



## BUY

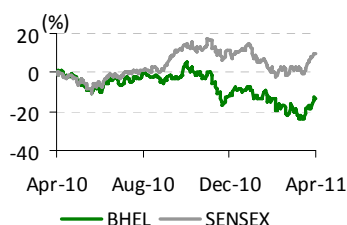
### Q4 result review

#### Analyst

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**Price** Rs2,198  
**Target** Rs2,780  
**BSE Index** 19,612

#### Historical Chart



Performance	1m	3m	6m
Absolute (%)	8.9	-4.1	-15.6
Relative (%)	1.2	-3.7	-12.2

#### Stock Information

Ticker code	BHEL IN
Market cap (US\$ bn)	23.8
52-week high (Rs)	2,694
52-week low (Rs)	1,901
Shares issued (m)	490
6m avg d.vol (US\$m)	37.8
Free float (%)	32.3
Major shareholders (%)	
President of India	67.7

#### Statutory Auditor

M/s Murthy Associates

#### Key Indicators (FY12F)

ROE (%)	29.2
Net gearing (%)	Net cash
Interest cover (x)	N.A.

## Bharat Heavy Electricals (BHEL)

### Profit momentum to continue, Maintain BUY

BHEL surprised with Q4 profit of Rs57/sh (+50% Y/Y and 10% above consensus estimate) as GM exceeded expectations. EPS was in line with our estimate but the consensus may upgrade FY12 forecast. We forecast FY12 EPS increase of 22% on new orders of Rs665bn which will calm investors who think BHEL is facing competition from Chinese manufacturers. We maintain BUY with TP of Rs2,780/sh.

#### Current backlog of Rs1.6tn, new FY12 orders of Rs665bn

The company is confident of a 10% rise in new orders in FY12, which would take FY12 backlog to Rs1.7tn, and revenue growth to 25%. This combined with stable GM (see below) supports our EPS growth forecast of 22% for FY12 and 18% for FY13.

#### GM of 22.9% exceeded consensus estimate by 100bp

BHEL managed to increase margin by 260bp in FY11 despite a 15% rise in RM costs due to execution of high-margin orders (super-critical boilers, turbines) and increased capacity utilization - 75% vs 60% in FY10. We believe BHEL can maintain GM of 23% this year – proportion of contracts with high-margin and cost hike pass-through clauses is now above 50% of backlog.

#### Superior product diminish competitive threats

BHEL prices its product at 15% above Chinese competitors. Its domestic customers however prefer BHEL due to superior quality and timely delivery. New orders from private sector now account for 90% of total vs 30% in FY09.

#### Gov't JVs ensure competitors stay away

In the last 2 years, BHEL formed 4 JVs with state gov't to build and operate power plants with capacity of 7.1k MW. BHEL, which owns 26%, will supply equipment to the JV worth Rs177bn by FY13 vs. its investment of Rs20bn.

#### Our share TP of Rs2,780 is based on discounted CF

We maintain our BUY recommendation for BHEL due to an increasing backlog that provides strong earnings visibility for the company.

Year End March 31	FY09	FY10	FY11	FY12F	FY13F
Revenue (Rs bn)	265	332	434	542	651
Net profit (Rs bn)	31	43	60	73	86
Recurring EPS (Rs)	64	88	123	149	177
Growth (%)	20	39	39	22	18
Net cash (Rs bn)	102	97	112	142	191
PER (x)	34.5	24.9	17.9	14.7	12.4
PBV (x)	8.3	6.8	5.4	4.3	3.5

SEE APPENDIX I FOR IMPORTANT DISCLOSURES AND ANALYST CERTIFICATIONS

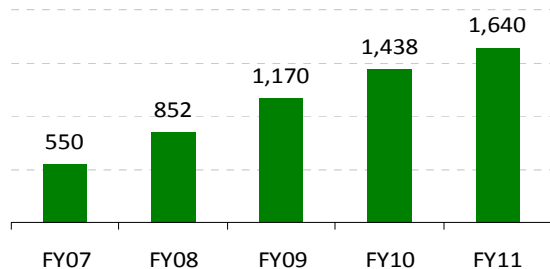
**Impact of change in new orders, GM not high on earnings**

According to our sensitivity analysis, BHEL's EPS will change 4% if new orders change by Rs100bn. A 200bp change in GM will affect EPS by 10%.

