

Larsen & Toubro

STOCK INFO.	BLOOMBERG
BSE Sensex: 9,521	LT IN
	REUTERS CODE
S&P CNX: 2,901	LART.BO

20 January 2006

Buy
Previous Recommendation: Buy
Rs1,869

Equity Shares (m)	141.6
52-Week Range	1,925/901
1,6,12 Rel. Perf. (%)	5/14/43
M.Cap. (Rs b)	264.6
M.Cap. (US\$ b)	6.0

YEAR	NET SALES	PAT*	EPS*	EPS	P/E*	P/BV	ROE	ROCE	EV/	EV/
END	(RS M)	(RS M)	(RS)	GROWTH (%)*	(X)	(X)	(%)	(%)	SALES	EBITDA
3/05A	134,363	6,408	49.3	3.8	37.9	7.3	19.2	19.2	2.0	30.8
3/06E	160,725	9,802	69.2	40.3	27.0	5.9	21.4	23.4	1.6	20.7
3/07E	208,145	14,455	102.1	47.5	18.3	5.1	24.8	29.4	1.3	15.3

* Consolidated; EPS is fully diluted

L&T reported robust financial performance during 3QFY06, with pre exceptional net profit at Rs1.9b, up 42% YoY, in line with our estimates. 15.8% YoY revenue growth and EBITDA margin expansion to 8.3% in 3QFY06 v/s 5.3% in 3QFY05 and 7.9% in 2QFY06 have driven this performance.

Key result highlight: Management has revised upward FY06 order intake guidance to 50% YoY v/s 35% earlier. It is significant to note that this is the second consecutive quarter of upward revision — the previous upward guidance to 35% was made in September 2005 from 20% YoY in June 2005.

Based on the revised guidance, we upgrade FY07 and FY08 consolidated earnings by 6.1% (to Rs14.4b) and 9.7% (to Rs17.5b) respectively. A significant part of this upgrade is on the back of increased order intake, with no change to our EBITDA margin estimates.

We revise our target price to Rs2,200 (from Rs1,770), driven by earnings upgrades and the shift to FY08 estimates v/s FY07. Given (1) increased momentum in order intake (2) higher contribution from high margin business segments; and (3) value unlocking potential by subsidiaries, we maintain **Buy**.

Y/E MARCH	QUARTERLY PERFORMANCE									
	FY05				FY06				(RS MILLION)	
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4QE	FY05	FY06E
Net Sales	26,832	29,882	32,689	42,908	31,611	34,372	37,623	55,004	132,311	158,609
Change (%)					17.8	15.0	15.1	28.2	36.3	20.3
EBITDA	1,265	1,219	1,754	4,332	1,758	1,407	3,182	5,577	8,570	11,923
Change (%)					38.9	15.5	81.4	28.7	47.1	53.5
As of % Sales	4.6	4.0	5.3	10.0	5.5	7.9	8.3	10.0	6.4	7.4
Depreciation	207	220	215	299	294	260	266	287	942	1,108
Interest	99	134	141	162	98	147	225	289	536	759
Other Income	202	503	473	972	227	1,309	206	1,007	2,150	2,748
Extraordinary Income	0	3,620	0	0	382	0	715	0	3,620	617
Reported PBT	1,160	4,988	1,870	4,844	1,975	2,308	3,611	6,008	12,862	13,422
Tax	359	611	547	1,507	545	878	557	1,862	3,023	3,842
Effective Tax Rate (%)	30.9	12.2	29.2	31.1	27.6	38.0	15.4	31.0	23.5	28.6
Reported Profit	802	4,377	1,324	3,337	1,430	1,431	2,593	4,060	9,839	8,964
Adjusted PAT	802	757	1,324	3,337	1,048	1,431	1,878	4,060	6,219	8,347
Change (%)					30.7	89.0	41.9	21.7	16.7	34.2

E: MOST; All quarterly numbers are for standalone entity

Robust financial performance, adjusted net profit up 42% YoY

L&T reported robust financial performance during 3QFY06, with pre exceptional net profit at Rs1.9b, up 42% YoY, in line with our estimates. Driving this performance is 15.8% YoY revenue growth and EBITDA margins expansion to 8.3% in 3QFY06 v/s 5.3% in 3QFY05 and 7.9% in 2QFY06.

