



Larsen & Toubro

STOCK INFO.	BLOOMBERG
BSE Sensex: 12,724	LT IN
	REUTERS CODE
S&P CNX: 3,678	LART.BO

19 October 2006

Neutral

Previous Recommendation: Neutral

Rs1,276

Equity Shares (m)	286.8
52-Week Range	1,458/643
1,6,12 Rel. Perf. (%)	-10/-10/25
M.Cap. (Rs b)	366.0
M.Cap. (US\$ b)	8.1

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
3/06A	148,239	10,302	36.4	47.5	35.1	3.8	19.6	21.2	2.4	32.6
3/07E	178,884	16,559	57.7	58.7	22.1	6.3	23.2	27.0	2.0	21.1
3/08E	220,166	20,617	71.9	24.5	17.8	5.5	23.0	28.0	1.7	16.9

* Consolidated; EPS is fully diluted

Robust financial performance, adjusted net profit up 53% YoY: For 2QFY07, L&T has reported revenues of Rs37.4b (up 11.7% YoY), EBITDA of Rs3.1b (up 117.6% YoY) and net profit of Rs1.8b (up 53% YoY). While reported revenues are lower than our estimate of Rs40.1b, EBITDA margins at 8.9% have been higher than our estimate of 7.2%. Net profit of Rs1.8b is in line with our estimate.

Revision in management guidance for FY07: The management has now guided for order intake growth of 30% YoY (maintained), revenue growth of 20% YoY (v/s 20-25% earlier) and 50bp improvement in E&C EBITDA margins (v/s stagnant to marginal improvement guidance earlier). For EBG and MIP businesses, the management has guided for EBITDA margins of 17% and 15-16%, respectively.

Consolidated profits – positive surprise: During 1HFY07, L&T's consolidated profits stood at Rs9.3b, v/s Rs5.1b during 1HFY06 (up 83% YoY). Adjusted for exceptional items, profit for 1HFY07 is Rs6b, up 89% YoY. Contribution of subsidiaries to adjusted profit was Rs2.6b in 1HFY07, up from Rs1b during 1HFY06.

Upgrade in earnings estimates, price target: We revise our earnings estimates to factor in slower than expected revenue growth, margin improvement and improved performance of subsidiary companies. We now estimate consolidated profits at Rs16.6b (up 59% YoY, upgrade of 8.2%) for FY07 and at Rs20.6b (up 25% YoY, upgrade of 6.2%) for FY08. We expect L&T to report consolidated profit of Rs25.2b in FY09 (up 22% YoY). We arrive at a price target of Rs1,401 based on SOTP valuation. At the CMP of Rs1,276, L&T trades at a PER of 22.1x FY07, 17.8x FY08 and 14.5x FY09.

Y/E MARCH	QUARTERLY PERFORMANCE										(RS MILLION)	
	FY06				FY07				FY06	FY07E		
	1Q	2Q	3Q	4Q	1Q	2Q	3QE	4QE				
Net Sales	31,111	33,457	36,664	45,943	34,689	37,361	47,095	57,834	146,529	176,979		
Change (%)	15.9	12.0	12.2	7.1	11.5	11.7	28.5	25.9	12.5	20.8		
EBITDA	1,758	1,407	3,182	6,304	2,698	3,062	4,077	7,466	12,653	17,304		
Change (%)	38.9	15.5	81.4	45.5	53.5	117.6	28.1	18.4	46.4	60.8		
As of % Sales	5.5	7.9	8.3	13.2	9.2	8.9	8.4	12.6	8.3	9.5		
Depreciation	294	260	266	324	309	336	340	381	1,145	1,367		
Interest	98	147	225	281	158	106	170	313	751	747		
Other Income	227	1,309	206	638	216	437	535	910	2,379	2,098		
Extraordinary Income	382	0	235	81	0	0	0	0	698	0		
Reported PBT	1,975	2,308	3,131	6,418	2,448	3,057	4,102	7,682	13,834	17,289		
Tax	545	878	557	1,752	877	1,046	1,395	1,866	3,713	5,191		
Effective Tax Rate (%)	27.6	38.0	17.8	27.3	35.8	34.2	34.0	24.3	26.8	30.0		
Reported Profit	1,430	1,431	2,593	4,666	1,571	2,011	2,707	5,816	10,121	12,098		
Adjusted PAT	971	1,197	1,878	4,585	1,571	1,831	2,707	5,816	8,702	12,098		
Change (%)	21.1	58.0	41.9	37.4	61.9	53.0	44.2	26.8	39.9	39.0		

