

Larsen & Toubro

Key growth drivers in place

L&T Power is likely to see strong growth post FY13, once its equipment manufacturing operations attain scale. Moreover, as the Centre embarks on an aggressive plan to expand domestic capacities for nuclear power, the company, with an untarnished record in this space, stands to gain with potential orders of Rs 50bn-60bn per annum over the long term. At the current market price of Rs 1682 (target Rs 1791), the stock trades at 22x its FY11E consolidated earnings. We maintain our Buy recommendation on L&T.

Equipment manufacturing – revenues to zoom post FY13: L&T Power's equipment manufacturing business, under its joint venture with Mitsubishi Heavy Industries (MHI), has a current order book of 4900MW for turbines and 3300MW for boilers. Despite a robust order book, this business is unlikely to report profits till FY12 since the company follows a policy of recognising profits only once these long-gestation projects attain a 25% threshold level. However, we expect the segment to gain significant traction from FY13 with its revenues doubling to Rs 80bn-100bn in FY15 (from ~Rs 50bn in FY13) as its projects attain scale.

Nuclear power – potential orders of ~Rs 50bn-60bn p.a.: The government of India envisages a five-fold increase in the country's nuclear power capacity – from ~4,000MW currently to 20,000MW by 2020. This translates into orders worth Rs 1000-1200bn over the next 10-11 years. L&T is one of the few Indian construction companies with requisite experience of building plants designed by the Nuclear Power Corporation of India (NPCIL). Order potential for L&T over the long-term could be in the range of ~Rs 50bn-60bn per annum.

IDPL – Diverse portfolio: The L&T-IDPL (Infrastructure Development Projects) combine has exposure to various infrastructure projects like roads, bridges, ports, and airports. At present, the company has a portfolio of 14 roads & bridges project, four port projects, one airport project, and 21 urban infrastructure projects. The total project cost of the portfolio is Rs 288bn, with an equity commitment of Rs 42.5bn. The total invested equity is ~Rs 21.5bn.

Prospects, valuations reinforce a Buy: At the CMP of 1682, the stock trades at 22x its FY11E consolidated earnings. We maintain our Buy recommendation on L&T on account of a) a 25% topline growth in FY11E arising from strong order inflows; we expect the company to end FY10 with order inflows of Rs 650bn b) strong growth beyond FY12E stemming from robust performance of L&T-IDPL and the equipment business. We have a target of Rs 1791 for the stock.

What's New? Target Rating Estimates

CMP	TARGET	RATING	RISK
Rs 1,682	Rs 1,791	BUY	MEDIUM

BSE	NSE	BLOOMBERG
500510	LT	LT IN

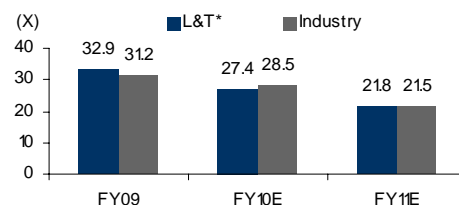
Company data

Market cap (Rs mn / US\$ mn)	1,009,659/21,643
Outstanding equity shares (mn)	600
Free float (%)	86
Dividend yield (%)	0.9
52-week high/low (Rs)	1800/556
2-month average daily volume	1,806,741

Stock performance

Returns (%)	CMP	1-mth	3-mth	6-mth
L&T	1,682	3.0	0.8	11.2
Industry	14,017	4.3	4.0	11.5
Sensex	17,361	1.3	3.5	20.4

P/E comparison



* Consolidated

Valuation matrix

(x)	FY08	FY09	FY10E	FY11E
P/E @ CMP*	45.0	36.3	31.1	25.1
P/E @ Target	47.9	38.6	33.1	26.7
EV/EBITDA @ CMP	35.9	27.7	24.0	18.9

* Standalone

Financial highlights (Standalone)

(Rs mn)	FY08	FY09E	FY10E	FY11E
Revenue	250,094	339,264	390,894	488,119
Growth (%)	42.0	35.7	15.2	24.9
Adj net income	21,713	27,097	31,945	40,259
Growth (%)	54.9	24.8	17.9	27.1
FDEPS (Rs)	37.4	46.4	54.1	67.1
Growth (%)	54.4	24.1	16.6	24.1

Profitability and return ratios

(%)	FY08	FY09E	FY10E	FY11E
EBITDA margin	11.8	11.3	11.3	11.5
EBIT margin	11.0	10.5	10.3	10.6
Adj PAT margin	8.7	8.0	8.2	8.2
ROE	28.3	24.6	21.9	22.1
ROIC	22.9	20.1	15.7	16.5
ROCE	21.5	18.5	16.1	16.4



