Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

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 Oct 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. 2,84,242 cr
52-week high/low:	Rs. 2,079/1,456
NSE volume: (No of shares)	20.0 lakh
BSE code:	500510
NSE code:	LT
Free float: (No of shares)	140.5 cr

Shareholding (%)

Promoters	0.0
FII	22.1
DII	40.9
Others	37.0

Price chart

Price performance

(%)	1m	3m	6m	12m
Absolute	9.5	12.0	19.4	14.6
Relative to Sensex	3.7	6.5	12.9	12.1

Sharekhan Research, Bloomberg

Larsen & Toubro

Good show in Q2; growth prospects promising

Capital Goods	Sharekhan code: LT
Reco/View: Buy ↔	CMP: **Rs. 2,023**
	Price Target: **Rs. 2,390** ↑

↑ Upgrade ↔ Maintain ↓ Downgrade

Summary

- Q2FY2023 numbers exceeded our expectations on both sales and profitability fronts with a marginal miss on OPM. It maintained order intake/revenue growth guidance of 12-15% for FY23E (strong bias towards higher range of 15%), OPM in projects business to be at 9.5% and working capital to be ~20% of sales for FY23E.
- Order inflows recorded a growth of 23% y-o-y at Rs 51,914 crore including international orders of Rs 17,341 crore (33% of total inflows), while order prospects for H2FY2023 stand at Rs 6.3 trillion with increasing proportion of private orders. Order book stands strong at ~Rs 3.7 lakh crore (2.2xTTM revenue).
- Pick-up in infrastructure spends by the government, expansion of PLI schemes as well as private capex pick up bodes well for growth. Apart from oil & gas, GCC region's increasing spend on metals, renewable energy and infrastructure would drive the international order intake.
- We maintain a Buy on L&T with a revised PT of Rs. 2,390, factoring in execution tailwinds in the core business and upward revision in valuation of key IT & TS and finance subsidiaries.

Q2FY2023 consolidated numbers beat ours and the street's expectations. Consolidated revenues grew by ~23% y-o-y to Rs. 42,763 crore. The growth continued to be led by accelerated execution in the infrastructure projects segment and IT&TS portfolio. Operating profit increased by ~22.6% y-o-y to Rs 4,899 crore, in line with strong revenue growth. OPM came flattish on y-o-y basis at 11.5% but were up by 42 bps on q-o-q basis, slightly below our estimate of 11.7%. Operating performance was largely driven by improved performance in financial services and strong EBITDA margin in energy projects (8.5% vs 6.6% in Q2FY22) and hi-tech manufacturing (18.5% vs 14.5% in Q2FY22) segments, while its infrastructure projects business continued to witness cost pressures. Hence, EBITDA margins of the infrastructure segment came in lower at 6.6% vs 8.3% in Q2FY22. Adjusted net profit grew by ~29% y-o-y to Rs. 2,229 crore (vs our estimate of Rs 2,160 crore) due to good operating performance and aided by higher other income (+38.8% y-o-y). L&T's order book stands at a record level of Rs. 3.7 lakh crore, translating to 2.2x its TTM consolidated revenue. The management maintained its order intake and revenue growth guidance of 12-15% for FY2023E with strong bias towards upper range. 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.

Key positives

- Order inflows rose 23% y-o-y at Rs. 51,914 crore. Orders were received across multiple segments like public spaces, nuclear power, irrigation, ferrous metal, health, renewables and refinery sectors.
- Infrastructure projects segment secured order inflows of Rs 25,058 crore, registering a substantial growth of ~107% y-o-y.
- Order book remains strong at Rs. 3.7 lakh crore, up 13% y-o-y – 72% domestic orders, 28% international orders.
- Infrastructure projects and IT & TS segments led the topline by growing at 39% and 29% y-o-y.

Key negatives

- OPM of infrastructure projects (6.6% vs 8.3% in Q2FY22) segment has been hit due to input cost escalations in a few projects.
- Revenues in energy projects dipped 7% y-o-y and hi-tech manufacturing also witnessed marginal y-o-y decline in revenues.
- The company has not revised its margin guidance upwards for core business despite a decline in commodity prices.
- The company has refrained from revising its order inflow guidance of 12-15% y-o-y growth despite 36% y-o-y growth in order intake in H1FY23.

Management Commentary

- Order intake and revenue growth guidance have been maintained at 12-15% with strong bias towards upper band of the range. Projects business OPM@9.5% and working capital @20% of sales for FY23.
- Company has removed slow moving order of Rs 1,600 crore from the order book and 3-4% of its order book is slow-moving.
- Order pipeline stands at Rs 7.6 trillion, which includes Rs 1.1 trillion in international market.
- Increase in government and private capex bodes well for long-term growth. International markets also look promising as GCC region is seeing investments in non-oil sectors too such as metals, renewable energy and infrastructure.
- Two-thirds 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. 27% of its order book is funded by bilateral and multilateral funding agencies.

