

Fixed cost analysis

| INR b | TFC (excl. Dep.) | as % of rev | Cash coverage of TFC (in months) |
|---------|------------------|-------------|----------------------------------|
| Siemens | 23.5 | 17.1 | 25 |
| ABB | 9.3 | 12.7 | 21 |
| Cummins | 7.7 | 13.6 | 15 |
| Thermax | 10.4 | 17.4 | 13 |

Target price changes

| Company | Earlier TP | Current TP | Rating |
|---------|------------|------------|---------|
| L&T | 1,320 | 1,320 | Buy |
| ABB | 1,410 | 1,255 | Buy |
| Siemens | 1,520 | 1,450 | Neutral |
| Cummins | 670 | 360 | Neutral |
| Thermax | 855 | 865 | Neutral |
| BHEL | 40 | 22 | Neutral |

Source: MOFSL, Company

Short-cycle businesses brace for sharp revenue drop

Capex plays appear more vulnerable due to leverage and high working capital

- Short-cycle businesses set to witness plunge in order inflows / revenue over next six months:** While we remain structurally positive on short-cycle businesses (ABB and Siemens) owing to their technological advantage, digitalization and automation theme, and robust balance sheet, we brace for the risk of order inflows and revenue plummeting in the near term. We note that ABB's OB/Rev stood at 0.6x and that of Siemens at 0.9x at Dec'19 end. We expect order inflows to decline sharply in the 4QFY20/1QFY21 quarters and revenue to plunge in the subsequent two quarters. We expect short-cycle businesses to rebound sharply once the situation improves; however, it is difficult for us to predict recovery in timelines in the near term.
- Plant closures to weigh on Industrial Automation:** Various manufacturing units across sectors, including automobile and cement, have suspended operations until mid-April owing to the COVID-19 lockdown. The suspension may be extended depending on the situation. The same has been cited as a risk factor by various business leaders across companies. In our view, such a move would weigh heavily on the Industrial Automation business and hence we have lowered our estimates for the same.
- Robust balance sheets provide comfort on strong comeback subsequently:** A positive of such short-cycle businesses is their net cash balance sheets, which help in maintaining low fixed cost v/s that of highly levered players. Companies with stronger balance sheets would be able to ride out such uncertain times of cash flow mismatch.
- Continued preference for net cash balance sheets and low working capital cycle:** Within our coverage universe, we prefer companies with net cash balance sheets and those with superior working capital (WC) cycles as they are relatively better placed. In comparison, companies with high leverage/WC may face short-term challenges in cash flow management and require support from government agencies (for payment) or banks (for easing interest and principal payments).
- Low fixed cost businesses with high cash balances prove better off:** In these uncertain times, as a part of stress testing, we have attempted to approach our coverage universe based on the balance sheet ability to absorb fixed cost. Siemens and ABB stand out as they have low fixed costs and the highest cash balances, thereby enabling them to absorb the shock from economic downturn, if any, for a considerable time. Also, their strong global parentage provides additional comfort to us. Thermax has relatively high fixed cost, which may require some addressing if the situation worsens. L&T has multiple levers to ride out the crisis situation; however, it is likely to witness the worsening of WC in the near term. Moreover, the development business, such as road, metro, and power projects, may require cash funding.
- Top picks:** We have cut our FY20–22E earnings estimates across our coverage universe by 0–37% (refer to Exhibit 24). We believe L&T, ABB, and Siemens are better placed to navigate the current turbulent times. We maintain our Buy rating on L&T and ABB and Neutral rating on Siemens, Cummins, BHEL, and Thermax.

