

## Larsen & Toubro

Proxy play on India's growth story

Already strong in infrastructure sector, L&T is preparing itself for big growth in power, shipping, IT and other sectors as well

Buy	Larsen and Toubro
BSE Code	500510
NSE Code	LT
Bloomberg	LT@IN
Reuter	LART.BO
52-week High/Low	Rs 1778 / Rs 903
Current Price	Rs 1612 (as on 13th April 2007)

Larsen and Toubro (L&T) is south east Asia's largest engineering and construction conglomerate having additional interests in IT and electrical business. Many of the engineering projects executed by L&T have set new benchmarks in terms of scale, sophistication and speed. It also manufactures and markets a wide range of engineering products like earthmoving, industrial and chemical machinery, switchgears, valves, welding alloys and cement machinery. A strong, customer-focussed approach and the constant quest for top-class quality have enabled the company to attain and sustain leadership position for over six decades. The company's broad-spectrum capabilities are unmatched in Indian engineering space. Furthermore, the company is best placed to exploit maximum potential of big ticket projects as it satisfies basic requirements such as balance sheet size, past track record, technical know-how and has adequate liquidity.

L&T is, in a sense, a proxy play on India's capex and infrastructure growth story. Broadly, L&T's business can be categorized into three segments: (1) engineering & construction (E&C), (2) electrical & electronics (EBG), and (3) diversified businesses/others.

### **Financials-Consolidated financials are much better than standalone**

On standalone basis, for the quarter ended December 2007, sales of the company grew 12% on a higher base to Rs 4118.42 crore. The share of revenue from international operations constituted 19% of the gross revenue. Operating profit margin for the quarter expanded by 280 basis points (bps) to 10.3% on the back of better order mix, better control on cost/ contract execution. Thus OP was up 53% to Rs 425.53 crore. PBT rose by 75% to Rs 516.57 crore and PAT grew 46% to Rs 343.90 crore. On standalone basis, net revenue for the nine monthh grew by 12% to Rs 11330.60 crore. OPM expanded by 330 bps to 8.3% and OP was up 84% to Rs 936.70 crore. PAT before EO (net of tax) was higher by 45% to Rs 702.25 crore.

Moreover, consolidated figures and growth are significantly higher. L&T has 18 Indian subsidiaries, 6 foreign subsidiaries and 26 associate companies.

On consolidated basis the net revenue for the company has increased by 21% to Rs 5183 crore. The PBDIT was higher by 75% to Rs 795 crore and PBT was higher by 87% to Rs 697 crore. After providing for taxation, which is higher by 89% the PAT before EO (net of tax), minority interest and profit on associate company was higher by 86% to Rs 504 crore. After accounting for profit on associate companies amounting Rs 18 crore (up 125%) and minority interest of Rs 22 crore (up 38%) the PAT before EO net of tax was higher by 90% to Rs 500 crore. EO net of tax on account of divestures and other misc. non recurring items amounts Rs 104 crore. Finally the net profit was higher by 80% to Rs 604 crore.

For the nine month ended Dec '06 the total net consolidated revenue was higher by 20% to Rs 14121 crore and PBT was higher by 88% to Rs 1517 crore. After accounting for taxation (Rs 420 crore, up 75%), Share of profit in associate companies (Rs 67 crore, up 43%) and Minority interest (Rs 65 crore, up 103%) the PAT before EO (net of tax) was higher by 89% to Rs 1099 crore. The EO on account of divestures and other was higher by 65% to Rs 430 crore. Spurred by this the net-profit was higher by 82% to Rs 1529 crore.

The fastest growing subsidiaries are L&T Infotech, L&T Finance, HPL Cogeneration, L&T Oman and L&T Electromech.

### **E&C division order backlog at Rs 34142 crore as at Dec 31, '06**

Riding pretty on the strong economic activity in infrastructure and hydro carbon sector the E&C segment of the company continue to see strong order intake. During the December quarter, the E&C order booking at Rs 8172 crore was higher by 26% y-o-y. The share of international orders booked during the quarter was around 12% of the total orders booked. Cumulative order booking, for the nine month ended Dec '06 for E&C division stood higher by 43% at Rs 19127 crore. The order backlog of E&C business of the company was at Rs 34142 crore as at end of Dec 31, '06.

This apart, recently, L&T and its consortium partner Paul Wurth Italia have bagged an EPC (Engineer-Procure-Construct) package, valued over Rs 1,400 crore, for the expansion of Vizag Steel Plant of Rashtriya Ispat Nigam Ltd (RINL).

L&T also bagged a contract worth around \$250 million from Maersk Oil Qatar for development work at the latter's oil field 'Block 5' in February 2007. The contract is for a project that involves construction of two new offshore platform topsides, a flare platform and an interconnecting bridge. The contract is one of their 'largest overseas projects' said a news release from L&T. Maersk Oil Qatar is developing the field under a production-sharing agreement with Qatar Petroleum. The 'Block 5' package is to be executed in 28 months.

