

Sector: Capital Goods  
Result Update

	Change
Reco: Buy	↔
CMP: Rs. 1,431	
Price Target: Rs. 1,765	↔

↑ Upgrade ↔ No change ↓ Downgrade

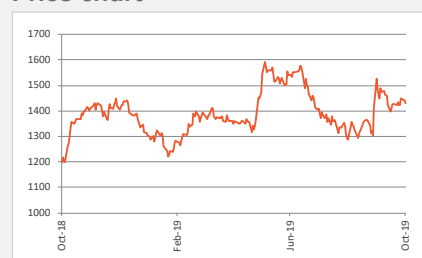
## Company details

Market cap:	Rs. 2,00,800 cr
52-week high/low:	Rs. 1,607/1,183
NSE volume: (No of shares)	30.1 lakh
BSE code:	500510
NSE code:	LT
Sharekhan code:	LT
Free float: (No of shares)	140.3 cr

## Shareholding (%)

FII	21.7
DII	36.9
Others	41.4

## Price chart



## Price performance

(%)	1m	3m	6m	12m
Absolute	2.2	4.1	7.4	21.1
Relative to Sensex	-0.3	1.4	5.7	4.8

Sharekhan Research, Bloomberg

Larsen and Toubro (L&T) reported in-line operational performance for Q2FY2020. Its consolidated adjusted net profit grew 31% y-o-y (adjusting for Rs. 295 crore exceptional item in Q2FY2019) to Rs. 2527 crore. The revenue grew by 15% y-o-y led by Infrastructure, Hydrocarbon and IT&TS (propelled by consolidation of Mindtree). Higher interest and higher depreciation offset other income leading to PBT decline of 2% y-o-y. Lower minority interest led to reported PAT growth of 13% y-o-y. Strong intake in order inflows drove 20% y-o-y rise in order inflows for Q2FY2020 with order backlog healthy at Rs. 3 lakh crore (2.1x TTM revenue). On the back of strong order backlog and strong order prospects (Rs. 5.2 lakh crore), the management retained guidance (revenue of 12-15%, order inflow of 10-12%) for FY2020 along with stable OPM. However, key challenges of lower credit growth in SME sector, increased working capital requirement and weakness in private consumption and industrial capex persists. L&T remains our preferred infra play owing to its strong order backlog, healthy balance sheet and diversified business portfolio. We retain Buy with unchanged SOTP-based price target (PT) of Rs. 1,765.

## Key positives

- In-line operational performance along with strong order inflows led by international division.
- Management retains guidance for order inflow, revenue growth and OPM for FY2020.
- Order pipeline visibility of 5.2 lakh crore across different segments for H2FY2020.

## Key negatives

- Vendor support continues with increased working capital requirement as seen from the beginning of the fiscal year.
- Almost Rs. 16,000 crore stuck project orders in Irrigation (A.P.) and coastal road verticals.
- Domestic order inflow showed weakness with 2% y-o-y decline.

## Our Call

**Valuation - Maintain Buy with a unchanged PT of Rs. 1,765:** L&T's strong order backlog along with its presence across verticals and geographies in its core E&C business has lend support in healthy order inflow during H1FY2020 (despite lull in the industry). The incumbent government's sustained efforts in reviving spending on infrastructure and private industrial capex bodes well for L&T in terms of order inflows in the medium to long term. Additionally, L&T has benefited from its geographical diversification especially during the time period when the domestic environment remained muted. We have fine tuned our estimates for FY2020-FY2021. We maintain our Buy rating on the stock with an unchanged SOTP-based price target (PT) of Rs. 1,765.

## Key Risks

Slowdown in the domestic macro environment or weakness in international capital investment can negatively affect business outlook and earnings growth.

