

RETAIL EQUITY RESEARCH

Larsen & Toubro Ltd.

Construction & Engineering

BSE CODE: 500510

NSE CODE: LT

Bloomberg CODE: LT:IN

SENSEX: 34,446

BUY

Rating as per Largcap

12months investment period

CMP Rs. 1,339 TARGET Rs. 1,515 RETURN 13% ↑

27th February 2018

Stellar Quarter

L&T is an engineering & construction (E&C) conglomerate. Further, it has presence in IT & financial services sectors.

- Consolidated sales posted a robust 10% YoY growth in Q3FY18 led by solid execution in infrastructure, hydrocarbon and heavy engineering segments.
- Order inflow surged 37.8% YoY led by domestic order inflows (up 71% YoY) in hydrocarbon and infrastructure segments resulting in 5% YoY growth in order backlog.
- Overall EBITDA margin expanded by 134 bps YoY to 10.9% supported largely by services business.
- We increase our EBITDA margin estimates by 70/60 bps in FY18/19E to factor in better than expected performance.
- Recovery in domestic business, strong order pipeline, sale of non-core assets, focus on improving RoE & working capital and healthy execution of large order backlog will drive the stock going forward.
- Hence, we upgrade the stock to BUY as we roll forward our valuations to FY20 with a SOTP based TP of Rs. 1,515.

Solid execution drives topline

Consolidated sales registered 10% YoY growth in Q3FY18 led by strong execution in infrastructure, hydrocarbon and heavy engineering segments. With pick-up in domestic execution, Infrastructure segment witnesses 10% YoY growth in Q3FY18. Growth in heavy engineering (up 14% YoY) was driven by higher execution of defence orders while hydrocarbons reported strong growth (up 29% YoY) on the back of healthy execution of international order book. Development projects segment benefitted from favorable court orders on Nabha power. On the flip side, power segment (down 22% YoY) reported dismal numbers on account of weak order book and order inflow due to aggressive competition. Others segment (down 14% YoY) was impacted by lower industrial offtake and delay in clearances. The management maintained its sales growth guidance of 12% and margin improvement of 25bps YoY excluding services for FY18.

Margin beats estimates

Overall EBITDA margin expanded by 134 bps YoY to 10.9% in Q3FY18 supported largely by services business. Margin in Infrastructure segment (down 50bps YoY) was impacted by job mix and non-recognition of revenue in certain projects which didn't meet revenue recognition threshold. While Electrical and Automation segment witnessed 170 bps YoY improvement in margin led by product mix and operation efficiencies, hydrocarbon segment saw margin improvement due to higher execution and close of all legacy orders. Development projects margin witnessed sharp improvement with EBITDA margin of 8.5% (-10.6% in Q3FY17) on recognition of revenue and margin for Nabha project. On the other hand, heavy engineering reported lower margin (down 150 bps YoY) largely due to job mix. Adj PAT increased by robust 55% YoY owing to strong operational performance and lower depreciation.

Domestic Order inflow up 71% YoY; Order backlog up 5% YoY

Backed by strong order inflow from the domestic market, overall order inflows were up by 38% YoY. This was largely led by uptick in orders from infrastructure and hydrocarbon space. As a result, order backlog increased by 5% YoY to Rs 2,707 bn. The order pipeline continues to be healthy with a few large orders expected in infrastructure and defence segments. We factor order inflow CAGR of 9% over FY17-20E for core E&C segment.

Outlook & Valuation

We project Sales/PAT CAGR of 12.2/17.5% over FY17-20E. Recovery in domestic business, strong order pipeline, sale of non-core assets, focus on improving RoE & working capital and healthy execution of large order backlog will drive the stock going forward. Hence, we upgrade the stock to BUY as we roll forward our valuation to FY20 with a SOTP based TP of Rs. 1,515.

