Larsen & Toubro Ltd

July 4, 2019

DALAL & BROACHA
STOCK BROKING PVT. LTD.

Analyst: Abhilasha Satale / Tanush Mehta

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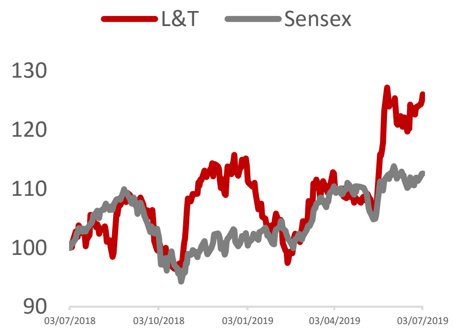
BUY	
Current Price	1578
Target Price	1850
Upside/Downside	18%
52 Week Range	1183/1606

Key Share Data	
Market Cap (Rs.bn)	2205
Market Cap (US$ mn)	324
No of o/s shares (mn)	1401
Face Value	2
Monthly Avg. Volume (BSE+NSE) Nos'000	2598
BSE Code	500510
NSE Code	LT
Bloomberg	LT:IN

Price performance



% Shareholding	Mar-19	Dec-18
Promoters	-	-
Institutions	56.89	57.14
Others	43.11	42.86
Total	**100.0**	**100.0**

Larsen & Toubro (L&T)'s order inflows have increased by 16% yoy in FY19E to Rs2.9bn (2.5xFY19 revenues). We expect order inflows to improve with better prospects in domestic and international market. L&T is well-placed to take advantage of country's infrastructure boom with strong balance sheet, strong cash flows, better technical expertise and high management bandwidth. We expect L&T's revenue and PAT to increase at a CAGR of 14% and 16% over FY19-FY21E. We value L&T on sum-of-the-parts method and arrive at target price of Rs1850 We recommend 'BUY'.

Huge Spending by Government to be a Growth Driver: With NDA getting into power again we feel infrastructure investment is likely to get major boost in the country. NDA government has vision to invest $800bn for infrastructure investment over five years. Many big infrastructure projects will get boost like Metro Rail, road development, bullet train, railway capex, defense procurement Bharatmala Pariyojana, SagarMala etc. L&T being largest developer in the country is likely to be major beneficiary of the same.

Incremental growth at lower capital employed

L&T has incorporated prudent change in strategy—exited non-core businesses (INR90bn over FY15-18) and pruned working capital despite adverse cycle. Working capital requirement for L&T has gone down to 18% of sales. Management has guided that working capital requirement will be maintained at 18%. This will improve ROE of L&T from 15% to 16% over FY19-21E.

Valuation

L&T has proven skills of project execution which makes the company formidable player in infra space. L&T's strength has led to rise in average ticket size and complex jobs, lending it a solid competitive edge. Great thrust on execution and balance sheet strength will lead L&T to capture large pie $800bn infra opportunity over FY19-23. We expect L&T's revenue and PAT to increase at a CAGR of 14% and 16% over FY19-FY21E. Levers to achieve this include maintaining steady growth in revenues with improvement in margins, control on working capital, divestment of non-core businesses, endeavoring to turn around under-utilized facilities, minimizing capital expenditure, avoiding investment in long-gestation or asset-heavy businesses and higher pay-outs to shareholders. At CMP L&T is trading at 23xFY20E and 19xFY21E earnings and 18xFY20E and 16xFY21E EV/EBITDA. We value L&T on sum-of-the-parts method and arrive at target price of Rs1850. We recommend **'BUY'**.

Key Financials (Rs Mns)

Year	Op Income	% Growth	EBIDTA	OPM%	PAT	% Growth	EPS	PE (x)	ROE%	ROCE%
FY17	1,100,110.0	9.4%	110,746.9	10.1%	60,412.3	148.0%	43.2	36.5	12.0	7.0
FY18	1,196,831.6	8.8%	136,414.8	11.4%	73,698.6	22.0%	52.6	29.9	13.4	8.1
FY19	1,410,070.9	17.8%	163,246.8	11.6%	89,051.0	20.8%	63.5	24.8	14.3	8.7
FY20E	1,628,512.4	15.5%	191,664.0	11.8%	97,972.7	10.0%	69.8	22.6	14.2	9.3
FY21E	1,838,995.0	12.9%	220,027.2	12.0%	116,123.0	18.5%	82.8	19.0	15.1	9.6

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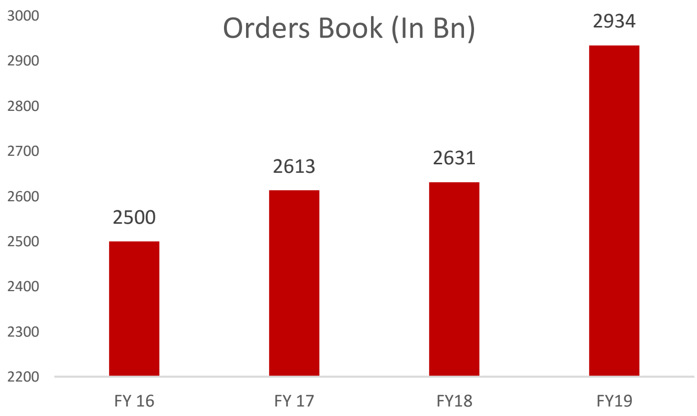
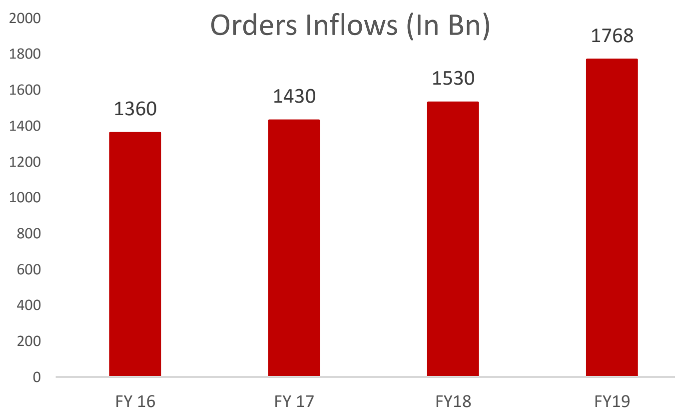
Investment Rationale

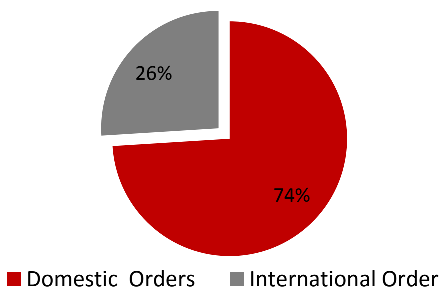
BJP's second term envisages $1.5tn infrastructure investment over five years

