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Markets Research

Asia
India

Transportation
Infrastructure

Industry
India Infrastructure Sector

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Industry Update

Outlook 2012: is India likely to display remarkable growth deceleration?

Manish Saxena
Research Analyst
(+91) 22 6658 4034
manish.saxena@db.com

Anup Kulkarni
Research Associate
(+91) 22 6658 4265
anup.kulkarni@db.com

Chockalingam Narayanan
Research Analyst
(+91) 22 6658 4056
chockalingam.narayanan@db.com

Abhishek Puri
Research Analyst
(+91) 22 6658 4214
abhishek.puri@db.com

We do not believe so; accordingly, our top infra picks are CIL, JSPL and L&T

Heading into CY12, valuations (E&C, Coal India) seem to be factoring in deep pessimism. Valuations imply a coal volume de-growth of ~2% CAGR over FY13-20e and new order growth of 5-10% CAGR over FY13-20e vs. 25-30% CAGR over FY02-11. Our lead indicators suggest a recovery as: (a) new project approvals show signs of a pick-up (b) cement demand has rebounded of late (c) CY11 power demand growth at a decade high. For CY12, key themes could be valuations and recovery. We prefer companies with strong balance sheets, high RoEs/FCF as being the best positioned to benefit from an upturn.

Valuations and cyclical recovery to be key themes in CY2012

While perceptions of pricing power emerged as a key differentiated theme for CY11, for the coming year and beyond we believe that the following themes could emerge: (a) capex cycle recovery – our expectation in early H2CY12; (b) improving business confidence, especially on clearances; and restoration of faith in capital markets; (c) pricing a big differentiator in energy themes, i.e., Coal India JSPL; (d) realignment (forced or friendly), a rate cut reversal may help leveraged companies; and (f) currency could benefit exporters, hurting earnings from unhedged forex liability.

Our top picks are among the best positioned for cyclical recovery

Our top picks in the pan-Indian infrastructure coverage universe are companies that offer: (a) benefits from operating leverage as and when the economy recovers; (b) a strong balance sheet and RoE, giving us comfort that companies are not stuck with receivables; (c) either strong FCF or earnings yields, which offer some cushion to valuations and (d) reverse DCF, which suggests that stocks are currently factoring in deep pessimism. Stocks that fit in these metrics are Coal India, JSPL, L&T, ACC and NTPC.

Our target prices are based on a combination of mid-cycle multiples and DCF

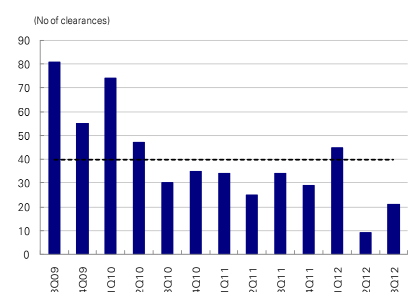
After the series of consensus downgrades, we now find our estimates largely in line with consensus. Our 12-month target prices are premised on 16x one-year forward exit P/E for E&C companies and Coal India, and USD125 EV/t for cement names. For power utility names, we use a combination of project DCF, using 12.5% CoE for operational projects and 13-15% for projects under construction. For PSUs, which operate under two-part tariffs, we use exit price/book target multiples of 2-2.25 regulated equity, as per the Gordon Growth Model. Key risks:(a) recovery in India's investment cycle gets pushed back by another year; (b) Coal India rolls back to the previous pricing mechanism; (c) the cement industry players once again shift their objectives from maintaining discipline to market share; resulting in price wars and (d) a global slowdown resulting in a sharp reduction in worldwide coal prices, which would hurt Coal India's EPS as well as JSPL's competitive strengths.

This report changes target prices and estimates of several stocks under coverage. Please refer to Figure 1 and Figure 2 for details

Top Picks	
Larsen & Toubro Ltd (LART.BO),INR1,143.55	Buy
Coal India Limited (COAL.BO),INR320.20	Buy
Jindal Steel & Power (JNSP.BO),INR488.40	Buy
NTPC Limited (NTPC.BO),INR159.20	Buy
ACC (ACC.BO),INR1,112.00	Buy

Companies Featured	
Larsen & Toubro Ltd (LART.BO),INR1,143.55	Buy
Coal India Limited (COAL.BO),INR320.20	Buy
BHEL (BHEL.BO),INR264.75	Buy
Thermax Limited (THMX.BO),INR439.80	Buy
Jindal Steel & Power (JNSP.BO),INR488.40	Buy
NTPC Limited (NTPC.BO),INR159.20	Buy
ACC (ACC.BO),INR1,112.00	Buy

Project Clearances picks up



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Nice talk, but would they walk?	25 Nov 2011

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Summary of changes

Changes in ratings and target prices

Figure 1: Changes in ratings and target prices

	Rating		Target Price (INR/sh)		
Stock	Old	Revised	Old	Revised	% Change
L&T	Buy	Buy	1,850	1,600	(14)
JSPL	Buy	Buy	755	710	(6)
NTPC	Hold	Buy	190	185	(3)

Source: Deutsche Bank

Changes in forecasts

Figure 2: Revised estimates and changes

	Sales (INR mn)			EBITDA (INR mn)			Net Income (INR mn)		
	FY12E	FY13E	FY14E	FY12E	FY13E	FY14E	FY12E	FY13E	FY14E
ACC	93,320	107,965	123,817	19,856	23,790	30,847	11,598	14,379	19,094
% Change	-	-	-	0	(1)	(5)	0	(1)	(5)
L&T	653,399	744,346	854,462	92,850	101,305	115,033	44,443	48,045	56,244
% Change	(1)	(3)	(4)	(1)	(4)	(4)	(2)	(5)	(6)
Coal India	622,761	713,258	709,111	177,767	197,000	173,191	149,065	173,246	161,441
% Change	2	7	6	5	13	(4)	4	11	(1)
JSPL	175,136	207,090	265,718	71,608	94,508	129,920	41,800	55,779	75,477
% Change	2	0	2	0	(6)	(3)	1	(8)	(4)
NTPC	678,884	749,597	879,247	154,332	173,080	209,922	101,127	108,482	122,778
% Change	6	2	2	(6)	(9)	(4)	3	(1)	(1)
Ambuja	84,866	98,180	112,441	21,552	26,325	32,825	12,819	15,856	20,589
% Change	-	-	-	0	(0)	(5)	0	(0)	(6)
Grasim	239,780	269,450	305,424	51,907	60,555	76,920	23,349	26,012	32,636
% Change	-	-	-	(1)	(0)	(2)	(1)	(0)	(2)
India Cements	42,031	47,803	54,331	8,600	10,115	12,996	2,764	3,036	4,845
% Change	-	-	-	(0)	(3)	(5)	(0)	(7)	(9)
Ultratech Cement	175,921	202,629	232,703	37,698	46,271	60,740	19,267	24,021	33,562
% Change	-	-	-	(1)	(0)	(2)	(2)	(1)	(3)

Source: Deutsche Bank

Investment framework

Figure 3: Framework for outperformance

2012 Outlook

We premise our sectoral framework for CY12E on a start in spending in the road and rail networks. We see pricing and gradual improvement in business confidence as important themes to play out in 1HCY12E, while the recovery of the capex cycle, clarity on sectoral trends in the Twelfth Plan and benefits from the rate cut cycle to play out in 2HCY12E. We do not rule out corporate/asset realignment, share buybacks or special dividends to boost minority holders' returns in the interim. Our top picks are the companies with good balance sheets, high RoEs or high FCF yields and prevailing valuations factoring in low long-term volume growth assumptions vs. the All India GDP.

Key themes	Key Enablers	Thematic Winners & Losers	Risks
Pricing	(a) Coal India's delivered energy prices on INR per 1,000 kcal basis at a 45% discount to international prices; (b) Low-cost units tariffs for new plants to rise above INR3.5/kWh, resulting in possible floor prices for merchant rates to INR3.5/kWh, up 20-35% YoY over last year's lows; (c) Industry maturity and the start of the busy season could help cement prices move up.	Coal India, Jindal Steel & Power and Cement players (ACC, Grasim and Shree Cement).	Inflation compulsions not permitting government to allow these hikes, especially in case of coal and cement.
Recovery in the investment cycle: Twelfth Plan shifts focus to rail/roads	Tailwinds in construction segment suggest a possible inflection point and a period of profitable order flows starting Q1FY13E. DFC orders to kick-start and NHAI to continue with current spate of orders. New orders from states for mono/metro rails	With competition dwindling, companies with strong b/s Larsen and Toubro, IRB could be early beneficiaries. Cement players (ACC, Grasim and Shree Cement) may also derive benefits	Deterioration in collection cycle of existing orders making construction companies cautious
Benefits of operating leverage	Low capacity utilization and inputs largely in place	ACC, JPA, NTPC, JSPL and Adani Power	Fuel procurement especially for private IPPs
Incremental cost of new energy rising	Higher fuel cost from blending with imports, rupee depreciation, aligning local cost to global	Coal India and JSPL, Thermax with ability to provide for solutions in alternate energy space would benefit. So would ABB India and Siemens on automation technology products for energy savings	Global GDP drops to a level where energy prices collapse
A continued weakness in Indian currency	Continued rupee depreciation or rupee not appreciating vs. global currencies	Exporters such as Larsen and Toubro, companies with forex loans and no foreign exposures such as Lanco and JPA, would be big losers	
Share buyback/dividend payout	Government's recent cabinet note to consider buyback of shares in cash-rich PSUs could be earnings accretive and also a better alternative to special dividend or cross holding structures. MNCs may also consider buybacks.	Minority shareholders in cash-rich PSUs, such as Coal India and BHEL, are likely beneficiaries in case of a buyback/dividend payout. Among companies with MNC parents, ABB, Siemens, ACC and Ambuja could be beneficiaries.	Cross holding in PSUs may not be taken positively, as seen historically.
M&A/realignment of stressed assets/rate cuts	Banks are closely evaluating financials of stressed assets and may exercise loan covenants or effect realignment of these stressed assets like in the case of Andhra Cements in CY11/fall in bond yields.	Historically, stocks such as Lanco and JPA have done well in a falling bond yield scenario	Any stressed assets for operational-commercial factors could drag down the b/s until the asset becomes viable

Source: Deutsche Bank

Figure 4: Summary of key investment ideas

Sub-sector	Key industry drivers	Top stock ideas
Industrials	Pick-up in order inflow led by construction orders in roads and railways, (export orders given the rupee depreciation) followed by oil & gas and T&D. Orders for energy efficiency.	Stocks trading at the lowest EV/order book multiples and factor in a new order inflow growth of 6-7%. Any move to change could result in upticks for L&T and Thermax largely in 2HCY12.
Coal	Coal India's delivered energy prices on INR per 1,000 kcal basis at a 45% discount to international prices could help sustain the recent price hike and outweigh any impact from the proposed wage hikes or shortfall in coal volumes (vs. MOU targets).	Stock trading at a discount to regional players and factors in negative long-term volume growth. Acceptability of the recent price hikes could result in significant outperformance as early as 1HCY12. Coal India remains the preferred pick, while JSPL could also benefit.
Power utilities	Continued power demand and low availability of cheap energy may result in a higher floor rates for merchant power. High operating leverage with a preference on domestic coal use could benefit Indian central utilities.	NTPC with complete backing of the central regulators stands out as our top pick. Current stock price factors in FY17 capacity of 52 GW vs. management guidance of 66 GW. JSPL is a likely beneficiary of the sustained reasonable merchant power prices.
Cement	Industry maturity and the start of the busy season could help cement prices to move up. Incremental capacity would lag the incremental demand and we would move one year closer to upturn likely in H2CY13E onward.	Stocks factoring in a reasonable volume growth of 8%. Ability to demonstrate pricing power during the start of the busy season could result in outperformance in as early as 1HCY12. Our picks are ACC, Grasim and Shree.
Infrastructure	The Twelfth Plan details a possible shift to rail/road capex, relatively profitable projects being tendered out, MoEF clearances and a stable currency.	Our picks in the space continue to be relatively better balance sheet companies such as L&T and IRB. We agree that rate cut cycle could benefit leveraged plays, but we would tend to focus on companies with a greater share of profitable projects on hand.

Source: Deutsche Bank

Executive summary

India's premium infrastructure stocks at compelling valuations

Global headwinds and macro concerns have taken their toll on the entire Indian infrastructure space, barring the cement sector. After the correction, our reverse DCF for the premium infrastructure plays across our coverage suggest that valuations are currently factoring in very low volume growth and, in some cases, negative volume growth – illustrating a case for deep pessimism. Our reverse DCF valuation for three of our top picks, Coal India, JSPL and Larsen & Toubro, is based on CoE of +13%, WACC of 10.7-13.2%. In addition, terminal free cash flow growth of 2% beyond FY20E shows the following volumes that each company needs to deliver:

- Coal India: A negative volume growth of 1.5% over FY13-20E, assuming annual regulated price inflation of 3% and considering the coal reserves of Coal India as well as its production plan targets. From a historical perspective, coal price inflation has been at a 5% CAGR over the last 10 years and volumes have grown at a 5% CAGR for the last 10 years.
- JSPL: In the first scenario, we have assumed that the steel business is valued at 50% to replacement, implying long-term merchant rates at INR3.5/kWh over the longer term. In the second scenario, we have assumed IPP unit valuations at 1x P/B and mining assets at a 50% discount to NPV, implying steel EBITDA would be at USD200/t and captive power would sell power at less than INR2/kWh unit (c50% lower than current levels).
- Larsen & Toubro: Important assumptions are that the IT division is valued at 8x FY13E P/E, the infrastructure division is valued at 1x FY13E P/B and L&T Finance at its current price. Under these assumptions, the core engineering division's new orders would need to grow at about 10% between FY12E and FY20E and have long-term E&C margins of ~10%. Over last 10 years, L&T order inflows have grown at 26% CAGR and E&C division margins have been on average 11%. Assuming 6% long-term inflation, order inflow volume growth is 4% – much lower than Indian GDP.

While perceptions of pricing power led outperformance in CY11

Indian cement prices showed a remarkable resilience by inching up 5% in CY11 despite low capacity utilisation. Notwithstanding weak demand-growth (one of the lowest in the last decade), industry maturity helped the DB cement index outperform by c34% to the BSE Sensex. Power Grid, with a tariff structure largely independent of operational volumes, was poised to report a steady growth in earnings, outperforming the market by 27%. Coal India, which had a stellar run after its listing, lost most of its gains on perceptions of a lack of pricing power, especially in relation to additional cost for wages and new mining taxes. Industrial stocks suffered on both accounts; weak order inflow outlook and rising competition – *a pointer toward lack of pricing power.* Stocks such as JSPL underperformed the market on perceptions of weak merchant tariffs and risk of profits from operating captive coal block coming under regulatory scrutiny.

…Valuation comfort and recovery will emerge as key themes in CY12

From an outperformance perspective; we list the following important themes for CY12:

(1) an upturn in capex cycle, notably driven by a resurgence of the construction sector

Key stock themes: Larsen & Toubro, IRB

Our sectoral hypothesis continues to be premised on a resurgence of the capex cycle largely driven by the construction sector starting in H2CY12E. Our detailed project-by-project tabulation suggests that construction sector orders in FY13E could well touch INR1,353bn – primarily driven by roads/railways and a few export orders. Mining capex could also show some progress, which could drive up power capex by CY13E.

(2) , benefits flowing from operating leverage

Key stock themes: ACC, JPA, NTPC, Adani Power, JSPL

The companies that stand out in terms of having the benefits of operating leverage are ACC, JPA and Ultratech in cement and NTPC and Adani Power in utilities. Within our diversified universe, JSPL can benefit significantly from volume growth as many capacities with captive mines are up for commissioning in the next few years. Coal India and Larsen & Toubro also have high fixed costs and could once again derive high benefits of operating leverage.

(3) , improving business confidence especially on clearances

Key stock themes: Larsen, Coal India, JSPL

It is interesting to note that we are steadily seeing an increase in project approvals at the Ministry of Environment and Forest. From a low of nine clearances in Q3CY11, we now find that the government is approving seven projects per month. While this is far below the peak clearances that we saw in FY07, this seems to have had an immediate impact in the business confidence index, which has moved up after a gap of five months.

(4) , pricing could be a big differentiator in energy themes: Coal India, JSPL

Key Stock Themes: Coal India, JSPL and Thermax

We find the biggest dichotomy between perceptions and reality in the coal segment, with too much news floating around the recent coal price hike and matters being referred to Indian high courts. While Indian courts are independent, historical judgment on issues of energy prices shows that the Indian Supreme Court had ruled that it is government's prerogative to fix energy prices. Apart from Coal India, another stock that could benefit from rising energy prices is JSPL, wherein the company's cost competitiveness of the business model becomes even better. Thermax, in mid-caps, has products that offer boilers, which use a variety of feedstock ranging from renewable to non-renewable and would also be a beneficiary along with models such as ABB India and Siemens India that offer energy-savings products.

(5) , realignment (forced or friendly), rate cut reversal may help leveraged companies

Key Stock Themes: JPA, Lanco Infratech

After the Indian private sector banks facilitation of the sale of Andhra Cements to the promoters of JPA, various assets are on the block as per management communiqué and filings as shown in Figure 57. Our interactions with the project teams of various institutions suggest that apart from the publicly-known potential asset sales as listed in Figure 57, there could be many more transactions if the existing promoters do not inject sufficient equity to cover the cost over-runs. Banks would be keenly evaluating the financials of each stressed asset before exercising any loan covenants. Highly leveraged companies could also benefit from the much-talked-about rate cycle reversal.

(6) , currency could benefit exporters, hurting earnings from un-hedged forex liability

Neutral for Larsen as gains in forex offset by forex liabilities; negative for JPA, Tata Power, Lanco Infratech

For E&C companies that are net exporters, the sharp depreciation in the Indian rupee (INR) particularly against the US dollar (USD) and Chinese yuan (CNY) is positive for exports, especially for contracts that were entered in CY12E. Also, imports could become more difficult in India, making the cost differential between Indian and Chinese vendors quite low. However, issue for all the companies would be forex liability. For companies such as JSPL, the management communiqué suggest that it would move the forex debt to its subsidiaries, which have forex earnings to obtain a natural hedge. The new accounting norms would provide some lee-way to Indian corporates in an effort to write off the losses closer to maturity. However, some companies with forex debt, such as JPA, do not have a natural hedge from forex earnings.

Our lead indicators continue to suggest capex cycle turnaround

Our lead indicators for the country's economic activities, i.e., power volumes, cement demand, environmental clearances, have all started showing an uptick. Our interaction with promoters suggests that at the margin, funds are being committed to the greenfield/brownfield projects by cash-rich developers. Furthermore, infrastructure development banks have started saying that disbursements in Q4 for the segment could be equal to that of the first three quarters, which suggests a capex cycle turnaround sooner rather than later in this calendar year.

Our top picks are companies best positioned to benefit from upturn

Our top picks in the pan-Indian infrastructure coverage universe are companies that offer the following:

- Benefits from operating leverage as and when the economy recovers
- Strong balance sheet and RoE, giving us comfort that the company is not stuck with large receivables in this downcycle
- Either strong FCF or earnings yields, which offer some cushion to base-case valuations
- Reverse DCF, which suggests that the stock is currently factoring in deep pessimism

Figure 5: Summary of our target prices

Company	Target price (INR/sh)	Implied value of core business (INR/sh)	Implied P/E (x)		EPS YoY growth (%)		RoE (%)		Remarks
			FY13E	FY14E	FY13E	FY14E	FY13E	FY14E	
BHEL	320	320	12.8	11.1	(7.4)	15.7	20.9	20.0	
Larsen & Toubro (E&C)	1,600	1,231	18.8	17.3	1.7	8.9	15.3	15.0	Implied value of core E&C business at P/E of 16x FY13E
Thermax	550	550	16.4	14.2	(3.5)	15.7	23.3	23.3	
ACC	1,250	1,250	16.3	12.3	24.0	32.8	19.2	22.4	
Grasim Industries (Cement)	3,000	1,931	12.5	8.9	18.1	40.4	11.3	11.9	VSF business valued at P/E of 7x FY13E
Shree Cement (Cement)	2,280	1,894	15.8	7.6	297.5	106.4	24.8	30.6	Power business valued at capital employed of 1.5x FY13E
JSPL									
Scenario-1: Steel is assumed as core business	712	203	8.6	8.4	9.3	1.5	24.8	27.3	Power business valued NPV at CoE of 12.5% for operational projects and 14.5% for under-construction projects
Scenario 2: Power is assumed as core business	712	458	16.4	13.1	39.6	25.1	24.8	27.3	Steel business valued at P/E of 8x FY13E
NTPC	185	185	14.1	12.4	7.3	13.2	13.8	14.4	
Coal India	430	430	15.7	16.8	16.2	(6.8)	34.7	26.1	

Source: Deutsche Bank estimates, Bloomberg Finance LP

ACC – Our top pick in the Indian cement sector segment

Analyst – Chockalingam Narayan

- Recent outperformance has currently taken valuations to the third quartile of the 17-year trading band. However, sustainable FCF of 8+% and cash/share of INR121, could propel management to increase dividend payout.
- ACC's current utilisation rate of 78% shows good probability that the company could deliver volume growth higher than the industry average as and when cement demand picks up.
- Key risk is that industry players start a price war and focus more on market share.

Coal India – Our top pick in the Indian energy segment

Analyst – Manish Saxena

- The recent correction in the stock price has taken the valuation closer to regional peers; an earnings yield of ~8% is strong support. Reverse DCF at CMP implies negative volume growth of 2% over FY13-20E.
- Initiatives for a price hike are likely to be approved as the delivered price of coal in India on average remains at a 45% discount to international prices.
- Re-start of approvals from MoEF is likely to drive up long-term volume growth, which is a significant positive.
- Strong cash balance raises the possibility of a one-time special dividend or buyback, which is also a big positive.
- A key risk is if the government directs the company to roll back the prices as per prior methodology of sales.

Larsen & Toubro – Our top pick in the Indian industrials segment

Analyst – Manish Saxena

- The recent correction implies residual E&C valuations are at less than 10x – one of the lowest in the last decade. At CMP, our reverse DCF factors in order inflow growth of about 10% CAGR between FY12E and FY20E – much lower than historical growth of 26% over FY01-11.
- We expect the order inflow cycle to slowly turnaround by Q1FY13E, largely driven by the revival of orders from road/rail sectors. With the competition having weak balance sheets, L&T could be an early beneficiary of an uptick in the capex cycle.
- A good set of risk management policies is now in place and could ensure that balance sheet strength is largely intact and the company is among the best positioned within the sector to benefit from an upturn.

JSPL – Our top pick in the Indian conglomerate/energy segment

Analyst – Manish Saxena

- If we assume that the power business trades at price/book of 1x, then the recent correction in the stock implies long-term steel business EBITDA/t of USD200/t vs. USD300/t currently. In addition, captive power units' realisations would drop to less than INR2/unit. We believe that there is no additional volume growth in the steel and captive power business over and above the capacities under construction.
- Conversely, if we assume that the steel business is valued at a 50% discount to replacement, then the power business needs a merchant tariff of 3.5/kWh unit for the rest of its life.
- The earnings growth looks achievable as the company's incremental capacity growth is under the low quartile of the cost curve.

NTPC – Our top pick in the Indian regulated utility sector

Analyst – Abhishek Puri

- NTPC's sharp underperformance over last three years has taken the valuations closer to regional peers and is now trading at 1.6x P/B – valuations are near 2004 lows.
- With its PLF at one of the lowest levels seen in the last three years, NTPC seems to be one of the few models that could cater to India's power demand as private IPPs struggle to procure coal or change the commercial terms of their agreement. Also, incremental volume from hydro and nuclear power projects is likely to be limited.
- Critical catalysts will be monthly volume growth and start of captive coal.

Thermax – Our top pick among the Indian mid-cap industrials segment

Analyst – Anup Kulkarni

- The recent correction of the stock price implies that the company needs a new order CAGR of 10% over FY13-20E vs. 30% achieved over the last eight years.
- The Thermax product offering, especially in areas of energy renewable, is likely to drive medium-term growth.
- Thermax's risk management looks quite good as its NWC/sales continue to be well below 20%.

Valuations imply low growth expectations

Infra stocks are trading close to historically low multiples

A look at Figure 6 would suggest that Indian infrastructure companies are possibly trading within the lowest quartile of the valuation band over the last 15 years.

Figure 6: A snapshot of infra companies' P/E band

March year-end	BHEL			Larsen and Toubro			ACC			JSPL			Remarks
	Min	Max	Avg.	Min	Max	Avg.	Min	Max	Avg.	Min	Max	Avg.	
FY96	2.9	9.8	5.3	5.7	9.7	7.7	18.7	46.2	24.8				Valuations at bottom of capex cycle in FY94-96
FY97	6.0	11.3	8.4	8.6	11.8	10.1	42.5	136.3	69.2				Peak cycle valuations
FY98	6.1	8.5	7.1	8.5	11.9	9.9	26.1	109.0	46.4				Mid-cycle valuations
FY99	5.0	8.9	6.8	7.4	12.7	10.0	NA	142.5	NA				Valuations at bottom of cycle before pick in FY99
FY00	6.6	27.9	16.2	10.2	31.0	19.3	NA	1595.7	133.0				Valuations at bottom of cycle with pick up in capex in 'FY99
FY01	6.9	13.4	9.9	8.0	13.9	11.3	12.1	25.0	17.6	2.2	5.3	4.1	Mid-cycle valuations
FY02	6.5	10.0	8.4	8.1	13.0	10.3	15.1	22.9	18.2	1.2	2.8	1.7	Peak cycle valuations
FY03	6.7	8.9	7.9	5.5	8.3	6.8	11.8	20.6	15.8	1.2	1.8	1.5	Sector stagnating with lackluster investment flows
FY04	8.7	16.1	12.5	5.7	12.1	8.9	10.5	13.6	12.4	1.4	3.4	2.3	Power sector reforms process initiated
FY05	10.2	14.6	11.6	9.0	12.6	10.8	11.3	18.1	14.2	2.1	4.6	3.3	Power reforms set in motion and orders start flowing
FY06	11.1	22.7	15.2	10.7	19.7	14.6	9.1	15.4	12.0	3.6	6.9	5.1	Roads drive the valuations
FY07	18.7	23.5	20.8	16.2	21.3	18.6	9.6	16.8	13.5	4.5	6.6	5.5	Capex from other sectors picks up
FY08	21.1	43.1	32.6	20.9	46.3	33.3	11.9	18.6	14.7	6.0	18.3	10.5	Peak cycle valuations, for Eng companies, JSPL gets prominence
FY09	15.7	28.8	20.0	10.7	29.5	18.9	4.9	10.8	7.1	3.3	12.0	7.2	Global credit crisis
FY10	18.2	23.2	21.0	14.9	27.2	24.0	7.8	15.8	12.5	7.1	17.7	14.0	Recovery from crisis commences
FY11	15.0	20.1	18.0	21.0	28.9	25.2	13.5	17.4	15.3	15.0	18.4	16.3	Some pick-up in capex
YTD FY12	9.4	15.5	12.8	12.8	24.5	19.2	14.0	16.7	15.1	9.5	14.1	11.8	Valuations at bottom of cycle

Source: Bloomberg Finance LP, Deutsche Bank. Note for ACC, year ending is December from FY06. Earnings of JSPL were largely driven by the steel business up to FY08.

Consensus has cut on an average 12-15% in earnings for FY13E

It is interesting to see that a majority of the Street is now factoring in just -1% to 16% EPS growth for FY13 after cutting their expectations for FY13 by 5% to 20% across most companies. (Figure 7 depicts the consensus expectations.)

The maximum cuts have been for engineering companies, with upgrades in the last year largely being in the space of Coal India and a few cement names, such as ACC and Grasim. For Power Grid, our sense is that the Street upgrades are driven more by factors that are non-operating in nature, such as other income and minor businesses.

Figure 7: Consensus estimates have seen significant downgrades

	Change in consensus EPS from March 2011 to December2011 (%)		Analyst ratings			Consensus EPS growth (%)	
	FY12	FY13	Buys	Holds	Sells	FY12	FY13
Coal India	7.2	4.4	31	9	4	31.0	11.9
JSPL	(18.2)	(21.3)	21	7	4	24.4	13.7
BHEL	(4.3)	(9.4)	20	15	11	14.9	7.6
L&T	(10.6)	(14.7)	37	6	4	11.2	14.1
Thermax	(8.1)	(20.3)	12	16	10	9.8	4.8
IRB Infra	(11.2)	(6.9)	43	1	2	0.1	11.1
NTPC	(2.0)	(5.2)	28	16	4	8.8	9.0
Tata Power	(10.0)	(19.2)	21	12	5	10.7	(1.6)
Power Grid	6.3	6.0	29	3	3	9.1	15.5
ACC	5.8	3.5	10	15	31	(3.4)	16.4
Grasim	5.4	3.3	31	4	-	13.4	6.2
Shree Cement	(39.6)	(30.3)	25	11	6	(1.3)	70.8

Source: Bloomberg Finance LP, Deutsche Bank

Reverse DCF implies low volume growth expectations

Looking at what is factored into the reverse DCF, we find that valuations of JSPL, Coal India and Larsen & Toubro assume that volume growth in India over the seven-year period between FY13E and FY20E would be virtually negative.

Figure 8: Reverse DCF implications

Company	CMP (INR/sh)	Imp. assumptions	Key conclusions
JSPL	480		
Scenario -1		CoE of 13.65%, WACC of 10.7%, TCF growth of 2%, 1,000MW, 2,400MW and hydro project at P/B of 1x, operational mining assets – other than captive mining assets at 50% disc. to NPV	Implies long-term steel business EBITDA/t of USD200/t vs. current at USD300/t; captive power rates would drop to less than INR2/unit. No further volume growth in steel and captive power business
Scenario 2		CoE of 13.65%, WACC of 10.7%, TCF growth of 2%, All standalone assets (3mnt steel, 2mnt pellet, 1.2mnt Sponge) valued at 50% discount to replacement, 1,700MW captive power capacity, Mining assets at 50% to NPV	Implies IPP would sell merchant power at INR3.5/unit, No further capacity over 2,400MW
Coal India	318	CoE of 12.4%, TCF growth of 2%, Coal prices rises by 3% pa from FY14-20E	Implies volumes CAGR of -2% from FY14-20E
Larsen and Toubro	1,090	CoE of 13.2%, WACC of 12.6%, TCF growth of 2%, L&T IT valued at P/E of 8xFY13E, L&T IDPL valued at P/B of 1xFY13E, L&T Finance valued at CMP,L&T E&C to have a medium-term margins of 11%	Implies E&C orders CAGR of 10.5% over FY13-20E; Assuming 6% long-term inflation, order inflow volume growth of 4% – much lower than Indian GDP
BHEL	250	CoE of 13.2%, TCF growth of 2%, Long-term EBITDA margins at 18%.	Order inflow growth over FY13-20E at CAGR of 1.2% on a base of 11GW in FY13E
Thermax	431	CoE of 13.2%, TCF growth of 2%, Long-term EBITDA margins at 11%.	Implies order inflow growth over FY13-20E at CAGR of c10% vs. 30% witnessed over FY03-11.
ACC	1101	CoE of 14.5%, WACC of 12%, TCF growth of 2%; Long term EBITDA/t at USD19/t	Implies volume growth CAGR of 8% from FY13-19E
NTPC	156	CoE of 12.4%, WACC of 9.6%, TCF growth of 2%; No value for mining assets; All new capacity on two-part tariffs	Implies capacity of 51GW by FY17E vs. company guidance of 66GWe
Grasim	2426	CoE of 14.5%, WACC of 12%, TCF growth of 2%; Long-term cement EBITDA/t at USD18/t. VSF business valued at 5x FY12E earnings, much lower than steel multiples.	Implies cement volume growth CAGR of 8% from FY13-19E

Source: Deutsche Bank

FCF yields also look reasonable vis-à-vis position to cycle

With capex programmes of most of our top picks (barring JSPL and Grasim) largely completed, FCF yields of other companies suggest that there are many negatives reflected in the price.

Figure 9: FCF yields could not look better

	Price (INR/sh)	FCF Yield (%)		OCF Yield (%)		D/E (x)		EBIT/interest (x)	
		FY13E	FY14E	FY13E	FY14E	FY13E	FY14E	FY13E	FY14E
ACC	1,127	8.3	7.7	10.2	13.1	(0.3)	(0.3)	14.9	20.1
BHEL	266	8.1	11.3	10.1	13.3	(0.2)	(0.3)	519.4	596.0
Coal India	318	12.1	9.4	14.3	17.2	(1.5)	(1.4)	160.2	164.8
Grasim	2,427	3.1	9.2	28.5	35.7	0.1	0.0	7.9	10.5
JSPL	500	(9.1)	(12.2)	18.6	25.4	0.9	1.0	9.0	8.7
L&T	1,128	1.8	10.1	2.6	10.9	0.4	0.3	8.4	9.2
NTPC	158	(3.4)	(0.8)	9.3	13.1	0.5	0.5	6.6	6.0
Shree	2,080	16.5	23.8	19.9	26.5	(0.1)	(0.5)	6.1	132.0
Thermax	434	6.9	11.3	10.0	14.5	(0.4)	(0.5)	93.2	91.4

Source: Deutsche Bank estimates, Note: L&T figures are Standalone

Infra stocks no longer at premium to regional/global peers

A look at comparative valuations for industrial companies would suggest that BHEL is now trading at a discount to its Chinese peers. L&T's stock is trading above regional peers. However, if we were to take residual engineering valuations, the stock would also be cheaper than regional peers.

Figure 10: Global comparative valuation for industrials

	Reco..	Target price	Price	Currency	Mkt. cap.	----EV/EBITDA (x)---		-------P/E (x)--------		--------RoE (%) -------		EBITDA Margin (%)	
		(INR)			(INRm)	FY12E	FY13E	FY12E	FY13E	FY12E	FY13E	FY12E	FY13E
ABB Ltd India #	Sell	530	635	INR	177,176	33.2	20.2	45.8	26.4	11.5	17.6	6.2	8.4
Bharat Heavy Electricals	Buy	396	266	INR	865,643	6.2	6.3	9.9	10.7	28.3	20.9	21.3	21.3
Larsen & Toubro	Buy	1,600	1,128	INR	983,327	11.6	11.5	15.5	14.3	15.5	14.4	14.2	13.6
Siemens India ##	Hold	680	701	INR	301,314	13.8	10.7	23.9	19.6	24.9	23.5	11.3	11.4
Thermax	Buy	550	434	INR	58,285	7.2	7.4	12.5	12.9	28.5	23.3	10.7	9.7
IRB Infra.	Buy	192	139		48,774	7.4	7.4	9.3	10.6	18.0	13.8	43.8	44.0
Average						**13.3**	**10.6**	**19.5**	**15.8**	**21.1**	**18.9**	**17.9**	**18.1**
Global Average						**6.4**	**5.0**	**15.1**	**12.3**	**14.5**	**14.8**	**9.9**	**10.2**

Source: Bloomberg Finance LP, Deutsche Bank estimates # FY12 is Dec'11, ## FY12 is Sep'12

Long energy themes such as Coal India seem to trade on a par with regional average coal companies. However, if one looks at Coal India, it is trading on a par with Chinese Shenhua, and JSPL is trading at a discount to regional mining peers.

Figure 11: Mining companies are trading by and large on a par with regional comparables

	EV/EBITDA (x)		P/E (x)		RoE (%)		EV/Reserve (USD/ton)
	FY12E	FY13E	FY12E	FY13E	FY12E	FY13E	
Coal India Limited	6.8	5.2	13.5	11.6	40.4	34.3	1.3
Jindal Steel & Power	9.0	7.4	11.2	8.4	26.0	27.4	
Average - China	5.9	5.4	10.5	10.0	18.6	16.7	3.7
Average - Asia	9.8	6.3	12.3	8.3	40.3	44.5	8.7
Average - Aus+Europe	8.9	6.9	17.3	13.2	14.1	15.3	7.2
Average - Americas	6.2	4.7	10.3	8.1	21.1	21.3	3.0
Average - Global	8.1	5.9	12.4	9.4	27.3	29.0	6.0

Source: Deutsche Bank estimates, company data

The Indian cement names have had an extended outperformance, running into a third year. At this juncture, we do estimate that there is value, but on selective basis.

