

June 27, 2012

| | |
|---------------------------------------|---------------|
| Rating Remains | Reduce |
| Target price Remains | INR 992 |
| Closing price June 26, 2012 | INR 1349 |

RBI data suggests a gloomy capex outlook

Quick Note

RBI data on corporate capex paints grim outlook for FY13 & beyond

Our India Banks analyst, Vijay Sarathi, highlights a weak trend in corporate capex as revealed by data from the RBI, in his note entitled "The Capex Picture Book", earlier today. As per the RBI data:

- Capex in FY13 is likely to be only 60% of FY12 levels (assuming no more major sanctions in FY12, in line with feedback from most banks).
- The outlook beyond FY13 seems to be even grimmer as projected capex spending is likely to decline to just 40% of FY12 levels.
- The situation appears more alarming when we consider that project sanctions in FY12 were just 33.7% of the level seen in FY11.

As per Vijay, new corporate capex proposals have dried up over the past year and we are likely to see corporate loan growth (outside of regular working capital loans) reduce to a trickle. The current corporate loan growth appears to be largely feeding off the existing loan sanctions, and banks are seeing very little fresh appetite for new loans.

L&T order inflows highly correlated with capex data: -ve takeaways

We highlight the relevance of this data for L&T as a declining pipeline of corporate capex has a significant bearing on L&T's order inflow outlook.

- We note an historically strong correlation between L&T's domestic orders and the sanction as well as disbursement data from RBI (Fig 2-3).
- We also highlight the correlation between BSE500 corporate capex and L&T's order inflows for corresponding segments and note risk for L&T's order inflow estimates.

Summary: Overall, we note negative takeaways for the order environment in the medium-term from the RBI data on bank sanctions and disbursements. While we note that significant new sanctions over the next few months could change sentiment positively, our banking team's feedback from most banks suggests that currently new project sanction requests are only few and far between.

Fig. 1: RBI data suggests corporate capex is on a sharp decline in FY13-14

Phasing of capex of projects sanctioned assistance by Banks/FIs (INR bn)

| Capex in the year | Upto 2007-08 | 2008-09 | 2009-10 | 2010-11 | 2011-12 | 2012-13 | Beyond 2013-14 | Grand Total |
|-------------------|--------------|---------|---------|---------|---------|---------|----------------|-------------|
| Yr of sanction | | | | | | | | |
| Upto 2007-08 | 1,826 | 1,317 | 583 | 376 | 98 | 47 | | 4,247 |
| 2008-09 | 265 | 1,029 | 864 | 568 | 366 | 84 | 46 | 3,222 |
| 2009-10 | 2 | 448 | 1,494 | 1,282 | 853 | 365 | 116 | 4,560 |
| 2010-11 | | 3 | 373 | 1,262 | 1,294 | 979 | 691 | 4,602 |
| 2011-12* | | | 14 | 154 | 527 | 419 | 437 | 1,551 |
| Grand Total # | 2,093 | 2,797 | 3,328 | 3,642 | 3,138 | 1,894 | 1,290 | |

*Data available up to Q3: 2011-12; # These estimates are ex ante, incorporating only the envisaged investments, and thus are different from those actually realised/utilised. Source: RBI

Research analysts

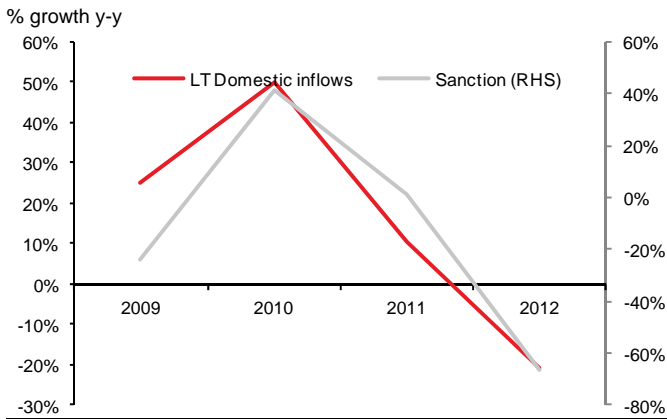
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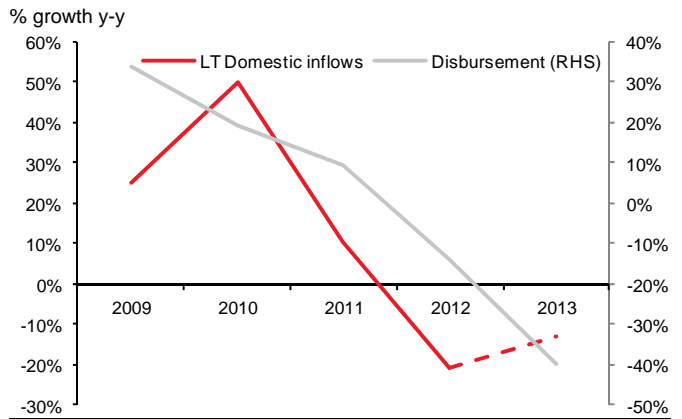
See Appendix A-1 for analyst certification, important disclosures and the status of non-US analysts.

