Stock Update

Result Update

Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Larsen & Toubro

Strong execution drives stellar quarter

Capital Goods	Sharekhan code: LT
Reco/View: Buy ↔	CMP: **Rs. 2,561**
	Price Target: **Rs. 3,005** ↑

↑ 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 Updated Jul 08, 2023				34.1
High Risk				
NEGL	LOW	MED	HIGH	SEVERE
0-10	10-20	20-30	30-40	40+

Source: Morningstar

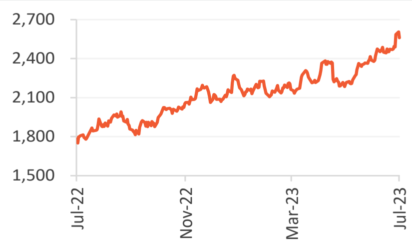
Company details

Market cap:	Rs. 3,59,910 cr
52-week high/low:	Rs. 2,638/1,742
NSE volume: (No of shares)	20.7 lakh
BSE code:	500510
NSE code:	LT
Free float: (No of shares)	140.5 cr

Shareholding (%)

Promoters	0.0
FII	25.3
DII	38.1
Others	36.6

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	7.7	13.9	17.7	43.7
Relative to Sensex	2.3	3.6	7.5	24.7

Sharekhan Research, Bloomberg

Summary

- Q1FY24 revenue and net profit recorded stellar growth of 33.6%/46.5% y-o-y, beating the street's estimates by a wide margin, while OPM missed estimates as infrastructure biz margin fell y-o-y.
- Order inflow for Q1FY24 was robust at Rs. 65,520 crore (up 57% y-o-y). Order book continues to grow at a swift pace and stands at an all-time high of ~Rs 4.1 lakh crore (2.1xTTM revenue).
- L&T maintained 12-15% revenue and 10-12% order intake growth guidance for FY24. Core business OPM is expected to be at ~9% (up 40/50bps y-o-y). Working capital/sales to be at 16-18%.
- Special dividend of Rs. 6 per share and share buyback at Rs. 3,000 per share comprising ~2.4% of total equity is sentimentally positive. We maintain a Buy on L&T with a revised PT of Rs. 3,005, factoring in strong execution, margin tailwinds in the near to medium term and upward revision in valuation of its subsidiaries.

Q1FY24 consolidated sales and net profit beat our estimates by ~13%/~17% on y-o-y basis led by strong execution momentum in projects and manufacturing portfolio. OPM, however, fell short of expectations and came in lower at 10.2% vs 11% in Q1FY23. Consolidated revenues grew by 33.6% y-o-y to Rs. 47,882 crore. Revenue growth was largely driven by infrastructure (+55.5% y-o-y) and energy (up 31.5% y-o-y) segments. Operating profit growth was restricted to ~23% y-o-y to Rs 4,869 crore as margin in the infrastructure segment dipped y-o-y basis despite strong execution. OPM, thus, came in lower by 87bps y-o-y to 10.2% (vs estimates of 11.3%). Net profit grew by ~46.5% y-o-y to Rs 2,493 crore led by strong revenues and aided by ~65% y-o-y jump in other income. The order intake was strong at Rs. 65,520 crore registering a whopping 57% y-o-y growth. Order book grew by 14% y-o-y to Rs. 4,12,648 crore. L&T's order book stands at a record high of ~2.1x its TTM consolidated revenues. The company has proposed a buyback of 3.33 crore equity shares at a maximum price of up to Rs. 3,000 per equity share for an aggregate consideration of up to Rs. 10,000 crore, through the tender offer route. Further, it has declared a special dividend of Rs.6 per share, the total outlay for the same amounting to ~Rs. 841 crore.

Key positives

- Strong execution in infrastructure and energy segments.
- Energy segment margin improved to 9.1% (from 8.5% in Q1FY23) due to execution cost savings in power.
- Other income jumped by 65% y-o-y to Rs.1,146 crore due to higher treasury income and improved yields.
- Order prospects as on Q1FY24 for the rest of FY24 stands at Rs 10.07 lakh crore (up ~34% y-o-y).
- Order inflows for Q1FY24 grew by 57% y-o-y to Rs. 65,520 crore comprising of 42% of the international orders.
- Strong order inflow was witnessed across multiple segments in infrastructure projects and hydrocarbon.Infrastructure and energy (particularly hydrocarbon) order inflows grew by a whopping 118%/66% y-o-y respectively.
- Order book remains strong at Rs. 4.12 lakh crore, up 14% y-o-y – 71% domestic orders and 29% international orders.

