NOMURA
NOMURA FINANCIAL ADVISORY AND SECURITIES (INDIA) PRIVATE LIMITED

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NEW THEME

ANCHOR REPORT

Small plays on the big capex idea

We believe the coming multi-year boom in infrastructure and capex spending in India will drive earnings and valuations not only for the direct and obvious beneficiaries among large-cap construction and equipment players, but also for their supply chains. It is with this idea that we have gone looking for relatively undiscovered stories in the mid-cap space, and we have found what we believe are four solidly profitable BUY ideas that offer much more potential upside than the large-cap primary plays. On our conservative numbers, all four offer sustained earnings growth, while their order books are picking up. Voltas (an 18.4% earnings CAGR over FY10-12F, 40.6% ROE, 15x FY12F P/E) is a well established, liquid stock with a world-class engineering project portfolio and a successful refrigeration business. Triveni Engineering's (52% earnings CAGR over FY10-12F, 20% ROE, 14.6x FYF12 P/E) tie-up with GE brings its market-leading turbine business into sharper focus and a spin-off could unlock value. Sterlite Technologies' (14% earnings CAGR over FY10-12F, 32% ROE, 10.7x FY12F P/E) strengths in optical fibre and power conductors fit right into telecoms expansion and the remarkable growth in power capacity. Maharashtra Seamless (13% earnings CAGR over FY10-12F, 16% ROE, 7.5x FY12F P/E) is the leading supplier of seamless pipes to the Indian oil and power-generation industries.

① **Infrastructure capex — next ramp-up point approaching**

② **Industrial capex turning around**

③ **Looking for mid-cap beneficiaries**

④ **Our top picks: Voltas, Triveni, Sterlite Tech, Maharashtra Seamless**

Nomura Anchor Reports examine the key themes and value drivers that underpin our sector views and stock recommendations for the next 6 to 12 months.

Stocks for action

All our BUY ratings are backed by strong competitive positioning in relatively consolidated industries, ongoing and large capacity expansion (without equity dilution), stable returns and conservatively projected growth. We also include Nomura Nuggets on three non-rated companies.

Stock	Rating	Price (Local)	Price target
Triveni Engineering (TRE IN)	BUY*	107	154
Voltas (VOLT IN)	BUY*	223	270
Maharashtra Seamless (MHS IN)	BUY*	381	505
Sterlite Technologies (SOTL IN)	BUY*	97	143

*Initiating coverage. Prices as of 15 September.

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Any authors named on this report are research analysts unless otherwise indicated.
See the important disclosures and analyst certifications on pages 89 to 92.

Small & Mid Caps | INDIA

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Action

We initiate coverage of Triveni Engineering, Voltas, Maharashtra Seamless and Sterlite Technologies with BUY ratings. These companies are strong derivative plays on the expected inflection in infrastructure and capex spending, and market leaders in their respective niches. We think their valuations will be re-rated to reflect high projected earnings growth in the next few years, catalysed by strong order flows.

Catalysts

All these companies are likely to see a significant and sustained jump in EPS growth from FY12F, according to our estimates.

Anchor themes

Despite some short-term delays, the story on both infra and corporate capex is expected to be strong in India. We believe that 2012-13 will see a significant inflection point in investment capex in India.

Stocks for action

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* Initiating coverage. Prices as of 15 September.

Small plays on the big capex idea

① Infra capex — next ramp-up point approaching

We believe the Indian investment cycle is likely to witness a significant structural inflection in the next few years, led by a significant improvement in the cashflows of private infrastructure operators. Despite some short-term delays, the story on both infra and corporate capex is expected to be strong in India. We think that 2012-13 will see a significant inflection in activity levels in the Indian infrastructure sector.

② Industrial capex turning around

On the corporate capex side, while the picture is becoming positive, companies with dependence on large and late-cycle industrial capex have not recovered fully. Overall, strong demand, high capacity utilisation and a relatively stable macro environment present a positive environment for a revival in corporate capex.

③ Looking for mid-cap beneficiaries

We have looked at mid-cap (US$200mn-US$1.5bn) companies which are fairly leveraged to and are likely to benefit significantly from a pick-up in capex activities. These are companies with strong competitive positions in relatively consolidated industries with large capacity expansions (without equity dilution).

④ Our top mid-cap picks

Voltas (18.4% earnings CAGR over FY10-12F, 40.6 % ROE, 15x FY12F P/E) is a well established, liquid stock with a world-class engineering project portfolio and a successful refrigeration business. Triveni Engineering's (52% CAGR over FY10-12F, 20% ROE FY09, 14.6x FY12F P/E) tie-up with GE brings its market-leading turbine business into sharper focus and a spin-off could unlock value. Sterlite Technologies' (14% CAGR over FY10-12F, 32% ROE, 10.7x FY12F P/E) strengths in optical fibre and power conductors fit right into telecom expansion and the significant growth in power capacity. Maharashtra Seamless (13% CAGR over FY10-12F, 16% ROE, 7.5x FY12F P/E) is the leading supplier of seamless pipes to the oil and power industries. We also present Nomura Nuggets (non-rated reviews) on GEI Industrial Systems, Elgi Equipments and Techno-Electricals.

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Also see our Anchor Report: India Infrastructure — *Different strokes* (12 August, 2010)

And our Anchor Report: Global Insight — Pharmaceuticals sector: *Inexpensive drugs from India to transform the global pharmaceutical industry — trend toward biosimilars* (21 June, 2010)

Executive Summary

Investment cycle – on the cusp of inflection

Pick-up in capex cycle expected soon and likely to reach an inflection point by FY12

We believe that the Indian investment cycle is likely to witness a significant structural inflection in the next few years, led by a significant improvement in the cashflow of private infrastructure operators. In this report, we highlight a number of derivative plays – companies that are small in size, but that we believe have the potential to benefit significantly from the continued ramp-up in opportunity in the sector.

Both infrastructure and corporate capex are turning around

Despite some short-term delays, we expect the story on both infrastructure and corporate capex to be strong in India. We think that 2012-13 will see a significant inflection in activity levels in the Indian infrastructure sector. We expect this to come as the private sector starts to generate its first cash flows from the projects it is in process of executing currently.

On the corporate capex side, while the picture is becoming more positive, companies with dependence on large and late-cycle industrial capex have not recovered fully. Overall, strong demand, high capacity utilisation and a relatively stable macro environment present a positive environment for a revival in corporate capex, in our view. Metals & mining, oil & gas, cement and autos are some of the sectors contributing to the revival in corporate capex. Ferrous and non-ferrous capex is also picking up as cheaper raw materials and labour present a strong economic rationale for setting up plants in India. In oil & gas, capex is driven by exploration and production (E&P), petrochemical and gas infrastructure.

Large-cap picks – L&T, Crompton Greaves and IVRCL Infra are our top picks

Our infrastructure theme report (*Different Strokes*, 12 August 2010) looked at large-cap plays on the capex theme and identified L&T, Crompton Greaves and IVRCL Infra as the top picks.

Exhibit 1. Large-cap picks

Company	Bloomberg ticker	Price	Rating
L&T	LT IN	1,918	BUY
Crompton Greaves	CRG IN	307	BUY
IVRCL	IVRC in	158	BUY

Pricing as of 15 Sep 2010
Source: Nomura estimates

Mid caps – looking for beneficiaries

In this report, we look at mid-cap (US$200mn-US$1.5bn) companies which are fairly leveraged to and are likely to benefit significantly from a pick-up in capex activities. These are companies with strong competitive positions in relatively consolidated industries with large capacity expansions (without equity dilution).

Due to their linkage with the capex cycle, we estimate that these companies will see sharp increases in EPS growth from FY12F and this EPS growth is likely to be sustained for a few years after that. The early signs of this growth are becoming apparent (and are likely to become more prominent, in our view), in a pick-up of order books for these companies.

We initiate coverage of Triveni Engineering, Voltas, Maharashtra Seamless and Sterlite Technologies with BUY ratings. We also present Nomura Nuggets (non-rated reviews) on GEI Industrial Systems, Elgi Equipments and Techno-Electricals.

Exhibit 2. Companies discussed

Company	Bloomberg ticker	Core business	Market cap (Rs mn)	Current price (Rs)	Target price (Rs)	Rating
Voltas	VOLT IN	Electro-mechanical projects and services, engineering and cooling products	73,638	223	270	BUY
Triveni Engineering & Industries	TRE IN	Turbines, high speed gears, water and sugar	27,451	106	154	BUY
Maharashtra Seamless	MHS IN	Seamless and ERW pipes	26,854	381	505	BUY
Sterlite Technologies Ltd	SOTL IN	Optical fiber and power conductors	34,352	97	143	BUY
GEI Industrial Systems	GEIN IN	Air-cooled steam condenser	2,777	167	n.a.	Not rated
Techno Electric	TEE IN	Power generation EPC	15,746	276	n.a.	Not rated
Elgi Equipment	ELEQ IN	Compressors	11,402	142	n.a.	Not rated

Pricing as of 15 Sep 2010
Source: Bloomberg, Nomura research

Voltas

Voltas is one of the few globally competitive services companies from India, which has the capability and expertise to execute world-class projects, in our view. The company is likely to be a significant beneficiary of a pick-up in the capex cycle and likely to see a 20% EPS CAGR for several years after FY12E. The company has zero long-term debt, produces significant free cash flow (FCF) every year and enjoys relatively high ROCE and ROE. We initiate coverage with a price target of Rs270 (P/E of 18x FY12E EPS of Rs14.9).

Triveni Engineering

We initiate coverage of Triveni Engineering with a BUY rating and a price target of Rs154 as the company's turbine business is top quality in terms of growth potential and margins and is likely to get listed at much higher valuations than currently implied by the combined entity. Triveni's turbine business has a dominant position in the <30 MW segment, and is likely to get a big boost after the recent technology and marketing tie-up with GE. This turbine business is likely to be hived-off in a separate listed company by December 2010, as per management.

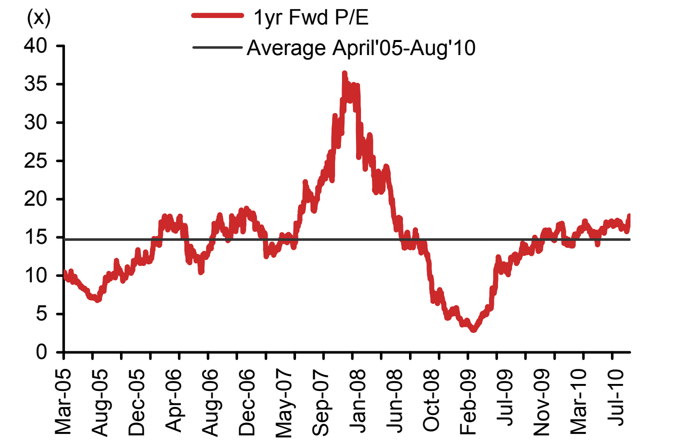
Maharashtra Seamless

We initiate coverage of MHS with a BUY rating and a price target of Rs505, offering potential upside of 33% from current levels. MHS has a strong competitive position in both seamless and ERW pipes and has been able to maintain profitability despite being exposed to business cycle risks (users' industries and raw materials). At 7.5x FY12F EPS of Rs50.5, we find its valuation inexpensive. MHS has a dominant position in the seamless and electric resistance welded (ERW) pipe markets and is a direct play on the capex of both the industrial (oil & gas) and power-generation sectors. The company has been able to maintain EBIDTA per tonne in a narrow range despite wide fluctuations in steel prices and has been able to grow EPS consistently (a 15% CAGR over the past four years).

Sterlite Technologies

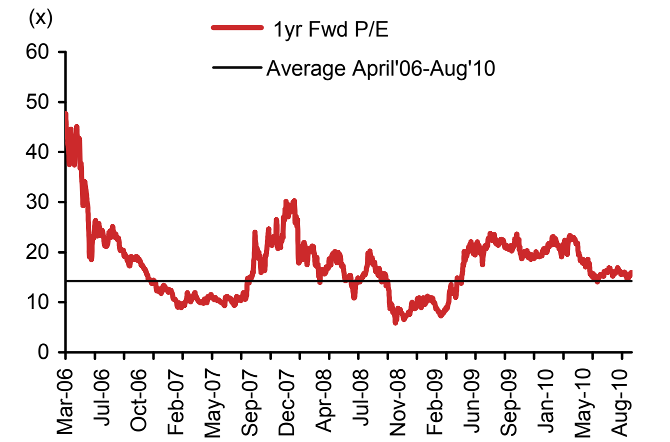
We initiate coverage of SOTL with a BUY rating and a price target of Rs143. The company has a dominant position in the optical fibre and power conductor businesses in India, both of which have strong demand drivers in place. The company has recorded an EPS CAGR of above 45% over the past five years (2005-10) and expanded the capacity of both its product lines recently. Sterlite Technologies (SOTL) has a dominant market position in the optical fibre cable as well as power conductors businesses in India, and is a play on industrial (largely telecom) and power transmission capital expenditure in India and other emerging countries.

Exhibit 3. Voltas — one-year forward P/E



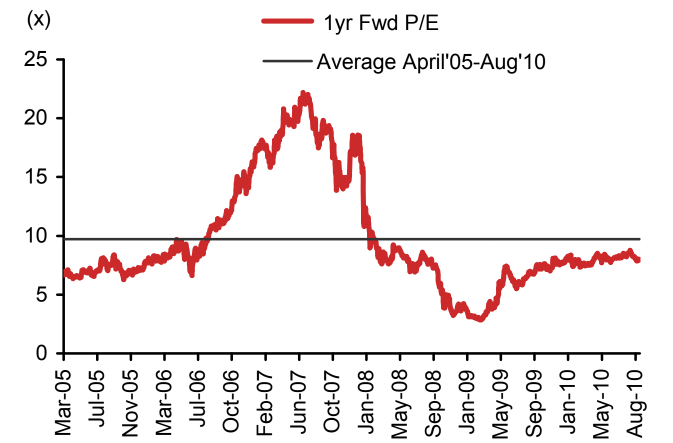
Source: Bloomberg, Company data, Nomura research

Exhibit 4. Triveni — one-year forward P/E



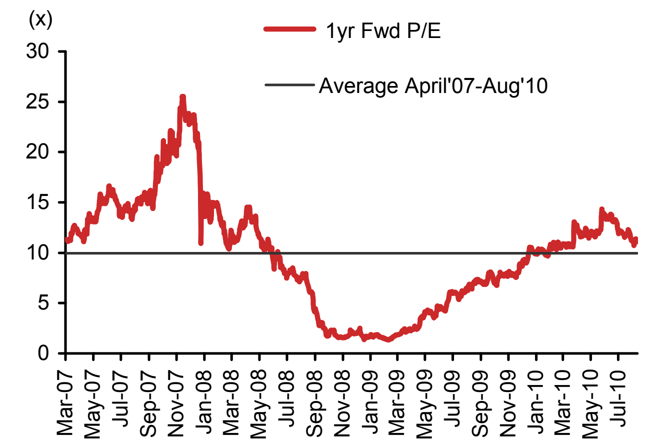
Source: Bloomberg, Company data, Nomura research

Exhibit 5. Maharashtra — one-year forward P/E



Source: Bloomberg, Company data, Nomura research

Exhibit 6. Sterlite — one-year forward P/E



Source: Bloomberg, Company data, Nomura research

Drilling down

The road to inflection – a macro perspective

We think that 2012-13 will see a significant inflection in activity levels in the Indian infrastructure sector. This would come as the private sector starts to generate its first cashflow from the projects it is in process of executing currently.

The road to infection in capex will be facilitated by cash generation by private projects

The first phase of reforms focused on putting framework for private participation in place

The structural challenge in India has been about the change in approach to building infrastructure. Until the late 1990s, almost all infrastructure (including telecoms) was exclusively the domain of the Indian government. Given the poor finances of the government, there has been a need to enhance the role of the private sector in infrastructure. This has needed reforms across the board.

- **Institutionalization of regulation** – Typically, the government was both the regulator and the operator across all infrastructure sectors. Given that there was no private participation, there was no major conflict between the operator and regulator. However, for the private sector to operate and compete in the same space, it was imperative for the formation of independent regulators to resolve the conflict of interest issues. This has largely been done across sectors.
- **Creation of models which can be monetized** – The second challenge was that most of the infrastructure was largely a social service. Given that the infrastructure was owned by the government, political considerations often drove sectors such as electricity into deep losses – as the sector was used for doling out subsidies to the public. Similarly in telecoms, the social policy overtones were visible in terms of subsidies to local voice from long distance revenues.

  The creation of monetizable models has meant different things for different sectors e.g. spectrum privatisation for telecom and viability gap funding in roads. We note that private sector participation is largely contingent upon returns available and this would mean that several sectors such as urban infrastructure would continue to remain in the purview of the public sector.
- **Operationalising risk transfer** – Setting the ball rolling in various sectors has also been a challenge. Since the government was the sole player across infrastructure segments, there is a paucity of strong balance sheets which can take risk on a large scale. In addition, given the risks associated with getting into new areas, initial projects have been given with higher returns than would otherwise ensue once the model is established.

Yet, sectors have needed significant capital market support

The decision to involve the private sector in a big way in sectors other than telecoms gained momentum in the earlier part of the last decade. There are two interlinked challenges in being able to increase private participation in a short space of time:

1. Given that the private sector was not present in infrastructure traditionally, there were no large traditional players with large enough balance sheets as well execution capabilities to enable a quick transfer. Typically, infrastructure players in India have largely been construction players which have relied on government contracts for the bulk of their revenues.
2. Second, apart from telecoms, all other infrastructure businesses are long gestation. Until the time projects reach completion, they are cash guzzlers. The timeframe for this negative cash flow could be from 3-5 years, depending on the type of infrastructure.

Therefore, the infrastructure sector needs a reasonable amount of capital, both from equity and debt.

The good news is that equity money has already been raised

The positive news is that a large part of the first phase of private sector players have obtained funding. The table below shows the equity market fund raising achieved over the past three years by power and telecom sectors. The significant amount of funds raised has ensured that the bulk of the equity requirements for the private sector for the currently planned capacity are funded. For example, if we assume that 60% of the total funds raised for the power sector are for generation, then the money is sufficient to fund about 35,000 MW of capacity additions without assuming use of FDI/PE/ Internal generation for further equity funding, according to our estimates.

Exhibit 7. Equity market fund raising

(Rs bn)	Power	Telecom	% of total
FY07	3.0	299.4	-
FY08	1,371.0	100.0	16.9
FY09	95.8	10.0	6.5
FY10	2,529.3	0	43.9

Source: Nomura research

Debt funding could become a constraint

The table below shows the funds flow from various debt instruments into infrastructure. The banking system continues to be the main funding vehicle for the infrastructure sector. In fact, of the total ECBs raised, about 70% have gone into air transport, telecom and shipping. This effectively means that the dependence of ex-telecom infrastructure on bank finance is even higher.

Exhibit 8. Sources of debt funding to infrastructure sector

(Rs bn)	FY08A		FY09A	
	Amount	% to total	Amount	% to total
Incremental flow of bank credit to infrastructure	6,174.4	50	6,487.3	56
Investment by insurance companies in infra	1,040.0	8	1,308.9	11
Private placement of debt	385.6	3	1,465.9	13
ECBS	4,677.7	38	2,403.3	21
Total	**12,277.7**	**100**	**11,665.3**	**100**

Source: Nomura research, Reserve Bank of India

The dependence of infrastructure on banks for raising debt is a challenge, in our view. Given the prudential norms, sector- and group-wide borrowing limits may not be sufficient for all planned works. In FY09, 10.2% of bank advances were given to the infrastructure sector. This number is up from 1.8% in 2001. Given the government's ambition to raise this target by 2.5x for the next five-year plan, coupled with larger private sector share, funding may become increasingly tight.

Building competencies

The bigger issue today revolves around execution and execution capabilities. We believe that a general shortage exists for technical qualified personnel. Industry feedback suggests that even larger companies in construction and engineering businesses are seeing attrition rates bordering on 30-40% p.a. The struggle for personnel is likely to grow as the volume of work continues to see significant growth. This presents larger challenges for smaller companies as their ramp-ups are critically dependent upon increasing execution capabilities.

Diving Deep – Looking at infrastructure

Infrastructure capex – dissecting the components

Power expected to be largest capex driver in India

The challenge in the infrastructure space is to find companies that are likely to benefit from positive demand trends. There are four types of players in the capex space:

- Developer model – The developers are the owners of infrastructure. The ownership could be on a long-term or short-term basis.

Exhibit 9. Typical models and return expectations

Sector	Typical model	Return expectations
Roads	Bid based acquisition, BOT model, compared to power – much less capital intensive	Amongst the lowest. Too much competition. Low entry barriers
Ports		
Airports	Bid based acquisition.	Money made through real estate in later bids. Good assets to own in the long term.
Power Generation	BOO model, largely tariff based bidding for UMPP, PPAs prevalent, Merchant power provides potential upside	Decent return expectations. Early movers have made
Power Transmission	BOO model, tariff based bidding	
Power Distribution		

Source: Nomura research

- Construction companies – There are several degrees of competence within construction companies, ranging from companies that do low end work such as road construction to high-end construction companies that do complex engineering jobs as well. The return profile of construction companies, therefore, has been very diverse.
- Construction companies have also ventured into the development space. Part of the desire to get into development has been driven by generating captive construction business and part is aided by the opportunity to turn into developers due to the significant privatization drive by the government.
- First-tier equipment suppliers – Equipment suppliers are typically more relevant from a power and corporate capex perspective. These companies are typically highly profitable and have strong visibility in their order books.
- Second-tier equipment suppliers – these players are largely suppliers to the EPC contractors/larger equipment suppliers. In this report, our primary focus is to look at some of these players.

Sector preferences

Since we are working with mid-cap companies in this report, we need to look at sectors with large long-term opportunities. For relatively smaller companies to scale up, it is essential, from our perspective, that the company is helped by significant sector tailwinds.

In this respect, we are less enthused by plays on roads, ports, airports and railways for the following reasons:

Exhibit 10. Opportunity size in infrastructure

Sector	Size of opportunity (Rsbn)	Characteristics	Implications for second-tier players
Power	6.586	At the margin, increasingly driven by private sector, timely completion key	Very strong opportunities
Roads	2787	BOT driven, very competitive, lower returns, important to keep capital costs low	Good for construction equipment suppliers
Telecoms	3451	Very competitive, operators are suffering	Not very strong
Railways	2008	Monetization models not clear. Pvt sector still largely supplier to railways	Not very strong
Irrigation	2462	Low end, competitive, state subject – payment risks	Not very strong
Water supply	1117	Getting interesting. Funding from JNNURM	Sector-specific players could benefit
Ports	406	Small, good opportunity for developers	Limited
Airports	361	Small, good opportunity for developers	Limited

Source: Nomura research, JNNURM – Jawahar Lal Nehru Urban Renewal Mission

The size of the opportunity is the strongest in the power sector. The sector is well funded and the long-term demand for supply is very clear. The private sector is well advanced in the generation space.

We believe that roads are a strong opportunity, but the sector does not require high end-technology in general and therefore for suppliers into the sector, returns are likely to be on the lower side, in our view. There would still be general suppliers of earth-moving equipment into the sector which should benefit from road development (as well as from a recovery in the general capex cycle).

Telecom is again a not-so-exciting sector. The large capex would likely be focussed on 3G and wireless broadband rollouts. Most of the electronics capex would likely be met through imports, in our view.

Diving Deep – looking at corporate capex

Corporate capex – revving up slowly

In an overall sense, we are positive on corporate capex over the medium and long term. This is underpinned by our economy team's forecasts of strong GDP growth, strong incomes and a general stretch of capacity utilisation in the system.

Capacity utilisation has been rising

As seen below, capacity utilisation in the economy has risen rapidly following the exit from the global financial crisis in 2008.

Exhibit 11. Percent responses under expectations for capacity utilisation

(Percentage responses)

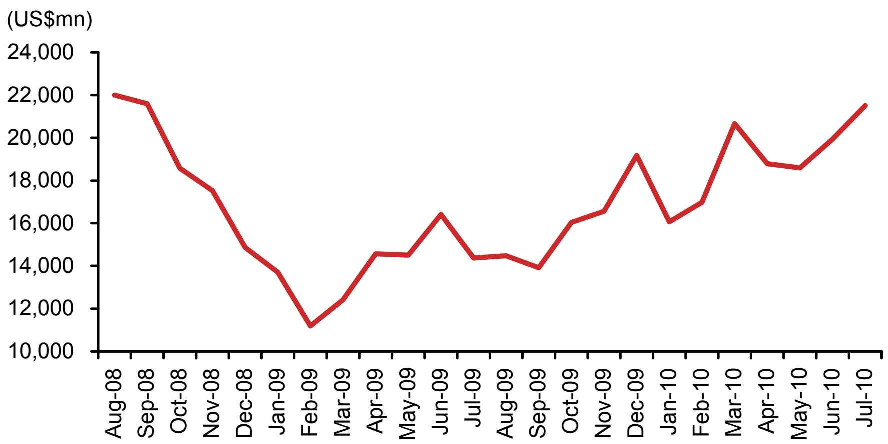
		Assessment for quarter		Expectations for quarter	
Parameter	**Options**	**Apr-Jun 2009**	**July-Sep 2009**	**July-Sep 2009**	**Oct-Dec 2009**
Capacity utilisation	Increase	21.6	28.3	26.6	32.9
	No change	53.1	53.5	57.5	56.2
	Decrease	25.3	18.2	15.9	10.9
	Net response	(3.7)	10.1	10.7	22
Level of capacity utilization (compared to the average in last 4 quarters)	Above normal	8.3	10.2	8.6	10.1
	Normal	64.2	68.4	70.8	76
	Below normal	27.5	21.4	20.7	13.9
	Net response	(19.2)	(11.2)	(12.1)	(3.8)
	Net response	4.6	5.8	5.5	6.5

Source: Reserve Bank of India

Non-oil imports increase point to shortage of capacity

Despite strong production increases, rising non-oil imports point to the fact that domestic capacity is not able to meet enhanced demand sufficiently. This should lead to strong capacity additions across the manufacturing sector, in our view.

Exhibit 12. Non-oil imports



Source: Nomura research, Business Beacon

Pick-up is evident but somewhat held back due to risk appetite

In general, our analyst feedback suggests strong capacity addition plans in most sectors. Exhibits 12-14 give estimates of capex in some of the large sectors in the economy. Our consistent feedback suggests that the cement, metals and oil and gas sectors continue to be large spenders even now.

Despite the evident lack of capacity, however, the general pick-up in overall capex is still not as strong as in the pre-crisis era. The two main attributable reasons seem to be:

- **Less risk taking appetite among corporates –** after the financial crisis, the general environment for corporates has become cautious. Even as profits are growing and capacities are stretched, continued uncertainty in the global economy has held corporates back from going full steam ahead on their expansion plans. One of the important reasons for this is also because of the fact that many Indian corporates are still sponsor-controlled entities. This concentrates big decision-making at the top and has led to the postponement of capex spending even after planning it. We met with several companies that complained about order book execution being very slow. Almost all company feedback suggests that the level of activity in the sector remains well below pre-crisis levels.
- **Timing issues between cycles –** Corporate India was in the midst of one of the heaviest capex cycles before the global financial crisis. The corporate sector response to the crisis was to shelve projects in the planning stage altogether. The post-crisis focus of corporates was to essentially complete ongoing projects. As demand has picked up, corporates have gone back to reviving these previously shelved projects. We believe that we are currently experiencing the lull period between the ending of the last capex cycle and the start of a new one.

This means there could be short-term risks to capex plays

An analysis of the result of the capex-related plays puts the above in some perspective. We looked at the result of companies supplying capital goods and we found that companies with relatively short lead times and dependence on largely industrial capex have not seen a full recovery. Similarly, companies with late cycle capex are seeing fairly tough times. The other negative factor putting pressure on companies is on account of the fact that the orders which came after the lull in the capex cycle post crisis were bid very aggressively (period of March 2009-September 2009). Coupled with the fact that raw material prices have recovered very strongly post that period, margin pressure for orders taken in that period is very high. This is manifesting itself in two ways: 1) EPC margins are getting squeezed and 2) suppliers to EPC players (transformer companies, etc.) are seeing the derivative impact of margin pressure.

The longer-term picture continues to get better

The key sectors contributing to corporate capex are metals and mining, oil & gas, cement and autos. The table below shows data from our respective sector analysts on large projects in the steel, oil and gas sectors. We believe that metals, oil and gas and cement would remain key sectors for corporate capex.

Exhibit 13. Capacity expansion planned in steel over next 5 years

Company	Project	Capex (Rs bn)
Tata Steel	Chattisgarh - 6mtpa	120
Tata Steel	Jharkhand	400
Posco	Orissa	510
Arcelor Mittal	Orissa/Jharkhand 10 mtpa each	720
JSW	Bengal/Jharkhand - 10 mtpa each	700
JSW	Karnataka - 5 mtpa brownfield	150
SAIL	10mn tonnes in Jharkhand	400
Total		**3,000**

Source: Company data, Nomura estimates

Exhibit 14. ONGC projects — being implemented and planned

Project	Investment (Rs bn)
Additional Development of D-1 Field	21.6
Group-A of Assam Renewal Project, Assam Asset	24.7
B-46 Cluster Fields development, Mumbai	14.4
Mumbai High North Redevelopment Phase II	68.6
Additional Processing units at Uran	18.0
Mumbai High South Redevelopment-Phase-2	80.6
Heera & South Heera redevelopment	23.1
B-193 Cluster fields development	56.3
B-22 Cluster Fields development	29.2
Development of C-Series Fields	32.0
New Process Complex MHN in place of old BHN, Mumbai High North Field	63.3
C2-C3 & LPG Recovery from LNG Dahej	14.9
Integrated Development of G-1 and GS-15 fields	12.6
Cluster 7 development	32.4
MARS	18.0
UD-1 development	106.3
Total	**615.9**

Source: Company data, Nomura estimates

Exhibit 15. Trunk gas pipeline infrastructure under development

Project	Length (km)
Developed by GAIL	
Dadri - Bawana – Nangal	600
Chainsa - Gurgaon - Jhajjar - Hissar	400
Jagdishpur – Haldia	2,000
Dabhol – Bangalore	1,400
Kochi - Kanjirkkod – Mangalore - Bangalore	1,100
Developed by RGTIL	
Kakinada-Haldia	1,100
Kakinada-Chennai	445
Chennai-Bangalore-Mangalore	600
Chennai-Tuticorin	670
EOI submitted	
Mehsana – Bhatinda	1,670
Mallavaram – Bhilwara	1,585
Bhatinda – Srinagar	740
Surat – Paradeep	1,600
Vijaywada – Vijaypur	2,750
Total	**16,660**

Source: Company data, Nomura estimates

Diving Deep – timing the pick up

Timing the inflection point

The issue with understanding the dynamics of the capital goods sector is the diversity of products and services, multiple industry dependence and the multiplicity of business models. Still, we believe it is possible to call a strong recovery in capex cycle – and indeed make investment decisions around this core thesis. We do acknowledge that the timing of the recovery can not be absolutely precise but we believe that it is more important to get the magnitude of the inflection and general timing right.

Infrastructure capex – strong and set to get stronger

Infrastructure sector is going through a risk transfer stage

As noted earlier, the problem with Indian infrastructure was the lack of ability of the private sector to assume large risks. However, there would be a significant mitigation of these risks as projects come on stream. As cashflows get better, the ability to reinvest is likely to rise sharply. The table below shows the completion schedule for private sector power capacity. This capacity needs to be seen with respect to the current installed capacity of 8491 MW in the private sector including captive capacity.

Exhibit 16. Power capacity completion schedule

	Central	State	Private	Captive	Total
FY11	3,690	3,112	4,285	2,362	13,449
FY12	5,736	2,800	6,397	2,722	17,655
FY13	5,262	3,510	7,620	2,351	18,743
FY14	3,021	3,103	12,675	2,673	21,472
FY15	3,705	2,648	14,545	2,865	23,763
Total	**21,414**	**15,173**	**45,522**	**12,973**	**95,082**

Source: Nomura research, Ministry of Power

Exhibit 17. Ports statistics

	Investment size (Rs bn)
Currently operating private/captive ports	648.55
Private/captive ports under implementation	1,037.2
PPP projects under bidding	1,477.1

Source: Nomura research, Planning commission

Exhibit 18. Roads statistics (for central sector)

	Investment size (Rs bn)
94 projects awarded on toll basis	3,816.8
43 projects completed	n.a.

