

Bharat Heavy Electricals

Juggernaut rolls on

We still like BHEL for its steady order-book growth as we approach the 11th five-year plan, execution strengths and the ability to maintain leadership status in the generation-equipment market. We maintain Buy with an increased target price of Rs2,801.12.

Key forecasts

	FY05A	FY06A	FY07F	FY08F	FY09F
Revenue (Rsm)	98343.5	136602	181311	232189	273090
EBITDA (Rsm)	17679.6	27052.8	36541.8▲	45975.3▲	55542.0
Reported net profit (Rsm)	9554.0	16721.5	23322.5▲	28900.3▲	34686.1
Normalised net profit (Rsm) ¹	9733.9	16756.7	23322.5	28900.3	34686.1
Normalised EPS (Rs)	39.8	68.5	95.3▲	118.1▲	141.7
Dividend per share (Rs)	9.09	13.7	17.1	19.2	19.2
Dividend yield (%)	0.39	0.59	0.74	0.83	0.83
Normalised PE (x)	58.1	33.8	24.3▼	19.6▼	16.3
EV/EBITDA (x)	30.5	19.6	14.6	11.7	9.66
Price/book value (x)	9.39	7.75	6.16	4.91	3.94
ROIC (%)	38.0	56.9	73.0	53.1	42.0

1. Post-goodwill amortisation and pre-exceptional items
 Source: Company data, ABN AMRO forecasts
 Accounting Standard: Local GAAP

year to Mar, fully diluted

Order-book growth should be sustained as we approach the 11th plan

Consistent order-book growth has been one of the key features of BHEL's performance in the past three years. It has been able to maintain order flow in the fiscal year to date, achieving 50% of the FY06 order book. This is despite the fact that this is the final year for the government's 10th five-year plan. BHEL's order flow in the current fiscal year predominantly comprises non-NTPC projects, which suggests we are at the beginning of an upswing in the power-generating capacity of state electricity boards (SEBs). We expect the business momentum for BHEL to remain strong, on the back of orders from projects under the 11th plan. We estimate the 11th plan will offer Rs776bn worth of projects for BHEL, based on the government's current plans.

Largest beneficiary of the super-critical range, in our view

India is moving towards the next higher size of thermal stations, with the 800MW super-critical range, for which orders are likely to be placed in FY07/08, as it seeks to add capacity in line with its stated GDP growth expectation. We believe it is likely BHEL will win these contracts, probably on a negotiated basis, as has happened in the past. This would enable BHEL to indigenise quickly, which would help ward off competition once these plants move towards competitive bidding.

Execution looks on track

BHEL has maintained its execution traction so far, in our view. The company is ramping up capacity to 10,000MW, which is scheduled to begin at end-FY07. This should increase its delivery levels. Our discussions with NTPC's project monitoring team and ground-level engineers at project sites indicate BHEL is on track to meet deliverables over the next three years.

Upgrading our numbers and introducing FY09F

We introduce our explicit forecasts for FY09 and also raise our earnings estimates by 9% for FY07 and 10% for FY08. We maintain our Buy recommendation and increase our target price to Rs2,801.12 (from Rs2170.22). We have used a WACC of 13.5% to arrive at our DCF-based target price.

Priced at close of business 5 October 2006. Use of ▲ ▼ indicates that the line item has changed by at least 5%.

Buy

Absolute performance

n/a

Short term

Underweight

Market relative to region

Capital Goods

India

Price

Rs2311.55

Target price

Rs2801.12 (from Rs2170.22)

Market capitalisation

Rs565.78bn (US\$12.40bn)

Avg (12mth) daily turnover

Rs188.23m (US\$4.13m)

Reuters

BHEL.BO

Bloomberg

BHEL IN

Asset allocation

Equities Underweight

Cash Overweight

Bonds Overweight

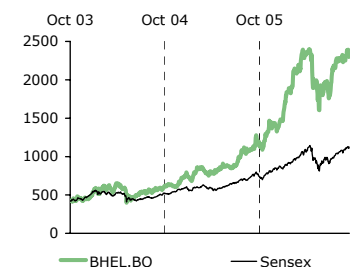
Price performance (1M) (3M) (12M)

Price (Rs) 2287.6 1973.3 1259.6

Absolute % 1.0 17.1 83.5

Rel market % -2.9 3.2 29.2

Rel sector % 3.2 11.5 68.7



Stock borrowing: Difficult

Volatility (30-day): 22%

Volatility (6-month trend): ↓

52-week range: 2465.00-1080.00

Sensex: 12389.41

BBG AP Electronic & Elec: 136.42

Source: ABN AMRO, Bloomberg

Researched by

ABN AMRO Institutional
Equities Team

www.abnamrobroking.co.in

The juggernaut rolls on

We are confident about BHEL's growth profile, given the order-book growth visibility, low execution risks and its ability to maintain a leadership position in the Indian market. Buy with a target price of Rs2,801.12.

