10 March 2010 | 17 pages

# Thermax (THMX.BO)

Equity ☑
Rating change ☑
Target price change ☑
Estimate change ☑

## Metamorphosis Complete: Upgrade to Buy/Medium Risk

- **Announced super-critical technology JV with Babcock and Wilcox —** Thermax will own 51% in the JV. A new facility is being planned with a capacity of 3000MW. Thermax expects revenues of Rs30bn in sales in five years; the JV will have initial capitalization of Rs7.6bn and Thermax will invest Rs1.75bn as equity in the venture (from internal accruals) (Source: Bloomberg).
- **Metamorphosis complete:** Thermax's foray into the supercritical space completes the metamorphosis from executing small-sized captive power plants to super-critical utility range of boilers. We believe that the business will significantly change and with its relatively small base compared to BHEL, incremental order inflows could significantly improve revenues and the earnings outlook.
- **Momentum in current business is back, we increase est —** Order inflow is strong; order book is up 36% YoY with 65-75% executable in FY11E. There is a strong pipeline of orders, with a reasonable chance of strong order wins in the near future. We are raising our est. for FY11E by 9% on the back of strong order inflows in FY10E and expect OB to grow at 31%, revenues to grow at 45% and earnings to grow at 37% over FY10E-12E. We expect (unlevered) ROEs of 32-34%. **Our estimates do not capture any upside from the foray in to super-critical space.**
- **Increasing TP to Rs787; Upgrade to Buy/Medium Risk —** Our Rs787 target price is based on PE of 22x Sept11E (from 16x Sept10E). We believe that 1) the structural change in the business, 2) the broader economic revival; 3) the strong outlook (compared to a year ago) should drive a re-rating. Our target multiple is 1) at a premium to Thermax's historical avg. PE (16x), given the strong outlook 2) at a discount to BHEL (23x) despite Thermax's superior earnings outlook and RoE (EPS CAGR of 37% vs 22% for BHEL, RoEs of 32-34% vs BHEL RoE's of 29-31%); given BHEL's larger size and market share. 3) the target multiple is also at a discount to ABB (24x) given ABB's superior earnings outlook (39% CAGR). **Thermax is our preferred pick in the mid-cap engineering sector.**

| **Buy/Medium Risk** | **1M** |
|---|---|
| *from Sell/Medium Risk* | |
| Price (10 Mar 10) | Rs655.15 |
| Target price | Rs787.00 |
| *from Rs414.00* | |
| Expected share price return | 20.1% |
| Expected dividend yield | 0.8% |
| **Expected total return** | **20.9%** |
| Market Cap | Rs78,065M |
| | US$1,712M |

**Price Performance (RIC: THMX.BO, BB: TMX IN)**


**Figure 1. Thermax Statistical Abstract**

| Year to | Net Profit | Diluted EPS | EPS growth | P/E | P/B | ROE | Yield |
|---|---|---|---|---|---|---|---|
| 31-March | (RsM) | (Rs) | (%) | (x) | (x) | (%) | (%) |
| 2007A | 1,992.10 | 16.72 | 96% | 39.19 | 13.24 | 38% | 0.01 |
| 2008A | 2,786.68 | 23.39 | 40% | 28.01 | 10.33 | 41% | 0.01 |
| 2009E | 3,553.61 | 29.82 | 28% | 21.97 | 7.87 | 41% | 0.01 |
| 2010E | 2,509.64 | 21.06 | -29% | 31.11 | 7.84 | 25% | 0.01 |
| 2011E | 3,834.52 | 32.18 | 53% | 20.36 | 6.03 | 33% | 0.01 |
| 2012E | 4,693.04 | 39.39 | 22% | 16.63 | 4.72 | 32% | 0.01 |

Source: Citi Investment Research and Analysis estimates

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See Appendix A-1 for Analyst Certification and important disclosures.

