

Strong Q1 orders; sustainability a key concern

First Look

L&T has announced orders worth INR157bn in 1QFY13 so far (excluding an order from Sadara Chemical Company, Saudi Arabia, for which the order value has not been disclosed). Historically, disclosed order proportion has been 60-80% of a total quarter's inflows, and thus the company could potentially end 1QFY13 with INR200-250bn worth of overall inflows. The risk, though, remains that the share of disclosed orders in 1QFY13 is higher than in prior quarters. Nevertheless, even with L&T ending up in excess of INR160bn for 1QFY13 inflows, it would be seen positively by the markets in our view. In the recent past, 1QFY13 orders have been ~23-24% of reported full-year inflows for the company; however, this year, we believe, 1QFY13 has witnessed higher order activity due to a carry-over of orders delayed from the previous year. As such, the adjusted full-year run-rate seems to be between INR670-800bn, which is higher than our current FY13 estimate of INR694bn.

Over the past few quarters and especially in 1QFY13, we note that order inflow has been primarily driven by sectors such as building and factories, roads and power T&D.

Fig. 1: Sector-wise breakup of order inflow

INR bn	2007	2008	2009	2010	2011	2012	Q1FY13	FY13 Company Guidance
Hydrocarbon	46	105	62	139	56	93	-	150
Infrastructure	129	130	202	188	303	324	125	325
Transportation							64	100
Roads							58	
Railways							6	
Airport							-	
Urban Infra (Buildings & Factories)							50	200
Water							6	25
Other							5	
Power	37	59	130	230	255	148	29	200
Process	43	63	83	91	128	78	3	50
Other	52	63	41	49	56	64		75
Total	306	420	518	696	798	706	157	800

Note: Order from Sidara Chemical Company is not included. Orders from Amravati-Jalgaon and Jalgaon-Surat considered worth INR38bn (net of Interest-during-construction and other charges from the BOT project cost)

Source: Company data, Nomura research

We also highlight below a chartbook on IIP data, cement dispatch numbers and their correlation with L&T in the past. While we note a very strong correlation between cement dispatch volumes and L&T order inflow (both y-y growth trends), L&T's inflows relate only modestly to the IIP data. We also map L&T's valuation, with IIP data and 10-year G-sec bond yield, and find a strong correlation with bond yield rather than IIP data, suggesting that any upcoming rate cut might potentially lead to compression in valuation multiples; this follows from our strategist's arguments that cut in interest rates may not be a panacea for falling IIP and, consequently, order inflow. Below we highlight two phases where interest rates were falling but it was accompanied by a fall in growth rates (please refer to Fig. 1). Also, historical evidence suggests that falling rates, by themselves, are neither necessary nor sufficient for market/L&T rerating.

July 6, 2012

Rating
Remains **Reduce**

Target price
Remains **INR 992**

Closing price
July 5, 2012 **INR 1428**

Research analysts

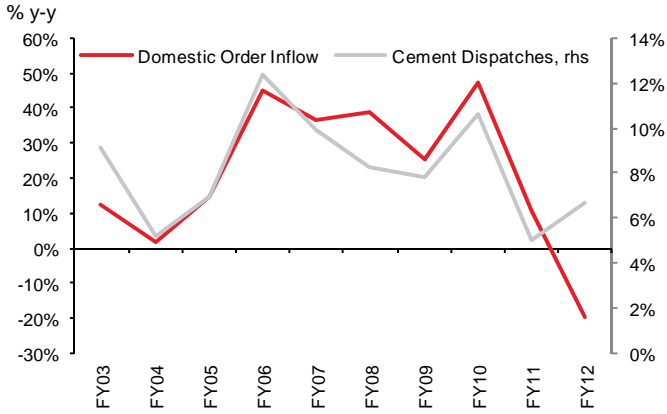
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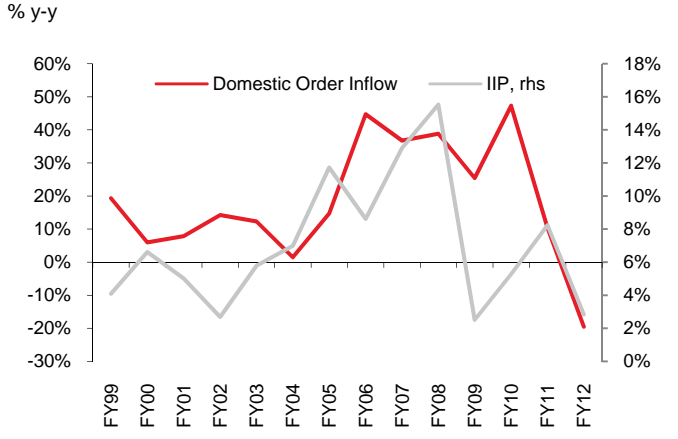
See Appendix A-1 for analyst certification, important disclosures and the status of non-US analysts.

