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BGR Energy Systems Ltd

PRICE : RS.255 | **RECOMMENDATION : BUY**
TARGET PRICE : RS.349 | **FY10E PE : 11X**

Stock details

BSE code	:	532930
NSE code	:	BGRENERGY
Market cap (Rs mn)	:	18360
Free float (%)	:	18.69
52-wk Hi/Lo (Rs)	:	988/209
Avg. daily volume BSE	:	194912
Avg. daily volume NSE	:	273477
Shares o/s (mn)	:	72

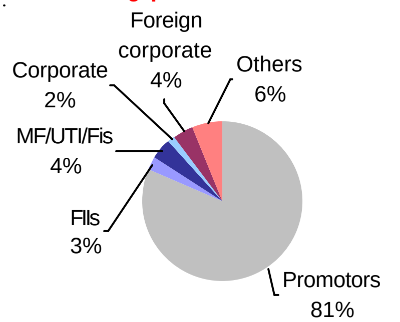
Summary table

(Rs bn)	FY08	FY09E	FY10E
Sales	15,205	22,808	33,756
Growth (%)	93.3	50.0	48.0
EBITDA	1,554	2,281	3,038
EBITDA margin (%)	10.2	10.0	9.0
Net profit	885	1,207	1,663
Net debt	1,957	1,221	2,829
EPS (Rs)	12.3	16.8	23.1
DPS (Rs)	2.0	2.0	2.0
ROE (%)	31.8	23.0	25.5
ROCE (%)	23.7	21.4	25.2
EV/Sales (x)	1.2	0.8	0.6
EV/EBITDA (x)	12.1	7.9	6.5
P/E (x)	20.7	15.2	11.0
P/BV (x)	3.9	3.2	2.5

FY08/09	Q3/08	Q4/08	Q1/09
Sales	3,828	5,786	3,068
EPS (Rs)	3.3	4.4	2.4

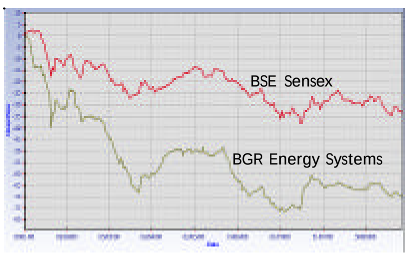
Source: Company, Kotak Securities - Private Client Research

Shareholding pattern



Source: Capitaline

One-year performance (Rel to sensex)



Source: Capitaline

Incorporated in 1985 as a joint venture between GEA Energietechnik GmbH, Germany and Mr. B.G. Raghupathy, company has now emerged as a key player in the Balance of Plant (BoP) and EPC space. BGR energy has now expanded its presence in providing entire gamut of services for the power plant commissioning. Apart from having expertise in executing power projects, it has also diversified its presence across captive power projects, oil and gas equipment, air fin coolers, environmental engineering, electrical projects and infrastructure projects. With the capacity expansion at the existing locations as well as commissioning of new facilities, company is set to cater to a wider base of clients.

We believe that, with an order book of Rs 110bn and with significant expertise in the above segments, company is set to emerge as a leading player in the BOP and EPC segment with huge investments planned by state and central governments in power, oil and gas, electrical and infrastructure. We thus expect revenues to grow at a CAGR of 49% and net profits to grow at a CAGR of 37% between FY08-FY10. At current price of Rs.255, stock is trading at very attractive valuations of 15.2x and 11x on P/E multiples and 7.9x and 6.5x on EV/EBITDA estimates for FY09 and FY10 respectively. We recommend BUY with a price target of Rs.349 based on the DCF valuation methodology on FY10 estimates using a WACC of 13% and terminal growth rate of 5%.

Key investment positives

- **Leading player in the BOP space with strong experience.** BGR energy has emerged as a leading player in the BOP space after successfully executing several power projects ranging from 25MW to 500MW using different types of fuels. It has also designed custom projects for clients across a range of industries such as power, oil and gas, petrochemicals, refineries and other process industries. We expect company to leverage its experience across larger sized projects as well as for enhancing the scope of work towards EPC projects.

- **Enhanced presence in EPC space with key order wins.** BGR has expanded its presence to the EPC space wherein it would also provide the power island for the plant including boilers, turbines and generators along with the mechanical, electrical, control instrumentation and civil features for the project. It has recently bagged significantly large sized EPC orders totaling Rs 80bn for setting up thermal power plants. With these orders, company has taken a significant stride in the EPC space. This would also enable company to have better control over work flow.

- **Huge opportunities expected to come up for power sector.** Government of India has a planned capacity addition target of about 78,750MW in the power sector during the eleventh five year plan. With a probability of 65% target completion, we expect capacity addition to the tune of 49-50GW in the eleventh five year plan. With an estimated cost of Rs 40-50mn for 1MW, potential of EPC order inflows could be to the tune of Rs 2 trillion. With balance of plant portion contributing almost 40-50% of the total project cost, potential of order inflow in the BOP segment can also be enormous. This would be extremely positive for players like BGR energy having significant expertise in executing BOP projects. With its entry into the EPC segment, company is well positioned to capture the upcoming opportunities in the coming years.

