Stock Update

Results Update

Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

L&T Technology Services Ltd

Decent Q4, Maintain Hold

IT & ITES	Sharekhan code: LTTS
Reco/View: Hold ↔	CMP: Rs. 3,448
Price Target: Rs. 3,800 ↑	

↑ Upgrade ↔ Maintain ↓ Downgrade

3R MATRIX	+	=	-
Right Sector (RS)		✓	
Right Quality (RQ)	✓		
Right Valuation (RV)		✓	

\+ Positive = Neutral – Negative

What has changed in 3R MATRIX

	Old		New
RS		↔	
RQ		↔	
RV		↔	

ESG Disclosure Score NEW

ESG RISK RATING	18.86
Updated March 08, 2023	

Low Risk

NEGL	LOW	MED	HIGH	SEVERE
0-10	10-20	20-30	30-40	40+

Source: Morningstar

Company details

Market cap:	Rs. 36,413 cr
52-week high/low:	Rs. 4,317 / 2,923
NSE volume: (No of shares)	2.8 lakh
BSE code:	540115
NSE code:	LTTS
Free float: (No of shares)	2.8 cr

Shareholding (%) (31-03-2023)

Promoters	73.9
FII	6.7
DII	8.4
Others	11.1

Price chart

Price performance

(%)	1m	3m	6m	12m
Absolute	1.9	4.2	-3.3	-14.7
Relative to Sensex	-3.0	4.0	-4.5	-19.8

Sharekhan Research, Bloomberg

Summary

- LTTS reported a revenue of $255.1million with constant currency (cc) revenue growth of 2.2% q-o-q/12.1% y-o-y, beating our estimates of 1.2% cc revenue growth q-o-q led by strong growth in Medical devices and Plant Engineering verticals.
- EBIT margin was flat q-o-q at 18.7% slightly above our estimates of 18.5%. LTTS won a $40 million deal and three $10 million plus TCV during Q4FY23
- The management expects to see another strong year of growth for FY24 and provided guidance of 20% plus in constant currency terms, within this organic growth would be 10% plus while the rest would come from SWC. The company expects the margin to decline by 180 bps q-o-q (180-200 bps earlier) due to integration of SWC in Q1FY24
- Apart from near term uncertainty, the SWC acquisition is margin dilutive for FY24 and may provide only marginal synergies in the near-term. Hence, we maintain Hold rating on LTTS with revised PT of Rs 3800 despite strong deal wins, differentiated engineering capabilities and domain expertise in the diversified vertical mix. At CMP, the stock trades at 28.6x / 23.5x its FY24E/FY25E EPS respectively.

LTTS reported revenue of $255.1million with constant currency (cc) revenue growth of 2.2% q-o-q/12.1% y-o-y, beating our estimates of 1.2% cc revenue growth. Revenue in rupee terms stood at Rs 2096.2 crore up 2.3% q-o-q/19.4% y-o-y beating our estimates of Rs 2075.4 crore. EBIT margin was flat q-o-q at 18.7% slightly above our estimates of 18.5%. Net profit of Rs. 309.6 crore (up 2% q-o-q) was below our estimates of Rs. 317.7 crore due to lower other income on account of forex loss. Revenue growth was led by 4 out 5 segments growing more than 4% sequentially with Medical devices and Plant Engineering growing 7.7%/6.2% respectively. Transportation vertical declined 1.1% q-o-q. LTTS won a $40 million deal and three $10 million+ TCV during Q4FY23 compared to 5 deal wins above $10mn in TCV in Q3FY23. The number of active clients were 341 compared 343 during Q3FY23. LTM Attrition fell up by 110bps q-o-q to 22.2% in Q4FY23. Net employee additions stood at 584, taking the total headcount to 22,233. The management expects to sees another strong year of growth for FY24 and has provided revenue guidance of 20% plus in constant currency terms, within this organic growth will be 10% plus while the rest will come from SWC. The management stated that with the addition of SWC they aspire for EBIT margin to be in the range of 17% in FY24 on a consolidated basis. Also, the management indicated that they aspire to get back to 18% EBIT levels by H1FY26. Apart from near term uncertainty, the SWC acquisition is margin dilutive for FY24 and may provide only marginal synergies in the near-term. Hence, we maintain Hold rating on LTTS with revised PT of Rs 3,800 despite strong deal wins, differentiated engineering capabilities and domain expertise in the diversified vertical mix. At CMP, the stock trades at 28.6x / 23.5x its FY24E/FY25E EPS respectively.

