"L&T Technology Services Limited Q3 FY18 Earnings Call"

January 23, 2018

MANAGEMENT: **DR. KESHAB PANDA –CEO & MANAGING DIRECTOR, L&T TECHNOLOGY SERVICES LIMITED**
MR. P. RAMAKRISHNAN – CHIEF FINANCIAL OFFICER, L&T TECHNOLOGY SERVICES LIMITED
MR. AMIT CHADHA – PRESIDENT, SALES & BUSINESS DEVELOPMENT AND MEMBER OF THE BOARD, L&T TECHNOLOGY SERVICES LIMITED
MR. BHUPENDRA BHATE – CHIEF OPERATING OFFICER, L&T TECHNOLOGY SERVICES LIMITED
MR. PINKU PAPPAN – HEAD OF INVESTOR RELATIONS, L&T TECHNOLOGY SERVICES LIMITED

Moderator: Ladies and Gentlemen, Good Day and Welcome to L&T Technology Services Limited Q3 Fiscal 2018 Earnings Conference Call. As a reminder, all participant lines will be in the listen-only mode. There will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the conference call, please signal an operator by pressing '*' 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: Thank you, Ali. Hello everyone and welcome to the third quarter FY18 Earnings Conference Call of LTTS. I am Pinku from the Investor Relations team. I hope you have had a chance to go through our investor release and financial statements. If not, you can download them from our website www.LntTechservices.com. On today's call, you will hear from Keshab Panda, CEO; Amit Chadha, President, Sales & Business Development; Bhupendra Bhate, COO and P. Ramakrishnan, CFO.

The agenda for today's call is as follows. Dr. Panda will provide an overview of the results and comment on the business outlook. Amit will talk about our sales execution in detail, Bhateji will comment on the margin performance and operation levers and PR will walk you through the financial statements. We will then open the line for questions. Let me now turn the call over to Dr. Panda.

Keshab Panda: Thank you, Pinku. Good evening to all of you and welcome to this call and Happy New Year to all of you. This is the first call in 2018. Let me walk you through the highlights of quarter 3.

We had a good quarter with over 8% sequential growth in dollar terms. Growth was broad based. All our verticals grew on annual basis including process industry, which has turned around from last quarter onwards. The deal pipeline is robust and this quarter too, we won several multimillion dollar deals across the board for our multiple verticals. We are seeing a healthy demand in the market. Our clients across the board are investing in technology upgrades, smarter systems, digital engineering and artificial intelligence, that is our differentiator. I think that too we did reasonably well. Today, digital engineering is 20% of our portfolio and it has been rising quarter-on-quarter. If you recall last year, it was 12.5%, it is 20% now. I would like to highlight that our multi-vertical exposure and competency allows us to scale up and bring in innovation for our clients globally.

Profits - our EBITDA margin held steady at 15.3% same as last quarter despite wage hike. As you know last time we talked about wage hike which happened in quarter 3, still we are able to maintain margins. Our net profit grew 16% year-on-year in quarter 3.

Let me now talk about our five industry verticals:

First, let me start with **Transportation**:

We had a good growth of nearly 4% quarter-on-quarter in Transportation which was led by auto and truck and off-highway. Aerospace had a marginal growth, but we see lot more opportunity coming in Aerospace area. On the auto side, we are seeing a very good pipeline of opportunities. We are participating in fairly large deals in the segment. The key growth areas continue to be autonomous and electric vehicles and we are present across the spectrum; hardware, software, mechanical, electrical etc. In our truck and off-highway segment, we are seeing a demand for functional safety, setup of automotive test system, value engineering and competitive benchmark projects. I am happy to say this segment is opening up very well last few quarters and will continue to grow. We expect strong growth to continue both in auto and truck and off-highway segment.

Let me go to Aerospace now:

In Aerospace, we are happy to report a large deal. We announced last week a 50 million deal with a global Aerospace electronic system manufacturer. This deal which will kick off in quarter 4 itself, this quarter itself involves working on the customer's next generation suite of in-flight systems which is our focus area. We are also ramping up projects at a newer client in the commercial segment which will continue to grow in coming quarters. We are seeing a few large opportunities in this pipeline and we expect growth to pick up in the coming quarters in this segment as well.

Medical - in medical, we do lot of innovative work for customers especially in Japan, in the futuristic technology areas. In medical, we are seeing a lot of demand from medical equipment manufacturers in the area of kidney, lung and ophthalmic**.** Hardware support, certification and compliance testing is an area where clients are increasingly outsourcing and that is where we play and that is also our strength. We have started ramping up in the Japanese logos that I talked about last time or last quarter. This quarter too, we have won a few logos with leaders in medical equipment manufacturers. We will continue to grow in medical segment in the coming quarters as well.

Let me talk about **Industrial Products** now:

We had flat growth in industrial product this quarter, Q2 to Q3. This is typically a weak quarter for industrial segment which is what we saw here. We expect growth to pick up in quarter 4. We have a few wins recently and we believe quarter 4 is going to be better for Industrial Products moving forward. Within IP, we are doing well on the building automation side with project in security, surveillance, safety and HVAC that is our growth area and that is our strength as well. As an example, LTTS has an IoT solution which we had built for European airport to make it smart and connected. We believe this can be taken to multiple customers as well. In this solution, we developed smart bins to monitor wastage levels, and sensors to monitor outdoor pond water. We are also looking at selling this solution to other multiple customers in Europe and outside. We are leveraging our expertise in video tracking and analytics to win more projects in industrial segment. We won an exciting project with a new client this quarter focusing on artificial intelligence in manufacturing using it to prevent failures. We are also working on packaging this into new solutions. On the Power side: Demand is strong in renewable energy and smart electric devices where I think that is our strength area as well. So this is something we believe is going to grow in coming quarters.

