

27 July 2021

Larsen & Toubro

*Record OB provides robust revenue assurance; maintaining a Buy*Rating: **Buy**

Target Price: Rs.1,932

Share Price: Rs.1,598

On lower execution, L&T's Q1 FY22 consolidated revenue was up 38% y/y to Rs293bn, less than ARe. The EBITDA margin was 10.8% (largely, in line), a 319bp expansion y/y, aided by better cost management and operating leverage. Excl. Services, order inflow was a modest 11% up y/y due to delays in tendering and awarding. For the rest of FY22, the overall opportunity pipeline continues to be strong at Rs8.96trn (Rs9.06trn at end-FY21). We reiterate our positive stance on the company's execution pace of the robust order backlog (~Rs3.24trn), sturdy balance sheet and no near competitor. We retain a Buy, with a higher TP of Rs1,932 (a sum-of-parts valuation on FY23e).

Public sector exposure augurs well in present context: The order book at end-Jun'21 was Rs3.24trn, up 6% y/y, of which 80% is domestic. We believe that, in the present situation, L&T's greater public-sector exposure (i.e. 84% of its domestic order book) augurs well in credit risk and limited opportunities from private industries (however, showing some signs of improvement). Also, 60% of the order book comprises variable price contracts that cushion margins in such an inflationary environment.

Guidance: low to mid-teen revenue and OI growth: Management retained its low to mid-teen growth guidance for order inflows and revenue, and maintains stable core-business margins for FY22. NWC to continue at the current ~23%. We have slightly trimmed our other-income estimates. The opportunity pipeline of Rs8.96trn for the rest of FY22 looks encouraging with the past strike rate of 15-18%, and makes us confident regarding the FY22 order-inflow estimates of Rs1.5trn (growth of 15%).

Valuations: With a robust order book in hand and a sturdy pipeline, revenue assurance is healthy. We expect revenue/PAT CAGRs of 17%/31% over FY21-23. Valuing the company on a sum-of-parts basis and at a 20x multiple for its core business, we arrive at a target price of Rs1,932. We retain a Buy.

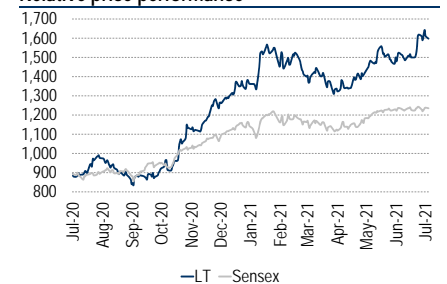
Risks: Sluggish capex, volatile crude-oil prices.

Key data	LT IN / LART.BO
52-week high / low	Rs.1647 / 826
Sensex / Nifty	52852 / 15824
3-m average volume	\$57.8m
Market cap	Rs.2244bn / \$30147.6m
Shares outstanding	1404m

Shareholding pattern (%)	Mar-21	Dec-20	Sep-20
Promoters	-	-	-
- of which, Pledged			
Free float	100.0	100.0	100.0
- Foreign institutions	19.6	23.8	20.2
- Domestic institutions	36.1	31.1	33.8
- Public	44.3	45.1	46.1

Estimates revision (%)	FY22e	FY23e
Sales	0.0	0.0
EBITDA	0.0	0.0
EPS	-1.5	-1.3

Relative price performance



Source: Bloomberg

Key financials (YE Mar)	FY19	FY20	FY21	FY22e	FY23e
Sales (Rs bn)	1,352	1,455	1,360	1,533	1,859
Net profit (Rs bn)	80	89	70	91	121
EPS (Rs)	57.4	63.4	49.8	64.9	86.0
P/E (x)	24.1	23.9	30.4	23.3	17.6
EV / EBITDA (x)	19.2	19.9	19.1	16.7	13.7
P/BV (x)	3.1	3.2	2.8	2.6	2.3
RoE (%)	13.7	13.8	9.8	11.5	14.0
RoCE (%)	8.3	7.8	7.2	8.0	9.4
Dividend yield (%)	1.3	1.3	2.4	1.3	1.7
Net debt / equity (x)	1.4	1.5	1.0	0.9	0.8