| Fiscal year end 31-Mar | 2008 | 2009 | 2010E | 2011E | 2012E |
|---|---|---|---|---|---|
| **Valuation Ratios** | | | | | |
| P/E adjusted (x) | 28.0 | 22.0 | 31.1 | 20.4 | 16.6 |
| EV/EBITDA adjusted (x) | 17.6 | 14.3 | 19.6 | 12.8 | 10.0 |
| P/BV (x) | 10.3 | 7.9 | 7.8 | 6.0 | 4.7 |
| Dividend yield (%) | 0.9 | 0.8 | 0.8 | 0.9 | 1.2 |
| **Per Share Data (Rs)** | | | | | |
| EPS adjusted | 23.39 | 29.82 | 21.06 | 32.18 | 39.39 |
| EPS reported | 24.40 | 24.25 | 6.33 | 32.18 | 39.39 |
| BVPS | 63.41 | 83.28 | 83.53 | 108.69 | 138.72 |
| DPS | 6.00 | 5.00 | 5.00 | 6.00 | 8.00 |
| **Profit & Loss (RsM)** | | | | | |
| Net sales | 34,815 | 34,603 | 29,651 | 47,198 | 61,914 |
| Operating expenses | -30,923 | -29,791 | -26,239 | -41,770 | -54,985 |
| **EBIT** | **3,893** | **4,812** | **3,412** | **5,428** | **6,929** |
| Net interest expense | -17 | -38 | -18 | -18 | -18 |
| Non-operating/exceptionals | 439 | 404 | 408 | 400 | 200 |
| **Pre-tax profit** | **4,315** | **5,178** | **3,802** | **5,810** | **7,111** |
| Tax | -1,528 | -1,624 | -1,293 | -1,975 | -2,418 |
| Extraord./Min.Int./Pref.div. | 121 | -664 | -1,755 | 0 | 0 |
| **Reported net income** | **2,907** | **2,889** | **755** | **3,835** | **4,693** |
| Adjusted earnings | 2,787 | 3,554 | 2,510 | 3,835 | 4,693 |
| Adjusted EBITDA | 4,125 | 5,163 | 3,825 | 5,900 | 7,431 |
| **Growth Rates (%)** | | | | | |
| Sales | 49.6 | -0.6 | -14.3 | 59.2 | 31.2 |
| EBIT adjusted | 44.5 | 23.6 | -29.1 | 59.1 | 27.6 |
| EBITDA adjusted | 42.8 | 25.2 | -25.9 | 54.2 | 25.9 |
| EPS adjusted | 39.9 | 27.5 | -29.4 | 52.8 | 22.4 |
| **Cash Flow (RsM)** | | | | | |
| **Operating cash flow** | **2,667** | **1,393** | **-544** | **2,814** | **3,116** |
| Depreciation/amortization | 232 | 351 | 413 | 472 | 502 |
| Net working capital | -538 | -1,874 | -1,712 | -1,492 | -2,078 |
| **Investing cash flow** | **-1,788** | **2,204** | **-1,000** | **-1,375** | **-1,375** |
| Capital expenditure | -1,928 | -1,954 | -1,000 | -500 | -500 |
| Acquisitions/disposals | 140 | 4,158 | 0 | -875 | -875 |
| **Financing cash flow** | **-1,271** | **-481** | **-766** | **-836** | **-1,115** |
| Borrowings | -22 | 41 | -41 | 0 | 0 |
| Dividends paid | -1,115 | -697 | -697 | -836 | -1,115 |
| **Change in cash** | **-392** | **3,116** | **-2,310** | **603** | **626** |
| **Balance Sheet (RsM)** | | | | | |
| **Total assets** | **20,278** | **23,847** | **19,996** | **26,876** | **32,871** |
| Cash & cash equivalent | 580 | 3,696 | 1,386 | 1,989 | 2,615 |
| Accounts receivable | 5,305 | 5,719 | 5,362 | 8,534 | 11,195 |
| Net fixed assets | 3,485 | 5,088 | 5,675 | 5,703 | 5,701 |
| **Total liabilities** | **12,722** | **13,924** | **10,043** | **13,925** | **16,342** |
| Accounts payable | 4,552 | 4,199 | 3,327 | 5,421 | 7,167 |
| Total Debt | 0 | 41 | 0 | 0 | 0 |
| **Shareholders' funds** | **7,556** | **9,923** | **9,953** | **12,951** | **16,529** |
| **Profitability/Solvency Ratios (%)** | | | | | |
| EBITDA margin adjusted | 11.8 | 14.9 | 12.9 | 12.5 | 12.0 |
| ROE adjusted | 41.4 | 40.7 | 25.3 | 33.5 | 31.8 |
| ROIC adjusted | 122.4 | 59.5 | 26.6 | 35.1 | 37.0 |
| Net debt to equity | -7.7 | -36.8 | -13.9 | -15.4 | -15.8 |
| Total debt to capital | 0.0 | 0.4 | 0.0 | 0.0 | 0.0 |

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## Announces super-critical technology JV with Babcock and Wilcox

Thermax announced a JV to manufacture super-critical boilers. Thermax will own 51% in the JV. A new facility is being planned with a capacity of 3000MW.

Thermax expects revenues of Rs30bn in sales in 5 years; the JV will have initial capitalization of Rs7.6bn and Thermax will invest Rs1.75bn as equity in the venture (Source: Bloomberg).

Thermax's foray into the supercritical space completes the metamorphosis from executing small-sized captive power plants to super-critical utility range of boilers. We believe that the business will significantly change and with its relatively small base compared to BHEL, incremental order inflows could significantly improve revenues and the earnings outlook.

