

Indian Capital Goods

Turning the corner; valuations attractive

Ratings and valuation summary

Company	Share price	Market cap (INRbn)	Old rating	New rating	Old TP (INR)	New TP (INR)	Pot. return (%)
ABB India	849	179.9	UW	UW	590	590	-30%
Areva T&D	253	60.4	Neutral	OW	340	310	23%
Siemens	849	300.5	OW	Neutral	950	985	16%
Crompton Greaves	258	165.6	OW	OW	330	330	28%
Kalpataru Power	125	19.1	OW	OW	185	185	48%
KEC Intl	80	20.6	OW	OW	105	105	31%
Jyoti Structures	85	7.0	OW	OW	165	115	35%

Note: Share prices at close 27 June, 2011
Source: HSBC estimates, Thomson Reuters Datastream

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- ▶ **Earnings bottoming out; valuations look attractive even in worst case scenario**
- ▶ **Fat order books to drive earnings growth; competitive outlook also improving**
- ▶ **Downgrade Siemens to Neutral, upgrade ATD to OW; still prefer CRG and KPP**

The focus shifts to project execution. We think the market will switch its focus from order books to profit growth this year. With strong growth in transmission orders (c50%) and sector backlog (c17%) in FY11, investors will want to see these fat order books translate into earnings growth in FY12, with no project delays. In this context, we believe the sector outlook remains strong as companies should be able to deliver on time thanks to recent capacity addition. We forecast sales growth of c17% in FY12e and c18% in FY13e, up from c11% in FY11.

Order books to continue to grow. While we expect transmission orders to be weak in the short term (-c5% in FY12e but +c40% in FY13e), the sector backlog should continue to grow (c12% in FY12e and c18% in FY13e), benefiting from international demand and above-normal growth in new business ventures.

Competition still intense but dynamics improving. Our channel checks suggest that while competition remains intense in the transformer and tower segments, the dynamics are slowly changing in favour of the major players we cover. While changes in qualification requirements are helping transformer vendors, EPC players are benefiting from Power Grid's increasing focus on project execution, an area where some new entrants struggle.

Expectations nearing bottom, execution remains key: With earnings disappointing for three out of the last four quarters, consensus has come down c13% and our universe has underperformed by c6.8%(c15.5% ex-ABB and Siemens) in spite of rising order books. This implies that execution is becoming crucial and will be the likely driver for re-rating.

Sector looks attractive, even in worst case scenario:

Our coverage universe remains at a discount of c12% (c30% ex-ABB and Siemens) to its historical average. The current valuation implies a sector margin decline of c180bps, which we think is highly unlikely; even in a worst case scenario, we estimate the risk to our FY12-13e EPS is only c5-14%. Hence, we find the sector attractive on a risk adjusted basis.

Ratings changes: We downgrade Siemens to Neutral and upgrade ATD to Overweight on valuation. We still prefer CRG and KPP, as they provide strong growth opportunities at an attractive price.

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Valuation summary - Coverage universe

Company	Current share price	Mcap (INRm)	FY12e								FY13e							
			PE (x)	EV/ EBITDA (x)	EV/ Sales (x)	PB (x)	EPS growth (%)	ROE (%)	EBITDA margin(%)	Div yield (%)	PE (x)	EV/ EBITDA (x)	EV/ Sales (x)	P/B (x)	EPS growth (%)	ROE (%)	EBITDA margin(%)	Div yield (%)
Jyoti Structures	85	7,008	5.99	4.20	0.46	1.00	0.7%	16.6%	11.0%	1.4%	5.46	3.89	0.42	0.85	9.7%	15.6%	10.8%	1.5%
Kalpataru Power	125	19,187	7.19	4.54	0.48	0.94	28.9%	14.8%	10.6%	1.6%	6.01	4.04	0.43	0.81	19.6%	15.9%	10.6%	1.6%
KEC Intl	80	20,623	8.11	7.32	0.77	1.76	15.7%	21.7%	10.5%	1.5%	6.25	6.41	0.66	1.41	29.7%	22.5%	10.3%	1.6%
ABB Ltd	849	179,908	33.57	21.70	2.12	5.42	42.5%	16.1%	9.8%	0.3%	25.16	16.49	1.78	4.53	33.4%	18.0%	10.8%	0.4%
Areva T&D India	253	60,423	18.99	10.20	1.28	3.96	17.2%	20.9%	12.5%	0.9%	14.02	7.95	1.07	3.20	35.4%	22.8%	13.4%	1.0%
Crompton Greaves	258	165,574	15.82	10.02	1.39	3.96	12.2%	25.1%	13.8%	1.1%	13.69	8.30	1.15	3.20	15.6%	23.4%	13.8%	1.2%
Siemens Ltd	883	300,513	24.28	14.26	1.90	5.56	15.2%	22.9%	13.3%	0.7%	20.69	12.11	1.56	4.56	17.4%	22.1%	12.9%	0.9%
Average - simple			16.28	10.32	1.20	3.23	18.9%	19.7%	11.7%	1.1%	13.04	8.46	1.01	2.65	23.0%	20.0%	11.8%	1.2%
Average - weighted			23.17	14.25	1.71	4.78	21.4%	21.3%	12.3%	0.8%	18.77	11.55	1.42	3.93	22.6%	21.2%	12.5%	0.9%

Note: Priced as on 27th June, 2011.
Source: Company, HSBC estimates

Valuation summary - coverage universe (calendarised)

Company	Current share price	Mcap (INRm)	FY12e								FY13e							
			PE (x)	EV/ EBITDA (x)	EV/ Sales (x)	PB (x)	EPS growth (%)	ROE (%)	EBITDA margin(%)	Div yield (%)	PE (x)	EV/ EBITDA (x)	EV/ Sales (x)	PB (x)	EPS growth (%)	ROE (%)	EBITDA margin(%)	Div yield (%)
Jyoti Structures	85	7,008	5.99	4.20	0.46	1.00	0.7%	16.6%	11.0%	1.4%	5.46	3.89	0.42	0.85	9.7%	15.6%	10.8%	1.5%
Kalpataru Power	125	19,187	7.19	4.54	0.48	0.94	28.9%	14.8%	10.6%	1.6%	6.01	4.04	0.43	0.81	19.6%	15.9%	10.6%	1.6%
KEC Intl	80	20,623	8.11	7.32	0.77	1.76	15.7%	21.7%	10.5%	1.5%	6.25	6.41	0.66	1.41	29.7%	22.5%	10.3%	1.6%
ABB Ltd	849	179,908	44.91	27.58	2.39	6.31	119.2%	14.0%	8.7%	0.3%	32.18	20.12	2.03	5.36	39.6%	16.7%	10.1%	0.3%
Areva T&D India	253	60,423	22.24	11.33	1.39	4.74	32.4%	21.3%	12.3%	0.9%	18.18	9.54	1.22	3.90	22.3%	21.4%	12.8%	0.9%
Crompton Greaves	258	165,574	15.82	10.02	1.39	3.96	12.2%	25.1%	13.8%	1.1%	13.69	8.30	1.15	3.20	15.6%	23.4%	13.8%	1.2%
Siemens Ltd	883	300,513	27.11	15.36	2.07	6.47	23.5%	23.6%	13.5%	0.7%	23.30	13.10	1.71	5.28	16.3%	22.5%	13.1%	0.8%
Average - simple			18.77	11.48	1.28	3.60	33.2%	19.6%	11.5%	1.0%	15.01	9.34	1.09	2.97	21.8%	19.7%	11.6%	1.1%
Average - weighted			27.27	16.18	1.85	5.42	44.3%	21.1%	12.1%	0.7%	21.83	12.94	1.55	4.47	22.6%	21.0%	12.3%	0.8%

Note: Priced as on 27th June, 2011.
Source: Company, HSBC estimates

Share price performance summary – Coverage universe

Company	Current price	Absolute performance (%)					Relative performance to sector(%)				
		1 week	1 month	3 mths	6 mths	12 mths	1 week	1 month	3 mths	6 mths	12 mths
Jyoti Structures	85	0.8%	4.7%	2.9%	-32.0%	-43.8%	-4.2%	-0.2%	-1.5%	-21.5%	-37.7%
Kalpataru Power	125	0.0%	3.0%	2.8%	-23.5%	-39.1%	-5.1%	-1.9%	-1.6%	-13.0%	-33.0%
KEC Intl	80	1.5%	2.6%	4.2%	-17.2%	-13.4%	-3.5%	-2.2%	-0.2%	-6.8%	-7.3%
ABB Ltd	849	3.2%	-0.2%	8.3%	5.5%	-2.8%	-1.8%	-5.0%	3.9%	16.0%	3.3%
Areva T&D India	253	1.6%	4.7%	2.9%	-20.4%	-12.9%	-3.4%	-0.1%	-1.5%	-9.9%	-6.9%
Crompton Greaves	258	3.3%	0.1%	-3.8%	-16.6%	1.2%	-1.7%	-4.8%	-8.2%	-6.1%	7.3%
Siemens Ltd	883	4.4%	1.6%	0.9%	8.8%	21.0%	-0.6%	-3.3%	-3.5%	19.3%	27.1%
Average - simple		2.1%	2.4%	2.6%	-13.6%	-12.8%	-2.9%	-2.5%	-1.8%	-3.1%	-6.8%
Average - weighted		3.4%	1.2%	1.9%	-1.8%	5.2%	-1.6%	-3.7%	-2.5%	8.6%	11.2%
BSE Sensex	18,412	5.2%	0.8%	-2.1%	-8.1%	4.8%					
BSE Capital Goods	13,593	5.0%	4.9%	4.4%	-10.5%	-6.1%					

Source: Thomson Reuters Datastream, HSBC

Investment summary

- ▶ Focus will likely be on execution this year; expect transmission orders to be weak but sales and earnings growth to drive stocks
- ▶ While competition remains intense, dynamics are improving; expect margins to remain stable in FY12
- ▶ Expectations nearing bottom; sector looks attractive on risk adjusted basis even in worst case scenario. We downgrade Siemens to Neutral, upgrade ATD to OW; prefer CRG and KPP

Shifting focus to execution from order growth

FY11 (Mar YE) turned out to be a surprisingly strong year in terms of new orders due to significant activity by Power Grid and others in Q4 FY11. Power Grid alone awarded orders worth cINR130bn in Q4, taking full year orders to cINR185bn, up c50% y-o-y.

Consequently, most of the transmission companies under our coverage saw significant increase in new orders, with average sector order intake in FY11 increasing by c15% compared to c3% in FY10 and c6% in FY09. In this context, we believe FY11 turned out to be an inflection point for a pick-up in orders.

Unsurprisingly, as one could infer from the weak order intake in FY09-10, the earnings growth in FY11 (c11%) failed to catch up with the order growth and consequently the order books rose c17% on average in FY11, with book-to-bill reaching a historic peak of c1.5x. Against this strong backlog, we believe that FY12 will most

likely turn out to be an inflection point for a pick-up in revenues (and subsequently earnings).

We believe that order books have lengthened to a point where marginal comfort/visibility from incremental orders has somewhat diminished. We believe the question now is whether these order books are profitable and whether the project execution will get delayed. Hence, we believe that the focus this year will be more on execution and less on new orders.

In this context, we believe the outlook for the sector remains strong in FY12 as we expect better execution this year, driven by prior years' capacity expansion and pick up in deliveries. We forecast average sector sales growth to pick up to c17% in FY12e and c18% in FY13e.

Calendarized sales and order book estimates

	FY07	FY08	FY09	FY10	FY11	FY12e	FY13e
Order book (INRm)							
Jyoti Structures	18,000	33,500	36,000	41,500	45,000	46,250	53,956
Kalpataru Power Transmission	31,000	53,882	68,091	76,705	96,500	115,715	142,785
KEC International	30,860	43,180	51,630	55,000	78,000	99,136	130,928
ABB Ltd	37,857	53,100	67,410	84,681	84,668	87,446	97,098
Areva T&D India	20,945	30,836	42,640	47,979	47,958	46,146	49,967
Crompton Greaves	44,061	50,782	65,660	63,650	71,690	77,160	87,492
Siemens India	84,666	96,207	100,629	119,379	147,063	169,880	193,724
Total	267,389	361,486	432,060	488,894	570,879	641,734	755,951
Growth - y/y			20%	13%	17%	12%	18%
CAGR (FY11-13e)							16%
CAGR (FY12-13e)							15%
Order intake (INRm)							
Jyoti Structures	0	29,238	20,894	25,970	27,610	27,265	36,126
Kalpataru Power Transmission	18,665	49,714	46,435	48,135	62,788	72,147	89,282
KEC International	26,206	40,465	42,738	42,442	67,742	76,901	102,292
ABB Ltd	61,348	77,647	82,118	81,009	65,576	76,496	96,531
Areva T&D India	25,471	32,040	40,632	42,066	42,429	46,727	57,952
Crompton Greaves	63,478	66,009	88,121	77,039	88,039	96,014	114,469
Siemens India	88,873	91,721	87,843	106,134	131,873	151,174	177,966
Total	284,040	386,832	408,780	422,796	486,056	546,723	674,618
Growth - y/y			6%	3%	15%	12%	23%
CAGR (FY11-13e)							17%
CAGR (FY12-13e)							18%
Gross sales (INRm)							
Jyoti Structures	9,724	13,738	18,394	21,298	24,847	26,143	28,567
Kalpataru Power Transmission	15,982	26,749	32,460	39,963	43,687	52,382	61,587
KEC International	20,406	28,145	34,288	39,072	44,742	55,764	70,500
ABB Ltd	46,881	61,570	66,871	62,497	64,915	74,246	87,716
Areva T&D India	17,059	21,650	28,724	36,794	41,526	46,598	51,966
Crompton Greaves	56,396	68,323	87,373	91,409	100,051	115,205	133,716
Siemens India	77,054	95,292	94,831	94,533	108,467	132,338	158,730
Total	243,502	315,467	362,940	385,565	428,234	502,677	592,782
Growth y-o-y		30%	15%	6%	11%	17%	18%
CAGR (FY11-13e)							15%
CAGR (FY12-13e)							18%

Source: Company data, HSBC estimates

Transmission orders set to fall in FY12 and pick up in FY13;

But order book to continue to grow

We expect domestic transmission orders in FY12 to decline marginally by c5%, driven by three factors:

- 1 FY11 being a tough comp due to c50% y-o-y growth in Power Grid orders.
- 2 Changes in Power Grid management (Finance Director and Chairman) are likely to disrupt project finalization and order activity.
- 3 Slippage of orders related to the nine high capacity power transmission corridors (HCPTCs) to FY13-14.

Given mounting concerns regarding the financial health of State Electricity Boards (SEBs) and the fuel concerns associated with generation projects leading to delays, we have taken a conservative approach in our assumptions for transmission capex. We now assume a 'cancellation' of c25% of the expenditure related to the HCPTCs and a 'slippage' of c30% of the planned expenditure in the XIIth Five-year plan (FY13-17) ex-HCPTC.

We note that the orders related to XIIth Plan capex should ideally start flowing through FY12; however, for the reasons discussed above (management changes at Power Grid and the push back in HCPTC orders), we expect orders to gather pace only from Q4 FY12 and peak in

FY14. Consequently, we forecast transmission orders to grow by c40% in FY13e after declining by c5% in FY12e.

Transmission order forecasts

Year	INRm	% Growth
FY11e	233,951	
FY12e	218,227	-5%
FY13e	308,418	41%
FY14e	417,671	35%
FY15e	467,624	12%
FY16e	376,473	-19%
FY17e	351,580	-7%
Total	2,373,943	9%

Note: Assuming 18-month lead time
Source: Company data, HSBC estimates

While we expect transmission orders to be weak in the short term, we expect sector backlog to continue to grow (c12% in FY12e and c18% in FY13e) benefiting from international demand and above-normal growth in new business ventures.

We note that the key risk to sector order forecasts is as follows:

- ▶ Delay/cancellation in transmission projects
- ▶ Increasing competition in the domestic transmission market
- ▶ Slowdown in industrial capex

Competition remains intense but dynamics improving

Increasing competition in the domestic transmission market has been a key concern for the last couple of years. We note that the dynamics of competition differ within each sub-segment. While the transformer segment, particularly in the 765kV range, is facing tough competition from foreign vendors (Chinese/Korean), EPC is under pressure from domestic players.

Our channel checks suggest that while competition in both these segments remains intense, the dynamics are slowly changing in favour of the companies we cover, which are

regarded as major players in this segment. This is also evident in the market share data for FY11, which shows that most of the majors under our coverage have regained their market position after losing share in FY10.

In the transformer segment, the majors are finding some comfort from the change in qualification requirements, which now requires foreign vendors to establish Indian manufacturing facilities within three years of getting the order. This, in our opinion, should ward off some competition from China.

Market share of coverage universe

Segment	FY09	FY10	FY11	FY12 y-t-d
765KV+ Transformers/Reactors	39%	39%	45%	NA
765KV+ Substation	69%	100%	100%	NA
upto 400KV Transformers/Reactors	67%	49%	63%	100%
upto 400KV Substation	68%	76%	51%	0%
Tower EPC	43%	17%	24%	NA

Source: Company data

In addition, most of our companies are now close to attaining two years of operational experience in supplying 765kV transformers, which is a pre-requisite for the domestic players to qualify for supplying an entirely 'Indian made' transformer (Crompton has now already qualified for this). We believe that once companies are qualified, their cost of manufacturing will fall significantly, allowing them to bid much more competitively against the Chinese/Korean players, thereby helping them to improve their market share.

In the tower segment (transmission line EPC), the majors (such as KPP and KEC) are finding that many new entrants are being increasingly disqualified for the projects as they have failed to execute prior orders as per expectations. Their failure is largely attributed to their aggressive bidding, poor project management, lack of expertise and short-term focus on growth. Hence, some of the majors have recently won significant orders despite not being the lowest bidder in most of them.

Overall, while we expect competition to remain intense (as gauged by the number of players), we believe price rationality will return soon to the market and hence pricing pressure might ease up going forward. *For details on market share, please refer to the chapter on competition.*

Expect margins to be stable, earnings growth to pick up

While we acknowledge that margins will remain under pressure due to pricing pressures and cost inflation, we believe that the benefits of volume growth (operational leverage) and fruition of prior investments should help offset these pressures. Hence, we remain optimistic on margin resilience and forecast sector margins (ex-ABB) to remain flat over FY11, at 11.9%.

Consequently, with stable margins and a pick-up in revenue growth (as highlighted earlier), we believe earnings growth can pick up sharply in FY12-13. We forecast earnings growth to increase to c28% in FY12e and c22% in FY13e compared to c10% in FY11 and c1% in FY10.

Expectations nearing bottom, but valuations attractive

In FY11, earnings disappointed in three out of four quarters with the biggest miss (c19%) coming in Q1 and the smallest (c2%) in Q4. Consequently, earnings estimates saw continued downward revisions in FY11 with a total downgrade of c13%. As result, even though the companies resorted to cautious guidance in Q4, the downward revision was only modest at c2%, implying that expectations had already corrected substantially.

We believe that expectations are now close to bottom and we remain c3% ahead of consensus on FY12e sector earnings on average. As we have highlighted above, we believe that execution will likely surprise on the upside in FY12 and could be a key catalyst for upgrades and subsequent share price movements.

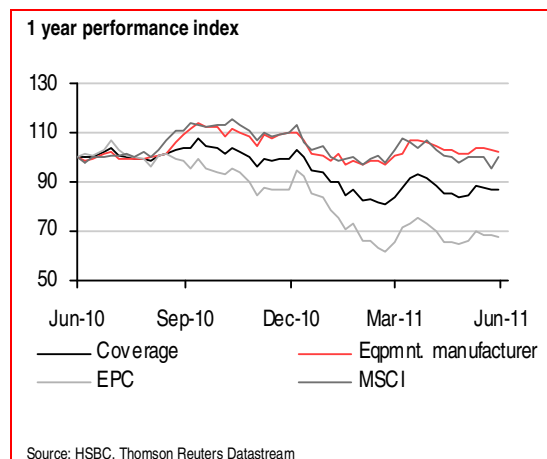
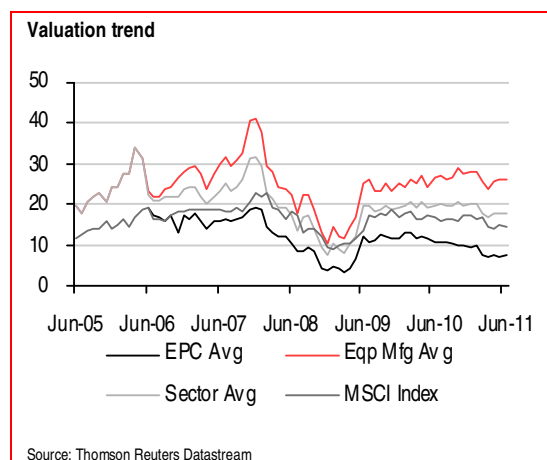
We note that in spite of earnings downgrades, the sector remains at a discount of c12% to its historical trading average, with five out of seven

Aggregate EBITDA margin and EPS

	FY08	FY09	FY10	FY11	FY12e	FY13e
Clean EBITDA margins						
Jyoti Structures	13.0%	12.4%	10.3%	11.4%	11.0%	10.8%
Kalpataru Power Transmission	12.3%	10.4%	10.8%	10.6%	10.6%	10.6%
KEC International	12.2%	11.5%	10.2%	10.8%	10.4%	10.3%
ABB Ltd	13.5%	11.7%	8.7%	5.0%	8.6%	10.0%
Areva T&D India	18.1%	15.4%	11.5%	11.3%	12.3%	12.7%
Crompton Greaves	10.9%	12.9%	14.0%	13.4%	13.8%	13.8%
Siemens India	8.1%	9.3%	12.4%	13.7%	13.5%	13.1%
Average margins	12.6%	12.0%	11.1%	10.9%	11.5%	11.6%
<i>Growth y-o-y</i>	(3)	(64)	(82)	(23)	58	15
<i>CAGR (FY11-13e)</i>						49
<i>CAGR (FY12-13e)</i>						72
EPS (INRm)						
Jyoti Structures	9.3	11.7	9.3	14.2	14.3	15.6
Kalpataru Power Transmission	12.4	8.8	12.9	13.2	17.0	20.4
KEC International	6.7	7.2	7.5	8.5	9.6	12.8
ABB Ltd	24.7	22.7	15.3	8.6	18.9	26.4
Areva T&D India	10.3	9.7	8.1	8.6	11.4	13.9
Crompton Greaves	6.3	10.0	12.4	14.4	16.2	18.7
Siemens India	21.3	14.9	20.1	26.4	32.6	37.9
Average	91.1	85.0	85.6	93.9	119.9	145.7
<i>Growth y-o-y</i>	12%	-7%	1%	10%	28%	22%
<i>CAGR (FY09-10)</i>						-3%
<i>CAGR (FY11-13e)</i>						19%
<i>CAGR (FY12-13e)</i>						25%

Source: Company data, HSBC estimates

companies (excluding ABB and Siemens) under our coverage trading a significant discount of c30%. The EPC players clearly offer higher value at this stage with an average discount of c40%, followed by equipment manufacturers like Crompton Greaves & Areva T&D, which are trading at a discount of c9-11%.



To further put the sector valuation into context, we note that current share prices suggest that the market expects the average sector through cycle margin to deteriorate by c180bps over the coming years. We believe this is highly unlikely in the medium term given that the average EBITDA margin for our universe has already moderated from the peak of FY07-08 by c170bps and should now stabilize for the reasons mentioned earlier.

Consequently, we believe that risks to earnings are adequately compensated for in the valuation and we continue to find the sector attractive on a risk adjusted basis.

Worst case scenario: risk to FY12-13 earnings only 5-14%

Even though we believe expectations are nearing the bottom and we see limited risk to earnings estimates, we have done a scenario analysis to gauge the ultimate risk to FY12-13e earnings in an unlikely worst case scenario.

In this scenario, we assume that the order growth falls short of our expectations by c5% in FY12e and c10% in FY13e. In such a case, we conclude that the downward risk to our earnings estimate is only c5% in FY12e and c14% in FY13e.

Given that the sector is already trading at a 12% discount to its historical average (c30% ex-ABB and Siemens), we believe the sector currently looks attractive even in the worst case scenario. *For more details on scenario analysis, please refer to the respective chapter.*

Downgrade SIEM to Neutral; upgrade ATD to OW

Siemens (Neutral, TP INR985): We believe that the outlook for Siemens remains strong as last year's (FY10, Sept YE) growth in new orders (c41%) and order book (c32%) is now feeding through into sales growth (37-38% in H1 FY11). The margins have also shown improvement, benefiting from volume growth and productivity.

However, we believe that much of this performance is already factored into the share price (with c19% out-performance in last 6 months) and the stock appears relatively fully valued at c29.2x FY11e PE and c24.3x FY12e PE. We have raised our FY11-13e estimates by c2-3% and increased our price target to INR985 from INR950; however, we downgrade the stock to

Neutral as our target price offers only modest potential return of c12% from current levels. Our target price implies that 12 months from now, the stock would be trading at a 12-month forward multiple of c25x PE.

Areva T&D (OW, TP INR310): Areva T&D saw weak order intake in CY10 (Dec YE) and the order book remained flat. Given that we are bearish on transmission orders in FY12 (Mar YE), we expect order intake and sales in CY11e to grow only modestly by c6% and c11%, respectively. However, we believe the group can surprise positively on margins, benefiting from its past restructuring efforts. Consequently, we remain c8% ahead of consensus on CY11e EPS and forecast an earnings growth of c40% in CY11e and c17% in CY12e.

While the company has not seen any downward earnings revision in the last six months, the stock has underperformed the benchmark index (BSE Capital Goods) by c10% and looks attractive on valuation, trading at c23.2x CY11e PE and c19x CY12e PE vs. a historic average of c26.9x (5-yr average of 12m fwd PE). Consequently, we upgrade the stock to Overweight from Neutral while lowering our target price to INR310 from INR340. Our target price implies that 12 months from now, the stock would be trading at a 12-month forward multiple of c20.6x PE.

Maintain preference for CRG and KPP

Crompton Greaves (OW, TP INR330):

With management change behind us, we believe Crompton remains well placed to expand its reach, both in terms of product offering and geographical presence. We further note that while competition remains intense in the domestic transmission market, Crompton did well in FY11 to retain its no.1 position in the 765kV transformer segment. We believe that the recent

localization of its manufacturing footprint places it well to compete with the Chinese/Korean players going forward. Consequently, we expect margins at Crompton to remain broadly stable and new acquisitions to provide strong impetus to the earnings growth.

We further note that Crompton remains the best company in our universe on fundamentals such as return ratios, cash margins and WC management; however, the stock remains at a discount, to its peers as well as its own history. On our estimates, the stock is currently trading at c15.8x FY12e PE and c13.7x FY13e PE compared to the historic average of c18.3x (5yr average of 12m fwd PE). We continue to find the valuation attractive and re-iterate our Overweight recommendation on the stock with a price target of INR330. Our target price implies that 12 months from now, the stock would be trading at a 12-month forward multiple of c17x PE.

Kalpataru Power (OW, TP INR185): With a record backlog of cINR105bn and strong visibility of c2.4 yrs, we believe Kalpataru Power remains well placed to deliver strong growth. We forecast earnings growth to pick up sharply to c29% in FY12e and c20% in FY13e compared to c2% in FY11. At c7.2x FY12e PE (vs. historic average of c12.0x), we believe risks are more than compensated in valuation and hence we re-iterate our OW rating on the stock with a TP of INR185. Our target price implies that 12 months from now, the stock would be trading at a 12-month forward multiple of c8.4x PE.

KEC International (OW, TP INR105):

Like KPP, we expect KEC to deliver strong earnings growth going forward, driven by a strong growth of c60% in new orders and c42% in backlog in FY11. We forecast earnings growth to pick up sharply to c23% in FY12e and c30% in FY13e compared to c4% in FY11. We note that while KEC remains expensive to KPP, we continue to find the stock attractive at c8.1x

FY12e PE (vs. historic average of c11.5x) and hence we maintain OW on the stock with TP of INR105. Our target price implies that 12 months from now, the stock would be trading at a 12-month forward multiple of c7.4x PE.

Jyoti Structures (OW, TP INR115): Unlike KPP and KEC, Jyoti reported only a modest growth of c6% in new orders in FY11. Given our bearish view on domestic transmission orders and Jyoti's limited exposure elsewhere, we expect FY12 to be a difficult year for Jyoti, both in terms of new orders and earnings growth. Consequently, we lower our FY12-13e EPS for Jyoti by c16-24% and forecast an earnings growth of c1% in FY12e and c10% in FY13e. We further note that while we expect improvement in execution to be the key catalyst for most of our companies, we believe growth in new orders will likely remain the key catalyst for Jyoti because of weak orders last year.

However, at this price and the current valuation of c6.0x FY12e PE and c5.5x FY13e PE, compared to historic trading average of c11.3x (5yr average of 12m fwd PE), we believe that the risks are adequately factored in and hence we maintain our Overweight recommendation on the stock. We reduce our target price to INR115 (from INR165) driven largely by our earnings downgrade. Our target price implies that 12 months from now, the stock would be trading at a 12-month forward multiple of c6.8x PE.

ABB (UW, TP INR590): Over the last 5 quarters, ABB has continued to disappoint on new orders; however, management guided for an improving outlook during the last quarter. Consequently, a recovery in both order intake and margins is expected over the coming years. While new order growth should benefit from the firm's increasing focus in Discrete Automation & Motion and Low Voltage businesses, the margins should benefit from a mix of factors: 1) increasing localization of the manufacturing platform, 2) significant reduction in the RE exit costs, and 3) rationalization of the operating activities.

While this recovery is widely expected, there is little consensus and/or guidance on the quantum of margin improvement. In addition, the stock remains significantly expensive in spite of our optimistic estimates. We believe that even if the recovery surprises significantly on the upside, it will do little to justify ABB's current PE multiple of c49.7x and c33.6x for CY11e and CY12e. Consequently, while we remain optimistic on earnings recovery, we continue to believe valuations remain stretched. Hence, we maintain our UW recommendation on the stock with a TP of INR590. Our target price implies that 12 months from now, the stock would be trading at a 12-month forward multiple of c21x PE.

Summary: Change in earnings estimates

Earnings estimate (INRm)		Revenue		EBITDA		EPS (INR)		Target price (INR)	Rating
		FY1e	FY2e	FY1e	FY2e	FY1e	FY2e		
ABB Ltd.	New	71,047	83,842	5,851	8,195	17.1	24.3	590	Underweight
	Old	72,592	87,594	6,171	8,376	18.0	24.8	590	Underweight
	Change	-2%	-4%	-5%	-2%	-5%	-2%		
Areva T&D	New	45,501	49,887	5,537	6,239	10.9	12.8	310	Overweight
	Old	46,803	55,343	5,479	6,979	10.3	14.2	340	Neutral
	Change	-3%	-10%	1%	-11%	5%	-10%		
Siemens Ltd	New	120,733	143,944	16,539	19,143	30.3	34.9	985	Neutral
	Old	115,936	141,265	15,620	18,659	29.8	34.9	950	Overweight
	Change	4%	2%	6%	3%	2%	0%		
Crompton Greaves	New	115,205	133,716	15,945	18,518	16.2	18.7	330	Overweight
	Old	115,673	134,928	15,967	19,088	16.2	19.4	330	Overweight
	Change	0%	-1%	0%	-3%	0%	-3%		
Jyoti Structures	New	26,143	28,567	2,881	3,081	14.3	15.6	115	Overweight
	Old	30,285	36,328	3,376	3,958	16.9	20.6	165	Overweight
	Change	-14%	-21%	-15%	-22%	-16%	-24%		
Kalpataru Power	New	52,382	61,587	5,569	6,511	17.0	20.4	185	Overweight
	Old	53,057	63,092	5,700	6,791	17.6	21.6	185	Overweight
	Change	-1%	-2%	-2%	-4%	-3%	-6%		
KEC International	New	56,539	70,229	5,934	7,223	9.8	12.7	105	Overweight
	Old	58,147	73,449	6,159	7,377	10.4	13.0	105	Overweight
	Change	-3%	-4%	-4%	-2%	-5%	-2%		

*FY1 is FY12 (Mar YE) for Crompton, Jyoti, Kalpataru and KEC, **FY1 is CY11 (Dec YE) for ABB and Areva T&D, ***FY1 is FY11 (Sept YE) for Siemens
Source: Company data, HSBC estimates

HSBC vs Consensus

	Sales (INRm)		EBITDA (INRm)		EPS (INR)	
	FY1e	FY2e	FY1e	FY2e	FY1e	FY2e
HSBC estimates						
Jyoti Structures	26,143	28,567	2,881	3,081	14.3	15.6
Kalpataru Power	52,382	61,587	5,569	6,511	17.0	20.4
KEC International	56,539	70,229	5,934	7,223	9.8	12.7
ABB Ltd	71,047	83,842	5,851	8,195	17.1	24.3
Areva T&D	45,501	49,887	5,537	6,239	10.9	12.8
Crompton Greaves	115,205	133,716	15,945	18,518	16.2	18.7
Siemens Ltd	120,733	143,944	16,539	19,143	30.3	34.9
Sector Total	487,550	571,772	58,256	68,909	115.6	139.4
Consensus						
Jyoti Structures	27,839	31,409	3,089	3,478	14.4	16.2
Kalpataru Power	54,178	62,931	5,856	6,754	16.3	21.2
KEC International	56,705	65,845	5,869	6,744	9.7	11.9
ABB Ltd	73,154	87,401	5,842	8,058	17.6	24.3
Areva T&D	47,380	55,427	5,363	6,631	9.5	13.7
Crompton Greaves	114,623	131,939	15,727	18,077	15.9	18.6
Siemens Ltd	112,038	136,660	15,042	18,104	29.7	35.3
Sector Total	485,917	571,612	56,788	67,846	113.1	141.2
HSBC vs. Consensus						
Jyoti Structures	-6%	-9%	-7%	-11%	-1%	-3%
Kalpataru Power	-3%	-2%	-5%	-4%	4%	-4%
KEC International	0%	7%	1%	7%	1%	7%
ABB Ltd	-3%	-4%	0%	2%	-3%	0%
Areva T&D	-4%	-10%	3%	-6%	15%	-7%
Crompton Greaves	1%	1%	1%	2%	2%	1%
Siemens Ltd	8%	5%	10%	6%	2%	-1%
Sector Total	-1%	-2%	1%	-1%	3%	-1%

*FY1 is FY12 (Mar YE) for Crompton, Jyoti, Kalpataru and KEC, **FY1 is CY11 (Dec YE) for ABB and Areva T&D, ***FY1 is FY11 (Sept YE) for Siemens
Source: HSBC estimates, Bloomberg

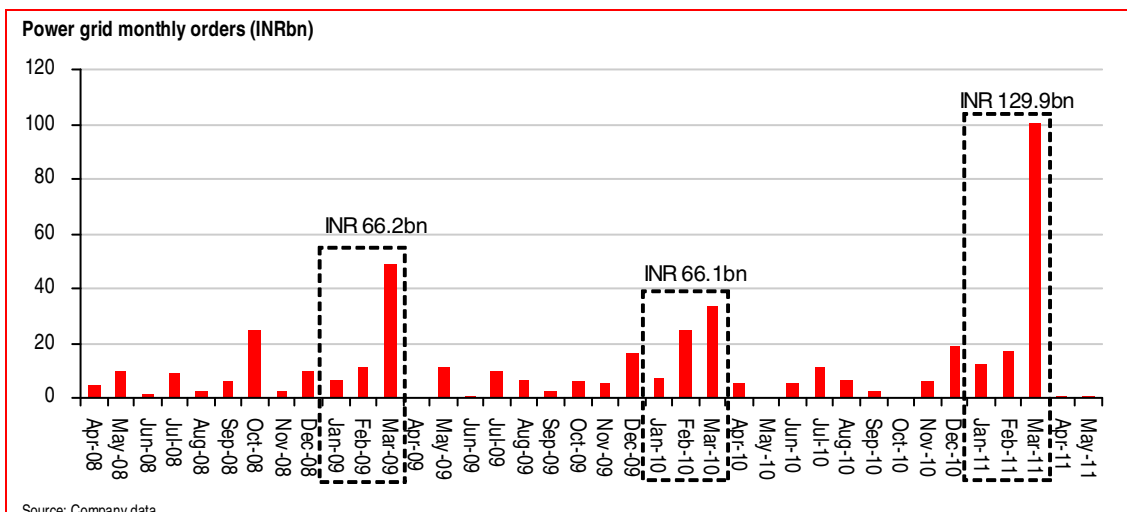
Shifting focus to execution from orders

- ▶ FY11 was an inflection point for demand, with c15% growth in orders; FY12 will likely be an inflection point for earnings growth
- ▶ We believe sector backlog has lengthened to a point where marginal comfort from incremental orders has somewhat diminished; expect focus to shift to execution
- ▶ Expect order books to continue to grow in spite of short term weakness in domestic transmission orders (-c5% in FY12e, +c40% in FY13e); sales growth to pick up sharply in FY12 (c17%)

Power Grid orders surprise in Q4 FY11

After a lacklustre growth in the first nine months of FY11 (Mar YE), Power Grid (PG) orders rose sharply in Q4 to cINR130bn, leading to growth of c50% y-o-y in FY11. The order growth in Q4 was driven largely by one big substation order worth

cINR53bn and several tower related orders in the range of INR1-3bn. Order activity was muted in the next two months (April and May), largely due to seasonality in our opinion, with total orders of cINR1.3bn. We highlight the monthly orders from Power Grid in the chart.



Moreover, as we had anticipated in our initiation report on 25 January 2011, *Indian Capital Goods – Brighter days ahead*, the order mix is increasingly shifting towards higher voltage equipment (765kV+). In FY11, c62% of the total transformer/reactor orders and c85% of the total substation orders were in the 765kV+ category. We expect this trend to continue given that the XIIth plan focuses on increasing the capacity of the 765kV transmission network. Consequently, we believe that transmission vendors, both substation equipment suppliers and EPC contractors, who are well established and have the requisite expertise and experience, will remain better placed to capture the growth in transmission capex.

Power Grid order mix

Components	FY09	FY10	FY11	FY12e y-t-d
Tower	33%	39%	35%	0%
Insulator	2%	8%	2%	53%
Civil	0%	1%	2%	0%
Conductor	23%	12%	16%	0%
Rural Elec	11%	2%	0%	0%
Substation	19%	17%	39%	36%
Transformers/reactors	11%	20%	6%	11%
Others	1%	2%	0%	0%
Total	100%	100%	100%	100%

Source: Company Data

Order mix between 765KV and 400/220KV

Transformer order mix	FY09	FY10	FY11	FY12e y-t-d
765kV	58%	80%	62%	62%
400/220kV	42%	20%	38%	38%
Total	100%	100%	100%	100%

Substation order mix

765kV AC / 800kV DC	42%	14%	85%	85%
400/220kV	58%	86%	15%	15%
Total	100%	100%	100%	100%

Source: Company Data

Order growth in FY12 likely to be muted

The base effect

We expect transmission order growth to be muted in FY12 as a result of the unexpected surge in orders in Q4 FY11 and the consequent base effect. Having said that, we believe that companies

which are well established and are technology leaders will continue to remain better placed than the new entrants (*please refer to the next section for discussion on competitive dynamics*).

Management changes at Power Grid

In addition to the base effect, we believe the changes in the Power Grid management mentioned earlier are likely to disrupt ordering activity for most of FY12, particularly in the first half. We expect large orders, if any, to materialize in Q4 FY12 at the earliest.

HCPTC orders to be pushed back

Due to management changes, we believe that orders related to the planned High Capacity Power Transmission Corridors (HCPTCs), which were the key driver of our earlier bullish view on order growth in FY12, will now get pushed into FY13-14. In our new transmission order forecasts, we assume that only c10% of HCPTCs will be ordered in FY12 and c20% in FY13, with the rest coming in FY14 -15.

In addition, we believe that due to fuel related issues some of the associated generation projects may stall and we might see cancellation of some of the ‘radial’ lines associated with these corridors. Consequently, we have taken a conservative view on these corridors and assumed that only c75% of the related capacity will materialise over the coming years. We highlight our estimates for HCPTC orders in the table below.