Source: Company, Anand Rathi Research

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Quick Glance – Consolidated Financials and Valuations

Fig 1 – Income statement (Rs bn)

Year-end: Mar	FY19	FY20	FY21	FY22e	FY23e
Order book	2,994	3,110	3,269	3,724	4,097
Net revenues	1,352	1,455	1,360	1,533	1,859
<i>Growth (%)</i>	13.0	7.6	-6.5	12.7	21.3
Material cost	750	760	660	783	949
Employee, other expenses	449	531	543	572	692
EBITDA	153	163	156	178	218
<i>EBITDA margins (%)</i>	11.3	11.2	11.5	11.6	11.7
- Depreciation	19	25	29	30	32
Other income	18	24	34	35	38
Interest expenses	18	28	39	38	38
PBT	134	134	122	145	186
<i>Effective tax rate (%)</i>	30.3	24.3	32.1	28.0	28.0
+ Associates / (Minorities)	-13	-13	-13	-13	-13
Net income	80	89	70	91	121
Adjusted income	80	89	70	91	121
WANS	1.40	1.40	1.40	1.40	1.40
FDEPS (Rs / sh)	57.4	63.4	49.8	64.9	86.0
<i>EPS growth (%)</i>	11.0	10.4	-21.5	30.4	32.5

Fig 3 – Cash-flow statement (Rs bn)

Year-end: Mar	FY19	FY20	FY21	FY22e	FY23e
PBT	134	134	122	145	186
+ Non-cash items	19	29	34	33	32
Oper. prof. before WC	153	163	156	178	218
- Incr. / (decr.) in WC	121	116	-146	64	97
Others incl. taxes	51	25	30	41	52
Operating cash-flow	-18	22	272	74	69
- Capex (tang. + intang.)	-48	-124	-7	-38	-37
Free cash-flow	-66	-102	265	36	32
Acquisitions	-	-	-	-	-
- Div. (incl. buyback & taxes)	28	30	51	27	36
+ Equity raised	-	0	0	-	-
+ Debt raised	180	155	-84	5	5
- Fin investments	57	-53	196	5	-
- Misc. (CFI + CFF)	-8	42	-77	4	1
Net cash-flow	37	34	11	5	-0

Source: Company, Anand Rathi Research

Fig 5 – Price movement


Source: Bloomberg

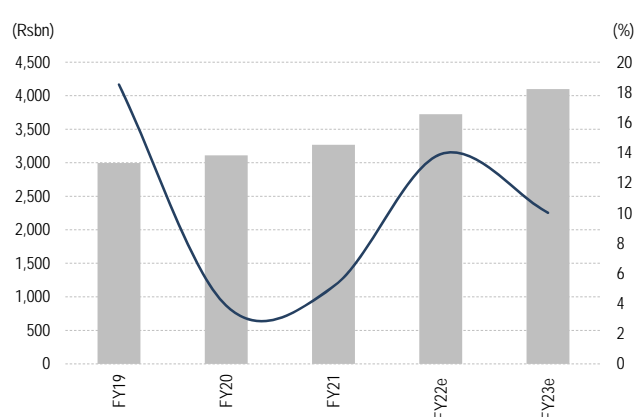
Fig 2 – Balance sheet (Rs bn)

Year-end: Mar	FY19	FY20	FY21	FY22e	FY23e
Share capital	3	3	3	3	3
Net worth	624	652	759	822	907
Debt	1,256	1,410	1,326	1,331	1,336
Minority interest	68	95	121	134	147
DTL / (Assets)	-31	-24	-15	-15	-15
Capital employed	1,916	2,134	2,190	2,272	2,374
Net tangible assets	109	101	114	119	122
Net intangible assets	157	256	250	251	253
Goodwill	18	80	81	81	81
CWIP (tang. & intang.)	25	32	4	4	5
Investments (strategic)	114	73	86	91	91
Investments (financial)	139	127	310	310	310
Current assets (ex cash)	2,078	2,222	2,079	2,241	2,550
Cash	117	136	162	166	166
Current liabilities	841	894	896	993	1,204
Working capital	1,237	1,327	1,183	1,248	1,345
Capital deployed	1,916	2,134	2,190	2,272	2,374