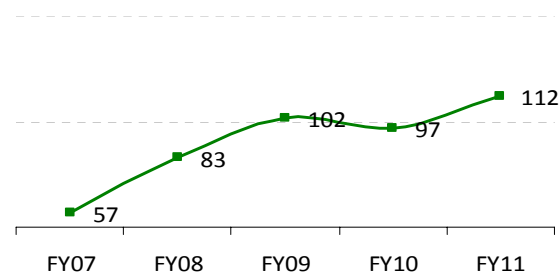
**Sensitivity analysis**

Sensitivity matrix (FY12F)	Change in EPS (%)
<b>New orders (base case - Rs665bn)</b>	
Impact of change of Rs50bn	2
Impact of change of Rs100bn	4
<b>Gross margin (base case - 23%)</b>	
Impact of change of 100bp	5
Impact of change of 200bp	10

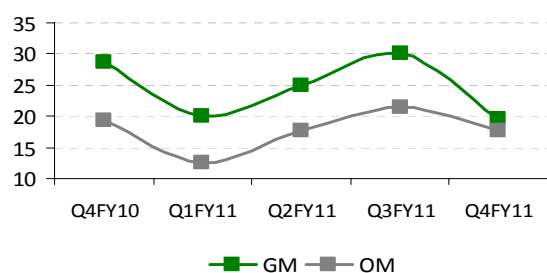
Source: Company data, KESI estimates

**Backlog (Rs bn)**

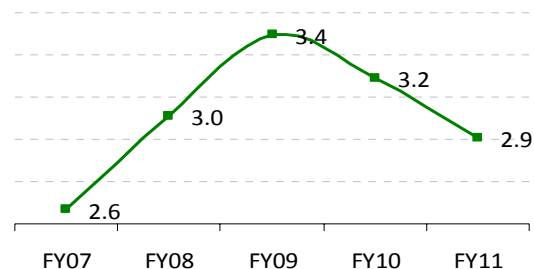
Source: Company data, KESI estimates

**Net cash (Rs bn)**

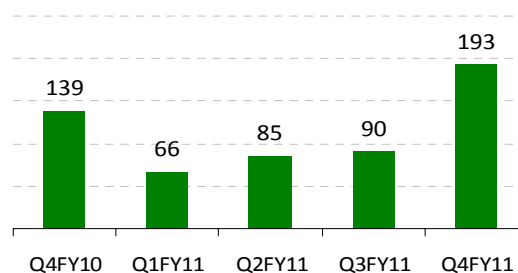
Source: Company data, KESI estimates

**Margin (%)**

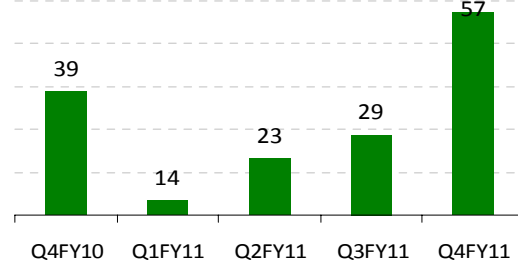
Source: Company data, KESI estimates

**Backlog to revenue (x)**

Source: Company data, KESI estimates

**Revenue (Rs bn)**

Source: Company data, KESI estimates

**EPS (Rs)**

Source: Company data, KESI estimates

**Key power equipment orders secured in FY11**

Customer	Order details	Size (Rs bn)
Dainik Bhaskar Power	2X600 MW	27
Raichur Power Corp	2X800 MW	63
Karnataka Power Corp	1X700 MW	37
NTPC Ltd	1X800 MW	36
Visa Power	2X600MW	27
Indiabulls Power	5X270 MW	29
Indiabulls Power	5X270 MW	29
APGENCO	1X600 MW	16
Gov't of Yemen	400 MW	20
West Bengal Power	2X500 MW	32
Lalitpur Power (Bajaj Group)	3X600 MW	55
APGENCO	1X600 MW	15

Source: Company data, KESI estimates

**Revenue**

(Rs bn)	FY09	FY10	FY11
Backlog	1,170	1,438	1,640
New orders	597	590	605
Revenue	283	345	451

**Company description:**

BHEL, 67% owned by the gov't, provides turnkey services to the power sector. The company is responsible for 64% or 85.7K MW of installed capacity in India. It manufactures turbine-generator sets for thermal, nuclear and hydro power plants and makes boilers and various electrical equipments for power transmission and industrial applications. We believe that none of its Chinese competitors can replicate BHEL's integrated infrastructure and there is no threat to the company's market share of 64%.

**Investment thesis:**

Our BUY recommendation for BHEL is supported by an increasing backlog that provides strong earnings visibility for the company. The company can maintain GM of 23% this year as proportion of contracts with high-margin and cost hike pass-through clauses is now above 50% of backlog. Our share TP of Rs2,780 is based on discounted CF.

