ANANDRATHI

India I Equities

Industrial Consumables

Company Update

Change in Estimates ☑ Target ☑ Reco ☐

24 July 2019

Larsen & Toubro

Rating: **Buy**
Target Price: ₹1,720
Share Price: ₹1,410

Growth prospects intact; maintaining a Buy

L&T's Q1 FY20 sales grew 10% y/y. Its EBITDA margin expanded 100bps to 11.2%. Adj. PAT grew 21% y/y to ₹13.6bn. Despite sluggish capex investment, order inflows grew 11% y/y to ₹387bn. Working capital deteriorated 200bps largely helping vendor liquidity. We believe that the forthcoming capex in select private sectors and in the Railways will lead to healthy inflows for the company. Adjusting for its discontinued operations, we reduce our FY20e and FY21e earnings respectively 4% and 6%. Considering the strong prospects, we maintain a Buy, with a revised TP of ₹1,720 (a sum-of-parts valuation, based on FY21).

Strong prospects. As per management, domestic pipeline in FY20 will be ~₹8,400bn. Infra ₹5400bn, generation ₹500bn, T&D ₹1,000bn, hydrocarbons ₹1,200bn, etc comprise most of the domestic pipeline. The FY20 international pipeline will be ~ ₹1,650bn. In domestic infra, L&T enjoys a ~20-25% market share. Internationally, it has ~10-15%. This would lead to ~10-12% growth in order inflows of ~ ₹1900bn-2,000bn, in line with management guidance. In Q1, order inflows grew 11% y/y to ₹387bn (international 23%). The order book has grown 9% y/y to ₹2,940bn (international 21%).

Likely to meet guidance. On the robust order book, we expect the company to achieve its ~ 12-15% sales growth guidance. We have adjusted our sales estimate for the discontinued operations in electrical & automation. Excl. the services business, margins likely to sustain. In infra, a pick-up in execution is expected to lead to margin improvement. Further, hydrocarbons and power are expected to show margin improvement in the core business.

Outlook. With a strong book, we believe that sales growth will be healthy and margins are likely to sustain or improve from current levels. Further, monetisation of non-core assets will help the company release capital and improve return ratios. We maintain a Buy. **Risk:** Sluggish capex cycle.

Key financials (YE Mar)	FY17	FY18	FY19	FY20e*	FY21e*
Sales (₹ bn)	1,093	1,197	1,410	1,530	1,743
Net profit (₹ bn)	60	74	89	99	115
EPS (₹)	42.3	51.7	61.6	70.6	81.7
PE (x)	24.9	25.4	22.5	20.0	17.3
EV / EBITDA (x)	22.3	20.1	18.0	17.2	15.0
PBV (x)	3.0	3.3	3.1	2.8	2.5
RoE (%)	12.6	13.8	14.7	15.0	15.4
RoCE (%)	6.4	8.3	8.9	8.9	9.4
Dividend yield (%)	1.2	1.2	1.3	1.3	1.3
Net debt / equity (x)	1.4	1.5	1.4	1.5	1.4

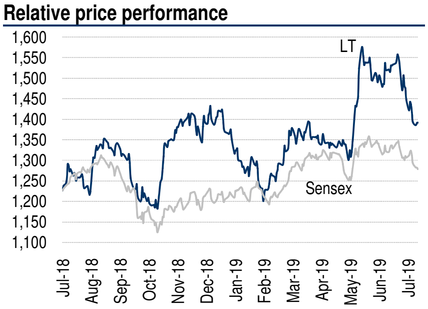
*Source: Company, Anand Rathi Research * Not comparable due to discontinued op and acquisition*

Key data	LT IN / LART.BO
52-week high / low	₹1,607 / 1,183
Sensex / Nifty	37875 / 11276
3-m average volume	$67.6m
Market cap	₹1953bn / $28300m
Shares outstanding	1403m

