

BUY

TP: Rs 2,440 | ▲ 15%

LARSEN & TOUBRO

| Capital Goods

| 31 January 2023

Revenue beat; commentary optimistic

- Q3 revenue ahead of estimates at Rs 464bn (+17% YoY); LT confident of exceeding 13-15% revenue and order growth guidance for FY23
- Hyderabad Metro showings signs of turnaround; fund infusion guided to ebb going forward
- LT remains our preferred pick; we tweak FY24/FY25 EPS by +1%/+3% and roll to a new TP of Rs 2,440 (vs. Rs 2,390)

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Q3 net in line: LT's Q3FY23 revenue beat our estimates at Rs 464bn (Rs 431bn Bobcaps est.), rising 17% YoY. EBITDA margin stood at 10.9% (11.6% est.), down 50bps YoY mainly due to one-time LTI Mindtree integration cost. Adj. PAT was in line with our forecast at Rs 24bn, up 18% YoY. Order inflows held strong at Rs 607bn, climbing 21% YoY.

Optimism remains high for FY23 and beyond: Despite forecasting core EBITDA margin compression of 30-50bps to 8.8-9% in FY23 (9.3% in FY22), management remains confident of exceeding its revenue and order flow guidance of 13-15% growth for the fiscal year. LT's current tendering pipeline totals ~Rs 5tn, with the company's win rate at 15-20%. Net working capital-to-sales as of Mar'23 is now guided at 19-20% vs. 20-22% expected at the start of the year.

Private sector gaining traction: Q3 private sector orders accounted for 39% of LT's total inflows, up from 18% in the year-ago period, a positive trend seen for the second consecutive quarter. Management is optimistic about private capex given growing orders in the metals and buildings & factories segments. Q4FY23 order prospects from the private sector are guided to be at 10-15% of the overall order mix.

Hyderabad Metro showing signs of turnaround: Q3FY23 saw a rise in average ridership on the Hyderabad Metro to 394k passengers per day with a peak of 471k. Despite a 40% EBITDA margin in Q3, net losses on the project were high at Rs 3.3bn due to higher interest costs. Debt totals Rs 130bn with Rs 80bn in mid-term and Rs 50bn in short-term debt. Despite LT's cumulative losses of Rs 45bn on the metro, management foresees minimal fund infusion over the next two years due to support from the Telangana government (Rs 30bn) and monetisation of TOD assets (Rs 10bn-15bn p.a.). We believe this support would help offset the short-term debt.

Top pick: LT remains the best play on India's capex story and is our preferred capital goods pick. We retain BUY and revise our SOTP-based TP from Rs 2,390 to Rs 2,440 as we adjust estimates and roll valuations to Dec'24E. We continue to value the core business ex-services at 14x EV/EBITDA and subsidiaries at 25% holding discount.

Key changes

Target	Rating
▲	◀ ▶

Ticker/Price	LT IN/Rs 2,113
Market cap	US\$ 36.4bn
Free float	86%
3M ADV	US\$ 49.2mm
52wk high/low	Rs 2,298/Rs 1,456
Promoter/FPI/DII	0%/21%/35%

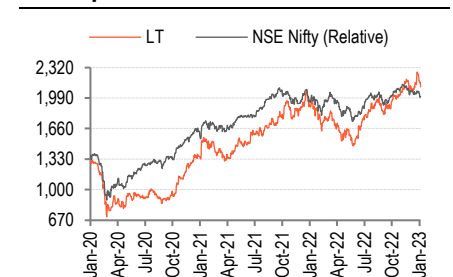
Source: NSE | Price as of 30 Jan 2023

Key financials

Y/E 31 Mar	FY22A	FY23E	FY24E
Total revenue (Rs mn)	15,65,212	17,52,555	21,38,981
EBITDA (Rs mn)	1,82,173	1,96,691	2,55,255
Adj. net profit (Rs mn)	85,724	1,00,705	1,42,114
Adj. EPS (Rs)	61.0	71.7	101.2
Consensus EPS (Rs)	61.0	79.6	96.6
Adj. ROAE (%)	10.8	11.7	15.0
Adj. P/E (x)	34.6	29.5	20.9
EV/EBITDA (x)	11.6	12.9	8.8
Adj. EPS growth (%)	24.2	17.5	41.1