Key negatives

- In Q1FY24, OPM declined by 87 bps y-o-y to 10.2% due to weak OPM of 5.1% (down 140 bps y-o-y) in infrastructure segment.
- Hydrocarbon margin also dipped by 50 bps y-o-y to 9.5% despite strong revenue growth due to few orders being in the initial stage of execution.
- Lower revenue and muted order inflows in power sector.
- Company maintained its order intake guidance of 10-12% growth despite robust order intake in Q1FY24 and strong order prospects.

Management Commentary

- Maintained order intake guidance of 10-12% and revenue growth guidance at 12-15% y-o-y for FY24.
- Project and manufacturing business OPM to be at ~9% for FY24 with meaningful margin expansion expected in H2FY24. Working capital to be at 16-18% of sales for FY24.
- Company is confident of a better margin trajectory from H2FY24 onwards as the covid related jobs are nearing completion in the infrastructure segment. Further, orders with favorable margin would gain scale leading to favorable job mix.
- Company sees ample opportunities in the middle east region in hydrocarbon and renewables. The capex size is large in this region and therefore all the players would get a fair share of the pie.
- The company expects 19,000-20,000 crore of orders to be awarded in the defence segment in the near to medium term.
- Company has removed slow-moving orders of Rs. 1,700 crore from the books, out of which Rs. 1,000 crore are from real estate sector. Further, slow-moving orders is less than 1% of the total order book.

Revision in estimates – We have marginally tweaked our estimates for FY24-FY25 following strong Q1FY24 results.

Our Call

Maintain Buy with a revised PT of Rs. 3,005: Q1FY24 performance has been strong barring subdued OPM. The performance was driven by healthy opening order book leading to robust execution. The company remains optimistic on order momentum in domestic and international markets with prospects of Rs. 10 trillion for the rest of FY24. Sectors such as infrastructure, hydrocarbon and defence are witnessing huge investments and would continue to drive the order book of the company. It also expects margin trajectory to improve from H2FY24 as many large projects are likely to achieve margin threshold and favorable job mix would drive margin expansion. Its all-time high order book provides strong revenue visibility. 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 and is the best proxy for domestic capex. Further, a buyback of ~2.4% equity and special dividend of Rs. 6 per share is sentimentally positive for the stock. We maintain a Buy on the stock with a revised SOTP-based price target (PT) of Rs. 3,005.

Key Risks

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

Valuation (Consolidated) Rs cr

Particulars	FY22	FY23	FY24E	FY25E
Revenue	1,56,521	1,83,341	2,11,287	2,39,811
OPM (%)	11.6	11.3	11.8	12.2
Adjusted PAT	8,573	10,335	12,841	15,492
% YoY growth	24.2	20.6	24.3	20.6
Adjusted EPS (Rs.)	61.2	73.7	91.6	110.5
P/E (x)	41.9	34.7	28.0	23.2
P/B (x)	4.4	4.0	3.6	3.1
EV/EBITDA (x)	20.7	17.3	14.2	11.7
RoCE (%)	7.6	8.7	10.5	12.1
RoNW (%)	13.2	14.6	16.1	17.1

Source: Company; Sharekhan estimates

Stellar quarter, albeit margin remains under pressure

Consolidated revenues grew by 33.6% y-o-y to Rs. 47,882 crore. Revenue growth was largely driven by infrastructure (+55.5% y-o-y) and energy (+ 31.5% y-o-y) segments. Operating profit growth was restricted to ~23% y-o-y to Rs 4,869 crore as margin in the infrastructure segment dipped on y-o-y basis despite strong execution. OPM, thus, came in lower by 87 bps y-o-y to 10.2% (vs estimates of 11.3%). Net profit grew by ~46.5% y-o-y to Rs 2,493 crore led by strong revenues and aided by ~65% y-o-y jump in other income. Order intake was strong at Rs. 65,520 crore registering a whopping 57% y-o-y growth. Order book grew by 14% y-o-y to Rs. 4,12,648 crore. L&T's order book stands at a record level, translating to ~2.1x its TTM consolidated revenues.

Robust execution and prudent working capital management would drive growth

Management has provided a strong guidance for both order intake and revenue despite a high base. ROE has also improved sequentially to 12.8% as of June, 2023 and it expects working capital to improve due to better collection efficiencies in the Gulf Cooperation Council (GCC) region. The infrastructure sector is witnessing healthy tendering and awarding activity, wherein private sector project announcements are also gaining momentum. Although margins have been under stress from past few quarters, improvement is expected from H2FY24 onwards. 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 current investments in a few non-core areas is being aggressively pursued.

