

RETAIL EQUITY RESEARCH

Larsen & Toubro Ltd.

Construction & Engineering

BSE CODE:500510

NSE CODE: LT

Bloomberg CODE: LT IN

SENSEX: 26,231

BUY

Rating as per Large cap

12months investment period

CMP Rs1360 TARGET Rs1589 RETURN 17%

5th December, 2016

Decent earnings

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

- During Q2FY17, consolidated sales/Adj PAT increased by 8%/41% on YoY basis. Notably, the numbers were in line with our estimates.
- L&T reported 11% YoY jump in Q2 order intake primarily driven by domestic infra & international hydrocarbon verticals.
- EBITDA margin was stable at 9.2% as savings in employee costs (down 70bps) got offset by higher other expenses.
- We reduce our FY17/FY18 revenue estimates by 4.4%/8.2% owing to the execution challenges witnessed in the domestic business.
- Robust order book, improvement in net working capital (NWC) coupled with L&T's efforts to unlock value from investments augur well for L&T.
- We value the stock on SOTP basis with TP of Rs1,589, ascribing Rs1,268 to the core E&C business and Rs321 to the subsidiary portfolio. Notably, we upgrade the stock to 'BUY', from earlier 'HOLD'.

Q2 results were in line with estimates

Consolidated revenues registered a moderate growth of 8.2% YoY during Q2FY17 mainly impacted by weaker execution in infrastructure division. The bread and butter segment (Infra contributed ~47% to revenues in FY16) reported a modest growth of 6% YoY on account of prolonged monsoon & client side issues at about 40 projects. The management highlighted that it lost revenues worth Rs800cr due to client specific issues in these projects. However, power/hydrocarbon/heavy engineering segments registered a robust net revenue growth of 30%/33%/25% YoY in Q2FY17. We expect revenue/PAT to grow at 10.1%/14.3% CAGR over FY16-18E led by strong execution.

Stable operating performance

Consolidated EBITDA margin was stable at 9.2% YoY as savings in employee costs (down 70bps) got offset by higher other expenses. Notably, the overall margin got a jolt from Infra segment which witnessed margin contraction (down 220 bps YoY) led by cost overruns in some of the domestic projects. However, the decline in Infra margin got offset by uptick in margins of Hydrocarbon (up 570bps YoY) & IT&TS (up 110bps YoY). Despite EBITDA growth of just 7.8% YoY, Adj PAT increased by robust 41% YoY owing to higher other income (up 49.6% YoY) & lower interest costs.

Guidance maintained

The order inflows grew by 11% YoY (up 12% YoY in H1FY17) in Q2FY17 to Rs31,119cr aided by orders in the infrastructure and hydrocarbon segments. The management maintained its order inflow growth guidance of 15% YoY for FY17 as order pipeline remains healthy with projects worth ~Rs4,500bn. Notably, the order backlog at the end of Q2FY17 was up 4% YoY at Rs2,518bn (2x TTM revenues). Further, L&T's NWC to sales has improved from 24% in FY16 to 22% in Q2FY17. Moreover, L&T has maintained guidance for a 12-15% sales growth with margin improvement of 50bps.

Outlook & Valuation

We reduce our EPS estimates by 11.9%/9.2% for FY17/FY18 to mainly factor in lower revenue forecasts & margin assumptions. Further, we lower our earlier EBITDA margin estimates for FY17/FY18 by 180/140bps. We maintain positive stance on the stock as L&T remains a default pick in India infrastructure play. Moreover, the strong order book provides decent revenue visibility. Hence, we upgrade the stock to 'BUY', from earlier 'HOLD'. However, L&T might witness delay in order execution owing to the demonetisation & thus execution rate remains the key monitorable. We value the stock using SOTP methodology, ascribing separate values to its core E&C business (21.0x P/E) and investments in subsidiaries (using P/E, P/BV and M-cap), revising TP to Rs1,589 from Rs1,590 (earlier).

