

October 22, 2012

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Rating	Accumulate
Price	Rs1,671
Target Price	Rs1,749
Implied Upside	4.7%
Sensex	18,793
Nifty	5,717

(Prices as on October 22, 2012)
Trading data

Market Cap. (Rs bn)	1,017.4
Shares o/s (m)	608.9
3M Avg. Daily value (Rs m)	2785.2

Major shareholders

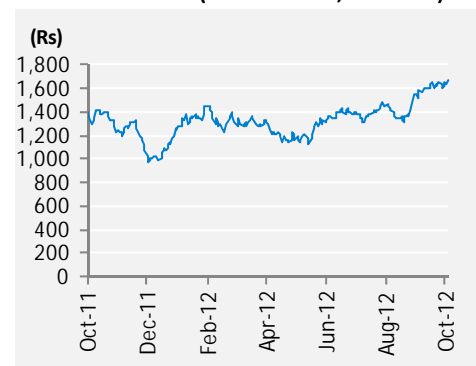
Promoters	0.00%
Foreign	15.40%
Domestic Inst.	37.84%
Public & Other	46.76%

Stock Performance

(%)	1M	6M	12M
Absolute	5.4	29.4	25.1
Relative	5.2	21.2	13.2

How we differ from Consensus

EPS (Rs)	PL	Cons.	% Diff.
2013	77.7	77.7	0.0
2014	88.6	85.6	3.5

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


Source: Bloomberg

■ **Revenues continue their good run, EBITDA margins above expectations:** Larsen and Toubro (L&T) reported a healthy 17.3% YoY growth in net sales at Rs132bn in Q2FY13 exhibiting on-track execution and was largely above our expectations. Reported EBITDA included a forex MTM of Rs330m, thus, adjusted margins were 46bps up YoY at 10.9%. Interest cost continued to grow YoY, mainly on account of higher debt, but the impact was limited due to lower interest cost. OI was lower by 9.3% YoY as major dividend income was booked in Q1FY13. One-off gains and reversals included in this quarter amounted to Rs2.2bn. Thus, reported PAT at Rs11.3bn grew by 42.5% YoY. Adjusted APAT is estimated to be at Rs9.5bn, taking the MTM losses up by 18.8%. NWC in H1FY13 has been 16.5% (15.3% Q1FY13) of sales. This has led to increasing debt burden (which was Rs114bn in Q1FY13 to Rs120bn in H1FY13).

■ **Sectoral performance:** E&C division registered a revenue growth of 19%, with 12.2% EBITDA margins (20bps up YoY). E&E business registered 6% sales growth, with EBITDA margin of 11.1% (40bps higher YoY). MIP business continued to show a weak performance, with 12% de-growth in sales and 300bps decline in EBITDA margins at 14.7%. Others segment continues to be robust, with 46% YoY growth in sales at Rs3.2bn; however, EBITDA margins at 23.5% are flat YoY.

■ **Order inflow details:** L&T had announced Rs158.7bn orders in Q2FY13 on exchanges. However, the declared order inflows came in at Rs209.7bn. The difference of Rs51bn orders are explained by Rs8.3bn order from BOP of Lata Tapovan Hydro Electric Project, EPC contract for stretches of Kishangarh-Udaipur-Ahmedabad of Rs6.4bn, Railways projects of Rs5bn, Water project from Rajasthan of Rs5bn and Rs7bn (constituting small-sized projects) from infrastructure projects across verticals, where clients are not disclosed. Balance Rs19bn worth of orders has not been disclosed as yet. However, these undisclosed orders are more or less quantified as sales in E&E, MIP and Integrated engineering segments as execution cycle is one year.

