

Larsen & Toubro

 BSE SENSEX
54,949

 S&P CNX
16,637

CMP: INR1,595 TP: INR1,950(+22%)
Buy

Stock Info

Bloomberg	LT IN
Equity Shares (m)	1,402
M.Cap.(INRb)/(USDb)	2240.3 / 30.2
52-Week Range (INR)	1677 / 826
1, 6, 12 Rel. Per (%)	-6/-3/21
12M Avg Val (INR M)	5387
Free float (%)	100.0

Financials Snapshot (INR b)

Y/E Mar	2021	2022E	2023E
Sales	1,360	1,568	1,774
EBITDA	156	183	214
PAT	69	91	113
EBITDA (%)	11.5	11.7	12.1
EPS (INR)	49.1	64.9	80.4
EPS Gr. (%)	-22.4	32.0	24.0
BV/Sh. (INR)	540	569	630

Ratios

Net D/E	1.5	1.5	1.4
RoE (%)	9.1	11.4	12.8
RoCE (%)	5.0	5.7	6.2
Payout (%)	43.7	30.0	30.0

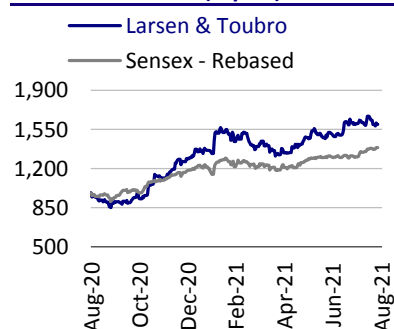
Valuations

P/E (x)	32.5	24.6	19.8
P/BV (x)	3.0	2.8	2.5
EV/EBITDA (x)	19.2	16.7	14.5
Div Yield (%)	2.8	1.5	1.9
FCF Yield (%)	10.6	-1.0	-0.1

Shareholding pattern (%)

As On	Jun-21	Mar-21	Jun-20
Promoter	0.0	0.0	0.0
DII	32.5	33.2	36.0
FII	24.0	23.1	19.9
Others	43.5	43.7	44.0

FII Includes depository receipts

Stock Performance (1-year)

Rightly placed to benefit from macro improvement
TP increase driven by IT subs

- L&T remains best story to play capex upcycle:** L&T's core E&C business remains best placed to benefit from any capex upcycle, supported by its leaner asset-light business model and diversified segments. Therefore, although the Buildings and Power segments were weaker in FY21, this was largely offset by strong orders from the international Power T&D and Hydrocarbons segments. L&T's capability to win large ticket size projects, such as airports and high-speed rail (HSR), has been remarkable and has compensated for its exit from the Roads sector.
- Business model only strengthens in past few years; await macro upturn:** Since its last five-year plan announced in 2016, L&T has been strengthening its business model by exiting non-core businesses, going asset-light (no exposure to road HAMs), and sharpening its focus on receivables rather than just execution. L&T continues to maintain high liquidity on its balance sheet. On account of the pandemic, order inflows have been weaker, especially if adjusted for a one-time big ticket size order (HSR project) and weak state finances. However, things should start to improve as we move past the pandemic. In fact, surprisingly, other capital goods stocks are factoring in strong order inflows over the next 3–5 years and trading at elevated multiples, while L&T's stock has been an underperformer, especially when adjusted for subsidiary valuations. We do not see any strong fundamental reasons to justify such a stark difference in stock price performance.
- Catalysts to watch out for:** Over the next two years, we see multiple catalysts emerging for L&T, including **(a)** asset monetization for Hyderabad Metro and Nabha Power, **(b)** FCF generation of USD1.5–2.0b p.a. in the core business, **(c)** an improvement in order inflows prior to the elections, and **(d)** improved execution, aided by a better working capital cycle – as the government focuses on capex towards economic growth and job creation. If the macro improves, the strong FCF generation should enable L&T to hike dividend payouts as there is hardly any capex requirement beyond the maintenance capex.
- Increase TP to INR1,950, largely driven by MTM of listed IT subs:** In the past month, L&T Infotech has rallied ~18%, MindTree ~28%, and L&T Technology Services ~11%. Factoring in the current market prices of the listed subsidiaries (after applying an unchanged holding company discount of 20%), our TP for L&T now stands at INR1,950. Adj. for the valuation of subsidiaries, the core business is available at FY23E PE of 13.5x v/s the long-term one-year forward average PE multiple of 22x. We maintain a Buy rating. L&T is our top pick in the wider Capital Goods sector as a proxy to play India's capex story.

