Industrials
India Engineering

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India Engineering

Sept 08 results: A glass half full

- **Order inflow for engineering companies under coverage up 40% yoy and 7% qoq**
- **Order cancellation risk overplayed and positive impact of commodity prices on EBIDTA margins to be visible with a lag**
- **Continue to favour strong revenue visibility and balance sheet. Still OW(V) on BHEL, L&T and Thermax, UW(V) on ABB India, and N(V) on Thermax**

In this report, we update our sector view and reproduce our analysis of results for the latest quarter. We maintained estimates, target prices and ratings across the sector.

Business momentum: orders up 40% yoy but only 7% qoq. The India engineering sector was quite successful in 2QFY09 with order inflow up 40% yoy. We note the slowdown to 7% qoq, but order inflow still exceeds quarterly revenue, meaning increased revenue visibility. Company managements are still giving upbeat guidance. However, we would be slightly cautious on orders from the industrial sector. We continue to favour long-cycle capex like power/process.

Order cancellation risk overplayed. Most orders are backed by customer advances with financial closure already achieved. However, companies are tracking customer profiles and are slightly cautious before booking. We regard the risk of order cancellation from government projects (power, infrastructure) or large private sector firms as insignificant.

Lower commodity price benefits to be visible with a lag. Falling commodity prices will have more visible impact on margins of companies with a longer execution cycle (BHEL, L&T) but only post 4QFY09. However, at the same time, companies with a shorter execution cycle have recorded a decline in raw material to sales ratio.

Key data

Company	BBG code	Price (INR)	Rating	Target price	Pot'l rtn
ABB India	ABB IN	508	UW(V)	545	7.3%
BHEL	BHEL IN	1,389	OW(V)	1750	26.0%
L&T	LT IN	859	OW(V)	1250	45.5%
Punj Lloyd	PUNJ IN	199	OW(V)	247	24.2%
Thermax	TMX IN	329	N(V)	380	15.6%

Source: Bloomberg, HSBC. Prices as on 6 November 2008

10 November 2008

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Issuer of report: HSBC Securities and Capital Markets (India) Private Limited

Contents

Sector update

- Business momentum continues with strong orders (up 40%); lag effect of lower commodity prices visible (margins down 137bps)
- We prefer companies with strong balance sheet, high revenue visibility and exposure to long-cycle capex
- BHEL and L&T are our top picks in the sector

Business momentum

Orders up 40% yoy, 7% qoq – however, absolute order inflow number still higher than sales

In terms of new order inflow, the India engineering sector has been quite successful this year. The pace of order inflows continued to outstrip the absolute amount of quarterly revenue in 2QFY09, and the increase in orders improves revenue visibility. Order backlog for the companies under our coverage increased by 43% yoy at the end of 2QFY09, driven by 40% yoy growth in order inflow. However, order growth was muted on a qoq basis at 7% in 2QFY09.

Management outlook: At recent results briefings, company managements maintained upbeat guidance in terms of future visibility. Some management teams have made it clear that they are cautious about booking orders from private sector entities, given the financial uncertainty. State/central government orders are viewed as lower risk than private sector orders.

Exchange rate movements and concern about the cost of purchasing foreign equipment have helped companies like BHEL to attract private sector orders. However, BHEL has stated that it only books orders where it can see financial backing.

Our view: We continue to be positive on companies with exposure to long-cycle capex (like power and process) or government or large private sector projects. Companies in this category include BHEL and L&T, which are our top picks in the sector. We do not expect any near-term slowdown in order inflow to affect revenue growth given book-to-bill ratios of c3x.

Summary of September 2008 results

Growth (YoY)	L&T	BHEL	ABB	Thermax	Punj Lloyd	Overall
Order backlog	43%	43%	46%	26%	46%	43%
Order inflow	65%	1%	13%	149%	298%	39%
Sales	40%	35%	10%	3%	56%	35%
EBIDTA	37%	2%	0%	-7%	80%	21%
Margin	(23)	(423)	(120)	(117)	134	(137)
PAT	33%	12%	-9%	-33%	60%	17%

Source: Company, HSBC

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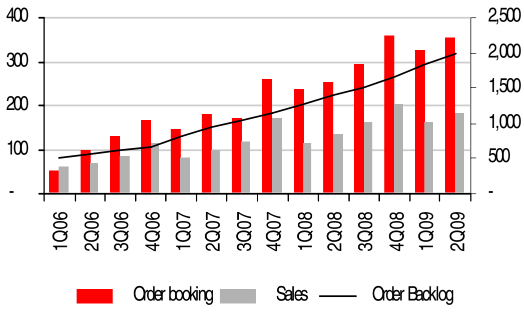
New order bookings still higher than sales (INRbn)

Source: Company, HSBC

Sales, order inflow and order backlog (RHS) (INRbn)



Source: Company, HSBC

We are slightly cautious about the outlook for order inflows from the industrial sector. We are also cautious on private sector projects that have yet to achieve financial closure. Such projects also face higher cost of funds which has an impact on overall profitability. A few infrastructure projects were bid for with commercial real estate attached. Given the weakness in the real estate market, these projects might face delays.

Order cancellation risk overplayed

Management outlook: Most orders are backed by customer advances with financial closure already achieved. All of the companies' managements stated that they do not expect any orders to be cancelled. However, they are cautious and noted that they track customer profiles and take a conservative approach to booking orders. Companies have retreated from segments where margins or payment have become a concern. ABB India has moved out of the Rural Electrification Project, citing lower margins.

Our view: We think the risk of order cancellation for players like BHEL is not significant, as their orders are backed by advances and are from government-backed entities. Historically, BHEL has not experienced significant order cancellations. However, projects where solid progress has not been made can be at risk of delay. The current uncertainty might impact projects that are still at the drawing board stage.

Impact of commodity prices: benefit comes with a lag

Management outlook: Most of the management teams maintained that they expect to be able to maintain their full year EBIDTA margins. This view is derived from the expectation that lower commodity prices and the price variation clause as well as operating leverage should help to support margins.

Our view: The positive impact of lower commodity prices on margins is visible with a lag effect for companies with a longer execution cycle (BHEL, L&T). We expect effects of the recent commodity price correction to be visible only post 4QFY09. However, at the same time, companies with a shorter execution cycle have seen their raw material to sales ratio decline.

We do not read much into the quarterly margin numbers because 30-35% of profit is booked in the last quarter. Also, for BHEL in FY10e the increase in staff cost will not be that significant since they have already provided for the required one-time wage increase.

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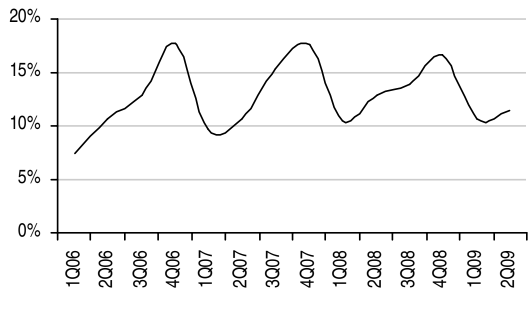
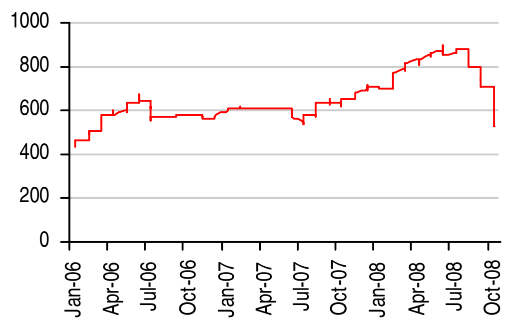
Engineering sector margin trend



Source: Company, HSBC

HR steel prices (USD/ton)



Source: Bloomberg, HSBC

Quarterly key financials

INRm	1Q08	2Q08	3Q08	4Q08	1Q09	2Q09	YoY
L&T							
Order backlog	416	440	496	527	582	630	43%
Order booking	98	75	130	120	122	125	65%
Sales	45.1	55.0	63.8	84.7	69.0	77	40%
EBIDTA	5.0	6.1	7.9	14.5	8.6	8	37%
% margin	11.1%	11.1%	12.4%	17.2%	12.4%	10.8%	(23)
PAT	2.9	3.5	4.8	9.7	5.0	5	33%
BHEL							
Order backlog	624	726	780	854	950	1,040	43%
Order booking	101	142	104	146	145	144	1%
Sales	32.3	39.7	49.6	72.0	43.3	53	35%
EBIDTA	3.1	7.0	10.0	14.0	3.7	7	2%
% margin	9.6%	17.5%	20.1%	19.5%	8.6%	13.3%	(423)
PAT	2.9	5.5	7.7	11.2	3.8	6	12%
ABB							
Order backlog	50	49	50	62	68	71	46%
Order booking	20	17	20	27	22	19	13%
Sales	14.0	13.8	18.4	15.4	16.2	15	10%
EBIDTA	1.6	1.7	2.6	1.7	1.9	1.7	0%
% margin	11.7%	12.5%	14.1%	11.3%	11.8%	11.3%	(120)
PAT	1.1	1.2	1.8	1.2	1.3	1.0	-9%
THERMAX							
Order backlog	31	32	29	26	28	43	32%
Order booking	7	9	7	7	9	23	156%
Sales	7.1	8.2	9.3	10.3	7.7	8.4	3%
EBIDTA	0.8	1.0	1.1	1.4	0.9	0.9	-14%
% margin	10.7%	12.8%	11.7%	13.2%	11.9%	10.7%	(205)
PAT	0.6	0.7	0.8	0.8	0.6	0.5	-33%
PUNJ LLOYD							
Order backlog	158	149	160	196	202	217	46%
Order booking	10.8	11.2	32.8	59.3	26	45	298%
Sales	13.9	18.9	21.2	23.5	26.5	29.5	56%
EBIDTA	1.2	1.7	1.0	2.5	2.1	3.0	80%
% margin	8.7%	8.8%	4.9%	10.6%	8.0%	10.1%	134
PAT	0.6	0.9	0.5	1.2	1.0	1.4	60%
Sector Average							
Order backlog	1,279	1,396	1,516	1,665	1,829	2,000	43%
Order booking	237	254	293	359	325	354	40%
Sales	112	136	162	206	163	183	35%
EBIDTA	12	17	23	34	17	21	20%
% margin	10.4%	12.9%	13.9%	16.6%	10.6%	11.5%	(141.47)
PAT	8	12	16	24	12	14	17%

Source: Company, HSBC

Flashnote

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Industrials
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ABB India

Reiterate UW and add V-flag: 3Q08 disappoints; cutting estimates and target price

- **3Q08 results disappoint: sales up 12% and PAT down 9%**
- **Shift in order mix to higher-execution orders and additional cost for ERP impacted revenue and margin**
- **Reducing our profit estimates by 8.5-9.7%, cutting TP to INR545 from INR890, adding V-flag to Underweight rating**

Underweight (V)

Target price (INR)	**545.00**
Share price (INR)	**587.40**
Potential total return (%)	**-7.2**

Performance	1M	3M	12M
Absolute (%)	-29.4	-36.1	-60.0
Relative^ (%)	-2.0	-2.2	-24.3

Index^	BOMBAY SE IDX
RIC	ABB.BO
Bloomberg	ABB IN
Market cap (USDm)	2,499
Market cap (INRm)	124,475
Enterprise value (INRm)	113,105
Free float (%)	48

Note: (V) = volatile (please see disclosure appendix)

3Q08 results disappoint: ABB India reported sales rose 12% yoy, driven by lower revenue growth from the power and automation division (revenue up +15% yoy). The order mix has shifted towards higher-execution cycle orders, and hence, the order-to-revenue conversion has been muted; as this moves forward, we expect execution to improve. The order inflow has been muted primarily because ABB India has withdrawn from Rural Electrification projects due to lower margin and high competition.

Margin impacted but should improve: The margin declined significantly, by 210bps yoy, due to higher staff and other expenses. The company booked additional costs related to SAP implementation in 3Q08 in other expenses, which we expect to decline going forward. Due to softer commodity prices, such declines should help ABB improve its margin from 4Q08e.

Change in estimates: We are reducing our estimates of revenue by 6-11% and of profit by 8.5-9.7% for 2008-10 to incorporate lower revenue growth due to a slowdown in future order inflow from the industrial automation division. We expect ABB India to report a 21% CAGR in revenue for2008-10, resulting in a 23% profit CAGR for the same period.

Valuation: We value ABB India using our MACC model. ABB is trading at a 330bps premium to the global sector median MACC value of 16.2%. It has traded at a significant premium to peers, given its strong EPS growth (48% CAGR from 2004-07) and improved RoE (21% in 2004 to c35% in 2007). However, we expect a 23% EPS CAGR for 2008-10 (50% reduction in the growth rate). Thus, the premium valuation should decline. We expect ABB to trade between its current MACC of 13.2-16.2%. Based on this, we derive a new target price of INR545, down from INR890. At our new target price, ABB would trade at 16x 2009e EPS. We are adding a volatility indicator to our Underweight rating.