Order pattern for HCPTC

Year	INRm	% spent
FY11e	0	0%
FY12e	43,500	10%
FY13e	87,000	20%
FY14e	152,250	35%
FY15e	130,500	30%
FY16e	21,750	5%
FY17e	0	0%
Total HCPTC	435,000	100%

Source: Company data, HSBC estimates

Orders to decline c5% in FY12 but grow c40% in FY13

Transmission capex is expected to be around INR2,400bn in the XII Plan (FY13-17), up c70% over the planned expenditure in the XIth Plan (FY08-12). The orders related to the XIIth Plan capex should ideally start flowing through FY12; however, due to management changes at PG and the push back in HCPTC orders, we expect orders to gather pace only from Q4 FY12 and peak in FY14. Consequently, we forecast transmission orders to grow by c40% in FY13e after declining by c5% in FY12e.

In addition, due to the mounting fuel concerns in the generation sector and the deteriorating financial environment, we assume that only c70% of the XIIth Plan transmission capex ex-HCPTC will materialize over the coming years. Overall, we assume that only cINR1.7trn of the planned transmission capex of INR2.4trn will materialise during the XIIth Plan. We expect Power Grid to spend cINR8.7trn of this. We highlight our transmission order forecasts in the table below.

Transmission order forecasts

Year	INRm	% Growth
FY11e	233,951	
FY12e	218,227	-5%
FY13e	308,418	41%
FY14e	417,671	35%
FY15e	467,624	12%
FY16e	376,473	-19%
FY17e	351,580	-7%
Total	2,373,943	9%

Source: Company data, HSBC estimates
 Note: Assuming 18m lead time

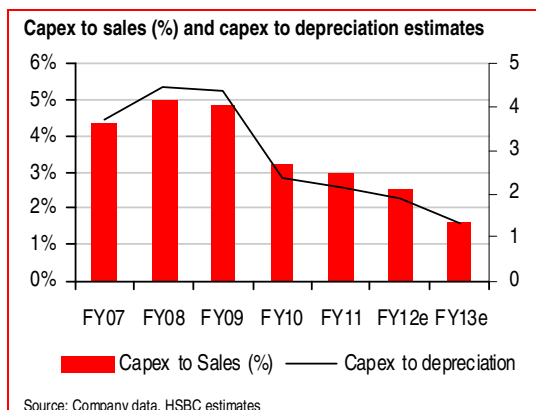
Sharp sales growth in FY12, driven by strong execution

In FY11, companies under our coverage saw strong growth of c15% in new orders, driven largely by a pick-up in industrial capex and continued orders in the transmission segment. However, due to the relatively longer lead times (c18-20 months) and weak order intake in the

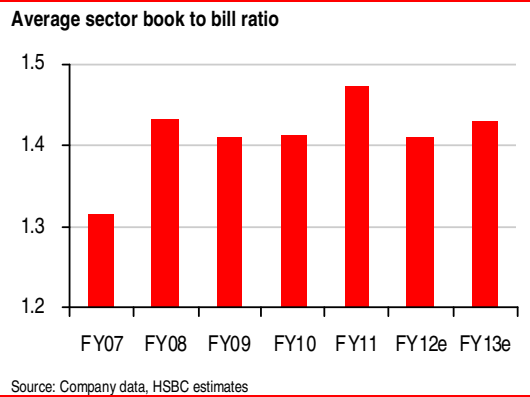
prior years (order growth of c6% in FY09 and c3% in FY10), the sales growth in FY11 weakened to c11% y-o-y. Consequently, order books rose to an all time high and increased on average by c17% in FY11.

While we expect growth in new orders, at c12% y-o-y, to be weaker in FY12, we believe that sales growth should be stronger (c17% y-o-y) as deliveries pick up and the current order book is executed.

We remain comfortable with our companies' ability to execute their inflated order books because most have ramped up capacity over the last two years and have room to increase their execution rate.



We further note that the book-to-bill (order book/LTM sales) ratio is at an all time high of c1.5x in FY11. In our opinion, these levels provide sufficient visibility into future earnings and we believe that investors should now shift their focus to execution (i.e. earnings growth) from growth in new orders.



We expect forecast sector sales growth of c17% in FY12e and c18% in FY13e, up from c11% in FY11. We highlight our estimates of sales, new orders and order book for the sector in the chart on the next page.

Financial year sales and order book estimates

	FY06	FY07	FY08	FY09	FY10	FY11	FY12e	FY13e
Order book (INRm)								
Jyoti Structures		18,000	33,500	36,000	41,500	45,000	46,250	53,956
Kalpataru Power Transmission		31,000	53,882	68,091	76,705	96,500	115,715	142,785
KEC International	25,060	30,860	43,180	51,630	55,000	78,000	99,136	130,928
ABB Ltd	33,723	50,260	61,618	84,787	84,362	85,587	93,024	109,319
Areva T&D India	18,771	27,465	40,948	47,717	48,765	45,538	47,969	55,963
Crompton Greaves	29,867	44,061	50,782	65,660	63,650	71,690	77,160	87,492
Siemens India	75,258	94,074	98,340	102,918	135,839	158,286	181,474	205,975
Total		295,720	382,250	456,803	505,821	580,602	660,727	786,418
Order intake (INRm)								
Jyoti Structures			29,238	20,894	25,970	27,610	27,265	36,126
Kalpataru Power Transmission		18,665	49,714	46,435	48,135	62,788	72,147	89,282
KEC International		26,206	40,465	42,738	42,442	67,742	76,901	102,292
ABB Ltd	56,236	76,682	80,541	86,847	63,496	71,815	90,538	114,512
Areva T&D India	24,180	29,343	40,129	42,139	41,848	44,171	54,396	68,621
Crompton Greaves		63,478	66,009	88,121	77,039	88,039	96,014	114,469
Siemens India	82,025	95,720	87,722	87,964	124,304	139,441	162,906	193,026
Total			393,817	415,138	423,234	501,606	580,166	718,327
Gross sales (INRm)								
Jyoti Structures	6,993	9,724	13,738	18,394	21,298	24,847	26,143	28,567
Kalpataru Power Transmission		15,982	26,749	32,460	39,963	43,687	52,382	61,587
KEC International	17,272	20,406	28,145	34,288	39,072	44,742	55,764	70,500
ABB Ltd	42,740	59,303	68,370	62,372	62,871	71,047	83,842	99,339
Areva T&D India	16,058	20,063	26,412	35,659	40,200	45,501	49,887	58,201
Crompton Greaves	41,265	56,396	68,323	87,373	91,409	100,051	115,205	133,716
Siemens India	60,323	93,786	96,798	92,865	96,201	120,733	143,944	173,517
Total		275,659	328,535	363,410	391,014	450,608	527,168	625,427

Source: Company data, HSBC estimates

Calendarized sales and order book estimates

	FY07	FY08	FY09	FY10	FY11	FY12e	FY13e
Order book (INRm)							
Jyoti Structures	18,000	33,500	36,000	41,500	45,000	46,250	53,956
Kalpataru Power Transmission	31,000	53,882	68,091	76,705	96,500	115,715	142,785
KEC International	30,860	43,180	51,630	55,000	78,000	99,136	130,928
ABB Ltd	37,857	53,100	67,410	84,681	84,668	87,446	97,098
Areva T&D India	20,945	30,836	42,640	47,979	47,958	46,146	49,967
Crompton Greaves	44,061	50,782	65,660	63,650	71,690	77,160	87,492
Siemens India	84,666	96,207	100,629	119,379	147,063	169,880	193,724
Total	267,389	361,486	432,060	488,894	570,879	641,734	755,951
Growth - y/y			20%	13%	17%	12%	18%
CAGR (FY11-13e)							16%
CAGR (FY12-13e)							15%
Order intake (INRm)							
Jyoti Structures	0	29,238	20,894	25,970	27,610	27,265	36,126
Kalpataru Power Transmission	18,665	49,714	46,435	48,135	62,788	72,147	89,282
KEC International	26,206	40,465	42,738	42,442	67,742	76,901	102,292
ABB Ltd	61,348	77,647	82,118	81,009	65,576	76,496	96,531
Areva T&D India	25,471	32,040	40,632	42,066	42,429	46,727	57,952
Crompton Greaves	63,478	66,009	88,121	77,039	88,039	96,014	114,469
Siemens India	88,873	91,721	87,843	106,134	131,873	151,174	177,966
Total	284,040	386,832	408,780	422,796	486,056	546,723	674,618
Growth - y/y			6%	3%	15%	12%	23%
CAGR (FY11-13e)							17%
CAGR (FY12-13e)							18%
Gross sales (INRm)							
Jyoti Structures	9,724	13,738	18,394	21,298	24,847	26,143	28,567
Kalpataru Power Transmission	15,982	26,749	32,460	39,963	43,687	52,382	61,587
KEC International	20,406	28,145	34,288	39,072	44,742	55,764	70,500
ABB Ltd	46,881	61,570	66,871	62,497	64,915	74,246	87,716
Areva T&D India	17,059	21,650	28,724	36,794	41,526	46,598	51,966
Crompton Greaves	56,396	68,323	87,373	91,409	100,051	115,205	133,716
Siemens India	77,054	95,292	94,831	94,533	108,467	132,338	158,730
Total	243,502	315,467	362,940	385,565	428,234	502,677	592,782
Growth - y/y		30%	15%	6%	11%	17%	18%
CAGR (FY11-13e)							15%
CAGR (FY12-13e)							18%

Source: Company data, HSBC estimates

Competitive environment gradually improving

- ▶ Competition remains intense but majors under our coverage are regaining market share
- ▶ While transformer vendors benefit from tougher qualification requirements and increasing localization, EPC players are being helped by Power Grid's focus on execution record
- ▶ Expect pricing rationality to return and margins to remain stable

Competition remains intense, but dynamics improving

Increasing competition has been one of the key issues for this sector, leading to price distortion and market share dilution for major players. We note that while the competitive environment remains tough, the overall dynamics are slowly shifting in favour of the major players.

At a very broad level, this change can be gauged from the Herfindahl–Hirschman Index (HHI) for the transmission sector, which points to falling competitive intensity in many sub-segments.

Clearly, not every new player who entered in FY09 has managed to survive until FY11.

Herfindahl-Hirschman Index (HHI)

Segments	FY09	FY10	FY11	FY12 y-t-d
765kV Transformers/Reactors	0.52	0.25	0.22	N.A.
765kV Substations	0.38	0.51	0.82	N.A.
400/220kV Transformers/Reactors	0.22	0.33	0.23	1.00
400/220kV Substations	0.12	0.25	0.20	1.00
Tower EPC	0.12	0.09	0.10	N.A.

Source: Company data, HSBC

Majors regaining market position

At a more granular level, we note that the majors have emerged as winners and have regained their market position in both the substation/transformer and EPC segments.

Transformers/Reactors in 765KV+ segment

Company	FY09	FY10	FY11	FY12 y-t-d
Crompton Greaves	39%	34%	31%	N.A.
Baoding (China)	0%	13%	26%	N.A.
Hyosung Corp	61%	21%	18%	N.A.
Hyundai Engg	0%	0%	11%	N.A.
Areva T&D	0%	0%	3%	N.A.
TBEA (China)	0%	28%	0%	N.A.
ABB	0%	5%	11%	N.A.
Total	100%	100%	100%	N.A.

Source: Company data, HSBC

Substation in 765KV+ segment

Company	FY09	FY10	FY11	FY12 y-t-d
ABB	50%	0%	90%	N.A.
Siemens	19%	41%	5%	N.A.
Areva T&D	0%	59%	4%	N.A.
GET Power	0%	0%	0%	N.A.
L&T and Areva JV	31%	0%	0%	N.A.
Total	100%	100%	100%	N.A.

Source: Company data, HSBC

Transformers/Reactors in 400KV+ segment

Company	FY09	FY10	FY11	FY12 y-t-d
Vijai Electricals	0%	3%	31%	0%
Siemens	10%	0%	30%	100%
Areva T&D	15%	16%	12%	0%
Crompton Greaves	26%	33%	11%	0%
BHEL	33%	43%	6%	0%
ABB	5%	0%	0%	0%
EMCO	0%	5%	0%	0%
Siemens AG	12%	0%	9%	0%
Total	100%	100%	100%	100%

Source: Company data, HSBC

Substations in 400KV+ segment

Company	FY09	FY10	FY11	FY12 y-t-d
Siemens/Siemens AG	24%	45%	29%	0%
GET Power	9%	3%	29%	100%
KEC International	0%	0%	12%	0%
Tata Projects	2%	0%	7%	0%
Jyoti Engineers	0%	0%	6%	0%
Hyosung Corp	0%	8%	5%	0%
Jyoti Structures	8%	0%	4%	0%
ABB	7%	8%	4%	0%
Areva T&D	4%	13%	2%	0%
L&T and Areva JV	17%	0%	0%	0%
PSC Engineers	0%	0%	1%	0%
Bharat Bijlee	0%	0%	0%	0%
ICSA	0%	7%	0%	0%
Crompton Greaves	8%	9%	0%	0%
Indo Power	0%	1%	0%	0%
BHEL	2%	0%	0%	0%
ECI Engg	8%	0%	0%	0%
EMC	2%	0%	0%	0%
EMCO	4%	5%	0%	0%
Shyama Power	4%	0%	0%	0%
Voltech Projects	1%	0%	0%	0%
Total	100%	100%	100%	100%

Source: Company data, HSBC

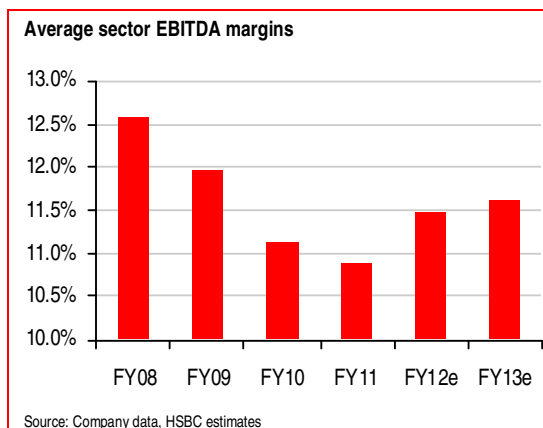
EPC towers

Company	FY09	FY10	FY11	FY12 y-t-d
KEC International	14%	2%	11%	N.A.
Jyoti Structures	15%	11%	1%	N.A.
Kalpataru Power	14%	5%	11%	N.A.
Tata Projects	6%	20%	19%	N.A.
Gammon India	0%	2%	6%	N.A.
JV of RSC & Sujana	0%	0%	1%	N.A.
Tata Power	0%	0%	1%	N.A.
A2Z	0%	3%	1%	N.A.
Aravali	0%	3%	1%	N.A.
ATSL	19%	1%	0%	N.A.
C & C CONSTRUCTIONS	0%	0%	1%	N.A.
JV of SPIC & BST	0%	0%	4%	N.A.
JV of A2Z & Karamtara	0%	2%	0%	N.A.
L&T	7%	9%	6%	N.A.
EMC	2%	0%	0%	N.A.
EMCO	9%	0%	2%	N.A.
JV of EMC & ICOMM	6%	8%	4%	N.A.
Jyoti Engineers	1%	0%	0%	N.A.
Shyama Power	1%	0%	4%	N.A.
JV of SPIC & Aster	1%	4%	6%	N.A.
Aster Tele	1%	0%	0%	N.A.
JV of ECI & ICOMM	1%	0%	0%	N.A.
Bajaj Electricals	1%	2%	0%	N.A.
JV of RSC & Skipper	0%	3%	0%	N.A.
JV of RSC & BST	0%	2%	0%	N.A.
ICOMM Tele	0%	7%	0%	N.A.
Inabensa	0%	4%	0%	N.A.
IVRCL Infra	0%	8%	6%	N.A.
JV of SPIC & Sujana	0%	2%	0%	N.A.
Lanco	0%	2%	0%	N.A.
JV of Utkal & Jagabandhu	0%	1%	0%	N.A.
JV of EMC & Amitasha	0%	0%	13%	N.A.
JV of EMC & BIL	0%	0%	2%	N.A.
Best & Crompton	1%	0%	0%	N.A.
Total	100%	100%	100%	N.A.

Source: Company data, HSBC

Margins have shown resilience

Despite market fears, the average EBITDA margin for the sector fell by an average of only c25bps in FY11. Interestingly, the deterioration in margin was not broad based and was driven largely by a c360bp margin decline at ABB, which was company specific in nature.



Pricing pressure easing; execution capability becoming key

Most of the companies at their last quarter results guided for stable or improving margins going into FY12. Assuming the companies have reasonable visibility on the profitability embedded in their order books, their guidance implies that order growth in FY11 has not come at the expense of margins.

This, in turn, implies that the industry (or at least Power Grid) is slowly moving away from pricing led demand towards execution capability led demand. This trend is evident in the transmission line EPC orders, where in FY11 both Kalpataru and KEC won a significant number of orders despite not being the lowest bidder in many of them. We believe this is a positive trend for our companies which have proven execution capabilities and are better placed to win large orders compared to new entrants.

Change in qualification requirements supporting domestic players

While the tower and 400/220kV substation/transformer segments have seen competition from domestic players, the 765kV segment has attracted several Chinese/Korean players. However, we believe that the situation is not grim, as the domestic players are now well placed to compete with other Asian players. The reasons why we remain comfortable with the competitive environment in this segment are:

- ▶ The number of players, including foreign vendors, remains limited so pricing distortion is likely to be minimal.
- ▶ Most of the domestic players, from this year onwards, will qualify to supply the entire order from their local manufacturing facility. This will bring them at par with other Asian players in terms of costs and will improve their ability to bid aggressively
- ▶ Power Grid is expected to introduce a new qualification requirement which will require foreign bidders to establish Indian manufacturing facilities within three years of getting the order. This should ward off some competition from China.

Expectations bottoming; valuations attractive

- ▶ With three out of the last four quarters disappointing on earnings, consensus has come down by c13% in the last 12 months
- ▶ Valuations remain attractive, with the sector trading at a discount of c12% (c30% ex-ABB and SIEM) to its historical average
- ▶ Current valuations imply that sector margins are expected to decline c180bp, which we believe is highly unlikely; EPC players offer greater value (c40% discount to historical average)

Earnings disappointed in three out of last four quarters...

FY11 (Mar YE) was a disappointing year for the sector, with companies missing expectations in three out of four quarters. While order books were on the rise, a combination of weaker execution and cost pressures took a toll on earnings.

The biggest disappointment came in the first quarter of FY11, where the sector missed EPS estimates by c19% on average, driven by a c4% miss in revenues and c80bp in EBITDA margins. However, in the subsequent quarters the earnings

miss was more modest as analysts adjusted their estimates to factor in weaker execution, pricing pressures and cost inflation. The smallest miss came in the last quarter, where sector earnings disappointed only by c2% on average.

...consequently expectations have corrected sharply

As a result of continued disappointment, the earnings expectations for FY12 have corrected sharply by c13% over the last 12 months, with the latest downward revision coming after the Q4 FY11 results. However, in line with the pace of

Q1, Q3 earnings miss consensus estimates

Actual vs. Cons	Sales			EBITDA			EPS		
	Q1 FY11	Q2 FY11	Q3 FY11	Q1 FY11	Q2 FY11	Q3 FY11	Q1 FY11	Q2 FY11	Q3 FY11
ABB	-15%	-17%	3%	-57%	-74%	-80%	-62%	-86%	-94%
Areva T&D	-1%	20%	1%	-12%	57%	11%	23%	103%	15%
Siemens	-1%	3%	12%	-14%	28%	28%	-34%	30%	49%
Crompton Greaves	0%	1%	-2%	4%	2%	-2%	1%	4%	7%
Kalpataru Power	-12%	-2%	-3%	-2%	-8%	-2%	-23%	-28%	-12%
KEC International	0%	-5%	-11%	-3%	-5%	3%	-36%	-4%	10%
Jyoti Structures	0%	-3%	-9%	2%	0%	-8%	0%	1%	-6%
Sector average	-4%	-1%	-1%	-12%	0%	-7%	-19%	3%	-4%

Source: Company data, Bloomberg estimates

Q4 earnings also miss consensus estimates

Company (INRm)	Actual			Consensus			Actual vs. Consensus		
	Sales	EBITDA	EPS	Sales	EBITDA	EPS	Sales	EBITDA	EPS
ABB	17,813	1,016	2.8	16,603	1,096	3.5	7%	-7%	-19%
Areva T&D	9,949	837	1.2	9,115	787	1.5	9%	6%	-20%
Siemens	30,377	4,449	8.2	28,064	3,627	7.1	8%	23%	15%
Crompton Greaves	29,080	3,731	4.5	28,286	4,257	4.5	3%	-12%	0%
Kalpataru Power	8,846	985	4.0	10,138	1,160	4.8	-13%	-15%	-16%
KEC International	15,574	1,636	3.1	16,600	1,704	2.8	-6%	-4%	11%
Jyoti Structures	7,218	840	4.3	6,796	786	3.7	6%	7%	16%
Sector average							2%	0%	-2%

Source: Company data, Bloomberg estimates

disappointment, the pace of downward revision has also slowed through the quarters, with only c2% of the total c13% downgrade coming after the Q4 FY11 results.

FY12 EPS revision (INR) post Q4 results

Company	Pre Q4	Post Q4	Revision
ABB	18.5	17.6	-4.9%
Areva T&D	9.4	9.5	1.3%
Siemens	27.6	29.7	7.5%
Crompton Greaves	16.5	15.9	-3.8%
Kalpataru Power	18.4	16.3	-11.5%
KEC International	10.0	9.7	-3.0%
Jyoti Structures	14.5	14.4	-0.8%
Sector average			-2.2%

Source: Bloomberg estimates

FY12 EPS revision (INR) in last 12 months

Company	Jun-10	Jun-11	Revision
ABB	28.7	17.6	-39%
Areva T&D	10.4	9.5	-8%
Siemens	28.3	29.7	5%
Crompton Greaves	15.7	15.9	1%
Kalpataru Power	21.6	16.3	-25%
KEC International	10.3	9.7	-6%
Jyoti Structures	17.6	14.4	-18%
Sector average			-13%

Source: Bloomberg estimates

We remain above consensus; expectations have bottomed

We believe that the risks are now adequately factored into the earnings estimates (and more so in the share prices as we discuss in the following sections) and the expectations are now nearing bottom. In addition, management of most companies are now guiding cautiously, which in our opinion has further brought rationality to the earnings estimates.

As we have highlighted in the earlier chapters, we believe that FY12 is likely to witness strong execution and modest alleviation in pricing pressure, at least for the major players.

Consequently, we believe that FY12 earnings will most likely surprise on the upside. Hence, we remain modestly ahead of consensus (c3%) on FY12e sector earnings.

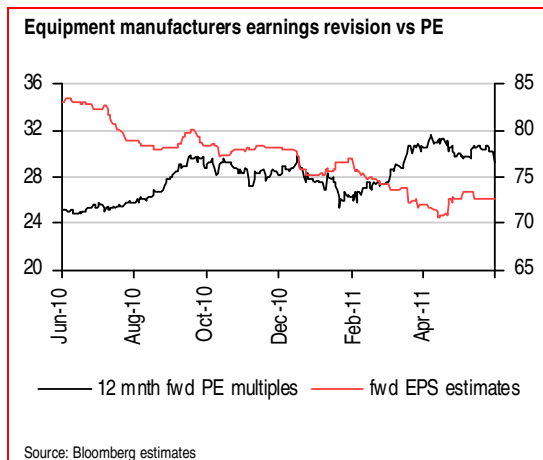
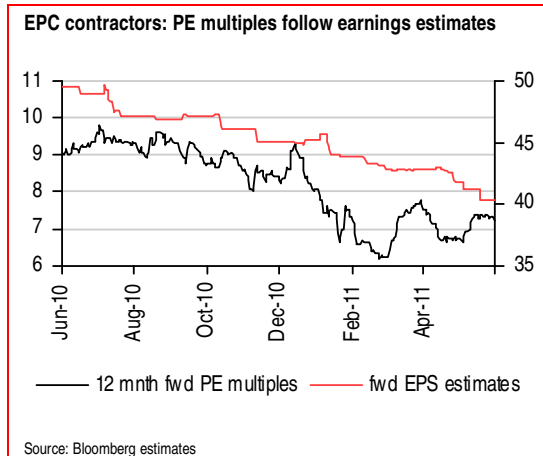
HSBC EPS vs consensus

Company	HSBC	Cons	Revision
ABB	17.1	17.6	-3%
Areva T&D	10.9	9.5	15%
Siemens	30.3	29.7	2%
Crompton Greaves	16.2	15.9	2%
Kalpataru Power	17	16.3	4%
KEC International	9.8	9.7	1%
Jyoti Structures	14.3	14.4	-1%
Sector Average			3%

Source: HSBC estimates, Bloomberg

The sector looks attractive on a risk-reward basis

Trading multiples have come down in spite of downgrades

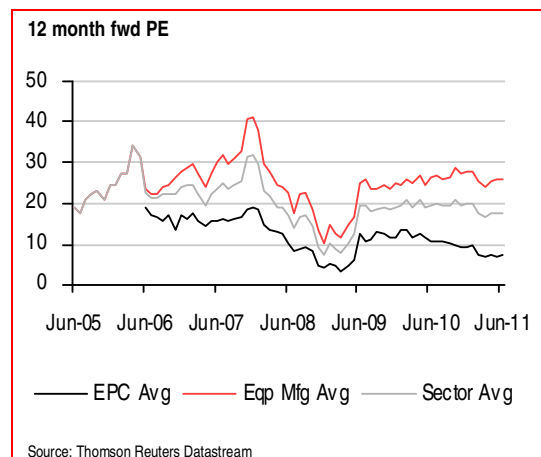
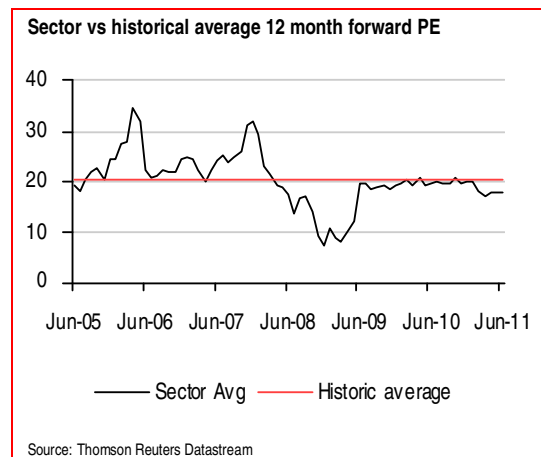


The 12m fwd PE multiples for five out of our seven companies have fallen significantly in spite of downward earnings revisions. In this context, we believe that the sector valuation looks attractive given that the sector has de-rated on a risk adjusted basis.

Valuation remains attractive vs. historical average

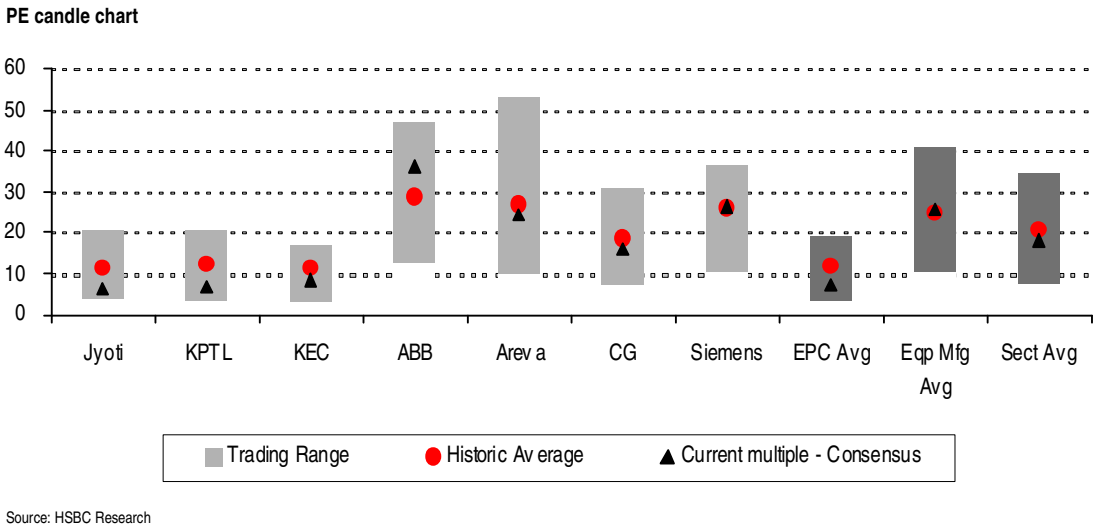
Our coverage universe as a whole is trading a discount of c12% (on 12m fwd PE) to its historical average. However, if we exclude ABB and Siemens, which have re-rated upwards, the

trading discount increases to c30%. Therefore, we believe that except for these two stocks, there is a lot of value in the sector.

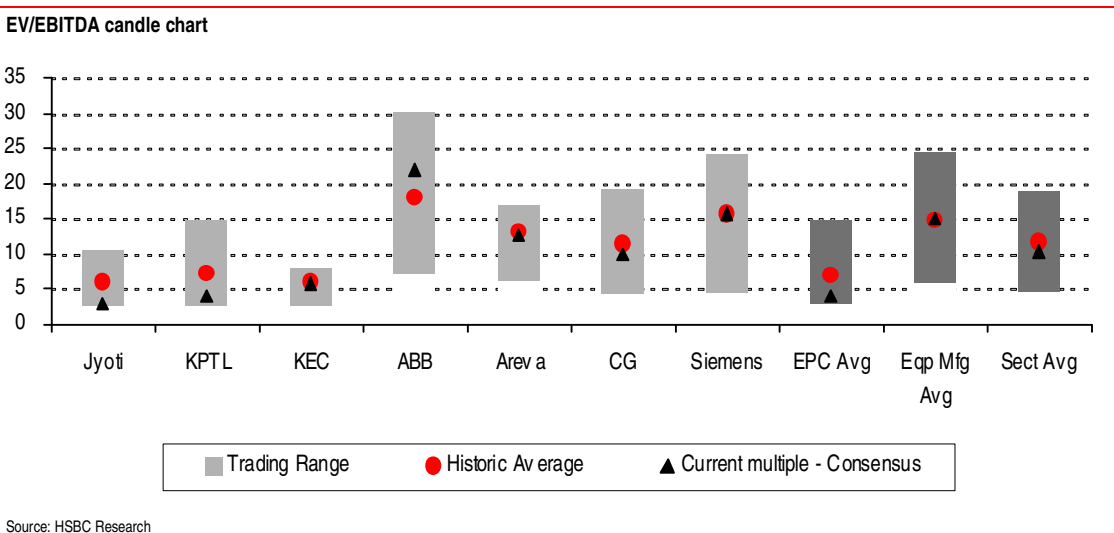
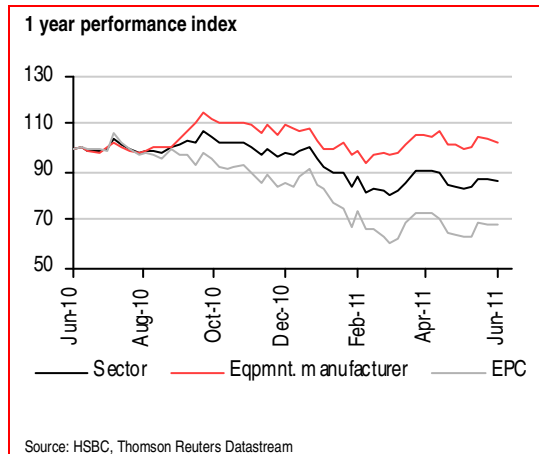


EPC players offer more value than equipment manufacturers

As we highlight in the chart that follows, EPC players have significantly underperformed our coverage universe and despite earnings downgrades are trading at a discount of c40% to their historical average. Therefore, we find a lot of value in these names and believe that this sub-segment looks very attractive on a risk reward basis.



By contrast, the performance of the equipment manufacturers has been flat over the last year and they are trading in line with their historical average. However, we note that even within this segment, there is value in Crompton Greaves and Areva T&D, which are both trading at a discount of c9-11% to their historical average.

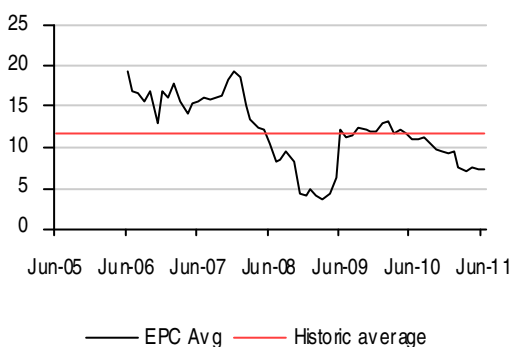


Implied margins

Companies	Avg OR margin (FY07-13e)	Through cycle margins		Implied margin vs.	
		HSBC est	Implied in CMP	Avg margin	HSBC est
ABB	9.7%	10.0%	13.9%	4.3%	3.9%
Areva T&D	12.6%	11.0%	9.7%	-2.9%	-1.3%
Crompton Greaves	11.1%	11.5%	9.0%	-2.1%	-2.5%
Siemens	10.8%	12.5%	11.2%	0.4%	-1.3%
Kalpataru Power	10.7%	10.5%	8.7%	-2.0%	-1.8%
KEC International	10.5%	10.0%	9.3%	-1.2%	-0.7%
Jyoti Structures	11.4%	10.0%	8.4%	-3.0%	-1.6%
Sector average				-0.9%	-0.7%
Sector average ex-ABB				-1.8%	-1.5%

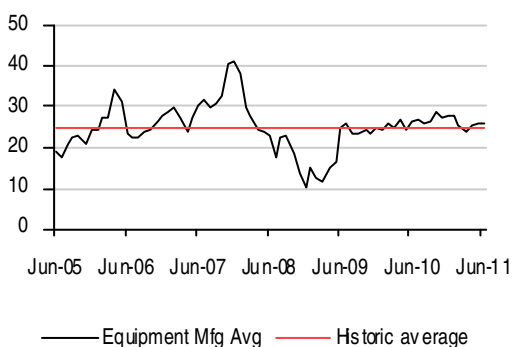
Source: Company data, HSBC estimates

EPC 12 month fwd PE vs historical average



Source: HSBC, Thomson Reuters Datastream

Equipment manufacturers 12m fwd PE vs historical average



Source: HSBC, Thomson Reuters Datastream

Current prices imply margin decline of c180bps, which is highly unlikely

Using our preferred EVA valuation methodology, we have estimated the through cycle margins which are baked into the current valuation of companies under our coverage. Our analysis suggests that the current market prices for our

companies imply that the sector (ex-ABB) will witness an impairment of c180bps in its through cycle operating return (OR) margins compared to the average margin during FY07-13e.

We note that the average EBITDA margin for our universe has already moderated from the peak of FY07-08 by c170bps. We expect margins to largely remain stable at these levels as support from volume growth and improvement in productivity should offset cost pressures. Subsequently, we believe that a margin decline of c180bps on a through cycle basis is highly unlikely. Therefore, we continue to find the current sector valuation unjustified.

Our companies remain inexpensive vs. their trade peers and wider sector

Most of the companies under our coverage, particularly the three EPC players and Crompton Greaves, remain at a significant discount to their trade peers as well as the wider capital goods sector. While EPC players are trading at an average discount of c40% (FY12e PE) to their trade peers, Crompton is trading at a discount of c20%. These companies are also trading at a similar discount to the wider capital goods sector, as we highlight in the valuation tables that follow.

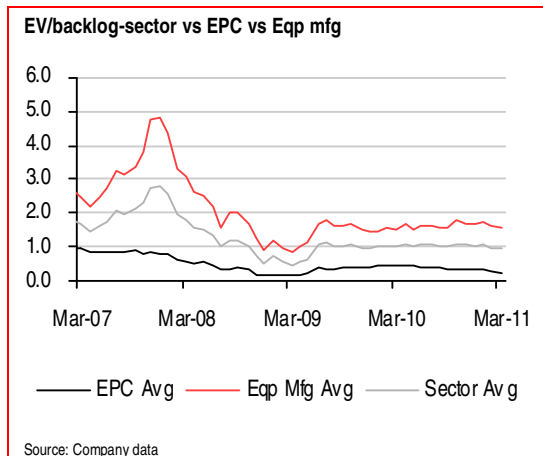
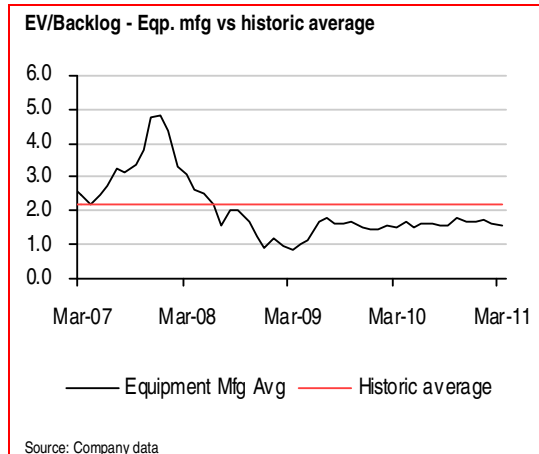
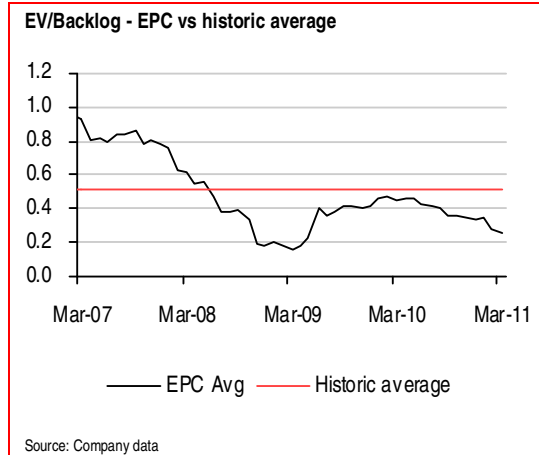
On our FY12e EPS estimates, Jyoti Structures remains the cheapest stock within our universe (discount of c78%) followed by Kalpataru Power (c74% discount). Within equipment

manufacturers, Crompton remains the cheapest stock, trading at a discount of c58% to our coverage universe.

On the other hand, ABB remains the most expensive stock within our sector, trading at a premium of c213% to its trade peers and c207% to the sector. The stock is also trading at a premium of c30% to its historical average.

Sector remains inexpensive on EV/Backlog as well

As we highlight in the charts below, our coverage universe remains inexpensive on EV/Backlog when compared to its historic average. This in our opinion implies that the focus is now increasingly shifting to execution.



