

Chairman's Statement – Annual Report 2017-18

Dear Shareholders



Across the last eight decades, L&T has kept pace with technological developments as well as the evolving needs of the nation. Your Company is, in every sense, leading the change.



My greetings and good wishes to you on the 80th anniversary of the formation of L&T.

The tiny partnership firm set up on May 1, 1938 is now a leading engineering & construction conglomerate, operating at the upper end of the technology spectrum. Across the last eight decades, we have kept pace with technological developments as well as the evolving needs of the nation. Your Company is, in every sense, leading the change.

Economic Scenario

In the last fiscal, the Indian economy has emerged after grappling boldly with multiple challenges. Structural reforms, by their very nature, are

initially disruptive because they unsettle the existing ways of doing business, and can often impact public perceptions negatively. However, their long-term benefits outweigh the early tremors. The GST regime and other reforms such as Insolvency & Bankruptcy Code, Demonetisation and RERA are the building blocks of a healthier, more wholesome economic environment.

In addition to the volatility sparked by reform-led change, industry encountered a host of other challenges, viz., muted private sector capex, reduced investment opportunities in Middle East markets and the increasing unpredictability of geo-political developments.

On the other hand, some areas of public sector infrastructure capex have seen strong investment momentum and several large investment programs have been initiated. We are also beginning to glimpse the green shoots of private sector capex revival in the industrial space. It is expected that the economic reforms initiated by the Government will expand the tax base, enhance revenues and in turn spur GDP growth and infrastructure allocations.

With private sector participation in roads, airports, power, real estate and industrial capex remaining subdued, the needle of increased investment has largely shifted towards the public sector. The Government has also been focusing on development of infrastructure and energy facilities to drive strong, sustainable economic growth. Rural reform is receiving the attention it deserves. Larger allocations towards irrigation, measures to insulate farmers against the vagaries of the monsoon, rural road connectivity, and the proverbial last mile in rural electrification are heartening.

Positive markers at the national level include a wider tax base, increased allocation of share of revenues to states, strong Balance Sheets of some PSUs and larger quantum of funding from international development agencies such as JICA and World Bank. All of them have provided a robust financial platform for building infrastructure facilities in the country.

On the global front, the signals are mixed. Major governments are being lured into populist measures such as protectionism. Geo-political re-alignments are impacting traditional trade flows and commodity prices and currencies experience never-before volatility. Amid all this, we see encouraging signs of global growth revival.

Performance Overview

Your Company has turned in a commendable performance on key financial parameters in 2017-18. Even though awarding of infrastructure projects continued to be unpredictable in terms of timelines, we registered a 7% growth in fresh order inflows of ₹ 152,908 crores over inflows in the previous year. The unexecuted Order Book at the end of 2017-18 stands at ₹ 263,107 crores which provides good revenue visibility in 2018-19. While execution was impacted in 2017-18 due to disruptions

caused by implementation of GST as well as bottlenecks in some projects due to tardy customer payments, delayed clearances, and land acquisition / right of way issue, your Company clocked revenues of ₹ 119,862 crores. This translates to a growth of 9.5% on a like-to-like basis over the previous year after adjusting for Excise Duties which were subsumed in GST from 1st July 2017 onwards. Profit after Tax recorded an all-time high of ₹ 7,370 crore – representing a 22% increase over PAT of 2016-17.

It gives me great pleasure to inform you that the Board of Directors has recommended a Dividend of ₹ 16.00 per share. Corresponding dividend in the previous year was ₹ 14.00 per share.

International Business

The thrust on international business initiated almost two decades ago has contributed to your Company being recognized as a marquee player in the Middle East in the hydrocarbon and infrastructure sectors. This has ensured that despite fiscal contraction in oil producing countries, we continued to enjoy business traction throughout 2017-18. The recent spurt in oil prices could trigger an increased round of investments in the region, opening possibilities for resurgent growth.

In line with our aim of diversifying the spread of our international business beyond the Middle East, we are also actively pursuing opportunities in East and North Africa Region (including Algeria and Egypt) and other 'near shore' geographies of East Asia (Bangladesh, Myanmar, Thailand, Vietnam and Sri Lanka). The unexecuted Order Book from international markets stood at ₹ 62,500 crore, which translates to 24% of the total Order Book. Of the total international Order Book, non-GCC business now accounts for 31% of the Book size.

Digital Future

Leveraging technology across all operations is a prime focus area. While our digitalization journey will extend far into the future, some operational benefits are already visible - better asset utilization, improved labour productivity and sourcing efficiencies through the use of IoT (Internet of Things) and other digital solutions. L&T Infotech and L&T Technology Services are our partners in this initiative,

and your Company expects to continue harvesting the wide-ranging benefits of digitalization in the years ahead.

