

# Stock Note

## Larsen & Turbo Limited

19 JULY 2021



Industry	LTP	Recommendation	Fair Value	Bull Case Value	Time Horizon
Construction & Engineering	Rs. 1618.7	Buy at LTP and add on further dip on Rs. 1478	Rs. 1782	Rs. 1894	2 quarters

HDFC Scrip Code	LARTOU
BSE Code	500510
NSE Code	LT
Bloomberg	LT IN
CMP July 16, 2021	1618.7
Equity Capital (Rs cr)	280.7
Face Value (Rs)	2
Equity Share O/S (cr)	140.3
Market Cap (Rs cr)	227,370
Book Value (Rs)	540.9
Avg. 54 Wk Volumes	2,05,54,288
52 Week High	1622.8
52 Week Low	843.0

Share holding Pattern % (Mar, 2021)	
Promoters	0.0
Institutions	55.7
Non Institutions	44.3
Total	100

## Fundamental Research Analyst

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### Our take

Larsen & Toubro is the foremost player in Infrastructure and Engineering space in India and has footprints in technology and financial services as well. The company addresses critical needs in key sectors such as Hydrocarbon, Infrastructure, Power, Process Industries and Defence. Its order book stands at Rs.327,400 cr providing three years of revenue visibility for the business. The company is a major beneficiary of Government's thrust on infrastructure development and the unveiling of National Infrastructure Pipeline (NIP) augurs well for the company. L&T remains the best proxy of the Indian capex/Infra story. It could further consolidate its market share in the post-COVID-19 era as tough macro environment throws up several challenges for debt-ridden companies. L&T could emerge stronger after this painful period comes to an end. Its IT subsidiaries are performing exceptionally well and are contributing significantly to company's sum of the parts valuations.

### Valuation and recommendation

Improvement in EBITDA margin and strong cash collections were the highlight of the recent quarterly results. With improving macros in international markets and government's focus on infrastructure at home, L&T is hopeful of low to mid-teens growth in order inflow. We remain comfortable on L&T, given its (1) strong order book (Rs 3.3 lakh cr, ~3x FY21 core EPC revenue), (2) healthy balance sheet, and (3) robust services business. L&T can deliver high-teens PAT CAGR over FY2020-23 and pay out high dividends. L&T (standalone) has invested negligible capital on a net basis over FY16-21 vs Rs11000 cr it invested over FY10-15 and instead paid dominant share of its FCF over FY16-21 to shareholders. We feel investors could look at buying the stock at the LTP and add on dips to Rs 1,478 (18.5x FY23E EPS) for base case fair value based on SOTP of the stock is Rs 1,782 and bull case fair value is Rs 1,894 over 2 quarters.

			Base Case	Bull Case
Business	Valuation methodology	Rs bn	Rs/sh	Rs/sh
<b>L&amp;T E&amp;C business</b>	19.5/21.5x Mar-23 E&C Earnings	1,532	1,092	1,204
L&T Infotech	HDFC Sec Target Valuation with 25% holdco disc	436	311	311
L&T Tech services	HDFC Sec Target Valuation with 25% holdco disc	157	112	112
Mindtree	HDFC Sec Target Valuation with 25% holdco disc	199	142	142
L&T Finance	Mcap with 25% holdco disc	100	71	71
Other Subsidiaries, Associates and Developmental Portfolio	0.7x P/BV of Invested Equity	75	53	53
<b>Target price</b>		2,500	<b>1,782</b>	<b>1,894</b>

## Financial Summary

Particulars (Rs. Cr)	FY2019	FY2020	FY2021	FY2022e	FY2023e
Revenue	135,220	145,452	135,979	156,364	181,709
EBITDA	15,330	16,329	15,624	17,740	21,295
Depreciation & Amortisation	1,923	2,462	2,904	3,108	3,257
Finance Cost	1,803	2,797	3,913	3,619	3,694
Other Income	2,131	2,361	8,111	3,050	3,203
Profit for the Year	8,905	9,549	11,583	8,837	11,210
Adj. Earnings per Share (EPS)	61.4	68.1	49.2	63.0	79.9
RoE (%)	14.59%	14.79%	9.68%	11.32%	13.45%
P/E (x)	25.4	23.7	19.5	25.6	20.2

Source: Company, HDFC Research; Data in Rs crore

## Recent Developments

### Key Highlights on Q4 FY21:

L&T reported revenue of Rs 481bn (+9%/+35% YoY/QoQ). Execution recovered to normalcy as revenue from core EPC business grew by 8%/53% YoY/QoQ. Increased productivity, improved utilisation in IT/ITES, and better profitability in transportation projects led to expansion of EBITDA margin by 171/126bps to 13.3% (vs 11.9% est.).

