Sector Update

IT Services

Merger to create a behemoth

Summary

The merger of LTI & Mindtree will create a US$3.5 billion company. The combined entity will have 69% presence Americas, 17% in Europe and 14% in RoW. As per the merger, Mindtree shareholders will receive 73 shares of LTI for 100 shares of Mindtree. Post the merger promoters will hold 68.73% stake in the company. Upon obtaining all approvals and post 9-12 months, Mindtree will be merged in LTI. The entity will be named as LTIMindtree Limited. The merger has significant synergies in revenues and cost. We have assumed in near term (i.e FY24) 1% revenue and cost synergies. In addition, the entity will be able to bid for bigger deals ($ 100+ mn), cross sell and have end to end capabilities. However, considering macro-economic challenges and leadership & client related integration prompt us to maintain HOLD rating on LTI & Mindtree with revised target price of Rs 4984 and Rs 3638.

Key Highlights

- **Diversified presence, synergies and scale key positives:** The new combined entity will have scale which will help in winning higher market share, win large deals vs larger players and cross sell to fortune 500 clients. Further, the company will have big BFSI verticals (US$1 bn), CMT (US$875 mn) and Retail (US$910 mn) which will help target fortune 1000 clients. The company will also have higher cash (~US$1 bn), complementary verticals, wider access to talent pool and better geo presence. Hence, the merger bodes well in longer run.
- **Margins to improve over medium term:** The combined entity will be able to save S&M and G&A cost (duplicity of offices). These will enable the combined entity to drive margins in long run. Hence, we expect PAT to grow at CAGR of 22% over FY22-FY24E.

India IT Services Sector: Valuation and Rating

Companies	Rating	CMP (Rs)	TP (Rs)	Mkt Cap (Rs bn)	Upside (%)	PE (x) FY23E	PE (x) FY24E
IT Service s Companies							
LTI	**HOLD**	4,593	4,984	805	9	29.6	25.1
Mindtree	**HOLD**	3,375	3,638	556	8	27.6	23.9

Source: IDBI Capital, Company

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Other Key Highlights

- The key rationale driving this merger are – enhanced scale of operations and competitiveness, matched presence across various verticals, better pricing power, edge over peers, opportunities to cross sell, minimal client overlap, access to higher free cash, expansion across geographies and access to wider talent pool.
- Combined entity is expected to benefit from synergies in terms of both revenue and cost thus allowing the management to pursue expansion of EBITDA margins in the long term and achieving industry-leading growth.
- A steering committee will be formed which shall be entrusted with the responsibility of overseeing this transition.
- Both the Companies believe demand environment will be led by digital business which requires end to end capabilities, thus making this merger all the more important.
- Combined entity will leverage its end to end capabilities and enhanced service offerings to chase larger deals, increase its wallet share and cross sell.
- As LTI and Mindtree have successfully closed many deals working together, management is confident of the same continuing post the merger.
- Management of both the Companies ruled out the possibility of cultural differences causing internal disturbances in the near term.
- Post the merger, BFSI would be the biggest industry vertical (35%), followed by Mfg, CPG, Retail & Healthcare (26%) and Communications, Media & Technology (25%)
- In terms of geography, combined entity would have highest exposure in America (69%) followed by Europe (17%) and ROW (14%)
- End to end capabilities post the merger will provide employees with greater opportunities.

Valuation

Particulars – Combined Entity Valuation	
FY24 PAT combined entity	58,933
PE	25
Mcap in mn	14,73,322

For LTI Shareholders

Particulars	
Target Price	4,984
CMP	4,593
Upside/downside (%)	8.5

For Mindtree Shareholders

Particulars	
Target Price	3,638
CMP	3,375
Upside/downside (%)	7.8

Combined Entity – LTI Mindtree Merged Entity Financial Information (Rs mn)