Fig 4 – Ratio analysis

Year-end: Mar	FY19	FY20	FY21	FY22e	FY23e
P/E (x)	24.1	23.9	30.4	23.3	17.6
EV / EBITDA (x)	19.2	19.9	19.1	16.7	13.7
EV / Sales (x)	2.2	2.2	2.2	1.9	1.6
P/B (x)	3.1	3.2	2.8	2.6	2.3
RoE (%)	13.7	13.8	9.8	11.5	14.0
RoCE (%) - after tax	8.3	7.8	7.2	8.0	9.4
RoIC (%) - after tax	7.2	7.3	6.5	8.0	9.3
DPS (Rs /sh)	18.0	19.6	36.0	19.5	25.8
Dividend yield (%)	1.3	1.3	2.4	1.3	1.7
Dividend payout (%) - incl. DDT	34.3	33.9	72.4	30.0	30.0
Net debt / equity (x)	1.4	1.5	1.0	0.9	0.8
Receivables (days)	100	102	113	111	109
Inventory (days)	17	14	16	13	12
Payables (days)	131	123	139	132	130
CFO : PAT %	-22.1	24.4	389.1	80.8	57.1

Source: Company, Anand Rathi Research

Fig 6 – Order book


Source: Company, Anand Rathi Research

Result Highlights

Fig 7 – Result trend

(Rs m)	Q1 FY22	Q1 FY21	YY (%)	Q4 FY21	Q/Q (%)
Net revenue	293,347	212,600	38.0	480,879	(39.0)
EBITDA	31,716	16,205	95.7	63,889	(50.4)
EBITDA margins (%)	10.8	7.6	319bps	13.3	-247bps
Other income	6,480	7,774	(16.6)	10,283	(37.0)
Depreciation	7,174	6,722	6.7	8,168	(12.2)
Interest	8,275	10,559	(21.6)	8,531	(3.0)
Exceptional items	-	2,247		-	
Profit before tax	22,747	8,945	154.3	57,474	(60.4)
Tax	7,184	2,564	180.2	20,867	(65.6)
Minority Interest	(3,572)	(2,408)	48.4	(4,029)	(11.3)
Reported PAT	11,745	3,031	287.5	32,928	(64.3)
Adjusted PAT	11,745	2,961	296.7	34,173	(65.6)
Net margins (%)	4.0	1.4	261bps	7.1	-310bps
Adjusted EPS	8.4	1.0	722.2	23.2	(63.9)

Source: Company

Fig 8 – Order-book details

(Rs m)	Q3 FY19	Q4 FY19	Q1 FY20	Q2 FY20	Q3 FY20	Q4 FY20	Q1 FY21	Q2 FY21	Q3 FY21	Q4 FY21	Q1 FY22	YY (%)
Infrastructure	2,192,580	2,218,500	2,187,360	2,152,720	2,236,950	2,164,292	2,211,150	2,204,300	2,453,160	2,445,650	2,446,210	10.6
Power	81,070	70,780	129,360	151,600	163,870	158,490	154,430	146,950	137,100	128,440	129,070	(16.4)
Heavy engineering	48,570	47,600	41,160	30,320	37,880	41,210	41,180	33,770	36,450	43,720	43,730	6.2
Defence engineering	114,850	115,320	111,720	121,280	96,660	89,648	85,810	91,320	87,950	78,890	76,870	(10.4)
Hydrocarbons	316,880	397,170	402,780	515,440	464,410	441,300	420,940	377,800	458,870	441,790	408,250	(3.0)
Others	56,810	58,160	67,620	60,640	63,230	60,740	137,320	134,860	137,080	135,050	133,080	(3.1)
Total	2,810,760	2,907,530	2,940,000	3,032,000	3,063,000	3,031,056	3,050,830	2,989,000	3,310,610	3,273,540	3,237,210	6.1