**Figure 2. Planned Thermal Power capacity addition**

| Plan Period | Sub critical (MW) | 660MW (nos) | 800MW (nos) | Super critical (MW) | Total (MW) | % of super-critical |
|---|---|---|---|---|---|---|
| 10th | 9,620 | 0 | 0 | - | 9,620 | |
| 11th | 44,490 | 9 | 2 | 7,540 | 52,030 | 14% |
| 12th | 30,473 | 54 | 10 | 43,640 | 74,113 | 59% |
| 13th | 0 | 54 | 23 | 64,100 | 64,100 | 100% |

Source: International Conclave for Key Inputs for 12th Plan, August 2009

While the opportunity in the super critical space looks huge in the coming years, one has to be cognizant that there are quite a few players who have tied-up or are in the process of tying up the technology and set-up capacities.

However, we believe that Thermax is strongly positioned in this space, given that it is one of the few established domestic manufacturers with an extensive execution track record. The tie-up with Babcock and Wilcox (currently B&W boilers generate 300,000MW of power around the world) should bolster its ability to win orders in this space.

Also, an increase in planned capacity additions and delays in setting up of capacities by competitors could improve prospects for Thermax.

**Figure 3. Supercritical – Competitive Landscape**

| | Tie-ups | | Mfg capacity | |
|---|---|---|---|---|
| Company/JV | Boiler | Turbine | Boiler | Turbine |
| BHEL | Alstom | Siemens | | |
| L&T - MHI | MHI | MHI | 4000 | 4000 |
| Bharat Forge - Alstom | | Alstom | | 5000 |
| JSW-Toshiba | | Toshiba | | 3000 |
| GB Engg-Ansaldo | Ansaldo | | 2000 | |
| Cethar Vessels | Riley Power | | | |
| BGR-Energy | Foster - Wheeler | | | |

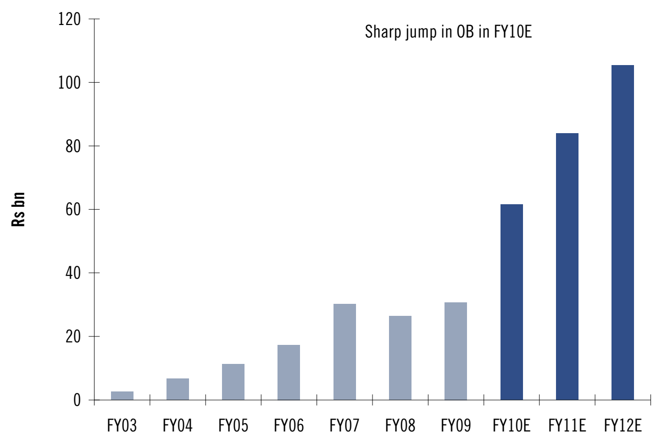
Source: International Conclave for Key Inputs for 12thPlan, August 2009

## Strong Momentum in the current business.

### OB to grow at 31%, Revenues at 45% CAGR over FY10-12E

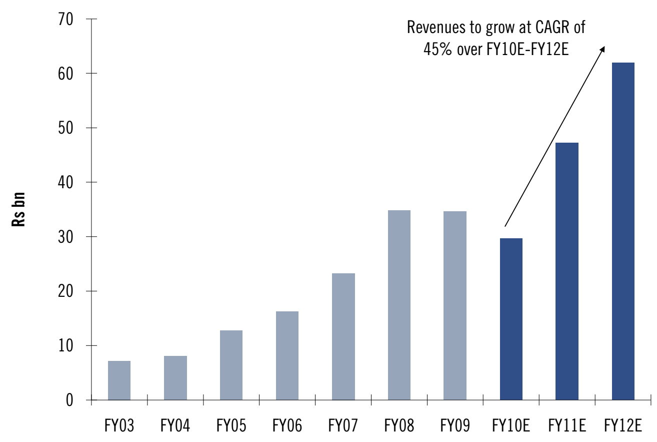
- The company has seen a sharp pick-up in order inflow momentum in FY10E and continues to see good traction from sectors like cement, ferrous metals, refineries and power generation.
- The company has an orderbook of Rs56bn as of 9MFY10E (up 37% YoY) and **according to management ~65-75% is executable next year i.e. FY11E**. According to the company, its ability to execute is also dependent on the client, namely how far the client's execution of the project has progressed.
- **In advanced discussions for two orders of Rs8-10bn each:** Management mentioned that it is in advanced discussions with clients for two large orders. If it wins these orders the order book would increase by ~29% and our revenue estimates will go up by 12% in FY11E and 9% in FY12E.
- **Continued demand for sub-critical orders:** The company maintained that while a lot of planned capacity is in the super critical side, it does not see a dip in demand for sub-critical units as the sheer size of investment in super-critical technology will restrict the amount of capacity addition. The company thinks that there will be continued demand in the sub-500MW sized units.
- **We expect revenues to grow at a CAGR of 45% over FY10E-12E on the back of strong order inflow momentum.**

**Figure 4. Thermax – Orderbook**




Source: Citi Investment Research and Analysis

**Figure 5. Thermax Revenues**




Source: Citi Investment Research and Analysis

## Operating Margins to remain largely stable over FY10E-12E

According to the company, as the proportion of utility boilers increases, the ability to expand margins will likely remain limited. It aims to maintain margins at current levels going forward. We believe that Thermax has demonstrated its ability to control its costs effectively – margins expanded by 300bps in FY09 while sales remained flat. We have built in a 90bps decline in margins over FY10E-12E due to the change in product mix. Management mentioned that some of the large orders have some pass-through clauses (i.e. costs pass-throughs are linked to an index).

