LARSEN & TOUBRO LIMITED
RESEARCH

EQUITY RESEARCH **August 29, 2009**

RESULTS REVIEW

Share Data

Market Cap	Rs. 946.5 bn
Price	Rs. 1,614.6
BSE Sensex	15,922.3
Reuters	LART.BO
Bloomberg	LT IN
Avg. Volume (52 Week)	0.90 mn
52-Week High/Low	Rs. 2,825 / 557
Shares Outstanding	586.2 mn

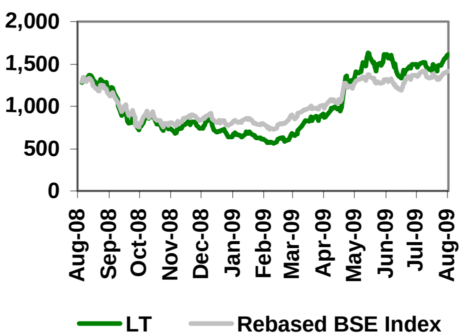
Valuation Ratios (Consolidated)

Year to 31 March	2010E	2011E
EPS (Rs.)	55.0	59.8
+/- (%)	11.5%	8.8%
PER (x)	29.4x	27.0x
EV/ Sales (x)	2.5x	2.2x
EV/ EBITDA (x)	20.3x	18.1x

Shareholding Pattern (%)

Promoters	0
FIIs	16
Institutions	37
Public & Others	48

Relative Performance



Larsen & Toubro Ltd. — Hold

Promising future; but fairly valued

Larsen & Toubro (L&T) reported mixed results for Q1'10 with an 11% yoy growth in sales but a 20% yoy decrease in order inflows (excluding the RMC business). We believe the Company will be a key beneficiary of the Government of India's (GOI) infrastructure spending; however, considering the recent run-up in the share price, we believe the stock is fairly valued and continue to maintain the Hold rating.

Large fiscal spending holds promise: To provide impetus to the current sluggish economic growth, the government is looking at boosting spending on infrastructure, removing policy bottlenecks, and simplifying the procedures for project approvals. L&T has vast experience in a wide range of infrastructure projects and a proven track record of executing such projects efficiently. Thus, the Company is likely to be one of the biggest beneficiaries of the government's increased spending on infrastructure. Accordingly, we have upwardly revised L&T's order book growth for FY10 to 25% as against our earlier estimate of a 20% growth in the previous quarter.

Operating margin expected to remain stable: L&T's operating margin improved by 68 bps yoy in Q1'10 to 10%, mainly due to a 94 bps yoy increase in the margin of the Engineering and Construction (E&C) segment as a result of a) a larger proportion of orders that crossed the margin recognition threshold and b) a reduction in the cost of materials. We expect the Company's operating margin to largely remain stable in the remaining quarters of FY10 due to the relatively lower commodity prices (compared with H1'09) and the management's discretion in picking up projects with higher margins.

Key Figures (Standalone)

Quarterly Data	Q1'09	Q4'09	Q1'10	YoY	QoQ	FY08	FY09	YoY
(Figures in Rs. mn, except per share data)								
Net Sales	69,014	104,690	73,627	6.7%	(29.7%)	248,547	336,466	35.4%
EBITDA	7,101	15,870	8,319	17.2%	(47.6%)	28,622	38,568	34.8%
Net Profit	5,024	11,424	5,783	15.1%	(49.4%)	21,734	27,092	24.7%
Margins(%)								
EBITDA	10.3%	15.2%	11.3%			11.5%	11.5%	
NPM	7.3%	10.9%	7.9%			8.7%	8.1%	
Per Share Data (Rs.)								
EPS	8.5	19.5	10.2	20.5%	(47.8%)	38.1	46.3	21.5%

Valuation: L&T's stock is currently trading at a forward (FY10) P/E of 29.4x. Our fair value estimate of Rs. 1,721, based on the SOTP methodology, factors in the major positives but provides limited upside potential from the current market price. Thus, we maintain our Hold rating.

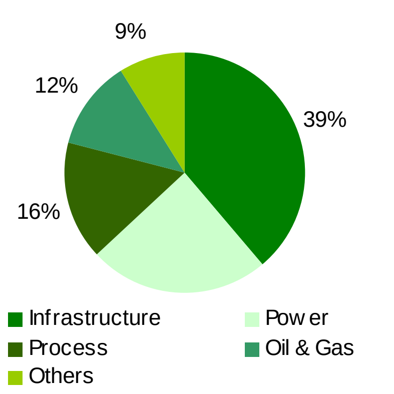
Result Highlights

Order run-rate is under stress

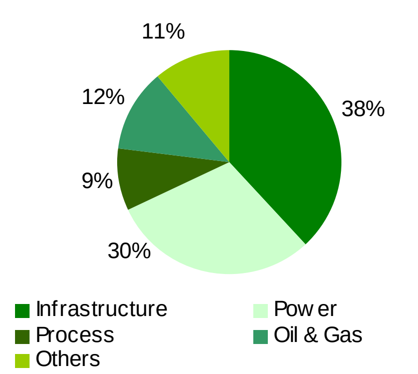
The order intake in Q1'10 fell by 22% to Rs. 95.7 bn. If we exclude the order intake from the Ready Mix Concrete (RMC) business (discontinued in H2'09), the order intake has fallen by 20%. This fall is higher than market expectations. The primary reasons for lower order intake in Q1'10 are a) the award decision for a few very large tenders was deferred during the quarter due to elections and b) the slowdown in the global and domestic private capital expenditure.

