

Reassuring Results Likely From 'Fallen Angels'



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30% Sales & 47% Bottom-line Growth Reinforce Confidence

Likely 30%YoY top-line growth and a 47% growth in bottom line of Indian Engg. & Construction (E&C) majors during the April-June quarter should reinforce our bullish stance on the sector and reassure the markets after a 23% correction in stocks from the peak. While we expect muted growth in order backlog led by focus on acquiring better priced orders, the key issue to watch out for is rise in EBITDA margins led by new better priced orders. Reiterate buy on all the stocks we cover in the sector.

Margin expansion and sales growth to drive PAT 47%YoY

We expect the Indian E&C Sector, represented by BHEL, L&T, ABB, IVRCL and Nagarjuna (NJCC), to report sales growth of 30% YoY, EBITDA growth of 49% YoY and Recurring PAT growth of 47%YoY.

Growth Leaders - BHEL (Big-Cap) & Nagarjuna (Mid-Cap)

BHEL remains our preferred pick in the sector as it fixed technology issues such as advance class gas turbines & super-critical plants. This should not only complete its product offering but also drive order backlog (2.6x sales). Also, the Indian Government focus on indigenizing super-critical technology through BHEL & likely implementation of ultra mega power projects should drive future orders. Expect BHEL to post 35%, 63% & 54%YoY growth in Sales, EBITDA & PAT resp.

We expect **L&T's** strong growth in order inflow to be continued in 1Q FY07 as the company has booked a series of big ticket orders in the recent past from domestic as well as export market. Overall L&T should experience 22% Sales growth, 35% EBITDA growth and a 34% PAT growth. Meanwhile, **ABB's** strong results should be driven by continued strong sales growth of 32% YoY led by strong order backlog. Improved labour productivity and stable O&M costs should result in 50% YoY earning growth.

Nagarjuna & IVRC - Preferred Mid-cap E&C Picks

NJCC & IVRCL remain our preferred picks in the Mid-cap E&C space. Expect NJCC's PAT to grow 52%y-y in 1QFY07 led by 55% y-y growth in sales and margin improvement by 36bps YoY.

Table 1: Valuation and Return Table

Company	Price	Rating	Mcap	P/E			Return	
				Rsbn	FY06	FY07E	FY08E	3mth
L&T Cons	2243	C-1-7	288	27.2	20.9	16.7	-8%	22%
BHEL	1952	C-1-7	440	26.2	18.4	16.3	-13%	41%
ABB	2496	C-1-7	99	45.3	29.4	20.9	-15%	29%
NCC	256	C-1-7	25	23.9	13.9	9.3	-29%	-0.6%
IVRCL	228	C-1-7	23	24.6	15.0	11.4	-18%	55%

Source: Merrill Lynch Research Estimates

Table 2: Quarterly estimates

(Rsmn)	1QFY06A	1QFY07E	YoY
Sales			
ABB	6,589	8,698	32.0%
BHEL	19,365	26,145	35.0%
L&T	31,111	37,914	21.9%
IVRCL	3,007	4,310	43.3%
Nagarjuna Construction Co	3,594	5,570	55.0%
Sector	63,665	82,637	29.8%
EBITDA			
ABB	604	887	46.9%
BHEL	1,715	2,798	63.1%
L&T	1,765	2,375	34.6%
IVRCL	235	353	50.5%
Nagarjuna Construction Co	278	451	62.3%
Sector	4,597	6,864	49.3%
PAT			
ABB	436	655	50.2%
BHEL	1,279	1,963	53.5%
L&T	903	1,213	34.3%
IVRCL	171	245	43.7%
Nagarjuna Construction Co	192	291	51.9%
Sector	2,980	4,367	46.5%

Source: Merrill Lynch Research Estimates

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Refer to important disclosures on page 6 to 9. Analyst Certification on page 4. Price Objective Basis/Risk on page 3.