ABB India: Key financials

(INRm)	Sales	EBIDTA	Margin	PAT	PE	EV/EBIDTA	RoE	Yield
2008e	68,764	8,538	12.4%	5754	21.6	13.3	30.6%	0.5%
2009e	83,732	10,477	12.5%	7182	17.3	10.5	29.4%	0.6%
2010e	100,479	12,556	12.5%	8772	14.2	8.3	27.9%	0.8%

Source: HSBC

27 October 2008

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ABB India: Summary financials

(INRm)	3Q08	3Q07	% y-o-y	9M08	% y-o-y
Sales	**15,562**	**13,875**	**12.2%**	**47,078**	**14.8%**
Raw materials	10,792	9,321	15.8%	32,778	14.7%
% of net sales	66.2%	67.1%		69.6%	
Personnel cost	1,018	788	29.2%	3,003	31.9%
% of net sales	6.5%	5.7%		6.4%	
Other expenses	1,715	1,333	28.6%	5,050	17.1%
% of net sales	11.0%	9.6%		10.7%	
EBITDA	**1,719**	**1,823**	**-5.7%**	**5,349**	**12.7%**
EBITDA margin %	**11.0%**	**13.1%**	**(209)**	**11.4%**	**(21)**
Interest	67	16	329.6%	103	113.4%
Depreciation	92	79		264	
Other Income	28	59	-52.2%	426	19.3%
PBT	1,588	1,787	-11.1%	5,408	12.4%
Net profit	**1,048**	**1,157**	**-9.4%**	**3,543**	**13.9%**
Net profit margin %	**6.7%**	**8.3%**	**(160)**	**7.5%**	**(6)**
Divisional performance					
Sales (gross)					
Power	10,029	8,751	14.6%	29,865	14.1%
Automation	6,643	5,779	14.9%	20,343	19.0%
EBIT					
Power	971	901	7.8%	2,939	10.8%
Automation	607	803	-24.4%	2,322	13.6%
EBIT margin %					
Power	9.7%	10.3%	(62)	9.8%	(29)
Automation	9.1%	13.9%	(475)	11.4%	(54)

Source: Company reports, HSBC estimates

Order book (1.2x CY07 revenue) mix shifting towards higher-execution cycle

The current order book stood at INR71.5bn (1.2x CY07 revenue), increased by order inflows of INR18.9bn in 3QCY08 (+13%). It has shifted towards higher-margin business and has been withdrawing from lower-margin Rural Electrification projects. Drivers of future order inflows are investment in T&D, as well as capex growth in industrials, including the automation business (oil and gas, metals and mining, cement, power generation, and paper and pulp). We expect ABB's export business to take off with the increased focus by the parent.

Shifting order mix profile: The order inflow has been muted primarily because ABB India has withdrawn from the Rural Electrification projects. As per management, these projects have lower margin and are highly competitive. Also, the company has been shifting its focus towards higher-execution cycle orders to provide better revenue visibility.

The company plans to continue its focus on new-business segments such as water, SEZ, ports, wind, railways, automobiles, and asset management. These new segments now contribute c10% to overall revenue. The company expects outsourcing from the parent to continue, with ABB India now the seventh-largest contributor to the parent company.

Investing in capacity building: The company maintains its focus on expansion plans to increase its manufacturing capacity by investing USD100m over the next two years, focusing on its Vadodara, Faridabad, and Bangalore facilities.

ABB India: Quarterly revenue and order details; book-to-bill above 1x revenue (INRbn)

Source: Company reports

Changes to our estimates

We are reducing our estimates of revenue by 6-11% and of profit by 8.5-9.7% for 2008-10 to incorporate lower revenue growth due to a slowdown in future order inflow from the industrial automation division. We are slightly reducing our 2008e margin, by 20bps; however, we are improving our margin expectations for 2009 and 2010. We expect ABB India to report a 21% CAGR in revenue for2008-10, resulting in a 23% profit CAGR for the same period.

ABB India: Changes to our estimates

(INRm)	Sales			EBITDA			Margin			PAT		
	New	Old	% change	New	Old	% change	New	Old	Change (bps)	New	Old	% change
2008e	68,764	73,606	-6.6%	8,538	9,283	-8.0%	12.4%	12.6%	(20)	5,754	6,369	-9.7%
2009e	83,732	91,059	-8.0%	10,477	11,370	-7.9%	12.5%	12.5%	3	7,182	7,852	-8.5%
2010e	100,479	113,214	-11.2%	12,556	13,838	-9.3%	12.5%	12.2%	27	8,772	9,713	-9.7%

Source: HSBC

Valuation

We use our global industrial valuation model called Market Assessed Cost of Capital. The MACC model seeks to overcome some of the shortcomings of the capital asset pricing model (CAPM) for assessing a stock's cost of capital. In our computational methodology, our MACC framework follows four basic stages, using cash returns on investment (CROIC) as the key return measure: i) calculating key inputs, comprising gross cash invested (GCI) and CROIC; ii) determining a growth rate consistent with our three-year financial forecasts; iii) calculating MACC (via iterations); and iv) comparing the derived current MACC value with historical MACC values and with current peer MACC values.

We value ABB India using our MACC model. ABB is trading at a 330bps premium to the global sector median MACC value of 16.2%. It has been trading at a significant premium to its peers, given its strong EPS growth (48% CAGR from 2004-07) and improved RoE (21% in 2004 to c35% in 2007). However, we expect a 23% CAGR in EPS for 2008-10 (50% reduction in the growth rate). Thus, we expect that the premium valuation will decline. We expect ABB to trade between its current MACC of 13.2-16.2%.

Based on this, we derive a new 12-month target price of INR545. We are lowering our target price from INR890. At our new target price, ABB would be trading at 16x 2009e EPS. We also are adding a volatility indicator to our rating.

Under our research model, for stocks with a volatility indicator, the Neutral band is 10ppt around our hurdle rate for Indian stocks of 11%. This translates into a Neutral band of 1% to 21% around the current share price. Our new target price of INR545 suggests a potential total return of minus-7.2% from the closing price on 24 October 2008, and this is below the Neutral band; therefore, we are reiterating our Underweight rating but adding a volatility flag to this rating. Volatile ratings are defined as stocks having historical volatility (defined as the past month's average of the daily 365-day moving average volatilities) of over 40%. As at 23 October, ABB India scored 43.07% on this measure.

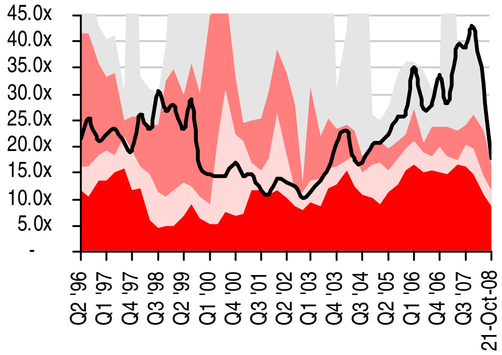
Key risks

The key upside risks that we see to our Underweight (V) view are a higher level of outsourcing from the company's global parent, ABB; a possible buyback of the minority shareholding by the parent, and prudent acquisitions that could help the company generate higher returns.

Business risk

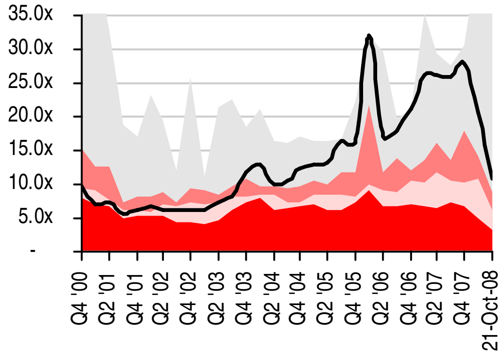
The company is likely to face competition from domestic and international players, we believe. Besides this, it derives 60% of its business from the power sector, which is highly dependent on power reforms. Any delay in these would affect business momentum. It also runs a risk in terms of any potential delay in execution or slowdown in the parent's business.

ABB India: PE vs. global power tech peers



Source: Company reports, Bloomberg, HSBC

ABB India: EV/EBIDTA vs. global power tech peers



Source: Company reports, Bloomberg, HSBC

Financials & valuation

Financial statements

Year to	12/2007a	12/2008e	12/2009e	12/2010e
Profit & loss summary (INRm)				
Revenue	59,303	68,764	83,732	100,479
EBITDA	7,246	8,538	10,477	12,556
Depreciation & amortisation	-324	-373	-510	-537
Operating profit/EBIT	6,922	8,165	9,967	12,018
Net interest	642	423	752	1,074
PBT	7,565	8,588	10,719	13,092
HSBC PBT	7,565	8,588	10,719	13,092
Taxation	-2,648	-2,834	-3,537	-4,320
Net profit	4,917	5,754	7,182	8,772
HSBC net profit	4,917	5,754	7,182	8,772
Cash flow summary (INRm)				
Cash flow from operations	3,139	5,914	6,625	7,510
Capex	-1,585	-941	-1,500	-500
Cash flow from investment	-1,516	-1,091	-1,650	-651
Dividends	-535	-730	-852	-1,095
Change in net debt	-974	-4,093	-4,123	-9,888
FCF equity	1,554	4,973	5,125	7,010
Balance sheet summary (INRm)				
Intangible fixed assets	0	0	0	0
Tangible fixed assets	4,579	5,146	6,137	6,099
Current assets	41,107	45,369	57,079	71,331
Cash & others	6,429	10,516	14,639	20,404
Total assets	46,390	51,370	64,220	78,586
Operating liabilities	29,993	29,955	36,475	43,165
Gross debt	6	0	0	0
Net debt	-6,423	-10,516	-14,639	-20,404
Shareholders funds	16,263	21,287	27,617	35,293
Invested capital	9,264	10,045	12,101	13,862

Ratio, growth and per share analysis

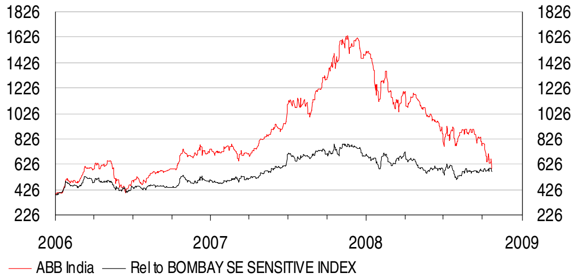
Year to	12/2007a	12/2008e	12/2009e	12/2010e
Y-o-y % change				
Revenue	38.8	16.0	21.8	46.1
EBITDA	52.0	17.8	22.7	47.1
Operating profit	53.8	18.0	22.1	47.2
PBT	44.6	13.5	24.8	52.4
HSBC EPS	44.5	17.0	24.8	52.4
Ratios (%)				
Revenue/IC (x)	7.8	7.1	7.6	7.7
ROIC	59.3	56.7	60.3	62.0
ROE	34.8	30.6	29.4	27.9
ROA	12.6	12.0	12.6	12.5
EBITDA margin	12.2	12.4	12.5	12.5
Operating profit margin	11.7	11.9	11.9	12.0
EBITDA/net interest (x)				
Net debt/equity	-39.5	-49.4	-53.0	-57.8
Net debt/EBITDA (x)	-0.9	-1.2	-1.4	-1.6
CF from operations/net debt				
Per share data (INR)				
EPS reported (fully diluted)	23.20	27.15	33.89	41.39
HSBC EPS (fully diluted)	23.20	27.15	33.89	41.39
DPS	2.20	3.00	3.50	4.50
Book value	76.75	100.45	130.32	166.55

Valuation data

Year to	12/2007a	12/2008e	12/2009e	12/2010e
EV/sales	2.0	1.6	1.3	1.0
EV/EBITDA	16.2	13.2	10.4	8.2
EV/IC	12.7	11.3	9.0	7.4
PE*	25.3	21.6	17.3	14.2
P/Book value	7.7	5.8	4.5	3.5
FCF yield (%)	1.3	4.0	4.2	5.7
Dividend yield (%)	0.4	0.5	0.6	0.8

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

Price relative



Source: HSBC

Note: price at close of 23 Oct 2008

Flashnote

HSBC Global Research

Industrials
Electrical Equipment
Equity – India

BHEL

Overweight (V)

Target price (INR)	**1750.00**
Share price (INR)	**1172.55**
Potential total return (%)	**49.2**

Performance	**1M**	**3M**	**12M**
Absolute (%)	-27.9	-33.9	-48.9
Relative^ (%)	0.1	1.1	-3.3

Index^	BOMBAY SE IDX
RIC	BHEL.BO
Bloomberg	BHEL IN
Market cap (USDm)	11,522
Market cap (INRm)	573,987
Enterprise value (INRm)	490,995
Free float (%)	32

Note: (V) = volatile (please see disclosure appendix)

Reiterate OW(V): Outlook still positive

- **2Q09 result lays to rest execution issues with sales up 35%, recurring PAT growth of 17%**
- **Subsiding cost pressure and long-term visibility provide a strong future outlook**
- **We continue to be positive on BHEL's long-term prospects, but adjust our target price to INR1750 from INR2300 due to lower global sector valuation. Reiterate OW(V) rating**

2Q09 results. Revenue increased 35% yoy to INR53.4bn driven by strong execution in the power division. This clearly indicates concern about execution risk is misplaced. The management has increased revenue guidance to 25-30% growth in FY09. The EBITDA margin declined by 420bps on account of the lagged effect of higher commodity prices and staff provisioning. We expect cost pressure to subside in FY10e given lower commodity prices as well as lower staff cost inflation.