Order-book growth should be sustained on projects under 11th plan

One of the key features of BHEL's performance has been its consistent order-book growth in the past three years. We expect the trend to be maintained, as we approach the 11th five-year plan. The government plans to add 67,000MW of power-generating capacity under the 11th plan, which means a potential order book of Rs776bn for BHEL, based on our market-share assumptions (Table 1).

Table 1 : Potential order flow for BHEL from 11th plan

	11th Plan target MW	Awarded MW	Yet to be awarded MW	Project value Rs m	EPC value Rs m	BHEL market share	Inflow Rs m
Coal Sub Critical	31,905	87,50	23,155	926,200	509,410	80%	407,528
Coal Supercritical	8,000	0	8,000	320,000	176,000	80%	140,800
Gas	7,000	0	7,000	245,000	171,500	70%	120,050
Hydro	18,000	2,000	16,000	800,000	120,000	70%	84,000
Nuclear	3,160	0	3,160	126,400	31,600	75%	23,700
Total	68,065	10,750	57,315	241,7600	100,8510		776,078

*The 8000MW of super-critical plants are assumed to be those awarded in the 800MW category. The CEA has said there are around 10 such units under the 11th plan. We have included the 660MW NTPC projects in the sub-critical segment, of which two projects have already been awarded
Source: MoP, ABN AMRO estimates*

Even looking from an overall perspective, BHEL is executing 60% of the proposed capacity addition under the 10th plan. Should BHEL maintain this share in the 11th plan, we are looking at a potential capacity addition of 40,000MW, implying almost Rs850bn worth of projects for the company.

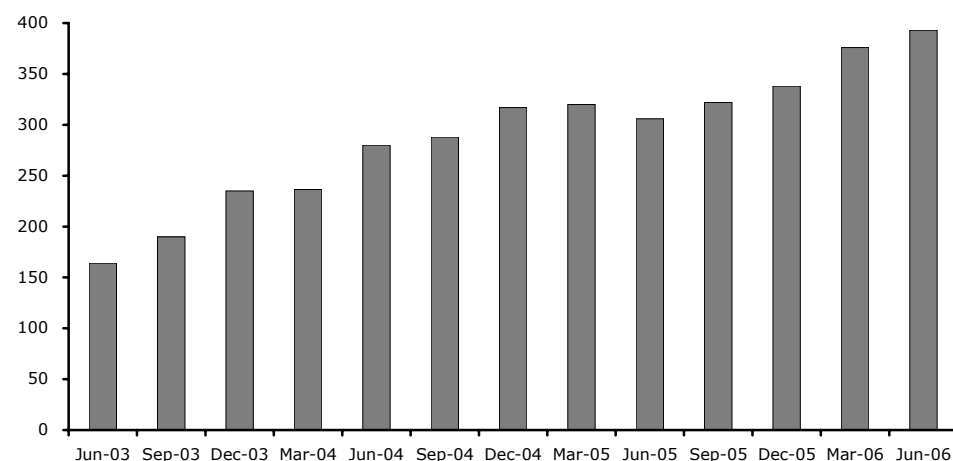
Order momentum maintained even as 10th plan nearing its end

BHEL has been able to maintain order-flow momentum despite this being the final year of the 10th plan. This has also been driven by fresh orders from SEBs. In fact, most of the new orders for FY07-to-date comprise non-NTPC orders, which shows the uptick in the capacity addition from SEBs given the gradual reduction in their losses. April-September 2006, the company has already achieved 50% of its order inflow for full-year FY06, indicating that the order inflow remains strong.

