

BGR Energy

BSE SENSEX	S&P CNX
16,883	5,069
Bloomberg	BGRL IN
Equity Shares (m)	72.0
52-Week Range (INR)	784/280
1,6,12 Rel. Perf. (%)	-15/-35/-47
M.Cap. (INR b)	20.2
M.Cap. (USD b)	0.4

CMP: INR281

TP: INR266

Neutral

YEAR	NET SALES	PAT	EPS	EPS	P/E	P/BV	ROE	ROCE	EVI	EVI
END	(INR M)	(INR M)	(INR)	GR (%)	(X)	(X)	(%)	(%)	SALES	EBITDA
03/10A	30,779	2,016	28.0	74.2	-	-	31.7	15.7	-	-
03/11A	47,632	3,226	44.7	59.7	6.3	2.1	38.9	16.8	0.5	4.2
03/12E	42,942	2,627	36.4	-18.6	7.7	1.8	25.2	10.8	0.8	6.7
03/13E	44,228	2,402	33.3	-8.6	8.4	1.5	19.7	8.7	0.8	6.7

- 2QFY12 results below estimates; Revenue falls significantly:** BGR Energy Systems (BGRL) reported 2QFY12 revenue of INR7.7b (down 32% YoY), significantly below our estimate of INR12.7b (up 12% YoY). Revenue was impacted by a longer monsoon and delayed offtake by customers in some cases. PAT was INR514m (down 34% YoY), below our estimate of INR846m (up 9% YoY).
- EBITDA margins benefited from less project-specific delivery:** EBITDA margin was up 260bp YoY at 14.3%, ahead of our estimate of 11.8%, driven by a favorable sales mix (higher BOP sales). There were delays in project-specific deliveries, related to Kalisindh and Mettur projects in 2QFY12, which resulted in higher margins at the cost of lower sales. We expect margins to contract in FY12 and FY13, driven by a speed up in project-specific deliveries.
- Extended slowdown in order intake disappoints:** The order book is at about INR72b (INR79b at the end of FY11, INR94b as at 1QFY11). Rajasthan SEB order was delayed further, which is disappointing. On the positive side, BGRL is likely to win orders worth INR30b for four TG sets in NTPC bulk tender-2. We expect order intake of about INR15b-20b (apart from NTPC bulk tender-2 for a 9x 800MW project in which BGRL is L1) through the rest of the year.
- Execution healthy; Poor growth visibility in FY12:** Execution is healthy though 2QFY12 revenues were hit by delays in project-specific delivery. BGRL is executing three major projects: A BOP order for a 2x 500MW project worth INR16.3b (36% complete) from Mahagenco, a 2x 500MW project worth INR16.3b (21% complete) from Chattisgarh State Electricity and a 2x 660MW BOP order (INR21.6b) from Thermal Powertech Corporation in Andhra Pradesh.
- Rising working capital loans worrying, balance sheet deteriorating:** Gross debt rose to INR23b at the end of 2QFY12 from INR14b at the end of 2QFY11 and INR13b at the end of FY11, mainly due to a rise in net working capital, which increased due to a rise in debtors and retention money. Interest cost rose sharply due to a rise in debt.
- Cutting estimates, downgrading stock to Neutral:** We cut our FY12 and FY13 earnings estimates by 26% and 37% respectively in the light of a poor order pipeline and deteriorating revenue visibility. We downgrade BGRL to **Neutral** with a revised target price of INR266, based on 8x FY13E earnings. We have lowered our target P/E multiple to 8x from 10x. We believe it will be challenging for BGRL to secure new orders in the foreseeable future.

Quarterly Performance (Standalone)