E: MOST; All quarterly numbers are for standalone entity

Robust financial performance, adjusted net profit up 53% YoY

For 2QFY07, L&T has reported revenues of Rs37.4b (up 11.7% YoY), EBITDA of Rs3.1b (up 117.6% YoY) and net profit of Rs1.8b (up 53% YoY). While reported revenues are lower than our estimate of Rs40.1b, EBITDA margins at 8.9% have been higher than our estimate of 7.2%. Net profit of Rs1.8b is in line with our estimate.

Adjusted for forex loss, 2QFY07 EBITDA margins stand at 8.9%

During 2QFY07, L&T provided for Rs380m towards actuarial valuation under Accounting Standard 15 (mandatory from FY07). Adjusted for this, EBITDA margins for the quarter stand at 8.9%, v/s the reported 7.9%.

Order intake momentum maintained

Order backlog at the end of 2QFY07 stood at Rs307b (equivalent to 2.1x FY06 revenues), up from Rs235b in 2QFY06 and Rs283b in 1QFY07. Order booking was Rs61.4b in 2QFY07, up 24% YoY. During FY06, order intake stood at Rs223b, and we expect order intake of Rs296b in FY07 (1HFY07 Rs135b).

E&C business: strong margin improvement

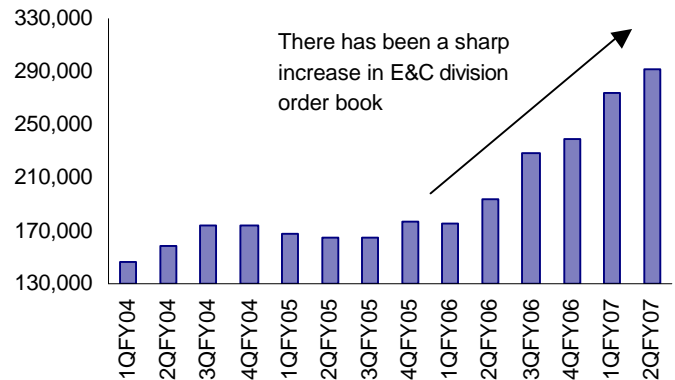
During 2QFY07, L&T's E&C business reported revenues of Rs27b, up 7.4% YoY. EBITDA margins improved to 8.6% from 7% in 2QFY06. During 2QFY07, order intake was Rs46b, up 8% YoY; and order backlog increased to Rs293b from Rs239b in 4QFY06 and Rs275b in 1QFY07.

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

	2QFY07	2QFY06	% YOY	1QFY07	% QOQ
Order Intake	46,310	42,890	8.0	63,260	-26.8
Domestic	37,860	34,740	9.0	53,020	-28.6
Export	8,450	8,150	3.7	10,240	-17.5
Order Backlog	292,700	193,010	51.7	274,630	6.6
Gross Sales (excl. Cement)	26,970	25,110	7.4	25,810	4.5
EBITDA	2,320	1,770	31.1	2,170	6.9
EBITDA Margins of E&C	8.6	7.0		8.4	

Source: Company

E&C DIVISION ORDER BACKLOG (RS M)



Source: Company/ Motilal Oswal Securities

ORDER BOOK COMPOSITION (%)

	FY03	FY04	FY05	FY06	1HFY07
Process Industries	17	16	14	11	12
Oil & Gas	21	23	20	25	24
Power	10	10	8	5	9
Infrastructure	35	33	35	36	37
Others	17	18	23	24	18
Total	100	100	100	100	100

Source: Company

EBG business: strong revenue growth

The Electricals Business Group (EBG) registered 28.3% YoY growth in revenues, driven by switchgears. EBITDA margins expanded 36bp to 17.5%, driven by higher volume growth coupled with cost optimization initiatives.

