Angel Securities
Institutional Investment Services

Larsen & Toubro

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Large & Towering

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Larsen and Toubro

Large and Towering

The stock price of Larsen and Toubro (L&T) has underperformed the BSE Sensex over the last 3-6 months, primarily on account of its poor quarterly performances and rich valuations that provided limited scope for disappointment. However, after this underperformance, we believe that the stock has once again entered a comfortable valuation zone and will undoubtedly catch the eye of long-term investors, given that L&T is the largest E&C player with opportunities abound and has a ~24% CAGR earnings' story over FY2010-12E. **Hence, we Initiate Coverage on the stock with an Accumulate and a Target Price of Rs1,761.** We have used the SOTP methodology and have valued L&T's Parent business at 20x FY2012E Earnings and its subsidiaries/investments at Rs386/share.

Proxy to India's Infra Story: We believe that L&T is in an enviable position, given the apparent shortage of good quality constructors in India. It is in a position to choose its contracts and negotiate for price variation clauses. L&T's strong Balance Sheet, a sound execution engine, wide array of capabilities, integrated operations tailored to suit India's infrastructure growth story and multiple, recurring value-unlocking triggers over the medium-term, lead us to place faith in this default India infrastructure story. Further, L&T has an Order Book of Rs91,104cr, lending revenue visibility. Although there has been a poor show on the execution front in recent times, the management has guided for an improving scenario and we also believe that most of the pieces are falling into place.

Well-capitalised balance sheet funding the expansion: L&T has a well-capitalised balance sheet, at a debt-equity ratio of 0.5x in FY2009, inspite of having a strong portfolio of assets and having invested in future growth areas. We believe that the key factors for the same are: 1) High margins, and 2) Better working capital management.

Key Financials (Standalone)

Y/E March (Rs cr)	FY2009	FY2010E	FY2011E	FY2012E
Net Sales	**33,926**	**36,359**	**45,204**	**55,496**
% chg	*36.4*	*7.2*	*24.3*	*22.8*
Adj. Net Profit	**2,479**	**2,764**	**3,374**	**4,201**
% chg	*26.5*	*11.5*	*22.1*	*24.5*
Adj. FDEPS (Rs)	**42.2**	**45.6**	**55.6**	**69.2**
EBITDA Margin (%)	11.4	12.1	11.8	11.9
P/E (x)	38.2	35.4	29.0	23.3
RoAE (%)	22.5	17.9	17.1	18.4
RoACE (%)	22.0	17.6	17.5	19.4
P/BV (x)	7.6	5.3	4.6	4.0
EV/Sales (x)	3.1	2.8	2.3	1.9
EV/EBITDA (x)	27.0	23.1	19.4	15.9

Source: *Company, Angel Research*

ACCUMULATE

CMP	Rs1,611
Target Price	Rs1,761
Investment Period	12 Months

Stock Info	
Sector	Infrastructure
Market Cap (Rs cr)	97,029
Beta	1.3
52 Week High / Low	1,800/604
Avg Daily Volume	558359
Face Value (Rs)	2
BSE Sensex	17,451
Nifty	5,225
Reuters Code	LART.BO
Bloomberg Code	LT@IN

Shareholding Pattern (%)	
Promoters	0.0
MF / Banks / Indian FIs	43.0
FII / NRIs / OCBs	20.1
Indian Public / Others	36.9

Abs. (%)	3m	1yr	3yr
Sensex	1.3	85.2	31.3
L&T	(3.6)	166.5	97.4

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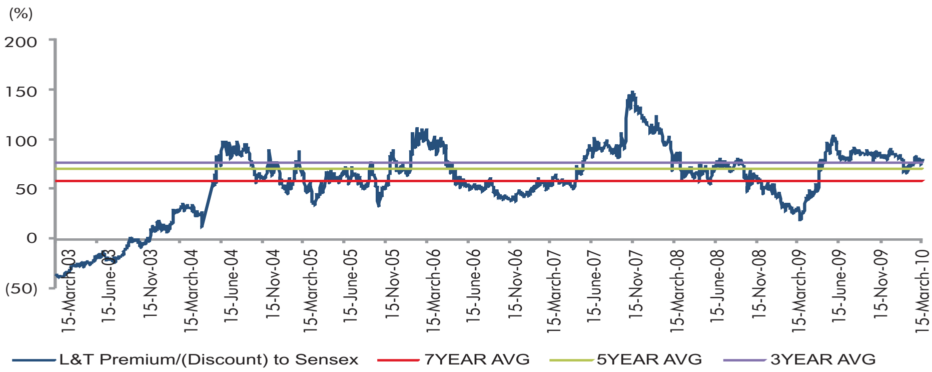
Valuation: SOTP of Rs1,761

In the past, on a longer term horizon (7 years), L&T has always traded at an average premium of almost 60% to Sensex valuations, given its strong operating cash flows, superior return ratios (in excess of 20%) and excellent capital efficiency. Pertinently, for the shorter period (say 3-5 years) there has been a gradual increase in this premium to >70%, mainly to account for its investments in areas of future growth thereby enhancing visibility. Further, in terms of stock performance, L&T has outperformed the Sensex over the last few years. However, on a shorter duration (3-6 months) the company has underperformed the Sensex. We believe that this was primarily on account of its poor quarterly performances and rich valuations that provided limited scope for disappointment. However, after this underperformance, we believe that the stock has once again entered a comfortable valuation zone and will undoubtedly catch the eye of long-term investors. We believe that going ahead, L&T's growth momentum, coupled with better pricing power, superior margins, an earnings CAGR of ~24% over FY2010-12E and opprtunities abound, would justify its superior valuations and would lead to outperformance.

At the CMP of Rs1,611, the stock is trading at 23.3x FY2012E Earnings and 4.0x FY2012E P/BV, on a standalone basis. **We Initiate Coverage on the stock, with an Accumulate rating.** We have used the sum-of-the-parts (SOTP) methodology to value the company and to capture all the business initiatives taken by it, and also to factor in the investments/stakes in different businesses. **On an SOTP basis, by ascribing separate values to its Parent business on a P/E basis and investments in subsidiaries using the P/E, P/BV and MCap basis, we have arrived at a Fair Value of Rs1,761, which provides ~9% upside from the current levels; hence, we recommend an Accumulate view on the stock.** Further, it should be noted that at our SOTP Target Price the stock would be trading at around 25.5x FY2012E standalone EPS of Rs69.2, which would imply a premium of ~50% over Angel's Sensex Target FY2012 P/E multiple of 17x. This is at a discount to the historical premium commanded by L&T over the Sensex.

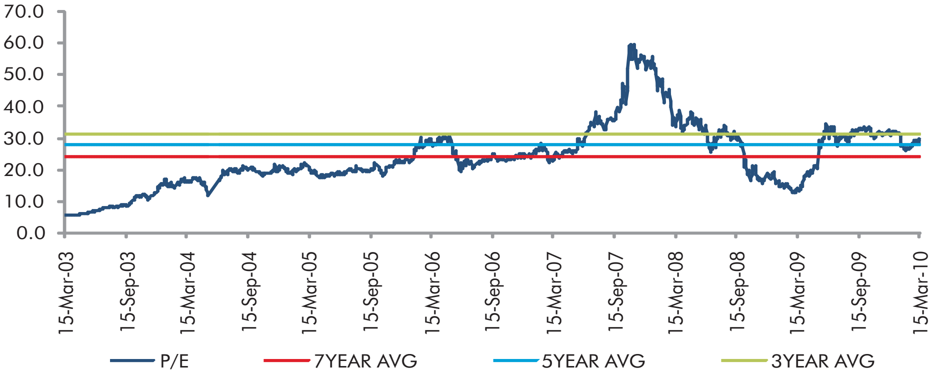
Exhibit 1: L&T: Parent historic P/E multiple premium to Sensex



Source: Company, Angel Research

Also, the historical 1-year forward P/E band shows that L&T has always traded at an average P/E of 24x, 28x and 31x, on the past seven, five and three year basis, respectively. Therefore, our SOTP Target P/E multiple (25.5) is lower than the historical average. Further, it should be noted that FY2012E would be an excellent year, given that most of its investments in the IDPL and Power equipment businesses would start generating significant revenues and would enhancing visibility.

Exhibit 2: L&T - Parent 1-year forward P/E bands



Source: Company, Angel Research

Our SOTP Target Price for L&T is Rs1,761, based on FY2012E numbers, translating into a potential upside of ~9% from the current levels . We Initiate Coverage on the stock with an Accumulate recommendation.

Exhibit 3: SOTP Valuation

Business Segment	Methodology	Remarks	Rs cr	Rs/Share	% to TP
L&T- Parent	**P/E**	**20x FY2012E Earnings**	**84,016**	**1,385**	**78.7**
Infrastructure Subsidiaries			**6,953**	**115**	**6.5**
IDPL (stake - 78.4%)	P/BV	2.5x FY2012E Book value	6,953	115	6.5
Key Subsidiaries - Services			**8,075**	**133**	**7.6**
L&T Infotech	P/E	14x FY2012E Earnings	4,971	82	4.7
L&T Finance	P/BV	1.5x FY2012E Book value	2,016	33	1.9
L&T Infrastructure Finance	P/BV	1.5x FY2012E Book value	1,089	18	1.0
Key Subsidiaries - Manufacturing			**5,204**	**86**	**4.9**
Tractor Engineers	P/E	12x FY2012E Earnings	242	4	0.2
Associate Companies	P/E	12x FY2012E Earnings	1,540	25	1.4
L&T MHI Boilers and Turbines (stake - 51%)	P/E	16x FY2012E Earnings	3,422	56	3.2
Other Subsidiaries			**2,573**	**42**	**2.4**
Satyam 6.1% Stake	Mcap	20% holding company discount	412	7	0.4
Other Investments	P/BV	1x FY2012E Book Value	2,161	36	2.0
Total			**106,822**	**1,761**	**100**

Source: Company, Angel Research

Investment Arguments

Proxy to India's Infra Story

L&T's strong Balance Sheet, a sound Execution engine, a wide array of capabilities, integrated operations tailored to suit India's infrastructure growth story, and multiple recurring value-unlocking triggers over the medium-term, lead us to place faith in this default Indian infrastructure story

We believe that L&T is in an enviable position, given the apparent shortage of good quality constructors in India. It is in a position to choose its contracts and negotiate for price variation clauses. Moreover, it has created natural monopolies of scale and is the only company in India capable of executing large orders. For instance, L&T is the only competent player to handle big-sized complex contracts, owing to which it has won the EPC contracts for all the four large airports to be modernised by private developers in India in the last few years. This has not only resulted in vast opportunities coming the company's way, but has also given it pricing power capability, enabling it to register some of the highest Margins and Return Ratios in the industry. Moreover, L&T's strong Balance Sheet, a sound Execution engine, a wide array of capabilities, integrated operations tailored to suit India's infrastructure growth story, and multiple recurring value-unlocking triggers over the medium-term, lead us to place faith in this default Indian infrastructure story.

Infrastructure: Lifeline of an Economy

Infrastructure development provides insights into how an economy has performed in the past, as well as providing a basis for extrapolating possible future growth. Thus, overall, infrastructure development serves as a lag as well as a lead indicator.

The Passive Past

Over the years, India has been experiencing power deficits, an inadequate road network to support the ever-burgeoning vehicular traffic, ports serving as bottlenecks rather than the means to increase foreign trade (in spite of India having a long coastline, of around 7,200km), and so on and so forth. However, it is imperative that the growth of the human population is accompanied by a matching growth in the underlying infrastructure (at the minimum), if not more. When this does not happen, it starts to have a draw-down effect on the overall growth of the economy, which was being experienced by India until recently. The factors which we believe impeded infrastructural development prior to 2004 included a lack of political will, poor financial health of the country and a lack of innovation.

When the going gets tough, the tough get going

Investment in infrastructure has been the focal point in recent years, as realisation dawned on the government that inadequate infrastructure has been withholding India's growth and deterring foreign players from investing in the country. The 'Global Competitiveness Report' by the World Bank points at the 'Inadequate supply of infrastructure', which is the most problematic factor for doing business in India, and which sums up the crucial role that infrastructure plays in ushering future growth.

Political Will: Resistance becomes support

Political consensus is a necessity for infrastructure development in India, as until and unless the need is severely felt by the government, major fund flows will not materialise (either in the form of orders/contracts awarded or grants/benefits made). However, as has been seen in the recent past, which is expected to continue henceforth, we believe that the government has no other option but to continue its focus on infrastructure development in the country. This is considering that, in the backdrop of the 8% GDP growth that India has achieved in the last 3-4 years, infrastructural bottlenecks have only magnified, threatening to create strong hurdles in the country's path to prosperity, if not adequately dealt with. Hence, notwithstanding the near-term pressure points (like a high fiscal deficit) we believe that the current conditions are conducive, with the UPA government back in power to continue to implement the infrastructure development agenda.

PPP: Combining the Best of both Worlds

Historically, infrastructure projects have been financed and controlled by the government. As a result, the implementation of these projects centered on the availability and adequacy of funds, because of which, in most cases, projects got delayed and resulted in cost overruns. The Core Group of Committee on Infrastructure noted this and, subsequently, the Public Private Partnership (PPP) model of financing has gained importance over the past few years. Currently, the PPP mode is quite popular as far as Infrastructure projects are concerned, where the private player (read: L&T) has a major role to play. A major benefit of the PPP mode is that it brings in the expertise of the private sector and that too at a reasonable cost. Hence, there has been an increasing proportion of participation from the Private sector in the Eleventh Five-year Plan (at 30% versus 20% in the Tenth Five-Year Plan).

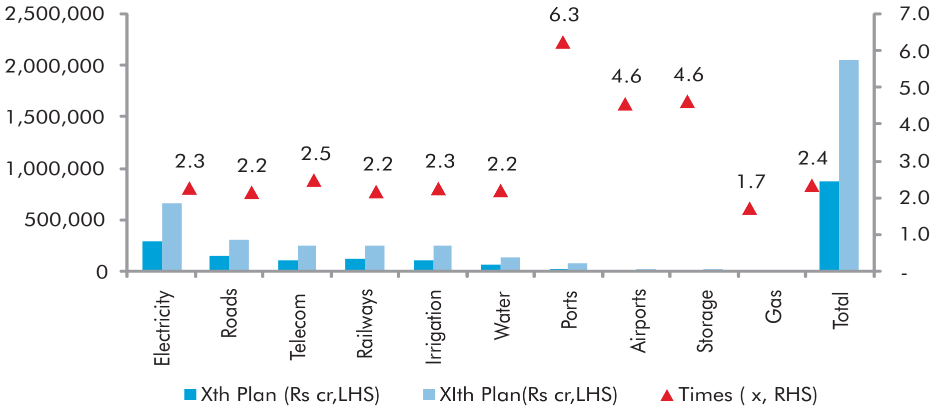
Infrastructure Sector poised for interesting times

L&T's overall opportunity is abound, going ahead, as we expect action to pick up in the space after the formation of a stable government by the incumbent UPA party

L&T has established its presence in all the growing segments of the Indian Infrastructure space. It has presence in the EPC space via the parent company (which has a robust order book of Rs91,104cr as on 9MFY2010), and as a developer via IDPL (Infrastructure Development Projects Limited, which has a portfolio of assets spread across roads, ports and airports). Thus, L&T's business model clearly has an edge over other infrastructure companies, which have a limited presence and that too at a much lower scale as compared to L&T. Therefore, we believe that L&T offers investors with an opportunity to play out a more resilient and diversified theme of the Indian infra story, which will be able to deliver growth for a long time.

