

May 9, 2022

LTI, Mindtree merger to create US\$3.5 bn revenue entity

LTI and Mindtree have announced a merger with an all-stock amalgamation of Mindtree with LTI. The MergedCo will become the fifth largest IT services company in India with a combined MCap of US\$18 bn, surpassing TechM. The combined entity will have revenues of US\$3.5 billion (bn) as on FY22. With a strong presence across geographies and minimal overlapping in terms of vertical mix, the combined entity will have a strong client base of 750+ clients.

Key highlights of merger

- Shareholders of Mindtree will receive 73 shares of LTI in exchange for 100 shares in Mindtree. We note that that this implies that Mindtree has been valued at -0.6% lower than Friday's closing (₹ 3374), assuming LTI's share price (₹ 4593) as base in the swap
- Post the merger, LTI promoters will have a 43.9% stake while Mindtree promoters will have a 24.8% stake in the combined entity, taking total promoter shareholding to 68.7%
- The LTI CEO & MD has tendered his resignation due to personal reasons while Debashis Chatterjee who is currently CEO & MD of Mindtree has been appointed as CEO & MD of the combined entity. For now, the companies will function independently while a steering committee will be constituted to oversee the transition till the merger process is complete. Closing is expected to be achieved in nine to 12 months subject to completion of shareholders and regulatory approvals
- The combined entity will have revenues of US\$3.5 bn as on FY22, with EBIT and PAT margins of 17.8% and 15.1%, respectively. It will have access to a cash pool of US\$991 mn while the employee strength would be 81,719

Benefits arising out of merger

We believe that since the both companies have minimal overlap (25% of revenue share), the merger would widen the vertical presence. The merged entity will have a strong presence across BFSI/manufacturing, CPG, retail, healthcare/communication, media, technology), which now forms 35%, 26%, 25%, respectively, of the mix. The company will have access to a large pool of 82K+ employees with end to end capabilities. It will have access to a cash pool of over US\$991 million (mn), which could be used for potential M&A opportunities in the future. It would also enhance the geographical presence across US/Europe and RoW (33 countries for LTI and 24 countries for Mindtree. On account of minimal overlap there could be lower risk of layoffs in our view. Since both companies are part of the L&T group, there could be minimal cultural shock among employees.

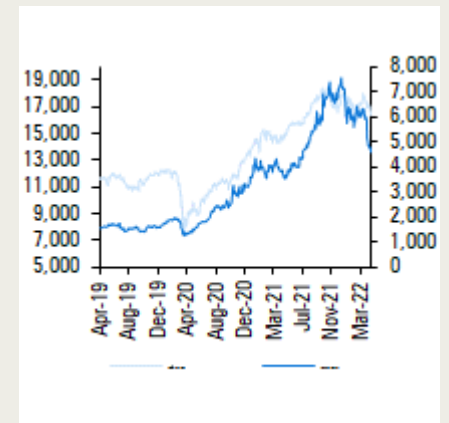
Near term disruption likely

However, we do see some near term disruptions. We believe that since the steering committee has been formed to oversee the merger process and merger would take nine to 12 months to complete, we do not rule out a few large potential deals going to competition till the integration process is completed. We also believe that due to unexpected exit of LTI CEO, we cannot rule out vulnerability at the second layer of management at LTI and possible poaching by competition in this strong demand environment. We believe retention of talent is a key for merged entity to start on a positive note. We are not building in cost synergy benefits as of now. We maintain **HOLD** on both LTI and Mindtree and assign a target price of ₹ 4490/share for LTI (valued at 30x FY24E EPS) and ₹ 3700 per share for Mindtree (valued at 29x FY24E EPS) while we value the combined entity at 30x on the MergedCo FY24E earnings.