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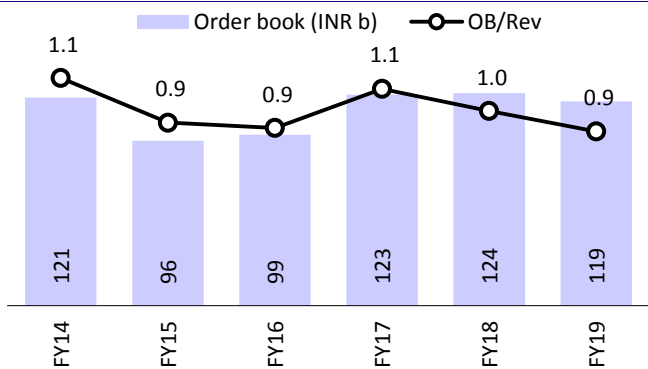
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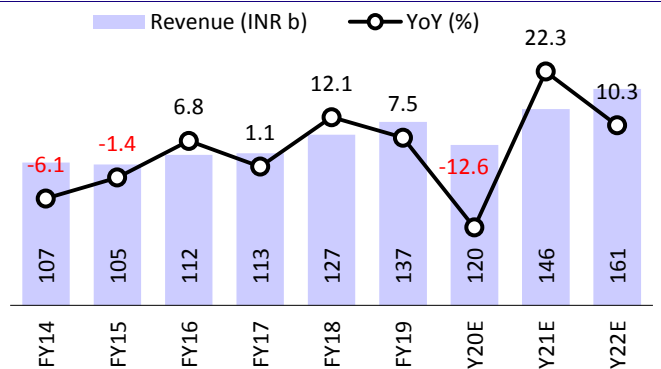
Order book position and revenue estimation across companies

Exhibit 1: Siemens: Current order book offers coverage for next one year



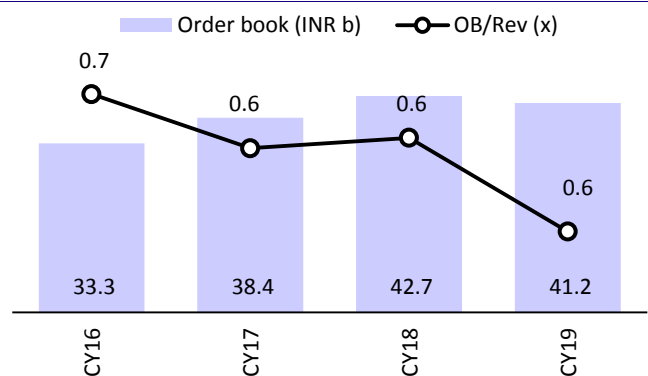
Source: MOFSL, Company, Sep ending FY

Exhibit 2: Siemens: We forecast FY19–22E CAGR at just 5.7%, after building in near-term weak execution in FY20



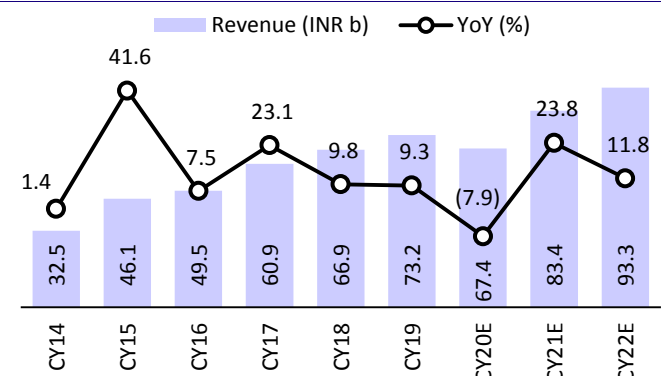
Source: MOFSL, Company, Sep ending FY

Exhibit 3: ABB: Lowest OB/rev ratio due to short-cycle nature of business



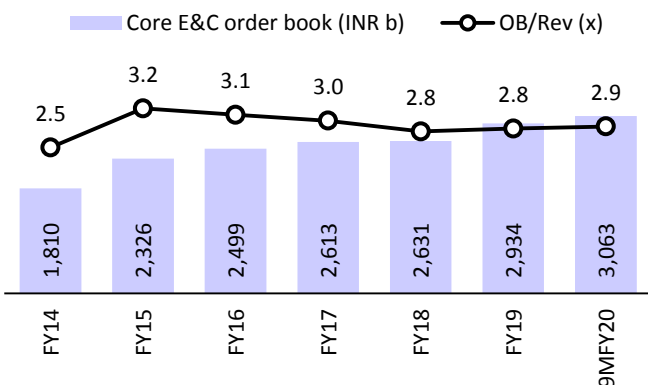
Source: MOFSL, Company, Ex-PG

Exhibit 4: ABB: We forecast CY19–22E CAGR at just 8.4%, after building in sharp decline over next two quarters



