

Sector: Capital Goods

Company Update

	Change
Reco: Buy	↔
CMP: Rs. 982	
Price Target: Rs. 1,250	↔

↑ Upgrade ↔ No change ↓ Downgrade

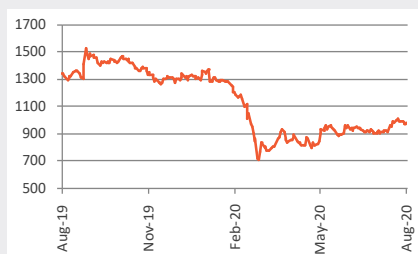
Company details

Market cap:	Rs. 137,848 cr
52-week high/low:	Rs. 1554/661
NSE volume: (No of shares)	56.9 lakh
BSE code:	500510
NSE code:	LT
Sharekhan code:	LT
Free float: (No of shares)	140.4 cr

Shareholding (%)

Promoters	0.0
FII	18.8
DII	36.1
Others	45.2

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	8%	9%	-17%	-27%
Relative to Sensex	5%	-14%	-20%	-32%

Sharekhan Research, Bloomberg

Larsen and Toubro (L&T) remains at the forefront to reap benefits from the recently-announced Atma Nirbhar Bharat scheme from the government of India with its diversified businesses across sectors like defence, infrastructure (roads, railways, metros, DRC), heavy engineering, IT (digitalisation). In the recent move from the Ministry of Defence, wherein the import embargo was placed for 101 defence items will prove to be beneficial for L&T as it is already manufacturing more than 50% of the items stated in the first negative list of 101 items. The company have been focusing on the defence manufacturing and have also been ramping up operations (invested ~Rs. 8,000 crore) in the space over the last few year. Further, the government's announcement to create a domestic capital procurement budget of Rs. 52,000 crore with intention to scale-up allocation at a 15% CAGR over the next five years augurs well for the company. Further, the National Infrastructure Pipeline project formulated by the government is likely to lead to increased spends in critical areas, L&T is poised to capitalise on these opportunities. The company's more than 95% of the sites being operational and gradual improvement seen in labour force is expected to witness recovery in execution with improvement more evident from H2FY21. The focus remains on improving productivity with new norms like social distancing at workforce in place; but the company is well-placed to overcome the current challenges and expects normalisation in the second half of FY2021. Company has bagged orders in the range of Rs 1,000-2,500 crore across its businesses such as water effluents, power T&D and Building & Factories till date in Q2FY21. Order backlog remains diversified and healthy at ~Rs. 3,05,083 crore (2.2x TTM revenue) in Q1FY21. In the concluded quarter, the management indicated that the order pipeline stood at Rs. 6.5 lakh crore comprising Rs. 5.3 lakh crore of domestic orders and Rs. 1.2 lakh crore of international orders. Segmental break-up of the order pipeline is as follows - Infrastructure - Rs. 1.5 lakh crore; Power T&D: Rs. 60,000 crore; Defence - Rs. 10,000 crore and collections from clients have been normal through the quarter (both from the states and Centre) and the company has restricted working capital to the extent of collections with well-managed cash flow during the quarter. We expect L&T to sail through a weak FY2021 as it is well-placed to ride 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 (at a P/E of 18.8x/14.5x its FY2021E/FY2022E earnings). Hence, we maintain our Buy rating on the stock with an unchanged SOTP-based price target (PT) of Rs. 1,250.

L&T to benefit from Aatma Nirbhar Bharat Defence push: In the recent move from Ministry of Defence, wherein the import embargo was placed for 101 defence items will prove to be beneficial for L&T as it is already manufacturing more than 50% of the items stated in the first negative list of 101 items and intends to add more items so as to enhance the business opportunity. The company have been focusing on defence manufacturing and have also been ramping up operations (invested ~Rs 8000 crore) in the space over the last few year. Further, the government's announcement to create a domestic capital procurement budget of Rs 52,000 crore with an intention to scale up allocation at a 15% CAGR over next five years augurs well for the company.

