

# Stock Update

A strategic fit; retain Buy

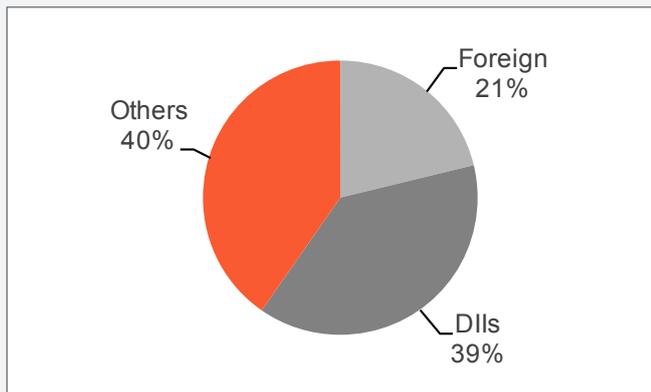
## Larsen & Toubro

Reco: Buy | CMP: Rs1,357

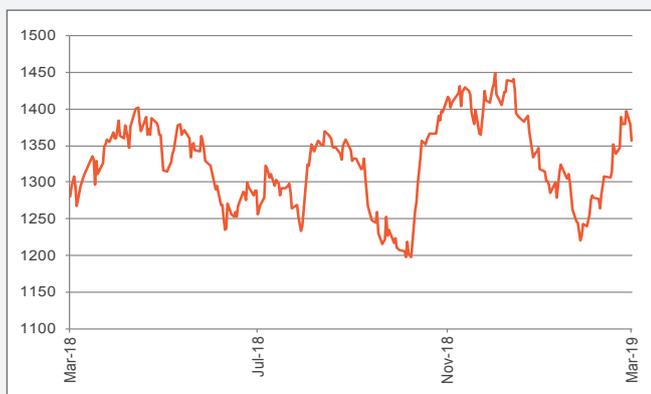
### Company details

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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by BNP PARIBAS

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