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National Stock Exchange of India Limited
Exchange Plaza, Bandra-Kurla Complex
Bandra (East), Mumbai – 400 051.
NSE Symbol: LTTS

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Phiroze Jeejeebhoy Towers,
Dalal Street, Mumbai- 400001
BSE Script Code: 540115

Subject: Transcript of Earnings Conference Call for L&T Technology Services Limited (LTTS) for quarter ended December 31,2020

Dear Sirs,

Please find attached the transcript of Earnings Conference Call organized by the Company on January 20, 2021 for the quarter ended December 31, 2020 for your information and records.

Thanking You,

Yours sincerely,
For L&T Technology Services Limited

Kapil Bhalla

Kapil Bhalla
Company Secretary
FCS.3485

Encl: As above

L&T Technology Services
Q3 FY21 Earnings Conference Call Transcript

January 20, 2021, 20:30hrs IST

MANAGEMENT: **DR. KESHAB PANDA – CEO,**
MR. AMIT CHADHA – DEPUTY CEO,
MR. ABHISHEK – COO,
MR. RAJEEV GUPTA – CFO,
MR. PINKU PAPPAN – HEAD, INVESTOR RELATIONS

Moderator: Good day and welcome to the L&T Technology Services Q3 FY 2021 Earnings Conference Call. As a reminder, all participant lines will be in the listen-only mode. And there will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during this call, please signal an operator by pressing '*' and then '0' on your touchtone phone. Please note that this conference is being recorded. I now hand the conference over to Mr. Pinku Pappan – Head of Investor Relations. Thank you and over to you, sir.

Pinku Pappan: Welcome to the Quarter 3 FY21 Earnings Call of LTTS. I am Pinku, heading Investor Relations. To those of you who have joined from India, thank you for participating at this late hour. We apologize for having to hold the call at this time. Our financial results, investor release and press release have been filed on the stock exchanges and are also available on our website, www.ltts.com. I hope you have had a chance to go through them.

This call is for 60 minutes. We will try to wrap the management remarks in 25 minutes and then open up for Q&A. The audio of this call will be available for replay on our website approximately one hour after the call ends.

Let me introduce the leadership team present on this call. We have Keshab Panda – CEO, Amit Chadha – Deputy CEO, Abhishek – COO, and Rajeev Gupta – CFO. We will begin with Dr. Panda providing an overview of the company performance and outlook. Amit will talk about the verticals and the deal pipeline, followed by Abhishek, with an update on operations. And finally, Rajeev will walk you through the financial statements.

Let me now turn the call over to Dr. Panda.

Keshab Panda: Thank you, Pinku. And thank you all for joining this call today. I wish you all a very Happy New Year and hope you are all keeping safe and well.

I will talk briefly about our performance in the quarter and the outlook. We grew revenues by 6.8% quarter-on-quarter with broad-based growth across all our segments. Three of our verticals - Industrial Products, Plant Engineering, and Telecom & Hi-Tech, grew in excess of 5% sequentially.

Our operational performance was also good. The EBIT margin expanded 150 basis points quarter-on-quarter to 15.2% - again in line with what we had guided in Q1 that we will see a sequential margin improvement from Q2 to Q4. Free cash flow generation continues to be robust with our DSO remaining with a narrow band.

Last quarter was significant for us in terms of large deal wins. We had our highest order bookings ever, helped by a $100 million-plus O&G deal we signed. We won total of seven deals greater than $10 million.

Coming to the **guidance**: The deal pipeline is healthy, and we see sequential growth continuing across all the segments like this quarter. We hope to cross the Q4 FY20 revenue mark in Q4 of FY21. We raised our FY21 revenue guidance; we now expect a USD revenue decline of around 6.5%.

The digital engineering opportunity is large in each of our segments, we are leveraging new-age and digital technologies, which are about 50% of our revenues to gain competitive differentiation and market share. I am happy to share with you that Zinnov rated LTTS as a leader, not only in the conventional ER&D, but in newer areas like digital engineering, IoT, AI, and digital thread which forms the backbone of new product development today.

Before I close, let me touch upon the transition. We announced last quarter that from 1st April, Amit will step in as CEO. I have been helping Amit transition into the CEO role, and he will provide the update on our vertical performance in addition to large deals pipeline we have.

As I look back at the last 11 years, building this company has been my biggest passion. And I would like to thank all the employees of the company and the people who have worked with me for having shared the same passion. I also want to take this opportunity to thank the investor community during the last five years for your patience in understanding the engineering services business and for supporting and encouraging LTTS in all the way.

I have strong conviction that this is just the beginning of our journey, and the next set of leaders will take the company to greater heights. I will always be available to assist and guide the leadership team whenever required.

Thank you, once again. And I now hand over to Amit.

Amit Chadha: Sure. Thank you, Dr. Panda. I wish you all a very healthy and Happy New Year. I will talk about the demand outlook and large deal pipeline at each of our five verticals.

Starting with **Transportation**: we had a sequential growth of 3.1% with all three sub-segments, Aero, Auto, and Trucks & Off Highway growing. Aero turned the corner in quarter three, growing sequentially in line with what we had talked in quarter two. Growth was led by the defense part, while the outlook in commercial Aero is still challenged. We see consolidation and product software opportunities here.