Revision in estimates – We have introduced FY2025 estimates and marginally tweaked our estimates for FY2023-FY2024.

Our Call

Maintain Buy with a revised PT of Rs. 2,390: L&T reported healthy performance despite cost pressures in its core business and supply chain challenges. Robust order intake and strong order pipeline going forward gives us comfort. International outlook is also buoyant given a healthy order pipeline and emerging opportunities in non-oil segments as well. 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 on the stock with a revised SOTP-based price target (PT) of Rs. 2,390, factoring in increase in valuation multiple for the core business given robust order book of Rs 3.7 lakh crore (2.2xTTM revenue) and a promising long-term growth outlook.

Key Risks

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

Valuation (Consolidated) Rs cr

Particulars	FY22	FY23E	FY24E	FY25E
Revenue	1,56,521	1,80,607	2,05,892	2,33,688
OPM (%)	11.6	11.7	12.0	12.1
Adjusted PAT	8,573	10,677	13,268	15,982
% YoY growth	24.2	24.5	24.3	20.5
Adjusted EPS (Rs.)	61.2	76.2	94.7	114.0
P/E (x)	33.1	26.6	21.4	17.7
P/B (x)	3.4	3.2	2.9	2.5
EV/EBITDA (x)	17.0	14.0	11.7	9.6
RoNW (%)	13.2	12.4	14.0	14.9
RoCE (%)	7.8	9.0	10.5	11.9

Source: Company; Sharekhan estimates

Stellar quarter, order book stays strong

Q2FY2023 consolidated numbers beat ours and the street's expectations. Consolidated revenues grew by ~23% y-o-y to Rs. 42,763 crore. The growth continued to be led by accelerated execution in the infrastructure projects segment and IT&TS portfolio. Operating profit increased by ~22.6% y-o-y to Rs 4,899 crore, in line with strong revenue growth. OPM came flattish on y-o-y basis at 11.5% but were up by 42 bps on q-o-q basis, slightly below our estimate of 11.7%. Operating performance was largely driven by improved performance in financial services and strong EBITDA margin in energy projects (8.5% vs 6.6% in Q2FY22) and hi-tech manufacturing (18.5% vs 14.5% in Q2FY22) segments as its infrastructure projects business continued to witness cost pressures. Hence, EBITDA margins of the infrastructure segment came in lower at 6.6% vs 8.3% in Q2FY22. Adjusted net profit grew by ~29% y-o-y to Rs. 2,229 crore (vs our estimate of Rs 2,160 crore) due to good operating performance and aided by higher other income (+38.8% y-o-y). L&T's order book stands at a record level of Rs. 3.7 lakh crore, translating to 2.2x its TTM consolidated revenue. The management maintained its order intake and revenue growth guidance of 12-15% for FY2023E with strong bias towards upper range. 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.

Optimistic outlook across business verticals

The management maintained its order intake and revenue growth guidance of 12-15% for FY2023E with a bias towards the upper band, while it expects OPM in the core projects business to be at 9.5%. It expects working capital requirements to be at ~20% of sales for FY23. The company's ROE has also improved sequentially to 12.1% in Q2FY23 as compared to 11.5% in Q1FY23. The company has chalked out a detailed five-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 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 8 at over 18% during FY21-FY26E. The order prospects are strong and with increasing proportion of private orders there could be a case for margin expansion going forward.

Key highlights from Q2FY23 earnings call

- **Order book stands strong at Rs. 3.7 lakh crore (up 13% y-o-y):** Out of the total order book of Rs 3.7 lakh crore – Rs. 1.04 lakh crore is international. Of the international order book, 80% comes from Middle East, 10% from Africa and remaining from South East Asian countries. In Domestic order book of Rs 2.66 lakh crore – central government orders have a 10% share, state@ 30% PSU @ 42 % and private sector @ 18%. Also, 27% of the order book is funded by bilateral and multi-lateral agencies. 91% of orders are from infrastructure and energy segments. The company has removed Rs 1,600 crore of orders from the order book and 3-4% of its order book is slow moving.
- **Strong order intake:** Group order inflows were up 23% y-o-y to Rs. 51,914, led by infrastructure, energy and services. International orders stood at Rs 22,842 crore during the quarter and comprised 44% of the total order inflows.
- **Order prospects strong at Rs. 6.3 trillion:** The order prospects for H2FY23 is Rs 6.3 trillion of which Rs 1.3 trillion is international. Out of domestic orders, infrastructure segment has prospects of Rs 4.54 trillion and Hydrocarbon is at Rs 1.13 trillion and the rest is hi-tech engineering and other segments. The award to tender ratio in Q2 was 34% vs 69% in Q1, however for H1FY23 the ratio stands higher at 49% vs 40% in H1FY22.