Source: Nomura research, Economic Survey of India

We believe that visibility of cashflow would be very strong by FY12

By end FY13, power capacity in the private hands is likely to quadruple from current levels and then double again in the next two years, according to CrisInfac estimates. This would mean that the cashflows would finally start to flow through from FY12 onwards. As internal generation rises, the ability to increase investments would rise further. The table below gives a very simple calculation

Exhibit 19. A sample calculation of inflection in the power sector

	FY10	FY11	FY12	FY13	FY14	FY15
Current capacity	8,491	15,138	24,257	34,228	49,576	66,986
capacity to produce	74,381	132,609	212,491	299,837	434,286	586,797
Profit/unit	1.5	1.5	1.5	1.5	1.5	1.5
Profit on power	111,571	198,913	318,737	449,756	651,429	880,196
Can fund annual capacity	11,157	19,891	31,874	44,976	65,143	88,020
Currently under implementation	58,495	51,848	42,729	32,758	17,410	0

Source: Nomura research

What the above simplistic depiction shows is that the ability to fund capacity would be much higher than the capacity under implementation by FY12 as the new capacity comes on-stream.

Inflection post FY12F, dependence on the capital markets to decline

We believe that similar statistic would hold true for other parts of infrastructure as well. We therefore believe that FY12 should see the next cycle of infrastructure capex take hold. Since internal cash flows would be funding a lot of the capex, the dependence on capital markets would reduce prospectively, in our view.

Policy is a key risk

The risk to the investment story in the sector is primarily from the policy environment. Infrastructure demand and return fundamentals are well established. As we have highlighted, the ability of the private sector to invest in new projects would improve multi-fold as projects currently under implementation start to come on stream.

However, unlike telecoms, the role of the government in creating a new investment opportunity remains very large. This could take the shape of the ability to acquire land, environmental clearance or, in case of roads, creating a bank of projects for the private sector to take over. Again, unlike telecoms where pricing is free, returns in the rest of the infrastructure space are much more tightly regulated.

Corporate capex – not very far from accelerating

This brings us to corporate capex. The challenge in forming a view on corporate capex is the general lack of data. Unlike the infrastructure sector where the data is much easer to find, corporate capex is spread out across a vast number of companies. In addition, the presence of a large unorganized sector also makes the task of reviewing the capex cycle more difficult.

Mixed signals from companies in cap goods sector

As a part of working on this report, we met a large number of companies across the capital goods space. Interestingly, the business traction across companies differs widely. The feedback is summarized as below –

- Transformers – demand has picked up, but is well below industry's expectations. Capacity additions have been strong in transformer capacity, resulting in sharp erosion in margins. This situation is likely to persist for some more time. In addition, feedback also suggests that EPC players bid aggressively for T&D projects in the initial period of demand recovery.
- Air-conditioning – demand has picked up but is still not at 2007-08 levels. We expect a gradual recovery. There is still a fair amount of dependence on commercial real estate which has still not picked up to the extent of 07-08 levels.
- Crane hiring – Picked up but still well below 2007-08 levels. The encouraging sign is that the number of enquiries has started to increase. From the bottom, enquiries are up 3x but are still 30-40% below the peak. Crane hire enquiry typically takes place 4-6 months before the actual need for cranes in projects.

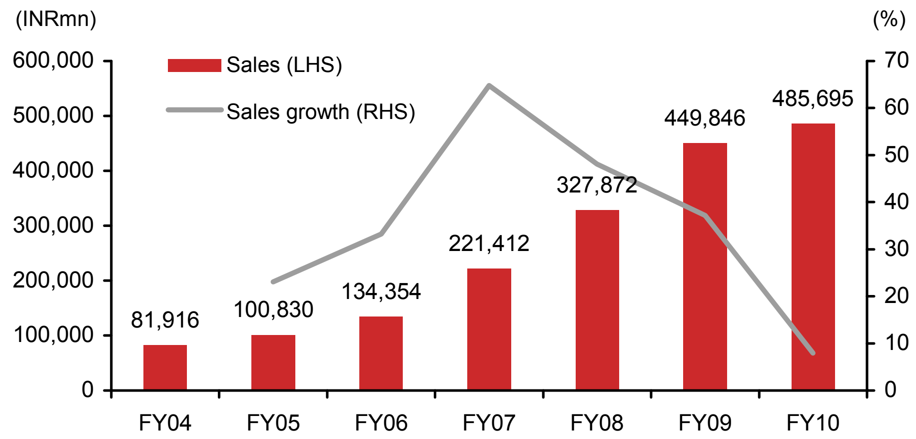
- Pumps – Quite slow. Pumps are short lead items – with an order execution cycle of approximately 7-8 months. The feedback from here is that new project cycle is still slow, price competition is high. In addition, the order books are also not moving because clients have been delaying orders which have already been placed. This is essentially due to the fact that company management's risk appetite is still low and any risk flare globally makes them even more risk-averse, leading to project delays.
- Compressors – Strong demand growth here. These companies are benefitting from strong demand from steel, textiles, cement, paper, automobiles and auto service centres. This could be because compressors are early recovery items and they also go into sectors which are linked to consumption strength.
- Gears – picked up, though still slower than the peak level of activity.
- Transmission towers – strong activity led by capex on the back of a follow up to generating capacity is leading to strong activity in this sector. Even though the sector is dominated by the public sector, there is increasing participation from the private sector leading to growth acceleration.
- Seamless pipes – Strong recovery in oil price has led to a smart recovery in exploration and drilling activity which consumes the bulk of the seamless pipe demand.

Large cap construction has also been slow in the recent past

Slowdown in sales growth in FY10 mainly due to external issues

Sales growth for large-cap construction companies has slowed down with a lag to the financial crisis which is consistent with the feedback of some of the mid cap companies as well.

Exhibit 20. Sales growth slowed down significantly in FY10

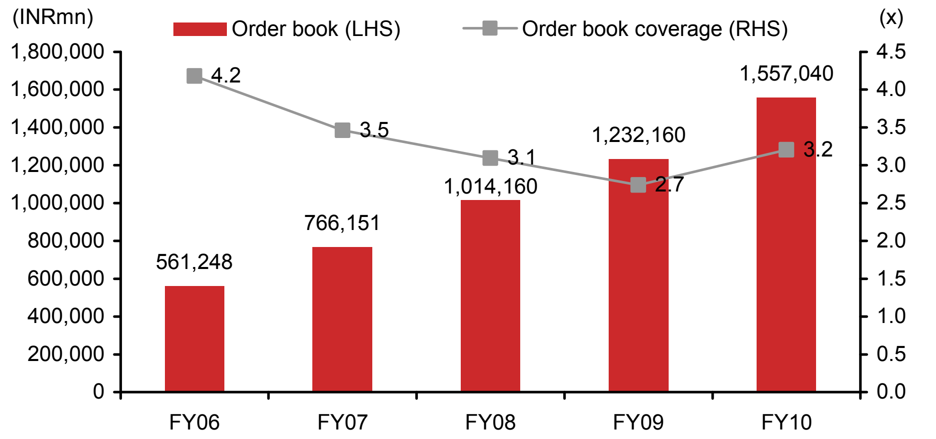


Source: Company data, Nomura estimates.

However, order book growth points to a lagged pick up

Slower execution rate and increased order intake in 2HFY10 has resulted in an increased backlog ratio for most construction companies. On average, the order book coverage ratio is at 3.2x, presenting strong visibility for revenue growth. In the very near term, growth is likely to remain muted as large orders which accrued towards H2FY10 enter the execution phase only in 2HFY11. Therefore revenue growth may accelerate starting in 2HFY11 and into FY12.

Exhibit 21. Order book coverage has increased



Companies considered for the analysis are: Ahluwalia Contracts, B.L.Kashyap, Gammon India, HCC, IVRCL Infra,Madhucon Projects,Nagarjuna Construction,Patel Engg.,Punj Lloyd,Simplex Infra,Unity Infra,Era Infra, Sadbhav Engg, CCC Limited

Source: Company data, Nomura estimates

Beginning FY12F should be the inflection point for sales growth

Based on company commentary and recent sales trends, we expect sales would remain slow for another 1-2 quarters in the corporate capex space. Post that, we should see a strong inflection in sales growth for capital goods companies, in our view. We believe that the fact that momentum in the economy would remain strong would mean that capacity stretch would reach significantly higher levels to lead to imperative capex spending in the economy.

Stock recommendations

Drilling down on mid-caps

The challenge in picking small companies arises due to: 1) relatively less time tested business models, 2) challenges in understanding scalability from management bandwidth perspective and 3) their ability to weather an adverse cycles.

We looked at several mid-caps before zeroing in on the list of mid caps we have covered in the segment.

Criteria for stock selection 1 – strong market position

We have selected mid-caps which typically operate in a consolidated industry in which they have dominant positions (and market share) due to some sustainable competitive advantage.

The industry is likely to have a big multiplier impact due to the pick-up in capex cycle which is likely to result in industry growth of at-least 15-20% in the next five years, we believe. In our view, our selected companies are most likely to lead industry growth due to dominant positions in the industry and also maintain their capital return ratios. In most cases, this growth may also come by expansion of products and markets (like new geographies).

For companies producing manufactured goods, we also looked at the impact of competition from both China and Western companies, and selected companies that are not likely to be impacted negatively. Typically, the presence of new foreign competition is limited for these companies due to factors such as brand, distribution, post-sales services, hiring and management of local labour and so on.

The other important thing we looked at is the ability of management to expand capacities without much dilution of equity, i.e the businesses should have steady cash, which can fund required capital expansion. Thus most of the companies selected have not raised equity funding in past few years despite a significant rise in net profits. Of course, this is also a function of industries (relatively less capital intensive) in which these companies operate.

Criteria for stock selection 2 – strong return ratios

All selected companies have been able to maintain high return ratios like ROCE and ROE – typically higher than 20% even during the industry downtrends proving the robustness of the operating model. We are all too aware of the susceptibility of mid cap stocks to business cycles. In addition, we believe that the inherent profitability of the business needs to be strong in order for the business to scale up over time.

Key selected stocks

The general framework for stock selection has been based on: 1) industry tailwinds, 2) competitiveness of the business and 3) scalability of the business model.

Triveni has more than a 60% market share in small to medium turbine segment (>30 MW) and 70% market share in high speed gears. Both these industry segments are fairly consolidated (with one or two other large competitors). The company has technology, brand name and after sales support for the >30 MW segment and has gone in for technology tie-up for 30-100 MW from GE, who will also market its products outside India.

Similarly, Sterlite technologies is the only player from India to have preform technology for making optical fiber from Silica. This has limited the number of competitors to only a handful (mainly from Japan and the US and none in China). Similarly, Voltas is one of the few globally competitive industrial project execution companies from India, which has the ability and track-record of having done high-end and complex projects successfully.

Exhibit 22. Mid cap universe covered.

Featured companies in the report	Business	ROE-FY10	Sector cycle	Scalability premise
Triveni	Sugar, Turbines, Water	11.6	Sugar bottoming out, strong secular cycle in the other two	GE tie up for turbines. Time tested business, in FY08 Triveni's ROE was 20%.
Voltas	Air conditioning, EPC	40.6	Strong cycle	Well tested in local and overseas markets. Tata group company
Sterlite Technology	OFC Cables, Power cables, Transmission BOO	32.0	Strong industry cycle	Transmission asset ownership opportunities. Strong data growth for OFC.
Maharashtra Seamless	Seamless pipes and ERW pipes	18.3	Good cycle. Cost competitive	Cost competitiveness
Elgi Equipment	Compressors for across the industry use	22.1*	Strong industry cycle	Business cycle. High ROE through the years
GEI Industrial	Heat Exchangers used in power generation	14.5*		Power generation capex, differentiated offerings
Techno Electric	Power sector EPC	38.1	Strong industry cycle	EPC in power generation, excellent cash management.

Source: Company, Nomura research

* These numbers are for FY09

Appendix 1

We expect US$600bn of infra investments over the next five years

This appendix is from a report written by our analysts Saion Mukherjee and Amar Kedia.

Overall, we expect investment across the infrastructure segment at US$600bn over the next five years (FY11-FY15). Of this, we expect private investment of US$190bn, representing 30% of total investments.

Exhibit 23. US$600bn of infra investment opportunity

	Total opportunity	Private opportunity	ROE/IRR range (%)	ROE trend	Construction opportunity	Risks	Comment
Contractors	400		15-16	↑		Receivables, interest rates	Includes infrastructure (US$350bn) (US$300bn) and real estate in key cities (US$50bn). Additional upside from corporate capex.
Equipment							
Construction	30		15-30	↑		Derivative of construction, significant revenue volatility	
Power generation	85		30	↓		Derivative of actual power capacity addition, execution risks	
Power T&D	65		20-40	↑		Derivative of actual T&D capacity addition, execution risks, receivables, competition	
Developers							
Roads	135	60	15-17	↓	108	Traffic, toll, construction, interest rate	US$80bn in NHAI, US$35bn in state roads, US$20bn in rural roads. Private participation $50bn under NHDP and US$10bn under state.
Thermal power	135	90	17-40	↓	68	Construction, environment, financing, offtake, merchant prices	40GW in rest of 11th Plan + 110GW over FY13-15. Of this, ~65% is expected to be by private developers
Hydro power	25	12	25-30	↔	20	Construction, environment, financing, offtake, merchant prices	30GW to be commissioned in the next 10 years. Of this, ~50% is expected to be by private developers
Nuclear power	16	0	n.a.		5	Nuclear liability bill, environment	12,000 MW to be constructed in next 5 years.
Airports	5	2	17-20	↓	3	Environment, financing, regulatory, traffic pick-up	Based on analysis of projects planned (Nomura estimates)
Ports	10	7	20-30	↓	5	Environment, financing, traffic pick-up	Based on analysis of projects planned (Nomura estimates)
T&D	130	8	15	↔	29	Right of way, construction, environment, financing	Analysis of CEA targets and Nomura estimates
Railways (incl Metros)	70	7	15-20 (Metros)	↔	43	Right of way, construction, financing	Analysis of Indian Railways targets and Nomura estimates. Approx US$15bn to be invested in Metros, of which US$6bn from private developers
Water supply and sanitation	33	2	15	↔	26	Receivables, interest rates	Assuming 10% pa growth. Private participation based on existing pipeline
Irrigation	70	0	n.a.		56	Financing (from state govts)	Assuming 10% pa growth in other states excl Andhra Pradesh. In AP, no increase assumed y-y.

Source: Nomura estimates

Triveni Engineering & Industries

TRE IN

TECHNOLOGY | INDIA

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Initiation

BUY

NOMURA

NOMURA FINANCIAL ADVISORY AND SECURITIES (INDIA) PRIVATE LIMITED

Action

We initiate coverage of Triveni Engineering with a BUY rating and a price target of Rs154 as the company's turbine business is top quality in terms of growth potential and margins and is likely to get listed at much higher valuations than currently implied by the combined entity.

Catalysts

Demerger of turbine business into a separate listed entity expected to be completed by December 2010.

Anchor themes

The engineering business (turbines, high speed gears and water) should get a significant boost from the pick-up in industrial and infrastructure capex in the country. This is especially after the expansion of its turbine product range and target markets post the tie-up with GE. The company has more than a 75% market share for its range upto 20MW in the steam turbine business.

Closing price on 15 Sep	Rs106.5
Price target	**Rs154.0**
Upside/downside	44.7%
Difference from consensus	42.6%
FY11F net profit (Rsmn)	1,573
Difference from consensus	-36.9%

Source: Nomura

Nomura vs consensus

There is a wide consensus range for this stock; we are at the bottom of the range (only two estimates given)

Compelling value unlocking

① Demerger of world-class turbine business

Triveni's turbine business has a dominant position in the <30 MW segment, and is likely to get a big boost after the recent technology and marketing tie-up with GE. This turbine business is likely to be hived-off in a separate listed company by December 2010, as per management.

② Leading to significant unlocking of value

In our view, the turbine business will have strong growth (20% CAGR) in the next few years as new capacities come up in industries like steel, cement, paper, sugar – all of which require uninterrupted power. The expansion of product the range from 30 MW to 100 MW is also likely to give further boost to the growth prospects of this segment.

③ Shouldn't wait for de-merger to happen

We believe a significant re-rating of the turbine business is likely once the business is listed due to its strong fundamentals (expected growth and margins). We rate Triveni BUY now (along with sugar and engineering businesses).

④ Both short-term and long-term catalysts present

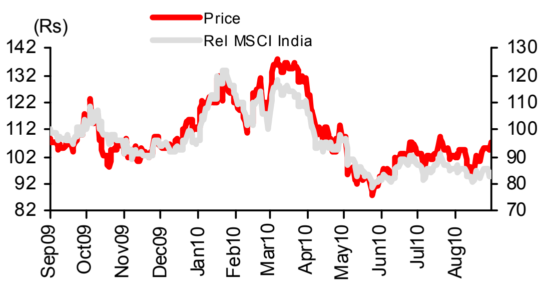
We initiate coverage with a price target of Rs154. In our view, the demerger of the turbine business, demerger of the high speed gear business and an improvement in sugar cycle are potential catalysts for the stock. The risk reward is favourable and the stock has limited potential downside from current levels, on our estimates.

Key financials & valuations

30 Sep (Rsmn)	FY09	FY10F	FY11F	FY12F
Revenue	18,948	22,577	23,158	25,492
Reported net profit	1,698	1,119	1,573	1,881
Normalised net profit	1,819	793	1,573	1,881
Normalised EPS (Rs)	7.06	3.08	6.10	7.29
Norm. EPS growth (%)	63.1	(56.4)	98.3	19.6
Norm. P/E (x)	15.1	34.6	17.5	14.6
EV/EBITDA (x)	8.0	11.9	8.7	7.5
Price/book (x)	3.0	2.7	2.4	2.1
Dividend yield (%)	1.0	0.8	1.1	1.4
ROE (%)	19.9	11.6	14.6	15.5
Net debt/equity (%)	87.4	73.4	56.4	42.1
Earnings revisions				
Previous norm. net profit		na	na	na
Change from previous (%)		na	na	na
Previous norm. EPS (Rs)		na	na	na

Source: Company, Nomura estimates

Share price relative to MSCI India



	1m	3m	6m
Absolute (Rs)	3.8	11.9	(7.8)
Absolute (US$)	4.7	12.3	(9.3)
Relative to Index	(3.3)	1.0	(19.1)
Market cap (US$mn)			592
Estimated free float (%)			0.0
52-week range (Rs)			138.3/87.7
3-mth avg daily turnover (US$mn)			1.73
Stock borrowability			
Major shareholders (%)			
Promoters			68.0

Source: Company, Nomura estimates

Investment argument and investment risks

Demerger of turbine business leading to value unlocking-

Triveni's turbine business has a dominant position in the <20 MW segment, which is likely to get a big boost after the recent technology and marketing tie-up with GE. This turbine business is likely to be hived-off in a separate listed company by December 2010, as per management (analyst conference call dated July 22 2010). We believe a significant re-rating of the turbine business is likely once that business is listed, due to its strong fundamentals (expected growth and margins). We rate Triveni BUY now (along with the sugar and engineering businesses).

Valuation and price target: We arrive at value of Rs154 per share by valuing the turbine, gear and water business on a P/E basis and the sugar business at a 20% discount to the nearest similar pure play competitor, Balrampur Chini.

Exhibit 24. SOTP valuation of Triveni engineering

	P/E multiple on FY12F EPS	Value (Rs mn)
Turbine business	15	18,023
Gear business	10	3,005
Water business	10	2,730
Sugar business		13,309
Total value		37,068
No of shares		257
Per share value (September 2011 — Rs)		154

Source: Nomura Estimates

Investment risks

Delay in pick-up of capex cycles: the engineering business is dependent upon a strong domestic capex cycle and may get impacted negatively if there is any de-acceleration in that cycle.

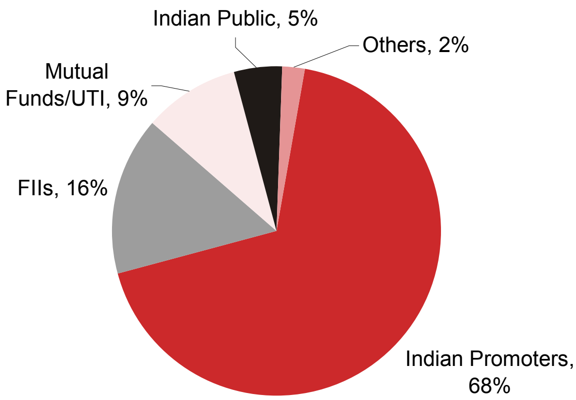
Delay in listing of turbine business: We have assumed that the turbine business will be listed sometime during FY11 (December 2010 as per management plans). Any significant delay in the listing of the turbine business may impact of valuations and our estimates.

Further sharp downturn in sugar cycle: We have assumed that current sugar prices will continue. Any sharp decline in the fall of sugar prices may have a negative impact on the financials and valuations of the sugar business.

Triveni Engineering – company and promoter

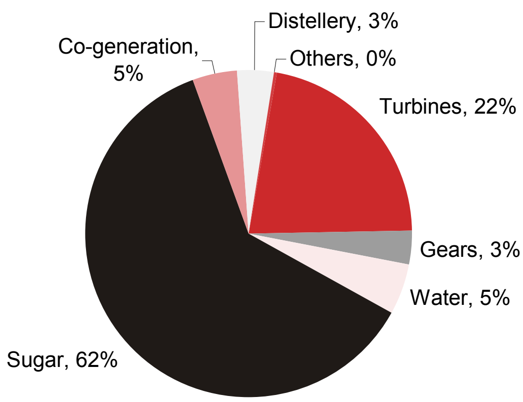
The company is diversified with revenues coming from sugar and engineering businesses. Within the engineering business, it has steam turbines, high speed gears and a water business. The promoters of the company own 60% of the company.

Exhibit 25. Shareholding pattern as of 30 Sep 2009



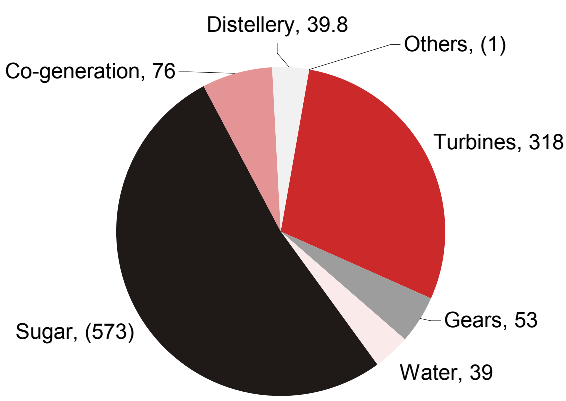
Source: Company data, Nomura research

Exhibit 26. Segment revenue for June 2010 quarter (Rs mn)



Source: Company data, Nomura research

Exhibit 27. Segment EBIT for June 2010 quarter (Rs mn)



Source: Company data, Nomura research

Turbine business could see remarkable growth

Triveni has a stronghold in the Indian market in the <30 MW steam turbine segment, with a dominant market share of more than 50%. In this segment, revenue has grown at 18% on a Y-o-Y basis in the past four quarters. The steam turbines in this range are used by a variety of industries which require uninterrupted power supply, such as sugar, paper, textiles, cement and steel. In recent times, even small independent power plants (IPP) typically producing power from reusable resources such as wheat trash, rice husks, coconut shells, are also buying turbines in 15-20MW range.

Exhibit 28. Revenue growth

Turbine business (Rs mn)	FY07	FY08	FY09	FY10F
Revenue	6,935*	5,086	4,752	5,781
EBIT	1,539*	1,287	1,156	1,292
EBIT margin (%)	22	25	24	22

* This is for 18 months period

Source: Company data, Nomura research

Exhibit 29. Growth rate

(% y-y)	FY08	FY09	FY10F
Revenue	10	(7)	20
EBIT	20	(10)	10

Source: Company data, Nomura research

Revenue quality is improving also. Almost 15% of turbine revenues come from spares and servicing, a number that has been growing in a steady manner. The company does retro-fitting and refurbishing for turbines in all ranges (upto 200 MW), a market which we expect to grow faster than the new turbine market. The company's profitability is also higher in this business by 5-10% compared to profitability in the turbine business. The company has one of the largest service and post-sales support operations with 13 service centres and a dedicated field force of more than 150 people. Also, the company has an in-house training institute which trains 60 to 70 people in the design and service of steam turbines.

Exhibit 30. Contribution of retrofitting business to turbine business

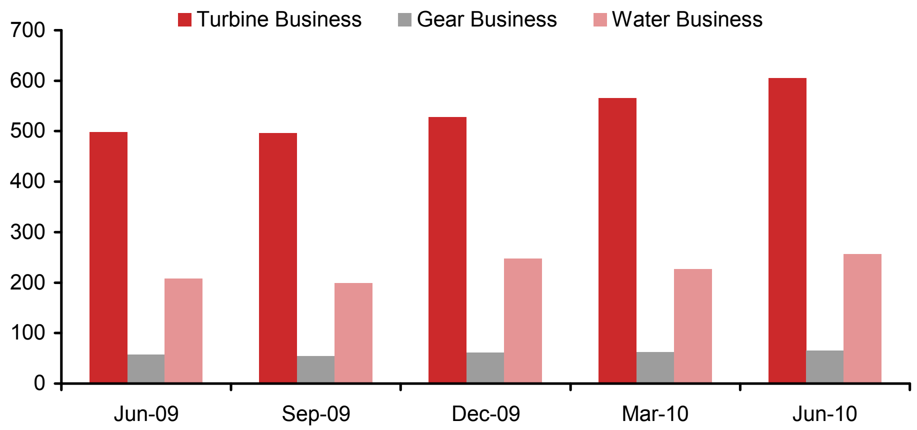
Revenue contribution (%)	FY09	FY08
Retrofitting business	16.0	12.0

Source: company

The company has a 75% market share in the <20 MW and a 30% market share in the 20-30 MW domestic market. The only other strong player with manufacturing and services in India is Siemens, which operates <120 MW. The presence of Chinese players in steam turbines is limited, due to the requirement for local post sales support and services.

Steady growth in order book: The current order book is Rs6bn in a typically 8-10 month cycle. The order book composition is 35% sugar, paper 20%, textiles 20%, 15% metal and 10-15% IPP. In FY09, the company saw the deferral of orders, and its order book reduce to Rs4.75bn.

Exhibit 31. Order book for different business over the past five quarters



(Rs crores)

Source: Company data, Nomura research

Tie-up with GE to expand products and markets

The company has formed a 50:50 JV with GE which will:

- Make Triveni GE's exclusive global manufacturing hub for turbines <100 MW.
- Market turbines 30-100 MW in the Indian market through Triveni's channel.
- Market turbines <100 MW through GE worldwide channels.

As per company's estimates, the worldwide market for 30-100 MW is US$2bn (3,200 MW) out of which US$500mn is in India.

The company has almost zero working capital in the turbine business as the number of creditor days is less than days receivable and inventory days. Thus, this business has a very high ROCE on minimal investment of Rs0.4bn in the business.

The final structure will be as follows, according to management (conference call dated May 11, 2010):

The turbine business will be demerged and listed as a separate entity (called Triveni Turbines) in which Triveni Engineering will hold a 30% stake.

The gear, water and sugar businesses will continue to be in the parent company

Exhibit 32. turbine business revenue growth – y-y

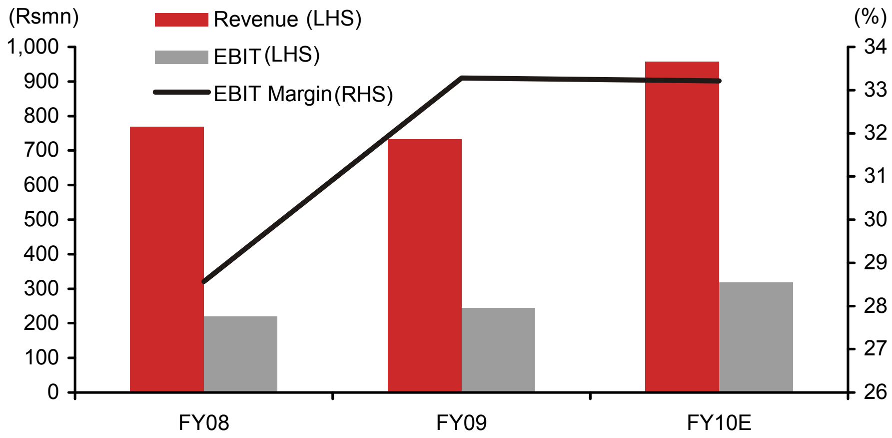
	Sep-09	Dec-09	Mar-10	Jun-10
Revenue growth rate (%)	12	33	19	12

Source: Company data, Nomura research

High-end gear business

The company has a 70% market share in the high speed gear business in which it has a technology tie-up with Lafken. Apart from Triveni, there is no other high speed gear manufacturing facility in the country and even Siemens, which is the company's competitor in turbine business, buys high speed gears from the company. High speed gears are used in industries such as cement, power (<60 MW) and transportation.

Exhibit 33. Growth in gear business



Source: Company data, Nomura research

Exhibit 34. Gear business revenue growth – y-y

	Sep-09	Dec-09	Mar-10	Jun-10
Revenue growth rate (%)	(6)	57	55	(1)

Source: Company data, Nomura research

Due to the company's dominant position, the capital employed in this business is very low (Rs3.5bn), as the company gets advance payment from customers on receiving orders.

Water business

This is the fastest-growing business for the company with a revenue CAGR of 60%-70% in the past three years (87% in the past five years). Here, the company is focused on providing complete end-to-end solutions for water treatment to both industrial and municipal customers. The company is also focusing on higher order sizes, some of which are in the advanced stage of completion, thereby establishing the company and increasing its market share.

Exhibit 35. Water business revenue growth – y-y

	Sep-09	Dec-09	Mar-10	Jun-10
Revenue growth rate (%)	72	56	141	22

Source: Company data, Nomura research

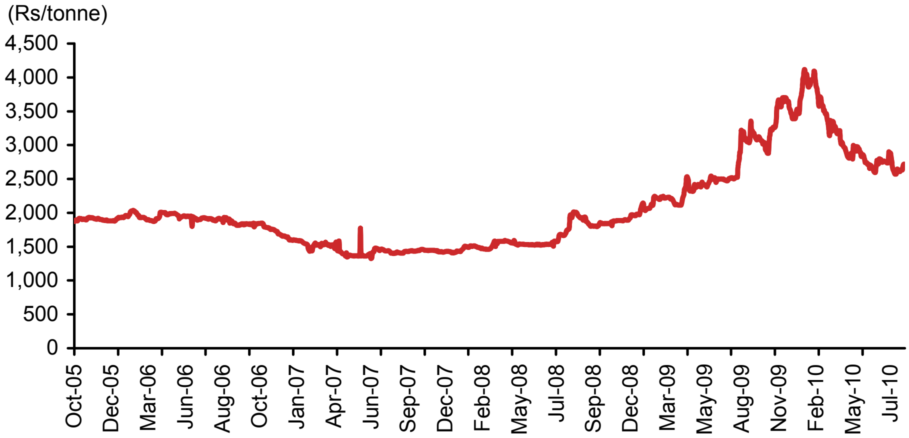
Sugar fundamentals are still good

Triveni is one of the largest players in the Indian sugar industry with an installed capacity of 61,000 TCD and co-gen capacity of 65 MW.

During the previous sugar season, the industry, buoyed by rising sugar prices, steadily paid higher cane prices to ensure optimum supply of cane and to stop the diversion of cane and to producers of alternate sweeteners.

The government also introduced levy prices of Rs13.40 per kg to bring down sugar prices.

Exhibit 36. Movement of sugar prices in India



Source: Bloomberg

With increased production of sugarcane to around 19-24mn tonnes in FY10 and FY11, respectively, the cost of production for sugar is likely to remain at normal levels. Also with increased production and a changed scenario of stable sugar prices (refer to exhibit above), we expect that the government will ease and reverse measures initiated earlier that are necessary to stabilize sugar prices, such as likely reduce the levy obligation from 20% to 17.5%, the imposition of import duty, stock limitation, increase of levy price. Even after increased production, we believe inventory won't be high enough to pull down sugar prices.

We believe this will lead to an average realization of Rs24-25 per kg and average spread of around Rs1 per kg for the company.