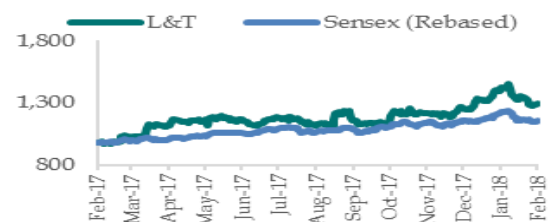
Company Data

Market Cap (Rs cr)	187,522
Enterprise Value (Rs cr)	265,712
Outstanding Shares (cr)	140.0
Free Float	100%
Dividend Yield	1.2
52-week high	Rs. 1,470
52 week low	Rs. 974
6m average volume (cr)	0.3
Beta	1.1
Face value	Rs. 2

Shareholding %	Q1FY18	Q2FY18	Q3FY18
Promoters	0.0	0.0	0.0
FII's	17.6	17.2	16.9
MFs/Insti	52.3	52.8	53.4
Public	21.8	21.1	21.7
Others	8.3	8.9	8.0
Total	100	100.0	100

Price Performance	3mth	6mth	1 Year
Absolute Return	10%	19%	36%
Absolute Sensex	2%	9%	19%
Relative Return*	8%	10%	17%

*over or under performance to benchmark index



Consolidated (Rs.cr)	FY18E	FY19E	FY20E
Sales	1,21,730	1,37,496	1,55,142
Growth (%)	11.4%	13.0%	12.8%
EBITDA	13,512	15,812	18,307
Margin(%)	11.1	11.5	11.8
PAT Adj	7,052	8,085	9,646
Growth (%)	19.1%	14.6%	19.3%
Adj.EPS	50.4	57.7	68.9
Growth (%)	19.1%	14.6%	19.3%
P/E	26.6	23.2	19.4
P/B	3.4	3.1	2.8
EV/EBITDA	21.0	18.1	15.8
RoE (%)	13.5	14.2	15.4
D/E	1.7	1.6	1.4

Quarterly Financials (Consolidated)

Profit & Loss Account

(Rs cr)	Q3FY18	Q3FY17	YoY Growth %	Q2FY18	QoQ Growth %	9MFY18	9MFY17	YoY Growth %
Sales	28,747	26,110	10.1	26,447	8.7	79,005	72,693	8.7
EBITDA	3,144	2,505	25.5	2,962	6.1	8,163	6,709	21.7
Margin (%)	10.9	9.6	134bps	11.2	(26bps)	10.3	9.2	110bps
Depreciation	454	722	(37.1)	431	5.6	1,436	1,647	(12.8)
EBIT	2,690	1,783	50.8	2,531	6.2	6,727	5,062	32.9
Interest	362	379	(4.3)	393	(7.7)	1,120	1,043	7.4
Other Income	213	274	(22.4)	400	(46.7)	997.4	1,031.9	(3.3)
Exceptional Items	(14)	-	-	137	-	123	402	-
PBT	2,526	1,679	50.5	2,675	(5.6)	6,727	5,453	23.3
Tax	737	440	67.6	544	35.5	1,741	1,669	4.3
Minority Interest/ P/L of Associates	(299)	(266)	12.3	(311)	(3.9)	(783)	(767)	2.1
Reported PAT	1,490	973	53.2	1,820	(18.1)	4,202	3,017	39.3
Adjustment	14	-	-	(137)	-	123	402	-
Adj PAT	1,504	973	54.6	1,683	(10.7)	4,079	2,614	56.0
No. of shares (cr)	140.0	140.0	-	140.0	-	140.0	140.0	-
EPS (Rs)	10.7	6.9	54.6	12.0	(10.7)	29.1	18.7	56.0

