

Industrials
Electrical Equipment
 Equity – India

Indian Capital Goods

Q2 FY12 preview: All eyes on execution & margins

- ▶ **Order intake & execution likely to remain seasonally weak**
- ▶ **Margins of equipment suppliers could miss expectations**
- ▶ **Reiterate OW ratings on KPP & KEC and UW on ABB**

Order intake & execution likely to remain weak. We have seen few large order announcements so far in the transmission space, owing largely to the seasonal weakness of the second quarter and the ongoing changes at Power Grid. Hence, we expect companies to report weak order inflows in Q2. In addition, our channel checks suggest that execution has not really picked up compared to Q1, driven by delays in right-of-way (RoW) approvals and a slower pick-up in deliveries. Consequently, we expect domestic sales to register only modest growth in Q2. However, because of the recent depreciation of the INR, we expect companies, like KEC and Crompton, with significant international exposure to benefit from a favourable currency translation impact.

Margins could drive negative surprises. Companies in our coverage universe have lately shown significant fluctuations in quarterly margins, driven by changing product mix, volatility in commodity prices, and increasing pricing pressures. We note that Q2 results are crucial for ABB, Crompton, and Areva as their delivery on margin recovery will prove key in determining investor confidence in these stocks. We remain cautious on this recovery going into Q2. We expect margins for KPP and Jyoti to remain stable, but KEC, in our opinion, is likely to report lower q-o-q margins, suffering from the negative impact of current movement on its foreign customer advances.

Sector investment thesis. As we highlighted in our recent 12 October 2011 sector update, [EPC space offers better value picks](#), we believe equipment suppliers currently offer little value at significant earnings risk, as they struggle with deteriorating demand and mounting pricing pressures. We remain c17-23% below FY12-13e consensus EPS on ABB, Areva, and Crompton, putting us c9-10% below consensus EPS for the sector as a whole. Q2 results are likely to validate our hypothesis and drive the consensus downwards. We maintain our preference for EPC players going into the earnings season and while they are likely to demonstrate seasonal weakness in execution, margins should remain intact. We'll remain buyers of KPP & KEC.

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 the Disclosure appendix,
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Q2 FY12 estimates summary

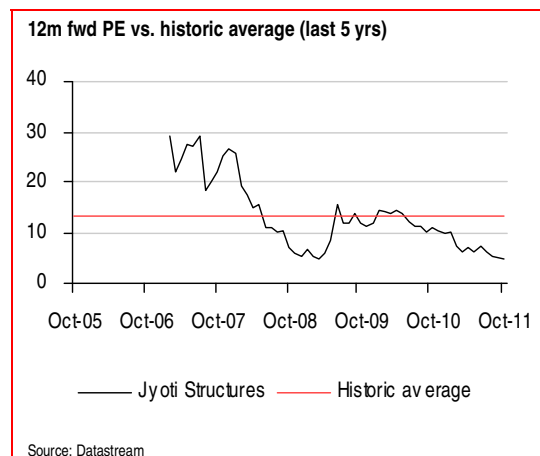
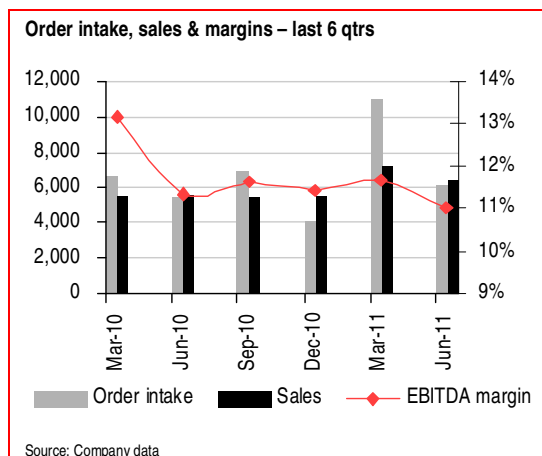
Company	Rating	TP	Q2 FY12 estimates			Y-o-Y			HSBC vs. Cons		
			Sales	EBITDA margin	EPS	Sales (%)	EBITDA (bps)	EPS (%)	Sales (%)	EBITDA (bps)	EPS (%)
Jyoti	OW	100	6,120	10.8%	2.7	12.8%	(84)	-10.8%	0.6%	(33)	-14.2%
KPP	OW	165	6,591	11.2%	2.5	4.4%	(39)	-8.5%	-4.2%	1	-10.1%
KEC	OW	86	11,786	8.5%	1.4	17.8%	(154)	-14.9%	0.2%	(126)	-28.7%
ABB	UW	570	15,876	6.8%	2.8	19.0%	422	411.3%	-0.7%	(16)	-15.9%
Areva T&D	N	235	10,433	10.5%	1.9	-0.4%	(221)	-26.2%	-9.7%	(32)	-15.5%
Crompton	N	170	25,685	9.0%	1.8	7.1%	(490)	-44.8%	-1.2%	(49)	-8.1%
Siemens	N	940	34,502	12.5%	8.2	13.7%	(71)	8.6%	-1.8%	(25)	0.8%

