Flashnote

HSBC Global Research

Industrials
Electrical Equipment
Equity – India

Indian Capital Goods

Q4 FY12 preview: Earnings weakness likely to continue

- **Order inflows likely to be weak; sales growth may fall to c5%**
- **We remain more bearish than consensus on margins; expect an average decline of c140bp y-o-y**
- **Remain bearish on most transmission & industrial suppliers; maintain preference for KPP**

Order outlook mixed; sales growth likely to marginalise: The order inflow is likely to remain weak in the sector, with the exception of Kalpataru Power and Alstom T&D, both of which have witnessed strong inflows in the past three months. In general, we expect the outlook for domestic transmission orders (both equipment & EPC) to remain healthy but believe that industrial capex and international orders will remain weak. In addition, we think that execution should continue to face headwinds from receding order books and project delays, driving down revenue growth in Q1 to around mid-single digits. We forecast average sales growth of c5% for the sector, and while we differ from consensus on individual company estimates, we are largely in line with it at the aggregate level. Within our universe, we expect KPP and KEC to record the best sales growth, while Thermax and Siemens should witness a sales decline.

Margins are likely to remain under pressure: In the past three quarters, the profitability of equipment suppliers has become highly volatile and remains the single largest risk to our estimates and ratings. We remain more bearish than consensus regarding margins for most companies, and at the aggregate level we forecast a margin decline of c140bp y-o-y versus consensus of c105bp. While the margin drivers are diverse for different companies at this stage, some of persistent negatives include project delays (and hence cost overruns), high fixed costs in certain segments, intense competition (and hence persistent pricing pressure) and weaker sales mix (ie, low-margin orders of the past). Increasing inventories may also dampen margins.

Sector investment thesis: Among several end markets, we prefer exposure to the transmission sector as demand (domestic & other emerging markets) is likely to remain robust. We continue to believe that recovery in industrial capex is still distant, and hence we expect large industrial orders to remain scarce and base orders to moderate. However, pricing pressure remains intense in the transmission equipment segment and, even with healthy inflows, earnings growth is likely to remain muted. Therefore, we stay bearish on most transmission and industrial equipment suppliers, and maintain our preference for KPP, which offers reasonable growth at an attractive valuation.

Q4 FY12 estimates summary

			Q4 FY12 estimates			Y-o-Y			HSBC vs. Cons		
Company	Rating	TP	Sales	EBITDA margin	EPS	Sales (%)	(bps)	EPS (%)	Sales (%)	(bps)	EPS (%)
KPP	OW	150	10,828	11.3%	4.6	22.4%	20	15.0%	5.9%	2	11.7%
KEC	OW	80	18,321	10.3%	3.5	17.6%	(20)	12.9%	7.9%	201	49.0%
ABB	UW	510	19,535	6.8%	3.3	10%	110	17.9%	4.7%	50	17.7%
Alstom T&D	UW(V)	180	9,034	9.8%	1.6	n/a	n/a	n/a	-1%	(90)	-18%
Crompton	UW(V)	140	31,930	7.8%	2.2	9.8%	(500)	-51.1%	-3.0%	(25)	-19.1%
Siemens	UW	625	29,194	8.5%	4.4	-4.0%	(620)	-46.3%	-12.9%	(299)	-47.9%
Thermax	UW	400	15,825	10.0%	8.2	-9.0%	(120)	-22.6%	-1.2%	(69)	-10.8%

Source: HSBC Estimates, Bloomberg consensus

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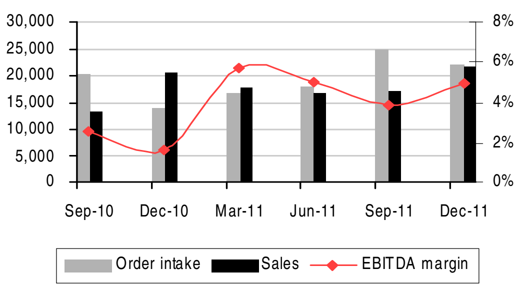
ABB (UW, TP INR510): An expensive turnaround, if at all

ABB is likely to report its Q1 CY12 results later this month. We discuss our expectations from the results below and highlight our estimates and valuation in the following charts and tables.