Table 2 : Year-to-date order inflow for BHEL in FY07

Customer	Location	Product MW	Value (Rs m)
Domestic order inflow for BHEL			
CESC	Budge Budge	1x250	8,540
UPRVUNL	Paricha	2x250	12,240
UPRVUNL	Harduaganj	2x250	12,240
Tata Power	Trombay	1x250	8,540
JSPL	Raigarh	4x250	24,480
GIPCL	Surat	2x125	12,000
NTPC	Dadri	1x500	11,000
Essar	Hazira	1x110	1,130
APGenco	Nagarjuna Sagar	2x25	820
APGenco	Sriram Sagar	1x9	
Total Order inflow			90,990
Export order inflow for BHEL			
Ethiopia Electric Power Co (EPCO)	Ethiopia	1x230kV substation	460
Afghan Electric Board	Kabul	1x220kV substation+42 MW(3x14MW) Hydro turbines	2,200
Egypt Electric Transco	Egypt	14x125MVA transformers	800
Total Export Value			3,460
Total Order value YTD			94,450
FY06 Order inflows			189,380
YTD inflow as % of FY06 order inflow			50%

Source: ABN AMRO, company reports, media reports

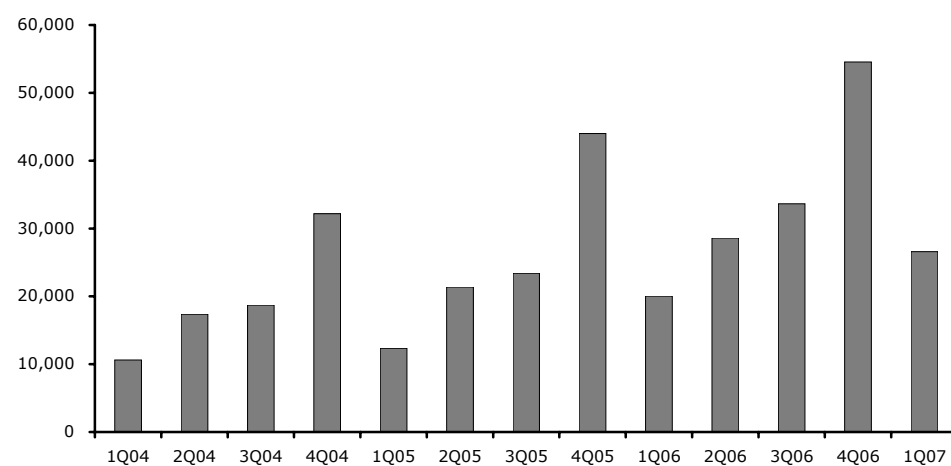
Chart 1 : Order book trend in BHEL (Rs bn)

Source: Company, ABN AMRO

Execution appears on track

BHEL has been able to maintain its execution traction so far, in our view. The company is ramping up capacity to meet equipment orders for 10,000MW pa, which is scheduled to begin at the end of FY07. This should increase delivery levels from BHEL. Our discussions with NTPC's project-monitoring cell and our meetings with its ground-level engineers at project sites indicate that BHEL is on track to meet its delivery targets over the next couple of years. In fact, NTPC's capacity addition plans under the 11th plan take into account BHEL's delivery capability. BHEL works on a two-shift basis, but increases it to three shifts for certain components. The situation should ease further, when the ramp-up to 10,000MW is completed.

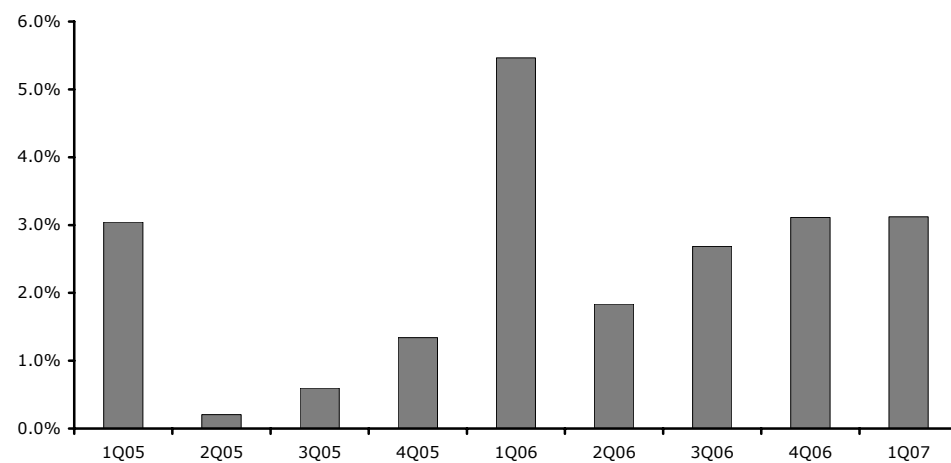
We expect the value of production (which reflects the actual activity taking place at BHEL) to start increasing, touching a new peak yet again this year. Chart 2 shows the company's value of production has touched new peaks each year as we moved forward in the 10th plan, and the trend should be maintained in the current year before the 11th plan activity starts to catch up.