Y/E March	(INR Million)								FY11	FY12E
	FY11				FY12					
	1Q	2Q	3Q	4Q	1Q	2Q	3QE	4QE		
Sales	9,067	11,356	12,569	14,616	7,342	7,715	10,736	17,150	47,608	42,942
Change (%)	191.5	143.7	97.9	-11.8	-19.0	-32.1	-14.6	17.3	55.1	-9.8
EBITDA	1,038	1,323	1,472	1,674	961	1,102	1,218	1,918	5,507	5,199
Change (%)	145.7	122.0	106.1	-4.5	-7.4	-16.7	-17.2	14.6	58.2	-5.6
As of % Sales	11.4	11.7	11.7	11.5	13.1	14.3	11.3	11.2	11.6	12.1
Depreciation	31	33	34	70	37	40	45	44	168	166
Interest	116	138	168	183	180	302	302	303	605	1,087
Other Income	26	26	17	17	0	0	3	2	86	5
PBT	917	1,178	1,287	1,438	743	761	874	1,572	4,820	3,951
Tax	312	400	411	454	241	247	293	543	1,578	1,324
Effective Tax Rate (%)	34.0	34.0	32.0	31.6	32.4	32.5	33.5	34.5	32.7	33.5
Reported PAT	605	778	876	984	503	514	581	1,030	3,242	2,627
Change (%)	199.2	154.5	108.9	-9.2	-17.0	-34.0	-33.6	4.7	61.3	-19.0
Adj PAT	605	778	876	984	503	514	581	1,030	3,242	2,627
Change (%)	199.2	154.5	108.9	(9.2)	(17.0)	(34.0)	(33.6)	4.7	61.3	(19.0)

E: MOSL Estimates

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2QFY12 results below estimates; Exhausting order book a major concern; Cutting estimates sharply; Downgrade to Neutral

- **2QFY12 results below estimates; Revenue falls significantly:** BGR Energy Systems (BGRL) reported 2QFY12 revenue of INR7.7b (down 32% YoY), significantly below our estimate of INR12.7b (up 12% YoY). Revenue was impacted by a longer monsoon and delayed offtake by customers in some cases. EBITDA margin was up 260bp YoY at 14.3%, ahead of our estimate of 11.8%, driven by a favorable sales mix (higher BOP sales). PAT was INR514m (down 34% YoY) below our estimate of INR846m (up 9% YoY).
- **EBITDA margins benefit from less project-specific delivery:** EBITDA margins improved due to a favorable mix, driven by a higher contribution from BOP contracts relative to EPC contracts. BOP accounted for 45% of revenue in 2QFY12 against 20% a year earlier. There were delays in project-specific deliveries, related to Kalisindh and Mettur projects in 2QFY12, which resulted in higher margin at the cost of lower sales. RM/sales declined 631bp YoY and employee cost/sales increased 118bp YoY. We expect margins to contract in FY12 and FY13, driven by a speed-up in project-specific deliveries.
- **Extended slowdown in order intake disappoints:** An exhausting order book remains a major concern for BGRL. The order book is currently at around INR72b (INR79b at the end of FY11, INR94b as at 1QFY11). The Rajasthan SEB order has been delayed further, which is disappointing. On the positive side BGRL is likely to win orders worth INR30b for four TG sets in NTPC bulk tender-2. We expect order intake of about INR15b-20b (besides, an NTPC bulk tender-2 for a 9x 800MW project in which BGRL is L1) over the rest of the year.
- **Execution healthy; Poor growth visibility in FY12:** Execution is healthy though 2QFY12 revenue was impacted by delays in certain project-specific deliveries. Currently BGRL is executing three major projects: A BOP order for a 2x 500MW project worth INR16.3b (36% complete) from Mahagenco, a 2x 500MW project worth INR16.3b (21% complete) from Chattisgarh State Electricity, and a 2x 660MW BOP order worth INR21.6b from Thermal Powertech Corporation in Krishnapatnam, AP.
- **Rising working capital loans worrying, balance sheet deteriorating:** Gross debt increased to INR23b at the end of 2QFY12 from INR14b at the end of 2QFY11 and INR13b at the end of FY11, mainly due to a rise in net working capital, which in turn, increased due to a rise in debtors and retention money. Interest cost increased sharply due to a rise in debt.
- **Cutting estimates, downgrading stock to Neutral:** We have cut our FY12 and FY13 earnings estimates by 26% and 37% respectively in the light of a poor pipeline of orders and deteriorating revenue visibility. We downgrade the stock to Neutral with a revised target price of INR266, based on 8x FY13E earnings (earlier Buy with a target price INR524). We have lowered our target P/E multiple to 8x from 10x due to lack of order visibility, downside risk to earnings and a worsening balance sheet. We believe it will be challenging for BGRL to secure new orders in the foreseeable future.