Key positives

- LTTS won a $40 million deal and three $10 million plus TCV during Q4FY23 compared to 5 deal wins above $10 million in TCV in Q3FY23
- For FY24, the management is guiding for a constant currency revenue growth of 20% plus (10% plus organic growth).
- LTM Attrition fell up by 110 bps q-o-q to 22.2% in Q4FY23.

Key negatives

- The number of active clients in Q4FY23 were 341 as compared to 343 during Q3FY23.
- Transportation vertical declined 1.1% sequentially.

Management Commentary

- The management highlighted that there are three clear areas where they are seeing money is being spent 1) Energy transition 2) Electrification and 3) Digital which includes cyber, AI, automation, connectivity computation and cloud adoption.
- Management highlighted that they are seeing spends across US, Europe and Japan for auto and not just auto for Trucks and Off-Highway segments as well while they mentioned they are seeing some stress in Hitech and Semiconductors.
- The company expects the margin to decline by 180 bps q-o-q (earlier 180-200bps) due to integration of SWC in Q1FY24. The management stated that with the addition of SWC they aspire for EBIT margin to be in the range of 17% in FY24 on a consolidated basis. Also, the management indicated that they aspire to get back to 18% EBIT levels by H1FY26.

Revision in estimates – We have revised our estimates for FY24/25 to incorporate SWC acquisition.

Our Call

Valuation – Decent Q4, Maintain Hold: Apart from near-term uncertainty, the SWC acquisition is margin dilutive for FY24 and may provide only marginal synergies in the near-term. Hence, we maintain Hold rating on LTTS with revised PT of Rs 3800 despite strong deal wins, differentiated engineering capabilities and domain expertise in the diversified vertical mix. At the CMP, the stock trades at 28.6x / 23.5x its FY24E/FY25E EPS respectively.

Key Risks

Rupee appreciation and/or adverse cross-currency movements, slackening pace in deal closures, and/or constraints in local talent supply in the US would affect earnings.

Valuation Rs cr

Particulars	FY22	FY23	FY24E	FY25E
Revenue	6,569.7	8,013.6	9,386.5	10,964.5
OPM (%)	21.5	21.3	19.7	20.2
Adjusted PAT	957.0	1,172.5	1,273.5	1,553.2
% y-o-y growth	44.3	22.5	8.6	22.0
Adjusted EPS (Rs.)	90.7	110.5	120.5	146.8
P/E (x)	38.0	31.2	28.6	23.5
P/B (x)	8.6	7.2	6.2	5.3
EV/EBITDA (x)	23.9	19.3	17.7	14.7
RoNW (%)	25.1	25.7	23.7	24.7
RoCE (%)	27.2	28.9	27.0	27.8

Note : We are including the SWC acquisition to our estimate as acquisition has been completed
Source: Company; Sharekhan estimates