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Key financials (Y/e March)	2011	2012	2013E	2014E
Revenues (Rs m)	434,959	531,705	649,286	785,292
Growth (%)	18.6	22.2	22.1	20.9
EBITDA (Rs m)	52,136	62,826	73,295	88,543
PAT (Rs m)	36,720	44,196	47,597	54,252
EPS (Rs)	60.3	72.2	77.7	88.6
Growth (%)	14.7	19.7	7.7	14.0
Net DPS (Rs)	11.5	16.6	19.6	22.9

Profitability & Valuation

	2011	2012	2013E	2014E
EBITDA margin (%)	12.0	11.8	11.3	11.3
RoE (%)	18.3	18.8	17.6	17.6
RoCE (%)	15.2	15.2	13.6	13.2
EV / sales (x)	2.5	2.1	1.8	1.5
EV / EBITDA (x)	20.6	17.6	15.7	13.4
PE (x)*	21.1	17.5	16.3	14.3
P / BV (x)	4.7	4.1	3.5	3.1
Net dividend yield (%)	0.7	1.0	1.2	1.4

Source: Company Data; PL Research

* Excluding Subsidiary Valuation

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- **FY13E order inflow target achievement on lower end should not be a problem, OB still robust at Rs1.6trn:** L&T, in Q2FY13, bagged orders worth Rs210bn, a growth of 30% YoY and 7.1% QoQ. In H1FY13, the order inflow stands at Rs406bn, up by 26% YoY. The company has maintained the order inflow guidance of 15-20% YoY which amounts to Rs811bn at lower band. L&T has seen some revival in hydrocarbon and international orders. However, Infrastructure projects remain the prime contributor. Within Infrastructure, Water and Buildings show a promising growth path ahead. Big chunks of orders are still needed from Hydrocarbon and Utilities, along with stable and strong orders from Buildings sector, to draw it closer to the upper end of the target.

We change our stance from a flat YoY order intake view to a 15% growth YoY amounting to Rs811bn, keeping in view the revival in order inflow growth. Big orders from Power equipment and Hydrocarbon could add to over and above our numbers where the company remains bullish in H2FY13E.

- **Valuations and our take:** We were primarily worried about EBIDTA margins at a cost of higher Infrastructure projects which has been more or less dealt with in the results so far. The E&C margins were maintained YoY in H1FY13. Thus, our overall estimated 11.3% margins are more or less quite achievable.

Working capital scenario will ease out with easing liquidity on the vendor's side. However, NWC in H1FY13 has been 16.5% of sales from 15.3% in Q1FY13. This has led to increasing debt burden (which was Rs114bn in Q1FY13 to Rs120bn in H1FY13) and thus, interest cost. Further, equity investments in IDPL (Rs1.5-2bn approx) would put stress on the cash flows for the company.

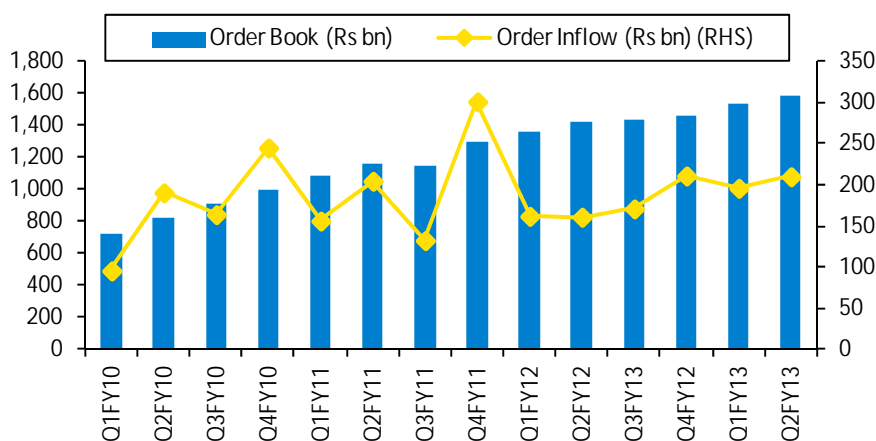
We have upgraded our FY13E and FY14E revenues estimates on account of robust execution in H1FY13E. However, increasing WC needs will lead to higher debt and interest cost. Thus, like a typical construction player, the gains at above the EBITDA levels will be eaten away by higher interest costs.

On core P/E basis, L&T is trading at 16.3x FY13E and 14.3x FY14E. On consolidated basis, it trades at 20.1x FY13E and 18.4x FY14E. The stock is currently trading at closer to higher bands which have a lower room for bigger upsides; however, in any cyclical economic improvement, L&T always stands to benefit being the leader of the pack. A stake sale in subsidiaries and on track execution will lend some stability to this stock in and around current levels. Thus, we maintain our '**Accumulate**' rating on the stock and increase our target price from Rs1,690 to Rs1,749 on account of EPS and multiple upgrade of FY14E.

