Sharekhan
by BNP PARIBAS

Larsen & Toubro

Resilient quarter in tough times

Sector: Capital Goods
Result Update

	Change
Reco: **Buy**	↔
CMP: **Rs. 955**	
Price Target: **Rs. 1,250**	↔

↑ Upgrade ↔ No change ↓ Downgrade

Company details

Market cap:	Rs. 134,114 cr
52-week high/low:	Rs. 1592/661
NSE volume: (No of shares)	46.9 lakh
BSE code:	500510
NSE code:	LT
Sharekhan code:	LT
Free float: (No of shares)	140.4 cr

Shareholding (%)

Promoters	0.0
FII	16.9
DII	38.0
Others	45.1

Price chart

Price performance

(%)	1m	3m	6m	12m
Absolute	14	-18	-26	-37
Relative to Sensex	5	-9	-11	-24

Sharekhan Research, Bloomberg

Larsen and Toubro (L&T) reported steady performance in Q4FY2020 despite challenges. The company's performance was in line with our estimates. L&T's revenue stood at Rs. 44,245 crore, up 2.2% y-o-y (in line with our estimate). L&T's ex-services revenue, which comprises 77% of total revenue, declined by 5% y-o-y to Rs. 33,941 crore, as revenue across segments declined y-o-y, barring hydrocarbons (up 15% y-o-y). Infrastructure (75% of ex-service revenue) declined by 6% y-o-y on account of slow-moving orders, stoppage of A.P. jobs, funding constraints, and COVID-19 impact. The company lost Rs. 1,750 crore revenue, Rs. 400 crore PAT, and Rs. 1,500 crore collections in Q4FY2020 due to the lockdown. Operating profit margin (OPM) at 11.6% was lower by -62 bps y-o-y (in line with our estimates), led by marginal dip in ex-services margins along with dip in IT&TS margins. Higher interest cost (up 62% y-o-y, higher debt and phased commencement of Hyderabad metro), higher depreciation (63% y-o-y, Mindtree consolidation) led to adjusted PAT declining by 6.5% y-o-y to Rs. 3,197 crore. Despite the challenging business environment, the company was able to bag orders worth ~Rs. 57,785 crore (up 2% y-o-y) in Q4FY2020, driven by the domestic business, especially in the infrastructure segment. Further, FY2020 order inflow was Rs. 1,86,356 crore (up 9% y-o-y) to slightly short of management guidance of 10-12% at the start of the year. Order backlog remains healthy at Rs. 3,03,857 crore (2.1x its FY2020 revenue, removed slow-moving orders worth ~Rs. 29,000 crore during FY2020). Management refrained from providing any revenue or order inflow guidance as it is too early to quantify the same. Management highlighted 90% of the sites have been functional and the situation is expected to improve in the latter part of FY2020. However, key challenges with persistence issues such as slowdown in consumption, shortage of labour, sluggish liquidity scenario, deferment in ordering activity, and uncertain geopolitical scenario persist. Further, the steep fall in crude will delay new order projects prospects (no execution delays with the existing order book) in Middle East, which the company would have to make up through scaling up work in other geographies (such as Africa). We expect L&T to sail through weak FY2021 as it is better poised to ride the current uncertainties owing to multiple levers such as strong business model, diversified order book, and healthy balance sheet, while it refurbishes its order book and maintains the liquidity position to bounce back in FY2022. Consequently, the steep correction in L&T's stock price provides a favourable risk reward ratio to investors (P/E of 16x/13x its FY2021E/FY2022E earnings). Hence, we continue to maintain our Buy rating on the stock with an unchanged SOTP-based price target (PT) of Rs. 1,250.

Key positives

- Domestic order inflow remained strong led by the infrastructure segment.
- Working capital remains stable q-o-q.

Key negatives

- Overall L&T has 40% of the labour on the sites and expects it to improve in the next 30-45 days.
- International order inflow remained lower.