- **Robust order book and diversified business model**. BGR energy has a current order book of approx. Rs 110 bn diversified across several segments. Though power projects contribute a major proportion of BGR Energy's order book as well as revenue composition, diversification into captive power, oil and gas equipment, air fin coolers, environmental engineering, electrical projects and infrastructure projects expands the entire gamut of opportunities which the company can tap going forward.
- **Set to emerge as one of the key players based on its project expertise as well as cost competitiveness.** BGR energy has acquired significant industry expertise and knowledge over past 20 years for managing various complex projects. It has a proven track record in designing, manufacturing, procuring, constructing, commissioning and testing the packaged system as well as providing turnkey solutions to its clients. This enables the company to compete with other players as well as international players and bag large sized complex projects. Along with this, it also designs and manufactures a range of equipment inhouse which provides a better control over costs.
- **Technological collaborations and strong management team to enable company to bag large and complex projects.** BGR has strategic tie ups with key world players in power island equipments & is poised to execute turnkey contracts for power plants with unit sizes upto 1000 MW using latest technologies. Company is managed by a team of highly motivated team of professionals. Management team of BGR has a vast experience in sale of industrial equipment and control systems, project and business management. Average industry experience of the management team is more than 25 years. Each segment of BGR energy is headed by a separate business head who has relevant expertise to grow their respective units. Thus strong management team coupled with excellent client base also helps in expanding the order book size in a rapid manner.
- **Strong balance sheet.** BGR Energy had recently raised Rs3.37 bn from a fresh issue of shares as well as private placement to invest in working capital requirements and expanding the production facility to set up manufacturing facility in India, China and Middle East. This is expected to enable the company to increase production as well as extend operations to locations in Middle East and China for customers located around the world.
- **Robust order book to lead to steep growth in revenues and profitability.** With a robust order book diversified across various sectors, we expect revenues to grow at a CAGR of 49% and net profits to grow at a CAGR of 37% between FY08-FY10. Operating margins are expected to decline from the current levels due to larger proportion of fixed price contracts as well as higher proportion of revenues from EPC projects in the current order book.

We initiate coverage on BGR Energy with BUY recommendation with a price target of Rs.349

- **Attractive valuations**. At current price of Rs.255, stock is trading at very attractive valuations of 15.2x and 11x on P/E multiples and 7.9x and 6.5x on EV/EBITDA estimates for FY09 and FY10 respectively. BGR Energy can be compared well with the EPC players as well as construction players based on its project expertise and order book mix. We remain positive on the company based on its strong order book as well as upcoming order inflows. We recommend **BUY** with a price target of Rs.349 based on the DCF valuation methodology on FY10 estimates.

Key risks and concerns

- Delay in implementation of orders
- Manpower attrition
- Steep increase in commodity prices
- Potential slowdown in order inflows

Company Background

BGR Energy was incorporated in 1985 as a joint venture between GEA Energietechnik GmbH, Germany and Mr. B.G. Raghupathy, to produce and sell on-line condenser tube cleaning systems, debris filters and rubber cleaning balls used in thermal and nuclear power plants. Later in 1993, company expanded its range of product and services into power and oil and gas industries and changed its name to BGR Energy Systems Limited in 2007.

Company had initially focused on supply of the BOP (balance of plant) equipment for several projects. It has now extended its presence in the EPC contracts providing entire gamut of services from supply of a range of equipment and services, including the civil works required for a project and other work as may be required under the contract. BOP package for a particular power project includes supply of services such as civil works, coal handling, ash handling, cooling tower, chimneys, transformers, switchgears, sub stations, cables, fire protection systems, control and instrumentation. Extending the capabilities from simply BOP service provider to an EPC provider, BGR has emerged as a key player in setting up an entire power plant and compete with large players such as BHEL, Tata Projects, Reliance Infrastructure etc.

Company's business segment is diversified across power projects, captive power projects, oil and gas equipment, air fin coolers, environmental engineering, electrical projects and infrastructure projects division. Along with this, its subsidiary Progen manufactures custom equipment used in the power, process (chemicals and fertilizers), oil and gas and petrochemicals industries. This includes exchangers, pressure vessels, reactors, columns, surface condensers, heaters and boiler components. We believe that with an order book of Rs 110bn and with significant expertise in the above segments, company is set to emerge as a leading player in the BOP and EPC segment with huge investments planned by state and central governments in power, oil and gas, electrical and infrastructure.

Experienced management team

Company is managed by a team of highly motivated team of professionals. Management team of BGR has a vast experience in sale of industrial equipment and control systems, project and business management. Prior to joining BGR energy, most of them have an experience in various private and public sector undertakings in the power sector. Each segment of BGR energy is headed by a separate business head who has relevant expertise to grow their respective units. Average industry experience of the management team is more than 25 years.

Experienced management team

Name	Position	Industry experience (Years)	Experience with BGR Energy (Years)
Mr B. G. Raghupathy	Chairman and MD	34	23
Mr S Rathinam	Director(Finance)	29	16
Mr V R Mahadevan	Director(Technology, HR, Infrastructure)	26	21
Mr A Swaminathan	President and CEO, Power projects	29	11
Major H L Khajuria	President and CEO, Environmental Eng	38	11
Mr R Ramesh Kumar	President, Corporate and Secretary	21	16
Mr G Suresh	President and CEO, Captive Power	23	20
Mr V Balakrishnan	President and CEO, Electrical Projects	26	5
Mr. S. Ilanchezhiyan	President and CEO, Air Fin Coolers	23	2
Mr N Murali	President and CEO, Oil and gas equipment	28	2
Mr P R Easwar Kumar	CFO	16	15

Source: Company

Business Overview

Power projects business

Power projects division carries out turnkey EPC and BOP projects for thermal power plants as well as gas based power plants. BGR Energy initially had focused only on providing the BOP packages to EPC contractors with supply of services other than boiler, turbine and generator. Eventually it moved on for supplying the entire power plant package (EPC package) and emerged as a key player in bagging projects in the EPC segment.Company has tied up with key Chinese players like Dong Feng for supply of BTG equipment for its large sized EPC projects.