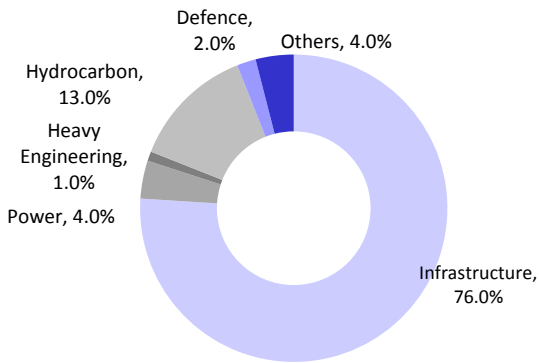
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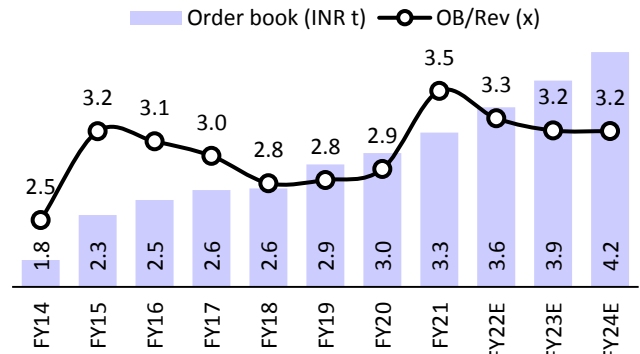
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Exhibit 1: Order book breakup (INR3.2t; +6% YoY)