Chart 2 : Trend in value of production at BHEL (Rs m)

Source: Company, ABN AMRO

Continues to exhibit operating leverage

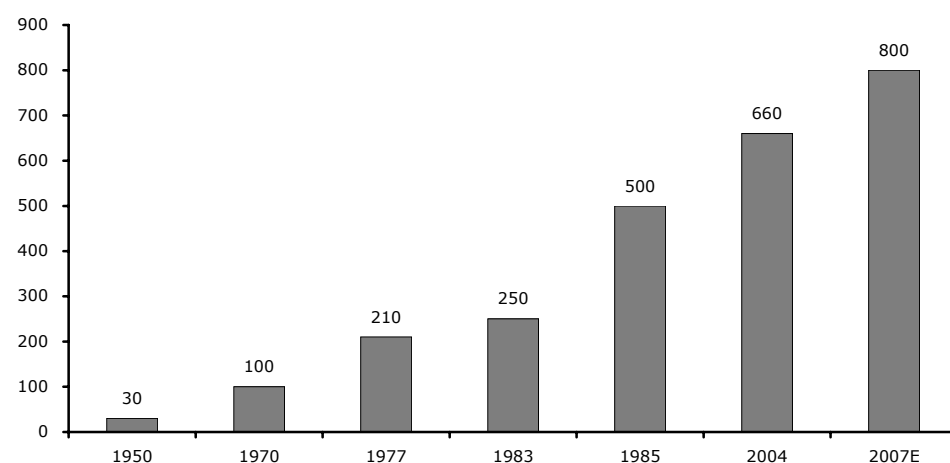
BHEL has continuously shown operating leverage for the past several quarters and we expect this to continue on the back of higher volume growth. In our view, the increase in the planned equipment-producing capacity from 6,000 to 10,000MW will not add to manpower and overheads in the same proportion, as these are brownfield expansions. We believe the incremental volume growth generated from higher capacity will keep leverage strong, though the absolute basis-point jump may not be as high as in the past. A wage revision for state-owned enterprises (including BHEL) is scheduled for 4QFY07, and so our forecasts assume a 30% increase in wage costs from FY08.

Chart 3 : BHEL has continued to maintain its operating leverage (% yoy)

Source: Company, ABN AMRO

India moving to next-generation thermal stations...

India is moving towards the next higher size of thermal stations, with 800MW station projects due to be awarded in 2007. This is in line with India's stated objective of rapidly adding power capacity to maintain GDP growth. The new power plants would be in the 800MW range and would be super-critical plants operating at enhanced steam pressure and boiler temperature.

Chart 4 : Trend in Indian coal stations (MW vs year of introduction)

Source: MoP, ABN AMRO forecasts

... which should make BHEL the largest beneficiary

We believe it is likely BHEL will win contracts for the first few units of the 800MW super-critical units, probably on a negotiated basis. The Central Electricity Authority (CEA), the main planning body for the power sector in India, is talking about setting up 40 supercritical plants in the country over the 11th and 12th five-year plan periods. We believe 8-10 plants may be given to BHEL on a negotiated basis, such that by the time these plants move towards competitive bidding, the level of indigenisation for BHEL would be so high that it would be difficult for competition to make inroads. There is a historical precedence to this, as the government did this when the 500MW technology was introduced in India for the first time in the 1980s.

