

# BHARAT EARTH MOVERS

INR 1,020-1,090

*Play on core capex and defense***SUBSCRIBE****\* Play on core capex and defense**

BEML is a play on capex across major developmental and infrastructural sectors such as coal and mining, construction, railways, and defense. We expect coal production to grow at a CAGR of 8.6% to 550 mn tones by 2012. The construction and mining industry is expected to reach INR 170 bn by 2010 from INR 85 bn currently. Further, the Indian Railways is focused on greater infrastructure creation and virtually doubling the traffic volume over the next five years. By virtue of being a government company, BEML is likely to be amongst the biggest beneficiaries of this infrastructure boom. Additionally, BEML is poised to benefit from the defense budget of INR 96 bn for FY08, an 11.6% increase over the previous year, being one of the major Indian defense contractors. Thus, BEML with its large infrastructure, unutilised capacities, and long track record of catering to the core sectors is an investment play on the major infrastructural activities likely over the next few years.

**\* Growth initiatives**

In addition to growing its existing business segments, BEML intends to explore captive mining opportunities. Towards this, it has already signed an MoU with Midwest Granite Private Limited for establishing a joint venture (JV), to take up contract mining. Further, the decision of the Indian ministry to allocate 148 coal mine blocks for leasing (of which 65% has already been allocated) provides BEML a long term business model. It also ensures supply of mining equipment by the company to the JV. BEML's success in catering to requirements of Delhi Metro is likely to position it as a preferred supplier of coaches to other planned metro projects over the coming decade in Mumbai, Chennai, Bangalore, Hyderabad, Ahmedabad, and Kochi. The company is investing INR 2.5 bn to augment its metro coach manufacturing capacity. It has already emerged as the lowest bidder for the Delhi Metro phase III to supply 161 coaches of ~INR 10 bn.

**\* Long term investment**

BEML has a capex plan of INR 9 bn spread over the next 3-4 years for funding growth opportunities in mining, railways, and defense sectors. We expect a revenue and PAT CAGR of 17% and 22%, respectively, over FY07-09E. Management has guided to PAT growth of 32% in FY08E. At the lower band of INR 1020, BEML trades at a PE of 15.7 and 13.7 on our FY08E and FY09E earnings estimates, respectively; on the higher band of INR 1090, it trades at a PE of 15.7 and 14.6 on our FY08E and FY09E earnings estimates, respectively. We believe that this valuation does not capture the long-term growth opportunities of metro railways and higher capex in the mining and railways sectors. Given the historically irregular nature of spend in these segments, we believe, BEML represents a good long-term bet for investors over the long term. We recommend 'subscribe' to the FPO offering.

**Financials**

Year to March	Q4FY07	Q4FY06	Y-o-Y%	Q3FY07	Q-o-Q%	FY07	FY08E
Revenue (INR mn)	9,384	5,551	69	6,076	54	24,239	29,053
EBITDA (INR mn)	1,318	805	64	494	167	2,798	4,019
Net profit (INR mn)	936	557	68	366	156	2,051	2,709
EPS (INR)	25	15	68	10	156	49	65
P/E (x)						21	16
EV/EBITDA (x)						11	8
ROE (%)						21	19

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Bloomberg : BEML IN

**Market Data**

52-week range (INR) : 1,270 / 772  
Share in issue (mn) : 36.7  
M cap (INR bn/USD mn) : 43.0 / 1,051.8  
Avg. Daily Vol. BSE/NSE ('000) : 146.9

**Share Holding Pattern (%)**

Promoters : 61.2  
MFs, FIs & Banks : 19.9  
FII : 6.3  
Others : 12.6



## Earth moving and mining – strong play on coal requirement for thermal power and steel

### \* Background

BEML is among the largest manufacturers of earth moving equipment in Asia. It manufactures equipment like bull-dozers, dump trucks, hydraulic excavators, wheel loaders, rope shovels, walking draglines, motor graders, and scrapers. All these equipment find application in mining major developmental and infrastructural sectors such as coal and mineral mining, irrigation, road and power projects, port, steel, cement, and fertilizers.

### \* Growth drivers

We expect Coal India Limited (CIL) to increase coal production from 363 MT to 550 MT by 2012, entailing an investment of INR 190 bn. At ~40% domestic market share for BEML, we expect an opportunity of INR 21 bn over the same period from CIL alone. In iron ore, our estimate suggests an increase in iron ore production from 140 MT in FY05 to 250 MT by FY12, creating an INR 23 bn market for BEML. In terms of limestone production, our estimate suggests an increase in limestone production from 161 MT in FY05 to 240 MT by 2012, providing a market of INR 23 bn for BEML. In other words, the total market opportunity for BEML from this space over the next five years is estimated at INR 86 bn.