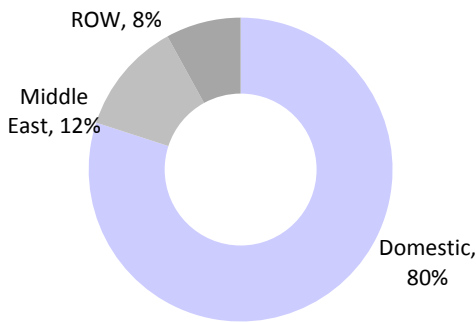
Source: MOFSL, Company

Exhibit 2: OB/Rev ratio of >3.0x provides strong revenue visibility



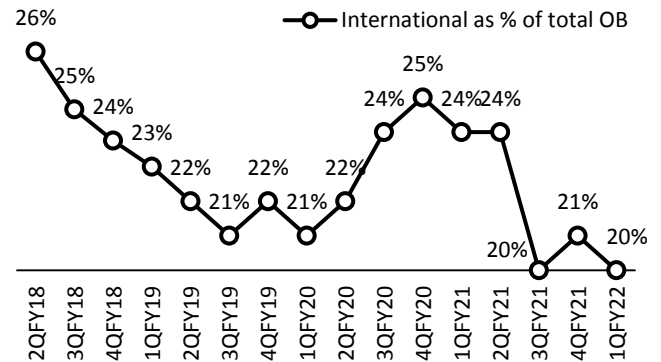
Source: MOFSL, Company

Exhibit 3: Middle East constitutes 12% of order book



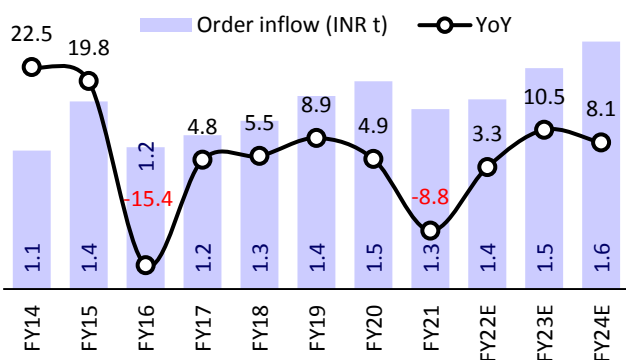
Source: MOFSL, Company

Exhibit 4: Share of international orders at 20%



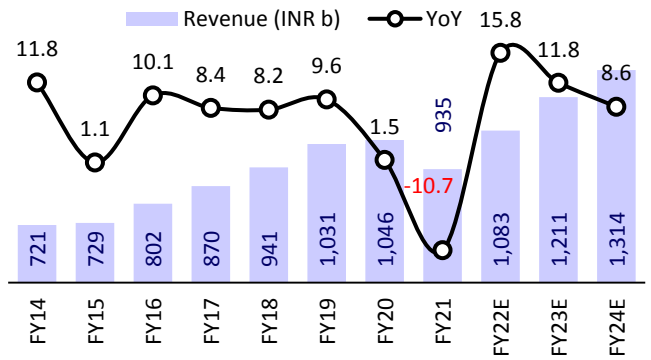
Source: MOFSL, Company

Exhibit 5: Core E&C order inflow trend and assumptions – we build in muted core order inflow growth in FY22E v/s management guidance in low/mid-teens



