"Larsen & Toubro Limited Q4 & FY21 Earnings Conference Call"

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Moderator: Ladies and gentlemen, good day, and welcome to the Larsen & Toubro Limited Q4 & FY21 Earnings Conference Call. As a reminder, all participant lines will be in the listen-only mode and there will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the conference call, please signal an operator by pressing "*" then "0" on your touchtone phone. Please note that this conference is being recorded.

I now hand the conference over to Mr. P. Ramakrishnan – Head Investor Relations, Larsen & Toubro Limited. Thank you and over to you, sir.

P. Ramakrishnan: Thank you, Margaret. Good morning, ladies and gentlemen. A very warm welcome to all of you to this Q4 and FY21 Earnings Call of Larsen & Toubro Limited. We have with us on the call today, our Chief Executive Officer and Managing Director – Mr. S. N. Subrahmanyan, and our Whole-Time Director and Chief Financial Officer – Mr. Shankar Raman.

The Analyst Presentation was uploaded on our website yesterday at 7 pm. Hope all of you would have had a chance to go through the same. Instead of going through the entire presentation, I will give you a brief overview of the performance in the first 15 minutes or so. Post which we will take Q&A.

Before I begin the overview, a brief disclaimer. The presentation which we have uploaded on our website yesterday and the discussions we will have on the call today contains or may contain certain forward-looking statements concerning L&T’s business prospects and profitability, which are subject to several risks and uncertainties, and the actual results could materially differ from those in such forward-looking statements or discussions.

FY21 was a year that witnessed unprecedented change. It can be best described as the year of test for all the constituents of the Indian economic system, be it households, Corporates and the Government. The financial year commenced with a lockdown and the country had to face a deep contraction in economic output. Moreover, thanks to the timely intervention from both the Government and the Reserve Bank of India, the country recovered progressively with each passing quarter. The Q1 economic contraction was the most, followed by a shallow contraction in Q2 and Q3 reported growth. Q4 GDP numbers are yet to be published, but we do believe India would have degrown between 7% to 8% in real GDP terms in FY21.

Now coming to company performance:

We have had multiple surprises in a COVID impacted year. Important is, most of the parameters of our core business had come back to normalcy much faster than we expected. Our order inflows for the year at Rs. 1.75 trillion was achieved on the back of strong domestic wins in Infrastructure and Hydrocarbon segments. We picked up very large and prestigious orders, notably the Mumbai-Ahmedabad High Speed Rail, the bridge across the Brahmaputra in Assam, and the EPCC Package for the Rajasthan refinery. The order book at Rs. 3.27 trillion as of March 31, 2021, is at near record levels. A healthy and diversified order book provides us revenue visibility and mitigates cyclicality.

Secondly, a predominance of public exposure in the order book, around 83%, reduces credit risk in these challenging times. Our revenues picked up momentum with every passing quarter, despite experiencing productivity challenges due to the ongoing pandemic. We ended the year with revenues of Rs. 1.36 trillion. Just for reference, our Q1 revenues were Rs. 210 billion, Q2 at Rs. 310 billion, Q3 at Rs. 356 billion and we ended Q4 with revenues of Rs. 481 billion. As you can see, there is a strong sequential pickup with every passing quarter of FY21. The Q4 FY21 growth on a Y-o-Y basis was 9% higher, evidencing return to pre-COVID levels of activity.

Our overall EBITDA margins for FY21 improved from 11.2% in FY20 to 11.5% in FY21, despite the headwinds emerging from the overhead under recoveries in a COVID year.

We have been most surprised on the customer collections front in FY21. Thanks to the government for having adequately prepared itself in a COVID year, through a large borrowing program, we witnessed strong cash flows in FY21. Our group level collections in FY21 were Rs. 1.26 trillion, whereas at a parent level, in FY21, we collected Rs. 760 billion, out of which Q4 collections was Rs. 270 billion. We ensured that the collection from customers also got passed on to our supply chain in a similar manner.

In addition to making normal payments, the government in a difficult year also supported contractors by releasing claims, retention payments, as well as relaxing bank guarantee requirements. Consequently, our net working capital improved from 23.7% as at March 2020, to 22.3% as at March 2021. The robust operational cash flows in a difficult year enabled us to repay a part of our borrowings as well. Both our gross and net debt levels have improved at the parent level. We began the year with gross and debt levels of 0.49 and 0.31 respectively, and we have ended the year with gross and net debt levels of 0.39 and 0.04 respectively. Finally, as you may be aware, the Electrical and Automation divestment was also concluded during this year.

Now a quick summary of Q4 FY21 performance:

Our order inflows for Q4 at Rs. 507 billion registered a degrowth of 12% on Y-on-Y basis, mainly due to some tender deferments and delay in award closures. As we said before, our Q4 revenues at Rs. 481 billion registered a growth of 9% on Y-on-Y basis. Our recurring PAT for Q4 at Rs. 34 billion registered a growth of 12% Y-on-Y basis. On a sequential basis, though both revenues and overall PAT are up 35% and 33% respectively, again, largely due to normalization on the easing of COVID restrictions prior to the onset of the current COVID second wave. Our return on net worth for FY21 is at 16.2% vis-à-vis 14.8% last year. The return on net worth for FY21 includes the gain on the divestment of the E&A business.

Some comments on order inflows and order book before we proceed ahead:

Our Q4 orders at Rs. 507 billion were largely led by Infrastructure, Hydrocarbon and Heavy Engineering. Power Generation continues to remain subdued. Within Infrastructure, we dig bag a couple of Middle East orders in Q4. Significant orders during the quarter were received across most segments like factories, hydel and tunnel, metros, special bridges, nuclear power, rural water, renewables, hydrocarbon offshore and minerals and metals. There is a visible focus on Capex in the Union Budget, which should fructify as the year progresses.

Our Projects business prospect pipeline for FY22 has improved by 8.5% as compared to the level witnessed at the start of FY21. We see total prospects of Rs. 9.06 trillion for FY22, comprising of domestic projects of Rs. 6.56 trillion and Rs. 2.5 trillion of international prospects. For FY21, the prospect pipeline was Rs. 8.35 trillion. Infrastructure has the major share of these other prospects of almost 77%, followed by Hydrocarbons at 16%.

Our order booked at Rs. 3.27 trillion as at March 31, 2021, comprises of around 79% domestic orders and 21% international orders. Around Rs. 1 trillion of the current total order book of Rs. 3.27 trillion is funded by multilateral agencies. This represents around 31% of the total order book. The split between domestic and international order book is Rs. 2.58 trillion and Rs. 688 billion respectively.

Further, the split of the domestic order book of Rs. 2.58 trillion is as follows:

Central government takes a share of 9%, state government 31%, public sector corporations 44%, and private 16%. Overall group performance-financial parameters are covered in the presentation, along with explanations for major variations. I hope you all had a chance to go through the same. The only point I want to mention here, that the profit from discontinued operations, net of tax, in Q4 reflects the final post-closing adjustments envisaged that are pending discussions and closure.

Now, I come to the segment performance before I move to the final part on outlook:

Infrastructure:

The ordering momentum continued in this segment in Q4 as well. During the quarter, we received the order for the largest solar PV plant in Saudi Arabia. Full year order inflows in this segment are Rs. 1.02 trillion, registering a growth of 4% despite the muted ordering activity in the first half of the year. Our bottoms-up prospect pipeline in infra is Rs. 6.97 trillion for FY22 vis-à-vis Rs. 6.35 trillion in FY21. The share of international prospects to this total is higher around 24%. The revenues in Q4 at Rs. 262 billion, up 5% on Y-on-Y basis.

The strict safety protocols amidst continuing pandemic moderates the progress. Full year revenues in this segment is impacted due to the slow progress in H1 due to lockdown. Q4 and FY margins improved due to the tapering of certain stressed jobs in the transportation infrastructure sub-segment, reduced expected credit loss provisions due to collections of overdue sums and claim settlements in a few projects. It is important to note here that our full year margins have improved despite under recoveries in a COVID year.

I come to Power segment:

The award activity deferments we were witnessed in the thermal power space during the current year. However, for us, this segment is largely un-impacted because of a large opening order book, and a couple of quarters of award deferments will not impact the fortunes of the segment in the near-term. Having said that, we did receive an FGD order, the flue gas desulfurization order in Q4. The robust revenue growth in Q4 and 12m is a function of a good opening order book. The margins for Q4 and FY21 remains subdued as major part of the order book is yet to cross the margin recognition threshold. The previous year Q4 and FY margins were higher due to a favorable customer claims settlement.

I come to Heavy Engineering segment:

The robust order wins in the nuclear power business, around Rs. 1,200 crore of fleet orders from NPCIL drives the Q4 FY21 order inflow. The full year order inflow also registers a smart recovery over the previous year. The ratio of domestic and international order inflow for FY21 is 65:35. The pickup in execution across multiple jobs leads to a strong revenue recovery in Q4. The robust Q4 margins is reflective of job mix and claims. The variation in the full year margin is explained by a settlement reached with an international client pertaining to a warranty claim.

I come to Defense segment:

The ordering momentum in Defense Engineering segment remains subdued in Q4. Multiple small order values continue to replenish the existing order book. The recent policy pronouncements are encouraging for the domestic industry and we remain excited about the future outlook. Implementation, however, may happen over the course of time. The better progress in multiple jobs drive healthy revenue growth in Q4. The cost savings drive margin buoyancy again in the Q4 quarter.

