

BSE SENSEX 18,518
S&P CNX 5,575

CMP: INR1,909

TP: INR2,465

Buy

	BHEL IN	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
Bloomberg	BHEL IN	03/10A	334,757	46,839	95.7	31.3			32.5	51.4		
Equity Shares (m)	489.5	03/11A	406,932	56,599	115.6	20.8	16.5	4.6	31.4	52.2	2.1	9.9
52-Week Range (INR)	2,695/1,873	03/12E	506,994	67,485	137.9	19.2	13.8	3.8	30.1	47.8	1.6	8.0
1,6,12 Rel. Perf. (%)	-3/-13/-25	03/13E	609,305	80,439	164.3	19.2	11.6	3.1	29.4	44.5	1.3	6.6
M.Cap. (INR b)	934.5											
M.Cap. (USD b)	20.6											

- 1QFY12 operational performance below expectations:** BHEL reported muted sales growth in 1QFY12. Revenue grew 10% YoY to INR71b, lower than our estimate of INR82b. However, net profit grew in line with expectations, led by margin expansion and higher other income. EBITDA margin was up 10bp YoY at 15.3% (higher than our estimate of 14.6%). Net profit was INR8.2b (up 15% YoY, adjusted), in line with our estimate of INR8.1b.
- Revenue growth adversely impacted by logistics issues:** The management highlighted that revenue could have been higher by INR6b-7b, but for some operational issues at ports. This led to a delay in the delivery of certain imported components, in turn resulting in lower sales for the quarter. These issues have been resolved and we expect execution to accelerate in the remainder of FY12. The company maintains its sales guidance of ~20%.
- Order intake muted; maintains guidance of 10% growth in order intake in FY12:** BHEL booked new orders worth INR25b in 1QFY12 against INR108b in 1QFY11. Orders in the power segment declined significantly while the industrial and international segments posted healthy growth of 36% YoY. The company has an impressive pipeline of orders (of around 9GW, including NTPC bulk order) at advanced stage of booking and another 1,500-2,000MW of orders with letter of intent. The management maintained its guidance of 10% growth in order intake in FY12. Given the pipeline of projects, we expect BHEL to meet its guidance.
- EBITDA margin expands, driven by favorable mix in industry business:** EBITDA margin expanded by 10bp YoY to 15.3%, driven by improvement in industry segment margin. Profitability of the power segment declined sharply, due to change in product mix. We expect BHEL to maintain EBITDA margin of ~20% in FY12-13 (21% in FY11).
- Valuation and view:** BHEL trades at 14x FY12E earnings and is attractively valued in context of the estimated 19% earnings CAGR over FY11-13. Our EPS estimates are INR138 (up 19%) for FY12 and INR164 (up 19%) for FY13. While concerns around the power sector may remain an overhang, pick-up in ordering will act as a key catalyst for the stock. Maintain **Buy**.

Quarterly Performance

Y/E March	FY11				FY12				(INR Million)	
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q	FY11	FY12
Sales (Ilet)	64,797	83,284	88,493	179,214	71,257	102,014	111,967	212,392	415,788	497,629
Change (%)	15.8	25.7	24.6	32.2	10.0	22.5	26.5	18.5	26.5	19.7
EBITDA	9,670	16,324	20,717	42,916	11,133	20,529	23,073	47,288	89,627	102,022
Change (%)	63.4	32.5	32.7	49.4	15.1	25.8	11.4	10.2	43.2	13.8
As a % Sales	14.6	19.2	23.0	23.4	15.3	19.7	20.2	21.9	21.1	20.1
Adjusted EBITDA	10,276	17,047	21,474	35,507	11,133	20,529	23,073	47,288	84,304	102,022
Change (%)	73.6	38.4	37.5	1.2	8.3	20.4	7.4	33.2	22.3	21.0
As a % Sales	15.2	19.6	23.2	22.2	15.3	19.7	20.2	21.9	20.7	20.1
Interest	38	59	145	305	88	52	127	214	547	482
Depreciation	1,269	1,341	1,447	1,384	1,709	1,700	1,700	1,700	5,441	6,809
Other Income	1,635	1,620	1,529	1,634	2,487	1,782	1,682	1,568	6,418	7,518
PBT	9,998	16,544	20,655	42,881	11,822	20,558	22,928	46,941	90,057	102,249
Tax	3,301	5,121	6,623	14,901	3,667	6,784	7,108	17,206	29,945	34,765
Effective Tax Rate (%)	33.0	31.0	32.1	34.7	31.0	33.0	31.0	36.7	33.3	34.0
Reported PAT	6,697	11,423	14,032	27,980	8,155	13,774	15,820	29,735	60,112	67,485
Change (%)	42.3	33.2	30.8	46.5	21.8	20.6	12.7	6.3	39.5	12.3
Adj. PAT	7,104	11,569	14,346	23,580	8,155	13,774	15,820	29,735	56,599	67,485
Change (%)	56.7	34.9	29.3	4.2	14.8	19.1	10.3	26.1	20.8	19.2

