

BHARAT BIJLEE LTD.

'Step'ping up prospects...

Q1 FY 2007 update

COMPANY DETAILS

Auditors	Dalal & Shah
Chairman	Bansi S Mehta
Regd. Office	Electric House, 6th Floor, Appasaheb Marathe Marg, Prabhadevi, Mumbai-400025
Plant Location	MIDC, Thane
Website	www.bharatbijlee.com

SCRIP DETAILS

Market Capitalisation	Rs. 5.5 bn.
Book Value per share	Rs. 137
Equity Shares O/S (F.V. Rs 10)	5.7 mn.
Median Volumes (12 mths)	13,901 (BSE)
52 Week High/Low	Rs. 1,628 / 454
BSE Scrip Code	503960
NSE Scrip Code	BARATBIJLE
Bloomberg Code	BIJL@IN
Reuters Code	BBJL.BO

SHAREHOLDING PATTERN (%)

Qtr. Ended	Dec-05	Mar-06	Jun-06
Promoters	35.2	35.2	35.2
MFs/FIs	19.6	19.7	19.9
FIIIs/NRIs/OCBs	5.1	5.7	5.8
PCBs	8.3	7.2	7.3
Indian Public/Others	31.8	32.1	31.8

KEY FINANCIALS (STANDALONE)

Rs Mn	Quarter Ended			Year Ended (Mar)		
	Dec-05	Mar-06	Jun-06	2006	2007E	2008E
Net Sales	854	1,031	710	3,011	4,099	5,099
YoY Gr. (%)	43.6	34.8	21.9	22.4	36.1	24.4
Op. Profits	157	216	76	512	681	859
Op. Marg. (%)	18.4	21.0	10.7	17.0	16.6	16.8
Net Profits	93	131	43	341	452	579
Eq. Capital	57	57	57	57	57	57

KEY RATIOS

Year Ended (Mar)	EPS (Rs.)	ROCE (%)	RONW (%)	P/E (x)	EV/Sales (x)	EV/EBDIT (x)
2006	60.3	51.4	52.6	16.2	1.7	10.7
2007E	80.2	49.5	47.6	12.2	1.3	8.2
2008E	102.4	47.0	42.2	9.5	1.0	6.3

SUMMARY

- Bharat Bijlee Ltd (BBL) manufactures transformers and electric motors and caters to the utilities and industrial segments.
- Transformers accounted for 54% of revenues in FY06 followed by electric motors at 33%. The company also has trading in pumps, which accounts for around 2-3% of revenues.
- BBL reported a 22% YoY growth in net sales to Rs 710 mn in Q1FY07. This was led largely by a the transformers division.
- Op. margins shrank by 109 bps to 10.7% due to an introductory pricing strategy adopted in the 100 mVA transformers and curtailment of high margin sale of spares relating to the lift division.
- Operating profits rose by 11% to Rs 76 mn on back of the volume growth in transformers.
- Commissioning of the new transformer line, led to a 32% dip in depreciation charges to Rs 5 mn.
- Consequent to the lower margins and higher depreciation charges, net profit growth as restricted to 8%, to Rs 43 mn.
- BBL's order backlog in the transformer segment was Rs 2.5 bn at the end of Q1FY07 vis-a-vis Rs 1.6 bn at the of FY06.
- *The CMP of Rs 975 discounts FY07E EPS of Rs 80.2 by 12.2x. The stock trades at an EV/Sales of 1.3x and an EV/EBIDTA of 8.2x, its FY07 estimates. BBL has managed to maintain growth, while also expanding its margins. The margin expansion is expected to continue as BBL forays into the higher capacity segments. Thus, we initiate a coverage with a 'BUY' recommendation, with a price target of Rs 1,300; on a 12 month investment perspective.*

Aug 18, 2006

Sensex : 11465

Nifty : 3356

CMP : Rs 975

Recomm : BUY

Bharat Bijlee Ltd (BBL) was incorporated in 1946 to manufacture electric motors. In 1958, it forayed into manufacture of transformers in collaboration with Siemens (Germany) for manufacturing motors and transformers at its plant in Thane. In 1965, BBL commenced manufacturing heavy duty transformers.

In 1972, the company set up its lifts division in technical partnership with Schindler (Switzerland) and was subsequently divested in FY05 to Kone Elevators P Ltd.