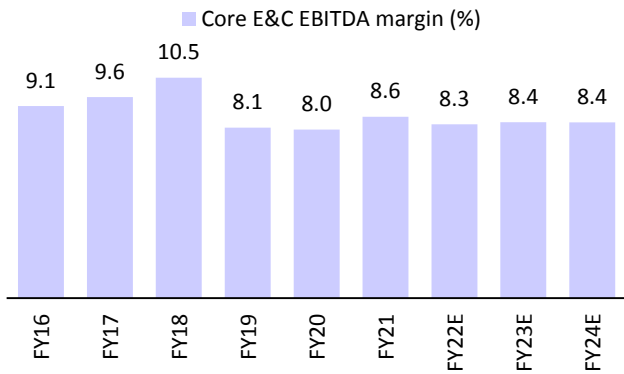
Source: MOFSL, Company

Exhibit 6: Expect core E&C rev CAGR of 12% over FY21–24E



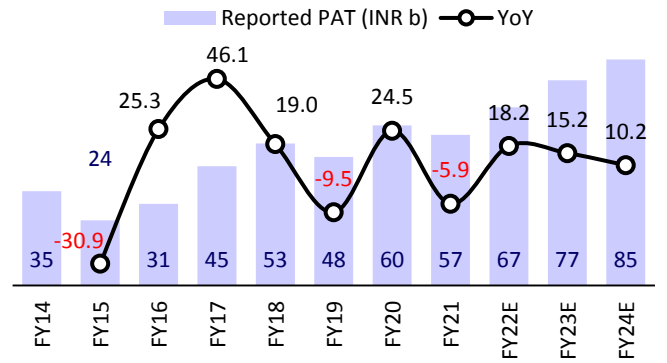
Source: MOFSL, Company

Exhibit 7: EBITDA margin to stabilize at ~8.4% in FY22-24E



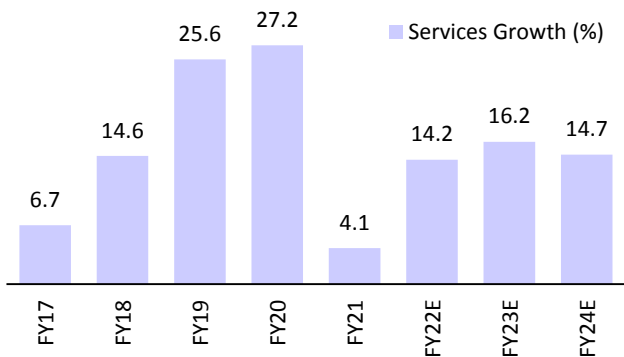
Source: MOFSL, Company

Exhibit 8: Core E&C to post 15% PAT CAGR over FY21-24E



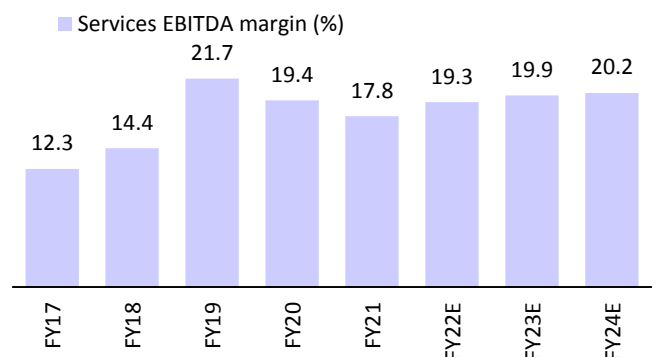
Source: MOFSL, Company

Exhibit 9: Expect ~15% revenue CAGR in Services over FY21-24E



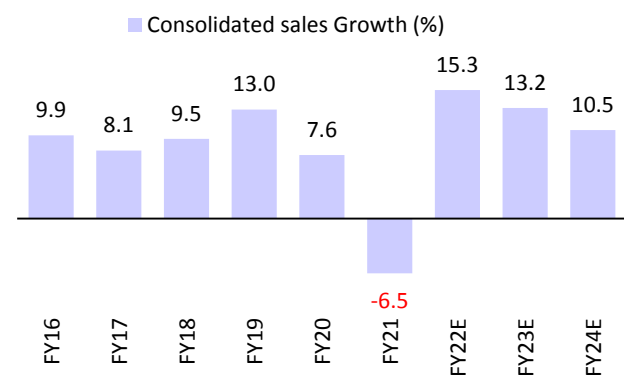
Source: MOFSL, Company

Exhibit 10: Expect EBITDA margin for Services biz to rebound to 19-20% over FY22-24E



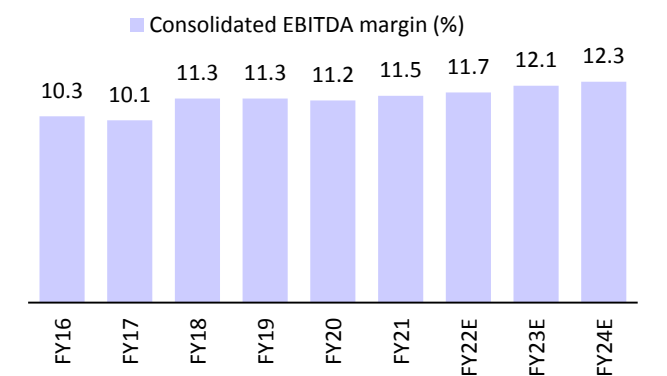
Source: MOFSL, Company

Exhibit 11: Expect consolidated revenue CAGR of 13% over FY21-24E

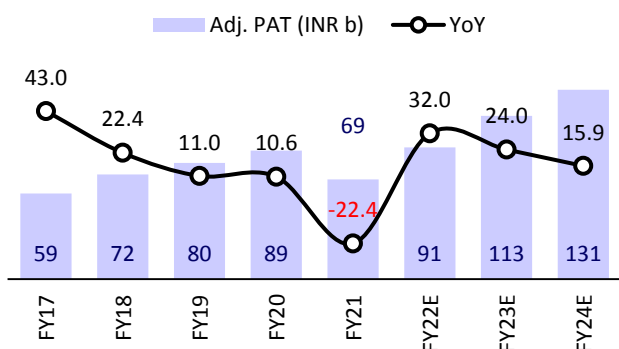


Source: MOFSL, Company

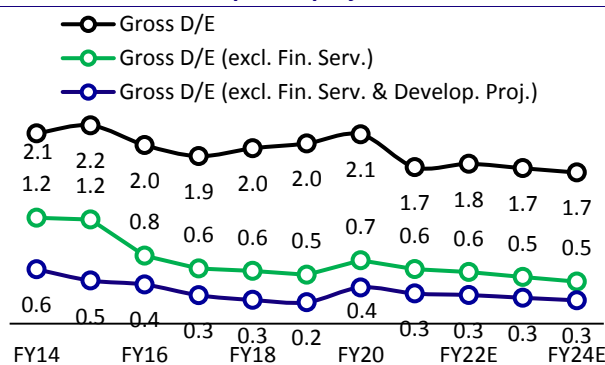
Exhibit 12: Expect consolidated EBITDA to expand 80bp over FY21-24E