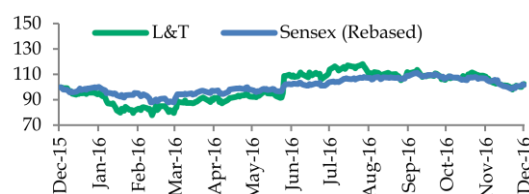
Company Data

Market Cap (Rscr)	126,707
Enterprise Value (Rscr)	229,081
Outstanding Shares (cr)	93.2
Free Float	88%
Dividend Yield	1.3%
52 week high	Rs1,615
52 week low	Rs1,017
6m average volume (cr)	0.19
Beta	1.1
Face value	Rs2

Shareholding %	Q4 FY16	Q1 FY17	Q2 FY17
Promoters	-	-	-
FII's	16.6	17.0	17.6
MFs/Insti	39.1	39.5	39.4
Public& Others	44.4	43.5	43.1
Total	100	100	100

Price Performance	3mth	6mth	1 Year
Absolute Return	(9)%	(8)%	0%
Absolute Sensex	(8)%	(2)%	0%
Relative Return*	(1)%	(6)%	0%

*over or under performance to benchmark index



Y.E Mar (Rscr)	FY16	FY17E	FY18E
Sales	102,632	111,807	124,357
Growth (%)	11.6	8.9	11.2
EBITDA	12,343	12,072	14,533
EBITDA Margin (%)	12.0	10.8	11.7
PAT Adj	4,732	4,742	6,178
Growth (%)	7.1	0.2	30.3
Adj.EPS	50.8	50.9	66.3
Growth (%)	6.9	0.2	30.3
P/E	26.8	26.7	20.5
P/B	2.9	2.7	2.5
EV/EBITDA	19.4	20.2	17.1
RoE (%)	11.1	10.4	12.6
Adj. D/E	2.2	2.2	2.1



Quarterly Financials (Consolidated)

Profit & Loss Account

(Rscr)	Q2FY17	Q2FY16	YoY Growth %	Q1FY17	QoQ Growth %	H1FY17	H1FY16	YoY Growth %
Sales	25,011	23,123	8.2%	21,874	14.3%	46,885	43,172	8.6%
EBITDA	2,298	2,131	7.8%	1,905	20.6%	4,203	3,772	11.4%
Depreciation	460	529	-12.9%	465	-1.0%	925	994	-7.0%
EBIT	1,838	1,602	14.7%	1,440	27.6%	3,278	2,778	18.0%
Interest	352	439	-19.9%	337	4.2%	689	828	-16.8%
Other Income	481	322	49.6%	302	59.2%	784	605	29.5%
Exceptional Items	402	46	-	-	-	402	46	-
PBT	2,370	1,531	54.8%	1,405	68.6%	3,775	2,600	45.2%
Tax	681	535	27.3%	549	24.0%	1,230	963	27.7%
Minority Interest/ P/L of Associates	(254)	(218)	16.6%	(247)	3.0%	(501)	(440)	13.9%
Reported PAT	1,435	778	84.3%	610	135.3%	2,044	1,197	70.7%
Adjustment	(402)	(46)	-	-	-	(402)	(46)	-
Adj PAT	1,032	733	40.9%	610	69.3%	1,642	1,152	42.6%
No. of shares (cr)	93.2	93.1		93.2		93.2	93.1	
EPS (Rs)	15.4	8.4		6.5		21.9	12.9	

Gross segment Revenue

(Rscr)	Q2FY17	Q2FY16	YoY Growth %	Q1FY17	QoQ Growth %	H1FY17	H1FY16	YoY Growth %
Infrastructure	11,597	11,178	3.8%	9,288	24.9%	20,884	19,682	6.1%
Power	1,745	1,340	30.2%	1,723	1.3%	3,467	2,419	43.4%
Heavy Engineering	808	622	30.0%	734	10.1%	1,542	1,266	21.8%
Electrical & Automation	1,252	1,318	-5.0%	1,081	15.8%	2,333	2,432	-4.1%
Hydrocarbon	2,501	1,896	31.9%	2,146	16.5%	4,646	4,050	14.7%
IT & Technology Services	2,462	2,270	8.4%	2,375	3.7%	4,837	4,334	11.6%
Financial Services	2,140	1,891	13.2%	2,091	2.4%	4,231	3,673	15.2%
Developmental Projects	1,073	1,146	-6.4%	1,383	-22.4%	2,456	2,284	7.5%
Others	2,181	2,387	-8.6%	1,818	20.0%	3,999	4,509	-11.3%

Source: Company, Geojit BNP Paribas Research

Sum-of-the-parts Valuation

	Basis	Multiple (x)	Value (Rscr)	Value/share (Rs)
L&T Standalone	Mar-18 P/E	21	114,184	1,225
L&T Hydrocarbons	Mar-18 P/E	21	4,019	43
Financial Services	20% Holdco Disc. To Market Cap		8,291	89
IT & Tech Services	20% Holdco Disc. To Market Cap		13,323	143
Developmental Projects	Mar-18 P/BV	1	5,906	63
L&T Mitsubishi JV	Mar-18 P/E	15	2,370	25
Total Valuation			148,093	1,589

