



DEALMONEY SECTOR REPORT

DealMoney

World-Class Financial Services

**SECTOR OF
THE MONTH
IT**



**PICKS OF
THE MONTH**

MINDTREE LTD

#L&T TECHNOLOGY SERVICES

EQUITIES | COMMODITIES | WEALTH | MUTUAL FUNDS | INSURANCE

Sector of the Month: Information Technology

The IT-BPM industry stood at \$191 bn in 2020 and is expected to grow to \$350 bn by 2025. India's IT industry contributed around 7.7 per cent to the country's GDP and is expected to contribute 10 per cent to India's GDP by 2025. As of FY19, IT industry employed 4.1 million people. IT industry is fueling the growth of start-ups in India with presence of around 5,300 tech start-ups in India. The IT-BPM industry is the largest contributor to the total exports of the country, with 43% of the IT-BPM services being exported in 2018. Total revenue from IT services & BPM for FY2019-20 accounts for \$135 bn. The sector is headed towards achieving \$1 tn digital economy by 2022. The country has become the global digital capabilities hub with around 75% of global digital talent present in the country.

India is the leading sourcing destination across the world, accounting for approximately 55 per cent market. Share of the US\$ 185-190 billion global services sourcing business in FY19. India acquired a share of around 38 per cent in the overall BPM sourcing market.

The computer software and hardware sector in India attracted cumulative foreign direct investment (FDI) inflow worth US\$ 43.58 billion between April 2000 and December 2019. It ranked second in FDI inflow as per the data released by the Department for Promotion of Industry and Internal Trade (DPIIT). Moreover the total export revenue of the industry is expected to grow 8.3 per cent y-o-y to US\$ 136 billion in FY19. IT-BPM. Sector accounted for the largest share in the Indian services export at 45 per cent. Total number of employees grew to 1.02 million cumulatively for four Indian IT majors* as on December 31,2019.

SEGMENTS OF INDIA'S IT SECTOR

IT & ITeS sector

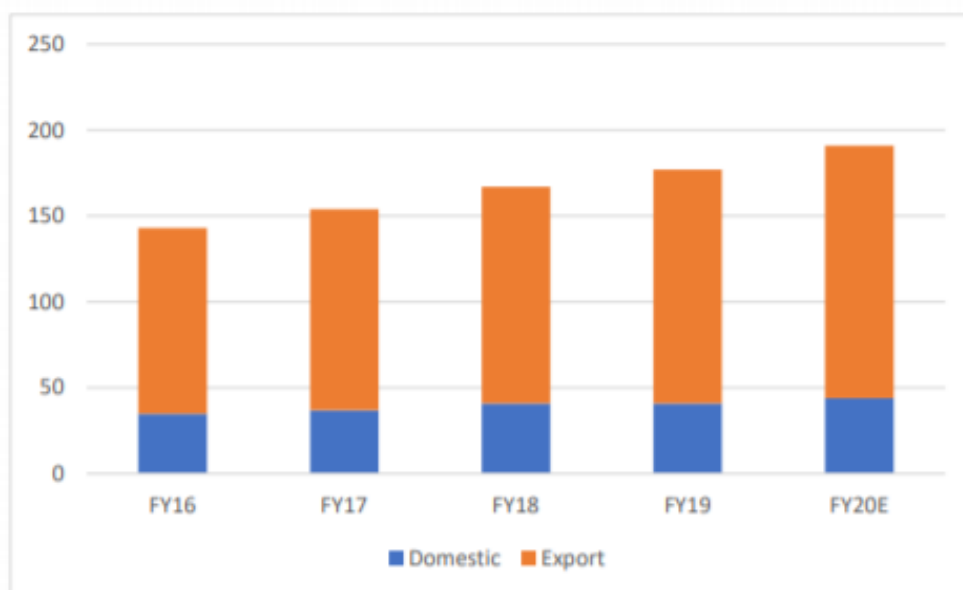
IT services	Business Process Management	Software products and engineering services	Hardware
<p>Market Size: US\$ 92.49 billion during FY19. Over 81 per cent of revenue comes from the export market. BFSI continues to be the major vertical for the IT sector. IT services accounted for almost 51 per cent share of IT industry's revenue in India in FY19.</p>	<p>Market size: US\$ 36.2 billion during FY19. Around 87 per cent of revenue comes from the export market. Market size of BPM industry to reach US\$ 54 billion by FY25. BPM had a 20 per cent share of IT industry's revenue in India in FY19.</p>	<p>Market size: US\$ 34.39 billion during FY19. Over 83.9 per cent of revenue comes from export. It had around 19 per cent revenue share in the Indian IT space in FY19</p>	<p>Market size: US\$ 14.48 billion in FY19. The domestic market accounts for a significant share. Hardware exports from India was estimated to grow at 7-8 per cent in FY19. ^</p>