2QFY12 results below estimates; Revenue falls significantly

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- EBITDA margin was up 260bp YoY at 14.3%, ahead of our estimate of 11.8%, driven by a favorable sales mix (higher BOP sales).
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EBITDA margins benefit from less project-specific delivery

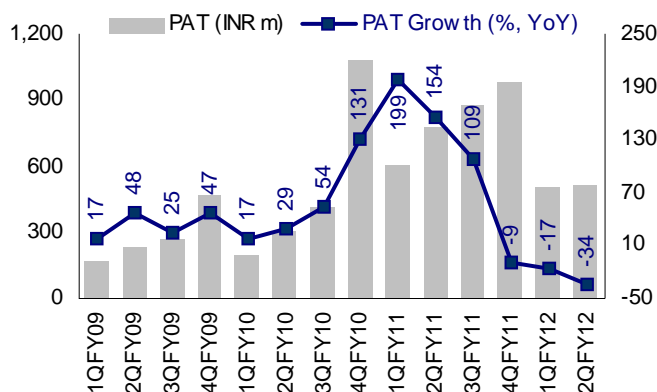
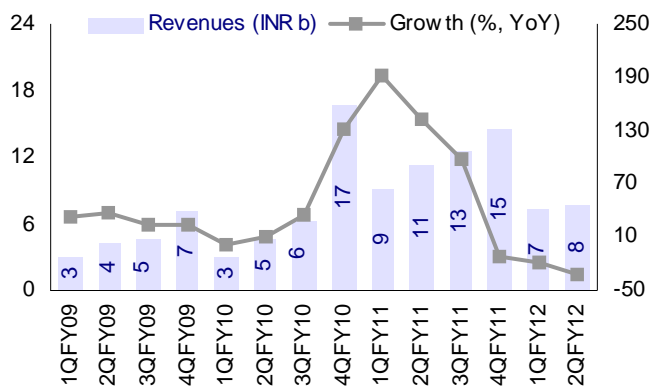
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- There were delays in project-specific deliveries related to Kalisindh and Mettur projects in 2QFY12, which resulted in higher margins at the cost of lower sales. RM/sales declined 631bp YoY and employee cost/sales increased 118bp YoY.
- We expect margins to contract in FY12 and FY13, driven by a speed-up in project-specific deliveries.

Execution healthy; Poor growth visibility in FY12

- BGRL is executing two large EPC projects in Rajasthan (2x 600MW, INR49b) and Tamil Nadu (1x 300MW, INR31b), both awarded in 2008. The projects are 80-90% complete and have been driving revenue growth in recent quarters.
- Currently BGRL is executing three major projects: A BOP order for a 2x 500MW project, worth INR16.3b (36% complete) from Mahagenco, a 2x500MW project worth INR16.3b (21% complete) from Chattisgarh State Electricity and a 2x 660MW BOP order worth INR21.6b from Thermal Powertech Corporation in Krishnapatnam, AP.

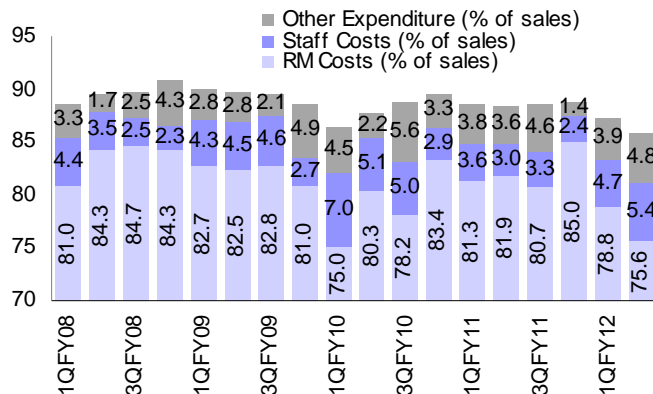
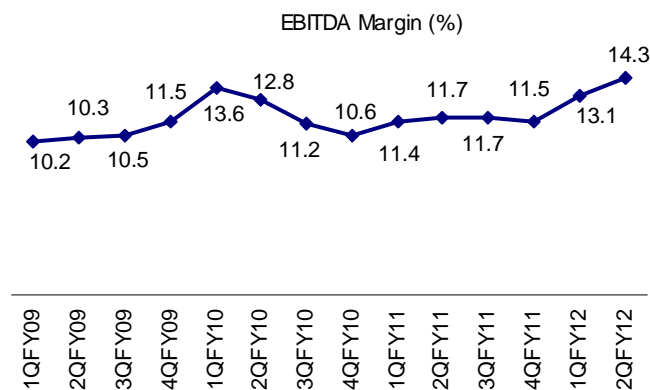
BGRL revenue growth declines due to deteriorating order book