Key projects completed or being carried out by the company are –

Project schedule

Project	Status	Size(Rs mn)	Type
95MW CCPP, Valuthur,Tamil Nadu	Completed	594	BOP
23MW Coal fired power plant,Rajasthan	Completed	444	BOP
120MW CCPP, Karuppur,Tamil Nadu	Completed	2697	EPC
330MW CCPP, Rajasthan for RRVUNL	Completed	2095	BOP
500MW Thermal power station,Vijayawada,AP for APGENCO	Under execution	5788	BOP
500MW Thermal power station,Kakatiya,AP for APGENCO	Under execution	6949	BOP
500MW Thermal power station,Khaperkheda,Maharashtra for MAHAGENCO	Under execution	9980	BOP
500MW Thermal power station,Kothagudem,AP for APGENCO	Recently awarded	7930	BOP
600MW Thermal power plant, for TN electricity board	Recently awarded	31000	EPC
2X600MW Thermal Power plant, Rajasthan for RRVUNL	Recently awarded	49000	EPC

*Source: Company; *CCPP - Combined Cycle Power plant*

Current order book in this division is Rs.102 bn

BGR energy has recently been awarded two large EPC projects. Scope of the work for the first 600MW EPC project from Tamil Nadu Electricity Board(TNEB) includes design, engineering, supply of boiler, steam turbine, generator and complete BoP equipments required for commercial operation of the plant. This 600MW sub critical power plant is to be completed in a time frame of 39 months. This project is an expansion of the existing 4X210MW thermal power project of TNEB at Mettur and marked the entry of BGR Energy into the EPC space for large projects of 500MW. The second project of 2X600MW EPC project for Kalisindh Thermal Power Project at Jhalawar, Rajasthan from RRVUNL is the largest contract bagged by the company till date. This project will also have two of Asia's tallest natural draft cooling towers to be built by the company in-house. These projects were secured in international competitive bidding and BGR Energy outbid players like BHEL in winning the contracts.

With BGR winning key orders such as TN and Rajasthan, outbidding players like BHEL, company has taken an important step towards bagging large sized orders. Timely and successful execution is going to be a key challenge for the company going forward.

Air fin coolers business

Current order book in this division is Rs.1.4 bn

Air fin coolers business designs, manufactures and markets air-cooled heat exchangers, air-cooled radiators and finned tubes for use in the oil and gas, power, process and petrochemical industries. This division can produce upto 750 coolers per year and plans to increase capacity with the expected addition of two finning machines to existing group of five machines. Air fin coolers division is active in India, Middle East, South East Asia and north Africa and key clients include Samsung Engineering, Hyundai, Reliance and L&T.

Oil and gas equipment business

Current order book in this division is Rs.8.2 bn

Oil and gas equipment division was set up in 2001 and provides a range of products such as production separators, water bath heaters, gas gathering systems, gas metering systems, gas compressor packages, storage tanks, gas dehydration and sweetening systems and various pipeline equipment. This division primarily caters to the demand from oil and gas fields, cross country pipelines, refineries, petrochemicals and power. Company has an exclusive agreement with Ariel Corporation to package and sell reciprocating gas compressors in India and Bangladesh. It also received three export orders from the State Company for Oil Projects (SCOP) in Iraq for US$ 103.89 Mn. Orders under execution are:

- Hydrogen Gas Compressors for Jubail Oil Chemicals, Saudi Arabia
- Booster Compressor for TNEB, Valathur
- CNG Compressors for Maulana & Sons, Sonergan, Bangladesh

Captive power business

Current order book in this division is Rs.220 mn

Captive power business of BGR energy was set up in 2006 to cater to the increased requirement of captive power plants in user industries. Company has entered into strategic alliances with Chinese manufacturers for supply of steam generators, turbines and cooling systems. It has alliance with Sichuan Chuanghua Boiler Company for supply of steam generators, with Qingdao Jieneng Power Station Engineering Company Limited for supply of steam turbines and with GEA Cooling Tower technologies for sourcing cooling towers.

We believe that this division is expected to be benefited with increasing capex plans of metals, cement, chemicals and textile industry.

Environmental engineering business

Current order book in this division is Rs.140 mn

This division manufactures a range of equipment such as deaerators, desalination and waste water treatment equipment. This business completed a water treatment project for a 95 MW power plant in Perungulam, Tamil Nadu and has also supplied water systems for other power projects ranging from 24 MW to 120 MW. It is currently designing and building the water systems at 500 MW power plants in Kakatiya and Vijayawada.

Electrical Projects division

Current order book in this division is Rs.400 mn

Electrical projects division works in conjunction with other businesses of BGR Energy as well as for third parties. It was established in 2003 and undertakes turnkey contracts to set up transmission and distribution networks, gas insulated substations, switchgears and other electrical projects. The electrical projects business also focuses on electrical BOP contracts for hydro-electric power plants, in which it completes all of the electrical requirements for the project.

Infrastructure Business

This division was established in 2004 to address the growing demand of construction of roads, bridges, highways and tunnels. Currently one of the projects in this division is under arbitration with the client and another one is under cancellation stage due to disagreements with the client. BGR energy intends to be selective in bidding for projects in this division going forward.

Progen

Progen was incorporated in 1994 and began commercial operation in 1997. Being a subsidiary of the company, it is a common manufacturer for the group. It designs and manufactures heat exchangers, pressure vessels, reactors, columns, surface condensers, high pressure and low pressure heaters, high frequency resistance welded finned tubes and various boiler components. Progen builds custom equipment used in the power, process (chemicals and fertilizers), oil and gas and petrochemicals industries. Manufacturing facility of Progen is located in Panjetty, near Chennai along with the internal manufacturing facility of BGR Energy in the same area. It has manufactured an evaporator for a sea water desalination plant. It has also manufactured four ASME certified 36 metric ton air tanks for a hydro power plant for Mitsui & Company Limited and has also made one of the largest deaerators ever made in India, with a weight of 128 metric tons.

Competitive Analysis

BGR Energy has established a track record and a brand image of being the early adopter of Balance of Plant concept in India. It has executed over 130 contracts in 45 overseas countries. Company designs and manufactures a range of equipments in house based on the clients' requirements and is capable of targeting a wider spectrum of the BOP space as compared to its competitors. In house design and engineering gives better control over costs, delivery as well as completion and enable execution of large, multifaceted complex projects. Successful tie ups with several international companies for various technologies and products differentiate company from rest of the peers. BGR energy's future growth strategy is to target the clients like SEB's and power generation companies directly and emerge as a main contractor for the projects.