## Environment Business: Water to be main growth driver

According to the company, the water division of the environment business will be the key growth driver for the business. Growth will be driven by urbanization and industrialization and we believe the segment can grow at ~20% over the next three years. The Chemical and air divisions are expected to grow at ~10-15% over the next three years.

## Gearing up for growth – Investing in capacities/technologies

Thermax has invested in expanding its capacities to capture the growth opportunity. The company currently has capacity of 1500MW.

**Figure 6. Thermax- Mfg capacities.**

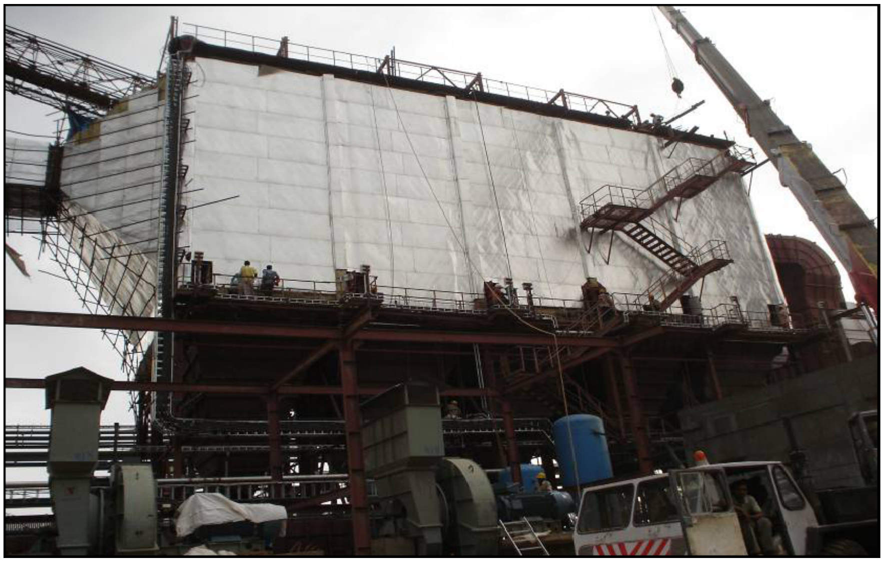
| Location | Details |
|---|---|
| Pune | Spread across 50 acres with manufacturing set-up of 65000 sq meters capable of producing boilers and chillers |
| Paudh | Spread across 47 acres with manufacturing area of 110000 sq meters. This plant has capacity to manufacture 20000 cu.m/yr of resin |
| Savli | Spread across 100 acres capable to address the need of large size field erected boilers & heaters |
| Mundra | Spread across 10 acres. Port based assembly facility developed for shipment of large –size plants |
| China | Spread across 6.5 acres. Green-field project completed with an investment of USD 11 Million |

Source: Thermax

Thermax has also entered various technical tie-ups to capitalize on growth opportunities in various sectors.

- Thermax and SPX Corporation, a global infrastructure leader in providing power plant equipment and services, have entered a joint venture. The joint venture investment will be on a 51% Thermax and 49 % SPX ownership basis and the new company will be based in Pune, India. The JV will provide technology solutions above the 300 MW range for large power plants. In the initial phase, it will provide air pollution control systems for power plants above 300 MW – namely, ESPs and bag filters; and also energy-efficiency equipment called rotary heat exchangers and equipment for reducing emissions from power plants.

**Figure 7. First ESP designed based on Technology of Balcke-Durr**



Source: Thermax

- Thermax Ltd and Georgia-Pacific Chemicals, based in Atlanta, Ga., USA, have signed a technology and manufacturing license agreement for performance-enhancing chemicals that find extensive applications in the paper industry. The agreement is valid for seven years and will enable Thermax to expand its business in the paper industry in India and South East Asia.

- Thermax has entered marketing agreements with GE Water, USA, for Membrane Bio Reactor technology in Sewage Treatment & for Reverse Osmosis membranes in the Indian market.

- Thermax has entered into a Technology licensing agreement with Wehrle, a German company, to support customers in cleaning up 'difficult to treat effluents'.

