

23<sup>rd</sup> January 2023

CMP – ₹3,232/-

View – **ACCUMULATE**

### Q3FY23 Result Highlights

- **Flat QoQ revenue growth with higher than expected furlough** – L&T Technology Services Ltd (LTTS) reported sequential revenue growth of 0.4% QoQ & 10.2% YoY (flat QoQ & +13.5% YoY in CC terms) to US\$ 248mn, attributed to higher-than-expected furloughs in the plant engineering vertical. Apart from plant engineering, the hi-tech and medical devices verticals declined QoQ, while the transportation vertical grew at a healthy pace, aided by the ramp-up of large deals. Top-5 clients' revenue declined 0.1% QoQ (US\$ terms). EBIT margin improved by 51 bps QoQ to 18.7% led by higher offshore mix and rupee depreciation, offset to some extent by higher SG&A costs. Net profit stood at ₹3.04bn, up 7.5% QoQ and 22% YoY. While Q3FY23 was expected to be weaker, QoQ revenue declines in three verticals (plant engineering; telecom and hi-tech; and medical devices) and sub-1% growth in industrial products among verticals and revenue decline in top-5 and non-top-20 clients indicate pressure on discretionary spends. Transportation has been the sole bright spot, with healthy growth being aided by earlier deal wins and continued spends EACV. ERD is more vulnerable to a rationalisation in spends in a slowdown environment.
- **FY23 revenue growth guidance lowered** – The company expects to return to growth in Q4FY23, aided by the absence of furloughs that impacted plant engineering revenue and the ramp-up of large deal wins in Q3FY23. This is despite the persisting weakness in the hi-tech business through FY23. Within independent software vendor (ISV) and consumer electronics, the company indicated client-specific weakness impacting growth. Overall, management lowered its organic revenue growth guidance for FY23 to 15% from 15.5-16.5%. The company retained its aspiration of US\$1.5 bn annualized revenue by FY25, including SWC.
- **Airbus empanelment to further drive growth in transportation vertical** – LTTS announced the expansion of partnership with Airbus, with the company now being empaneled as strategic engineering partner. The engagement is a multi-year contract to provide digital manufacturing services and advanced engineering capabilities to Airbus and its Indian subsidiary. LTTS will support Airbus' Numerical Control Programming (NCP) cluster, which includes composite production, trimming & cutting, standard machining, advanced machining, drilling & riveting, control & metrology, fast shop machining and technical support. The company indicated increasing spends in aerospace with the restart of design cycle for next-gen smaller/single-aisle aircraft with focus on structures and avionics. The design cycles generally last for 7-10 years. Further, electrification from mechanical components is another emerging opportunity, albeit with a relatively shorter time frame (5 years).
- **EBIT margin to return to 18% range by 1HFY26 post Smart World & Communication(SWC) acquisition from L&T** – For the core business, LTTS' EBIT margin is expected to remain in the 18-18.5% range over the medium term, aided by increased offshore revenue mix to 60% range (from 57% in Q3FY23) and increasing fresher hiring in the overall mix. Management expects 180-200 bps impact on combined EBIT margin in Q1FY24 due to lower margin profile of SWC (8-10% range), amortization of acquisition-related intangibles and investments required to pivot the business toward managed services model.

### Important Statistics

<b>M.CAP (₹ bn)</b>	₹341.3
<b>52 Week H/L (₹)</b>	5,660/2,923
<b>NSE Code</b>	LTTS
<b>BSE Code</b>	540115

Shareholding Pattern	Dec'22 (%)
<b>Promoters</b>	73.9
<b>DII's</b>	7.9
<b>FII's</b>	7.2
<b>Public &amp; Others</b>	11.0

