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Larsen & Toubro Ltd.

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L&T is an engineering & construction (E&C) conglomerate. Further, it has presence in IT & financial services sectors.

Investment Rationale

Revenue to grow at 12% CAGR over FY17-20E

Consolidated sales registered 10% YoY growth in Q3FY18 led by strong execution in infrastructure, hydrocarbon and heavy engineering segments. With pick-up in domestic execution, Infrastructure segment witnesses 10% YoY growth in Q3FY18. Growth in heavy engineering (up 14% YoY) was driven by higher execution of defence orders while hydrocarbons reported strong growth (up 29% YoY) on the back of healthy execution of internation order book. Development projects segment benefitted from favorable court orders on Nabha power. On the flip side, power segment (down 22% YoY) reported dismal numbers on account of weak order book and order inflow due to aggressive competition. Others segment (down 14% YoY) was impacted by lower industrial offtake and delay in clearances. The management maintained its sales growth guidance of 12% and margin improvement of 25bps YoY excluding services for FY18. We factor revenue CAGR of ~12% over FY17-20E.

EBITDA margin to stay healthy

Overall EBITDA margin expanded by 134 bps YoY to 10.9%in Q3FY18 supported largely by services business. Margin in Infrastructure segment (down 50bps YoY) was impacted by job mix and non-recognition of revenue in certain projects which didn't meet revenue recognition threshold. While Electrical and Automation segment witnessed 170 bps YoY improvement in margin led by product mix and operation efficiencies, hydrocarbon segment saw margin improvement due to higher execution and close of all legacy orders. Development projects margin witnessed sharp improvement with EBITDA margin of 8.5% (-10.6% in Q3FY17) on recognition of revenue and margin for Nabha project. On the other hand, heavy engineering reported lower margin (down 150 bps YoY) largely due to job mix. Adj PAT increased by robust 55% YoY owing to strong operational performance and lower depreciation. Going ahead, we estimate EBITDA margin of 11.1/11.5/11.8% for FY18E/19E/20E.

Domestic Order inflow up 71% YoY; Order backlog up 5% YoY

Backed by strong order inflow from the domestic market, overall order inflows were up by 38% YoY. This was largely led by uptick in orders from infrastructure and hydrocarbon space. As a result, order backlog increased by 5% YoY to Rs 2,707 bn. The order pipeline continues to be healthy with a few large orders expected in infrastructure and defence segments. We factor order inflow CAGR of 9% over FY17-20E for core E&C segment.

Valuation: We project Sales/PAT CAGR of 12.2/17.5% over FY17-20E. Recovery in domestic business, strong order pipeline, sale of non-core assets, focus on improving RoE & working capital and healthy execution of large order backlog will drive the stock going forward. Hence, we recommend 'BUY' rating on the stock with SOTP based TP of Rs. 1,515.

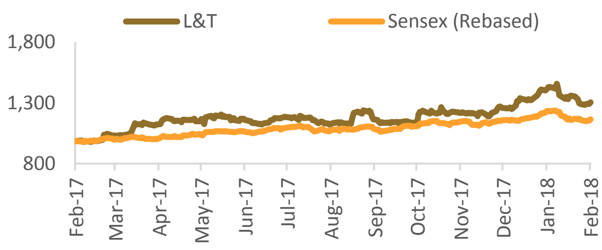
Market Data

Rating	**BUY**
CMP (Rs.)	1,339
Target (Rs.)	**1,515**
Potential Upside	13%
Duration	Long Term
Face Value (Rs.)	2
52 week H/L (Rs.)	1,470/974
Adj. all time High (Rs.)	1,470
Decline from 52WH (%)	8.9
Rise from 52WL (%)	37.5
Beta	1.1
Mkt. Cap (Rs.Cr)	187,522

Fiscal Year Ended

Y/E	FY17	FY18E	FY19E	FY20E
Revenue (Rs.Cr)	1,09,312	1,21,730	1,37,496	1,55,142
Adj. Net profit (Rs.Cr)	5,920	7,052	8,085	9,646
Adj. EPS (Rs.)	42.3	50.4	57.7	68.9
Adj. P/E (x)	31.7	26.6	23.2	19.4
P/BV (x)	3.7	3.4	3.1	2.8
ROE (%)	12.5	13.5	14.2	15.4