I come to Hydrocarbon segment:

The healthy domestic wins in Q4 replenishes the order book. Further, improved activity levels at our fabrication yards and peaking of revenues in the onshore vertical aided revenue recovery in Q4. The margin buoyancy in Q4 is the result of cost savings and job mix. The variation in full year margins is explained by under recoveries in a COVID year. Our bottoms-up prospects pipeline in hydrocarbon for FY22 is Rs. 1.4 trillion, comprising of domestic prospects of Rs. 600 billion and around Rs. 800 billion of international prospects. With Brent prices stabilizing above $60 per barrel, we expect the return of international awards in FY22. Secondly, we are also witnessing a lot of bunching up of prospects in this segment now, due to the muted ordering in the hydrocarbon sector over the last four to six quarters.

I come to Development Project segment:

This segment includes our Power Development business that mainly comprises thermal and hydro power plant, and the Hyderabad Metro as well as the investment in the L&T Infrastructure Development Projects JV. As you are aware, the Roads and Transmission line concessions are housed in L&T IDPL and consolidated only at the PAT level under the Equity method. The strong Q4 revenues in this segment is largely contributed by the Power Development business, as strong electricity demand drives revenue growth in Nabha. The Hyderabad Metro ridership is reflective of the continuing pandemic. The segment margin in Q4 is impacted by Opex under recovery in Metro.

Coming to Hyderabad Metro:

The Hyderabad Metro, we believe, is a remunerative long-term concession. However, it has been severely impacted due to COVID. Now, it is important that the capital structure of the L&T Hyderabad Metro Rail should be such that the asset can sustain itself. From loans refinancing to getting support from the State Government for soft loans and claims for cost overruns, to exploring of monetizing TOD rights, to assistance from L&T, all such options are being explored. The metro has about 60 years of remaining concession left, and since the construction risks are off the table, we will now have to deal only with operational risks. All the options will be explored to improve traffic through network effects and last mile connectivity. We will work closely with the Fare Fixation Committee to set up annual fare escalations based on cost increases. We have around 18 million square feet of transit-oriented development, which will be monetized over time. We will keep you posted on the developments.

Now I come to the Information Technology and Technology Services segment:

For us, this segment comprises of the three listed companies, L&T Infotech, L&T Technology Services and Mindtree. All the three companies have declared their results and the same are available in the public domain. Without getting into too much of details, let me mention that this segment has largely been un-impacted due to COVID and it continues to grow. You would have noticed that the margin improvements in this segment have been driven by a combination of improved utilization, better onshore-offshore mix, and operational efficiencies.

I come to Financial Services segment:

The Q4 revolved around strong pickup on rural disbursements, robust collections, improved net income margins and maintenance of adequate liquidity on the Balance Sheet. Post the rights issue, the business has sufficient growth capital. The loan book has decreased to Rs. 94,013 crore as on March 2021, compared to Rs. 98,384 crore as on March 2020. The drop is largely due to focus on collections, portfolio sell down as well as the reduction in the de-focused book.

I come to the last segment, which is Others, which comprises of Realty, Construction and Mining Equipment, Rubber Processing Machinery, Industrial Valves and Smart World and Communication.

The strong Q4 revenue growth led by Smart World and Communications, Construction and Mining Equipment, Rubber Processing Machinery and Industrial Valves. The Q4 margins in the segment is largely stable as compared to Q4 of the previous year.

Before I move to Environment and Outlook, I would like to spend a couple of minutes on our ESG journey:

I am happy to report that L&T has been upgraded to BB by MSCI in March 2021. Secondly, we are having active discussions with leading ESG rating agencies to explain our progress on the various ESG initiatives being carried out by the company. Our group is eight decades old, and we have been at the forefront on many of the sustainability initiatives long before it was mandated by law. In other words, we have tried to implement many of the ESG initiatives both in letter and spirit. Further, through disclaimers in our integrated report, we have also clarified our position on the involvement in controversial weapons in the Defense Engineering segment.

For the benefit of everyone on this call, I state below. The Defense Engineering business does not manufacture any explosives, nor ammunitions of any kind, including cluster munitions, or anti-personnel landmines, or nuclear weapons, or components for such munitions. The business also does not customize any delivery systems for such ammunitions.

Finally, in our Analyst Presentation that has been loaded, we have included a couple of slides on energy conservation and renewable energy, occupational health and safety, our green portfolio as well as the group's initiatives towards employees, contract workmen and society in times of the COVID pandemic. The data provided in these ESG slides are subject to audit, our Integrated Report FY21 will be ready in a couple of months. Lastly, we are working to create a long-term ESG framework, that would get integrated with the five year strategic business plan, FY22 to FY26 which should get ready in a couple of months and we will articulate the same at an appropriate time.

Coming to the last part on environment and outlook:

During the year of FY21, our country has demonstrated tremendous economic resilience despite the stiff lockdowns, reversed labour migrations, supply chain distributions, resulting into GDP contraction in the initial part of the year, followed by a progressive pick up in the second half. Further, the growth momentum has been given a fillip with the Finance Minister announcing an investment-focused budget. Just when we thought the worst is behind us, the country is impacted by the onset of a more ferocious second wave of COVID which has unfortunately impacted many states today.

Having said that, I wish to highlight here a couple of positives and how the current wave may not disproportionately impact economic activity as it was witnessed in the previous wave.

Firstly, movements are permitted this time around, though in a restricted manner as against a full lockdown last time. Secondly, vaccination programs have commenced in full swing and hopefully a good part of the population should get covered over time. The RBI with an accommodative monetary policy and the government with its enlarged fiscal spend, continue to provide the base level support to the economy. For the reasons just mentioned, we believe that the recovery is “delayed” but not “derailed”. As per the various reports, the infection curve should start subsiding sometime this quarter, and we could witness domestic recovery from Q2 onwards.

Elsewhere, most parts of the global economy are also gradually recovering from the impact of the COVID-19 pandemic. But it continues to remain uneven across countries with economic activities in many countries still below pre COVID-19 levels. With oil back above $60 per barrel, we should see a pickup in GCC Capex as well as improved prospects in Africa and Southeast Asia. This view is confirmed by our bottoms-up aggregation of international order prospects for FY22.

Despite the ongoing challenges, we expect up to a low to mid-teens growth in order inflows and revenues, while maintaining stable core business margins for FY22. We will endeavor to maintain the net working capital around the same levels as of March 2021.

In the backdrop of the COVID-19 pandemic and the resultant challenging economic environment, the company, while upholding the primary dictum of maintaining the health and safety of its personnel, will continue to aggressively pursue opportunities for growth, both in domestic and international markets. The focus would be on large project wins, efficient execution of its large order book, productive utilization of its monetary resources, all targeted to ensure a sustainable business model, and thereby improved shareholder return.

Ladies and gentlemen, thank you for your patient hearing. We will now move on to Q&A. As I said earlier, we have with us today our CEO and MD, Mr. S. N. Subrahmanyan, and Whole-Time Director and CFO, Mr. R. Shankar Raman on the call today, who will be taking the questions. To make the best use of the available time, I would request all participants to focus on questions related to business strategy and other relevant macro matters. The IR team, led by me and my colleague, Harish Barai, would be happy to take the detailed bookkeeping questions offline. Over to Margaret.

Moderator: Thank you very much. We will now begin with the Question and Answer session. The first question is from the line of Mohit Kumar from DAM Capital. Please go ahead.

Mohit Kumar: Congratulations on a good quarter in a very, very challenging environment. So my first question is on, the macro has become uncertain, especially in domestic segment. International was barely anything significant in FY21. What is your expectation for the order finalization, especially in domestic and Middle East? And can you please give some granular detailing segment-wise and geography-wise? That's the first question.

R. Shankar Raman: See, in terms of the prospects, infrastructure prospects continue to be the largest piece in our overall pipeline. We did mention during the commentary and by my colleague P. Ramakrishnan, that we assess the prospect pipeline for FY22 to be around 8% to 10% higher than what we saw last year this time. But of course, last year this time was very difficult and a different scenario, so it's not comparable. So, we will focus on what we are able to see ahead. A lot of our belief stems from the fact that the Government is focused on economic recovery through investments in key sectors. Fortunately, the sectors that they are talking about are the sectors that L&T is deeply involved in. Several facets of construction will get busy if the government's plans comes through.

There has been an expanded fiscal allowance for the government through the budgetary provisions and endorsement by the Parliament, where the government can both, state and center, borrow a little more liberally than what they do normally and secondly, the international money especially the developmental funding is focusing on India, because like us, they do believe India has rich prospects. So, we do think that a combination of government fiscal allocation and the international funding should see us have opportunities to bid in the areas of Heavy Civil, Water, Power Transmission & Distribution, etc.

It's pertinent to note that in FY20, the infrastructure segment bagged orders worth about Rs. 98,000 crores and in FY 21 we gave bagged orders worth Rs. 102,000 crores. So, if you see over a two-year period, and one of which has been considerably impacted by the pandemic, we think that around Rs. 8 to 9 lakh crore of infrastructure spend happens in the system and we have a share of possibly 15%-16% out of that. So, going by that same logic, we do think that out of the Rs. 7 lakh crores worth of infrastructure opportunities, we should be able to get that 15% to 20% share. Because I think country still needs healthcare facilities, country still need transportation infrastructure facilities, urban congestion continues to be a problem and a headache for the Municipal Corporations.