Talent Management and Succession Planning

Our Human Resources policies and practices centre around moulding our employees into leaders in their areas of work. Your Company's structured 7-step Leadership Development Programme plays a key role in helping build a robust leadership and succession pipeline. A comprehensive programme for monetary and non-monetary rewards incentivises excellence.

While I have handed over the reins of day-to-day operational management to the CEO & MD, I am focusing on business portfolio rationalisation, mentoring the next generation of leaders and expanding the outreach of your Company's CSR initiatives.

Sustainable Development

The sustainability of business pivots on the quality of the ecosystem within which it operates. It is therefore a moral imperative for responsible corporates to actively implement measures to improve business performance, reduce social disparities, and mitigate the environmental impact of industrial development. Our sustainability focus is on reduction of our carbon footprint and introduction of green technologies, while improving the lives of the communities around us through health, education, water & sanitation and skill-building initiatives.

Total spends on CSR initiatives in 2017-18 by your Company amounted to ₹ 101 crore under eligible items, as defined in the Companies Act. This translates to 2% of the average annual net profits of the Company over the last three years.

Outlook

India is witnessing the increasing 'formalisation' of an economy which for decades had sections operating below the radar. Structural reforms such as Demonetisation, GST and the Insolvency & Bankruptcy Code have resulted in a larger pool of assesses and growth in the volume of tax collection. The increase in tax revenues should enable the Government to invest in essential infrastructure on a sustained basis.

While international business opportunities continue to remain reasonably healthy, 2018-19 is also expected to witness strong domestic growth, aided by supportive fiscal policies and the focused development agenda being adopted by the Government. Business prospects in different sectors provide a large canvas of opportunity which could be tapped in 2018-19. Segments which hold promise in the current year include:

1) Infrastructure

a) Roads – The Government has committed sizeable budgetary allocation to augmenting road infrastructure. We expect this momentum to continue, aided by increased investments in expressway programs.

b) Railways – A thrust on railway electrification and track augmentation is paving the way for increased opportunities in your Company's railways business. We are geared to tap these prospects as they develop.

c) Metro Rail – We have been participating in Metro Rail programs in multiple cities in India and in two projects in the Middle East. The investment flow continues to gather pace as more cities adopt mass rapid transit as an effective and eco-friendly solution to urban traffic congestion. Continued growth is expected in this business segment.

d) Urban Infrastructure – Your Company is a leader in providing building solutions – across the urban spectrum - residential real estate, commercial buildings, affordable housing, hospitals, educational institutions, hotels and convention centres. While residential buildings have seen a lull over the last few years, other prospects in this vertical continue to hold promise. The new frontier in urban infrastructure is Smart Cities. A growing number of cities are adopting elements of smart city infrastructure such as intelligent traffic management and surveillance systems, smart electric grids & lighting, fibre optic cabling and transport & logistics systems. Your Company has the unique advantage of in-house domain expertise to provide end-to-end offerings to customers. This enables us to play the role of a Master System Integrator for the Smart Cities of the future.

e) Water Infrastructure – The water sector has seen sub-optimal investment levels in the past. This could change for the better, thanks to the growing realization that ground water is being overexploited and that better irrigation facilities are essential to provide a sustainable livelihood for our farmers. Your Company's diverse range of offerings in the water sector will benefit from the Government's programmes to clean the country's major rivers as well as from bulk transmission and water treatment for municipalities, sewage & effluent treatment plants, lift irrigation and inland waterways infrastructure.

2) Thermal Power Generation – A slowdown in the thermal power generation sector across the last few years has led to aggressive bidding, as competitors vie for the limited opportunities on offer. Your Company looks forward to prospects aggregating 6 GW which are likely to be awarded in the current year, and these constitute targeted business. We have successfully constructed gas-fired power plants in Bangladesh and will continue to tap similar prospects likely to come up in the neighbouring country in the current year. We also continue to engage with our joint venture partners for increased international business in our efforts to increase manufacturing capacity utilisation.

3) Power Transmission & Distribution (PT&D) – We have built strong business foundations in the PT&D space in India and the Middle East. Inroads have also been made into parts of East Africa, Algeria and Egypt. This is in line with our objective of creating an international PT&D business covering dispersed geographies. On the domestic front, the thrust by the Government on strengthening power grids through Central and State utilities, as well as intensive electrification of rural households is expected to yield good business in the current year. We also continue to see good traction in international business prospects.

4) Hydrocarbon – Oil prices are rebounding from their historic low points. This will brighten prospects for your Company's hydrocarbon business in the Middle East region which had seen contraction of spends over the last two years. We have adopted a policy of judicious bidding for projects with selected customers in the GCC region. Projects are selected based on a strong customer connect and the predictable prospects of streamlined execution.

