Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Stock Update

Result Update

L&T Technology Services Ltd

Good Q2, Maintain Hold

IT & ITES	Sharekhan code: LTTS
Reco/View: Hold ↔	CMP: **Rs. 4,615**
	Price Target: **Rs. 5,100** ↑

↑ 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 19.55

Updated Aug 08, 2023

Low Risk

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

Source: Morningstar

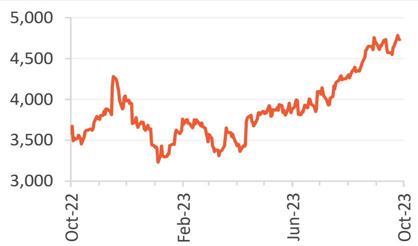
Company details

Market cap:	Rs. 48,790 cr
52-week high/low:	Rs. 4860/3218
NSE volume: (No of shares)	2.5 lakh
BSE code:	540115
NSE code:	LTTS
Free float: (No of shares)	2.8 cr

Shareholding (%)

Promoters	73.8
FII	5.9
DII	10.8
Others	9.6

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	-2.2	12.6	34.5	28.7
Relative to Sensex	-0.2	12.8	23.7	14.9

Sharekhan Research, Bloomberg

Summary

- LTTS reported revenue of $288.1 million with constant currency (cc) revenue growth of 3.2% q-o-q/1.4% y-o-y, nearly in line with our 3.5% CC revenue growth estimate led by broad-based growth, especially from Transportation and Plant & Engineering verticals.
- EBIT margin was flat q-o-q at 17.1% slightly missing our estimates of 17.3% as margin pressure due to wage hikes and investments in new technologies was offset by improved utilization and cost optimisation. Large deal wins were broad based, with seven deals more than $10 million plus TCV out of which six were $15 million each.
- The management has revised the revenue growth guidance for FY24 to 17.5-18.5% in constant currency from 20% plus considering the UAW strikes from mid-September in US and the macros that are developing amid prevailing uncertainty.
- Despite the strong deal wins and improving traction in its diversified verticals, the management has baked in a general caution by revising the guidance to reflect the longer decision cycles and incremental headwinds from the macro-economic stress in various geographies. Hence, we maintain a Hold rating with a revised price target of Rs. 5,100 (increase in PT reflects roll forward to FY26E EPS). Stock is currently trading at a multiple of 31.4/27.2x its estimated FY25 and FY26E EPS, respectively.

LTTS reported revenue of $ 288.1 million with constant currency (cc) revenue growth of 3.2% q-o-q/1.4% y-o-y, nearly in line with our 3.5% cc revenue growth. Revenue in rupee terms stood at Rs 2,386.5 crore, up 3.7% q-o-q/19.6% y-o-y in line with our estimates of Rs 2389.6 crore. EBIT margin was flat q-o-q at 17.1% slightly missing our estimates of 17.3% as margin pressure due to wage hikes and investments in new technologies was offset by improved utilization and cost optimization. Net profit of Rs. 315.4 crore (up 1.4% q-o-q/11.7% y-o-y) was below our estimates of Rs. 324.6 crore due to lower other income. Revenue growth was broad based led by Transportation, Plant Engineering and Telecom & Hi-tech which grew 4.4%, 3.8% and 2.3% q-o-q respectively. Medical Devices and Industrial Products grew 1.4% and 1% q-o-q respectively. Large deal wins were broad based, with 7 deals more than $10 million plus TCV out of which 6 were $15 million each. LTM Attrition fell up by 220 bps q-o-q to 16.7%. Net additions stood at 488 taking the total headcount to 23,880. The management has revised the revenue growth guidance for FY24 to 17.5-18.5% in constant currency from 20% plus considering the UAW strikes from mid-September in US and the macros that are developing amid prevailing uncertainty. LTTS reported good Q2 results with broad based revenue growth, deal wins and improving traction across its diversified verticals. However, the management has baked in a general caution by revising the guidance to reflect the longer decision cycles and incremental headwinds from the macro-economic stress in various geographies. Hence, we maintain a Hold rating with a revised price target of Rs. 5,100 (increase in PT reflects roll forward to FY26E EPS). Stock is currently trading at a multiple of 31.4/27.2x its estimated FY25 and FY26E EPS, respectively.

Key positives

- Large deal wins were broad based, with 7 deals more than $10 million plus TCV out of which 6 were $15 million each.
- LTM attrition fell up by 220 bps q-o-q to 16.7%.
- Transportation and Plant & Engineering grew 4.4% and 3.8% q-o-q respectively.