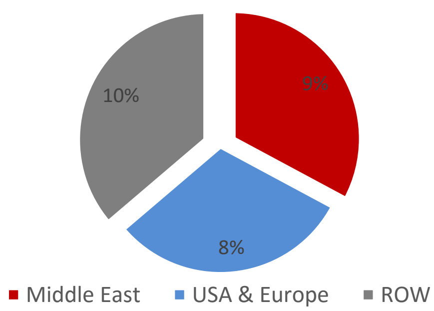
With NDA getting into power again we feel infrastructure investment is likely to get major boost in the country. NDA government has vision to invest $1.5tn for infrastructure investment over five years. Many big infrastructure projects will get boost like Metro Rail, road development, bullet train, railway capex, defense procurement Bharatmala Pariyojana, SagarMala etc. L&T being largest developer in the country is likely to be major beneficiary of the same. Total allocation for infrastructure in Budget of 2019-20 stands at 4.56lakh crore. We expect overall infrastructure spend to increase over next five years.

L&T's order inflows have gone up *16% YoY* to Rs1768bn in FY19. We expect order inflows momentum to improve in FY20E and FY21E with improved domestic as well as international prospects. The order inflows will be driven by segments like infrastructure, hydrocarbons and heavy engineering. Public sector contributes 70% to current order book. We expect order inflows to be driven by public sector in the medium term. The Current order book stands at Rs2934bn (2xFY19 sales).









Source – Company Presentation, Dalal & Broacha Research

L&T's Vision Lakshya is Well on-track

L&T has formulated its 5 year strategic plant LAKSHYA- spanning the years from 2016-17 to 2020-21. The strategic plan lays emphasis on profitable growth, harnessing emerging opportunities in defence, nuclear power and smart cities, productivity improvements. The overarching goal is to enhance ROE. Levers to achieve this include maintaining steady growth in revenues with improvement in margins, control on working capital, divestment of non-core businesses, endeavoring to turn around under-utilized facilities, minimizing capital expenditure, avoiding investment in long-gestation or asset-heavy businesses and higher pay-outs to shareholders. Over three years from FY17-19 management has been on-track to achieve vision 'Lakshya' through reducing working capital requirement and divesting non-core assets. For FY19 L&T achieve 12% revenue growth while working capital requirement has been reduced to 18% which is likely continue.

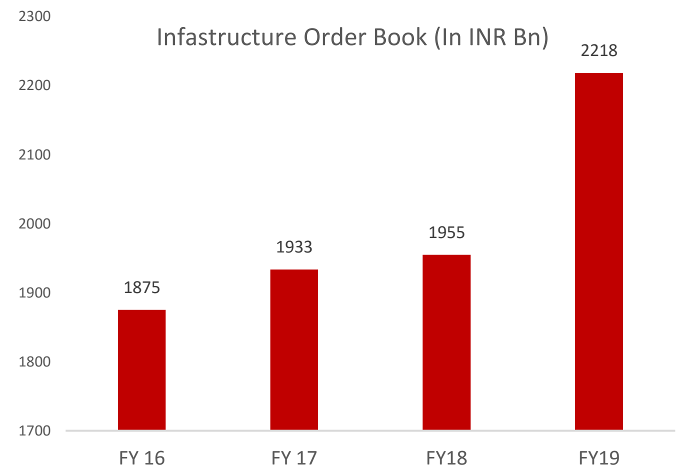
5 year strategic vision- FY17-22	
Revenue growth	12-15%
Sustainable EBITDA margin	11-12%
Net working capital(% of sales)	18
Divest operational road assets to LT investors	
Divest non-core assets, Nabha power, Hyd. Metro	
Improve ROE	

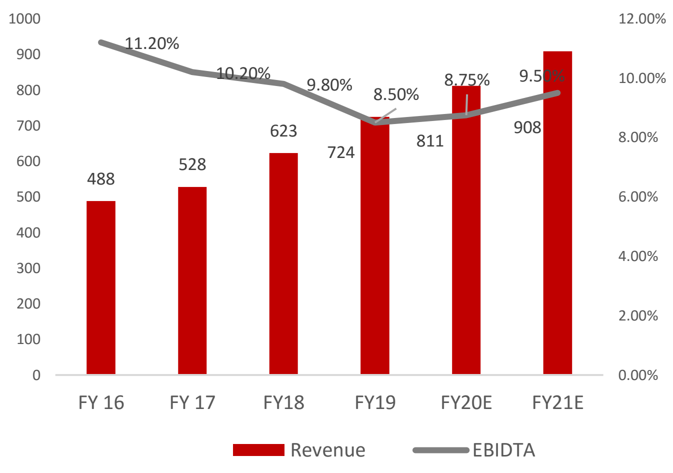
Infrastructure segment to drive growth

Infrastructure segment contributes 51.4% of L&T's revenue. Over FY14-18 infrastructure segment revenues posted growth of 13% CAGR. During FY19 order inflows for the segment have gone up 10% yoy at Rs954bn. The segment accounts for 75% of total order book at Rs2186bn which is 3xFY19 infrastructure segment sales. **We expect infrastructure segment to post growth of 12% CAGR over FY19-21E backed by better order execution from transport, building & factories and heavy civil infra.**

Composition of order inflows shifted towards large sized projects in FY19. Order inflows in infrastrucre segment are driven by building & factories, heavy civil infra and transport segment.

We expect infrastrure segment to post topline growth of 12% driven by improved order inflows outlook. Margin for the segment has gone down by 150bps yoy due to high commodity prices and merger of low margin MMH business. Overall fixed price orders contribute 50% to L&T's turnover. With contribution from fixed priced contracts going down over next 2-3 quarters we expect margin for the segment is likely to improve to 9.5% by FY21E.





