

# Solid Quarter - Trigger For Re-rating



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## E&C Sector Surprise With Order Book & Margin expansion

With sales growth of 29% YoY (MLe 30%) and recurring PAT growth of 75%YoY (MLe 44%), all the five E&C companies in our universe met or even exceeded our positive view in our report *Reassuring Results Likely From 'Fallen Angels'* dt June 30, 2006. Further, EBITDA margin expansion & strong growth in order book across our universe should drive stock re-rating. Maintain L&T and BHEL as top picks among large-caps and Nagarjuna & IVRCL as mid-cap top picks.

### Sales +29%YoY; EBITDA +71%YoY; Rec. Net profits +75% YoY

All the Indian E&C stocks in our universe represented by ABB, BHEL, L&T, IVRCL and Nagarjuna had a remarkable quarter. However, other firms had a mixed quarter, with Suzlon doing extremely well while, JP Associates (E&C business), HCC & Simplex disappointed. The most reassuring factor for the Indian E&C sector was that all the five companies reported a massive EBITDA margin expansion led by a) execution of new better priced orders &/or b) shift in better priced domains, which was commendable. **Order book**, the harbinger to future visibility, remained robust – Rs832bn (up 41% YoY), supporting our view of FY07 being one more year of growth in backlogs, which should improve visibility of sales till FY09E.

### BHEL - the major growth driver

**BHEL** led the E&C sector growth with its sales +37%YoY growth, EBITDA margin expansion of 312bps (highest amongst the sector) and PAT +85%. BHEL's order backlog, at Rs393bn (up 28%YoY), reinforces our stand on BHEL being the core beneficiary of the continued momentum in the power capex. **L&T** was the other big beneficiary, with an order backlog of Rs283bn (up 55% YoY) and Rec. PAT +60%YoY. ABB also had an exceptional quarter with all round growth.

### Nagarjuna and IVRCL - Preferred Mid-cap Picks

Nagarjuna, our top pick among mid-caps, had the best result in that segment – doubled its Rec. net profits on sales growth of 81% YoY. IVRCL witnessed strong growth too. Order backlog for Nagarjuna & IVRCL remain robust at Rs54bn and Rs70bn respectively and their stocks remain our preferred mid-cap picks.

Table 1: Valuation and Return Table

Company	Price	ML Rating	Rating	Market Cap. Rsbn	P/E			Return	
					FY06	FY07E	FY08E	3mth	YTD
L&T Cons	2,286	C-1-7	1- Buy	308	29.9	23.0	18.3	-18%	24%
BHEL	2,166	C-1-7	1- Buy	530	31.6	22.1	19.6	-9%	57%
ABB	2,670	C-1-7	1- Buy	113	51.7	33.6	23.9	-19%	39%
NCC	290	C-1-7	1- Buy	30	28.8	16.8	11.2	-24%	2%
IVRCL	216	C-1-7	1- Buy	23	24.9	15.2	11.5	-30%	42%

Source: Company, Merrill Lynch Research

Table 2: April - June Performance

(Rsmn)	April - June		% YoY
	FY06	FY07	
<b>Order Backlog</b>			
ABB	18,575	31,375	69%
BHEL	306,000	393,000	28%
L&T	183,170	283,180	55%
IVRCL	35,430	70,000	98%
Nagarjuna	48,722	54,340	12%
Sector	591,897	831,895	41%
<b>Sales</b>			
ABB	6,589	9,742	48%
BHEL	19,365	26,564	37%
L&T	30,878	34,689	12%
IVRCL	2,977	4,266	43%
Nagarjuna	3,594	6,517	81%
Sector	63,402	81,778	29%
<b>EBIDTA</b>			
ABB	604	1,020	69%
BHEL	1,715	3,182	86%
L&T	1,922	2,915	52%
IVRCL	204	408	99%
Nagarjuna	278	550	98%
Sector	4,724	8,074	71%
<b>EBIDTA Margin (in bps)</b>			
ABB	9.2%	10.5%	130
BHEL	8.9%	12.0%	312
L&T	6.2%	8.4%	218
IVRCL	6.9%	9.6%	269
Nagarjuna	7.7%	8.4%	70
Sector	7.5%	9.9%	242
<b>PAT</b>			
ABB	436	719	65%
BHEL	1,279	2,367	85%
L&T	985	1,571	60%
IVRCL	140	261	87%
Nagarjuna	192	384	100%
Sector	3,032	5,303	75%