Key negatives

- Management revised the USD revenue growth guidance for FY24 to 17.5-18.5% in constant currency from 20% plus.
- North America revenue growth was muted at 0.7% q-o-q.

Management Commentary

- The management revised the USD revenue growth guidance for FY24 to 17.5%-18.5% in constant currency from 20% plus. The company maintains its aspiration to be at 17% EBIT levels in FY24 and to get back to 18% EBIT level by H1FY26.
- Q3FY24 will be a soft quarter in line with seasonality, expect growth to bounce back fromQ4FY24 onwards.
- The company is investing in software defined vehicles, AI, cybersecurity and will have close to 2,000 employees trained over the next few quarters.

Revision in estimates – We have fine tuned our estimates for FY24/25E to factor revised guidance for FY24.

Our Call

Valuation –Maintain Hold with revised price target of Rs. 5,100: LTTS reported good Q2 results with broad based revenue growth, deal wins and improving traction across its diversified verticals. We expect revenue/PAT CAGR of 13%/14% respectively over FY23-FY26E. However, the management has baked in a general caution by revising the guidance to reflect the longer decision cycles and incremental headwinds from the macro-economic stress in various geographies. Hence, we maintain a Hold rating with a revised price target of Rs. 5,100 (increase in PT reflects roll forward to FY26E EPS). Stock is currently trading at a multiple of 31.4/27.2x its estimated FY25 and FY26E EPS, respectively.

Key Risks

Rupee appreciation and/or adverse cross-currency movements. Contagion effect of banking crisis and macro headwinds and possible recession in the US are likely to moderate the pace of technology spending.

Valuation (Consolidated) Rs cr

Particulars	FY22	FY23	FY24E	FY25E	FY26E
Revenue	6,569.7	8,815.5	9,717.0	11,284.5	12,859.7
OPM (%)	21.5	20.0	20.3	20.3	20.7
Adjusted PAT	957.0	1,212.1	1,331.2	1,557.1	1,798.4
% y-o-y growth	44.3	26.7	9.8	17.0	15.5
Adjusted EPS (Rs.)	90.7	114.5	125.9	147.2	169.9
P/E (x)	50.9	40.3	36.7	31.4	27.2
P/B (x)	11.5	9.7	8.3	7.1	6.1
EV/EBITDA (x)	32.5	25.7	22.9	19.6	16.7
RoNW (%)	25.1	26.6	24.8	25.0	24.8
RoCE (%)	27.2	29.8	29.0	29.0	29.2

