

26 January 2021

Larsen & Toubro

Record OB provides robust revenue visibility; maintaining a Buy

With its core E&C revenue down 2% y/y to Rs.248bn (ARe Rs.245bn), L&T's Q3 FY21 execution was broadly as we estimated. Consolidated revenue (incl. Services) was down 2% y/y to Rs.356bn; however the 12% EBITDA margin surprised (ARe 10.5%) due to the IT Services strong margin. Q3 FY21 saw stellar E&C orders of Rs.622bn (up 100% y/y), led by infra and hydrocarbons. Management talked of a healthy opportunity pipeline of Rs.2.65trn (Rs.2.2trn domestic infrastructure, Rs.400bn exports) in Q4. With labour available and supply-chain-related issues now behind, we expect to see a further pick-up in execution. NWC was high (26.2% in 9M FY21), likely to improve with the pick-up in execution. Considering the robust order backlog (~Rs.3.3trn), sturdy balance sheet and no near competitor, we retain a Buy, with a revised TP of Rs1,616 (a sum-of-parts valuation on FY23e).

Public sector exposure augurs well in present context: Q3 orders (incl. Services) were a robust Rs732bn, major ones being in infrastructure (for high-speed rail orders). The order book at end-Dec'20 (the highest) was Rs.3.3trn (80% domestic). We believe that, in the present situation, L&T's greater public-sector exposure augurs well, with muted capex from private industries.

Major headwinds in Development. The segment saw major issues in Q3 with under-utilisation of Hyderabad metro services and low PLF in Nabha on account of the 'rail-roko' farmer agitation in Punjab (affecting business for a month). We expect the situation to gradually improve for this segment.

Valuations: With a robust order book in hand and a sturdy pipeline, revenue assurance is healthy. We have rolled our estimates to FY23 considering revenue/PAT growth of 11.4%/17% y/y. Valuing the company on a sum-of-parts basis and at an 18x multiple for its core business, we arrive at a target price of Rs1,616. We retain a Buy. **Risks:** Sluggish capex, volatile crude-oil prices.

Key financials (YE Mar)	FY19	FY20	FY21e	FY22e	FY23e
Sales (Rs bn)	1,352	1,455	1,363	1,668	1,858
Net profit (Rs bn)	80	89	71	100	117
EPS (Rs)	57.4	63.4	50.6	71.3	83.5
PE (x)	24.1	21.5	26.9	19.1	16.3
EV / EBITDA (x)	19.2	18.6	20.0	15.7	13.6
PBV (x)	3.1	2.9	2.7	2.4	2.2
RoE (%)	13.7	13.8	10.3	13.4	14.2
RoCE (%)	8.3	7.8	6.5	8.1	9.0
Dividend yield (%)	1.3	1.3	1.3	1.6	1.8
Net debt / equity (x)	1.4	1.5	1.3	1.2	1.0

Source: Company, Anand Rathi Research

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Rating: Buy

Target Price: Rs.1,616

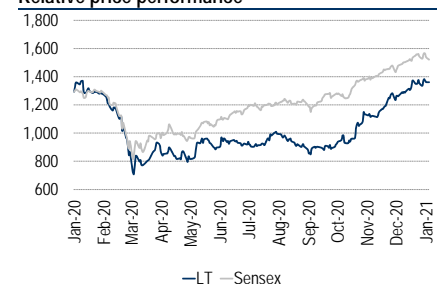
Share Price: Rs.1,361

Key data	LT IN / LART.BO
52-week high / low	Rs1396 / 648
Sensex / Nifty	48348 / 14239
3-m average volume	\$97.6m
Market cap	Rs1912bn / \$26205.3m
Shares outstanding	1404m

Shareholding pattern (%)	Dec'20	Sep'20	Jun'20
Promoters	-	-	-
- of which, Pledged	-	-	-
Free float	100.0	100.0	100.0
- Foreign institutions	23.8	20.2	21.2
- Domestic institutions	31.1	33.8	34.2
- Public	45.1	46.1	44.7

