

# BHARAT HEAVY ELECTRICALS

## Slowdown blues

India Equity Research | Engineering and Capital Goods



**BHEL delivered a weak set of numbers with flattish revenue and a sharp drop in order intake during the quarter. While EBIDTA margins dropped by only 60 bps YoY vs 190 bps as expected, PAT came in line, led by a sharp drop in other income due to weak advances and a reduction in cash levels. We maintain 'HOLD/SP' rating on BHEL.**

### Weak customer off-take leads to lower than expected revenues

Client side delays in utilities coupled with weak ordering in industrial segment impacted BHEL's revenue growth, which came flattish. This was significantly below the expectation. Management indicated that there is a general slowdown in the industry which is impacting revenue booking for BHEL, including in the export market.

### OB sustains downward trend; order intake weak across verticals

BHEL reported a sharp 24 % YoY drop in order book to INR 1223 bn, led by a weak order intake during the quarter (down 77 % YoY) to INR 31.5 bn. For H1FY13, order intake remained at INR 87bn (down 49 % YoY) which corresponds to 4.4 GW. Management indicated a slowdown in project closure across utilities and industrial segment, while maintaining that the overall market in terms of project pipeline remains healthy at 12-14 GW, most of which belongs to the government sector.

### BHEL counting on transportation, power EPC orders

BHEL management maintained its incremental focus on power EPC projects to answer the decline in revenue visibility. Also, the company has started bidding for metro projects (recently submitted DMRC metro coach bid with Hitachi) and is keen on expanding in locomotive segment to counter the slowdown in the power segment.

### Outlook and valuations: No triggers; maintain 'HOLD'

Weak tendering in the BTG and industrial segment coupled with overcapacity and pricing pressure would remain an overhang for BHEL, going ahead. While we had already built in the impact from weak project awards in our intake assumptions, we are further tweaking our revenue numbers for BHEL, building in further execution delays. The stock trades at a PE of 9.0 & 9.9X on our FY13E & FY14E EPS. We maintain our 'HOLD/SP' rating with a revised TP of INR 195 (earlier-204) assigning 8.5x on FY14E EPS.

#### Financials

Year to March	Q2FY13	Q2FY12	% change	Q1FY13	% change	FY12	FY13E	FY14E
Net rev. (INR bn)	105.6	105.5	0.2	84.4	25.2	479.8	506.9	484.1
EBITDA (INR bn)	19.0	19.6	(3.0)	12.0	58.0	99.1	94.2	87.3
Core profit (INR bn)	12.7	14.1	(9.7)	9.2	38.4	70.6	61.8	56.0
Diluted EPS (INR)	5.2	5.8	(9.7)	3.8	38.4	28.8	25.2	22.9
Diluted P/E (x)						7.9	9.0	9.9
EV/EBITDA (x)						4.9	5.4	5.8
ROAE (%)						31.0	22.2	17.2

#### EDELWEISS 4D RATINGS

Absolute Rating	HOLD
Rating Relative to Sector	Performer
Risk Rating Relative to Sector	Low
Sector Relative to Market	Overweight

#### MARKET DATA (R: BHEL.BO, B: BHEL IN)

CMP	: INR 227
Target Price	: INR 195
52-week range (INR)	: 340 / 195
Share in issue (mn)	: 2,447.6
M cap (INR bn/USD mn)	: 555/ 10,285
Avg. Daily Vol.BSE/NSE('000)	: 5,757.0

#### SHARE HOLDING PATTERN (%)

	Current	Q1FY13	Q4FY12
Promoters *	67.7	67.7	67.7
MF's, FI's & BK's	12.7	13.1	12.8
FII's	14.3	12.9	13.5
others	5.2	6.2	6.0
* Promoters pledged shares (% of share in issue)			NIL

#### PRICE PERFORMANCE (%)

	Stock	Nifty	EW Capital Goods Index
1 month	3.5	(0.0)	12.5
3 months	9.6	11.2	2.5
12 months	(24.9)	12.7	(14.2)