Source: Company; Sharekhan estimates

Key result highlights

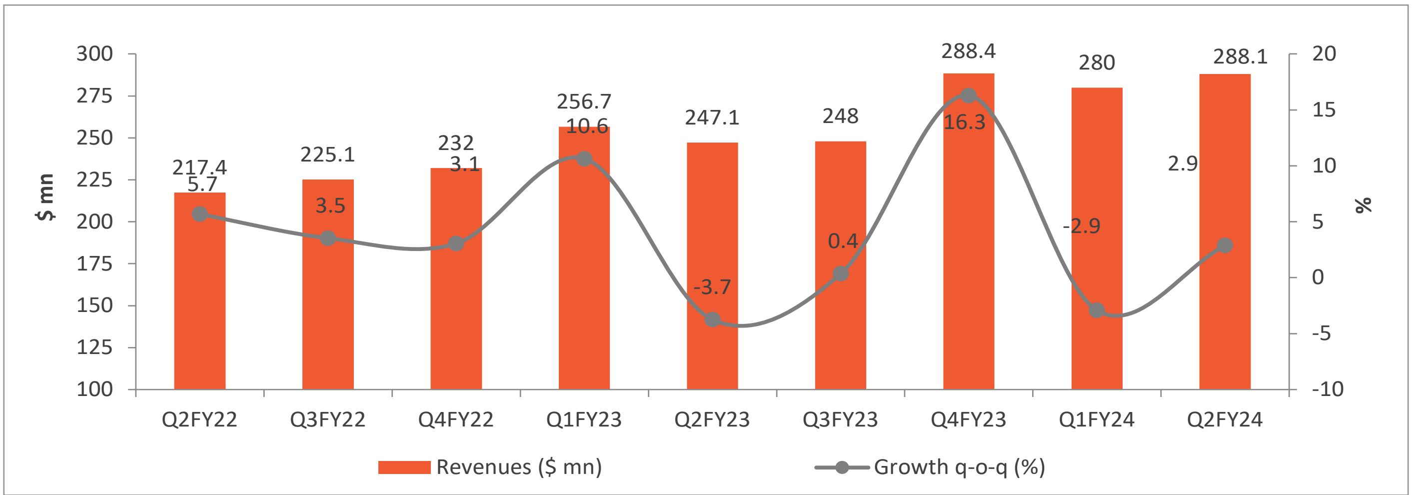
- **Broad-based revenue growth:** LTTS reported revenue of $288.1 million with constant currency (cc) revenue growth of 3.2% q-o-q/1.4% y-o-y, nearly in line with our 3.5% cc revenue growth estimate. Revenue in rupee terms stood at Rs 2386.5 crore, up 3.7% q-o-q/19.6% y-o-y in line with our estimates of Rs 2389.6 crore. Revenue growth was broad based led by the Transportation, Plant Engineering and Telecom & Hi-tech which grew 4.4%,3.8% and 2.3% q-o-q respectively. Medical Devices and Industrial Products grew 1.4% and 1% q-o-q, respectively.
- **EBIT margin:** EBIT margin was flat q-o-q at 17.1%, slightly missing our estimates of 17.3% as margin pressure due to wage hikes and investments in new technologies was offset by improved utilization and cost optimisation. Segmental margin performance was better in three out of five segments on a sequential basis with improvements in Transportation, Telecom Hitech and Plant Engineering segments.
- **Guidance:** The management revised the USD revenue growth guidance for FY24 to 17.5%-18.5% in constant currency from 20% plus. Though the company's target would be to reach original number, the company has been prudent and cautious while revising the guidance considering the UAW strikes from mid-September in US and the situation developing in the world though their operations in Israel is very small.
- **Deal wins:** Large deal wins were broad-based, with 7 deals with a more than $10 million plus TCV out of which six were $15 million each. The company won a significant $10 million deal in North America as a result of having a superior end-to-end technology stack for wireless and 5G communications. This was the first large deal leveraging SWC capabilities in the global market.
- **Commentary on verticals:** In the Transportation segment, the company had a good quarter with growth in all three sub-segments: Auto Trucks, Off Highway, and Aerospace. They are accelerating training and capability building in software-defined vehicles (SDV) to take advantage of the next wave of spending. The company is partnering with US chip majors to develop next-generation chips and software for SDV. In Plant Engineering, the company had strong growth across FMCG, oil & gas, and chemicals, with investments in shale, low carbon energy, carbon capture, and renewables. They are also experiencing growth in Industrial Products, driven by digital products and digital manufacturing, with a focus on AI and robotics. In Telecom and Hitech, the company grew by 2% sequentially despite challenges in Semicon and Consumer Electronics portfolios. They are engaged in the new age chipsets designed for AI and cloud computing workloads. The company is in discussions with enterprise customers for operational technology and cybersecurity services and won a large deal in the global market leveraging SWC capabilities for wireless and 5G communications. In the Medical segment, the company saw traction and won two large deals worth close to $20 million each. These deals involve developing a NextGen platform for faster market entry and providing assistance with subsidiaries and manufacturing optimization. The company is seeing increased demand for digital solutions in areas like process automation, optimization, productivity improvement, and cybersecurity in the Medical sector.
- **Client additions:** The number of clients in $1 million, $5 million and /$10 million categories declined sequentially by 4/1 and 1 respectively. The number of clients in $30 million+ category increased by 1 while the number of active clients increased by 5.
- **Attrition & Headcount:** LTM attrition fell by 220 bps q-o-q to 16.7% . Net additions stood at 488, taking the total headcount to 23,880 which was lower than the company's anticipations of 750+ . Last year, the company hired 2,000 freshers and has successfully onboarded a similar number this year. Over 1,000 freshers have already been onboarded, and the remaining offers will be honored within the next two quarters. The company is also actively planning college campus hiring for next year.
- **DSO days:** The combined DSO, including unbilled stood at 118 days compared to 117 days in Q1, which is within the target range of 115 to 125 days for the year.
- **FCF generation:** Free cash flow (FCF) generation stood at Rs. 201.9 crore with FCF/PAT at 64%.