Source: Company Data, HSBC

Jyoti Structures (OW, TP INR100)

Jyoti is likely to report its Q2 FY12 numbers later this month. We discuss our expectations from the results below and highlight our estimates and valuation in the following charts and tables.

- ▶ We expect the order intake to remain flat over last quarter but decline by c10% y-o-y. We believe sales growth will remain around low double-digit levels and the order book is likely to grow by mid single digit to INR44.9bn
- ▶ We expect margins to continue to inch lower, driven by lower volume growth, rising wage inflation, and continued pricing pressure. Currently, we forecast a modest margin decline of c30bps q-o-q. Overall, we forecast an EPS of INR2.7 in Q2 vs. INR3.2 in Q1
- ▶ During Q2 results, we expect investors to focus on demand outlook, expansion plans, funding requirement (i.e. in the absence of warrant exercise) and working capital management
- ▶ On our current estimates, Jyoti remains inexpensive, trading at c4.9x FY12e PE and c4.3x FY13e PE vs the historic trading average of c13.3x. We maintain OW on the stock with a TP of INR100.



Q2FY12 forecast summary

Mar YE (INR m)	Q2FY11	Q3FY11	Q4FY11	Q1FY12	Q2FY12e	BB Cons Q2FY12e	HSBC vs. s Con
Net Sales	5,423	5,513	7,218	6,377	6,120	6,082	0.6%
EBITDA	631	629	840	701	661	677	-2.4%
Profit before tax	374	371	527	390	331	n/a	n/a
Net Income	249	247	350	261	222	259	-14.2%
EPS	3.0	3.0	4.3	3.2	2.7	3.2	-14.2%

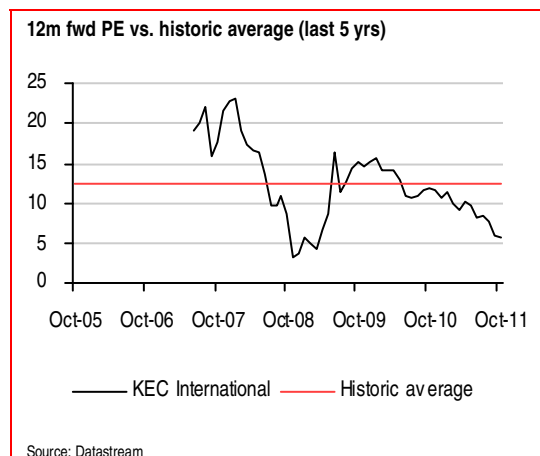
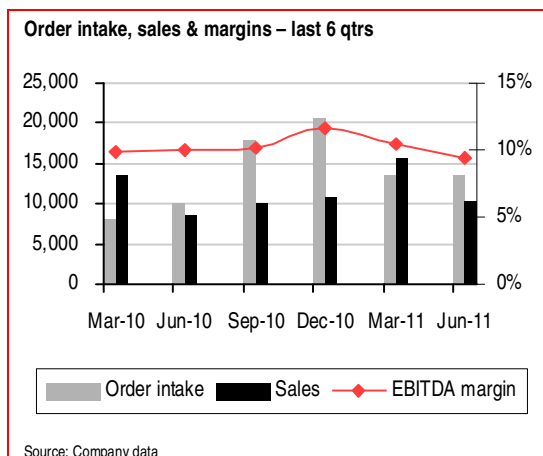
Margins & Trend	Q2FY11	Q3FY11	Q4FY11	Q4FY11	Q2FY12e	BB Cons Q2FY12e	HSBC vs. Cons
Sales growth	15.5%	8.4%	32.3%	13.0%	12.8%	12.1%	0.7%
EBITDA mgn	11.6%	11.4%	11.6%	11.0%	10.8%	11.1%	(33)
PBT mgn	6.9%	6.7%	7.3%	6.1%	5.4%	n/a	n/a
NI mgn	4.6%	4.5%	4.8%	4.1%	3.6%	4.3%	(63)