Source: Company, Bloomberg, BOBCAPS Research

Stock performance



Source: NSE



Fig 1 – Quarterly performance

Particulars (Rs mn)	Q3FY23	Q3FY22	YoY (%)	Q2FY23	QoQ (%)
Revenue	4,63,897	3,95,629	17.3	4,27,626	8.5
EBITDA	50,730	45,304	12.0	48,994	3.5
EBITDA margin (%)	10.9	11.5	(50bps)	11.5	(50bps)
Depreciation	8,252	7,325	-	8,602	-
Interest	8,025	8,138	-	8,357	-
Other Income	7,550	5,714	-	7,385	-
PBT	42,004	35,556	18.1	39,421	6.6
Tax	12,705	10,587	-	11,229	-
Adjusted PAT	24,169	20,547	17.6	22,290	8.4
Exceptional item	(1,360)	0	-	0	-
Reported PAT	25,529	20,547	24.2	22,290	14.5
Adj. PAT margin (%)	5.2	5.2	0bps	5.2	0bps
EPS (Rs)	17.2	14.6	17.6	15.9	8.4

Source: Company, BOBCAPS Research

Fig 2 – Segment revenue

Segment Revenue	Q3FY23	Q3FY22	YoY (%)	Q2FY23	QoQ (%)
Consolidated (ex-services)	3,19,508	2,76,483	15.6	2,85,937	11.7
Infrastructure	2,22,057	1,86,190	19.3	1,96,682	12.9
Energy	63,462	59,678	6.3	55,934	13.5
Hi-tech manufacturing	18,631	15,485	20.3	15,889	17.3
Others	15,360	15,131	1.5	17,432	(11.9)
IT and Technology services	1,06,051	85,066	24.7	1,01,839	4.1
Financial services	33,486	29,706	12.7	31,519	6.2
Developmental projects	11,067	9,756	13.4	13,446	(17.7)
Total Revenue	4,70,112	4,01,011	17.2	4,32,741	8.6
Inter-segment revenue	6,214	5,382	15.5	5,115	21.5
Net revenue	4,63,897	3,95,629	17.3	4,27,626	8.5

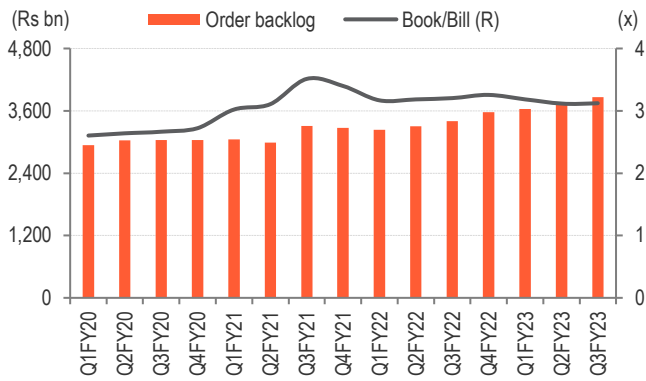
Source: Company, BOBCAPS Research

Fig 3 – Margin profile

Particulars	Q3FY23	Q3FY22	YoY (%)	Q2FY23	QoQ (%)
Consolidated (ex-services)	23,133	20,043	15.4	19,504	18.6
EBIT Margin (%)	7.2	7.2	(1bps)	6.8	42bps
Infrastructure	13,042	11,147	17.0	10,668	22.3
EBIT Margin (%)	5.9	6.0	(11bps)	5.4	45bps
Energy	4,966	4,629	7.3	4,192	18.4
EBIT Margin (%)	7.8	7.8	7bps	7.5	33bps
Hi-tech manufacturing	2,480	2,533	(2.1)	2,216	11.9
EBIT Margin (%)	13.3	16.4	(304bps)	13.9	(64bps)
Others	2,645	1,735	52.5	2,427	9.0
EBIT Margin (%)	17.2	11.5	575bps	13.9	330bps
IT and Technology services	17,053	17,005	0.3	18,928	(9.9)
EBIT Margin (%)	16.1	20.0	(391bps)	18.6	(251bps)
Financial services	6,304	4,340	45.2	6,132	2.8
EBIT Margin (%)	18.8	14.6	422bps	19.5	(63bps)
Developmental projects	(56)	(480)	(88.4)	(115)	(51.6)
EBIT Margin (%)	(0.5)	(4.9)	442bps	(0.9)	35bps