Source – Company Presentation

Over the last one year L&T has won many projects across segments but majorly towards Infrastructure segment. Some of the large projects bagged are as under –

Date	FY	Name of the Client	Location/Country	Size of the Project
02.05.2019	2019-20	MA'ADEN Gold and Base Metal Company	Saudi Arabia	2500-5000 cr
02.04.2019	2019-20	Various	Middle East and the ASEAN region	2500-5000 cr
01.04.2019	2019-20	Kuwait oil Compay	Kuwait	2500-5000 cr
25.03.2019	2018-19	Jharkhand State Building Construction Corporation	Jharkhand, India	2500-5000 cr
07.03.2019	2018-19	Various Projects	Telangana & New Delhi	2500-5000 cr
06.03.2019	2018-19	Bangalore Metro Rail Corporation Limited	Banglore, India	2500-5000 cr
05.03.2019	2018-19	Water and Effluent Treatment Across various States	India	5000-7000 cr
18.02.20119	2018-19	Airport	India	>7000 cr
13.02.2019	2018-19	Construction of Hospitals	India	5000-7000 cr
01.10.2018	2018-19	Mumbai Coastal Road Project	Maharashtra, India	7489 cr
28.05.2018	2018-19	Narmada Valley Development Authority (NVDA), Government of Madhya Pradesh	Madhya Pradesh, India	5704 cr
22.05.2018	2018-19	PMAY	India	4033 cr

The Segments contributing to infrastructure are –

- **Building & Factories (B&F)**

L&T is leader in providing building solutions across the urban spectrum including residential and commercial buildings, affordable housing etc. The B&F segment has remained challenging over last 2 years. The client base has shifted towards public sector, as private sector deferred the investment plans due to economic reforms. Implementation of RERA and GST are positive for industrial development in the long-term, in our view. The new frontier in urban infrastructure is Smart Cities.

The company, bolstered by its execution prowess and balance sheet might, is well placed to corner a lion's share of the huge INR40tn potential infra opportunity over the next five years entailing multiple mega projects. As the capex cycle gets broad based, tight leash on working capital is envisaged to drive significant free cash flow.

- **Smart cities to attract investment**

The total investment in the Smart Cities Mission is envisaged to be over Rs 2tn through 5,151 projects. 896 projects worth approximately Rs 15,000 crore have been completed and another 1,895 projects worth Rs 75,000 crore are under implementation. The mission works closely with private players, including international firms, to leverage their capital, expertise, human resource, and technology. With initiatives like 'Housing for All' and 'Smart Cities Mission' the Government of India is working on reducing bottlenecks and impeding growth in the infrastructure sector. Rs 2.05 lakh crore (US$ 31.81 billion) will be invested in the smart cities mission. All 100 cities have been selected as of June 2018.

- **Rising compliance levels and utilization levels to boost private capex**

While tightening compliance norms are pushing up costs for companies, they are also opening up new growth opportunities for capital goods companies. Post implementation of Bharat Stage (BS) - I in 2002 over capex level seen 3-6% increase for automobile companies. Post that for every BS implementation capex levels has gone up by 5-8%. BS-VI implementation is expected in 2020E and overall capex levels are likely to go up by 8-10% for automobile companies benefiting capital goods companies. In May 2019, NITI Aayog CEO Amitabh Kant had suggested a complete switch to the use of electric two and three wheelers in India in a phased manner by March 31, 2023. This action would further attract more CAPEX in the auto industry.

Private sector capacity utilization levels have increased to 76% in March 19. With increasing demand and improving economic conditions we expect private sector capex to pick up across segments.

- **Water and Effluent Treatment**

India's wastewater treatment plants market is projected to grow at a CAGR of over 12% during 2016-2021, on account of surging demand for wastewater treatment plants from municipal and industrial sectors.

Over the last several years, L&T has commissioned 26 projects having a treatment capacity of 871 MLD treatment capacity. Currently, L&T has won 32 new orders projects under this segment and currently the order book stands at Rs. 16000 crores. Out of the above mentioned 32 projects, 10 are towards industrial and large water system, 10 towards waste water and 12 towards water supply and distribution. The said projects are spread across India, Srilanka, Africa and Middle East.

- **<u>Defense capex to get push</u>**

Since September 2017, Rs1.8 tn of approved weapon acquisitions have been reserved for domestic vendors providing a medium-term opportunity to both defence PSUs (DPSUs) and private players. The government has also set an ambitious target of achieving annual domestic defence production worth Rs1.7 tn by FY2025 (versus ~Rs380 bn in FY2019E).

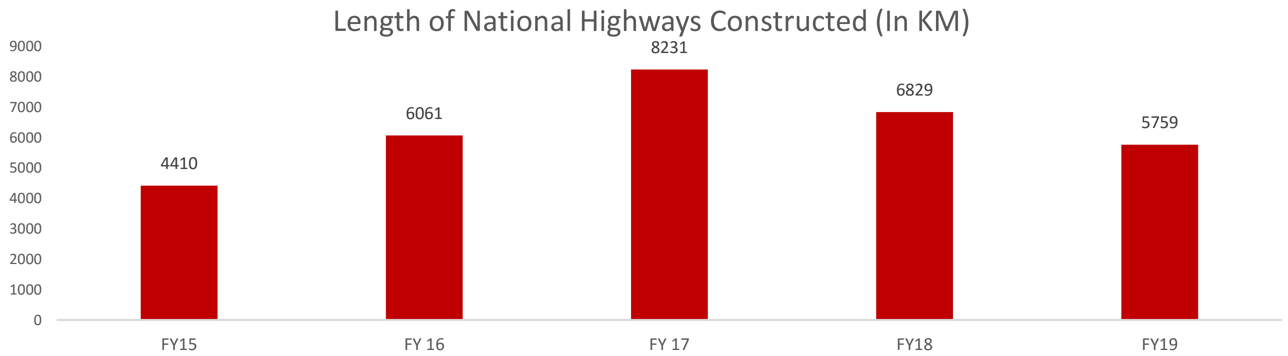
With 40-60% indigenous content requirement, it will significantly increase domestic manufacturing of weapons and subsystems and provide domestic players a business opportunity worth Rs310- 470 bn from Indigenously Designed Developed and Manufactured (IDDM) approvals over the last 18 months. In FY19, L&T won mega order from the Indian Navy.

- **NHAI investment has seen highest growth**

Highway construction in India increased at 23 per cent CAGR between FY14-18. In FY18, 9,829 km of highways were constructed with an expenditure of Rs 1.16 trillion (US$ 18.05 billion). Road building in India has become the second cheapest in Asia. In Union Budget 2019-20, Rs 83,015.97 crore (US$ 11.51 billion) was allocated for National Highways Authority of India (NHAI) while Rs 19,000 crore (US$ 2.63 billion) was allocated to Pradhan Mantri Gram Sadak Yojana (PMGSY) for development of roads in rural and backward areas of the country.

All villages in India will be connected through a road network by 2019 under Pradhan Mantri Gram Sadak Yojana (PMGSY). A target of constructing 10,000 km long National Highways during 2018-19 was set up out of which 6,715 km have been constructed, as of December 2018. Order awarding picked up in 4QFY19 (before the election code of conduct kicked in), resulted in awards touching 2,200km, a far cry from NHAI's initial target of 7,500km awards during FY19. Post elections Nitin Gadkari has given a vision of investing Rs15lacs in roads infrastructure over 5 years. NHAI has started the tendering process for projects worth ~Rs 960bn. Out of this HAM accounts for ~41%.