With order book of Rs 3.3 lakh cr, L&T is aiming low to mid-teens growth in execution. While 60% of the order book is variable price, 40% fixed prices contracts have buffer to protect against higher commodity prices.

During Q4, margins were higher owing to better job mix, several project reaching threshold, better cost efficiencies and some reversal of provisions. Other income was up 45%, on account of higher level of treasury investments and yields earned.

A large deferred tax charge led to slower rise in reported PAT.

## Segment Wise:

**Infrastructure:** Revenue grew 5% YoY due to slow execution on account of pandemic. Margins expanded to 11.5% vs 11.1%, on account of better order mix and increase in site productivity.

**Power:** Reported 2x revenue YoY on account of pickup in execution. Award deferments were seen in FY21 due to pandemic, however order book remains healthy due to large orders booked in FY20. Margins remained subdued as major part of order book is yet to cross margin recognition threshold.

**Heavy Engineering:** Revenue grew 57% YoY on account of pick up in execution. Segment reported robust order wins in Nuclear power business worth Rs 1200 cr.

**Defence:** Revenue grew 43% YoY on account of pickup in execution during the quarter. Ordering activity during the quarter was subdued and contributed by small size orders. Recent policy pronouncements around indigenization is expected to drive order inflows in medium to long term.

**Hydrocarbon:** Revenue grew 9% YoY due to improved activity level. Margins were stable contributed by efficient execution and job mix. Order pipeline for FY22 stands at Rs 1.4 lakh cr, with Domestic at ~Rs 60000 cr and International at ~Rs80000 cr.

**Development Projects:** Includes Power Development business (Thermal and Hydro) and Hyderabad Metro. Revenue were up 13% YoY, largely contributed by Power Development Business. Strong Electricity demand drove revenue growth in Nabha whereas Hyderabad Metro ridership was impacted by the pandemic. Rs 1000 cr were allocated to Hyderabad metro in FY21 and additional ~Rs 2000 cr is expected to be infused going ahead.

**Reality business:** Has sold 400 flats in FY21 compared to 800 flats in FY20. Reality business in FY21 was supported for Mumbai location on account of reduction in stamp duty by Government of Maharashtra.

Particulars (Rs Cr)	Q4FY21	Q4FY20	YoY (%)	Q3FY21	QoQ (%)
Revenue	48,088	44,245	-8.0%	35,596	-26.0%
EBITDA	6,389	5,121	-19.8%	4,280	-33.0%
D/A	817	711	-13.0%	702	-14.0%
EBIT	5,572	4,410	-20.9%	3,578	-35.8%
PBT	5,747	4,250	-26.1%	3,681	-36.0%
PAT	3,293	3,197	-2.9%	2,467	-25.1%

Source: Company Filings, HDFC Research

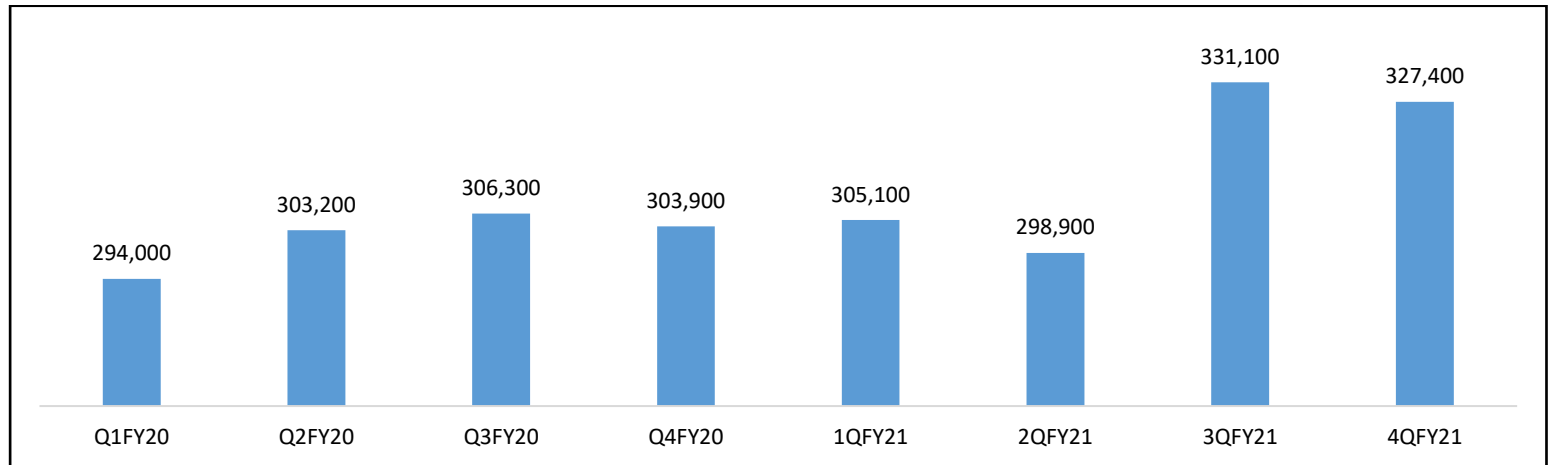
### Capex cycle to kick off afresh after a big gap