The government of India has chalked out an aggressive road map for spend on the infrastructure sector over the XIth Five-Year Plan, which is expected to post a CAGR of 9% over the Xth Five-Year Plan; we expect L&T to play a major role in the whole scheme of things. L&T's overall opportunity is abound, going ahead, as we expect action to pick up in the space after the formation of a stable government by the incumbent UPA party.

Exhibit 4: India's Infra spend in XIth plan expected to increase



Source: Company, Angel Research

Opportunities for L&T

We are expecting lot of action in the Infra space, especially in work related to Roads (change in guard at the ministry level), Power (demand outstripping supply in a major way) and Railways (a better financial position)

Government funded projects, Infrastructure, and Oil and Gas projects form a major share of L&T's order book. Therefore, L&T's business is connected in one way or another with government policies. The period before the election had seen little action on the ground due to the electoral code of conduct, and there was a general lull for the next four months. However, things have changed and we believe that the slowdown in order inflows is a thing of the past. The oil and gas sector has started moving, particularly upstream (read: ONGC), and it is further expected that one or two private players will also start investing now. The Middle East is starting to pick up again in oil and gas, refinery and petrochemicals, and in mid and downstream. So, two of L&T's operating companies, which are in upstream oil and gas, and in midstream, have seen a pickup in activity. Infrastructure is now beginning to push forward, with the government policy focused on building infrastructure in India.

Oil and Gas: Many big ticket oil and gas tenders have been floated repeatedly over the past 6-12 months. Key projects likely to be awarded in the near term include: i) B-193 platform contract from ONGC worth ~US $1bn, ii) offshore gas field development contracts off Kakinada coast from GSPC worth ~US $1.6bn, and iii) feedstock conversion projects at PSU fertilizer units in Bhatinda and Panipat. The management expects around ~US $3bn award activity in the hydrocarbon sector in the near future, and considering L&T's dominance in the segment we are expecting the company to garner a decent share of this opportunity.

Infrastructure: We are expecting lot of action in this space, especially in work related to Roads, Power and Railways. The reasons for this can be attributed to a change in guard at the ministry level (roads), demand outstripping supply in a major way (power) and a better financial position (railways). *(Refer Annexure).*

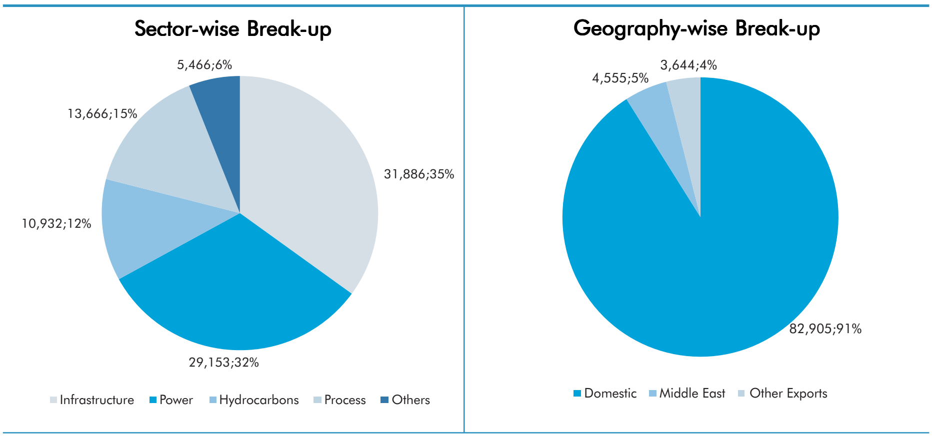
L&T has an OB of Rs91,104cr as on 9MFY2010, which constitutes orders from Infrastructure (35%), Power (32%), Hydro carbons (12%), Process (15%) and Others (6%), which are at 2.5x FY2010E revenues

Robust Order Book: Expect order inflows to pick up

L&T has an order book of Rs91,104cr as on 9MFY2010, which constitutes orders from Infrastructure (35%), Power (32%), Hydro carbons (12%), Process (15%) and Others (6%), which are at 2.5x FY2010E revenues. The company had witnessed a surge in order inflows (an average growth of nearly 32%) over FY2003-08, which can mainly be attributed to the huge capex and infra spend from the private and government sectors. However, FY2009 was a year in which the company experienced a slowdown (if it can be described so), by registering a growth of a mere 22% in order inflows. We believe that L&T faced the brunt of the global and domestic economic slowdown. Although the company's financial performance was less impacted as compared to its peers, however in terms of share price, a correction of 55% was witnessed in the stock in FY2009. This dip in the share price, we believe, was mainly due to the uncertainty surrounding the future growth prospects (concerns over order inflows - slowdown in private and public sector capex) and the sustainability of high margins due to weak global & domestic environment (in light of high commodity prices).

However, the government had taken measures (in the form of stimulus packages) to improve the overall economic environment - the RBI reduced the CRR and SLR to improve the liquidity in the domestic banking system, changes in norms for raising money via ECBs etc. As a result of these measures, things are once again falling in place for the economy and for the infrastructure sector (read: L&T). In line with this, the infrastructure sector has witnessed a good order inflow of late. In recent times, though the RBI has increased the CRR, we believe that such a step has been undertaken to tame inflation, rathen than to choke the liquidity in the system.

Exhibit 5: Order Book - High revenue Visibility (Rs cr, % to Total O/s Order Book)



Source: Company, Angel Research

Yet, the pertinent questions in this regard are the endurance of this recovery and the factors which can impact the infrastructure sector in general and L&T in particular. We have analysed the capex cycle in our economy, as we believe that it is one of the important factors in giving an idea about the company's future performance.

Capex Cycle: Which way it's headed, which way it's going to roll

India bore the brunt of the global crisis, which not only led to a dent in the financial markets, but also had a severe impact on the capex spree, owing to a difficulty in raising funds through the equity markets, risk aversion by banks and the shifting of the burden of development to private players

India had witnessed an unprecedented capex-expansion cycle (from corporates, in the sectors of steel, power, oil and gas, and cement, which laid huge expansion plans, on account of a demand-supply mismatch, and from the Government, through initiatives like strengthening the road network, enhancing the power capacity and improving the urban geographies) over the last five years (FY2003-08), until the global economy witnessed a crisis in 2HFY2009. This huge capex was managed on the back of support from the soaring equity markets, robust FDI flows and easy liquidity. Hence, the heavy capex during this period was on account of readily available funds via IPOs (Rs1,49,500cr), FCCBs/GDRs (Rs2,19,400cr), preferential allotments, QIPs and rights issues. Even on the debt front, the capex was supported by benign interest rates (6-9%) over the same period. This resulted in order inflows of never-seen-before proportions for the Indian Construction and Engineering sectors.

But, the gradual increase in the commodity prices during 2006-2008 started showing its impact on industry players and shaved 2-3% off their EBITDA margins. During FY2009, India bore the brunt of the global crisis, which not only led to a dent in the financial markets, but also had a severe impact on the capex spree, owing to a difficulty in raising funds through the equity markets, risk aversion by banks and the shifting of the burden of development to private players (due to a lack of government funding).

India continues to progress steadily, although GDP growth has slowed down from over 8% achieved in the previous fiscal, it is one of a few select nations that are on course to achieving a GDP growth of over 6.5% this year. Going ahead, the growth is expected to continue on the back of increased investments to meet the growing domestic demand and due to India's competitive advantage in a few sectors (read Exports). Favourable macroeconomic indicators, relatively comfortable leverage levels of companies, and the willingness of banks to lend to corporates with strong balance sheets will drive these investments. Aggregate industrial capex to the tune of Rs10.5 trillion is expected during next few years (Source: Crisil). Although this is a decline of around 25% from the previously announced level, the investments are still significant.

Going ahead, over the next couple of years, companies are expected to be cautious in their investment decision-making (in the midst of lower economic growth), while the government is expected to step up spending, particularly in the infrastructure space. We believe that sectors such as roads, power and railways offer vast opportunities to invest in, due to their relatively strong fundamentals and large planned capex.

A strong push to investments in infrastructure and education, and structural reforms (decontrol of oil prices, and curbing non-productive expenditure and subsidies), aimed at attracting capital flows into India, would result in higher investments than those projected

To conclude, we expect aggregate industrial investments to continue to grow at a moderate pace over the next few quarters. This growth is notwithstanding the expectations of a relatively muted GDP growth, and is in contrast to experiences in the past, when a deceleration in economic growth resulted in a huge decline in corporate investments. The political stability brought about by the election of a stable government at the Centre also augurs well for investments. A strong push to investments in infrastructure and education, and structural reforms (decontrol of oil prices, and curbing non-productive expenditure and subsidies), aimed at attracting capital flows into India, would result in higher investments than those projected. This would ensure a consistent and strong order inflow for companies like L&T. As on 9MFY2010, L&T has a robust order backlog of Rs91,104cr, spread across sectors, ensuring revenue visibility for the next two-three years. Going ahead, we are expecting order inflows to the tune of ~Rs75,000cr and ~Rs88,000cr for FY2011E and FY2012E, respectively, which are on the back of the reasons mentioned above.

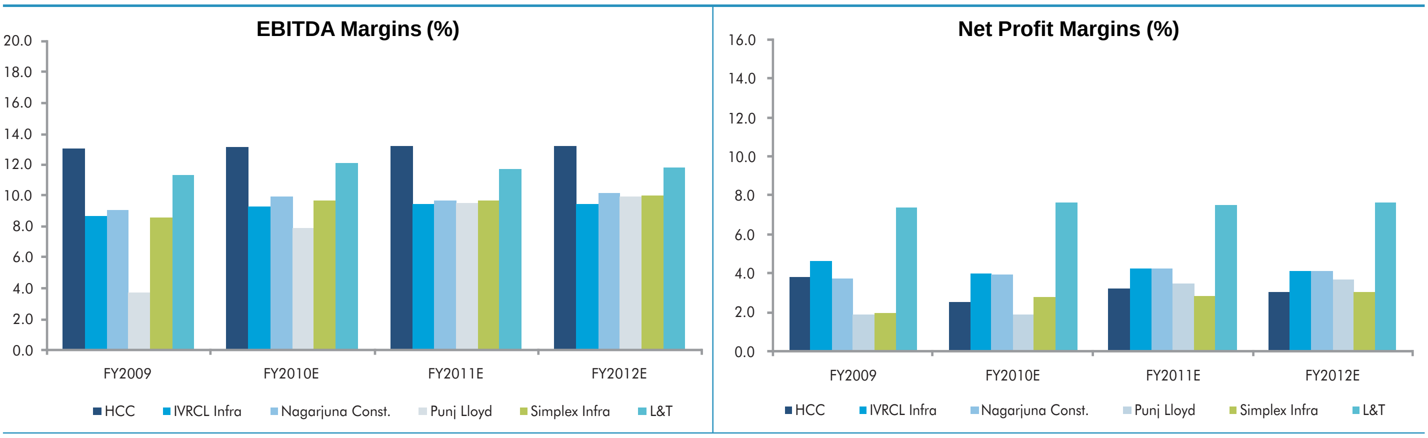
Well-capitalised balance sheet...

We believe that the key differentiating factors for L&T are High margins and Better working capital management

L&T, inarguably the market leader of the Indian construction industry, has a well-capitalised balance sheet, with a comfortable debt-equity ratio of 0.5x in FY2009, inspite of having a strong portfolio of assets and having invested in future areas of growth. We believe that the key factors in the same are: 1) High margins, and 2) Better working capital management.

L&T has been able to maintain high margins as compared to its peers owing to: 1) Good selection of projects, 2) Economies of scale, 3) Leveraging on its brand for funding projects at very competitive rates, and 4) Better utilisation of resources.

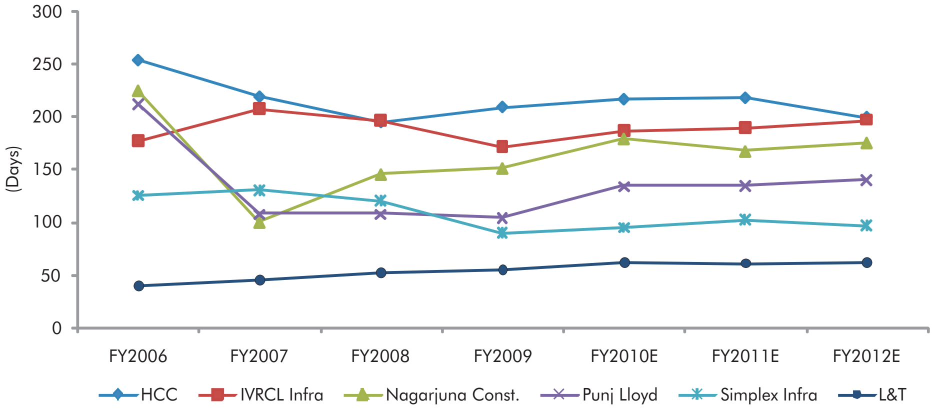
Exhibit 6: L&T leads on the Margin front



Source: Company, Angel Research

Working capital management is an important yardstick to measure a company's operational and financial efficiency. It is important that companies minimise risk by prudent working capital management. In short, the quicker you get cash in the door from your customers and the slower it has to leave to pay your suppliers, the better, as that cash stays longer in the business and works harder for you. The essence of effective working capital management is proper cash flow forecasting and accounting for the impact of unforeseen events. Market leaders (read: L&T) can manage uncertainty better, as they have contingency plans to tide over unexpected events. Addressing the issue of working capital on a corporate-wide basis has certain advantages. Cash generated at one location can well be utilised at another. This can be said to be true in the case of L&T, as the company has been working on several new business verticals to drive growth.

Exhibit 7: L&T - Most efficient working capital management



Source: Company, Angel Research

...funding the expansion

The management expects segments like power (power equipment and power project development), shipbuilding, railways and nuclear power to emerge as new growth areas going ahead

The management expects segments like power (power equipment and power project development), shipbuilding, railways and nuclear power to emerge as new growth areas post FY2010. In nuclear power, L&T has also formed a JV with NPCIL for building a forging facility. Also, the railways segment presents an interesting growth option, given the planned investments in the Dedicated Freight Corridor, metro rail projects planned in various cities etc. L&T also plans to extend its product portfolio to rolling stocks, cast wheel manufacturing etc. In shipbuilding, the company is in the process of acquiring 1,200 acres near Chennai in Tamil Nadu. This facility will comprise of shipbuilding, ship repair, heavy manufacturing/fabrication and a port.

