Larsen & Toubro

STOCK INFO.	BLOOMBERG
BSE Sensex: 16,720	LT IN
	REUTERS CODE
S&P CNX: 4,988	LART.BO

Equity Shares (m)	601.8
52-Week Range	1,800/557
1,6,12 Rel. Perf. (%)	3/-5/37
M.Cap. (Rs b)	992.2
M.Cap. (US$ b)	21.2

18 December 2009

Neutral

Previous Recommendation: Neutral

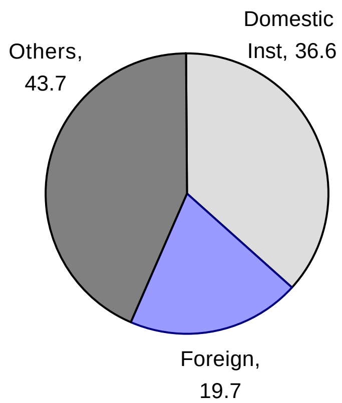
Rs1,649

YEAR END	NET SALES (RS M)	PAT* (RS M)	EPS* (RS)	EPS GROWTH (%)*	P/E* (X)	P/BV (X)	ROE (%)	ROCE (%)	EV/ SALES	EV/ EBITDA
3/08A	249,387	22,910	39.3	25.1	42.0	10.1	27.0	29.5	4.0	34.9
3/09A	339,264	30,046	51.5	31.1	32.0	7.8	24.5	26.0	3.0	27.1
3/10E	389,398	34,507	57.3	11.8	28.8	5.4	19.9	21.9	2.6	22.6
3/11E	462,794	40,375	67.1	17.0	24.6	4.7	18.1	20.3	2.2	19.0

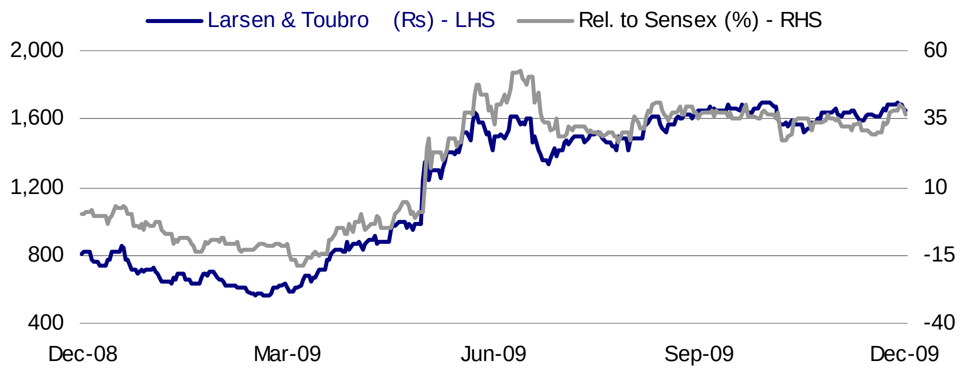
** Consolidated; EPS is fully diluted*

- **Order intake driven by long gestation projects; unlikely to favorably impact FY11/FY12 revenues and margins:** L&T's order intake during YTD FY10 has been disappointing in most business segments. The power equipment segment, which has witnessed strong traction (expect ~30% contribution to overall order intake in FY10), is an exception. However, as power equipment projects entail long gestation and L&T recognizes margins only on achievement of 25% project completion, we expect initial margins on these projects to be accounted only from FY13. The increased order intake in FY10 is unlikely to result in higher revenues and margin recognition in FY11/FY12.
- **Power equipment JVs with Mitsubishi to report initial losses, at least till FY12:** We expect L&T's power equipment JVs with Mitsubishi to report losses of Rs2.3b in FY11 and Rs2.7b in FY12. L&T has 51% stake in these JVs, implying that its share in the losses would be Rs1.2b and Rs1.4b, respectively. The power equipment projects are likely to cross the margin recognition threshold of 25% project completion in FY13. Hence, we believe that the inflexion point in terms of earnings contribution from subsidiaries will come only in FY13/FY14.
- **Exciting long-term growth opportunities:** Unlike several of its peers, L&T is continuously developing new skill sets / entering new segments and geographies. We believe that its entry into new areas like power equipment, nuclear power plants, defense, shipbuilding, power development projects, and forgings (thermal and nuclear), increased presence in the Middle East, and its ability to take new PPP projects (due to strong balance sheet) will help L&T to ensure long-term sustainability of order flow. Further, some of these business segments could contribute meaningfully to consolidated revenues and profitability, going forward.
- **Downgrading earnings estimates; maintain Neutral:** We now expect L&T to report consolidated net profit of Rs34.5b in FY10 (up 14.9%), Rs40.4b in FY11 (up 17%) and Rs51.6b in FY12 (up 27.9%). Our SOTP-based target price is Rs1,617/share. We maintain **Neutral**.