So, given the thrust on climate, both metros as a means of mass transportation, as well as green energy in form of solar etc. is getting the required attention, and it is also getting international funding support because these are our broader themes on preserving the deterioration in the climate conditions. We do think that the opportunities around data centers and IT spaces will continue to engage us. Because the one industry which has thrived in the pandemic has been the technology industry and India is blessed with abundant talent for this technology innovation. We are also serving as a large backroom for global organizations, be it their normal processing or R&D center or any of those kinds. So, we think that some of the inflationary pressures that are there in the raw material prices will also make it interesting for the manufacturers of these products to step up their capacity. So, we do think that some amount of activity will happen around the factory space as well.

The government has also been focusing on spending a fair bit around public spaces, and we have been seeing stadiums and large public facilities being put up, including the hospital facilities. So, we think that the buildings and factories segment also will see some traction. So, considering all of this, we do think that notwithstanding the current low sentiment, we have to stay positive being in business. We do believe that this time over, the country has got a little better wherewithal to deal with the virus as compared to the previous time. Previous time we didn't know, it was a black box. Now we have vaccination, we have health programs, etc. The challenges around rolling all of that out to cover majority of the population remains. But notwithstanding that and hoping that things will get better from second quarter, we are looking to the current year as promising year for domestic markets.

International markets, you are right, I think the previous year was a little uncertain. But as compared to India, many of the international geographies have actually done better on the COVID management, because their population was much lesser, and the societal complexities were also lower. So, we see some of the economies coming back to growth mode. With the rise in crude prices, I think Middle East also will begin to revisit their plans for hydrocarbon. Except that nowadays, like in India, our presence in Middle East is more widespread across verticals, we are not only dependent on Hydrocarbon in Middle East. The way we are scaled up in India, across verticals in a much more modest way, we are scaled up in the Middle East. So, I think we will get engaged with their multiple programs.

Africa has been a land of opportunity, but except that it is too large continent with several countries and very, very different socio-political dynamics. So, we are trying to mark the spots where we can operate safely and be meaningfully contributory to the local society. So, we have taken steps to explore and gain some foothold in the businesses of power transmission, distribution, water. Like India, in fact, a few notches lower than India, basic facilities are still a luxury in parts of Africa. So, I think much of the investment will happen around the base infrastructure and not the sophisticated infrastructure. We do think that will happen.

Water has been a major issue, I think both preservation, transmission, distribution, storage, treatment, as well as desalination solutions are being explored in India. It is the lifeline for the country, so a considerable attention of the states have been going towards water and we are almost pan-India in terms of water opportunities.

So, I think between all of this, there is a good reason for us to remain hopeful. Of course, the pandemic permitting and things getting better from where we are today in at least in two odd months' time.

Mohit Kumar: Thank you for such clear answer. My second question is on infrastructure segment, there has been improvement in EBITDA margin, can you please quantify the one-off in the PAT quarter? And how confident you are of maintaining this margin given the commodities inflation in the past few months?

R. Shankar Raman: There is no one-off that I can recall in the margin improvement of Q4 or the current year, current year meaning FY21. It's a function of several things that happen; margins, unfortunately, in our business is not just a function of one or two parameters, it is a function of several parameters, the mix of jobs, the progress on those jobs that we achieve, the ratio of jobs which are at margin recognition threshold, the degree of cost releases that happen when jobs get completed and handed over, the release of cost contingencies, hence, also the price variation settlements that happen during the course of execution, as well as in the conclusion of the job, all of this kick in. On top of that is the execution efficiencies, our ability to procure smartly, our ability to execute first-time right, our ability to automate the processes.

One of the interesting things that the company has been doing over the last few years under the direct push given by our CEO is digitalizing the entire process of manufacturing, construction, engineering, etc. We are today far more evolved as a company to use automated levers, use machine learning and the intelligence around the data that we gather on productivity of men, machines in the businesses that we deploy them in. Now, we have connected machinery, we have tracked workmen, we have productivity measures defined for many things, including drone-based surveys, etc. So consequently, I think, while inflationary pressures in terms of input costs being select in commodities or wage etc. would be a matter of, in fact, regular attention for the business, these productivity levers enable us to be far more consistent in the quality that we produce, far more precise in our estimation in quantities and in bidding process. So, it's overall efficiency that I would attribute to for improved margins.

As far as our confidence about this being a continuing factor, I think the effort would be to ensure that we sustain margins. If you have been watching us over a long period of time, and when I am talking about long period of time I am saying, let's say, last 10-15 years, we have been through several cycles of commodity prices going up and down and the inflationary pressures playing out, as well as the economic development being swing between high and low. But one redeeming feature of our performance through this period of 10-15 years, has been the margin trajectory. We have always been around 8% to 10%, 8% to 12% margin company in terms of bands. There are often one-off years where some projects that we execute has cost overrun, that's inevitable in our business, and not getting adequately compensated by cost savings in other projects. In such cases, we have some spike in terms of costs and hence margin deflates. But notwithstanding all of those, we have always been rock steady in terms of our margin profile. So, we do believe that we have the wherewithal to deal with these volatilities and maintain the margin trajectory that we are known for.

Moderator: Thank you. The next question is from the line of Sumit Kishore from Axis Capital. Please go ahead.

Sumit Kishore: Sir, my first question is, where are we in the private Capex cycle presently? The share of private orders in the India order book of L&T is at a record low, how do you see this shaping over the next one to two years?

R. Shankar Raman: Currently, it's about 18% and it's been so last year as well. So, not much change has happened in the last few years. In fact, even pre-COVID, if you really trace back from 2016-17 onwards, I think the economy has been a bit lackluster in terms of investment and the private sector, having got out of a bout of investment between 2006-07 to about 2014, actually they are taking a breather. Much of the private investment we saw spike up is in the areas of public infrastructure assets and many contracting companies recycle their profits and capital into owning infrastructure assets, so did L&T and the belief was that on completion of these assets, there would be a takeout that is feasible. The insurance companies and the pension funds were actually ideal candidates for owning all of these assets, would possibly step up and invest in these assets and help the initial investor to recycle the capital. But that is not to be and I think the challenges of owning public infrastructure and dealing with the government concessions, continues to evolve and it possibly is still a little distance away from being the ideal model, concession agreement, which will facilitate very smooth transition of completed assets to the next set of owners.

But having said that, the industrial Capex has always been a function of opportunities and the economic environment. Whenever we find that the products and services of the private sector companies are looking promising, the private sector entrepreneurs have come in forward and invested. I mean, it's sort of once in several years development, like what possibly the investments that some of the major companies did when they changed their focus from traditional businesses to new-age businesses. But we do think that once the inflation stays at a steady clip, the monetary policies continues to remain attractive for capital to be invested and the global markets for products and services continue to remain stable and positive, the investments will happen. The format of private sector investment can vary, it need not be only on industry, we have seen that it logistics, it was in services, it was also now moving towards supply chain infrastructure in the country and some health infrastructure as well. So, I think private sector capital will first have to delever, most of the balance sheets that I see are levered now. In the next couple of years, I expect them to unlock some capital, repay some debt, create headroom for their investment. But my belief is, over the next 2-3 years, the private sector's share could move from this 18% to possibly anywhere between 25% and 30%.

Sumit Kishore: Thank you. My second question is, we saw the High-Speed Rail contract, particularly a large order last fiscal. On that base, you have given a guidance of decent growth. What are the big-ticket order prospects for FY22? And when I say big ticket, maybe Rs. 30 billion plus for L&T, both domestically and overseas, which areas do we see these contracts coming from?

R. Shankar Raman: See, I don't think it's a good idea to just focus on big ticket orders only. Because these kind of orders like the one in High Speed Rail, does not happen every now and then. In the past, we have had opportunities to build all the all the international airports in India. So they became big ticket at some point in time and then we have this High-Speed Rail. Otherwise, in our country, we believe in comfort of numbers. The government tenders are generally or public sector tenders are generally more geared towards attracting more participants. If they aggregate all the bids, or the projects into very large projects, very, very few companies will have the balance sheet capability to bid. L&T might bid but I don't think the clients would prefer just receiving two bids or three bids, they want to see possibly six, seven, eight bids and that can happen only when you break up the projects into its sizes. So, I think it is not going to be possible for L&T to only focus on big prospects, it will continue to focus on more modest projects. But having said that, I don't see large bits like the high speed as a normal thing. It's one-off and lumpy.

Moderator: Thank you. The next question is from the line of Puneet Gulati from HSBC. Please go ahead.

Puneet Gulati: Congratulations on great earnings. Would you be able to comment upon whether the under recoveries in the past year are likely to get paid or not? Where are the discussions with the government and other clients?

R. Shankar Raman: See, normally, all these discussions go all the way up to completion of project. I mean, you can visualize, you can step into the shoes of a client and visualize that you commissioned a contract. The contract does go through twists and turns and many of these are understandably documented, so the clients are generally empathetic to what has happened. The under recoveries have happened because we were not allowed by the circumstances to perform. So, I think the clients do realize the situation. So, I think, instead of guessing what would be the outcome, our approach has always been to complete the jobs to client satisfaction, not use these as excuses for abandoning the project or not completing the project. Our business teams have put their lives on line, in making sure that they go ahead and stay connected, committed to the project and its completion. We do believe that with many of them, were most of them being repeat customers, there is a deep relationship between L&T and success of their own enterprises. We do believe that there will be fair consideration given to all of this and I should hope that through conversation and negotiations, we should be able to recover much of it, whether we recover 90% of it, 80% of it, etc., time will tell, but we are reasonably confident because I think we are well prepared to hold these conversations.