EXTRA-ORDINARIES IN 3QFY06 REPORTED NUMBERS

EXTRAORDINARY ITEMS	WHERE REPORTED IN P&L	(RS M)
Profit on divesture of dairy and glass business	Extraordinary items	234.8
Write back from part settlement of deferred Sales Tax liability from John Deere	Netted off from sales and administrative expenses	240.0
Reversal of Income Tax provision in 2QFY06, as invested gains from divesture in tax savings instruments	Netted off from income tax provision	242.0

Source: Company/Motilal Oswal Securities

During 3QFY06, revenues were Rs36.7b, up 16% YoY. Interest expense at Rs225m during 3QFY06 includes Rs70m as exchange loss on FCCB conversion. Operational other income is at Rs959m (3QFY06) v/s Rs1.0b (3QFY05).

Significant expansion in EBITDA margins

During 3QFY06, EBITDA margins (pre exceptional) expanded significantly to 8.3%, compared with 5.3% in 3QFY05, up 300bp. Even on a QoQ basis, margins expanded by 40bp (2QFY06-7.9%). This is largely a result of stable raw material cost, increasing proportion of variable price contracts and operating leverage.

Order intake guidance revised to 50% YoY (FY06)

The key highlight of 3QFY06 results is an upward revision in FY06 order intake guidance by management to 50% YoY v/s 35% earlier. Again, significant to note is that this is the second consecutive quarter of upward revision: from 20% YoY growth guidance in June 2005, to 35% YoY in September 2005 and again revised to 50% YoY during December 2005. We have upgraded our estimate of order backlog as of March 2006 to Rs250b v/s Rs179b in March 2005, up 40% YoY. We also upgrade our FY06 estimated order intake to Rs230.4b v/s Rs149.3b for FY05.

During 3QFY06, order intake stood at Rs74b, up 108% YoY; while order backlog increased to Rs235b compared with Rs199b in 2QFY06 and Rs170b in 3QFY05. Based on the revised guidance, during 4QFY06, we expect order intake of Rs70.2b, up 18% YoY.

TREND IN ORDER INTAKE, ORDER BACKLOG AND REVENUES (RS B)

	FY04	FY05	FY06E	FY07E	FY08E
Order Booking	130.8	149.3	230.4	278.8	314.2
Change (%)	21.3	14.1	54.3	21.0	12.7
Order Backlog	169.7	179.1	248.6	321.3	394.4
Change (%)	24.0	5.5	38.8	29.3	22.7
Revenues	98.9	133.6	158.8	206.0	241.1
Change (%)	34.4	35.1	18.9	29.7	17.0

Source: Company/Motilal Oswal Securities

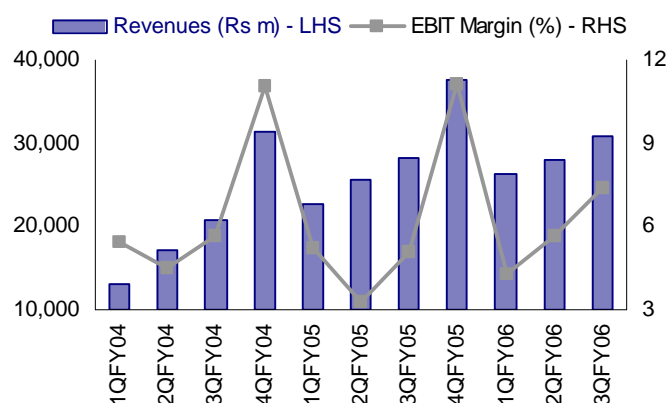
E&C Division: Order intake up 118% YoY

L&T - E&C DIVISION PERFORMANCE (RS M)

