

BGR ENERGY SYSTEMS*Execution on track*

We visited the 1x600MW Mettur power project in Tamil Nadu, where BGR Energy (BGR) is executing the EPC (engineering, procurement and construction) contract. We came back convinced on BGR's capability of executing large-scale power projects. The EPC project is on track towards scheduled commissioning by September 2011. Also, we were confident on the company's progress on its BTG venture with Hitachi, post our interaction with management.

■ Execution in full steam

The INR 31 bn Mettur power project is BGR's first large EPC contract, bagged in June 2008 through international competitive bidding. The company has already achieved significant milestones, with drum lifting (February 2010) and condenser fabrication (June 2010) completed as per schedule. Further, BGR intends to conduct the boiler hydro test and boiler light up in November 2010 and March 2011, respectively. The coal handling and ash handling system is expected to complete in April 2011, with plant synchronisation likely to start in May 2011.

■ Equipment largely received

BGR has already received 80-85% of BTG equipment from Dongfang Electric (Dongfang), China, for executing the contract, and is expected to receive the balance in next few months. This eliminates the risk of delayed execution to a large extent. Moreover, BGR has already started working towards the transmission network and has received equipment for the 400kV & 220 kV GIS (gas insulated sub-station) from Areva.

■ Outlook and valuations: Execution on track; maintain 'BUY'

With 80-85% of equipment already received from Dongfang, the possibility of execution delay is remote and thus ensuring revenue visibility in the next two years. The JV with Hitachi assures superior quality of equipment for the future projects. We believe with the Hitachi manufacturing tie-up, BGR is well equipped to tap the broader customer base unlike earlier which should augur well for the stock over medium to long term. From our interaction with the management, we understand that BGR's order pipeline is very strong, though it expects order inflows only in H2FY11. The stock is trading at 19.2x and 14.7x its FY11E and FY12E earnings, respectively. We maintain 'BUY/ Sector Outperformer' on the stock.

Financials

Year to March	FY09	FY10	FY11E	FY12E
Revenues (INR mn)	19,303	30,734	46,255	61,166
Rev. growth (%)	27.0	59.2	50.5	32.2
EBITDA (INR mn)	2,089	3,441	5,224	6,908
Net profit (INR mn)	1,156	2,015	2,889	3,785
Share outstanding (mn)	72	72	72	72
Diluted EPS (INR)	16.1	28.0	40.1	52.6
EPS growth (%)	30.6	74.3	43.4	31.0
P/E (x)	48.0	27.6	19.2	14.7
EV/EBITDA (x)	27.0	15.9	11.3	8.8
ROAE (%)	22.3	31.7	33.7	31.9

September 23, 2010

Reuters: BGRE.BO | Bloomberg: BGRL IN

EDELWEISS 4D RATINGS

Absolute Rating	BUY
Rating Relative to Sector	Outperformer
Risk Rating Relative to Sector	Medium
Sector Relative to Market	Overweight

Note:
Please refer last page of the report for rating explanation

MARKET DATA

CMP	:	INR 771
52-week range (INR)	:	871 / 424
Share in issue (mn)	:	72.1
M cap (INR bn/USD mn)	:	56 / 1,220
Avg. Daily Vol. BSE/NSE ('000):	:	217.0

SHARE HOLDING PATTERN (%)

Promoters*	:	81.3
MFs, FIs & Banks	:	6.6
FIIIs	:	2.9
Others	:	9.2
* Promoters pledged shares (% of share in issue)	:	NIL

PRICE PERFORMANCE (%)

	Stock	Nifty	EW Capital Goods Index
1 month	(5.0)	8.3	4.1
3 months	3.5	12.7	4.9
12 months	72.2	19.3	15.3