Puneet Gulati: And I presume that once this comes in, they will only provide an upside to margins, there is no risk of any write-off from the previous year?

R. Shankar Raman: Yes, the costs generally are getting accounted as they are incurred and of course, just as there is an opportunity for upside right till the end, till the execution completion of the project there is also a cost escalation prospect right through till the end, the job is not done until it is done. So we have been balancing this quite well as an organization. I suppose we will continue to do that going forward. Whether it's only upside and no downside, again, time will tell. But our endeavor would be to retain the upside and not let downs slip in.

Puneet Gulati: Okay, got it. Secondly, can you comment a bit upon the margin improvements in defence, in heavy engineering both seem to have done quite well this quarter.

R. Shankar Raman: See, as we complete large projects, I did mention in other context, that when projects get completed, the cost efficiencies completely play out. Because we bid for projects based on estimated cost over two, three, four, five years, depending on the length of the duration of the project and as the project gets completed, the efficiencies play out. Some of them do play out progressively through the quarter, some of them do right at the end. Normally, we do operate with cost contingencies, because we don't know until the project is done as to what will come and hit us, there's no point in releasing margins ahead of time, paying tax on it later to write-back and not get the tax concessions. So many of these areas, you mentioned about defence, heavy engineering, etc., there have been large order completions, large in relation to their business, not in relation to infra business, completion during FY21 and some of them, in fact, in heavy engineering also included some extra consideration for early completion. So, I think it's been featured. But generally, the margins for these businesses are very reflective of high-tech manufacturing that we are engaged in. So, we do believe that the margins would be at considerable premium over the infrastructure margin.

Puneet Gulati: Okay, excellent. My third question is on the pace of construction right now, we are hearing a bit about exodus of migrants again, are you seeing the same thing or is it more media related?

R. Shankar Raman: No, I don't think it is media related, because I think it is a reality that last year we lost considerable amount of people. In fact, the strength came to almost 60,000 people in our various sites, and it was a massive, massive effort by our teams to get most of them back. As we close the quarter, March 2021, we were operating at close to 240,000 people in our various sites and we were looking, given the large order book that we have now, we were looking to actually step it up to possibly 2.75-3 lakh people. But this second wave has thrown a spanner in the wheel now. We have a new issue, only different this time is, rural India is not spared from this pandemic. I mean, there are enough reports to indicate that the villages are not necessarily more safe than the cities.

So we have been carrying on extensive communication to our workmen, saying that it is safe to remain in L&T sites and not necessarily risky proposition, considering the lack of healthcare facilities in their hometowns and the fact that thanks to some indiscretion of our large public who participated in huge gatherings and scattered back to various villages carrying with them, possibly, the disease. So I think there has been a reduction of 20% of the people having sort of wanting to go back out of their anxiety to villages, etc. But it is nowhere near the mass exodus that we saw last year. But we do hope that, with the plateauing of the infection rate and death rate coming down, particularly in large cities and towns that we operate our projects in, the workforce will begin to see sense in staying safe at where they are. Of course, the company is taking enormous efforts to step up on the healthcare facilities that are provided at our labour camps, including running quarantine centers and providing health kits and ambulances and stuff like that. So, I think they will realize the safety of staying and working at our sites rather than running home.

Moderator: Thank you. Next question is from the line of Ankur Sharma from HDFC Life Insurance. Please go ahead.

Ankur Sharma: Good morning and thanks for the opportunity. A couple of questions. So, one goes on the infra segment growth for the quarter, so at about 5% overall and when I look at the domestic piece it was about 3%, coming out of a slightly weak-ish base of last year. So, just trying to understand, what are the constraints for one of our largest segments, if not the largest in the company, is it labour? Is it payment being slow? Are there any other constraints which led to this slightly subdued growth in the quarter?

R. Shankar Raman: I am not sure whether the base is small, because I just mentioned a little while ago, infrastructure sector close to Rs. 1 lakh crore last year, actually it is Rs. 98,000 crores and this FY21 we have won orders worth Rs. 102,000 crores, I think it is a massive number.

Ankur Sharma: Sorry, the sales, not the orders, I was talking about the execution.

R. Shankar Raman: Okay. As far as execution is concerned, I think infrastructure by definition are a little longer-term duration as compared to the normal, let's say, a factory order or a typical residential building order, etc. So, the execution does pick up speed as the project progresses. The initial period often goes in getting the engineering cleared and the procurement planning done, etc. If I were to divide these projects into two halves, two-thirds of the work happens in the second half and one-third of the work happens in the first half. Depending on the mix of jobs that we have at any point in time, be it a quarter or a year, the majority if it is going to be falling in the one-third bucket, you will find softer execution and if you find majority on the other bucket, then obviously you will see pickup in pace.

The execution challenges remain around the clearances, time delays around clearances, the right of way that unfortunately infrastructure business and the project involves the right of way especially projects with linear access, land acquisition and compensation settlements and now we have additional layers of environment clearance and then the public interest litigations, all of that the companies go through. In many of these projects, it is not possible to have all of this pre-cleared and then the project given so that the execution happens almost in a robotic manner, it doesn't happen that way. Many of these clearances are taken as we go along.and that is the way the project business is. So, to that extent, the challenges are centered around access clearances. Our ability to manage a large workforce has been time tested. We do think that that will not be a challenge, unless of course there are disruptions like the current times where people have other reasons not to assemble at site.

Productivity and skill upgradation is a major task. I am not calling it as a difficulty, but it is a task, and as we try to automate our construction and delivery capabilities, we also make sure that the workforce that come in, are more aligned to these improved productivity norms. As we keep scaling up our operations, we need to naturally increase the number of people we employ, either through subcontractors or otherwise and when you have these large number of people coming, several of them possibly not adequately trained, safety does become a big issue. And I think the company is spending a lot of energy in making sure that the safety protocols are well understood, well defined, and as and when we keep having new people come into our sites, that these guys are aware of what are our expectation out of these safety standards.

You should realize in a construction site, the labourers, the gang keeps turning around at least four times a year, either because of harvest and sowing requirements back home in their agricultural part of their family, or because of wedding or because of festivities. The churn in the labour camps happen easily four times a year. So, every now and then we have to deal with training a new set of people, so productivity, safety, etc., becomes challenges for a company like us, especially since we place so much emphasis on the health.

Ankur Sharma: Okay, that's helpful. So broadly, then, the current order book of close to Rs. 3.30 lakh odd crore is broadly executable, or do you see any sizable slow-moving orders there?

R. Shankar Raman: Generally, over the past few years, we have been purging slow moving orders out of our backlog, not because clients have cancelled those orders, it is just that our assessment, that the order book that we reflect, should be a workable order book. So, every now and then this spring cleaning happens of the order book that we have. We do believe that the order book that we have is workable. There is always a possibility of 2% to 3% of these orders developing some slowness. That's a standard thing that we have observed over time. So, barring that, I think this order book is workable order book.

Ankur Sharma: Fair, and just one question on the order inflows, and you have given a pretty detailed kind of answer on potential orders. But when I look at orders, starting from February there has been a marked slowdown in terms of order finalization and that's kind of continued into May as well, especially from the state side. Even when I look at our full year orders, excluding the high speed, and when we look at the state specific orders in, say, Water or T&D, that's clearly been a little subdued and given the COVID and the state focus on controlling that, do you believe that even going into FY22 it's more of a second half when you see states kind of ordering coming back once this whole COVID thing is kind of resolved?

R. Shankar Raman: In a non-COVID period, my reading has always been that a lot of action picks up in the second half of the year, because of the budgetary reasons for consuming the budgets, etc. A lot of work happens in quarter four, where either awards are given or project is commissioned, or even settlements of payment happens because there is a focus on consuming the budget to be eligible for additional budget in the budget year for the State Governments and Central Government projects. But I think there has been a bias towards second half, no doubt and like last year, this year the first quarter, at least, so far, the government, both state and centre, is so preoccupied with safety of people, I can understand that the attention is a little diverted at this point in time. But we do believe that by the time confidence returns to the system that the healthcare infrastructure is able to cope with things, vaccination is better done, etc., we do expect from August things to improve. This was the pattern last year as well, so I picked FY22 to be similar. So, I am not reading much into the slowdown, as you rightly observed, between March and May. But I do expect things could change.

Ankur Sharma: Fair, and sir, if you could also on the infra orders of close about Rs. 103,000 crores, if you could kind of break that down into B&F, Water, T&D, Heavy Civil, the breakup which you normally give, so that we can have a better comparison over the previous year?

R. Shankar Raman: See, Water and Power Transmission normally are the bigger lots out of this, because pan-India if that happens, so these are around Rs. 20,000 crores sized businesses. Then we have the Buildings and Factories around about Rs. 10,000 odd crores size, the transportation infra will be around Rs. 11,000 crores or Rs. 12,000 crores and Heavy Civil has been a big year for us, the high-speed rail order of Rs. 20,000 crores. So, we are possibly looking at heavy civil current accumulation at about Rs. 35,000-36,000 crores. So that broadly will add up to your Rs. 1 lakh crore that we have.