L&T - EBG DIVISION PERFORMANCE (RS M)

	2QFY07	2QFY06	% YOY	1QFY07	% QOQ
Sales	4,350	3,390	28.3	3,820	13.9
EBITDA	760	580	31.0	690	10.1
EBITDA Margins (%)	17.5	17.1		18.1	

Source: Company/ Motilal Oswal Securities

MIP business: strong growth and improving margins

The Machinery and Industrial Parts (MIP) Business Group registered 25.9% YoY growth in revenues, and 210bp improvement in EBITDA margins to 15.2%. Marketing income of valves, rubber processing, machinery, welding, paper machinery, construction equipments, etc, are included under this business and we expect the growth momentum to sustain.

L&T – MIP DIVISION PERFORMANCE (RS M)

	2QFY07	2QFY06	% YOY	1QFY07	% QOQ
Sales	4,355	3,460	25.9	3,290	32.4
EBITDA	660	450	46.7	600	10.0
EBITDA Margins (%)	15.2	13.0		18.2	

Source: Company/ Motilal Oswal Securities

Revision in management guidance for FY07

The management has now guided for order intake growth of 30% YoY (maintained), revenue growth of 20% YoY (v/s 20-25% earlier) and 50bp improvement in E&C EBITDA margins (v/s stagnant to marginal improvement guidance earlier). For EBG and MIP businesses, the management has guided for EBITDA margins of 17% and 15-16%, respectively. We believe that while revenue growth could be restricted due to execution constraints, there exists possibility for further margin expansion.

Increased capex

During FY07, the management has indicated a capex plan of Rs10-12b, higher than our expectation of Rs9-10b. Also, for FY08, we expect the company to incur capex of Rs8-9b, largely towards addition to manufacturing capacities (excluding capex towards ship building and power equipment). The current utilization rates stand at ~90-92%. Existing manufacturing facilities for L&T are: Powai in Maharashtra, Chennai in Tamil Nadu, Hazira and Ranoli in Gujarat. In May 2005, Coimbatore was identified as the fifth growth centre and a 10-year growth plan (till 2015) was chalked out, where facilities for manufacture of precision tools, valves unit, components units 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.

L&T Infotech – strong performance

L&T Infotech reported strong financial performance during 2QFY07, with revenues of Rs3.3b (up 74% YoY) and net profit of Rs410m (up 273% YoY). USA accounted for 74% of the company's revenues during 2QFY07, and employees stood at 6,777, v/s 4,878 as at end-2QFY06.

L&T INFOTECH PERFORMANCE (RS M)

	2QFY07	2QFY06	% YOY	1QFY07	% QOQ
Revenues	3,280	1,890	74.0	2,960	10.8
PAT	410	110	273.0	370	10.8
PAT (%)	12.5	5.8		12.5	

Source: Company/ Motilal Oswal Securities

Consolidated profits – positive surprise

During 1HFY07, L&T's consolidated profits stood at Rs9.3b, v/s Rs5.1b during 2HFY06 (up 83% YoY). Adjusted for exceptional items, profit for 1HFY07 is Rs6b, up from Rs3.2b during 1HFY06 (up 89% YoY). Contribution of subsidiaries to adjusted profit was Rs2.6b in 1HFY07, up from Rs1b during 1HFY06, largely driven by improved performance of L&T Infotech, L&T Finance and L&T Infrastructure Development Projects (where some SPVs have started making profits).

CONSOLIDATED PERFORMANCE (RS M)

	1HFY07	1HFY06	% YOY
Consolidated Profits (Reported)	9,250	5,050	83.2
Consolidated Profits (Adjusted)	5,990	3,170	89.1
Standalone Profits (Adjusted)	3,402	2,167	57.0
Addition to Standalone Profits	2,588	1,003	155.0

Source: Company/ Motilal Oswal Securities

Upgrading earnings estimates, price target

We revise our earnings estimates to factor in slower than expected revenue growth, margin improvement and improved performance of subsidiary companies. We now estimate consolidated profits at Rs16.6b (up 59% YoY, upgrade of 8.2%) for FY07 and at Rs20.6b (up 25% YoY, upgrade of 6.2%) for FY08. We expect L&T to report consolidated profit of Rs25.2b in FY09 (up 22% YoY).