Estimates revision (%)	FY21e	FY22e	FY23e
Sales	-	6.3	-
EBITDA	-	6.7	-
EPS	-	6.6	-

Relative price performance



Source: Bloomberg

Ashwani Sharma
Research AnalystRahul Jain
Research Associate

Quick Glance – Consolidated Financials and Valuations

Fig 1 – Income statement (Rsbn)

Year-end: Mar	FY19	FY20	FY21e	FY22e	FY23e
Order book	2,994	3,126	3,616	3,945	4,342
Net revenues	1,352	1,455	1,363	1,668	1,858
Growth (%)	13.0	7.6	-6.3	22.4	11.4
Material cost	750	760	716	876	976
Employee, other expenses	449	531	499	601	667
EBITDA	153	163	148	191	215
EBITDA margins (%)	11.3	11.2	10.9	11.5	11.6
- Depreciation	19	25	27	29	32
Other income	18	24	26	28	31
Interest expenses	18	28	39	37	35
PBT	134	134	108	153	179
Effective tax rate (%)	30.3	24.3	25.0	25.0	25.0
+ Associates / (Minorities)	-13	-13	-10	-14	-17
Net income	80	89	71	100	117
Adjusted income	80	89	71	100	117
WANS	1.40	1.40	1.40	1.40	1.40
FDEPS (Rs / sh)	57.4	63.4	50.6	71.3	83.5
EPS growth (%)	11.0	10.4	-20.1	40.8	17.1

Fig 3 – Cash-flow statement (Rsbn)

Year-end: Mar	FY19	FY20	FY21e	FY22e	FY23e
PBT	134	134	108	153	179
+ Non-cash items	19	29	40	38	36
Oper. prof. before WC	153	163	148	191	215
- Incr. / (decr.) in WC	121	116	-55	100	32
Others incl. taxes	51	25	27	38	45
Operating cash-flow	-18	22	176	53	139
- Capex (tang. + intang.)	-48	-124	-29	-38	-38
Free cash-flow	-66	-102	147	15	101
Acquisitions	-	-	-	-	-
- Div. (incl. buyback & taxes)	28	28	25	30	35
+ Equity raised	-	0	-	-	-
+ Debt raised	180	155	50	-50	-50
- Fin investments	57	-53	52	5	-
- Misc. (CFI + CFF)	-8	44	14	10	5
Net cash-flow	37	34	107	-79	10

Source: Company, Anand Rathi Research

Fig 5 – Price movement


Source: Bloomberg

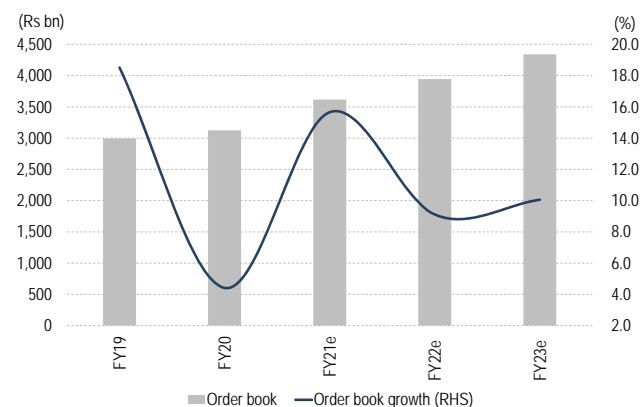
Fig 2 – Balance sheet (Rsbn)

Year-end: Mar	FY19	FY20	FY21e	FY22e	FY23e
Share capital	3	3	3	3	3
Net worth	624	652	713	783	865
Debt	1,256	1,410	1,460	1,410	1,360
Minority interest	68	95	105	120	137
DTL / (Assets)	-31	-24	-24	-24	-24
Capital employed	1,916	2,134	2,255	2,289	2,338
Net tangible assets	109	101	101	107	112
Net intangible assets	157	256	258	259	261
Goodwill	18	80	80	80	80
CWIP (tang. & intang.)	25	32	33	33	34
Investments (strategic)	114	73	105	110	110
Investments (financial)	139	127	147	147	147
Current assets (ex cash)	2,078	2,222	2,088	2,386	2,557
Cash	117	136	258	179	189
Current liabilities	841	894	815	1,013	1,151
Working capital	1,237	1,327	1,273	1,373	1,406
Capital deployed	1,916	2,134	2,255	2,289	2,338