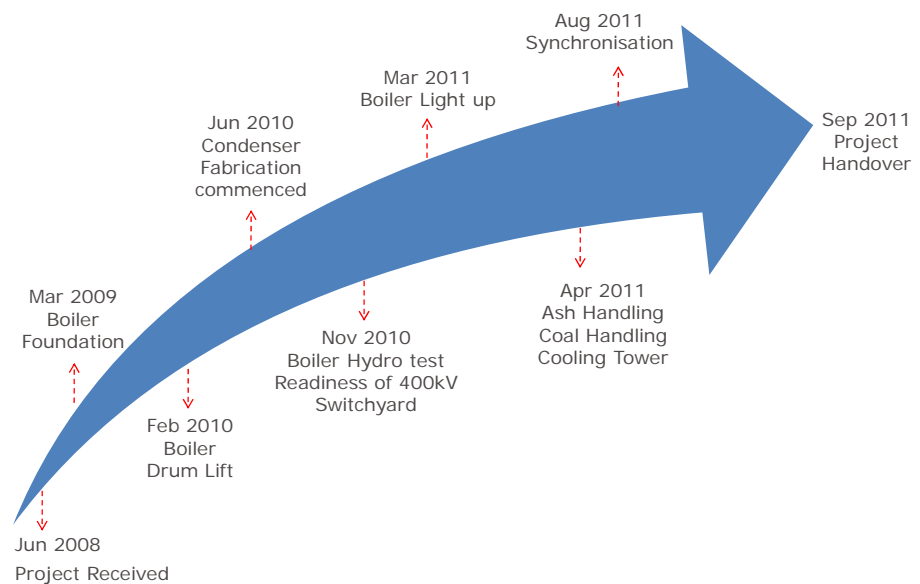
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- **Execution in full steam**

Mettur Thermal Power Project (worth INR 31 bn) is BGR's first large EPC contract, bagged in June 2008 from Tamil Nadu Electricity Board (TNEB) through international competitive bidding (where BHEL was the only other bidder). BGR has employed 20 sub-contractors and ~4,000 workers at the project site including ~20 Chinese supervisors. The company has already achieved significant milestones with drum lifting (February 2010) and condenser fabrication (June 2010) completed as per schedule. Further, the company intends to conduct boiler hydro test and boiler light up in November 2010 and March 2011, respectively. The coal handling and ash handling system is expected to complete in April 2011, with plant synchronisation likely to start in May 2011. BGR is to handover the power plant to TNEB by September 2011.

Fig. 1: Mettur Power Project Milestones



Source: Company, Edelweiss research

- **Equipment (BTG & transmission) largely received**

BGR has completed major portion of the boiler erection; the turbine generator house is currently under construction. Also, it has already received 80-85% of BTG equipment from Dongfang Electric, China, for executing the EPC contract, and is expected to receive the balance over the next few months. This eliminates the risk of delayed execution to a large extent. Further, BGR has already started work towards the transmission network and has received equipment for the 400kV & 220 kV GIS from Areva.

- **Strong order pipeline from SEBs**

The company is currently executing five BoP (Balance of Plant) and two EPC projects from various SEBs. So far, it has not done any large power project for the private sector, and hopes to bag a few contracts only after completing its ongoing large projects. BGR is expecting strong order pipeline as several SEBs are expected to dole out EPC and BoP orders cumulating ~10-15 GW, during the next few quarters. The existing plant at Mettur is an expansion of the 4x210MW power plant, and we believe that TNEB could look at further expansion by adding 2x800MW plants at a later date. The company has currently placed bids for two EPC projects of 2x660MW each in Rajasthan and 11x660MW

boiler bulk tender for NTPC. The company is confident of bagging at least one of the two EPC contracts in Rajasthan each worth INR 60-65 bn.