Within Transportation, the auto segment had a bit of a soft quarter in Q3 on account of seasonality. The spending continues to rise in electric, autonomous, and connected vehicles space. We signed up with a few new-age EV logos for some very interesting work involving both electric and autonomous vehicles.

In T&OH, the opportunity continues to be in localization, value engineering, and electrification.

For Transportation overall, we won three deals greater than $10 million in Q3, and we see multiple deals in the pipeline - consolidation opportunities in some cases, and others in the autonomous and EV space. We see the momentum of Transportation picking up as we head into Q1 of next fiscal.

Moving on to **Plant Engineering**: we had a good quarter with 9.2% quarter-on-quarter growth with the momentum strengthening versus the previous quarter. In FMCG and chemicals, we see traction in the areas of EPCM services relating to brownfield expansion, low-cost automation of plants, and discussions around sustainability. In the O&G segment, companies are looking to increase reliability and performance and want to leverage digital technologies to achieve the same.

Talking about large deals, you are aware of the $100 million deal in Q3 we got from an oil and gas major. We see large deal potentials with others in oil and gas as well as chemical sector through the Engineering Value Center (EVC) model. The growth momentum will continue in Plant Engineering, with opportunities in the pipeline as well as the ramp-up of the $100 million deal, which will start in the February/March timeframe.

Now on to **Industrial Products**: this is another segment where the momentum improved from Q2 to Q3. We had growth of 5% plus quarter-on-quarter in Q3.

Demand was driven by digital - in creating smart products, value engineering of existing products, and productivity improvement initiatives on the shop floor. We are setting up specialized labs to create solutions in areas like cyber-security and test automation for our customers. The sustainability trend is driving more spend towards alternative energy sources like wind and solar, and we are leveraging our domain and technical strength to assist with the technology framework and optimization in this area.

We signed three large deals in IP in Q3, and we see additional deals in the pipeline in the digital space, which gives us confidence about growth continuing in Industrial Products.

On to **Telecom & Hi-Tech**: we saw growth recover in Q3, in line with what we had guided in Q2. The Q3 number also includes the Orchestra acquisition. So overall growth in Telecom & Hi-Tech was 14% quarter-on-quarter, of which, organic growth was 3.7%.

In semi or semiconductor, we are seeing an improvement in the deal pipeline driven by spend towards new generation chips that leverage 5G and AI, giving us opportunities in design, chip verification, network interoperability, etc.

In media, there is traction in design of software for applications and media devices, using technologies like RDK, Android, as well as consolidation opportunities in the legacy product maintenance area.

In Telecom, with the help of Orchestra, we are participating in network virtualization and 5G-related activities.

Coming to large deals, we won one large deal with a net new client in the Telecom & Hi-Tech area in Q3, and we are working with a few large deals in the 5G space in Telecom and semiconductor. Overall, we see growth continuing and expect the momentum to increase pace by Q1 with the conversion of some of the large deals in the pipeline.

Lastly, **Medical**: we had a soft quarter of 2.4% quarter-on-quarter. There was some caution in spending as elective surgeries got pushed back yet again because of resurgence of COVID cases in the U.S. The outlook remains positive, however, with opportunities in digital product design, digital manufacturing, and regulatory compliance.

New growth areas for us are in the areas of precision medicine, population health management and telehealth. We won two large deals here in Q3. One was a $25 million-plus vendor consolidation deal with a prominent OEM, which will help us expand our existing engagement to multiple geos. We see good deals in the pipeline and expect growth to bounce back in Q4 and beyond.

To summarize, Q3 saw us sign TCV which was double of the previous quarter, driven by the $100 million deal as well as others that we signed. We are seeing a continuous flow of deals with speed of decision-making close to pre-COVID levels. We, however, are watchful about the lockdowns in Europe and Japan. And though we have not seen any impact so far, there could be a slowdown in decision-making in the current quarter. That said, our deal pipeline has grown sequentially over the previous quarter. We expect this to help us continue the growth momentum.

Before I close, on behalf of the employees of LTTS, executive management and I personally would like to thank Dr. Panda for his leadership and guidance. Some of us, like myself, having worked with him for more than two decades, others have worked about more than a decade with him, have always been inspired by his drive and motivation to take LTTS to the top.

When we started this journey in 2009, IT was a known industry and Engineering services was a possibility. Dr. Panda, under your leadership, LTTS has today emerged as the largest pure-play engineering services company based in India. We congratulate and thank you for your guidance, and we look forward to continuing the journey under your guidance. Thank you so much, again.

I now would like to hand over to Abhi.

Abhishek Sinha: Thank you, Amit. Greetings and a very Happy New Year to everyone. It has been three full quarters since we have been managing business with the pandemic, and I would like to provide an update on some of the initiatives and progress on the Operations front.

Firstly, let me talk about training and up-skilling, which is an area where we have made very good progress. We had invested in setting up a Global Engineering Academy three quarters back, with a vision to provide deep technical training and certifications in line with our customer needs. We couldn't have thought of a better and more timely investment. As a result, we have been able to provide cross-skilling and up-skilling to over 9,000 employees, which in turn helped us grow the business in the digital and leading-edge technologists faster.