Gross segment Revenue

(Rs cr)	Q3FY18	Q3FY17	YoY Growth %	Q2FY18	QoQ Growth %	9MFY18	9MFY17	YoY Growth %
Infrastructure	13,966	12,735	9.7	11,989	16.5	36,683	33,620	9.1
Power	1,270	1,633	(22.2)	1,667	(23.8)	4,701	5,100	(7.8)
Heavy Engineering	988	870	13.5	1,211	(18.4)	2,930	2,412	21.5
Electrical & Automation	1,287	1,356	(5.0)	1,309	(1.7)	3,865	3,689	4.8
Hydrocarbon	3,090	2,402	28.6	2,561	20.6	8,201	7,049	16.3
IT & Technology Services	2,915	2,502	16.5	2,724	7.0	8,205	7,339	11.8
Financial Services	2,634	2,108	25.0	2,413	9.2	7,342	6,339	15.8
Developmental Projects	1,213	905	34.1	1,416	(14.3)	3,889	3,361	15.7
Others	2,084	2,434	(14.4)	1,845	12.9	5,683	6,445	(11.8)

Source: Company, Geojit Research

Sum-of-the-parts Valuation

	Basis	Multiple (x)	Value (Rscr)	Value/share (Rs)
Core E&C	Mar-20 P/E	22	155,610	1,111
Financial Services	Geojit TP		19,650	140
IT & Tech Services	20% Holdco Disc. To Market Cap		26,639	190
Developmental Projects	Mar-20 P/BV	1	10,317	74
Total Valuation			212,217	1,515

Change in estimates

Year / Rs cr	Old estimates		New estimates			Change %	
	FY18E	FY19E	FY18E	FY19E	FY20E	FY18E	FY19E
Revenue	119,524	133,799	121,730	137,496	155,142	1.8	2.8
EBITDA	12,488	14,584	13,512	15,812	18,307	8.2	8.4
Margins (%)	10.4%	10.9%	11.1%	11.5%	11.8%	70bps	60bps
PAT	6,316	7,500	7,052	8,085	9,646	11.7	7.8
EPS	45.1	53.6	50.4	57.7	68.9	11.7	7.8

Source: Company, Geojit Research

Consolidated Financials

Profit & Loss Account

Y.E March (Rs cr)	FY16	FY17	FY18E	FY19E	FY20E
Sales	1,01,122	1,09,312	1,21,730	1,37,496	1,55,142
% change	9.9%	8.1%	11.4%	13.0%	12.8%
EBITDA	10,457	11,073	13,512	15,812	18,307
% change	-7.8%	5.9%	22.0%	17.0%	15.8%
Depreciation	1,781	2,368	2,016	2,395	2,704
EBIT	8,676	8,705	11,496	13,417	15,603
Interest	1,655	1,340	1,495	1,550	1,581
Other Income	904	1,401	1,350	1,418	1,488
PBT	7,925	8,766	11,350	13,285	15,511
% change	15.4%	10.6%	29.5%	17.0%	16.8%
Tax	2,485	2,007	3,178	4,118	4,808
Tax Rate (%)	31.4%	22.9%	28.0%	31.0%	31.0%
Reported PAT	4,232	6,041	7,175	8,085	9,646
Adj*	94	121	123	-	-
Adj PAT	4,138	5,920	7,052	8,085	9,646
% change	-6.3%	43.1%	19.1%	14.6%	19.3%
No. of shares (cr)	93.2	93.3	140.0	140.0	140.0
Adj EPS (Rs)	29.5	42.3	50.4	57.7	68.9
% change	-6.3%	43.1%	19.1%	14.6%	19.3%
DPS (Rs)	12.2	14.0	16.0	17.6	20.0

Cash flow

Y.E March (Rs cr)	FY16	FY17	FY18E	FY19E	FY20E
Pre-tax profit	7,925	8,766	10,880	12,885	15,171
Depreciation	1,787	2,370	2,016	2,395	2,704
Changes in W.C	(10,510)	(1,763)	(7,108)	(7,494)	(8,368)
Others	773	63	145	132	92
Tax paid	(3,215)	(3,202)	(3,178)	(4,118)	(4,808)
C.F.O	(3,240)	6,234	2,756	3,801	4,791
Capital exp.	(4,322)	(2,979)	(3,500)	(3,000)	(3,000)
Change in inv.	19	(5,609)	-	-	-
Other invest.CF	(324)	(1,153)	1,350	1,418	1,488
C.F - investing	(4,627)	(9,740)	(2,150)	(1,583)	(1,512)
Issue of equity	70	53	0	-	-
Issue/repay debt	10,516	5,073	5,000	2,000	2,000
Dividends paid	(1,842)	(2,093)	(2,697)	(2,967)	(3,371)
Other finance.CF	(1,491)	494	(1,495)	(1,550)	(1,581)
C.F - Financing	7,253	3,527	808	(2,516)	(2,952)
Chg. in cash	(613)	21	1,414	(298)	327
Closing cash	5,390	5,572	6,987	6,689	7,016