- **Power:** For power equipment manufacturing, L&T has entered in a joint venture with Mitsubishi - the boiler manufacturing facility is expected to be operational by April 2010 and the turbine facility by 1HFY2011. The initial capacity is 4GW, but the plant has been configured to enable quick ramp-up to 6GW. This would depend on the pace of order book accretion. Nuclear power is likely to emerge as a growth area post FY2012, for which L&T has also formed a JV with NPCIL.

- **Shipbuilding:** L&T is setting up an integrated shipyard complex at Kattupalli, near Ennore, in Tamil Nadu, and has signed an MOU with the Tamil Nadu Industrial Development Corporation. The shipyard will have the capability to build vessels for the defense sector, commercial ships (including Very Large Crude Carriers), specialised cargo ships for liquid/gas transportation, and cruise vessels. The facility will also have the capability of building off-shore platforms and Floating, Production, Storage and Offloading (FPSOs). The Ennore shipyard is expected to receive all statutory clearances and achieve financial closure in the near future. Order booking is expected from the start of FY2011 onwards, and shipbuilding is anticipated to start in mid-FY2011.

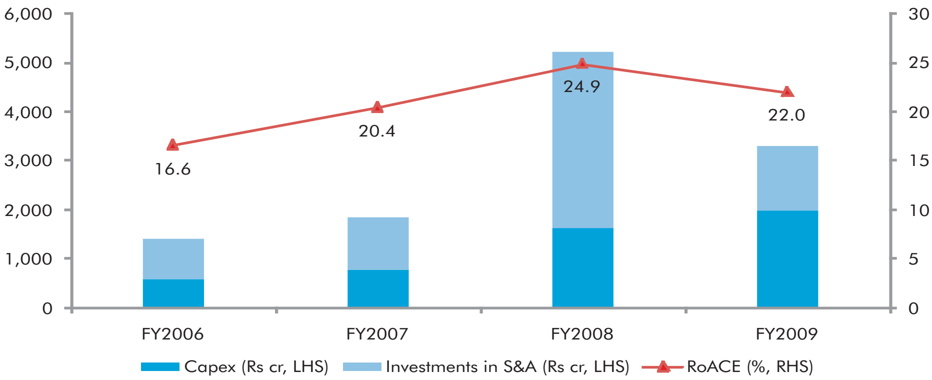
- **International operations:** L&T has placed a greater emphasis on accelerated growth in GCC countries, with exports accounting for nearly 20% of the sales during FY2009. L&T established a fabrication facility at Sohar, Oman, in a 65:35 JV with the Zubair Group. This facility will mainly help in the fabrication of modular structures, oil and gas platforms, and heavy jackets. Also, the company is setting up a Greenfield plant in Sohar for the manufacture of high-tech equipment for the oil and gas sector. To expand its presence in electrical switchgears beyond the low-voltage category, L&T acquired TAMCO (Malaysia), which has a strong presence in MV switchgears in

South-East Asia and the Middle East. The acquisition also provides L&T with a manufacturing footprint in Malaysia, Indonesia, China and Australia.

L&T has always been conservative in funding its expansion plans and has raised money much before the actual need arises. The same phenomenon has been witnessed recently, when the company raised money to the tune of Rs2,807cr (QIP+FCCB), which, we believe, would only be required sometime next year. We are expecting the company to have an outlay of Rs7,000cr (capex and investments in subsidiaries) over the next two years, which would be funded through the recent dilution, positive operating cash flows and the raising of loans.

Besides Capex, L&T is also investing heavily in areas of growth

Exhibit 8: Investing for future growth



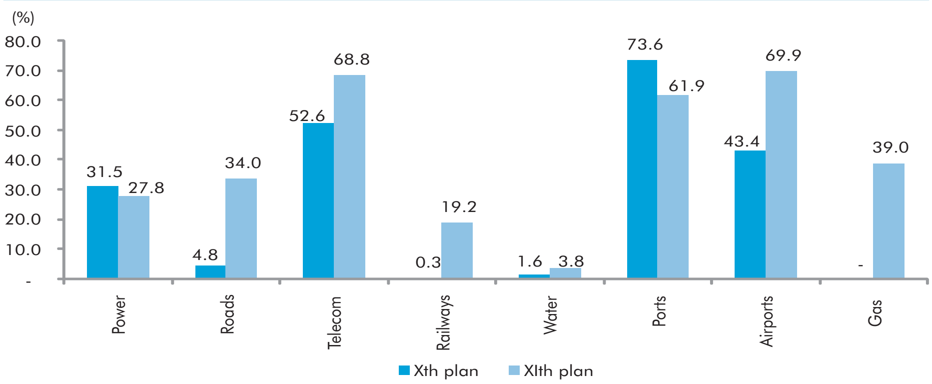
Source: Company, Angel Research

Great Infusion-Dilution opportunity

Given the high growth opportunities present in L&T's varied business verticals (Infrastructure and Finance), we feel that the company provides a great infusion-dilution opportunity

Investment in the Construction segment is expected to double over the Eleventh Plan Period, and the PPP model is assuming a greater significance in delivering and meeting physical targets in different segments of the Infrastructure space. The government, through Regulatory changes, is focusing on the Construction segment through the PPP mode of investment. It expects the PPP share in the Eleventh Plan to be 30%, as against a mere 19.8% in the Tenth Plan. This has become imperative due to the widening gap between the demand for infrastructure and financial resources available with the Government to fund the same.

Exhibit 9: Private Sector participation set to increase



Source: Planning Commission, Angel Research

We believe that IDPL, the asset-owning subsidiary, offers a great infusion-dilution opportunity

Given the high growth opportunities present in L&T's varied business verticals (Infrastructure and Finance), we feel that the company provides a great infusion-dilution opportunity. It should be noted that such moves lead to a short-term dilution in equity, leading to the EPS getting temporarily depressed. However, such moves also shore up the net worth of the company, which fuels its future growth. Further, it also serves as a benchmark for valuing the entity.

In the case of L&T, IDPL, the asset-owning subsidiary, usually undertakes projects in any infrastructure sub-sector, except thermal power plants (which we believe could be routed via L&T's power projects division). IDPL usually bids for projects of a minimum size of Rs250cr, with prequalification in all the announced projects across all sectors. However, IDPL believes that it is very important that the project must make commercial sense at the bidding stage itself and must cross the internal IRR hurdle. No projects are taken for swelling the order book, and the project must make economic sense for IDPL as the developer, while giving market margins to L&T's construction division. We believe that IDPL, the asset-owning subsidiary, offers a great infusion-dilution opportunity, owing to the reasons mentioned above.

Concerns

Continued Order inflow essential to sustain Top-line growth

Any slowdown in global economies may hamper the credit availability for the industrials, the demand for capital goods and may defer the capex plans of companies, which may have a negative impact on the order inflow of L&T

A consistent Order inflow is the lifeline (for growth) of any infrastructure company and L&T is no different. Even the fear surrounding the uncertainty/cancellation of order inflows has a huge bearing on the stock price (which was witnessed in FY2009). The order inflows, for L&T, from the public sector have shown a growth of 16.9% during FY2009, as compared to an 11.5% growth in order inflows from the Private Sector. Going forward, we expect the private sector to be the major contributor of order inflows to L&T, which also poses a higher risk in the form of execution delays and cancellations. Moreover, L&T is exposed both directly and indirectly to the uncertainties in the global markets, especially to any slowdown in the Middle-Eastern economies. Any slowdown in global economies may hamper the credit availability for the industrials, the demand for capital goods and may defer the capex plans of companies, which may have a negative impact on the order inflow of L&T. We are factoring in order inflow to the tune of ~Rs75,000cr and ~Rs88,000cr for FY2011E and FY2012E, respectively. Order inflow below this would pose a risk to our recommendation. However, given L&T's position and the planned outlay for the sector, we believe that it is highly improbable that L&T does not achieve our targeted order inflow.

Rising Raw Material prices

A sharper-than expected increase in the prices of raw materials could impact L&T's Margins

A sharper-than expected increase in the prices of raw materials could impact L&T's Margins. L&T engages in hedging policies to immunise itself from any such commodity risks and also enters in back-to-back contracts. However, we believe that, inspite of several hedging policies in place, any unfavorable change in commodity prices could impact the margins.

Execution risks

The construction business is fraught with project risks and one cannot ignore the inherent risks associated with the business

The construction business is fraught with project risks. The timely execution of projects is the key to success in the infra space and L&T has mastered that over the years. Execution delays not only stretch the working capital requirements, but also impact the profitability (legal costs, penalties etc.) of the company. We believe that L&T, as in the past, would maintain its high standard of due diligence and would not incur any loss from execution delays. However, one cannot ignore the inherent risks associated with the business.

Risks due to Currency fluctuation

Any unfavorable movement in currency can pose a risk to our recommendation

L&T operates in many countries, owing to which it is exposed to currency fluctuation risks. Being an Indian-based company, L&T reports its revenues in Indian Rupees, and accounts for Losses or enters into hedging, which impacts its Profitability. Going ahead, any unfavorable movement in currency can pose a risk to our recommendation. However, over the years, the company has managed to cover such risk and we expect L&T to continue to do so, going ahead.

Financial Outlook

Top-line: Expect growth in coming quarters

Over FY2010-12E, we are expecting L&T to post a CAGR of 23.5% to Rs55,496cr (from Rs36,359cr), which would primarily be driven by a robust order backlog and good order inflow traction expected for the company

L&T witnessed a surge in its Top-line over FY2007-09, registering a CAGR of 38.8% to Rs33,926cr, thanks to a number of factors like: 1) The overall growth in the economy, 2) Stronger impetus placed on infrastructure, and 3) L&T, with its presence across almost all the domains of infrastructure, was able to reap the maximum benefit. This was supported by its order backlog which had witnessed a CAGR of 44.0% during FY2005-08. During the period, a significant Order inflow traction was witnessed, particularly in the Power and Infrastructure segments.

However, CY2008 was a challenging year for the global economy, which was plagued by liquidity concerns, volatility in commodity prices and an overall slowdown in demand. Mirroring this, L&T's order intake registered a relatively slow growth rate of 22.8%, as against an average of 42.5% over the previous three years.

This was very much reflected in L&T's 9MFY2010 performance - the company posted a growth of a mere 1% on the Top-line front, and a de-growth of 3% on the Bottom-line front. Further, to aggravate the pain there were issues like order deferment, some projects faced unexpected bottlenecks like land acquisition, financial closure, and the financial strength of clients was doubtful, hence the company intentionally delayed the projects. Some of L&T's own BOT projects (Roads) also faced delays in achieving financial closure, which resulted in execution delays.

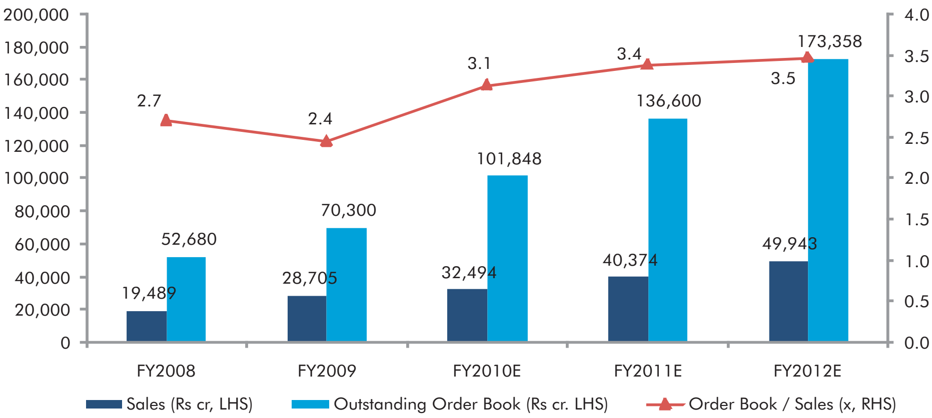
Against this backdrop, for FY2010E, we are factoring in for the company a growth of 7.2% to Rs36,359cr, against the management's guidance of 10%. However, it should be noted that we are factoring in a 22% yoy growth on the Top-line front to Rs12,910cr for 4QFY2010E.

However, for FY2011E and FY2012E, we are expecting the company to be back on the growth path, with the major force behind this being the E&C segment, which is expected to post a growth of nearly 25%. Moreover, we are expecting some recovery in the MIP and E&E segments as well, which would post a modest growth (read: 10-15%).

To conclude, over FY2010-12E, we are expecting L&T to post a CAGR of 23.5% to Rs55,496cr (from Rs36,359cr), which would primarily be driven by a robust order backlog and good order inflow traction expected for the company (mainly from the road, power and oil and gas sectors). However, this growth would be lower than the growth posted by the company in the past, owing to: 1) High base effect, and 2) The average execution period of L&T has gone up with a larger contribution from the high gestation segments.

Sales Growth	(%)
FY2008	10.7
FY2009	47.3
FY2010E	13.2
FY2011E	24.3
FY2012E	23.7
Order Book Growth	
FY2008	42.8
FY2009	33.4
FY2010E	44.9
FY2011E	34.1
FY2012E	26.9

Exhibit10: Good order inflow → Healthy Order book to sales (E&C Segment)



Source: Company, Angel Research

Exhibit11: Segmental Break-up of E&C Revenues, order inflows and backlog of L&T (FY08-12E)

(Rs cr)	FY08	FY09	FY10E	FY11E	FY12E
Total E&C					
Order Inflow	42,020	51,600	64,041	75,219	87,750
Revenues	19,489	28,705	32,494	40,374	49,943
Order Backlog (Y/E)	52,680	70,300	101,848	136,600	173,358
Order Book to Sales ratio (x)	2.7	2.4	3.1	3.4	3.5
Segmental Break up					
Process					
Order Inflow	6,303	8,256	7,018	8,070	10,088
Revenues	3,356	4,383	4,920	5,822	6,843
Order Backlog (Y/E)	7,375	11,248	13,345	15,593	18,838
Order Book to Sales ratio (x)	2.2	2.6	2.7	2.7	2.8
Oil & Gas					
Order Inflow	10,505	6,192	8,235	10,294	11,324
Revenues	5,400	8,466	5,745	6,390	7,641
Order Backlog (Y/E)	12,116	9,842	12,333	16,237	19,919
Order Book to Sales ratio (x)	2.2	1.2	2.1	2.5	2.6
Power					
Order Inflow	5,883	12,900	28,380	29,799	34,269
Revenues	3,358	5,863	4,621	9,992	14,373
Order Backlog (Y/E)	8,429	15,466	39,225	59,031	78,927
Order Book to Sales ratio (x)	2.5	2.6	8.5	5.9	5.5
Infrastructure					
Order Inflow	13,026	20,124	17,105	23,092	27,711
Revenues	8,452	10,266	12,213	14,410	18,067
Order Backlog (Y/E)	18,965	28,823	33,715	42,398	52,041
Order Book to Sales ratio (x)	2.2	2.8	2.8	2.9	2.9
Others					
Order Inflow	6,303	4,128	3,302	3,963	4,359
Revenues	5,674	5,002	4,994	3,852	4,068
Order Backlog (Y/E)	5,795	4,921	3,230	3,341	3,632
Order Book to Sales ratio (x)	1.0	1.0	0.6	0.9	0.9

Source: Company, Angel Research

Operating performance - Managing risk, boosting profitability

There are the various aspects of L&T's business model that ensure that the company enjoys healthy margins

We believe that L&T has one of the strongest risk management teams in the Indian Engineering, Procurement and Construction (EPC) space, which has allowed the company to maintain healthy EBITDA margins, even during the toughest times for the industry. Over the past years, L&T has taken several measures like consolidating its operations, increasing the average ticket size of its orders (it has increased the threshold order size from Rs50cr to Rs200cr) and more favourable sources from vendors, which are part of the ongoing process for the optimum utilisation of resources, and which benefit the company in the long-run, by allowing it to maintain healthy margins. Moreover, L&T has created a niche space for itself (handling big-sized, complex contracts - L&T has won the EPC contracts for all the four airports in India to be modernised by private developers in the last few years) and has always stayed ahead of the competition. In line with this, L&T has a presence in high margin segments like oil and gas, and process, which adds quality to the order backlog. L&T was one of the early entrants in the Middle-East markets, which gave it an early-mover advantage; over the years, international operations have also stabilised and are currently generating decent margins. With the buoyancy witnessed in the space (order books of most construction companies are swelling to unprecedented levels), L&T enjoys pricing power. Currently, about 60% of the order backlog has escalation or raw material pass-through clauses in place, and in case of cooling commodity prices there are chances of L&T gaining on 40% of its portfolio. Also, L&T enters into back-to-back contracts to protect its margins. These are the various aspects of L&T's business model that ensure that the company enjoys healthy margins.