Table 3: Quarterly estimates for Engineering & Construction stocks

(Rs mn)	ABB	BHEL	L&T	IVRCL	NCC	Sector
Sales						
1QFY06A	6,589	19,365	31,111	3,007	3,594	63,665
4QFY06A	8,029	55,157	45,943	5,906	6,404	121,439
1QFY07E	8,698	26,145	37,914	4,310	5,570	82,637
% change						
YoY	32.0%	35.0%	21.9%	43.3%	55.0%	29.8%
QoQ	8.3%	-52.6%	-17.5%	-27.0%	-13.0%	-32.0%
EBITDA						
1QFY06A	604	1,715	1,765	235	278	4,597
4QFY06A	695	11,949	6,945	558	532	20,678
1QFY07E	887	2,798	2,375	353	451	6,864
% change						
YoY	46.9%	63.1%	34.6%	50.5%	62.3%	49.3%
QoQ	27.7%	-76.6%	-65.8%	-36.6%	-15.2%	-66.8%
PAT						
1QFY06A	436	1,279	903	171	192	2,980
4QFY06A	513	8,680	4,588	438	350	14,568
1QFY07E	655	1,963	1,213	245	291	4,367
% change						
YoY	50.2%	53.5%	34.3%	43.7%	51.9%	46.5%
QoQ	27.7%	-77.4%	-73.6%	-44.0%	-16.7%	-70.0%

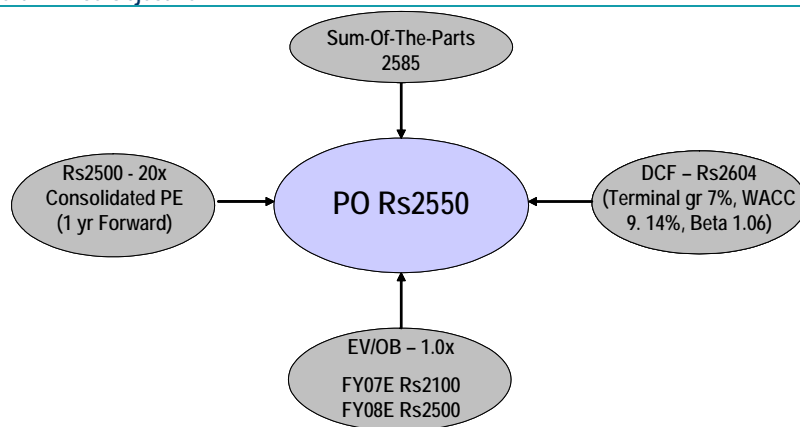
Source: Respective Company, Merrill Lynch Research Estimates

Price Objective Basis & Risk

Larsen & Turbo

Our PO of Rs2550 for L&T has been arrived at through a multi-pillar approach At Rs2550, the stock would trade at consolidated PER of 20x 1-year-forward (FY08E) earnings. Risks: Raw materials, increasing competition & project execution.

Chart 1: Price Objective



Source: Merrill Lynch Research

BHEL

Our Rs2,760 PO is based on FY08E PER of 25x – in line with peak PE in the last cycle (94-97) & PEG of 1x. Risks: Chinese competition, project execution and cap on FII holding.

Nagarjuna Construction

Our PO of Rs400 is based on sum-of-the-parts. We have valued NJCC's core business at PE 13x FY08E – a 30% discount to majors & in line with its own FY07E multiples. Risks: Government capex, raw material costs, competition, potential denial of tax benefits (80IA), traffic/interest rate risk in Infra projects, & project execution.

Table 4: NJCC- Sum Of The Parts

Parts	Rational / stake	Value	
		(Rs Mn)	Rs/share
NCC Construction business	13x FY08E PER - 30% discount to majors and in-line with NCC's own multiples	37,250	361
Bangalore-Maddur Road SPV	DCF Value - 33% equity share	407	4
Meerut-Mu'nagar SPV	DCF Value - 30% equity share	452	4
Bagalore Elevated Tollway Pvt Ltd	DCF Value -33.5% equity share	1,172	11
Orai-Bhognipur Infrastructure Ltd	DCF Value - 64%equity share	1,052	10
National Games Housing Complex project at Ranchi	DCF Value -100% equity share	205	2
Andhra Pradesh Housing Board project in Vishakhapatnam	DCF Value -89% equity share	227	2
Land Bank	4x Book Value; 20% discount to market	960	9
Gautami Power	Book value of Investment	226	2
Total		41,952	406

Source: ML Research Estimates

ABB

Our 12m PO is Rs3850 (+25%), based on 1-yr forward P/E of 30x. We believe our target valuation is justified considering its MNC parentage, technology and outsourcing opportunity leading to sustained earnings growth over CY05-08E (CAGR of 41%) and expanding RoE (34% by CY07E v/s 26.8% in CY05). Key risks: Competition & delay in power sector reforms/capex.

IVRCL

Our Rs330 PO is based on sum-of-the-parts approach. We have valued IVRCL's core construction business at PER 15.0x FY08E – a 25% discount to E&C majors despite its faster growth, which should leave further upside. **Risks:** Government capex, raw material costs, competition, potential denial of tax benefits (u/s 80IA), traffic/interest rate risk in toll/annuity projects, and project execution risk.