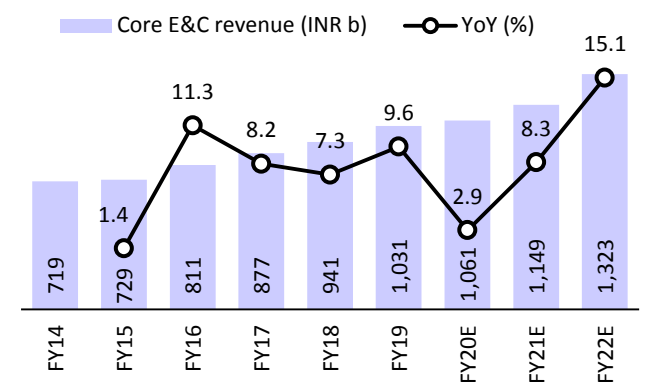
Source: MOFSL, Company, Ex-PG

Exhibit 5: L&T core E&C: OB/Rev of ~3x gives strong visibility



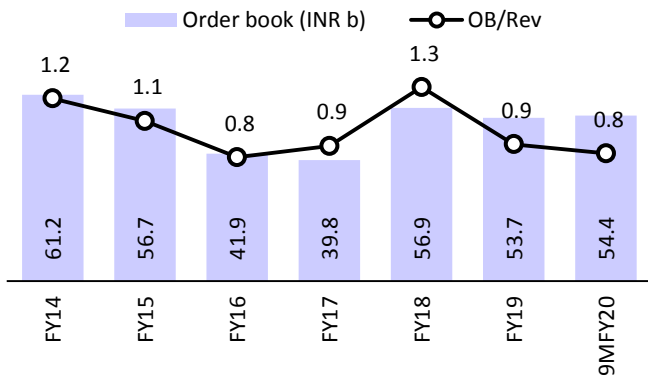
Source: MOFSL, Company

Exhibit 6: L&T: Core E&C business expected to grow at revenue CAGR of 11.7% over FY20–22E



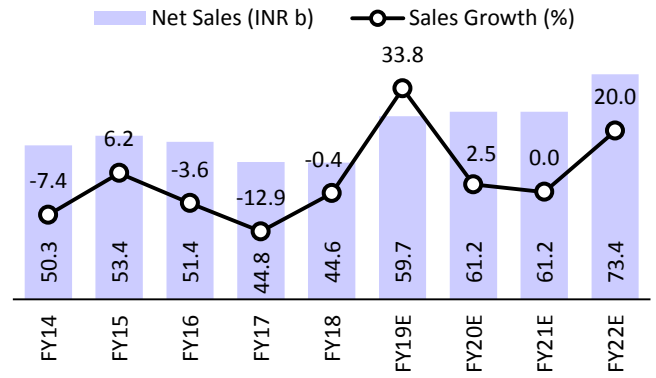
Source: MOFSL, Company

Exhibit 7: Thermax: OB/Rev ratio weakens on faster OB depletion



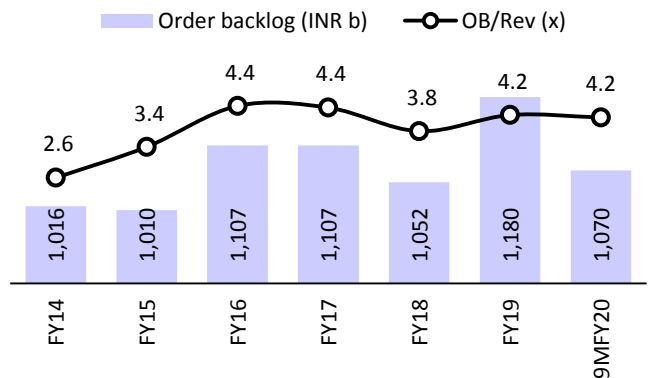
Source: MOFSL, Company

Exhibit 8: Thermax: Downside risk over revenue assumptions if order inflow does not rebound