Competitive analysis

Division	Competitors
Power projects	L&T, Tata Projects, Punj Lloyd, Reliance Infra, BHEL
Captive power projects	Thermax, L&T, Tata Projects, BHEL, Conduit Ventures Ltd
Oil and gas equipment	Gastech Process Engineering India Pvt Ltd, Multitex Filteration Engineering Ltd,Punj Lloyd
Air Fin coolers	Paharpur Cooling Towers and GEI Industrial Systems Ltd
Environmental Engineering	BHEL, L&T, Thermax and Allied Energy India Limited
Electrical Projects	ABB Limited, L&T, Crompton Greaves,Areva T&D,Siemens,IVRCL
Infrastructure	L&T,Gammon, HCC, IVRCL, NCC,MPL, Simplex Infra, Era Infra
Progen	Jord Engineers Limited, Akshar Precision Tubes India Limited, BHEL,L&T

Source: Company

INDUSTRY SCENARIO

Power sector scenario in India

Government targets capacity addition of 78,750 MW during Eleventh Five Year Plan

Power sector has continued to witness a deficit scenario in the tenth five year plan with capacity addition accounting for only 52% of the actual targets. Keeping in view the slow pace of implementation and deficit in the power sector, government had targeted capacity additions of about 78,750 MW during the Eleventh Five Year Plan. Further, the government tentatively plans to add around 82,200 MW of fresh capacities during the Twelfth Plan period (2012 - 2017).

Capacity

Type	Central(MW)	State (MW)	Private(MW)	Total(MW)
Thermal	24,890	23,301	11,552	59,743
Hydro	8,654	3,482	3,491	15,627
Nuclear	3,380	0	0	3,380
Total	**36,924**	**26,783**	**15,043**	**78,750**

Source: Central Electricity Authority of India

Plan-wise capacity target and achievement

Five year plans	Target(MW)	Achievement(MW)	% achievement
8th Plan	30,538	16,423	53.8
9th Plan	40,245	19,119	47.5
10th Plan	41,110	21,180	51.5
11th Plan*	78,700	10,832	13.8

*Source: Central Electricity Authority(CEA), * as on June 30, 2008*

Based on past performance, the targeted capacity additions may fall short of their target by 35-40% and may be in the range of 49-50GW during the Eleventh five year plan.

Capacity additions

(MW)	Central	State	Private	Total
2007-08	3,240	5,273	750	**9,263**
2008-09	2,936	3,143	1,666	**7,745**
2009-10	3,926	2,492	1,596	**8,014**
2010-11	6,110	4,953	1,600	**12,663**
2011-12	7,680	1,380	3,060	**12,120**
Total	**23,892**	**17,241**	**8,672**	**49,805**

Source: Cris Infac, Kotak Securities - Private Client Research

However, even on assuming a target achievement of 65% in the eleventh plan, we expect capacity addition to the tune of 49-50GW in the eleventh five year plan. With an estimated cost of Rs 40-50mn for 1MW, potential of EPC order inflows could be to the tune of Rs 2 trillion. With balance of plant portion contributing almost 40-50% of the total project cost, potential of order inflow in the BOP segment can also be enormous. This would be extremely positive for players like BGR energy having significant expertise in executing BOP projects. With its entry into the EPC segment, company is well positioned to capture the upcoming opportunities in the coming years.

Upcoming projects of state electricity boards

Near term orders expected in the BOP and EPC segment

Location	Owner	Size (MW)	Fuel	Type
Koradi, Maharashtra	MAHAGENCO	1800	Coal	EPC
Uran, Maharashtra	MAHAGENCO	1150	Gas	EPC
Chabra, Rajasthan	RRVUNL	500	Coal	EPC
Malwa, Chattisgarh	MPPGENCO	1200	Coal	BOP
Satpura, Chattisparh	MPPGENCO	500	Coal	BOP
Krishnapatnam, AP	APGENCO	1600	Coal	BOP

Source: Company

Along with the new order inflows, a large amount of investments are expected to happen for renovation and modernization program for existing power projects which can further lead to significant order inflows for the experienced players in the power segment.

Renovation and modernisation programme

	R&M	LEP
No. of thermal power stations	22	31
No. of thermal units	77	81
Estimated cost (Rs mn)	41,250	134,050
Total capacity involved (MW)	19,205	13,032

*Source: Ministry of Power; *R&M - Renovation and modernisation; LEP - Life Extension programme*

Upcoming captive power projects

A large number of user industries are setting up their own captive power plants to cater to their increased requirement for power as well as to reduce their power cost. The captive capacity is at around 20% of the total installed capacity in the country with metals and chemicals account for around 41% of the total captive power capacity and other sectors such as cement, textiles and other diversified sectors account for the rest.

Growth in the captive power capacity is expected to come from the upcoming plants of various industries. This is expected to open up opportunities for players like BGR, BHEL, L&T, Tata Projects etc in terms of order inflows.

Installed capacity break up for year 2006

	(%)
Metals	26
Chemicals	15
Textiles	10
Cement	8
Others	41

Source: Crisil

Upcoming captive power plants in cement sector

	MW
ACC	
Bargarh	30
New Wadi	50
Chanda	25
Gujarat Ambuja	**112**
Grasim	**250**
Ultratech Cements	
Gujarat	92
Chattisgarh	50
Maharashtra	33
Shree Cements	**10**
Sagar Cements	**60**
Century Textiles	**40**
JP Associates	**308**

Source: Industry, Kotak Securities - Private Client Research

Upcoming captive power plants in metals sector

	MW
Ispat industries	**100**
Jindal Saw	**15**
JSPL	
Raigarh	340
Raigarh	270
Raigarh	270
Orrissa	1080
Jharkhand	1320
Total addition	**2940**
Visa Steel	**25**
Rohit Ferro-Tech	**110**
Nalco	**240**
JSW Steel	**30**
Sarda Energy and minerals ltd	**48**

Source: Industry, Kotak Securities - Private Client Research

Upcoming investments in oil and gas sector

It is quite imperative for the government to step up exploration and production (E&P) activity in the country to address the growing demand of oil and gas. The most important step taken by the government towards stepping up E&P activity in the country was the New Exploration and Licensing Policy, commonly called NELP. The main objective of NELP is to attract latest technology and investment to the exploration sector from national or international E&P companies in order to reduce dependence on imports. Till date, 160 blocks have been awarded under 6 rounds of NELP bidding. Under NELP VII, 57 blocks were on offer with an initial estimated investment of $3.5 billion. This is expected to offer a large number of EPC projects in the hydrocarbon segment for the winning bidders. Along with this, in order to tap the huge opportunity in natural gas transportation, various companies have lined up pipeline network expansion plans. This would also result in large order inflows for key players in oil and gas EPC segment such as Punj Lloyd, Larsen and Toubro and BGR energy.