The break-up of the current order inflow highlights that major contributors during Q1'10 were the Infrastructure, Power, and Oil & Gas (Mid and Down stream) sectors.

Sectorwise allocation of the current order book



Sectorwise allocation of the current order intake



Source: Company data

The management continues to maintain a guidance of a 25%–30% growth in the order intake for FY'10. Even the lower end of the guidance translates into an order intake of ~Rs. 650 bn for FY'10 or an implied 35–40% qoq growth in the next three quarters. We believe that the management should be able to meet at least the lower end of its guidance, given the high infrastructure spending (~Rs. 1,800 bn) planned by the government and the diversified operations of L&T.

Government's infrastructure development programmes

Announcements	Amount (Rs. bn)	Increase in allocation over FY09 (%)
National Highways Authority of India (NHAI)	159.5	23
Jawaharlal Nehru National Urban Renewal Mission (JNNURM)	128.9	87
Allocation for housing and basic amenities to urban poor	39.7	NA
Briham Mumbai Storm Water Drainage Project (BRIMSTOWA)	5.0	150
Accelerated Power Development & Reform Programme (APDRP)	20.8	160
Accelerated Irrigation Benefit Programme (AIBP)	350.0	75
Rashtriya Krishi Vikas Yojana (RKVY)	325.0	30
Bharat Nirman	453.6	45
Pradhan Mantri Gram Sadak Yojana (PMGSY)	120.0	59
Rajiv Gandhi Grameen Vidutikaran Yojana (RGGVY)	70.0	27
Indra Awaas Yojana (IAY)	88.0	63
Rural Housing Fund (RHF) in National Housing Bank (NHB)	20.0	NA
Commonwealth Games	34.7	64
Total	**1,815.2**	

Source: Union Budget highlights (2009-10)

Revenue increased due to better execution

Gross sales for Q1'10 increased a modest 6.3% yoy to Rs. 74.3 bn, primarily due to a considerable increase in the E&C segment revenue and a faster order execution rate. If we exclude the revenue of the RMC business (discontinued in H2'09) from Q1'09 numbers, the revenue for Q1'10 has increased by 11% yoy.

Segmentwise revenue and operating profit

(Amount in Rs. bn)	Q1'09	Q2'09	Q3'09	Q4'09	Q1'10	YoY
Revenue						
Engineering & Construction	55.8	59.9	76.3	94.4	65.7	17.9%
Electricals & Electronics	5.8	7.6	6.5	7.9	5.8	(0.3%)
Machine & Industrial Products	6.4	6.8	5.3	6.2	4.4	(31.3%)
Others	3.8	4.0	1.8	1.3	0.8	(79.5%)
EBIT						
Engineering & Construction	5.4	6.5	7.9	14.7	7.0	29.3%
Electricals & Electronics	0.7	0.8	0.7	1.0	0.7	(0.1%)
Machine & Industrial Products	1.5	1.4	0.7	1.2	1.0	(35.2%)
Others	0.3	0.2	0.1	(0.1)	0.0	(83.2%)

Source: Company data

The segment break-up of revenue reveals that growth in gross sales was due to a 17.9% increase in the E&C business. Consequently, the share of the E&C business in the total revenue increased from 77.8% in Q1'09 to 85.8% in Q1'10.

The growth in revenue for the Electrical and Electronics (E&E) segment was subdued and its revenue of Rs. 5.8 bn in Q1'10 was approximately at the same level as in Q1'09. Furthermore, the performance of the Machinery and Industrial Products (M&IP) segment was under stress during Q1'10 and revenue for this segment fell by 31.3% to Rs. 4.4 bn. This is a direct result of the slowdown in the global and domestic private capital expenditure.

Improved EBIT margin likely to remain stable

The overall EBIT margin increased to 10% in Q1'10 from 9.3% in Q1'09, primarily due to a 94 bps yoy increase in the margin of the E&C segment, which accounts for more than 80% of L&T's standalone revenue. The margin improvement is primarily a result of a) a larger proportion of orders that crossed the margin recognition threshold and b) the reduction in the cost of materials. However, the margins of the other two segments–E&E and M&IP–remained under pressure. Overall, we expect the Company's operating margin to largely remain stable in the remaining quarters of FY'10 due to the relatively lower commodity prices (compared with H1'09) and the Company's intent to execute only such incremental projects that are in line with the current margin levels.