Exhibit 1: Q2FY13 Result Overview (Rs m)

Y/e March	Q2FY13	Q2FY12	YoY gr. (%)	Q1FY13	H1FY13	H1FY12	YoY gr. (%)
Net Sales	131,962	112,452	17.3	119,554	251,516	207,279	21.3
Expenditure							
Consumption of RM	31,910	30,906	3.2	37,201	69,111	56,572	22.2
<i>% of Net Sales</i>	<i>24.2</i>	<i>27.5</i>		<i>31.1</i>	<i>27.5</i>	<i>27.3</i>	
Construction, Mfg. & Others	33,495	23,730	41.1	20,891	54,386	42,924	26.7
<i>% of Net Sales</i>	<i>25.4</i>	<i>21.1</i>		<i>17.5</i>	<i>21.6</i>	<i>20.7</i>	
Sub Contracting	28,688	17,504	63.9	24,905	53,593	35,959	49.0
<i>% of Net Sales</i>	<i>21.7</i>	<i>15.6</i>		<i>20.8</i>	<i>21.3</i>	<i>17.3</i>	
Total Expenditure	117,899	100,711	17.1	106,514	224,412	184,273	21.8
EBITDA	14,394	12,741	13.0	13,040	27,434	23,005	19.3
<i>Margin (%)</i>	<i>10.9</i>	<i>10.4</i>	<i>46.6</i>	<i>10.91</i>	<i>10.9</i>	<i>11.1</i>	<i>(19.1)</i>
Depreciation	2,040	1,709	19.3	1,919	3,959	3,388	16.9
EBIT	12,354	10,032	23.1	11,121	23,475	19,618	19.7
Interest	2,350	1,970	19.3	2,284	4,634	3,583	29.4
Other Income	3,294	3,632	(9.3)	3,858	7,152	6,594	8.5
PBT	13,298	11,694	13.7	12,695	25,993	22,629	14.9
Tax	3,815	3,709	2.9	4,189	8,004	7,183	11.4
<i>Tax Rate (%)</i>	<i>28.7</i>	<i>31.7</i>		<i>33.0</i>	<i>30.8</i>	<i>31.7</i>	
Recurring PAT (ADJ)	9,483	7,984	18.8	8,506	17,989	15,445	16.5
PAT	11,373	7,984	42.5	8,637	20,010	15,445	29.6

Source: Company Data, PL Research

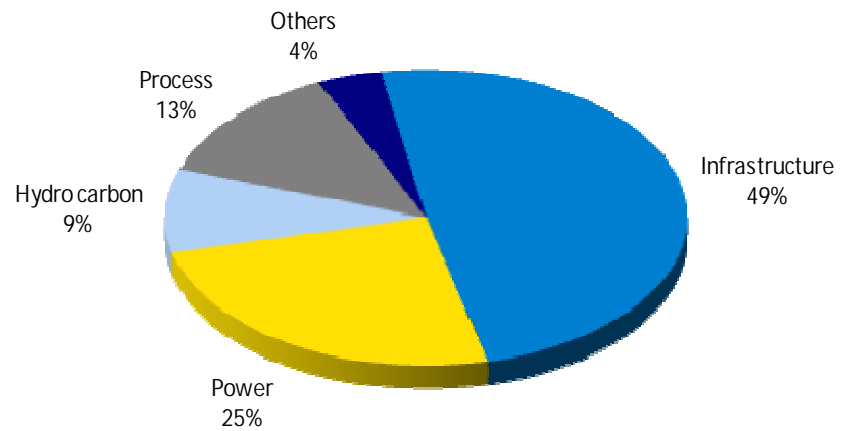
Exhibit 2: Order Inflow Analysis


Source: Company Data, PL Research

Exhibit 3: Business Snapshot (Rs bn)