## Valuation (Consolidated)

Particulars	Rs cr				
	FY17	FY18	FY19	FY20E	FY21E
Revenues	109,312	119,683	141,007	160,977	184,099
OPM (%)	10.1	11.4	11.6	12.1	12.3
Adjusted PAT	5,920	7,247	8,610	10,456	12,074
% YoY growth	43.0%	22.4%	18.8%	21.4%	15.5%
Adjusted EPS (Rs.)	42.2	52.5	63.4	74.6	86.1
P/E (x)	33.9	27.3	22.6	19.2	16.6
P/B (x)	4.0	3.7	3.2	2.9	2.5
EV/EBITDA (x)	22.3	19.0	16.1	14.6	12.6
RoNW (%)	12.8	14.0	15.2	15.7	16.3
RoCE (%)	6.0	7.2	8.0	8.8	9.9

Source: Company; Sharekhan estimates

**In-line operational performance for Q2FY2020:** L&T consolidated revenue grew by 15% y-o-y led by Infrastructure, Hydrocarbon and IT&TS (propelled by consolidation of Mindtree). The company reported in-line operational performance for Q2FY2020 with OPM at 11.4% (remained flat y-o-y), leading to 14% y-o-y growth in operating profit to Rs. 4022 crore. Its consolidated adjusted net profit grew 31% y-o-y (adjusting for Rs. 295 crore exceptional item in Q2FY2019) to Rs. 2527 crore. Higher interest and higher depreciation offset higher other income (higher treasury gains) leading to PBT decline of 2% y-o-y. Lower minority interest led to reported PAT growth of 13% y-o-y.

**Order inflow remained strong for Q2FY2020:** During Q2FY2019, order inflow remained strong and was better than expected. Order inflow for the quarter came in at Rs. 48,300 crore (up 20% y-o-y), of which Rs. 31,600 crore constituted domestic order (down 2% y-o-y). International order inflow almost doubled for the quarter at Rs. 16,700 crore (Rs 7900 crore in Q2FY19). Thus, order backlog grew by 9% y-o-y to Rs. 3,03,222 crore at the end of Q2FY2020, which provides revenue visibility of 2.1x TTM consolidated revenue. Further geographical diversification too helped L&T in better international order inflow.

#### Key result highlights from earnings call

- ◆ **Healthy order prospects across segments:** L&T eyes Rs. 5.2 lakh crore order prospects includes Rs 4.5 lakh crore orders in Infrastructure segment, Rs 40,000 crore in Hydrocarbon segment, Rs 10,000 crore in Heavy Engineering segment and defence
- ◆ **Order backlog remains healthy:** Order book stands at Rs. 3,03,222 crore (2.1x TTM consolidated revenues) at the end of Q2FY2020 and order inflow grew 20% y-o-y to Rs 48,300 crore
- ◆ **Net working capital still stretched:** Vendor support continues with increased working capital requirement as seen from start of the fiscal year. Although no impact on trade receivables.
- ◆ **Guidance maintained:** Management retained its guidance (revenue growth of 12-15% y-o-y, order inflow growth of 10-12% y-o-y) for FY2020 along with stable OPM. Further order deferrals pose a risk to management revenue growth guidance of 12-15% for FY2020.
- ◆ **Stuck projects remains a concern:** Almost Rs. 16,000 crore stuck project orders in Irrigation (A.P.) and coastal road verticals which are a part of current order book.
- ◆ **Tax rate:** The company has guided for tax rate between 25-26 % for the current fiscal year.

Results (Consolidated)					Rs cr	
Particulars	Q2FY20	Q2FY19	YoY %	Q1FY20	QoQ %	
Net Sales	35,328	30,678	15.2%	29,636	19.2%	
Total Expenditure	31,307	27,137	15.4%	26,317	19.0%	
Operating profits	4,022	3,542	13.6%	3,319	21.2%	
Other Income	596	408	46.0%	384	55.2%	
Interest	686	398	72.2%	587	16.9%	
Depreciation	630	478	31.8%	461	36.4%	
PBT	3,303	3,369	-2.0%	2,562	28.9%	
Exceptional item	-	(295)		94		
PBT	3,303	3,369	-2.0%	2,562	28.9%	
Tax	791	817	-3.2%	795	-0.5%	
PAT	2,527	2,230	13.3%	1,473	71.6%	
Adj. PAT	2,527	1,936	30.6%	1,566	61.4%	
EPS	18.0	13.8	30.5%	11.2	61.4%	
<b>Margins (%)</b>						
OPM	11.4	11.5	(16)	11.2	19	
PATM	7.2	6.3	84	5.3	187	
Tax Rate	24.0	24.3	(30)	31.0	(707)	