Ankur Sharma: Perfect, and just one last one if I may just squeeze in. On the margin specifically, and I think this was also a previous question, so we have seen pretty sharp improvement, heavy engineering, defense at close to 29%, even hydrocarbons at 13%. When I look at the press release, there are some mentions of some claims that remain, some lower ECL provisions, etc., also sitting there. So just to clarify, I think you mentioned that it's more of job completion and less of claims, is that how we should read it? So, it's more of better mix, better productivity and less of claims over there, is that how we should read it?

R. Shankar Raman: See, generally, in our project business, claims settlements is part and parcel of our lives, it is embedded in every quarter. There are some quarters where the claim settlement plus jobs reaching margin recognition threshold combine. There are also some quarters where the claim settlement and handover, and hence cost contingencies release combined. So very difficult to pinpoint saying this is what, if you have to do that you will have to get into each of the 1,000 jobs that we execute, to see what has contributed where; a very, very tough ask. But broadly, you can conclude that these spikes are a function of the job mix at a particular point in time, rather than anything unusual or abnormal.

Moderator: Thank you. The next question is from the line of Renu Baid from IIFL Securities. Please go ahead.

Renu Baid: Congratulations for a good operating performance and the balance sheet repair that we have seen. So my first question would be on the margins for the infra business, though historically we haven't seen any clear correlation between the commodity prices and operating margins, but we not also seen this unprecedented jump in steel prices the way we have seen in the last quarter or so. So, when we look at your broad margin guidance of flat numbers at 8.5% what we saw last year, does this bake in cost implications because of inflationary impact on fixed price projects or some hit coming on that side as well? Because until two years back before we had the provisions for transportation and last year for COVID, margins in infra used to be 9% to 10% range. So, if you can help us understand what are we baking in terms of soft margins for FY22 and by when do we expect core infra margins to head back towards double-digit level?

R. Shankar Raman: See, I think it's a function of several things. I mean, as the country evolves, as the competitive landscape becomes more and more mature, ability to sustain double-digit margins in infra business particularly, where the pre-qualification is getting lower and lower. So, function of our margin reporting also depends on the economic moat that gets created. Now, it is good from one perspective, that there are multiple people who are capable of bidding and delivering, because one L&T cannot build entire India, you need multiple agencies. So, from one perspective, it is good that there is competitive pressure and it is also equally important that as we upgrade our participation in project business, the investment that we need to do to keep our skill levels high also has to be accounted for. I mean, the kind of skill that we needed to build an airport was way different as compared to the skill that we needed to put up a residential complex, and the kind of skill that we need to now deliver the High Speed Rail or the Trans-Harbour Bridge across the sea is again very, very different. So, every time this is to be done, it has to be reinvested, skill has to be reinvested.

In IT industry, I think people are able to very easily accept the reinvestment of skill and accept in the margins. The same thing happens in our industry also, except that the play is half, IT industries are able to report 20% to 25% margin, in our business, despite all the risk of working under the sun and the rain, we land up making possibly 8% to 10%. But as a mix of portfolio that we have between commoditized infrastructure build that we do and the sophisticated infrastructure that we do, and depending on how much of it is outsourced, how much of this is in sourced, because we have an integrated model of engineering, design, manufacturing, as well as delivering on the construction. Depending on how integrated the model operates, we have been operating on a band of 8% to 12% and you can refer back to our performance over a period of time that the band has been between 8% and 12%. Depending on the mix, depending on the complexity of the job and the competitive landscape, we have been operating at 12%.

And I remember, on such calls whenever we had reported around 12%, saying that this is not likely to be sustainable, nowhere in the global EPC landscape will you find this kind of margin. Also, the fact that we are now stepping out, we are into Middle East and 35% of our presence in terms of order book is international, between Middle East, Africa, etc., all these countries require investment. And where does the investment come from? Investment comes from redeploying the money earned in projects only. So, to that extent, I think we are quite okay in looking at the margin profile of this 8% to 10% band as compared to 8% to 12% band, given the way we look at building our business going forward.

Well, our effort is to keep moving up. We have, as you might have heard, about 60% of our projects have pass-throughs, so to that extent, all these inflationary pressures will have some way of readjusting the price with the customers. Of course, 40% of the jobs are fixed price contract, but we know that we are bidding for fixed price contracts as we sit down to bid. So, there is cost cushions that gets projected, especially when we sit down to price the bids and hopefully, these inflationary things will operate within the cost cushion. So, my belief is that, when we talk about stable margins, it's more a directional thing that we are giving. We do expect FY22 to continue to have challenges. There are definite unknowns in the year ahead because I don't think we are back to normal times yet. So, given all of that, I thought, the best effort for the company would be to make sure that it hangs on to the margins that it has been able to make. But despite COVID we did improve by 30 basis points, so effort would be to see how to keep moving up. But I don't want to speculate on a commitment today. But the trajectory, the focus of the company is clear, it will work to optimize on margins.

Renu Baid: Sure, that's helpful. The second question would be to understand, globally, now we are seeing the entire energy transition towards de carbonization. So here at L&T how are we looking at this opportunity? And are there any businesses, except for the power generation portfolio, which would face challenges on account of this? So, what kind of steps are we talking to improve the capabilities towards the next generation energy technologies and practices?

R. Shankar Raman: We are looking at it more as an opportunity than a challenge because I think to construct something, you will have to destroy something. So, to that extent existing business models need to make way for newer models. The entire energy space will go through transition, the way the fuel was being used, the way hydrocarbon industry operated, the way the power industry generally operated, all of that is undergoing change. The company is, I think, streaks ahead of the competition in India insofar as this transition is concerned. You would have read in our reports that we have won one of the largest solar project in Saudi Arabia, we have been working a lot on water solutions, both in India and overseas. Today we have hydrocarbon and power as two leading businesses, which will evolve into greener space. Already, our buildings and factories have adopted green technologies. Many of our buildings are certified as green buildings. So, to that extent, I think it is the energy space that will see the transition. Company has set up task forces to explore the new opportunities and I think we are in the middle of the work that we are doing on this and hopefully, in some time, we should be able to spell out the specific plans that we have. But we have seized off those opportunities and we are working aggressively at it.

Renu Baid: Sure. And one last question if I may, any update in terms of the restructuring that was being worked out for Hyderabad Metro, progress on discussions with bankers, and divestment of the power assets. So, has that also hit the second wave roadblock or some things are in progress on that front?

R. Shankar Raman: No, I think these are all irons in the fire, a lot of discussions that are happening. But as you know, we don't want to throw the baby with the bathwater. These are top class assets in terms of their functionality, it is unfortunate that these assets are receiving attention at a discount to their potential price, because of the environment. Because people who want to buy these assets have a lot of options today, there are a lot of distressed assets available. So, there must be a very good reason as to why they pay a premium to our assets as compared to an alternate asset that is available. So hence the discussions are taking more time. We are ok with it because I think it is important to find a good home for all of these assets. We do think that the power assets will move towards closure, not in a position to exactly predict a timeline because I think internally we have had challenges in meeting the timeline that we have set for ourselves because of this environment. But we do hope that sooner than later we can move towards some of those solutions.

Insofar as Hyderabad Metro as concerned, it's a top-class asset and a very long concession. But unfortunately, it is completely exposed to the pandemic. Today, the ridership is next to nothing, considering the restrictions and the lockdowns and all of that that has happened. So the restructuring has to have multiple efforts. The bank loans that we have raised during construction has to be refinanced, the efforts are on towards doing that. We also need to monetize our transit-oriented development space, the efforts are on towards that and as you know, any real-estate transaction takes time where there are a lot of uncertainties around utilization of space, particularly commercial, because the transit-oriented development that they have is commercial. It's understandable, so that's also work in progress. We have been having several rounds of discussions with the government on formation of Fare Fixation Committee as well as the grant that they would be required to provide. The good news is that the Telangana government in their State Government budget has accommodated Rs. 1,000 crores allocation for metro projects. We have to make sure that we find a way to translate that through the bureaucracy of the state to find its way to the project. But all these, when you deal with governments, and especially deal with governments which at a time are more preoccupied with healthcare, that takes a lot of effort.

But my sense is that during the course of the year, these multiple steps one by one we need to take off and move forward. Meanwhile, we hope that the ridership would improve, but ultimately the solution would be if the ridership improves for the project. And for ridership to improve, I think normalcy has to come in. It's a fantastic transport solution, very transformative for Hyderabad and Hyderabad is a growing metropolis. Unfortunately, much of the people who commute or whom we thought will commute are all IT industry people and all of them are working from home. So, to that extent, I think there has to be some redefining of the work arrangements for the metro to come up. So, I think you are going to keep hearing about the metro being a work in progress for some more time. It's not an easy one step solution. But rest assured, we are working hard towards finding these solutions.

Moderator: Thank you. The next question is from the line of Amish Shah Bank of America. Please go ahead.

Amish Shah: Congrats on the results. My question is actually still on margins. You spoke about productivity gains, but specifically within the fourth quarter the company has also reported improvement within gross margins and this is certainly something that the company is doing to circumvent the impact of rising commodity prices. So if you can please share some perspectives on what are we doing to not have the commodity price impact us? And from an FY22 perspective, is it fair to say that commodity prices will hurt margins, but productivity gains will help cushion that impact?

