Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Stock Update

Result Update

Larsen & Toubro

Robust Q1; growth prospects bright

Capital Goods	Sharekhan code: LT
Reco/View: Buy ↔	CMP: **Rs. 1,751** / Price Target: **Rs. 2,075** ↑

↑ Upgrade ↔ Maintain ↓ Downgrade

3R MATRIX

	+	=	-
Right Sector (RS)	✓		
Right Quality (RQ)	✓		
Right Valuation (RV)	✓		

+ Positive = Neutral – Negative

What has changed in 3R MATRIX

	Old		New
RS		↔	
RQ		↔	
RV		↔	

ESG Disclosure Score NEW

ESG RISK RATING 34.29

Updated Apr 08, 2022

High Risk

NEGL	LOW	MED	HIGH	SEVERE
0-10	10-20	20-30	30-40	40+

Source: Morningstar

Company details

Market cap:	Rs. 246,024 cr
52-week high/low:	Rs. 2079/1456
NSE volume: (No of shares)	22.7 lakh
BSE code:	500510
NSE code:	LT
Free float: (No of shares)	140.5 cr

Shareholding (%)

Promoters	0.0
FII	20.8
DII	35.7
Others	43.5

Price chart

Price performance

(%)	1m	3m	6m	12m
Absolute	14.0	4.4	-8.4	8.9
Relative to Sensex	10.1	7.2	-4.9	3.8

Sharekhan Research, Bloomberg

Summary

- Q1FY2023 numbers were broadly in line with our expectations. Order inflows improved significantly by 57% y-o-y led by strong intake across verticals including international orders (43% of total inflows), while order prospects for FY2023 stand at Rs 7.6 trillion.
- Maintained order intake and revenue growth guidance of 12-15% for FY23E, OPM in projects business to be at 9.5% and the company expects to bring down working capital to ~20% of sales for FY23E.
- Pick-up in infrastructure spend by the government and incentivizing domestic manufacturing bodes well for growth. Further, private capex likely to pick up in H2FY23. Middle East region's hydrocarbon and infrastructure capex spends too have increased due to a rise in crude oil prices.
- We maintain a Buy on L&T with a revised PT of Rs. 2,075, factoring in increase in valuation multiple for the core business given robust order book of Rs 3.6 lakh crore (2.2xTTM revenue) and a promising long-term outlook.

Q1FY2023 numbers were in line with our and street expectations. Consolidated revenues grew by ~22% y-o-y to Rs. 35,853 crore. The growth was led by strong execution in infrastructure (40% of the total revenues) and IT & technology Services (TS) businesses. Operating profit increased by ~25% y-o-y to Rs 3,957 crore, in-line with strong revenue growth. OPM came in at 11% (up 22 bps y-o-y but down 130 bps q-o-q) beating our estimate of 10.8%. The OPM was largely driven by improved services portfolio's performance. However, EBITDA margin of the infrastructure segment came in lower at 6.5% vs 7.1% in Q1FY22. Margins for the quarter have been hit by input cost escalations and change in revenue mix. Net profit grew by ~45% y-o-y to Rs. 1,702 crore (vs our estimate of Rs 1,617 crore) due to the decline in interest cost and lower tax rate. Q1FY23 order inflows stood at Rs 41,805crore, up 57% y-o-y led by infrastructure, hydrocarbon & defence and international orders. Its order book is at a record level at Rs. 3.6 lakh crore, translating to 2.2x its TTM consolidated revenues. The management maintained its order intake and revenue growth guidance of 12-15% for FY2023E, while it expects OPM in the core projects business to be at 9.5% and working capital requirements to be at 20% of sales for FY23E. The company has reorganized its business segments in line with the business strategy to be adopted by the company under its 5-year plan (Lakshya 2026). The segments now comprise - Infrastructure Projects, Energy Projects, Hi-tech Manufacturing, IT&TS, Financial services and Development projects.

Key positives

- Order inflows rose 57% y-o-y at Rs. 41,805 crore driven by infrastructure, hydrocarbon, defence and strong contribution from international orders. Notably, international order inflow constituted 91% of the total order inflow of the energy projects segment.
- Order book remains strong at Rs. 3.6 lakh crore, up 12% y-o-y – 72% domestic, 28% international.
- In core business, infrastructure and IT & TS segments led the topline by growing at 36% and 30% y-o-y.