Now **Process Industry** as we indicated last quarter, in the process industry the worst is behind us and we are now seeing growth picking up last quarter onwards and we saw this quarter as well and this process will continue. This quarter, we are nearly 8% quarter-on-quarter growth led by projects in the Consumer and Specialty chemical areas. Consumers and chemical clients are investing in Greenfield expansion. We are involved in everything from design, detailed engineering to construction management and that is an area which we again continue to grow. We are also participating in a few plant digitization project in some of our top clients. Based on the pipeline, we expect the growth to continue in quarter 4 and beyond.

Telecom and Hi-Tech:

We had a 25% quarter-on-quarter growth in Q3, helped by the growth across our client portfolio as well as ramp up of one of our large deals I spoke about last quarter. In semiconductors, with the help of Esencia, as you know we acquired the company Esencia which is California based. We are now being considered for large projects of complicated chip design and so on**.** This is again a growth area, I think we did reasonably well. Jointly with Esencia, we have been able to win a few large projects involving VLSI ASIC design in storage and computing area and we believe that is the future and will continue to grow in this area. We are also ramping up on a field testing project for a 5G mobile chipset. In the consumer electronic space, we are seeing demand for upgrades, enhancement, localization of mobile and POS devices. In the media and entertainment space, the large deals we won with the US technology company has ramped up as per schedule and we are now leveraging the skillset acquired to win new deals with different MSOs or Multi Service Operators. This expertise also helped us win new large deals in the internet media platform space, I think which is we are very excited about and continue to grow again for coming quarters. We remain very positive about the vertical and expect healthy growth going forward.

Let me conclude by providing the outlook on the business going forward:

We continue to be optimistic about growth on the back of healthy demand. I must have covered around 25 customers in this quarter. I visited across geographies Japan, Korea, Europe and US and we see lot of demand in various areas and I think we continue to see growth. We expect a broad based growth in quarter 4 also. We will end FY18 with at least 18% US dollar revenue growth this year. Our margins in Q3, we managed to offset the impact of wage hike with operational improvement thus keeping our margins steady at 15.3, same as what we did last quarter. In the near term, we do face margin headwinds. This could be rupee appreciation. Utilization maybe need to come down little bit because I think in engineering services, utilization, you cannot continue to grow beyond 78 to 80. I think we have multiple levers we have worked out, and we remain committed to improving margins going forward. The levers we will work on are Greater offshoring, higher bill rate which we have achieved, some accounts will continue to do for other customers as well, optimize the employee pyramid which we have, part of it we have achieved, will continue to push that SG&A leverages as we increase our scale to our T30 customers.

So to summarize, we are very happy with the progress we are making with our clients. The kind of programs we have been invited to participate and our focus on driving innovation within the company. The one point which I have been saying every time that T30 account we talked about, the T30 accounts are investing in technology and artificial intelligence, machine learning, IoT and I think that is working reasonably well for us. 67% of the business comes from T30, that T30 accounts last quarter and this quarter has done reasonably well. We are bullish about the coming quarters as well. The demand pipeline what we see in the market, this is going to drive the growth for coming quarters. Now, I hand over to Amit Chadha, our President, Sales & Marketing who will highlight the key deals we won last quarter.

Amit Chadha: Thank you so much, Dr. Panda. Thank you, Pinku. As has been stated in our release and earlier on this call as well, we continue to see growth driven by three factors amongst other things. One, demand for digital solutions that are bigger in scope and extending beyond proof of concepts. Second, large deals and third, T30 account focus and a clear drive to move clients up the pyramid.

So let me get into a little more detail on **large deals**. This past quarter, we have had success across all segments with significant ones being in aero, telecom and hi-tech and plant engineering segment as well as rampups within the quarter from past deals. To give some examples specific to quarter 3, in the oil and gas sector in Europe, we have closed a deal which will allow us to digitize client's assets across multiple refineries in the UK and mainland Europe which will help our client to improve their utilization, improve their safety compliance and reliability of operations. This deal was won based on our domain experience in oil and gas as well as our ability to take preexisting constructs and algorithms to the client. We are also in the final stages of a large contract to digitize assets including building an artificial intelligence framework for a global oil major, but we will speak about this more in our next quarterly call as agreements are just being signed.

A second example is the Aerospace segment where we have been awarded two contracts. The first one like Dr. Panda said is for upgrading and supporting a client's in-flight entertainment systems. This was won because of our unique managed services model where we will take on responsibility for releasing the existing products with upgrades as well as newer product lines for the same product family on behalf of our client. We have also won a contract to provide end-to-end testing for a North American aero client to provide EMI/EMC as well as environmental testing for all their electrical system products for the Aerospace segment.

Our journey in the telecom hi-tech segment continues with two deals. One is the development of a global contract for a client's media platform being rolled out globally. Here, we have been able to leverage the qualifications that we gained from an earlier deal. The second one is like again Dr. Panda mentioned ASIC design and testing work for a client where this time we are moving some of their labs from overseas to India and we will provide a worldwide test setup to them. We do see continuous flow of large deals in all verticals and will continue to report on this in the next quarter.