Valuation summary – Trade peers (based on consensus estimates)

Company	Current share price (INR)	Mcap (INRm)	FY12e								FY13e							
			PE (x)	EV/EBITDA (x)	EV/Sales (x)	PB (x)	EPS growth (%)	ROE (%)	EBITDA margin (%)	Div yield (%)	PE (x)	EV/EBITDA (x)	EV/Sales (x)	PB (x)	EPS growth (%)	ROE (%)	EBITDA margin (%)	Div yield (%)
EPC:																		
Bajaj Electricals	249	24,608	16.40	9.57	0.93	3.44	19.7%	26.1%	9.7%	1.4%	12.85	7.57	0.77	2.86	27.6%	27.1%	10.2%	1.6%
EMCO	48	3,153	na	7.02	0.42	0.55	-157.6%	-4.1%	5.9%	2.1%	6.41	3.17	0.36	0.52	-324.3%	7.1%	11.3%	1.4%
Gammon	91	12,389	10.75	11.47	0.97	0.56	-11.5%	4.9%	8.4%	0.8%	8.64	10.45	0.87	0.54	24.5%	5.5%	8.4%	0.7%
Jyoti Structures	85	7,008	6.15	4.01	0.45	0.97	3.0%	17.7%	11.2%	1.2%	5.39	3.55	0.39	0.83	14.2%	16.5%	11.0%	1.5%
Kalpataru Power	125	19,187	7.53	5.76	0.64	1.08	31.9%	14.9%	11.0%	1.4%	7.35	5.31	0.61	0.96	2.5%	13.6%	11.5%	1.4%
KEC Intl	80	20,623	8.33	6.96	0.71	1.78	15.6%	23.1%	10.3%	1.6%	7.01	5.95	0.61	1.46	18.9%	22.6%	10.3%	1.7%
L&T	1,787	1,090,049	24.81	19.20	2.39	4.34	11.9%	18.9%	12.4%	0.8%	20.88	16.00	1.98	3.71	18.8%	19.2%	12.3%	1.1%
Average - simple			12.33	9.14	0.93	1.82	-12.4%	14.5%	9.9%	1.3%	9.79	7.43	0.80	1.55	-31.1%	16.0%	10.7%	1.4%
Average - weighted			23.73	18.36	2.27	4.15	11.7%	18.9%	12.3%	0.9%	19.99	15.31	1.88	3.55	17.8%	19.2%	12.2%	1.1%
Eqp Mfg:																		
ABB Ltd	849	179,908	43.29	na	na	6.24	189.5%	15.4%	8.3%	0.3%	33.49	na	na	5.40	29.3%	17.5%	9.2%	0.4%
Areva T&D India	253	60,423	23.80	12.65	1.41	4.78	27.5%	21.4%	11.1%	0.8%	18.56	na	na	na	28.3%	na	na	0.9%
BHEL	1,968	963,418	14.43	9.17	1.78	3.88	11.0%	28.9%	19.4%	1.6%	12.80	8.12	1.54	3.19	12.7%	26.8%	18.9%	1.9%
Crompton Greaves	258	165,574	16.32	10.84	1.46	4.00	9.4%	27.0%	13.5%	0.9%	14.03	9.41	1.27	3.26	16.3%	25.3%	13.5%	1.1%
Indotech	127	1,349	11.23	6.80	0.54	0.91	-249.5%	8.4%	8.0%	1.3%	4.77	3.10	0.46	0.78	135.4%	17.6%	14.8%	3.2%
Siemens Ltd	883	300,513	27.03	16.45	2.16	6.60	24.6%	26.2%	13.2%	0.7%	22.93	14.14	1.84	5.30	17.9%	24.6%	13.0%	0.8%
Voltamp	503	5,089	7.60	5.35	0.83	1.28	-18.9%	18.5%	15.5%	2.7%	6.18	4.30	0.72	1.07	22.9%	19.2%	16.7%	2.7%
Average - simple			20.53	10.21	1.37	3.96	-0.9%	20.8%	12.7%	1.2%	15.70	7.81	1.16	3.17	37.5%	21.8%	14.4%	1.7%
Average - weighted			20.29	10.94	1.80	4.65	32.8%	26.5%	16.2%	1.2%	15.17	9.51	1.57	3.83	16.5%	25.2%	16.2%	1.4%

Note: Priced as on 23 June, 2011.

Source: Company data, Thomson Reuters Datastream, HSBC

Valuation summary – Sector peers (based on consensus estimates)

Company	Current share price (INR)	Mcap (INRm)	FY12e								FY13e							
			PE (x)	EV/ EBITDA (x)	EV/ Sales (x)	PB (x)	EPS growth (%)	RoE (%)	EBITDA margin (%)	Div yield (%)	PE (x)	EV/ EBITDA (x)	EV/ Sales (x)	PB (x)	EPS growth (%)	ROE (%)	EBITDA margin (%)	Div yield (%)
ABB Ltd	849	179,908	43.29	na	na	6.24	189.5%	15.4%	8.3%	0.3%	33.49	na	na	5.40	29.3%	17.5%	9.2%	0.4%
Areva T&D India	253	60,423	23.80	12.65	1.41	4.78	27.5%	21.4%	11.1%	0.8%	18.56	na	na	na	28.3%	na	na	0.9%
Bajaj Electricals	249	24,608	16.40	9.57	0.93	3.44	19.7%	26.1%	9.7%	1.4%	12.85	7.57	0.77	2.86	27.6%	27.1%	10.2%	1.6%
Bharat Electronics	1,557	124,596	13.28	7.51	1.37	2.21	27.9%	16.6%	18.2%	1.7%	11.77	6.62	1.18	1.95	12.8%	16.6%	17.9%	2.5%
BHEL	1,968	963,418	14.43	9.17	1.78	3.88	11.0%	28.9%	19.4%	1.6%	12.80	8.12	1.54	3.19	12.7%	26.8%	18.9%	1.9%
Blue Star	294	26,402	13.39	9.12	0.91	3.71	27.2%	30.2%	10.0%	3.3%	11.77	8.10	0.79	3.25	13.7%	31.2%	9.8%	na
Crompton Greaves	258	165,574	16.32	10.84	1.46	4.00	9.4%	27.0%	13.5%	0.9%	14.03	9.41	1.27	3.26	16.3%	25.3%	13.5%	1.1%
Cummins India	672	133,076	17.39	13.42	2.59	5.67	29.4%	34.6%	19.3%	2.4%	15.12	11.15	2.15	4.76	15.1%	32.4%	19.3%	3.2%
EMCO	48	3,153	na	7.02	0.42	0.55	-157.6%	-4.1%	5.9%	2.1%	6.41	3.17	0.36	0.52	-324.3%	7.1%	11.3%	1.4%
Gammon	91	12,389	10.75	11.47	0.97	0.56	-11.5%	4.9%	8.4%	0.8%	8.64	10.45	0.87	0.54	24.5%	5.5%	8.4%	0.7%
Indotech	127	1,349	11.23	6.80	0.54	0.91	-249.5%	8.4%	8.0%	1.3%	4.77	3.10	0.46	0.78	135.4%	17.6%	14.8%	3.2%
IVRCL Infra	67	17,974	8.79	11.12	1.06	0.86	2.2%	10.2%	9.5%	1.5%	7.59	9.20	0.89	0.77	15.9%	10.6%	9.6%	1.6%
Jaiprakash Assoc	80	170,472	14.13	11.16	3.01	1.64	119.0%	11.5%	27.0%	1.3%	13.58	10.53	2.66	1.50	4.1%	11.2%	25.2%	1.5%
Jyoti Structures	85	7,008	6.15	4.01	0.45	0.97	3.0%	17.7%	11.2%	1.2%	5.39	3.55	0.39	0.83	14.2%	16.5%	11.0%	1.5%
Kalpataru Power	125	19,187	7.53	5.76	0.64	1.08	31.9%	14.9%	11.0%	1.4%	7.35	5.31	0.61	0.96	2.5%	13.6%	11.5%	1.4%
KEC Intl	80	20,623	8.33	6.96	0.71	1.78	15.6%	23.1%	10.3%	1.6%	7.01	5.95	0.61	1.46	18.9%	22.6%	10.3%	1.7%
L&T	1,787	1,090,049	24.81	19.20	2.39	4.34	11.9%	18.9%	12.4%	0.8%	20.88	16.00	1.98	3.71	18.8%	19.2%	12.3%	1.1%
Patel Engineering	144	10,029	5.72	5.78	0.88	0.64	36.5%	10.3%	15.2%	1.3%	5.94	5.30	0.86	0.57	-3.7%	9.6%	16.1%	1.2%
Punj Lloyd	67	22,206	105.99	9.81	0.70	0.74	-90.5%	-0.5%	7.1%	0.4%	13.64	6.61	0.54	0.71	677.0%	4.4%	8.1%	0.5%
Siemens Ltd	883	300,513	27.03	16.45	2.16	6.60	24.6%	26.2%	13.2%	0.7%	22.93	14.14	1.84	5.30	17.9%	24.6%	13.0%	0.8%
Simplex	270	13,343	9.37	5.17	0.50	1.20	16.1%	13.6%	9.6%	0.8%	7.32	4.30	0.41	1.05	28.1%	15.3%	9.5%	0.9%
Thermax	583	69,442	15.90	9.63	1.07	4.16	209.2%	28.6%	11.1%	1.4%	13.58	8.29	0.92	3.37	17.0%	27.2%	11.1%	1.6%
Voltamp	503	5,089	7.60	5.35	0.83	1.28	-18.9%	18.5%	15.5%	2.7%	6.18	4.30	0.72	1.07	22.9%	19.2%	16.7%	2.7%
Volta	159	52,573	13.14	8.98	0.81	3.06	11.8%	26.0%	9.1%	1.6%	11.30	7.84	0.70	2.54	16.3%	24.8%	8.9%	1.7%
Average - simple			18.90	9.43	1.20	2.68	12.3%	17.8%	12.3%	1.4%	11.93	7.68	1.02	2.19	35.3%	18.5%	12.9%	1.5%
Average - weighted			20.94	13.44	1.99	4.18	31.7%	22.8%	15.2%	1.2%	17.30	11.50	1.69	3.50	20.2%	22.2%	15.1%	1.4%

Note: Priced as on 23 June, 2011.

Source: Company, Thomson Reuters Datastream, HSBC

Valuation summary - Coverage universe

Company	Current share price (INR)	Mcap (INRm)	FY12e								FY13e							
			PE (x)	EV/ EBITDA (x)	EV/ Sales (x)	PB (x)	EPS growth (%)	RoE (%)	EBITDA margin (%)	Div yield (%)	PE (x)	EV/ EBITDA (x)	EV/ Sales (x)	PB (x)	EPS growth (%)	ROE (%)	EBITDA margin (%)	Div yield (%)
Jyoti Structures	85	7,008	5.99	4.20	0.46	1.00	0.7%	16.6%	11.0%	1.4%	5.46	3.89	0.42	0.85	9.7%	15.6%	10.8%	1.5%
Kalpataru Power	125	19,187	7.19	4.54	0.48	0.94	28.9%	14.8%	10.6%	1.6%	6.01	4.04	0.43	0.81	19.6%	15.9%	10.6%	1.6%
KEC Intl	80	20,623	8.11	7.32	0.77	1.76	15.7%	21.7%	10.5%	1.5%	6.25	6.41	0.66	1.41	29.7%	22.5%	10.3%	1.6%
ABB Ltd	849	179,908	33.57	21.70	2.12	5.42	42.5%	16.1%	9.8%	0.3%	25.16	16.49	1.78	4.53	33.4%	18.0%	10.8%	0.4%
Areva T&D India	253	60,423	18.99	10.20	1.28	3.96	17.2%	20.9%	12.5%	0.9%	14.02	7.95	1.07	3.20	35.4%	22.8%	13.4%	1.0%
Crompton Greaves	258	165,574	15.82	10.02	1.39	3.96	12.2%	25.1%	13.8%	1.1%	13.69	8.30	1.15	3.20	15.6%	23.4%	13.8%	1.2%
Siemens Ltd	883	300,513	24.28	14.26	1.90	5.56	15.2%	22.9%	13.3%	0.7%	20.69	12.11	1.56	4.56	17.4%	22.1%	12.9%	0.9%
Average - simple			16.28	10.32	1.20	3.23	18.9%	19.7%	11.7%	1.1%	13.04	8.46	1.01	2.65	23.0%	20.0%	11.8%	1.2%
Average - weighted			23.17	14.25	1.71	4.78	21.4%	21.3%	12.3%	0.8%	18.77	11.55	1.42	3.93	22.6%	21.2%	12.5%	0.9%

Note: Priced as on 23 June, 2011.

Source: Company, HSBC estimates

Valuation summary - coverage universe (calendarised)

Company	Current share price (INR)	Mcap (INRm)	FY12e								FY13e							
			PE (x)	EV/ EBITDA (x)	EV/ Sales (x)	PB (x)	EPS growth (%)	RoE (%)	EBITDA margin (%)	Div yield (%)	PE (x)	EV/ EBITDA (x)	EV/ Sales (x)	PB (x)	EPS growth (%)	ROE (%)	EBITDA margin (%)	Div yield (%)
Jyoti Structures	85	7,008	5.99	4.20	0.46	1.00	0.7%	16.6%	11.0%	1.4%	5.46	3.89	0.42	0.85	9.7%	15.6%	10.8%	1.5%
Kalpataru Power	125	19,187	7.19	4.54	0.48	0.94	28.9%	14.8%	10.6%	1.6%	6.01	4.04	0.43	0.81	19.6%	15.9%	10.6%	1.6%
KEC Intl	80	20,623	8.11	7.32	0.77	1.76	15.7%	21.7%	10.5%	1.5%	6.25	6.41	0.66	1.41	29.7%	22.5%	10.3%	1.6%
ABB Ltd	849	179,908	44.91	27.58	2.39	6.31	119.2%	14.0%	8.7%	0.3%	32.18	20.12	2.03	5.36	39.6%	16.7%	10.1%	0.3%
Areva T&D India	253	60,423	22.24	11.33	1.39	4.74	32.4%	21.3%	12.3%	0.9%	18.18	9.54	1.22	3.90	22.3%	21.4%	12.8%	0.9%
Crompton Greaves	258	165,574	15.82	10.02	1.39	3.96	12.2%	25.1%	13.8%	1.1%	13.69	8.30	1.15	3.20	15.6%	23.4%	13.8%	1.2%
Siemens Ltd	883	300,513	27.11	15.36	2.07	6.47	23.5%	23.6%	13.5%	0.7%	23.30	13.10	1.71	5.28	16.3%	22.5%	13.1%	0.8%
Average - simple			18.77	11.48	1.28	3.60	33.2%	19.6%	11.5%	1.0%	15.01	9.34	1.09	2.97	21.8%	19.7%	11.6%	1.1%
Average - weighted			27.27	16.18	1.85	5.42	44.3%	21.1%	12.1%	0.7%	21.83	12.94	1.55	4.47	22.6%	21.0%	12.3%	0.8%

Note: Priced as on 23 June, 2011.

Source: Company, HSBC estimates

Valuation table - Global Peers

Company	Ticker (RIC Code)	Currency	Current share price (INR)	Mcap (INRm)	FY12e								FY13e							
					P/E (x)	EV/ EBITDA (x)	EV/ Sales (x)	P/B (x)	EPS growth (%)	RoE (%)	EBITDA margins (%)	Div yield (%)	P/E (x)	EV/ EBITDA (x)	EV/ Sales (x)	P/B (x)	EPS growth (%)	RoE (%)	EBITDA mgns (%)	Div yield (%)
India:																				
Bajaj Electricals	BJEL.NS	INR	249	24,608	13.1	7.9	0.8	3.4	31.4%	26.9%	9.9%	1.6%	11.0	6.6	0.7	2.9	20.0%	25.8%	9.8%	2.0%
EMCO Ltd	EMCO.NS	INR	48	3,153	8.5	3.7	0.4	0.5	na	6.2%	10.4%	1.4%	12.1	4.3	0.3	0.5	-30.1%	4.5%	7.8%	0.4%
Gammon	GAMM.NS	INR	91	12,389	10.8	11.5	1.0	0.6	-11.5%	4.9%	8.4%	0.8%	8.6	10.4	0.9	0.5	24.5%	5.5%	8.4%	0.7%
Jyoti Structures	JYTS.NS	INR	85	7,008	6.2	4.0	0.4	1.0	3.0%	17.7%	11.2%	1.2%	5.4	3.5	0.4	0.8	14.2%	16.5%	11.0%	1.5%
Kalpataru Power	KAPT.NS	INR	125	19,187	7.5	5.8	0.6	1.1	31.9%	14.9%	11.0%	1.4%	7.4	5.3	0.6	1.0	2.5%	13.6%	11.5%	1.4%
KEC Initl	KECL.NS	INR	80	20,623	8.3	7.0	0.7	1.8	15.6%	23.1%	10.3%	1.6%	7.0	5.9	0.6	1.5	18.9%	22.6%	10.3%	1.7%
Larsen and Toubro Ltd	LART.NS	INR	1,787	1,090,049	24.8	19.2	2.4	4.3	11.9%	18.9%	12.4%	0.8%	20.9	16.0	2.0	3.7	18.8%	19.2%	12.3%	1.1%
ABB Ltd	ABB.NS	INR	849	179,908	46.8	30.6	2.4	6.5	509.0%	14.7%	7.9%	0.3%	35.4	22.8	2.1	5.6	32.1%	17.3%	9.1%	0.4%
Areva T&D India	AREV.NS	INR	253	60,423	25.6	13.3	1.5	5.0	26.3%	21.0%	11.0%	0.8%	19.6	11.1	1.3	4.2	30.5%	22.7%	11.4%	0.9%
BHEL	BHEL.NS	INR	1,968	963,418	14.4	9.2	1.8	3.9	11.0%	28.9%	19.4%	1.6%	12.8	8.1	1.5	3.2	12.7%	26.8%	18.9%	1.9%
Crompton Greaves	CROM.NS	INR	258	165,574	16.3	10.8	1.5	4.0	9.4%	27.0%	13.5%	0.9%	14.0	9.4	1.3	3.3	16.3%	25.3%	13.5%	1.1%
Indotech	INTT.NS	INR	127	1,349	13.1	7.9	0.8	1.2	na	-1.4%	9.6%	3.2%	11.9	7.3	0.6	1.1	10.3%	9.6%	7.9%	na
Siemens Ltd	SIEM.BO	INR	882	300,513	29.5	17.8	2.4	7.4	33.1%	26.9%	13.3%	0.7%	24.9	15.3	2.0	6.0	18.2%	25.4%	13.0%	0.7%
Voltamp	VOTL.NS	INR	503	5,089	7.9	5.5	0.8	1.1	24.5%	15.5%	14.5%	2.7%	7.9	5.8	0.7	1.1	0.1%	14.5%	12.8%	na
Average - simple					16.6	11.0	1.2	3.0	20.4%	17.5%	11.6%	1.4%	14.2	9.4	1.1	2.5	13.5%	17.8%	11.3%	1.1%
Average - weighted					22.2	15.4	2.1	4.5	45.3%	23.4%	14.6%	1.1%	18.7	12.9	1.7	3.8	17.5%	22.7%	14.4%	1.3%
Asia Pacific:																				
Hyundai Heavy	009540.KS	KRW	432,000	34,180,343	8.4	9.8	1.6	1.9	-16.4%	24.7%	16.2%	1.6%	8.6	10.2	1.5	1.6	-2.9%	19.8%	14.7%	1.6%
Harbin Power	1133.HK	HKD	9	1,623	11.4	0.1	0.0	1.2	-8.4%	9.2%	5.7%	1.2%	12.0	0.1	0.0	1.1	12.5%	9.5%	5.6%	1.4%
Hyosung Corp	004800.KS	KRW	90,400	3,304,993	7.8	10.9	0.9	0.9	42.7%	12.7%	8.5%	1.1%	6.4	9.7	0.9	0.8	21.2%	13.6%	9.0%	1.1%
Mitsubishi	7011.T	JPY	369	1,274,446	na	9.6	0.8	1.0	na	3.5%	8.5%	1.6%	na	8.5	0.8	0.9	na	4.8%	9.0%	1.6%
Shanghai Electric	601727.SS	CNY	7	80,001	25.1	12.1	1.0	3.1	26.5%	12.7%	8.4%	1.2%	23.4	10.5	0.9	2.8	7.2%	12.5%	8.2%	1.3%
Dongfang	600875.SS	CNY	26	51,814	15.6	10.3	1.1	3.9	27.2%	24.6%	10.3%	0.8%	13.6	8.8	0.9	3.1	14.6%	24.5%	10.8%	0.5%
Samsung C&T	000830.KS	KRW	81,000	13,310,984	26.0	27.9	1.0	1.5	-1.7%	6.0%	3.5%	0.7%	21.8	23.2	0.9	1.4	19.2%	6.7%	3.7%	0.7%
Sungjin Geotech	051310.KS	KRW	13,800	572,947	11.5	10.4	1.4	3.6	na	41.9%	13.4%	0.0%	7.3	8.1	1.0	2.3	58.5%	33.9%	12.8%	0.0%
Doosan Heavy	034020.KS	KRW	56,300	6,203,652	11.9	24.1	2.3	1.5	280.7%	12.9%	9.5%	1.0%	8.9	19.8	1.9	1.3	34.5%	15.3%	9.6%	1.1%
Hanwha	000880.KS	KRW	46,450	3,632,784	7.8	44.0	2.5	1.1	50.5%	14.5%	5.7%	1.3%	7.0	40.7	2.4	1.0	11.5%	14.1%	5.9%	1.4%
BHI Co Ltd	083650.KQ	KRW	18,150	247,152	8.0	7.8	1.1	2.3	35.3%	27.5%	14.3%	0.0%	5.9	6.1	0.9	1.9	34.7%	28.6%	14.0%	1.0%
Average - simple					13.3	15.2	1.2	2.0	4.7%	17.3%	9.4%	1.0%	11.5	13.3	1.1	1.6	21.1%	16.7%	9.4%	1.1%
Average - weighted					12.3	17.1	1.5	1.7	20.2%	18.1%	11.6%	1.3%	11.0	15.6	1.4	1.4	8.4%	15.8%	10.9%	1.3%
Europe:																				
Cobra	COBRA.MI	EUR	1	24	na	8.6	0.6	0.8	na	-5.7%	6.7%	0.0%	na	5.8	0.5	0.8	na	0.7%	8.8%	0.0%
Elecnor	ENOR.MC	EUR	10	955	11.3	7.6	0.9	1.5	-37.4%	na	11.2%	6.1%	7.4	5.8	0.7	1.3	52.2%	na	12.5%	4.8%
Siemens	SIEGn.DE	EUR	93	89,653	11.4	7.8	1.3	2.4	na	22.9%	16.4%	3.5%	11.6	7.6	1.2	2.1	-1.9%	19.5%	16.0%	3.6%
ABB	ABB.NS	INR	849	3,998	49.1	0.7	0.1	6.5	509.0%	14.7%	7.9%	0.3%	35.4	0.5	0.0	5.6	32.1%	17.3%	9.1%	0.4%
Areva	AREVA.PA	EUR	26	386	18.6	4.3	0.6	1.1	-20.4%	5.2%	13.1%	1.2%	12.9	3.4	0.5	1.0	44.6%	7.3%	14.8%	1.8%
Alstom	ALSO.PA	EUR	42	12,969	12.3	7.5	0.7	2.5	-20.8%	20.2%	9.5%	2.4%	10.7	6.7	0.7	2.1	15.1%	20.7%	10.1%	3.0%
Average - simple					20.5	6.1	0.7	2.5	69.5%	11.5%	10.8%	2.2%	15.6	5.0	0.6	2.2	7.6%	13.1%	11.9%	2.3%
Average - weighted					12.9	7.5	1.2	2.6	15.9%	22.0%	15.2%	3.2%	12.3	7.2	1.1	2.3	2.0%	19.3%	15.0%	3.4%

Source: HSBC estimates, Thomson Reuters Datastream

Share price performance summary – trade peers

Company	CMP	Absolute performance (%)					Relative performance to sector (%)				
		1 week	1 mth	3 mths	6 mths	12 mths	1 week	1 mth	3 mths	6 mths	12 mths
EPC:											
Bajaj Electricals	249	-2.1%	1.0%	0.4%	7.3%	13.4%	-7.1%	-3.8%	-4.0%	17.8%	19.5%
EMCO	48	-1.9%	-17.2%	-25.8%	-22.5%	-40.9%	-6.9%	-22.0%	-30.2%	-12.0%	-34.9%
Gammon	91	-1.0%	-9.8%	-19.3%	-48.2%	-55.3%	-6.0%	-14.7%	-23.7%	-37.7%	-49.3%
Jyoti Structures	85	0.8%	4.7%	2.9%	-32.0%	-43.8%	-4.2%	-0.2%	-1.5%	-21.5%	-37.7%
Kalpataru Power	125	0.0%	3.0%	2.8%	-23.5%	-39.1%	-5.1%	-1.9%	-1.6%	-13.0%	-33.0%
KEC Intl	80	1.5%	2.6%	4.2%	-17.2%	-13.4%	-3.5%	-2.2%	-0.2%	-6.8%	-7.3%
L&T	1,787	7.6%	9.1%	11.8%	-8.4%	1.6%	2.6%	4.2%	7.4%	2.1%	7.6%
Average - simple		0.7%	-1.0%	-3.3%	-20.6%	-25.4%	-4.3%	-5.8%	-7.7%	-10.1%	-19.3%
Average - weighted		7.0%	8.4%	10.8%	-9.1%	-0.1%	2.0%	3.5%	6.4%	1.4%	6.0%
Eqp Mfg:											
ABB Ltd	849	3.2%	-0.2%	8.3%	5.5%	-2.8%	-1.8%	-5.0%	3.9%	16.0%	3.3%
Areva T&D India	253	1.6%	4.7%	2.9%	-20.4%	-12.9%	-3.4%	-0.1%	-1.5%	-9.9%	-6.9%
BHEL	1,968	2.5%	1.6%	-5.9%	-14.1%	-19.8%	-2.5%	-3.3%	-10.3%	-3.6%	-13.7%
Crompton Greaves	258	3.3%	0.1%	-3.8%	-16.6%	1.2%	-1.7%	-4.8%	-8.2%	-6.1%	7.3%
Indotech	127	-3.1%	-0.6%	-14.8%	-32.5%	-51.7%	-8.1%	-5.5%	-19.2%	-22.0%	-45.7%
Siemens Ltd	883	4.4%	1.6%	0.9%	8.8%	21.0%	-0.6%	-3.3%	-3.5%	19.3%	27.1%
Voltamp	503	-2.6%	1.8%	-9.6%	-34.6%	-46.6%	-7.7%	-3.0%	-14.0%	-24.2%	-40.5%
Average - simple		1.3%	1.3%	-3.1%	-14.9%	-15.9%	-3.7%	-3.6%	-7.6%	-4.4%	-9.9%
Average - weighted		2.9%	1.4%	-2.7%	-8.5%	-8.4%	-2.1%	-3.5%	-7.1%	2.0%	-2.4%
BSE Sensex	18,412	5.2%	0.8%	-2.1%	-8.1%	4.8%					
BSE Capital Goods	13,593	5.0%	4.9%	4.4%	-10.5%	-6.1%					

Source: Thomson Reuters Datastream, HSBC

Share price performance summary – Sector peers

Company	CMP	Absolute performance (%)					Relative performance to sector (%)				
		1 week	1 mth	3 mths	6 mths	12 mths	1 week	1 mth	3 mths	6 mths	12 mths
ABB Ltd	849	3.2%	-0.2%	8.3%	5.5%	-2.8%	-1.8%	-5.0%	3.9%	16.0%	3.3%
Areva T&D India	253	1.6%	4.7%	2.9%	-20.4%	-12.9%	-3.4%	-0.1%	-1.5%	-9.9%	-6.9%
Bajaj Electricals	249	-2.1%	1.0%	0.4%	7.3%	13.4%	-7.1%	-3.8%	-4.0%	17.8%	19.5%
Bharat Electronics	1,557	-2.9%	-7.7%	-7.5%	-9.9%	-9.0%	-7.9%	-12.6%	-11.9%	0.6%	-2.9%
BHEL	1,968	2.5%	1.6%	-5.9%	-14.1%	-19.8%	-2.5%	-3.3%	-10.3%	-3.6%	-13.7%
Blue Star	294	-4.3%	-7.6%	-16.1%	-32.7%	-29.0%	-9.3%	-12.5%	-20.5%	-22.2%	-22.9%
Crompton Greaves	258	3.3%	0.1%	-3.8%	-16.6%	1.2%	-1.7%	-4.8%	-8.2%	-6.1%	7.3%
Cummins India	672	0.1%	-4.2%	2.4%	-10.2%	17.8%	-5.0%	-9.1%	-2.1%	0.3%	23.8%
EMCO	48	-1.9%	-17.2%	-25.8%	-22.5%	-40.9%	-6.9%	-22.0%	-30.2%	-12.0%	-34.9%
Gammon	91	-1.0%	-9.8%	-19.3%	-48.2%	-55.3%	-6.0%	-14.7%	-23.7%	-37.7%	-49.3%
Indotech	127	-3.1%	-0.6%	-14.8%	-32.5%	-51.7%	-8.1%	-5.5%	-19.2%	-22.0%	-45.7%
IVRCL Infra	67	-0.2%	-2.5%	-12.0%	-47.5%	-63.3%	-5.2%	-7.4%	-16.4%	-37.0%	-57.3%
Jaiprakash Assoc	80	1.5%	-2.4%	-11.3%	-21.4%	-38.0%	-3.6%	-7.2%	-15.8%	-10.9%	-31.9%
Jyoti Structures	85	0.8%	4.7%	2.9%	-32.0%	-43.8%	-4.2%	-0.2%	-1.5%	-21.5%	-37.7%
Kalpataru Power	125	0.0%	3.0%	2.8%	-23.5%	-39.1%	-5.1%	-1.9%	-1.6%	-13.0%	-33.0%
KEC Intl	80	1.5%	2.6%	4.2%	-17.2%	-13.4%	-3.5%	-2.2%	-0.2%	-6.8%	-7.3%
L&T	1,787	7.6%	9.1%	11.8%	-8.4%	1.6%	2.6%	4.2%	7.4%	2.1%	7.6%
Patel Engineering	144	-0.1%	2.3%	-0.5%	-52.0%	-66.0%	-5.1%	-2.5%	-4.9%	-41.5%	-60.0%
Punj Lloyd	67	3.0%	19.8%	5.0%	-38.0%	-48.1%	-2.0%	15.0%	0.6%	-27.5%	-42.1%
Siemens Ltd	883	4.4%	1.6%	0.9%	8.8%	21.0%	-0.6%	-3.3%	-3.5%	19.3%	27.1%
Simplex	270	-5.4%	-12.2%	-19.5%	-33.9%	-44.2%	-10.4%	-17.0%	-23.9%	-23.4%	-38.1%
Thermax	583	-1.7%	-1.5%	-1.5%	-30.5%	-17.5%	-6.7%	-6.3%	-5.9%	-20.0%	-11.5%
Voltamp	503	-2.6%	1.8%	-9.6%	-34.6%	-46.6%	-7.7%	-3.0%	-14.0%	-24.2%	-40.5%
Voltas	159	-1.4%	-3.5%	-7.5%	-27.6%	-19.0%	-6.4%	-8.4%	-11.9%	-17.1%	-13.0%
Average - simple		0.1%	-0.7%	-4.7%	-23.0%	-25.2%	-4.9%	-5.6%	-9.1%	-12.5%	-19.2%
Average - weighted		3.6%	2.9%	1.3%	-10.9%	-7.4%	-1.4%	-2.0%	-3.2%	-0.4%	-1.3%
BSE Sensex	18,412	5.2%	0.8%	-2.1%	-8.1%	4.8%					
BSE Capital Goods	13,593	5.0%	4.9%	4.4%	-10.5%	-6.1%					

Source: Thomson Reuters Datastream, HSBC

Share price performance summary – Coverage universe

Company	CMP	Absolute performance (%)					Relative performance to sector (%)				
		1 week	1 mth	3 mths	6 mths	12 mths	1 week	1 mth	3 mths	6 mths	12 mths
Jyoti Structures	85	0.8%	4.7%	2.9%	-32.0%	-43.8%	-4.2%	-0.2%	-1.5%	-21.5%	-37.7%
Kalpataru Power	125	0.0%	3.0%	2.8%	-23.5%	-39.1%	-5.1%	-1.9%	-1.6%	-13.0%	-33.0%
KEC Intl	80	1.5%	2.6%	4.2%	-17.2%	-13.4%	-3.5%	-2.2%	-0.2%	-6.8%	-7.3%
ABB Ltd	849	3.2%	-0.2%	8.3%	5.5%	-2.8%	-1.8%	-5.0%	3.9%	16.0%	3.3%
Areva T&D India	253	1.6%	4.7%	2.9%	-20.4%	-12.9%	-3.4%	-0.1%	-1.5%	-9.9%	-6.9%
Crompton Greaves	258	3.3%	0.1%	-3.8%	-16.6%	1.2%	-1.7%	-4.8%	-8.2%	-6.1%	7.3%
Siemens Ltd	883	4.4%	1.6%	0.9%	8.8%	21.0%	-0.6%	-3.3%	-3.5%	19.3%	27.1%
Average - simple		2.1%	2.4%	2.6%	-13.6%	-12.8%	-2.9%	-2.5%	-1.8%	-3.1%	-6.8%
Average - weighted		3.4%	1.2%	1.9%	-1.8%	5.2%	-1.6%	-3.7%	-2.5%	8.6%	11.2%
BSE Sensex	18,412	5.2%	0.8%	-2.1%	-8.1%	4.8%					
BSE Capital Goods	13,593	5.0%	4.9%	4.4%	-10.5%	-6.1%					

Source: Thomson Reuters Datastream, HSBC

Limited downside in worst case scenario

- ▶ To gauge the risk to earnings, we assume that order growth disappoints by c5% in FY12e and c10% in FY13e
- ▶ In such a case, we forecast the risk to FY12-13e EPS remains limited at 5% and 14%, respectively
- ▶ We believe this risk is already factored into the valuation, so we find the sector very attractive on a risk adjusted basis

Worst case scenario: FY12-13e earnings risk only 5-14%

As we highlighted in the previous chapter, we believe expectations are nearing the bottom after earnings downgrades of c13% in the last 12 months. Even though we are currently modestly ahead of consensus by c3%, we have taken a fairly conservative view on order growth (particularly in the transmission segment) and a prudent view on execution.

We estimate sector order growth to average c12% in FY12e and then pick up to c23% in FY13e. This, coupled with strong growth of c17% in the order book last year, should lead to sales growth of c17% and 18% over FY12e and FY13e, respectively, and earnings growth of c28% and 22%.

While we do not see much risk to these estimates, we have done a scenario analysis to gauge the ultimate risk to FY12-13e earnings in the worst case scenario. In this scenario we assume that order growth falls short of our expectations by c5% in FY12e and c10% in FY13e. In such a

scenario, we conclude the downward risk to our earnings estimate is only c5% in FY12e and c14% in FY13e. We highlight our assumptions and the scenario analysis in the table on the next page.

...which, in our view, is factored into the valuation

As we discussed in the previous chapter, our coverage universe (ex-ABB and Siemens) is trading at a discount of c30% to its historical average, which more than compensates for the earnings risk in the worst case scenario.

Therefore, we continue to believe the sector has de-rated more than warranted and we find the current valuations very attractive on a risk reward basis.

Scenario analysis

Assumptions	FY11a*	FY12e		FY13e		
		Base case	Worst case	Base case	Worst case	
Order growth:						
ABB	-27%	13%	8%	26%	16%	
Areva T&D	-1%	6%	1%	23%	13%	
Siemens	41%	12%	7%	17%	7%	
Crompton Greaves	14%	9%	4%	19%	9%	
Kalpataru Power	30%	15%	10%	24%	14%	
KEC International	60%	14%	8%	33%	23%	
Jyoti Structures	6%	-1%	-6%	33%	23%	
Total order growth	18%	10%	4%	25%	15%	
<i>Potential downside (%)</i>			-5%		-10%	
Sales growth:						
ABB	1%	13%	11%	18%	12%	
Areva T&D	13%	13%	11%	10%	3%	
Siemens	4%	26%	23%	19%	13%	
Crompton Greaves	9%	15%	12%	16%	8%	
Kalpataru Power	9%	20%	18%	18%	12%	
KEC International	15%	25%	22%	26%	20%	
Jyoti Structures	17%	5%	3%	9%	4%	
Total sales growth	10%	17%	14%	17%	10%	
<i>Potential downside (%)</i>			-3%		-6%	
EBITDA margins:						
ABB	4.0%	8.2%	8.0%	9.8%	8.9%	
Areva T&D	11.0%	12.2%	11.9%	12.5%	11.5%	
Siemens	13.7%	13.7%	13.6%	13.3%	12.9%	
Crompton Greaves	13.4%	13.8%	13.3%	13.8%	13.2%	
Kalpataru Power	10.6%	10.6%	10.5%	10.6%	10.1%	
KEC International	10.8%	10.4%	10.4%	10.3%	10.1%	
Jyoti Structures	11.4%	11.0%	11.0%	10.8%	10.7%	
Average margins	10.7%	11.4%	11.2%	11.6%	11.1%	
<i>Potential downside (%)</i>			-21bps		-51bps	
Implied EPS (clean)						
ABB	5.8	17.1	16.1	24.3	20.4	
Areva T&D	7.8	10.9	10.2	12.8	10.2	
Siemens	22.5	30.3	29.2	34.9	31.0	
Crompton Greaves	14.4	16.2	15.0	18.7	15.9	
Kalpataru Power	13.2	17.0	16.3	20.4	17.5	
KEC International	8.5	9.6	9.1	12.8	11.2	
Jyoti Structures	14.2	14.3	13.8	15.6	14.1	
Average EPS	12.3	16.5	15.7	19.9	17.2	
<i>Potential downside (%)</i>			-5%		-14%	
Implied FY12e PE						
ABB	142.3	50.5	53.6	35.4	42.3	
Areva T&D	37.0	23.7	23.7	20.2	20.2	
Siemens	29.6	29.0	30.0	25.2	28.3	
Crompton Greaves	19.7	16.3	17.7	14.1	16.6	
Kalpataru Power	13.5	7.2	7.5	6.0	7.0	
KEC International	11.3	8.4	8.8	6.3	7.1	
Jyoti Structures	9.4	6.1	6.3	5.6	6.2	
Average PE	37.5	20.2	21.1	16.1	18.2	
<i>Potential downside (%)</i>			5%		13%	

Source: Company Data, HSBC estimates

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Company analysis

ABB: Unjustifiably expensive

- ▶ ABB continues to disappoint on new orders but the guidance remains positive
- ▶ Margins remain poised for recovery, but there is little visibility on by how much
- ▶ We remain optimistic on recovery, but believe valuations are stretched; maintain UW and TP of INR590

CY10 was one of the weakest years for ABB, with order intake declining by c27% and EBITDA margins eroding a significant c690bps. While new orders suffered because of pricing pressure and competition in the transmission segment (Power Systems and Power Products business divisions), margins suffered largely due to the exit costs associated with the rural electrification (RE) business.

A recovery in both order intake and margins is expected over the coming years. While new order growth should benefit from the firm's increasing focus in Discrete Automation and Motion and Low Voltage businesses, the margins should benefit from a mix of factors: 1) increasing localization of the manufacturing platform; 2) significant reduction in the RE exit costs; 3) rationalization of the operating activities.

While this recovery is widely expected, there is little consensus and/or guidance on the scale of margin improvement. In addition, the performance of ABB in Q1 FY11 has been lacklustre, with a marginal decline in order intake

of c2% and a weaker than expected recovery in EBITDA margins to c5.7% (for details on Q1 FY11 earnings, please refer to our note on 16 May titled, *UW: Recovery remains expensive*).

The company has guided for improvement in new orders over the coming quarters but has remained silent on the pace of margin improvement. In spite of weak performance in Q1, we estimate new orders at ABB to grow by c13% in CY11 and EBITDA margins to recover to c8.2%.

However, in spite of our optimistic estimates the stock remains expensive. We believe that even if the recovery surprises significantly on the upside, it will do little to justify ABB's current PE multiple of c49.7x and c43.3x for CY11e and CY12e, respectively. Even on consensus, the stock is trading at a premium of c30% (on 12m fwd PE) to its historical trading average.

Using our preferred EVA valuation methodology, we estimate that the current share price implies that the market expects ABB's through cycle margins to increase to c13.9% compared to

average FY08-13e OR margin of c9.7%, which we believe is highly unlikely. We maintain our Underweight rating with a target price of INR590. We highlight the key bull and bear points related to ABB below.

Bull points:

- ▶ Strong outlook for the Discrete Automation and Low Voltage products
- ▶ Restructuring and RE exit benefits should now start flowing through P&L.
- ▶ Strong and under-leveraged balance sheet provides ability to grow acquisitively.

Bear points:

- ▶ Order intake remains sluggish due to the absence of large order wins.
- ▶ Limited visibility/guidance on the pace of margin recovery.
- ▶ One of the weakest company in our universe in terms of fundamentals, such as return ratios and working capital management.
- ▶ The stock remains expensive vs. its peers and vs. its own trading history (last five years)

We highlight our CY11-13e estimates for ABB in the table below.