Year-end: March	FY19	FY20	FY21	FY22	FY23E	FY24E
US$ revenues	2,351	2,613	2,747	3,513	4,216	4,950
Change (yoy, %)		*11.2*	*5.1*	*27.9*	*20.0*	*17.4*
Revenue	1,64,673	1,86,429	2,03,376	2,61,940	3,16,206	3,76,176
Change (yoy, %)		*13.2*	*9.1*	*28.8*	*21*	*19*
EBIT	26,365	25,431	37,897	46,571	56,436	70,909
EBIT Margin (%)	*16.0*	*13.6*	*18.6*	*17.8*	*17.8*	*18.9*
Adjusted Net Profit	22,698	21,508	30,466	39,497	47,104	58,933
PAT Margin (%)	*13.8*	*11.5*	*15.0*	*15.1*	*14.9*	*15.7*

Pre-merger Shareholding pattern

No. of shares in Mn.	Promoter	Public	Total
LTI	130	45	175.3
Mindtree	101	64	164.8

Post-merger Shareholding pattern

No. of shares in Mn.	Promoter	Public	Total
LTI	130	45	175.3
Mindtree	73	47	120.3
Total			295.6
Promoter holding %	68.7%	-	
Public Holding %	-	31.3%	

Exhibit 1: Both the entities have matched capabilities across industries

Complementary Industry Capabilities

FY22 Revenue Split by Vertical (%; $mn)

LTI – Let's Solve

	Revenue ($mn)	Revenue Share (%)
BFSI	$974	47%
Hi-Tech & Media	$255	12%
CPG, Retail & Pharma	$216	10%
Manufacturing	$339	16%
Energy & Utilities	$187	9%
Others	$131	6%
Total	$2,102	100%

Mindtree – Welcome to possible

	Revenue ($mn)	Revenue Share (%)
BFSI	$251	18%
Communications, Media & Technology	$614	43%
CPG, Retail, Mfg	$334	24%
Healthcare	$17	1%
Travel, Transportation & Hospitality	$195	14%
Total	$1,411	100%

Proforma (As-is)

	Revenue ($mn)	Revenue Share (%)
BFSI	$1,225	35%
Communications, Media & Technology	$869	25%
Mfg, CPG, Retail, Healthcare	$906	26%
Energy & Utilities	$187	5%
Travel, Transportation & Hospitality	$195	5%
Others	$131	4%
Total	$3,513	100%