Shareholding pattern (%)	Jun'19	Mar'19	Dec'18
Promoters	-	-	-
- of which, Pledged	-	-	-
Free float	100.0	100.0	100.0
- Foreign institutions	20.0	19.0	18.8
- Domestic institutions	37.6	39.1	38.4
- Public	42.4	42.1	42.7

Estimates revision (%)	FY20e	FY21e
Sales	(4.5)	(3.9)
EBITDA	(4.5)	(3.7)
EPS	(3.6)	(6.4)

Relative price performance



Source: Bloomberg

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Quick Glance – Consolidated Financials and Valuations

Fig 1 – Income statement (₹ bn)

Year-end: Mar	FY17	FY18	FY19	FY20e*	FY21e*
Order book (₹ bn)	2,613	2,631	2,934	3,294	3,697
Net revenues	1,093	1,196.	1,410	1,530	1,743
Growth (%)	*8.1*	*9.5*	*17.8*	*8.5*	*14.0*
Material cost	367	419	489	532	606
Employee, other expenses	626	641	756	817	926
EBITDA	99	136	163	181	211
EBITDA margins (%)	*9.1*	*11.4*	*11.6*	*11.8*	*12.1*
- Depreciation	23	19	20	22	26
Other income	14	13	18	20	20
Interest expenses	3	15	18	21	23
PBT	87	115	143	157	181
Effective tax rate (%)	*22.8*	*27.7*	*30.2*	*30.2*	*30.2*
+ Associates / (Minorities)	-8	-11	-13	-11	-12
Net income	60	74	89	99	115
Adjusted income	59	73	86	99	115
WANS	1.4	1.4	1.4	1.4	1.4
FDEPS (₹ / sh)	42.3	51.7	61.6	70.6	81.7
EPS growth (%)	*43.3*	*22.4*	*19.0*	*14.6*	*15.7*

Fig 2 – Balance sheet (₹ bn)

Year-end: Mar	FY17	FY18	FY19	FY20e*	FY21e*
Share capital	2	3	3	3	3
Net worth	502	557	624	683	787
Debt	940	1,075	1,256	1,342	1,436
Minority interest	36	56	68	74	84
DTL / (Assets)	-11	-15	-31	-34	-38
Capital employed	**1,466**	**1,673**	**1,916**	**2,065**	**2,269**
Net tangible assets	131	142	169	203	234
Net intangible assets	99	95	96	96	96
Goodwill	15	18	18	18	18
CWIP (tang. & intang.)	19	21	25	23	23
Investments (strategic)	91	102	114	197	212
Investments (financial)	143	95	139	160	185
Current assets (ex cash)	1,554	1,876	2,078	2,142	2,416
Cash	53	80	117	47	69
Current liabilities	638	756	841	822	984
Working capital	916	1,119	1,237	1,320	1,433
Capital deployed	**1,466**	**1,673**	**1,916**	**2,065**	**2,269**
Contingent liabilities	199	212	232	-	-

Fig 3 – Cash-flow statement (₹ bn)

Year-end: Mar	FY17	FY18	FY19	FY20e*	FY21e*
PBT	89	116	146	157	181
+ Non-cash items	15	21	28	23	30
Oper. prof. before WC	103	138	174	181	211
- Incr. / (decr.) in WC	30	207	96	80	109
Others incl. taxes	7	31	126	50	59
Operating cash-flow	67	-100	-47	50	42
- Capex (tang. + intang.)	-28	-20	-35	-53	-57
Free cash-flow	38	-120	-82	-3	-15
Acquisitions	-	-	-	-	-
- Div. (incl. buyback & taxes)	18	23	30	25	25
+ Equity raised	2	2	-2	-	-
+ Debt raised	58	136	180	86	95
- Fin investments	79	-37	57	118	25
- Misc. (CFI + CFF)	2	4	-27	9	9
Net cash-flow	-1	27	37	-70	22