The downturn in industry during the 1998-2002 period, continued stagnation in investments by the state electricity boards (SEBs) in generation & transmission capacities and undercutting by players to garner business severely impacted the company's fortunes.

Since then, reforms in the manufacturing and power sectors with a renewed thrust on creation of generation and transmission capacities resulted in the company witnessing a turnaround. Concurrent to the turnaround, BBL also divested the lifts division.

Transformer industry

Demand for transformers emanates from the SEBs and manufacturing sector, with the SEBs accounting for the bulk of demand. The power (step-up) transformer helps in stepping up voltage at the power generation end to ease transmission of power, while cutting down on the voltage levels at the various distribution points for consumption by the households, commercial establishments and industries engaged in the manufacturing and services sector. There are generally three segments viz. Low voltage (<1.1/3.3 kV, Medium voltage (11-66 kV) & high voltage (132 kV & above).

Typically, generation of power occurs at around 11 kV. For ease of transmitting power to the load center, the voltage is ramped up to 400 kV and then subsequently

stepped down in stages to 220 kV, 132 kV, 66 kV, 33kV at the sub-transmission level. For consumption by the households and commercial establishments, the voltage is stepped down to the 1.1 kV and then to 440/220 V. Thus, each stage involving a change in voltage requires either a power or a distribution transformer.

The ramp up of voltage (V) helps by correspondingly lowering the current (A) level (Power=Volt x Ampere or VxA). Transmission with high current levels requires a greater cross-section of cable for transmitting power.

The weak financial position of the SEBs has led to negligible investments in the power sector, either in generation or in transmission & distribution (T&D). While the norm for investing in generation and T&D is 1:1, capital formation in the sector has largely been tilted towards the generation side at around 3:1. This completely disregarded the considerable losses and inefficiencies in the distribution side of the sector.

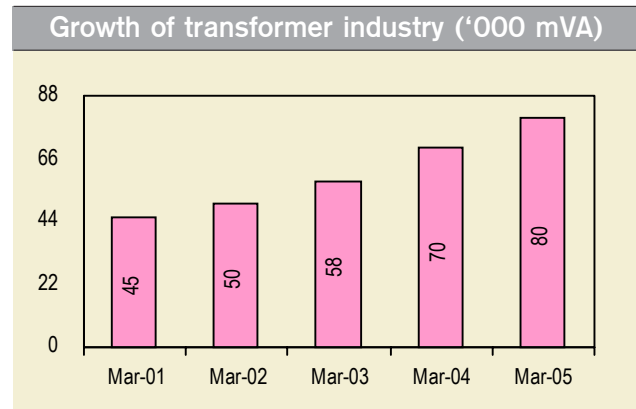
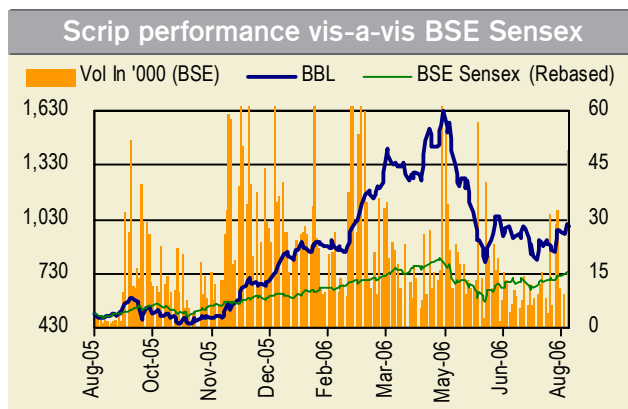
Critical Components of a Transformer

The transformer can be said to be one of the simplest and most efficient electrical equipment. A transformer is largely dependent on three critical components. First, the copper winding wire. Secondly, the transformer core, which is made of silicon steel or Cold Rolled Grain Oriented (CRGO). Finally, insulators that prevent a jumping of high voltages across connectors.

The transformer core is made of CRGO steel plates that have a high proportion of silicon at around 3-4%. This high content of silicon helps in reducing 'core losses', or losses through resistance in the steel.