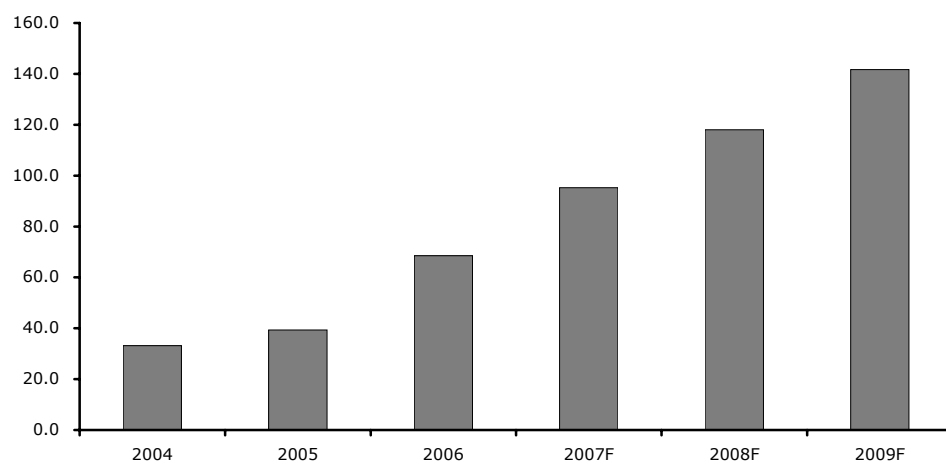
We project an earnings CAGR of 27%

We forecast BHEL will show a 27% earnings CAGR over FY06-09. While we estimate the company's earnings will increase 40% in FY07, we have moderated our CAGR assumption to 22% over FY08-09, as these would be the first two years of the 11th plan. Hence, the company's performance could surprise on the upside. We raise our earnings estimates by 9% for FY07 and 10% for FY08.

Table 3 : Earnings revision

Rs m	FY07F	FY08F	FY09F*
Earlier PAT estimates	87.1	107.8	-
Revised PAT estimates	95.3	118.1	141.7
% change	9%	10%	-

* Introducing our FY09 numbers
Source: ABN AMRO forecasts

Chart 5 : EPS trend for BHEL (Rs)

Source: Company, ABN AMRO estimates

Buy with a target price of Rs2,801.12

We introduce our explicit forecasts for FY09 and increase our target price for BHEL to Rs2,801.12. Our DCF-based target price assumes a WACC of 13.5% and a risk-free rate of 8.5%, keeping in line the increase in interest rates.

Key risks to our target price would be:

- BHEL losing out on super-critical projects despite having the required technology;
- Slippage in execution time, leading to liquidation damages; and,
- Increased concerns about manpower, especially on the project management side.

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BHARAT HEAVY ELECTRICALS: KEY FINANCIAL DATA

Income statement

Rsm	FY05A	FY06A	FY07F	FY08F	FY09F
Revenue	98343.5	136602	181311	232189	273090
Cost of sales	-74964	-103705	-138263	-178961	-209452
Operating costs	-5700.2	-5844.2	-6506.2	-7252.4	-8095.8
EBITDA	17679.6	27052.8	36541.8	45975.3	55542.0
DDA & Impairment (ex gw)	-2188.7	-2459.3	-2927.0	-3019.9	-3112.9
EBITA	15491.0	24593.5	33614.8	42955.4	52429.2
Goodwill (amort/impaird)	n/a	n/a	n/a	n/a	n/a
EBIT	15491.0	24593.5	33614.8	42955.4	52429.2
Net interest	525.3	1015.1	954.1	751.4	701.6
Associates (pre-tax)	n/a	n/a	n/a	n/a	n/a
Forex gain / (loss)	n/a	n/a	n/a	n/a	n/a
Exceptionals (pre-tax)	-200.2	0.00	0.00	0.00	0.00
Other pre-tax items	0.00	0.00	0.00	0.00	0.00
Reported PTP	15816.0	25608.6	34568.9	43706.8	53130.8
Taxation	-6282.3	-8851.9	-11246	-14807	-18445
Minority interests	n/a	n/a	n/a	n/a	n/a
Exceptionals (post-tax)	20.3	-35.2	0.00	0.00	0.00
Other post-tax items	0.00	0.00	0.00	0.00	0.00
Reported net profit	9554.0	16721.5	23322.5	28900.3	34686.1
Normalised Items Excl. GW	-179.9	-35.2	0.00	0.00	0.00
Normalised net profit	9733.9	16756.7	23322.5	28900.3	34686.1

Source: Company data, ABN AMRO forecasts

year to Mar

Balance sheet

Rsm	FY05A	FY06A	FY07F	FY08F	FY09F
Cash & market secs (1)	31778.6	41339.7	37068.3	31202.5	34585.1
Other current assets	101651	121968	162885	211929	250478
Tangible fixed assets	11395.6	11668.5	15495.9	13976.0	12363.1
Intang assets (incl gw)	n/a	n/a	n/a	n/a	n/a
Oth non-curr assets	89.5	82.9	100.0	100.0	100.0
Total assets	144915	175059	215549	257208	297526
Short term debt (2)	157.7	29.2	29.2	29.2	29.2
Trade & oth current liab	84458.9	103200	124833	143173	154943
Long term debt (3)	5212.2	5553.2	5553.2	5553.2	5554.2
Oth non-current liab	n/m	n/m	n/m	n/m	n/m
Total liabilities	84646.0	102045	123678	142018	153789
Total equity (incl min)	60268.9	73013.8	91871.1	115190	143736
Total liab & sh equity	144915	175059	215549	257208	297526
Net debt (2+3-1)	-26409	-35757	-31486	-25620	-29002