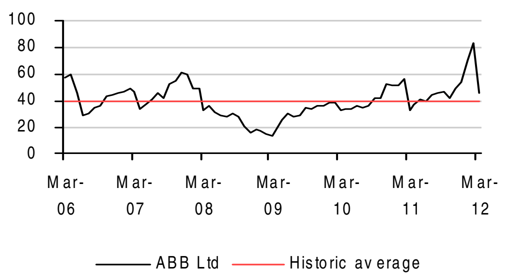
- We expect weak order intake in Q1 CY12 as ABB has not won any orders from Power Grid and industrial demand has also remained weak (as pointed out by various economic indicators). We forecast an order intake of cINR2bn but believe there is downside risk to our estimates.
- Sales growth is likely to improve as ABB had indicated in the last quarter, driven by last year's order wins and a healthy order book of INR91bn. Hence, we remain more bullish than consensus on sales and forecast revenue growth of c10% in Q1, which we think ABB should achieve.
- Visibility on margins remains opaque. While restructuring benefits should have already started kicking in, the order book quality (in terms of profitability) remains questionable given that pricing pressure is unabated. We remain slightly more hopeful than consensus and forecast an EBITDA margin of c6.8% in Q1 assuming some benefit from higher volumes and lower input costs.
- We maintain our bearish stance (UW rating) on the stock as visibility on earnings remains poor, the competitive environment is intense and the stock is still significantly expensive, trading at c49x CY12e PE and c33x CY13e PE versus the sector average FY13 PE of c11.8x.

Order intake (INRm), sales (INRm) and margins – last six qtrs



Source: Company data, HSBC

12m fwd PE versus historical average (last five years)



Source: Thomson Reuters Datastream, HSBC

ABB standalone - Dec YE (INR m)

	Q1FY11	Q2FY11	Q3FY11	Q4FY11	Q1FY12e	BB Cons Q1FY12e	*HBSC vs. Cons*
Net Sales	17,813	16,930	17,263	21,696	19,535	18,652	*4.7%*
EBITDA	1,016	855	666	1,080	1,328	1,175	*13.1%*
Profit before tax	877	589	371	840	1,058	880	*20.3%*
Net Income	595	387	222	641	699	610	*14.5%*
EPS (INR)	2.8	1.8	1.0	3.0	3.3	2.8	*17.7%*
Margins & Trend	**Q1FY11**	**Q2FY11**	**Q3FY11**	**Q4FY11**	**Q1FY12e**	**BB Cons Q1FY12e**	***HBSC vs. Cons***
Sales growth	22%	17%	29%	6%	10%	5%	*5.0%*
EBITDA mgn	5.7%	5.0%	3.9%	5.0%	6.8%	6.3%	*50*
PBT mgn	4.9%	3.5%	2.1%	3.9%	5.4%	4.7%	*70*
NI mgn	3.3%	2.3%	1.3%	3.0%	3.6%	3.3%	*31*

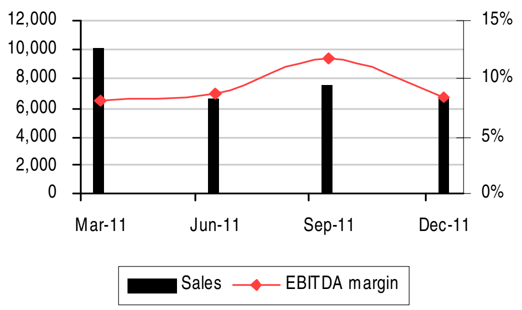
Source: Company data, Bloomberg, HSBC estimates

ATD (UW(V), TP INR180): Orders may beat, margins may miss

Alstom T&D is likely to report its Q1 CY12 (Q4 FY12 in a 15-month financial year) results early next month (May). We discuss our expectations from the results below and highlight our estimates and valuation in the following charts and tables.