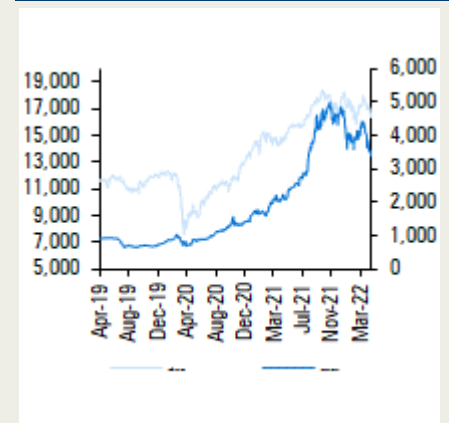
Rating & Target price (₹)

Company	Rating	CMP	TP	% Upside
LTI	HOLD	4,593	4,990	9
Mindtree	HOLD	3,374	3,700	10

LTI – Share Price



Mindtree – Share Price



Key Risks

1. Second level of leadership may be vulnerable to churn in LTI after CEO exit
2. Possible loss of few deals to competition till the merger is in process

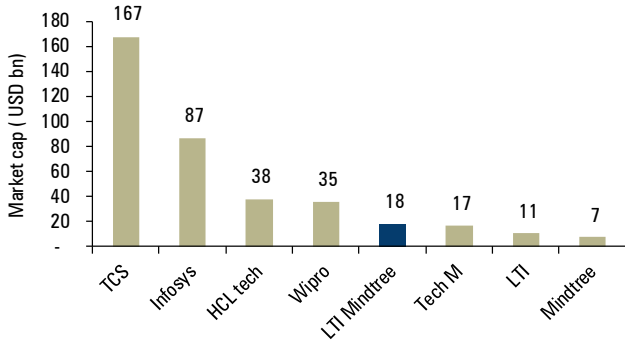
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Key highlights of call

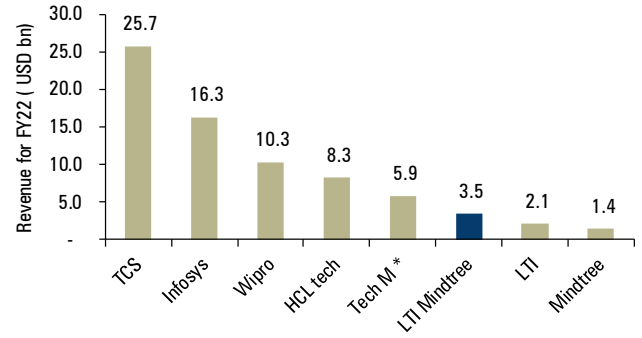
- **Rationale for merger:** The management attributed the following rationale for the merger
 - **Scale:** The company indicated that merger would enhance scale of the merged entity, which would help it to participate in the larger deals (>US\$100 mn and able to compete with its larger peers) especially in the three large verticals of BFSI/manufacturing, CPG, retail, healthcare / communication, media, technology)
 - **Diversified service offering:** The merged entity is expected to have an edge over some of its peers due to enhanced capabilities and strong relationships across partner ecosystem i.e. hyper scalars (cloud infra providers) as well product partners (e.g. Temenos)
 - **Cross selling & up scaling:** The company indicated that both companies have very few common clients out of the client base of 750+ clients, which provides them an opportunity for cross-selling and up scaling
 - **Access to higher cash pool:** The combined entity would have access to large pool of cash of over US\$990 mn, which could be utilised for any future M&A opportunity
 - **Diverse employee base:** The combined entity to have a diverse pool of more than 82,000 employees. Since for only 25% of the business, there is overlapping, the combined entity will have employees with enhanced capabilities
- **Other highlights**
 - **Attrition:** The company does not expect attrition to shoot up due to the merger process in the near term due to minimal overlapping. The company believes that due to current strong demand environment, it would give more opportunities for employees
 - **Cost:** The company expects cost synergies to play out in the medium term as the current priority is for the smooth integration of the two companies with diverse culture and diverse employee base
 - **Client feedback:** The company indicated that for the past couple of years, LTI and Mindtree were jointly working on selected opportunities. As per the management, one of the trigger points of the merger was suggestions by a few of its clients to jointly work on those deals to provide end to end capabilities
 - **Large deals:** The company indicated that Fortune 1000 companies would like to work with large scale companies and with this merger competition for those clients is expected to intensify
 - **Pricing:** The merged entity would be in a better position to command price hike vs. standalone companies
 - **Leadership disruption in LTI:** The company is confident that they do not see attrition at the top leaders in LTI on account of LTI CEO departure considering strong leadership pool accumulated over the years at LTI