We value L&T based on sum of the parts (SOTP) methodology. We arrive at a price target of Rs1,401 based on: core business Rs1,055/share (20x FY08 PER), L&T Infotech at Rs118/share (12x FY08 PER), L&T Infrastructure Development Projects at Rs74/share, Ultratech Cemco stake at Rs37/share (20% discount to CMP), L&T Finance at Rs32/share (10x FY08 PER), International Ventures at Rs32/share and Manufacturing Ventures at Rs31/share. At the CMP of Rs1,276, L&T trades at a PER of 22.1x FY07, 17.8x FY08 and 14.5x FY09. We maintain **Neutral**.

L&T: SUM OF PARTS VALUE

	BUSINESS SEGMENT	METHOD	VALUATION (X)	VALUE (RS M)	VALUE (RS/SH)	RATIONALE
L&T Standalone	Engineering, Construction, & Electricals	FY08E PER (x)	20	286,596	1,055	Premium to industry average
Ultratech Cemco (11.5% Stake)	Cement	Discount to Current Price	708	10,124	37	20% discount to current price
L&T Infotech (100% Stake)	Infotech	FY08E PER (x)	12	32,141	118	Discount to niche second tier IT companies
L&T Infrastructure Development Projects Limited						
L&T Infrastructure Development Projects				19,976	74	Based on benchmark price (recent stake sale to strategic investors)
L&T Power Investments Pvt Ltd						
HPL Co Generation	Captive Power Projects	FY08E PER (x)	10	6,105	22	Discount to sector average PER
India Infrastructure Developers	Captive Power Projects	FY08E PER (x)	10	608	2	Discount to sector average PER
L&T Finance (100% stake)	Hire Purchase, Leasing, Bill Discounting	FY08E PER (x)	10	8,645	32	In line with SREI Finance L&T has advantage of catering to in house requirement of L&T's dealers / vendors / customers, etc
International Ventures						
L&T (Oman) Llc	EPC Projects in Oman	FY08E PER (x)	10	2,324	9	Discount to L&T's valuations
L&T Saudi Arabia Llc	EPC Projects in Saudi Arabia	FY08E PER (x)	10	1,225	5	Discount to L&T's valuations
Zubair Kilpatrick Llc	Electrical and Instrumentation for Oil / Gas	FY08E PER (x)	10	529	2	Discount to L&T's valuations
L&T International FZE	Commodity Hedging	FY08E PER (x)	8	4,274	16	Lower PER, given risks in commodity hedging
Manufacturing Ventures						
L&T Komatsu	Excavators and Hydraulic System	FY08E PER (x)	10	3,550	13	In line with industry average
Audco India	Industrial Valves	FY08E PER (x)	10	3,738	14	Revenue growth and margins have shown strong consistency
EWAC Alloys	Welding	FY08E PER (x)	10	1,032	4	In line with industry average
Total					1,401	

Larsen & Toubro: an investment profile

Company description

L&T is India's largest engineering and construction company. It undertakes projects on engineering, procurement and commissioning basis. 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 a comprehensive exposure to Indian industry and infrastructure. It has many subsidiaries and associate companies, which will gradually start adding robustly to its bottom-line.

Key investment arguments

- ✍ L&T is witnessing increased traction in order inflows. Management has guided for 30% growth in order intake for FY07.
- ✍ 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 FY06-09, we expect L&T to report 34.6% consolidated earnings CAGR.

COMPARATIVE VALUATIONS

		L&T	SIEMENS**	ABB*
P/E (x)	FY07E	22.1	37.5	41.7
	FY08E	17.8	26.4	30.0
P/BV (x)	FY07E	6.3	16.2	11.4
	FY08E	5.5	12.0	8.6
EV/Sales	FY07E	2.0	3.0	3.2
	FY08E	1.7	2.2	2.3
EV/EBIDTA	FY07E	21.1	22.9	26.3
	FY08E	16.9	17.2	18.2

* December Ending ; ** September Ending

SHARE-HOLDING PATTERN (%)

	SEP06	JUN.06	SEP05
Promoters	0.0	0.0	0.0
Domestic Institutions	36.5	37.2	36.6
FII's/FDIs	25.1	21.7	23.9
Others	38.4	41.1	39.5

Key investment concerns

- ✍ Higher borrowings warranted for investments in SPVs
- ✍ Liabilities in terms of cost overruns and other failures may arise on the 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
- ✍ HDFC and HDFC India Real Estate Fund invested Rs950m (25% stake) in equity and quasi equity of L&T Urban Infrastructure Limited

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.