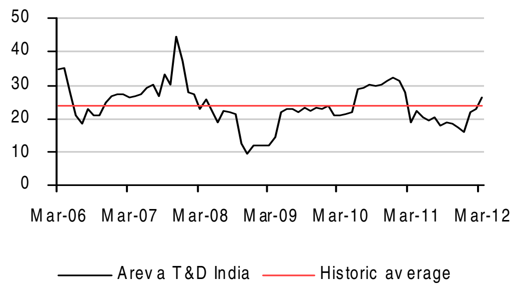
- Alstom T&D is likely to report strong order intake in Q1 CY12 as the company has won several orders from Power Grid, totalling around INR5.6bn. We forecast order inflow in Q1 to exceed around INR10bn.
- We expect a pick-up in revenues from last quarter to cINR9bn in Q1, driven largely by a strong order book of INR43.4bn. Persistent delays in delivery pick-ups remain a key risk to our revenue estimates.
- We believe margins should benefit from higher volumes and self-help initiatives, but we are not as bullish as consensus and forecast an EBITDA margin of c9.8% versus consensus of c10.7% (Q4 CY11: c8.4%). We believe margins may miss consensus as pricing pressure remains intense and the risk of delays (projects and delivery pick-ups) exists.
- The stock remains expensive on our estimates, trading at c29x CY12e PE. Hence, we maintain our UW(V) rating with a 12-month forward target price of INR180, which a 12-month forward target PE multiple of c21x on CY13e EPS of INR8.6.

Sales (INRm) & margins – last four quarters



Source: Company data, HSBC

12m fwd PE versus historical average (last five years)



Source: Thomson Reuters Datastream, HSBC

Areva T&D – Dec YE (INR m)

	Q1CY11	Q2CY11	Q3CY11	Q4CY11	Q1CY12e	BB Cons Q1CY12e	*HBSC vs. Cons*
Net sales	10,176	6,633	7,565	6,789	9,034	9,105	*-1%*
EBITDA	831	580	888	570	885	974	*-9%*
Profit before tax	431	271	588	278	555	673	*-17%*
Net income	288	180	400	302	372	453	*-18%*
EPS (INR)	1.2	0.8	1.7	1.3	1.6	1.9	*-18%*
Margins & trend	**Q1CY11**	**Q2CY11**	**Q3CY11**	**Q4CY11**	**Q1CY12e**	**BB Cons Q1CY12e**	***HBSC vs. Cons***
Sales growth	n/a	n/a	n/a	n/a	n/a	n/a	n/a
EBITDA mgn	8.2%	8.7%	11.7%	8.4%	9.8%	10.7%	*-90bps*
PBT mgn	4.2%	4.1%	7.8%	4.1%	6.1%	7.4%	*-124bps*
NI mgn	2.8%	2.7%	5.3%	4.4%	4.1%	5.0%	*-86bps*

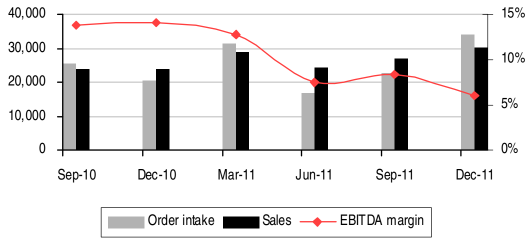
Source: Company data, Bloomberg, HSBC estimates

CRG (UW(V), TP INR140): Another miss likely

Crompton is likely to report its Q4 FY12 results early next month (May). We discuss our expectations from the results below and highlight our estimates and valuation in the following charts and tables.