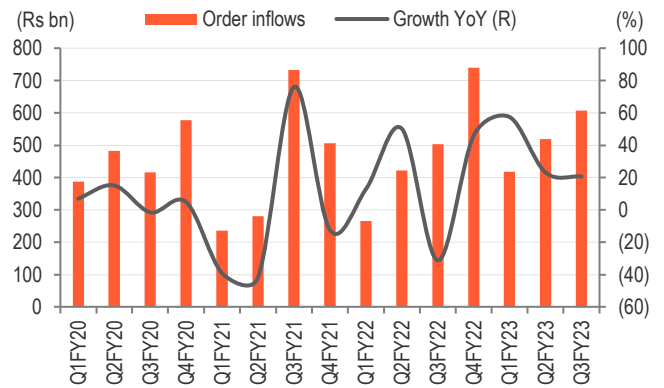
Source: Company, BOBCAPS Research

Fig 4 – Order backlog trend



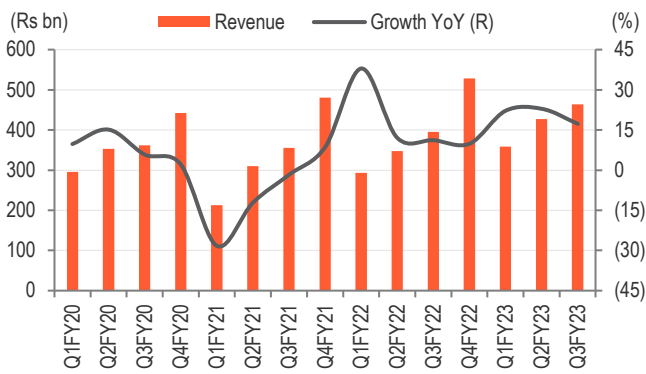
Source: Company, BOBCAPS Research

Fig 5 – Order inflow trend



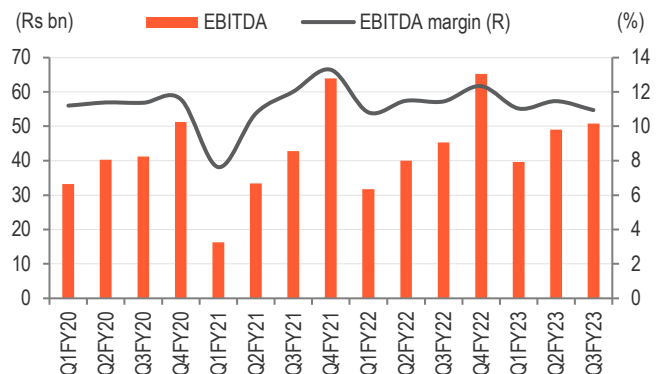
Source: Company, BOBCAPS Research

Fig 6 – Revenue trend



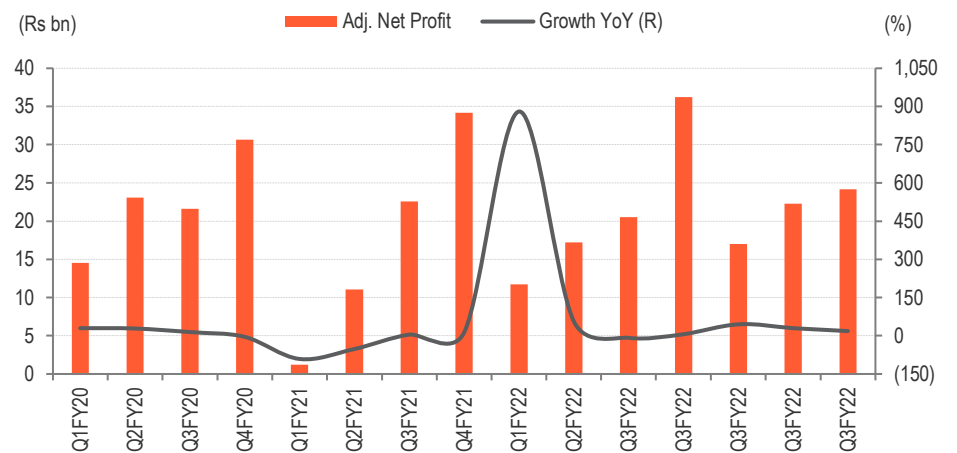
Source: Company, BOBCAPS Research

Fig 7 – EBITDA trend



Source: Company, BOBCAPS Research

Fig 8 – Net profit trend



Source: Company, BOBCAPS Research

Earnings call highlights

- **Guidance:** Management remains confident of achieving the upper end of its revenue and order inflow guidance (13-15% growth) for FY23. The core EBITDA margin is expected to decrease by 30-50bps to 8.8-9% (9.3% in FY22) due to the completion of orders booked during previous inflationary conditions and ongoing geopolitical supply chain disruptions. Net working capital-to-sales is anticipated to close the year at 19-20% vs. 20-22% guided at the start of the year.
- **Demand outlook:** LT's award-to-tender ratio has been a bit soft, at 56% in Q3FY23 (9MFY23: 52%), but improved tendering momentum bodes well. Per management, domestic growth momentum is strong, fueled primarily by private consumption and public capex. Private capex is gaining traction, with private orders accounting for 39% of LT's book (vs. 29%/18% in Q2FY23/Q3FY22), largely from the building & factories and metals segments. The Gulf Coop Council (GCC) outlook remains positive due to stabilising oil prices.
- **Order backlog:** LT's order backlog stood at Rs 3.9tn in Q3. Domestic business accounts for 74% of the total, while international orders constitute 26% (Middle East 81% and Africa 10%, with the remainder coming from various Southeast Asian countries). Of the domestic backlog, 9% is from the central government, 31% from the state government, 40% from state-owned enterprises, and 20% from the private sector. In all, 27% is funded by bilateral and multilateral agencies.
