



BHEL

BSE SENSEX	S&P CNX	CMP: INR227	TP: INR233	Neutral						
18,636	5,666									
Bloomberg	BHEL IN									
Equity Shares (m)	2,447.6									
52-Week Range (INR)	368/198									
1,6,12 Rel. Perf. (%)	-7/-7/-35									
M.Cap. (INR b)	556.2									
M.Cap. (USD b)	10.3									
Year	Net Sales	PAT	EPS	EPS	P/E	P/BV	RoE	RoCE	EV/	EV/
End	(INR m)	(INR m)	(INR)	Gr. (%)	(x)	(x)	(%)	(%)	Sales	EBITDA
03/11A	404,443	56,650	23.1	20.9	-	-	31.4	35.0	-	-
03/12A	479,788	68,918	28.2	21.7	11.5	3.1	30.3	33.0	1.5	7.3
03/13E	478,511	63,744	26.0	-7.5	8.7	1.9	23.2	24.6	1.0	5.2
03/14E	445,927	47,616	19.5	-25.3	11.7	1.7	15.3	16.2	1.1	6.7

- Operational performance beats estimates:** Bharat Heavy Electricals Ltd's (BHEL) 2QFY13 performance was ahead of our estimates led by better-than-expected EBITDA margins. Revenues grew 1% YoY and PAT was flat YoY. Adj EBITDA margins at 18% were up 200bp YoY (v/s est of 150bp decline). Growth in net profit was muted as other income declined 60% YoY (partly led by a forex loss of INR1.3b and lower treasury income), while depreciation increased 15% YoY. Revenue growth was impacted by a decline in industrial segment sales (down 31% YoY), while power segment sales grew 15% YoY.
- Order intake declines 78% YoY:** Order intake stood at INR31b, down 78% YoY, impacted by a fall in industrial and power sector orders over a very high base last year. Order book stands at INR1.22t, 2.4x TTM sales and remains in an uncomfortable zone. Management reiterated that there were no order cancellations and the increased quantum is largely due to exchange rate adjustments on overseas orders (~INR100b). NTPC's bulk tender orders for Darlipalli (1.6GW, INR26b) and Nabinagar (1.98GW, INR28b) are now expected by end-December 2012, while Gajmara (1.6GW, INR42b) is uncertain due to land acquisition issues.
- Working capital cycle under pressure:** Working capital in 1H showed further deterioration due to decline in trade payables. However, we note that the number has been largely stable in 2Q. Net working capital, excluding cash, was at 36% of sales in 1HFY13, up from 28% of sales at end-March 2012 and 21% at end-March 2011.
- Valuation and view:** We assume BHEL's order intake would grow by 34% YoY in FY13 (INR295b in FY13, v/s INR221b in FY12) supported by orders from NTPC's bulk tenders and a low base. However, the key issues to be noted are order cancellations and execution delays, as private sector contributes 25-30% of the company's order book. The stock trades at 9X FY13E and 12X FY14E EPS. Maintain **Neutral**.