In roads segment L&T bids for high ticket EPC orders. The company mainly concentrates on expressways as cost of building expressway is 3xmore than building roads. The cost of building road is Rs10-12cr/km while the same for expressways is Rs30-40cr/km. **L&T witnessing order inflows of Rs150-200bn under this vertical.**



Source – NHAI

- **Railways and Metro- big investments expected**

For 2019-20, the total capital expenditure of Railways is expected to be Rs 1.59 trillion (US$ 22.04 billion). As per Union Budget 2018-19, capacity constraints in the railways network will be eliminated through doubling of 18,000 km of tracks, third and fourth lines and conversion of 5,000 km of tracks into broad gauge.

Railway has network of 69768kms and 30318kms (45%) has been electrified. Government is likely to electrify 36000kms upto FY22 unfolding opportunity of Rs360bn.

At least Ten Indian Cities are working on metro railway projects and the government initiated a plan in 2012 to study the feasibility of such networks in all cities with a population of more than 2 million. **Metro rail projects worth over Rs 2.5tn are underway in India and this pile will probably grow.** A new Metro Rail Policy was announced in August 2017, which will give boost to private investments by mandating public private partnership (PPP) component in new projects. A new committee to lay down standards for metro rail systems was approved in June 2018.

- **Airports and coastal development to attract investment of Rs210bn**

2,000 kms of coastal connectivity roads have been identified for construction and development. Select airports in Tier 2 cities will be taken up for operation and maintenance in the PPP mode in the coming years. The Government of India will construct 65,000 km of highways by 2022.

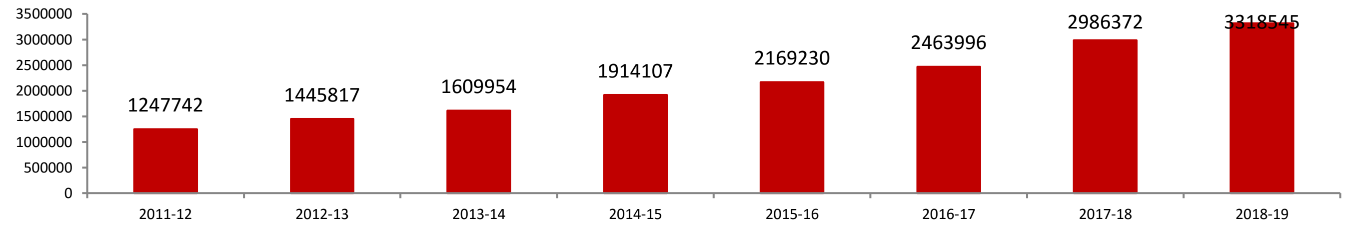
The Airports Authority of India aims to bring around 250 airports under operation across the country by 2020. The AAI has developed and upgraded over 23 metro airports in the last 5 years. AAI plans to develop city-side infrastructure at 13 regional airports across India. The AAI plans to spend over Rs 21,000 crore (US$ 3.2 billion) between 2018-22 to build new terminal and expand capacity of existing ones. AAI plans to develop over 20 airports in tier II and III cities in next 5 years. 56 new airports are expected to become functional in the country over the next few years.

- **Indian states' share in overall infrastructure spend is increasing**

In the last eight years, the total expenditure of states has witnessed an average annual growth rate of 15%. It has increased from Rs 12.4tn in 2011-12 to Rs 33.2tn in 2018-79. As per Crisil report central government's contribution in overall capex has gone down from 67.4% in 2010 to 51.3% in 2018. Tamil Nadu and Rajasthan are the other large spenders on overall infrastructure and are also growing at a higher rate of 22-28%. Between states, there is a marked difference in terms of the spend pattern. For instance, while Rajasthan, Telangana, and UP are the big spenders in water supply & sanitation, it is Tamil Nadu, West Bengal and Karnataka for urban development. For transport, Odisha, Jharkhand and Chhattisgarh are the big spenders, while UP is practically the only worthwhile spender on housing. Currently there are 9400 infrastructure projects under construction rendered by various states having total investment of around $1tn.

The following chart represents the expenditure incurred by all the states cumulatively, followed by a table representing list of states and their top areas of expenditure –

Expenditure incurred by States Cumulatively (Rs Cr)



Soucre – Dalal & Broacha Research, Industry Reports

States- areas of major investments

Areas of Expenditure(In Crore)	FY17A	FY18RE	FY19BE
Irrigation and Flood Control	833	946	1118
Housing, Water and Sanitation	948	1080	1111
Energy	452	632	779
Rural Development	531	489	456
Others	239	340	426
Education and Wealth	250	324	422
General Services	253	342	405
Activities	189	288	350
Welfare of ST/SC	164	156	1859

Soucre – Dalal & Broacha Research, Industry Reports

Multilateral agencies funding has increased substantially

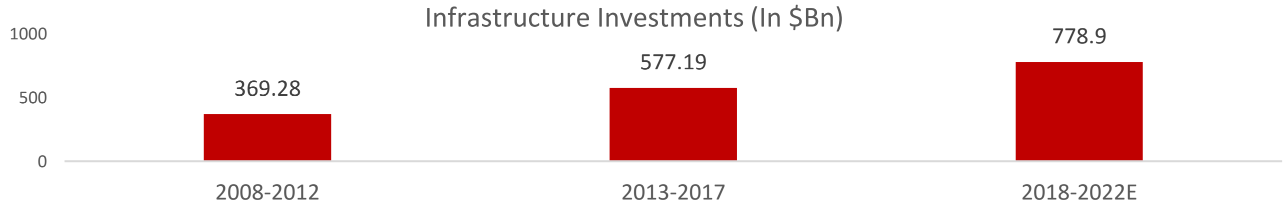
Foreign Direct Investment (FDI) received in Construction Development sector (townships, housing, built up infrastructure and construction development projects) from April 2000 to December 2018 stood at US$ 24.91 billion, according to the Department of Industrial Policy and Promotion (DIPP). Many Multi-lateral agencies China Harbour Engineering, JICA and Mizuho Financial Group have invested in India infrastructure.

India has a requirement of investment worth Rs 50 trillion (US$ 777.73 billion) in infrastructure by 2022 to have sustainable development in the country. India is expected to become the third largest construction market globally by 2022. 100 per cent FDI is permitted under the automatic across various infrastructure sectors. India is witnessing significant interest from international investors in the infrastructure space. Some key investments in the sector are listed below.