Exhibit 1: US\$18 bn market cap combined entity



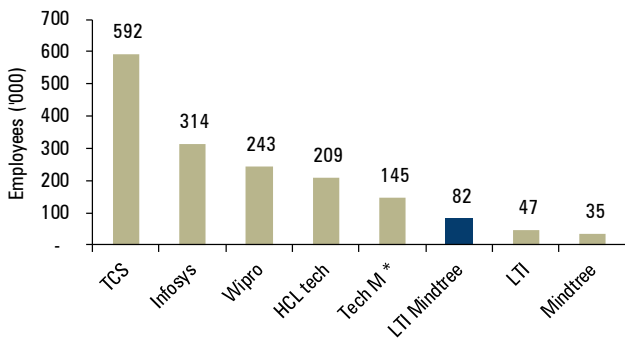
Source: Company, ICICI Direct Research

Exhibit 2: With revenues of US\$3.5 bn as of FY22



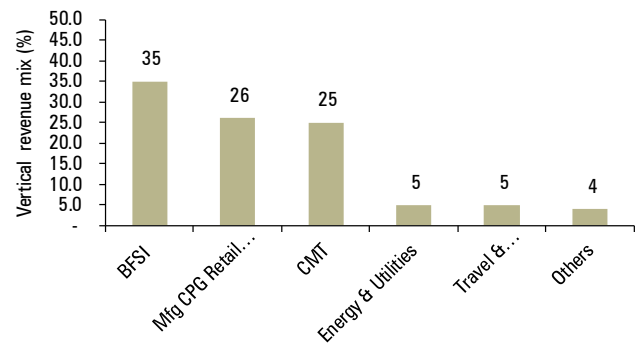
Source: Company, ICICI Direct Research, * Tech M annualised numbers for 9MFY22

Exhibit 3: With employee strength of over 82,000



Source: Company, ICICI Direct Research, * Tech M as on 3QFY22

Exhibit 4: With strong presence across verticals



Source: Company, ICICI Direct Research

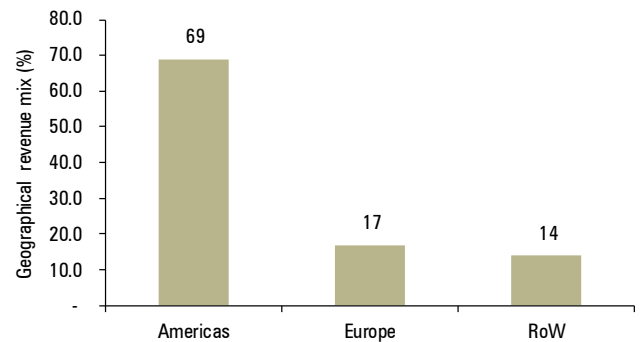
Exhibit 5: With minimal overlap (~25-26% of revenue share)

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

	Revenue (\$mn)	Revenue Share (%)		Revenue (\$mn)	Revenue Share (%)
LTI Let's Solve	\$974	47%	Mindtree Welcome to possible	\$251	18%
Hi-Tech & Media	\$255	12%	Communications, Media & Technology	\$614	43%
CPG, Retail & Pharma	\$216	10%	CPG, Retail, Mfg	\$334	24%
Manufacturing	\$339	16%	Healthcare	\$17	1%

