Sharekhan
by BNP PARIBAS

Larsen and Toubro

Resilient performance in unprecedented times

Sector: Capital Goods
Result Update

	Change
Reco: **Buy**	↔
CMP: **Rs. 916**	
Price Target: **Rs. 1,250**	↔

↑ Upgrade ↔ No change ↓ Downgrade

Company details

Market cap:	Rs. 128,655 cr
52-week high/low:	Rs. 1554/661
NSE volume: (No of shares)	53.8 lakh
BSE code:	500510
NSE code:	LT
Sharekhan code:	LT
Free float: (No of shares)	140.4 cr

Shareholding (%)

Promoters	0.0
FII	19.0
DII	37.5
Others	43.5

Price chart

Price performance

(%)	1m	3m	6m	12m
Absolute	-4	9	-27	-35
Relative to Sensex	-13	-11	-22	-35

Sharekhan Research, Bloomberg

Larsen and Toubro (L&T) reported decent performance in Q1FY2021 despite challenges. The company's operational performance was broadly in line with our estimates. L&T's revenue declined by 28% y-o-y to Rs. 21,260 crore, affected by 53% y-o-y decline in E&C revenue (33% of revenue). L&T's core E&C was affected by COVID-19 led stringent lockdown hampering project execution. The company lost Rs. 12,500 crore revenue in Q1FY2021 due to the lockdown. Operating profit margin (OPM) at 7.6% was lower by -273 bps y-o-y (marginally lower than estimates) as margins shrank across all segments. E&C margins dipped by 340 bps to 3.9%, while service margins declined by 875 bps to 10.4% on losses on developmental project and provisions in financial business. The company reported higher interest cost (up 80% y-o-y, on higher borrowings taken with the intent to create a liquidity buffer and impact of commissioning of Hyderabad metro), while depreciation increased by 46% y-o-y (due to Mindtree consolidation), which led to adjusted PAT declining by 79% y-o-y to Rs. 303 crore. Despite the challenging business environment, lower fresh investments, and deferment of awarded orders, the company was able to bag orders worth ~Rs. 23,574 crore (down 39% y-o-y) in Q1FY2021, driven by the domestic business, especially in the infrastructure segment. International orders during the quarter at Rs. 8,872 crore constituted 38% of the total order inflow. Order backlog remained diversified and healthy at Rs. 3,05,083 crore (2.2x TTM revenue). Order pipeline at Rs. 6.5 lakh crore comprising of Rs. 5.3 lakh crore from domestic order and Rs. 1.2 lakh crore from International orders. Segmental breakup of the order pipeline: Infrastructure Rs1.5 lakh crore; Power T&D: Rs. 60,000 crore; Defence - Rs. 10,000 crore. Management highlighted that collections from clients have been normal through the quarter (both from states and centre) and the company has restricted working capital to the extent of collections with well-managed cash flow during the quarter. Management refrained from providing any revenue or order inflow guidance as it is too early to quantify the same considering the current uncertainty led by COVID-19. Currently, 95% of the sites have been functional and the situation is expected to improve in the latter part of FY2021. However, key challenges with persistence issues such as slowdown in consumption, shortage of labour (gradually improving), sluggish liquidity scenario, deferment in ordering activity, and uncertain geopolitical scenario persist. Further, on the procurement from China, the company highlighted that for existing projects there will not be any issues; and going ahead, the company's philosophy would be to procure from alternative sources and form strategic JVs with companies from other countries. We expect L&T to sail through weak FY2021 as it is better poised to ride the current uncertainties owing to multiple levers such as strong business model, diversified order book, and healthy balance sheet, while it refurbishes its order book and maintains the liquidity position to bounce back in FY2022. Consequently, the steep correction in L&T's stock price provides a favourable risk-reward ratio to investors (P/E of 17x/13x its FY2021E/FY2022E earnings). Hence, we continue to maintain our Buy rating on the stock with an unchanged SOTP-based price target (PT) of Rs. 1,250.

Key positives

- Order book remains healthy, providing visibility for 2.2x its TTM revenue
- L&T's focus on cash flows helped control NWC intensity at 27% of sales (vs. 24% qoq). This led to a positive OCF of Rs 800 crore in Q1FY2021.
- Infra margins was relatively less impacted considering sharp decline in execution

Key negatives

- Core E&C business declined by 53% y-o-y
- Higher interest cost during the quarter.