BEML, through a JV with Mind West Granite, intends to take up contract mining. The company's stake in the JV is 45% and the authorised paid up capital of the JV company is INR 1 bn. This JV is essentially formed for private sector coal mining that is expected to emerge in a big way. The ministry has decided to allocate 148 coal mine blocks for leasing, out of which, 65% has already been allocated. We do not expect any earnings over FY07-09E from the same, but this allocation is expected to offer BEML great long term earnings opportunity.

### \* Revenue growth and margins

Currently, BEML is operating at 116% capacity utilisation in the construction and mining equipment space. The future growth in the division is expected to be through an outsourcing model where the components will be outsourced, but fabrication will be done in house. We expect revenue and contribution CAGR growth of 22% and 14%, respectively, from this segment over FY07-09E.

### \* Order book

The current product profile in this segment includes hydraulic excavators, bull dozers, pipe layers, rope shovels, walking draglines, loaders, graders, sprinklers, dumpers, dozers, and handlers. The order book, as on February 2007, is INR 8 bn (they typically have one year order book in this segment) and its profile is as below:

**Table 1: Order book**

Particulars	Equipment range
Dozers	300 HP, 320 HP, 410 HP
Hydraulic excavators	4.3 cu.m
Dumpers	35T, 50T, 85T, 100T, 150T, 190T, 250T

Source: Company, Edelweiss research

## Railways – a play on the upcoming metro facilities

### \* Background

In 1964, BEML started the first rail coach factory in the Indian sub-continent at Bangalore. Currently, it has an annual production capacity of over 400 non-metro and 150 metro coaches. It also manufactures overhead equipment inspection cars, track laying equipments, electric multiple units, rail bus, treasury vans, and spoil disposal wagons. The company's Bangalore unit also manufactures heavy duty trucks and trailers, and a number of variants such as crash fire tenders, recovery vehicles, road headers, and side discharge loaders for usage in underground mining and transport sectors.

### \* Growth drivers

As of February 2007, BEML has confirmed orders worth INR 1.02 bn (300 non-metro coaches) from the railway board New Delhi, to be executed over FY08. Further, it also has a letter of intent for supply of 857 coaches during FY08 and FY09, for which the price is yet to be fixed. Indian Railways proposes to introduce enhanced passenger capacity coaches, increase production of diesel electrical multiple unit (DEMU), main line electrical multiple unit (MEMU), and electric motor unit (EMU) coaches. Further, it is examining feasibility of introducing high-speed corridors and intends to introduce air-conditioned EMU coaches in Mumbai, Chennai, and Kolkata. Since BEML has been one of the largest suppliers of coaches and wagons to the Indian Railways, we expect BEML to be a front runner in getting these orders.

Metro transport is planned to be implemented in all the Indian cities with more than 3 mn population. In the immediate future, the focus is on cities like Mumbai, Chennai, Bangalore, Hyderabad, Ahmedabad, and Kochi. Currently, BEML has a capacity to manufacture 150 coaches per annum, which is expected to increase to 190 coaches, post capex of INR 2.5 bn from the FPO proceeds. BEML has already bagged the 188 metro coaches order from DMRC. Currently, it is the lowest bidder for the DMRC phase III metro project for 161 coaches, totaling to order of ~INR 10 bn. The project is expected to be executed before the 2010 Commonwealth Games in Delhi.

### \* Revenue growth and margins

For FY06, BEML recorded sales of INR 1.05 bn with an EBIT of INR (-) 150 mn. The commissioning of the DMRC Phase III, combined with the orders in the pipeline, is likely boost BEML's rail business tremendously. We expect revenues from railways to grow at a CAGR of 39% over FY07-09. We expect the company's non-metro project to breakeven by FY09E and the metro project to generate a contribution of 5%.

### \* Product portfolio

BEML's product portfolio in railways currently includes metro trains, integral rail coaches, AC/DC EMUs, stainless steel EMU, postal vans, utility vehicles, overhead equipment inspection cars, track laying equipments, broad gauge rail buses, treasury vans, and spoil disposal units. The major customers for this business from FY02 to 9MFY06 have been the railway board, DMRC, and the ministry of defense.

## Defense – Steady business

### \* Background

BEML is among India's major defense equipment manufacturers for the past four decades and continues to hold a major share of supplies for the ground support equipment to the Indian defense orders. BEML's equipment and vehicles are deployed extensively for movement of ammunition and men to forward areas for construction of border roads and gun-towing applications to maintain national security.