Changing pricing environment

From the throes of bankruptcy during the mid-to-late 1990s to the current period which is witnessing strong

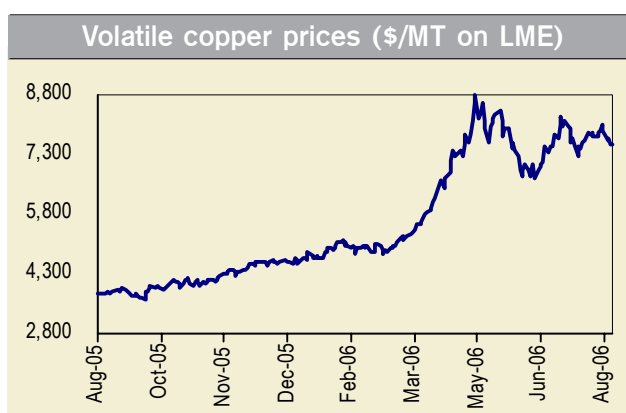


Source: IEEMA statistics

volume growth, the industry has undergone a sea change in pricing. In the earlier period, SEBs used to tender for fixed price contracts for transformers with manufacturers pricing any anticipated rise in prices.

However, a surge in copper prices in the last one year, has led to manufacturers not being able to price in the entire increase in cost of copper, due to the time lag in manufacturing a transformer and delivery schedule of the copper wire. Accordingly, the Price Variation Clause (PVC) has undergone phased relaxation from nil PVC to 10% PVC and now to full-PVC.

The thumb-rule of 7 MVA of transformers per MW, results in an estimated 700K MVA of demand by 2012. This has potential to result in a turnover of ~Rs 110-120 bn during the same period or ~Rs 24-25 bn p.a. This does not include replacement demand. Further, majority of industrial and commercial investments, are being undertaken in the northern and western region. Thus, the high step down-to-step up ratio is likely to remain. However, despite the high ratio of step down transformers, the value breakup of the industry is in favour of medium voltage (MV) and high voltage (HV) transformers as per unit cost of MV/HV is higher.



Source: Capitaline

Silicon steel is entirely imported with domestic manufacturers sourcing the same from fabrication companies like Bilpower that have slitting lines for cutting the CRGO sheets to required dimensions. Prices of silicon steel have risen from ~Rs 90k/mt to current levels of ~Rs 300k/mt.

This has been due to both demand and supply side factors. While demand has been growing, supply for such steel is by handful of players. Further, silicon steel also competes with auto grade steel in a manufacturer's scheduling of its plant. The growing demand for auto grade steel has also resulted in accentuating the shortage of silicon steel.

Installed base

The installed base of transformers highlights that the number of step-down transformers are in a 3.6:1 ratio to step-up transformers. However, this ratio varies as per the region. For instance, the northern and western regions have the highest ratio at 4.1 & 4.4, while the northeastern region has the lowest at 1.5. This is due to the fact that the density and variation in voltage profile of load centres is highest in these regions.

Installed base of Transformers (mVA)			
	Step-up	Step-down	Ratio (SD/SU)
Northern region	40,015	165,832	4.1
Western region	36,415	160,386	4.4
Southern region	38,233	136,805	3.6
Eastern region	27,775	54,815	2.0
North eastern region	3,900	5,861	1.5
Total	146,338	523,699	3.6

Source: CEA General Review FY06

Main players in the industry

The industry is dominated by companies like ABB, BHEL, Crompton Greaves, Emco, Indo Tech Transformers, Vijai Electricals and Areva. While all the players are present in the distribution transformer segment, the presence of players thins out in the higher capacity ranges like 100 MVA.

Major players in the transformer industry (kVA)		
Major manufacturers	Capacity (MVA)	Max range of class (kV)
BHEL	16,000	750
Crompton	23,404	750
Voltamp	5,400	132
Areva	8,500	440
Emco	8,500	440
ABB	10,000	440
Bharat Bijlee	8,000	220
Indo Tech	2,450	220
Siemens (by Dec'06)	-	750

Source: Industry

Rising order backlog

The last few years have witnessed a burgeoning order backlog, which is generally for delivery over a period of 6-10 months, with SEBs as primary customers.

