

## Company Flash

28 January 2008 | 7 pages

# Larsen & Toubro (LART.BO)

## Buy: 3QFY08 - Solid Quarter of 40% PAT Growth

- PAT Up 40% YoY** — L&T had a solid 3QFY08 with PAT at Rs4.8bn up 40% YoY (8% above consensus estimates of Rs4.5bn and 7% below CIR estimates of Rs5.1bn). This was well supported by net sales growth of 55% YoY and a 48bps YoY margin expansion.
- Robust Order Booking** — L&T booked Rs130bn of orders in 3QFY08, up 37% YoY, led by the Rs55bn Mumbai Airport and the Rs13bn Cairn Energy orders. L&T ended 3QFY08 with an order backlog of Rs496bn up 39% YoY. Further the company has already booked Rs65bn of orders in the first month of 4QFY08.
- Shipbuilding Ready to Roll** — With L&T's shipyard at Ennore getting approval from the Tamil Nadu (TN) government, we believe this business is ready to roll. Currently Hazira can build 2 ships annually which will be expanded to 8 ships annually. The new TN shipyard will have capacity to build 5 VLCCs and 20 Panamax vessels per year and repair 60 - 80 ships per year.
- BTG Venture Waiting for Clearance** — The BTG (boiler-turbines-generator) facility is likely to be developed in Hazira and L&T is keen to get the clearance and land from the Gujarat government now that elections are over in the state. The facility will have 3000 - 4000MW per annum capacity and it will take 18 - 20 months to set up the facility post land acquisition.
- Top Indian E&C Pick** — L&T, in our view, is still the safest play on India capex given its diversified skills sets, strong corporate governance and risk management procedures, and one of the best execution capabilities.

<b>Buy/Low Risk</b>	<b>1L</b>
Price (28 Jan 08)	Rs3,740.00
Target price	Rs4,561.00
Expected share price return	22.0%
Expected dividend yield	0.4%
<b>Expected total return</b>	<b>22.4%</b>
Market Cap	Rs1,091,435M US\$27,744M

### Price Performance (RIC: LART.BO, BB: LT IN)



Figure 1. Statistical Abstract

Year to	Net Profit	EPS	EPS Growth	P/E	Adj P/E	P / Book	ROE	ROCE	Div. Yield
31-Mar	(Rsmn)	(Rs)	(%)	(x)	(x)	(x)	(%)	(%)	(%)
2005A	6,305	24.32	13.6%	153.8	121.7	29.2	20.9%	11.4%	0.4%
2006A	8,632	29.50	21.3%	126.8	100.3	22.4	21.8%	13.2%	0.3%
2007A	13,846	47.32	60.4%	79.0	62.5	18.5	26.8%	15.8%	0.3%
2008E	21,502	72.24	52.6%	51.8	41.0	11.5	28.3%	19.6%	0.4%
2009E	30,082	101.06	39.9%	37.0	29.3	9.2	28.1%	20.9%	0.5%
2010E	39,973	134.29	32.9%	27.9	22.0	7.1	29.4%	22.6%	0.5%

Source: Citi Investment Research estimates

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Figure 2. L&T 3QFY08 Results

(Rsmn)	3QFY07	3QFY08	% Chg
Order Inflow	94980	130190	37.1%
Order Backlog	357100	495750	38.8%
<b>Gross Sales</b>	<b>41995</b>	<b>64618</b>	<b>53.9%</b>
Excise	(811)	(791)	
% of sales	1.9%	1.2%	
<b>Net Sales</b>	<b>41184</b>	<b>63827</b>	<b>55.0%</b>
<b>Total Expenditure</b>	<b>(36929)</b>	<b>(56924)</b>	
<b>Core EBITDA</b>	<b>4255</b>	<b>6903</b>	<b>62.2%</b>
<b>Core EBITDA Margin</b>	<b>10.3%</b>	<b>10.8%</b>	<b>48bps</b>
Operational Income	38	22	
<b>EBITDA</b>	<b>4293</b>	<b>6925</b>	<b>61.3%</b>
<b>EBITDA Margin</b>	<b>10.4%</b>	<b>10.8%</b>	
D&A	(357)	(527)	
<b>EBIT</b>	<b>3936</b>	<b>6398</b>	<b>62.5%</b>
<b>EBIT Margin</b>	<b>9.6%</b>	<b>10.0%</b>	
Interest	(12)	(438)	
Other Income	1242	987	
<b>PBT</b>	<b>5166</b>	<b>6946</b>	<b>34.5%</b>
<b>PBT Margin</b>	<b>12.5%</b>	<b>10.9%</b>	
Total Tax	(1727)	(2128)	
Tax Rate	33.4%	30.6%	
<b>Recurring PAT</b>	<b>3439</b>	<b>4818</b>	<b>40.1%</b>

