

Larsen & Toubro

Marginal miss, bracing for recovery

While LT 2QFY21 revenue/EBITDA/APAT was (7)/0.4/(19)% (miss)/beat on our estimate, robust FCF generation, contained NWC, and directionally strong commentary on ordering were key positives. LT has taken impairment on key non-core assets to make them monetisation ready. Talks on Hyderabad Metro project restructuring/refinancing have been initiated, and focus is on re-investing the surplus E&A proceeds towards high RoE growth businesses. Despite near-term challenges, we reiterate BUY on LT, given its (1) strong order book (Rs 2.99tn, ~3x FY20 core EPC revenue), (2) healthy balance sheet and (3) robust services business. We tweak our FY21/FY22 estimate by 0.1/-0.6% and keep the target price unchanged at Rs 1,260/sh.

- **Execution recovery underway:** LT reported revenue of Rs 310bn, missing our estimate by 7%. While services business remained resilient with IT & ITES registering growth of 5% YoY and finance clocking de-growth of 3% YoY, core business faced productivity headwinds (due to social distancing norms), declining 17% YoY. Finance cost rose sharply by 52% YoY, on full commissioning of Hyderabad Metro. After adjusting the one-off gains from E&A sale (Rs 81bn) and impairment of power development assets (Rs 27bn) and funded exposure in heavy forging facility JV (Rs 11bn), APAT came in Rs 11.5bn, missing our estimates by 19%. Near-normal level of labour and healthy order book would lead to execution recovery in 2HFY21.
- **Ex-services orders decline by 54% YoY; await pick-up in ordering:** Total order inflow came in at Rs 280bn, a decline of 42% YoY. Order inflow, excluding the services, fell by 54% YoY, taking OB to Rs 2.99tn. The order pipeline stood at Rs 6.1tn (domestic Rs 4.7tn and international at Rs 1.3tn). Management expects domestic ordering activity to gain traction in 2HFY21, given the government's continuous focus on infrastructure and uptick in economic indicators and tax revenues. L&T has received LOI for Package C4 of Mumbai-Ahmedabad high-speed rail with ~Rs 250bn value.
- **E&A sale concluded:** L&T has received Rs 132bn from the sale of E&A business, and net of taxes and costs, the total inflow amounts to Rs 110bn. L&T is planning to utilise the cash to repay Rs 50bn of debt, infuse Rs 20bn in the services business and restructure capital allocation of Hyderabad Metro (Rs 20bn committed). L&T also declared special dividend Rs 18/sh, to be paid out from the proceeds.
- **Balance sheet remains comfortable:** With E&A proceeds consolidated net debt reduced to Rs 1tn from Rs 1.13tn on Mar 20-end. While the net working capital as a percentage of sales remains elevated at 26.7% (on low TTM Rev, <23.5% on normal base), receivables declined from Rs 407bn to Rs 361bn (vs Mar-20). L&T generated Rs 27.6bn/36.5bn of FCFF during 2Q/1HFY21, which is very robust, given the impact of the pandemic.

Financial summary

(Rs mn)	2Q FY21	2Q FY20	YoY (%)	1Q FY21	QoQ (%)	FY20	FY21E	FY22E	FY23E
Net Revenues	3,10,347	3,53,285	(12.2)	2,12,600	46.0	14,54,524	13,85,101	15,62,133	17,37,135
EBITDA	33,348	40,219	(17.1)	16,205	105.8	1,63,290	1,33,734	1,78,394	1,95,511
APAT	11,515	25,273	(54.4)	784	1,368.4	88,945	63,902	98,740	1,09,783
Diluted EPS (Rs)	8.2	18.0	(54.4)	0.6	1,368.4	63.4	45.6	70.4	78.3
P/E (x)						14.7	20.5	13.3	11.9
EV / EBITDA (x)						15.1	19.5	14.3	12.8
RoE (%)						14.6	9.4	13.7	14.1

Source: Company, HSIE Research

BUY

CMP (as on 29 Oct 2020)	Rs 935
Target Price	Rs 1,260
NIFTY	11,671

KEY CHANGES	OLD	NEW
Rating	BUY	BUY
Price Target	Rs 1,260	Rs 1,260
EPS %	FY21E	FY22E
	0.1	-0.6

KEY STOCK DATA

Bloomberg code	LT IN
No. of Shares (mn)	1,404
MCap (Rs bn) / (\$ mn)	1,312/17,640
6m avg traded value (Rs mn)	5,109
52 Week high / low	Rs 1,492/661

STOCK PERFORMANCE (%)

	3M	6M	12M
Absolute (%)	1.4	6.8	(36.0)
Relative (%)	(3.0)	(14.7)	(35.8)

SHAREHOLDING PATTERN (%)

	Jun-20	Sep-20
Promoters	0.0	0.0
FIs & Local MFs	36.56	35.43
FPIs	18.77	17.89
Public & Others	44.67	46.68
Pledged Shares	0.0	0.0

Source : BSE

Parikshit D Kandpal, CFA
 parikshitd.kandpal@hdfcsec.com
 +91-22-6171-7317

Chintan Parikh
 chintan.parikh@hdfcsec.com
 +91-22-3021-7355

Rohan Rustagi
 rohan.rustagi@hdfcsec.com
 +91-22-3021-7355

Disclosure:

Authors and the names subscribed to this report, hereby certify that all of the views expressed in this research report accurately reflect our views about the subject issuer(s) or securities. HSL has no material adverse disciplinary history as on the date of publication of this report. We also certify that no part of our compensation was, is, or will be directly or indirectly related to the specific recommendation(s) or view(s) in this report.

