

Larsen & Toubro

BSE Sensex 19,924	S&P CNX 6,019
Bloomberg	LT IN
Equity Shares (m)	608.9
M.Cap. (INR b)/(USD b)	965/18
52-Week Range (INR)	1,720/971
1,6,12 Rel. Perf. (%)	-3/24/11

CMP: INR1,586
TP: INR1,870
Buy

Financials & Valuation (INR b)

Y/E March	2013E	2014E	2015E
Sales	623.7	725.4	850.1
EBITDA	67.1	82.3	99.5
Adj PAT *	50.5	56.0	68.0
EPS (INR)*	82.5	91.5	111.1
EPS Gr. (%)	5.8	10.8	21.4
BV/Sh (INR)	470.4	532.8	608.6
RoE (%)	16.6	16.5	17.5
RoCE (%)	13.5	13.6	14.7
Payout (%)	29.3	28.9	28.9

Valuation

P/E (x)*	19.2	17.3	14.3
P/BV (x)	3.4	3.0	2.6
EV/EBITDA (x)	15.0	12.5	10.5
Div Yield (%)	1.2	1.4	1.7

* Consolidated

- Operating performance below expectations:** While Larsen and Toubro's (LT) operating performance for 3QFY13 was significantly below expectations, the key positives are continued strong order inflows (INR195b; up 14% YoY) and positive cash flow from operations. Adjusted EBITDA margin declined 84bp YoY in 3QFY13, impacted by lower sales and poor fixed cost absorption. Adjusted net profit declined 7.8% YoY to INR10.4b (below our estimate of INR11.4b).
- Order intake - key positive surprise:** Order intake at INR195b (up 14% YoY), in line with the quarterly run-rate of INR200b during the last four quarters, supported by robust 22% contribution from overseas business (v/s 23.7% in 2QFY13), surprising positively as the announced order intake (through press releases) was just INR98b. Management mentioned about improving order pipeline while strategy on overseas business seems to be playing out.
- E&C revenue moderated due to slower order inflow during FY12:** E&C revenue in the domestic market declined 6.2% in 3QFY13 against 13.3% growth in 1HFY13 due to (1) sluggish order inflow during FY12, impacting execution with a lag of ~4 quarters, (2) passing of peak execution of large hydrocarbon orders in the domestic E&C business, (3) increasing share of slow moving orders (largely domestic) from 10% in mid-FY12 to ~14% now.
- Management maintains FY13 guidance:** The management maintained its guidance of 15-20% growth in revenue/order intake and +/-50bp change in E&C EBITDA margin in FY13.
- Valuation and view:** We maintain **Buy** with a revised SOTP-based target price of INR1,870 (18% upside). We value L&T standalone at 14x FY15E earnings and subsidiaries at INR377/share.

Quarterly Performance (Standalone)

Y/E March	FY12				FY13				FY12	FY13E	FY13	% YoY
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4QE				
Net Sales	94,826	112,442	139,836	184,609	119,554	131,952	154,294	211,307	531,705	617,107	161,466	-4%
Change (%)	21.1	20.5	22.5	21.0	26.1	17.4	10.3	14.5	21.1	16.1	15.5	
EBITDA	11,265	12,165	13,677	25,608	10,870	14,054	14,751	27,401	62,826	67,076	17,600	-16%
Change (%)	12.1	21.0	10.5	9.3	-3.5	15.5	7.9	7.0	11.4	6.8	29.0	
Margin (%)	11.9	10.8	9.8	13.9	9.1	10.7	9.6	13.0	11.8	10.9	10.9	
Adjusted EBITDA	11,265	12,165	15,677	25,608	12,470	14,054	16,001	27,401	64,826	69,926	17,600	-9%
Adjusted Margin (%)	11.9	10.8	11.2	13.9	10.4	10.7	10.4	13.0	12.2	11.3	10.9	
Depreciation	1,679	1,709	1,803	1,804	1,919	2,040	2,004	2,234	6,995	8,196	2,100	-5%
Interest	1,613	1,970	1,907	1,211	2,284	2,350	2,380	2,186	6,661	9,200	2,300	3%
Other Income	2,962	3,201	4,236	3,142	6,058	3,294	5,302	2,502	13,383	17,156	2,850	86%
Extraordinary Inc/(Exp)	0	0	0	550	-383	2,672	0	0	550	2,289	0	
Reported PBT	10,935	11,687	14,202	26,285	12,341	15,630	15,669	25,484	63,103	69,124	16,050	-2%
Tax	3,474	3,703	4,286	6,988	3,705	4,257	4,450	7,308	18,538	19,719	4,654	-4%
Effective Tax Rate (%)	31.8	31.7	30.2	26.6	30.0	27.2	28.4	28.7	29.4	28.5	29.0	
Reported PAT	7,461	7,984	9,916	19,297	8,636	11,373	11,219	18,177	44,565	49,405	11,395	-2%
Adjusted PAT	7,461	7,984	11,276	18,747	10,025	9,151	10,394	18,208	44,825	47,777	11,395	-9%
Change (%)	12.0	15.0	40.0	22.7	34.4	14.6	-7.8	-2.9	23.7	6.6	1.1	
Adj PAT (excl Subs Dividend)	6,901	7,094	9,086	18,237	7,105	8,521	9,464	17,872	40,745	42,962	10,945	
Change (%)	12.0	10.6	19.5	26.2	2.9	20.1	4.2	-2.0	20.0	5.4	20.5	
Order Intake	162	161	171	212	196	210	195	219	706	820	130	
Order book (INR b)	1,362	1,422	1,464	1,457	1,531	1,585	1,623	1,659	1,457	1,659	1,554	
BTB (x)	3.0	3.0	2.9	2.7	2.8	2.8	2.7	2.7	3.3	2.7	2.6	