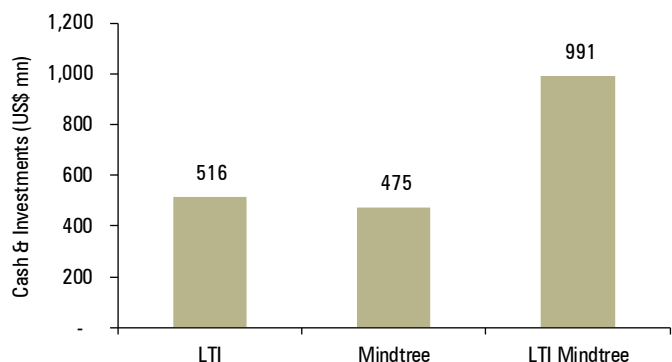
Source: Company, ICICI Direct Research

Exhibit 6: With strong presence across US/Europe



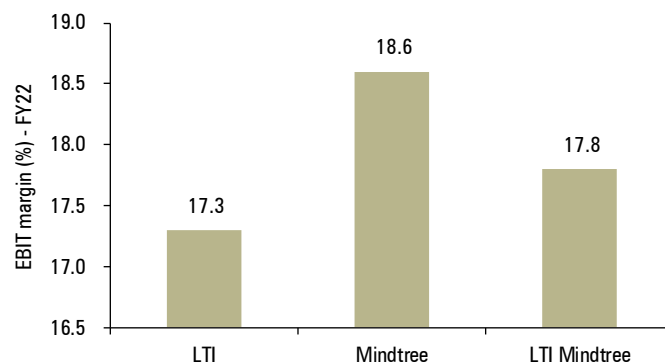
Source: Company, ICICI Direct Research

Exhibit 7: With access to US\$991 mn cash & investments



Source: ICICI Direct Research, Company

Exhibit 9: With decent EBIT margins as on FY22



Source: ICICI Direct Research, Company

Exhibit 8: LTI Mindtree P&L as on FY22

₹ crore	LTI	Mindtree	LTI Mindtree
Revenue	FY22	FY22	FY22
Dollar revenue (in US\$ mn) - FY22	2,103	1,411	3,513
Rupee revenue (₹ crore) - FY22	15,669	10,525	26,194
Costs			
Employee benefit expenses	9,701	6,328	16,029
Employee expenses as % of sales	61.9	60.1	61.2
Other expenses	2,910	2,002	4,912
EBITDA	3,058	2,196	5,254
EBITDA margin (%)	19.5	20.9	20.1
Depreciation	355	242	597
EBIT	2,704	1,954	4,657
EBIT margin (%)	17.3	18.6	17.8
Other income	467	307	774
Finance charges	73	50	123
PBT	3,097	2,211	5,308
PBT margin (%)	19.8	21.0	20.3
Tax charges	799	558	1,357
PAT	2,299	1,653	3,951
PAT margin (%)	14.7	15.7	15.1
EPS (Basic)	131.2	100.3	231.5

Source: Company, ICICI Direct Research

Exhibit 10: Combined entity valuation

	LTI		Mindtree		LTI Mindtree without synergy	
	FY23E	FY24E	FY23E	FY24E	FY23E	FY24E
Revenue	18,807	21,121	12,925	15,007	31,732	36,128
EBIT	3,049	3,630	2,262	2,626	5,311	6,256
EBIT margin (%)	16.2	17.2	17.5	17.5	16.7	17.3
PAT	2,466	2,916	1,812	2,111	4,278	5,026
EPS	140.3	165.9	109.8	127.9	250.1	293.8
PAT Margin (%)	13.1	13.8	14.0	14.1	13.5	13.9
Combined entity Mcap (₹ crore)					30x P/E	150,789
Current Mcap (₹ crore)						136,145
% Upside						11

