

23 March 2011

MF Global Sector Update

# Capital Goods

| PGCIL order flow—pick up in the last three months

- » PGCIL orders have seen a sharp pick-up in the last few months (Dec-Feb 2011 orders account for **58%** of ordering YTD) and we expect the traction in orders to continue into March; competitive intensity remains high across all segments, especially in transmission lines and towers.
- » Orders at Rs 82.7bn were down 4% in the period Apr-Feb 2011; transformer orders see the sharpest fall with orders down 72% YoY and substation orders dropping 29% YoY. Transmission line orders saw a jump of 53% and conductor orders are up by 43%.
- » Crompton Greaves and BHEL remain our top picks in the sector; we maintain our SELL rating on ABB India.

## Orders gain traction over the last few months

There have been concerns on the street with regard to a slowdown in ordering from PGCIL over the past year. However, there has been a sharp pick-up in ordering over the last 3 months (Dec-Feb 2011 orders account for **58%** of ordering); orders placed by PGCIL between April-Feb 2011 now stand at Rs 82.7bn (down 4% YoY). Transformer orders have seen the sharpest fall with orders being hit on change in pre-qualification norms, in our view. We expect PGCIL orders to pick up further in March, which historically sees the highest amount of ordering. For FY11, we would expect orders to be flat to marginally positive compared to last year's order flow of INR119bn.

## Competitive intensity remains high

There is no let up in competition across segments. Within transformers, the Chinese (TBEA Shenyang and Baoding) have not been able to win any orders in FY11; however, Hyosung increased its share to 27% at the expense of Crompton Greaves. Within substations, the Indian MNCs (ABB, Areva and Siemens) have managed to recapture 50% share (38% share in FY10), which could indicate the first signs of consolidation in this segment. Within transmission lines, KEC International along with Tata Projects, SPIC and EMC garnered 70% of the orders; Jyoti Structures and L&T have not received any orders from PGCIL in FY11.

## Valuation and picks

The sector has seen a sharp de-rating over the last few months on a slowdown in ordering along with macro concerns on rising commodity prices and interest rates. Resumption in ordering from PGCIL may be the first signs of a reversal in this trend. Our top picks in the sector remain Crompton Greaves and BHEL, while we maintain a SELL rating on ABB India.

## COMPANIES

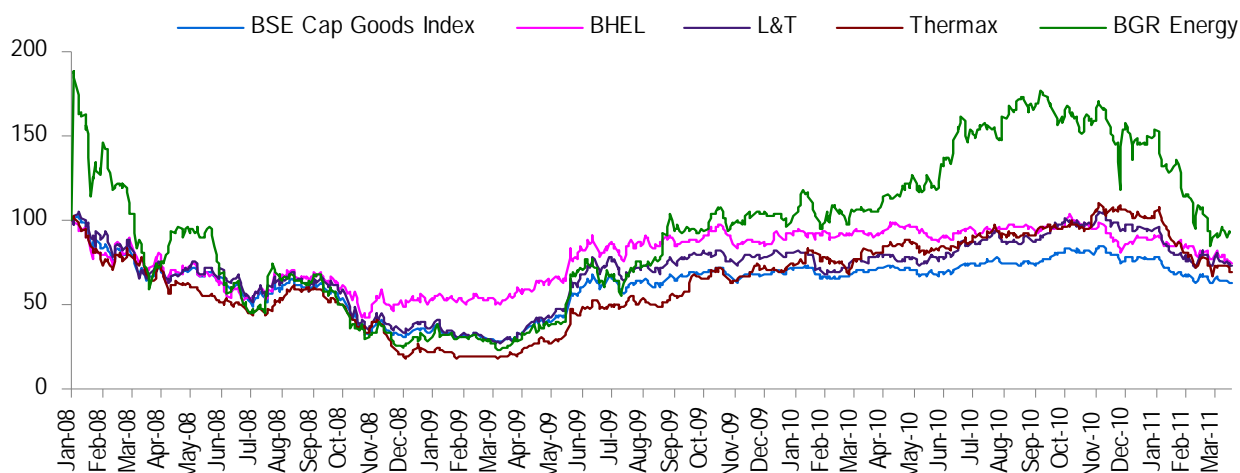
<b>ABB INDIA</b>	CMP Rs746
Reco	SELL
Target Price	Rs 630
<b>BHEL</b>	CMP Rs1, 938
Reco	BUY
Target Price	Rs 2500
<b>CROMPTON GREAVES</b>	CMP Rs266
Reco	BUY
Target Price	Rs 290
<b>JYOTI STRUCTURES</b>	CMP Rs77
Reco	NEUTRAL
Target Price	Rs 100