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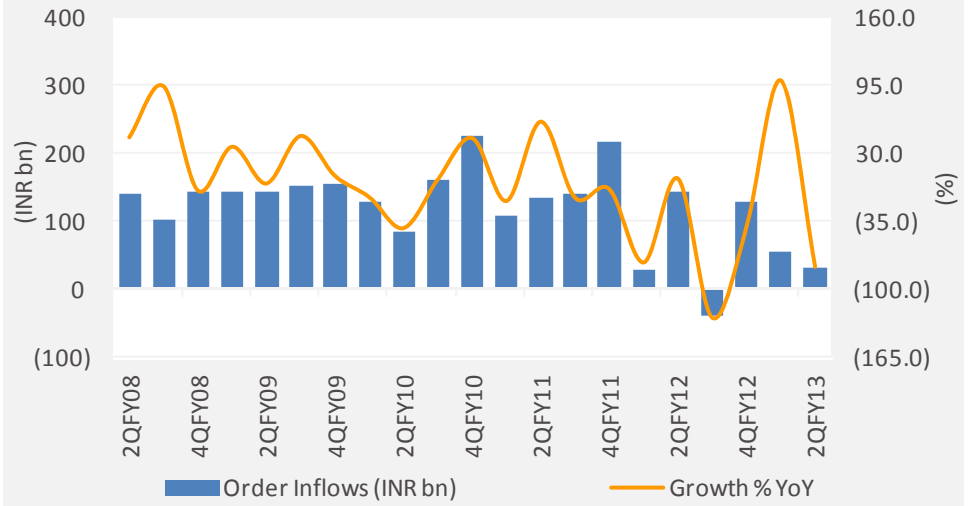
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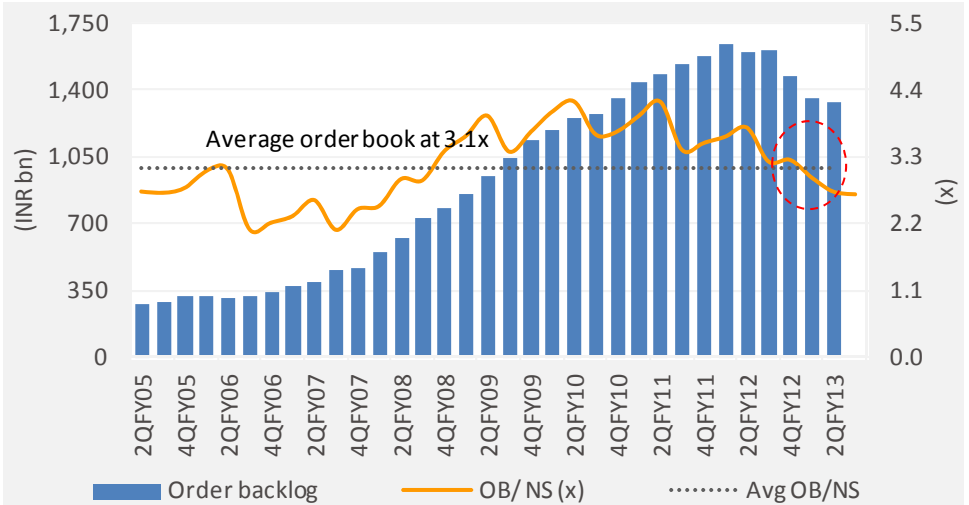
### Key notes from Q2FY13 Conference call:

- **Weaker client off-take:** Management indicated slower traction from customer side owing to various issues like clearances, liquidity etc, which impacted BHELs revenue growth during Q2.
- **Strong project pipeline but weaker finalizations:** BHEL foresees more than 14 GW of projects to come up for bidding, mostly from government sector. However confidence wrt time line of project awards given current scenario remains low.
- **Status on Metro & Loco orders:** BHEL has recently bid for DMRC metro coaches with Hitachi, and is expecting the award by December, 2012. Company is also banking on incremental orders from Indian Railways towards 2HFY13 and is alreadding in expansion mode at its Jhansi and Bhopal loco plants by 50 %.
- **NTPC bulk projects status:** BHEL is expecting Darlipalli project award by Q3FY13, while it expects land related issues in Nabinagar to get resolved by Q3FY13. However, mgt was not very confident on Gajmara project in the near term. BHEL is L1 in INR 85 bn worth of NTPC projects which is yet to be included in the order book.
- **No project cancellations:** BHEL indicated that there is no cancellation of projects during the quarter, however order book change in mainly pertaining to adjustment wrt currency changes.
- **Order booking** - The company has booked orders worth INR 31.5bn (1423MW) of which Power segment accounted for INR 19bn, Industry accounted for INR 12bn and the balance 1bn from its international operations. This is against INR 14bn reported in Q2FY12.
- **Major order booked during the quarter** – The company has booked following major order during Q2FY13 which are as follows :- 2\*400MW Rawat bhata (TG + C&I packages ) from NPCIL, 44 locos sets worth around INR 100crs, 220KV substation from BSEB, 765KV , 400KV , 220KV Transformers order in Kobra worth 225crs etc.
- **Break up of current OB** – The current order book at the end of Q2FY13 stood at INR 1224bn of which Power segment makes 79% , Industry makes up 13% and the balance 8% from the Exports market.
- **Potential Orders** - Around 12-14GW orders are expected to be tendered out from Central & State Government on EPC basis. Some of them are: Rajasthan SEB order - 2660MW (4x660MW) which is expected to be tendered in Q3-Q4FY13, Maharashtra SEB – 660MW (1x660MW), Newweli Lignite – 1000MW (2x500MW), NTPC – 3960MW (2x660M x3projects). Andhra Pradesh SEB- 1000MW( 2\*500MW)
- **Reasons for low other income & other operating income:** Other income was down due to lower advances as a result of low order inflows. There was also a Forex loss of INR 810mn in Q2FY13. Other operational income was down due to lower scrap sales & lower export incentives.
- **Reasons for W Capital increase:** Increase in Working Capital was on account of increase in Inventory and delays in payment from the customers.

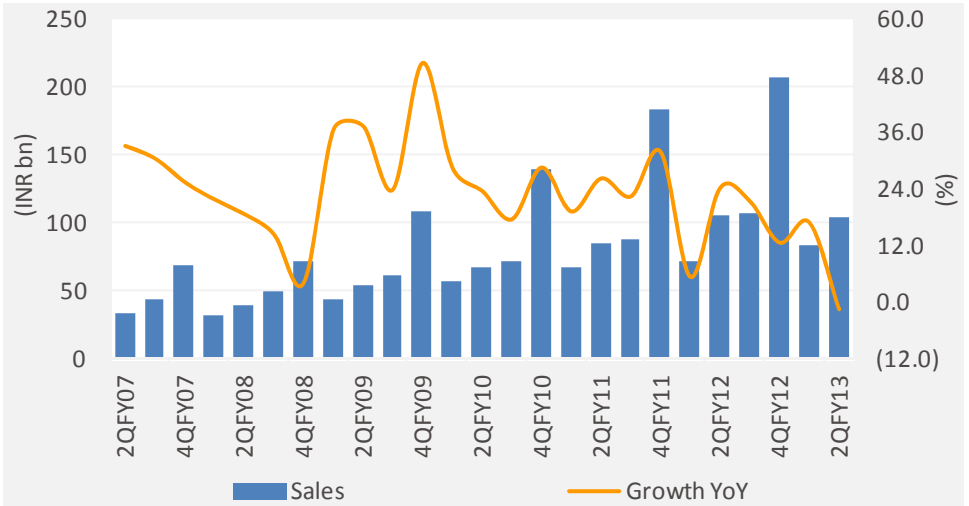
**Chart 1: Order inflow movmnt –Decline on a high base and fewer order closures in Q2**