Rapid growth in market size of Industry

IT-BPM industry revenue was estimated at around US\$ 191 billion in FY20 at 7.7 per cent growth y-o-y. The domestic revenue^ of the IT industry is estimated at US\$ 44 billion and export revenue is estimated at US\$ 147 billion in FY20. The market size of India's IT-BPM sector is expected to grow to US\$ 350 billion by 2025 and BPM is expected to account for US\$ 50-55 billion out of the total revenue.

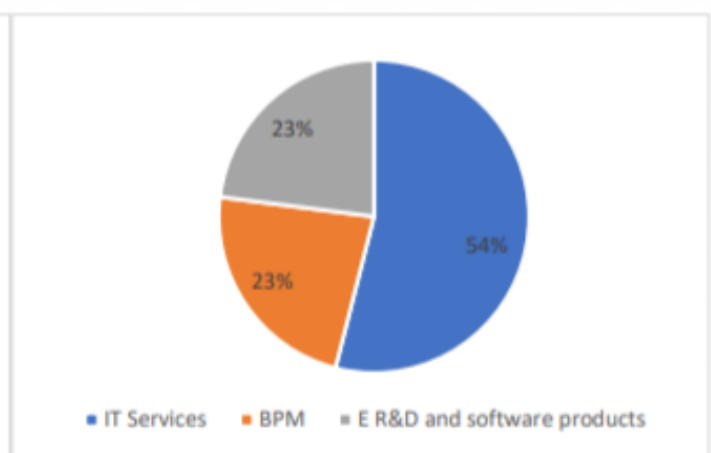
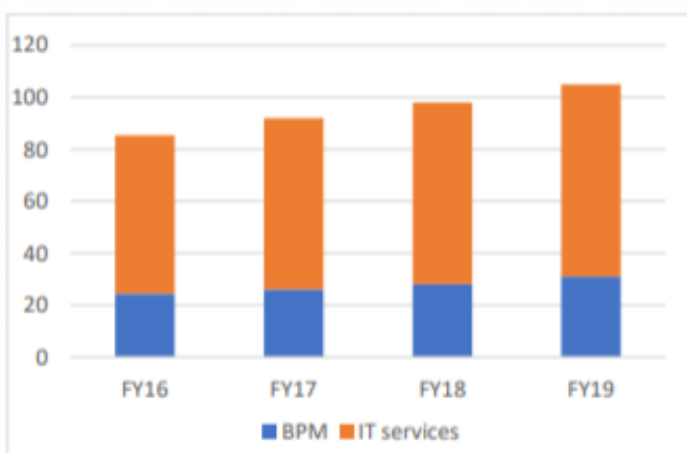
Spending on information technology in India is expected to reach US\$ 90 billion in 2019. Outsourcing of large technology contracts by clients is expected to accelerate the growth of the industry in FY20. The cloud market in India is expected to grow three-fold to US\$ 7.1 billion by 2022 with the help of growing adoption of Big Data, analytics, artificial intelligence and Internet of Things (IoT) according to Cloud Next Wave of Growth in India report. India's digital economy is estimated to reach US\$ 1 trillion by 2025.