FY11-13e earnings forecast

Dec YE (INRm)			New forecasts			Old forecasts			Change		
	CY09	CY10	CY11e	CY12e	CY13e	CY11e	CY12e	CY13e	CY11e	CY12e	CY13e
Order Backlog	84,787	84,362	85,587	93,024	109,319	91,086	100,930	111,800	-6.0%	-7.8%	-2.2%
Net Sales	62,372	62,871	71,047	83,842	99,339	72,592	87,594	98,403	-2.1%	-4.3%	1.0%
Clean EBITDA	6,382	2,506	5,851	8,195	10,735	6,171	8,376	9,930	-5.2%	-2.2%	8.1%
Reported EBITDA	5,832	1,560	5,851	8,195	10,735	6,171	8,376	9,930	-5.2%	-2.2%	8.1%
Clean EBIT	5,897	1,989	5,200	7,495	10,019	5,484	7,656	9,209	-5.2%	-2.1%	8.8%
Reported EBIT	5,347	1,043	5,200	7,495	10,019	5,484	7,656	9,209	-5.2%	-2.1%	8.8%
Other Income	0	0	0	0	0	0	0	0			
Net Financials	(73)	(41)	286	321	411	286	319	408			
Profit before tax	5,274	1,002	5,485	7,816	10,430	5,770	7,974	9,618	-4.9%	-2.0%	8.4%
Income tax	(1,728)	(370)	(1,865)	(2,657)	(3,546)	(1,962)	(2,711)	(3,270)			
Extraordinary items	0	0	0	0	0	0	0	0			
Minorities	0	0	0	0	0	0	0	0			
Clean Net Income	3,916	1,229	3,620	5,158	6,884	3,808	5,263	6,348	-4.9%	-2.0%	8.4%
Reported Net Income	3,546	632	3,620	5,158	6,884	3,808	5,263	6,348	-4.9%	-2.0%	8.4%
Clean EPS	18.5	5.8	17.1	24.3	32.5	18.0	24.8	30.0	-4.9%	-2.0%	8.4%
Reported EPS	16.7	3.0	17.1	24.3	32.5	18.0	24.8	30.0	-4.9%	-2.0%	8.4%
DPS	2.0	2.0	2.2	2.5	3.0	2.2	2.5	3.0	0.0%	0.0%	0.0%

Margins & Trend			New forecasts			Old forecasts			Change		
	CY09	CY10	CY11e	CY12e	CY13e	CY11e	CY12e	CY13e	CY11e	CY12e	CY13e
Sales visibility (yrs)	1.4	1.3	1.2	1.1	1.1	1.3	1.2	1.1	-4.0%	-3.7%	-3.1%
Sales growth	16%	1%	13%	18%	18%	15%	21%	12%	-2.5%	-2.7%	6.1%
Clean EBITDA margin	10.2%	4.0%	8.2%	9.8%	10.8%	8.5%	9.6%	10.1%	-0.3%	0.2%	0.7%
Reported EBITDA mgn	9.4%	2.5%	8.2%	9.8%	10.8%	8.5%	9.6%	10.1%	-0.3%	0.2%	0.7%
Clean EBIT margin	9.5%	3.2%	7.3%	8.9%	10.1%	7.6%	8.7%	9.4%	-0.2%	0.2%	0.7%
Reported EBIT margin	8.6%	1.7%	7.3%	8.9%	10.1%	7.6%	8.7%	9.4%	-0.2%	0.2%	0.7%
PBT margin	8.5%	1.6%	7.7%	9.3%	10.5%	7.9%	9.1%	9.8%	-0.2%	0.2%	0.7%
Clean NI margin	6.3%	2.0%	5.1%	6.2%	6.9%	5.2%	6.0%	6.5%	-0.1%	0.1%	0.5%
Reported NI margin	5.7%	1.0%	5.1%	6.2%	6.9%	5.2%	6.0%	6.5%	-0.1%	0.1%	0.5%

Source: Company data, HSBC estimates

Valuation

Our target price of INR590 is derived from our preferred EVA valuation methodology. In our valuation model, we assume target sales growth of c9%, through-cycle operating return margin of c10.0% and WACC of c11.7%.

Our target price implies that 12 months from now the stock would be trading at a 12-month forward multiple of c21x PE compared with the current multiple of c49.7x CY11e and c33.6x CY12e.

Our implied target multiple is based on 24m fwd EPS of INR28.4.

Under HSBC's research model, for stocks without a volatility indicator, the Neutral rating band is five percentage points above and below the hurdle rate for India stocks of 11%. This translates into a Neutral rating band of 6% to 16% around the current share price. Our 12-month target price of INR590 suggests a potential negative return of c30% (ex-dividend), which is below the Neutral rating band; hence, we reiterate Underweight on the stock.

Risks

We highlight key risks related to our investment case on ABB below:

- ▶ Better-than-expected improvement in margins.
- ▶ Significant increase in market share.

Financials & valuation: ABB India

Underweight

Financial statements

Year to December	12/2010a	12/2011e	12/2012e	12/2013e
Profit & loss summary (INRm)				
Revenue	62,871	71,047	83,842	99,339
EBITDA	2,506	5,851	8,195	10,735
Depreciation & amortisation	-517	-651	-700	-716
Operating profit/EBIT	1,989	5,200	7,495	10,019
Net interest	-41	286	321	411
PBT	1,002	5,485	7,816	10,430
HSBC PBT	1,948	5,485	7,816	10,430
Taxation	-370	-1,865	-2,657	-3,546
Net profit	632	3,620	5,158	6,884
HSBC net profit	1,229	3,620	5,158	6,884

Cash flow summary (INRm)

Cash flow from operations	2,165	3,240	4,192	5,582
Capex	-1,042	-2,530	-1,530	-1,030
Cash flow from investment	-1,042	-2,530	-1,530	-1,030
Dividends	-495	-493	-545	-620
Change in net debt	-995	-217	-2,117	-3,932
FCF equity	1,124	710	2,662	4,552

Balance sheet summary (INRm)

Intangible fixed assets	295	274	258	245
Tangible fixed assets	7,943	9,842	10,689	11,015
Current assets	49,262	54,035	64,148	77,766
Cash & others	9,413	9,630	11,747	15,679
Total assets	57,714	64,365	75,308	89,240
Operating liabilities	31,630	35,154	41,484	49,152
Gross debt	0	0	0	0
Net debt	-9,413	-9,630	-11,747	-15,679
Shareholders funds	24,237	27,365	31,978	38,242
Invested capital	28,795	33,429	38,457	43,856

Ratio, growth and per share analysis

Year to	12/2010a	12/2011e	12/2012e	12/2013e
Y-o-y % change				
Revenue	0.8	13.0	18.0	18.5
EBITDA	-60.7	133.5	40.1	31.0
Operating profit	-66.3	161.4	44.1	33.7
PBT	-81.0	447.3	42.5	33.4
HSBC EPS	-68.6	194.5	42.5	33.4

Ratios (%)

Revenue/IC (x)	2.2	2.1	2.2	2.3
ROIC	5.2	11.1	13.7	15.9
ROE	5.1	13.2	16.1	18.0
ROA	1.3	5.9	7.4	8.4
EBITDA margin	4.0	8.2	9.8	10.8
Operating profit margin	3.2	7.3	8.9	10.1
EBITDA/net interest (x)	61.3			
Net debt/equity	-38.8	-35.2	-36.7	-41.0
Net debt/EBITDA (x)	-3.8	-1.6	-1.4	-1.5
CF from operations/net debt				

Per share data (INR)

EPS Rep (fully diluted)	2.98	17.08	24.34	32.48
HSBC EPS (fully diluted)	5.80	17.08	24.34	32.48
DPS	2.00	2.20	2.50	3.00
Book value	114.38	129.14	150.90	180.46

Valuation data

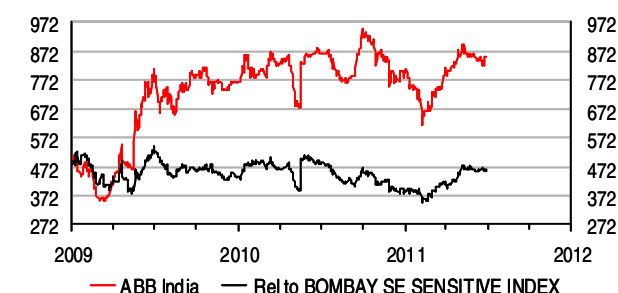
Year to	12/2010a	12/2011e	12/2012e	12/2013e
EV/sales	2.8	2.6	2.2	1.8
EV/EBITDA	70.9	31.5	22.5	17.1
EV/IC	6.2	5.5	4.8	4.2
PE*	142.3	49.7	34.9	26.1
P/Book value	7.2	6.6	5.6	4.7
FCF yield (%)	0.6	0.4	1.5	2.5
Dividend yield (%)	0.2	0.3	0.3	0.4

Note: * = Based on HSBC EPS (fully diluted)

Issuer information

Share price (INR)	848.80	Target price (INR)	590.00	Potent'l return (%)	-30.5
Reuters (Equity)	ABB.BO	Bloomberg (Equity)	ABB IN		
Market cap (USDm)	3,996	Market cap (INRm)	179,868		
Free float (%)	16	Enterprise value (INRm)	170,070		
Country	India	Sector	Electrical Equipment		
Analyst	Rahul Garg	Contact	+91 22 22681245		

Price relative



Source: HSBC

Note: price at close of 27 Jun 2011

ABB India

Income statement (INRm)	FY07	FY08	FY09	FY10	FY11e	FY12e	FY13e
Net Sales	59,303	68,370	62,372	62,871	71,047	83,842	99,339
Cost of Goods Sold (COGS)	(42,920)	(49,504)	(45,179)	(48,021)	(53,357)	(62,342)	(73,622)
Gross Income	16,383	18,866	17,193	14,850	17,691	21,500	25,717
Employee expense	(3,061)	(4,030)	(3,892)	(4,901)	(5,149)	(5,410)	(5,628)
Selling General & Admin exp (SG&A)	(6,076)	(7,095)	(8,011)	(9,111)	(7,401)	(8,733)	(10,348)
Other operating income	433	1,093	542	722	710	838	993
EBITDA	7,679	8,835	5,832	1,560	5,851	8,195	10,735
Exceptionals	(551)	475	(550)	(946)	0	0	0
Clean EBITDA	8,230	8,360	6,382	2,506	5,851	8,195	10,735
Depreciation & Amortization	(324)	(367)	(485)	(517)	(651)	(700)	(716)
EBIT	7,355	8,468	5,347	1,043	5,200	7,495	10,019
Clean EBIT	7,906	7,994	5,897	1,989	5,200	7,495	10,019
Other income	0	70	0	0	0	0	0
O/w Exceptional	0	70	0	0	0	0	0
O/w Dividend/Inv income	0	0	0	0	0	0	0
Interest income	277	141	183	223	286	321	411
Interest expense	(68)	(347)	(256)	(264)	0	0	0
Other financial exp/inc	0	0	0	0	0	0	0
Profit before tax (PBT)	7,565	8,332	5,274	1,002	5,485	7,816	10,430
Clean PBT	8,116	7,788	5,824	1,948	5,485	7,816	10,430
Income tax	(2,648)	(2,858)	(1,728)	(370)	(1,865)	(2,657)	(3,546)
Income from JVs (Post tax)	0	0	0	0	0	0	0
Profit after tax (PAT)	4,917	5,474	3,546	632	3,620	5,158	6,884
Extraordinary Items	0	0	0	0	0	0	0
Minorities	0	0	0	0	0	0	0
Reported Net income	4,917	5,474	3,546	632	3,620	5,158	6,884
HSBC Net income	5,275	5,117	3,916	1,229	3,620	5,158	6,884
No. of shares outstanding	211.9	211.9	211.9	211.9	211.9	211.9	211.9
Reported EPS	23.2	25.8	16.7	3.0	17.1	24.3	32.5
HSBC EPS (Recurring)	24.9	24.1	18.5	5.8	17.1	24.3	32.5

Source: Company data, HSBC estimates

ABB India

Margin & trend analysis	FY07	FY08	FY09	FY10	FY11e	FY12e	FY13e
Sales growth	38.8%	15.3%	-8.8%	0.8%	13.0%	18.0%	18.5%
Organic growth	38.6%	15.0%	-11.5%	1.8%	12.0%	18.0%	18.5%
Clean EBITDA growth	54.4%	1.6%	-23.7%	-60.7%	133.5%	40.1%	31.0%
Clean EBIT growth	56.1%	1.1%	-26.2%	-66.3%	161.4%	44.1%	33.7%
Reported EPS growth	44.5%	11.3%	-35.2%	-82.2%	472.6%	42.5%	33.4%
HSBC EPS growth	53.7%	-3.0%	-23.5%	-68.6%	194.5%	42.5%	33.4%
Gross margins	27.6%	27.6%	27.6%	23.6%	24.9%	25.6%	25.9%
Clean EBITDA margins	13.9%	12.2%	10.2%	4.0%	8.2%	9.8%	10.8%
Clean EBIT margins	13.3%	11.7%	9.5%	3.2%	7.3%	8.9%	10.1%
OR margins	13.8%	12.1%	10.0%	3.7%	7.9%	9.5%	10.7%
PBT margins	12.8%	12.2%	8.5%	1.6%	7.7%	9.3%	10.5%
PAT margins	8.3%	8.0%	5.7%	1.0%	5.1%	6.2%	6.9%
Change in no. of Employees	6.7%	17.4%	-4.2%	-1.5%	2.0%	2.0%	1.0%
Wage inflation	18.8%	12.2%	0.8%	27.8%	3.0%	3.0%	3.0%
Rate on interest income	3.4%	1.7%	2.4%	2.5%	3.0%	3.0%	3.0%
Rate on interest expense	na	na	na	na	na	na	na
P&L tax rate	35.0%	34.3%	32.8%	36.9%	34.0%	34.0%	34.0%
Dividend tax rate	17.0%	17.0%	17.0%	16.2%	17.0%	17.0%	17.0%
Excise duty	7.1%	6.9%	4.0%	4.9%	4.0%	4.0%	4.0%
Dividend payout ratio	9.5%	8.5%	12.0%	67.0%	12.9%	10.3%	9.2%

Source: Company data, HSBC estimates

ABB India

Balance sheet (INRm)	FY07	FY08	FY09	FY10	FY11e	FY12e	FY13e
Share Capital	424	424	424	424	424	424	424
Reserves & Surplus	15,840	20,766	23,814	23,813	26,941	31,554	37,818
Shareholders Equity	16,263	21,190	24,237	24,237	27,365	31,978	38,242
Minorities	0	0	0	0	0	0	0
Total Equity	16,263	21,190	24,237	24,237	27,365	31,978	38,242
Secured Loans	0	0	0	0	0	0	0
Unsecured Loans	(6)	(0)	0	0	0	0	0
Total Debt	(6)	(0)	0	0	0	0	0
Loan & Advances	2,802	3,518	3,177	3,542	3,542	3,542	3,542
Cash & Equivalents	6,429	3,482	5,241	5,871	6,088	8,205	12,138
Net (Debt)/Cash	9,225	7,000	8,418	9,413	9,630	11,747	15,679
Tangible assets	3,382	5,350	6,624	7,366	9,265	10,112	10,438
Intangible assets	137	109	107	295	274	258	245
Capital Work-in-progress (CWIP)	1,059	1,375	1,163	577	577	577	577
Deferred tax assets	0	0	1	46	46	46	46
Investments	705	611	169	168	168	168	168
Other assets	0	0	0	0	0	0	0
Total Fixed Assets	5,283	7,445	8,064	8,452	10,330	11,161	11,474
Inventories	4,887	6,427	7,294	6,979	7,771	9,170	10,865
Sundry debtors	24,236	29,759	28,577	29,260	32,563	38,427	45,530
Sundry creditors	(15,693)	(16,501)	(14,784)	(16,402)	(17,762)	(20,960)	(24,835)
Customer advances	(5,016)	(5,778)	(6,534)	(7,280)	(8,141)	(9,607)	(11,383)
Acceptances	(7,009)	(7,268)	(5,832)	(5,059)	(5,921)	(6,987)	(8,278)
Other receivables	2,754	3,813	3,203	3,611	4,070	4,803	5,691
Other payables	(1,596)	(2,073)	(2,719)	(2,890)	(3,330)	(3,930)	(4,657)
Total Working Capital	2,561	8,379	9,205	8,219	9,251	10,917	12,935
Provisions	(678)	(1,596)	(1,450)	(1,846)	(1,846)	(1,846)	(1,846)
Deferred tax liability	(128)	(38)	0	0	0	0	0
Other Long term liabilities	0	0	0	0	0	0	0
Net Assets	16,263	21,190	24,237	24,237	27,365	31,978	38,242

Source: Company data, HSBC estimates

ABB India

Key balance sheet ratios	FY07	FY08	FY09	FY10	FY11e	FY12e	FY13e
Gearing	-56.7%	-33.0%	-34.7%	-38.8%	-35.2%	-36.7%	-41.0%
Gearing incl Acceptances	-13.6%	1.3%	-10.7%	-18.0%	-13.6%	-14.9%	-19.4%
Leverage	0.43	0.67	0.65	0.61	0.65	0.63	0.59
Leverage incl Acceptances	0.86	1.01	0.89	0.82	0.86	0.85	0.81
Interest Cover (on EBIT)	(35.21)	41.22	73.30	25.53	(18.20)	(23.37)	(24.35)
Net debt to EBITDA	(1.12)	(0.84)	(1.32)	(3.76)	(1.65)	(1.43)	(1.46)
Fixed Asset turns	12.95	10.01	7.90	7.63	7.02	7.66	8.82
Asset (CE) turn	3.09	2.42	2.12	2.18	2.13	2.18	2.27
Asset (CE) turn - excl Cust Adv	4.19	3.04	2.72	2.92	2.81	2.91	3.06
Total Working Capital Days	76	101	105	101	29	111	111
Inventories	48	51	56	55	56	58	58
Sundry Debtors	173	170	160	171	178	181	181
Sundry Creditors	(154)	(130)	(114)	(128)	(128)	(132)	(133)
Other receivables	20	22	18	21	(59)	23	23
Other payables	(11)	(12)	(15)	(17)	(18)	(19)	(19)
Working Capital as % sales	5.0%	13.1%	14.1%	13.1%	13.8%	14.1%	14.1%

Source: Company data, HSBC estimates

ABB India							
Cash flow statement (INRm)	FY07	FY08	FY09	FY10	FY11e	FY12e	FY13e
EBITDA	7,679	8,835	5,832	1,560	5,851	8,195	10,735
Adjusted for:							
Unrealized fx (gains)/losses	0	0	0	403	0	0	0
Loss on sale of fixed assets	0	0	73	42	0	0	0
Other non-cash exceptionals	(0)	225	(77)	0	0	0	0
Change in Working Capital	(2,245)	(6,484)	403	785	(1,032)	(1,666)	(2,018)
Tax paid	(2,759)	(2,378)	(2,687)	(582)	(1,865)	(2,657)	(3,546)
Net Financials	193	(71)	(61)	(42)	286	321	411
Others	0	0	0	0	0	0	0
Cash flow from operations	2,869	126	3,484	2,165	3,240	4,192	5,582
Capital Expenditure	(1,489)	(2,721)	(1,633)	(1,044)	(2,550)	(1,550)	(1,050)
Disposals	20	82	13	3	20	20	20
Change in other assets	0	0	0	0	0	0	0
Free cash flow (FCF)	1,400	(2,513)	1,864	1,124	710	2,662	4,552
Dividends	(495)	(544)	(544)	(495)	(493)	(545)	(620)
FCF post dividend	905	(3,058)	1,320	629	217	2,117	3,932
Acquisition - Subs/Assoc/Investments	69	117	439	1	0	0	0
Change in debt	(10)	(5)	(0)	(20)	0	0	0
Share buyback/issue	0	0	0	0	0	0	0
Others	0	0	0	0	0	0	0
Net cash flow	964	(2,946)	1,759	609	217	2,117	3,932

Source: Company data, HSBC estimates

ABB India							
Key cash ratios	FY08	FY08	FY09	FY10	FY11e	FY12e	FY13e
Cash tax rate	35.9%	26.9%	46.1%	37.3%	31.9%	32.4%	33.0%
Change in WC as % sales	-3.8%	-9.5%	0.6%	1.2%	-1.5%	-2.0%	-2.0%
Capex to depreciation	4.6	7.4	3.4	2.0	3.9	2.2	1.5
Capex as % sales	2.5%	4.0%	2.6%	1.7%	3.6%	1.8%	1.1%
Operating cash conversion	39.0%	1.5%	65.2%	207.6%	62.3%	55.9%	55.7%
FCF Yield	0.6%	-1.3%	1.4%	0.6%	0.4%	1.5%	2.6%
FCF Yield post dividend	0.4%	-1.6%	1.0%	0.4%	0.1%	1.2%	2.3%

Source: Company data, HSBC estimates

ABB India

Valuation	FY07	FY08	FY09	FY10	FY11e	FY12e	FY13e
Avg Price	1,059	917	628	825	817	817	817
Market Cap	224,434	194,231	133,085	174,918	173,172	173,172	173,172
Net debt	(9,225)	(7,000)	(8,418)	(9,413)	(9,630)	(11,747)	(15,679)
Customer advances	5,016	5,778	6,534	7,280	8,141	9,607	11,383
Banker's Acceptances	7,009	7,268	5,832	5,059	5,921	6,987	8,278
Minorities	0	0	0	0	0	0	0
Investments/Associates	(705)	(611)	(169)	(168)	(168)	(168)	(168)
Enterprise Value (EV)	226,531	199,666	136,864	177,676	177,435	177,850	176,985
EV/Sales	382%	292%	219%	283%	250%	212%	178%
EV/CE	1182%	707%	464%	617%	531%	462%	404%
EV/EBITDA	27.5	23.9	21.4	70.9	30.3	21.7	16.5
EV/EBIT	28.7	25.0	23.2	89.3	34.1	23.7	17.7
EV/OR	27.8	24.1	22.0	75.5	31.6	22.3	16.7
P/E	42.5	38.0	34.0	142.3	47.8	33.6	25.2
P/Book	13.8	9.2	5.5	7.2	6.3	5.4	4.5
Dividend Yield	0.2%	0.2%	0.3%	0.2%	0.3%	0.3%	0.4%
FCF Yield	0.6%	-1.3%	1.4%	0.6%	0.4%	1.5%	2.6%
FCF Yield - post dividend	0.4%	-1.6%	1.0%	0.4%	0.1%	1.2%	2.3%
RoCE	27.7%	19.3%	14.2%	5.2%	11.1%	13.7%	15.9%
RoCE - excl Cust Adv	36.3%	23.4%	17.3%	5.8%	13.6%	17.1%	20.4%
RoE	32.4%	24.1%	16.2%	5.1%	13.2%	16.1%	18.0%

Source: Company data, HSBC estimates

ABB India

Profitability - RoCE	FY07	FY08	FY09	FY10	FY11e	FY12e	FY13e
Clean EBIT	7,906	7,994	5,897	1,989	5,200	7,495	10,019
Add back: Return on Cust Adv	251	289	327	364	407	480	569
Less: Associate/Div Income	0	0	0	0	0	0	0
Assumptions:							
Return on Cust Adv	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%
Tax rate	35.0%	34.3%	32.8%	36.9%	34.0%	34.0%	34.0%
Operating Return (OR)	8,157	8,282	6,224	2,353	5,607	7,975	10,588
Post tax OR	5,302	5,441	4,185	1,485	3,700	5,264	6,988
Equity	16,263	21,190	24,237	24,237	27,365	31,978	38,242
Net Deferred tax liability	128	38	(1)	(46)	(46)	(46)	(46)
Provisions	678	1,596	1,450	1,846	1,846	1,846	1,846
Debt	6	0	0	0	0	0	0
Customer advances	5,016	5,778	6,534	7,280	8,141	9,607	11,383
Bank's Acceptances	7,009	7,268	5,832	5,059	5,921	6,987	8,278
Less:							
Cash & Eqv	6,429	3,482	5,241	5,871	6,088	8,205	12,138
Loans & Advances	2,802	3,518	3,177	3,542	3,542	3,542	3,542
Investment/Associates	705	611	169	168	168	168	168
Capital Employed	19,166	28,259	29,466	28,795	33,429	38,457	43,856
Pre-tax RoCE	42.6%	29.3%	21.1%	8.2%	16.8%	20.7%	24.1%
RoCE	27.7%	19.3%	14.2%	5.2%	11.1%	13.7%	15.9%
RoCE ex-Cust Adv	36.3%	23.4%	17.3%	5.8%	13.6%	17.1%	20.4%

Source: Company data, HSBC estimates

Areva T&D: Valuation now looks attractive

- ▶ Given weak orders last year and our bearish view on transmission orders this year, we expect new orders and sales to grow only modestly in CY11e by c6% and c11%, respectively
- ▶ However, we believe Areva will likely surprise on margins, benefiting from its past restructuring efforts
- ▶ We remain c8% ahead of consensus on CY11e and find the valuation attractive; upgrade from Neutral to OW and lower TP from INR340 to INR310

Areva T&D saw weak order intake in CY10 (Dec YE) when the order book remained flat. Given the company is highly geared to the transmission business and we don't expect much growth in transmission orders in FY12 (Mar YE), we expect order intake growth to be a modest 6% in CY11. Given that Areva T&D has invested significantly in its capacity over the last couple of years, we expect execution to improve this year and forecast a slightly stronger sales growth of c11% in CY11.

We note that Areva reported strong results in Q1, recording order intake growth of c23% and sales growth of c28%. While Q1 also benefited from a weak comp last year, the strong performance nonetheless highlights an upward risk to our growth assumptions. While we believe that a strong order growth is unlikely in Q211 (given that it is usually the weakest quarter seasonally), a positive surprise will act as a catalyst for the stock and can potentially drive earnings upgrades.

We further note that consensus has been bearish on margins, giving little credit to the restructuring from which Areva is just emerging. We, on the other hand, believe that Areva's margins have troughed in CY10 (at c11%) and the company should witness a much sharper improvement of c120bps in its margins in CY11 compared to the market expectations.

We expect this improvement to be driven by benefits of restructuring and increasingly localization of transformer/substation components. A strong performance in Q1, with an EBITDA margin of c8.4% (Q110: c5.4%), indicates that these benefits have already started flowing through the P&L.

Overall, we remain c8% ahead of consensus on our CY11e EPS and forecast an earnings growth of c40% in CY11e and c17% in CY12e.

We note that over the last six months the stock has underperformed the benchmark index (BSE

Capital Goods Index) by c10%, while estimates have remained flat and the outlook for Areva T&D and clarity on de-merger has improved. Therefore, we believe the stock now looks attractive on valuation, trading at c22.3x CY11e PE and c19x CY12e PE vs. a historical average of c26.9x (5yr average of 12m fwd PE). We upgrade the stock to Overweight from Neutral with a new target price of INR310 (INR340 earlier).

We now highlight bull and bear points:

Bull points

- ▶ Key beneficiary of growth in the domestic transmission business

- ▶ Strong presence with Power Grid
- ▶ Margins set to benefit from restructuring and increasing localization over the coming years
- ▶ The de-merger of the transmission and distribution business should improve performance and drive re-rating of the stock
- ▶ Balance sheet has strengthened
- ▶ Valuation looks attractive

Bear points

- ▶ Little exposure to international transmission markets
- ▶ Order book visibility remains low compared to competitors

FY11-13e earning forecast

Dec YE (INRm)	CY09	CY10	New forecasts			Old forecasts		Change	
			CY11e	CY12e	CY13e	CY11e	CY12e	CY11e	CY12e
Order Backlog	47,717	48,765	45,538	47,969	55,963	57,232	67,675	-20.4%	-29.1%
Net Sales	35,659	40,200	45,501	49,887	58,201	46,803	55,343	-2.8%	-9.9%
Clean EBITDA	4,183	4,407	5,537	6,239	7,806	5,479	6,979	1.1%	-10.6%
Reported EBITDA	4,188	4,407	5,537	6,239	7,806	5,479	6,979	1.1%	-10.6%
Clean EBIT	3,572	3,471	4,567	5,214	6,792	4,519	5,964	1.1%	-12.6%
Reported EBIT	3,577	3,471	4,567	5,214	6,792	4,519	5,964	1.1%	-12.6%
Other Income	(68)	0	0	0	0	(100)	(100)		
Net Financials	(579)	(655)	(650)	(624)	(576)	(554)	(549)		
Profit before tax	2,930	2,816	3,917	4,590	6,215	3,865	5,315	1.3%	-13.6%
Income tax	(1,010)	(949)	(1,312)	(1,538)	(2,082)	(1,391)	(1,913)		
Extraordinary items	0	0	0	0	0	0	0		
Minorities	0	0	0	0	0	0	0		
Clean Net Income	1,961	1,867	2,605	3,052	4,133	2,538	3,465	2.6%	-11.9%
Reported Net Income	1,920	1,867	2,605	3,052	4,133	2,474	3,401	5.3%	-10.3%
Clean EPS	8.2	7.8	10.9	12.8	17.3	10.6	14.5	2.6%	-11.9%
Reported EPS	8.0	7.8	10.9	12.8	17.3	10.3	14.2	5.3%	-10.3%
DPS	1.8	1.8	2.0	2.2	2.4	2.0	2.2	0.0%	0.0%

Dec YE (INRm)	CY09	CY10	New Forecasts			Old Forecasts		Change in f/c	
			CY11e	CY12e	CY13e	CY11e	CY12e	CY11e	CY12e
Sales visibility (yrs)	1.3	1.2	1.0	1.0	1.0	1.2	1.2	-18.2%	-21.4%
Sales growth	16%	13%	13%	10%	17%	14%	18%	-0.8%	-8.6%
Clean EBITDA margin	11.7%	11.0%	12.2%	12.5%	13.4%	11.7%	12.6%	0.5%	-0.1%
Reported EBITDA margin	11.7%	11.0%	12.2%	12.5%	13.4%	11.7%	12.6%	0.5%	-0.1%
Clean EBIT margin	10.0%	8.6%	10.0%	10.5%	11.7%	9.7%	10.8%	0.4%	-0.3%
Reported EBIT margin	10.0%	8.6%	10.0%	10.5%	11.7%	9.7%	10.8%	0.4%	-0.3%
PBT margin	8.2%	7.0%	8.6%	9.2%	10.7%	8.3%	9.6%	0.4%	-0.4%
Clean NI margin	5.5%	4.6%	5.7%	6.1%	7.1%	5.4%	6.3%	0.3%	-0.1%
Reported NI margin	5.4%	4.6%	5.7%	6.1%	7.1%	5.3%	6.1%	0.4%	0.0%

Source: Company data, HSBC estimates

- ▶ The stock might remain range bound until more clarity is obtained on the impending de-merger

We highlight our CY11-13e estimates for Areva T&D in the table on the previous page.

Valuation

Our target price of INR310 is derived from our preferred EVA valuation methodology. In our valuation model, we assume target sales growth of c9%, through-cycle operating return margin of c11% and WACC of 12.1%. We have lowered our price target from INR340, driven largely by our CY12e earnings downgrade of c10%.

Our target price implies that 12 months from now the stock would be trading at a 12-month forward multiple of c20.6x PE compared with the current multiple of c23.2x CY11e and c19.8x CY12e. Our implied target multiple is based on 24m fwd EPS of INR15.

Under HSBC's research model, for stocks without a volatility indicator, the Neutral rating band is five percentage points above and below the hurdle rate for India stocks of 11%. This translates into a Neutral rating band of 6% to 16% around the current share price. Our 12-month target price of INR310 suggests a potential return of c28% (ex-dividend), which is above the Neutral rating band; hence, we upgrade our rating on the stock to Overweight from Neutral.

Risks

We highlight key risks related to our investment case on Areva T&D below:

- ▶ Increasing competition in the domestic T&D space
- ▶ Adverse change in qualification requirements on future tenders
- ▶ Weaker than expected improvement in the profitability
- ▶ Poor valuation of the distribution business during de-merger

Financials & valuation: Areva T&D

Overweight

Financial statements

Year to December	12/2010a	12/2011e	12/2012e	12/2013e
Profit & loss summary (INRm)				
Revenue	40,200	45,501	49,887	58,201
EBITDA	4,407	5,537	6,239	7,806
Depreciation & amortisation	-936	-970	-1,025	-1,014
Operating profit/EBIT	3,471	4,567	5,214	6,792
Net interest	-655	-650	-624	-576
PBT	2,816	3,917	4,590	6,215
HSBC PBT	2,816	3,917	4,590	6,215
Taxation	-949	-1,312	-1,538	-2,082
Net profit	1,867	2,605	3,052	4,133
HSBC net profit	1,867	2,605	3,052	4,133

Cash flow summary (INRm)

Cash flow from operations	427	5,170	3,584	4,212
Capex	-1,131	-980	-980	-880
Cash flow from investment	-1,131	-980	-980	-880
Dividends	-500	-502	-560	-615
Change in net debt	1,389	-3,688	-2,044	-2,717
FCF equity	-704	4,190	2,604	3,332

Balance sheet summary (INRm)

Intangible fixed assets	0	0	0	0
Tangible fixed assets	8,939	8,949	8,904	8,770
Current assets	35,740	38,887	43,901	52,247
Cash & others	4,391	8,079	10,123	12,840
Total assets	44,682	47,838	52,807	61,019
Operating liabilities	24,636	25,689	28,166	32,859
Gross debt	8,957	8,957	8,957	8,957
Net debt	4,566	878	-1,166	-3,883
Shareholders funds	10,024	12,127	14,620	18,137
Invested capital	21,292	20,325	21,376	23,320

Ratio, growth and per share analysis

Year to	12/2010a	12/2011e	12/2012e	12/2013e
Y-o-y % change				
Revenue	12.7	13.2	9.6	16.7
EBITDA	5.3	25.6	12.7	25.1
Operating profit	-2.8	31.6	14.2	30.3
PBT	-3.9	39.1	17.2	35.4
HSBC EPS	-4.8	39.5	17.2	35.4

Ratios (%)

Revenue/IC (x)	1.9	2.2	2.3	2.5
ROIC	11.6	16.0	17.3	20.5
ROE	18.6	21.5	20.9	22.8
ROA	5.6	5.6	6.1	7.3
EBITDA margin	11.0	12.2	12.5	13.4
Operating profit margin	8.6	10.0	10.5	11.7
EBITDA/net interest (x)	6.7	8.5	10.0	13.5
Net debt/equity	45.6	7.2	-8.0	-21.4
Net debt/EBITDA (x)	1.0	0.2	-0.2	-0.5
CF from operations/net debt	9.3	588.6		

Per share data (INR)

EPS Rep (fully diluted)	7.81	10.89	12.77	17.29
HSBC EPS (fully diluted)	7.81	10.89	12.77	17.29
DPS	1.80	2.00	2.20	2.40
Book value	41.92	50.72	61.14	75.85

Valuation data

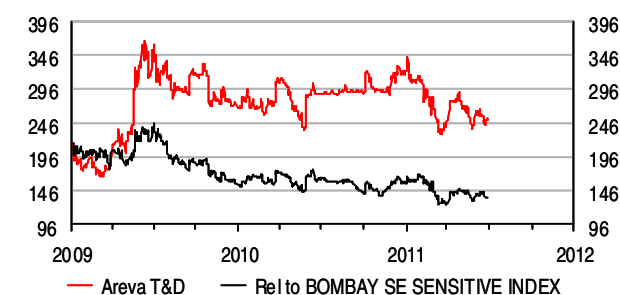
Year to	12/2010a	12/2011e	12/2012e	12/2013e
EV/sales	2.0	1.5	1.3	1.1
EV/EBITDA	18.0	12.2	10.6	8.3
EV/IC	3.7	3.3	3.1	2.7
PE*	37.0	23.2	19.8	14.6
P/Book value	6.9	5.0	4.1	3.3
FCF yield (%)	-1.0	6.9	4.3	5.5
Dividend yield (%)	0.6	0.8	0.9	0.9

Note: * = Based on HSBC EPS (fully diluted)

Issuer information

Share price (INR)	252.65	Target price (INR)	310.00	Potent'l return (%)	22.7
Reuters (Equity)	AREV.BO	Bloomberg (Equity)	ATD IN		
Market cap (USDm)	1,342	Market cap (INRm)	60,410		
Free float (%)	23	Enterprise value (INRm)	61,286		
Country	India	Sector	ELECTRICAL EQUIPMENT		
Analyst	Rahul Garg	Contact	+91 22 22681245		

Price relative



Source: HSBC

Note: price at close of 27 Jun 2011

Areva T&D

Income statement (INRm)	FY07	FY08	FY09	FY10	FY11e	FY12e	FY13e
Net Sales	20,063	26,412	35,659	40,200	45,501	49,887	58,201
Cost of Goods Sold (COGS)	(12,671)	(17,258)	(24,926)	(27,531)	(31,893)	(34,741)	(40,382)
Gross Income	7,391	9,154	10,733	12,669	13,608	15,146	17,820
Employee expense	(1,532)	(2,091)	(2,924)	(3,460)	(3,559)	(3,960)	(4,242)
Selling General & Admin exp (SG&A)	(2,285)	(2,812)	(3,794)	(4,971)	(4,740)	(5,197)	(6,063)
Other operating income	159	139	173	169	228	249	291
EBITDA	3,734	4,390	4,188	4,407	5,537	6,239	7,806
Exceptionals	0	1	5	0	0	0	0
Clean EBITDA	3,733	4,389	4,183	4,407	5,537	6,239	7,806
Depreciation & Amortization	(231)	(340)	(611)	(936)	(970)	(1,025)	(1,014)
EBIT	3,503	4,049	3,577	3,471	4,567	5,214	6,792
Clean EBIT	3,502	4,049	3,572	3,471	4,567	5,214	6,792
Other income	0	(281)	(68)	0	0	0	0
O/w Exceptional	0	(281)	(68)	0	0	0	0
O/w Dividend/Inv income	0	0	0	0	0	0	0
Interest income	19	4	1	2	156	182	230
Interest expense	(85)	(302)	(579)	(657)	(806)	(806)	(806)
Other financial exp/inc	(5)	0	0	0	0	0	0
Profit before tax (PBT)	3,432	3,470	2,930	2,816	3,917	4,590	6,215
Clean PBT	3,431	3,751	2,993	2,816	3,917	4,590	6,215
Income tax	(1,269)	(1,207)	(1,010)	(949)	(1,312)	(1,538)	(2,082)
Income from JVs (Post tax)	0	0	0	0	0	0	0
Profit after tax (PAT)	2,163	2,263	1,920	1,867	2,605	3,052	4,133
Extraordinary Items	0	0	0	0	0	0	0
Minorities	0	0	0	0	0	0	0
Reported Net income	2,163	2,263	1,920	1,867	2,605	3,052	4,133
HSBC Net income	2,163	2,446	1,961	1,867	2,605	3,052	4,133
No. of shares outstanding	210.2	239.1	239.1	239.1	239.1	239.1	239.1
Reported EPS	10.3	9.5	8.0	7.8	10.9	12.8	17.3
HSBC EPS (recurring)	10.3	10.2	8.2	7.8	10.9	12.8	17.3