Another area I want to highlight is our focus on design labs. We continue to invest in technology solutions for and with our clients. One such investment done helped us get enrolled as the only India-based service provider, and one of the six globally authorized partners in the world to support Amazon, Alexa Voice Service integration for connected devices, spanning multiple domains and industries. Another example of investing along with our clients is the opening of a Hub development center - to provide our auto customer DRiV - support in developing intelligent next generation solutions.

As you know, we leverage our labs to win new business. We also have an in-house asset management portal where we keep building an inventory of reusable assets, which have seen good traction in the last few quarters. Many of our engineering labs have been enabled to be demo-ed virtually to our global customers without them having to physically visit our development centers.

Now let me shift gears to discuss Utilization. We have improved this metric over the past two quarters, going from 71% in Q1 to 75% in Q2, and then to 77.5% in Q3, which has been one of the primary levers for the EBIT margin improvement. We are also keeping a close watch on attrition, which at 10.7% YTD is the lowest level in the past few years.

Finally, on Work From Anywhere or what we like to call WFX. Our employees have been getting back to office since June 2020 in a gradual way. Today, around 66% or two-third of our employees in India are working from office at least once a week. Through our trademarked Omni-Opus WFX methodology, we have trained and WFX-certified more than 200 of our project and program managers in areas like productivity management, team morale management, customer trust enhancement, and security, which are essential in today's times.

So to summarize, we have tried to adapt to these challenging times and become operationally more resilient. We will share the progress with you as we move forward. I would now like to hand it over to Rajeev.

Rajeev Gupta: Thanks, Abhi. Good evening to all of you and wish you a very Happy New Year. Let me walk you through our Q3 FY21 financials, starting with the P&L.

Our revenue for the quarter was Rs. 1,401 crores, growth of 6.6% on a sequential basis. We had a second consecutive quarter of margin improvement with EBIT margin rising by 150 basis points to 15.2%. The improvement was driven by a combination of higher Utilization, improvement in offshore revenue mix, and better operational efficiency, partly offset by reinstatement of variable pay in full and higher subcontracting costs. While the margin improvement at the EBITDA level was 200 basis points, there was an additional 50 basis points impact at the EBIT level due to amortization on account of Orchestra Technologies acquisition starting from Q3. This explains EBIT margin improvement of 150 basis points on a sequential basis.

Moving to below EBIT, the Other Income was lower on a quarter-on-quarter basis, primarily due to lower export incentive scheme, partly offset by higher forex gains. Net income for the quarter stood at Rs. 186 crores, which is 13.3% of revenue, up 12% on quarter-on-quarter basis, driven by higher revenue and operating margin.

Moving to balance sheet, let me highlight the key line items. Goodwill and intangible assets have increased due to Orchestra acquisition. DSO was fairly steady at 73 days at the end of Q3 compared to 72 days in Q2. The unbilled days reduced from 20 days to 17 days sequentially. So combined DSO, including unbilled, stood at 90 days, well within our target range of less than 95 days. Improvement in DSO has resulted in cash and investment rising to Rs. 1,450 crores plus. And this is after the payout of FY21 interim dividend and the payout for acquisition of Orchestra in October 2020.

Let me now talk about cash flows. The year-to-date free cash flow stands at Rs. 962 crores, which is roughly double our year-to-date net income. This performance was largely driven by a sharp reduction in DSO in the first half of the year, that is over Q1 and Q2. We aim to maintain combined DSO within our target range of less than 95 days. So to that extent, the free cash flow conversion on a sustainable basis will moderate from what you see currently.

Moving to revenue metrics. The dollar revenue grew 6.8% in Q3. And if you look at the performance by segment, we had a broad-based performance, as Dr. Panda and Amit highlighted. Growth was led by Industrial Products, Telecom & Hi-Tech, and Plant Engineering. The segmental margin performance also saw improvement across the board. All segments improved margin by 100 basis points plus, except for Telecom & Hi-Tech, which would be equally strong but for the impact from earn-out provisions due to Orchestra acquisition.

Moving on to operational metrics. Utilization has seen an improvement of 210 basis points on a sequential basis, while onsite-offshore mix improved in favor of offshore by around 200 basis points sequentially. Fixed price and T&M mix remained broadly within the range of 40-60.

Client profile, which is number of $1 million plus accounts across categories showed a sequential improvement in the $1 million-plus range, while others are either marginally down or flat. I would like to highlight that this metric is on a last 12-month basis and not on a quarterly annualized basis. So to that extent, it will take longer to reflect the quarterly improvement we are seeing in every category, as LTM includes the Q1 FY21 revenue, which had a sharp dip.

In terms of client contribution to revenue, here again, this is on an LTM basis, and it appears that top accounts have declined sequentially. However, we have seen growth across top five, top 10, and top 20 on a sequential basis, which is in line with the overall company growth of 6.8%.

Headcount increased by 167 people sequentially, while attrition remains flat at 10.7%. Our realized rupee for Q3 was at 73.7, largely flat on a sequential basis.