Market size of IT industry in India (US\$ billion)



Growth in export revenue (US\$ billion)

Sector-wise breakup of export revenue (FY19)

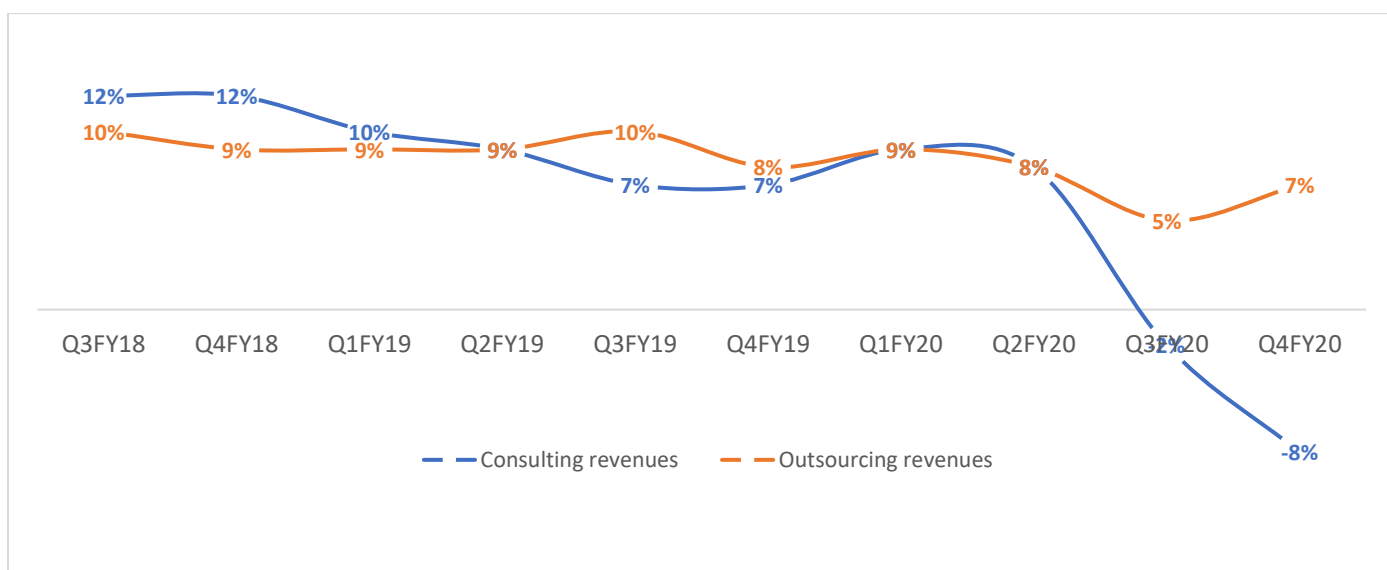


Outsourcing business to drive growth

Outsourcing business grew 3.2% q-q in USD (+7% y-y in CC), while the consulting business declined 5.3% q-q in USD (-8% y-y in CC), driving overall weakness. The outsourcing business is more relevant for India IT. Further, we think spending cuts in the consulting business is temporary given the discretionary nature of the business, but the business is likely to rebound as the overall digital transformation picks-up pace.

Indian IT companies have seen moderation in revenue growth over the past several years due to multiple factors. However, the Covid-19 pandemic has driven increased focus on digital transformation, with tech spending expected to hold up better (and possible increase as a percentage of revenues) as customers invest to ensure business continuity and seamless operations. We expect this trend to help drive improvement in the sector's revenue growth prospects through the next few years

Consulting and Outsourcing revenue growths



1QFY21 guidance implies 3-6.5% q-q growth in USD, suggesting a recovery in demand. FY21F guidance of 4-7% y-y growth in USD (2-5% y-y in CC), implies a 2% CQGR over 2Q-4QFY21F to reach the guidance range. Accenture indicated that it no longer needs to navigate the pandemic and targets to return to pre-COVID-19 growth levels from a y-y perspective by 2HFY21. FY21 guidance implies weak growth from a y-y basis in 1H given the difficult comparison and implies high single digit to low double-digit growth on a y-y basis in 2H.