# Adjusting Estimates, Increasing Target Price

We are adjusting our estimates for Thermax by -5%/+9% for FY10E/11E. We are cutting our revenue estimates for FY10E based on the current run-rate of the company. We have cut our margin assumptions for FY11E given the change in product mix towards larger sized boilers. We expect earnings to grow at a CAGR of 37% over FY10E-12E. **Our estimates do not capture any upside from the foray in to the super-critical space.**

**Figure 8. Thermax – Estimates revisions**

| | FY10E | FY11E |
|---|---:|---:|
| **Sales** | | |
| Old | 32,052 | 40,962 |
| New | 29,651 | 47,198 |
| % change | -7% | 15% |
| | | |
| **EBITDA** | | |
| Old | 12.55% | 13.00% |
| New | 12.90% | 12.50% |
| % change | 35.00 | (50.00) |
| | | |
| **PAT** | | |
| Old | 2,651 | 3,520 |
| New | 2,510 | 3,835 |
| **% change** | **-5%** | **9%** |

Source: Citi Investment Research and Analysis

**Figure 9. Thermax –Peer group comparison**

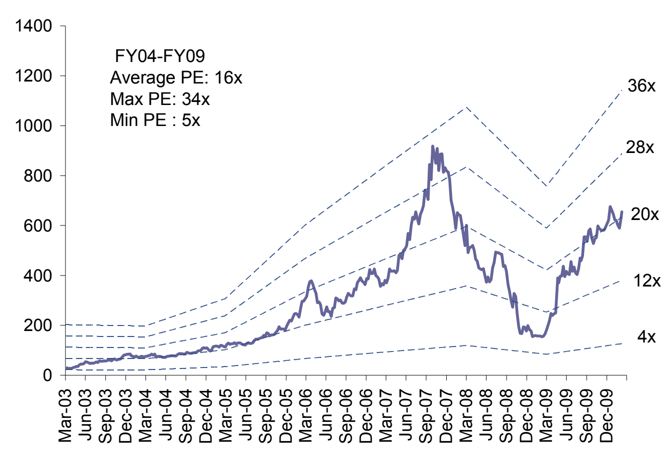
| | EPS CAGR | Target PE |
|---|---:|---:|
| Areva | 24% | 23 |
| ABB | 39% | 24 |
| BHEL | 22% | 23 |

Source: Citi Investment Research and Analysis

## Raising target price to Rs787; Upgrade to Buy/Medium Risk

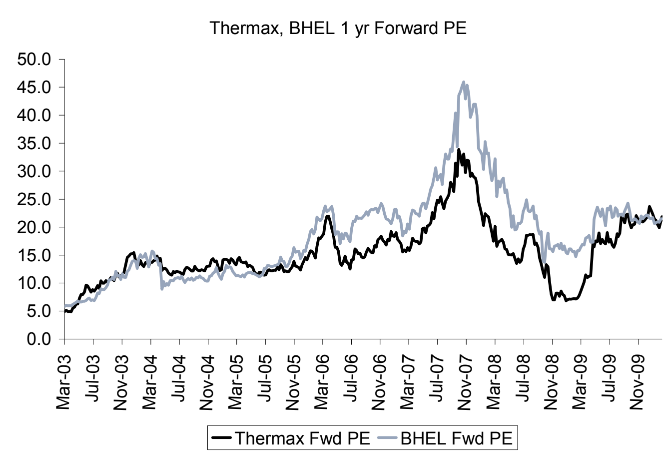
Our Rs787 target price is based on PE of 22x Sept11E (from 16x Sept10E). We believe that 1) the structural change in the business, 2) the broader economic revival; 3) the strong outlook (compared to a year ago) should drive a re-rating. Our target multiple is 1) at a premium to Thermax's historical avg. PE (16x), given the strong outlook 2) at a discount to BHEL (23x) despite Thermax's superior earnings outlook and RoE (EPS CAGR of 37% vs 22% for BHEL, RoEs of 32-34% vs BHEL RoE's of 29-31%); given BHEL's larger size and market share. 3) the target multiple is also at a discount to ABB (24x) given ABB's superior earnings outlook (39% CAGR).