**COMPANY ONLY QUARTERLY FINANCIALS (Yr to Mar)**

PROFIT & LOSS (Rs bn)	Q4FY10	Q1FY11	Q2FY11	Q3FY11	Q4FY11*
Revenue	139.4	66.0	84.9	90.2	192.8
Cost of sales	-97.7	-51.5	-62.3	-61.6	-153.5
Depreciation	-1.6	-1.3	-1.3	-1.4	-1.5
Selling, admn. & R&D exp.	-13.0	-4.9	-6.3	-7.9	-3.6
Operating profit	27.0	8.3	15.0	19.3	34.1
Other income / expense	2.1	1.6	1.6	1.5	10.2
Interest expensed	-0.2	0.0	-0.1	-0.1	-0.3
Profit before tax	28.9	9.9	16.5	20.7	44.0
Tax	-9.9	-3.3	-5.1	-6.6	-15.9
Recurring net profit	19.0	6.6	11.4	14.0	28.1
Exceptional items	0.0	0.0	0.0	0.0	0.0
Net profit	19.0	6.6	11.4	14.0	28.1
EPS (Rs)	38.8	13.5	23.3	28.7	57.3
Recurring EPS (Rs)	38.8	13.5	23.3	28.7	57.3
Fully diluted no. of share (m)	490	490	490	490	490

Ratios (%)	Q4FY10	Q1FY11	Q2FY11	Q3FY11	Q4FY11*
Gross margin	28.7	20.0	25.0	30.2	19.6
Operating margin	19.4	12.6	17.6	21.4	17.7
Net margin	13.6	10.0	13.4	15.6	14.6
SG&A / Sales	9.3	7.4	7.4	8.8	1.9
Effective Tax rate	34.2	33.3	31.0	32.0	36.2

Source: Company data \*Provisional result

**CONSOLIDATED YEARLY FINANCIALS (Year to Mar)**

<b>PROFIT &amp; LOSS (Rs bn)</b>	<b>FY08</b>	<b>FY09</b>	<b>FY10</b>	<b>FY11F</b>	<b>FY12F</b>	<b>FY13F</b>
Revenue	193.1	264.9	331.5	433.9	542.4	650.8
Cost of sales	-147.5	-213.5	-259.7	-328.9	-411.1	-493.4
Depreciation	-3.0	-3.4	-4.6	-5.6	-6.6	-7.4
Selling and admn expenses	-12.3	-14.3	-17.4	-22.8	-28.4	-34.1
<b>Operating profit</b>	<b>30.2</b>	<b>33.8</b>	<b>49.9</b>	<b>76.6</b>	<b>96.1</b>	<b>115.9</b>
Other income / Expense	11.7	15.0	16.6	15.0	15.3	15.6
Interest expensed	-0.4	-0.4	-0.4	-0.5	-0.5	-0.5
<b>Profit before tax</b>	<b>41.6</b>	<b>48.4</b>	<b>66.1</b>	<b>91.1</b>	<b>110.9</b>	<b>131.0</b>
Tax	-15.7	-17.2	-22.9	-31.0	-37.7	-44.5
Minorities	0.0	0.0	0.0	0.0	0.0	0.0
<b>Recurring net profit</b>	<b>25.9</b>	<b>31.2</b>	<b>43.3</b>	<b>60.1</b>	<b>73.2</b>	<b>86.4</b>
Exceptional items	2.7	0.0	0.0	0.0	0.0	0.0
<b>Net profit</b>	<b>28.6</b>	<b>31.2</b>	<b>43.3</b>	<b>60.1</b>	<b>73.2</b>	<b>86.4</b>
EPS (Rs)	58.4	63.7	88.4	122.8	149.5	176.6
Recurring EPS (Rs)	52.9	63.7	88.4	122.8	149.5	176.6
Fully diluted no. of share (m)	490	490	490	490	490	490

<b>KEY ASSUMPTIONS (Rs bn)</b>	<b>FY08</b>	<b>FY09</b>	<b>FY10</b>	<b>FY11F</b>	<b>FY12F</b>	<b>FY13F</b>
Revenue (Rs bn)	193.1	264.9	331.5	433.9	542.4	650.8
New orders (Rs bn)	502.7	596.7	590.3	605.0	665.5	732.1
Backlog (Rs bn)	852.0	1,170.0	1,438.0	1,640.0	1,741.9	1,797.6
Backlog to revenue (x)	3.0	3.4	3.2	2.9	2.6	2.2
Total average debt (Rs bn)	0.9	1.3	1.6	1.5	1.5	1.5
Average interest rate (%)	7.5	6.9	9.0	9.0	9.0	9.0

