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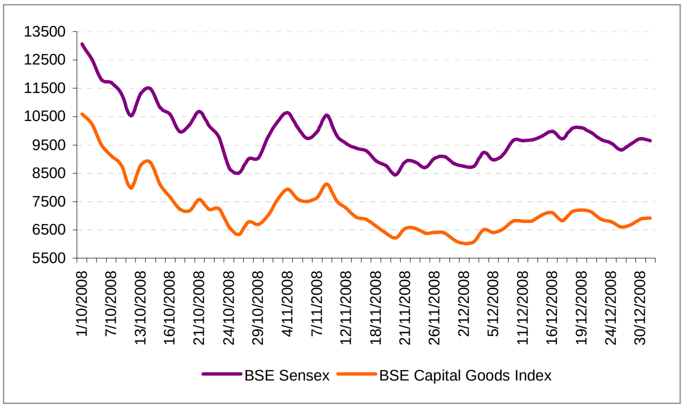
Q3FY2009 Capital Goods earnings preview

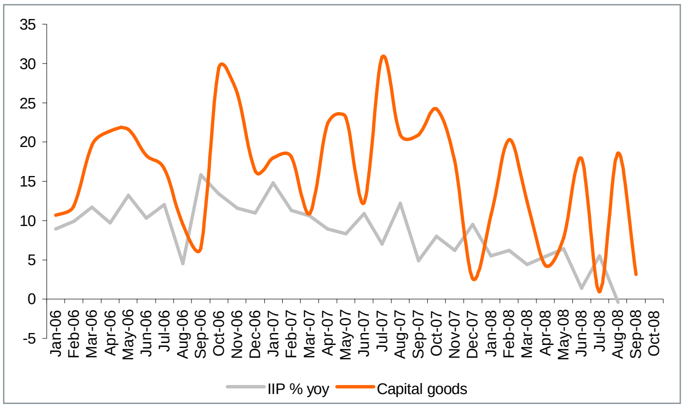
Expect mixed bag performance; order inflow revival holds key

- After an outperformance in Q2FY2009, the sector underperformed the broader markets in Q3FY2009 amidst growing concerns of slowdown in order inflows and liquidity crunch. The third quarter saw the capital goods index underperform the benchmark index as the BSE Capital Goods index declined by 34.8% as against a 26.1% decline witnessed by BSE Sensex.
- The capital goods index in the monthly index of industrial production (IIP) numbers continued to be volatile, as it rose by 3.1% in October 2008, though on a very high base of 20.9% of October 2007. The base effect would continue to have an impact for the coming couple of months due to high base of November 2007 (24.2%) and December 2007 (17.6%).

Performance of the Capital Goods index



IIP performance



Quarterly estimates Rs (cr)

Company	Net sales Q3FY2009E	Net sales Q3FY2008	Net sales % yoy chg	Net profit Q3FY2009E	Net profit Q3FY2008	Net profit % yoy chg
Bharat Bijlee	128.3	111.6	15.0	12.6	12.3	2.3
BHEL	6,146.7	4,964.2	23.8	881.7	771.9	14.2
Crompton (Stand-alone)	1,054.7	915.2	15.3	81.6	67.9	20.1
Crompton (Consolidated)	2,076.7	1,713.6	21.2	106.9	84.1	27.2
Esab India*	102.3	87.8	16.6	15.0	13.3	13.0
Genus Power	141.2	105.3	34.0	13.1	9.97	31.2
Indo Tech	64.5	52.1	23.8	11.3	12.2	-7.8
KSB Pumps*	150.6	131.8	14.3	14.6	19.6	-25.3
Larsen & Toubro	8,221.7	6,382.7	28.8	581.3	514.8	12.9
Patels Airtemp	12.8	10.4	23.0	1.5	1.4	7.3
Punj Lloyd	2,773.3	2,117.0	31.0	120.2	91.7	31.1
Sanghvi Movers	74.7	64.4	16.0	18.6	17.8	4.5
Thermax (Stand-alone)	898.2	845.4	6.2	76.8	75.0	2.3
WS Inds	57.5	56.3	2.0	3.5	3.6	-3.1
Total	**21,903.1**	**17,557.7**	**24.7**	**1,938.5**	**1,695.5**	**14.3**

