

May 25, 2006

Stock Rating
Equal-weight

Industry View
In-Line

Larsen & Toubro

Spirited Performance in F06

Quick Comment: During F4Q06, the order book grew marginally by 2.7% to Rs 61 Bn. This lackluster growth was due to the bunching up of orders in F4Q05. L&T posted 8%, 31% and 38% YoY growth in operating revenues, EBITDA and core net earnings respectively in F4Q06. EBITDA margins grew by nearly 210 bps to 12.4% for the quarter due to lower raw material expenses. Other income and depreciation expense grew by 36% and 9% YoY to Rs 1.1 Bn and Rs 324 Mn respectively. The tax rate for the quarter was 27.6%, a YoY decrease of 350 bps.

F2006 ends on a winsome note: L&T ended F2006 with an order book growth of 49% to Rs 223 Bn and order backlog growth of 38% YoY to Rs 247 Bn. The company posted a 12%, 36% and 36% growth in revenues, EBITDA and core earnings respectively. EBITDA margins grew by nearly 130 bps to 7.4% for F2006. Margins have improved on account of global sourcing of materials, hedging of commodities and experience gained in export orders, which enabled L&T to win new export orders with improved margins. Meanwhile, net interest and depreciation expenses rose 38% and 22% respectively.

E&C division order backlog impressive: The Engineering & Construction (E&C) business secured record orders worth Rs 54 Bn in F4Q06. The growth rate was a modest 1.7% YoY as there was bunching of orders in F4Q05. The division ended F2006 with order bookings growing nearly 50% YoY. For the year, order backlog too posted strong YoY growth of 37% to Rs 242 Bn. Export orders booked during F4Q06 almost doubled to Rs 8 Bn due to increase in infrastructure spending in Middle East driven by high oil prices. Key domestic E&C orders include critical booster and high pressure compression module for ONGC in consortium with Samsung (Rs 7.76 Bn), executing Parbati hydro electric project (Rs 4.28 Bn) and fuel depot project at Kuwait international airport (Rs 5.8 Bn)

Key Ratios and Statistics

Reuters: LART.BO Bloomberg: LT IN GDR: LARTq.L

India Multi-Industry

Price target	Rs2,308.00
Shr price, close (May 25, 2006)	Rs2,295.45
Mkt cap, curr (mn)	Rs298,179
52-Week Range	Rs2,915.00-1,033.50

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Exhibit 1

L&T: Key Orders for E&C Business in F4Q06

Description	Client	Rs Bn
Critical booster and high pressure compression modules for the Vasai East Development project.	ONGC	7.76
New fuel depot project at Kuwait International Airport	Kuwait Aviation Fuelling Company	5.8
520 MW Parbati Hydro Electric Project Stage (III) in Himachal Pradesh	National Hydro Electric Power Corporation	4.28
Construction of treated water transmission main and associated works for water supply to Kozhikode, Project 2A and 2B	Kerala Water Authority	2.68
Construction of 85 Km long 220 KV transmission lines in UAE	Abu Dhabi Water & Electricity Authority	1.41
Construction of Ludhiana City Center RCC basement structure and allied works in Ludhiana, Punjab	Today Home & Infrastructure Pvt Ltd	1.24
Civil, structural and enabling work at new zinc plant, Chanderiya, Rajasthan	Hindustan Zinc	1.06

Source: Company data, Morgan Stanley Research

Exhibit 2

L&T: E&C Division

Rs Bn	F4Q06	F4Q05	YoY	F2006	F2005	YoY
Orders booked	54.5	53.7	1.3%	196.2	130.5	50.4%
Net Revenues	39.0	37.2	4.9%	122.8	112.9	8.8%
EBITDA	4.6	4.4	5.5%	10.0	8.3	21.2%
EBITDA Margin	11.8%	11.8%	0.1%	8.2%	7.3%	0.8%
Net Segment Assets	-	-	-	29.6	32.4	-8.6%
Order Backlog				243.3	176.3	38.0%

Source: Company data, Morgan Stanley Research

The E&C division posted 9% YoY growth in revenues with EBITDA growing by 21% YoY in F2006. Exports constituted nearly 20% of revenues and 19% of order booking. Order backlog comprises 36% in infrastructure, 25% in hydrocarbons, 5% in power and 11% in process equipments. Over the past three years, infrastructure orders have comprised nearly 30-35% of order backlog with oil and gas segment growing from 20% to 25% due to large orders received from ONGC.