Source: Company, Merrill Lynch Research

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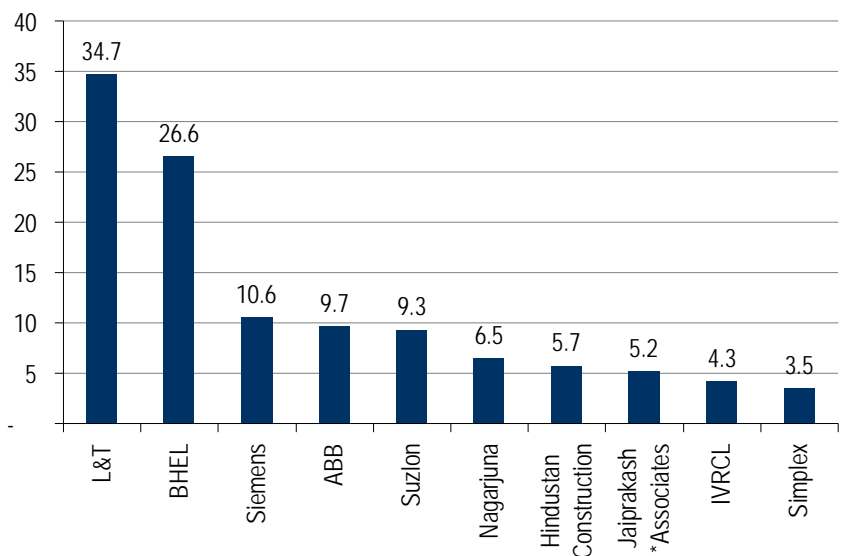
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Refer to important disclosures on page 7 to 10. Analyst Certification on page 5. Price Objective Basis/Risk on page 5.

**Table 3: April - June Performance vs. Merrill Lynch Estimates**

(Rs mn)	April - June		% YoY	April - June		Difference
	FY06	FY07		FY07E	YoY	
<b>Sales</b>						
ABB	6,589	9,742	48%	8,698	32%	16%
BHEL	19,365	26,564	37%	26,145	35%	2%
L&T	30,878	34,689	12%	37,914	23%	-10%
IVRCL	2,977	4,266	43%	4,310	45%	-1%
Nagarjuna	3,594	6,517	81%	5,570	55%	26%
<b>Sector</b>	<b>63,402</b>	<b>81,778</b>	<b>29%</b>	<b>82,637</b>	<b>30%</b>	<b>-1%</b>
<b>EBIDTA</b>						
ABB	604	1,020	69%	887	47%	22%
BHEL	1,715	3,182	86%	2,798	63%	22%
L&T	1,922	2,915	52%	2,375	24%	28%
IVRCL	204	408	99%	353	73%	26%
Nagarjuna	278	550	98%	451	62%	36%
<b>Sector</b>	<b>4,724</b>	<b>8,074</b>	<b>71%</b>	<b>6,864</b>	<b>45%</b>	<b>26%</b>
<b>EBIDTA Margin</b>			<b>(in bps)</b>		<b>(in bps)</b>	
ABB	9.2%	10.5%	130	10.2%	103	27
BHEL	8.9%	12.0%	312	10.7%	184	128
L&T	6.2%	8.4%	218	6.3%	4	214
IVRCL	6.9%	9.6%	269	8.2%	133	135
Nagarjuna	7.7%	8.4%	70	8.1%	36	34
<b>Sector</b>	<b>7.5%</b>	<b>9.9%</b>	<b>242</b>	<b>8.3%</b>	<b>86</b>	<b>157</b>
<b>PAT</b>						
ABB	436	719	65%	655	50%	15%
BHEL	1,279	2,367	85%	1,963	54%	32%
L&T	985	1,571	60%	1,213	23%	36%
IVRCL	140	261	87%	245	75%	12%
Nagarjuna	192	384	100%	291	52%	48%
<b>Sector</b>	<b>3,032</b>	<b>5,303</b>	<b>75%</b>	<b>4,368</b>	<b>44%</b>	<b>31%</b>

