

BSE SENSEX
19,008S&P CNX
5,697**Rs2,218****Buy**Bloomberg
Equity Shares (m)
52-Week Range (Rs)
1,6,12 Rel. Perf. (%)
M.Cap. (Rs b)
M.Cap. (US\$ b)BHEL IN
489.5
2,695/2,060
0/-13/-15
1,085.5
23.8

YEAR	NET SALES	PAT	EPS	EPS	P/E	P/BV	ROE	ROCE	EV/	EV/
END	(RS M)	(RS M)	(RS)	GR (%)	(X)	(X)	(%)	(%)	SALES	EBITDA
03/10A	334,757	46,839	95.7	31.3	23.2	6.8	32.5	51.4	3.0	16.7
03/11E	403,304	58,340	119.2	24.6	18.6	5.5	32.6	53.1	2.4	11.0
03/12E	496,027	71,656	146.4	22.8	15.1	4.4	32.2	53.5	2.0	8.8
03/13E	601,472	84,707	173.0	18.2	12.8	3.6	30.8	50.1	1.6	7.3

- **3QFY11 earnings above estimates:** BHEL reported a robust 3QFY11 financial performance, ahead of estimates. Reported revenues were Rs90b (up 25% YoY), better than our estimate of Rs88b (up 23% YoY). Reported EBITDA margins were 23%, up 140bp YoY (against our estimate of 20.4%). Reported net profit was Rs14b (up 31% YoY), better than our estimate of Rs12b (up 14% YoY). 9mFY11 revenue and PAT growth was 23% and 33% YoY respectively.
- **Change in accounting mechanism leads to revenue, EBITDA adjustment of Rs4.4b, Rs880m:** In 3QFY11 BHEL re-aligned its mismatch in booking revenue and costs, which led to an increase of Rs4.4b in revenue and Rs880m in EBITDA. If we exclude this, revenue was Rs86b, up 18.7% YoY and adjusted PAT was Rs13.4b, up 21% YoY.
- **Raw material cost falls 100bp YoY, EBITDA margin up 140bp at 23%:** In 3QFY11 raw material costs were 54.4% (down 116bp YoY) and other expenditure was up 194bp due to the creation of an LD provision of Rs1b. Staff costs were down 200bp YoY at 15.2% to sales. The management expects staff costs to be about Rs56b in FY11. Staff cost during 9mFY11 was Rs39b, implying likely staff cost of Rs17b in 4QFY11.
- **Order intake guidance maintained:** BHEL maintained its guidance of order-flow of Rs600b in FY09, implying 4QFY11 inflow of Rs23b. Given the pipeline of projects, we expect BHEL to meet its guidance.
- **Valuation and view:** In the context of improved earnings visibility and strong industry tailwinds, BHEL is attractively valued. Our EPS estimates are Rs119.2 (up 24% YoY) for FY11 and Rs146.4 (up 24% YoY) for FY12. Our price target is Rs2,927 (20x FY12E), an upside of 32% from current levels. Maintain **Buy**.

QUARTERLY PERFORMANCE

(Rs Million)

Y/E MARCH	FY10				FY11				FY10	FY11E
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4QE		
Sales (Net)	55,957	66,252	72,292	135,591	64,797	84,907	90,233	162,154	328,803	394,785
Change (%)	29.3	24.0	20.0	28.6	15.8	28.2	24.8	19.6	25.3	20.1
EBITDA	5,920	12,318	15,617	28,728	9,670	16,324	20,717	39,493	62,583	86,204
Change (%)	28.8	51.6	36.1	43.2	63.4	32.5	32.7	37.5	41.4	37.7
As a % Sales	10.6	18.6	21.6	21.2	14.9	19.2	23.0	24.4	19.0	21.8
Adjusted EBITDA	5,920	12,318	15,617	35,074	9,670	16,324	20,717	39,493	68,929	86,204
Change (%)	9.3	35.6	24.5	47.3	63.4	32.5	32.7	12.6	35.5	25.1
As a % Sales	10.6	18.6	21.6	25.9	14.9	19.2	23.0	24.4	21.0	21.8
Interest	43	45	69	178	38	59	145	239	335	482
Depreciation	961	934	1,038	1,647	1,269	1,341	1,447	1,396	4,580	5,453
Other Income	2,271	1,955	1,933	2,080	1,635	1,620	1,529	2,021	8,239	6,805
PBT	7,187	13,294	16,443	28,983	9,998	16,544	20,655	39,879	65,907	87,075
Tax	2,481	4,715	5,717	9,887	3,301	5,121	6,623	13,691	22,800	28,735
Effective Tax Rate (%)	34.5	35.5	34.8	34.1	33.0	31.0	32.1	34.3	34.6	33.0
Reported PAT	4,706	8,579	10,726	19,096	6,697	11,423	14,032	26,189	43,106	58,340
Change (%)	22.4	39.3	35.7	41.7	42.3	33.2	30.8	37.1	37.4	35.3
Adj. PAT	4,533	8,579	11,096	22,633	6,697	11,423	13,432	26,789	46,839	58,340
Change (%)	3.5	26.6	29.0	42.2	47.7	33.2	21.1	18.4	31.3	24.6