Change in Estimates

Year / Rscr	Old estimates		New estimates		Change %	
	FY17E	FY18E	FY17E	FY18E	FY17E	FY18E
Revenue	116,966	135,506	111,807	124,357	-4.4	-8.2
EBITDA	14,707	17,729	12,072	14,533	-17.9	-18
Margins (%)	12.6%	13.1%	10.8%	11.7%	-180bps	-140bps
PAT	5,383	6,797	4,742	6,178	-11.9	-9.1
EPS	57.8	73	50.9	66.3	-11.9	-9.2



Consolidated Financials

Profit & Loss Account

Y.E March (Rscr)	FY14	FY15	FY16	FY17E	FY18E
Sales	85,128	92,005	102,632	111,807	124,357
% change	14%	8%	12%	9%	11%
EBITDA	10,730	11,336	12,343	12,072	14,533
% change	8%	6%	9%	-2%	20%
Depreciation	1,446	2,623	2,756	2,136	2,353
EBIT	9,284	8,713	9,587	9,936	12,180
Interest	3,138	2,851	3,041	2,871	2,996
Other Income	982	1,007	1,183	1,330	1,410
PBT	7,128	6,870	7,729	8,395	10,593
% change	-1%	-4%	13%	9%	26%
Tax	2,628	2,284	2,549	2,602	3,284
Tax Rate (%)	37%	33%	33%	31%	31%
Reported PAT	4,902	4,765	5,091	5,145	6,178
Adj*	355	348	358	402	-
Adj PAT	4,547	4,417	4,732	4,742	6,178
% change	-5%	-3%	7%	0%	30%
No. of shares (cr)	93	93	93	93	93
Adj EPS (Rs)	49.1	47.5	50.8	50.9	66.3
% change	-37%	-3%	7%	0%	30%
DPS (Rs)	14.3	16.3	18.3	15.6	19.4

Cash flow

Y.E March (Rscr)	FY14	FY15	FY16	FY17E	FY18E
Pre-tax profit	7,128	6,870	7,729	7,705	9,876
Depreciation	1,446	2,623	2,756	2,136	2,353
Changes in W.C	(15,380)	(7,884)	(12,397)	(2,519)	(3,283)
Others	2,611	702	2,002	1,541	1,587
Tax paid	(2,947)	(2,979)	(3,318)	(2,602)	(3,284)
C.F.O	(7,143)	(669)	(3,229)	6,261	7,248
Capital exp.	(6,967)	(6,929)	(5,264)	(7,000)	(7,000)
Change in inv.	780	(966)	(124)	-	-
Other invest.CF	677	2,432	1,256	1,330	1,410
C.F - investing	(5,510)	(5,463)	(4,132)	(5,670)	(5,590)
Issue of equity	144	99	70	-	-
Issue/ repay debt	17,422	11,449	11,391	5,000	5,000
Dividends paid	(1,418)	(1,603)	(1,512)	(1,743)	(2,168)
Other finance.CF	(3,012)	(2,055)	(2,461)	(2,871)	(2,996)
C.F - Financing	13,136	7,891	7,488	385	(165)
Chg. in cash	483	1,759	128	976	1,493
Closing cash	4,097	5,756	5,902	6,877	8,371