Source: Company; Sharekhan Research

**Segmental Performance**

Particulars	Q2FY20	Q2FY19	YoY/BPS	Comment
<b>Infra</b>	<b>16,781</b>	<b>15,408</b>	<b>8.9%</b>	Strong revenue growth on robust order book conversion across business verticals Margins reflect stage of execution and job mix
PBIT margin (%)	5.9	5.6	26	
<b>Power</b>	<b>492</b>	<b>1,060</b>	<b>-53.6%</b>	Revenue decline reflect depleted opening order book. Margins reflective of job mix & stage of execution. Profits of MHPS and other JV companies are consolidated at PAT level under equity method.
PBIT margin (%)	2.1	5.0	(285)	
<b>Heavy Engg.</b>	<b>706</b>	<b>544</b>	<b>29.7%</b>	Strong revenue growth driven by healthy opening Order Book. Global competence, technology differentiation, proven track record and cost efficiencies yield strong margins.
PBIT margin (%)	20.1	18.8	126	
<b>Defence Engg.</b>	<b>1,017</b>	<b>962</b>	<b>5.7%</b>	Execution of the tracked gun order continues to drive revenue & margins. Margins reflect stage of execution, job mix and operational efficiency.
PBIT margin (%)	14.4	20.7	(625)	
<b>E&amp;A</b>	<b>1,484</b>	<b>1,490</b>	<b>-0.4%</b>	Revenue growth driven by Product businesses and Meters business. Margin increase reflects operational efficiencies and better realization
PBIT margin (%)	18.2	14.1	414	
<b>Hydrocarbon</b>	<b>4,305</b>	<b>3,558</b>	<b>21.0%</b>	Revenue growth on the back of higher Order Book. Margins contributed by efficient execution, job mix & claims. Significant order Inflows obtained from domestic & international markets
PBIT margin (%)	11.7	8.8	292	
<b>IT &amp; Tech</b>	<b>5,904</b>	<b>3,606</b>	<b>63.7%</b>	Mindtree results consolidated in Q2.LTI revenue growth led by Manufacturing and Energy & Utilities. LTTS revenue growth led by Transportation, Plant Engineering and Medical Devices verticals. Mindtree revenue growth led by Travel & Hospitality & High tech & Media. Margin variation is outcome of increased resource cost
PBIT margin (%)	15.1	22.2	(707)	
<b>Developmental proj.</b>	<b>1,452</b>	<b>1,297</b>	<b>12.0%</b>	Segment includes Power Development business, Hyderabad Metro. Revenue largely contributed by Power Development Business. Hyd. Metro: Partial CoD of 30 Km in Nov'17, 16 km in Sept'18 and 9 km in Mar'19. Total of 55 km. Margin profile still emerging. IDPL (Roads & TL) consolidated at PAT level under Equity method
PBIT margin (%)	8.3	(3.5)	1,186	
<b>Others</b>	<b>1,592</b>	<b>1,488</b>	<b>7.0%</b>	Segment comprises Construction & Mining Equipment, Rubber processing Machinery, Industrial Valves and Realty businesses. Q2 revenue growth driven by realty & valves. Margin drop due to business mix variation
PBIT margin (%)	19.6	20.8	(124)	