E: MOSL Estimates

Satyam Agarwal (AgarwalS@MotilalOswal.com); +91 22 3982 5410

Deepak Narnolia (Deepak.Narnolia@MotilalOswal.com); +91 22 3029 5126

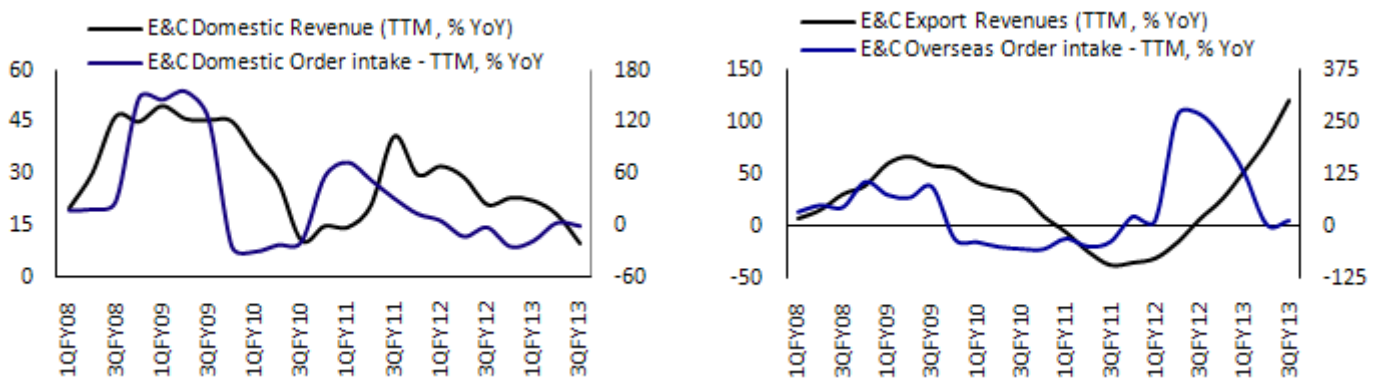
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Investors are advised to refer through disclosures made at the end of the Research Report.

Domestic E&C revenue impacted, given sluggish order intake in FY12

- Domestic E&C revenue declined 6.2% in 3QFY13 against 13.3% growth in 1HFY13. This was largely due to constrained macro environment, which led to 25% decline in E&C order intake during FY12, impacting execution with a lag of ~4 quarters.
- In exports, order intake was robust (up 58%) in FY12, favorably impacting execution in FY13 (up 121% YoY TTM).
- Sales decline of 6.2% in domestic market led to moderate 11% revenue growth in E&C business (which was supported by strong 191% growth in exports). We will be watchful of the trends and believe that there are increased possibilities of disappointments in execution, particularly in 1HFY14.

