

Larsen & Toubro

BSE SENSEX
38,901

S&P CNX
11,470

CMP: INR955

TP: INR1,100(+15%)

Buy



Stock Info

	LT IN
Bloomberg	LT IN
Equity Shares (m)	1,402
M.Cap.(INRb)/(USDb)	1341 / 18.2
52-Week Range (INR)	1554 / 661
1, 6, 12 Rel. Per (%)	1/-21/-32
12M Avg Val (INR M)	5011
Free float (%)	100.0

Financials Snapshot (INR b)

Y/E Mar	2020	2021E	2022E
Sales	1,455	1,419	1,631
EBITDA	163	156	189
PAT	89	69	93
EBITDA (%)	11.2	11.0	11.6
EPS (INR)	63.4	49.5	66.1
EPS Gr. (%)	10.5	-21.9	33.7
BV/Sh. (INR)	475	577	599

Ratios

Net D/E	1.9	1.6	1.7
RoE (%)	13.3	8.6	11.1
RoCE (%)	5.7	4.5	5.1
Payout (%)	26.5	30.0	30.0

Valuations

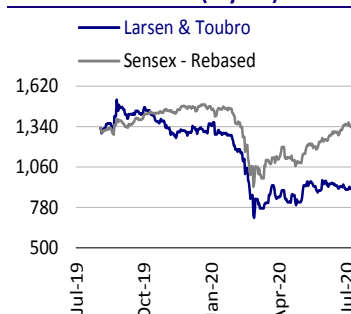
P/E (x)	15.1	19.3	14.4
P/BV (x)	2.0	1.7	1.6
EV/EBITDA (x)	18.9	20.2	17.3
Div Yield (%)	1.4	2.8	1.5
FCF Yield (%)	0.8	-1.1	-3.8

Shareholding pattern (%)

As On	Jun-20	Mar-20	Jun-19
Promoter	0.0	0.0	0.0
DII	36.0	37.9	37.3
FII	19.9	17.9	21.3
Others	44.0	44.2	41.4

FII Includes depository receipts

Stock Performance (1-year)



E&A sale complete – is the delay a blessing in disguise?

E&A proceeds may easily take care of any COVID-19-led non-core funding risk

- E&A proceeds fructify; expect after-tax cash inflow of USD1.4b:** L&T announced the completion of the much-awaited E&A division sale to Schneider. The deal was initially announced two years ago at EV of INR140b and took time to achieve completion on account of the necessary approvals needed and the fulfillment of other conditions. Barring the subsidiary in Saudi Arabia – L&T Electrical & Automation Saudi Arabia Company Limited (LTEASA) – for which local approvals are pending, E&A's manufacturing facilities in India and related subsidiaries in the UAE, Kuwait, Malaysia, and Indonesia are being transferred to Schneider Electric. Note that Schneider Electric would use the L&T brand for a specified period as the brand is highly popular and has a strong recall in the Switchgear market. Adjusting for taxes and debt, the company is likely to garner net cash inflow of USD1.4b as proceeds.
- Likely nature of use of proceeds may have changed:** When the deal was originally announced, and even until the days preceding the COVID-19 outbreak, we expected the proceeds to be utilized for buybacks or put toward a one-time special dividend of INR70–80/sh. However, COVID-19 has posed various challenges, including the risk of funding requirements in non-core businesses such as L&T Finance and Hyderabad Metro. In light of this, as well as given the uncertainties surrounding the local lockdowns and macro environment risks, we do not expect any meaningful special dividend in the near term. Instead, we expect L&T to use the liquidity firepower to mitigate any troublesome risks that may emerge.
- Better late than never – The delay may not be that bad:** The likely change in the nature of use of the proceeds may be against the original expectation; however, this has more to do with COVID-19-led risks than any change in the management's intention to return excess cash to shareholders. Also, despite the long delay, proceeds of ~USD1.9b amid the pandemic further strengthen the balance sheet – which is the primary risk for any company in the current scenario. Owing to the proceeds, L&T is likely to maintain a strong liquidity position and does not have to depend on debt on a net basis to support core business execution.
- Sufficient ammunition to fund any non-core funding risks:** The management had already communicated that it may utilize part of the funds to restructure the capital structure of the Hyderabad Metro by replacing external debt. Thereafter, it may opt to divest the asset through the InvIT route as and when the market for asset monetization turns conducive. Along with the recapitalization of the Hyderabad Metro, the E&A sale's proceeds could easily take care of any funding risk in the L&T Finance business (given the impact of COVID-19 and likely rise in NPAs for banks and NBFCs). We believe that even after taking care of such funding requirements and the tax on the profits, the