Results (Consolidated) Rs cr

Particulars	Q2FY24	Q2FY23	Q1FY24	y-o-y (%)	q-o-q (%)
Revenues in USD (mn)	**288.1**	**247.1**	**280.0**	**16.6**	**2.9**
Revenues In INR	**2,386.5**	**1,995.1**	**2,301.4**	**19.6**	**3.7**
Employee benefit expenses	1,241.7	1,152.8	1,215.1	7.7	2.2
Operating expenses	669.2	423.0	633.5	58.2	5.6
EBITDA	**475.6**	**419.3**	**452.8**	**13.4**	**5.0**
Depreciation	68.1	59.1	57.4	15.2	18.6
EBIT	**407.5**	**360.2**	**395.4**	**13.1**	**3.1**
Other income	41.2	41.8	47.7	-1.4	-13.6
Finance cost	12.6	13.1	12.0	-3.8	5.0
PBT	**436.1**	**388.9**	**431.1**	**12.1**	**1.2**
Provision for taxation	120.2	105.7	119.0	13.7	1.0
Minority interest	-0.5	-0.8	-1.0		
Net profit	**315.4**	**282.4**	**311.1**	**11.7**	**1.4**
EPS (Rs)	29.8	26.7	29.4	11.5	1.3
Margin (%)					
EBITDA	19.9	21.0	19.7	-109	25
EBIT	17.1	18.1	17.2	-98	-11
NPM	13.2	14.2	13.5	-94	-30
Tax rate	27.6	27.2	27.6	38	-4

