

Equities

26 May 2011 | 11 pages

BGR Energy Systems (BGRE.BO)

Difficult to Build a Bullish Case Currently

- 4QFY11 PAT down 9% YoY** — At Rs984m PAT was 13% below CIRA despite higher margins on account of lower sales. FY11 PAT at Rs3.2bn up +61% YoY was 4% below CIRA. Inflows at Rs29bn were down 20% YoY and backlog at Rs79.7bn was down 22% YoY. Backlog/ sales at 1.7x is at historic lows given the tepid inflows in FY11.
- Balance stretched – But this was expected** — Debt at end-FY11 has increased 43% YoY to Rs13.4bn but this is in line with expectations. BGRL had negative cash flow from operations (CFO) of (Rs2.2bn) v/s Rs3.1bn of +ve CFO in FY10. WC requirement has gone up to Rs13bn from Rs8bn due to an increase in retention money. We were expecting Vijaywada retention money to come in Mar 11 but it has not come in yet.
- Guidance for FY12E** — The company has given sales growth guidance of 15% YoY implying sales of Rs54.6bn (v/s CIRA at Rs48.8bn) and a PAT margin guidance of 6.5% implying PAT of Rs3.5bn (v/s CIRA at Rs2.9bn) in FY12. The company expects the order book to improve in 2QFY12/ 3QFY12, which should contribute to FY12 sales.
- Guidance achievement track record good but ...** — For FY11 BGRL had guided sales of Rs45-50bn (delivered Rs47.5bn) and PAT guidance of Rs3.1bn (delivered Rs3.2bn). We believe FY12E guidance assumes at least one RRVUNL order coming by Jun 11 and this is not a given as the project is stuck for the want of coal linkage.
- BTG facilities update** — Land for plant has been acquired, and acquiring some land for ancillaries is in progress. Ordering machinery now and financial closure should happen in the next three months. After 14-18 months the first batch of production will roll out. It has invested Rs1.5bn to Mar 11 and expects to invest Rs2.5-3bn in FY12.
- Good company - But difficult to make a case right now** —BHEL, with a 3.6 year backlog, trades at 12.5x FY12E and BGRL, with 1.7 yrs backlog, trades at 11.5x on our numbers and 9.2x on the company's EPS guidance.

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	28.8	5.9	22.2	0.7
2010A	2,015	27.98	74.5	16.5	4.7	31.7	1.5
2011E	3,391	47.10	68.3	9.8	3.4	40.1	1.5
2012E	2,883	40.05	-15.0	11.5	2.7	26.2	1.5
2013E	2,763	38.37	-4.2	12.0	2.3	20.9	1.5

Source: Powered by dataCentral

Company Update

Sell/Medium Risk	3M
Price (26 May 11)	Rs460.90
Target price	Rs470.00
Expected share price return	2.0%
Expected dividend yield	1.5%
Expected total return	3.5%
Market Cap	Rs33,259M US\$734M