## VALUATION TABLE FOR THE CAPITAL GOODS SECTOR

COMPANY	BBG CODE	PRICE	TARGET	RATING	EV/EBITDA (X)			P/E (X)			P/B (X)		
					2011E	2012E	2013E	2011E	2012E	2013E	2011E	2012E	2013E
ABB INDIA	ABB IN EQUITY	746	630	SELL	26.6	19.0	15.6	40.2	28.4	22.9	5.7	4.9	4.1
AREVA T&D	ATD IN EQUITY	242	N/R	-	13.1	10.9	-	25.4	19.7	25.4	4.9	4.1	-
BGR ENERGY	BGRL IN EQUITY	441	510	NEU	7.1	6.4	5.7	10.2	9.5	8.6	3.3	2.6	2.1
BHEL	BHEL IN EQUITY	1,938	2,500	BUY	10.2	8.4	7.1	16.9	13.7	11.6	4.8	3.8	3.1
CROMPTON GREAVES	CRG IN EQUITY	266	290	BUY	11.9	10.4	9.1	18.1	16.2	14.3	5.2	4.1	3.3
JYOTI STRUCTURES	JYS IN EQUITY	77	100	NEU	3.5	3.2	3.0	6.0	5.9	5.7	1.0	0.8	0.7
LARSEN AND TOUBRO	LT IN EQUITY	1,519	-	-	13.5	11.0	9.1	20.8	17.2	14.3	3.9	3.3	2.8
KEC INTERNATIONAL	KECI IN EQUITY	73	N/R	-	6.7	5.4	4.7	8.9	7.2	6.1	1.9	1.6	1.3
KALPATARU TRANSMISSION	KPP IN EQUITY	112	N/R	-	5.0	4.1	3.6	7.6	6.1	4.9	1.0	0.9	0.8
SIEMENS INDIA	SIEM IN EQUITY	869	N/R	-	18.5	15.6	13.0	29.8	25.4	21.2	7.3	5.9	4.8
THERMAX	TMX IN EQUITY	568	700	BUY	11.4	9.7	8.4	17.9	15.5	13.6	5.0	4.0	3.3
SECTOR AVERAGE					11.6	9.5	7.9	18.3	15.0	13.5	4.0	3.3	2.6
SECTOR MEDIAN					11.4	9.7	7.8	17.9	15.5	13.6	4.8	3.8	3.0

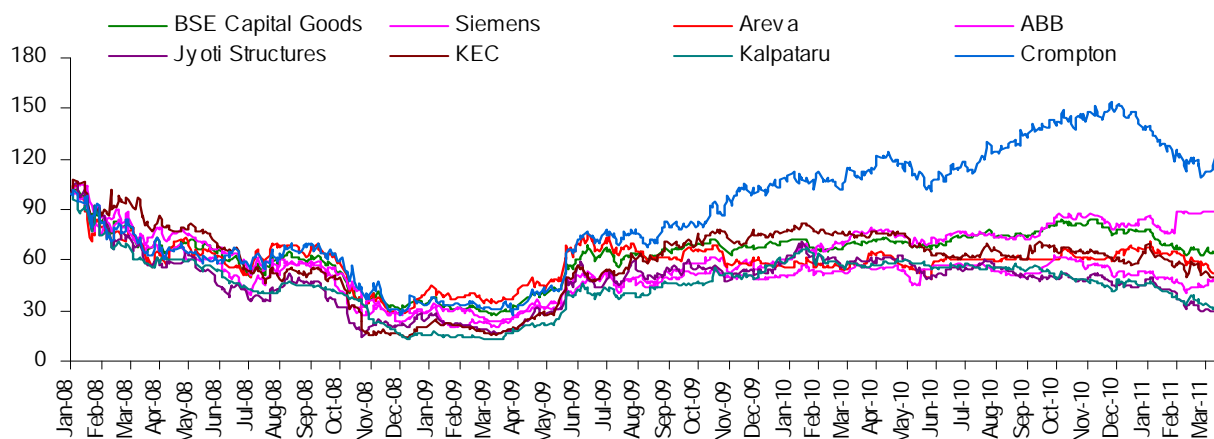
Source: Company, MF Global India Research Estimates