**Chart 2: Order backlog and visibility – continues to decline**

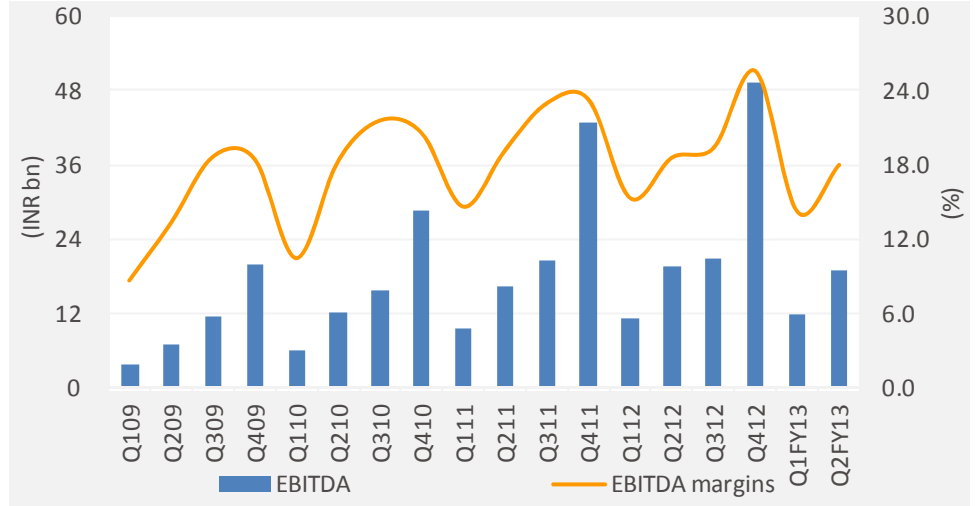


**Chart 3: Revenue and revenue growth movement**



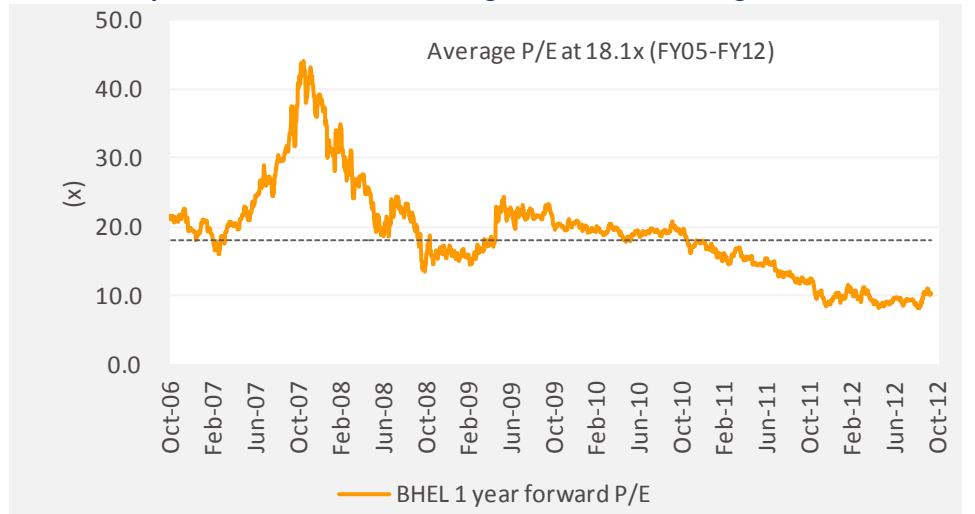
Source: Company, Edelweiss research

**Chart 4: EBITDA and EBITDA margin movement**



Source: Company, Edelweiss research

**Chart 5: One year forward PE band – Trading at close to 50% its avg. valuation**



Source: Company, Edelweiss research

**Table 1: Segmental snapshot**

Year to March	Q2FY13	Q2FY12	% change	H1FY13	H1FY12	% change
<b>Revenue (INR mn)</b>						
Power	89,581	77,973	14.9	157,300	135,776	15.9
Industry	20,549	29,603	(30.6)	40,265	46,132	(12.7)
<b>Total revenue</b>	<b>110,129</b>	<b>107,576</b>	<b>2.4</b>	<b>197,566</b>	<b>181,908</b>	<b>8.6</b>
<b>Segment revenue mix (%)</b>						
Power	81.3	72.5		79.6	74.6	
Industry	18.7	27.5		20.4	25.4	
<b>EBIT (INR mn)</b>						
Power	17,690	13,159	34.4	29,754	22,677	31.2
Industry	4,380	8,004	(45.3)	8,515	11,737	(27.5)
<b>Total EBIT</b>	<b>22,070</b>	<b>21,163</b>	<b>4.3</b>	<b>38,269</b>	<b>34,414</b>	<b>11.2</b>
<b>EBIT margin (%)</b>						
Power	19.7	16.9	287 bps	18.9	16.7	221 bps
Industry	21.3	27.0	-572 bps	21.1	25.4	-430 bps
<b>EBIT mix (%)</b>						
Power	80.2	62.2		77.8	65.9	
Industry	19.8	37.8		22.2	34.1	