- **Slow-moving order book:** In Q3FY23, the company cancelled orders worth Rs 19bn (Rs 16bn in Q2FY23). Non-moving orders currently account for 3-4% of the book.
- **Order prospects:** Order prospects for the remainder of FY23 are guided at Rs 4.87tn (domestic: Rs 3.82tn, international: Rs 1.05tn). Private sector prospects are pegged at 10-15% of the overall order mix. Per management, Q3FY23 saw favourable project announcements, though tendering is expected only after the Union Budget scheduled for 1 February.
- **Hyderabad Metro:** Improvement in daily ridership has led to a Q3FY23 EBITDA margin of 40% (39%/13% in Q2FY23/Q1FY23). Average ridership in Q3FY23 stood at 394k per day (355k/218k in Q2FY23/Q3FY22), with peak ridership at 471k per day in January. Net loss on the project stood at Rs 3.3bn (Rs 4.8bn in Q3FY22), with operating & amortization cost at Rs 0.8bn-0.9bn each and interest cost at Rs 3.2bn (Rs 4.3bn in Q3FY22). Currently, L&T Metro has debt of Rs 130bn (Rs 80bn: medium-term and Rs 50bn: short-term). LT's cumulative exposure stands at Rs 75bn (vs. Rs 72bn at the start of FY23).

Management expects the short-term borrowings of Rs 50bn to be offset by (i) Rs 30bn in assistance from the Telangana state government over the next 2-3 years (Rs 1bn released as of Dec'22 with Rs 9bn anticipated in Q4FY23), and (ii) transit-oriented development (TOD) asset monetisation in the range of Rs 10bn-15bn p.a. over the next 2-3 years.

- **Net working capital:** NWC intensity improved to 19% in Dec'22 (20.2% in Sep'22). TTM ROE stood at 12.4% vs. 11% in the year-ago quarter.

- **L&T's** group collection (ex-finance) stood at Rs 433bn in Q3 (Rs 0.38tn in Q2FY23) and Rs 1.16tn in 9MFY23 (Rs 0.93tn in 9MFY22).
- **One-offs:** Q3FY23 had a one-off gain on divestment of the mutual fund business, and a one-time charge for remeasurement of wholesale loan assets.
- **Capex:** For new businesses, investment outlay is envisaged at Rs 70bn-75bn, which includes: (i) data centres: Rs 20bn, (ii) electrolyzers: Rs 15bn, and (iii) storage batteries: Rs 30bn-35bn.