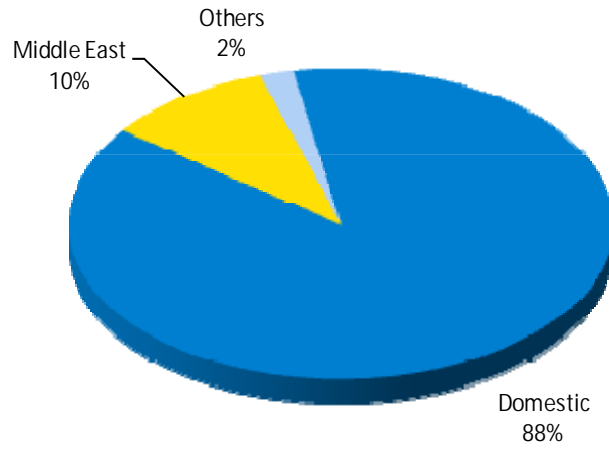
Business Snapshots QoQ	Q2FY13	Q1FY13	Q4FY12	Q3FY12	Q2FY12
Sales					
Engineering & Construction	116.7	104	167	124.5	97
Electrical & Electronics	8.8	7.6	11.4	8.4	8
MIP	5.6	5.7	8.1	7.2	7
Others	3.3	3.6	2.7	2.6	2
EBIT					
Engineering & Construction	12.6	9.88	22.6	12.8	10.3
Electrical & Electronics	0.73	0.4	1.59	0.7	0.7
MIP	0.70	0.73	1.3	1.3	1.1
Others	0.68	1	0.32	0.67	0.4
EBIT (%)					
Engineering & Construction	10.8	9.5	13.5	10.3	10.6
Electrical & Electronics	8.3	5.3	13.9	8.3	8.3
MIP	12.4	12.8	16.0	18.1	16.4
Others	20.6	27.8	11.9	25.8	18.2

Source: Company Data, PL Research

Exhibit 4: Order Book Composition


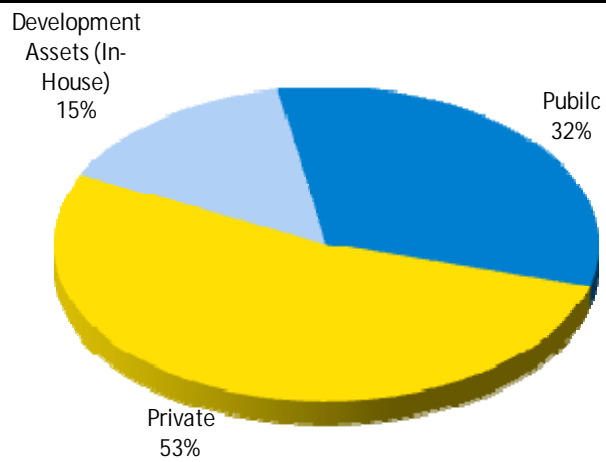
Source: Company Data, PL Research

Exhibit 5: Order Book by Geography



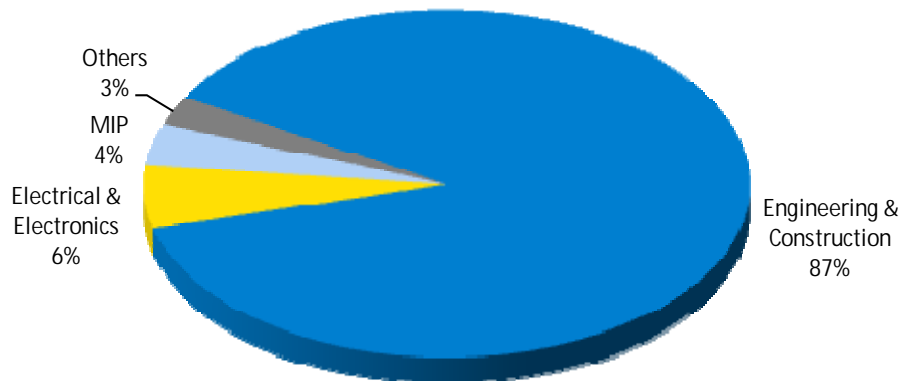
Source: Company Data, PL Research

Exhibit 6: Client-wise Order Book



Source: Company Data, PL Research

Exhibit 7: H1FY13 Sales Break-up



Source: Company Data, PL Research

Analyst call highlights

Management has maintained 15-20% growth in order inflow, 15-20% growth in revenues and aiming to maintain EBITDA at FY12 levels. Equity raising in IDPL is expected to happen by the year end. Overall equity requirement, going forward, is close to Rs20bn. Any stake sale would reduce that amount.