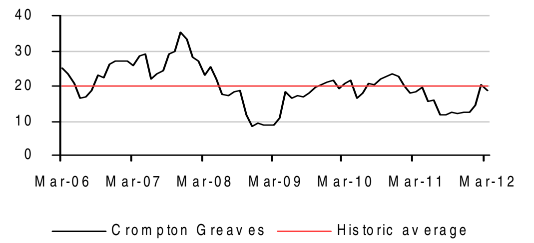
- The order inflow is likely to be weak in Q4, as the company has not won many orders from Power Grid (cINR2.4bn) and international demand remains weak, particularly for T&D equipments. We forecast order intake of cINR30bn in Q1 but believe there remains downside risk to our estimates.
- We forecast sales growth of c10%; however, Crompton may outperform our expectations owing to seasonally strong execution in Q4. In addition, a stronger-than-expected pick-up in consumers sales can also drive the beat.
- We expect margins to improve over Q3 as some of the short-term pain arising from inventory liquidation & high input costs should ease. On the other hand, persistent downward pressure from poor project mix, low utilisation in international business and intense domestic competition are likely to cap the improvement.
- Crompton is not very expensive on our estimates, trading at c13.3x FY13e PE versus the sector average of c11.8x; however, we believe the business outlook is still uncertain and the quality of the order book and inflows (in terms of profitability) remain questionable; hence, earnings risk remains high. Consequently, we maintain our bearish view until we obtain more clarity on the outlook.

Order intake (INRm), sales (INRm) & margins – last six qtrs



Source: Company data, HSBC

12m fwd PE versus historical average (last five years)



Source: Thomson Reuters Datastream, HSBC

Crompton (Consol) – Mar YE (INR m)

	Q4FY11	Q1FY12	Q2FY12	Q3FY12	Q4FY12e	BB Cons Q4FY12e	*HSBC vs. Cons*
Net Sales	29,080	24,377	27,055	30,280	31,930	32,925	*-3.0%*
EBITDA	3,731	1,819	2,260	1,826	2,498	2,658	*-6.0%*
Profit before tax	3,530	1,253	1,646	1,242	1,977	2,383	*-17.0%*
Net Income	2,896	795	1,167	771	1,401	1,655	*-15.3%*
EPS (INR)	4.5	1.2	1.8	1.2	2.2	2.7	*-19.1%*
Margins & Trends	**Q4FY11**	**Q1FY12**	**Q2FY12**	**Q3FY12**	**Q4FY12e**	**BB Cons Q4FY12e**	***HSBC vs. Cons***
Sales growth	16.0%	5.9%	12.8%	26.3%	9.8%	13.2%	*-3.4%*
EBITDA mgn	12.8%	7.5%	8.4%	6.0%	7.8%	8.1%	*(25)*
PBT mgn	12.1%	5.1%	6.1%	4.1%	6.2%	7.2%	*(105)*
NI mgn	10.0%	3.3%	4.3%	2.5%	4.4%	5.0%	*(64)*

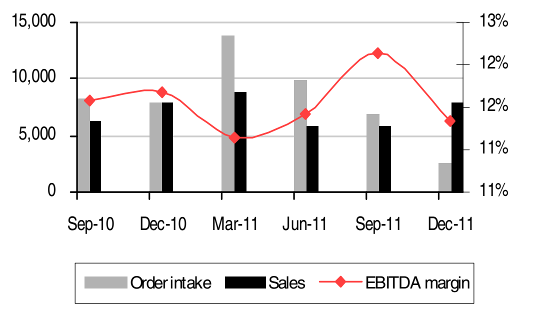
Source: Company data, Bloomberg, HSBC estimates

KPP (OW, TP INR150): Order inflow may surprise positively

Kalpataru Power is likely to report its Q4 FY12 results later next month (May). We discuss our expectations from the results below and highlight estimates and valuation in the following charts and tables.

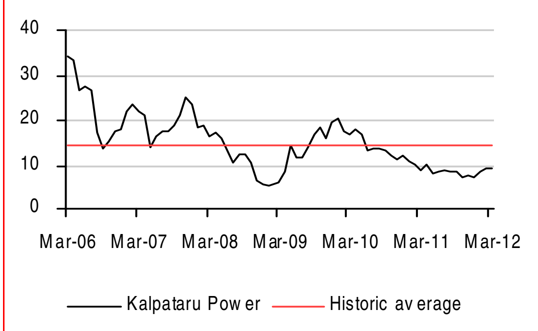
- The order inflow is likely to remain strong during Q4 FY12, as the company has not only won major Power Grid orders (cINR5bn) but has also finalised a few large international orders. We forecast an order intake of INR17bn in Q4, expecting it to be the best quarter ever in term of inflows.
- We forecast sales growth of c22% at KPTL and c32% at JMC Projects. We note that there remains a modest downside risk to our KPTL revenue estimate of INR10.8bn owing to a strike at JNPT at the quarter end.
- We expect margins at both KPTL and JMC Projects to remain broadly stable compared with the last quarter. We expect margin pressure to persist at JMC owing to high input costs (mainly steel) and poor project mix (ie, higher road EPC projects).
- Overall, we remain bullish on Kalpataru as we believe order outlook remains robust, sales growth will continue in double digits, margins are stable and valuations remain attractive (c6.2x FY13e PE). We maintain our OW rating and TP of INR150.