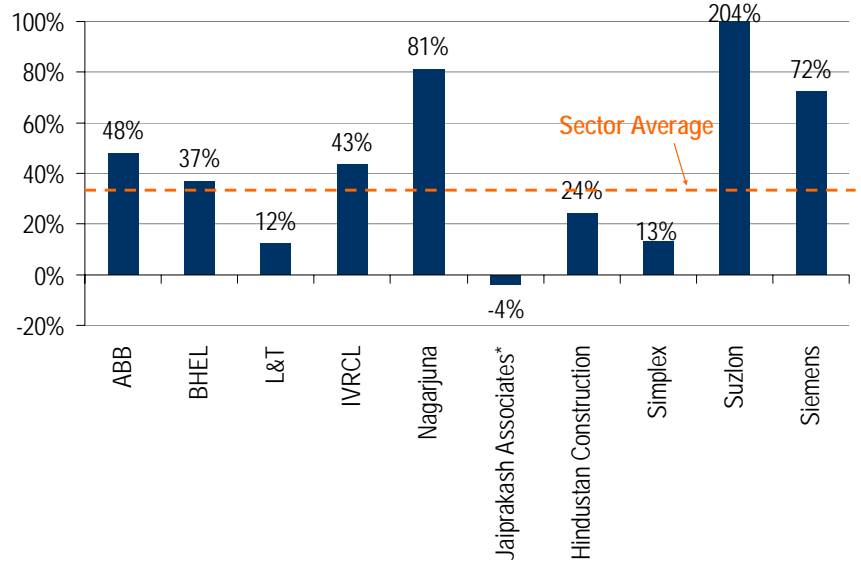
Source: Company, Merrill Lynch Research

**Chart 1: E&C Sector By Sales (April - June '06 - Rs bn)**


\* Only E&amp;C sales considered for Jaiprakash Associates

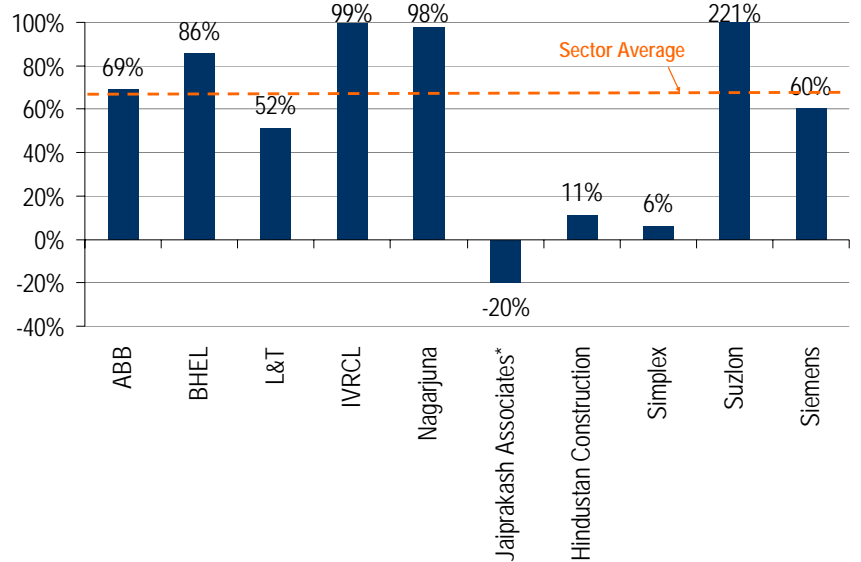
Source: Company, Merrill Lynch Research

**Chart 2: Sales growth YoY for April – June '06 quarter**



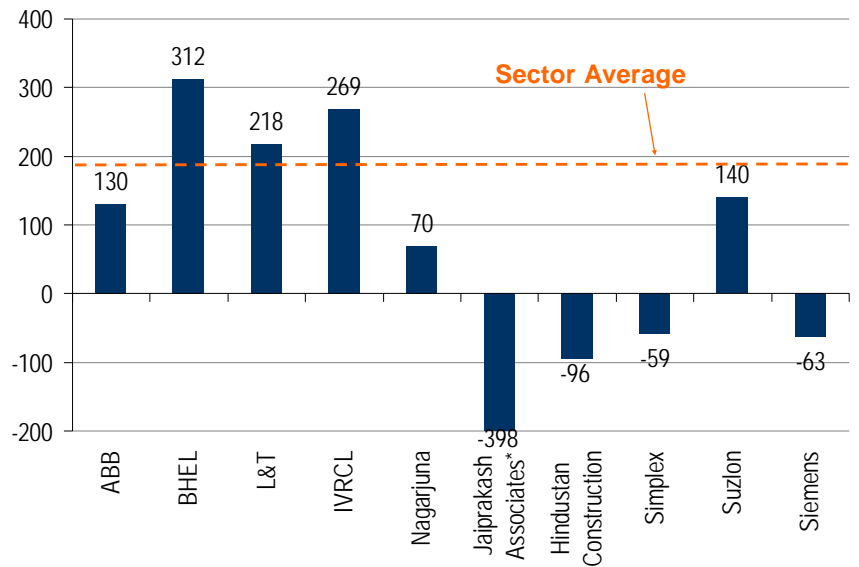