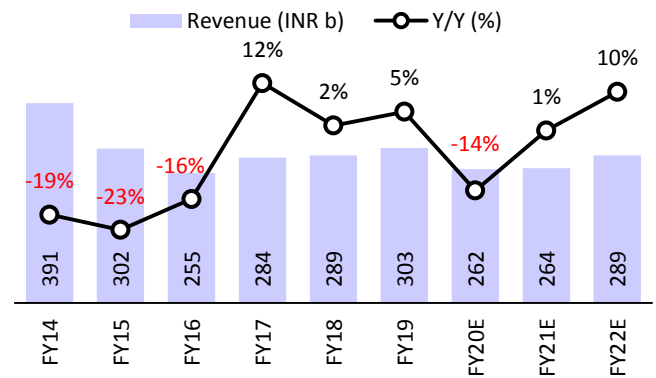
Source: MOFSL, Company

Exhibit 9: BHEL: OB marked with slow-moving orders



Source: MOFSL, Company

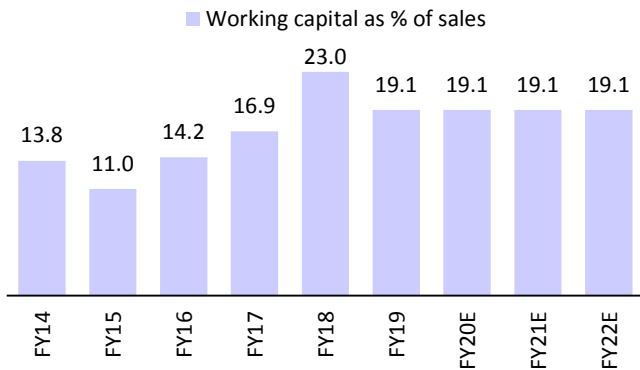
Exhibit 10: BHEL: Revenue to grow at 5% CAGR over FY20–22E



Source: MOFSL, Company

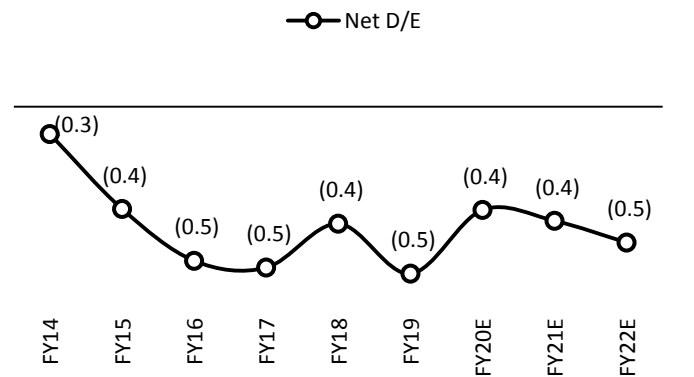
Working capital and balance sheet strength across companies

Exhibit 11: Siemens: Low working capital requirements



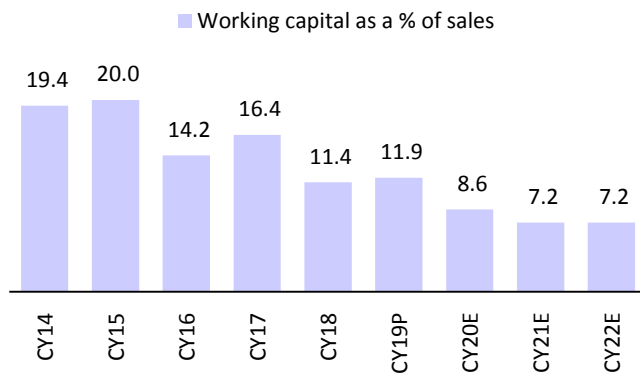
Source: MOFSL, Company

Exhibit 12: Siemens: Improving cash position with no leverage



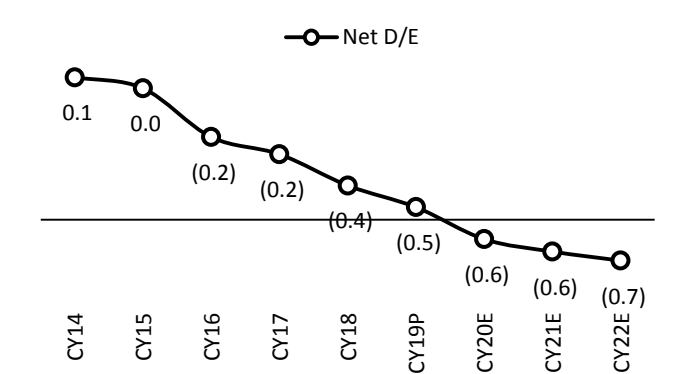
Source: MOFSL, Company

Exhibit 13: ABB: Working capital requirement gradually reduces owing to short-cycle nature of business