### FINANCIALS

Particulars	FY20	FY21	FY22
<b>Revenue</b>	<b>56,192</b>	<b>54,497</b>	<b>65,697</b>
<b>EBIT</b>	<b>9,276</b>	<b>7,891</b>	<b>12,005</b>
<b>EBIT Margin (%)</b>	<b>19.8</b>	<b>14.5</b>	<b>18.3</b>
<b>Net Profit</b>	<b>8,186</b>	<b>6,634</b>	<b>9,606</b>
EPS (₹)	77.9	63.1	91.1
DPS (₹)	21.0	22.0	35.0
RoE (%)	32.2	21.2	25.0
RoCE (%)	42.2	16.2	20.3
P/E (x)	119.8	51.2	35.5
P/BV (x)	12.3	9.8	8.2
EV/EBITDA (x)	29.7	32.0	22.8

Particulars	FY23E	FY24E	FY25E
<b>Revenue</b>	<b>79,886</b>	<b>94,776</b>	<b>108,984</b>
<b>EBIT</b>	<b>14,718</b>	<b>15,981</b>	<b>18,589</b>
<b>EBIT Margin (%)</b>	<b>18.4</b>	<b>16.9</b>	<b>17.1</b>
<b>Net Profit</b>	<b>11,876</b>	<b>12,987</b>	<b>14,985</b>
EPS (₹)	112.6	123.1	142.0
DPS (₹)	30.0	35.0	40.0
RoE (%)	25.2	23.3	23.1
RoCE (%)	27.7	25.9	26.2
P/E (x)	28.7	26.3	22.8
P/BV (x)	6.9	5.8	4.9
EV/EBITDA (x)	18.5	17.3	14.7

Source: Company, Way2Wealth

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- **Smart World & Communication(SWC) Acquisition to address gaps in communication and sustainability practices** – SWC was founded in 2016 and primarily operates across 3 segments – (1) communications (74% of revenue), (2) safe & smart solutions (25% of revenue), and (3) cyber security (1% of revenue). Over the past 6 years, SWC primarily engaged with Indian state and central government entities to provide design, implementation, monitoring, modernization & cloud-based network management solutions with track record of implementing large-scale projects for cities, utilities, and government entities. Within communications, SWC has end-to-end capabilities in network design, architecture, implementation, monitoring, modernization and network management, and Operations Support Services (OSS). The business had revenue of ₹10.98bn with 700 employees, implying RPP of ₹15.7mn (US\$191K/employee) implying pass-through component. The revenues were entirely derived from India. LTTS will acquire the business for a consideration of ₹8bn in cash, implying 7-9x FY22 EV/EBITDA. The acquisition is expected to close by end of Mar'23.
- LTTS expected demand from its existing enterprise clients for Security Operating Centers (SOC), Network Operations Center (NOC), private 5G and localised data centers, where the competition is fragmented while client tech-spends are increasing and expects synergies from cross-sell of SWC capabilities. The management highlighted that 55 of its top-100 clients expressed interest in the expanded offering. Within telecom clients, management expects to benefit from improved scale of the business (+US\$160 mn annual revenue from telecom post acquisition, including US\$100 mn contribution from SWC) to gain share of network engineering spends and also track-record of executing larger deals. While the combined offering growth is expected to be ahead of the company average, LTTS's organic telecom business is expected to grow at a healthy pace, while SWC growth is expected to be slightly lower due to pivot in business model toward managed services. The combined portfolio is expected to be largely services-led and management expects to transform its positioning from master systems integrator to a master software solutions provider in the domain. The company expects to leverage SWC capabilities to engage with clients in its existing geo footprint by leveraging direct sales and partner network. Further, it expects to triple the scale of its cyber security practice, US\$10mn currently for LTTS+SWC, in the next two years. Leadership teams of both companies plan for joint delivery and GTM. Integration process expected to last over next six months, focused on (1) top-line, (2) service line, (3) technology road-map, (4) enabling functions, (5) bottom-line, and (6) working capital and cash flows.
- **Cautiously optimistic on demand** – Cautiously optimistic on demand with the pipeline at healthy levels and five +US\$10 mn deals signed in Q3FY23. However, softening macro and client-specific weaknesses would have an impact on overall demand. **Transportation** –Expect healthy spends from clients, with new programs being initiated across subsegments – auto, aero and truck & off-highway. While there were no +US\$10 mn deals, several +US\$5 mn deal wins are an indicator of demand strength. EACV continues to be a key trend in the auto subsegment and are likely to be key growth driver going forward. **Industrial Products** –Q3FY23 growth was driven by electrical machinery, power & utilities subsegments. The company announced 3 +US\$10 mn deals in the vertical. The company sees demand in digital manufacturing to support automation and software development programs, which, in turn, are expected to be converted into annuity contracts. **Telecom & Hi-tech**– Weakness in ISV, consumer electronics and semi-conductor clients were a drag on growth in the vertical. However, better spends in 5G, network engineering and cyber security