BGRL PAT declines by 34% YoY in 2QFY12



BGRL margins improve, supported by a favorable sales mix

RM cost declines due to fewer project-specific deliveries



Source: Company/MOSL

Rising working capital loans worrying, balance sheet deteriorating

- Gross debt increased to INR23b at the end of 2QFY12 against INR14b at the end of 2QFY11 and INR13b at the end of FY11.
- Debt increased mainly due to a significant increase in net working capital, which rose from 103 days at the end of FY11 to 206 days at the end of 2QFY12. Debtors went up from 243 days at the end of FY11 to 341 days at the end of 2QFY12, due to a sharp rise in retention money, which was INR13b at the end of 2QFY12 (INR9b due to projects under execution and INR4b against completed projects) v/s INR11b at the end of FY11. BGRL expects debt to fall to INR20b by the end of the year as part of retention money is realized.
- Due to a sharp rise in debt, interest costs more than doubled (up 118% YoY) in 2QFY12. Interest costs as a percentage of sales increased by 270bp to 2.9% in 2QFY12 from 1.2% of sales in 2QFY11.

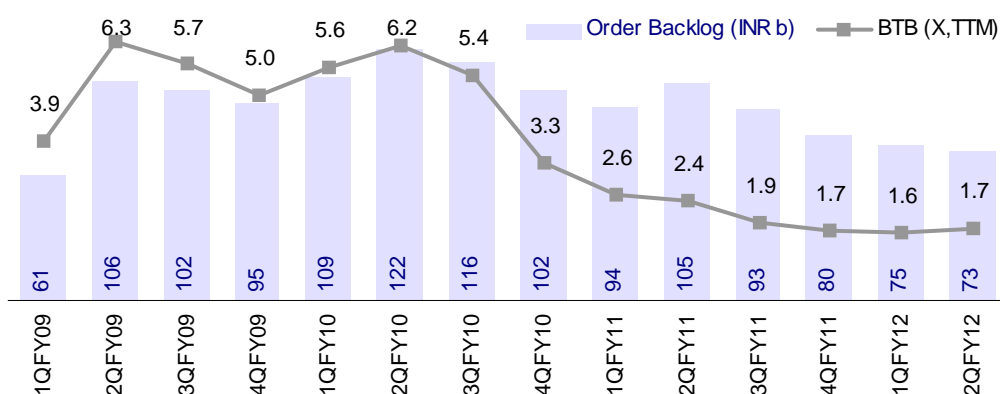
Balance Sheet (INR m)

	Sept'10	March'11	Sept'11
Share Capital	721	722	722
Reserves & surpluses	7,743	8,776	9,792
Net worth	8,464	9,498	10,514
Loan Funds	14,224	13,363	23,074
Deferred Tax Liability	1,884	3,117	3,304
Capital Employed	24,572	25,978	36,891
Net Fixed Assets	1,618	1,754	1,972
Investments	1,368	1,368	2,149
Inventories	252	384	387
Sundry Debtors	28,875	31,572	39,325
Cash and bank balance	8,275	9,465	9,026
Other current assets	316	478	391
Loans & advances	6,951	8,369	9,601
Current Liabilities	20,502	23,868	22,666
Provisions	2,580	3,544	3,294
Net Current Assets	21,587	22,856	32,770
Total Assets	24,572	25,978	36,891

Source: Company/MOSL

Extended slowdown in order intake disappoints

- An exhausting order book remains a major concern for BGRL. The order book is at around INR72b (INR79b at the end of FY11, INR94b as at 1QFY11).
- BGRL received orders worth INR7.9b during the first half of the year. Orders worth INR122b from Rajasthan SEB for two projects of 2x 660MW each, in which BHEL and BGR were shortlisted, were expected to be placed by December 2011. However, the projects have been stalled for more than a year due to delays in getting coal linkages and environmental clearances.
- On the positive side, BGRL is L1 in bidding for TG sets in NTPC's bulk tender-2 for a 9x 800MW project in which BGRL is likely to win orders worth INR30b. BGRL is also in the race for a INR130b NTPC project (along with BHEL and L&T).
- We expect order intake of INR15b-20b (besides NTPC bulk tender-2 for a 9x 800MW project, in which BGRL is L1) over the rest of the year.