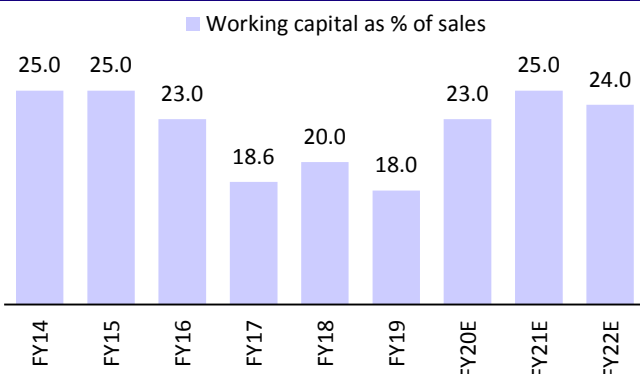
Source: MOFSL, Company

Exhibit 14: ABB: Healthy cash position leads to improvement in net D/E



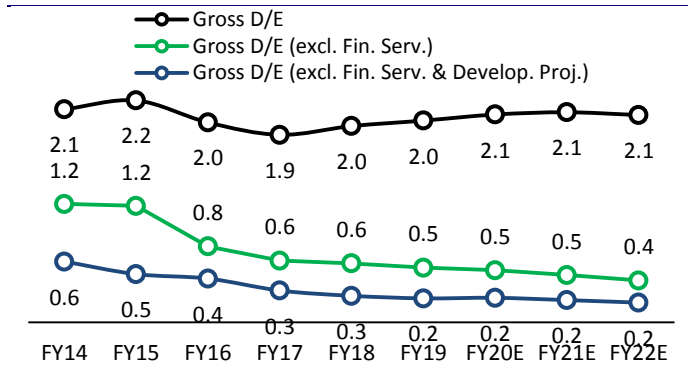
Source: MOFSL, Company

Exhibit 15: L&T core E&C: We build in escalation of working capital in FY21



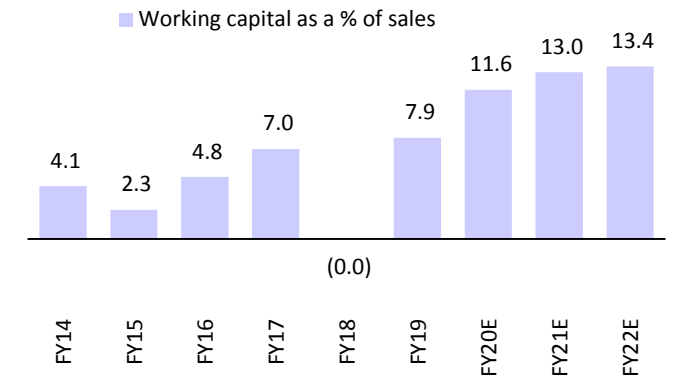
Source: MOFSL, Company

Exhibit 16: L&T core E&C: Core E&C leverage to remain under control at 0.2x although gross leverage may look higher owing to NBFC debt