Other business highlights

Power equipment business – Revenues to gain traction post FY13

- ❖ L&T Power, through its joint venture (JV) with Mitsubishi Heavy Industries (MHI), intends to set up a 4000MW boiler and turbine capacity on a total capex of Rs 16bn – this will be funded through a mix of debt and equity (60:40). The boiler plant is likely to commence operations in December '09 and the turbine plant in H1FY11.
- ❖ The company's current order book stands 4900MW for turbines and 3300MW for boilers. Despite this, the JV is expected to clock lower margins (~8-10%) for its initial few orders due to high level of import contents (~75-80%). However, once the capacity stabilises, margins could stand in the 15-16% range.
- ❖ The company is also looking at indigenising majority of its equipment; doing so would give it a significant edge over its competitors.
- ❖ L&T Power believes that Chinese players are likely to lose market share to their Indian counterparts due to lower energy efficiency of the Chinese and Korean sets and improving supply conditions in India.
- ❖ We expect the company's power equipment business to generate revenues of Rs 50bn-55bn in FY13 with an EBITDA margin of ~10%. However, the JV is likely to post a net loss of ~Rs 1.2bn in FY11 and ~Rs 723mn in FY12 due to its conservative accounting policy – the company records profits only when projects are 25% complete. These projects have an execution cycle of more than two years.
- ❖ The per share value for the power equipment business works out to ~Rs 37 for L&T's 50% stake in the MHI. We have valued the power business at 12x FY11 EV/EBITDA (FY13 EBITDA discounted to FY11).

Current order book stands at 4900MW for turbines and 3300MW for boilers

Nuclear power segment – to emerge as a key beneficiary of proposed expansions

- ❖ The Government of India proposes to increase the country's nuclear power capacity to 20,000MW by 2020, a five-fold increase from the current levels of ~4,000MW. This translates into orders worth Rs 1000bn-1200bn over the next 10-11 years.
- ❖ The government has identified five sites to set up light water reactors: Jaitapur in Maharashtra, Kudankulam in Tamil Nadu, Haripur in West Bengal, Chhayamithi Virdi in Gujarat, and Kovvada in Andhra Pradesh. The orders for these plants are expected to be placed in the next 4-5 years.
- ❖ L&T is one of the few Indian construction companies with requisite experience of building plants designed by the Nuclear Power Corporation of India (NPCIL). Therefore, the order potential for L&T could be ~Rs 50-60 per annum over the long-term.
- ❖ The company has also signed MoUs with most leading nuclear technology companies to be qualified for building plants as per new designs.

Among few Indian construction companies to meet NPCIL norms

Fig 1 - SOTP Valuation

	Basis	Per Share Value
L&T Standalone	23x FY11	1544.0
L&T Infotech	12x FY11	65.0
L&T IDPL	Based on 1.75x P/E deal	59.9
L&T Finance	1.1x FY11 Book Value	14.5
L&TIFC	1.1x FY11 Book Value	21.2
MHI JV	12x EV/ EBITDA FY13(discounted to FY11)	37.3
Manufacturing JV's	12x FY11	19.4
International Subsidiaries	12x FY11	30.0
Total		1791

Source: RHH



Standalone financials

Profit and Loss statement

Y/E March (Rs mn)	FY08	FY09E	FY10E	FY11E
Revenues	250,094	339,264	390,894	488,119
Growth (%)	42.0	35.7	15.2	24.9
EBITDA	29,579	38,342	44,268	56,251
Growth (%)	66.3	29.6	15.5	27.1
Depreciation & amortisation	2,022	2,828	3,900	4,450
EBIT	27,556	35,513	40,368	51,801
Growth (%)	71.1	28.9	13.7	28.3
Interest	1,227	3,502	5,076	5,349
Other income	5,203	15,122	10,344	11,061
EBT	31,533	47,134	45,636	57,513
Income taxes	9,821	12,312	13,691	17,254
Effective tax rate (%)	31.1	26.1	30.0	30.0
Extraordinary items	-	-	-	-
Min into / inc from associates	-	-	-	-
Reported net income	21,713	34,822	31,945	40,259
Adjustments	-	(7,725)	-	-
Adjusted net income	21,713	27,097	31,945	40,259
Growth (%)	54.9	24.8	17.9	27.0
Shares outstanding (mn)	583.6	584.0	594.9	594.9
FDEPS (Rs) (adj)	37.4	46.4	54.1	67.1
Growth (%)	54.4	24.1	16.6	24.1
DPS (Rs)	9.8	15.5	14.0	17.6