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within telecom and strength in media & entertainment partially offset the impact. Cost-takeout deals in the pipeline should aid growth in the future quarters. The vertical is expected to recover gradually, with recovery in hi-tech, consumer electronics and semi-conductor clients expected in Q1FY24. **Medical devices** – The deferral in customers' tech spends impacted the vertical's performance in Q3FY23. Management expects return to growth in Q4FY23, driven by the ramp-up of a large deal won in the quarter and strength of pipeline.

- **DSO** – Receivable days decreased by 1 day QoQ to 77 days, while including unbilled, receivable days stood at 94 days, down 2 days QoQ and within the company's target range of 95 days. **Healthy cash conversion** -CFO/PAT was at 134.8% and FCF/PAT was healthy at 123.4%.

## View

The company posted weak revenue Q3FY23 performance impacted by higher-than-expected furloughs in the plant engineering vertical and weakness in the telecom & hi-tech vertical, resulting in a guidance cut. With organic US\$ revenue growth now expected at 15% for FY24, LTTS is likely to underperform pure-play Indian ER&D services peers (ex-Cyient) and also larger peers such as HCL Tech. Key positives for the quarter include (1) five deals of +USD 10mn deals booked in Q3FY23 as compared to eight deals in 1HFY23; (2) traction in the transportation vertical, also supplemented by empanelment from Airbus as a strategic partner, which will augment growth in the vertical; and (3) recovery in the plant engineering vertical in Q4FY23, aided by a strong pipeline. The key strategic imperatives for the company are now integration of Smart World & Communication (SWC) acquisition, which can increase its deal pipeline in the telecom & hi-tech vertical. While FY23 revenue growth guidance was cut to 15% CC (from 15.5-16.5% CC), the medium-term outlook was maintained at US\$ 1.5bn revenue run rate by FY25 (implying 3.4% CQGR post-SWC consolidation in Q1FY24) which we estimate in the range of US\$ 1.4-1.5bn. The overall ERD segment will take a bigger hit in a slowing economic environment. ***We continue to maintain our ACCUMULATE stance with the stock trading at P/E 22.8x FY25E EPS ₹142.***

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**FINANCIAL PERFORMANCE**
**Vertical-Mix Revenues (%)**

Verticals	Q1 FY20	Q2 FY20	Q3 FY20	Q4 FY20	Q1 FY21	Q2 FY21	Q3 FY21	Q4 FY21	Q1 FY22	Q2 FY22	Q3 FY22	Q4 FY22	Q1 FY23	Q2 FY23	Q3 FY23
Transportation	34.9	35.0	35.8	35.7	31.5	31.5	30.4	31.2	31.2	31.4	31.8	33.3	33.2	34.5	35.9
Industrial Products	19.6	19.4	19.2	19.4	19.4	19.5	19.3	18.9	19.5	20.0	19.5	18.8	19.0	18.9	19.0
Telecom & Hi-tech	22.2	20.6	18.4	18.7	22.4	21.4	22.9	22.1	22.0	21.1	21.4	21.0	20.3	19.4	18.8
Plant &Process Industry	15.3	16.2	17.2	16	13.8	14.4	14.7	15.5	15.5	15.3	15.4	15.4	16.0	16.3	15.5
Medical Devices	8.0	8.8	9.4	10.3	12.8	13.2	12.7	12.3	11.7	12.2	11.9	11.5	11.5	10.9	10.7