An investment cycle is to start taking shape in India, after a long gap. Capital expenditure (capex) over the next 3-4 in core sectors—cement, metals, oil refining and power (esp. renewables)—can be double that in the preceding 3-4 years. Also, the government’s production linked incentives (PLI)—led capex should be large in other sectors such as consumer durables, pharmaceuticals and automobiles. Household spend on residential property, and Govt. infrastructure spend should also see large rise. Governments globally are looking to spend large sums on infrastructure, to recover from the COVID-19-led economic challenges. L&T among the industrial companies could be a key beneficiary of the above.

### Strong order pipeline for FY22

L&T registered 12% YoY decline in order inflows to Rs 50700 cr in Q4FY21, as awarding was deferred. For FY21, order inflow de-grew by 6% YoY to Rs 1.76 lakh cr. Order book now stands at Rs 3.3 lakh cr providing three years of revenue visibility for the EPC business. Management believes FY22 will witness healthy ordering in both domestic and international markets. Total bottom up order pipeline stood at Rs 9.6 lakh cr, of which 6.6 lakh cr is from domestic market. Infrastructure at 77% constitutes major share of the pipeline, followed by hydrocarbon at 17%. Order inflow guidance is also pegged at low to mid-teens. Recovery in key international markets, continuous focus on infrastructure by the government, and rebound in crude oil prices augur well for L&T. Going ahead sectors like Metro, Roads and Expressways, Water, Renewables and Power T&D are expected to drive growth. Further, it is exploring the opportunities in African market for Power T&D and Water segment.