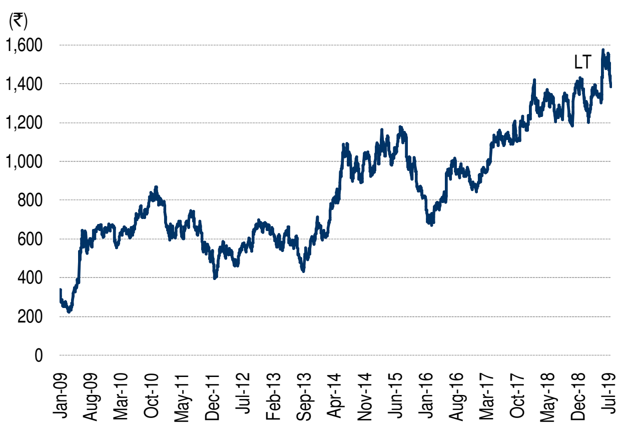
Source: Company, Anand Rathi Research

Fig 4 – Ratio analysis

Year-end: Mar	FY17	FY18	FY19	FY20e*	FY21e*
P/E (x)	24.9	25.4	22.5	20.0	17.3
EV / EBITDA (x)	22.3	20.1	18.0	17.2	15.0
EV / Sales (x)	2.0	2.3	2.1	2.0	1.8
P/B (x)	3.0	3.3	3.1	2.8	2.5
RoE (%)	12.6	13.8	14.7	15.0	15.4
RoCE (%) - after tax	6.4	8.3	8.9	8.9	9.4
RoIC (%) - after tax	6.0	7.3	7.6	7.7	8.2
DPS (₹ / sh)	13.1	16.2	18.0	18.0	18.0
Dividend yield (%)	1.2	1.2	1.3	1.3	1.3
Dividend payout (%) - incl. DDT	30.5	30.9	33.8	25.5	22.0
Net debt / equity (x)	1.4	1.5	1.4	1.5	1.4
Receivables (days)	96	106	96	108	108
Inventory (days)	14	15	17	17	17
Payables (days)	17	22	24	23	25
CFO : PAT %	112.3	-138.2	-54.6	50.5	37.0

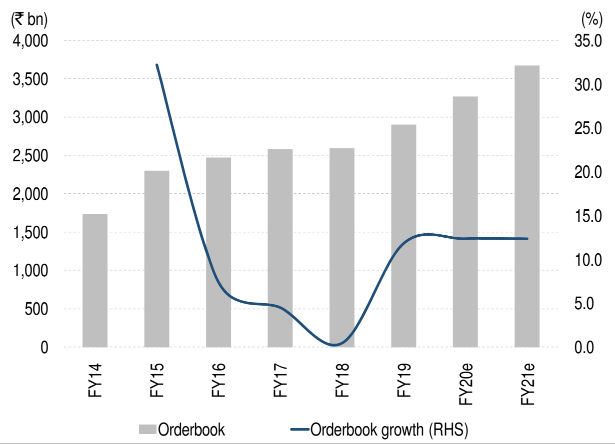
Source: Company, Anand Rathi Research

Fig 5 – Price movement



Source: Bloomberg

Fig 6 – Order book



Source: Company

Result Highlights

Fig 7 – Sales volumes, realisations trend (₹ mn)

	Q1 FY20	Q1 FY19	Y/Y (%)
Sales	2,96,360	2,70,048	*9.7*
EBIDTA	33,190	27,577	*20.4*
EBIDTA margins %	*11.2*	*10.2*	
Interest	5,867	3,637	*61.3*
Depreciation	4,615	6,047	*-23.7*
Other income	3,844	2,280	*68.6*
PBT	25,617	20,173	*27.0*
Tax	7,948	8,896	*-10.7*
Adj. PAT	13,605	11,294	*20.5*

Source: Company, Anand Rathi Research

Fig 8 – Order book details (₹ mn)