Source: Company Reports and Citi Investment Research

Figure 3. L&T 3QFY08 Segmental Results

(Rsmn)	3QFY07	3QFY08	% Chg
<b>Revenues</b>			
E&C	31595	49625	57.1%
E&E	4825	6157	27.6%
Machinery and Industrial products	4066	5896	45.0%
Others	2677	3815	42.5%
<b>Total</b>	<b>43163</b>	<b>65492</b>	<b>51.7%</b>
<b>PBIT</b>			
E&C	3252	5683	74.8%
E&E	709	954	34.6%
Machinery and Industrial products	554	1163	109.8%
Others	84	179	113.4%
<b>Total PBIT</b>	<b>4599</b>	<b>7978</b>	<b>73.5%</b>
<b>PBIT Margins</b>			
E&C	10.3%	11.5%	116
E&E	14.7%	15.5%	81
Machinery and Industrial products	13.6%	19.7%	609
Others	3.1%	4.7%	156
<b>Total</b>	<b>10.7%</b>	<b>12.2%</b>	<b>153</b>

Source: Company Reports and Citi Investment Research

**Figure 4. L&T Order Inflow Post 2QFY08**

Date	Rsmn Client	Order
10-Jul-07	5,420 Indian Oil Corporation	Motor spirit quality (MSQ) upgradation unit
13-Jul-07	3,660 Abu Dhabi WEA	Two 132/22 kV substations at Saadiyat Island
13-Jul-07	2,000 PGCIL	Turnkey construction of 400/220 kV EHV Substations
13-Jul-07	1,950 Tamil Nadu WSSB	Comprehensive water supply schemes
13-Jul-07	925 Delhi Jal Board (DJB)	22km mild steel raw water transmission main
16-Jul-07	6,233 Tata Steel	Single largest sinter plant to be built in India
16-Jul-07	1,888 Technip	10 pre assembled process modules
16-Jul-07	2,167 ENOC	Naptha hydrotreater and reformer
16-Jul-07	1,529 Qatar Petroleum / Shell	Pearl GTL Project package C5 liquid processing unit (
16-Jul-07	1,882 Oil Tanking Company	
17-Jul-07	9,800 Tata Steel	Supply and installation of blast furnace
16-Jul-07	2,336 Tata Steel	Civil & structural steel works of steel melt shop
13-Aug-07	2,030 DMRC	Underground station and a tunnel
27-Aug-07	2,870 RollDock BV	Two vessels.
4-Sep-07	2,670 IOCL/Liaoning Huajin	Capacity expansion projects
5-Sep-07	7,605 Bhushan Steel	2.5 million TPA blast furnace
14-Sep-07	6,400 SAIL	3.80 mn TPA plant
17-Sep-07	770 RCF Chembur	Methanol reformer package
10-Oct-07	6,930 IOCL	Two trains of 300 tons per day sulphur recovery units
10-Oct-07	2,400 Methanol Chemicals	Setting up high technology methyl Amines plants.
18-Oct-07	4,520 NTPC and Govt. of AP	Coal handling
15-Nov-07	3,550 SAIL-Bokaro Steel Plant	Upgradation of blast furnace at Bokaro.
19-Dec-07	2,870 MMRDA	Elevated access road
26-Dec-07	4,335 Muscat Golf Course	
26-Dec-07	3,152 Oman	2 EPC contracts for electrical substations
In 3QFY08	55,000 MIAL	Mumbai Airport Order
7-Jan-08	13,000 Cairn India	2 contracts for the construction of civil works
10-Jan-08	20,000 ICICI/ CSJ Infrastructure	Construction of official and residential buildings
21-Jan-08	16,950 Kuwait Petroleum	22 hydro-cracker & de-sulphurisation (ARDS) reactors
<b>Total</b>	<b>194,842</b>	

Source: Citi Investment Research

## Larsen & Toubro

### Company description

L&T is a diversified conglomerate with market leadership in the engineering and construction (E&C) and electrical-equipment businesses in India. L&T Information Technology is its 100% subsidiary engaged in software services. L&T demerged its cement business into a separate company, and sold it to Grasim. L&T holds a residual stake of 11.5% in Ultratech Cemco.