Figure 12: Indian cement names are at a premium to Chinese companies, but at a discount to Indonesian names

Company	M.cap	PER (x)			EV/EBITDA (x)			EV/Ton (USD)			P/B (x)			RoE (%)			EPS (CAGR)
	USDm	FY12	FY13	FY14	FY12	FY13	FY14	FY12	FY13	FY14	FY12	FY13	FY14	FY12	FY13	FY14	%
India																	
ACC	3,950	18.1	14.6	11.0	9.4	7.4	5.4	115	108	102	3.0	2.7	2.3	17.1	19.3	23.4	28.3
Ambuja Cements	4,372	18.2	14.7	11.3	9.5	7.6	5.7	148	145	135	2.9	2.5	2.2	16.6	18.3	21.7	26.7
Grasim	3,994	9.1	8.2	6.5	7.0	5.6	4.0	88	87	60	1.3	1.1	1.0	16.8	15.4	14.9	18.2
India Cements	410	7.9	7.2	4.5	5.7	4.6	3.5	62	59	58	0.5	0.5	0.5	1.7	6.6	7.5	32.4
Shree Cement	1,339	29.2	11.7	7.3	5.7	3.6	2.1	81	65	41	3.3	2.6	2.0	11.0	11.8	24.8	99.7
UltraTech	5,991	16.6	13.3	9.5	8.5	6.8	5.1	122	120	100	2.6	2.2	1.8	18.4	17.0	17.9	32.0
India Avg		**17.1**	**12.0**	**8.6**	**8.1**	**6.3**	**4.8**	**106**	**97**	**84**	**2.1**	**1.8**	**1.5**	**13.5**	**13.6**	**17.3**	**39.7**
India large cement Avg		17.6	14.2	10.6	9.2	7.3	5.4	128	124	112	2.8	2.5	2.1	17.4	18.2	21.0	29.0
China avg		5.7	5.9	4.8	4.9	4.9	4.2	72	59	54	1.6	1.4	1.1	27.1	20.9	21.6	11.9
Indonesia avg		17.5	15.7	13.6	10.5	8.9	7.4	315	298	256	3.7	3.2	2.7	22.4	21.6	21.5	18.3
Asia ex India avg		**13.1**	**11.7**	**10.3**	**9.0**	**7.8**	**8.9**	**141**	**133**	**123**	**2.5**	**2.3**	**2.1**	**20.3**	**19.5**	**20.3**	**18.3**

Source: Deutsche Bank estimates

Indian utility names have been among the worst performers and most are currently trading at a discount to their regional peers

Figure 13: Indian utilities are trading at a discount to the regional peer group

Company	EV/EBITDA (x)			P/E (x)			RoE (%)			Price to book (x)		
	FY12E	FY13E	FY14E	FY12E	FY13E	FY14E	FY12E	FY13E	FY14E	FY12E	FY13E	FY14E
Power Grid Corporation of India	11	10	8	16	13	12	14	15	15	2.0	1.9	1.5
Adani Power	16	7	6	13	6	5	17	29	28	2.0	1.5	1.1
Jindal Steel & Power	9	7	6	11	8	6	26	27	29	2.6	2.0	1.6
JSW Energy	11	9	8	14	16	12	8	7	8	1.1	1.0	1.0
NTPC	10	10	9	13	12	10	14	14	14	1.7	1.6	1.4
Tata Power	10	8	7	10	10	10	15	13	12	1.4	1.3	1.2
NHPC	8	9	8	11	10	9	10	8	8	0.8	0.8	0.8
Indian Companies – Avg	**10**	**8**	**7**	**13**	**11**	**9**	**15**	**16**	**16**	**1.7**	**1.4**	**1.2**
Chinese Companies – Avg	**10**	**8**	**8**	**24**	**11**	**9**	**8**	**10**	**11**	**1.2**	**1.1**	**1.0**
Global Companies (ex China) - Avg	**8**	**8**	**8**	**13**	**12**	**11**	**14**	**16**	**14**	**1.8**	**1.6**	**1.5**

Source: Deutsche Bank estimates

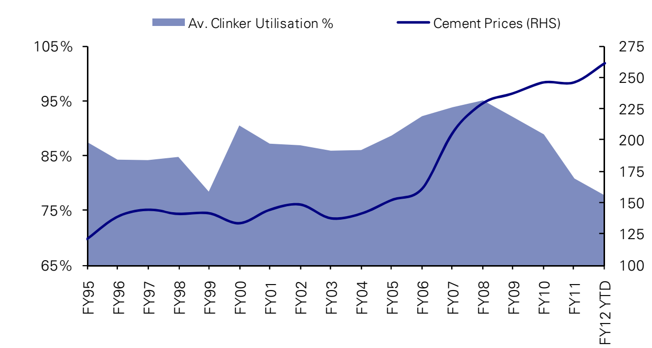
The focus for CY11 was pricing power

Cement companies showed a fine example of pricing power

Price discipline helped DB cement index to out-perform

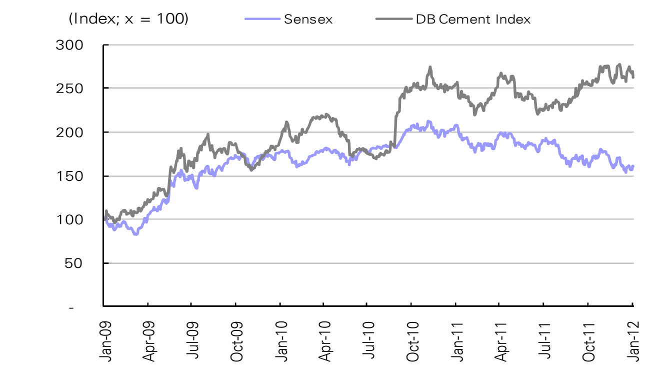
Indian cement prices showed a remarkable resilience – as despite low capacity utilisation, cement prices inched up by 5% in CY11. Notwithstanding the weak demand growth (one of the lowest in the last decade), industry maturity helped the Deutsche Bank cement index outperform by c34% relative to the BSE Sensex.

Figure 14: Long-term average cement utilisation and cement prices



Source :Cement manufacturer's Association, Deutsche Bank

Figure 15: Deutsche Bank cement index outperformed the BSE Sensex by c34% in CY11 and by c63% in three years

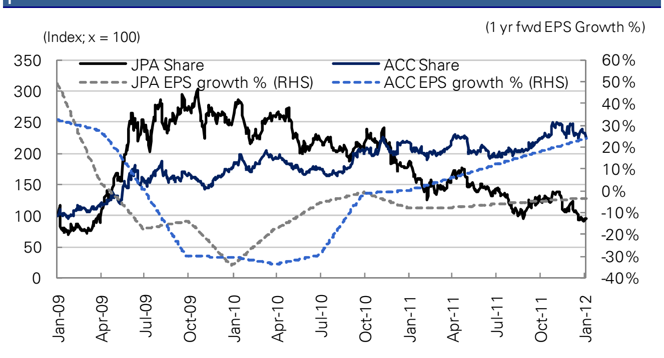


Source: Bloomberg Finance LP, Deutsche Bank

Leverage a clear difference for stocks

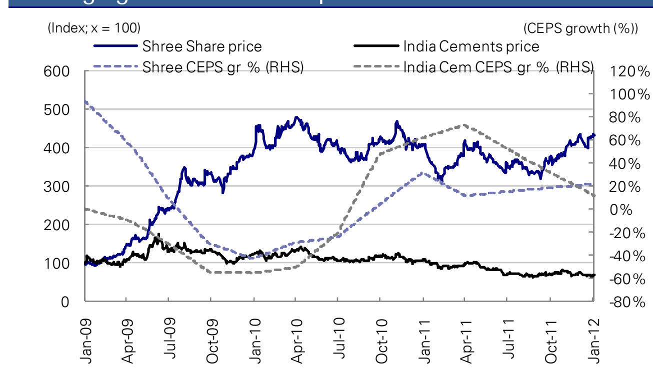
However, within the cement universe, there was a clear distinction between companies with stronger balance sheets and earnings growth and those with higher leverage.

Figure 16: ACC and Jaiprakash EPS growth and stock performance



Source: Company data, Bloomberg Finance LP, Deutsche Bank

Figure 17: Shree Cement and India Cements cash earnings growth and stock performance



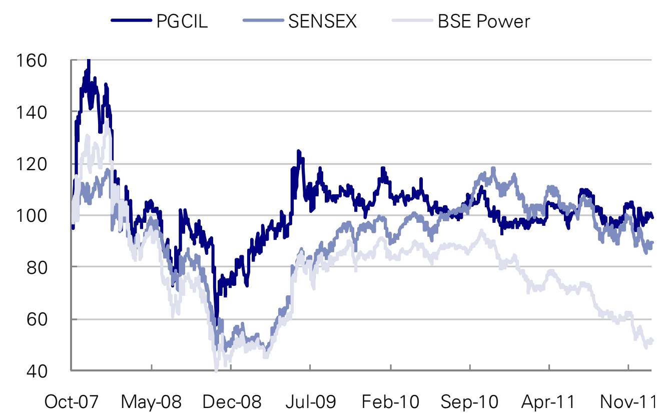
Source: Company data, Bloomberg Finance LP, Deutsche Bank

Even PGCIL outperformed, given the low operational risk

Power Grid tariff structure independent of operational volumes helped out-performance

Power Grid, with a tariff structure largely independent of operational volumes, could report a steady growth in earnings. Earnings yields at 7-8% acted as the floor and with a negative overall market, the stock outperformed sector peers as well as the BSE Sensex. To recap, Power Grid's RoE starts to be billed once the asset is commissioned, and is largely independent of the extent of power transmitted by the user through the transmission lines. While one can argue that PGCIL would rollout new capacity only after the consumer requests new capacities, the earnings yields of ~8% for FY13E and expectations of interest rates peaking out helped the stock outperform.

Figure 18: PGCIL stock performance clearly stands out vs. power peers as well as broader indices



Source: Deutsche Bank

Figure 19: Earnings yield seems to have matched or surpassed bond yields now

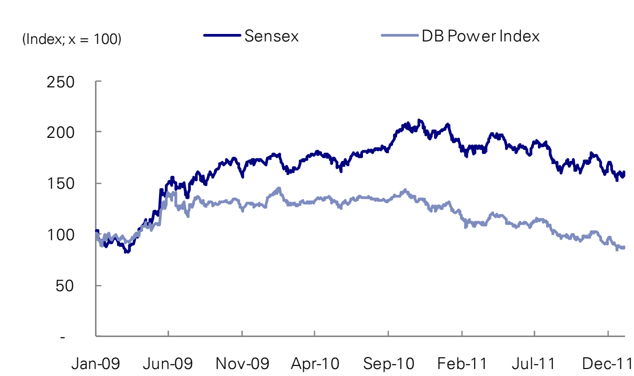
Companies	Earnings Yield (%)		Prem/Disc to Bond Yields	Dividend Yield
	FY12E	FY13E		
Adani Power	8%	18%	10%	-
NTPC	8%	8%	0%	2.6
NHPC	10%	11%	2%	3.3
Power Grid	7%	8%	-1%	2.0
Lanco Infratech	3%	11%	3%	-
JSW Energy	8%	7%	-2%	1.4
Tata Power	10%	10%	1%	2.5

Source: Deutsche Bank

NTPC and host of private IPPs, however, got punished

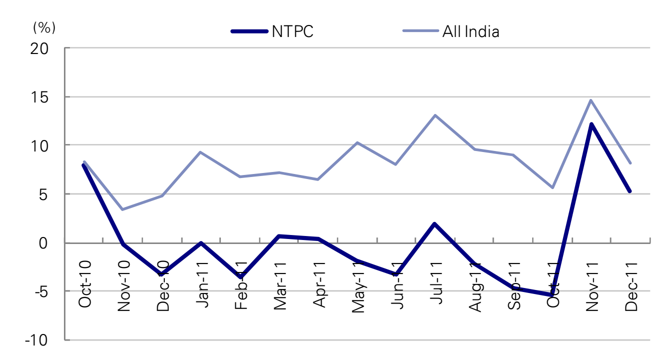
An obvious factor to blame for the underperformance of utility stocks is policy paralysis. However, a closer look at individual business models suggests that a large part of the underperformance was due to micro reasons of individual businesses.

Figure 20: Deutsche Bank utility index has underperformed



Source: Bloomberg Finance LP, Deutsche Bank

Figure 21: NTPC generation growth lags

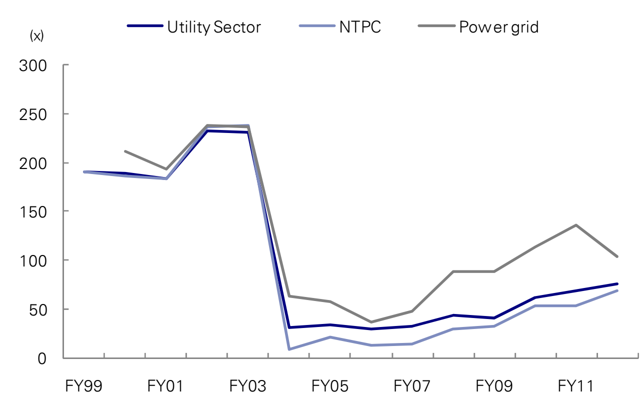


Source: Central Electricity Authority, Deutsche Bank

In the case of NTPC, the underperformance was a result of low generation volume growth – much lower than the country's average for a large part during the last few years. Delays in COD for capacity commissioned also did not help the situation. In the case of Lanco, new asset commissioning delays, risk of adequate fuel availability in upcoming plants, acquisition of foreign mining assets, E&C losses and high leverage caused a sharp collapse in the stock price. For Adani Power, risk of coal availability and push back in capacity commissioning hurt performance.

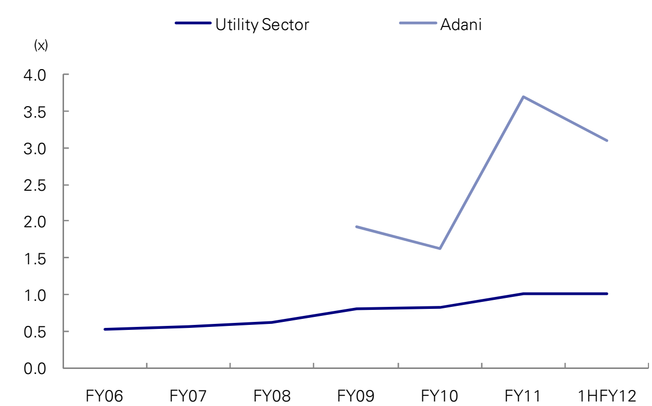
Another concern that was highlighted was the inability of a few of the trading companies to obtain proceeds from the distribution companies. Receivable days for PTC shot up and so did those of Power Grid. However, it is interesting to note that gencos in India raised their decibel levels and communicated to the distribution companies in unequivocal terms that if they do not pay-up, gencos would divert the power to other customers. The regulator also sided with the generating companies and accordingly the distribution companies slowly raised tariffs and started clearing both the current and past dues.

Figure 22: Rising debtors a new risk for a few players



Source: Deutsche Bank

Figure 23: Barring private IPP- sectoral leverage is low



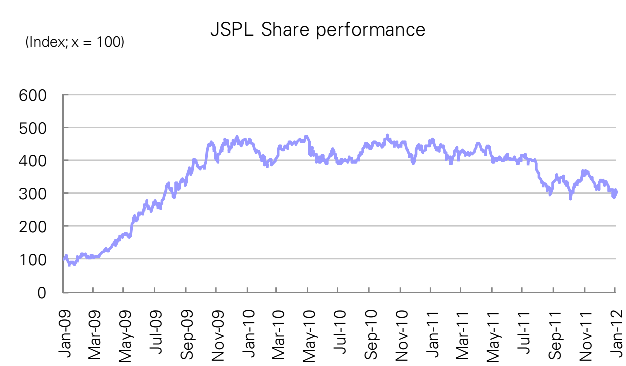
Source: Deutsche Bank

Cost leaders: Coal India/JSPL fell on risks of low pricing power

Coal India faced concerns on its ability to pass on (a) the possibility of a steep wage hike and (b) the impact of the draft MMDR bill to impose a 26% tax on the mining profits. Delays in obtaining clearances for expansion projects also constrained the volume growth in CY11. One of the government's proposals to use PSUs cash to cross hold in other PSUs did not help conditions either.

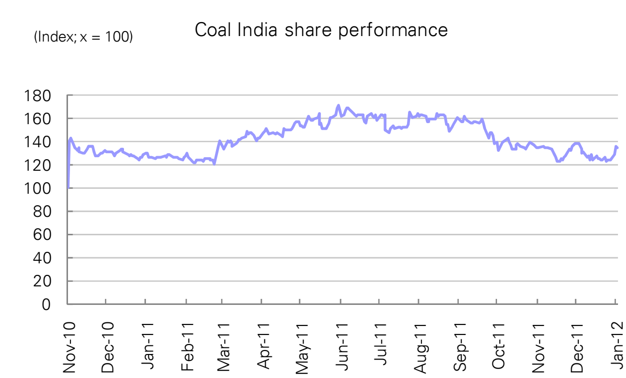
Perception of weak pricing power led to second half underperformance of Coal India

Figure 24: JSPL fell on perceptions of low pricing power



Source: Bloomberg Finance LP, Deutsche Bank

Figure 25: Coal India also fell on risk from low pricing



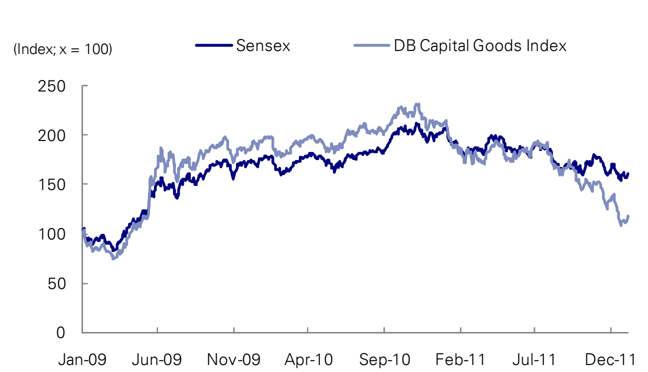
Source: Bloomberg Finance LP, Deutsche Bank

Meanwhile, stocks of cost leaders like Coal India and JSPL fell on a host of concerns but primarily those concerning risk of low pricing power. In the case of Jindal Steel and Power, concerns emerged on the possible imposition of a cap on power tariffs for players with captive coal blocks. In addition, investors were worried that product sales in steel could face the brunt of a sharp drop in margins from possible steel price declines due to global steel weakness.

Slowdown in order inflow outlook hurt industrial stocks

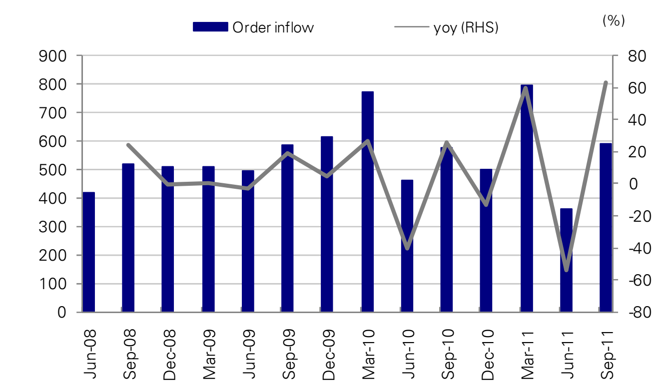
Weak IIP data, coupled with a bleak Indian macro outlook for investment given by senior management teams of large-cap industrial companies were among the major reasons for the sharp underperformance of the sector over the last quarter.

Figure 26: Of late, Capital Goods Index has fallen sharply...



Source: Bloomberg Finance LP, Deutsche Bank

Figure 27: ...despite uptick in the order inflows in Q2FY12

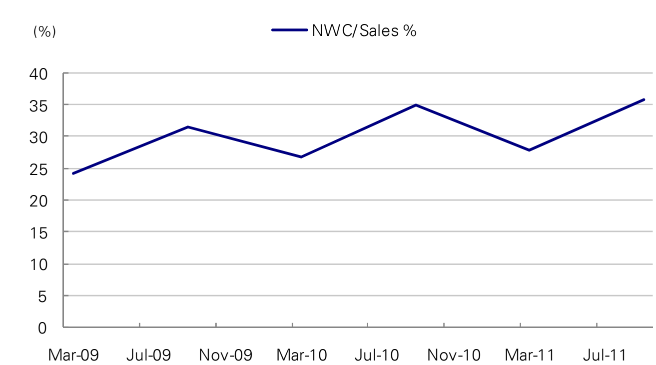


Source: Annual Reports, Company Press Releases, Deutsche Bank

The weak management commentary was also partly related to the Indian industrials sector investing in significant manufacturing capacities, especially in power generation/transmission as well as shipbuilding capacities. With new order inflows dwindling, the prospects of weak utilisation in new capacities hurting RoEs were clearly a big drag on valuations. In addition, rising NWC/sales, especially in the construction business, added to worries that a high interest environment is taking its toll on collections.

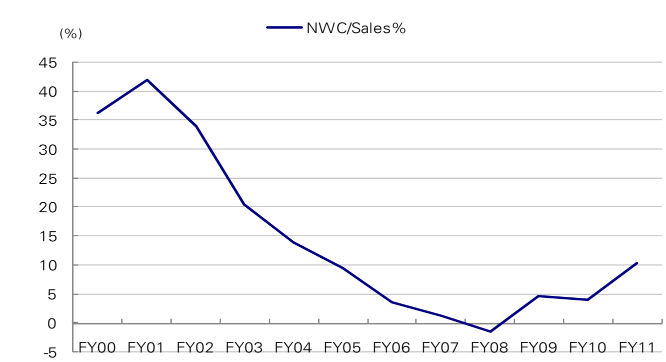
Stalling of projects under execution, inability of promoters to get concessions hurt industrial stocks

Figure 28: Construction company NWC/sales on the rise



Source: Annual reports, company press releases, Deutsche Bank

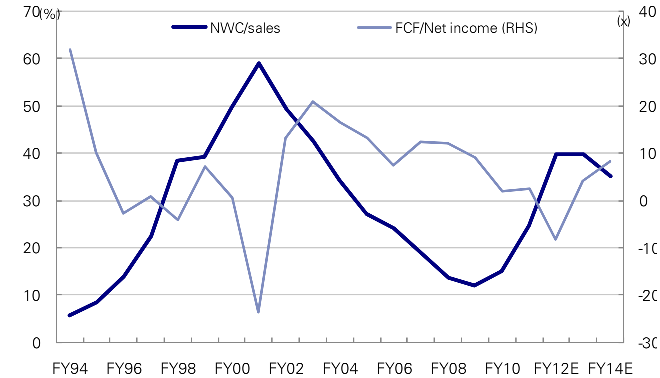
Figure 29: NWC/sales for non-construction companies



Source: Company data(L&T, ABB, BHEL, Siemens, Thermax) Deutsche Bank

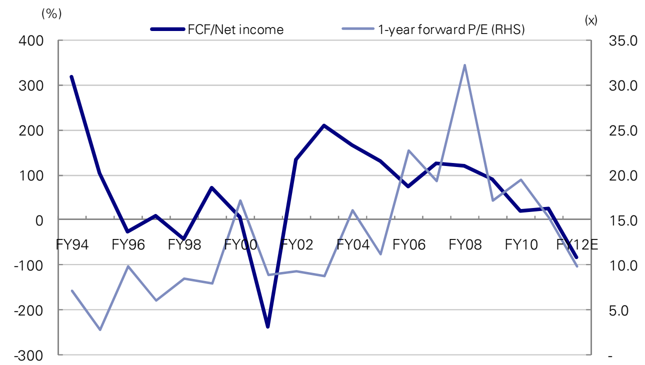
Clearly, the valuations which follow the FCF generation cycle compressed and industrial stocks fell to levels last seen during FY00-04.

Figure 30: BHEL - NWC/sales vs. FCF/Net income



Source: Deutsche Bank, company data, Bloomberg Finance LP

Figure 31: BHEL – FCF/net income and 1-year forward P/E



Source: Deutsche Bank, company data, Bloomberg Finance LP

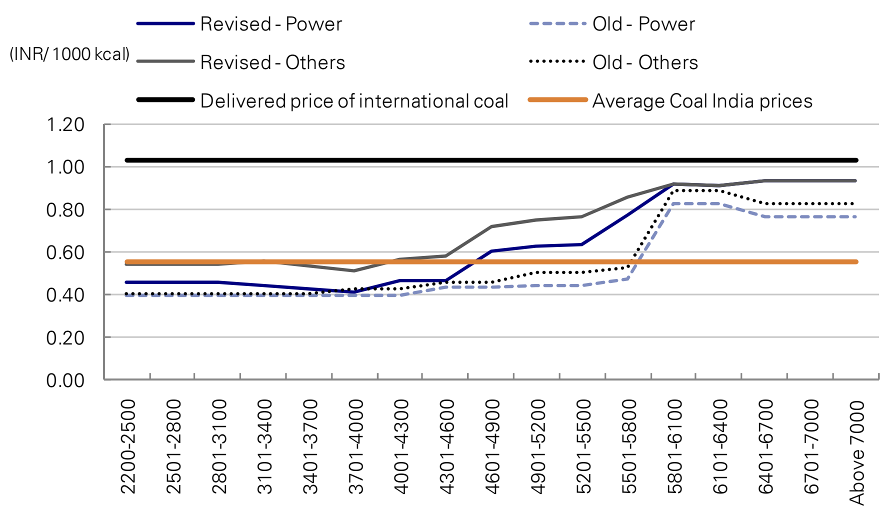
Some of the themes for CY12

Pricing is a good theme to begin with…

Supreme Court judgment on energy pricing gives us a perspective that energy price should be set by government

Price themes on products that are at discounts to global equivalents could be a good theme. On 1 January 2012, Coal India increased non-coking coal prices by a minimum of 15-29% and a maximum of 40-65%. While this may appear considerable, a look at delivered prices on an INR/kcal basis would show that Coal India's prices after the minimum level of increase are still at an average of 45% lower than landed cost of imports. Accordingly, we would rather be in the camp that believes that there is a reasonable probability that the price rise would be approved. Considering the Supreme Court judgement that the government has the prerogative to set energy prices, we see less regulatory risk.

Figure 32: Regulated coal prices

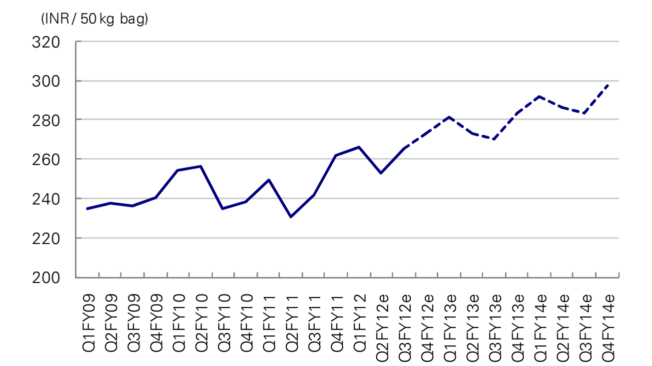


Source: Coal India, Deutsche Bank, Bloomberg Finance LP

In the cement and power segments, rising energy prices could be passed on for different reasons.

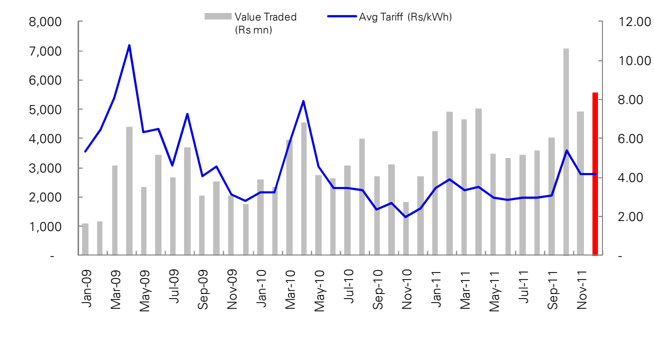
First, in the case of cement, the industry discipline has been a complete surprise. Second, with a busy period about to commence beginning 14 January, the probability of a further hike in prices due to higher costs may not be ruled out. We note that a cement price hike is a small contributor to the overall cost of construction and incremental demand is not driven by real estate – a lobby that earlier fought the cement industry fiercely for every monthly price increase set by different players.

Figure 33: Cement prices – a small portion of overall construction cost – have been helped by industry maturity



Source: Cement Manufacturer's Association, Deutsche Bank

Figure 34: Merchant tariffs have moved as a result of strong demand growth and rising two-part tariffs



Source: Power exchanges, Deutsche Bank

In the case of the power sector, incremental power capacities now have a tariff in excess of INR3.5/unit, especially those on a two-part basis. Therefore, the net impact could be that spot rates may now settle closer to INR3.5/unit.

Figure 35: Summary of pricing themes for CY12

Sector	Enabler	Likelihood of sustained price rise	Potential negatives	Stock calls
Non-coking coal	New gradation policy	Quite high Largely whole-sale buyers Most buyers have automatic pass-through mechanisms	Only if customers take it to street, But small users are anyway on e-auction	Coal India, JSPL
Cement	Start of busy season	High, much depends on industry maturity sustaining	Political backlash in few states	ACC, Shree Cement, Grasim
Power-regulated	Coal price hike, higher blending	Under CERC regulations	Rising receivable, but so far in control	NTPC
Power-spot	Rising energy cost	CERC has never capped rates below INR8/unit	States like UP and TN not paying dues on time	JSPL, JSW-energy
	Low cost supplies are limited	Floor rate with new coal price of ~INR3.5-4/kwh unit		
	Strong power demand			

Source: Deutsche Bank

Operating leverage is equally an important theme

Most of the manufacturing companies and those with high fixed costs could get good operating leverage -if demand improves

Companies that stand out in terms of having the benefits of operating leverage are ACC, JPA, Ultratech in cement and NTPC and Adani Power in utilities. Within a diversified universe, JSPL can benefit significantly from volume growth as many capacities with captive mines are coming up for commissioning in next few years. Coal India, along with L&T, has high fixed costs and once again the benefits of operating leverage could be quite high.

Figure 36: Operating leverage plays

Company	Units	Capacity		Capacity utilisation		Ability to procure inputs	Volume growth	
		FY11	FY14E	FY11	FY14E		Base case	Bear base
Cement companies								
ACC	m tonnes	27.6	30.6	78%	92%	Limestone - High; Coal - Limited captive source	9%	4%
Jaiprakash Associates	m tonnes	26.2	35.9	58%	60%	Limestone - High; Coal - Limited captive source	10%	5%
UltraTech	m tonnes	49.1	58.3	72%	83%	Limestone - High; Coal - Limited captive source	9%	4%
Power utilities								
NTPC	MW	34,194	47,094	88%	77%	Captive mines allocated and gets preferential coal allotment	6%	4%
Adani	MW	1,980	9,240	90%	81%	Captive group mines for coal; domestic sourcing could face hurdles	90%	70%
Other industrials								
JSPL - Steel	m tonnes	3.00	4.50	76%	72%	Iron ore - high; coal - high	19%	10%
JSPL - Sponge iron	m tonnes	1.37	3.37	96%	87%	Iron ore - high; coal - high	42%	30%
JSPL - Power	MW	1,758	4,503	88%	77%	Captive coal blocks	30%	20%

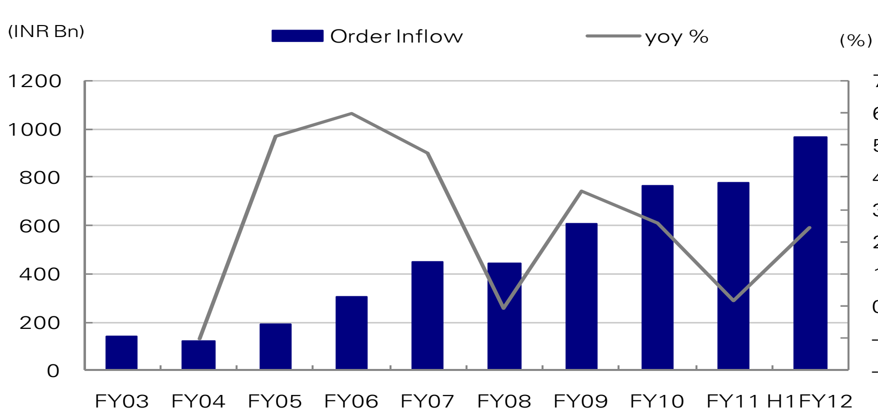
Source: Deutsche Bank estimates, company data

Pick-up in profitable construction orders benefits few companies

We are assuming a pick up in construction orders

Historically, construction sector orders have led the capex cycle. In the last cycle, orders in the construction sector grew by c50% and led order growth in the power, metal and cement sectors. The construction orders for the previous cycle were led by the roads, infrastructure and real estate segments. Figure 37 depicts the order inflow cycle in the construction space.

Figure 37: Construction order inflows



Source: Company data, Deutsche Bank

As we estimate the segments that could drive growth in CY12E, we believe that the construction sector clearly has many tailwinds to give us comfort that the situation could be at an inflection point. Figure 38 encapsulates our assumptions for new order inflow growth, particularly for the roads, railways and prominent export orders. Please note our assumptions factor in 80% of road projects that have already been awarded by NHAI for development in CY11, achieves financial closure with a lag of three quarters (from the date of award).

Figure 38: Construction order prospects for CY12E

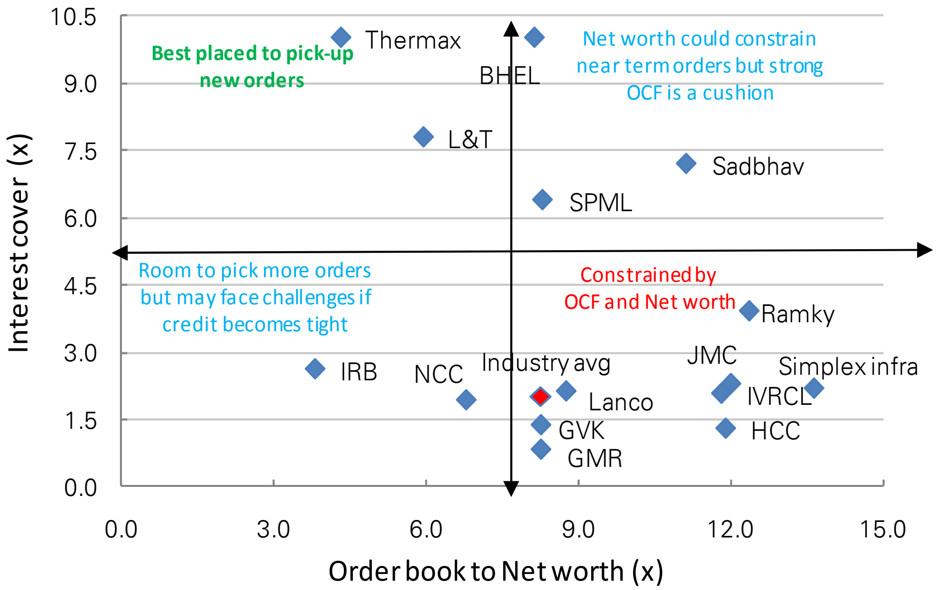
Sector	Order Enabler	Progress so far	Likely award in CY13(INRbn)	Timeline	Remarks
A) Roads					
	555 Kms development awards	EC / FC	54	Q4FY12	Assuming 80% of developer orders gets FC within 3 quarters
	780 Kms development awards	EC / FC	78	Q1FY13	Assuming 80% of developer orders gets FC within 3 quarters
	1693 Kms development awards	EC / FC	141	Q2FY13	Assuming 80% of developer orders gets FC within 3 quarters
	1069 Kms development awards	EC / FC	107	Q3FY13	Assuming 80% of developer orders gets FC within 3 quarters
	2000 Kms development awards	EC / FC	220	Q4FY13	Assuming 80% of developer orders gets FC within 3 quarters
Total Roads			**600**		
B) Dedicated Freight Corridor					
	Eastern Corridor Phase 1 Khurja Kanpur 343 Kms	EC / FC	45	Q2FY13	RFQ Stage
	Western Corridor Phase 1 Rewari Vadodara 920 Kms	EC / FC	62	Q2FY13	RFQ Stage
Total Dedicated Freight Corridor			**107**		
C) Metro					
	Ahmedabad Metro Phase 1	EC / FC	120	H1FY13	
	Jaipur Metro Phase 2	EC / FC	65	H1FY13	
	Delhi Metro Phase 2	EC / FC	189	H2FY13	
	Chennai Monorail Phase 1	EC / FC	160	H2FY13	
	Kolkota Line 2	EC / FC	49	H1FY14	
Total Metro/Mono-rail			**583**		
D) Airports					
	Abu Dhabi International airport terminal expansion for Indian players	EC / FC	64	Q1FY13	
Total Airport			**64**		
Grand Total (A+B+C+D)			**1,353**		

Source: National Highways Authority of India, Dedicated Freight Corridor Corporation of India, Planning Commission, Deutsche Bank estimates

.. but benefits may accrue largely to companies with good balance sheets

The increased business risks and higher leverage have resulted in fewer companies having the capacity to take on incremental projects when a revival in the capex cycle comes. For instance, among road developers, L&T appears to be the best positioned to take on incremental projects when road project award activity picks up in 2HFY12. More importantly, these orders are likely to have better margins. Among other players, IRB, after the recent large Ahmedabad-Vadodara expressway project, may to a certain extent be constrained by its lower interest cover to take on more large incremental projects with better margins.