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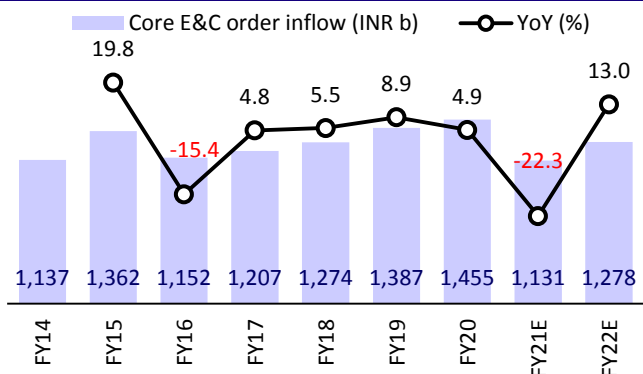
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company would be left with net cash of ~INR50b from the proceeds. The timing of such non-core funding risks may not be ascertainable. However, we believe: a) Any likely funding in the non-core business would either happen over the next few months or not at all. Either way, the overhang of funding risk is likely to be over in the next three to six months. b) Incremental delay, coupled with the subsequent opening up of the economy, may actually lower such risks.

- **Valuation and view:** We factor the E&A proceeds in our model. However, instead of taking the benefit of other income on the entire proceeds, we limit the benefit only to the extent of net proceeds of INR50b, thereby taking care of any cash infusion risks in the non-core business. Once the overhang of such requirements is over, we believe L&T is likely to be re-rated, even at a minor improvement in the macro trends. Near-term macro risks (likely government capex cut) may appear challenging, but current valuations are adequately pricing-in such risks, in our view. On account of higher other income, we raise our consol. EPS marginally by 1.6%/2.3% in FY21/FY22E. Maintain **Buy**, with TP of INR1,100 on account of: (a) core business target P/E multiple of 16x v/s long term average of 22x, and (b) contribution from four listed subsidiaries after applying a 20% holding company discount. Adj. for valuation of subsidiaries, L&T trades at FY22E PE of 12.7x.

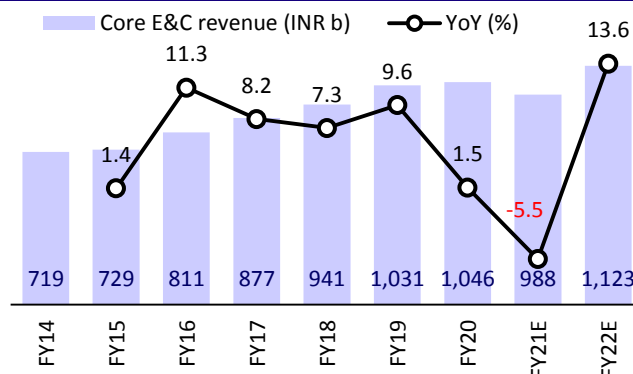
Story in charts

Exhibit 1: Core E&C order inflows expected to gradually recover after sharp decline in FY21E