Quarterly Performance										(INR Million)		
Y/E March	FY12				FY13				FY12	FY13E	MOSL	Var.
	1Q	2Q	3Q	4Q	1Q	2Q	3QE	4QE			Est	Vs Est
Sales (Net)	71,234	102,991	105,426	192,595	83,262	103,996	102,163	180,295	472,279	469,717	105,257	-1.2%
Change (%)	9.9	23.7	19.1	7.5	16.9	1.0	-3.1	-6.4	13.6	-0.5	2.2	
EBITDA	10,184	18,616	20,350	49,372	12,022	18,995	18,216	43,413	98,880	92,646	17,694	7.4%
As a % Sales	14.3	18.1	19.3	25.6	14.4	18.3	17.8	24.1	20.2	19.4	16.8	
Adjusted EBITDA	8,524	16,956	20,350	49,372	12,022	18,995	18,216	43,413	97,076	92,646	17,694	7.4%
Change (%)	-17.1	-0.6	-5.3	68.5	41.0	12.0	-10.5	-12.1	20.6	-4.6	-1.3	
As a % Sales	14.1	16.0	19.1	25.2	14.2	18.0	17.5	23.5	20.3	19.4	16.5	
Interest	88	96	145	183	55	259	130	274	513	718	125	106.9%
Depreciation	1,709	1,888	1,861	2,541	2,284	2,163	2,200	2,257	8,000	8,904	2,200	-1.7%
Other Income	3,435	3,174	2,415	3,989	3,663	1,307	2,200	2,189	12,656	9,358	2,500	-47.7%
PBT	11,822	19,806	20,758	50,637	13,346	17,880	18,086	43,071	103,023	92,382	17,869	0.1%
Tax	3,667	5,686	6,432	16,838	4,137	5,135	5,607	13,760	32,623	28,638	5,539	-7.3%
Effective Tax Rate	31.0	28.7	31.0	33.3	31.0	28.7	31.0	31.9	31.7	31.0	31.0	
Reported PAT	8,155	14,120	14,326	33,798	9,209	12,745	12,479	29,311	70,400	63,744	12,329	3.4%
Change (%)	21.8	23.6	2.1	20.8	12.9	-9.7	-12.9	-13.3	17.1	-9.5	-12.7	
Adj. PAT	8,155	12,858	14,326	33,580	9,209	12,745	12,479	29,311	68,919	63,744	12,329	3.4%
Change (%)	14.8	11.1	-0.2	73.6	12.9	-0.9	-12.9	-12.7	21.8	-7.5	-4.1	
Order intake	24,710	143,060	(15,040)	68,230	55,900	31,530	60,000	147,591	220,960	295,021	30,000.0	
Order book (INRb)	1,596	1,610	1,465	1,347	1,330	1,223	1,181	1,139	1,353	1,139	1,254.5	
BTB (x)	3.8	3.6	3.2	2.9	2.7	2.5	2.4	2.4	2.9	2.4	2.6	

E: MOSL Estimates

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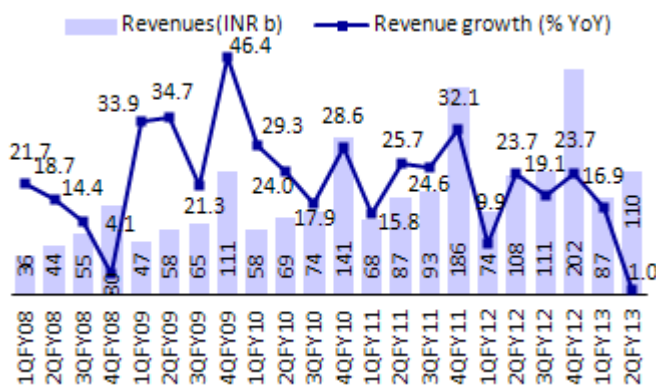
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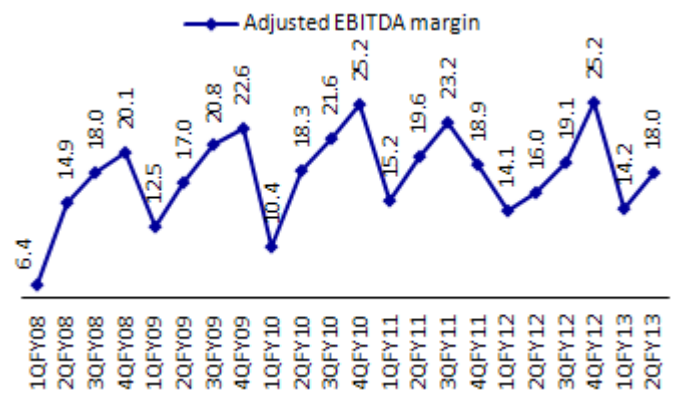
2QFY13 operational performance ahead of estimates

- BHEL's financial performance during 2QFY13 was ahead of estimates led by better-than-expected EBITDA margins. Revenues stood at INR104b (up 1% YoY) and in line with estimates of INR105b. EBITDA margins stood at 18%, up 200bp YoY (above estimate of 16.5%), while net profit was INR12.7b (flat YoY), better than the estimate of INR12.3b.
- Growth in sales was muted due to significant decline in industrial sales, which was impacted by a fall in short cycle orders from the industrial sector. Industrial segment sales (20% of total sales) declined by 31%, while power segment sales posted a growth of 15% YoY led by execution of existing order book. Management indicated that existing orders from the private sector could face execution delays at the customers end.
- Net profit was flat, despite a 12% YoY growth in EBITDA, due to an increase in depreciation expenses (15% YoY) and decline in other income (59% YoY). Depreciation cost increased due to capacity additions at the end of last financial year. Other income declined due to lower treasury income arising from a decline in surplus cash and a forex loss of INR1.3b during the quarter.