Source: Company, IDBI Research

Exhibit 2: Combined entity to have balanced operations across geographies

Diversified and Balanced Operations Across Geographies

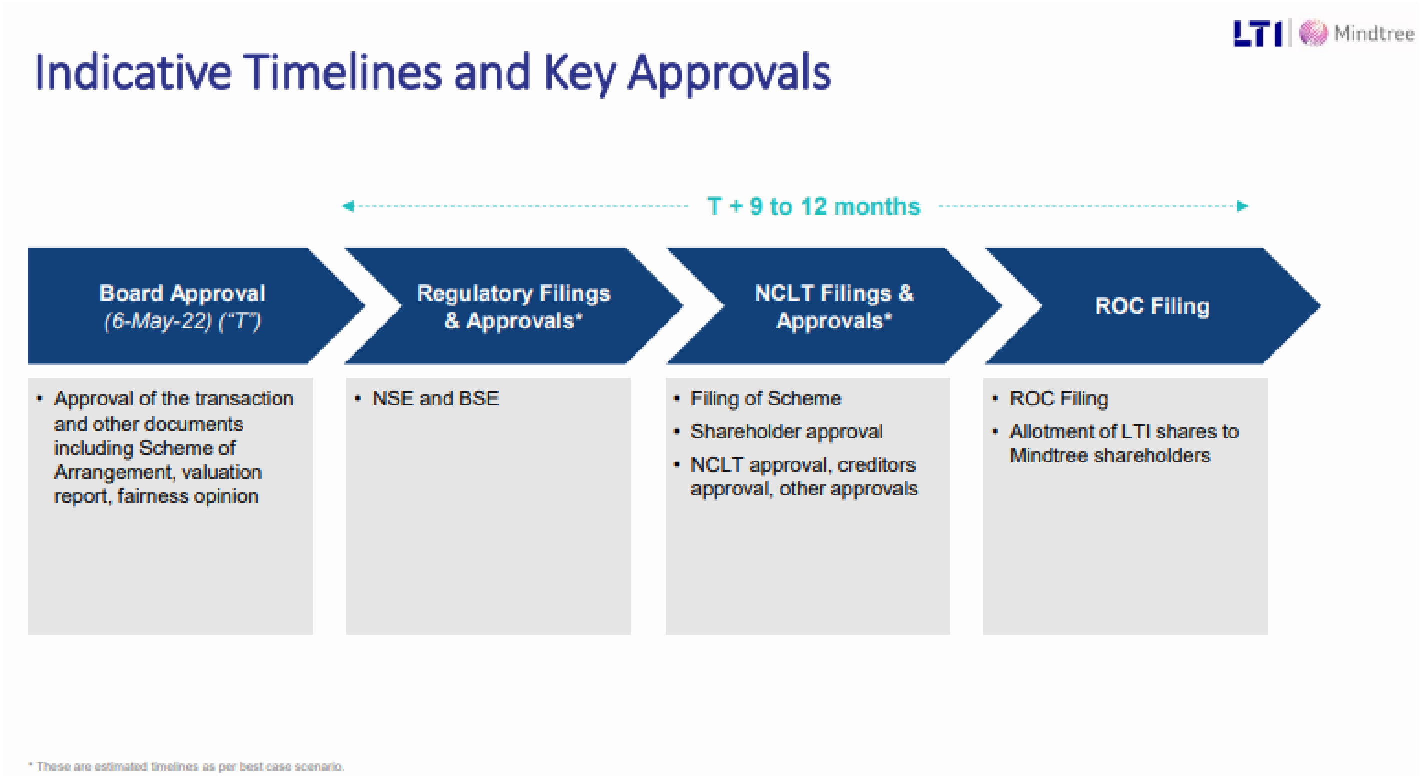
FY22 Revenue Split by Geography (%; $mn)

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

Note: RoW – Rest Of the World.

Source: Company, IDBI Research

Exhibit 3: Merger timeline and approvals



Source: Company, IDBI Research

Larsen & Tourbo Infotech – Financial Summary

Profit & Loss Account

(Rs mn)

Year-end: March	FY19	FY20	FY21	FY22	FY23E	FY24E
Net sales	**94,458**	**1,08,786**	**1,23,698**	**1,56,687**	**1,89,921**	**2,21,975**
Change (yoy, %)	*29*	*15*	*14*	*27*	*21*	*17*
Operating expenses	(75,625)	(88,494)	(96,447)	(1,26,103)	(1,53,497)	(1,79,518)
EBITDA	**18,833**	**20,292**	**27,251**	**30,584**	**36,423**	**42,457**
Change (yoy, %)	*59*	*8*	*34*	*12*	*19*	*17*
Margin (%)	*19.9*	*18.7*	*22.0*	*19.5*	*19.2*	*19.1*
Depreciation	(1,472)	(2,730)	(3,325)	(3,549)	(3,570)	(3,793)
EBIT	**17,361**	**17,562**	**23,926**	**27,035**	**32,853**	**38,664**
Interest paid	(106)	(826)	(788)	(728)	(707)	(679)
Other income	3,022	3,292	2,744	4,667	4,161	5,063
Pre-tax profit	**20,277**	**20,028**	**25,882**	**30,974**	**36,308**	**43,048**
Tax	(5,123)	(4,825)	(6,500)	(7,989)	(9,367)	(11,106)
Effective tax rate (%)	*25*	*24*	*25*	*26*	*26*	*26*
Minority Interest	3	(4)	(21)	(17)	(48)	(48)
Net profit	-	-	-	-	-	-
Adjusted net profit	**15,157**	**15,199**	**19,361**	**22,968**	**26,892**	**31,893**
Change (yoy, %)	*36*	*0*	*27*	*19*	*17*	*19*
EPS	87.1	87.4	110.6	131.2	153.7	182.2
DPS	28	28	40	55	60	70
Dividend Payout %	*39*	*39*	*36*	*42*	*39*	*38*