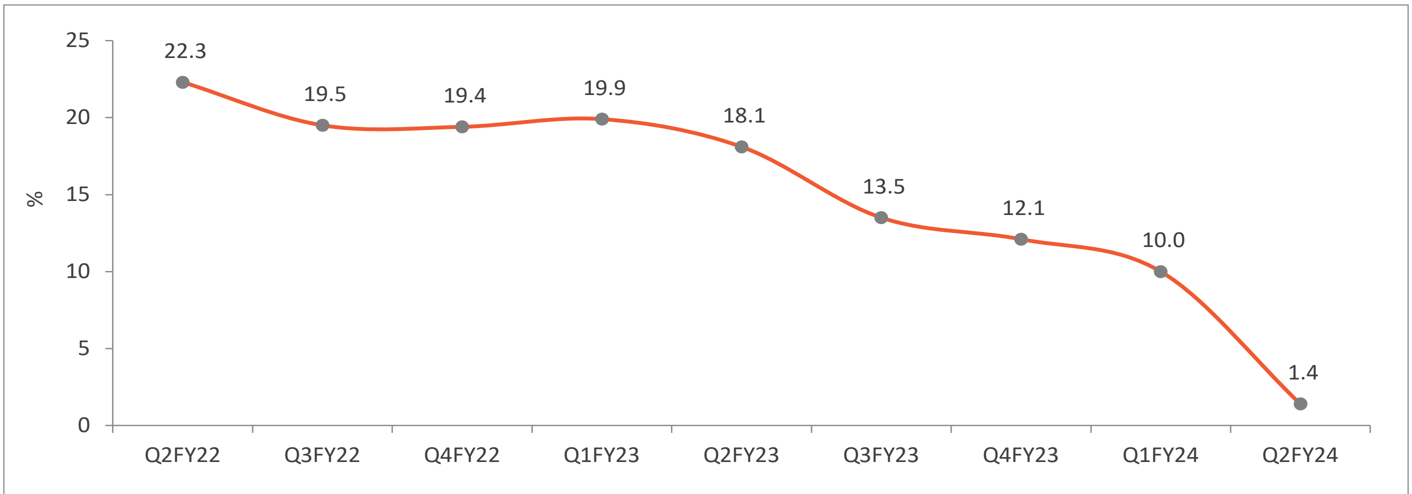
Source: Company, Sharekhan Research

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



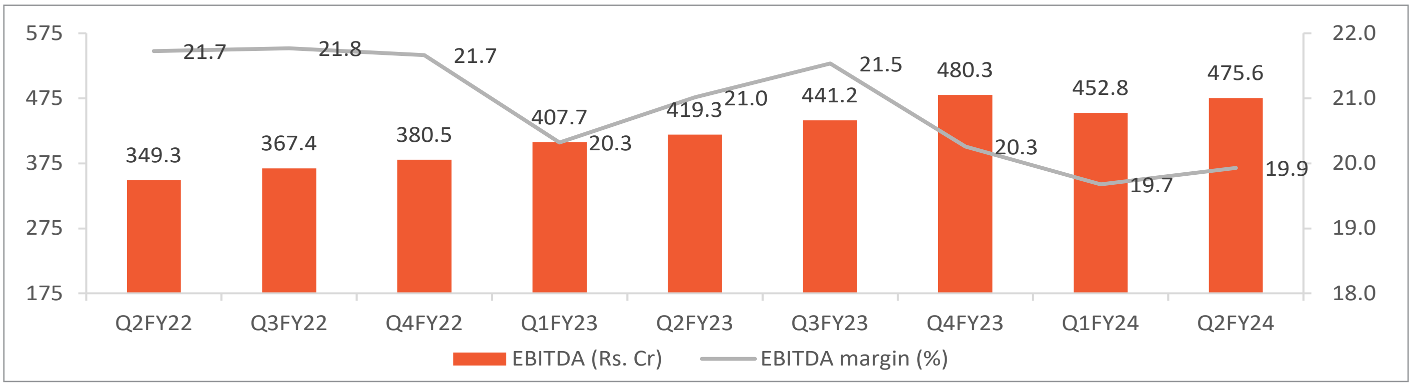
Source: Company, Sharekhan Research

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



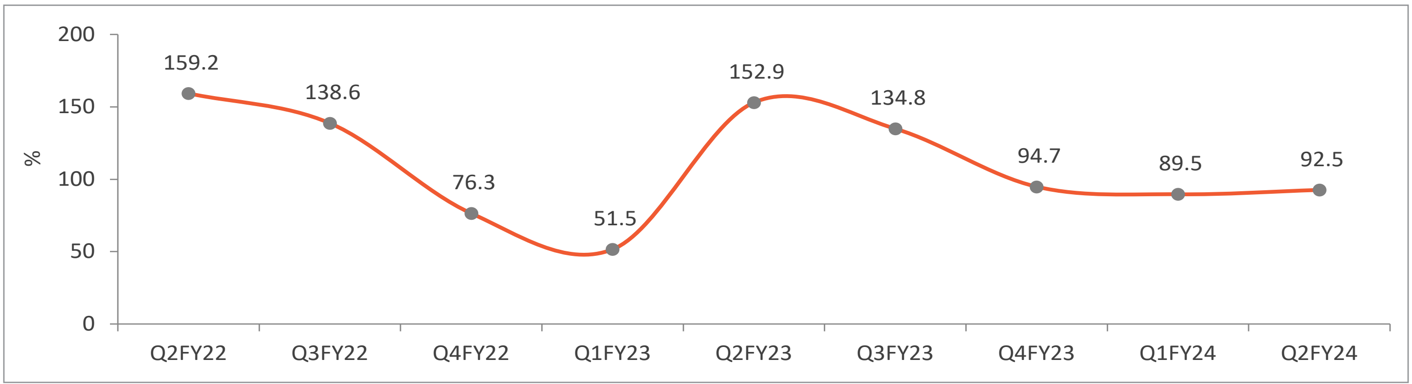
Source: Company, Sharekhan Research