Revenue growth slows due to depleting order book



EBITDA margins supported by stable RM costs



Source: Company, MOSL

Revenues impacted by steep decline in industrial sales

- Revenue growth was impacted by a decline in industrial segment sales (down 31% YoY), while power segment sales grew 15% YoY.
- Industry segment EBIT margins were down 570bp YoY to 21.3% given the negative operating leverage and base effect, while power margins expanded by 280bp YoY.
- Order intake in the industrial segment declined to ~INR8-12b per quarter and thus would impact the revenue run rate of ~INR20b/quarter as key sectors like cement and metals are witnessing capex slowdown. Execution of power projects is also expected to be constrained due to issues in clearances and funding, particularly for IPPs (contributing ~25-30% of BHEL's order book), while margins shall be impacted by poor operating leverage.
- We assume a revenue decline of 1% in FY13 and 7% in FY14 and EBITDA margins of 19.4% in FY13 (down 91bps) and 15.9% in FY14 (down 347bps).

Segmental Performance (INR m)

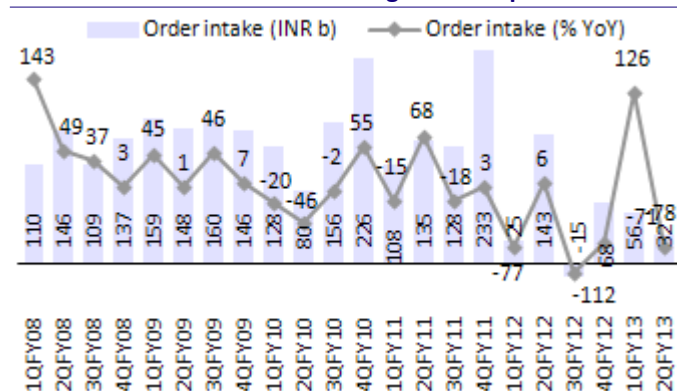
	FY12				FY13		FY11	FY12
	1Q	2Q	3Q	4Q	1Q	2Q		
Revenues	74,332	107,575	110,783	202,527	87,436	110,129	433,799	495,217
Power	57,803	77,973	87,115	155,738	67,720	89,581	331,655	378,629
Growth (%)	7.6	10.5	58.3	2.2	17.2	14.9	23.5	14.2
Industry	16,529	29,602	23,668	46,789	19,717	20,549	102,144	116,589
Growth (%)	19.1	78.2	(37.3)	38.1	19.3	(30.6)	29.6	14.1
EBIT	13,251	21,163	24,046	56,803	16,198	22,070	102,173	115,262
Power	9,518	13,159	16,560	42,601	12,064	17,690	79,351	81,838
Growth (%)	(11.1)	(7.2)	(3.3)	14.1	26.7	34.4	25.6	3.1
Industry	3,733	8,004	7,486	14,201	4,134	4,380	22,822	33,424
Growth (%)	93.2	137.7	100.7	3.0	10.7	(45.3)	39.0	46.5
EBIT margin (%)	17.8	19.7	21.7	28.0	18.5	20.0	23.6	23.3
Power	16.5	16.9	19.0	27.4	17.8	19.7	23.9	21.6
Industry	22.6	27.0	31.6	30.4	21.0	21.3	22.3	28.7

Source: Company, MOSL

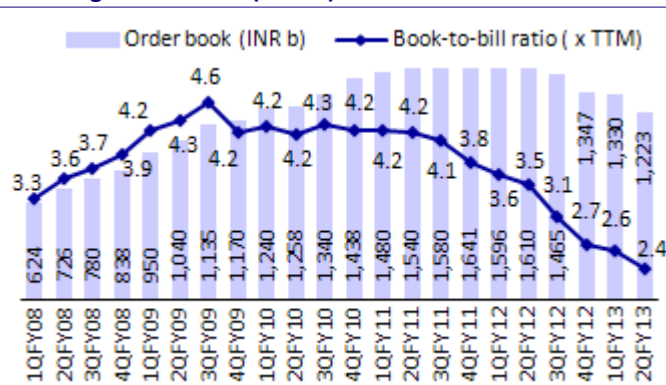
Order intake remains sluggish; management continues to expect 10-15GW of orders in FY13