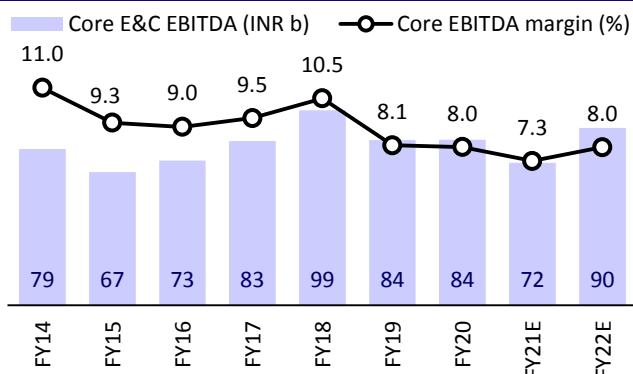
Source: MOFSL, Company

Exhibit 2: Core E&C revenue expected to rise at 3.6% CAGR over FY20–22E



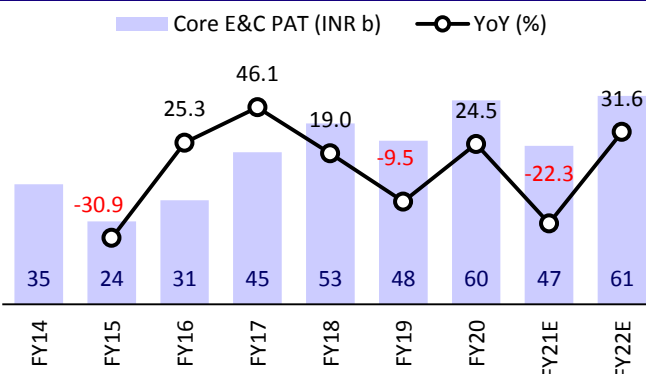
Source: MOFSL, Company

Exhibit 3: Core E&C EBITDA estimated to rise at 3.5% CAGR over FY20–22E



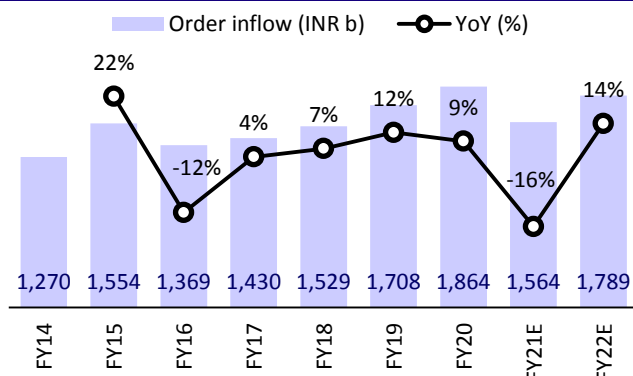
Source: MOFSL, Company

Exhibit 4: Core E&C PAT expected to remain almost flat over FY20–22E



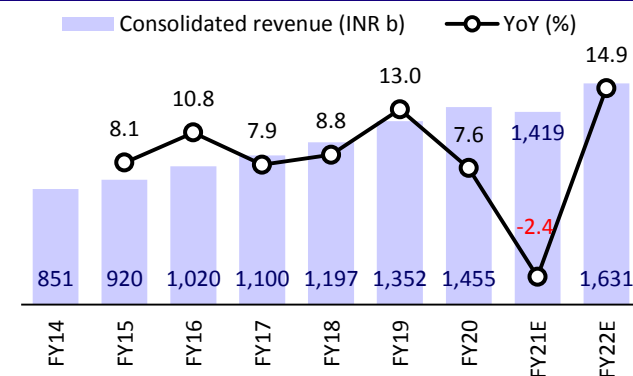
Source: MOFSL, Company

Exhibit 5: Consolidated order inflow expected to remain flat over FY20–22E



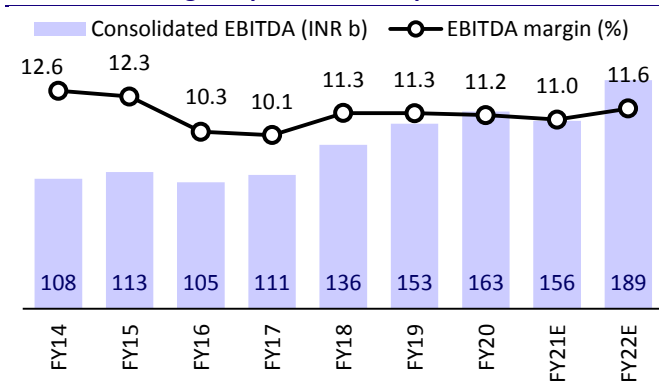
Source: MOFSL, Company

Exhibit 6: Consolidated revenue expected to rise at 6% CAGR over FY20–22E



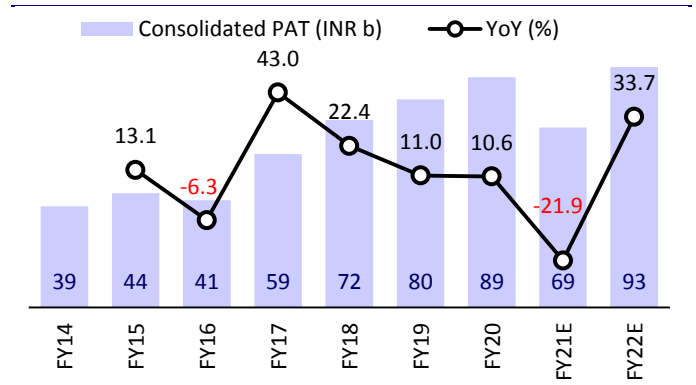
Source: MOFSL, Company

Exhibit 7: Consolidated EBITDA estimated to rise at 7.7% CAGR, with margin expansion of 40bp over FY20–22E