Revenue lagging order intake by four quarters

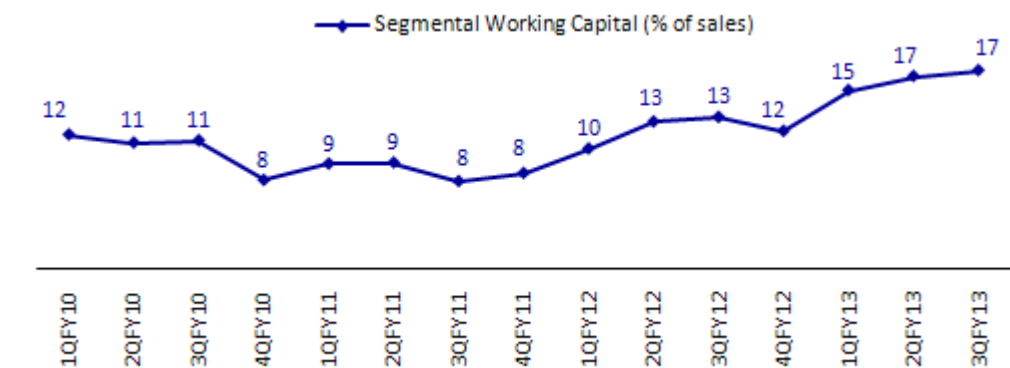


Source: Company, MOSL

Net working capital remains under pressure, but trend of sharp increase has moderated

- Net working capital (NWC) remains under pressure at 17% of sales, up from 11.9% as at the end of FY12, given increased support to vendors. Having said that, we believe that the trend of significant increase seen during 1QFY13 has been curtailed and this is comforting. We expect segmental NWC to peak at current levels of ~17% by the end of FY13.
- Gross borrowings have declined to INR110b (from INR120b in 2QFY13). Net debt has declined to INR43b v/s INR48b in 2QFY13 and INR44b in 1QFY13.

Working capital under strain in a tight liquidity environment



Source: Company, MOSL

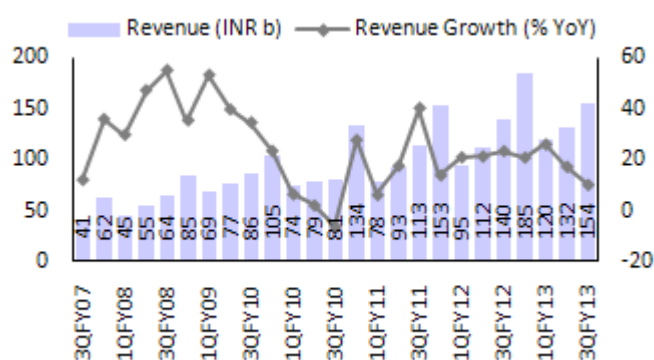
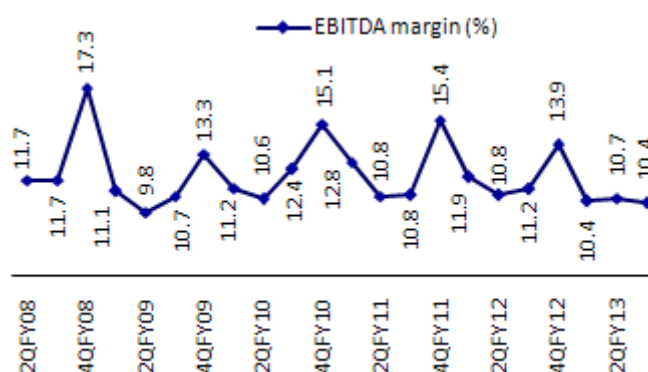
Balance Sheet (INR m)

	FY11	FY12	1QFY13	2QFY13	3QFY13
Net worth	218,460	252,230	260,030	273,920	285,710
Non Current liabilities	59,790	61,140	63,390	68,180	70,190
Current Liabilities	292,820	363,200	368,800	351,910	349,930
Total Sources	571,070	676,570	692,220	694,010	705,830
Fixed Assets	74,160	83,640	85,940	87,390	87,690
Investment/adv to subs	106,000	127,530	140,130	140,440	136,950
Cash and liquid investments	90,140	86,920	69,260	72,210	67,080
Current assets	300,770	378,480	396,890	393,970	414,120
Total Applications	571,070	676,570	692,220	694,010	705,840

