L&T Technology Services

April 3, 2018

Analyst: Mayank Babla (022) 67141442

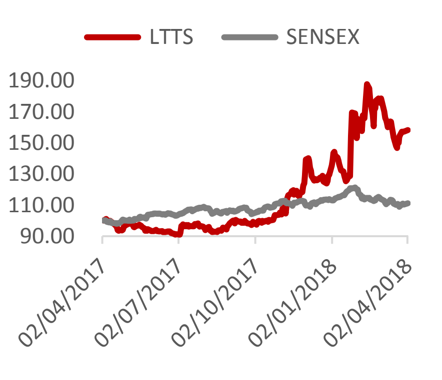
DALAL & BROACHA
STOCK BROKING PVT. LTD.

Stock Idea @ Dalal&Broacha

BUY	
Current Price	1,242
Target Price	1,425
Upside	15%
52 Week Range	1,545/712

Key Share Data	
Market Cap (Rs.bn)	126
Market Cap (US$ mn)	1,940
No of o/s shares (mn)	102
Face Value	2
Monthly Avg. Vol(BSE+NSE) Nos ('000)	51
BSE Code	540115
NSE Code	LTTS
Bloomberg	LTTS.IN

Price performance



% Shareholding	Dec-17	Sept-17
Promoters	89.2	89.5
Public	10.7	10.5
Others	-	-
Total	**100**	**100**

L&T Technology Services is a pure-play Engineering, Research and Development (ER&D) Services Company that provides design and development solutions in the areas of Mechanical & Manufacturing Engineering, Embedded Systems, Software and Process Engineering.

Investment Rationale:

Expect overall Engineering outsourcing market to increase as well as outsourcing to India to grow at 13.7% CAGR between FY17 and FY2021E

Of the $232 Bn spent by G500 companies on ER&D, only $85 Bn is outsourced to 'offshore inhouse R&D centers' ($34 Bn) and 'Offshore 3rd party engineering service providers' $51 Bn). Industry estimates indicate that the pie of 3rd party engineering providers will increase at a CAGR of 9.3% between FY17 and FY21E. Of the $51 Bn outsourced to 3rd party, Indian companies account for on $8.9 Bn only. This figure is estimated to grow at 14% CAGR between FY17 and FY21E. We expect IT engineering service providers such as Cyient, Persistent, KPIT and Tata Elxsi to be major beneficiary of this trend.

Diversified vertical presence and strong revenue guidance coupled with existence of margin levers to bode well for company's performance

LTTS' vertical mix consists of Transportation, Industrial Products, Telecom & HiTech, Process Industry and Medical Devices, which contribute 30.9%, 21.8%, 27.9%, 12.7% and 6.7% to total revenues, respectively. In Q3FY18, management has given a strong and broad-based FY18 USD revenue growth guidance of 18% yoy (highest amongst peers). Expect growth in Transportation segment due to heightened demand in the Autonomous Vehicle, EV, Aerospace and Truck & Off-highway space. Medical segment is expected deliver good growth due to high demand from Japan (which is a big market for LTTS in the Med space). Telecom & HiTech delivered strong growth in Q3FY18 and is expected to continue the trend due to extensive client ramp-ups, growth in semiconductor business (post acquisition of Esencia) and due to high demand from Consumer Electronics and Media segment. The worse seems to be over for Process Industry and Industrial Products as the company expects growth to pick up in these 2 verticals from Q4. We expect EBITDA margins to remain steady at 15% with a possibility of expansion to 17% due to levers such as higher off-shoring from Q3FY18 levels of 49%, increase in Billing Rates (company has won higher bill rates in certain clients and better leverage in next gen technologies) and reduction in SGA expenses.

Strategy revamp to result in immense value unlocking for LTTS

LTTS redefined its growth strategy in Q2FY18 through 5 main initiatives namely

i. **Geo-specific targeting:** Matching supply of services to identified demand in specific regions to reduce inefficiencies
ii. **Augmenting Client Relationships:** through various programs and initiatives which improve involvement with clients and in turn result in higher client mining
iii. **Hunting Agencies**: Snowballing strategy by approaching client offices in other geographies and other stakeholders of existing clients
iv. **Micro-vertical focus**: Increased focus on sub-verticals which have high potential. For example, emphasize only Aerospace, Automotive and Off-Highway sub-verticals in the Transportation segment.
v. **Focus on Innovation, Solutions and Frameworks:** LTTS plans to monetize technology trends such as Connected Products & Services, Smart Manufacturing Operations, Perceptual Engineering and Pervasive Technologies through specialized offerings. The company has also developed solution frameworks such as i-BEMS for Intelligent Buildings, UBIQWeise – IoT Platform and WAGES for managing utilities (Water, Air, Gas, Energy, Steam) of companies.

LTTS has ~300 patents (across its verticals) in its portfolio as of Q3FY18, of which 228 are co-authored and 72 are own authored. Going ahead, the company also plans to focus on this segment through continuously authoring new patents and monetizing developed ones.

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Outlook and Valuation:

LTTS is currently trading at a PE Multiple of 21.7x and 17.4x to its FY19E and FY20E EPS. Factors such as Industry leading revenue growth guidance (18% USD revenue growth in FY18E), broad-based growth across verticals, revival of growth in Process Industry and Industrial Products segments coupled with presence of margin levers such as increase in Billing rates, higher off-shoring and leverage in SG&A expenses as company focuses on Top 30 accounts will be the primary triggers for outperforming the peer group and commanding premium valuations. We assign a PE multiple of 20x FY20E EPS of INR 71.3 to arrive at a target of INR 1,425.

Consolidated Financials (In INR Mn)

	Net Sales	Growth (%)	EBITDA	EBITDA Margin (%)	PAT	PAT Margin (%)	EPS	P/E	ROE (%)
FY16	30662.0	17%	5786.4	18.9%	4191.0	13.7%	55.9	-	-
FY17	32483.0	6%	5593.0	17.2%	4255.6	13.1%	41.9	29.7	33.3%
FY18E	36966.3	14%	5871.3	15.9%	4763.4	12.9%	46.6	26.7	27.8%
FY19E	43314.0	17%	7363.4	17.0%	5847.4	13.5%	57.2	21.7	27.0%
FY20E	50244.2	16%	9044.0	18.0%	7285.4	14.5%	71.3	17.4	27.0%

Source: Company, Bloomberg Estimates and Dalal & Broacha Research

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