## BSE CAPITAL GOODS INDEX VERSUS THE POWER GENERATION PLAYERS—PRICE PERFORMANCE



Source: PGCIL, MF Global India Research

## BSE CAPITAL GOODS INDEX VERSUS THE POWER T&amp;D PLAYERS—PRICE PERFORMANCE

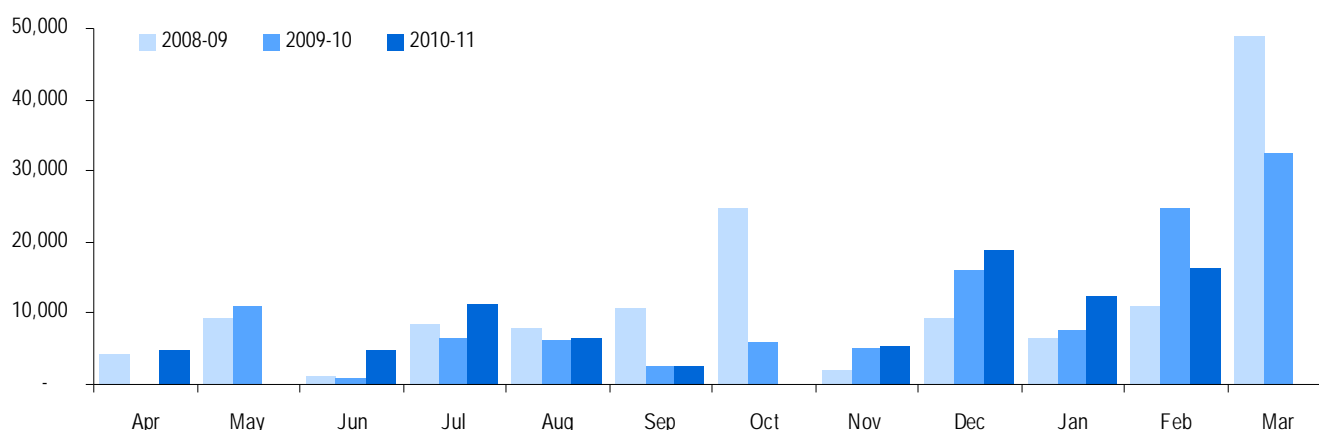


Source: PGCIL, MF Global India Research

### Orders pick pace in the last few months—now down 4% in April-February 2011

Orders from PGCIL in the first 11 months of the year are down 4% to Rs 82,702m. Ordering has picked up in the last 3 months (Dec 2010-Feb, 2011), which accounted for **58%** of the total ordering till date. In fact, the months of December and January saw the highest orders awarded compared to the corresponding last three years.

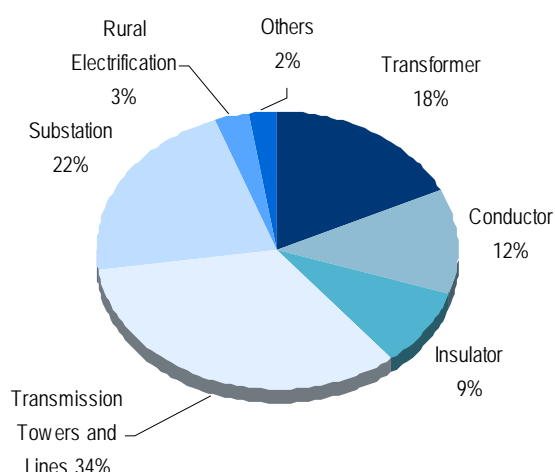
#### PGCIL MONTHLY ORDER FLOW: DECEMBER-MARCH ACCOUNT FOR A MAJORITY OF THE ORDERS