EBITDA margin (%) trend



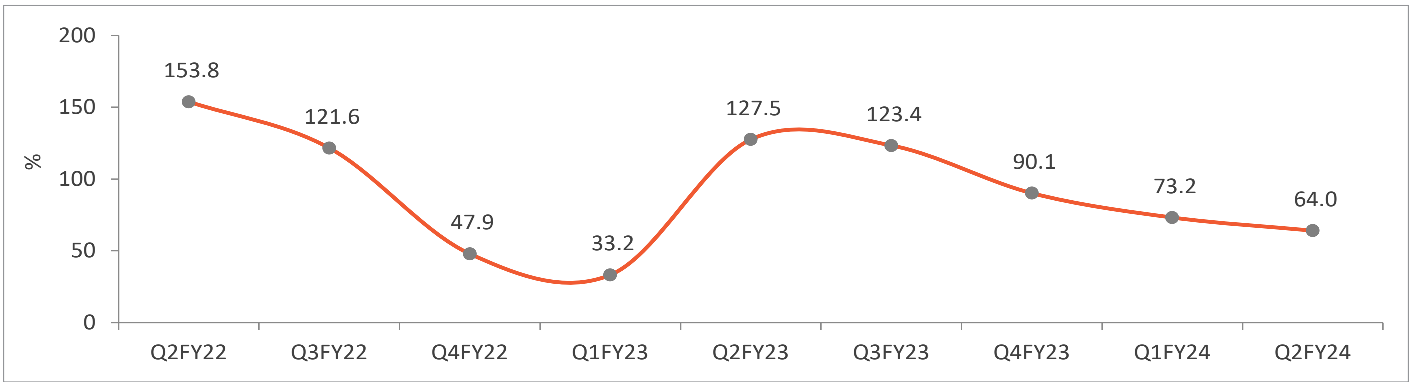
Source: Company, Sharekhan Research

OCF as a % of net profit



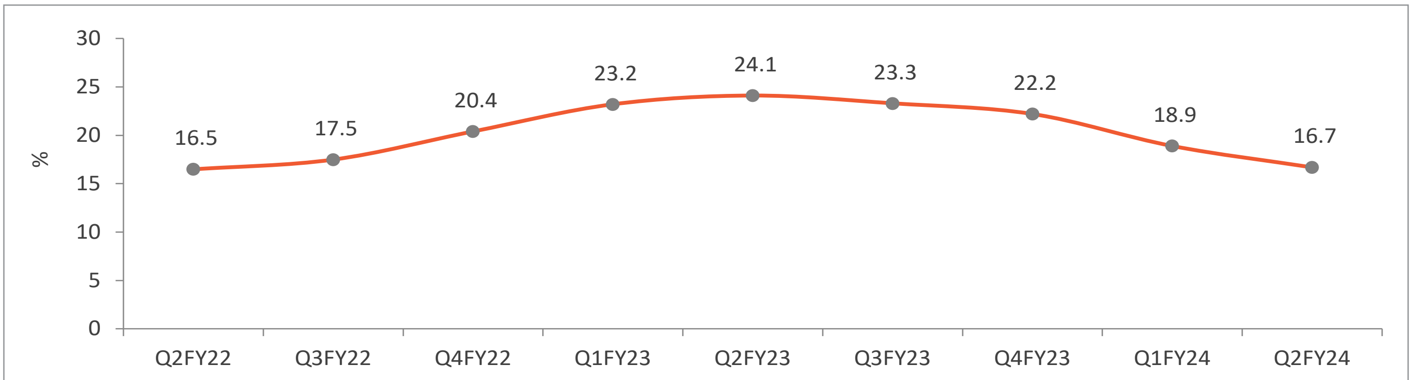
Source: Company, Sharekhan Research

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.

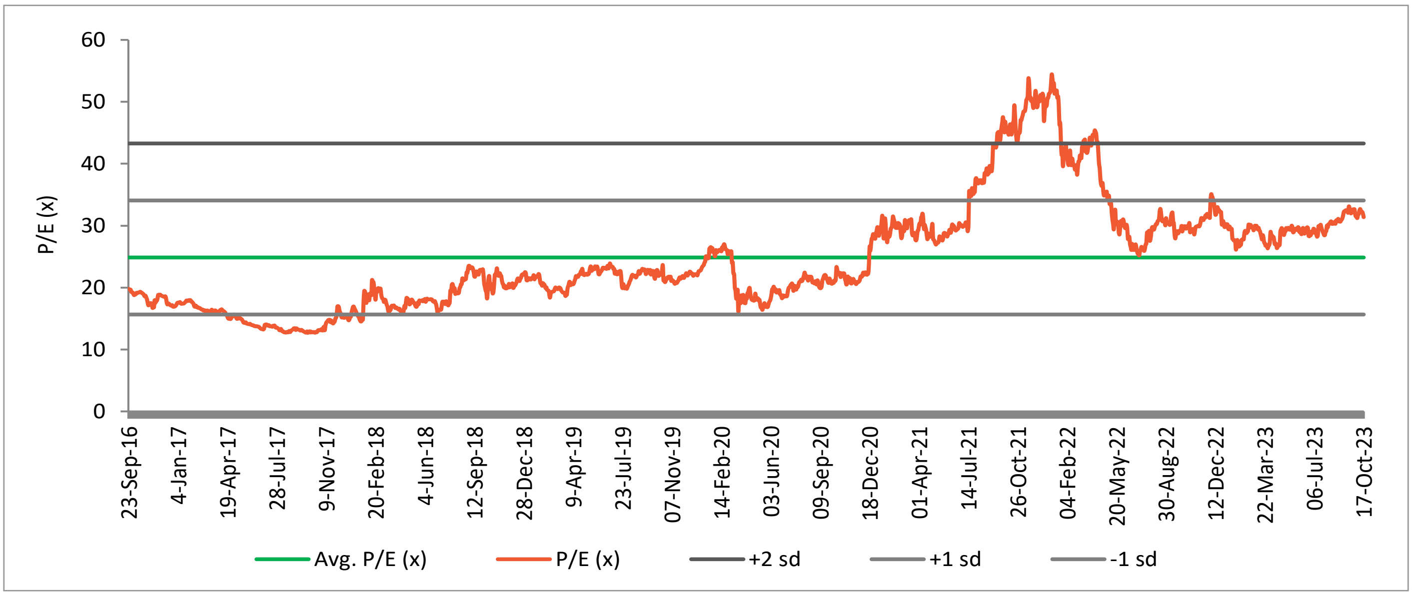
■ Company outlook - Broad portfolio to support long growth runway