	Q2 FY17	Q3 FY17	Q4 FY17	Q1 FY18	Q2 FY18	Q3 FY18	Q4 FY18	Q1 FY19	Q2 FY19	Q3 FY19	Q4 FY19	Q1 FY20	Y/Y (%)
Infrastructure	18,63,320	19,39,500	19,33,620	19,71,450	19,05,500	20,03,380	19,54,833	21,79,300	21,82,112	21,92,480	22,18,104	21,88,250	*0.4*
Power	1,76,260	1,55,160	1,30,650	1,31,430	1,03,000	1,08,291	94,716	84,360	92,796	82,360	70,416	1,29,330	*53.3*
Heavy Engineering	75,540	77,580	1,30,650	1,05,144	1,28,750	1,35,364	1,34,181	42,180	50,616	48,280	46,944	40,810	*-3.2*
Electrical & Automation	25,180	25,860	26,130	26,286	25,750	27,073	31,572	30,932	30,932	28,400	26,406	*	*NA**
Hydrocarbon	2,01,440	2,06,880	2,61,300	2,36,574	2,57,500	2,97,800	2,65,731	2,92,448	2,78,388	3,18,080	3,99,024	4,04,080	*38.2*
Others	1,76,260	1,81,020	1,30,650	1,57,716	1,54,500	1,35,364	1,49,967	87,780	1,77,156	1,70,400	1,73,106	1,77,670	*102.4*
Total	**25,18,000**	**25,86,000**	**26,13,000**	**26,28,600**	**25,75,000**	**27,07,270**	**26,31,000**	**26,86,068**	**28,12,000**	**28,40,000**	**29,34,000**	**29,40,140**	***9.5***

*Source: Company, Anand Rathi Research * Not comparable due to sale of Electrical and Automation business*

Fig 9 – Order inflow detail (₹ mn)

	Q2 FY17	Q3 FY17	Q4 FY17	Q1 FY18	Q2 FY18	Q3 FY18	Q4 FY18	Q1 FY19	Q2 FY19	Q3 FY19	Q4 FY19	Q1 FY20	Y/Y (%)
Infrastructure	1,85,297	2,22,245	2,60,150	1,50,480	1,19,510	2,66,718	3,35,855	1,93,857	2,34,131	2,19,226	3,07,506	1,74,970	*-9.7*
Power	21,358	4,382	-110	5,280	230	15,133	3,807	1,083	24,690	693	3,590	67,000	*6086.5*
Heavy Engineering	6,366	894	52,360	5,280	16,760	19,245	16,784	14,079	13,256	5,146	8,183	1,880	*-86.6*
Electrical & Automation	18,530	17,440	9,350	13,200	14,350	13,735	15,256	13,357	16,321	16,036	14,398	*	*NA**
Hydrocarbon	4,954	29,691	71,060	7,920	47,180	68,756	33,542	47,652	27,324	77,805	1,26,563	34,240	*-28.1*
IT & Technology ser.	53,044	53,212	66,110	55,440	65,780	64,563	69,414	78,698	80,626	81,276	79,408	88,029	*11.9*
Others	21,642	21,137	14,080	26,400	23,670	33,150	21,342	12,274	23,652	21,818	25,352	20,881	*70.1*
Total	**3,11,190**	**3,49,000**	**4,73,000**	**2,64,000**	**2,87,480**	**4,81,300**	**4,96,000**	**3,47,643**	**4,20,000**	**4,22,000**	**5,65,000**	**3,87,000**	***11.3***

*Source: Company, Anand Rathi Research * Not comparable due to sale od Electrical and Automation business*

Fig 10 – Segment-wise results (₹m)