Key highlights from Q1FY24 earnings call and investor update

- **Order book jumps by 14% y-o-y to 4.12 lakh crore:** Out of the total order book of Rs 4.12 lakh crore – ~Rs. 1.2 lakh crore (29% of the total order book) is international. Of the international order book, 87% comes from the Middle East, 5% from Africa and the remaining ~8% from various countries including South-East Asia. In the domestic order book of Rs 2.92 lakh crore (~71% of the total order book) – central government orders have a 12% share, state@ 29%, state-owned enterprises or PSU @ 39 % and private sector @ 20%. Also, 23% of the total order book is funded by bilateral and multilateral agencies. Of the total order book - ~91% of orders are from infrastructure and energy segments.

- **Removal of Rs. 1,700 crore of slow moving orders:** The company has removed ~Rs. 1,700 crore orders from order book which were largely from the real estate sector. Slow-moving orders is less than 1% of the total order book.

- **Order prospects up by ~34% y-o-y to Rs 10.07 trillion for the remaining nine months of FY24:** The order prospects for FY24 are robust at Rs 10.07 trillion (vs ~7.52 trillion in the corresponding quarter of the previous year). In total, the infrastructure segment has prospects of Rs 5.85 trillion (Rs. 5.47 trillion last year) of which domestic orders comprise Rs 4.61 trillion and Rs 1.24 trillion is international. In energy: hydrocarbon is at ~Rs 3.4 trillion (~Rs. 1 trillion offshore and ~Rs. 2.5 trillion onshore), while power segment's prospects are at Rs 0.45 trillion. The rest Rs. 0.29 trillion comprises of prospects of hi-tech manufacturing, defence and green energy.

- **Defence prospects:** The order prospects of defence segment aggregates to Rs. 19,000- 20,000 crore (vs Rs. 24,000 crore last year). The addressable opportunity does not include P75 (I) submarine orders.

- **Capex guidance:** Project and manufacturing capex could be in the range of ~Rs. 3,000-4,000 crore on an annual basis.

- **Order inflows grew by whopping 57% y-o-y:** Q1FY24 order inflows were up 57% y-o-y to Rs. 65,540 crore, led by infrastructure (rail, renewables, rural, water, power T&D, commercial and residential real estate) and hydrocarbon sectors. International orders came in at Rs 27,646 crore and comprised ~42% of the total order inflows.

- **Order inflow guidance maintained:** The company has maintained an order inflow guidance of 12-15% y-o-y in FY24. The company is confident of achieving the growth if the current tendering and award momentum continues at the same pace particularly in infrastructure and hydrocarbon segments.
- **Revenue guidance maintained:** The company maintained a 12-15% y-o-y revenue growth driven by continued execution momentum in its projects and manufacturing as well as services business. The scale of the projects have been expanding and this shall also lead to higher execution.
- **Opportunities galore in the Middle East:** There are plenty of opportunities in the Middle East in hydrocarbons, renewables as well as minerals & metals. The hydrocarbon business has been reporting stable margins and the company expects to sustain those margin levels in the future as well. The quantum of the capex in this region is large and therefore all the approved bidders are likely to get a fair share of the pie.
- **Update on divestment of Nabha power:** At present, the company does not have an active buyer's interest for this asset. This is the best performing thermal power plants with PLF of 85%.
- **Margin guidance:** The company maintained its core margin guidance of ~9% (improvement by 40-50 bps y-o-y) in FY24. The margin expansion is likely to occur in H2FY24 due to better job mix as many large projects would be achieving margin recognition threshold during that period. The infrastructure segment's margins are expected to improve going forward as legacy covid jobs are nearing completion.
- **Additional investment of up to ~Rs. 506 crore in L&T Energy Green Tech:** The company would be investing ~Rs. 506 crore in L&T Energy Green Tech either by subscribing to equity/ preference shares or by way of inter-corporate deposits or company guaranteed debt or a combination of these at arm's length. The company aims to consolidate various arms of green energy business such as manufacturing and EPC of green hydrogen value chain & its derivatives.
- **Hyderabad Metro update:** Average ridership has been significantly improving thereby aiding revenue growth. The company has received Rs. 550 crore till date out of the first instalment of Rs. 1,000 crore interest free loan from the Telangana government.
- **Strong improvement in working capital:** The net working capital to sales ratio significantly improved to 17% in Q1FY24 vs 20.6% in Q1FY23.
- **Debt/Equity and ROE:** Gross debt/equity is at 1.06. ROE is at 12.8% at Q1FY24 end (up 60 bps vs March 2023).