Source: Company, Edelweiss research

## Financial snapshot

(INR mn)

Year to March	Q2FY13	Q2FY12	% Change	Q1FY13	% Change	FY12	FY13E	FY14E
Net revenues	105,616	105,455	0.2	84,390	25.2	479,789	506,879	484,104
Staff costs	14,814	13,491	9.8	13,950	6.2	54,658	57,965	61,472
Direct costs	61,326	61,180	0.2	48,578	26.2	280,845	306,741	289,638
Other operating expenses	10,481	11,192	(6.4)	9,840	6.5	45,213	47,962	45,714
Total expenditure	86,621	85,863	0.9	72,368	19.7	380,717	412,669	396,824
EBITDA	18,995	19,592	(3.0)	12,022	58.0	99,072	94,211	87,280
Depreciation	2,163	1,888	14.6	2,284	(5.3)	8,000	9,521	10,383
EBIT	16,832	17,704	(4.9)	9,738	72.8	91,072	84,689	76,898
Other income	1,307	2,199	(40.6)	3,663	(64.3)	12,656	8,133	7,514
Interest	259	96	168.3	55	368.5	513	607	803
Profit before tax	17,880	19,806	(9.7)	13,346	34.0	103,023	92,216	83,608
Tax	5,135	5,686	(9.7)	4,137	24.1	32,623	30,431	27,591
Net profit	12,745	14,120	(9.7)	9,209	38.4	70,400	61,784	56,017
Equity capital	4,895	4,895		4,895		4,895	4,895	4,895
No. of shares (mn)	2,448	2,448		2,448		2,448	2,448	2,448
Diluted EPS (INR)	5.2	5.8	(9.7)	3.8	38.4	28.8	25.2	22.9
<b>As % of net revenues</b>								
Direct costs	58.1	58.0		57.6		58.5	60.5	59.8
Employee cost	14.0	12.8		16.5		11.4	11.4	12.7
Other operating expenses	9.9	10.6		11.7		9.4	9.5	9.4
EBITDA	18.0	18.6		14.2		20.6	18.6	18.0
Adjusted net profit	12.1	13.4		10.9		14.7	12.2	11.6
Tax rate	28.7	28.7		31.0		31.7	33.0	33.0

## Change in Estimates

	FY13E			FY14E			Comments
	New	Old	% change	New	Old	% change	
Net Revenue	506,879	518,142	(2.2)	484,104	528,589	(8.4)	As a result of lowered order inflow for FY13E & FY14E and lowered execution rate.
EBITDA	94,211	93,813	(0.4)	87,280	93,618	(6.8)	Due to lowered revenue growth.
EBITDA Margin	18.6	18.1		18.0	17.7		Building in impact of better than expected H1FY13 performance.
Core profit	61,784	62,217	(0.7)	56,017	61,573	(9.0)	Due to lowered operating performance and decline in other income.
PAT Margin	12.2	12.0		11.6	11.6		
Capex	12,000	12,000	0.0	10,000	10,000	0.0	

## Company Description

BHEL is the largest heavy engineering and manufacturing enterprise in India in the energy-related/infrastructure sector. It manufactures over 180 products under 30 major product groups and caters to core sectors of the Indian economy viz., power generation & transmission, industry, transportation, telecommunications, and renewable energy. The company has a wide network with 14 manufacturing divisions, four power sector regional centers, over 100 project sites, eight service centers, and 18 regional offices across the country. An extensive network enables the company promptly serve its customers and provide them with suitable products, systems, and services. The company derives major revenues from power equipment manufacturing including boiler, turbine generators, major auxiliaries etc with more than 65 % of the total component manufacturing in house.

## Investment Theme

Domestic power equipment market is expected to see a total ordering of ~14-15 GW per annum over FY12E-FY14E which coupled with an increasing BTG capacity planned hints at a huge overcapacity and pricing pressures. With most of the 12<sup>th</sup> Plan orders already placed, we do not expect any great addition to the current BTG pipeline and thus remain negative on the sector profitability over the next 2-3 years. While BHEL will be the largest capacity BTG Company in the country with a total installed capacity of 20 GW per annum by March, 2012E, we see a huge risk of under utilization for the company owing to limited order pipeline. This could lead to a sharp dip in order inflows over the next two years, ultimately slowing the revenue growth for BHEL.

