

Larsen & Toubro Ltd

Hazira complex - well equipped to cater to order flows

L&T-Mitsubishi Heavy Industries (MHI) JV's 4GW boiler and turbine manufacturing facilities, set up at a cost of Rs 36bn, are ramping up production. The level of indigenisation is on the rise with the company expecting +80% of value addition to be done in-house in few years time, thus leaving only low value parts to be outsourced from Indian vendors. As per the management, this will take BTG segment margins at similar level as L&T's standalone business (currently at ~12.5%). While the modular fabrication facility at Hazira (on river front) is already manufacturing offshore platforms and jackets, the new facilities at Oman and Katupalli (both on sea front) will also cater to deep water rigs. The management is also working towards scaling up the capacity of shipbuilding division, though the benefit will be realised only once orders pick up. The Rs 17.3bn forgings facility with annual capacity of 40,000 tonnes is under construction and is expected to be commissioned in 12 months time. We see L&T well placed to capitalise on the order inflows in these segments.

Hazira complex: Hazira complex houses a number of facilities including heavy engineering shop, boiler manufacturing facility, turbine manufacturing facility, modular fabrication facility, shipbuilding facility and under construction forgings plant. The campus is spread over 750 acres and currently employs ~4,500 people (on L&T's rolls) and contract labour of over 14,000 people.

Boiler manufacturing facility – scale up seen in FY12: The facility started operations in June '10, and dispatched its first unit for Jaiprakash Associates' Nigrie plant in February '11. Currently, ~60% of the shop floor is operating in two shifts while rest 40% is operating in three shifts. The management aims to scale up production from 5,000t in FY11 to 25,000t in FY12. The facility currently employs 600 workers which will be increased to 800 in six months.

Turbine and generator facility – development of in-house expertise for components: L&T won its first order of steam turbine generator island in June '08 from Andhra Pradesh Power Development Company Ltd (APPDCL) for 2x800MW units. While L&T has already dispatched the first unit, the second unit is in final stages of development at the facility. For APPDCL order, ~83% of components were imported. L&T faced a lot of difficulties in remaining 17% as Indian vendors lacked capabilities in manufacturing components with high precision. Today, L&T has set up the facilities to manufacture a number of components in-house, which has helped them deliver superior quality products. One of the employees indicated that MHI may look to source some of its component requirement from this facility in future.

Current BTG facility can deliver upto 5GW per annum: While the rated capacity of the boiler and turbine generator facility is 4GW, the management indicated that they can scale up the operations to deliver ~5GW of equipment per annum, when the need arises. The management indicated that EBITDA margin of BTG facilities is likely to be similar to L&T standalone (currently 12.5%) in few years.

SOTP target at Rs 2,250: We have valued L&T in the following manner: (1) L&T's standalone business at Rs 1,700/sh based on DCF analysis, (2) L&T's finance subsidiaries at Rs 80/sh (2x FY12 P/B) and L&T Infotech at Rs 93/sh (13x FY12 EPS), (3) L&T IDPL at Rs 96/sh, assuming an 18% p.a. return on April '06 PE deal-based value and (4) the power business, other subsidiaries (E&C, MIP and EBG segments) and cash equivalents at Rs 281/sh. Maintain BUY.

What's New?	Target	Rating	Estimates
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CMP	TARGET	RATING	RISK
Rs 1,665	Rs 2,250	BUY	MEDIUM

BSE	NSE	BLOOMBERG
500510	LT	LT IN

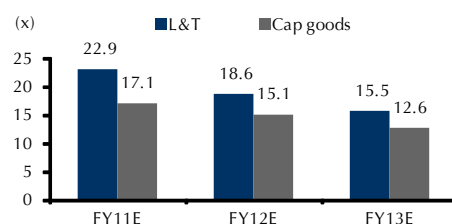
Company data

Market cap (Rs mn / US\$ mn)	1,002,330 / 22,252
Outstanding equity shares (mn)	603
Free float (%)	86
Dividend yield (%)	0.7
52-week high/low (Rs)	2,213 / 1,461
2-month average daily volume	2,352,151

Stock performance

Returns (%)	CMP	1-mth	3-mth	6-mth
L&T	1,665	2.1	(17.6)	(9.3)
CG Sector	13,223	1.2	(14.4)	(10.2)
Sensex	18,490	2.2	(7.5)	1.4

P/E comparison



Valuation matrix

(x)	FY10	FY11E	FY12E	FY13E
P/E @ CMP	30.2	22.9	18.6	15.5
P/E @ Target	40.8	30.9	25.1	21.0
EV/EBITDA @ CMP	18.3	15.5	12.8	10.6

In the interest of timeliness this report has not been edited.