Outlook remains positive. We think the outlook for BHEL remains strong due to 1) strong order backlog of INR1tr, c4.8x trailing 2-month revenue; 2) strong new order pipeline for 12^{th} plan; 3) risk to order cancellation not significant due to orders from state and central utilities and customer advances received against these orders; 4) favourable forex rate has reduced overseas competition; 5) capacity expansion to cater to growth; 6) cost pressure to reduce in FY10e given lower commodity prices as well as no wage provision; 7) new business segments like gas turbine to add to growth; 8) JV with entities to explore opportunities in nuclear power plant, super critical thermal projects, locomotive business.

Valuation. We maintain our FY09e and FY10e estimates. Based on our MACC model, BHEL is currently trading at a discount to its global sector median MACC value of 16.2%. We expect BHEL to trade at a premium given its positive outlook, higher margin, and higher RoE. We expect BHEL to trade at 0-400bps premium to sector median MACC. Based on this, we derive a new target price of INR1750 (earlier INR2300). The reduction in target price is primarily due to declining sector valuation multiple (i.e., 1-year forward sector PE reduced to 10x from 14x). Reiterate our Overweight (V) rating.

BHEL key financials (INRmn)

	Revenue	EBIDTA	EBITDA Margin	PAT	P/E	EV/EBITDA	RoE
FY08	197269	45197	22.9%	28594	20.3	11.0	27%
FY09e	275705	57257	20.8%	41639	14.0	8.1	30%
FY10e	354159	74707	21.1%	54888	10.6	6.2	31%

Source: Company, HSBC

27 October 2008

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HSBC

2QFY09: Positive results, maintain outlook for FY09e

2Q revenue up 35%, PAT up 12% year-on-year

BHEL declared its 2QFY09 results with revenue increasing to INR53.4bn (+35%), driven by strong execution during the quarter. EBITDA margin declined by 420bps on account of higher commodity prices and increase in staff costs. The recent correction in commodity prices will be visible with a lag in 4Q09 or FY10e, since the company holds inventory of c90 days and prices have firmed up for a period of 2-3 months. The rise in staff costs includes provisioning of INR2.2bn on account of wage revision (full year FY09 is INR13.1bn).

BHEL – Key financial summary

INRmn	2Q09	2Q08	Y-o-Y	1Q09
Net sales	53,426	39,654	34.7%	43,293
(Incr)/ Dec in stock-in-trade	(4,400)	(3,798)	15.9%	144
Raw materials	36,212	25,435	42.4%	25,178
% of net sales	59.5%	54.6%		58.5%
Staff cost	8,898	6,296	41.3%	8,953
% of net sales	16.7%	15.9%		20.7%
Other exp.	5,609	4,769	17.6%	5,280
% of net sales	10.5%	12.0%		12.2%
EBITDA	7,107	6,952	2.2%	3,739
EBITDA margin %	13.3%	17.5%		8.6%
Depreciation	743	694	7.1%	726
EBIT	6,364	6,258	1.7%	3,013
Interest	22	193	-88.6%	26
Other income	3,072	5,009	-38.7%	2,917
PBT	9,414	11,074	-15.0%	5,905
Tax	3,256	4,196	-22.4%	2,059
Reported PAT	6,158	6,878	-10.5%	3,846
Recurring PAT	6,158	5,263	17%	3,846

Source: Company, HSBC

Business fundamentals continue to improve

Order flow remains strong

The company's order book stood at INR1040bn (4.8x trailing 12 months net sales) propelled by continued strong momentum in order inflows of INR143.5bn during the quarter (INR145bn in 1Q09), achieving c58% of order inflow guidance of INR500bn for FY09 by the company. This is in spite of most of the 11th plan orders already having been awarded, clearly indicating that order inflow continues to be higher than sales. Also, this order intake does not include the expected negotiated order from NTPC to domestic equipment manufacturers. BHEL is expected to receive orders from its JVs with various state utilities in FY10e.

Low risk of cancellation of existing order backlog

BHEL's major customers are central utilities (NTPC, DVC etc) and state utilities. The central utilities like NTPC have strong balance sheet size. As regards state utilities, they are funded through state budgets. BHEL is paid a 10% customer advance, hence, any cancellation is not a significant risk. In the past, there have been no instances of order cancellation as well. Also in the case of private players, BHEL's market share is only around 15%, where the company does not foresee any risk of cancellation. However, financial closure might be a risk for private players. Further, it has not booked projects from players where only partial customer advance has been received.

Insignificant risk from delayed supply of balance of plant equipment

BHEL's customers are experiencing some delays in execution and installation of power plants on account of delay in supply of critical balance of plant (BoP) equipment from sub contractors/ manufacturers. However, the management feels that the risk is insignificant because 85% of revenue is derived from supply of equipment that is not impacted by these BoP delays. It is the EPC revenue (15% of total) that might get delayed by any delay from BoP equipment suppliers.

Currency movement favourable to reduce overseas competition

The recent depreciation of the rupee against major currencies including the USD has made BHEL competitive in the domestic market. (INR has depreciated against USD by 22% since April 08) as against imported equipment. At present, BHEL offers c5% discount to match overseas competitor prices.

Favourable working capital cycle

There has been a significant reduction in the working capital cycle of BHEL, with the net working capital cycle reduced to c100 days vs 200 days in FY03. The company has a cash balance of INR90bn, primarily due to customer advance of INR113bn (13% of FY08 order backlog, up from 9.1%).

Cost pressure to reduce from FY10e

In FY09, BHEL is exposed to the lagged effect of higher commodity prices as well as provisioning for wage increases required by the 6th Pay Commission. We expect that BHEL will derive twin benefits of lower commodity prices as well lower staff cost increases (due to no additional wage provision) in FY10e. The management has indicated that their staff costs will increase by c10% only, accounting for manpower as well as salary increase.

Future growth drivers

New business segments: BHEL is expanding its smaller business segments like gas turbine as well as spares business along with its core coal-based power equipment business. Order inflow from the gas turbine business for 1HCY 2008 was up 300%.

JVs for future growth:

- BHEL has entered into a 50:50 JV with NTPC to take up EPC contracts and later on manufacturing of power equipments. BHEL and NTPC each will be awarding two project management and EPC contracts to this subsidiary to start with. As regard to power equipment manufacturing it would be only after 2014.
- Plans to venture into forgings and castings with an investment of about INR15bn. It has signed an agreement with Heavy Engineering Corporation Ltd. for supply of Castings and Forgings to ease the supply of critical input material for manufacture of Power Plant Equipment.
- BHEL and NPCIL to float a JV company to carry out EPC activities for nuclear power plants both within the country and outside.
- BHEL and GE Transportation have entered into a JV to acquire the locomotive manufacturing bid of Indian Railways (to manufacture and deliver 1,000 diesel locomotives to the Indian Railways).

- It has formed separate JVs (26% stake owned by BHEL) with state utilities like Tamilnadu, Gujarat and Maharashtra to set up supercritical power projects in respective states. These JVs provide BHEL assured equipment order supply as well as helping BHEL to improve utilisation of surplus cash on its balance sheet.

Capacity ramp up: BHEL is planning to ramp up capacity addition from 10,000MW to 15,000MW by December 2009 at a cost of cINR42bn and further expanding it to 20,000MW by December 2010 at a cost of INR48bn, mostly in thermal power generation.

A "long cycle" capex company

Power equipment manufacturer orders are driven by sovereign and large utilities, making them part of the "long capex" cycle sector, unlike "short cycle" sectors such as manufacturing, process plants, and construction. "Long cycle" capex has relatively few links to the overall economic cycle. BHEL derives more than 90% of its investment from the "long capex" cycle. Valuation tends to increase as this percentage rises.

The recent series of orders has eased concerns about increased competition and provided good visibility. The current order backlog of INR1040bn should help BHEL to sustain revenue growth. Also, capacity additions, to 15GW by 2009 and 20GW by 2012, should help BHEL to execute its current order backlog and drive revenue growth. We expect BHEL to report an EPS CAGR of 36.1% over FY08-10e.

Valuation

BHEL is currently trading on FY10e EV/EBITDA of 6.2x and FY10e PE of 10.6x. However, the momentum of Indian power technology market growth remains strong, and BHEL is the main beneficiary. BHEL's success in supercritical projects also provides visibility for future growth prospects. Hence, we believe that BHEL should trade at a premium to its global peers. The focus on the power sector over the last two years, BHEL's success rate in winning significant new orders, and its success thus far in entering the supercritical segment, providing higher visibility post-FY10, should help it maintain its premium valuation.

We use our proprietary market assessed cost of capital (MACC) valuation methodology to value BHEL shares. Our MACC framework follows four basic stages, using cash returns on invested capital (CROIC) as the key return measure: (1) calculating key inputs, comprising gross cash invested (GCI) and CROIC; (2) determining a growth rate consistent with our three-year financial forecasts; (3) calculating MACC (via iterations); and (4) comparing the derived current MACC value with historical MACC values and with current peer MACC values.

Based on our MACC model, BHEL is currently trading at a discount to its global sector median MACC value of 16.2%. We expect BHEL to trade at 0-400bps premium to sector median MACC. Based on this, we derive a new target price of INR1750 (earlier INR2300). The reduction in target price is primarily due to declining sector valuation multiple (i.e., 1-year forward sector PE reduced to 10x from 14x). We reiterate our Overweight (V) rating.

Key risks

Potential downside risks include execution risk, a slowdown in power reforms, manpower and raw material shortage risks, rising interest rate risk, and a possible backward integration of its key customer.

HSBC

Financials & valuation

Financial statements

Year to	03/2007a	03/2008e	03/2009e	03/2010e
Profit & loss summary (INRm)				
Revenue	174,203	197,269	275,705	354,159
EBITDA	37,770	45,197	57,257	74,707
Depreciation & amortisation	-2,730	-2,972	-3,324	-4,284
Operating profit/EBIT	35,040	42,225	53,933	70,423
Net interest	4,035	9,871	8,681	12,115
PBT	37,359	44,304	62,615	82,538
HSBC PBT	37,359	44,304	62,615	82,538
Taxation	-13,214	-15,711	-20,976	-27,650
Net profit	24,146	28,594	41,639	54,888
HSBC net profit	25,861	36,385	41,639	54,888
Cash flow summary (INRm)				
Cash flow from operations	37,291	44,939	56,654	26,483
Capex	-3,974	-6,452	-8,670	-15,000
Cash flow from investment	-3,974	-6,452	-8,680	-15,010
Dividends	-6,925	-8,734	-12,600	-14,318
Change in net debt	-21,427	-25,724	-35,374	2,845
FCF equity	35,032	46,278	47,984	11,483
Balance sheet summary (INRm)				
Intangible fixed assets	0	0	0	0
Tangible fixed assets	12,913	16,393	21,739	32,455
Current assets	210,618	277,047	360,410	424,898
Cash & others	58,077	83,860	118,482	115,637
Total assets	232,965	306,902	395,621	470,835
Operating liabilities	144,189	198,208	258,640	293,285
Gross debt	893	952	200	200
Net debt	-57,184	-82,908	-118,282	-115,437
Shareholders funds	87,883	107,742	136,781	177,350
Invested capital	21,265	11,372	5,026	48,431

Ratio, growth and per share analysis

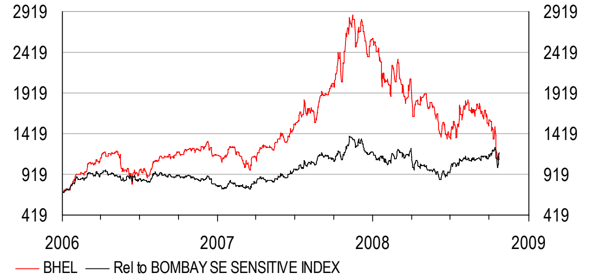
Year to	03/2007a	03/2008e	03/2009e	03/2010e
Y-o-y % change				
Revenue	29.0	13.2	39.8	28.5
EBITDA	31.7	19.7	26.7	30.5
Operating profit	33.6	20.5	27.7	30.6
PBT	45.7	18.6	41.3	31.8
HSBC EPS	32.1	40.7	14.4	31.8
Ratios (%)				
Revenue/IC (x)	6.7	12.1	33.6	13.2
ROIC	87.6	167.0	437.4	175.2
ROE	32.1	37.2	34.1	34.9
ROA	11.8	10.7	11.9	12.7
EBITDA margin	21.7	22.9	20.8	21.1
Operating profit margin	20.1	21.4	19.6	19.9
Net debt/equity	-65.1	-77.0	-86.5	-65.1
Net debt/EBITDA (x)	-1.5	-1.8	-2.1	-1.5
Per share data (INR)				
EPS reported (fully diluted)	49.32	58.41	85.06	112.13
HSBC EPS (fully diluted)	52.83	74.33	85.06	112.13
DPS	12.25	15.25	22.00	25.00
Book value	179.53	220.10	279.42	362.29

Valuation data

Year to	03/2007a	03/2008e	03/2009e	03/2010e
EV/sales	3.0	2.5	1.7	1.3
EV/EBITDA	13.7	10.9	8.0	6.1
EV/IC	24.3	43.2	90.6	9.5
PE*	22.2	15.8	13.8	10.5
P/Book value	6.5	5.3	4.2	3.2
FCF yield (%)	6.1	8.1	8.4	2.0
Dividend yield (%)	1.0	1.3	1.9	2.1

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

Price relative



Source: HSBC

Note: price at close of 23 Oct 2008

Flashnote

HSBC Global Research

Industrials
Construction & Engineering
Equity – India

Larsen & Toubro (LART)

Overweight (V)

Target price (INR)	**1250**
Share price (INR)	**896**
Potential total return (%)	**40**

Performance	1M	3M	12M
Absolute (%)	-29.5	-21.4	-47.6
Relative^ (%)	-11.8	-7.8	-7.6

Index^	BOMBAY SE IDX
RIC	LART.BO
Bloomberg	LT IN
Market cap (USDm)	10,799
Market cap (INRm)	524,091
Enterprise value (INRm)	516903
Free float (%)	96

Note: (V) = volatile (please see disclosure appendix)

16 October 2008

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Reiterate OW(V): Lowering target; 2Q09 margin impact, guidance intact

- **2Q09 results in line, with sales up 40% and PAT up 33%**
- **Margins impacted marginally; company maintains its guidance**
- **Maintaining our estimates, reducing our target to INR1,250 from INR1,652 due to lower global sector valuation**

2Q09 results: L&T reported in-line numbers for 2Q09, with sales up 40% yoy to INR76.8bn and net profit up 33% to INR4.6bn. EBIDTA margin declined 20bps considering forex translation losses. The order book stood at INR630bn (2.6x FY08 revenue), driven by new order inflow of INR124bn, up 45% yoy.

