

Stock Update

A strategic fit; retain Buy

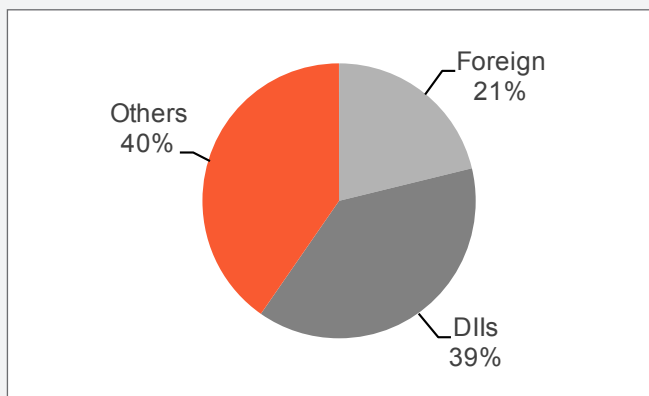
Larsen & Toubro

Reco: Buy | CMP: Rs1,357

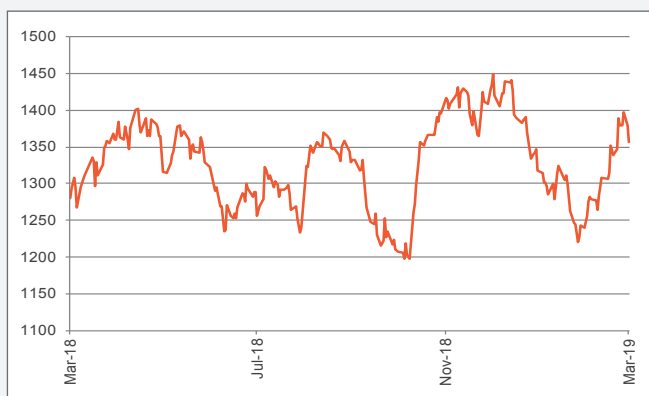
Company details

Price target:	Rs1,655
Market cap:	Rs190,301 cr
52-week high/low:	Rs1459/1183
NSE volume: (No of shares)	27.3 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	10.8	-3.5	3.8	10.0
Relative to Sensex	3.1	-8.1	1.2	-5.4

Key points

- L&T to acquire significant stake in Mindtree:** Larsen and Toubro (L&T) has entered into a share purchase agreement with Mr. V. G. Siddhartha, Coffee Day Trading Limited and Coffee Day Enterprises Limited for acquisition of 20.32% stake in Mindtree aggregating to Rs 3269 crore. Going forward, the company wishes to deploy close to Rs10,700 crore to buy 66.7% stake in Mindtree.
- Cash rich balance sheet:** L&T's cash including investments on its consolidated balance sheet at the end of Q3FY19 stands at approximately Rs 23,900 crore with standalone D/E ratio of 0.4x and the company generates close to Rs5,000 crore of free cash flows every year. The company would have to shell out Rs 10,733 crores for 66.7% stake acquisition in Mindtree. Moreover, L&T is also looking at exiting some non-core businesses that could bring in close to Rs18,000-20,000 crore. Thus, the acquisition will not put any stress on the books of L&T.
- Acquisition is not EPS or RoE dilutive:** L&T generated a little over 5% yield on its current investments, cash & cash equivalents during the first nine months of FY2019. As per our rough calculations, the acquisition will not have any material impact on the earnings estimates of L&T for FY2020 and FY2021. (Refer to the table below). Also, the deployment of free cash in a business with relatively higher return ratios would not adversely impact L&T's return ratios on a consolidated basis.

Indicative impact of acquisition

Particulars	FY2020E	FY2021E
Net profit of Mindtree (Bloomberg estimates) Rs cr	799.1	893.1
L&T's proforma Profit share for its 66.75% stake (A)	527.4	589.4
Yield loss on cash/investment of Rs10,700 cr @5% (B)	535.0	535.0
Proforma Gain/Loss (Rs cr)	-7.6	54.4

- Unwarranted resistance by existing management of Mindtree could be near term challenge:** Though the deployment of free cash into Mindtree which has a business profile complimentary to L&T Infotech is a strategically positive move in the long term, the unwarranted resistance by the existing management of Mindtree could create some near term challenges. The L&T management intends to

run Mindtree as an independent entity for the initial few years. And we believe that L&T has a vast pool of talent to effectively manage the transition woes, if any, during the acquisition.

- ♦ **Valuation - retain buy:** The company is likely to meet its order inflow guidance of 12% for FY2019 and considering several orders inflow towards end of quarter as well as unannounced order inflows. The management is also expected to achieve its topline guidance of 12-15% YoY growth

for FY2019. 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 superior capital allocation augur well for earnings to report a 17% CAGR over FY2018-FY2021E. Notwithstanding the near term challenges related to unwarranted resistance by the management of Mindtree, we see the acquisition as a positive move by L&T and retain our Buy rating on the stock with target price of Rs1655.

Valuations (consolidated)

Particulars	Rs cr					
	FY16	FY17	FY18	FY19E	FY20E	FY21E
Net sales	101,122	109,312	119,683	135,379	148,772	168,613
Growth (%)	9.9	8.1	9.5	13.1	9.9	13.3
OPM (%)	10.3	10.1	11.3	11.4	11.4	11.5
Adj Net profit	4,139	5,920	7,247	9,124	10,053	11,545
EPS	29.5	42.2	51.7	65.1	71.7	83.8
Growth (%)	(6.3)	43.0	22.4	25.9	10.2	16.8
PER	46.0	32.1	26.2	20.8	18.9	16.2
P/B	4.3	3.8	3.4	3.1	2.7	2.4
EV/EBIDTA	23.9	21.5	18.3	15.7	14.4	12.6
ROCE (%)	6.1	6.2	7.8	8.1	8.8	9.6
RONW (%)	9.9	12.8	13.9	15.5	15.2	15.8

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