Source: Company

Fig 9 – Order-inflow details

(Rs m)	Q3 FY19	Q4 FY19	Q1 FY20	Q2 FY20	Q3 FY20	Q4 FY20	Q1 FY21	Q2 FY21	Q3 FY21	Q4 FY21	Q1 FY22	YY (%)
Infrastructure	219,080	310,330	174,970	156,690	281,150	412,390	113,490	145,220	455,740	312,560	110,230	(2.9)
Power	-	2,720	67,000	43,150	8,160	2,180	472	-	-	7,920	9,110	1,832.1
Heavy engineering	5,530	7,910	1,880	6,800	4,970	9,933	4,760	3,230	9,980	17,780	5,670	19.1
Defence engineering	4,950	11,700	4,430	5,730	1,680	10,444	1,400	13,410	7,050	2,820	5,160	268.6
Hydrocarbons	77,740	125,680	34,240	148,510	-	25,112	12,200	-	128,200	35,910	10,020	(17.9)
Services	81,336	76,364	84,753	106,647	117,240	45,520	99,015	107,441	109,850	111,432	114,195	15.3
Others	17,645	14,706	19,737	15,463	2,590	83,680	4,715	11,089	21,511	18,088	11,185	137.2
Total	406,281	551,000	387,010	482,990	415,790	589,259	235,750	280,390	732,330	506,510	265,570	12.6

Source: Company

Fig 10 – Results, by segment

(Rs m)	Q1 FY22	Q1 FY21	Y/Y (%)	Q4 FY21	Q/Q (%)
Infrastructure	105,435	64,561	63.3	264,367	(60.1)
Power	7,645	3,800	101.2	12,202	(37.3)
Heavy engineering	6,298	4,251	48.1	10,819	(41.8)
Defence engineering	6,901	4,765	44.8	11,408	(39.5)
Hydrocarbons	42,016	30,701	36.9	54,217	(22.5)
IT & Technology services	72,413	60,434	19.8	68,454	5.8
Financial services	30,614	32,842	(6.8)	33,767	(9.3)
Development projects	11,263	5,543	103.2	11,138	1.1
Others	13,840	7,684	80.1	19,065	(27.4)
Total sales	293,347	212,600	38.0	480,879	(39.0)
EBIT					
Infrastructure	5,567	2,448	127.4	27,955	(80.1)
Power	110	-50	(320.2)	949	(88.4)
Heavy engineering	867	543	59.7	2,806	(69.1)
Defence engineering	1,107	250	343.7	3,028	(63.4)
Hydrocarbons	3,593	1,179	204.9	6,583	(45.4)
IT & Technology services	13,827	9,670	43.0	13,660	1.2
Financial services	2,338	-1,252	(286.7)	7,308	(68.0)
Development projects	-907	-386	-	-652	-
Others	1,777	229	676.0	2,333	(23.8)
Total EBIT	28,280	12,630	123.9	63,972	(55.8)
EBIT margins %					
			y/y bps		q/q bps
Infrastructure	5.3	3.8	149	10.6	(529)
Power	1.4	-1.3	276	7.8	(634)
Heavy engineering	13.8	12.8	100	25.9	(1,217)
Defence engineering	16.0	5.2	1,081	26.5	(1,050)
Hydrocarbon	8.6	3.8	471	12.1	(359)
IT & Technology services	19.1	16.0	309	20.0	(86)
Financial services	7.6	-3.8	1,145	21.6	(1,400)
Development projects	-8.1	-7.0	-	-5.9	-
Others	12.8	3.0	986	12.2	60