### \* Growth drivers

The defense product has delivered steady growth with improving profitability, which is evident from the fact that the segmental EBIT margins increased from 6% in FY04 to 22% in 9MFY07. Defense continues to be the major growth area for BEML. The company supplies Tatra 10x10, 8x8, 8x6, 4x4 series vehicles and new products like mines scattered laying vehicles, medium and light armored recovery vehicle, mobile pontoon bridge, mirali wagons, field artillery tractors, and ammunition loader vehicles to the Indian defense sector.

The total defense budget for FY08 is proposed at INR 96 bn, which is an increase of 11.6% over the previous year. Out of the total defense budget, INR 41 bn is allocated for capital expenditure, an increase of 19% over the previous fiscal years actual capital expenditure. Further, the new defense procurement procedure 2006 stipulates a 30% offset for contracts exceeding INR 3 bn. The concerned vendors will have to source goods or services to this extent from the Indian defense industry, which will provide local defense contractors like BEML huge growth opportunities.

### \* Revenue growth and margins

In FY06, BEML recorded sales of INR 7 bn with an EBIT margin of 32%. We expect revenue and contribution CAGR of 6% each over FY07-09E. The lower contribution is on account of likelihood of increasing competition with de-reservation of the defense sector that was until recently reserved for the public sector. The Indian companies are now eligible to apply for license to set up defense industry for manufacturing all types of defense equipment under license.

### \* Product portfolio

The current product portfolio encompasses recovery vehicle (armored, heavy, and medium) high mobility trucks, crash fire tenders, bridge layers, heavy duty carriers for artillery equipment, combat vehicles, ammunition loaders, tank transportation trailers, dozers, graders, aircraft towing tractors, radar carrier vehicles, mil rail coaches, and wagons. It also supports country's integrated guided missile development programme by supplying ground support vehicles.

## New Ventures

### \* Off shore expansion in the Latin American market

BEML's proposed joint venture company with Companhia Comercio E Construcoes (CCC) is expected to manufacture and supply rail wagons and bogies, mining and construction equipment, and spares. Given the growing demand of coal mining in Brazil and South America (in terms of expansion of mines and off take of wagons), this JV is expected to consolidate BEML's position in the mineral-rich territory of Brazil and provide the company a foothold for expanding into Latin America and west Africa.

### \* Contract mining

BEML has signed an MoU with Midwest Granite Private Limited to form a JV to take up contract mining, as coal blocks have been offered by the coal ministry for captive mining. This JV is essentially formed for private sector coal mining, which is expected to emerge in a big way. The ministry has decided to allocate 148 coal mine blocks for leasing, out of which, 65% has already been allocated. We do not expect any earnings over FY07-09E from the same, but the allocation is expected to offer BEML great long term earnings opportunity.

### \* Investment in production facilities of Indian tyre companies for manufacturing OTR tyres

BEML's mining and construction business is suffering due to shortage in supply of off-the-road (OTR) tyres. Hence, BEML has tied up with two Indian tyre companies and has signed an agreement to invest in setting up production facilities to manufacture OTR tyres at Mysore to meet its captive tyre requirements.

**Table 2: Business volumes**

<b>Mining and construction (Units)</b>	<b>FY04</b>	<b>FY05</b>	<b>FY06</b>
Hydraulic excavators	49	109	88
Bull dozers	203	296	258
Pipe layers	14	7	4
Rope shovels	2	-	3
Walking draglines	-	-	-
Side discharge loader	-	-	3
wheel loader	8	8	19
Back hoe loader	6	2	10
Motor grader	8	23	2
water sprinkler	8	5	4
Rear dumpers	201	280	371
Wheel dozers	3	2	12
Tyre handlers	2	-	1
<b>Defense</b>			
Tatra vehicles	834	224	256
Armoured recovery vehicles	62	43	105
Pontoon mainstream bridge system	2	23	-
Specialised vehicles	256	16	50
Ammunition loader vehicles	6	10	-
Bheema 1000	24	3	18
<b>Railways</b>			
Integral rail coaches	35	270	225
Stainless steel metro coaches	32	76	72

Source: Company, Edelweiss research

**Table 3: Segmental profitability**

<b>Revenue (Gross)</b>	<b>FY02</b>	<b>FY03</b>	<b>FY04</b>	<b>FY05</b>	<b>FY06</b>	<b>9mFY07</b>
Railway	240	0	255	1,005	1,051	453
Defense	5,832	6,450	7,770	6,010	7,030	4,476
Mining and cons	8,693	11,544	9,203	11,157	13,978	11,083
<b>PBIT</b>						
Railway	(35)	(50)	(61)	(25)	(16)	(18)
Defense	157	399	502	458	714	973
Mining and cons	757	572	1,444	2,371	2,478	1,051
<b>Margins</b>						
Railway	(15)	-	(24)	(2)	(2)	(4)
Defense	3	6	6	8	10	22
Mining and cons	9	5	16	21	18	9