Key negatives

- OPM of infrastructure projects business has been impacted by input cost escalations and change in revenue mix. Further, margin in hi-tech manufacturing have also declined y-o-y.
- Subdued y-o-y revenue growth in energy projects and hi-tech manufacturing segments at 3% each.
- The company has not revised its margin guidance upwards for core business despite decline in commodity prices.

Management Commentary

- Order intake growth guidance of 12-15% growth, Projects business OPM@9.5% and working capital @20% of sales for FY23. Company has removed slow moving order of Rs 1,400 crore from the order book belonging to power T&D and infrastructure segments.
- Order pipeline stands at Rs 7.6 trillion which includes Rs 1.1 trillion in international market.
- Increase in government spend and likely private capex revival in H2FY23 bodes well for long-term growth. International markets also look promising particularly in hydrocarbon and renewables space.
- 2/3 of L&T's order book has certain price escalation clauses (although some are not complete pass-through), while the rest is fixed price contracts. 26% of its order book is funded by bilateral and multilateral funding agencies.
- Normalized tax rate expected to be in the range of 25-27%. Q1FY23 was a normal quarter, similar to any pre covid quarter.

Revision in estimates – We have marginally tweaked our estimates for FY2023-FY2024.

Our Call

Maintain Buy with a revised PT of Rs. 2,075: L&T reported all round performance despite global headwinds, supply chain challenges and a rise in input cost in a seasonally weak quarter. Healthy order inflow guidance and optimistic management commentary on order prospects going forward gives us comfort. International outlook too looks buoyant as there are a host of opportunities. Over the long term, L&T remains at the forefront to reap benefits from the AtmaNirbhar Bharat scheme with its diversified businesses across sectors such as defence, infrastructure, heavy engineering and IT. The company remains the best proxy for domestic capex. We maintain a Buy rating on the stock with a revised SOTP-based price target (PT) of Rs. 2,075 factoring in increase in valuation multiple for the core business given robust order book of Rs 3.6 lakh crore (2.2xTTM revenue) and a promising long-term outlook.

Key Risks

Slowdown in the domestic macro-economic environment and geo-political conflicts can adversely impact its order prospects.

Valuation (Consolidated) Rs cr

Particulars	FY21	FY22	FY23E	FY24E
Revenue	1,35,979	1,56,521	1,80,607	2,05,892
OPM (%)	11.5	11.6	11.7	12.0
Adjusted PAT	6,901	8,573	10,440	12,971
% YoY growth	-22.5%	24.2%	21.8%	24.2%
Adjusted EPS (Rs.)	49.2	61.2	74.5	92.5
P/E (x)	35.6	28.6	23.5	18.9
P/B (x)	3.2	3.0	2.8	2.5
EV/EBITDA (x)	16.9	14.0	11.4	8.9
RoNW (%)	18.1	13.2	12.5	14.7
RoCE (%)	7.4	7.9	9.2	10.9

Source: Company; Sharekhan estimates

Robust performance in a seasonally weak quarter

Q1FY2023 numbers were in line with our and street expectations. Consolidated revenues grew by ~22% y-o-y to Rs. 35,853 crore. The growth was led by strong execution in infrastructure (40% of the total revenues) and IT & technology Services (TS) businesses. Operating profit increased by ~25% y-o-y to Rs 3,957 crore, in-line with strong revenue growth. OPM came in at 11% (up 22 bps y-o-y but down 130 bps q-o-q) beating our estimate of 10.8%. The OPM was largely driven by improved services portfolio's performance. However, EBITDA margin of the infrastructure segment came in at 6.5% vs 7.1% in Q1FY22. Margins for the quarter have been hit by input cost escalations and change in revenue mix. Net profit grew by ~45% y-o-y to Rs. 1,702 crore (vs our estimate of Rs 1,617 crore) due to the decline in interest cost and lower tax rate. Q1FY23 order inflows stood at Rs 41,805crore, up 57% y-o-y led by infrastructure, hydrocarbon & defence and international orders. Its order book is at a record level at Rs. 3.6 lakh crore, translating to 2.2x its TTM consolidated revenues.