SHAREHOLDING PATTERN (SEP-09, %)



STOCK PERFORMANCE (1 YEAR)



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

Order intake driven by long gestation projects

L&T's order intake has been disappointing in most segments except power equipment

FY10 till date has been a disappointing year of order intake for L&T in most business segments, except power equipment. Order awards from segments like infrastructure (including roads, railways, urban infrastructure, etc); process industries (fertilizers feedstock conversion, metals, etc); hydrocarbons (upstream, clean fuel projects, etc) have been lower than initial estimates.

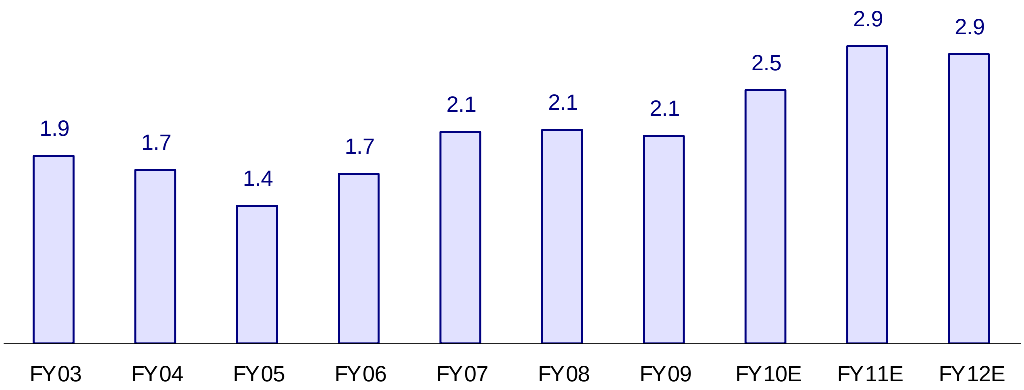
Power equipment would account for ~30% of the intake in FY10

However, thermal power equipment has witnessed strong traction, and L&T has reported order intake of 4GW worth Rs130b [comprising of Jaiprakash Nigrie (1.32GW), GMR Vemagiri expansion (0.8GW) and Mahagenco Koradi project (1.98GW)]. We expect order award for Rajpura Power Project (1.32GW, on development basis by L&T) to be booked in 4QFY10, as the PPA is expected to be signed in January 2010. Thus, power equipment should contribute Rs180b-200b (excluding boilers, etc for Nigrie Power Project, which is not part of standalone order book) in FY10. At the lower end of the management's overall order intake guidance of Rs650b, power equipment would account for ~30% of the intake in FY10.

Given the long gestation, order intake in FY10 is unlikely to favorably impact FY11/FY12 revenues and margins

Given that power equipment projects entail a long gestation period of 54 months, we expect limited revenue bookings in FY11 and FY12. Also, given the accounting practice wherein margins are accounted by L&T post 25% project completion, we expect initial margins on these power projects to be accounted for only from FY13. Thus, increased order intake in FY10 will not result in higher revenues and margin recognition in FY11/ FY12. We expect the book-to-bill ratio to increase from 2.1x in FY09 to 2.5x in FY10 and further to 2.9x in FY11, given higher gestation periods on new orders.

EXPECT BOOK-TO-BILL RATIO TO INCREASE TO 2.9X IN FY11 V/S 2.1X IN FY09



Source: Company/MOSL

Power equipment JVs with Mitsubishi to report initial losses

Power equipment JVs with Mitsubishi would report losses in FY11 and FY12

We expect L&T's power equipment JVs with Mitsubishi to report losses of Rs2.3b in FY11 and Rs2.7b in FY12. L&T has 51% stake in these JVs, implying that its share in the losses would be Rs1.2b and Rs1.4b, respectively. The power equipment projects are likely to cross the margin recognition threshold of 25% project completion in FY13. Limited margin recognition, and charge of interest, depreciation and non-production related costs like marketing, etc, to the profit and loss account will result in initial losses.