*Dec ending companies

- The heavyweights continued to impress in terms of order inflows with Larsen & Toubro (L&T) and Bharat Heavy Electricals Ltd (BHEL) reporting a number of order wins during the quarter. The management of L&T has yet again reiterated its view of achieving a 30% order inflow for the current fiscal. However, the order inflows appeared to have dried up for smaller and mid-sized companies, as the affect of the slowdown became more pronounced due to liquidity crisis. The companies relying on private capital expenditure (capex) will continue to face greater pressure, as corporates cut down their capex plans amidst the slowdown, while companies such as BHEL, which are primarily relying on public spend, are not likely to see much slowdown in their order inflows. Moreover, with PGCIL already floating tenders worth about Rs2,700-2,800 crore and in the process of doing many more, the order inflows for transmission & distribution (T&D) sector is likely to pick up in the coming times.

- The growth in the current year would still continue to be driven by the existing strong order book position for most of the companies, though for future growth we continue to actively monitor the order inflows for all the companies in the sector, particularly those for mid-sized and smaller companies.

- Key raw material prices eased significantly during the quarter, with the base metal prices currently trading at multi-year lows. However, the impact of the same is unlikely to be felt in the current quarter, as the bulk of the raw material booking for the orders executed during the present quarter had been done earlier at higher prices. Hence, the impact of softening prices would only be felt with a lag of couple of quarters, and we should be able to see the benefits from the next quarter.

- Lack of funding, execution delays and further cuts in the private capex remain primary concerns for the sector and future performance of the companies. Lately, we have noticed a number of infrastructure projects getting delayed on account of funding constraints or funding gap, which could potentially delay the execution of these projects. Though the government has reacted well, offering a number of measures to facilitate infrastructure funding through its stimulus packages, the risks still loom large over the industry.

- For the quarter ended December 31, 2008, we expect our capital goods universe to report a top line growth of 24.7% and a bottom line growth of 14.3%. Our preferred buys in the sector are BHEL, Crompton Greaves and Genus Power Infrastructures.

Key highlights (company-wise)

Bharat Bijlee

- Bharat Bijlee has brought on-stream 3,000MVA of new capacity, which has been operational from Q3FY20009. While the capacity has come on-stream, the revenues from the plant in Q3FY2009 may not be significant.

- We expect the revenues to grow by 15% to Rs128.3 crore.

- We have built in a 220-basis-points year-on-year (y-o-y) decline in the operating margins on the back of higher costs. Consequently we expect the net profit to grow marginally by 2.3% to Rs12.6 crore.

- The key monitorable for the company would be stabilisation of new capacity and order flows in a changing business scenario.

BHEL

- BHEL has announced close to Rs8,955 crore worth of order wins during Q3FY2009. The company has also managed to garner substantial order from private players.

- In Q3FY2009, we expect BHEL to post a 23.8% growth in it net revenues.

- We have built in an increased wage provision in line with the recommendations of the Sixth Pay Commission. We expect the company to post a 14.2% increase in the net profits to Rs881.7 crore.

- BHEL finished Q3FY2009 with outstanding order book of over Rs104,000 crore. With decent order inflows in the current quarter too, BHEL provides the best visibility to the earnings in the capital goods space. BHEL would continue to be the prime beneficiary of the government's spending in the power sector and remains our top pick in the sector.

Crompton Greaves

- On a stand-alone basis we expect Crompton greaves to post a revenue growth of 15.3% in Q3FY2009. The net profit of the company is expected to grow at a healthy 20.1% to Rs81.6 crore.

- On a consolidated basis, in Q2FY2009, Crompton Greaves' revenues are expected to grow at 21.2% year on year (yoy). We have built in a slower growth in the subsidiary companies, mainly on account of slowing demand in global economies. The appreciation in the Euro against the Indian rupee would continue to add positively to the top line of the company.

- The consolidated profit of the company is expected to grow by 27.2% to Rs106.9 crore.

Esab India

- Esab India would be announcing its Q4CY2008 and annual results.
- During the quarter the company had announced one day cut in production in a week, which could provide negative surprise in the results of the company. We expect the company to post a 16.6% revenue growth.
- We expect the margins to come down slightly, by 60 basis points, to 21.4%. Consequently, the profit for the quarter is expected to grow by 13% to Rs15.04 crore.

