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# Capital Goods & Engineering

## 1QFY12 Results Preview

## Executive Summary

### Capital Goods – All round execution pace to continue; Select players to see order inflow uptick

- We expect revenue growth for the capital goods companies under our coverage to grow at by 14% in 1QFY12 on yoy basis. This is a function of better order inflow during the latter part of FY11 (mainly T&D players), improving execution environment in the international segment & pick up in domestic execution as well.
- EBITDA margin is expected to pick up by 32bps yoy to 10.7% for our coverage universe, mainly due to the improved margin performance of ABB at 7.5% for the quarter from 3.5% in 2QCY10 & a 28bps improvement is expected in BHEL margins to 14.9%. EBITDA margin pressure is expected to continue for most other players on the back of both high commodity prices and continued competition across segments.
- While T&D contractors like KECI, KPP & JYS are expected to have seen considerable traction in order inflow in both domestic & international markets, Power equipment manufacturers like ABB and CRG would continue to see muted order inflow for the quarter in the domestic market. On the generation side, both BGRL and TMX are yet to see pick up in order inflow.
- To watch out for:** We expect ABB to grow by 22% due to improved execution in the power segment. The 3 T&D contractors are expected to witness revenue growth in excess of 15%. with KECI expected to grow by 20% with increased contribution from both domestic & international markets. We remain positive on BHEL, but at the same time BGRL is expected to report muted numbers for the quarter due to negligible revenue recognition from Krishnapatnam during the quarter.

### Engineering – Consumer plays to see high growth moderate; MEP to remain under strain

- Consumption driven players like BJE and HAVL are expected to see their stellar growth to moderate to around 15% due to a combination of various factors including, higher base, early onset of monsoon/milder summer & entry of new players in the lucrative consumer durable segment. However, these companies are expected to perform better than MEP centric players like BLSTR as tough market conditions are to lower growth & dent margins.
- Overall EBITDA margins for the companies under our coverage are expected to expand by 32bps to 9.9% with AIAE, HAVL & VATW contributing positively.
- AIAE is to continue with its strong performance and record 27% revenue growth & maintain margins aided by pass through of ferrochrome prices in this quarter.
- To watch out for:** In spite of lowered sales growth in the quarter (fans) for HAVL & BJE we continue to prefer them as their structural story remains intact. Also we continue to remain positive on niche players like AIAE & VATW.

Date	July 12, 2011		
Market data			
SENSEX	18715		
Nifty	5617		
Capital Goods & Engineering			
	TP (Rs)	Abs.	Rel.
ABB	517	SELL	UPF
AIAE	416	ADD	OPF
BJE	288	ADD	OPF
BGRL	513	ADD	OPF
BHEL	2,357	BUY	OPF
BLSTR	308	REDUCE	UPF
CRG	260	ADD	UPF
HAVL	472	BUY	OPF
JYS	97	ADD	OPF
KPP	136	ADD	OPF
KECI	95	BUY	OPF
TMX	653	ADD	OPF
VATW	1,352	ADD	OPF
VAMP	499	REDUCE	UPF
VOLT	204	BUY	OPF

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# 1QFY12 Results Preview Snapshot