(₹m)	Q1 FY20	Q1 FY19	y/y (%)	FY 18	FY 19	y/y (%)
Revenue						
Infrastructure	1,40,376	1,23,314	13.8	634,169	7,32,038	15.4
Power	5,632	10,806	-47.9	62,079	39,831	-35.8
Heavy Engineering	9,915	3,773	162.8	16,351	25,137	53.7
Defence Engineering	9,692	7,336	32.1	32,202	38,492	19.5
Electrical & Automation	14,237	13,237	7.6	55,083	60,936	19.5
Hydrocarbon	37,667	35,163	7.1	117,596	151,762	10.6
IT & Technology Services	38,444	33,558	14.6	113,574	145,531	29.1
Financial Services	34,621	30,576	13.2	100,638	126,377	28.1
Developmental Projects	11,784	14,945	-21.2	42,941	50,680	25.6
Others	11,938	13,732	-13.1	44,442	59,350	18.0
Total	3,14,326	2,86,438		1,219,074	1,430,134	
Inter segmental	-17,966	-3,603		-20,471	-20,063	
Total Net Sales	**2,96,360**	**2,70,047**		**1,198,604**	**1,410,071**	
EBIT						
Infrastructure	7,046	6,645	6.0	54,401	53,888	-0.9
Power	86	335	-74.3	1,640	1,299	-20.8
Heavy Engineering	1,599	1,104	44.9	2,051	4,870	137.4
Defence Engineering	1,242	477	160.1	1,204	4,722	292.1
Electrical & Automation	1,732	1,318	31.4	6,688	8,501	27.1
Hydrocarbon	2,468	2,090	18.1	7,718	11,781	52.6
IT & Technology Services	7,842	7,606	3.1	21,465	30,842	43.7
Financial Services	7,463	7,288	2.4	14,406	30,526	111.9
Developmental Projects	937	3,880	-75.8	1,964	3,144	60.1
Others	2,550	-4,172	-161.1	11,826	7,762	-34.4
Total EBIT	**32,964**	**26,570**		**1,23,364**	**1,57,335**	
EBIT margins						
(%)	Q1 FY20	Q1 FY19	y/y (in bps)	FY 18	FY 19	y/y (in bps)
Infrastructure	5.0	5.4	-37	8.58	7.36	(120)
Power	1.5	3.1	-157	2.64	3.26	60
Heavy Engineering	16.1	29.3	-1313	12.55	19.37	680
Defence Engineering	12.8	6.5	630	3.74	12.27	850
Electrical & Automation	12.2	10.0	221	12.14	13.95	180
Hydrocarbon	6.6	5.9	61	6.56	7.76	120
IT & Technology Services	20.4	22.7	-227	18.90	21.19	230
Financial Services	21.6	23.8	-228	14.32	24.16	980
Developmental Projects	8.0	26.0	-1801	4.57	6.20	160
Others	21.4	-30.4	5174	26.61	13.08	(1,350)

Source: Company, Anand Rathi Research

Fig 11 – Segment-wise profitability

	Q1 FY20		Q1 FY19		
(₹ m)	EBIDTA	EBIDTA margins (%)	EBIDTA	EBIDTA margins (%)	Y/Y (bps)
Infrastructure	8,810	*6.4*	8,320	*6.8*	*-40*
Power	180	*3.3*	440	*4.1*	*-80*
Hydrocarbon	2,850	*7.6*	2,470	*7.0*	*60*
Heavy Engineering	1,710	*19.5*	1,200	*36.1*	*-1660*
Defence Engineering	1,600	*16.5*	810	*11.1*	*540*
Electrical & Automation	2,300	*16.9*	1,690	*13.3*	*360*
Others	2,770	*24.1*	3,560	*26.5*	*-240*
IT & Technology Services	8,880	*23.2*	8,240	*24.8*	*-160*
Financial Services	7,620	*22.0*	7,400	*24.2*	*-220*
Developmental Projects	1,180	*10.0*	4,540	*30.4*	*-2040*
Total	**37,880**		***38670***		
Less: Segmental depreciation	-4,920		-4,560		
Less: One time realty provisions	0		-7,540		
Segment PBIT	**32,960**		**26,570**		