Before I end, let me give some color on the EBIT margin trajectory we are seeing going forward. Similar to what I had indicated in Q2, on the positive side, we will continue to improve utilization and achieve better operational efficiency across parameters like employee pyramid, productivity, and attrition. We see scope to increase margins in segments like Telecom & Hi-Tech while continuing to push for better growth in high-margin segments like Medical, Industrial Products, and Plant Engineering. On the adverse side, we have headwinds from rupee appreciation, wage hikes, onsite localization, and other expenses that are linked to growth…for example, usage of third-party contractors, sub-contracting, etc. Overall, we aspire to take EBIT margins to the earlier range of 17% on constant currency basis and continue to work sequentially to improve margins.

With that, now I hand it over to the moderator for any questions.

Moderator: Thank you very much. We will now begin the questions-and-answer session. The first question is from the line of Vibhor Singhal from PhillipCapital. Please go ahead.

Vibhor Singhal: Sir, my question was primarily on the outlook that we across different verticals. Because generally we seen that, I mean, post any financial crisis or because of any kind of external events because of which corporates are basically forced to cut down their spends, we see the R&D spend comes with a lag, maybe with one or two quarters. And this was specifically across segments is what we have historically seen. So do you see that kind of a trend this time as well? And that we are basically in the mode of vaccine being rolled out across the globe, so those spends are slowly coming back? And not just the keeping the lights on kind of spend, but also incremental spends which could lead to strong growth momentum for us in FY22 and beyond?

Keshab Panda: Amit, can you take that question, please?

Amit Chadha: Sure, sir. And you were cutting in and out, Vibhor, so if your question, I will repeat it, is that, do we expect growth in spends…is there a lag or is it coming back to pre-COVID levels, correct?

Vibhor Singhal: Yes. So specifically speaking, sir basically historically is this understanding correct that R&D spends recovery come with a lag? And if it is, then is that lag behind us or do we expect maybe it to recover maybe in the coming quarters?

Amit Chadha: So number one is that we definitely are seeing ER&D spend back as we stand today, that is number one. Number two is, the spend that we are seeing coming back is in two areas, one is digital engineering and the second one is legacy engineering. And in both these areas, we see consistency in spend coming back across all the verticals, except commercial aerospace that we believe will take a little bit more time. For commercial aerospace we are turning around, and we are focusing on the defense area in the U.S. But outside of that, all other sectors, as we see today, have had spends that they used to have. Are we exactly at where they were? Are they higher? Slightly lower? But broad based we are seeing them back at where they used to be. We do believe that that will provide us a tailwind as we move forward towards growth.

Vibhor Singhal: Sure, sir. Sir just my second question, if I could squeeze in, is on the Plant Engineering division. I think you have done phenomenally well in that segment and that continues to be our strength. Up till now I think we have seen on the basis of the deals also is being driven by the oil and gas segment and the likes of it. In terms of retail and CPG segment, how far do you believe we are from a full-fledged recovery and we could see some, let's say, Greenfield expansions or those kinds of strength coming back in this segment for us?

Keshab Panda: So from a Plant Engineering side I will attempt that I will ask Amit to answer this. See, it is like our growth is in overall Plant Engineering, not just oil and gas. We are growing in FMCG segment as well. The FMCG segment has done reasonably well. Some of the learning we had in FMCG segment, we have taken into oil and gas. The large deals we won, that is because of that. So these two, we always draw a line between what is common between all these segments, specialty chemical, oil, and gas or FMCG, and those common service offering we take one to other. So that has given us this. Earlier, if you see one, two years ago, our dependency was more on the Greenfield projects and brownfield projects. And that's something we don't control. But what we control is, we understand the plant very well, we understand what technology required for the plant very well. Then how do we take that for the customers, the efficiency improvement, then we take over complete plant as a whole. I think that model is working well, more and more is going to be in that area I would think moving forward.

Moderator: Thank you. The next question is from the line of Sandeep Shah from Equirus Securities. Please go ahead.

Sandeep Shah: Just wanted to understand, as the decision-making has come back to pre-COVID levels, do you guys believe that the FY22 or CY21 could be a year of pent-up demand or do you believe it is too early to expect the same? And a related question is just on the fourth quarter. If I look at your implied guidance, it comes to around 3.2% Q-on-Q, of which, if I am not wrong, 1.5% to 1.8% growth may be driven through $100 million deal, and 0.4% may be through cross currency. So the rest of the business outside the $100 million deal and a cross-currency tailwind would be just 1% to 1.5%. So is it a conservative because your deal wins are robust even outside the $100 million deal? And then I have a last question on margins after this?

Keshab Panda: Yes, on the deal side, Amit, can you please discuss about the customers buying and what's going on? And Rajeev will answer the margin part of it, he will talk about Q3 to Q4 how we look at it overall. Can you do that?

Amit Chadha: Sure. So Sandeep, as far as decision-making is concerned, as far as that is concerned we are seeing decision-making happening at a faster pace than it was in Q3 and Q2, right? So that is point number one. Point number two, is there pent-up demand that we will all of a sudden see a big rush coming in? The answer is that things have been gradually coming back quarter-on-quarter, and that shows up in our results as well, right, also in our deal closures, etc. So as we go forward, we continue to be optimistic about the future in terms of growth, right? So that is point number one.

