

RESULTS REVIEW

Larsen & Toubro Ltd.

Hold

Share Data

Market Cap	Rs. 919.5 bn
Price	Rs. 1,568.3
BSE Sensex	14,493.8
Reuters	LART.BO
Bloomberg	LT IN
Avg. Volume (52 Week)	1.00 mn
52-Week High/Low	Rs. 2,930/ 557
Shares Outstanding	586.3 mn

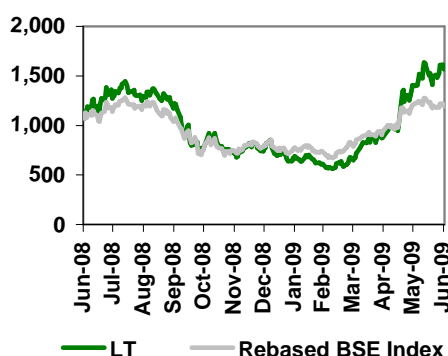
Valuation Ratios (Consolidated)

Year to 31 March	2010E	2011E
EPS (Rs.)	54.5	64.8
+/- (%)	10.6%	18.9%
PER (x)	28.8x	24.2x
EV/ Sales (x)	2.3x	1.9x
EV/ EBITDA (x)	18.8x	15.3x

Shareholding Pattern (%)

Promoters	0
FII's	12
Institutions	38
Public & Others	50

Relative Performance



UPA-led government spells hopes

Larsen & Toubro (L&T) reported a 35.4% yoy growth in net sales and a 33.5% yoy growth in its order book in FY09. Considering the infrastructure spending boost by the government, L&T's efficient execution skills and run up in the current share price, we have revised the stock's rating to Hold.

Likely to benefit from Gol's spending on infrastructure: To provide impetus to the current sluggish economic growth, the Government of India (GoI) is looking at boosting spending on infrastructure, removing policy bottlenecks, and simplifying procedures for project approvals. L&T has experience in a wide range of infrastructure projects and has a proven track record of executing such projects efficiently. Thus, the Company is likely to be one of the biggest beneficiaries of the Government's increased spending on infrastructure. Accordingly, we have upwardly revised L&T's order book growth for FY10 to 20% as against our earlier estimate of 9% growth.

Operating margins likely to remain stable: During FY09, the standalone margins of L&T remained almost stable as the Company continued to execute its orders efficiently and also because it was well-covered by pass-through clauses of cost escalations in its contracts. We expect Engineering and Construction (E&C) segment's margin to improve, owing to a healthy top-line growth and relatively lower commodity prices (as compared to H109). However, the margins of the other two segments—Electrical & Electronics (E&E) and Machinery & Industrial (M&I) are likely to remain under pressure. Thus, we expect the Company's overall operating margins to remain stable in FY10.

Key Figures (Standalone)

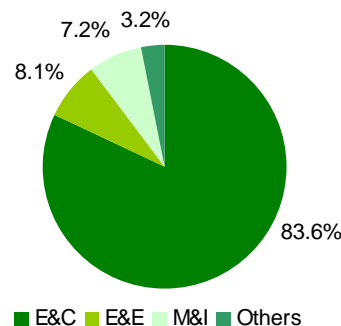
Quarterly Data	Q4'08	Q3'09	Q4'09	YoY%	QoQ%	FY08	FY09	YoY%
(Figures in Rs. mn, except per share data)								
Net Sales	84,669	85,940	104,690	23.6%	21.8%	248,547	336,466	35.4%
EBITDA	11,856	7,799	15,870	33.9%	103.5%	29,694	38,568	29.9%
Net Profit	9,037	5,315	11,424	26.4%	114.9%	20,652	26,441	28.0%
Margins(%)								
EBITDA	14.0%	9.1%	15.2%			11.9%	11.5%	
NPM	10.7%	6.2%	10.9%			8.3%	7.9%	
Per Share Data (Rs.)								
EPS	30.3	9.0	19.5	(35.7%)	116.2%	34.6	44.6	29.0%

Valuation: The stock is currently trading at a forward (FY10) P/E of 28.8x. Our fair value estimate of Rs. 1,621, based on the Sum-of-the-Parts (SOTP) methodology, factors in all the major positives and thus, provides limited upside potential from the current market price. Thus, we change our rating to Hold.

Result Highlights

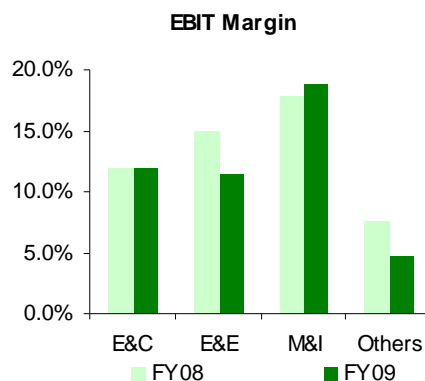
- During FY09, net sales surged 35.4% yoy, mainly driven by a 47.3% yoy revenue growth in the Engineering & Construction (E&C) segment. A strong order backlog and a faster order execution rate resulted in this growth in the revenue. However, E&E's revenue grew by only 3.8% yoy in FY09; it had declined by 6.3% yoy in Q4'09, impacted by the overall slowdown in the economy. Keeping up the trend, the revenue for the M&I segment increased 2.4% yoy in FY09 but decreased 23.3% yoy in Q4'09.