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 amid 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 a healthy balance sheet. The company continues to focus on its strategic plan of improving return ratios. Consequently, the steep correction in L&T's stock price provides a favourable risk-reward ratio to investors (P/E of 18.8x/14.5x its FY2021E/FY2022E earnings). Hence, we 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)

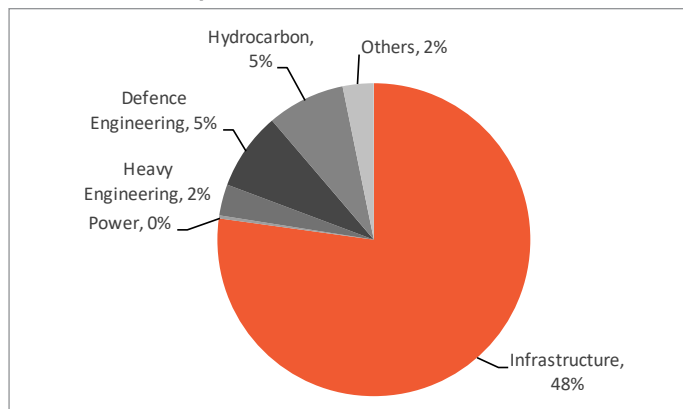
Particulars	FY19	FY20	FY21E	FY22E
Revenue	1,35,220	1,45,452	1,43,889	1,62,237
OPM (%)	11.3	11.2	11.0	11.5
Adjusted PAT	8,905	9,549	7,308	9,487
% y-o-y growth	20.8	7.2	(23.3)	29.8
Adjusted EPS (Rs.)	63.4	68.0	52.1	67.7
P/E (x)	15.5	14.5	18.8	14.5
P/B (x)	2.2	2.1	1.9	1.8
EV/EBITDA (x)	13.4	13.0	13.9	11.8
RoNW (%)	14.2	13.8	10.6	12.7
RoCE (%)	7.4	7.2	6.5	7.5

Source: Company; Sharekhan estimates

L&T to benefit from Aatma Nirbhar Bharat Defense push: The Ministry of Defence (MoD) announced an import embargo list of 101 defence items under the Aatma Nirbhar Bharat and Make in India initiatives. This was one of the major steps proposed in the Draft Defence production and Export Promotion Policy (DPEPP) 2020. The decision offers a great opportunity to the Indian defence industry to manufacture the items in the negative list by using their own design and development capabilities or adopting technologies designed & developed by the DRDO to meet the needs of Armed Forces in the coming years. L&T remains the key beneficiary for the same as L&T is already manufacturing more than 50% of the items stated in the 1st negative list of 101 items and intends to add more items so as to enhance the business opportunity in the space. The company have been focusing on the defence manufacturing and have also been ramping up operations (invested ~Rs 8,000 crore) in the space over the last few year. L&T expects the submarine order of Rs 40,000 crore where L&T and Mazgaon docks have been shortlisted as a strategic partner to finalize over the next year, which if procured successfully can be a game changer for L&T. Further, the government’s announcement to create Domestic capital procurement budget of Rs 52,000 crore with intention to scale up allocation at 15% CAGR over next five years augurs well for the company. L&T order book in defence comprises at present ~3% of the total order book and is currently 2.7% overall FY20 revenues and expected to gain from the recent initiatives by government in defence.

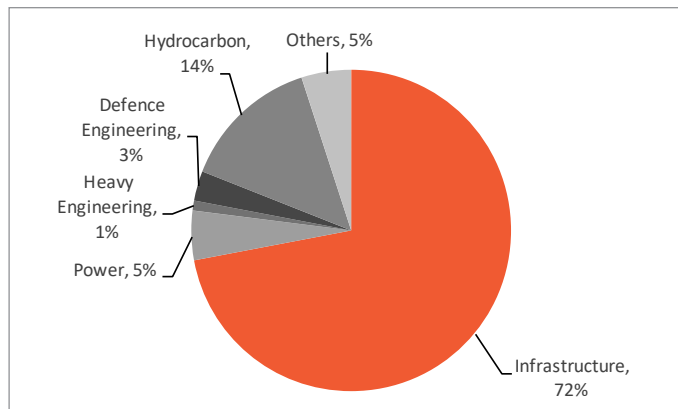
Strong diversified order book provides healthy revenue visibility: The company has bagged orders of Rs 1,000-2,500 crore across businesses such as water effluents, Power, T&D and Building & Factories, till date in Q2FY21. The order backlog remains diversified and healthy at ~Rs. 3,05,083 crore (2.2x TTM revenue) in Q1FY21. In the concluded quarter management indicated that order pipeline of 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 - Rs. 1.5 lakh crore; Power and T&D - Rs. 60,000 crore; Defence – Rs. 10,000 crore.