Fig 4 – Ratio analysis

Year-end: Mar	FY19	FY20	FY21e	FY22e	FY23e
P/E (x)	24.1	21.5	26.9	19.1	16.3
EV / EBITDA (x)	19.2	18.6	20.0	15.7	13.6
EV / Sales (x)	2.2	2.1	2.2	1.8	1.6
P/B (x)	3.1	2.9	2.7	2.4	2.2
RoE (%)	13.7	13.8	10.3	13.4	14.2
RoCE (%) - after tax	8.3	7.8	6.5	8.1	9.0
RoIC (%) - after tax	7.2	7.3	6.3	7.9	8.6
DPS (Rs / sh)	18.0	17.9	17.8	21.4	25.1
Dividend yield (%)	1.3	1.3	1.3	1.6	1.8
Dividend payout (%) - incl. DDT	34.3	30.9	35.2	30.0	30.0
Net debt / equity (x)	1.4	1.5	1.3	1.2	1.0
Receivables (days)	100	102	102	101	99
Inventory (days)	17	14	14	13	12
Payables (days)	24	23	25	25	25
CFO : PAT %	-22.1	24.4	248.2	52.9	118.6

Source: Company, Anand Rathi Research

Fig 6 – Orderbook


Source: Company, Anand Rathi Research

Result Highlights

Fig 7 –Result trend

(Rs m)	Q3FY21	Q3FY20	Y/Y (%)	Q2FY21	Q/Q (%)
Net revenue	355,964	362,427	(1.8)	310,347	14.7
EBITDA	42,797	41,177	3.9	33,348	28.3
EBITDA margins (%)	12.0	11.4	66 bps	10.7	128 bps
Other income	10,647	4,690	127.0	5,590	90.4
Depreciation	7,021	6,602	6.3	7,131	(1.5)
Interest	9,620	7,033	36.8	10,425	(7.7)
Profit before tax	36,803	32,232	14.2	21,382	72.1
Tax	10,408	7,110	46.4	6,754	54.1
Minority interest	(3,910)	(3,995)	(2.1)	(3,037)	28.7
Reported PAT	24,665	23,521	4.9	55,203	(55.3)
Adjusted PAT	22,486	21,127	6.4	11,591	94.0
Net margins (%)	6.3	5.8	49 bps	3.7	258 bps
Adjusted EPS	16.0	16.8	(4.4)	8.3	94.0

Source: Company

Fig 8 –Order-book details

(Rs m)	Q1 FY19	Q2 FY19	Q3 FY19	Q4 FY19	Q1 FY20	Q2 FY20	Q3 FY20	Q4 FY20	Q1 FY21	Q2 FY21	Q3 FY21	Y/Y (%)
Infrastructure	2,105,990	2,182,610	2,192,580	2,218,500	2,187,360	2,152,720	2,236,950	2,244,670	2,211,150	2,204,300	2,453,160	9.7
Power	80,510	92,830	81,070	70,780	129,360	151,600	163,870	158,490	154,430	146,950	137,100	-16.3
Heavy engineering	40,550	49,910	48,570	47,600	41,160	30,320	37,880	41,210	41,180	33,770	36,450	-3.8
Defence engineering	115,990	118,850	114,850	115,320	111,720	121,280	96,660	92,160	85,810	91,320	87,950	-9.0
Hydrocarbons	283,770	279,270	316,880	397,170	402,780	515,440	464,410	441,300	420,940	377,800	458,870	-1.2
Others	59,114	57,610	56,810	58,160	67,620	60,640	63,230	60,740	137,320	134,860	137,080	116.8
Total	2,685,924	2,781,080	2,810,760	2,907,530	2,940,000	3,032,000	3,063,000	3,038,570	3,050,830	2,989,000	3,310,610	8.1