- BHEL expects new orders of 10-15GW in FY13 (largely from the government sector), compared with 4GW in FY12. However, several of these projects are contingent on land acquisitions and require clearances.
- Order intake stood at INR31b, down 78% YoY, impacted by a fall in industrial and power sector orders over a very high base last year. The quarter saw a large order worth INR12b from NPCIL. Management reiterated that there were no order cancellations and the increased quantum is largely due to exchange rate adjustments on overseas orders (~INR100b). We await details on the same.
- Order book stands at INR1.22t, 2.4x TTM sales and remains in an uncomfortable zone. NTPC's bulk tender orders for Darlipalli (1.6GW, INR26b) and Nabinagar (1.98GW, INR28b) are now expected by end-December 2012, while Gajmara (1.6GW, INR42b) is uncertain given land acquisition issues.
- Also, order intake in the industrial segment declined to ~INR8-12b per quarter and thus would impact the revenue run rate of ~INR20b/quarter as key sectors like cement and metals are witnessing a capex slowdown.
- BHEL has built capacities for EPC power projects. Water, transportation (including metro rail coaches), transmission segments etc have been identified as future growth drivers. Management highlighted progress of projects -- received the first order for 765kv substations, bid for the Delhi Metro project in consortium with Hitachi, ramp-up of locomotive manufacturing plans for Indian Railways and also setting up manufacturing facilities for diesel locos etc.

Order intake muted due to slowing orders in power sector



Declining trend in BTB (x TTM)



Source: Company, MOSL

Working capital cycle under pressure

- Working capital in 1H showed further deterioration due to decline in trade payables. However, in 2Q we note that the number has been largely stable. Net working capital, excluding cash, was at 36% of sales in 1HFY13, up from 28% of sales at end-March 2012 and 21% at end-March 2011. Given the tough macro environment, while managing debtors/inventory is critical, customer advances are declining due to lower orders.

Balance Sheet (INR m)

	March'11	March'12	Sept'12
Share Capital	4,895	4,895	4,859
Reserves and Surplus	196,643	248,837	270,783
Net Worth	201,538	253,732	275,642
LT Borrowings	1,021	1,234	1,283
Deferred Tax Liabilities			
Other LT Liabilities	91,424	75,508	74,934
LT Provisions	49,232	50,057	53,986
Long Term Liabilities	141,678	126,799	130,203
ST Borrowings			16,685
Trade Payables	80,954	102,713	81,633
Other Current Liabilities	141,700	158,159	152,657
ST Provisions	26,733	26,357	20,086
Current Liabilities	249,387	287,229	254,375
Total Funds Employed	592,603	667,760	660,220
Fixed Assets	51,347	56,444	55,707
LT investments	4,392	4,617	4,617
DTA	21,636	15,462	14,468
LT loans and advances	8,829	9,001	15,044
Other non current assets	73,621	95,087	103,873
Non current assets	159,824	180,611	193,709
Current investments			1,000
inventories	108,521	134,445	140,763
Debtors	201,035	263,361	262,691
Cash and bank	96,302	66,720	53,077
ST Loans and advances	23,825	21,117	23,495
Other Current assets	3,096	1,506	2,206
Total Current assets	432,779	487,149	482,232
Total Assets	592,603	667,760	675,941
Debtors (% of sales)	48	56	54
Net Working Capital (% of sales)	21	28	36

Valuation and view

- Indian power equipment market is witnessing a tough phase, with slowing demand and rising costs. Lack of coal linkages, volatile spot prices and other hurdles like land availability have impacted new project awards in the past year.
- While the investment climate remains constrained, we believe that the situation could possibly improve driven by structural drivers: i) imposition of 21% effective import duty improved the competitive positioning of domestic players by 14%, ii) financial restructuring plan for SEBs, iii) coal price pooling and increased domestic coal availability, iv) new standard bidding document enabling fuel cost pass-through and v) continued strong power consumption growth etc.
- Hence, in our view, the ordering activity could improve in the next 12-18 months based on the successful implementation of these initiatives. Possible correction in commodity prices shall also help company's margins, as ordinary steel, which contributes 15-20% of the raw material basket, is generally procured on a spot basis.
- We believe the current valuations factor the de-rating catalysts namely 1) possible worsening of external environment in the power sector and 2) execution constraints and deteriorating working capital. The stock trades at 9X FY13E and 12XFY14EPS. Maintain **Neutral**.