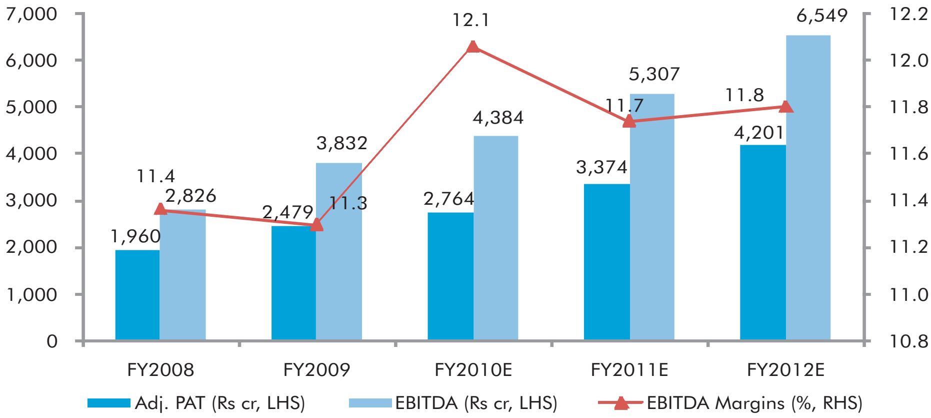
To put things in perspective, L&T has increased its EBITDA margins over the last five years from 5.5% in FY2004 to 11.3% in FY2009, which was mainly on account of operating leverage (contributed 553bp to margin expansion), and disciplined bidding and project execution, which has helped margins by 39bp (inspite of fluctuating commodity prices).

In terms of Earnings, we have factored in a CAGR of 23.3% over FY2010-12E, on account of robust Top-line growth and stable margins

With this backdrop, we are expecting L&T to maintain its margins at their current levels in FY2011E and FY2012E. We are not expecting the greater competitive pressure to impact the EBITDA margins, as we believe that the infra pie is big enough for L&T to enjoy its pricing power. Thus, we expect operating profits to post a CAGR of 22.2% over FY2010-12E to Rs6,549cr (from Rs4,384cr). In terms of Earnings, we have factored in a CAGR of 23.3% over FY2010-12E, on account of robust Top-line growth and stable margins.

PAT Growth	(%)
FY2008	47.5
FY2009	26.5
FY2010E	11.5
FY2011E	22.1
FY2012E	24.5

Exhibit 12: Top-line Growth and Operating leverage to boost profitability



Source: Company, Angel Research

Profitability Analysis

L&T has always been a good returns yielding company, due to its scale of operations and capital allocation efficiency

L&T has always been a good returns yielding company, due to its scale of operations and capital allocation efficiency. We have analyzed L&T's RoE over the last five years, the key findings of which are given below:

Exhibit 13: DuPont Analysis

	FY07	FY08	FY09	FY10E	FY11E	FY12E
1) EBIT margin(%)	9.2	10.5	10.5	11.0	10.7	10.7
2) Tax retention ratio (x)	0.7	0.7	0.7	0.7	0.7	0.7
3) Asset turnover (x)	2.6	2.6	2.2	1.8	1.9	1.9
RoIC (Post-tax) (%)	**16.6**	**19.0**	**17.2**	**14.6**	**13.3**	**13.9**
4) Cost of Debt (Post Tax) (%)	3.1	3.0	5.1	5.2	4.7	5.1
5) Leverage (x)	0.2	0.2	0.4	0.3	0.2	0.3
Operating RoE (%)	**18.9**	**22.8**	**21.8**	**17.5**	**15.2**	**16.2**

Source: Company, Angel Research

(1) L&T has enjoyed higher-than-industry EBIT margins and we expect that the good show will continue. We are factoring a marginal downtick in margins due to a likely spike in commodity prices.

(2) L&T is one of the few companies which have never claimed tax benefits (like Section 80IA) for its parent company, and has been consistently paying full tax, thereby having no issues of any claims by any authorities with regard to Section 80IA. We have factored in a full tax rate going ahead as well.

(3) For the last few years, the asset-turnover ratio is under pressure due to heavy investments in the areas of future growth (which are not adding to the Top-line) and have dragged L&T's RoE. Going ahead, we expect the ratio to stabilise at current levels.

(4) The Interest and depreciation burdens have slowly and steadily gone up, mainly on account of higher investments in fixed assets and subsidiaries, the returns on which are back-ended. Even during testing times, L&T has never shied away from investing in facilities for the medium to longer term, as it was confident that India's infrastructure capex is a long-term theme. As a consequence, the company has done Rs1,980cr in capex and Rs1,330cr in investments, during FY2009. Going ahead, we are expecting the same trend to continue, as the company continues its investment for growth.

(5) The company has been conservative not to leverage itself and we have maintained that, going ahead. Therefore, the company does not enjoy the benefit of financial leverage, which is enjoyed by its peers.

Financial Outlook of key Subsidiaries (Services)

L&T Finance (LTF)

We are expecting LTF to post a CAGR of 26.5% and 19.7% over FY2010-12E on the total income and net profit fronts, respectively

As on FY2009, LTF had 78 Branches and 233 points of presence. The network has been built to cater to growing business needs and to provide satisfactory customer services. Being a subsidiary of L&T, it has leveraged the knowledge, experience and businesses of L&T, while continuing to grow and expand independently. It had an asset base of Rs5,219cr in FY2009, while Revenues for the year stood at Rs831cr. It has consistently made profits and generated a Return on Assets of over 1.85% in the past 5 years.

Going ahead, we believe that LTF would continue to grow on the back of: 1) a Diversified and Balanced mix of businesses and customers, which reduces the risk of product and client concentration, and also allows it to offer innovative financial solutions, 2) Portfolio Quality - reflected in a relatively lower level of delinquencies represented by the Gross NPA levels, 3) a Respected brand arising out of its parentage, which has not only provided LTF with a platform to reach out to potential customers and lenders, but also provided it with the knowledge of the dynamics of different industries, 4) Adequately Capitalised - 16.4% and 16.8% as on FY2009 and June 2009, respectively - and maintains capital adequacy higher than the statutorily prescribed CAR of 12%, and 5) High credit ratings, which allow LTF to access funds at competitive rates from a wide variety of market participants.

Over FY2006-08, LTF had been growing at a very fast pace (>100%) on the total income front, driven by its enhanced presence. The surge in the asset-base had resulted in the total income growing by a CAGR of 101.6% to Rs606cr and in a net profit CAGR of 45.2% during the same period. However, in FY2009, the company posted a subdued growth of a mere 11% in its asset base, which can largely be attributed to the slowdown faced by the economy. With the changed scenario and with the economy back on track, we are expecting the company to be back on a growth trajectory, and are factoring in a 25% and 35% growth in the asset-base for FY2011E and FY2012E, respectively. Additionally, the company's capital adequacy remains comfortable at ~15%, compared to the statutory requirement of 12%. During the year, LTF raised Rs1,000cr through NCDs (Non-convertible debentures) to meet its growth needs.

With this backdrop, we are expecting LTF to post a CAGR of 26.5% and 19.7% over FY2010-12E on the total income and net profit fronts, respectively.

Exhibit 14: LTF's financial model snapshot

Particulars (Rs cr)	FY2008	FY2009	FY2010E	FY2011E	FY2012E
Total Income	**606.1**	**830.3**	**967.9**	**1,212.4**	**1,549.6**
Growth (%)	120.1	37.0	16.6	25.3	27.8
PAT	**115.0**	**98.8**	**137.5**	**164.0**	**196.9**
Growth (%)	83.7	(14.1)	39.1	19.3	20.1
Leverage	6.6	6.6	7.0	7.5	8.7
RoA (%)	3.0	1.9	2.2	2.1	1.9
RoE (%)	20.9	12.6	15.0	15.4	15.8

Source: Company, Angel Research

L&T InfoTech

We believe that L&T has big plans for L&T Info Tech and is on the constant lookout for opportunities (organic and inorganic) to increase its scale of operations and any successful move on this front would add lot of value to the company in the long run

During FY2009, L&T InfoTech registered a growth of 24.9% in its net sales and registered a PAT growth of ~25.5%, due to the depreciation of the rupee and better capacity utilisation. We expect L&T InfoTech to register a growth of a mere 3.2% in Revenues during FY2010E and 6.3% during FY2011E, in INR terms, which is mainly on account of a slow recovery in the US, which contributes more than 70% of its revenues. However, for FY2012E we are factoring in some recovery and are expecting the company to post a growth of 20.4%.

On the net profit front, we are expecting that the company would report CAGR of 18.1% over FY2010-12E. We believe that L&T has big plans for this arm and is on the constant lookout for opportunities (organic and inorganic) to increase its scale of operations. Any successful move on this front would add lot of value to the company in the long run.

Exhibit 15: L&T InfoTech's financial model snapshot

Particulars (Rs cr)	FY2008	FY2009	FY2010E	FY2011E	FY2012E
Net Sales	**1,582**	**1,975**	**2,038**	**2,166**	**2,609**
EBITDA	285.0	343.0	336.5	378.6	484.4
EBITDAM (%)	18.0	17.4	16.5	17.5	18.6
PAT	**211.1**	**265.0**	**254.5**	**275.9**	**355.0**
PATM (%)	13.3	13.4	12.5	12.7	13.6
Growth in PAT (%)	39.7	25.5	(4.0)	8.4	28.7

Source: Company, Angel Research

Outlook

The last 18 months have been a roller coaster ride for the infrastructure sector, starting with the economic slowdown, high commodity prices and a dearth of liquidity, and concluding with the re-election of the Congress-led UPA government, which has seemingly changed the ballgame for Indian E&C companies. With this transformation, we have seen the market cap of these companies soaring to levels which were never thought possible in such a short span of time, and L&T has been no different.

Over the last five years, since the great India infra capex cycle began, L&T has always traded at a premium to its peers and to the BSE Sensex (due to the overall re-rating of the sector, per se), owing to its superior business model (which provides revenue visibility), higher growth (coupled with excellent return ratios), successful diversification (having presence across the whole value chain). Moreover, post FY2007, this premium increased, owing to a number of triggers in the stock, and the stock started trading at more than a 60% premium to the Sensex (on a standalone basis), until the global meltdown hit the capital markets in CY2008 and brought L&T's scrip down along with the Sensex. However, since the beginning of the current rally, L&T is once again on the path to command a premium of >60%. We expect the premium commanded by L&T to sustain, going forward, owing to:

Super Company, Super Management: L&T is spearheaded by Mr. A.M. Naik, CMD, who is a recipient of the Padma Bhusan from the President of India, on March 31, 2009, for his contribution to Indian industry and the role that L&T has played in nation building. Further, Mr. A. M. Naik was awarded the coveted Business Leader of the Year by The Economic Times (January 17, 2009), in acknowledgement of his clarity of vision, entrepreneurial ability, business acumen and integrity. Moreover, L&T bagged the award for the Top Indian Company in a survey of India's 500 leading companies, conducted by Dun & Bradstreet. Such recognition bears testimony to the quantum and quality of work done by the company, and also instills confidence in the vision of the leaders at the helm of its affairs.

Expanded Addressable Market: Over the years, L&T has made huge investments in areas of growth. As a result of this, we are expecting a gradual shift in the revenue-mix of L&T in the years to come. L&T has made huge investments in the Power and Shipbuilding spaces, and continues to do so, which would ensure a substantial amount of revenues flowing in after FY2012. These businesses have huge potential, as demonstrated by the performance of listed companies (read: BHEL in power and ABG Shipyard in shipbuilding) in the space and the kind of outlay forecasted by the government for the same. Therefore, leveraging its brand and on the back of an excellent track record, we are expecting L&T to do well in these avenues.

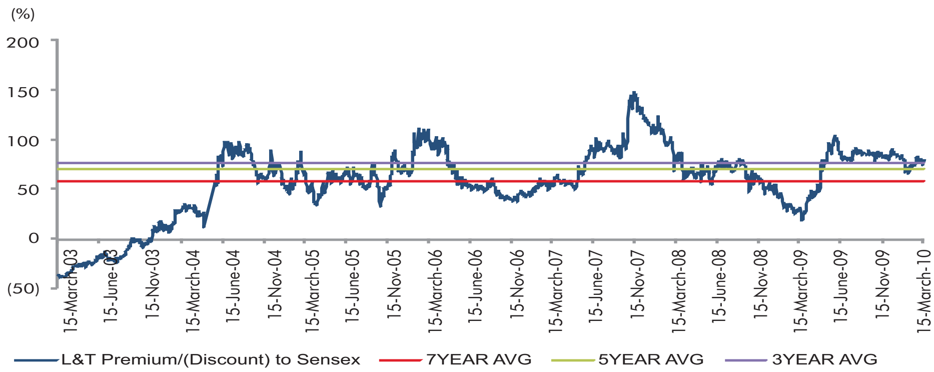
Gateway to the Infra sector: We believe that, over the years, its excellent performance on all fronts has made L&T one of the obvious bets for all kinds of investors to have an exposure to India's evergreen Infrastructure story. We expect the company to continue its good show in the future; therefore, we see no reason for the company to lose its undisputed number one position.