Key result highlights

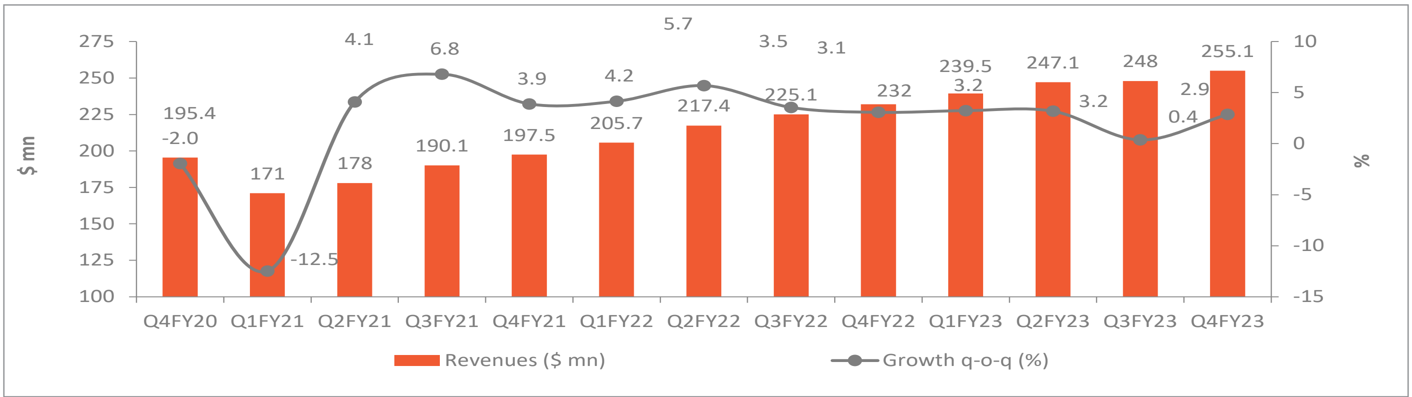
- **Strong sequential revenue growth:** LTTS reported revenue of $255.1million with constant currency (cc) revenue growth of 2.2% q-o-q/12.1% y-o-y, beating our estimates of 1.2% cc revenue growth. The company posted strong revenue growth as 4 out 5 segments grew more than 4% sequentially with Medical devices and Plant Engineering verticals growing 7.7%/6.2% respectively. Industrial Products and Telecom & Hitech grew 4.5%/4.0% q-o-q respectively, while Transportation vertical declined 1.1% q-o-q.
- **EBIT margin:** EBIT margin was flat q-o-q at 18.7%, slightly above our estimate of 18.5%. FY23 EBIT margin was the highest ever at 18.5% on the back of consistent focus on strengthening operational playbook. The management stated that with the addition of SWC they aspire for EBIT margin to be in the range of 17% in FY24 on a consolidated basis. Also, the management indicated that they aspire to get back to 18% EBIT levels by H1FY26.
- **FY24 Guidance:** The management see another strong year of growth for FY24 and provided guidance of 20% plus in CC terms, within this organic growth will be 10% plus while the rest would come from SWC. The management also reiterated their aspiration to hit a $1.5 Billion run rate in FY25.
- **Deal wins and deal pipeline:** LTTS won a $40 million deal with US Transportation major for a complete transformation of their tech stack and three $10 million plus TCV during Q4FY23 compared to five such deal wins in TCV in Q3FY23. The company also won multiple sub $10 million deals with MNC's to setup their newer plants in countries including India.
- **Onsite-Offshore Mix:** The onsite and offshore revenue mix during the quarter was 43% and 57%, respectively. Offshore revenue mix remained flat sequentially. The company aspires to improve the offshore ratio to 60% levels in the medium term.
- **Client additions:** LTTS added one client on q-o-q basis in the 20 million dollar+ and 2 clients in the $5 million+ category, while it added eleven clients under the $1 million dollar+ client bucket. Clients in the 30 million dollar+ and 10 million dollar+ category, however, declined by one sequentially.
- **Headcount metrics:** Headcount increased sequentially by 584 employees to 22,233 while Attrition moderated to 22.2%, a fall of 110 bps sequentially. The company aspires to get Attrition below 20%. through various employee engagement measures.
- **SWC Acquisition:** The company has successfully closed the transaction, effective first April 2023 and integrated around 800 employees of SWC into LTTS. To get synergies the company would focus on **1) Revenue:** Priorities being internationalization of customer base, expansion of services portfolio and creating large deals opportunities. **2) Margins:** Expanding margins through internationalization business mix and SG&A optimization **3) DSO and working capital:** Improve collections and transform into a solutions and services play to get into more asset light deals. The company is seeing a good pipeline of opportunities with three international deal wins, so far, leveraging the SWC offerings.
- **Decline in DSO days:** For Q4FY23 DSO days declined to 75 days from 77 days in Q3FY23. Management aspiration for combined DSO (including SWC) stood at 115-125 days.
- **FCF generation :** Free cash flow (FCF) generation was at Rs. 306.5 crore (versus Rs. 374.5 crore in Q3FY2023). OCF/PAT was at 104% and FCF/PAT was at 99%.