Fig. 2: Strong correlation between L&T orders and bank sanctions



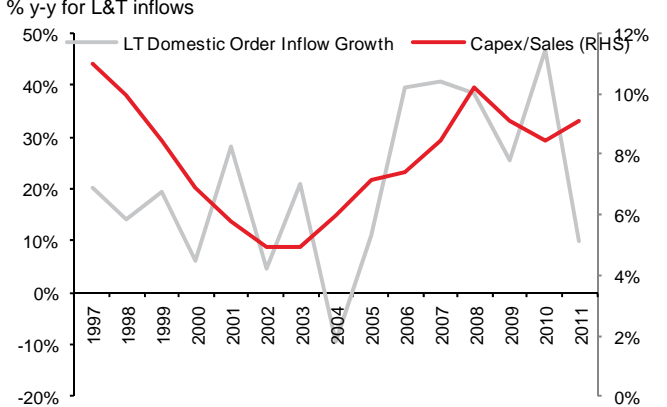
Source: Reserve Bank of India, Company Data, Nomura Estimates

Fig. 3: ...and also with disbursements; our numbers for FY13 seem to be at risk



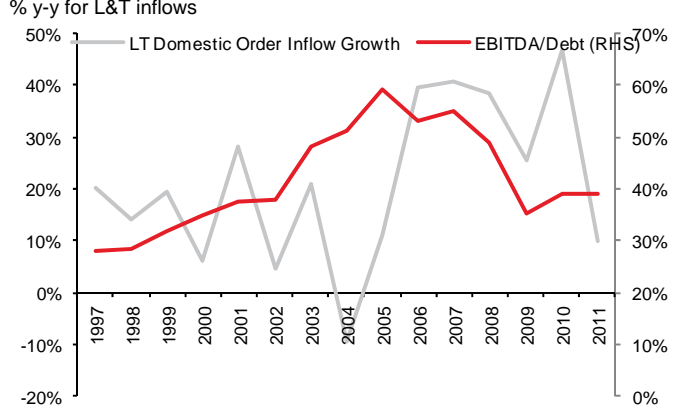
Source: Reserve Bank of India, Company Data, Nomura Estimates

