



## 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 Updated Oct 08, 2022 **34.29**

## High Risk

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

Source: Morningstar

## Company details

Market cap:	Rs. 2,90,002 cr
52-week high/low:	Rs. 2,096/1,456
NSE volume: (No of shares)	19.4 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	4.5	8.3	29.0	16.1
Relative to Sensex	0.3	2.1	15.1	6.7

Sharekhan Research, Bloomberg

## Larsen &amp; Toubro

## Taking the next leap of growth

## Capital Goods

## Sharekhan code: LT

## Reco/View: Buy



Upgrade



Maintain



Downgrade

CMP: Rs. 2,064

Price Target: Rs. 2,390

## Summary

- L&T is the best proxy for domestic capex given its market leadership in the engineering and construction industry, diversified revenue stream and strengthening balance sheet.
- Order inflows for H2FY2023 has been robust at Rs. 93,700 crore (including international orders of Rs. 35,600 crore - 38% of total inflows), while order prospects for H2FY2023 stand at Rs. 6.3 trillion with increasing proportion of private orders.
- A pick-up in infrastructure spends by the government, PLI schemes, uptick in private capex and traction in GCC region would drive long-term growth. Further, green hydrogen, data centers and e-commerce present strong growth opportunities.
- We maintain a Buy on L&T with an unchanged PT of Rs. 2,390 given revenue and margin tailwinds in the core business and healthy prospects of its key IT & TS and finance subsidiaries.

L&T, the engineering behemoth, with its decades of experience in engineering & construction and robust track record is well poised to be the key beneficiary of capex upcycle driven by investments in both public and private sectors. For FY2023, it is well on track to attain order intake and revenue growth guidance of 12-15% with a bias towards the upper band. It expects OPM in the core projects business to be at 9.5% with a downside risk of 30 bps. However, with margin tailwinds in the form of better margin new orders, declining commodity prices and operating leverage we expect better margin profile in the coming quarters. 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. Under the plan, company aims to grow its order inflows/revenue at 14%/15% CAGR and achieve core RoE of over 18% during FY21-FY26E. This should be achieved by pursuing new opportunities in datacenters, green hydrogen and e-commerce businesses. In addition, unlocking of investments in Hyderabad metro and Nabha Power is being aggressively pursued and successful monetisation of the same should improve its working capital and debt profile. We expect its core business revenue/PAT to grow at 15%/20% over FY2022-FY2025E.

- Diversified and robust order book is the key to growth:** L&T's order book stands at a record level of Rs. 3.7 lakh crore, translating to revenue visibility of more than two years. 72% of the order book comprises of infrastructure orders which include orders from buildings & factories (B&F), heavy civil, water, Power T&D, Mineral & Metals. Energy projects which is 19% of the order backlog comprises of hydrocarbons, Power and green EPC projects. The order book is well diversified as 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. The order prospects for H2FY23 are at 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 formed by hi-tech engineering and other segments. 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%. In addition, 27% of the order book is funded by bilateral and multi-lateral agencies. Hence, a diversified order book and well-funded projects should help the company achieve strong long-term growth.
- Margin to improve in the medium to long term:** Despite a conservative guidance of 9.5% (with a downside risk of 30 bps) for FY2023 for projects and manufacturing business, we see multiple tailwinds, which if plays out, can provide fillip to the margins after a quarter or two. The increase in share of private orders from current ~20% of the order book to 22-25% would lead to better margin profile. Moreover, in order prospects, private sector contribution has increased to 29% versus 22% last year largely driven by building & factories (B & F) and minerals & metals, which bodes well for margin expansion in the future. Further, there has been a heavy correction in commodity prices e.g. steel has corrected by ~30% in the last one year which should reduce raw material cost. In addition, the new orders have been received at higher margin after factoring in the escalated input cost. Hence, we expect improvement in margin going forward.
- Focus on new and emerging avenues would aid growth:** L&T under its 'The Lakshya 2026 plan' envisages venturing into emerging businesses like green hydrogen development, electrolyser & battery manufacturing, data centres and scaling up digital and e-Commerce businesses. It has an existing portfolio of green businesses, which includes solar, water, green hydrogen constituting more than 35% of the total revenue. For countries like India, green hydrogen can help reduce the overall dependence on imported fossil fuels. In August 2022, L&T and ReNew Power, India's leading renewable energy company, signed a JV to develop, own, execute and operate green hydrogen projects in India. Green hydrogen can be used as an alternative to natural gas in refineries and fertilizers. Additionally, Indian Oil and L&T has entered a JV to manufacture and sell electrolysers used in the production of green hydrogen and are scouting for another partner which would supply them renewable energy. Hence, L&T is further de-risking its business profile in order to achieve consistent growth.