	3QFY06	3QFY05	% YOY	2QFY06	% QOQ
Order Intake	67,230	30,860	117.9	42,890	56.7
Domestic	53,670	28,990	85.1	34,740	54.5
Export	13,560	1,870	625.1	8,150	66.4
Order Backlog	229,150	164,340	39.4	193,010	18.7
Gross Revenues	30,870	28,214	9.4	27,963	10.4
EBITDA	2,410	1,580	52.5	1,770	36.2
EBITDA Margins (%)	7.8	5.6		6.3	

Source: Company/Motilal Oswal Securities

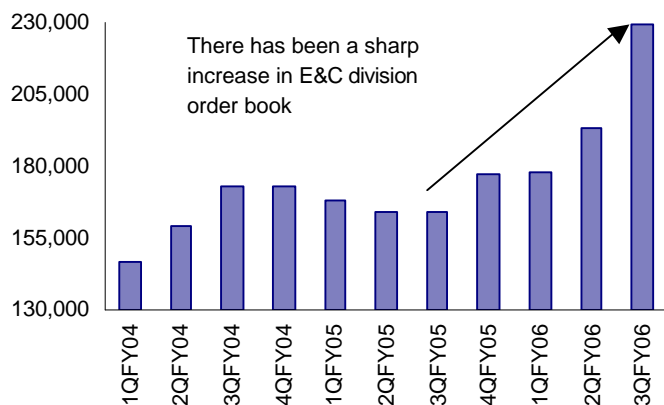
E&C DIVISION REVENUES (RS M) AND EBIT MARGINS (%)



Source: Company/Motilal Oswal Securities

EBITDA margins for the E&C division improved to 7.8% in 3QFY06 v/s 5.6% in 3QFY05 and 6.3% in 2QFY06. Management appeared confident of a further improvement in EBITDA margins going forward. During FY06, management has given guidance for 100bp YoY improvement in E&C margins.

E&C DIVISION ORDER BACKLOG (RS M)



Source: Company/Motilal Oswal Securities

COMPOSITION OF ORDER BOOK (%)

	FY03	FY04	FY05	1QFY06	2QFY06	3QFY06
Process Indus.	17	16	14	13	16	13
Oil & Gas	21	23	20	19	17	25
Power	10	10	8	7	6	6
Infrastructure	35	33	35	38	39	37
Others	17	18	23	23	22	19
Total	100	100	100	100	100	100

Source: Company/Motilal Oswal Securities

We note, a large share of incremental orders is from the hydrocarbons sector, process industries, etc., which entail a significantly improved margin profile than plain vanilla infrastructure orders. During December 2005, share of infrastructure in the order backlog has declined to 37% v/s 39% in September 2005.

EBG business: strong growth and improving margins

The Electricals Business Group (EBG) registered 27.4% YoY growth in revenues, driven by switchgear and 520bp improvement in EBITDA margins. The sharp improvement in EBITDA margins to 17% during 3QFY06 came as a positive surprise to us. Management has given guidance for 35% revenue growth during FY06 and FY07, and also improvement in EBITDA margins.

L&T – EBG DIVISION PERFORMANCE (RS M)

	3QFY06	3QFY05	% YOY	2QFY06	% YOY
Sales	3,770	2,960	27.4	3,790	-0.5
EBITDA	640	350	82.9	580	10.3
EBITDA Margins (%)	17.0	11.8		15.3	

Source: Company/Motilal Oswal Securities

Improvement in capital efficiency

L&T's asset turnover, both in E&C and EBG business segments witnessed a significant increase. In E&C, asset turnover improved to 3.6x, while in EBG, it improved to 3.7x during 3QFY06, from 2.3x in 3QFY05.