Balance Sheet

(Rs mn)

Year-end: March	FY19	FY20	FY21	FY22	FY23E	FY24E
Shareholders' funds	**48,938**	**54,040**	**73,034**	**88,146**	**1,04,538**	**1,24,182**
Share capital	174	174	175	175	175	175
Reserves & surplus	48,764	53,866	72,859	87,971	1,04,363	1,24,007
Total Debt	**-**	**330**	**414**	**519**	**-**	**-**
Other liabilities	(1,489)	(2,121)	(511)	(444)	(444)	(444)
Curr Liab & prov	**17,690**	**33,767**	**33,571**	**35,866**	**49,827**	**56,914**
Current liabilities	14,917	31,179	29,522	31,170	44,624	50,833
Provisions	2,773	2,588	4,049	4,696	5,203	6,082
Total liabilities	**16,201**	**31,976**	**33,474**	**35,941**	**49,383**	**56,470**
Total equity & liabilities	**65,147**	**86,027**	**1,06,545**	**1,24,144**	**1,54,027**	**1,80,805**
Net fixed assets	9,414	19,789	19,722	25,790	25,767	25,374
Investments	1	2	1,013	3,454	3,454	3,454
Other non-curr assets	3,558	2,386	4,040	6,244	4,163	4,865
Current assets	**52,174**	**63,850**	**81,770**	**88,656**	**1,20,643**	**1,47,112**
Inventories	-	-	-	-	-	-
Sundry Debtors	23,845	27,541	26,906	37,368	51,513	60,207
Cash and Bank	21,552	27,438	43,876	39,139	53,260	68,357
Loans and advances	544	689	757	2,830	1,301	1,520
Total assets	**65,147**	**86,027**	**1,06,545**	**1,24,144**	**1,54,027**	**1,80,805**

Cash Flow Statement **(Rs mn)**

Year-end: March	FY19	FY20	FY21	FY22	FY23E	FY24E
Pre-tax profit	20,277	20,028	25,882	30,974	36,308	43,048
Depreciation	1,458	2,730	3,325	3,549	3,570	3,793
Tax paid	(4,823)	(5,457)	(4,890)	(7,922)	(9,367)	(11,106)
Chg in working capital	1,498	12,236	371	(10,240)	1,346	(1,827)
Other operating activities	(3,280)	(5,018)	2,929	2,837	(3,809)	(2,998)
Cash flow from operations (a)	**15,130**	**24,519**	**27,617**	**19,198**	**28,047**	**30,910**
Capital expenditure	(3,998)	(13,105)	(3,258)	(11,977)	(1,187)	(3,400)
Chg in investments	-	(1)	(1,011)	(2,441)	-	-
Other investing activities	-	-	-	-	-	-
Cash flow from investing (b)	**(3,998)**	**(13,106)**	**(4,269)**	**(14,418)**	**(1,187)**	**(3,400)**
Equity raised/(repaid)	2	-	1	-	-	-
Debt raised/(repaid)	-	330	84	105	(519)	-
Chg in monorities	(2)	(1)	5	3	-	-
Other financing activities	-	-	-	-	-	-
Cash flow from financing (c)	**(5,856)**	**(5,527)**	**(6,910)**	**(9,517)**	**(11,019)**	**(12,250)**
Net chg in cash (a+b+c)	**5,276**	**5,886**	**16,438**	**(4,737)**	**15,841**	**15,260**