Source: MOFSL, Company

Exhibit 13: Expect consolidated adj. PAT CAGR of 24% over FY21–24E

Source: MOFSL, Company

Exhibit 14: Gross D/E trend – balance sheet remains strong adj. for NBFC and development project debt

Source: MOFSL, Company

Valuation and view

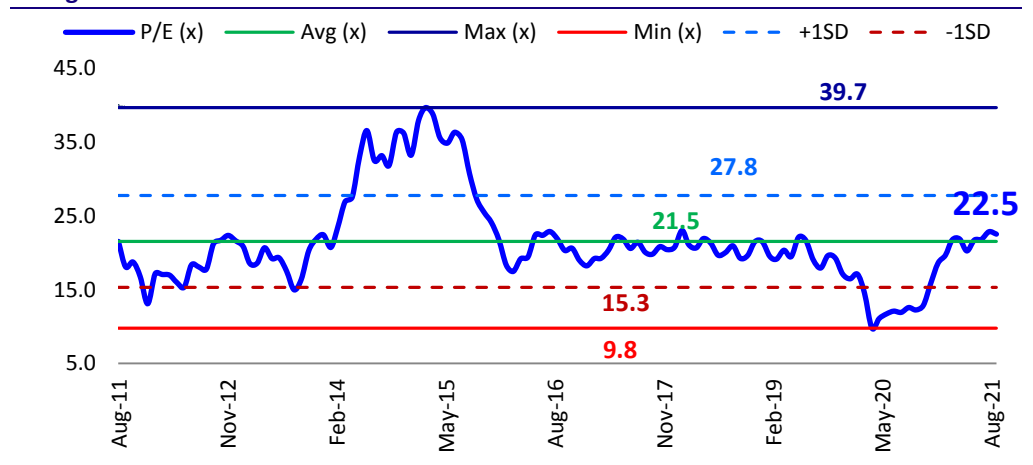
- Company fundamentals fairly strong; await macro tailwinds:** L&T has rightly prioritized its balance sheet strength over growth during the second COVID wave. While the second wave led to similar challenges as last year, construction activity was allowed to continue (unlike last year); hence, the impact was much lower than that seen in FY21. Labor availability no longer poses a challenge, with the current strength at 235k (v/s the peak requirement of 250k) – which is fair given the monsoon season. We believe L&T is poised for strong earnings growth momentum, if and when order inflows gain momentum. The company has some more asset monetization opportunities to capitalize on, including the sale of Nabha Power, a stake sale in L&T IDPL, and the monetization of the Hyderabad Metro.
- Maintain Buy, with higher TP of INR1,950/share:** We maintain our earnings estimate, but increase TP to INR1,950 (prior: INR1,835), driven by (a) MTM of the CMPs of the listed subsidiaries (Holdco discount of 20%) and (b) an unchanged target PE multiple of 20x on the core business. We estimate an FY21–24E EPS CAGR of 24%, driven by a 15% CAGR in the core E&C business and declining loss from the Hyderabad Metro. Adj. for the subsidiaries' valuation (~INR850/sh), the core E&C business trades at an FY22/FY23E PE multiple of 15.6x/13.5x v/s the historical one-year fwd avg. PE multiple of 22x. Should the stock revert to the historical average trading multiple of 22x, our TP would increase to ~INR2,060 on the stock. L&T remains the best play on the capex cycle in India. Maintain Buy.

Exhibit 15: Our SoTP-based TP stands at INR1,950/share

Business segment	Mar'23E (INR)	Remarks
Core E&C	1,097	❖ 20x Core E&C EPS v/s long-term average of 22x
LTI, LTTS, and MTCL	747	❖ 20% discount to current m-cap
Finance holdings	73	❖ 20% discount to current m-cap
Development projects	35	❖ P/Inv. based approach
Total	1,950	

