

**Company Update**

# Larsen & Toubro

**BUY**

 Bloomberg: LT IN  
 Reuters: LART.NS  
 Mkt cap: INR 470.2bn/USD 11.2bn

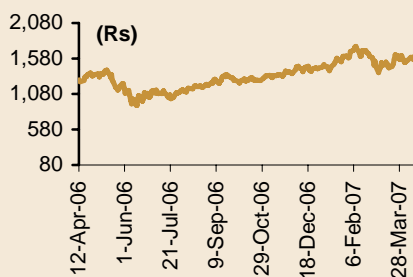
**Current price: INR 1,669\***
**Target price: INR 1,812\*\***

## New initiatives taking shape

L&amp;T inks JV for super critical boilers with MHI; also to enter water segment

*Horizon: March 2008*
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**Stock performance**


(%)	Absolute	Relative to	
		Sensex	Sector
3 months	11.3	15.6	7.8
6 months	31.7	23.3	1.8
12 months	26.5	9.9	1.9

**Expected performance relative to Sensex** **IN LINE**
**Beta relative to Sensex** **1.11**
**Key financials**

Y/E 31 Mar	FY07E	FY08E	FY09E
Net sales (INR m)	200,229	267,638	350,671
Net profit (INR m)	15,509	21,323	28,705
Adj EPS (INR)	53.8	74.0	99.7
<b>PER (x)</b>	<b>31.0</b>	<b>22.6</b>	<b>16.8</b>
PCE (x)	26.5	19.6	14.7
EV/Core EBITDA (x)	21.3	15.2	11.0
Price/Book (x)	7.6	5.9	4.5
ROE (%)	27.3	29.6	30.5
ROCE (%)	22.5	26.8	30.2
Consensus EPS (INR) *	49.7	64.6	

\* Bloomberg

**L&T ink JV with MHI for boilers for super critical thermal plants**

L&T and Mitsubishi Heavy Industries (MHI) have signed an agreement to create a joint venture (JV) for manufacturing boilers for super critical power plants in India. The JV would manufacture boilers for the power plant units in the range of 500-1,000MW. L&T would hold 51% stake in the JV. This follows the technology-transfer agreement between the two companies signed earlier.

The site for the manufacturing plant would be declared shortly and the plant would be commissioned by the H2FY09. The capital outlay for the plant would be INR3bn.

In a separate statement, MHI said that they are targeting revenues of USD690m from this plant in five-year's time.

**L&T entering into water segment**

M.V.Kotwal, Senior Vice President, was quoted in some media reports that L&T would enter into the water treatment and water supply segment. Water treatment offers a significant opportunity in industrial sector, especially in thermal power plants. Similarly, the opportunity is huge in the water supply/sewerage segment in the urban infrastructure space. Bulk of the projects approved under Jawaharlal Nehru Urban Renewal Mission (JNNURM) has been in the water supply/sewerage/sanitation areas. In the budget this year, government has increased allocation to water segment by 26% to INR68bn.

We remain positive on the company's efforts to diversify into higher margin manufacturing areas. We have Buy rating with March 2008 price target of INR1,812.

<b>Income statement</b>						<i>INR m</i>
Year ended 31 Mar	FY05	FY06	FY07E	FY08E	FY09E	
<b>Net sales</b>	<b>145,517</b>	<b>165,604</b>	<b>200,229</b>	<b>267,638</b>	<b>350,671</b>	
<i>growth (%)</i>	34.1	13.8	20.9	33.7	31.0	
Operating expenses	(133,873)	(149,765)	(177,185)	(235,778)	(307,759)	
<b>Core EBITDA</b>	<b>11,644</b>	<b>15,838</b>	<b>23,044</b>	<b>31,859</b>	<b>42,913</b>	
Other income	1,665	4,582	3,254	3,644	4,081	
<b>EBITDA</b>	<b>13,309</b>	<b>20,420</b>	<b>26,297</b>	<b>35,503</b>	<b>46,994</b>	
Depreciation	(2,137)	(2,435)	(2,645)	(3,242)	(3,957)	
<b>EBIT</b>	<b>11,172</b>	<b>17,985</b>	<b>23,652</b>	<b>32,261</b>	<b>43,036</b>	
Interest paid	(1,021)	(1,303)	(1,181)	(1,181)	(1,181)	
Non-recurring items (net of taxes)	3,855	698	0	0	0	
<b>Pre-tax profit</b>	<b>14,005</b>	<b>17,380</b>	<b>22,470</b>	<b>31,080</b>	<b>41,855</b>	
Tax (current + deferred)	(2,881)	(4,633)	(6,581)	(9,177)	(12,470)	
<b>Profit after tax</b>	<b>11,124</b>	<b>12,747</b>	<b>15,889</b>	<b>21,903</b>	<b>29,385</b>	
Minority interests	(677)	265	(380)	(580)	(680)	
<b>Net profit</b>	<b>10,448</b>	<b>13,012</b>	<b>15,509</b>	<b>21,323</b>	<b>28,705</b>	
<b>Adjusted net profit</b>	<b>6,593</b>	<b>12,315</b>	<b>15,509</b>	<b>21,323</b>	<b>28,705</b>	
<i>growth (%)</i>	10.1	86.8	25.9	37.5	34.6	

