Stock Update

Result Update

Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

L&T Technology Services

Healthy Q2, Guidance intact

IT & ITES	Sharekhan code: LTTS

Reco/View: Buy	↔	CMP: Rs. 5,351	Price Target: Rs. 6,500	↔

↑ 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		↔	

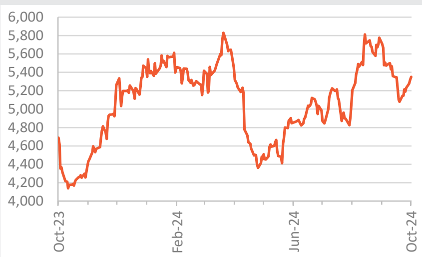
Company details

Market cap:	Rs. 56,629 cr
52-week high/low:	Rs. 5,990/4,107
NSE volume: (No of shares)	2.0 lakh
BSE code:	540115
NSE code:	LTTS
Free float: (No of shares)	2.8 cr

Shareholding (%)

Promoters	73.7
FII	4.5
DII	13.1
Others	8.8

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	-6.2	9.9	0.6	14.1
Relative to Sensex	-4.4	8.9	-11.1	-9.1

Sharekhan Research, Bloomberg

Summary

- Reported revenue stood at $307 million, up 3.4% q-o-q/ up 6.3% y-o-y in constant currency (cc) in line with our estimate.
- EBIT margin declined by ~50 bps q-o-q to 15.1%, missing our estimates of 16.2%.
- Deal wins were steady as company won two $20 million and four $10 million TCV deals along with two significant empanelment agreements in the sustainability vertical.
- Management is confident of broad-based growth continuing in the coming quarters and reaffirmed its FY25 guidance of 8-10% revenue growth in constant currency and aspiration of 16% EBIT margin levels
- We maintain Buy on the stock with unchanged PT of Rs 6,500. At CMP, stock trades at 41.2/35.1/29.3x its FY25/26/27E EPS.

LTTS reported revenue of $307 million, up 3.4% q-o-q/6.3% y-o-y in constant currency (cc), in line with our estimate led by Sustainability and Mobility verticals which grew by ~6.5% and ~5% q-o-q respectively. Revenue in $terms was up 3.9% q-o-q/6.5% y-o-y while revenue in rupee terms stood at Rs 2,573 crore, up 4.5% q-o-q/7.8% y-o-y. EBIT margin fell by ~50 bps q-o-q to 15.1%, missing our estimates of 16.2% owing to investments in sales and technology. Net profit stood at Rs 319.6 crores, up 1.9%q-o-q/1.3% y-o-y missing our estimates of Rs 341 crores. Deal wins were steady as the company won two $20 million and four $10 million TCV deals along with two significant empanelment agreements in Sustainability. Management is confident of broad-based growth continuing in the coming quarters and reaffirmed its FY25 guidance of 8-10% revenue growth in constant currency and aspiration of 16% EBIT margin levels. The company expects EBIT margins to be better in H2FY25 than H1FY25. The company reported a healthy quarter after a weak Q1FY25. Although the ask rate of ~4.5-7.5% CQGR over Q3-Q4 required to achieve revenue growth guidance for FY25 appears daunting, we believe the company is well placed to see incremental uptick in revenue from broad based growth across verticals, ramp up of large deals, strong pipeline, SWC seasonality and milestone payments from Cyber security project in H2FY25. We maintain Buy on the stock with unchanged PT of Rs 6,500. At CMP, the stock trades at 41.2/35.1/29.3x its FY25/26/27E EPS.

Key positives

- Company won two $20 million and four $10 million TCV deals along with two significant empanelment agreements in Sustainability
- Sustainability vertical grew 6.5% q-o-q.
- Attrition (LTM) fell 50 bps q-o-q to 14.3%

Key negatives

- No of Active clients declined to 373 from 378 in Q1FY25
- Hi-tech vertical growth was muted, up 0.8% q-o-q.