Exhibit 3

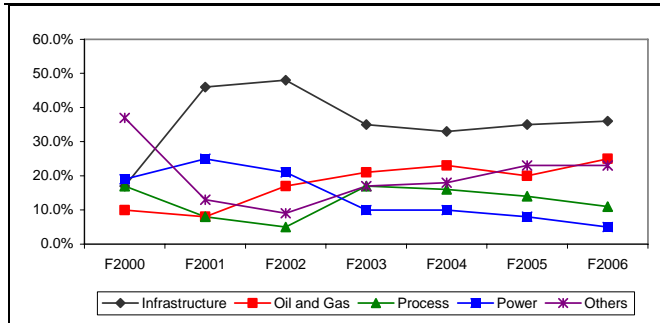
L&T: Order Backlog

Order Backlog (%)	F2000	F2001	F2002	F2003	F2004	F2005	F2006
Infrastructure	17.0%	46.0%	48.0%	35.0%	33.0%	35.0%	36.0%
Oil and Gas	10.0%	8.0%	17.0%	21.0%	23.0%	20.0%	25.0%
Process	17.0%	8.0%	5.0%	17.0%	16.0%	14.0%	11.0%
Power	19.0%	25.0%	21.0%	10.0%	10.0%	8.0%	5.0%
Others	37.0%	13.0%	9.0%	17.0%	18.0%	23.0%	23.0%

Source: Company data, Morgan Stanley Research

Exhibit 4

L&T: Order Backlog



Source: Company data, Morgan Stanley Research

Healthy performance by Electrical Division

The E&E division posted revenues of Rs 4.3 Bn, a growth of 39% YoY in F4Q06 led by standard products and systems, control & automation, and metering protection systems. EBITDA for F4Q06 has grown impressively by 180 bps for the quarter to 17.1%. For F2006, revenues and EBITDA have grown by 33% and 63% YoY with EBITDA margins coming in at 16.8%. During the year, this business has been on the expansion mode with two acquisitions and a JV in the Middle East.

- L&T has entered into an agreement to acquire Nashik-based Datar Switchgear under a scheme to be approved by BIFR. Datar manufactures miniature circuit breakers and earth leakage circuit breakers, which L&T imports from Hager for the premium-end of the building segment.
- L&T also entered into a joint venture with a local player in Saudi Arabia for a high-end electrical systems project. This entails manufacture, marketing and sales of switchboards and related systems solutions and allied products. L&T will hold majority stake in the new company, and will also be in management and operational control. These business prospects offer a large potential for L&T's switchboards business.
- L&T has acquired a Bangalore-based defence electronics and aerospace R&D company called Spectrum Infotech Pvt Ltd. The acquisition is in line with L&T's strategy to strengthen its leadership position in the area of defence electronics and avionics. Spectrum Infotech focuses on technology and product development in embedded computation, control and signal processing, for both hardware and software. It is currently engaged in design and development of prototype sub-systems and units.

The client base covers defence research & development laboratories and defence public sector units