Moving on to our **Top 30 accounts**:

We have just concluded our account planning exercise across the company and given efforts from the teams as well as our CTO organization, I am happy to share in quarter 3, we have moved one client to the 40 million plus category and we also grown other clients including adding one more in the 30 million category. If I look at our quarter 3 exit run rate, we actually have two clients in the 40 million plus category. Our growth is not just limited to these, but from our top 5, top 10, top 20 clients. If you go through our release, you will see that we have also added two new logos into our 5 million plus category. We see a promising demand and continue to see a runway to grow our accounts up the pyramid in the mid-tier range as well.

From a geo standpoint, the US continues to show growth for us across verticals with specific mention of telecom, hi-tech and media as well as ground Transportation. Coming to Europe: We continue to see progress again. Europe has grown 13.3% sequentially and we see key traction in automotive, industrial IoT and smart manufacturing as well as chemical and O&G sector. For ROW, in Israel we won our first significant project on ASIC design and development on the back of the team that we have set up there as we announced last quarter. We continue our journey to build a center for security solutions, center of excellence there. Japan continues to grow in Transportation, auto and medical like we said earlier.

With that, thank you so much and I will hand over to Mr. Bhate, our Chief Operating Officer.

Bhupendra Bhate: Thank you, Amit. I will briefly talk on margins, operational metrics and some of the steps that we are taking to improve margins.

This quarter, we sustained EBITDA margins at 15.3 despite the impact of wage hike, slight bit of rupee appreciation. The levers that helped up were utilization and employee pyramid optimization. If we talk about utilization, it showed an uptick of 270 basis points quarter-on-quarter driven by strong volume growth in the quarter. We might see utilization taper down marginally from here as we hire more for the growth. Segmentally if you see, we have had margin improvement of nearly 400 basis points quarter-on-quarter in telecom where we were able to optimize the pyramid and reduce some of the employee cost. Pyramid optimization is an ongoing effort across verticals and will be one of our key margin levers going forward. As we increase our scale in the top 30 accounts, we will have better flexibility to increase freshers and thereby reduce overall employee cost. Our offshore mix remains flat quarter-on-quarter at 49%. We are working on increasing this in the longer-to-medium terms. However, the offshore mix does get impacted when we win large deals which are typically onsite heavy during the initial phase. On the bill rate, we have won bill rate increases at select clients and this is an ongoing exercise. Plus in new-age technologies we get higher bill rates and margins and as we take this share higher, we expect this to be a major margin contributor.

To sum it up, we are working on various operational levers and remain committed to improving margins. Thank you.

P. Ramakrishnan: Thank you, Bhateji. Good evening to all of you. This is PR, P. Ramakrishnan. I will summarize the financials for the quarter and the 9 months ended, then conclude with the explaining of various metrics which we have put in the fact sheet and then afterwards we will have the question-answer.

At the cost of repetition, I would like to tell you that the revenues for the quarter at Rs. 9,691 million grew on a Q-on-Q basis at 7.6% and when compared to Q3 FY17, the revenues grew at 19.6% consolidated revenues. In dollar terms, the revenues for the quarter was 151 million dollars equivalent as compared to 139.3 registering a Q-on-Q growth of around 8.3% and a Y-on-Y growth of around 25.6%. In constant currency given the fact that the dollar rupee was fairly stable during the period under review, the Q-on-Q growth in constant currency has been around 8.3%.

Coming to the EBITDA part:

Despite the wage increase which we had in the current quarter, we also had around 400 people being added to the company, but while the 400 people addition has happened, this quarter we have seen additions more on the freshers or on the people with lesser experience - that is one of the reasons when Bhateji was explaining about rejigging the pyramid, so that journey to improve profitability by improving the pyramid has started. So in the current quarter, we had more of lesser experience people joining the company and plus we also saw a little amount of increase in the overall cost related to subcontracts, that is one of the reasons partly offset by the savings which we had on account of rejigging pyramid, but despite that we still have maintained the EBITDA margins for the quarter at 15.3%.

The other income which we have reported for the quarter at Rs. 435 million, assuming let us say it is 44 crores, broadly split into three main items. The first would be the foreign exchange cash flows that is on account of hedge gains and translation differences is around Rs. 26 crores, then like we had the earlier quarter, we also had non-recurring sale of certain export licenses around Rs. 14 crore and the balance 3 crores, I would say related to largely treasury income. So that is how the other income has panned out. Our net profit for the quarter is at Rs. 1,265 million, it includes a blended tax rate for the quarter was around 28.4% that has not been a major change, last quarter I think it was just below 28%. So not a major change in the tax rate for the quarter.

Now coming to the vertical performance:

For the quarter Transportation segment continues to be the biggest share of the company in terms of the revenue share. It is almost around 31% followed by Industrial Products at 22. Telecom, hi-tech because of the large deals which we secured in the later part of Q2, that obviously we have seen the complete 3 months of revenue, so that is one of the reasons that telecom and hi-tech revenue share has increased to 28%. Plant engineering or process industry is around 13 and the last medical is around 7%.