Valuation methodology

LT remains a pure engineering, procurement & construction (EPC) play with no element of build-operate-transfer (BOT) and hybrid annuity in its road projects. In fact, the company has been focusing on an asset-light business model by shedding its non-core assets. Most importantly, its acquisition of technology services firm Mindtree has paid off – serving to steady earnings when infrastructure spending slowed and also during the Covid-19 pandemic. This apart, the company's expertise in hydrocarbons has spurred stronger order wins in the Middle East amid rising oil prices.

We expect LT to deliver a revenue/EBITDA/PAT CAGR of 15%/17%/25% over FY22-FY25, and retain BUY with a revised SOTP-based TP of Rs 2,440 (earlier Rs 2,390) as we adjust FY23/FY24/FY25 EPS by -12%/+1%/+3% to bake in softer margins for FY23 and roll valuations forward to Dec'24E. We have valued the core business (ex-services) at Rs 1,710/sh (14x Dec'24E EV/EBITDA) and the services subsidiaries at Rs 690/sh (25% holding company discount).

Fig 9 – Revised estimates

(Rs mn)	New			Old			Change (%)		
	FY23E	FY24E	FY25E	FY23E	FY24E	FY25E	FY23E	FY24E	FY25E
Sales	17,52,555	21,38,981	23,67,795	17,61,180	20,46,693	22,97,649	(0.5)	4.5	3.1
EBITDA	1,96,691	2,55,255	2,93,677	2,10,870	2,47,810	2,81,000	(6.7)	3.0	4.5
PAT	1,00,705	1,42,114	1,68,290	1,14,839	1,40,250	1,62,698	(12.3)	1.3	3.4
EPS (Rs)	71.7	101.2	119.8	81.8	99.9	115.9	(12.3)	1.3	3.4
EBITDA Margin (%)	11.2	11.9	12.4	12.0	12.1	12.2	(75bps)	(17bps)	17bps

Source: Company, BOBCAPS Research

Fig 10 – SOTP valuation

Business	Methodology	Rs bn	Rs/share
Core business (Ex-services)	14x Dec'24E Core business EBITDA	2,395	1,710
LTI Mindtree	25% holding co. discount to current market cap	670	480
Financial Services	25% holding co. discount to current market cap	104	70
Technology Services	25% holding co. discount to current market cap	193	140
IDPL, Hyderabad Metro & Others	0.5x P/B of Invested Equity	55	40
Total	-	3,416	2,440

Source: Company, BOBCAPS Research

Key risks

Key downside risks to our estimates are:

- slowdown in capex, and
- continued pressure on services margin.

Sector recommendation snapshot

Company	Ticker	Market Cap (US\$ bn)	Price (Rs)	Target (Rs)	Rating
ABB India	ABB IN	7.3	2,815	3,100	HOLD
AIA Engineering	AIAE IN	3.1	2,645	3,300	BUY
Cummins India	KKC IN	4.7	1,390	1,300	HOLD
Hitachi Energy	POWERIND IN	1.6	3,025	3,600	BUY
KEC International	KECI IN	1.4	459	500	BUY
Larsen & Toubro	LT IN	36.4	2,113	2,440	BUY
Siemens India	SIEM IN	12.7	2,917	3,500	BUY
Thermax	TMX IN	2.8	1,901	2,100	HOLD

Source: BOBCAPS Research, NSE | Price as of 30 Jan 2023

Financials

Income Statement

Y/E 31 Mar (Rs mn)	FY21A	FY22A	FY23E	FY24E	FY25E
Total revenue	13,59,790	15,65,212	17,52,555	21,38,981	23,67,795
EBITDA	1,56,241	1,82,173	1,96,691	2,55,255	2,93,677
Depreciation	29,042	29,480	35,375	37,144	39,001
EBIT	1,27,199	1,52,694	1,61,315	2,18,111	2,54,675
Net interest inc./(exp.)	39,134	31,257	27,506	27,781	28,059
Other inc./(exp.)	34,294	22,671	23,804	24,518	25,254
Exceptional items	0	0	0	0	0
EBT	1,22,358	1,44,107	1,57,613	2,14,848	2,51,870
Income taxes	40,108	42,166	39,719	54,142	63,471
Extraordinary items	(46,819)	(83,349)	0	0	0
Min. int./Inc. from assoc.	(13,240)	(16,217)	(17,190)	(18,593)	(20,109)
Reported net profit	1,15,829	1,69,073	1,00,705	1,42,114	1,68,290
Adjustments	(46,819)	(83,349)	0	0	0
Adjusted net profit	69,010	85,724	1,00,705	1,42,114	1,68,290