<b>Balance sheet</b>						<i>INR m</i>
Year ended 31 Mar	FY05	FY06	FY07E	FY08E	FY09E	
Current assets	101,220	116,392	137,951	176,504	229,416	
Investments	6,801	16,757	16,757	16,757	16,757	
Fixed assets	21,706	28,950	33,304	39,563	45,105	
Other assets	2,094	2,357	2,357	2,357	2,357	
<b>Total assets</b>	<b>131,821</b>	<b>164,456</b>	<b>190,369</b>	<b>235,181</b>	<b>293,635</b>	
Current liabilities	52,056	65,243	78,936	105,513	138,251	
Total Debt	34,538	34,987	34,987	34,987	34,987	
Other liabilities	11,020	13,514	13,514	13,514	13,514	
<b>Total liabilities</b>	<b>97,614</b>	<b>113,744</b>	<b>127,437</b>	<b>154,014</b>	<b>186,752</b>	
Paid-up capital	260	275	576	576	576	
Reserves & surplus	32,900	49,370	60,689	78,124	102,940	
<b>Shareholders' funds</b>	<b>34,207</b>	<b>50,711</b>	<b>62,932</b>	<b>81,166</b>	<b>106,883</b>	
Minorities	1,048	1,066	1,666	2,466	3,366	
<b>Total equity &amp; liabilities</b>	<b>131,821</b>	<b>164,456</b>	<b>190,369</b>	<b>235,181</b>	<b>293,635</b>	

<b>Cash-flow</b>						<i>INR m</i>
Year ended 31 Mar	FY05	FY06	FY07E	FY08E	FY09E	
Pre-tax profit	14,005	17,380	22,470	31,080	41,855	
Depreciation	2,137	2,435	2,645	3,242	3,957	
Tax paid	(2,881)	(4,633)	(6,581)	(9,177)	(12,470)	
Chg in working capital	<b>(7,202)</b>	<b>(1,556)</b>	<b>(2,593)</b>	<b>(5,032)</b>	<b>(6,198)</b>	
<b>Cash flow from operations (a)</b>	<b>6,060</b>	<b>13,626</b>	<b>15,942</b>	<b>20,113</b>	<b>27,144</b>	
Capital expenditure	(2,894)	(7,416)	(7,000)	(9,500)	(9,500)	
Chg in investments	(563)	(9,956)	0	0	0	
<b>CF from investing (b)</b>	<b>(3,457)</b>	<b>(17,372)</b>	<b>(7,000)</b>	<b>(9,500)</b>	<b>(9,500)</b>	
<b>Free cash flow (a+b)</b>	<b>2,603</b>	<b>(3,746)</b>	<b>8,942</b>	<b>10,613</b>	<b>17,644</b>	
Equity raised/(repaid)	11	15	301	0	0	
Chg in minorities	(170)	284	220	220	220	
Debt raised/(repaid)	6,846	448	0	0	0	
Dividend (incl. tax)	(4,067)	(4,498)	(3,889)	(3,889)	(3,889)	
Other financing activities	(692)	5,753	(301)	0	0	
<b>CF from financing (c)</b>	<b>1,929</b>	<b>2,002</b>	<b>(3,669)</b>	<b>(3,669)</b>	<b>(3,669)</b>	
<b>Net chg in cash (a+b+c)</b>	<b>4,531</b>	<b>(1,744)</b>	<b>5,274</b>	<b>6,944</b>	<b>13,975</b>	