Coming to revenue by geography, before I go to revenue by geography, would like to talk about the segment operating margins:

Transportation segment operating margins for the quarter has been relatively, I would say unchanged barring for a small drop, minor drop up to 12.1% from 12.3% of the previous quarter. Telecom-hi-tech, we did see a good improvement in operating margin as Bhateji pointed out. We almost saw almost close to 400 basis points improvement and as I explained to you, it is because how the initial large deals which we secured in the earlier quarter as people get realigned and we start process of offshoring, that is one of the reasons. Plant engineering also, we have had because of the increase in overall revenue, small marginal increase, we have been able to see almost a 30 basis points improvement in operating margin from 19.1 to 19.4.

Industrial Products was actually a drop. It is not that it was unplanned because of Industrial Products for their onsite revenues, there was some amount of furloughs which happened in the US. So that is one of the reasons that we saw a drop in operating margin from almost 21.7 to 20.9. So with this, I come to the revenue by geography.

North America continues to be a significant contributor with 59% of the revenues coming from North America. Europe follows second at 17. The rest of the world excluding India is at 13% and India at around 11. The increase in the share of India is because of one of the large deals which we secured had a large India base. So with this, I come to the revenue mix.

We still continue to have in the current year, in Q3 as well the onsite-offshore revenue mix continues to be at almost 51 to 49 which is largely unchanged from that of Q2. The Q3 also is at 51:49. Fixed price contracts to T&M, it is in the ratio of around 38:62. As far as the client profile is concerned, we have not added any new clients during the quarter, but wish to tell you that on an annualized basis, this quarter, we saw one client moving to a $40 million plus account and we have one more client joining the $30 million plus. So in the previous quarter we had none in the $40 million size bracket. So we had one client moving there and in the $30 million account, we have from two clients in Q2, it has now become 3. That demonstrates as Dr. Panda talked about and also collaborated by Amit that our emphasis on T30 and emphasis to grow with some of our major clients, I think that is gaining strength.

Now coming to utilization, Bhateji did mention that our utilization now is almost 79% which in our opinion, which we have been maintaining that utilization anywhere between 78-80 is the most optimal considering this kind of work which we do in the engineering services space. We don’t find any kind of major uptick from this current level. However, having said that, we still have a lot of room in terms of overall pyramid fixation in our pursuit to improving operating margin besides also bringing down the onsite-offshore revenue mix. In terms of employee statistics, as I explained to you earlier, we have around 400 people who joined during the quarter and all of them have joined on the billable side. So our total headcount is around 12,000 people and the exchange rate for the quarter, the closing exchange rate was 63.88 and the average exchange rate was 64.19.

With this, I have given you an overall flavor of performance for the quarter and we are now free to take questions.

Moderator: Thank you very much. Ladies and gentlemen, we will now begin the question and answer session. We will take the first question from the line of Pankaj Kapoor from JM Financial. Please go ahead.

Pankaj Kapoor: I just wanted to get some flavor in terms of the client interaction that you mentioned you had during the quarter as well as the pipeline do you see, you think the kind of a strong growth that we had this year is something which can probably continue say next year on a qualitative basis, if you can give some commentary that will be very helpful. And my second question was to Amit, if he can help the order backlog and the pipeline data that you share every quarter?

Keshab Panda: I think, what I talked about the meetings we had with customers, if you see last two quarters ago I said the growth is going to be double digit. Now, we announced that 18% is we are going to do this year. What I can say very confidently is that next year again double digit growth is possible, with the orders in hand. No problem on double digit growth next year. When we progress little further, one or two quarters will tell you exact number where we are going to hit, but double digit is something absolutely going to happen. I have no doubt about that.

Amit Chadha: So Pankaj, Thank you so much. Pankaj, as Dr. Panda was already, we have been providing pipeline as well as order backlog every quarter because we weren't giving a growth percentage for the year. We have substituted that by giving a percentage for the year saying we will at least have 18% growth. And we do see a heavy pipeline as well as order backlog, plus a queue of large deals that have closed, are closing and continue to be pursued. And at least see that at the pipeline as well as the order backlog going up quarter-on-quarter and we do see next quarter, next year being double digit. So we will pause at this time rather than giving any more quantitative information.

Pankaj Kapoor: Okay. And PR, just couple of question on the margin side, given that our deal engine continues to be extremely strong. Do you see the room for you to maneuver on the reported margin could be relatively less and given that we are obviously trying to mitigate some of these things like the employee pyramid with utilization, you are probably hitting the top-end. So on an overall basis with the kind of a wage hike and the kind of a rupee scenario we have, do you think that more or less the focus on FY19 will be again on the revenue growth and margin could still be stable or you think that you will have a scope for improving margins further from where they are?

Keshab Panda: You know Pankaj, I think let me attempt to do that. The margin improvement when you look at it, of course there are multiple levers we worked out and we are very confident that the margins will continue to increase. There is no question about that. We are working towards, I think one of the levers available, as you know when you start a large deal, knowledge transfer take some time at the beginning, but that is what is happening now. How quickly, once you do knowledge transfer, the deal will stabilize and so on. So then pyramid what Bhateji talked about, Bhate talked about pyramid and also onsite-offshore ratio. This is something which we are going to work out and there are multiple other areas we have. We believe that there is room for improvement. I am pretty sure about that.

Moderator: Thank you. We will take the next question from the line of Priyankar Sarkar from Motilal Oswal Asset Management. Please go ahead.