Table 5: IVRCL - Sum of Parts (PO Basis)

Parts	Basis	Rs/share
	15x FY08E EPS - 25% discount to majors & -16% to current	
IVRCL Construction business	FY07E	281
Hind-dorr-Oliver Equity Stake	Current Mkt value	14.8
IVR Realty Prime	Expected Profit	4.4
Land Bank	40% discount to market	11
Jalandhar -Amritsar	DCF - 100% stake	6.8
Chennai Desalination Plant	DCF - 75% stake	10
Kumarapalayam–Chenagmpali Project	DCF - 100% stake	11.8
Salem - Kumarapalayam Project	DCF - 100% stake	16.4
Total Value		356.4
Less Debt (FY08E)		26.6
Total		330

Source: ML Research Estimates

Analyst Certification

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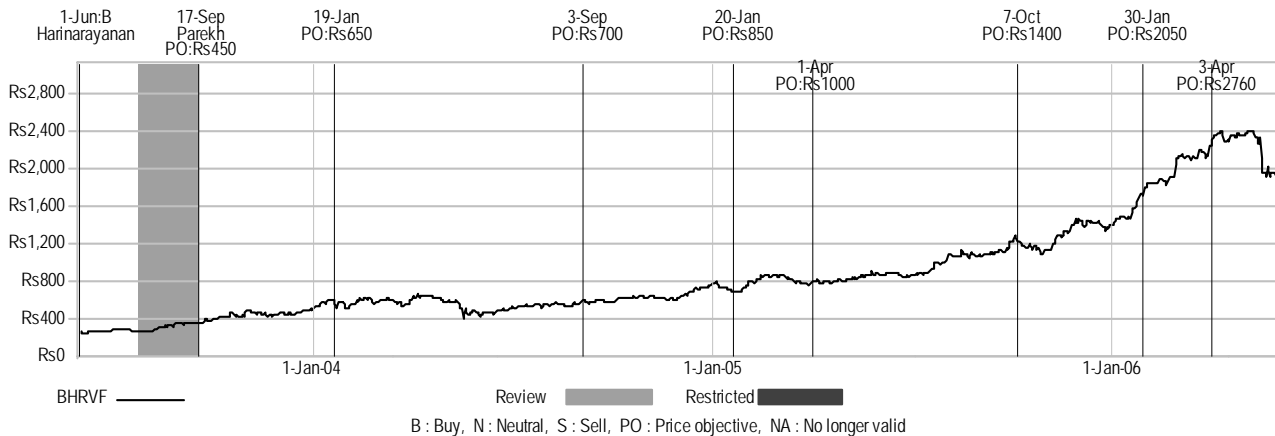
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ABVFF Price Chart



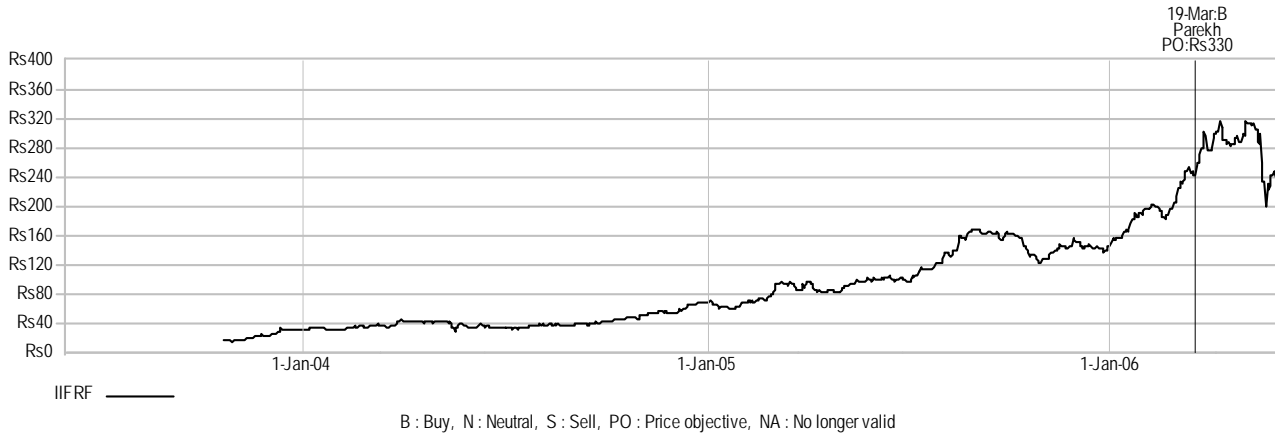
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BHRVF Price Chart