Order inflow mix to change: L&T has been a significant beneficiary of industrial as well as oil and gas capex in the last 2-3 years. In 2Q09, it received a significant order from the metal and construction space. We expect new verticals such as power, railways, and the international market to dominate the order inflow mix going forward.

EBIDTA margin conundrum: L&T changed its accounting methodology and had accounted for the transaction forex losses as expenditures, above operating income. It has restated its 2Q08 numbers. It incurred INR900m and INR590m of losses for 2Q08 and 2Q09, respectively. Hence, the margin on a like-to-like basis was down 20bps, including forex losses. It incurred cINR300m for the new business segment, such as power and railways.

Valuation: We maintain our FY09e and FY10e estimates. Based on our MACC model, L&T is trading at a 330bps premium over its global-sector median MACC value of 16.2%. The sector median MACC in the last three months has increased to 16.2% from 13.2%, on the declining valuation multiple (i.e., 1-year forward sector PE reduced to 10x from 14x). We expect L&T will continue to trade at a premium to the global average; however, the absolute value will be lower. Hence, we are reducing our core L&T standalone value to INR987 based on a 200-400bps premium to the sector-median MACC value. At our new target price, L&T trades at 15.8x FY10e (vs 21.4x earlier). We also are reducing L&T subsidiaries' value to INR263 per share from INR314 to incorporate a lower relative valuation multiple. Based on this, we derive our new target price of INR1,250 (from INR1,652).

Larsen & Toubro: Key financial summary, standalone basis

(INRm)	Sales	EBIDTA	Margin	PAT	EPS growth	PE*	EV/EBIDTA*	RoE
FY09e	323,625	36,360	11.2%	27,071	37.3%	13.6	9.6	23.4%
FY10e	426,577	49,224	11.5%	36,523	34.8%	10.1	7.0	25.3%

Source: HSBC estimates, *Excluding the value of subsidiaries

HSBC

2Q09 margin impact, management maintains FY09 guidance

Sales up 40%, driven by robust order book, while recurring PAT up 32%

Larsen & Toubro (L&T) reported results, with sales up 40% on the back of a robust order book (2Q08 – INR630bn, 2.4x revenue), driven by revenue growth in the engineering and construction (E&C) division (+45% yoy). Growth in other divisions remained flat at 12-17% yoy.

Margin impacted marginally; management expects margin to be maintained

L&T changed its accounting policy and had started booking transaction losses and operating expenses. This resulted in restatement of its 2Q08 numbers. It booked INR900m and INR590m of losses for 2Q08 and 2Q09, respectively.

Larsen & Toubro: Restated EBITDA

(INRbn)	1H09	1H08	Chg (bps)	2Q09	2Q08	Chg (bps)
Net sales including other operational income	145.91	100.08		76.86	55.02	
EBITDA	13.55	10.12		6.77	4.97	
EBITDA margins	9.3%	10.1%	(82.54)	8.8%	9.0%	(22.49)
Exchange gain/(loss)	(0.41)	0.00		(0.59)	(0.90)	
EBITDA margins excluding exchange loss	9.6%	10.1%	(54.44)	9.6%	10.7%	(109.30)

Source: Company data

The margin was impacted due to lower contribution from the electrical business, which has been impacted due to lower capacity utilisation and higher input prices.

Larsen & Toubro: Segmental EBITDA margins

(%)	Q209	Q208	Chg(bps)	1H09	1H08	Chg (bps)
Engineering & Construction	11.5%	11.5%	—	11.0%	10.6%	40
Electrical & Electronics	12.8%	18.4%	(560)	13.2%	17.6%	(440)
Machinery & Industrial Products	21.2%	15.8%	540	22.8%	18.5%	430

Source: Company data

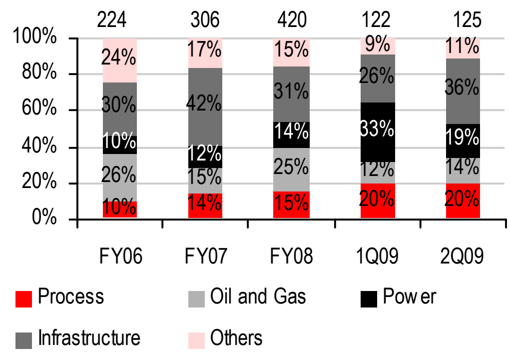
Larsen & Toubro: Results summary

(INRm)	2QFY09	2QFY08 (Restated)	YoY
Net sales	76,864	55,021	39.7%
Total expenditure	(70,095)	(50,049)	40.1%
EBITDA	6,768	4,972	36.1%
EBITDA margin	8.8%	9.0%	
D&A	(731)	(483)	51.2%
EBIT	6,038	4,489	34.5%
EBIT margin	7.9%	8.2%	
Interest	(690)	(132)	421.1%
Other income	1,559	1,124	38.7%
PBT	6,907	5,481	26.0%
total tax	(2,304)	(2,001)	15.2%
Tax rate	33.4%	36.5%	
Recurring PAT	4,603	3,480	32.3%
PAT margin	6.0%	6.3%	

Source: Company data

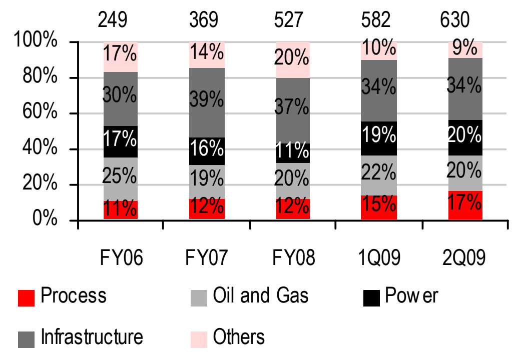
Management indicated that c70% of the current order book has a price variation clause, and back to back subcontracting should help in sustaining margins, despite volatile commodity prices. Further, the order inflows in 2H08 in higher-margin segments like oil & gas (20%) and process (17%) should help to

Shift toward better margin order inflows (INRbn)



Source: Company data

Better margin order backlog to help at operating level (INRbn)



Source: Company data

maintain margins. Management during the analyst call maintained its 30-35% revenue growth target for FY09, driven by the existing order backlog and growth in order inflows of 30%.

Robust order book (2.6x FY08 revenue), coupled with growing order inflow, offers visibility for FY09 and beyond

The strong increase in order flow of INR125bn (+74%) during the quarter, despite concerns about a slowdown, propelled L&T's order book to INR630bn (2.34x FY08 revenue), continuing the strong momentum and providing visibility of sales for our FY09 and FY10 growth estimates of 31.7% and 31.8%, respectively. The order inflows were driven primarily by the buildings & factories segment (INR50bn, 40% of order inflow) and metal & mining segment (21% of the order inflow), while growth in order inflows in the oil & gas sector remained muted. According to management, order flow from oil & gas is likely to be robust in 2HFY09. We expect new verticals such as power, railways, and the international market to dominate the order inflow mix.

Larsen & Toubro: Order inflow breakdown by industry

(INRm)	1QFY08	2QFY08	3QFY08	4QFY08	1QFY09	2QFY09
Steel/Zinc	800	32,374	3,550	11,070	27,500	26,840
Power	3,290	6,585	4,309	13,332	31,710	4,460
Oil & Gas	8,770	15,200	6,930	13,247	7,260	6,400
Road	—	—	2,870	—	6,000	—
Water	1,992	5,270	—	—	6,350	—
Coal	—	—	—	1,700	3,300	—
Petrochemicals	—	—	2,400	22,710	—	—
Construction	5,660	—	60,078	50,299	—	50,000
Shipping	—	2,800	9,780	—	—	—
Rail	—	2,030	1,403	—	—	—
Process	2,091	—	—	—	—	—
Chemicals	—	770	—	—	—	—
Others(not announced)	41,890	75,397	10,441	38,871	7,393	16,300

Source: Company data

Growth driver post 2010e

L&T has been reorganising its business with the formation of new verticals to focus on key sectors. It has formed verticals to cater to railways, hydrocarbon, power equipment manufacturing, shipbuilding, and others. We expect the power equipment venture to start production by 2010. It has acquired a mediumvoltage manufacturing business to complement its low-voltage electrical business. It has formed a JV with Gulf Interstate Engineering Co. to provide engineering and project management services to the hydrocarbon pipeline industry. It is setting up another greenfield fabrication facility in Oman, which will cater to manufacturing of equipment for petrochemical and fertiliser projects.

Valuation and risks

We value L&T's core business using our global industrial valuation model called Market Assessed Cost of Capital (MACC). The MACC model seeks to overcome some of the shortcomings of the capital asset pricing model (CAPM) for assessing a stock's cost of capital.

Computational methodology: Our MACC framework follows four basic stages, using cash returns on investment (CROIC) as the key return measure: i) calculating key inputs, comprising gross cash invested (GCI) and CROIC; ii) determining a growth rate consistent with our three-year financial forecasts; iii) calculating MACC (via iterations); and iv) comparing the derived current MACC value with historical MACC values and with current peer MACC values. Based on our MACC model, L&T is trading at a 330bps premium to its global-sector median MACC value of 16.2%. The sector-median MACC in the last three months increased to 16.2% from 13.2%, indicating the declining valuation multiple (i.e., 1-year forward sector PE reduced to 10x from 14x). We believe that given the current scenario, although L&T should continue to trade at a premium to the global average, the absolute value will be lower. Hence, we are reducing our core L&T standalone value to INR987m from INR1,338m based on 200-400bps premium to sector median MACC value. We are reducing the value of L&T subsidiaries to INR263 per share from INR314 to incorporate a lower relative valuation multiple. The major decline in the subsidiaries' value has been due to a lower multiple for the Infotech and financial business. Based on this, we derive our new target price of INR1,250, down from INR1,652. At our new target price, L&T trades at 15.8x FY10e (vs 21.4x earlier). Under our research model, for stocks with a volatility indicator, the Neutral band is 10ppts above and below our hurdle rate for Indian stocks of 11%. Our new target price suggests a potential total return of 40%; thus, we reiterate our Overweight (V) rating on L&T shares.

Larsen & Toubro: SOTP (per share value INR)

Part	New basis	New value	Basis	Old value
Core company valuation	MACC methodology - CROIC 8.4%-9.5%, MACC 12.2-14.2%	987	MACC methodology – CFROI 8.4%-9.4%, MACC 8.0-9.5%	1338
Key subsidiaries				
Services				
L&T Infotech	8x FY09E PER (in line with mid size company)	41	14x FY09e PE (in line with midsize company)	70
L&T Finance	8x FY09E PER (in line with mid size company)	29	12x FY09e PE (in line with midsize company)	33
L&T Infrastructure finance	1x equity investment	9	2x equity investment	18
Power subsidiaries				
India Infra Developer Ltd	12x FY06 PAT	1	12x FY06 PAT	6
Power JV with Mitsubishi	1.5x equity investment	8	2.5x equity investment	11
Infrastructure SPV				
L&T IDPL	At 30% premium to the private-equity deal valuation	91	At 25% premium to the private-equity deal valuation	91
Other subsidiaries	2X book value	2	At 2.5x book value	3
Associates				
Ultratech Cement	At our target price of INR636 per share	16	At current market price	32
Other associates	2.5x investments made	4	2.5x investments made	4
Manufacturing JV				
JVs	2.5x investments made	1	2.5x investments made	1
Cash & cash equivalents		62		40
Total		1250		1652

Source: HSBC estimates

Among downside risks that we see: Execution of projects in the order book will be very important, as any delay could hit profitability. Significant increases in prices of raw materials (e.g., cement, steel) could hurt near-term earnings. A change in government (general elections are due in H109) may result in policy changes, which may adversely affect the infrastructure sector, as could rising interest rates and commodity prices.