Priyankar Sarkar: Sir, just wanted to understand what was the quantum of the wage hike and what was the impact of that on the margin and my second question is on the non-linearity of the revenue. What is the kind of IP that we have filed in this quarter and how much percentage is non-linear revenue as percentage of your overall sales?

P. Ramakrishnan: Overall impact I would say, as far as the wage hike is concerned, it will be around 1% or so, 1%-1.2% on the margins. But as Bhateji talked about that the increase in wage hike has been partly compensated because of we had a better pyramid fixing and that journey continues. So to some extent we have been able to absorb this. So that is the impact which I just now communicated.

Keshab Panda: You know the second part of your question, you asked about nonlinear. This is our effort always to do that and we are working on it. There are multiple things, our investment in terms of nonlinear, creating a solution around the patent or platform. This is ongoing now and I am pretty sure we will be able to make that happen in due course of time.

Priyankar Sarkar: Right sir. Just a follow up on the wage hike, other than the margin impact I wanted to know what was the actual quantum in terms of onsite revenue hike and offshore?

P. Ramakrishnan: So there has been I would say that the offshore wage hike would be in the range of 6% to 7% and onsite maybe 1.5% to 2%.

Moderator: Thank you. We will take the next question from the line of Abhishek S from Equirus Securities. Please go ahead.

Abhishek S: The first question is regarding growth, sir how should we look at the growth of the company, I am not asking from a quarterly perspective but over a 1 to 2 year timeframe. We have quarters of high single digit sequential growth rate. So is this the best that is happening after a period of silence or you feel that this growth is sustainable?

Keshab Panda: Yes. I can tell you that you look at it, if you see the growth point of view, two years is a long period in technology company. I can only see one year to 18 months and so on. Today's technology is old tomorrow. I can only tell you that the growth what we got now, double digit growth is something we see next year, there is no doubt about that. Beyond that, what happens, 2 years, 3 years, we will continue to innovate and I am sure I think we are leading the segment. There is no reason why we cannot maintain beyond that.

Abhishek S: Okay. That is helpful. And second question is to PR. From a margin perspective, you highlighted that the impact of wage hike was 100 basis points. If I look at the offset, the FPP has increased almost 500 basis points and obviously there was a tailwind from utilization as well. So is there anything else in terms of margins that we are missing out, apart from the decline in segmental margins, that we should be aware of? Thank you.

P. Ramakrishnan: Abhishek, as I talked about that, when I was explaining to you about the segmental margins, I did explain about Transportation being where it is despite the increase. I mean the wage hikes have been across but it has been related to the best performing people within the company. But having said that, the only thing where our margins have dropped during the quarter, I would say is only related to the Industrial Products and that is more to do with because of the fact that there was a drop in revenue because of some furloughs in some of the accounts which happened in the month of December and some of the fixed price contracts getting into completion. So I don't think we have anything which says unusual for us to in the quarter in terms of the margin, what to say compression. Going forward, I believe that in Q4 especially Industrial Products and the medical division and plant engineering, these 3 segments which roughly around 50% of our revenue will come back into normal margin trajectory even after having absorbed, the additional wage cost at today's exchange rate.

Moderator: Thank you. We will take the next question from the line of Ravi Menon from Elara Securities. Please go ahead.

Ravi Menon: Any one off impact that led to the sharp increase in other expenses or is this largely subcontracting?

P. Ramakrishnan: This I explained, when I was explaining to you that part of the margins which has despite the wage hike, there has been increase in subcontract cost and that was one of the reasons which is almost relating to some of the jobs which got completed. So I would believe that that is something one-off and it is not going to recur in the same manner.

Ravi Menon: Sir, what impact did furloughs and holidays have on your realization this quarter?

P. Ramakrishnan: I would not say it is substantial. It was related to industrial product because of that we actually saw some amount of flattishness there. So otherwise it is not that it is going to be of a material significance for other businesses barring for IP.

Ravi Menon: Sure. And I think Mr. Bhate talked about how you look at realization as a significant driver for margins going forward. What would be the kind of service mix change or are you looking at asset based contracts. What would really drive up the realization from current levels?

Bhupendra Bhate: So one thing we did mention that increasingly our offerings are getting more in the digital space and that is why we are seeing better rates and better margins.

Keshab Panda: You know, I think we can look at it this way - our digital and new technology has grown to 20%, right? Artificial intelligence, machine learning and industrial IoT, we do many more projects in these areas, even for existing customers, we get a rate increase because of the new technologies coming in. So that is always going to be helpful. What we are trying to say always is when engineering companies, 78% to 80% when you do utilization, I think we have to go different way of doing it. The right pyramid and get more money for the services you provide and which I think we have been successful in doing that. That will continue to pursue.

Moderator: Thank you. We will take the next question from the line of Madhu Babu from Prabhudas Lilladher. Please go ahead.

Madhu Babu: The 50 million deal which we have won, so how was the competition and could you just give us, I mean how the deal has been won, who are the competitors, some view on that?

Keshab Panda: You know, one thing I will tell you, I think before we talked about the two areas we focused in Aerospace, one is ATM, which is called air traffic management and inflight entertainment areas, right? I think we have created solution for this for quite some time. You know who are the players in the segment. There is somebody working on that, we have replaced them. We got the deal there. And you know I would not say beyond that. Any deal you go to, they are all names in this segment, they are always there. And they were also there in this segment.