Electrical segment

Transmission and distribution sector is expected to see increased investments as per the Eleventh Plan. An amount of Rs 1360 billion is planned to be invested in the transmission sector in the eleventh plan as against Rs 496 billion for the Tenth Plan. This higher amount is allocated for setting up of national and regional grids. Thus these investments are expected to generate opportunities for the electrical division of BGR Energy.

Planned infrastructure investments

According to planning commission, during eleventh five year plan total investment in the infrastructure sector is expected to be around $500bn over FY07-FY12. This is expected to translate into huge investments in various segments of roads, electricity, telecom, railways, irrigation, water supply, ports, airports and gas. Though BGR energy was unable to achieve completion of road projects due to litigation issues, but we expect that company may leverage its experience in different segments and may benefit from increased order inflows in the respective sectors of roads and water supply and sanitation.

Infrastructure sector investment

Sector	Total 11th plan
Electricity (incl. NCE)	6,165
Roads	3,118
Telecom	2,670
Railways (incl. MRTS)	2,580
Irrigation (Incl. Watershed)	2,231
Water Supply and Sanitation	1,991
Ports	739
Airports	347
Storage	224
Gas	205
Total Investment	20,272
Total (US $ billion)	494.43
Investment as % of GDP	7.53

Source: Planning Commission

Key Investment Positives

Leading player in the BOP space with strong experience

BGR Energy is a leading player in the BOP space

BGR Energy was among one of the first companies in India to develop the BOP concept to allow providers of boilers, turbines and generators to utilize one contract to source the range of products and services required to complete the power plant. BGR energy has emerged as a leading player in the BOP space after successfully executing several power and oil & gas projects ranging from 25MW to 500MW using different types of fuels. It has successfully executed power projects in Valuthur in TN and Chittorgarh and Dholpur in Rajasthan. Company has also designed custom products for clients across a range of industries such as power, oil and gas, petrochemicals, refineries and other process industries. We expect company to leverage its experience across larger sized projects as well as for enhancing the scope of work towards EPC projects.

Enhanced presence in EPC space with key order wins

Company recently won large size EPC orders worth Rs.80 bn in the power segment

BGR Energy has expanded its presence to the EPC space wherein it would also provide the power island for the plant including boilers, turbines and generators along with the mechanical, electrical, control instrumentation and civil features for the project. It has won various large sized orders recently in the EPC space outbidding other large players in the EPC space such as BHEL. Following are the key orders bagged by the company in this space –

- 600MW Thermal power plant, for TN electricity board worth Rs 31bn
- 2X600MW Thermal Power plant, Rajasthan for RRVUNL worth Rs 49bn

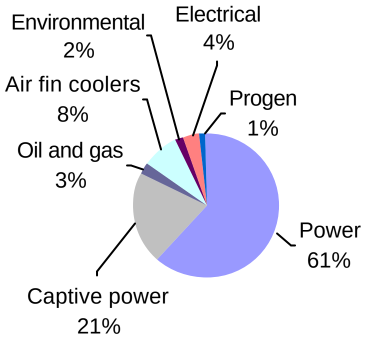
With these orders, company has taken a significant stride in the EPC space. This would also enable company to have better control over work flow. Company has tied up with key Chinese players like Dong Feng for supply of BTG equipment for its large sized projects.

Huge opportunities expected to come up for power sector

Company is well positioned to target upcoming opportunities in the power sector

Government of India has planned capacity addition of about 78,750MW in the power sector during the eleventh five year plan. With a probability of 65% target completion, we expect capacity addition to the tune of 49-50GW in the eleventh five year plan. With an estimated cost of Rs 40-50mn for 1MW, potential of EPC order inflows could be to the tune of Rs 2 trillion. With balance of plant portion contributing almost 40-50% of the total project cost, potential of order inflow in the BOP segment can also be enormous. This would be extremely positive for players like BGR energy having significant expertise in executing BOP projects. With its entry into the EPC segment, company is well positioned to capture the upcoming opportunities in the coming years.

Revenue breakup FY08



Source: Company

Diversified business model

Though power projects contribute a major proportion of BGR Energy's order book as well as revenue composition, diversification into captive power, oil and gas equipment, air fin coolers, environmental engineering, electrical projects and infrastructure projects expands the entire gamut of services which BGR can offer to its clients. Along with this, it also opens up several new opportunities for the company to bag projects in varied business segments. We expect company to gain from this diversification in terms of order inflows as well as to tap the growing opportunity in other segments.

Power segment to continue to remain the key growth driver

Power segment contributes 93% of the current order book

Power segment constitutes a significant portion of the company's order book as well as revenues. BGR energy plans to leverage on the growing opportunity in the power segment specifically from the state government related power projects. Company has successfully bagged large sized projects from Tamil Nadu, Andhra Pradesh and Rajasthan electricity boards. Order book in the power segment has grown from Rs.14.8 bn in FY07 to Rs.104 bn as on Q1FY09. We expect power sector to remain the key growth driver for the company going forward also.

Set to emerge as one of the key players based on its project expertise as well as cost competitiveness

Company has a proven track record in executing complex projects

BGR energy has acquired significant industry expertise and knowledge over past 20 years for managing various complex projects. It has a proven track record in designing, manufacturing, procuring, constructing, commissioning and testing the packaged system as well as providing turnkey solutions to its clients. Along with this, it also designs and manufactures a range of equipment such as exchangers, pressure vessels, reactors, columns, surface condensers, heaters and boiler components inhouse which provides a better control over costs. This enables the company to compete with other players as well as international players and bag large sized complex projects.