E: MOSL Estimates

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1QFY12 earnings in-line; lower revenue offset by improved margins, higher other income

BHEL reported disappointing financial performance for 1QFY12. Revenue grew 10% YoY to INR71b, lower than our estimate of INR82b. However, net profit grew in line with expectations, led by margin expansion and higher other income. EBITDA margin was up 10bp YoY at 15.3% (higher than our estimate of 14.6%). Net profit was INR8.2b (up 15% YoY, adjusted), in line with our estimate of INR8.1b.

Revenue growth adversely impacted by logistics issues: The management highlighted that revenue could have been higher by INR6b-7b, but for some operational issues at ports. This led to a delay in project exports, in turn resulting in deferment of revenue booking. JNPT was closed for almost six weeks, resulting in a delay in shipments. Revenue was impacted because of delays in component supply by collaborators.

Order intake muted; maintains guidance of 10% growth in order intake in FY12:

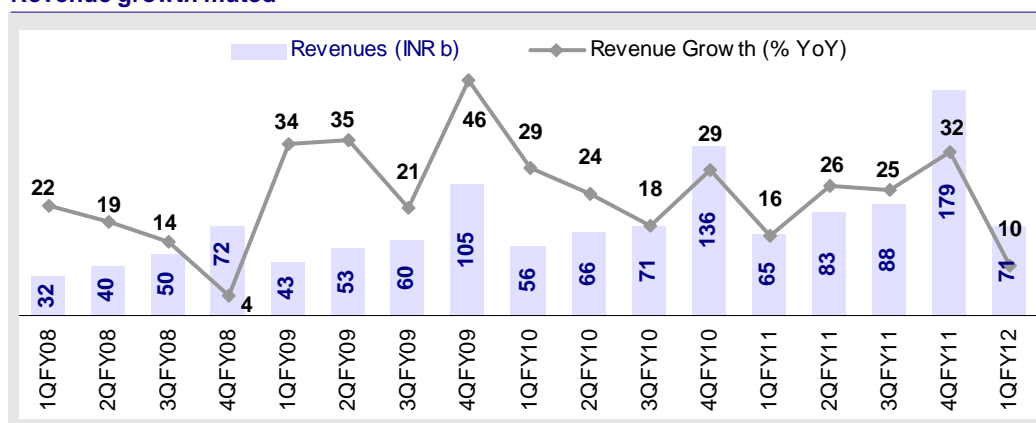
BHEL booked new orders worth INR25b in 1QFY12 against INR108b in 1QFY11. Orders in the power segment declined significantly while the industrial and international segments posted healthy growth of 36% YoY. The company has an impressive pipeline of orders (of around 9GW, including NTPC bulk order) at advanced stage of booking and another 1,500-2,000MW of orders with letter of intent. The management maintained its guidance of 10% growth in order intake in FY12. Given the pipeline of projects, we expect BHEL to meet its guidance.

