

Company

27 July 2010 | 11 pages

Larsen & Toubro (LART.BO)

 Equity
 Target price change
 Estimate change

Satisfactory Quarter: Raising Target Price to Rs2,110

- Recurring PAT up 15% YoY** — At Rs6.7bn was 6% below CIRA expectations of Rs7.1bn. Gross sales at Rs79.1bn up 7% YoY (13% below CIRA - Rs91.1bn). Sales miss was more or less made up by 153bps margin expansion. Asking rate is 23% YoY in the remaining 9 months of FY11E to meet 20% sales growth guidance.
- Why was sales growth muted?** — Inflows were heavily back ended in FY11E with 60% of orders coming in 2HFY10 and 34% of orders coming in 4QFY10. Quantity of long-cycle jobs with lengthier execution timelines has increased. However, 7% YoY sales growth in 1QFY11 is in line with the company's revenues accruals planned this year to meet the 20% YoY growth guidance.
- Order inflows up 63% YoY** — At Rs156bn the company is largely on track to meet FY11E inflow guidance of Rs870bn. Company ended the quarter with a backlog of Rs1078bn up 51% YoY. Asking rate is 19% YoY (Rs713bn) in the remaining 9 months of FY11E to meet 25% inflow growth guidance.
- Strong subsidiary performance** — L&T Infotech, L&T Finance and L&T Infra Finance reported robust PAT growth of 30%, 142% and 118% YoY respectively.
- FY11E-12E parent EPS & cons EPS increased by 3-6% & 12-15%** — To factor in 4% higher inflows, 1-2% higher sales, 41-51bps higher margins and revision of estimates in L&T Infotech/ L&T Finance/ L&T Infra Finance. We expect L&T to grow parent and cons EPS at a CAGR of 23% & 21% respectively over FY10-13E.
- Target price increased to Rs2,110** — From Rs1,875 to factor in: (1) upward EPS revision (2) roll forward of target multiples to Dec11E (Sep11E) and (3) L&T IDPL and UIL at 3.0x private equity valuations (2.0x). Maintain Buy (1L).

Buy/Low Risk	1L
Price (27 Jul 10)	Rs1,845.00
Target price	Rs2,110.00
	<i>from Rs1,875.00</i>
Expected share price return	14.4%
Expected dividend yield	0.8%
Expected total return	15.1%
Market Cap	Rs1,110,340M
	US\$23,597M

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



Figure 1. L&T – Statistical Abstract

Year End	Parent PAT	Parent Growth EPS	Parent P/E	Parent EV/E	Parent RoE	Cons PAT	Cons Growth EPS	Cons P/E	Yield
31-Mar	Rsmn	Rs %	x	x	%	Rsmn	Rs %	x	%
FY08	20,123	34.4 45.3%	53.6	38.9	26.4%	22,841	39.1 29.6%	47.2	0.5%
FY09	27,092	46.3 34.4%	39.9	29.5	24.7%	30,059	51.3 31.4%	36.0	0.6%
FY10	31,076	51.2 10.7%	36.0	24.6	20.2%	37,946	62.5 21.8%	29.5	0.7%
FY11E	40,507	66.7 30.3%	27.7	20.0	20.4%	48,489	79.9 27.8%	23.1	0.8%
FY12E	48,301	79.6 19.2%	23.2	16.4	20.8%	57,277	94.3 18.1%	19.6	0.9%
FY13E	57,482	94.7 19.0%	19.5	13.5	21.0%	67,661	111.4 18.1%	16.6	0.9%

Source: Citi Investment Research and Analysis estimates

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See Appendix A-1 for Analyst Certification, Important Disclosures and non-US research analyst disclosures.