Fund raising to accrue benefits in future

BGR Energy has a strong balance sheet post the fund raising exercise

Company had recently raised Rs 2.07bn from a fresh issue of shares to invest in working capital requirements, expanding the production facility, to set up manufacturing facility in India, China and Middle East as well as for general corporate purposes. It has also raised funds to the tune of Rs 1.3bn from private placement at Rs 450 per share, thereby resulting in a total issue size of Rs 3.37bn from issue of 7.2million shares. Setting up of new manufacturing units is expected to enable the company to increase production as well as extend operations to locations in Middle East and China for customers located around the world.

Funds raising details

	No. of shares (mn)	Mode
Citigroup Venture capital(@ Rs 450 per share)	2.88	Fresh issue
Reliance Capital Trustee Company Limited (@Rs 450 per share)	1.44	Transfer of shares by promoter
IPO(@Rs 480 per share)	4.32	Fresh issue

Source: Company

Fund deployment details (through IPO)

	FY08	FY09
Long term working capital requirements (Rs mn)	1250	
Setting up of manufacuring units		
Facility at Mundra SEZ	144	128
Facility in Bahrain	175	160
Facility in China	100	119
Total	1669	407
Total funds raised through fresh issue(Rs mn)	**2076**	

Source: Company

Timely capacity expansion to cater to international markets

Its capacity expansion will cater to a wider client base

Work related to setting up of new facility at Bahrain has already started along with the expansion plan at the existing locations in India. This would enable the company to extend its presence in the Middle east, Europe and North America and tap the upcoming opportunities in those areas. Company management believes that once these facilities reach an operational stage, BGR would go for setting up facility in China and Mundra SEZ.

Technological collaboration and alliances

BGR has strategic tie ups with key world players in Power island equipment and is poised to execute turnkey contracts for power plants with unit sizes upto 1000 MW using latest technologies.

Details of technological tie-ups

Product	Collaborator/technical know how
Deaerators	Crane Environmental Inc, USA
Desalination plants	INIMA Servicios Europeos del Medio Ambiente, Madrid
Water Treatment	Termomeccanica Ecologia Sede Centrale E Aministrativa V
Waste to energy plants	Termomeccanica Ecologia Sede Centrale E Aministrativa V
Condensate polishing units	Termomeccanica Ecologia Sede Centrale E Aministrativa V
Air fin coolers	GEA Batignolles Technologies
Gas compressor packaging	Authorized Packager for Ariel Corporation U.S.A.
Reverse Osmosis	American Engineering Services, (AES) Arabia

Source: Company

Strong management team and excellent client base

Average industry experience of the management team is more than 25 years

Company is managed by a team of highly motivated team of professionals. Management team of BGR has a vast experience in sale of industrial equipment and control systems, project and business management. Average industry experience of the management team is more than 25 years. Each segment of BGR energy is headed by a separate business head who has relevant expertise to grow their respective units. It has also worked with reputed clients such as APGENCO, APCL, RRVUNL and other state electricity boards. Strong management team and excellent client base also helps in expanding the order book size in a rapid manner.

Healthy order book to lead to robust growth

Current order book stands at approx. Rs.110 bn

BGR energy has a current order book of approx. Rs.110 bn diversified across power, oil and gas, air fin coolers, environmental engineering, captive power, electrical and infrastructure division. With a robust order book diversified across various sectors, we expect revenues to grow at a CAGR of 49% between FY08-FY10 and order book to grow at a CAGR of 37% between FY08-FY10.

Attractive valuations

At current price of Rs.255, stock is trading at very attractive valuations of 15.2x and 11x on P/E multiples and 7.9x and 6.5x on EV/EBITDA estimates for FY09 and FY10 respectively. BGR can be compared well with the EPC players as well as construction players based on its project expertise and order book mix. We remain positive on the company based on its strong order book as well as upcoming order inflows.

Key Risks

Accusations by BHEL on BGR energy

BGR energy has been accused by BHEL of forming a cartel along with Techno Electric and Engineering Company Limited to bag the order as well as to quote higher prices. BHEL has thus banned business dealings with the company and allied/sister companies for a period of three years starting Mar, 2006. Thus correspondingly company is currently not doing any work for BHEL. This move could have hampered the business of the company in terms of order inflows but BGR Energy has been able to bag large sized orders directly from power generating companies and state electricity boards and has emerged as one of the key players.

Delay in implementation of orders

Though company has a robust order book and it has been able to bag large sized projects in the power segment, successful and timely implementation is going to be the key risk for the company going forward.

Manpower attrition

Construction industry is currently facing a manpower crunch. It is very important for BGR energy to retain as well as attract talented manpower in order to execute its current order book successfully. To address this risk, company is planning to increase the number of employees from 1094 to 1500 by end of FY09.

Rise in commodity prices

Further rise in the commodity prices are expected to have a negative impact on the company since most of the contracts in its order book are fixed price contracts, thereby exposing company to the raw material risk.

Potential slowdown in order inflows

Slowdown in the order inflows in power, captive power, oil and gas, electrical and infrastructure related segments pose a significant risk for the company going forward. However we feel that current order book is strong enough to provide revenue visibility for next 2.5 years.