\* Only E&C sales considered for Jaiprakash Associates  
 Source: Company, Merrill Lynch Research

**Chart 3: EBITDA growth YoY for April – June '06 quarter**



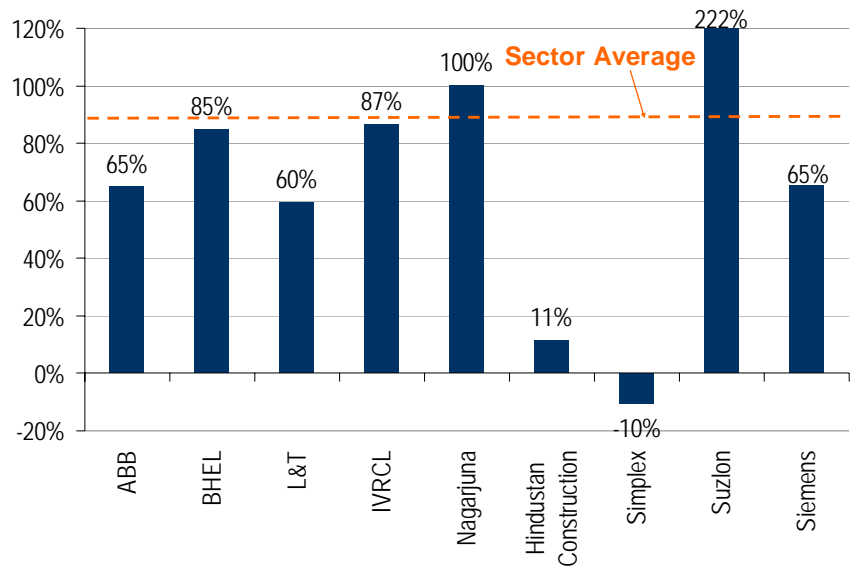
\* Only E&C operating profit considered for Jaiprakash Associates  
 Source: Company, Merrill Lynch Research