Figure 39: A few companies with strong balance sheets are likely to benefit disproportionately from any revival in orders

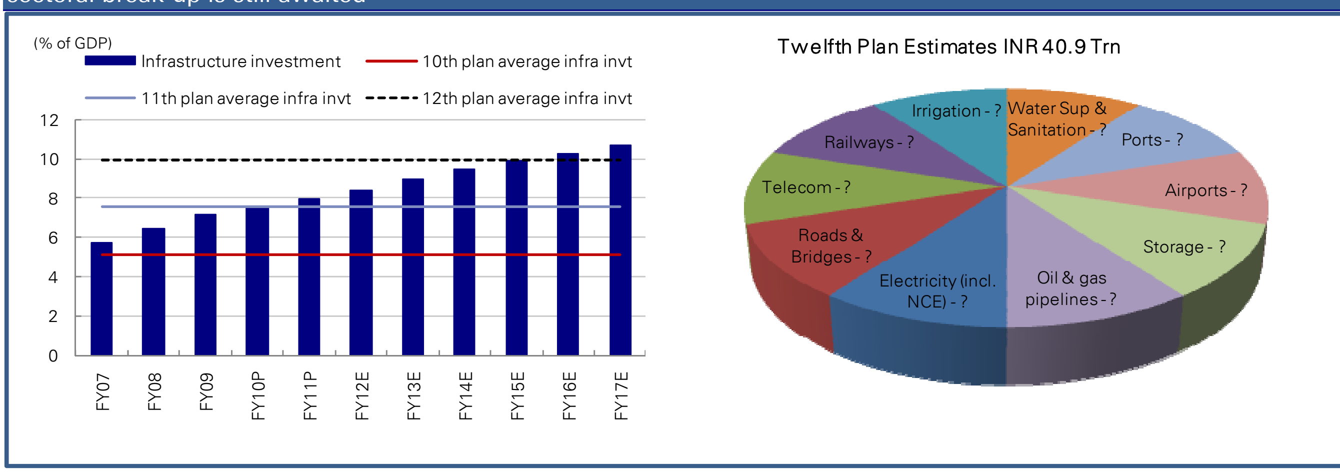


Source: Deutsche Bank, company data*Note that BHEL & Thermax, being net-cash companies, have very high interest covers. Hence, interest cover for both of them has been assumed to be 10x to avoid the skew

Twelfth Plan target, could focus shift to rail/road transportation?

The planning commission is currently envisaging an infrastructure investment of nearly INR41tr for the Twelfth Plan in FY12-17E. Press reports (i.e. Business Standard, 28 December 2011) suggest that there has been a delay in the documentation of the entire plan's approach.

Figure 40: Planning commission estimates infrastructure investments at c10% of GDP under the Twelfth Plan. However, sectoral break-up is still awaited

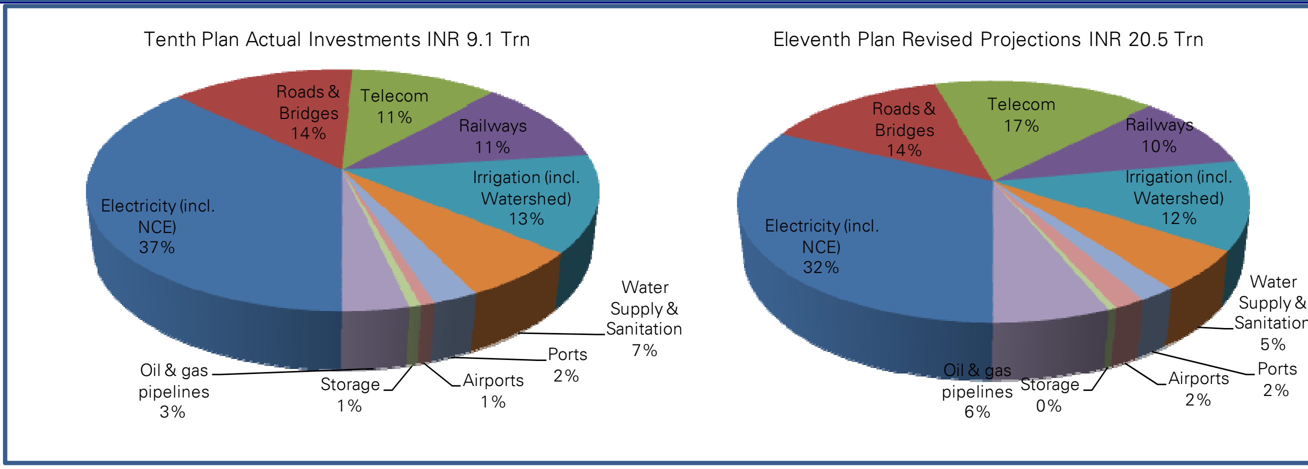


Source: Planning Commission, Deutsche Bank

According to the approach paper, the Indian planning commission has been suggesting that the country's infrastructure investments would rise to 10% of GDP vs. The ~8.5% achieved on average in the last plan period. With regard to financing, after looking at the trend in the Eleventh Plan, our analysis suggests that, at the current rate, equity financing availability may constrain infrastructure investments under the Twelfth Plan to a level of 7-8% of GDP (assuming a debt/equity of 3:1).

With regard to the Twelfth Plan, what also remains to be seen is which sectors receive prominence. In the previous two plans, the power sector, followed by the telecom, road, irrigation and railway sectors were the key focus areas. The achievement levels have improved from around 50% in the Tenth Plan to nearly 80% in the Eleventh Plan, due partly to the higher-than-private-sector-led investments in the telecom and airport sectors.

Figure 41: Sector-wise infrastructure investments in the Tenth and Eleventh Plans



Source: Planning commission, Deutsche Bank. Figures are on 2006-07 prices

From a sectoral point of view, our micro-analysis of the various projects under implementation suggests that the investments would be largely led by roads and railways, followed by oil & gas and then the power sector. Investments in the metal sector would be driven by policies on captive resources. Other than the aforementioned, cash-rich companies in commodities (cement, metals) would invest in a manner to retain their market share at the least.

Figure 42: Uptick in capex largely led by roads, railways and construction

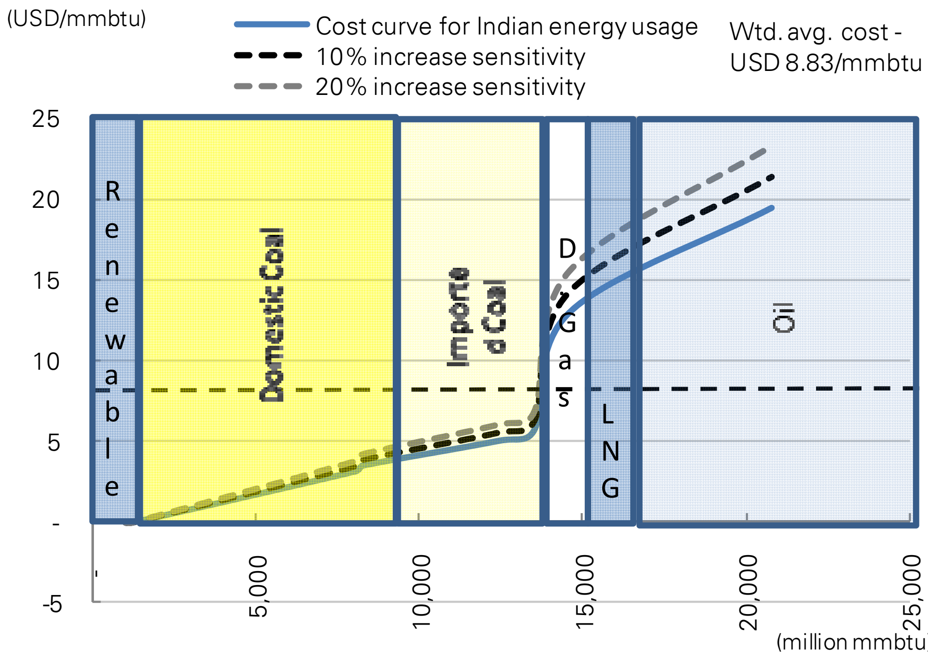
INRbn	FY08	FY09	FY10	FY11	FY12E	FY13E	FY14E	Remarks
Auto	117	121	92	95	119	116	110	Based on Deutsche Bank autos analyst estimates
Consumer	10	10	11	11	12	12	12	Does not factor in the food industry capex
Fertilisers	4	10	3	3	5	10	20	Assuming orders in non-urea capacity continue
Industrial	608	802	468	528	686	1,029	1,543	Capex surge seen in chemicals
NHAI roads	268	215	259	375	504	671	896	Assuming average execution time of 2.5 years
DFC/mono/metro-rails					4	150	300	Assuming ordering pick-up by June 2012
Metals & mining	164	266	335	394	313	313	375	No incremental orders in metals
Oil & gas	607	1,157	572	960	828	894	892	Assumes a drop in KG basin capex
Power	247	525	838	790	1,030	972	794	
Generation	190	430	737	671	853	802	624	Assumes a drop in power capex
T&D	57	94	100	119	177	170	170	Estimates do not factor in pick-up in T&D capex
Total	**1,757**	**2,891**	**2,319**	**2,781**	**2,993**	**3,346**	**3,746**	
YoY change (%)		*65*	*-20*	*20*	*8*	*12*	*12*	

Source: Deutsche Bank estimates

Energy cost could become an important differentiating factor

India currently uses around 20bn mmbtu of energy on an annual basis. Our analysis of energy consumption in the country suggests that the average cost of energy for Indian consumers is about USD8.83/mmbtu.

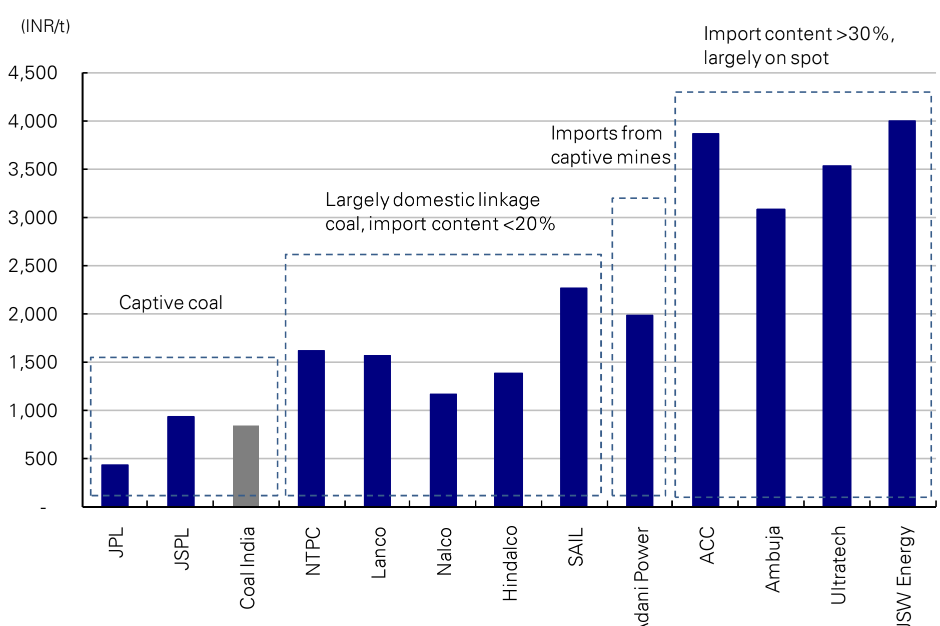
Figure 43: Energy cost curve for India (2010)



Source: Deutsche Bank, BP Statistics 2011

With rupee depreciation against other major currencies and the rising inability of Indian developers to tap into a low-cost energy base in the country, the differentiation could well play out from buying into models with low-cost energy. In Figure 44, based on FY10 annual reports of JSPL vs other large energy-intensive companies; we see that JSPL appears to have a competitive edge as far as fuel costs are concerned.

Figure 44: JSPL's energy cost is probably among the lowest in India



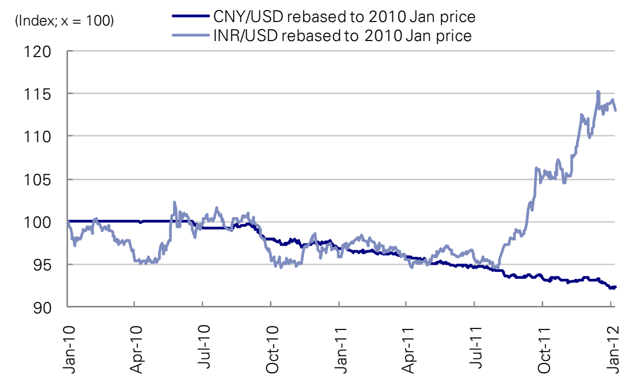
Source: Company data, Deutsche Bank

Net exporters to gain, but companies with forex loans would lose

With the Indian rupee (INR) sharply depreciating, particularly against the Chinese yuan (CNY), exports in the international market could become more competitive. Also, imports could become more difficult into India, making the cost differential between Indian and Chinese vendors likely to be quite low going forward.

Issue that needs to be understood are how long are the hedges, in addition to how much are the hedges

Figure 45: INR depreciation has improved the competitiveness of exports



Source: Bloomberg Finance LP, Deutsche Bank

Figure 46: Major exporter companies within the industrials segment

Company	FY11 exports (INR mn)	FY11 turnover (INR mn)	Export as % of turnover
ABB*	5,104	63,279	8.1
BHEL	14,032	436,786	3.2
Crompton Greaves	9,128	59,515	15.3
Cummins India	10,604	39,454	26.9
L&T	46,614	442,952	10.5
Siemens#	26,053	119,419	21.8

Source: Company data, Deutsche Bank *FY11 is year ending Dec-11, #FY11 is year ending Sep-11

The major issue for Indian infrastructure plays is the debt exposure. While the new accounting norms would give some leeway to Indian corporates in an effort to write off the losses closer to maturity, the problem is that some of the companies do not have substantial forex earnings. This would be a problem for players such as JPA.

Figure 47: Impact of currency fluctuations from forex borrowings could be high

Company (all figures in INRm)	Forex borrowings at March 2011	Forex loss in Q2FY12	Forex loss estimate in Q3FY12	Q2+Q3 forex loss as % of FY12 PAT estimate
Adani Power	26,522	630	628	16.5
JSPL	20,878	1,000	996	4.8
L&T	50,000	1,080	1,076	4.9
Lanco Infratech	36,224	2,878	500	NA
Tata Power	21,095	6,390	6,366	54.0

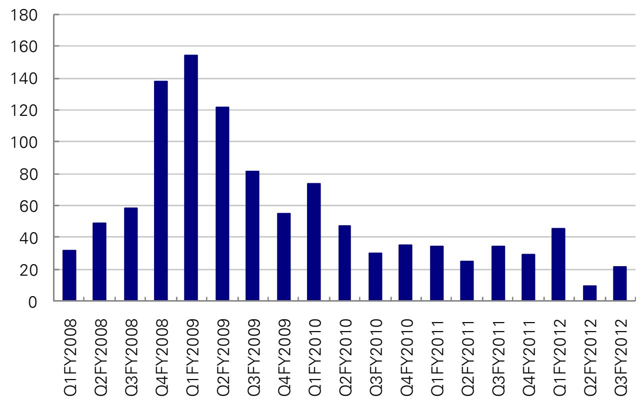
Source: Company data, Deutsche Bank

Improvement in business confidence index

The recent spate of big ticket project approvals, coupled with government initiatives for follow-on approvals for others, has ushered in hope that an ongoing cyclical downturn may not play out as a structural slowdown.

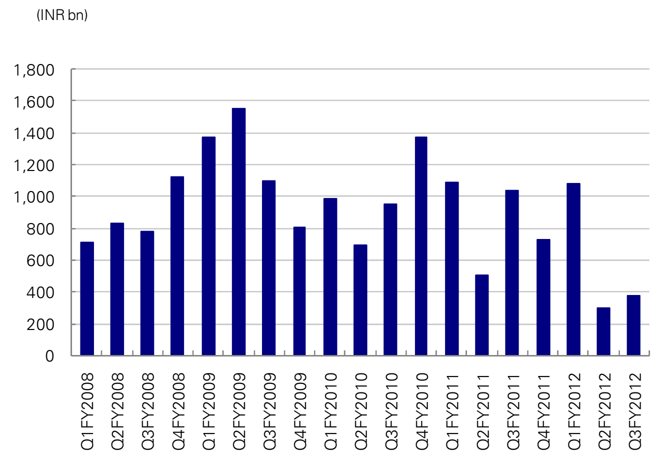
Slow and steady improvement in clearances

Figure 48: Pick-up in the no. of projects awarded EC



Source: Government data, Deutsche Bank

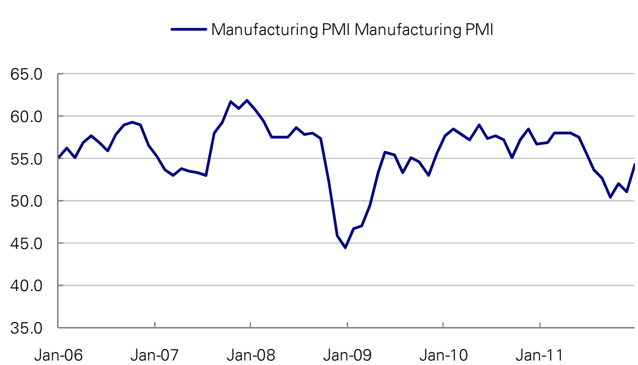
Figure 49: Value of projects awarded EC



Source: Government data, Deutsche Bank

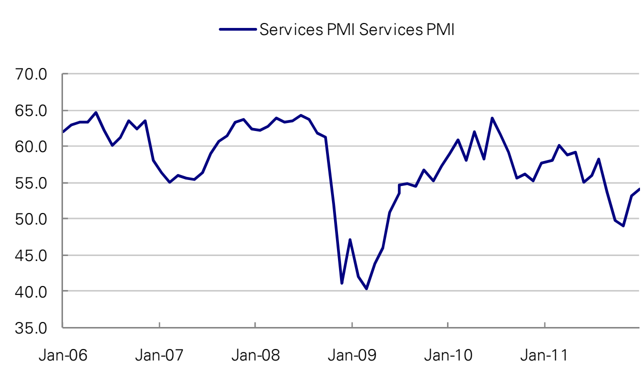
As seen in Figure 48 and Figure 49, the number of monthly clearances has now slowly started to increase. Among important projects, MoEF has granted approvals for the Lavasa Project, ToR for the 2,400MW – the Tamnar project is being built by JSPL so that the construction could commence. The government has put a list of 12 projects under fast clearance. Our quick survey among business leaders in the infrastructure space, which includes Jindal Group, Coal India, Larsen and Toubro, Areva and many others, suggests that, excluding projects that are done for local political factors, clearances have started to be granted. It appears that going forward, project clearance, per se, should no longer be the biggest impediment to work. Government initiatives, especially on the environment front, are starting to be reflected in the monthly PMI indices, which are improving after a gap of five months.

Figure 50: Surge in manufacturing PMI growth



Source: HSBC, Deutsche Bank

Figure 51: Encouraging tidings on the service sector

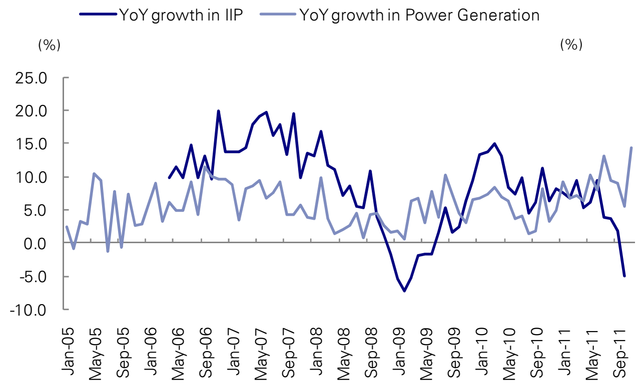


Source: HSBC, Deutsche Bank

Power and Cement data upsurge likely to flow into IIP numbers

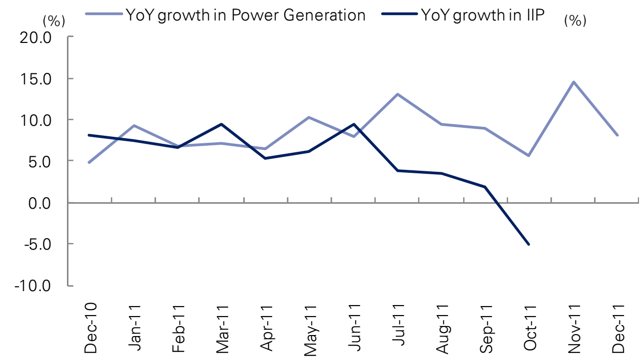
In CY11, we were increasingly disillusioned by the disconnect between measurable volume data of the industry and those in the IIP index. Power, which is one of the key engines for manufacturing, has now been growing at 9% YTD – the highest in the last decade – and surprisingly, the strong correlation it had with IIP has diminished. IIP figures YTD show meager growth of 6% (the last three-month average was 3%).

Figure 52: IIP and power typically enjoy strong correlation



Source: Ministry of Statistics and Programme implementation, Central Electricity Authority, Deutsche Bank

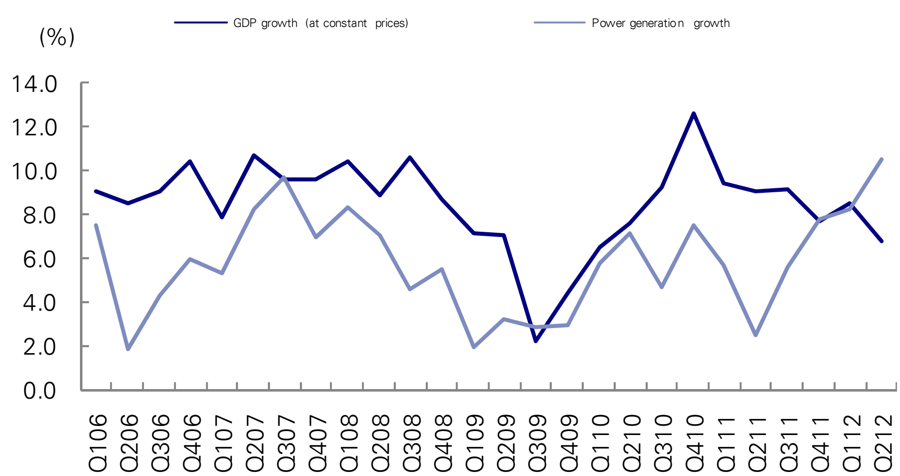
Figure 53: The correlation has considerably weakened



Source: Ministry of Statistics and Programme implementation, Central Electricity Authority, Deutsche Bank

However, a good part of the power sector is that it has historically been a good lead/coincidental indicator for economic activity. A continued demand surge in power bodes well for the extent of activity in the system.

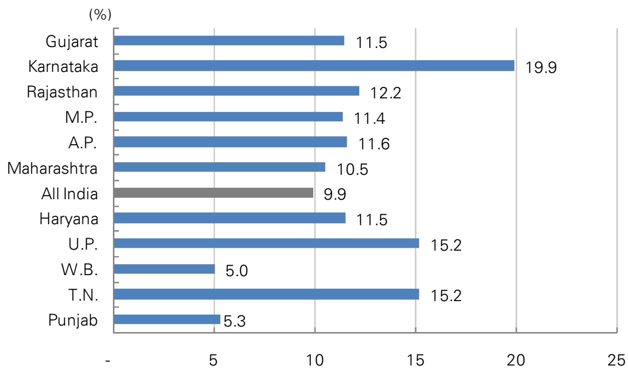
Figure 54: Historically, power has been a good lead/coincidental indicator



Source: Ministry of Statistics and Programme implementation, Central Electricity Authority, Deutsche Bank

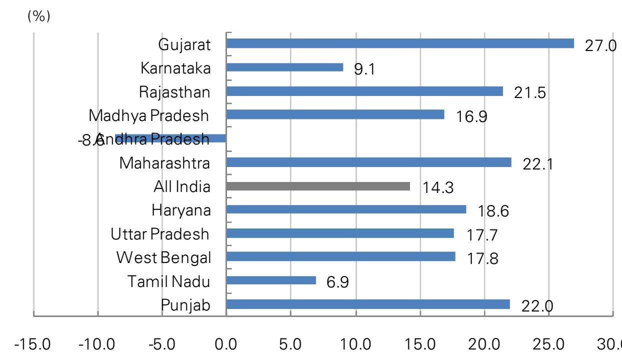
With an uptick in power and cement demand, especially with the demand upsurge seen in the states shown in Figure 55, we tend to believe that the IIPs would reflect this sooner than later.

Figure 55: Power consumption YTD growth



Source: CEA, Deutsche Bank

Figure 56: Cement consumption YTD growth



Source: Cement Manufacturer's Association, Deutsche Bank

Our interaction with officials of the planning commission as well as press statements of these officials suggests some merits in the argument that IIP numbers are understated. Important areas of concern are as follows:

(1) Reporting production for goods that are excisable – leaving aside goods produced earmarked for exports

(2) Delays in reporting production by units in manufacturing segments of pharma/chemicals/textiles/auto ancillaries

Mining and land acquisition bills may cause flutter

A few months ago, the cabinet approved a draft law that seeks to create a better legislative environment to attract investments in mining and ease land acquisitions through higher compensation to people displaced by projects. However, mining companies are not entirely convinced of this strategy, as they must pay higher royalties and want changes to be made before the law is enacted. From a Coal India perspective, it needs to be seen whether the company benefits from this offset against the social overhead costs.

Important points that require focus include:

- The new bill proposes to free state governments from taking the centre's approval to grant mining leases and, therefore, does not completely prohibit small lessees from mining ore. The highest bidder would be granted the lease and the party may not be the most capable of investing and arranging for scientific, eco-friendly and community support mining. This could result in a pick-up in mining by the unorganised sector. Small-scale miners operate in small land holdings with little application of technology and bypass most standard operating procedures by violating environmental norms.
- Second, in India, unlike many other countries, all minerals beneath the surface are properties of the state. Ergo, when the state arranges for the mine's exploitation by itself or an agency nominated by it, the benefits should accrue for all parties: the miner, the state and the locals.

- Again, the bill requires more clarity on how all parties concerned will equally benefit. It calls for an equal amount of the royalty paid to the state to be deposited in a special district development fund meant for the region's advancement. For coal miners, the amount would be 26% of profits from the projects. If the state grants leases, a number of vested interests could gain leases. The issue of recovering money from mining companies for district development funds needs to be debated further.
- Last, as far as the land acquisition bill is concerned, most of the developers are saying that they are not opposed to increasing land acquisition costs but they would want clarity on the process to acquire land to shorten. Thus far, the debate has not taken place and we await the results.

Share buyback/dividend payout may benefit PSUs

According to media reports (CNBC), the government has floated a cabinet note to consider the buyback of shares in cash-rich PSUs as a route to achieve the divestment targets. These initiatives to achieve divestment targets could be great from a company point of view, as cash yields are lower than earnings yields. However, what remains to be seen is if the government, given the current valuations, would be open to buybacks at these levels.

Sensitivity analysis shows buyback is likely to be earnings accretive

While one does not know the quantum of the buyback, our sensitivity analysis shows that for an INR50/100bn of buyback in Coal India at the current stock price (INR320), earnings could fall by 1%/2% and EPS could rise by 2%/4%. Similarly, in the case of BHEL, an INR20bn/40bn of buyback could result in earnings declines of 1%/2% and EPS increases of 2%/6%.

Buyback seems a better alternative to a special dividend or a cross-holding structure

The buyback, in our view, seems to be a better alternative than either a special dividend or a cross-holding structure among PSU companies (similar to the exercise done in February 1998 among ONGC (Buy, INR253), GAIL (Hold, INR387) and Indian Oil (Hold, INR261). The cross-holding structure is likely to lead into a possible de-rating of the stocks, while a special dividend may result in relatively higher leakages than a buyback option (as in the case of a buyback, minority shareholders have an option not to participate).

Weak markets and high interest rates could drive up M&A

After signing the Andhra Cement sales agreement to the promoters of JPA by Indian private sector banks, the assets on the block as per various management communiqués and filings are as shown in Figure 57.

Figure 57: Management communiqué as well as regulatory filings suggest that following assets are on the block

Companies	Sectors	Assets on block	Remarks
Jaiprakash Associates	Cement	c10mtpa cement assets in the southern and western India	Cement assets have been put in separate company
IVRCL	Road	3 projects in TN	Have communicated in analyst calls
Gujarat IPP	Power	Transmission line from western to northern India	Notices in regulatory websites
Coastal	Power	Project based on imported coal	
DB Power	Power	P. E. investors have recently put in money in the form of equity	
Tata Power	Power	Stake sale in SPV holding coal assets	Have communicated in Analyst calls

Source: Company data, Deutsche Bank

Our interactions with the project teams of various institutions suggest that, apart from publicly known potential asset sales as aforementioned, there could be far more if the existing promoters do not inject sufficient equity to offset cost over-runs. Banks would be keenly evaluating the financials of each of the stressed assets before exercising any loan covenants.

Opening up options for minorities from benefits of realignment

While it is next to impossible to figure out which assets could be sold and at what value, we have used the following screens to determine which companies will have a greater probability of success for any potential sale of assets.

- First, we have used a filter for the percentage of shares pledged with banks as a proportion of total shares outstanding. The higher the ratio, the higher the pressure on the bank, provided the business cycle remains weak and there are delays on commissioning of new projects.
- Companies with higher leverage and low interest cover ratios.
- Companies that have announced their intention to sell stakes in assets either fully or partially.

Figure 58: Players with high leverage and high proportion of promoter holding, which is pledged

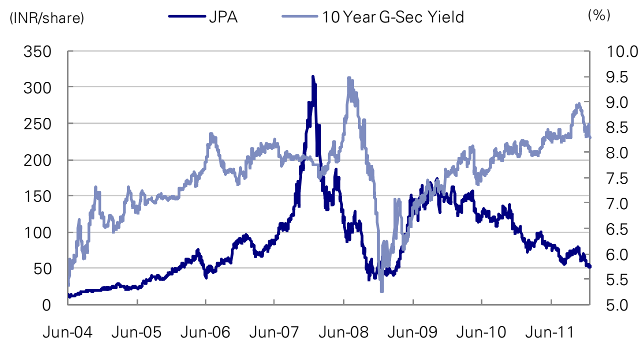
Company	Rating	Promoters' holdings (%)	Shares pledged % of promoters shares	Shares pledged % of total shares outstanding	Net debt/equity FY11	Net debt/equity FY12	Remarks
Adani Power	Buy	73.5	53.6	39.4	3.4	3.4	A high level of promoter pledge
GMR	Unrated	71.4	28.6	20.4	2.7	na	Low interest cover
GVK	Buy	54.3	0.0	0.0	1.1	1.2	Low interest cover at consol. levels
IRB Infra	Buy	74.9	24.5	18.4	1.3	1.7	A high level of promoter pledge
IVRCL	Unrated	11.0	0.0	0.0	1.3	na	Low interest cover at cons levels
Jaiprakash Associates	Hold	46.9	0.3	0.1	2.0	2.1	As per Management's communiqué
Jaypee Infratech	Unrated	83.3	54.1	45.0	0.9	na	A high level of promoter pledge
JP Power	Hold	76.5	63.6	48.7	2.1	na	A high level of promoter pledge
JSW Energy	Hold	76.7	20.5	15.7	1.5	1.8	A high level of promoter pledge
Lanco Infra	Buy	69.2	54.2	37.5	2.6	2.6	A high level of promoter pledge
Sadbhav	Unrated	47.59	0.0	0.0	1.7	na	
Suzlon Energy	Hold	54.8	69.4	38.1	1.6	2.0	A high level of promoter pledge
Tata Power	Hold	31.8	6.9	2.3	1.7	2.0	As per management's communiqué

*Source: Bloomberg Finance LP, BSE, Deutsche Bank *Data for unrated stocks sourced from Bloomberg*

But sharp rate cut could help leveraged companies

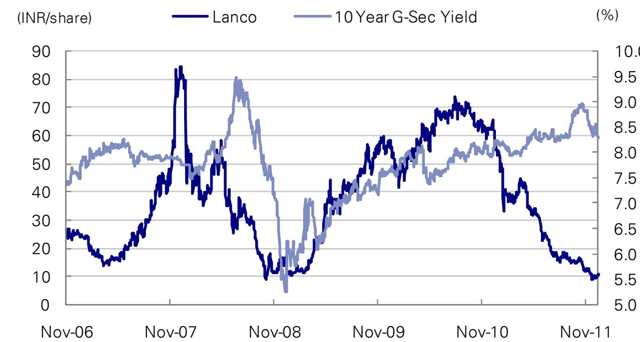
Clearly, leveraged companies such as JPA and Lanco's stock performance could see some upsurge if the RBI starts reducing the interest rates. Historically, whenever the rate cycle has turned, the asset valuations of some of these companies have shown a sharp upturn.

Figure 59: JPA stock performance vs. 10-year G-Sec yield



Source: Bloomberg Finance LP, Deutsche Bank

Figure 60: Lanco stock performance vs.10-year G-Sec yield



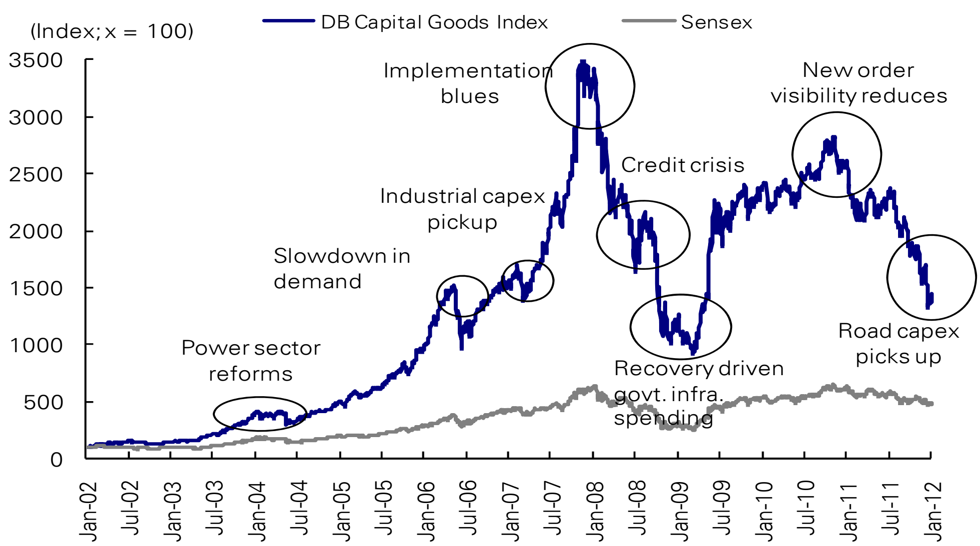
Source: Bloomberg Finance LP, Deutsche Bank

Which events could trigger the stock performance?

