

October 21, 2011

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	Accumulate
Rating	
Price	Rs1,335
Target Price	Rs1,562
Implied Upside	17.0%
Sensex	16,786

(Prices as on October 21, 2011)
Trading data

Market Cap. (Rs bn)	813.0
Shares o/s (m)	608.9
3M Avg. Daily value (Rs m)	3599.5

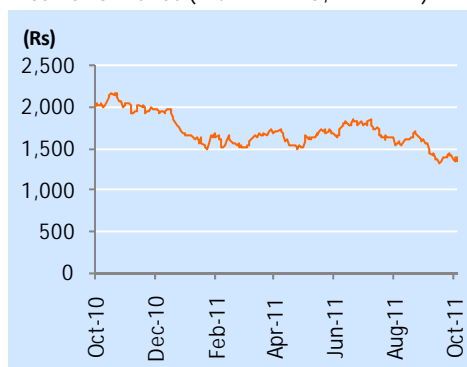
Major shareholders

Promoters	0.00%
Foreign	15.94%
Domestic Inst.	36.24%
Public & Other	47.82%

Stock Performance

(%)	1M	6M	12M
Absolute	(14.3)	(21.8)	(34.6)
Relative	(12.7)	(7.4)	(17.5)

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



Source: Bloomberg

■ **Revenues higher, EBITDA margins sobered, FY12 sales guidance maintained @25%:** Larsen and Toubro (L&T) reported a healthy 19.3% YoY growth in net sales at Rs112bn in Q2FY12 and was above our expectations of Rs100bn. This was again driven by inclusion of revenues from the Power division and a pick-up in core execution. EBITDA margins dropped by 19bps during the quarter at 10.4% and were in line with our expectations. Depreciation was substantially up by 41% YoY, mainly on account of increased capex. PAT stood at Rs7.9bn, a 15% YoY growth, which was above our expectation of Rs6.7bn.

■ **Sectoral performance:** E&C division registered a revenue growth of 21%, with 11.9% EBITDA margins (drop of 50bps YoY). Also, the E&E business was good and posted 20% YoY growth with 10.7% EBITDA margins (which were lower by 450bps YoY), indicating competitive pressures. MIP business registered a sales de-growth of 3% and EBITDA margin stood at 17.7% (60bps lower YoY).

■ **Order inflow target lowered to 5%, OB at Rs1.4trn:** As expected, L&T lowered the order inflow guidance to 5% YoY from 15%, which still remains an uphill task. L&T, in Q2FY12, bagged orders worth Rs161bn, a 21% YoY de-growth. The company has amassed Rs322bn orders in H1FY12 and still has to bag Rs514bn in H2FY12E to meet the revised target, which we maintain would be still difficult.

■ **Valuations and our take:** Post the revision of order inflow guidance downwards, the business sentiment looks a little hazy. However, the company has a strong techno economical footing in the E&C space and any uptick in capex cycle will stand to benefit L&T first. The company is still upbeat on Infra and Hydro carbon segments for future inflows. However, with weak ordering environment, increased competition and slower execution, there lies a worry of revenue growth to moderate and margins to further dip. On core P/E basis, L&T is trading in line with our FY13E coverage core earnings P/E at 11.2x, which has an upward bias as our estimates are cautious. Thus, we maintain our '**Accumulate**'.

Key financials (Y/e March)	2010	2011	2012E	2013E
Revenues (Rs m)	366,752	434,959	531,612	639,286
Growth (%)	9.0	18.6	22.2	20.3
EBITDA (Rs m)	44,558	52,136	59,433	71,095
PAT (Rs m)	31,649	36,720	40,607	46,664
EPS (Rs)	52.6	60.3	66.7	76.6
Growth (%)	13.4	14.7	10.6	14.9
Net DPS (Rs)	12.5	11.5	13.1	13.1

Source: Company Data; PL Research

Profitability & Valuation	2010	2011	2012E	2013E
EBITDA margin (%)	12.1	12.0	11.2	11.1
RoE (%)	20.6	18.3	17.1	17.6
RoCE (%)	15.9	15.2	14.6	15.3
EV / sales (x)	2.3	2.0	1.6	1.4
EV / EBITDA (x)	19.2	16.6	14.6	12.3
PE (x)	25.4	22.1	20.0	17.4
P / BV (x)	4.4	3.7	3.2	3.0
Net dividend yield (%)	0.9	0.9	1.0	1.0

