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Capital Goods

Company update and
target price revision

Target price: Rs1,760

Target price revision

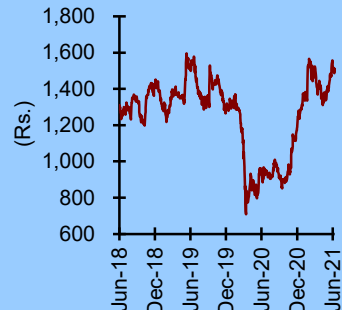
Rs1,760 from Rs1,670

Shareholding pattern

	Sep '20	Dec '20	Mar '21
Promoters	0.0	0.0	0.0
Institutional investors	53.5	54.4	55.2
MFs and other	16.6	14.9	15.4
FIs/Ins Co	18.9	18.2	17.4
FII	18.0	21.3	22.4
Others	46.5	45.6	44.8

Source: BSE

Price chart



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INDIA

Larsen & Toubro

BUY

Maintained

Focus on de-carbonisation and green solutions **Rs1,511**

We hosted Larsen & Toubro (L&T) at ICICI Securities Virtual ESG Conference'21 on 25th Jun'21. The representatives elaborated on the various initiatives taken in terms of water conservation, steps to reduce electricity consumption, carbon neutrality, etc. An insight into the company's defence business was also provided. Factoring-in the change in market cap of subsidiaries, we raise the target price for L&T to Rs1,760 (earlier Rs1,670).

- **Handling of labour:** Code of conduct both for the company and suppliers are adhered to, ensuring no unfair practices. L&T provides training to contract workers; it has also come up with a supplier questionnaire and assessment to fill any gaps in the same. Periodic audits are done to ensure adherence to rules by the sub-contractors.
- **Reduction in labour fatality:** A committee, headed by a Board member, has been formed to reduce fatalities and improve processes to move towards zero fatality (automation and digitalisation-related solutions are being used for the same). Training is provided to employees using virtual reality to improve safety and ensure proper working practices.
- **Vendor relationships:** MSME vendors are paid within 30-45 days of supply; the company has 60,000-70,000 vendors. It also works with them to improve logistical and other bottlenecks and advise on solutions involving digital and other technologies.
- **Defence business:** L&T is engaged in manufacture of systems, vehicles and platforms and not in the ammunition part. It does not manufacture explosives or ammunition of any kind including cluster munitions, anti-personnel landmines, nuclear weapons, or components for such munitions. The business also does not customise any delivery systems for such munitions.
- **Green portfolio focus:** Currently, green energy consumption is at 8.5% of the total energy consumed and the target is to increase it to 15% in 2-3 years. Have achieved its 60% target for water recycling, L&T is working on further increasing the same. The major steps being taken on water conservation are: use of aerators, waterless urinals, plant operations improvement to stop leakages in the older plant pipelines, etc.
- **Energy management:** 10,028mn-kWh of energy has been saved in the past 5-6 years cumulatively. This can supply energy to ~60,000 households for a year.

Market Cap	Rs2122bn/US\$28.6bn	Year to Mar	FY20	FY21	FY22E	FY23E
Reuters/Bloomberg	LART.BO/LT IN	Revenue (Rs bn)	1,455	1,360	1,525	1,723
Shares Outstanding (mn)	1,404.6	Rec. Net Income (Rs bn)	89	69	90	113
52-week Range (Rs)	1566/851	EPS (Rs)	63.2	49.1	64.2	80.2
Free Float (%)	100.0	% Chg YoY	6.7	(22.3)	30.7	24.8
FII (%)	22.4	P/E (x)	23.9	30.7	23.5	18.8
Daily Volume (US\$/000)	69,739	CEPS (Rs)	89.8	79.1	94.4	111.7
Absolute Return 3m (%)	8.1	EV/E (x) (Incl. Indus)	19.9	20.2	18.4	16.0
Absolute Return 12m (%)	65.8	Dividend Yield (%)	1.2	1.2	1.2	1.3
Sensex Return 3m (%)	7.7	RoCE (%)	7.8	7.3	7.2	8.0
Sensex Return 12m (%)	52.4	RoE (%)	13.8	9.7	11.3	12.6

Please refer to important disclosures at the end of this report

Outlook and valuation

L&T's current ex-services orderbook at Rs3.3trn (3.5x TTM ex-services sales) provides growth visibility. Given the restart of ordering activity on large multilateral projects such as high-speed rail, we believe demand will improve and aid ordering from similar projects in segments like metro, water, etc.