**Chart 4: EBITDA margin change (in bps) YoY for April – June '06 quarter**



Only E&C operating margin considered for Jaiprakash Associates  
 Source: Company, Merrill Lynch Research

**Chart 5: Recurring Net Profit growth YoY for April – June '06 quarter**



Source: Company, Merrill Lynch Research

## Price Objective Basis & Risk

### Larsen & Toubro Construction

Our PO of Rs2550 for L&T has been arrived at through a multi-pillar approach using a combination of 4 methods: PER (Rs2,500, 20x 1 year consolidated PE), Sum-of-the-parts (Rs2,585), EV/Order backlog (Rs2,500 on EV/OB of 1.0x FY08E) and DCF (Rs2,604). At Rs2,550, the stock would trade at consolidated PER of 20x 1-year-forward (FY08E) earnings.

Risks: Raw materials, increasing competition & project execution

### Bharat Heavy Electricals

Our PO of Rs2760 is based on FY08E PER of 25x. We believe our target multiple is reasonable as it is in line with the peak PE in the last cycle (94-97) & PEG of 1x. Risk to our price objective: Chinese competition, project execution and cap on FII holding.

### Nagarjuna Construction

Our PO of Rs400 is based on sum-of-the-parts. We have valued NJCC's core business at PE 14x FY08E – a 30% discount to majors & in line with its own FY07E multiples. The SPV projects are valued on DCF/book values and have total value of Rs46 per share. **Risks:** Government capex, raw material costs, competition, denial of tax benefits, traffic/interest rate risk in Infra projects, & proj. execution.

### IVRCL Infrastructure

Our PO of Rs 300 is based on a sum-of-the-parts approach. We have valued IVRCL's core construction business at PER 14x FY08E – a 30% discount to E&C majors despite its faster growth. Based on the multiple above, the core business is valued at Rs263 per share, BOOT projects at Rs38, value of stake in HDO at Rs12 and value of IVR prime at Rs15.5 and net debt of Rs26 per share. **Risks:** Government capex, raw material costs, competition, denial of tax benefits (u/s 80IA), traffic/interest rate risk in toll/annuity projects, and project execution risk.