Management Commentary

- Management is confident of broad-based growth continuing in the coming quarters and reaffirmed its FY25 guidance of 8% to 10% revenue growth in constant currency and aspiration of 16% EBIT margin levels
- Company reiterated its aspiration to reach $2 billion in revenue with EBIT margin of 17-18% in the medium term.
- Deal pipeline is expanding steadily, with numerous large deals in the $25 to $100 million range, and they expect to close several in Q3 and early Q4
- The company expects EBIT margin to be better in H2FY25 than H1FY25. Company expects Q3 to be a good quarter for Tech as well as for the Sustainability vertical.
- Management to continue improvement efforts on operational levers like offshoring, pyramid optimization, higher productivity using tools and reusable platforms including SG&A optimization.
- Company is confident of absorbing impact of wage hike impact of ~80 bps in Q3FY25. Wage hike to be effective from November.

Revision in estimates – We have fine-tuned our estimates to factor Q2FY25 performance

Our Call

Valuation – Maintain Buy with unchanged price target of Rs. 6,500: LTTS reported a healthy quarter with strong revenue growth while margin performance was muted owing to investments in Sales and Technology. The company is confident of achieving an 8-10% revenue growth and eyes a 16% EBIT margin for FY25. The company expects EBIT margin trajectory in H2FY25 to be better than H1FY25. Although the ask rate of ~4.5-7.5% CQGR over Q3-Q4 required to achieve the revenue growth guidance for FY25 appears daunting, we believe the company is well placed to see incremental uptick in revenue from broad based growth across verticals, ramp up of large deals, strong pipeline, SWC seasonality and milestone payments from cyber-security project in H2FY25. We expect a sales/PAT CAGR of ~13%/14% over FY24-27E. We maintain Buy with unchanged PT of Rs 6,500. At CMP, the stock trades at 41.2/35.1/29.3x its FY25/26/27E EPS.

Key Risks

Rupee appreciation and/or adverse cross-currency movements. The contagion effect of banking crisis, macro headwinds and recession in the US can moderate the pace of technology spending.

Valuation (Consolidated) Rs cr

Particulars	FY24	FY25	FY26E	FY27E
Revenue	9,647.2	10,593.6	12,147.9	13,808.9
OPM (%)	19.9	19.1	19.4	20.1
Adjusted PAT	1,303.6	1,374.5	1,613.0	1,937.4
% y-o-y growth	7.5	5.4	17.3	20.1
Adjusted EPS (Rs.)	123.0	129.9	152.4	182.9
P/E (x)	43.5	41.2	35.1	29.3
P/B (x)	10.6	9.2	7.9	6.8
EV/EBITDA (x)	28.1	26.5	22.6	19.0
RoNW (%)	26.7	23.9	24.1	24.9
RoCE (%)	29.8	26.0	27.0	28.4