Countries being targeted include Saudi Arabia, UAE, Kuwait, Oman, Algeria and a few in East Asia. On the domestic front, prospects in offshore production, onshore refinery capex, fertiliser plants and pipeline projects are a cause for cheer.

The Company has built up a good order book and possesses proven capabilities to harness upcoming prospects.

5) Heavy Engineering – The Heavy Engineering business faced hurdles over the last few years due to shrinking global spends on hydrocarbon equipment compounded by the slow pace of revival of the nuclear power industry. Prospects for the current year are reasonably strong with some signs of a higher level of ordering for hydrocarbon equipment. The Nuclear Power Corporation of India Ltd. has also progressed in its plan to build ten new nuclear power plants using its 700 MW indigenous design. The commencement of awarding orders for equipment is encouraging news for the Heavy Engineering business.

6) Electrical & Automation (E&A) – The Electrical & Automation business continued to record stable operational indicators in 2017-18. It remains a market leader in many segments within its wide range of low voltage switchgear. The range includes Air Circuit Breakers, Moulded Case Circuit Breakers, Switch Disconnect Fuses and other electric protection devices for application in industry, agriculture and segments such as buildings. Its expanding product spectrum covers building automation systems including smart meters and energy management systems, and a range of customised energy distribution solutions. Business opportunities for the current year are positive, and likely to stimulate growth.

In line with its strategic plan to exit non-core businesses, your Company signed an agreement with Schneider Electric to divest this business, subject to regulatory approvals. We envisage that these approvals could be forthcoming in timelines in excess of a year.

7) Realty – This sector has been impacted by Demonetisation, RERA and the increased financialization of savings where individuals shift their investments from

real estate or gold to financial assets. While the industry continues to be weighed down by excess inventory and low absorption rates, business is gradually improving and we expect 2018-19 to be better than the last two years in terms of order inflows and offtake. Your Company intends to continue with monetisation of its properties in Mumbai, Bangalore and Chennai, subject to Government approvals.

8) Information Technology and Technology Services (IT and TS) – After listing of L&T Infotech Ltd (LTI) and L&T Technology Services (LTTs) in mid-2016-17, the businesses have recorded above average growth while maintaining margins and returns on capital. Markets have responded positively, and have rewarded the IPO shareholders through capital appreciation. At the heart of the success of both these subsidiaries is the customer-focused lineage of Larsen & Toubro. While drawing extensively on the domain knowledge and operational expertise of their parent company, they have also leveraged its international client base which includes global majors. The focus of the businesses is on increased digital offerings, with special emphasis on client mining, talent management, enhanced utilisation of resources and superior service offering. These listed subsidiaries are well equipped to address and overcome global challenges including increasing protectionist policies while maintaining healthy shareholder returns.

9) Financial Services – This business, which was listed in 2011, continues to perform well, and had a loan book of ₹ 83,654 crore at the end of 2017-18, representing a strong Year-on-Year growth of 26%. Its growth momentum continues in both lending and investment management where the average AUM has risen to ₹ 66,000 crore in 2017-18. Digital and data analytics have facilitated operations even as growth in focused businesses, asset quality, fee income and operational excellence measures are enabling the business to increase returns on capital. Equity capital was raised in end-2017-18, and your Company subscribed to the equity issue in order to maintain its equity stakes since it believes that growth capital infusion will be return accretive.

10) Development Projects – Your Company owns a portfolio of concession assets comprising roads, a transmission line, power generation, a container port and a metro rail. The metro rail project and some hydel plant projects are currently under construction. In the current year, we have divested five road concessions to an Investment Trust, and will continue to evaluate options for monetisation of value created in the remaining concession assets.

Strategic Plan

Your Company formulated its 5-year strategic plan – LAKSHYA - spanning the years from 2016-17 to 2020-21 (both years inclusive), and has largely been on track in execution of this plan. The overarching goal is to enhance Return on Equity (RoE). Levers to achieve this include maintaining steady growth in revenues with improvement in margins, control on working capital, divestment of non-core businesses, endeavouring to turn around under-utilised facilities, minimising capital expenditure, avoiding investment in long gestation or asset heavy businesses and higher pay-outs to shareholders. Both 2016-17 and 2017-18 have shown that our efforts are yielding positive results. Your Company is confident of continuing its RoE enhancement journey during the current year as well.

I would like to conclude by thanking Team L&T as well as our customers, vendors and other stakeholders who have made it possible for your Company to maintain its trajectory of growth during a challenging phase of the Indian economy. I also wish to thank my fellow Board members for their invaluable support.

Thank You.

A. M. Naik
Group Chairman