Exhibit 37. Overall company financials

(Rs mn)	FY08	FY09	FY10F
Revenue	15,919	18,948	22,489
EBIT	2,356	3,710	2,105
EBIT margin (%)	15	20	9

Source: Company data, Nomura research

Exhibit 38. Growth rate – company

(% y-y)	FY08	FY09	FY10F
Revenue	21	19	19
EBIT	301	57	(43)

Source: Company data, Nomura research

Exhibit 39. Water business

(Rs mn)	FY08	FY09	FY10F
Revenue	668	997	1,599
EBIT	105	148	195
EBIT margin (%)	16	15	12

Source: Company data, Nomura research

Exhibit 40. Growth rate for water business

(% y-y)	FY08	FY09	FY10F
Revenue	67	49	60
EBIT	129	41	31

Source: Company data, Nomura research

Exhibit 41. Sugar business

(Rs mn)	FY08	FY09	FY10F
Revenue	8,863	12,529	14,115
EBIT	359	2,023	(61)
EBIT margin (%)	4	16	0

Source: Company data, Nomura research

Exhibit 42. Growth rate for sugar business

(% y-y)	FY08	FY09	FY10F
Revenue	17	41	13
EBIT	140	464	(103)

Source: Company data, Nomura research

Exhibit 43. Co-generation business

(Rs mn)	FY08	FY09	FY10F
Revenue	1,174	948	1,368
EBIT	480	201	296
EBIT margin (%)	41	21	22

Source: Company data, Nomura research

Exhibit 44. Growth rate for co-generation business

(% y-y)	FY08	FY09	FY10F
Revenue	(12)	(19)	44
EBIT	7	(58)	47

Source: Company data, Nomura research

Exhibit 45. Distillery business

(Rs mn)	FY08	FY09	FY10F
Revenue	737	539	870
EBIT	177	92	136
EBIT margin (%)	24	17	16

Source: Company data, Nomura research

Exhibit 46. Growth rate distillery business

(% y-y)	FY08	FY09	FY10F
Revenue	305	(27)	61
EBIT	727	(48)	47

Source: Company data, Nomura research

Valuation and price target (PT)

We have use a SOTP valuation and have valued the turbine, gear and water business by using one-year fwd P/E multiples after forecasting the earnings for these businesses. We have valued the sugar business based on comparison with closest and similar comparable player - Balrampur Chini (BRCM, not rated) after using a suitable discount (20%) for the relatively smaller (around 15%) size of Triveni's crushing capacities. Also, we have taken a 20% holding discount for the holding of the parent company into the demerged entity (Triveni Turbines).

Turbine business: We have valued the turbine business at a one-year fwd P/E of 15x. This is justified based on the distinctive position of this business, very high ROCE, tie-up with GE, and the expected earnings CAGR of more than 20% in the next few years, according to our estimates. The comparable companies here could be companies like Thermax (which make boilers in the similar category as Triveni makes turbines).

Exhibit 47. Projections for the turbine business

	FY08	FY09	FY10F	FY11F (Rs mn)	FY12F
Net sales	5,090	4,750	5,710	6,850	8,220
EBT	1,290	1,160	1,280	1,510	1,810
Tax	420	380	420	500	600
PAT	860	770	850	1,010	1,210
EBIT (%)	25	24	22	22	22
PAT (%)	17	16	15	15	15
Capital employed	950	810	360	360	360
ROCE (%)	91	96	234	277	332

Source: Company data, Nomura research

We have assumed 20% revenue growth and constant EBIT margins of 22% for the turbine business in FY11E and FY12E. This is justified, in our view, based on a strong capex cycle in power, expanded product range for the company (<100 MW) and continuing growth in higher margin retrofitting revenues.

We have valued turbine listed entity at Rs12,705 mn based on 15x FY12E PAT of Rs1,200mn. Also, the 30% stake of Triveni Turbines has been valued at a 20% holding discount at Rs4,356 mn.

Exhibit 48. Comparable companies

Company name	Ticker	Nomura rating	Revenue (Rs bn)	Mkt cap (Rs bn)	Price	P/E	P/BV	EV/EBITDA
Triveni Eng & Inds Ltd.	TRE IN	BUY	19	27	106	20.6	2.6	6.0
BHEL	BHEL IN	REDUCE	332	1,211	2,474	28.0	7.6	19.5
Thermax Ltd	TMX IN	REDUCE	33	96	802	36.9	8.9	22.3
BGR Energy Systems Ltd	BGRL IN	Not Rated	31	60	826	29.5	8.4	11.0
Balrampur Chini Mills Ltd	BRCM IN	Not Rated	17	23	89	10.9	2.0	8.4

Price as of 15th Sep ,2010; P/E. P/BV and EV/EBIDTA on TTM (trailing twelve months) basis

Source: Bloomberg, Nomura research

Gear business

We have valued high speed gear business based on a one-year fwd P/E multiple of 10x. This is justified, in our view, based on good fundamentals of this business, very limited competition, high margins and return ratios. We expect this business to grow by a 20% CAGR in the next two years and maintain EBIT margins at FY10 levels in FY11E and FY12E.

Exhibit 49. Projections for gear business

	FY08	FY09	FY10F	FY11F (Rs mn)	FY12F
Net sales	770	730	960	1,200	1,490
EBT	220	240	320	360	450
Tax	70	80	100	120	150
PAT	150	160	210	240	300
EBIT (%)	29	33	33	300	30
PAT (%)	19	22	22	200	20
Capital employed	370	470	550	550	550
ROCE (%)	40	35	39	44	55

Source: Company data, Nomura research

The gear business has been valued at Rs3,005 mn based on 10x FY12E PAT of Rs300 mn.

Water business

Exhibit 50. Projections for water business

				(Rs mn)	
	FY08	**FY09**	**FY10F**	**FY11F**	**FY12F**
Net sales	670	1,000	1,600	2,240	3,130
EBT	110	150	190	290	410
Tax	30	50	60	100	130
PAT	70	100	130	200	270
EBIT (%)	16	15	12	13	13
PAT (%)	11	10	8	9	9
Capital employed	240	340	580	580	580
ROCE (%)	29	29	22	33	47

Source: Company data, Nomura research

The water business has been valued at Rs2,730 mn based on 10x FY12E PAT of Rs270mn. The water business has been valued at P/E of 10X FY12E PAT. This is based on strong past revenue growth (87% CAGR in past five years) which is likely to continue, in our view.

Exhibit 51. Sugar business valuation

	Balrampur	**Triveni**
Mkt cap (Rs mn)	21,960	16,637
Debt (Rs mn)	9,720	6,400
EV (Rs mn)	31,680	23,037
TCD	73,500	61,000
EV/tonne (Rs)	431,020	377,651
Power in MW	180	68
EV/Tonne ex power (Rs)	333,061	333,061

Source: Company data, Nomura research

In our view, Balrampur Chini is the nearest comparable company to Triveni both in terms of crushing capacity, debt profile and geographical location (which is important for sourcing sugarcane, etc).

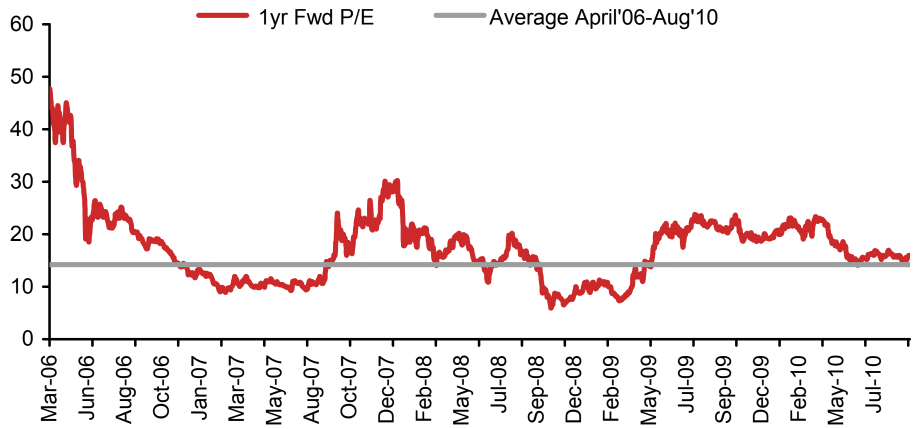
The value of sugar business comes to Rs13,304 mn based on a comparable company valuation after assuming a 20% discount.

Based on above, the total valuation comes to Rs37,068 .

As mentioned above, using SOTP valuation of Triveni Engineering, total values come out to be 37,068 and a per share value as Rs154.

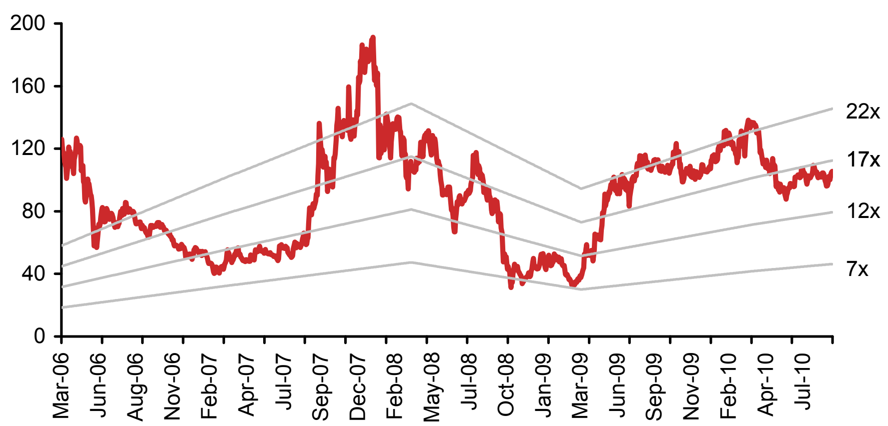
P/E and EV/EBITDA charts

Exhibit 52. 1 year forward P/E (x)



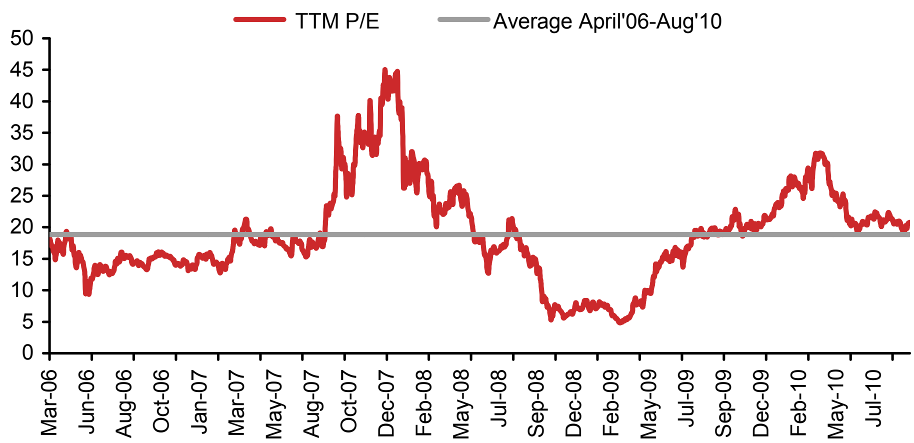
Source: Company data, Nomura research

Exhibit 53. 1 year forward P/E band



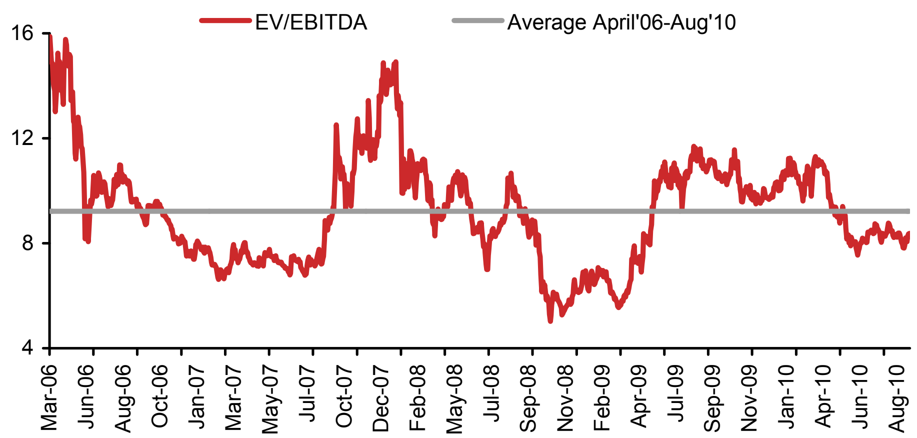
Source: Company data, Nomura research

Exhibit 54. Trailing 12 months P/E (x)



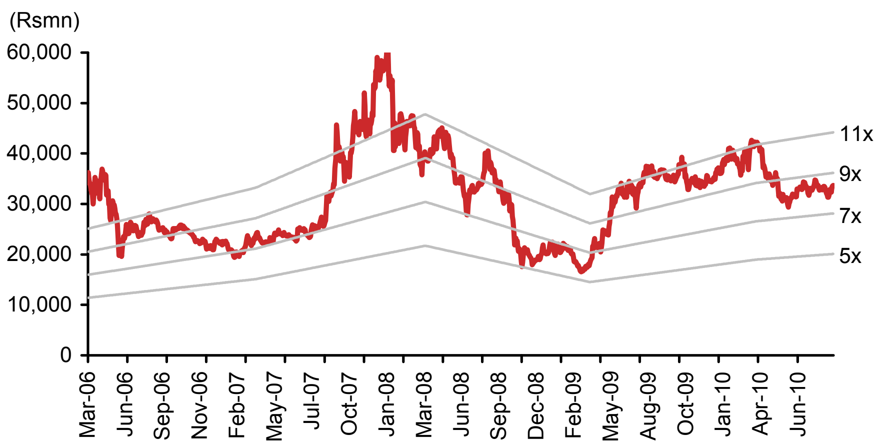
Source: Company data, Nomura research

Exhibit 55. 1 year forward EV/EBITDA (x)



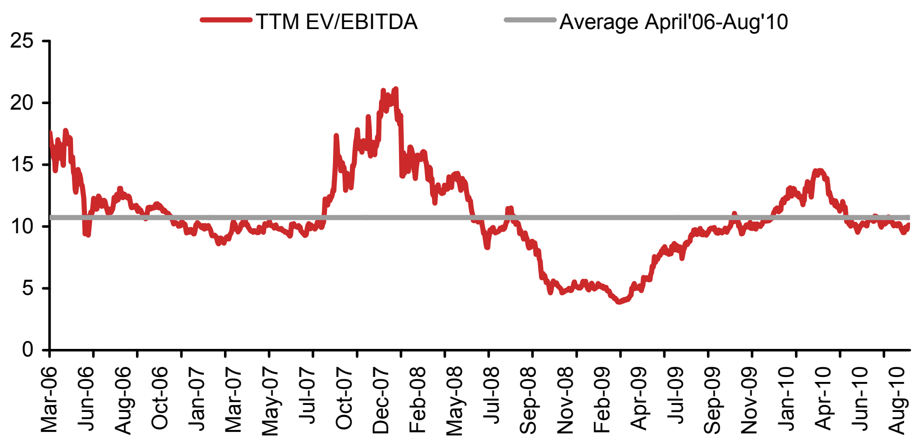
Source: Company data, Nomura research

Exhibit 56. 1 year forward EV/EBITDA band



Source: Company data, Nomura research

Exhibit 57. Trailing 12 month EV/EBITDA (x)



Source: Company data, Nomura research

Financial statements

Income statement (Rsmn)					
Year-end 30 Sep	**FY08**	**FY09**	**FY10F**	**FY11F**	**FY12F**
Revenue	15,922	18,948	22,577	23,158	25,492
Cost of goods sold	(10,479)	(12,268)	(15,985)	(16,422)	(18,033)
Gross profit	**5,444**	**6,680**	**6,591**	**6,736**	**7,459**
SG&A	(3,191)	(3,082)	(4,508)	(3,732)	(3,998)
Employee share expense	-	-	-	-	-
Operating profit	**2,253**	**3,598**	**2,083**	**3,004**	**3,460**
EBITDA	**3,092**	**4,415**	**2,933**	**3,901**	**4,405**
Depreciation	(797)	(758)	(804)	(851)	(898)
Amortisation	(43)	(60)	(46)	(46)	(46)
EBIT	**2,253**	**3,598**	**2,083**	**3,004**	**3,460**
Net interest expense	(998)	(1,159)	(799)	(733)	(780)
Associates & JCEs	-	-	-	-	-
Other income	91	112	39	77	127
Earnings before tax	**1,346**	**2,551**	**1,323**	**2,348**	**2,808**
Income tax	(230)	(732)	(530)	(775)	(927)
Net profit after tax	**1,115**	**1,819**	**793**	**1,573**	**1,881**
Minority interests	-	-	-	-	-
Other items					
Preferred dividends					
Normalised NPAT	**1,115**	**1,819**	**793**	**1,573**	**1,881**
Extraordinary items	-	(122)	326	-	-
Reported NPAT	**1,115**	**1,698**	**1,119**	**1,573**	**1,881**
Dividends	(31)	(273)	(224)	(315)	(376)
Transfer to reserves	**1,084**	**1,425**	**895**	**1,258**	**1,505**
Valuation and ratio analysis					
FD normalised P/E (x)	24.6	15.1	34.6	17.5	14.6
FD normalised P/E at price target (x)	35.6	21.8	50.1	25.2	21.1
Reported P/E (x)	24.6	16.2	24.5	17.5	14.6
Dividend yield (%)	0.1	1.0	0.8	1.1	1.4
Price/cashflow (x)	224.6	5.1	12.6	10.2	10.1
Price/book (x)	3.5	3.0	2.7	2.4	2.1
EV/EBITDA (x)	12.6	8.0	11.9	8.7	7.5
EV/EBIT (x)	17.3	9.9	16.7	11.3	9.5
Gross margin (%)	34.2	35.3	29.2	29.1	29.3
EBITDA margin (%)	19.4	23.3	13.0	16.8	17.3
EBIT margin (%)	14.1	19.0	9.2	13.0	13.6
Net margin (%)	7.0	9.0	5.0	6.8	7.4
Effective tax rate (%)	17.1	28.7	40.0	33.0	33.0
Dividend payout (%)	2.8	16.1	20.0	20.0	20.0
Capex to sales (%)	5.2	3.3	3.1	3.0	2.7
Capex to depreciation (x)	1.0	0.8	0.9	0.8	0.8
ROE (%)	na	19.9	11.6	14.6	15.5
ROA (pretax %)	na	14.7	8.4	11.5	12.3
Growth (%)					
Revenue		19.0	19.1	2.6	10.1
EBITDA		42.8	(33.6)	33.0	12.9
EBIT		59.7	(42.1)	44.2	15.2
Normalised EPS		63.1	(56.4)	98.3	19.6
Normalised FDEPS		63.1	(56.4)	98.3	19.6
Per share					
Reported EPS (Rs)	4.32	6.58	4.34	6.10	7.29
Norm EPS (Rs)	4.32	7.06	3.08	6.10	7.29
Fully diluted norm EPS (Rs)	4.32	7.06	3.08	6.10	7.29
Book value per share (Rs)	30.39	35.79	39.26	44.14	49.98
DPS (Rs)	0.12	1.06	0.87	1.22	1.46

Source: Nomura estimates

Sharp margin drop in FY10F due to losses in sugar business during Q3FY10

Cashflow (Rsmn)					
Year-end 30 Sep	**FY08**	**FY09**	**FY10F**	**FY11F**	**FY12F**
EBITDA	3,092	4,415	2,933	3,901	4,405
Change in working capital	(2,880)	1,538	(557)	(441)	(765)
Other operating cashflow	(90)	(572)	(204)	(775)	(927)
Cashflow from operations	**122**	**5,381**	**2,172**	**2,685**	**2,713**
Capital expenditure	(833)	(616)	(700)	(700)	(700)
Free cashflow	**(711)**	**4,766**	**1,472**	**1,985**	**2,013**
Reduction in investments	5	17	145	-	-
Net acquisitions	-	-	-	-	-
Reduction in other LT assets	12	6	-	-	-
Addition in other LT liabilities	-	-	-	-	-
Adjustments	63	67	40	78	127
Cashflow after investing acts	**(631)**	**4,856**	**1,657**	**2,062**	**2,140**
Cash dividends	(31)	(273)	(224)	(315)	(376)
Equity issue	-	-	-	-	-
Debt issue	1,687	(3,343)	-	-	-
Convertible debt issue	-	-	-	-	-
Others	(1,094)	(1,155)	(799)	(733)	(780)
Cashflow from financial acts	**563**	**(4,771)**	**(1,023)**	**(1,048)**	**(1,156)**
Net cashflow	**(68)**	**85**	**634**	**1,015**	**984**
Beginning cash	257	188	273	907	1,922
Ending cash	189	273	907	1,922	2,906
Ending net debt		8,065	7,431	6,416	5,432

Source: Nomura estimates

Balance sheet (Rsmn)					
As at 30 Sep	**FY08**	**FY09**	**FY10F**	**FY11F**	**FY12F**
Cash & equivalents	188	273	907	1,922	2,906
Marketable securities	-	155	10	10	10
Accounts receivable	2,134	2,429	2,894	2,968	3,268
Inventories	5,398	4,581	5,459	6,672	8,976
Other current assets	3,821	4,165	4,332	4,505	4,685
Total current assets	**11,542**	**11,604**	**13,601**	**16,076**	**19,844**
LT investments	116	115	115	115	115
Fixed assets	12,997	12,738	12,619	12,453	12,241
Goodwill	-	-	-	-	-
Other intangible assets	39	101	69	38	6
Other LT assets	19	13	13	13	13
Total assets	**24,713**	**24,570**	**26,417**	**28,695**	**32,218**
Short-term debt	3,998	950	950	950	950
Accounts payable	2,784	3,832	4,541	5,522	7,384
Other current liabilities	953	1,264	1,506	1,545	1,701
Total current liabilities	**7,735**	**6,046**	**6,998**	**8,017**	**10,035**
Long-term debt	7,689	7,388	7,388	7,388	7,388
Convertible debt	-	-	-	-	-
Other LT liabilities	1,452	1,906	1,906	1,906	1,906
Total liabilities	**16,876**	**15,341**	**16,292**	**17,311**	**19,330**
Minority interest	-	-	-	-	-
Preferred stock	-	-	-	-	-
Common stock	258	258	258	258	258
Retained earnings	7,579	8,972	9,867	11,126	12,631
Proposed dividends	-	-	-	-	-
Other equity and reserves	-	-	-	-	-
Total shareholders' equity	**7,837**	**9,230**	**10,125**	**11,384**	**12,888**
Total equity & liabilities	**24,713**	**24,570**	**26,417**	**28,695**	**32,218**
Liquidity (x)					
Current ratio	1.49	1.92	1.94	2.01	1.98
Interest cover	2.3	3.1	2.6	4.1	4.4
Leverage					
Net debt/EBITDA (x)	net cash	1.83	2.53	1.64	1.23
Net debt/equity (%)	net cash	87.4	73.4	56.4	42.1
Activity (days)					
Days receivable		44.0	43.0	46.2	44.8
Days inventory		148.5	114.6	134.8	158.8
Days payable		98.4	95.6	111.8	131.0
Cash cycle	-	94.0	62.1	69.2	72.6

Source: Nomura estimates

Most of the debt due to sugar business working cap requirements

Voltas VOLT IN

TECHNOLOGY | INDIA

Initiation

BUY

NOMURA

NOMURA FINANCIAL ADVISORY AND SECURITIES (INDIA) PRIVATE LIMITED

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Action

We initiate coverage of Voltas with a BUY rating and a price target of Rs270. The company has strong brand presence in all the three business segments it operates in and has consistently delivered EPS growth across business cycles. It has strong balance, zero debt and high return ratios. Also, it is moving towards becoming an integrated product and services play.

Catalysts

The order book for EMP is likely to pick up in the next few quarters, leading to a significant up-tick in growth in FY12F and beyond.

Anchor themes

Voltas will likely be a key beneficiary of the pick-up in both infrastructure and industrial capex in India, the Middle East and ASEAN countries.

Closing price on 15 Sep	Rs222.6
Price target	**Rs270.0**
Upside/downside	21.3%
Difference from consensus	17.8%
FY11F net profit (Rsmn)	3,619
Difference from consensus	-4.5%

Source: Nomura

Nomura vs consensus

Our FY12F EPS estimates are 8.5% above consensus due to our higher revenue growth assumption for the period.

Direct capex play

① Globally competitive businesses

Voltas is one of India's few globally competitive electro-mechanical products (EMP) and services companies and a strong play on both infrastructure and industrial capex in India. The company has a strong brand name in its other businesses — engineering products and services (EPS) and unitary cooling (UCP).

② Strong free cash flows

The company has a very strong brand name in all the three business segments it operates in, a strong balance sheet with zero debt, generates sufficient free cashflows and has consistently high return ratios (both ROCE and ROE). The company is re-orienting itself to provide end-to-end services to its customers.

③ Order book likely to pick up

We expect Voltas' EMP order book to pick up in the next few quarters, resulting in 30% revenue growth for the segment in FY12F. We expect the company to record a secular y-y 20% EPS growth trajectory post FY12F, due to a pick-up in industrial and infrastructure capex.

④ We initiate with a BUY and PT of Rs270

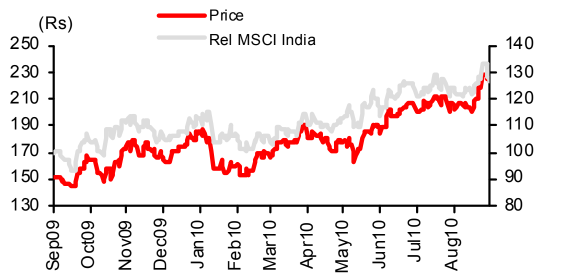
Our PT of Rs270 is based on 18x FY12F EPS of Rs14.9. We initiate with a BUY rating since we believe the company will benefit significantly from a pick-up in the domestic capex cycle due to the nature of its businesses and its strong competitive position.

Key financials & valuations

31 Mar (Rsmn)	FY09	FY10	FY11F	FY12F
Revenue	43,617	48,236	54,393	69,770
Reported net profit	2,514	3,810	3,619	4,919
Normalised net profit	2,253	3,560	3,619	4,919
Normalised EPS (Rs)	6.81	10.76	10.94	14.87
Norm. EPS growth (%)	27.9	58.0	1.7	35.9
Norm. P/E (x)	32.7	20.7	20.3	15.0
EV/EBITDA (x)	22.2	14.5	13.1	9.4
Price/book (x)	9.3	6.8	5.4	4.2
Dividend yield (%)	0.7	0.8	1.0	1.3
ROE (%)	36.8	40.6	29.4	31.3
Net debt/equity (%)	net cash	net cash	net cash	net cash
Earnings revisions				
Previous norm. net profit		na	na	na
Change from previous (%)		na	na	na
Previous norm. EPS (Rs)		na	na	na

Source: Company, Nomura estimates

Share price relative to MSCI India



	1m	3m	6m
Absolute (Rs)	7.5	18.4	34.1
Absolute (US$)	8.4	18.8	31.8
Relative to Index	1.8	8.9	23.5
Market cap (US$mn)			1,588
Estimated free float (%)			-
52-week range (Rs)			227.7/144.9
3-mth avg daily turnover (US$mn)			5.92
Stock borrowability			-
Major shareholders (%)			
Tata Group of Companies			27.7

Source: Company, Nomura estimates

Investment argument and risks

Globally competitive businesses with strong cashflow generation

Voltas is one of India's few globally competitive EMP and services companies

Voltas is one of India's few globally competitive electro-mechanical products (EMP) and services companies and a strong play on both infrastructure and industrial capex in India. The company has a strong brand name in its other businesses —engineering products and services (EPS) and unitary cooling (UCP).

The company has a very strong brand name in all the three business segments it operates in, a strong balance sheet with zero debt, generates sufficient free cashflows and has consistently high return ratios (both ROCE and ROE). The company is re-orienting itself to provide end-to-end services to its customers.

Orderbook likely to pick up

We expect the company's EMP order book to pick up in the next few quarters, resulting in 30% revenue growth for the segment in FY12F. We expect the company to record a secular y-y 20% EPS growth trajectory post FY12F due to a pick-up in industrial and infrastructure capex.

Valuation and price target

We believe the company will benefit significantly from a pick-up in the domestic capex cycle

Our price target of Rs270 is based on 18x FY12F EPS of Rs14.9. We initiate with a BUY rating since we believe the company will benefit significantly from a pick-up in the domestic capex cycle due to the nature of its businesses and its strong competitive position.

Investment risks

A delay in pick-up in the domestic capex cycle would pose a key risk to our numbers and BUY recommendation. Both domestic EMP (49% of revenues) and EPS (9% of revenues) businesses are dependent on domestic capex spending and may be affected by any delay there.

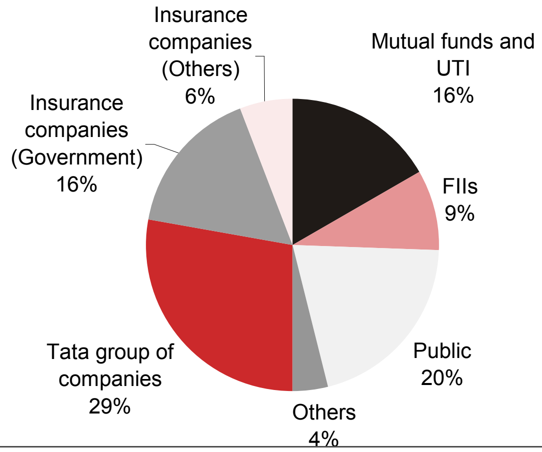
Sharp fall in prices of crude

Middle East order book and revenue would get delayed if there is a sharp fall in crude prices, especially to levels such as US$50/bbl seen in 2008. At these levels, as observed in the past, the decision-making cycle gets prolonged and may result in a slowdown in revenue and EPS growth for FY12F and beyond.

Promoter and shareholders

Voltas is a leading air conditioning and engineering services provider based in India. The Tata Group holds a 29% stake in the company. Voltas offers heating, cooling, ventilation and other engineering services through three different business segments.

Exhibit 58. Shareholding structure

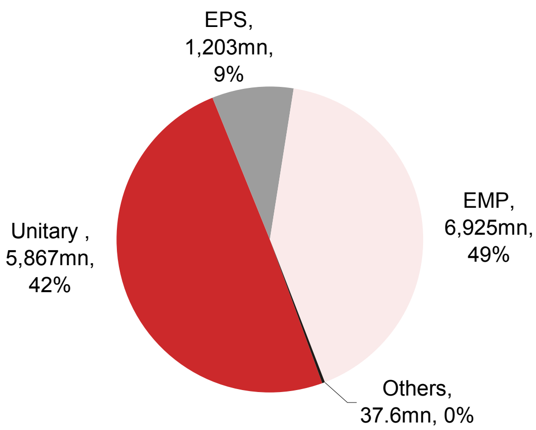


Note: Shareholding pattern as on 31 March 2010

Source: Company data

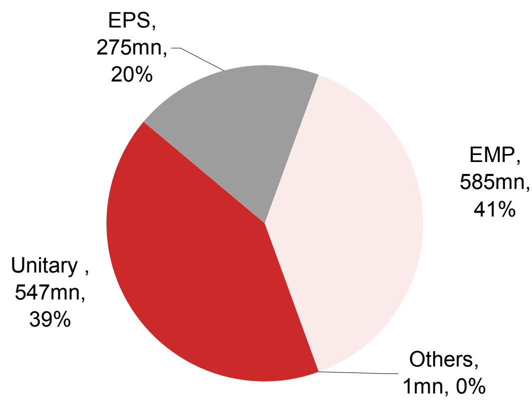
Voltas has three main businesses — EMP and services, EPS and UCP for comfort and commercial use. The following charts show the contribution of the different businesses to total revenue and EBIT.

Exhibit 59. Revenue for quarter ended June 2010 (Rs)



Source: Company data, Nomura research

Exhibit 60. EBIT for quarter ended June 2010 (Rs)



Source: Company data, Nomura research

Business overview

Electro-mechanical projects and services (EMP)

Voltas is India's largest provider and exporter of EMP and services, and covers infrastructure (airports, metros, etc.), real-estate (buildings, hospitals, hotels, IT parks) and industrial (power, cement, steel, paper and others) sectors. EMP contributed around 49% of the company's revenue in 1Q FY11 and 54% of this revenue came from international operations.

EMP contributed around 49% of the company's revenue in 1Q FY11

Domestic EMP

With projects becoming more complex, Voltas is moving away from pure heating ventilation and air conditioning (HVAC) to more integrated projects (MEP) (integration of electrical, plumbing, HVAC and other components such as fire and safety) in the domestic market. This is evident as revenue from pure HVAC has come down from 90% to 50% in the past three years and we believe it is likely to drop further. The company acquired Rohini Industrial Electricals Ltd in August 2008, an electrical contracting company, to compete effectively as an MEP solution provider.

Of its EMP revenue, 40% comes from the industrial (steel, cement and textiles) sector, while the remaining comes from real estate and infrastructure. Voltas is a market leader in India's HVAC and MEP segments, followed by Bluestar. This segment has seen a revenue CAGR of 15% in the past two years and its order book has grown to Rs15bn (as of 30 June 2010).

Voltas is a market leader in India's HVAC and MEP segments, followed by Bluestar

The main drivers of the domestic EMP order book are: 1) commercial real estate including IT parks and campuses; 2) hospitals; 3) airports; 4) metros and 5) industrial and power plants.