Expect meaningful contribution from power equipment & BOT subsidiaries from FY13 onwards

We believe that the inflexion point in terms of earnings contribution from subsidiaries will come in FY13/FY14. We expect earnings contribution from subsidiaries and associate companies to increase from Rs6b in FY09 to Rs6.5b in FY10 (up 7%), Rs7.5b in FY11 (up 16%) and Rs10b in FY12 (up 33%). This is a downgrade of 16-25% during FY10-12 v/s earlier estimates, given the initial losses in power equipment subsidiaries and moderate profit growth in L&T IDPL (BOT projects). Also, we believe that profit breakeven in other ventures like shipbuilding, defense, nuclear forging, etc will be in phases between FY13-15, as projects cross margin recognition threshold.

EXHIBIT: NET PROFIT TREND OF SUBSIDIARIES (RS M)

	FY07	FY08	FY09	FY10E	FY11E	FY12E
L&T Infotech	1,511	1,955	2,674	2,022	2,245	2,508
L&T Finance	626	1,150	990	1,317	1,646	2,058
L&T IDPL	1,264	156	85	-27	48	354
L&T International FZE	106	-2,673	981	1,428	2,097	2,729
L&T Infrastructure Finance	0	452	765	1,036	1,616	2,101
Power Equipments	0	0	0	0	-1,155	-1,375
Others	1,103	1,000	522	688	1,024	1,659
Total	**4,610**	**2,039**	**6,017**	**6,463**	**7,521**	**10,033**

Source: Company/MOSL

Decline in yield on treasury book; investment plans of Rs60b-80b over two years

The size of L&T's treasury book has increased from Rs56b in September 2009 to Rs90b

L&T has a treasury book of Rs90b, which has increased from Rs56b in September 2009 and Rs49b in March 2009. The recent increase in treasury book is largely driven by fund raising of USD600m through a QIP and FCCB issue. We understand that treasury book has been invested in equity and debt instruments. Given the decline in market yields for both equity and debt, the yield on treasury book now stands at ~6%. This compares with cost of debt of ~7% (debt ~Rs65b), resulting in a negative carry of 100bp. In FY09 and 1HFY10, we estimate that L&T had a positive spread of ~250bp. The decline in yield on investment book will impact reported profits in 2HFY10.

Its strong balance sheet gives it an edge over smaller peers in bidding for large projects

Maintaining cash/treasury book is a conscious decision of the management to have sufficient liquidity for financing project investment, capex and other business requirements over the next 2-3 years. Incremental opportunities in infrastructure would be mostly through PPP route, particularly for transportation, ports, airports, thermal power and T&D. Given that L&T has a very strong balance sheet, it will have an edge over its smaller peers in participation in larger size projects.

A large part of its current investment commitment is towards equity commitment in BOT projects, shipbuilding, forging, power equipment JVs, power development projects (thermal, nuclear, etc). Also, L&T has capex plans of Rs12b in 2HFY10 v/s Rs6b in 1HFY10. Further, we expect deterioration in working capital (excluding cash and advances to subsidiary companies) from 7.2% in FY09 to 11.4% in FY11 and 16.1% in FY12, given the change in composition of business mix towards manufacturing and government projects.

Exciting long-term growth opportunities

Unlike several of its peers, L&T is continuously developing new skill sets / entering new segments and geographies. We believe that its entry into new areas like power equipment, nuclear power plants, defense, shipbuilding, power development projects, and forgings (thermal and nuclear), increased presence in the Middle East, and its ability to take new PPP projects (due to strong balance sheet) will help L&T to ensure long-term sustainability of order flow. Further, some of these business segments could contribute meaningfully to consolidated revenues and profitability, going forward.

Certain business segments like nuclear power plants, shipbuilding and defense have witnessed strong support and initial action from the government. The first few orders could be received over the next 12-18 months. In the nuclear segment, L&T has tied up with global nuclear equipment suppliers to cater to India's planned addition of 16GW of nuclear power by 2020. This will entail investments of Rs1,600b over the next 8-10 years and the ordering of these projects is expected from FY11.

In power equipment, L&T had good initial success with project wins of 3.3GW BTG in the supercritical segment and additional 1.6GW turbine-generators. This demonstrates the management's ability to identify high growth business areas, to tie up technological partners, etc.

L&T has presence in financial services (L&T Finance/Infra Finance) and IT/ITES (L&T Infotech). In the last 2-3 years, these businesses have attained critical scale. With L&T's plan to grow these businesses plus manufacturing to 40% of group revenues by FY14, we see substantial organic and inorganic scaling up of these two verticals in 2-3 years.