During FY06-FY08E, we expect L&T to incur capex of Rs8-Rs9b, mainly for adding manufacturing capacities. The current utilization rates stand at ~90%-92%. Existing manufacturing facilities for L&T are: Powai in Maharashtra, Chennai in Tamil Nadu and Hazira and Ranoli in Gujarat. In May 2005, Coimbatore was identified as the fifth growth centre and a 10-year growth plan (to 2015) was chalked out, where facilities for the manufacture of precision tools, valves, components are to be set up. In October 2005, L&T announced the setting up of its sixth growth centre to manufacture marine structures requiring an investment of about Rs5b. The company has selected two locations in Gujarat, two in Andhra Pradesh and one in Tamil Nadu to set up this facility and awaits final clearance.

Upgrade in earnings estimates

Based on the revised order intake guidance (FY06 up 50% YoY v/s 35% earlier), we upgrade consolidated earnings estimates for FY07 by 6.1% (to Rs14.4b) and for FY08 to 9.7% (to Rs17.5b) respectively. A significant part of this upgrade is on the back of increased order intake, with no change to our EBITDA margin estimates.

REVISION IN NET PROFIT ESTIMATES (RS M)

	REVISED	PAST	CHANGE	CHG. (%)
FY07	14,455	13,569	887	6.1
FY08	17,514	15,810	1,703	9.7

Source: Motilal Oswal Securities

Revision in price target to Rs2,200/sh, maintain Buy

We value L&T based on a sum-of-the-parts methodology. We revise our target price to Rs2,200/sh (from Rs1,770/sh), driven by earnings upgrades and the shift to FY08 estimates vs FY07 earlier. We now value core business at Rs1,651/sh (16x FY08 PER), L&T Infotech at Rs158/sh (10x FY08PER), L&T Infrastructure at Rs180/sh (P/BV and 10x FY08 PER), manufacturing associates at Rs64/sh

(10x FY08 PER), international ventures at Rs41/sh (10x FY08 PER), L&T Finance at Rs22/sh (8x FY08 PER) etc. Given the increased momentum in order intake and margin improvement, we maintain **Buy**.

L&T: SUM OF THE PARTS METHODOLOGY

	BUSINESS SEGMENT	METHOD	VALUATION MULTIPLE (X)	VALUE (RS M)	VALUE (RS/SH)	RATIONALE
L&T Standalone	Engineering, Construction & Electricals	FY08E PER (x)	16	224,320	1,651	In line with industry average at at 16x FY08, BHEL is 18x FY08
Ultratech Cemco (11.5% stake)	Cement	Target Price (Rs/sh)	375	5,363	39	Target Price Rs375/sh (US\$85/t)
L&T Infotech (100% stake)	Infotech	FY08E PER (x)	10	21,488	158	10x FY08 PER in line with niche Tier-II IT companies
L&T Infrastructure Development Projects	Infrastructure					
- BoT Projects	BoT	P/BV vs RoE		6,365	47	Valued at RoE over eventual project life
- L&T Infocity	Real Estate	Real estate		6,905	51	Real Estate at discount to market prices
- L&T Cross Roads	Real Estate	Real estate		861	6	Real Estate at discount to market prices
- CyberPark Development & Construction	Real Estate	Real estate		323	2	Real Estate at discount to market prices
L&T Power Investments Pvt Ltd						
- HPL Co Generation	Captive Power Projects	FY08E PER (x)	10	6,242	46	Discount to NTPC average PER
- India Infrastructure Developers	Captive Power Projects	FY08E PER (x)	10	3,500	26	Discount to NTPC average PER
- Other Projects	Captive Power Projects	P/BV	10	315	2	Option Value as projects not yet commenced operations
L&T Finance (100% stake)	Hire Purchase, Leasing, Bill Discounting	FY08E PER (x)	8	3,043	22	In line with SREI Finance L&T has advantage of catering to in house requirement of L&T's dealers/vendors/ customers, etc; L&T Finance Book size Rs9.5b, NPAs less than 0.5%
International Ventures						
- L&T (Oman) Llc	EPC projects in Oman	FY08E PER (x)	10	2,666	20	Discount to L&T's valuations
- L&T Qatar Llc	EPC projects in Qatar	FY08E PER (x)	10	1,213	9	Discount to L&T's valuations
- L&T Saudi Arabia Llc	EPC projects in Saudi Arabia	FY08E PER (x)	10	1,225	9	Discount to L&T's valuations
- Zubair Kilpatrick Llc	Electrical and Instrumentation for Oil / Gas	FY08E PER (x)	10	429	3	Discount to L&T's valuations
Manufacturing Ventures						
- L&T Komatsu	Excavators and Hydraulic System	FY08E PER (x)	12	4,815	35	In line with BEML, 12x PER FY07E
- Audco India	Industrial Valves	FY08E PER (x)	10	3,098	23	Revenue growth and margins have shown strong consistency
- EWAC Alloys	Welding	FY08E PER (x)	10	737	5	
Other Investments				-	-	
Book Value				5,187	38	
Total					2,200	