## Capital Goods & Engineering Sector – All numbers in Rs mn except per share data

	Quarter			Change		Comments / Watch out for	Recommendation		
	Jun-11	Mar-11	Jun-10	yoy	qoq		Absolute	Relative	
<b>ABB Ltd (ABB)</b>							<b>Power segment to sustain growth, better margins seen</b>		
Net Sales	17,623	17,813	14,466	22%	-1%	Strong execution in power systems segment to continue at 35% yoy increase.			
EBITDA	1,265	870	500	153%	45%	Automation segment to see healthy growth of 13.5% thereby leading to overall revenue growth of 22% yoy.			
EBITDA margin	7.2%	4.9%	3.5%	372 bps	229 bps	EBITDA Margin to see uptick due drop in provisioning, seen at 7.2%.	<b>SELL</b>	<b>UPF</b>	
PAT	871	595	383	127%	46%	Key Trackables: RE provisioning, execution & margin in power product segment, order inflow details			
EPS	4.1	2.8	1.8	127%	46%				
<b>AIA Engineering (AIAE)</b>							<b>Mining to continue to drive growth, input cost passthrough to improve margins</b>		
Net Sales	3,091	3,471	2,425	27%	-11%	Mining volumes to help sales grow by 27% yoy.			
EBITDA	726	725	567	28%	0%	Improvement in EBITDA margin to be witnessed as ferro-chrome price pass through is to be witnessed this quarter.			
EBITDA margin	23.5%	20.9%	23.4%	11 bps	260 bps	Key Trackables: Mining volumes, realisations, Ferro-chrome prices & progress in new countries/verticals	<b>ADD</b>	<b>OPF</b>	
PAT	501	524	398	26%	-4%				
EPS	5.3	5.6	4.2	26%	-4%				
<b>Bajaj Electricals (BJE)</b>							<b>Lowered growth in fans segment , Engg. Segment to face margin pressure</b>		
Net Sales	5,572	9,796	4,839	15%	-43%	Lighting & consumer segment to see lowered growth of 15~20% across products.			
EBITDA	449	1,017	408	10%	-56%	Engineering segment is to see both subdued growth (4%) and lowered EBIT margin due to issue related to closure of certain sites are to result in higher than expected expenses.			
EBITDA margin	8.1%	10.4%	8.4%	-38 bps	-233 bps	Key Trackables: Volumes in new products launched, Order inflow in project segment	<b>ADD</b>	<b>OPF</b>	
PAT	239	618	225	6%	-61%				
EPS	2.4	6.2	2.3	6%	-61%				
<b>BGR Energy Systems (BGRL)</b>							<b>High base effect to continue</b>		
Net Sales	8,653	14,573	9,054	-4%	-41%	High base effect due to strong execution in 1QFY11 & revenue recognition yet to happen for Krishnapatnam are likely to lead to a 4% de-growth in revenue.			
EBITDA	969	1,630	1,025	-5%	-41%	EBITDA margin to remain stable at 11.2% & PAT to de-grow by 12% on the back of higher interest cost & relatively lower execution.			
EBITDA margin	11.2%	11.2%	11.3%	-12 bps	1 bps	Key trackables: RRVUNL order , Order inflow from IPPs.	<b>ADD</b>	<b>OPF</b>	
PAT	531	984	605	-12%	-46%				
EPS	7.4	13.7	8.4	-12%	-46%				
<b>Bharat Heavy Electricals Ltd (BHEL)</b>							<b>Another good quarter on cards</b>		
Net Sales	76,007	183,805	66,010	15%	-59%	Execution to remain robust leading to 15% growth in revenue on the back of strong order book of 3x FY12E.			
EBITDA	11,325	42,936	9,650	17%	-74%	Operating leverage to improve EBITDA margin by 28bps yoy due to relatively lower employee cost.			
EBITDA margin	14.9%	23.4%	14.6%	28 bps	-846 bps	Key trackables: Industrial and private sector orders	<b>BUY</b>	<b>OPF</b>	
PAT	7,737	27,980	6,677	16%	-72%				
EPS	15.8	57.2	13.6	16%	-72%				

