Sharekhan
by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Stock Update

Result Update

Larsen & Toubro

Growth prospects remain firm

Capital Goods	Sharekhan code: LT
Reco/View: Buy ↔	CMP: Rs. 3,633
Price Target: Rs. 4,100 ↑	

↑ 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		↔	

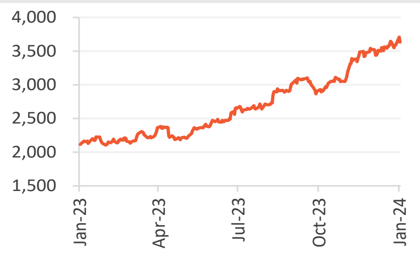
Company details

Market cap:	Rs. 4,99,428 cr
52-week high/low:	Rs. 3,739/2,074
NSE volume: (No of shares)	20.7 lakh
BSE code:	500510
NSE code:	LT
Free float: (No of shares)	137.4 cr

Shareholding (%)

Promoters	0.0
FII	25.5
DII	37.7
Others	36.8

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	3.2	24.2	35.6	71.8
Relative to Sensex	4.7	13.2	28.6	52.3

Sharekhan Research, Bloomberg

Summary

- Consolidated revenues came in better than consensus estimates although it lagged on OPMs. International orders continue to drive 25% y-o-y order inflow growth.
- L&T raised order inflow growth guidance to 20% plus y-o-y and revenue growth to high teens y-o-y for FY2024. However, core business OPM guidance was cut to 8.25-8.5% from 8.5-9%.
- The company has healthy order prospects of ~Rs. 6.27 lakh crore in the near term. Order book at an all-time high of ~Rs 4.7 lakh crore (2.2x TTM revenues).
- We maintain a Buy on L&T with a revised PT of Rs. 4,100, rolling forward our core business valuation multiple to FY2026E earnings and considering strong order prospects.

L&T reported better-than-expected consolidated revenues for Q3FY2024 although OPMs lagged consensus estimates. Consolidated revenues stood at Rs. 55,128 crore (up 19% y-o-y) led by strong execution in its Projects & manufacturing vertical (revenues up 26% y-o-y at Rs. 39,305 crore, aided by 40% y-o-y rise in international revenues). Consolidated OPMs at 10.4% (down 50 bps y-o-y) surprised negatively on account of lower OPMs of Projects & Manufacturing (P&M) segment (at 7.6% as against 8.5% in Q3FY2023 owing to the job mix and legacy orders). Overall, consolidated adjusted net profit rose by 22% y-o-y to Rs. 2,947 crore. Order inflows rose 25% y-o-y at Rs. 75,990 crore leading to record high order book of Rs. 4,69,807 crore, up 22% y-o-y and 2.2x TTM consolidated revenues. The management raised guidance on order inflow growth (20% plus y-o-y from 10-12% y-o-y) and revenue growth (high teens y-o-y from 12-15% y-o-y) for FY2024. However, P&M segment's OPM guidance for FY2024 continue to get lowered to 8.25-8.5% from 8.5-9% as new projects are expected to achieve margin recognition threshold from FY2025.

Key positives

- Consolidated revenues rose 19% y-o-y beating consensus estimates led by strong execution in the P&M segment. International revenues saw a 40% y-o-y rise.
- Management raised guidance on order inflow growth and revenue growth for FY2024.
- Order book stood at a lifetime high at Rs. 4,69,807 crore, up 22% y-o-y and 2.2x TTM consolidated revenues. Order prospect pipeline stands strong at Rs. 6.27 lakh crore.

Key negatives

- OPM lagged consensus estimates owing to continued job mix and sustained cost pressures in legacy orders.
- P&M OPMs for FY2024 stands lowered to 8.25-8.5% from 8.5-9% as new projects are expected to achieve margin recognition threshold in FY2025.