Source: Company data, HSBC estimates

Areva T&D

Margin & trend analysis	FY07	FY08	FY09	FY10	FY11e	FY12e	FY13e
Sales growth	24.9%	31.6%	35.0%	12.7%	13.2%	9.6%	16.7%
Organic growth	25.7%	27.5%	31.8%	14.6%	11.1%	9.6%	16.7%
Clean EBITDA growth	70.5%	17.6%	-4.7%	5.3%	25.6%	12.7%	25.1%
Clean EBIT growth	74.8%	15.6%	-11.7%	-2.9%	31.6%	14.2%	30.3%
Reported EPS growth	49.8%	-8.0%	-15.2%	-2.7%	39.5%	17.2%	35.4%
HSBC EPS growth	57.2%	-0.6%	-19.8%	-4.8%	39.5%	17.2%	35.4%
Gross margins	36.8%	34.7%	30.1%	31.5%	29.9%	30.4%	30.6%
Clean EBITDA margins	18.6%	16.6%	11.7%	11.0%	12.2%	12.5%	13.4%
Clean EBIT margins	17.5%	15.3%	10.0%	8.6%	10.0%	10.5%	11.7%
OR margins	17.9%	16.3%	10.7%	9.2%	10.7%	11.1%	12.3%
PBT margins	17.1%	13.1%	8.2%	7.0%	8.6%	9.2%	10.7%
PAT margins	10.8%	8.6%	5.4%	4.6%	5.7%	6.1%	7.1%
Change in no. of Employees	9.4%	24.3%	19.5%	-2.9%	3.0%	7.0%	3.0%
Wage inflation	20.5%	9.8%	17.0%	17.0%	4.0%	4.0%	4.0%
Rate on interest income	1.2%	0.2%	0.0%	0.0%	2.5%	2.0%	2.0%
Rate on interest expense	16.3%	10.6%	9.4%	7.9%	9.0%	9.0%	9.0%
P&L tax rate	37.0%	34.8%	34.5%	33.7%	33.5%	33.5%	33.5%
Dividend tax rate	17.0%	17.0%	17.0%	16.6%	17.0%	17.0%	17.0%
Excise duty	9.5%	6.6%	4.2%	5.8%	4.0%	4.0%	4.0%
Dividend payout ratio	17.5%	19.0%	22.4%	23.0%	18.4%	17.2%	13.9%

Source: Company data, HSBC estimates

Areva T&D

Balance sheet (INRm)	FY07	FY08	FY09	FY10	FY11e	FY12e	FY13e
Share Capital	478	478	478	478	478	478	478
Reserves & Surplus	5,015	6,772	8,188	9,546	11,649	14,141	17,659
Shareholders Equity	5,493	7,250	8,666	10,024	12,127	14,620	18,137
Minorities	0	0	0	0	0	0	0
Total Equity	5,493	7,250	8,666	10,024	12,127	14,620	18,137
Secured Loans	0	0	0	0	0	0	0
Unsecured Loans	(1,012)	(4,692)	(7,676)	(8,957)	(8,957)	(8,957)	(8,957)
Total Debt	(1,012)	(4,692)	(7,676)	(8,957)	(8,957)	(8,957)	(8,957)
Loan & Advances	1,347	2,816	3,174	3,192	3,192	3,192	3,192
Cash & Equivalents	230	451	1,325	1,199	4,887	6,932	9,648
Net (Debt)/Cash	565	(1,425)	(3,177)	(4,566)	(878)	1,166	3,883
Tangible assets	1,666	1,963	8,384	8,715	8,725	8,680	8,546
Intangible assets	41	8	0	0	0	0	0
Capital Work-in-progress (CWIP)	586	4,500	519	224	224	224	224
Deferred tax assets	283	387	100	0	0	0	0
Investments	0	0	0	2	2	2	2
Other assets	0	0	0	0	0	0	0
Total Fixed Assets	2,576	6,858	9,003	8,941	8,951	8,906	8,772
Inventories	2,729	3,862	3,790	4,808	4,740	5,197	6,063
Sundry debtors	10,286	11,889	15,994	21,400	20,381	22,345	26,069
Sundry creditors	(7,462)	(4,089)	(7,460)	(8,390)	(9,479)	(10,393)	(12,125)
Customer advances	(1,887)	(5,245)	(4,793)	(4,948)	(6,162)	(6,756)	(7,881)
Acceptances	(206)	(141)	(86)	(691)	(95)	(104)	(121)
Other receivables	0	2,583	4,475	5,141	5,688	6,236	7,275
Other payables	(7)	(5,930)	(7,982)	(10,607)	(9,953)	(10,913)	(12,732)
Total Working Capital	3,454	2,929	3,939	6,714	5,119	5,612	6,548
Provisions	(1,101)	(1,111)	(1,099)	(1,027)	(1,027)	(1,027)	(1,027)
Deferred tax liability	0	0	0	(38)	(38)	(38)	(38)
Other Long term liabilities	0	0	0	0	0	0	0
Net Assets	5,493	7,250	8,666	10,024	12,127	14,620	18,137

Source: Company data, HSBC estimates

Areva T&D

Key balance sheet ratios	FY07	FY08	FY09	FY10	FY11e	FY12e	FY13e
Gearing	-10.3%	19.7%	36.7%	45.6%	7.2%	-8.0%	-21.4%
Gearing incl Acceptances	-6.5%	21.6%	37.7%	52.4%	8.0%	-7.3%	-20.7%
Leverage	0.90	1.20	1.37	1.46	1.07	0.92	0.79
Leverage incl Acceptances	0.93	1.22	1.38	1.52	1.08	0.93	0.79
Interest Cover (on EBIT)	52.82	13.59	6.18	5.30	7.02	8.35	11.78
Net debt to EBITDA	(0.15)	0.32	0.76	1.04	0.16	(0.19)	(0.50)
Fixed Asset turns	8.75	4.08	4.01	4.50	5.08	5.60	6.64
Asset (CE) turn	2.56	1.79	2.01	1.89	2.24	2.33	2.50
Asset (CE) turn - excl Cust Adv	3.37	2.77	2.76	2.46	3.21	3.41	3.77
Total Working Capital Days	61	129	83	103	79	78	80
Inventories	85	94	66	67	58	57	59
Sundry Debtors	208	187	188	206	174	171	176
Sundry Creditors	(232)	(100)	(129)	(117)	(116)	(114)	(118)
Other receivables	0	41	53	49	48	48	49
Other payables	(0)	(93)	(94)	(102)	(85)	(84)	(86)
Working Capital as % sales	19.1%	12.6%	12.7%	17.7%	11.9%	11.8%	12.1%

Source: Company data, HSBC estimates

Areva T&D

Cash flow statement (INRm)	FY07	FY08	FY09	FY10	FY11e	FY12e	FY13e
EBITDA	3,734	4,390	4,188	4,407	5,537	6,239	7,806
Adjusted for:							
Unrealized FX (gains)/losses	3	148	343	422	0	0	0
Loss on sale of fixed assets	(0)	0	0	(0)	0	0	0
Other non-cash exceptionals	115	179	185	269	0	0	0
Change in Working Capital	(2,384)	(1,586)	(1,195)	(3,428)	1,595	(493)	(935)
Tax paid	(1,114)	(1,509)	(1,282)	(595)	(1,312)	(1,538)	(2,082)
Net Financials	(77)	(269)	(595)	(649)	(650)	(624)	(576)
Others	55	(80)	39	0	0	0	0
Cash flow from operations	332	1,274	1,684	427	5,170	3,584	4,212
Capital Expenditure	(1,375)	(4,224)	(3,224)	(1,133)	(1,000)	(1,000)	(900)
Disposals	1	6	22	2	20	20	20
Change in other assets	0	0	0	0	0	0	0
Free cash flow (FCF)	(1,042)	(2,943)	(1,518)	(704)	4,190	2,604	3,332
Dividends	(332)	(500)	(499)	(500)	(502)	(560)	(615)
FCF post dividend	(1,374)	(3,443)	(2,017)	(1,205)	3,688	2,044	2,717
Acquisition -	97	118	16	0	0	0	0
Subs/Assoc/Investments							
Change in debt	979	3,543	2,872	0	0	0	0
Share buyback/issue	0	0	0	0	0	0	0
Others	0	0	0	0	0	0	0
Net cash flow	(298)	217	870	(1,205)	3,688	2,044	2,717

Source: Company data, HSBC estimates

Areva T&D

Key cash ratios	FY08	FY08	FY09	FY10	FY11e	FY12e	FY13e
Cash tax rate	29.8%	34.4%	30.6%	13.5%	23.7%	24.6%	26.7%
Change in WC as % sales	-11.9%	-6.0%	-3.3%	-8.5%	3.5%	-1.0%	-1.6%
Capex to depreciation	5.9	12.4	5.3	1.2	1.0	1.0	0.9
Capex as % sales	6.9%	16.0%	9.0%	2.8%	2.2%	2.0%	1.5%
Operating cash conversion	9.5%	31.5%	47.1%	12.3%	113.2%	68.7%	62.0%
FCF Yield	-1.6%	-4.2%	-2.4%	-1.0%	7.2%	4.5%	5.7%
FCF Yield post dividend	-2.1%	-5.0%	-3.2%	-1.7%	6.4%	3.5%	4.7%

Source: Company data, HSBC estimates

Areva T&D

Valuation	FY07	FY08	FY09	FY10	FY11e	FY12e	FY13e
Avg Price	319	290	266	289	242	242	242
Market Cap	67,007	69,446	63,591	69,170	57,959	57,959	57,959
Net debt	(565)	1,425	3,177	4,566	878	(1,166)	(3,883)
Customer advances	1,887	5,245	4,793	4,948	6,162	6,756	7,881
Banker's Acceptances	206	141	86	691	95	104	121
Minorities	0	0	0	0	0	0	0
Investments/Associates	(0)	(0)	(0)	(2)	(2)	(2)	(2)
Enterprise Value (EV)	68,535	76,257	71,647	79,373	65,091	63,650	62,077
EV/Sales	342%	289%	201%	197%	143%	128%	107%
EV/CE	874%	516%	404%	373%	320%	298%	266%
EV/EBITDA	18.4	17.4	17.1	18.0	11.8	10.2	8.0
EV/EBIT	19.6	18.8	20.1	22.9	14.3	12.2	9.1
EV/OR	19.1	17.7	18.8	21.3	13.4	11.5	8.6
P/E	31.0	28.4	32.4	37.0	22.3	19.0	14.0
P/Book	12.2	9.6	7.3	6.9	4.8	4.0	3.2
Dividend Yield	0.6%	0.6%	0.7%	0.6%	0.8%	0.9%	1.0%
FCF Yield	-1.6%	-4.2%	-2.4%	-1.0%	7.2%	4.5%	5.7%
FCF Yield - post dividend	-2.1%	-5.0%	-3.2%	-1.7%	6.4%	3.5%	4.7%
RoCE	28.9%	19.0%	14.1%	11.6%	16.0%	17.3%	20.5%
RoCE - excl Cust Adv	37.1%	27.7%	18.1%	14.1%	21.4%	23.7%	29.3%
RoE	39.4%	33.7%	22.6%	18.6%	21.5%	20.9%	22.8%

Source: Company data, HSBC estimates

Areva T&D

Profitability - RoCE	FY07	FY08	FY09	FY10	FY11e	FY12e	FY13e
Clean EBIT	3,502	4,049	3,572	3,471	4,567	5,214	6,792
Add back: Return on Cust Adv	94	262	240	247	308	338	394
Less: Associate/Div Income	0	0	0	0	0	0	0
Assumptions:							
Return on Cust Adv	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%
Tax rate	37.0%	34.8%	34.5%	33.7%	33.5%	33.5%	33.5%
Operating Return (OR)	3,597	4,311	3,812	3,718	4,875	5,552	7,186
Post tax OR	2,267	2,811	2,498	2,466	3,242	3,692	4,778
Equity	5,493	7,250	8,666	10,024	12,127	14,620	18,137
Net Deferred tax liability	(283)	(387)	(100)	38	38	38	38
Provisions	1,101	1,111	1,099	1,027	1,027	1,027	1,027
Debt	1,012	4,692	7,676	8,957	8,957	8,957	8,957
Customer advances	1,887	5,245	4,793	4,948	6,162	6,756	7,881
Bank's Acceptances	206	141	86	691	95	104	121
Less:							
Cash & Eqv	230	451	1,325	1,199	4,887	6,932	9,648
Loans & Advances	1,347	2,816	3,174	3,192	3,192	3,192	3,192
Investment/Associates	0	0	0	2	2	2	2
Capital Employed	7,839	14,785	17,721	21,292	20,325	21,376	23,320
Pre-tax RoCE	45.9%	29.2%	21.5%	17.5%	24.0%	26.0%	30.8%
RoCE	28.9%	19.0%	14.1%	11.6%	16.0%	17.3%	20.5%
RoCE ex-Cust Adv	37.1%	27.7%	18.1%	14.1%	21.4%	23.7%	29.3%

Source: Company data, HSBC estimates

Siemens: Strong outlook but priced in

- ▶ With growth of c41% in new orders and c32% in backlog last year, we expect SIEM to report strong sales growth in FY11e
- ▶ We expect margins to remain stable, driving earnings growth of c35% in FY11e and c15% in FY12e
- ▶ However, with an outperformance of c19% (last 6m) and a multiple of c29.2x FY11e PE, we see limited upside from current levels; downgrade to Neutral and raise TP from INR950 to INR985

After a moderate sales growth of c11% in FY10 (Sept YE), Siemens has shifted gears this year and has reported earnings growth of c37-38% in Q1 and Q2. Consequently, EBITDA margins have also been strong and stood at c14.4% in Q1 and c14.7% in Q2. However, the order intake in the first half of FY11 has been weak and recorded a marginal fall of c1%. However, to be fair to the company, we note that FY10 is tough comp as new orders in FY10 had grown by c41% and order book had risen by c32%.

While we expect new order growth to be weaker this year, at c12%, we believe revenues will benefit from a surge in the order book last year. Consequently, we forecast earnings growth to pick up to c26% in FY11e and c19% in FY12e (the strongest in the last three years).

We expect EBITDA margins in FY11e to remain stable at c13.9%, as the benefits of strong volume growth this year should compensate for

exceptionally strong performance in Q1 last year (Q1 FY10 EBITDA margins: c19.8%).

Overall, we forecast an earnings growth of c35% in FY11e and c15% in FY12e. We remain largely in line with consensus on our FY11-12e estimates.

Now that the open offer is out of the way, we believe that regular order announcements and the quarterly performance will be the likely catalysts for the stock.

However, we note that the stock has already outperformed the benchmark index (BSE Capital Goods Index) by c19% in the last six months, driven largely by the open offer. The stock is currently trading at c29.2x FY11e PE and c25.3x FY12e PE vs. historical average of c25.8x (5-yr average of 12m fwd PE). Therefore, at these levels, we see the valuation of Siemens as relatively full and believe that upside from here on is modest. We have raised our FY11-13e numbers by c2-3% and consequently, we raise our target price to INR985 from INR950 earlier,

which offers a potential return of c16%.

Consequently, we downgrade Siemens to Neutral from Overweight.

We highlight the key bull and bear points related to Siemens below:

Bull points

- ▶ After strong order growth of c40% in FY10, the order book visibility of c1.4yrs remains the best amongst peers
- ▶ Has significantly improved its presence with Power Grid, particularly in the 400/220kV segment

- ▶ The company has delivered a margin improvement of c500bps in the last three years
- ▶ Strong balance sheet provides ability to go after acquisitive growth
- ▶ Currently one of the best company in terms of fundamentals (i.e. return ratios)

Bear points

- ▶ The company has lost ground to ABB in the 765kV substation segment
- ▶ Operating margins may face downward pressure going forward, driven by higher capex in the medium term and increasing proportion of the low value products in longer term

FY11-13e earnings forecast

Sept YE (INRM)	New forecasts				Old forecasts			Change		
	FY10	FY11e	FY12e	FY13e	FY11e	FY12e	FY13e	FY11e	FY12e	FY13e
Order Backlog	135,839	158,286	181,474	205,975	168,481	205,659	245,791	-6.1%	-11.8%	-16.2%
Net Sales	96,201	120,733	143,944	173,517	115,936	141,265	168,734	4.1%	1.9%	2.8%
Clean EBITDA	13,196	16,539	19,143	22,396	15,620	18,659	21,590	5.9%	2.6%	3.7%
Reported EBITDA	13,196	16,539	19,143	22,396	15,620	18,659	21,590	5.9%	2.6%	3.7%
Clean EBIT	11,509	14,619	16,839	19,772	13,700	16,354	18,965	6.7%	3.0%	4.3%
Reported EBIT	11,509	14,619	16,839	19,772	13,700	16,354	18,965	6.7%	3.0%	4.3%
Other Income	0	0	0	0	0	0	0			
Net Financials	557	731	854	1,015	733	856	1,012			
Profit before tax	12,066	15,350	17,693	20,786	14,433	17,210	19,978	6.4%	2.8%	4.0%
Income tax	(4,501)	(5,219)	(6,016)	(7,067)	(4,474)	(5,507)	(6,593)			
Extraordinary items	0	0	0	0	0	0	0			
Income from JVs	0	85	85	85	85	85	85			
Minorities	12	(10)	(10)	(10)	(10)	(10)	(10)			
Clean Net Income	7,578	10,206	11,752	13,794	10,034	11,778	13,460	1.7%	-0.2%	2.5%
Reported Net Income	7,578	10,206	11,752	13,794	10,034	11,778	13,460	1.7%	-0.2%	2.5%
Clean EPS	22.5	30.3	34.9	40.9	29.8	34.9	39.9	1.7%	-0.2%	2.5%
Reported EPS	22.5	30.3	34.9	40.9	29.8	34.9	39.9	1.7%	-0.2%	2.5%
DPS	5.0	5.5	6.3	7.6	5.5	6.3	7.6	0.0%	0.0%	0.0%

Margins & Trend	New Forecasts				Old Forecasts			Change in f/c		
	FY10	FY11e	FY12e	FY13e	FY11e	FY12e	FY13e	FY11e	FY12e	FY13e
Sales visibility (yrs)	1.4	1.3	1.3	1.2	1.5	1.5	1.5	-9.8%	-13.4%	-18.5%
Sales growth	16%	26%	19%	21%	21%	22%	19%	5.0%	-2.6%	1.1%
Clean EBITDA mgn	13.7%	13.7%	13.3%	12.9%	13.5%	13.2%	12.8%	0.2%	0.1%	0.1%
Reported EBITDA mgn	13.7%	13.7%	13.3%	12.9%	13.5%	13.2%	12.8%	0.2%	0.1%	0.1%
Clean EBIT mgn	12.0%	12.1%	11.7%	11.4%	11.8%	11.6%	11.2%	0.3%	0.1%	0.2%
Reported EBIT mgn	12.0%	12.1%	11.7%	11.4%	11.8%	11.6%	11.2%	0.3%	0.1%	0.2%
PBT mgn	12.5%	12.7%	12.3%	12.0%	12.4%	12.2%	11.8%	0.3%	0.1%	0.1%
Clean NI mgn	7.9%	8.5%	8.2%	7.9%	8.7%	8.3%	8.0%	-0.2%	-0.2%	0.0%
Reported NI mgn	7.9%	8.5%	8.2%	7.9%	8.7%	8.3%	8.0%	-0.2%	-0.2%	0.0%

Source: Company data, HSBC estimates

- ▶ The stock now appears fully valued

We highlight our FY11-13e estimates for Siemens in the table above.

Valuation

Our target price of INR985 is derived from our preferred EVA valuation methodology. In our valuation model, we assume target sales growth of c9%, through-cycle operating return margin of c12.5% and WACC of c11.3%. We have increased our price target from INR950 earlier, driven largely by an earnings upgrade of c2-3% for FY11-13e.

Our target price implies that 12 months from now, the stock would be trading at a 12-month forward multiple of c25x PE compared with the current multiple of c29.2x FY11e and c25.3x FY12e.

Our implied target multiple is based on 24m fwd EPS of INR39.4.

Under HSBC's research model, for stocks without a volatility indicator, the Neutral rating band is five percentage points above and below the hurdle rate for India stocks of 11%. This translates into a Neutral rating band of 6% to 16% around the current share price. Our 12-month target price of INR985 suggests a potential return of c16% (ex-dividend), which is within the Neutral rating band; hence, we downgrade our recommendation on the stock to Neutral from Overweight earlier.

Risks

We highlight key risks related to our investment case on Siemens below:

- ▶ Downward risk: Increasing competition in the domestic T&D space
- ▶ Downward risk: Higher than expected margin dilution due to value priced products
- ▶ Upward risk: Significant increase in market share in the Power Grid orders

Financials & valuation: Siemens India

Neutral

Financial statements

Year to September	09/2010a	09/2011e	09/2012e	09/2013e
Profit & loss summary (INRm)				
Revenue	96,201	120,733	143,944	173,517
EBITDA	13,196	16,539	19,143	22,396
Depreciation & amortisation	-1,687	-1,920	-2,304	-2,624
Operating profit/EBIT	11,509	14,619	16,839	19,772
Net interest	557	731	854	1,015
PBT	12,066	15,350	17,693	20,786
HSBC PBT	12,066	15,350	17,693	20,786
Taxation	-4,501	-5,219	-6,016	-7,067
Net profit	7,590	10,196	11,742	13,784
HSBC net profit	7,578	10,206	11,752	13,794

Cash flow summary (INRm)

Cash flow from operations	8,321	10,697	12,694	14,691
Capex	-2,797	-4,700	-4,700	-5,200
Cash flow from investment	-2,797	-4,700	-4,700	-5,200
Dividends	-1,972	-1,972	-2,170	-2,495
Change in net debt	-3,552	-4,025	-5,825	-6,996
FCF equity	5,524	5,997	7,994	9,491

Balance sheet summary (INRm)

Intangible fixed assets	2,746	3,334	3,769	4,090
Tangible fixed assets	9,594	11,786	13,747	15,502
Current assets	76,188	92,675	110,378	132,432
Cash & others	27,497	31,521	37,346	44,342
Total assets	89,725	108,992	129,091	153,220
Operating liabilities	43,107	54,140	64,657	77,987
Gross debt	6	6	6	6
Net debt	-27,490	-31,515	-37,339	-44,336
Shareholders funds	33,418	41,652	51,235	62,534
Invested capital	34,234	42,706	50,527	59,980

Ratio, growth and per share analysis

Year to	09/2010a	09/2011e	09/2012e	09/2013e
Y-o-y % change				
Revenue	3.6	25.5	19.2	20.5
EBITDA	27.7	25.3	15.7	17.0
Operating profit	33.8	27.0	15.2	17.4
PBT	10.9	27.2	15.3	17.5
HSBC EPS	26.8	34.7	15.2	17.4

Ratios (%)

Revenue/IC (x)	2.8	2.8	2.8	2.9
ROIC	22.6	24.2	23.6	23.4
ROE	22.7	24.5	22.9	22.1
ROA	8.8	10.3	9.9	9.8
EBITDA margin	13.7	13.7	13.3	12.9
Operating profit margin	12.0	12.1	11.7	11.4
EBITDA/net interest (x)				
Net debt/equity	-82.1	-75.6	-72.8	-70.8
Net debt/EBITDA (x)	-2.1	-1.9	-2.0	-2.0
CF from operations/net debt				

Per share data (INR)

EPS Rep (fully diluted)	22.48	30.27	34.86	40.91
HSBC EPS (fully diluted)	22.48	30.27	34.86	40.91
DPS	5.00	5.50	6.33	7.59
Book value	99.28	123.70	152.13	185.64

Valuation data

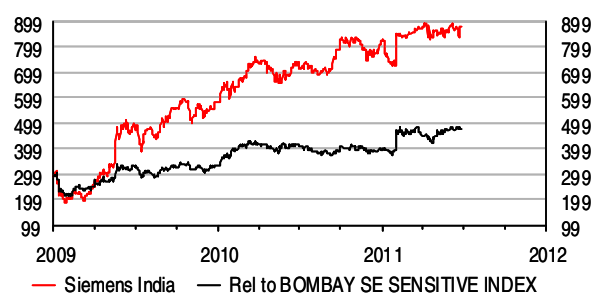
Year to	09/2010a	09/2011e	09/2012e	09/2013e
EV/sales	2.2	2.4	2.0	1.6
EV/EBITDA	16.2	17.4	14.9	12.7
EV/IC	6.2	6.7	5.6	4.7
PE*	39.3	29.2	25.3	21.6
P/Book value	6.7	7.1	5.8	4.8
FCF yield (%)	2.5	2.0	2.7	3.2
Dividend yield (%)	0.8	0.6	0.7	0.9

Note: * = Based on HSBC EPS (fully diluted)

Issuer information

Share price (INR)	849.00	Target price (INR)	985.00	Potent'l return (%)	16.0
Reuters (Equity)	SIEM.BO	Bloomberg (Equity)	SIEM IN		
Market cap (USDm)	6,674	Market cap (INRm)	300,446		
Free float (%)	31	Enterprise value (INRm)	268,988		
Country	India	Sector	ELECTRICAL EQUIPMENT		
Analyst	Rahul Garg	Contact	+91 22 22681245		

Price relative



Source: HSBC

Note: price at close of 27 Jun 2011

Siemens India

Income Statement (INR m)	FY07	FY08	FY09	FY10	FY11e	FY12e	FY13e
Net Sales	93,786	96,798	92,865	96,201	120,733	143,944	173,517
Cost of Goods Sold (COGS)	(66,214)	(69,643)	(65,679)	(70,325)	(88,120)	(106,319)	(129,895)
Gross Income	27,572	27,155	27,185	25,876	32,612	37,625	43,622
Employee expense	(9,139)	(9,203)	(9,444)	(7,052)	(7,772)	(8,566)	(9,264)
Selling General & Admin exp (SG&A)	(8,984)	(9,326)	(7,853)	(6,857)	(9,844)	(11,756)	(14,179)
Other operating income	389	498	627	1,229	1,543	1,839	2,217
EBITDA	9,837	9,123	10,515	13,196	16,539	19,143	22,396
Exceptionals	1,704	1,854	179	0	0	0	0
Clean EBITDA	8,133	7,269	10,336	13,196	16,539	19,143	22,396
Depreciation & Amortization	(1,403)	(1,617)	(1,733)	(1,687)	(1,920)	(2,304)	(2,624)
EBIT	8,433	7,506	8,783	11,509	14,619	16,839	19,772
Clean EBIT	6,730	5,652	8,604	11,509	14,619	16,839	19,772
Other income	894	1,334	1,616	0	0	0	0
O/w Exceptional	798	1,235	1,501	0	0	0	0
O/w Dividend/Inv income	96	99	115	0	0	0	0
Interest income	588	648	558	564	738	861	1,021
Interest expense	(45)	(66)	(74)	(6)	(6)	(6)	(6)
Other financial exp/inc	0	0	0	0	0	0	0
Profit before tax (PBT)	9,869	9,422	10,883	12,066	15,350	17,693	20,786
Clean PBT	7,367	6,334	9,203	12,066	15,350	17,693	20,786
Income tax	(3,007)	(3,483)	(3,960)	(4,501)	(5,219)	(6,016)	(7,067)
Income from JVs (Post tax)	78	75	82	0	85	85	85
Profit after tax (PAT)	6,940	6,014	7,005	7,566	10,216	11,762	13,804
Extraordinary Items	0	0	0	0	0	0	0
Minorities	(11)	(19)	41	12	(10)	(10)	(10)
Reported Net income	6,929	5,995	7,046	7,578	10,206	11,752	13,794
HSBC Net income	5,189	4,048	5,977	7,578	10,206	11,752	13,794
No. of shares outstanding	169.4	337.2	337.2	337.2	337.2	337.2	337.2
Reported EPS	40.9	17.8	20.9	22.5	30.3	34.9	40.9
HSBC EPS (Recurring)	30.6	12.0	17.7	22.5	30.3	34.9	40.9

Source: Company data, HSBC estimates

Siemens India

Margin & Trend analysis	FY07	FY08	FY09	FY10	FY11e	FY12e	FY13e
Sales growth	55.5%	3.2%	-4.1%	3.6%	25.5%	19.2%	20.5%
Organic growth	54.0%	3.0%	-4.9%	3.6%	25.6%	19.4%	20.6%
Clean EBITDA growth	26.1%	-10.6%	42.2%	27.7%	25.3%	15.7%	17.0%
Clean EBIT growth	59.4%	-11.0%	17.0%	31.0%	27.0%	15.2%	17.4%
Reported EPS growth	76.9%	-56.5%	17.5%	7.5%	34.7%	15.2%	17.4%
HSBC EPS growth	36.9%	-60.8%	47.6%	26.8%	34.7%	15.2%	17.4%
Gross margins	29.4%	28.1%	29.3%	26.9%	27.0%	26.1%	25.1%
Clean EBITDA margins	8.7%	7.5%	11.1%	13.7%	13.7%	13.3%	12.9%
Clean EBIT margins	7.2%	5.8%	9.3%	12.0%	12.1%	11.7%	11.4%
OR margins	7.6%	6.9%	10.1%	12.8%	13.0%	12.6%	12.3%
PBT margins	10.5%	9.7%	11.7%	12.5%	12.7%	12.3%	12.0%
PAT margins	7.4%	6.2%	7.5%	7.9%	8.5%	8.2%	8.0%
Change in no. of Employees	8.9%	0.0%	2.8%	5.0%	7.0%	7.0%	5.0%
Wage inflation	11.9%	0.7%	-0.2%	-28.9%	3.0%	3.0%	3.0%
Rate on interest income	3.9%	3.8%	2.6%	2.2%	2.5%	2.5%	2.5%
Rate on interest expense	25.4%	30.5%	124.5%	100.0%	100.0%	100.0%	100.0%
P&L tax rate	30.5%	37.0%	36.4%	37.3%	34.0%	34.0%	34.0%
Dividend tax rate	25.5%	56.3%	17.0%	17.0%	17.0%	17.0%	17.0%
Excise duty	3.4%	3.2%	2.4%	2.4%	2.4%	2.5%	2.5%
Dividend payout ratio	11.7%	16.9%	23.9%	22.2%	18.2%	18.1%	18.6%

Source: Company data, HSBC estimates

Siemens India

Balance Sheet (INR m)	FY07	FY08	FY09	FY10	FY11e	FY12e	FY13e
Share Capital	337	674	674	674	674	674	674
Reserves & Surplus	17,964	22,100	27,139	32,744	40,978	50,560	61,859
Shareholders Equity	18,301	22,774	27,813	33,418	41,652	51,235	62,534
Minorities	80	147	56	56	56	56	56
Total Equity	18,381	22,921	27,869	33,475	41,708	51,291	62,590
Secured Loans	(302)	(102)	(1)	(1)	(1)	(1)	(1)
Unsecured Loans	(15)	(11)	(6)	(6)	(6)	(6)	(6)
Total Debt	(317)	(112)	(6)	(6)	(6)	(6)	(6)
Loan & Advances	5,415	6,450	9,199	9,199	9,199	9,199	9,199
Cash & Equivalents	8,570	13,222	14,746	18,298	22,322	28,147	35,143
Net (Debt)/Cash	13,668	19,559	23,938	27,490	31,515	37,339	44,336
Tangible assets	5,583	6,499	6,965	7,978	10,170	12,131	13,886
Intangible assets	1,963	1,449	2,303	2,746	3,334	3,769	4,090
Capital Work-in-progress (CWIP)	1,103	1,068	1,616	1,616	1,616	1,616	1,616
Deferred tax assets	775	1,462	1,196	1,196	1,196	1,196	1,196
Investments	1,943	2,450	0	0	0	0	0
Other assets	0	0	0	0	0	0	0
Total Fixed Assets	11,367	12,928	12,081	13,537	16,317	18,712	20,788
Inventories	7,898	8,257	10,555	10,973	13,781	16,458	19,851
Sundry debtors	25,628	37,564	36,134	37,719	47,373	56,574	68,239
Sundry creditors	(26,045)	(26,666)	(25,731)	(26,452)	(33,223)	(39,676)	(47,856)
Customer advances	(8,622)	(21,177)	(16,304)	(16,655)	(20,918)	(24,981)	(30,131)
Acceptances	0	0	0	0	0	0	0
Other receivables	0	0	0	0	0	0	0
Other payables	(10)	(11)	(14)	0	0	0	0
Total Working Capital	(1,151)	(2,033)	4,640	5,584	7,014	8,376	10,103
Provisions	(5,503)	(7,534)	(12,791)	(12,791)	(12,791)	(12,791)	(12,791)
Deferred tax liability	0	0	0	0	0	0	0
Other Long term liabilities	0	0	0	0	0	0	0
Net Assets	18,381	22,921	27,869	33,821	42,054	51,637	62,436

Source: Company data, HSBC estimates

Siemens India

Key balance sheet ratios	FY07	FY08	FY09	FY10	FY11e	FY12e	FY13e
Gearing	-74.4%	-85.3%	-85.9%	-82.1%	-75.6%	-72.8%	-70.8%
Gearing incl Acceptances	-74.4%	-85.3%	-85.9%	-82.1%	-75.6%	-72.8%	-70.8%
Leverage	0.26	0.15	0.14	0.18	0.24	0.27	0.29
Leverage incl Acceptances	0.26	0.15	0.14	0.18	0.24	0.27	0.29
Interest Cover (on EBIT)	(15.55)	(12.89)	(18.13)	(20.66)	(19.99)	(19.71)	(19.49)
Net debt to EBITDA	(1.68)	(2.69)	(2.32)	(2.08)	(1.91)	(1.95)	(1.98)
Fixed Asset turns	10.84	10.74	8.53	7.80	7.98	8.22	8.86
Asset (CE) turn	5.82	3.44	2.92	2.81	2.83	2.85	2.89
Asset (CE) turn - excl Cust Adv	12.51	13.86	5.98	5.47	5.54	5.63	5.81
Total Working Capital Days	(5)	45	57	63	70	69	70
Inventories	55	44	57	59	63	62	61
Sundry Debtors	121	144	139	146	159	156	157
Sundry Creditors	(182)	(143)	(139)	(142)	(153)	(149)	(148)
Other receivables	0	0	0	0	0	0	0
Other payables	(0)	(0)	(0)	0	0	0	0
Working Capital as % sales	-1.5%	-2.1%	4.9%	5.9%	6.5%	6.3%	6.4%

Source: Company data, HSBC estimates

Siemens India							
Cash Flow Statement (INR m)	FY07	FY08	FY09	FY10	FY11e	FY12e	FY13e
EBITDA	9,837	9,123	10,515	13,196	16,539	19,143	22,396
Adjusted for:							
Unrealized fx (gains)/losses	(2,091)	(455)	(1,027)	0	0	0	0
Loss on sale of fixed assets	(936)	(260)	(241)	0	0	0	0
Other non-cash exceptionals	139	408	112	0	0	0	0
Change in Working Capital	(5,142)	1,138	589	(944)	(1,429)	(1,362)	(1,727)
Tax paid	(3,305)	(4,715)	(5,928)	(4,501)	(5,219)	(6,016)	(7,067)
Net Financials	639	607	539	557	731	854	1,015
Others	722	157	318	12	75	75	75
Cash flow from operations	(137)	6,003	4,877	8,321	10,697	12,694	14,691
Capital Expenditure	(2,375)	(2,369)	(2,826)	(3,054)	(5,000)	(5,000)	(5,500)
Disposals	195	418	306	257	300	300	300
Change in other assets	0	0	0	0	0	0	0
Free cash flow (FCF)	(2,317)	4,052	2,357	5,524	5,997	7,994	9,491
Dividends	(811)	(946)	(1,578)	(1,972)	(1,972)	(2,170)	(2,495)
FCF post dividend	(3,128)	3,106	779	3,552	4,025	5,825	6,996
Acquisition - Subs/Assoc/Investments	253	1,035	2,116	0	0	0	0
Change in debt	(95)	(205)	(106)	0	0	0	0
Share buyback/issue	0	0	0	0	0	0	0
Others	34	0	0	0	0	0	0
Net cash flow	(2,937)	3,936	2,789	3,552	4,025	5,825	6,996

Source: Company data, HSBC estimates

Siemens India							
Key cash ratios	FY08	FY08	FY09	FY10	FY11e	FY12e	FY13e
Cash tax rate	33.6%	51.7%	56.4%	34.1%	31.6%	31.4%	31.6%
Change in WC as % sales	-5.5%	1.2%	0.6%	-1.0%	-1.2%	-0.9%	-1.0%
Capex to depreciation	1.7	1.5	1.6	1.8	2.6	2.2	2.1
Capex as % sales	2.5%	2.4%	3.0%	3.2%	4.1%	3.5%	3.2%
Operating cash conversion	-1.6%	80.0%	55.5%	72.3%	73.2%	75.4%	74.3%
FCF Yield	-2.3%	1.7%	2.0%	2.5%	2.1%	2.8%	3.3%
FCF Yield post dividend	-3.1%	1.3%	0.7%	1.6%	1.4%	2.0%	2.5%

Source: Company data, HSBC estimates

Siemens India

Valuation	FY07	FY08	FY09	FY10	FY11e	FY12e	FY13e
Avg Price	599	693	347	665	846	846	846
Market Cap	101,570	233,570	116,841	224,309	285,372	285,372	285,372
Net debt	(13,668)	(19,559)	(23,938)	(27,490)	(31,515)	(37,339)	(44,336)
Customer advances	8,622	21,177	16,304	16,655	20,918	24,981	30,131
Banker's Acceptances	0	0	0	0	0	0	0
Minorities	80	147	56	56	56	56	56
Investments/Associates	(1,943)	(2,450)	(0)	(0)	(0)	(0)	(0)
Enterprise Value (EV)	94,662	232,885	109,263	213,530	274,832	273,070	271,224
EV/Sales	101%	241%	118%	222%	228%	190%	156%
EV/CE	587%	827%	343%	624%	644%	540%	452%
EV/EBITDA	11.6	32.0	10.6	16.2	16.6	14.3	12.1
EV/EBIT	14.1	41.2	12.7	18.6	18.8	16.2	13.7
EV/OR	13.2	34.7	11.6	17.3	17.5	15.1	12.7
P/E	19.6	57.7	19.5	29.6	28.0	24.3	20.7
P/Book	5.5	10.2	4.2	6.7	6.8	5.6	4.6
Dividend Yield	0.8%	0.4%	1.4%	0.8%	0.6%	0.7%	0.9%
FCF Yield	-2.3%	1.7%	2.0%	2.5%	2.1%	2.8%	3.3%
FCF Yield - post dividend	-3.1%	1.3%	0.7%	1.6%	1.4%	2.0%	2.5%
RoCE	30.9%	15.0%	18.8%	22.6%	24.2%	23.6%	23.4%
RoCE - excl Cust Adv	62.4%	51.0%	35.3%	41.1%	44.3%	43.5%	43.7%
RoE	28.4%	17.8%	21.5%	22.7%	24.5%	22.9%	22.1%

Source: Company data, HSBC estimates

Siemens India

Profitability - RoCE	FY07	FY08	FY09	FY10	FY11e	FY12e	FY13e
Clean EBIT	6,730	5,652	8,604	11,509	14,619	16,839	19,772
Add back: Return on Cust Adv	431	1,059	815	833	1,046	1,249	1,507
Less: Associate/Div Income	0	0	0	0	0	0	0
Assumptions:							
Return on Cust Adv	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%
Tax rate	30.5%	37.0%	36.4%	37.3%	34.0%	34.0%	34.0%
Operating Return (OR)	7,161	6,711	9,419	12,342	15,665	18,088	21,278
Post tax OR	4,979	4,231	5,992	7,738	10,339	11,938	14,044
Equity	18,381	22,921	27,869	33,475	41,708	51,291	62,590
Net Deferred tax liability	(775)	(1,462)	(1,196)	(1,196)	(1,196)	(1,196)	(1,196)
Provisions	5,503	7,534	12,791	12,791	12,791	12,791	12,791
Debt	317	112	6	6	6	6	6
Customer advances	8,622	21,177	16,304	16,655	20,918	24,981	30,131
Bank's Acceptances	0	0	0	0	0	0	0
Less:							
Cash & Eqv	8,570	13,222	14,746	18,298	22,322	28,147	35,143
Loans & Advances	5,415	6,450	9,199	9,199	9,199	9,199	9,199
Investment/Associates	1,943	2,450	0	0	0	0	0
Capital Employed	16,120	28,161	31,829	34,234	42,706	50,527	59,980
Pre-tax RoCE	44.4%	23.8%	29.6%	36.1%	36.7%	35.8%	35.5%
RoCE	30.9%	15.0%	18.8%	22.6%	24.2%	23.6%	23.4%
RoCE ex-Cust Adv	62.4%	51.0%	35.3%	41.1%	44.3%	43.5%	43.7%

Source: Company data, HSBC estimates

Crompton: concerns easing

- ▶ With management changes behind us, CRG is poised to grow internationally while maintaining its position in the local markets
- ▶ Well placed to defend its strong position in the transformer segment, benefiting from changes in quality requirements
- ▶ Expect margins to remain broadly stable and new acquisitions to provide impetus to earnings growth; valuation attractive at c15.9x FY12e PE; reiterate OW and TP of INR330

Crompton reported disappointing Q4 FY11 (Mar YE) results which, in spite of being in line with expectations at the sales and EPS level, hurt market sentiment due to a significant miss in EBITDA margins. As we highlighted in our research note on 5 May 2011, *OW: Concerns overdone, valuation attractive*, we note that the margin miss was one-off and primarily driven by the Industrial Systems business. But with Q4 results behind us, we believe that things are moving in the right direction when it comes to bigger structural concerns.