E: MOSL Estimates

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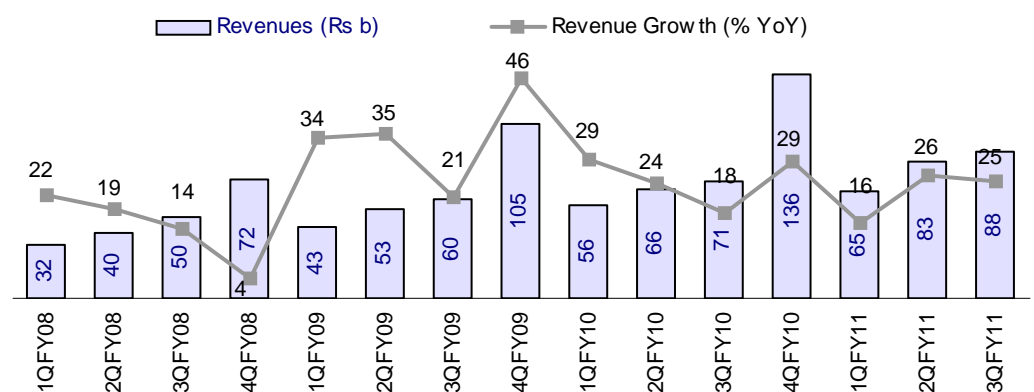
BHEL: 3QFY11 results ahead of estimates, PAT up 31% YoY, material costs fall; maintain Buy

- BHEL posted robust financial performance, ahead of estimates. 3QFY11 revenue was Rs90b (up 25% YoY), better than our estimate of Rs88b (up 23% YoY). EBITDA margins were 23%, up 140bp YoY (above our estimate of 23%). Net profit was Rs14b (up 31% YoY), better than our estimate of Rs12b (up 14% YoY). In the 9mFY11 revenue and PAT grew 23% and 33% YoY respectively.
- In 3QFY11, BHEL re-aligned its mismatch in booking revenue and costs, which led to an increase of Rs4.4b in revenue and Rs880m in EBITDA. If we exclude this, revenue was Rs86b, up 18.7% YoY and adjusted PAT was up 21% YoY at Rs13.5b.
- Order backlog at the end of 3QFY11 was Rs1,580b and BTB ratio was 4.2x TTM revenue. In 3QFY11 order intake was Rs128b, down 18% YoY. Intake in 9mFY11 was Rs371b, flat YoY. Implied order intake in 4QFY11 is Rs228b according to the management's FY11 intake guidance of Rs600b. The power and industry segment revenues improved by 28% and 19% YoY respectively. Power segment EBIT margins were 22.4% (down 51bp YoY) and industry segment margins were 21.2% (down 129bp YoY).

Revenue growth buoyant, capacity to expand to 20GW, to ease execution challenges

- For 3QFY11, revenues were Rs90b (up 25% YoY), above our estimate of Rs88b (up 23% YoY). The power segment's revenue grew 28%, and the industrial segment's revenue grew 19%. Adjusted for a Rs4.4b increase in revenue due to a change in accounting policy, revenue was Rs85b, up 19% YoY. 9mFY11 revenues were Rs239b up 23% YoY
- The management indicated in the past that overall shop floor production would touch 17GW in FY11 against 11GW in FY10. This reflects BHEL's enhanced ability to handle increased tonnage of steel at its plant, which includes castings, steel pipes and valves due to enhanced capacity to 15GW.
- BHEL is on track to expand capacity to 20GW a year by FY12. We believe, with expanded capacity, the company will be able to grow production at an accelerated pace in FY13-14.