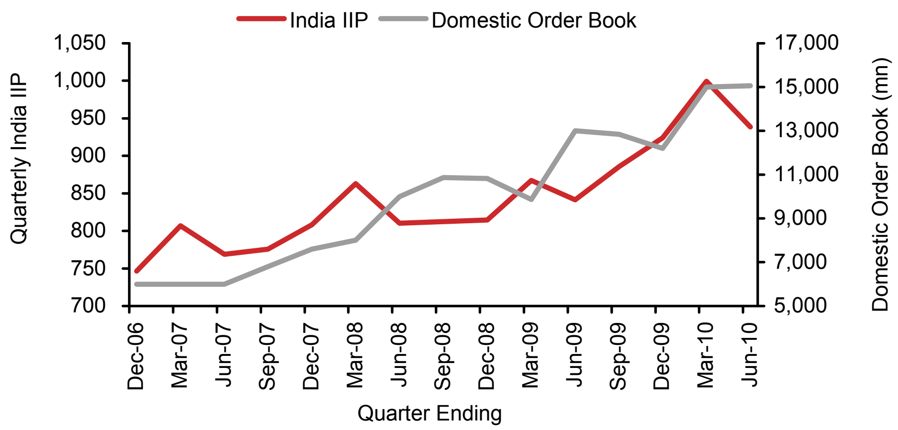
The company has secured two orders worth Rs3bn for EMP work for the new airports at Chennai and Kolkata. Both projects involve Voltas undertaking HVAC, internal electrification, plumbing and drainage works over a period of two years. The company had undertaken similar work at Hyderabad, HK and Bahrain international airports in the past.

Exhibit 61. Contours of airport development programme

	(US$bn)
Restructuring Delhi & Mumbai Airports	0.33
Modernisation Chennai & Kolkata Airports	1.09
Upgradation 25 Selected Airports	1.52
Modernisation / Improvement 55 Airports	0.65
Greenfield airports Bangalore, Hyderabad, Goa, Pune, Navi Mumbai, Nagpur (Hub) & Greater Noida	2.17
Total investment by 2010	5.76

Source: Airport development programme

Exhibit 62. Voltas' domestic EMP order book over the past few

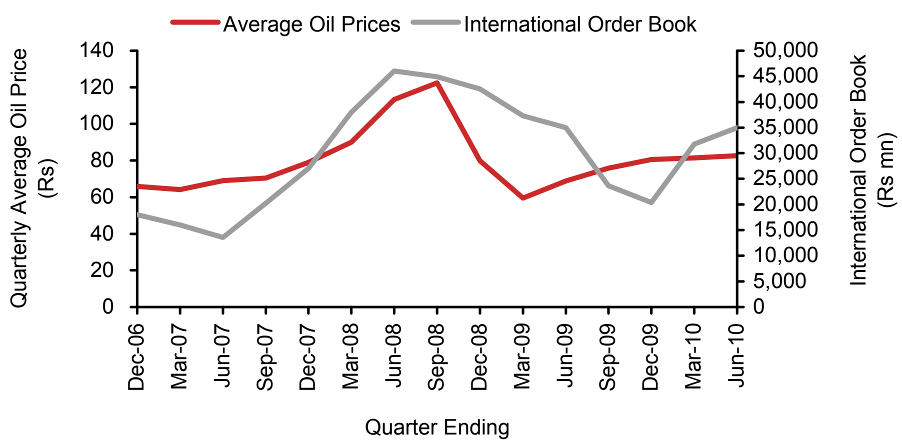


Source: Bloomberg, Company data, Nomura research

International EMP

Voltas operates mainly in ASEAN and Middle East markets and has undertaken complex and sophisticated projects (refer to the list below) in these markets. In the Middle East, the company started with Dubai and has now expanded to other areas such as Abu Dhabi, Qatar, Saudi Arabia and Oman. In Singapore, the company recently undertook some prestigious projects, where it has a Contractor A status. According to management, investments in major GCC countries have picked up from the second half of last year, especially in Abu Dhabi, Qatar and Saudi Arabia and the company has good order visibility for the next 18 months' revenue.

Exhibit 63. Oil prices



Source: Bloomberg, Company data, Nomura research

List of projects executed in ME and ASEAN:

- Hong Kong International Airport
- Emirates Palace Hotel
- Mall of the Emirates
- Bahrain City Centre
- Sentosa Bay District Cooling Plant (Singapore)
- District Cooling Plant at the Dubai International Financial Centre
- Burj Khalifa (Dubai)
- Formula 1 Racing Track (Abu Dhabi)
- Etihad Towers (Abu Dhabi)

The international order book has started to pick up as the company won orders worth Rs4bn in 1Q FY11. This includes order for tunnel ventilation for the metro rail in Singapore.

Exhibit 64. Burj Khalifa, Dubai

Source: Company data

Exhibit 65. Sidra Medical and Research Centre, Doha, Qatar

Source: Company data

The list of projects under execution is:

- Sidra Medical and Research Centre (Qatar)
- Barwa City Project (Qatar)
- Ferrari Experience (Abu Dhabi)
- Central Market Project T2 & T3 Towers (Abu Dhabi)
- Regent Emirates Pearl Hotel (Abu Dhabi)
- Marina Costal Expressway, (Singapore)

Exhibit 66. Revenue and profitability of EMP business

EMP business performance (Rs mn)	FY06	FY07	FY08	FY09	FY10
Net sales	11,751	14,383	17,449	27,668	31,134
EBIT	683	686	1,170	2,134	3,091
Operating margins (%)	5.8	4.8	6.7	7.7	9.9
ROCE (%)	102	43	NA	158	148

Source: Company data, Nomura research

The operating margins of Voltas' EMP business have been improving due to changes in its business mix towards MEP and better operating efficiencies. This business also continues to enjoy a very high ROCE.

Engineering Products and Services (EPS)

This segment contributes 10% of the company's revenues, of which 25% is agency business, in which the company gets commission on sales and services of third-party products. The company has tie-ups with Terex (USA/UK) for construction equipment and Laksmi Machine Works and two group companies for textile machinery. The margins in the agency business are typically much higher than other parts of the engineering products and services business.

The company is mainly present in three segments — textile machinery, mining and construction and forklifts.

According to management, textile machinery products have seen significant traction in the past few quarters, while mining and construction and material handling businesses have seen a pick-up in inquires and sales on a month-on-month basis. Also, the agency business is expected to see greater growth than the manufacturing business for the next few years, leading to improved profitability, as per management.

Exhibit 67. EPS business

(Rs mn)	FY06	FY07	FY08	FY09	FY10
Net sales	2,434	4,162	5,535	5,422	4,680
EBIT	697	984	1,136	626	768
Operating margins (%)	28.6	23.6	20.5	11.6	16.4
ROCE (%)	249	121	144	49	80

Source: Company data, Nomura research

Exhibit 68. Engineering products

Source: Company data

Exhibit 69. Engineering products

Source: Company data

Unitary cooling

This segment contributes 23% of the company's revenues, which grew 41% y-y in 1Q FY11. The room air conditioner business accounts for 70% of this segment's revenue, while the remaining comes from commercial refrigeration.

According to management, the Indian room conditioner industry is likely to grow at 25-30% pa over the next few years and the company is likely to grow more than the market rate in this segment

In the consumer segment, the company's brand is ranked number two in India with a market share of 18% after LG (24%); Samsung is ranked number three with a 17% market share. According to management, the Indian room conditioner industry is likely to grow at 25-30% pa over the next few years and the company is likely to grow more than the market rate in this segment.

Similarly, as per management, the Indian commercial refrigeration industry is expected to grow at 35% pa over the next few years driven by:

- growing need for cold chain solutions in Indian
- growing demand-gap in the user industries — retail, dairy, ice cream and brewery
- need for quality infrastructure

Exhibit 70. Voltas air-conditioners

Source: Company data

Exhibit 71. Unitary cooling product business performance

(Rs mn)	FY06	FY07	FY08	FY09	FY10
Net sales	4,596	5,957	8,259	9,223	11,871
EBIT	(337)	26	553	550	1,203
Operating margins (%)	(7.3)	0.4	6.7	6.0	10.1
ROCE (%)	-ve	2	46	34	85

Source: Company data, Nomura research

Financial overview

Likely pick-up in order book

The company has seen a slowdown in order booking in the EMP business in the past few quarters due to a slowdown in corporate capex in its markets such as India and the Middle East. In our view, this is likely to change because:

A slowdown in order booking in the EMP business in the past few quarters likely to change, in our view

- The capex related to commercial real estate such as IT parks and campuses is likely to increase again as net employee addition in the IT services sector has been good in the recent quarters. As a result, companies could add office space again.
- We have been seeing an increase in activities on the ground in sectors such as power, steel and mining in the country, evident from the increase in number of new projects being announced in these sectors.
- On the international front, there has been substantial new order flow from markets such as the Middle East and Singapore, a trend likely to continue.

In our view, the capex cycle in India is likely to see a steep increase from FY12F and this is likely to result in a substantial increase in Voltas' order book.

Financial analysis — P&L and BS

The company has consistently increased revenues, EBIDTA and EPS in the past five years.

Exhibit 72. Financials Rs mn

	FY06	FY07	FY08	FY09	FY10
Revenue	19,544	25,267	32,155	43,617	48,236
EBITDA	1,118	1,280	2,656	3,189	4,769
EPS	2.23	6.09	6.28	7.60	11.51
EBITDA margin (%)	5.7	5.1	8.3	7.3	9.9

Source: Company data, Nomura research; Note: EPS is reported number.

Exhibit 73. Growth rate

(%)	FY06	FY07	FY08	FY09	FY10
Revenue	32	29	27	36	11
EBITDA	110	14	108	20	50
EPS	41	173	3	21	52

Source: Company data, Nomura research

Also, the company's balance sheet has become stronger with a decrease in debt/equity and improved ROCE. The free cashflows produced by the business (as a percentage of revenues) has also been increasing.

Exhibit 74. Free cashflow (Rs mn)

	FY06	FY07	FY08	FY09	FY10
FCF	220	(290)	3083	551	2743
% of sales	1.1	(1.1)	9.6	1.3	5.7

Source: Company data, Nomura research

Exhibit 75. ROE and ROCE

(%)	FY08	FY09	FY10	FY11F	FY12F
ROE	36.0	36.8	40.6	29.4	31.3
ROCE	38.2	30.7	40.7	35.2	36.6

Source: Company data, Nomura estimates

Exhibit 76. financial leverage

(%)	FY06	FY07	FY08	FY09	FY10
D/E ratio	33	26	13	23	3

Source: Company data, Nomura research

EPS growth in FY11F looks depressed due to:

- our expectation that revenue growth of its EMP business will gradually pick up y-y, from -1% in 1Q FY11 to 10% by 4Q FY11F.
- a steep fall in EBIT margins in the EMP business from 11.1% in 4Q FY10 to 8.5% in Q1 FY11 on one-off gains in 4Q FY10.

We expect revenues to pick up from FY12F.

The company has seen a pick-up in its EMP order book in 1Q FY11, a trend which is likely to pick up, in our opinion. This is based on our expectations of a pick-up in industrial and infrastructure capex in the next few quarters.

Segment revenue projections

We have built in a pick-up in EMP revenue growth from 6% in FY11F to 30% in FY12F and for the EPS business from 9% in FY11F to 15% in FY12F. For the UCP business, we estimate growth of 35% in FY11F and 30% in FY12F.

On the margin front, we assume that EMP margins will pick up, after a likely steep decline in FY11F (due to one-off gains in FY10), on better pricing and efficiency. For the EPS business, we have assumed a gradual decline in margins from 22.9% in 1Q FY11 to 20% in FY12F.

Exhibit 77. Segment mix in revenue

(%)	FY08	FY09	FY10	FY11F	FY12F
Electro Mechanical Project & Services	55	64	65	61	62
Engineering Product & Services	17	13	10	9	8
Unitary Cooling Products	26	21	25	29	30
Others	1	2	1	0	0

Source: Company data, Nomura estimates

Exhibit 78. Segment revenue growth rate

(%)	FY08	FY09	FY10	FY11F	FY12F
Electro Mechanical Project & Services	21	59	13	6	30
Engineering Product & Services	33	(2)	(14)	9	15
Unitary Cooling Products	39	12	29	34	30
Others	(1)	161	(62)	(68)	(67)

Source: Company data, Nomura estimates

Exhibit 79. Segment EBIT margin (%)

(%)	FY08	FY09	FY10	FY11F	FY12F
Electro Mechanical Project & Services	7	8	10	9	10
Engineering Product & Services	21	12	16	22	20
Unitary Cooling Products	7	6	10	9	9
Others	10	9	18	7	9

Source: Company data, Nomura estimates

Exhibit 80. VOLT's EBIT margin (%)

(%)	FY08	FY09	FY10	FY11F	FY12F
Operating margin	7.7	6.8	9.4	9.1	9.4

Source: Company data, Nomura estimates

Valuation

BUY rating and price target of Rs270

In our view, Voltas is one of India's few globally competitive services companies, which have the capability and expertise to execute world-class projects. Also, the company has successfully changed its focus and direction based on macro conditions and continued to increase revenues and profits. In our view, the company will be a significant beneficiary of the pick-up in the domestic capex cycle and will likely see 20% CAGR in EPS for several years after FY12E.

The company has zero long-term debt, produces significant FCF every year and enjoys relatively high ROCE and ROE. Operating parameters are likely to remain strong as the company has developed capabilities to execute large and complex projects across the world.

The stock is likely to be re-rated once the order book picks up over the next few quarters, in our view.

Exhibit 81. Comparable companies

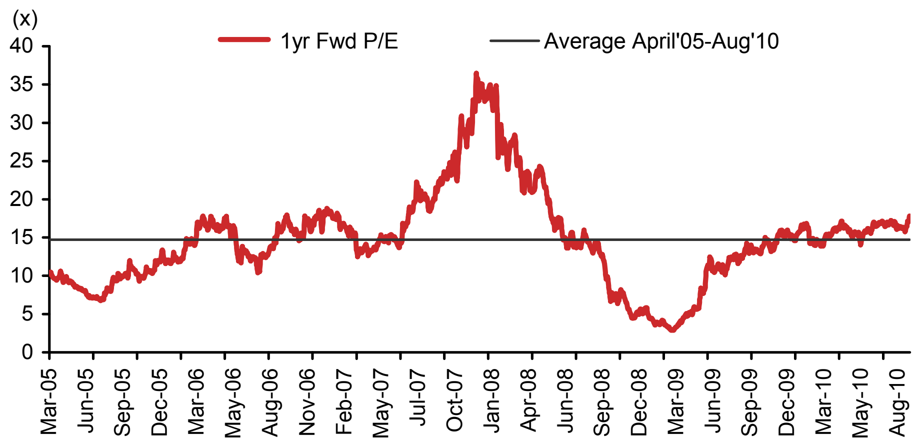
Comparable companies	Ticker (Bloomberg)	Revenue (Rs mn)	Mkt cap (Rs mn)	Price (Rs)	P/E	P/B	EV/EBITDA
Voltas Limited	Voltas IN	48,059	74,532	225	20.02	6.13	14.04
Blue Star Ltd	BLSTR IN	24,984	41,469	461	19.61	8.43	11.99

Note: Pricing and mkt cap are as of 13 Sep 2010; P/E, P/B and EV/EBITDA on TTM basis, revenue is for FY10

Source: Bloomberg for Blue Star, Company data, Nomura estimates

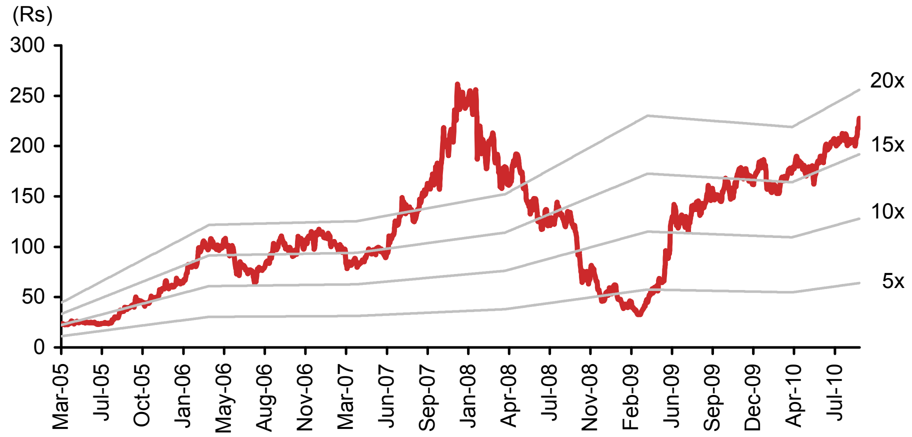
Our price target of Rs270 is based on 18x FY12F EPS of Rs14.9. Our target one-year forward P/E multiple of 16.5x is in line with the average of the past one year and we expect this multiple to sustain, due to a pick-up in EPS growth from FY12F.

Exhibit 82. One-year forward P/E (X)



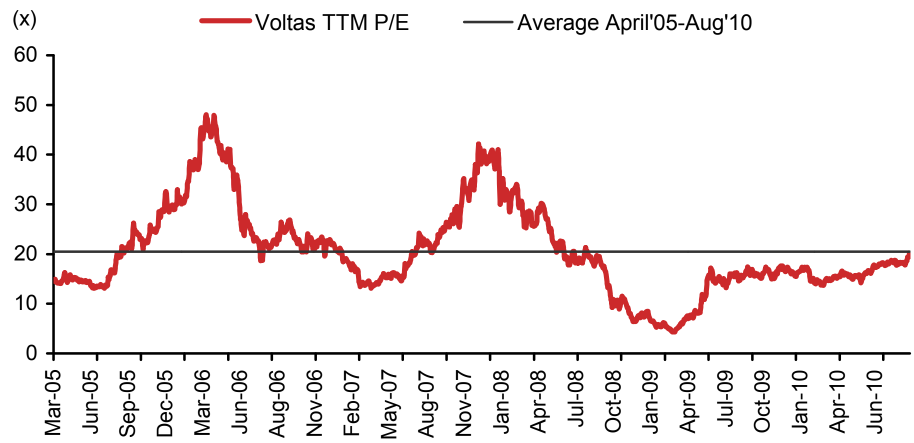
Source: Company data, Nomura research

Exhibit 83. One-year forward P/E band



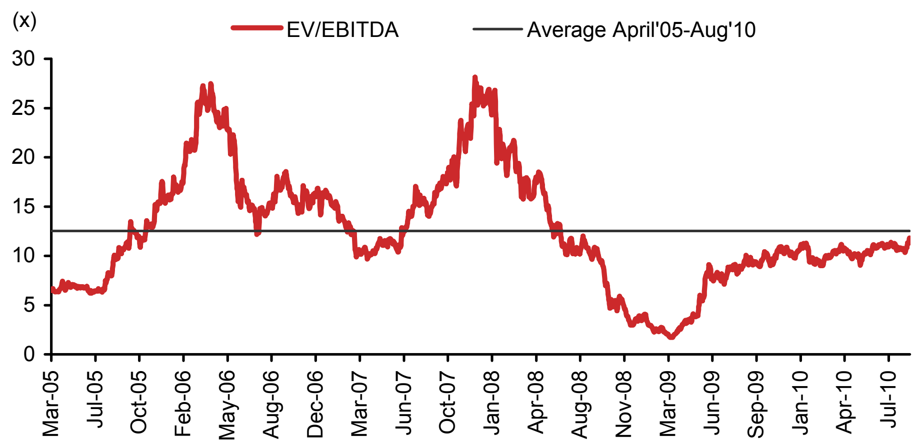
Source: Company data, Nomura research

Exhibit 84. Trailing 12 months P/E (X)



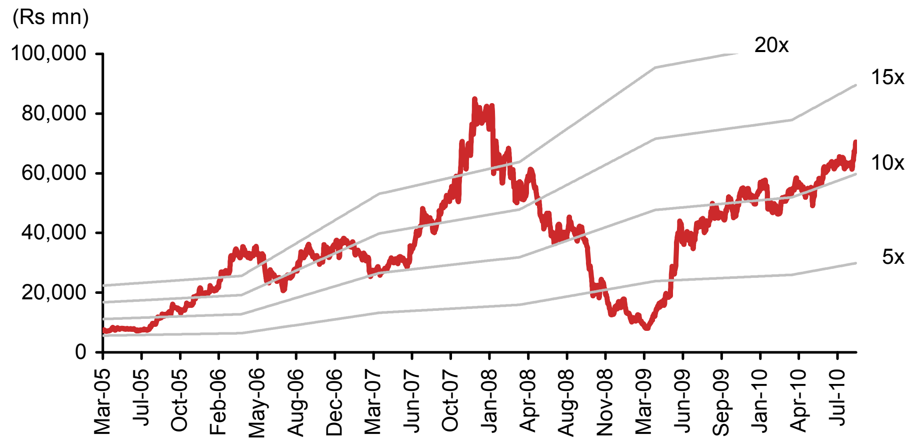
Source: Company data, Nomura research

Exhibit 85. One-year forward EV/EBITDA (X)



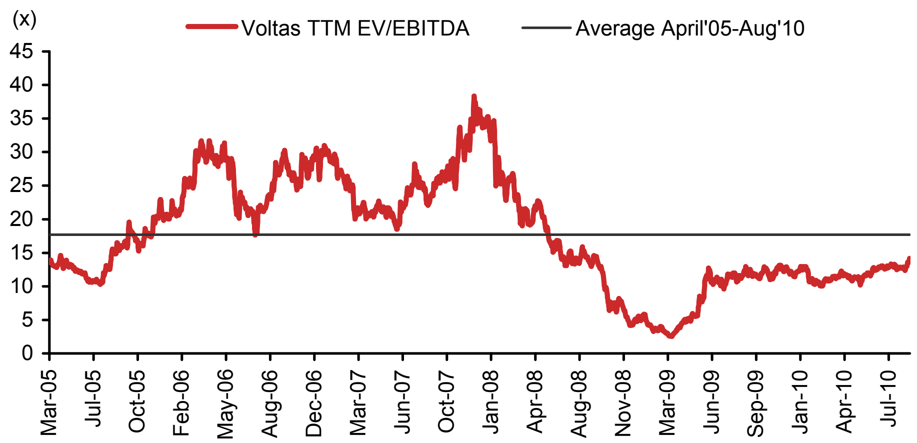
Source: Company data, Nomura research

Exhibit 86. One- year forward EV/EBITDA band



Source: Company data, Nomura research

Exhibit 87. Trailing 12 months EV/EBITDA (X)



Source: Company data, Nomura research

Financial statements

We estimate a pick-up in EPS growth from FY12F onwards

Income statement (Rsmn)					
Year-end 31 Mar	**FY08**	**FY09**	**FY10**	**FY11F**	**FY12F**
Revenue	32,155	43,617	48,236	54,393	69,770
Cost of goods sold	(23,551)	(31,895)	(33,206)	(37,437)	(48,017)
Gross profit	**8,604**	**11,722**	**15,030**	**16,956**	**21,753**
SG&A	(6,115)	(8,743)	(10,475)	(11,999)	(15,167)
Employee share expense	-	-	-	-	-
Operating profit	**2,489**	**2,980**	**4,555**	**4,956**	**6,586**
EBITDA	**2,656**	**3,189**	**4,769**	**5,190**	**6,844**
Depreciation	(167)	(210)	(214)	(234)	(257)
Amortisation	-	-	-	-	-
EBIT	**2,489**	**2,980**	**4,555**	**4,956**	**6,586**
Net interest expense	(50)	(128)	(98)	(203)	(200)
Associates & JCEs	2	(3)	-	-	-
Other income	318	604	612	701	1,008
Earnings before tax	**2,759**	**3,453**	**5,068**	**5,455**	**7,395**
Income tax	(997)	(1,172)	(1,472)	(1,800)	(2,440)
Net profit after tax	**1,762**	**2,282**	**3,595**	**3,655**	**4,954**
Minority interests	(1)	(29)	(36)	(36)	(36)
Other items					
Preferred dividends					
Normalised NPAT	**1,761**	**2,253**	**3,560**	**3,619**	**4,919**
Extraordinary items	316	261	250	-	-
Reported NPAT	**2,077**	**2,514**	**3,810**	**3,619**	**4,919**
Dividends	(388)	(520)	(615)	(731)	(991)
Transfer to reserves	**1,689**	**1,994**	**3,195**	**2,888**	**3,928**
Valuation and ratio analysis					
FD normalised P/E (x)	41.8	32.7	20.7	20.3	15.0
FD normalised P/E at price target (x)	50.7	39.7	25.1	24.7	18.2
Reported P/E (x)	35.5	29.3	19.3	20.3	15.0
Dividend yield (%)	0.5	0.7	0.8	1.0	1.3
Price/cashflow (x)	20.6	74.4	24.1	22.6	18.2
Price/book (x)	12.8	9.3	6.8	5.4	4.2
EV/EBITDA (x)	26.9	22.2	14.5	13.1	9.4
EV/EBIT (x)	28.7	23.8	15.2	13.7	9.8
Gross margin (%)	26.8	26.9	31.2	31.2	31.2
EBITDA margin (%)	8.3	7.3	9.9	9.5	9.8
EBIT margin (%)	7.7	6.8	9.4	9.1	9.4
Net margin (%)	6.5	5.8	7.9	6.7	7.1
Effective tax rate (%)	36.1	33.9	29.1	33.0	33.0
Dividend payout (%)	18.7	20.7	16.1	20.2	20.1
Capex to sales (%)	1.5	1.0	0.7	0.6	0.5
Capex to depreciation (x)	2.9	2.1	1.5	1.3	1.4
ROE (%)	36.0	36.8	40.6	29.4	31.3
ROA (pretax %)	na	13.0	16.0	15.8	17.6
Growth (%)					
Revenue		35.6	10.6	12.8	28.3
EBITDA		20.1	49.5	8.8	31.9
EBIT		19.7	52.9	8.8	32.9
Normalised EPS		27.9	58.0	1.7	35.9
Normalised FDEPS		27.9	58.0	1.7	35.9
Per share					
Reported EPS (Rs)	6.3	7.6	11.5	10.9	14.9
Norm EPS (Rs)	5.3	6.8	10.8	10.9	14.9
Fully diluted norm EPS (Rs)	5.3	6.8	10.8	10.9	14.9
Book value per share (Rs)	17.4	23.9	32.8	41.5	53.4
DPS (Rs)	1.2	1.6	1.9	2.2	3.0

Source: Nomura estimates

Cashflow (Rsmn)					
Year-end 31 Mar	**FY08**	**FY09**	**FY10**	**FY11F**	**FY12F**
EBITDA	2,656	3,189	4,769	5,190	6,844
Change in working capital	1,117	(2,195)	(526)	(139)	(347)
Other operating cashflow	(205)	(4)	(1,183)	(1,800)	(2,440)
Cashflow from operations	**3,567**	**990**	**3,059**	**3,252**	**4,056**
Capital expenditure	(484)	(439)	(317)	(300)	(350)
Free cashflow	**3,083**	**551**	**2,743**	**2,952**	**3,706**
Reduction in investments	(1,311)	1,076	(775)	(1,470)	-
Net acquisitions	-	(536)	-	-	-
Reduction in other LT assets	197	72	350	-	-
Addition in other LT liabilities	-	-	-	-	-
Adjustments	213	475	(22)	665	973
Cashflow after investing acts	**2,182**	**1,639**	**2,295**	**2,147**	**4,679**
Cash dividends	(388)	(520)	(615)	(731)	(991)
Equity issue	-	-	-	-	-
Debt issue	(378)	577	(1,463)	-	-
Convertible debt issue	-	-	-	-	-
Others	(91)	(128)	(99)	(203)	(200)
Cashflow from financial acts	**(857)**	**(71)**	**(2,177)**	**(934)**	**(1,191)**
Net cashflow	**1,325**	**1,569**	**119**	**1,214**	**3,488**
Beginning cash	1,677	3,002	4,571	4,689	5,903
Ending cash	3,002	4,571	4,689	5,903	9,391
Ending net debt		(2,756)	(4,337)	(5,551)	(9,039)

Source: Nomura estimates

Balance sheet (Rsmn)					
As at 31 Mar	**FY08**	**FY09**	**FY10**	**FY11F**	**FY12F**
Cash & equivalents	3,002	4,571	4,689	5,903	9,391
Marketable securities	2,199	1,184	2,030	3,500	3,500
Accounts receivable	5,703	9,521	10,060	11,344	14,562
Inventories	6,398	11,194	11,441	12,901	16,562
Other current assets	1,528	2,203	2,078	2,343	3,008
Total current assets	**18,830**	**28,673**	**30,297**	**35,991**	**47,023**
LT investments	386	378	309	309	309
Fixed assets	1,898	2,280	2,262	2,328	2,421
Goodwill	-	675	764	764	764
Other intangible assets	-	-	-	-	-
Other LT assets	204	224	204	204	204
Total assets	**21,318**	**32,231**	**33,837**	**39,596**	**50,720**
Short-term debt	-	76	45	45	45
Accounts payable	6,397	11,782	11,142	12,564	16,128
Other current liabilities	6,222	7,932	8,706	10,155	13,787
Total current liabilities	**12,620**	**19,790**	**19,893**	**22,765**	**29,961**
Long-term debt	737	1,739	306	306	306
Convertible debt	-	-	-	-	-
Other LT liabilities	2,184	2,645	2,647	2,647	2,647
Total liabilities	**15,541**	**24,174**	**22,846**	**25,717**	**32,914**
Minority interest	5	159	139	139	139
Preferred stock	-	-	-	-	-
Common stock	331	331	331	331	331
Retained earnings	5,442	7,567	10,521	13,409	17,337
Proposed dividends	-	-	-	-	-
Other equity and reserves	-	-	-	-	-
Total shareholders' equity	**5,772**	**7,897**	**10,852**	**13,740**	**17,668**
Total equity & liabilities	**21,318**	**32,231**	**33,837**	**39,596**	**50,720**
Liquidity (x)					
Current ratio	1.49	1.45	1.52	1.58	1.57
Interest cover	49.9	23.4	46.3	24.5	32.9
Leverage					
Net debt/EBITDA (x)	net cash	net cash	net cash	net cash	net cash
Net debt/equity (%)	net cash	net cash	net cash	net cash	net cash
Activity (days)					
Days receivable		63.7	74.1	71.8	67.9
Days inventory		100.7	124.4	118.7	112.3
Days payable		104.0	126.0	115.6	109.4
Cash cycle	-	60.3	72.5	74.9	70.9

Source: Nomura estimates

Strong balance sheet with zero long term debt and 30% plus ROE

Maharashtra Seamless MHS IN

TECHNOLOGY | INDIA

Initiation

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NOMURA

NOMURA FINANCIAL ADVISORY AND SECURITIES (INDIA) PRIVATE LIMITED

BUY

Action

We initiate coverage of MHS with a BUY rating and a price target of Rs505, offering potential upside of 33% from current levels. MHS has a strong competitive position in both seamless and ERW pipes and has been able to maintain profitability despite being exposed to business cycle risks (users' industries and raw materials). At 7.5x FY12F EPS of Rs50.5, we find its valuation inexpensive.

Catalysts

A pick-up in the capex of both the power-generation and oil & gas sectors could spur an increase in order book and revenue growth for the company.

Anchor themes

MHS is a play on the capex of the industrial (oil & gas) and power-generation sectors in India, and we expect capex in these segments to increase further. The company is in the process of expanding capacity for its product lines.

Closing price on 15 Sep	Rs380.6
Price target	Rs505
Upside/downside	32.7%
Difference from consensus	10.8%
FY11F net profit (Rsmn)	3,349
Difference from consensus	22.0%

Source: Nomura

Nomura vs consensus

Our EPS estimates for FY11F and FY12F are in-line with consensus estimates for the company.

Play on oil & gas and power capex

① Dominant market position

Maharashtra Seamless (MHS) has a dominant position in the seamless and electric resistance welded (ERW) pipe markets and is a direct play on the capex of both the industrial (oil & gas) and power-generation sectors. The company has been able to maintain EBIDTA per tonne in a narrow range despite wide fluctuations in steel prices and has been able to grow EPS consistently (a 15% CAGR over the past four years).

② Set for good revenue growth

We believe demand for MHS's products is likely to be good, in view of the increased capex in the oil & gas and power-generation sectors. The capex surge is likely to drive more than 20% revenue growth for the company in the next few years, in our view. This is also reflected in its order book, which has grown to Rs4.5bn.

③ Relatively inexpensive valuations

The stock trades at 7.5 x FY12F EPS of Rs50.5 and has a book value of Rs340 against the market price of Rs380. We believe this is inexpensive for a company which has a strong competitive position, generates free cashflow and has high ROCE and ROE, in our opinion.

④ Initiate with BUY

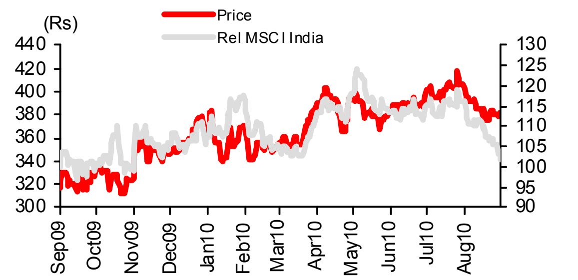
We initiate coverage of MHS with a BUY rating and a price target of Rs505. Any sharp decline in oil prices is the key risk factor to our recommendation.