Valuation: SOTP of Rs1,761

In the past, on a longer term horizon (7 years), L&T has always traded at an average premium of almost 60% to Sensex valuations, given its strong operating cash flows, superior return ratios (in excess of 20%) and excellent capital efficiency. Pertinently, for the shorter period (say 3-5 years) there has been a gradual increase in this premium to >70%, mainly to account for its investments in areas of future growth thereby enhancing visibility. Further, in terms of stock performance, L&T has outperformed the Sensex over the last few years. However, on a shorter duration (3-6 months) the company has underperformed the Sensex. We believe that this was primarily on account of its poor quarterly performances and rich valuations that provided limited scope for disappointment. However, after this underperformance, we believe that the stock has once again entered a comfortable valuation zone and will undoubtedly catch the eye of long-term investors. We believe that going ahead, L&T's growth momentum, coupled with better pricing power, superior margins, an earnings CAGR of ~24% over FY2010-12E and opprtunities abound, would justify its superior valuations and would lead to outperformance.

At the CMP of Rs1,611, the stock is trading at 23.3x FY2012E Earnings and 4.0x FY2012E P/BV, on a standalone basis. **We Initiate Coverage on the stock, with an Accumulate rating.** We have used the sum-of-the-parts (SOTP) methodology to value the company and to capture all the business initiatives taken by it, and also to factor in the investments/stakes in different businesses. **On an SOTP basis, by ascribing separate values to its Parent business on a P/E basis and investments in subsidiaries using the P/E, P/BV and MCap basis, we have arrived at a Fair Value of Rs1,761, which provides ~9% upside from the current levels; hence, we recommend an Accumulate view on the stock.** Further, it should be noted that at our SOTP Target Price the stock would be trading at around 25.5x FY2012E standalone EPS of Rs69.2, which would imply a premium of ~50% over Angel's Sensex Target FY2012 P/E multiple of 17x. This is at a discount to the historical premium commanded by L&T over the Sensex.

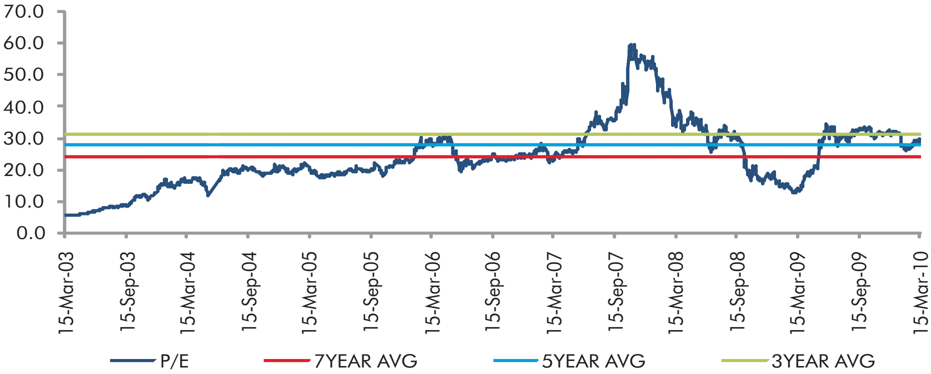
Exhibit 16: L&T: Parent historic P/E multiple premium to Sensex



Source: Company, Angel Research

Also, the historical 1-year forward P/E band shows that L&T has always traded at an average P/E of 24x, 28x and 31x, on the past seven, five and three year basis, respectively. Therefore, our SOTP Target P/E multiple (25.5x) is lower than the historical average. Further, it should be noted that FY2012E would be an excellent year, given that most of its investments in the IDPL and Power equipment businesses would start generating significant revenues and would enhancing visibility.

Exhibit 17: L&T - Parent 1-year forward P/E bands



Source: Company, Angel Research

Our SOTP Target Price for L&T is Rs1,761, based on FY2012E numbers, translating into a potential upside of ~9% from the current levels . We Initiate Coverage on the stock with an Accumulate recommendation.

Exhibit 18: SOTP Valuation

Business Segment	Methodology	Remarks	Rs cr	Rs/Share	% to TP
L&T- Parent	**P/E**	**20x FY2012E Earnings**	**84,016**	**1,385**	**78.7**
Infrastructure Subsidiaries			**6,953**	**115**	**6.5**
IDPL (stake - 78.4%)	P/BV	2.5x FY2012E Book value	6,953	115	6.5
Key Subsidiaries - Services			**8,075**	**133**	**7.6**
L&T Infotech	P/E	14x FY2012E Earnings	4,971	82	4.7
L&T Finance	P/BV	1.5x FY2012E Book value	2,016	33	1.9
L&T Infrastructure Finance	P/BV	1.5x FY2012E Book value	1,089	18	1.0
Key Subsidiaries - Manufacturing			**5,204**	**86**	**4.9**
Tractor Engineers	P/E	12x FY2012E Earnings	242	4	0.2
Associate Companies	P/E	12x FY2012E Earnings	1,540	25	1.4
L&T MHI Boilers and Turbines (stake - 51%)	P/E	16x FY2012E Earnings	3,422	56	3.2
Other Subsidiaries			**2,573**	**42**	**2.4**
Satyam 6.1% Stake	Mcap	20% holding company discount	412	7	0.4
Other Investments	P/BV	1x FY2012E Book Value	2,161	36	2.0
Total			**106,822**	**1,761**	**100**

Source: Company, Angel Research

We have valued the Parent business at Rs1,385/share (20x FY2012E Earnings)

We believe that L&T offers the best opportunity to play out the growing Infrastructure theme in India. For the Parent Business, we have assigned a 20x P/E, at a ~40% premium to mid-size C&EPC business companies like IVRCL Infra, Hindustan Construction (HCC) and Nagarjuna Construction (NCC). L&T justifies its premium valuations in comparison to its peers on account of its scale of operations, global presence, strong brand recall, better working capital management, excellent Return Ratios, superior EBITDA Margins and well-diversified order book. We have assigned a P/E of 20x for its Parent, which has been derived by assigning premium of 20% over Angel's Sensex Target FY2012 P/E of 17x, given its higher CAGR earnings growth and superior return ratios. Further, on our Target Multiple (20x), it would imply a PEG ratio of <1.0x FY2012E Earnings growth, which we believe is reasonable, given the long-term growth opportunity that the company offers. In our view, the target multiple on the core business is reasonable, as the parent company would have a higher order coverage at end- FY11 and end-FY12 than it does currently. As compared to a book-bill ratio of 2.4x as at the end of FY09, we forecast an end-FY12 book-to-bill ratio of 3.5x. We also believe that the industrial capex cycle will be much stronger by FY12, and this would lend support to the valuations.

Exhibit 19: Comparative Valuation - Domestic

Company	Price	Revenue (Rs cr)				EPS (Rs)				Adj. P/E(x)		
	(Rs)	FY10E	FY11E	FY12E	CAGR (%)	FY10E	FY11E	FY12E	CAGR (%)	FY10E	FY11E	FY12E
Hindustan Const.	139	3,661	4,146	4,900	15.7	3.1	4.4	4.9	26.3	24.2	16.9	15.2
IVRCL Infra	164	5,941	7,570	8,741	21.3	8.6	11.6	12.9	22.5	12.8	9.5	8.5
Punj Lloyd	177	12,339	14,037	15,868	13.4	7.0	14.7	17.6	58.2	23.1	11.1	9.2
Nagarjuna Constructions	161	4,743	5,913	6,758	19.4	7.2	9.7	10.9	22.8	17.7	13.1	11.7
Simplex Infra	432	4,766	5,783	6,730	18.8	26.4	33.3	41.0	24.6	16.4	13.0	10.5
Average		**6,290**	**7,490**	**8,600**	**16.9**	**10.5**	**14.8**	**17.5**	**29.2**	**18.8**	**12.7**	**11.0**
L&T	1,611	36,359	45,204	55,496	23.5	45.6	55.6	69.2	23.3	27.1	22.2	17.8

Company	RoE (%)			RoCE (%)			Rating
	FY10E	FY11E	FY12E	FY10E	FY11E	FY12E	
Hindustan Const.	6.0	8.0	8.3	9.1	9.7	11.3	Neutral
IVRCL Infra	12.0	14.1	13.6	13.4	14.2	13.6	Buy
Punj Lloyd	7.9	13.7	14.4	10.9	13.9	15.0	Buy
Nagarjuna Constructions	8.5	10.5	10.7	11.3	12.0	12.1	Buy
Simplex Infra	14.0	15.4	16.4	13.8	15.0	15.8	Buy
Average	**9.7**	**12.3**	**12.7**	**11.7**	**13.0**	**13.6**	
L&T	17.9	17.1	18.4	17.6	17.5	19.4	Acc.

*Source: Company, Angel Research *Note : (1) For Hindustan Construction value of Lavasa,Vikhroli Project , and Road BOT Total to Rs64.3/share; (2) For IVRCL value of IVR Prime and BOT projects amount total to Rs54/share; (3) We have valued Punj's stake in Pipavav Shipyard on Current Mcap basis at Rs14.7/share; (4) For Nagarjuna - value of land bank , BOT projects and investments amount total to Rs33.6/share; (5) For Simplex Infra there are no major investments in subsidiary. (6) For L&T investments in subsidiaries amount to Rs376/share*

We have valued its asset-owning arm, IDPL, at Rs115/share (2.5x FY2012E P/BV)

As on FY2009, the total equity investments in IDPL are to the tune of Rs1,250cr. In the next two years, we are expecting the company to invest more than Rs2,400cr, considering the projects under commissioning and the bidding pipeline. We have valued this subsidiary at 2.5x FY2012E P/BV. We believe that dilution at IDPL poses an upside risk to our fair value, given that L&T garners rich valuations as compared to our estimates of 2.5x P/BV. However, we believe that the timing of the issue would be important and would be dependent on a number of factors (like the risk appetite of investors). Further, as per the management, the dilution is not expected in the near future; thus, we would prefer to be conservative and have not factored in any such dilutions which, if done at valuations higher than our estimates, would create further value for the company.

Exhibit 20: Comparative Valuation

	FY12EBV (Rs/Share)	Price (Rs/Share)	FY12E P/BV (x)
GMR Infra	19.0	58	3.0
IRB Infra	87.1	265	3.0
GVK Power & Infra	27.1	42	1.6
Mundra Port & SEZ	155.5	727	4.7
Average			3.1
L&T IDPL	45.8	115	2.5

Source: Company, Angel Research, Bloomberg Consensus Estimates

We have valued its Finance companies at Rs51/share (1.5x FY2012E P/BV)

We have valued L&T's finance subsidiaries at 1.5x FY2012E P/BV, which we believe is reasonable considering the growth opportunities, synergies enjoyed and rich parentage.

We have valued its IT arm at Rs82/share (14x FY2012E P/E)

We have valued L&T InfoTech at 14x FY2012E earnings, in line with its peer group. We do not expect huge growth for this arm and we see the scaling of the business as an issue. Further, we believe that, as was the case in the past, the company would probably attempt the inorganic route for its expansion, which would bring in scale to the business and would subsequently target value-unlocking.

Exhibit 21: Comparative Valuation - Domestic

Company	Price	Revenue (Rs cr)				EPS (Rs)				P/E(x)		
	(Rs)	FY10E	FY11E	FY12E	CAGR (%)	FY10E	FY11E	FY12E	CAGR (%)	FY10E	FY11E	FY12E
Tech Mahindra	907	4,607	4,989	5,704	*11.3*	53.2	60.7	67.8	*12.9*	17.0	14.9	13.4
Mphasis	675	5,066	5,990	7,043	*17.9*	48.8	54.5	64.5	*15.0*	13.8	12.4	10.5
HCL Tech.	349	12,110	13,921	16,058	*15.2*	18.8	24.4	27.7	*21.4*	18.5	14.3	12.6
KPIT Cummins#	124	717	803	1,028	*19.8*	10.3	11.0	14.8	*19.7*	12.0	11.2	8.4
Average		**5,625**	**6,426**	**7,458**	***16.0***	**32.8**	**37.7**	**43.7**	***17.2***	**15.4**	**13.2**	**11.2**
L&T Infotech	82	2,038	2,166	2,609	*13.1*	4.2	4.5	5.9	*18.1*	20	18	14

Source: Company, Angel Research; Note: # Bloomberg Consensus Estimates

We have valued its Power equipment venture at Rs56/share (16x FY2012E P/E)

We believe that BHEL will face keen competition from L&T in the most important segment - supercritical projects - which form a total of 85GW, or 73.5% of the total projects that can be awarded over the next 4-5 years.

Exhibit 22: Eligible bidders for 11x 660MW supercritical units

Boiler package	Turbine package
BHEL	BHEL
L&T - Mitsubishi	L&T - Mitsubishi
Ansaldo Caldie	Ansaldo Caldie
	Toshiba - JSW

Source: Angel Research, Industry

For FY2012E, we have factored for a Top-line and Bottom-line of Rs3,495cr and Rs419cr, respectively. We have valued L&T's power business on a P/E basis, in line with our valuation method for other companies in this space (like BHEL). We have valued its FY2012E earnings at 16x, which is backed by the excellent order inflow generated by the company. It has won orders from both public (MahaGenco) and private entities (Jaiprakash).

Exhibit 23: Comparative Valuation

Company	Mcap	P/E(x)			P/BV (x)			EV/EBITDA(x)		
	(Rs cr)	FY10/CY09	FY11/CY10	FY12/CY11	FY10/CY09	FY11/CY10	FY12/CY11	FY10/CY09	FY11/CY10	FY12/CY11
BHEL	115,377	26.5	21.5	18.1	7.1	5.7	4.6	16.7	12.9	11.2
Dong-Fang#	28,703	21.6	17.9	14.3	5.4	4.4	3.6	13.2	10.2	8.3
Shanghai Electric#	68,587	17.2	15.8	14.2	1.7	1.6	1.5	21.2	18.7	16.5
Average	**70,889**	**21.8**	**18.4**	**15.5**	**4.7**	**3.9**	**3.2**	**17.0**	**13.9**	**12.0**

Source: Company, Angel Research, Bloomberg Concensus; Note: # CY ending companies

Company Background

Over the years, L&T has diversified across various segments to encash upon the untapped infra opportunity, not only in India but across the globe, and it has an excellent track record in achieving the same

L&T, an Indian infrastructure conglomerate, has a presence across almost all the infrastructure segments and is at the forefront of the India Infra growth story. L&T is one of oldest infra companies in India and is in existence since 1946. Over the years, the company has diversified across various segments to encash upon the untapped infra opportunity, not only in India but across the globe, and it has an excellent track record in achieving the same. To put things in perspective, the company, over the last fourteen years (FY1995-2009), has grown at a CAGR of 18.8% and 19.8% on the Top-line and Bottom-line fronts, respectively, with a healthy average RoCE and RoE of 17.8% and 16.6%, respectively, over the same period.