BHEL: an investment profile

Company description

BHEL is India's dominant producer of power and industrial machinery, and a leading EPC company. The government currently has an equity stake of 67.7%. BHEL has 14 manufacturing divisions, 8 service centers, 4 power sector regional centers, besides project sites spread across India and abroad. It has an annual installed capacity of 20,000MW of power equipments. It has formed 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 stands at INR1.22t, and book-to-bill (BTB) at 2.6x TTM revenue. While the BTB is in an uncomfortable zone, it provides revenue visibility for the next two years.
- Post capacity expansion to 20GW, BHEL's capacity is at par with its Chinese and Korean counterparts, giving BHEL sizeable muscle to compete.
- Stock trades at 12x FY14E EPS, at 50% discount to its long-term average P/E. Dividend yield stands at 3.2%.

Key investment risks

- Orders in the power equipment space have slowed down drastically due to macro headwinds, which is likely to significantly impact BHEL's growth prospects. Intensified competition from Chinese, Korean and

private Indian players will result in deterioration in pricing environment and margin squeeze.

- The current order book is likely to face execution delays, particularly the orders from private sector.

Recent developments

- For NTPC bulk tender, BHEL is yet to recognize orders for INR110b comprising of: Raghunathpur (TG, 1320MW, INR16.5b), Nabinagar (Boiler, 1980MW, INR28b) and 800MW projects Darlipalli and Gajmara (INR68b). The management stated that the orders for the 800MW sets will possibly be booked by Dec'12.
- BHEL received its first order for 765kv substations and the company has also bid for the Delhi Metro project in consortium with Hitachi.

Valuation and view

- We believe that the current valuations largely factor in the de-rating catalysts, namely 1) Possible worsening of external environment in the power sector; 2) execution constraints and deteriorating working capital. The stock trades at 9X FY13E and 12XFY14EPS. Maintain **Neutral**.

Sector view

- We have a **Neutral** view on the sector.

Comparative valuations

		BHEL	L&T	Crompton
P/E (x)	FY13E	8.7	18.8	13.2
	FY14E	11.7	17.3	9.7
P/BV (x)	FY13E	1.9	3.5	2.0
	FY14E	1.7	3.1	1.7
EV/Sales (x)	FY13E	1.0	1.7	0.6
	FY14E	1.1	1.5	0.5
EV/EBITDA (x)	FY13E	5.2	14.5	7.6
	FY14E	6.7	12.4	5.8

Shareholding pattern (%)

	Sep-12	Jun-12	Sep-11
Promoter	67.7	67.7	67.7
Domestic Inst	12.7	13.1	13.4
Foreign	14.6	13.2	13.0
Others	5.0	6.0	5.9

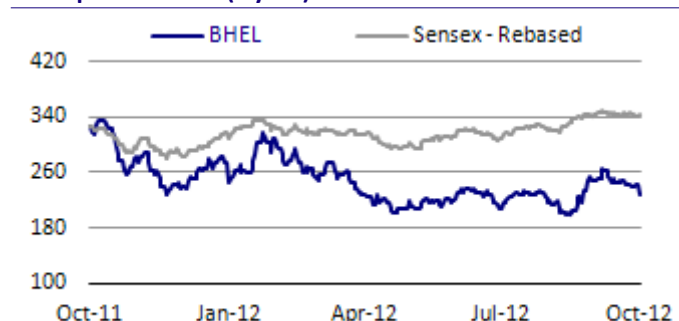
EPS: MOSL forecast v/s consensus (INR)

	MOSL Forecast	Consensus Forecast	Variation (%)
FY13	26.0	26.0	-0.1
FY14	19.5	23.3	-16.2

Target price and recommendation

Current Price (INR)	Target Price (INR)	Upside (%)	Reco.
227	233	2.7	Neutral

Stock performance (1 year)



Financials and Valuation

Income Statement		(INR Million)			
Y/E March	2011	2012	2013E	2014E	
Total Income	404,443	479,788	478,511	445,927	
Change (%)	21.0	18.8	-0.5	-7.1	
Staff Cost	54,769	54,658	58,968	61,917	
Mfg. Expenses	230,816	280,845	277,709	259,320	
Selling Expenses	38,325	45,213	49,188	53,826	
EBITDA	80,532	99,072	92,646	70,864	
Change (%)	36.0	23.0	-6.5	-23.5	
% of Net Sales	19.9	20.6	19.4	15.9	
Depreciation	5,441	8,000	8,904	10,349	
Interest	547	513	718	810	
Other Income	10,206	12,656	9,358	9,304	
Extra-ord. Items (net)	5,305	-193	0	0	
PBT	90,055	103,022	92,382	69,009	
Tax	29,945	32,623	28,638	21,393	
Rate (%)	33.3	31.7	31.0	31.0	
Reported PAT	60,110	70,399	63,744	47,616	
Adjusted PAT	56,650	68,918	63,744	47,616	
Change (%)	20.9	21.7	-7.5	-25.3	