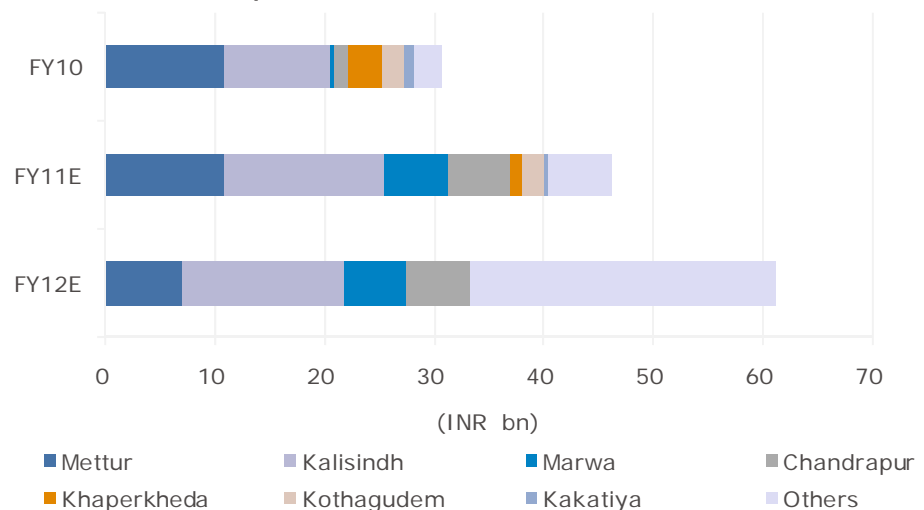
Table 1: SEB order pipeline

Sr No	SEB	Capacity (MW)	Value (INR mn)
1	Rajasthan	2,640	132,000
2	UP	1,320	66,000
3	Haryana	660	33,000
4	Maharashtra	1,320	66,000
5	Chhattisgarh	1,320	66,000
6	Orissa	1,320	66,000
7	Tamil Nadu	1,320	66,000
8	IPPs	2,640	132,000
Total		12,540	627,000

Source: Company, Edelweiss research

We believe that new order inflows are crucial for BGR to increase visibility, given that most of the current projects are likely to be completed by FY12. The order book, at INR 94 bn, provides visibility at 3.1x its FY10 revenue. Bagging one of the large EPC orders from Rajasthan will significantly diminish concerns related to order inflows and increase the book-to-bill to ~5.1x its FY10 revenue.

Chart 1: Revenue composition in FY11 & FY12



Source: Company, Edelweiss research

- **Good progress on BTG venture with Hitachi**

BGR has already identified land (~250 acres) for the manufacturing facility of boiler and turbine-generator through tie-up with Hitachi. It hopes to have the manufacturing facility ready by March 2012 and work towards indigenisation of the super-critical technology in the next few years. While the total capex for the BTG venture is pegged at INR 44 bn with debt:equity at 70:30, the total equity contribution by BGR towards the two JVs (each for boiler and turbine-generator) would be INR 9.6 bn which is expected to be funded through internal accruals. BGR, through the two JVs, plans to employ ~3,000 people. It is closely working with Hitachi towards training its engineers.

■ **Key triggers and value driver**

Qualifying in the NTPC bulk tender together with development of its BTG manufacturing facility with Hitachi will be a significant milestone for the company. Also given the lull in order inflows for the company, new order inflows will be key trigger for the stock going forward given the strong order pipeline of SEBs where we believe BGR has strong handle. BGR could witness competition in the EPC space with many new entities vying for orders. However, with strong order backlog, along with in-house manufacturing of various BoP components and design engineering, BGR seems to have a competitive edge over peers.

■ **Outlook and valuations: Order accretion crucial; maintain 'BUY'**

With 80-85% of equipment already received from Dongfang, the possibility of execution delay is remote and thus ensuring revenue visibility in the next two years. The JV with Hitachi assures superior quality of equipment for the future projects. We believe with the Hitachi manufacturing tie-up, BGR is well equipped to tap the broader customer base unlike earlier which should augur well for the stock over medium to long term. From our interaction with the management, we understand that BGR's order pipeline is very strong, though it expects order inflows only in H2FY11.