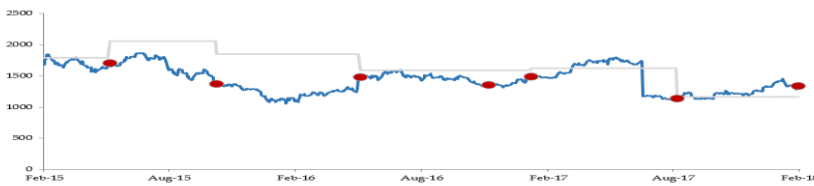
Balance Sheet

Y.E March (Rs cr)	FY16	FY17	FY18E	FY19E	FY20E
Cash	5,390	5,572	6,987	6,689	7,016
Accounts Receivable	26,025	27,970	32,034	36,183	40,827
Inventories	4,854	4,140	4,544	5,117	5,735
Other Cur. Assets	62,110	68,478	75,708	84,203	93,625
Investments	11,079	19,753	19,753	19,753	19,753
Gross Fixed Assets	19,462	18,989	23,460	26,960	29,960
Net Fixed Assets	17,115	15,105	17,560	18,665	18,961
CWIP	10,974	13,471	12,500	12,000	12,000
Intangible Assets	1,447	1,399	1,399	1,399	1,399
Def. Tax (Net)	736	1,125	1,125	1,125	1,125
Other Assets	54,360	54,436	54,436	54,436	54,436
Total Assets	1,94,091	2,11,449	2,26,046	2,39,569	2,54,877
Current Liabilities	58,121	61,307	65,898	71,621	77,937
Provisions	-	-	-	-	-
Debt Funds	88,135	93,976	98,976	1,00,976	1,02,976
Other Liabilities	761	2,386	2,386	2,386	2,386
Equity Capital	186	187	280	280	280
Reserves and Surplus	43,994	50,030	54,292	59,410	65,685
Shareholder's Fund	44,180	50,217	54,572	59,690	65,965
Minority Interest	2,893	3,564	4,214	4,896	5,613
Total Liabilities	1,94,091	2,11,449	2,26,046	2,39,569	2,54,877
BVPS (Rs)	315.5	358.6	389.7	426.2	471.0

Ratios

Y.E March	FY16	FY17	FY18E	FY19E	FY20E
Profitab. & Return					
EBITDA margin (%)	10.3	10.1	11.1	11.5	11.8
EBIT margin (%)	8.6	8.0	9.4	9.8	10.1
Net profit mgn.(%)	4.1	5.4	5.8	5.9	6.2
ROE (%)	9.7	12.5	13.5	14.2	15.4
ROCE (%)	7.0	7.1	8.4	9.2	10.1
W.C & Liquidity					
Receivables (days)	93	93	96	96	96
Inventory (days)	21	17	17	17	16
Payables (days)	109	111	111	111	111
Current ratio (x)	1.7	1.7	1.8	1.8	1.9
Quick ratio (x)	1.6	1.7	1.7	1.8	1.8
Turnover & Levq.					
Gross asset T.O (x)	2.8	5.7	5.7	5.5	5.5
Total asset T.O (x)	0.5	0.5	0.6	0.6	0.6
Int. covge. ratio (x)	5.2	6.5	7.7	8.7	9.9
Adj. debt/equity (x)	1.9	1.7	1.7	1.6	1.4
Valuation ratios					
EV/Net Sales (x)	2.7	2.6	2.3	2.1	1.9
EV/EBITDA (x)	26.1	25.2	21.0	18.1	15.8
P/E (x)	45.3	31.7	26.6	23.2	19.4
P/BV (x)	4.2	3.7	3.4	3.1	2.8

