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Larsen & Toubro Ltd, (L&T) is India's largest private sector engineering and Construction Company in India. The major EPC Company has unique business models which mark its presence in almost all sectors and provides it immense growth opportunities in terms of revenues and expansion. Its business is categorized in three segments, engineering and construction (E&C), electrical and electronics (E&E), Machinery and Industrial product (MIP) and other diversified businesses.

Investor's Rationale

The major engineering company, L&T posted an 18% YoY jump in third-quarter standalone net profit at ₹9.92 billion, mainly due to sharp increase in other income and top-line growth. It crossed the expectation of ₹8.95 billion net profit in this quarter. L&T has reported a better than expected sales of ₹139.99 billion in Q3FY'12 from ₹113.96 billion in the corresponding period last year.

The engineering and construction (E&C) segment, which contributes 80% to the total revenue, registered 25% YoY growth in revenue at ₹124.65 billion, with the bulk of orders from the infrastructure, power and hydrocarbon sectors. While the electrical & electronics registered a flat growth of 6% YoY to ₹8.42 billion on account of low industrial off-take, liquidity crunch in the domestic market and sluggish international demand. Machinery & Industrial Products (MIP) recorded muted growth of 6% to ₹7.03 billion. However, MIP's export revenues doubled in quarter.

L&T operating margin dropped by 117bps to 9.6% against 10.8% in Q3FY'11 on account of increase in operating expenses by 24.4% to ₹126.55 billion mainly due to increase in construction material cost which grew by 44% to ₹30.23 billion against ₹20.87 billion. Other income including gains from financial investments for the reporting quarter jumped by 78.9% YoY to ₹4.48 billion against ₹2.51 billion and by 23.6%QoQ which included dividends from subsidiary companies and treasury gains.

Although the quarter witnessed project deferments, aggressive competition and rupee depreciation, L&T's order book grew in size by 28% YoY rise in order inflow for the quarter at ₹171.29 billion, taking the Company's Order Book to ₹1457.68 billion as on December 31, 2011 due to increase in demand in foreign market. The company's had revised its order expectation to 5% from 15% for this fiscal, L&T bagged orders worth ₹500 billion in the first three quarters. It needs to secure another ₹300 billion of orders to meet the target.

Market Data

CMP (₹)	1,354
Target Price	1,600
Stop Loss	1,286
Duration	Mid-term
52-week High-Low (₹)	1,932.9/971.0
Rise from 52WL (%)	39.4
Correction from 52WH (%)	29.9
Beta	1.34
1 year Average Volume (mn)	0.34
Stock Return (%)	3M- (1.9) 6M- (18.3) 9M- (15.6)
Market Cap (₹bn)	828.3
Enterprise Value (₹bn)	1,130.1

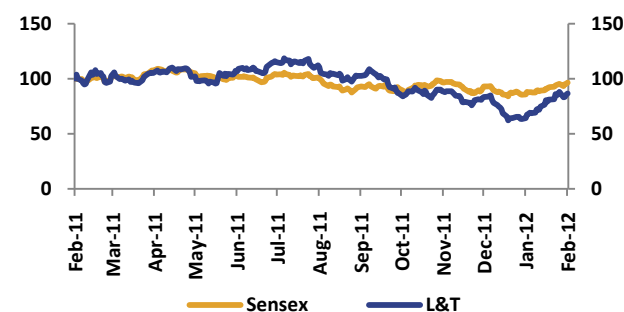
Shareholding Pattern

	Dec'11	Sep'11	Chg
Promoters (%)	-	-	-
FII (%)	13.84	15.94	(2.1)
DII (%)	37.81	36.24	1.57
Public & Others (%)	48.35	47.82	0.53

