

Stock Update

On a strong footing; Buy

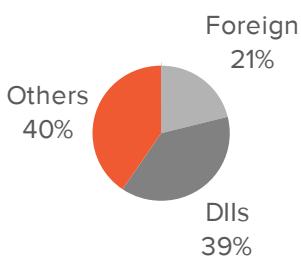
Larsen & Toubro

Reco: Buy | CMP: Rs1,286

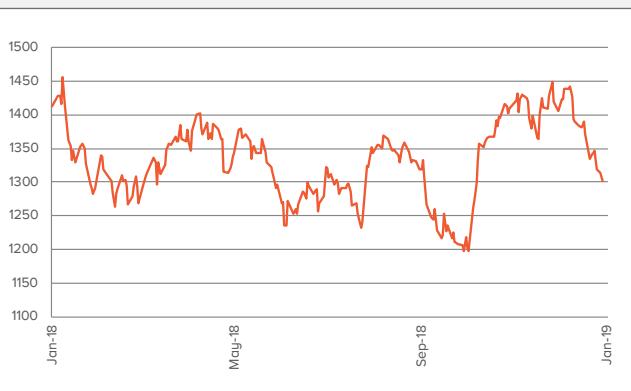
Company details

Price target:	Rs1,655
Market cap:	Rs180,262 cr
52-week high/low:	Rs1470/1183
NSE volume: (No of shares)	2.0 lakh
BSE code:	500510
NSE code:	LT
Sharekhan code:	LT
Free float: (No of shares)	140.2 cr

Shareholding pattern



Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	-7.8	6.3	-0.9	-6.4
Relative to Sensex	-9.7	-0.3	0.4	-7.6

Key points

- Outperformance continues on execution along with stable operating margins: In Q3FY2019, the consolidated net sales of Larsen & Toubro (L&T) were ahead of our estimates, driven by healthy execution and strong order backlog during the quarter. Net sales grew by 24% y-o-y to Rs. 35,709 crore, driven by strong execution in the project business along with strong performance in the service business. Revenue was mainly driven by strong growth in domestic sales led by infra, realty, hydrocarbon and services business. Operating efficiencies led to operating profit margin (OPM) expanding by 26 BPS to 11.2% (in-line with our estimate), leading to 27% y-o-y growth to Rs. 3,996 crore in operating profit. The company had increased debt during Q3FY2019 as a buffer due to volatile liquidity environment and to execute planned buy-back plan. The funds parked in investments generated higher treasury income (other income up 183% y-o-y) leading to 35% y-o-y growth in net profit to Rs. 2,230 crore.

- Order inflows better than expected considering high base during Q3FY2018: During Q3FY2019, the order inflow was fairly good in tough macro environment and was better than expected. Order inflow for the quarter came in at Rs 42,333 crore down by 12% y-o-y due to high base (order inflow skewed towards H2FY2018 as against evenly spread during 9MFY2019). The international order grew 30% y-o-y to Rs11,454 crore driven by higher order booking in Middle East and rest of the world. Domestic order inflow came in lower for the quarter at Rs 30,879 crore (-21% y-o-y). The infra, hydrocarbons and heavy engineering businesses largely contributed to order inflow growth. Thus, order backlog grew by 5% y-o-y to Rs. 2,84,049 crore at the end of Q3FY2019, which provides revenue visibility of 2.1 years on TTM basis.

- Options kept open to reward share holders: Post the SEBI rejection of buyback, the management has kept various options open for rewarding its shareholders such as special dividends. The management may also consider the option of re-opening a dialogue with SEBI at a later stage on the issue. It can also approach SAT to appeal against the order.

- Maintain Buy with unchanged PT of Rs. 1,655:** L&T delivered yet another quarter of strong overall performance in Q3FY2019. Moreover, management sees traction in order inflow across geographies, especially from the domestic market, led by public capex. Some green shoots are visible from some private players, but it expects to see acceleration in the medium term. Hence, the management reiterates its order inflow and topline guidance of 10-12%/12-15%, respectively, with 25 BPS

margin improvements on a consolidated level (excluding service business). L&T is the best play on the domestic capex cycle recovery and management's focus on the strategic plan of achieving profitable growth and increased RoE in the medium term and superior capital allocation augur well for earnings to report an 18% CAGR over FY2018-FY2020E. Hence, we maintain our Buy rating with an unchanged price target (PT) of Rs. 1,655.