Source: Company, Anand Rathi Research

Concall Highlights

Important Points

- Guidance for FY20:
  - Revenue: 12-15%,
  - EBIDTA margins (excluding IT services, financial services, developmental projects and discontinued operations) to sustain,
  - Order inflows: 10-12%,
  - RONW: 18%.
- Order inflows were ₹387bn (up 11% y/y), largely concentrated in infrastructure (45.2%) and power (17.3%), with growth coming domestically.
- Order book position was ₹2940bn (up 9% y/y) dominated by infrastructure (~75%).
- The domestic pipeline was ₹8,400bn (infra ₹5,400bn, power generation ₹500bn, T&D ₹1,000bn, hydrocarbons ₹1,200bn, HE and Defence ₹200bn, Metallurgy ₹100bn).
- The international pipeline was ₹1,650bn (hydrocarbon, power T&D, infra).
- Management said that though some non-industrial select private capex has taken place, large investments would take 12-18 months.
- Despite sluggish consumption demand, management is optimistic of growth continuing in infra, hydrocarbons and its key growth segments (roads, commercial buildings, metro-rail, healthcare, water, lift irrigation, power transmission and railways). Hence, it maintains its earlier guidance.
- Working capital increased to 23% on account of the overall liquidity crises in the economy, sluggishness in payments by the Central and state governments (delayed budget approvals) and payment of vendor credit (to support vendors in tight liquidity). Also, payment terms are getting tighter.
- Management's efforts to diversify to other than Middle East countries are continuing. The present international order book consists of 50% orders from RoW (the US, Europe, East and North Africa, South-east Asia).
- Coastal roads (₹50bn) and AP orders constitute 2-3% of the order book. Management confirms that an insignificant amount of work (<25%) has started and thus exposure is minimal.
- ₹60bn orders of metals and real estate have been removed from the order book as no significant activity was started.
- Major events during the quarter: Approval for sale of the electrical and automation business to Schneider Electric by the CCI; acquisition of Mindtree (current shareholding 60.6%).

Financial Performance

- Employee costs increased due to increased resource augmentation in the IT and engineering services businesses. 10,000 employees were added.
- Higher other income was due to a higher investment base (increased buffer to acquire Mindtree).
- Revenue growth was largely domestic while the international business was flat.
- Higher finance costs were on account of increased borrowing (in standalone books) to reach the targeted D/E, and keep a liquidity buffer in current economic scenario.
- Higher operating finance cost was due to an increase in the loan book.
- Exceptional items included impairment of equity investment in a road SPV.

Segmental Performance

Infrastructure

- Though orders from the Central and state governments were sluggish, orders from the public and private sectors (for airports, corporate buildings, healthcare, de-salination plants, etc) compensated for the loss. Growth was largely driven by domestic order execution.
- Margins declined 40bps due to a change in the mix and degree of revenue recognition based on stage of execution. Also, provisioning in the transportation business led to certain dips. However, with raised claims for cost overruns, management expects margins to improve.

Power

- Revenue (-48%) was due to sluggishness in industry and low opening OB. FGD and SCR are picking up (pipeline of 30GW). A large EPC order of 2x660 MW ultra-supercritical thermal power plant in Bihar was recently won, beating strong players like BHEL. The international (Bangladesh) OB is tapering.
- Margins saw an 80bp decline due to a change in the order intake and a write-back last year in one of the provisions.

Heavy engineering

- Order inflow declined 87% due to deferred orders in oil and gas. Revenue grew 162% due to the healthy opening order book.
- Margins reduced from 36.1% to 19.5%. However, this was on account of a write-back of huge provisions (due to IND AS 115) last year. The segment is currently working at 100% capacity with an order book of ₹40bn.

Defence engineering

- A pickup in the execution of a significant order for tracked artillery guns led to 33% revenue growth. The sector still shows poor participation of private and international players.

Hydrocarbon

- Large orders from Kuwait, the UAE, Saudi Arabia and Algeria are expected to be floated in Q2. Overall, order inflows were majorly seen domestically. Margins improved 60bps. This segment continues to provide the highest RoIC compared to other segments

IT and Technology Services

- Higher visa costs and localisation of employees abroad led to higher costs and the margin dipping 160bps. Healthy, 15%, revenue growth has been maintained. The international business currently forms 91%.