**Revision in estimates –** We maintain our estimates for FY2023-FY2025E.

## Our Call

**Maintain Buy with an unchanged PT of Rs. 2,390:** L&T's H1FY23 performance has been commendable despite cost pressures in its core business and supply chain challenges. Further, a robust order intake and pipeline 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 infrastructure, heavy engineering, hydrocarbons, defence, IT as well as green energy. The company is the best proxy for domestic capex upcycle. We maintain a Buy on the stock with an unchanged SOTP-based price target (PT) of Rs. 2,390.

## Key Risks

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

## Valuation (Consolidated)

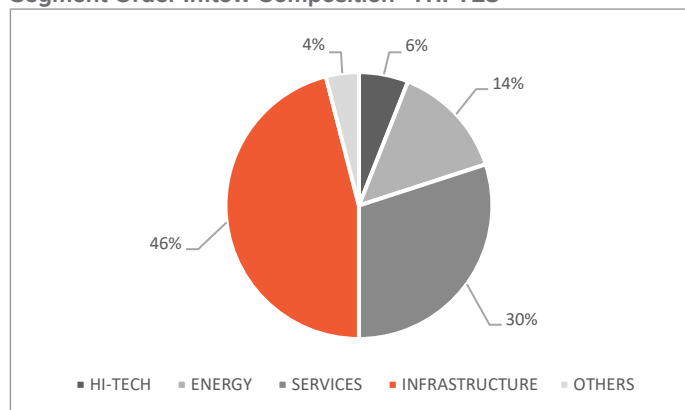
Particulars	FY22	FY23E	FY24E	FY25E
Revenue	1,56,521	1,80,607	2,05,892	2,33,688
OPM (%)	11.6	11.7	12.0	12.1
Adjusted PAT	8,573	10,677	13,268	15,982
% YoY growth	24.2	24.5	24.3	20.5
Adjusted EPS (Rs.)	61.2	76.2	94.7	114.0
P/E (x)	33.7	27.1	21.8	18.1
P/B (x)	3.5	3.2	2.9	2.5
EV/EBITDA (x)	17.3	14.2	11.9	9.8
RoCE (%)	7.8	9.0	10.5	11.9
RoNW(%)	13.2	12.4	14.0	14.9

Source: Company; Sharekhan estimates

## Diversified and robust order book would drive long-term growth

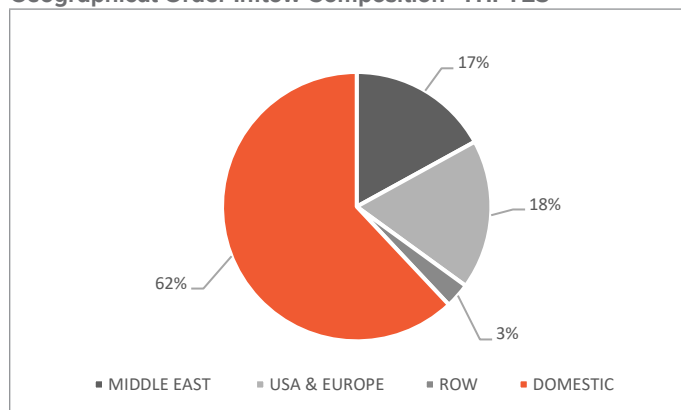
L&T's order book stands at a record level of Rs. 3.7 lakh crore, translating to revenue visibility of more than 2 years. The order book is well diversified as out of the total order book of Rs 3.7 lakh crore – Rs. 1.04 lakh crore is international. Of the international order book, 80% comes from Middle East, 10% from Africa and the remainder from South-East Asian countries. 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. 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%. In addition, 27% of the order book is funded by bilateral and multi-lateral agencies.