Soaring Working capital remains a concern and can go up to 17-20% of sales.

Signs of reforms will lead to an order inflow with a lag effect. Power and Hydrocarbon orders are expected to come in, going further. Eight GWs of power projects are expected to be awarded by the year end by PSUs and State utilities.

New orders taken in the Infrastructure sector is not margin dilutive in India. However, in the international scenario, the competition is stiff and thus, margins would be lower by 1-2%.

Opportunities in ME are plenty and with technical expertise, the company believes it will not be difficult to win orders in Hydrocarbon. International T&D orders will continue to come as usual. In India, ONGC orders are in the process of tendering.

In DFC western side projects (Rs30-40bn each) are no in process of getting awarded to the shortlisted players. Similarly, in Railways, orders are expected to flow in from RVNL and Central Organisation for Railway Electrification. Capex for FY13E is expected to be Rs10bn.

Exhibit 8: SOTP

Sectors	Valuation Parameter	Rs / Share	Value (Rs m)
L&T Standalone	15.25x FY14 EPS of Rs89	1,351	596,785
L&T Infotech	8.5x FY14E PAT of Rs 5.9 bn @25% HOLDCO	62	37,783
L&T Finance Holdings	25% HOLDCO Discount to Mkt Cap of LT Finance -LT share 82%	80	49,200
L&T IDPL	1.5x Equity in FY13E of Rs70bn @ HOLDCO of 25%	134	81,844
L&T Power Equipment	P/E 7.8x FY14E PAT of Rs2.9bn on USD 1bn sales @ HOLDCO of 25%	27	16,446
L&T Manufacturing	5x FY14E Rs3bn PAT of various facilities	25	15,485
Others	5x FY14E Rs8bn PAT of various businesses	70	42,968
Total Value		1,749	840,511

Source: PL Research

Income Statement (Rs m)

Y/e March	2011	2012	2013E	2014E
Net Revenue	434,959	531,705	649,286	785,292
Raw Material Expenses	100,640	117,646	198,085	256,924
Gross Profit	334,319	414,059	451,201	528,368
Employee Cost	28,845	9,754	39,887	45,828
Other Expenses	253,338	341,479	338,019	393,997
EBITDA	52,136	62,826	73,295	88,543
Depr. & Amortization	5,992	6,995	7,952	9,000
Net Interest	6,474	6,661	8,550	11,701
Other Income	16,511	13,383	14,537	13,424
Profit before Tax	56,181	62,553	71,330	81,266
Total Tax	19,459	18,357	23,443	26,722
Profit after Tax	36,722	44,196	47,887	54,544
Ex-Od items / Min. Int.	(2)	—	—	—
Adj. PAT	36,720	44,196	47,597	54,252
Avg. Shares O/S (m)	608.9	612.4	612.4	612.4
EPS (Rs.)	60.3	72.2	77.7	88.6

Cash Flow Abstract (Rs m)

Y/e March	2011	2012	2013E	2014E
C/F from Operations	16,148	5,705	(10,831)	(8,580)
C/F from Investing	(18,461)	(27,669)	(28,929)	(22,946)
C/F from Financing	5,298	23,713	38,445	32,473
Inc. / Dec. in Cash	2,985	1,749	(1,314)	947
Opening Cash	14,319	17,304	19,053	17,738
Closing Cash	17,304	19,053	17,738	18,685
FCFF	8,939	(1,683)	(15,988)	(11,318)
FCFE	12,542	25,676	31,417	21,987