Our Call

Maintain Buy with an unchanged PT of Rs. 1,250: L&T's strong order backlog along with its presence across verticals and geographies in its core E&C business provides healthy revenue visibility. Further L&T's recent order wins amidst current uncertainties and unprecedented times are likely to improve upon execution during FY2022-FY2023. Hence, we believe although FY2021 may be relatively weak on account of macro uncertainties, we expect L&T to bounce back during FY2022 owing to multiple levers such as strong business model, diversified order book, and healthy balance sheet. The company continues to focus on its strategic plan of improving its return ratios. Consequently, the steep correction in L&T's stock price provides a favourable risk reward ratio to investors (P/E of 17x/13x its FY2021E/FY2022E earnings). We have fine-tuned our estimates for FY2021-FY2022, and we continue to maintain our Buy rating with an unchanged SOTP-based PT of Rs. 1,250.

Key Risks

Slowdown in the domestic macro environment or weakness in international capital investment can negatively affect business outlook and earnings growth.

Valuation (Consolidated) Rs cr

Particulars	FY19	FY20	FY21E	FY22E
Revenue	1,35,220	1,45,452	1,43,889	1,62,237
OPM (%)	11.3	11.2	11.0	11.5
Adjusted PAT	8,905	9,549	7,308	9,487
% YoY growth	20.8	7.2	(23.3)	29.8
Adjusted EPS (Rs.)	63.4	68.0	52.1	67.7
P/E (x)	14.5	13.5	17.6	13.5
P/B (x)	2.1	1.9	1.8	1.6
EV/EBITDA (x)	12.9	12.5	13.4	11.4
RoNW (%)	14.2	13.8	10.6	12.7
RoCE (%)	7.4	7.2	6.6	7.6

Source: Company Data; Sharekhan estimates

Descent performance in uncertain times: L&T reported decent performance in Q1FY2021 despite challenges. The company's performance was in line with our estimates. L&T's revenue stood at Rs. 21,260 crore, down 28% y-o-y (in line with our estimates). L&T's core E&C comprising 33% of revenue declined by 53% y-o-y due to COVID-19 led stringent lockdown hampering project execution. The company lost Rs. 12,500 crore revenue in Q1FY2021 due to the lockdown. EBITDA declined by 47% y-o-y to Rs. 1,620 crore (our estimate was Rs. 1,728 crore) on under recovery of fixed costs and provisions, despite sales mix with higher contribution from high-margin service business. OPM contracted by 273 bps to 7.6%, as margins shrank across all segments. E&C margin dipped by 340 bps to 3.9%, while service margins declined by 875 bps to 10.4% on losses on developmental project and provisions in finance business. Interest expense rose by 80% y-o-y/30% q-o-q on higher borrowings taken with the intent to create a liquidity buffer and impact of commissioning of Hyderabad metro, while depreciation was higher by 46% y-o-y (due to Mindtree consolidation). Higher interest cost and depreciation along with lower operating leverage led to net profit declining 79% to Rs. 303 crore in Q1FY2021 vs. Rs. 1,472 crore in Q1FY2020. Adjusting for extraordinary gain of Rs. 225 crore (divestment of wealth management business), adjusted PAT came at Rs. 78 crore. Management highlighted that collections from clients have been normal through the quarter (both from states and centre) and the company has restricted working capital to the extent of collections with well-managed cash flow during the quarter. Management refrained from providing any revenue or order inflow guidance as it is too early to quantify the same. Currently, 95% of the sites have been functional and the situation is expected to improve in the latter part of FY2021. However, key challenges with persistence issues such as slowdown in consumption, shortage of labour (gradually improving), sluggish liquidity scenario, deferment in ordering activity, and uncertain geopolitical scenario persist. Further, on procurement from China, the company highlighted that for existing projects there will not be any issues; and going ahead, the company's philosophy would be to procure from alternative sources and forming strategic JVs with companies from other countries.

Strong order book provides revenue visibility: Despite the challenging business environment and lower fresh investments and deferment of awarded orders, the company was able to bag orders worth ~Rs. 23,574 crore (down 39% y-o-y) in Q1FY2021, driven by the domestic business, especially in the infrastructure segment. International orders during the quarter at Rs. 8,872 crore constituted 38% of the total order inflow. Order backlog remains diversified and healthy at Rs. 3,05,083 crore (2.2x TTM its revenue). In Order pipeline for FY21E, the total opportunity basket is Rs6.5lakh crore – comprising of Rs5.3 lakh crore from domestic order and Rs1.2 lakh crore from International orders. Segmental breakup of the order pipeline: InfrastructureRs1.5 lakh crore; Power T&D: Rs60000 crore; Defence - Rs10000 crore. In domestic markets management expects significant orders from multilateral funded projects. It expects large orders in Heavy Infra, Power and Water segments which are in immediate pipeline. In international market it expects significant orders in social Infra projects (Power and Water segment) and projects in augmentation of existing facilities. However, new order inflow remain challenging till Oil price is back at 50-55$/bbl

Key result highlights from earnings call

Financial impact of COVID-19 on Q1FY2021: The company estimates revenue loss of Rs. 12,500 crore on account of COVID-19 led lockdown in Q1FY2021. The execution is likely to recover gradually with the productivity loss likely to remain till the time social distancing needs to be maintained. Currently, 95% sites are operational.