Order intake (INRm), sales (INRm) & margins – last six qtrs



Source: Company data, HSBC

12m fwd PE versus historical average (last five years)



Source: Thomson Reuters Datastream, HSBC

KPP standalone – Mar YE (INR m)

	Q4FY11	Q1FY12	Q2FY12	Q3FY12	Q4FY12e	BB Cons Q4FY12e	*HSBC vs. Cons*
Net sales	8,846	5,846	5,833	8,008	10,828	10,228	*5.9%*
EBITDA	985	667	708	908	1,222	1,152	*6.0%*
Profit before tax	790	474	483	568	990	806	*22.8%*
Net income	616	336	343	403	703	630	*11.5%*
EPS (INR)	4.0	2.2	2.2	2.6	4.6	4.1	*11.7%*
Margins & Trend	**Q4FY11**	**Q1FY12**	**Q2FY12**	**Q3FY12**	**Q4FY12e**	**BB Cons Q4FY12e**	***HSBC vs. Cons***
Sales growth	5.5%	8.7%	-7.6%	1.0%	22.4%	15.6%	*6.8%*
EBITDA mgn	11.1%	11.4%	12.1%	11.3%	11.3%	11.3%	*2*
PBT mgn	8.9%	8.1%	8.3%	7.1%	9.1%	7.9%	*126*
NI mgn	7.0%	5.7%	5.9%	5.0%	6.5%	6.2%	*33*

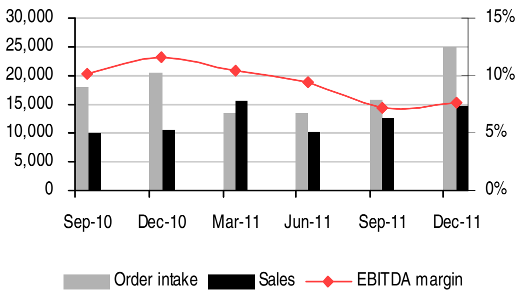
Source: Company data, Bloomberg, HSBC estimates

KEC (OW, TP INR80): Looking for margin improvement

KEC is likely to report its Q4 FY12 results early next month (May). We discuss our expectations from the results below and highlight our estimates and valuation in the following charts and tables.

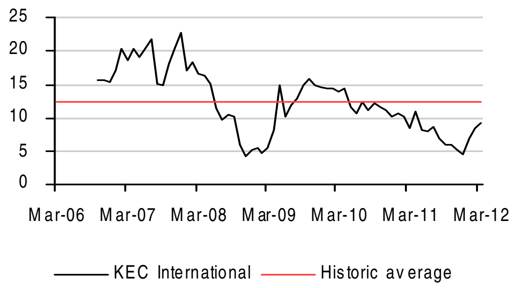
- The order inflow is likely to remain weak compared with last quarter as the company has not announced any major order wins during Feb-Mar. However, this is not a negative for the stock, as last quarter was exceptional in terms of order intake and the order book of INR92bn is already very strong.
- Sales growth is likely to be strong given the strong backlog from the previous quarter and robust execution. We forecast revenues of INR18.3bn and believe KEC may outperform our expectations.
- Margins are likely to show improvement in Q4, as per management's earlier guidance, driven by the absence of hedging losses and some improvement in the underlying margins of the new businesses. We forecast a FY12 EBITDA margin of c8.7% versus management guidance of c8.5% ±25bp.
- We remain bullish on the stock as the order outlook remains strong, sales growth is likely to be in high teens and valuations appear attractive (c6.0x FY13e PE). We note that continued pressure on margins remains a key downside risk to our estimates and recommendation.