Source: Company, MOSL

Adjusted EBITDA margin down 84bp YoY, adjusted PAT down 8%

- Adjusted EBITDA margin declined 84bp YoY in 3QFY13, impacted by lower sales and poor fixed cost absorption. In 3QFY13, E&C EBITDA margin declined 110bp (to 10.4% v/s 11.5% in 3QFY12) while over 9MFY13, E&C EBITDA margin declined 60bp YoY (to 11.1% v/s 11.7% in 9MFY12). The decline is marginally higher than the lower band of the annual guidance of +/-50bp for FY13.
- Machinery and Industrial Product (MIP) margins declined 230bp YoY to 18%, impacted by slower product sales while E&E business improved (EBITDA margin up 330bp), driven by better price realizations and favorable product mix.
- Adjusted net profit declined 7.8% YoY to INR10.4b (below our estimate of INR11.4b).
- 3QFY13 numbers include MTM provisions of INR1.25b on forex debt of ~USD300m and capital gains of INR2b on property sale.

Revenue growth impacted, given constrained execution**Adjusted EBITDA margin down**

Source: Company, MOSL

Segmental details (INR m): E&C EBITDA margin down 104bp

	FY12				FY13			% YoY*	FY12
	1Q	2Q	3Q	4Q	1Q	2Q	3Q		
Revenues									
Engineering & Construcion	80,994	97,941	125,259	167,085	105,584	116,691	138,818	11%	469,788
Electrical & Electronics	7,462	8,478	8,420	11,435	7,603	8,803	8,865	5%	35,794
Machinery & Industrial	6,904	6,037	6,449	8,169	5,067	5,508	5,932	-8%	28,538
Others	1,989	2,221	2,671	2,749	3,630	3,320	3,383	27%	9,630
Revenue Growth YoY %									
Engineering & Construcion	22.8	22.2	25.2	22.3	30.4	19.1	10.8		22.9
Electrical & Electronics	0.5	26.1	5.9	14.2	1.9	3.8	5.3		11.5
Machinery & Industrial	26.3	(13.5)	(5.3)	(5.7)	(26.6)	(8.8)	(8.0)		2.2
Others	65.6	39.1	58.8	30.6	82.5	49.5	26.7		46.0
EBIT margin (%)									
Engineering & Construcion	10.0	10.7	10.3	13.6	9.4	10.8	9.2	-108bp	11.5
Electrical & Electronics	8.3	8.4	8.5	13.9	10.3	8.3	11.1	264bp	10.2
Machinery & Industrial	17.7	16.0	19.0	16.3	13.5	12.6	27.1	814bp	17.2
Others	21.2	21.5	25.4	11.8	28.7	20.5	42.9	1745bp	19.8
EBIDTA margin (%)									
Engineering & Construcion	11.7	11.9	11.4	14.3	10.7	12.1	10.3	-104bp	12.6
Electrical & Electronics	9.5	9.3	9.5	13.9	10.7	9.9	12.4	291bp	10.9
Machinery & Industrial	19.0	17.1	21.6	17.3	16.2	13.6	16.7	-487bp	18.4
Others	23.1	23.9	27.7	14.2	30.6	22.9	22.5	-524bp	21.9

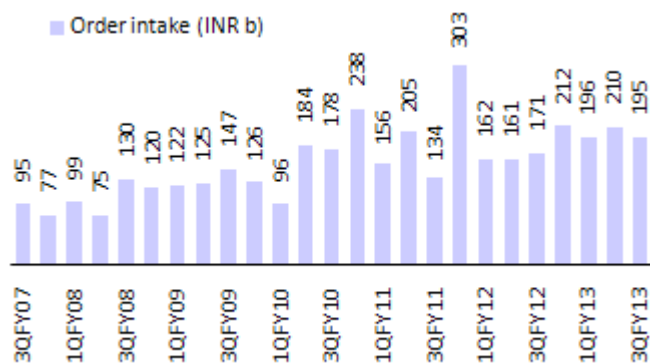
* for margins bp

Source: Company, MOSL

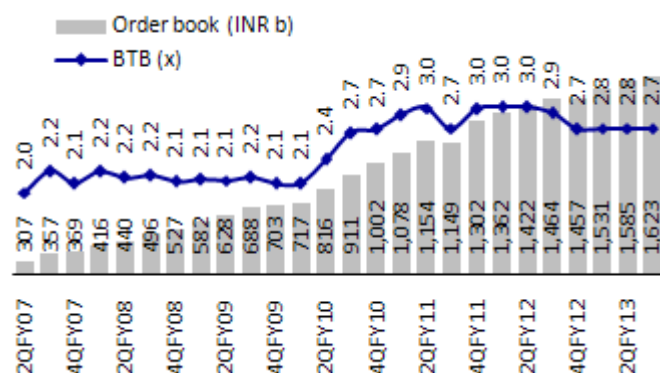
Order intake robust; overseas markets contribute 22% of intake in 3QFY13