Source: Company, Sharekhan Research

### Outlook - Government-led infrastructure spending to maintain healthy business outlook

L&T has retained its upbeat outlook for FY2020, with order inflow guidance of 10-12% y-o-y, revenue growth of 12-15%, accompanied by stable EBIDTA margin (ex-services). Bidding pipeline for L&T is expected to be around Rs. 5.2 crore for H2FY2020 (majorly from the infra segment, hydrocarbons and balance from other segments). Order inflows remained strong and expected to continue in the second half. The consolidated order book of Rs 3,03,222 crore provides strong revenue visibility over the next two years. On the back of strong order backlog and strong order prospects (Rs. 5.2 lakh crore for H2FY2020), the management retained guidance (revenue growth of 12-15% y-o-y, order inflow growth of 10-12% y-o-y) for FY2020 along with stable OPM.

### Valuation - Maintain Buy with a unchanged PT of Rs. 1,765

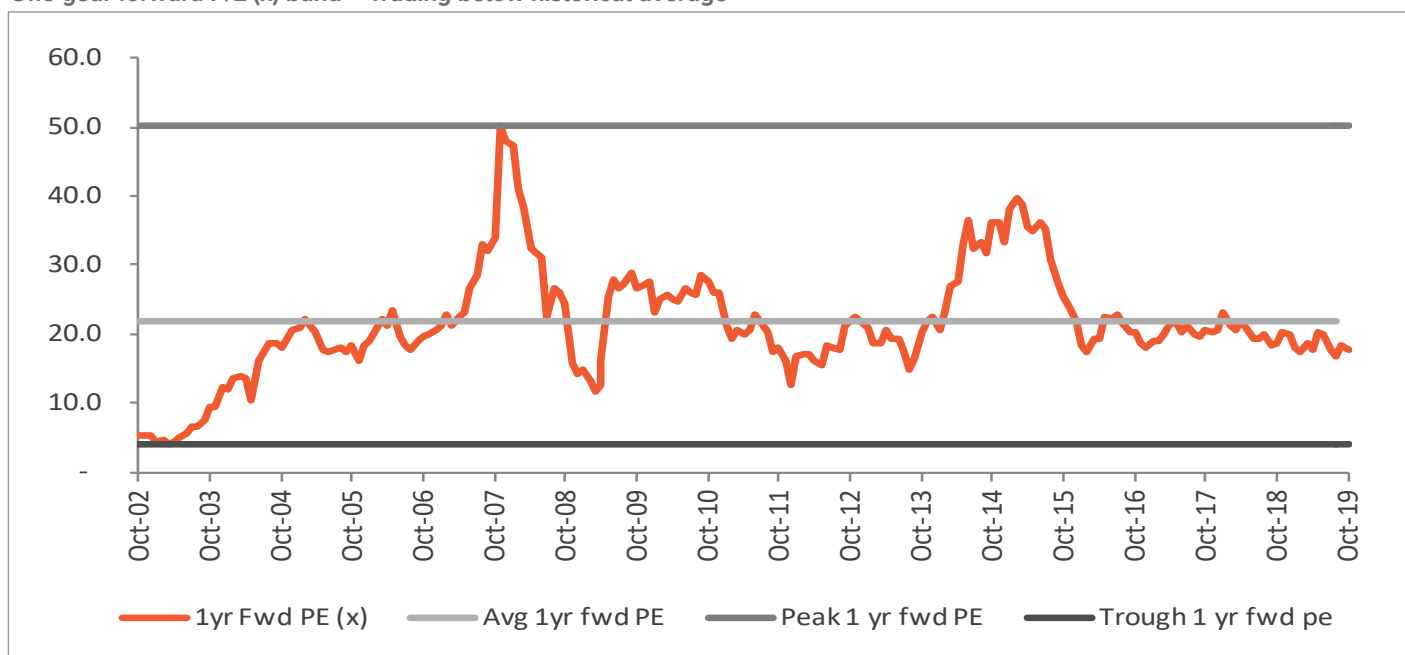
We maintain our Buy rating on the stock with an unchanged SOTP-based price target (PT) of Rs. 1,765. We have fine tuned our estimates for FY2020-FY2021. L&T's strong order backlog along with its presence across verticals and geographies in its core E&C business has lent support in healthy order inflow during H1FY2020 (despite lull in the industry). The incumbent government's sustained efforts in reviving spending on infrastructure and private industrial capex bodes well for L&T in terms of order inflows in the medium to long term. Additionally, L&T has benefited from its geographical diversification especially during the time period when the domestic environment remained muted.