**Segment Order Inflow Composition - H1FY23**



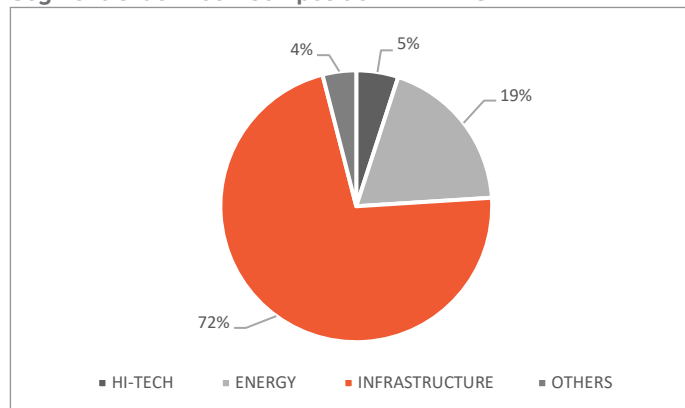
Source: Company, Sharekhan Research

**Geographical Order Inflow Composition - H1FY23**



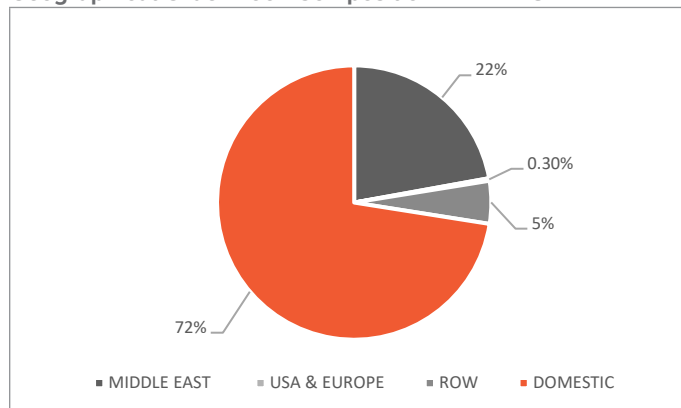
Source: Company, Sharekhan Research

**Segment Order Book Composition - H1FY23**



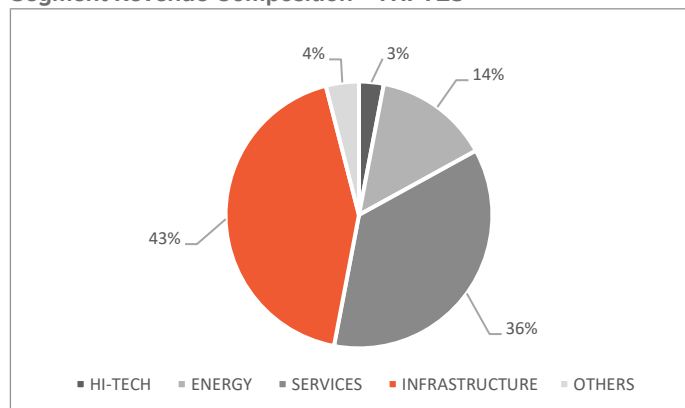
Source: Company, Sharekhan Research

**Geographical Order Book Composition – H1FY23**



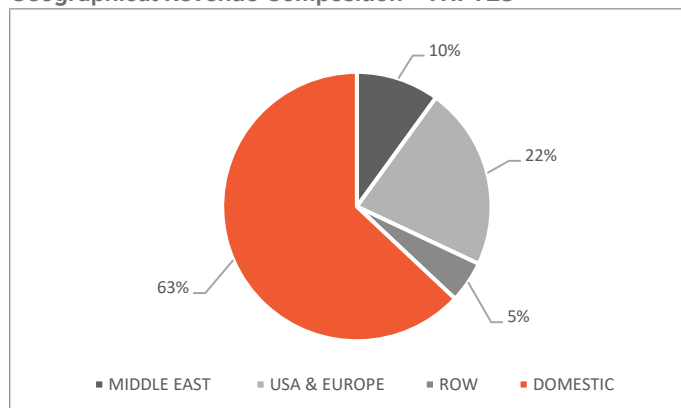
Source: Company, Sharekhan Research

**Segment Revenue Composition – H1FY23**



Source: Company, Sharekhan Research

**Geographical Revenue Composition – H1FY23**

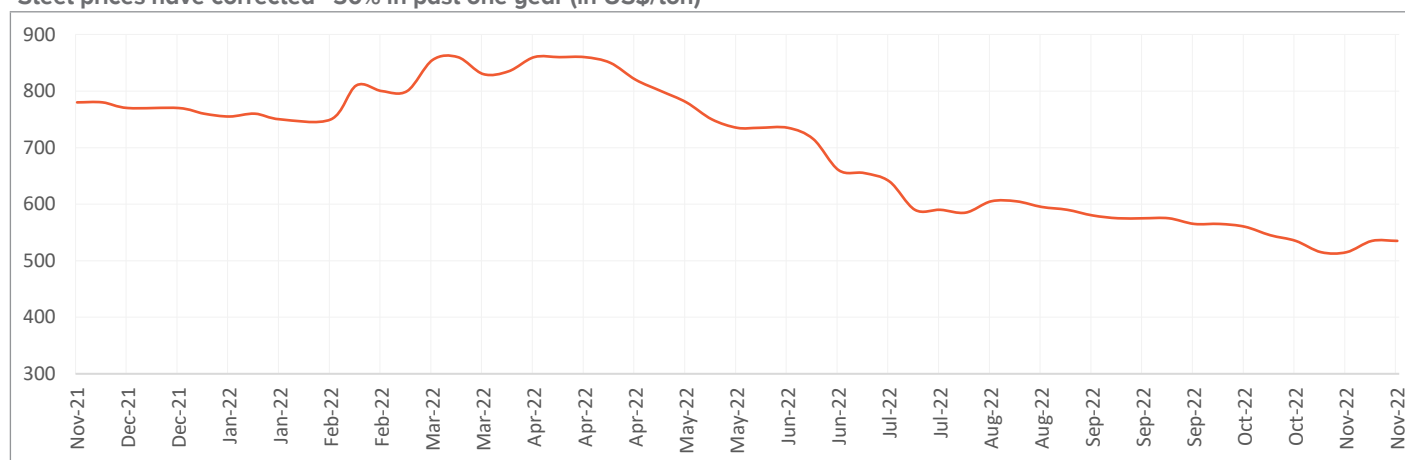


Source: Company, Sharekhan Research

## Multiple margin tailwinds can play out in the medium to long-term

L&T has given conservative guidance of 9.5% for FY2023 for Projects and Manufacturing business with a downside risk of 30 bps given the disrupted supply chain and volatility in input costs. However, there are multiple tailwinds which if play out can provide fillip to the margins after a quarter or two. Currently, the mix of orders in domestic order book is largely public which has lower margins as compared to private orders which currently form ~20% of the order book. However, in order prospects, the private sector has seen an increase of ~10% y-o-y. Hence, private sector contribution in the total order prospects has increased to 29% versus 22% last year largely driven by building & factories (B & F) and minerals & metals (M & M). The margin could improve if contribution from the private sector goes up to 22-25% going forward. Further, there has been a heavy correction in commodity prices E.g. steel has corrected by ~30% in the last one year which should lead to reduction in input cost. Further, the new orders have factored in the escalated input cost which should also support margins.