Development projects

- The Hyderabad metro project completed 30km in Nov'17, 16km in Sep'18 and 9 in Mar'19 (out of 70km). Post-commissioning of the entire project, revenue of ₹2bn will be added in FY20.
- Margins have declined from 30.4% to 10%. This was on account of the gain from divestment of the Kattupalli port last year and its exclusion in the current year.

Financial Services

- Though the quality of assets has deteriorated, strong, 16%, loan growth was achieved in a challenging environment. This led to increases in finance operating cost. PAT was impacted by exposure to DHFL. Management has guided to focusing on prudent ALM.

Other segment

- Due to higher handover of residential apartments in the previous year in the realty business (two in Powai, one in Parel and several others in Bangalore and Seawoods), a 14% decline was seen in Q1 FY20. Also, the IND AS 115 led to revenue re-classification.
- Margins fluctuated due to a change in the business mix.

Valuation

The strong order book is expected to lead to healthy sales growth. Domestic and international prospects are expected to support order growth in the next two years. Working capital deterioration is expected to improve with liquidity improvement. We believe that management is continuing its long-term strategy of monetizing non-core assets and improving return ratios of the core business. We maintain a Buy, with a revised TP of ₹1,720 (SOTP based).

Fig 12 – Sum-of-parts valuations

Particulars	Value (₹ / sh)
Core Business	1,332
Infotech	133
IDPL	64
Finance	57
Super-critical JV	10
Mindtree acquisition (61% of current MCAP)	48
Net Value of electrical & auto business	75
Target Price	**1,720**

Source: Company, Anand Rathi Research

Fig 13 – One-year-forward PER

Source: Company, Anand Rathi Research

Key risks

- Lack of a pick-up in the capex cycle in India, especially in oil & gas.
- Deceleration in international markets due to the ongoing trade war and the subdued global growth situation.

Appendix

Analyst Certification

The views expressed in this Research Report accurately reflect the personal views of the analyst(s) about the subject securities or issuers and no part of the compensation of the research analyst(s) was, is, or will be directly or indirectly related to the specific recommendations or views expressed by the research analyst(s) in this report. The research analysts are bound by stringent internal regulations and also legal and statutory requirements of the Securities and Exchange Board of India (hereinafter "SEBI") and the analysts' compensation are completely delinked from all the other companies and/or entities of Anand Rathi, and have no bearing whatsoever on any recommendation that they have given in the Research Report.

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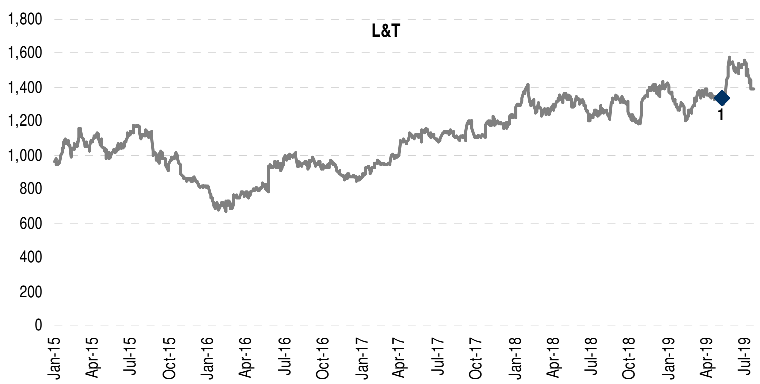
Rating and Target Price History (as of 24 July 2019)



	Date	Rating	TP (₹)	Share Price (₹)
1	10-Jun-19	Buy	1,820	1,514

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Analysts' ratings and the corresponding expected returns take into account our definitions of Large Caps (>US$1bn) and Mid/Small Caps (<US$1bn) as described in the Ratings Table below:

Ratings Guide (12 months)	Buy	Hold	Sell
Large Caps (>US$1bn)	>15%	5-15%	<5%
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