Source: Company; Sharekhan estimates

Key result highlights

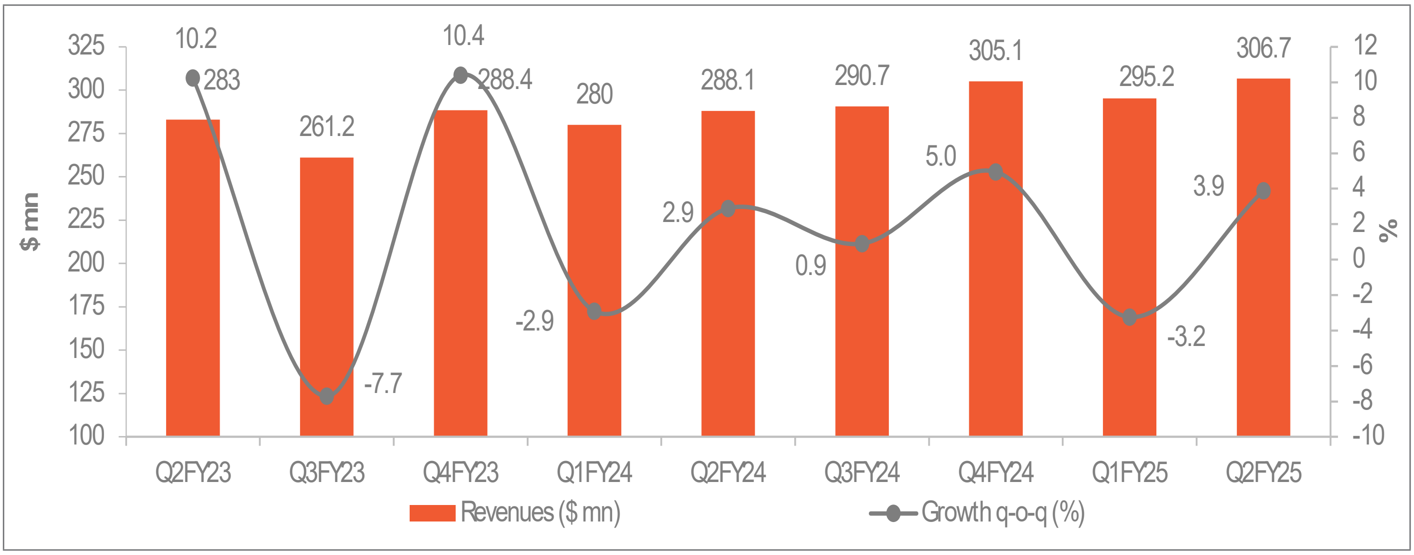
- **Strong revenue growth:** Reported revenue stood at $307 million, up 3.4% q-o-q/6.3% y-o-y in constant currency (cc), in line with our estimate. Revenue in $ terms was up 3.9% q-o-q/6.5% y-o-y while revenue in rupee terms stood at Rs 2,573 crore, up 4.5% q-o-q/7.8% y-o-y. Strong sequential revenue growth was led by Sustainability at 6.5% on the back of earlier large deals and empanelment agreements followed by the mobility which grew by~ 5%. Hi-tech vertical growth was muted, up 0.8% q-o-q.
- **EBIT margin:** Due to investments in sales and technology, the company's SG&A costs as a percentage of revenue rose by 40 basis points sequentially, resulting in an EBIT margin of 15.1%, down ~50 bps q-o-q. The company expects EBIT margin trajectory in H2FY25 to be better than H1FY25. The company aspires for a 16% EBIT margin for FY25.
- **Vertical-wise performance:** Sustainability and Mobility verticals grew 6.5%/4.8% q-o-q respectively while Hitech vertical saw muted growth of 0.8 % q-o-q.
- **Deal wins and pipeline:** LTTS won two $20 million and four $10 million TCV deals along with two significant empanelment agreements in Sustainability. The company's pipeline is expanding steadily, with numerous large deals in the $25 to $100 million range, and they expect to close several in Q3 and early Q4
- **Maharashtra Cyber-security Project:** The project has been launched, with a portion already live, while other parts are set to be completed within the next three to six months. Additionally, there will be an operations and maintenance phase that the company plans to execute over a five-year period. The revenue recognition is tied to the milestones being achieved and the company is on target in terms of achieving the milestones.
- **Client Profile:** On a sequential basis, the client profile improved sequentially in the $30 million+, $20 million+ and $10 million by 1,1 and 2, respectively. Number of active clients declined by 5 q-o-q.
- **Attrition & headcount:** Net addition were 121 taking total headcount to 23,698 while Attrition (LTM) fell 50 bps q-o-q to 14.3%%. Company has planned fresher intake of 2,000 in FY25 which was 1,500 in FY24.