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 - Maintain Hold with revised price target of Rs. 5,100

LTTS reported good Q2 results with broad based revenue growth, deal wins and improving traction across its diversified verticals. We expect revenue/PAT CAGR of 13%/14% respectively over FY23-FY26E. However, the management has baked in a general caution by revising the guidance to reflect the longer decision cycles and incremental headwinds from the macro-economic stress in various geographies. Hence, we maintain a Hold rating with a revised price target of Rs 5,100 (increase in PT reflects roll forward to FY26E EPS). Stock is currently trading at a multiple of 31.4/27.2x its estimated FY25 and FY26E EPS, respectively.

One-year forward P/E (x) band



Source: Sharekhan Research

About 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

1) Rupee appreciation and/or adverse cross-currency movements, and 2) Contagion effect of banking crisis3) macro headwinds and possible recession in the US are likely to moderate the pace of technology spending.

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
Alind Saxena	President Sales & whole time Director

Source: Company

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Life Insurance Corp of India	5.69
2	Vanguard Group Inc/The	0.94
3	Seafarer Capital Partners LLC	0.84
4	SBI Funds Management Ltd	0.66
5	Capital Group Cos Inc/The	0.49
6	Wasatch Advisors Inc	0.44
7	UTI Asset Management Co Ltd	0.22
8	PGIM India Asset Management Pvt Lt	0.22
9	Motilal Oswal Asset Management Co	0.21
10	Credit Agricole Group	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

Sharekhan
by BNP PARIBAS

DISCLAIMER

This information/document has been prepared by Sharekhan Ltd. (SHAREKHAN) and is intended for use only by the person or entity to which it is addressed to. This Document may contain confidential and/or privileged material and is not for any type of circulation and any review, retransmission, or any other use is strictly prohibited. This information/ document is subject to changes without prior notice.

Recommendation in reports based on technical and derivatives analysis is based on studying charts of a stock's price movement, trading volume, outstanding positions, as opposed to focusing on a company's fundamentals and as such, may not match with a report on a company's fundamentals. However, this would only apply for information/document focused on technical and derivatives research and shall not apply to reports/documents/ information focused on fundamental research.

This information/document does not constitute an offer to sell or solicitation for the purchase or sale of any financial instrument or as an official confirmation of any transaction. Though disseminated to all customers who are due to receive the same, not all customers may receive this report at the same time. SHAREKHAN will not treat recipients as customers by virtue of their receiving this information/report.

The information contained herein is obtained from publicly available data or other sources believed to be reliable and SHAREKHAN has not independently verified the accuracy and completeness of the said data and hence it should not be relied upon as such. While we would endeavour to update the information herein on reasonable basis, SHAREKHAN, its subsidiaries and associated companies, their directors and employees ("SHAREKHAN and affiliates") are under no obligation to update or keep the information current. Also, there may be regulatory, compliance, or other reasons that may prevent SHAREKHAN and affiliates from doing so. This document is prepared for assistance only and is not intended to be and must not alone be taken as the basis for an investment decision. Recipients of this report should also be aware that past performance is not necessarily a guide to future performance and value of investments can go down as well. The user assumes the entire risk of any use made of this information. Each recipient of this document should make such investigations as it deems necessary to arrive at an independent evaluation of an investment in the securities of companies referred to in this document (including the merits and risks involved) and should consult its own advisors to determine the merits and risks of such an investment. The investment discussed or views expressed may not be suitable for all investors. We do not undertake to advise you as to any change of our views. Affiliates of Sharekhan may have issued other recommendations/ reports that are inconsistent with and reach different conclusions from the information presented in this recommendations/report.