EBITDA margin expands, driven by favorable mix in industry business: EBITDA margin expanded by 10bp YoY to 15.3%, driven by improvement in industry segment margin. Profitability of the power segment declined sharply, largely due to change in product mix. We expect BHEL to maintain EBITDA margin of ~20% in FY12-13 (21% in FY11).

Revenue growth adversely impacted by logistics issues; capacity expansion on track

- For 1QFY12, revenue was INR71b (+10% YoY), below our estimate of INR82b. While power segment revenue grew 7% YoY, industrial segment grew 19% YoY.
- The management highlighted that revenue could have been higher by INR6b-7b, but for some operational issues at ports. This led to a delay in project exports, in turn resulting in deferment of revenue booking. JNPT was closed for almost six weeks, resulting in a delay in shipments. Revenue was impacted because of delays in component supply by collaborators.
- The company is well on track to expand capacity to 20GW per annum by the end of FY12. With expanded capacity, we believe the company will be able to grow production at an accelerated pace in FY13-14.

Revenue growth muted



Source: Company/MOSL

PAT in line, driven by improved margins, lower tax and higher other income

- Adjusted PAT for 1QFY12 was INR8.2b (up 15% YoY), v/s our estimate of INR8.1b.
- Though revenue was lower than estimated, EBITDA margin expansion (up 10bp YoY), higher other income and lower tax rate enabled in-line PAT.
- Tax rate declined to 31% as against 33% in 1QFY11, because of tax credit of INR510m on account of R&D expense. Other income increased significantly to INR2,487m in 1QFY12 from INR1,635m in 1QFY11, driven by high interest income on cash.

Muted growth in power division; robust performance in industry segment

- For 1QFY12, power segment revenue was INR57.8b (up 7% YoY) while industrial segment revenue was INR16.5b (up 19% YoY). The power division contributed 81% to total revenue while the industrial division contributed 19%. EBIT margin for the power division declined significantly (down 324bp YoY) to 16.6% due to unfavorable sales mix. Industry segment margin expanded by over 1,000bp YoY to 22.6%, driven by favorable sales mix. The company highlighted that the margin shrinkage in the power segment is temporary.
- In the industry segment, BHEL has made new forays into railways (propulsion systems for locomotives of 700HP range with Alstom), defense (naval guns), etc. The management foresees a revenue growth of 20-25% for this segment over the next 4-5 years, with new segments driving growth.

Segmental performance (INR m)

	FY11				FY12
	1Q	2Q	3Q	4Q	
Revenues					
Power	53,999	69,650	72,820	151,444	57,803
Growth (%)	18.2	28.3	27.6	35.8	7.0
Industry	13,870	18,577	21,429	37,091	16,529
Growth (%)	4.1	16.4	18.9	17.8	19.2
EBIT					
Power	10,701	14,731	16,321	41,363	9,581
Growth (%)	29.2	78	45.5	216.1	(10.5)
Industry	1,704	3,055	4,542	9,851	3,733
Growth (%)	5.2	89	67.9	143.2	119.1
EBIT Margin (%)					
Power	19.8	21.1	22.4	27.3	16.6
Industry	12.3	16.4	21.2	26.6	22.6

Source: Company

EBITDA margin expanded 10bp, driven by favorable mix in industry business

- EBITDA margin expanded 10bp YoY to 15.3%, driven by improvement in industry segment margin. Profitability of the power segment declined sharply, largely due to change in product mix. We expect BHEL to maintain EBITDA margin of ~20% in FY12-13 (21% in FY11).
- RM/sales was 57.1% (down 64bp YoY) while SG&A/sales was up 235bp YoY.
- Staff cost declined 237bp YoY and stood at 18% of sales. The management guided overall staff cost of INR60b in FY12, an increase of over 10%, driven by 3% increase in wage rates and increase in employee base by ~3,000.