Buoyant revenue growth



Source: Company/MOSL

Power drives performance, industrial segment a long term focus area

- 3QFY11 power segment revenue was Rs73b (up 28% YoY) and revenue from the industrial segment was Rs22b (up 19% YoY). The power division contributed 77% to total revenue and the industrial division contributed 23%. EBIT margins for the power division dropped 51bp YoY to 22.4% and for the industry segment they were 21.2%, down 129bp YoY.
- In the industry segment, BHEL entered into railways (propulsion systems for locomotives of 700HP range with Alstom) and defense (naval guns). These will keep long term drivers for the industry segment intact as the management foresees consistent revenue growth of 20-25% for this segment in four-five years with new segments driving revenue growth.

Segmental details (Rs m)

	FY10				FY11			FY10	% YoY
	1Q	2Q	3Q	4Q	1Q	2Q	3Q		
Revenues									
Power	45,688	54,283	57,087	111,549	53,999	69,650	72,820	268,607	27.6
Growth (%)	30.2	23.1	18.5	29.6	18.2	28.3	27.6	25.8	
Industry	13,325	15,954	18,020	31,491	14,763	18,577	21,429	78,790	18.9
Growth (%)	3.7	6.6	2.8	15.9	10.8	16.4	18.9	8.7	
EBIT									
Power	8,281	11,219	13,086	30,584	10,701	14,731	16,321	63,170	24.7
Growth (%)	26	47	83.7	77	29	78	45.5	63.6	
Industry	1,620	2,706	4,051	8,049	1,704	3,055	4,542	16,425	12.1
Growth (%)	-11	20	81.3	38	5	89	67.9	35.2	
EBIT Margin (%)									
Power	18.1	20.7	22.9	27.4	19.8	21.1	22.4	23.5	(51) bp
Industry	12.2	17.0	22.5	25.6	11.5	16.4	21.2	20.8	(129)bp

Source: Company/MOSL

RM cost up 235bp YoY, adjusted EBITDA margin up 63bp at 19.2%

Raw material cost falls, EBITDA margins expand

- In 3QFY11 raw material costs were 54.4% (down 116bp YoY) and other expenditure was up 194bp due to provisions of Rs1b according to the management.
- Staff costs were down 200bp YoY and were 15.2% of sales. The management has guided for overall staff costs of Rs56b in FY11 and 9mFY11 staff costs were Rs39b, implying 4QFY11 staff costs of Rs17b.

Operating cost break-up: material costs fall 116bp YoY

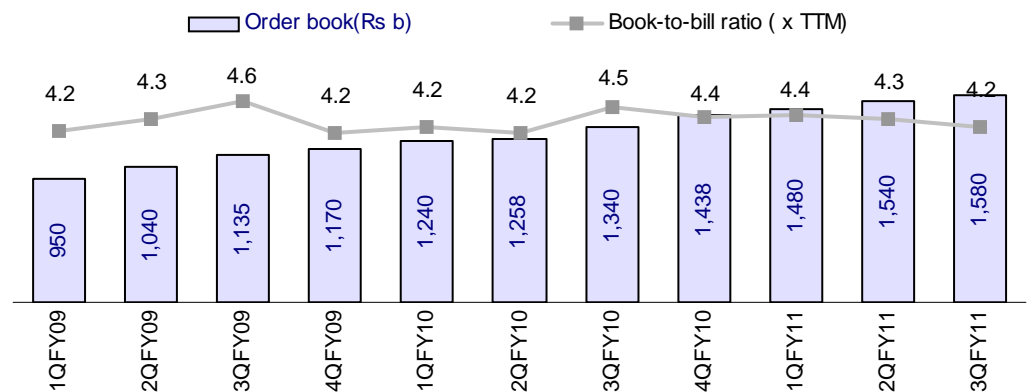
% of sales	FY09				FY10				FY11			YoY.Ch (bp)
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q	1Q	2Q	3Q	
RM Cost	58.5	59.5	58.2	64.0	63.4	57.3	55.5	59.2	58.8	59.6	54.4	-116.1
Staff Cost	20.7	16.7	15.3	13.4	19.9	16.1	17.3	12.9	20.6	15.2	15.2	-204.0
Other Costs	12.2	10.5	9.6	6.5	7.5	9.6	7.0	9.6	7.5	7.6	9.0	193.6