**Key ratios**

Year ended 31 Mar	FY05	FY06	FY07E	FY08E	FY09E
Adjusted EPS (Rs)	25.4	46.6	53.8	74.0	99.7
Adjusted EPS growth (%)	10.1	83.5	15.6	37.5	34.6
Core EBITDA growth (%)	47.4	36.0	45.5	38.3	34.7
Core EBITDA margin (%)	8.0	9.6	11.5	11.9	12.2
Pre-tax margin (%)	9.6	10.5	11.2	11.6	11.9
ROE (%)	21.5	29.0	27.3	29.6	30.5
ROCE (%)	15.4	20.1	22.5	26.8	30.2
Net debt/Equity (%)	72.0	52.9	34.2	18.0	0.6

**Valuation parameters**

Year ended 31 Mar	FY05	FY06	FY07E	FY08E	FY09E
PER (x)	65.8	35.8	31.0	22.6	16.8
PCE (x)	49.7	29.9	26.5	19.6	14.7
Price/Book (x)	12.7	8.7	7.6	5.9	4.5
Yield (%)	0.8	0.9	0.7	0.7	0.7
EV/Net sales (x)	3.4	3.0	2.5	1.8	1.3
EV/Core EBITDA (x)	42.5	31.4	21.3	15.2	11.0

**L&T: Recommendation history**

Date	Stock price (INR)	Recommendation	Price target (INR)	Report
19-May-05	1037	NEUTRAL	1090	Good business, bad price - Stock price anticipates improving order book
28-May-05	1102	NEUTRAL	1090	Q4FY05 result: Sluggish growth in order book - Stock prices in future growth—maintain Neutral
4-Jul-05	1186	NEUTRAL	1090	Visit note
29-Jul-05	1225	NEUTRAL	1090	Q1FY06 Result: E&C business still sluggish - Any upsides to growth are already priced in—we maintain Neutral
5-Aug-05	1365	NEUTRAL	1090	Additions to order book
18-Aug-05	1319	NEUTRAL	1090	L&T wins new Hyderabad airport contract
26-Aug-05	1312	NEUTRAL	1090	L&T acquires Datar Switchgear Ltd
18-Oct-05	1410	BUY	1916	Big daddy
29-Oct-05	1343	BUY	1916	Q2FY06 result: Order booking gathering momentum - We maintain Buy
23-Nov-05	1572	BUY	1916	Sector update
20-Dec-05	1731	BUY	1916	L&T wins Rs13bn order from ONGC
26-Dec-05	1748	BUY	1916	LT awarded EPC contract for Gangavaram port project
23-Jan-06	1869	NEUTRAL	1916	Q3FY06 result: Revenues below expectation - We downgrade stock to Neutral
27-Feb-06	2377	NEUTRAL	1916	LT consortium wins US\$345m order - LT's share: US\$198m
31-Mar-06	NA	NEUTRAL	1916	Cyclical vs Secular
26-May-06	2295	NEUTRAL	Under review	Q4FY06 result: Sluggish revenue growth - Margin improvement driven by non-E&C businesses
25-Jul-06	2063	Under review	Under review	Q1FY07 result: Margins surprise on the positive side - Management maintains its guidance for full year margins
28-Nov-06	1396	BUY	1656	Initiating coverage: Nation-building. The best play on India's capex and infrastructure boom
12-Dec-06	1436	BUY	1656	LT bags INR 54bn order for Delhi airport - Company's largest order so far
2-Feb-07	1601	BUY	1812	Q3FY07 result: Margins surprise on the positive side. We recommend Buy, shift to a March 2008 price target of INR 1,812.
19-May-05	1037	NEUTRAL	1090	Good business, bad price - Stock price anticipates improving order book
<b>17-Apr-07</b>	<b>1,669</b>	<b>BUY</b>	<b>1,812</b>	<b>New initiatives taking shape: L&amp;T inks JV for super critical boilers with MHI; also to enter water segment</b>

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