BGRL BTB ratio has been declining since 3QFY10

Source: Company/MOSL

Success in NTPC bulk tender will improve outlook for manufacturing JVs

- BGRL is L1 in the TG package of an NTPC bulk tender, and is expected to secure orders worth INR30b (for the supply of 4 TG sets). It is also in the race along with BHEL and L&T for NTPC's boiler package, a 11x 660MW project, worth INR110b.
- BGRL will spend INR44b over 3.5 years to set up a super-critical boiler and turbine manufacturing facility through a JV with Hitachi, Japan.
- The current debt/equity structure for the JV is 3.5:1 and it looks steep, but the management is confident that with cash flows from current operations, D/E will not go above 2:1. The JV will be held by BGRL and Hitachi in the ratio of 74:26 for the turbine JV (INR30b investment) and 70:30 for the boiler JV (INR14b investment). The total equity commitment for BGRL stands at INR9.5b.
- Success in NTPC's boiler package (under arbitration; price bids due) is critical for the growth of BGRL's manufacturing JVs.

Valuation and view

We have cut our FY12 and FY13 earnings estimates by 26% and 37% respectively in the light of a poor pipeline of orders and deteriorating revenue visibility. Our revised EPS stands at INR36.4 and INR33.3 for FY12 and FY13 respectively. We expect revenue and PAT to post negative CAGR of 4% and 14% respectively over F11-13. We believe the Indian power equipment market is going through a bad phase with slowing demand and rising costs. Lack of coal linkages, volatile spot prices and other hurdles such as land availability adversely impacted new project awards over the past year. At current market prices BGRL trades at 8x FY12E EPS and 9x FY13E EPS. We downgrade the stock to **Neutral** with a revised target price of INR266, based on 8x FY13E earnings (earlier Buy with a target price INR524).

Revised estimates (INR m)

	Revised		Earlier		% Change	
	FY12	FY13	FY12	FY13	FY12	FY13
Sales	42,942	44,228	52,861	58,540	(18.8)	(24.4)
Growth (%)	(9.8)	3.0	11.0	10.7		
EBITDA	5,199	5,095	6,314	6,819	(17.7)	(25.3)
Margin (%)	12.1	11.5	11.9	11.6	120bp	80bp
PAT	2,627	2,402	3,539	3,784	(25.8)	(36.5)
Growth (%)	(18.6)	(8.6)	9.7	6.9		
EPS (INR)	36.4	33.3	49.0	52.4	(25.7)	(36.5)

Source: MOSL

BGR Energy: an investment profile

Company description

BGR Energy Systems (BGRL) is one of India's growing engineering companies in the power sector. BGRL carries the business in two segments namely the supply of systems and equipment and turnkey engineering project contracting. It was incorporated in 1985 as a JV between JV Energie Technik GmbH and Mr BG Raghupathy. BGRL employs about 1,700 people with 84% of them being engineers and the rest in support functions.

Key investment arguments

- BGRL, a strong BOP contractor, entered the power plant EPC business over the past two years. It is well placed to capitalize on a growing shortage of power plant contractors in India. BGRL has a JV with Hitachi to make boilers and turbine-generators, which could be a huge long-term growth driver.
- We believe BGRL is well placed for over INR150b worth of orders. Success in one or two EPC projects will drive strong earnings growth beyond FY12.

Key investment risks

- Margin compression is possible due to the entry into the super-critical BTG due to high initial import content (18-20%).
- Higher working capital days due to a large share of EPC projects in the revenue mix going forward can compress return ratios and cash flows.