Promising future outlook across verticals

The management maintained its order intake and revenue growth guidance of 12-15% for FY2023E, while it expects OPM in the core projects business to be at 9.5%. It expects working capital requirements to be at ~20% of the sales for FY23. The company's ROE has also improved sequentially to 11.5% in Q1FY23 as compared to 11% in Q4FY22. The company has chalked out a detailed 5-year strategic plan 'Lakshya 2026' for pursuing profitable growth in its traditional businesses of EPC projects and manufacturing and expanding the size and scale of its IT&TS portfolio. Further, unlocking of its current investments in few non-core areas would be aggressively pursued. Under the plan, company aims to grow its order inflows/Revenue at 14%/15% CAGR and achieve core RoE at over 18% during FY21-FY26E. The company has reorganized its business segments in line with the business strategy to be adopted by the company under Lakshya 2026. The segments now comprise - Infrastructure Projects, Energy Projects, Hi-tech Manufacturing, IT&TS, Financial services and Development projects.

Key highlights from Q1FY23 earnings call

- **Q1FY23 performance:** The Q1FY23 performance was largely led by strong revenue growth in infrastructure projects and IT&TS businesses. The revenue growth was also helped by low base of last year, which was hit by Covid. While, input cost headwinds continued to impact core business margin, the consolidated business margin was supported by strong performance by services portfolio.
- **Order book:** Group order inflows stood at Rs. 41,805 crore, up 57% y-o-y, led by infrastructure, hydrocarbon and defence. International orders stood at Rs 17,842 crore during the quarter and comprised 43% of the total order inflow. The order book stood at Rs. 3.6 lakh crore with domestic share of 72% and overseas 28%. Out of the international order book of Rs. 1,01,752 crore, ~79% is from middle east and the rest from USA/ Europe and ROW. Infrastructure and energy segments comprise over 90% of the order book. About 26% of the total order book is funded by bilateral and multilateral agencies.
- **Divestments:** The company is aggressively pursuing divestments of its non-core power & road concession projects under L&T IDPL and Hyderabad Metro Project in which L&T's current exposure is ~Rs 7,000 crore.
- **Tax rate to be between 25-27%:** The lower tax rate of ~22% during the quarter was led by adjustment of Rs 134 crore as Mindtree Limited shifted to the new tax regime. The normalized tax rate is expected to be 25-27%.
- **Streamlining business segments:** The company has reorganized its business segments in line with the business strategy to be adopted by the company under Lakshya 2026.
- **Strong order pipeline:** The company has identified order prospects of Rs 7.6 trillion of which Rs 1.1 trillion is expected from international markets. Out of the Rs 7.6 trillion, infrastructure comprises of Rs 5.6 trillion followed by Energy (Rs 1.6 trillion) and project & manufacturing segments (Rs 0.4 trillion).
- **Margin guidance for core project business maintained at 9.5%:** The company had arrived at the margin guidance of 9.5% after taking the average of commodity prices in FY22. Currently, the commodity prices are hovering at the average of FY22 and therefore the company does not see any need to up its margin guidance as of now.

Results Consolidated Rs cr

Particulars	Q1FY23	Q1FY22	YoY %	Q4FY22	QoQ %
Net Sales	**35,853**	**29,335**	**22.2**	**52,851**	**-32.2**
Total Expenditure	31,897	26,163	21.9	46,330	-31.2
Operating profit	3,957	3,171	24.8	6,521	-39.3
Other Income	695	648	7.2	516	34.7
Interest	756	827	-8.6	705	7.2
Depreciation	963	717	34.3	769	25.2
PBT	2,932	2,275	28.9	5,562	-47.3
Tax	639	718	-11.1	1,555	-58.9
Adjusted PAT	**1,702**	**1,174**	**44.9**	**3,621**	**-53.0**
EPS (Rs.)	**12.1**	**8.4**	**44.9**	**25.8**	**-53.0**
Margins (%)			**BPS**		**BPS**
OPM	11.0	10.8	22	12.3	(130)
PATM	4.7	4.0	74	6.9	(210)
Tax Rate	21.8	31.6	(979)	28.0	(617)