Source: Company Data; PL Research

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Exhibit 1: Q2FY12 Result Overview (Rs m)

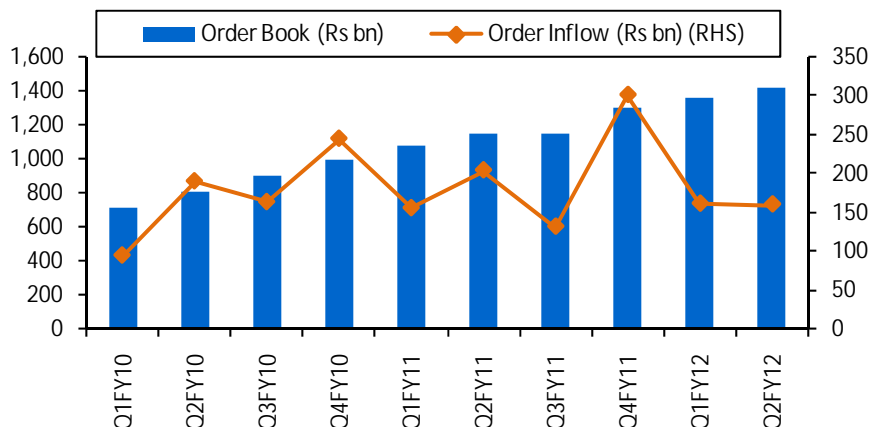
Y/e March	Q2FY12	Q2FY11	YoY gr. (%)	Q1FY12	H1FY12	H1FY11	YoY gr. (%)
Net Sales	112,452	94,222	19.3	94,826	207,279	172,533	20.1
Expenditure							
Consumption of RM	30,906	20,978	47.3	25,666	56,572	38,502	46.9
<i>% of Net Sales</i>	<i>27.5</i>	<i>22.3</i>		<i>27.1</i>	<i>27.3</i>	<i>22.3</i>	
Purchase of traded goods	4,435	5,219	(15.0)	4,885	9,320	9,664	(3.6)
<i>% of Net Sales</i>	<i>3.9</i>	<i>5.5</i>		<i>5.2</i>	<i>4.5</i>	<i>5.6</i>	
Sales and Admin	5,865	5,564	5.4	2,819	8,684	7,703	12.7
<i>% of Net Sales</i>	<i>5.2</i>	<i>5.9</i>		<i>3.0</i>	<i>4.2</i>	<i>4.5</i>	
Construction, Mfg. & Others	23,730	19,329	22.8	19,194	42,924	37,282	15.1
<i>% of Net Sales</i>	<i>21.1</i>	<i>20.5</i>		<i>20.2</i>	<i>20.7</i>	<i>21.6</i>	
Sub Contracting	17,504	18,679	(6.3)	18,455	35,959	35,542	1.2
<i>% of Net Sales</i>	<i>15.6</i>	<i>19.8</i>		<i>19.5</i>	<i>17.3</i>	<i>20.6</i>	
Other Expenses	8,529	7,110	20.0	7,819	16,348	13,666	19.6
<i>% of Net Sales</i>	<i>7.6</i>	<i>7.5</i>		<i>8.2</i>	<i>7.9</i>	<i>7.9</i>	
Personnel Cost	11,041	8,302	33.0	7,660	18,701	13,942	34.1
<i>% of Net Sales</i>	<i>9.8</i>	<i>8.8</i>		<i>8.1</i>	<i>9.0</i>	<i>8.1</i>	
Increase decrease in stock in trade	(1,298)	(976)		(2,936)	(4,234)	(3,924)	
Total Expenditure	100,711	84,205	19.6	83,561	184,273	152,376	20.9
EBITDA	11,741	10,017	17.2	11,265	23,005	20,158	14.1
<i>Margin (%)</i>	<i>10.4</i>	<i>10.6</i>		<i>11.9</i>	<i>11.1</i>	<i>11.7</i>	
Depreciation	1,709	1,212	41.0	1,679	3,388	2,354	43.9
EBIT	10,032	8,805	13.9	9,586	19,618	17,804	10.2
Interest	1,970	1,870	5.4	1,613	3,583	3,252	10.2
Other Income	3,632	3,801	(4.4)	2,962	6,594	5,957	10.7
PBT	11,694	10,735	8.9	10,935	22,629	20,509	10.3
Tax	3,709	3,794	(2.2)	3,474	7,183	6,905	4.0
<i>Tax Rate (%)</i>	<i>31.7</i>	<i>35.3</i>		<i>31.8</i>	<i>31.7</i>	<i>33.7</i>	
Recurring PAT	7,984	6,942	15.0	7,462	15,445	13,604	13.5
Extraordinary Items- Inc	-	708		-	-	708	
PAT	7,984	7,650	4.4	7,462	15,445	14,313	7.9