Segmentwise operating profit margins

Segment	Q1'09	Q2'09	Q3'09	Q4'09	Q1'10	YoY
EBIT Margin (%)						
Engineering & Construction	9.7	10.8	10.4	15.6	10.6	0.9
Electricals & Electronics	11.8	11.1	10.5	12.4	11.8	0.0
Machine & Industrial Products	23.2	20.0	12.5	18.8	21.8	(1.3)
Others	6.7	5.4	6.6	(4.8)	5.4	(1.2)

Source: Company data

Exceptional profit from Ultratech's sale drives net profit

Reported net profit increased significantly to Rs. 15.9 bn in Q1'10, primarily due to an exceptional gain of Rs. 10.2 bn from sale of the Company's long-term investment in Ultratech Cement Ltd. If we exclude this exceptional gain, the Company's net profit increased by only 15.1% yoy to Rs. 5.8 bn. The corresponding basic and diluted EPS for the quarter ended June 30, 2009, works out to Rs. 9.87 and Rs. 9.71 per share, respectively.

Stable performance of subsidiaries

During Q1'10, L&T Infrastructure Finance and L&T Finance Limited reported double-digit revenue growth, mainly due to an increase in infrastructure spending and business activity. At the same time, L&T Infotech managed to post only a modest growth due to the global slowdown. The current book size for L&T Finance and L&T Infra Finance stands at Rs. 54 bn and Rs. 30 bn, respectively.

Subsidiary performance	Total Revenue			PAT		
(Amount in Rs. bn)	Q1'10	Q1'09	YoY	Q1'10	Q1'09	YoY
L&T Infotech Limited (Consolidated)	4.74	4.52	4.9%	0.62	0.61	1.6%
L&T Finance Limited	1.98	1.78	11.2%	0.24	0.25	(4.0%)
L&T Infrastructure Finance Limited	0.86	0.75	14.7%	0.22	0.18	22.2%

Source: Company data

Outlook

Keeping in view the improving macroeconomic fundamentals and the development focus of the UPA-led government at the Centre, we are optimistic about an increase in spending on infrastructure in India over the next few years. L&T's strategic initiatives to augment business prospects in some of the most promising sectors such as Power, Railways, Defence, and Nuclear Energy and excellent execution skills are likely to help the Company exploit the full potential of the emerging opportunities. Consequently, we believe that the Company will be able to record a ~25% order intake growth in FY'10.

We further believe that the relatively lower commodity prices (compared with H1'09) and the management's discretion in picking up projects with higher margins should lead to a stability in the margins of the E&C segment. However, margins of the E&E and M&IP segments are likely to remain under pressure as a result of their muted top-line growth; this will in turn impact their utilisation levels. Further, the net margin is likely to be negatively impacted by a higher average borrowing cost. During FY09, in the absence of low-cost foreign debt, the Company had to borrow high-cost rupee debt to finance its capital expenses.

Valuation: The stock is currently trading at a forward (FY10) P/E of 29.4x. Our fair value estimate of Rs. 1,721, based on the SOTP methodology, factors in all the major positives but provides limited upside potential from the current market price. Thus, we maintain our Hold rating.

SOTP

Business	Basis	Value per share
Standalone	DCF	1,412
L&T Finance	P/E	39
L&T Infotech	P/E	90
L&T Infrastructure Finance Limited	P/E	23
Larsen & Toubro (Oman) LLC	P/E	14
Tamco Switchgears	P/E	9
Investments/Others	BV	116
Cash from the sale of stake in Ultratech	Sale Value	18
Target Price		**1,721**

Source: Indiabulls research

Sensitivity analysis of fair value estimate

Sensitivity Analysis						
		Cost of Capital (WACC)				
		10.1%	10.6%	11.1%	11.6%	12.1%
Terminal growth	6.0%	1,709	1,573	1,463	1,374	1,298
	6.5%	1,889	1,715	1,578	1,468	1,378
	7.0%	2,127	1,896	1,721	1,583	1,473
	7.5%	2,455	2,134	1,902	1,727	1,589
	8.0%	2,938	2,464	2,142	1,909	1,732

Source: Indiabulls research

Key Figures (Standalone)

Year to March	FY07	FY08	FY09	FY10E	FY11E	CAGR (%)
(Figures in Rs. mn, except per share data)						(FY09-11E)
Net Sales	175,671	248,547	336,466	395,853	447,589	15.3%
EBITDA	17,953	28,622	38,568	45,634	50,256	14.2%
Net Profit	14,030	21,734	27,092	30,703	33,090	10.5%
Margins(%)						
EBITDA	10.2%	11.5%	11.5%	11.5%	11.2%	
NPM	8.0%	8.7%	8.1%	7.8%	7.4%	
Per Share Data (Rs.)						
EPS	25.2	38.1	46.3	52.4	56.5	10.5%
EPS (Cons)	33.1	37.4	49.3	55.0	59.8	
PER (x)	24.4x	18.0x	34.9x	30.8x	28.6x	

Source: Company data

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