

L&T InfoTech

IPO Note – Decent upsides

L&T InfoTech (LTI) is one of India's global IT services and solutions companies. In 2015, NASSCOM ranked the company as the sixth largest Indian IT services company in terms of export revenues. The company is a subsidiary of engineering and construction giant Larsen and Toubro (L&T). L&T holds close to 95% in LTI and is launching an IPO to offload 10.3% of its stake. Its clients comprise some of the world's largest and well-known organisations, including 49 of the Fortune Global 500 companies.

One of the leading mid-tier IT companies: LTI has been one of the leading players in the IT industry with it having posted a 20.1% CAGR in sales during FY2011-2015. A small part of the same was driven by acquisitions that the company made during the period. Among the acquisitions were Citigroup's IT platform (acquired in Jan 2011; had revenues of ~₹204.8cr) and Otis Elevator Co's IT arm (ISRC) (acquired in Oct 2014; had revenues of ~₹56.5cr). In USD terms, LTI outperformed the industry by posting a 12.1% CAGR in sales as against an 11.2% sales CAGR posted by the Indian IT industry during FY2011-2015.

Good capital allocation: LTI generates a healthy RoE of ~40% compared to the peer group's average of ~30%. This is mainly because the company holds a relatively low amount of cash on its books vis-a-vis its peers by following an aggressive dividend policy. LTI has had a dividend pay-out ratio as high as ~75% over the last five years, while the commensurate figure for its peers stood at 30-50% over the same period. On capital invested basis also, the company earns a ROIC of around 46%, again outperforming its mid-cap peers, which earn ~35-40%.

Outlook and Valuation: LTI has reported a strong CAGR of 20.1% and 23.1% on the revenue and net profit fronts respectively over FY2011-2015. At ₹710, which is the upper end of the offer price band, the company is available at ~13x its FY2016E earnings, which is at a slight discount to its mid-cap peers trading at an average PE of ~15x FY2016E earnings. Plus, assuming that the company maintains its historical average rate of dividend payouts, it would translate into a yield of 4-5% for the investor. Apart from the favorable prospects of the company, we also foresee decent gains on listing. Thus, **we recommend a SUBSCRIBE to the issue.**

Key Financials

Y/E March (₹ cr)	FY2012	FY2013	FY2014	FY2015
Net Sales	3,182	3,851	4,920	4,978
% chg	33.1	21.0	27.8	1.2
Net Profit	433	574	689	761
% chg	30.9	32.5	20.0	10.5
EPS (₹)	26.8	35.5	42.6	47.1
EBITDA Margin (%)	21.7	22.6	23.3	20.2
P/E (x)	26.5	20.0	16.7	15.1
RoE (%)	38.7	47.0	46.7	41.9
RoCE (%)	42.8	49.0	57.6	39.8
P/BV (x)	10.4	8.6	7.1	5.7
EV/Sales (x)	3.6	3.0	2.3	2.3
EV/EBITDA (x)	16.6	13.1	9.9	11.3

Source: Company, Angel Research; Note: The valuations are on the higher price band

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Issue Open: July 11, 2016
 Issue Close: July 13, 2016

Issue Details

Face Value: ₹1

Present Eq. Paid up Capital: ₹16.9cr

Fresh Issue**: NA

Offer for sale: 1.75cr Shares

Post Eq. Paid up Capital: ₹16.9cr

Market Lot: 20 Shares

Issue (amount): ₹1,234-1,243cr

Price Band: ₹705-710 (Discount of ₹10 on issue price (per equity share) to all eligible retail applicants)

Post-issue implied mkt. cap ₹12,056cr*-12,141cr**

Note:*at Lower price band and **Upper price band

Book Building

QIBs	50%
Non-Institutional	15%
Retail	35%

Post Issue Shareholding Pattern(%)

Promoters Group	84.6
MF/Banks/Indian FIs/FIIs/Public & Others	15.4

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Company background

Incorporated in 1996, L&T InfoTech (LTI) is a Mumbai-based ~100% owned subsidiary of the L&T group that provides information technology services to clients primarily based in US and Europe. Post the IPO, the L&T group's stake in the company will come down to 84.5%. As of June 30, 2015, the company had a network of 22 delivery centers and 42 sales offices globally. It employed ~19,500 people as of March 2015.