Operating cost break-up: material costs come down 64bp YoY

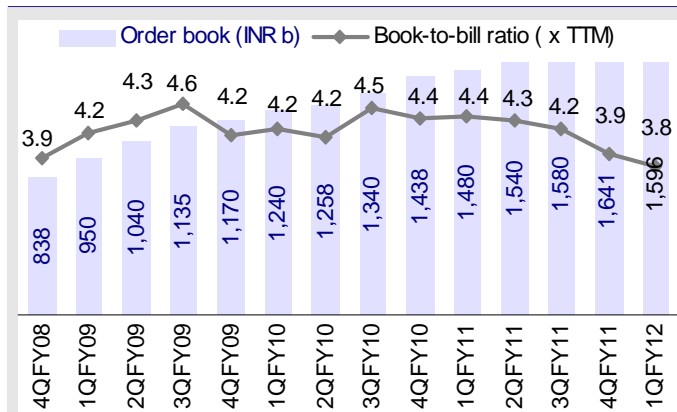
	1QFY10	2QFY10	3QFY10	4QFY10	1QFY11	2QFY11	3QFY11	4QFY11	4QFY11	YoY.
										Ch (bp)
RM Cost	62.5	56.4	54.5	57.6	57.7	58.5	53.3	48.7	57.1	-63.7
Staff Cost	19.6	15.9	17.0	12.5	20.3	14.9	14.9	7.9	17.9	-237.5
Other Costs	7.4	9.4	6.9	9.3	7.4	7.4	8.8	19.9	9.7	235.1

Source: Company

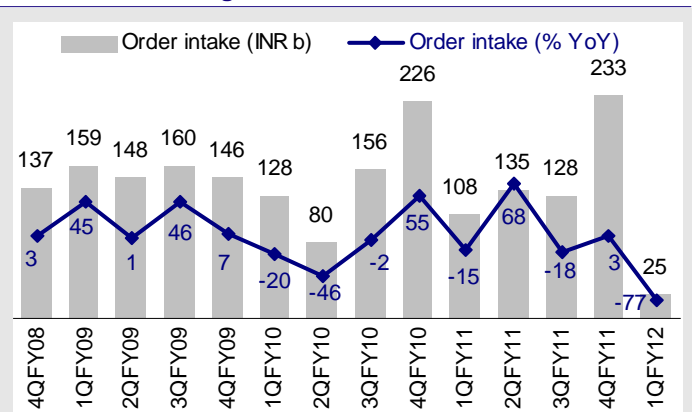
Order intake muted; maintains guidance of 10% growth in FY12

- BHEL's order book as at end-1QFY12 stood at INR1,596b (up 8% YoY, down 3% QoQ), adversely impacted by sluggish order inflow in the power segment.
- The company booked new orders worth INR25b in 1QFY12 against INR108b in 1QFY11. Orders in the power segment declined significantly while the industrial and international segments posted healthy growth of 36% YoY. The company has an impressive pipeline of orders (of around 9GW, including NTPC bulk order) at advanced stage of booking and another 1,500-2,000MW of orders with letter of intent.
- The management maintained its guidance of 10% growth in order intake in FY12. Given the pipeline of projects, we expect BHEL to meet its guidance.
- The Boiler order award, part of the bulk tendering by NTPC and DVC for 11 sets of 660MW is now under arbitration due to the stay order brought in by one of the bidders, Gammon-Ansaldo. The Supreme Court is expected to hear the case in the next few days, following which NTPC will open the price bids. Once this process is completed, we expect final award of 11x 660MW boiler and turbine package.
- The company has formed several joint ventures with SEBs for development of projects. Its JV with Karnataka SEB is already developing 16GW, while its JV with Tamil Nadu SEB is likely to award the contract by the end of FY12. BHEL's JVs with MP SEB and Maharashtra SEB will most likely to be pushed to next year.