Indo Tech Transformers

- For Q3FY2009, we expect the sales of Indo Tech Transformers to grow at 23.8%. We expect the volumes to rise, as the new capacity of the company was up and running.
- The realisation would rise on a sequential basis, as the company has executed export orders during the quarter (export orders enjoy better realisations). However, on a high base we expect the margins to come down (Q3FY2008 margins were at 34%). Consequently, we expect the profit of the company to record a marginal decline of 7.8% .

L&T

- The order inflow continued to be strong during the quarter, with the company bagging prestigious orders such as Rs2,460 crore mono-rail order in consortium with Scomi Engineering, Rs1,450 crore orders in buildings & factories division, a 700-crore order in the hydrocarbon space and three orders in EPC space totaling Rs937 crore among others. The company has maintained its 30% order inflow guidelines for the year.
- At the end of the previous quarter, the company had an order book of Rs60,931 crore for its E&C division, which along with the recent additions provides strong earnings visibility for the next couple of years. The company is confident of achieving its target of a 30% order inflow growth during the fiscal, and the top management has re-iterated its view during the quarter.
- For the current quarter, we expect the company to report a top line growth of 28.8%, while the operating margins are expected to decline a bit by 100 basis points to 10.6%. However, on back of a higher interest and depreciation costs, we expect the adjusted profits to report a growth of 12.9% yoy and a 20.6% growth in reported profit.

KSB Pumps

- For KSB Pumps, we expect a 14.3% top line growth for the current quarter.
- Though the margins had shown a positive surprise in the previous quarter, we do not expect the same performance for the present quarter.
- We expect the operating margins to contract by about 430 basis points on a y-o-y comparison, and consequently expect a 25% fall in the profit to Rs14.6 crore.

Patels Airtemp

- Patels Airtemp is expected to continue delivering a steady top line growth for the present quarter as well, as we expect the company to report a 23% growth in its top line to Rs12.8 crore.
- The operating margins in such a business can vary depending on the revenue mix and the type of orders executed. Hence, the operating margins in the comparable quarter last year were quite high at about 23.2%, while we expect them to be about 20% for the current quarter.
- Consequently we expect the net profits to report a growth of 7.3% on a y-o-y basis.

Punj Lloyd

- Incremental orders for Punj Lloyd during Q3FY2009 has been disappointing, making slowing order flow an evident fact. The company in H1FY2009 has displayed strong performance, which we expect to continue in Q3FY2009.
- We expect the revenues of the company to grow at 31% to Rs2,773.3 crore.
- We have built in a 100-basis -point improvement in the consolidated operating margins mainly on account of execution of higher margin orders in Sembawang.
- We have estimated a 65% decline in other income and a 55% increase in interest income on anticipation of higher borrowing on account of higher working capital needs.
- Consequently, we expect the net profit of the company to grow a robust 31.1% to Rs120.2 crore.

Sanghvi Movers

- Sanghvi Movers has delivered a stupendous performance in H1FY2009 led by better utilisation and higher yields.
- For Q3FY2009, we expect the company to post a 16% growth in revenues. The growth is on a very high base for the same quarter last year (a 65.4% growth). On the back of infrastructure spending the demand for cranes are expected to remain firm.
- We expect the operating performance of the company to remain stable and have built in a marginal 20-basis-point increase in the operating profit margin (OPM). On a high base of the previous year ,the profits of the company are expected to report a 4.5% increase on a y-o-y basis.

Thermax

- In Q3FY2009, Thermax' revenue growth is expected to be muted at 6.2%, as slow order flow in the past would affect revenues.
- The OPM of the company is expected to improve by 60 basis points. Consequently the net profit of the company is expected to increase by a measly 2.3%.
- Two order wins in captive power generation equipment in the previous quarter would bring about improved revenue flow going forward.

WS Industries

- WS Industries, a dominant player in the domestic insulator business, is currently operating near full capacity. The new plant has been further delayed and expected to come on-stream during the current month (January 2009). Further, due to flooding in Chennai the company had to shut down its warehouse that led to lost sales during the period.
- Consequently we estimate a near-flat (2%) growth in net sales.
- The decline in crude oil prices would provide much-needed relief to the operating margin, however lower absorption of fixed costs could lead to a 100-basis-point y-o-y decline in the OPM.
- On the back of higher interest cost (due to increased working capital) and lower operating margin, we estimate a 3.1% decline in the profit of the company.

The author doesn't hold any investment in any of the companies mentioned in the article.