Relative Valuations

Valuations

Company	EPS (Rs) FY09E	EPS (Rs) FY10E	P/E (x) FY09E	P/E (x) FY10E	Revenue CAGR (%) (FY08-10)	OPM (%) FY09E	OPM (%) FY10E	PAT CAGR (%) FY08-10	Current price (Rs)
BGR energy	16.8	23.1	15.2	11.0	49.0	10.0	9.0	37.1	255
BHEL	69.0	94.0	22.5	16.5	27.0	18.8	20.2	27.0	1,550
L&T	110.0	138.0	22.4	17.9	26.0	12.5	12.5	30.0	2,468
ABB	29.7	37.2	27.0	21.6	24.0	12.5	12.4	26.0	802
HCC	4.0	6.0	20.3	13.5	30.0	11.8	11.8	28.3	81
NCC	7.7	9.4	14.0	11.5	26.0	9.5	9.5	17.0	108
Simplex Infra	29.0	43.1	14.3	9.6	35.0	10.5	11.5	62.0	415
Sunil Hitech	21.8	35.0	6.9	4.3	76.0	14.9	13.4	65.0	150

Source: Kotak Securities - Private Client Research

FINANCIAL OUTLOOK

FY08 and Q1FY09 result analysis

Revenues of the company for full year FY08 registered a healthy growth of 93% over an 18 month fiscal FY07. This was led by strong order book as well as healthy revenue booking. Company received order inflows to the tune of Rs 26 bn in FY08. Operating margins of the company for fiscal FY08 registered a decline due to steep increase in the commodity prices. Depreciation charges declined in FY08 as compared to FY07 due to sale of its Energy division business to GEA BGR Energy System India Ltd. Net profits grew by 117% led by strong revenue growth.

For Q1FY09, revenues grew by 32%YoY and net profits grew by 18%YoY. Operating margins however have declined due to impact of higher commodity prices. Increased borrowings have resulted in increasing the interest outgo for the company. Company management believes that the slow growth in the first half of the fiscal is compensated by a healthy growth in the second half of the fiscal.

Quarterly & yearly performance

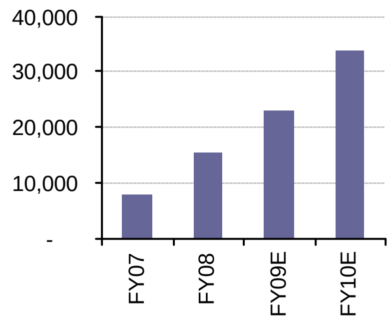
	Q1FY09	Q1FY08	YoY (%)	FY08	FY07 (18M)	YoY (%)
Net Sales	**3,068**	**2,324**	**32.0**	**15,205**	**7,868**	**93.3**
Expenditure	2,757	2,061	33.8	13,652	6,984	95.5
EBITDA	**312**	**263**	**18.5**	**1,554**	**884**	**75.7**
EBITDA margin (%)	10.2	11.3		10.2	11.2	
Depreciation	14	12		55	89	
EBIT	**298**	**251**	**18.8**	**1,498**	**795**	**88.4**
Interest	76	35		254	180	
EBT(exc other income)	223	216	3.1	1,244	616	102.0
Other Income	41	8		52	3	
EBT	**263**	**224**	**17.5**	**1,296**	**619**	**109.5**
Tax	91	78		411	210	
Tax (%)	34.5	34.8		31.7	34.0	
PAT	**172**	**146**	**18.1**	**885**	**408**	**116.8**
NPM (%)	5.6	6.3		5.8	5.2	
Equity Capital	720	108		720	108	
EPS (Rs)	**2.4**	**13.5**		**12.3**	**37.8**	

Source: Company

Revenues

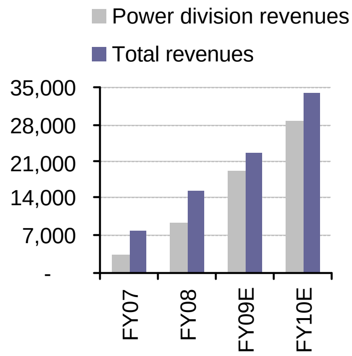
We expect revenues to grow at a CAGR of 49% between FY08-FY10E led by robust order book as well as expected order inflows in different segments. We expect power segment to remain the growth driver for the company going forward also.

Revenues (Rs mn)



Source: Company

Proportion of power project



Source: Company

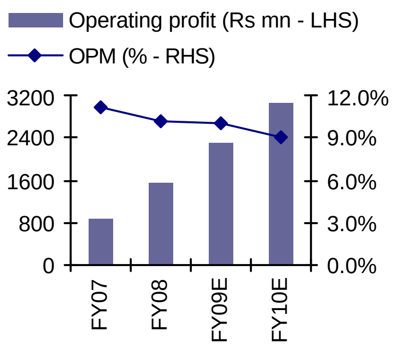
Operating margins

We expect operating margins to be in the range of 10% for the current fiscal. However due to higher proportion of fixed price contracts and higher execution from EPC contracts, we expect margins to decline next year onwards. Upsides in margins may come from cooling down of commodity prices going forward.

Profitability

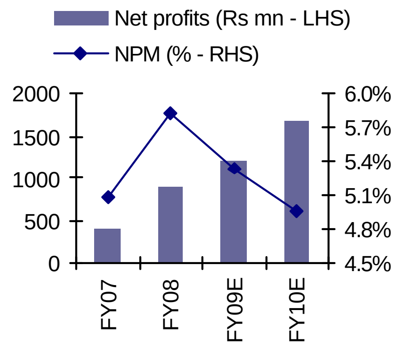
Net profits are expected to grow at a CAGR of 37% between FY08-FY10 driven by robust order inflows and healthy revenue growth. Due to decline in operating margins from FY10, net profits margins are expected to decline from 5.8% in FY08 to 5% in FY10.

Operating margin trend



Source: Company

Net profit trend



Source: Company

VALUATION AND RECOMMENDATION

We have valued the company on a consolidated basis using DCF methodology. Company is easily compared with the power equipment suppliers executing the EPC contracts as well as the construction companies. This is on account of its expertise in executing BOP projects and recent order wins for EPC projects.