Source: Company

Fig 9 – Order-inflow details

(Rs m)	Q1 FY19	Q2 FY19	Q3 FY19	Q4 FY19	Q1 FY20	Q2 FY20	Q3 FY20	Q4 FY20	Q1 FY21	Q2 FY21	Q3 FY21	Y/Y (%)
Infrastructure	193,950	234,060	219,080	310,330	174,970	156,690	281,150	412,390	113,490	145,220	455,740	62.1
Power	1,080	24,850	-	2,720	67,000	43,150	8,160	2,180	472	-	-	-
Heavy engineering	14,090	12,960	5,530	7,910	1,880	6,800	4,970	4,990	4,760	3,230	9,980	100.8
Defence engineering	1,392	11,950	4,950	11,700	4,430	5,730	1,680	6,800	1,400	13,410	7,050	319.6
Hydrocarbons	47,850	27,440	77,740	125,680	34,240	148,510	-	22,290	12,200	-	128,200	-
IT & Technology ser.	75,874	80,474	81,336	76,364	84,753	106,647	117,240	45,520	99,015	107,441	109,850	-6.3
Others	13,811	11,185	17,645	14,706	19,737	15,463	2,590	83,680	4,715	11,089	21,511	730.5
Total	348,047	419,210	406,281	551,000	387,010	482,990	415,790	577,850	235,750	280,390	732,330	76.1

Source: Company

Fig 10 – Results, by segment

(Rs m)	Q3FY21	Q3FY20	Y/Y (%)	Q2FY21	Q/Q (%)
Infrastructure	159,732	171,758	(7.0)	130,957	22.0
Power	9,037	6,983	29.4	6,887	31.2
Heavy engineering	8,034	8,061	(0.3)	7,081	13.5
Defence engineering	10,240	10,042	2.0	7,688	33.2
Hydrocarbons	44,224	43,926	0.7	40,497	9.2
IT & Technology services	65,301	61,259	6.6	61,998	5.3
Financial services	34,007	35,501	(4.2)	33,419	1.8
Development projects	8,138	12,382	(34.3)	11,396	(28.6)
Others	20,507	16,004	28.1	13,672	50.0
Total sales	355,964	362,427	(1.8)	310,347	14.7
EBIT					
Infrastructure	8,226	8,796	(6.5)	6,586	24.9
Power	88	139	(36.9)	125	(29.7)
Heavy engineering	1,347	1,586	(15.1)	187	619.1
Defence engineering	1,384	1,746	(20.8)	1,508	(8.3)
Hydrocarbons	4,932	4,930	0.0	2,990	65.0
IT & Technology services	13,595	9,955	36.6	11,307	20.2
Financial services	3,520	7,269	(51.6)	3,283	7.2
Development projects	-760	1,825	-	-168	-
Others	6,553	2,638	148.4	2,114	209.9
Total EBIT	38,885	38,884	0.0	27,932	39.2
EBIT margins %			y/ybps	q/qbps	
Infrastructure	5.2	5.1	3	5.0	12
Power	1.0	2.0	(102)	1.8	(84)
Heavy engineering	16.8	19.7	(291)	2.6	1,412
Defence engineering	13.5	17.4	(387)	19.6	(611)
Hydrocarbon	11.2	11.2	(7)	7.4	377
IT & Technology services	20.8	16.3	457	18.2	258
Financial services	10.4	20.5	(1,013)	9.8	53
Development projects	(9.3)	14.7	-	(1.5)	-
Others	32.0	16.5	1,547	15.5	1,649