Order intake (INRm), sales (INRm) & margins – last six qtrs



Source: Company Data, HSBC

12m fwd PE versus historical average (last five years)



Source: Thomson Reuters Datastream, HSBC

KEC Intl (Consolidated) – Mar YE (INR m)

	Q4FY11	Q1FY12	Q2FY12	Q3FY12	Q4FY12e	BB Cons Q4FY12e	*HSBC vs. Cons*
Net Sales	15,574	10,225	12,630	14,588	18,321	16,986	*7.9%*
EBITDA	1,636	960	906	1,123	1,883	1,404	*34.1%*
Profit before tax	1,197	511	398	1,163	1,388	726	*91.1%*
Net Income	786	331	212	806	900	639	*40.8%*
EPS (INR)	3.1	1.3	0.8	3.1	3.5	2.4	*49.0%*
Margins & Trend	**Q4FY11**	**Q1FY12**	**Q2FY12**	**Q3FY12**	**Q4FY12e**	**BB Cons Q4FY12e**	***Act vs. HSBC***
Sales growth	14.8%	20.9%	26.3%	36.3%	17.6%	9.1%	*8.6%*
EBITDA mgn	10.5%	9.4%	7.2%	7.7%	10.3%	8.3%	*201*
PBT mgn	7.7%	5.0%	3.2%	8.0%	7.6%	4.3%	*330*
NI mgn	5.0%	3.2%	1.7%	5.5%	4.9%	3.8%	*115*

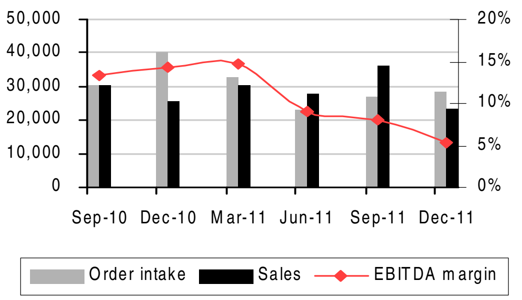
Source: Company data, Bloomberg, HSBC estimates

SIEM (UW, TP INR625): Expect another weak quarter

Siemens is likely to report its Q2 FY12 (September YE) on 27 April. We discuss our expectations from the results below and highlight our estimates and valuation in the following charts and tables.

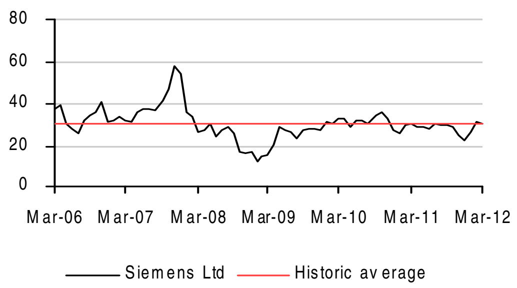
- We expect order intake to remain flat over last year driven by the absence of a large order and moderating growth in base orders. We note that industrial activity has come under significant pressure in the past three months, as a result of which Siemens may actually underperform our expectations.
- Unless there are any large deliveries in Q2, we believe revenues will continue to fall y-o-y (c4%), driven largely by a weaker order book. Moderating growth in base orders is also likely to have a negative impact on sales growth in Q2.
- We remain hopeful of margin improvement in Q2 as we expect some resolution on project delays in addition to support from higher volumes. However, there is no visibility on the quantum of improvement at this stage and, hence, this remains a key risk to our estimates. We forecast an EBITDA margin of c8.5% in Q2 versus consensus estimate of c11.5%.
- Even though we are a good 30% below consensus on our FY12/13e EPS, we believe the risk to our estimates is still skewed to the downside. This coupled with an expensive valuation (c39x FY12e PE and c34x FY13e PE) drives are bearish view on the stock. We remain UW with a TP of INR625.