Balance Sheet

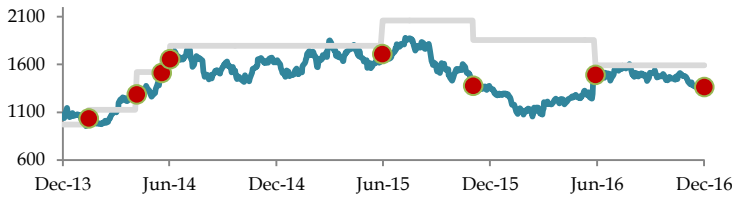
Y.E March (Rscr)	FY14	FY15	FY16	FY17E	FY18E
Cash	4,097	5,756	5,902	6,877	8,371
Accounts Receivable	26,385	30,089	35,990	39,223	43,626
Inventories	5,527	6,518	5,362	5,932	6,494
Other Cur. Assets	42,563	44,661	50,096	53,174	57,160
Investments	8,109	9,612	10,080	10,080	10,080
Gross Fixed Assets	49,348	53,624	65,393	72,393	79,393
Net Fixed Assets	40,275	42,626	52,114	56,978	61,625
CWIP	4,165	5,420	6,486	6,486	6,486
Intangible Assets	2,136	2,215	2,172	2,172	2,172
Def. Tax (Net)	(337)	185	392	392	392
Other Assets	35,625	46,561	58,521	58,521	58,521
Total Assets	168,544	193,645	227,114	239,835	254,927
Current Liabilities	42,443	52,287	61,592	65,954	71,623
Provisions					
Debt Funds	83,812	93,604	112,357	117,357	122,357
Other Liabilities	1,398	1,847	2,404	2,404	2,404
Equity Capital	185	186	186	186	186
Reserves and Surplus	37,526	40,723	43,805	46,804	50,814
Shareholder's Fund	37,712	40,909	43,992	46,991	51,000
Minority Interest	3,179	4,999	6,769	7,129	7,543
Total Liabilities	168,544	193,645	227,114	239,835	254,927
BVPS (Rs)	406.9	440.1	472.3	504.5	547.5

Ratios

Y.E March	FY14	FY15	FY16	FY17E	FY18E
Profitab. & Return					
EBITDA margin (%)	12.6	12.3	12.0	10.8	11.7
EBIT margin (%)	10.9	9.5	9.3	8.9	9.8
Net profit mgn.(%)	5.3	4.8	4.6	4.2	5.0
ROE (%)	12.7	11.2	11.1	10.4	12.6
ROCE (%)	9.0	7.4	7.1	6.7	7.7
W.C & Liquidity					
Receivables (days)	112.1	118.4	126.9	126.9	126.9
Inventory (days)	28.9	31.6	23.3	23.3	23.1
Payables (days)	102.3	112.5	118.8	118.9	119.1
Current ratio (x)	1.9	1.7	1.6	1.6	1.6
Quick ratio (x)	1.7	1.5	1.5	1.5	1.5
Turnover & Levg.					
Gross asset T.O (x)	1.8	1.8	1.7	1.6	1.6
Total asset T.O (x)	0.5	0.5	0.5	0.5	0.5
Int. covge. ratio (x)	3.0	3.1	3.2	3.5	4.1
Adj. debt/equity (x)	2.0	2.0	2.2	2.2	2.1
Valuation ratios					
EV/Net Sales (x)	2.5	2.4	2.3	2.2	2.0
EV/EBITDA (x)	19.5	19.3	19.4	20.2	17.1
P/E (x)	27.7	28.6	26.8	26.7	20.5
P/BV (x)	3.3	3.1	2.9	2.7	2.5



Recommendation Summary (last 3 years)



Source: Bloomberg, Geojit BNP Paribas Research

Dates	Rating	Target
15-Jan-14	BUY	1125
7-Apr-14	BUY	1520
20-May-14	BUY	1643
3-Jun-14	BUY	1795
1-Jun-15	BUY	2060
3-Nov-15	BUY	1855
30-May-16	HOLD	1590
05-Dec-16	BUY	1589

Investment Rating Criteria

Large Cap Stocks;

Buy	-	Upside is 10% or more.
Hold	-	Upside or downside is less than 10%.
Reduce	-	Downside is 10% or more.

Mid Cap and Small Cap;

Buy	-	Upside is 15% or more.
Accumulate*	-	Upside between 10% - 15%.
Hold	-	Absolute returns between 0% - 10%.
Reduce/Sell	-	Absolute returns less than 0%.

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

The recommendations are based on 12 month horizon, unless otherwise specified. The investment ratings are on absolute positive/negative return basis. It is possible that due to volatile price fluctuation in the near to medium term, there could be a temporary mismatch to rating.

* For reasons of valuations/return/lack of clarity/event we may revisit rating at appropriate time. Please note that the stock always carries the risk of being upgraded to BUY or downgraded to a HOLD, REDUCE or SELL.

Geojit BNP Paribas Financial Services Limited has outsourced the preparation of this research report to DION Global Solutions Limited whose relevant disclosures are available hereunder. However, Geojit BNP Paribas's research desk have reviewed this report for any untrue statement of material fact or any false or misleading information.

General Disclosures and Disclaimers

CERTIFICATION

I, Rohit Joshi, employee of Dion Global Solutions Limited (Dion) is engaged in preparation of this report and hereby certify that all the views expressed in this research report (report) reflect my personal views about any or all of the subject issuer or securities.