Key Financial Metrics

Y/e March	2011	2012	2013E	2014E
Growth				
Revenue (%)	18.6	22.2	22.1	20.9
EBITDA (%)	17.0	20.5	16.7	20.8
PAT (%)	16.0	20.4	7.7	14.0
EPS (%)	14.7	19.7	7.7	14.0
Profitability				
EBITDA Margin (%)	12.0	11.8	11.3	11.3
PAT Margin (%)	8.4	8.3	7.3	6.9
RoCE (%)	15.2	15.2	13.6	13.2
RoE (%)	18.3	18.8	17.6	17.6
Balance Sheet				
Net Debt : Equity	0.2	0.3	0.4	0.5
Net Wrkng Cap. (days)	(767)	(968)	(454)	(309)
Valuation				
PER (x)*	21.1	17.5	16.3	14.3
P / B (x)	4.7	4.1	3.5	3.1
EV / EBITDA (x)	20.6	17.6	15.7	13.4
EV / Sales (x)	2.5	2.1	1.8	1.5
Earnings Quality				
Eff. Tax Rate	34.6	29.3	33.0	33.0
Other Inc / PBT	32.0	21.4	20.2	16.4
Eff. Depr. Rate (%)	6.7	6.6	6.8	6.8
FCFE / PAT	34.2	58.1	66.0	40.5

Source: Company Data, PL Research.

* Excluding Subsidiary Valuation

Balance Sheet Abstract (Rs m)

Y/e March	2011	2012	2013E	2014E
Shareholder's Funds	218,463	252,231	288,308	329,094
Total Debt	71,611	98,969	146,375	179,679
Other Liabilities	2,635	1,331	1,564	1,988
Total Liabilities	292,708	352,532	436,247	510,761
Net Fixed Assets	74,581	83,709	93,003	99,840
Goodwill	—	—	—	—
Investments	146,848	158,719	175,255	182,815
Net Current Assets	71,279	110,104	167,934	228,065
Cash & Equivalents	17,304	19,053	17,738	18,685
Other Current Assets	332,208	486,193	513,966	580,262
Current Liabilities	278,233	395,142	363,770	370,882
Other Assets	—	—	56	42
Total Assets	292,708	352,532	436,247	510,761

Quarterly Financials (Rs m)

Y/e March	Q3FY12	Q4FY12	Q1FY13	Q2FY13
Net Revenue	139,986	184,609	119,554	131,962
EBITDA	13,431	25,608	13,040	14,394
% of revenue	9.6	13.9	10.9	10.9
Depr. & Amortization	1,803	1,804	1,919	2,040
Net Interest	1,907	1,211	2,284	2,350
Other Income	4,487	3,142	3,858	3,294
Profit before Tax	14,208	26,285	12,695	13,298
Total Tax	4,292	7,081	4,189	3,815
Profit after Tax	9,915	19,204	8,506	11,626
Adj. PAT	9,915	18,836	8,637	11,626

Key Operating Metrics

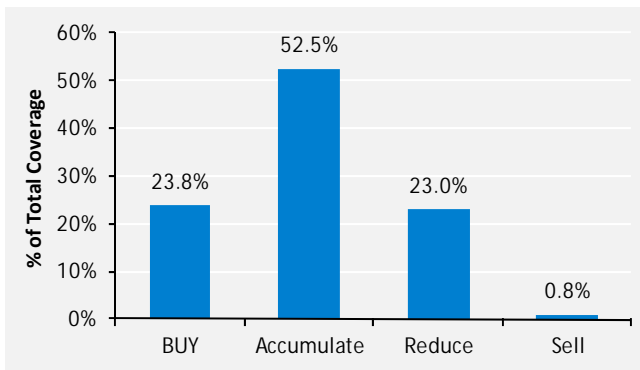
Y/e March	2011	2012	2013E	2014E
E&C (Rs m)	377,400	469,788	584,452	629,019
E&E (Rs m)	28,380	35,794	25,306	28,973
MIP (Rs m)	26,660	28,538	25,306	25,306
Others (Rs m)	6,600	9,630	14,222	18,338
Blended EBITDA Marg. (%)	12.0	11.8	11.3	11.3
Interest as a % to sales	1.5	1.3	1.3	1.5
Order Book (Rs bn)	1,334	1,457	1,620	1,727
Other Inc. / PAT (%)	43.7	30.3	30.2	24.5
Order intake (Rs bn)	797	706	812	893
Int. Rate (%)	9.0	6.7	5.8	6.5
Capex (Rs bn)	15.8	16.8	12.7	15.7
NCA/Sales (%)	16.4	20.2	25.7	28.9
RM & Const Cost (%)	67.9	62.6	69.8	71.2

Source: Company Data, PL Research.



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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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