Fig 1 - BTG order booking by L&T#

Quarter	Description	Client	Amount (Rs bn)
2QFY10	Setting up Gas based power plant at Vemagiri for GMR Energy Limited	GMR Energy	20.5
2QFY10	Steam turbine generators package for 2x660 MW Jaypee Nigrie Power Project	JPVL	17.7
3QFY10	BTG units for 3x660 MW supercritical power plant at Koradi, Maharashtra	Mahagenco	69.0
4QFY10	EPC project for steam turbine & generators and auxillary packages for 2x660 MW Rajpura Thermal Power Project	Nabha Power Limited	14.3
1QFY11	Gautami combined cycle power plant	GVK Power	3.0*
2QFY11	1x700 MW EPC project	Nabha Power, Rajpura	18.0*
2QFY11	3x660 MW STG package along with auxiliaries (Karchana project)	JPVL	28.0
Total			170.6

Source: Company, RCML Research # - These are the orders which L&T has booked in the parent company * - The values indicated are only for equipment contracts (although these are part of larger EPC contracts)

Fig 2 - Shipbuilding orders won by L&T

Quarter	Description	Client	Amount (Rs bn)
2QFY08	RO/RO LO-LO Semi submersible heavy lift vessels	RollDock – BV - Netherlands	2.9
1QFY08	Multipurpose Heavy Lift Vessels	BigLift Shipping B.V., Netherlands	3.9
1QFY07	Construction of 4 roll-on-roll-off heavy lift container cargo ships	RollDock B V, Netherlands	4.4
Total			11.2

Source: Company, RCML Research

Valuation

Fig 3 - SOTP valuation summary

Particulars	Basis	Rs/share
Standalone business	DCF valuation based on WACC of 9.8%	1,700
Financial services	2.0x FY12 P/B (assuming 16% CAGR in book value over FY10-12E)	80
IT business	13x FY12E EPS, 14% PAT margin	93
L&T IDPL	Assuming 18% return on implied equity value based on April 2006 PE deal*	96
Power equipment business	Based on EV/E of 12x on EBITDA that is not part of the standalone business but is part of the consolidated; discounted to now	85
E&C, product business in subs, others	EV/E basis	196
Total		2,250

Source: RCML Research * PE investors bought 22% stake in L&T IDPL at implied equity valuation of Rs25bn



Consolidated financials

Profit and Loss statement

Y/E March (Rs mn)	FY10	FY11E	FY12E	FY13E
Revenues	436,649	529,666	653,971	784,466
Growth (%)	8.3	21.3	23.5	20.0
EBITDA	60,520	71,613	86,551	104,927
Growth (%)	26.7	18.3	20.9	21.2
Depreciation & amortisation	9,806	8,257	9,765	11,515
EBIT	50,714	63,356	76,786	93,411
Growth (%)	25.3	24.9	21.2	
Interest	6,919	10,039	10,812	11,586
Other income	9,728	11,735	14,484	14,728
EBT	53,522	65,052	80,458	96,554
Income taxes	20,374	21,590	26,703	32,045
Effective tax rate (%)	38.1	33.2	33.2	33.2
Extraordinary items	21,288	-	-	-
Min into / inc from associates	84	372	269	136
Reported net income	54,507	43,819	54,006	64,624
Adjustments	(21,288)	-	-	-
Adjusted net income	33,219	43,819	54,006	64,624
Growth (%)	14.7	31.9	23.2	19.7
Shares outstanding (mn)	602.2	602.2	602.2	602.2
FDEPS (Rs) (adj)	55.2	72.8	89.7	107.3
Growth (%)	11.8	31.9	23.2	19.7
DPS (Rs)	12.5	12.5	12.5	12.5