Results (Consolidated) Rs cr

Particulars	Q4FY23	Q4FY22	Q3FY23	y-o-y (%)	q-o-q (%)
Revenues in $(mn)	**255.1**	**232.0**	**248.0**	**10.0**	**2.9**
Revenues In INR	**2,096.2**	**1,756.1**	**2,048.6**	**19.4**	**2.3**
Employee benefit expenses	1,166.5	948.5	1,176.3	23.0	-0.8
Operating expenses	480.5	427.1	431.1	12.5	11.5
EBITDA	**449.2**	**380.5**	**441.2**	**18.1**	**1.8**
Depreciation	56.5	53.1	58.3	6.4	-3.1
EBIT	**392.7**	**327.4**	**382.9**	**19.9**	**2.6**
Other income	49.8	41.9	74.2	18.9	-32.9
Finance cost	10.6	10.5	11.5	1.0	-7.8
PBT	**431.9**	**358.8**	**445.6**	**20.4**	**-3.1**
Provision for taxation	121.0	95.6	140.6	26.6	-13.9
Minority interest	-1.3	-1.2	-1.4		
Net profit	**309.6**	**262.0**	**303.6**	**18.2**	**2.0**
EPS (Rs)	**29.2**	**24.8**	**28.7**	**17.9**	**2.0**
Margin (%)					
EBITDA	21.4	21.7	21.5	-24	-11
EBIT	18.7	18.6	18.7	9	4
NPM	14.8	14.9	14.8	-15	-5
Tax rate	28.0	26.6	31.6	137	-354