Our Call

Maintain Buy with an unchanged PT of Rs. 1,250: L&T's strong order backlog along with its presence across verticals and geographies in its core E&C business provides healthy revenue visibility. Further L&T's recent order wins amidst current uncertainties are likely to improve upon execution during FY2022-FY2023. Hence, we believe although FY2021 may be relatively weak on account of macro uncertainties, we expect L&T to bounce back during FY2022 owing to multiple levers such as strong business model, diversified order book, and healthy balance sheet. The company continues to focus on its strategic plan of improving its return ratios. Consequently, the steep correction in L&T's stock price provides a favourable risk reward ratio to investors (P/E of 16x/13x its FY2021E/FY2022E earnings). We have fine-tuned our estimates for FY2021-FY2022 and we continue to maintain our Buy rating with an unchanged SOTP-based PT of Rs. 1,250.

Key Risks

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

Valuation (Consolidated) Rs cr

Particulars	FY19	FY20	FY21E	FY22E
Revenue	1,35,220	1,45,452	1,44,833	1,63,566
OPM (%)	11.3	11.2	11.3	11.7
Adjusted PAT	8,905	9,549	8,356	10,130
% YoY growth	22.9%	7.2%	-12.5%	21.2%
Adjusted EPS (Rs.)	63.4	68.0	59.6	72.3
P/E (x)	15.1	14.1	16.0	13.2
P/B (x)	2.1	2.0	1.8	1.7
EV/EBITDA (x)	13.2	12.8	13.4	11.3
RoNW (%)	14.2	13.8	12.0	13.3
RoCE (%)	7.5	7.4	7.1	8.2

Source: Company; Sharekhan estimates

Steady performance in Q4FY2020: L&T reported steady performance in Q4FY2020 despite challenges and was in line with our estimates. L&T's revenue at Rs. 44,245 crore grew by 2.2% y-o-y (in line with our estimates). Segment wise – ex-services sales (76% of revenue) was Rs. 35,180 crore (-6% y-o-y), as all segments saw revenue decline with infrastructure revenue declining 6% y-o-y, impacted by slow-moving orders, stoppage of Andhra Pradesh jobs, funding constraints, and impact of COVID-19. Management highlighted that the company lost Rs. 1,750 crore worth revenue in Q4FY2020 due to the lockdown and execution was deliberately slowed to maintain to preserve working capital levels. OPM at 11.6% was lower by -62 bps y-o-y (in line with our estimates) and consequently EBITDA stood at Rs. 5,121 crore. Margins for all segments except power, hydrocarbon, and others contracted. Infrastructure margin stood at 10.3% (-112 bps y-o-y). Service business margin declined due to sharp contraction in financial business. Further, higher interest cost (up 62% y-o-y) on increased debt and phased commencement of Hyderabad metro along with higher depreciation (up 63% y-o-y) on account of Mindtree consolidation offset by higher other income (8% y-o-y), and lower tax rate at 22.7% versus 24.9% y-o-y led to adjusted PAT of Rs. 3,197 crore (-6.5% y-o-y). Despite a challenging business environment, the company was unable to bag orders worth ~Rs. 57,785 crore (up 2% y-o-y growth) in 4QFY2020, largely driven by high-value orders in the international business. Further, FY2020 order inflow was Rs. 1,86,356 crore (up 9% y-o-y), slightly short of management guidance of 10-12% at the start of the year. Order backlog remains healthy at Rs. 3,03,857 crore (2.1x FY20 revenues). Management has refrained from providing any revenue or order inflow guidance. Order inflow visibility is seen in water, infrastructure (highways), heavy engineering, and power; diversified international order book provides cushion despite lower new order prospects from Middle East due to the sharp fall in oil prices.

Strong order book provides revenue visibility: Order inflow for the quarter increased by ~5% y-o-y to Rs. 57,785 crore mainly led by the domestic business in the infrastructure segment. However, for FY2020, order inflow increased by 9% y-o-y, contributed by international order wins in sectors such as IT&TS, power T&D, and metallurgical business. Order book stands strong at Rs. 3,03,857 crore as of FY2020 majorly comprising the domestic market (75%), providing revenue visibility of 2.1x its FY2020 revenue. The company has removed ~Rs. 29,000 crore slow moving orders from its order book in FY2020 primarily from Andhra Pradesh, Delhi and some developers facing liquidity issues. Going ahead, management indicated segments such as heavy civil, power transmission, and water to see good traction for order inflows. While management expects segments such as hydrocarbon, buildings, and transportation to gradually pick-up by Q2FY2021E/Q3FY2021E, and construction equipment segment is expected to pick up by H2FY2021E.