Guidance: Management has not been able to give guidance on order inflows, revenue, and OPM for FY2021, as it is currently assessing the impact of COVID-19, while it is too early to quantify the same.

Order inflow: Despite the challenging business environment, the company's was able to bag order worth Rs. 23,574 crore, down 39% y-o-y). Order inflow during Q1FY2021 was driven by the infrastructure segment.

Order book: The company's order book was up 4% y-o-y to Rs. 3.05 lakh crore at the end of Q1FY2021. Infrastructure comprises 72% of the order book. Domestic orders constituted 76% of the order book.

Order pipeline FY21E: The total opportunity basket is Rs6.5lakh crore – comprising of Rs5.3 lakh crore from domestic order and Rs1.2 lakh crore from International orders. Segmental breakup of the order pipeline: InfrastructureRs1.5 lakh crore; Power T&D: Rs60000 crore; Defence - Rs10000 crore. In domestic markets management expects significant orders from multilateral funded projects. It expects large orders in Heavy Infra, Power and Water segments which are in immediate pipeline. In international market it expects significant orders in social Infra projects (Power and Water segment) and projects in augmentation of existing facilities. However, new order inflow remain challenging till Oil price is back at 50-55$/bbl

Cost escalation: Majority of the projects have escalation clause (55% of order book). While the company continues to work toward cost optimization, it expects to benefit from declining commodity prices.

Focus on cash flows: L&T's focus on cash flows helped control NWC intensity at 27% of sales (vs. 24% qoq). This led to a positive OCF of Rs 800 crore in Q1FY2021.

Current scenario: Currently, the company has 95% of sites operational. Payment from the public space has been tough. The company generally employs ~2,75,000 to 3,00,000 labourers. At the peak, in January, the company had 2,60,000 workers at their sites; this fell to 70,000 labourers in April and May. Now there is back up at 190,000 labourers. Moreover, the company is adding 1,500 workers to its sites every day; and if this pace continues, the company is expected to return to its pre-COVID-19 worker strength in the 45-60 days.

Procurement from China: On the procurement from China, the company highlighted that for existing projects there will not be any issues; and going ahead, the company's philosophy would be to procure from alternative sources and form strategic JVs with companies from other countries.

Collection from clients: Management highlighted that collections from clients have been normal through the quarter (both from states and centre) and the company has restricted working capital to the extent of collections with well-managed cash flow during the quarter.

Capital requirements: Hyderabad metro may require capital infusion as equity or debt retirement (to the extent of sustainable debt) while Nabha doesn't require any equity support. Hyderabad Metro debt on the books as on June'20 at ~Rs15000 crore.

Results (Consolidated) Rs cr

Particulars	Q1FY21	Q1FY20	YoY %	Q4FY20	QoQ %
Net Sales	**21,260**	**29,636**	**-28.3%**	**44,245**	**-51.9%**
Total Expenditure	19,640	26,568	-26.1%	39,124	-49.8%
Operating profits	**1,620**	**3,068**	**-47.2%**	**5,121**	**-68.4%**
Other Income	777	635	22.4%	660	17.7%
Interest	1,056	587	80.0%	821	28.6%
Depreciation	672	461	45.7%	711	-5.4%
PBT	894	2,655	-66.3%	4,250	-79.0%
Exceptional item	(225)	-		-	
PBT	894	2,655	-66.3%	4,250	-79.0%
Tax	256	795	-67.7%	966	-73.5%
PAT	303	1,473	-79.4%	3,197	-90.5%
EPS (Rs.)	0.6	10.5	-94.7%	22.8	-97.5%
Margins (%)					
OPM	7.6	10.4	(273)	11.6	(395)
PATM	0.4	5.0	(460)	7.2	(686)
Tax Rate	28.7	29.9	(126)	22.7	593

Source: Company; Sharekhan Research

Segmental Performance (Rs crore)

