

Capital Goods

3QFY18E Results Preview

10 Jan 2018

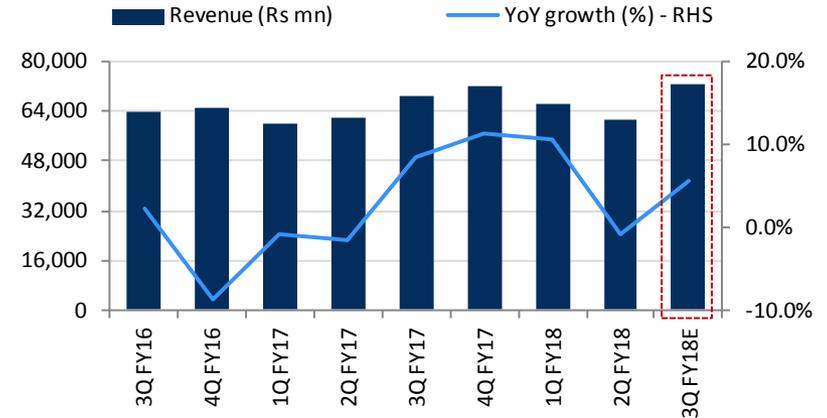
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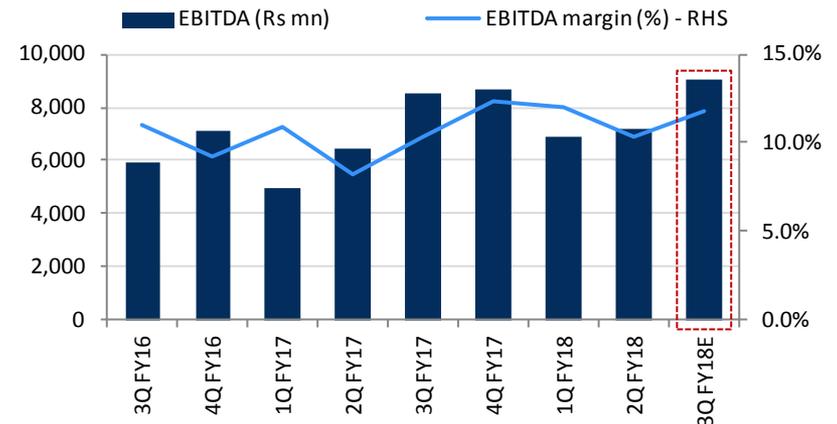
3QFY18E: Margin improvement; rise in order flows QoQ

- Our coverage universe is likely to witness ~6% YoY growth in revenues. While Engineers India (EIL), Skipper and Swaraj Engines may clock healthy revenue growth, Cummins (KKC)/Thermax (TMX) are likely to witness lower growth at ~5/6% due to sluggish exports/lower book to bill. While Skipper's revenue growth may be aided by the likely come back of the polymers segment, EIL's growth is on the back of a strong order book. Swaraj's growth may be driven by a 13% YoY volumes growth.
- GST impact behind the sector:** With the GST transition getting absorbed well, the performance may look better QoQ. The polymers segment of Skipper was impacted in 2Q because of delays in input credit. The same is expected to have bounced back in 3Q. Also, the shift from unorganised to organised sector is likely to benefit Skipper's polymer business in the long run.
- Low PGCIL ordering:** Orders from PGCIL, declined ~24% to Rs 24.4bn in 3QFY18. However, traction in order inflows would continue from Railways, Metros and Hydrocarbons. The momentum in order flows is likely to have picked up and will get reflected in rising order flows QoQ, especially for TMX, ABB and GE T&D.
- Company specific monitorables:** Traction in exports for CIL, Pickup in state and private T&D capex for ABB, GE T&D and Skipper, brownfield and greenfield expansion by oil refiners for EIL and increasing penetration, both domestic and international, for Skipper.
- Top picks:** Cummins (weakness in exports may be behind KKC) and Swaraj (potential compounding in volumes) are our top picks in the sector.
- Reco/TP changes:** Rolling forward the valuation methodology from Sept-19E to Dec-19E, the TPs for Skipper/KKC/EIL/TMX have increased to Rs 271 (vs 261)/ Rs 1,016 (vs Rs 1,007)/Rs 216 (vs Rs 183)/Rs 1,014 (vs Rs 985). Also, the TP for Swaraj has increased to Rs 2,566 (vs Rs 2,489).