LTI is one of India's global IT services and solutions companies. In 2015, NASSCOM ranked the company as the sixth largest Indian IT services company in terms of export revenues. Its clients comprise some of the world's largest and well-known organizations, including 43 of the Fortune Global 500 companies.

The company's growth has been marked by significant expansion of business verticals and geographies. For FY2015, the percentage of its revenue from continuing operations from North America, Europe, Asia Pacific and the rest of the world amounted to 68.6%, 17.9%, 2.4% and 6.9%, respectively.

In terms of services, LTI derives a large proportion of its revenues from providing Application Development and Maintenance (43.4% of FY2015 revenues) and Enterprise Solutions (24.8% of FY2015 revenues). The fast growing digital business accounts for 9.5% of its FY2015 revenues. The company has a modest presence in Infrastructure Management Services (8.7% of FY2015 revenues) and aims to grow further in this segment through the inorganic route.

In terms of verticals, the banking, financial services and insurance (BFSI) is LTI's largest industry vertical accounting for 47% of its FY2015 revenue. The company also has the highest exposure among peers to the energy segment which constituted 16.2% of its FY2015 revenues.

Issue details

The objects of the Offer are to achieve the benefits of listing the equity shares on the stock exchanges and to carry out the sale of up to ~17,500,000 equity shares by the existing shareholder. LTI will not receive any proceeds from the offer and the company will not receive any proceeds from the issue.

Exhibit 1: Shareholding pattern

Particulars	Pre-Issue		Post-Issue	
	No. of shares	(%)	No. of shares	(%)
Promoter group	16,120,812	94.94	14,371,872	84.64
Others	8,59,188	5.06	26,08,128	15.36
Total	16,980,000	100.0	16,980,000	100.0

Source: Company, Angel Research

Industry

According to a recent report released by NASSCOM, Indian IT's (US\$132bn) share in the country's total service exports is estimated at over 45% and the industry's contribution relative to India's GDP is over 9.3%. Overall, the industry is estimated to employ nearly 3.7mn people going forward, implying an addition of ~200,000 people from the current numbers. The industry's share in the global sourcing arena was ~56% in 2015. In 2015, a turbulent economic environment, volatility in currency, and technological shifts impacted global IT spend, which grew by a meager 0.4% to US\$1.2trn. Unlike global spending, global sourcing continued its growth journey, posting an 8.5% growth in 2015 to an estimated US\$162-166bn. India's IT-BPM sector's total revenue is projected to reach US\$350bn by 2025, ie a CAGR of 10.5%.

Key investment rational

One of the leading mid-tier IT companies

LTI has been one of the leading players in the IT industry, with it having posted a CAGR of 20.1% in sales during FY2011-2015. A small part of the same was driven by acquisitions that the company made during the period. Among the acquisitions were Citigroup's IT platform (acquired in Jan 2011; had revenues of ~₹204.8cr) and Otis Elevator Co's IT arm (ISRC) (acquired in Oct 2014; had revenues of ~₹56.5cr). In USD terms, LTI outperformed the industry by posting a 12.1% CAGR in sales as against an 11.2% sales CAGR posted by the Indian IT industry during FY2011-2015.

A detailed analysis of the company's client concentration reveals that its growth is getting broad-based but at a slower pace. For FY2015 the top client of the company accounted for 14.1% of sales and posted a CAGR of 12.2% during FY2013-16, while the top-5 of its clients accounted for 37.2% of sales and posted a CAGR of 13.2%. Further, its top-10 clients accounted for 50.5% of sales in FY2015 and posted a CAGR of 17.4% during FY2013-16. Excluding the top-10 clients the company has posted a CAGR of 10.9% during the same period. Thus, the top-10 clients contribute substantially to the company's growth. This is also evident from the fact that new business has been around only ~2% of its sales.