Exhibit 5

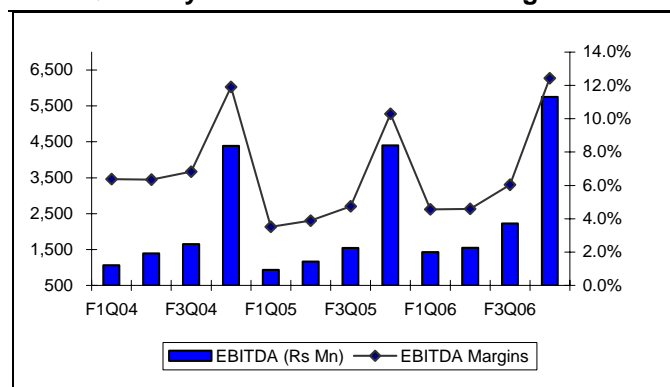
L&T: E&E Segment Performance

Rs Bn	F4Q06	F4Q05	YoY	F2006	F2005	YoY
Net Revenues	4.3	3.1	38.6%	14.2	10.7	33.2%
EBITDA	0.7	0.5	55.3%	2.4	1.5	62.6%
EBITDA Margin	17.1%	15.3%	1.8%	16.8%	13.8%	3.0%
Net Segment Assets				3.9	3.6	8.3%

Source: Company data, Morgan Stanley Research

Exhibit 6

L&T: Quarterly EBITDA and EBITDA Margin Trend



Source: Company data, Morgan Stanley Research

F2007 Outlook – 25-30% growth in Order Book

The L&T management is confident of achieving an order book growth of 25-30% YoY in F2007 after nearly 49% YoY growth in F2006. On the basis of the strong order backlog, management is also confident of posting 20-25% growth in revenues next year across all segments. In the analyst meeting, management indicated that it would strive to improve operating margins by 50-100 bps in F2007.

L&T is looking at expanding capacity at its Hazira manufacturing facility and plans to set up new development facilities at Coimbatore, in the Middle East and in China. Management is also positive on the outlook for orders in the hydro carbon sector, which has been encouraged by high oil prices. L&T expects capex growth in the minerals and metal sector to be driven by high metal prices and capacity utilization levels, and infrastructure sector investments should continue to be a focus area, with airport infrastructure being spruced up and capacity enhancement at 12 major ports being planned. L&T expects to receive a steady flow of orders from the power segment too, where five ultra mega power projects have been announced and additional capacity of 61000 MW is being planned by March 2012. There has also

been interest in new technology areas like coal gasifiers and gas to liquid technology.

The key concern continues to be a shortage of skilled labor, with attrition levels at 13-14%

Exhibit 7

L&T: Consolidated Results

Rs Bn	FY05	FY06	YoY
Total Income	150.4	170.2	13.2%
PBDIT	13.7	18.5	35.0%
PAT	7.6	10.3	34.2%
Consolidated PAT (Incl Extraordinary and share in Associate's profits)	10.5	13.2	25.5%

Source: Company data

Strong Performance by Subsidiaries

On a consolidated basis, L&T group ended F2006 with a 13% growth in revenues, 35% growth in EBITDA and a 34% growth in core earnings. L&T manufacturing, services and construction subsidiaries (L&T Finance, L&T Infotech and Middle East subsidiaries) posted YoY growth of 50% and 43% in revenues and net earnings respectively. L&T's power subsidiaries (India Infrastructure Developers Ltd [IIDL] and HPL Cogeneration) posted a 16% growth in revenues while its associate companies (L&T Komatsu, L&T Case Equipment and Audco India) posted 45% growth in revenues and 99% growth in net earnings.

L&T's IT subsidiary L&T Infotech has posted a healthy 42% YoY growth in revenues to Rs 8 Bn in F2006 with a net profit margin of around 9%. L&T InfoTech has established new centers at Bangalore, Chennai and Mumbai and increased its staff strength to 6,371 employees in F2006. Management expects to take the company public by F2008. Meanwhile, it is open to strengthening its IT portfolio by acquiring companies in the IT space prior to the listing of L&T Infotech.

L&T Finance limited has posted 36% YoY growth in revenues with net earnings growing by 46% YoY. Total value dispersed by the company in F2006 amounted to Rs 26 Bn.

L&T – Forays into New Businesses

L&T has formed its shipbuilding venture by securing a key contract for construction of four ships valued at over Rs 4.4 Bn from Netherland-based Zadeco Ship Management CV. The vessels will be built at a new shipyard that will form part of the company's engineering complex at Hazira, Surat. The shipbuilding is scheduled to commence in July 2006 and would significantly expand the Company's high technology manufacturing capabilities.