Point number two is the $100 million deal that we talked about, I also mentioned that the ramp-up will start in a gradual manner, at the end of February, early March is when it will start. And it will take time for it to ramp up completely. So the guidance that Dr. Panda has provided right now and we have provided, is where we are comfortable in sharing you right now. Of course, we will make all efforts to make sure that we bounce back faster, stronger, better, etc. That is two. So that's regarding the deal in quarter four. EBIT, I will request Rajeev to cover.

Sandeep Shah: Yes. Rajeev, just want on the EBIT margin…

Keshab Panda: Sandeep, I think one more point I want to say. Look at it this way, the $100 million deal has not contributed revenue till now, we are taking over from a western company, they have been doing for the last 20 years. Now there is a knowledge transfer, there are a lot of things, process understanding, doing that, it takes time. One thing for sure, this deal is going to contribute in a big way next year. Whereas actual revenue, how much we are going to do in February and part of March, part of February and March, I think that we are still working on it. So that is one of the reasons we want to make sure that we give a guidance where we know for sure. We don't have a luxury of not meeting what we talk to you. So we are very careful about that. And based on that, what I see today, we have given a guidance. Anything you want to add, Rajeev.

Rajeev Gupta: Dr. Panda, I think I will just let them pose the question on margin, and then I will add to it.

Keshab Panda: Yes. Okay, that's fine. Thank you.

Sandeep Shah: So Rajeev, my question on margin is, the implied guidance indicates that our revenue run rate would be similar in the Q4 versus the pre-COVID level. And in the earlier quarters, we have shared whenever we go to that kind of run rate, our margin can improve to the pre-COVID level, which is close to 16.5% to 17%. So, is it fair to say that by fourth quarter itself we can aspire to be there or it may take slightly longer time? And when are we planning for a wage inflation? Because it looks like if it's not coming in fourth quarter, we are not giving any wage hikes in FY21, so do you believe this may be a risk to the attrition because across industry there could be two round of wage inflation in a span of two or three quarters?

Rajeev Gupta: Sure. So I think you have got three questions, let me respond to each one of them. So we have always maintained over the last two quarters that we will exit Q4 FY21 at Q4 FY20 levels, right? And you have sort of computed the implied guidance for Q4. To be specific, I think as far as the revenue, we see the trajectory to come back to Q4 FY20 levels. And at the back of it, right, I think what we endeavor to do is also to have profitability come to levels of Q4 FY20, and that's how we see it.

The second part is, in terms of the wage increases, we will see wage increases effective April 1 for junior grades. And for senior grades, we will see that effective July 1. As far as attrition, we have been around 10%, 10.5%, 10.8% range. We believe that Q4 there may be a slight uptick on attrition, I think the attrition has been rather tepid over the last couple of quarters. But we see that going up slightly, but it's not concerning at this point in time that I would call out there. I hope that responds to your question.

Sandeep Shah: Yes. And all the best, Dr. Panda, it's always informative to talk to you.

Moderator: Thank you. The next question is from the line of Pankaj Kapoor from CLSA. Please go ahead.

Pankaj Kapoor: I just wanted to understand the large deal win which you have signed with the oil and gas major. Any color in terms of how the commercial construct of this deal is different from previously signed deals or the other large deals that you typically have won? Because it's significantly larger in size, so maybe in terms of any kind of a pass-through to this or is this pure-play services, any color that you can give here that would be useful?

Keshab Panda: Pankaj, it is like this. The deal what we got now, again, I did explain last time, our sustenance engineering and use of new technology for the performance improvement and so on. So the clear difference from what we did earlier and what we do now, earlier was upstream, this is downstream, okay? Because a lot of investment in upstream is not happening when oil price has gone down or limited investment is happening there. So we realized we are not going to wait for oil price to come back to $60, of course, it has increased now to $50 to $53 now. So we said when this oil price is lower now, what are the options available to us and what technology offering we have, we can go to different areas. So this is the downstream what we are doing it for the refinery and that's where, I think, much more opportunity.

And imagine these are two biggest plants is what we have taken over and which we are providing services. And I strongly believe this is a great opportunity for this segment as a whole, if we do it well, and there is no question of if, I am sure we will do it well. This can be taken to multiple refineries from the same customer itself. So this is a different type of deal, and we are creating a center very close to the plant. And then we have a center where major part of the employees is going to work from India. So combining both together, and this is the first time the customer decided to do this because of cost pressure, and we have done good job for the same customer, we have been working for a long-time, they know us well. So they decided to switch from a supplier who has been doing it for the last 20 years, they shifted to LTTS. So I think there is a lot more things we learned in the process of doing it. And I believe this is a great opportunity for an engineering services company like us.

Pankaj Kapoor: I understand that Dr. Panda, this is really useful. My question actually was more around any kind of an investment that we need to make. As you mentioned, you will be putting in some people for the transition, etc. So my question was more around that, how much would be the margin impact of this deal? That was the one which I was looking for.