Madhu Babu: Okay. So you are talking of larger tier 1 which has a good engineering practice or mid cap company which has an engineering. I mean, whom have we replaced?

Keshab Panda: I will not comment on this. I will not go beyond this. Only thing I could tell you is if you look at the Aerospace who are strong, who was there, you can figure it out I think, I would not go beyond this.

Madhu Babu: Okay. And second sir, we are talking of pyramid correction. I mean our specialization is more on the high end engineering as well as some of the new technologies which we are talking of. So would pyramid correction really be a lever or that we would be fine with this kind of margin and chase absolute EBITDA growth?

Keshab Panda: See, pyramid, we will have to look at multiple things. Pyramid, automation and multiple areas when we look at it. Automation and pyramid is more effective when you look at skill based engineering. The bottom part of the pyramid, right? We always look at it what is possible, which area, that is what we examine always.

Moderator: Thank you. We will take the next question from the line of Vibhor Singhal from PhillipCapital. Please go ahead.

Vibhor Singhal: Sir, I had a couple of questions on the business side of our growth this quarter. So the first question that I had is on the process design segment. So after many quarters, I think we have seen some growth in this segment. So just wanted your idea as to, and you mentioned that the growth was driven by the power segment and maybe E&U companies probably recovering after a stable crude oil price. So how do we see this segment going forward? I mean is this kind of growth, maybe not the quantum, but at least the direction of that is sustainable in the coming quarters and are we also seeing some green shoots in the CPG or FMCG companies putting more planned CAPEX which could provide additional boost to this growth in this segment.

Keshab Panda: So if you look at this segment, last quarter itself we started growing. We degrew few quarters before that and we saw the positive signs from last quarter onwards and we grew last quarter, we continue to grow this quarter and the order book, there are multiple things. It is the plant engineering in the defense segment, CPG, food and beverage industry, then specialty chemical, then oil and gas. Now if you see segment all together, only thing I can tell you is that the order pipeline we have on hand today, what we won and what we are likely to win, this segment will continue to grow in coming quarters. The worst is behind us which we have gone through 3 quarters of drop and now last quarter onwards we started growing and this is a highly profitable business as well. So both growth and profit, I think both of this will do well moving forward. As you know oil price going above, that also is helpful, there is no doubt about that. We have couple of deals we are working on right now. Hopefully, we will announce soon. Amit talked about a deal which is hopefully in a final stage now. We will make an announcement soon.

Amit Chadha: So I will divide it into three segments. If you look at process segment, right, oil and gas upstream as well as downstream, both of these, we see deals happening. Some deals closed and ramp ups happening. And that is driven by their; one, they are wanting to digitize, right, number one. Number two, use artificial intelligence algorithms and third, their need to become much more reliable. So that is the oil and gas side. CPG, we continue to see plant expansion. You ask the question specifically. So we see plant expansion opportunities where we are supporting people in Asia as well as in India. So both these are adding to our CPG story. Not only that, in the US also, we are seeing growth in that area. So that will also grow. Specialty chemicals, Dr. Panda spoke about and again that is an area where we continue to win, not just specialty chemicals in Europe but specialty chemicals in the far east where we are supporting European clients to try and expand their footprint. So therefore we are bullish about the process industry segment, subsegment and overall segment as well.

Vibhor Singhal: Sure sir. That is really helpful. Amit, so if I can just ask, I will take this opportunity to ask you another question, you also mentioned about this deal in the Aerospace in which we have gone into the inflight entertainment and Dr. Panda mentioned that who's who of the IT industry was probably there. So in fact I want to take that to a broader level as to are we seeing kind of a convergence between the Engineering services and also the kind of traditional services that the other traditional IT companies tend to provide. So let us say things like IoT or even some digital expertise that we provide. So are we going to see this kind of an overlap and more and more companies which were let us say not qualified to bid for these kind of engineering services contracted now, they are also becoming our competitors over the next couple of years.

Keshab Panda: You know I think one positive point from our side is we do engineering and only engineering. When you talk about IoT, we understand what data comes. The complete ecosystem when you look at it starting from sensors to gateway, to the cloud, to the final one, the analytics what we do, right? So I think overall point of view the customers when we talked to them, they look at us an engineering player whom you understand whether what sensor data we need, what sensor they need and then they also look at it the gateway design. What gateway they select, how do they are programming for the gateway. So complete ecosystem when you go to a manufacturing company, industrial company, they would prefer to do with an engineering player like us than looking at IT. But there is a convergence which is happening in the world, I think it is important for us which we are working on that making sure we understand this part of it and for example we have made a huge team which called LTTS Technology Team or Technology Architecture. So how can you find out the new technology? We have qualified people who are trained, who can look at it complete architecture of a system when you design an IoT system, I think altogether. So I think overall are they going to be everybody, not that we are the only smartest people in the world, people do that. But I still believe the differentiator which we continue to maintain as an engineering company, understand the product design, understanding manufacturing shop floor**,** I think that becomes very important for us and will continue to do that.

Moderator: Thank you. We will take the next question from the line of Apurva Prasad from HDFC Securities. Please go ahead.

Apurva Prasad: Sir my first question is, are you really seeing bill rates improving within the top accounts or is it more volume led?