Outlook

Upsides in the sector would be supported by improvement in revenue growth as well as margins, negating the multi-year trend of moderating growth and margins. This should support EPS upgrades over at least the next 2-3 quarters, which would in turn boost stock upsides in the sector. With that backdrop, we suggest playing the sector through selective picks among Tier I companies and a few mid/small cap names.

Source: Ace Equity, Dealmoney Research

Pick of the Month (Mindtree Ltd.):

CMP: 1338.5

Target: 1560

MindTree was incorporated in the year 1999 by a group of 10 industrial professionals who came from Cambridge Technology Partners, Lucent Technologies and Wipro and this team was led by Ashok Soota. Mindtree has formed successful business and technology alliances with big companies like Microsoft, Hewlett Packard, Oracle, Bluetooth SIG, Intel, IBM, SAP, Orange, Sun Microsystems and many more. The client list includes name like Getronics, Sonoco, ABB, Elance, Symantec, while consumer goods major Samsung is among others.

IT Services- Under this it provides services such as Application Maintenance Services, Business Intelligence, Mainframe and System, Infrastructure Management and Technical Support, etc.

Management expects Q2 revenue to be better than Q1: It is positive on CMT and CPG verticals. Adoption of Cloud, digital transformations, cost takeouts are accelerating. Recovery in Travel vertical will be slower than rest of the verticals – though the management expects it to be close to bottom, if not bottomed already.

Orderbook remains healthy: Mindtree continued to renew contracts & gain market share. Also it is well spread out between top client and rest of the clients. Large deal closures are taking time, as company continues to focus on multi-year annuity deals.

Margins expansion in the quarter was driven by operational efficiencies and FX. Management believes the expansion is sustainable, and can further expand from here. While top client reported 10% qoq growth in this quarter, management doesn't see any slowdown in the account. It however, is actively trying to reduce dependency on it.

Valuations: Mindtree is trading at the valuation of 28.2x TTM PE. We recommend buy on Mindtree Limited with a price target of Rs. 1560.

NSE/BSE Code	Mindtree / 532819
Sector	IT
Industry	IT—Software
Face value/Book Value (Rs.per share)	10 / 210.2
Dividend yield(%)	0.98%
52H/L(Rs.)	1365 / 675
Market Cap.(Rs.mn)	21,797,44.2
Shares Outstanding (mn)	164.7

(In Rs. Cr)	FY17	FY18	FY19	FY20
Net Sales	52,917	56,530	71,108	78,399
Sales Growth	12.06	4.32	28.53	10.58
EBITDA	7,598	9,307	11,538	11,571
EBITDA Margin	14.51	17.04	16.43	14.9
PAT	4,186	5,701	7,541	6,309
PAT Margin	7.99	10.44	10.74	8.13
EPS (Rs)	24.96	34.78	45.93	38.33

	FY17	FY18	FY19	FY20
P/E (x)	18.16	22.25	20.55	21.61
P/B (x)	2.96	4.66	4.71	4.33
EV/Sales	1.42	2.32	2.17	1.68
EV/EBITDA	9.8	13.6	13.21	11.28
ROE	16.82	21.54	25.09	19.6
ROCE	22.35	26.55	31.17	27.28

Qtr Earnings (in Rs. mn)	Q1FY21	Q4FY20	Q-o-Q %	Q1FY19
Net Sales	19,088.0	20,505.0	-6.9	18,342.0
Total Expenditure	15,868.0	17,268.0	-8.1	16,501.0
PBIDT (Excl OI)	3,220.0	3,237.0	-0.5	1,841.0
PAT	2,130.0	2,062.0	3.3	927.0
PBIDTM% (Excl OI)	16.9	15.8	6.8	10.0
PBIDTM%	19.0	16.7	13.9	11.2
PATM%	11.2	10.1	10.9	5.1
Adj. EPS(Rs)	12.9	12.5	3.3	5.6

Source: Ace equity, IBEF, Dealmoney research

Pick of the Month (L&T Technology Services Ltd.): CMP: 1618

Target: 1790

The company is a leading global pure-play ER&D services company. It provides ER&D services, which is defined as the set of services provided to manufacturing, technology and process engineering companies, to help them develop and build products, processes and infrastructure required to deliver products and services to their end customers.