Triggers for stock performance?

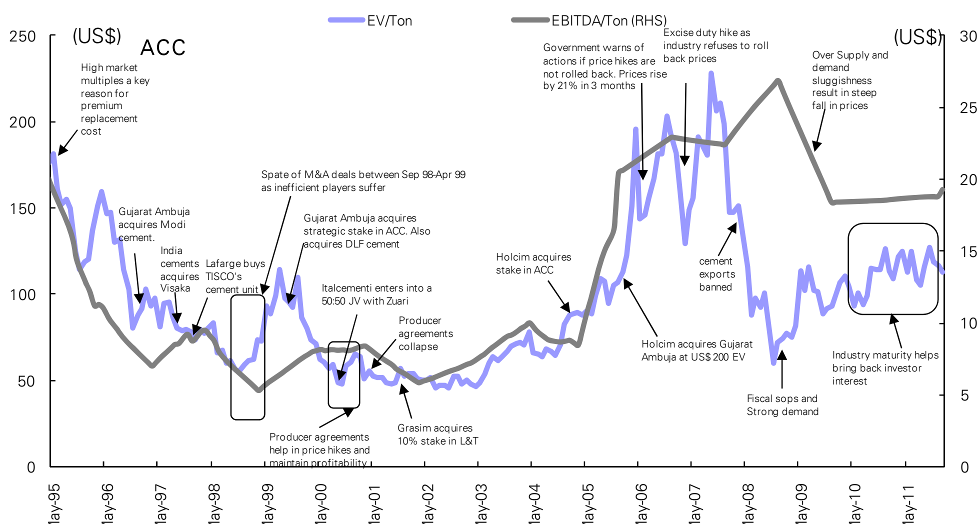
The Deutsche Bank Capital Goods Index suggests Indian industrial stocks have fallen back to levels of credit crises, largely on issues of poor visibility of new orders. However, with a pick-up in the railroad segment, recovery could be sooner than later, albeit difficult to time.

Figure 61: Deutsche Bank Capital Goods Index vs. Sensex



Source: Deutsche Bank, Bloomberg Finance LP

Figure 62: Historical snapshot of cement performance using ACC as a proxy



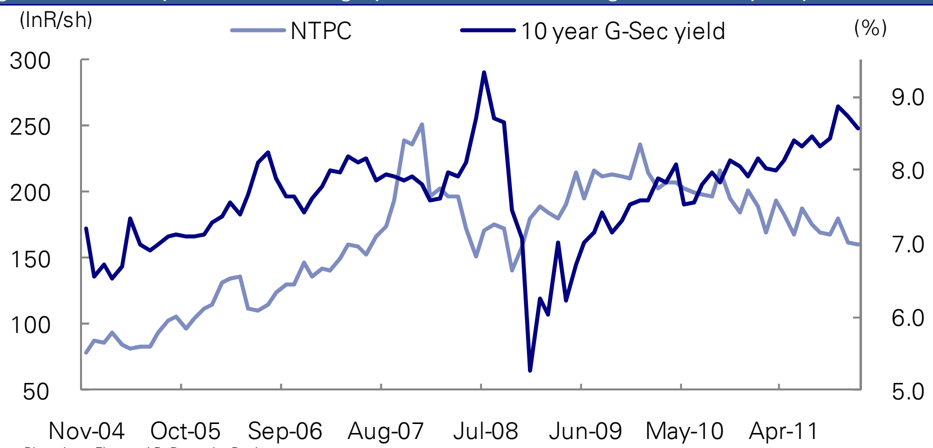
Source: ACC annual reports and press releases, companies, Bloomberg Finance LP, Cement Manufacturer's Association, Deutsche Bank

As far as cement stocks are concerned, the triggers have been varied across cycles ranging from better price arrangements, to M/A of assets as well as government actions. Going forward, our case rests on the ability of the industry to hold on to its price arrangements as well as positive demand growth resulting in higher utilisation levels.

Bond yields vs. earnings yields for utilities

The sharp divergence between bond yields and NTPC's earnings suggest that regulated return models could be back in vogue once consensus estimates stabilise.

Figure 63: Bond yields vs. earnings yields of utilities using NTPC as a proxy



Source: Bloomberg Finance LP, Deutsche Bank

Important lead indicators

The important lead indicators for the next 12 months are:

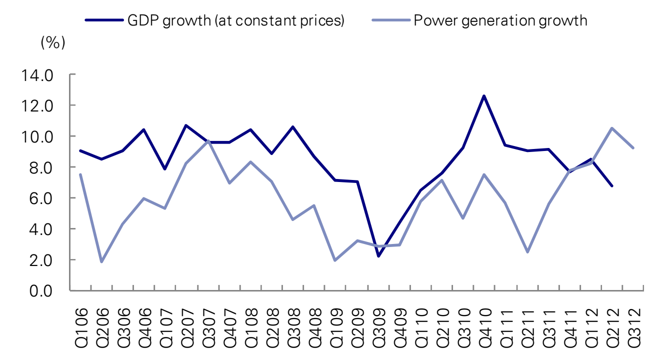
A) Working capital for industrials/utilities

One of things cited to us by mid-cap construction companies is a complete focus on collecting cash from customers. L&T has also stated the same that high interest rates impact the SME segment, which has to be supported during difficult periods. Accordingly, as the NWC/sales ratio starts to rise it suggests a downcycle. Any drop in this ratio suggests reversal. While large companies report this data every quarter, all companies are required to report every six months as per listing policies.

B) Power demand remains the sole micro data that is measurable on a daily basis

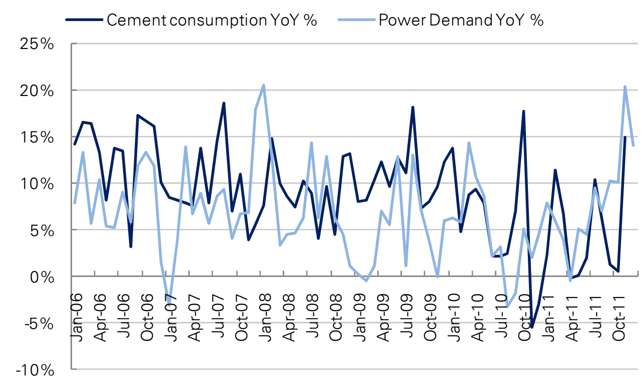
India's sole monitor-able daily micro data – "the power demand" – continues to surprise even a few optimists like us on the state of economic activity. With YTD power demand being driven largely by states having major industrial clusters, we would rather be in the school of thought that Indian IIP is likely understated. The power sector has historically been a good leading/coincidental indicator for economic activity. A continued demand surge in power bodes well for the extent of activity in the system and if our hypothesis is correct, cement demand typically lags power demand growth by six to eight months.

Figure 64: Power demand has by and large led GDP



Source: Central Electricity Authority, RBI, Deutsche Bank

Figure 65: Power demand tends to lead cement by 3-6M

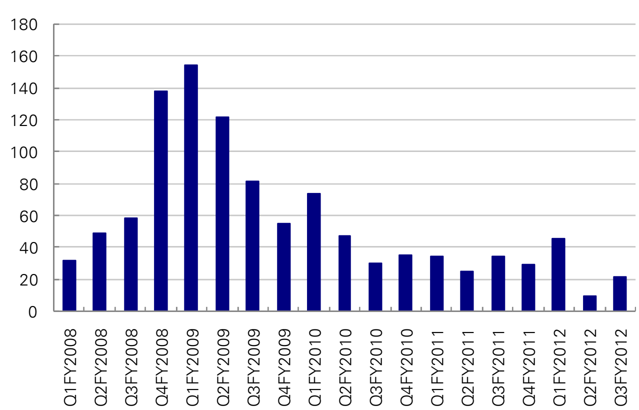


Source: Central Electricity Authority, Cement Manufacturer's Association, Deutsche Bank

C) Environmental clearances are paramount for improvement in business confidence

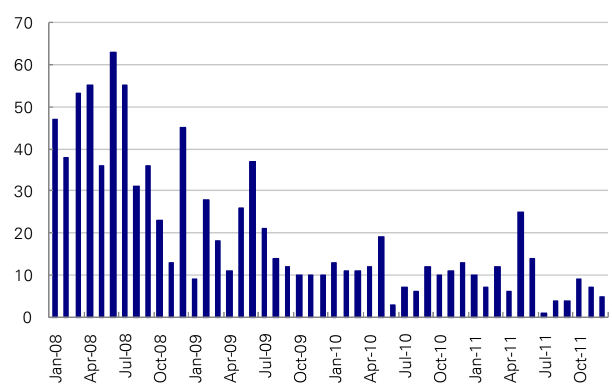
The recent spate of clearances has given an initial respite to business confidence. While the removal of "go, no go" classification helped Coal India's mining prospects in the future, the continued effort of corporates as well as the government in this regard is being keenly awaited.

Figure 66: Improvement in the no. of projects awarded EC



Source: Government data, Deutsche Bank

Figure 67: Projects awarded EC

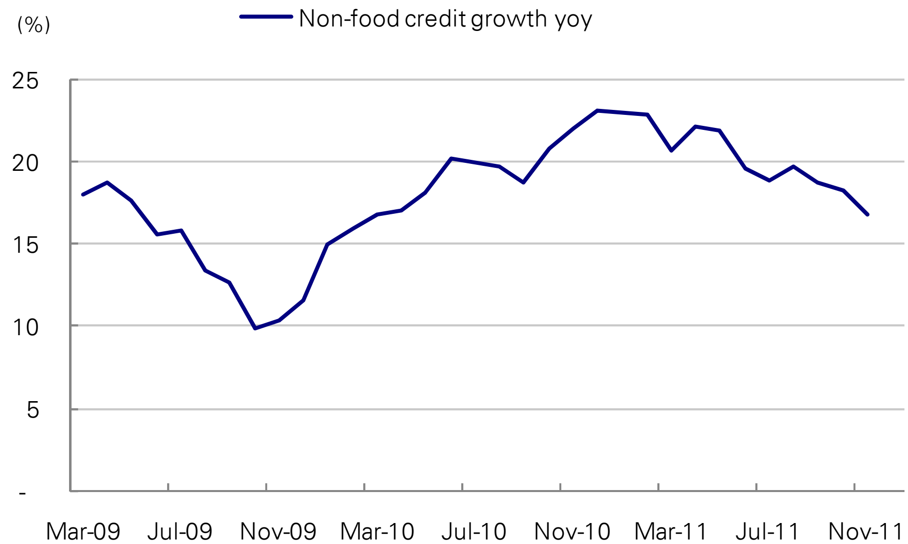


Source: Government data, Deutsche Bank

D) Non-food credit growth is a good coincidental indicator

One of the most-talked about indicators – the non-food credit growth – is a good coincidental indicator of investment cycle. Our banking team expects the non-food credit growth to grow at 16% in FY13, with a pick-up –largely in H2FY13.

Figure 68: Non-food credit growth has moderated to the higher-teens during 2011

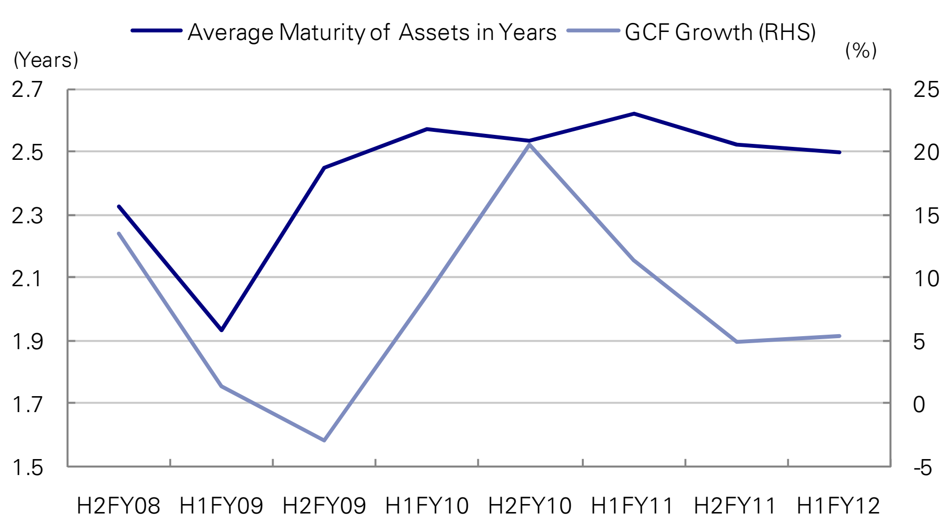


Source: Reserve Bank of India, Deutsche Bank

E) Duration of banking credit

We also estimated the duration of the banking credit and found that typically a drop toward 1.9 years suggests a greater focus on working capital loans. Surprisingly, the banking data still do not suggest that banks have moved from investment to working capital.

Figure 69: Duration of banking credit

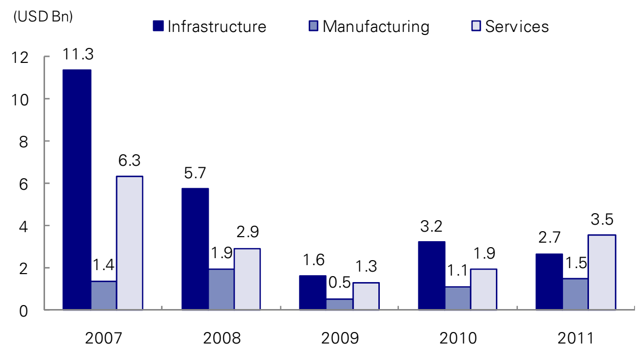


Source: Company data (includes, Axis Bank, Bank of India, Canara Bank, ICICI Bank, IDBI Bank, Indusind Bank, Indian Bank, Oriental Bank of Commerce, Punjab National Bank, State Bank of India), Deutsche Bank

F) Realignment of stressed assets to stronger hands

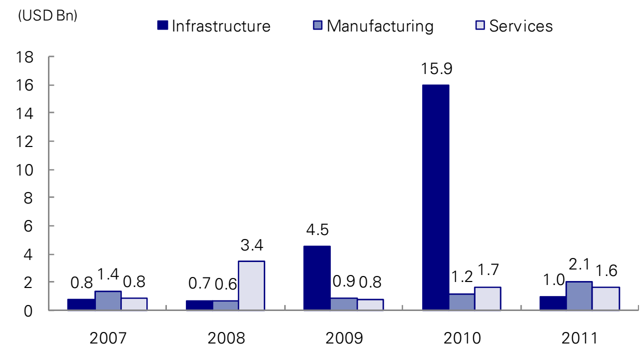
News flow on realignment of assets could be a big positive; this has worked well for cement stocks. However, we do not rule out a similar possibility for the power sector as well as road assets.

Figure 70: Private equity



Source: Deutsche Bank, company press release, News articles

Figure 71: Domestic M&A trend

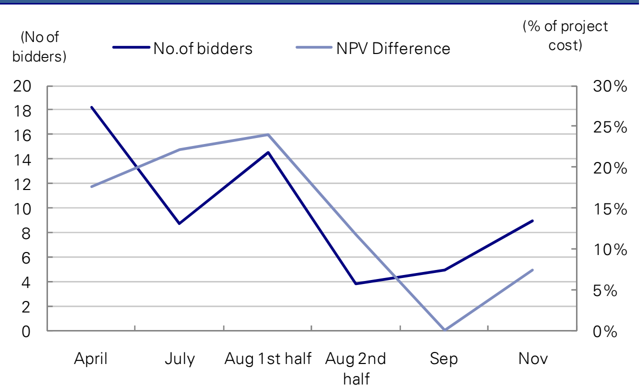


Source: Deutsche Bank, company press release, News articles

G) Lowering competitive intensity in the road and T&D segments

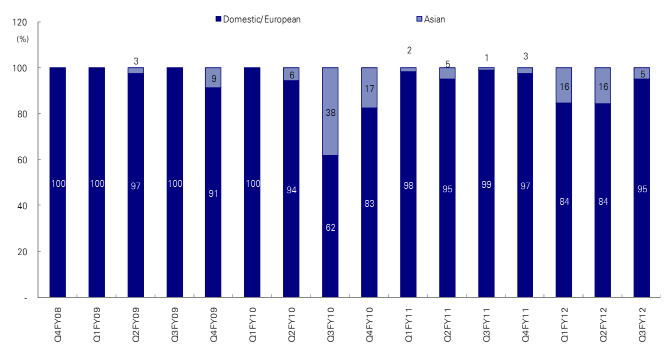
Our checks with industry leaders suggest that many of them see profitability for the road sector improving from the easing of competition. The difference between the top two bids in roads is now 2-7%, and the number of bidders has also dropped from 25 to less than 10 currently. In the power T&D segment, we are starting to see the competitive pressures easing gradually, given that the Chinese and Korean competition is far lower than what was seen in FY10 and FY11.

Figure 72: Competition in road projects has eased of late



Source: National Highway Authority of India, company and industry data, Deutsche Bank

Figure 73: The market share gains of Asian competitors too are waning, which could indicate benign pricing



Source: Power Grid Corporation of India, Deutsche Bank

The Indian CEO of Areva T&D made a very interesting remark on competition: '*there are fewer suicide bombers who are trying to win a jackpot project*', as evident from the latest couple of bids. According to management, the players that bid aggressively to win orders over the last two years have faced a number of difficulties in execution and hence, they may have realized that they had set prices too low. As a result, there are fewer 'adventurous' players left in the market. Company management also clarified that the competitive intensity from Chinese and Korean players is limited mostly to the 765kV segment, while lower segments have been relatively immune. On the pricing trend, it also commented that the rate of pricing declines appear to have dropped significantly compared to the steep fall witnessed over last two years and we believe that prices will remain flat in the near future.

H) Orders from new housing starts

The surprise in the pack could be real estate. Our real estate analysts Abhay Shanbhag and Mayank Kankaria have suggested that the investments in the real estate sector could see a tremendous boost over a three-year period. However, over the next 12 months, much would depend on the interest rate cycle and whether there is any significant pick-up in new housing starts and affordability.

Figure 74: Real estate development activities could start as and when affordability returns

Company name	Net worth (INRm)	Net debt (cash)(INRm)			msf developed in last 3 years	Launch plans for FY12E (msf)	Launch plans for next 3 years (msf)
		FY09	FY10	FY11			
Covered							
Sobha	19,284	19,108	13,915	12,130	18	6.6	30.0
DLF	270,230	151,245	207,484	226,442	30	12.0	50.0
HDIL	98,288	40,678	33,099	40,901	14	3.3	12.0
IBREL	76,377	(13,988)	(7,854)	18,337	9	4.2	12.0
Unitech	119,789	84,090	52,319	52,446	30	10.0	40.0
Non-covered							
Hubtown Ltd	16,268	10,459	11,839	17,385			
Ansal Properties	20,074	13,027	16,113	14,857			
Brigade Enterprises Ltd	11,647	4,961	7,263	8,781			
D B Realty Ltd	33,525	11,589	5,088	4,040			
D.S. Kulkarni	4,700	4,790	5,681	4,378			
Godrej Properties Ltd	9,417	6,295	6,141	7,958			
Mahindra Life Space	10,769	976	1,582	2,355			
Oberoi Realty Ltd	35,648	(1,562)	(3,607)	(13,993)			
Omaxe Ltd	17,268	18,324	16,274	13,473			
Orbit Corporation Ltd	10,506	6,704	8,587	9,735			
Parsvnath Developers	26,681	18,449	18,455	20,503			
Peninsula Land Ltd	15,537	1,954	(1,831)	4,234			
Phoenix Mills Ltd	16,516	3,542	5,937	8,605			
Prestige Estates	21,064	9,715	14,286	11,496			
Purvankara Projects Ltd	16,341	7,878	8,029	10,588			
Sunteck Realty	7,010	1,177	3,622	3,772			

Source: Company data, Deutsche Bank

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Rating
Buy

Asia
India

Resources
Construction Materials

Company
ACC

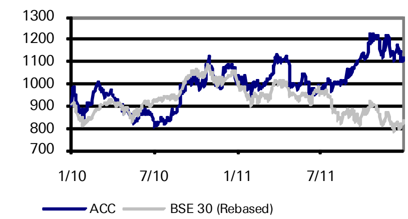
Reuters	Bloomberg
ACC.BO	ACC IN

Price at 11 Jan 2012 (INR)	1,112.00
Price target - 12mth (INR)	1,250.00
52-week range (INR)	1,223.40 - 936.50
BSE 30	16,165

Key changes

Op prof margin (FYE)	12.8 to 12.8	↑	0.1%
Net profit (FYE)	11,593.7 to 11,598.4	↑	0.0%

Price/price relative



Performance (%)	1m	3m	12m
Absolute	-4.5	-1.9	8.1
BSE 30	-0.3	-2.2	-15.8

Stock Data

Market cap (INRm)	207,275
Market cap (USDm)	4,009
Shares outstanding (m)	188.0
Major shareholders	Promoters (42.71%)
Free float (%)	65
Avg daily value traded (USDm)	6.7

Key Indicators (Fy1)

ROE (%)	17.1
Net debt/equity (%)	-14.4
Book value/share (INR)	376.65
Price/book (x)	2.95
Net interest cover (x)	–
Operating profit margin (%)	12.8

On concrete footing

Pricing and increasing FCF yields provide comfort; maintaining Buy

ACC remains our top cement pick because of three key reasons. First, the company is likely to reap benefits of pricing power with the start of a busy season in construction. Second, with the current capacity utilisation of 78%, the company remains well positioned to benefit from the upturn once it comes. Third, the strong FCF yields of more than 8% is likely to sustain in the medium term, which could result in management looking at higher payouts from accumulated cash per share of INR121. At an EV/t of US$108, it trades at a discount to replacement cost.

Reverse DCF implies reasonable 8% volume growth, EBITDA/t of US$19/t

Our reverse DCF analysis, based on a WACC of 12% and a terminal growth rate of 2%, implies that at current levels the stock is factoring in a volume growth assumption of 8% and an EBITDA/t of US$19/t between CY14E and CY18E. This seems reasonable in the light of the new capacities which are coming at a cost of US$125/t and long-term GDP growth rates.

Recent coal price hike to lower EPS by 1-5%; FCF though remains healthy

We have adjusted our CY12E and CY13E earnings by 1% and 5%, respectively, to factor in the recent coal price increase and the change in coal price forecasts of our commodities team. In spite of this, ACC's FCF yields are healthy at 8.6% and 8% in CY12E and CY13E and help the net cash to rise to INR186/share by CY12E.

ACC remains our top cement pick with a target price of INR1,250/share

With the 26% outperformance to the BSE Sensex in CY11, ACC trades at the third quartile of its 17-year PE and EV/EBITDA bands. On a regional basis, it trades at par or marginal premium to its peers. However, being an MNC subsidiary, net cash of INR186/share in CY12E (INR236/share by CY13E) raises the likelihood of a better dividend or buyback. Our 12M target price remains at INR1,250, although we have lowered our exit EV/t from US$140/t to US$125/t to adjust for the recent currency fluctuations. Industry discipline falling through remains the key risk.

Forecasts And Ratios

Year End Dec 31	2009A	2010A	**2011E**	2012E	2013E
Sales (INRm)	80,272.0	77,173.3	**93,319.8**	107,965.0	123,816.6
EBITDA (INRm)	24,796.7	15,539.8	**16,568.6**	21,515.4	28,346.5
Reported NPAT (INRm)	16,067.3	11,200.1	**11,598.4**	14,378.9	19,093.8
Reported EPS FD(INR)	85.51	59.59	**61.71**	76.50	101.66
DB EPS FD(INR)	85.51	59.59	**61.71**	76.50	101.66
OLD DB EPS FD(INR)	85.51	59.59	**61.69**	77.13	107.11
% Change	0.0%	0.0%	**0.0%**	-0.8%	-5.1%
DB EPS growth (%)	36.3	-30.3	**3.6**	24.0	32.9
PER (x)	8.3	15.6	**18.0**	14.5	10.9
EV/EBITDA (x)	4.7	9.8	**10.9**	7.8	5.6
DPS (net) (INR)	22.97	30.47	**25.00**	28.00	30.00
Yield (net) (%)	3.2	3.3	**2.2**	2.5	2.7

Source: Deutsche Bank estimates, company data

1 DB EPS is fully diluted and excludes non-recurring items
2 Multiples and yields calculations use average historical prices for past years and spot prices for current and future years, except P/B which uses the year end close

Running the Numbers

Asia

India

Infrastructure

ACC

Reuters: ACC.BO Bloomberg: ACC IN

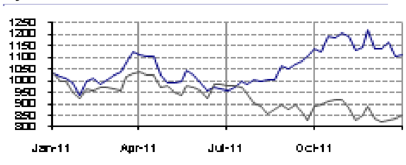
Buy

Price (11 Jan 12)	Rs 1112.00
Target price	Rs 1250.00
52-w eek Range	Rs 936.50 – 1223.40
Market Cap	Rs 207,275m US$ 4,009m

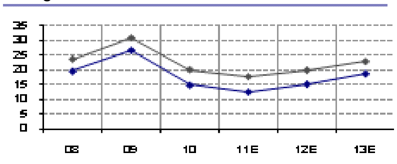
Company Profile

Associated Cement Companies (ACC) is one of the oldest cement companies in India. ACC`s main businesses comprise manufacturing and marketing of cement, ready-mixed concrete, bulk cement and refractory products.

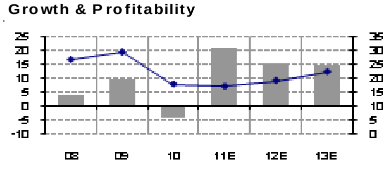
1yr Price Performance



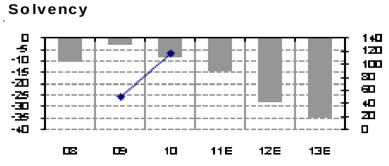
Margin Trends



Growth & Profitability



Solvency



Chockalingam Narayanan
9122 6658 4056 chockalingam.narayanan@db.com

Financial Summary						
DB EPS (Rs)	62.73	85.51	59.59	61.71	76.50	101.66
Reported EPS (Rs)	64.54	85.51	59.59	61.71	76.50	101.66
DPS (Rs)	19.98	22.97	30.47	25.00	28.00	30.00
BVPS (Rs)	262.28	320.11	344.21	376.67	420.42	486.91
Weighted average shares (m)	188	188	188	188	188	188
Average market cap (Rsm)	121,079	134,003	175,211	207,275	207,275	207,275
Enterprise value (Rsm)	109,266	117,452	152,622	180,028	168,335	158,483
Valuation Metrics						
P/E (DB) (x)	10.3	8.3	15.6	18.0	14.5	10.9
P/E (Reported) (x)	10.0	8.3	15.6	18.0	14.5	10.9
P/BV (x)	1.82	2.72	3.12	2.95	2.64	2.28
FCF Yield (%)	2.8	6.9	6.3	5.4	8.2	7.7
Dividend Yield (%)	3.1	3.2	3.3	2.2	2.5	2.7
EV/Sales (x)	1.50	1.46	1.98	1.93	1.56	1.28
EV/EBITDA (x)	6.3	4.7	9.8	10.9	7.8	5.6
EV/EBIT (x)	7.6	5.5	13.1	15.1	10.1	6.8

Income Statement (Rsm)						
Sales revenue	**73,086**	**80,272**	**77,173**	**93,320**	**107,965**	**123,817**
Gross profit	**38,216**	**44,485**	**38,075**	**41,818**	**49,486**	**58,714**
EBITDA	**17,332**	**24,797**	**15,540**	**16,569**	**21,515**	**28,347**
Depreciation	2,942	3,421	3,927	4,653	4,930	5,009
Amortisation	0	0	0	0	0	0
EBIT	**14,390**	**21,376**	**11,613**	**11,916**	**16,585**	**23,337**
Net interest income(expense)	391	-433	-100	493	700	815
Associates/affiliates	0	0	0	0	0	0
Exceptionals/extraordinaries	489	0	0	0	0	0
Other pre-tax income/(expense)	2,097	2,001	3,101	3,813	2,825	3,125
Profit before tax	**17,366**	**22,944**	**14,615**	**16,222**	**20,110**	**27,277**
Income tax expense	5,238	6,877	3,414	4,623	5,731	8,183
Minorities	0	0	0	0	0	0
Other post-tax income/(expense)	0	0	0	0	0	0
Net profit	**12,128**	**16,067**	**11,200**	**11,598**	**14,379**	**19,094**
DB adjustments (including dilution)	-341	0	0	0	0	0
DB Net profit	**11,787**	**16,067**	**11,200**	**11,598**	**14,379**	**19,094**

Cash Flow (Rsm)						
Cash flow from operations	**17,399**	**25,101**	**18,307**	**13,717**	**21,191**	**27,009**
Net Capex	-14,028	-15,840	-7,234	-2,372	-4,000	-11,000
Free cash flow	**3,371**	**9,261**	**11,073**	**11,345**	**17,191**	**16,009**
Equity raised/(bought back)	120	0	0	0	0	0
Dividends paid	-4,391	-4,392	-5,045	-6,687	-5,497	-6,157
Net inc/(dec) in borrowings	1,756	849	-431	-2,099	0	0
Other investing/financing cash flows	1,551	-8,097	-2,270	0	0	0
Net cash flow	**2,408**	**-2,379**	**3,327**	**2,559**	**11,693**	**9,852**
Change in working capital	*-690*	*4,859*	*-916*	*3,653*	*774*	*454*

Balance Sheet (Rsm)						
Cash and other liquid assets	9,842	7,464	10,800	13,359	25,053	34,904
Tangible fixed assets	50,726	63,145	66,452	64,172	63,242	69,232
Goodwill/intangible assets	0	0	0	0	0	0
Associates/investments	6,791	14,756	17,027	17,027	17,027	17,027
Other assets	17,510	15,481	16,733	16,155	17,898	19,784
Total assets	**84,868**	**100,846**	**111,013**	**110,712**	**123,218**	**140,947**
Interest bearing debt	4,820	5,669	5,238	3,139	3,139	3,139
Other liabilities	30,771	35,015	41,080	36,778	41,062	46,293
Total liabilities	**35,591**	**40,684**	**46,318**	**39,916**	**44,201**	**49,432**
Shareholders' equity	49,277	60,162	64,695	70,796	79,018	91,515
Minorities	0	0	0	0	0	0
Total shareholders' equity	**49,277**	**60,162**	**64,695**	**70,796**	**79,018**	**91,515**
Net debt	*-5,022*	*-1,795*	*-5,562*	*-10,220*	*-21,914*	*-31,766*

Key Company Metrics						
Sales growth (%)	4.3	9.8	-3.9	20.9	15.7	14.7
DB EPS growth (%)	-8.0	36.3	-30.3	3.6	24.0	32.9
EBITDA Margin (%)	23.7	30.9	20.1	17.8	19.9	22.9
EBIT Margin (%)	19.7	26.6	15.0	12.8	15.4	18.8
Payout ratio (%)	31.0	26.9	51.1	40.5	36.6	29.5
ROE (%)	26.7	29.4	17.9	17.1	19.2	22.4
Capex/sales (%)	19.2	19.7	9.4	2.5	3.7	8.9
Capex/depreciation (x)	4.8	4.6	1.8	0.5	0.8	2.2
Net debt/equity (%)	-10.2	-3.0	-8.6	-14.4	-27.7	-34.7
Net interest cover (x)	nm	49.4	116.6	nm	nm	nm

Source: Company data, Deutsche Bank estimates

Valuations factor in reasonable volume growth

Reverse DCF suggests reasonable volume growth of 8% and EBITDA/t of US$19 between CY14E and CY18E

Our reverse DCF analysis assumes a target debt-equity ratio of 1:1, a CoE of 14.5%, WACC of 12.04% and terminal growth of 2%.

Figure 75: Key assumptions for reverse DCF

Key assumptions	
Target Debt	0.5
Target Equity	0.5
CoE	14.50%
Kd * 1-t	9.6%
WACC (%)	12.04%
Terminal growth (%)	2%
Tax rate	33.90%

Source: Deutsche Bank

Based on these assumptions, at the current price, we arrive at an implied volume growth of 8% between CY14E and CY18E and an implied EBITDA/t of INR990 (US$19/t). This seems reasonable in the light of the new capacities which are coming at a cost of US$125/t and the long-term GDP growth rates.

Figure 76: Reverse DCF implies an EBITDA/t of US$19 vs. capacity cost of US$125/t

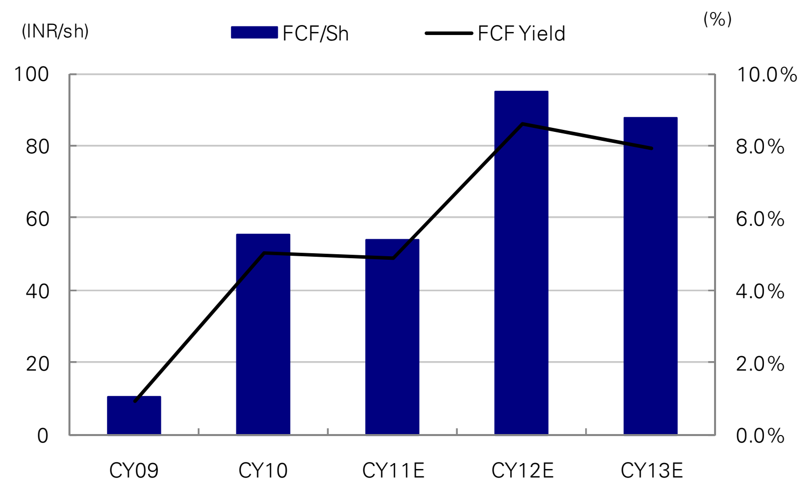
INR m	**CY12E**	**CY13E**	**CY14E**	**CY15E**	**CY16E**	**CY17E**	**CY18E**
Stage	I	I	II	II	II	II	II
Volumes (mn tonnes)	25.9	28.2	30.4	32.9	35.5	38.4	41.4
Implied Volume growth		9%	8%	8%	8%	8%	8%
Implied EBITDA/t (INR)	920	1,094	990	990	990	990	990
EBITDA	23,790	30,847	30,144	32,556	35,160	37,973	41,011
Other Income	550	625	625	625	625	625	625
Depreciation	4,930	5,009	5,592	6,369	7,208	7,590	7,993
EBIT	19,410	26,462	25,177	26,812	28,577	31,008	33,643
Taxes on EBIT	5,532	7,939	8,535	9,089	9,688	10,512	11,405
NOPLAT	13,878	18,524	16,642	17,722	18,889	20,496	22,238
Change in working capital		3,346	-677	-731	-789	-852	-921
Working capital	-19,549	-22,894	-22,218	-21,487	-20,698	-19,845	-18,925
Capex	-4,000	-11,000	-14,660	-15,833	-7,208	-7,590	-7,993
FCFF	14,808	15,878	6,897	7,528	18,100	19,644	21,318
Terminal Value (INRm)							216,524
NPV of explicit period (INR m)							58,404
NPV of terminal period (INR m)							109,450
Total (INR m)							167,854
CY12E Net Debt - Investments – (INR m)							(38,940)
DCF Value (INR m)							206,795
DCF/sh (INR)							1,101

Source: Deutsche Bank estimates

FCF yield remains attractive

At current valuations, ACC is implying an FCF yield of 8.6% in CY12E and 8% in CY13E. This will help the already high net cash balance of INR23bn (or INR124/share, 11% of market cap) to rise to INR35bn (or INR186/share, 17% of market cap). With the global parent, Holcim, already owning assets across various geographies, we think the cash balance could result in an increased dividend payout, a buyback, or inorganic expansions within the country.