## Key Risks

- Sustained material improvement in coal availability and land clearance issues in the country could change the outlook for the power sector, leading to a substantial improvement in BTG demand and its current over capacity.
- Any major inorganic expansion by BHEL in the non-thermal space poses a key risk to our call.

## Financial Statements

### Key Assumptions

Year to March		FY10	FY11	FY12	FY13E	FY14E
Macro -	GDP(Y-o-Y %)	8.4	8.4	6.5	5.8	6.5
	Inflation (Avg)	3.6	9.9	8.8	7.8	6.0
	Repo rate (exit rate)	5.0	6.8	8.5	7.5	6.8
	USD/INR (Avg)	47.4	45.6	47.9	53.5	52.0
Company -	Order intake ( In Mws)	16,489.0	15,071.0	3,320.0	7,350	7,500
	Order intake (INR bn)	590	601	222	256	265
	Order backlog (INR bn)	1,417	1,640	1,367	1,106	895
	Revenue visibility (x)	4.3	3.8	2.9	2.2	1.9
	Headcount addition (% change)	1.0	1.0	5.7	1.0	1.0

### Income statement

(INR mn)

Year to March	FY10	FY11	FY12	FY13E	FY14E
Income from operations	333,549	422,466	479,789	506,879	484,104
Direct costs	186,214	230,817	280,845	306,741	289,638
Employee costs	64,458	53,967	54,658	57,965	61,472
Other Expenses	24,884	51,827	45,213	47,962	45,714
Total operating expenses	275,555	336,612	380,717	412,669	396,824
EBITDA	57,994	85,854	99,072	94,211	87,280
Depreciation & Amortization	3,371	5,441	8,000	9,521	10,383
EBIT	54,622	80,413	91,072	84,689	76,898
Other income	11,549	10,206	12,656	8,133	7,514
Interest expenses	335	547	513	607	803
Profit before tax	65,836	90,072	103,215	92,216	83,608
Provision for tax	22,803	29,942	32,623	30,431	27,591
Net profit	43,033	60,130	70,592	61,784	56,017
Extraordinary income/ (loss)	73	(8)	(193)	-	-
Profit After Tax	43,106	60,122	70,400	61,784	56,017
Shares outstanding (mn)	2,448	2,448	2,448	2,448	2,448
Diluted EPS (INR)	17.6	24.6	28.8	25.2	22.9
Dividend payout (%)	31.0	23.9	12.8	18.5	24.8

### Common size metrics - as % of net revenues

Year to March	FY10	FY11	FY12	FY13E	FY14E
Operating expenses	82.6	79.7	79.4	81.4	82.0
EBITDA margins	17.4	20.3	20.6	18.6	18.0
EBIT margins	16.4	19.0	19.0	16.7	15.9
Net profit margins	12.9	14.2	14.7	12.2	11.6

### Growth ratios (%)

Year to March	FY10	FY11	FY12	FY13E	FY14E
Rev. growth (%)	24.8	26.7	13.6	5.6	(4.5)
EBITDA	39.5	48.0	15.4	(4.9)	(7.4)
Net profit	37.6	39.7	17.4	(12.5)	(9.3)



