

Company

6 August 2010 | 8 pages

BGR Energy Systems (BGRE.BO)

Equity

BTG Manufacturing JV: Step In Right Direction

- Announces BTG manufacturing JV** — BGR Energy has signed JVs for manufacturing supercritical turbine - generators (TG) and supercritical boilers (B) with Hitachi Limited, Japan and Hitachi Power Europe, Germany respectively. BGR will have 74% and 70% stake in TG and boiler JVs respectively.
- Step in right direction** — Both JVs will start production in 2012 and will have capacity to manufacture 5 units of 660/800/1000MW per annum. Entry into BTG manufacturing is a step in right direction, makes BGR the only company other than L&T to offer EPC/BOP/BTG in India and will drive next stage of growth for the company.
- Capex higher / JV partner's stake lower than expected** — BTG JV will require capex of Rs44bn (B=Rs14bn, TG=Rs30bn,) v/s CIRA estimate of Rs32bn (B=Rs10bn, TG=Rs22bn). Hitachi's stake in JVs (B= 30% and TG=Rs26%) is also lower than CIRA estimate of 51%.
- Increased possibility of capital raising** — Higher capex and equity stake in the JVs increase possibility of capital raising ahead. BGR will need to infuse ~Rs11.2bn (D/E = 65/35) as equity in the JVs over next two years. Company had a cash balance of Rs9.3bn and 1.3xD/E at FY10 end.
- Maintain Buy** — In the first stage of growth when BGRL transformed itself into an integrated BOP player, it grew PAT at a CAGR of 70% over FY07-10. In the second stage, during which it aims to transform itself into an EPC player (60% of backlog from EPC), we expect PAT CAGR of 27% over FY10-13E with 33% average RoE. Entry into BTG manufacturing will drive third stage of growth beyond FY13.

Buy/Medium Risk	1M
Price (06 Aug 10)	Rs797.80
Target price	Rs884.00
Expected share price return	10.8%
Expected dividend yield	0.9%
Expected total return	11.7%
Market Cap	Rs57,506M
	US\$1,248M

Price Performance (RIC: BGRE.BO, BB: BGRL IN)



Statistical Abstract

Year to	Net Profit	Diluted EPS	EPS growth	P/E	P/B	ROE	Yield
31 Mar	(RsM)	(Rs)	(%)	(x)	(x)	(%)	(%)
2009A	1,154	16.03	32.2	49.8	10.2	22.2	0.4
2010A	2,015	27.98	74.5	28.5	8.1	31.7	0.9
2011E	3,025	42.01	50.1	19.0	6.0	36.5	0.9
2012E	3,705	51.45	22.5	15.5	4.6	33.7	1.1
2013E	4,157	57.73	12.2	13.8	3.6	29.3	1.2