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Other Per Share Data

NAV	240.75
Discount to NAV	-666%

Fiscal year end 31-Mar	2009	2010	2011E	2012E	2013E
Valuation Ratios					
P/E adjusted (x)	39.9	36.0	27.7	23.2	19.5
P/BV (x)	8.7	6.1	5.2	4.4	3.8
Dividend yield (%)	0.6	0.7	0.8	0.9	0.9
Payout Ratio (%)	22.7	24.4	21.0	20.1	18.0
Per Share Data (Rs)					
EPS adjusted	46.25	51.19	66.72	79.56	94.68
EPS reported	59.44	72.07	66.72	79.56	94.68
BVPS	212.30	303.69	354.58	416.07	491.63
DPS	10.50	12.50	14.00	16.00	17.00
Profit & Loss (RsM)					
Net sales	336,466	366,752	439,956	527,947	620,337
Operating expenses	-300,957	-323,630	-386,754	-465,053	-547,489
EBIT	35,509	43,122	53,201	62,894	72,849
Net interest expense	-3,502	-5,100	-5,093	-4,447	-2,681
Non-operating/exceptionals	7,398	9,177	11,460	12,584	14,364
Pre-tax profit	39,404	47,199	59,569	71,031	84,532
Tax	-12,312	-16,123	-19,062	-22,730	-27,050
Extraord./Min.Int./Pref.div.	7,725	12,679	0	0	0
Reported net income	34,817	43,755	40,507	48,301	57,482
Adjusted earnings	27,092	31,076	40,507	48,301	57,482
Adjusted EBIT	35,509	43,122	53,201	62,894	72,849
Growth Rates (%)					
Sales	35.4	9.0	20.0	20.0	17.5
EBIT adjusted	35.2	21.4	23.4	18.2	15.8
EPS adjusted	34.4	10.7	30.3	19.2	19.0
Cash Flow (RsM)					
Operating cash flow	6,097	59,625	57,097	83,991	99,868
Depreciation/amortization	3,060	4,146	5,044	6,267	7,438
Net working capital	-31,651	11,434	11,541	29,418	34,943
Investing cash flow	-31,979	-70,287	-45,214	-42,714	-42,714
Capital expenditure	-18,565	-15,871	-20,214	-17,714	-17,714
Acquisitions/disposals	-13,415	-54,416	-25,000	-25,000	-25,000
Financing cash flow	23,991	17,228	-11,864	-26,273	-43,449
Borrowings	29,720	2,448	-2,000	-15,000	-31,471
Dividends paid	-7,168	-8,630	-9,864	-11,273	-11,978
Change in cash	-1,892	6,566	19	15,004	13,705
Balance Sheet (RsM)					
Total assets	368,818	464,094	535,468	623,776	711,783
Cash & cash equivalent	7,753	14,319	14,338	29,342	43,047
Accounts receivable	100,555	111,637	133,920	160,704	188,827
Net fixed assets	50,292	61,998	77,066	88,412	98,587
Total liabilities	244,469	281,211	321,942	373,222	415,725
Accounts payable	98,000	0	0	0	0
Total Debt	65,560	68,008	66,008	51,008	19,537
Shareholders' funds	124,348	182,884	213,526	250,554	296,058
Profitability/Solvency Ratios (%)					
EBITDA margin adjusted	10.6	11.8	12.1	11.9	11.7
ROE adjusted	24.7	20.2	20.4	20.8	21.0
ROA adjusted	8.5	7.5	8.1	8.3	8.6
Net debt to equity	46.5	29.4	24.2	8.6	-7.9
Total debt to capital	34.5	27.1	23.6	16.9	6.2

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Satisfactory 1QFY11 – Recurring PAT up 15% YoY

- L&T's 1QFY11 Recurring PAT at Rs6.7bn was up 15% YoY was 6% below CIRA expectations of Rs7.1bn. Gross sales at Rs79.1bn up 7% YoY was 13% below CIRA expectations of Rs91.1bn. The sales miss was more or less made up by 153bps margin expansion on favorable sales mix in E&C and lower sub-contracting. The asking rate is 23% YoY in the remaining 9 months of FY11E to meet the full year sales guidance of 20% YoY growth.
- Order inflows at Rs156bn up 63% YoY imply the company is largely on track to meet its full year order inflow guidance of Rs870bn up 25% YoY. The company ended the quarter with a backlog of Rs1078bn up 51% YoY. The asking rate is 19% YoY (Rs713bn) in the remaining 9 months of FY11E to meet the full year inflow guidance of 25% YoY growth.