## Total Order Backlog (Rs cr)

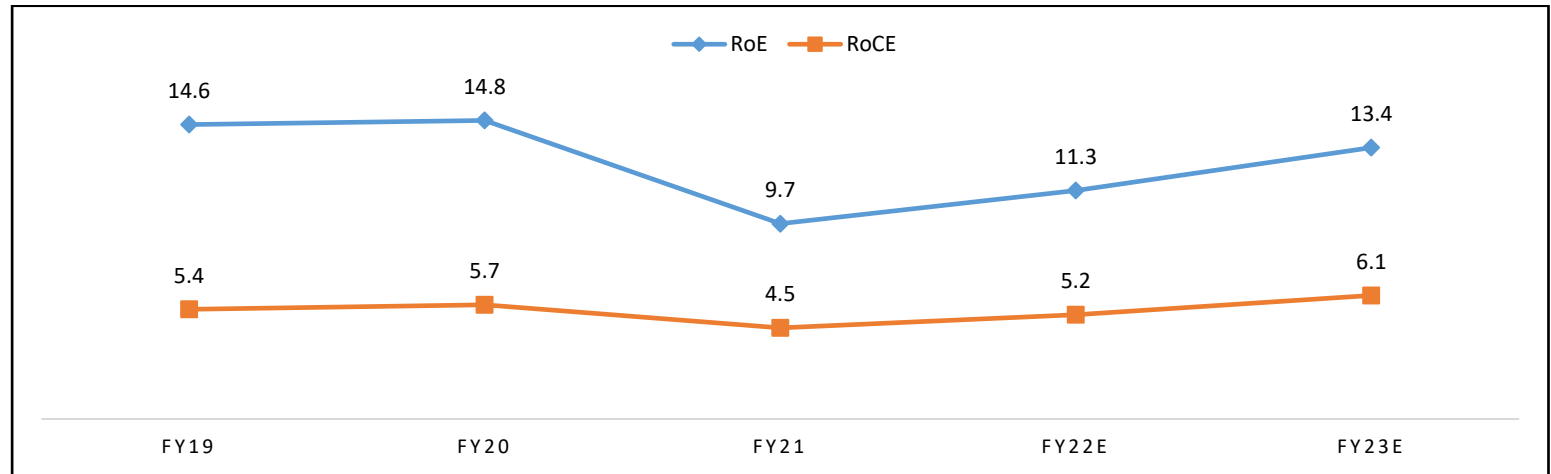


Source: Company Filings, HDFC Research

### Balance sheet remains healthy

Net debt reduced to Rs 85500 cr (vs Rs 99800 cr as of Dec 20). Improvement in working capital led to robust CFO/FCFF of Rs 22800/21900 cr. To guard against the uncertainty, L&T has kept cash reserves at elevated levels (Rs 47300 cr ). While IT business is generating robust cash flows, the recent rights issue has provided enough growth capital to L&T Finance. Hyderabad Metro would require Rs 2000 cr support till the ridership picks up. With core business requiring limited investment, L&T may reward its shareholders with higher dividends. Management expects low to mid teen revenue growth and order inflow for FY22 and also expects margin to be at same level as on FY21. Going ahead focus will be on execution of projects. Targeted ROE to be 18%. Asset monetization, re-orienting the businesses earning less than the cost of capital, growing in core and services business, cost optimization are some measures that LT will deploy to achieve the target.

## Improved Return Ratio (%)



Source: Company Filings, HDFC Research

### Government's Infra spend to boost growth for Larsen & Toubro (LT)

According to a National Infrastructure Pipeline (NIP) report, the Indian government formulated Rs 111 lakh cr in FY20 to be spent over the next six years. NIP indicated that the next few years would likely see spends on water, metro rail, roads, renewable energy, power T&D as well as urban infrastructure. Government reiterated its commitment to shore up the economic growth when it announced in FY22 budget that the number of projects in NIP would increase from 6835 to 7400. L&T with its wide reach across different segments will get the benefit from the substantial spending by Government of India. L&T's diverse presence and unique capabilities across segments of Transportation Infra, Power, Urban & Rural infra, Water & Irrigation will aid the company to get maximum benefit of NIP's projects.

### Defence business to benefit from 'Atma Nirbhar Bharat' and 'Make in India' in Defence Sector

In the last few years, L&T has had "Make in India" success stories in the defence sector; K9 Vajra-T, Pinaka & BM 21 Upgrade for the Army Artillery, Akash for Army & Air Force, BrahMos, Range of Bridging Systems for Army Engineers, Platform specific Engineering systems for

Naval Platform, Floating Dock for the Navy (FDN-2) and Offshore Patrol Vessels & Interceptor Boats for the Coast Guard to name the significant ones. After a weak FY20, Defence segment has now started to rebound due to local production and procurement, on back of government's focus on 'Atma Nirbhar Bharat'. The Defence acquisition council (DAC) has finally approved the project of Rs. 43,000 cr to domestically build six new generation stealth submarines (P75i) with foreign collaboration. The contract will be awarded to L&T shipbuilders and PSU player Mazagaon Dock under a strategic partnership policy. As per the contract, the first submarines will be delivered nearly seven years after the contract is signed and as a result of this, the cash outflow will be spread over the next 10-12 years. We expect order inflow from Defence sector to further increase and contribute much more to the company's revenue and margins over the medium term.

### **Services business continues to grow and monetization activities to gain momentum**

In FY20 annual report, the Chairman's letter states, 'going forward, we are confident that the contribution of the services businesses will exceed 40 per cent of group turnover (from 25%+ in FY20)'. This points to rising capital allocation and importance to Services (IT /ITES and Financial services) over the long term

Monetisation of existing assets in DP, possibly starting with reduction of 51% stake in L&T IDPL, followed by sale of 1.4GW Nabha, Hyderabad metro stake sale (via InvIT route, strategic investor entry; over 3 years) could all lead to better return ratios.