First, we believe the management changes have been quite satisfactory. The appointment of Mr. Laurent Demortier as the new CEO and Mr. Sudhir Trehan as the Vice Chairman should help the company grow internationally while at the same time maintain its position in the Indian market.

Second, we note that while competition remains intense in the domestic transmission market, Crompton did well in FY11 to retain its No.1

position in the 765kV transformer segment. We believe the recent localization of its manufacturing footprint leaves it well placed to compete with the Chinese/Korean players going forward.

Third, we believe that while the company should continue to face margin pressure in its domestic transmission business, the improvement in its international margins should help offset most of that pressure. We saw this phenomenon occurring in Q4, where the net Power Systems margins improved by c40bps q-o-q despite a c170bp margin decline in domestic Power Systems business.

Last, we highlight that Crompton remains prudent with acquisitions and have recently announced two niche strategic bolt-ons with a total ticket size of USD112m. We believe these are strong acquisitions as they help Crompton fill its product gap and increase its geographical footprint without putting a dent in its balance sheet.

Overall, we remain of the view that Crompton is moving in the right direction with a clear strategy and therefore investors should find comfort from recent developments.

We note that Crompton remains the best company in our universe on fundamentals such as return ratios, cash margins and working capital management; however, the stock remains at a discount to its peers as well as its own history. On our estimates, the stock is trading at c15.9x FY12e PE and c13.8x FY13e PE compared to the historical average of c18.3x (5-yr average of 12m fwd PE). We continue to find the valuation attractive and re-iterate our Overweight rating and target price of INR330.

We highlight the key bull and bear points related to Crompton below.

Bull points

- ▶ Management change is now behind us and has been satisfactory.
- ▶ Crompton remains No.1 in the 765kV segment in the face of strong competition
- ▶ Crompton continues to grow its product range and its reach through strategic acquisitions
- ▶ Net Power Systems margins have seen little erosion

FY 12-14e earnings forecast

- Mar YE (INRm)	FY10	FY11	New forecasts			Old forecasts			Change		
			FY12e	FY13e	FY14e	FY12e	FY13e	FY14e	FY12e	FY13e	FY14e
Order Backlog	63,650	71,690	77,160	87,492	104,408	82,428	94,682	104,011	-6.4%	-7.6%	0.4%
Net Sales	91,409	100,051	115,205	133,716	156,296	115,673	134,928	154,415	-0.4%	-0.9%	1.2%
Clean EBITDA	12,771	13,438	15,945	18,518	21,735	15,967	19,088	22,054	-0.1%	-3.0%	-1.4%
Reported EBITDA	12,770	13,438	15,945	18,518	21,735	15,967	19,088	22,054	-0.1%	-3.0%	-1.4%
Clean EBIT	11,220	11,502	13,547	15,967	19,107	13,569	16,537	19,427	-0.2%	-3.4%	-1.6%
Reported EBIT	11,219	11,502	13,547	15,967	19,107	13,569	16,537	19,427	-0.2%	-3.4%	-1.6%
Other Income	937	999	713	827	965	716	835	953			
Net Financials	(265)	(209)	(217)	(114)	28	(217)	(112)	37			
Profit before tax	11,891	12,291	14,043	16,680	20,100	14,067	17,260	20,417	-0.2%	-3.4%	-1.5%
Income tax	(3,618)	(3,020)	(3,616)	(4,635)	(5,995)	(3,623)	(4,798)	(6,090)			
Extraordinary items	352	(381)	0	0	0	0	0	0			
Minorities	(26)	(4)	(30)	(30)	(30)	(30)	(30)	(30)			
Clean Net Income	7,982	9,268	10,397	12,015	14,075	10,415	12,432	14,297	-0.2%	-3.4%	-1.5%
Reported Net Income	8,599	8,887	10,397	12,015	14,075	10,415	12,432	14,297	-0.2%	-3.4%	-1.5%
Clean EPS	12.4	14.4	16.2	18.7	21.9	16.2	19.4	22.3	-0.2%	-3.4%	-1.5%
Reported EPS	13.4	13.9	16.2	18.7	21.9	16.2	19.4	22.3	-0.2%	-3.4%	-1.5%
DPS	2.2	2.4	2.7	3.0	3.5	2.7	3.0	3.5	0.0%	0.0%	0.0%

Margins & Trend	FY10	FY11	New Forecasts			Old Forecasts			Change in f/c		
			FY12e	FY13e	FY14e	FY12e	FY13e	FY14e	FY12e	FY13e	FY14e
Sales visibility (yrs)	0.70	0.72	0.67	0.65	0.67	0.71	0.70	0.67	-6.0%	-6.8%	-0.8%
Sales growth	5%	9%	15%	16%	17%	16%	17%	14%	-0.5%	-0.6%	2.4%
Clean EBITDA mgn	14.0%	13.4%	13.8%	13.8%	13.9%	13.8%	14.1%	14.3%	0.0%	-0.3%	-0.4%
Reported EBITDA margin	14.0%	13.4%	13.8%	13.8%	13.9%	13.8%	14.1%	14.3%	0.0%	-0.3%	-0.4%
Clean EBIT margin	12.3%	11.5%	11.8%	11.9%	12.2%	11.7%	12.3%	12.6%	0.0%	-0.3%	-0.4%
Reported EBIT margin	12.3%	11.5%	11.8%	11.9%	12.2%	11.7%	12.3%	12.6%	0.0%	-0.3%	-0.4%
PBT margin	13.0%	12.3%	12.2%	12.5%	12.9%	12.2%	12.8%	13.2%	0.0%	-0.3%	-0.4%
Clean NI margin	8.7%	9.3%	9.0%	9.0%	9.0%	9.0%	9.2%	9.3%	0.0%	-0.2%	-0.3%
Reported NI margin	9.4%	8.9%	9.0%	9.0%	9.0%	9.0%	9.2%	9.3%	0.0%	-0.2%	-0.3%

Source: Company data, HSBC estimates

- ▶ International order intake has picked up and the sales growth is now expected to be double digit
- ▶ Crompton remains one of the best companies on fundamentals
- ▶ The stock remains attractive on valuation

Bear points

- ▶ Power Grid orders likely to be weak this year which may create an overhang on the stock
- ▶ Concerns on margin pressure and the impact of management change will linger until the company delivers steady results over the coming quarters

We highlight our FY11-13e estimates for Crompton in the table on the next page.

Valuation

Our target price of INR330 is derived from our preferred EVA valuation methodology. We assume target sales growth of c7%, through-cycle operating return margin of c11.5% and WACC of 12.4%. Our target price implies that 12 months from now the stock would be trading at a 12-month forward multiple of c17x PE compared with the current multiple of c15.8x FY12e and c13.7x FY13e. Our implied target multiple is based on 24m fwd EPS of INR19.5.

Under HSBC's research model, for stocks without a volatility indicator, the Neutral rating band is five percentage points above and below the hurdle rate for India stocks of 11%. This translates into a Neutral rating band of 6% to 16% around the current share price. Our 12-month target price of INR330 suggests a potential return of c29% (ex-dividend), which is above the Neutral rating band; hence, we remain Overweight on the stock.

Risks

We highlight risks to our investment case:

- ▶ Pricing pressure and cost inflation
- ▶ Delay in transmission orders
- ▶ Delay in Industrial Systems margin recovery

Financials & valuation: Crompton Greaves Ltd

Overweight

Financial statements

Year to December	03/2011a	03/2012e	03/2013e	03/2014e
Profit & loss summary (INRm)				
Revenue	100,051	115,205	133,716	156,296
EBITDA	13,438	15,945	18,518	21,735
Depreciation & amortisation	-1,936	-2,398	-2,551	-2,627
Operating profit/EBIT	11,502	13,547	15,967	19,107
Net interest	-209	-217	-114	28
PBT	12,291	14,043	16,680	20,100
HSBC PBT	12,291	14,043	16,680	20,100
Taxation	-3,100	-3,651	-4,670	-6,030
Net profit	8,883	10,367	11,985	14,045
HSBC net profit	9,268	10,397	12,015	14,075

Cash flow summary (INRm)

Cash flow from operations	8,272	11,889	13,096	16,544
Capex	-4,200	-4,200	-3,200	-3,200
Cash flow from investment	-4,200	-4,200	-3,200	-3,200
Dividends	-947	-1,801	-2,026	-2,252
Change in net debt	1,176	-5,888	-7,870	-11,092
FCF equity	4,072	7,689	9,896	12,344

Balance sheet summary (INRm)

Intangible fixed assets	3,469	3,532	3,587	3,635
Tangible fixed assets	15,948	17,687	18,281	18,806
Current assets	45,496	56,306	71,045	88,790
Cash & others	7,661	13,549	21,419	32,511
Total assets	72,744	85,356	100,745	119,063
Operating liabilities	29,595	33,611	39,012	45,506
Gross debt	4,703	4,703	4,703	4,703
Net debt	-2,958	-8,846	-16,716	-27,808
Shareholders funds	32,747	41,342	51,331	63,154
Invested capital	36,955	41,053	44,889	47,686

Ratio, growth and per share analysis

Year to	03/2011a	03/2012e	03/2013e	03/2014e
Y-o-y % change				
Revenue	9.5	15.1	16.1	16.9
EBITDA	5.2	18.7	16.1	17.4
Operating profit	2.5	17.8	17.9	19.7
PBT	3.4	14.3	18.8	20.5
HSBC EPS	16.1	12.2	15.6	17.1

Ratios (%)

Revenue/IC (x)	2.7	2.8	3.0	3.3
ROIC	24.1	25.3	26.5	29.0
ROE	28.3	25.1	23.4	22.3
ROA	13.3	13.2	12.9	12.8
EBITDA margin	13.4	13.8	13.8	13.9
Operating profit margin	11.5	11.8	11.9	12.2
EBITDA/net interest (x)	64.2	73.4	162.5	
Net debt/equity	-9.0	-21.3	-32.5	-43.9
Net debt/EBITDA (x)	-0.2	-0.6	-0.9	-1.3
CF from operations/net debt				

Per share data (INR)

EPS Rep (fully diluted)	13.85	16.21	18.73	21.94
HSBC EPS (fully diluted)	14.45	16.21	18.73	21.94
DPS	2.40	2.70	3.00	3.50
Book value	51.29	64.69	80.26	98.69

Valuation data

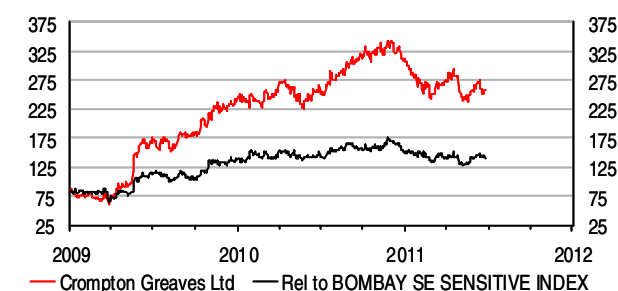
Year to	03/2011a	03/2012e	03/2013e	03/2014e
EV/sales	1.8	1.4	1.2	0.9
EV/EBITDA	13.6	10.1	8.4	6.7
EV/IC	4.9	3.9	3.4	3.0
PE*	17.9	15.9	13.8	11.8
P/Book value	5.5	4.0	3.2	2.6
FCF yield (%)	2.2	4.6	6.0	8.1
Dividend yield (%)	0.8	1.0	1.2	1.4

Note: * = Based on HSBC EPS (fully diluted)

Issuer information

Share price (INR)	258.05	Target price (INR)	330.00	Potent'l return (%)	27.9
Reuters (Equity)	CROM.BO	Bloomberg (Equity)	CRG IN		
Market cap (USDm)	3,677	Market cap (INRm)	165,537		
Free float (%)	54	Enterprise value (INRm)	150,101		
Country	India	Sector	ELECTRICAL EQUIPMENT		
Analyst	Rahul Garg	Contact	+91 22 22681245		

Price relative



Source: HSBC

Note: price at close of 27 Jun 2011

Crompton Greaves

Income statement (INRm)	FY07	FY08	FY09	FY10	FY11	FY12e	FY13e	FY14e
Net Sales	56,396	68,323	87,373	91,409	100,051	115,205	133,716	156,296
Cost of Goods Sold (COGS)	(38,483)	(45,660)	(56,938)	(57,966)	(62,689)	(73,983)	(86,362)	(102,203)
Gross Income	17,912	22,663	30,435	33,443	37,363	41,222	47,354	54,094
Employee expense	(7,171)	(7,968)	(10,646)	(11,131)	(11,811)	(13,400)	(15,051)	(16,279)
Selling General & Admin exp (SG&A)	(5,914)	(7,256)	(9,833)	(9,542)	(12,113)	(11,877)	(13,785)	(16,080)
Other operating income	0	0	0	0	0	0	0	0
EBITDA	4,827	7,439	9,956	12,770	13,438	15,945	18,518	21,735
Exceptionals	0	0	(1,278)	(2)	0	0	0	0
Clean EBITDA	4,827	7,439	11,234	12,771	13,438	15,945	18,518	21,735
Depreciation & Amortization	(954)	(1,263)	(1,216)	(1,551)	(1,936)	(2,398)	(2,551)	(2,627)
EBIT	3,873	6,176	8,740	11,219	11,502	13,547	15,967	19,107
Clean EBIT	3,873	6,176	10,018	11,220	11,502	13,547	15,967	19,107
Other income	1,053	677	587	937	999	713	827	965
O/w Exceptional	0	0	39	383	0	0	0	0
O/w Dividend/Inv income	0	0	14	2	0	0	0	0
Interest income	0	0	153	163	155	159	262	404
Interest expense	(566)	(701)	(808)	(428)	(364)	(376)	(376)	(376)
Other financial exp/inc	0	0	0	0	0	0	0	0
Profit before tax (PBT)	4,360	6,152	8,672	11,891	12,291	14,043	16,680	20,100
Clean PBT	4,360	6,152	9,911	11,509	12,291	14,043	16,680	20,100
Income tax	(1,495)	(2,054)	(3,047)	(3,650)	(3,100)	(3,651)	(4,670)	(6,030)
Income from JVs (Post tax)	0	17	(9)	32	80	35	35	35
Profit after tax (PAT)	2,865	4,115	5,616	8,272	9,272	10,427	12,045	14,105
Extraordinary Items	0	0	0	352	(381)	0	0	0
Minorities	(47)	(48)	(17)	(26)	(4)	(30)	(30)	(30)
Reported Net income	2,818	4,067	5,599	8,599	8,887	10,397	12,015	14,075
HSBC Net income	2,818	4,067	6,403	7,982	9,268	10,397	12,015	14,075
No. of shares outstanding	641.5	641.5	641.6	641.5	641.5	641.5	641.5	641.5
Reported EPS	4.4	6.3	8.7	13.4	13.9	16.2	18.7	21.9
HSBC EPS (Recurring)	4.4	6.3	10.0	12.4	14.4	16.2	18.7	21.9

Source: Company data, HSBC estimates

Crompton Greaves

Margin & trend analysis	FY07	FY08	FY09	FY10	FY11	FY12e	FY13e	FY14e
Sales growth	36.7%	21.2%	27.9%	4.6%	9.5%	15.1%	16.1%	16.9%
Organic growth	36.5%	21.0%	25.8%	3.8%	10.2%	15.0%	16.1%	16.6%
Clean EBITDA growth	48.4%	54.1%	51.0%	13.7%	5.2%	18.7%	16.1%	17.4%
Clean EBIT growth	55.5%	59.5%	41.5%	28.4%	2.5%	17.8%	17.9%	19.7%
Reported EPS growth	-12.4%	44.3%	37.6%	53.6%	3.4%	17.0%	15.6%	17.1%
HSBC EPS growth	-12.4%	44.3%	57.4%	24.7%	16.1%	12.2%	15.6%	17.1%
Gross margins	31.8%	33.2%	34.8%	36.6%	37.3%	35.8%	35.4%	34.6%
Clean EBITDA margins	8.6%	10.9%	12.9%	14.0%	13.4%	13.8%	13.8%	13.9%
Clean EBIT margins	6.9%	9.0%	10.0%	12.3%	11.5%	11.8%	11.9%	12.2%
OR margins	7.0%	9.5%	11.9%	12.7%	11.9%	12.2%	12.4%	12.6%
PBT margins	7.7%	9.0%	9.9%	13.0%	12.3%	12.2%	12.5%	12.9%
PAT margins	5.1%	6.0%	6.4%	9.0%	9.3%	9.1%	9.0%	9.0%
Change in no. of Employees	2.2%	4.2%	3.1%	1.0%	5.0%	6.0%	8.0%	4.0%
Wage inflation	26.8%	6.6%	29.6%	3.6%	4.0%	4.0%	4.0%	4.0%
Rate on interest income	0.0%	0.0%	2.2%	1.9%	1.8%	1.5%	1.5%	1.5%
Rate on interest expense	8.5%	8.0%	10.4%	7.0%	7.5%	8.0%	8.0%	8.0%
P&L tax rate	34.3%	33.4%	35.1%	30.7%	25.2%	26.0%	28.0%	30.0%
Dividend tax rate	14.3%	17.0%	17.1%	17.5%	17.0%	17.0%	17.0%	17.0%
Excise duty	5.0%	4.9%	3.3%	2.5%	3.2%	3.0%	3.0%	2.8%
Dividend payout ratio	31.9%	25.2%	22.9%	16.4%	17.3%	16.7%	16.0%	16.0%

Source: Company data, HSBC estimates

Crompton Greaves

Balance sheet (INRm)	FY07	FY08	FY09	FY10	FY11	FY12e	FY13e	FY14e
Share Capital	733	733	733	1,283	1,283	1,283	1,283	1,283
Reserves & Surplus	8,955	12,285	17,577	23,760	31,464	40,059	50,048	61,871
Shareholders Equity	9,688	13,018	18,311	25,043	32,747	41,342	51,331	63,154
Minorities	284	123	139	43	157	157	157	157
Total Equity	9,972	13,140	18,449	25,086	32,904	41,499	51,488	63,311
Secured Loans	(8,726)	(8,120)	(6,923)	(4,766)	(4,554)	(4,554)	(4,554)	(4,554)
Unsecured Loans	(319)	(300)	(260)	(244)	(149)	(149)	(149)	(149)
Total Debt	(9,045)	(8,420)	(7,182)	(5,010)	(4,703)	(4,703)	(4,703)	(4,703)
Loan & Advances	3,644	3,704	2,290	2,455	4,677	4,677	4,677	4,677
Cash & Equivalents	2,415	2,445	5,656	6,688	2,984	8,872	16,742	27,833
Net (Debt)/Cash	(2,986)	(2,271)	764	4,134	2,958	8,846	16,716	27,808
Tangible assets	7,317	8,799	9,363	9,220	14,811	16,551	17,145	17,669
Intangible assets	2,535	3,170	3,886	3,404	3,469	3,532	3,587	3,635
Capital Work-in-progress (CWIP)	1,021	476	537	1,137	1,137	1,137	1,137	1,137
Deferred tax assets	930	1,307	1,330	896	1,084	1,084	1,084	1,084
Investments	645	934	1,672	5,536	6,747	6,747	6,747	6,747
Other assets	1	0	0	0	0	0	0	0
Total Fixed Assets	12,449	14,685	16,787	20,192	27,248	29,050	29,699	30,272
Inventories	9,156	10,664	10,949	10,412	11,893	13,658	15,853	18,492
Sundry debtors	14,214	17,204	20,556	21,463	25,427	28,504	33,084	36,984
Sundry creditors	(11,662)	(12,229)	(14,319)	(14,865)	(16,887)	(19,003)	(22,056)	(25,728)
Customer advances	(1,701)	(6,736)	(7,290)	(7,263)	(8,265)	(9,501)	(11,028)	(12,864)
Acceptances	0	0	(1,565)	(1,233)	(1,033)	(1,188)	(1,379)	(1,608)
Other receivables	0	0	0	0	515	594	689	804
Other payables	(6,874)	(2,750)	(2,847)	(3,206)	(3,409)	(3,919)	(4,549)	(5,306)
Total Working Capital	3,133	6,153	5,484	5,308	8,240	9,145	10,615	10,774
Provisions	(2,112)	(4,708)	(3,739)	(3,603)	(4,298)	(4,298)	(4,298)	(4,298)
Deferred tax liability	(512)	(719)	(848)	(945)	(1,244)	(1,244)	(1,244)	(1,244)
Other Long term liabilities	0	0	0	0	0	0	0	0
Net Assets	9,972	13,140	18,449	25,086	32,904	41,499	51,488	63,311

Source: Company data, HSBC estimates

Crompton Greaves

Key balance sheet ratios	FY07	FY08	FY09	FY10	FY11	FY12e	FY13e	FY14e
Gearing	29.9%	17.3%	-4.1%	-16.5%	-9.0%	-21.3%	-32.5%	-43.9%
Gearing incl Acceptances	29.9%	17.3%	4.3%	-11.6%	-5.9%	-18.5%	-29.8%	-41.4%
Leverage	1.30	1.17	0.96	0.84	0.91	0.79	0.68	0.56
Leverage incl Acceptances	1.30	1.17	1.04	0.88	0.94	0.82	0.70	0.59
Interest Cover (on EBIT)	6.84	8.81	13.34	42.35	54.95	62.38	140.08	(676.98)
Net debt to EBITDA	0.62	0.31	(0.07)	(0.32)	(0.22)	(0.55)	(0.90)	(1.28)
Fixed Asset turns	5.19	5.49	6.34	6.64	5.15	5.43	6.11	6.96
Asset (CE) turn	3.59	2.70	3.11	3.32	2.71	2.81	2.98	3.28
Asset (CE) turn - excl Cust Adv	4.03	3.67	4.19	4.50	3.49	3.65	3.95	4.49
Total Working Capital Days	27	71	59	46	56	57	57	54
Inventories	101	93	78	66	72	73	72	72
Sundry Debtors	106	101	96	88	97	97	97	93
Sundry Creditors	(129)	(106)	(102)	(94)	(102)	(101)	(100)	(100)
Other receivables	0	0	0	0	2	2	2	2
Other payables	(51)	(16)	(13)	(13)	(13)	(13)	(13)	(13)
Working Capital as % sales	6.4%	9.9%	7.0%	5.9%	8.6%	8.5%	8.5%	7.4%

Source: Company data, HSBC estimates

Crompton Greaves

Cash flow statement (INRm)	FY07	FY08	FY09	FY10	FY11	FY12e	FY13e	FY14e
EBITDA	4,827	7,439	9,956	12,770	13,438	15,945	18,518	21,735
Adjusted for:								
Unrealized FX (gains)/losses	(57)	(4)	897	(1,010)	0	0	0	0
Loss on sale of fixed assets	(62)	(9)	(39)	(67)	0	0	0	0
Other non-cash exceptionals	8	180	190	304	0	0	0	0
Change in Working Capital	(751)	(844)	58	543	(2,932)	(905)	(1,469)	(159)
Tax paid	(1,136)	(1,868)	(2,165)	(2,920)	(3,100)	(3,651)	(4,670)	(6,030)
Net Financials	(563)	(684)	(702)	(288)	(209)	(217)	(114)	28
Others	960	625	561	943	1,076	718	832	970
Cash flow from operations	3,226	4,836	8,756	10,275	8,272	11,889	13,096	16,544
Capital Expenditure	(6,484)	(2,583)	(2,012)	(2,904)	(4,500)	(4,500)	(3,500)	(3,500)
Disposals	119	58	36	833	300	300	300	300
Change in other assets	0	0	0	0	0	0	0	0
Free cash flow (FCF)	(3,139)	2,311	6,779	8,205	4,072	7,689	9,896	13,344
Dividends	(503)	(696)	(814)	(1,159)	(947)	(1,801)	(2,026)	(2,252)
FCF post dividend	(3,642)	1,614	5,965	7,046	3,125	5,888	7,870	11,092
Acquisition - Subs/Assoc/Investments	(880)	(676)	(1,380)	(3,845)	0	0	0	0
Change in debt	4,863	(908)	(1,374)	(2,169)	0	0	0	0
Share buyback/issue	0	0	0	0	0	0	0	0
Others	0	0	0	0	0	0	0	0
Net cash flow	341	30	3,212	1,032	3,125	5,888	7,870	11,092

Source: Company data, HSBC estimates

Crompton Greaves

Key cash ratios	FY08	FY08	FY09	FY10	FY11	FY12e	FY13e	FY14e
Cash tax rate	23.5%	25.1%	21.8%	22.9%	23.1%	22.9%	25.2%	27.7%
Change in WC as % sales	-1.3%	-1.2%	0.1%	0.6%	-2.9%	-0.8%	-1.1%	-0.1%
Capex to depreciation	6.8	2.0	1.7	1.9	2.3	1.9	1.4	1.3
Capex as % sales	11.5%	3.8%	2.3%	3.2%	4.5%	3.9%	2.6%	2.2%
Operating cash conversion	83.3%	78.3%	100.2%	91.6%	71.9%	87.8%	82.0%	86.6%
FCF Yield	-5.0%	2.1%	9.5%	6.8%	2.2%	4.7%	6.0%	8.1%
FCF Yield post dividend	-5.9%	1.4%	8.4%	5.8%	1.7%	3.6%	4.8%	6.7%

Source: Company data, HSBC estimates

Crompton Greaves

Valuation	FY07	FY08	FY09	FY10	FY11	FY12e	FY13e	FY14e
Avg Price	97	175	111	188	284	256	256	256
Market Cap	62,163	111,980	71,370	120,608	182,485	164,511	164,511	164,511
Net debt	2,986	2,271	(764)	(4,134)	(2,958)	(8,846)	(16,716)	(27,808)
Customer advances	1,701	6,736	7,290	7,263	8,265	9,501	11,028	12,864
Banker's Acceptances	0	0	1,565	1,233	1,033	1,188	1,379	1,608
Minorities	284	123	139	43	157	157	157	157
Investments/Associates	(645)	(934)	(1,672)	(5,536)	(6,747)	(6,747)	(6,747)	(6,747)
Enterprise Value (EV)	66,490	120,175	77,928	119,477	182,235	159,764	153,611	144,585
EV/Sales	118%	176%	89%	131%	182%	139%	115%	93%
EV/CE	423%	474%	277%	433%	493%	389%	342%	303%
EV/EBITDA	13.8	16.2	6.9	9.4	13.6	10.0	8.3	6.7
EV/EBIT	17.2	19.5	7.8	10.6	15.8	11.8	9.6	7.6
EV/OR	16.8	18.5	7.5	10.3	15.3	11.4	9.3	7.3
P/E	22.1	27.5	11.1	15.1	19.7	15.8	13.7	11.7
P/Book	6.2	8.5	3.9	4.8	5.5	4.0	3.2	2.6
Dividend Yield	1.4%	0.9%	1.8%	1.2%	0.8%	1.1%	1.2%	1.4%
FCF Yield	-5.0%	2.1%	9.5%	6.8%	2.2%	4.7%	6.0%	8.1%
FCF Yield - post dividend	-5.9%	1.4%	8.4%	5.8%	1.7%	3.6%	4.8%	6.7%
RoCE	16.6%	17.1%	23.9%	29.1%	24.1%	25.3%	26.5%	29.0%
RoCE - excl Cust Adv	18.2%	22.1%	31.2%	38.3%	30.0%	31.8%	34.0%	38.4%
RoE	29.1%	31.2%	35.0%	31.9%	28.3%	25.1%	23.4%	22.3%

Source: Company data, HSBC estimates

Crompton Greaves

Profitability - RoCE	FY07	FY08	FY09	FY10	FY11	FY12e	FY13e	FY14e
Clean EBIT	3,873	6,176	10,018	11,220	11,502	13,547	15,967	19,107
Add back: Return on Cust Adv	85	337	365	363	413	475	551	643
Less: Associate/Div Income	0	0	0	0	0	0	0	0
Assumptions:								
Return on Cust Adv	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%
Tax rate	34.3%	33.4%	35.1%	30.7%	25.2%	26.0%	28.0%	30.0%
Operating Return (OR)	3,958	6,513	10,383	11,584	11,915	14,023	16,518	19,751
Post tax OR	2,601	4,338	6,735	8,028	8,910	10,377	11,893	13,825
Equity	9,972	13,140	18,449	25,086	32,904	41,499	51,488	63,311
Net Deferred tax liability	(418)	(588)	(482)	49	160	160	160	160
Provisions	2,112	4,708	3,739	3,603	4,298	4,298	4,298	4,298
Debt	9,045	8,420	7,182	5,010	4,703	4,703	4,703	4,703
Customer advances	1,701	6,736	7,290	7,263	8,265	9,501	11,028	12,864
Bank's Acceptances	0	0	1,565	1,233	1,033	1,188	1,379	1,608
Less:								
Cash & Eqv	2,415	2,445	5,656	6,688	2,984	8,872	16,742	27,833
Loans & Advances	3,644	3,704	2,290	2,455	4,677	4,677	4,677	4,677
Investment/Associates	645	934	1,672	5,536	6,747	6,747	6,747	6,747
Capital Employed	15,708	25,333	28,125	27,564	36,955	41,053	44,889	47,686
Pre-tax RoCE	25.2%	25.7%	36.9%	42.0%	32.2%	34.2%	36.8%	41.4%
RoCE	16.6%	17.1%	23.9%	29.1%	24.1%	25.3%	26.5%	29.0%
RoCE ex-Cust Adv	18.2%	22.1%	31.2%	38.3%	30.0%	31.8%	34.0%	38.4%

Source: Company data, HSBC estimates

Kalpataru: strong growth at attractive price

- ▶ With a record backlog of cINR105bn and strong visibility of c2.4 yrs, we believe KPP remains well placed to deliver strong growth
- ▶ We forecast earnings growth to pick up sharply to c29% in FY12e and c20% in FY13e compared to c2% in FY11
- ▶ At c7.3x FY12e PE, we believe risks are in the price; reiterate OW and target price of INR185

Kalpataru Power (KPP) reported weak results in Q4 FY11 (Mar YE), with sales growth and margins missing expectations. The Q4 EPS came in c3% below our expectation but c15% below consensus. However, we believe that one should not read too much into the quarterly performance as it can be often lumpy (i.e. based on delivery schedules).

But more importantly, Kalpataru reported very strong c117% y-o-y growth in new orders in its standalone business and c34% growth in its JMC order book. Consequently, the group's order book has now reached an all time high of cINR105bn (c96.5bn as of 31 Mar 2011) with the highest visibility amongst peers of c2.4 yrs (on FY11 sales) at the group level.

We expect the company to focus on execution this year and deliver strong growth in revenues. We estimate sales growth of c20% in FY12e and c18% in FY13e. We expect margins to remain stable during FY12-13e as the benefits of volume growth and operational improvement at JMC should offset pricing pressure and cost inflation.

Consequently, we forecast Kalpataru Power to deliver strong pick up in earnings growth to c29% in FY12e and c20% in FY13e compared to c2% in FY11. For more details, please refer to our research note on Kalpataru on 26 May titled, *OW: Expectations bottom, valuation remains attractive*.

We believe the market is giving little heed to this inflection in earnings growth as the stock remains at a significant discount, trading at c7.3x FY12e PE and c6.1x FY13e PE vs. historical trading average of c12x (5yr average of 12m fwd PE).

Using our preferred EVA valuation methodology, we estimate the current share price implies that the market expects KPP's through cycle margins to fall to c8.7% compared to an average FY08-13e OR margin of c10.7%, which we believe is highly unlikely.

Therefore, we continue to find a lot of value in the stock at these levels and reiterate our Overweight rating and target price of INR185.

We highlight the key bull and bear points related to Kalpataru below.

Bull points

- ▶ The biggest domestic transmission EPC player with an order book visibility of c1.9yrs
- ▶ Strong growth in JMC order book now provides visibility of c3yrs
- ▶ Kalpataru regained top three position in Power Grid orders in FY11
- ▶ Improvement in profitability at JMC and Biomass division should support group margins over the next couple of years

- ▶ Cash flows should show significant improvement from next year onwards, as all the assets (BOT, real estate, Shubham etc) turn cash positive

- ▶ The valuation looks very attractive

Bear Points:

- ▶ Increasing competition in the domestic transmission market
- ▶ Sales growth in last 5-yrs has not translated into earnings growth
- ▶ Margins remain under pressure due to competition and cost inflation

FY 11-13e earnings forecast

Mar YE (INRm)	New forecasts					Old forecasts			Change		
	FY10	FY11	FY12e	FY13e	FY14e	FY12e	FY13e	FY14e	FY12e	FY13e	FY14e
Order Backlog	76,705	96,500	115,715	142,785	176,131	119,516	145,504	168,517	-3.2%	-1.9%	4.5%
Net Sales	39,963	43,687	52,382	61,587	74,017	53,057	63,092	71,836	-1.3%	-2.4%	3.0%
Clean EBITDA	4,331	4,645	5,569	6,511	8,050	5,700	6,791	7,653	-2.3%	-4.1%	5.2%
Reported EBITDA	4,404	4,645	5,569	6,511	8,050	5,700	6,791	7,653	-2.3%	-4.1%	5.2%
Clean EBIT	3,586	3,765	4,724	5,663	7,230	4,854	5,943	6,834	-2.7%	-4.7%	5.8%
Reported EBIT	3,659	3,765	4,724	5,663	7,230	4,854	5,943	6,834	-2.7%	-4.7%	5.8%
Other Income	222	277	172	195	231	175	203	220			
Net Financials	(1,234)	(1,052)	(967)	(1,022)	(1,048)	(972)	(1,036)	(1,035)			
Profit before tax	2,647	2,990	3,928	4,836	6,414	4,057	5,110	6,019	-3.2%	-5.3%	6.6%
Income tax	(691)	(773)	(1,068)	(1,356)	(1,797)	(1,104)	(1,435)	(1,682)			
Extraordinary items	0	0	0	0	0	0	0	0			
Minorities	(179)	(126)	(248)	(356)	(483)	(248)	(356)	(483)			
Clean Net Income	1,715	2,001	2,612	3,124	4,135	2,705	3,318	3,854	-3.4%	-5.8%	7.3%
Reported Net Income	1,777	2,091	2,612	3,124	4,135	2,705	3,318	3,854	-3.4%	-5.8%	7.3%
Clean EPS	12.9	13.2	17.0	20.4	26.9	17.6	21.6	25.1	-3.4%	-5.8%	7.3%
Reported EPS	13.4	13.2	17.0	20.4	26.9	17.6	21.6	25.1	-3.4%	-5.8%	7.3%
DPS	1.7	1.5	1.9	2.0	2.0	1.9	2.0	2.0	0.0%	0.0%	0.0%

Margins & trend	New forecasts					Old forecasts			Change		
	FY10	FY11	FY12e	FY13e	FY14e	FY12e	FY13e	FY14e	FY12e	FY13e	FY14e
Sales visibility (yrs)	1.9	2.2	2.2	2.3	2.4	2.3	2.3	2.3	-1.9%	0.5%	1.4%
Sales growth	16%	9%	20%	18%	20%	21%	19%	14%	-1.5%	-1.3%	6.3%
Clean EBITDA margin	10.8%	10.6%	10.6%	10.6%	10.9%	10.7%	10.8%	10.7%	-0.1%	-0.2%	0.2%
Reported EBITDA margin	11.0%	10.6%	10.6%	10.6%	10.9%	10.7%	10.8%	10.7%	-0.1%	-0.2%	0.2%
Clean EBIT margin	9.0%	8.6%	9.0%	9.2%	9.8%	9.1%	9.4%	9.5%	-0.1%	-0.2%	0.3%
Reported EBIT margin	9.2%	8.6%	9.0%	9.2%	9.8%	9.1%	9.4%	9.5%	-0.1%	-0.2%	0.3%
PBT margin	6.6%	6.8%	7.5%	7.9%	8.7%	7.6%	8.1%	8.4%	-0.1%	-0.2%	0.3%
Clean NI margin	4.3%	4.6%	5.0%	5.1%	5.6%	5.1%	5.3%	5.4%	-0.1%	-0.2%	0.2%
Reported NI margin	4.4%	4.8%	5.0%	5.1%	5.6%	5.1%	5.3%	5.4%	-0.1%	-0.2%	0.2%

Source: Company data, HSBC estimates

We highlight our FY11-13e estimates for Kalpataru in the table on the previous page.

Valuation

Our target price of INR185 is derived from our preferred EVA valuation methodology. For the standalone business, we assume target sales growth of c8%, through-cycle operating return margin of c10.5% and WACC of 14.7%. For JMC, we assume target sales growth of c8%, through-cycle operating return margin of c7.0% and WACC of 15%.

Our target price implies that 12 months from now, the stock would be trading at a 12-month forward multiple of c8.4x PE compared with the current multiple of c7.3x FY12e and c6.1x FY13e. Our implied target multiple is based on 24m fwd EPS of INR22.

Under HSBC's research model, for stocks without a volatility indicator, the Neutral rating band is five percentage points above and below the hurdle rate for India stocks of 11%. This translates into a Neutral rating band of 6% to 16% around the current share price. Our 12-month target price of INR185 suggests a potential return of c50% (ex-dividend), which is above the Neutral rating band; hence, we maintain our Overweight rating on the stock.