In terms of industry mix the BFSI segment contributed 38% of its sales in FY2015 which is significant but in line with the trend followed by its peers; the BSFI industry is expected to contribute ~41% of the overall IT industry's revenues in FY2016. LTI also has the highest exposure among peers to the energy segment which accounted for 16.2% of its FY2015 revenues, where Chevron is its second biggest client contributing 7% of its revenues. This is in contrast to its peers where the energy segment contributes by a far lesser proportion to the overall revenues. Wipro is far next in terms of highest exposure to the energy segment with only ~6-7% of its revenues coming from the segment in FY2015. Whilst exposure to energy will weigh on LTI's growth in the near term, the company could likely boost revenue growth in the long term and emerge as a stronger player with a higher market share.

On the operating front, with margins (EBDITA) at ~21%, the company is in line with its mid-cap peers in terms of productivity per employee.

Better capital allocation: LTI generates a healthy RoE of ~40% compared to the peer group's average of ~30%. This is mainly because the company holds a relatively low amount of cash on its books vis-a-vis its peers by following an aggressive dividend policy. LTI has had a dividend pay-out ratio as high as ~75% over the last five years, while the commensurate figure for its peers stood at 30-50% over the same period. The total assets turnover ratio is helped by low cash on the balance sheet as a result of which the company's total assets figure is not high as is the case of many of its peers. This is prudent given that the cash on book if unutilized could dilute the ROE. On capital invested basis also the company earns a ROIC of around 46%, which is better than ~35-40% earned by its mid-cap peers, and is also better than that of some of its large cap peers like Wipro and Tech Mahindra.

Valuation

LTI, the sixth largest IT company in India, has a solid parentage of L&T, and has an experienced Management and a strong business model. LTI has reported a strong CAGR of 20.1% and 23.1% on the revenue and net profit fronts respectively over FY2011-2015. At ₹710, which is the upper end of the offer price band, the company is available at ~13x its FY2016E earnings, which is at a slight discount to its mid-cap peers trading at an average PE of ~15x FY2016E earnings. Plus, assuming that the company maintains its historical average rate of dividend payouts, it would translate into a yield of 4-5% for the investor. We believe that the valuations are bit attractive in spite of the concerns related to the company's business risk like client concentration and employee productivity. Also, retail investors are being offered a discount of ₹10/share on the offer price and we foresee a fair likelihood of decent gains on listing. **Thus, we recommend a SUBSCRIBE to the issue.**

Risks to upside

- Like other IT companies, LTI has high dependence on USA and is hence exposed to the economic risks of the geography.
- Its largest client (Citigroup is LTI's largest customer since 2001) accounted for ~14.1% of its revenues in FY2015, which is higher than its comparable large cap peers. Another client, Chevron, contributed ~7.0% of its FY2015 sales. In BSFI, Barclays contributed 3.4% of sales in FY2015. Thus the company is exposed to client concentration risk.
- Also, its top 5 clients contributed ~ 37.2% of its sales in FY2015, which is high in comparison to its large cap peers. This is also evident from the fact that the company gets almost 97-98% of its sales from the repeat business (unlike its peers which have a higher new business share of ~3-5% V/s 2.5% for LTI).
- Given the export nature of the company's business, it is exposed to currency risk.
- Inability to address senior Management attrition could affect performance of the business. The attrition rate of the company has been around 19% (LTM March 2015).
- Lack of diversification in terms of business verticals (BSFI and Energy segments accounted for 63.2% of its FY2015 revenues) can impact the company's performance as it did in FY2015. The possibility of LTI losing out on business from large BFSI and energy clients due to vendor consolidation cannot be ruled out.
- LTI has historically availed to direct and indirect tax benefits given by the government for the export of IT services from SEZs. As a result, a substantial portion of its profits are exempt from income tax, thus leading to a lower overall effective tax rate. If there is a change in tax regulations, then LTI's tax liabilities may increase and thus adversely affect its financial position.
- LTI runs an active ESOP programme pertaining to which there are vested and unexercised stock options owned by its current and former employees. As per the company's DRHP, a total of 1.12cr shares will have to be issued if all the options that were granted were to be exercised. This represents 6.6% dilution; in case all ESOP are exercised at one go.