### What could go wrong?

- The unprecedented event of COVID-19 has halted activities across the nation and infrastructure spending has taken a hit. Even in Govt. backed projects we may witness some execution delay due to lack of materials, men or funds.
- Deep global recession and slower than expected recovery.
- Higher than expected losses from the Hyderabad Metro. L&T is looking at improving the financial performance of Hyderabad Metro by looking to refinance project debt, hike fares, infusion of grants by the state government and real estate monetisation. However, the process is slow currently.



- Stressed payment cycles for government projects.
- L&T may choose working capital management above revenue growth for some time.
- Return ratios (esp. RoCE) of L&T may remain low for some more time even as it grapples with rising working capital requirements and low OPM in its core E&C business.
- Reversal in high valuations of IT/ITES subsidiaries like LTI, LTTS, Mindtree.

## Company profile:

Larsen & Toubro Limited is a conglomerate with technology, engineering, construction, manufacturing and financial services businesses.

It is a technology-driven engineering and construction organisation and one of the largest companies in India's private sector. It has business interests in manufacturing, services and Information Technology. The evolution of the company into the country's largest engineering and construction organisation is among the more remarkable success stories in Indian industry. The company sets engineering benchmarks in terms of scale and complexity, and it has successfully executed many marquee projects in India and abroad.

The Company's segments include Infrastructure, which is engaged in engineering and construction of building and factories, transportation infrastructure and heavy civil infrastructure; Power, which offers solutions for coal-based and gas-based thermal power plants; Heavy Engineering, which manufactures and supplies custom designed, engineered critical equipment and systems; Defense Engineering, which is engaged in designing, development, serial production and supporting of equipment, systems and platforms of defense and aerospace sectors, and Other includes communication projects (including military communications), hydrocarbon, marketing and servicing of construction and mining machinery and parts thereof, and manufacture and sale of rubber processing machinery. Defense engineering segment is also involved in designing, constructing and repairing of defense vessels.

## Segment wise Revenue Breakup

Segmental Revenue (Rs cr)	FY19	FY20	FY21	FY22E	FY23E
Infra	73,204	73,777	61,962	70,646	81,110
Power	3,983	2,318	3,193	3,491	4,055
Heavy Engineering (including Defence)	2,514	3,205	3,018	3,254	4,038
Defence	3,849	3,979	3,410	3,770	4,184
Electrical Automation	6,094	5,567	1,606	0	0
Hydrocarbons	15,176	17,445	16,964	20,310	24,571
IT & services	14,553	22,335	25,619	30,046	35,636
Financial Services	12,638	13,822	13,404	14,342	15,510
Development projects	5,068	4,850	3,621	3,983	4,529
Others	5,935	5,309	6,093	6,521	8,077
<b>Total</b>	<b>143,013</b>	<b>152,609</b>	<b>138,889</b>	<b>156,364</b>	<b>181,709</b>
Less: Intersegmental	1,700	1,590	1,304	0	0
Less: Discontinued operations	6,094	5,567	1,606	0	0
<b>Net segmental revenues</b>	<b>135,220</b>	<b>145,452</b>	<b>135,979</b>	<b>156,364</b>	<b>181,709</b>
Core E&C	102,961	104,444	93,335	107,992	126,035

# Larsen & Turbo Limited

## Financials (Consolidated)

### Income statement (Rs Cr)

Year ending March	FY19	FY20	FY21	FY22E	FY23E
Net Revenues (including E&A)	135,220	145,452	135,979	156,364	181,709
Growth (%)	13.0	7.6	-6.5	15.0	16.2
Material Expenses	88,247	89,321	86,701	99,291	115,198
Employee Expenses	17,466	23,114	24,762	26,354	29,215
Other Operating Expenses	14,177	16,689	8,892	12,979	16,001
EBIDTA	15,330	16,329	15,624	17,740	21,295
EBIDTA (%)	11.3	11.2	11.5	11.3	11.7
EBIDTA Growth (%)	13.0	6.5	-4.3	13.5	20.0
Depreciation	1,923	2,462	2,904	3,108	3,257
EBIT	13,407	13,867	12,720	14,633	18,038
Other Income (Incl. EO Items)	2,131	2,361	8,111	3,050	3,203
Interest	1,803	2,797	3,913	3,619	3,694
PBT	13,735	13,431	16,918	14,064	17,547
Tax	4,067	3,263	4,011	3,727	4,650
Minority Interest	742	691	1,338	1,551	1,754
Share of Associate profits	-21	72	14	51	67
RPAT	8,905	9,549	11,583	8,837	11,210
EO items (net of tax)	-295	0	-4,682	0	0
APAT	8,610	9,549	6,901	8,837	11,210
APAT Growth (%)	18.8	10.9	-27.7	28.1	26.8
Adj. EPS	61.4	68.1	49.2	63.0	79.9
Adj. EPS Growth (%)	18.8	10.9	-27.7	28.1	26.8