Source: Company Data, PL Research

Exhibit 2: H1FY12 Balance Sheet (Rs m)

Y/e March	H1FY12	H1FY11	FY11
Share Capital	1,222	1210	1218
Reserves	232,422	198,201	217,245
Loans	86,153	77,236	71,611
DTL	1,551	845	2,635
FA	76,612	68,406	74,162
Investments	129,956	128,776	146,848
NCA	114,780	80,309	71,698

Source: Company Data, PL Research

Exhibit 3: Order Inflow Analysis


Source: Company Data, PL Research

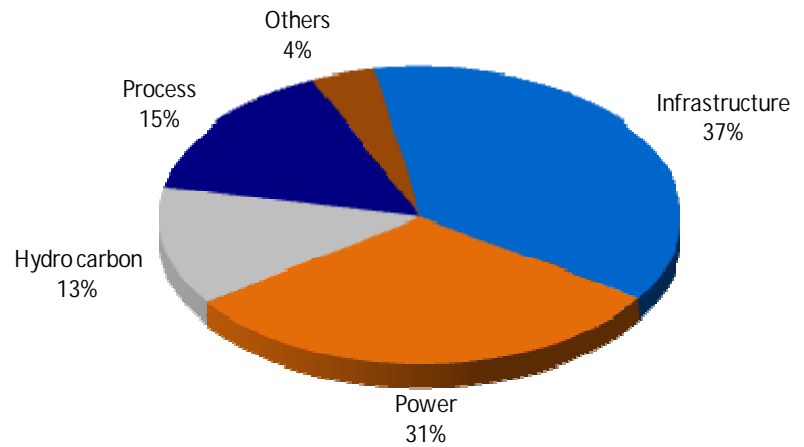
Order inflow has been showing some signs of equanimity in H1FY12 at Rs332bn which is a de-growth of 11% YoY. We feel a huge task is ahead to achieve a 5% YoY inflow growth as Power and Hydro carbon projects are hard to come by. However, the order book growth of 24% YoY at Rs1.4trn in H1FY12 is mainly aided by inclusion of Hyderabad Metro order and increased export orders in the book.

Exhibit 4: Business Snapshot (Rs bn)

	Q2FY12	Q1FY12	Q4FY11	Q3FY11	Q2FY11
Sales					
Engineering & Construction	97	81	136	100.0	80.2
Electrical & Electronics	8	7	10	8.0	6.7
MIP	7	7	8.6	6.8	7.0
Others	2	2	2.1	1.7	1.2
EBIT					
Engineering & Construction	10.3	8.1	19.9	10.6	9
Electrical & Electronics	0.7	0.6	1.5	0.9	0.86
MIP	1.1	1.2	1.7	1.3	1.2
Others	0.4	0.4	0.45	0.2	0.17
EBIT (%)					
Engineering & Construction	10.6	10.0	14.6	10.6	11.2
Electrical & Electronics	8.3	8.3	15.0	10.9	12.8
MIP	16.4	17.7	19.8	18.9	17.1
Others	18.2	21.2	21.4	12.7	14.2