Source: Powered by dataCentral

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Fiscal year end 31-Mar	2009	2010	2011E	2012E	2013E
Valuation Ratios					
P/E adjusted (x)	49.8	28.5	19.0	15.5	13.8
EV/EBITDA adjusted (x)	28.1	17.2	11.6	9.4	8.3
P/BV (x)	10.2	8.1	6.0	4.6	3.6
Dividend yield (%)	0.4	0.9	0.9	1.1	1.2
Per Share Data (Rs)					
EPS adjusted	16.03	27.98	42.01	51.45	57.73
EPS reported	16.03	27.98	42.01	51.45	57.73
BVPS	78.32	98.09	131.91	173.42	220.03
DPS	3.00	7.00	7.00	8.50	9.50
Profit & Loss (RsM)					
Net sales	19,303	30,734	47,044	61,146	70,048
Operating expenses	-17,289	-27,395	-41,987	-54,742	-62,831
EBIT	2,014	3,339	5,057	6,404	7,217
Net interest expense	-579	-538	-775	-1,089	-1,217
Non-operating/exceptionals	317	250	299	296	296
Pre-tax profit	1,752	3,051	4,581	5,611	6,295
Tax	-596	-1,037	-1,556	-1,906	-2,139
Extraord./Min.Int./Pref.div.	-1	0	0	0	0
Reported net income	1,154	2,015	3,025	3,705	4,157
Adjusted earnings	1,154	2,015	3,025	3,705	4,157
Adjusted EBITDA	2,089	3,442	5,197	6,604	7,477
Growth Rates (%)					
Sales	27.0	59.2	53.1	30.0	14.6
EBIT adjusted	34.4	65.8	51.5	26.6	12.7
EBITDA adjusted	34.5	64.8	51.0	27.1	13.2
EPS adjusted	32.2	74.5	50.1	22.5	12.2
Cash Flow (RsM)					
Operating cash flow	330	2,096	-820	222	3,722
Depreciation/amortization	75	103	140	200	260
Net working capital	-1,292	-825	-4,140	-3,873	-909
Investing cash flow	941	-629	-1,800	-3,150	-2,700
Capital expenditure	-568	-629	-750	-750	-750
Acquisitions/disposals	1,509	0	-1,050	-2,400	-1,950
Financing cash flow	1,812	1,655	2,910	2,684	-800
Borrowings	2,063	2,246	3,500	3,400	0
Dividends paid	-253	-590	-590	-716	-800
Change in cash	3,083	3,123	290	-244	221
Balance Sheet (RsM)					
Total assets	26,733	38,262	52,265	66,206	75,941
Cash & cash equivalent	6,152	9,274	9,564	9,321	9,542
Accounts receivable	12,789	19,803	30,933	41,043	47,019
Net fixed assets	1,031	1,557	2,167	2,717	3,207
Total liabilities	21,066	31,171	42,739	53,692	60,070
Accounts payable	4,413	8,723	12,539	15,659	17,180
Total Debt	7,090	9,336	12,836	16,236	16,236
Shareholders' funds	5,667	7,091	9,525	12,514	15,870
Profitability/Solvency Ratios (%)					
EBITDA margin adjusted	10.8	11.2	11.0	10.8	10.7
ROE adjusted	22.2	31.7	36.5	33.7	29.3
ROIC adjusted	20.3	25.5	27.8	25.6	24.4
Net debt to equity	16.6	0.9	34.3	55.3	42.2
Total debt to capital	55.6	56.8	57.4	56.5	50.6

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BGR Energy Systems

Company description

BGRL was incorporated in 1985 as a joint venture (JV) between GEA Energietechnik GmbH, Germany (40% stake) and Mr. B.G. Raghupathy (60% stake). It was initially in the business of supplying condensate tube-cleaning systems and debris filters, with a turnover of ~Rs100m. In 1993, GEA's stake was bought out by B.G. Raghupathy. Around FY00, BGR decided to approach clients with an integrated power equipment offering, rather than multiple divisions of BGRL approaching the same set of clients. BGRL then also tied up with BHEL to provide BOP solutions to clients. It won BOP orders for 95MW Valthur CCPP from TNEB and for 23MW captive plant from Aditya Cements in Rajasthan. In FY01, BGRL won the EPC contract from Aban for a 120MW gas power plant in TN. Following an IPO, BGRL listed on the stock exchanges on January 3, 2008. The company won its first 600MW EPC contract from TNEB in FY09. BGRL has also announced collaboration with Hitachi Power Europe GmbH, Germany (660MW, 800MW, 1,000MW and 1,100MW) for supercritical boilers and with Hitachi, Japan (660MW, 700MW, 800MW and 1,000MW) for supercritical turbines and generators.

Investment strategy

We have Buy/ Medium (1M) risk rating on BGRL as we believe the company is well positioned to benefit from India's huge power deficit, leading to the average annual power generation equipment market expanding from 5GW in the Xth plan to 16GW in the XIth plan and to 20-25GW in the future. We estimate that the current balance of plant (BOP) annual market size is set to increase from Rs220bn to Rs305bn in the future.

Currently most BOP component suppliers lack the skill sets and balance sheets to provide integrated BOP solutions and larger turnkey suppliers are diversified with limited focus on BOP. BGRL's power BOP focus and sourcing of ~ 40% of any BOP order in-house provides it a competitive advantage. Leveraging the gains of BOP business, the company has now transformed itself into a company capable of taking US\$1bn+ EPC orders.