### **Management confident of achieving guidance**

Earlier the management had said that it expects total revenues to grow 20-25% at better profit margins and order book to grow 25-30% in FY 2007. However sales for the nine month ended December 2006 has grown by just 12%. But the management had reiterated the full-year sales guidance of 20%. The slippages in sales have largely been on account of certain orders in the water and effluent treatment; roads; and oil and gas, which have been sorted out in Jan 2007.

### **Other positive developments**

L&T has signed a definitive agreement to acquire GDA Technologies, and all of its design centers in the USA and India. GDA, a privately held electronic design firm based in California, USA, is one of the fastest growing companies in the Silicon valley. GDA has expertise in various semiconductor developments from front-end design to physical design for design for deep sub-micron process technologies.

The company has also entered into a technological collaboration with Mitsubishi Heavy Industries for manufacture of equipment for mega power projects being planned in the country. The companies will together invest Rs 450 crore in the venture, currently registered as L&T Boilers Ltd. Under the agreement, the Japanese company will transfer technology to L&T for manufacture of supercritical boilers that can meet the

requirements of the domestic mega power projects being planned. Currently, there are few Indian companies in this space, the notable player being Bharat Heavy Electricals Ltd.

L&T has signed a joint venture agreement with a subsidiary of the Kuwait-based Bader Al Mulla group in Jun '06. Under this agreement a new JV company in the name of 'Larsen & Toubro Kuwait Construction WLL' will be set up in Kuwait to deal with construction projects in oil & gas, power and infrastructure, with a primary focus on electro-mechanical construction in Kuwait. Both companies hope to benefit from the construction boom in Kuwait, specifically in the sectors of oil refining and infrastructure development.

Moreover the company has also set up a 60:40 joint venture with Malaysian drilling company, SapuraCrest Petroleum Berhad (SapuraCrest), to build, own and operate a derrick-cum-pipeline barge valued at \$100 million. The barge is to be completed in the last quarter of 2008 and will provide offshore installation services including sub-sea pipe laying, platform installation opportunities in India, west Asia, South East Asia, Australia and the Sakhalin region. This venture will strengthen the armory of L&T by bridging the missing link in installation capabilities in the upstream offshore sector.

L&T in consortium with Toyo Engineering Corporation (Toyo), Japan, has won a large scale turnkey contract valued over Rs 2600 crore from Indian Oil Corporation (IOCL). This contract is for project management, engineering, procurement and construction of naphtha cracker and associated units at IOCL's Panipat petrochemical complex in Haryana.

L&T is planning to set up a mega shipyard in the country at an estimated investment of Rs 1,000 crore. L&T owns a shipyard at Hazira near Surat for construction of high-technology vessels of up to 150 metre length and displacement of 20,000 tonne. Currently, L&T is scouting for a deep water facility on the east and west coasts for its second shipyard. Earlier, its shipyard at Hazira won a key contract for construction of four ships valued at over Rs 440 crore from the Netherlands-based Zadeko Ship Management CV. Production of the ships will start next month.

The company has made a foray in the dredging business by acquiring a majority stake in International Seaport Dredging Pvt Ltd, promoted by Belgian dredging multinational, Dredging International NV.

### **Bright outlook**

Ongoing investment splurge in infrastructure sector especially power, roads, ports, airports holds great opportunity for L&T given its ability to execute complex projects. This is likely to result in sustained order flow of infrastructure projects. Moreover with robust demand growth both in Indian and overseas there is large scale capacity creation is happening. This is likely to augur well for all business segments of L&T. Further high oil prices have resulted in increased investments in the hydrocarbon sector with thrust on development of new oil wells, which command higher margins. L&T is in the process of building up its brand in Middle East in the areas of infrastructure, construction, hydrocarbon and power. The company is also looking at doubling business from China to \$200 million in next 2-3 years.

Capacity expansion of heavy engineering fabrication facility at Hazira and new facilities in Coimbatore & Middle East are some of the initiatives by the company in E&C division. The company is also taking other measures like: institutionalizing risks management system for E&C orders, focusing on operational excellence & talent management. The focus of the company in Shipbuilding also to augurs well.

The margin of core E&C segment is expanding with the company picking the right cherry that is fitting its profile in the engineering and construction space where there is plenty of opportunities. Right strategy with control on cost and scale of operation the company managed to improve the margins in the core business and is all likely to sustain it at the level of about 7-8%. Empirically the last quarter of any fiscal being strong one both on order intake as well as revenue booking the numbers are expected to be strong given current strong order book.