Chart 2: One year forward PE of BGR

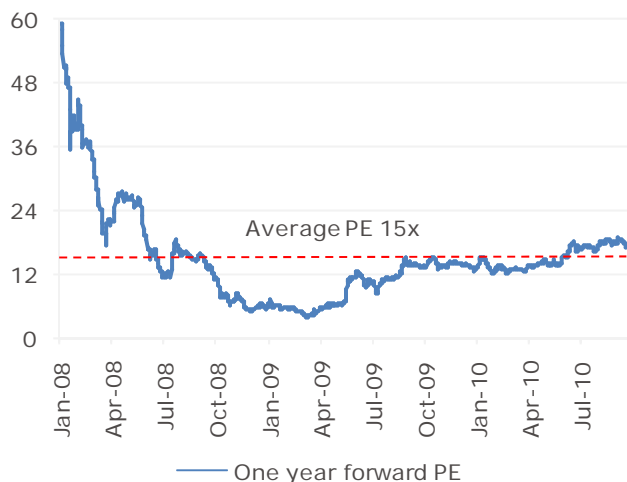
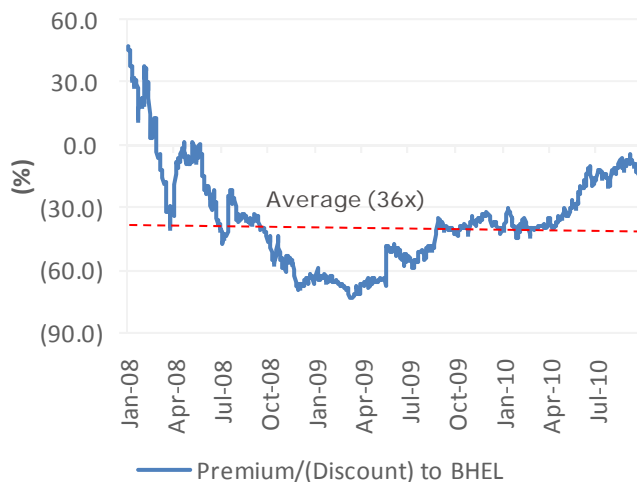


Chart 3: Premium / Discount to BHEL one year forward PE



Source:

The company is currently trading at 17.3x its one year forward earnings above its average P/E of 15x. This is near the highest it has traded after its listing period. Further, the discount to BHEL's one year forward P/E has also narrowed down sharply to 12.9% against the historic average discount of 36.3%. The company has outperformed the broader market by 41% and 55% return over the past 6 months and 1 year, respectively, while it has underperformed by 7% during the past 3 months. The stock is trading at 19.2x and 14.7x its FY11E and FY12E earnings, respectively. We maintain **'BUY/ Sector Outperformer'** on it.

■ Company Description

BGR was incorporated in 1985 as a joint venture between GEA Energietechnik (Germany) and Mr. B.G. Raghupathy, promoter. Initially, the company manufactured products essentially used in thermal and nuclear power plants such as on line condenser tube cleaning systems, debris filters, and rubber cleaning balls. In 1993, the promoter and promoter family bought GEA Energietechnik's stake and became the sole shareholders of the company. In 1993, the company expanded its range of products and services in the power and oil and gas industries. Currently, it manufactures and supplies equipment and also does turnkey engineering project contracting. In the equipment segment, the company manufactures equipment for power, oil & gas, refinery, petrochemical, and process industries. In the turnkey engineering project contracting business, the company executes projects in the power and oil & gas sectors, wherein it takes turnkey responsibility to supply a range of equipment and services, including civil and other works for a project. It has not entered the BTG manufacturing space through a tie-up with Hitachi.

■ Investment Theme

India is expected to add ~ 60 GW power generation capacities, which is more than what was added in the past fifteen years. This target is achievable, as most of the capacity is under construction in various stages. Further, with government expected to add ~100 GW of capacity in the Twelfth Plan, which implies doubling of India's power generation capacity from the present. BGR has expertise to cater to EPC and BoP segments of power plants, which implies a substantial increase in the potential addressable market over the Eleventh Plan period. Further, due to lack of pre-qualified and experienced EPC players, the company's market share is also likely to increase, lending additional visibility to revenue growth over the long term. Its recent tie-up with Hitachi for manufacturing boiler and turbine-generator is expected to take the company into the next league of heavy engineering.