Cash flow statement

Y/E March (Rs mn)	FY10	FY11E	FY12E	FY13E
Net income + Depreciation	33,274	40,320	49,261	61,380
Non-cash adjustments				
Changes in working capital	(29,172)	(8,787)	(42,784)	(45,051)
Cash flow from operations	4,101	31,533	6,477	16,330
Capital expenditure	(35,993)	(30,000)	(25,000)	(25,000)
Change in investments	2,190	-	-	-
Other investing cash flow	31,016	11,735	14,484	14,728
Cash flow from investing	(2,788)	(18,265)	(10,516)	(10,272)
Issue of equity	15,865	2,033	2,339	3,078
Issue/repay debt	43,080	18,419	18,419	18,419
Dividends paid	(8,778)	(8,780)	(8,780)	(8,780)
Other financing cash flow	-	-	-	-
Change in cash & cash eq	51,481	24,940	7,939	18,774
Closing cash & cash eq	118,813	143,195	151,133	169,908

Economic Value Added (EVA) analysis

Y/E March	FY10	FY11E	FY12E	FY13E
WACC (%)	9.3	9.6	9.8	10.1
ROIC (%)	17.1	16.8	17.7	18.0
Invested capital (Rs mn)	515,468	598,619	687,168	803,722
EVA (Rs mn)	39,969	43,091	54,357	63,189
EVA spread (%)	7.8	7.2	7.9	7.9

Balance sheet

Y/E March (Rs mn)	FY10	FY11E	FY12E	FY13E
Cash and cash eq	118,813	143,195	151,133	169,908
Accounts receivable	125,280	173,390	213,885	256,227
Inventories	97,186	90,981	111,868	134,584
Other current assets	161,328	161,262	197,856	239,053
Investments	13,681	13,681	13,681	13,681
Gross fixed assets	109,580	139,580	164,580	189,580
Net fixed assets	79,558	101,301	116,536	130,020
CWIP	41,147	41,147	41,147	41,147
Intangible assets	69,084	69,084	69,084	69,084
Deferred tax assets, net	(21,043)	(21,022)	(20,997)	(20,966)
Other assets	-	-	-	-
Total assets	685,035	773,019	894,192	1,032,737
Accounts payable	116,996	123,784	151,660	181,916
Other current liabilities	95,950	118,503	141,550	167,591
Provisions	24,743	28,454	32,722	37,631
Debt funds	229,804	248,223	266,642	285,061
Other liabilities	10,873	11,735	12,904	14,443
Equity capital	1,204	1,204	1,204	1,204
Reserves & surplus	205,214	241,114	287,509	344,892
Shareholder's funds	206,418	242,319	288,714	346,096
Total liabilities	685,035	773,019	894,192	1,032,737
BVPS (Rs)	227.5	287.7	364.7	460.0

Financial ratios

Y/E March	FY10	FY11E	FY12E	FY13E
Profitability & Return ratios (%)				
EBITDA margin	13.9	13.5	13.2	13.4
EBIT margin	13.8	14.2	14.0	13.8
Net profit margin	7.4	8.1	8.1	8.1
ROE	31.2	28.2	27.5	26.0
ROCE	11.9	12.8	13.5	13.8
Working Capital & Liquidity ratios				
Receivables (days)	105	120	120	120
Inventory (days)	105	81	81	81
Payables (days)	126	110	110	110
Current ratio (x)	2.1	2.1	2.1	2.1
Quick ratio (x)	2.1	2.6	2.4	2.3
Turnover & Leverage ratios (x)				
Gross asset turnover	6.0	6.0	6.3	6.3
Total asset turnover	1.3	1.3	1.4	1.4
Interest coverage ratio	8.7	7.5	8.4	9.3
Adjusted debt/equity	1.9	1.6	1.3	1.1
Valuation ratios (x)				
EV/Sales	2.5	2.1	1.7	1.4
EV/EBITDA	18.3	15.5	12.8	10.6
P/E	30.2	22.9	18.6	15.5
P/BV	7.3	5.8	4.6	3.6



Quarterly trend

Particulars	Q3FY10	Q4FY10	Q1FY11	Q2FY11	Q3FY11
Revenue (Rs mn)	81,456	135,850	78,853	93,308	114,131
YoY growth (%)	(6.3)	27.8	6.4	17.7	40.3
QoQ growth (%)	2.6	65.7	(41.4)	18.2	22.3
EBITDA (Rs mn)	10,068	20,507	10,071	10,057	12,379
EBITDA margin (%)	12.4	15.1	12.8	10.8	10.8
Adj net income (Rs mn)	6,963	12,934	6,662	6,941	8,052
YoY growth (%)	15.3	13.2	24.7	25.5	15.6
QoQ growth (%)	25.9	85.8	(48.5)	4.2	16.0