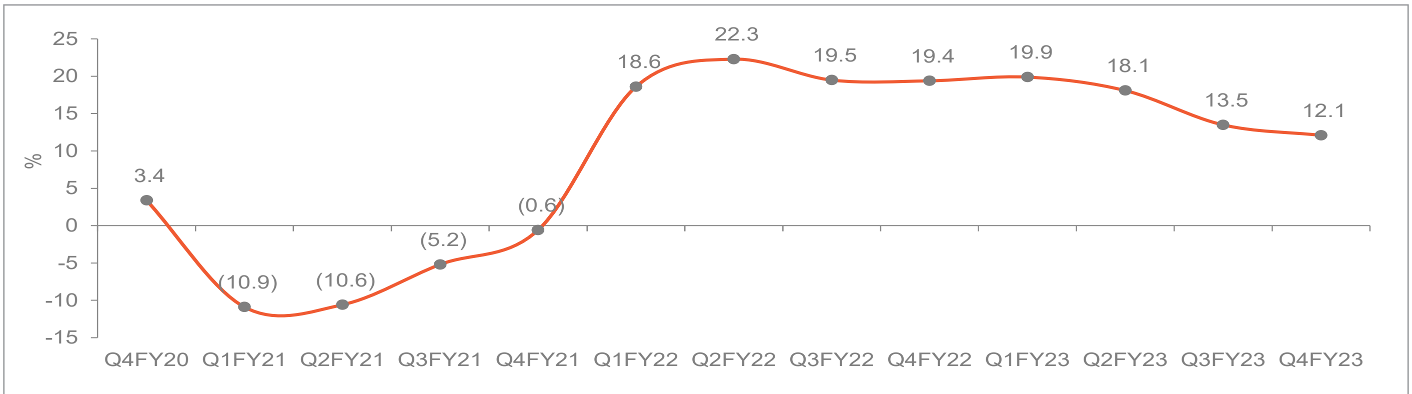
Source: Company, Sharekhan Research

Revenue ($ mn) and growth (% q-o-q



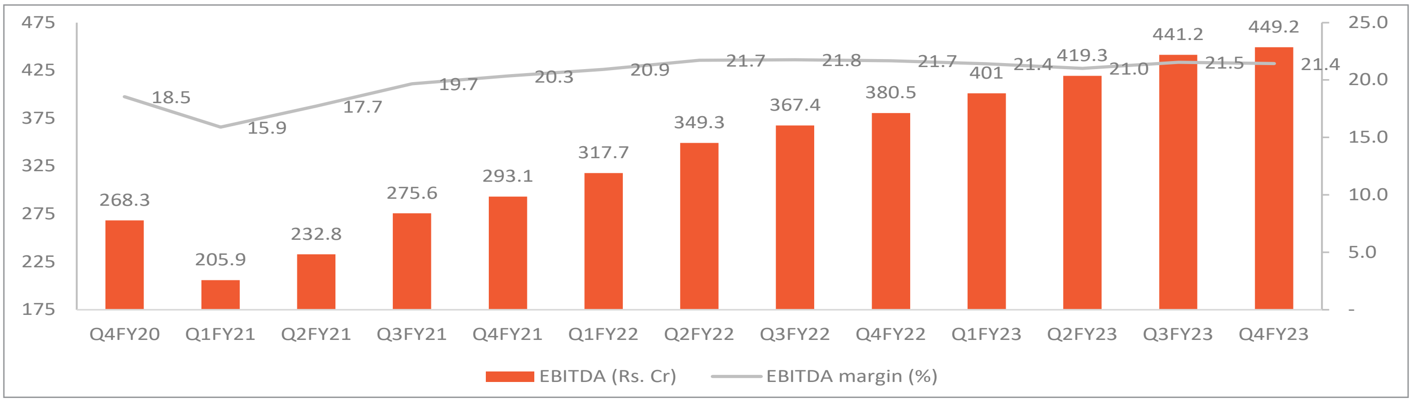
Source: Company, Sharekhan Research

Revenue growth trend (% y-o-y) on CC



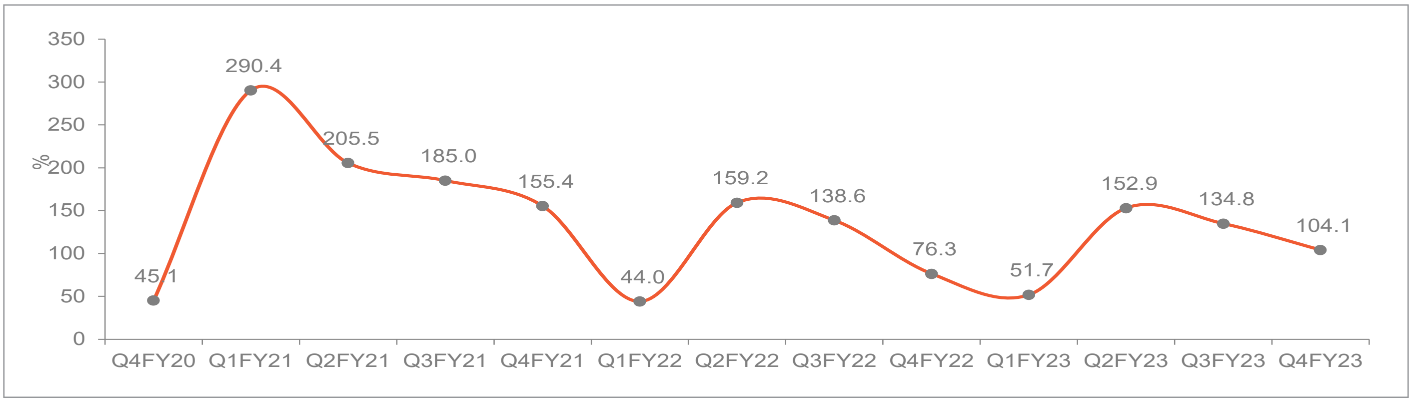
Source: Company, Sharekhan Research

EBITDA margin (%) trend



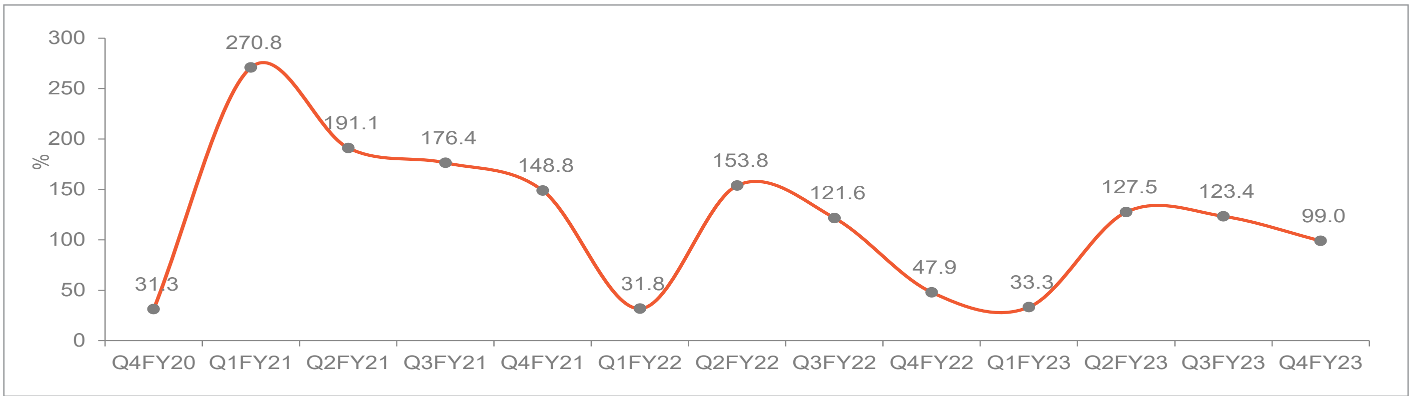
Source: Company, Sharekhan Research

OCF as a % of net profit



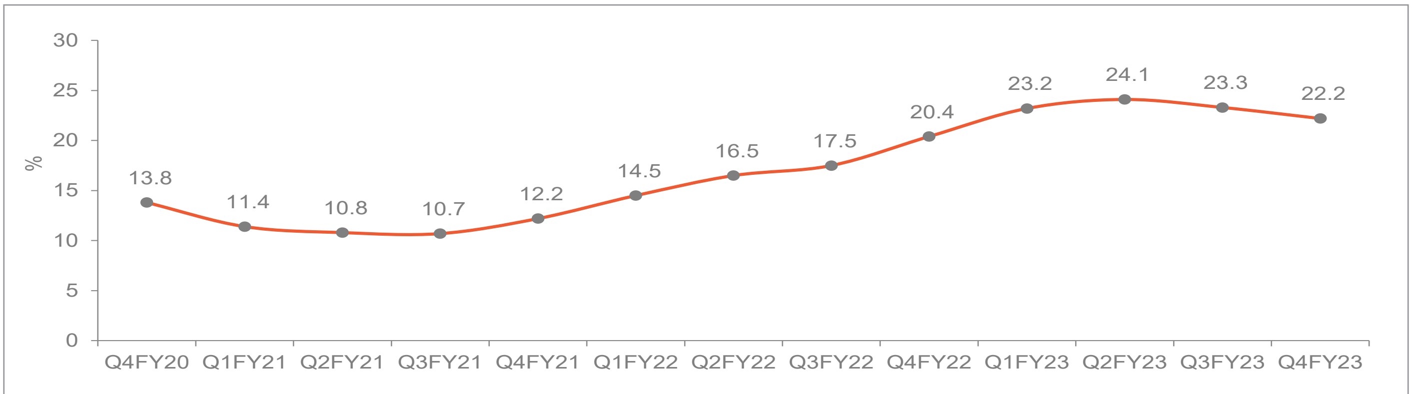
Source: Company, Sharekhan Research

FCF as a % of net profit



Source: Company, Sharekhan Research

Attrition rate (on LTM basis) trend



Source: Company, Sharekhan Research

Outlook and Valuation

■ Sector View – Persisting multiple global headwinds turning outlook for FY24E uncertain

Owing to multiple global headwinds the outlook for FY24E looks uncertain, and the recovery could be gradual in the coming quarters. Hence, concerns relating to macro headwinds are unlikely to abate anytime soon thus restricting any material outperformance for Indian IT companies.