Source: Company data, HSBC estimates, Bloomberg

KEC International (OW, TP INR86)

KEC is likely to report its Q2 FY12 numbers on 25 September. We discuss our expectations from the results below and highlight our estimates and valuation in the following charts and tables.

- ▶ We expect the order intake to decline marginally (c5%) over last year to INR17bn. However, we expect sales growth to remain robust (c18%) benefitting from past order wins and positive currency translation effect. We expect the order book to continue to grow in Q2
- ▶ We expect margins to take a one-off hit in Q2 driven by the negative impact of currency movement (mark-to-market) on the value of foreign customer advances. We estimate that this negative impact could be in the range of c150-180bps of Q1 sales
- ▶ During Q2 results, we expect to hear more on demand outlook in US, pricing pressure in the domestic market and any update on likely acquisitions in the US
- ▶ On our current estimates KEC remains attractive, trading at c6.4x FY12e PE and c5.0x FY13e PE vs the historic trading average of c12.5x. We maintain OW on the stock with a TP of INR86.



Q2FY12 forecast summary

Mar YE (INR m)	Q2FY11	Q3FY11	Q4FY11	Q1FY12	Q2FY12e	BB Cons Q2FY12e	HSBC vs. s Con
Net Sales	10,001	10,707	15,574	10,225	11,786	11,759	0.2%
EBITDA	1,009	1,246	1,636	960	1,008	1,153	-12.6%
Profit before tax	630	846	1,197	511	543	n/a	n/a
Net Income	427	580	786	331	364	510	-28.7%
EPS	1.7	2.3	3.1	1.3	1.4	2.0	-28.7%

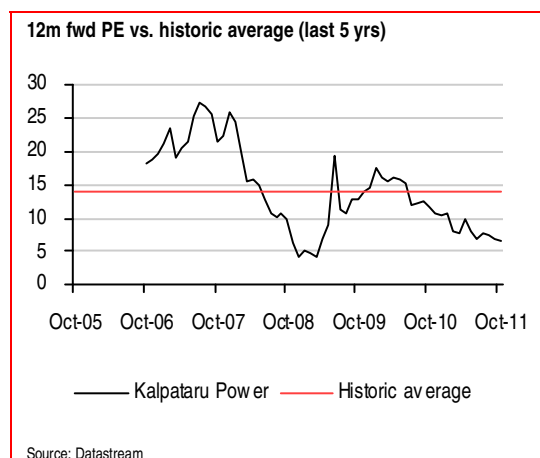
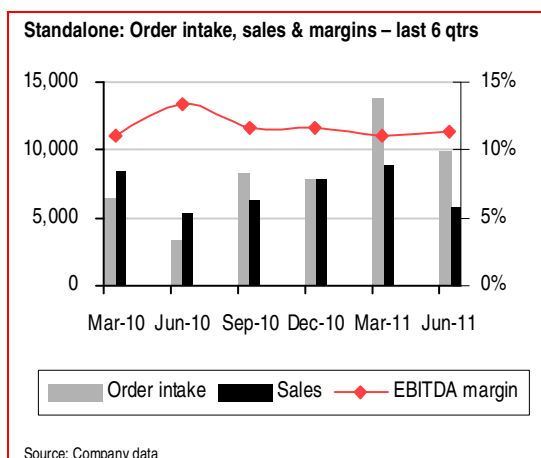
Margins & Trend	Q2FY11	Q3FY11	Q4FY11	Q4FY11	Q2FY12e	BB Cons Q2FY12e	HSBC vs. Cons
Sales growth	14.3%	12.8%	14.8%	20.9%	17.8%	17.6%	0.3%
EBITDA mgn	10.1%	11.6%	10.5%	9.4%	8.5%	9.8%	(126)
PBT mgn	6.3%	7.9%	7.7%	5.0%	4.6%	n/a	n/a
NI mgn	4.3%	5.4%	5.0%	3.2%	3.1%	4.3%	(125)

Source: Company data, HSBC estimates, Bloomberg

Kalpataru Power (OW, TP INR165)

Kalpataru is likely to report its standalone and JMC Projects' Q2 FY12 numbers later this month. We discuss our expectations from the results below and highlight our estimates and valuation in the following charts and tables.