Robust order book, BTB ratio to drive execution



Order intake during 1QFY12 was INR25b, down 77% YoY



Key highlights of 1QFY12 results conference call

- BHEL reported lower revenue growth during the quarter due to logistics issues at JNPT, a Mumbai-based port. Certain imported components could not be delivered, which impacted revenue by INR6b-7b. These issues have been resolved. The company expects to maintain strong execution during the current year and sees sales growing by around 20%.
- The company has maintained its guidance of 10% growth in order inflow for FY12 (order intake in FY11 at INR600b, power orders: 15GW), despite sluggish order booking in 1QFY12. The company highlighted that it has ~9,000MW (including NTPC bulk order) of power projects at advanced level of activity and will be awarded in the next few months. It already has letters of intent for 2GW orders. However, issues pertaining to coal linkages and land availability may have an impact on final award of these projects.
- The company has formed several joint ventures with SEBs for development of projects. Its JV with Karnataka SEB is already developing 16GW, while its JV with Tamil Nadu SEB is likely to award the contract by the end of FY12. BHEL's JVs with MP SEB and Maharashtra SEB will most likely to be pushed to next year.
- EBITDA margin improved during the quarter, largely due to sharp improvement in industry sector margin, driven by favorable sales mix. The company expects margins to be maintained in the foreseeable future.
- BHEL is expanding manufacturing capacity from 15GW per annum to 20GW per annum, which is likely to be commissioned by March 2012.

Other highlights

- Capex during FY12 is expected to be INR12b during the year. Working capital during the quarter was INR14.2b (INR12.6b as at end-FY11). Receivables were at INR305b (INR274b as at end-FY11). Inventory was at INR118b (INR110b as at end-FY11). Working capital increased in line with sales growth because of increase in retention money and lower growth in customer advances during the quarter.
- Tax rate declined during the quarter to 31% from 33% in 1QFY10 because of tax credit of INR510m on account of R&D expense.

Valuation and view

- We estimate revenue CAGR of 22% and PAT CAGR of 19% over FY11-13. Our EPS estimates are INR138 (up 19%) for FY12 and INR164 (up 19%) for FY13.
- BHEL trades at 14x FY12E earnings and is attractively valued in context of the estimated 19% earnings CAGR over FY11-13.
- While concerns around the power sector may remain an overhang, pick-up in ordering will act as a key catalyst for the stock. Maintain Buy.
- Our price target is INR2,465 (16x FY13E EPS), an upside of 30%.

BHEL: an investment profile

Company description

- BHEL, a PSU, is India's dominant producer of power and industrial machinery, and a leading EPC company.
- Post divestment, the government now has an equity stake of 67.7%. The company has 14 manufacturing divisions, 8 service centers, and 4 power sector regional centers, besides project sites across India and abroad. It has an annual installed capacity of 6,000MW.
- It has a tie-up with Alstom and an alliance with Siemens for the manufacture of super-critical 800MW boilers and turbines, respectively.

Key investment arguments

- Order backlog as at end-1QFY12 stands at INR1,596b, and book-to-bill ratio is 3.8x TTM revenue. BHEL offers the best revenue visibility in our Engineering universe. We estimate revenue CAGR of 22% and PAT CAGR of 19% over FY11-13.
- Post capacity expansion to 20GW by the end of FY12, BHEL's capacity will be at par with its Chinese and Korean counterparts, giving BHEL sizeable competitive muscle to compete, execute and deliver on time.

Key investment risks

- The key challenge is to meet execution deadlines and improve cost efficiencies.
- Intensified competition from Chinese, Korean and private Indian player (L&T).

Comparative valuations

		BHEL	L&T	Crompton
P/E (x)	FY12E	13.8	20.8	16.4
	FY13E	11.6	16.3	11.7
P/BV (x)	FY12E	3.8	4.4	2.7
	FY13E	3.1	3.8	2.3
EV/Sales (x)	FY12E	1.6	2.1	0.9
	FY13E	1.3	1.6	0.8
EV/EBITDA (x)	FY12E	8.0	17.2	9.7
	FY13E	6.6	13.8	7.0

Shareholding Pattern (%)

	Jun-11	Mar-11	Jun-10
Promoter	67.7	67.7	67.7
Domestic Inst	12.7	12.7	11.3
Foreign	13.2	13.0	15.0
Others	6.3	6.5	6.0

Recent developments

- The Boiler order award, part of the bulk tendering by NTPC and DVC for 11 sets of 660MW is under arbitration due to the stay order brought in by one of the bidders, Gammon-Ansaldo.
- The Supreme Court is expected to hear the case in the next few days, following which NTPC will open the price bids.
- The government of India is planning to divest its 5% stake in the company, through a Follow-on-offer (FPO). The sale is expected to be completed by October 2011.