One year Price Chart

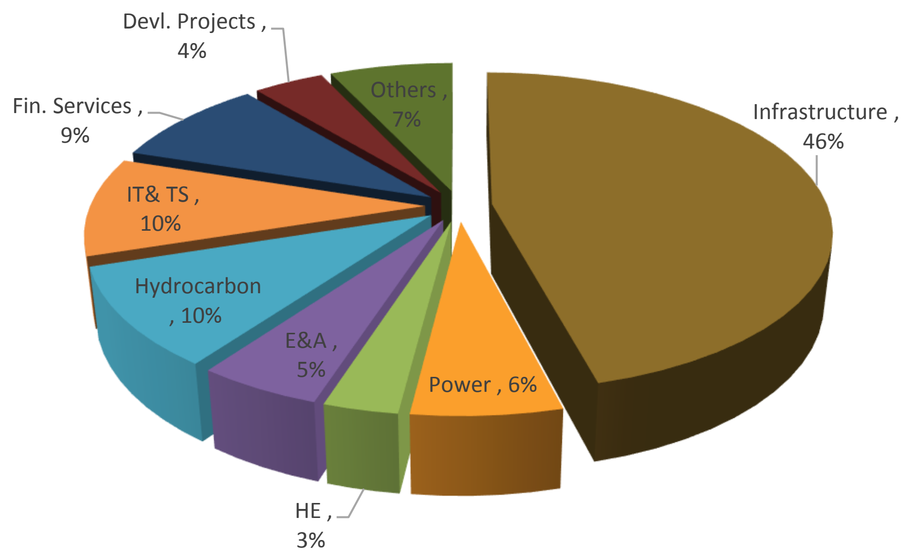


Shareholding Pattern	Dec-17	Sep-17	Chg.
Promoters	0.0	0.0	0.0
FII's	17.6	17.2	0.4
MFs/Insti	52.3	52.8	(0.5)
Public	21.8	21.1	0.7
Others	8.3	8.9	(0.6)

L&T Ltd: Business overview

Larsen & Toubro Ltd (L&T) is India's largest engineering and construction (E&C) company. The company operates in various key sectors include; hydrocarbon, infrastructure, power, process industries and defence. Further, it has presence in IT & financial services sectors. The company operates in over 30 coutries world wide. As at March 31, 2017, L&T Group comprises of 89 subsidiaries, 10 associates, 34 joint venture companies and 27 joint operations.

L&T revenue mix



Source: Company

Quarterly Financials (Consolidated)

(Rs cr)	Q3FY18	Q3FY17	YoY Growth %	Q2FY18	QoQ Growth %	9MFY18	9MFY17	YoY Growth %
Sales	**28,747**	**26,110**	*10.1*	**26,447**	*8.7*	**79,005**	**72,693**	*8.7*
EBITDA	**3,144**	**2,505**	*25.5*	**2,962**	*6.1*	**8,163**	**6,709**	*21.7*
Margin (%)	10.9	9.6	*134bps*	11.2	*(26bps)*	10.3	9.2	*110bps*
Depreciation	454	722	*(37.1)*	431	*5.6*	1,436	1,647	*(12.8)*
EBIT	**2,690**	**1,783**	*50.8*	**2,531**	*6.2*	**6,727**	**5,062**	*32.9*
Interest	362	379	*(4.3)*	393	*(7.7)*	1,120	1,043	*7.4*
Other Income	213	274	*(22.4)*	400	*(46.7)*	997.4	1,031.9	*(3.3)*
Exceptional Items	(14)	-	-	137	-	123	402	-
PBT	**2,526**	**1,679**	*50.5*	**2,675**	*(5.6)*	**6,727**	**5,453**	*23.3*
Tax	737	440	*67.6*	544	*35.5*	1,741	1,669	*4.3*
Minority Interest/ P/L of Associates	(299)	(266)	*12.3*	(311)	*(3.9)*	(783)	(767)	*2.1*
Reported PAT	**1,490**	**973**	*53.2*	**1,820**	*(18.1)*	**4,202**	**3,017**	*39.3*
Adjustment	14	-	-	(137)	-	123	402	-
Adj PAT	**1,504**	**973**	*54.6*	**1,683**	*(10.7)*	**4,079**	**2,614**	*56.0*
No. of shares (cr)	140.0	140.0	-	140.0	-	140.0	140.0	-
EPS (Rs)	**10.7**	**6.9**	*54.6*	**12.0**	*(10.7)*	**29.1**	**18.7**	*56.0*