Key financials & valuations

31 Mar (Rsmn)	FY09	FY10	FY11F	FY12F
Revenue	20,642	16,112	18,403	22,054
Reported net profit	2,578	2,836	3,349	3,561
Normalised net profit	2,578	2,836	3,349	3,561
Normalised EPS (Rs)	36.6	40.4	47.5	50.5
Norm. EPS growth (%)	31.9	10.4	17.7	6.3
Norm. P/E (x)	10.4	9.4	8.0	7.5
EV/EBITDA (x)	7.2	6.6	6.3	5.1
Price/book (x)	2.0	1.2	1.1	1.0
Dividend yield (%)	1.5	1.6	2.5	2.7
ROE (%)	21.5	15.8	14.0	13.5
Net debt/equity (%)	net cash	3.1	net cash	net cash
Earnings revisions				
Previous norm. net profit		na	na	na
Change from previous (%)		na	na	na
Previous norm. EPS (Rs)		na	na	na

Source: Company, Nomura estimates

Share price relative to MSCI India



	1m	3m	6m
Absolute (Rs)	(6.4)	(0.8)	7.4
Absolute (US$)	(5.6)	(0.4)	5.6
Relative to Index	(13.6)	(11.7)	(4.2)
Market cap (US$mn)			579
Estimated free float (%)			0.0
52-week range (Rs)			418.2/312.2
3-mth avg daily turnover (US$mn)			0.88
Stock borrowability			
Major shareholders (%)			
Promoters			51.1

Source: Company, Nomura estimates

Investment argument and risks

Investment argument

Capex play on oil & gas and power sectors

MHS is a play on the capex of oil & gas and power-generation sectors, in our view

Maharashtra Seamless (MHS) has a dominant position in the seamless and ERW pipe markets and is a direct play on the capex of both the industrial (oil & gas) and power-generation sectors. The company has been able to maintain EBIDTA per tonne in a narrow range despite wide fluctuations in steel prices and has been able to grow EPS consistently (15% CAGR in the past four years). Also, the company is in the process of expanding its capacity substantially.

Relatively inexpensive valuations

The stock currently trades at 7.5x FY12F EPS of Rs50.5 and has a book value of Rs340 (vs the market price of Rs380). We believe this is inexpensive for a company that enjoys a strong competitive position, generates free cashflow and has high ROCE and ROE, in our view.

Valuation and price target

Initiate with BUY and PT of Rs505

MHS has been able to grow EBIDTA and EPS for many years despite fluctuations in the business and steel cycles. This, in our view, is an indication of its competitive position and robust business model. Our price target of Rs505 is based on 10x FY12F EPS of Rs50.5 and we initiate coverage with a BUY rating on the stock.

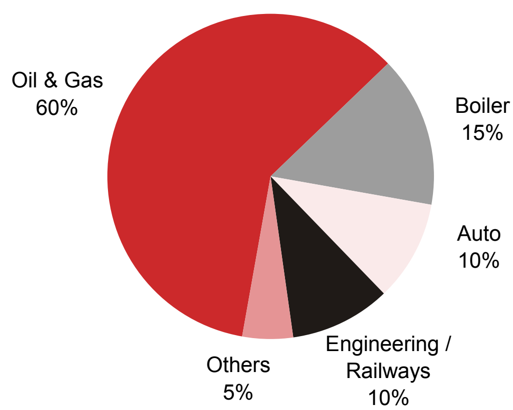
Investment risks

A sharp fall in crude prices — demand for the company's product largely (60% of revenues) depends upon continuing oil and gas drilling activities in India and other parts of the world. A sharp decline in crude prices to, say, US$50/bbl may impact the global drilling activities and demand for seamless pipes.

Company background

MHS is the largest manufacturer of seamless steel pipes and tubes in India, with a production capacity of over 350,000 MT per annum. The company's wide product range spans sizes and specifications catering to diverse application areas in sectors such as oil & gas, hydrocarbon, boilers & heat exchangers, automotive, bearing and general engineering.

Exhibit 88. Industrial breakdown for the seamless business (March FY10)



Source: Company data

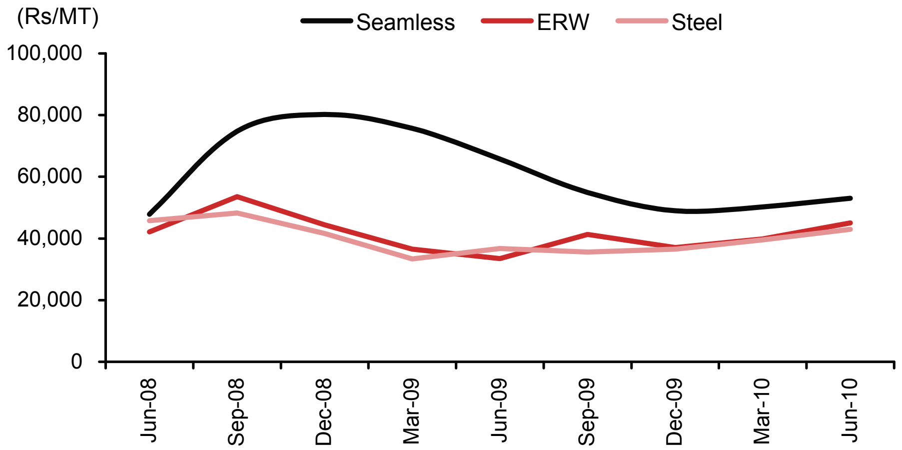
The company also manufactures large diameter ERW pipes for use in sectors as diverse as natural gas or oil, diesel, drinking water and sewage/water treatment.

Exports, mainly to markets such as the US, account for around 25% of its revenues.

Low capex intensity business with high return ratios

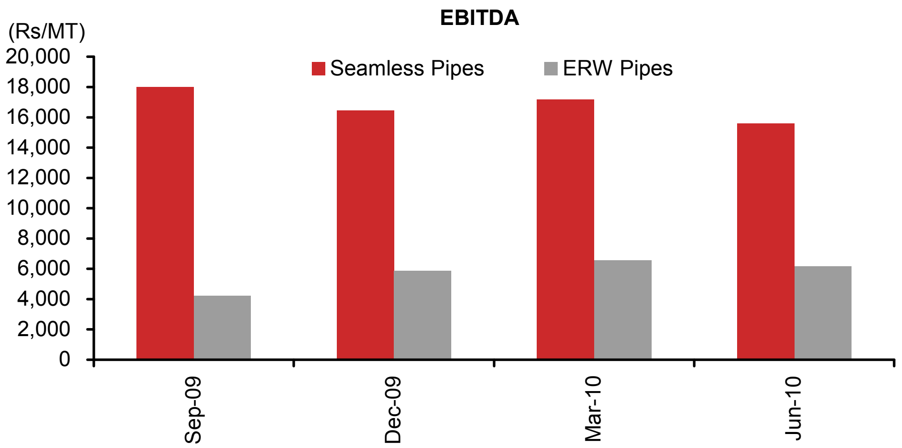
The company has been able to maintain consistently stable EBIDTA per tonne for both seamless and ERW pipes through several business cycles of steel.

Exhibit 89. Realisation (Rs/MT)



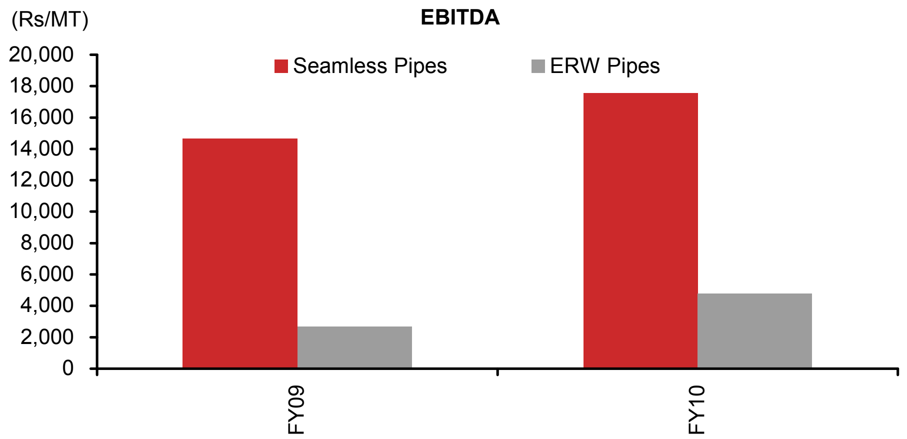
Source: Company data, Nomura research

Exhibit 90. EBIDTA per tonne for seamless and ERW pipes



Source: Company data, Nomura research

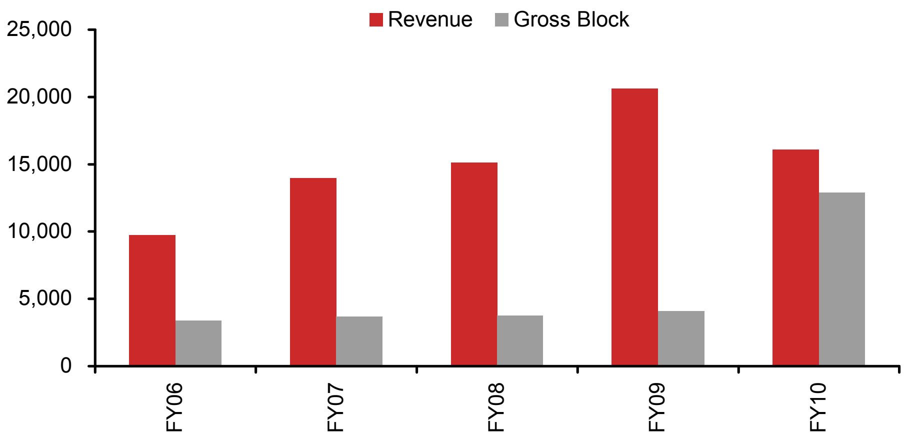
Exhibit 91. EBIDTA per tonne for seamless and ERW pipes (FY09-10)



Source: Company data, Nomura research

Also, MHS has been able to expand its capacity through the takeover route; it acquires existing but struggling capacity and turns them around. For example, in FY10 the company acquired a closed down mill in Romania, refurbished it and achieved a capacity of 200,000 MT by FY10 end, after making an investment of only Rs3bn.

Exhibit 92. Revenues versus gross block for MHS (Rsmn)



Note: Gross Block of FY10 includes Revaluation Reserve of Rs7832.4mn

Source: Company data, Nomura research

Capacity expansion in place

MHS acquired a closed down plant in Romania, which added 200,000 MT to the capacity at a cost of Rs3bn only

MHS is expanding capacity, which we estimate is likely to go up from 350,000 MT in FY10 for seamless to 600,000 MT by FY12F. This has been done by acquiring a closed down plant in Romania, which added 200,000 MT to the capacity at a cost of Rs3bn only.

The company also has coal-blocks and is likely to get iron-ore mines, according to management. In addition, it has plans to enter into production of steel billets (raw material for pipes). This is likely to boost profitability by Rs4,000 per tonne, according to management.

Consolidated industry

The seamless pipe industry is a consolidated industry with only three companies in India – MHS, ISMT Ltd and Jindal Saw. Out of these, MHS has the widest range (½" to 14") of pipes.

Exhibit 93. Comparable companies

Name of company	Ticker	Rating	Revenue (Rs mn)	Mkt cap (Rs mn)	Price	P/E	P/B	EV/EBITDA
Maharastra Seamless	MHS IN	BUY	16,112	26,845	382	8.8	1.6	6.5
Jindal Saw	JSAW IN	Not rated	53,321	57,552	204	16.6	1.9	4.8
Welspun Corp	WLCO IN	Not rated	73,503	52,725	253	8.1	1.8	5.2
ISMT Ltd	ISMT IN	Not rated	11,851	7,633	52	10.4	1.4	5.8

Source: Bloomberg for Jindal Saw, Welspun Corp and ISMT Ltd, Nomura estimates; Pricing as of 15th Sep 2010

P/E, P/B and EV/EBITDA on trailing twelve months (TTM) basis

Demand outlook

Global demand for seamless tubes is a function of ongoing drilling and exploration activity around the world and is reflected by rig-counts. The number of rig-counts, which peaked at 2,200 in 2008, dropped to 800 when oil prices tanked in August/September 2008; it has since recovered to 1,200.

Exports, mainly to the US, account for 25% of its revenues

MHS's main customers are ONGC, GAIL, Reliance, Cairn, BHEL and Indian Railways, and the company has a 50% share in the domestic market (a 700,000-tonne market for seamless pipes). Exports, mainly to the US, account for 25% of its revenues.

Recent counts

Exhibit 94. Number of rig counts

Area	Last count	Count	Change from prior count	Date of prior count	Change from last year	Date of last year's count
U.S.	3 Sept 10	1,653	(3)	from 27 Aug 10	+644	from Sept 4 09
Canada	3 Sept 10	388	+2	from 27 Aug 10	+204	from Sept 4 09
International	July 2010	1,109	+10	July 2010	+135	July 2009

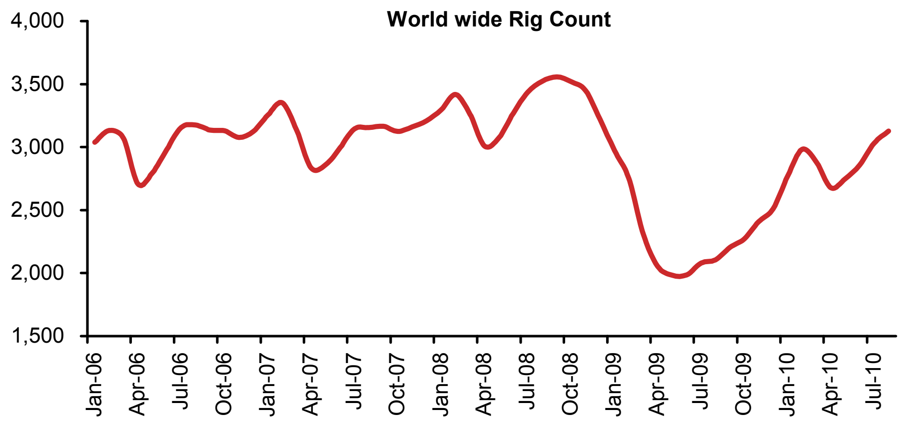
Source: Baker Hughes

Exhibit 95. ONGC projects — being implemented and planned

Project	Investment (Rs bn)
Additional Development of D-1 Field	21.6
Group-A of Assam Renewal Project, Assam Asset	24.7
B-46 Cluster Fields development, Mumbai	14.4
Mumbai High North Redevelopment Phase II	68.6
Additional Processing units at Uran	18.0
Mumbai High South Redevelopment-Phase-2	80.6
Heera & South Heera redevelopment	23.1
B-193 Cluster fields development	56.3
B-22 Cluster Fields development	29.2
Development of C-Series Fields	32.0
New Process Complex MHN in place of old BHN, Mumbai High North Field	63.3
C2-C3 & LPG Recovery from LNG Dahej	14.9
Integrated Development of G-1 and GS-15 fields	12.6
Cluster 7 development	32.4
MARS	18.0
UD-1 development	106.3
Total	**616.0**

Source: Company data, Nomura research

Exhibit 96. Rig counts from Baker & Hughes



Source: Baker & Hughes

Financial analysis

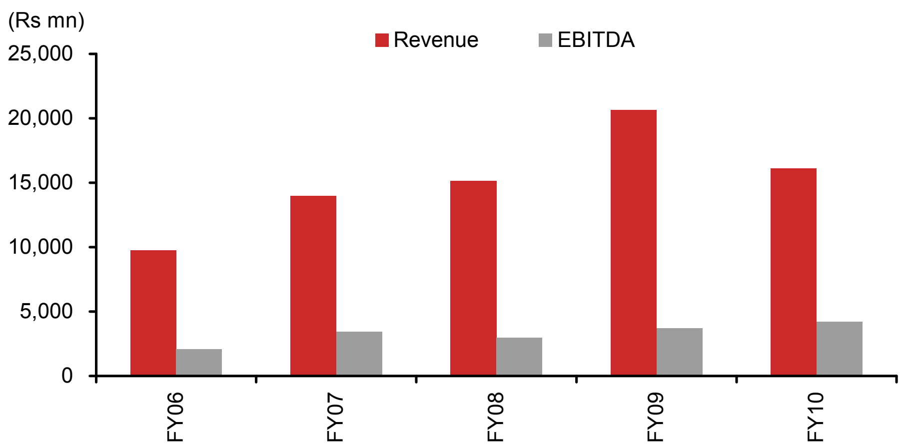
MHS has been consistently growing EBIDTA and EPS on a y-y basis despite fluctuations in revenues (as realisations depend upon global steel prices).

Exhibit 97. MHS financials

(Rs mn)	FY06	FY07	FY08	FY09	FY10
Revenue	9,743	13,971	15,122	20,642	16,112
EBITDA	2,080	3,410	2,939	3,677	4,203
EPS (Rs)	24.13	38.38	27.71	36.56	40.35

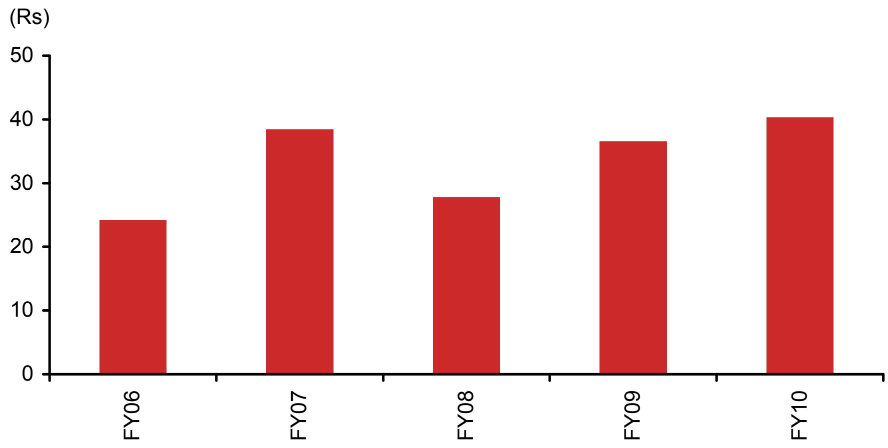
Source: Company data, Nomura research

Exhibit 98. Revenue and EBITDA



Source: Company data, Nomura research

Exhibit 99. EPS



Source: Company data, Nomura research

MHS has been able to consistently generate free cashflow, pay dividend and increase cash balance in the past few years despite adding capacity.

Exhibit 100. Free cashflow, dividend and cash balance

(Rs mn)	FY06	FY07	FY08	FY09	FY10
FCF	(416)	1,313	(518)	2,313	1,198
Dividend	(163)	(529)	(139)	(411)	(423)
Cash Balance & Marketable Sec	3333	5210	6272	7219	8728

Source: Company data, Nomura research

Also, it has maintained consistently high ROCE and ROE (after adjusting for re-valuation of reserves in FY10). Its debt/equity ratio has been under 10% for the past three years and is declining.

Exhibit 101. Return ratios

	FY08	FY09	FY10	FY11F	FY12F
ROE (%)	17.9	19.7	18.3	18.4	16.9
ROCE (%)	16.3	18.5	17.4	17.6	16.3

ROE and ROCE has been calculated by excluding re-valuation reserves

Source: Company data, Nomura estimates

Valuation and price target

MHS has been able to grow EBIDTA and EPS for many years despite fluctuations in the business and steel cycles. This, in our view, is an indication of its competitive position and its robust business model. We believe this performance is likely to continue in the next few years, as we expect capex in industries such as oil & gas, power-generation and manufacturing to be strong.

We expect EBITDA per tonne for seamless pipes to decline steadily from Rs15,596 to Rs14,000 in the next few quarters.

Exhibit 102. EBIDTA per tonne for seamless pipes

Q/E	Mar-10	Jun-10
EBITDA (Rs/MT)	17,171	15,596

Source: Company data, Nomura research

Similarly, we have assumed EBIDTA per tonne of Rs4,000 for ERW pipes for FY11F and FY12F.

Exhibit 103. EBIDTA per tonne for ERW pipes

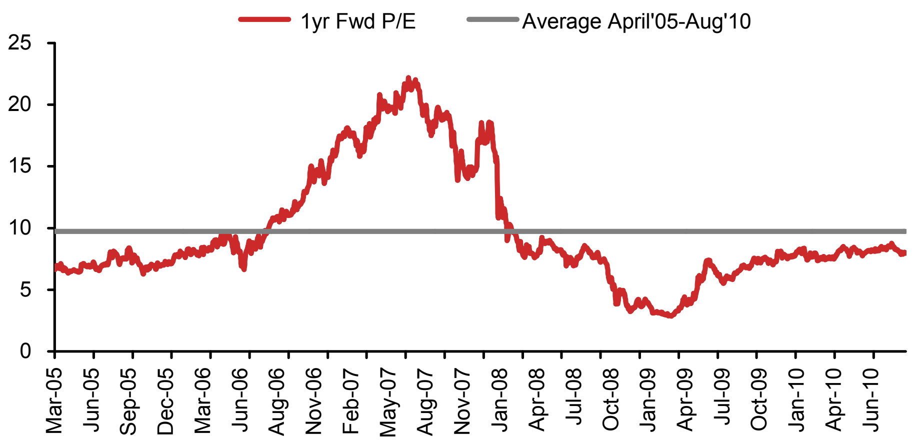
Q/E	Mar-10	Jun-10
EBITDA (Rs/MT)	6,569	6,147

Source: Company data, Nomura research

For FY11F, We have assumed y-y volume growth of 14% and 12%, respectively, for seamless and ERW pipes, and for FY12F, 20% for both.

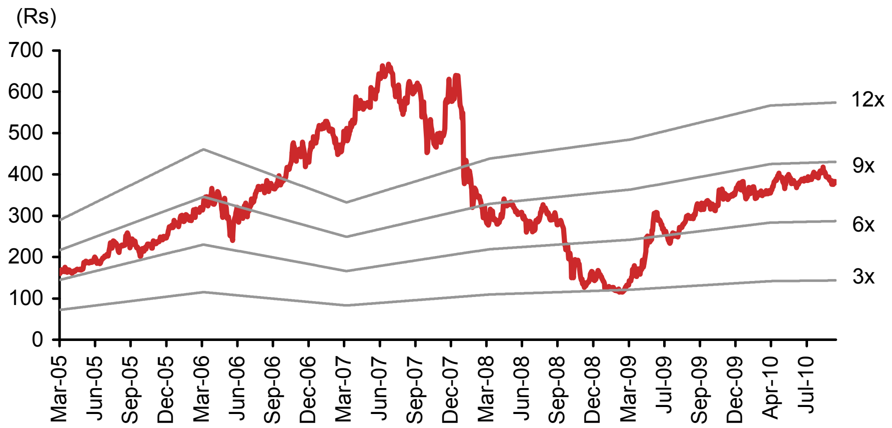
Our price target of Rs505 is based on 10x one-year forward P/E, which is in line with the past multiples for the company.

Exhibit 104. One-year forward PER (x)



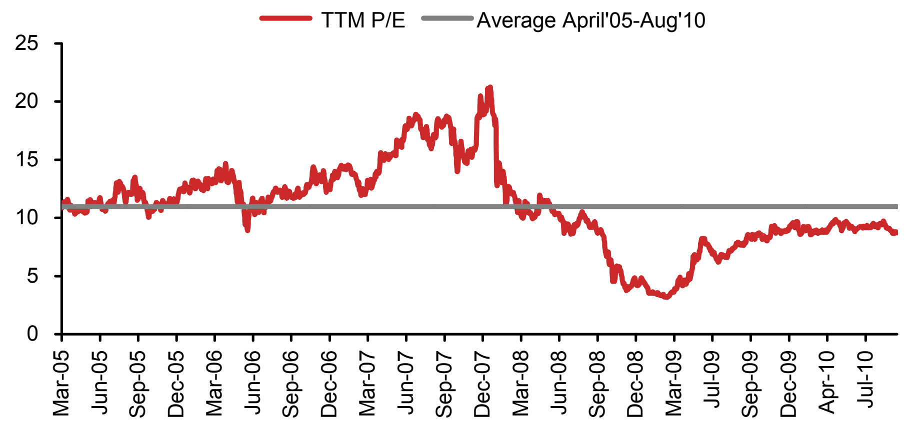
Source: Company data, Nomura research

Exhibit 105. One-year forward PER Band



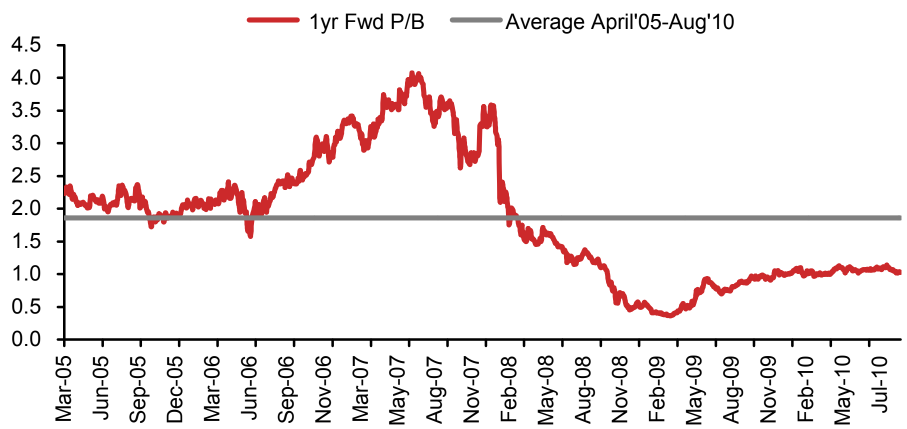
Source: Company data, Nomura research

Exhibit 106. Trailing 12 month P/E (x)



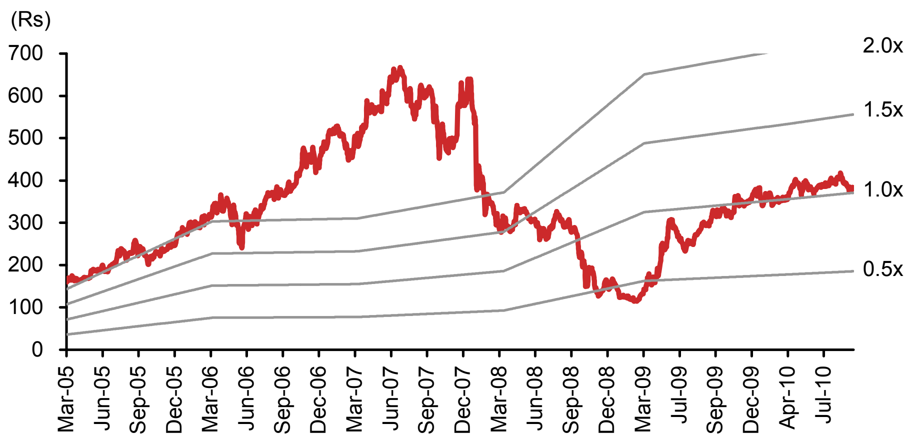
Source: Company data, Nomura research

Exhibit 107. One-year forward P/B(x)



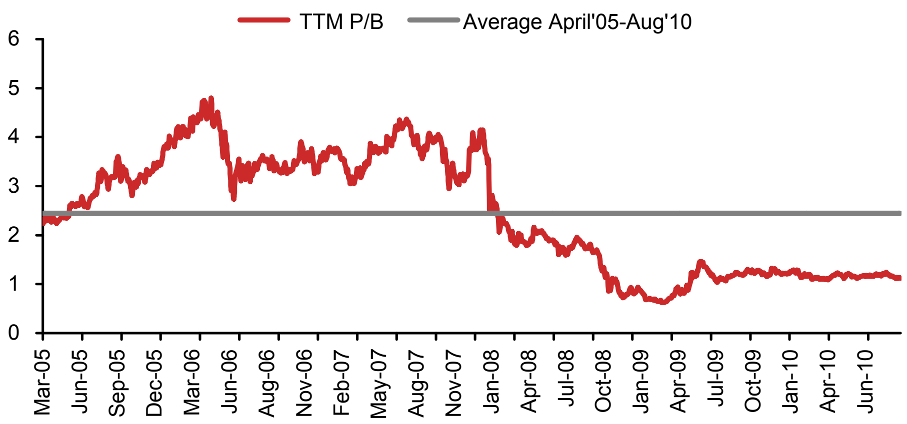
Source: Company data, Nomura research

Exhibit 108. One-year forward P/B Band



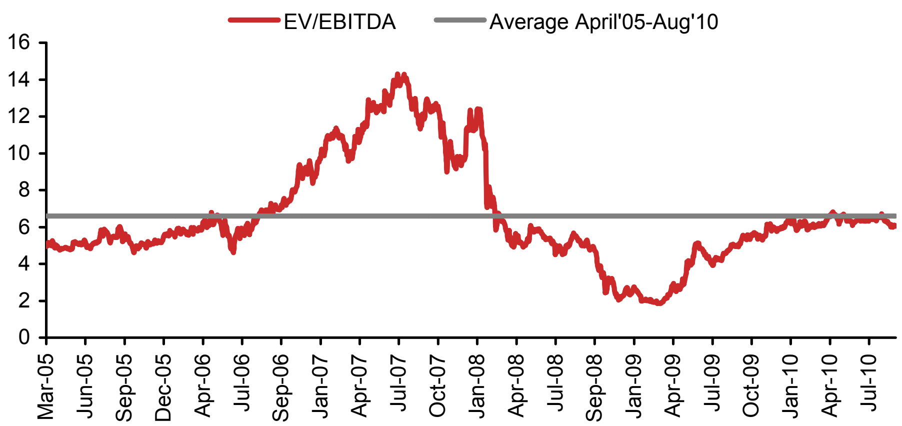
Source: Company data, Nomura research

Exhibit 109. Trailing 12 month P/B (x)



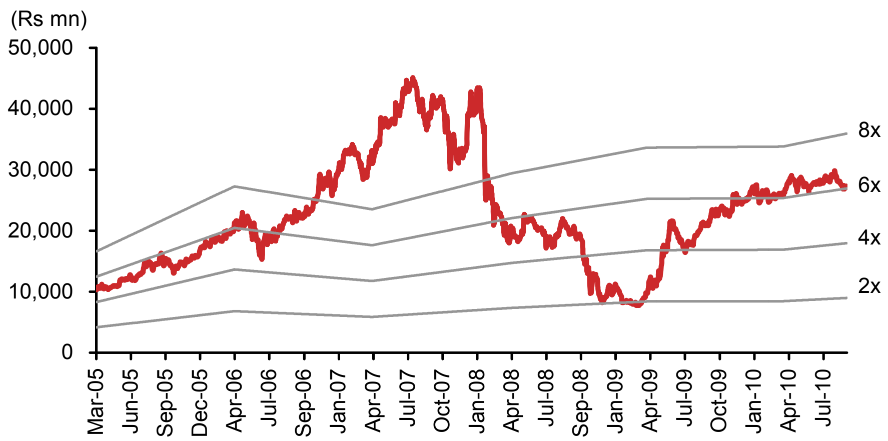
Source: Company data, Nomura research

Exhibit 110. One-year forward EV/EBITDA(x)



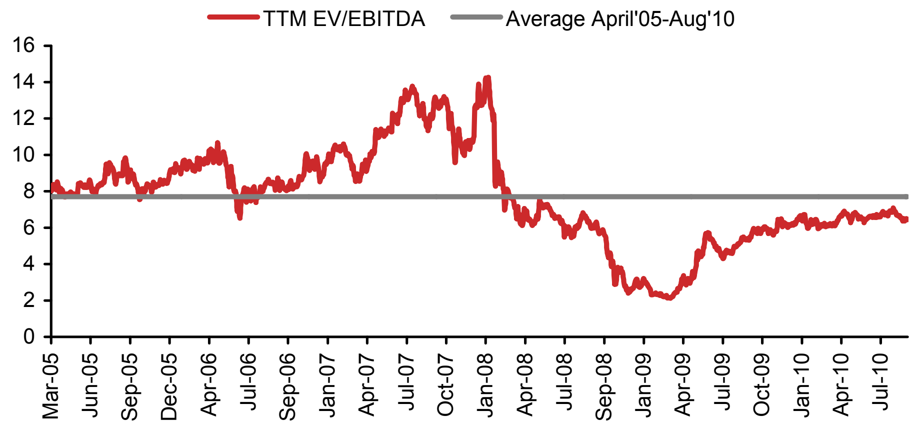
Source: Company data, Nomura research

Exhibit 111. One-year forward EV/EBITDA Band



Source: Company data, Nomura research

Exhibit 112. Trailing 12 month EV/EBITDA (x)