Financials & valuation

Financial statements

Year to	03/2007a	03/2008e	03/2009e	03/2010e
Profit & loss summary (INRm)				
Revenue	174,996	247,865	323,625	426,577
EBITDA	16,673	27,464	36,360	49,224
Depreciation & amortisation	-1,700	-2,116	-2,857	-3,369
Operating profit/EBIT	14,973	25,348	33,503	45,855
Net interest	-339	-382	-593	-595
PBT	18,673	29,769	38,672	52,176
HSBC PBT	18,673	29,769	38,672	52,176
Taxation	-6,022	-9,821	-11,602	-15,653
Net profit	12,651	19,949	27,071	36,523
HSBC net profit	12,651	19,949	27,071	36,523
Cash flow summary (INRm)				
Cash flow from operations	19,762	20,017	23,581	35,010
Capex	-7,915	-16,344	-4,707	-7,500
Cash flow from investment	-15,583	-26,110	-17,207	-20,000
Dividends	-4,216	-5,716	-5,701	-7,692
Change in net debt	-2,818	-12,055	122	-7,319
FCF equity	8,178	-1,129	13,111	20,594
Balance sheet summary (INRm)				
Intangible fixed assets	0	0	0	0
Tangible fixed assets	21,968	36,195	38,045	42,177
Current assets	135,161	207,897	233,717	294,552
Cash & others	27,259	54,376	52,254	58,323
Total assets	171,854	268,584	308,754	386,220
Operating liabilities	93,267	136,838	158,434	208,318
Gross debt	20,778	35,840	33,840	32,590
Net debt	-6,481	-18,536	-18,414	-25,733
Shareholders funds	57,405	95,293	115,866	144,699
Invested capital	36,603	52,878	61,075	70,088

Ratio, growth and per share analysis

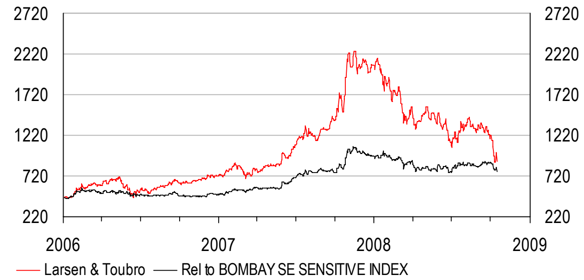
Year to	03/2007a	03/2008e	03/2009e	03/2010e
Y-o-y % change				
Revenue	18.6	41.6	30.6	31.8
EBITDA	57.4	64.7	32.4	35.4
Operating profit	58.7	69.3	32.2	36.9
PBT	60.8	59.4	29.9	34.9
HSBC EPS	55.4	52.8	35.9	34.8
Ratios (%)				
Revenue/IC (x)	4.8	5.5	5.7	6.5
ROIC	27.9	38.0	41.2	48.9
ROE	24.5	26.1	25.6	28.0
ROA	8.8	9.4	10.2	11.2
EBITDA margin	9.5	11.1	11.2	11.5
Operating profit margin	8.6	10.2	10.4	10.7
EBITDA/net interest (x)	49.1	71.9	61.3	82.8
Net debt/equity	-11.3	-19.5	-15.9	-17.8
Net debt/EBITDA (x)	-0.4	-0.7	-0.5	-0.5
CF from operations/net debt				
Per share data (INR)				
EPS reported (fully diluted)	22.67	34.66	46.34	62.54
HSBC EPS (fully diluted)	22.33	34.12	46.38	62.51
DPS	6.60	8.61	8.34	11.26
Book value	101.33	162.98	198.50	247.64

Valuation data

Year to	03/2007a	03/2008e	03/2009e	03/2010e
EV/sales	3.0	2.1	1.6	1.1
EV/EBITDA	31.4	18.8	13.8	9.8
EV/IC	14.3	9.8	8.2	6.9
PE*	40.1	26.3	19.3	14.3
P/Book value	8.8	5.5	4.5	3.6
FCF yield (%)	1.5	-0.2	2.5	4.1
Dividend yield (%)	0.7	1.0	0.9	1.3

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

Price relative



Source: HSBC

Note: price at close of 15 Oct 2008

Flashnote

HSBC Global Research

Industrials
Construction & Engineering
Equity – India

Punj Lloyd (PUNJ)

Overweight (V)

Target price (INR)	247.00
Share price (INR)	172.40
Potential total return (%)	43.5

Performance	1M	3M	12M
Absolute (%)	-39.2	-32.7	-61.2
Relative^ (%)	-11.6	7.2	-17.0

Index^	BOMBAY SE IDX
RIC	PUJL.BO
Bloomberg	PUNJ IN
Market cap (USDm)	1,049
Market cap (INRm)	52,317
Enterprise value (INRm)	56,033
Free float (%)	32

Note: (V) = volatile (please see disclosure appendix)

29 October 2008

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Disclaimer & Disclosures

This report must be read with the disclosures and the analyst certifications in the Disclosure appendix, and with the Disclaimer, which forms part of it

Reiterate OW(V): Positive results

- **2QFY09 results beat our expectations; revenue up 54% and net profit, 61%, driven by stable margins**
- **Management expects to continue focus on infrastructure and oil and gas sector**
- **Reiterate Overweight (V), lower target price to INR247 from INR378 to account for valuation discount to peers**

2QFY09 results beat our estimates. Punj Lloyd (PLL) announced its consolidated results; revenue was up 54% at INR29.5bn (our estimate was INR25.9bn, consensus estimate INR26.2bn). Net profit was up 61% to INR1.44bn (our estimate INR0.84bn, consensus INR1.1bn). A large part of the order inflow of INR56bn in 2QFY09 was driven by the INR36.4bn EPC order by Qatar Petroleum.

Key takeaways from the analyst conference call. Management indicated that they continued to focus on infrastructure and oil and gas (O&G), and said they had minimal exposure to the real estate sector. Most orders were from the public sector and large O&G companies; customer advances have already been paid to PLL. They expect order inflows from ONGC and other O&G companies in 2H09. They expect the increase in interest expense to be compensated by the decline in commodity prices. Management expects petrochemicals and refining to slow down, but investment in gas infrastructure and exploration should increase significantly.

Valuation. We retain our FY09e and FY10e estimates. We value PLL at 20% discount to its comparable peer's, Larsen & Toubro's, core business target multiple of 15x FY10e EPS. Based on this, we reduce PLL's target price to INR237 per share, based on 12x FY10e EPS. We have valued PLL's stake in Pipavav Shipyard at cost. Based on this we derive a target price of INR247 (from INR378 earlier) and retain our OW (V) rating.

Punj Llyod key financials (INRm)

	Sales	EBIDTA	Margin	PAT	EPS (INR)	EPS g'th (y-o-y)	PE (x)	EV/EBIDTA (x)	RoE(%)
FY09e	106,301	9,433	8.9%	4,876	14.6	24%	11.8	5.0	14.3%
FY10e	124,769	11,934	9.6%	6,614	19.7	36%	8.7	3.8	15.2%

Source: HSBC

HSBC

Beats our expectations

PLL announced its consolidated results, with revenue up 54% y-o-y to INR29.5bn (our estimate of INR25.9bn vs. consensus of INR26.2bn), primarily driven by execution in the infrastructure segment (39% of sales in 2QFY09 vs. 10% in 2QFY08). Net profit was up 61% at INR1.44bn (our estimate of INR0.84bn vs. consensus of INR1.1bn).

Our FY09, FY10 EBITDA margin estimates unchanged

Management has guided for 11.5% EBITDA margin for PLL India, 7.5% margin for its subsidiary, Sembawang E&C, which implies a consolidated EBITDA margin of c9.8% for FY09. We expect the margin to be 8.9% and 9.6% for FY09e and FY10e respectively. PLL's focus on large size orders should help it sustain margins.

Consolidated financial summary

INRm	2Q09	2Q08	Y-o-y	1Q09
Net sales	**29,530**	**19,236**	**53.5%**	**26,488**
Raw material	10,470	7,996	30.9%	7,028
% of net sales	35.5%	41.6%		26.5%
Contractor charges	8,420	5,034	67.3%	9,043
% of net sales	28.5%	26.2%		34.1%
Staff cost	2,687	1,998	34.5%	3,276
% of net sales	9.1%	10.4%		12.4%
Other exp.	4,959	2,248	120.6%	5,024
% of net sales	16.8%	11.7%		19.0%
EBITDA	**2,994**	**1,960**	**52.8%**	**2,116**
EBITDA margin %	**10.1%**	**10.2%**		**8.0%**
Depreciation	439	334	31.5%	392
EBIT	2,555	1,626	57.1%	1,725
EBIT margin %	8.7%	8.5%		6.5%
Interest	490	394	24.6%	368
Other income	11	11	0.9%	94
PBT	2,076	1,243	66.9%	1,451
PBT margin %	7.0%	6.5%		5.5%
Tax	647	349	85.3%	469
PAT	1,429	894	59.8%	982
Net profit (Recurring)	**1,441**	**895**	**61.1%**	**976**
Net profit margin %	**4.9%**	**4.7%**		**3.7%**
Exceptional (net of tax)				143
Reported net profit	**1,441**	**895**	**61.1%**	**1,119**

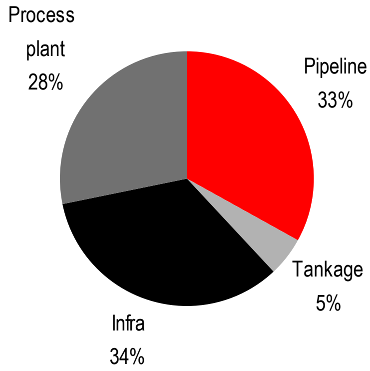
Source: Company

With an interim settlement amounting to INR1.1bn during 1Q FY09 between Simon Carves and its customer, the loss estimate as guided by the company has been reduced to INR2.2bn (from INR3.1bn earlier). Management expects to complete most of the project by December 2008, and said it was confident of settling the balance losses. We believe in the near term the unresolved issue of unaccounted losses will play on the share price of the stock.

Order book at INR217bn

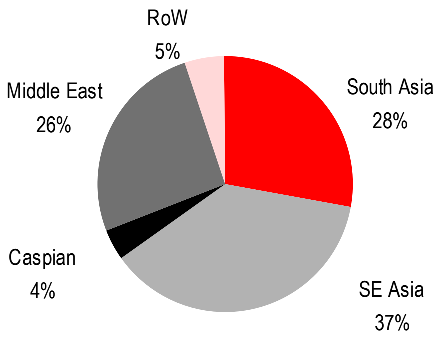
The current order backlog of INR217bn (2.8x FY08 revenue) was propelled by order inflow of INR56bn in 2QFY09. It won two large orders in the quarter: a) a INR36.4bn order for laying of 211 km of pipeline with associated stations and infrastructure, by Qatar Petroleum and b) a INR10.0bn order for setting up 2x270 MW Govindwal Sahib thermal power plant in the state of Punjab. PLL also expanded its presence

Punj Lloyd consolidated order backlog by segments (INR217bn)



Source: Company

Punj Lloyd consolidated order backlog by geography (INR217bn)



Source: Company

in the upstream business with its subsidiary, Punj Lloyd Upstream, winning its first order of INR1.9bn for deploying two onshore rigs from Waha Oil Company in Libya. The continued momentum in order inflows and the current order book provides visibility for our revenue growth estimate of 27% CAGR for FY08-10e.

Key updates on its subsidiaries

Simon Carves India: is focused on leveraging and enhancing Simon Carves's design and engineering capabilities for Oil & Gas, Petrochemical, Infrastructure and other sectors.

Pipavav Shipyard Ltd (PSL) (22.3% stake): is currently constructing a shipyard in India to carry out ship construction and repair of vessels of different sizes. PSL has order backlog of USD1bn for construction of 26 Panamax bulk carriers for delivery from 2009 to May 2012.

Joint venture with Ramprastha Group: This 50:50 JV with Ramprastha Group is involved in developing 3.5m square feet of residential buildings at a 29-acre lot in Viashali, Gaziabad. However, given the current downturn in real estate, we do not expect significant upside from this JV.

Punj Lloyd Upstream Ltd: PLL set up Punj Lloyd Upstream Ltd. to provide offshore integrated drilling services to E&P companies in the domestic market. The company initially plans to acquire two rigs and lease them to oil and gas companies. The total investment envisaged in the initial phase is INR4.4bn. During the quarter the company was able to bag its first order of INR1.9bn for deploying two onshore rigs from Waha Oil Company in Libya.

Technodyne International Limited, UK(74% stake): To enable the group to provide end-to-end solutions for complete delivery of complex cryogenic, high pressure LNG and other similar storage tanks, besides leveraging the capabilities for design of refinery and petrochemical projects.

Singapore Technologies Kinetics Ltd: Punj Lloyd has recently signed an agreement for the manufacture of guns, rockets and missile artillery and other defence equipment for the Ministry of Defence, Government of India.