Source: Company data, ABN AMRO forecasts

year ended Mar

Cash flow statement

Rsm	FY05A	FY06A	FY07F	FY08F	FY09F
EBITDA	17679.6	27052.8	36541.8	45975.3	55542.0
Change in working capital	-2680.0	-1575.6	-19284	-30705	-26778
Net interest (pd) / rec	525.3	1015.1	954.1	751.4	701.6
Taxes paid	-6282.3	-8851.9	-11246	-14807	-18445
Other oper cash items	-329.0	-1645.0	0.00	0.00	0.00
Cash flow from ops (1)	8913.7	15995.4	6965.1	1215.6	11021.2
Capex (2)	-1447.0	-2607.1	-6754.3	-1500.0	-1500.0
Disposals/(acquisitions)	0.00	0.00	0.00	0.00	0.00
Other investing cash flow	200.3	6.60	-17.1	0.00	0.00
Cash flow from invest (3)	-1246.7	-2600.5	-6771.4	-1500.0	-1500.0
Incr / (decr) in equity	n/a	n/a	n/a	n/a	n/a
Incr / (decr) in debt	-260.6	212.6	0.00	0.00	1.00
Ordinary dividend paid	-2224.4	-4046.8	-4465.4	-5581.8	-6139.9
Preferred dividends (4)	n/a	n/a	n/a	n/a	n/a
Other financing cash flow	n/a	n/a	n/a	n/a	n/a
Cash flow from fin (5)	-2485.1	-3834.2	-4465.4	-5581.8	-6138.9
Forex & disc ops (6)	n/a	n/a	n/a	n/a	n/a
Inc/(decr) cash (1+3+5+6)	5181.9	9560.8	-4271.7	-5866.1	3382.2
Equity FCF (1+2+4)	7466.7	13388.4	210.8	-284.4	9521.2

Lines in bold can be derived from the immediately preceding lines.