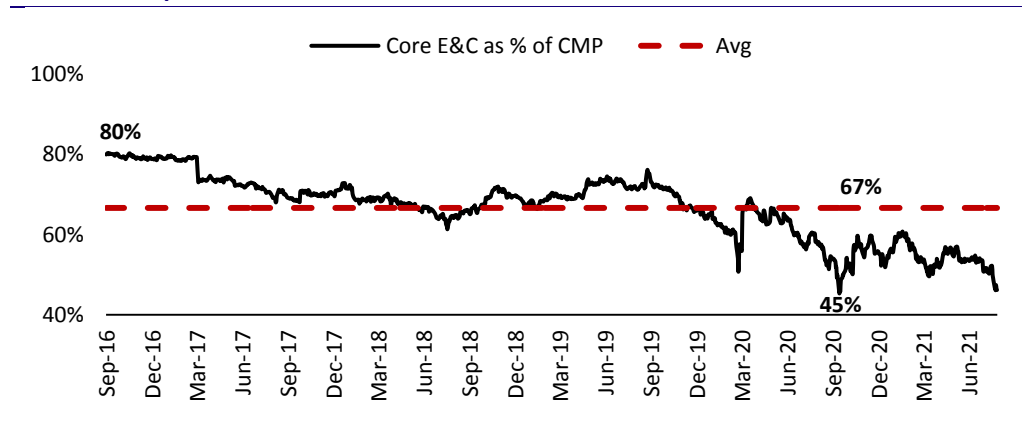
Source: MOFSL, Company

Exhibit 16: L&T trading slightly above long-term average P/E; valuations catch up largely owing to subsidiaries



Source: MOFSL, Company

Exhibit 17: Implied core E&C contribution to CMP almost at lows



Source: MOFSL, Company

Financials and valuations

Income Statement							(INR b)
Y/E March	FY18	FY19	FY20	FY21	FY22E	FY23E	FY24E
Net Sales	1,197	1,352	1,455	1,360	1,568	1,774	1,961
Change (%)	9.5	13.0	7.6	-6.5	15.3	13.2	10.5
EBITDA	136	153	163	156	183	214	241
Change (%)	21.9	13.0	6.5	-4.3	17.1	16.8	12.6
Margin (%)	11.3	11.3	11.2	11.5	11.7	12.1	12.3
Depreciation	19	19	25	29	30	31	32
EBIT	116	134	139	127	153	183	208
Net Interest	15	18	28	39	37	37	37
Other Income	14	18	24	34	33	35	36
PBT	115	134	134	122	149	180	208
Tax	32	41	33	40	41	48	55
Rate (%)	27.8	30.3	24.3	32.8	27.9	26.8	26.3
Reported Profit (Before MI and AI)	84	102	108	129	107	132	153
Less: Minority Interest	6	13	13	13	17	20	23
Add: Profits of Associates	-4	-0	1	0	1	1	1
EO Adjustments	1	9	7	47	0	0	0
Adjusted PAT	72	80	89	69	91	113	131
Change (%)	22.4	11.0	10.6	-22.4	32.0	24.0	15.9
Cons. Profit (Reported)	74	89	95	116	91	113	131

Balance Sheet							(INR b)
Y/E March	FY18	FY19	FY20	FY21	FY22E	FY23E	FY24E
Share Capital	3	3	3	3	3	3	3
Reserves	546	621	664	756	796	882	979
Net Worth	549	624	667	759	799	885	982
Loans	1,075	1,256	1,410	1,326	1,426	1,536	1,657
Deferred Tax Liability	-21	-31	-24	-15	-15	-15	-15
Minority Interest	52	68	95	121	137	157	180
Capital Employed	1,655	1,916	2,149	2,190	2,348	2,563	2,804
Gross Fixed Assets	220	262	535	571	591	611	631
Less: Depreciation	58	74	99	128	158	189	221
Add: Capital WIP	158	163	33	5	5	5	5
Net Fixed Assets	320	351	470	448	438	427	415
Investments	153	211	200	396	396	396	396
Inventory	48	64	57	58	67	76	84
Debtors	331	370	407	422	487	551	609
Cash and Bank Balance	80	117	151	162	194	275	375
Loans and Advances	24	25	22	11	13	15	16
Other Current Assets	575	615	688	647	746	844	933
Current Assets	1,923	2,195	2,353	2,241	2,546	2,908	3,285
Current Liab. and Prov.	741	841	875	896	1,033	1,169	1,292
Net Current Assets	1,182	1,354	1,478	1,346	1,513	1,740	1,993
Capital Deployed	1,655	1,916	2,149	2,190	2,348	2,563	2,804

