

27 May 2019

L&T Technology – BUY

CMP :Rs.1,720.0
Target Price :Rs.2,074.0
Upside : 20%+
Stop Loss :Rs.1,522.0 (Closingbasis)

Investment Thesis

Recently, the stock price of L&T Technology Services Ltd. (L&T Technology) corrected by ~8% from 52-week high of Rs.1,855.00 despite reporting good set of numbers by the company in the recent quarters.

L&T Technology is a pure engineering design services player with presence across multiple verticals and hence has a much diverse positioning in comparison to other peers. It offers engineering, research & development (ER&D) services and solutions to all major industries which include transportation, industrial products, telecom & hi-tech, medical devices and process industry. It offers design and development solutions throughout the product development value chain and provides solutions in the areas of mechanical and manufacturing engineering, embedded systems, software engineering and process engineering. Apart from engineering design services to clients, L&T Technology also has IP and Platforms, which it independently sells to clients. The company has plans to increase share of IP-led offerings going ahead.

L&T Technology has diversified very well across five verticals viz. transportation, industrial products, telecom and hi-tech, process industry and medical devices. L&T Technology works with most of the top vendors within its focus verticals. Some of the marquee clients include Intel, DANA HAR, P&G, UTAS, Boeing, Caterpillar. It also has a moderate client concentration with top 10 clients contributing to 40% of total revenues and top 20 clients contributing to 55% of total revenues. The company currently has only two accounts with annual billing of over US\$50mn per year. However, each of its clients have large R&D budgets and hence the company has ample room for scalability. The management also believe that each of its top-50 clients spends more than US\$1.0bn annually and wants to focus on its top clients to grow its business.

Financials

- During the past 4 years, revenue of L&T Technology grew at a CAGR of 18.0% while PAT grew at a CAGR of 25.4% in the same period.

Consol. (Rs.Mn.)	FY17	FY18	FY19	FY20E	FY21E
Revenue	32,483	37,471	50,783	58,400	67,161
EBITDA	5,644	5,629	9,147	10,519	12,097
% growth	8.7	-0.3	62.5	15.0	15.0
PAT	4,250	5,066	7,684	8,821	10,127
EPS (INR)	41.9	49.4	73.9	84.8	97.4
P/E (x)	41.7	35.3	23.6	20.6	17.9
RoE (%)	28.6%	26.2%	31.0%	32.3%	33.8%

- L&T Technology has reported 2.0% QoQ growth in revenue to Rs.13,431mn in Q4FY19 led by led by growth in Transportation (6.8%), Process industry (5.2%) and Medical devices (7.6%) verticals.

Stock Data

Market Cap (Rs. Mn)	180,181
Market Cap (\$ Mn)	2,591.6
Shares O/S (in Mn)	104.0
Avg. Volume (3 month)	112,000
52-Week Range (Rs.)	1,855 / 1,156

Shareholding Pattern

Promoters	78.88%
FIIIs	5.09%
Institutions	4.43%
Others (incl. body corporate)	11.60%

Performance (%)	1M	6M	1Yr
Absolute	2.9%	15.5%	33.1%
BSE IT	-4.0%	12.1%	54.5%

Key Ratios

Div Yield	1.2%
TTM PE	23.5x
ROE	31.0%
TTM EPS (Rs.)	73.9/-

- EBITDA of L&T Technology grew by 2.6% QoQ to Rs.2,481mn in Q4FY19 led by higher offshoring and higher fixed-price, which offset the impact of rupee appreciation. As a result, EBITDA margin of L&T Technology has also grown by 12bps QoQ to 18.5% in Q4FY19.
- L&T Technology's PAT has also improved by 3.4% QoQ to Rs.1,924mn in Q4FY19 due to lower tax rate at 24.3% against 26.5% in Q3FY19.

Key Business Highlights

- L&T Technology is a leading global ER&D services company, backed by the rich engineering expertise of parent company, L&T. It provides a range of engineering services and related technologies in the areas of embedded systems, mechanical and others.
- L&T Technology has broad-based vertical mix offering Engineering Services across Transport, Industrial Products, Medical, Process Engineering and Telecom and Hi-tech verticals.
- L&T Technology exports engineering and design services to North America, Europe, the Middle East, Japan, Korea and other Asia-Pacific countries.