Fig. 2: L&T's domestic orders are highly correlated with cement dispatch data



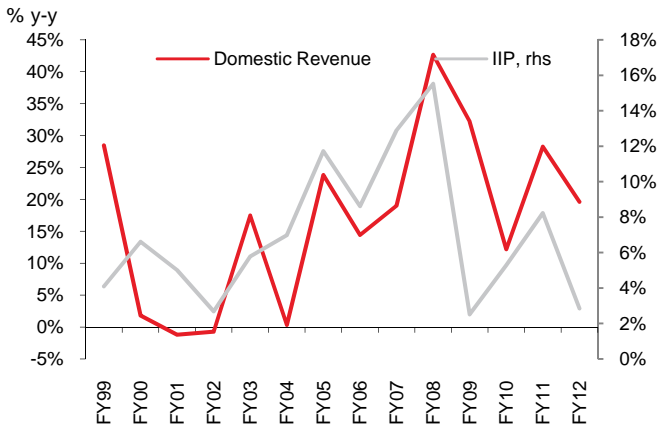
Source: Company data, Nomura research

Fig. 3: Domestic order inflows follow IIP growth



Source: RBI, Company data, Bloomberg

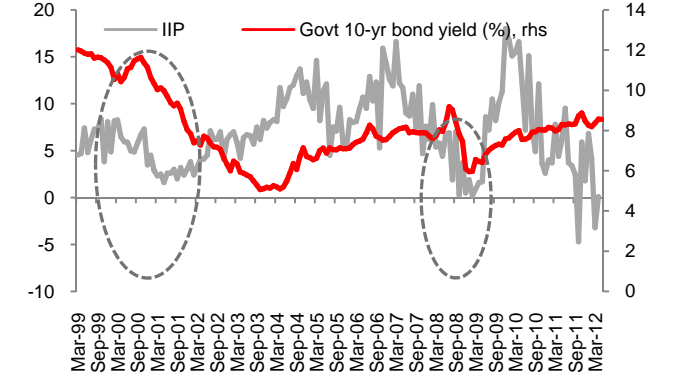
Fig. 4: Domestic revenues relate modestly to IIP data



Source: RBI, Company data, Bloomberg

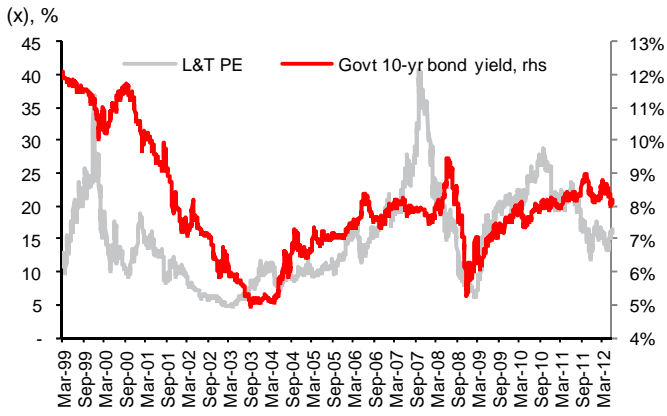
Fig. 5: Bond yields vs growth

The encircled portions in this chart show episodes of falling interest rates. In both cases, falling rates were accompanied by weak growth