Key result highlights from earnings call

Financial impact of COVID-19 on Q4FY2020: The company estimates revenue loss of Rs. 1,750 crore, Rs. 400 crore on net profit, and Rs. 1,500 crore on collections during Q4FY2020 on account of COVID-19 led lockdown during March 2020.

Order inflow: The company's order inflow increased by 5% y-o-y to Rs. 57,800 crore, driven by domestic order inflows. Order inflow during Q4FY2020 was driven by the infrastructure segment.

Order book: The company's order book was up 4% y-o-y to Rs. 3.04 lakh crore at the end of FY2020. Infrastructure comprises 74% of the order book. Domestic orders constituted 75% of the order book.

Current scenario: Currently, the company has 90% of sites operational and 40% labour. Payment from the public space has been tough. The company generally employs ~2,75,000 to 3,00,000 labourers. The company had held back ~1,70,000 labourers during COVID-19 lockdown, which dropped to 70,000 on easing of restrictions and currently stands at 1,20,000 labourers. It may take 30 to 45 days for the number of labourers to increase to 220,000.

Removal of slow-moving orders: The company has removed ~Rs. 29,000 crore orders from its order book in FY2020, primarily from Andhra Pradesh, Delhi and some developers facing liquidity issues. Thus, its current order book has only 5% slow-moving orders.

Sale of non-core assets: The engineering and automation business sale is expected to take two to three months as COVID-19 had affected international travel. Nabha power and Hyderabad metro sale is expected to take time as it will have to resume normal operations in the post COVID-19 scenario.

Middle East scenario: The company expects future order prospects from Middle East to slow down due to the steep decline in crude oil prices along with COVID-19 led disruption. However, it has seen an increase in solar and social infrastructure orders. In Africa, some states were affected but it was quite low as compared to Middle East and India.

Working Capital: The company's working capital had increased to 23.7% from 18.1% in FY2019, as public space payment was tough. However, it has been able to maintain the working capital sequentially, as the company has been consciously slowing execution to control working capital. Vendor issues continue to persist; however, the situation is slowly improving and the company has started to receive collections from customers.

Guidance: Management has not been able to give guidance on order inflows, revenue, and OPM for FY2021, as it is currently assessing the impact of COVID-19, while it is too early to quantify the same.

Results (Consolidated) Rs cr

Particulars	Q4FY20	Q4FY19	YoY %	Q3FY20	QoQ %
Net Sales	44,245	43,303	2.2	36,243	22.1
Total Expenditure	39,124	38,024	2.9	32,125	21.8
Operating profit	5,121	5,279	-3.0	4,118	24.4
Other Income	660	611	8.1	469	40.8
Interest	821	507	62.1	703	16.7
Depreciation	711	435	63.3	660	7.7
PBT	4,250	4,948	-14.1	3,223	31.8
Exceptional item	-	-		-	
PBT	4,250	4,948	-14.1	3,223	31.8
Tax	966	1,234	-21.7	711	35.9
PAT	3,197	3,418	-6.5	2,352	35.9
Adj. PAT	3,197	3,418	-6.5	2,352	35.9
EPS (Rs.)	22.8	24.4	-6.5	16.8	35.9
Margins (%)					
OPM	11.6	12.2	(62)bps	11.4	21bps
PATM	7.2	7.9	(67)bps	6.5	74bps
Tax Rate	22.7	24.9	-	22.1	-

Source: Company; Sharekhan Research

Segmental Performance (Rs crore)