## 1QFY12 Results Preview Snapshot (Cont'd)

### Capital Goods & Engineering Sector – All numbers in Rs mn except per share data

	Quarter			Change		Comments / Watch out for	Recommendation		
	Jun-11	Mar-11	Jun-10	yoy	qoq		Absolute	Relative	
<b>Blue Star (BLSTR)</b>							<b>Low revenue growth in EMP segment to impact profitability</b>		
Net Sales	7,219	9,085	6,598	9%	-21%	Execution in project segment is likely to remain weak on a yoy basis.			
EBITDA	599	956	559	7%	-37%	Weak summer demand is to keep demand for Unitary cooling products' sales under check.			
EBITDA margin	8.3%	10.5%	8.5%	-17 bps	-222 bps	EBITDA margin to compress 17bps yoy due to higher input costs	<b>REDUCE</b>	<b>UPF</b>	
PAT	380	568	368	3%	-33%	Key trackables: Execution in EMP segment, improvement in Unitary cooling sales			
EPS	4.2	6.3	4.1	3%	-33%				
<b>Crompton Greaves (CRG)</b>							<b>Power segment to drag numbers, Margin pressure across all segments seen</b>		
Net Sales	26,164	29,080	23,022	14%	-10%	Moderate growth of 9% in power segment is expected, while industrial & consumer segments			
EBITDA	3,237	3,731	2,973	9%	-13%	are to see 20% revenue growth on yoy basis. Margin across all segment are to come under			
EBITDA margin	12.4%	12.8%	12.9%	-54 bps	-46 bps	pressure on increase in competition, execution of low margin orders.	<b>ADD</b>	<b>UPF</b>	
PAT	2,082	2,847	1,897	10%	-27%	Key Trackable: PGCIL ordering, power segment performance, further capex plans			
EPS	3.2	4.4	3.0	10%	-27%				
<b>Havells (HAVL)</b>							<b>Domestic operations to remain upbeat, Sylvania to stabilize</b>		
Net Sales	8,174	8,408	7,170	14%	-3%	Sustenance of higher demand in consumer and lighting segment reinforced with new product			
EBITDA	921	990	802	15%	-7%	launch would drive 14% revenue growth.			
EBITDA margin	11.3%	11.8%	11.2%	8 bps	-51 bps	EBITDA margin to improve slightly as increased input costs are passed on through price hikes	<b>BUY</b>	<b>OPF</b>	
PAT	635	690	533	19%	-8%	in consumer durable, cable & wires segment. Sylvania margin to stabilize at 5.5%			
EPS	5.1	5.5	4.3	19%	-8%	Key Trackables: Fan sales, sylvania growth, price increases in products			
<b>Jyoti Structures (JYS)</b>							<b>Execution to remain robust, order inflow to stay strong</b>		
Net Sales	6,499	7,218	5,642	15%	-10%	We expect revenues to grow by 15% on the back of high domestic execution.			
EBITDA	728	840	638	14%	-13%	EBITDA margin is expected to stay flat at 11.2%.			
EBITDA margin	11.2%	11.6%	11.3%	-11 bps	-44 bps	PAT is expected to come in slightly lower due to higher interest costs.	<b>ADD</b>	<b>OPF</b>	
PAT	297	350	262	13%	-15%	Key Trackables: Order inflows in international operations, debt & working capital position			
EPS	3.6	4.3	3.2	13%	-15%				
<b>Kalpataru Power (KPP)</b>							<b>Transmission margin to remain under pressure</b>		
Net Sales	6,223	8,831	5,356	16%	-30%	Execution pace in the transmission segment to remain slightly lower (13% growth) due to			
EBITDA	717	969	698	3%	-26%	project delays & competition.			
EBITDA margin	11.5%	11.0%	13.0%	-152 bps	54 bps	Biomass & infra to see strong growth on yoy basis.	<b>ADD</b>	<b>OPF</b>	
PAT	386	616	369	5%	-37%	EBIT margin in transmission segment to remain under pressure			
EPS	2.9	4.6	2.8	5%	-37%	Key Trackables: Orders in International T&D and JMC, execution in domestic T&D segment			