Source: Company, In-house research

Revenue to grow at 12% CAGR over FY17-20E

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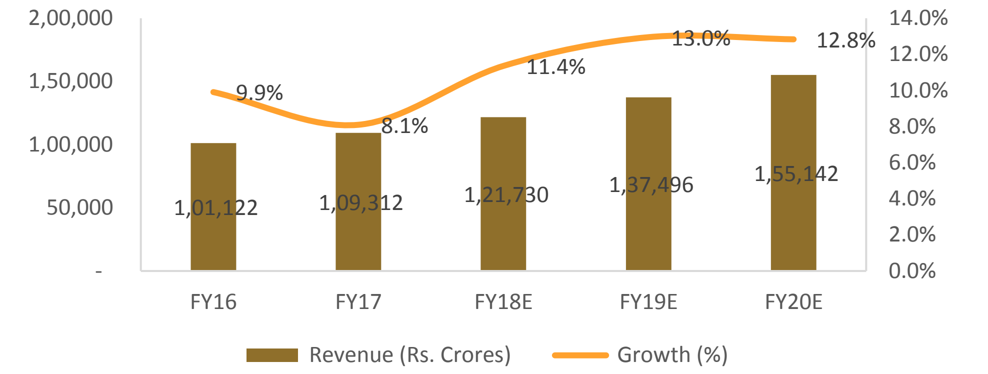
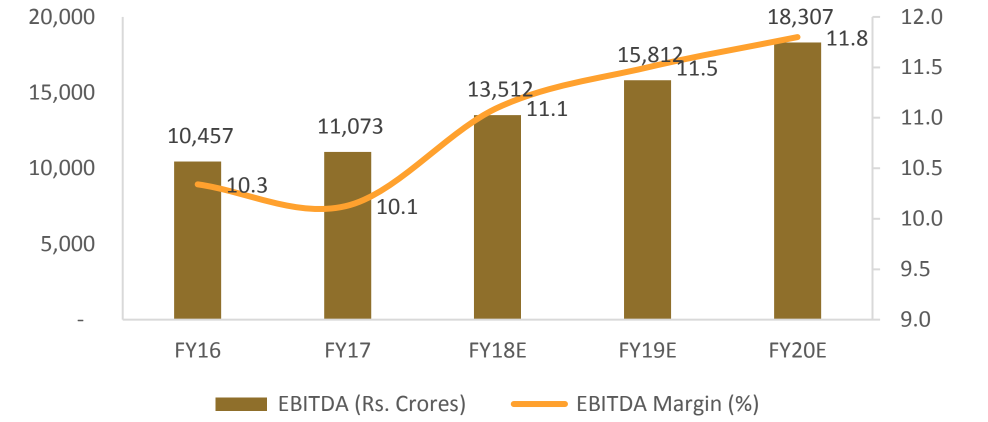
Robust order pipeline

Backed by strong order inflow from the domestic market, overall order inflows were up by 38% YoY. This was largely led by uptick in orders from infrastructure and hydrocarbon space. As a result, order backlog increased by 5% YoY to Rs 2,707 bn. The order pipeline continues to be healthy with a few large orders expected in infrastructure and defence segments. We factor order inflow CAGR of 9% over FY17-20E for core E&C segment.

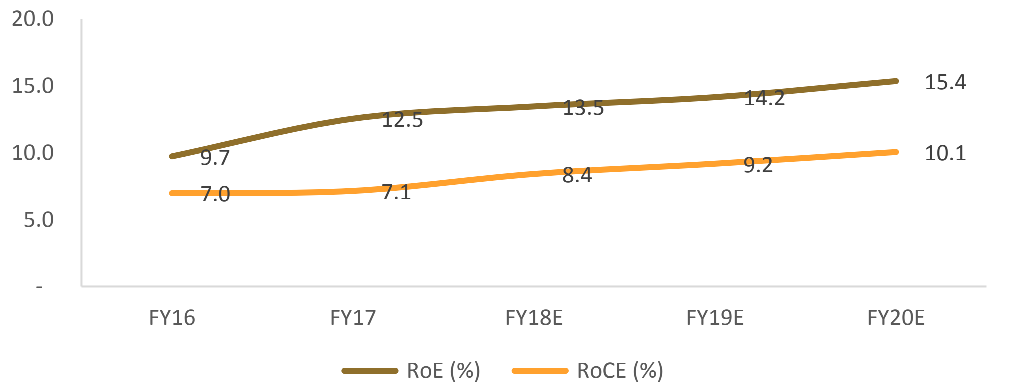
Revenue to grow at 12% CAGR over FY17-20E



Ebitda to grow at 18% CAGR over FY17-20E



Return ratios trend



Source: Company, In-house research

Key risks:

- Slow down in economic growth can adversely impact order book
- Dealy in timely execution of projects

Profit & Loss Account (Consolidated)

Y/E (Rs.Cr)	FY17	FY18E	FY19E	FY20E
Total operating Income	**1,09,312**	**1,21,730**	**1,37,496**	**1,55,142**
EBITDA	**11,073**	**13,512**	**15,812**	**18,307**
Depreciation	2,368	2,016	2,395	2,704
EBIT	**8,705**	**11,496**	**13,417**	**15,603**
Interest cost	1,340	1,495	1,550	1,581
Other Income	1,401	1,350	1,418	1,488
Profit before tax	**8,766**	**11,350**	**13,285**	**15,511**
Tax	2,007	3,178	4,118	4,808
Profit after tax	**6,760**	**8,172**	**9,167**	**10,702**
Minority Interests	444	650	683	717
P/L from Associates	(395)	(470)	(400)	(340)
Adjusted PAT	**5,920**	**7,052**	**8,085**	**9,646**
E/o income / (Expense)	121	123	-	-
Reported PAT	**6,041**	**7,175**	**8,085**	**9,646**