Fig. 4: L&T orders vs. BSE 500 capex/sales



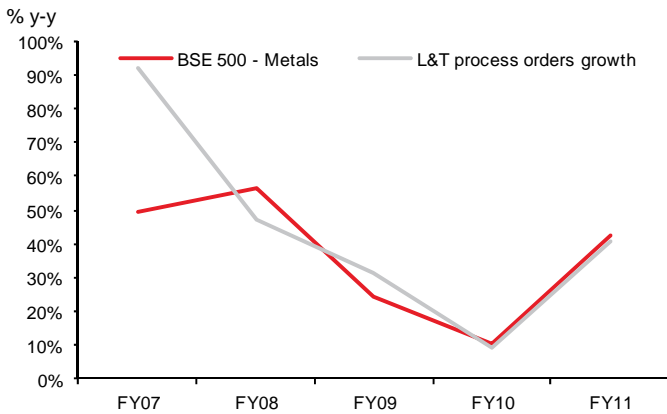
Source: ACE equity, Nomura research

Fig. 5: L&T inflows tracking corporate debt cover



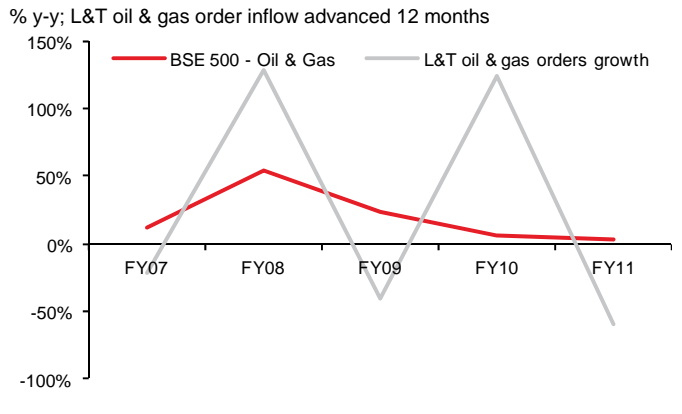
Source: ACE equity, Nomura research

Fig. 6: L&T's process order inflow is strongly correlated with domestic metals capex cycle...



Source: Company Data, Nomura Research

Fig. 7: ...while oil & gas order inflow leads domestic sector capex by a year



Source: Company Data, Nomura Research

Fig. 8: SBI's project finance loan book trend

(INR bn)

| (INR bn) | FY09 | FY10 | FY11 | FY12 |
|-------------------|---------|---------|---------|-------|
| Total debt outlay | 1,338.9 | 1,847.3 | 2,366.1 | 844.1 |
| Sanctions | 258.5 | 410.5 | 592.1 | 249.8 |
| Syndications | 640.7 | 699.0 | 730.8 | 186.1 |

Source: Company data, Nomura research

Appendix A-1

Analyst Certification

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| Larsen & Toubro | LT IN | INR 1349 | 26-6-2012 | Reduce | Not rated | A4,A5,A6 |

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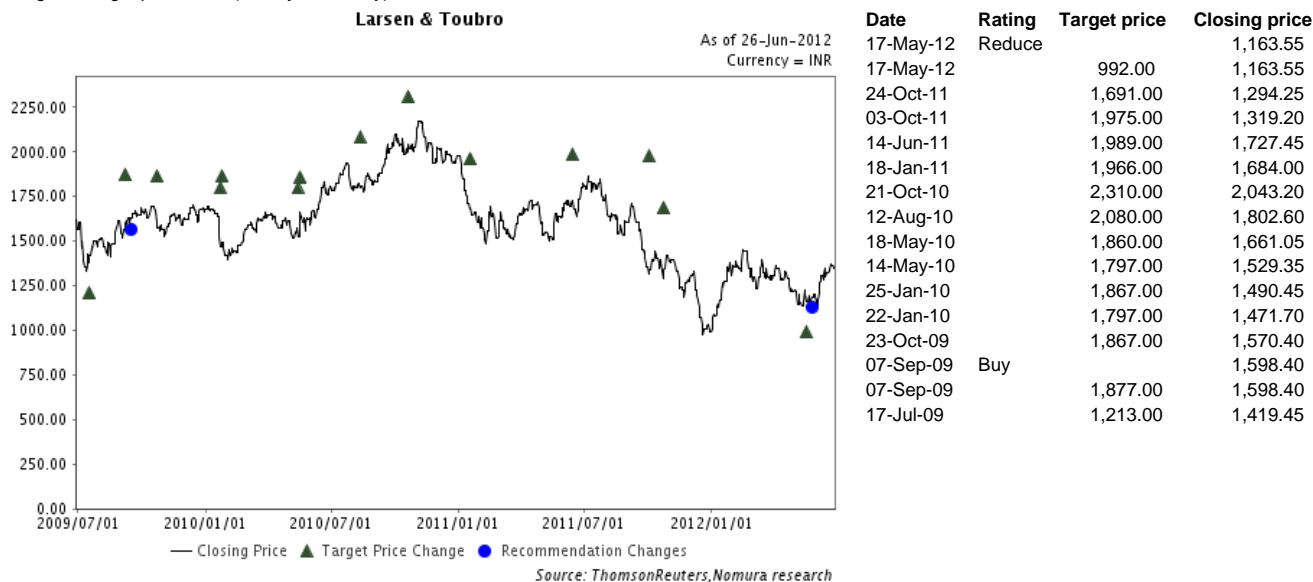
Previous Rating

| Issuer name | Previous Rating | Date of change |
|-----------------|-----------------|----------------|
| Larsen & Toubro | Buy | 17-5-2012 |

Larsen & Toubro (LT IN)

INR 1349 (26-6-2012) 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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Explanation of Nomura's equity research rating system in Japan and Asia ex-Japan

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