Balance Sheet

Y/E 31 Mar (Rs mn)	FY21A	FY22A	FY23E	FY24E	FY25E
Accounts payables	4,55,046	5,11,442	5,28,167	6,44,624	7,13,582
Other current liabilities	4,14,182	7,77,326	5,13,763	6,27,044	6,94,121
Provisions	0	0	0	0	0
Debt funds	13,26,053	9,20,953	8,90,953	8,60,953	8,30,953
Other liabilities	1,58,771	1,65,894	1,84,443	2,04,476	2,26,112
Equity capital	2,809	2,810	2,810	2,810	2,810
Reserves & surplus	7,55,876	8,21,267	8,91,760	9,91,239	11,09,043
Shareholders' fund	7,58,685	8,24,077	8,94,570	9,94,050	11,11,853
Total liab. and equities	31,12,737	31,99,692	30,11,896	33,31,147	35,76,620
Cash and cash eq.	4,72,527	4,87,457	1,71,752	1,16,305	1,40,997
Accounts receivables	4,22,298	4,61,389	4,80,152	5,86,022	6,48,711
Inventories	58,205	59,433	72,023	87,903	97,307
Other current assets	9,96,638	10,65,225	11,66,770	14,24,034	15,76,368
Investments	86,154	1,00,639	1,03,014	1,08,165	1,13,573
Net fixed assets	4,44,313	4,08,274	4,17,778	4,21,778	4,25,778
CWIP	3,884	11,703	6,200	6,200	6,200
Intangible assets	0	0	0	0	0
Deferred tax assets, net	0	0	0	0	0
Other assets	6,28,718	6,05,572	5,94,207	5,80,740	5,67,687
Total assets	31,12,737	31,99,692	30,11,896	33,31,147	35,76,620

Cash Flows

Y/E 31 Mar (Rs mn)	FY21A	FY22A	FY23E	FY24E	FY25E
Cash flow from operations	2,28,441	1,91,636	(2,25,107)	50,014	1,40,536
Capital expenditures	(9,223)	(30,399)	(44,879)	(41,144)	(43,001)
Change in investments	(1,84,746)	(2,19,767)	3,128	(5,151)	(5,408)
Other investing cash flows	1,39,681	2,13,489	11,365	13,468	13,053
Cash flow from investing	(54,288)	(36,677)	(30,386)	(32,827)	(35,357)
Equities issued/Others	159	110	0	0	0
Debt raised/repaid	(87,325)	(84,132)	(30,000)	(30,000)	(30,000)
Interest expenses	0	0	0	0	0
Dividends paid	0	0	0	0	0
Other financing cash flows	(15,637)	(67,793)	(30,211)	(42,634)	(50,487)
Cash flow from financing	(1,02,803)	(1,51,815)	(60,211)	(72,634)	(80,487)
Chg in cash & cash eq.	71,350	3,144	(3,15,704)	(55,447)	24,692
Closing cash & cash eq.	4,72,527	4,87,457	1,71,752	1,16,305	1,40,997

Per Share

Y/E 31 Mar (Rs)	FY21A	FY22A	FY23E	FY24E	FY25E
Reported EPS	82.5	120.4	71.7	101.2	119.8
Adjusted EPS	49.1	61.0	71.7	101.2	119.8
Dividend per share	36.0	36.0	21.5	30.4	36.0
Book value per share	540.3	586.8	637.0	707.9	791.8

Valuations Ratios

Y/E 31 Mar (x)	FY21A	FY22A	FY23E	FY24E	FY25E
EV/Sales	1.3	1.4	1.4	1.1	0.9
EV/EBITDA	11.7	11.6	12.9	8.8	7.6
Adjusted P/E	43.0	34.6	29.5	20.9	17.6
P/BV	3.9	3.6	3.3	3.0	2.7