Source: Company, ICICI Direct Research

Exhibit 11: Shareholding post-merger

Post merger	No of shares	%
LTI	129,784,034	43.9
Mindtree	73,385,246	24.8
Promoter	203,169,280	68.7
Public -LTI	45,486,122	15.4
Public -Mindtree	46,943,408	15.9
Public	92,429,530	31.3
Total	295,598,809	100.0

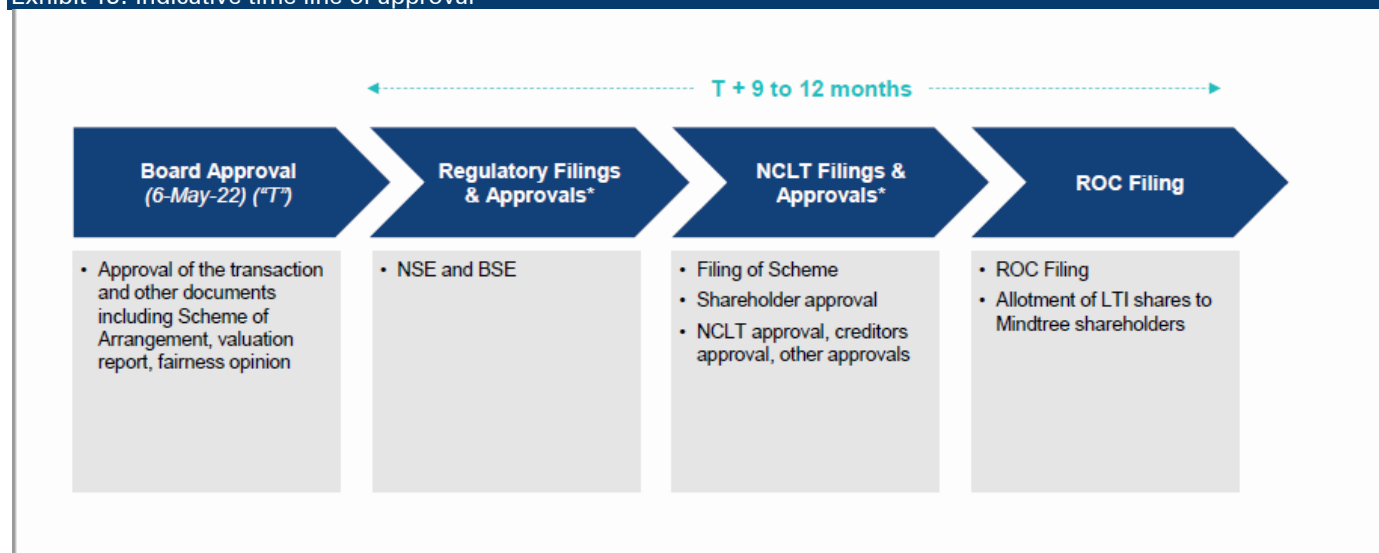
Source: Company, ICICI Direct Research

Exhibit 12: Key employee metric

Key employee metrics	LTI	Mindtree	Combined Entity
Total number of employees	46,648	35,071	81,719
Software professionals	44,566	33,206	77,772
Software professionals as % of total wokforce	95.5	94.7	95.2
Sales & Support	2,082	1,865	3,947
Sales & Support % of total wokforce	4.5	5.3	4.8
LTM attrition as on Q4FY22	24.0	23.8	

Source: Company, ICICI Direct Research

Exhibit 13: Indicative time line of approval



Source: Company, ICICI Direct Research

Exhibit 14: Enhanced capabilities, stronger relationships across partner ecosystem

✔ Capabilities complimentary to vertical and synergistic at horizontal

✔ Combined experience and expertise to enable tier status upgrade

✔ Combined collaboration opportunity with 75 unique partnerships

Strong Relationships with Hyperscalers and Other Strategic Partners

Other Select Partners

Source: Company, ICICI Direct Research

Exhibit 15: Complementary industry capabilities

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, ICICI Direct Research

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