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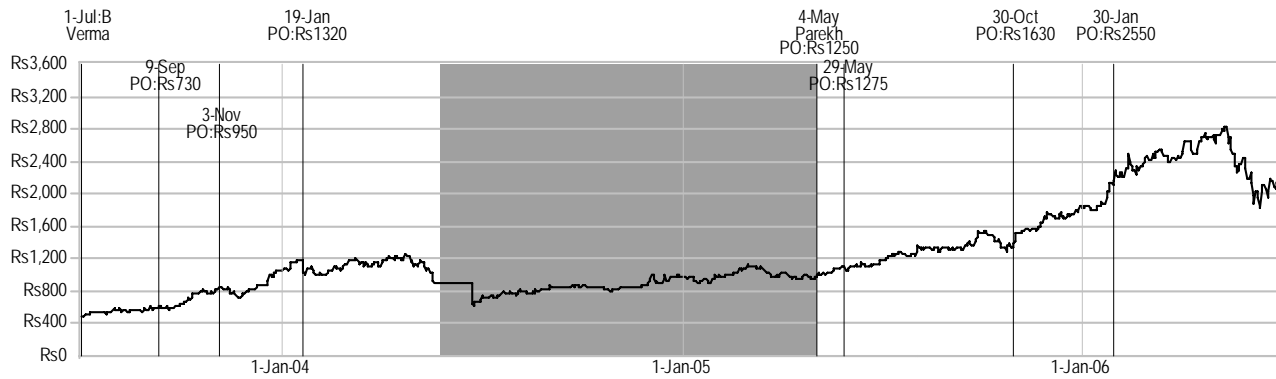
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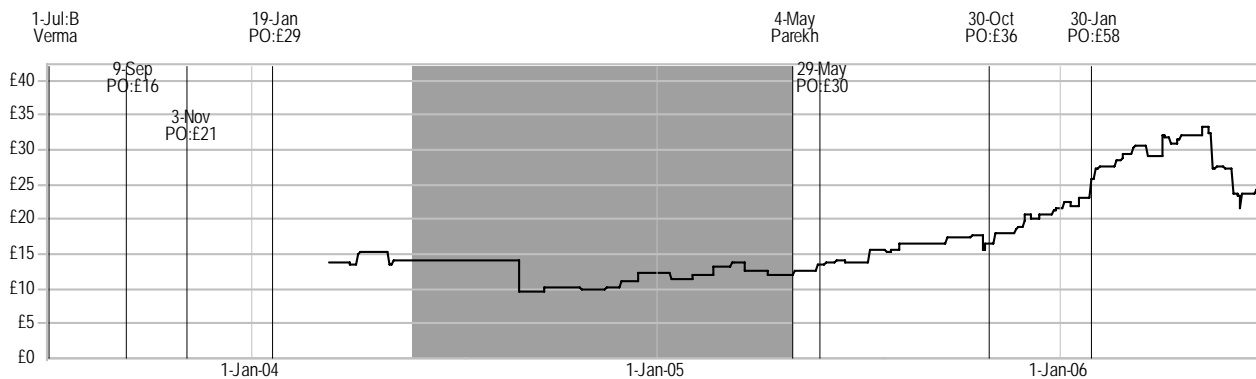
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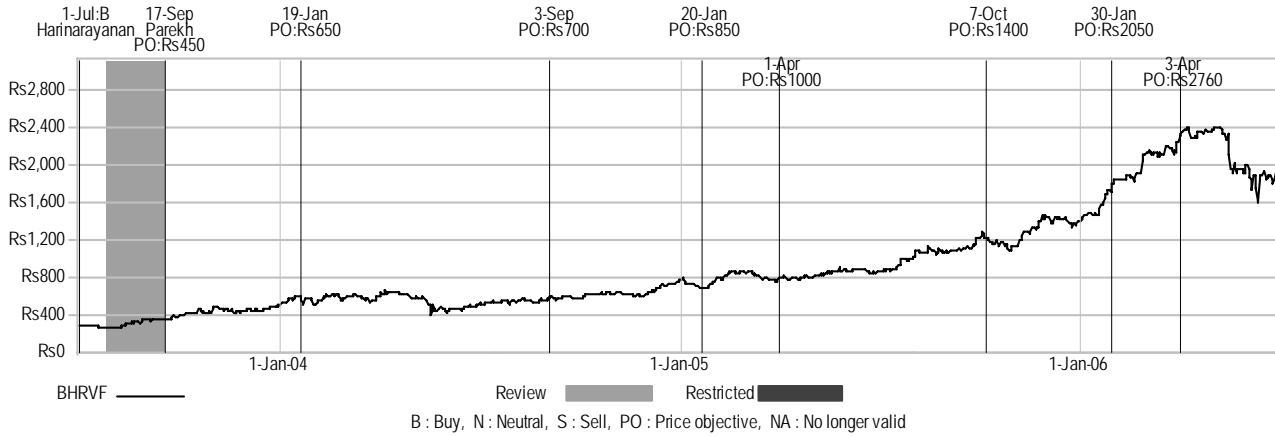
### LTORF Price Chart