Source: Motilal Oswal Securities

Larsen & Toubro: an investment profile

Company description

L&T is India's largest engineering and construction company. Its business is categorized in three segments viz. engineering and construction (E&C), electrical and electronics (E&E) and other diversified businesses. It has demerged its cement and other non-core businesses and emerged as a focused engineering player offering comprehensive exposure to Indian industry and infrastructure. It has many subsidiaries and associate companies, which will gradually start adding robustly to the bottom line.

Key investment arguments

- ✍ L&T is witnessing increased traction in order inflows. Management has revised FY06 order intake guidance at 50% YoY, vs 35% earlier
- ✍ We are also excited about the growth opportunity and L&T's positioning in high-end segments like nuclear, defence and aerospace
- ✍ We believe that L&T's subsidiaries, particularly infrastructure and infotech, can unlock sizeable value going forward
- ✍ During FY05-FY08, we expect L&T to report a 39.8% consolidated earnings CAGR

Key investment risks

- ✍ Higher borrowings warranted for investments in special purpose vehicles (SPVs)
- ✍ Liabilities in terms of cost overruns and other failures may arise with respect to international projects

Recent developments

- ✍ Has signed an MOU with Dubai Aluminum Company for an alumina joint venture; will increase E&C order scope in excess of Rs30b
- ✍ Divested stake in L&T-John Deere Private

Valuation and view

- ✍ L&T offers the best play on the Indian Infrastructure and industry. Increased momentum in order intake, value unlocking probability from subsidiaries and increasing share of high margin businesses would drive re-rating.
- ✍ On consolidated basis, the stock trades at a P/E of 27.2x FY06, 18.4x FY07 and 15.2x FY08.

Sector view

- ✍ Investments in manufacturing industries are likely to gain momentum as operating at peak utilization rates
- ✍ Government thrust on infrastructure and allotment of projects on a BOT basis is positive for larger players

COMPARATIVE VALUATIONS

		L&T	BHEL	CROMPTON
P/E (x)	FY06	27.2	25.9	19.4
	FY07	18.4	19.9	15.2
P/BV (x)	FY06	5.9	5.1	8.0
	FY07	5.1	4.2	6.3
EV/Sales (x)	FY06	1.6	2.6	1.7
	FY07	1.3	2.2	1.5
EV/EBITDA (x)	FY06	20.7	14.1	16.9
	FY07	15.2	10.9	12.9

SHAREHOLDING PATTERN (%)

	DEC.05	SEP.05	DEC.04
Promoters	0.0	0.0	0.0
Domestic Institutions	35.9	36.6	36.5
FII's/FDIs	25.7	23.9	23.5
Others	38.4	39.4	40.0