Results (Consolidated) Rs cr

Particulars	Q1FY24	Q1FY23	YoY%	Q4FY23	QoQ%
Net Sales	**47,882**	**35,853**	**33.6**	**58,335**	**-17.9**
Total Expenditure	43,014	31,897	34.9	51,503	-16.5
Operating Profit	**4,869**	**3,957**	**23.0**	**6,833**	**-28.7**
Other Income	1,146	695	64.9	741	54.6
Interest	851	756	12.6	813	4.7
Depreciation	830	963	-13.8	854	-2.7
PBT	**4,332**	**2,932**	**47.8**	**5,907**	**-26.7**
Tax	1,216	639	90.4	1,461	-16.7
Adjusted PAT	**2,493**	**1,702**	**46.5**	**3,986**	**-37.5**
Adj. EPS (Rs.)	**17.7**	**12.1**	**46.5**	**28.4**	**-37.5**
Margins (%)			**BPS**		**BPS**
GPM	38.8	45.6	(678)	34.9	386
OPM	10.2	11.0	(87)	11.7	(154)
PATM	5.2	4.7	46	6.8	(163)
Tax Rate	28.1	21.8	628	24.7	335

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 the National Infrastructure Plan (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. In FY23, the government's continued thrust on infrastructure-driven, capex-led economic growth and signs of revival of private sector investments in manufacturing and an improvement in capacity utilization maintained the growth momentum. We believe that the huge outlay towards infrastructure is expected to provide healthy growth opportunities for companies in this space.

Company outlook - Expect strong performance in the coming years backed by robust order book

The management expects strong growth momentum to continue with a focus on growth in both revenue and order inflows for FY2024/FY2025. Order inflows would grow by 10-12% in FY24 and revenue would grow by 12-15% y-o-y. Projects and manufacturing business OPM may increase from 8.6% to ~9% for FY24 with margins improving largely in H2FY24. Working capital is expected to be at 16-18% of sales for FY24. Order prospects are also healthy with the rise in government spends and private capex and strong traction in international orders. On the asset divestment front, for the Hyderabad Metro, the company is evaluating various options. Thus, we expect L&T to perform consistently 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. 3,005

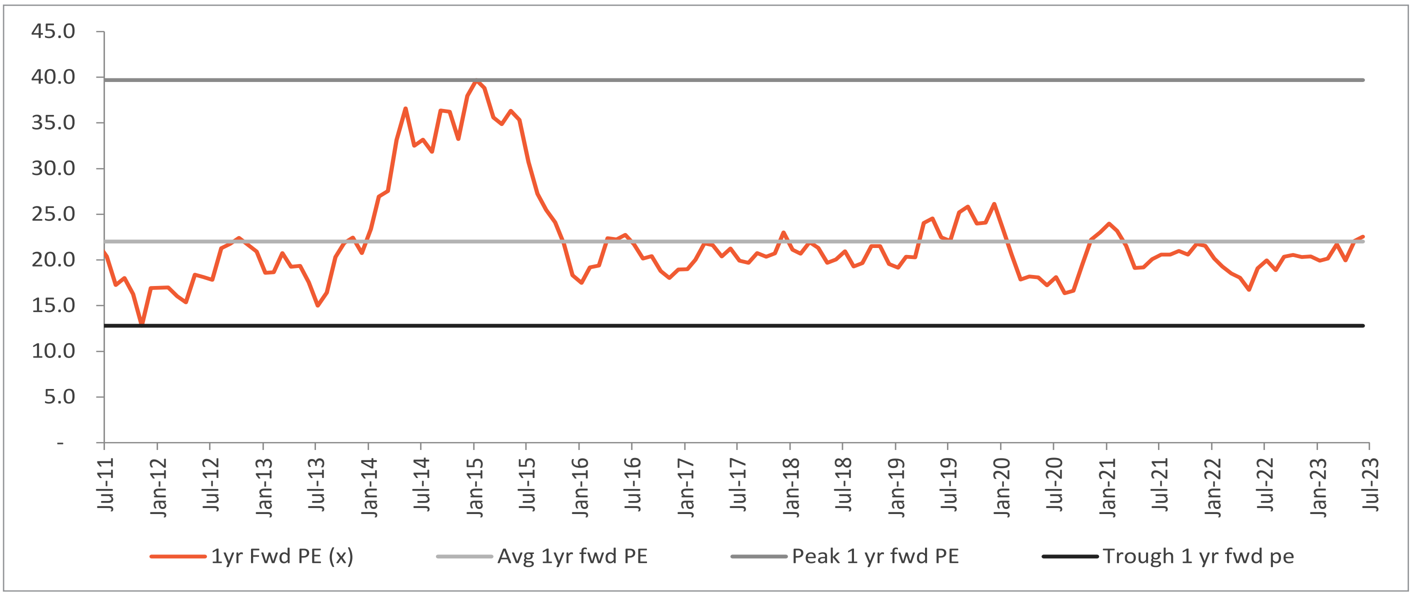
Q1FY24 performance has been strong barring subdued OPM. The performance was driven by healthy opening order book leading to robust execution. The company remains optimistic on order momentum in domestic and international markets with prospects of Rs. 10 trillion for the rest of FY24. Sectors such as infrastructure, hydrocarbon and defence are witnessing huge investments and would continue to drive the order book of the company. It also expects margin trajectory to improve from H2FY24 as many large projects are likely to achieve margin threshold and favorable job mix would drive margin expansion. Its all-time high order book provides strong revenue visibility. 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 and is the best proxy for domestic capex. Further, a buyback of ~2.4% equity and special dividend of Rs. 6 per share is sentimentally positive for the stock. We maintain a Buy on the stock with a revised SOTP-based price target (PT) of Rs. 3,005.