Sector view

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

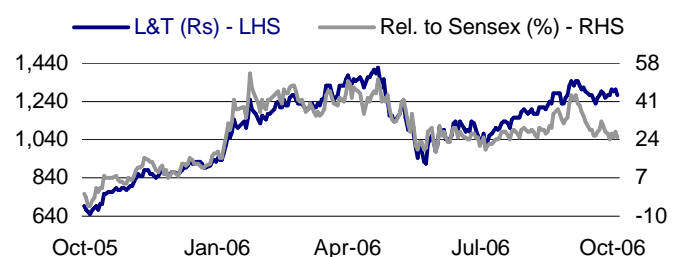
EPS: MOST FORECAST VS CONSENSUS (RS)

	MOST FORECAST	CONSENSUS FORECAST	VARIATION (%)
FY07	57.7	48.7	18.4
FY08	71.9	61.3	17.2

TARGET PRICE AND RECOMMENDATION

CURRENT PRICE (RS)	TARGET PRICE (RS)	UPSIDE (%)	RECO.
1,276	1,401	9.8	Neutral

STOCK PERFORMANCE (1 YEAR)



INCOME STATEMENT					
(Rs Million)					
Y/E MARCH	2005	2006	2007E	2008E	2009E
Total Revenues	134,363	150,546	181,669	223,593	270,029
Growth Rate (%)	35.4	12.0	20.7	23.1	20.8
Excise Duty	1,768	2,308	2,785	3,427	4,139
Net Revenues	132,595	148,239	178,884	220,166	265,890
Growth Rate (%)	37.0	11.8	20.7	23.1	20.8
Manufacturing Expenses	105,161	115,903	135,558	166,079	199,710
Staff Cost	7,645	8,900	11,125	13,907	17,383
S G & A Expenses	10,961	12,170	14,897	18,335	22,142
EBITDA	8,828	11,266	17,304	21,846	26,654
Change (%)	57.4	27.6	53.6	26.3	22.0
EBITDA Margin (%)	7.5	9.6	10.8	10.9	10.9
Depreciation	926	1,141	1,367	1,749	2,154
EBIT	7,902	10,125	15,937	20,097	24,500
Net Interest	536	751	747	1,193	1,812
Recurring Other Income	1,261	2,061	2,033	2,089	2,227
Non-recurring Other Income	4,028	1,622	0	0	0
Add: Trf to Revaluation Res	15	15	15	15	15
Share from Subsidiaries	191	64	65	65	65
Profit before Tax	12,861	13,137	17,304	21,073	24,995
Tax	3,023	3,713	5,191	6,743	8,248
Effective Tax Rate (%)	23.5	28.3	30.0	32.0	33.0
Reported Profit	9,838	9,424	12,113	14,330	16,747
Extra-ordinary Adjustments	4,028	1,622	0	0	0
Adjusted Profit	5,811	7,802	12,113	14,330	16,747
Growth (%)	12.1	34.3	55.2	18.3	16.9
Consolidated Profit	6,408	10,302	16,559	20,617	25,170
Growth (%)	8.4	60.8	60.7	24.5	22.1