DuPont analysis

(%)	FY09	FY10	FY11E	FY12E	FY13E
Tax burden (Net income/PBT)	0.7	0.6	0.7	0.7	0.7
Interest burden (PBT/EBIT)	0.9	0.9	0.9	0.9	0.9
EBIT margin (EBIT/Revenues)	11.8	13.8	14.2	14.0	13.8
Asset turnover (Revenues/Avg TA)	1.6	1.3	1.3	1.4	1.4
Leverage (Avg TA/Avg equity)	3.3	3.3	2.8	2.5	2.3
Return on equity	36.3	31.2	28.2	27.5	26.0

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.

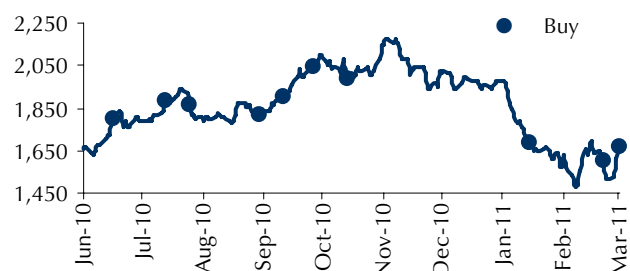
Shareholding pattern

(%)	Jun-10	Sep-10	Dec-10
Promoters	-	-	-
FIs	18.9	21.0	21.3
Banks & FIs	38.4	37.3	37.2
Public	42.7	41.7	41.5

Recommendation history

Date	Event	Reco price	Tgt price	Reco
24-Jun-10	Initiating Coverage	1,799	2,100	Buy
15-Jul-10	Company Update	1,877	2,100	Buy
27-Jul-10	Results Review	1,861	2,100	Buy
1-Sep-10	Company Update	1,814	2,100	Buy
14-Sep-10	Company Update	1,908	2,100	Buy
28-Sep-10	Company Update	2,047	2,100	Buy
18-Oct-10	Results Review	2,016	2,330	Buy
17-Jan-11	Results Review	1,680	2,330	Buy
23-Feb-11	Quarterly Review	1,601	2,250	Buy
03-Mar-11	Company Update	1,665	2,250	Buy

Stock performance





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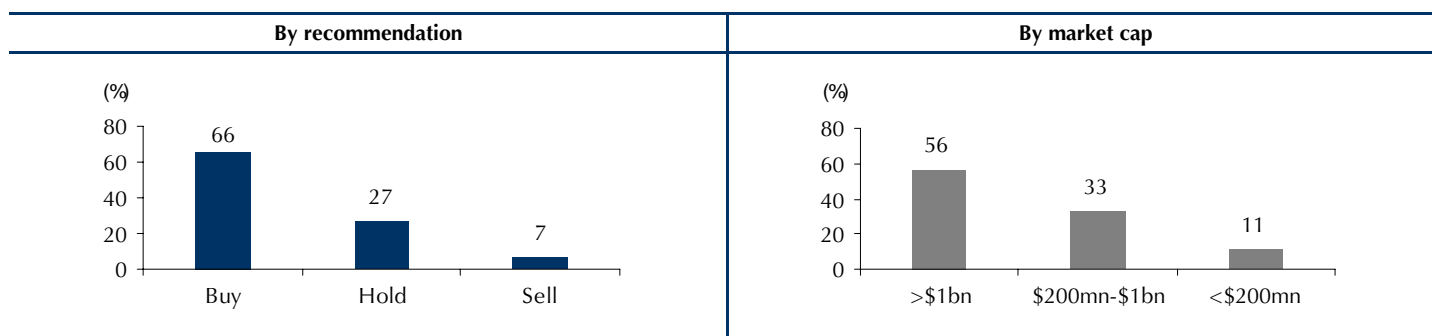
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Recommendation	Expected absolute returns (%) over 12 months
Buy	More than 15%
Hold	Between 15% and -5%
Sell	Less than -5%

Recommendation structure changed with effect from March 1, 2009

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