The company with an order book at INR 94 bn has strong visibility with coverage at 3.1x FY11E revenue. The company has already bid for several large EPC projects and expects strong order inflows during H2FY11E. The company demonstrated strong execution capability during FY10.

■ Key Risks

BGR's business model has high working capital requirements. Significant amounts of working capital is required to finance the purchase of materials, contract initiation costs, and the performance of engineering, construction and other work on projects before progress payments, are received from clients. Consequently, we believe, to meet working capital requirements there could be risk of dilution or higher indebtedness in the long term.

The company's order backlog currently is at INR 102 bn. Of this, the Kalisindh thermal power plant at Jalawar (Rajasthan) has an order value of INR 49 bn, while the TNEB's thermal power plant at Mettur has an order value of INR 31 bn. Delay in execution of these orders can potentially swing earnings on either side

Financial Statements (Consolidated)

Income statement		(INR mn)				
Year to March	FY08	FY09	FY10	FY11E	FY12E	
Income from operations	15,205	19,303	30,734	46,255	61,166	
Direct costs	12,502	15,238	24,890	37,436	49,501	
Employee costs	450	744	1,262	1,773	2,346	
Other expenses	700	1,232	1,141	1,823	2,412	
Total operating expenses	13,652	17,214	27,293	41,031	54,259	
EBITDA	1,553	2,089	3,441	5,224	6,908	
Depreciation and amortisation	55	75	103	150	187	
EBIT	1,498	2,014	3,338	5,073	6,721	
Interest expenses	254	579	538	933	1,233	
Other income	52	317	251	227	232	
Profit before tax	1,296	1,752	3,051	4,368	5,720	
Provision for tax	411	596	1,037	1,479	1,935	
Core profit	885	1,156	2,015	2,889	3,785	
PAT before min. int.	885	1,156	2,015	2,889	3,785	
PAT after minority interest	885	1,156	2,015	2,889	3,785	
Adjusted net profit	885	1,156	2,015	2,889	3,785	
Basic shares outstanding (mn)	72	72	72	72	72	
EPS (INR) basic	12.3	16.1	28.0	40.1	52.6	
Diluted equity shares (mn)	72	72	72	72	72	
EPS (INR) fully diluted	12.3	16.1	28.0	40.1	52.6	
CEPS (INR)	17	23	39	52	65	
Dividend per share	3.0	2.0	3.0	3.0	3.0	
Dividend payout (%)	19.0	21.9	12.5	8.7	6.7	

Common size metrics- as % of net revenues

Year to March	FY08	FY09	FY10	FY11E	FY12E
Direct cost	82.2	78.9	81.0	80.9	80.9
Employee expenses	3.0	3.9	4.1	3.8	3.8
S G &A expenses	4.6	6.4	3.7	3.9	3.9
Operating expenses	89.8	89.2	88.8	88.7	88.7
Depreciation and Amortization	0.4	0.4	0.3	0.3	0.3
Interest expenditure	1.7	3.0	1.7	2.0	2.0
EBITDA margins	10.2	10.8	11.2	11.3	11.3
EBIT margins	9.9	10.4	10.9	11.0	11.0
Net profit margins (adjusted)	5.8	6.0	6.6	6.2	6.2

Growth metrics (%)

Year to March	FY08	FY09	FY10	FY11E	FY12E
Revenues	189.9	27.0	59.2	50.5	32.2
EBITDA	163.6	34.5	64.7	51.8	32.2
PBT	214.1	35.2	74.2	43.1	31.0
Net profit	225.1	30.6	74.3	43.4	31.0
EPS	225.3	30.6	74.3	43.4	31.0