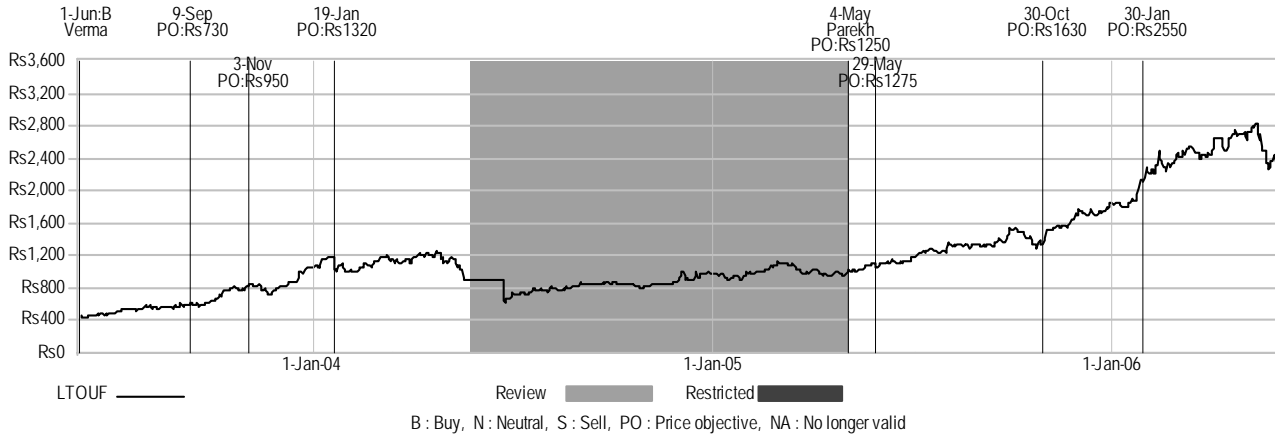
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IIFRF Price Chart



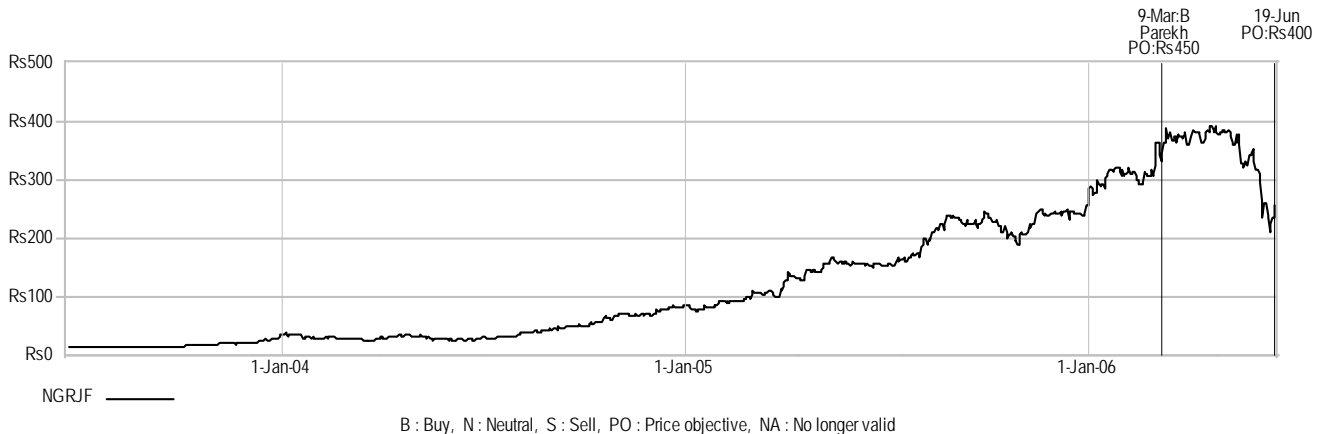
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LTOUF Price Chart



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NGRJF Price Chart



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Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	11	64.71%	Buy	4	36.36%
Neutral	6	35.29%	Neutral	1	16.67%
Sell	0	0.00%	Sell	0	0.00%

Investment Rating Distribution: Global Group (as of 31 Mar 2006)

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	1145	40.29%	Buy	393	34.32%
Neutral	1474	51.86%	Neutral	430	29.17%
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