## Valuation-Consolidated valuations are much attractive

For the FY ended March 2007, we expect the company to register standalone sales and standalone net profit of Rs 17580.60 crore and 1220.37 crore respectively. On equity of Rs 56.11 crore and face value of Rs 2 per share, standalone EPS works out to Rs 43.5. However consolidated EPS for FY 2007 works out to phenomenal Rs 63.2. The standalone EPS is expected to rise to Rs 53.6 and consolidated EPS to Rs 78.6 in FY 2008. At the current price of Rs 1612, P/E on consolidated EPS works out to 25.5 for FY 2007 and 20.5 for FY 2008. Considering the company's premier position in the infrastructure sector (which holds tremendous investment potential) and prospects of value-unlocking in many of its subsidiaries and associate companies, the scrip will continue to outperform the market.

### Larsen & Toubro: Standalone Financials

	0603 (12)	0703 (12P)	0803 (12P)
Sales	14733.85	17580.60	20920.91
OPM (%)	7.0	9.5	10.0
OP	1038.43	1663.70	2092.09
Other inc.	464.78	378.15	397.06
PBIDT	1503.21	2041.85	2489.15
Interest	75.07	52.60	42.08
PBDT	1428.14	1989.25	2447.07
Dep.	114.49	140.20	168.24
PBT	1313.65	1849.05	2278.83
EO	0.00	0.00	0.00
PBT	1313.65	1849.05	2278.83
Tax	371.26	628.68	774.80
PAT before EO (net of tax)	942.39	1220.37	1504.03
EO (net of tax)	69.75	0.00	0.00
Reported PAT	1012.14	1220.37	1504.03
PAT Excluding EO (net of tax)	942.39	1220.37	1504.03
EPS (Rs)*	33.6	43.5	53.6
Conolidated EPS (Rs)*	37.4	63.2	78.6

\* Annualised on current equity of Rs 56.18 crore.

(P): Projections

Face Value: Rs 2

EO: Extraordinary items

\*EPS is calculated after excluding EO net of tax

Figures in Rs crore

Source: Capitaline Corporate Databases



### L&T: Consolidated Performance

Q3 07	Q3 06	Var.	Rs. crore	9M 07	9M 06	Var.	FY06
5183	4277	21%	Total Net Revenues	14121	11743	20%	17019
795	453	76%	PBDIT (w/o gain on divestitures)	1807	1061	70%	1846
697	373		PBT (w/o gain on divestitures)	1517	806		1472
193	102		Tax - (Incl Deferred, FBT &	420	240		447
504	271		Dividend Tax)				
18	8		PAT (w/o gain on divestitures )	1097	566		1025
-22	-16		Share of profits in Associate Cos.	67	47		71
			Minority Interest	-65	-32		-45
500	263	90%	Group PAT (w/o gain on	1099	581	89%	1051
104	48		divestitures )				
			Gain on divestitures net of tax &	43	198		196
			Minority Interest				
	24		Extraordinary items net of tax		62		70
604	335	80%	Group Profit After Tax	1529	841	82%	1317

### L&T Performance of Subsidiaries\* –Manufacturing / Services / Construction/ Power

FY 06	Rs. crore	9M07	9M06	Var.
2110	Total Income	2211	1352	63%
295	PAT	287	145	97%
14.00%	PAT / Total Income (%)	13.00%	10.70%	

\* Excluding Infrastructure Companies

## Larsen & Toubro: Standalone results

	0612 (3)	0512 (3)	Var. (%)	0612 (9)	0512 (9)	Var. (%)	0603 (12)
Sales	4118.42	3688.72	12	11330.6	10117.8	12	14733.85
OPM (%)	10.3	7.5	37	8.3	5	0	7
OP	425.53	277.95	53	936.7	510.38	84	1038.43
Other inc.	127.93	60.79	110	258.15	298.35	-13	464.78
PBIDT	553.46	338.74	63	1194.85	808.73	48	1503.21
Interest	1.22	22.5	-95	27.6	46.97	-41	75.07
PBDT	552.24	316.24	75	1167.25	761.76	53	1428.14
Dep.	35.67	26.64	34	100.2	82.06	22	114.49
PBT	516.57	289.6	78	1067.05	679.7	57	1313.65
EO	0	0	0	0	0	0	0
PBT	516.57	289.6	78	1067.05	679.7	57	1313.65
Current Tax	174.33	55.69	213	367.35	200.97	83	386.61



Engineering & Construction	2782.41	3311.67	-16	75	2782.41	3311.67	-16	75	2761.99	78
Electrical & Electronics	584.15	309.02	89	16	584.15	309.02	89	16	363.39	10
Machinery & Indl. Products	194.37	215.56	-10	5	194.37	215.56	-10	5	210.18	6
Others	173.69	228.69	-24	5	173.69	228.69	-24	5	188.18	5
Total CE in Segments	3734.62	4064.94	-8	100	3734.62	4064.94	-8	100	3523.74	100
Add: Unallocable	3565.96	2003.83			3565.96	2003.83			2647.28	
Total CE	7300.58	6068.77			7300.58	6068.77			6171.02	

Figures in Rs crore

Var. (%) exceeding 999 has been truncated to 999

LP: Loss to Profit; PL: Profit to Loss

Source: Capitaline Corporate Databases