Source: MOFSL, Company

Exhibit 8: Consolidated PAT estimated to rise at 2.2% CAGR over FY20–22E



Source: MOFSL, Company

Valuation and view

- Maintain Buy:** We factor the E&A proceeds in our model. However, instead of taking the benefit of other income on the entire proceeds, we limit the benefit only to the extent of net proceeds of INR50b, thereby taking care of any cash infusion risks in the non-core business. Once the overhang of such requirements is over, we believe L&T is likely to be re-rated, even at a minor improvement in the macro trends. Near-term macro risks (likely government capex cut) may appear challenging, but current valuations are adequately pricing-in such risks, in our view. On account of higher other income, we raise our consol. EPS marginally by 1.6%/2.3% in FY21/FY22E. Maintain **Buy**, with TP of INR1,100 on account of: (a) core business target P/E multiple of 16x v/s long term average of 22x, and (b) contribution from four listed subsidiaries after applying a 20% holding company discount. Adj. for valuation of subsidiaries, L&T trades at FY22E PE of 12.7x.

Exhibit 9: Our SOTP-based TP stands at INR1,100

Business segment	Mar'22E	Remarks
Core E&C	700	❖ 16x core E&C EPS
IT & TS + MindTree	316	❖ 20% discount to current mkt cap
Finance Holdings	48	❖ 20% discount to current mkt cap
Development projects	35	❖ P/Inv based approach
Total	1,100	

Source: MOFSL, Company

Financials and valuations

Income Statement						(INR m)
Y/E March	2017	2018	2019	2020	2021E	2022E
Net Sales	10,93,118	11,96,832	13,52,203	14,54,524	14,19,023	16,30,757
Change (%)	7.2	9.5	13.0	7.6	-2.4	14.9
EBITDA	1,11,305	1,35,714	1,53,296	1,63,290	1,55,613	1,89,254
Change (%)	6.4	21.9	13.0	6.5	-4.7	21.6
Margin (%)	10.2	11.3	11.3	11.2	11.0	11.6
Depreciation	23,699	19,287	19,230	24,623	25,579	26,679
EBIT	87,606	1,16,427	1,34,066	1,38,667	1,30,034	1,62,575
Net Interest	13,387	15,385	18,026	27,967	38,847	38,847
Other Income	13,441	14,120	18,365	23,609	25,817	27,108
PBT	87,659	1,15,162	1,34,406	1,34,310	1,17,004	1,50,836
Tax	20,066	31,989	40,671	32,632	32,690	40,592
Rate (%)	22.9	27.8	30.3	24.3	27.9	26.9
Reported Profit (Before MI & AI)	68,808	84,403	1,02,376	1,08,223	1,87,661	1,10,244
Less: Minority Interest	4,443	6,346	13,115	13,453	15,631	18,377
Add: Profits of Associates	-3,953	-4,359	-210	720	800	1,000
EO Adjustments	1,214	1,230	8,641	6,546	1,03,347	0
Adjusted PAT	59,198	72,469	80,411	88,945	69,483	92,867
Change (%)	43.0	22.4	11.0	10.6	-21.9	33.7
Cons. Profit (Reported)	60,412	73,699	89,051	95,490	1,72,830	92,867

Balance Sheet						(INR m)
Y/E March	2017	2018	2019	2020	2021E	2022E
Share Capital	1,866	2,803	2,806	2,808	2,808	2,808
Reserves	5,00,299	5,46,232	6,20,943	6,64,424	8,06,930	8,37,579
Net Worth	5,02,165	5,49,035	6,23,748	6,67,232	8,09,738	8,40,386
Loans	9,39,761	10,75,241	12,55,552	14,10,071	15,75,071	17,56,571
Deferred Tax Liability	-11,252	-21,170	-31,078	-23,935	-23,935	-23,935
Minority Interest	35,636	52,014	68,261	95,208	1,10,839	1,29,216
Capital Employed	14,66,310	16,55,120	19,16,483	21,48,576	24,71,713	27,02,239
Gross Fixed Assets	1,71,779	2,19,694	2,62,141	5,35,180	5,55,180	5,75,180
Less: Depreciation	38,375	57,939	74,024	98,646	1,24,225	1,50,904
Add: Capital WIP	1,67,374	1,58,481	1,63,017	33,111	33,111	33,111
Net Fixed Assets	3,00,778	3,20,236	3,51,134	4,69,645	4,64,066	4,57,387
Investments	1,97,530	1,53,113	2,11,203	2,00,475	2,00,475	2,00,475
Inventory	41,397	48,478	64,139	57,467	56,064	64,429
Debtors	2,79,696	3,31,170	3,70,382	4,07,315	4,25,707	4,40,304
Cash & Bank Balance	55,725	80,327	1,17,262	1,51,178	2,66,221	3,16,787
Loans & Advances	19,547	23,536	24,890	22,383	21,837	25,095
Other Current Assets	4,88,977	5,74,595	6,14,870	6,87,673	6,70,889	7,70,993
Current Assets	16,05,954	19,23,256	21,94,782	23,52,974	26,07,196	29,63,772
Current Liab. & Prov.	6,37,950	7,41,486	8,40,637	8,74,518	8,00,023	9,19,396
Net Current Assets	9,68,004	11,81,771	13,54,146	14,78,457	18,07,172	20,44,376
Capital Deployed	14,66,312	16,55,120	19,16,483	21,48,576	24,71,713	27,02,239