Segmentwise allocation of net revenue for FY09



Source: Company data

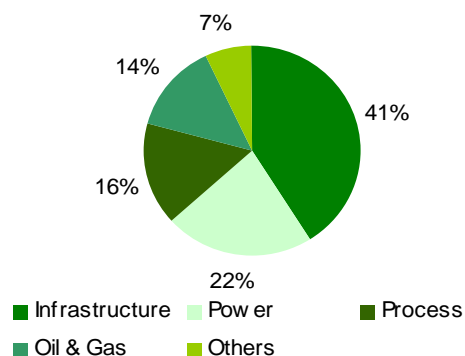
- The EBIT margin declined 56 bps yoy to 11.0%, impacted by the E&E segment. The EBIT margin of the E&E segment declined by 350 bps yoy to 11.4%, as a result of capacity underutilisation, competitive pricing pressures, and higher commodity prices in H109.
- The adjusted net profit margin for FY09 declined 46 bps yoy to 7.8%, impacted primarily by higher interest expenses and depreciation charges. Interest expenses surged 185.5% yoy and depreciation increased 44.6% yoy.



Source: Company data

- L&T's order inflow grew 22.9% yoy in FY09; however, in Q4'09 it increased by just 4.5% yoy. During Q4'09, the growth in order inflow was mainly driven by E&C, as E&E and M&I suffered from the economic slowdown. E&C's contribution to the total order inflow grew from 85.3% in Q4'08 to 90.2% in Q4'09.

Sectorwise allocation of the current order book



Source: Company data

- During FY09, the Company's debt balance surged 82.9% to Rs. 65.6 bn resulting in an increase in the debt-to-equity ratio from 0.38 at the end of FY08 to 0.53 at the end of FY09. The interest coverage ratio fell from 22.5x for FY08 to 10.1x for FY09.

Key Event

In June 2009, L&T offloaded its complete stake of 11.49% in Ultratech Cement Limited in the open market at an average price of around Rs. 725 per share, amounting to around Rs. 10.4 bn.

Outlook

Keeping in view the improving macroeconomic fundamentals and the UPA-led government at the Centre, we are optimistic about an increase in spending on infrastructure in India over the next few years. L&T's strategic initiatives to augment business prospects in some of the most promising sectors such as Power, Railways, Defence, and Nuclear Energy and excellent execution skills are likely to help the Company exploit the full potential of emerging opportunities. Consequently, we have upwardly revised the order book growth estimate for FY10 to 20%, as against the earlier expectation of a 9% growth.

We believe that relatively lower commodity prices (compared with H109) will help E&C improve its margins. However, E&E's and M&I's margins are likely to remain under pressure as a result of their muted top-line growth, which will impact their utilisation levels. Further, the net margins are likely to be impacted by higher average borrowing cost. During FY09, in the absence of low-cost foreign debt the Company had to borrow high-cost rupee debt to finance its capital expenses.

Valuation: The stock is currently trading at a forward (FY10) P/E of 28.8x. Our fair value estimate of Rs. 1,621, based on the SOTP methodology, factors in all the major positives and thus, provides limited upside potential from the current market price.

SOTP

Business	Basis	Value per share
Standalone	DCF	1,255
L&T Finance	P/E	39
L&T Infotech	P/E	60
L&T Infrastructure Finance Limited	P/E	26
Larsen & Toubro (Oman) LLC	P/E	21
Tamco Switchgears	P/E	9
Investments/Others	BV	193
Cash from the sale of stake in Ultratech	Sale Value	18
Target Price		1,621

Key Figures (Consolidated)

Year to March	FY07	FY08	FY09	FY10E	FY11E	CAGR (%)
(Figures in Rs mn, except per share data)						(FY09-11E)
Net Sales	203,360	291,985	401,870	442,782	546,987	16.7%
EBITDA	26,163	36,083	49,587	55,119	67,541	16.7%
Net Profit	18,864	22,846	30,058	31,974	38,003	12.4%
Margins(%)						
EBITDA	12.9%	12.4%	12.3%	12.4%	12.3%	
NPM	9.3%	7.8%	7.5%	7.2%	6.9%	
Per Share Data (Rs.)						
EPS	33.1	37.4	49.3	54.5	64.8	14.7%
PER (x)	24.4x	18.0x	31.8x	28.8x	24.2x	

Sensitivity analysis of fair value estimate

		Sensitivity Analysis				
		Cost of Capital (WACC)				
		11.0%	11.5%	12.0%	12.5%	13.0%
Terminal growth	6.0%	1,611	1,513	1,431	1,361	1,302
	6.5%	1,736	1,616	1,517	1,435	1,365
	7.0%	1,893	1,742	1,621	1,522	1,439
	7.5%	2,095	1,900	1,748	1,626	1,526
	8.0%	2,362	2,102	1,906	1,754	1,631

Source: Indiabulls research

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