### Steel prices have corrected ~30% in past one year (in US\$/ton)



Source: Bloomberg, Sharekhan Research

## Focus on new products and offerings to further diversify business

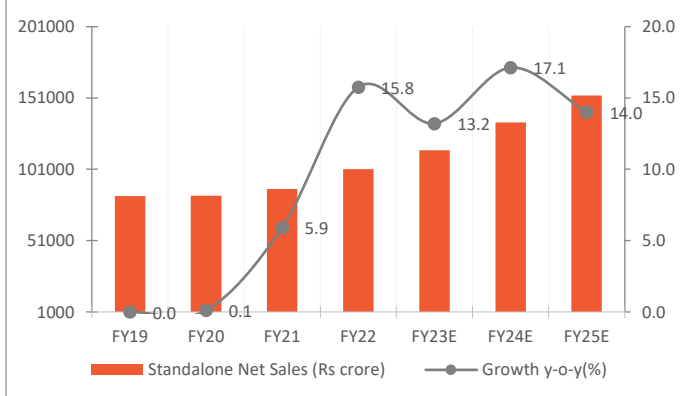
L&T under its 'The Lakshya 2026 plan' envisages venturing into emerging businesses like green hydrogen development, electrolyser & battery manufacturing, data centres and scaling up digital and e-commerce businesses. It has an existing portfolio of green businesses, which includes solar, water, green hydrogen constituting more than 35% of the total revenues. For countries like India, green hydrogen can help reduce the overall dependence on imported fossil fuels. In August 2022; L&T and ReNew Power, India's leading renewable energy company, signed a JV to develop, own, execute and operate green hydrogen projects in India. Green hydrogen can be used as an alternative to natural gas in refineries and fertilizers. Additionally, Indian Oil and L&T has entered a JV to manufacture and sell electrolysers used in the production of green hydrogen and are scouting for another partner which would supply them renewable energy. Hydrogen is currently used in refining, steel and fertiliser sectors, which will be the focus of the JV. The company's first hydrogen plant at Hazira manufacturing complex is being used for captive consumption and should be commercially operational in November. The battery storage plant should come on stream in the early part of FY2024. Hence, we believe, foray into new products and solutions should help the company further de-risk its business profile and achieve consistent growth.