Financial Ratios

Year-end: March	FY19	FY20	FY21	FY22	FY23E	FY24E
Book Value (Rs)	281	311	417	504	597	710
Adj EPS (Rs)	*87*	*87*	*111*	*131*	*154*	*182*
Adj EPS growth (%)	*35*	*0*	*27*	*19*	*17*	*19*
EBITDA margin (%)	*19.9*	*18.7*	*22.0*	*19.5*	*19.2*	*19.1*
Pre-tax margin (%)	*21*	*18*	*21*	*20*	*19*	*19*
Net Debt/Equity (x)	*0*	*-1*	*-1*	*0*	*-1*	*-1*
ROCE (%)	*41*	*35*	*38*	*34*	*34*	*34*
ROE (%)	*34.6*	*29.5*	*30.5*	*28.5*	*27.9*	*27.9*
DuPont Analysis						
Asset turnover (x)	1.6	1.4	1.3	1.3	1.4	1.3
Leverage factor (x)	1.3	1.5	1.5	1.4	1.5	1.5
Net margin (%)	*16.0*	*14.0*	*15.7*	*14.7*	*14.2*	*14.4*
Working Capital & Liquidity ratio						
Inventory days	0	0	0	0	0	0
Receivable days	92	92	79	87	87	87
Payable days	23	29	31	23	23	23

Mindtree - Financial Summary

Profit & Loss Account

(Rs mn)

Year-end: March	FY19	FY20	FY21	FY22	FY23E	FY24E
Net sales	**70,215**	**77,643**	**79,678**	**1,05,253**	**1,28,872**	**1,49,047**
Change (yoy, %)	*29*	*11*	*3*	*32*	*22*	*16*
Operating expenses	(59,570)	(67,020)	(63,111)	(83,297)	(1,02,325)	(1,18,344)
EBITDA	**10,645**	**10,623**	**16,567**	**21,956**	**26,548**	**30,704**
Change (yoy, %)	*44*	*(0)*	*56*	*33*	*21*	*16*
Margin (%)	*15.2*	*13.7*	*20.8*	*20.9*	*20.6*	*20.6*
Depreciation	(1,641)	(2,754)	(2,596)	(2,420)	(2,964)	(3,428)
EBIT	**9,004**	**7,869**	**13,971**	**19,536**	**23,584**	**27,276**
Interest paid	(29)	(529)	(504)	(502)	(502)	(502)
Other income	893	948	1,517	3,073	3,875	4,365
Pre-tax profit	**9,868**	**8,288**	**14,984**	**22,107**	**26,957**	**31,138**
Tax	(2,327)	(1,979)	(3,879)	(5,578)	(6,793)	(7,847)
Effective tax rate (%)	*23.6*	*23.9*	*25.9*	*25.2*	*25.2*	*25.2*
Minority Interest	-	-	-	-	-	-
Net profit	**7,541**	**6,309**	**11,105**	**16,529**	**20,164**	**23,292**
Exceptional items	-	-	-	-	-	-
Adjusted net profit	**7,541**	**6,309**	**11,105**	**16,529**	**20,164**	**23,292**
Change (yoy, %)	*32.3*	*(16.3)*	*76.0*	*48.8*	*22.0*	*15.5*
EPS	45.9	38.3	67.4	100.3	122.4	141.4
Dividend per sh	13.3	36.1	17.5	27.5	45.4	52.4
Dividend Payout %	*29*	*94*	*26*	*27*	*37*	*37*

Balance Sheet (Rs mn)

Year-end: March	FY19	FY20	FY21	FY22	FY23E	FY24E
Shareholders' funds	**33,065**	**31,568**	**43,190**	**54,739**	**67,422**	**82,072**
Share capital	1,642	1,646	1,647	1,648	1,648	1,648
Reserves & surplus	31,423	29,922	41,543	53,091	65,774	80,424
Total Debt	**179**	**6,762**	**4,498**	**4,826**	**4,826**	**4,826**
Other liabilities	-	-	-	-	-	-
Curr Liab & prov	**8,550**	**13,236**	**15,926**	**22,008**	**26,089**	**27,064**
Current liabilities	7,151	11,512	13,699	19,566	23,099	23,606
Provisions	1,399	1,724	2,227	2,442	2,990	3,458
Total liabilities	**8,729**	**19,998**	**20,424**	**26,834**	**30,915**	**31,890**
Total equity & liabilities	**41,794**	**51,566**	**63,614**	**81,573**	**98,337**	**1,13,963**
Net fixed assets	9,966	14,228	12,982	13,967	14,678	15,188
Investments	-	-	-	-	-	-
Other non-curr assets	1,588	2,639	1,512	3,116	3,116	3,116
Current assets	**30,240**	**34,699**	**49,120**	**64,490**	**80,543**	**95,659**
Inventories	-	-	-	-	-	-
Sundry Debtors	13,356	14,389	12,742	17,313	21,349	24,608
Cash and Bank	2,562	5,870	7,597	10,513	20,677	30,834
Loans and advances	7,638	7,500	19,824	24,855	25,155	25,455
Total assets	**41,794**	**51,566**	**63,614**	**81,573**	**98,337**	**1,13,963**