### Balancesheet (Rs Cr)

As at March	FY19	FY20	FY21	FY22E	FY23E
<b>SOURCES OF FUNDS</b>					
Share Capital	281	281	281	281	281
Reserves	62,094	66,442	75,588	79,936	86,209
Total Shareholders' Funds	62,375	66,723	75,869	80,217	86,489
Minority Interest	6,826	9,521	12,052	13,602	15,356
Long Term Debt	96,331	105,986	104,839	103,839	102,839
Short Term Debt	29,224	35,021	27,766	26,766	25,766
Unsecured Loans					
Total Debt	125,555	141,007	132,605	130,605	128,605
Other Non-Current Liabilities	912	3,383	2,647	2,647	2,647
Deferred Taxes	311	1,453	1,179	1,179	1,179
<b>TOTAL SOURCES OF FUNDS</b>	<b>195,979</b>	<b>222,087</b>	<b>224,351</b>	<b>228,250</b>	<b>234,276</b>
<b>APPLICATION OF FUNDS</b>					
Net Block	15,112	29,701	30,584	29,827	28,620
CWIP	13,919	3,311	500	600	700
Goodwill	1,827	8,011	8,067	8,067	8,067
Investments	11,429	13,289	14,284	15,712	17,283
Other Non-Current Assets	103,746	108,527	96,714	98,594	100,512
Total Non-current Assets	146,034	162,839	150,149	152,800	155,182
Inventories	6,414	5,747	5,821	5,985	6,943
Debtors	37,038	40,732	42,230	48,842	56,819
Cash & bank balances	25,672	27,818	47,253	44,326	43,871
ST Loans & Advances	2,489	2,238	1,131	1,697	1,951
Other Assets	61,487	68,767	64,690	67,278	75,351
Total Current Assets	133,101	145,301	161,125	168,128	184,937
Creditors	42,995	43,644	45,505	48,965	56,810

## Cashflow Statement (Rs Cr)

Year ending March	FY19	FY20	FY21	FY22E	FY23E
PBT	14,286	14,314	23,026	14,115	17,614
Non-operating & EO items	-999	-219	-12,121	-3,050	-3,203
Interest expenses	902	1,968	2,536	3,619	3,694
Depreciation	1,923	2,462	2,904	3,108	3,257
Working Capital Change	-16,247	-7,784	9,970	-6,055	-6,018
Tax paid	-4,582	-4,046	-3,471	-3,727	-4,650
OPERATING CASH FLOW ( a )	-4,717	6,694	22,844	8,010	10,695
Capex	-3,475	-3,299	-922	-2,450	-2,150
Free cash flow (FCF)	-8,191	3,394	21,922	5,560	8,545
Investments	-8,280	3,783	-17,711	-1,428	-1,571
Non-operating income	755	-8,740	13,205	3,050	3,203
INVESTING CASH FLOW ( b )	-10,999	-8,256	-5,429	-829	-519
Share capital Issuance	11	18	16	0	0
Debt Issuance	17,865	13,818	-8,732	-2,000	-2,000
Dividend Payment	-2,647	-4,551	-3,651	-4,489	-4,938
Interest expenses	-2,982	-2,740	-3,388	-3,619	-3,694
Others	3,194	-173	481	0	0
FINANCING CASH FLOW ( c )	15,441	6,372	-15,274	-10,108	-10,631
NET CASH FLOW (a+b+c)	-275	4,809	2,141	-2,926	-455
Opening Cash & Equivalents	17,497	25,672	27,818	47,253	44,326
Adj - EO Items	3,969	-1,418	-1,017	0	0
Cash from Acq of Subsidiary	0	0	0	0	0
Adj - Treasury Investments	4,482	-1,246	18,311	0	0

Other Current Liabilities & Provisions	40,160	42,409	41,418	43,713	49,033
Total Current Liabilities	83,155	86,053	86,923	92,678	105,842
Net Current Assets	49,946	59,248	74,202	75,450	79,094
TOTAL APPLICATION OF FUNDS	195,979	222,087	224,351	228,250	234,276