Comparative valuations

		BGR	BHEL	L&T
P/E (x)	FY12E	7.7	11.8	16.4
	FY13E	8.4	10.3	14.4
P/BV (x)	FY12E	1.8	3.1	3.2
	FY13E	1.5	2.6	2.8
EV/Sales (x)	FY12E	0.8	1.3	1.6
	FY13E	0.8	1.1	1.4
EV/EBITDA (x)	FY12E	0.8	6.7	13.7
	FY13E	0.8	5.7	12.1

Shareholding pattern (%)

	Sep-11	Jun-11	Sep-10
Promoter	81.1	81.1	81.2
Domestic Inst	2.7	3.3	6.0
Foreign	5.6	6.9	7.6
Others	10.6	8.7	5.3

Recent developments

- BGR is L1 in a TG package for an NTPC bulk tender, and is expected to secure orders worth INR30b (for the supply of four TG sets). BGRL is also in the race (along with BHEL and L&T) for NTPC's boiler package, a 11x 660MW project worth INR110b.
- The Rajasthan SEB is due to award two BTG contracts of INR61b each (1,320MW each) in which BHEL is L1 and BGRL is L2. BGRL is confident of matching the L1 price in at least one of the orders, however the order has been delayed due to pending environment clearances.

Valuation and view

- Success in the forthcoming tenders is critical for BGRL's growth in FY13. BGRL needs to book orders worth INR80b-100b in FY12 to grow by 15% in FY13 which looks like an uphill task. We cut our FY12E and FY13E EPS by 26% and 37% respectively, in light of deteriorating outlook and a deteriorating balance sheet. Expect BGR to post negative CAGR of 4% and 14% in revenue and earnings, respectively, over FY11-13.
- We have lowered our target price to INR266 and lowered our target multiple to 8x from 10x earlier in light of increasing balance sheet risk. We downgrade the stock to **Neutral**.

Sector view

- We are Neutral about the sector.

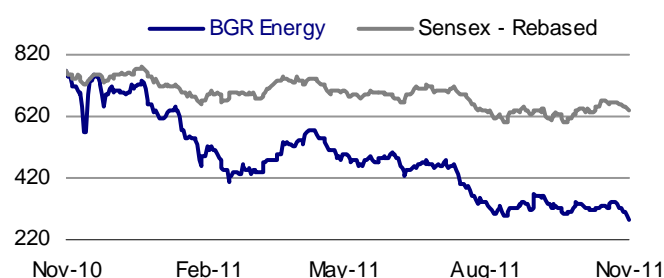
EPS: MOSL forecast v/s consensus (INR)

	MOSL Forecast	Consensus Forecast	Variation (%)
FY12	36.4	43.0	-15.3
FY13	33.3	42.6	-21.7

Target price and recommendation

Current Price (INR)	Target Price (INR)	Upside (%)	Reco.
281	266	-5.3	Neutral

Stock performance (1 year)



Financials and Valuation

Income Statement		(INR Million)				
Y/E March	2009	2010	2011	2012E	2013E	
Total Income	19,355	30,779	47,632	42,942	44,228	
Change (%)	27.3	59.0	54.8	-9.8	3.0	
Raw Material Cost	13,522	21,870	34,559	31,155	32,168	
Staff Cost	744	1,262	1,447	1,808	2,351	
Other Mfg. Expenses	2,948	4,161	6,130	4,780	4,614	
EBITDA	2,140	3,487	5,496	5,199	5,095	
Change (%)	37.8	62.9	57.6	-5.4	-2.0	
% of Net Sales	11.1	11.3	11.5	12.1	11.5	
Depreciation	75	103	174	166	204	
Interest	579	538	605	1,087	1,287	
Other Income	266	205	89	5	8	
PBT	1,752	3,051	4,806	3,951	3,611	
Tax	596	1,037	1,577	1,324	1,210	
Rate (%)	34.0	34.0	32.8	33.5	33.5	
Reported PAT	1,156	2,015	3,229	2,627	2,402	
Adjusted PAT	1,157	2,016	3,226	2,627	2,402	
Change (%)	29.2	74.2	60.0	-18.6	-8.6	

