| | | | | |
|---|---------------|---------------|---------------|---------------|
| Net Block | 7,985 | 9,028 | 8,970 | 8,876 |
| CWIP | 224 | 215 | 215 | 215 |
| Investments | 19,307 | 22,391 | 24,591 | 27,141 |
| Current Assets, Loans & Advances | 35,747 | 49,939 | 61,789 | 74,169 |
| Inventories | 0 | 0 | 0 | 0 |
| Receivables | 13,903 | 20,429 | 21,044 | 23,600 |
| Cash and Bank Balances | 7,597 | 10,513 | 21,254 | 29,668 |
| Loans and Advances | 0 | 0 | 0 | 0 |
| Other Current Assets | 14,247 | 18,997 | 19,492 | 20,901 |
| Less: Current Liabilities & Provisions | 20,424 | 26,673 | 28,995 | 30,592 |
| Payables | 2,676 | 5,357 | 5,510 | 5,688 |
| Other Current Liabilities | 17,748 | 21,316 | 23,484 | 24,903 |
| <i>sub total</i> | | | | |
| Net Current Assets | 15,323 | 23,266 | 32,794 | 43,578 |
| Total Assets | 42,839 | 54,900 | 66,571 | 79,810 |

E – Estimates

Important Ratios

| Particulars | FY21A | FY22A | FY23E | FY24E |
|---|---------|---------|---------|---------|
| (A) Margins (%) | | | | |
| Gross Profit Margin | 35.8 | 39.9 | 39.6 | 39.4 |
| EBIDTA Margin | 20.8 | 20.9 | 20.1 | 19.8 |
| EBIT Margin | 17.5 | 18.6 | 17.9 | 17.6 |
| Tax rate | 25.9 | 25.2 | 25.5 | 25.5 |
| Net Profit Margin | 13.9 | 15.7 | 14.5 | 14.0 |
| (B) As Percentage of Net Sales (%) | | | | |
| COGS | 64.2 | 60.1 | 60.4 | 60.6 |
| Employee | 0.0 | 0.0 | 0.0 | 0.0 |
| Other | 15.0 | 19.0 | 19.5 | 19.6 |
| (C) Measure of Financial Status | | | | |
| Gross Debt / Equity | 0.0 | 0.0 | 0.0 | 0.0 |
| Interest Coverage | 27.7 | 38.9 | 51.1 | 73.9 |
| Inventory days | 0 | 0 | 0 | 0 |
| Debtors days | 64 | 71 | 61 | 60 |
| Average Cost of Debt | | | | |
| Payable days | 12 | 19 | 16 | 14 |
| Working Capital days | 70 | 81 | 95 | 111 |
| FA T/O | 10.0 | 11.7 | 14.0 | 16.2 |
| (D) Measures of Investment | | | | |
| AEPS (Rs) | 67.4 | 100.1 | 110.7 | 122.1 |
| CEPS (Rs) | 83.1 | 114.8 | 127.1 | 141.2 |
| DPS (Rs) | 25.0 | 36.9 | 39.9 | 41.9 |
| Dividend Payout (%) | 37.1 | 36.9 | 36.1 | 34.3 |
| BVPS (Rs) | 262.1 | 331.6 | 402.3 | 482.6 |
| RoANW (%) | 29.7 | 33.8 | 30.2 | 27.6 |
| RoACE (%) | 32.0 | 34.9 | 30.8 | 28.0 |
| RoAIC (%) | 47.3 | 49.1 | 50.3 | 53.0 |
| (E) Valuation Ratios | | | | |
| CMP (Rs) | 3374 | 3374 | 3374 | 3374 |
| P/E | 50.1 | 33.7 | 30.5 | 27.6 |
| Mcap (Rs Mn) | 556,871 | 556,871 | 556,871 | 556,871 |
| MCap/ Sales | 7.0 | 5.3 | 4.4 | 3.9 |
| EV | 549,274 | 546,358 | 535,617 | 527,202 |
| EV/Sales | 6.9 | 5.2 | 4.3 | 3.7 |
| EV/EBITDA | 33.2 | 24.9 | 21.2 | 18.5 |
| P/BV | 12.9 | 10.2 | 8.4 | 7.0 |
| Dividend Yield (%) | 0.7 | 1.1 | 1.2 | 1.2 |
| (F) Growth Rate (%) | | | | |
| Revenue | 2.6 | 32.1 | 19.6 | 14.3 |
| EBITDA | 52.0 | 32.5 | 15.1 | 12.5 |
| EBIT | 71.5 | 39.8 | 15.5 | 12.1 |
| PBT | 80.8 | 47.5 | 10.9 | 10.4 |
| APAT | 76.0 | 48.8 | 10.5 | 10.4 |
| EPS | 75.8 | 48.6 | 10.5 | 10.4 |