- Order intake in 3QFY13 was a robust INR195b (up 14% YoY), in line with the quarterly trend of INR200b in the last four quarters. We are positively surprised, as the announced order intake (through press releases) was just INR98b. International business contributed 22% of the intake in 3Q, similar to 23.7% in 2QFY13. However, we still await greater clarity on the INR35b-40b each of exports and domestic projects, included in the order intake. Also, this is the highest gap between reported and announced orders in the last several quarters.
- The management stated that incrementally, the order pipeline has shown some signs of improvement, particularly in hydrocarbons, power, railways, fertilizers, etc. Even the strategy on the overseas business seems to be playing out, with new geographies (apart from the Middle East) contributing 38% of the export orders in 9MFY13.

Order intake robust (INR b)



Order book to bill (BTB) at 2.8x TTM



Source: Company, MOSL

Cutting estimates; maintain Buy

- The management maintained its guidance of 15-20% growth in revenue/order intake and +/-50bp change in E&C EBITDA margin in FY13. We model 16% growth in revenue/order intake and 62bp E&C EBITDA margin for FY13.
- We cut our FY13/FY14E consolidated EPS by 7% / 5% to model constraints in execution and poor fixed cost absorption. Adjusted for dividend income from subsidiaries, standalone EPS for FY12 was INR67 (up 11%). For FY13 / FY14, we expect standalone EPS (net of dividend from subsidiaries) to increase at 10% CAGR till FY14 (INR70 in FY13 / INR81 in FY14). We model revenue CAGR of 16% / E&C margin decline of 112bp over FY12-14. Consolidated EPS stands at INR83 (up 6%) for FY13, INR92 (up 11%) for FY14 and INR111 (up 21%) for FY15.
- We maintain **Buy** with a revised SOTP-based target price of INR1,870 (18% upside). We value L&T standalone at 14x FY15E earnings and subsidiaries at INR377/share.

Larsen & Toubro: an investment profile

Company description

Larsen and Toubro (LT) is India's largest engineering and construction (E&C) company. Apart from its core construction activity, LT is making significant inroads into a diverse range of products and services through its subsidiaries and manufacturing JVs in power BTG, forging and shipbuilding. The company is also involved in various developmental projects on BOT basis in roads, ports, railways and power. Exports contribute ~18% of the order intake.

Key investment arguments

- LT is well placed to capitalize on long-term infrastructure demand. Its order backlog is worth INR1,623b implying BTB ratio of 2.7x TTM. We believe LT is the best play on capex with its strong execution skills, diversified portfolio and strong balance sheet.
- LT's operational performance continues to be encouraging in a challenging environment. Revenue growth is robust, with the management guiding FY13 growth at 15-20%, on the back of 21% growth in FY12.

Key investment risks

- Working capital has increased over last 2-3 quarters, driven by tightened liquidity. Also, significant part of LT's capital is tied up in manufacturing JVs and infrastructure concession projects that are yet to show meaningful returns.

- An unfavorable political climate and logjams relating to project clearances stifle fresh order intake growth, hampering earnings growth.

Recent developments

- LT has restructured its IT and L&T Integrated Engineering Services (IES) businesses with a view to accelerate growth in the technology space. L&T Infotech has been reorganized around two business clusters, "Industrial" and "Services", and the current IES will be rebranded as L&T Technology Services.
- Media reports are making the rounds that Adani Group has agreed to buy 100% equity in Dhamra Port for an enterprise value of INR55b. However, none of the parties have confirmed such a deal.

Valuation and view

- We expect standalone EPS (net of dividend from subsidiaries) to increase at 10% CAGR till FY14 (INR70 in FY13 / INR81 in FY14). We model revenue CAGR of 16% / E&C margin decline of 112bp over FY12-14.
- We maintain **Buy**, with a revised SOTP-based target price of INR1,870. We value LT standalone at 14x FY15E earnings and subsidiaries at INR377/share.

Sector view

- We maintain our **Neutral** view on the sector.