Source: Company data, ABN AMRO forecasts

year to Mar

BHARAT HEAVY ELECTRICALS: PERFORMANCE AND VALUATION

Standard ratios	BHEL					ABB			Siemens India		
Performance	FY05A	FY06A	FY07F	FY08F	FY09F	FY06F	FY07F	FY08F	FY06F	FY07F	FY08F
Sales growth (%)	19.8	40.8	32.8	28.5	17.8	9.91	3.17	1.00	76.9	37.3	24.1
EBITDA growth (%)	23.3	53.0	35.1	25.8	20.8	27.7	6.44	0.26	85.2	40.6	24.4
EBIT growth (%)	25.3	58.8	36.7	27.8	22.1	37.6	8.02	0.32	96.1	43.1	25.9
Normalised EPS growth (%)	8.07	72.1	39.2	23.9	20.0	56.9	12.6	3.11	77.6	44.1	26.5
EBITDA margin (%)	18.6	20.2	20.6	20.1	20.6	12.1	12.5	12.4	13.4	13.8	13.8
EBIT margin (%)	16.3	18.4	18.9	18.8	19.5	9.72	10.2	10.1	12.2	12.7	12.8
Net profit margin (%)	10.2	12.5	13.1	12.6	12.9	5.69	6.22	6.35	8.43	8.85	9.02
Return on avg assets (%)	7.17	10.1	11.6	12.0	12.3	7.05	7.06	6.63	14.5	14.6	14.0
Return on avg equity (%)	17.2	25.1	28.3	27.9	26.8	32.9	27.8	23.4	47.9	46.2	40.5
ROIC (%)	38.0	56.9	73.0	53.1	42.0	26.7	27.5	27.6	151.3	179.6	113.0
ROIC - WACC (%)	24.5	43.3	59.5	39.6	28.4	20.6	21.4	21.5	139.6	168.0	101.3
				<i>year to Mar</i>			<i>year to Dec</i>			<i>year to Sep</i>	
Valuation											
EV/sales (x)	5.67	3.96	3.01	2.36	1.99	1.17	1.08	1.01	2.62	1.88	1.49
EV/EBITDA (x)	30.5	19.6	14.6	11.7	9.66	9.68	8.65	8.18	19.5	13.6	10.8
EV/EBITDA @ tgt price (x)	37.3	24.0	17.9	14.4	11.8	9.17	8.17	7.71	20.7	14.5	11.5
EV/EBIT (x)	34.8	21.6	15.9	12.6	10.2	12.1	10.6	10.0	21.5	14.8	11.6
EV/invested capital (x)	18.8	17.4	9.96	6.52	4.97	4.38	4.17	3.95	40.7	20.1	11.3
Price/book value (x)	9.39	7.75	6.16	4.91	3.94	5.72	4.57	3.80	13.1	8.79	6.20
Equity FCF yield (%)	1.32	2.37	0.04	-0.05	1.68	5.58	5.97	6.03	2.33	2.15	3.47
Normalised PE (x)	58.1	33.8	24.3	19.6	16.3	20.6	18.3	17.7	32.8	22.7	18.0
Norm PE @tgt price (x)	70.4	40.9	29.4	23.7	19.8	19.5	17.3	16.8	34.7	24.1	19.1
Dividend yield (%)	0.39	0.59	0.74	0.83	0.83	1.11	1.18	1.18	0.38	0.47	0.56
				<i>year to Mar</i>			<i>year to Dec</i>			<i>year to Sep</i>	
Per share data	FY05A	FY06A	FY07F	FY08F	FY09F	Solvency	FY05A	FY06A	FY07F	FY08F	FY09F
Tot adj dil sh, ave (m)	244.8	244.8	244.8	244.8	244.8	Net debt to equity (%)	-43.8	-49.0	-34.3	-22.2	-20.2
Reported EPS (INR)	39.0	68.3	95.3	118.1	141.7	Net debt to tot ass (%)	-18.2	-20.4	-14.6	-9.96	-9.75
Normalised EPS (INR)	39.8	68.5	95.3	118.1	141.7	Net debt to EBITDA	-1.49	-1.32	-0.86	-0.56	-0.52
Dividend per share (INR)	9.09	13.7	17.1	19.2	19.2	Current ratio (x)	1.58	1.58	1.60	1.70	1.84
Equity FCF per share (INR)	30.5	54.7	0.86	-1.16	38.9	Operating CF int cov (x)	-27.9	-23.5	-18.1	-20.3	-41.0
Book value per sh (INR)	246.2	298.3	375.4	470.6	587.3	Dividend cover (x)	4.97	4.72	5.96	5.90	6.44
				<i>year to Mar</i>						<i>year to Sep</i>	

Priced as follows: BHEL.BO - Rs2311.55; ABBZn.VX - Sfr16.90; SIEM.BO - Rs1065.90
Source: Company data, ABN AMRO forecasts

BHARAT HEAVY ELECTRICALS: VALUATION METHODOLOGY

Economic Profit Valuation			Rs m	%	Discounted Cash Flow Valuation			Rs m	%		
Adjusted Opening Invested Capital			93622.0	14	Value of Phase 1: Explicit (2007 to 2009)			11671.0	2		
NPV of Economic Profit During Explicit Period			34017.7	5	Value of Phase 2: Value Driver (2010 to 2017)			112066.3	17		
NPV of Econ Profit of Remaining Business (1, 2)			91932.2	14	Value of Phase 3: Fade (2018 to 2031)			326097.0	50		
NPV of Econ Profit of Net Inv (Grth Business) (1, 3)			430124.1	66	Terminal Value			199844.4	31		
Enterprise Value			649696.0	100	Enterprise Value			649678.8	100		
Plus: Other Assets			0.0	0	FCF Grth Rate at end of Phs 1 implied by DCF Valuation			12.6			
Less: Minorities			0.0	0	FCF Grth Rate at end of Phs 1 implied by Current Price			12.4			
Less: Net Debt (as at 04 Oct 2006)			-35840.2	-6							
Equity Value			685536.2	106							
No. Shares (millions)			244.8								
Per Share Equity Value			2800.9								
Current Share Price			2311.6								
Returns, WACC and NPV of Free Cash Flow											
Sensitivity Table											
		No of Years in Fade Period									
		15	18	20	23	25					
WACC	11.5%	3771.13	4364.20	4798.26	5512.41	6033.81					
	12.5%	3311.65	3783.49	4123.92	4676.05	5073.48					
	13.5%	2919.56	3295.27	3562.63	3990.28	4293.93					
	14.5%	2583.97	2883.34	3093.55	3425.32	3657.81					
	15.5%	2295.89	2534.54	2699.95	2957.70	3136.05					
Performance Summary											
		2007	2008	2009	Phase 2 Avg (2010 - 2017)						
Invested Capital Growth (%)		24.0	24.0	23.7	22.6						
Operating Margin (%)		18.5	18.5	19.2	18.4						
Capital Turnover (x)		2.3	2.4	2.3	2.1						