Results (Consolidated)

Particulars	Q3FY19	Q3FY18	YoY %	Q2FY19	Rs cr QoQ %
Net Sales	35,709	28,747	24.2%	32,081	11.3%
Total Expenditure	31,713	25,606	23.8%	28,310	12.0%
Operating profits	3,996	3,141	27.2%	3,771	6.0%
Other Income	606	214	183.4%	425	42.6%
Interest	535	361	48.2%	399	34.0%
Depreciation	449	454	-1.2%	516	-12.9%
PBT	3,619	2,526	43.3%	3,576	1.2%
Exceptional item	-	14		(295)	
PBT	3,619	2,526	43.3%	3,576	1.2%
Tax	1,200	737	62.8%	886	35.4%
PAT	2,042	1,490	37.0%	2,230	-8.5%
Adj. PAT	2,042	1,504	35.8%	1,936	5.5%
EPS	14.6	10.7	35.7%	13.8	5.5%
Margins (%)			BPS		BPS
OPM	11.2	10.9	26	11.8	(56)
PATM	5.7	5.2	49	6.0	(32)
Tax Rate	33.2	29.2	398	24.8	838

Valuations (Consolidated)

Particulars	FY16	FY17	FY18	FY19E	FY20E
Net sales	101,122	109,312	119,683	135,379	148,772
Growth (%)	9.9	8.1	9.5	13.1	9.9
OPM (%)	10.3	10.1	11.3	11.4	11.4
Adj Net profit	4,139	5,920	7,247	9,124	10,053
EPS	29.5	42.2	51.7	65.1	71.7
Growth (%)	(6.3)	43.0	22.4	25.9	10.2
PER	43.5	30.4	24.9	19.7	17.9
P/B	4.1	3.6	3.2	2.9	2.6
EV/EBIDTA	23.0	20.6	17.6	15.1	13.9
ROCE (%)	6.1	6.2	7.8	8.2	8.8
RONW (%)	9.9	12.8	13.9	15.5	15.2

SOTP valuation		Rs cr	
Particulars	Remarks	Value (Rs cr)	Per share
L&T's core business (standalone)	At 23x FY2020 estimates	158,731	1,132
Subsidiaries			
L&T Infotech (LTI)	Based on our target price	28,502	203
L&T Finance Holdings (L&TFH)	Based on our target price	16,761	120
L&T Technology Services Ltd (LTTS)	25% holding discount to Mcap	10,559	75
Development projects (including IDPL)	At 0.8x Book Value	10,790	77
Hydrocarbon subsidiary	At 0.8x Book Value	1,300	9
Other subsidiaries	At 0.8x Book Value	4,697	34
Associates & Other	At 0.8x Book Value	620	4
Total subsidiary valuation		73,229	522
Fair value		231,960	1,655

Segmental Performance

Particulars	Q3FY19	Q3FY18	YoY/bps	Comment
Infra	18,371	14,924	23.1%	Strong growth across business verticals . Margins reflect stage of execution, job mix and cost provisions arising from execution headwinds in some transportation infra projects
PBIT margin (%)	4.2	6.2	(198)	
Power	908	1,270	-28.5%	Revenue decline reflect depleting order book due to limited opportunities and aggressive competition. Profits of MHPS and other JV companies are consolidated at PAT level under equity method
PBIT margin (%)	1.7	1.6	10	
Heavy Engg.	693	392	77.0%	Revenue growth predominantly driven by Orders from Oil & Gas and Nuclear sectors and international market showing strong traction in Refineries space. Global competence, technology differentiation, proven track record and cost efficiencies yield strong margins
PBIT margin (%)	15.1	37.3	(2,222)	
Defence Engg.	1,045	740	41.1%	Execution of tracked artillery gun order contributing to revenue growth. Margin variation due to stage of execution and job mix
PBIT margin (%)	5.3	-	531	
E&A	1,565	1,287	21.5%	Revenue growth driven by Product businesses across Industrials, Buildings, Agriculture and Rural electrification sub-sectors. Margin growth led by operational efficiencies a improved realisation
PBIT margin (%)	13.9	13.6	29	
Hydrocarbon	3,778	3,090	22.3%	Higher Order Book and efficient execution leads to strong revenue growth. Stable margins and superior ROIC obtained through execution efficiency
PBIT margin (%)	7.1	6.8	37	
IT & Tech	3,764	2,915	29.1%	Strong growth by LTI a LTTS continues in 3Q. LTI Q3 revenue growth led by BFS, CPG, Retail & Pharma and High-Tech, Media Et Entertainment verticals. LTTS Q3 revenue growth led by Transportation, Telecom & Hi-Tech and Process Industry verticals. Margin improvement aided by operational efficiencies
PBIT margin (%)	20.2	19.2	108	
Financials	3,259	2,634	23.7%	The business successfully navigated a volatile liquidity environment in Q3; liquidity conditions currently stable. Focus is on increased retiralisation, stable NIMs, containment of credit costs, ALM / Interest rate management and superior ROE
PBIT margin (%)	23.8	14.1	967	
Developmental proj.	1,194	1,032	15.7%	Segment includes Power Development business, Hyderabad Metro and Kattupalli Port (until divestment). Higher PLF drives revenue in Nabha Power. Drop in margins due to higher operating cost in Nabha
PBIT margin (%)	2.7	6.5	(379)	
Others	1,661	962	72.7%	Segment comprises Industrial Products & Machinery (IPM) and Realty business; PY includes Welding Products Business. Revenue & Margin growth largely contributed by Realty business. Steady revenue growth in Construction & Mining Business
PBIT margin (%)	43.9	23.6	2,028	

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

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