Comparative valuations

		L&T	BHEL	Thermax
P/E (x)	FY13E	19.2	9.3	21.9
	FY14E	17.3	12.7	19.5
P/BV (x)	FY13E	3.4	1.9	3.6
	FY14E	3.0	1.7	3.2
EV/Sales (x)	FY13E	1.6	1.1	1.1
	FY14E	1.4	1.2	0.9
EV/EBITDA (x)	FY13E	15.0	5.9	13.3
	FY14E	12.5	7.3	10.1

Shareholding pattern (%)

	Dec-12	Sep-12	Dec-11
Promoter	0.0	0.0	0.0
Domestic Inst	36.8	37.8	37.8
Foreign	21.0	19.5	17.9
Others	42.3	42.7	44.3

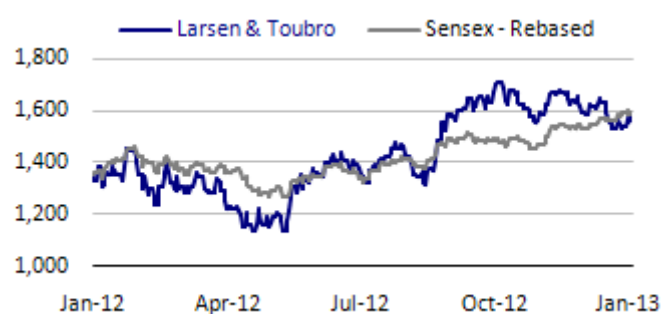
EPS: MOSL forecast v/s consensus (INR)

	MOSL Forecast	Consensus Forecast	Variation (%)
FY13	82.5	84.8	-2.7
FY14	91.5	95.5	-4.2

Target price and recommendation

Current Price (INR)	Target Price (INR)	Upside (%)	Reco.
1,586	1,870	17.9	Buy

Stock performance (1 year)



Financials and Valuation

Income Statement		(INR Million)			
Y/E March	2012	2013E	2014E	2015E	
Total Revenues	537,378	623,690	725,364	850,099	
Growth Rate (%)	21.3	16.1	16.3	17.2	
Excise Duty	5,673	6,584	7,657	8,974	
Net Revenues	531,705	617,107	717,707	841,125	
Growth Rate (%)	21.1	16.1	16.3	17.2	
Manufacturing Expenses	410,202	484,053	561,257	657,945	
Staff Cost	36,635	41,031	45,134	49,647	
S G & A Expenses	22,230	24,948	29,015	34,004	
EBITDA	62,639	67,076	82,302	99,529	
Change (%)	11.3	7.1	22.7	20.9	
EBITDA Margin (%)	12.2	10.9	11.5	11.8	
Depreciation	6,817	8,196	9,219	10,549	
EBIT	55,822	58,879	73,083	88,980	
Net Interest	6,661	9,200	9,800	9,800	
Other Income	13,078	15,156	12,870	13,385	
Non-recurring Other Inco	305	2,000	0	0	
Add: Trf to Rev. Res.	10	10	10	10	
Share from Subsidiaries	0	0	0	0	
Profit before Tax	62,554	66,846	76,163	92,574	
Tax	18,538	19,719	22,468	27,309	
Effective Tax Rate (%)	29.6	29.5	29.5	29.5	
Reported Profit	44,566	49,415	53,695	65,265	
EO Adjustments	550	2,289	0	0	
Adjusted Profit	44,826	47,777	53,695	65,265	
Cons. Profit (Adj)	47,730	50,511	55,976	67,980	
Growth (%)	12.5	5.8	10.8	21.4	

Balance Sheet		(INR Million)			
Y/E March	2012	2013E	2014E	2015E	
Equity Capital	1,224	1,224	1,224	1,224	
Reserves and Surplus	251,005	286,630	324,828	371,255	
Net Worth	252,229	287,854	326,052	372,479	
Debt	98,958	115,000	120,000	120,000	
Deferred Tax Liability	1,330	1,330	1,330	1,330	
Capital Employed	352,517	404,184	447,382	493,810	
Gross Fixed Assets	105,544	128,631	148,631	168,631	
Less : Depreciation	29,495	37,692	46,911	57,459	
Add : Capital WIP	7,587	4,500	4,500	4,500	
Net Fixed Assets	83,636	95,440	106,221	115,672	
Investments	158,719	140,870	159,631	187,539	
Inventory	17,766	18,513	21,531	25,234	
Sundry Debtors	187,298	234,501	272,729	319,628	
Cash & Bank	17,781	45,864	38,257	20,078	
Loans & Advances	91,280	103,845	114,304	126,445	
Other Current Assets	120,448	137,035	159,167	186,319	
Current Assets	434,574	539,758	605,988	677,703	
Current Liabilities	324,411	371,883	424,458	487,104	
Net Current Assets	110,163	167,875	181,530	190,599	
Capital Deployed	352,518	404,184	447,382	493,810	