- ▶ We expect the order intake to remain strong in the standalone business with growth likely to be in excess of c20-25%. However, given the already strong order book of the company, we expect focus to continue to remain on execution, particularly at JMC where the order book is in excess of 3x FY11 sales
- ▶ We expect margins to broadly remain flat, with some negative impact from the revaluation of foreign assets due to depreciation of the INR against the USD, and the EUR. Overall, we forecast an EPS of INR2.6 for the standalone business and INR2.5 for JMC Projects
- ▶ We believe during results, investors will be keen to obtain more visibility on execution, cash flow improvement and expansion plans in the US
- ▶ On our current estimates KPP remains attractive, trading at c6.4x FY12e PE and c5.3x FY13e PE vs. historic trading average of c13.5x. We maintain OW on the stock with a TP of INR165.



Standalone: Q2FY12 forecast summary

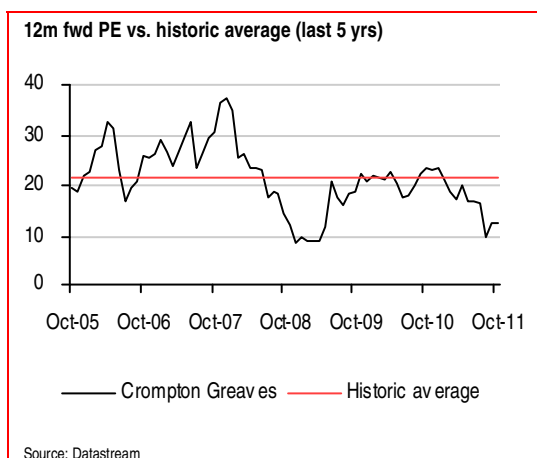
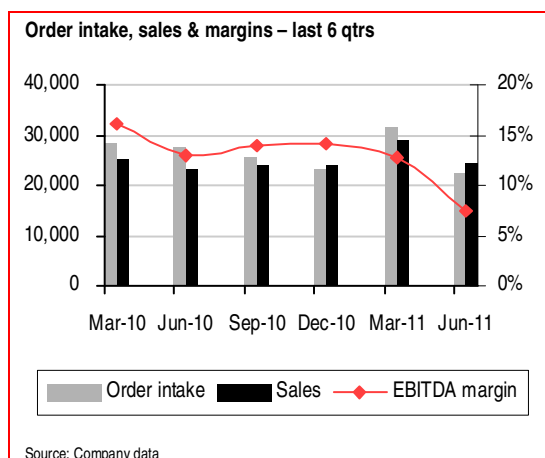
Mar YE (INR m)	Q2FY11	Q3FY11	Q4FY11	Q1FY12	Q2FY12e	BB Cons Q2FY12e	HSBC vs. s Con
Net Sales	6,315	7,930	8,846	5,846	6,591	6,879	-4.2%
EBITDA	732	926	985	667	738	770	-4.1%
Profit before tax	570	703	790	474	533	n/a	n/a
Net Income	414	508	616	336	379	421	-10.1%
EPS	2.7	3.3	4.0	2.2	2.5	2.7	-10.1%
Margins & Trend	Q2FY11	Q3FY11	Q4FY11	Q4FY11	Q2FY12e	BB Cons Q2FY12e	HSBC vs. Cons
Sales growth	14.3%	10.3%	5.5%	8.7%	4.4%	8.9%	-4.6%
EBITDA mgn	11.6%	11.7%	11.1%	11.4%	11.2%	11.2%	1
PBT mgn	9.0%	8.9%	8.9%	8.1%	8.1%	n/a	n/a
NI mgn	6.6%	6.4%	7.0%	5.7%	5.7%	6.1%	(38)

Source: Company data, HSBC estimates, Bloomberg

Crompton Greaves (Neutral, TP INR170)

Crompton Greaves will report its Q2 FY12 numbers on 19 October. We discuss our expectations from the results below and highlight our estimates and valuation in the following charts and tables.