Figure 77: FCF yield of more than 8% in the coming two years could result in higher dividend payouts

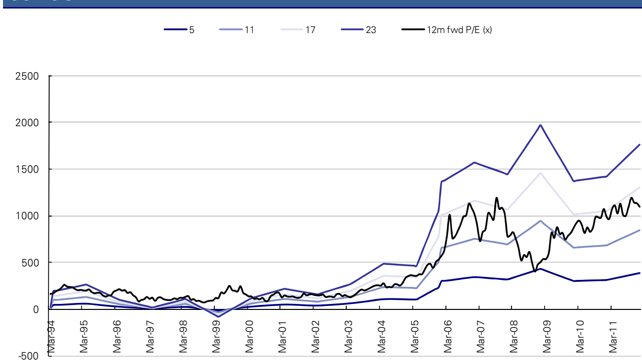


Source: Company data, Deutsche Bank estimates

ACC trades at the third quartile of its long-term P/E and EV/EBITDA bands

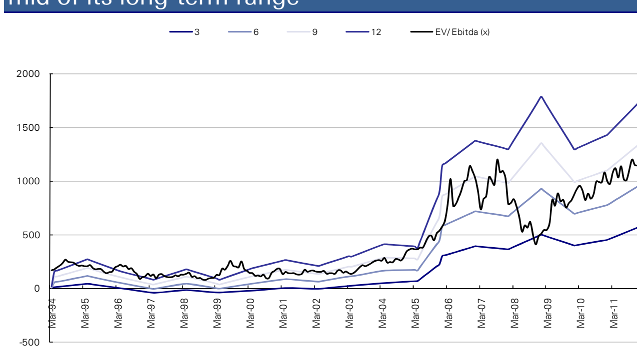
ACC is trading at 14.6x CY12E P/E and 7.4x CY12E EV/EBITDA. This is in the third quartile of its last 17-year historical one-year forward PER and EV/EBITDA bands. The historical bands have ranged between 5x and 30x on the PER basis and 3x and 15x on the EV/EBITDA basis over the last 17 years.

Figure 78: ACC's trades at the mid 1-year forward PER bands



Source: Bloomberg Finance LP, Deutsche Bank

Figure 79: On EV/EBITDA bands too, ACC trades at the mid of its long-term range



Source: Bloomberg Finance LP, Deutsche Bank

On a regional basis, ACC trades at par or a marginal premium

Figure 80: ACC trades at par or a marginal premium to the regional peers

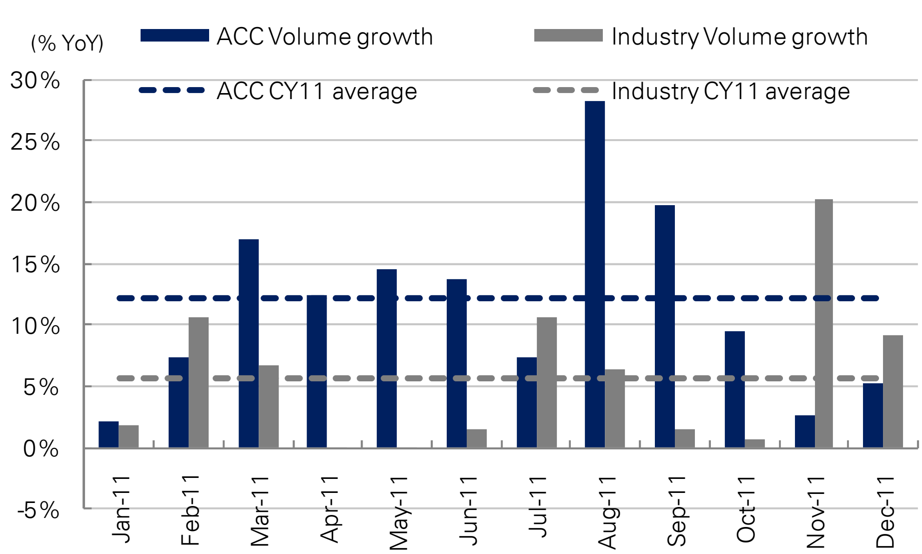
	Price	PER (x)			EV/EBITDA (x)			EV/Ton (US$)			P/B (x)			RoE (%)			EPS (CAGR)
Company	INR	FY12	FY13	FY14	FY12	FY13	FY14	FY12	FY13	FY14	FY12	FY13	FY14	FY12	FY13	FY14	%
India																	
ACC	1,121	18.1	14.6	11.0	9.4	7.4	5.4	115	108	102	3.0	2.7	2.3	17.1	19.3	23.4	28.3
Ambuja Cements	153	18.2	14.7	11.3	9.5	7.6	5.7	148	145	135	2.9	2.5	2.2	16.6	18.3	21.7	26.7
Grasim	2,321	9.1	8.2	6.5	7.0	5.6	4.0	88	87	60	1.3	1.1	1.0	16.8	15.4	14.9	18.2
India Cements	71	7.9	7.2	4.5	5.7	4.6	3.5	62	59	58	0.5	0.5	0.5	1.7	6.6	7.5	32.4
Shree Cement	2,050	29.2	11.7	7.3	5.7	3.6	2.1	81	65	41	3.3	2.6	2.0	11.0	11.8	24.8	99.7
UltraTech	1,165	16.6	13.3	9.5	8.5	6.8	5.1	122	120	100	2.6	2.2	1.8	18.4	17.0	17.9	32.0
India Avg		17.1	12.0	8.6	8.1	6.3	4.8	106	97	84	2.1	1.8	1.5	13.5	13.6	17.3	39.7
India large cap cement Avg		17.6	14.2	10.6	9.2	7.3	5.4	128	124	112	2.8	2.5	2.1	17.4	18.2	21.0	29.0
China avg		5.7	5.9	4.8	4.9	4.9	4.2	72	59	54	1.6	1.4	1.1	27.1	20.9	21.6	11.9
Indonesia avg		17.5	15.7	13.6	10.5	8.9	7.4	315	298	256	3.7	3.2	2.7	22.4	21.6	21.5	18.3
Asia ex India avg		13.1	11.7	10.3	9.0	7.8	8.9	141	133	123	2.5	2.3	2.1	20.3	19.5	20.3	18.3

Source: Bloomberg Finance LP, Deutsche Bank estimates; Prices as of Jan 11 2012

While volume growth has remained ahead of industry…

ACC's volume growth in CY11 has remained ahead of the industry by a good 650bps, at 12.2%. The company's diversified presence across the country and capacity additions at Chanda and Wadi have helped it to capture the high demand growth in western and northern regions of the country during the year. With its overall capacity utilisation still at only 78%, ACC's volumes may grow along the industry average at the least.

Figure 81: ACC's volume growth has been a good 650bps



Source: ACC, Cement Manufacturer's Association, Deutsche Bank

…recent coal price increase would pull down earnings

Coal India recently shifted to the GCV-based pricing mechanism from the UHV-based pricing, which effectively resulted in a nearly 30% increase in coal prices for user industries like cement. After factoring in this increase and the downward revision in global thermal coal price forecasts of our commodities team from the August 2011 forecasts, we lower our EPS for CY12E and CY13E by 1% and 5%, respectively. After these revisions, our CY12E estimates remain ahead of consensus by 11%.

Figure 82: Revise EPS downwards by 1% and 5% in CY12E and CY13E, respectively, on recent rise in coal prices

	CY12E			CY13E		
INR m	**Revised**	**Old**	**Var (%)**	**Revised**	**Old**	**Var (%)**
Sales volume (mn tons)	25.9	25.9	-	28.2	28.2	-
Average net realisation (INR/t)	4,174	4,174.1	-	4,392	4,391.7	-
Power & fuel cost (INR/t)	954	947.4	1	969	917.1	6
EBITDA/t (INR)	920	926.1	(1)	1,094	1,145.9	(5)
Net Sales	107,965	107,965.0	-	123,817	123,816.6	-
EBITDA	23,790	23,954.4	(1)	30,847	32,307.4	(5)
PAT	14,379	14,496.1	(1)	19,094	20,117.0	(5)
EPS (INR/sh)	76.5	77.1	(1)	101.6	107.0	(5)

Source: Deutsche Bank estimates

We realign our exit EV/t value for currency fluctuations

We realign our exit EV/t from US$140 to US$125/t for ACC to adjust for currency fluctuations in arriving at our target price. This is in line with the other large cap peer Ultratech (Hold; INR1165.25), given the comparable profitability levels, and with our estimate for the replacement cost of the new units being added at US$125/t. At our target price of INR1,250 (unchanged), the implied exit P/E multiple of 16.3x CY12E and exit EV/EBITDA of 8.4x CY12E look reasonable as the industry's profitability is stabilising at these levels.

Risks

The key risks are: (1) any break-up in the industry discipline or government probe into cement price rises; (2) demand growth below 5% for FY13E. Note that a 1% rise in cement prices from our estimates could increase our earnings by 5% in CY12E and vice versa. Similarly, 1% higher volume growth would increase our earnings by 1.2% in CY12E and vice versa. On the costs front, a 1% rise in the cost of coal would reduce earnings by 1% in CY12E.

Rating
Buy

Asia
India

Resources
Metals & Mining

Company
Coal India Limited

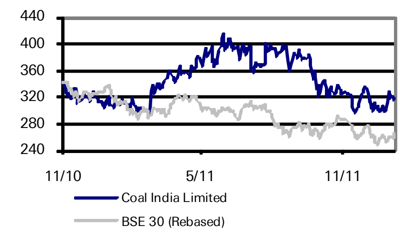
Reuters	Bloomberg
COAL.BO	COAL IN

Price at 10 Jan 2012 (INR)	317.75
Price target - 12mth (INR)	430.00
52-week range (INR)	414.70 - 291.90
BSE 30	16,165

Key changes

Sales (FYE)	611,971 to 622,761	↑	1.8%
Op prof margin (FYE)	28.8 to 29.6	↑	2.9%
Net profit (FYE)	143,352.2 to 149,064.8	↑	4.0%

Price/price relative



Performance (%)	1m	3m	12m
Absolute	0.3	-7.3	4.2
BSE 30	-0.3	-2.4	-15.9

Stock Data

Market cap (INRm)	2,007,025
Market cap (USDm)	38,817
Shares outstanding (m)	6,316.4
Major shareholders	President of India (90%)
Avg daily value traded (USDm)	27.5
Free float(%)	10

Key Indicators (Fy1)

ROE (%)	38.6
Net debt/equity (%)	-146.6
Book value/share (INR)	69.38
Price/book (x)	4.6
Net interest cover (x)	148.3
Operating profit margin (%)	29.6

In the driver's seat

Valuations belie ground realities

Coal India is among our top picks because: (1) it remains a beneficiary of the country's continued and rising shortage of cheap energy, (2) the 45% discount to international coal on delivered basis, despite recent price hikes, leaves enough scope for the company to pass on cost pressures from a proposed wage hike or the draft mining bill, and (3) its valuations, post the 20% correction in the past six months, are now at a discount to regional and global peers. Maintaining Buy with a target price of INR430/share.

Reverse DCF implies a negative volume CAGR of 2% in FY14E-20E

Our analysis suggests the market is factoring in a negative sales volume CAGR of 2% over the medium term (FY14E-20E), assuming a marginal CAGR of 3% in net realisation over the same period, much below the historical inflation in India.

We revise our EPS upwards by 4% for FY12E and 11% for FY13E

We have raised our regulated coal price realisation by 1% for FY12E and 6% for FY13E to factor in a part of the recent GCV-based price notification. In addition, the revision in e-auction prices (to factor in the impact of rupee depreciation) has resulted in our average realisations moving up by 2% for FY12 and 7% for FY13.

Maintaining Buy with a target price of INR430/share (rounded)

We continue to base our target price on an average of life-of-mine DCF (discount rate 12.3%) and exit P/E multiples. However, we have lowered our exit P/E from 18x FY12E to 16x FY13 as the price hike (that was earlier justified given the large discount of domestic coal prices to international coal prices) materialized in January 2012 through the migration to GCV-based pricing from UHV-based pricing. Key risks include: (1) any roll-back of the announced price hike, and (2) inability to deliver volumes of 459mnt in FY13, i.e., a growth of 5% YoY. Lower volumes by 1% could result in EPS drop of 2% in FY13E. See pages 52-53 for more details.

Forecasts And Ratios

Year End Mar 31	2010A	2011A	**2012E**	2013E	2014E
Sales (INRm)	446,152.5	502,335.9	**622,761.3**	713,257.6	709,111.5
EBITDA (INRm)	130,618.4	153,083.6	**201,654.8**	224,288.7	200,323.4
EBIT(INRm)	117,324	136,355	**184,372**	206,468	180,925
Reported EPS FD(INR)	15.23	17.21	**23.60**	27.43	25.56
Reported NPAT (INRm)	96,224.6	108,673.5	**149,064.8**	173,246.5	161,441.0
DB EPS growth (%)	155.0	12.9	**37.2**	16.2	-6.8
DB EPS FD(INR)	15.23	17.21	**23.60**	27.43	25.56
OLD DB EPS FD(INR)	15.23	17.21	**22.70**	24.71	25.79
% Change	0.0%	0.0%	**4.0%**	11.0%	-0.9%
PER (x)	–	18.6	**13.5**	11.6	12.4
EV/EBITDA (x)	–	10.2	**6.7**	5.2	5.1
DPS (net) (INR)	3.50	3.90	**5.90**	6.86	6.39
Yield (net) (%)	–	1.2	**1.9**	2.2	2.0

Source: Deutsche Bank estimates, company data

1 DB EPS is fully diluted and excludes non-recurring items
2 Multiples and yields calculations use average historical prices for past years and spot prices for current and future years, except P/B which uses the year end close

Model updated: 10 January 2012

Running the Numbers

Asia

India

Metals & Mining

Coal India Limited

Reuters: COAL.BO | Bloomberg: COAL IN

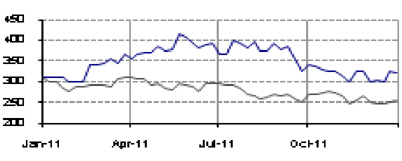
Buy

Price (11 Jan 12)	Rs 320.20
Target price	Rs 430.00
52-week Range	Rs 291.90 – 414.70
Market Cap	Rs 2,022,500m US$ 39,116m

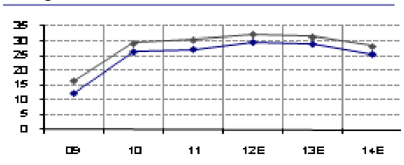
Company Profile

Coal India Limited produces and markets coal and coal products, as well as provides related consulting services.

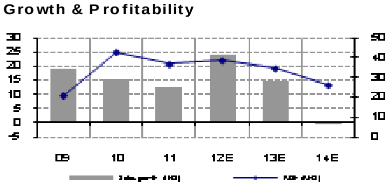
1yr Price Performance



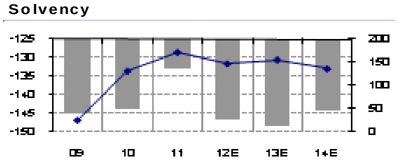
Margin Trends



Growth & Profitability



Solvency



Manish Saxena
+9122 6658 4811 manish.saxena@db.com

Fiscal year end 31-Mar	2009	2010	2011	2012E	2013E	2014E
Financial Summary						
DB EPS (Rs)	5.97	15.23	17.21	23.60	27.43	25.56
Reported EPS (Rs)	5.97	15.23	17.21	23.60	27.43	25.56
DPS (Rs)	2.70	3.50	3.90	5.90	6.86	6.39
BVPS (Rs)	30.09	40.84	52.74	69.38	88.72	106.74
Weighted average shares (m)	6,316	6,316	6,316	6,316	6,316	6,316
Average market cap (Rsm)	na	na	2,018,954	2,022,500	2,022,500	2,022,500
Enterprise value (Rsm)	na	na	1,565,556	1,369,135	1,179,376	1,041,171
Valuation Metrics						
P/E (DB) (x)	na	na	18.6	13.6	11.7	12.5
P/E (Reported) (x)	na	na	18.6	13.6	11.7	12.5
P/BV (x)	na	na	6.58	4.62	3.61	3.00
FCF Yield (%)	na	na	5.1	12.1	11.9	9.2
Dividend Yield (%)	na	na	1.2	1.8	2.1	2.0
EV/Sales (x)	na	na	3.12	2.20	1.65	1.47
EV/EBITDA (x)	na	na	10.2	6.8	5.3	5.2
EV/EBIT (x)	na	na	11.5	7.4	5.7	5.8
Income Statement (Rsm)						
Sales revenue	**387,888**	**446,153**	**502,336**	**622,761**	**713,258**	**709,111**
Gross profit	**331,580**	**384,739**	**447,725**	**570,598**	**650,756**	**653,101**
EBITDA	**64,222**	**130,618**	**153,084**	**201,655**	**224,289**	**200,323**
Depreciation	16,909	13,294	16,729	17,283	17,821	19,398
Amortisation	0	0	0	0	0	0
EBIT	**47,313**	**117,324**	**136,355**	**184,372**	**206,468**	**180,925**
Net interest income(expense)	-1,789	-886	-791	-1,243	-1,321	-1,321
Associates/affiliates	0	0	0	0	0	0
Exceptionals/extraordinaries	310	-537	-602	0	0	0
Other pre-tax income/(expense)	28,537	23,748	29,670	42,693	57,308	64,966
Profit before tax	**74,371**	**139,649**	**164,632**	**225,822**	**262,456**	**244,571**
Income tax expense	36,632	43,425	55,959	76,757	89,209	83,130
Minorities	0	0	0	0	0	0
Other post-tax income/(expense)	0	0	0	0	0	0
Net profit	**37,739**	**96,225**	**108,673**	**149,065**	**173,246**	**161,441**
DB adjustments (including dilution)	0	0	0	0	0	0
DB Net profit	**37,739**	**96,225**	**108,673**	**149,065**	**173,246**	**161,441**
Cash Flow (Rsm)						
Cash flow from operations	**130,128**	**148,082**	**128,011**	**283,941**	**280,867**	**225,830**
Net Capex	-26,121	-26,473	-24,877	-40,000	-40,000	-40,000
Free cash flow	**104,007**	**121,609**	**103,133**	**243,941**	**240,867**	**185,830**
Equity raised/(bought back)	0	-16	-17	0	0	0
Dividends paid	-22,548	-29,871	-29,068	-43,974	-51,108	-61,064
Net inc/(dec) in borrowings	2,646	-1,853	-4,096	0	0	0
Other investing/financing cash flows	19	217	0	0	0	0
Net cash flow	**84,124**	**90,085**	**69,952**	**199,967**	**189,759**	**124,767**
Change in working capital	*59,667*	*63,969*	*-5,205*	*108,074*	*82,646*	*45,319*
Balance Sheet (Rsm)						
Cash and other liquid assets	296,950	390,782	458,623	658,590	848,348	986,554
Tangible fixed assets	129,283	142,461	150,610	173,327	195,506	216,108
Goodwill/intangible assets	0	0	0	0	0	0
Associates/investments	15,052	12,821	10,637	10,637	10,637	10,637
Other assets	181,962	162,070	194,070	202,063	215,738	215,112
Total assets	**623,247**	**708,135**	**813,939**	**1,044,616**	**1,270,230**	**1,428,410**
Interest bearing debt	21,485	19,631	15,536	15,536	15,536	15,536
Other liabilities	411,661	430,331	464,939	590,526	694,000	738,365
Total liabilities	**433,146**	**449,963**	**480,475**	**606,061**	**709,536**	**753,901**
Shareholders' equity	190,081	257,936	333,138	438,229	560,368	674,184
Minorities	19	236	326	326	326	326
Total shareholders' equity	**190,100**	**258,172**	**333,464**	**438,555**	**560,694**	**674,510**
Net debt	*-275,465*	*-371,151*	*-443,087*	*-643,054*	*-832,813*	*-971,018*
Key Company Metrics						
Sales growth (%)	18.9	15.0	12.6	24.0	14.5	-0.6
DB EPS growth (%)	-5.4	155.0	12.9	37.2	16.2	-6.8
EBITDA Margin (%)	16.6	29.3	30.5	32.4	31.4	28.2
EBIT Margin (%)	12.2	26.3	27.1	29.6	28.9	25.5
Payout ratio (%)	45.2	23.0	22.7	25.0	25.0	25.0
ROE (%)	20.8	43.0	36.8	38.6	34.7	26.2
Capex/sales (%)	6.7	5.9	5.0	6.4	5.6	5.6
Capex/depreciation (x)	1.5	2.0	1.5	2.3	2.2	2.1
Net debt/equity (%)	-144.9	-143.8	-132.9	-146.6	-148.5	-144.0
Net interest cover (x)	26.4	132.4	172.5	148.3	156.4	137.0

Source: Company data, Deutsche Bank estimates

Valuation

Reverse DCF implies negative volume growth over medium term

We perform a reverse-DCF analysis (three stages) to determine the market's expectation on growth as implied by the current market price (INR315). Our analysis suggests that the market is factoring in a negative sales volume CAGR of 2% over the medium term (FY14E–20E), assuming a marginal CAGR of 3% in net realisation over the same period, much below the historical inflation in India.

Figure 83 details our cash flow forecast; FY12-14 is an explicit forecast period, FY14–20 is a semi-explicit period and our terminal cash-flow growth assumption is 2%.

Figure 83: Coal India – Cash flow projection for reverse DCF

	FY10	FY11	FY12	FY13E	FY14E	FY15E	FY16E	FY17E	FY18E	FY19E	FY20E	CAGR (FY14E-20E)
Net Sales	**446,153**	**502,336**	**622,761**	**713,258**	**709,111**	**716,203**	**723,365**	**730,598**	**737,904**	**745,283**	**752,736**	1.0%
Growth (%)		*13*	*24*	*15*	*(1)*	*1*	*1*	*1*	*1*	*1*	*1*	
EBITDA	**130,618**	**153,084**	**201,655**	**224,289**	**200,323**	**236,347**	**238,710**	**241,097**	**243,508**	**245,943**	**248,403**	3.7%
Margin (%)	*29.3*	*30.5*	*32.4*	*31.4*	*28.2*	*33.0*	*33.0*	*33.0*	*33.0*	*33.0*	*33.0*	
Depreciation	13,294	16,729	17,283	17,821	19,398	21,486	21,701	21,918	22,137	22,358	22,582	
% of sales	*3.0*	*3.3*	*2.8*	*2.5*	*2.7*	*3.0*	*3.0*	*3.0*	*3.0*	*3.0*	*3.0*	
EBIT	117,324	136,355	184,372	206,468	180,925	214,861	217,009	219,179	221,371	223,585	225,821	
Margin (%)	*26.3*	*27.1*	*29.6*	*28.9*	*25.5*	*30.0*	*30.0*	*30.0*	*30.0*	*30.0*	*30.0*	
Taxes on EBIT	(38,952)	(45,270)	(61,211)	(68,547)	(60,067)	(71,334)	(72,047)	(72,768)	(73,495)	(74,230)	(74,973)	
NOPLAT	**91,667**	**107,814**	**140,443**	**155,741**	**140,256**	**165,013**	**166,663**	**168,330**	**170,013**	**171,713**	**173,430**	3.6%
Working capital	(263,091)	(263,388)	(380,981)	(470,780)	(515,772)	-485,119	-489,971	-494,870	-499,819	-504,817	-509,865	
% of sales	*-59.0*	*-52.4*	*-61.2*	*-66.0*	*-72.7*	*-67.7*	*-67.7*	*-67.7*	*-67.7*	*-67.7*	*-67.7*	
Change in working capital		297	117,593	89,800	44,991	-30,652	4,851	4,900	4,949	4,998	5,048	
Capex	-19,815	-17,832	-20,000	-20,000	-40,000	-28,648	-28,935	-29,224	-29,516	-29,811	-30,109	
% of sales	*4.4*	*3.5*	*3.2*	*2.8*	*5.6*	*4.0*	*4.0*	*4.0*	*4.0*	*4.0*	*4.0*	
Cash flow												
FCFF (Stg. I + II)		**90,279**	**238,036**	**225,541**	**145,248**	**105,713**	**142,580**	**144,006**	**145,446**	**146,900**	**148,369**	0.4%
Stage I		90,279	238,036	225,541	145,248							
Stage II		-	-	-	-	105,713	142,580	144,006	145,446	146,900	148,369	
Terminal value		-	-	-	-	-	-	-	-	-	1,459,369	
Total FCFF		**90,279**	**238,036**	**225,541**	**145,248**	**105,713**	**142,580**	**144,006**	**145,446**	**146,900**	**1,607,738**	
Business implication												
Sales volume (mnt)	415	425	437	459	464	455	446	437	429	421	412	-1.9%
Net realisation/ ton (INR m)	1,074	1,183	1,425	1,553	1,529	1,575	1,622	1,671	1,721	1,772	1,825	3.0%

Source: Deutsche Bank estimates

Figure 84: Reverse DCF valuation of Coal India

Enterprise value	INR m	% of total NPV
NPV of Stage I	315,742	24%
NPV of Stage II	439,844	33%
NPV of TV	574,066	43%
NPV of FCFF	**1,329,652**	**100%**
Net cash	658,590	
Total Equity Value	**1,988,242**	

Per share basis								
				Sensitivity to key assumptions				
NPV of Stage I	50			Cost of Equity (%)				
NPV of Stage II	70		315	**10.37**	**11.37**	**12.37**	**13.37**	**14.37**
NPV of TV	91	Terminal growth rate (%)	-	335	315	299	284	272
NPV of FCFF	**211**		**1.00**	347	325	306	290	277
Net cash	104		**2.00**	362	336	315	297	283
Total Equity Value	**315**		**3.00**	381	350	325	306	289
			4.00	406	368	339	316	297

Source: Deutsche Bank estimates

Our key assumptions to arrive at this implied reverse-DCF value of Coal India are shown in Figure 85.

Figure 85: Key assumptions for WACC

Terminal growth rate (%)	2.00
Tax rate (%)	33.20
Cost of Equity (%)	12.37
Risk free rate (%)	6.70
Equity risk premium (%)	8.10
Beta	0.70
No. of shares (m)	6,316

Source: Deutsche Bank

We raise our regulated price assumptions by 1% for FY12E and 6% for FY13E…

We have raised our regulated coal price realisation by 1% for FY12E and 6% for FY13E to factor in a part of the recent GCV-based price notification announced by the company. In addition, we have changed our INR-USD assumptions for FY12, FY13 and FY14 to 49.0, 52.0 and 50.0 from 46.9, 47.0 and 46.0, respectively, due to the sharp depreciation of INR against USD over the last two quarters, resulting in an increase in the e-auction coal prices (c16% of sales) of Coal India (as it closely follows the trend in the landed cost of imported coal). In effect, our average realisations rise by 2%, 7% and 6% for FY12E, FY13E and FY14E, respectively.

Figure 86: We lower production assumptions by c4% and off-take assumptions by c6%

	FY12E			FY13E			FY14E		
	Revised	Old	Chg (%)	Revised	Old	Chg (%)	Revised	Old	Chg (%)
Production volume (mn t)	425	425	-	450	450	-	464	464	-
Sales Volume (mn t)	437	437	-	459	459	-	464	464	-
Average net realisation (INR/t)	1,425	1,400	2	1,553	1,453	7	1,529	1,436	6

Source: Deutsche Bank

…and consequently EPS estimates rise by 4% for FY12E and 11% for FY13E

Post the changes mentioned above, our earnings for FY12E and FY13E are higher by 4% and 11%, respectively. The fall in FY14E is largely due to a higher wage bill of INR272bn (vs. INR250bn earlier).

Figure 87: Lower welfare expenses in FY12E offset the dip in volumes

	FY12E			FY13E			FY14E		
	Revised	Old	Chg (%)	Revised	Old	Chg (%)	Revised	Old	Chg (%)
Net Sales (INR m)	622,761	611,971	2	713,258	667,204	7	709,111	666,311	6
EBITDA (INR m)	177,767	169,865	5	197,000	174,487	13	173,191	179,637	(4)
Other Income	66,581	65,828	1	84,597	81,054	4	92,099	87,828	5
PAT (INR m)	149,065	143,352	4	173,246	156,047	11	161,441	162,877	(1)
EPS (INR)	23.6	22.7	4	27.4	24.7	11	25.6	25.8	(1)

Source: Deutsche Bank estimates

Our EPS estimates for FY12E and FY13E are c2% and c5% above consensus, respectively

Our earnings are now 2% and 5% above consensus for FY12E and FY13E, respectively. This seems to be largely on account of our numbers incorporating a part of the recent price hike assumed by us, and as a result our earnings for FY12E and FY13E have gone up by 4% and 11%, respectively. For FY14E, our numbers are 13% below consensus due to the higher wage cost assumptions.

Figure 88: Our estimates are 2% and 5% above consensus for FY12E and FY13E, respectively

	FY12E			FY13E			FY14E		
	Deutsche Bank	Consensus	Variation (%)	Deutsche Bank	Consensus	Variation (%)	Revised	Consensus	Variation (%)
Net Sales (INR m)	622,761	616,244	1	713,258	674,410	6	709,111	734,796	(3)
EBITDA (INR m)	201,655	179,722	12	224,289	206,707	9	200,323	234,821	(15)
PAT (INR m)	149,065	146,432	2	173,246	162,664	7	161,441	185,052	(13)
EPS (INR)	23.6	23.2	2	27.4	26.0	5	25.6	29.2	(13)

Source: Deutsche Bank estimates; Bloomberg Finance LP Consensus estimates

Reiterating target price of INR430/share based on average of life-of-mine DCF and 18x FY12E P/E

We continue to use an average of the values derived using life-of-mine DCF and P/E to arrive at our target price. However, we have rolled over the target P/E multiple from 18x FY12E to 16x FY13E. We believe the reduction in multiple is now justified as the price hike (that was earlier justified given huge discount of domestic coal price to international coal price) materialized in January 2012 with migration to GCV-based pricing from UHV-based pricing. In the life-of-mine DCF methodology, we value the currently-stated extractable coal reserves of 22.3bn tons. This excludes any upside from conversion of the company's remaining c30.1bn tons of proven reserves into extractable reserves. We assume volume growth of 3% till FY17 and then 4% until extractable reserves become zero. We also assume constant prices and rising costs after FY17E, implying diminishing profitability. We further assume a discount rate of 12.3% (beta of 0.7, a risk-free rate of 8.1% and an equity risk premium of 6.7%). In the P/E methodology, we assume an exit P/E of 16x FY13E as we believe the valuation paid for Indonesian coal mines by Indian developers and the upcoming auction of captive mines within India warrants a premium for Coal India's operating assets, which have one of the lowest cost structures. However, this multiple is at a modest premium to international peers. We believe the premium is justified largely on account of understated profits at CIL, a strong balance sheet with ~USD10.8bn of net cash, and also because CIL works with negative operating assets, resulting in very high returns.

Risks

Key downside risks include lower-than-expected production growth due to delays in environmental clearance, higher-than-expected operating costs and the profit-sharing provisions in the proposed new 'Mining Bill' leading to dip in earnings (depending on when and how the act is implemented). Our sensitivity analysis shows that if sales volume for FY13E is 2% lower than expected, then FY13E EPS could fall by 4%. Diversion of e-auction coal to power sector with regulated price increase of less than 4% could have a negative impact on earnings. In case the proposed mining bill is imposed and the government does not allow any price hike, Coal India's FY13E profit may dip by c40%.

Rating
Buy

Asia
India

Resources
Metals & Mining

Company
Jindal Steel & Power

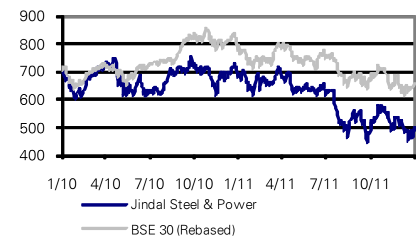
Reuters	Bloomberg
JNSP.BO	JSP IN

Price at 11 Jan 2012 (INR)	488.40
Price target - 12mth (INR)	710.00
52-week range (INR)	714.30 - 445.35
BSE 30	16,165

Key changes

Price target	755.00 to 710.00	↓	-6.0%
Sales (FYE)	175,136 to 178,607	↑	2.0%
Op prof margin (FYE)	33.8 to 33.4	↓	-1.2%
Net profit (FYE)	41,561.7 to 41,800.2	↑	0.6%

Price/price relative



Performance (%)	1m	3m	12m
Absolute	-8.0	0.0	-27.9
BSE 30	-0.3	-2.2	-15.8

Stock Data

Market cap (INRm)	456,297
Market cap (USDm)	8,825
Shares outstanding (m)	934.3
Major shareholders	Promoters (58.4%)
Avg daily value traded (USDm)	0.0
Free float(%)	42

Key Indicators (Fy1)

ROE (%)	26.0
Net debt/equity (%)	89.5
Book value/share (INR)	192.73
Price/book (x)	2.5
Net interest cover (x)	8.6
Operating profit margin (%)	33.4

A silent worker; reiterating Buy, with INR 710 target price

Probably one of the best developers for minority shareholders in India

Our recent visits to various plants of JSPL were reassuring, especially on understanding the roadmap for doubling earnings over the next three/four years. The pace of development work being done by ~25K workers would probably put it at among the fastest in the country. The valuation looks compelling: new projects still have hurdle rates higher than 30% RoI. Our revised target price incorporates a lower steel exit P/E multiple, in line with Deutsche Bank's steel analyst's valuation methodology.

Project development work reinforces the company's press communiqué

In Angul we visited the upcoming 2mnt sponge iron facilities, 6*135MW captive power plant and 1.5mnt rolling steel facility; in Raigarh we saw the 4*135MW plant and coal mine and upcoming 2400MW IPP. Of note was the three commissioned units of the 4*135MW plant working at 80%+ PLF using only coal-middling, i.e., generating power at virtually no variable cost.

JSPL seems on track to double its profits over the next three to four years

Important drivers for incremental profits are 1) commissioning of Phase-1 facilities in Angul, to come in stages (we estimate INR 30-35bn net income, with a timeline of 6-30 months), 2) new coal mines starting in Indonesia/Mozambique (we estimate annual PAT of INR 4-5bn at full utilization over 6-24 months), 3) new CPP (10x135MW), working at 80% PLF (we estimate INR 14-15bn net income).

Our 12-month target price of INR 710 implies 42% upside potential; risks

Our 12-month SOTP target price estimates the value of the steel business at a revised P/E of 8x FY13E (in line with DB estimates for peers); we value the power business by the NPV method, with CoE of 12.5-14.5%. Risks: delays in implementation; global fuel prices falling over 40% from current levels. (pp.56&61).

Forecasts And Ratios

Year End Mar 31	2010A	2011A	**2012E**	2013E	2014E
Sales (INRm)	110,835.1	130,924.6	**178,607.1**	208,025.2	272,126.0
EBITDA (INRm)	58,396.8	62,974.5	**71,746.8**	88,989.6	126,224.3
EBIT(INRm)	48,427	51,464	**59,713**	75,482	107,516
Reported EPS FD(INR)	38.35	40.04	**44.74**	55.04	77.60
Reported NPAT (INRm)	35,649.4	37,347.4	**41,800.2**	51,424.0	72,503.6
DB EPS growth (%)	17.2	4.4	**11.7**	23.0	41.0
DB EPS FD(INR)	38.35	40.04	**44.74**	55.04	77.60
OLD DB EPS FD(INR)	38.35	40.04	**44.49**	59.70	80.79
% Change	0.0%	0.0%	**0.6%**	-7.8%	-3.9%
PER (x)	14.3	16.9	**10.9**	8.9	6.3
EV/EBITDA (x)	10.1	12.1	**8.6**	7.6	5.9
DPS (net) (INR)	1.50	1.80	**4.65**	5.58	5.58
Yield (net) (%)	0.3	0.3	**1.0**	1.1	1.1

Source: Deutsche Bank estimates, company data

1 DB EPS is fully diluted and excludes non-recurring items
2 Multiples and yields calculations use average historical prices for past years and spot prices for current and future years, except P/B which uses the year end close

Model updated: 10 January 2012

Running the Numbers

Asia

India

Metals & Mining

Jindal Steel & Power

Reuters: JNSP.BO Bloomberg: JSP IN

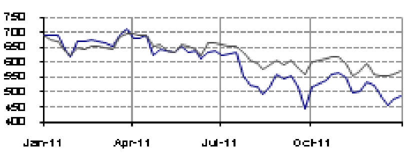
Buy

Price (11 Jan 12)	Rs 488.40
Target price	Rs 710.00
52-week Range	Rs 445.35 – 714.30
Market Cap	Rs 456,297m
	US$ 8,825m

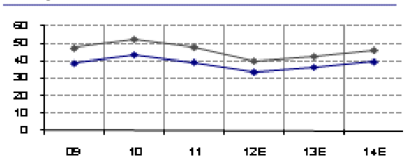
Company Profile

Jindal Steel and Power Ltd (JSPL) one of the leaders in Steel Manufacturing and Power Generation in India, Part of the US$10 Billion Jindal Organization. Company is in a major expansion mode with steel capacity expansion in excess of 20mnt with captive power of 13GW. Jindal Power Limited, subsidiary of JSPL, has set up a 1000 MW Super Thermal Power Plant at Raigarh and proposes to add an additional 2400MW.