Balance sheet**(INR mn)**

As on 31st March	FY08	FY09	FY10	FY11E	FY12E
Equity capital	720	720	720	720	720
Reserves & surplus	4,017	4,919	6,343	9,352	12,908
Shareholders funds	4,737	5,639	7,063	10,072	13,628
Minority interest	27	28	29	32	35
Secured loans	4,992	6,360	8,567	13,178	16,178
Unsecured loans	35	730	769	789	769
Borrowings	5,027	7,090	9,336	13,967	16,947
Sources of funds	9,791	12,757	16,428	24,071	30,611
Gross block	734	1,245	1,933	2,793	3,053
Depreciation	206	268	375	525	712
Net block	527	977	1,558	2,268	2,341
Capital work in progress	11	54	0	0	0
Total fixed assets	538	1,031	1,558	2,268	2,341
Goodwill	6	6	6	6	6
Investments	1,514	5	5	5	5
Inventories	150	140	162	255	353
Sundry debtors	7,360	12,789	19,803	30,298	39,231
Cash and equivalents	3,070	6,152	10,280	10,701	11,973
Loans and advances	2,749	6,610	7,455	7,869	12,078
Total current assets	13,329	25,690	37,699	49,123	63,634
Sundry creditors and others	4,838	12,551	18,955	24,005	31,474
Provisions	402	677	2,334	1,774	2,349
Total CL & provisions	5,240	13,229	21,289	25,779	33,824
Net current assets	8,089	12,462	16,410	23,345	29,810
Net deferred tax	(356)	(747)	(1,551)	(1,552)	(1,552)
Uses of funds	9,791	12,757	16,428	24,071	30,611
Adjusted BV per share (INR)	66	78	98	140	189
Contingent liabilities					

Free cash flow**(INR mn)**

Year to March	FY08	FY09	FY10	FY11E	FY12E
Net profit	885	1,156	2,015	2,889	3,785
Depreciation	55	75	103	150	187
Deferred tax	263	391	683	683	683
Gross cash flow	1,203	1,622	2,801	3,723	4,655
Less: Changes in WC	3,060	1,292	673	6,513	5,195
Operating cash flow	(1,858)	330	3,267	(2,541)	10
Less: Capex	81	555	634	860	260
Free cash flow	(1,939)	(224)	2,634	(3,401)	(250)

Cash flow metrics

Year to March	FY08	FY09	FY10	FY11E	FY12E
Operating cash flow	(1,858)	330	3,267	(2,541)	10
Financing cash flow	6,268	1,919	1,493	3,482	1,531
Investing cash flow	(1,592)	954	(631)	(860)	(260)
Net cash flow	2,818	3,203	4,129	81	1,281
Capex	(81)	(555)	(634)	(860)	(260)
Dividends paid	(32)	(144)	(216)	(216)	(216)

Profitability & liquidity ratios

Year to March	FY08	FY09	FY10	FY11E	FY12E
ROAE (%) (on adjusted profits)	31.8	22.3	31.7	33.7	31.9
ROACE (%)	22.9	17.9	22.9	25.1	24.6
Debtors days	133	190	194	198	207
Inventory days	6	3	2	2	2
Fixed assets t/o (x)	33.4	25.7	24.2	24.2	26.5
Debt/equity (x)	1.1	1.3	1.3	1.4	1.2
Interest coverage (x)	5.9	3.5	6.2	5.4	5.5
Payable days	110	208	231	209	205
Cash conversion cycle (days)	30	(14)	(35)	(10)	5
Current ratio (x)	2.5	1.9	1.8	1.9	1.9
Debt/EBITDA (x)	3.2	3.4	2.7	2.7	2.5
Adjusted debt/Equity (x)	1.1	1.3	1.3	1.4	1.2

Operating ratios

Year to March	FY08	FY09	FY10	FY11E	FY12E
Total asset turnover (x)	2.3	1.7	2.1	2.3	2.2
Fixed asset turnover (x)	33.4	25.7	24.2	24.2	26.5
Equity turnover (x)	5.5	3.7	4.8	5.4	5.2