L&T boasts of expertise in the design, engineering and construction spaces across various industries, including oil and gas, petrochemicals, refineries, fertilisers, metals and power. L&T is one of the largest players in the domestic infrastructure space and has a presence across all segments (roads, ports, urban infrastructure, airport, water and sanitation and railways). L&T also operates through a number of segment-specific subsidiaries, the prominent among these being L&T InfoTech (IT services), L&T Finance (Financial services), L&T IDPL (Real estate and infrastructure projects developer) and L&T International FZE (which houses all its international subsidiaries). This diversified expanse and gamut of offerings that L&T caters to helps it in commanding a market leader position in the Indian engineering and construction sectors.

Engineering and Construction (E&C)

E&C is L&T's core business and accounts for nearly 85% of its standalone revenues (FY2009). This segment is sub-divided into three operating divisions (OD) - Engineering Construction and Contracts (ECC), Engineering Construction Projects (E&CP) and the Heavy Engineering Division (HED).

Engineering Construction and Contracts (ECC)

ECC is one of the largest construction organisations in India and undertakes projects on a lump-sum, turnkey basis

ECC is one of the largest construction organisations in India and undertakes projects on a lump-sum, turnkey basis. This involves the engineering, design and construction of infrastructure, and industrial projects covering civil, mechanical, and electrical and instrumentation faculties. The ECC division has been further sub-divided into five business segments:

- Industrial projects and utilities
- Buildings and factories
- Transportation infrastructure
- Power transmission and distribution
- Hydro-electric and Nuclear sectors

Engineering construction projects (E&CP)

This OD of the E&C arm undertakes EPC (engineering, procurement and construction) projects in selected sectors, such as oil and gas, power and minerals. This division has design centers in Mumbai, Baroda, Delhi and Abu Dhabi. Additionally, it is strengthening its operations in the Middle-East to tap new opportunities in new capacity creation, clean fuel projects and downstream petrochemicals.

Heavy Engineering Division (HED)

HED manufactures and supplies customised critical equipment and systems to sectors such as fertilisers, refinery, petrochemicals, and oil and gas

The HED manufactures and supplies customised critical equipment and systems to sectors such as fertilisers, refinery, petrochemicals, oil and gas, thermal and nuclear power, aerospace, and equipment and systems for defense applications. The HED division also plans to start shipbuilding activities for the construction of special commercial vessels and warships for the Indian Navy and for the Coast Guard.

The division has manufacturing and fabrication facilities located at Mumbai, Hazira and Baroda (Gujarat) and Vishakhapatnam (Andhra Pradesh). It has also commenced construction work for a precision manufacturing facility at Coimbatore in Tamil Nadu, which will cater to the needs of aerospace, aviation, nuclear power and sub-systems for defense.

Electrical and Electronics (E&E)

E&E makes low-tension switch gears, air circuit breakers, molded case circuit breakers, switch boards, electronic control systems

This division of L&T makes low-tension switch gears, air circuit breakers, molded case circuit breakers, switch boards, electronic control systems, petrol dispensing stations and energy meters. Switchgear products account for nearly 66% of the E&E division's revenue and are expected to be the key driver for future growth in this business.

Machinery and Industrial products (MIP)

The MIP division is organised into three main business segments: 1) Construction equipment, 2) Industrial products, and 3) Industrial machinery. This division is involved in manufacturing, trading and servicing, and was created with a view to consolidate L&T's construction and mining equipment businesses. This division markets and provides support for construction and mining equipment, valves, plastic processing machinery and welding products.

Major Subsidiaries

- L&T InfoTech

L&T InfoTech, a fully-owned subsidiary of L&T, is a typical IT service provider, including application development and maintenance, ERP, data warehousing, business intelligence, high-end BPO/KPO, testing and infrastructure management services. In terms of verticals and geographies, the focus is on manufacturing and engineering-related services, and on the US, respectively.

- L&T Finance

LTF was incorporated as a Non Banking Finance Company (NBFC) in November 1994, through which L&T aims at making a strong foray in the ever-growing financial services sector

L&T Finance (LTF) is a wholly-owned subsidiary of L&T Capital Holdings, which is in turn a 99.99% subsidiary company of L&T. LTF is headquartered in Mumbai and has a presence in major cities in India. LTF was incorporated as a Non Banking Finance Company (NBFC) in November 1994. Through LTF, L&T aims at making a strong foray in the ever-growing financial services sector. LTF offers a spectrum of financial products and services for trade, industry and agriculture, and has evolved into a multi-product finance company, with a diversified corporate and retail portfolio. Despite the turbulence in the financial services markets in the past, L&T Finance has adapted well to the changing market dynamics to remain consistently profitable. Like the rest of the companies in the L&T group, LTF is also professionally managed. A steady growth rate validates the trust that the industry has reposed in the company and its rich parentage. The business of LTF is that of asset-backed finance, covering a wide range of commercial and farm assets. Asset-backed loans constitute 90.8% of its total loan assets. They also provide loans for meeting the working capital needs of small and medium enterprises (primarily to vendors and dealers of large corporates), and loans against capital market assets for corporates.

- **L&T IDPL**

L&T currently holds 78.4% of L&T IDPL, while the remaining 21.6% is held by private equity investors (JP Morgan Chase and IDFC). IDPL's portfolio currently comprises of projects in the road, port and airport sectors

L&T's BOT assets (except power projects) are housed under L&T IDPL. IDPL's portfolio currently comprises of projects in the road, port and airport sectors. L&T currently holds 78.4% of L&T IDPL, while the remaining 21.6% is held by private equity investors (JP Morgan Chase and IDFC). We believe that IDPL plays a crucial role for domestic infrastructure orders for L&T. IDPL usually bids for projects of a minimum size of Rs250cr, with prequalification in all announced projects across all sectors. However, IDPL believes that it is very important that the project must make commercial sense at the bidding stage itself and must cross the internal IRR hurdle. No projects are taken for capturing value in the construction contract, and the project must make economic sense for IDPL as the developer, while giving market margins to L&T's construction division.

Roads portfolio

At the end of FY2010, L&T IDPL will have six, fully operational road projects

L&T IDPL had three BOT road projects at the end of FY2008, while three new road projects were commissioned in FY2009. In addition, one new road project was commissioned in FY2010. However, one out of these seven road projects' concession periods (Western India toll bridge) would be over in December 2009. Thus, in total, at the end of FY2010, L&T IDPL will have six, fully operational road projects.

- **NICE (Narmada Infrastructure Construction Enterprise), Narmada:** NICE is a special purpose vehicle (SPV) formed by L&T for the operation of the second Narmada Bridge, at Zadeshwar on NH-8 in Gujarat. It includes a 1.4km bridge and 4.6km of approach roads. Commercial services began in November 2000 and the concession agreement ends in November 2012.

- **TIL (Transportation Infrastructure Limited), Coimbatore:** This project entailed a bypass road at Coimbatore, on a Build-Operate-Transfer (BOT) basis. The project scope included the construction of a 28km bypass road, along with an additional two-lane bridge across the river Noyyal at Athupalam. The concession period, inclusive of the construction period, is 32 years for the bypass and 21 years for the Athupalam Bridge. The commercial operations at the Athupalam Bridge and the bypass commenced in December 1998 and January 2000, respectively.

- **Panipat Elevated Corridor:** This is a 10km elevated road project, which was commissioned on July 17, 2008. The project has a concession agreement until January 2026.

- **Krishnagiri-Thoppur Tollroad:** This is a 62km, four-lane road project on a BOT basis from Krishnagiri to Thopurghat in Tamil Nadu. The concession period is for a period of 20 years, which runs until July 2026. The project was commissioned on February 7, 2009.

- **Western Andhra Tollways:** This 56km BOT project covers the four-laning of Jadcherla to the Kothakota section in Andhra Pradesh. The concession period is for a period of 20 years and runs until February 2026. The project was commissioned on March 14, 2009.

- **Vadodara-Bharuch Tollway:** This is a six-lane NH-8 BOT project from Vadodara to Bharuch in Gujarat. The 83.3km stretch is part of the golden quadrilateral, and is an important link in the high density corridor connecting Mumbai and Delhi. The concession period is 15 years, which ends in July 2021. The toll-way was commissioned last October and would contribute to the tune of around Rs90cr to the FY2010E consolidated revenues.

Ten, fully operational road projects in the next two-three years

Going ahead, L&T would have ten, fully operational road projects, which the management expects will generate revenues of Rs1,300cr-Rs1,500cr every year

In the meantime, L&T IDPL is also constructing five new road projects, which will all start generating revenues over the next 2-3 years. Going ahead, L&T would have ten, fully operational road projects, which the management expects will generate revenues of Rs1,300cr-Rs1,500cr every year (vis-à-vis Rs100cr at the end of FY2009).

- **Gujarat roads:** This is L&T IDPL's most significant road project, which entails three BOT projects in Gujarat, the Ahmedabad-Maliya toll way, the Halol-Shamlaji toll way and the Rajkot- Vadinar toll way. All these three projects were awarded on September 9, 2008, with two having concession agreements until September 2028 and one until September 2030. The three road projects total 489km in length and are expected to contribute around >Rs500cr in revenues annually (once fully operational).

- **Chennai-Tada toll way:** This is a 43km stretch, which was awarded on March 24, 2009. The project has a concession agreement until June 2023 and is expected to be commissioned by FY2012. It is expected to contribute around Rs60cr-70cr in revenues annually (once fully operational).

- **Interstate corridor (Palanpur-Swaroopganj):** This project entails the four-laning of the 76km highway between Palanpur and Swaroopganj on the East-West Corridor on a BOT-Annuity basis. This is the main route for east-bound commercial traffic from the Kandla and Mundra ports. NHAI will pay the annuity as equated half-yearly installments, for a period of 15 years. The concession agreement runs until June 2023 and the project is expected to be commissioned by FY2012.

Other portfolio

Dhamra Port (27mn tonnes of bulk cargo capacity by May 2010)

Dhamra Port is L&T IDPL's key port asset in a 50:50 joint venture with Tata Steel in Orissa. The project is getting commissioned in May 2010 with a capacity of 27mn tonnes

Dhamra Port is L&T IDPL's key port asset in a 50:50 joint venture with Tata Steel in Orissa. The project is getting commissioned in May 2010 with a capacity of 27mn tonnes. The port would essentially be used for iron ore exports and coal imports, and would compete with Paradip port, which also has a 25-30mn tonnes capacity. The port may further expand to dry bulk, steel cargo, container cargo, etc., and take its capacity up to 80mn tonnes. L&T has a take or pay agreement with Tata Steel, in which it has initially booked 5mn tonnes of capacity, which could go up to 10-15mn tonnes. Dhamra Port would require a total investment of Rs2,400cr in a debt-equity ratio of 2:1, which implies that L&T would have to bring in Rs400cr of equity. The company has already invested Rs200cr and would require an additional Rs200cr funding over the next couple of years.

L&T IDPL owns a 75% stake in L&T Urban Infrastructure (L&T UIL), which is currently developing 32mn sq ft of commercial and residential space. The remaining stake is held by HDFC

L&T Urban Infrastructure (32mn sq ft under development)

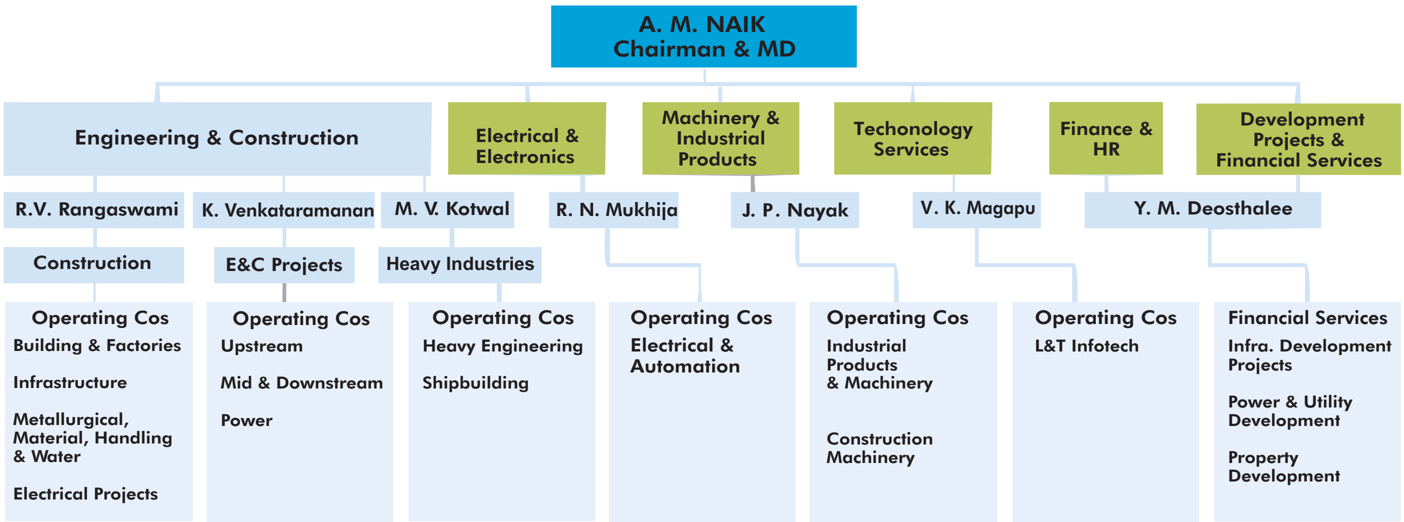
L&T IDPL owns a 75% stake in L&T Urban Infrastructure (L&T UIL), which is currently developing 32mn sq ft of commercial and residential space. The remaining stake is held by HDFC. This land was acquired in 2006. However, given the economic slowdown, the company had scaled back its commercial projects in IT, retail and hospitality in the past six months, while moving ahead with its residential projects in Hyderabad and Chennai. There are early signs of revival in the commercial business. However, the company is more bullish on the residential business, with large projects coming up in Hyderabad and Chennai. Hyderabad Infocity, a large 35 acre plot in Vijaywada, and 80 acres of land in Chennai are the recent residential initiatives by L&T UIL.

L&T UIL has invested in nine projects, six of which are operational and three are under construction (L&T south city projects, L&T hi-tech city and L&T Infra projects Lanka). A total of 5mn sq ft has been developed so far.

- International Operations

Currently, 15% of the company's revenues come from international operations. The focus regions for L&T in the export market are the Middle-East and China. China is being looked at both as a market, and a sourcing and global manufacturing hub. L&T has set up a manufacturing plant in China (Wuxi Electric Company) for the manufacture of switch gear products, an industrial valve manufacturing company in Jiangsu and a Rubber Machinery Company in Qingdao.