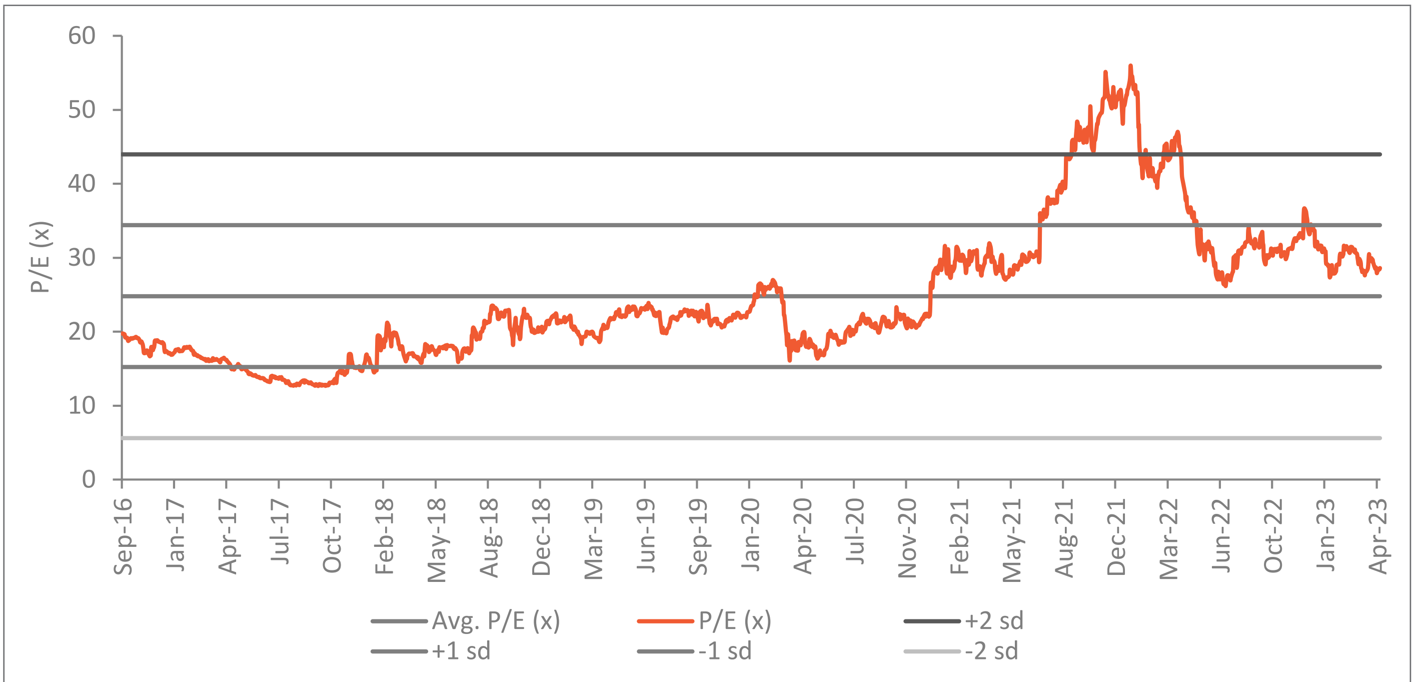
■ Company Outlook – Broad portfolio to support long growth runway

LTTS is the third-largest engineering service provider (ESP) in India and is well-diversified across verticals. The large ERD addressable market and a huge scope in deepening relationships with top-30 customers provide multi-year sustainable growth prospects. Technology shifts in verticals are also positive for the company as they create huge growth opportunities for ESPs. We expect strong growth from FY2022E on the back of rising spends in both digital engineering and legacy engineering areas.

■ Valuation – Decent Q4, Maintain Hold

Apart from near term uncertainty, the SWC acquisition is margin dilutive for FY24 and may provide only marginal synergies in the near-term. Hence, we maintain Hold rating on LTTS with revised PT of Rs 3800 despite strong deal wins, differentiated engineering capabilities and domain expertise in the diversified vertical mix. At the CMP, the stock trades at 28.6x / 23.5x its FY24E/FY25E EPS respectively.