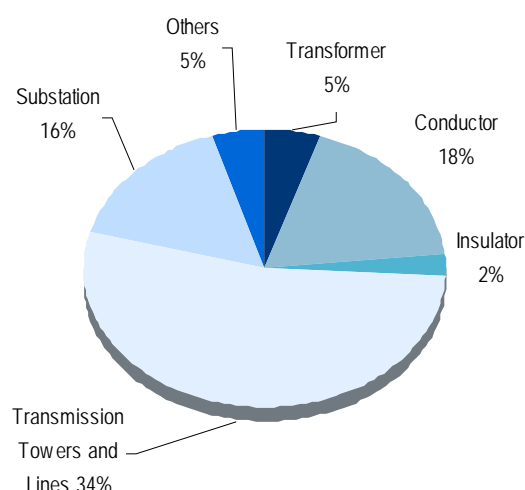
Source: PGCIL, MF Global India Research

By order type, there has been a fall in orders for transformers (including reactors), substations and insulators in the first 11 months of the year. Transformers orders stood at Rs 4.2bn (-72% YoY), insulator orders at Rs 1.9bn (-75% YoY) and substation orders at Rs 13.2bn (-29% YoY). However, orders for conductors at Rs 15bn were up by 43% and transmission line orders at Rs 44.3bn were up 53%.

#### PGCIL ORDER FLOW BREAK-UP 2009-10



#### PGCIL ORDER FLOW BREAK-UP 2010-11



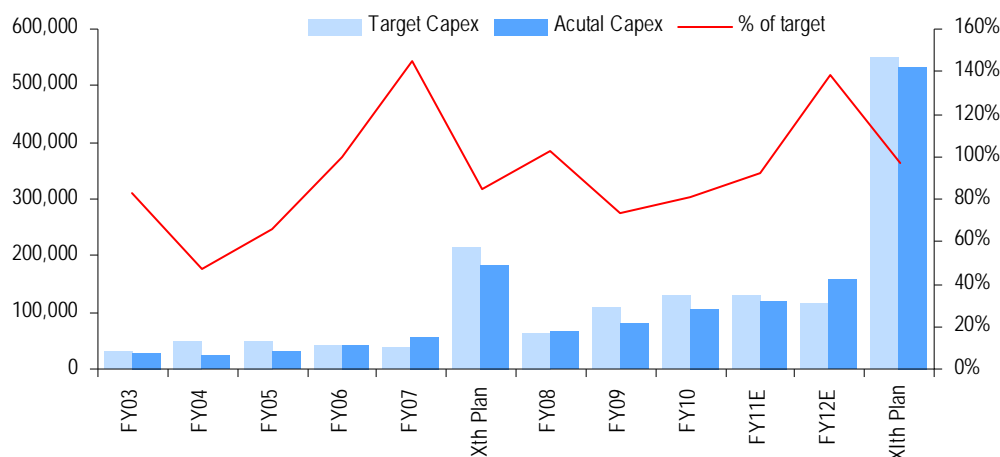
Source: PGCIL, MF Global India Research

In our view, we should see further strength in ordering in March, 2011 and end the year with a positive growth in order flow (*ex HVDC orders to ABB-BHEL consortium for substations*). We would expect the HVDC substation order from Biswanath Chariali to Agra worth Rs 60,000mn to be awarded to the BHEL-ABB India consortium soon, which alone would be worth more than the total orders in March 2010.

### PGCIL ordering to pick up steam—large capex planned for the 12<sup>th</sup> Five-Year Plan

We do expect ordering to pick up once again as PGCIL resumes spending to meet its 12<sup>th</sup> Plan capex target of Rs 1,050bn. According to PGCIL's management, most of the ordering for the 11<sup>th</sup> Plan projects has already been completed and we therefore expect that PGCIL should come close to meeting its 11<sup>th</sup> Plan target of Rs 550bn. PGCIL intends to spend capex of Rs 119,00mn in FY11 and Rs 160,000mn in FY12.