Expect 6% YoY Rev Growth For Our Capital Goods Universe



Overall EBITDA Margins Are Expected To Be Marginally Higher YoY



Source: Company, HDFC sec Inst Research

3QFY18E: Expect better post results commentary

COMPANY	3QFY18E OUTLOOK	WHAT'S LIKELY	KEY MONITORABLES
ABB	AVG	<ul style="list-style-type: none"> Expect better order flows QoQ. The same will be lower YoY due to a significant base. Revenue growth will continue to remain muted at 2% owing to a high base in Power Grids (-11% YoY fall in sales). The same may be offset by 5/3% growth in Robotics & Motion/Industrial Automation divisions. EBITDAM is expected to remain healthy at 11.3%, though lower by 80bps YoY owing to higher staff costs . 	<ul style="list-style-type: none"> The outlook for orders from PGCIL and state utilities. The outlook for orders from high growth sectors such as renewables, services and railways.
Cummins India	AVG	<ul style="list-style-type: none"> We expect a 4.6% YoY revenue growth led largely by the domestic business. Exports are expected to remain muted (5% fall expected). However, QoQ we expect better export numbers. We expect EBITDA margins to decline 171bps YoY to ~15% on the back of an increase in commodity prices. With higher tax rates, APAT may decline 6% YoY. 	<ul style="list-style-type: none"> Pricing pressures and demand outlook in export market. Pricing environment in the domestic market.
Thermax	AVG	<ul style="list-style-type: none"> The order inflows may continue to grow in double digits YoY. We expect a 5% YoY revenue growth riding on the scale up in the chemicals division. Expect EBITDAM to rise 71bps on the back of healthy performance in the chemicals division. 	<ul style="list-style-type: none"> Pick up in execution of overseas orders especially the Dangote order. Mid to large size orders from the core sectors such as cement, hydrocarbons etc.
Engineers India	GOOD	<ul style="list-style-type: none"> We expect robust execution with revenue growth of 31% led by 24% revenue growth in PMC and 69% growth in LSTK revenues (lower base effect). Expect better order flows YoY (lower base). With EBIT margins of 31.3/7.8% for PMC/LSTK, we expect APAT to grow ~15% YoY. 	<ul style="list-style-type: none"> The outlook for order inflows from the domestic and overseas markets. Outlook on petrochemical production capex by refineries.

3QFY18E: Expect better post results commentary

COMPANY	3QFY18E OUTLOOK	WHAT'S LIKELY	KEY MONITORABLES
GE T&D	AVG	<ul style="list-style-type: none"> The order inflows may decline YoY but are expected to rise QoQ. We expect flat revenues, given the high base. Expect EBITDAM to rise 211bps on the back of execution of certain better margin orders. APAT is expected to grow by 23% YoY riding on strong operating performance. 	<ul style="list-style-type: none"> The outlook for orders from PGCIL and state utilities. Finalization of some of the orders delayed due to GST transition.
Skipper	GOOD	<ul style="list-style-type: none"> We expect strong revenue growth of 25% led by 25/47% (lower base) growth in Engineering/polymers segments. GST impact to be behind the polymers segment. EBIT margins to rise 42/10bps YoY for Engineering and Polymer segments on back of oplev benefits. 	<ul style="list-style-type: none"> The outlook for increasing penetration domestically in the Polymer segment. The outlook for orders from state utilities in the Engineering segment.
Swaraj Engines	GOOD	<ul style="list-style-type: none"> Expect strong revenue growth of 20.3% YoY, driven by 13/6.4% YoY volume/realization growth. Expect strong EBITDA growth of 32.0% YoY led by improvement in EBITDAM by 144bps to 16.3% (with lower employee costs and other expenses). APAT is expected to grow strongly by 32.6% YoY. 	<ul style="list-style-type: none"> The outlook for domestic tractor industry where growth is driven by Government spending on agriculture and rural infra projects. Capacity expansion plan.