Source: Company/MOSL

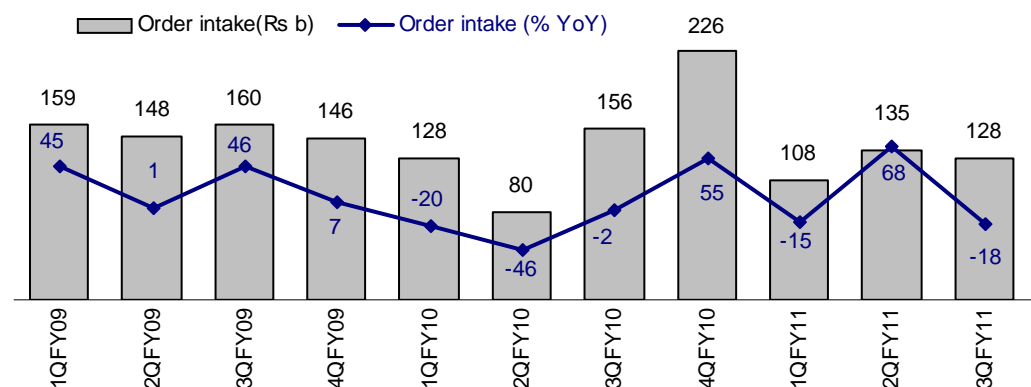
Order intake fall 18% YoY, FY11 order intake expected to increase 6%

- BHEL's order book as at December 2010 was Rs1,548b (up 18% YoY, and up 2% QoQ).
- In 3QFY11 BHEL reported order intake of Rs126b, down 18% YoY. The boiler order awards, part of the bulk tendering by NTPC and DVC for 11 sets of 660MW plants is under arbitration due to a stay order brought in by one of the bidders Gammon-Ansaldo. The consortium claims Ansaldo was reportedly disqualified because of a technical reason that it did not design the 'evaporator' of the boiler that was offered as the reference operating plant in the tender.
- Once this process is complete, we expect final awards. Bharat Forge (will get five units), BHEL (four units) and Toshiba (two units) have been short listed. We do not expect Ansaldo to get a favorable response from the Court. In the turbine-generator (TG) package of the same tender earlier, L&T, which had been disqualified had filed a Court case, but without a favorable ruling. The court will now announce its hearing on the matter on 3 February 2011. The management expects price bids for the boiler package to open on 4 February 2011, and final awards by March 2011.

Robust order book, BTB ration to drive excution



Order intake in 3QFY11 was Rs128b, down 18% YoY



Source: Company/MOSL

Order intake for 9mFY11 was 10GW, worth Rs126b

Segment	3QFY11			9MFY11		
	Value (Rs b)	MW	% share	Value (Rs b)	MW	% share
Power	79	3,300	62.6	282	8,921	81.4
Industry	27	680	21.7	69	1,292	11.8
Exports	20	692	15.7	22	752	6.9
Total	126	4,672		373	10,965	

3QFY11 order intake strong from private sector

Client	MW	Value (Rs.b)
Indiabulls (Nashik)	5X270	27.9
Indiabulls (Amravati)	5X270	28.3
APGENCO	1X600	14.5
Total		70.6