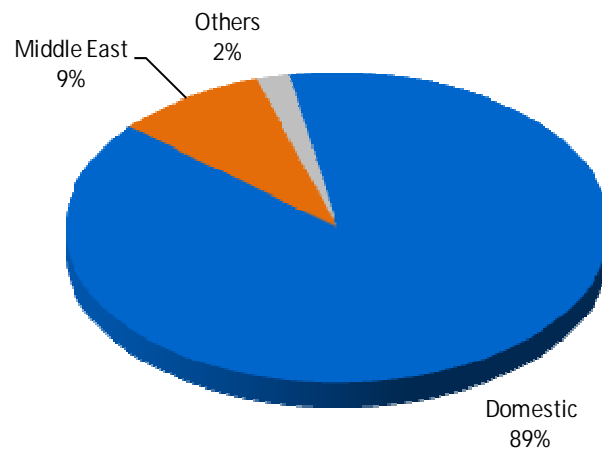
Source: Company Data, PL Research

Exhibit 5: Order Book Composition



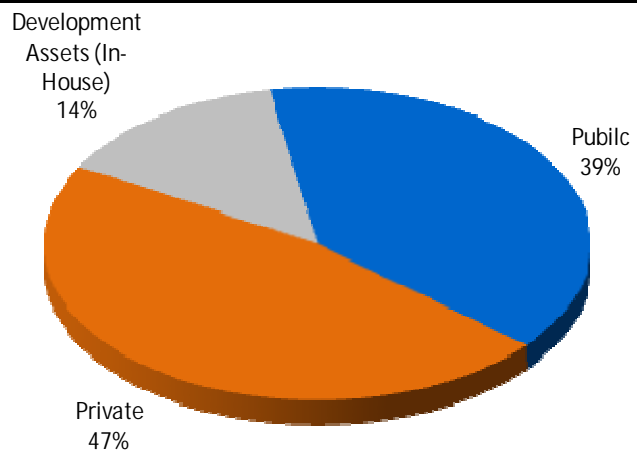
Source: Company Data, PL Research

Exhibit 6: Order Book by Geography



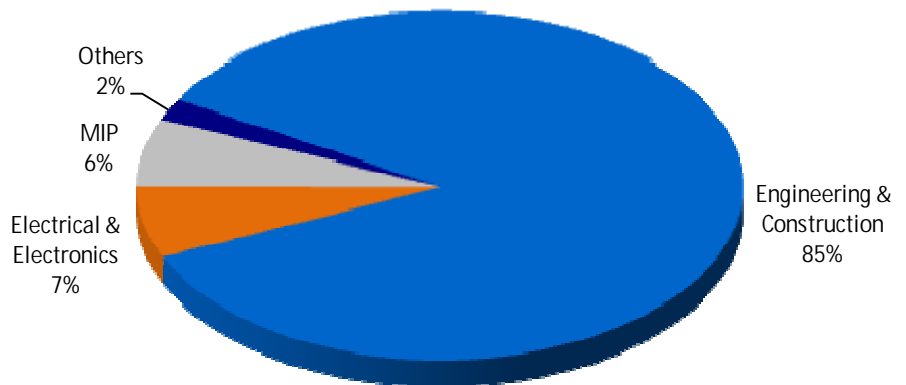
Source: Company Data, PL Research

Exhibit 7: Client-wise Order Book



Source: Company Data, PL Research

Exhibit 8: Q2FY12 Sales Break-up



Source: Company Data, PL Research

Analyst Call Highlights

- Ordering environment has been competitive and domestic scenario looks difficult to predict. L&T foresees greater opportunity, going forward, in Hydro carbon, Middle-East opportunities and Infrastructure sector. Order inflows have been good in Building and Factories sector till now and will continue. In the power sector, T&D is the only segment which looks promising. Abu Dhabi Airport order will happen next year.
- International order wins in H1FY12 have been robust at Rs73.5bn (growth of 345% YoY), which is a contribution of 25% in total order inflow. Also, the undisclosed orders of Rs60bn approx are mainly from buildings.
- Slow moving order is now 10% of the order book. Working capital has increased on account of support to vendors.
- Employee cost has gone up 33% YoY on account of addition of nearly 6200 employees from last year same period and increased cost.
- Forex loss in this quarter stood at Rs1bn as against Rs1.2bn in Q2FY11. Cost of debt is currently 8.5% and domestic is 10-10.5%.
- Increase in working capital has been managed on account of residual free cash flow of Rs10bn after dividend, capex and investment in subsidiaries. Thus, debt has not gone up significantly.
- Margins have been revised downwards in the range of 75-125bps YoY from 50-75bps in E&C segment on account on increased commodity prices (mainly on fixed price contracts bagged two years back) and assessment of ground level execution. For overall EBITDA margin, the company is not expected to give any guidance on account of volatility in other segment margins.
- Margins in E&E have been lower on account of hike in prices of copper and silver and extremely high competition, especially from MNCs.