SOTP Valuation

Particulars	Remarks	Value (Rs cr)	Per share (Rs)
L&T's core business (standalone)	At 21x FY25E estimates	2,77,025	1,976
Subsidiaries			
LTI-Mindtree	Based on our target price	89,591	639
L&T Finance Holdings (L&TFH)	Based on our target price	19,056	136
L&T Technology Services Ltd (LTTS)	Based on our target price	24,718	176
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 and Other	At 0.8x Book Value	382	3
Total subsidiary valuation		**1,44,158**	**1,028**
Fair value		**4,21,182**	**3,005**

Source: Company, Sharekhan Research

One-year forward P/E (x) band



Source: Sharekhan Research

About company

L&T is an Indian multinational company engaged in technology, engineering, construction, manufacturing, and financial services and is one of the largest engineering conglomerates 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. India is expected to invest significantly in infrastructure creation over the next few years and the government would continue its thrust on domestic manufacturing through 'Make in India' project. Hence, companies like L&T which are present in the domestic infrastructure market are in a sweet spot. The government is also likely to extend PLI scheme to more sectors. Shifts in global value chains, sustained digitalisation initiatives at home, backed by India's de-carbonisation objectives could well make India the world's third largest economy by 2030. It is also expected that private capex will provide tailwinds to the growth momentum. L&T's proven expertise in building world-class infrastructure and high-tech manufacturing makes it well positioned to ride the growth wave.

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	Whole-time Director & Chief Financial Officer
D.K. Sen	Sr. Executive V.P- Minerals & Metals, Development Projects
M.V. Satish	Sr. Executive V.P- Buildings and Factories
J.D. Patil	Sr. Executive V.P- Defence & Smart Technologies

Source: Company

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Life Insurance Corporation of India	11.42
2	SBI Funds Management	4.41
3	Government of Singapore	3.34
4	ICICI Prudential Asset Management	2.70
5	FMR LLC	2.16
6	NPS Trust A/c UTI Retirement Solutions	1.91
7	Vanguard Group Inc	1.89
8	HDFC Asset Management	1.78
9	BlackRock Inc	1.62
10	General Insurance Corp of India	1.60

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

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Registration and Contact Details: Name of Research Analyst - Sharekhan Limited, Research Analyst Regn No.: INH000006183. (CIN): - U99999MH1995PLC087498. Registered Office: The Ruby, 18th Floor, 29 Senapati Bapat Marg, Dadar (West), Mumbai – 400 028, Maharashtra, INDIA. Tel: 022-6115000.

Other registrations of Sharekhan Ltd.: SEBI Regn. Nos.: BSE / NSE / MSEI (CASH / F&O / CD) / MCX - Commodity: INZ000171337; DP: NSDL/CDSL-IN-DP-365-2018; PMS: INP000005786; Mutual Fund: ARN 20669.

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For any complaints/grievance, email us at igc@sharekhan.com or you may even call Customer Service desk on - 022- 41523200/022- 33054600