- ▶ We expect sales growth to fare better than the last quarter but still remain in the single digit domain, driven by continued downward pressures on the demand side. We expect new order inflow to remain in line with the last quarter, registering a double digit decline y-o-y
- ▶ While we expect margins to improve in Q2, supported by lower commodity prices and absence of low margin Nelco orders, there is little visibility on the quantum of improvement. We think margin progression, particularly in Power Systems, will prove key in driving investor sentiment
- ▶ Overall, we believe this is a crucial quarter for Crompton and investors will look to obtain more visibility on demand outlook (primarily in the international business), pricing pressure (in domestic Power business) and 'sustainable' margins
- ▶ We currently remain c20-21% below consensus on FY12-13e EPS as we believe that the company will most likely miss margin expectations. On our estimates, the stock doesn't offer much valuation discount, trading at c16.2x 12m fwd PE. We maintain Neutral on the stock with a TP of INR170.



Q2FY12 forecast summary

Mar YE (INR m)	Q2FY11	Q3FY11	Q4FY11	Q1FY12	Q2FY12e	BB Cons Q2FY12e	HSBC vs. Cons
Net Sales	23,979	23,970	29,080	24,377	25,685	25,993	-1.2%
EBITDA	3,332	3,402	3,731	1,819	2,312	2,467	-6.3%
Profit before tax	3,054	3,017	3,530	1,253	1,737	2,031	-14.5%
Net Income	2,136	2,328	2,896	795	1,179	1,380	-14.6%
EPS	3.3	3.6	4.5	1.2	1.8	2.0	-8.1%

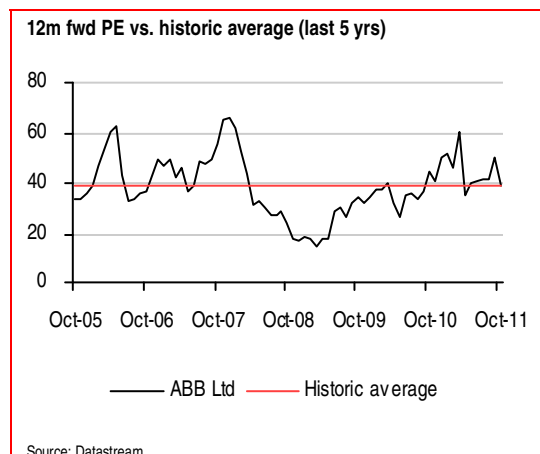
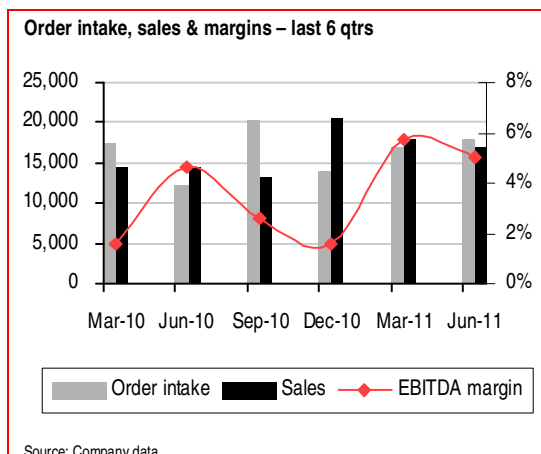
Margins & Trend	Q2FY11	Q3FY11	Q4FY11	Q4FY11	Q2FY12e	BB Cons Q2FY12e	HSBC vs. Cons
Sales growth	9.5%	6.7%	16.0%	5.9%	7.1%	8.4%	-1.3%
EBITDA mgn	13.9%	14.2%	12.8%	7.5%	9.0%	9.5%	(49)
PBT mgn	12.7%	12.6%	12.1%	5.1%	6.8%	7.8%	(105)
NI mgn	8.9%	9.7%	10.0%	3.3%	4.6%	5.3%	(133)

Source: Company data, HSBC estimates, Bloomberg

ABB Ltd (UW, TP INR570)

ABB will report its Q3 FY11 (Dec YE) numbers on 8 November. We discuss our expectations from the results below and highlight our estimates and valuation in the following charts and tables.