Risks

We highlight key risks related to our investment case on Kalpataru below:

- ▶ Weaker-than-expected execution, particularly at JMC
- ▶ Delay/cancellation in transmission projects
- ▶ Excessive pricing pressure
- ▶ Higher-than-expected depreciation at JMC

Financials & valuation: Kalpataru Power Transmiss

Overweight

Financial statements

Year to March	03/2011a	03/2012e	03/2013e	03/2014e
Profit & loss summary (INRm)				
Revenue	43,687	52,382	61,587	74,017
EBITDA	4,645	5,569	6,511	8,050
Depreciation & amortisation	-880	-845	-848	-819
Operating profit/EBIT	3,765	4,724	5,663	7,230
Net interest	-1,052	-967	-1,022	-1,048
PBT	2,990	3,928	4,836	6,414
HSBC PBT	2,990	3,928	4,836	6,414
Taxation	-773	-1,068	-1,356	-1,797
Net profit	2,091	2,612	3,124	4,135
HSBC net profit	2,001	2,612	3,124	4,135

Cash flow summary (INRm)

Cash flow from operations	3,316	563	2,389	2,632
Capex	-1,270	-1,170	-670	-670
Cash flow from investment	-1,270	-1,170	-670	-670
Dividends	-267	-266	-341	-359
Change in net debt	-2,828	-2,962	-1,302	-1,527
FCF equity	2,046	-607	1,719	1,962

Balance sheet summary (INRm)

Intangible fixed assets	202	0	0	0
Tangible fixed assets	10,830	6,154	5,976	5,827
Current assets	34,862	39,782	46,459	55,529
Cash & others	5,954	6,828	8,129	9,656
Total assets	47,250	48,675	55,174	64,094
Operating liabilities	19,395	20,376	23,812	28,550
Gross debt	8,318	6,230	6,230	6,230
Net debt	2,365	-598	-1,899	-3,426
Shareholders funds	16,430	17,706	19,695	22,396
Invested capital	26,737	26,252	29,267	33,664

Ratio, growth and per share analysis

Year to	03/2011a	03/2012e	03/2013e	03/2014e
Y-o-y % change				
Revenue	9.3	19.9	17.6	20.2
EBITDA	7.2	19.9	16.9	23.6
Operating profit	5.0	25.5	19.9	27.7
PBT	13.0	31.4	23.1	32.6
HSBC EPS	2.1	28.9	19.6	32.3

Ratios (%)

Revenue/IC (x)	1.6	2.0	2.1	2.2
ROIC	11.0	13.9	14.7	16.3
ROE	12.2	14.8	15.9	18.5
ROA	5.2	6.0	6.7	7.7
EBITDA margin	10.6	10.6	10.6	10.9
Operating profit margin	8.6	9.0	9.2	9.8
EBITDA/net interest (x)	4.4	5.8	6.4	7.7
Net debt/equity	13.5	-3.0	-8.2	-12.6
Net debt/EBITDA (x)	0.5	-0.1	-0.3	-0.4
CF from operations/net debt	140.2			

Per share data (INR)

EPS Rep (fully diluted)	13.21	17.02	20.36	26.94
HSBC EPS (fully diluted)	13.21	17.02	20.36	26.94
DPS	1.50	1.90	2.00	2.00
Book value	115.88	130.44	150.39	177.64

Valuation data

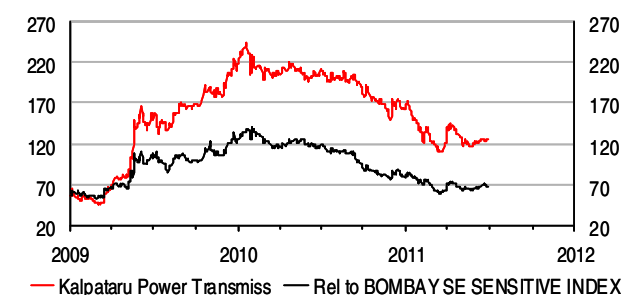
Year to	03/2011a	03/2012e	03/2013e	03/2014e
EV/sales	0.8	0.5	0.4	0.4
EV/EBITDA	7.6	4.6	4.1	3.5
EV/IC	1.3	1.0	0.9	0.8
PE*	13.5	7.3	6.1	4.6
P/Book value	1.5	1.0	0.8	0.7
FCF yield (%)	7.6	-3.2	9.0	10.2
Dividend yield (%)	0.8	1.5	1.6	1.6

Note: * = Based on HSBC EPS (fully diluted)

Issuer information

Share price (INR)	125.00	Target price (INR)	185.00	Potent'l return (%)	48.0
Reuters (Equity)	KAPT.BO	Bloomberg (Equity)	KPP IN		
Market cap (USDm)	426	Market cap (INRm)	19,183		
Free float (%)	39	Enterprise value (INRm)	15,846		
Country	India	Sector	ELECTRICAL EQUIPMENT		
Analyst	Rahul Garg	Contact	+91 22 22681245		

Price relative



Source: HSBC

Note: price at close of 27 Jun 2011

Kalpataru Power Transmission

Income Statement (INRM)	FY07	FY08	FY09	FY10	FY11	FY12e	FY13e	FY14e
Net Sales	15,982	26,749	32,460	39,963	43,687	52,382	61,587	74,017
Cost of Goods Sold (COGS)	(11,982)	(19,525)	(24,828)	(29,950)	(32,118)	(39,424)	(46,628)	(56,356)
Gross Income	3,999	7,224	7,632	10,013	11,569	12,958	14,959	17,661
Employee expense	(777)	(1,522)	(1,988)	(2,632)	(3,279)	(3,711)	(4,166)	(4,485)
Selling General & Admin exp (SG&A)	(505)	(2,408)	(2,352)	(2,977)	(3,645)	(3,863)	(4,513)	(5,411)
Other operating income	0	0	0	0	0	186	232	285
EBITDA	2,718	3,294	3,292	4,404	4,645	5,569	6,511	8,050
Exceptionals	0	0	(79)	73	0	0	0	0
Clean EBITDA	2,718	3,294	3,370	4,331	4,645	5,569	6,511	8,050
Depreciation & Amortization	(182)	(386)	(576)	(745)	(880)	(845)	(848)	(819)
EBIT	2,536	2,908	2,716	3,659	3,765	4,724	5,663	7,230
Clean EBIT	2,536	2,908	2,794	3,586	3,765	4,724	5,663	7,230
Other income	92	158	190	222	277	172	195	231
O/w Exceptional	1	4	2	11	0	0	0	0
O/w Dividend/Inv income	74	253	49	0	0	0	0	0
Interest income	31	93	162	26	229	242	232	259
Interest expense	(439)	(674)	(1,149)	(1,452)	(1,281)	(1,209)	(1,254)	(1,307)
Other financial exp/inc	0	0	(220)	192	0	0	0	0
Profit before tax (PBT)	2,220	2,485	1,700	2,647	2,990	3,928	4,836	6,414
Clean PBT	2,219	2,481	1,777	2,563	2,990	3,928	4,836	6,414
Income tax	(590)	(689)	(417)	(691)	(773)	(1,068)	(1,356)	(1,797)
Income from JVs (Post tax)	0	0	0	0	0	0	0	0
Profit after tax (PAT)	1,630	1,797	1,283	1,956	2,217	2,860	3,480	4,617
Extraordinary Items	0	0	0	0	0	0	0	0
Minorities	(17)	(148)	(173)	(179)	(126)	(248)	(356)	(483)
Reported Net income	1,613	1,649	1,109	1,777	2,091	2,612	3,124	4,135
HSBC Net income	1,612	1,646	1,167	1,715	2,001	2,612	3,124	4,135
No. of shares outstanding	132.5	132.5	132.5	132.5	151.5	153.5	153.5	153.5
Reported EPS	12.2	12.4	8.4	13.4	13.2	17.0	20.4	26.9
HSBC EPS (recurring)	12.2	12.4	8.8	12.9	13.2	17.0	20.4	26.9

Source: Company data, HSBC estimates

Kalpataru Power Transmission

Margin & trend analysis	FY07	FY08	FY09	FY10	FY11	FY12e	FY13e	FY14e
Sales growth	na	67.4%	21.4%	23.1%	9.3%	19.9%	17.6%	20.2%
Organic growth	na	23.4%	9.2%	19.9%	17.5%	20.2%	19.0%	13.2%
Clean EBITDA growth	na	21.2%	2.3%	28.5%	7.2%	19.9%	16.9%	23.6%
Clean EBIT growth	na	14.7%	-6.6%	34.7%	2.9%	25.5%	19.9%	27.7%
Reported EPS growth	na	2.2%	-32.7%	60.2%	-1.5%	28.9%	19.6%	32.3%
HSBC EPS growth	na	2.1%	-29.1%	46.9%	2.1%	28.9%	19.6%	32.3%
Gross margins	25.0%	27.0%	23.5%	25.1%	26.5%	24.7%	24.3%	23.9%
Clean EBITDA margins	17.0%	12.3%	10.4%	10.8%	10.6%	10.6%	10.6%	10.9%
Clean EBIT margins	15.9%	10.9%	8.6%	9.0%	8.6%	9.0%	9.2%	9.8%
OR margins	16.6%	11.4%	9.1%	9.5%	9.1%	9.6%	9.7%	10.3%
PBT margins	13.9%	9.3%	5.2%	6.6%	6.8%	7.5%	7.9%	8.7%
PAT margins	10.2%	6.7%	4.0%	4.9%	5.1%	5.5%	5.7%	6.2%
Change in no. of Employees	na	0.0%	0.0%	#DIV/0!	8.3%	5.3%	5.4%	2.8%
Wage inflation	na	0.0%	0.0%	#DIV/0!	15.0%	7.5%	6.6%	4.7%
Rate on interest income	na	3.2%	4.6%	0.7%	4.7%	3.8%	3.1%	2.9%
Rate on interest expense	na	14.6%	15.0%	13.9%	12.5%	13.4%	15.2%	15.2%
P&L tax rate	26.6%	27.7%	24.5%	26.1%	26.7%	27.2%	28.0%	28.0%
Dividend tax rate	17.0%	22.0%	19.3%	16.2%	17.0%	17.0%	17.0%	17.0%
Excise duty	2.6%	1.1%	1.0%	1.2%	1.1%	1.0%	1.0%	1.0%
Dividend payout ratio	12.3%	12.1%	17.9%	13.0%	11.4%	11.2%	9.8%	7.4%

Source: Company data, HSBC estimates

Kalpataru Power Transmission

Balance sheet (INRm)	FY07	FY08	FY09	FY10	FY11	FY12e	FY13e	FY14e
Share Capital	265	265	265	265	307	307	307	307
Reserves & Surplus	6,178	7,566	8,433	10,006	16,123	17,399	19,388	22,089
Shareholders Equity	6,443	7,831	8,698	10,271	16,430	17,706	19,695	22,396
Minorities	625	822	947	1,254	1,120	2,311	3,384	4,865
Total Equity	7,067	8,653	9,645	11,525	17,550	20,017	23,080	27,261
Secured Loans	(3,954)	(4,150)	(7,530)	(7,926)	(7,241)	(5,153)	(5,153)	(5,153)
Unsecured Loans	(32)	(317)	(1,922)	(1,088)	(1,077)	(1,077)	(1,077)	(1,077)
Total Debt	(3,986)	(4,467)	(9,451)	(9,014)	(8,318)	(6,230)	(6,230)	(6,230)
Loan & Advances	1,458	1,959	3,395	3,266	4,080	5,826	5,826	5,826
Cash & Equivalents	1,367	1,085	583	557	1,873	1,002	2,303	3,830
Net (Debt)/Cash	(1,161)	(1,423)	(5,474)	(5,192)	(2,365)	598	1,899	3,426
Tangible assets	3,098	4,297	5,331	6,843	10,715	6,033	5,855	5,705
Intangible assets	83	83	83	83	202	0	0	0
Capital Work-in-progress (CWIP)	51	80	1,132	1,895	113	113	113	113
Deferred tax assets	na	na	na	na	na	na	na	na
Investments	1,392	356	34	66	1,357	2,739	2,739	2,739
Other assets	1	29	17	9	2	8	8	8
Total Fixed Assets	4,625	4,844	6,598	8,898	12,388	8,893	8,715	8,565
Inventories	1,890	2,677	3,270	3,485	4,036	4,418	5,125	6,127
Sundry debtors	6,999	9,332	14,160	18,263	20,747	24,239	28,325	33,961
Sundry creditors	(2,498)	(3,617)	(5,177)	(6,900)	(10,176)	(9,157)	(10,735)	(12,887)
Customer advances	(2,454)	(3,053)	(3,280)	(4,157)	(4,592)	(5,637)	(6,612)	(7,939)
Acceptances	(329)	(459)	(901)	(1,491)	(1,600)	(1,904)	(2,184)	(2,599)
Other receivables	1,747	2,857	3,553	3,292	4,126	4,297	4,880	5,785
Other payables	(815)	(1,272)	(1,695)	(2,884)	(3,027)	(3,678)	(4,282)	(5,126)
Total Working Capital	4,541	6,465	9,931	9,609	9,513	12,579	14,518	17,322
Provisions	(780)	(1,023)	(1,203)	(1,593)	(1,849)	(1,853)	(1,853)	(1,853)
Deferred tax liability	(158)	(210)	(206)	(196)	(139)	(178)	(178)	(178)
Other Long term liabilities	0	0	0	0	0	0	0	0
Net Assets	7,067	8,653	9,645	11,525	17,550	20,039	23,102	27,284

Source: Company data, HSBC estimates

Kalpataru Power Transmission

Key balance sheet ratios	FY07	FY08	FY09	FY10	FY11	FY12e	FY13e	FY14e
Gearing	16.4%	16.4%	56.8%	45.1%	13.5%	-3.0%	-8.2%	-12.6%
Gearing incl Acceptances	21.1%	21.7%	66.1%	58.0%	22.6%	6.5%	1.2%	-3.0%
Leverage	1.16	1.16	1.57	1.45	1.13	0.97	0.92	0.87
Leverage incl Acceptances	1.21	1.22	1.66	1.58	1.23	1.07	1.01	0.97
Interest Cover (on EBIT)	6.21	5.01	2.75	2.56	3.58	4.88	5.54	6.90
Net debt to EBITDA	0.43	0.43	1.62	1.20	0.51	(0.11)	(0.29)	(0.43)
Fixed Asset turns	4.95	6.00	4.96	4.53	3.96	8.52	10.32	12.72
Asset (CE) turn	1.51	1.85	1.57	1.66	1.63	2.00	2.10	2.20
Asset (CE) turn - excl Cust Adv	1.97	2.34	1.87	2.01	1.97	2.54	2.72	2.88
Total Working Capital Days	na	165	166	143	118	141	138	138
Inventories	na	62	54	46	47	45	43	43
Sundry Debtors	na	159	175	184	181	184	181	183
Sundry Creditors	na	(84)	(85)	(92)	(120)	(93)	(91)	(91)
Other receivables	na	49	44	33	36	33	31	31
Other payables	na	(22)	(21)	(29)	(26)	(28)	(27)	(28)
Working Capital as % sales	na	30.3%	33.5%	26.5%	22.7%	26.2%	25.5%	25.5%

Source: Company data, HSBC estimates

Kalpataru Power Transmission

Cash Flow Statement (INRm)	FY07	FY08	FY09	FY10	FY11	FY12e	FY13e	FY14e
EBITDA	2,718	3,294	3,292	4,404	4,645	5,569	6,511	8,050
Adjusted for:								
Unrealized fx (gains)/losses	(0)	(2)	44	(1)	0	0	0	0
Loss on sale of fixed assets	2	7	(1)	(1)	0	0	0	0
Other non-cash exceptionals	1	0	1	0	0	0	0	0
Change in Working Capital	(2,308)	(2,139)	(4,541)	1,014	4	(3,143)	(1,939)	(2,804)
Tax paid	(556)	(628)	(589)	(889)	(763)	(1,068)	(1,356)	(1,797)
Net Interest paid	(252)	(390)	(760)	(1,044)	(1,073)	(967)	(1,022)	(1,048)
Others	(73)	(31)	(262)	59	503	172	195	231
Cash flow from operations	(468)	111	(2,817)	3,543	3,316	563	2,389	2,632
Capital Expenditure	(869)	(1,652)	(2,691)	(3,039)	(1,300)	(1,200)	(700)	(700)
Disposals	2	30	29	18	30	30	30	30
Change in other assets	0	0	0	0	0	0	0	0
Free cash flow (FCF)	(1,335)	(1,511)	(5,480)	522	2,046	(607)	1,719	1,962
Dividends	(124)	(235)	(238)	(237)	(267)	(266)	(341)	(359)
FCF post dividend	(1,459)	(1,746)	(5,718)	285	1,778	(873)	1,378	1,603
Acquisition - Subs/Assoc/Investments	(3,009)	1,277	886	17	(343)	0	0	0
Change in debt	978	480	4,119	(1,112)	0	0	0	0
Share buyback/issue	3,442	50	0	0	0	0	0	0
Others	0	0	752	828	0	0	0	0
Net cash flow	(48)	61	39	18	1,435	(873)	1,378	1,603

Source: Company data, HSBC estimates

Kalpataru Power Transmission

Key cash ratios	FY07	FY08	FY09	FY10	FY11	FY12e	FY13e	FY14e
Cash tax rate	20.4%	19.1%	17.9%	20.2%	16.4%	19.2%	20.8%	22.3%
Change in WC as % sales	-14.4%	-8.0%	-14.0%	2.5%	0.0%	-6.0%	-3.1%	-3.8%
Capex to depreciation	4.8	4.3	4.7	4.1	1.5	1.4	0.8	0.9
Capex as % sales	5.4%	6.2%	8.3%	7.6%	3.0%	2.3%	1.1%	0.9%
Operating cash conversion	-18.5%	3.8%	-103.7%	96.8%	88.1%	11.9%	42.2%	36.4%
FCF Yield	-5.7%	-3.9%	-33.1%	2.3%	7.6%	-3.2%	9.2%	10.4%
FCF Yield post dividend	-6.2%	-4.5%	-34.5%	1.3%	6.6%	-4.6%	7.3%	8.5%

Source: Company data, HSBC estimates

Kalpataru Power Transmission

Valuation	FY07	FY08	FY09	FY10	FY11	FY12e	FY13e	FY14e
Avg Price	178	294	125	169	178	122	122	122
Market Cap	23,519	38,939	16,573	22,344	27,033	18,784	18,784	18,784
Net debt	1,161	1,423	5,474	5,192	2,365	(598)	(1,899)	(3,426)
Customer advances	2,454	3,053	3,280	4,157	4,592	5,637	6,612	7,939
Banker's Acceptances	329	459	901	1,491	1,600	1,904	2,184	2,599
Minorities	625	822	947	1,254	1,120	2,311	3,384	4,865
Investments/Associates	(1,392)	(356)	(34)	(66)	(1,357)	(2,739)	(2,739)	(2,739)
Enterprise Value (EV)	26,695	44,341	27,140	34,372	35,352	25,300	26,325	28,021
EV/Sales	167%	166%	84%	86%	81%	48%	43%	38%
EV/CE	253%	307%	131%	143%	132%	96%	90%	83%
EV/EBITDA	9.8	13.5	8.1	7.9	7.6	4.5	4.0	3.5
EV/EBIT	10.5	15.2	9.7	9.6	9.4	5.4	4.6	3.9
EV/OR	10.0	14.5	9.2	9.1	8.9	5.1	4.4	3.7
P/E	14.6	23.7	14.2	13.0	13.5	7.2	6.0	4.5
P/Book	3.3	4.5	1.7	1.9	1.5	0.9	0.8	0.7
Dividend Yield	0.8%	0.5%	1.2%	1.0%	0.8%	1.6%	1.6%	1.6%
FCF Yield	-5.7%	-3.9%	-33.1%	2.3%	7.6%	-3.2%	9.2%	10.4%
FCF Yield - post dividend	-6.2%	-4.5%	-34.5%	1.3%	6.6%	-4.6%	7.3%	8.5%
RoCE	18.5%	15.3%	10.8%	11.6%	11.0%	13.9%	14.7%	16.3%
RoCE - excl Cust Adv	23.0%	18.4%	12.1%	13.3%	12.5%	16.7%	18.0%	20.2%
RoE	25.0%	21.0%	13.4%	16.7%	12.2%	14.8%	15.9%	18.5%

Source: Company data, HSBC estimates

Kalpataru Power Transmission

Profitability - RoCE	FY07	FY08	FY09	FY10	FY11	FY12e	FY13e	FY14e
Clean EBIT	2,536	2,908	2,794	3,586	3,765	4,724	5,663	7,230
Add back: Return on Cust Adv	123	153	164	208	230	282	331	397
Less: Associate/Div Income	0	0	0	0	0	0	0	0
Assumptions:								
Return on Cust Adv	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%
Tax rate	26.6%	27.7%	24.5%	26.1%	26.7%	27.2%	28.0%	28.0%
Operating Return (OR)	2,659	3,060	2,958	3,793	3,995	5,006	5,993	7,627
Post tax OR	1,952	2,212	2,233	2,803	2,929	3,645	4,313	5,490
Equity	7,067	8,653	9,645	11,525	17,550	20,017	23,080	27,261
Net Deferred tax liability	158	210	206	196	139	178	178	178
Provisions	780	1,023	1,203	1,593	1,849	1,853	1,853	1,853
Debt	3,986	4,467	9,451	9,014	8,318	6,230	6,230	6,230
Customer advances	2,454	3,053	3,280	4,157	4,592	5,637	6,612	7,939
Bank's Acceptances	329	459	901	1,491	1,600	1,904	2,184	2,599
Less:								
Cash & Eqv	1,367	1,085	583	557	1,873	1,002	2,303	3,830
Loans & Advances	1,458	1,959	3,395	3,266	4,080	5,826	5,826	5,826
Investment/Associates	1,392	356	34	66	1,357	2,739	2,739	2,739
Capital Employed	10,557	14,465	20,675	24,087	26,737	26,252	29,267	33,664
Pre-tax RoCE	25.2%	21.2%	14.3%	15.7%	14.9%	19.1%	20.5%	22.7%
RoCE	18.5%	15.3%	10.8%	11.6%	11.0%	13.9%	14.7%	16.3%
RoCE ex-Cust Adv	23.0%	18.4%	12.1%	13.3%	12.5%	16.7%	18.0%	20.2%

Source: Company data, HSBC estimates

KEC: Poised to deliver strong growth

- ▶ Like KPP, with growth of c60% in new orders and c42% in backlog in FY11, we expect KEC to deliver strong earnings growth in FY12-13
- ▶ We forecast earnings growth of c23% in FY12e and c30% in FY13e compared to c4% in FY11
- ▶ While KEC is expensive compared to KPP, we find the stock attractive at c8.2x FY12e PE; maintain OW and TP of INR105

KEC saw strong growth of c60% in new orders in FY11, driven by the acquisition of SAE Towers and a ramp up in new business areas, such as Railways, Cables and Substations, where order intake grew many-fold. As a result, KEC recorded an increase in its order book of c42% in FY11, the highest in the last five years.

While we expect order intake growth to be modest in FY12e (c14%), particularly because of a very strong comp from last year, we believe KEC will deliver strong sales growth due to its inflated order book. Consequently, we forecast a sales growth of c26% in FY12e and c24% in FY13e.

We expect EBITDA margins at KEC to largely remain stable as improvement in productivity in new businesses should offset pricing pressure in the domestic transmission market. In addition, the group should benefit from the full year consolidation of SAE Towers (which is a higher margin business) in FY12 compared to only six months of consolidation last year.

Therefore, we expect strong growth in revenues to percolate through the bottom line and hence, we forecast an earnings growth of c23% in FY12e and c30% in FY13e compared to c4% growth in FY11. We believe KEC is similar to Kalpataru in the sense that both these companies are currently at an inflection point as far as earnings growth is concerned.

We continue to find KEC attractive on valuation – it is trading at c8.2x FY12e PE and c6.3x FY13e PE and – maintain our Overweight rating and target price of INR105. For more details, please refer to our research note on 10 May, [Upgrade to OW: Strong outlook, muted reaction](#).

While we remain bullish on both Kalpataru and KEC, we find more upside in Kalpataru at this stage, given that the stock is trading at a c11% discount to KEC. Therefore, we maintain our preference for Kalpataru over KEC.

We highlight the key bull and bear points related to KEC:

Bull points

- ▶ Strong growth new orders drives order book visibility to c1.7yrs
- ▶ The company has regained its top three position in Power Grid orders
- ▶ New business ventures are delivering strong growth
- ▶ SAE Tower is performing better than expectations
- ▶ Strong balance sheet with better returns and working capital management compared to the peer group
- ▶ The stock looks attractive on valuation

Bear points

- ▶ Balance sheet remains highly leveraged increasing financial risk premium
- ▶ Relatively higher exposure to fixed price contracts compared to peers
- ▶ Significant exposure to international markets posed currency risk, both translational and transactional

We highlight our FY11-13e estimates for KEC in the table below.

FY 12-14e earnings forecast

- Mar YE (INRm)			New forecasts			Old forecasts			Change		
	FY10	FY11	FY12e	FY13e	FY14e	FY12e	FY13e	FY14e	FY12e	FY13e	FY14e
Order Backlog	55,000	78,000	98,362	130,425	169,617	105,648	133,450	153,710	-6.9%	-2.3%	10.3%
Net Sales	39,072	44,742	56,539	70,229	91,332	58,147	73,449	86,462	-2.8%	-4.4%	5.6%
Clean EBITDA	3,979	4,844	5,934	7,223	9,556	6,159	7,377	8,805	-3.7%	-2.1%	8.5%
Reported EBITDA	4,069	4,735	5,934	7,223	9,556	6,159	7,377	8,805	-3.7%	-2.1%	8.5%
Clean EBIT	3,709	4,436	5,366	6,623	8,954	5,591	6,778	8,203	-4.0%	-2.3%	9.2%
Reported EBIT	3,798	4,327	5,366	6,623	8,954	5,591	6,778	8,203	-4.0%	-2.3%	9.2%
Other Income	0	(85)	0	0	0	0	0	0			
Net Financials	(865)	(1,075)	(1,483)	(1,589)	(1,594)	(1,493)	(1,621)	(1,579)			
Profit before tax	2,934	3,167	3,883	5,035	7,360	4,098	5,156	6,624	-5.3%	-2.4%	11.1%
Income tax	(1,037)	(1,111)	(1,359)	(1,762)	(2,576)	(1,434)	(1,805)	(2,318)			
Extraordinary items	0	0	0	0	0	0	0	0			
Minorities	0	0	0	0	0	0	0	0			
Clean Net Income	1,839	2,182	2,524	3,273	4,784	2,664	3,352	4,305	-5.3%	-2.4%	11.1%
Reported Net Income	1,897	2,056	2,524	3,273	4,784	2,664	3,352	4,305	-5.3%	-2.4%	11.1%
Clean EPS	7.5	8.5	9.8	12.7	18.6	10.4	13.0	16.7	-5.3%	-2.4%	11.1%
Reported EPS	7.7	8.0	9.8	12.7	18.6	10.4	13.0	16.7	-5.3%	-2.4%	11.1%
DPS	1.2	1.2	1.2	1.3	1.3	1.2	1.3	1.3	0.0%	0.0%	0.0%

Margins & Trend			New forecasts			Old forecasts			Change		
	FY10	FY11	FY12e	FY13e	FY14e	FY12e	FY13e	FY14e	FY12e	FY13e	FY14e
Sales visibility (yrs)	1.4	1.7	1.7	1.9	1.9	1.8	1.8	1.8	-4.2%	2.2%	4.5%
Sales growth	16%	15%	26%	24%	30%	30%	26%	18%	-3.6%	-2.1%	12.3%
Clean EBITDA margin	10.2%	10.8%	10.5%	10.3%	10.5%	10.6%	10.0%	10.2%	-0.1%	0.2%	0.3%
Reported EBITDA margin	10.4%	10.6%	10.5%	10.3%	10.5%	10.6%	10.0%	10.2%	-0.1%	0.2%	0.3%
Clean EBIT margin	9.5%	9.9%	9.5%	9.4%	9.8%	9.6%	9.2%	9.5%	-0.1%	0.2%	0.3%
Reported EBIT margin	9.7%	9.7%	9.5%	9.4%	9.8%	9.6%	9.2%	9.5%	-0.1%	0.2%	0.3%
PBT margin	7.5%	7.1%	6.9%	7.2%	8.1%	7.0%	7.0%	7.7%	-0.2%	0.1%	0.4%
Clean NI margin	4.7%	4.9%	4.5%	4.7%	5.2%	4.6%	4.6%	5.0%	-0.1%	0.1%	0.3%
Reported NI margin	4.9%	4.6%	4.5%	4.7%	5.2%	4.6%	4.6%	5.0%	-0.1%	0.1%	0.3%

Source: Company data, HSBC estimates

Valuation

Our target price of INR105 is derived from our preferred EVA valuation methodology. In our valuation model, we assume target sales growth of c9%, through-cycle operating return margin of c10% and WACC of 12.3%. Our target price implies that 12 months from now, the stock would be trading at a 12-month forward multiple of c7.4x PE compared with the current multiple of c8.2x FY12e and c6.3x FY13e. Our implied target multiple is based on 24m fwd EPS of INR14.2.

Under HSBC's research model, for stocks without a volatility indicator, the Neutral rating band is five percentage points above and below the hurdle rate for India stocks of 11%. This translates into a Neutral rating band of 6% to 16% around the current share price. Our 12-month target price of INR105 suggests a potential return of c31% (ex-dividend), which is above the Neutral rating band; hence, we maintain our Overweight rating on the stock.

Risks

We highlight key risks related to our investment case on KEC below:

- ▶ Delay/cancellation in transmission projects
- ▶ Excessive pricing pressure
- ▶ Expensive acquisition

Financials & valuation: KEC International

Overweight

Financial statements

Year to March	03/2011a	03/2012e	03/2013e	03/2014e
Profit & loss summary (INRm)				
Revenue	44,742	56,539	70,229	91,332
EBITDA	4,844	5,934	7,223	9,556
Depreciation & amortisation	-408	-568	-599	-602
Operating profit/EBIT	4,436	5,366	6,623	8,954
Net interest	-1,075	-1,483	-1,589	-1,594
PBT	3,167	3,883	5,035	7,360
HSBC PBT	3,361	3,883	5,035	7,360
Taxation	-1,111	-1,359	-1,762	-2,576
Net profit	2,056	2,524	3,273	4,784
HSBC net profit	2,182	2,524	3,273	4,784

Cash flow summary (INRm)

Cash flow from operations	614	32	995	951
Capex	-780	-1,682	-739	-567
Cash flow from investment	-780	-1,682	-739	-567
Dividends	-354	-357	-361	-391
Change in net debt	4,592	2,007	105	6
FCF equity	-168	-1,649	256	385

Balance sheet summary (INRm)

Intangible fixed assets	4,626	4,400	4,186	3,981
Tangible fixed assets	6,595	7,934	8,289	8,458
Current assets	35,873	42,560	51,703	65,799
Cash & others	4,807	4,807	4,807	4,807
Total assets	47,094	54,894	64,178	78,238
Operating liabilities	22,262	25,890	32,157	41,819
Gross debt	14,308	16,314	16,419	16,426
Net debt	9,500	11,507	11,612	11,618
Shareholders funds	9,466	11,632	14,544	18,937
Invested capital	29,825	35,672	41,468	50,151

Ratio, growth and per share analysis

Year to	03/2011a	03/2012e	03/2013e	03/2014e
Y-o-y % change				
Revenue	14.5	26.4	24.2	30.0
EBITDA	21.8	22.5	21.7	32.3
Operating profit	19.6	21.0	23.4	35.2
PBT	8.0	22.6	29.7	46.2
HSBC EPS	13.9	15.7	29.7	46.2

Ratios (%)

Revenue/IC (x)	1.5	1.6	1.7	1.8
ROIC	10.1	10.1	10.8	12.0
ROE	23.1	21.7	22.5	25.3
ROA	6.9	4.9	5.5	6.7
EBITDA margin	10.8	10.5	10.3	10.5
Operating profit margin	9.9	9.5	9.4	9.8
EBITDA/net interest (x)	4.5	4.0	4.5	6.0
Net debt/equity	100.4	98.9	79.8	61.4
Net debt/EBITDA (x)	2.0	1.9	1.6	1.2
CF from operations/net debt	6.5	0.3	8.6	8.2

Per share data (INR)

EPS Rep (fully diluted)	8.00	9.82	12.73	18.61
HSBC EPS (fully diluted)	8.49	9.82	12.73	18.61
DPS	1.20	1.20	1.30	1.30
Book value	36.82	45.25	56.57	73.66

Valuation data

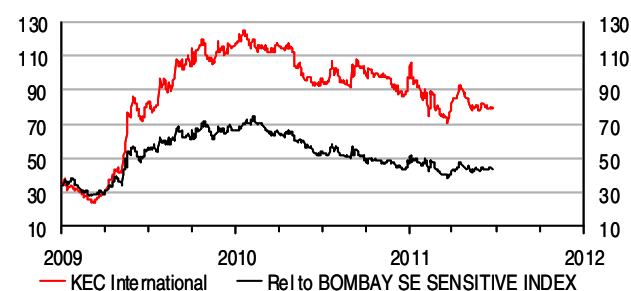
Year to	03/2011a	03/2012e	03/2013e	03/2014e
EV/sales	1.0	0.8	0.7	0.6
EV/EBITDA	9.1	7.3	6.4	5.3
EV/IC	1.5	1.2	1.1	1.0
PE*	9.4	8.2	6.3	4.3
P/Book value	2.6	1.8	1.4	1.1
FCF yield (%)	-0.7	-8.0	1.2	1.9
Dividend yield (%)	1.3	1.5	1.6	1.6

Note: * = Based on HSBC EPS (fully diluted)

Issuer information

Share price (INR)	80.20	Target price (INR)	105.00	Potent'l return (%)	30.9
Reuters (Equity)	KECL.BO	Bloomberg (Equity)	KECI IN		
Market cap (USDm)	458	Market cap (INRm)	20,613		
Free float (%)	91	Enterprise value (INRm)	32,120		
Country	India	Sector	ELECTRONIC EQUIPMENT		
Analyst	Rahul Garg	Contact	+91 22 22681245		

Price relative



Source: HSBC

Note: price at close of 27 Jun 2011

KEC International

Income Statement (INRM)	FY07	FY08	FY09	FY10	FY11	FY12e	FY13e	FY14e
Net Sales	20,406	28,145	34,288	39,072	44,742	56,539	70,229	91,332
Cost of Goods Sold (COGS)	(14,564)	(20,319)	(25,508)	(29,709)	(32,358)	(43,206)	(54,177)	(70,878)
Gross Income	5,843	7,826	8,780	9,363	12,384	13,333	16,052	20,455
Employee expense	(955)	(1,233)	(1,420)	(1,689)	(2,748)	(2,252)	(2,436)	(2,584)
Selling General & Admin exp (SG&A)	(2,370)	(3,050)	(4,350)	(3,616)	(4,926)	(5,164)	(6,414)	(8,342)
Other operating income	7	3	6	10	26	17	21	27
EBITDA	2,525	3,546	3,016	4,069	4,735	5,934	7,223	9,556
Exceptionals	43	104	(940)	90	(109)	0	0	0
Clean EBITDA	2,483	3,441	3,957	3,979	4,844	5,934	7,223	9,556
Depreciation & Amortization	(334)	(251)	(230)	(270)	(408)	(568)	(599)	(602)
EBIT	2,191	3,295	2,786	3,798	4,327	5,366	6,623	8,954
Clean EBIT	2,148	3,191	3,727	3,709	4,436	5,366	6,623	8,954
Other income	0	0	0	0	(85)	0	0	0
O/w Exceptional	0	0	0	0	(85)	0	0	0
O/w Dividend/Inv income	0	0	0	0	0	0	0	0
Interest income	11	4	17	80	67	48	48	48
Interest expense	(603)	(681)	(1,017)	(945)	(1,142)	(1,531)	(1,637)	(1,642)
Other financial exp/inc	0	0	0	0	0	0	0	0
Profit before tax (PBT)	1,599	2,619	1,786	2,934	3,167	3,883	5,035	7,360
Clean PBT	1,556	2,514	2,727	2,844	3,361	3,883	5,035	7,360
Income tax	(552)	(897)	(618)	(1,037)	(1,111)	(1,359)	(1,762)	(2,576)
Income from JVs (Post tax)	0	0	0	0	0	0	0	0
Profit after tax (PAT)	1,046	1,722	1,168	1,897	2,056	2,524	3,273	4,784
Extraordinary Items	0	0	0	0	0	0	0	0
Minorities	0	0	0	0	0	0	0	0
Reported Net income	1,046	1,722	1,168	1,897	2,056	2,524	3,273	4,784
HSBC Net income	1,018	1,653	1,783	1,839	2,182	2,524	3,273	4,784
No. of shares outstanding	188.4	246.7	246.7	246.7	257.1	257.1	257.1	257.1
Reported EPS	5.6	7.0	4.7	7.7	8.0	9.8	12.7	18.6
HSBC EPS (Recurring)	5.4	6.7	7.2	7.5	8.5	9.8	12.7	18.6

Source: Company data, HSBC estimates

KEC International

Margin & trend analysis	FY07	FY08	FY09	FY10	FY11	FY12e	FY13e	FY14e
Sales growth	18.1%	37.9%	21.8%	14.0%	14.5%	26.4%	24.2%	30.0%
Organic growth	17.4%	37.5%	22.0%	13.5%	11.8%	26.1%	24.6%	30.6%
Clean EBITDA growth	39.5%	38.6%	15.0%	0.6%	21.8%	22.5%	21.7%	32.3%
Clean EBIT growth	61.4%	50.4%	-15.4%	36.3%	13.9%	24.0%	23.4%	35.2%
Reported EPS growth	112.3%	25.7%	-32.2%	62.4%	4.1%	22.7%	29.7%	46.2%
HSBC EPS growth	72.2%	24.0%	7.9%	3.1%	13.9%	15.7%	29.7%	46.2%
Gross margins	28.6%	27.8%	25.6%	24.0%	27.7%	23.6%	22.9%	22.4%
Clean EBITDA margins	12.2%	12.2%	11.5%	10.2%	10.8%	10.5%	10.3%	10.5%
Clean EBIT margins	10.5%	11.3%	10.9%	9.5%	9.9%	9.5%	9.4%	9.8%
OR margins	11.1%	11.6%	11.3%	9.6%	10.4%	9.8%	9.8%	10.2%
PBT margins	7.8%	9.3%	5.2%	7.5%	7.1%	6.9%	7.2%	8.1%
PAT margins	5.1%	6.1%	3.4%	4.9%	4.6%	4.5%	4.7%	5.2%
Change in no. of Employees	25.8%	20.5%	4.0%	23.1%	10.0%	10.0%	5.0%	3.0%
Wage inflation	-9.4%	7.2%	10.8%	-3.4%	7.0%	3.0%	3.0%	3.0%
Rate on interest income	0.5%	0.2%	0.5%	2.5%	1.7%	1.0%	1.0%	1.0%
Rate on interest expense	16.8%	13.9%	16.8%	13.4%	10.3%	10.0%	10.0%	10.0%
P&L tax rate	34.5%	34.3%	34.6%	35.3%	35.1%	35.0%	35.0%	35.0%
Dividend tax rate	17.0%	17.0%	17.0%	17.0%	15.8%	17.0%	17.0%	17.0%
Excise duty	1.7%	1.4%	1.5%	1.1%	2.1%	1.5%	1.5%	1.5%
Dividend payout ratio	16.2%	14.3%	21.1%	15.6%	15.0%	12.2%	10.2%	7.0%

Source: Company data, HSBC estimates

KEC International

Balance Sheet (INRm)	FY07	FY08	FY09	FY10	FY11	FY12e	FY13e	FY14e
Share Capital	507	597	493	493	514	514	514	514
Reserves & Surplus	2,213	4,354	5,087	7,377	8,952	11,118	14,030	18,423
Shareholders Equity	2,720	4,952	5,581	7,871	9,466	11,632	14,544	18,937
Minorities	0	0	0	0	0	0	0	0
Total Equity	2,720	4,952	5,581	7,871	9,466	11,632	14,544	18,937
Secured Loans	(3,863)	(5,906)	(5,839)	(7,755)	(14,296)	(16,303)	(16,408)	(16,414)
Unsecured Loans	(1)	(11)	(379)	(112)	(11)	(11)	(11)	(11)
Total Debt	(3,864)	(5,918)	(6,218)	(7,867)	(14,308)	(16,314)	(16,419)	(16,426)
Loan & Advances	1,717	2,701	2,121	2,262	3,194	3,194	3,194	3,194
Cash & Equivalents	214	680	1,411	698	1,614	1,614	1,614	1,614
Net (Debt)/Cash	(1,933)	(2,536)	(2,686)	(4,908)	(9,500)	(11,507)	(11,612)	(11,618)
Tangible assets	1,871	2,245	3,099	4,882	6,177	7,516	7,870	8,039
Intangible assets	2,205	2,069	1,937	1,868	4,626	4,400	4,186	3,981
Capital Work-in-progress (CWIP)	18	169	504	379	278	278	278	278
Deferred tax assets	44	246	0	0	0	0	0	0
Investments	206	5	0	0	0	0	0	0
Other assets	5	20	76	71	141	141	141	141
Total Fixed Assets	4,350	4,754	5,615	7,200	11,221	12,335	12,475	12,439
Inventories	1,506	2,053	2,258	2,498	3,359	4,188	5,203	6,767
Sundry debtors	9,041	14,300	18,662	19,624	26,177	30,982	38,486	50,054
Sundry creditors	(3,783)	(7,567)	(9,651)	(9,568)	(12,406)	(14,344)	(17,818)	(23,173)
Customer advances	(2,248)	(1,434)	(2,850)	(900)	(4,035)	(4,016)	(4,989)	(6,488)
Acceptances	(3,498)	(3,605)	(5,905)	(6,708)	(5,766)	(7,459)	(9,265)	(12,050)
Other receivables	0	0	907	1,694	1,530	2,582	3,207	4,171
Other payables	(10)	(28)	(25)	(37)	(41)	(57)	(71)	(93)
Total Working Capital	1,008	3,720	3,396	6,601	8,817	11,877	14,753	19,187
Provisions	(370)	(540)	(445)	(562)	(561)	(561)	(561)	(561)
Deferred tax liability	(335)	(447)	(298)	(461)	(497)	(497)	(497)	(497)
Other Long term liabilities	0	0	0	0	(14)	(14)	(14)	(14)
Net Assets	2,720	4,952	5,581	7,871	9,466	11,632	14,544	18,937