Source: Company

Fig 11 – Profitability, by segment

(Rsm)	Q3FY21		Q3FY20		Y/Y (bps)
	EBIDTA	EBIDTA margins (%)	EBIDTA	EBIDTA margins (%)	
Infrastructure	9,813	6.2	10,523	6.1	10
Power	179	2.0	235	3.4	(137)
Heavy engineering	1,466	20.0	1,692	23.5	(350)
Defence engineering	1,727	16.9	2,173	20.9	(400)
Hydrocarbons	5,377	12.2	5,312	12.1	10
IT & Technology services	16,588	25.5	12,789	21.0	450
Financial services	3,741	11.0	7,744	21.3	(1,030)
Development projects	8	0.1	2,145	17.3	(1,720)
Others	6,822	34.3	2,716	18.7	1,560
Total	45,722		45,327		

Source: Company

Concall Highlights

Result highlights

- Most of divisions are operating at pre-Covid levels. However, productivity at sites was affected in Q3 FY21 by strict safety norms, though execution was better q/q. This should improve significantly in the next six months, aided by the ongoing vaccination drive.
- **Labour** is almost normal (265,000 workers at 900 sites in the country). The **supply chain** in the domestic market has improved significantly.
- Impact of **increases in commodity prices** on steel is 9%; on cement, 6%. Prices should stabilise in the near term. Also, such impact partially affects margins as 50% of the contracts are on a cost-plus basis.
- **Other income** jumped 124% due to returns from higher investable surplus with the company sitting on Rs450bn cash.
- The **finance cost** increase of ~36% y/y is attributable to greater borrowings and the full commissioning of the Hyderabad metro-rail.
- The **Sales and Administration** expenses 7% y/y increase was largely on account of credit provisions, partly offset by savings in overheads.
- **Cash flow from operations** was a strong Rs43.7bn, boosted by healthy cash collections. Group gross collections were Rs320bn, of which Rs180bn was standalone. A Rs4.5bn advance was received for the high-speed rail order. Entire Q3 execution was done from cash collection.
- Of **cash and investments** of Rs452bn, financial services and IT & TS contributes Rs70bn each; the rest is standalone.
- Rs5bn debt was repaid in Q4 FY21. Standalone debt is expected to shrink in the next two quarters. Net D/E (standalone) is 0.1x, expected to be negligible by end-Mar'21.
- Of Rs310bn **working capital**, core business working capital was Rs220bn. Management aims to keep working capital at end-Mar'21 at a similar level y/y, with hopes of healthy cash collections.

Order book

- L&T registered strong **order inflow** growth of 76% y/y, aided by inflows in infrastructure and hydrocarbons.
- Of the record Rs3.3trn **order book**, 80% is domestic, 20% international. Rs910bn has been funded by multi-lateral agencies.
- **Domestic order split**: Central government 12%, state governments 34%, PSUs 41%, private sector 15%.
- The company had an edge over competition for certain orders won in Q3 due to their greater complexity and its better execution ability.
- **Encouraging prospects pipeline**: The Q4 FY21 order pipeline is a promising Rs2.65trn; of which infrastructure alone is Rs2.2trn. Internationally, the pipeline is a healthy Rs400bn. Domestic opportunities would arise from metro-rail/RRTS/HSR, water, roads & expressways, renewables and power T&D. Private capex has yet to pick up momentum.

Division-wise highlights

Infrastructure

- Revenue down 7% y/y to Rs160bn; sequentially, however, improving 22%, driven by greater execution because of workers available and the normalising supply chain.
- The EBITDA margin was flat y/y at 6.1%.
- It secured two large high-speed rail orders, leading to 80% y/y growth in orders. The medium-term ordering outlook is robust.

Power

- Revenue grew a robust ~29% y/y boosted by execution of the sturdy order book.
- The EBITDA margin was suppressed at 2% (3.4% a year ago), as the order book has yet to cross the margin threshold.
- No order was bagged in Q3 due to awarding deferred because of the pandemic.

Heavy engineering

- Revenue was flat at Rs8bn, though q/q improving because of better capacity utilisation.
- The EBITDA margin contracted 274bps y/y to 18.2% on account of the job mix.
- The robust 101% y/y order growth to Rs10bn was mainly due to nuclear and international orders (61% of the division's orders).

