

13 January 2009

India Capital Goods

Business resilience is key. Hold BHEL, L&T

Neutral

Nifty/Sensex: 2873/9406



Anand Rathi Financial Services, its affiliates and subsidiaries, do and seek to do business with companies covered in its research reports. Thus, investors should be aware that the firm may have a conflict of interest that could affect the objectivity of this report. Investors should consider this report as only a single factor in making their investment decision. Disclosures and analyst certifications are located in Appendix 1.

13 January 2009

India Capital Goods

Neutral

Business resilience is key. Hold BHEL, L&T

Nifty/Sensex: 2873/9406

- **Initiating sector at Neutral.** Slower infrastructure growth would limit order inflows while liquidity issues would squeeze working capital and earnings, in our view. Yet this would be a key growth sector in the medium term. We believe that, in selecting stocks, investors should focus on business model resilience and balance sheet strength rather than segments in which companies operate.
- **Order flows to slow.** The slower-than-expected GDP growth should hit capital formation and decelerate infrastructure growth. Lack of liquidity threatens to affect order inflows as developers find it difficult to close projects financially. Finally, banks' cautiousness in lending casts shadows on infrastructure projects. We expect these factors and the elections to lead to a slowdown in future order inflows for companies in the sector.
- **Slowdown in earnings growth expected.** The combination of order-inflow slowdown and tight liquidity should stretch the working capital of engineering companies and put pressure on earnings. We expect our universe earnings at 14% CAGR in FY08-11e compared to 43% in the previous three years. Consensus earnings have not fully factored this in some cases.
- **Business model resilience – key selection criteria.** Business model resilience should be the key stock selection criteria. We like BHEL and L&T (both rated Hold). Among midcaps, we like Voltas (Hold). Key Sells are ABB, Suzlon, Siemens and Punj Lloyd in our coverage universe, which include 11 initiations.

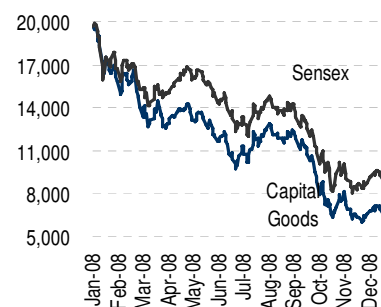
India capital goods valuation matrix

Company name	Rating	Price	Target Price	Target PE FY10	Current PE FY10	PBV FY10e
Bharat Heavy Electricals Ltd	Hold	1,417	1,441	16.0	15.7	4.1
Larsen & Toubro Ltd*	Hold	721	807	14.0	12.3	3.0
ABB Ltd/India **	Sell	493	426	14.0	16.2	6.4
Siemens India Ltd ***	Sell	261	210	12.0	15.0	4.1
Suzlon Energy Ltd	Sell	53	66	7.0	5.6	0.7
Crompton Greaves Ltd	Sell	136	129	10.0	10.5	2.5
Areva T&D India Ltd **	Sell	199	155	13.0	16.7	1.7
Punj Lloyd Ltd	Sell	115	118	6.0	5.9	0.9
Cummins India Ltd	Sell	203	176	9.0	9.8	2.2
Thermax Ltd	Sell	190	194	7.0	6.7	2.0

Source: Anand Rathi Research

*Core business PE, **Dec ending, *** Sept. ending, Price as on 9 Jan, 2009

Capital goods vs Sensex



Source: Anand Rathi Research

Anand Rathi Financial Services, its affiliates and subsidiaries, do and seek to do business with companies covered in its research reports. Thus, investors should be aware that the firm may have a conflict of interest that could affect the objectivity of this report. Investors should consider this report as only a single factor in making their investment decision. Disclosures and analyst certifications are located in Appendix 1.