Source: Company/MOSL

Takeaways from 3QFY11 results conference call

- The management sees power equipment demand staying strong in future. BHEL does not see a serious threat from competition and expects to maintain market share.
- The accounting adjustment in 3QFY11 pertained to standardization of liquidated damages at 2.5% of the contract value for all projects and hence is a one-off.
- PBT impact of Rs880m from Rs4.4b of revenue (due to change in the accounting method) translates into Rs3.56b of operating costs. Most of this (~50%) is adjusted towards material costs.
- The management is confident of achieving FY11 inflows of Rs600b, translating into 4QFY11 inflows of Rs228b. We expect FY12 inflows to exceed Rs600b. The company expects the bulk tender of 9x 800MW from NTPC to come through in 2QFY12.
- Besides the JV with Karanatak State Electricity Board (KSEB) most of the other JVs with Andhra (AP), TN (Tamil Nadu) and MP (Madhya Pradesh) will award EPC contracts in FY12.
- Material costs, which dropped by 116bp YoY during 3QFY11, were the result of better sourcing of and integration of processes within the shop floor. Material inventory of six months is maintained by BHEL.
- BHEL intends to make critical parts like CRGO steel in collaboration with SAIL and expand its vendor base going forward to ease bottlenecks in its execution.
- The company expects an addition of 4,000 employees in FY11 and FY12 each. The current employee strength is 47,000. BHEL expects staff costs as a percentage of sales to fall from 15.5% currently as a revenue ramp up creates more leverage in the system.
- BHEL firmed up plans for the formation of an NBFC that will finance equipment purchase for its clients to better tackle competition from Chinese vendors.
- BHEL formed a JV with Alstom to make turbines for nuclear powered plants and will bid for NPCIL tenders in FY12.
- The company's net current assets were Rs15b and cash on books was Rs80b.

Power market to grow to 50GW a year, BHEL to maintain 50% share

To reach a targeted power generation capacity base of 700GW by FY27, India needs to award 500GW of orders during the next 10 years, implying a market opportunity of nearly 50GW a year for power equipment in the next 5-7 years. With projected equipment manufacturing capacity of 38GW a year by FY15 and growing concern over imports, the Indian power equipment market will be in short-supply. We believe BHEL will continue to enjoy over 50% market share, providing long term growth visibility.

Valuation and view

- BHEL is expected to maintain revenue and PAT CAGR of 22% and 24% respectively over FY10-12.
- BHEL has countered the competitive threats from Chinese and Korean players. With environment in the power equipment industry turning favorable to domestic manufacturers, BHEL is well placed to maintain its market share.
- With a wage settlement in place, we expect economies of scale to play out in three years, boosting margins.
- In the context of improved earnings visibility and strong industry tailwinds, BHEL is attractively valued. Our EPS estimates for BHEL are Rs119.2 (up 24% YoY) for FY11 and Rs146.4 (up 24% YoY) for FY12. Our price target is Rs2,927 (20x FY12E), an upside of 32% from current levels. Maintain **Buy**.

BHEL: an investment profile

Company description

BHEL is India's dominant producer of power and industrial machinery and a leading EPC company, established in the late 1950s as the government's wholly-owned subsidiary. After divestment, the government has an equity stake of 67.7%. The company has 14 manufacturing divisions, eight service centers, four power sector regional centers besides project sites all over India and abroad. It has an annual installed capacity of 6,000MW. It formed a tie-up with Alstom and an alliance with Siemens to make super-critical 800MW boilers and turbines respectively.

Key investment arguments

- Order backlog at the end of 2QFY11 was Rs1,540b, a book-to-bill ratio of 4.3x TTM providing the best revenue visibility in our engineering universe
- Its earnings and revenue CAGR was 22% and 24% respectively and adjusted EBITDA margin expansion is expected to be 250bp over FY10-12 at 22.1%.
- After capacity expansion to 20GW by 2012, BHEL's capacity will be at par with its competitors, giving BHEL sizeable muscle to compete, execute and deliver on time.

Key investment risks

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

Comparative valuations

		BHEL	L&T	Crompton
P/E (x)	FY11E	18.6	25.0	20.1
	FY12E	15.1	20.1	18.0
P/BV (x)	FY11E	5.5	5.0	7.2
	FY12E	4.4	4.4	7.1
EV/Sales (x)	FY11E	2.4	2.5	2.3
	FY12E	2.0	2.0	2.4
EV/EBITDA (x)	FY11E	11.0	21.1	14.2
	FY12E	8.8	16.7	14.9

Shareholding Pattern (%)

	Dec-10	Sep-10	Dec-09
Promoter	67.7	67.7	67.7
Domestic Inst	12.0	11.2	10.8
Foreign	14.1	14.8	15.6
Others	6.2	6.3	5.9

Recent developments

- NTPC opened price-bids for a turbine-generator (TG) package of its Rs250b bulk tender to set up 11 units (including two units of DVC) of 660MW super-critical power projects on 8 October 2010. Based on 'read out' prices (prices quoted by bidders), the Alstom-Bharat Forge joint venture is the lowest bidder (Rs13m/MW). The company will get two projects (a maximum of four or five units of 660MW each). BHEL is the second lowest bidder (8% higher than the Alstom-Bharat Forge venture) and will get two projects (four or five units of 660MW each). BHEL will have to match the L1 price.