In the first stage when BGRL transformed itself into an integrated BOP player, the company grew PAT at a CAGR of 70% of FY07-10. In the second stage, during which the company aims to transform itself into an integrated EPC player, we expect PAT CAGR of 27% over FY10-13E with average RoEs of 33%.

The next stage of growth is backward integrating into boiler and turbine generator (BTG) manufacturing, and company has tied up with a credible international partner, Hitachi, for the same. If BGRL does succeed in the last leg of transformation, it will be in an enviable position of being the only company other than L&T to offer EPC, BOP and BTG manufacturing in India.

Valuation

We set a target price of Rs884 for BGRL, which is based on a target P/E multiple of 18x December 2011E EPS. Our target price is set at ~20% discount to peers like BHEL and Thermax, given their superior cash flow from operations (CFO), PAT margins, RoE, order backlog and longer execution track record. Our target P/E multiple is also set at ~30% premium to mid cap construction peers like IVRCL, Nagarjuna, HCC and Punj Lloyd, given BGRL's superior PAT margins and RoE.

BGRL has traded in a P/E multiple band of 4x to 58x post listing with average P/E multiples of 14x. Our target P/E multiple is set at a ~30% premium to the historical average, given (1) the company's successful transformation from a BOP player to an EPC player, (2) credible steps to expand into BTG manufacturing and (3) the historical average is to an extent deflated by a period of global market correction.

Risks

Our quantitative risk-rating system, which tracks 260-day historical share price volatility, assigns a Medium Risk rating to BGRL. The key downside risks include the following:

- (1) The biggest challenge for BGRL is the timely and effective management of projects in hand.
- (2) Of the current order book, nearly ~ 70% of the projects are on a fixed price basis which implies that any adverse fluctuation of raw materials prices and bought-out items could negatively effect margins
- (3) High working capital needs with long payment cycles and retention money held by clients imply a sharp spike in the interest rates could result in higher borrowing costs
- (4) The majority of BGRL's orders are from state power utilities. SPU losses increased from Rs46bn in FY93 to Rs319bn in FY08 and are expected to be ~Rs500bn in FY10. At FY08 tariff levels the 13th Finance Commission believes this could be as high as Rs686bn in FY11E and move up to Rs1,161bn by FY15E.
- (5) BGRL does not have the balance sheet to support the equity investment into 2,640MW of projects. If BGRL ends up investing in these power plants, it would strain the company's balance sheet significantly.

Appendix A-1

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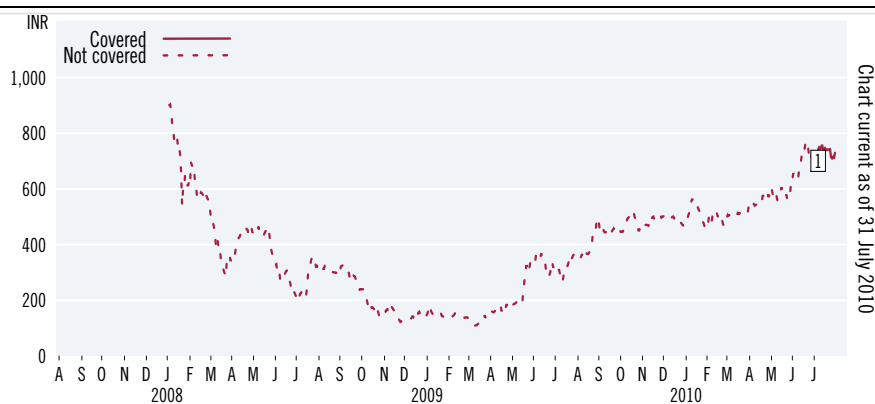
BGR Energy Systems (BGRE.BO)

Ratings and Target Price History

Fundamental Research

Analyst: Venkatesh Balasubramaniam

Covered since July 7 2010



Date	Rating	Target Price	Closing Price
7-Jul-10	*1M	*884.00	742.80

* Indicates change

Rating/target price changes above reflect Eastern Standard Time

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Data current as of 30 Jun 2010

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