Order intake (INRm), sales (INRm) & margins – last six qtrs



Source: Company data, HSBC

12m fwd PE versus historical average (last five years)



Source: Thomson Reuters Datastream, HSBC

Siemens standalone – Sep YE (INR m)

	Q2FY11	Q3FY11	Q4FY11	Q1FY12	Q2FY12e	BB Cons Q2FY12e	*HSBC vs. Cons*
Net sales	30,337	27,785	36,043	23,610	29,194	33,533	*-12.9%*
EBITDA	4,449	2,503	2,916	1,231	2,481	3,853	*-35.6%*
Profit before tax	4,234	2,288	2,575	1,049	2,281	3,854	*-40.8%*
Net income	2,777	1,548	1,692	707	1,506	3,672	*-59.0%*
EPS (INR)	8.2	4.5	5.0	2.1	4.4	8.5	*-47.9%*
Margins & Trend	**Q2FY11**	**Q3FY11**	**Q4FY11**	**Q1FY12**	**Q2FY12e**	**BB Cons Q2FY12e**	***HSBC vs. Cons***
Sales growth	37%	24%	19%	-7%	-4%	11%	*-14.3%*
EBITDA mgn	14.7%	9.0%	8.1%	5.2%	8.5%	11.5%	*(299)*
PBT mgn	14.0%	8.2%	7.1%	4.4%	7.8%	11.5%	*(368)*
NI mgn	9.2%	5.6%	4.7%	3.0%	5.2%	11.0%	*(579)*

Source: Company data, Bloomberg, HSBC estimates

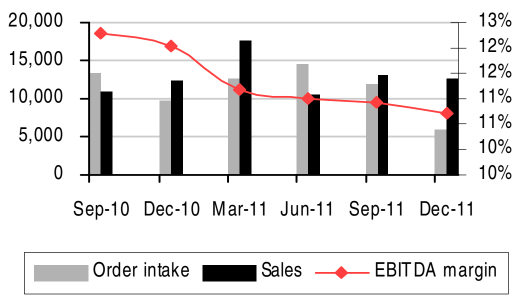
HSBC

TMX (UW, TP INR400): Margins at risk

Thermax is likely to report its Q4 FY12 results earlier next month (May). We discuss our expectations from the results below and highlight our estimates and valuation in the following charts and tables.

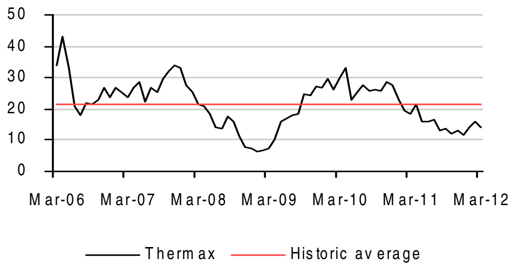
- We expect order inflows to remain weak y-o-y driven by continuing demand erosion for captive power equipment and air pollution products. We forecast an order inflow of INR12.4bn but believe there remains a downside risk to our estimates in the absence of large orders.
- We believe revenues are likely to fall in Q4 driven by the weakening order book, which has eroded to INR51bn from a peak of INR66bn. We forecast a sales decline of c9% y-o-y and are largely in line with consensus.
- Driven largely by lower volumes and lower utilisation rates, we expect margins to come under further pressure and fall c70bp q-o-q. We believe margins are likely to miss consensus, which currently expects a flat EBITDA margin q-o-q.
- We remain bearish on the stock as we believe Thermax is likely to witness muted demand over the next 12-15 months because of its late-cycle nature (please see our latest initiated report dated 29 March 2012 titled *'Initiate UW: A late-cycle play'*). The stock remains expensive on our estimates, trading at c17.5x; hence, we maintain our UW rating and TP of INR400.