Valuation and view

- In the context of improved earnings visibility and strong industry tailwinds, BHEL is attractively valued. Our EPS estimates for BHEL are Rs119.2 (up 24% YoY) for FY11 and Rs146.4 (up 24% YoY) for FY12. Our price target is Rs2,927 (20x FY12E), an upside of 32% from current levels. Maintain **Buy**.

Sector view

- We maintain a positive view on the sector.

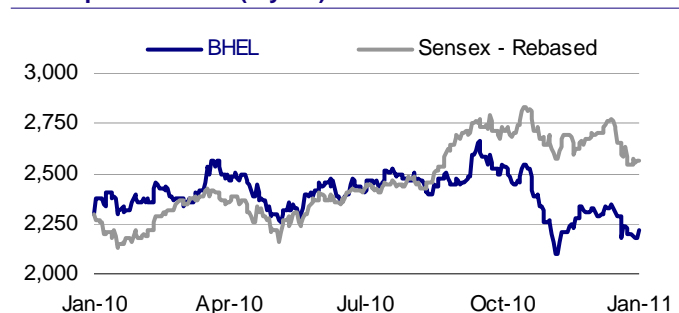
EPS: MOSL forecast v/s Consensus (Rs)

	MOSL Forecast	Consensus Forecast	Variation (%)
FY11	119.2	113.7	4.9
FY12	146.4	138.5	5.7

Target Price and Recommendation

Current Price (Rs)	Target Price (Rs)	Upside (%)	Reco.
2,218	2,927	32.0	Buy

Stock performance (1 year)



Financials and Valuation

INCOME STATEMENT						(Rs Million)				
Y/E MARCH	2009	2010	2011E	2012E	2013E					
Total Income	267,879	334,757	403,304	496,027	601,472					
<i>Change</i>	<i>35.8</i>	<i>25.4</i>	<i>20.1</i>	<i>23.3</i>	<i>21.4</i>					
Staff Cost	41,127	51,529	56,170	61,454	69,010					
Mfg. Expenses	164,685	198,857	236,871	299,360	370,746					
Selling Expenses	19,877	25,172	24,058	27,345	34,671					
EBITDA	42,189	59,200	86,204	107,867	127,046					
<i>Change</i>	<i>12.8</i>	<i>40.3</i>	<i>45.6</i>	<i>25.1</i>	<i>17.8</i>					
<i>% of Net Sales</i>	<i>15.7</i>	<i>17.7</i>	<i>21.4</i>	<i>21.7</i>	<i>21.1</i>					
Depreciation	3,343	4,580	5,453	6,977	8,922					
Interest	307	335	482	482	482					
Other Income	9,829	11,549	6,805	10,685	12,676					
Extra-ord. Items (net)	119	73	0	0	0					
PBT	48,488	65,907	87,075	111,094	130,318					
Tax	17,106	22,800	28,735	39,438	45,611					
<i>Rate (%)</i>	<i>35.3</i>	<i>34.6</i>	<i>33.0</i>	<i>35.5</i>	<i>35.0</i>					
Reported PAT	31,382	43,106	58,340	71,656	84,707					
Adjusted PAT	35,670	46,839	58,340	71,656	84,707					
<i>Change</i>	<i>42.1</i>	<i>31.3</i>	<i>24.6</i>	<i>22.8</i>	<i>18.2</i>					