Particulars	Q4FY20	Q4FY19	YoY/bps	Comment
Infrastructure	25,560	27,094	-5.7%	Muted revenue in Q4 reflective of execution challenges (slow-moving orders, stoppage of AP jobs, funding constraints and impact of COVID-19). Margins reflect stage of execution and job mix.
PBIT margin (%)	10.3	11.4	(112)	
Power	565	934	-39.5%	Revenue decline reflects depleted opening order book and tapering of international jobs. Margins reflective of job mix and stage of execution and claims. Profits of MHPS and other JV companies are consolidated at PAT level under the equity method.
PBIT margin (%)	35.9	3.0	3,290	
Heavy Engineering	702	899	-22.0%	Strong revenue for the year driven by large opening order book. Q4 revenue slowdown due to client delays and shutdown. Global competence, technology differentiation, proven track record, and cost efficiencies yield strong margins. Q4 and full-year margins impacted by cost provisions.
PBIT margin (%)	15.1	18.8	(379)	
Defence Engineering	928	1,108	-16.3%	Q4 revenue impacted by delays and non-receipt of targeted orders. Margins reflect stage of execution, job mix, and operational efficiency. Policy bottlenecks, fiscal constraints, and lengthy MoD procurement procedures continue to beset investment momentum in the sector.
PBIT margin (%)	13.3	15.4	(203)	
Hydrocarbon	4,979	4,324	15.1%	Strong revenue growth due to in-line execution of large opening order book. Margins contributed by efficient execution, job mix and claims. Slowdown in order inflows due to global volatility in oil prices.
PBIT margin (%)	10.1	8.9	115	
IT & Tech	6,461	3,827	68.8%	Mindtree results consolidated from Q2FY2020 post the acquisition on July 2, 2019. LTI revenue growth led by manufacturing, energy and Utilities and CPG, retail, and pharma. LTTS revenue growth led by medical devices, plant engineering, and transportation verticals. Mindtree revenue growth led by high-tech and media and travel and hospitality. Margin variation is the outcome of increased resource cost.
PBIT margin (%)	15.8	19.9	(411)	
Developmental projects	981	1,083	-9.4%	Revenue largely contributed by power development business. Maintenance shutdown of one unit in Nabha Power impacts Q4 revenue. Hyd. Metro: Fully commissioned in early Q4. Lockdown impacts ridership in March 2020. Margin profile still emerging.
PBIT margin (%)	(1.0)	(5.6)	459	
Others	1,207	1,413	-14.6%	Q4 revenue impacted by delayed handover in the realty business; Low demand impacts construction and mining equipment revenue, industrial valves records positive growth because of large opening order book and revenue and margins included lumpy sale of commercial premises in the realty business.
PBIT margin (%)	12.5	11.0	150	

Source: Company, Sharekhan Research

Outlook

FY2021 may be relatively weak on account of macro uncertainties, bounce back likely during FY2022: Even though the government has announced a wide ranging raft of stimulus measures designed to alleviate stress in various sectors, it is likely that economic growth will still take a few quarters more to revive to a healthy level. Although the government has reportedly announced a slew of measures to bring in comfort to the infrastructure sector, weak finances of centre and state pose challenges in meeting planned infrastructure investments in the near term. The consolidated order book of Rs. 3,03,785 crore provides strong revenue visibility over the next two years. FY2021 may be relatively weak on account of macro uncertainties, thus we expect L&T to bounce back from FY2022, owing to multiple levers such as strong business model, diversified order book, and healthy balance sheet. The company continues to focus on its strategic plan of improving its return ratios.