R. Shankar Raman: That is right. I think, not only productivity gains in a very limited way, but I think overall cost efficiencies will also kick in. Because I think one of the things that the pandemic has taught us is to work in different ways, which helps us in containing some of the costs, which we used to take it for granted in the past life. Insofar as margins are concerned, I think, one of the important levers also, last few quarters we were pushed back by some of the stressed projects in the transportation infrastructure sector where cost overruns were actually deflating the margins and in Q4FY21, the transportation infrastructure businesses has returned to black, having left behind those stressed projects. So, one of the large businesses coming back to black also helps the margin recovery which is what is expected to be normal. We slipped back because of some of these cost overruns, but we hope that that will be a thing of the past and we should be able to move forward. The order backlog that we have and which will translate into revenue for FY22 appears healthy. Much of these have been bid and won through the period where the inflationary pressures were visible. Whether we are completely insulated or not, time will tell. About 60% of the projects we have sort of insulated by price variation formula, the other 40% whether the inflationary assumptions that we have taken, whether it plays out, needs to be seen.

Of course, not all of this needs to be bought today. See, the procurement also happens over time and we have some headroom to time the procurement as well. So, I think the company is a very seasoned project execution company. So, I am sure our team will try to find levers to optimize, and secondly, we are also large buyers. So, the relationship with our vendors normally transcend beyond small transactions. So, we will also try to find out a way to deal with the supply chain on some of this, negotiate well and of course, the customers do appreciate extraordinary times. If they are going to be extraordinary price movements, there will always be an empathy to the current situation, and I think they do realize that the project cannot prosper on the ills of a contractor. I think there has to be a healthy relationship. So, I am sure we will deal with this. It is not the first time we are in this kind of situation; we have been there in the past, we have sort of survived, managed. So, I think we are hopeful.

Amish Shah: Okay. And then now finally two quick questions. One, right now the skew of order book is completely in favor of State Governments, in comparison to Central Government. But from an order flow perspective, in FY22, should we expect the ratio to move the other way around? And finally, I also wanted to ask about the large $6.5 billion of cash balance that we have on books, so if we could please share some thoughts on what are we planning to do with that too.

R. Shankar Raman: See, insofar as percentage is skewed depends on which projects come through and which don't. But I think it is safe to presume, I think, state followed by PSU followed by central government will be the pecking order. So, it's important that the state governments find their means, either their own means or through funded assistance to go through with their projects. So, I think that percentage I don't expect in the context of FY22 to be very different, given and take a few percentage points. Insofar as cash balance is concerned, you would have read about, we have declared Rs. 18 per share dividend and on top of the Rs. 18 that we did as extraordinary earlier, so the regular dividend of Rs. 18 per share represents almost 46% payout of the recurring profit after tax of the company, which I think is a fairly good share.

Whether it's fortunate or unfortunate, I do not know, but because our portfolio business includes financial services business, SEBI in their wisdom are considering the consolidated debt equity as one of the criteria for allowing the standalone L&T to do buybacks. We had approached SEBI two years ago with a proposal and SEBI said that you run financial services business, so we will have to take the debt of financial services along with your debt to decide the debt level post buyback is up to the prescribed norm which can never be, because financial services business by nature is to borrow and lend. So, we have tried in vain so far in convincing SEBI that that's not the right way to go. So, unless the regulatory mindset changes, to pass cash back to shareholders in terms of buyback seems to be a bit challenged policy wise now. But from about 28%, 30% payout, we have stepped up to mid-40s now, and I think that is something that should keep the shareholders interested.

Now, we obviously have built in some cash buffers, because of the extraordinary pandemic situation, it is not normal for the company to have this kind of cash reserves. But it was done so because of just in case, when the liquidity in the system gets onto panic mode, etc. and given our commitment to the huge order backlog that we have, we can never run out of cash for maintaining our contractual commitments. So, there is a buffer that we are carrying, but that's more point in time situation. We have created this buffer partially by operations and partially by borrowing as well. So we would like to possibly also run down the borrowings out of the buffer, plus we are having a large project on hand in terms of Hyderabad Metro, last year we allocated about Rs. 1,000 crores to Hyderabad Metro. We might have to keep considering Rs. 1,000 crores to Rs. 2,000 crores of reserve for that business as well. So, if we do that and find some long-term solutions, I also expect shareholders to enjoy some share price appreciation. Today I do believe share price of L&T is depressed because of this exposure to Hyderabad Metro, and if we are able to find some solution to that, the gains to shareholders will come from multiple parts. One is the larger dividend payout that we are doing, second is possibly the better performance and better appreciation of share price.

Amish Shah: Sir, very helpful. But just to clarify, so are you saying that special dividends can possibly be a norm for the initial few years?

R. Shankar Raman: I am not sure whether you can call it a norm, because special dividend is special, so we need to have an occasion. So let's hope we get occasions.

Moderator: Thank you. The next question is from the line of Lavina Quadros from Jeffries India. Please go ahead.

Lavina Quadros: Sir, I wanted to understand how is management looking at L&T Finance, is that a business that you will want to continue to be running in five years' time? Or is that something that you will look to restructure with time? Just your thoughts over there please. Thank you.

R. Shankar Raman: I think it is part of our services business portfolio and I do think that the business has opportunities. It has done well over the past 20 years and I think in our credit delivery system, there is a space for non-banking companies. So, at the moment, our thinking is that we will continue to keep that as part of our services business and manage it well so that it can also contribute to the shareholder value creation.

Moderator: Thank you. The next question is from the line of Girish Achhipalia from Morgan Stanley. Please go ahead.

Girish Achhipalia: Congratulations on your reappointment. I have just two questions. In the media call, I think you did mention some growth guidance, so if you could clarify what exactly did you say on the revenue growth side? And order inflow, was it low-to mid-teen on our core business or was it the consol? And secondly, just on the ESG side, congratulations that the fatalities are down to 25, so if you can just highlight key steps you are taking already to bring this down further?

R. Shankar Raman: Yes, thank you. See, in terms of margin guidance, let me articulate once again. Last year, we were not in a position to indicate anything at all because we didn't know, it's was a new situation, completely new situation. This year, helped by the recovery of quarter three and quarter four, and looking at the order book that we have, we have made some assumptions that the current wave would plateau and possibly things will begin to return back to normal from Q2 onwards. That's one big assumption. The second big assumption is the government will rediscover its path to implement the budgetary plans that they announced in February, by continuing to invest in the economy. The third big assumption that we have made is the kind of market support for funding these projects would continue to happen and the country would be a destination for some of these investments. These are fundamental assumptions to our outlook.

Our outlook for FY22 has been one of growth. Last year, we were looking at degrowth, and our best-case scenario was to meet up with FY20 levels and I think, we almost got there. I think its credit to my business colleagues for having got us there, despite a five-month hiatus last year. So this year, our mindset is to grow on the basis of FY21 numbers. We are not in a position to hard code the guidance, as we normally do, because it shouldn’t appear very speculative and misplaced. So the way we are looking at it is that, if I am looking at growth, both in terms of orders and revenue, our projections seems to indicate that anywhere up to low-teens to mid-teens could be the potential for this growth to play out. Where exactly the growth percentage lands up, we will know as we go along, because even now as we speak, we have still not solved all the uncertainties ahead for the year, it is more out of mindset, hope, optimism that we are making this projection. So, we said, both in terms of revenue and order inflow, anywhere up to low-teens to mid-teens is what we see and we said stable margins.

Now revenue is a function of our execution of order book which is there with us now. So, I think the execution headwinds permitting, we should be able to move forward and execute, because we are not dependent on winning an order this year to realize revenue for this year. They are all in the bag, we will have to only find a way to have them executed. Order inflow is a little more difficult to predict because of the uncertainty inherent in that projection. So, we are putting out a best case, guesstimate, if you can and hence, we have said a range of growth up to this place.

Girish Achhipalia: And just on the ESG point, sir, fatalities.

R. Shankar Raman: Yes, I think we are not happy with 25. Our mindset is a zero-fatality company, just as we are saying we are a zero-emission company. So, 25 bothers us, and so did 41. But every quarter we have a very detailed discussion at our board, the highest body in the company, about each of these cases and a lot of details are gone into. I think workman safety is something that we constantly have to work. We are doing a fair bit of work on this already, I think every site, every morning there are safety protocols and drills that are done, etc., etc. But there is always this case of a stray worker or malfunctioning of an equipment or an accident. We have had things like people resting under a shade of an equipment and equipment gets disengaged and runs over them. So, all these kinds of mechanical malfunction also has contributed. We have worked very hard to bring it down, but I don't think we would like to rest. We want this to be zero, fatality to be zero. Very hard to prescribe that this will happen by two quarters, three quarters, four quarters, but the effort is towards that and considerable amount of internal communication is happening. Since everybody is connected for work on mobile, the number of small videos, safety videos plus we use AR/VR technology to buy these equipment and make workers wear them and see them before they start working on heights, etc. So far, I think a considerable emphasis is being given.

Moderator: Thank you. The next question is from the line of Amit Mahavar from Edelweiss. Please go ahead.