- In 2018, infrastructure sector in India witnessed private equity and venture capital investments worth US$ 1.97 billion.
- In June 2018, the Asian Infrastructure Investment Bank (AIIB) has announced US$ 200 million investment into the National Investment & Infrastructure Fund (NIIF).
- Indian infrastructure sector witnessed 91 M&A deals worth US$ 5.4 billion in 2017

- Japanese investment has played significant role in India's growth story. Japan has pledged investments of around US$35 billion for the period of 2014-19 to boost India's manufacturing and infrastructure sectors.

- As of October 2018, the US government's Overseas Private Investment Corporation (OPIC) is planning to invest in India's infrastructure, port and solar energy sectors.



Source – Dalal & Broacha Research, Industry Reports

Municipal bonds gaining momentum

The key to fund city infra projects, the first muni bonds (bonds issued by Municipal Corporation) were issued in India in 1998 by the Ahmedabad Municipal Corporation. After a long gap, municipal corporations in recent times are once again issuing bonds to finance their infrastructure project requirements.

Power Generation- Inflows to remain stable for L&T

A slowdown in the thermal power generation sector across the last few years has led to aggressive bidding, as competitors vie for the limited opportunities on offer. Overall capacity addition in the domestic industry in thermal power is 6-7GW per annum as against capacity of 36GW. Thus, there is lot of unutilized capacity in this space. With overcapacity prevailing in power sector in India the sector is not likely to revive soon. Therefore, we expect order inflows from power generation to remain lull. L&T has made in-roads into international markets through successfully implementing gas-fired power plants in Bangladesh. Management plans to augment international opportunities in this segment through JV partners and improve capacity utilization.

Power segment contributes 2.8% to revenue. Order inflows for this segment have gone down by 25% yoy to Rs70bn in FY19. We expect order inflows to pick up from low base in FY20E. Overall revenue growth is likely to remain lackluster in this segment.

Power T&D

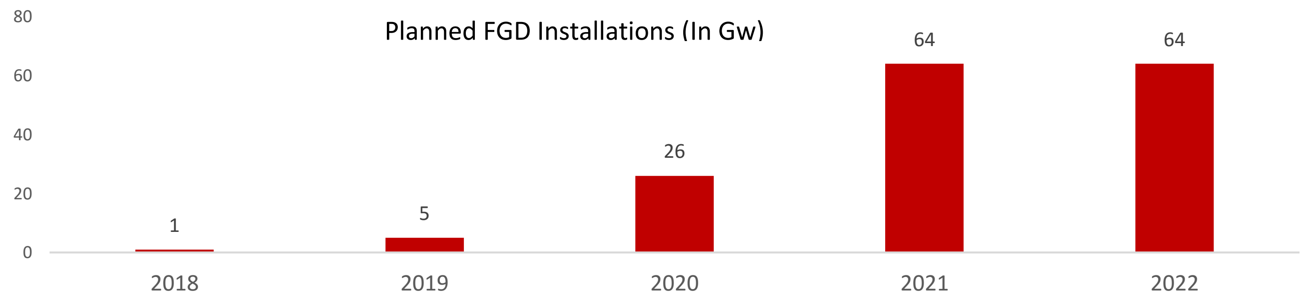
In last few years, India has seen strong capex in power distribution space led by Pradhan Mantri Sahaj Bijli Har Ghar Yojana (SAUBHAGYA) and various distribution reforms by the SEBs for reducing AT&C loss and strengthening network. Urban power sector also witnessed strong growth in underground cable networks and advanced metering facilities. Currently, there are huge opportunities for EHV (Extra High Voltage) cabling projects in large cities. Power T&D capex is pegged at Rs2.6bn over next five years.

Power- FGD opportunity

To improve the air quality around power plants, the Ministry of Environment, Forests and Climate Change had set, in 2015, new norms for coal-based power stations aimed at cutting emissions of Sulphur dioxide (SO2) and oxides of nitrogen (NOx) to certain levels within two years from the date of notification. It also specifies modified limits for specific water consumption by TPPs and insists to convert existing once through based condenser cooling system to recirculation type. Different limits are specified based on capacity of power plant and year of installation. Over the period, the deadline has been extended to 2022.

Based on the CEA's report, out of the 197GW of installed capacity considered, about 162GW worth of capacity would require compliance with FGD norms. These projects will be awarded in a phased manner up to FY22, translating into an overall opportunity of about INR500bn. At end-September 2018, 15GW contracts have been awarded. Selective Catalyst Reduction (SCR) compliance is likely to open an opportunity of INR300bn over the next few years.

Source – Dalal & Broacha Research, Industry Reports



Hydrocarbons

L&T Hydrocarbon delivers design-to-build for oil & gas processing, petroleum refining, chemicals & petrochemicals and fertilizer sectors. L&T has in-house expertise and experience, synergized with strategic partnerships enables them to deliver a single point solution for every phase of a project – from front-end design through engineering, fabrication, project management, and construction and installation right up to commissioning.

Further, over the period of last 3 years, Hydrocarbons business contribution to the business has increased from 9% in FY16 to 10.7% in FY19. On the other hand, this segment contributes 11.20% of the orders in hand as compared to 6% in FY19. **The order inflows have remained strong over the last 3 years, which has increased from Rs. 96bn in FY 16 (7% of the Order Inflows) to Rs. 279bn in FY19 (15.8% of the Order Inflows).** Currently under this segment, 47% of the revenue is coming from Domestic projects and the balance 53% from International projects, as of FY19.

We expect this segment to have huge order inflows over the years from international and domestic markets to speed up this sector –

Global CAPEX - Globally more than US$3 trillion in capital expenditure is expected to be spent across oil and gas value chain on planned and announced projects during 2018 to 2025. Of the total capex, about 43% could be spent on midstream projects,

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23% on upstream production projects and 21% on crude oil refineries. The petrochemicals sector is expected to account for about 13% of the global capex.

Domestic CAPEX – The domestic CAPEX is driven by majorly by Government expenditure and then followed by private expenditure. As per the latest Budget, The Exploration and Production (E&P) segment's overall capital outlay is seen dropping 6.69 per cent to Rs 49,057 in 2019-2020 from Rs 52,575 crore spent in 2018-2019. The Refining and Marketing segment has witnessed a 6 per cent increase in capital outlay at Rs 39,390 crore for the next financial year as compared to Rs 37,136 crore spent in 2018-2019.