- ▶ Given a very strong comp last year, we expect the order intake in this quarter to be marginally weaker y-o-y. We expect execution to remain robust and ABB to continue to report high teen growth
- ▶ We expect margins to inch higher benefiting from lower cost of materials, increasing contribution from higher margin acquisitions and a better mix of short cycle orders vs. low margin projects
- ▶ We expect the company to remain cautious on margin recovery and highlight continuing pricing pressure during the results call. We expect the commentary on demand outlook to remain positive
- ▶ ABB remains unjustifiably expensive on our estimates, trading at c57.2x FY11e PE and c35.1x FY12e PE vs historic trading average of c39x. We maintain our UW rating on the stock with a TP of INR570.



Q3FY11 forecast summary

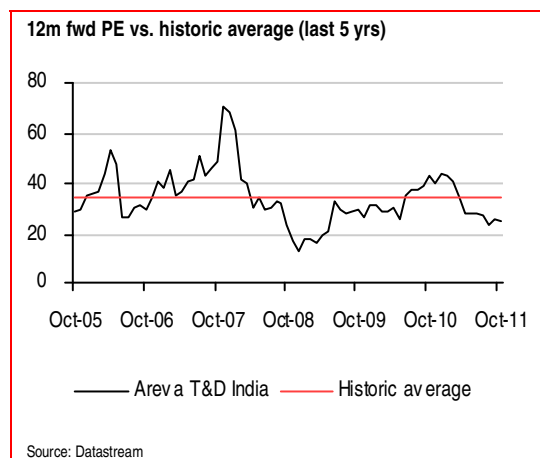
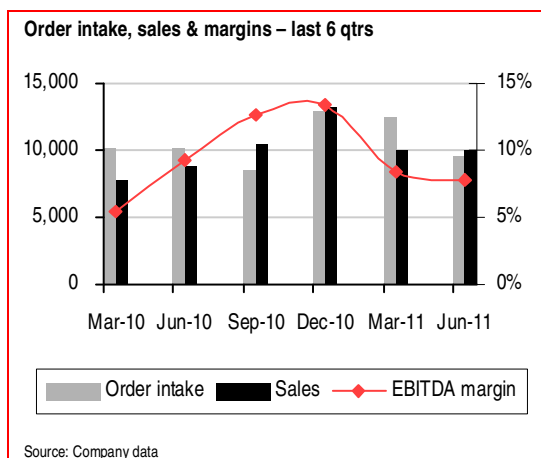
Dec YE (INR m)	Q3FY10	Q4FY10	Q1FY11	Q2FY11	Q3FY11e	BB Cons Q3FY11e	HSBC vs. Cons
Net Sales	13,340	20,506	17,813	16,930	15,876	15,982	-0.7%
EBITDA	345	327	1,016	855	1,080	1,113	-3.0%
Profit before tax	208	156	877	589	878	902	-2.6%
Net Income	115	68	595	387	588	685	-14.1%
EPS	0.5	0.3	2.8	1.8	2.8	3.3	-15.9%
Margins & Trend	Q3FY10	Q4FY10	Q1FY11	Q2FY11	Q3FY11e	BB Cons Q3FY11e	HSBC vs. Cons
Sales growth	-8%	9%	22%	17%	19%	20%	-0.8%
EBITDA mgn	2.6%	1.6%	5.7%	5.0%	6.8%	7.0%	(16)
PBT mgn	1.6%	0.8%	4.9%	3.5%	5.5%	5.6%	(11)
NI mgn	0.9%	0.3%	3.3%	2.3%	3.7%	4.3%	(58)

Source: Company data, HSBC estimates, Bloomberg

Areva T&D (Neutral, TP INR235)

Areva T&D is likely to report its Q3 FY11 (Dec YE) numbers later this month. We discuss our expectations from the results below and highlight our estimates and valuation in the following charts and tables.