Keshab Panda: No, this deal doesn't have a margin dilution, we don't have huge investments, there is no major investment there and there is no dilution in margin, Pankaj.

Pankaj Kapoor: Understood. And Rajeev, my second question was on this quarter margin profile. You had several good levers playing out like utilization, offshore mix, etc. And SG&A lever also played well. I was curious to know what where the headwinds here because the margin expansion could have been far higher, given the kind of movement in these levers. So what were the drags in the margins? If you can highlight and if you can give some quantitative color on that, that would be useful.

Rajeev Gupta: Sure, Pankaj. I think you already highlighted as far as the tailwind, right, I mean, we saw utilization improve, we saw offshore revenue mix improve. In terms of the headwinds, as we have mentioned in the previous quarter commentary, this quarter as we are now moving towards pre-COVID levels, we did provide for variable pay in this quarter. So that was the headwind. The other is, we did see increase in subcontracting costs as we service the increase in revenue. Those were the clear two impacts. And the third is, we had to take earn-out provisions for Orchestra Technologies, while that's not significant, but those were the three headwinds to talk about.

Moderator: Thank you. The next question is from the line of Vimal Gohil from Union Asset Management. Please go ahead.

Vimal Gohil: Sir, my first question is on digital engineering. You cited Zinnov, and one of the reports they have released mentions that digital engineering is expected to grow at almost 20-25% over the next maybe three or four years. I just want to know how LTTS is planning to capture this trend. And what is the proportion of work that we do in digital engineering as a percentage of our total revenue? If that data is possible.

Secondly, one of the margin headwinds that you spoke about was onsite localization. Given the current situation we are in, I mean, in this pandemic, probably one thing is proven that things are moving as smoothly virtually as well. You winning $100 million deals effectively virtually right now. So I just wanted to know what is the rationale behind going back to further aggressively increasing onsite localization because that is going to put pressure on margins? So these are my two questions.

Keshab Panda: See, the other part I would ask Amit to answer. But one thing I will tell you, Zinnov report saying that 20% - 25% increase in ER&D, if you see 2019 to 2025, the digital engineering or the new tech engineering CAGR is for 20% growth. Whereas if you see legacy engineering, ER&D spend, its growth is only 2%. That means if you see in 2030 or so, the legacy engineering is almost going to die down, anything you do in the new tech engineering it is called digital engineering. So today we have 49% of our business comes from digital engineering right now. So we are moving much faster than what the industry is growing, and we will continue to maintain that moving forward. Amit, do you want to add and take this, please?

Amit Chadha: Sure, sir. So when we talk about digital engineering, we divide that up into multiple parts. Digital engineering for us is product design, cloudification, analytics, creating cyber security modules on products, as well as remote design collaboration, right? So these are elements as far as product is concerned, including looking at the total experience of the product from customer to user to employee, putting it together, as well as looking at the AI/ML part of it, etc. So that is one part in the digital product for us.

Then the second part for us for digital is digital manufacturing, which is on the shopfloor, which is smart manufacturing. And some people call it Industry 4.0, other people have got different names for it, IIoT, etc. So we have been spending energy, time; and like Dr. Panda said, we have been investing in this area by creating; one, labs; second, reusable assets; third, filing patents for ourselves and our customers; fourth, setting up a training academy that Abhi alluded to in terms of training our people. So all these four have been going on in parallel and the Zinnov rating is just an indication of what we've been able to do.

Our wins that we have had in the Industrial Products, growth that we have seen is also backed by the work we have won in digital in discrete manufacturing in that area. In addition to that, 5G rollout as well as OTT for Hi-Tech will continue to be areas for us in digital that will grow. So those are the various components, or subcomponents, whether if I look at the digital piece for us. Rajeev, do you want to take the localization part?

Rajeev Gupta: So the only part that I will add for localization, see, this is also a measure that we are taking to mitigate any H1B-related challenges. So this is a thought-through step. I mean, and also we will try to see this over a period. So that's what I will add to as far as that question is concerned.

Moderator: Thank you. The next question is from the line of Salil Desai from Marcellus Investment. Please go ahead.

Salil Desai: Sir, I am not sure if this has been discussed in the earlier calls. But Dr. Panda, after 1st of April do you have any role of any sort in the company, would you be mentoring the...

Keshab Panda: I am sorry, I don't know, the line is not very clear. Are you saying after March 31 am I going to be around in the company?

Salil Desai: Yes. I mean, what role would you have, if any?

Keshab Panda: No, I am not going to be in LTTS. As you know, we announced to the market that I am going to be Non-Executive Director for LTTS, right? That we have already announced in our stock exchange filing last quarter when we did, we did that. And I am very passionate about this company, it's very close to my heart. And a team of people, we all worked together to build what we did. But be rest assured that nothing we are going to leave it to any lose end, making sure that whatever the foundation we created, 538 patents and the customers. And if you see, one more I will request all of you to have a look at it. Zinnov came with a report, Digital Engineering Services Ready for 2020, all the companies around the world they have taken. And then in that they have taken AI, digital thread, OTT, IoT, you see the positioning what we have in LTTS. This company, 2014, we created an independent company as L&T Technology Services. Today, in a very short time, anything on the new technology, our positioning I think, we are always in the leadership zone. And we will do everything possible, I will do everything possible to make sure this company's flag continues to fly high.