Cash Flow

| (Rs Mn) | FY21A | FY22A | FY23E | FY24E |
|--------------|----------|---------|---------|---------|
| CFO | 19,960 | 15,370 | 19,895 | 18,922 |
| CFI | (11,833) | (6,860) | (2,561) | (3,585) |
| CFF | (4,225) | (5,957) | (6,593) | (6,922) |
| FCFF | 19,341 | 13,398 | 17,145 | 15,772 |
| Opening Cash | 3,909 | 7,597 | 10,513 | 21,254 |
| Closing Cash | 7,597 | 10,513 | 21,254 | 29,668 |

E – Estimates

DART RATING MATRIX

Total Return Expectation (12 Months)

| | |
|-------------------|------------------|
| Buy | > 20% |
| Accumulate | 10 to 20% |
| Reduce | 0 to 10% |
| Sell | < 0% |

DART Team

| | | | |
|--------------------|--------------------------|--------------------------------|------------------------|
| Purvag Shah | Managing Director | purvag@dolatcapital.com | +9122 4096 9747 |
|--------------------|--------------------------|--------------------------------|------------------------|

| | | | |
|--------------------------|-------------------------|------------------------------|------------------------|
| Amit Khurana, CFA | Head of Equities | amit@dolatcapital.com | +9122 4096 9745 |
|--------------------------|-------------------------|------------------------------|------------------------|

CONTACT DETAILS

| Equity Sales | Designation | E-mail | Direct Lines |
|-----------------------|--|-------------------------------|---------------------|
| Dinesh Bajaj | VP - Equity Sales | dineshb@dolatcapital.com | +9122 4096 9709 |
| Kapil Yadav | VP - Equity Sales | kapil@dolatcapital.com | +9122 4096 9735 |
| Jubbin Shah | VP - Equity Sales | jubbins@dolatcapital.com | +9122 4096 9779 |
| Anjana Jhaveri | VP - FII Sales | anjanaj@dolatcapital.com | +9122 4096 9758 |
| Ruchi Bhadra | AVP - Equity Sales | ruchib@dolatcapital.com | +9122 4096 9784 |
| Equity Trading | Designation | E-mail | |
| P. Sridhar | SVP and Head of Sales Trading | sridhar@dolatcapital.com | +9122 4096 9728 |
| Chandrakant Ware | VP - Sales Trading | chandrakant@dolatcapital.com | +9122 4096 9707 |
| Shirish Thakkar | VP - Head Domestic Derivatives Sales Trading | shirisht@dolatcapital.com | +9122 4096 9702 |
| Kartik Mehta | Asia Head Derivatives | kartikm@dolatcapital.com | +9122 4096 9715 |
| Dinesh Mehta | Co - Head Asia Derivatives | dinesh.mehta@dolatcapital.com | +9122 4096 9765 |
| Bhavin Mehta | VP - Derivatives Strategist | bhavinm@dolatcapital.com | +9122 4096 9705 |

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Member: BSE Limited and National Stock Exchange of India Limited.

SEBI Registration No: BSE - INZ000274132, NSE - INZ000274132, Research: INH000000685

Registered office: Unit no PO6-02A - PO6-02D, Tower A, WTC, Block 51, Zone-5, Road 5E, Gift City, Gandhinagar, Gujarat – 382355

Board: +9122 40969700 | Fax: +9122 22651278 | Email: research@dolatcapital.com | www.dolatresearch.com