3QFY18E: Financial summary

Company	NET SALES (Rs bn)			EBITDA (Rs bn)			EBITDA Margin (%)			APAT (Rs bn)			Adj. EPS (Rs/sh)		
	3Q FY18E	QoQ (%)	YoY (%)	3Q FY18E	QoQ (%)	YoY (%)	3Q FY18E	QoQ (bps)	YoY (bps)	3Q FY18E	QoQ (%)	YoY (%)	3Q FY18E	2Q FY18	3Q FY17
ABB Ltd	25.4	32.5	1.8	2.9	113.8	-4.9	11.3	429.6	-79.6	1.8	114.5	12.7	8.4	3.9	7.5
Cummins India	14.2	22.8	4.6	2.1	26.9	-6.1	15.0	48.7	-171.4	1.9	22.2	-5.7	6.7	5.5	7.1
Thermax Ltd*	10.3	-0.6	5.5	1.0	4.6	13.8	9.7	48.9	70.9	0.7	14.5	18.8	5.5	4.8	4.6
Engineers India	4.3	-0.5	31.4	1.1	-23.7	31.0	24.8	-755.9	-6.9	1.0	-17.9	15.1	1.5	1.9	1.3
GE T&D	11.5	32.2	-1.2	1.0	21.5	31.5	8.5	-75.1	211.4	0.5	14.9	23.3	2.1	1.9	1.7
Skipper Ltd	5.4	4.3	24.9	0.7	4.8	25.4	13.3	5.7	5.3	0.3	13.2	17.7	2.6	2.3	2.2
Swaraj Engines	1.9	-10.8	20.3	0.3	-13.5	32.0	16.3	-51.2	144.6	0.2	-13.6	32.6	16.7	19.4	12.6
Aggregate	72.8	18.9	5.6	9.0	25.7	6.3	12.4	67.4	8.3	6.3	24.3	8.9			

*represents consolidated numbers.

Source: Company, HDFC sec Inst Research .

3QFY18E: Peer valuation

Company	Mcap (Rs bn)	CMP (Rs/sh)	Rating	TP (Rs)	EPS (Rs/sh)			P/E (x)			EV/EBITDA (x)			ROE (%)		
					FY18E	FY19E	FY20E	FY18E	FY19E	FY20E	FY18E	FY19E	FY20E	FY18E	FY19E	FY20E
ABB Ltd.\$	300	1,416	NA	NA	21.3	24.2	27.0	66.4	58.6	52.4	35.6	31.0	27.9	13.1	13.4	13.5
Cummins India	259	934	BUY	1,016	25.9	28.9	34.0	36.0	32.3	27.5	31.6	27.8	23.9	18.6	19.4	21.2
Thermax Ltd.*	158	1,325	NEU	1,014	22.8	29.2	35.3	58.0	45.3	37.5	36.6	28.4	23.2	10.4	12.3	13.5
Engineers India	125	198	BUY	216	6.4	7.4	9.5	30.9	26.8	20.8	26.3	20.8	14.6	16.2	20.6	24.8
GE T&D Ltd.	114	445	NA	NA	10.3	11.5	14.0	43.4	38.9	31.9	27.1	24.1	20.8	23.1	21.6	22.0
Skipper Ltd.#	28	276	NEU	271	10.4	13.6	17.6	26.6	20.3	15.6	12.3	10.2	8.6	19.8	21.6	23.1
Swaraj Engines Ltd	26	2,182	BUY	2,566	70.3	77.8	88.1	31.0	28.1	24.8	19.2	16.4	14.2	32.9	37.3	36.2

\$ represents CY17E, CY18E, CY19E numbers.

* represents consolidated numbers.

SOTP methodology. We assign 15/15/25x to Dec-19E PAT for Engineering/Infrastructure/Polymer division.

INSTITUTIONAL RESEARCH

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- SELL : Where the stock is expected to deliver less than (-) 10% returns over the next 12 month period

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