

Bharat Heavy Electricals

20 September 2012

Reuters: BHEL.BO; Bloomberg: BHEL IN

Likely To Escape Coalgate, But New Orders Key

Bharat Heavy Electricals (BHEL) is likely to sail through safely without being majorly impacted by the ongoing coal mine controversy and subsequent review by the Inter Ministerial group (IMG) for coal block de-allocation. IMG is nearing phase I of scrutiny of 29 coal mines allotted to the private sector. So far, no coal mine whose EPC/BTG contract has been awarded to BHEL, has witnessed de-allocation. While IMG has recommended deduction of bank guarantee in case of a couple of BHEL clients, GVK Power and DB Power, it is unlikely to result in any delay/cancellation of order execution for BHEL. However, we believe the key challenge for BHEL continues to be winning new incremental orders to arrest the likely decline in revenue growth along with pressure on margins. We maintain our revenue and earnings estimates for BHEL and also retain our Hold rating on it with a target price of Rs221.

GVK Power/DB Power projects to stay unaffected: IMG has recommended deduction of bank guarantee for Seregarha coal block of GVK Power and Durgapur II/Sariya coal block of DB Power. The recommendation will now be put before the coal ministry for final approval. BHEL has 2x270MW BTG order from GVK Power linked to power project with Seregarha coal mine and 2x600MW BTG order from DB Power linked to Durgapur II/Sariya coal block. Though deduction of bank guarantee does not pose the risk of coal block de-allocation, even in a worst-case scenario if GVK and DB Power were to lose coal blocks in future, our analysis (as shown in Exhibit 1) indicates that it would not impact BHEL.

Other projects unlikely to be affected: BHEL has four additional projects under execution which features in the Comptroller and Auditor General of India (CAG)/IMG list of coal block review. These include Monnet Power (2x525MW), Adhunik Power (2x270MW), Visa Power (2x600MW) and Jindal India Thermal Power (2x600MW). However, as explained in Exhibit 1, some of them have alternate coal linkages or have signed long-term PPAs (power purchase agreements) which places these power projects favourably.

Outlook: We believe the key challenge for BHEL continues to be winning new incremental orders to arrest the likely decline in revenue growth along with pressure on margins. BHEL is yet to be awarded orders worth Rs93.8bn by NTPC through its bulk tenders, affecting its execution traction. In addition, compression in operating margin is likely to lead to earnings CAGR decline of 7.9% over FY12-14E capping its valuation. We value the stock at 9x FY14E EPS of Rs24.6 with a target price of Rs221 and retain our Hold rating on it.

Y/E Mar (Rsmn)	FY10	FY11	FY12	FY13E	FY14E
Net sales	328,611	418,547	475,990	478,457	475,835
EBITDA	53,054	79,499	91,951	84,810	76,936
Net profit	42,961	60,534	70,873	65,141	60,151
EPS (Rs)	17.6	24.7	29.0	26.6	24.6
EPS growth (%)	37.4	40.4	17.1	(8.1)	(7.7)
EBITDA margin (%)	16.1	19.0	19.3	17.7	16.2
PER (x)	12.3	8.7	7.5	8.1	8.8
P/BV (x)	3.3	2.6	2.1	1.8	1.6
EV/EBITDA (x)	8.1	5.5	4.6	4.9	4.3
Dividend yield (%)	2.5	3.4	3.7	3.7	3.7
RoCE (%)	34.1	40.7	36.1	27.1	21.1
RoE (%)	29.8	33.6	31.4	24.1	19.4

Source: Company, Nirmal Bang Institutional Equities Research

HOLD

Sector: Capital Goods

CMP: Rs216

Target Price: Rs221

Upside: 2%

Chirag Muchhala

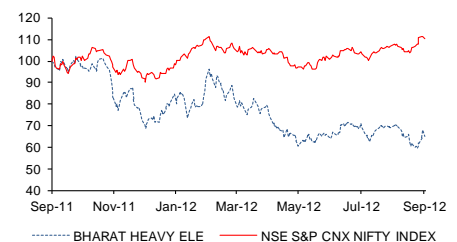
chirag.muchhala@nirmalbang.com

+91-22-3926 8092

Key Data

Current Shares O/S (mn)	2,447.6
Mkt Cap (Rsbn/US\$bn)	529.0/9.7
52 Wk H / L (Rs)	344/195
Daily Vol. (3M NSE Avg.)	4,401,571