Disclaimer

This report has been prepared by Dion and the report & its contents are the exclusive property of the Dion and the client cannot tamper with the report or its contents in any manner and the said report, shall in no case, be further distributed to any third party for commercial use, with or without consideration.

Geojit BNP Paribas Financial Services Limited has outsourced the assignment of preparation of this report to Dion.

Recipient shall not further distribute the report to a third party for a commercial consideration as this report is being furnished to the recipient solely for the purpose of information.

Dion has taken steps to ensure that facts in this report are based on reliable information but cannot testify, nor make any representation or warranty, express or implied, to the accuracy, contents or data contained within this report. It is hereby confirmed that wherever Dion has employed a rating system in this report, the rating system has been clearly defined including the time horizon and benchmarks on which the rating is based.

Descriptions of any company or companies or their securities mentioned herein are not intended to be complete and this report is not, and should not be construed as an offer or solicitation of an offer, to buy or sell any securities or other financial instruments. Dion has not taken any steps to ensure that the securities referred to in this report are suitable for any particular investor. This report is not to be relied upon in substitution for the exercise of independent judgment. Opinions or estimates expressed are current opinions as of the original publication date appearing on this report and the information, including the opinions and estimates contained herein, are subject to change without notice. Dion is under no duty to update this report from time to time.

Dion or its associates including employees engaged in preparation of this report and its directors do not take any responsibility, financial or otherwise, of the losses or the damages sustained due to the investments made or any action taken on basis of this report, including but not restricted to, fluctuation in the prices of securities, changes in the currency rates, diminution in the NAVs, reduction in the dividend or income, etc.

The investments or services contained or referred to in this report may not be suitable for all equally and it is recommended that an independent investment advisor be consulted. In addition, nothing in this report constitutes investment, legal, accounting or tax advice or a representation that any investment or strategy is suitable or appropriate to individual circumstances or otherwise constitutes a personal recommendation of Dion.



REGULATORY DISCLOSURES:

Dion is engaged in the business of developing software solutions for the global financial services industry across the entire transaction lifecycle and inter-alia provides research and information services essential for business intelligence to global companies and financial institutions. Dion is listed on BSE Limited (BSE) and is also registered under the SEBI (Research Analyst) Regulations, 2014 (SEBI Regulations) as a Research Analyst vide Registration No. INH100002771. Dion's activities were neither suspended nor has it defaulted with requirements under the Listing Agreement and / or SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 with the BSE in the last five years. Dion has not been debarred from doing business by BSE / SEBI or any other authority.

In the context of the SEBI Regulations, we affirm that we are a SEBI registered Research Analyst and in the course of our business, we issue research reports / research analysis etc that are prepared by our Research Analysts. We also affirm and undertake that no disciplinary action has been taken against us or our Analysts in connection with our business activities.

In compliance with the above mentioned SEBI Regulations, the following additional disclosures are also provided which may be considered by the reader before making an investment decision:

1. Disclosures regarding Ownership

Dion confirms that:

- (i) It/its associates have no financial interest or any other material conflict in relation to the subject company (ies) covered herein at the time of publication of this report.
- (ii) It/its associates have no actual / beneficial ownership of 1% or more securities of the subject company (ies) covered herein at the end of the month immediately preceding the date of publication of this report.

Further, the Research Analyst confirms that:

- (i) He, his associates and his relatives have no financial interest in the subject company (ies) covered herein, and they have no other material conflict in the subject company at the time of publication of this report.
- (ii) He, his associates and his relatives have no actual/beneficial ownership of 1% or more securities of the subject company (ies) covered herein at the end of the month immediately preceding the date of publication of this report.

2. Disclosures regarding Compensation:

During the past 12 months, Dion or its Associates:

(a) Have not managed or co-managed public offering of securities for the subject company (b) Have not received any compensation for investment banking or merchant banking or brokerage services from the subject company (c) Have received compensation for products or services other than investment banking or merchant banking or brokerage services from the subject. (d) Have not received any compensation or other benefits from the subject company or third party in connection with this report

3. Disclosure regarding the Research Analyst's connection with the subject company:

It is affirmed that I, Rohit Joshi employed as Research Analyst by Dion and engaged in the preparation of this report have not served as an officer, director or employee of the subject company

4. Disclosure regarding Market Making activity:

Neither Dion /its Research Analysts have engaged in market making activities for the subject company.

Copyright in this report vests exclusively with Dion.