DCF valuation

DCF valuation per share (Rs mn)

Total FCFF at the end of FY10	7,350
Terminal value	19,067
Total FCFF	26,417
add investment value	1,514
Less: Net Debt	2,829
Shareholders' Value	25,101
Value per share (Rs)	349
Terminal value as % of total FCFF	72.2

Source: Kotak Securities - Private Client Research

Assumptions

Adjusted beta	1.1
Risk free rate	8.5
Market risk Premium	6.0
Cost of equity	15.1
Cost of debt (Post tax) %	7
Debt	5,027
Equity	18,360

Source: Kotak Securities - Private Client Research

Free Cash Flow to firm

	FY10	FY11	FY12	FY13	FY14	FY15	FY16	FY17	FY18
PAT	**1,663**	**2,300**	**2,890**	**3,510**	**4,094**	**4,649**	**5,175**	**5,646**	**5,838**
Depreciation	149	219	299	379	459	539	619	699	779
Interest (1-Tax)	286	315	357	372	352	312	264	207	150
Capex	600	800	800	800	800	800	800	800	800
Change in NWC	2,656	2,295	1,802	2,030	2,100	1,923	1,791	1,573	636
FCFF	**(1,158)**	**(262)**	**945**	**1,430**	**2,005**	**2,777**	**3,466**	**4,179**	**5,331**
WACC (%)	**13.0**	**12.7**	**12.5**	**12.5**	**12.7**	**13.0**	**13.3**	**13.6**	**14.0**
Discounted Value	(1,024)	(206)	660	886	1,093	1,327	1,437	1,492	1,627

Source: Kotak Securities - Private Client Research

Sensitivity analysis

		Beta				
		1	**1.1**	**1.2**	**1.3**	**1.4**
Terminal growth	2%	294	277	254	237	221
	3%	316	297	271	252	235
	4%	342	320	291	269	250
	5%	374	**349**	315	290	268
	6%	415	385	345	316	290
	7%	469	431	382	347	317

Source: Kotak Securities - Private Client Research

- Our target price based on FY10 estimates comes out to be Rs.349, providing an upside of 37% from current levels.
- At our target price, stock would trade at 15.1x on P/E and 8.7x on EV/EBITDA estimates on FY10 estimates.
- We thus recommend **BUY** on the stock.

CONSOLIDATED FINANCIALS:

Profit & Loss Statement (Rs mn)

(Year-end March)	FY07	FY08	FY09E	FY10E
Revenues	**7,868**	**15,205**	**22,808**	**33,756**
% change YoY	166.0	93.3	50.0	48.0
EBITDA	**884**	**1,554**	**2,281**	**3,038**
% change YoY	210.2	75.7	46.8	33.2
Other Income	3	52	20	20
Depreciation	89	55	96	149
EBIT	**798**	**1,550**	**2,204**	**2,909**
% change YoY	217.8	94.2	42.2	32.0
Net interest	**180**	**254**	**402**	**427**
Profit before tax	619	1,296	1,802	2,482
% change YoY	225.8	109.5	39	37.7
Tax	210	411	595	819
as % of PBT	34.0	31.7	33.0	33.0
Profit after tax	**408**	**885**	**1,207**	**1,663**
Net income	**408**	**885**	**1,207**	**1,663**
% change YoY	201.3	116.8	36.4	37.7
Shares outstanding (m)	10.8	72.0	72.0	72.0
EPS (reported) (Rs)	37.8	12.3	16.8	23.1
CEPS (Rs)	46.0	13.1	18.1	25.2
DPS (Rs)	3.00	2.00	2.00	2.00

Source: Company, Kotak Securities - Private Client Research

Balance Sheet (Rs mn)

(Year-end March)	FY07	FY08	FY09E	FY10E
Cash and cash equivalents	929	3,070	3,806	2,198
Accounts receivable	3,688	7,360	8,248	12,208
Inventories	295	150	312	462
Loans and advances & Others	920	2,749	2,774	4,064
Current assets	5,832	13,329	15,141	18,931
LT investments	3	1,514	1,514	1,514
Net fixed assets	419	544	898	1,349
Total assets	**6,254**	**15,387**	**17,553**	**21,794**
Payables	2,555	4,482	5,247	7,765
Others	115	356	356	356
Current liabilities	2,670	4,838	5,603	8,121
Provisions	276	402	759	983
LT debt	2,464	5,027	5,027	5,027
Other liabilities	15	382	382	382
Equity	108	720	720	720
Reserves	721	4,017	5,061	6,559
Total liabilities	**6,254**	**15,387**	**17,552**	**21,793**
BVPS (Rs)	76.8	65.8	80.3	101.1

Source: Company, Kotak Securities - Private Client Research

Cash Flow Statement (Rs mm)

(Year-end March)	FY08	FY09E	FY10E
EBIT	1,550	2,204	2,909
Depreciation	55	96	149
Change in working capital	(3,429)	(311)	(2,881)
Change in other net current assets	327	357	224
Operating cash flow	**(1,496)**	**2,347**	**402**
Interest	(254)	(402)	(427)
Tax	(411)	(595)	(819)
Cash flow from operations	**(2,161)**	**1,350**	**(845)**
Capex	(82)	(450)	(600)
(Increase)/decrease in investments	(1,511)	-	-
Cash flow from investments	(1,594)	(450)	(600)
Proceeds from issue of equity	72	-	-
Increase/(decrease) in debt	2,563	-	-
Proceeds from share premium	3,298	-	-
Dividends	(37)	(164)	(164)
Cash flow from financing	**5,896**	**(164)**	**(164)**
Opening cash	929	3,070	3,806
Closing cash	3,070	3,805	2,198

Source: Company, Kotak Securities - Private Client Research

Key Ratios (%)

(Year-end March)	FY08	FY09E	FY10E
EBITDA margin (%)	10.2	10.0	9.0
EBIT margin (%)	10.2	9.7	8.6
Net profit margin (%)	5.8	5.3	4.9
Receivables (days)	132.6	132.0	132.0
Inventory (days)	5.3	5.0	5.0
Loans and advances (days)	42.5	43.0	43.0
Creditors (days)	46	46	46
Interest coverage (x)	3.5	3.0	3.9
Debt/equity ratio	1.3	1.0	0.8
ROE (%)	31.8	23.0	25.5
ROCE (%)	23.7	21.4	25.2
EV/ Sales	1.2	0.8	0.6
EV/EBITDA	12.1	7.9	6.5
Price to earnings (P/E)	20.7	15.2	11.0
Price to book value (P/B)	3.9	3.2	2.5
Price to Cash Earnings	19.5	14.1	10.1

Source: Company, Kotak Securities - Private Client Research

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