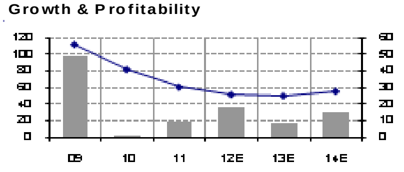
1yr Price Performance



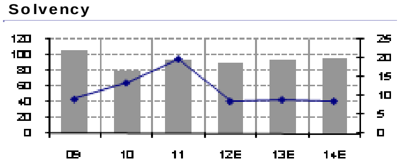
Margin Trends



Growth & Profitability



Solvency



Manish Saxena
+9122 6658 4811 manish.saxena@db.com

Fiscal year end 31-Mar	2009	2010	2011	2012E	2013E	2014E
Financial Summary						
DB EPS (Rs)	32.72	38.35	40.04	44.74	55.04	77.60
Reported EPS (Rs)	32.72	38.35	40.04	44.74	55.04	77.60
DPS (Rs)	1.08	1.50	1.80	4.65	5.58	5.58
BVPS (Rs)	75.99	111.86	151.03	192.73	242.19	313.29
Weighted average shares (m)	926	930	933	934	934	934
Average market cap (Rsm)	224,189	508,343	629,802	456,297	456,297	456,297
Enterprise value (Rsm)	293,171	590,726	763,104	620,021	674,566	748,069
Valuation Metrics						
P/E (DB) (x)	7.4	14.3	16.9	10.9	8.9	6.3
P/E (Reported) (x)	7.4	14.3	16.9	10.9	8.9	6.3
P/BV (x)	2.64	6.28	4.63	2.53	2.02	1.56
FCF Yield (%)	0.7	nm	nm	nm	nm	nm
Dividend Yield (%)	0.4	0.3	0.3	1.0	1.1	1.1
EV/Sales (x)	2.71	5.33	5.83	3.47	3.24	2.75
EV/EBITDA (x)	5.7	10.1	12.1	8.6	7.6	5.9
EV/EBIT (x)	7.0	12.2	14.8	10.4	8.9	7.0
Income Statement (Rsm)						
Sales revenue	**108,343**	**110,835**	**130,925**	**178,607**	**208,025**	**272,126**
Gross profit	**61,765**	**66,102**	**76,000**	**83,076**	**100,829**	**138,873**
EBITDA	**51,527**	**58,397**	**62,975**	**71,747**	**88,990**	**126,224**
Depreciation	9,641	9,970	11,510	12,034	13,508	18,708
Amortisation	0	0	0	0	0	0
EBIT	**41,886**	**48,427**	**51,465**	**59,713**	**75,482**	**107,516**
Net interest income(expense)	-4,567	-3,576	-2,596	-6,930	-8,354	-12,420
Associates/affiliates	396	139	158	0	0	0
Exceptionals/extraordinaries	0	0	0	-850	-1,477	-1,260
Other pre-tax income/(expense)	624	603	820	4,063	4,679	5,349
Profit before tax	**37,943**	**45,454**	**49,689**	**56,846**	**71,807**	**100,446**
Income tax expense	8,040	9,189	11,840	13,110	17,079	24,222
Minorities	10	755	659	1,086	1,827	2,460
Other post-tax income/(expense)	0	0	0	0	0	0
Net profit	**30,290**	**35,649**	**37,347**	**41,800**	**51,424**	**72,504**
DB adjustments (including dilution)	0	0	0	0	0	0
DB Net profit	**30,290**	**35,649**	**37,347**	**41,800**	**51,424**	**72,504**
Cash Flow (Rsm)						
Cash flow from operations	**38,737**	**55,747**	**40,321**	**63,073**	**80,018**	**109,189**
Net Capex	-37,160	-62,419	-81,069	-81,136	-119,171	-161,732
Free cash flow	**1,576**	**-6,672**	**-40,748**	**-18,063**	**-39,153**	**-52,543**
Equity raised/(bought back)	140	441	113	0	0	0
Dividends paid	-452	-956	-1,367	-4,343	-5,211	-6,080
Net inc/(dec) in borrowings	7,398	6,412	55,382	58,311	66,405	36,914
Other investing/financing cash flows	-8,176	-4,791	-9,706	-6,930	-8,354	-12,420
Net cash flow	**487**	**-5,566**	**3,675**	**28,974**	**13,686**	**-34,129**
Change in working capital	*9,152*	*-4,010*	*13,300*	*279*	*-4,904*	*-3,097*
Balance Sheet (Rsm)						
Cash and other liquid assets	6,694	1,128	4,802	33,777	47,463	13,334
Tangible fixed assets	126,863	178,444	248,844	317,946	423,609	566,633
Goodwill/intangible assets	31	78	204	204	204	204
Associates/investments	5,502	4,191	3,997	3,997	3,997	3,997
Other assets	46,797	58,928	93,006	117,341	122,410	137,537
Total assets	**185,886**	**242,769**	**350,853**	**473,264**	**597,682**	**721,705**
Interest bearing debt	81,133	86,043	139,766	198,077	264,481	301,395
Other liabilities	34,194	50,900	67,649	91,706	101,678	119,902
Total liabilities	**115,327**	**136,943**	**207,415**	**289,782**	**366,160**	**421,297**
Shareholders' equity	70,515	104,168	141,103	180,061	226,275	292,700
Minorities	45	1,659	2,335	3,420	5,248	7,707
Total shareholders' equity	**70,560**	**105,827**	**143,438**	**183,482**	**231,523**	**300,407**
Net debt	*74,440*	*84,915*	*134,964*	*164,300*	*217,018*	*288,061*
Key Company Metrics						
Sales growth (%)	98.0	2.3	18.1	36.4	16.5	30.8
DB EPS growth (%)	120.3	17.2	4.4	11.7	23.0	41.0
EBITDA Margin (%)	47.6	52.7	48.1	40.2	42.8	46.4
EBIT Margin (%)	38.7	43.7	39.3	33.4	36.3	39.5
Payout ratio (%)	3.3	3.9	4.5	10.4	10.1	7.2
ROE (%)	55.5	40.8	30.5	26.0	25.3	27.9
Capex/sales (%)	34.3	58.8	64.8	45.4	57.3	59.4
Capex/depreciation (x)	3.9	6.5	7.4	6.7	8.8	8.6
Net debt/equity (%)	105.5	80.2	94.1	89.5	93.7	95.9
Net interest cover (x)	9.2	13.5	19.8	8.6	9.0	8.7

Source: Company data, Deutsche Bank estimates

Stock looks attractively placed

Reverse DCF implies low growth expectations

At the current market price, we have modeled two scenarios to estimate what the valuations are currently discounting. In the first scenario (Figure 89), we have assumed CoE of 13.65%, WACC of 10.7% and a terminal growth rate of 2%. We value 2400MW and hydro project at a P/B of 1x and 1000MW at NPV, and the operational mining assets (other than captive mining assets) at a 50% discount to NPV.

Figure 89: Scenario 1: We assume the power division trades at price/book of 1x

Assumptions			**INR/sh**	**Remark**
Terminal growth rate (%)	2.00	**Current price**	**480**	
Tax rate (%)	30.00	Value of other businesses		
Cost of equity (%)	13.65	Sponge iron (Shadeed)	19	
Risk-free rate (%)	6.00	JPL 1000MW	222	At NPV
Equity risk premium (%)	8.50	JPL 2400MW	42	At P/B of 1.0x
Beta	0.90	JPL Hydro	5	At P/B of 1.0x
Pre-tax cost of debt	11.00	Mining assets	25	50% discount to NPV
Post-tax cost of debt	7.70	Total	314	
Target debt: capital ratio (%)	50.00	Implied value of standalone business	166	
WACC (%)	**10.68**			
No. of shares (m)	934.30			

Source: Deutsche Bank estimates

Using these assumptions, we calculate that the residual steel business should generate an operating profit of USD 200/t, and that the captive power plants should have a tariff of less than INR 2/kwh unit.

In the second scenario, we again assume CoE of 13.65%, WACC of 10.7% and a terminal growth rate of 2%. All standalone assets (3mnt steel, 2mnt pellet, 1.2mnt sponge iron) are valued at a 50% discount to replacement value. The 1700MW captive power capacity and mining assets are also valued at 50% discount to NPV. This scenario implies the value of Tamnar projects (both 1000MW and 2400MW) at a value of INR 288/sh,

This scenario implies that IPP would sell merchant power at INR 3.5/unit over the long term, and no further capacity additions over 2400MW.

Our revised SOTP-based target price is INR 710/share

We cut our SOTP-based target price marginally, from INR 755/share to INR 710/share. The key drivers of our SOTP valuation are as follows:

- Steel – we value the steel business (excluding captive power) at INR 203/share. We have revised our target P/E multiple for steel business to 8x FY13E from 11x FY12E earlier, in line with the multiple used by our metals analyst Abhay Laijawala for SAIL (Buy; INR88).
- Captive power – we value captive power at INR 123/share, based on NPV at cost of equity of 12.5% (unchanged).

- IPP (Jindal Power) – we value the IPP business at INR 336/share, comprising values of INR 222/share, INR 108/share and INR 5/share for the JPL 1000MW, JPL 2400MW and JPL hydro projects, respectively.
- Overseas mining – our total value for this business is INR 50/share, comprising INR 9/share for South African coal mines, INR 35/share for Indonesian coal mines and INR 6/share for Australian coal resources.

Figure 90: Sum-of-the parts valuation of JSPL

Division	Business	Status	% Shareholding	Valuation basis	Total equity value (INR m)	Equity value for JSPL stake (INR m)	Value/share (INR/sh)
Steel	Metallics, Finished , Semi-finished Steel, Shadeed (Oman)	NA	100	P/E of 8x - FY13E, in line with peers	189,961	189,961	203
Captive Power	Captive power - 1978MW	NA	100	NPV at CoE of 12.5%	114,685	114,685	123
JPL 1000MW	Power subsidiary	Operational	96	NPV at CoE of 12.5%	215,374	207,685	222
JPL 2400MW	Power subsidiary	Under construction	96	NPV at CoE of 14.5%	105,093	101,341	108
JPL Hydro	Power subsidiary		96	P/B of 1x	4,726	4,557	5
South Africa	Overseas mining	Operational	74	NPV at CoE of 12.5%	11,632	8,608	9
Indonesia	Overseas mining	Production to start in FY12	100	NPV at CoE of 12.5%	32,573	32,573	35
Australia	Overseas mining	Exploration	27	Average of $0.5/t for resource and $2/t for reserves	21,375	5,833	6
Total				Rounded-off	695,419	665,244	710

Source: Deutsche Bank estimates

Substantial optional value remains

We believe JSPL's ownership of mining assets gives management a unique chance to look for monetization of these assets over a period of time. Being mining assets, a few of the non-operating assets would need to be considered in light of whether the requisite infrastructure is developed. If these assets eventually do develop, the potential value from the mining assets alone is INR 960/sh, on our estimates – which is around 35% above our 12-month target price. It remains to be seen how management fares in terms of obtaining approvals, what the other initiatives are to unlock the value in mines, and the timelines for these.

Figure 91: A snapshot of value that could be realized from mining assets

Assets	Location	Geological reserve (mt)	USD/t	Value (USD m)	Stake	Value adj. for stake (INR bn)	Remarks
Operating mining assets							
Iron ore in India	Orissa/ Jharkhand/ Chattisgarh	200	5.5	1,100	100%	49,500	Valued in line with recent stake change of Sesa Goa
Coal in India	Chhattisgarh	570	20.0	11,400	100%	513,000	Valued in line with our survey of Indian developers
Coal in South Africa	South Africa	50	4.0	200	74%	6,660	Valued in line with recent stake change
Sub-total						569,160	
Assets that are likely to be monetized over the next 12 months							
Coal in India	Orissa	224	5.0	1,120	100%	50,400	Valued in line with our survey of Indian developers
Coal in Indonesia	Indonesia	500	3.5	1,750	100%	78,750	Valued in line with recent stake change
Sub-total						129,150	
Assets that may take 2-5 years to develop							
Coal in India	Jharkhand/ M.P./ Orissa	1,860	2.0	3,720	100%	167,400	Using Coal India as benchmark
Coal in Australia	Australia	350	2.0	700	100%	31,500	Using recent transaction value
Sub-total						198,900	
Total						897,210	Implies a value of INR 960/sh excluding Bolivia
Assets which have an option value							
Iron ore in Bolivia	Bolivia	20,000	5.5	110,000	100%	4,950,000	A lot depends on progress of work

Source: Company data, Deutsche Bank estimates

Many assets still not considered by us in our valuation

We have not considered the following company initiatives, as they are still in the early stages of development.

Figure 92: Assets we have not included in our SOTP

Particulars	Expansion details	Potential value (INR m)	Value/sh
Raigarh	2mtpa cement plant	NA	NA
Patratu in the State of Jharkhand	3 MTPA integrated steel plant	NA	NA
Barbil, Orissa			
Coal gas producer plant	90000 NM3 / Hr Coal Gasification Plant	NA	NA
Iron ore loading complex	1.5mt of iron ore lumps, fines & pellets handling capacity	NA	NA
Iron ore washing plant (Phase II)	9.6 MTPA	NA	NA
Jindal Power Limited			
Trading of power	Membership of The Indian Energy Exchange Ltd.		
JPL 1320MW	Captive fuel, equipment not ordered yet – NPV at 16.5%	27,838	30
JPL 660MW	Captive fuel, equipment not ordered yet – NPV at 16.5%	11,130	12
El-Mutun Iron Ore Mine, Bolivia			
Iron ore reserves	20,000 mt (at USD 0.25/t)	225,000	241
Pellet plant	10MTPA	In phased manner over the next eight years	
Sponge iron plant	6MTPA		
Steel plant	1.7MTPA		
Power plant	450MW		

Source: Company data, Deutsche Bank estimates

Assumptions, forecasts and risks

We have cut our estimates on delays in captive units

We have cut our earnings estimates over the forecast period as we now build in a slower ramp-up of captive power units and delays in the openings of captive coal mines feeding the captive units in Orissa. Hence, we have cut our assumptions for external sales volumes from these units by 60%, 39% and 9% for FY12, FY13 and FY14, respectively. Owing to the delays in the opening of captive coal until FY13, we believe the company will have to buy coal from e-auctions/ other expensive sources – thus lowering the profitability of the captive power units. However, we also build in better tariffs as, owing to the latest regulatory approval, the company has now obtained open-access for captive power plants.

Figure 93: Key changes in our assumptions

Year-end 31 March	FY11	FY12E	FY13E	FY14E
Sales volume				
Captive power (MU)	1,491	616	4,035	6,522
Change (%)		-60%	-39%	-9%
JPL (MU)	7,910	7,909	7,909	12,305
Change (%)		0%	0%	-3%
Average realization				
Captive power (INR/kWh)	2.5	4.0	3.5	3.5
Change (%)		30%	23%	57%

Source: Deutsche Bank estimates

Figure 94 depicts our changes in estimates.

Figure 94: Changes in forecasts

Consolidated	FY12E			FY13E			FY14E		
INR m	Old estimate	Revised estimate	Chg (%)	Old estimate	Revised estimate	Chg (%)	Old estimate	Revised estimate	Chg (%)
Revenue	175,136	178,607	2.0	207,090	208,025	0.5	265,718	272,126	2.4
EBITDA	71,608	71,747	0.2	94,508	88,990	-5.8	129,920	126,224	-2.8
PAT	41,562	41,800	0.6	55,779	51,424	-7.8	75,477	72,504	-3.9
EPS (INR)	44.5	44.7	0.6	59.7	55.0	-7.8	80.8	77.6	-3.9

Source: Deutsche Bank estimates

Our FY13 and FY14 estimates are significantly above consensus

Our FY12 earnings estimates are largely in line with the consensus, but our FY13 and FY14 estimates are 9% and 24% above consensus, as the Street seems to be factoring in delays in the ramp-up of captive power units, as well as weak merchant tariffs going forward.

Figure 95: Our FY13 and FY14 estimates are significantly above consensus

Consolidated	FY12E			FY13E			FY14E		
	Deutsche Bank	Consensus	Diff (%)	Deutsche Bank	Consensus	Diff (%)	Deutsche Bank	Consensus	Diff (%)
Sales	178,607	166,208	7.5	208,025	195,055	6.6	272,126	246,009	10.6
EBITDA	71,747	72,508	(1.0)	88,990	83,855	6.1	126,224	103,363	22.1
PAT	41,800	41,440	0.9	51,424	47,031	9.3	72,504	58,686	23.5
EPS	44.7	44.5	(0.9)	55.0	50.5	8.9	77.6	62.8	23.5
CFO/share	67.5	58.3	15.7	85.6	66.9	28.1	116.9	81.8	42.9

Source: Deutsche Bank, Bloomberg Finance LP

Key risks

Company-specific risks include a slowdown in project implementation, thereby missing the capacity addition targets; a reduction in utilization levels; a delay in the development of captive mines and obtaining fuel linkages; and regulatory intervention in the form of capping merchant tariffs.

- MMDR act if implemented could have 7%-10% impact on EPS over the forecast period.
- If steel realizations are 10% lower than expected, then our FY12, FY13 and FY14 EPS estimates could be 12%, 10% and 9% lower, respectively.
- If merchant tariffs were INR 0.5/kWh lower-than-expected, then our EPS estimates would be 5-6% lower over our forecast period.

Rating
Buy

Asia
India

Conglomerates

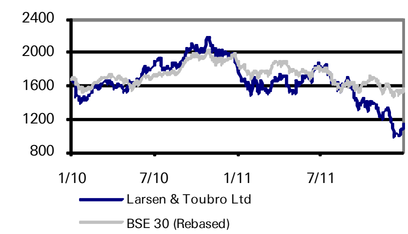
Company
Larsen & Toubro Ltd

Reuters	Bloomberg
LART.BO	LT IN

Price at 10 Jan 2012 (INR)	1,134.55
Price target - 12mth (INR)	1,600.00
52-week range (INR)	1,861.25 - 979.10
BSE 30	16,165

Key changes	
Price target	1,850.00 to 1,600.00 ↓-13.5%
Sales (FYE)	661,895 to 653,399↓-1.3%
Op prof margin (FYE)	10.4 to 10.4 ↓ -0.4%
Net profit (FYE)	45,171.2 to 44,443.1 ↓ -1.6%

Price/price relative



Performance (%)	1m	3m	12m
Absolute	-7.5	-18.2	-36.3
BSE 30	-0.3	-2.4	-15.9

Stock Data	
Market cap (INRm)	690,773
Market cap (USDm)	13,360
Shares outstanding (m)	609
Major shareholders	Financial Institutions (35%)
Free float (%)	87
Avg daily value traded (USDm)	67.3

Key Indicators (Fy1)	
ROE (%)	16.1
Net debt/equity (%)	124.3
Book value/share (INR)	496.96
Price/book (x)	2.3
Net interest cover (x)	5.0
Operating profit margin (%)	10.4

Among the best placed for cyclical upturn

Larsen & Toubro remains our top industrial pick

L&T remains our top industrial pick for two key reasons: (1) at the current price, our reverse DCF implies a long-term order inflow CAGR of just 10% for FY12-20E, much lower than the historical CAGR of 26% in FY01-11; (2) with competition suffering from weak balance sheets, L&T seems to be among the best placed for the recovery in capex cycle expected in H2CY12. Our new target price factors in a lower exit P/E multiple for the IT division and exit P/B of 1x for L&T-IDPL. For the core E&C business, we continue to use a mid-cycle exit P/E of 16x; Buy.

L&T remains an early beneficiary of the cyclical upturn

We continue to base our sectoral hypothesis on a resurgence of the capex cycle, largely driven by the construction sector, starting from H2CY12. Our detailed project-by-project tabulation suggests that construction sector orders in FY13E could well touch INR1,353bn, primarily driven by roads/railways and a few export orders. L&T, with its strong balance sheet, appears to be among the best placed to benefit from the upturn as and when it happens.

Reverse DCF implies only 4% order inflow volume CAGR over medium term

Our revised estimates for L&T continue to be below consensus. Using our estimates, the reverse DCF at CMP (WACC of 13.2%), suggests that the stock is factoring in an order inflow CAGR (FY14-20E) of 10% and mid-cycle E&C margins of 10.8%. Assuming long-term inflation in India of c6%, this implies an order inflow volume CAGR (FY13E-20E) of 4%, well below the long-term GDP forecast.

Core E&C business at 11x FY13E P/E – similar to FY08 credit crisis level; Buy

We derive our 12m target price of INR1,600/sh using the SOTP method. Non-E&C business is valued at INR371/sh. We continue to value the core E&C business at an exit P/E of 16x. Key risks: (1) volatility in quarterly order inflows and lumpiness in earnings; (2) rupee depreciation of 10% reduces EPS by 0.5% and 1% lower margins reduce FY13E EPS by 10%. See pages 64 & 73 for more details.

Forecasts And Ratios

Year End Mar 31	2010A	2011A	**2012E**	2013E	2014E
Sales (INRm)	435,135.8	515,520.3	**653,399.1**	744,345.6	854,461.6
EBITDA (INRm)	59,135.2	71,538.8	**82,041.6**	89,979.0	103,688.3
Reported NPAT (INRm)	54,507.7	44,561.7	**44,443.1**	48,044.6	56,244.1
Reported EPS FD (INR)	93.18	74.64	**72.99**	78.91	92.38
DB EPS FD (INR)	57.41	69.93	**73.18**	78.91	92.38
OLD DB EPS FD (INR)	57.41	69.93	**74.38**	83.27	98.11
% Change	0.0%	0.0%	**-1.6%**	-5.2%	-5.8%
DB EPS growth (%)	14.3	21.8	**4.7**	7.8	17.1
PER (x)	25.8	25.7	**15.5**	14.4	12.3
EV/EBITDA (x)	14.9	16.1	**9.9**	9.2	8.5
DPS (net) (INR)	12.61	14.50	**16.00**	17.85	17.85
Yield (net) (%)	0.9	0.8	**1.4**	1.6	1.6

Source: Deutsche Bank estimates, company data

1 DB EPS is fully diluted and excludes non-recurring items
2 Multiples and yields calculations use average historical prices for past years and spot prices for current and future years, except P/B which uses the year end close

Model updated: 10 January 2012

Running the Numbers

Asia

India

Conglomerates

Larsen & Toubro Ltd

Reuters: LART.BO Bloomberg: LT IN

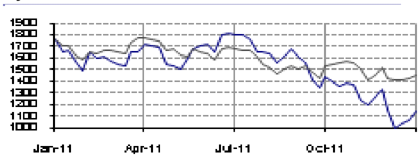
Buy

Price (11 Jan 12)	Rs 1143.55
Target price	Rs 1600.00
52-week Range	Rs 979.10 – 1861.25
Market Cap	Rs 696,253m
	US$ 13,466m

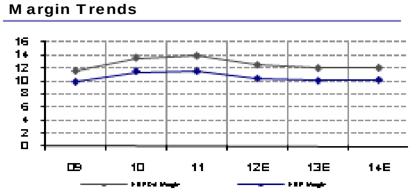
Company Profile

Larsen & Toubro Ltd is India's largest engineering and construction company. L&T's business model has evolved into a distinct E&C and non-E&C business. The long-cycle E&C portion is cyclical and dependent largely on new project capex. The short-cycle non-E&C business largely comprises business segments such as electrical and electronics, industrial products, IT(L&T Infotech), Financial services (L&T Finance) and various infrastructure projects under public private partnership.

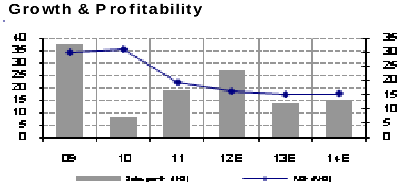
1yr Price Performance



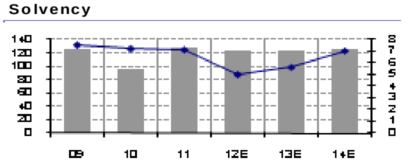
Margin Trends



Growth & Profitability



Solvency



Manish Saxena
+9122 6658 4811 manish.saxena@db.com

Fiscal year end 31-Mar	2009	2010	2011	2012E	2013E	2014E
Financial Summary						
DB EPS (Rs)	50.24	57.41	69.93	73.18	78.91	92.38
Reported EPS (Rs)	63.73	92.27	74.11	73.18	78.91	92.38
DPS (Rs)	10.52	12.61	14.50	16.00	17.85	17.85
BVPS (Rs)	239.22	358.66	411.44	496.96	561.45	646.49
Weighted average shares (m)	585	585	597	609	609	609
Average market cap (Rsm)	613,139	865,318	1,071,346	696,253	696,253	696,253
Enterprise value (Rsm)	673,682	880,418	1,152,731	815,890	833,762	885,872
Valuation Metrics						
P/E (DB) (x)	20.9	25.8	25.7	15.6	14.5	12.4
P/E (Reported) (x)	16.5	16.0	24.2	15.6	14.5	12.4
P/BV (x)	2.81	4.53	4.02	2.30	2.04	1.77
FCF Yield (%)	nm	nm	nm	nm	3.3	nm
Dividend Yield (%)	1.0	0.9	0.8	1.4	1.6	1.6
EV/Sales (x)	1.68	2.02	2.24	1.25	1.12	1.04
EV/EBITDA (x)	14.3	14.9	16.1	9.9	9.3	8.5
EV/EBIT (x)	17.0	17.7	19.5	12.0	11.2	10.2
Income Statement (Rsm)						
Sales revenue	**401,870**	**435,136**	**515,520**	**653,399**	**744,346**	**854,462**
Gross profit	**47,004**	**59,135**	**71,539**	**82,042**	**89,979**	**103,688**
EBITDA	**47,004**	**59,135**	**71,539**	**82,042**	**89,979**	**103,688**
Depreciation	7,283	9,273	12,432	14,164	15,210	16,810
Amortisation	0	0	0	0	0	0
EBIT	**39,721**	**49,862**	**59,106**	**67,878**	**74,769**	**86,878**
Net interest income(expense)	-5,281	-6,919	-8,309	-13,602	-13,334	-12,358
Associates/affiliates	509	1,060	796	767	937	1,097
Exceptionals/extraordinaries	7,891	20,593	2,515	0	0	0
Other pre-tax income/(expense)	8,997	11,275	14,718	10,808	11,326	11,345
Profit before tax	**51,328**	**74,811**	**68,031**	**65,084**	**72,761**	**85,866**
Income tax expense	14,257	20,387	23,479	19,790	22,769	25,750
Minorities	314	975	786	1,618	2,884	4,969
Other post-tax income/(expense)	0	0	0	0	0	0
Net profit	**37,266**	**54,508**	**44,562**	**44,443**	**48,045**	**56,244**
DB adjustments (including dilution)	-7,891	-20,593	-2,515	0	0	0
DB Net profit	**29,375**	**33,915**	**42,047**	**44,443**	**48,045**	**56,244**
Cash Flow (Rsm)						
Cash flow from operations	**4,960**	**21,178**	**-10,838**	**-2,156**	**89,023**	**58,864**
Net Capex	-75,335	-38,139	-96,491	-48,084	-66,029	-67,807
Free cash flow	**-70,375**	**-16,961**	**-107,329**	**-50,240**	**22,994**	**-8,943**
Equity raised/(bought back)	869	36	5,925	-290	-1,618	0
Dividends paid	-6,150	-7,528	-8,828	-13,320	-14,096	-15,380
Net inc/(dec) in borrowings	39,348	36,910	92,631	51,591	48,470	30,511
Other investing/financing cash flows	35,290	6,168	20,841	4,352	-26,059	-22,361
Net cash flow	**-1,017**	**18,626**	**3,239**	**-7,907**	**29,691**	**-16,173**
Change in working capital	*78,574*	*15,091*	*17,784*	*-62,381*	*22,885*	*-19,158*
Balance Sheet (Rsm)						
Cash and other liquid assets	14,590	33,216	36,454	28,547	58,239	42,066
Tangible fixed assets	155,892	189,789	281,637	399,901	452,053	503,051
Goodwill/intangible assets	0	0	0	0	0	0
Associates/investments	139,153	208,630	265,822	280,822	310,822	340,822
Other assets	258,491	277,996	361,864	436,081	473,681	577,988
Total assets	**568,127**	**709,632**	**945,777**	**1,145,352**	**1,294,795**	**1,463,927**
Interest bearing debt	203,700	246,073	373,402	418,103	494,442	558,689
Other liabilities	213,967	242,773	311,610	413,773	446,388	497,801
Total liabilities	**417,667**	**488,847**	**685,012**	**831,875**	**940,830**	**1,056,489**
Shareholders' equity	139,874	209,913	250,506	302,572	341,837	393,619
Minorities	10,586	10,873	10,260	10,905	12,128	13,818
Total shareholders' equity	**150,460**	**220,785**	**260,766**	**313,477**	**353,966**	**407,438**
Net debt	*189,110*	*212,857*	*336,948*	*389,555*	*436,203*	*516,623*
Key Company Metrics						
Sales growth (%)	37.6	8.3	18.5	26.7	13.9	14.8
DB EPS growth (%)	25.5	14.3	21.8	4.7	7.8	17.1
EBITDA Margin (%)	11.7	13.6	13.9	12.6	12.1	12.1
EBIT Margin (%)	9.9	11.5	11.5	10.4	10.0	10.2
Payout ratio (%)	16.5	13.5	19.4	21.9	22.6	19.3
ROE (%)	30.1	31.2	19.4	16.1	14.9	15.3
Capex/sales (%)	18.7	8.8	18.7	7.4	8.9	7.9
Capex/depreciation (x)	10.3	4.1	7.8	3.4	4.3	4.0
Net debt/equity (%)	125.7	96.4	129.2	124.3	123.2	126.8
Net interest cover (x)	7.5	7.2	7.1	5.0	5.6	7.0

Source: Company data, Deutsche Bank estimates

Valuation

Reverse DCF implies low growth expectations

We have performed a reverse-DCF analysis (three-stage) to determine the market expectations for growth as implied by the current market price (INR1,090 at time of calculation). Our analysis suggests that the market is factoring annual order inflow growth of only 10% over the medium term (FY14E-20E), which implies an order inflow volume CAGR of only c4%, with annual inflation in India at c6%.

Figure 96 details our cash flow forecast; FY12-14 is the explicit forecast period, FY14-20 is the semi-explicit period and our terminal cash flow growth assumption is 2%.

Figure 96: L&T – Cash flow projection for reverse DCF

	FY10	FY11	FY12E	FY13E	FY14E	FY15E	FY16E	FY17E	FY18E	FY19E	FY20E	CAGR FY14-20E
Net sales	**366,752**	**434,959**	**516,688**	**580,468**	**667,139**	**740,524**	**821,982**	**912,400**	**1,012,764**	**1,124,168**	**1,247,826**	**11.0%**
Growth (%)		*19*	*19*	*12*	*15*	*11*	*11*	*11*	*11*	*11*	*11*	
Of which E&C	322,361	379,097	450,770	504,663	579,963	640,272	706,692	779,816	860,293	948,826	1,046,184	**10.3%**
Growth (%)		*18*	*19*	*12*	*15*	*12*	*12*	*12*	*12*	*12*	*12*	
EBITDA	**47,394**	**55,985**	**60,296**	**61,646**	**67,658**	**74,052**	**82,198**	**91,240**	**101,276**	**112,417**	**124,783**	
Margin (%)	*12.9*	*12.9*	*11.7*	*10.6*	*10.1*	*10.0*	*10.0*	*10.0*	*10.0*	*10.0*	*10.0*	
Of which E&C	38,454	45,595	49,411	49,129	53,263	59,015	64,905	71,352	78,406	86,116	94,536	
E&C margin	*13.5*	*13.6*	*12.6*	*11.3*	*10.8*	*10.8*	*10.8*	*10.7*	*10.7*	*10.7*	*10.6*	
Depreciation	3,784	5,614	6,514	7,414	8,314	9,627	10,686	11,861	13,166	14,614	16,222	
% of sales	*1.0*	*1.3*	*1.3*	*1.3*	*1.2*	*1.3*	*1.3*	*1.3*	*1.3*	*1.3*	*1.3*	
EBIT	43,610	50,372	53,782	54,232	59,344	64,426	71,512	79,379	88,110	97,803	108,561	
Margin (%)	*11.9*	*11.6*	*10.4*	*9.3*	*8.9*	*8.7*	*8.7*	*8.7*	*8.7*	*8.7*	*8.7*	
Taxes on EBIT	(13,083)	(15,111)	(16,135)	(16,270)	(17,803)	(19,328)	(21,454)	(23,814)	(26,433)	(29,341)	(32,568)	
NOPLAT	**34,311**	**40,874**	**44,161**	**45,376**	**49,855**	**54,725**	**60,744**	**67,426**	**74,843**	**83,076**	**92,214**	
Working capital	36,869	53,975	89,682	120,118	100,614	88,863	98,638	109,488	121,532	123,658	124,783	
% of sales	*10.1*	*12.4*	*17.4*	*20.7*	*15.1*	*12.0*	*12.0*	*12.0*	*12.0*	*11.0*	*10.0*	
Change in working capital		-17,107	-35,707	-30,435	19,503	11,751	-9,775	-10,850	-12,044	-2,127	-1,124	
Capex	-14,756	-15,101	-4,969	-5,000	-5,000	-7,405	-8,220	-9,124	-10,128	-11,242	-12,478	
% of sales	*4.0*	*3.5*	*1.0*	*0.9*	*0.7*	*1.0*	*1.0*	*1.0*	*1.0*	*1.0*	*1.0*	
Cash flow												
FCFF (Stg. I + II)			**3,485**	**9,941**	**64,358**	**59,071**	**42,750**	**47,452**	**52,672**	**69,708**	**78,612**	**3.4%**
Stage I			3,485	9,941	64,358	-	-	-	-	-	-	
Stage II			-	-	-	59,071	42,750	47,452	52,672	69,708	78,612	
Terminal value			-	-	-	-	-	-	-	-	717,211	
Total FCFF			**3,485**	**9,941**	**64,358**	**59,071**	**42,750**	**47,452**	**52,672**	**69,708**	**795,823**	
Business implication												
Order book	1,002,390	1,302,170	1,480,066	1,691,478	1,910,854	2,221,573	2,465,946	2,737,200	3,038,292	3,372,504	3,743,479	
Book: Bill ratio	2.7	3.0	2.9	2.9	2.9	3.0	3.0	3.0	3.0	3.0	3.0	
Order inflow	695,720	798,000	706,060	804,908	901,497	1,051,243	1,066,355	1,183,654	1,313,856	1,458,380	1,618,802	**10.2%**

Source: Deutsche Bank estimates

Figure 97: Reverse DCF valuation to arrive at the current implied market price of E&C business

Enterprise value	INR m	% of total NPV
NPV of Stage I	59,558	12%
NPV of Stage II	180,550	35%
NPV of TV	276,919	54%
NPV of FCFF	**517,026**	**100%**
Net cash/ (debt)	(82,869)	
Total Equity Value	**434,158**	

Per share basis			Sensitivity to key assumptions					
						WACC (%)		
NPV of Stage I	98							
NPV of Stage II	297		713	**11.18**	**12.18**	**13.18**	**14.18**	**15.18**
NPV of TV	455	Terminal growth rate (%)	-	795	709	636	574	521
NPV of FCFF	**849**		**1.00**	851	753	672	603	544
Net cash	(136)		**2.00**	918	805	713	636	571
Total Equity Value	**713**		**3.00**	1,002	869	763	675	603
			4.00	1,110	949	823	722	640

Source: Deutsche Bank estimates

Figure 98 details our key assumptions used to arrive at this implied reverse-DCF value of E&C business.