Amit Mahavar: Sir, I just have two questions, first for Mr. Subrahmanyan. Sir, in your assessment, so last year COVID did impact far more than what we thought and this year, do you think in terms of site execution, with the kind of compliance we have to follow, that is the reason why our guidance in FY22 is far lower on a low base? Or you think we have been more conservative? That's my first question.

S. N. Subrahmanyan: To answer your question, COVID did affect us last year, and I think we have put in sufficient measures to come out of it in the fourth quarter and we had practically got back our momentum and sales and profit growth in Q4 reflects that. One never expected the second wave as it has happened. It has happened in the magnitude that it has happened and one has to be a little cautious about it from that perspective. So what RSR had indicated is low to mid-teen growth, basically a double-digit growth for the year. We will see how it pans out because of this uncertainties of the COVID still around us, to make bold statements is not correct and not proper too, as there is caution being exercised in all aspects of operations, including supply chain and such other aspects of our work. Let's hope that with the huge measures that have been taken, both by the central government, state governments and many organizations including ours, are able to curb it within the next couple of months and if that can be done, with the learnings of last year and with the measures that have been taken, which are deemed to be adequate this year, hopefully, we should move forward more positively. But one is not in a position to predict it. So let's not look at it from a low base of last year, what one has to look at is that there is a huge backlog at hand, one has to take it forward. Basically, both our people and the company is prepared to go ahead in full blast on that. But one has to look at the environment and be cautious about what it is, and one has to be circumspect towards it and that's what we are trying to put forth.

Amit Mahavar: Thank you, sir. Quickly second question is on our ESG initiatives. Now, as we understand, Defence business has been one of the perception problem, if I recall it, especially to a lot of Western investors. But do you think like other companies are thinking on the engineering side who have defence and non-defence business, some of them have put the defense business in a different vertical, but that has problem with DRDO and Ministry. So, any thoughts you have on that? Can L&T think of putting those debatable businesses from ESG compliance as a business in separate entity or do you think that is something which is not in our active thoughts?

S. N. Subrahmanyan: I think let's not exaggerate this problem beyond what is required. I am not sure why we got classified in the way that we have got classified. Our defence business is nothing but precision engineering and system integration and certain radar and other works that we do. We have clarified many times and extremely clearly that we are not into bombs, ammunitions, cluster munitions and so on and so forth and therefore, to keep on saying why are into the defence business is not right. L&T is into businesses which are appropriate from the nation's point of view, from taking our infrastructure point of view forward and from a national point of view forward. We do certain precision engineering and certain system integration which we believe are an extension of our engineering and manufacturing activities from that point of view and therefore, to classify us as some kind of a big Defence contractor is not right. Maybe one can even think of not taking the name of defense and calling it precision engineering or something like that, but that's exactly what we do.

And in my opinion, to put it separately, to classify is separately is not correct, because the kind of talent that we have free flows from our manufacturing into the so called precision engineering and system integration, and back into other areas as and when required, that is what is the strength of the organization all about. There is a lot of engineering and learning in all of this which we pass it on. For example, today DRDO wants to make oxygen generators. We have about Rs. 375 crores of orders from them to quickly make these oxygen generators. Now, why it was given by DRDO to our defence business is because they feel they have the engineers, the people involved there, the people who can quickly understand this and quickly put it together. Now, if it was separate, I don't think they would be able to do it because the process engineers are part of hydrocarbons, the certain amount of process engineers are part of minerals and metals and all these engineers come together both as engineers and as fabricators and manufacturers to put it all together. That's how the company functions. So, in my opinion, to make a drum and dance out of it is fine, but we are nowhere involved in any kind of ammunitions or bombs or cluster munitions, etc., to be classified any such.

Amit Mahavar: Thank you, that's very helpful. Sir, just last question for Mr. Shanker Raman. Sir, out of all the provisioning cycle that we have made, the claims that we have submitted around COVID time, where are we in that cycle? Maybe FY21, if you can help us understand the impact, plus the impact of recovery that has happened and possible number in FY22, that will be helpful. Thank you.

R. Shankar Raman: No, it's difficult to quantify because we are still peddling the cycle and it's a constant process. So I think we are in a reasonable place. I don't have the data to say, how much of what we submitted as compensation we have got. I can only tell you that majority of the cases, the time extension that is required, that's the first step to be taken in all of this has been obtained. So, I think that's a good first positive step.

Moderator: Thank you. The next question is from the line of Priyankar Biswas from Nomura. Please go ahead.

Priyankar Biswas: So, my question is regarding, would you give some comment on your Realty business? Because as you see that we are again probably in a second phase of COVID and some bits of lockdown type situations in Mumbai. So, how are you seeing the sales or enquiry momentum? And how do you see the year ahead, particularly on this piece, like probably in some numbers, it would be helpful.

R. Shankar Raman: See, our Realty business is a very measured business, it's not that we are all over the country, we are in select markets; we are in Mumbai, we are in Bangalore, we are in Chennai and consequent to Hyderabad Metro, we are present in Hyderabad. Much of the projects that we are doing are on the land that has been made available by the parent company when it moved its manufacturing facilities etc. to most cost competitive towns from the major metros. So, we have time, because we have not paid any current cost of acquiring all this, these are properties of the company which has been invested many, many, many years ago. So to that extent, I think we have the ability to time the launches, we are able to do it in a phased manner, we are not forced to build everything and then try to put out in the market. So, some demand supply readjustment we constantly do.

We have had a fairly reasonable year last year and maybe helped by the Maharashtra Government's reduction in stamp duty. Since October last year and particularly in the last quarter of last year, the sales of Mumbai real-estate, properties that we were developing are brisk. Bangalore has also been selling, because intrinsically the project is extremely well located and people who have visited the development are very, very pleased with the development that we are offering and then Bangalore still continues to be a hub of end people working in the well-paying IT industry. So, I think the tendency to own residential apartments early in their life is a big catalyst for demand to be there.

So we do find, given that we are very measured in our launches, the demand to be sustainable. Obviously as we scale up and go beyond L&T owned premises and look for joint ventures, we have a couple of them announced in Mumbai already. They have had a good start in quarter four, we will have to wait and watch as to what happens this year. But somehow my experience is that investment in a house is much beyond just the season being good or bad. I think it's a very fundamental household decision that people take. Earlier, there used to be a rush to book as the projects get announced. Nowadays, the tendency, given that the real-estate sector has seen many failed projects, the tendency is to wait for near completion before people make the booking. So, to that extent, there has been some readjustment of the booking preferences in the market.

Regulations like RERA has possibly helped, because it gives them a comfort about a regulated space to operate in, and that people will not be left high and dry at the mercy of some unscrupulous developers. Companies like us have an inherent advantage because of brand L&T and rightly so, people do believe that whenever we launch a project, we will launch, complete within time, before time and handover. So good quality within cost. So, I think that is going to be a major, major help. But at the moment, it's a space where we are very watchful and careful about what we will do going forward. But we have projects on hand to keep us busy, for the next few years we have enough projects on hand.

Priyankar Biswas: Sir, what I meant was actually like, what is the kind of like the sales outlook that you are possibly seeing for this year?

R. Shankar Raman: Please understand, the sales outlook, as represented by numbers, happens when the projects are handed over. There is a change in the accounting regulations, and for real-estate, the current guideline is that you account as sales only when you hand over completed apartment. Earlier, it used to be like construction business, progress used to be reported as sales, having booked in order. That's no more the case. So, you will find all real-estate companies having huge volatility in their quarterly numbers, because in some quarters they are able to hand over more flats, some quarters they are not able to hand over more flats. For example, for FY21, the entire year we handed over about 400 flats, in your FY20 we handed over 800 flats. So, if you compare between FY20 and FY21, the handover has got lower, so the sales booked has got lower. We are looking at adding on equal or more number of flats in the current year. But again, it depends on whether people are ready to move in. We had a very funny situation, the flat was ready, but people were not willing to come in and take possession because of COVID and whatever travel restrictions, etc. So, multiple levers are at play here. So, at the moment, it is safe to say that we will do same or better as compared to FY21.

Moderator: Thank you. The next question is from the line of Deepak Krishnan from Goldman Sachs. Please go ahead.

Pulkit Patni: This is Pulkit. Sir, I just wanted to get a sense over the medium-term of some of the businesses like our Power Development business, Shipbuilding, Defence. In many of these businesses we have been seeing underutilization of capacities. So, as we look at the next four to five years, and I guess your next five-year plan also, there's time for that to be drawn out. How should we look at some of these businesses where utilization and profitability have been lower?

R. Shankar Raman: Power development is a business where we will monetize. We have no ambition of running a power utility. Some of them have been built in the past in a certain context and those objectives having been met, the assets that we currently own, as Power Development assets will get monetized. So, I don't think there is any thinking around creating further investments in Power

Development area. Insofar as the shipyard is concerned, it's a very precious asset. You would know, in this country to get waterfront that too very close to a metropolis is next to impossible. We have been singularly lucky that we had an opportunity to acquire that waterfront area, and we are putting that waterfront area to multiple businesses, it is not only for defence, we are also using it for fabricating, hydrocarbon structures, etc. So, it's a large space, so anything that requires a larger area for fabrication etc. and with needs to be transported that becomes a handy facility.