One-year forward P/E (x) band



Source: Company; Sharekhan Research

About the company

L&T Technology Services (LTTS) is a leading global ER&D services company, backed by the rich engineering expertise and experience of parent company, Larsen & Toubro. LTTS is a pure-play Engineering Design Services firm with a presence across multiple verticals (transportation, industrial products, telecom & hi-tech, medical devices and process industries). The company derives revenue 62.3% from North America, 16.1% from Europe, 14.5% from India and 7.1% from Rest of the World (RoW). The company offers ERD practices to 57 of the top R&D spenders worldwide. LTTS also has IP and Platforms which it independently sells to clients.

Investment theme

LTTS currently generates a mere 0.5% of its Top-30 (T-30) customers' R&D spends ($75 billion) as revenue ($376 million), which provides a long runway for growth. We believe the multi-sectoral presence and robust horizontal technology practice would help LTTS to deliver sustainable revenue growth momentum. Additionally, technology shifts in verticals is positive for LTTS as any change in technology creates huge growth opportunities for ESPs. Unlike peers, LTTS has a broader portfolio, which helps the company to mitigate the risk relating to vertical-specific cyclicality. We believe LTTS is well poised to deliver strong multi-year growth going forward, led by leadership depth, broad client portfolio, and multi-domain expertise across verticals and under-penetrated ERD outsourcing market.

Key Risks

Regulatory visa norms could have an impact on employee expenses; 2) Any instability in leadership; additional exits at senior management level; 3) Rupee appreciation and/or adverse cross-currency movements; and 4) Increasing attrition rate.

Additional Data

Key management personnel

A.M. Naik	Non-Executive Chairman
S.N. Subrahmanyan	Vice Chairman
Amit Chadha	Chief Executive Officer
Rajeev Gupta	Chief Financial Officer
Abhishek Sinha	Chief Operating Officer (COO)

Source: Company Website

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Life Insurance Corp of India	4.5
2	Vanguard Group Inc	0.9
3	Wasatch Advisors Inc	0.8
4	Seafarer Capital Partners LLC	0.7
5	SBI Funds Management Ltd	0.5
6	Capital Group Cos Inc	0.5
7	Credit Agricole Group	0.2
8	HDFC Asset Management Co Ltd	0.2
9	UTI Asset Management Co Ltd	0.2
10	ICICI Prudential Asset Management	0.2

Source: Bloomberg

Understanding the Sharekhan 3R Matrix

Right Sector	
Positive	Strong industry fundamentals (favorable demand-supply scenario, consistent industry growth), increasing investments, higher entry barrier, and favorable government policies
Neutral	Stagnancy in the industry growth due to macro factors and lower incremental investments by Government/private companies
Negative	Unable to recover from low in the stable economic environment, adverse government policies affecting the business fundamentals and global challenges (currency headwinds and unfavorable policies implemented by global industrial institutions) and any significant increase in commodity prices affecting profitability.
Right Quality	
Positive	Sector leader, Strong management bandwidth, Strong financial track-record, Healthy Balance sheet/cash flows, differentiated product/service portfolio and Good corporate governance.
Neutral	Macro slowdown affecting near term growth profile, Untoward events such as natural calamities resulting in near term uncertainty, Company specific events such as factory shutdown, lack of positive triggers/events in near term, raw material price movement turning unfavourable
Negative	Weakening growth trend led by led by external/internal factors, reshuffling of key management personal, questionable corporate governance, high commodity prices/weak realisation environment resulting in margin pressure and detoriating balance sheet
Right Valuation	
Positive	Strong earnings growth expectation and improving return ratios but valuations are trading at discount to industry leaders/historical average multiples, Expansion in valuation multiple due to expected outperformance amongst its peers and Industry up-cycle with conducive business environment.
Neutral	Trading at par to historical valuations and having limited scope of expansion in valuation multiples.
Negative	Trading at premium valuations but earnings outlook are weak; Emergence of roadblocks such as corporate governance issue, adverse government policies and bleak global macro environment etc warranting for lower than historical valuation multiple.

Source: Sharekhan Research

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by BNP PARIBAS

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