Figure 98: Key assumptions

SOTP (All nos. in INR/sh)		Assumptions for WACC	
Current market price	1,090		
Value of other businesses		Terminal growth rate (%)	2.00
Software company	55	Tax rate (%)	30.00
Finance companies	92	Pre-tax cost of debt (%)	11.00
L&T IDPL	73	Post-tax cost of debt (%)	7.70
Add: Investment in Infrastructure and other subs.	152	Cost of Equity (%)	13.18
Total	**371**	Risk free rate (%)	6.70
Implied value of engineering business	**719**	Equity risk premium (%)	8.10
Implied market cap of engineering business (INR m)	437,533	Beta	0.80
		Debt/ capital (%)	10.00
		WACC (%)	**12.63**
		No. of shares (m)	608.85

Source: Deutsche Bank

Our SOTP-based target price is INR1,600/sh

Our target price is derived from a sum-of-the-parts (SOTP) methodology. Key valuation drivers are the following: (1) we use a target earnings multiple for the long-cycle engineering business of 16x FY13E, which adequately factors in the various challenges currently faced by the infrastructure developers in India and macroeconomic headwinds; and 20x FY13E for the short-cycle engineering business as we see greater traction in orders due to a potential revival of industrial capex (both multiples unchanged); and (2) 16-year P/E bands suggest the stock has historically traded between 10x and 60x earnings with an average of 27x during FY06-10, and our target P/E multiple is lower than this average to factor in these negatives. Note that we value: (1) L&T-IDPL's investments at a P/B of 1.0x FY11 (from 1.75x earlier); (2) the software division in line with its peers at a P/E of 8x FY13E (from 15x earlier – in line with peers); and (3) L&T Finance, along with L&T Infra Finance, at a FY11 P/B of 2.25x, since both these businesses have demonstrated reasonable RoEs of 16-18%, justifying this multiple. (4) We haven't applied any conglomerate discount given that management has successfully listed L&T Finance Holdings to unlock shareholder value. Also, our earnings estimates already reflect significant 'stress' levels across its businesses. Hence, we arrive at a SOTP value of INR1,600/sh (rounded-off), which implies a consolidated P/E of 20x FY13E.

Figure 99: Sum-of-the-parts value of L&T

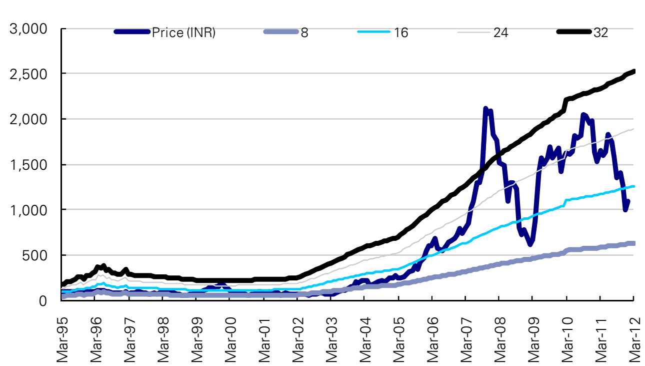
Segments	Estimates of PAT (INR bn)	BV (INR bn)	Valuation measure	Market cap (INR bn)	Value of Share (INR)	Remarks
Long cycle engineering business	32.0		16x exit P/E 1yr forward	513	846	In line with peers such as BHEL
Short cycle non E&C business	11.5		20x exit P/E 1yr forward	230	380	In line with peers such as BHEL
Software company	4.2		8x exit P/E 1yr forward	33	55	In line with mid-cap peers
Finance Company	6.2	30	2.25x P/B for FY11	56	92	Adjusted for L&T's stake of 82.64%
L&T IDPL	0.0	44	1x P/B for FY11	44	73	L&T's effective share of NPV
Add: Investment in Infrastructure and other subsidiaries		92	Price/Book of 1x	92	152	Valued at Book Value
Equity Value				968	1,597	
Less Conglomerate Discount			0%	-	-	
Target price of L&T			Rounded off	968	1,600	.

Source: Deutsche Bank estimates

P/E and EV/EBITDA

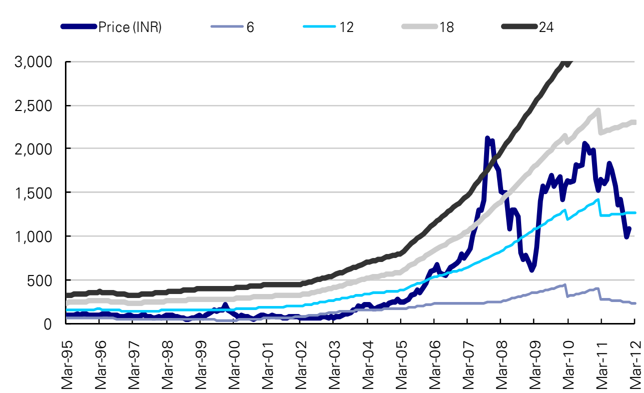
After the 42% fall in stock price over the past 12 months and 19% underperformance relative to the Sensex over the same period, the stock is now trading in the lower quartiles of both the one-year forward P/E and EV/EBITDA bands.

Figure 100: L&T – One-year forward P/E bands



Source: Company data, Deutsche Bank, Bloomberg Finance LP

Figure 101: L&T – One-year forward EV/EBITDA bands

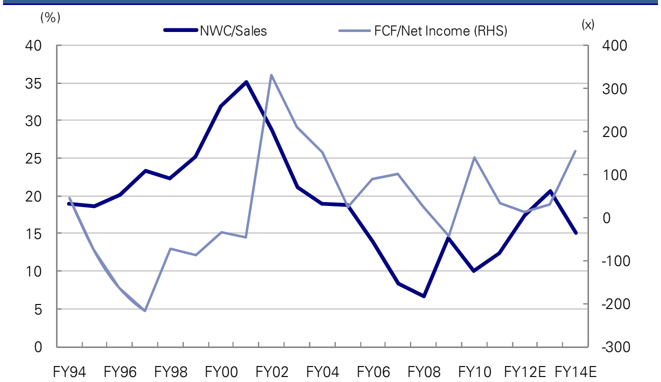


Source: Company data, Deutsche Bank, Bloomberg Finance LP

Free cash flow growth has been a key driver of valuation

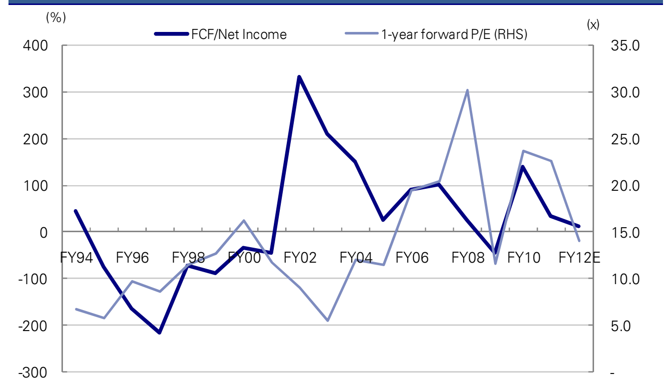
Figure 102 and Figure 103 depict the relation between NWC/sales and FCF/net income, which in turn drives the forward P/E multiples of the stock. At the current valuation, the market seems to be already factoring in working capital stress in the near term, leading to FCF generation in FY12E below that of net income for FY12E.

Figure 102: L&T – NWC/sales vs. FCF/net income



Source: Company data, Deutsche Bank estimates

Figure 103: L&T – FCF/net income vs. one-year forward P/E



Source: Company data, Deutsche Bank estimates

Comparative valuation

With the significant price correction in engineering stocks over the past year, the premium in valuation of Indian industrial names – especially L&T – over global/regional peers has contracted sharply; L&T now trades more in line with global peers, despite its superior margins and ROE profile.

Figure 104: Comparative valuation for Industrials vs. Global average

	Rec.	Target price	Price	Mkt. cap.		EV/EBITDA (x)		P/E (x)		ROE (%)		EBITDA Margin (%)	
		(INR)		(INR m)		FY12E	FY13E	FY12E	FY13E	FY12E	FY13E	FY12E	FY13E
ABB Ltd India #	Sell	530	635	INR	177,176	33.2	20.2	45.8	26.4	11.5	17.6	6.2	
Bharat Heavy Electricals	Buy	396	266	INR	865,643	6.2	6.3	9.9	10.7	28.3	20.9	21.3	
Larsen & Toubro	Buy	1,600	1,128	INR	983,327	11.6	11.5	15.5	14.3	15.5	14.4	14.2	
Siemens India ##	Hold	680	701	INR	301,314	13.8	10.7	23.9	19.6	24.9	23.5	11.3	
Thermax	Buy	550	434	INR	58,285	7.2	7.4	12.5	12.9	28.5	23.3	10.7	
IRB Infra.	Buy	192	139		48,774	7.4	7.4	9.3	10.6	18.0	13.8	43.8	
Average						**13.3**	**10.6**	**19.5**	**15.8**	**21.1**	**18.9**	**17.9**	
Global Average						**6.4**	**5.0**	**15.1**	**12.3**	**14.5**	**14.8**	**9.9**	

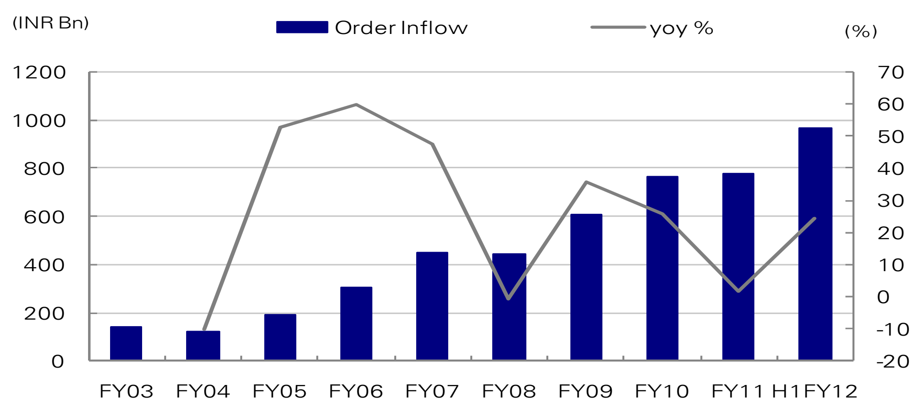
*Source: Company data, Deutsche Bank *Prices as of 7-Jan-12, # FY12 is Dec'11, ## FY12 is Sep'12*

Capex cycle likely to recover by H2CY12

Construction sector likely to drive the upturn…

Historically, construction sector orders have led the capex cycle. In the last cycle, orders in the construction sector grew by c50% and led order growth in the power, metals and cement sectors. Construction orders in the previous cycle were led by the roads, infrastructure and the real estate segments. Figure 105 depicts the order inflow cycle in the construction space.

Figure 105: Construction order inflows



Source: Companies, Deutsche Bank

For us, as we estimate those segments which could drive growth in CY12, the construction sector clearly has a lot of tailwinds to give us comfort that things could be at an inflection point. Figure 106 encapsulates our assumptions for new order inflow growth, particularly in the roads, railways and prominent export orders. Please note our assumptions factor in 80% of road projects that have already been awarded by NHAI for development in CY11, achieving financial closure with a lag of three quarters (from the date of award).

Figure 106: Construction order prospects for CY12E

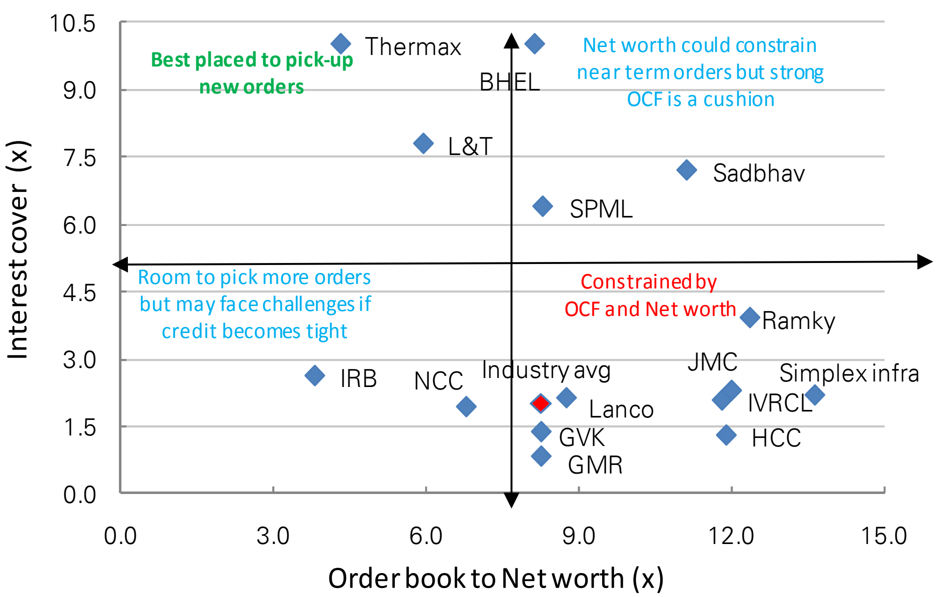
Sector	Order Enabler	Progress so far	Likely award in CY13 (INR bn)	Timeline	Remarks
A) Roads					
Roads	555 Kms development awards	EC / FC	54	Q4FY12	Assuming 80% of developer orders gets FC within 3 quarters
	780 Kms development awards	EC / FC	78	Q1FY13	Assuming 80% of developer orders gets FC within 3 quarters
	1693 Kms development awards	EC / FC	141	Q2FY13	Assuming 80% of developer orders gets FC within 3 quarters
	1069 Kms development awards	EC / FC	107	Q3FY13	Assuming 80% of developer orders gets FC within 3 quarters
	2000 Kms development awards	EC / FC	220	Q4FY13	Assuming 80% of developer orders gets FC within 3 quarters
Total Roads			**600**		
B) Dedicated Freight Corridor					
	Eastern Corridor Phase 1 Khurja Kanpur 343 Kms	EC / FC	45	Q2FY13	RFQ Stage
	Western Corridor Phase 1 Rewari Vadodara 920 Kms	EC / FC	62	Q2FY13	RFQ Stage
Total Dedicated Freight corridor			**107**		
C) Metro					
	Ahmedabad Metro Phase 1	EC / FC	120	H1FY13	
	Jaipur Metro Phase 2	EC / FC	65	H1FY13	
	Delhi Metro - Phase 2	EC / FC	189	H2FY13	
	Chennai Monorail - Phase 1	EC / FC	160	H2FY13	
	Kolkota Line 2	EC / FC	49	H1FY14	
Total Metro/Mono-rail			**583**		
D) Airports					
	Abu Dhabi International airport terminal expansion for Indian players	EC / FC	64	Q1FY13	
Total Airport			**64**		
Grand Total (A+B+C+D)			**1,353**		

Source: National Highways Authority of India, Dedicated Freight Corridor Corporation of India, Planning Commission, Deutsche Bank estimates

…but benefits may accrue largely to companies with good balance sheets

The increased business risks and higher leverage have resulted in fewer companies having the headroom to take on incremental projects when a revival in the capex cycle comes. For instance, among road developers, L&T appears to be the best placed to take on incremental projects when road project award activity picks up in 2HFY12. More importantly, these orders are likely to have better margins. Among other players, IRB, after the recent large Ahmedabad-Vadodara expressway project, may to a certain extent be constrained by its lower interest cover to take on more large incremental projects with better margins.

Figure 107: L&T, followed by IRB, appears best positioned to pick up new road orders

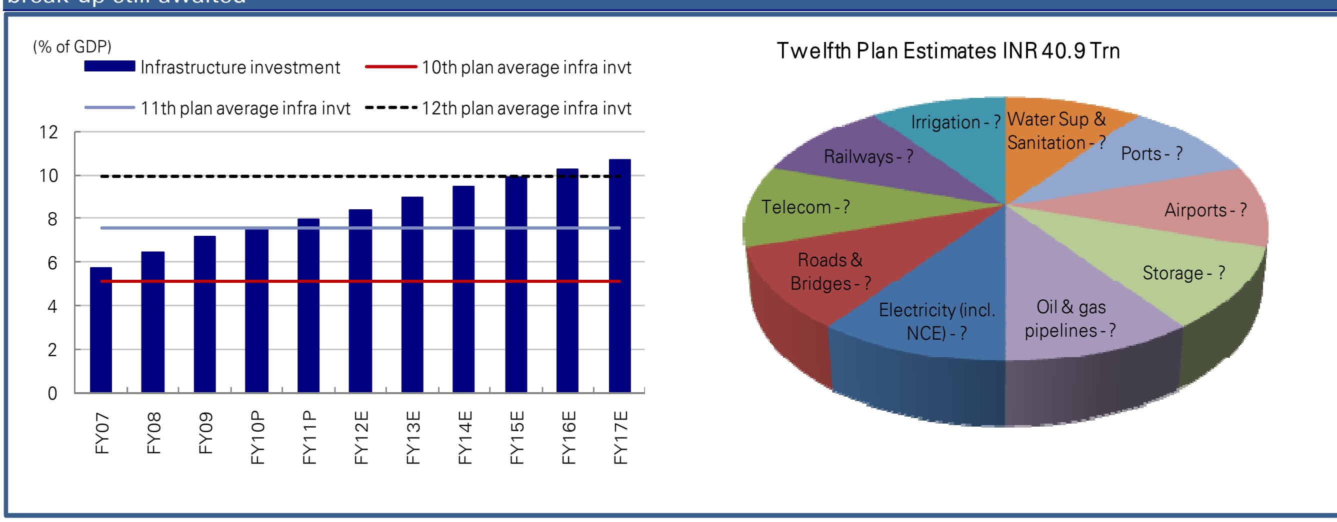


Source: Deutsche Bank, Company data*Note that BHEL & Thermax, being net-cash companies, have very high interest covers. Hence, interest cover for both of them has been assumed to be 10x to avoid the skew

XIIth Plan target, could focus shift to rail/road transportation?

The planning commission is currently envisaging an infrastructure investment of nearly INR41trn for the twelfth plan, i.e. FY12-17 period. Press reports (i.e. Business Standard dated 28 December 2011) suggest that there has been a delay in the documentation of the entire plan approach.

Figure 108: Planning commission estimates infrastructure investments at c10% of GDP under the twelfth plan…sectoral break-up still awaited

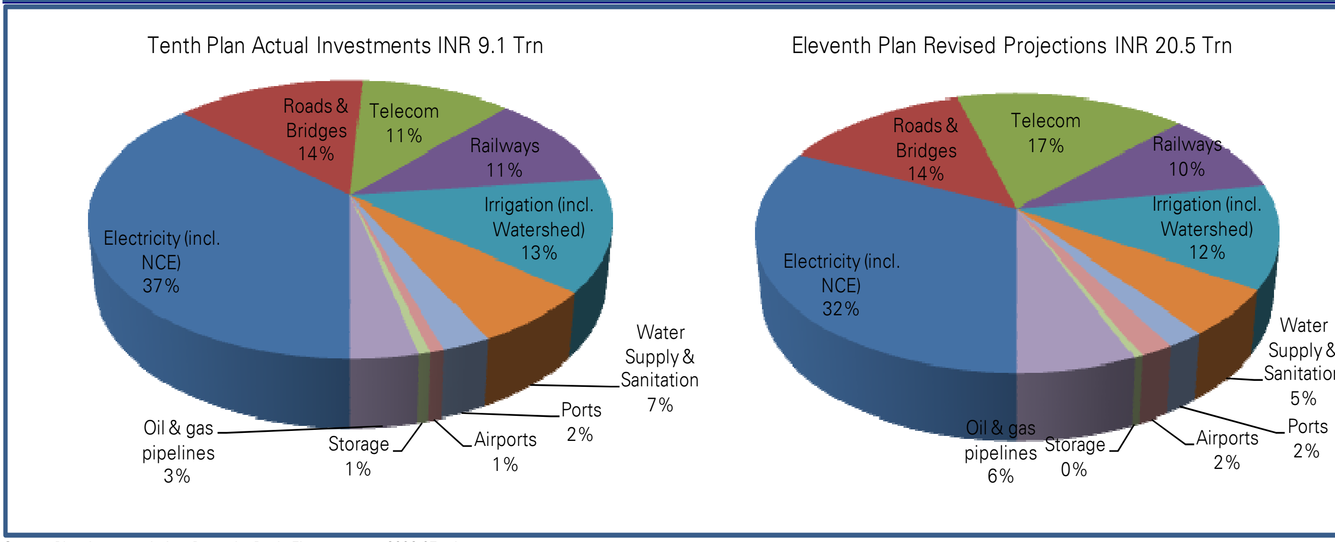


Source: Planning Commission, Deutsche Bank

According to the approach paper, the Indian planning commission has been suggesting that India's infrastructure investments would rise to 10% of the country's GDP v/s ~8.5% achieved on average in the last plan period. As far as financing goes, post looking at the trend in the eleventh plan, our analysis suggests that, at the current rate, equity financing availability may constrain infrastructure investments under the twelfth plan to a level of 7-8% of GDP (assuming a debt/equity of 3:1).

With regards to the twelfth plan, what also remains to be seen is which sectors receive prominence. In the previous two plans, power, followed by telecom, roads, irrigation and railways sectors were key focus areas. The achievement levels have improved from around 50% in the tenth plan to nearly 80% in the eleventh plan, thanks partly to the higher than private sector led investments in the telecom and airports sectors.

Figure 109: Sector-wise infrastructure investments in the tenth and eleventh plans



Source: Planning commission, Deutsche Bank. Figures are on 2006-07 prices

From a sectoral point of view, our micro-analysis of the various projects under implementation suggests that the investments would be largely led by roads and railways followed by oil & gas and then the power sector. Investments in the metals sector would be driven by policies on captive resources. Other than the above, cash rich companies in commodities (cement, metals) would invest in a manner to retain their market share on the least.

Figure 110: Uptick in capex largely led by roads, railways and construction

INR bn	FY08	FY09	FY10	FY11	FY12E	FY13E	FY14E	Remarks
Auto	117	121	92	95	119	116	110	Based on Deutsche Bank autos analyst estimates
Consumer	10	10	11	11	12	12	12	Does not factor in the food industry capex
Fertilisers	4	10	3	3	5	10	20	Assuming orders in non urea capacity continue
Industrial	608	802	468	528	686	1,029	1,543	Capex surge seen in chemicals
NHAI roads	268	215	259	375	504	671	896	Assuming average execution time of 2.5 years
DFC/mono/metro-rails					4	150	300	Assuming ordering to pick up by June 2012
Metals & mining	164	266	335	394	313	313	375	No incremental orders in metals
Oil & gas	607	1,157	572	960	828	894	892	Assumes a drop in KG basin capex
Power	247	525	838	790	1,030	972	794	
Generation	190	430	737	671	853	802	624	Assumes a drop in power capex
T&D	57	94	100	119	177	170	170	Estimates do not factor in pick-up in T&D capex
Total	**1,757**	**2,891**	**2,319**	**2,781**	**2,993**	**3,346**	**3,746**	
yoy change (%)		*65*	*-20*	*20*	*8*	*12*	*12*	

Source: Deutsche Bank estimates

Assumptions and forecasts

We have factored in sluggish order inflow and revenue growth

Our revised assumptions factor in the pace of execution slowing down to a level similar to that in FY11 – the slowest over the FY03-11 cycle. We have maintained our E&C margin assumptions whereby we assume that E&C margins would fall by 320bs over the next three years from the FY11 peak of 13.7%. Accordingly, we have cut our consolidated top-line forecast over FY12-14 by 1% to 4% and consolidated net income forecast by 2-6%. Overall, our revised estimates forecast consolidated sales CAGR (FY11-14E) of 18% and consolidated PAT CAGR (FY11-14E) of 10%.

Figure 111: Summary of changes in assumptions and forecast

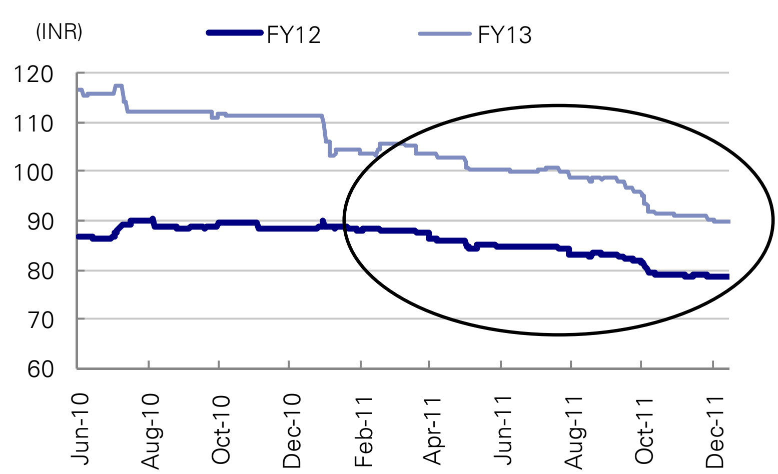
Consolidated			FY12E			FY13E			FY14E
All figures in INR m	New Estimates	Old Estimates	% chg	New Estimates	Old Estimates	% chg	New Estimates	Old Estimates	% chg
Sales	653,399	660,947	(1)	744,346	769,591	(3)	854,462	887,339	(4)
EBITDA	92,850	94,047	(1)	101,305	105,211	(4)	115,033	120,153	(4)
EBIT	78,686	79,883	(1)	86,095	90,001	(4)	98,224	103,344	(5)
PAT	44,443	45,269	(2)	48,045	50,740	(5)	56,244	59,777	(6)
EPS (INR)	73	74	(2)	79	83	(5)	92	98	(6)
E&C margins	12.5	12.5	-	11.0	11.0	-	10.5	10.5	-
ROE (%)*	15.5	15.7	(26)	14.4	15.1	(71)	14.8	15.5	(71)

*Source: Deutsche Bank estimates *Change in bps*

Consensus downgrade cycle – the worst could be behind us

Over the past three quarters, L&T's consensus EPS estimates for FY12 and FY13 have seen downgrades of 11% and 15%, respectively. The cuts have been particularly sharp since the Jun-Q results, as the investor community started factoring in the possibility that management might miss its guidance of 15% order inflow growth for FY12.

Figure 112: Over past three quarters, L&T's consensus EPS estimates for FY12 and FY13 have been downgraded by 11% and 15%, respectively



Source: Bloomberg Finance LP, Deutsche Bank

Our estimates are premised on bottom-of-cycle margins

Our estimates are based on the assumption that the company will achieve margins similar to those achieved in previous recessions.

Figure 113: Our earnings estimates are 7-25% below consensus over FY12-14

Consolidated	FY12E			FY13E			FY14E		
	Deutsche Bank estimate	Consensus	Variation (%)	Deutsche Bank estimate	Consensus	Variation (%)	Deutsche Bank estimate	Consensus	Variation (%)
Revenues (INR bn)	653	623	5	744	715	4	854	868	(14)
EBITDA (INR bn)	93	88	5	101	101	(0)	115	121	(16)
PAT (INR bn)	44	48	(7)	48	55	(13)	56	64	(25)
EPS (INR/sh)	73	79	(7)	79	90	(12)	92	105	(25)

Source: Deutsche Bank estimates, Bloomberg Finance LP,

Risks and sensitivity

Key downside risks stem from poor order inflows and margin pressure resulting in quarterly earnings disappointment. Based on our earnings model, if revenue from engineering projects is 10% above/below our expectations, standalone EPS could fall by 15%, 16% and 17% in FY12E, FY13E and FY14E, respectively. Likewise, if E&C margins are 1% below our estimates, earnings could be lower by 9% for FY12E and 10% for FY13E and 11% for FY14E.

Figure 114: Sensitivity of earnings

Standalone			FY12E			FY13E			FY14E
	Sales	EBITDA	PAT	Sales	EBITDA	PAT	Sales	EBITDA	PAT
Base Case estimates (INR m)	516,688	60,296	39,198	580,468	61,646	39,853	667,139	67,658	43,381
Sensitivity to Revenue Recognition cycle									
E&C revenues 10% higher than our estimates	568,809	68,569	44,907	639,036	70,709	46,107	734,453	78,141	50,614
Change(%)-yoy	10	14	15	10	15	16	10	15	17
E&C revenues 10% lower than estimates	464,567	52,022	33,489	521,900	52,583	33,600	599,825	57,175	36,147
Change(%)-yoy	(10)	(14)	(15)	(10)	(15)	(16)	(10)	(15)	(17)
Sensitivity to E&C Margins									
100 bps higher than estimates	516,688	65,463	42,763	580,468	67,450	43,859	667,139	74,329	47,984
Change(%)-yoy	-	9	9	-	9	10	-	10	11
100 bps lower than estimates	516,688	55,129	35,633	580,468	55,841	35,848	667,139	60,987	38,778
Change(%)-yoy	-	(9)	(9)	-	(9)	(10)	-	(10)	(11)

Source: Deutsche Bank estimates

Rating
Buy

Asia
India

Utilities
Utilities

Company
NTPC Limited

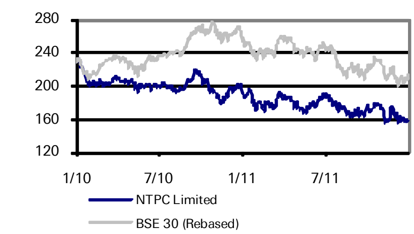
Reuters	Bloomberg
NTPC.BO	NTPC IN

Price at 11 Jan 2012 (INR)	159.20
Price target - 12mth (INR)	185.00
52-week range (INR)	195.90 - 154.85
BSE 30	16,165

Key changes

Rating	Hold to Buy	↑
Price target	190.00 to 185.00	↓-2.6%
Sales (FYE)	638,131 to 678,884	↑6.4%
Op prof margin (FYE)	20.7 to 18.2	↓-11.9%
Net profit (FYE)	98,633.3 to 101,126.8	↑ 2.5%

Price/price relative



Performance (%)	1m	3m	12m
Absolute	-4.2	-9.8	-16.3
BSE 30	-0.3	-2.2	-15.8

Stock Data

Market cap (INRm)	1,312,677
Market cap (USDm)	25,388
Shares outstanding (m)	8,245.5
Major shareholders	President of India (84.5%)
Free float (%)	15.5
Avg daily value traded (USDm)	13.5

Key Indicators (Fy1)

ROE (%)	14.0
Net debt/equity (%)	46.6
Book value/share (INR)	91.05
Price/book (x)	1.7
Net interest cover (x)	6.5
Operating profit margin (%)	18.2

Better positioned for thermal volume recovery: Buy

Upgrading to Buy on generation growth and valuation cushion

With NTPC trading at P/B of 1.6x FY13E (core RoE of ~23%), we upgrade to Buy based on the following: (1) with the continued stock underperformance, earnings yield is edging close to bond yields, which is especially interesting when the interest rate cycle could reverse; (2) at the current price, our reverse DCF suggests valuations factor in additional 16GW capacity in the 12th Plan vs 30GW guided by management; (3) NTPC's generation volume growth could pick up as supply from alternative cheap fuels, i.e., hydro/nuclear, looks largely limited.

NTPC continues to get preferential coal allocations from government

The recent re-allocation of 2.7bn reserves to NTPC was not a surprise, but the stiff two-year development target attached to these coal blocks poses a challenge. Looking at the progress in blocks, the development target seems achievable for Kerandri and CB, but looks difficult for the remaining 2.2bT mines. Meanwhile, with Coal India's production rising on a MoM basis, NTPC's plant also seems to be reflecting better coal inventory. Over the past month, NTPC's coal inventory levels in three important locations have increased from less than 4 days to about 7 days.

Volume recovery to bring back operating leverage

We reckon NTPC's capacity addition is gaining momentum with >1GW/quarter new capacity coming over the next eight quarters. Given that hydro and nuclear generation have hit a high base, incremental low cost energy availability is low and presents a unique opportunity for NTPC to benefit from demand growth.

Trimming target price to INR185/sh but upgrading to Buy; risks

We value NTPC on DCF and exit P/B. Factoring in marginally higher receivables, our revised DCF value on 12.4% COE and 3% TG suggest a 12m target price of INR185. We value the core equity at an exit P/B of 2.25x FY13E, in line with Gordon Growth Model estimates. Rising receivables is emerging as a new risk. A 10-day increase in receivable days affects our 12m target price by 3%. Other risks are execution delays and unanticipated regulatory/ policy changes. *(See pages 77-79 for details).*

Forecasts And Ratios

Year End Mar 31	2010A	2011A	**2012E**	2013E	2014E
Sales (INRm)	483,243.0	574,910.1	**678,884.2**	746,304.0	867,373.8
EBITDA (INRm)	130,952.0	149,783.6	**154,332.3**	169,786.1	198,048.5
Reported NPAT (INRm)	88,377.2	93,482.3	**101,126.8**	108,481.6	122,777.8
Reported EPS FD(INR)	10.718	11.337	**12.265**	13.157	14.890
DB EPS FD (INR)	10.718	11.337	**12.265**	13.157	14.890
OLD DB EPS FD (INR)	10.718	11.337	**11.962**	13.292	15.025
% Change	0.0%	0.0%	**2.5%**	-1.0%	-0.9%
DB EPS growth (%)	9.21	5.78	**8.18**	7.27	13.18
PER (x)	19.41	17.26	**12.98**	12.10	10.69
EV/EBITDA (x)	14.4	12.5	**10.3**	9.9	8.8

Source: Deutsche Bank estimates, company data

1 DB EPS is fully diluted and excludes non-recurring items
2 Multiples and yields calculations use average historical prices for past years and spot prices for current and future years, except P/B which uses the year end close

Model updated: 09 January 2012

Running the Numbers

Asia

India

Power/Utilities

NTPC Limited

Reuters: NTPC.BO Bloomberg: NTPC IN

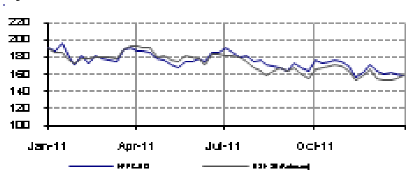
Buy

Price (11 Jan 12)	Rs 159.20
Target price	Rs 185.00
52-w eek Range	Rs 154.85 – 195.90
Market Cap	Rs 1,312,677m
	US$ 25,388m

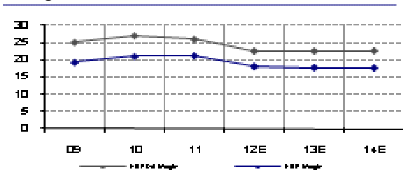
Company Profile

NTPC Limited (PSU incorporated in 1975) is the largest thermal-power generating company of India. It is the largest power utility of the country. The installed capacity of NTPC as on July 31, 2007 is 27,904 MW through its 15 coal based (22,895 MW), 7 gas/liquid fuel based (3,955 MW) and 4 joint-venture of which 3 coal based projects (314 MW) and 1 gas based project (740 MW). NTPC is aggressively adding up capacity through green field projects, expansion of existing stations, JV's, takeover of SEB`s stations, significant addition of hydro-capacity, and forays into non-conventional and nuclear power generation.