L&T has also entered the dredging business by acquiring a 61% stake in International Seaport Dredging Pvt Ltd, an India-based company. L&T acquired a 61 per cent stake in the company for an undisclosed amount from Belgium headquartered Dredging International NV, which holds the remaining 39 per cent stake. L&T's entry into the dredging business is also in synergy with its ports construction business, where the company is a major construction partner in several Indian public and private ports at Nhava Sheva, Dhamra, Chennai, Mundra, Gangavaram, Hazira, and other places.

According to management, these new business areas should tend to provide higher margin orders than plain-vanilla E&C orders.

Maintaining our Equal-weight rating

At the current market price of Rs 2,296, L&T trades at a P/E of 22.6x and 17.6x on our F2007 and F2008 estimates. We maintain our Equal-weight rating on the stock.

We have an In-Line view on the India Engineering Industry – an emphasis on infrastructure and government spending are the key positives. Loosening of reforms due to political uncertainties is the key risk.

Exhibit 8

L&T: Quarterly Results

Rs mn	Mar-05	Dec-05	Mar-06	YoY	QoQ	YTD F05	YTD F06	YoY
E&C Segment								
Order Booking	53,540	67,230	54,430	1.7%	-19.0%	130,560	196,090	50.2%
Domestic	49,500	53,670	46,419	-6.2%	-13.5%	113,560	158,230	39.3%
Exports	4,040	13,560	8,011	98.3%	-40.9%	17,000	37,860	122.7%
Order Backlog	177,070	229,150	241,690	36.5%	5.5%	177,070	241,690	36.5%
Total								
Order Booking	59,480	73,970	61,090	2.7%	-17.4%	149,650	223,180	49.1%
Order Backlog	179,110	235,300	247,000	37.9%	5.0%	179,110	246,640	37.7%
Gross Sales	43,026	37,195	46,727	8.6%	25.6%	132,630	149,482	12.7%
Less Excise Duty	617	531	784	27.1%	47.5%	1,875	2,307	23.1%
Net Sales	42,410	36,664	45,943	8.3%	25.3%	130,755	147,175	12.6%
Other Operating Income	330	246	313	-5.1%	27.1%	788	991	25.7%
Total Operating Income	42,740	36,910	46,257	8.2%	25.3%	131,543	148,165	12.6%
Raw Materials	12,897	8,775	12,130	-5.9%	38.2%	43,126	38,282	-11.2%
Manufacturing/Operating Expenses	20,926	20,304	23,353	11.6%	15.0%	61,886	77,729	25.6%
Staff Costs	1,784	2,287	2,112	18.4%	-7.7%	7,645	8,900	16.4%
Sales & Admin Exp	2,732	3,314	2,910	6.5%	-12.2%	10,848	12,291	13.3%
Total Expenses	38,339	34,681	40,505	5.6%	16.8%	123,504	137,203	11.1%
Operating Profit	4,401	2,229	5,752	30.7%	158.0%	8,039	10,962	36.4%
<i>Operating Margin</i>	<i>10.3%</i>	<i>6.0%</i>	<i>12.4%</i>	<i>2.1%</i>	<i>6.4%</i>	<i>6.1%</i>	<i>7.4%</i>	<i>1.3%</i>
Share of Profit from JVs (net of tax)	50	45	22	-55.6%	-50.1%	191	64	-66.2%
Other Income	860	873	1,171	36.2%	34.1%	2,583	3,532	36.8%
Net Interest	168	225	281	66.9%	24.9%	543	751	38.4%
Depr & Amortz	299	266	324	8.5%	21.8%	942	1,145	21.6%
PBT & Extraordinary	4,844	2,656	6,339	30.9%	138.7%	9,328	12,663	35.7%
Adjusted Tax	1,507	456	1,752	16.3%	283.8%	2,634	3,533	34.1%
Core PAT	3,337	2,200	4,588	37.5%	108.6%	6,694	9,130	36.4%
Extraordinary Net of Tax	-	393	81	NA	NA	3,145	992	-68.5%
Reported PAT	3,337	2,593	4,668	39.9%	80.1%	9,838	10,122	2.9%