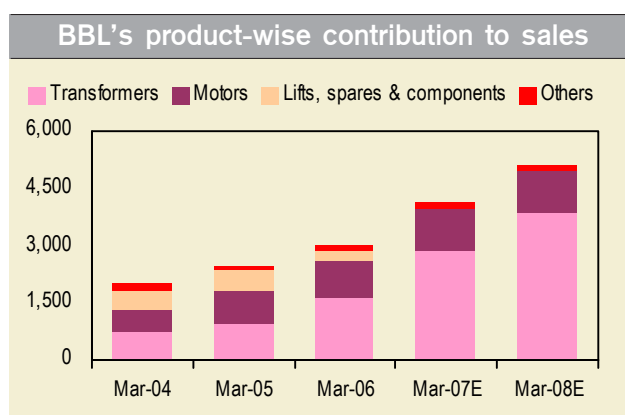
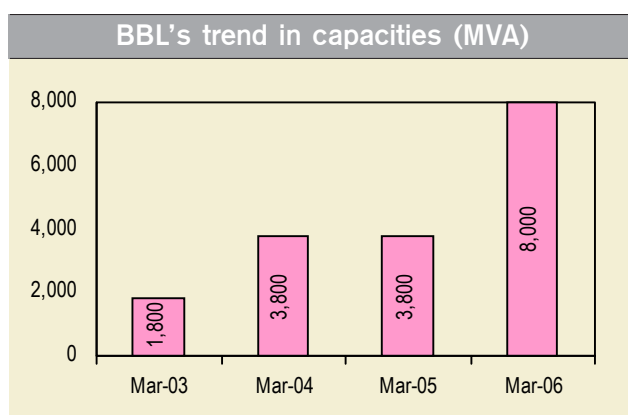
Electric motors industry

Electric motors are a prime mover for a large number of machinery involved in manufacturing (compressors, conveyors, mills etc.), agricultural (pumpsets) or service sectors (compressors). The motors industry is estimated at around Rs 30 bn with a significant

the market is witnessing growth, the market is largely price sensitive and subject to the volatile copper prices. Thus, margins in the business are comparatively lower. However, due to the commodity nature of the business, the short working capital cycle helps ease the burden from a lengthy recovery period in transformers.

BBL's changing product profile

BBL has steadily increased capacities and has recently forayed into the 220 kV class. It has also increased capacity from 3,800 MVA to 8,000 MVA in Q4FY06 at a capex of Rs 90 mn.



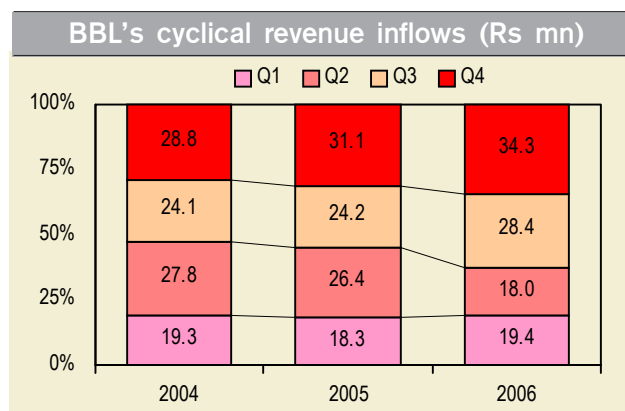
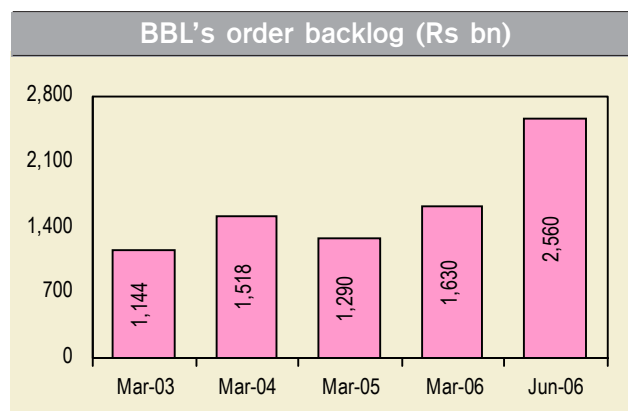
Note: Lift operations divested in 2004, spares curtailed from Q4FY06

presence of the unorganised segment at the lower end (<10 hp). The medium (50-200 hp) and higher-end (>300 hp) segments are largely in the hands of the organised sector owing to the greater possibility of inefficient construction and subsequent power loss.