## Key Ratio

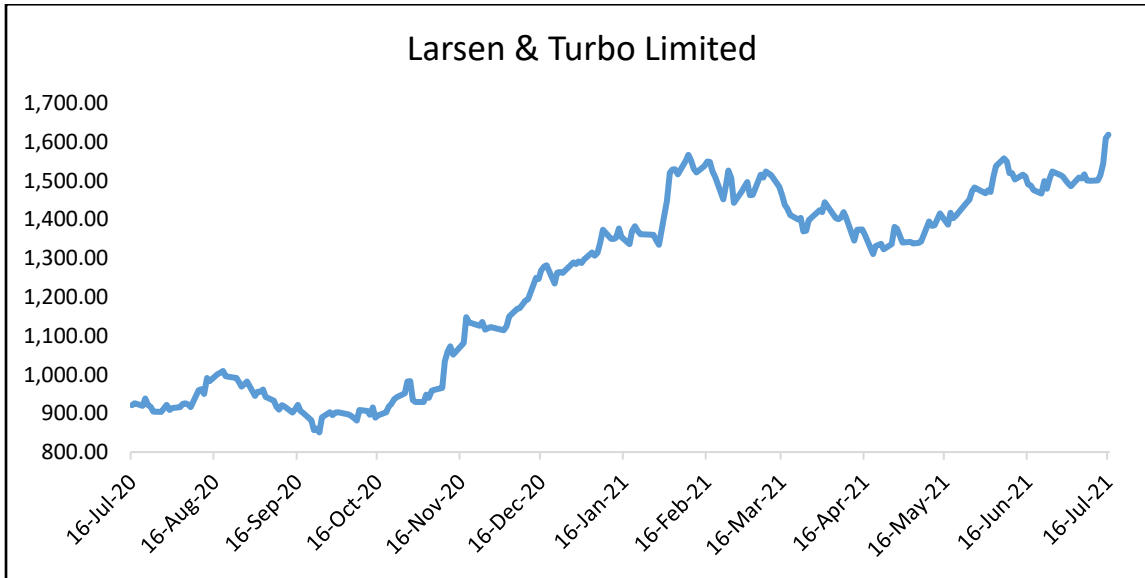
Year ending March	FY19	FY20	FY21	FY22E	FY23E
PROFITABILITY (%)					
GPM	34.7	38.6	36.2	36.5	36.6
EBITDA Margin	11.3	11.2	11.5	11.3	11.7
EBIT Margin	9.9	9.5	9.4	9.4	9.9
APAT Margin	6.4	6.6	5.1	5.7	6.2
RoE	14.6	14.8	9.7	11.3	13.4
Core RoCE	6.3	6.2	5.6	6.6	7.9
RoCE	5.4	5.7	4.5	5.2	6.1
EFFICIENCY					
Tax Rate (%)	29.6	24.3	23.7	26.5	26.5
Asset Turnover (x)	6.0	3.7	3.2	3.5	3.8
Inventory (days)	17.3	14.4	15.6	14.0	13.9
Debtors (days)	100	102	113	114	114
Other Current Assets (days)	173	178	177	161	155
Payables (days)	116	110	122	114	114
Other Current Liabilities (days)	108	106	111	102	98
Net Working Capital Cycle (Days)	66	79	72	73	71
Debt/EBITDA (x)	8.2	8.6	8.5	7.4	6.0
Net D/E	1.6	1.7	1.1	1.1	1.0
Interest Coverage	7.4	5.0	3.3	4.0	4.9
PER SHARE DATA	0.0	0.0	0.0	0.0	0.0
Reported EPS (Rs/sh)	63.5	68.1	82.6	63.0	79.9

# Larsen & Turbo Limited

Closing Cash & Equivalents	25,672	27,818	47,253	44,326	43,871
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CEPS (Rs/sh)	75.1	85.6	69.9	85.2	103.1
DPS (Rs/sh)	18.9	32.4	26.0	32.0	35.2
BV (Rs/sh)	444.7	475.7	540.9	571.9	616.6
VALUATION	0.0	0.0	0.0	0.0	0.0
P/E	25.4	23.7	19.5	25.6	20.2
P/BV	3.6	3.4	3.0	2.8	2.6
EV/EBITDA	21.3	20.8	20.0	17.6	14.6

## One Year Price Chart



## Disclosure:

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