Balance sheet						(INR mn)
As on 31st March	FY10	FY11	FY12	FY13E	FY14E	
Equity capital	4,895	4,895	4,895	4,895	4,895	
Reserves & surplus	154,278	196,643	248,837	299,167	341,282	
Shareholders funds	159,173	201,538	253,732	304,062	346,177	
Minority interest (BS)	-	-	-	1	2	
Unsecured loans	1,278	1,634	1,234	2,234	2,634	
Borrowings	1,278	1,634	1,234	2,234	2,634	
<b>Sources of funds</b>	<b>160,451</b>	<b>203,172</b>	<b>254,966</b>	<b>306,296</b>	<b>348,811</b>	
Gross block	65,801	80,497	97,066	109,066	119,066	
Depreciation	41,647	46,488	54,099	64,010	74,392	
Net block	24,154	34,009	42,968	45,057	44,674	
Capital work in progress	15,296	17,622	13,476	13,476	13,476	
Total fixed assets	39,450	51,631	56,444	58,533	58,150	
Investments	798	4,392	4,617	4,617	4,617	
Inventories	92,355	109,630	134,445	147,068	142,835	
Sundry debtors	206,887	273,546	358,448	369,943	372,941	
Cash and equivalents	97,901	96,302	66,720	47,285	44,198	
Loans and advances	32,205	35,469	31,624	33,205	38,107	
Total current assets	429,348	514,947	591,237	597,501	598,081	
Sundry creditors and others	280,237	313,465	336,380	293,404	251,086	
Provisions	44,180	75,968	76,414	76,414	76,414	
Total current liabilities & provisions	324,417	389,433	412,794	369,818	327,500	
Net current assets	104,931	125,514	178,443	227,683	270,581	
Net Deferred tax	15,272	21,636	15,462	15,462	15,462	
<b>Uses of funds</b>	<b>160,451</b>	<b>203,172</b>	<b>254,966</b>	<b>306,296</b>	<b>348,811</b>	
Book value per share (INR)	65.0	82.3	103.7	124.2	141.4	

Free cash flow						(INR mn)
Year to March	FY10	FY11	FY12	FY13E	FY14E	
Net profit	46,872	60,122	70,400	61,784	56,017	
Depreciation	4,582	5,441	8,000	9,521	10,383	
Deferred tax	3,131	(6,363)	(218)	-	-	
Others	(11,307)	(1,686)	(465)	997	803	
Gross cash flow	43,278	57,515	77,716	72,303	67,203	
Less: Changes in WC	27,428	30,929	85,852	68,676	45,985	
Operating cash flow	15,850	26,586	(8,136)	3,627	21,219	
Less: Capex	17,137	17,238	12,979	12,000	10,000	
<b>Free cash flow</b>	<b>(1,287)</b>	<b>9,348</b>	<b>(21,115)</b>	<b>(8,373)</b>	<b>11,219</b>	

Cash flow metrics					
Year to March	FY10	FY11	FY12	FY13E	FY14E
Operating cash flow	15,850	26,586	(8,136)	3,627	21,219
Investing cash flow	(9,666)	(13,428)	(3,297)	(12,000)	(10,000)
Financing cash flow	(11,429)	(14,757)	(18,149)	(11,062)	(14,306)
Net cash flow	(5,246)	(1,599)	(29,582)	(19,435)	(3,087)
Capex	(17,137)	(17,238)	(12,979)	(12,000)	(10,000)
Dividends paid	(8,730)	(10,879)	(14,563)	(17,937)	(11,455)

**Profitability & efficiency ratios**

Year to March	FY10	FY11	FY12	FY13E	FY14E
ROAE (%)	29.8	33.3	31.0	22.2	17.2
ROACE (%)	37.7	44.9	40.6	30.7	23.8
Inventory day	167	160	159	167	183
Debtors days	201	208	240	262	280
Payable days	504	469	422	375	343
Cash conversion cycle (days)	(136)	(102)	(23)	55	120
Current ratio	1.3	1.3	1.4	1.6	1.8
Interest coverage	163.1	146.9	177.6	139.5	95.7

**Operating ratios**

Year to March	FY10	FY11	FY12	FY13E	FY14E
Total asset turnover	2.3	2.3	2.1	1.8	1.5
Fixed asset turnover	17.2	14.5	12.5	11.5	10.8
Equity turnover	2.3	2.3	2.1	1.8	1.5

**Valuation parameters**

Year to March	FY10	FY11	FY12	FY13E	FY14E
Diluted EPS (INR)	17.6	24.6	28.8	25.2	22.9
Y-o-Y growth (%)	37.6	39.7	17.4	(12.5)	(9.3)
CEPS (INR)	20.2	24.2	32.0	29.1	27.1
Diluted PE (x)	12.9	9.2	7.9	9.0	9.9
Price/BV (x)	3.5	2.8	2.2	1.8	1.6
EV/Sales (x)	1.4	1.1	1.0	1.0	1.1
EV/EBITDA (x)	7.9	5.3	4.9	5.4	5.8