<b>RATIOS (%)</b>	<b>FY08</b>	<b>FY09</b>	<b>FY10</b>	<b>FY11F</b>	<b>FY12F</b>	<b>FY13F</b>
Gross margin	22.1	18.1	20.3	22.9	23.0	23.1
Operating margin	15.7	12.7	15.0	17.7	17.7	17.8
Net margin	13.4	11.8	13.0	13.9	13.5	13.3
SG&A / Sales	6.4	5.4	5.2	5.2	5.2	5.2
Effective Tax	37.8	35.6	34.6	34.0	34.0	34.0
Book value per share(Rs)	220.1	264.0	324.7	409.2	512.1	633.6
ROA	9.3	7.5	8.9	9.6	9.3	9.1
ROE	26.6	24.1	27.2	30.0	29.2	27.9
Net Debt/ Equity (x)	0.0	0.0	0.0	0.0	0.0	0.0
Dividend payout ratio	26.1	27.0	26.7	26.7	26.7	26.7

<b>CASHFLOW (Rs bn)</b>	<b>FY08</b>	<b>FY09</b>	<b>FY10</b>	<b>FY11F</b>	<b>FY12F</b>	<b>FY13F</b>
EBITDA	33.2	37.2	54.5	82.2	102.8	123.3
Accounts receivables	-23.6	-41.0	-47.2	-64.2	-68.0	-68.0
Inventory	-15.2	-21.6	-13.9	-28.7	-30.4	-30.4
Working capital	52.2	76.6	36.9	91.7	97.1	96.9
<b>Operating cash flow</b>	<b>46.6</b>	<b>51.3</b>	<b>30.3</b>	<b>81.1</b>	<b>101.4</b>	<b>121.8</b>
TAX	-15.7	-17.2	-22.9	-31.0	-37.7	-44.5
Interest	-0.4	-0.4	-0.4	-0.5	-0.5	-0.5
<b>Residual cash flow</b>	<b>30.5</b>	<b>33.7</b>	<b>7.0</b>	<b>49.6</b>	<b>63.2</b>	<b>76.7</b>
Fixed Assets	-6.6	-15.6	-17.2	-20.0	-20.0	-10.0
Change in investments	0.0	0.0	0.0	0.0	0.0	0.0
<b>Free cashflow</b>	<b>23.9</b>	<b>18.2</b>	<b>-10.1</b>	<b>29.6</b>	<b>43.2</b>	<b>66.7</b>
Capital increase	0.0	0.0	0.0	0.0	0.0	1.0
Dividend payments	-6.9	-8.7	-9.9	-13.5	-18.7	-22.8
Others/interest income	8.8	9.3	15.4	-1.3	5.5	4.7
<b>Net change in cashflow</b>	<b>25.7</b>	<b>18.7</b>	<b>-4.6</b>	<b>14.8</b>	<b>29.9</b>	<b>49.6</b>
Net cash beg	57.2	82.9	101.6	97.1	111.9	141.8
<b>Net cash end</b>	<b>82.9</b>	<b>101.6</b>	<b>97.1</b>	<b>111.9</b>	<b>141.8</b>	<b>191.4</b>

<b>BALANCE SHEET (Rs bn)</b>	<b>FY08</b>	<b>FY09</b>	<b>FY10</b>	<b>FY11F</b>	<b>FY12F</b>	<b>FY13F</b>
Cash & equivalent	83.9	103.3	98.6	113.3	143.3	192.9
Receivables	119.7	160.7	207.9	272.1	340.1	408.2
Inventories	57.4	78.9	92.8	121.5	151.9	182.2
Other current assets	16.1	26.9	30.9	40.0	49.7	59.7
Fixed assets (net)	9.8	16.7	26.1	40.5	53.9	56.5
Investments	0.1	0.1	0.1	0.1	0.1	0.1
Capital WIP	6.6	11.6	15.3	15.3	15.3	15.3
Other assets	13.4	18.4	15.3	26.4	32.1	37.9
<b>Total assets</b>	<b>306.9</b>	<b>416.5</b>	<b>486.9</b>	<b>629.1</b>	<b>786.3</b>	<b>952.7</b>
Working capital - liabilities	198.2	285.6	326.6	427.4	534.2	641.0
Debt	1.0	1.7	1.5	1.5	1.5	1.5
<b>Shareholders' Funds</b>	<b>107.7</b>	<b>129.2</b>	<b>159.0</b>	<b>200.3</b>	<b>250.7</b>	<b>310.1</b>

Source: Company Data, Kim Eng Securities Estimates

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**Recommendation definitions**

**Our recommendation is based on the following expected price performance within 12 months:**

+15% and above: BUY

-15% to +15%: HOLD

-15% or worse: SELL

**APPENDIX I: TERMS FOR PROVISION OF REPORT, DISCLOSURES  
AND  
DISCLAIMERS**

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