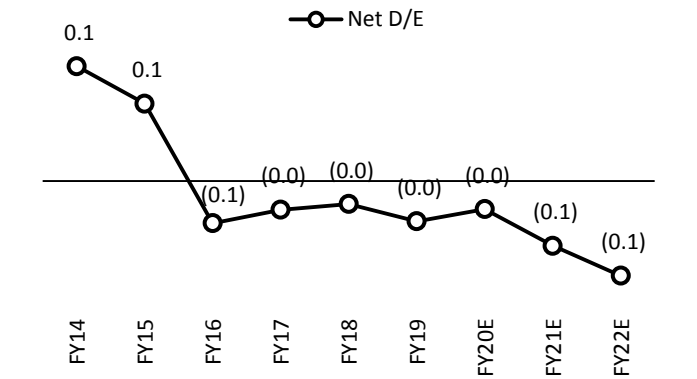
Source: MOFSL, Company

Exhibit 17: Thermax: Working capital expected to rise



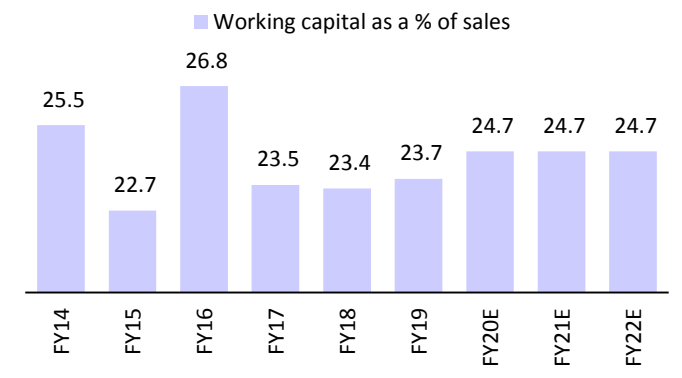
Source: MOFSL, Company

Exhibit 18: Thermax: Balance sheet remains strong



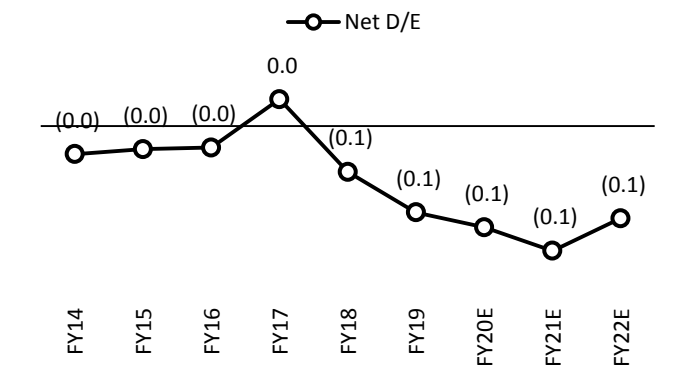
Source: MOFSL, Company

Exhibit 19: Cummins: Working capital to remain elevated at ~25% of sales



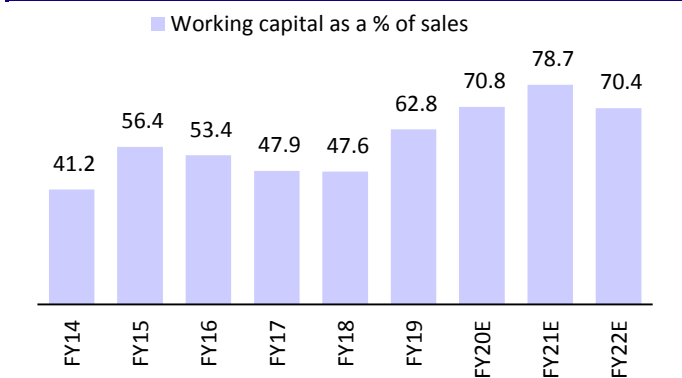
Source: MOFSL, Company

Exhibit 20: Cummins: Focus on cash flow leads to improvement in net D/E



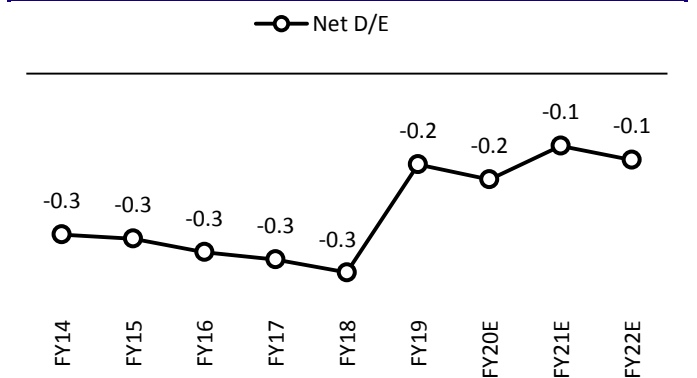
Source: MOFSL, Company

Exhibit 21: BHEL: Delay in receivables leads to rising working capital requirements



Source: MOFSL, Company

Exhibit 22: BHEL: While balance sheet is still net cash, large chunk of fund is stuck in working capital



Source: MOFSL, Company

Siemens has the best cash coverage of fixed costs

Exhibit 23: Fixed cost (FC) analysis and cash coverage ratio for key companies (INR m)

| Company | FY19 rev. | Operating FC | Int. exp. | Dep. | TFC (incl. Dep.) | as % of rev | TFC (excl. Dep.) | as % of rev | Cash coverage of TFC (in months) |
|---------|-----------|--------------|-----------|-------|------------------|-------------|------------------|-------------|----------------------------------|
| Siemens | 1,36,838 | 23,336 | 114 | 2,173 | 25,623 | 18.7 | 23,450 | 17.1 | 25 |
| ABB | 73,151 | 9,106 | 214 | 904 | 10,223 | 14.0 | 9,319 | 12.7 | 21 |
| Cummins | 56,590 | 7,521 | 162 | 1,103 | 8,786 | 15.5 | 7,683 | 13.6 | 15 |
| Thermax | 59,732 | 10,221 | 143 | 920 | 11,284 | 18.9 | 10,364 | 17.4 | 13 |