L&T has also forayed into thermal and hydro power project development, and currently has a portfolio of 1.32GW of thermal power and 728MW of hydro power under development. The management has through various media articles stated its intent of setting up ~5GW of power capacity as developer by 2015. Mr Ravi Uppal had in the recent past been appointed as Managing Director and Chief Executive Officer of L&T Power (Mr Uppal was previously the head of Global Markets and a Member of the Group Executive Committee of the ABB Group). The foray will attempt to leverage L&T's expertise and skill sets in manufacturing supercritical BTG equipments (in JV with Mitsubishi), balance of plants (ash handling, coal handling, etc), electricals (control, instrumentations, switchgears, transmission towers, etc) and civil construction.

Downgrade earnings to factor in increased execution period, lower initial margins and losses till FY12 in power equipment subsidiaries

We now expect L&T to report consolidated net profit of Rs34.5b in FY10 (up 14.9%), Rs40.4b in FY11 (up 17%) and Rs51.6b in FY12 (up 27.9%). This means an EPS of Rs57.3 in FY10 (up 11.4%), Rs67.1 in FY11 (up 17%) and Rs85.8 in FY12 (up 27.9%). The stock quotes at 29.6x FY10E, 25.3x FY11E and 19.8x FY12E earnings.

We value L&T at Rs1,617/ share; maintain Neutral

We value L&T based on sum of the parts (SOTP) methodology. We arrive at a price target of Rs1,617/share based on: core business at Rs1,293/share (18x FY12E EPS), L&T Infotech at Rs50/share (12x FY11E EPS), L&T Infrastructure Development Projects at Rs50/share, L&T Finance at Rs29/share, L&T Infrastructure Finance at Rs14/share, International Ventures at Rs68/share and Manufacturing Ventures at Rs113/share. We have valued L&T IDPL at Rs30b (Rs50/share), comprising of road portfolio at Rs15b (P/BV of 1.56x), ports at Rs3.4b (P/BV of 1.3x), cash at Rs7b (P/BV of 1x, receivable from Bangalore airport stake sale), Urban Infra at Rs6b (P/BV at 1.2x). We maintain **Neutral**.

L&T: SUM OF PARTS VALUE

	BUSINESS SEGMENT	METHOD	VALUATION (X)	VALUE (RS M)	VALUE (RS/SH)	RATIONALE
L&T Standalone	Engineering, Construction, & Electricals	FY12E PER (x)	18	778,398	1,293	Premium to industry average Net of dividend received
L&T Infotech (100% stake)	Infotech	FY12E PER (x)	12	30,091	50	At par to niche second tier IT companies
L&T Infrastructure Dev. Projects Ltd.	Infrastructure			30,000	50	Road portfolio Rs15b (P/BV 1.56x), Ports Rs3.4b (P/BV 1.3x), Urban Infra Rs6b (P/BV 1.2x), Cash Rs7b
L&T Finance (100% stake)	Hire Purchase, Leasing, Bill Discounting	Book Value	1.5	17,525	29	BV of investments till Mar 10; L&T has advantage of catering to in house requirement of L&T's dealers / vendors / customers, etc
L&T Infrastructure Finance (100% stake)	Infrastructure Finance	Book Value	1.5	8,469	14	BV of investments till March 2010
International Ventures (L&T FZE)		FY12E PER (x)	15	40,936	68	Discount to L&T's valuations
Manufacturing Ventures						
- Power Equipments	Thermal BTG	FY14E PER (x)	12	49,426	82	At par with industry average; FY14 to be the year of meaningful revenue and margin ramp up
- L&T Komatsu	Excavators and Hydraulic System	FY12E PER (x)	15	20,443	17	In line with industry average
- Audco India	Industrial Valves	FY12E PER (x)	15	11,483	10	Revenue growth and margins have shown strong consistency
- EWAC Alloys	Welding	FY12E PER (x)	15	5,156	4	In line with industry average
Total					**1,617**	