Order inflow composition



Source: Company, Sharekhan Research

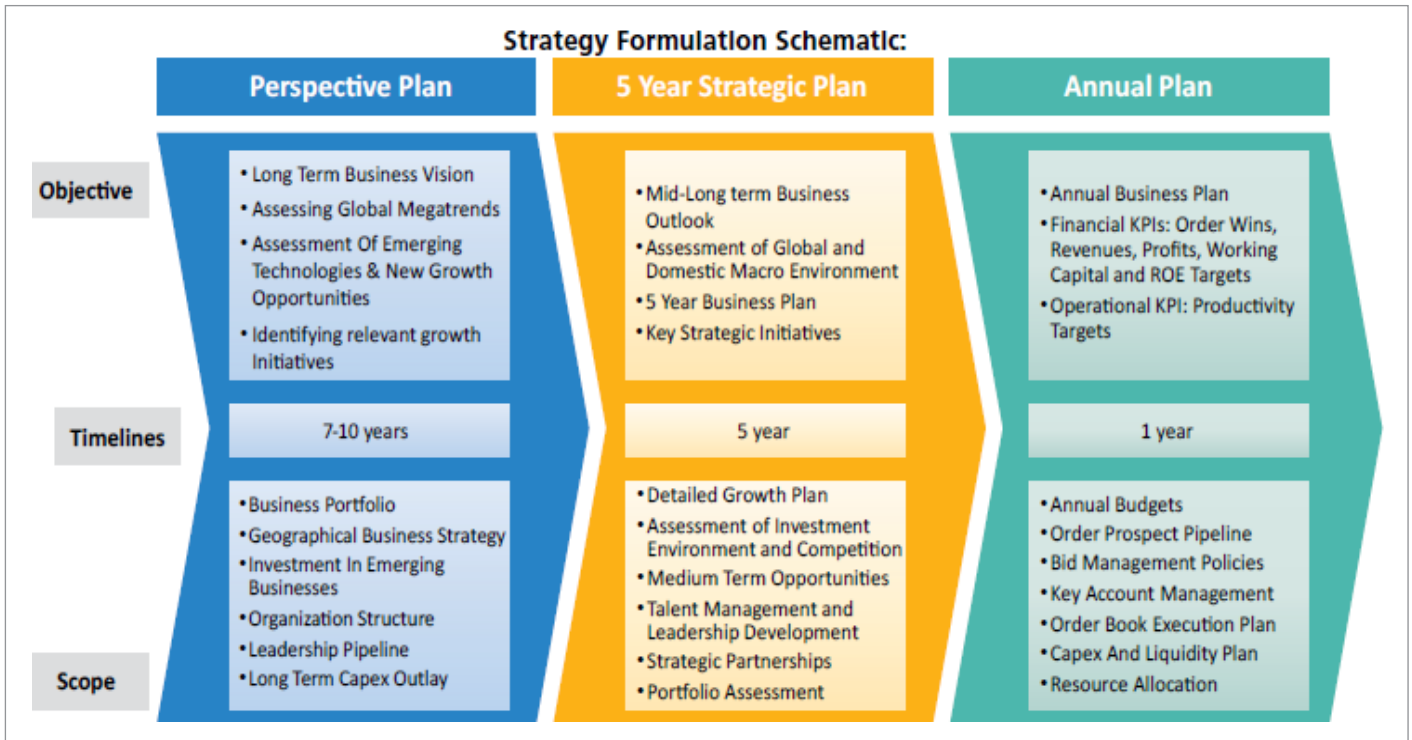
Order book trend



Source: Company, Sharekhan Research

Focus remains on working capital management: Collections from clients have been normal through the quarter (both from the states and the Centre) and the company has restricted working capital to the extent of collections with well-managed cash flow during the quarter. Working capital improvement has been one of the key focus area for L&T, however in the current challenging business environment, the working capital cycle has seen elongation from 18% in 4QFY19 to 26% in 1QFY21 as company provided vendor support and as execution slumped in Q1FY21 given lockdown. L&T suggested that cash collection from customers remain healthy and is able to support the existing level of operations. However, as execution level reaches normalcy, collection from customers would be closely monitored. The management