Research Analyst or his/her relative or HDFC Securities Ltd. **does not have** any financial interest in the subject company. Also Research Analyst or his relative or HDFC Securities Ltd. or its Associate may have beneficial ownership of 1% or more in the subject company at the end of the month immediately preceding the date of publication of the Research Report. Further Research Analyst or his relative or HDFC Securities Ltd. or its associate **does not have** any material conflict of interest.

HDFC Securities Limited (HSL) is a SEBI Registered Research Analyst having registration no. INH000002475.

Disclaimer:

This report has been prepared by HDFC Securities Ltd and is solely for information of the recipient only. The report must not be used as a singular basis of any investment decision. The views herein are of a general nature and do not consider the risk appetite or the particular circumstances of an individual investor; readers are requested to take professional advice before investing. Nothing in this document should be construed as investment advice. Each recipient of this document should make such investigations as they deem necessary to arrive at an independent evaluation of an investment in securities of the companies referred to in this document (including merits and risks) and should consult their own advisors to determine merits and risks of such investment. The information and opinions contained herein have been compiled or arrived at, based upon information obtained in good faith from sources believed to be reliable. Such information has not been independently verified and no guaranty, representation of warranty, express or implied, is made as to its accuracy, completeness or correctness. All such information and opinions are subject to change without notice. Descriptions of any company or companies or their securities mentioned herein are not intended to be complete. HSL is not obliged to update this report for such changes. HSL has the right to make changes and modifications at any time.

This report is not directed to, or intended for display, downloading, printing, reproducing or for distribution to or use by, any person or entity who is a citizen or resident or located in any locality, state, country or other jurisdiction where such distribution, publication, reproduction, availability or use would be contrary to law or regulation or what would subject HSL or its affiliates to any registration or licensing requirement within such jurisdiction.

If this report is inadvertently sent or has reached any person in such country, especially, United States of America, the same should be ignored and brought to the attention of the sender. This document may not be reproduced, distributed or published in whole or in part, directly or indirectly, for any purposes or in any manner.

Foreign currencies denominated securities, wherever mentioned, are subject to exchange rate fluctuations, which could have an adverse effect on their value or price, or the income derived from them. In addition, investors in securities such as ADRs, the values of which are influenced by foreign currencies effectively assume currency risk. It should not be considered to be taken as an offer to sell or a solicitation to buy any security.

This document 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. This report should not be construed as an invitation or solicitation to do business with HSL. HSL may from time to time solicit from, or perform broking, or other services for, any company mentioned in this mail and/or its attachments.

HSL and its affiliated company(ies), their directors and employees may; (a) from time to time, have a long or short position in, and buy or sell the securities of the company(ies) mentioned herein or (b) be engaged in any other transaction involving such securities and earn brokerage or other compensation or act as a market maker in the financial instruments of the company(ies) discussed herein or act as an advisor or lender/borrower to such company(ies) or may have any other potential conflict of interests with respect to any recommendation and other related information and opinions.

HSL, its directors, analysts or employees 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 shares and bonds, changes in the currency rates, diminution in the NAVs, reduction in the dividend or income, etc.

HSL and other group companies, its directors, associates, employees may have various positions in any of the stocks, securities and financial instruments dealt in the report, or may make sell or purchase or other deals in these securities from time to time or may deal in other securities of the companies / organizations described in this report.

HSL or its associates might have managed or co-managed public offering of securities for the subject company or might have been mandated by the subject company for any other assignment in the past twelve months.

HSL or its associates might have received any compensation from the companies mentioned in the report during the period preceding twelve months from the date of this report for services in respect of managing or co-managing public offerings, corporate finance, investment banking or merchant banking, brokerage services or other advisory service in a merger or specific transaction in the normal course of business.

HSL or its analysts did not receive any compensation or other benefits from the companies mentioned in the report or third party in connection with preparation of the research report. Accordingly, neither HSL nor Research Analysts have any material conflict of interest at the time of publication of this report. Compensation of our Research Analysts is not based on any specific merchant banking, investment banking or brokerage service transactions. HSL may have issued other reports that are inconsistent with and reach different conclusion from the information presented in this report.

Research entity has not been engaged in market making activity for the subject company. Research analyst has not served as an officer, director or employee of the subject company. We have not received any compensation/benefits from the subject company or third party in connection with the Research Report.

HDFC securities Limited, I Think Techno Campus, Building - B, "Alpha", Office Floor 8, Near Kanjurmarg Station, Opp. Crompton Greaves, Kanjurmarg (East), Mumbai 400 042 Phone: (022) 3075 3400 Fax: (022) 2496 5066 Compliance Officer: Binkle R. Oza Email: complianceofficer@hdfcsec.com Phone: (022) 3045 3600

HDFC Securities Limited, SEBI Reg. No.: NSE, BSE, MSEI, MCX: INZ000186937; AMFI Reg. No. ARN: 13549; PFRDA Reg. No. POP: 11092018; IRDA Corporate Agent License No.: CA0062; SEBI Research Analyst Reg. No.: INH000002475; SEBI Investment Adviser Reg. No.: INA000011538; CIN - U67120MH2000PLC152193

HDFC securities
Institutional Equities

Unit No. 1602, 16th Floor, Tower A, Peninsula Business Park,
 Senapati Bapat Marg, Lower Parel, Mumbai - 400 013
 Board: +91-22-6171-7330 www.hdfcsec.com