#### PGCIL PLANNED CAPEX FOR THE 11<sup>TH</sup> PLAN



Source: PGCIL, MF Global India Research

#### PGCIL PLANNED CAPEX IN THE 12TH FIVE-YEAR PLAN

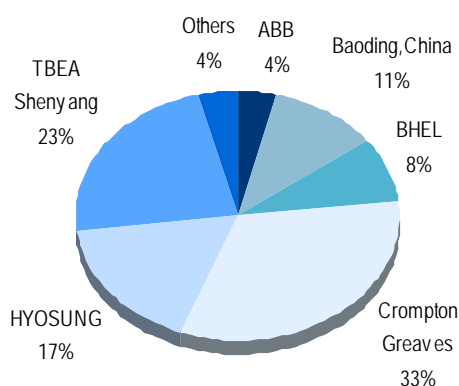
DESCRIPTION	INRB	% OF TOTAL
TOTAL ESTIMATED CAPEX	1,050	
9 HCTC FOR EVACUATING 50GW	580	55%
GRID STRENGTHENING	158	15%
TRANSMISSION SYSTEM FOR UMPP	313	30%

Source: PGCIL, MF Global India Research

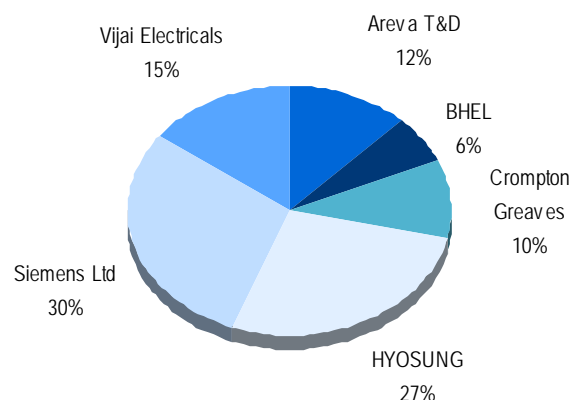
### Transformer Orders

Transformer orders at Rs 4.2bn for April-February 2011 were down 72% YoY. This category was the worst hit in terms of order flow. However, we do note that since January, a number of new bids for transformers have been invited and we would expect ordering in this segment to pick up in the next few quarters—especially for the 765kv transformers, ordering for which was extremely weak in FY11. We believe that the delay in ordering transformers is due to the change in pre-qualification norms that have been introduced by PGCIL since late last year.

## TRANSFORMER ORDERS—RS 22.9BN (2009-10)



## TRANSFORMER ORDERS—RS 4.2BN (APR, 2010-FEB, 11)



Source: PGCIL, MF Global India Research

Competitive intensity has remained high, both from domestic and foreign players. Hyosung (Korea's largest transformer maker) managed to bag the only **765kv order placed till date** worth Rs 1156mn and managed to capture 27% of the market share (2<sup>nd</sup> in line after Siemens with a 29% share).

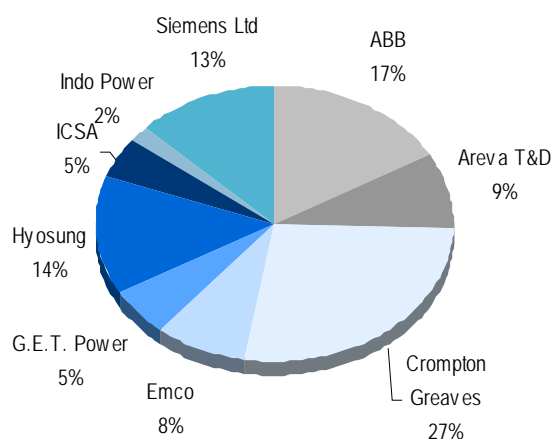
We also note that Crompton Greaves has lost market share (down to 10% from 33% in FY10). This could be due to selective bidding by the company as it does not want to compromise on margins. ABB India, along with the Chinese (TBEA Shenyang and Baoding), have not managed to bag any order till date while Vijai Electricals with order wins of Rs 620mn managed to get a 15% market share.

## Substation Orders

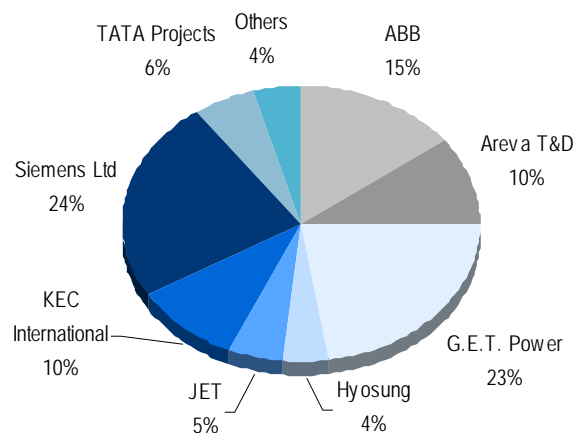
Substation orders at Rs 13.2bn for the period April-February, 2011 were down 29% YoY. The Indian MNCs, namely ABB India, Arev a T&D and Siemens, have together managed to recapture ~50% of the market, which they had earlier lost to domestic and foreign players. KEC International was able to win a substation order for the first time in 2011 from PGCIL and this marks its entry into this segment. GET Power, which is a new entrant in the substation segment, has managed to garner a share of 23%.