Source: Company

Fig 11 – Profitability, by segment

(Rsm)	Q1 FY22		Q1 FY21		Y/Y (bps)
	EBIDTA	EBIDTA margins (%)	EBIDTA	EBIDTA margins (%)	
Infrastructure	7,391	7.1	4,028	6.3	80
Power	190	2.5	37	1.0	150
Heavy engineering	985	17.9	662	17.5	40
Defence engineering	1,401	20.3	610	12.9	740
Hydrocarbons	4,022	9.6	1,623	5.3	430
IT & Technology services	16,678	23.1	12,478	20.7	240
Financial services	2,570	8.4	2,956	9.0	(60)
Development projects	(45)	-0.4	388	7.0	(740)
Others	2,104	15.2	478	6.7	850
Total	35,296		23,259		

Source: Company

Concall Highlights

Q1 FY22 update

Despite the second wave of Covid-19 affecting operations at many locations, the company's overall execution was healthy. Project progress was hampered by regional lockdowns, shortage of industrial oxygen and supply-chain disruptions. L&T's revenue was Rs293bn, up 38% y/y, aided by the lower base. International revenues were Rs111.9bn, constituting 38% of total revenue. Net-working-capital-to-sales rose to 22.9% in Q1 FY22 compared to 22.3% the previous quarter. This was boosted by strong group-level collection of Rs276bn. Debt levels, hence, have sequentially improved with gross D/E of 1.41x and net D/E of 0.93x.

Order book and order inflow

Order intake was largely in line with what we expected, at Rs266bn in Q1 FY22, up ~13% y/y. International inflows constituted 34% and were Rs90.5bn. Q1 were order inflows from infra, hydrocarbons, power, heavy engineering and industrial machinery business. Infrastructure order inflows declined a slight 3% y/y on account of delays in tendering and awarding. Despite order wins, the overall prospects pipeline is Rs8.96trn, against Rs9.06trn at the beginning of FY22.

At end-Jun'21, the order book was Rs3.2trn, up 6% y/y. The domestic book accounted for 80% of the total book. The infrastructure order book was Rs2.4trn (76%). Of the domestic order book, orders from the Central government comprise 9%, states 31%, public sector corporations 43%, and the private sector 16%. Of the total order book, 40% is fixed-price and 60% variable-price contracts. Hence, margins are protected to some extent.

- International execution was back to pre-Covid levels.
- High-speed railway project – Start date was Jan'21 and should be completed in 48 months. Revenue would start come in the next financial year.
- 32% coastal road project has been completed. The company usually starts realising margins after completing 25% of the projects.
- Exposure to AP projects is to the tune of Rs12bn and discussions are on-going with the state government to release the amount and also these projects are funded by multi-lateral agencies, thereby cushioning the collections.

Guidance

Management reiterated its guidance of low to mid-teens growth in order inflows and revenue, and maintains margins similar of those of FY21. Despite commodity price rises, the company has maintained its margin guidance as its focuses on 60% of the order book with variable-price contracts. Various projects have crossed the margin-contingency level and enhance productivity through the automation program. NWC would be maintained at the same level. The focus is on large prospects, execution of the huge OB and efficient utilisation of resources.

Division-wise highlights

Infrastructure

Despite the second-wave disruptions, the execution momentum continued and this division's revenue was up 63% y/y to Rs104bn, though on a lower base. The EBITDA margin in Q1 FY22 expanded 70bps y/y to 7.1%, primarily because of a better job mix and improved overheads recovery. Ordering momentum in Q1 FY22 was disrupted and the company saw tendering and awarding delays. Order inflows saw a slight, 3% y/y, decline to Rs110bn and the order book was Rs2.4trn at end-Jun'21. Order prospects for this division are strong at Rs6.4trn for the remaining 9M, up 33% y/y. Many projects are coming under the margin threshold level this year (FY22). This, coupled with greater execution, will help bring margins to last year's level.