There are continuing interest in looking at large naval program. The government policy should permit, both in terms of speed of thinking and action as well as their mindset, to utilize these facilities for ramping up. I think India's requirements are well documented. I think the Navy particularly, since we are talking about shipyard, is in a need of definitely supplementing their arsenal. So it's important that multiple next generation vessels, be it a survey vessel, be it a patrolling vessel or be it even a landing platform or a warship, there is enough and more to be done. Except that the government historically has been extremely slow, and very, very reluctant about private sector participation, and the public sector shipyards are all overflowing with backlogs running up to five to 10 years delay and whenever we have got an opportunity, we have overemphasized the point well by delivering much, much ahead of time, years ahead of time. Except the government is surprised at the speed at which we are able to do and they are not ready to take deliveries. That's another problem. But as asset, it's extremely precious and I think its country's responsibility actually to use this asset well. I think the government is very familiar with our capabilities around this space.

So, in terms of the other defense businesses, I don't think it is underutilization of capacity, because it's not so much of hardware and space lockup, it is a lot of engineering talent. As Mr. Subrahmanyan was mentioning in another context, they are fungible skills as well, as engineers are precious resources for the country, and they are all very well-trained engineers. We do today 2% to 3% of our revenues is from defense. So, to that extent, I think the defense business is busy in its own way. Except that, can it ramp up and do much better. Obviously, I think there is potential to do that and we have not really ramped up and waiting for work. I mean, like in the case of IT, etc., you don't have 20%, 30% sitting in the bench, there is no such thing that is happening in terms of underutilization. We always say potential for defense is much higher than what it is today. I don't think it's a case of underutilization.

Pulkit Patni: Sir, in the same breath, any ROE targets over the medium term?

R. Shankar Raman: We want to get back to 18%, for sure. We came up to about 15%, 15.3% in our last part. In 2016 to 2021 strategic plan, we started FY16 at 9%, and idea was to end FY21 at 18%. We were well on our way because year-on-year there has been an improvement, there was a roadmap as well. But didn't expect FY20 and the FY21 to end the way it has ended. So, to that extent, I think there has been a setback. But we are not going to lose focus on that. I think if we are able to do a couple of things, one, unlock some investments which are earning less than cost of capital, and these are essentially the infrastructure assets, the concession assets that we own, sell the Power Development business, find some sustainable solution for Hyderabad Metro concession. Minimizing the loss by itself is a big lever for ROE improvement. On top of it, we are growing in our core business, and we are growing in our services business. So, I think if these plans, we stick to and continue to work hard as we have been doing, we will keep our focus on 18% ROE.

Moderator: Thank you. The next question is from the line of Deepika Mundra from JP Morgan. Please go ahead.

Deepika Mundra: Congratulations on a good quarter. Sir, firstly just on your capital allocation. I just wanted to confirm that the core business, it seems that there is very limited capital requirement at the moment. So, any thoughts on the company's larger plans or longer-term plans on capital allocation between E&C and services businesses, both?

R. Shankar Raman: See, services business or other than financial services are generating cash by themselves. So, I don't think the parent needs to allocate any further capital to services business. The last large allocation we did to services business was to acquire Mindtree and fortunately, that acquisition has played out well and we are doing well on that capital that we have invested. We invested when the share price was about Rs. 980, and it's excess of Rs. 2,100 today. So, I think to that extent, that investment has done well. In our E&C business, the requirement has always been working capital, it never has been large outlay of capital. Of course, we have to buy some strategic equipment whenever we get large projects, but that is okay, because the cost of those equipment are most often amortized over the period of the project as well. So, I think that is not going to be a major drainer.

Financial services, we had allocated Rs. 2,000 crores last year to participate in the rights issue, to maintain our shareholding. We do believe for the next few years, the capital that we have infused and the headroom that they have for growth should suffice. I don't expect any significant capital allocation for financial services business in the next couple of years. As far as Hyderabad Metro, it's a work in progress. We allocated about Rs. 1,000 crores last year, I do think up to about Rs. 2,000 crores we need to set aside for solving some of the debt equity problems of Hyderabad Metro. The debt that has been contracted in that business was based on 7-8 lakhs of people travelling every day. It's a far smaller fraction as compared to that target number. So, it cannot, at the current ridership or even projected improved ridership, sustain the debt levels currently. So, we need to, A, refinance the debt, push the liability back; B, convert some portion of debt into equity or preferential equity and third, we also need to get some additional equity investors. All of these are work in progress.

Now, other than maybe Rs. 2,000-odd crores, I don't see Hyderabad Metro to suck in more money for the FY22 and in that asset, we will have to take a call year-on-year, depending on how far we are progressing on the several fronts that we are working on. So, in my mind, much of the cash accruals, and of course, we are trying to unlock from Power development assets, etc., hopefully that will generate some cash flow as well. So, in my mind, there is not a big consumption plan for the cash that we are likely to generate in the following year.

Deepika Mundra: Sir, my second question would be in the international business, it seems like a pretty strong pipeline for hydrocarbons. Sir, just wanted to gauge, what is the margin profile now for international orders given current commodity prices and just overall on both domestic and international, is there a potential pitch towards more variable contracts coming in, given the volatility again in commodity prices?

R. Shankar Raman: It is largely dictated by the client, because in some of the bids, the conditions is fixed price. But there are, as I told you, 60% of the cases that are also pass-through variation clauses, etc. to mitigate the commodity price hikes. The margin profile for EPC businesses have been around 8%- 9% and international, depending on the cost of resources that we use there, because many of the international markets are also insisting on using the local resources, which are more expensive, and maybe in on occasions thus less productive. So, the margins on the international businesses are more like 7% thereabout, whereas in domestic they are around 9%. So, we are still able to manage somewhere around in between that depending on the international-domestic mix for our EPC business. But the manufacturing business which feeds into the EPC business, obviously are better margin businesses and we have been trying to register growth in that business as well, and that's a function of opportunities that we have, both standalone supplies as well as feeding into our EPC. So, I think with the mix, service busines is high margin, manufacturing business which is better margin, and EPC which is on the pecking order is low margin but extremely large volume. I think we should be able to maintain this band of blended margin of 10%-10.5% that we have been reporting.

Moderator: Thank you. The next question is from the line of Ajinkya Bhat from Macquarie Capital. Please go ahead.

Ajinkya Bhat: Sir, just one question from my side. Sir, regarding your private sector order book and inquiry pipeline, could you just throw some light on which sectors are dominating this pipeline? Is it residential, real-estate, IT campuses within your buildings and factories segment or industrial facilities? And a related question being, since you mentioned that you expect the private corporate balance sheets to de-lever over the course of next two to three years, what is the typical lag between a private Capex inquiry coming in and order finalization? Basically, I am trying to gauge when would we get the earliest indications of a broad large-scale manufacturing Capex revival in the country? That's it from my side, thank you.

R. Shankar Raman: Let me answer the second question first. First, I will refresh my mind on what the question was, it is a long question. As far as the cycle for industrial orders, they are far shorter, because it's very critical for them that the time to market is crashed and hence, typically, we find 18-24 months cycle for many of these industrial orders. So, the time for an opportunity to scale up market presence and the decision to go ahead and award is far lower as compared to scenario where public sector or government is involved. I would think a private sector between the in-principle decision and really ordering out should be possible in about four months' time or thereabout whereas in government it can be anywhere between six- and nine-months' time. What was the first question?

Ajinkya Bhat: Basically, in your current private order book and inquiry pipeline, which sectors are dominating, is it residential, real-estate, IT campuses or industrial Capex? If industrial, then which sector, cement, steel, food and beverages, pharma, like heavy industries versus light industries, etc.?

R. Shankar Raman: It is pretty spread. There are some opportunities for select residential buildings. There are opportunities for data centers, there are opportunities for logistics parks. We have not yet seen the Textile Park that the Minister announced in February and there are opportunities for brownfield expansion of some of the capacities. So, I think it is outside of water and power transmission and heavy civil, which are large infra projects. There are scattered opportunities, I think it's very specific to a project, we can't say residential projects are out, it's never the case. I think we ourselves have launched in the last quarter residential project in Ghatkopar. So, I think it is very project specific opportunity. So, I think, given our size of operations and the breadth of operations, we find fairly uniform and scattered opportunities.

Ajinkya Bhat: Okay. And has the inquiry pipeline been going up, especially after the announcement of PLI schemes and related incentives? Do you see any material pick up there in inquiries?

R. Shankar Raman: I think not specific to PLI, but the sentiment of the country changed from post Diwali FY20. People were thirsting to get back to action, so to that extent I think the inquiries, the bidding that we did, etc. were reflective of that sentiment. That sentiment has received a setback in April. I think the number of deaths that have happened in the country has been disturbing. So, it is fair to say that sentiment has got disturbed. But we hope that sooner than later we get out of this difficult situation. But the country has taken very little time to bounce back in terms of mood change and I think that's a positive for me. And if the country can just afford to forget the difficult period that has gone by and focus on what needs to be done ahead, and they continue to sustain that as what we saw last year, I think we should be able to see revival.

Moderator: Thank you. Ladies and gentlemen, due to time constraints, that was the last question. I now hand the conference over to Mr. P. Ramakrishnan for closing comments.

P. Ramakrishnan: Thank you, Margaret, and thanks to all of you for participating in this call. Stay safe and wishing you all the best. Thank you.

Moderator: Thank you. On behalf of Larsen & Toubro Limited, that concludes this conference. Thank you for joining us, and you may now disconnect your lines.