This information/recommendation/report is not directed or intended for distribution to, or use by, any person or entity who is a citizen or resident of or located in any locality, state, country or other jurisdiction, where such distribution, publication, availability or use would be contrary to law, regulation or which would subject SHAREKHAN and affiliates to any registration or licensing requirement within such jurisdiction. The securities described herein may or may not be eligible for sale in all jurisdictions or to certain category of investors. Persons in whose possession this document may come are required to inform themselves of and to observe such restriction.

The analyst certifies that the analyst might have dealt or traded directly or indirectly in securities of the company and that all the views expressed in this document accurately reflect his or her personal views about the subject company or companies and its or their securities and do not necessarily reflect those of SHAREKHAN. The analyst and SHAREKHAN further certifies that either he or his relatives or Sharekhan associates might have direct or indirect financial interest or might have actual or beneficial ownership of 1% or more in the securities of the company at the end of the month immediately preceding the date of publication of the research report. The analyst and SHAREKHAN encourages independence in research report/ material preparation and strives to minimize conflict in preparation of research report. The analyst and SHAREKHAN does not have any material conflict of interest or has not served as officer, director or employee or engaged in market making activity of the company. The analyst and SHAREKHAN has not been a part of the team which has managed or co-managed the public offerings of the company, and no part of the analyst's compensation was, is or will be, directly or indirectly related to specific recommendations or views expressed in this document. Sharekhan Ltd or its associates or analysts have not received any compensation for investment banking, merchant banking, brokerage services or any compensation or other benefits from the subject company or from third party in the past twelve months in connection with the research report.

Either SHAREKHAN or its affiliates or its directors or employees / representatives / clients or their relatives may have position(s), make market, act as principal or engage in transactions of purchase or sell of securities, from time to time or may be materially interested in any of the securities or related securities referred to in this report and they may have used the information set forth herein before publication. SHAREKHAN may from time to time solicit from, or perform investment banking, or other services for, any company mentioned herein. Without limiting any of the foregoing, in no event shall SHAREKHAN, any of its affiliates or any third party involved in, or related to, computing or compiling the information have any liability for any damages of any kind.

Forward-looking statements (if any) are provided to allow potential investors the opportunity to understand management's beliefs and opinions in respect of the future so that they may use such beliefs and opinions as one factor in evaluating an investment. These statements are not a guarantee of future performance and undue reliance should not be placed on them. Such forward-looking statements necessarily involve known and unknown risks and uncertainties, which may cause actual performance and financial results in future periods to differ materially from any projections of future performance or result expressed or implied by such forward-looking statements. Sharekhan/its affiliates undertakes no obligation to update forward-looking statements if circumstances or management's estimates or opinions should change except as required by applicable securities laws. The reader/investors are cautioned not to place undue reliance on forward-looking statements and use their independent judgement before taking any investment decision.

Investment in securities market are subject to market risks, read all the related documents carefully before investing. The securities quoted are for illustration only and are not recommendatory. Registration granted by SEBI, and certification from NISM in no way guarantee performance of the intermediary or provide any assurance of returns to investors.

Client should read the Risk Disclosure Document issued by SEBI & relevant exchanges and the T&C on www.sharekhan.com

Registration and Contact Details: Name of Research Analyst - Sharekhan Limited, Research Analyst Regn No.: INH000006183. CIN): - U99999MH1995PLC087498. Registered Office: The Ruby, 18th Floor, 29 Senapati Bapat Marg, Dadar (West), Mumbai – 400 028, Maharashtra, INDIA. Tel: 022-6115000.

Correspondence/Administrative Office: Gigaplex IT Park, Unit No 1001, 10th Floor, Building No.9, TTC Industrial Area, Digha, Airoli-West, Navi Mumbai – 400 708. Tel: 022 61169000 / 61150000, Fax No. 61169699.

Other registrations of Sharekhan Ltd.: SEBI Regn. Nos.: BSE / NSE / MSEI (CASH / F&O / CD) / MCX - Commodity: INZ000171337; DP: NSDL/CDSL-IN-DP-365-2018; PMS: INP000005786; Mutual Fund: ARN 20669.

Compliance Officer: Ms. Binkle Oza; Tel: 022-62263303; email id: complianceofficer@sharekhan.com

For any complaints/grievance, email us at igc@sharekhan.com or you may even call Customer Service desk on - 022 - 41523200/022 - 69920600