Source: Company data, Nomura research

Financial statements

Income statement (Rsmn)					
Year-end 31 Mar	**FY08**	**FY09**	**FY10**	**FY11F**	**FY12F**
Revenue	15,122	20,642	16,112	18,403	22,054
Cost of goods sold	(9,724)	(13,507)	(9,716)	(11,528)	(13,937)
Gross profit	**5,398**	**7,134**	**6,396**	**6,875**	**8,117**
SG&A	(2,634)	(3,637)	(2,383)	(2,832)	(3,426)
Employee share expense	-	-	-	-	-
Operating profit	**2,765**	**3,498**	**4,013**	**4,043**	**4,691**
EBITDA	**2,939**	**3,677**	**4,203**	**4,250**	**4,932**
Depreciation	(174)	(179)	(190)	(208)	(241)
Amortisation	-	-	-	-	-
EBIT	**2,765**	**3,498**	**4,013**	**4,043**	**4,691**
Net interest expense	(38)	(116)	(33)	(31)	(31)
Associates & JCEs	-	-	-	-	-
Other income	292	468	321	722	655
Earnings before tax	**3,019**	**3,850**	**4,301**	**4,734**	**5,315**
Income tax	(1,067)	(1,272)	(1,465)	(1,385)	(1,754)
Net profit after tax	**1,952**	**2,578**	**2,836**	**3,349**	**3,561**
Minority interests	-	-	-	-	-
Other items					
Preferred dividends					
Normalised NPAT	**1,952**	**2,578**	**2,836**	**3,349**	**3,561**
Extraordinary items	-	-	-	-	-
Reported NPAT	**1,952**	**2,578**	**2,836**	**3,349**	**3,561**
Dividends	(139)	(411)	(423)	(670)	(712)
Transfer to reserves	**1,813**	**2,168**	**2,413**	**2,679**	**2,849**
Valuation and ratio analysis					
FD normalised P/E (x)	13.7	10.4	9.4	8.0	7.5
FD normalised P/E at price target (x)	18.2	13.8	12.5	10.6	10.0
Reported P/E (x)	13.7	10.4	9.4	8.0	7.5
Dividend yield (%)	0.5	1.5	1.6	2.5	2.7
Price/cashflow (x)	155.3	8.9	12.2	13.9	12.8
Price/book (x)	2.5	2.0	1.2	1.1	1.0
EV/EBITDA (x)	8.6	7.2	6.6	6.3	5.1
EV/EBIT (x)	9.2	7.6	6.9	6.6	5.4
Gross margin (%)	35.7	34.6	39.7	37.4	36.8
EBITDA margin (%)	19.4	17.8	26.1	23.1	22.4
EBIT margin (%)	18.3	16.9	24.9	22.0	21.3
Net margin (%)	12.9	12.5	17.6	18.2	16.1
Effective tax rate (%)	35.3	33.0	34.1	29.3	33.0
Dividend payout (%)	7.1	15.9	14.9	20.0	20.0
Capex to sales (%)	4.6	3.4	6.2	5.4	2.3
Capex to depreciation (x)	4.0	4.0	5.2	4.8	2.1
ROE (%)	17.9	21.5	15.8	14.0	13.5
ROA (pretax %)	na	26.1	19.7	15.3	16.9
Growth (%)					
Revenue		36.5	(21.9)	14.2	19.8
EBITDA		25.1	14.3	1.1	16.0
EBIT		26.5	14.7	0.7	16.0
Normalised EPS		31.9	10.4	17.7	6.3
Normalised FDEPS		31.9	10.4	17.7	6.3
Per share					
Reported EPS (Rs)	27.7	36.6	40.4	47.5	50.5
Norm EPS (Rs)	27.7	36.6	40.4	47.5	50.5
Fully diluted norm EPS (Rs)	27.7	36.6	40.4	47.5	50.5
Book value per share (Rs)	155.2	185.7	325.4	355.7	389.5
DPS (Rs)	2.0	5.8	6.0	9.5	10.1

Source: Nomura estimates

Pick-up in revenue growth from FY12F

Cashflow (Rsmn)					
Year-end 31 Mar	**FY08**	**FY09**	**FY10**	**FY11F**	**FY12F**
EBITDA	2,939	3,677	4,203	4,250	4,932
Change in working capital	(1,209)	419	(525)	(940)	(1,081)
Other operating cashflow	(1,557)	(1,071)	(1,486)	(1,385)	(1,754)
Cashflow from operations	**173**	**3,025**	**2,192**	**1,925**	**2,097**
Capital expenditure	(691)	(711)	(993)	(1,000)	(500)
Free cashflow	**(518)**	**2,313**	**1,198**	**925**	**1,597**
Reduction in investments	(342)	(3,217)	(2,085)	-	-
Net acquisitions	-	-	-	-	-
Reduction in other LT assets	0	0	-	-	-
Addition in other LT liabilities	-	-	-	-	-
Adjustments	231	151	321	722	655
Cashflow after investing acts	**(629)**	**(753)**	**(566)**	**1,648**	**2,252**
Cash dividends	(139)	(411)	(423)	(670)	(712)
Equity issue	-	-	-	-	-
Debt issue	95	(201)	-	-	-
Convertible debt issue	-	-	-	-	-
Others	(11)	(78)	(33)	(31)	(31)
Cashflow from financial acts	**(55)**	**(690)**	**(457)**	**(701)**	**(743)**
Net cashflow	**(684)**	**(1,442)**	**(1,023)**	**947**	**1,509**
Beginning cash	3,232	2,549	1,106	84	1,031
Ending cash	2,549	1,106	84	1,031	2,540
Ending net debt		(283)	717	(230)	(1,739)

Source: Nomura estimates

Balance sheet (Rsmn)					
As at 31 Mar	**FY08**	**FY09**	**FY10**	**FY11F**	**FY12F**
Cash & equivalents	2,549	1,106	84	1,031	2,540
Marketable securities	784	4,103	6,189	6,189	6,189
Accounts receivable	2,695	2,788	1,826	2,099	2,414
Inventories	3,803	3,521	5,140	5,911	6,798
Other current assets	985	617	429	493	567
Total current assets	**10,816**	**12,135**	**13,667**	**15,723**	**18,507**
LT investments	109	95	95	95	95
Fixed assets	3,375	3,906	12,078	12,407	12,202
Goodwill	-	-	-	-	-
Other intangible assets	-	-	-	-	-
Other LT assets	-	-	-	-	-
Total assets	**14,300**	**16,137**	**25,840**	**28,225**	**30,805**
Short-term debt	158	1	1	1	1
Accounts payable	1,424	1,207	1,129	1,298	1,493
Other current liabilities	501	579	600	600	600
Total current liabilities	**2,083**	**1,787**	**1,730**	**1,900**	**2,094**
Long-term debt	863	823	800	800	800
Convertible debt	-	-	-	-	-
Other LT liabilities	420	427	434	434	434
Total liabilities	**3,366**	**3,037**	**2,965**	**3,134**	**3,329**
Minority interest	-	-	-	-	-
Preferred stock	-	-	-	-	-
Common stock	353	353	353	353	353
Retained earnings	10,581	12,747	22,523	24,738	27,123
Proposed dividends	-	-	-	-	-
Other equity and reserves	-	-	-	-	-
Total shareholders' equity	**10,934**	**13,100**	**22,876**	**25,091**	**27,476**
Total equity & liabilities	**14,300**	**16,137**	**25,840**	**28,225**	**30,805**
Liquidity (x)					
Current ratio	5.19	6.79	7.90	8.28	8.84
Interest cover	73.7	30.3	120.9	131.3	152.3
Leverage					
Net debt/EBITDA (x)	net cash	net cash	0.17	net cash	net cash
Net debt/equity (%)	net cash	net cash	3.1	net cash	net cash
Activity (days)					
Days receivable		48.5	52.3	38.9	37.5
Days inventory		99.0	162.7	174.9	166.9
Days payable		35.5	43.9	38.4	36.6
Cash cycle	-	111.9	171.1	175.4	167.7

Source: Nomura estimates

Strong balance sheet with free cash flow generating

Sterlite Technologies SOTL IN

TECHNOLOGY | INDIA

Initiation

NOMURA

NOMURA FINANCIAL ADVISORY AND SECURITIES (INDIA) PRIVATE LIMITED

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BUY

Action

We initiate coverage of SOTL with a BUY rating and a price target of Rs143. The company has a dominant position in the optical fibre and power conductor businesses in India, both of which have strong demand drivers in place. The company has recorded an EPS CAGR of above 45% over the past five years (2005-10) and expanded the capacity of both its product lines recently.

Catalysts

Recent capacity expansions and continuing demand for its products will likely to lead to EPS growth of more than 20% over the next few years.

Anchor themes

SOTL is a play on industrial (telecom) and infrastructure (power transmission) capex in India. In line with our theme – investment cycle at the cusp of inflection - we expect a pick-up in industrial and infrastructure capex, especially from FY12F.

Closing price on 15 Sep	Rs96.6
Price target	Rs143.0
Upside/downside	48.0%
Difference from consensus	14.4%
FY11F net profit (Rsmn)	2,626
Difference from consensus	3.3%

Source: Nomura

Nomura vs consensus

Our EPS estimates for FY11F and FY12F are in-line with consensus estimates.

From strength to strength

① Dominant market position in both product lines

Sterlite Technologies (SOTL) has a dominant market position in the optical fibre cable as well as power conductors businesses in India, and is a play on industrial (largely telecom) and power transmission capital expenditure in India and other emerging countries.

② Strong demand drivers in place

Both optical fibre and power conductor products have strong demand drivers in place, such as growth in the number of telecom subscribers, 3G and broadband penetration and the requirement to spend on the power transmission sector in India and other emerging countries. We believe growth in demand for both these businesses is robust and will likely continue over the next few years.

③ Capacity expansion will lead to EPS growth

The company is currently expanding the capacity of both its businesses by 60-70%. This, along with strong demand, will see the company record more than a 15% EPS CAGR over the next few years, on our reading.

④ Stock is relatively inexpensive

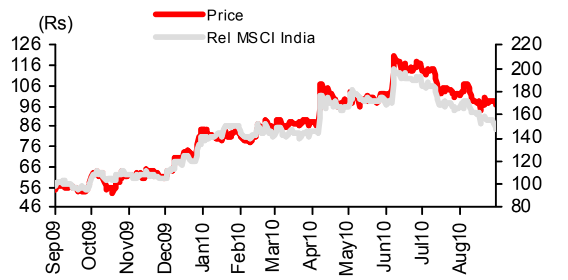
Given the growth prospects of the company, the stock is trading at an inexpensive multiple of 10.7x FY12F EPS of Rs9.53. We initiate coverage of the stock with a BUY rating and price target of Rs143, representing 15x FY12F EPS.

Key financials & valuations

31 Mar (Rsmn)	FY09	FY10	FY11F	FY12F
Revenue	22,892	24,316	28,606	34,357
Reported net profit	902	2,461	2,626	3,078
Normalised net profit	880	2,461	2,626	3,078
Normalised EPS (Rs)	2.73	7.62	8.13	9.53
Norm. EPS growth (%)	(15.1)	179.1	6.7	17.2
Norm. P/E (x)	35.6	13.2	12.3	10.5
EV/EBITDA (x)	16.5	9.4	8.3	6.9
Price/book (x)	5.0	3.4	2.7	2.1
Dividend yield (%)	2.6	3.0	3.0	3.0
ROE (%)	15.5	32.0	25.2	23.3
Net debt/equity (%)	67.4	16.2	10.7	2.5
Earnings revisions				
Previous norm. net profit		na	na	na
Change from previous (%)		na	na	na
Previous norm. EPS (Rs)		na	na	na

Source: Company, Nomura estimates

Share price relative to MSCI India



	1m	3m	6m
Absolute (Rs)	(5.3)	(5.2)	15.6
Absolute (US$)	(4.5)	(4.8)	13.6
Relative to Index	(12.5)	(16.1)	3.9
Market cap (US$mn)			741
Estimated free float (%)			0.0
52-week range (Rs)			121.1/53.4
3-mth avg daily turnover (US$mn)			1.81
Stock borrowability			
Major shareholders (%)			
Promotor Group			50.0

Source: Company, Nomura estimates

Investment argument and investment risks

Dominant market position …

We believe Sterlite is a play on both industrial (largely telecom) and power (mainly transmission) capex in the country and other emerging markets. The company enjoys a competitive advantage in terms of superior technology and dominant market-shares in the segments in which it operates. Based on the company's rapid capacity additions in the recent past, we estimate the company's operating profit will grow by 60% over the next three years

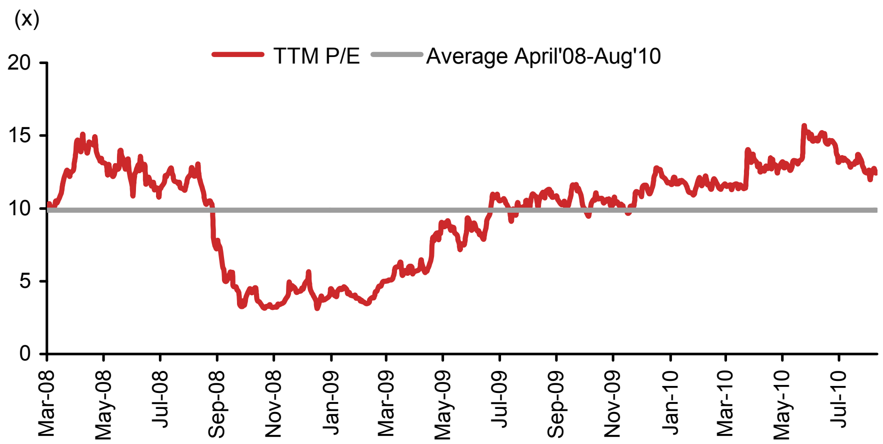
… with strong demand drivers in place

We expect good demand for the company's products – optical fibre and power conductors – over the next few years, on the back of demand drivers such as growth in the number of telecom subscribers, 3G and broadband penetration and necessity to spend on the power transmission sector in India and other emerging countries. We believe growth in demand for both these businesses is robust and is likely to continue over the next few years.

Relatively inexpensive valuations

The stock is currently trading at 10.7x FY12F EPS of Rs9.53. The company is currently expanding the capacity of both its businesses by 60-70%. This, along with strong demand, will likely result in a more than 15% EPS CAGR over the next few years, on our reading. We initiate coverage of the stock with a BUY rating and price target of Rs143 (15x FY12F EPS of Rs9.53). Based on pick-up in growth from FY12F , we expect a P/E re-rating of the stock and our target one-year forward P/E multiple is 13.6x or 15x FY12E EPS.

Exhibit 113. Trailing 12 Month P/E



Source: Bloomberg, Company data, Nomura research

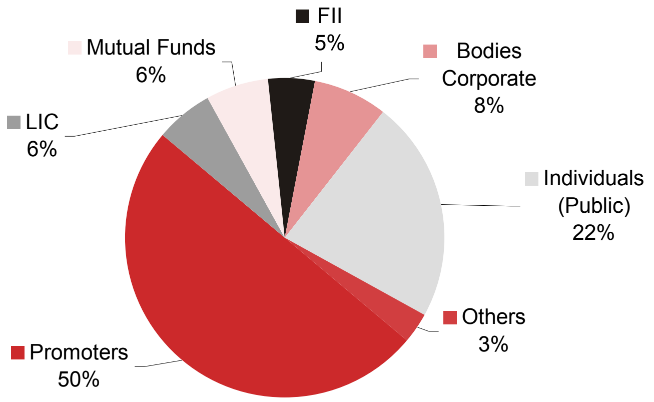
Investment risks

Delay in pick-up of capex cycle: Demand for optical fibre and cables is dependent on growth in the number of telecom subscriber, 3G and broadband services. Therefore, any major economic shock to the global economy could have a negative impact on growth of these demand drivers. Also, revenues of the power conductor business could be affected if transmission capex in India is delayed.

Promoter group write-up and shareholding pattern

SOTL is part of the Sterlite Group, which has diversified into non-ferrous metals and mining, with revenues of US$5bn in FY10. STOL, incorporated in 2000, was Sterlite Industries' de-merged telecom business arm.

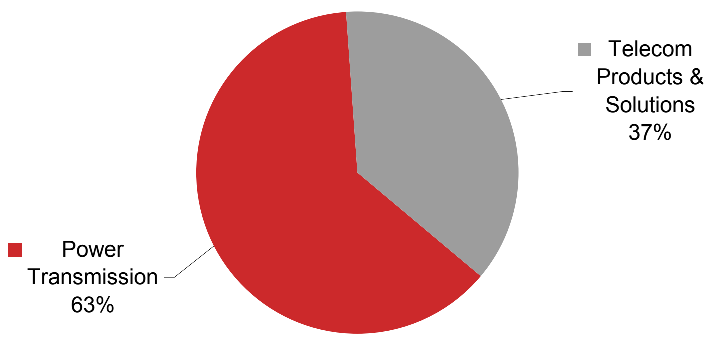
Exhibit 114. Shareholding Pattern as of 31 Match 2010



Source: Company data

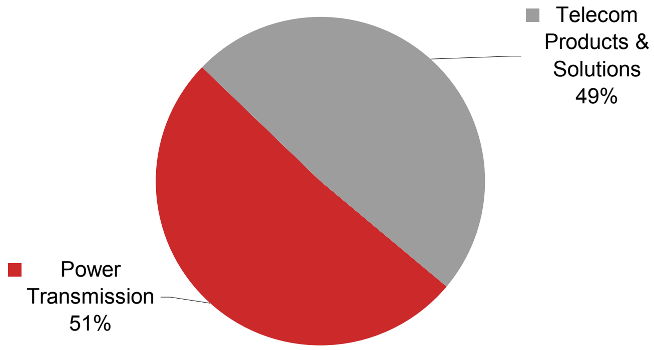
The company has two businesses – telecom and power – with relative contribution to revenue and EBITDA as given below

Exhibit 115. Revenue contribution (FY10)



Source: Company data

Exhibit 116. EBITDA contribution (FY10)



Source: Company data

Telecom business

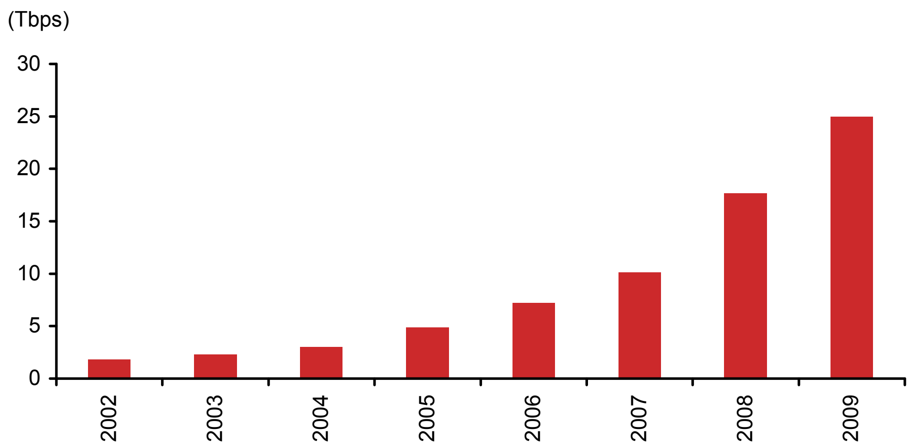
Telecom: optical fibre and cable

The company currently has a 45% market share in India for optical fibre and cables, according to management.

Demand for telecom optical fibre is linked to growth in the number of mobile and broadband subscribers and penetration of 3G services. This drives growth in the core network (city-to-city and within a city) and also in tier-2 cities and rural areas where there is no network.

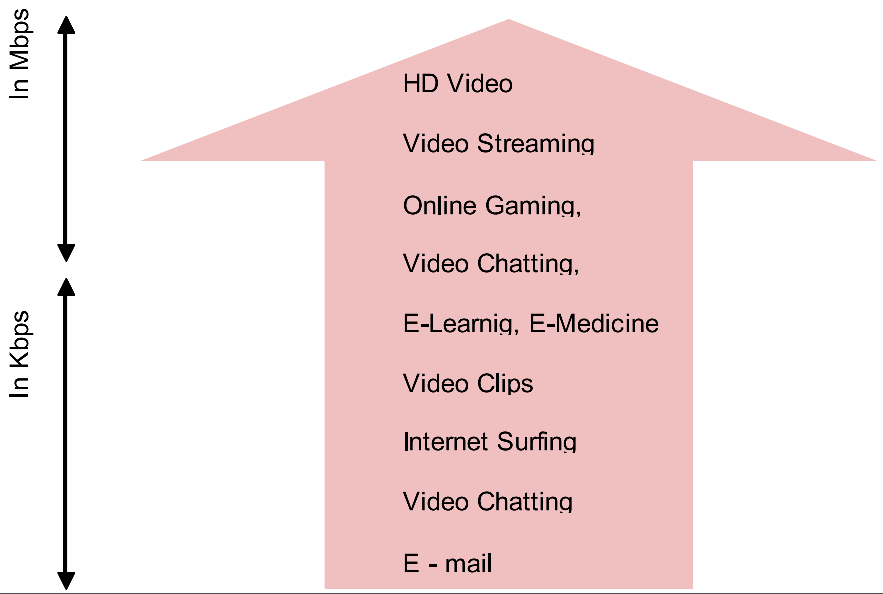
Demand for bandwidth

Exhibit 117. International bandwidth traffic



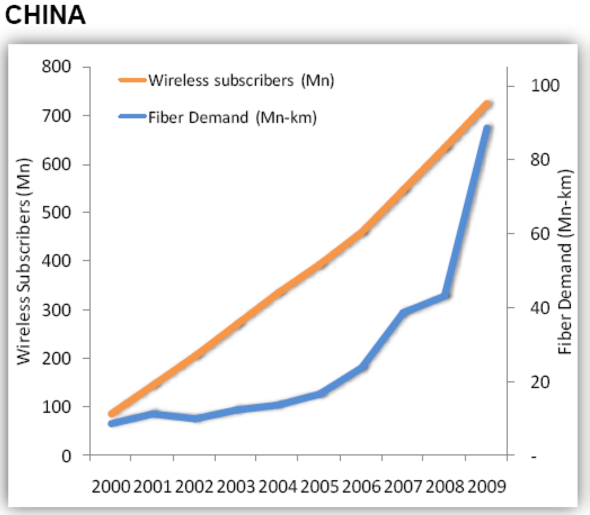
Source: Gigaom.com, Company data

Exhibit 118. Consumption of Bandwidth



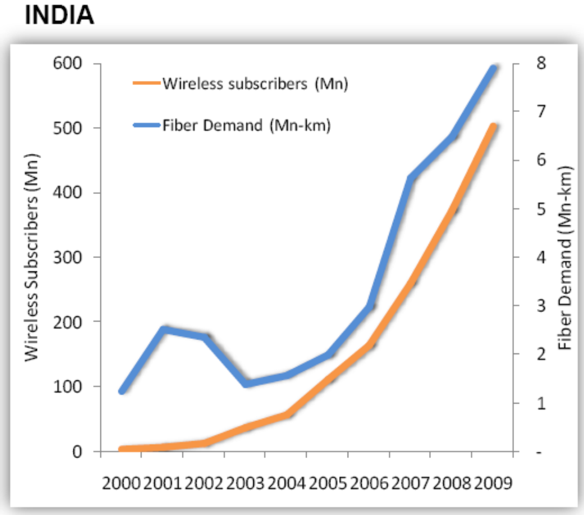
Source: Company data, Nomura research

Exhibit 119. China – wireless subscribers growth



Source: Company data, Nomura research

Exhibit 120. India – wireless subscribers growth



Note: India wireless subscribers in 2009 is on LTM basis ending 30-Sep-09

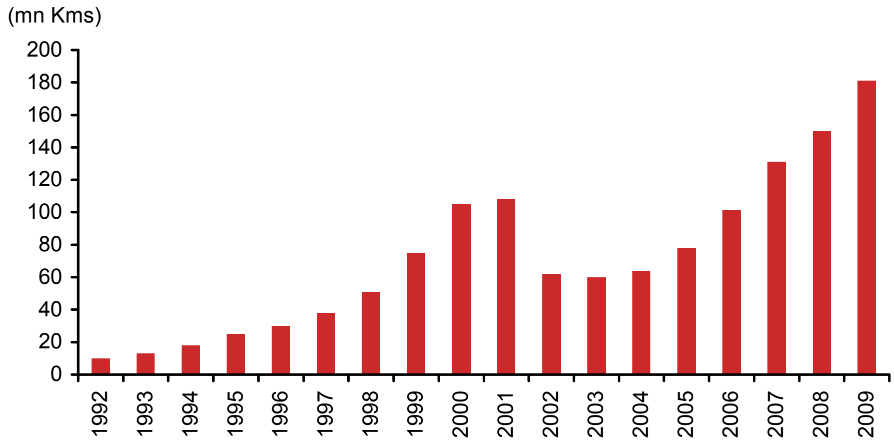
Source: Company data, Nomura research

Global demand for optical fibre largely comes from expansion of 3G and other networks by telecom service providers (TSP) in China and expansion of telecom network in other parts of the world.

- Countries such as the US, Japan, Germany, Portugal, South Korea and Netherlands continue to build Fiber-to-the-Node and Fiber-to-the-Home (FTTH) networks.
- European countries (especially the UK, France, Scandinavia) and North America (US and Canada) consumed fibre to ease bandwidth pressure, owing to further penetration of 3G and the anticipated launch of 4G services.
- Developing regions such as Africa and South America are still building their optical backbone networks.
- India and other countries in South-East Asia deployed fibre networks in the mobile backhaul to cater to the increased bandwidth requirement due to their burgeoning wireless subscriber base.
- The biggest consumer, however, was China, which accounted for 46% of global demand in 2009. This can be put into perspective by noting that in 2009, 85mn kms of fibre was consumed in China, of total global demand of 183mn km. Demand was driven by network operators who continued to deploy fibre in the backbone, in the mobile backhaul for its 2G users, in anticipation of 3G/4G usage growth, for FTT X and to provide improved connectivity to their businesses, cities and citizens.

According to management, India's predominant microwave centric backbone network is all set to be transformed into a fibre-based one, resulting in to good demand for fibre in the country. Also, in 1Q FY11, the Indian defence force announced a tender for a major optical fibre requirement of almost 60,000 route kms network, which translates into fibre demand of almost 3mn kms. The government of India, through Bharat Sanchar Nigam Limited (BSNL), has announced that it is likely to spend Rs180bn to lay almost 500,000 km of optical fibre backbone network to ensure than broadband connectivity reaches every *Panchayat* in the country.

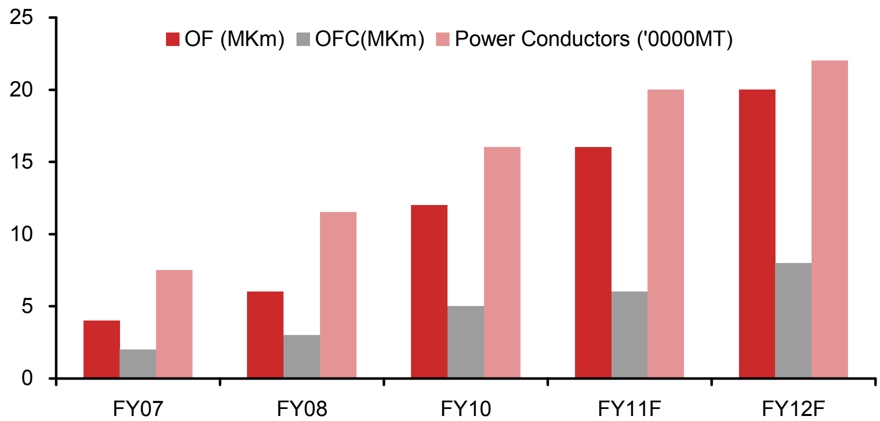
Exhibit 121. Global fibre demand



Source: CRU, UK – January 2010, Company data

STOL announced its plans to enhance the company's optical fibre annual manufacturing capacity to 20mn-km, which would position the company amongst the top-three manufacturers globally. The company's current facility of 6mn-km is already being expanded to 12mn-km, which will become functional in the current fiscal year. The enhanced capacity of 20mn-km, which is expected to be functional by 2011, would require a capex outlay of Rs2,500mn (US$52mn).

Exhibit 122. Capacity expansion across business



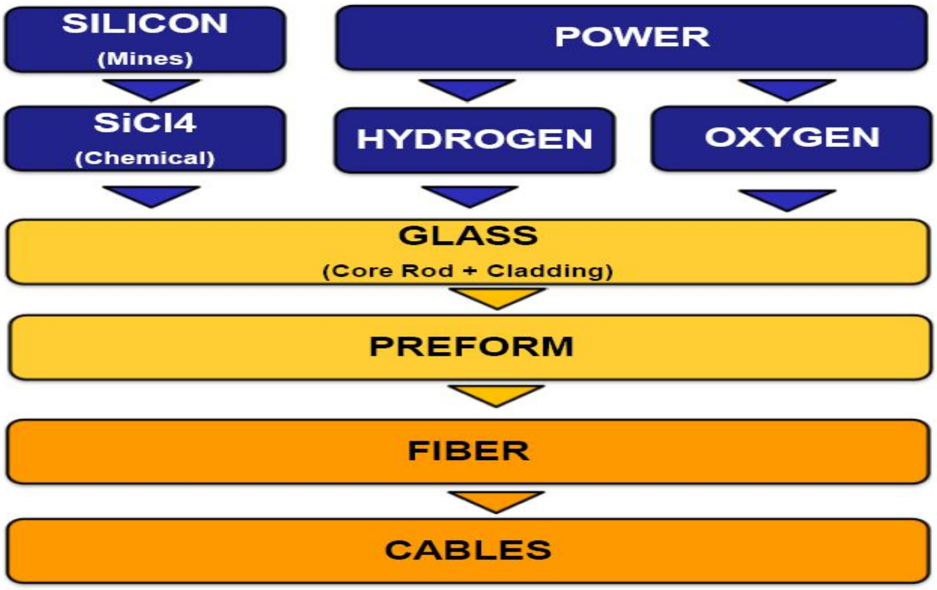
Source: Company data, Nomura estimates

Entry barriers for 'preform' technology

The company has, over a period of time, perfected 'pre-form' technology which is used to convert silica into fibre. According to management, only seven large players in the world have this technology, and none of them are Chinese, thus limiting the pricing pressure in the industry. In India, SOTL is the only player to have this technology, and it supplies fibre to meet in-house requirements (around 30% of total), as well as to other cable manufacturing units such as Aksh, Vindhyar.

Only seven players have 'pre-form' technology in the world: Corning (capacity: 35mn-km), Furkawa (28-29mn-km), Draka (19-20mn-km), Fujikawan (16-17mn-km), SOTL (12mn-km), Sumitomo (10-15mn-km) and Fresbian (10-15-mn-km).

Exhibit 123. Company Fully Integrated Optical Manufacturing Facility



Source: Company data

The company's capacity expansion from 12mn-km to 20mn-km will make it the third-largest manufacturer of optical fibre in the world, behind Corning (USA) and Furkawa (Japan).

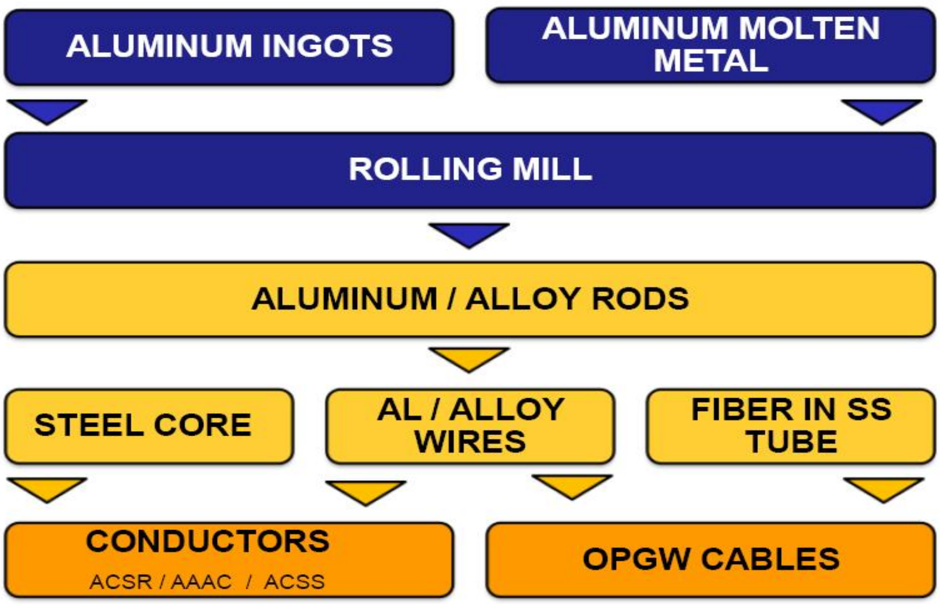
Power business

Power conductors

Currently, SOTL is the largest manufacturer of power conductors in the world, with a capacity of 160,000 MT, which the company expects to increase to 200,000 MT by end-FY11.