Figure 2. L&T – 1QFY11 Results

Year End Mar31 (Rsmn)	1QFY10	1QFY11	Change	1QFY11E	Change
Order Inflow	95,710	156,260	63.3%		
Order Backlog	716,530	1,078,160	50.5%		
Gross Sales	74309	79130	6.5%	91054	22.5%
Excise	(681)	(779)		(835)	
% of sales	0.9%	1.0%		0.9%	
Net Sales	73627	78351	6.4%	90219	22.5%
Pure EBITDA	7863	9568	21.7%	9744	23.9%
Pure EBITDA Margin	10.7%	12.2%	1.53%	10.8%	
Operational Income	456	502		500	
EBITDA	8319	10071	21.1%	10244	23.1%
EBITDA Margin	11.3%	12.9%		11.4%	
PBDIT (EBITDA + Other Income)	10547	12338		12844	
Margin	14.3%	15.7%		14.2%	
D&A	(937)	(1142)		(1212)	
EBIT	7382	8929	21.0%	9031	22.3%
EBIT Margin	10.0%	11.4%		10.0%	
Interest	(1096)	(1423)		(1256)	
Other Income	2228	2268		2600	
PBT	8514	9773	14.8%	10376	21.9%
Total Tax	(2730)	(3112)		(3328)	
Tax Rate	32.1%	31.8%		32.1%	
Recurring PAT	5783	6662	15.2%	7048	21.9%
Exceptional Items	10199	0		0	
Reported PAT	15982	6662	-58.3%	7048	-55.9%

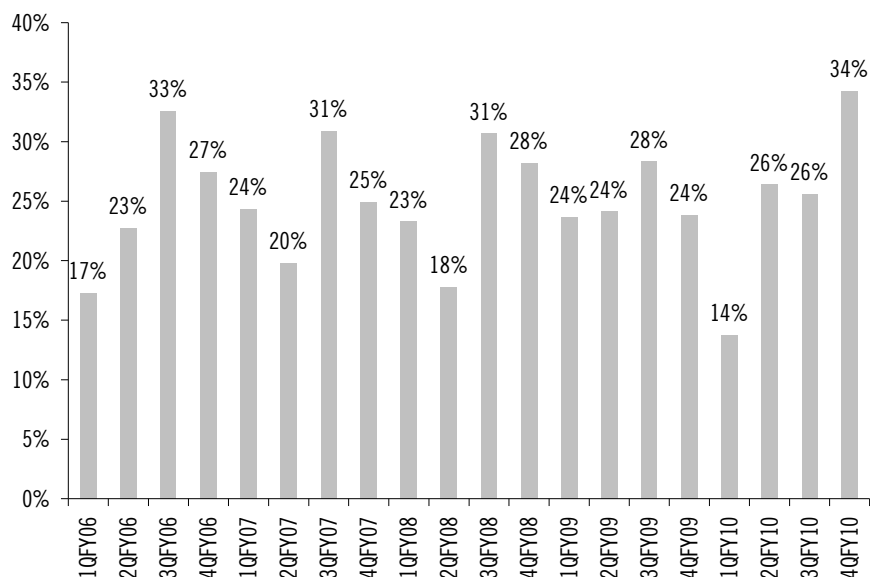
Source: Company and Citi Investment Research and Analysis estimates

Why was sales growth muted in 1QFY11?

- L&T's order inflows were heavily back ended in FY11E with 60% of the orders coming in the 2HFY10 and almost 34% of the orders coming in 4QFY10. These back ended orders are in initial stages of execution and revenues could not be booked on the same.
- Besides this the quantity of long-cycle jobs with lengthier contracted execution timelines has increased.

- However, 7% YoY sales growth in 1QFY11 is in line with the company's revenues accruals planned this year to meet the 20% YoY growth guidance.