Source: Company, Way2Wealth

**Geography-wise Break up (%)**

Region	Q1 FY20	Q2 FY20	Q3 FY20	Q4 FY20	Q1 FY21	Q2 FY21	Q3 FY21	Q4 FY21	Q1 FY22	Q2 FY22	Q3 FY22	Q4 FY22	Q1 FY23	Q2 FY23	Q3 FY23
North America	60.9	61.7	61.2	61.2	61.2	60.0	61.2	61.5	62.3	62.9	62.5	62.3	62.9	63.4	62.7
Europe	15.6	14.4	14.1	16.7	16.0	16.0	16.1	16.7	16.8	16.7	16.5	16.1	16.4	15.9	16.1
India	12.8	13.1	13.2	12.8	13.0	13.6	13.9	13.1	12.9	13.0	13.7	14.5	13.2	12.8	13.6
Rest of the World	10.7	10.7	11.4	9.2	9.8	10.4	8.8	8.8	8.0	7.4	7.4	7.0	7.4	7.9	7.6

Source: Company, Way2Wealth

**Client Composition (%)**

Clients	Q1 FY20	Q2 FY20	Q3 FY20	Q4 FY20	Q1 FY21	Q2 FY21	Q3 FY21	Q4 FY21	Q1 FY22	Q2 FY22	Q3 FY22	Q4 FY22	Q1 FY23	Q2 FY23	Q3FY 23
Top 5	24.7	22.9	21.1	19.2	17.8	17.0	16.3	16.1	16.4	17.0	17.3	17.2	16.7	16.4	16.0
Top 10	36.7	35.7	33.9	31.8	29.7	28.3	27.3	26.9	27.4	28.2	28.5	28.3	27.6	26.9	26.6
Top 20	52.5	51.3	49.8	48.5	46.8	44.9	44.0	43.8	43.9	44.1	43.8	43.5	43.2	42.4	42.1
Beyond top 20	47.5	48.7	50.2	51.5	53.2	55.1	56.0	56.2	56.1	55.9	56.2	56.5	56.8	57.6	57.9

Source: Company, Way2Wealth

Client data	Q1 FY20	Q2 FY20	Q3 FY20	Q4 FY20	Q1 FY21	Q2 FY21	Q3 FY21	Q4 FY21	Q1 FY22	Q2 FY22	Q3 FY22	Q4 FY22	Q1 FY23	Q2 FY23	Q3 FY23
Number of Active Clients	258	258	265	270	270	283	296	306	305	314	318	324	337	343	343
More than 50m USD	1	1		-	-	-	-	-	-	-	-	-	-	-	-
More than 30 mn USD	3	3	3	2	1	1	1	-	-	1	2	2	2	3	2
More than 20 mn USD	5	5	7	8	4	5	4	3	5	6	6	6	7	8	8
More than 10 mn USD	17	17	20	21	22	20	18	20	20	21	22	22	23	24	25
More than 5 mn USD	44	44	43	43	43	44	41	39	43	45	44	48	51	49	50
More than 1 mn USD	110	110	107	113	113	116	118	122	122	125	126	236	142	150	158

Source: Company, Way2Wealth

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Revenue by Project Type (%)	Q1 FY20	Q2 FY20	Q3 FY20	Q4 FY20	Q1 FY21	Q2 FY21	Q3 FY21	Q4 FY21	Q1 FY22	Q2 FY22	Q3 FY22	Q4 FY22	Q1 FY23	Q2 FY23	Q3 FY23
Fixed Price	42.4	41.8	42.7	38.6	38.5	39.7	38.5	36.5	33.8	30.0	29.0	28.6	26.9	27.0	28.6
Time and Material Contract	57.6	58.2	57.3	61.4	61.5	60.3	61.5	63.9	66.2	70.0	71.0	71.4	73.1	73.0	71.4
Revenue Mix (%)															
Onsite	44.3	43.8	44	47.1	48.3	45.1	42.9	42.1	41.9	40.8	41.3	45.4	43.8	45.1	43.0
Offshore	55.7	56.2	56	52.9	51.7	54.9	57.1	57.9	58.1	59.2	58.7	54.6	56.2	54.9	57.0
Utilization (%) including Trainees															
	79.6	77.8	79.2	78.1	70.9	75.4	77.5	78.9	79.2	78.1	75.9	75.1	NA	NA	NA