Financials and valuations

Ratios

Y/E March	FY18	FY19	FY20	FY21	FY22E	FY23E	FY24E
Adjusted EPS	51.7	57.3	63.4	49.1	64.9	80.4	93.3
Growth (%)	22.4	10.9	10.5	-22.4	32.0	24.0	15.9
Cons. EPS (fully diluted)	51.7	63.5	68.0	82.5	64.9	80.4	93.3
Growth (%)	22.4	22.8	7.1	21.2	-21.3	24.0	15.9
Cash EPS	65.5	77.2	85.6	103.1	86.2	102.7	116.3
Book Value	391.7	444.7	475.3	540.2	569.0	630.0	699.1
DPS	15.9	18.0	18.0	36.0	19.5	24.1	28.0
Payout (incl. Div. Tax.)	30.8	28.4	26.5	43.7	30.0	30.0	30.0
Valuation (x)							
P/E	25.8	27.6	25.0	32.2	24.4	19.7	17.0
Cash P/E	20.4	16.9	15.2	12.6	15.1	12.7	11.2
EV/EBITDA	21.1	19.3	18.9	19.2	16.7	14.5	12.9
EV/Sales	2.5	2.2	2.1	2.2	2.0	1.7	1.6
Price/Book Value	3.7	3.6	3.3	2.9	2.8	2.5	2.3
Dividend Yield (%)	1.2	1.4	1.4	2.8	1.5	1.9	2.1
Profitability Ratios (%)							
RoE	13.2	12.9	13.3	9.1	11.4	12.8	13.3
RoCE	5.7	5.5	5.7	5.0	5.7	6.2	6.4
Turnover Ratios							
Debtors (Days)	101.0	100.0	102.2	113.4	113.4	113.4	113.4
Inventory (Days)	14.8	17.3	14.4	15.6	15.6	15.6	15.6
Asset Turnover (x)	0.7	0.7	0.7	0.6	0.7	0.7	0.7
Leverage Ratio							
Current Ratio (x)	2.6	2.6	2.7	2.5	2.5	2.5	2.5
Net Debt/Equity (x)	1.8	1.8	1.9	1.5	1.5	1.4	1.3

Cash Flow Statement

Y/E March	FY18	FY19	FY20	FY21	FY22E	FY23E	FY24E
PBT before EO Items	115	143	143	230	149	180	208
Add: Depreciation	19	21	25	29	30	31	32
Others	(11)	(12)	(1)	(121)	1	1	1
Less: Direct Taxes Paid	(34)	(46)	(40)	(35)	(41)	(48)	(55)
(Inc.)/Dec. in WC	(34)	(24)	(78)	54	(37)	(37)	(33)
CF from Operations	56	82	48	157	101	127	153
(Inc.)/Dec. in FA	(185)	(173)	(33)	37	(119)	(129)	(140)
Free Cash Flow	(129)	(91)	15	194	(18)	(2)	13
(Pur.)/Sale of Investments	54	(35)	(64)	(54)	-	-	-
CF from Investments	54	(35)	(64)	(54)	-	-	-
(Inc.)/Dec. in Net Worth	0	0	0	0	-	-	-
(Inc.)/Dec. in Debt	128	179	141	(87)	100	110	121
Others	(5)	11	(13)	(5)	-	-	-
Dividend Paid	(24)	(26)	(46)	(37)	(51)	(27)	(34)
CF from Fin. Activity	99	163	83	(128)	49	83	87
Inc./Dec. in Cash	25	37	34	11	31	81	100
Add: Opening Balance	56	80	117	151	162	194	275
Closing Balance	80	117	151	162	194	275	375

(INR b)

NOTES

Explanation of Investment Rating	
Investment Rating	Expected return (over 12-month)
BUY	>=15%
SELL	< - 10%
NEUTRAL	< - 10 % to 15%
UNDER REVIEW	Rating may undergo a change
NOT RATED	We have forward looking estimates for the stock but we refrain from assigning recommendation

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