Recommendation Summary (last 3 years)



Source: Bloomberg, Geojit Research

Dates	Rating	Target
15-Jan-14	BUY	1125
7-Apr-14	BUY	1520
20-May-14	BUY	1643
3-Jun-14	BUY	1795
1-Jun-15	BUY	2060
3-Nov-15	BUY	1855
30-May-16	HOLD	1590
02-Dec-16	BUY	1589
01-Feb-17	BUY	1629
4-Sep-17	HOLD	1,161
27-Feb-18	BUY	1,515

Investment Rating Criteria

Large Cap Stocks;

Buy	-	Upside is above 10%.
Hold	-	Upside is between 0% - 10%.
Reduce	-	Downside is more than 0%.
Neutral	-	Not Applicable.

Mid Cap and Small Cap;

Buy	-	Upside is above 15%.
Accumulate	-	Upside is between 10% - 15%.
Hold	-	Upside is between 0% - 10%.
Reduce/Sell	-	Downside is more than 0%.
Neutral	-	Not Applicable.

To satisfy regulatory requirements, we attribute 'Accumulate' as Buy and 'Reduce' as Sell. The recommendations are based on 12 month horizon, unless otherwise specified. The investment ratings are on absolute positive/negative return basis. It is possible that due to volatile price fluctuation in the near to medium term, there could be a temporary mismatch to rating.

For reasons of valuations/return/lack of clarity/event we may revisit rating at appropriate time. Please note that the stock always carries the risk of being upgraded to BUY or downgraded to a HOLD, REDUCE or SELL.

Neutral - The analyst has no investment opinion on the stock under review.

Geojit Financial Services Limited has outsourced the preparation of this research report to DION Global Solutions Limited whose relevant disclosures are available hereunder. However, Geojit's research desk has reviewed this report for any untrue statement of material fact or any false or misleading information.

General Disclosures and Disclaimers

CERTIFICATION

I, Abhijit Kumar Das, employee of Dion Global Solutions Limited (Dion) is engaged in preparation of this report and hereby certify that all the views expressed in this research report (report) reflect my personal views about any or all of the subject issuer or securities.

Disclaimer

This report has been prepared by Dion and the report & its contents are the exclusive property of the Dion and the client cannot tamper with the report or its contents in any manner and the said report, shall in no case, be further distributed to any third party for commercial use, with or without consideration.

Geojit Financial Services Limited has outsourced the assignment of preparation of this report to Dion.

Recipient shall not further distribute the report to a third party for a commercial consideration as this report is being furnished to the recipient solely for the purpose of information.

Dion has taken steps to ensure that facts in this report are based on reliable information but cannot testify, nor make any representation or warranty, express or implied, to the accuracy, contents or data contained within this report. It is hereby confirmed that wherever Dion has employed a rating system in this report, the rating system has been clearly defined including the time horizon and benchmarks on which the rating is based.

Descriptions of any company or companies or their securities mentioned herein are not intended to be complete and this report is not, and should not be construed as an offer or solicitation of an offer, to buy or sell any securities or other financial instruments. Dion has not taken any steps to ensure that the securities referred to in this report are suitable for any particular investor. This report is not to be relied upon in substitution for the exercise of independent judgment. Opinions or estimates expressed are current opinions as of the original publication date appearing on this report and the information, including the opinions and estimates contained herein, are subject to change without notice. Dion is under no duty to update this report from time to time.

Dion or its associates including employees engaged in preparation of this report and its directors do not take any responsibility, financial or otherwise, of the losses or the damages sustained due to the investments made or any action taken on basis of this report, including but not restricted to, fluctuation in the prices of securities, changes in the currency rates, diminution in the NAVs, reduction in the dividend or income, etc.