In India, 25% of India's national grid is developed using SOTL's conductors, and the company which has supplied 35% of Power Grid Corporation of India Limited (PGCIL) total conductor requirements, according to Crisil.

Exhibit 124. Company Totally Integrated Power Conductors Facility

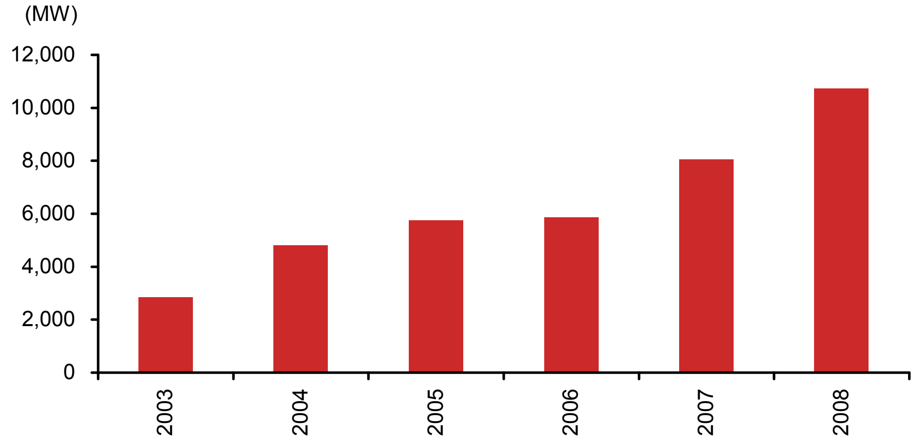


Source: Company data

The main growth driver of the power conductor business is:

- Lag in transmission capacity: In India, investment in transmission capacity has significantly lagged investments in power generation.

Exhibit 125. Power generation Capacity added per year in India



Source: Company data, Nomura research

Exhibit 126. Transmission capacity in India

Source: Company data, Nomura research

- Major investments have been planned to strengthen the transmission grid in the country, with an investment of US$95bn outlined under the Eleventh Five-Year Plan (2007-2012) and US$140 bn under the Twelfth Five-Year Plan (2012-2017). As a rule of thumb, conductor capex is generally 9-10% of generation capex.
- Recently, Power Grid Corporation announced its mega plan to invest Rs640bn (apart from the Eleventh Five-Year Plan investments) over the next five to six years to build nine high-capacity transmission super highways across the country to carry power from new generation projects in Orissa, Sikkim, Jharkhand, Chattisgarh, Madhya Pradesh, Andhra Pradesh and Tamil Nadu. These proposed corridors will add around 23,000 circuit kilometres of line length and 65,000 MVA of transmission capacity to India’s transmission capability. The Rs80bn Orissa corridor is being taken up first for implementation for which the tendering process has already been initiated.
- The other drivers of global conductor demand are:
  - In a number of developed markets, a significant proportion of T&D infrastructure is nearing the end of their design life of 35-40 years. Indeed, utilities are evaluating whether to maintain and refurbish the current equipment for a few

more years or to pump in additional investments to upgrade and commission intelligent, high-capacity transmission networks.

- Renewable energy installations also demand that new T&D infrastructure, which recognises the variable nature of power generation, is available to reduce losses and better utilise the generated electricity. Smart grids and intelligent metering systems will also benefit from newer transmission grids, compared with the existing networks.
- The growing awareness about reducing T&D losses and, thus, contributing towards a more 'green planet' has resulted in individuals and corporations increasingly demanding that utilities find energy-efficient alternatives.

- In emerging and under-developed markets, investments in the transmission grid still continue to be high. After years of an unbalanced focus on power generation and distribution networks, utilities are working overtime to eliminate the wasteful imbalances that have been created. Consequently, the transmission sector is benefiting from such historical under-investments. For instance, in Africa, the US$800mn power transmission interconnected project, linking Zambia, Tanzania and Kenya is expected to start towards the end of this year. This transmission link will facilitate power transmission between southern and eastern Africa and also rural communities along the project, which would access the electricity. In Latin America, Chile is moving ahead to interconnect the country's northern and central transmission grids at a cost of US$1bn. In the long term, this interconnection is expected to improve system reliability, provide greater security for the National Transmission Network and have diversified generation.

Exhibit 127. SOTL's order book

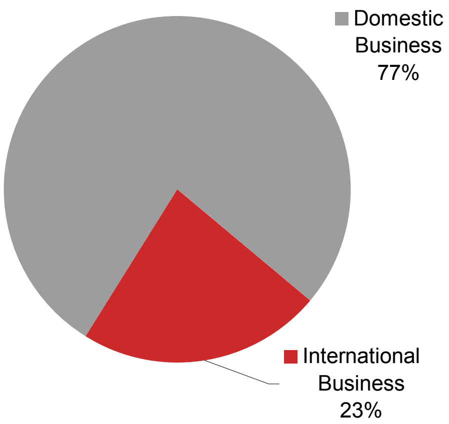
	(Rs mn)	
Order Book (Q/E)	**Mar-10**	**Jun-10**
Power Business	9,000	18,000
Telecom business	15,000	8,000
Total	**24,000**	**26,000**

Source: Company data

Global footprint

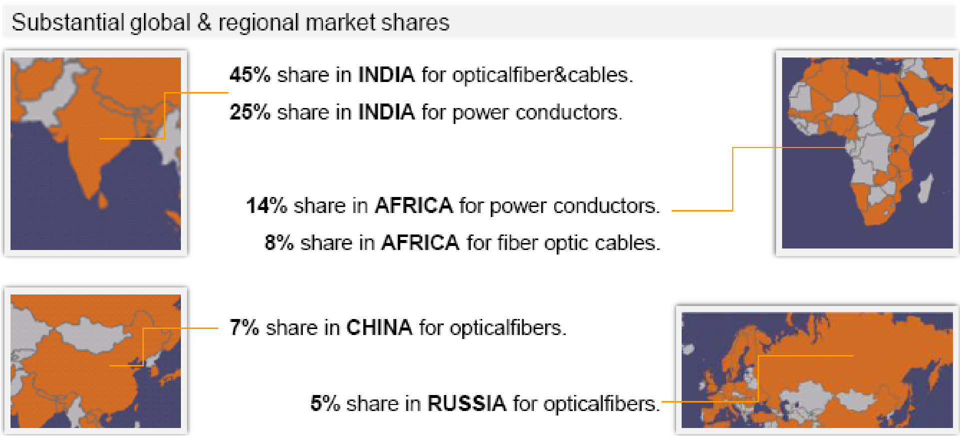
The company exports optical fibre as well as power conductors to more than 30 countries in the world and has a decent presence in markets such as Africa, Russia, and Europe.

Exhibit 128. Revenue contribution (FY10)



Source: Company data, Nomura research

Exhibit 129. Sterlite Industries – global footprint



Source: Company data

As of early-2Q FY11, the company had a strong order book of more than Rs26,000mn (~US$580mn), compared with an order book of Rs1,600mn (~ US$356mn) at end-1Q FY10.

Financial analysis and projections

The company's revenue, EBIDTA and EPS have each grown at a CAGR of more than 45% over the past four years (FY06-FY10).

Exhibit 130. Company performance

(Rs mn)	FY07	FY08	FY09	FY10
Revenue	11,982	16,858	22,892	24,316
EBITDA	1,209	1,967	2,342	3,810
EPS	1.72	3.22	2.80	7.61

Growth rate (y-y, %)	FY08	FY09	FY10
Revenue (%)	41	36	6
EBITDA (%)	63	19	63
EPS (%)	87	(13)	172

Source: Company data

Other financial indicators, such as debt/equity ratio, FCF, net working capital days and ROCE have also improved, as shown below.

Exhibit 131. Company's performance

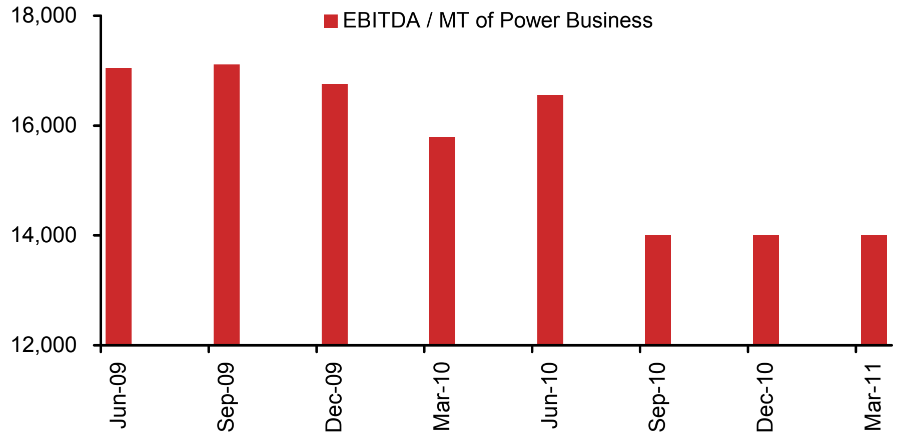
(Rs mn)	FY07	FY08	FY09	FY10	FY11F	FY12F
FCF	326	(623)	3,305	2,584	554	1,183
D/E	1.41	1.23	0.80	0.39	0.31	0.24
ROCE (%)	9	14	18	28	25	24

Source: Company data, Nomura research

Assumptions

- We have assumed its power business volumes would rise from 124,000MT in FY10 to 145,000MT in FY11F and 170,000MT in FY12F.
- We have also assumed the company's optical fibre volumes to rise from 8.2mn-km to 10.5mn-km in FY11F and 13.50mn-km in FY12F.
- We have assumed an EBITDA of Rs14,000/tonne for power conductors.

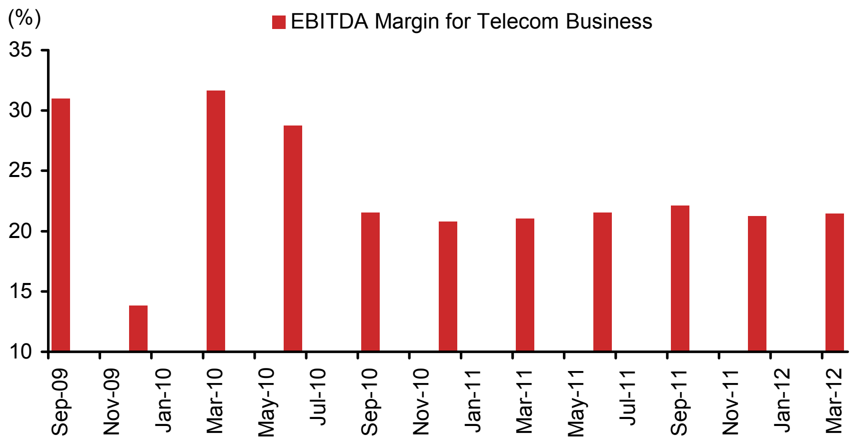
Exhibit 132. EBITDA/MT for Power Business



Source: Company data, Nomura research

We have assumed a 35% EBITDA margin for its optical fibre business and a 15% EBITDA margin for its optical fibre cables business for the next two years.

Exhibit 133. EBITDA Margin for Telecom Business



Source: Company, Nomura Research

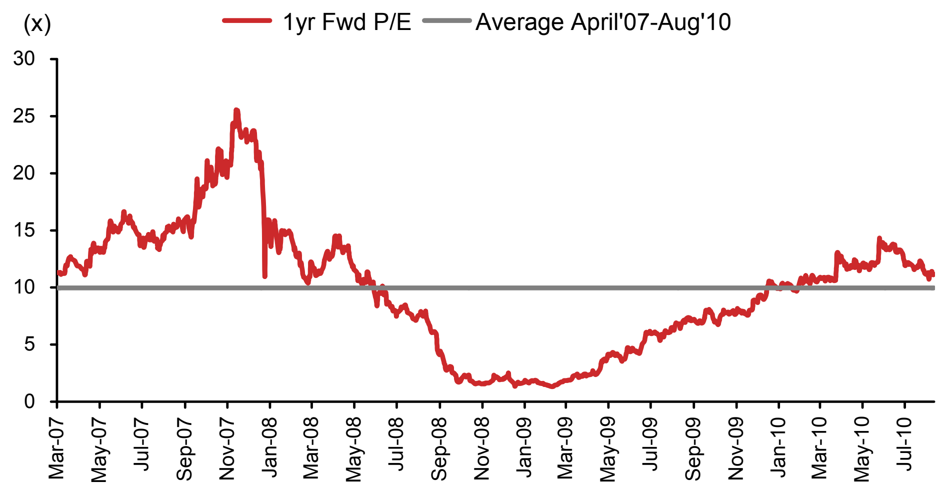
Valuation methodology and risks

SOTL is currently trading at 10.7x FY12F EPS of Rs9.53. We have valued the company based on a P/E of 15x FY12F EPS, which results in a price target of Rs143, representing 48% potential upside from current levels. We expect the company's EPS growth to pick up from FY12F and is likely to sustain a CAGR of 15%-20% for at least three years. Based on this, we expect a P/E re-rating of the stock and our target one-year forward P/E multiple is 13.6x.

Investment risks

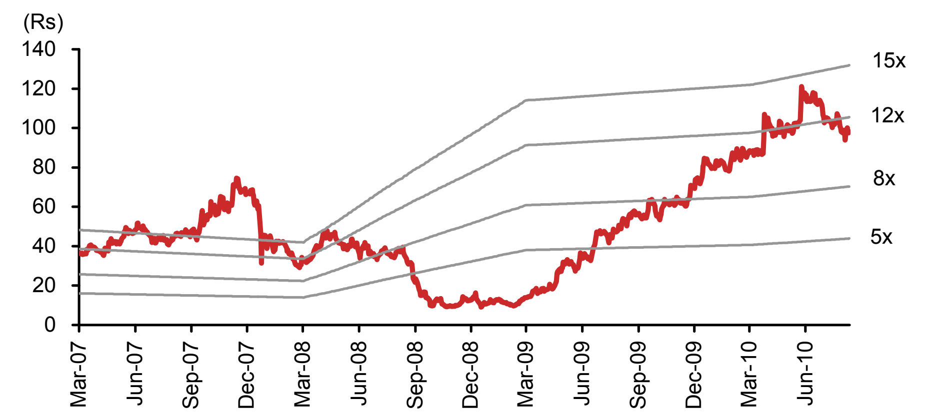
Delay in pick-up of capex cycle: Demand for optical fibre and cables is dependent on growth in the number of telecom subscriber, 3G and broadband services. Therefore, any major economic shock to the global economy could have a negative impact on growth of these demand drivers. Also, revenues of the power conductor business could be affected if transmission capex in India is delayed.

Exhibit 134. One-year forward PER



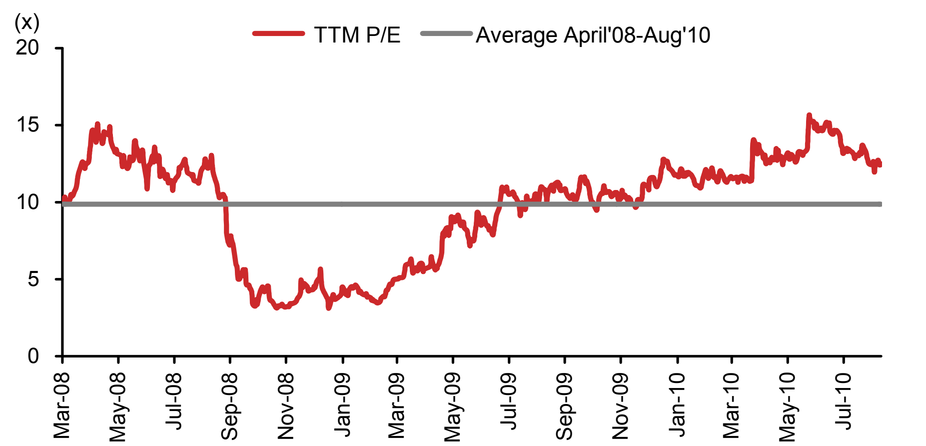
Source: Bloomberg, Company data, Nomura research

Exhibit 135. One-year forward PER band



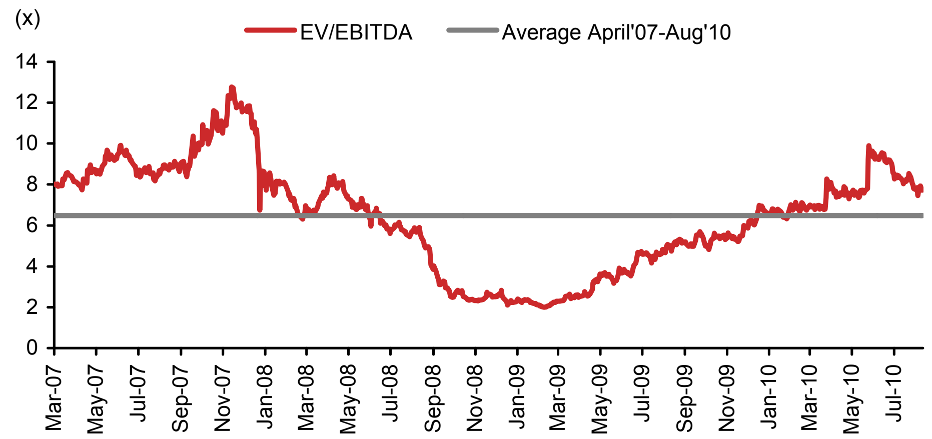
Source: Bloomberg, Company data, Nomura research

Exhibit 136. Trailing 12-month P/E



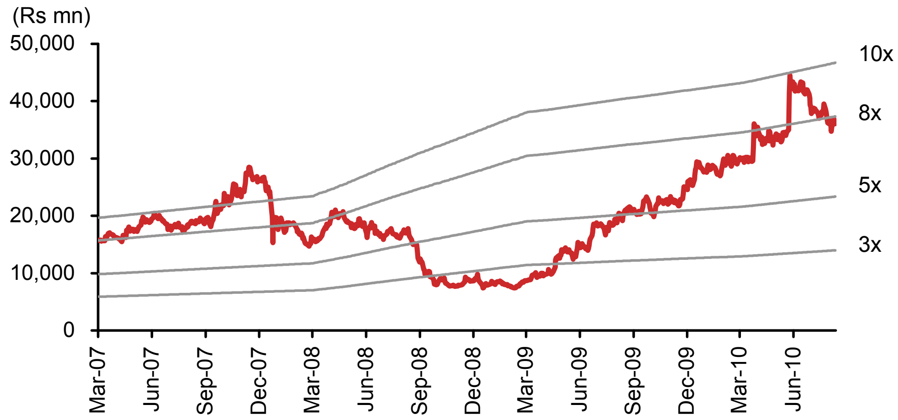
Source: Bloomberg, Company data, Nomura research

Exhibit 137. One-year forward EV/EBITDA



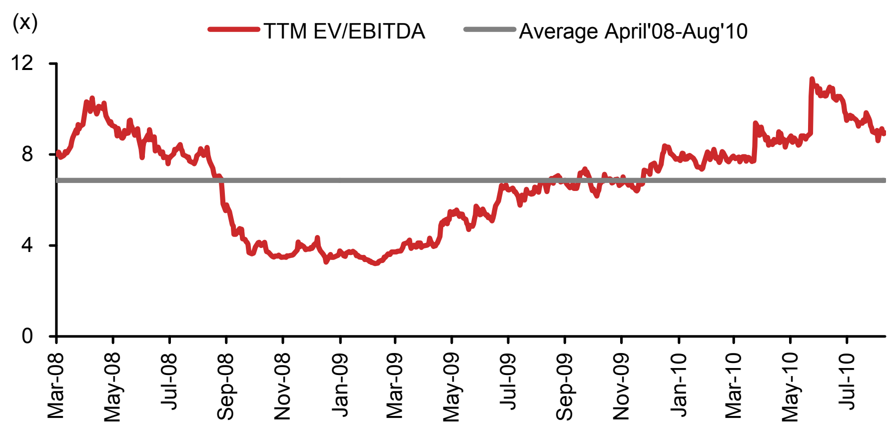
Source: Bloomberg, Company Data, Nomura Research

Exhibit 138. One-year forward EV/EBITDA Band



Source: Bloomberg, Company data, Nomura research

Exhibit 139. Trailing 12-month EV/EBITDA



Source: Bloomberg, Company data, Nomura research

Financial statements

EPS growth expected to pick up from FY12F onwards

Income statement (Rsmn)					
Year-end 31 Mar	FY08	FY09	FY10	FY11F	FY12F
Revenue	16,858	22,892	24,316	28,606	34,357
Cost of goods sold	(12,551)	(17,394)	(16,537)	(19,702)	(23,827)
Gross profit	**4,307**	**5,498**	**7,779**	**8,904**	**10,531**
SG&A	(2,712)	(3,582)	(4,452)	(5,225)	(6,269)
Employee share expense	-	-	-	-	-
Operating profit	**1,595**	**1,916**	**3,327**	**3,679**	**4,262**
EBITDA	**1,967**	**2,342**	**3,810**	**4,315**	**5,068**
Depreciation	(372)	(425)	(483)	(636)	(807)
Amortisation	-	-	-	-	-
EBIT	**1,595**	**1,916**	**3,327**	**3,679**	**4,262**
Net interest expense	(332)	(905)	(381)	(313)	(322)
Associates & JCEs	-	-	-	-	-
Other income	41	62	229	89	111
Earnings before tax	**1,304**	**1,073**	**3,175**	**3,455**	**4,050**
Income tax	(297)	(193)	(714)	(829)	(972)
Net profit after tax	**1,007**	**880**	**2,461**	**2,626**	**3,078**
Minority interests	-	-	-	-	-
Other items					
Preferred dividends					
Normalised NPAT	**1,007**	**880**	**2,461**	**2,626**	**3,078**
Extraordinary items	-	21	-	-	-
Reported NPAT	**1,007**	**902**	**2,461**	**2,626**	**3,078**
Dividends	(530)	(803)	(945)	(945)	(945)
Transfer to reserves	**477**	**99**	**1,516**	**1,681**	**2,133**
Valuation and ratio analysis					
FD normalised P/E (x)	31.2	35.6	13.2	12.3	10.5
FD normalised P/E at price target (x)	46.2	52.7	19.5	18.3	15.6
Reported P/E (x)	30.0	34.6	12.7	11.9	10.1
Dividend yield (%)	1.8	2.6	3.0	3.0	3.0
Price/cashflow (x)	51.9	6.6	9.0	11.1	9.8
Price/book (x)	5.6	5.0	3.4	2.7	2.1
EV/EBITDA (x)	20.4	16.5	9.4	8.3	6.9
EV/EBIT (x)	25.1	20.1	10.8	9.7	8.1
Gross margin (%)	25.6	24.0	32.0	31.1	30.7
EBITDA margin (%)	11.7	10.2	15.7	15.1	14.8
EBIT margin (%)	9.5	8.4	13.7	12.9	12.4
Net margin (%)	6.0	3.9	10.1	9.2	9.0
Effective tax rate (%)	22.8	18.0	22.5	24.0	24.0
Dividend payout (%)	52.6	89.1	38.4	36.0	30.7
Capex to sales (%)	7.2	6.3	3.6	7.9	5.8
Capex to depreciation (x)	3.2	3.4	1.8	3.5	2.5
ROE (%)	na	15.5	32.0	25.2	23.3
ROA (pretax %)	na	12.5	19.9	19.3	18.9
Growth (%)					
Revenue		35.8	6.2	17.6	20.1
EBITDA		19.1	62.7	13.3	17.5
EBIT		20.1	73.6	10.6	15.8
Normalised EPS		(15.1)	179.1	6.7	17.2
Normalised FDEPS		(12.2)	170.3	6.7	17.2
Per share					
Reported EPS (Rs)	3.22	2.80	7.62	8.13	9.53
Norm EPS (Rs)	3.22	2.73	7.62	8.13	9.53
Fully diluted norm EPS (Rs)	3.09	2.72	7.34	7.83	9.18
Book value per share (Rs)	17.23	19.25	28.36	36.20	45.43
DPS (Rs)	1.69	2.49	2.93	2.93	2.93

Source: Nomura estimates

Cashflow (Rsmn)					
Year-end 31 Mar	**FY08**	**FY09**	**FY10**	**FY11F**	**FY12F**
EBITDA	1,967	2,342	3,810	4,315	5,068
Change in working capital	(1,415)	2,355	(178)	(681)	(913)
Other operating cashflow	31	59	(162)	(829)	(972)
Cashflow from operations	**583**	**4,755**	**3,469**	**2,804**	**3,183**
Capital expenditure	(1,206)	(1,451)	(885)	(2,250)	(2,000)
Free cashflow	**(623)**	**3,305**	**2,584**	**554**	**1,183**
Reduction in investments	28	(860)	(141)	-	-
Net acquisitions	-	-	-	-	-
Reduction in other LT assets	105	79	238	-	-
Addition in other LT liabilities	-	-	-	-	-
Adjustments	(3)	71	(167)	89	111
Cashflow after investing acts	**(494)**	**2,595**	**2,514**	**643**	**1,294**
Cash dividends	(53)	(80)	(95)	(95)	(95)
Equity issue	252	-	419	271	-
Debt issue	765	(1,702)	(1,384)	-	-
Convertible debt issue	-	-	-	-	-
Others	(369)	(924)	(136)	(584)	(322)
Cashflow from financial acts	**595**	**(2,707)**	**(1,195)**	**(407)**	**(417)**
Net cashflow	**101**	**(112)**	**1,318**	**236**	**877**
Beginning cash	789	891	779	2,097	2,333
Ending cash	891	779	2,097	2,333	3,209
Ending net debt		4,187	1,485	1,249	372

Source: Nomura estimates

Balance sheet (Rsmn)					
As at 31 Mar	**FY08**	**FY09**	**FY10**	**FY11F**	**FY12F**
Cash & equivalents	891	779	2,097	2,333	3,209
Marketable securities	60	60	-	-	-
Accounts receivable	5,191	5,459	6,290	7,399	8,887
Inventories	2,194	1,004	1,709	2,011	2,415
Other current assets	1,689	2,012	1,567	1,843	2,213
Total current assets	**10,025**	**9,313**	**11,663**	**13,585**	**16,725**
LT investments	-	860	1,061	1,061	1,061
Fixed assets	5,601	6,567	6,834	8,448	9,642
Goodwill	-	-	-	-	-
Other intangible assets	-	-	-	-	-
Other LT assets	-	-	-	-	-
Total assets	**15,626**	**16,740**	**19,558**	**23,095**	**27,427**
Short-term debt	1,790	1,292	331	331	331
Accounts payable	3,035	4,791	5,704	6,710	8,059
Other current liabilities	-	-	-	-	-
Total current liabilities	**4,825**	**6,083**	**6,034**	**7,040**	**8,389**
Long-term debt	4,842	3,674	3,251	3,251	3,251
Convertible debt	-	-	-	-	-
Other LT liabilities	564	774	1,112	1,112	1,112
Total liabilities	**10,231**	**10,530**	**10,397**	**11,403**	**12,752**
Minority interest	-	-	-	-	-
Preferred stock	-	-	-	-	-
Common stock	322	323	711	982	982
Retained earnings	5,016	5,834	8,139	10,670	13,654
Proposed dividends	-	-	-	-	-
Other equity and reserves	57	53	310	39	39
Total shareholders' equity	**5,395**	**6,209**	**9,160**	**11,691**	**14,675**
Total equity & liabilities	**15,626**	**16,740**	**19,558**	**23,095**	**27,427**
Liquidity (x)					
Current ratio	2.08	1.53	1.93	1.93	1.99
Interest cover	4.8	2.1	8.7	11.8	13.2
Leverage					
Net debt/EBITDA (x)	net cash	1.79	0.39	0.29	0.07
Net debt/equity (%)	net cash	67.4	16.2	10.7	2.5
Activity (days)					
Days receivable		84.9	88.2	87.3	86.7
Days inventory		33.5	29.9	34.5	34.0
Days payable		82.1	115.8	115.0	113.4
Cash cycle	-	36.3	2.3	6.8	7.3

Source: Nomura estimates

Strong balance sheet with free cashflow

GEI Industrial Systems GEIN IN

TECHNOLOGY | INDIA

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NOT RATED

Key findings

India is expected to add more than 100GW of power-generation capacity in the next five years and GEI industrial is expected to benefit significantly, since its products, such as air-cooled heat exchangers are seeing increasing use amid scarcity of water across much of the country. The company has expanded capacity some 5x recently and this, along with firm demand, is likely to result in solid EPS growth for the company in the next few years, per the company.

Business model	**SUPERIOR**	SUSTAINABLE	INFERIOR
Earnings/cashflow growth	**HIGH**	AVERAGE	LOW
Earnings/cashflow quality	**HIGH**	AVERAGE	LOW
Financial strength	STRONG	**ADEQUATE**	WEAK
Corporate governance	**TRANSPARENT**	ADEQUATE	LIMITED
Investment liquidity	HIGH	ADEQUATE	**LOW**
Volatility	LOW	**MEDIUM**	HIGH

NUGGETS

Non-rated ideas from Nomura

Company description

The company is a leader in air-cooled steam condensers in India and is a play on both power and oil & gas capex in India. The company has executed more than 90 projects in the power sector, with a total installed base of more than 2300MW and has a marquee set of clients.

Closing price on 14 Sep, 2010 Rs167.4

Growing profitably

① Largest player in air-cooled heat-exchangers in India

The company has a 70% market share in the air-cooled steam condenser market in India — a market expected to grow fast since scarcity of water is pushing power generators to prefer air-cooled to water-cooled units. The company has developed efficient technology (fin-based) that makes it cost-competitive against international players, such as SPX and GEA.

② Creating energy creates heat and it is key to lose that heat

GEI products contribute 5% to 7% of capex of a thermal power plant — which contributes 60% of a company's revenues. It also manufactures air-cooled heat exchangers for the oil & gas sector — this is where the remaining 40% of revenue comes from. The company has until now handled cooling for plants up to 150MW and plans to move to higher capacities (300MW-600 MW) down the road.

③ India power generation capacity on significant ramp-up

India has the fifth-largest power capacity in the world and plans to add 100GW of power capacity in the 12th five-year plan, out of which 75GW is coal-based thermal (CEA). This opens up wide opportunities for GEI Industrial: cooling is absolutely essential to all thermal power plants

④ Resulting in build-up in orderbook for the company

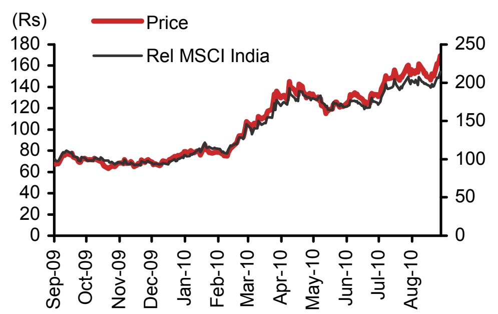
The company has an orderbook of more than INR3.5bn and the company plans to increase capacity from 1000MW to 5000MW by FY12F. This, along with robust demand, is expected to result in an EPS CAGR of 30-40% in the next few years, per management.

Key financials

FY 31 March (Rsmn)	FY07	FY08	FY09	Guided
Revenue	1,084	1,867	2,135	⇧
Reported net profit	53.0	89.7	103.7	⇩
Reported EPS	4.1	6.4	7.3	⇔
Rep EPS growth (%)	23.6	54.8	13.3	⇧
Rep P/E (x)	40.4	26.1	23.0	⇩
Price/book (x)	5.1	3.5	3.2	⇔
Dividend yield (%)	0.8	1.0	0.8	⇧
ROE (%)	12.6	16.4	14.5	⇩
Net debt/equity (%)	Net cash	55.5	68.6	⇔

Source: Company data

Share price relative to MSCI India



	1m	3m	6m
Absolute (Rs)	9.7	33.9	60.3
Absolute (US$)	10.6	34	57.3
Relative to Index	3	21.8	45.5
Market cap (US$mn)			59.9
Estimated free float (%)			45.5
52-week range (Rs)			174.9/62.1
3-mth avg daily turnover (US$mn)			.3
Major shareholders (%)			45.5
Indian Promotors			41.9
Indian Public			36.8

Source: Bloomberg

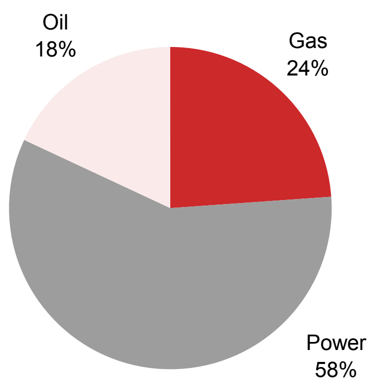
Drilling down

Local market leader in air-cooled steam condenser and heat exchangers

The company provides air-cooled solutions largely to the power and oil & gas sectors. In the power sector, the company makes air-cooled steam condensers required for cooling steam coming out of turbines and re-circulating the water. Air-cooled steam condensers are a critical component in biomass based and coal-based power plants. Some 58% of company revenue is from the power sector. The company also makes air-cooled heat exchangers for offshore gas platforms, gas-processing stations, gas transportation network, booster stations and LNG terminals.