#### SOTP Valuation

Particulars	Remarks	Value (Rs cr)	Rs cr Per share
<b>L&amp;T's core business (standalone)</b>	<b>At 24x FY2021 estimates</b>	<b>168,178</b>	<b>1,200</b>
<b>Subsidiaries</b>			
L&T Infotech (LTI)	Based on our target price	23,433	167
L&T Finance Holdings (L&TFH)	Based on our target price	12,398	88
L&T Technology Services Ltd (LTTS)	Based on our target price	11,490	82
Mintree	Based on current market cap at 20% discount	5,728	41
Development projects (including IDPL)	At 0.8x Book Value	12,600	90
Hydrocarbon subsidiary	At 0.8x Book Value	6,500	46
Other subsidiaries	At 0.8x Book Value	6,142	44
Associates & Other	At 0.8x Book Value	954	7
<b>Total subsidiary valuation</b>		<b>79,244</b>	<b>565</b>
<b>Fair value</b>		<b>247,422</b>	<b>1,765</b>

Source: Company; Sharekhan Research

#### One-year forward P/E (x) band – Trading below historical average



Source: Sharekhan Research

## About company

L&T is an Indian multinational engaged in technology, engineering, construction, manufacturing and financial services and is one of the largest players in India's private sector. A strong customer-focused approach and constant quest for top-class quality has enabled the company to attain and sustain leadership in major lines of businesses over eight decades. The company operates in over 30 countries worldwide.

## Investment theme

Capex in the economy continues to be driven by the public sector mainly in the areas of power (renewable and T&D), transportation (roads, railways and metro projects) and defence (mainly towards indigenisation); and L&T remains the key beneficiary. With India expected to invest significantly in infrastructure creation over the next few years and with re-election of the governments providing thrust on domestic manufacturing through 'Make in India' project, companies focusing on the domestic market are in a sweet spot compared to export-centric companies. Continued emphasis on infrastructure spending with focus on rail, road and renewable is expected to benefit L&T.

## Key Risks

Slower-than-expected project execution in domestic and international markets due to various reasons such as pending approvals and clearances from government agencies and land acquisition could affect revenue. Further, weakness in domestic investment could impact growth and award of large projects, thus posing a downside risk. Moreover, unexpected political changes in some of the developed countries, trade barriers and conflict in the Middle East are some of the risks that can affect the company's performance.

## Additional Data

### Key management personnel

A.M Naik	Group Chairman
S.N Subrahmanyam	Chief Executive office and Managing Director
R. Shankar Raman	Chief Financial Officer
Shailendra Roy	Sr. Executive V.P- Power, Heavy Engg and Nuclear
D.K. Sen	Sr.Executive V.P- Infrastructure
M.V. Satish	Sr.Executive V.P- Building, Minerals and Metals
J.D. Patil	Sr.Executive V.P- Defence

Source: Company Website

### Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Life Insurance Corp of India	15.93
2	L&T EMPLOYEES TRUST	12.27
3	HDFC Asset Management Co Ltd	3.91
4	SBI Funds Management Pvt Ltd	2.65
5	ICICI Prudential Life Insurance Co	2.02
6	ICICI Prudential Asset Management	1.99
7	Reliance Capital Trustee Co Ltd	1.74
8	General Insurance Corp of India	1.72
9	BlackRock Inc	1.64
10	Nomura Holdings Inc	1.28

Source: Bloomberg

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