### Investment strategy

We rate L&T Buy/Low Risk (1L) with a target of Rs4,561. With earnings CAGR of 40%+ over FY07-FY10E in the core business and the spawning of new businesses like shipbuilding and power equipment which could hit critical mass in the next 3 - 4 years, L&T remains one of the fundamentally best proxies to India's infrastructure build-out. Buoyed by strong infrastructure tailwinds, L&T is in the envious position of picking and choosing orders. L&T's order backlog of Rs440bn plus and forecast stable margins provide good earnings visibility. That most process industries are operating at near peak

capacity utilization, together with the thrust on hydrocarbon and infrastructure spending, should augur well for the order pipeline. We are positive on management's efforts at improving the company's product mix by increasing the share of high-technology products for process industries, defense, nuclear, and aerospace applications; and of engineering and embedded services. These segments have better growth potential and margins than the projects business, in our view.

## Valuation

Using a comps-based P/E of 30x Dec 09E, we get a core business value of Rs3,779 per share for L&T's core business. We also believe that the parent numbers do not capture the value inherent in the subsidiaries of L&T. We use a sum-of-the-parts (SOTP) methodology to value the L&T group, resulting in a target price of Rs4,561. We value L&T's subsidiaries at Rs741 with L&T Infotech at Rs145 (14x FY09E EPS, in-line with second-tier peers); L&T Finance at Rs98 (2.5x FY09E P/BV); L&T IDPL at Rs79 (1.5x private equity valuations); L&T Shipbuilding at Rs122 and L&T MHI at Rs135.

## Risks

We rate L&T Low Risk, as opposed to the High Risk suggested by our quantitative risk-rating system, because L&T's order backlog of c.Rs440bn represents two years' sales and provides earnings visibility. Downside risks to our target price include: 1) Attracting and retaining talent; 2) the E&C and electrical equipment businesses are sensitive to economic variables; 3) Competitive pressures; and 4) L&T needs to keep abreast of technology trends to sustain valuations and earnings.

# Appendix A-1

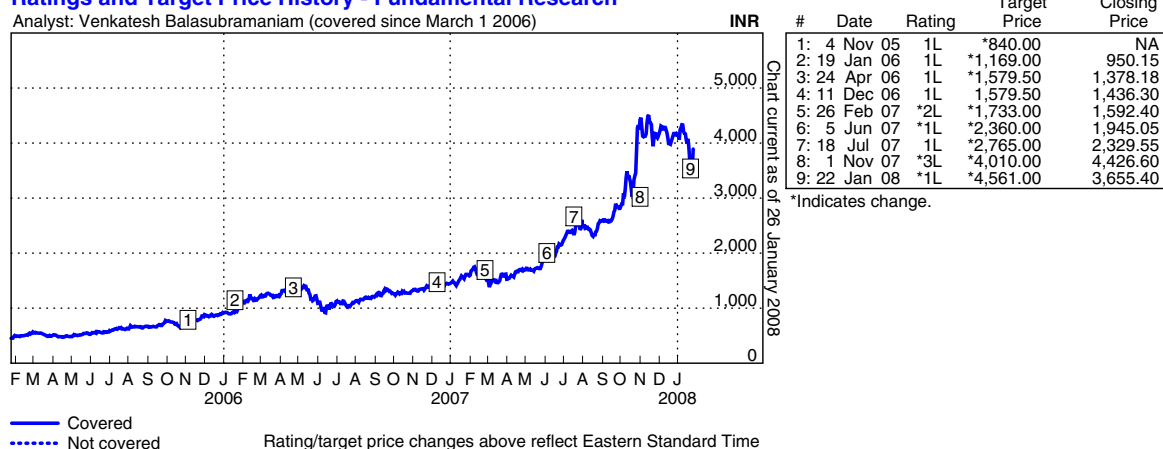
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