- Increase in developmental projects investment is primarily on account of Sea woods project included in order book and commitment in overall equity for FY12E stands at Rs15-16bn. In H1FY12, the total investments in equity are at Rs16bn.

Exhibit 9: SOTP

Sectors	Valuation Parameter	Rs / Share	Value (Rs m)
L&T Standalone	14x (25% higher multiple than our coverage universe P/E) FY13 EPS of Rs76	1,073	653,286
L&T Infotech	11x FY13 PAT of Rs4bn	83	50,615
L&T Finance Holdings	15% HOLDCO Discount to Mkt Cap of LT Finance	102	61,969
L & T IDPL	1.75x Equity in FY12E of Rs65bn @ HOLDCO of 15%	163	98,940
LT Power Equipment	10x FY13E PAT of Rs2.9bn on USD 1bn sales	46	27,753
L & T Manufacturing	6x FY13E Rs3bn PAT of various facilities	25	15,485
Others	5x FY13E Rs8bn PAT of various businesses	71	42,968
Total Value		1,562	951,016

Source: PL Research



Income Statement (Rs m)

Y/e March	2010	2011	2012E	2013E
Net Revenue	366,752	434,959	531,612	639,286
Raw Material Expenses	82,773	100,640	144,332	175,887
Gross Profit	283,979	334,319	387,280	463,399
Employee Cost	23,791	28,845	35,958	39,887
Other Expenses	215,629	253,338	291,889	352,417
EBITDA	44,558	52,136	59,433	71,095
Depr. & Amortization	4,146	5,992	6,652	7,445
Net Interest	5,053	6,474	6,900	8,150
Other Income	12,699	16,511	15,016	14,437
Profit before Tax	48,058	56,181	60,897	69,937
Total Tax	16,409	19,459	20,000	22,983
Profit after Tax	31,649	36,722	40,897	46,954
Ex-Od items / Min. Int.	24,210	(2)	—	—
Adj. PAT	31,649	36,720	40,607	46,664
Avg. Shares O/S (m)	602.1	608.9	608.9	608.9
EPS (Rs.)	52.6	60.3	66.7	76.6

Cash Flow Abstract (Rs m)

Y/e March	2010	2011	2012E	2013E
C/F from Operations	47,230	27,753	15,004	53,598
C/F from Investing	(71,006)	(25,622)	(9,376)	25,340
C/F from Financing	30,318	854	(5,496)	(77,701)
Inc. / Dec. in Cash	6,543	2,985	132	1,237
Opening Cash	7,776	14,319	17,304	17,435
Closing Cash	14,319	17,304	17,435	18,738
FCFF	30,234	8,939	4,171	42,668
FCFE	32,682	12,542	7,033	46,985

Key Financial Metrics

Y/e March	2010	2011	2012E	2013E
Growth				
Revenue (%)	9.0	18.6	22.2	20.3
EBITDA (%)	24.6	17.0	14.0	19.6
PAT (%)	16.8	16.0	10.6	14.9
EPS (%)	13.4	14.7	10.6	14.9
Profitability				
EBITDA Margin (%)	12.1	12.0	11.2	11.1
PAT Margin (%)	8.6	8.4	7.6	7.3
RoCE (%)	15.9	15.2	14.6	15.3
RoE (%)	20.6	18.3	17.1	17.6
Balance Sheet				
Net Debt : Equity	0.3	0.2	0.2	0.2
Net Wrkng Cap. (days)	(667)	(767)	(578)	(507)
Valuation				
PER (x)	25.4	22.1	20.0	17.4
P / B (x)	4.4	3.7	3.2	3.0
EV / EBITDA (x)	19.2	16.6	14.6	12.3
EV / Sales (x)	2.3	2.0	1.6	1.4
Earnings Quality				
Eff. Tax Rate	34.1	34.6	33.0	33.0
Other Inc / PBT	26.4	32.0	24.5	20.5
Eff. Depr. Rate (%)	5.7	6.7	6.6	6.7
FCFE / PAT	103.3	34.2	17.3	100.7

Source: Company Data, PL Research.