Balance Sheet		(INR Million)			
Y/E March	2011	2012	2013E	2014E	
Share Capital	4,895	4,895	4,895	4,895	
Reserves	196,643	248,837	291,698	322,601	
Net Worth	201,538	253,732	296,593	327,496	
Loans	1,021	1,234	1,234	1,234	
Differed Tax Liability	-21,636	-15,462	-15,462	-15,462	
Capital Employed	180,924	239,504	282,365	313,268	
Gross Fixed Assets	80,497	97,066	112,856	129,646	
Less: Depreciation	46,488	54,098	63,539	73,887	
Net Fixed Assets	34,009	42,968	49,317	55,759	
Capital WIP	17,338	13,476	5,000	5,000	
Investments	4,392	4,617	4,617	4,617	
Curr. Assets	515,229	591,237	612,823	617,171	
Inventory	108,521	134,445	136,218	130,959	
Debtors	274,656	358,448	377,031	376,974	
Cash & Bank Balance	96,302	66,720	70,278	81,270	
Loans & Advances	32,654	30,118	27,790	26,462	
Other Current Assets	3,096	1,506	1,506	1,506	
Curr. Liab. & Prov.	389,431	412,794	389,392	369,278	
Creditors	84,366	107,781	102,714	95,913	
Other Liabilities	229,100	228,599	205,313	190,772	
Provisions	67,203	67,407	72,441	75,451	
Net Current Assets	125,798	178,443	223,431	247,893	
Appli. of Funds	181,536	239,504	282,365	313,268	

E: MOSL Estimates

Ratios		2011	2012	2013E	2014E
Y/E March					
Basic (INR)					
EPS		23.1	28.2	26.0	19.5
Change (%)		20.9	21.7	-7.5	-25.3
Cash EPS		25.4	31.4	29.7	23.7
Book Value		82.3	103.7	121.2	133.8
DPS		6.2	6.4	7.3	5.8
Payout (incl. Div. Tax.)		25.4	22.3	28.0	30.0
Valuation (x)					
P/E			11.5	8.7	11.7
Cash P/E			10.3	7.7	9.6
EV/EBITDA			7.3	5.2	6.7
EV/Sales			1.5	1.0	1.1
Price/Book Value			3.1	1.9	1.7
Dividend Yield (%)			2.8	3.2	2.6
Return Ratio (%)					
RoE		31.4	30.3	23.2	15.3
RoCE		35.0	33.0	24.6	16.2
Turnover Ratios					
Debtors (Days)		241	264	281	303
Inventory (Days)		100	104	106	110
Creditors. (Days)		77	83	80	80
Asset Turnover (x)		11.7	11.0	9.5	7.8
Leverage Ratio					
Debt/Equity (x)		-0.6	-0.5	-0.3	-0.2

Cash Flow Statement		(INR Million)			
Y/E March	2011	2012	2013E	2014E	
PBT bef. EO Items	84,750	103,214	92,382	69,009	
Add : Depreciation	5,441	8,000	8,904	10,349	
Interest	547	513	718	810	
Less : Direct taxes paid	29,945	32,623	28,638	21,393	
(Inc)/Dec in WC	-37,208	-78,379	-12,359	9,686	
CF from Operations	35,586	-3,368	32,019	47,087	
EO Income	-5,305	-193	0	0	
CF from Op. Incl. EO Items	30,281	-3,560	32,019	47,087	
(Inc)/dec in FA	-17,339	-13,097	-6,778	-16,790	
(Pur)/Sale of Investments	-3,593	-225	0	0	
CF from Investments	-20,932	-13,322	-6,778	-16,790	
(Inc)/Dec in Networth	-6,369	6,178	0	0	
(Inc)/Dec in Debt	-256	213	0	0	
Less : Interest Paid	547	513	718	810	
Dividend Paid	12,509	15,425	17,931	16,067	
CF from Fin. Activity	-19,681	-9,547	-18,649	-16,877	
Inc/Dec of Cash	-10,332	-26,429	6,592	13,420	
Add: Beginning Balance	97,901	96,302	66,720	70,278	
Closing Balance	95,619	66,521	70,436	81,243	

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