Du pont analysis

Year to March	FY08	FY09	FY10	FY11E	FY12E
NP Margin (%)	5.8	6.0	6.6	6.2	6.2
Total Assets Turnover (x)	2.3	1.7	2.1	2.3	2.2
Leverage multiplier (x)	2.4	2.2	2.3	2.4	2.3
ROAE (%)	31.8	22.3	31.7	33.7	31.9

Valuation parameters

Year to March	FY08	FY09	FY10	FY11E	FY12E
EPS (INR) fully diluted	12.3	16.1	28.0	40.1	52.6
Y-o-Y growth (%)	116.9	30.6	74.3	43.4	31.0
CEPS (INR)	16.7	22.5	38.9	51.7	64.7
Diluted P/E (x)	62.8	48.0	27.6	19.2	14.7
Price/BV (x)	11.7	9.8	7.9	5.5	4.1
EV/Sales (x)	3.7	2.9	1.8	1.3	1.0
EV/EBITDA (x)	36.0	27.0	15.9	11.3	8.8
Dividend yield (%)	0.4	0.3	0.4	0.4	0.4



Company	Absolute reco	Relative reco	Relative risk	Company	Absolute reco	Relative reco	Relative Risk
ABB India	BUY	SO	L	AIA Engineering	BUY	SO	M
Bajaj Electricals	BUY	SO	M	BGR Energy Systems	BUY	SO	M
Bharat Heavy Electricals	BUY	SO	L	Crompton Greaves	BUY	SO	L
Cummins India	BUY	SO	L	Havell's India	BUY	SO	M
Jyoti Structures	HOLD	SP	M	Kalpataru Power Transmission	HOLD	SP	M
KEC International	BUY	SO	M	Kirloskar Oil Engines	BUY	SO	L
Larsen & Toubro	HOLD	SP	L	Punj Lloyd	HOLD	SU	M
Sanghvi Movers	BUY	SO	H	Siemens	HOLD	SU	L
Techno Electric & Engineering	BUY	SO	M	Texmaco	BUY	SP	H
Thermax	BUY	SO	L	Voltamp Transformers	HOLD	SP	M
Voltas	HOLD	SU	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

Edelweiss
Ideas create, values protect



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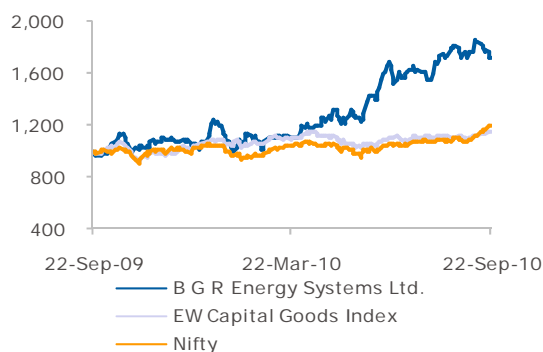
Coverage group(s) of stocks by primary analyst(s): Engineering and Capital Goods

ABB India, AIA Engineering, BGR Energy Systems, Bharat Heavy Electricals, Bajaj Electricals, Crompton Greaves, Havell's India, Jyoti Structures, KEC International, Cummins India, Kirloskar Oil Engines, Kalpataru Power Transmission, Larsen & Toubro, Punj Lloyd, Sanghvi Movers, Siemens, Techno Electric & Engineering, Thermax, Texmaco, Voltamp Transformers, Voltas

BGR Energy Systems



EW Indices



Distribution of Ratings / Market Cap

Edelweiss Research Coverage Universe

	Buy	Hold	Reduce	Total
Rating Distribution*	116	45	12	176
* 3 stocks under review				
	> 50bn	Between 10bn and 50 bn	< 10bn	
Market Cap (INR)	110	53	13	

Recent Research

Date	Company	Title	Price (INR)	Recos
22-Sep-10	Engg. Capital Goods	Visit to the boiler heartland of India; Sector Update		
07-Sep-10	KEC International	Attractive acquisition with a long term vision; Visit Note	494	Buy

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