Balance Sheet (Consolidated)

Y/E (Rs.Cr)	FY17	FY18E	FY19E	FY20E
Paid up capital	187	280	280	280
Reserves and Surplus	50,030	54,292	59,410	65,685
Net worth	**50,217**	**54,572**	**59,690**	**65,965**
Minority Interest	3,564	4,214	4,896	5,613
Total Debt	93,976	98,976	1,00,976	1,02,976
Other non-current liabilities	2,386	2,386	2,386	2,386
Total Liabilities	**1,50,142**	**1,60,148**	**1,67,948**	**1,76,940**
Net fixed assets	15,105	17,560	18,665	18,961
Capital WIP	13,471	12,500	12,000	12,000
Goodwill	1,399	1,399	1,399	1,399
Investments	19,753	19,753	19,753	19,753
Net Current Assets	**44,853**	**53,375**	**60,570**	**69,266**
Deferred tax assets (Net)	1,125	1,125	1,125	1,125
Other non-current assets	54,436	54,436	54,436	54,436
Total Assets	**1,50,142**	**1,60,148**	**1,67,948**	**1,76,940**

Cash Flow Statement (Consolidated)

Y/E (Rs.Cr)	FY17	FY18E	FY19E	FY20E
Pre tax profit	8,766	10,880	12,885	15,171
Depreciation	2,370	2,016	2,395	2,704
Chg in Working Capital	(1,763)	(7,108)	(7,494)	(8,368)
Others	63	145	132	92
Tax paid	(3,202)	(3,178)	(4,118)	(4,808)
Cash flow from operating activities	**6,234**	**2,756**	**3,801**	**4,791**
Capital expenditure	(2,979)	(3,500)	(3,000)	(3,000)
Chg in investments	(5,609)	-	-	-
Other investing cashflow	(1,153)	1,350	1,418	1,488
Cash flow from investing activities	**(9,740)**	**(2,150)**	**(1,583)**	**(1,512)**
Equity raised/(repaid)	53	0	-	-
Debt raised/(repaid)	5,073	5,000	2,000	2,000
Dividend paid	(2,093)	(2,697)	(2,967)	(3,371)
Other financing activities	494	(1,495)	(1,550)	(1,581)
Cash flow from financing activities	**3,527**	**808**	**(2,516)**	**(2,952)**
Net chg in cash	21	1,414	(298)	327

Key Ratios (Consolidated)

Y/E	FY17	FY18E	FY19E	FY20E
Valuation(x)				
P/E	31.7	26.6	23.2	19.4
EV/EBITDA	25.2	21.0	18.1	15.8
EV/Net Sales	2.6	2.3	2.1	1.9
P/B	3.7	3.4	3.1	2.8
Per share data				
EPS	42.3	50.4	57.7	68.9
DPS	14.0	16.0	17.6	20.0
BVPS	358.6	389.7	426.2	471.0
Growth (%)				
Net Sales	8.1	11.4	13.0	12.8
EBITDA	5.9	22.0	17.0	15.8
Net profit	43.1	19.1	14.6	19.3
Operating Ratios				
EBITDA Margin (%)	10.1	11.1	11.5	11.8
EBIT Margin (%)	8.0	9.4	9.8	10.1
PAT Margin (%)	5.4	5.8	5.9	6.2
Return Ratios (%)				
RoE	12.5	13.5	14.2	15.4
RoCE	7.1	8.4	9.2	10.1
Turnover Ratios (x)				
Net Sales/GFA	5.7	5.7	5.5	5.5
Sales/Total Assets	0.5	0.6	0.6	0.6
Liquidity and Solvency Ratios (x)				
Interest Coverage	6.5	7.7	8.7	9.9
Debt/Equity	1.7	1.7	1.6	1.4

Rating criteria

Large Cap.	Return	Mid/Small Cap.	Return
Buy	More than equal to 10%	**Buy**	More than equal to 15%
Hold	Upside or downside is less than 10%	**Accumulate***	Upside between 10% & 15%
Reduce	Less than equal to -10%	**Hold**	Between 0% & 10%
		Reduce/sell	Less than 0%

***** To satisfy regulatory requirements, we attribute 'Accumulate' as Buy and 'Reduce' as Sell.

***** L&T is a large cap company

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