Crompton Greaves has not managed to win any orders for substations this year; in 2009-10, it had a market share of 27%. This is in line with management comments that it would want to keep the EPC revenues below 5% of overall revenues for the standalone business.

## SUBSTATION ORDERS—RS 21.2BN (2009-10)



## SUBSTATION ORDERS—RS 13.2BN (APR, 2010-FEB, 11)

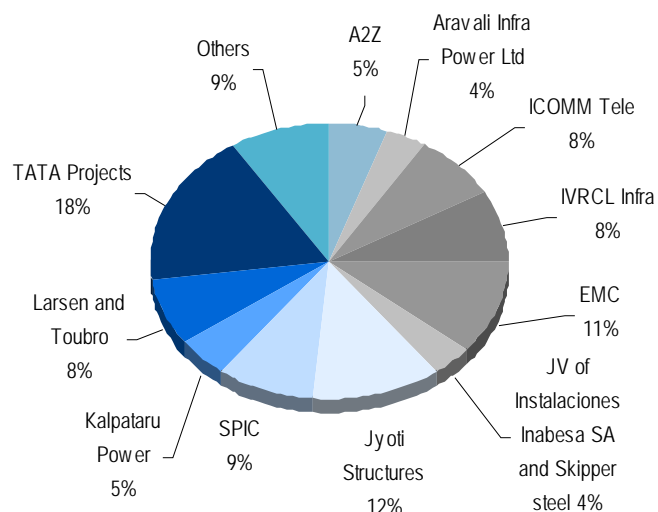


Source: PGCIL, MF Global India Research

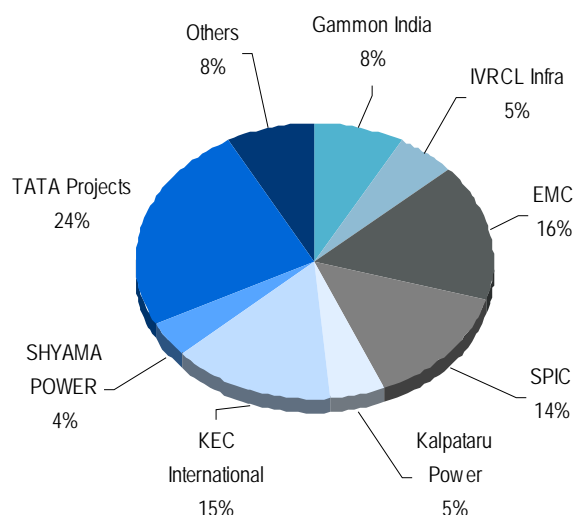
### Transmission lines and tower orders

Transmission lines and tower orders at Rs 44.3bn for April-February 2011 were up 53% YoY. This segment has seen the entry of a number of new players over the last 2 years. This has, in turn, led to a severe loss in market share for the incumbents namely, L&T, Gammon India, KEC International, Kalpataru Power and Jyoti Structures. Quite a few of the new players were originally sub-contractors for the aforementioned incumbents and have now entered the market as sole bidders.

TRANSMISSION LINE ORDERS—RS 45BN (2009-10)



TRANSMISSION LINE ORDERS—RS 44.3BN (APR, 2010-FEB, 11)



Source: PGCIL, MF Global India Research

However, we may be seeing the first signs of consolidation as the number of players who have been awarded orders have come down—the top-5 players took 77% of the orders in 2010-11 as against 57% share in 2009-10. The top-5 players by market share are Tata Projects, EMC, KEC International, SPIC and Gammon India. Interestingly, both **L&T** and **Jyoti Structures** have not been able to bag any orders from PGCIL in this segment till date. We need to see further signs of consolidation in this segment before we start getting positive on this sector.

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