- **Order prospects from private sector are getting better:** Out of the Rs 6.3 trillion of order prospects, private sector orders range around 18,000-20,000 crore. There has been an increase of ~10% in private order prospects y-o-y. Domestic proportion of private orders is higher as internationally most of the orders come from the government. The private sector contribution in the total order prospects has increased to 29% vs 22% last year largely driven by building & factories (B &F) and minerals & metals (M &M).
- **Strong order pipeline in infrastructure projects:** Order prospects in infrastructure is robust at Rs 4.54 trillion out of which Rs 3.98 trillion is domestic and Rs 0.56 trillion is international. In Sub segments – Water is @ 23%, heavy engineering @ 22%, B&F @ 19%, T&D @ 14% and transportation infrastructure @ 20%.
- **Infrastructure projects witness strong order inflows across verticals:** All sub-segments of infrastructure projects division barring transportation & infrastructure have shown strong revenue growth and have a sizeable order book. Similarly, order inflow is robust in all segments except transport and infrastructure. The 107% y-o-y growth in order intake is largely led by a surge in orders in B &F and M &M segments. In infrastructure projects, there has been an uptick in the private sector orders too.
- **New products/offerings:** In electrolysis, L&T's green hydrogen plant in Hazira is ready and should be commercially operational in the month of November. Its mainstream electrolysis JV with a partner should happen by March 2023. The battery storage plant should come on stream in the early part of FY2024.
- **Fixed proportion in order book remains intact:** There has been no change since the last quarter and two-thirds of its order book is variable price based and adjustable as per inflation indices and the rest is fixed price-based. Infrastructure order book is 85% variable, and the balance is fixed.
- **Order intake guidance intact with bias towards upward range:** The company maintained 12-15% y-o-y growth guidance of order inflows. However, looking at the robust order intake in H1FY23 and strong prospects, it aims to achieve upper end of the range in FY23.
- **Maintains margin guidance of 9.5% in projects and manufacturing, but with an upside risk:** The company has considered the higher margin orders that the company has bagged from Q4FY22 orders while building in the margin guidance of 9.5% for FY23. Moreover, for margins, stage of completion of orders and type of order is also a key factor. Currently, the mix of orders in domestic is largely public which is based on competitive bidding and therefore the margins would be lower as compared to private orders which are usually won on nomination basis. The company stated that currently, private sector contribution in order book is below 20%. Margin could improve if contribution from private sector goes up to 22-25% going forward.
- **Defence prospects:** Defence and ship building order prospects is at Rs 16,000 crore. In defence, there are 7-8 key opportunities that the company is pursuing.
- **Thermal order prospects:** Thermal prospects are at Rs 38,000 crore. L&T is aiming 3 projects of total 800x5 units and same should be finalized towards the end of this fiscal.
- **L&T IDPL:** Divestment in L&T IDPL should be concluded soon, while nothing has been materialised w.r.t the Nabha power front.
- **Hyderabad metro debt to reduce over a period of two years:** Current debt is Rs 16,000 crore of which external debt is Rs 13,000 crore. The Telangana government has provided Rs 3000 crore interest free loan which would be coming into tranches. The company expects to monetize the land parcel in the next 12 months which could fetch ~Rs 2,500 crore. Hence, the debt should come down to Rs 5,000-8000 crore in the next two years aided by remarkable improvement in the metro ridership in the recent past.
- **Debt/Equity and ROE:** Gross debt is at 1.33 and net debt/equity stands at 0.89. ROE is at 12.1% vs 11.8% in Q2FY22.

- **Capex guidance:** The company expects routine or traditional capex to be around Rs 2,500 - 3,500 crore. However, for certain project execution such as Hydel power or underground metro the company could incur a higher capex.

Results Consolidated Rs cr

Particulars	Q2FY23	Q2FY22	YoY%	Q1FY23	QoQ%
Net Sales	**42,763**	**34,773**	**23.0**	**35,853**	**19.3**
Total Expenditure	37,863	30,778	23.0	31,897	18.7
Operating Profit	**4,899**	**3,995**	**22.6**	**3,957**	**23.8**
Other Income	739	532	38.8	695	6.3
Interest	836	779	7.2	756	10.5
Depreciation	860	729	18.0	963	-10.7
PBT	**3,942**	**3,019**	**30.6**	**2,932**	**34.5**
Exceptional item(net of tax)	-	(97)		-	
PBT	**3,942**	**3,116**	**26.5**	**2,932**	**34.5**
Tax	1,123	885	27.0	639	75.8
Reported PAT	2,229	1,819	22.5	1,702	31.0
Adjusted PAT	**2,229**	**1,723**	**29.4**	**1,702**	**31.0**
EPS (Rs.)	15.9	12.3	29.4	12.1	31.0
Margins (%)					
OPM	11.5	11.5	(3)	11.0	42
PATM	5.2	5.0	26	4.7	47
Tax Rate	28.5	28.4	10	21.8	669