BALANCE SHEET						(Rs Million)				
Y/E MARCH	2009	2010	2011E	2012E	2013E					
Share Capital	4,895	4,895	4,895	4,895	4,895					
Reserves	124,492	154,278	193,506	241,687	298,644					
Net Worth	129,387	159,174	198,402	246,583	303,539					
Loans	1,494	1,278	1,278	1,278	1,278					
Differed Tax Liability	-18,403	-15,272	-15,272	-15,272	-15,272					
Capital Employed	112,478	145,179	184,407	232,588	289,545					
Gross Fixed Assets	52,249	65,801	77,591	114,381	136,171					
Less: Depreciation	37,545	41,647	47,458	54,435	63,357					
Net Fixed Assets	14,704	24,154	30,133	59,947	72,814					
Capital WIP	11,570	15,296	15,000	5,000	5,000					
Investments	523	798	798	798	798					
Curr. Assets	369,011	429,348	525,825	614,992	719,379					
Inventory	78,370	92,355	113,568	140,028	169,965					
Debtors	159,755	206,888	237,952	293,393	339,930					
Cash & Bank Balance	103,147	97,901	137,381	136,640	155,508					
Loans & Advances	24,237	28,137	32,448	40,008	48,561					
Other Current Assets	3,502	4,069	4,475	4,923	5,415					
Curr. Liab. & Prov.	283,329	324,417	387,350	448,149	508,447					
Creditors	58,529	75,798	90,855	118,924	147,283					
Other Liabilities	175,045	204,439	246,385	273,295	297,665					
Provisions	49,756	44,180	50,110	55,930	63,500					
Net Current Assets	85,682	104,931	138,475	166,843	210,932					
Appli. of Funds	112,479	145,179	184,407	232,588	289,545					

E: MCDL Estimates

RATIOS					
Y/E MARCH	2009	2010	2011E	2012E	2013E
Basic (Rs)					
EPS	72.9	95.7	119.2	146.4	173.0
<i>Change (%)</i>	<i>42.1</i>	<i>31.3</i>	<i>24.6</i>	<i>22.8</i>	<i>18.2</i>
Cash EPS	79.7	105.0	130.3	160.6	191.3
Book Value	264.3	325.2	405.3	503.7	620.1
DPS	17.0	23.3	33.4	41.0	48.5
Payout (incl. Div. Tax.)	26.5	28.0	28.0	28.0	28.0
Valuation (x)					
P/E	30.4	23.2	18.6	15.1	12.8
Cash P/E	27.8	21.1	17.0	13.8	11.6
EV/EBITDA	23.3	16.7	11.0	8.8	7.3
EV/Sales	3.8	3.0	2.4	2.0	1.6
Price/Book Value	8.4	6.8	5.5	4.4	3.6
Dividend Yield (%)	0.8	1.1	1.5	1.8	2.2
Return Ratio					
RoE	30.1	32.5	32.6	32.2	30.8
RoCE	46.9	51.4	53.1	53.5	50.1
Turnover Ratios					
Debtors (Days)	208	221	220	220	210
Inventory (Days)	109	103	105	105	105
Creditors (Days)	81	84	140	140	0
Asset Turnover (x)	17.8	13.6	13.1	8.1	8.1
Leverage Ratio					
Debt/Equity (x)	0.0	0.0	0.0	0.0	0.0

CASH FLOW STATEMENT						(Rs Million)				
Y/E MARCH	2009	2010	2011E	2012E	2013E					
PBT bef. EO Items	48,369	65,834	87,075	111,094	130,318					
Add: Depreciation	3,343	4,580	5,453	6,977	8,922					
Interest	307	335	482	482	482					
Less: Direct taxes paid	17,106	22,800	28,735	39,438	45,611					
(Inc)/Dec in WC	12,443	-24,495	5,936	-29,109	-25,221					
CF from Operations	47,355	23,454	70,211	50,005	68,890					
EO Income	119	73	0	0	0					
CF from Op. Incl. EC	47,474	23,526	70,211	50,005	68,890					
(Inc)/Dec in FA	-13,223	-17,756	-11,137	-26,790	-21,790					
CF from Investment	-13,663	-18,031	-11,137	-26,790	-21,790					
(Inc)/Dec in Networth	-5,024	3,131	0	0	0					
(Inc)/Dec in Debt	542	-216	0	0	0					
Less: Interest Paid	307	335	482	482	482					
Dividend Paid	9,736	13,321	19,112	23,474	27,750					
CF from Fin. Activit	-14,525	-10,741	-19,594	-23,956	-28,232					
Incl/Dec of Cash	19,286	-5,245	39,480	-741	18,868					
Add: Beginning Balance	83,860	103,147	97,901	137,381	136,640					
Closing Balance	103,146	97,901	137,381	136,640	155,508					

N O T E S



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Disclosure of Interest Statement

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1. Analyst ownership of the stock	No
2. Group/Directors ownership of the stock	No
3. Broking relationship with company covered	No
4. Investment Banking relationship with company covered	No

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