Results (Consolidated) Rs cr

Particulars	Q2FY25	Q2FY24	Q1FY25	y-o-y (%)	q-o-q (%)
Revenues in $(mn)	**307**	**288**	**295**	**6.5**	**3.9**
Revenues In INR	**2,573**	**2,387**	**2,462**	**7.8**	**4.5**
Employee benefit expenses	1,385	1,242	1,332	11.6	4.0
Operating expenses	722	669	674	7.8	7.1
EBITDA	**466**	**476**	**456**	**-2.0**	**2.1**
Depreciation	78	68	73	15.0	7.9
EBIT	**388**	**408**	**384**	**-4.9**	**1.1**
Other income	65	41	62	57.8	4.5
Finance cost	12	13	13	-5.6	-9.2
PBT	**441**	**436**	**433**	**1.1**	**1.9**
Provision for taxation	121	120	119	0.5	1.7
Minority interest	0	-1	0		
Net profit	**320**	**315**	**314**	**1.3**	**1.9**
EPS (Rs)	**30.1**	**29.8**	**29.6**	**1.3**	**1.9**
Margin (%)					
EBITDA	18.1	19.9	18.5	-182	-42
EBIT	15.1	17.1	15.6	-201	-51
NPM	12.4	13.2	12.7	-79	-32
Tax rate	27.4	27.6	27.5	-16	-5