## 1QFY12 Results Preview Snapshot (Cont'd)

### Capital Goods & Engineering Sector – All numbers in Rs mn except per share data

	Quarter			Change		Comments / Watch out for	Recommendation		
	Jun-11	Mar-11	Jun-10	yoy	qoq		Absolute	Relative	
<b>KEC International (KECI)</b>							<b>Increasing diversified presence to provide solid numbers</b>		
Net Sales	10,129	15,574	8,460	20%	-35%	Better execution pace in international markets especially Middle East and strong domestic execution is to lead to revenue growth of 20%.			
EBITDA	1,033	1,620	844	22%	-36%	EBITDA margin to improve by 23bps to 10.2% owing to higher contribution from SAE Towers.	<b>BUY</b>	<b>OPF</b>	
EBITDA margin	10.2%	10.4%	10.0%	23 bps	-20 bps	Order inflow & order book is expected to remain strong.			
PAT	415	786	264	57%	-47%	Key Trackables: SAE Towers margins, International execution			
EPS	1.7	3.2	1.1	57%	-47%				
<b>Thermax (TMX)</b>							<b>Revenue grow on high base, EPC contracts to compress margins</b>		
Net Sales	9,037	17,713	7,898	14%	-49%	Lowered revenue growth of 14% yoy is on the back of a high base in Q1FY11.			
EBITDA	1,030	1,951	960	7%	-47%	EBITDA margin to compress 75bps due to higher execution of lower margin EPC contracts.			
EBITDA margin	11.4%	11.0%	12.2%	-75 bps	38 bps	Key Trackables: Working capital position, growth in Environment business	<b>ADD</b>	<b>OPF</b>	
PAT	703	1,265	662	6%	-44%				
EPS	5.9	10.6	5.6	6%	-44%				
<b>VA Tech Wabag (VATW)</b>							<b>Domestic projects to propel revenue growth, EBITDA, PAT to turn positive yoy</b>		
Net Sales	1,895	5,092	1,723	10%	-63%	Revenue likely to grow 10% on the back of good execution in the domestic markets & comfortable order book position.			
EBITDA	69	826	-43	-	-92%	EBITDA margin to turn positive on yoy basis from -2.5% to 3.6% in this quarter.	<b>ADD</b>	<b>OPF</b>	
EBITDA margin	3.6%	16.2%	-2.5%	613 bps	-1260 bps	Key Trackables: Order inflow from new regions, domestic order execution			
PAT	40	459	-54	-	-91%				
EPS	4.0	46.4	(5.7)	-	-91%				
<b>Voltamp (VAMP)</b>							<b>Volumes to remain muted, margin aberration to correct</b>		
Net Sales	1,290	1,490	1,193	8%	-13%	We expect revenue to grow by 8% with volumes growth remaining muted due to weak demand for transformers in real estate sector & industries			
EBITDA	153	268	130	18%	-43%	EBITDA margin aberration, which occurred in 4QFY11 due to certain credit write back is to correct back to 11.9% in this quarter.	<b>REDUCE</b>	<b>UPF</b>	
EBITDA margin	11.9%	18.0%	10.9%	101 bps	-609 bps	Key trackables: Industrial capex pick up, Demand for dry type transformers			
PAT	116	190	107	8%	-39%				
EPS	11.4	18.8	10.6	8%	-39%				
<b>Voltas (VOLT)</b>							<b>EMP segment to perform better</b>		
Net Sales	15,074	16,709	14,031	7%	-10%	Better execution in the EMP segment is to compensate for the lower growth of 5% expected in the Unitary cooling (UCP) segment			
EBITDA	1,289	1,362	1,223	5%	-5%	Segmental margins for engineering segment are to face headwinds due to lower commission & sale of high margin material handling business.	<b>BUY</b>	<b>OPF</b>	
EBITDA margin	8.6%	8.1%	8.7%	-17 bps	40 bps	Key trackables: Segmental margins across segments, execution in MENA region			
PAT	967	959	937	3%	1%				
EPS	2.9	2.9	2.8	3%	1%				

## Valuation Matrix – Capital Goods & Engineering

Company	Sales (Rs. mn)			EBITDA (Rs. mn)			PAT (Rs. mn)			EPS (Rs.)			EBITDA Margin		
	FY11	FY12E	FY13E	FY11	FY12E	FY13E	FY11	FY12E	FY13E	FY11	FY12E	FY13E	FY11E	FY12E	FY13E
ABB	62,871	74,566	82,091	837	5,592	7,717	632	3,478	4,977	3.0	16.4	23.5	1.3%	7.5%	9.4%
AIAE	11,369	13,314	15,331	2,597	3,191	3,708	1,833	2,239	2,613	19.4	23.7	27.7	22.8%	24.0%	24.2%
BJE	27,404	32,370	38,689	2,576	3,057	3,682	1,499	1,810	2,220	15.0	18.1	22.4	9.4%	9.4%	9.5%
BGRL	47,475	54,084	60,214	5,374	5,895	6,443	3,242	3,385	3,699	44.9	46.9	51.3	11.3%	10.9%	10.7%
BHEL	424,955	487,226	561,406	89,627	99,881	113,965	60,112	66,906	76,656	122.8	136.7	156.6	21.1%	20.5%	20.3%
BLSTR	28,569	31,097	34,987	2,467	2,711	3,049	1,547	1,721	2,004	17.9	20.4	23.7	8.6%	8.7%	8.7%
CRG	100,051	113,993	132,740	13,438	14,887	17,123	9,191	10,042	11,618	14.4	15.7	18.2	13.4%	13.1%	12.9%
HAVL	56,356	63,956	71,391	5,718	6,521	7,488	3,061	3,720	4,517	24.5	29.8	36.2	10.1%	10.2%	10.5%
JYS	23,797	27,656	31,610	2,739	3,098	3,509	1,109	1,195	1,328	13.5	14.5	16.2	11.5%	11.2%	11.1%
KPP	43,547	53,192	60,925	4,504	5,133	6,048	2,127	2,521	2,966	13.0	15.3	17.8	10.3%	9.6%	9.9%
KECI	44,742	55,350	65,415	4,624	5,676	6,672	2,056	2,523	3,041	8.0	9.8	11.8	10.3%	10.3%	10.2%
TMX	53,374	58,898	68,593	5,742	6,390	7,442	3,770	4,163	4,865	32.0	34.9	40.8	10.8%	10.9%	10.9%
VATW	12,330	14,272	17,081	1,122	1,356	1,622	526	793	946	53.1	75.6	90.3	9.1%	9.5%	9.5%
VAMP	5,263	5,733	6,471	668	682	796	518	545	632	51.2	53.9	62.4	12.7%	11.9%	12.3%
VOLT	51,768	58,157	67,396	4,408	4,895	5,672	3,303	3,860	4,496	10.0	11.7	13.6	8.5%	8.4%	8.4%