Particulars	Q1FY21	Q1FY20	YoY/bps	Comment
Infra	**6,456**	**13,767**	**-53.1%**	Execution hindered by the lockdown across all verticals; graded resumption with limited workforce and disrupted supply chain. Stable margins attributable to favourable input cost and expense control.
PBIT margin (%)	3.8	5.1	(127)	
Power	**380**	**563**	**-32.5%**	Revenue decline reflects gradual resumption of operations during the quarter. High-value orders won last year yet to cross margin recognition threshold. Profits of MHPS and other JV companies are consolidated at PAT level under equity method.
PBIT margin (%)	(1.3)	1.5	(285)	
Heavy Engg.	**425**	**992**	**-57.1%**	Phased ramp up contracts revenue for the quarter. Margin variation on low capacity utilisation and under recoveries.
PBIT margin (%)	12.8	16.1	(335)	
Defence Engg.	**476**	**939**	**-49.3%**	Supply chain constraints hamper execution during Q1. Margins affected by job mix and under-recoveries.
PBIT margin (%)	5.2	12.9	(763)	
Hydrocarbon	**3,070**	**3,769**	**-18.5%**	Revenue growth impacted by low utilisation at yards and constraints on execution at job sites. Cost provisions and under-recovery of overheads in a restricted execution environment.
PBIT margin (%)	3.8	6.5	(271)	
IT & Tech	**6,043**	**3,844**	**57.2%**	LTI's revenue growth was led by manufacturing, CPG, retail and pharma, energy and utilities, and BFS. LTTS's revenue was largely contributed by strong growth in the medical devices vertical. Mindtree revenue growth was led by the communications, media and technology vertical. Quick transition to WFH at the onset of the pandemic. Headwinds being seen on pricing and staff furloughs.
PBIT margin (%)	16.0	20.4	(440)	
Developmental proj.	**554**	**1,178**	**-53.0%**	Revenue largely contributed by the power development business. Lower power demand during the lockdown led to revenue decline. Hyd. Metro: Fully commissioned in February 2020; Operations remained under lockdown for the entire quarter. Under-recovery of fixed opex, depreciation and interest expenses.
PBIT margin (%)	(7.0)	8.0	(1,491)	
Others	**768**	**1,494**	**-48.6%**	Q1 revenue was impacted by significantly lower handover in the realty business; Low demand environment impacts industrial valves, and construction and mining equipment revenue; SW&C execution affected by the lockdown. Margin drop due to under-recovery of overheads on low volumes.
PBIT margin (%)	3.0	17.8	(1,478)	

Source: Company, Sharekhan Research

Outlook

FY2021 may be relatively weak on account of macro uncertainties, bounce back likely during FY2022: Even though the government has announced a wide-ranging raft of stimulus measures designed to alleviate stress in various sectors, it is likely that economic growth will still take a few quarters more to revive to a healthy level. Although the government has reportedly announced a slew of measures to bring in comfort to the infrastructure sector, weak finances of centre and state pose challenges in meeting planned infrastructure investments in the near term. The consolidated order book of Rs. 3,05,083 crore provides strong revenue visibility over the next two years. FY2021 may be relatively weak on account of macro uncertainties, thus we expect L&T to bounce back from FY2022, owing to multiple levers such as strong business model, diversified order book, and healthy balance sheet.