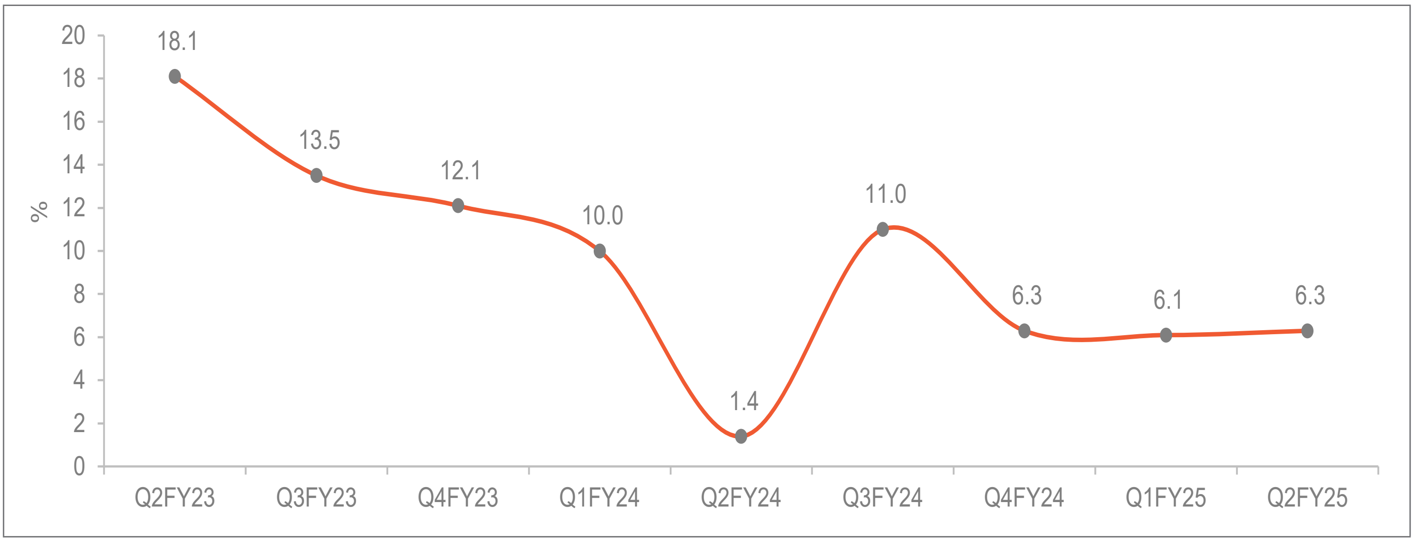
Source: Company, Sharekhan Research

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



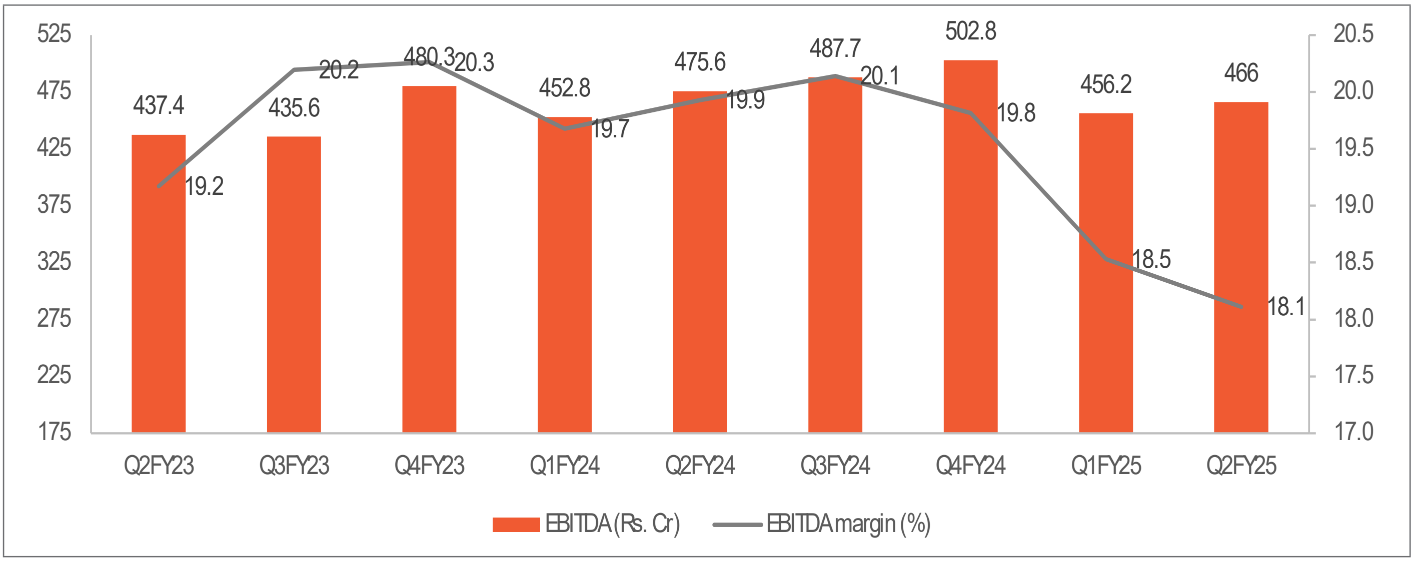
Source: Company; Sharekhan Research

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



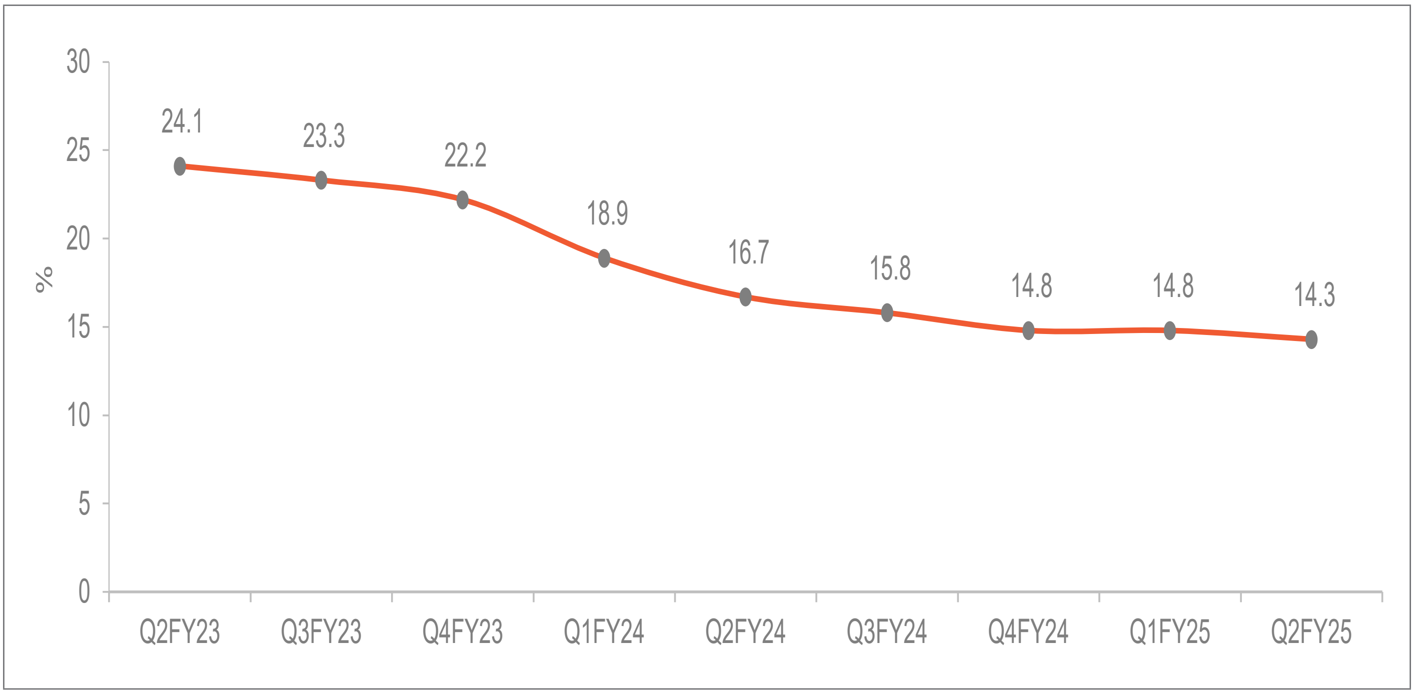