BALANCE SHEET					
(Rs Million)					
Y/E MARCH	2005	2006	2007E	2008E	2009E
Equity Capital	260	275	574	574	574
Reserves and Surplus	33,432	46,127	57,867	66,051	75,034
Net Worth	33,691	46,402	58,441	66,624	75,607
Debt	18,591	14,536	12,158	19,658	28,658
Deferred Tax Liability	945	773	773	773	773
Capital Employed	53,227	61,710	71,371	87,055	105,038
Gross Fixed Assets	21,066	23,007	30,367	38,867	47,867
Less : Depreciation	10,895	9,822	11,189	12,938	15,092
Add : Capital WIP	658	2,861	3,000	3,000	3,000
Net Fixed Assets	10,831	16,046	22,179	28,930	35,776
Investments	9,609	19,195	21,115	23,226	25,549
Inventory	23,108	22,103	28,370	34,917	42,169
Sundry Debtors	39,636	48,142	47,284	58,196	70,282
Cash & Bank	8,280	5,832	5,958	7,726	10,942
Loans & Advances	17,318	19,116	23,393	28,791	34,771
Other Current Assets	40	173	0	0	0
Current Assets	88,382	95,365	105,005	129,630	158,164
Current Liabilities	55,994	69,116	77,147	94,951	114,670
Net Current Assets	32,388	26,249	27,858	34,679	43,494
Miscellaneous Expenditure	399	220	220	220	220
Capital Deployed	53,227	61,710	71,371	87,055	105,038

E: MOST Estimates

RATIO					
Y/E MARCH	2005	2006	2007E	2008E	2009E
Basic (Rs)					
Adjusted EPS	22.4	56.8	42.2	50.0	58.4
Consolidated EPS	24.7	75.0	57.7	71.9	87.8
Con. EPS (Fully Diluted)	24.7	36.4	57.7	71.9	87.8
Growth (%)	3.8	47.5	58.7	24.5	22.1
Cash Earning per Share	23.6	31.3	47.0	56.1	65.9
Book Value	256.3	336.1	203.0	231.6	262.9
Dividend Per Share	27.5	22.0	15.0	19.0	24.0
Div. Payout (Incl. Div Tax) %	41.3	36.6	40.1	42.9	46.4
Valuation (x)					
P/E (Standalone)		22.5	30.2	25.5	21.9
P/E (Consolidated)		17.0	22.1	17.8	14.5
P/E (Consolidated) (Fully Diluted)		35.1	22.1	17.8	14.5
Price / CEPS		40.8	27.2	22.8	19.4
EV/EBITDA		32.6	21.1	16.9	14.1
EV/ Sales		2.4	2.0	1.7	1.4
Price / Book Value		3.8	6.3	5.5	4.9
Dividend Yield		1.7	1.2	1.5	1.9
Return Ratio (%)					
RoE	19.2	19.6	23.2	23.0	23.6
RoCE	19.2	21.2	27.0	28.0	27.8
Turnover Ratios					
Debtors (Days)	107.7	116.7	100.0	100.0	100.0
Inventory (Days)	62.8	53.6	60.0	60.0	60.0
Asset Turnover (x)	2.5	2.4	2.5	2.6	2.6
Leverage Ratio					
Current Ratio (x)	16	14	14	14	14
D/E (x)	0.6	0.3	0.2	0.3	0.4

CASHFLOW STATEMENT					
(Rs Million)					
Y/E MARCH	2005	2006	2007E	2008E	2009E
PBT before EO Items	12,861	13,137	17,304	21,073	24,995
Add : Depreciation	957	1,160	1,367	1,749	2,154
Interest	536	751	747	1,193	1,812
Less : Direct Taxes Paid	3,023	3,713	5,191	6,743	8,248
(Inc)/Dec in WC	-6,018	3,691	-1,483	-5,054	-5,598
CF from Operations	5,313	15,026	12,743	12,218	15,115
(Inc)/Dec in FA	-1,624	-6,375	-7,499	-8,500	-9,000
(Pur)/Sale of Investments	50	-9,586	-1,920	-2,111	-2,323
CF from Investments	-1,574	-15,961	-9,419	-10,611	-11,323
(Inc)/Dec in Network	38	6,740	4,779	0	0
(Inc)/Dec in Debt	5,347	-4,055	-2,378	7,500	9,000
Less : Interest Paid	536	751	747	1,193	1,812
Dividend Paid	4,061	3,446	4,852	6,146	7,764
CF from Fin. Activity	788	-1,512	-3,198	161	-575
Inc/Dec of Cash	4,528	-2,448	126	1,767	3,217
Add: Beginning Balance	3,753	8,280	5,832	5,958	7,726
Closing Balance	8,280	5,832	5,958	7,726	10,942

E: MOST Estimates

N O T E S

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