Valuation and view

- We estimate revenue CAGR of 22% and PAT CAGR of 19% over FY11-13. Our EPS estimates are INR138 (up 19%) for FY12 and INR164 (up 19%) for FY13.
- BHEL trades at 14x FY12E earnings and is attractively valued in context of the estimated 19% earnings CAGR over FY11-13.
- While concerns around the power sector may remain an overhang, pick-up in ordering will act as a key catalyst for the stock. Maintain **Buy**. Our price target is INR2,465 (16x FY13E EPS), an upside of 30%.

Sector view

- We maintain our positive view on the sector.

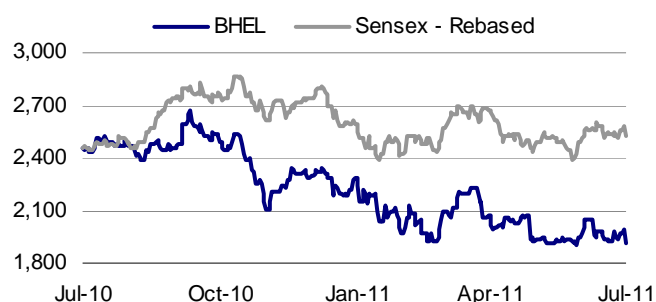
EPS: MOSL forecast v/s consensus (Rs)

	MOSL Forecast	Consensus Forecast	Variation (%)
FY12	137.9	139.7	-1.3
FY13	164.3	158.6	3.6

Target price and recommendation

Current Price (Rs)	Target Price (Rs)	Upside (%)	Reco.
1,909	2,465	29.1	Buy

Stock performance (1 year)



Financials and Valuation

Income Statement (INR Million)

Y/E March	2009	2010	2011	2012E	2013E
Total Income	267,879	334,757	406,932	506,994	609,305
Change (%)	35.8	25.4	21.0	25.1	20.3
Staff Cost	41,127	51,529	54,907	60,850	68,009
Mfg. Expenses	164,685	198,857	225,434	308,530	382,205
Selling Expenses	19,877	25,172	42,288	35,591	37,229
EBITDA	42,189	59,200	84,304	102,022	121,862
Change (%)	12.8	40.3	42.4	21.0	19.4
% of Net Sales	15.7	17.7	20.7	20.1	20.0
Depreciation	3,343	4,580	5,441	6,809	8,279
Interest	307	335	547	482	482
Other Income	9,829	11,549	6,418	7,518	8,776
Extra-ord. Items (net)	119	73	-4,509	0	0
PBT	48,488	65,907	90,057	102,249	121,878
Tax	17,106	22,800	30,759	34,765	41,438
Rate (%)	35.3	34.6	34.2	34.0	34.0
Reported PAT	31,382	43,106	60,112	67,485	80,439
Adjusted PAT	35,670	46,839	56,599	67,485	80,439
Change (%)	42.1	31.3	20.8	19.2	19.2

Balance Sheet (INR Million)