Figure 3. L&T – % Of Orders Booked In Quarter Compared To Full Year Inflows



Source: Citi Investment Research and Analysis

Figure 4. L&T – 1QFY11 Segmental Results

Year End Mar31 (Rsmn)	1QFY10	1QFY11	Change
Revenues			
E&C	65729	66438	1.1%
E&E	5759	7451	29.4%
Machinery and Industrial products	4370	5482	25.5%
Others	771	1220	58.3%
Total	76628	80592	5.2%
PBIT			
E&C	6992	8167	16.8%
E&E	680	738	8.4%
Machinery and Industrial products	954	1130	18.5%
Others	42	335	697.4%
Total PBIT	8668	10369	19.6%
PBIT Margins			
E&C	10.6%	12.3%	
E&E	11.8%	9.9%	
Machinery and Industrial products	21.8%	20.6%	
Others	5.4%	27.4%	
Total	11.3%	12.9%	

Source: Company and Citi Investment Research and Analysis

Figure 5. L&T – Order Wins In 1QFY11

Date	Details	Client	Rsmn
NA	EPC for BTG and auxiliary package for Rajpura 1320MW	L&T Power Development	52,000
14-Jul-10	Refurbishment of offshore jack-up rig "Sagar Uday"	ONGC	3,760
30-Jun-10	Ongoing metallurgical, material handling and water works	Various	1,290
30-Jun-10	Storm water drains, reservoir, laying of sea outfall pipeline and lift station	IOCL	2,390
30-Jun-10	Conversion of 11kV overhead lines to underground cabling	Goa Electricity Dept	2,040
30-Jun-10	220kV substation at Dhule and Bhabhleshwar	MSETCL	
30-Jun-10	220/66kV substation at Bengaluru	KPTCL	
30-Jun-10	SCADA works for water transmission network	PAEW	8,110
30-Jun-10	132/33kV substation at Quaiyat Area	OETC	
30-Jun-10	3X132kV substation at Sudha Port Faujairah	TRANSCO	
22-Jun-10	Civil works for 2x660 MW Talwandi Sabo developed by Sterlite Energy	SEPCO - I	2,250
22-Jun-10	Electrical & mechanical BOP for 2x392 MW Gautami Stage-II CCPP	GVK Power	6,020
18-Jun-10	Factory buildings	Various	1,460
18-Jun-10	Real estate buildings	Various	12,940
10-Jun-10	Aluminium Rolling Mill Complex at Hirakud, Orissa	Hindalco Industries	2,110
10-Jun-10	Coal Handling Plants at Amravati and Nasik Thermal Power Plant in Maharashtra.	Indiabulls Power	2,600
10-Jun-10	Coal Handling Plant at Northern Coalfield, Amlohri, in Madhya Pradesh	Coal India	2,760
11-May-10	Advanced Waste Water Treatment & Urban Reuse	Public Works Authority, Qatar	8,500
Data Available For			108,230
Actual Inflows			156,260

Source: Company and Citi Investment Research and Analysis

Figure 6. L&T – 1QFY11 Key Subsidiaries Performance

	1QFY10	1QFY11	Change
L&T Infotech			
Sales	4730	5650	19.5%
PAT	610	790	29.5%
Margins	12.9%	14.0%	109
L&T Finance			
Sales	1980	2870	44.9%
PAT	240	580	141.7%
Margins	12.1%	20.2%	809
L&T Infrastructure Finance			
Sales	860	1480	72.1%
PAT	220	480	118.2%
Margins	25.6%	32.4%	685

Source: Company and Citi Investment Research and Analysis

Figure 7. L&T – Earnings Revision Table

End Mar31 (Rsmn)	FY11E	FY12E	FY13E
Order Inflows (Rsbn)			
New	870	1,044	1,226
Old	839	1,007	
Change	3.7%	3.7%	
Net Sales			
New	439,956	527,947	620,337
Old	434,572	517,141	
Change	1.2%	2.1%	
Core EBITDA margins			
New	12.3%	12.2%	12.1%
Old	11.8%	11.8%	
bps	51	41	
Recurring PAT			
New	40,507	48,301	57,482
Old	38,023	46,484	
Change	6.5%	3.9%	
Parent EPS			
New	66.72	79.56	94.68
Old	62.97	76.99	
Change	6.0%	3.3%	
Consolidated EPS			
New	79.87	94.34	111.45
Old	69.29	84.56	
Change	15.3%	11.6%	