The motors market is dominated by players like Crompton Greaves at the lower end, Bharat Bijlee in the mid-range segment, Siemens among others. While

Cyclical asset sweating

Revenues for the industry are largely SEB-centric, which account for a major share of volumes. As a result, the a large part of the revenues accrue in H2 of a fiscal. Consequently, as a result of operating leverage, margins in the period are significantly higher than during H1 of a fiscal.



Source: Company

Improving margins

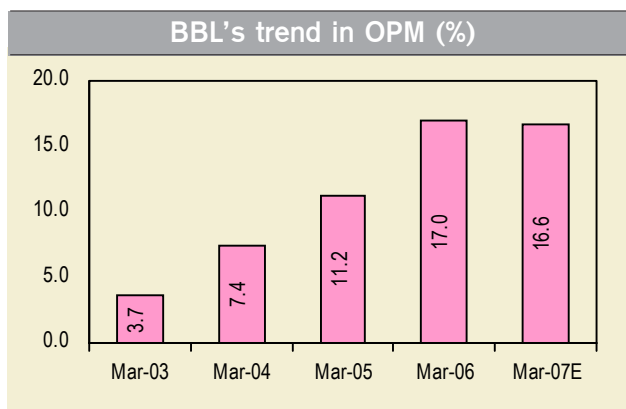
The increasing offtake of transformers and improvement in sweating its assets in the segment helped BBL capitalise on operating leverage, which was further aided by paring its employee costs over the last 3 years.

BBL's performance in Q1FY07 was below expectations. Net sales grew by 22% YoY to Rs 710 mn. This was largely contributed by the transformer segment. However, the growth was impacted due curtailment of sale of spares and components relating to the Lifts division. As a result, revenues in Q1FY06 were higher by around Rs 100 mn. Thus, on a comparative basis, net sales grew by 47%. Operating margins were lower by 109 bps at 10.7%.

This was largely due to the execution of 4 orders in the 100 mVA segment estimated at around Rs 120-130 mn. Since this is a new segment that the company has forayed into, BBL had to offer entry level pricing for the same, thereby impacting overall margins. The higher volumes however, helped operating profits grow by 11% to Rs 76 mn. Interest and depreciation charges rose by 17% and 32% to Rs 10 mn and Rs 5 mn respectively. Following the higher margins, net profits rose by 8% to Rs 43 mn.

BBL's order backlog at the end of Q1FY07 was Rs 2.5 bn vis-a-vis Rs 1.6 bn at the end of FY06 to be executed over 6-9 months. This should lead to an improvement in volumes from the new plant. The growing project and replacement demand for transformers should help BBL grow its volumes over the next few years.

Thus, we expect overall capacity utilisation to be ramped up significantly in FY07. Further, the steady demand for electric motors from all segments of the economy will help buoy performance of the segment.



In transformers segment, we expect capacity utilisation to be around 87%. Volumes should grow by 77% to 7,000 MVA in FY07 on the increased capacity and lead to a revenue growth of 78% to Rs 2.9 bn.

The company is also planning to steadily increase the share of projects from current levels of around 5-6%. This will help it to capitalise on the entire gamut of transformer business and help boost volume and revenue growth for BBL. However, the inherent nature of the EPC segment will imply an impact on margins from the current high levels of around 17-18%. Further, it may also lead to an increase in the receivables period.

The electric motors business is a fast moving near commodity business, which helps BBL improve its overall working capital cycle and also ease its financing burden. Thus, we expect revenues of the motors business to grow by 7.5% to Rs 1 bn.

BBL is exposed to the highly volatility in copper and CRGO prices. The increased volatility over the last 12 months has resulted in companies being unable to build up inventory to stabilise manufacturing costs. While the companies have the ability to pass on the increase in copper prices as per the price variation clause, it may occur with a lag.

We expect the lower margin 100 mVA orders being executed to impact overall margins in FY07. Accordingly, we expect operating margins to be impacted by 40 bps to 16.6%. Operating profits are however, expected to grow by 33% to Rs 681 mn.

The higher capacity, lower margins and corresponding increase in working capital requirement will lead to an increase in interest and depreciation charges. The higher volumes should help net profits grow by 33% to Rs 452 mn in FY07.