Source: Company, Edelweiss research

\* **Objects of the issue**

Public issue of 4.9 mn equity shares of INR. 10/- each for cash at a price band of INR.1020 to INR 1090 per equity share aggregating INR 5000 mn at the lower band and INR 5341 mn at the higher band including a reservation for eligible employees of 4,90,000 equity shares and a net issue to the public of 44,10,000 equity shares by BEML. The issue would constitute 11.77% of the fully diluted post issue paid-up equity capital of our company.

**Table 4: Objects of the issue**

<b>Particulars</b>	<b>(INR mn)</b>
Expansion of metro coach manufacturing facility at Bangalore	2,145
Capital expenditure including up gradation of current facilities	900
VRS for employees	900
Setting up of 5 MW wind mill for captive consumption	270
Contribution for setting up R&D center of excellence for metro coaches	90
<b>Total</b>	<b>4,305</b>

*Source: Company*



## Risks and Concerns

### \* Poor investor communication

BEML has a history of poor communication with the investor community. It does not provide any disclosures relating to the segmental break-up or EBIT margins on account of its engagements in the defense business. Given the historically irregular nature of spend in the railways and mining businesses, it becomes extremely difficult to track the company on a quarterly and even an annual basis.

### \* Schedule of implementation

Government of India (GoI) is BEML's biggest customer and accounted for ~40% of its sales in FY06. Losing GoI in any event of failure in delivery can badly hurt the company's financial statement. Besides this, the company also runs execution risk, as the number and value of defense and railway products that BEML supplies vary from year to year, depending on the government policies and budgets for defense and railway/metro transport.

### \* Staff costs due to the sixth pay commission

BEML's salaries and wages are controlled by the GoI's pay commissions. The sixth pay commission constituted by the GoI is likely to be announced in the next 1-2 years (fifth pay commission came in 1995). This may result in an upward revision in BEML's salary and wages costs, going forward, affecting its profitability adversely.

## Financial Statements

<b>Income statement</b>					<b>(INR mn)</b>
<b>Year to March</b>	<b>FY05</b>	<b>FY06</b>	<b>FY07E</b>	<b>FY08E</b>	<b>FY09E</b>
Income from operations	17,309	20,567	24,239	29,053	33,977
Direct costs	10,463	13,521	14,950	18,009	21,472
Employee costs	3,562	3,336	3,638	4,001	4,361
Other expenses	905	1,381	2,853	3,024	3,447
Total operating expenses	14,930	18,238	21,440	25,034	29,280
EBITDA	2,379	2,328	2,798	4,019	4,697
Depreciation and amortisation	230	141	135	155	189
EBIT	2,149	2,187	2,664	3,865	4,508
Interest expenses	18	46	56	40	45
Other income	586	712	554	343	312
Profit before tax	2,718	2,853	3,162	4,168	4,775
Prior period adjustment	(9)	(1)	-	-	-
Provision for tax	975	985	1,111	1,459	1,671
Extraordinary items	-	-	-	-	1
Reported profit	1,751	1,869	2,051	2,709	3,103
Adjusted net profit	1,751	1,869	2,051	2,709	3,103
Shares outstanding	37	37	37	42	42
Dividend per share	11.4	11.4	12.0	13.2	15.1
Dividend payout %	23.9	22.4	21.5	20.3	20.3

### Common size metrics- as % of net revenues

<b>Year to March</b>	<b>FY05</b>	<b>FY06</b>	<b>FY07E</b>	<b>FY08E</b>	<b>FY09E</b>
Operating expenses	86.3	88.7	88.5	86.2	86.2
Depreciation	1.3	0.7	0.6	0.5	0.6
Interest expenditure	0.1	0.2	0.2	0.1	0.1
EBITDA margins	13.7	11.3	11.5	13.8	13.8
Net profit margins	10.1	9.1	8.5	9.3	9.1

### Growth metrics (%)

<b>Year to March</b>	<b>FY05</b>	<b>FY06</b>	<b>FY07E</b>	<b>FY08E</b>	<b>FY09E</b>
Revenues	3.7	18.8	17.9	19.9	16.9
EBITDA	807.9	(2.1)	20.2	43.6	16.9
PBT	449.1	5.0	10.8	31.8	14.6
Net profit	624.8	6.7	9.7	32.1	14.5
EPS	624.8	6.7	9.7	32.1	14.6