Cash flow statement

Y/E March (Rs mn)	FY08	FY09E	FY10E	FY11E
Net income + Depreciation	25,212	40,263	35,845	44,709
Non-cash adjustments	(389)	(22,314)	-	-
Changes in working capital	(3,767)	(20,515)	(8,406)	(18,798)
Cash flow from operations	21,056	(2,565)	27,439	25,911
Capital expenditure	(16,221)	(19,798)	(16,197)	(9,000)
Change in investments	(37,886)	5,930	(15,200)	(15,000)
Other investing cash flow	(664)	(6,236)	-	-
Cash flow from investing	(54,770)	(20,105)	(31,397)	(24,000)
Issue of equity	17,016	230	18,581	-
Issue/repay debt	16,740	25,576	18,704	3,889
Dividends paid	(1,335)	(4,388)	(9,054)	(8,306)
Other financing cash flow	(5)	(667)	-	-
Change in cash & cash eq	(1,300)	(1,917)	24,274	(2,506)
Closing cash & cash eq	9,644	7,727	32,001	29,495

Economic Value Added (EVA) analysis

Y/E March	FY08	FY09E	FY10E	FY11E
WACC (%)	14.3	14.2	14.2	13.8
ROIC (%)	22.9	20.1	15.7	16.5
Invested capital (Rs mn)	98,515	162,967	197,845	241,347
EVA (Rs mn)	8,485	9,606	2,948	6,450
EVA spread (%)	8.6	5.9	1.5	2.7

Balance sheet

Y/E March (Rs mn)	FY08	FY09E	FY10E	FY11E
Cash and cash eq	9,645	7,753	32,001	29,495
Accounts receivable	73,650	100,555	112,449	140,418
Inventories	43,059	58,051	65,113	81,309
Other current assets	37,714	68,122	64,472	80,454
Investments	69,223	82,637	97,837	112,837
Gross fixed assets	42,058	55,905	70,905	80,905
Net fixed assets	29,192	41,174	52,274	57,824
CWIP	7,293	10,803	12,000	11,000
Intangible assets	-	-	-	-
Deferred tax assets, net	(614)	(485)	(485)	(485)
Other assets	-	(28)	923	3,645
Total assets	269,162	368,581	436,585	516,497
Accounts payable	54,922	68,136	69,183	86,390
Other current liabilities	62,495	79,623	87,282	108,991
Provisions	20,354	30,665	28,300	35,808
Debt funds	35,840	65,560	84,265	88,154
Other liabilities	-	-	-	-
Equity capital	585	1,171	1,194	1,194
Reserves & surplus	94,966	123,426	166,129	195,921
Shareholder's funds	95,551	124,597	167,323	197,115
Total liabilities	269,162	368,581	436,585	516,497
BVPS (Rs)	163.7	213.4	281.3	331.3

Financial ratios

Y/E March	FY08	FY09E	FY10E	FY11E
Profitability & Return ratios (%)				
EBITDA margin	11.8	11.3	11.3	11.5
EBIT margin	11.0	10.5	10.3	10.6
Net profit margin	8.7	8.0	8.2	8.2
ROE	28.3	24.6	21.9	22.1
ROCE	21.5	18.5	16.1	16.4
Working Capital & Liquidity ratios				
Receivables (days)	94	94	99	95
Inventory (days)	70	70	76	72
Payables (days)	90	86	84	77
Current ratio (x)	1.4	1.6	1.8	1.7
Quick ratio (x)	0.7	0.7	0.9	0.9
Turnover & Leverage ratios (x)				
Gross asset turnover	7.1	6.9	6.2	6.4
Total asset turnover	1.1	1.1	1.0	1.0
Interest coverage ratio	22.5	10.1	8.0	9.7
Adjusted debt/equity	0.4	0.5	0.4	0.4
Valuation ratios (x)				
EV/Sales	4.2	3.1	2.7	2.2
EV/EBITDA	35.9	27.7	24.0	18.9
P/E	45.0	36.3	31.1	25.1
P/BV	10.3	7.9	6.0	5.1



Quarterly trend

Particulars	Q2FY09	Q3FY09	Q4FY09	Q1FY10	Q2FY10
Revenue (Rs mn)	76,822	86,156	104,690	73,627	78,662
YoY growth (%)	39.7	34.9	23.6	6.7	2.4
QoQ growth (%)	11.3	12.1	21.5	(29.7)	6.8
EBITDA (Rs mn)	7,317	7,799	14,509	7,863	7,846
EBITDA margin (%)	9.5	9.1	13.9	10.7	10.0
Adj net income (Rs mn)	4,603	6,041	11,424	5,783	5,530
YoY growth (%)	32	25.4	17.6	15.1	20.1
QoQ growth (%)	(8)	31.2	89.1	(49.4)	(4.4)