Source: Company, Way2Wealth

Employee Statistics	Q1 FY20	Q2 FY20	Q3 FY20	Q4 FY20	Q1 FY21	Q2 FY21	Q3 FY21	Q4 FY21	Q1 FY22	Q2 FY22	Q3 FY22	Q4 FY22	Q1 FY23	Q2 FY23	Q3 FY23
Total Headcount	15,913	16,789	16,787	16,883	16,641	15,902	16,069	16,452	16,972	17,983	20,118	20,861	21,433	21,474	21,649
Billable	14,755	15,614	15,604	15,667	15,481	14,778	14,975	15,335	15,896	16,875	18,975	19,534	20,082	20,189	20,346
Sales & Support	1,158	1,175	1,183	1,216	1,160	1,124	1,094	1,117	1,076	1,108	1,143	1,327	1,351	1,285	1,303
Voluntary Attrition%(LTM)	15.8	13.4	13.9	13.8	11.4	10.8	10.7	12.2	14.5	16.5	17.5	20.4	23.2	24.1	23.3
Net Addition	773	876	-2	96	-242	-739	167	383	520	1,011	2,135	743	572	41	175

Source: Company, Way2Wealth

### Q3FY23 & 9MFY23 Performance

Particulars	Q3FY23	Q3FY22	YoY (%)	Q2FY23	QoQ (%)	9MFY23	9MFY22	YoY (%)
Revenue (US\$ mn)	248	225	10.2	247	0.4	735	648	13.3
Revenue	20,486	16,875	21.4	19,951	2.7	59,174	48,136	22.9
EBIT	3,829	3,144	21.8	3,628	5.5	10,891	8,731	24.7
EBIT Margin (%)	18.7	18.6	6	18.2	51	18.4	18.1	27
Net profit	3,036	2,488	22.0	2,824	7.5	8,602	6,950	23.8
EPS (₹)	28.8	23.6	22.0	26.8	7.5	81.5	66.1	23.3

Source: Company, Way2Wealth

### FINANCIALS & VALUATIONS

Particulars	FY19	FY20	FY21	FY22	FY23E	FY24E	FY25E
Revenue	50,783	56,192	54,497	65,697	79,886	94,776	108,984
EBIT	8,803	9,276	7,891	12,005	14,718	15,981	18,589
EBIT Margin (%)	15.9	19.8	14.5	18.3	18.4	16.9	17.1
Net Profit	7,684	2,836	6,634	9,606	11,876	12,987	14,985
EPS (₹)	73.1	27.0	63.1	91.1	112.6	123.1	142.0
DPS (₹)	21.0	21.0	22.0	35.0	30.0	35.0	40.0
RoE (%)	34.8	32.2	21.2	25.0	25.2	23.3	23.1
RoCE (%)	45.2	42.2	16.2	20.3	27.7	25.9	26.2
P/E (x)	44.2	119.8	51.2	35.5	28.7	26.3	22.8
P/BV (x)	13.7	12.3	9.8	8.2	6.9	5.8	4.9
EV/EBITDA(x)	35.8	29.7	32.0	22.8	18.5	17.3	14.7
Cash Balances	2,051	2,440	2,327	6,742	9,786	4,148	9,651
FCFF	6,492	4,141	11,917	8,610	6,718	(2,067)	10,118

Source: Company, Way2Wealth



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### Disclosure of Interest Statement L&T Technology Services Ltd. (LTTS) as on 23<sup>rd</sup> January 2023

Name of the Security	L&T Technology Services Ltd. (LTTS)
Name of the analyst	Jayakanth Kasthuri
Analysts' ownership of any stock related to the information contained	NIL
Financial Interest	
Analyst :	No
Analyst's Relative : Yes / No	Yes (5 shares)
Date of Buying	18 <sup>th</sup> June 2020
Analyst's Associate/Firm : Yes/No	No
Conflict of Interest	No
Receipt of Compensation	No
Way2Wealth ownership of any stock related to the information contained	NIL
Broking relationship with company covered	NIL
Investment Banking relationship with company covered	NIL

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