**Figure 10. Thermax – PE**




Source: Citi Investment Research and Analysis

**Figure 11. Thermax – BHEL 1 year forward PE**




Source: Citi Investment Research and Analysis

**Figure 12. Thermax – Peer group comparison**

| | FY09A | FY10E | FY11E | FY12E |
|---|---|---|---|---|
| **Sales growth** | | | | |
| Thermax (THMX.BO, Rs655, 1M) | -1% | -13% | 59% | 31% |
| BHEL ( BHEL.BO, Rs2447, 1L) | 36% | 27% | 25% | 20% |
| L&T (LART.BO, Rs1575, 1L) | 35% | 8% | 20% | 19% |
| ABB (ABB.BO, Rs840, 3L) | 15% | -9% | 22% | 23% |
| Areva (AREV.BO, Rs 275, 3M) | 32% | 36% | 15% | 15% |
| | | | | |
| **EPS growth** | | | | |
| Thermax (THMX.BO, Rs655, 1M) | 28% | -29% | 53% | 22% |
| BHEL ( BHEL.BO, Rs2447, 1L) | 16% | 41% | 27% | 18% |
| L&T (LART.BO, Rs1575, 1L) | 34% | 7% | 27% | 22% |
| ABB (ABB.BO, Rs840, 3L) | 8% | -33% | 52% | 27% |
| Areva (AREV.BO, Rs 275, 3M) | 0% | -12% | 16% | 32% |
| | | | | |
| **RoE** | | | | |
| Thermax (THMX.BO, Rs655, 1M) | 41% | 25% | 33% | 32% |
| BHEL ( BHEL.BO, Rs2447, 1L) | 26% | 30% | 31% | 29% |
| L&T (LART.BO, Rs1575, 1L) | 25% | 20% | 20% | 21% |
| ABB (ABB.BO, Rs840, 3L) | 29% | 16% | 20% | 21% |
| Areva (AREV.BO, Rs 275, 3M) | 34% | 24% | 23% | 25% |
| | | | | |
| **P/E** | | | | |
| Thermax (THMX.BO, Rs655, 1M) | 22.0 | 31.1 | 20.4 | 16.6 |
| BHEL ( BHEL.BO, Rs2447, 1L) | 38.1 | 27.0 | 21.3 | 18.0 |
| L&T (LART.BO, Rs1575, 1L) | 28.7 | 26.9 | 21.1 | 17.3 |
| ABB (ABB.BO, Rs840, 3L) | 33.7 | 50.3 | 33.1 | 26.0 |
| Areva (AREV.BO, Rs 275, 3M) | 30.5 | 34.6 | 29.8 | 22.7 |
| | | | | |
| **EV/EBITDA** | | | | |
| Thermax (THMX.BO, Rs655, 1M) | 14.4 | 20.0 | 12.7 | 9.9 |
| BHEL ( BHEL.BO, Rs2447, 1L) | 29.4 | 19.2 | 14.4 | 11.9 |
| L&T (LART.BO, Rs1575, 1L) | 21.7 | 18.3 | 14.7 | 11.8 |
| ABB (ABB.BO, Rs840, 3L) | 22.3 | 32.2 | 21.0 | 16.1 |
| Areva (AREV.BO, Rs 275, 3M) | 18.2 | 17.6 | 14.1 | 11.5 |

Source: Citi Investment Research and Analysis

# Quants View – Glamour

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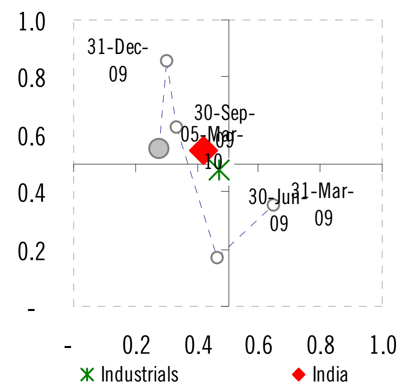
**Radar Screen Quadrant Definitions**

| | |
|---|---|
| **Glamor**<br>*Poor relative value but superior relative momentum* | **Attractive**<br>*Superior relative value and superior relative momentum* |
| **Unattractive**<br>*Poor relative value and poor relative momentum* | **Contrarian**<br>*Superior relative value but poor relative momentum* |

Thermax currently lies in the Glamour quadrant of our Value-Momentum map with strong momentum but relatively weak value scores. It has been a resident there since the past 5 months. Compared to its peers in the Industrials sector, Thermax fares worse on the valuation metric but better on the momentum metric. Similarly, compared to its peers in its home market of India, Thermax fares worse on the valuation metric but better on the momentum metric.

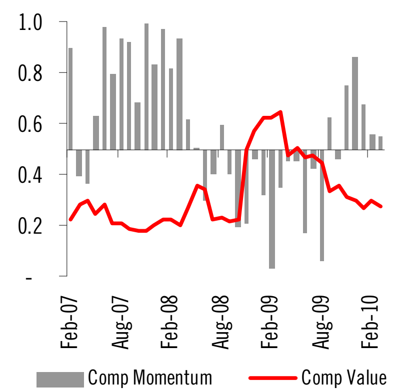
From a macro perspective, Thermax is likely to benefit from widening Asian interest rates, falling EM yields, weaker US Dollar, and a stronger Yen.