is clear on giving preference to cash over revenue and will prefer to execute projects with timely cash payments from customers, ensuring that the working capital cycle remains within control.

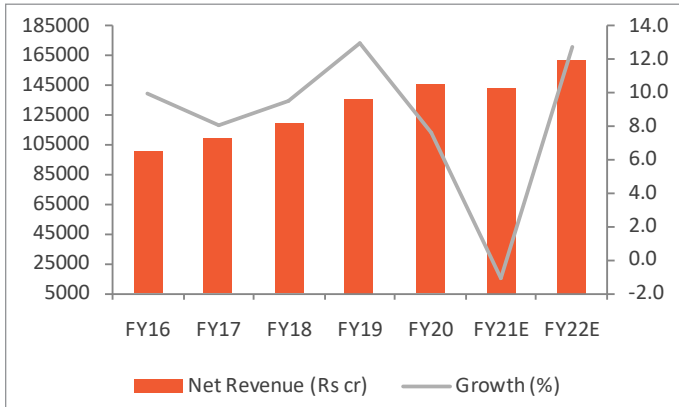
Strategic planning: Lakshya 2026; far more comprehensive: L&T has set out three plans with time horizons ranging from long term (7-10 years) to medium term (5 years) to short-term (annual) to exploit its strengths, identify new opportunities and build fresh capabilities. FY20-21 was the terminal year for the current five year strategic plan (Lakshya 21), which faced sharper cyclical headwinds along with additional burden of COVID-19. L&T will be undertaking the development of next five years' strategic plan 'Lakshya 2026'. The new plan's focus will be to capitalise on changes in various industry segments as well as focus on new areas of business factoring impact of COVID-19 to ensure profitable growth in the future.