Valuation

- L&T Technology's transportation segment, which is the largest segment and contributed 31.8% revenue in FY18, offers engineering services and solutions over the complete spectrum of the transportation industry that includes OEM and tier-1 suppliers in automotive, trucks & off-highway vehicles, aerospace and rail industries. L&T Technology is investing heavily on new areas like, digital cockpit, additive manufacturing, autonomous car middleware, active safety, electric / hybrid vehicles, etc. Strong technological growth witnessing in automotive segment led by advanced driver-assistance systems (ADAS), electric vehicles, telematics, etc. is likely to remain the growth driver for this vertical.
- Telecom and Hitech is second largest vertical of L&T Technology and contributed 25.8% in total revenue in FY18. Revenues from this vertical have grown at 16% CQGR over the past five quarters led by a large deal win from Intel as well as Escentia acquisition. However, the vertical has lower segmental margin and hence, impacting the overall margin trajectory for the company in FY18. With strong traction for Internet of Things (IoT) led technology growth, we expect this vertical to show steady growth in the years to come.
- In the new digital era, the engineering services landscape is expanding and maturing at a rapid pace. The addressable market for opportunities in R&D Globalization and Services is expected to grow to US\$302.0bn in 2021 from US\$232.0bn in 2016. India's ER&D Services market is also expected to reach US\$38.0bn by 2021 from US\$22.2bn in 2016 at a growth rate of 13.7%. L&T Technology is well poised to make the most of this opportunity.
- With pure engineering design services player, investing heavily into newer areas in transportation vertical, top-50 clients spends more than US\$1.0bn on R&D and ER&D service market will grow at over 13% to reach US\$38bn by 2021 in India, we value L&T Technology at 21.3x FY21E EPS of Rs.97.40 to arrive at target price of Rs.2,074.00, an upside of ~20%.

Risk & Concern

- Loss of any major client may have a material impact on business growth as well as financials of L&T Technology.
- L&T Technology has high dependence on North America and Europe, any slowdown in these regions may impact negatively.
- Foreign exchange rate fluctuations may adversely impact business operations and margin of L&T Technology.

Graphs & Charts

Figure 1: Net Sales Trend

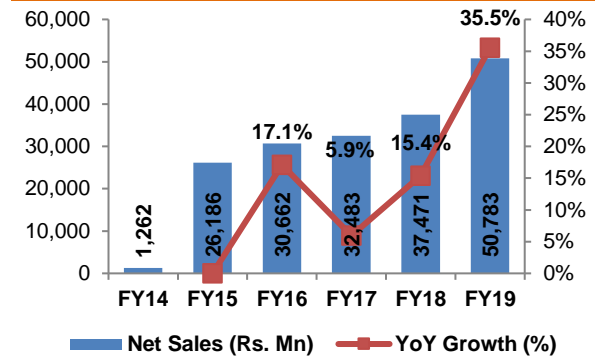


Figure 2: EBITDA & EBITDA Margin Trend

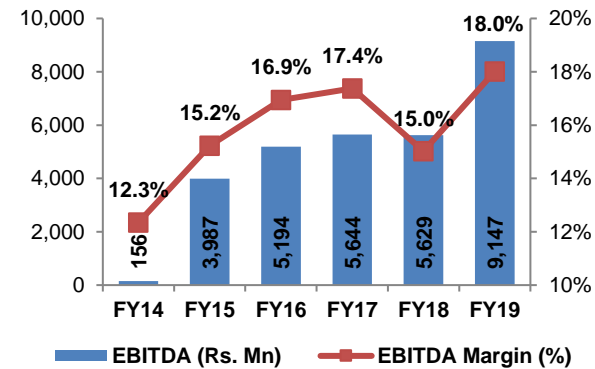


Figure 3: PAT Trend

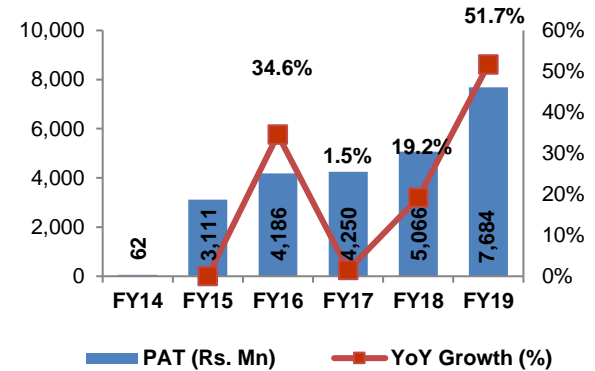
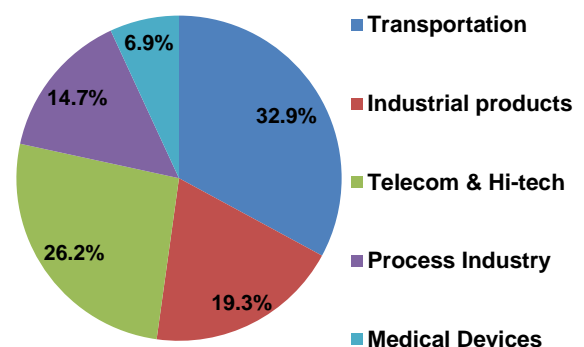


Figure 4: Vertical-wise Revenue Mix(Q4FY19)



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Disclosure:

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