Valuation

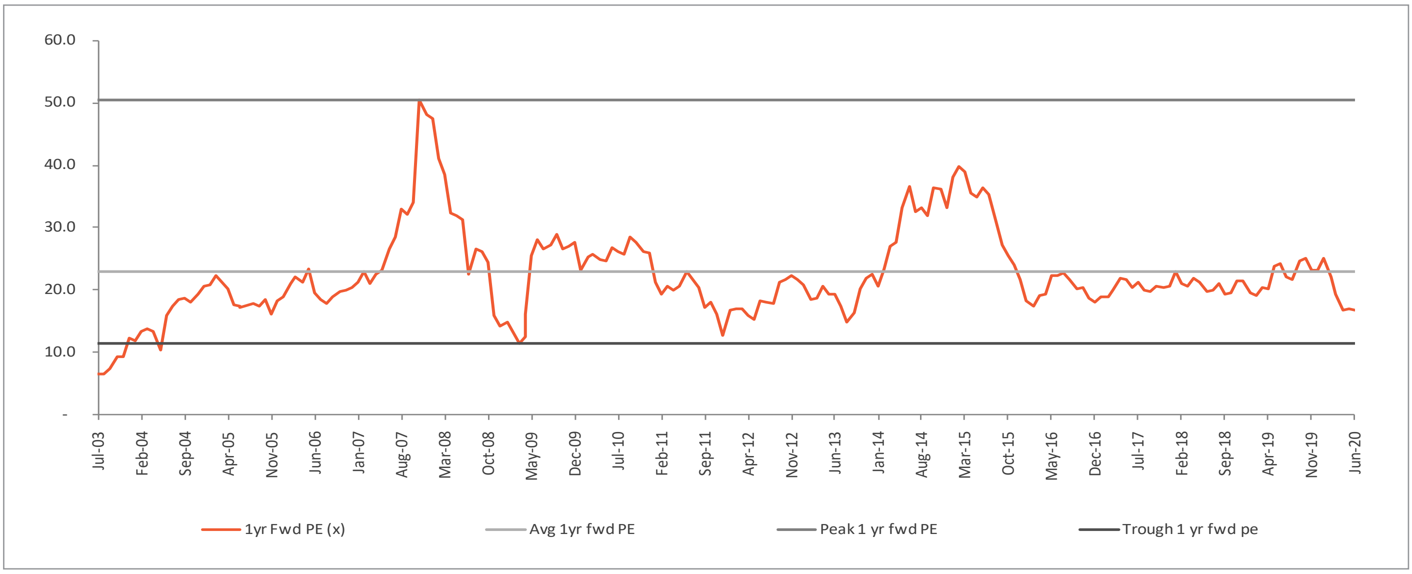
Maintain Buy with an unchanged PT of Rs. 1,250: L&T's strong order backlog along with its presence across verticals and geographies in its core E&C business provides healthy revenue visibility. Further L&T's recent order wins amidst current uncertainties and unprecedented times are likely to improve upon execution during FY2022-FY2023. Hence, we believe although FY2021 may be relatively weak on account of macro uncertainties, we expect L&T to bounce back during FY2022 owing to multiple levers such as strong business model, diversified order book, and healthy balance sheet. The company continues to focus on its strategic plan of improving its return ratios. Consequently, the steep correction in L&T's stock price provides a favourable risk reward ratio to investors (P/E of 17x/13x its FY2021E/FY2022E earnings). We have fine-tuned our estimates for FY2021-FY2022, and we continue to maintain our Buy rating with an unchanged SOTP-based PT of Rs. 1,250.

SOTP Valuation

Particulars	Remarks	Value (Rs. cr)	Per share (Rs)
L&T's core business (Standalone)	At 15x FY2022 estimates	1,08,017	771
Subsidiaries			
L&T Infotech (LTI)	Based on our target price	31,827	227
L&T Finance Holdings (L&TFH)	Based on our target price	6,615	47
L&T Technology Services Ltd (LTTS)	Based on our target price	9,969	71
Mindtree	Based on current market cap at 20% discount	8,045	57
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 & Other	At 0.8x Book Value	382	3
Total subsidiary valuation		**67,248**	**480**
Fair value		**1,75,265**	**1,250**

Source: Company, Sharekhan Research

One-year forward P/E (x) band



Source: Sharekhan Research

About company

L&T is an Indian multinational engaged in technology, engineering, construction, manufacturing, and financial services and is one of the largest players 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. With India expected to invest significantly in infrastructure creation over the next few years and with re-election of the governments providing thrust on domestic manufacturing through 'Make in India' project, companies focusing on the domestic market are in a sweet spot compared to export-centric companies. Continued emphasis on infrastructure spending with focus on rail, road, and renewable is expected to benefit L&T.

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. Further, weakness in domestic investment could impact growth and award of large projects, thus posing a downside risk. Moreover, 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	Chief Financial Officer
Shailendra Roy	Sr. Executive V.P- Power, Heavy Engineering and Nuclear
D.K. Sen	Sr. Executive V.P- Infrastructure
M.V. Satish	Sr. Executive V.P- Building, Minerals and Metals
J.D. Patil	Sr. Executive V.P- Defence

Source: Bloomberg

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Life Insurance Corp of India	14.9
2	L&T EMPLOYEES TRUST	13.22
3	HDFC Asset Management Co Ltd	4.49
4	SBI Funds Management Pvt Ltd	3.55
5	General Insurance Corp of India	1.8
6	ICICI Prudential Asset Management	1.79
7	Republic of Singapore	1.76
8	Reliance Capital Trustee Co Ltd	1.65
9	ICICI Prudential Life Insurance Co	1.42
10	Kotak Mahindra Asset Management Co	1.28

Source: Bloomberg

Sharekhan

by BNP PARIBAS

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Compliance Officer: Mr. Joby John Meledan; Tel: 022-61150000; email id: compliance@sharekhan.com;

For any queries or grievances kindly email igc@sharekhan.com or contact: myaccount@sharekhan.com

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