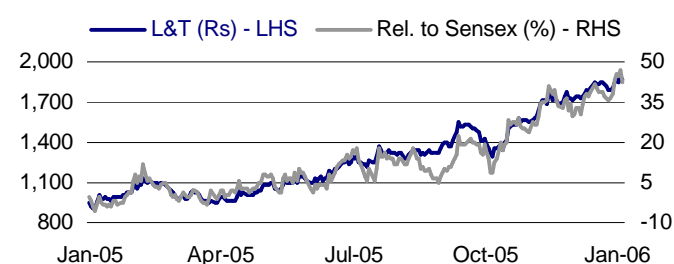
EPS: INQUIRE FORECAST VS CONSENSUS (RS)

	INQUIRE FORECAST	CONSENSUS FORECAST	VARIATION (%)
FY06	69.2	66.2	4.5
FY07	102.1	83.9	21.7

TARGET PRICE AND RECOMMENDATION

CURRENT PRICE (RS)	TARGET PRICE (RS)	UPSIDE (%)	RECO.
1,869	2,200	17.7	Buy

STOCK PERFORMANCE (1 YEAR)



INCOME STATEMENT						(Rs Million)				
Y/E MARCH	2004	2005	2006E	2007E	2008E					
Total Revenues	99,235	134,363	160,725	208,145	243,544					
Growth Rate (%)	-0.6	35.4	19.6	29.5	17.0					
Excise Duty	2,454	1,768	2,115	2,739	3,205					
Net Revenues	96,781	132,595	158,609	205,405	240,338					
Growth Rate (%)	2.1	37.0	19.6	29.5	17.0					
Manufacturing Expenses	74,916	105,161	123,462	160,534	186,956					
Staff Cost	6,781	7,645	9,556	11,945	14,932					
S G & A Expenses	9,477	10,961	12,858	15,611	18,266					
EBITDA	5,607	8,828	12,733	17,315	20,184					
Change (%)	-32.9	57.4	44.2	36.0	16.6					
EBITDA Margin (%)	5.8	6.7	8.0	8.4	8.4					
Depreciation	854	926	1,108	1,235	1,379					
EBIT	4,754	7,902	11,625	16,081	18,805					
Net Interest	366	536	759	480	478					
Recurring Other Income	2,739	1,261	1,115	1,325	1,495					
Non-recurring Other Income	145	4,028	617	0	0					
Add: Trf to Revaluation Res	16	15	15	15	15					
Share from Subsidiaries	400	191	191	191	191					
Profit before Tax	7,688	12,861	12,805	17,132	20,029					
Tax	2,361	3,023	3,842	5,140	6,009					
Effective Tax Rate (%)	30.7	23.5	30.0	30.0	30.0					
Reported Profit	5,328	9,838	8,964	11,992	14,020					
Extra-ordinary Adjustments	145	4,028	617	0	0					
Adjusted Profit	5,182	5,811	8,347	11,992	14,020					
Growth (%)	27.9	2.1	43.6	43.7	16.9					
Consolidated Profit	5,912	6,408	9,802	14,455	17,514					
Growth (%)		8.4	53.0	47.5	21.2					

BALANCE SHEET						(Rs Million)				
Y/E MARCH	2004	2005	2006E	2007E	2008E					
Equity Capital	249	260	283	283	283					
Reserves and Surplus	27,502	33,432	44,964	51,845	60,275					
Net Worth	27,750	33,691	45,247	52,129	60,558					
Debt	13,244	18,591	9,647	9,556	9,556					
Deferred Tax Liability	1,134	945	945	945	945					
Capital Employed	42,128	53,227	55,840	62,630	71,060					
Gross Fixed Assets	20,382	21,066	23,474	26,224	29,474					
Less : Depreciation	10,496	10,895	12,003	13,238	14,618					
Add : Capital WIP	262	658	750	1,000	1,250					
Net Fixed Assets	10,164	10,831	12,220	13,986	16,106					
Investments	9,659	9,609	10,570	11,627	12,790					
Inventory	18,123	23,108	26,420	34,216	40,035					
Sundry Debtors	33,146	39,636	46,236	57,026	66,724					
Cash & Bank	3,753	8,280	7,551	6,965	7,068					
Loans & Advances	12,974	17,318	20,696	26,802	31,360					
Other Current Assets	1	40	0	0	0					
Current Assets	67,997	88,382	100,903	125,009	145,187					
Current Liabilities	46,154	55,994	68,253	88,390	103,423					
Net Current Assets	21,843	32,388	32,651	36,618	41,765					
Miscellaneous Expenditure	462	399	399	399	399					
Capital Deployed	42,128	53,227	55,840	62,630	71,060					