Balance Sheet Abstract (Rs m)

Y/e March	2010	2011	2012E	2013E
Shareholder's Funds	183,115	218,463	255,825	273,250
Total Debt	68,008	71,611	74,473	78,790
Other Liabilities	774	2,635	865	867
Total Liabilities	251,897	292,708	331,163	352,907
Net Fixed Assets	63,658	74,581	80,910	86,245
Goodwill	—	—	—	—
Investments	137,054	146,848	146,539	161,193
Net Current Assets	51,187	71,279	103,665	105,478
<i>Cash & Equivalents</i>	<i>14,319</i>	<i>17,304</i>	<i>17,435</i>	<i>18,738</i>
<i>Other Current Assets</i>	<i>249,297</i>	<i>332,208</i>	<i>409,587</i>	<i>451,706</i>
<i>Current Liabilities</i>	<i>212,429</i>	<i>278,233</i>	<i>323,357</i>	<i>364,966</i>
Other Assets	—	—	50	60
Total Assets	251,898	292,708	331,163	352,907

Quarterly Financials (Rs m)

Y/e March	Q3FY11	Q4FY11	Q1FY12	Q2FY12
Net Revenue	113,217	150,784	94,826	112,452
EBITDA	11,465	20,350	11,265	11,741
<i>% of revenue</i>	<i>10.1</i>	<i>13.5</i>	<i>11.9</i>	<i>10.4</i>
Depr. & Amortization	1,281	2,358	1,679	1,709
Net Interest	1,757	1,362	1,613	1,970
Other Income	3,386	9,024	2,962	3,632
Profit before Tax	11,813	25,654	10,935	11,694
Total Tax	3,760	8,793	3,474	3,709
Profit after Tax	8,405	16,861	7,462	7,985
Adj. PAT	8,405	15,049	7,462	7,985

Key Operating Metrics

Y/e March	2010	2011	2012E	2013E
E&C (Rs m)	312,839	377,400	416,252	512,068
E&E (Rs m)	28,973	28,380	29,340	28,973
MIP (Rs m)	21,638	26,660	29,340	25,306
Others (Rs m)	3,668	6,600	20,905	18,338
Blended EBITDA Marg. (%)	12.1	12.0	11.2	11.1
Interest as a % to sales	1.4	1.5	1.3	1.3
Order Book (Rs bn)	972	1,334	1,600	1,877
Other Inc. / PAT (%)	40.1	43.7	36.6	30.6
Order intake (Rs bn)	630	797	797	917
Int. Rate (%)	7.4	9.0	9.3	10.3
Capex (Rs bn)	16.6	15.8	9.7	10.7
NCA/Sales (%)	14.0	—	19.5	16.5
RM & Const Cost (%)	66.5	67.9	68.2	67.5

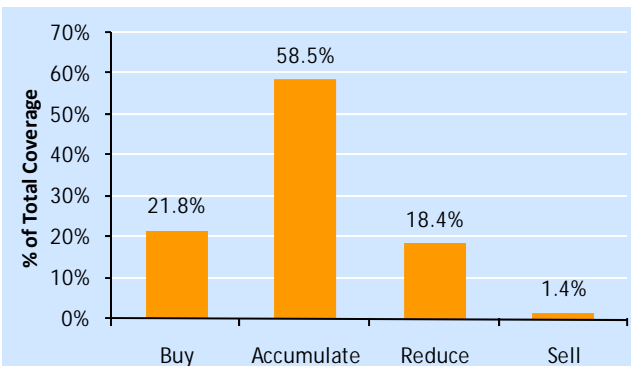
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BUY	: Over 15% Outperformance to Sensex over 12-months	Accumulate	: Outperformance to Sensex over 12-months
Reduce	: Underperformance to Sensex over 12-months	Sell	: Over 15% underperformance to Sensex over 12-months
Trading Buy	: Over 10% absolute upside in 1-month	Trading Sell	: Over 10% absolute decline in 1-month
Not Rated (NR)	: No specific call on the stock	Under Review (UR)	: Rating likely to change shortly

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