Management Commentary

- The management upped order inflow growth guidance to 20% plus y-o-y (earlier 10-12% y-o-y) and revenue growth guidance to high teens (earlier 12-15% y-o-y) for FY2024. However, core business OPMs are revised downwards to 8.25-8.5% from 8.5-9% earlier.
- The order prospects pipeline stands at Rs. 6.27 lakh crore in the near term as against Rs. 4.87 lakh crore in Q3FY2023, up 29% y-o-y.
- The company will be converting inter-corporate deposits provided as cash support to the Hyderabad Metro over the last two years to equity. Consequently, Rs. 3000 crore debt would be converted to equity and assuming an 8% interest rate, it would results in Rs. 240 crore annual savings in interest cost for Hyderabad Metro.

Revision in estimates – We have fine-tuned our earnings estimates for FY24-FY26 factoring higher execution although getting offset by lower OPMs.

Our Call

Maintain Buy with a revised PT of Rs. 4,100: L&T reported higher execution in its projects & manufacturing vertical although OPMs of this segment continued to lag expectation. Strong order inflows and lifetime higher order book provide healthy revenue visibility over the next two years. Order prospects in domestic and international markets remain healthy at Rs. 6.27 lakh crore in the near term. Sectors such as infrastructure, hydrocarbon and defence are witnessing huge investments and would continue to drive the order book. 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. We maintain a Buy on the stock with a revised SOTP-based price target (PT) of Rs. 4,100 as we roll forward the valuation multiple for its core business to FY2026E earnings and considering strong order prospects.

Key Risks

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

Valuation (Consolidated) Rs cr

Particulars	FY23	FY24E	FY25E	FY26E
Revenue	1,83,341	2,16,342	2,45,548	2,76,241.7
OPM (%)	11.3	10.9	11.5	12.1
Adjusted PAT	10,335	12,437	15,466	18,737
% YoY growth	20.6%	20.3%	24.4%	21.2%
Adjusted EPS (Rs.)	73.5	88.5	110.3	133.7
P/E (x)	49.3	41.0	32.9	27.2
P/B (x)	5.7	5.0	4.4	3.8
EV/EBITDA (x)	23.7	19.9	16.3	13.3
RoCE (%)	8.5	9.9	11.6	13.3
RoNW (%)	14.6	15.9	17.3	18.2

Source: Company; Sharekhan estimates

Conference Call key highlights

- **Guidance:** The management upped order inflow growth guidance to 20% plus y-o-y (earlier 10-12% y-o-y) and revenue growth guidance to high teens (earlier 12-15% y-o-y) for FY2024. However, the core business OPMs are revised downwards to 8.25-8.5% from 8.5-9% earlier as new jobs are expected to cross margin recognition threshold in FY2025. The projects and manufacturing business is expected to see y-o-y improvement over the next 4-5 quarters.

- **Order prospects:** The order prospects pipeline stands at Rs. 6.27 lakh crore in the near term as against Rs. 4.87 lakh crore in Q3FY2023, a growth of 29% y-o-y. Infrastructure order prospects stands at Rs. 4.1 lakh crore as against Rs. 3.88 lakh crore in Q3FY2023. Hydrocarbon segment's pipeline is at Rs. 1.7 lakh crore as against Rs. 0.61 lakh crore. Power at Rs. 0.3 lakh crore as against Rs. 0.2 lakh crore. Heavy Engineering, Defence and other segments at Rs. 0.16 lakh crore remain unchanged.

- **Order book:** Consolidated order book as on Q3FY2024 stands at Rs. 4.7 lakh crore, up 22% y-o-y. Domestic orders comprise 61% and international 39%. Of the Rs. 1.84 lakh crore international order book, 92% is from middle east, 2% from Africa and balance from other countries. Of the Rs. 2.86 lakh crore domestic order book, central government orders are 12%, state government 31%, PSUs 35% and private 22%. Of the total consolidated order book, 18% is funded by bilateral and multilateral agencies. It has removed Rs. 27 billion of orders from the order book. Slow-moving orders comprise less than 1% of the total order book.

- **Order inflow:** The order inflow for Q3FY2024 was up 25% y-o-y at Rs. 760 billion led by 32% y-o-y jump in P&M order inflows at Rs. 602 billion. Infrastructure and hydrocarbon segments drove overall order inflows. International orders in P&M comprised 67% as against 12% in Q3FY2023.