Power

Revenue jumped 104% y/y to Rs7.6bn. The EBITDA margin came at 2.5%, against 1% a year back. Better execution progress led to growth in revenue and margins. In this division, profits of the manufacturing portion (boilers, turbines and other JV companies) have been consolidated at the PAT level under the equity method. Order inflow was Rs9.1bn, boosted by an FGD order in Q1 FY22. The order backlog at end-Jun'21 was Rs129bn. Order prospects for this division amount to Rs1.07trn.

Heavy Engineering

Revenue was up 45% y/y to Rs5.5bn in Q1 FY22, aided by better execution. The EBITDA margin was a strong 17.9% (17.5% a year ago), driven by greater execution. Order inflow grew 19% y/y to Rs5.7bn. The order book at end-Jun'21 was Rs44bn.

Defence Engineering

The 46% y/y revenue growth to Rs6.9bn was driven by strong execution of projects in the weapons and engineering systems business. The EBITDA margin was a robust 20.3%, compared to 12.9% a year back. This was bolstered by cost savings and contingency releases in certain jobs. Order inflow was Rs5.2bn and the order book came at Rs77bn. Management said that policy pronouncements in connection with indigenisation would drive order inflows in the medium to long term.

Hydrocarbons

Q1 FY22 revenue was up 37% y/y to Rs42bn impelled by strong execution in the onshore vertical. The EBITDA margin, too, was a robust 9.6% aided by a one-time claim (Rs900m) and cost savings. The division saw order inflow of Rs10bn and the order backlog was Rs408bn at end-Jun'21. The prospects pipeline has improved due to improved O&G capex to Rs1.82trn for the remaining 9M (Rs1.44bn at end-Mar'21 and Rs668bn in Q1 FY22). Of the current prospects, 70% is from outside India (largely the Mid-east).

Developmental Projects

Q1 FY22 revenue doubled y/y to Rs11.3bn, largely contributed by the Power Development business. Consequent on strong power demand, Nabha operates at 90% PLF, whereas metro-rail ridership is reflective of the continuing pandemic. In Q1 FY22, metro-rail was partially operational, and had an average ridership of 55,000. In Jul, ridership increased to

120,000-130,000 per day due to the lifting of the lockdown. At the margin level, the division reported a loss on account of under-recovery of operating expenditure in metro-rail and non-recognition of the Nabha margin. The company is in talks to divest its stake from both the power projects and a 55% stake in Infrastructure Development Projects. For the Hyderabad metro-rail, the company is exploring various options from refinancing to new investors (either through debt or equity). It has set aside Rs20bn for this metro-rail for FY22, of which it spent Rs5bn in Q1 FY22.

IT & Technology Services (IT & TS)

Revenue grew 20% y/y to Rs72.2bn in Q1 FY22. LTI's revenue growth was driven by BFS, hi-tech, media and entertainment, manufacturing and CPG, retail and pharma. LITS revenue largely came from plant engineering, industrial products, transportation and telecoms, and hi-tech. Mindtree's revenue growth was supported by travel, transportation and hospitality, retail, CPG & manufacturing, and communications, media and technology. The margin improved 240bps y/y to 23.1%, aided by greater utilisation, a better on-site-offshore mix and operational efficiencies.

Financial Services

Income from operations was down 7% y/y to Rs30.6bn. Q1 revolved around a pick-up in rural & infra disbursements, robust collections, higher NIMs and fees, and maintenance of adequate liquidity on the balance sheet. The loan book shrunk from Rs884bn to Rs989bn. Sufficient growth capital was available after the rights issue in Jan'21.

Other key highlights

- Net cash from operations was a negative Rs7.9bn.
- The average work-force in Q1 FY22 was 170,000, dropping by 30,000-40,000. By end-Jun it reached the figure of 235,000-240,000. The company at this stage requires 250,000 workers to meet its target.
- Total exposure to the Hyderabad metro-rail was Rs136bn in debt, with Rs50bn as the company's exposure.

Valuation

As expected, execution was better than last year; however, the second wave of the pandemic hit certain project executions and disrupted supply-chains. Nevertheless, the impact was far less than last year. The strong order book (~Rs3.24trn) and healthy pipeline (Rs8.96trn) offer robust revenue and order-inflow assurance. Domestic and international prospects would continue to support OB growth in the next two years.