Source: Company data, Morgan Stanley Research



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(as of April 30, 2006)

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	Count	% of Total	Count	% of Total IBC	% of Rating Category
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Equal-weight/Hold	883	45%	295	46%	33%
Underweight/Sell	367	19%	84	13%	23%
Total	1,963		640		

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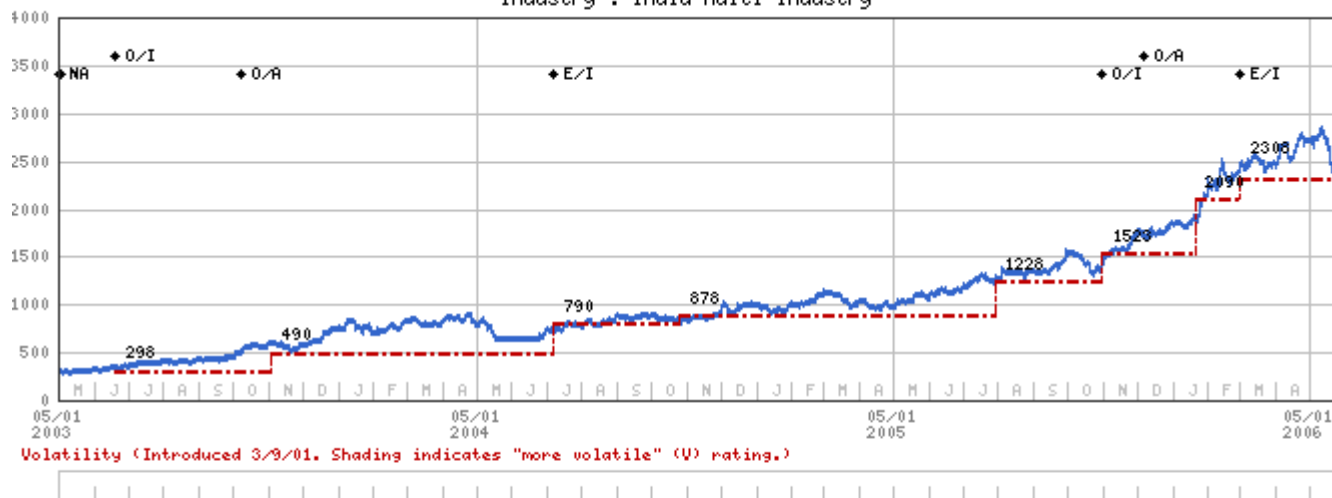
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Stock Price, Price Target and Rating History (See Rating Definitions)

Larsen & Toubro (LART.BO) - As of 5/25/06 in INR
 Industry : India Multi-Industry



Volatility (Introduced 3/9/01. Shading indicates "more volatile" (V) rating.)

Stock Rating History: 10/15/02 : NA; 5/2/03 : NA; 6/19/03 : O/I; 10/6/03 : O/A; 7/7/04 : E/I; 10/31/05 : O/I;
 12/6/05 : O/A; 2/28/06 : E/I
 Price Target History: 10/15/02 : NA; 6/19/03 : 298; 11/3/03 : 490; 7/7/04 : 790; 10/26/04 : 878; 7/29/05 : 1228;
 10/31/05 : 1523; 1/20/06 : 2090; 2/28/06 : 2308

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 Stock Price (Not Covered by Current Analyst) — Stock Price (Covered by Current Analyst) ■
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Industry Coverage:India Multi-Industry

Company (Ticker)	Rating (as of)	Price (05/25/2006)
Satish Jain		
Bharat Heavy Electricals (BHEL.BO)	E (02/28/2006)	Rs1901.35
Larsen & Toubro (LART.BO)	Equal-weight (02/28/2006)	Rs2295.45
Suzlon Energy (SUZL.BO)	E-V (12/15/2005)	Rs970.10

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