## Value unlocking through monetization of non-core assets

The company is likely to divest its L&T IDPL very soon, while nothing has been materialised w.r.t the Nabha power front. Under Nabha, L&T runs a 1,400-MW supercritical thermal power plant at Rajpura in Punjab. The majority of revenues in the development project segment is contributed by Nabha Power. Out of the total debt of Rs 16,000 crore, external debt is Rs 13,000 crore. The Telangana government has granted Rs 3000 crore interest free loan which would be dispersed in the next 2-2.5 years. The company expects to monetize the land parcels in the next 12 months which could fetch ~Rs 2,500 crore. Hence, the debt should come down to Rs 7,500-8000 crore in the next two years. Currently, net debt to equity ratio is comfortable at 0.89.

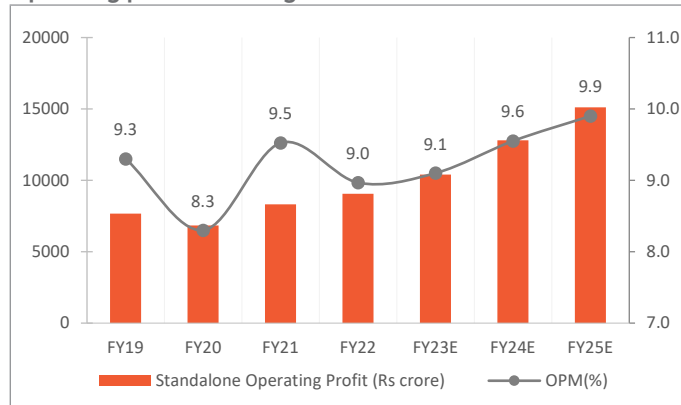
## Financials in charts

### Net sales growth trend



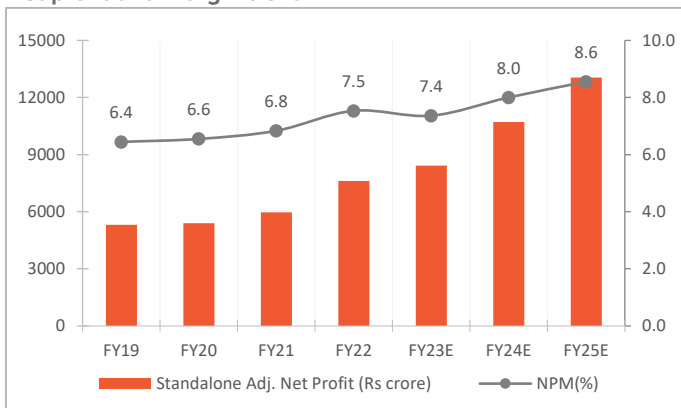
Source: Company, Sharekhan Research

### Operating profit and margin trend



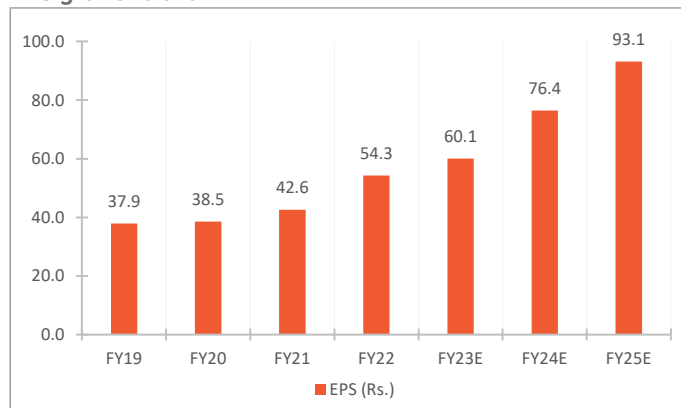
Source: Company, Sharekhan Research

### Net profit and margin trend



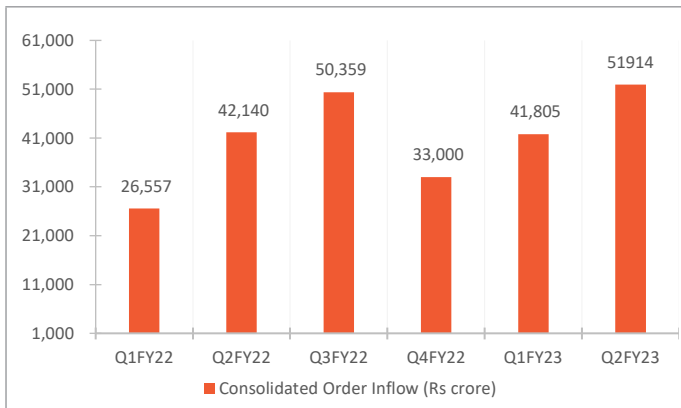
Source: Company, Sharekhan Research

### EPS growth trend



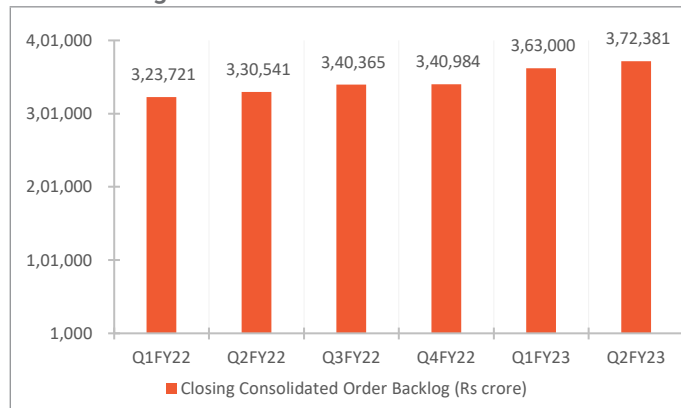