Quarterly Performance

(₹ bn)	Q3 FY'12	Q3 FY'11	Q2 FY'12	%Y-o-Y Change	%Q-o-Q Change
Revenue	139.99	113.96	112.45	22.8	24.5
Op. exp	126.55	101.69	100.71	24.4	25.7
EBITDA	13.43	12.26	11.74	9.5	14.4
OPM	9.6	10.8	10.4	(117bps)	(84bps)
Net profit	9.92	8.40	7.98	18.0	24.2
NPM (%)	61.5	62.3	58.4	(77bps)	309bps
EPS	16.11	13.65	12.94	18.0	24.5

One Year Relative Price Chart





Balance Sheet (Consolidated)

(₹billion)	FY10A	FY11A	FY12E
Share Capital	1.2	1.2	1.2
Employee stocks option	3.5	4.1	4.1
Reserve and surplus	205.2	245.1	288.0
Net Worth	209.9	250.5	293.3
Minority Interest	10.9	10.3	10.3
Secured funds	141.7	234.5	269.7
Unsecured Funds	84.9	93.8	107.9
Net deferred tax liabilities	1.5	3.1	3.1
Deferred payment liabilities	19.5	45.1	45.1
Capital Employed	468.3	637.2	729.3
Gross fixed assets	161.1	205.2	250.3
Less: Acc. depreciation	35.1	46.6	63.0
Net Fixed assets	123.6	156.2	187.3
Capital WIP	66.2	125.4	87.8
Total Fixed Assets	189.8	281.6	275.1
Loans for financing Act.	111.8	173.7	254.1
Investment	98.6	92.2	101.4
Net Current Assets	68.2	89.8	98.8
Capital Deployed	468.3	637.2	729.3

Key Ratios

	FY10A	FY11A	FY12E
EBITDA Margin (%)	16.1	16.4	16.0
EBIT Margin (%)	13.9	13.9	13.6
NPM (%)	8.41	8.05	8.29
ROCE (%)	13.3	11.5	12.3
ROE (%)	26.0	17.8	18.2
ROA (%)	13.1	8.3	8.7
EPS (₹)	90.8	73.7	88.2
P/E (x)	14.9	18.4	15.3
BVPS	349.8	414.0	484.9
P/BVPS (x)	3.9	3.3	2.8
EV/Operating Income (x)	2.3	2.2	1.8
EV/EBITDA (x)	14.1	13.0	10.9
EV/EBIT (x)	16.3	15.4	12.9

Profit & Loss Account (Consolidated)

(₹billion)	FY10A	FY11A	FY12E
Total Operating Income	439.7	520.9	651.1
Other Income	7.6	9.2	11.9
Total Income	447.3	530.1	663.1
Operating Expenses	375.3	443.3	556.7
EBITDA	72.0	86.8	106.4
EBITDA Margin (%)	16.1	16.4	16.0
Depreciation	9.8	13.2	16.5
EBIT	62.2	73.6	89.9
EBIT Margins (%)	13.9	13.9	13.6
Interest	6.9	8.3	10.4
PBT	73.5	67.3	79.5
Tax	20.4	23.6	26.2
Profit after tax	53.1	43.8	53.3
Extraordinary items	1.4	0.7	0.0
Minority Interest	(1.0)	(0.8)	(0.8)
Share of losses in Assoc. Co	1.1	0.9	0.9
Net profit	54.5	44.6	53.4
NPM %	8.41	8.05	8.29

Valuation

L&T has a long term strategy to capitalize on the prevailing strong and steady economic growth of India. In the recent past the company has taken several measures to accelerate its growth momentum. With an outlined capital expenditure of ₹40 billion for this fiscal, the balance sheet of the company is expected to witness a strong growth of above ₹700 billion by the fiscal end. Considering the above aspects, we rate the stock as 'BUY' at the current market price of ₹1,354 with ~18% potential upside. At the current market price, the stock is trading at PE of 18.4x on FY11 EPS of ₹73.7 and 15.3x on FY12E EPS of ₹88.2.



Indbank Merchant Banking Services Ltd.
I Floor, Khiviraj Complex I,
No.480, Anna Salai, Nandanam, Chennai 600035
Telephone No: 044 – 24313094 - 97
Fax No: 044 – 24313093
www.indbankonline.com

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