Balance Sheet		(INR Million)				
Y/E March	2009	2010	2011	2012E	2013E	
Share Capital	720	720	722	722	722	
Reserves	4,919	6,343	8,798	10,583	12,395	
Net Worth	5,639	7,063	9,520	11,305	13,117	
Loans	7,090	8,075	13,373	22,258	24,548	
Differed Tax Liability	775	1,580	3,596	2,057	1,288	
Capital Employed	13,504	16,717	26,490	35,621	38,953	
Gross Fixed Assets	1,245	1,819	2,508	3,074	3,640	
Less: Depreciation	268	365	530	697	901	
Net Fixed Assets	977	1,454	1,978	2,377	2,739	
Capital WIP	54	104	862	350	350	
Goodwill	6	6	6	6	6	
Investments	5	5	5	1,525	6,046	
Curr. Assets	25,690	36,438	51,155	55,838	56,485	
Inventory	140	162	411	394	407	
Debtors	12,789	19,803	31,580	38,692	36,219	
Cash & Bank Balance	6,152	9,019	10,449	7,910	10,753	
Loans & Advances	6,432	7,273	8,400	8,559	8,813	
Other Current Assets	178	181	315	284	293	
Curr. Liab. & Prov.	13,229	21,289	27,516	24,476	26,673	
Creditors	4,413	11,028	16,274	14,477	15,010	
Other Liabilities	8,138	7,928	7,697	6,450	8,453	
Provisions	677	2,334	3,545	3,549	3,211	
Net Current Assets	12,462	15,148	23,639	31,362	29,811	
Appli. of Funds	13,504	16,717	26,490	35,621	38,953	

E: MOSL Estimates

Ratios						
Y/E March	2009	2010	2011	2012E	2013E	
Basic (INR)						
EPS	16.1	28.0	44.7	36.4	33.3	
Growth (%)	29.2	74.2	59.7	-18.6	-8.6	
Cash EPS	17.1	29.4	47.2	38.8	36.2	
Book Value	78.3	98.1	132.2	157.0	182.2	
DPS	3.0	7.0	10.0	10.0	7.0	
Payout (incl. Div. Tax.)	21.8	29.3	26.1	32.1	24.6	
Valuation (x)						
P/E			6.3	7.7	8.4	
Cash P/E			6.0	7.2	7.8	
EV/EBITDA			4.2	6.7	6.7	
EV/Sales			0.5	0.8	0.8	
Price/Book Value			2.1	1.8	1.5	
Dividend Yield (%)			3.6	3.6	2.5	
Return Ratio						
RoE	22.3	31.7	38.9	25.2	19.7	
RoCE	13.0	15.7	16.8	10.8	8.7	

Turnover Ratios						
Debtors (Days)	241	235	242	329	299	
Inventory (Days)	1	1	1	1	1	
Creditors (Days)	23	36	34	34	34	
Asset Turnover (x)	1.4	1.8	1.8	1.2	1.1	
Leverage Ratio						
Debt/Equity (x)	1.3	1.1	1.4	2.0	1.9	

Cash Flow Statement		(INR Million)				
Y/E March	2009	2010	2011	2012E	2013E	
PBT bef. EO Items	1,752	3,051	4,806	3,951	3,611	
Add : Depreciation	75	103	174	166	204	
Interest	579	538	605	1,087	1,287	
Less : Direct taxes paid	596	1,037	1,577	1,324	1,210	
(Inc)/Dec in WWC	-1,292	180	-7,060	-10,262	4,395	
CF from Operations	519	2,835	-3,052	-6,382	8,287	
CF from Op. Incl. EO Item	519	2,835	-3,052	-6,382	8,287	
(Inc)/Dec in FA	-568	-629	-1,456	-54	-566	
(Pur)/Sale of Investments	1,509	0	0	-1,520	-4,521	
CF from Investments	941	-629	-1,456	-1,574	-5,087	
(Inc)/Dec in Net Worth	391	804	2,087	-1,539	-769	
(Inc)/Dec in Debt	2,063	985	5,299	8,885	2,289	
Less : Interest Paid	579	538	605	1,087	1,287	
Dividend Paid	253	590	842	842	590	
CF from Fin. Activity	1,622	661	5,939	5,417	-357	
Inc/Dec of Cash	3,081	2,867	1,430	-2,539	2,843	
Add: Beginning Balance	3,070	6,152	9,019	10,449	7,910	
Closing Balance	6,152	9,019	10,449	7,910	10,753	

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