Where there is power there is heat: where there is heat it must be dissipated

Exhibit 140. Revenue contribution for FY10F



Note: Contribution breakdown by industry to total company revenue

Source: Company data

Air-cooled is becoming widely-used owing to water shortages

Until recently, water was widely-used for the cooling and condensing needs of power plants in India. However, water is becoming increasingly scarce with the increase in the number of power plants and demand pressure via industry and population. Increased urbanisation and industrialisation is driving up water usage. The plant utilisation factor (PUF) of several thermal power plants in states such as Rajasthan and MP has come down on a lack of water for cooling. This has led to several power-generating companies moving from water-based to air-based cooling, which has also been found to have lower costs of overall ownership over the life of a plant: see the Exhibit below for comparison between water and air-based cooling).

Water is just too precious a resource to be used as an industrial coolant

Exhibit 141. Water-cooled steam condensers vs air-cooled steam condensers

	Water-cooled	Air-cooled
Availability of coolant	Limited	Abundant
Choice of plant location	Restricted to availability of water	Unrestricted
Material of construction	Water is corrosive	Air is non-corrosive
Failure of one fan	Complete shut-down	Natural draft cooling on
Fouling	Yes	No
Cleaning	Frequent and cumbersome	Less frequent and easy
Maintenance cost	High	Quarter of water-cooled

Source: Company, Nomura research

Huge power generation capacities planned in India

The Central Electricity Authority (CEA) has forecast 100GW of power capacity addition in the 12th five-year plan, of which some 75GW is coal-based thermal. Also, per PWC, it is estimated that some 30% of the total energy requirement of the Indian industry is now met through in-house power plants.

Exhibit 142. Power capacity addition proposed during 11th five-year plan

			Thermal break-up			(Figures in MW)	
	Hydro	Total thermal	Coal	Lignite	Gas	Nuclear	Total
Project commissioned	-	-	-	-	-	220	220
Projects under construction	14,431	31,364	26,625	1,200	3,539	3,160	48,955
Committed Projects (order yet to be placed)	2,122	27,280	26,280	250	750	-	29,402
Total	**16,553**	**58,644**	**52,905**	**1,450**	**4,289**	**3,380**	**78,577**

Source: Planning Commission

Exhibit 143. Power capacity addition proposed for 12th five-year plan

			(Figures in MW)	
	Hydro	Total thermal	Nuclear	Total
Project commissioned	30,000	42,200	10,000	82,200

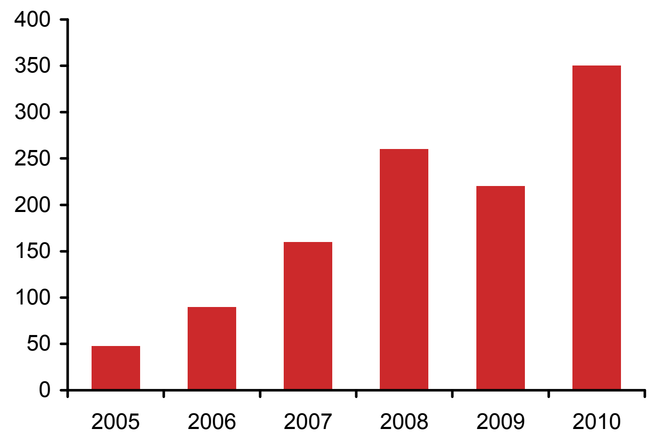
Source: Planning Commission

Resulting in good orderbook and customer profile-

Owing to its success in air-based cooling, the company has executed more than 90 projects in the capacity range of 6 to 150MW (total installed base — 2315MW to March 2010) in the power sector. The list of the customers includes Jaypee Group (6 x 60MW), Shree Cements (2 x150 MW) and several others.

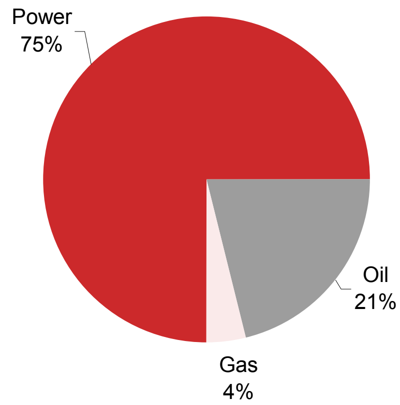
The company also manufactures air-cooled heat exchangers, which are used across the oil & gas industry from upstream production to refineries and petrochemical plants

Exhibit 144. Continuous growth in orderbook (Rs crores) at end of each financial year (March)



Source: Company data

Exhibit 145. Sectoral break-up of orderbook as of end-March, 2010



Source: Company data

Financial statements

Profit and loss (Rsmn)				
Year-end 31 March	**FY07**	**FY08**	**FY09**	**FY10**
Revenue	1,084	1,867	2,135	2,508
Cost of goods sold	(757)	(1,317)	(1,516)	(1,550)
Gross profit	**326**	**551**	**619**	**958**
SG&A	(181)	(264)	(345)	(587)
Operating profit	146	287	274	371
EBITDA	**160**	**303**	**292**	**395**
Depreciation and Amortisation	(15)	(16)	(18)	(24)
EBIT	**146**	**287**	**274**	**371**
Net interest expense	(47)	(94)	(113)	(138)
Other income	4	4	11	22
Income tax	(35)	(61)	(67)	(79)
Net profit after tax	**68**	**136**	**105**	**175**
Extraordinary items	(15)	(47)	(1)	(4)
Reported NPAT	**53**	**90**	**104**	**171**

Source: Company data

70% y-y growth in PAT in FY10

Balance sheet (Rsmn)				
As at 31 March	**FY07**	**FY08**	**FY09**	**FY10**
Cash and equivalents	96	74	124	95
Marketable securities	0	0	0	0
Accounts receivable	560	608	631	743
Inventories	427	507	864	1,019
Other current assets	60	110	158	187
Total current assets	**1,143**	**1,299**	**1,777**	**2,045**
Long-term investments	1	13	20	20
Fixed assets	227	380	420	427
Other LT Assets	5	2	5	5
Total assets	**1,375**	**1,693**	**2,223**	**2,498**
Short-term debt	172	236	396	396
Accounts payable	376	253	320	378
Other current liabilities	192	294	470	554
Total current liabilities	**741**	**783**	**1,186**	**1,328**
Long-term debt	192	209	247	247
Other LT liabilities	22	32	33	33
Total liabilities	**955**	**1,024**	**1,466**	**1,607**
Share Capital	169	173	179	179
Retained earnings	251	496	578	711
Total shareholders' equity	**421**	**670**	**757**	**890**
Total liabilities and equity	**1,375**	**1,693**	**2,223**	**2,498**

Source: Company data

Low capex intensity business

Techno Electric TEE IN

TECHNOLOGY | INDIA

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Key findings

Techno Electric has high business returns despite being an EPC player. While most EPC players are bogged down at 17-18% ROE, Techno generated 42% ROE in FY10. The company also exercises strong control over receivables which at close to 60 days are almost an anomaly given it is a supplier to PSUs. Its accounting is conservative — the company writes off all inventory it purchases in that year, whether used or not. Finally, growth visibility is strong with sector dynamics and strong order book.

Business model	**SUPERIOR**	SUSTAINABLE	INFERIOR
Earnings/cashflow growth	**HIGH**	AVERAGE	LOW
Earnings/cashflow quality	**HIGH**	AVERAGE	LOW
Financial strength	STRONG	**ADEQUATE**	WEAK
Corporate governance	**TRANSPARENT**	ADEQUATE	LIMITED
Investment liquidity	HIGH	ADEQUATE	**LOW**
Volatility	LOW	**MEDIUM**	HIGH

NUGGETS

Non-rated ideas from Nomura

Company description

Techno Electric has traditionally been an EPC player in the power business across the value chain and has grown very strongly over the past few years. The company is using cash flows from the EPC operations to fund its entry into wind energy and ownership of transmission assets.

Closing price on 15 Sep 2010 Rs 275.8

Growing profitably

① A fast-growing power sector player

Techno Electric is present across the power sector value chain. The company has recorded a CAGR of 27.7% in revenue terms over the past four years. Its profit CAGR was 174% during the same period. We believe that the power sector is the most attractive sector in the entire infrastructure space.

② Strong cash generator

Unlike many EPC players we cover, Techno has strong control over its working capital, because of which its ROE continued to rise even during and after the global financial crisis. In FY10, Techno's ROE at 42% was its highest in three years.

③ Utilising cash in asset-based businesses

The company has already set up 95 MW wind energy capacity, which it plans to ramp up to 250 MW in two years, according to the management. As much as 22% of its EBIT in FY10 came from the power business.

④ Built for strong future growth

The current orderbook of Rs12bn (almost 2x FY10 EPC revenues) provides strong visibility to EPC business growth. Management expects to maintain margins. The company is now venturing into ownership of generation and transmission assets and would not be averse to entering distribution in the future, according to management.

⑤ Relisting in about a month

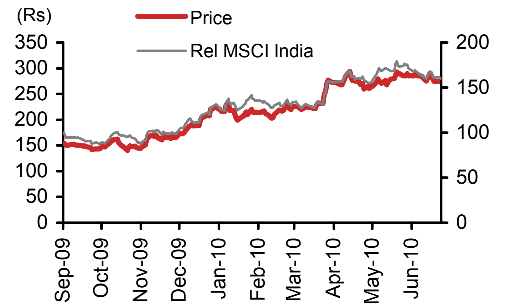
The company is merging its wind energy subsidiary with itself. This process is to be completed within a month, according to management.

Key financials

FY 31 March (Rs mn)	2008	2009	2010	Guided
Revenue	4,296	4,860	6,680	⇧
Reported net profit	491	631	1,138	⇩
Reported EPS	8.8	11.05	19.94	⇔
Rep EPS growth (%)	58.0	25.6	0.8	⇧
Rep P/E (x)	31.3	25..0	13.8	⇩
Price/book (x)	9.0	6.9	4.3	⇔
Dividend yield (%)	0.4	0.4	0.8	⇧
ROE (%)	28.6	31.6	38.1	⇩
Net debt/equity (%)	Net cash	1.6	41.7	⇔

Source: Company data

Share price relative to MSCI India



	1m	3m	6m
Absolute (Rs)		(3.3)	21.6
Absolute (US$)		(3.3)	19.4
Relative to Index		(12.1)	10.4
Market cap (US$mn)			339.0
Estimated free float (%)			34.6
52-week range (Rs)			318/134
3-mth avg daily turnover (US$mn)			0.2
Major shareholders (%) *			
Promoters			55.0
Private Corporate Bodies			34.8

* As per 31 March 2009
Source: Bloomberg, Company data

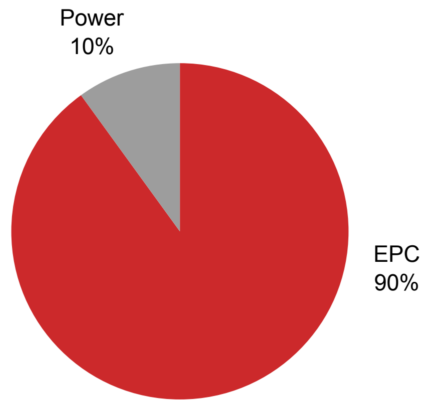
Drilling down

Powering profits

Despite being one of the many EPC players in a fast growing yet rather competitive business, the company has positioned itself for growth while maintaining very high ROE. The chart below shows the revenue profile of the company for FY10.

EPC player in power generation space, generating free cash flows

Exhibit 146. Techno Electric revenue profile – FY10A



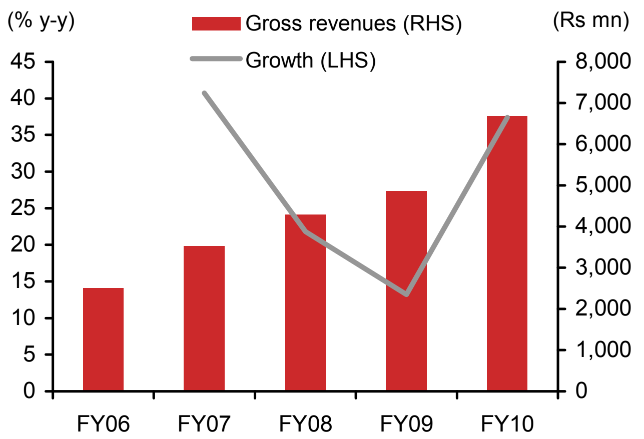
Source: Company data, Nomura research

Power sector

The company is an EPC player in the power sector with a presence across the value chain — generation, transmission and distribution. The company supplies EPC services to utilities and to larger EPC players. The company also undertakes full EPC contracts for smaller captive power plants of up to 100 MWs. It also undertakes power distribution and off-site EPC projects on a turnkey basis in refineries and the metallurgical sector (particularly aluminium smelter, petrochemical sector, etc.). Non-power businesses contribute about 20% of total EPC business revenues.

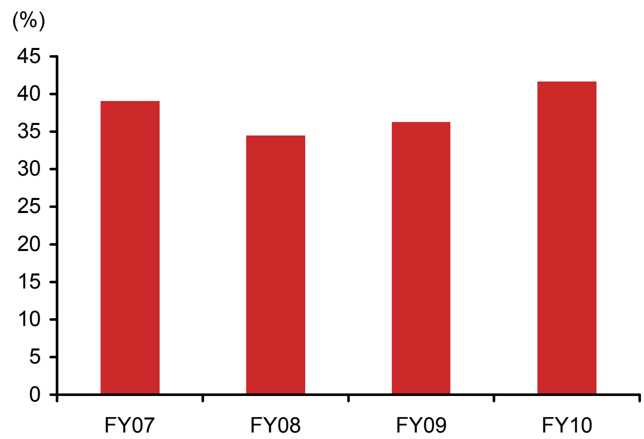
- Techno's revenues recorded a CAGR of 27.7% over the past four years.
- In the same period, the profit of the company has grown at a CAGR of 174%.

Exhibit 147. Revenue and revenue growth



Source: Company data, Nomura research

Exhibit 148. ROE



Source: Company data, Nomura research

The company's ROE rose even during the global financial crisis as the power assets it had been putting in place started to generate returns. The company has constantly enhanced its capabilities. From being a part supplier to 100 MW power plants, it has now developed capabilities to execute such projects on a standalone basis.

High cash generation from core business

The company has been able to generate cash almost in line with the profits generated in the business. This is better than experience of construction companies in this business that we cover. The company maintains very tight control over its working capital, especially chasing receivables. The receivables days compare well with the general industry norm of 150-200 days.

Exhibit 149. Techno Electric – Receivables and net working capital

Year	FY08	FY09	FY10
Receivables	50.4	63.4	66.7
Net working capital days	(9.7)	56.9	42.6

Source: Company data, Nomura research

Conservative accounting

Techno Electric's reported profit runs very close to cash generated from the business which is a result of its strong receivables control and conservative accounting policy. For example, the company charges any material purchased to cost even if it is not used up in that year.

Getting into asset-based businesses

The company is using its cash in two ways:

- Alternative energy — the company has already put up 95 MW of capacity in wind energy and is ramping it up to 250 MW, according to management. The company believes that it can generate about 16% IRR from its investments in these assets and it believes that this is better than keeping the money in cash, which yields much lower returns.
- Techno Electric, in consortium, was successful in bagging a contract for the establishment, operation and management of a 400-KV, 100-km long transmission link connecting 24 bay sub-stations at Rohtak and Sonepat to evacuate 1,320 MW (2 x 660) from the Jhajjar Power Plant built by CLP India (Unlisted).

The company estimates at least 15-16% IRR from both these businesses. In FY10, the power business contributed 22% of the company's consolidated EBIT.

Financial statements

Profit and loss (Rs mn)			
Year-end 31 March	**FY08**	**FY09**	**FY10**
Revenue	4,296	4,860	6,680
Cost of goods sold	(3,363)	(3,777)	(4,997)
Gross profit	**933**	**1,084**	**1,683**
SG&A	(434)	(525)	(711)
Operating profit	499	558	972
EBITDA	**505**	**565**	**1,119**
Depreciation and Amortisation	(6)	(6)	(147)
EBIT	**499**	**558**	**972**
Net interest expense	(3)	(6)	(128)
Other income	118	312	525
Income tax	(123)	(213)	(230)
Net profit after tax	**491**	**650**	**1,138**
Extraordinary items	0	(20)	0
Reported NPAT	**491**	**631**	**1,138**

Source: Company data

Balance sheet (Rs mn)			
As at 31 March	**FY08**	**FY09**	**FY10**
Cash and equivalents	243	385	125
Marketable securities	1,536	1,504	492
Accounts receivable	593	844	1,220
Inventories	10	6	70
Other current assets	128	1,384	1,701
Total current assets	**2,509**	**4,124**	**3,608**
Long-term investments	9	10	1,373
Fixed assets	48	47	2,605
Other LT Assets	(6)	(6)	(7)
Total assets	**2,560**	**4,175**	**7,580**
Short-term debt	0	0	136
Accounts payable	473	438	631
Other current liabilities	294	917	1,442
Total current liabilities	**768**	**1,355**	**2,209**
Long-term debt	1	420	1,530
Other LT liabilities	77	121	139
Total liabilities	**846**	**1,897**	**3,879**
Share Capital	114	114	114
Retained earnings	1,600	2,164	3,587
Total shareholders' equity	**1,714**	**2,278**	**3,701**
Total liabilities and equity	**2,560**	**4,175**	**7,580**

Source: Company data

High ROE

Elgi Equipments ELEQ IN

TECHNOLOGY | INDIA

NOMURA

NOMURA FINANCIAL ADVISORY AND SECURITIES (INDIA) PRIVATE LIMITED

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NOT RATED

Key findings

The compressor industry in India is closely leveraged to industrial and infrastructure capex, which we expect to pick up significantly from FY12F. Elgi Equipments has already shown more than 50% y-y revenue growth over the past two quarters and according to management, it is expected to grow revenues and EPS by 30-40% each in the next few years.

Business model	**SUPERIOR**	SUSTAINABLE	INFERIOR
Earnings/cashflow growth	**HIGH**	AVERAGE	LOW
Earnings/cashflow quality	**HIGH**	AVERAGE	LOW
Financial strength	STRONG	**ADEQUATE**	WEAK
Corporate governance	**TRANSPARENT**	ADEQUATE	LIMITED
Investment liquidity	HIGH	ADEQUATE	**LOW**
Volatility	LOW	**MEDIUM**	HIGH

NUGGETS

Non-rated ideas from Nomura

Company description

Elgi Equipments is a market leader and Asia's largest manufacturer of air compressors, a consolidated industry with only three to four large players. It has developed technologically advanced products and has wide sales and after-sales service presence in India.

Closing price on 15 Sep 2010 Rs 142

Strong play on industrial and power capex

① Market leader in a fast-growing industry

Elgi Equipments is a market leader and Asia's largest manufacturer of air compressors (according to management), an industry which has seen significant upturn in the recent past. This has resulted in y-y revenue growth of 50% for the company over the past two quarters.

② Good competitive position in a consolidated industry

The company has developed good products and created differentiation through products and wide service, as well as after-sales networks. The air compressor industry in India is consolidated with three to four players, contributing a majority of revenue and all of them are doing reasonably well now.

③ Direct play on industrial and power capex

Elgi's products are used in a wide range of applications in industries such as mining, power, transport, defense, oil, chemicals, textiles, printing, pharmaceuticals, medical, food and beverages and automobile service stations.

④ Strong financial performance

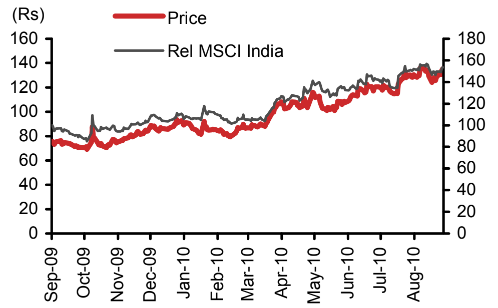
The company has witnessed y-y revenue growth of 50% in the past two quarters, and it expects the trend to continue in the near future given that it is seeing increased demand from sectors such as textiles, power and automobiles. On a y-y basis, according to management, revenues and EPS growth of 30-40% each is possible in the next two to three years.

Key financials

FY 31 March (Rs mn)	2007	2008	2009	Guided
Revenue	3,786	5,040	5,510	⇧
Reported net profit	234	419	407	⇩
Reported EPS	3.73	6.67	6.49	⇔
Rep EPS growth (%)	32.7	78.82	(2.70)	⇧
Rep P/E (x)	37.8	21.1	21.7	⇩
Price/book (x)	6.52	5.25	4.43	⇔
Dividend yield (%)	0.82	1.00	1.08	⇧
ROE (%)	17	28	22	⇩
Net debt/equity (%)	Net cash	Net cash	Net cash	⇔

Source: Company data

Share price relative to MSCI India



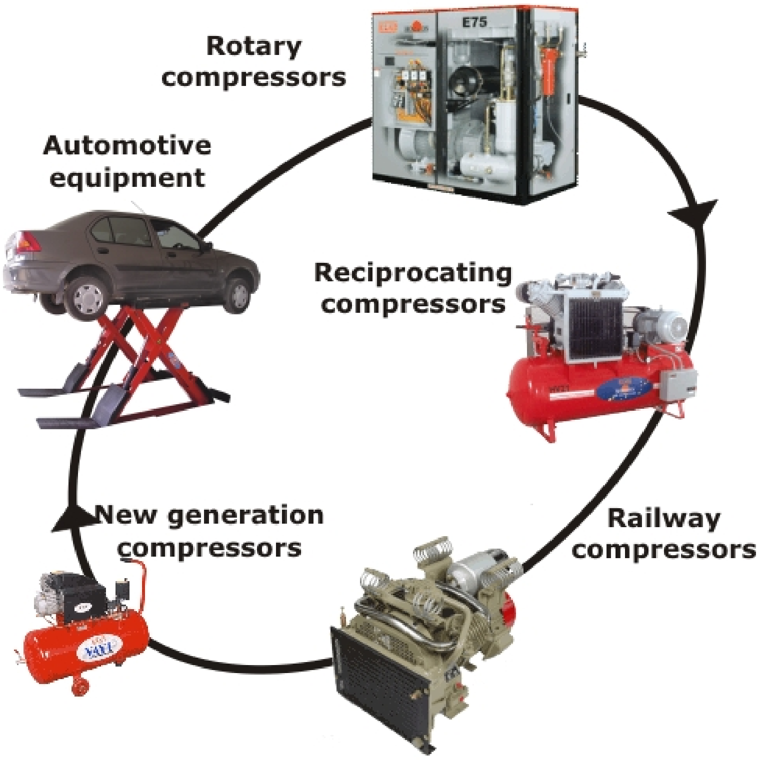
	1m	3m	6m
Absolute (Rs)	9.8	29.4	62.9
Absolute (US$)	10.6	29.5	59.8
Relative to Index	3.0	17.7	47.8
Market cap (US$mn)			237
Estimated free float (%)			56
52-week range (Rs)			149.0 / 65.9
3-mth avg daily turnover (US$mn)			.2
Major shareholders (%)			
Public			42.8
Body Corporates			33.8

Source: Bloomberg, Company

Largest manufacturer of air-compressors in Asia

Elgi Equipments is a leader in air-compressors and operates in a wide range of categories (from half to 2000 HP). Air compressors are used in many industries such as power plants, textiles, paper, cement, oil, railways etc, and are required to be put in place wherever an expansion of capacity is ongoing. Also, they are used in large numbers in auto-garages and auto-service stations. According to the company, it has developed technologically strong products with a large network of dealers (115-plus) over the past 40 years.

Exhibit 150. Showing Product mix of Elgi Equipments Ltd.



Source: Company Web Site

The company also has an automotive division (contributing around 20% of revenues), which manufacturers equipment for two, three and four wheelers.

International market

To play an active role in the international market worth INR300bn, according to the company, Elgi Equipments is looking to acquire Europe and US-based companies that can provide brand names for India’s markets. It has acquired the entire stake of Belair for INR43.5mn, using internal funding. Belair has established itself as a strong supplier of compressors to the industrial segment with a market share of about 3% in France.

Consolidated industry

The air-compressor industry in India has high barriers to entry in terms of technology and distribution, and is largely dominated by three to four players such as Elgi, Ingersoll and Atlas Copco Limited.

Exhibit 151. Performance review for quarter ending June 2010

(Rs mn)	Elgi Equipments Ltd.	Ingersoll-Rand (India) Ltd.	Atlas Copco (India) Ltd.
Revenue	2,083	1,052	3,922
EBIT	266	154	517
EPS (Rs)	2.5	5.1	13.9
EBIT margin (%)	13	15	13

Source: Company data, Nomura research

Strong financial performance

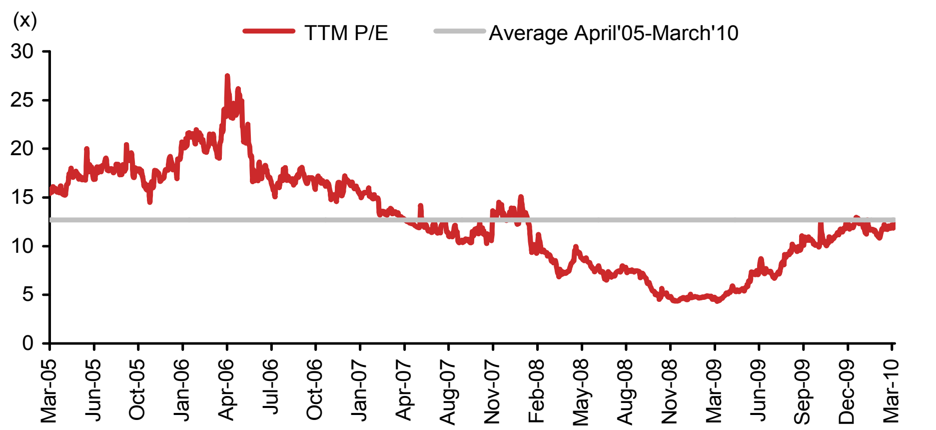
Elgi reported revenue and EPS growth of 22.4% and 42.3%, respectively, in FY10 as EBIDTA margins improved by 330bp in the year due to better operational efficiencies.

Exhibit 152. Consolidated performance of Elgi in Rs mn

Q/E	Jun-10	Mar-10	Dec-09	Sep-09
Revenue	2,083	2,038	1,821	1,615
EBIT	266	263	276	280
Diluted EPS (Rs)	2.45	1.37	2.42	2.21
EBIT margin (%)	13	13	15	17
y-y revenue growth rate (%)	59	49	32	10
y-y EBIT growth rate (%)	111	93	67	48
y-y EPS growth rate (%)	71	34	81	36

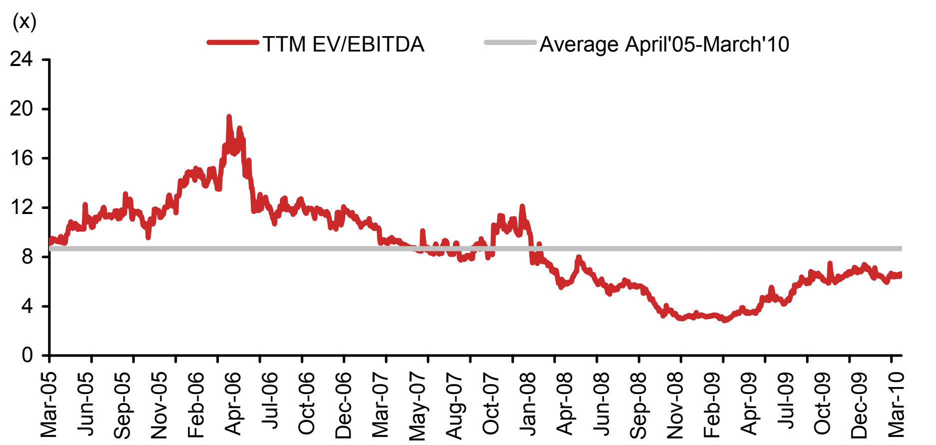
Source: Company data, Nomura research

Exhibit 153. Trailing 12 Month PE



Source: Company data, Nomura research

Exhibit 154. Trailing 12 Months EV/EBITDA



Source: Company data, Nomura research

Financial statements

Profit and loss (Rs mn)				
Year-end 31 March	**FY07**	**FY08**	**FY09**	**FY10**
Revenue	3,786	5,040	5,510	6,770
Cost of goods sold	(2,463)	(3,271)	(3,526)	(4,191)
Gross profit	**1,323**	**1,770**	**1,984**	**2,578**
SG&A	(1,011)	(1,248)	(1,398)	(1,637)
Operating profit	312	522	586	941
EBITDA	**388**	**599**	**677**	**1,046**
Depreciation and Amortisation	(75)	(77)	(90)	(105)
EBIT	**312**	**522**	**586**	**941**
Net interest expense	0	0	0	0
Other income	38	68	68	81
Income tax	(111)	(171)	(247)	(361)
Net profit after tax	**239**	**419**	**407**	**661**
Extraordinary items	(5)	0	0	(81)
Reported NPAT	**234**	**419**	**407**	**580**

Source: Company data

More than 45% y-y growth in PAT in FY10

Balance sheet (Rs mn)				
As at 31 March	**FY07**	**FY08**	**FY09**	**FY10F**
Cash and equivalents	118	120	246	188
Marketable securities	0	0	0	0
Accounts receivable	1,392	1,917	1,571	1,930
Inventories	557	707	705	866
Other current assets	2	2	5	6
Total current assets	**2,068**	**2,746**	**2,526**	**2,990**
Long-term investments	144	143	143	143
Fixed assets	400	516	666	794
Intangible and Other LT assets	20	40	34	26
Total assets	**2,633**	**3,445**	**3,369**	**3,953**
Short-term debt	0	0	0	0
Accounts payable	588	798	518	636
Other current liabilities	131	159	110	110
Total current liabilities	**719**	**958**	**627**	**746**
Long-term debt	2	0	0	0
Other LT liabilities	555	801	745	745
Total liabilities	**1,276**	**1,759**	**1,372**	**1,490**
Share Capital	63	63	63	63
Retained earnings	1,294	1,624	1,934	2,400
Total shareholders' equity	**1,356**	**1,687**	**1,997**	**2,463**
Total liabilities and equity	**2,633**	**3,445**	**3,369**	**3,953**

Source: Company data

Strong balance sheet with zero debt

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Issuer	Ticker	Price (as at last close)	Closing Price Date	Rating	Disclosures
Maharashtra Seamless Ltd	MHS IN	381 INR	15 Sep 2010	Not Rated	
Sterlite Technologies Ltd	SOTL IN	97 INR	15 Sep 2010	Not Rated	
Triveni Engineering & Industries Ltd	TRE IN	106 INR	15 Sep 2010	Not Rated	
Voltas Ltd	VOLT IN	223 INR	15 Sep 2010	Not Rated	

Previous Ratings

Issuer	Previous Rating	Date of change
Maharashtra Seamless Ltd	Not Rated	
Sterlite Technologies Ltd	Not Rated	
Triveni Engineering & Industries Ltd	Not Rated	
Voltas Ltd	Not Rated	

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Explanation of Nomura's equity research rating system in Japan published prior to 6 January 2009 (and ratings in Europe, Middle East and Africa, US and Latin America published prior to 27 October 2008)

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A '**Bearish'** stance, indicates that the analyst expects the sector to underperform the Benchmark during the next six months.
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Explanation of Nomura's equity research rating system for Asian companies under coverage ex Japan published prior to 30 October 2008

STOCKS

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A '**Strong buy'** recommendation indicates that upside is more than 20%.
A '**Buy'** recommendation indicates that upside is between 10% and 20%.
A '**Neutral'** recommendation indicates that upside or downside is less than 10%.
A '**Reduce'** recommendation indicates that downside is between 10% and 20%.
A '**Sell'** recommendation indicates that downside is more than 20%.

SECTORS

A **'Bullish'** rating means most stocks in the sector have (or the weighted average recommendation of the stocks under coverage is) a positive absolute recommendation.
A **'Neutral'** rating means most stocks in the sector have (or the weighted average recommendation of the stocks under coverage is) a neutral absolute recommendation.
A **'Bearish'** rating means most stocks in the sector have (or the weighted average recommendation of the stocks under coverage is) a negative absolute recommendation.

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