Source: CIRA estimates

Earnings revised upwards

We revise up FY11E-12E parent EPS estimates by 3-6% and consolidated EPS estimates by 12-15% to factor in:

- 4% higher inflows and 1-2% higher sales. We expect L&T's sales to grow 20% in FY11E, 20% in FY12E and 17.5% in FY13E
- Given the fall in cement and steel prices we increase our margins by 51bps in FY11E. We believe orders wins in FY11E will factor in better pricing power and as a consequence we increase margins by 41bps in FY12E.
- We also increase our estimates for L&T Infotech, L&T Finance and L&T Infrastructure finance

We expect L&T to grow parent EPS at a CAGR of 23% and consolidated EPS at a CAGR of 21% over FY10-13E.

Figure 8. CIRA L&T Parent and Consolidated EPS v/s Consensus

Year End Mar31 (Rsmn)	FY11E	FY12E	FY13E
Parent			
CIRA	66.72	79.56	94.68
Consensus	61.68	76.40	93.35
Difference	8.2%	4.1%	1.4%
Consolidated			
CIRA	79.87	94.34	111.45
Consensus	68.45	86.34	117.59
Difference	16.7%	9.3%	-5.2%

Source: Bloomberg and Citi Investment Research and Analysis estimates

Target price increased to Rs2,110 from Rs1,875 earlier

We increase our target price to Rs2,110 from Rs1,875 earlier to factor in: (1) parent EPS increase of 3-6% (2) consolidated EPS increase of 12-15% (2) roll forward of our target multiples to Dec11E from Sep11E earlier and (3) L&T IDPL and UIL at 3.0x private equity valuations vis-à-vis 2.0x earlier as the company has added more projects to its kitty in these entities.

Figure 9. L&T – Sum Of The Parts

Part	Old Methodology	New Methodology	Old Value	New Value
Parent	P/E Multiple 23x Sep11E EPS	P/E Multiple 23x Dec11E EPS	1610	1,756
Value of Subsidiaries			266	354
- L&T Infotech (100% Stake)	2nd tier IT 12x Sep11E EPS	2nd tier IT 12x Dec11E EPS	73	78
- L&T IDPL (78.4% Stake)	2.0x PE Valuations	3.0x PE Valuations	64	95
- L&T UIL (58.8% Stake)	2.0x PE Valuations	3.0x PE Valuations	7	11
- L&T Finance (100% Stake)	P/BV of 1.5x Sep11E	P/BV of 1.5x Dec11E	20	35
- L&T Infrastructure Finance	P/BV of 1.5x Sep11E	P/BV of 1.5x Dec11E	14	26
- Other Subsidiaries/Associates	P/BV of 1.0x FY09	P/BV of 1.0x FY10	42	64
- Satyam (6.9% stake)	20% discount to CMP	20% discount to CMP	10	10
- L&T MHI	P/E of 12x FY13E	P/E of 12x FY13E	36	36
Value/Share			1,875	2,110

Source: Citi Investment Research and Analysis estimates

Larsen & Toubro

Company description

L&T is a diversified conglomerate with market leadership in engineering and construction (E&C) and electrical-equipment businesses in India. L&T Information Technology is its 100% subsidiary in software services. L&T demerged its cement business into a separate company, selling it to Grasim.

Investment strategy

We rate L&T Buy/Low Risk. With an earnings CAGR of 23% over FY10-13E for the core business, and spawning new businesses such as railways and power equipment, we believe L&T is fundamentally one of the best proxies for India's infrastructure build-out. L&T's Rs1078bn order backlog and forecast stable margins provide good earnings visibility. Its thrust of process and hydrocarbons and India's infrastructure spending should augur well for the order pipeline. We are positive on management efforts to improve product mix by raising the share of high-technology products for process industries, defense, nuclear, and aerospace applications; and engineering and embedded services. These segments have better growth potential and margins than the projects business, in our view.