Cash Flow Statement

(Rs mn)

Year-end: March	FY19	FY20	FY21	FY22	FY23E	FY24E
Pre-tax profit	9,868	8,288	14,984	22,107	26,957	31,138
Depreciation	877	1,594	1,671	1,189	2,964	3,428
Tax paid	(1,963)	(2,795)	(1,397)	(5,495)	(6,793)	(7,847)
Chg in working capital	(4,606)	3,160	(8,985)	(3,252)	(254)	(2,584)
Other operating activities	155	142	(851)	(6,433)	(3,078)	(3,105)
Cash flow from operations (a)	**4,331**	**10,389**	**5,422**	**8,116**	**19,795**	**21,030**
Capital expenditure	(1,183)	(5,856)	(425)	(2,174)	(3,675)	(3,938)
Chg in investments	-	-	-	-	-	-
Other investing activities	22,885	5,735	955	3,177	4,029	4,209
Cash flow from investing (b)	**21,702**	**(121)**	**530**	**1,003**	**353**	**272**
Equity raised/(repaid)	3	4	1	1	-	-
Debt raised/(repaid)	85	6,583	(2,264)	328	-	-
Dividend (incl. tax)	(2,180)	(5,940)	(2,880)	(4,528)	(7,481)	(8,641)
Chg in monorities	-	-	-	-	-	-
Other financing activities	(4,862)	(7,607)	918	(2,004)	(2,504)	(2,504)
Cash flow from financing (c)	**(6,954)**	**(6,960)**	**(4,225)**	**(6,203)**	**(9,985)**	**(11,145)**
Net chg in cash (a+b+c)	**19,079**	**3,308**	**1,727**	**2,916**	**10,164**	**10,157**

Financial Ratios

Year-end: March	FY19	FY20	FY21	FY22	FY23E	FY24E
Book Value (Rs)	201	192	262	332	409	498
Adj EPS (Rs)	*46*	*38*	*67*	*100*	*122*	*141*
Adj EPS growth (%)	*35*	*-17*	*76*	*49*	*22*	*16*
EBITDA margin (%)	*15.2*	*13.7*	*20.8*	*20.9*	*20.6*	*20.6*
Pre-tax margin (%)	*14*	*11*	*19*	*21*	*21*	*21*
Net Debt/Equity (x)	*0*	*0*	*0*	*0*	*0*	*0*
ROCE (%)	*30*	*22*	*32*	*36*	*36*	*34*
ROE (%)	*24.9*	*19.5*	*29.7*	*33.8*	*33.0*	*31.2*
DuPont Analysis						
Asset turnover (x)	1.8	1.7	1.4	1.4	1.4	1.4
Leverage factor (x)	1.3	1.4	1.5	1.5	1.5	1.4
Net margin (%)	*10.7*	*8.1*	*13.9*	*15.7*	*15.6*	*15.6*
Working Capital & Liquidity ratio						
Inventory days	0	0	0	0	0	0
Receivable days	69	68	58	60	60	60
Payable days	13	14	15	23	23	23

Notes

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Key to Ratings Stocks:

BUY: 15%+; **HOLD:** -5% to 15%; **SELL:** -5% and below.

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