Source: Company data, HSBC estimates

KEC International

Key balance sheet ratios	FY07	FY08	FY09	FY10	FY11	FY12e	FY13e	FY14e
Gearing	71.1%	51.2%	48.1%	62.4%	100.4%	98.9%	79.8%	61.4%
Gearing incl Acceptances	199.7%	124.0%	153.9%	147.6%	161.3%	163.0%	143.5%	125.0%
Leverage	1.71	1.51	1.48	1.62	2.00	1.99	1.80	1.61
Leverage incl Acceptances	3.00	2.24	2.54	2.48	2.61	2.63	2.44	2.25
Interest Cover (on EBIT)	3.70	4.87	2.79	4.39	4.03	3.62	4.17	5.62
Net debt to EBITDA	0.78	0.74	0.68	1.23	1.96	1.94	1.61	1.22
Fixed Asset turns	4.98	6.28	6.19	5.48	4.04	4.64	5.69	7.43
Asset (CE) turn	1.88	2.12	1.93	1.82	1.50	1.58	1.69	1.82
Asset (CE) turn - excl Cust Adv	2.37	2.38	2.30	1.91	1.73	1.79	1.93	2.09
Total Working Capital Days	115	99	111	118	135	143	145	149
Inventories	40	43	36	33	40	40	39	39
Sundry Debtors	175	215	218	195	228	223	222	226
Sundry Creditors	(100)	(158)	(154)	(126)	(146)	(139)	(134)	(135)
Other receivables	0	0	11	17	13	19	18	19
Other payables	(0)	(0)	(0)	(0)	(0)	(0)	(0)	(0)
Working Capital as % sales	5.3%	15.3%	10.9%	18.0%	21.0%	23.5%	23.3%	23.8%

Source: Company data, HSBC estimates

KEC International

Cash Flow Statement (INRm)	FY07	FY08	FY09	FY10	FY11	FY12e	FY13e	FY14e
EBITDA	2,525	3,546	3,016	4,069	4,735	5,934	7,223	9,556
Adjusted for:								
Unrealized fx (gains)/losses	(136)	53	377	(431)	(12)	0	0	0
Loss on sale of fixed assets	0	19	3	7	2	0	0	0
Other non-cash exceptionals	0	0	0	0	30	0	0	0
Change in Working Capital	(2,213)	(2,669)	1,010	(2,519)	(2,297)	(3,060)	(2,876)	(4,434)
Tax paid	(395)	(905)	(640)	(778)	(678)	(1,359)	(1,762)	(2,576)
Net Financials	(601)	(663)	(1,032)	(864)	(1,080)	(1,483)	(1,589)	(1,594)
Others	(0)	(0)	(0)	(0)	(85)	0	0	0
Cash flow from operations	(819)	(619)	2,735	(517)	614	32	995	951
Capital Expenditure	(118)	(338)	(1,432)	(618)	(811)	(1,712)	(769)	(597)
Disposals	6	16	37	30	30	30	30	30
Change in other assets	0	0	0	0	0	0	0	0
Free cash flow (FCF)	(931)	(941)	1,340	(1,106)	(166)	(1,649)	256	385
Dividends	(51)	(197)	(287)	(285)	(354)	(357)	(361)	(391)
FCF post dividend	(982)	(1,138)	1,053	(1,391)	(521)	(2,007)	(105)	(6)
Acquisition - Subs/Assoc/Investments	(1)	0	0	0	(4,391)	0	0	0
Change in debt	567	1,470	(205)	551	5,455	0	0	0
Share buyback/issue	0	(50)	(149)	0	0	0	0	0
Others	0	0	0	0	0	0	0	0
Net cash flow	(416)	282	699	(840)	543	(2,007)	(105)	(6)

Source: Company data, HSBC estimates

KEC International

Key cash ratios	FY08	FY08	FY09	FY10	FY11	FY12e	FY13e	FY14e
Cash tax rate	24.7%	25.5%	21.2%	19.1%	14.3%	22.9%	24.4%	27.0%
Change in WC as % sales	-10.8%	-9.5%	2.9%	-6.4%	-5.1%	-5.4%	-4.1%	-4.9%
Capex to depreciation	0.4	1.3	6.2	2.3	2.0	3.0	1.3	1.0
Capex as % sales	0.6%	1.2%	4.2%	1.6%	1.8%	3.0%	1.1%	0.7%
Operating cash conversion	-37.4%	-18.8%	98.2%	-13.6%	14.2%	0.6%	15.0%	10.6%
FCF Yield	-6.8%	-2.9%	8.6%	-4.7%	-0.7%	-8.1%	1.3%	1.9%
FCF Yield post dividend	-7.2%	-3.5%	6.7%	-5.9%	-2.1%	-9.8%	-0.5%	0.0%

Source: Company data, HSBC estimates

KEC International

Valuation	FY07	FY08	FY09	FY10	FY11	FY12e	FY13e	FY14e
Avg Price	72	131	63	96	96	80	80	80
Market Cap	13,636	32,217	15,609	23,620	24,554	20,464	20,464	20,464
Net debt	1,933	2,536	2,686	4,908	9,500	11,507	11,612	11,618
Customer advances	2,248	1,434	2,850	900	4,035	4,016	4,989	6,488
Banker's Acceptances	3,498	3,605	5,905	6,708	5,766	7,459	9,265	12,050
Minorities	0	0	0	0	0	0	0	0
Investments/Associates	(206)	(5)	0	0	0	0	0	0
Enterprise Value (EV)	21,109	39,787	27,050	36,137	43,856	43,446	46,330	50,621
EV/Sales	103%	141%	79%	92%	98%	77%	66%	55%
EV/CE	195%	300%	152%	169%	147%	122%	112%	101%
EV/EBITDA	8.5	11.6	6.8	9.1	9.1	7.3	6.4	5.3
EV/EBIT	9.8	12.5	7.3	9.7	9.9	8.1	7.0	5.7
EV/OR	9.3	12.2	7.0	9.6	9.5	7.8	6.7	5.5
P/E	13.4	19.5	8.8	12.8	11.3	8.1	6.3	4.3
P/Book	5.0	6.5	2.8	3.0	2.6	1.8	1.4	1.1
Dividend Yield	1.2%	0.8%	1.6%	1.3%	1.3%	1.5%	1.6%	1.6%
FCF Yield	-6.8%	-2.9%	8.6%	-4.7%	-0.7%	-8.1%	1.3%	1.9%
FCF Yield - post dividend	-7.2%	-3.5%	6.7%	-5.9%	-2.1%	-9.8%	-0.5%	0.0%
RoCE	13.6%	16.2%	14.2%	11.3%	10.1%	10.1%	10.8%	12.0%
RoCE - excl Cust Adv	16.3%	17.7%	16.3%	11.7%	11.2%	11.0%	11.8%	13.3%
RoE	37.4%	33.4%	31.9%	23.4%	23.1%	21.7%	22.5%	25.3%

Source: Company data, HSBC estimates

KEC International

Profitability - RoCE	FY07	FY08	FY09	FY10	FY11	FY12e	FY13e	FY14e
Clean EBIT	2,148	3,191	3,727	3,709	4,436	5,366	6,623	8,954
Add back: Return on Cust Adv	112	72	143	45	202	201	249	324
Less: Associate/Div Income	0	0	0	0	0	0	0	0
Assumptions:								
Return on Cust Adv	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%
Tax rate	34.5%	34.3%	34.6%	35.3%	35.1%	35.0%	35.0%	35.0%
Operating Return (OR)	2,261	3,262	3,869	3,754	4,638	5,567	6,873	9,278
Post tax OR	1,480	2,145	2,530	2,427	3,011	3,618	4,467	6,031
Equity	2,720	4,952	5,581	7,871	9,466	11,632	14,544	18,937
Deferred tax liability	290	200	298	461	497	497	497	497
Provisions	370	540	445	562	561	561	561	561
Debt	3,864	5,918	6,218	7,867	14,308	16,314	16,419	16,426
Customer advances	2,248	1,434	2,850	900	4,035	4,016	4,989	6,488
Bank's Acceptances	3,498	3,605	5,905	6,708	5,766	7,459	9,265	12,050
Less:								
Cash & Eqv	214	680	1,411	698	1,614	1,614	1,614	1,614
Loans & Advances	1,717	2,701	2,121	2,262	3,194	3,194	3,194	3,194
Investment/Associates	206	5	0	0	0	0	0	0
Capital Employed	10,853	13,262	17,766	21,410	29,825	35,672	41,468	50,151
Pre-tax RoCE	20.8%	24.6%	21.8%	17.5%	15.6%	15.6%	16.6%	18.5%
RoCE	13.6%	16.2%	14.2%	11.3%	10.1%	10.1%	10.8%	12.0%
RoCE ex-Cust Adv	16.3%	17.7%	16.3%	11.7%	11.2%	11.0%	11.8%	13.3%

Source: Company data, HSBC estimates

Jyoti Structures: Weak outlook in the price

- ▶ Unlike KPP and KEC, Jyoti reported modest growth of c6% in new orders in FY11
- ▶ Given our bearish view on transmission orders and Jyoti's limited exposure elsewhere, we expect FY12 to be a tough year
- ▶ We lower our FY12-13e EPS by c16-24%; we continue to find the stock attractive on valuation (c6x FY12e PE and c5.5x FY13e PE); maintain OW but cut TP from INR165 INR115

Like others, Jyoti reported weak numbers in Q4 FY11, which came in c3-4% below our expectations. But in spite of c65% growth in new orders in Q4, Jyoti failed to catch up with its competitors on order intake and reported a very modest full year growth in new orders of only c6% (compared to c30% for KPP and c60% for KEC).

We note that while Jyoti's competitors have sizeable exposure to other business areas and other geographies, Jyoti derives most of its sales from the domestic transmission market. Given that we don't expect much growth in domestic transmission orders in FY12, we believe FY12 will be a very difficult year for Jyoti as far as order intake growth is concerned.

We estimate the order intake at Jyoti to decline marginally by c1% in FY12e before seeing a sharp pick up in FY13 and FY14. The biggest upside risk to our order estimates is a significant increase in Jyoti's market share in the domestic

transmission market, which in our opinion is difficult to foresee at this stage.

With a weak outlook for new orders and a limited growth in order book last year, we expect revenue growth to fall to single digits in FY12e (c5%) and FY13e (c9%) compared to healthy growth of c17% in FY11.

Furthermore, while the company has done a good job of maintaining healthy levels of profitability (FY11 EBITDA margin: c11.4%), we believe weaker volumes in FY12 and FY13, coupled with pricing pressure, can somewhat dent EBITDA margins. We forecast EBITDA margins to decline to c11% in FY12e and c10.8% in FY13e.

Overall, unlike its competitors, we expect Jyoti to report weaker earnings growth of c1% in FY12e and c10% in FY13e.

We further note that while we expect improvement in execution to be the key catalyst for most of our companies, we believe growth in

new orders will likely remain the key catalyst for Jyoti. In case the company fails to announce big orders during the next few quarters, we believe its shares may remain undervalued in the near term.

But having said that we continue to find the stock attractive on valuation, trading at c6x FY12e PE and c5.5x FY13e PE compared to a historical trading average of c11.3x (5yr average of 12m fwd PE). At this price, we believe that the risks are adequately factored in and hence we maintain our Overweight rating on the stock.

Given weak orders in FY11 and the muted outlook for FY12, we have reduced our FY12-13e EPS for Jyoti by c16-24%. Consequently, we

reduce our target price to INR115 from INR165. Given the risk reward proposition at this stage, we maintain our preference for KPP and KEC over Jyoti.

We highlight the key bull and bear points related to Jyoti below:

Bull points

- ▶ Better performance than peers on profitability
- ▶ Currently the cheapest stock in the sector

Bear points

- ▶ Weak order intake; losing market share in Power Grid orders

FY 12-14e earnings forecast

Mar YE (INRm)	FY10	FY11	New forecasts			Old forecasts		Change	
			FY12e	FY13e	FY14e	FY12e	FY13e	FY12e	FY13e
Order Backlog	41,500	45,000	46,250	53,956	65,304	62,870	75,618	-26.4%	-28.6%
Net Sales	21,298	24,847	26,143	28,567	35,255	30,285	36,328	-13.7%	-21.4%
Clean EBITDA	2,189	2,824	2,881	3,081	3,744	3,376	3,958	-14.7%	-22.2%
Reported EBITDA	2,326	2,824	2,881	3,081	3,744	3,376	3,958	-14.7%	-22.2%
Clean EBIT	2,011	2,629	2,674	2,868	3,524	3,169	3,745	-15.6%	-23.4%
Reported EBIT	2,147	2,629	2,674	2,868	3,524	3,169	3,745	-15.6%	-23.4%
Other Income	0	0	0	0	0	0	0		
Net Financials	(771)	(868)	(901)	(923)	(990)	(933)	(1,017)		
Profit before tax	1,376	1,761	1,773	1,944	2,535	2,236	2,728	-20.7%	-28.7%
Income tax	(533)	(599)	(603)	(661)	(862)	(850)	(1,037)		
Extraordinary items	0	0	0	0	0	0	0		
Minorities	0	0	0	0	0	0	0		
Clean Net Income	759	1,162	1,170	1,283	1,673	1,386	1,691	-15.6%	-24.1%
Reported Net Income	843	1,162	1,170	1,283	1,673	1,386	1,691	-15.6%	-24.1%
Clean EPS	9.3	14.2	14.3	15.6	20.4	16.9	20.6	-15.6%	-24.1%
Reported EPS	10.3	14.2	14.3	15.6	20.4	16.9	20.6	-15.6%	-24.1%
DPS	1.0	1.1	1.2	1.3	1.5	1.2	1.3	0.0%	0.0%

Margins & Trend	FY10	FY11	New forecasts			Old forecasts		Change	
			FY12e	FY13e	FY14e	FY12e	FY13e	FY12e	FY13e
Sales visibility (yrs)	1.9	1.8	1.8	1.9	1.9	2.1	2.1	-14.8%	-9.3%
Sales growth	16%	17%	5%	9%	23%	21%	20%	-15.8%	-10.7%
Clean EBITDA margin	10.3%	11.4%	11.0%	10.8%	10.6%	11.1%	10.9%	-0.1%	-0.1%
Reported EBITDA margin	10.9%	11.4%	11.0%	10.8%	10.6%	11.1%	10.9%	-0.1%	-0.1%
Clean EBIT margin	9.4%	10.6%	10.2%	10.0%	10.0%	10.5%	10.3%	-0.2%	-0.3%
Reported EBIT margin	10.1%	10.6%	10.2%	10.0%	10.0%	10.5%	10.3%	-0.2%	-0.3%
PBT margin	6.5%	7.1%	6.8%	6.8%	7.2%	7.4%	7.5%	-0.6%	-0.7%
Clean NI margin	3.6%	4.7%	4.5%	4.5%	4.7%	4.6%	4.7%	-0.1%	-0.2%
Reported NI margin	4.0%	4.7%	4.5%	4.5%	4.7%	4.6%	4.7%	-0.1%	-0.2%

Source: Company data, HSBC estimates

- ▶ Smaller balance sheet limits growth opportunities
- ▶ Business strategy remains opaque
- ▶ Equity dilution overhang persists

We highlight our FY11-13e estimates for Jyoti in the table on the previous page.

Valuation

Our target price of INR115 is derived from our preferred EVA valuation methodology. In our valuation model, we assume target sales growth of c7%, through-cycle operating return margin of c10% and WACC of 15.2%. We have lowered our price target from INR165 earlier, driven largely by our FY12-13e earnings downgrade of c16-24%.

Our target price implies that 12 months from now, the stock would be trading at a 12-month forward multiple of c6.8x PE compared with the current multiple of c6x FY12e and c5.5x FY13e. Our implied target multiple is based on 24m fwd EPS of INR16.8.

Under HSBC's research model, for stocks without a volatility indicator, the Neutral rating band is five percentage points above and below the hurdle rate for India stocks of 11%. This translates into a Neutral rating band of 6% to 16% around the current share price. Our 12-month target price of INR115 suggests a potential return of c35% (ex-dividend), which is above the Neutral rating band; hence, we maintain our Overweight rating on the stock.

Risks

We highlight key risks related to our investment case on Jyoti below:

- ▶ Delay/cancellation of transmission projects
- ▶ Further loss in market share
- ▶ Excessive pricing pressure and cost inflation
- ▶ Potential dilution in equity

Financials & valuation: Jyoti Structures Ltd

Overweight

Financial statements

Year to March	03/2011a	03/2012e	03/2013e	03/2014e
Profit & loss summary (INRm)				
Revenue	24,847	26,143	28,567	35,255
EBITDA	2,824	2,881	3,081	3,744
Depreciation & amortisation	-195	-207	-213	-220
Operating profit/EBIT	2,629	2,674	2,868	3,524
Net interest	-868	-901	-923	-990
PBT	1,761	1,773	1,944	2,535
HSBC PBT	1,761	1,773	1,944	2,535
Taxation	-599	-603	-661	-862
Net profit	1,162	1,170	1,283	1,673
HSBC net profit	1,162	1,170	1,283	1,673

Cash flow summary (INRm)

Cash flow from operations	416	1,144	949	382
Capex	-350	-290	-290	-290
Cash flow from investment	-350	-290	-290	-290
Dividends	-96	-106	-115	-125
Change in net debt	30	-749	-544	33
FCF equity	66	854	659	92

Balance sheet summary (INRm)

Intangible fixed assets	27	22	20	18
Tangible fixed assets	1,906	1,994	2,073	2,145
Current assets	15,417	16,701	18,506	21,952
Cash & others	2,357	3,106	3,650	3,617
Total assets	17,516	18,884	20,765	24,282
Operating liabilities	7,389	7,693	8,406	10,374
Gross debt	3,690	3,690	3,690	3,690
Net debt	1,333	584	40	73
Shareholders funds	5,978	7,042	8,211	9,759
Invested capital	12,093	12,593	13,650	16,428

Ratio, growth and per share analysis

Year to	03/2011a	03/2012e	03/2013e	03/2014e
Y-o-y % change				
Revenue	16.7	5.2	9.3	23.4
EBITDA	29.0	2.0	6.9	21.5
Operating profit	30.8	1.7	7.3	22.9
PBT	28.0	0.7	9.7	30.4
HSBC EPS	53.1	0.7	9.7	30.4

Ratios (%)

Revenue/IC (x)	2.1	2.1	2.1	2.1
ROIC	14.9	14.5	14.4	14.7
ROE	19.4	16.6	15.6	17.1
ROA	7.1	6.4	6.5	7.4
EBITDA margin	11.4	11.0	10.8	10.6
Operating profit margin	10.6	10.2	10.0	10.0
EBITDA/net interest (x)	3.3	3.2	3.3	3.8
Net debt/equity	22.3	8.3	0.5	0.7
Net debt/EBITDA (x)	0.5	0.2	0.0	0.0
CF from operations/net debt	31.2	196.0	2397.0	526.5

Per share data (INR)

EPS Rep (fully diluted)	14.17	14.27	15.65	20.40
HSBC EPS (fully diluted)	14.17	14.27	15.65	20.40
DPS	1.10	1.20	1.30	1.50
Book value	72.90	85.88	100.12	119.00

Valuation data

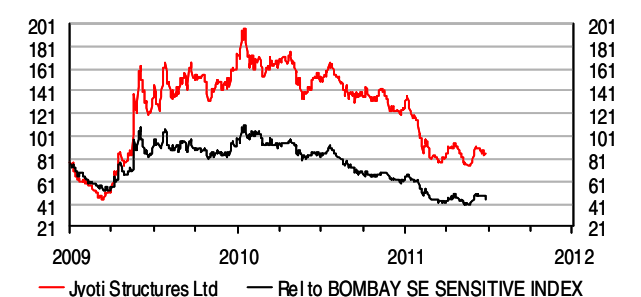
Year to	03/2011a	03/2012e	03/2013e	03/2014e
EV/sales	0.7	0.5	0.4	0.4
EV/EBITDA	5.9	4.2	3.9	3.5
EV/IC	1.4	1.0	0.9	0.8
PE*	9.4	6.0	5.5	4.2
P/Book value	1.8	1.0	0.9	0.7
FCF yield (%)	0.6	12.2	9.4	1.3
Dividend yield (%)	0.8	1.4	1.5	1.8

Note: * = Based on HSBC EPS (fully diluted)

Issuer information

Share price (INR)	85.30	Target price (INR)	115.00	Potent'l return (%)	34.8
Reuters (Equity)	JYTS.BO	Bloomberg (Equity)	JYS IN		
Market cap (USDm)	156	Market cap (INRm)	7,006		
Free float (%)	69	Enterprise value (INRm)	7,423		
Country	India	Sector	ELECTRICAL EQUIPMENT		
Analyst	Rahul Garg	Contact	+91 22 22681245		

Price relative



Source: HSBC

Note: price at close of 27 Jun 2011

Jyoti Structures

Income Statement (INRM)	FY07	FY08	FY09	FY10	FY11	FY12e	FY13e	FY14e
Net Sales	9,724	13,738	18,394	21,298	24,847	26,143	28,567	35,255
Cost of Goods Sold (COGS)	(7,327)	(10,631)	(14,241)	(16,286)	(19,207)	(20,182)	(22,154)	(27,564)
Gross Income	2,397	3,107	4,152	5,012	5,640	5,961	6,412	7,691
Employee expense	(277)	(358)	(461)	(719)	(763)	(810)	(851)	(885)
Selling General & Admin exp (SG&A)	(857)	(991)	(1,616)	(2,006)	(2,053)	(2,270)	(2,481)	(3,062)
Other operating income	8	15	52	39	0	0	0	0
EBITDA	1,271	1,772	2,127	2,326	2,824	2,881	3,081	3,744
Exceptionals	(11)	(16)	(161)	137	0	0	0	0
Clean EBITDA	1,283	1,789	2,288	2,189	2,824	2,881	3,081	3,744
Depreciation & Amortization	(59)	(72)	(99)	(178)	(195)	(207)	(213)	(220)
EBIT	1,212	1,700	2,027	2,147	2,629	2,674	2,868	3,524
Clean EBIT	1,223	1,717	2,188	2,011	2,629	2,674	2,868	3,524
Other income	0	0	0	0	0	0	0	0
O/w Exceptional	0	0	0	0	0	0	0	0
O/w Dividend/Inv income	0	0	0	0	0	0	0	0
Interest income	0	1	5	24	12	14	17	18
Interest expense	(329)	(467)	(688)	(796)	(880)	(915)	(940)	(1,008)
Other financial exp/inc	0	0	0	0	0	0	0	0
Profit before tax (PBT)	883	1,234	1,345	1,376	1,761	1,773	1,944	2,535
Clean PBT	894	1,250	1,505	1,239	1,761	1,773	1,944	2,535
Income tax	(328)	(489)	(493)	(533)	(599)	(603)	(661)	(862)
Income from JVs (Post tax)	0	0	0	0	0	0	0	0
Profit after tax (PAT)	555	745	851	843	1,162	1,170	1,283	1,673
Extraordinary Items	0	0	0	0	0	0	0	0
Minorities	0	0	0	0	0	0	0	0
Reported Net income	555	745	851	843	1,162	1,170	1,283	1,673
HSBC Net income	562	755	953	759	1,162	1,170	1,283	1,673
No. of shares outstanding	80.7	81.2	81.7	82.0	82.0	82.0	82.0	82.0
Reported EPS	6.9	9.2	10.4	10.3	14.2	14.3	15.6	20.4
HSBC EPS (Recurring)	7.0	9.3	11.7	9.3	14.2	14.3	15.6	20.4

Source: Company data, HSBC estimates

Jyoti Structures

Margin & trend analysis	FY07	FY08	FY09	FY10	FY11	FY12e	FY13e	FY14e
Sales growth	39.0%	41.3%	33.9%	15.8%	16.7%	5.2%	9.3%	23.4%
Organic growth	38.7%	36.7%	32.6%	17.1%	17.7%	4.1%	9.3%	23.4%
Clean EBITDA growth	66.4%	39.5%	27.9%	-4.3%	29.0%	2.0%	6.9%	21.5%
Clean EBIT growth	71.1%	40.3%	27.5%	-8.1%	30.8%	1.7%	7.3%	22.9%
Reported EPS growth	83.8%	33.5%	13.5%	-1.4%	37.9%	0.7%	9.7%	30.4%
HSBC EPS growth	79.7%	33.5%	25.5%	-20.6%	53.1%	0.7%	9.7%	30.4%
Gross margins	24.6%	22.6%	22.6%	23.5%	22.7%	22.8%	22.4%	21.8%
Clean EBITDA margins	13.2%	13.0%	12.4%	10.3%	11.4%	11.0%	10.8%	10.6%
Clean EBIT margins	12.6%	12.5%	11.9%	9.4%	10.6%	10.2%	10.0%	10.0%
OR margins	12.8%	12.7%	12.2%	9.8%	11.0%	10.6%	10.4%	10.4%
PBT margins	9.1%	9.0%	7.3%	6.5%	7.1%	6.8%	6.8%	7.2%
PAT margins	5.7%	5.4%	4.6%	4.0%	4.7%	4.5%	4.5%	4.7%
Change in no. of Employees	0.0%	0.0%	0.0%	n.a	3.0%	3.0%	2.0%	1.0%
Wage inflation	0.0%	0.0%	0.0%	n.a	3.0%	3.0%	3.0%	3.0%
Rate on interest income	0.0%	0.1%	0.3%	1.0%	0.5%	0.5%	0.5%	0.5%
Rate on interest expense	20.5%	24.2%	19.1%	14.7%	14.5%	14.5%	14.5%	14.5%
P&L tax rate	37.1%	39.6%	36.7%	38.7%	34.0%	34.0%	34.0%	34.0%
Dividend tax rate	17.0%	17.0%	17.0%	16.6%	17.0%	17.0%	17.0%	17.0%
Excise duty	5.3%	2.1%	1.2%	2.3%	3.2%	2.1%	2.1%	2.1%
Dividend payout ratio	8.7%	8.7%	8.6%	9.7%	7.8%	8.4%	8.3%	7.4%

Source: Company data, HSBC estimates

Jyoti Structures

Balance sheet (INRm)	FY07	FY08	FY09	FY10	FY11	FY12e	FY13e	FY14e
Share Capital	161	162	164	164	164	164	164	164
Reserves & Surplus	2,544	3,217	4,024	4,747	5,814	6,878	8,047	9,595
Shareholders Equity	2,705	3,380	4,188	4,911	5,978	7,042	8,211	9,759
Minorities	0	0	0	0	0	0	0	0
Total Equity	2,705	3,380	4,189	4,911	5,978	7,042	8,211	9,759
Secured Loans	(1,515)	(1,827)	(3,073)	(3,644)	(3,644)	(3,644)	(3,644)	(3,644)
Unsecured Loans	(93)	(422)	(52)	(46)	(46)	(46)	(46)	(46)
Total Debt	(1,608)	(2,249)	(3,125)	(3,690)	(3,690)	(3,690)	(3,690)	(3,690)
Loan & Advances	1,043	1,095	2,274	1,845	1,845	1,845	1,845	1,845
Cash & Equivalents	93	140	391	542	512	1,261	1,805	1,772
Net (Debt)/Cash	(471)	(1,014)	(460)	(1,303)	(1,333)	(584)	(40)	(73)
Tangible assets	594	684	1,339	1,729	1,879	1,966	2,046	2,118
Intangible assets	0	0	11	21	27	22	20	18
Capital Work-in-progress (CWIP)	11	15	44	17	17	17	17	17
Deferred tax assets	0	0	0	0	0	0	0	0
Investments	121	96	167	167	167	167	167	167
Other assets	24	18	20	10	10	10	10	10
Total Fixed Assets	750	813	1,581	1,944	2,099	2,182	2,259	2,330
Inventories	818	793	1,534	2,472	2,899	3,018	3,298	4,070
Sundry debtors	3,639	4,998	7,124	8,629	10,161	10,577	11,558	14,264
Sundry creditors	(1,976)	(2,290)	(2,184)	(2,206)	(2,566)	(2,671)	(2,919)	(3,602)
Customer advances	(521)	(430)	(1,002)	(1,688)	(1,924)	(2,003)	(2,189)	(2,702)
Acceptances	0	0	(1,833)	(2,195)	(2,566)	(2,671)	(2,919)	(3,602)
Other receivables	905	1,184	0	0	0	0	0	0
Other payables	(188)	(175)	(190)	(283)	(334)	(347)	(379)	(468)
Total Working Capital	2,678	4,081	3,448	4,729	5,670	5,903	6,450	7,961
Provisions	(197)	(432)	(290)	(282)	(282)	(282)	(282)	(282)
Deferred tax liability	(55)	(68)	(91)	(178)	(178)	(178)	(178)	(178)
Other Long term liabilities	0	0	0	0	0	0	0	0
Net Assets	2,705	3,380	4,189	4,911	5,978	7,042	8,211	9,759

Source: Company data, HSBC estimates

Jyoti Structures

Key balance sheet ratios	FY07	FY08	FY09	FY10	FY11	FY12e	FY13e	FY14e
Gearing	17.4%	30.0%	11.0%	26.5%	22.3%	8.3%	0.5%	0.7%
Gearing incl Acceptances	17.4%	30.0%	54.7%	71.2%	65.2%	46.2%	36.0%	37.7%
Leverage	1.17	1.30	1.11	1.27	1.22	1.08	1.00	1.01
Leverage incl Acceptances	1.17	1.30	1.55	1.71	1.65	1.46	1.36	1.38
Interest Cover (on EBIT)	3.68	3.64	2.97	2.78	3.03	2.97	3.11	3.56
Net debt to EBITDA	0.37	0.57	0.20	0.60	0.47	0.20	0.01	0.02
Fixed Asset turns	16.06	19.64	13.19	12.05	12.92	13.03	13.72	16.37
Asset (CE) turn	2.54	2.63	2.39	2.05	2.05	2.08	2.09	2.15
Asset (CE) turn - excl Cust Adv	2.94	2.86	2.75	2.45	2.44	2.47	2.49	2.57
Total Working Capital Days	124	126	138	160	162	153	156	165
Inventories	47	32	45	59	60	56	57	60
Sundry Debtors	159	156	162	159	161	151	154	163
Sundry Creditors	(114)	(93)	(64)	(53)	(53)	(50)	(50)	(53)
Other receivables	40	37	0	0	0	0	0	0
Other payables	(8)	(5)	(4)	(5)	(5)	(5)	(5)	(5)
Working Capital as % sales	32.0%	34.8%	21.5%	23.8%	24.6%	23.2%	23.6%	24.9%

Source: Company data, HSBC estimates

Jyoti Structures

Cash flow statement (INRm)	FY07	FY08	FY09	FY10	FY11	FY12e	FY13e	FY14e
EBITDA	1,271	1,772	2,127	2,326	2,824	2,881	3,081	3,744
Adjusted for:								
Unrealized fx (gains)/losses	0	0	0	(53)	0	0	0	0
Loss on sale of fixed assets	2	0	0	(7)	0	0	0	0
Other non-cash exceptionals	6	7	5	0	0	0	0	0
Change in Working Capital	(1,399)	(1,182)	(1,006)	(81)	(941)	(233)	(547)	(1,511)
Tax paid	(335)	(487)	(653)	(490)	(599)	(603)	(661)	(862)
Net Financials	(329)	(467)	(683)	(771)	(868)	(901)	(923)	(990)
Others	71	(0)	35	34	0	0	0	0
Cash flow from operations	(713)	(357)	(174)	957	416	1,144	949	382
Capital Expenditure	(115)	(163)	(768)	(579)	(370)	(310)	(310)	(310)
Disposals	13	1	2	20	20	20	20	20
Change in other assets	(0)	(20)	(20)	25	0	0	0	0
Free cash flow (FCF)	(815)	(540)	(961)	423	66	854	659	92
Dividends	(48)	(65)	(76)	(86)	(96)	(106)	(115)	(125)
FCF post dividend	(864)	(605)	(1,036)	337	(30)	749	544	(33)
Acquisition - Subs/Assoc/Investments	(71)	2	402	(756)	0	0	0	0
Change in debt	12	666	890	570	0	0	0	0
Share buyback/issue	1,019	8	9	5	0	0	0	0
Others	(43)	(25)	(14)	(6)	0	0	0	0
Net cash flow	54	47	251	151	(30)	749	544	(33)

Source: Company data, HSBC estimates

Jyoti Structures

Key cash ratios	FY07	FY08	FY09	FY10	FY11	FY12e	FY13e	FY14e
Cash tax rate	37.9%	27.5%	30.7%	21.1%	21.2%	20.9%	21.5%	23.0%
Change in WC as % sales	-14.4%	-8.6%	-5.5%	-0.4%	-3.8%	-0.9%	-1.9%	-4.3%
Capex to depreciation	1.9	2.3	7.7	3.2	1.9	1.5	1.5	1.4
Capex as % sales	1.2%	1.2%	4.2%	2.7%	1.5%	1.2%	1.1%	0.9%
Operating cash conversion	-58.9%	-21.0%	-8.6%	44.6%	15.8%	42.8%	33.1%	10.8%
FCF Yield	-8.5%	-3.0%	-12.3%	3.6%	0.6%	12.2%	9.4%	1.3%
FCF Yield post dividend	-9.0%	-3.4%	-13.3%	2.9%	-0.3%	10.7%	7.8%	-0.5%

Source: Company data, HSBC estimates

Jyoti Structures

Valuation	FY07	FY08	FY09	FY10	FY11	FY12e	FY13e	FY14e
Avg Price	118	221	96	142	133	86	86	86
Market Cap	9,546	17,942	7,804	11,663	10,943	7,011	7,011	7,011
Net debt	471	1,014	460	1,303	1,333	584	40	73
Customer advances	521	430	1,002	1,688	1,924	2,003	2,189	2,702
Banker's Acceptances	0	0	1,833	2,195	2,566	2,671	2,919	3,602
Minorities	0	0	0	0	0	0	0	0
Investments/Associates	(121)	(96)	(167)	(167)	(167)	(167)	(167)	(167)
Enterprise Value (EV)	10,416	19,290	10,933	16,682	16,599	12,103	11,992	13,221
EV/Sales	107%	140%	59%	78%	67%	46%	42%	38%
EV/CE	272%	369%	142%	161%	137%	96%	88%	80%
EV/EBITDA	8.1	10.8	4.8	7.6	5.9	4.2	3.9	3.5
EV/EBIT	8.5	11.2	5.0	8.3	6.3	4.5	4.2	3.8
EV/OR	8.3	11.1	4.9	8.0	6.1	4.4	4.0	3.6
P/E	17.0	23.8	8.2	15.4	9.4	6.0	5.5	4.2
P/Book	3.5	5.3	1.9	2.4	1.8	1.0	0.9	0.7
Dividend Yield	0.5%	0.4%	0.9%	0.7%	0.8%	1.4%	1.5%	1.8%
FCF Yield	-8.5%	-3.0%	-12.3%	3.6%	0.6%	12.2%	9.4%	1.3%
FCF Yield - post dividend	-9.0%	-3.4%	-13.3%	2.9%	-0.3%	10.7%	7.8%	-0.5%
RoCE	20.5%	20.1%	18.4%	12.4%	14.9%	14.5%	14.4%	14.7%
RoCE - excl Cust Adv	23.3%	21.6%	20.7%	14.2%	17.1%	16.7%	16.5%	16.9%
RoE	20.8%	22.3%	22.8%	15.5%	19.4%	16.6%	15.6%	17.1%

Source: Company data, HSBC estimates

Jyoti Structures

Profitability - RoCE	FY07	FY08	FY09	FY10	FY11	FY12e	FY13e	FY14e
Clean EBIT	1,223	1,717	2,188	2,011	2,629	2,674	2,868	3,524
Add back: Return on Cust Adv	26	21	50	84	96	100	109	135
Less: Associate/Div Income	0	0	0	0	0	0	0	0
Assumptions:								
Return on Cust Adv	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%
Tax rate	37.1%	39.6%	36.7%	38.7%	34.0%	34.0%	34.0%	34.0%
Operating Return (OR)	1,249	1,738	2,238	2,095	2,725	2,774	2,977	3,659
Post tax OR	785	1,050	1,417	1,284	1,799	1,831	1,965	2,415
Equity	2,705	3,380	4,189	4,911	5,978	7,042	8,211	9,759
Net Deferred tax liability	55	68	91	178	178	178	178	178
Provisions	197	432	290	282	282	282	282	282
Debt	1,608	2,249	3,125	3,690	3,690	3,690	3,690	3,690
Customer advances	521	430	1,002	1,688	1,924	2,003	2,189	2,702
Bank's Acceptances	0	0	1,833	2,195	2,566	2,671	2,919	3,602
Less:								
Cash & Eqv	93	140	391	542	512	1,261	1,805	1,772
Loans & Advances	1,043	1,095	2,274	1,845	1,845	1,845	1,845	1,845
Investment/Associates	121	96	167	167	167	167	167	167
Capital Employed	3,828	5,227	7,698	10,389	12,093	12,593	13,650	16,428
Pre-tax RoCE	32.6%	33.3%	29.1%	20.2%	22.5%	22.0%	21.8%	22.3%
RoCE	20.5%	20.1%	18.4%	12.4%	14.9%	14.5%	14.4%	14.7%
RoCE ex-Cust Adv	23.3%	21.6%	20.7%	14.2%	17.1%	16.7%	16.5%	16.9%

Source: Company data, HSBC estimates

Disclosure appendix

Analyst Certification

The following analyst(s), economist(s), and/or strategist(s) who is(are) primarily responsible for this report, certifies(y) that the opinion(s) on the subject security(ies) or issuer(s) and/or any other views or forecasts expressed herein accurately reflect their personal view(s) and that no part of their compensation was, is or will be directly or indirectly related to the specific recommendation(s) or views contained in this research report: Rahul Garg

Important disclosures

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Rating definitions for long-term investment opportunities

Stock ratings

HSBC assigns ratings to its stocks in this sector on the following basis:

For each stock we set a required rate of return calculated from the cost of equity for that stock's domestic or, as appropriate, regional market established by our strategy team. The price target for a stock represents the value the analyst expects the stock to reach over our performance horizon. The performance horizon is 12 months. For a stock to be classified as Overweight, the implied return must exceed the required return by at least 5 percentage points over the next 12 months (or 10 percentage points for a stock classified as Volatile*). For a stock to be classified as Underweight, the stock must be expected to underperform its required return by at least 5 percentage points over the next 12 months (or 10 percentage points for a stock classified as Volatile*). Stocks between these bands are classified as Neutral.

Our ratings are re-calibrated against these bands at the time of any 'material change' (initiation of coverage, change of volatility status or change in price target). Notwithstanding this, and although ratings are subject to ongoing management review, expected returns will be permitted to move outside the bands as a result of normal share price fluctuations without necessarily triggering a rating change.

*A stock will be classified as volatile if its historical volatility has exceeded 40%, if the stock has been listed for less than 12 months (unless it is in an industry or sector where volatility is low) or if the analyst expects significant volatility. However,

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Rating distribution for long-term investment opportunities

As of 29 June 2011, the distribution of all ratings published is as follows:

Overweight (Buy)	52%	(24% of these provided with Investment Banking Services)
Neutral (Hold)	36%	(19% of these provided with Investment Banking Services)
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HSBC & Analyst disclosures

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Company	Ticker	Recent price	Price Date	Disclosure
ABB INDIA	ABB.BO	870.85	28-Jun-2011	2, 4, 5, 6, 7, 11
AREVA T&D	AREV.BO	250.25	28-Jun-2011	2, 5, 7
CROMPTON GREAVES LTD	CROM.BO	256.10	28-Jun-2011	4
KALPATARU POWER TRANSMISSION	KAPT.BO	125.05	28-Jun-2011	4
SIEMENS INDIA	SIEM.BO	884.10	28-Jun-2011	4

Source: HSBC

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- 9 A covering analyst/s or a member of his/her household has a financial interest in the securities of this company, as detailed below.
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- 2 All market data included in this report are dated as at close 27 June 2011, unless otherwise indicated in the report.
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