**Figure 13. Radar Quadrant Chart History**




Source: CIRA

**Figure 14. Radar Valuation Momentum Ranks**




Source: CIRA

**Figure 15. Radar Model Inputs**

**IBES EPS (Actual and Estimates)**

| | | | |
|---|---|---|---|
| FY(-2) | 16.26 | Implied Trend Growth (%) | 10.45 |
| FY(-1) | 24.40 | Trailing PE (x) | 25.99 |
| FY0 | 24.25 | Implied Cost of Debt (%) | 9.38 |
| FY1 | 22.17 | Standardised MCap | (0.21) |
| FY2 | 29.57 | | |

*Note: Standardised MCap calculated as a Z score – (mkt cap - mean)/std dev – capped at 3*

Source: Citi Investment Research and Analysis, Worldscope, I/B/E/S

**Figure 16. Stock Performance Sensitivity to Key Macro Factors**

| | | | |
|---|---|---|---|
| Region | 1.10 | Commodity ex Oil | 0.11 |
| Local Market | 0.81 | Rising Oil Prices | 0.07 |
| Sector | 0.23 | Rising Asian IR's | 0.29 |
| Growth Outperforms Value | (0.78) | Rising EM Yields | (0.32) |
| Small Caps Outperform Large Caps | 0.36 | Weaker US$ (vs Asia) | 1.99 |
| Widening US Credit Spreads | (0.23) | Weaker ¥ (vs US$) | (0.59) |

Source: Citi Investment Research and Analysis

# Larsen & Toubro

## Valuation

Our Rs1,748 target price is based on sum-of-the-parts (SOTP). We use 23x Mar2011 earnings for the parent, at par with BHEL. We also believe that the parent's numbers do not capture the value inherent in subsidiaries, which we value at Rs263, with L&T Infotech at Rs68 (12x FY11E EPS, in-line with second-tier peers), L&T Finance at Rs18 (1.0x FY11E P/BV), 51% stake in L&T-MHI JV at Rs36, and L&T IDPL at Rs64. Over the past 15 years L&T has traded at an average premium of ~ 39% to BHEL. However, during economic slowdowns BHEL trades at a premium to L&T. The trend reverses in good times. We believe that India economic growth is still 6-9 months away from a full-fledged revival so we peg L&T on par with BHEL. Our target multiple for BHEL at 23x is set a ~ 25% premium line to the historical average P/E multiple of 18.4x. Our target multiple is well supported by EPS CAGR of 29% over FY09-12E with average RoEs at 30%.

## Risks

We rate L&T shares Low Risk, in line with our quantitative risk-rating system, and because L&T's order backlog of c.Rs911bn represents two years' sales and provides earnings visibility. Downside risks that could prevent the shares from reaching our target price include: 1) attracting and retaining talent; 2) the E&C and electrical equipment businesses are sensitive to economic variables; 3) competitive pressures; and 4) L&T needs to keep abreast of technology trends to sustain valuations and earnings. Upside risks to our target price include: 1) better-than-expected order booking; 2) a better-than-expected execution rate; and 3) higher-than-expected EBITDA margins.

# Bharat Heavy

## Valuation

Our Rs2,634 target price is based on a target P/E multiple of 23x on FY11E, set at a 30-50% premium to the BSE Sensex and a ~25% premium to its historical average P/E multiple of 18.4x. Our target multiple is well supported by EPS CAGR of 29% over FY09-12E with average RoEs at 30% over FY10-12E.

## Risks

We rate BHEL shares Low Risk in line with our quantitative risk-rating system, which tracks 260-day historical share price volatility. We also believe BHEL deserves a Low Risk rating as its order book provides good earnings visibility over the medium term. Key downside risks that could impede the stock from reaching our target price include: 1) Delays in power-sector reforms could affect order flows and earnings; 2) Regulatory uncertainties could hurt valuations and sentiment toward the stock; 3) Competitive pressures from global majors are a concern, particularly as technology upgrades are affected; and 4) In the short-term, progress on order flows would influence market sentiment. Key upside risks that could cause the shares to trade above our target price include: Better-than-expected order booking, lower raw material costs, earlier ramp up of capacity leading to better execution and increase in India's 12th plan capacity addition targets.

# ABB (India)

## Valuation

Our Rs694 target price for ABB is based on 24x P/E for June-2011E, which is in line with its historical average of 24x (trading band: 10x-66x). Our target multiple is at a marginal premium to peers like Areva T&D and BHEL at 23x. Investors tend to focus on P/E while valuing Indian electric equipment stocks. Our valuation methodology is similar to those used for peers BHEL/ Areva T&D.

## Risks

Our quantitative risk-rating system, which tracks 260-day historical share price volatility, assigns a Medium Risk rating to ABB India shares. However, we believe a Low Risk rating is more appropriate given strong power and industrial capex in India. Our Low Risk rating is also in line with BHEL's. Key upside risks to our target price are: 1) better-than-expected order wins; 2) better-than-expected order execution; and 3) better-than-expected margins.