Company	P/E			EV/EBITDA			EV/Sales			CMP (Rs)	Mkt Cap (Rs. mn)	Target		Rating	
	FY11	FY12E	FY13E	FY11	FY12E	FY13E	FY11	FY12E	FY13E			P/E	Price	Absolute	Relative
ABB	292.3x	53.1x	37.1x	213.6x	33.0x	23.7x	2.8x	2.5x	2.2x	871	184,614	22.0x	517	SELL	UPF
AIAE	19.1x	15.6x	13.4x	12.0x	9.7x	8.1x	2.7x	2.3x	2.0x	371	34,946	15.0x	416	ADD	OPF
BJE	17.2x	14.3x	11.5x	10.3x	8.2x	6.2x	1.0x	0.8x	0.6x	258	25,687	12.8x	288	ADD	OPF
BGRL	10.3x	9.9x	9.1x	7.0x	6.9x	6.4x	0.8x	0.8x	0.7x	464	33,483	10.0x	513	ADD	OPF
BHEL	16.0x	14.4x	12.5x	9.7x	8.5x	7.3x	2.0x	1.7x	1.5x	1,962	960,414	15.1x	2357	BUY	OPF
BLSTR	17.5x	15.3x	13.2x	12.2x	10.4x	9.6x	1.1x	1.0x	0.8x	313	28,150	13.0x	308	REDUCE	UPF
CRG	17.0x	15.6x	13.5x	11.9x	10.5x	9.0x	1.6x	1.4x	1.2x	246	157,743	14.3x	260	ADD	UPF
HAVL	15.8x	13.0x	10.7x	10.0x	8.5x	7.0x	1.0x	0.9x	0.7x	387	48,344	13.0x	472	BUY	OPF
JYS	6.6x	6.1x	5.5x	4.3x	4.0x	3.6x	0.5x	0.4x	0.4x	89	7,330	6.0x	97	ADD	OPF
KPP	10.0x	8.6x	7.3x	5.9x	5.2x	4.7x	0.6x	0.5x	0.5x	131	20,065	7.6x	136	ADD	OPF
KECI	10.0x	8.1x	6.8x	7.2x	6.0x	5.3x	0.7x	0.6x	0.5x	80	20,523	8.0x	95	BUY	OPF
TMX	19.2x	17.6x	15.1x	11.7x	10.5x	9.0x	1.3x	1.1x	1.0x	616	73,346	16.0x	653	ADD	OPF
VATW	24.1x	16.9x	14.2x	8.2x	7.0x	5.5x	0.7x	0.7x	0.5x	1,278	13,521	15.0x	1352	ADD	OPF
VAMP	10.1x	9.6x	8.3x	7.4x	7.3x	6.2x	0.9x	0.9x	0.8x	516	5,223	8.0x	499	REDUCE	UPF
VOLT	16.2x	13.8x	11.9x	10.9x	9.2x	7.5x	0.9x	0.8x	0.6x	162	53,454	15.0x	204	BUY	OPF

### Absolute Rating Interpretation

<b>BUY</b>	<b>Stock expected to provide positive returns of &gt; 15% over a 1-year horizon</b>
<b>ADD</b>	<b>Stock expected to provide positive returns of &lt;=15% over a 1-year horizon</b>
<b>REDUCE</b>	<b>Stock expected to fall &lt;=15% over a 1-year horizon</b>
<b>SELL</b>	<b>Stock expected to fall &gt;15% over a 1-year horizon</b>

### Relative Rating Interpretation

<b>OUTPERFORM</b>	<b>Stock expected to outperform sector index /sector peers in our coverage</b>
<b>UNDERPERFORM</b>	<b>Stock expected to underperform sector index/ sector peers in our coverage</b>

#### Analyst Certification

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