Moderator: Thank you. The next question is from the line of Pritesh Vora from Mission Holding. Please go ahead.

Pritesh Vora: Sir, congratulation on good sets of number and quarter-on-quarter bounce. My question is, our background feedback we have got is, we understand that a lot of OEMs have come to realize that a lot of cost saving can be done, and synergy can be attained because the work anyway is done by outsourcing personnel sitting in-home or their own personnel working from home. So the dividing line between employer as well as the outsourced employee is falling very fast, which will improve the growth in the sector over the years. How are you reading this development?

Keshab Panda: Listen, our customers are all outside of India. And the cost factor and some of the lab investment, multi-vertical knowledge what we have, it is very difficult for a customer, a German customer or a French customer for them to send people somewhere and all their employees to work in a place and get the productivity and innovation of what we have been doing. Working from home, it's helping in one way for a company like ours, what customers believed earlier cannot be done from home or offshore they are believing that this can be done now from offshore. That is a very positive move. And if you see, we believe that the revenue ratio offshore-to-onsite, that should work to our advantages, that's what we want. In engineering, we have different labs…a power electronic lab, tear-down labs, EV labs. So these labs when you create it, a lot of passion goes into this to create that. It is not something that you just put people at home or here or any country…there is a lot of complication there. So I don't think we are worried at all in this. If at all, I think it is going to help us more than what we did in the past. That's how I look at it.

Moderator: Thank you. The next question is from the line of Prashanth Uppuluri from Foyston, Gordon & Payne Inc. Please go ahead.

Prashanth Uppuluri: My question is a little bit more from a longer-term perspective on margins. And what is it about your Transport and Hi-Tech verticals that makes the margins appear to be structurally lower than the other verticals? Is it because of lower billing rates in these verticals or the mix of work? And what are the trends you see on both these counts? And kind of a related question is, who do you compete with within these sub-verticals?

Keshab Panda: I would like Abhishek to answer that on the margin front, Transportation, Telecom, let him try to do that. And on who do your compete part, Amit will answer or I would answer later. Abhishek, can you take this question, please?

Abhishek Sinha: Yes, Dr. Panda. See, I think the question you asked on was, first, let me talk about the Transportation vertical. So Transportation vertical, the fact is that as the pandemic broke, clearly more automotive T&OH customers asked for discounts than probably any other sectors. And that clearly showed in the drop that we saw in Transportation segment in Q1 and Q2. But as you can see, we are picking up there, definitely. We believe that by Q4 we will come closer, actually probably cross the numbers. That's one.

The second one, I think, on the Transportation sector is, I mean, all of you know, aerospace business took a big hit in terms of the pipeline and Amit already mentioned that. I think that is something that has hit us very hard. Despite that, like I am already saying, by Q4 we will pull it back, overall Transportation segment we'll pull it back to the levels that was in Q4. So I don't think there is a structural issue with the Transportation segment. Of course, there are more captives, most of the OEMs, Tier-1s and automotive have captives that creates some competitive pressure.

From a competition perspective in Transportation, while we look at definitely Tata Elxsi, TCS, HCL, KPIT, some of the competition in India. And of course, we look at the global companies as well, very closely watch them, especially in areas like powertrain where we believe that we have very strong differentiated offering.

Coming to Telecom & Hi-Tech. I think there is work to do there. I mean, the numbers are in front of us, we are not where we would like to be. Having said that, this specific quarter despite the Orchestra Technologies acquisition, we are still on the positive territory. I strongly believe that we will keep moving forward in the Hi-Tech segment as well from a margin perspective with every passing quarter over the next couple of quarters. I don't see any challenge there given the kind of pipeline we have and with Orchestra coming in….

Keshab Panda: Let me add. Thank you, Abhishek. See, I think if you see outsourcing dollars more happens in Transportation segment and Telecom & Hi-Tech segment. The truth is, Transportation has three components: Off-highway, Automotive and Aerospace. And this is crowded. If you work on the mechanical side, it is highly crowded. Any company will look at, if they are into transportation, doing piece of business in mechanical engineering or some subsystem design, system design. Whereas, what we have done now, this is a tough field though, unless you are attentive every minute, unless you have a clear differentiator, and this is going to be a difficult game to play with. We have made an investment for some time, this is a segment we entered late because other industrial, medical, plants, all that came from L&T legacy, a lot of experience we got from there. In this segment, they are now focused on more on the electric vehicle. So we have taken what we learned from industrial to automotive, now we are taking that to aerospace. This is a positive thing; we believe that's going to grow.

Connectivity and IoT, this is again a big area now, that's going to help. We have telematics and connectivity, that's the area we are focusing on. Then in Aerospace segment, the commercial aerospace will take some time to come back. Whereas we are looking at it on the military side or defense side, ITAR side. So we have a few wins we had with a sizable decent margin point of view. So I think we have improved from Q2 to Q3 if you see, 100 basis points we improved.