DuPont Analysis

Y/E 31 Mar (%)	FY21A	FY22A	FY23E	FY24E	FY25E
Tax burden (Net profit/PBT)	56.4	59.5	63.9	66.1	66.8
Interest burden (PBT/EBIT)	96.2	94.4	97.7	98.5	98.9
EBIT margin (EBIT/Revenue)	9.4	9.8	9.2	10.2	10.8
Asset turnover (Rev./Avg TA)	43.9	49.6	56.4	67.4	68.6
Leverage (Avg TA/Avg Equity)	4.3	4.0	3.6	3.4	3.3
Adjusted ROAE	9.7	10.8	11.7	15.0	16.0

Ratio Analysis

Y/E 31 Mar	FY21A	FY22A	FY23E	FY24E	FY25E
YoY growth (%)					
Revenue	(6.5)	15.1	12.0	22.0	10.7
EBITDA	(4.3)	16.6	8.0	29.8	15.1
Adjusted EPS	(22.4)	24.2	17.5	41.1	18.4
Profitability & Return ratios (%)					
EBITDA margin	11.5	11.6	11.2	11.9	12.4
EBIT margin	9.4	9.8	9.2	10.2	10.8
Adjusted profit margin	5.1	5.5	5.7	6.6	7.1
Adjusted ROAE	9.7	10.8	11.7	15.0	16.0
ROCE	10.9	13.6	14.4	19.5	22.9
Working capital days (days)					
Receivables	113	108	100	100	100
Inventory	16	14	15	15	15
Payables	122	119	110	110	110
Ratios (x)					
Gross asset turnover	2.4	2.8	2.9	3.3	3.4
Current ratio	1.4	1.3	1.4	1.4	1.4
Net interest coverage ratio	3.3	4.9	5.9	7.9	9.1
Adjusted debt/equity	1.1	0.5	0.8	0.7	0.6

Source: Company, BOBCAPS Research | Note: TA = Total Assets

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Recommendation scale: Recommendations and Absolute returns (%) over 12 months

BUY – Expected return >+15%

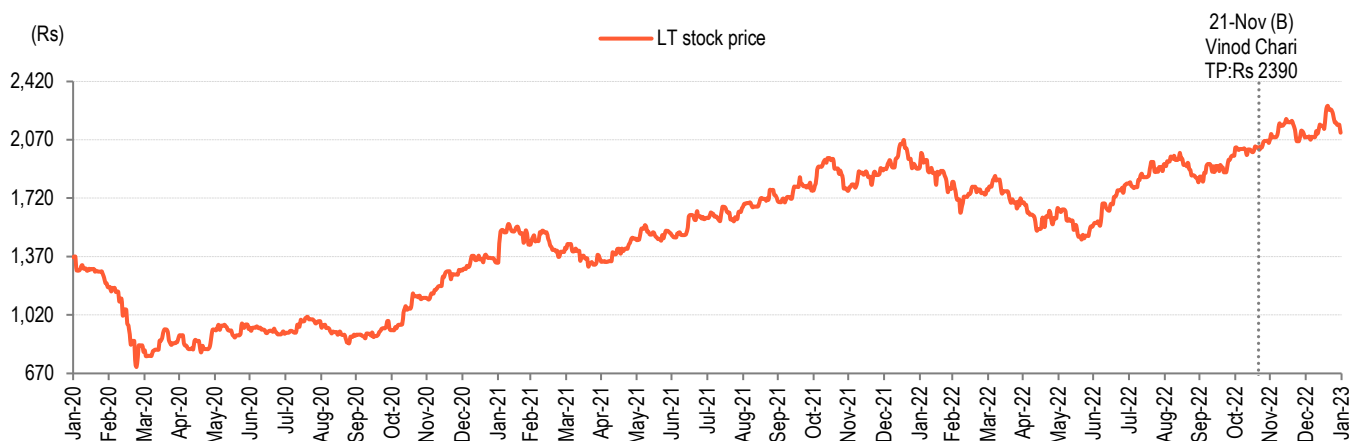
HOLD – Expected return from -6% to +15%

SELL – Expected return <-6%

Note: Recommendation structure changed with effect from 21 June 2021

Our recommendation scale does not factor in short-term stock price volatility related to market fluctuations. Thus, our recommendations may not always be strictly in line with the recommendation scale as shown above.

Ratings and Target Price (3-year history): LARSEN & TOUBRO (LT IN)



B – Buy, H – Hold, S – Sell, A – Add, R – Reduce

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