Valuation and risks

We forecast PLL's FY08-10e net profit CAGR at 42%, driven by 27% revenue CAGR. The INR217bn order backlog should support this revenue growth. Based on our estimates, we expect consolidated EPS of INR14.6 and INR19.7 for FY09e and FY10e. We believe the stock should trade at 20% discount to Larsen & Toubro's core business. Based on this, the core business is valued at INR237per share. We have also valued the investments in Pipavav Shipyard at cost. These should contribute cINR10 per share to valuation.

Under our research model, for stocks with a volatility indicator, the Neutral band is 10 percentage points above and below the hurdle rate for Indian stocks of 11.0%. For Punj Lloyd, this translates into a Neutral band of 1%-21% around the current share price. Our target price of INR247 implies a return of 43.5%, which is above the Neutral band; thus, we have an Overweight (V) rating on the Punj Lloyd stock.

Key risks

Execution risks, raw material prices, and decline in oil & gas capex, increased competition, and potential provision to be made for expected losses are key risks to our estimates.

HSBC

Financials & valuation

Financial statements

Year to	03/2007a	03/2008e	03/2009e	03/2010e
Profit & loss summary (INRm)				
Revenue	51,266	77,529	106,301	124,769
EBITDA	3,743	6,409	9,433	11,934
Depreciation & amortisation	-1,062	-1,462	-1,633	-1,874
Operating profit/EBIT	2,682	4,946	7,800	10,059
Net interest	-32	-481	-1,029	-873
PBT	2,650	4,465	6,772	9,186
HSBC PBT	2,650	4,465	6,772	9,186
Taxation	-690	-1,235	-1,896	-2,572
Net profit	1,969	3,212	4,876	6,614
HSBC net profit	1,969	3,212	4,876	6,614
Cash flow summary (INRm)				
Cash flow from operations	6,558	-6,214	4,724	3,822
Capex	-7,215	-4,366	-3,375	-2,500
Cash flow from investment	-8,498	-8,125	-3,375	-2,500
Dividends	-92	-142	-235	-314
Change in net debt	2,522	2,208	-9,278	-1,008
FCF equity	-657	-10,580	1,349	1,322
Balance sheet summary (INRm)				
Intangible fixed assets	0	0	0	0
Tangible fixed assets	13,329	16,233	17,975	18,601
Current assets	42,250	55,820	80,356	94,701
Cash & others	10,027	6,898	16,926	18,684
Total assets	57,278	77,511	103,789	118,760
Operating liabilities	27,077	32,869	45,592	53,513
Gross debt	16,992	16,072	16,822	17,572
Net debt	6,965	9,174	-105	-1,113
Shareholders funds	12,848	27,655	40,460	46,760
Invested capital	18,475	32,286	35,813	41,105

Ratio, growth and per share analysis

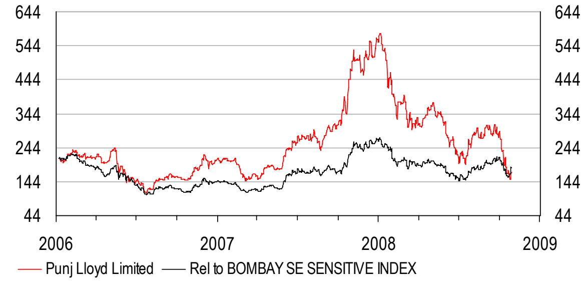
Year to	03/2007a	03/2008e	03/2009e	03/2010e
Y-o-y % change				
Revenue	204.3	51.2	37.1	17.4
EBITDA	96.0	71.2	47.2	26.5
Operating profit	105.4	84.5	57.7	29.0
PBT	219.7	68.5	51.7	35.7
HSBC EPS	164.3	27.1	51.8	35.7
Ratios (%)				
Revenue/IC (x)	3.0	3.1	3.1	3.2
ROIC	11.6	14.1	16.5	18.8
ROE	16.4	15.9	14.3	15.2
ROA	6.4	6.2	6.5	7.1
EBITDA margin	7.3	8.3	8.9	9.6
Operating profit margin	5.2	6.4	7.3	8.1
EBITDA/net interest (x)	118.4	13.3	9.2	13.7
Net debt/equity	54.2	33.2	-0.3	-2.4
Net debt/EBITDA (x)	1.9	1.4	0.0	-0.1
CF from operations/net debt	94.2			
Per share data (INR)				
EPS reported (fully diluted)	7.54	9.59	14.55	19.74
HSBC EPS (fully diluted)	7.54	9.59	14.55	19.74
DPS	0.30	0.43	0.63	0.80
Book value	49.19	97.77	126.53	139.55

Valuation data

Year to	03/2007a	03/2008e	03/2009e	03/2010e
EV/sales	1.1	0.7	0.4	0.4
EV/EBITDA	15.4	8.7	5.0	3.8
EV/IC	3.1	1.7	1.3	1.1
PE*	22.9	18.0	11.8	8.7
P/Book value	3.5	1.8	1.4	1.2
FCF yield (%)	-1.3	-22.6	2.9	2.8
Dividend yield (%)	0.2	0.2	0.4	0.5

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

Price relative



Source: HSBC

Note: price at close of 28 Oct 2008

Flashnote

HSBC Global Research

Industrials
Machinery
Equity – India

Thermax India

Neutral (V)

Target price (INR)	380.00
Share price (INR)	329.90
Potential total return (%)	18.3

Performance	1M	3M	12M
Absolute (%)	-18.6	-24.6	-63.0
Relative^ (%)	4.2	13.0	-24.6

Index^	BOMBAY SE IDX
RIC	THMX.BO
Bloomberg	TMX IN
Market cap (USDm)	795
Market cap (INRm)	39,310
Enterprise value (INRm)	33128
Free float (%)	32

Note: (V) = volatile (please see disclosure appendix)

Reiterate Neutral (V); growth only post FY09e

- **Thermax witnessed INR22.9bn of order inflow in 2Q09, revenue-booking of which to start only post FY09e**
- **Environment business will compensate for the decline in the energy business; however, energy to still dominate**
- **Reducing our FY09 and FY10 net profit estimates by 4.2% and 1.3%, respectively. Reducing our TP to INR380 from INR480; maintaining Neutral (V) rating**

Thermax's effort to shift toward long cycle capex paying dividends

Thermax's order book increased to INR42.5bn (1.2x FY08 revenue) from INR28bn in the 1QFY09 on account for order inflows of cINR22.9bn during the quarter. This has been driven by INR8.2bn in boiler orders, indicating Thermax's move toward a long capex cycle. This shift will help Thermax to mitigate the risk of any slowdown in industrial capex. Thermax has prepared for this shift by 1) setting up a new manufacturing facility at Baroda for utilities and industrial boilers; and 2) a technology tie up with Babcock & Wilcox Power Generation Group, for sub-critical utility boilers up to 800MW.

Environment business to compensate for decline in energy segment in the interim

The environment business continues to post robust revenue growth (+58.5% in 2QFY09). The outlook remains positive and the company could achieve 20-30% revenue growth over the next two years given its entry into new commercial and municipal segments and technology tie ups under the division. This will compensate for the decline in the energy business, we believe; however, the energy business should continue to dominate the revenue mix.

Estimates and valuation

We maintain that FY09e will be muted and expect the company to report 6% PAT growth (earlier 12%). We have valued Thermax at 12x FY10e forward earnings, deriving a new target price of INR380 (from INR480), for total potential return of 18.3%. We expect the stock to trade at a lower multiple given the risk of lower industrial capex and muted growth in FY09e. It trades at a 25% discount to our target multiple of BHEL. We maintain our Neutral (V) rating. Removing the cash (c15% of market cap), at our target price it would trade at 10.4x FY10e earnings.

3 November 2008

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Key financial data

INRm	Revenue	% rev y/y	EBITDA	Net profit	EPS	PE	PB	EV/EBITDA	Div. yield
FY2008a	34,815	45.8%	4,267	2,886	24.4	13.6	5.2	7.8	2.4%
FY2009e	39,245	12.7%	4,442	3,051	25.6	12.9	4.3	7.0	3.1%
FY2010e	48,085	22.5%	5,452	3,763	31.6	10.4	3.5	5.5	3.8%

Source: Company, HSBC estimates

Growth drivers: Positive outlook for FY10 and beyond

Utility segment to drive growth post FY10

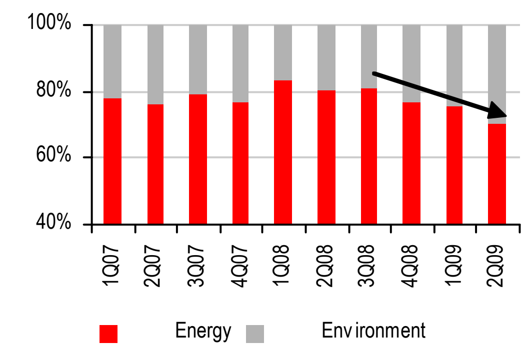
Thermax's new manufacturing facility being set up at Baroda, designed to cater to both utilities and industrial boilers and expected to be fully operational by January 2009, is on track. The agreement with B&W for manufacturing and selling sub-critical B&W utility boilers (up to 800MW capacity in India) will enable Thermax to cater to large utilities; however, we believe initially the company's target customers will be independent power producers looking at setting up capacity up to 2x250MW

Management indicates that the Baroda facility will break even by the end of FY10 and will contribute almost half the company's revenue by FY2011, given a positive business environment. The margins are expected to be better at the Baroda facility since the new facility is operationally efficient; also, the staff costs should be lower as most of the staff will be entry level personnel.

Environment business to compensate for the decline in the energy segment

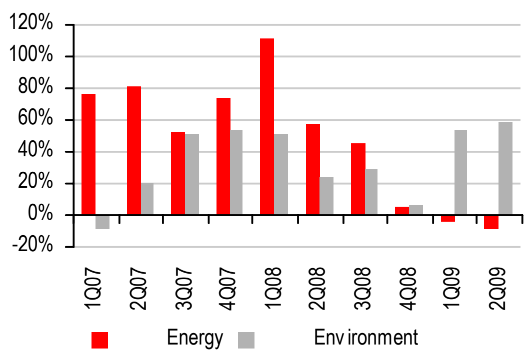
The environment business continues to post robust revenue growth (+58.5% in 2QFY09). The outlook remains positive and the company could achieve 20-30% revenue growth over the next two years given its entry into new commercial and municipal segments and the technology tie ups under the division. Thermax is venturing into the municipal water treatment business, which it had earlier shunned due to payment security issues. However, with the launch of the National Urban Renewal Mission, payment security has increased as the funds are available from the central government. Air pollution control is another future growth driver for Thermax, we believe.

Shifting revenue mix



Source: Company, HSBC

Environment division: growth higher



Source: Company, HSBC

Technology tie-ups to cater to growth

- Georgia-Pacific Chemicals LLC, USA for performance enhancing chemicals for the paper industry in India and South East Asia, a market with INR16bn potential.
- Balcke-Dürr GmbH, Germany for dry and wet electrostatic precipitators (ESP) – air pollution control equipment for power, industrial and utility segments, for up to 300MW. This will help Thermax access higher capacity projects in power generation, ferrous and non-ferrous metals, paper and pulp, cement and rock products, and refineries in India, South East Asia, the Middle East, and Africa.

- Babcock & Wilcox Power Generation Group, for sub-critical utility boilers up to 800MW. The agreement grants Thermax the right to manufacture and sell sub-critical B&W utility boilers.

Thermax's effort to shift toward long cycle capex paying dividends

Thermax's order book increased to INR42.5bn (1.2x FY08 revenue) from INR28bn in the 1QFY09 on account of order inflows of cINR22.9bn during the quarter. This has been driven by INR8.2bn in boiler orders, indicating Thermax's move toward a long capex cycle. This shift should help Thermax to mitigate the risk of any slowdown in industrial capex. Thermax has prepared for this shift by 1) setting up a new manufacturing facility at Baroda for utilities and industrial boilers; and 2) technology tie-ups with Babcock & Wilcox Power Generation Group for sub-critical utility boilers up to 800MW. Thermax has already received utilities orders of INR8.2bn for 4x750tph capacity for a private refinery.

2QFY09 results – well below our expectations

The company reported its standalone results with revenue growth being flat at 4.4%, while net profit declined by 17.7%. The decline in revenue growth was mainly attributed to declines in sales in the energy segment (-9.1%). EBIT margins from the energy segment declined by 410bp during the quarter, resulting in an overall decline in net profits. The start-up costs at its chiller manufacturing facility in China, which was commissioned during the quarter, and higher subcontracting led to an increase in other costs.

On the consolidated level, net profit declined by 33% against revenue growth of 2.8%, on account of 1) losses reported by its subsidiaries; and 2) mark-to-market FX losses of INR374m.