And our goal is to continue to do only profitable business, so we continue to grow and because this is a growth engine it's going to grow.

On Telecom & Hi-Tech, again, the component, if you divide it in two, we have telecom infra, we have semiconductors. So both segments are equally profitable, I would say, but we had Orchestra acquisition, which Rajeev talked about it. And one-time deal we have taken for the knowledge, understanding that technology, which is going to help us on the media entertainment side. For example, we believe we are going to build competency which is going to have long run. So it is a margin not at the level of what we would have got. So it's a transactional one-time deal, low-margin deal which has impacted there. But our goal is, sequentially, quarter-on-quarter we start growing margin in both the cases.

Prashanth Uppuluri: Thank you. That's a very helpful response. If I can just follow-up a little bit on that. Do you see greater competitive intensity in RFP type deals in these two verticals? And I am looking at margins pre-COVID, I mean, unless it's concerned about the past couple of quarters, but from a more longer-term perspective, if I go back even say two, three years, what is it about these two verticals that keeps their margins on a comparative basis lower than what you see in Plant Engineering or Industrial Products?

Keshab Panda: See, I think on the Transportation, Amit, why don't you answer this? Both Transportation and Telecom and Hi-Tech. Please do that.

Amit Chadha: Yes. So on Transportation, if you look at it structurally, right, as we look at the kind of work that we do and the type of work that we do, there is a little bit of onshore work, including a defense part that we do, that's being done in the U.S., right, done by our local delivery centers here. The new wins that we are having in automotive, that's in the areas of EV as well as autonomous, and electrification in T&OH and in-flight entertainment and software in aero, is all improving the offshore-ability of the work that's happening. So structurally, earlier if you go back, like you said, two years, three years, there was a higher percentage of work being done onshore in Transportation, that's slowly moving offshore. And as we move forward, you will see that there is headroom for us to grow, and we will improve the margins, right? That's number one.

Number two is, and I will also say one more thing on Transportation, and Dr. Panda alluded to it. See, our differentiated offerings in Auto and T&OH and Aero, the new offering that we have got is all-around software, right? And a lot of that is where we have differentiated because we are bringing it from our IT, we are bringing it from Telecom. So we are differentiated from traditional players and therefore we will see improvement in terms of growth as well as margins in this area. But structurally, on-site is more, and that's really going down.

Now let's go-to Telecom. Telecom, like was mentioned before, has been a very competitive marketplace. And therefore, if you look at it, we have had a challenge in terms of margin there, not just because of being competitive, but also because we had a division that was working out of, again, a non-India location, servicing the Telecom & Hi-Tech market. That particular center also now has been drawn down and the work has been moved offshore. There was a one-off transaction that we did to build technology in the areas of OTT in April of last year, April 2020, and that again as we move forward, that particular thing would also get smoothed out. And therefore, you are seeing there will be headroom for us to be able to improve our margins. So that's where we are.

Moderator: Thank you. The next question is from the line of Kunal from Bank of America. Please go ahead.

Kunal Tayal: Amit, I wanted to call out on I think a statement you made in your opening comments, that you might need to watch the pace of decision-making this quarter or in Q4. So just to better understand that comment, I mean, is it specific to lockdowns, new wave of lockdowns that are coming or is it because of general business uncertainty? And if it's because of lockdowns, would you still think that the risk this time around uncertainty could be lesser than what customers were foreseeing during the first wave? And maybe the final cut, did you mean that this is for Europe or U.S. as well?

Amit Chadha: Sure. So Kunal, thank you so much for that. Now one, we are watching the lockdowns in Europe, and I will call out Germany, U.K., Sweden, these countries that have announced lockdowns till early February, right, that's what they have done publicly. And even Japan has announced a lockdown till end of January, early February. So we are watchful of those lockdowns and whether they will get extended. And therefore, the impact of that on decision-making in terms of speed of decision-making is what we have said we are watchful about.

We do not think, to your second question, we do not think at this stage, that we will come to March-April levels of 2020. But we are watchful at this stage. I mean, it's not that we are concerned, but we are watchful at this stage. And at this stage, we have baked that in into whatever we have committed in terms of where we will end up.

Kunal Tayal: Got that. And maybe just a quick follow-up on the variable pay part of it. Broadly with the upward revision this quarter, are you in the ballpark that you expect to be going ahead as well? Or is there room for catchup even from here?

Rajeev Gupta: Let me answer that. This is Rajeev here. So yes, we will be in the ballpark to what has been in Q3. Hope that answers your question.

Moderator: Thank you very much. We will take that as the last question. I would now like to hand the conference back to Mr. Pinku Pappan for closing comments.

Pinku Pappan: Thank you all for joining us on the call today. We hope we were able to answer most of your questions. If you have any follow-up queries, please reach out to me on email. Wishing you, again, a very happy and prosperous 2021 and safe times. Goodbye, and have a great day.

Moderator: Thank you very much. On behalf of L&T Technology Services Limited, that concludes the conference. Thank you for joining us, ladies, and gentlemen. You may now disconnect your lines.

Note: This transcript has been lightly edited for clarity and accuracy.