Source: Company, Sharekhan Research

Outlook and Valuation

■ Sector view - Continued government focus on infrastructure spending to provide growth opportunities

To make India a $5-trillion economy by FY2025 and to continue growing at an escalated trajectory until 2030, it is estimated that the government would need to spend $4.5 trillion on infrastructure. To achieve the goal, the government drew up National Infrastructure Pipeline (NIP) through bottom-up approach, wherein all projects costing over Rs. 100 crore per project under construction, proposed greenfield and brownfield projects and those at conceptualization stage were captured. Consequently, the total capital expenditure in infrastructure sectors in India during FY2020-FY2025 is projected at ~Rs. 111 lakh crore. During the same period, sectors such as energy (24%), roads (18%), urban (17%) and railways (12%) are likely to amount to ~71% of the projected infrastructure investments in India. The huge outlay towards infrastructure is expected to provide healthy growth opportunities for companies in this space.

■ Company outlook - Expect healthy order inflows and improved execution

The management expects a domestic recovery with a focus on growth in both revenues and order inflows for FY2023. Hence, the management has guided for 12-15% growth in order intake and revenue for FY2023. The OPM is expected around 9.5% for core business and working capital requirement (as a percentage of sales) would be at ~20%. Order prospects are also healthy with rise in government spend and private capex as well as strong traction in international orders. On the asset divestment front, for the Hyderabad Metro, the company is evaluating various options while divestment of power assets to near closure. Thus, we expect L&T to bounce back owing to multiple levers such as a strong business model, a diversified order book and a healthy balance sheet.

■ Valuation - Maintain Buy with a revised PT of Rs. 2,075

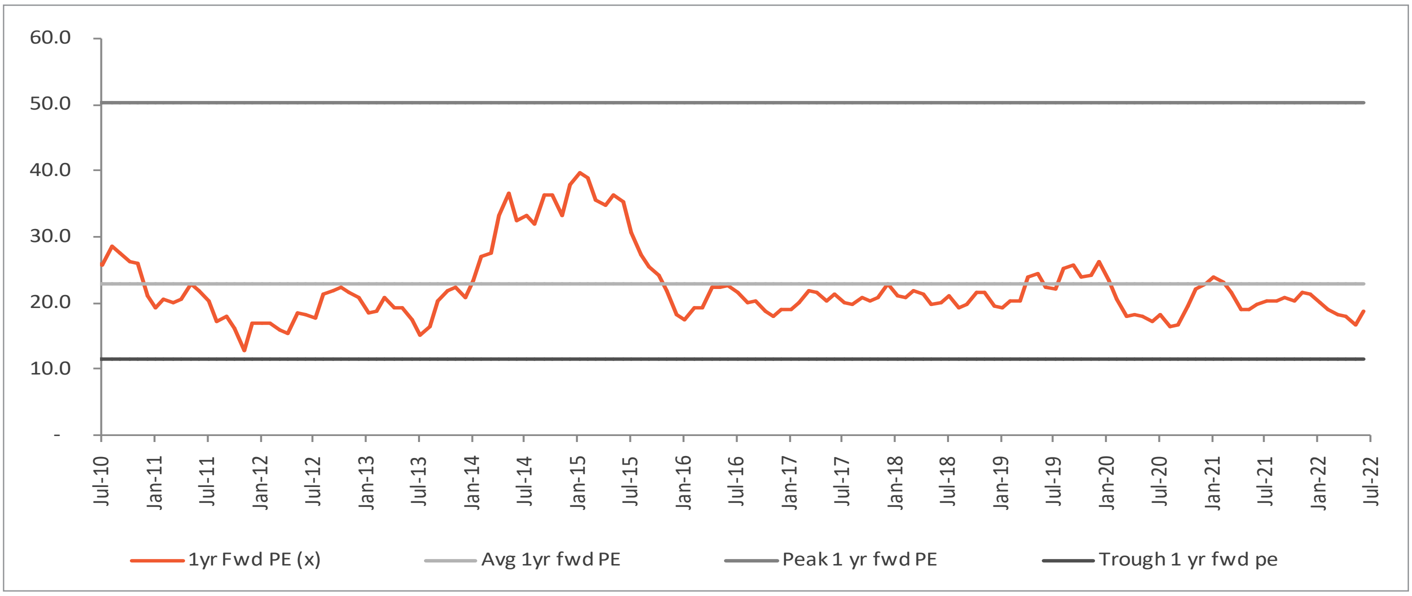
L&T reported all round performance despite global headwinds, supply chain challenges and a rise in input cost in a seasonally weak quarter. Healthy order inflow guidance and optimistic management commentary on order prospects going forward gives us comfort. International outlook too looks buoyant as there are a host of opportunities. Over the long term, L&T remains at the forefront to reap benefits from the AtmaNirbhar Bharat scheme with its diversified businesses across sectors such as defence, infrastructure, heavy engineering and IT. The company remains the best proxy for domestic capex and an improving business environment. We maintain a Buy rating on the stock with a revised SOTP-based price target (PT) of Rs. 2,075 factoring in increase in valuation multiple for the core business given robust order book of Rs 3.6 lakh crore (2.2xTTM revenue) and a promising long-term outlook.