Y/E March	2009	2010	2011	2012E	2013E
Share Capital	4,895	4,895	4,895	4,895	4,895
Reserves	124,492	154,278	196,643	242,020	296,107
Net Worth	129,387	159,174	201,538	246,915	301,002
Loans	1,494	1,278	1,634	1,278	1,278
Differed Tax Liability	-18,403	-15,272	-21,636	0	0
Capital Employed	112,478	145,179	181,536	248,192	302,280
Gross Fixed Assets	52,249	65,801	83,341	105,881	127,671
Less: Depreciation	37,545	41,647	47,671	54,481	62,760
Net Fixed Assets	14,704	24,154	36,631	51,401	64,912
Capital WMP	11,570	15,296	15,000	10,000	5,000
Investments	523	798	4,392	4,392	4,392
Curr. Assets	369,011	429,348	514,947	611,684	710,140
Inventory	78,370	92,355	109,630	136,337	163,999
Debtors	159,755	206,888	273,546	313,575	360,799
Cash & Bank Balanc	103,147	97,901	96,302	117,466	132,396
Loans & Advances	24,237	28,137	32,373	40,901	49,200
Other Current Asse	3,502	4,069	3,096	3,406	3,747
Curr. Liab. & Prov	283,329	324,417	389,434	429,284	482,164
Creditors	58,529	75,798	95,114	126,793	157,070
Other Liabilities	175,045	204,439	218,351	246,498	261,698
Provisions	49,756	44,180	75,968	55,993	63,395
Net Current Assc	85,682	104,931	125,514	182,400	227,977
Appli. of Funds	112,479	145,179	181,536	248,192	302,280

E: MOSL Estimates

Ratios

Y/E March	2009	2010	2011	2012E	2013E
Basic (INR)					
EPS	72.9	95.7	115.6	137.9	164.3
Change (%)	42.1	31.3	20.8	19.2	19.2
Cash EPS	79.7	105.0	126.7	151.8	181.2
Book Value	264.3	325.2	411.7	504.4	614.9
DPS	17.0	23.3	31.2	38.6	46.0
Payout (incl. Div. Tax.)	26.5	26.5	25.4	28.0	28.0
Valuation (x)					
P/E			16.5	13.8	11.6
Cash P/E			15.1	12.6	10.5
EV/EBITDA			9.9	8.0	6.6
EV/Sales			2.1	1.6	1.3
Price/Book Value			4.6	3.8	3.1
Dividend Yield (%)			1.6	2.0	2.4
Return Ratio					
RoE	30.1	32.5	31.4	30.1	29.4
RoCE	46.9	51.4	52.2	47.8	44.5
Turnover Ratios					
Debtors (Days)	208	221	240	230	220
Inventory (Days)	109	103	101	100	100
Creditors (Days)	81	84	140	140	0
Asset Turnover (x)	17.8	13.6	10.9	9.7	9.2
Leverage Ratio					
Debt/Equity (x)	0.0	0.0	0.0	0.0	0.0
Cash Flow Statement					
Y/E March	2009	2010	2011	2012E	2013E
PBT bef. EO Items	48,369	65,834	84,733	102,249	121,878
Add: Depreciation	3,343	4,580	5,441	6,809	8,279
Interest	307	335	547	482	482
Less: Direct taxes paid	17,106	22,800	30,759	34,765	41,438
(Inc)/Dec in WC	12,443	-24,495	-22,182	-35,722	-30,646
CF from Operation	47,355	23,454	37,781	39,054	58,554
EO Income	119	73	4,509	0	0
CF from Op. Incl. E	47,474	23,526	42,289	39,054	58,554
(Inc)/Dec in FA	-13,223	-17,756	-17,623	-16,579	-16,790
(Pur)/Sale of Investme	-441	-275	-3,593	0	0
CF from Investor	-13,663	-18,031	-21,216	-16,579	-16,790
(Inc)/Dec in Networth	-5,024	3,131	-6,269	21,636	0
(Inc)/Dec in Debt	542	-216	356	-356	0
Less: Interest Paid	307	335	547	482	482
Dividend Paid	9,736	13,321	17,841	22,108	26,352
CF from Fin. Activ	-14,525	-10,741	-24,302	-1,310	-26,834
Incl/Dec of Cash	19,286	-5,245	-3,228	21,165	14,930
Add: Beginning Balance	83,860	103,147	97,901	96,302	117,466
Closing Balance	103,146	97,901	96,302	117,466	132,396

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