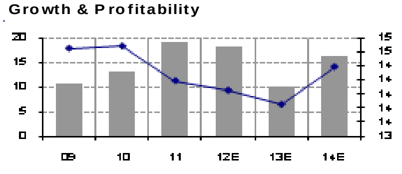
1yr Price Performance



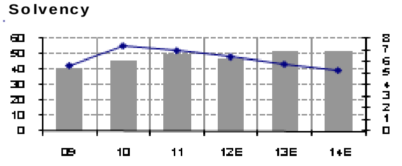
Margin Trends



Growth & Profitability



Solvency



Abhishek Puri
+91-22-6658 4214 abhishek.puri@db.com

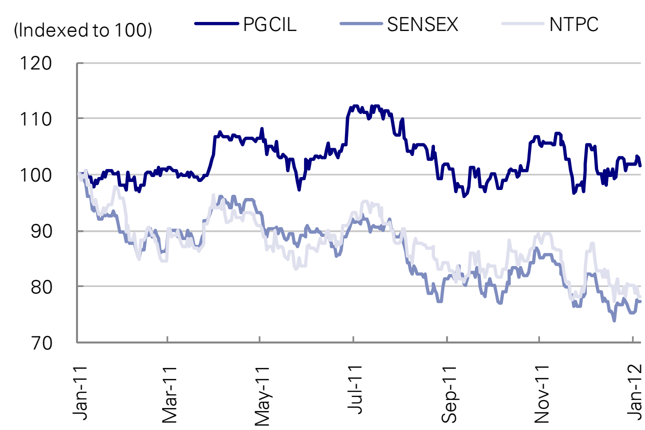
Fiscal year end 31-Mar	2009	2010	2011	2012E	2013E	2014E
Financial Summary						
DB EPS (Rs)	9.81	10.72	11.34	12.26	13.16	14.89
Reported EPS (Rs)	9.81	10.72	11.34	12.26	13.16	14.89
DPS (Rs)	3.61	3.82	3.80	4.11	4.41	0.00
BVPS (Rs)	69.82	76.29	83.60	91.05	99.04	108.09
Weighted average shares (m)	8,245	8,245	8,245	8,245	8,245	8,245
Average market cap (Rsm)	1,428,177	1,715,413	1,613,754	1,312,677	1,312,677	1,312,677
Enterprise value (Rsm)	1,546,828	1,886,467	1,873,864	1,591,202	1,675,525	1,734,988
Valuation Metrics						
P/E (DB) (x)	17.6	19.4	17.3	13.0	12.1	10.7
P/E (Reported) (x)	17.6	19.4	17.3	13.0	12.1	10.7
P/BV (x)	2.58	2.71	2.31	1.75	1.61	1.47
FCF Yield (%)	nm	nm	nm	2.7	nm	nm
Dividend Yield (%)	2.1	1.8	1.9	2.6	2.8	0.0
EV/Sales (x)	3.62	3.90	3.26	2.34	2.25	2.00
EV/EBITDA (x)	14.4	14.4	12.5	10.3	9.9	8.8
EV/EBIT (x)	18.7	18.5	15.3	12.9	12.6	11.3
Income Statement (Rsm)						
Sales revenue	**427,299**	**483,243**	**574,910**	**678,884**	**746,304**	**867,374**
Gross profit	**127,266**	**154,300**	**178,994**	**188,061**	**207,563**	**242,325**
EBITDA	**107,517**	**130,952**	**149,784**	**154,332**	**169,786**	**198,048**
Depreciation	24,949	28,944	27,197	30,741	36,347	43,857
Amortisation	0	0	0	0	0	0
EBIT	**82,568**	**102,008**	**122,587**	**123,591**	**133,439**	**154,192**
Net interest income(expense)	-14,419	-13,706	-17,456	-19,101	-22,812	-29,112
Associates/affiliates	0	0	0	0	0	0
Exceptionals/extraordinaries	-1,394	473	1,094	0	0	0
Other pre-tax income/(expense)	26,318	21,716	17,699	34,040	30,257	34,372
Profit before tax	**94,467**	**110,018**	**122,830**	**138,530**	**140,885**	**159,452**
Income tax expense	12,148	22,114	30,441	37,403	32,404	36,674
Minorities	0	0	0	0	0	0
Other post-tax income/(expense)	0	0	0	0	0	0
Net profit	**80,925**	**88,377**	**93,482**	**101,127**	**108,482**	**122,778**
DB adjustments (including dilution)	0	0	0	0	0	0
DB Net profit	**80,925**	**88,377**	**93,482**	**101,127**	**108,482**	**122,778**
Cash Flow (Rsm)						
Cash flow from operations	**91,147**	**106,519**	**112,822**	**157,035**	**124,841**	**170,383**
Net Capex	-145,997	-134,858	-159,517	-121,731	-164,987	-180,282
Free cash flow	**-54,850**	**-28,339**	**-46,695**	**35,304**	**-40,146**	**-9,899**
Equity raised/(bought back)	0	0	0	0	0	0
Dividends paid	-28,145	-37,720	-36,720	-39,689	-42,576	-48,187
Net inc/(dec) in borrowings	85,079	53,259	66,063	82,168	88,719	99,530
Other investing/financing cash flows	17,510	-816	34,203	12,037	13,125	13,125
Net cash flow	**19,594**	**-13,616**	**16,851**	**89,820**	**19,122**	**54,569**
Change in working capital	*-24,840*	*-4,963*	*-7,129*	*26,134*	*-19,987*	*3,748*
Balance Sheet (Rsm)						
Cash and other liquid assets	172,505	160,530	178,598	268,418	287,540	342,109
Tangible fixed assets	658,954	764,868	897,188	988,179	1,116,819	1,253,244
Goodwill/intangible assets	0	0	0	0	0	0
Associates/investments	116,960	117,776	83,573	71,536	58,412	45,287
Other assets	161,862	175,478	206,446	222,591	240,752	234,958
Total assets	**1,110,281**	**1,218,652**	**1,365,806**	**1,550,724**	**1,703,523**	**1,875,598**
Interest bearing debt	408,116	449,360	522,281	618,479	708,799	809,706
Other liabilities	126,427	140,223	154,239	181,522	178,095	174,671
Total liabilities	**534,543**	**589,583**	**676,521**	**800,001**	**886,894**	**984,378**
Shareholders' equity	575,738	629,069	689,286	750,723	816,629	891,220
Minorities	0	0	0	0	0	0
Total shareholders' equity	**575,738**	**629,069**	**689,286**	**750,723**	**816,629**	**891,220**
Net debt	*235,611*	*288,830*	*343,683*	*350,061*	*421,259*	*467,597*
Key Company Metrics						
Sales growth (%)	10.5	13.1	19.0	18.1	9.9	16.2
DB EPS growth (%)	8.3	9.2	5.8	8.2	7.3	13.2
EBITDA Margin (%)	25.2	27.1	26.1	22.7	22.8	22.8
EBIT Margin (%)	19.3	21.1	21.3	18.2	17.9	17.8
Payout ratio (%)	36.7	35.6	33.5	33.5	33.5	0.0
ROE (%)	14.6	14.7	14.2	14.0	13.8	14.4
Capex/sales (%)	34.2	27.9	27.7	17.9	22.1	20.8
Capex/depreciation (x)	5.9	4.7	5.9	4.0	4.5	4.1
Net debt/equity (%)	40.9	45.9	49.9	46.6	51.6	52.5
Net interest cover (x)	5.7	7.4	7.0	6.5	5.8	5.3

Source: Company data, Deutsche Bank estimates

Valuation looks reasonable post sharp underperformance vs peer

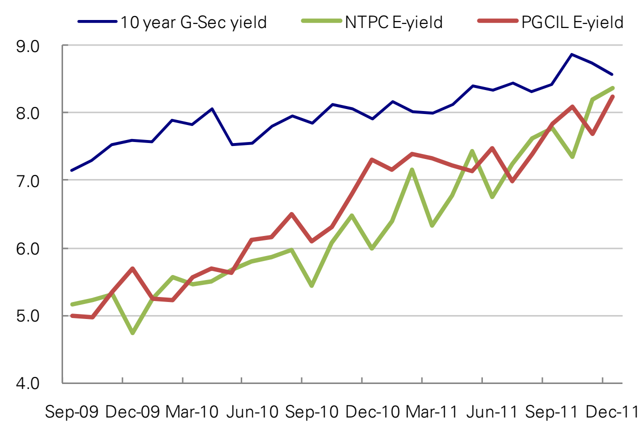
NTPC's stock underperformed the Sensex as well as local Indian peer Powergrid (PGCIL) by a large margin (22% vs. Powergrid) on operational concerns. Many of its projects were reportedly stranded for coal and it faced individual project-level issues ranging from environment to land acquisition, leading to below-average generation growth. With one-year of underperformance, we reckon trading multiples are reasonable at 11.9x FY13E earnings and 1.6x P/B. With this, NTPC is now more attractive on earnings yield than PGCIL. Both companies have seen P/E drop, but NTPC's decline was on the back of a 20% correction and earnings rollover.

Figure 115: NTPC has lagged peers…



Source: Deutsche Bank

Figure 116: …making earnings yield attractive



Source: Bloomberg Finance LP, Deutsche Bank

Reverse DCF suggests modest capacity addition growth vs targets

For NTPC, considering 12.5% cost of equity and 2.5% terminal growth rate (similar to utilities in developed economies), our reverse DCF model implies a 7.2% medium-term volume growth assumption until 2020 at NTPC's current market price. This implies NTPC's current price is factoring in capacity of 50GW by FY17 vs management's target of 66GW.

At 3% terminal growth, assumed currently in the valuation model, implied volume growth over FY13-20 is 6% YoY, which is conservative given that power demand is growing at 8-9% in India.

NTPC stock is trading at par with regional peers

Figure 117: Comparative valuations

Company	Rec.	Price	Curr	M-Cap (USD m)	P/E (x) FY12E	P/E (x) FY13E	P/E (x) FY14E	ROE(%) FY12E	ROE(%) FY13E	ROE(%) FY14E	Price to book (x) FY12E	Price to book (x) FY13E	Price to book (x) FY14E
Global Companies *													
American Electric Power	Buy	41	USD	19,870	13	13	12	11	10	10	1.4	1.3	1.3
Con Edison	Hold	59	USD	17,707	16	16	16	9	9	9	1.5	1.4	1.4
Exelon	Hold	41	USD	27,386	10	13	14	20	14	12	1.9	1.8	1.7
NRG	Hold	18	USD	3,642	12	23	NM	3	NA	(3)	0.5	0.5	0.5
DRAX	Buy	556	GBP	3,126	11	11	15	19	17	12	1.9	1.8	1.7
Fortum	Buy	16	EUR	18,161	11	9	9	20	16	15	1.5	1.4	1.3
First Gen	Buy	15	USD	1,137	16	8	8	3	13	12	1.2	1.0	0.9
PNOC	Buy	6.3	PHP	2,689	21	11	10	5	30	26	4.1	3.2	2.7
Average of Global Companies - excl China					13	12	11	14	16	14	1.8	1.6	1.5
Chinese companies													
China Power	Buy	1.9	CNY	1,228	12	7	6	5	9	9	0.6	0.6	0.5
CR Power	Buy	15	HKD	8,861	15	12	10	11	12	13	1.5	1.4	1.3
HK Electric	Hold	58	HKD	15,858	14	14	14	15	14	13	2.0	1.9	1.8
CLP Holdings	Hold	66.5	HKD	20,605	15	14	13	14	13	13	1.9	1.8	1.7
Datang	Buy	2.5	CNY	4,079	18	8	7	4	8	9	0.7	0.6	0.6
Huadin	Buy	1.5	CNY	1,341	62	8	7	1	6	7	0.5	0.5	0.5
Huaneng	Buy	4.2	CNY	6,450	26	9	8	3	10	11	0.9	0.8	0.8
Average of Chinese Companies				23	10	9	8	10	11	1.2	1.1	1.0	
Indian Rated Power Companies													
Power Grid Corporation	Buy	100	INR	7,959	15	13	11	14	15	15	2.0	1.8	1.5
Adani Power	Buy	65	INR	2,677	12	6	4	17	29	28	1.9	1.4	1.1
Jindal Steel & Power	Buy	466	INR	8,259	10	8	6	26	27	29	2.4	1.9	1.5
JSW Energy	Hold	39	INR	1,224	13	15	12	8	7	8	1.1	1.0	0.9
NTPC	Buy	157	INR	24,578	13	12	10	14	14	15	1.7	1.6	1.5
Tata Power	Hold	92	INR	4,139	10	10	10	15	13	12	1.4	1.3	1.2
NHPC	Buy	19	INR	4,351	10	9	8	10	9	9	0.8	0.8	0.7
Average of Rated Indian Companies				12	10	9	15	16	16	1.6	1.4	1.2	

Source: Bloomberg Finance LP, Deutsche Bank

Our new 12m target price of INR185 suggests 18% upside potential

We have used the average of a three-stage DCF methodology and a target exit P/BV multiple to arrive at a target price of INR185/sh (rounded-off). The DCF approach is based on a three-stage forecast of cash flows. Stage 1 covers an explicit forecast over FY12-17E. Stage 2 assumes a semi-explicit period of FY18-22E with free cash flow growth at a 10% CAGR. Stage 3 is the terminal growth phase, with a terminal growth rate of free cash flow assumed at 3%.

Our cost of equity is 12.4% (no change), based on risk-free rate of 8.1%, equity risk premium of 5.3% and beta of 0.8. Our terminal growth rate of 3% looks reasonable as it is lower than the long-term GDP forecast of 6-7% for India. This yields a value of INR185/sh.

In addition, we have used a sum-of-the-parts valuation methodology wherein we have maintained exit P/BV for the operating power assets at 2.25x FY13E, as we believe that the RoE of these assets is likely to remain stable within a 22-23% range based on our current forecast. We have reduced the exit P/B for the power assets under implementation to 1.5x vs 2.25x FY13E in line with Gordon Growth Model multiple, and 1x for investments and cash. We have valued the coal assets using NPV methodology considering 14.4% cost of equity. This SOTP approach yields a value of INR185/sh vs INR190 previously.

Figure 118: NTPC – Valuations

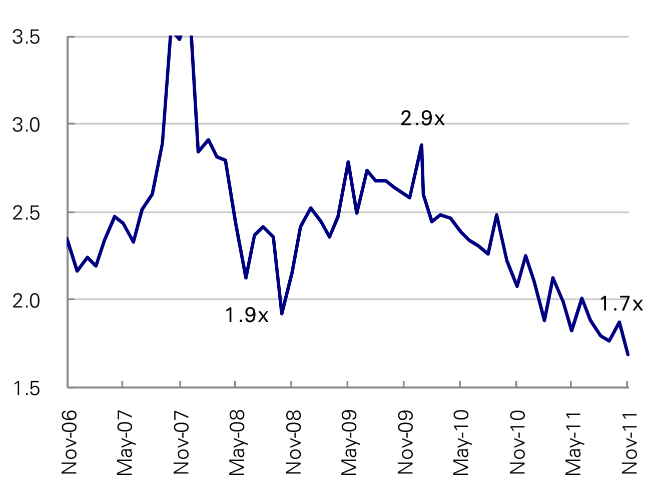
	Valuation multiple	Value in INR bn	Value in INR/share	Remarks
Methodology I - SOTP				
Book value of operating assets as on FY13E	2.25x FY13E True book	883	107	Low risk of receivables and coal availability implies RoE of c25% is sustainable
CWIP	1.5x equity portion of FY13E CWIP	177	21	Assumed at price/book of 1.5x FY13E
Investments	1x FY12E	72	9	Assumed at price/book of 1x FY12E
Cash	1x FY12E	272	33	Assumed at price/book of 1x FY12E
Add value of mining assets as on FY12E	NPV at CoE of 14.4%	111	14	2% higher cost of equity to cover new business risk
Consultancy business	2x FY13E EV/Sales	12	1	Maintain nil growth
Equity Value		1,515	185	Rounded off
Method II: DCF Approach	CoE of 12.4%; Terminal growth = 3%	1,514	184	
Average of the two methods		1,515	185	

Source: Deutsche Bank

Trading bands suggest that most negatives are priced in

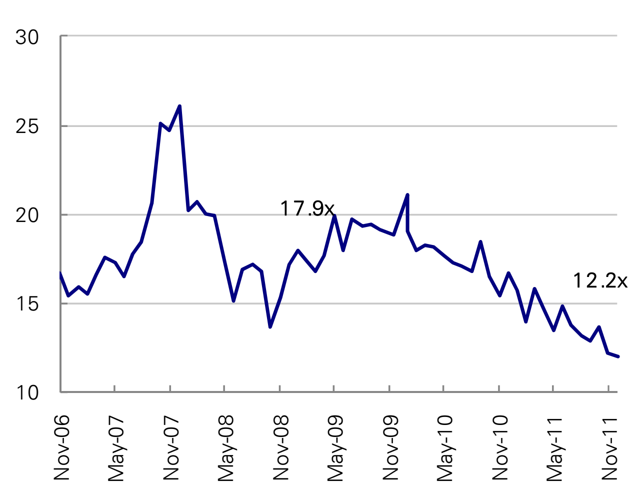
The trading multiples for NTPC are at a 5-year low and closer to its 2004 listing levels. The degree of clarity on reforms is much better today than at the times the stock traded at these levels.

Figure 119: One-year forward P/BV



Source: Bloomberg Finance LP, Deutsche Bank

Figure 120: One-year forward P/E



Source: Bloomberg Finance LP, Deutsche Bank

Risks

The key downside risks include delays in commissioning, a decline in RoEs on lack of fuel availability and push-back risks from loss-making State Electricity Boards (SEBs).

Frequent back-down by SEBs could risk efficiency gains at the margin and could lead to higher secondary oil consumption.

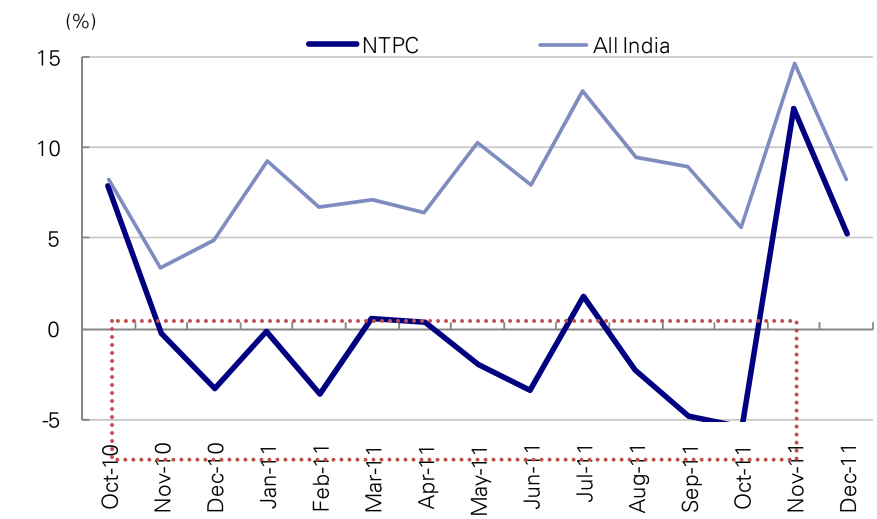
Although NTPC has a relatively strong balance sheet (0.5x net debt:equity) compared to its peers, any further increase in receivable days would reduce cash earnings, thereby limiting valuation upside potential.

Operational issues slowly being resolved

NTPC's generation on recovery path

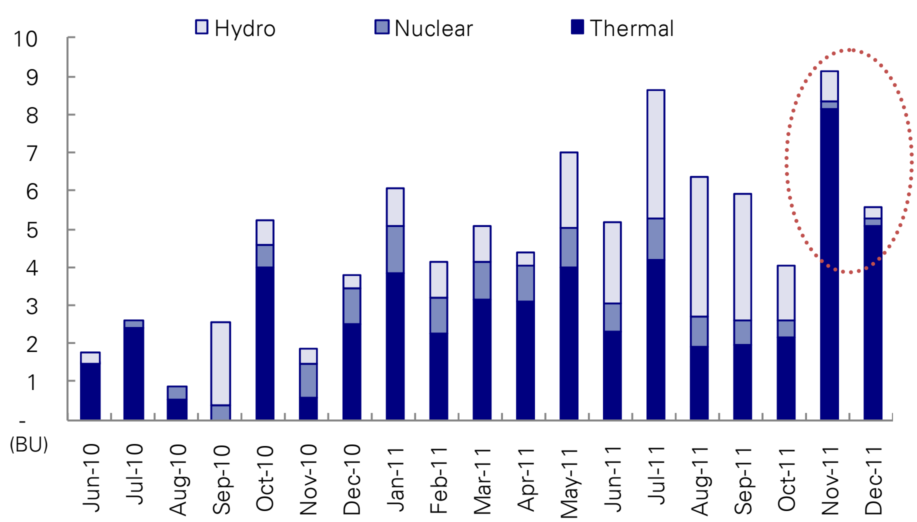
NTPC's generation remained below-par for almost one year on higher hydro and nuclear power generation, as well as partly due to coal supply issues at two of its project sites. With the high-base effect kicking-in for hydro as well as nuclear, incremental contribution without capacity addition looks difficult. NTPC seems to be best placed to push through volumes in the system due to its preferred status for receiving coal allocations as well as incremental blocks on a nomination basis.

Figure 121: NTPC generation growth lagged India's volume surge



Source: CEA, Deutsche Bank

Figure 122: Incremental contribution from hydro and nuclear tapering off

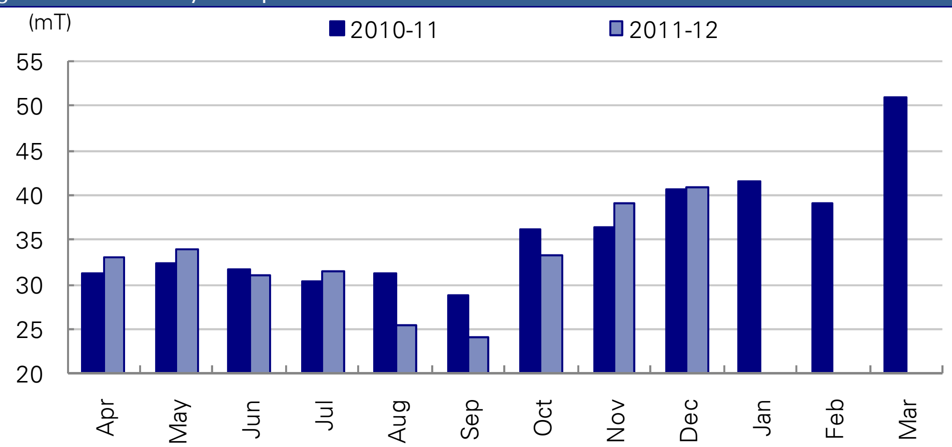


Source: CEA, Deutsche Bank

Monthly coal volumes/rake availability improving

Coal India's production data has started to show marginal improvement, albeit not enough. More encouragingly, rake availability has improved and the Railways Ministry has highlighted full rake availability towards the power sector. With NTPC receiving backing from both the Power Ministry and central regulator for preferred coal allocations, it bodes well for future coal availability. In the past month, three NTPC projects – Rihand, Unchahar and Vindhyachal – have shown improved coal stocks (moved from super-critical coal stock- <4days to critical coal stock- <7days), while Simhadri, Dadri, Farakka and Kahalgaon still have relatively low coal stocks.

Figure 123: Monthly coal production volume



Source: Company data, Deutsche Bank

Coal block re-allocation with two-year development deadline is positive

The Coal Ministry confirmed in early January the re-allocation of five coal blocks back to NTPC, which accounted for 2.7bT reserves of a total 5.7bT available for the company. NTPC will remain much more nimble-footed as the mines have been returned with a two-year deadline in which to make them operational. To recap, the Coal Ministry de-allocated five out of its seven captive coal blocks due to slow progress in early FY12. NTPC had spent INR1.6bn on the development of de-allocated mines and received environmental clearance and partially completed land acquisition also.

Figure 124: Captive coal mine status

Coal Mine	Reserves (MT)	Generation Prj	Mining capacity	Status
Pakri Baradih	1,436	Basket	15	MDO appointed; to start production in FY13
Kerandari	285	Barh St-II	6	Re-allocated
Chatti Bariatu & South	194	Barh St-II	7	Re-allocated
Dulanga	245	Darlipalli	7	Cleared from 'No-Go' area by MOEF
Talaipalli	1,267	Lara	18	MDO request for proposal
JV with Coal India				
Brahmini	1,900	Kahalgaon Exp. & Farakka Exp.	NA	Re-allocated
Chichro Patsimal	356		NA	Re-allocated
Total	**5,683**		**~ 50**	**47mtpa by 2017**

Source: Company data, Deutsche Bank

And it could receive further coal mines on priority basis

The Coal Minister has been quoted in the media as saying further coal blocks will be allocated to NTPC on a priority basis for four of its power projects of 7.6GW capacity, which could entail 1bT of further coal reserves. Future projects that could receive support are 500MW in Raibareilly, UP; 1,600MW at Kudgi in Karnataka; 1,600MW at Gajmara in Orissa; and 3,960MW at Berethi in Madhya Pradesh, which have been partly ordered via bulk tender-II.

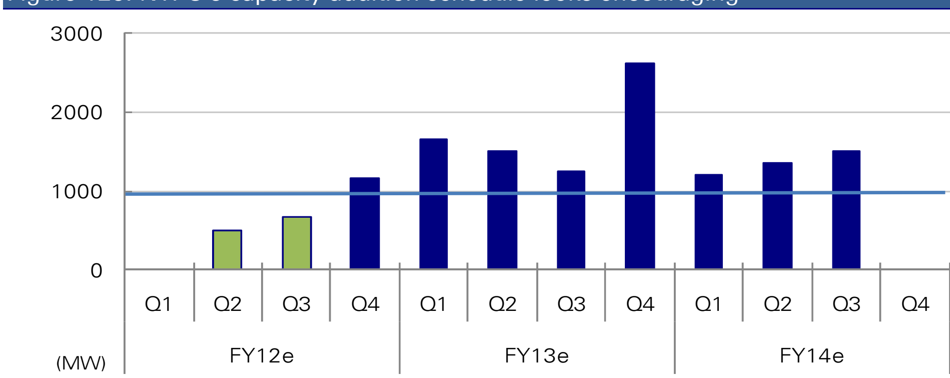
Rising coal prices could improve NTPC's coal availability

With the latest coal price increases for Coal India, A, B and C grade coal prices are now market-linked. Delivered prices for imported coal at coastal project locations are now comparable with delivered prices of high-grade coal to these locations. This is likely to improve coal availability for NTPC's power projects, which are generally closer to the coal mines. The question is whether coal traders will offer adequate imported coal quality as small industrial users don't have the wherewithal to import coal on their own.

Capacity addition gaining momentum

NTPC has disappointed on its capacity addition plans in past two years as Russian contractors continuously missed contractual commissioning schedules. Given that NTPC is well prepared, it is likely to achieve commercialization of >1GW/qtr over the next eight quarters. Most JVs initiated in 2007-08 are likely to yield benefits as projects are likely to be commissioned, and its maiden hydro venture could finally start to bear fruit with the boxing-up of Turbine-Generators now achieved at Koldam.

Figure 125: NTPC's capacity addition schedule looks encouraging



Source: CEA, Company, Deutsche Bank

Profitability in the medium term is reasonably hedged

Until the 2014 regulations are in place, we are reasonably comforted by the profitability assumptions for NTPC. Profitability is largely hedged from coal shocks and likely to return to a high growth path on operating leverage benefits in the form of volume growth.

Figure 126: Per unit profitability

INR/kWh	FY11	FY12E	FY13E	FY14E
Net Sales	2.71	3.13	3.25	3.19
EBITDA	0.71	0.71	0.75	0.76
PBT	0.58	0.64	0.61	0.58
PAT	0.44	0.47	0.47	0.45
Op PAT (Net of OI)	0.38	0.36	0.39	0.39
BV/share	83.6	91.0	99.0	108.1

Source: Company, Deutsche Bank estimates

Assumptions and forecasts

Unlike historically, assumptions do not capture incentives on coal

Our assumptions factor capacity additions with a slight lag, but low generation growth from both its existing gas and coal power projects. New capacity is expected to operate at low utilization rates of 50-60% for an initial period with plant availability levels at ~70% – assuming lower coal availability – thus, lower overall plant availability at 85% vs 92% for the past three years.

Figure 127: Key assumptions

All figures in INR m	FY11	FY12E	FY13E	FY14E
Generation Capacity (MW)	32,092	34,912	38,802	43,291
Coal	27,587	30,407	34,097	37,986
Gas	4,505	4,505	4,505	4,505
Hydro	-	-	200	800
- Capacity addition p.a.	2,240	2,820	3,890	4,489
PLF				
Steam/Coal	88%	77%	74%	77%
Gas	73%	70%	68%	68%
Hydro				25%
Plant Availability - Coal	92%	86%	85%	85%
NTPC Generation (m kwh)	220,621	222,741	234,803	265,430
Steam/Coal	195,366	198,440	211,387	240,262
Gas	25,256	24,301	23,416	23,416
Hydro	-	-	-	1,752
Sales (m kwh) inc JVs	212,088	216,828	230,712	275,525
Steam/Coal	184,183	189,849	204,595	238,373
Gas	27,905	26,979	26,116	26,116
Hydro	-	-	-	11,036
Weighted average tariff	2.71	3.13	3.25	3.19
Tariff - coal (INR/kwh)	2.38	2.78	2.90	2.94
Tariff - gas (INR/kwh)	3.61	4.75	4.97	5.17
Tariff - Hydro (INR/wh)	-	-	-	6.36

Source: Company, Deutsche Bank estimates

Assuming negligible generation growth for FY12E

We expect just marginal improvement in NTPC's generation over the past FY as existing projects faced generation issues in 1HFY12. Even with volumes reverting in 4Q, overall growth may remain dismal as gas production in the country took a serious blow. We have assumed the impact of further coal price hikes and INR depreciation (for its coal imports) with an 8% increase in coal costs. To reflect increased payment timelines by the state distribution companies, we have adjusted the receivable days upwards. The possibility of liquidity easing in FY14E is high as all major states' tariff hikes will be affected.

Figure 128: Changes in assumptions

Assumption Change		FY12E	FY13E	FY14E
Capacity (MW)	Revised	34,912	38,802	43,291
	Earlier	34,912	38,852	42,891
	% Change	-	(0)	1
Sales Volume (bn units)	Revised	217	231	266
	Earlier	219	245	275
	% Change	(1)	(6)	(3)
Tariff (INR/kwh)	Revised	3.0	3.1	3.2
	Earlier	2.8	2.9	3.0
	% Change	8	8	6
Coal Price (INR/t)	Revised	2,215	2,281	2,350
	Earlier	2,034	2,136	2,243
	% Change	9	7	5
Receivable days	Revised	49	50	37
	Earlier	37	38	39
	% Change	32	31	(5)

Source: Deutsche Bank estimates

With the cost pass-through mechanism, the tariffs/revenues have been adjusted upwards.

Figure 129: Changes in estimates

		FY12E	FY13E	FY14E
Revenues (INR bn)	Revised	679	750	879
	Earlier	638	737	858
	% Change	6	2	2
EBITDA (INR bn)	Revised	154	173	210
	Earlier	164	191	219
	% Change	(6)	(9)	(4)
PAT (INR bn)	Revised	101	108	123
	Earlier	99	110	124
	% Change	3	(1)	(1)
EPS (INR/sh)	Revised	12.3	13.2	14.9
	Earlier	12.0	13.3	15.0
	% Change	3	(1)	(1)
RoE (%)	Revised	14.0	13.8	14.4
	Earlier	13.7	14.0	14.5
	Bps change	33	(16)	(14)
Net debt/equity		**0.4**	**0.5**	**0.5**

Source: Deutsche Bank estimates

Figure 130: Deutsche Bank estimates are broadly in line with consensus

	Deutsche Bank			Consensus			% variation		
INR bn	**FY12E**	**FY13E**	**FY14E**	**FY12E**	**FY13E**	**FY14E**	**FY12E**	**FY13E**	**FY14E**
Revenues	679	750	879	634	727	853	7%	3%	3%
EBITDA	154	173	210	163	192	231	-5%	-10%	-9%
Profits	101	108	123	97	107	124	5%	1%	-1%
Book Value per share	91	99	108	90	98	106	1%	2%	2%
ROE (%)	14.0	13.8	14.4	13.6	13.9	15.0	49bps	-5bps	-63bps

Source: Bloomberg Finance LP, Deutsche Bank estimates

Appendix 1

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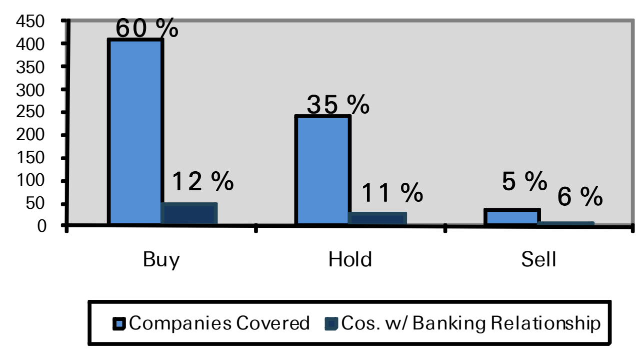

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Deutsche Bank AG/Hong Kong

Asia-Pacific locations

Deutsche Bank AG
Deutsche Bank Place
Level 16
Corner of Hunter & Phillip Streets
Sydney, NSW 2000
Australia
Tel: (61) 2 8258 1234

Deutsche Bank AG
Filiale Hongkong
International Commerce Centre,
1 Austin Road West,Kowloon,
Hong Kong
tel: (852) 2203 8888

Deutsche Equities India Pte Ltd
3rd Floor, Kodak House
222, Dr D.N. Road
Fort, Mumbai 400 001
SEBI Nos: INB231196834
INB011196830, INF231196834
Tel: (91) 22 6658 4600

Deutsche Securities Inc.
2-11-1 Nagatacho
Sanno Park Tower
Chiyoda-ku, Tokyo 100-6171
Japan
Tel: (81) 3 5156 6770

Deutsche Bank (Malaysia) Berhad
Level 18-20
Menara IMC
8 Jalan Sultan Ismail
Kuala Lumpur 50250
Malaysia
Tel: (60) 3 2053 6760

In association with
Deutsche Regis Partners, Inc.
Level 23, Tower One
Ayala Triangle, Ayala Avenue
Makati City, Philippines
Tel: (63) 2 894 6600

Deutsche Securities Korea Co.
17th Floor, YoungPoong Bldg.,
33 SeoRin-Dong,
Chongro-Ku, Seoul (110-752)
Republic of Korea
Tel: (82) 2 316 8888

Deutsche Bank AG
Singapore
One Raffles Quay
South Tower
Singapore 048583
Tel: (65) 6423 8001

Deutsche Securities Asia Ltd
Taiwan Branch
Level 6
296 Jen-Ai Road, Sec 4
Taipei 106
Taiwan
Tel: (886) 2 2192 2888

In association with
TISCO Securities Co., Ltd
TISCO Tower
48/8 North Sathorn Road
Bangkok 10500
Thailand
Tel: (66) 2 633 6470

In association with
PT Deutsche Verdhana Indonesia
Deutsche Bank Building,
6th Floor, Jl. Imam Bonjol No.80,
Central Jakarta,
Indonesia
Tel: (62 21) 318 9541

Deutsche Securities Inc.
2-11-1 Nagatacho
Sanno Park Tower
Chiyoda-ku, Tokyo 100-6171
Japan
Tel: (81) 3 5156 6770

International locations

Deutsche Securities Inc.
2-11-1 Nagatacho
Sanno Park Tower
Chiyoda-ku, Tokyo 100-6171
Japan
Tel: (81) 3 5156 6770

Deutsche Bank Securities Inc.
60 Wall Street
New York, NY 10005
United States of America
Tel: (1) 212 250 2500

Deutsche Bank AG London
1 Great Winchester Street
London EC2N 2EQ
United Kingdom
Tel: (44) 20 7545 8000

Deutsche Bank AG
Große Gallusstraße 10-14
60272 Frankfurt am Main
Germany
Tel: (49) 69 910 00

Deutsche Bank AG
Deutsche Bank Place
Level 16
Corner of Hunter & Phillip Streets
Sydney, NSW 2000
Australia
Tel: (61) 2 8258 1234

Deutsche Bank AG
Filiale Hongkong
International Commerce Centre,
1 Austin Road West,Kowloon,
Hong Kong
Tel: (852) 2203 8888

Deutsche Securities Inc.
2-11-1 Nagatacho
Sanno Park Tower
Chiyoda-ku, Tokyo 100-6171
Japan
Tel: (81) 3 5156 6770

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