E: M0St Estimates

RATIO					
Y/E MARCH	2004	2005	2006E	2007E	2008E
Basic (Rs)					
Adjusted EPS	41.7	44.7	59.0	84.7	99.0
Consolidated EPS	47.5	49.3	69.2	102.1	123.7
Consolidated EPS (Full)	47.5	49.3	69.2	102.1	123.7
Cash Earning per Share	42.7	47.8	66.8	93.4	108.8
Book Value	219.4	256.3	316.8	365.4	424.9
Dividend Per Share	16.0	27.5	25.0	32.0	35.0
Dividend Payout (Incl. Div Tax)	42.2	41.3	44.5	42.6	39.9
Valuation (x)					
P/E (Standalone)		41.8	31.7	22.1	18.9
P/E (Consolidated)		37.9	27.0	18.3	15.1
P/E (Consolidated) (Fully Diluted)		37.9	27.0	18.3	15.1
Price / CEPS		39.1	28.0	20.0	17.2
EV/EBITDA		30.8	20.7	15.3	13.1
EV/ Sales		2.0	1.6	1.3	1.1
Price / Book Value		7.3	5.9	5.1	4.4
Dividend Yield		1.5	1.3	1.7	1.9
Return Ratio (%)					
RoE	16.6	19.2	21.4	24.8	25.1
RoCE	12.7	19.2	23.4	29.4	30.4
Turnover Ratios					
Debtors (Days)	121.9	107.7	105.0	100.0	100.0
Inventory (Days)	66.7	62.8	60.0	60.0	60.0
Asset Turnover (x)	2.4	2.5	2.9	3.3	3.4
Leverage Ratio					
Current Ratio (x)	1.5	1.6	1.5	1.4	1.4
D/E (x)	0.5	0.6	0.2	0.2	0.2

CASHFLOW STATEMENT						(Rs Million)				
Y/E MARCH	2004	2005	2006E	2007E	2008E					
PBT before EO Items	7,688	12,861	12,805	17,132	20,029					
Add : Depreciation	861	957	1,108	1,235	1,379					
Interest	366	536	759	480	478					
Less : Direct Taxes Paid	2,361	3,023	3,842	5,140	6,009					
(Inc)/Dec in WC	1,709	-6,018	-991	-4,554	-5,043					
CF from Operations	8,263	5,313	9,839	9,153	10,834					
(Inc)/Dec in FA	29,537	-1,624	-2,498	-3,000	-3,500					
(Pur)/Sale of Investments	1,945	50	-961	-1,057	-1,163					
CF from Investments	31,482	-1,574	-3,459	-4,057	-4,663					
(Inc)/Dec in Networth	-18,069	38	6,585	0	0					
(Inc)/Dec in Debt	-18,517	5,347	-8,943	-91	0					
Less : Interest Paid	366	536	759	480	478					
Dividend Paid	2,246	4,061	3,993	5,111	5,590					
CF from Fin. Activity	-39,197	788	-7,109	-5,683	-6,068					
Inc/Dec of Cash	547	4,528	-729	-586	103					
Add: Beginning Balance	3,205	3,753	8,280	7,551	6,965					
Closing Balance	3,753	8,280	7,551	6,965	7,068					

N O T E S



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