Financials and valuations

Ratios

Y/E March	2017	2018	2019	2020	2021E	2022E
Basic (INR)						
Adjusted EPS	42.2	51.7	57.3	63.4	49.5	66.1
Growth (%)	43.0	22.4	10.9	10.5	-21.9	33.7
Cons. EPS (Fully Diluted)	42.2	51.7	63.5	68.0	123.1	66.1
Growth (%)	43.0	22.4	22.8	7.1	81.0	-46.3
Cash EPS	59.1	65.5	77.2	85.6	141.3	85.2
Book Value	358.3	391.7	444.7	475.3	576.8	598.6
DPS	8.9	15.9	18.0	18.0	36.9	19.8
Payout (incl. Div. Tax.)	21.0	30.8	28.4	26.5	30.0	30.0
Valuation (x)						
P/E	22.6	18.5	16.7	15.1	19.3	14.4
Cash P/E	16.2	14.6	16.9	15.2	9.2	15.3
EV/EBITDA	20.0	17.2	19.3	18.9	20.2	17.3
EV/Sales	2.1	2.0	2.2	2.1	2.2	2.0
Price/Book Value	3.0	2.7	2.1	2.0	1.7	1.6
Dividend Yield (%)	0.9	1.7	1.4	1.4	2.8	1.5
Return Ratios (%)						
RoE	11.8	13.2	12.9	13.3	8.6	11.1
RoCE	5.3	5.7	5.5	5.7	4.5	5.1
Turnover Ratios						
Debtors (Days)	93.4	101.0	100.0	102.2	109.5	98.6
Inventory (Days)	13.8	14.8	17.3	14.4	14.4	14.4
Asset Turnover (x)	0.8	0.7	0.7	0.7	0.6	0.6
Leverage Ratio						
Current Ratio (x)	2.5	2.6	2.6	2.7	3.3	3.2
Debt/Equity (x)	1.8	1.8	1.8	1.9	1.6	1.7

Cash Flow Statement

Y/E March	2017	2018	2019	2020	2021E	2022E
						(INR m)
PBT before EO Items	87,659	1,15,162	1,42,862	1,43,142	1,17,004	1,50,836
Add : Depreciation	23,699	19,287	20,840	24,623	25,579	26,679
Others	-7,971	-10,696	-11,636	-1,176	1,04,147	1,000
Less : Direct Taxes Paid	-32,017	-34,034	-45,816	-40,465	-32,690	-40,592
(Inc)/Dec in WC	43,459	-34,165	-23,921	-77,914	-50,323	-6,953
CF from Operations	1,14,830	55,554	82,329	48,210	1,63,717	1,30,970
(Inc)/Dec in FA	-85,646	-1,84,743	-1,73,298	-32,925	-1,83,350	-1,99,685
Free Cash Flow	29,184	-1,29,189	-90,969	15,285	-19,633	-68,715
(Pur)/Sale of Investments	-66,536	54,449	-35,366	-63,967	0	0
CF from Investments	-66,536	54,449	-35,366	-63,967	0	0
(Inc)/Dec in Net Worth	533	495	113	176	0	0
(Inc)/Dec in Debt	50,509	1,27,683	1,78,653	1,41,259	1,65,000	1,81,500
Others	9,066	-4,940	10,978	-13,324	0	0
Dividend Paid	-20,931	-23,898	-26,471	-45,513	-30,324	-62,219
CF from Fin. Activity	39,178	99,341	1,63,273	82,597	1,34,676	1,19,281
Inc/Dec of Cash	1,826	24,600	36,937	33,915	1,15,043	50,566
Add: Beginning Balance	53,899	55,725	80,325	1,17,262	1,51,178	2,66,221
Closing Balance	55,725	80,325	1,17,262	1,51,178	2,66,221	3,16,787

Explanation of Investment Rating	
Investment Rating	Expected return (over 12-month)
BUY	>=15%
SELL	< - 10%
NEUTRAL	< - 10 % to 15%
UNDER REVIEW	Rating may undergo a change
NOT RATED	We have forward looking estimates for the stock but we refrain from assigning recommendation

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