Amit Chadha: So we do see, so again we have talked about this often we are and want to position ourselves as a value player. So being a value player, we are able to get rate increases from our clients for our T&M projects and fixed-price projects, we are able to command a premium and we see that trend continuing positively across the client pyramid and regions.

Apurva Prasad: Okay. And on the telecom and hi-tech piece, is it possible to split how much of the incremental growth would have been ramp up of the large deal?

Amit Chadha: So if we look at, so like we talked about Apurva last time, it was not just one deal .We had reported last time one large deal and a couple of medium size deals that we have got. And all three have ramped up for us including the organic business that we had already, the small orders as well. There has been broad based growth across. So it is not just one deal or one client that has ramped up for us in telecom & hi-tech.

Moderator: Thank you. We will take the next question from the line of Ankur Rudra from CLSA. Please go ahead.

Ankur Rudra: My first question is on the IP business. We haven't seen an IP deal and I think close to four quarters. So just wanted to get a sense of what gives you confidence that it can come through perhaps this year?

Keshab Panda: Ankur, I think we are working on that still. We are going to customer now, that we talked about last year and few quarters we have not been able to, but I think we are very close to doing that. I am not sure it is going to be this quarter, next quarter, I cannot tell you right now. But I see lot of action happening there. I see lot of interest on the customer happening there and I see that differentiator positioning I think is happening there. So I still believe, if you sell a license and there are few cases we did, but giving you much more the services revenue by doing that. So the IP Revenue of course is going to happen. Only thing is matter of time, see there are few areas. We thought we straight away go and sell it. Now there is a team working on creating solution around that. So that I think should be ready and we have discussed with the customer, multiple customers across geography, I am very positive about this year we are going to make it happen.

Ankur Rudra: And if I look at your margin performance this quarter, I think at the gross margin level you appear to be almost back at your historical best, which is about 35%. And I think it can only go up only if you have maybe IP deals in future. But outside of that, if I just look at your margin commentary, it seems like a lot of the margin initiatives are still gross margin focused. I think you speak about pyramid, you speak about onsite-offshore ratio, whereas I feel if I just look at the numbers, it seems to be more on the SG&A side where the increase in expenses have happened. So just wanted to understand where would margin improvement come from? Will it come from further gross margin improvement or will it come from better SG&A management?

Keshab Panda: I think multiple things, right. We are working on multiple things. Pyramid is one, rate increase we talked about and also on the IP side, as you know we announced recently Microsoft and us together, some of the platform are there, we have ported in Microsoft cloud and there are multiple deals we are working along with Microsoft there. So one is onsite-offshore ratio, when you start a new deal, onsite is more as PR said 51:49 and that there is a possibility of changing it. We are working towards how do we do that. Rate increase, we have been successful in many customers now and many more customers are going to come. So I think multiple levers available, not just the SG&A. And I am sure I would request PR to add.

P. Ramakrishnan: Thanks Dr. Panda for adding up. Ankur, I think your question is valid that when we talk about margin improvement, it is just not gross margins coming from execution of jobs. The fact is margin improvement from the execution of jobs which will come through a blended combination of pyramid fixation by way of lowering cost for the same rate and as Amit talked about we are in the process of, we have bill rate increases selective in some of the select accounts and we see that robustness of the bill rate increases happening in some of the few select accounts even from this quarter. So pyramid rejig, then onsite offshore mix from what we are today at 51:49 to possibly what we were last year around 49:51, that is one more area. Now that is the levers which are resulting into improvement in overall the gross margin. But I see that as the fact is last year we were at $484 million and today we have gone to the next level as Dr. Panda talked about that we see almost 18% growth in the current year, so going back, in the next year as we go into the growth story, we definitely see some savings accruing in SG&A because as size goes up, I think we will be able to achieve overall leverage in the overall sales and marketing and general corporate expenses.

Moderator: Thank you. We will take the next question from the line of Om Praksh from Spark Capital. Please go ahead.

Om Prakash: Just wanted to understand how the trade receivables have moved this quarter and what are the kind of DSO days more comfortable with going forward?

P. Ramakrishnan: Yes. Our trade receivables in the month of September, our DSO was around 85. So today we have improved it to 83. And just wish to tell you that, we believe that we have some more room to improve it from what it is today, but structurally we see our DSO coming between 80 to 83, these kind of levels. So yes, there is some scope for improvement and we are working towards it.

Moderator: Thank you. We will take the next question from the line of Pankaj Kapoor from JM Financial. Please go ahead.

Pankaj Kapoor: Just one question on the impact of the US tax reforms. Any quantification or any assessment that you would have done, how it will impact us? That is all.

P. Ramakrishnan: Pankaj, first is we know of two things. One is that we hear and we have read that there is a drop in the overall tax rate from 35% to 21%. We also hear about the new legislation which is called the BEAT legislation. But having said this, we are going through the act, the provisions, but I think the regulations have not yet come in terms of the way it will apply as to how do you break the revenue from a tax perspective into how much of work which you are getting it done in India, out of India and reporting in the US branch. I think we await further pronouncements or the rules for us to actually work it out. Having said that, I believe that the drop in tax rate from 35 to 21 definitely will be good for us from a perspective that we have two subsidiaries in the US which is the LLC company and also Esencia. And once the clarity comes on BEAT, I think we will be in a position to possibly quantify as to how it will impact. But I think it is premature for me to say in the absence of rules on certain of this provision especially related to BEAT, it would not be proper of me to comment and quantify the impact of that.