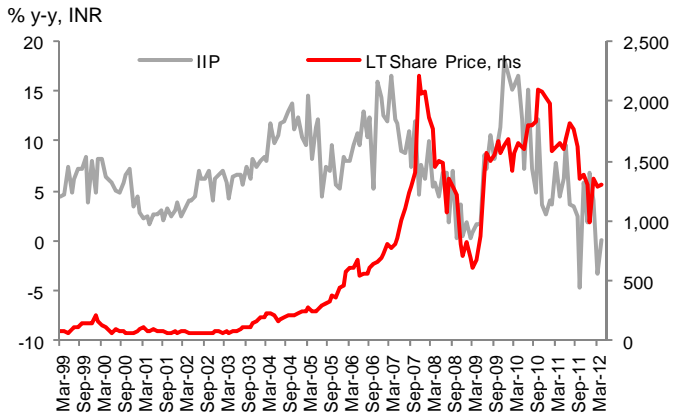
Source: RBI, Company data, Bloomberg

Fig. 6: L&T earnings multiple vs bond yields



Source: RBI, Company data, Bloomberg

Fig. 7: LT stock performance relates with IIP growth



Source: RBI, Company data, Bloomberg

Appendix A-1

Analyst Certification

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A5 A Nomura Group Company has received compensation for investment banking services from the issuer in the past 12 months.

A6 A Nomura Group Company expects to receive or intends to seek compensation for investment banking services from the issuer in the next three months.

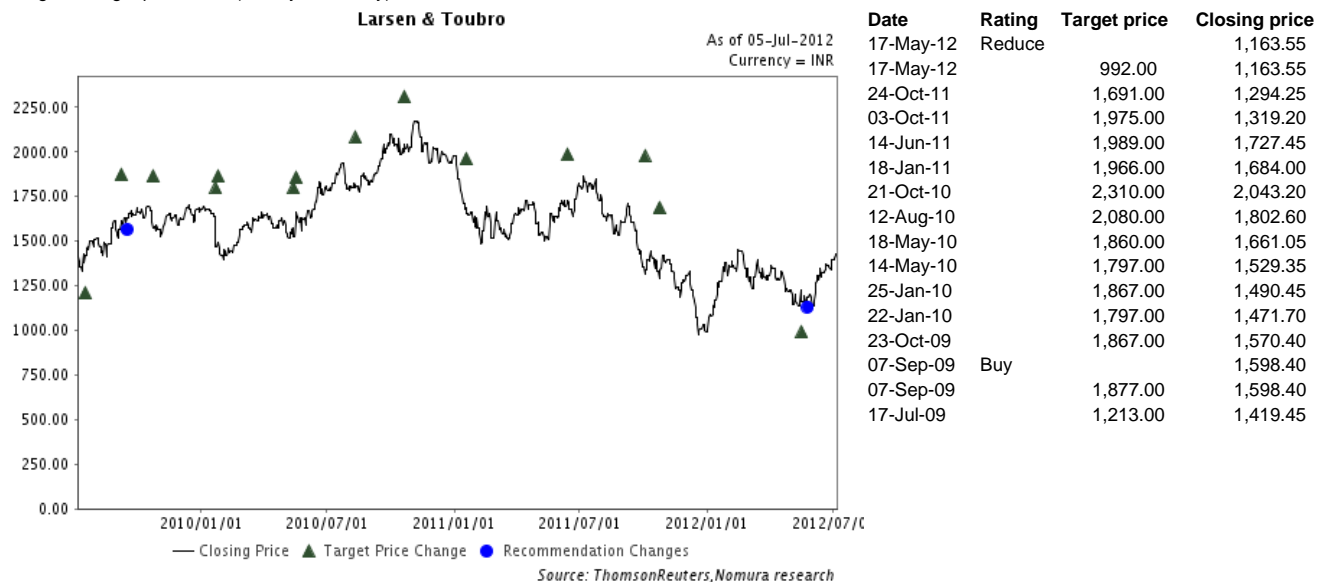
Previous Rating

Issuer name	Previous Rating	Date of change
Larsen & Toubro	Buy	17-May-2012

Larsen & Toubro (LT IN)

INR 1428 (05-Jul-2012) Reduce (Sector rating: Not rated)

Rating and target price chart (three year history)



For explanation of ratings refer to the stock rating keys located after chart(s)

Valuation Methodology We value the stand-alone business at 10x one-year forward earnings, average of previous downcycle trading range (FY99-FY04 and post Lehman crisis). We peg key subsidiaries such as Infotech and Finance to peer multiples and current market cap (less 20% holding co discount) respectively, while we attach a 0.8x FY14F P/B to L&T IDPL which is in-line with peers. We thus value the standalone business at INR675/share while all other subsidiary, associates and investments are valued at INR317/share together thus forming our SOTP based TP of INR992/share.

Risks that may impede the achievement of the target price Risks to our target price include better-than-expected order inflows, better than expected margin and execution, a substantial decrease in raw material prices and lower risk premium.

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SECTORS

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