We adjust the balance sheet to factor-in the acquisition of 60.6% stake in Mindtree. We have consolidated the financials of Mindtree in our FY22E/FY23E estimates. We value the 60.6% stake as per the current market cap of Mindtree.

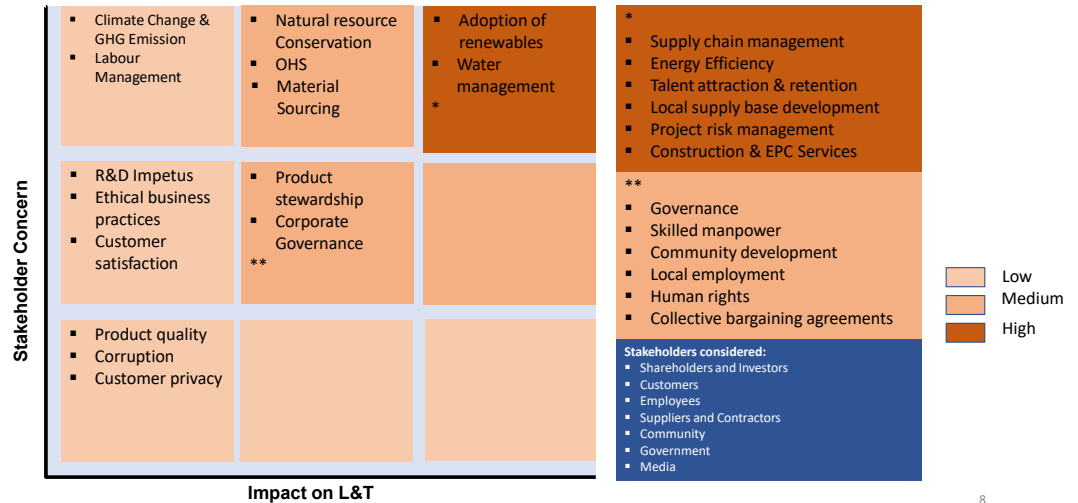
Given the business moat in terms of execution capabilities, we assign a target P/E multiple of 22x to the standalone business. Hydrocarbon business has been valued separately at 18x FY23E earnings, and 'other businesses' as per industry norms. We arrive at an SoTP-based target price of Rs1,760 where the standalone business is valued at Rs881, and other subsidiaries, associates and BOT assets at Rs879 (post holding company discount @20%) per share).

Table 1: Valuation summary

	Method	Valuation multiple	Value (Rs bn)	Value (Rs/sh)
Construction Business				
L&T Standalone	FY23 P/E (x)	22	1,239	881
International Ventures (L&T FZE)	FY23 P/E (x)	12	59	42
Mindtree	Market cap		258	183
Hydrocarbon				
Hydrocarbon Engineering	FY23 P/E (x)	18	238	169
Service Segments				
L&T Infotech	Market cap		540	384
L&T Technologies	Market cap		227	162
Finance	Market cap		152	108
Asset Ownership / Project Developer				
Infrastructure Development	P/BV	1	34	24
Seawoods	FY23 P/E (x)	10	6	5
Nabha Power	P/BV	1	23	17
Manufacturing Ventures				
Power Equipments	FY23 P/E (x)	25	2	1
L&T Komatsu	FY23 P/E (x)	18	6	2
Audco India	FY23 P/E (x)	15	6	2
Less: Holding Company Discount (@20%)			(310)	(220)
Total				1,760