- ▶ We expect order intake to remain weak in Q3 as growth in domestic transmission orders have remain muted in the previous quarter. Driven by this and a strong comp last year, we expect sales to largely remain flat over last year at around INR10.4bn
- ▶ We expect margins to improve q-o-q benefiting from higher sales and lower costs. However, we note that Areva and its peers have reported rising pricing pressures in the domestic market, in lieu of which, the company may disappoint on margin expectations
- ▶ We believe investors will look to obtain more visibility on the proposed demerger of the Transmission and Distribution business and unless market obtains more clarity on it, the stock is likely to remain range bound.
- ▶ On our current estimates Areva is trading at c28.1x FY11e PE and c21.2x FY12e PE vs. historic trading average of c34.5x. We maintain Neutral on the stock with a TP of INR235.



Q3FY11 forecast summary

Dec YE (INR m)	Q3FY10	Q4FY10	Q1FY11	Q2FY11	Q3FY11e	BB Cons Q3FY11e	HSBC vs. Cons
Net Sales	10,477	13,270	9,949	9,989	10,433	11,548	-9.7%
EBITDA	1,332	1,782	837	782	1,096	1,250	-12.4%
Profit before tax	943	1,335	431	394	696	994	-30.0%
Net Income	629	881	288	263	465	556	-16.4%
EPS	2.6	3.7	1.2	1.1	1.9	2.3	-15.5%
Margins & Trend	Q3FY10	Q4FY10	Q1FY11	Q2FY11	Q3FY11e	BB Cons Q3FY11e	HSBC vs. Cons
Sales growth	42%	14%	28%	13%	0%	10%	-10.6%
EBITDA mgn	12.7%	13.4%	8.4%	7.8%	10.5%	10.8%	(32)
PBT mgn	9.0%	10.1%	4.3%	3.9%	6.7%	8.6%	(194)
NI mgn	6.0%	6.6%	2.9%	2.6%	4.5%	4.8%	(36)

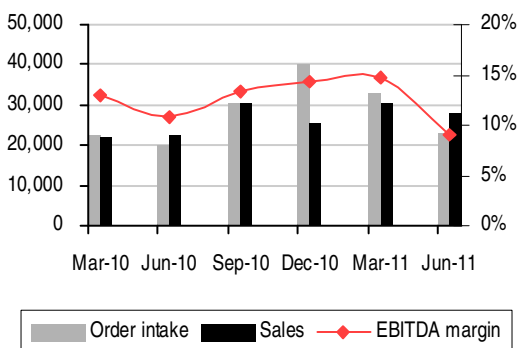
Source: Company data, HSBC estimates, Bloomberg

Siemens Ltd (Neutral, TP INR940)

Siemens is likely to report its Q4/FY11 results later this month. We discuss our expectations from the results below and highlight our estimates & valuation in the following charts & tables.

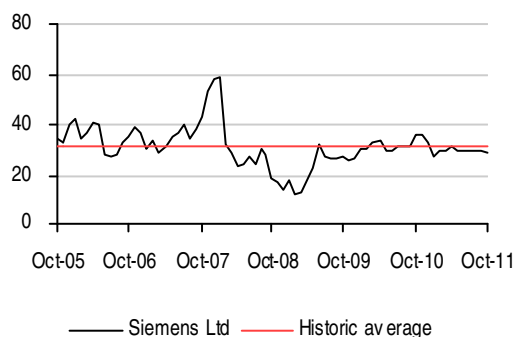
- ▶ We expect the y-o-y sales growth in Q4 to moderate to double digit level, driven by a much stronger comp last year. We believe that the order intake could surprise on the downside as the ordering activity in Power Transmission business has remained muted in last quarter
- ▶ We expect margins to improve from c9.0% in Q3 to c12.5% in Q4. We note that historically Siemens has demonstrated considerable volatility in its quarterly margins; hence the structural direction of margins will prove key during the results
- ▶ We expect the investor focus to remain on Siemens' strategy in India, outlook on margins and demand in its Industrials & Energy businesses
- ▶ On our current estimates, Siemens continues to trade close to its fair valuation, trading at c28.6x FY12e PE vs. historic average of c31.2x. We maintain Neutral on the stock with a TP of INR940.