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 and power assets the company is evaluating various options. We expect L&T to maintain its good performance 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. 2,390

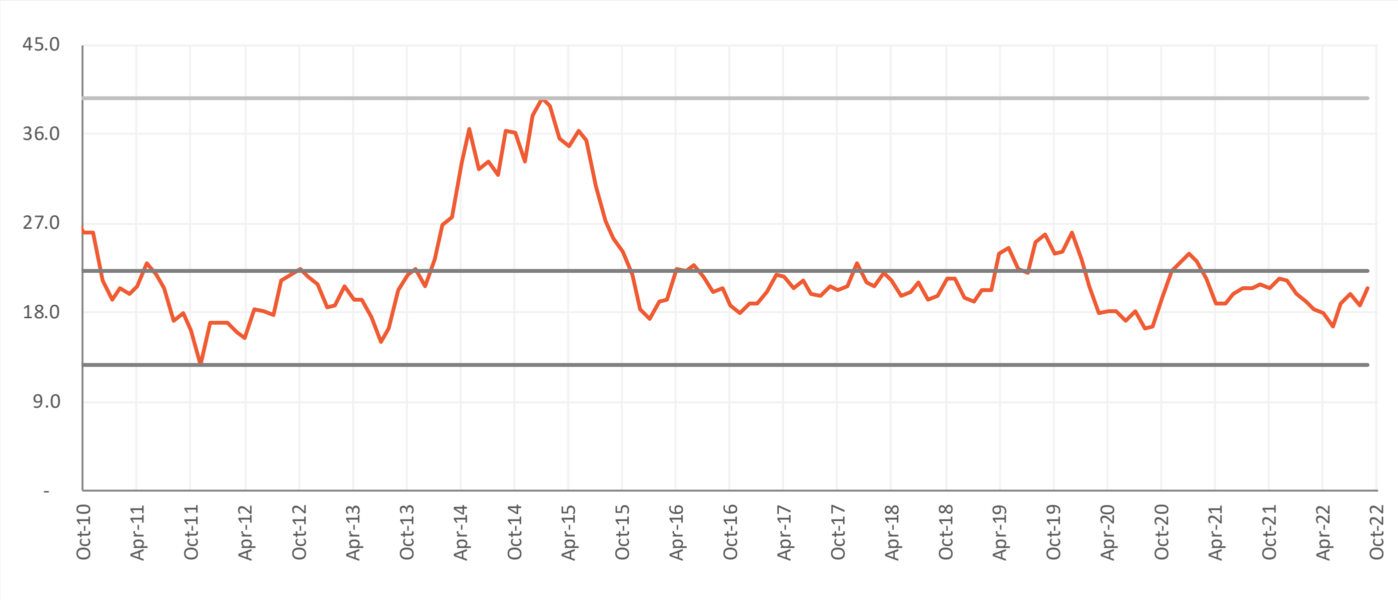
L&T reported healthy performance despite cost pressures in its core business and supply chain challenges. Robust order intake and strong order pipeline going forward gives us comfort. International outlook is also buoyant given a healthy order pipeline and emerging opportunities in non-oil segments as well. 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 on the stock with a revised SOTP-based price target (PT) of Rs. 2,390, factoring in increase in valuation multiple for the core business given robust order book of Rs 3.7 lakh crore (2.2xTTM revenue) and a promising long-term growth outlook.

SOTP Valuation

Particulars	Remarks	Value (Rs cr)	Per share (Rs)
L&T's core business (standalone)	**At 18x September FY2024E estimates**	**2,13,939**	**1,526**
Subsidiaries			
L&T Infotech (LTI)	Based on our target price	52,298	373
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	22,910	163
Mindtree	Based on current market cap at 25% discount	25,699	183
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		**95,426**	**864**
Fair value		**3,09,365**	**2,390**

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: Company Website

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Life Insurance Corp of India	12.47
2	SBI Magnum Equity Esg Fund	4.27
3	ICICI Prudential Asset Management	2.59
4	HDFC Mutual Fund	2.13
5	FMR LLC, General Insurance Corp of India	2.02
6	Vanguard Group Inc.	1.70
7	Blackrock Inc	1.64
8	Nippon Life India Asset Management Ltd	1.37
9	ICICI Prudential Life Insurance Company	1.36
10	Kotak Mahindra Asset Management	1.23

Source: 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

Sharekhan
by BNP PARIBAS

Know more about our products and services

For Private Circulation only

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