- **Q3FY2024 highlights:** Consolidated revenues were up 19% y-o-y at Rs. 551 bn of which international revenues comprised 44%. Projects and manufacturing (Rs. 393 billion revenues) execution drove overall revenues. OPMs stood at 10.4% (down 50 bps y-o-y) was affected by job mix and cost pressures in P&M legacy orders. P&M OPMs stood at 7.6% compared to 8.5% in Q3FY2023. Consolidated recurring PAT was up 20% y-o-y at Rs. 29 billion. Net working capital to sales stood at 16.6% as compared to 16.7% in Q2FY2024 led by higher collections. TTM RoE stood at 15.2% as against 12.4% in Q3FY2023.

- **Hyderabad Metro:** The metro achieved average daily ridership of 3.94 lakh in Q3FY2024 compared to 4.44 lakh/4.62 lakh on Q3FY2023/Q2FY2024. PAT loss on Hyderabad metro stood at Rs. 2.54 billion compared to Rs. 3.32 billion in Q3FY2023. The company will be converting inter-corporate deposits provided as cash support over last two years to equity. Consequently, Rs. 3000 crore debt would be converted to equity and assuming 8% interest rate, it would results in Rs. 240 crore annual savings in interest cost for Hyderabad Metro.

Results (Consolidated) **Rs cr**

Particulars	Q3FY24	Q3FY23	YoY %	Q2FY24	QoQ %
Net Sales	**55,128**	**46,390**	**18.8**	**51,024**	**8.0**
Total Expenditure	49,369	41,317	19.5	45,392	8.8
Operating Profit	**5,759**	**5,073**	**13.5**	**5,632**	**2.3**
Other Income	838	755	11.0	1,133	-26.1
Interest	904	802	12.7	864	4.6
Depreciation	921	825	11.6	910	1.2
PBT	4,772	4,200	13.6	4,991	-4.4
Exceptional item	-	(136)		-	
PBT	**4,772**	**4,336**	**10.0**	**4,991**	**-4.4**
Tax	1,177	1,271	-7.3	1,136	3.7
Reported PAT	**2,947**	**2,553**	**15.5**	**3,223**	**-8.5**
Adjusted PAT	**2,947**	**2,417**	**21.9**	**3,223**	**-8.5**
Adj. EPS (Rs.)	**21.4**	**17.6**	**21.9**	**23.4**	**-8.5**
Margins (%)			**BPS**		**BPS**
GPM	36.1	40.1	(396)	39.0	(293)
OPM	10.4	10.9	(49)	11.0	(59)
PATM	5.3	5.2	14	6.3	(97)
Tax Rate	24.7	29.3	(463)	22.8	192

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 20% plus in FY24 and revenue would grow in high teens y-o-y. Projects and manufacturing business' OPM may remain in 8.25% to 8.5% as new orders are expected to achieve margin recognition threshold from next fiscal year. 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. 4,100

L&T reported higher execution in its projects & manufacturing vertical although OPMs of this segment continued to lag expectation. Strong order inflows and lifetime higher order book provide healthy revenue visibility over the next two years. Order prospects in domestic and international markets remain healthy at Rs. 6.27 lakh crore in the near term. Sectors such as infrastructure, hydrocarbon and defence are witnessing huge investments and would continue to drive the order book. 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. We maintain a Buy on the stock with a revised SOTP-based price target (PT) of Rs. 4,100 as we roll forward the valuation multiple for its core business to FY2026E earnings and considering strong order prospects.

SOTP Valuation

Particulars	Remarks	Value (Rs cr)	Per share (Rs)
L&T's core business (standalone)	At 25.5x FY2026E	4,05,144	2,882
Subsidiaries			
LTI-Mindtree	Based on our target price	1,01,536	722
L&T Finance Holdings (L&TFH)	Based on our target price	22,815	162
L&T Technology Services Ltd (LTTS)	Based on our target price	36,083	257
Development projects (including IDPL)	At 0.8x Book Value	6720	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		**1,71,225**	**1,218**
Fair value		**5,76,369**	**4,100**

Source: Company, 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: Bloomberg

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	2.7
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	1.6

Source: Bloomberg

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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 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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