Moderator: Thank you. We will take the next question from the line of Prakash Challam from JM Financial. Please go ahead.

Prakash Challam: I know there was some commentary made on the telecom piece, just wanted to get some sense, if you could give some color, one of the outstanding parts of your performance has been on the telecom side as a segment. Could you just give us some color in terms of what is driving this growth? I notice that in the first 9 months in absolute terms, it has contributed close to 80% of the absolute growth. So if you have any color that you could share on that, that will be helpful, thank you?

Amit Chadha: So Prakash, couple of things here. Number one is that, if you look at the telecom and hi-tech segment, for us telecom and hi-tech segment is consumer electronics, its media entertainment., ASIC VLSI semiconductor third segment for us, and the fourth is telecom operators. Now, we have seen growth in all three segments, consumer electronics, VLSI Semi con , as well as media entertainment. And if we look at the deals that we have signed, right, has been in all three areas. In fact not only that, there is a number of our clients in the consumer electronics space as well as the media entertainment space that are wanting to up the game in IoT and that is where we are putting a lot of focus and interest to take it forward. In fact one of the things that we have tried to differentiate is that for us IoT is not just connectivity, but the telecom Hitech segment is working on various kinds of subsets of pervasive technologies, perceptual computing as well as connectivity solutions and all three has helped us in doing that. The other part is not just development, but middle of life support because a new TV comes out every six months, but you and I would change the TV in our living rooms every 7 to 9 years. So there is a fair bit of support that is required on these products that happen from middle of life and that we think is a niche that we have picked up on in the last, shall I say 18 months and we have been pursuing effectively and helping us grow as well. Lastly like Dr. Panda mentioned in his commentary, lot of people throw a lot of stuff out in the market in terms of introducing it, but then testing, verification, validation are extremely critical there to give error free beautiful experience to the consumer and we have been able to leverage that as well with our frameworks etc. to go after it. So that has been pretty broad based across segments, across sub service lines we have been able to do.

Keshab Panda: Prakash in today's world, number of chips used in the car called autonomous car, there are hundreds of them. Now some of the chips we develop with Esencia, the company we acquired. Esencia and L&T Tech together connecting with security solution what we do in Israel together, I think that is the exciting journey what we are in. It is mid of life project, that is continued to be there. But the transformational thing what we do, without Esencia we would not have been able to do that. Now these chips design which is continuing what some of the customers we have been very exciting, what now in terms of virtual reality some of the chips required for those application, auto application, there are multiple applications. These are the hi-tech area which we do. I think Esencia play a very integral part of this segment. That is the growth we get from there.

Amit Chadha: One more, last thing, we also building out in cyber security using the Israel center as the COE and we will report more as we go forward, but that is an another sub-area in telecom hi-tech that we are focusing on that will go across segments as well, Prakash.

Moderator: Thank you. We will take the next question from the line of Apurva Prasad from HDFC Securities. Please go ahead.

Apurva Prasad: PR, just a couple of bookkeeping ones. If you can help us with the operating cash flow and CAPEX for 3Q or 9 months?

P. Ramakrishnan: Okay. The operating cash flow for Q3 after CAPEX was around 118 crores and we had a CAPEX spend of around 10 crores this quarter.

Apurva Prasad: Okay. And if you can also help me with subcontracting cost for this quarter as well as the previous one?

P. Ramakrishnan: We will have a separate, I think you can get in touch with Pinku and get it.

Moderator: Thank you. We will take the next question from the line of Achal Phade from Wealth Managers Private Limited. Please go ahead.

Achal Phade: My question is related to other income. So the nonrecurring sale of export licenses is around 14 crores and last quarter it was around 18 crores. So as far as export licenses are concerned, as far as my understanding goes, as long as we are going to export our services outside, it is going to keep on accruing. So why would we call it as non-recurring and how long should we expect this other income?

P. Ramakrishnan: Achal, that is a good question. But please understand that when I apply for licenses, I am eligible under the SEIS Benefits which the government of India has given for engineering services. But it is good that when we apply the licenses, we should get those licenses, right? So only once we have the visibility that we are going to get in licenses, then the question comes. That is the reason I talked about, I mean we are technically talking of a nonrecurring. But yes, as a business model, till such time the scheme continues, we will continue to get it, but it is a question of when we actually get the license. So as and when we get the license, we will accrue the income.

Achal Phade: Okay. And my second question sir was with respect to margins of Process Engineering and Industrial Product segment. So last year quarter three, those margins were around 23% and 24% and today they are around 19% to 20%. So what could be the sustainable level for the margins for these segments?

P. Ramakrishnan: Actually 23 is not the number. Last one you see 21.87 or something, last time. I think if you look at last quarter to this quarter if you see, I think these three segments contribute almost 50% of business. That is almost 19-20 range. Last year if you see the dollar to rupee was 66-67, it has come down to 63.5. So that has impacted. Nothing has changed from last year to this year.

Moderator: Thank you. That was the last question in queue. I now hand the conference over to the management for their 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. In case you have follow-ups, please feel free to reach out to me. Have a good day.

Moderator: Thank you. Ladies and gentlemen, on behalf of L&T Technology Services Limited that concludes this conference call for today. Thank you for joining for us and you may now disconnect your lines.