We expect ~17% and 31% CAGRs over FY21-23 in revenue and PAT respectively, and 11.6% and 11.7% EBITDA margins in FY22 and FY23. We continue to be upbeat about L&T and maintain our Buy rating. Valuing the company on a sum-of-parts basis and at a 20x multiple for its core business, we arrive at a target price of Rs1,932 (earlier Rs1,812).

Fig 12 – Change in estimates

(Rsbn)	Old estimates		Revised estimates		Change %	
	FY22	FY23	FY22	FY23	FY22	FY23
Revenue	1,533	1,859	1,533	1,859	0.0	0.0
EBITDA	178	218	178	218	0.0	0.0
EPS (Rs)	65.9	87.1	64.9	86.0	-1.5	-1.3

Source: Company, Anand Rath Research

Fig 13 – Buy. Sum-of-parts-based TP of Rs1,932

	Fair Value (Rs)	Basis
L&T core business	1,069	20x FY23 EPS
L&T Finance Holdings	74	Market cap
L&T Infotech	303	Market cap
L&T Technology Services	144	Market cap
Mindtree	144	Market cap
L&T Hydrocarbon	142	13x FY22 EPS
L&T IDPL	36	1x BV
L&T's equity investment in BTG	5	1x equity investment
Other business	17	1x BV
Total subsidiaries	864	
Grand total	1,932	

Source : Anand Rath Research

Fig 14 – One-year-forward PER



Source: Company, Anand Rath Research

Key risks

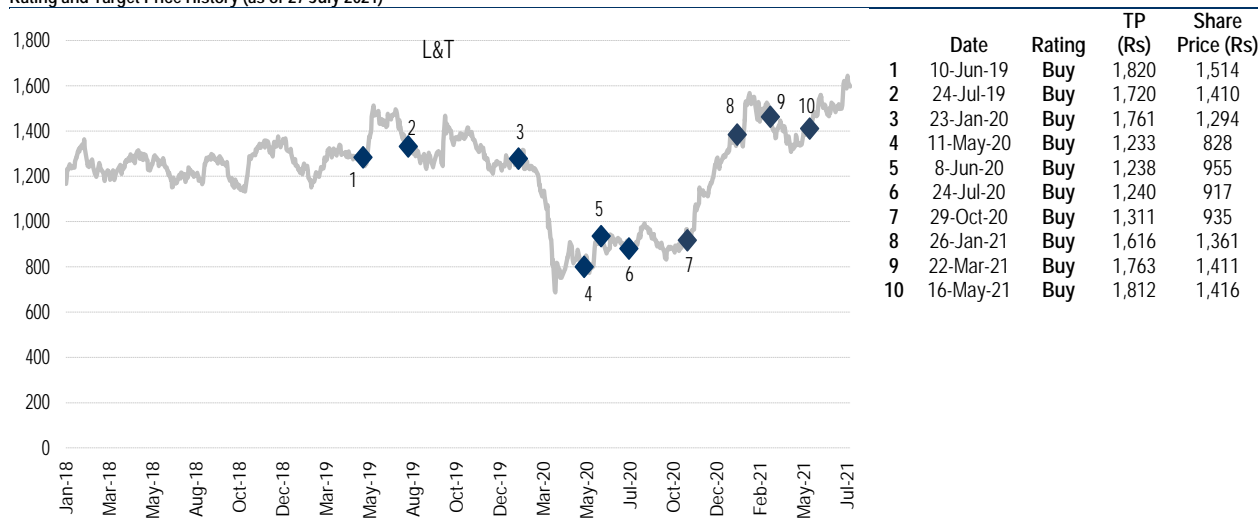
- Expectation of a third wave of Covid-19 could hamper order inflows and execution.
- Deceleration in international markets due to volatile crude-oil prices and a weak global economy.

Appendix

Analyst Certification

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