**Peer comparison valuation**

Name of the companies	CMP	Market cap (USD mn)	PE (x)		P/BV (x)		ROE (%)	
			2013E	2014E	2013E	2014E	2013E	2014E
L&T	1319	18,813.0	19.4	16.6	3.0	2.6	16.5	16.8
BGR Energy	275	356.0	10.1	9.0	1.5	1.4	16.1	16.1
Thermax	503	1,293	12.9	12.6	3.8	3.3	19.0	18.8
BHEL	247	10,911	9.0	9.9	1.8	1.6	22.2	17.2

Source: Edelweiss research

Company	Absolute reco	Relative reco	Relative risk	Company	Absolute reco	Relative reco	Relative Risk
ABB India	REDUCE	SU	L	Bajaj Electricals	HOLD	SP	M
BGR Energy	REDUCE	SU	M	Bharat Electronics	BUY	SO	H
Bharat Heavy Electricals	HOLD	SP	L	Crompton Greaves	BUY	SO	M
Cummins India	BUY	SO	L	Havells India	BUY	SO	M
Jyoti Structures	HOLD	SP	M	Kalpataru Power	HOLD	SP	M
KEC International	BUY	SO	M	Larsen & Toubro	BUY	SO	M
Siemens	HOLD	SO	L	Sterlite Technologies	HOLD	SP	H
Techno Electric & Engineering	BUY	SO	M	Thermax	HOLD	SP	L
Voltamp Transformers	REDUCE	SU	M	Voltas	HOLD	SP	L

### ABSOLUTE RATING

Ratings	Expected absolute returns over 12 months
Buy	More than 15%
Hold	Between 15% and - 5%
Reduce	Less than -5%

### RELATIVE RETURNS RATING

Ratings	Criteria
Sector Outperformer (SO)	Stock return > 1.25 x Sector return
Sector Performer (SP)	Stock return > 0.75 x Sector return
	Stock return < 1.25 x Sector return
Sector Underperformer (SU)	Stock return < 0.75 x Sector return

Sector return is market cap weighted average return for the coverage universe within the sector

### RELATIVE RISK RATING

Ratings	Criteria
Low (L)	Bottom 1/3rd percentile in the sector
Medium (M)	Middle 1/3rd percentile in the sector
High (H)	Top 1/3rd percentile in the sector

Risk ratings are based on Edelweiss risk model

### SECTOR RATING

Ratings	Criteria
Overweight (OW)	Sector return > 1.25 x Nifty return
Equalweight (EW)	Sector return > 0.75 x Nifty return
	Sector return < 1.25 x Nifty return
Underweight (UW)	Sector return < 0.75 x Nifty return



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### Coverage group(s) of stocks by primary analyst(s): Engineering and Capital Goods

ABB India, BGR Energy, Bharat Electronics, Bharat Heavy Electricals, Bajaj Electricals, Crompton Greaves, Havells India, Jyoti Structures, KEC International, Cummins India, Kalpataru Power, Larsen & Toubro, Siemens, Sterlite Technologies, Techno Electric & Engineering, Thermax, Voltamp Transformers, Voltas

#### Recent Research

Date	Company	Title	Price (INR)	Recos
26-Oct-12	<b>ABB Global</b>	Short cycle business to face inclement weather; <i>Global Pulse</i>		Not Rated
25-Oct-12	<b>Bajaj Electricals</b>	E&P drag earnings again; <i>Result Update</i>	215	Hold
22-Oct-12	<b>Larsen and Toubro</b>	Renewed confidence; re-iterate BUY; <i>Result Update</i>	1671	Buy

#### Distribution of Ratings / Market Cap

Edelweiss Research Coverage Universe

	Buy	Hold	Reduce	Total
Rating Distribution*	113	53	19	186
* 1 stocks under review				
	> 50bn	Between 10bn and 50 bn	< 10bn	
Market Cap (INR)	114	58	14	

#### Rating Interpretation

Rating	Expected to
<b>Buy</b>	appreciate more than 15% over a 12-month period
<b>Hold</b>	appreciate up to 15% over a 12-month period
<b>Reduce</b>	depreciate more than 5% over a 12-month period



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