Source: Company; Sharekhan Research

EBITDA margin (%) trend



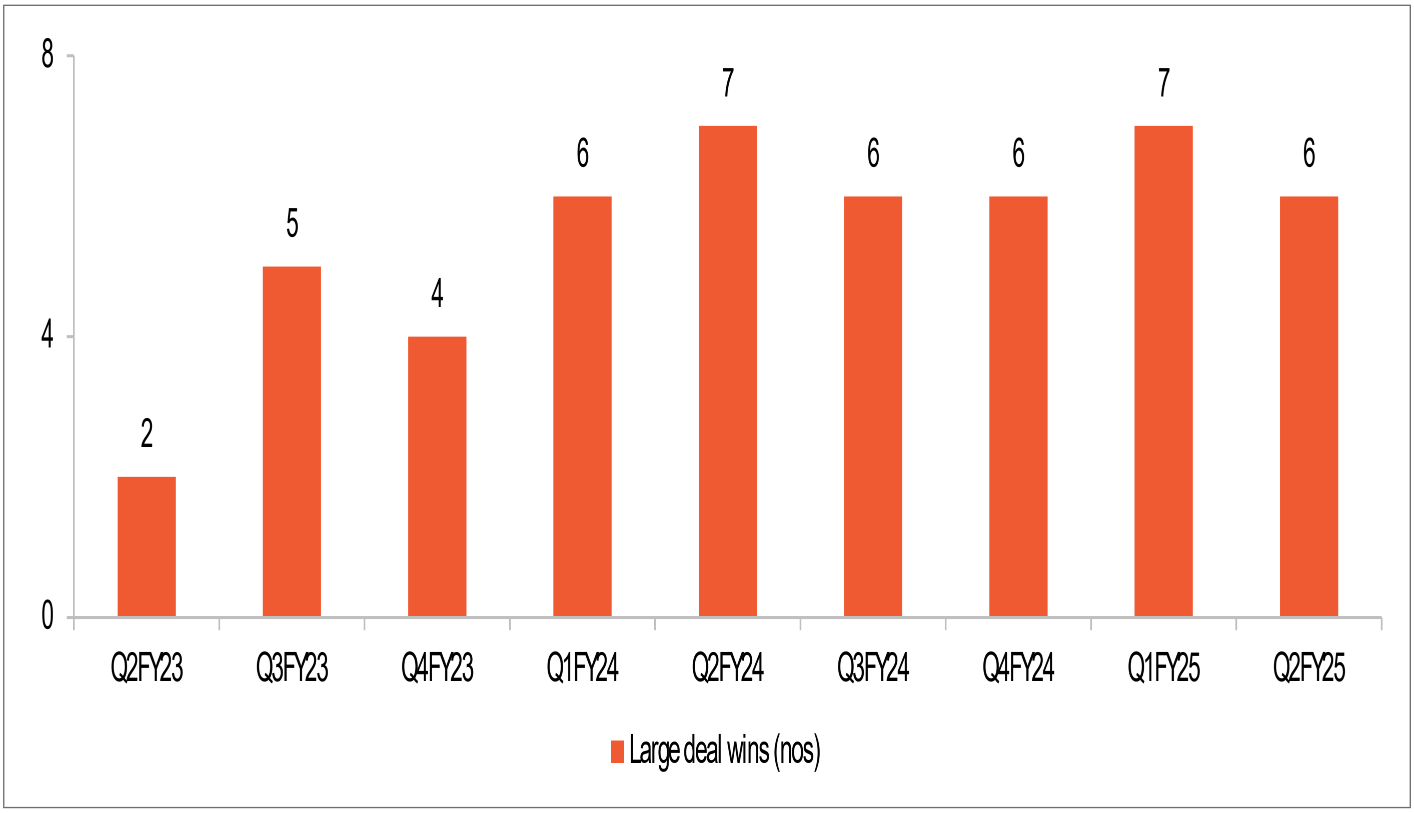
Source: Company; Sharekhan Research

Attrition rate (on LTM basis) trend



Source: Company; Sharekhan Research

Deal wins trend



Source: Company; Sharekhan Research

Outlook and Valuation

■ Sector Outlook – Macro headwinds bottoming out coupled with better earnings visibility

We anticipate growth momentum to return in FY25 aided by lower base coupled with easing sector headwinds. Though, IT sector has already outperformed Nifty last year, we expect overall outperformance in CY24 as well driven by receding headwinds and better earnings visibility.