Source: Company, Sharekhan Research

### Order inflows trend



Source: Company, Sharekhan Research

### Order backlog trend



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 a 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.

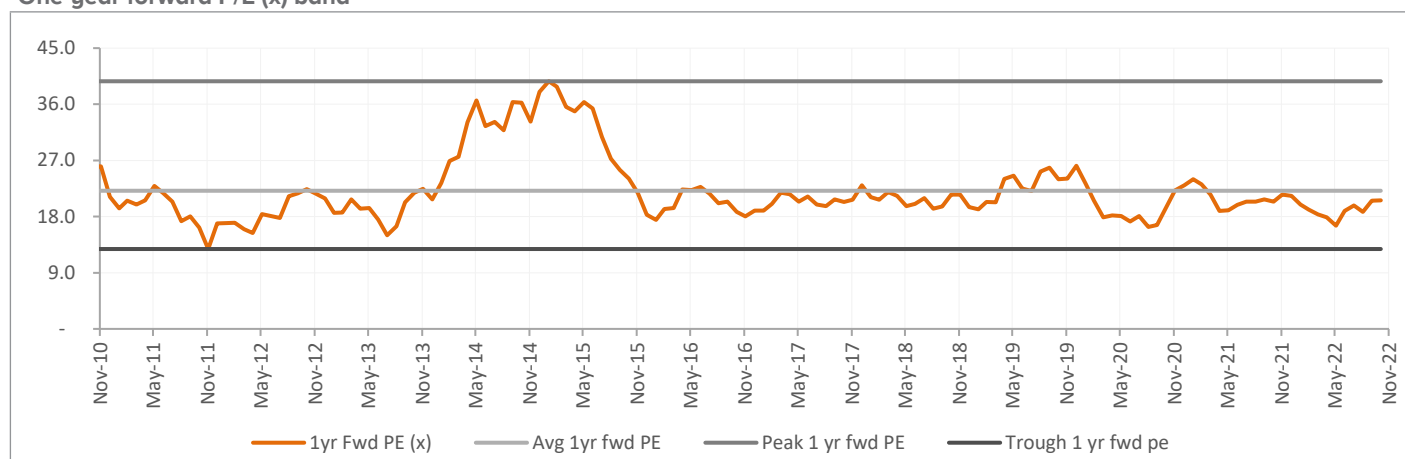
### ■ Company Outlook – Expect healthy order inflows and improved execution

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 an unchanged PT of Rs. 2,390

L&T's H1FY23 performance has been commendable despite cost pressures in its core business and supply chain challenges. Further, a Robust robust order intake and pipeline 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 infrastructure, heavy engineering, hydrocarbons, defence, IT as well as green energy. The company is the best proxy for domestic capex upcycle. We maintain a Buy on the stock with an unchanged SOTP-based price target (PT) of Rs. 2,390.

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: Capitaline, Bloomberg old data

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## 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 deteriorating 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

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