Defence Engineering

- Revenue was marginally up 2% y/y to Rs10.2bn (execution of a large order in the final stage).
- The EBITDA margin contracted 477bps y/y to 16.9% on account of the job mix and the order in the final stage.
- Due to the low base of Rs1.7bn in Q3 FY20, order inflows jumped 320% y/y to Rs7.1bn. The division saw multiple small order wins in the domestic market.
- Orders of Rs280bn have been cleared by the domestic government. The company will bid for orders of Rs35bn in Q4.

Hydrocarbons

- Revenue in hydrocarbons was flat y/y at Rs44bn. Execution of a fabrication yard order contributed to revenue in Q3.
- Margins too were flat at 12.2% primarily on account of increased execution.
- The division had a robust inflow of Rs128.2bn, led by some large value domestic orders in petrochemicals. International orders comprised only 4% of the divisions order inflows in Q3 FY21. However, management expects international opportunities from mid and down-stream.

Development projects

- Revenue declined 34% y/y to Rs8.1bn, mainly hurt by lower passenger ridership in the Hyderabad metro-rail and lower PLF at Nabha, owing to the *rail-roko* farmer agitation in Punjab, affecting business for one month.
- The EBITDA margin was hit by under-utilization of the Hyderabad metro-rail services due to Covid'19-related restrictions.
- **Hyderabad metro:** Of the Rs20bn set aside for funding the Hyderabad metro-rail, Rs5bn was infused in Q3. funding will continue as required. In Q3 FY21, the Hyderabad metro-rail had Rs500m revenue, of which Rs300m was from passengers. Operating expense was ~Rs500m-600m, depreciation was Rs750m and interest was Rs3.65bn. An average 300,000-350,000 people per day are required for profit at the operating level. The overhang would continue till work from office resumes.
- The Uttaranchal hydro-power project has been commissioned and it has started selling power through short-term PPAs.

IT & Technology Services (IT & TS)

- Revenue saw a modest 6.6% y/y growth to Rs65.3bn in Q3 FY21. LTI revenue growth was led by BFSI, manufacturing, high-tech M&E, consumer packaged goods (CPG), retail and pharma. LITS revenue largely came from strong growth in medical devices and the telecoms & hi-tech verticals. Whereas, Mindtree revenue growth was supported by communications, media & technology and retail, CPG and manufacturing.
- Margin improvement of 453bps y/y was led by higher utilisation, better onshore-offshore mix and operational efficiencies.

Financial Services

- Income from operations was down 4% y/y to Rs34bn. Q3 saw significant disbursements in rural and infra, robust collections, improved NIMs and fees, and maintenance of adequate liquidity in the balance sheet.
- However, higher credit-cost provisions led to a 51% y/y drop in PAT to Rs1.9bn.

Others

Realty – The number of residential units was 5,600, of which 2,600 were sold and revenue booked. Of the balance 3,000 units, 1,900 have been contracted for and the remaining 1,100 are unsold. In realty space, the company is executing orders of Rs450bn and has no major non-moving order, except the Navi-Mumbai airport tender. Other public projects such as state-owned hospitals, data centres and low-cost residential housing are seeing traction.

Valuation

As expected, execution picked up sequentially and will improve further with labour and supply-chain issues behind, said management. The strong order book and healthy pipeline offer robust revenue assurance. Domestic and international prospects are expected to support order-book growth in the next two years. Working capital is expected to improve as normalcy returns.

We introduce FY23e and expect ~17%/~28% revenue/PAT CAGRs over FY21-23 and an 11.6% EBITDA margin (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 an 18x multiple for its core business, we arrive at a target price of Rs1,616 (earlier Rs1,311).