The investments or services contained or referred to in this report may not be suitable for all equally and it is recommended that an independent investment advisor be consulted. In addition, nothing in this report constitutes investment, legal, accounting or tax advice or a representation that any investment or strategy is suitable or appropriate to individual circumstances or otherwise constitutes a personal recommendation of Dion.

REGULATORY DISCLOSURES:

Dion is engaged in the business of developing software solutions for the global financial services industry across the entire transaction lifecycle and inter-alia provides research and information services essential for business intelligence to global companies and financial institutions. Dion is listed on BSE

Limited (BSE) and is also registered under the SEBI (Research Analyst) Regulations, 2014 (SEBI Regulations) as a Research Analyst vide Registration No. INH100002771. Dion's activities were neither suspended nor has it defaulted with requirements under the Listing Agreement and / or SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 with the BSE in the last five years. Dion has not been debarred from doing business by BSE / SEBI or any other authority.

In the context of the SEBI Regulations, we affirm that we are a SEBI registered Research Analyst and in the course of our business, we issue research reports / research analysis etc that are prepared by our Research Analysts. We also affirm and undertake that no disciplinary action has been taken against us or our Analysts in connection with our business activities.

In compliance with the above mentioned SEBI Regulations, the following additional disclosures are also provided which may be considered by the reader before making an investment decision:

1. Disclosures regarding Ownership

Dion confirms that:

- (i) It/its associates have no financial interest or any other material conflict in relation to the subject company (ies) covered herein at the time of publication of this report.
- (ii) It/its associates have no actual / beneficial ownership of 1% or more securities of the subject company (ies) covered herein at the end of the month immediately preceding the date of publication of this report.

Further, the Research Analyst confirms that:

- (i) He, his associates and his relatives have no financial interest in the subject company (ies) covered herein, and they have no other material conflict in the subject company at the time of publication of this report.
- (ii) He, his associates and his relatives have no actual/beneficial ownership of 1% or more securities of the subject company (ies) covered herein at the end of the month immediately preceding the date of publication of this report.

2. Disclosures regarding Compensation:

During the past 12 months, Dion or its Associates:

(a) Have not managed or co-managed public offering of securities for the subject company (b) Have not received any compensation for investment banking or merchant banking or brokerage services from the subject company (c) Have received compensation for products or services other than investment banking or merchant banking or brokerage services from the subject (d) Have not received any compensation or other benefits from the subject company or third party in connection with this report.

3. Disclosure regarding the Research Analyst's connection with the subject company:

It is affirmed that I, Abhijit Kumar Das employed as Research Analyst by Dion and engaged in the preparation of this report have not served as an officer, director or employee of the subject company

4. Disclosure regarding Market Making activity:

Neither Dion /its Research Analysts have engaged in market making activities for the subject company.

Copyright in this report vests exclusively with Dion.

Please ensure that you have read the "Risk Disclosure Documents for Capital Market and Derivatives Segments" as prescribed by the Securities and Exchange Board of India before investing.

Geojit Financial Services Ltd. (formerly known as Geojit BNP Paribas Financial Services Ltd.), Registered Office: 34/659-P, Civil Line Road, Padivattom, Kochi-682024, Kerala, India. Phone: +91 484-2901000, Fax: +91 484-2979695, Website: geojit.com. For investor queries: customercare@geojit.com. For grievances: grievances@geojit.com. For compliance officer: compliance@geojit.com.

Corporate Identity Number: L67120KL1994PLC008403, SEBI Regn.Nos.: NSE: INB/INF/INE231337230 I BSE:INB011337236 & INF011337237 | MSEI: INE261337230, INB261337233 & INF261337233, Research Entity SEBI Reg No: INZ000104737, Investment Adviser SEBI Reg No: INA200002817, Portfolio Manager:INP000003203, NSDL: IN-DP-NSDL-24-97, CDSL: IN-DP-CDSL-648-2012, ARN Regn.Nos:0098, IRDA Corporate Agent (Composite) No.: CA0226.
Research Entity SEBI Registration Number: INZ000104737