Standalone summary financials: 2QFY09

INRm	2QFY09	2QFY08	YoY
Sales	8,041	7,701	4.4%
RM cost	5,085	5,264	-3.4%
% to sales	63.2%	68.4%	
Staff cost	586	639	-8.3%
% to sales	7.3%	8.3%	
Other exp	1,437	788	82.5%
% to sales	17.9%	10.2%	
Total exp	7,108	6,690	6.2%
EBITDA	932	1,011	-7.8%
EBITDA margin %	11.6%	13.1%	
EBIT	865	957	-9.6%
Other income	80	109	-26.6%
PBT	937	1,063	-11.9%
Tax	368	371	-1.0%
Reported PAT	570	692	-17.7%

Source: Company, HSBC

Estimate changes

We have slightly adjusted our revenue growth estimates by -1.1% and -0.3% for FY09e and FY10e, respectively, given the cautious outlook for revenue and order inflow growth during 2HFY09. We expect margins to remain under pressure, given that there are start-up costs being incurred at Thermax's China facility (commissioned during the quarter) and Baroda facility (partly commissioned and expected to be fully operational by January 2009). Hence, we slightly adjust our EBITDA margin expectation by c20bp for FY09e and expect it to be stable for FY10. Based on this, our net profit forecast is reduced by 4.2%

and 1.3% for FY09e and FY10e, respectively. The revenue from the increase in the order book from the utility segment during the quarter will begin being booked in FY10.

Estimate changes summary

	Sales			EBITDA			EBITDA margin			PAT		
	New	Old	Diff (%)	New	Old	Diff (%)	New	Old	Diff (bp)	New	Old	Diff (%)
FY09e	39,245	39,675	-1.1%	4,442	4,579	-3.0%	11.3%	11.5%	-22	3,051	3,185	-4.2%
FY10e	48,085	48,229	-0.3%	5,452	5,480	-0.5%	11.3%	11.4%	-2	3,763	3,811	-1.3%

Source: HSBC estimates

Valuation

We maintain that FY09e will be muted and expect Thermax to report 6% PAT growth in FY09e (earlier 12%). We have valued Thermax at 12x FY10e forward earnings, deriving a new target price of INR380 (from INR480), providing total potential return of 18.3% including an expected dividend yield of 3.1%. We expect the stock to trade at a lower multiple given the risk of lower industrial capex and expected muted growth in FY09. It trades at a 25% discount to our target multiple of BHEL. If we remove the cash (c15% of market cap), at our target price it would trade at 10.4x one-year forward earnings.

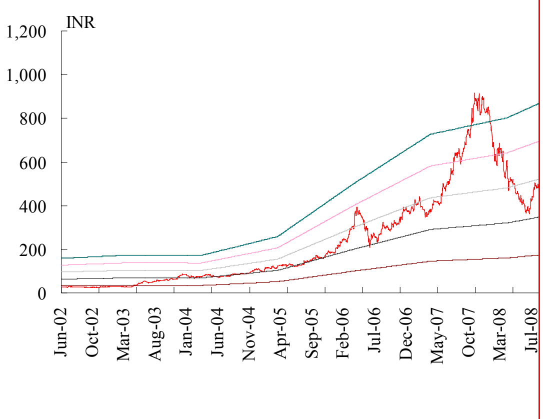
Under our research model, for stocks with a volatility indicator, the Neutral band is 10ppts above and below the hurdle rate for Indian stocks of 11%. Our new target price of INR380 provides total potential return of 18.3% including the expected dividend yield of 3.1%, which is in the Neutral band; therefore, we maintain our Neutral (V) rating.

Key risks

Upside risk: Any pickup in industrial capex, leading to higher order inflow and/or lower commodity prices.

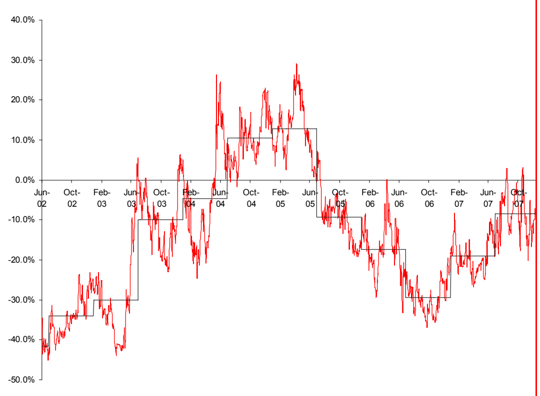
Downside risk: A slowdown in industrial capex, pending litigation, rising interest rates, execution risk, possible re-focus of BHEL on captive power plants, appreciating currency risk, and increased competition.

Thermax PE band chart



Source: Company, HSBC

Thermax-BHEL premium/discount



Source: Company, HSBC

Financials & valuation

Financial statements

Year to	03/2007a	03/2008e	03/2009e	03/2010e
Profit & loss summary (INRm)				
Revenue	23,886	34,815	39,245	48,085
EBITDA	3,508	4,267	4,442	5,452
Depreciation & amortisation	-195	-232	-260	-320
Operating profit/EBIT	3,313	4,035	4,182	5,132
Net interest	345	423	371	484
PBT	3,603	4,478	4,553	5,617
HSBC PBT	3,603	4,478	4,553	5,617
Taxation	-1,046	-1,571	-1,503	-1,853
Net profit	2,557	2,907	3,051	3,763
HSBC net profit	2,612	2,886	3,051	3,763
Cash flow summary (INRm)				
Cash flow from operations	4,064	2,601	4,275	3,653
Capex	-545	-1,928	-1,000	-500
Cash flow from investment	-2,317	-1,788	-1,500	-250
Dividends	-825	-1,115	-1,428	-1,761
Change in net debt	-473	371	-1,387	-1,642
FCF equity	3,574	652	3,275	3,153
Balance sheet summary (INRm)				
Intangible fixed assets	0	0	0	0
Tangible fixed assets	1,789	3,485	4,225	4,406
Current assets	10,235	11,191	14,649	18,443
Cash & others	972	580	1,967	3,609
Total assets	17,767	20,317	24,976	28,700
Operating liabilities	11,778	12,588	15,624	17,346
Gross debt	22	0	0	0
Net debt	-951	-580	-1,967	-3,609
Shareholders funds	5,899	7,595	9,218	11,220
Invested capital	-726	1,508	1,283	1,893

Ratio, growth and per share analysis

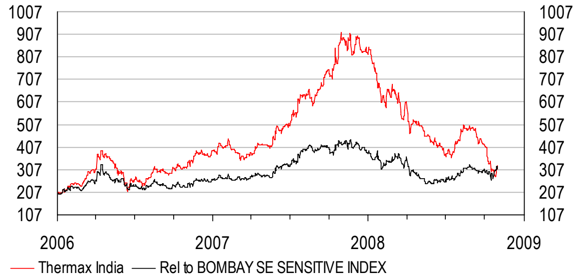
Year to	03/2007a	03/2008e	03/2009e	03/2010e
Y-o-y % change				
Revenue	47.0	45.8	12.7	22.5
EBITDA	98.5	21.6	4.1	22.7
Operating profit	106.1	21.8	3.7	22.7
PBT	108.5	24.3	1.7	23.4
HSBC EPS	154.7	10.5	5.7	23.4
Ratios (%)				
Revenue/IC (x)	-97.6	89.0	28.1	30.3
ROIC	-961.0	669.6	200.8	216.5
ROE	49.8	42.8	36.3	36.8
ROA	17.7	15.3	13.5	14.0
EBITDA margin	14.7	12.3	11.3	11.3
Operating profit margin	13.9	11.6	10.7	10.7
EBITDA/net interest (x)				
Net debt/equity	-16.1	-7.6	-21.3	-32.2
Net debt/EBITDA (x)	-0.3	-0.1	-0.4	-0.7
CF from operations/net debt				
Per share data (INR)				
EPS reported (fully diluted)	21.46	24.40	25.60	31.58
HSBC EPS (fully diluted)	21.92	24.22	25.60	31.58
DPS	6.00	8.00	10.24	12.63
Book value	49.51	63.74	77.37	94.17

Valuation data

Year to	03/2007a	03/2008e	03/2009e	03/2010e
EV/sales	1.4	1.0	0.8	0.6
EV/EBITDA	9.3	7.8	7.0	5.5
EV/IC		22.0	24.3	15.8
PE*	15.1	13.6	12.9	10.4
P/Book value	6.7	5.2	4.3	3.5
FCF yield (%)	10.6	1.9	9.9	9.4
Dividend yield (%)	1.8	2.4	3.1	3.8

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

Price relative

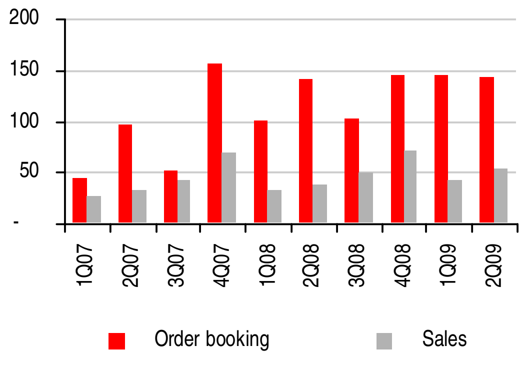


Source: HSBC

Note: price at close of 03 Nov 2008

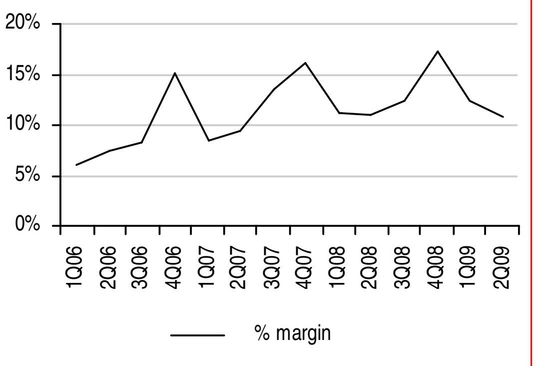
Appendix

BHEL order bookings and sales (INRbn)



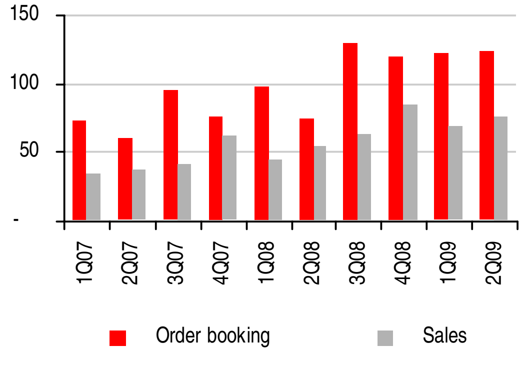
Source: Company, HSBC

BHEL: EBIDTA margin trends



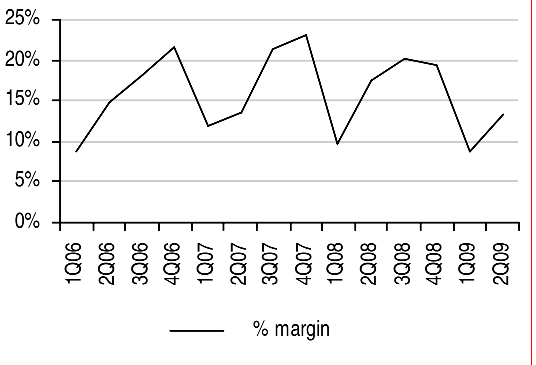
Source: Company, HSBC

L&T order bookings and sales (INRbn)



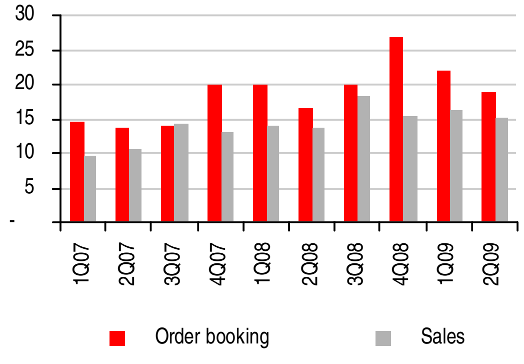
Source: Company, HSBC

L&T: EBIDTA margin trends



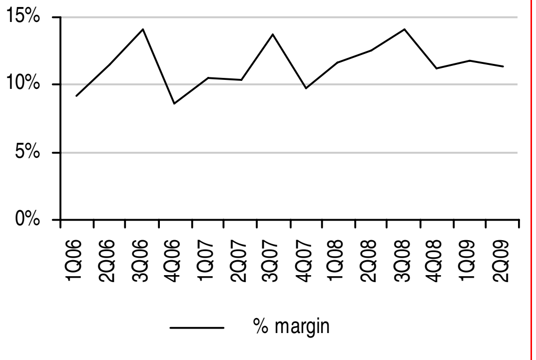
Source: Company, HSBC

ABB order bookings and sales (INRbn)



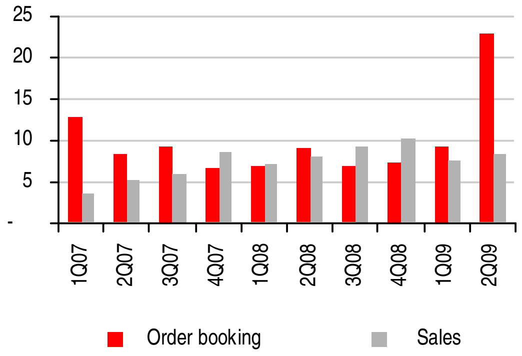
Source: Company, HSBC

ABB: EBIDTA margin trends



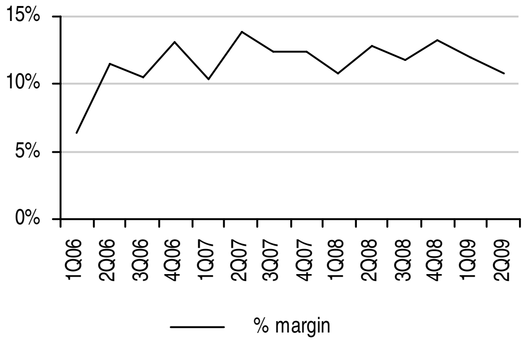
Source: Company, HSBC

Thermax order bookings and sales (INRbn)