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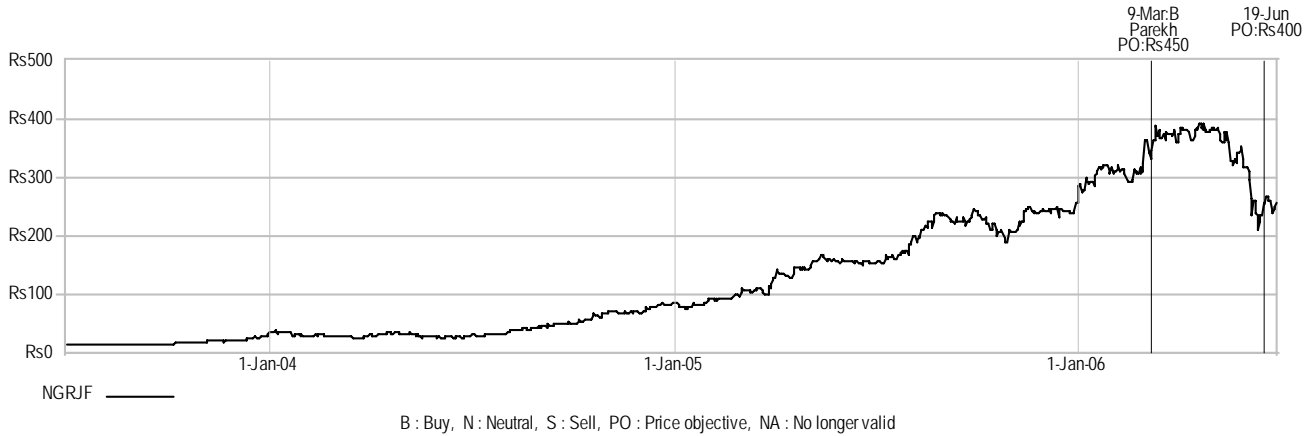
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**BHRVF Price Chart**



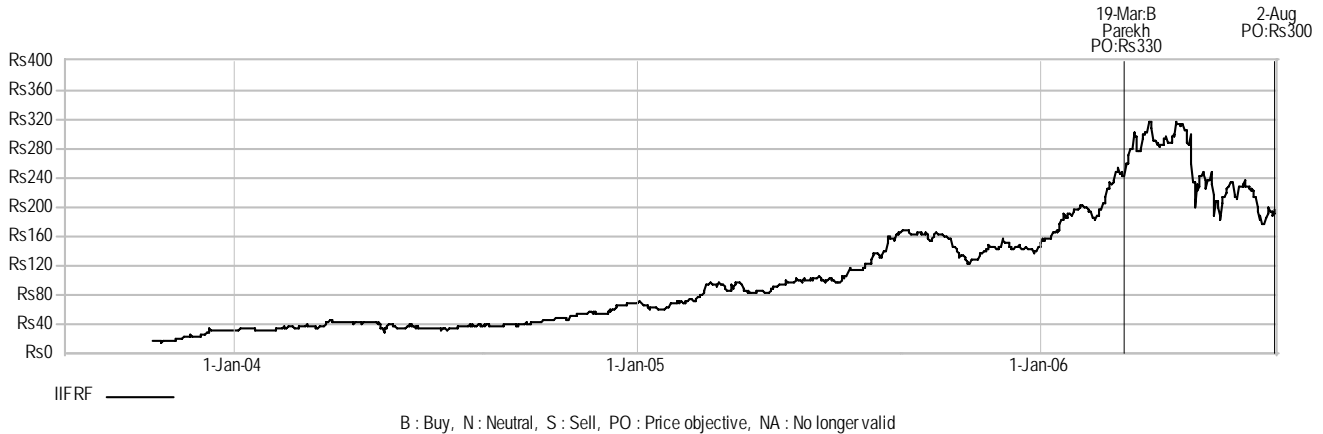
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**NGRJF Price Chart**



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**IIFRF Price Chart**



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Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	12	66.67%	Buy	4	33.33%
Neutral	6	33.33%	Neutral	2	33.33%
Sell	0	0.00%	Sell	0	0.00%

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Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
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Sell	203	7.09%	Sell	45	22.17%

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