Source: MOSL

INCOME STATEMENT					(Rs Million)
Y/E MARCH	2008	2009	2010E	2011E	2012E
Total Revenues	**252,715**	**343,248**	**393,971**	**468,229**	**624,845**
Growth Rate (%)	*40.3*	*35.8*	*14.8*	*18.8*	*33.4*
Excise Duty	3,328	3,985	4,574	5,436	7,254
Net Revenues	**249,387**	**339,264**	**389,398**	**462,794**	**617,591**
Growth Rate (%)	*41.0*	*36.0*	*14.8*	*18.8*	*33.4*
Manufacturing Expenses	191,305	262,320	296,067	347,708	468,258
Staff Cost	15,354	19,980	24,975	31,219	39,024
SG&A Expenses	13,856	18,640	23,638	29,498	39,365
EBITDA	**28,872**	**38,324**	**44,717**	**54,368**	**70,944**
Change (%)	*56.1*	*32.7*	*16.7*	*21.6*	*30.5*
EBITDA Margin (%)	13.1	13.2	13.6	13.4	12.6
Depreciation	2,022	2,828	4,223	4,951	5,731
EBIT	**26,850**	**35,495**	**40,494**	**49,417**	**65,213**
Net Interest	1,227	3,503	5,130	6,197	7,772
Recurring Other Income	4,271	6,451	9,573	8,901	7,873
Non-recurring Other Incon	1,640	947	0	0	0
Add: Trf to Revaluation Re	20	13	13	13	13
Share from Subsidiaries	0	0	0	0	0
Profit before Tax	**31,555**	**39,404**	**44,950**	**52,135**	**65,327**
Tax	9,821	12,312	14,159	16,422	20,578
Effective Tax Rate (%)	*31.1*	*31.2*	*31.5*	*31.5*	*31.5*
Reported Profit	**21,734**	**27,092**	**41,264**	**35,712**	**44,749**
Extra-ordinary Adjustment	1,640	7,910	10,473	0	0
Adjusted Profit	**20,668**	**26,968**	**30,791**	**35,712**	**44,749**
Growth (%)	*52.4*	30.5	14.2	16.0	25.3
Consolidated Profit	**22,910**	**30,046**	**34,507**	**40,375**	**51,641**
Growth (%)	*25.1*	*31.1*	*14.9*	*17.0*	*27.9*

BALANCE SHEET					(Rs Million)
Y/E MARCH	2008	2009	2010E	2011E	2012E
Equity Capital	585	1,171	1,204	1,204	1,204
Reserves and Surplus	94,966	123,426	183,769	209,174	241,008
Net Worth	**95,551**	**124,597**	**184,973**	**210,378**	**242,211**
Debt	35,840	65,560	81,024	96,024	126,024
Deferred Tax Liability	614	485	485	485	485
Capital Employed	**132,074**	**190,642**	**266,481**	**306,886**	**368,720**
Gross Fixed Assets	42,058	55,905	81,208	95,208	110,208
Less : Depreciation	12,827	14,762	18,985	23,935	29,666
Add : Capital WIP	7,293	10,803	3,500	4,500	4,500
Net Fixed Assets	**36,524**	**51,946**	**65,723**	**75,772**	**85,042**
Investments	69,223	82,637	81,835	92,558	97,223
Inventory	43,059	58,051	70,159	87,232	116,409
Sundry Debtors	73,650	100,555	118,731	146,241	200,293
Cash & Bank	9,645	7,753	49,670	41,548	31,610
Loans & Advances	36,638	67,906	82,597	98,795	124,540
Other Current Assets	143	216	0	0	0
Current Assets	163,135	234,480	321,158	373,817	472,852
Current Liabilities	136,838	178,424	202,235	235,261	286,397
Net Current Assets	**26,297**	**56,056**	**118,923**	**138,555**	**186,455**
Miscellaneous Expenditure	31	3	0	0	0
Capital Deployed	**132,074**	**190,642**	**266,481**	**306,886**	**368,720**

E: MOSL Estimates

RATIO					
Y/E MARCH	2008	2009	2010E	2011E	2012E
Basic (Rs)					
Adjusted EPS	**35.3**	**46.0**	**51.2**	**59.3**	**74.4**
Con. EPS (Fully Dilut	**39.3**	**51.5**	**57.3**	**67.1**	**85.8**
Growth (%)	*25.1*	31.1	11.4	17.0	27.9
Cash Earning per Share	37.9	49.9	58.2	67.6	83.9
Book Value	163.1	212.7	307.3	349.6	402.4
Dividend Per Share	8.5	10.2	12.8	14.8	18.6
Div. Payout (Incl. Div Tax)	26.3	26.5	28.9	28.9	28.9
Valuation (x)					
P/E (Standalone)	46.7	35.8	32.2	27.8	22.2
P/E (Consolidated)	42.1	32.1	28.8	24.6	19.2
P/E (Consolidated) (Fully I	42.0	32.0	28.8	24.6	19.2
Price / CEPS	43.5	33.0	28.3	24.4	19.7
EV/EBITDA	34.9	27.1	22.6	19.0	15.2
EV/ Sales	4.0	3.0	2.6	2.2	1.7
Price / Book Value	10.1	7.8	5.4	4.7	4.1
Dividend Yield	0.5	0.6	0.8	0.9	1.1
Return Ratio (%)					
RoE	27.0	24.5	19.9	18.1	19.8
RoCE	29.5	26.0	21.9	20.3	21.6
Turnover Ratios					
Debtors (Days)	106.4	106.9	110.0	114.0	117.0
Inventory (Days)	62.2	61.7	65.0	68.0	68.0
Asset Turnover (x)	1.9	1.8	1.5	1.5	1.7
Leverage Ratio					
Current Ratio (x)	1.2	1.3	1.6	1.6	1.7
D/E (x)	0.4	0.5	0.4	0.5	0.5