E: MOSL Estimates

Ratios					
Y/E March	2012	2013E	2014E	2015E	
Basic (INR)					
Adjusted EPS	73.2	78.1	87.7	106.6	
Growth (%)	23.0	6.6	12.4	21.5	
Consolidated EPS	78.0	82.5	91.5	111.1	
Growth (%)	11.9	5.8	10.8	21.4	
Con. EPS (Fully Diluted)	78.0	82.5	91.5	111.1	
Growth (%)	11.9	5.8	10.8	21.4	
Cash Earning per Share	84.7	91.5	102.8	123.9	
Book Value	412.1	470.4	532.8	608.6	
Dividend Per Share	16.5	19.5	21.9	26.7	
Div. Payout (Incl. Div Tax)	25.3	29.3	28.9	28.9	
Valuation (x)					
P/E (Standalone)	19.7	20.3	18.1	14.9	
P/E (Consolidated)	18.5	19.2	17.3	14.3	
Price / CEPS	18.7	17.3	15.4	12.8	
EV/EBITDA	14.3	15.0	12.5	10.5	
EV/ Sales	1.7	1.6	1.4	1.2	
Price / Book Value	3.5	3.4	3.0	2.6	
Dividend Yield	1.1	1.2	1.4	1.7	
Return Ratio (%)					
RoE	17.8	16.6	16.5	17.5	
RoCE	14.1	13.5	13.6	14.7	
Turnover Ratios					
Debtors (Days)	127.2	137.2	137.2	137.2	
Inventory (Days)	12.1	10.8	10.8	10.8	
Asset Turnover (x)	1.5	1.5	1.6	1.7	
Leverage Ratio					
Current Ratio (x)	1.3	1.5	1.4	1.4	
D/E (x)	0.0	0.1	0.2	0.2	

Cash Flow Statement		(INR Million)			
Y/E March	2012	2013E	2014E	2015E	
PBT before EO Items	62,554	66,846	76,163	92,574	
Add : Depreciation	7,005	8,196	9,219	10,549	
Interest	6,661	9,200	9,800	9,800	
Less : Direct Taxes Paid	18,538	19,719	22,468	27,309	
(Inc)/Dec in WC	-34,431	-28,772	-20,401	-28,019	
CF from Operations	23,250	35,750	52,313	57,595	
(Inc)/Dec in FA	-16,487	-20,000	-20,000	-20,000	
(Pur)/Sale of Investment	4,108	39,028	10,000	0	
Investment in subs	-15,979	-21,179	-28,761	-27,907	
Advances to subs	-4,703	-3,527	-2,569	-2,569	
CF from Investments	-33,061	-5,678	-41,331	-50,477	
(Inc)/Dec in Net Worth	-979	0	0	0	
(Inc)/Dec in Debt	27,347	16,042	5,000	0	
Less : Interest Paid	6,661	9,200	9,800	9,800	
Dividend Paid	9,962	11,119	13,790	15,498	
CF from Fin. Activity	9,745	-4,277	-18,590	-25,298	
Inc/Dec of Cash	483	28,084	-7,608	-18,179	
Add: Beginning Balance	17,296	17,781	45,864	38,257	
Closing Balance	17,779	44,095	39,634	21,455	

E: MOSL Estimates

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In respect of any matter arising from or in connection with the research you could contact the following representatives of Motilal Oswal Capital Markets Singapore Pte Limited:

Nihar Oza

Email: niharoza.sg@motilaloswal.com

Contact: (+65) 68189232

Kadambari Balachandran

Email: kadambari.balachandran@motilaloswal.com

Contact: (+65) 68189233 / 65249115

Office address: 21 (Suite 31), 16 Collyer Quay, Singapore 049318



Motilal Oswal Securities Ltd

Motilal Oswal Tower, Level 9, Sayani Road, Prabhadevi, Mumbai 400 025

Phone: +91 22 3982 5500 E-mail: reports@motilaloswal.com