Source: Company, HSBC

Thermax: EBIDTA margin trends

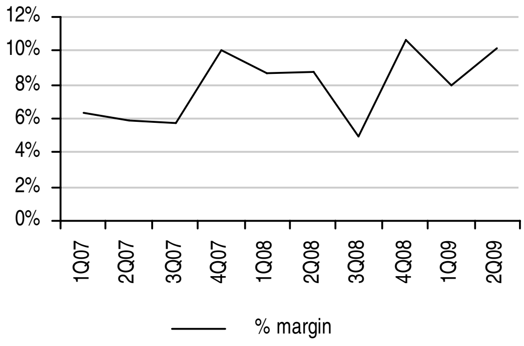


Source: Company, HSBC

Punj Lloyd order bookings and sales (INRbn)

Source: Company, HSBC

Punj Lloyd: EBIDTA margin trends

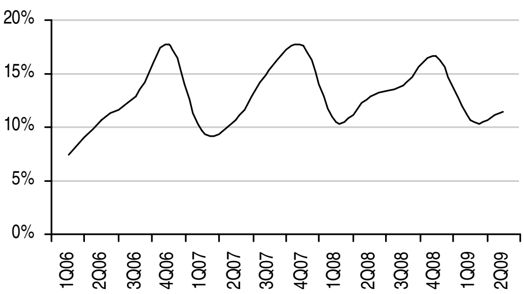


Source: Company, HSBC

Engineering sector order bookings and sales (INRbn)

Source: Company, HSBC

Engineering sector: EBIDTA margin trends



Source: Company, HSBC

HSBC

Disclosure appendix

Analyst certification

The following analyst(s), who is(are) primarily responsible for this report, certifies(y) that the opinion(s) on the subject security(ies) or issuer(s) and 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: Sumeet Agrawal

Important disclosures

Stock ratings and basis for financial analysis

HSBC believes that investors utilise various disciplines and investment horizons when making investment decisions, which depend largely on individual circumstances such as the investor's existing holdings, risk tolerance and other considerations. Given these differences, HSBC has two principal aims in its equity research: 1) to identify long-term investment opportunities based on particular themes or ideas that may affect the future earnings or cash flows of companies on a 12 month time horizon; and 2) from time to time to identify short-term investment opportunities that are derived from fundamental, quantitative, technical or event-driven techniques on a 0-3 month time horizon and which may differ from our long-term investment rating. HSBC has assigned ratings for its long-term investment opportunities as described below.

This report addresses only the long-term investment opportunities of the companies referred to in the report. As and when HSBC publishes a short-term trading idea the stocks to which these relate are identified on the website at www.hsbcnet.com/research. Details of these short-term investment opportunities can be found under the Reports section of this website.

HSBC believes an investor's decision to buy or sell a stock should depend on individual circumstances such as the investor's existing holdings and other considerations. Different securities firms use a variety of ratings terms as well as different rating systems to describe their recommendations. Investors should carefully read the definitions of the ratings used in each research report. In addition, because research reports contain more complete information concerning the analysts' views, investors should carefully read the entire research report and should not infer its contents from the rating. In any case, ratings should not be used or relied on in isolation as investment advice.

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 risk free rate for that stock's domestic, or as appropriate, regional market and the relevant equity risk premium 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, stocks which we do not consider volatile may in fact also behave in such a way. Historical volatility is defined as the past month's average of the daily 365-day moving average volatilities. In order to avoid misleadingly frequent changes in rating, however, volatility has to move 2.5 percentage points past the 40% benchmark in either direction for a stock's status to change.

Prior to this, from 7 June 2005 HSBC applied a ratings structure which ranked the stocks according to their notional target price vs current market price and then categorised (approximately) the top 40% as Overweight, the next 40% as Neutral and the last 20% as Underweight. The performance horizon is 2 years. The notional target price was defined as the mid-point of the analysts' valuation for a stock.

From 15 November 2004 to 7 June 2005, HSBC carried no ratings and concentrated on long-term thematic reports which identified themes and trends in industries, but did not make a conclusion as to the investment action that potential investors should take.

Prior to 15 November 2004, HSBC's ratings system was based upon a two-stage recommendation structure: a combination of the analysts' view on the stock relative to its sector and the sector call relative to the market, together giving a view on the stock relative to the market. The sector call was the responsibility of the strategy team, set in co-operation with the analysts. For other companies, HSBC showed a recommendation relative to the market. The performance horizon was 6-12 months. The target price was the level the stock should have traded at if the market accepted the analysts' view of the stock.

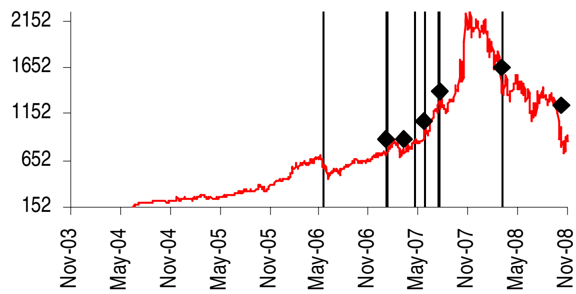
Rating distribution for long-term investment opportunities

As of 07 November 2008, the distribution of all ratings published is as follows:

Overweight (Buy)	49%	(31% of these provided with Investment Banking Services)
Neutral (Hold)	34%	(33% of these provided with Investment Banking Services)
Underweight (Sell)	17%	(24% of these provided with Investment Banking Services)

Share price and rating changes for long-term investment opportunities

Larsen & Toubro (LART.BO) Share Price performance INR Vs HSBC rating history



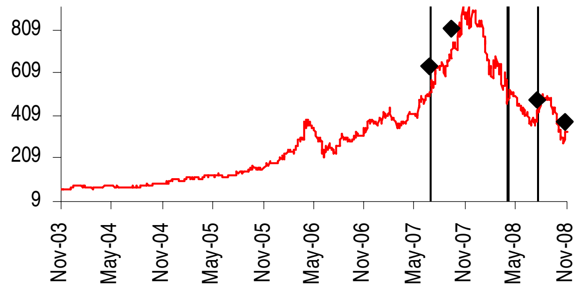
Source: HSBC

Recommendation & price target history

From	To	Date
Neutral	N/A	17 May 2006
N/A	Overweight	09 January 2007
Overweight	Underweight	20 April 2007
Underweight	Neutral	30 May 2007
Neutral	Overweight	23 July 2007
Overweight	Overweight (V)	12 March 2008
Target Price	**Value**	**Date**
Price 1	873.78	09 January 2007
Price 2	883.27	16 March 2007
Price 3	1067.12	30 May 2007
Price 4	1388.85	23 July 2007
Price 5	1650.63	12 March 2008
Price 6	1250.00	16 October 2008

Source: HSBC

Thermax India (THMX.BO) Share Price performance INR Vs HSBC rating history



Source: HSBC

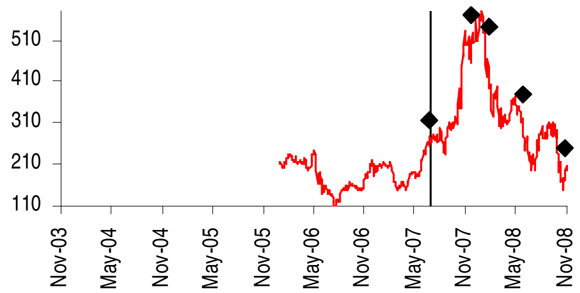
Recommendation & price target history

From	To	Date
N/A	Overweight (V)	03 July 2007
Overweight (V)	Overweight	08 April 2008
Overweight	Neutral (V)	24 July 2008

Target Price	Value	Date
Price 1	635.00	03 July 2007
Price 2	812.00	18 September 2007
Price 3	480.00	24 July 2008
Price 4	380.00	03 November 2008

Source: HSBC

Punj Lloyd Limited (PUJL.BO) Share Price performance INR Vs HSBC rating history



Source: HSBC

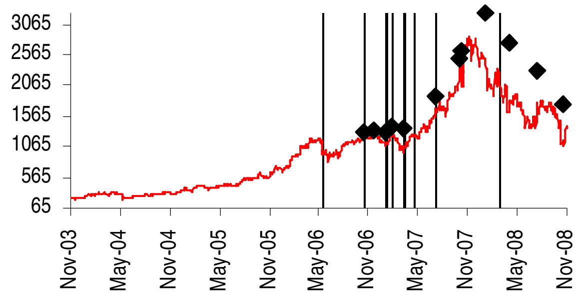
Recommendation & price target history

From	To	Date
N/A	Overweight (V)	03 July 2007

Target Price	Value	Date
Price 1	315.00	03 July 2007
Price 2	570.00	30 November 2007
Price 3	540.00	04 February 2008
Price 4	378.00	02 June 2008
Price 5	247.00	29 October 2008

Source: HSBC

BHEL (BHEL.BO) Share Price performance INR Vs HSBC rating history



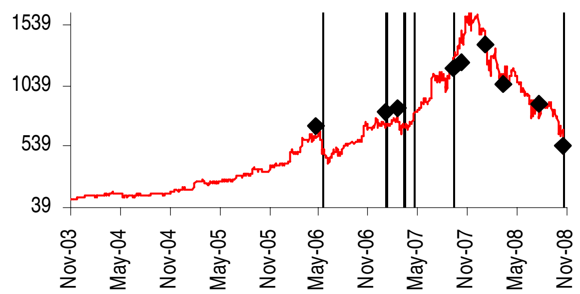
Source: HSBC

Recommendation & price target history

From	To	Date
Overweight	N/A	17 May 2006
N/A	Neutral	18 October 2006
Neutral	Overweight	12 January 2007
Overweight	Neutral	01 February 2007
Neutral	Overweight	16 March 2007
Overweight	Neutral	20 April 2007
Neutral	Overweight	11 July 2007
Overweight	Overweight (V)	03 March 2008
Target Price	**Value**	**Date**
Price 1	1313.88	18 October 2006
Price 2	1329.82	27 November 2006
Price 3	1295.95	12 January 2007
Price 4	1392.08	01 February 2007
Price 5	1374.64	16 March 2007
Price 6	1880.00	11 July 2007
Price 7	2500.00	10 October 2007
Price 8	2645.00	19 October 2007
Price 9	3250.00	11 January 2008
Price 10	2750.00	08 April 2008
Price 11	2300.00	23 July 2008
Price 12	1750.00	27 October 2008

Source: HSBC

ABB India (ABB.BO) Share Price performance INR Vs HSBC rating history



Source: HSBC

Recommendation & price target history

From	To	Date
Overweight	N/A	17 May 2006
N/A	Neutral	09 January 2007
Neutral	Overweight	16 March 2007
Overweight	Neutral	20 April 2007
Neutral	Underweight	13 September 2007
Underweight	Underweight (V)	26 October 2008
Target Price	**Value**	**Date**
Price 1	711.80	27 April 2006
Price 2	821.20	09 January 2007
Price 3	853.80	20 February 2007
Price 4	1178.00	13 September 2007
Price 5	1228.00	19 October 2007
Price 6	1386.00	11 January 2008
Price 7	1052.00	18 March 2008
Price 8	890.00	28 July 2008
Price 9	545.00	26 October 2008

Source: HSBC

HSBC & Analyst disclosures

Disclosure checklist

Company	Ticker	Recent price	Price Date	Disclosure
ABB INDIA	ABB.BO	508.15	06-Nov-2008	2, 5
LARSEN & TOUBRO	LART.BO	859.30	06-Nov-2008	2, 5, 6, 7

Source: HSBC

1 HSBC* has managed or co-managed a public offering of securities for this company within the past 12 months.
2 HSBC expects to receive or intends to seek compensation for investment banking services from this company in the next 3 months.
3 At the time of publication of this report, HSBC Securities (USA) Inc. is a Market Maker in securities issued by this company.
4 As of 30 September 2008 HSBC beneficially owned 1% or more of a class of common equity securities of this company.
5 As of 30 September 2008, this company was a client of HSBC or had during the preceding 12 month period been a client of and/or paid compensation to HSBC in respect of investment banking services.
6 As of 30 September 2008, this company was a client of HSBC or had during the preceding 12 month period been a client of and/or paid compensation to HSBC in respect of non-investment banking-securities related services.
7 As of 30 September 2008, this company was a client of HSBC or had during the preceding 12 month period been a client of and/or paid compensation to HSBC in respect of non-securities services.
8 A covering analyst/s has received compensation from this company in the past 12 months.
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.
10 A covering analyst/s or a member of his/her household is an officer, director or supervisory board member of this company, as detailed below.
11 At the time of publication of this report, HSBC is a non-US Market Maker in securities issued by this company.

Analysts are paid in part by reference to the profitability of HSBC which includes investment banking revenues.

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Additional disclosures

1 This report is dated as at 10 November 2008.
2 All market data included in this report are dated as at close 06 November 2008, unless otherwise indicated in the report.
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HSBC

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