<b>Cash flow statement</b>					<b>(INR mn)</b>
<b>Year to March</b>	<b>FY05</b>	<b>FY06</b>	<b>FY07E</b>	<b>FY08E</b>	<b>FY09E</b>
Net profit	1,751	1,869	2,051	2,709	3,104
Add: Depreciation	179	125	135	155	189
Gross cash flow	1,930	1,995	2,186	2,864	3,293
Less: Dividends	418	419	441	550	630
Less: Changes in W. C.	2,789	1,043	753	1,681	1,576
Operating cash flow	(1,277)	533	992	632	1,086
Less: Change in investments	(3)	-	-	-	-
Less: Capex	51	325	1,000	2,150	1,250
<b>Free cash flow</b>	<b>(1,326)</b>	<b>208</b>	<b>(8)</b>	<b>(1,518)</b>	<b>(164)</b>

<b>Balance sheet</b>					(INR mn)
<b>As on 31st March</b>	<b>FY05</b>	<b>FY06</b>	<b>FY07E</b>	<b>FY08E</b>	<b>FY09E</b>
Equity capital	367	367	367	416	416
Reserves & surplus	6,979	8,430	10,040	17,148	19,622
Shareholders funds	7,347	8,797	10,407	17,564	20,038
Short Term Loan	755	249	0	0	0
Borrowings	755	249	0	0	0
<b>Sources of funds</b>	<b>8,102</b>	<b>9,046</b>	<b>10,407</b>	<b>17,564</b>	<b>20,038</b>
Gross block	5,440	5,651	6,651	8,801	10,051
Depreciation	4,274	4,399	4,534	4,688	4,877
Net block	1,166	1,252	2,117	4,113	5,174
Capital work in progress	63	176	176	176	176
Total fixed assets	1,228	1,428	2,293	4,289	5,350
Investments	25	25	25	25	25
Inventories	6,208	6,491	7,318	8,373	9,327
Sundry debtors	6,082	7,702	8,745	10,084	11,328
Cash and equivalents	3,969	3,800	3,543	7,023	6,860
Loans and advances	2,325	1,542	1,696	1,865	2,051
Total current assets	18,584	19,535	21,302	27,346	29,566
Sundry creditors and others	11,370	11,843	11,908	12,334	12,849
Provisions	743	346	1,551	2,009	2,302
Total CL & provisions	12,112	12,189	13,460	14,343	15,150
Net current assets	6,472	7,346	7,842	13,004	14,416
Net deferred tax	26	11	11	11	11
Others	403	258	258	258	258
<b>Uses of funds</b>	<b>8,102</b>	<b>9,046</b>	<b>10,407</b>	<b>17,564</b>	<b>20,038</b>
Book value per share (BV) (INR)	200	239	283	422	481

**Ratios**

<b>Year to March</b>	<b>FY05</b>	<b>FY06</b>	<b>FY07E</b>	<b>FY08E</b>	<b>FY09E</b>
ROE (%)	26.2	23.2	21.4	19.4	16.5
ROCE (%)	37.9	33.8	33.1	30.1	25.6
Current ratio	1.5	1.6	1.6	1.9	2.0
Debtors (days)	128	137	132	127	122
Fixed assets t/o (x)	13.4	15.5	13.0	8.8	7.1

**Valuations parameters**

<b>Year to March</b>	<b>FY05</b>	<b>FY06</b>	<b>FY07E</b>	<b>FY08E</b>	<b>FY09E</b>
EPS (INR)	42.1	44.9	49.3	65.1	74.5
Y-o-Y growth (%)	624.8	6.7	9.7	32.1	14.6
CEPS (INR)	53.9	54.7	59.5	68.8	79.0
P/E (x)	24.3	22.7	20.7	15.7	13.7
Price/BV(x)	5.1	4.3	3.6	2.4	2.1
EV/Sales (x)	2.0	1.6	1.4	1.2	1.0
EV/EBITDA (x)	14.4	14.6	12.1	8.8	7.6

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### RATING INTERPRETATION

<b>Buy</b>	Expected to appreciate more than 20% over a 12-month period	<b>Reduce</b>	Expected to depreciate up to 10% over a 12-month period
<b>Accumulate</b>	Expected to appreciate up to 20% over a 12-month period	<b>Sell</b>	Expected to depreciate more than 10% over a 12-month period
<b>Trading Buy</b>	Expected to appreciate more than 10% over a 45-day period	<b>Trading Sell</b>	Expected to depreciate more than 10% over a 45-day period

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