Source: Company, Sharekhan Research

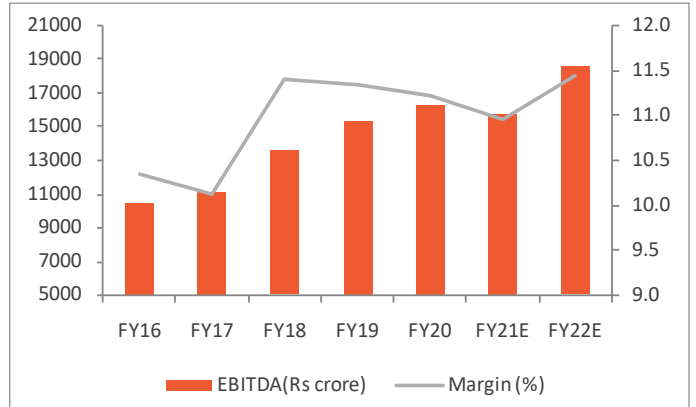
Financials in charts

Revenue trend



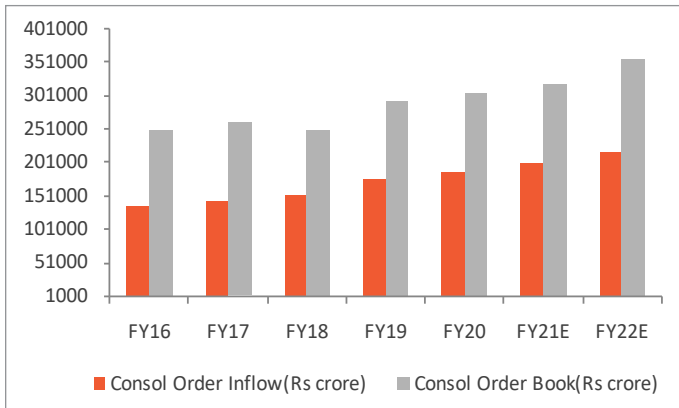
Source: Company, Sharekhan Research

EBITDA and margin trend



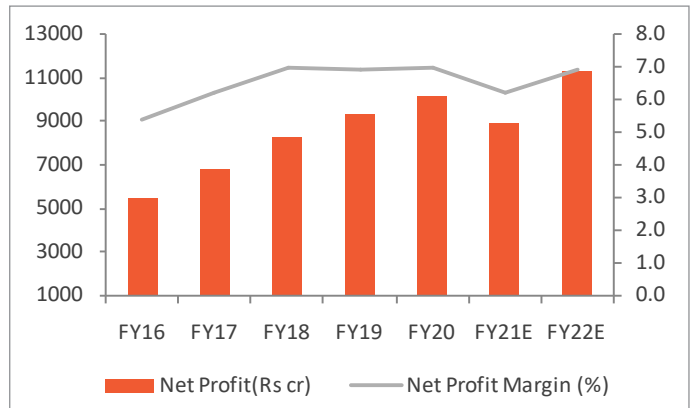
Source: Company, Sharekhan Research

Order inflow and order book trend



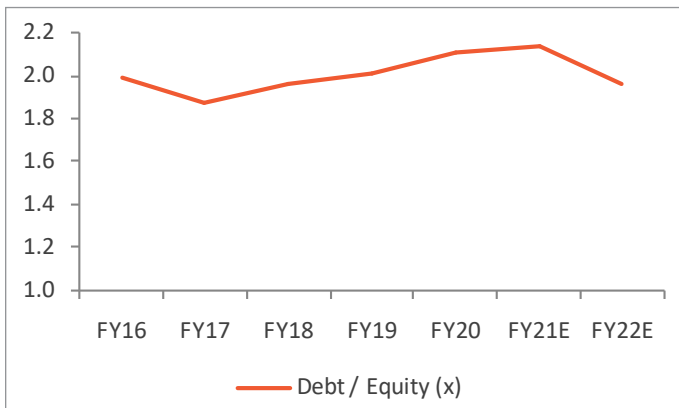
Source: Company, Sharekhan Research

Net profit and profit margin trend



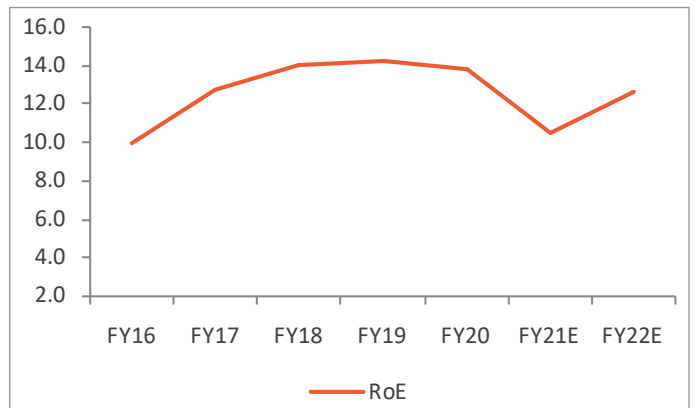
Source: Company, Sharekhan Research

Debt: Equity trend



Source: Company, Sharekhan Research

RoE trend



Source: Company, Sharekhan Research

Outlook

FY2021 may be relatively weak on account of macro uncertainties, gradual improvement from H2FY21: 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 comfort to the infrastructure sector, weak finances of the Centre and state governments pose challenges in meeting the planned infrastructure investments in the near term. The consolidated order book as of Q1FY2021 stood at Rs. 3,05,083 crore, provides strong revenue visibility over the next two years. FY2021 may be relatively weak on account of macroeconomic 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