Consolidated Profit & Loss Statement

Y/E March (₹ cr)	FY2011	FY2012	FY2013	FY2014	FY2015
Gross sales	2,391	3,182	3,851	4,920	4,978
Less: Excise duty	-	-	-	-	-
Net sales	2,391	3,182	3,851	4,920	4,978
Other operating income	71.5	9.6	22.1	(83.3)	91.5
Total operating income	2,463	3,192	3,874	4,837	5,070
% chg	44.2	29.6	21.4	24.9	4.8
Total expenditure	1,997	2,492	2,981	3,773	3,974
Employee Expenses	1,449	1,864	2,249	2,758	2,924
Operating Expenses	222	258	292	489	489
Sales, Admin and other Exp.	327	371	440	526	561
EBITDA	394	690	870	1,147	1,004
% chg		75.2	26.2	31.8	(12.4)
(% of Net Sales)	16.5	21.7	22.6	23.3	20.2
Depreciation & amortisation	81	105	123	130	158
Interest & other charges	10	34	21	31	10
Other income	-	-	-	-	-
(% of PBT)	-	-	-	-	-
Share in profit of Associates	-	-	-	-	-
Recurring PBT	375	560	749	903	928
% chg					
Extraordinary expense/(Inc.)	-	-	-	(300)	(8)
PBT (reported)	375	560	749	1,204	936
Tax	58.7	140.9	187.0	207.2	166.8
(% of PBT)	32.0	30.6	32.7	32.0	17.8
PAT (reported)	316	419	562	997	769
Add: Share of earnings of asso.	-	-	-	-	-
Less: Minority interest (MI)	-	-	0	0	0
Prior period items	15	14	12	(68)	1
PAT after MI (reported)	331	433	574	929	769
ADJ. PAT	331	433	574	689	761
% chg	53.5	30.9	32.5	20.0	10.5
(% of Net Sales)	13.8	13.6	14.9	18.9	15.5
Basic EPS (₹)	20.5	26.8	35.5	42.6	47.1
Fully Diluted EPS (₹)	20.5	26.8	35.5	42.6	47.1
% chg	53.5	30.9	32.5	20.0	10.5

Consolidated Balance Sheet

Y/E March (₹ cr)	FY2011	FY2012	FY2013	FY2014	FY2015
SOURCES OF FUNDS					
Equity share capital	16	16	16	16	16
Preference Capital	-	-	-	-	-
Reserves & surplus	1,120	1,089	1,323	1,594	2,010
Shareholders funds	1,136	1,105	1,339	1,610	2,026
Minority Interest	-	-	0.1	0.2	0.4
Total loans	113	253	171	113	56
Deferred tax liability	(31)	10	15	41	45
Total liabilities	1,218	1,368	1,525	1,765	2,127
APPLICATION OF FUNDS					
Net block	523	632	699	649	683
Capital work-in-progress	8	10	48	9	5
Goodwill	68	98	94	47	20
Long Term Loans and Advances	179	137	193	253	244
Investments	6.0	2.0	-	-	-
Current assets	1,153	1,247	1,325	1,741	2,104
Cash	146	132	119	159	201
Loans & advances	259	284	283	363	555
Other	747	831	923	1,219	1,348
Current liabilities	720	758	835	936	929
Net current assets	433	489	490	805	1,175
Mis. Exp. not written off	-	-	-	-	-
Total Assets	1,218	1,368	1,525	1,765	2,127

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