Order intake (INRm), sales (INRm) & margins – last six qtrs



Source: Company data, HSBC

12m fwd PE versus historical average (last five years)



Source: Thomson Reuters Datastream, HSBC

Thermax – Mar YE (INR m)

	Q4FY11	Q1FY12	Q2FY12	Q3FY12	Q4FY12e	BB Cons Q4FY12e	*HSBC vs. Cons*
Net sales	17,455	10,329	12,867	12,630	15,825	16,023	*-1.2%*
EBITDA	1,951	1,137	1,405	1,354	1,577	1,707	*-7.6%*
Profit before tax	1,959	1,170	1,485	1,384	1,474	1,789	*-17.6%*
Net income	1,265	799	1,017	955	978	1,156	*-15.4%*
EPS (INR)	10.6	6.7	8.5	8.0	8.2	9.2	*-10.8%*
Margins & Trend	**Q4FY11**	**Q1FY12**	**Q2FY12**	**Q3FY12**	**Q4FY12e**	**BB Cons Q4FY12e**	***HSBC vs. Cons***
Sales growth	49%	33%	23%	4%	-9%	-8.2%	*-1.1%*
EBITDA mgn	11.2%	11.0%	10.9%	10.7%	10.0%	10.7%	*(69)*
PBT mgn	11.2%	11.3%	11.5%	11.0%	9.3%	11.2%	*(185)*
NI mgn	7.2%	7.7%	7.9%	7.6%	6.2%	7.2%	*(103)*

Source: Company data, Bloomberg, HSBC estimates

HSBC

Valuation and risks

Under our research model, for stocks without a volatility indicator, the Neutral band is 5ppt above and below the hurdle rate for Indian stocks of 11% (and 10ppt above and below for stocks with a volatility indicator). At the time we set our target prices, they implied a potential return within the respective ratings bands in the table below; hence, we rate the stocks below as stated. Potential return equals the percentage difference between the current share price and the target price, including the forecast dividend yield when indicated.

Valuation summary table

Company	HSBC rating	Current price (INR)	HSBC TP (INR)	12m fwd target P/E	Potential return (in %)	Valuation methodology	Key assumptions	Key risks
Kalpataru Power	Overweight	104	150	8.3	45%	SOTP / EVA	Sales growth = 8.0% Target OR mgn = 10.5% (Parent); 5.5% (JMC) WACC = 14.7%	Downside risks: Weaker-than-expected execution and higher-than-expected depreciation at JMC
KEC International	Overweight	63	80	6.2	27%	EVA	Sales growth = 9.0% Target OR mgn = 9.5% WACC = 12.3%	Downside risks: Delay/cancellation of transmission projects
Alstom T&D India	Underweight (V)	179	180	21.0	1%	EVA	Sales growth = 8.0% Target OR mgn = 9.0% WACC = 12.1%	Upside risks: Significant pick-up in execution, resurgence of large orders
ABB Ltd	Underweight	823	510	23.6	-38%	EVA	Sales growth = 9.0% Target OR mgn = 9.0% WACC = 11.7%	Upside risks: Significant pick-up in execution, resurgence of large orders
Crompton Greaves	Underweight (V)	135	140	10.6	4%	EVA	Sales growth = 7.0% Target OR mgn = 8.5% WACC = 14.9%	Upside risks: Swift resolution of business crisis in West, large order wins
Siemens India	Underweight	770	625	26.2	-19%	EVA	Sales growth = 9.0% Target OR mgn = 11.0% WACC = 11.7%	Upside risks: Better-than-expected improvement in margins, strength in short-cycle orders
Thermax India	Underweight	452	400	14.9	-11%	EVA	Sales growth = 7.0% Target OR mgn = 8.5% WACC = 13.5%	Upside risks: Significant rate cut, large order wins, significant decline in raw material prices, particularly steel

Source: HSBC estimates

HSBC

Disclosure appendix

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HSBC & Analyst disclosures

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Company	Ticker	Recent price	Price Date	Disclosure
ABB INDIA	ABB.BO	823.25	11-Apr-2012	11
ALSTOM T&D INDIA	AREV.BO	178.90	11-Apr-2012	2, 5, 6, 7
CROMPTON GREAVES LTD	CROM.BO	135.05	11-Apr-2012	2, 4
KALPATARU POWER TRANSMISSION	KAPT.BO	103.55	11-Apr-2012	4

Source: HSBC

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