

29 January 2008

**Buy**

|                |                |
|----------------|----------------|
| Price          | Target Price   |
| <b>Rs2,092</b> | <b>Rs3,300</b> |

|               |               |
|---------------|---------------|
| <b>Sensex</b> | <b>18,153</b> |
|---------------|---------------|

**Price Performance**

| (%)            | 1M   | 3M   | 6M | 12M |
|----------------|------|------|----|-----|
| Absolute       | (19) | (14) | 27 | 71  |
| Rel. to Sensex | (10) | (9)  | 7  | 34  |

Source: Capitaline

**Stock Details**

|                               |             |
|-------------------------------|-------------|
| Sector                        | Engineering |
| Reuters                       | BHEL.BO     |
| Bloomberg                     | BHEL@IN     |
| Equity Capital (Rs mn)        | 4895        |
| Face Value (Rs)               | 10          |
| 52 Week H/L                   | 2,925/970   |
| Market Cap (Rs bn)            | 1024.2      |
| Daily Avg Vol. (No of shares) | 1058599     |
| Daily Avg Turnover (US\$mn)   | 68.1        |

**Shareholding Pattern (%)**

|               |      |
|---------------|------|
| (31 Dec.'07)  |      |
| Promoters     | 67.7 |
| FII/NRI       | 19.7 |
| Institutions  | 7.7  |
| Private Corp. | 3.0  |
| Public        | 1.9  |

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**BHEL****Hit by extraordinaries**Result  
Update

BHEL Q3FY2008 reported net profit at Rs7.71 bn is below expectations, primarily because of lower than expected topline growth and higher than expected employee cost. The staff cost includes higher provision (Rs500-700 mn) for expected increase in wages after implementation of 6<sup>th</sup> pay commission. Adjusting for the same the net profit at Rs8.3 bn (up 25% yoy) is marginally below estimates. The topline for the quarter at Rs49.64 bn grew by 14% yoy, below our estimates. The topline for the quarter came in below estimates as some of the projects reported lower ramp up and thereby falling short of profit booking thresholds. The operating profit at Rs10.57 bn grew by a relatively muted 14% yoy as the OPMS declined by 10 bps to 21.3%. The OPMS were impacted by significantly higher employee cost, which includes higher provision for expected increase in wages after implementation of 6<sup>th</sup> pay commission, which we have treated as one time extraordinary cost. The order backlog for the quarter at Rs780 bn is up 67% yoy, on the back of 91% yoy growth in order inflows of close to Rs110 bn. We are not changing our earnings estimates for BHEL. Meanwhile we remain positive on BHEL and believe that the concern on the street regarding BHEL's ability to bag supercritical set orders and addressing competition is overdone. We believe that the company is heading in a right direction for addressing the supercritical market and it's just a matter of time that BHEL bags its first supercritical order and significantly allay street fears.

**Results Highlights**

- BHEL 5 years wage agreement for its employees ended in December 2006 and the new wage agreement will be implemented in line with recommendations of sixth pay commission. However to be on a conservative side, BHEL has provided for expected increase in staff cost during Q3FY2008 itself. The company has made additional provision to the tune of Rs50-70 mn during 3QFY08. We have treated this additional provision as one time extraordinary cost.
- Adjusting for the one time extraordinary cost, BHEL Q3FY2008 pre-exceptional at Rs8.3 bn is marginally below estimates.
- The topline for the quarter came in below estimates as some the projects reported lower ramp up and thereby falling short of profit booking thresholds. The topline for the quarter at Rs49.64 bn grew by 14% yoy, driven by 19% yoy growth in the power segment (revenues-Rs42 bn) and 13% yoy (Rs14.35 bn).
- The pre-exceptional operating profit at Rs10.57 bn grew by a relatively muted 14% yoy as the OPMS declined marginally by 10 bps to 21.3%. The other income for the quarter grew by 43% yoy to Rs2.65 bn and interest charges declined by 18% yoy.
- The pre-exceptional net profit for the quarter at Rs 8.3 bn grew by 25% yoy. The order backlog for the quarter at Rs780 bn is up 67% yoy, on the back of 91% yoy growth in order inflows of close to Rs110 bn.
- We are not changing our earnings estimates for BHEL. Meanwhile we remain positive on BHEL and believe that the concern on the street regarding BHEL's ability to bag supercritical set orders and addressing competition is overdone. We believe that the company is heading in a right direction for addressing the supercritical market and it's just a matter of time that BHEL bags its first supercritical order and significantly allay street fears.