Order intake, sales & margins – last 6 qtrs



Source: Company data

12m fwd PE vs. historic average (last 5 yrs)



Source: Datastream

Q4FY11 forecast summary

Sept YE (INR m)	Q4FY10	Q1FY11	Q2FY11	Q3FY11	Q4FY11e	BB Cons Q4FY11e	HSBC vs. s Con
Net Sales	30,339	25,254	30,337	27,785	34,502	35,131	-1.8%
EBITDA	4,019	3,627	4,449	2,503	4,324	4,490	-3.7%
Profit before tax	3,918	3,651	4,234	2,288	4,282	4,325	-1.0%
Net Income	2,534	2,438	2,777	1,548	2,779	2,851	-2.5%
EPS	7.5	7.2	8.2	4.5	8.2	8.1	0.8%

Margins & Trend	Q4FY10	Q1FY11	Q2FY11	Q3FY11	Q4FY11e	BB Cons Q4FY11e	HSBC vs. Cons
Sales growth	22%	38%	37%	24%	14%	16%	-2.1%
EBITDA mgn	13.2%	14.4%	14.7%	9.0%	12.5%	12.8%	(25)
PBT mgn	12.9%	14.5%	14.0%	8.2%	12.4%	12.3%	10
NI mgn	8.4%	9.7%	9.2%	5.6%	8.1%	8.1%	(6)

Source: Company data, HSBC estimates, Bloomberg

Risks

We highlight key risks to our Q2 FY12 estimates below.

Downside risks

- ▶ Delays in the deliveries and/or project approvals
- ▶ Excessive pricing pressure
- ▶ Higher than expected effective tax rates

Upside risks

- ▶ Significant increase in the short cycle orders
- ▶ Better than expected translation impact from INR depreciation
- ▶ Positive impact from recent reduction in the commodity prices

Valuation

We highlight the valuation assumptions for all our companies in the table below.

Valuation Summary

Company	HSBC Rating	Current price (INR)	HSBC TP (INR)	12m fwd target P/E	Valuation methodology	Key assumptions
Jyoti Structures	Overweight	63	100	6.0	EVA	Sales growth = 7.0% Target OR mgn = 10.0% WACC = 16.1%
Kalpataru Power	Overweight	102	165	7.2	SOTP / EVA	Sales growth = 8.0% Target OR mgn = 10.5% (Parent); 6.5% (JMC) WACC = 14.7%
KEC International	Overweight	57	86	6.3	EVA	Sales growth = 9.0% Target OR mgn = 9.5% WACC = 12.3%
ABB Ltd	Underweight	679	570	25.4	EVA	Sales growth = 9.0% Target OR mgn = 10.0% WACC = 11.7%
Areva T&D India	Neutral	212	235	19.7	EVA	Sales growth = 9.0% Target OR mgn = 9.5% WACC = 12.1%
Crompton Greaves	Neutral	165	170	13.0	EVA	Sales growth = 7.0% Target OR mgn = 8.5% WACC = 14.9%
Siemens India	Neutral	847	940	26.9	EVA	Sales growth = 9.0% Target OR mgn = 12.0% WACC = 11.3%

Source: HSBC

Disclosure appendix

Analyst Certification

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

Important disclosures

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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.

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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 cost of equity for that stock's domestic or, as appropriate, regional market 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.

Rating distribution for long-term investment opportunities

As of 13 October 2011, the distribution of all ratings published is as follows:

Overweight (Buy)	55%	(27% of these provided with Investment Banking Services)
Neutral (Hold)	35%	(22% of these provided with Investment Banking Services)
Underweight (Sell)	10%	(15% of these provided with Investment Banking Services)

Information regarding company share price performance and history of HSBC ratings and price targets in respect of its long-term investment opportunities for the companies the subject of this report, is available from www.hsbcnet.com/research.

HSBC & Analyst disclosures

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Company	Ticker	Recent price	Price Date	Disclosure
ABB INDIA	ABB.BO	679.00	13-Oct-2011	4, 11
AREVA T&D	AREV.BO	212.25	13-Oct-2011	2, 5, 7
CROMPTON GREAVES LTD	CROM.BO	164.80	13-Oct-2011	4
KALPATARU POWER TRANSMISSION	KAPT.BO	102.00	13-Oct-2011	4
SIEMENS INDIA	SIEM.BO	846.65	13-Oct-2011	4

Source: HSBC

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