Source: Company data, I-Sec research

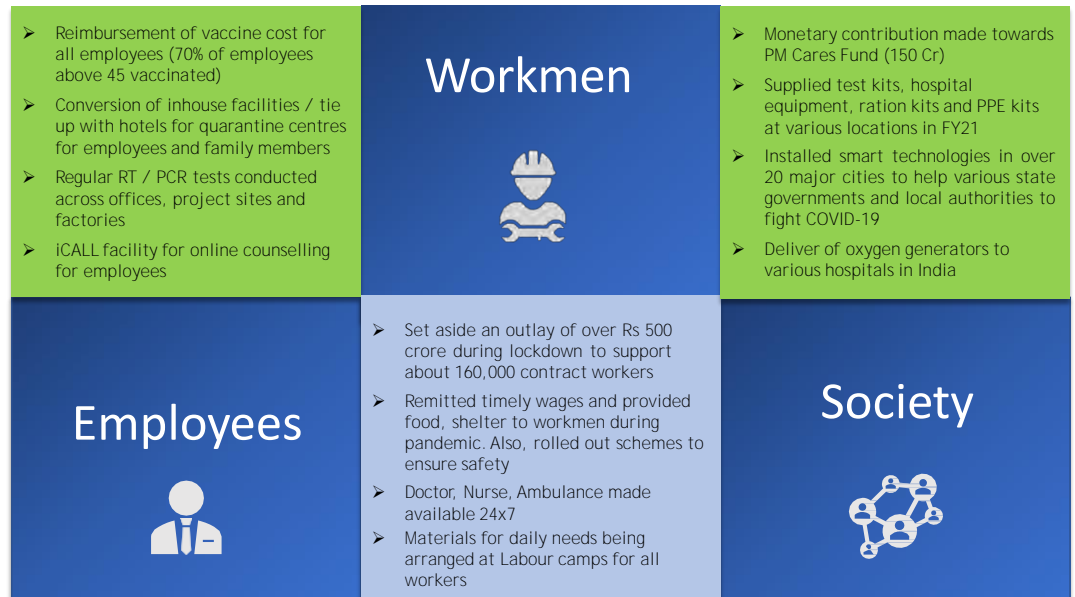
Chart 1: Materiality map



Source: Company data, I-Sec research

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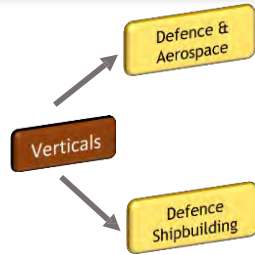
Chart 2: L&T's support during pandemic



Source: Company data, I-Sec research

Chart 3: ESG – Defence matters

- L&T partners with the Indian Defence Research, Defence Research and Development Organisation (DRDO) and the Indian Armed Forces in the development of defence products, systems and platforms across land, sea and air operations, in line with its commitment to 'Make in India'.
- With an integrated portfolio comprising technologies, products, systems, platforms and solutions, L&T Defence today offers solutions across the project lifecycle.



Defence Segment	FY19	FY20	FY21
Revenue (in Rs Bn)	37.5	39.7	34.0
% of Total Group Revenue	2.7%	2.7%	2.5%

The business does not manufacture any explosives nor ammunition of any kind, including cluster munitions or anti-personnel landmines or nuclear weapons or components for such munitions. The business also does not customise any delivery systems for such munitions.

Source: Company data, I-Sec research

Financial summary (consolidated)

Table 2: Profit & Loss statement

(Rs mn, year ending March 31)

	FY20	FY21	FY22E	FY23E
Total Income	14,54,524	13,59,790	15,25,470	17,22,983
Operating Expenses	12,91,234	12,03,549	13,50,254	15,19,787
EBITDA	1,63,290	1,56,241	1,75,216	2,03,195
% margins	11.2	11.5	11.5	11.8
Depreciation & Amortisation	24,623	29,042	31,476	34,623
EBIT	1,38,667	1,27,199	1,43,741	1,68,572
Gross Interest	27,967	39,134	29,404	26,950
Other Income	23,609	34,294	20,731	21,631
Recurring PBT	1,34,310	1,22,358	1,35,068	1,63,253
Add: Extraordinaries	-	-	-	-
Less: Taxes	32,632	40,108	33,767	40,813
Less: Minority Interest & Share in associates	12,733	13,240	11,079	9,862
Net Income (Reported)	88,945	69,010	90,222	1,12,578
Adjusted Net Income	88,945	69,010	90,222	1,12,578

Source: Company data, I-Sec research

Table 3: Balance sheet

(Rs mn, year ending March 31)