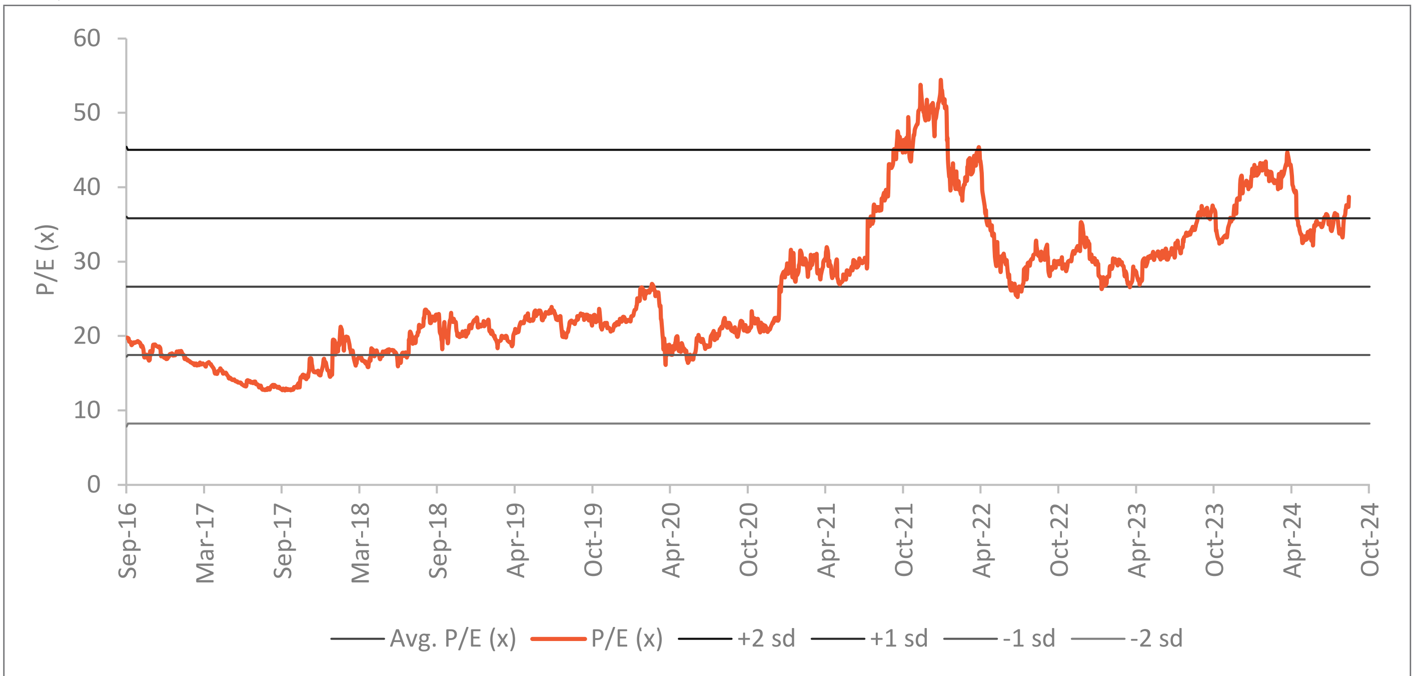
■ Company Outlook – Broad portfolio to support long growth runway

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. Management is confident of broad-based growth continuing in the coming quarters and reaffirmed its FY25 guidance of 8% to 10% revenue growth in constant currency and aspiration of 16% EBIT margin levels.

■ Valuation – Maintain Buy with unchanged price target of Rs. 6,500

LTTS reported a healthy quarter with strong revenue growth while margin performance was muted owing to investments in Sales and Technology. The company is confident of achieving an 8-10% revenue growth and eyes a 16% EBIT margin for FY25. The company expects EBIT margin trajectory in H2FY25 to be better than H1FY25. Although the ask rate of ~4.5-7.5% CQGR over Q3-Q4 required to achieve the revenue growth guidance for FY25 appears daunting, we believe the company is well placed to see incremental uptick in revenue from broad based growth across verticals, ramp up of large deals, strong pipeline, SWC seasonality and milestone payments from cyber-security project in H2FY25. We expect a sales/PAT CAGR of ~13%/14% over FY24-27E. We maintain Buy with unchanged PT of Rs 6,500. At CMP, the stock trades at 41.2/35.1/29.3x its FY25/26/27E EPS.

One-year forward P/E (x) band



Source: 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

1) Rupee appreciation and/or adverse cross-currency movements, and 2) Contagion effect of banking crisis, macro headwinds and recession in the US can 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 Website

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Life Insurance Corp of India	6.79
2	SBI Funds Management Ltd	1.81
3	SEAFARER OVERSEAS GROWTH & INC F	1.45
4	Seafarer Capital Partners LLC	1.45
5	Vanguard Group Inc/The	0.96
6	Axis Asset Management Co Ltd/India	0.49
7	Motilal Oswal Asset Management Co	0.41
8	NJ ASSET MANAGEMENT PVT INDIA	0.3
9	Norges Bank	0.29
10	PGIM India Asset Management Pvt Lt	0.23

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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