Exhibit 24: Corporate structure diagram



Source: Company

Annexure I - Opportunities for L&T abound

Road development: Increasing speed, Regaining Momentum

Our interaction with the management of different companies indicates that they are optimistic about the implementation of the Road Development plans, after the recent changes in guard at the Centre and the Ministry

There are various factors that necessitate an increase in the total length of the country's National Highways (NH), including an increase in the number of vehicles plying on the roads, rapid urbanisation and the retail revolution. The economic losses to the national exchequer due to sub-standard and inadequate roads are estimated to be more than Rs20,000cr per annum. Therefore, the National Highways Authority of India (NHAI) has kept a target for itself of building 20km a day, since the change of guard at the ministry. NHAI's past track record has not been very impressive, having achieved an average of a mere 5-6km/day over FY2005-09, which is much below the set target of 20km/day. Moreover, in the past, NHAI took on an average three years to award a contract and another three years for the construction to get completed. Against this backdrop, we believe that the target appears to be quite ambitious. However, in an attempt to improve things, Procedural and financial/bidding-related matters are slowly and steadily being taken care of or are under serious consideration by NHAI (such as *Standardisation of Documents, Selection of Consultants, Land Acquisition and Clause 3.5.2*). Our interaction with the management of different companies indicates that they are optimistic about the implementation of the Road Development plans, after the recent changes in guard at the Centre and the Ministry.

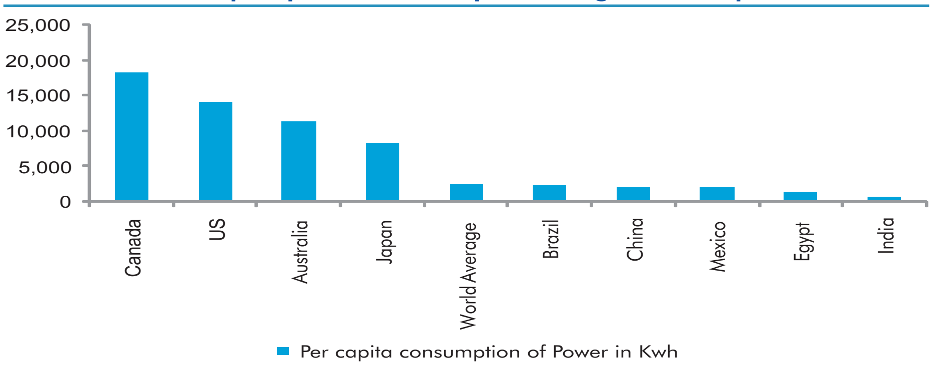
Thus, we believe that the Sector is on a fast track owing to: 1) Political will, 2) Structural Changes, and 3) Buoyant Capital Markets (boosts confidence levels that fund-raising is an option). NHAI has drawn up working plans for the next three years and expects to award projects of around 13,000km in FY2010E, which we believe would benefit companies in the roads segment (like L&T). Further, our talks with the L&T management indicates that there has been an increase in the ticket size of orders from the NHAI, which would work as an indirect entry barrier for smaller companies and would benefit bigger players like L&T.

Power: Fuelling growth

India has the fifth largest power generation volume in the world and has an installed power capacity of 143GW. In spite of this, it ranks among the lowest in terms of per capita consumption

Power happens to be the driving force (in the real sense of the word) behind the economic development of a country. India has the fifth largest power generation volume in the world and has an installed power capacity of 143GW. In spite of this, it ranks among the lowest in terms of per capita consumption. Hydro, Thermal (including gas and diesel), Nuclear and renewable energy sources account for 26%, 66%, 3% and 5%, respectively.

Exhibit 25: Per Capita power consumption - A global comparison

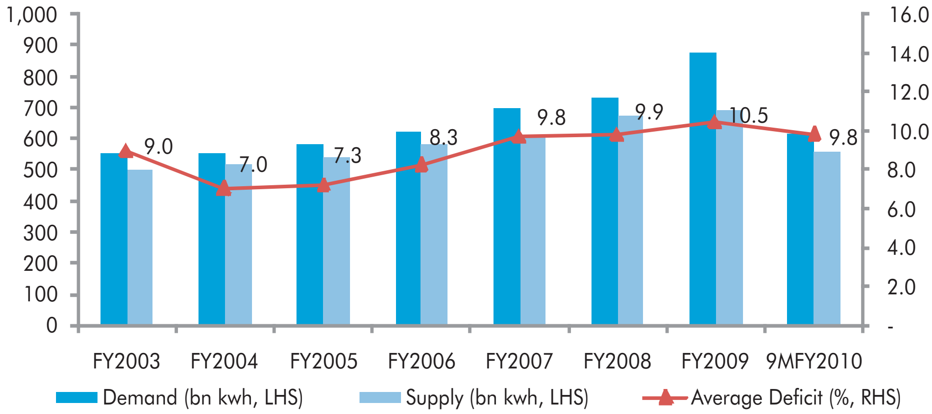


Source: Industry data, Angel Research

The peak demand for power is expected to grow at a CAGR of 7.8% in the Eleventh Five-Year Plan which is suggestive of the real dearth existing in the domain of power generation

Moreover, India experiences a peak load power deficit of 12.6% and an average power deficit of 9.8%. This is inspite of the per capita consumption (631 units) being at a dismal one-fourth of the world's average (2,490 units). The peak demand for power is expected to grow at a CAGR of 7.8% in the Eleventh Five-Year Plan. This is suggestive of the real dearth existing in the domain of power generation.

Exhibit 26: Power - Aggregate demand-supply



Source: Company, Angel Research; Note: 9MFY2010 are provisional numbers

With projected growth rates of the economy at 8-9% by the Planning Commission (over the next five years) and assuming a historical elasticity at 1x, as projected by the Integrated Energy Policy (IEP), power generation would have to grow at 9% per annum during the Eleventh Five-Year Plan period. Any fall back from the projected rate of growth in power generation would have detrimental effects on the dependent sectors.

As a consequence of the dearth in the Power sector and the efforts being made to ramp up capacity, the Engineering, Procurement and Construction (EPC) space will subsequently also provide a huge latent opportunity, where companies that already have a presence in this domain tend to benefit. EPC contracts constitute almost 60% of the quantum of planned investments in power projects. The power segment contributes 22% of the order book as on FY2009 and has seen an uptrend over the years. It offers turnkey construction services, from conceptualisation to commissioning, engineering, procurement and construction solutions. Moreover, L&T has already started taking the required strides (L&T's power equipment manufacturing, boilers and turbines, is on line and is expected to generate revenues in FY2011E) to move up the value chain and to seize the opportunity in the power space.

Railways

Investments to the tune of Rs2,51,000cr are envisaged over the Eleventh Five-Year Plan, with the primary focus on the areas of Freight Business, Passenger Business, Capacity augmentation and Technology upgradation

Railways form an indispensable part of India's transportation infrastructure, contributing to around 40% and 12% to the movement of goods and passengers, respectively (Source: Working Group report on Road Transport - Eleventh Five-Year Plan). The Indian railway network, which is more than 150 years old, is Asia's largest and is the second largest in the world, spanning across 63,332km and employing more than 14 lakh employees.

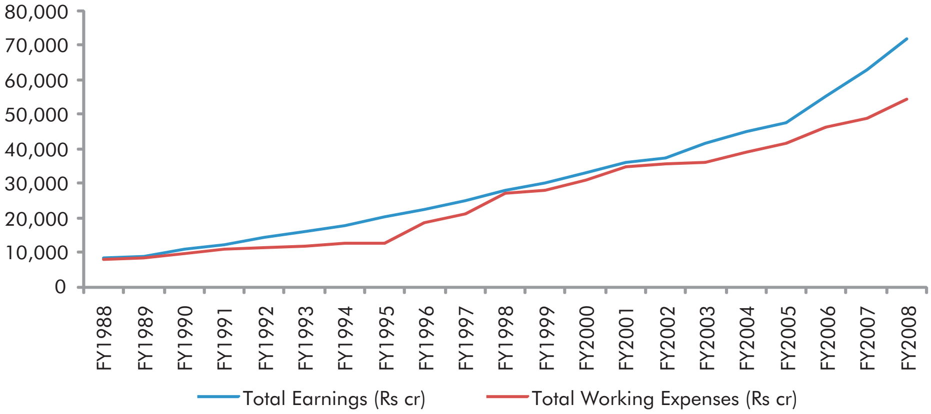
Railway infrastructure essentially consists of two segments, Rolling stock (wagons, passenger coaches and locomotives) and fixed components (tracks, passenger stations, freight terminals, signaling and communication systems). The railways own 2,07,175 wagons, 50,080 coaches and 8,025 locomotives. It runs around 14,000 trains on a daily basis, out of which 8,900 are passenger trains.

The investments made in these two segments are a function of the rate of growth of passenger traffic and goods movement. It is relatively easier to build rolling stock than it is to increase the fixed infrastructure capacity. However, there is a limit to which rolling stock capacity can be augmented without increasing the associated fixed component. Hence, the quantum of investments made in these two segments of railway infrastructure are complementary to each other. Investments in Rolling stock outpacing the investments in associated fixed infrastructure led to over-utilisation of capacity, causing a strain on the railway network. This over-utilisation of capacity is quite evident from the fact that the gap between the investments made in rolling stock and fixed infrastructure are in favor of the former, over the Tenth Five-Year Plan. Therefore, steps are now been taken to ramp-up the fixed component of infrastructure, by setting up dedicated railway freight corridors (DFC), spanning the length and breadth of the country, along with a subsequent augmentation of rolling stock.

Investments to the tune of Rs2,51,000cr are envisaged over the Eleventh Five-Year Plan, with the primary focus on the areas of Freight Business, Passenger Business, Capacity augmentation and Technology upgradation. The contribution of the Centre, States and Private players is seen at 77%, 4% and 19%, respectively. This contribution pattern shows increased participation coming in from Private players, as against that in the Tenth Five-Year Plan.

The Indian railways has annual revenues of more than Rs60,000cr, with a cash surplus in excess of Rs20,000cr. A base-case scenario, assuming that there is no accretion to the cash surplus and it remains the same for the next five years, leads us to an amount of Rs1,00,000cr. This accounts for almost 40% of the planned investments in railways.

Exhibit 27: Trend in earnings of Indian Railways



Source: Ministry of Railways, Angel Research

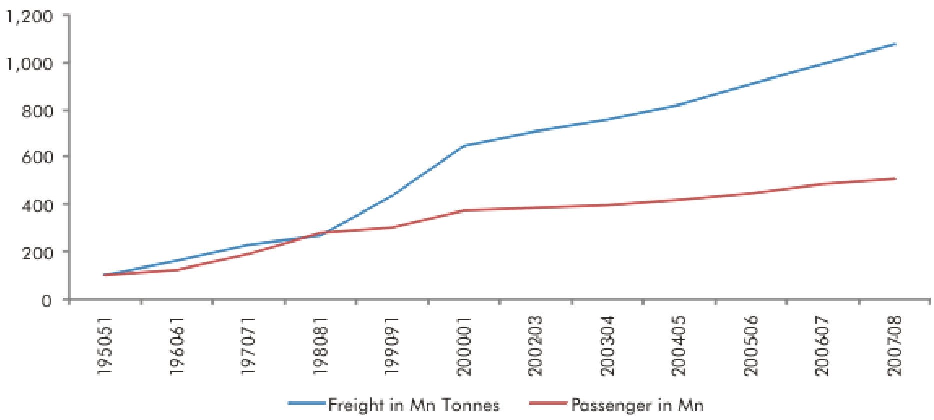
Funding pattern for the Indian Railways

On account of adequate funding in place, we do not expect a slowdown because of a dearth of funds, which augurs well for companies catering to railways like L&T

The envisaged investments to the tune of Rs2,51,000cr are planned to be raised primarily through internal resources (ranging between Rs75,000cr and Rs90,000cr) and Gross Budgetary support (around Rs85,000cr). This pattern of funding still leaves a gap of Rs75,000cr, which the railways plan to finance through extra-budgetary resources. The raising of funds through extra-budgetary resources includes sources like Market borrowings, Wagon investment schemes and the PPP model of financing. With the Private sector contribution in the total investment outlay pegged at 19% (~Rs.50,000cr) and the recent track record of registering a cash surplus of Rs23,000cr, we believe that the Railways are adequately funded to finance their growth plans. On account of such adequate funding in place, we do not expect a slowdown because of a dearth of funds, which augurs well for companies catering to railways (read: L&T).

Besides having obtained the requisite financial closure, what gives firm belief to the revenue visibility, going forward, is the historic growth achieved in the freight traffic and passenger traffic segments (the two main revenue drivers for the Indian Railways). The Freight and Passenger business segments account for 70% and 30% of the revenues, respectively. With the Indian economy poised to grow at rates of around 8-9%, we believe that freight and passenger traffic would at least grow at their historic rates, if not surpass them.

Exhibit 28: Trends in freight and passenger traffic growth



Source: Indian Railways Yearbook 2006-07, Note: The graph is an index plot with base 100

We believe that L&T's foray into the railways is going to be largely due to its internal strength, and will perhaps be supplemented if it is successful in acquiring Kalindee

L&T has beefed up its own internal capabilities in railways. It has setup its own engineering and construction wing for dealing with railway projects. Currently, the company is doing three jobs in the railway sector: one is a coach factory, which it is doing for the Indian Railways, the second one is the Monorail project, which it is doing in Mumbai, and the third one is a 'merry-go-round' project for one of the power plants. As per the management, there is scope in all these three areas. In line with this, L&T has bought a stake (about ~14%) in one of the leading players, Kalindee Rail Nirman, in the segment. Kalindee Rail Nirman is involved in the fields of signaling, telecommunications, gauge conversion, and track laying for the railways.

The basic strategy of L&T through Kalindee is to acquire its capabilities in the railway sector and to be a complete player. Therefore, we believe that L&T's foray into the railways is going to be largely due to its internal strength, and will perhaps be supplemented if it is successful in acquiring Kalindee.