SOTP Valuation

Particulars	Remarks	Value (Rs cr)	Per share (Rs)
L&T's core business (standalone)	**At 14x FY2024E estimates**	**1,81,593**	**1,295**
Subsidiaries			
L&T Infotech (LTI)	Based on our target price	46,303	330
L&T Finance Holdings (L&TFH)	Based on our target price	9,426	67
L&T Technology Services Ltd (LTTS)	Based on our target price	19,737	141
Mindtree	Based on current market cap at 25% discount	22,998	164
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		**86,259**	**779**
Fair value		**2,67,852**	**2,075**

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 have 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.
- Weakness in domestic investment could impact growth and award of large projects, thus posing a downside risk.
- 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	L&T EMPLOYEES TRUST	13.89
2	Life Insurance Corp of India	12.46
3	Sbi Magnum Equity Esg Fund	4.14
4	Bharat 22 ETF	3.10
5	Government Of Singapore	2.81
6	Hdfc Mutual Fund	2.33
7	NPS Trust- A/c SBI Pension Fund Scheme - Central G	1.91
8	General Insurance Corporation Of India	1.78
9	Kotak Equity Hybrid	1.25
10	ICICI Prudential Life Insurance Company	1.24

Source: Capitaline, Bloomberg

Understanding the Sharekhan 3R Matrix

Right Sector	
Positive	Strong industry fundamentals (favorable demand-supply scenario, consistent industry growth), increasing investments, higher entry barrier, and favorable government policies
Neutral	Stagnancy in the industry growth due to macro factors and lower incremental investments by Government/private companies
Negative	Unable to recover from low in the stable economic environment, adverse government policies affecting the business fundamentals and global challenges (currency headwinds and unfavorable policies implemented by global industrial institutions) and any significant increase in commodity prices affecting profitability.
Right Quality	
Positive	Sector leader, Strong management bandwidth, Strong financial track-record, Healthy Balance sheet/cash flows, differentiated product/service portfolio and Good corporate governance.
Neutral	Macro slowdown affecting near term growth profile, Untoward events such as natural calamities resulting in near term uncertainty, Company specific events such as factory shutdown, lack of positive triggers/events in near term, raw material price movement turning unfavourable
Negative	Weakening growth trend led by led by external/internal factors, reshuffling of key management personal, questionable corporate governance, high commodity prices/weak realisation environment resulting in margin pressure and detoriating balance sheet
Right Valuation	
Positive	Strong earnings growth expectation and improving return ratios but valuations are trading at discount to industry leaders/historical average multiples, Expansion in valuation multiple due to expected outperformance amongst its peers and Industry up-cycle with conducive business environment.
Neutral	Trading at par to historical valuations and having limited scope of expansion in valuation multiples.
Negative	Trading at premium valuations but earnings outlook are weak; Emergence of roadblocks such as corporate governance issue, adverse government policies and bleak global macro environment etc warranting for lower than historical valuation multiple.

Source: Sharekhan Research

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by BNP PARIBAS

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