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# Areva T & D India

## Valuation

Our target price of Rs246 is based on a target P/E multiple of 23x June-2011E. Our target P/E multiple is more or less in line with the average P/E of ~ 22x over the last 4.75 years and in line with that of BHEL. We use P/E as our primarily valuation tool given the equity investors focus on P/E multiples for Indian electric equipment names. Our valuation methodology is also similar to peers like BHEL and ABB.

## Risks

Our quantitative risk-rating system, which tracks 260-day historical share price volatility, suggests a High Risk rating to Areva T&D India shares. However, we believe Medium Risk is more appropriate given that strong power and industrial capex in India provides Areva T&D India with significant visibility on order inflows while its top-three spot in the India power and automation space. Areva T&D's peers BHEL and ABB are rated Low Risk. Our risk rating on the stock is based on a number of factors, namely industry-specific risks, financial risk and management risks. These upside risks that could cause shares to continue to exceed our target price: 1) better-than-expected order booking, 2) better-than-expected execution, and 3) better-than-expected margins. Key downside risks include: 1) increased competition, 2) slowdown in investments in generation, transmission and distribution, 3) slowdown in the industrial capex cycle, 4) substantial increase in input prices, and 5) employee retention.

# Thermax

## Company description

Thermax specializes in energy and environment engineering solutions. It offers products and services in heating, cooling, waste heat recovery, captive power, water treatment and recycling, waste management and performance chemicals

## Investment strategy

We have a Buy/Medium Risk rating on Thermax. Order inflow is strong; order book is up 36% YoY with 65-75% executable in FY11E. There is a strong pipeline of orders, with a reasonable chance of strong order wins in the near future. We are raising our est. for FY11E by 9% on the back of strong order inflows in FY10E and expect OB to grow at 31%, revenues to grow at 45% and earnings to grow at 37% over FY10E-12E. We expect (unlevered) ROEs of 32-34%. Our est. do not capture any upside from the foray in to super-critical space.

## Valuation

Our Rs787 target price is based on PE of 22x Sept11E (from 16x Sept10E). We believe that 1) the structural change in the business, 2) the broader economic revival; 3) the strong outlook (compared to a year ago) should drive a re-rating. Our target multiple is 1) at a premium to Thermax's historical avg. PE (16x), given the strong outlook 2) at a discount to BHEL (23x) despite Thermax's superior earnings outlook and RoE (EPS CAGR of 37% vs 22% for BHEL, RoEs of 32-34% vs BHEL RoE's of 29-31%); given BHEL's larger size and market share. 3) the target multiple is also at a discount to ABB (24x) given ABB's superior earnings outlook (39% CAGR).

## Risks

We rate Thermax shares Medium Risk. We believe this is appropriate given that Thermax's business model is dependent on private sector capex. Key upside risks to our target price include higher-than-expected order inflow, further pick-up in private-sector capex and faster execution. The key downside risk is a slow down in private sector capex and slower-than-expected power capacity addition in India.

# Appendix A-1

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### Thermax (THMX.BO)

**Ratings and Target Price History**
**Fundamental Research**

Analyst: Deepal Delivala
Covered since May 23 2007


| | Date | Rating | Target Price | Closing Price |
|---|---|---|---|---|
| 1 | 22-May-07 | *1L | *562.00 | 448.50 |
| 2 | 30-May-07 | 1L | *604.00 | 488.85 |
| 3 | 26-Jul-07 | 1L | *764.00 | 637.30 |
| 4 | 30-Jan-08 | 1L | *748.00 | 652.50 |
| 5 | 24-Jun-08 | 1L | *480.00 | 393.80 |
| 6 | 29-Jan-09 | *1M | *211.00 | 159.30 |
| 7 | 23-Jul-09 | *3M | *414.00 | 417.55 |

* Indicates change

Rating/target price changes above reflect Eastern Standard Time

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|---|---|---|---|
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| *% of companies in each rating category that are investment banking clients* | 48% | 45% | 37% |
| Citi Investment Research & Analysis Quantitative World Radar Screen Model Coverage | 30% | 40% | 30% |

| | | | |
|---|---|---|---|
| *% of companies in each rating category that are investment banking clients* | 23% | 22% | 20% |
| Citi Investment Research & Analysis Quantitative Decision Tree Model Coverage | 48% | 0% | 52% |
| *% of companies in each rating category that are investment banking clients* | 55% | 0% | 51% |
| Citi Investment Research & Analysis Quantitative European Value & Momentum Screen | 30% | 40% | 30% |
| *% of companies in each rating category that are investment banking clients* | 51% | 55% | 48% |
| Citi Investment Research & Analysis Asia Quantitative Radar Screen Model Coverage | 20% | 60% | 20% |
| *% of companies in each rating category that are investment banking clients* | 23% | 20% | 23% |
| Citi Investment Research & Analysis Australia Radar Model Coverage | 50% | 0% | 50% |
| *% of companies in each rating category that are investment banking clients* | 23% | 0% | 37% |

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