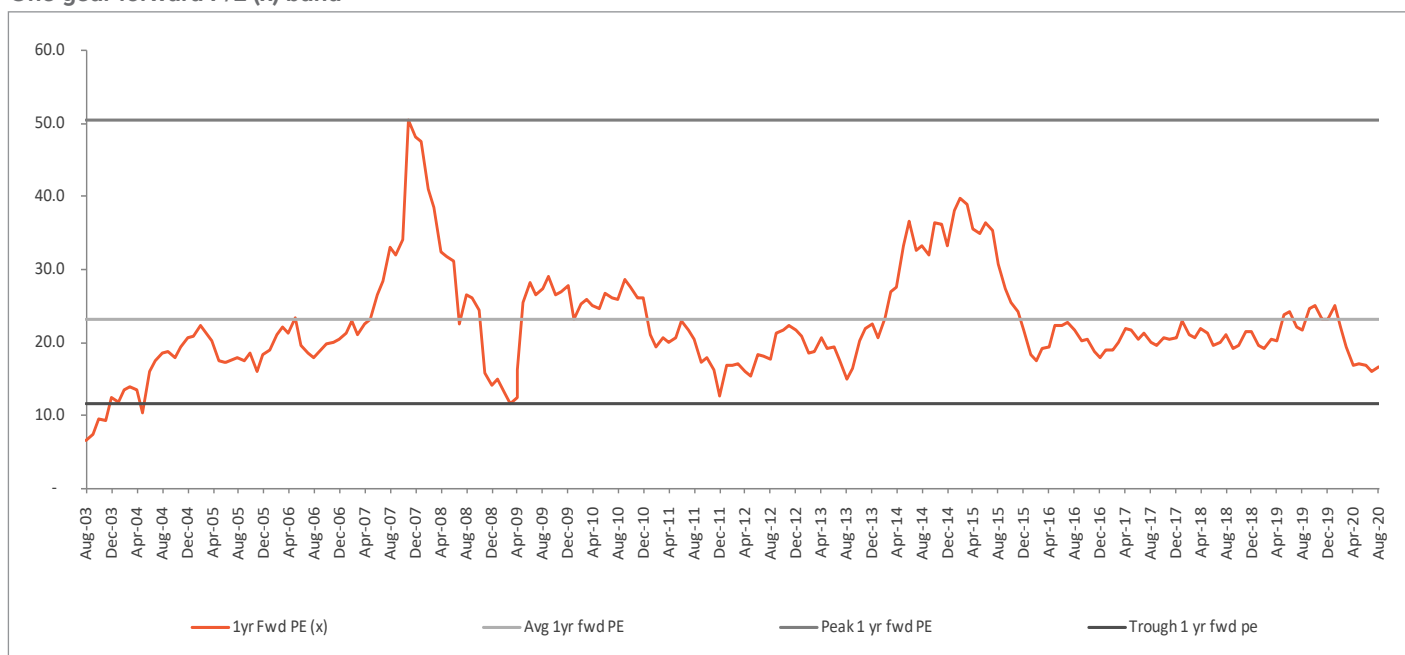
Maintain Buy with an unchanged PT of Rs. 1,250: L&T's strong order backlog along with its presence across verticals and geographies in its core E&C business provides healthy revenue visibility. Further L&T's recent order wins amid current uncertainties and unprecedented times are likely to improve upon 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 a healthy balance sheet. The company continues to focus on its strategic plan of improving return ratios. Consequently, the steep correction in L&T's stock price provides a favourable risk-reward ratio to investors (P/E of 18.8x/14.5x its FY2021E/ FY2022E earnings). Hence, we 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
<i>Subsidiaries</i>			
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.
- ◆ 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	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	14.90
2	L&T EMPLOYEES TRUST	13.37
3	HDFC Asset Management Co Ltd	4.42
4	SBI Funds Management Pvt Ltd	4.02
5	Republic of Singapore	2.25
6	ICICI Prudential Life Insurance Co	1.82
7	General Insurance Corp of India	1.80
8	ICICI Pru AMC	1.74
9	Kotak Mahindra AMC	1.33
10	Reliance Capital Trustee Co Ltd	1.21

Source: Bloomberg

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