PSU	FY19 (RE)	FY 20 (BE)
ONGC	33007	32921
IOC	25582	25084
HPCL	8425	9500
BPCL	7400	7900
ONGC Videsh	6111	5161
OIL India	3849	4105
GAIL	5902	5339
CPCL	1190	1105
Numaligarh Refinery	403	455
MRPL	995	818
Balmer Lawrie	125	40
EIL	1449	1212
TOTAL	**94438**	**93639**

Source – Dalal & Broacha Research, Industry Reports

Heavy Engineering Segment

The Heavy Engineering business designs and fabricates engineered critical equipment and systems for several sectors i.e. fertiliser, refinery, petrochemical, chemical, oil & gas, thermal/nuclear power, aerospace and defence applications. The segment contributes 1.5% of current order book and revenue. Order inflows have been driven by oders from oil & gas sector. International markets showing strong traction in Refineries space; has driven growth in inflows (78%) and order book 61% in FY19. Global competence, technology diffrentiation, proven tract record and cost efficiencies improved margin for the segment from 21% to 24.5% yoy in FY19.

Capex cycle by major players in the domestic sector by IOCL, HPCL, HMEL and BPCL for capacity enhancement and BS-VI upgradation to comply with the applicable fuel stanards. This is going to benefit the business in the form of steady order inlosw in the medium term.

In Nuclear power sector NPCIL is likely to build 10 nuclear power plants of 700MW each. This is likely to provide good opportunity for L&T. We expect revenue from heavy engineering segment to increase at a CAGR of 20% over FY19-21E and margin is likely to be 20%

Strong order inflows to improve revenue growth

L&T's order inflows increased by 12% yoy in FY19 to Rs1768bn. Oder inflows are contributed increased hydrocarbon orders from international operations and pick up in domestic public sector driven by state government orders. Domestic order inflows account for 73.5% of total order inflows followed by 8.7% from Middle East, 8.2% from USA & Europe, and 9.6% ROW.

Selling of non-core businesses has improved cash flows

In May'18, L&T announced sale of its E&A business to Schneider Electric for an all-cash consideration of Rs140bn. During last few years, the Company has monetized its investments in several asset-heavy businesses and JVs. It sold loss-making (loss of Rs1 bn) general insurance business, sold stakes in IT and tech services through IPO. Further, the Company demerged the port business and divested the stake in the company to Adani Group. The Company plans to divest Nabha Power and plans to monetize its operational road projects through a Trust structure.

L&T's Acquisition over Mindtree

L&T recently acquired 60.03% stake in Mindtree. For L&T, it is a good opportunity to grow the IT&TS business portfolio which already consists of L&T Infotech (LTI) and L&T Technology services(LTTS). This acquisition is highly revenue accretive. The acquisition is being carried out of surplus cash available with L&T. The maximum cost of acquisition would be Rs. 107.3 bn including the acquisition by open offer.

Synergies – Currently L&T offers IT services through LTI & LTTS. With this acquisition, there would be limited client overlap, significant boost to L&T Group's Hi-tech, CPG, Retail and Travel verticals and would significantly enhance digital capabilities and presence in IMS & cloud.

Future – Currently Mindtree earns 13-14% EBITDA margins and L&T plans to scale it upto LTI's levels of 17-18%. Post that the L&T plans to merge both the companies to create a complete synergy benefit.

Outlook – We expect this acquisition to be highly fruitful in the near future as there are high synergy benefits that will flow into the company bringing in high margins at EBIDTA levels.

Valuation

We expect L&T to post revenue CAGR of 14% over FY19-21E driven by better execution in its infrastructure division. We expect 50bps margin expansion over two years period. Over a period we expect bottomline to grow at a CAGR of 16%. We expect working requirement for the firm to be maintained at 18%. Therefore, improved cash flows are likely to improve ROE of the company from current 14% to 15% over FY19-21E and ROCE is likely to improve from 9% to 10% over the same period.

At current price L&T is trading at 23xFY20E and 19xFY21E earnings and 18xFY20E and 16xFY21E EV/EBITDA. We value the company on Sum-of-the-part methodology and arrive at target price of Rs1850 showing 18% upside from current levels.

Segments	L&T share	Valuation Metric	Multiple (x)	Rs bn FY20E EBITDA	Rs bn EV	Rs/ share
Infrastructure	100%	EV/EBITDA	15.0	89.5	1,342	957
Power	100%	EV/EBITDA	8.0	2.2	18	13
Heavy Engineering	100%	EV/EBITDA	12.5	7.4	92	66
Defence Engineering	100%	EV/EBITDA	12.5	6.1	76	54
Electrical and Automation	100%	EV/EBITDA	11.9	-	-	-
Hydrocarbon	100%	EV/EBITDA	14.0	25.2	353	252
IT & ITES	77%	EV/EBITDA	10.0	42.0	384	274
Others	100%	EV/EBITDA	10.0	18.8	188	134
			13.5	**191.2**	**2,453**	**1,749**
Less: Net Debt (ex- Dev projects and Fin services)					107	77
Less: Inter-segment elimination	7%	EV/EBITDA	13.5	12.1	11	8
Equity value (ex Dev Projects and Fin Services)					**2,357**	**1,681**

Segments	L&T share	Valuation Metric	Multiple (x)	Rs bn Book Value	Rs bn Equity Value	Rs/ share
Developmental Projects		P/BV (FY20)	0.7	98.4	71	50
Financial Services	64%				166	119
					238	**170**

	Equity Value (Rs bn)	Rs/ share
Equity Value L&T (March 2020)	**2,596**	**1,850**
% upside		**18%**

Developmental Projects

L&T IDPL

L&T IDPL is a major player in PPP projects in India for Roads & Bridges, Ports, Wind Energy and emerging sectors i.e. power transmission lines. Currently, it has a portfolio of 17 projects of with a cost of ~Rs175bn, which includes 15 road projects (7,182 km) 1 transmission line project and a port berth at Haldia. L&T IDPL's portfolio of infrastructure assets also includes windmills in Tamil Nadu. L&T IDPL is one of India's largest infrastructure developers with a proven track record across sectors.

The portfolio of road projects includes some of the most economically significant and high traffic corridors connecting key industrial cities and ports in India. Overall revenue increased by 19% yoy to Rs1893cr during FY19. The transmission line segment has gross collections of Rs202cr as annuity payments.

In May 2018 L&T IDPL launched a private placed InvIT (infrastructure investment trust) with an initial portfolio of five road assets. This InvIT raised Rs3700cr, with 55% of the funds coming from international investors from Canada and Germany.

Hyderabad Metro- Long term value creator

Hyderabad metro rail project implemented by an SPV namely L&T Metro Rail (Hyderabad) Ltd. on a Design-Build Finance-Operate-Transfer (DBFOT) basis vide a concession agreement signed with the Government of Telangana. The concession period is 35 years including the initial construction period of 5 years. The concession period is extendable for a further period of 25 years. The estimated project cost is Rs16375cr which includes the cost of rail system and 6mn TOD which is to be funded by a term loan of Rs11478cr and equity share capital of Rs3439cr and Viability Gap Fund from Government of Rs1458cr. The Hyderabad metro rail network will cover a total distance of ~72 km across 3 corridors. The project will include ~18.5mn sqr.ft of Transit-Oriented Development (TOD) in the earmarked parking and circulation areas and depots.