Valuation

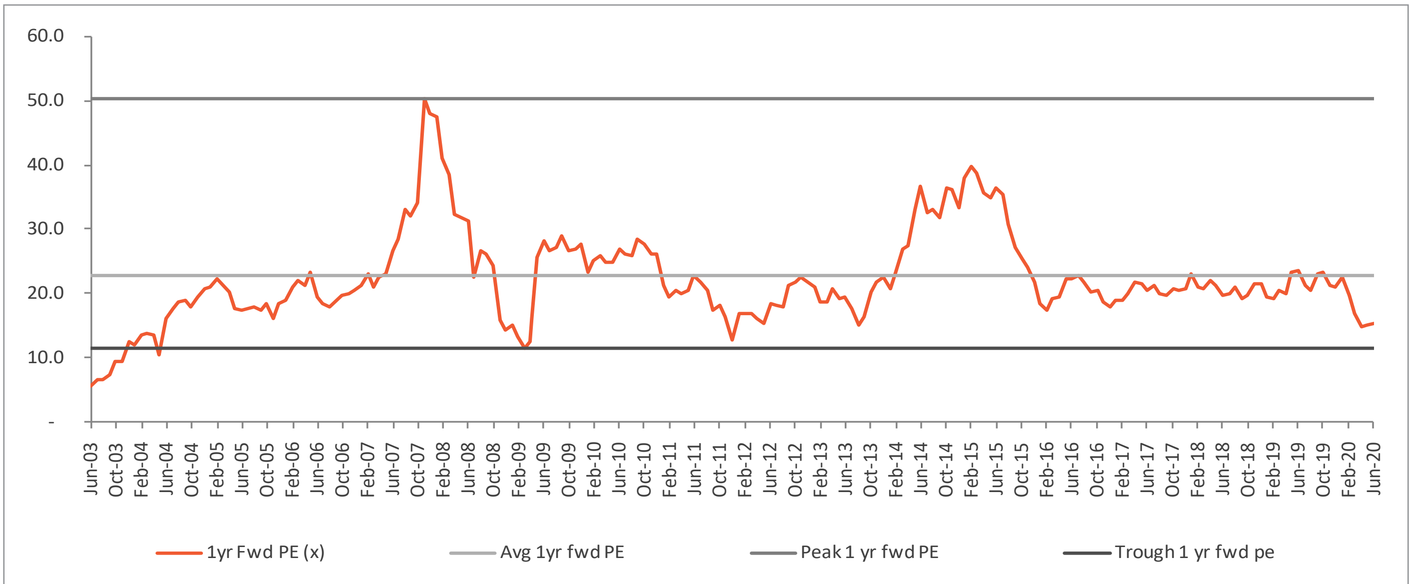
Maintain Buy with an unchanged PT of Rs. 1,250: L&T's strong order backlog along with its presence across verticals and geographies in its core E&C business provides healthy revenue visibility. Further L&T's recent order wins amidst current uncertainties are likely to improve upon execution during FY2022-FY2023. Hence, we believe although FY2021 may be relatively weak on account of macro uncertainties, we expect L&T to bounce back from FY2022, owing to multiple levers such as strong business model, diversified order book, and healthy balance sheet. The company continues to focus on its strategic plan of improving its return ratios. Consequently, the steep correction in L&T's stock price provides a favourable risk reward ratio to investors (P/E of 16x/13x its FY2021E/FY2022E earnings). We had fine-tuned our estimates for FY2021-FY2022 and we continue to maintain our Buy rating with an unchanged SOTP-based PT of Rs. 1,250.

SOTP Valuation

Particulars	Remarks	Value (Rs. cr)	Per share (Rs)
L&T's core business (standalone)	**At 15x FY2022 estimates**	**1,17,659**	**839**
Subsidiaries			
L&T Infotech (LTI)	Based on our target price	25,126	179
L&T Finance Holdings (L&TFH)	Based on our target price	5,671	40
L&T Technology Services Ltd (LTTS)	Based on our target price	8,669	62
Mindtree	Based on current market cap at 20% discount	7,320	52
Development projects (including IDPL)	At 0.8x Book Value	6,720	48
Hydrocarbon subsidiary	At 0.8x Book Value	800	6
Other subsidiaries	At 0.8x Book Value	2,890	21
Associates & Other	At 0.8x Book Value	382	3
Total subsidiary valuation		**57,578**	**411**
Fair value		**1,75,237**	**1,250**

Source: Company, Sharekhan Research

One-year forward P/E (x) band



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 a leadership position 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 Engineering 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: Bloomberg

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	BlackRockInc	1.64
10	Nomura Holdings Inc	1.28

Source: Bloomberg

Sharekhan

by BNP PARIBAS

Know more about our products and services

For Private Circulation only

Compliance Officer: Mr. Joby John Meledan; Tel: 022-61150000; email id: compliance@sharekhan.com;

For any queries or grievances kindly email igc@sharekhan.com or contact: myaccount@sharekhan.com

Registered Office: Sharekhan Limited, 10th Floor, Beta Building, Lodha iThink Techno Campus, Off. JVLR, Opp. Kanjurmarg Railway Station, Kanjurmarg (East), Mumbai – 400042, Maharashtra. Tel: 022 - 61150000. Sharekhan Ltd.: SEBI Regn. Nos.: BSE / NSE / MSEI (CASH / F&O / CD) / MCX - Commodity: INZ000171337; DP: NSDL/CDSL-IN-DP-365-2018; PMS: INP000005786; Mutual Fund: ARN 20669; Research Analyst: INH000006183;