Annexure II - Robust Order inflows

Date	Customer	Sector	Sub-sector	Order size (Rs bn)
23-Mar-10	HLL Lifecare and other private sector bodies	Infrastructure	Industrial and commercial buildings	15.0
22-Mar-10	Govt. of India	Defence	Defence	9.8
19-May-10	Sultanat of Oman	Power	Electrification/ T&D	5.2
9-Apr-10	Various Govt. bodies	Infrastructure	Water	6.1
2-Apr-10	MRPL Mangalore	Oil & gas	Petro-chemicals	13.4
2-Apr-10	Tata Steel	Infrastructure	Construction	11.4
1-Apr-10	Govt. of India and Royal Govt. of Bhutan	Infrastructure	Water	12.5
31-Mar-10	Power Grid and Rail Vikas Nigam Ltd	Power	Electrification/ T&D	11.0
30-Mar-10	Nuclear Power Corporation of India Limited	Power	Nuclear	3.5
9-Feb-10	Federal Electricity and Water Authority (FEWA)-UAE	Power	Electrification/ T&D	2.7
9-Feb-10	NLC Tamilnadu Power Ltd	Power	Electrification/ T&D	0.7
9-Feb-10	Crompton Greaves - Main Contractor (for UPPTCL)	Power	Electrification/ T&D	0.9
9-Feb-10	Tamil Nadu Electricity Board	Power	Electrification/ T&D	1.6
2-Feb-10	Various clients	Infrastructure	Industrial and commercial buildings	3.0
2-Feb-10	Arshiya International Ltd	Infrastructure	Industrial and commercial buildings	3.1
2-Feb-10	Raghuleela Lessors & Developers Pvt Ltd	Infrastructure	Industrial and commercial buildings	5.0
1-Feb-10	National Fertilizers Ltd	Process	Minerals and Metals	21.6
	Tata Steel Ltd	Process	Minerals and Metals	6.3
	Bangalore Metro Rail Project	Infrastructure	Railways	3.0
6-Jan-10	Oberoi Realty Pvt. Ltd	Infrastructure	Industrial and commercial buildings	8.0
6-Jan-10	D B Realty Ltd	Infrastructure	Industrial and commercial buildings	6.3
6-Jan-10	Engineering Projects (India)	Infrastructure	Industrial and commercial buildings	4.1
6-Jan-10	Various clients	Infrastructure	Industrial and commercial buildings	4.9
4-Jan-10	Gujarat Narmada Valley Fertilizers Company Limited	Process	Petrochemicals	9.9
31-Dec-09	Bangalore Water Supply & Sewerage Board	Infrastructure	Water	1.9
31-Dec-09	Adani Power	Power	BoP	3.9
8-Dec-09	Nuclear Power Corporation of India Limited	Power	BoP	8.4
9-Nov-09	Madhya Pradesh Generation Company Ltd.	Power	BoP	16.4
3-Nov-09	Mahagenco	Power	EPC	69.0
14-Oct-09	Gujarat Water Infrastructure Ltd	Infrastructure	Water	2.5
14-Oct-09	Uttar Pradesh Jal Nigam	Infrastructure	Water	4.9
14-Oct-09	Sterlite Industries India Ltd	Process	Minerals and Metals	2.3
6-Oct-09	Arshiya International Ltd	Infrastructure	Industrial and commercial buildings	2.9
6-Oct-09	NBCC	Infrastructure	Industrial and commercial buildings	3.7
6-Oct-09	ITC Group	Infrastructure	Industrial and commercial buildings	2.4
6-Oct-09	DB Hospitality Pvt. Ltd	Infrastructure	Industrial and commercial buildings	6.2
24-Sep-09	GMR Infrastructure Ltd.	Power	EPC	20.0
10-Sep-09	Nuclear Power Corporation of India Ltd	Power	Electrification/ T&D	4.1
24-Aug-09	Oman Electrivity Transmission Company	Power	Electrification/ T&D	1.0
24-Aug-09	Dubai Electricity and Water Authority	Power	Electrification/ T&D	1.2
24-Aug-09	KAHRAMAA	Power	Electrification/ T&D	1.0
24-Aug-09	Qatar Petroleum	Power	Electrification/ T&D	7.4
3-Aug-09	Jaypee Group	Power	Equipment	40.0
5-Aug-09	Neyveli Lignite Corporation Ltd.	Power	BoP	4.9
5-Aug-09	UP Rajya Vidyut Utpadam Nigam Ltd	Power	BoP	3.6
3-Aug-09	Oil and Natural Gas commission	Oil & gas	Platform	53.0
30-Jun-09	Katupulli, TN	Infrastructure	Industrial and commercial buildings	8.4
30-Jun-09	Engineers India Ltd	Process	Refineries	2.1
30-Jun-09	HPCL-Mittal Energy Ltd	Process	Refineries	4.4
30-Jun-09	Expansion on MIOT hospitals, Chennai	Infrastructure	Industrial and commercial buildings	2.1
30-Jun-09	Bharat Aluminium CompanyLtd.	Process	Minerals and Metals	4.2
30-Jun-09	Kohinoor square project, Mumbai	Infrastructure	Industrial and commercial buildings	3.0
30-Jun-09	Lucknow Development authority, Delhi	Infrastructure	Industrial and commercial buildings	2.9
30-Jun-09	Delhi Metro RailwayCorporation	Infrastructure	Railways	2.7
29-Jun-09	Maharashtra State Electricity Distribution Company Ltd	Power	Electrification/ T&D	1.3
29-Jun-09	Maharashtra State Electricity Transmission Company Ltd	Power	Electrification/ T&D	0.7
29-Jun-09	Rail Vikas Nigam Ltd	Infrastructure	Railways	1.9
29-Jun-09	Power Grid Corporation of India Limited	Power	Electrification/ T&D	1.0
29-Jun-09	Chattisgarh State Electricity Board	Power	Electrification/ T&D	2.5
29-Jun-09	MAHATRANSCO	Power	Electrification/ T&D	5.0
19-May-09	Oman Tourism Development Company	Infrastructure	Industrial and commercial buildings	1.1
19-May-09	Oman Electrivity Transmission Company	Power	Electrification/ T&D	2.1
19-May-09	Rural Areas Electricity Company SAOC, Oman	Power	Electrification/ T&D	2.1
	Total			**476.2**

Profit & Loss Statement (Standalone)

Rs crore

Y/E March	FY2007	FY2008	FY2009	FY2010E	FY2011E	FY2012E
Gross sales	**17,901**	**25,187**	**34,045**	**36,470**	**45,429**	**55,751**
Less: Excise duty	333	333	398	320	398	489
Net Sales	**17,567**	**24,855**	**33,647**	**36,150**	**45,031**	**55,262**
Other operating income	38	23	280	209	173	234
Total operating income	**17,605**	**24,878**	**33,926**	**36,359**	**45,204**	**55,496**
% chg	*19.2*	*41.3*	*36.4*	*7.2*	*24.3*	*22.8*
Total Expenditure	15,825	22,051	30,094	31,975	39,897	48,948
Net Raw Materials	8,782	12,963	16,798	17,678	22,110	27,189
Other Mfg costs	4,755	6,168	9,434	10,176	12,609	15,473
Personnel	1,259	1,535	1,998	2,350	2,747	3,316
Other	1,028	1,386	1,864	1,771	2,432	2,969
EBITDA	**1,780**	**2,826**	**3,832**	**4,384**	**5,307**	**6,549**
% chg		*58.8*	*35.6*	*14.4*	*21.0*	*23.4*
(% of Net Sales)	*10.1*	*11.4*	*11.4*	*12.1*	*11.8*	*11.9*
Depreciation& Amortisation	168	202	283	397	493	614
EBIT	**1,612**	**2,624**	**3,550**	**3,987**	**4,814**	**5,935**
% chg		*62.8*	*35.3*	*12.3*	*20.8*	*23.3*
(% of Net Sales)	*9.2*	*10.6*	*10.5*	*11.0*	*10.7*	*10.7*
Interest & other Charges	93	123	350	505	547	586
Other Income (incl pft from Ass/JV)	454	488	527	680	823	989
(% of PBT)	*23.0*	*16.3*	*14.1*	*16.3*	*16.2*	*15.6*
Recurring PBT	**1,973**	**2,989**	**3,726**	**4,162**	**5,090**	**6,339**
% chg		*51.5*	*24.6*	*11.7*	*22.3*	*24.5*
Extraordinary Expense/(Inc.)	(32)	(166)	(987)	(1,168)	-	-
PBT (reported)	**2,005**	**3,155**	**4,713**	**5,330**	**5,090**	**6,339**
Tax	602	982	1,231	1,382	1,680	2,092
(% of PBT)	*30.0*	*31.1*	*26.1*	*25.9*	*33.0*	*33.0*
PAT (reported)	**1,403**	**2,173**	**3,482**	**3,949**	**3,411**	**4,247**
Less: Minority interest (MI)	-	-	-	-	-	-
Prior period items	-	-	-	-	-	-
PAT after MI (reported)	**1,403**	**2,173**	**3,482**	**3,949**	**3,411**	**4,247**
ADJ. PAT	**1,330**	**1,960**	**2,479**	**2,764**	**3,374**	**4,201**
% chg		*47.5*	*26.5*	*11.5*	*22.1*	*24.5*
(% of Net Sales)	*7.6*	*7.9*	*7.4*	*7.6*	*7.5*	*7.6*
Basic EPS (Rs) (Reported)	**49.5**	**74.3**	**59.2**	**65.1**	**56.2**	**70.0**
Fully Diluted EPS (Rs) (Diluted)	**46.9**	**67.1**	**42.2**	**45.6**	**55.6**	**69.2**
% chg		*42.9*	*(37.1)*	*8.0*	*22.1*	*24.5*

Balance Sheet (Standalone) — Rs crore

Y/E March	FY2007	FY2008	FY2009	FY2010E	FY2011E	FY2012E
SOURCES OF FUNDS						
Equity Share Capital	56.7	58.5	117.5	121.3	121.3	121.3
Preference Capital	-	-	-	-	-	-
Reserves& Surplus	5,712	9,497	12,343	18,339	20,956	24,370
Shareholders Funds	**5,768**	**9,555**	**12,460**	**18,460**	**21,077**	**24,491**
Minority Interest	-	-	-	-	-	-
Total Loans	2,078	3,584	6,556	7,757	7,757	7,757
Deferred Tax Liability	40	61	48	48	48	48
Total Liabilities	**7,886**	**13,200**	**19,065**	**26,266**	**28,883**	**32,297**
APPLICATION OF FUNDS						
Gross Block	2,876	4,189	5,575	6,903	8,587	10,728
Less: Acc. Depreciation	1,087	1,239	1,418	1,816	2,308	2,922
Net Block	1,789	2,950	4,157	5,087	6,279	7,806
Capital Work-in-Progress	436	696	1,038	1,246	1,495	1,794
Goodwill	-	-	-	-	-	-
Investments	**3,104**	**6,922**	**8,264**	**10,264**	**11,264**	**12,264**
Current Assets	11,904	16,314	23,448	28,205	33,384	39,200
Cash	1,094	964	775	4,032	2,645	1,461
Loans & Advances	2,277	3,664	6,791	7,471	9,289	11,403
Other	8,532	11,685	15,882	16,702	21,451	26,335
Current liabilities	9,356	13,684	17,842	18,536	23,538	28,767
Net Current Assets	2,547	2,630	5,606	9,669	9,846	10,433
Mis. Exp. not written off	10	3	0	0	0	0
Total Assets	**7,886**	**13,200**	**19,065**	**26,266**	**28,883**	**32,297**

Cash Flow Statement (Standalone)

Rs crore

Y/E March	FY2007	FY2008	FY2009	FY2010E	FY2011E	FY2012E
Profit before tax	2,005	3,155	4,713	5,330	5,090	6,339
Depreciation	168	202	283	397	493	614
Change in Working Capital	(706)	377	2,049	806	1,564	1,771
Less: Other income	454	488	527	680	823	989
Direct taxes paid	604	988	873	1,382	1,680	2,092
Cash Flow from Operations	**1,821**	**1,505**	**1,547**	**2,860**	**1,516**	**2,100**
Inc./ (Dec.) in Fixed Assets	775	1,622	1,980	1,536	1,933	2,439
Inc./ (Dec.) in Investments	1,073	3,620	1,329	2,000	1,000	1,000
Other income	454	488	527	680	823	989
Cash Flow from Investing	**1,394**	**4,754**	**2,782**	**2,856**	**2,110**	**2,450**
Issue of Equity	24	1,702	23	2,807	-	-
Inc./(Dec.) in loans	739	1,560	1,922	1,201	-	-
Dividend Paid (Incl. Tax)	619	114	439	755	793	833
Others	(60)	(28)	(461)	-	-	-
Cash Flow from Financing	**84**	**3,119**	**1,045**	**3,253**	**(793)**	**(833)**
Inc./(Dec.) in Cash	511	(130)	(190)	3,257	(1,387)	(1,183)
Opening Cash balances	**583**	**1,095**	**965**	**775**	**4,032**	**2,645**
Closing Cash balances	**1,095**	**965**	**775**	**4,032**	**2,645**	**1,461**

Key Ratios

Y/E March	FY2007	FY2008	FY2009	FY2010E	FY2011E	FY2012E
Valuation Ratios (x)						
P/E (on FDEPS)	34.5	24.2	38.4	35.6	29.1	23.4
P/CEPS	30.6	21.9	34.5	31.1	25.4	20.4
P/BV	8.0	5.0	7.6	5.3	4.7	4.0
Dividend yield (%)	0.7	0.8	0.5	0.6	0.7	0.7
EV/Sales	5.3	3.9	3.1	2.8	2.3	1.9
EV/EBITDA	52.1	34.4	27.2	23.3	19.5	16.0
EV / Total Assets	11.8	7.4	5.5	3.9	3.6	3.2
Order Book to Sales	2.1	2.1	2.1	2.8	3.0	3.1
Per Share Data (Rs)						
EPS (Basic)	49.5	74.3	59.2	65.1	56.2	70.0
EPS (fully diluted)	46.9	67.1	42.2	45.6	55.6	69.2
Cash EPS	52.9	74.0	47.0	52.1	63.7	79.4
DPS	10.7	12.6	8.4	10.1	10.6	11.2
Book Value	203.7	326.8	212.0	304.3	347.4	403.7
Du Pont Analysis						
EBIT margin (%)	9.2	10.5	10.5	11.0	10.7	10.7
Tax retention ratio (%)	0.7	0.7	0.7	0.7	0.7	0.7
Asset turnover (x)	2.6	2.6	2.2	1.8	1.9	1.9
RoIC (Post-tax) (%)	16.6	19.0	17.2	14.6	13.3	13.9
Cost of Debt (Post Tax)	3.1	3.0	5.1	5.2	4.7	5.1
Leverage (x)	0.2	0.2	0.4	0.3	0.2	0.3
Operating RoE (%)	18.9	22.8	21.8	17.5	15.2	16.2
Returns (%)						
RoCE (Pre-tax)	20.4	24.9	22.0	17.6	17.5	19.4
Angel RoIC (Pre-tax)	23.7	27.6	23.3	19.7	19.9	20.8
RoAE	23.0	25.6	22.5	17.9	17.1	18.4
Turnover ratios (x)						
Asset Turnover (Gross Block)	6.1	7.0	6.9	5.8	5.8	5.7
Inventory / Sales (days)	54	54	54	60	57	57
Receivables (days)	107	94	94	103	97	100
Payables (days)	61	60	63	74	60	63
Working cap cycle (ex-cash) (days)	101.9	76.9	89.6	137.0	163.2	137.3
Solvency ratios (x)						
Net debt to equity	0.2	0.3	0.5	0.2	0.2	0.3
Net debt to EBITDA	0.6	0.9	1.5	0.8	1.0	1.0
Interest Coverage (EBIT / Interest)	17.3	21.4	10.1	7.9	8.8	10.1

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Disclosure of Interest Statement	L & T
1. Analyst ownership of the stock	No
2. Angel and its Group companies ownership of the stock	No
3. Angel and its Group companies' Directors ownership of the stock	No
4. Broking relationship with company covered	No

Note: : We have not considered any Exposure below Rs 5 lakh for Angel, its Group companies and Directors.

Ratings (Returns) :	Buy (> 15%)	Accumulate (5% to 15%)	Neutral (-5 to 5%)
	Reduce (-5% to 15%)	Sell (< -15%)	

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