L&T Power Development group

The power development group invests, develops, operates and maintains the power generation projects both thermal and hydel. If Hydel Power Projects: Hydel projects with an aggregate capacity of 870 MW are in various stages of execution.

NPL owns and operates a 2*700MW supercritical thermal power plant at Rajpura, Punjab. Entire power generated from this plant is sold to Punjab State Power Corp Ltd (PSPCL) under PPA. The power plant has been running successfully with PLF of 85% in FY19.

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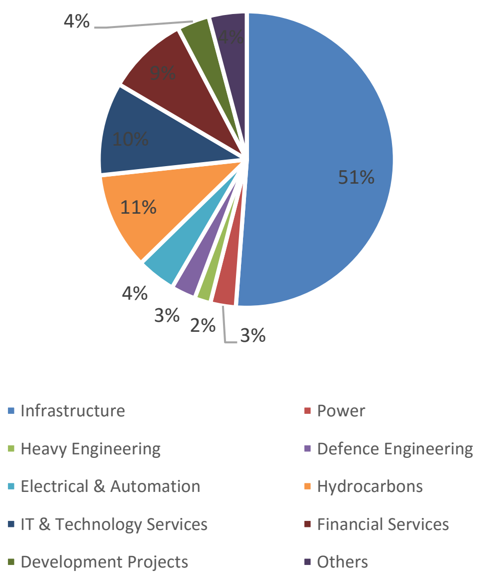
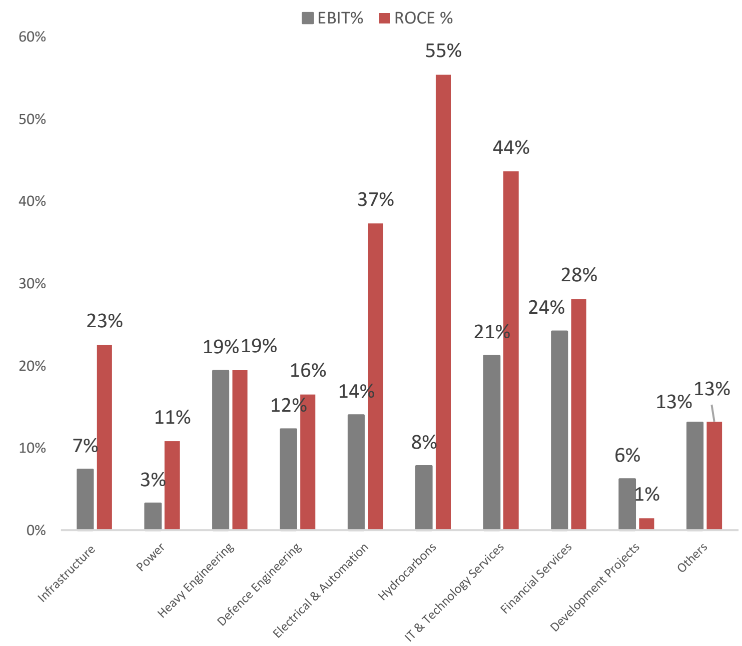
Company Background

Larsen & Toubro Limited, commonly known as L&T Limited is an Indian multinational conglomerate company leading in nearly every sphere of business it operates in. It serves customers in more than 30 countries, across various industries. The company has business interests in heavy engineering, construction, realty, manufacturing of capital goods, information technology, and financial services. As at March 31, 2018, L&T Group comprises 93 subsidiaries, 8 associates, 34 joint-venture and 33 joint operations companies

The company's Engineering Construction & Contracts Division (ECCD) undertakes engineering design and construction of infrastructure buildings factories water supply and metallurgical & material handling projects covering civil mechanical electrical and instrumentation engineering disciplines. Their Engineering & Construction Division designs engineering and executes projects for hydrocarbon sector with front-end design. Its heavy engineering division is organized into two independent companies: Heavy Engineering Independent Company and Ship Building Independent Company. It continues to grow its overseas manufacturing footprint with facilities in China and the Gulf region. The company's businesses are supported by a wide marketing and distribution network and have established a reputation for strong customer support. Further its technology arm, LTTS is s an engineering services company that operates in the global Engineering, Research and Development ("ER&D") space. L&T Technology Services offers design, development and testing services for the industrial products, medical devices, transportation, aerospace, telecom and process industries and LTI offers infrastructure management services, consulting services etc, across various industries. Its fiancé arm L&T Finance Holdings is in the lending business having spreads across Infrastructure, Rural Financing, corporate financing, 2W & 3W loans etc. The Revenue breakup of L&T followed by it's Margins and ROCE of respective segments for the FY19 is as under -





Source – Dalal & Broacha Research, Industry Reports

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L&T Ltd Financial data

P&L (Rs mn)	FY16	FY17	FY18	FY19	FY20E	FY21E
Net Sales	1,019,753.4	1,100,110.0	1,196,831.6	1,410,070.9	1,628,512.4	1,838,995.0
Cost of Sales	915,125.0	989,363.1	1,060,416.8	1,246,824.1	1,436,848.4	1,618,967.8
Operating Profit	**104,628.4**	**110,746.9**	**136,414.8**	**163,246.8**	**191,664.0**	**220,027.2**
Depreciation	17,867.3	23,699.3	19,287.3	20,840.0	25,492.2	28,378.1
PBIT	86,761.1	87,047.6	117,127.5	142,406.8	166,171.8	191,649.1
Other income	9,043.5	14,010.1	13,419.3	18,515.0	14,138.0	16,378.0
Interest	16,550.6	13,398.4	15,385.2	18,060.4	25,070.3	23,239.1
Profit before tax	79,254.0	87,659.3	115,161.6	142,861.4	155,239.4	184,788.0
Exceptional and Extra Ordinary Items	942.2	1,214.3	1,230.0	2,947.5	-	-
share of profit/loss in JV	(9,901.6)	(3,952.7)	(4,358.6)	(210.0)	(663.2)	600.8
PBT (Post Extra Ordinary)	70,294.6	84,920.9	112,033.0	145,598.9	154,576.2	185,388.8
Provision for tax	24,847.6	20,065.9	31,988.7	43,433.4	48,439.0	58,922.0
Reported PAT	**45,447.0**	**64,855.0**	**80,044.3**	**102,165.5**	**106,137.2**	**126,466.8**
MI	(3,118.2)	(4,442.7)	(6,345.7)	(13,114.5)	(8,164.5)	(10,343.8)
Adjusted PAT	**42,328.8**	**60,412.3**	**73,698.6**	**89,051.0**	**97,972.7**	**116,123.0**