One Year Indexed Stock Performance



Price Performance (%)

	1 M	6 M	1 Yr
BHEL	(5.8)	(17.6)	(34.1)
Nifty Index	3.5	5.7	10.4

Source: Bloomberg

Exhibit 1: BHEL - List of projects under execution named in CAG/IMG list

Company	Power project	MW	Linked coal block	Coal block allocation date	BTG award date	Remarks
GVK Power	Goindwal Sahib TPP	2x270	Tokisud and Seregarha	9-Jan-08	29-Aug-08	Seregarha mine faces deduction of bank guarantee, but Tokisud mine is not in CAG list, Project has PPA with PSPCL (Punjab) for 25 years, Most of the execution is complete as the project is scheduled to be commissioned in FY14.
DB Power	Baradarha TPP	2x600	Durgapur II/Sariya	6-Nov-07	19-Jul-10	Captive coal block of Durgapur II/Sariya has only 2mtpa capacity whereas 5mtpa coal linkage is through Coal India, PPA for 100% power supply has been signed.
Monnet Power	Malibrahmi TPP	2x525	Mandakini	9-Jan-08	21-Aug-09	Utkal B2 mine of Monnet, named by IMG, is not associated with Malibrahmi TPP
Adhunik Power	Jamshedpur TPP	2x270	Ganeshpur	28-May-09	21-Dec-09	The company has secured tapering coal linkage to take care of the coal requirement till the captive mine is operational for 540MW.
Visa Power	Raigarh TPP	2x600	Fatehpur East	23-Jan-08	21-Sep-10	PPA signed with Chhattisgarh and West Bengal.
Jindal India Thermal Power	Derang TPP	2x600	Mandakini	9-Jan-08	7-Aug-09	In addition to Mandakini mines, Derang TPP has 25-year coal linkage with Mahanadi coalfields.

Source: Company, Nirmal Bang Institutional Equities Research (Note: TPP – Thermal Power Plant)

Exhibit 2: NTPC bulk tender orders yet to be awarded to BHEL

Projects	State	Unit size	Scope of work	Tendered in	Likely value (Rsbn)	Bids opened in
Nabinagar	Bihar	3x660	Boiler	Bulk Tender 1	27.8	Feb 2012
Darlipalli	Orissa	2x800	Boiler	Bulk Tender 2	25.4	Sept 2011
Gajmara	Orissa	2x800	Boiler & Turbines	Bulk Tender 2	40.6	Sept 2011
Total					93.8	

Source: Company, Nirmal Bang Institutional Equities Research

Ratings track

Date	Rating	Market price (Rs)	Target price (Rs)
27 January 2012	Buy	281	327
30 January 2012	Buy	274	327
4 April 2012	Hold	264	286
13 April 2012	Hold	257	286
24 May 2012	Hold	209	221
27 July 2012	Hold	212	221

Disclaimer

Stock Ratings Absolute Returns

BUY > 15%

HOLD 0-15%

SELL < 0%

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Team Details:

Name		Email Id	Direct Line
Rahul Arora	CEO	rahul.arora@nirmalbang.com	+91 22 3926 8098 / 99
Hemindra Hazari	Head of Research	hemindra.hazari@nirmalbang.com	+91 22 3926 8017 / 18

Sales and Dealing:

Neha Grover	AVP Sales	neha.grover@nirmalbang.com	+91 22 3926 8093
Ravi Jagtiani	Dealing Desk	ravi.jagtiani@nirmalbang.com	+91 22 3926 8230, +91 22 6636 8833
Sudhindar Rao	Dealing Desk	sudhindar.rao@nirmalbang.com	+91 22 3926 8229, +91 22 6636 8832
Pradeep Kasat	Dealing Desk	pradeep.kasat@nirmalbang.com	+91 22 3926 8100/8101, +91 22 6636 8831
Michael Pillai	Dealing Desk	michael.pillai@nirmalbang.com	+91 22 3926 8102/8103, +91 22 6636 8830

Nirmal Bang Equities Pvt. Ltd.

Correspondence Address

B-2, 301/302, Marathon Innova,
 Nr. Peninsula Corporate Park
 Lower Parel (W), Mumbai-400013.
 Board No. : 91 22 3926 8000/1
 Fax. : 022 3926 8010