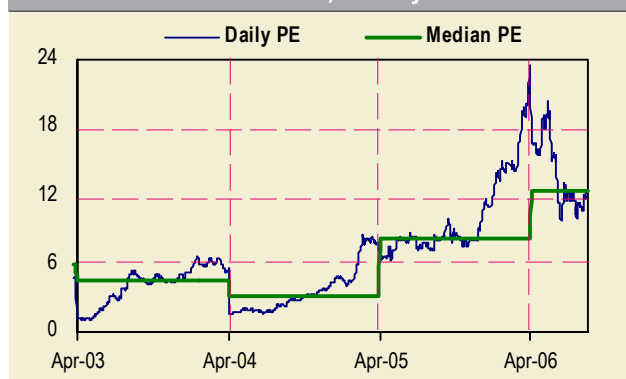
The CMP of Rs 975 discounts FY07E EPS of Rs 80.2 by 12.2x. The stock trades at an EV/Sales of 1.3x and an EV/EBIDTA of 8.2x its FY07 estimates. BBL has managed to maintain growth while also expanding its margins. We expect margins to expand going forward as the company forays into the higher capacity segments. We however, assume that project revenues will remain around 5-6%.

Thus, we recommend a 'BUY' with a price target of Rs 1,300, on a 12 month investment perspective.

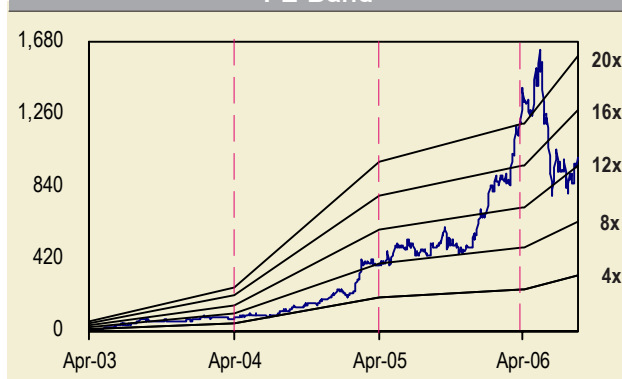
Financial Results for the quarter ended Jun'30, 2006 (Standalone)

Particulars (Rs Mn)	Quarter Ended			Year Ended		
	30/06/06	30/06/05	Gr %	31/03/06	31/03/05	Gr %
Gross Sales	824	665	23.9	3,417	2,748	24.4
Less: Excise Duty	114	83		410	290	
Net Sales	710	582	21.9	3,008	2,458	22.3
Total Expenditure	634	514	23.4	2,496	2,184	14.3
(Inc.)/dec.in stock-in-trade	(92)	(106)		(121)	(36)	
Raw Materials	584	474		1,942	1,571	
Packing material, fuel, bought outs	-	22		149	115	28.9
Staff Cost	70	59	20.1	252	226	11.6
Other expenditure	72	65	9.8	275	308	(10.8)
Operating profit	76	69	10.6	512	275	86.6
Other Income	8	7	16.7	37	44	(16.6)
PBDIT	84	76	11.2	549	319	72.3
Interest	10	9	16.5	47	38	23.7
Depreciation	5	4	31.7	18	17	9.5
PBT & extraordinary items	69	63	9.2	484	264	83.3
Provision for current tax	22	20		152.6	90	
Provision for deferred tax	-	-		13.5	(12)	
PAT & before extraordinary items	46	43	7.7	318	186	70.9
Ext. Ord. Inc.	-	-		35	151	
Ext. Ord. Exp.	4	3		16	59	
Net Profits	43	40	7.8	337	278	21.3
Equity Capital (F.V. Rs 10)	57	57		57	57	
Reserves (excl. rev. res.)	-	-		716	467	
EPS for the period (Rs)	8.2	7.6		56.2	32.9	
Book Value (Rs)	-	-		136.8	92.6	
OPM (%)	10.7	11.8		17.0	11.2	
NPM (%)	6.5	7.4		10.6	7.6	
Expend. (% of net sales)						
Materials	69.3	63.2		60.5	62.4	
Traded goods	0.0	3.7		4.9	4.7	
Staff Cost	9.9	10.1		8.4	9.2	
Other expenditure	10.1	11.2		9.1	12.5	

Median PE v/s Daily PE



PE Band



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