CASHFLOW STATEMENT					(Rs Million)
Y/E MARCH	2008	2009	2010E	2011E	2012E
PBT before EO Items	**31,555**	**39,404**	**44,950**	**52,135**	**65,327**
Add : Depreciation	2,136	3,073	4,223	4,951	5,731
Interest	1,227	3,503	5,130	6,197	7,772
Less : Direct Taxes Paid	9,821	12,312	14,159	16,422	20,578
(Inc)/Dec in WC	-2,053	-31,720	-20,949	-27,755	-57,838
CF from Operations	**23,044**	**1,948**	**19,195**	**19,105**	**414**
(Inc)/Dec in FA	-16,344	-18,495	-18,000	-15,000	-15,000
(Pur)/Sale of Investments	-38,178	-13,415	802	-10,723	-4,665
CF from Investments	**-54,522**	**-31,910**	**-17,198**	**-25,723**	**-19,665**
(Inc)/Dec in Networth	22,128	9,021	38,475	0	0
(Inc)/Dec in Debt	15,062	29,720	15,464	15,000	30,000
Less : Interest Paid	1,227	3,503	5,130	6,197	7,772
Dividend Paid	5,716	7,168	8,887	10,307	12,916
CF from Fin. Activity	**30,248**	**28,071**	**39,921**	**-1,504**	**9,313**
Inc/Dec of Cash	**-1,231**	**-1,892**	**41,917**	**-8,122**	**-9,938**
Add: Beginning Balance	10,944	9,645	7,753	49,670	41,548
Closing Balance	**9,645**	**7,753**	**49,670**	**41,548**	**31,610**

E: MOSL Estimates

N O T E S

For more copies or other information, contact
Institutional: Navin Agarwal. **Retail:** Manish Shah
Phone: (91-22) 39825500 Fax: (91-22) 22885038. E-mail: reports@motilaloswal.com

Motilal Oswal Securities Ltd, 3rd Floor, Hoechst House, Nariman Point, Mumbai 400 021

This report is for the personal information of the authorized recipient and does not construe to be any investment, legal or taxation advice to you. Motilal Oswal Securities Limited **(***hereinafter referred as MOSt***)** is not soliciting any action based upon it. This report is not for public distribution and has been furnished to you solely for your information and should not be reproduced or redistributed to any other person in any form.

The report is based upon information that we consider reliable, but we do not represent that it is accurate or complete, and it should not be relied upon such. MOSt or any of its affiliates or employees shall not be in any way responsible for any loss or damage that may arise to any person from any inadvertent error in the information contained in this report. MOSt or any of its affiliates or employees do not provide, at any time, any express or implied warranty of any kind, regarding any matter pertaining to this report, including without limitation the implied warranties of merchantability, fitness for a particular purpose, and non-infringement. The recipients of this report should rely on their own investigations.

MOSt and/or its affiliates and/or employees may have interests/ positions, financial or otherwise in the securities mentioned in this report. To enhance transparency, MOSt has incorporated a Disclosure of Interest Statement in this document. This should, however, not be treated as endorsement of the views expressed in the report.

Disclosure of Interest Statement	Larsen & Toubro
1. Analyst ownership of the stock	No
2. Group/Directors ownership of the stock	No
3. Broking relationship with company covered	No
4. Investment Banking relationship with company covered	No

This information is subject to change without any prior notice. MOSt reserves the right to make modifications and alternations to this statement as may be required from time to time. Nevertheless, MOSt is committed to providing independent and transparent recommendations to its clients, and would be happy to provide information in response to specific client queries.