Cash Flow St. (Rs. mn)	FY16	FY17	FY18	FY19	FY20E	FY21E
Net Profit	45,447.0	64,855.0	80,044.3	102,165.5	106,137.2	126,466.8
Add: Dep. & Amort.	17,867.3	23,699.3	19,287.3	20,840.0	25,492.2	28,378.1
Minority Interest	3,118.2	4,442.7	6,345.7	13,114.5	8,164.5	10,343.8
Cash profits	**66,432.5**	**92,997.0**	**105,677.3**	**136,120.0**	**139,794.0**	**165,188.7**
-Sundry debtors	40,643.9	(26,639.9)	(44,280.1)	(39,211.9)	(60,329.0)	(56,440.4)
-Inventories	16,639.8	7,144.7	(7,080.6)	(15,661.3)	2,020.6	(7,847.9)
-Loans/advances	(112,277.4)	(54,666.3)	(151,923.2)	(130,661.4)	(133,717.0)	(153,774.6)
'-Current Liab and Provisions	(48,919.0)	10,724.0	24,780.6	49,339.0	60,408.3	54,206.5
'- Other Assets	(214,295.2)	28.3	(106,386.8)	(36,635.8)	(69,523.7)	(46,148.5)
'- Sundry Creditors	21,445.7	32,913.0	75,001.0	51,998.5	(288.7)	55,466.1
Change in working capital	(296,762.2)	(30,496.2)	(209,889.1)	(120,832.9)	(201,429.6)	(154,538.8)
CF from Oper. activities	**(230,329.7)**	**62,500.8**	**(104,211.8)**	**15,287.1**	**(61,635.6)**	**10,649.9**
CF from Inv. activities	**102,902.4**	**(59,841.1)**	**60,414.3**	**(32,955.6)**	**11,543.0**	**10,270.0**
CF from Fin. activities	**(28,931.9)**	**58,467.3**	**114,171.9**	**156,614.5**	**(28,287.0)**	**85,764.0**
Cash generated/(utilised)	**(156,359.3)**	**61,127.1**	**70,374.4**	**138,946.0**	**(78,379.6)**	**106,683.9**
Cash at start of the year	58,555.2	53,899.1	53,059.6	80,325.3	117,262.4	(8,253.4)
Cash at end of the year	(97,804.1)	115,026.2	123,434.0	219,271.3	38,882.8	98,430.5

Balance Sheet	FY16	FY17	FY18	FY19	FY20E	FY21E
Equity capital	1,863.0	2,798.9	2,802.7	2,805.5	2,805.5	2,805.5
Reserves	439,940.60	499,366.35	546,232.30	620,942.50	687,937.50	767,560.50
Net worth	**441,803.6**	**502,165.2**	**549,035.0**	**623,748.0**	**690,743.0**	**770,366.0**
Minority Interest	**28,928.4**	**35,636.0**	**52,014.3**	**68,621.1**	**76,785.6**	**87,129.4**
Non Current Liabilites	918,629.0	978,834.8	1,114,163.2	1,276,174.5	1,278,028.8	1,398,942.5
Current Liabilites	544,181.4	587,818.4	687,600.0	788,937.5	849,057.1	958,729.7
CAPITAL EMPLOYED	**1,933,542.4**	**2,104,454.4**	**2,402,812.5**	**2,757,481.1**	**2,894,614.6**	**3,215,167.5**
Non Current Assets	421,947.0	513,774.4	488,473.6	562,411.1	559,396.6	553,834.2
Fixed Assets	252,826.5	266,125.0	276,284.1	290,393.7	287,379.2	281,816.8
Non Current Investments	154,650.9	233,662.8	196,571.7	253,748.3	253,748.3	253,748.3
Goodwill	14,469.6	13,986.6	15,617.8	18,269.1	18,269.1	18,269.1
Current Assets	1,511,595.5	1,590,680.1	1,928,981.1	2,194,740.3	2,414,314.9	2,728,158.4
Inventories	48,542.1	41,397.4	48,478.0	64,139.3	62,118.7	69,966.6
Trade Receivables	260,249.8	286,889.7	331,169.8	370,381.7	430,710.7	487,151.1
Cash and Bank Balances	53,899.1	53,059.6	80,325.3	117,262.4	71,491.0	116,019.0
Short Term Loans and Advances	688,469.5	748,926.7	902,214.5	1,039,527.6	1,177,041.4	1,335,920.2
Other Current Assets	460,435.0	460,406.7	566,793.5	603,429.3	672,953.0	719,101.5
CAPITAL DEPLOYED	**1,933,542.5**	**2,104,454.5**	**2,417,454.7**	**2,757,151.4**	**2,894,614.6**	**3,215,167.5**

Ratios	FY16	FY17	FY18	FY19	FY20E	FY21E
OPM	10.3	10.1	11.4	11.6	11.8	12.0
NPM	4.1	5.4	6.1	6.2	6.0	6.3
Tax rate	31.4	22.9	27.8	30.4	31.2	31.9
Growth Ratios (%)						
Net Sales	10.8	7.9	8.8	17.8	15.5	12.9
Operating Profit	(7.7)	5.8	23.2	19.7	17.4	14.8
PBIT	(0.4)	0.3	34.6	21.6	16.7	15.3
PAT	(3.5)	42.7	22.0	20.8	10.0	18.5
Per Share (Rs.)						
Net Earnings (EPS)	45.4	43.2	52.59	63.5	69.8	82.8
Cash Earnings (CPS)	26.3	26.2	38.8	48.6	51.7	62.6
Dividend	-	50.1	200.5	401.0	401.0	401.0
Book Value	474.3	358.8	391.8	444.7	492.4	549.2
Free Cash Flow	(136.8)	1.9	(31.3)	(12.6)	(35.7)	14.9
Valuation Ratios						
P/E(x)	**35**	**36**	**30**	**25**	**23**	**19**
P/B(x)	3.3	4.4	4.0	3.5	3.2	2.9
EV/EBIDTA(x)	22.4	28.4	23.9	20.8	18.0	16.0
Div. Yield(%)	-	3.2	12.7	25.5	25.5	25.5
FCF Yield(%)	**(8.7)**	**0.1**	**(2.0)**	**(0.8)**	**(2.3)**	**0.9**
Return Ratios (%)						
ROE	9.58	12.03	13.42	14.28	14.18	15.1
ROCE	6.96	6.96	8.08	8.74	9.31	9.63

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