| Rs millions                | Q308           | Q307           | Change     | 9M08            | 9M07            | Change     |
|----------------------------|----------------|----------------|------------|-----------------|-----------------|------------|
| <b>Net Sales</b>           | <b>49641.0</b> | <b>43396.9</b> | <b>14%</b> | <b>121634.0</b> | <b>103371.9</b> | <b>18%</b> |
| Raw Material Consumed      | 28509.5        | 25844.9        | 10%        | 72952.5         | 62827.8         | 16%        |
| <b>as % of sales</b>       | <b>57.4%</b>   | <b>59.6%</b>   |            | <b>60.0%</b>    | <b>60.8%</b>    |            |
| Stock Adjustment           | -687.1         | -1235.5        | -44%       | -4342.1         | -4196.7         | 3%         |
| <b>as % of sales</b>       | <b>-1.4%</b>   | <b>-2.8%</b>   |            | <b>-3.6%</b>    | <b>-4.1%</b>    |            |
| Employee Expenses          | 7463.6         | 5105.2         | 46%        | 19798.6         | 15473.8         | 28%        |
| <b>as % of sales</b>       | <b>15.0%</b>   | <b>11.8%</b>   |            | <b>16.3%</b>    | <b>15.0%</b>    |            |
| Other Expenses             | 4379.7         | 4390.3         | 0%         | 13190.7         | 12229.2         | 8%         |
| <b>as % of sales</b>       | <b>8.8%</b>    | <b>10.1%</b>   |            | <b>10.8%</b>    | <b>11.8%</b>    |            |
| Total Expenditure          | 39665.7        | 34104.9        | 16%        | 101600.2        | 86334.1         | 18%        |
| <b>as % of sales</b>       | <b>79.9%</b>   | <b>78.6%</b>   |            | <b>83.5%</b>    | <b>83.5%</b>    |            |
| <b>Operating profit</b>    | <b>9975.3</b>  | <b>9292.0</b>  | <b>7%</b>  | <b>20033.8</b>  | <b>17037.8</b>  | <b>18%</b> |
| Other Income               | 2648.6         | 1854.7         | 43%        | 9721.0          | 4754.5          | 104%       |
| PBIDT                      | 12623.9        | 11146.7        | 13%        | 29754.8         | 21792.3         | 37%        |
| Interest                   | 97.6           | 119.7          | -18%       | 312.0           | 386.5           | -19%       |
| Depreciation               | 761.5          | 662.1          | 15%        | 2144.5          | 1967.4          | 9%         |
| PBT                        | 11764.8        | 10364.9        | 14%        | 27298.3         | 19438.4         | 40%        |
| Tax                        | 4046.0         | 3688.4         | 10%        | 9813.0          | 6794.3          | 44%        |
| <b>Profit After Tax</b>    | <b>7718.8</b>  | <b>6676.5</b>  | <b>16%</b> | <b>17485.3</b>  | <b>12644.1</b>  | <b>38%</b> |
| Pre-exceptional net profit | 8319           | 6677           | 25%        | 18083.7         | 12644.1         | 43%        |
| OPM (%)                    | 20.1%          | 21.4%          |            | 16.5%           | 16.5%           |            |
| PBIDTM(%)                  | 25.4%          | 25.7%          |            | 22.3%           | 21.1%           |            |
| PBT(%)                     | 23.7%          | 23.9%          |            | 20.4%           | 18.8%           |            |
| PATM(%)                    | 15.5%          | 15.4%          |            | 13.3%           | 12.2%           |            |
| Tax Rate                   | 34.4%          | 35.6%          |            | 34.6%           | 35.0%           |            |

**Segmental Results**

| Rs millions     | Q308  | Q307  | Change     | 9M08   | 9M07    | Change     |
|-----------------|-------|-------|------------|--------|---------|------------|
| <b>Revenue</b>  |       |       |            |        |         |            |
| Power           | 42046 | 35387 | <b>19%</b> | 102447 | 84354.6 | <b>21%</b> |
| Industry        | 14354 | 12741 | <b>13%</b> | 35974  | 30845.9 | <b>17%</b> |
| <b>EBIT</b>     |       |       |            |        |         |            |
| Power           | 8612  | 8457  | <b>2%</b>  | 21570  | 18334.9 | <b>18%</b> |
| Industry        | 2469  | 1565  | <b>58%</b> | 4558   | 3194.8  | <b>43%</b> |
| <b>EBIT (%)</b> |       |       |            |        |         |            |
| Power           | 20.5% | 23.9% |            | 21.1%  | 21.7%   |            |
| Industry        | 17.2% | 12.3% |            | 12.7%  | 10.4%   |            |

| Order Book details (Rs bn)            | Q308 | Var (%) | Q208 | Var (%) | Q108   | Var (%) |
|---------------------------------------|------|---------|------|---------|--------|---------|
| Order at the beginning of the Quarter | 726  | 59%     | 624  | 59%     | 55000  | 46%     |
| Order inflow                          | 109  | 91%     | 146  | 46%     | 110    | 138%    |
| Revenue booked                        | 55   | 17%     | 44   | 21%     | 3569.5 | 24%     |
| Order backlog at the end of the Q     | 780  | 67%     | 726  | 59%     | 62400  | 59%     |

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