The company offers design and development solutions throughout the product development chain and provide solutions in the areas of mechanical and manufacturing engineering, embedded systems, software engineering and process engineering. For 'new' technologies, the company provides services and solutions in the areas of product lifecycle management, engineering analytics, power electronics, M2M connectivity and IoT.

Guidance of 9-10% revenue growth in FY21E:

Management has guided 9- 10% USD YoY organic growth for FY21E which implied avg. 2.5% growth for next 3 quarters. Segment wise outlook 1) Aerospace will take one more quarter to bottom out, 2) Automotive segment has bottomed out Q1FY21 3) Plant engineering segment has bottomed out in Q1FY21 4) FMCG will grow based on their current pipeline, 5) Telecom and high tech started to grow after so many quarters. This segment will continue to grow going forward. Aerospace was the hardest hit segment and led the revenue decline. This was primarily a result of cancellation of a project by Japanese's customer. In the automobile vertical, things are picking up. Customers are still investing in new technologies like EV and autonomous vehicles, where they have string capabilities.

New strategy for COVID-19:

As a response to the crisis, LTTS has formed two teams – one focusing on resilience and another on growth. Resilience team focuses on bench management, training and collections of receivables. Growth team is proactively engaging discussions on large deals, especially in verticals of Medical and Hi-tech. Management Decision making is prolonged vs pre Covid-19 levels.

Valuations: Currently, the stock is trading at 24.33x TTM PE. We recommend a buy at Rs.1 with the target of Rs. 1790.

NSE / BSE Code	LTTS / 540115
Sector	IT
Industry	Internet software & services
Face value / Book Value (Rs per share)	2/ 271.88
Dividend yield (%)	1.28%
52 H/L (Rs.)	1780 / 995
Market Cap. (Rs. mn)	17,072,51.6
Shares Outstanding (Cr)	1,048.70

(In Rs. Cr)	FY17	FY18	FY19	FY20
Net Sales	53,227	39,532	53,012	58,303
Sales Growth	5.94	15.36	35.53	10.65
EBITDA	6,438	7,690	11,375	13,196
EBITDA Margin	19.82	20.52	22.4	23.48
PAT	4,250	5,066	7,684	8,224
PAT Margin	13.08	13.52	15.13	14.64
EPS (₹)	41.86	49.37	73.62	78.33

	FY17	FY18	FY19	FY20
P/E (x)	18.69	25.11	21.34	14.84
P/B (x)	5.46	6.75	6.68	4.44
EV/Sales	2.46	3.37	3.19	2.12
EV/EBITDA	12.39	16.41	14.25	9.04
ROE	48	30.36	35.51	31.77
ROCE	40.81	37.85	45.36	42.51

Qtr Earnings (in Rs. mn)	Q1FY21	Q4FY20	Q-o-Q %	Q1FY19
Net Sales	12,947.0	14,466.0	-10.5	13,475.0
Total Expenditure	10,888.0	11,783.0	-7.6	10,748.0
PBIDT (Excl OI)	2,059.0	2,683.0	-23.3	2,727.0
PAT	1,180.0	2,063.0	-42.8	2,041.0
PBIDTM% (Excl OI)	15.9	18.6	-14.3	20.2
PBIDTM%	17.0	22.8	-25.6	24.4
PATM%	9.1	14.3	-36.1	15.2
Adj. EPS(Rs)	11.2	19.6	-42.8	19.6

Source: Ace equity, IBEF, Dealmoney research

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