Fig 12 – Change in estimates

Rs bn	Old Estimates			New Estimates			Change (%)		
	FY21e	FY22e	FY23e	FY21e	FY22e	FY23e	FY21e	FY22e	FY23e
Revenue	1,363	1,569	-	1,363	1,668	1,858	-	6.3	-
EBITDA	147	179	-	148	191	215	-	6.7	-
EPS (Rs)	50.6	66.9	-	50.6	71.3	83.5	-	6.6	-

Source: Anand Rathi Research

Fig 13 – Buy. Sum-of-parts-based TP of Rs1,616

	Fair Value (Rs)	Basis
L&T core business	891	18x FY23 EPS
L&T Finance Holdings	75	Market Cap
L&T Infotech	271	Market Cap
L&T Technology Services	98	Market Cap
Mindtree	92	Market Cap
L&T Hydrocarbon	131	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	725	
Grand total	1,616	

Source: Anand Rathi Research

Fig 14 – One-year-forward PER



Source: Company, Anand Rathi Research

Key risks

- Longer-than-expected delay returning to normal is likely to curtail order inflows and execution.
- Deceleration in international markets due to volatile crude-oil prices and a weak global economy.

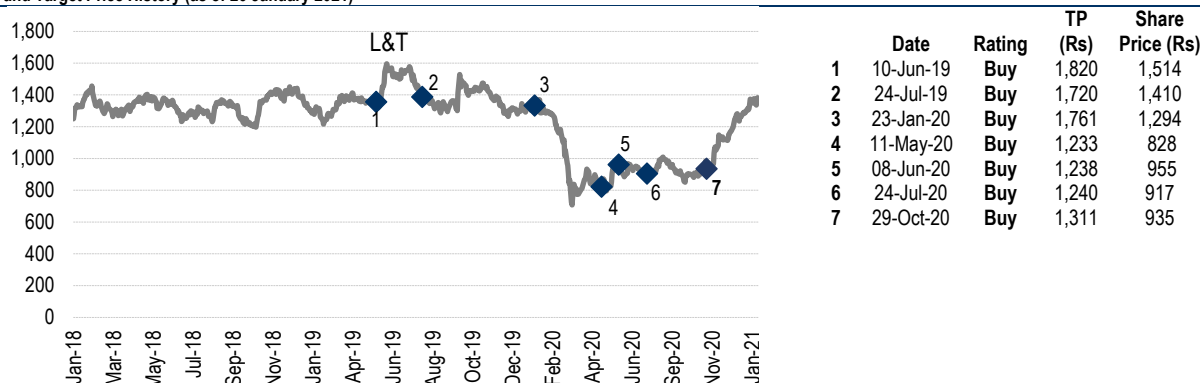
Appendix

Analyst Certification

The views expressed in this Research Report accurately reflect the personal views of the analyst(s) about the subject securities or issuers and no part of the compensation of the research analyst(s) was, is, or will be directly or indirectly related to the specific recommendations or views expressed by the research analyst(s) in this report. The research analysts are bound by stringent internal regulations and also legal and statutory requirements of the Securities and Exchange Board of India (hereinafter "SEBI") and the analysts' compensation are completely delinked from all the other companies and/or entities of Anand Rathi, and have no bearing whatsoever on any recommendation that they have given in the Research Report.

Important Disclosures on subject companies

Rating and Target Price History (as of 26 January 2021)



Anand Rathi Ratings Definitions

Analysts' ratings and the corresponding expected returns take into account our definitions of Large Caps (>US\$1bn) and Mid/Small Caps (<US\$1bn) as described in the Ratings Table below:

Ratings Guide (12 months)

	Buy	Hold	Sell
Large Caps (>US\$1bn)	>15%	5-15%	<5%
Mid/Small Caps (<US\$1bn)	>25%	5-25%	<5%

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ARSSBL registered address: Express Zone, A Wing, 9th Floor, Western Express Highway, Diagonally Opposite Oberoi Mall, Malad (E), Mumbai – 400097.
Tel No: +91 22 6281 7000 | Fax No: +91 22 4001 3770 | CIN: U67120MH1991PLC064106.