Source: ABN AMRO forecasts

- In periods following the Explicit Period i.e. Phase 2 and Phase 3
- Remaining Business is defined as Capital as at the end of Phase 1 and capex = depreciation thereafter
- Net Investment is defined as capex over and above depreciation after Phase 1

Bharat Heavy Electricals

Company description

BHEL is the one of the largest engineering enterprises in India and is one of the major power plant equipment manufacturers in the world. BHEL offers a wide spectrum of equipment, systems and services in the field of power, transmission, industry, transportation, oil & gas and non-conventional energy sources. The company has technology tie-ups with Alstom, Siemens and GE. Alstom provides technology in boilers, Siemens provides technology support for coal turbines, and GE provides technology support for gas turbines. These technological agreements restrict BHEL from entering directly into the American and European markets.

Buy

Price relative to country



Strategic analysis

Average SWOT company score: 4

Shareholding pattern

Strengths

4

BHEL is one of the lowest-cost manufacturers of power plant equipment in India. Power plants constructed by BHEL comprise almost 68% of the installed base in India, which gives it a clear advantage over rivals.

Weaknesses

4

Most of the critical technologies used by BHEL have been borrowed from large MNCs like Siemens, GE and Alstom. Also, all these companies are present in India and are competing with BHEL. BHEL may be deprived of significant technological advancement.

Opportunities

4

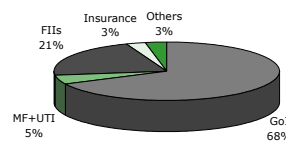
Power demand in India is growing at 8% (almost 8,000MW) annually and there is already a peak deficit of 12%. The addressable business opportunity is large and, if T&D losses are stemmed, we may see such capacities coming up.

Threats

3

Possibility of capacity additions from the private sector, courtesy of the Electricity Act. This may dilute BHEL's virtual monopoly in the power plant equipment business. Also, BHEL is now directly competing with the owners of its technology in the private generation space.

Scoring range is 1-5 (high score is good)



Source: Company data

Market data

Headquarters

BHEL House, Siri Fort, New Delhi - 110 049

Website

www.bhel.com

Shares in issue

244.8m

Freefloat

32%

Majority shareholders

Govt of India (68%)

India

Country view

Underweight

Country rel to Asia Pacific

We are concerned the Indian market is now significantly overvalued. We see a risk of a reversal in the strong liquidity flows into the market from local and foreign investors and with the earnings cycle becoming less clear due to the broadening of the corporate capex cycle and growing regulatory concerns in the local market. We believe the government is unlikely to engineer a meaningful slowdown in economic growth this fiscal year. We may see some fine-tuning in interest rates, but it should be mild and is unlikely to derail the growth momentum. We downgraded India in May 2006 from Neutral to Underweight.



The country view is set in consultation with the relevant company analyst but is the ultimate responsibility of the Strategy Team.

Competitive position

Average competitive score: 4+

Broker recommendations

Supplier power

4+

BHEL is almost a fully-integrated power equipment manufacturer in India. Therefore, most of the raw materials used are very basic.

Barriers to entry

4+

The power plant equipment EPC business is highly capital intensive. Besides, availability of technology is an issue. Although a mature business, barriers to entry are significant.

Customer power

3-

Customer power is beginning to slowly increase in the private sector where today a lot more new entrants are making inroads.

Substitute products

4-

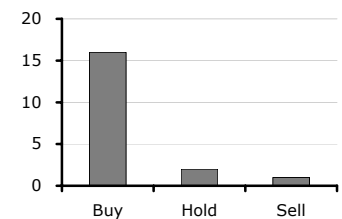
Within power plant equipment, there are substitutes given the kind of fuel being used. BHEL's strength lies in coal-based plants, which are currently the mainstay of power generated in India.

Rivalry

4+

BHEL enjoys a virtual monopoly because of its low cost and service network. But, gradually competition is expected to pick up for BHEL with the first signs already in the private sector.

Scoring range 1-5 (high score is good) Plus = getting better Minus = getting worse



Source : Bloomberg