DuPont analysis

(%)	FY07	FY08	FY09E	FY10E	FY11E
Tax burden (Net income/PBT)	70.0	68.9	57.5	70.0	70.0
Interest burden (PBT/EBIT)	124.4	114.4	132.7	113.0	111.0
EBIT margin (EBIT/Revenues)	9.1	11.0	10.5	10.3	10.6
Asset turnover (Revenues/Avg TA)	116.7	113.4	106.4	97.1	102.4
Leverage (Avg TA/Avg equity)	290.0	287.8	289.7	275.8	261.5
Return on equity	26.9	28.3	24.6	21.9	22.1

Company profile

Larsen & Toubro (L&T) is one of the largest technology, engineering, construction and manufacturing companies in India. Seven decades of a strong, customer-focused approach and the continuous quest for world-class quality have enabled it to attain and sustain leadership in all its major lines of business.

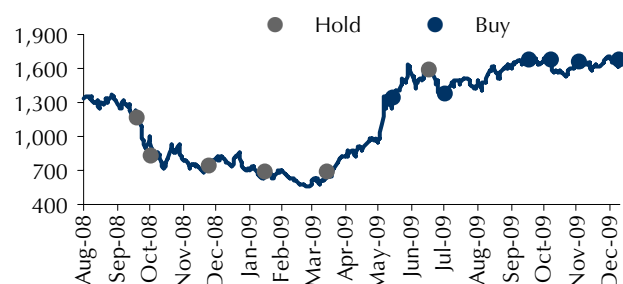
Shareholding pattern

(%)	Mar-09	Jun-09	Sep-09
Promoters	-	-	-
FII's	15.8	19.7	19.7
Banks & FI's	38.4	36.6	36.6
Public	45.8	43.7	43.7

Recommendation history

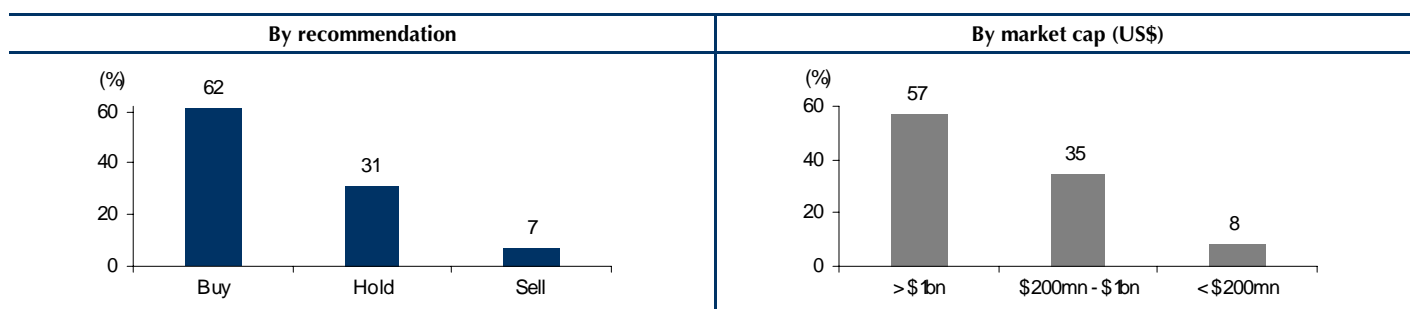
Date	Event	Reco price	Tgt price	Reco
6-Oct-08	Quarterly Preview	1,158	1,398	Hold
17-Oct-08	Results Review	823	977	Hold
10-Dec-08	Company Update	730	790	Hold
31-Jan-09	Results Review	690	770	Hold
30-Mar-09	Company Update	680	770	Hold
29-May-09	Results Review	1,341	1,498	Buy
2-Jul-09	Quarterly Preview	1,591	1,498	Hold
16-Jul-09	Results Review	1,378	1,527	Buy
5-Oct-09	Sector Report	1,665	1,781	Buy
22-Oct-09	Results Review	1,608	1,756	Buy
17-Nov-09	Flash Note	1,650	1,756	Buy
24-Dec-09	Company Update	1,682	1,792	Buy

Stock performance





Coverage Profile



Recommendation interpretation

Recommendation	Expected absolute returns (%) over 12 months
Buy	More than 15%
Hold	Between 15% and -5%
Sell	Less than -5%

Recommendation structure changed with effect from March 1, 2009

Expected absolute returns are based on share price at market close unless otherwise stated. Stock recommendations are based on absolute upside (downside) and have a 12-month horizon. Our target price represents the fair value of the stock based upon the analyst's discretion. We note that future price fluctuations could lead to a temporary mismatch between upside/downside for a stock and our recommendation.

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