	FY20	FY21	FY22E	FY23E
Assets				
Total Current Assets	23,43,507	24,20,727	25,04,323	27,10,384
of which cash & cash eqv.	1,51,178	1,62,415	1,02,357	76,157
Total Current Liabilities & Provisions	8,40,693	8,69,196	8,69,341	9,78,493
Net Current Assets	15,02,815	15,51,531	16,34,981	17,31,891
Investments	2,73,995	2,73,995	2,73,995	2,73,995
Other Non-Current Assets	3,30,119	3,10,844	3,34,573	3,60,675
Net Fixed Assets	-	-	-	-
Goodwill	80,114	80,670	80,670	80,670
Total Assets	21,87,042	22,17,040	23,24,219	24,47,231
Liabilities				
Borrowings	14,10,071	13,26,053	13,36,544	13,47,524
Deferred Tax Liability	14,530	11,787	11,787	11,787
Minority Interest	95,208	1,20,515	1,32,515	1,43,515
Equity Share Capital	2,808	2,809	2,809	2,809
Face Value (Rs)	2.00	2.00	2.00	2.00
Reserves & Surplus	6,64,424	7,55,876	8,40,564	9,41,596
Net Worth	6,67,232	7,58,685	8,43,373	9,44,405
Total Liabilities	21,87,042	22,17,040	23,24,219	24,47,231

Source: Company data, I-Sec research

Table 4: Cashflow statement

(Rs mn, year ending March 31)

	FY20	FY21	FY22E	FY23E
Operating Cashflow	1,33,760	3,55,080	1,12,045	1,35,432
Working Capital Changes	(66,890)	(1,26,639)	(1,43,509)	(1,23,110)
Capital Commitments	(1,01,644)	18,719	(23,729)	(26,102)
Free Cashflow	(34,774)	2,47,160	(55,192)	(13,780)
Cashflow from Investing Activities	19,081	(73,007)	20,731	21,631
Issue of Share Capital	-	-	-	-
Buyback of shares	-	-	-	-
Inc (Dec) in Borrowings	1,54,520	(84,019)	10,492	10,980
Interest paid	(27,967)	(39,134)	(29,404)	(26,950)
Dividend paid	(22,432)	(25,282)	(36,089)	(45,031)
Extraordinary Items/Others	(54,513)	(14,481)	29,404	26,950
Chg. in Cash & Bank balance	33,915	11,237	(60,058)	(26,200)

Source: Company data, I-Sec research

Table 5: Key ratios

(Year ending March 31)

	FY20	FY21	FY22E	FY23E
Per Share Data (in Rs.)				
Diluted adjusted EPS	63.2	49.1	64.2	80.2
Recurring Cash EPS	89.8	79.1	94.4	111.7
Dividend per share (DPS)	18.0	18.0	18.0	20.0
Book Value per share (BV)	474.4	539.5	599.7	671.5
Growth Ratios (%)				
Operating Income	7.6	(6.5)	12.2	12.9
EBITDA	6.5	(4.3)	12.1	16.0
Recurring Net Income	10.6	(22.4)	30.7	24.8
Diluted adjusted EPS	6.7	(22.3)	30.7	24.8
Diluted Recurring CEPS	9.0	(11.9)	19.3	18.3
Valuation Ratios				
P/E	23.9	30.7	23.5	18.8
P/CEPS	16.8	19.1	16.0	13.5
P/BV	3.2	2.8	2.5	2.2
EV / EBITDA	19.9	20.2	18.4	16.0
EV / Operating Income	2.2	2.3	2.1	1.9
EV / Operating FCF (pre - Capex)	48.5	13.8	(102.4)	264.4
Operating Ratios				
Raw Material/Sales (%)	33.6	31.9	32.2	33.5
SG&A/Sales (%)	20.6	21.7	21.9	21.6
Other Income / PBT (%)	17.6	28.0	15.3	13.3
Effective Tax Rate (%)	24.3	32.8	25.0	25.0
NWC / Total Assets (%)	61.8	62.7	65.9	67.7
Inventory Turnover (days)	14.4	15.6	20.0	20.0
Receivables (days)	102.2	113.4	96.0	96.0
Payables (days)	122.9	138.2	118.8	118.8
Net D/E Ratio (x)	2.1	1.7	1.6	1.4
Return/Profitability Ratios (%)				
Recurring Net Income Margins	6.1	5.1	5.9	6.5
RoCE	7.8	7.3	7.2	8.0
RoNW	13.8	9.7	11.3	12.6
Dividend Payout Ratio	28.5	36.6	28.0	25.0
Dividend Yield	1.2	1.2	1.2	1.3
EBITDA Margins	11.2	11.5	11.5	11.8

Source: Company data, I-Sec research

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