Valuation

Our Rs2,110 target price is based on sum-of-the-parts (SOTP). We use 23x Dec11E earnings for the parent (Rs1,756), on par with BHEL. We also believe that the parent's numbers do not capture the value inherent in subsidiaries, which we value at Rs354, with L&T Infotech at Rs78 (12x Dec11E EPS, in-line with second-tier peers), L&T Finance at Rs35 (1.0x Dec11E P/BV), 51% stake in L&T-MHI JV at Rs36, and L&T IDPL at Rs95. Over the past 15 years L&T has traded at an average premium of ~ 39% to BHEL. However, during economic slowdowns BHEL trades at a premium to L&T. The trend reverses in good times. We believe that India economic growth is still 6 months away from a full-fledged revival so we peg L&T on par with BHEL. Our target multiple for BHEL at 23x is set a ~25% premium to the stock's historical average P/E of 18.4x.

Risks

We rate L&T shares Low Risk, in line with our quantitative risk-rating system, and because L&T's order backlog of c.Rs1078bn represents two years' sales and provides earnings visibility. Downside risks that could prevent the shares from reaching 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 with technology trends to sustain valuations and earnings. Upside risks to our target price include: 1) better-than-expected order booking; 2) a better-than-expected execution rate; and 3) higher-than-expected EBITDA margins.

Appendix A-1

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Analyst: Venkatesh Balasubramaniam

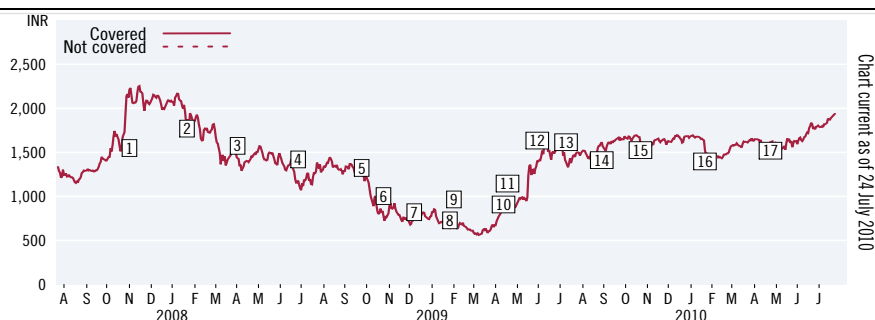


Chart current as of 24 July 2010

Date	Rating	Target Price	Closing Price
1 1-Nov-07	*3L	*2,005.00	2,213.30
2 22-Jan-08	*1L	*2,280.50	1,827.70
3 2-Apr-08	1L	*2,070.50	1,432.73
4 26-Jun-08	1L	*1,585.00	1,179.42
5 24-Sep-08	1L	*1,480.50	1,275.63
6 24-Oct-08	1L	*953.00	779.40

Date	Rating	Target Price	Closing Price
7 8-Dec-08	*2L	*787.00	740.20
8 27-Jan-09	2L	*697.00	638.20
9 1-Feb-09	*3L	*622.00	689.20
10 13-Apr-09	3L	*810.00	824.00
11 17-Apr-09	*1L	*955.00	866.50
12 29-May-09	*2L	*1,437.00	1,405.60

Date	Rating	Target Price	Closing Price
13 9-Jul-09	2L	*1,466.00	1,389.40
14 28-Aug-09	2L	*1,784.00	1,614.60
15 22-Oct-09	*1L	*1,828.00	1,608.50
16 21-Jan-10	1L	*1,748.00	1,524.35
17 23-Apr-10	1L	*1,875.00	1,617.85

* Indicates change

Rating/target price changes above reflect Eastern Standard Time

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Data current as of 30 Jun 2010

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% of companies in each rating category that are investment banking clients	47%	45%	40%

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