Source: MOFSL, Company

Earnings and TP change

Exhibit 24: We have cut earnings by 0–37% across our coverage universe over FY20–22E

| (INR m) | Old | | | New | | | Change (%) | | |
|---------|--------|--------|----------|--------|--------|----------|------------|-------|-------|
| | FY20E | FY21E | FY22E | FY20E | FY21E | FY22E | FY20E | FY21E | FY22E |
| L&T | 91,775 | 97,650 | 1,25,940 | 91,775 | 97,650 | 1,25,940 | - | - | - |
| Siemens | 13,663 | 14,462 | 16,814 | 10,481 | 13,256 | 14,988 | -23.3 | -8.3 | -10.9 |
| ABB | 4,965 | 6,348 | 7,555 | 3,322 | 5,686 | 6,599 | -33.1 | -10.4 | -12.7 |
| Cummins | 6,758 | 7,387 | 8,155 | 6,357 | 4,807 | 6,218 | -5.9 | -34.9 | -23.8 |
| Thermax | 2,801 | 3,276 | 4,419 | 2,801 | 3,276 | 4,419 | - | - | - |
| BHEL | 10,708 | 9,291 | 10,213 | 6,762 | 6,688 | 7,712 | -36.8 | -28.0 | -24.5 |

Source: MOFSL, Company

Exhibit 25: Maintain Buy on L&T and ABB

| | Earlier TP | Current TP | Rating | Valuation methodology |
|---------|------------|------------|---------|--|
| L&T | 1,320 | 1,320 | Buy | SOTP: (a) 18x Sep'21 core E&C (b) E&A sale net proceeds of INR112b (c) 30% discount to market cap of IT, TS, and Finance holdings (d) P/Inv-based valuation to development projects |
| ABB | 1,410 | 1,255 | Buy | 45x Mar'22 EPS |
| Siemens | 1,520 | 1,450 | Neutral | SOTP: (a) 35x Mar'22 EPS for core business (b) Acquisition value of C&S Electric |
| Cummins | 670 | 360 | Neutral | 16x Mar'22 EPS |
| Thermax | 855 | 865 | Neutral | 22x Mar'22 EPS |
| BHEL | 40 | 22 | Neutral | 10x Mar'22 EPS |

Source: MOFSL, Company

Exhibit 26: Valuation summary - Capital Goods

| Company name | Mkt Cap (INR bn) | CMP (INR) | TP (INR) | PE (x) | | | EV/EBITDA (x) | | | Net D/E (x) | | |
|---------------------------------|------------------|-----------|----------|-------------|-------------|-------------|---------------|-------------|-------------|-------------|------------|------------|
| | | | | FY20E | FY21E | FY22E | FY20E | FY21E | FY22E | FY20E | FY21E | FY22E |
| L&T | 1,136 | 808 | 1,320 | 12.3 | 11.6 | 9.0 | 18.4 | 16.8 | 14.3 | 2.0 | 2.0 | 1.8 |
| ABB | 197 | 929 | 1,255 | 56.8 | 50.3 | 33.3 | 35.4 | 34.0 | 22.1 | -0.3 | -0.3 | -0.3 |
| Siemens | 394 | 1,106 | 1,450 | 36.9 | 33.2 | 27.9 | 25.2 | 23.1 | 18.6 | -0.5 | -0.5 | -0.5 |
| Thermax | 80 | 714 | 865 | 28.7 | 24.5 | 18.2 | 16.6 | 16.5 | 12.2 | 0.0 | -0.1 | -0.1 |
| Cummins | 91 | 330 | 360 | 14.4 | 19.0 | 14.7 | 13.3 | 15.9 | 12.2 | -0.1 | -0.1 | -0.1 |
| BHEL | 74 | 21 | 22 | 10.9 | 11.1 | 9.6 | 1.2 | 2.6 | 1.8 | -0.2 | -0.1 | -0.1 |
| Mkt Cap weighted average | | | | 22.4 | 20.6 | 15.9 | 20.5 | 19.2 | 15.3 | 1.0 | 1.0 | 0.9 |

Source: MOFSL, Company, Bloomberg

| Explanation of Investment Rating | |
|----------------------------------|--|
| Investment Rating | Expected return (over 12-month) |
| BUY | >=15% |
| SELL | < - 10% |
| NEUTRAL | < - 10 % to 15% |
| UNDER REVIEW | Rating may undergo a change |
| NOT RATED | We have forward looking estimates for the stock but we refrain from assigning recommendation |

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