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



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Fiscal year end 31-Mar	2009	2010	2011E	2012E	2013E
Valuation Ratios					
P/E adjusted (x)	28.8	16.5	9.8	11.5	12.0
EV/EBITDA adjusted (x)	16.5	10.1	6.9	7.8	7.2
P/BV (x)	5.9	4.7	3.4	2.7	2.3
Dividend yield (%)	0.7	1.5	1.5	1.5	1.5
Per Share Data (Rs)					
EPS adjusted	16.03	27.98	47.10	40.05	38.37
EPS reported	16.03	27.98	47.10	40.05	38.37
BVPS	78.32	98.09	137.00	168.85	199.03
DPS	3.00	7.00	7.00	7.00	7.00
Profit & Loss (RsM)					
Net sales	19,303	30,734	51,086	48,800	48,424
Operating expenses	-17,289	-27,395	-45,612	-43,789	-43,595
EBIT	2,014	3,339	5,474	5,011	4,829
Net interest expense	-579	-538	-589	-890	-890
Non-operating/exceptionals	317	250	211	211	211
Pre-tax profit	1,752	3,051	5,095	4,332	4,150
Tax	-596	-1,037	-1,705	-1,449	-1,388
Extraord./Min.Int./Pref.div.	-1	0	0	0	0
Reported net income	1,154	2,015	3,391	2,883	2,763
Adjusted earnings	1,154	2,015	3,391	2,883	2,763
Adjusted EBITDA	2,089	3,442	5,619	5,168	4,998
Growth Rates (%)					
Sales	27.0	59.2	66.2	-4.5	-0.8
EBIT adjusted	34.4	65.8	64.0	-8.5	-3.6
EBITDA adjusted	34.5	64.8	63.3	-8.0	-3.3
EPS adjusted	32.2	74.5	68.3	-15.0	-4.2
Cash Flow (RsM)					
Operating cash flow	330	3,101	-6,975	6,338	3,211
Depreciation/amortization	75	103	145	157	169
Net working capital	-1,292	180	-10,682	3,153	140
Investing cash flow	941	-629	-1,835	-3,995	-3,275
Capital expenditure	-568	-629	-155	-155	-155
Acquisitions/disposals	1,509	0	-1,680	-3,840	-3,120
Financing cash flow	1,812	1,655	4,910	-590	-590
Borrowings	2,063	2,246	5,500	0	0
Dividends paid	-253	-590	-590	-590	-590
Change in cash	3,083	4,127	-3,901	1,753	-654
Balance Sheet (RsM)					
Total assets	26,733	39,267	49,691	53,961	56,729
Cash & cash equivalent	6,152	10,279	6,378	8,131	7,477
Accounts receivable	12,789	19,803	31,492	30,082	29,851
Net fixed assets	1,031	1,557	1,568	1,566	1,553
Total liabilities	21,066	32,176	39,799	41,775	42,371
Accounts payable	4,413	11,028	13,691	13,072	12,971
Total Debt	7,090	9,336	14,836	14,836	14,836
Shareholders' funds	5,667	7,091	9,892	12,185	14,358
Profitability/Solvency Ratios (%)					
EBITDA margin adjusted	10.8	11.2	11.0	10.6	10.3
ROE adjusted	22.2	31.7	40.1	26.2	20.9
ROIC adjusted	20.3	25.5	24.0	18.1	19.3
Net debt to equity	16.6	-13.3	85.5	55.0	51.3
Total debt to capital	55.6	56.8	60.0	54.9	50.8

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4QFY11 PAT 13% below expectations

- BGRL's 4QFY11 PAT at Rs984m, down 9% YoY, was 13% below CIRA despite higher EBITDA margins on account of lower sales. FY11 PAT at Rs3.2bn was up a solid 61% YoY but was 4% below CIRA expectations.
- Order inflows at Rs29bn were down 20% YoY and the order backlog at Rs79.7bn was down 22% YoY. Order backlog/ sales coverage at 1.7x is at historic lows given the tepid inflows in FY11.

Figure 1. BGRL – Parent 4QFY11 and FY11 Results Review

Year End Mar31 (Rsmn)	Q410	Q411	Q411E	FY10	FY11	FY11E
Backlog	102,300	79,710		102,300	79,710	
- Power Sector EPC + BOP	95,950	73,333		95,950	73,333	
- Oil & Gas Turnkey	4,510	3,200		4,510	3,200	
- Equipment	1,840	3,177		1,840	3,177	
Inflow				36,840	29,410	
Capital Goods	824	1,213		1,682	2,661	
Construction & EPC Contracts	15,747	13,359		29,010	44,814	
Total Sales	16,571	14,573	18,141	30,692	47,475	51,043
% growth YoY	130.7%	-12.1%	9.5%	59.7%	54.7%	66.3%
EBITDA	1,725	1,630	1,868	3,435	5,374	5,612
EBITDA margin%	10.4%	11.2%	10.3%	11.2%	11.3%	11.0%
Change bps	(105)	78	(89)	43	13	(20)
Depreciation	(31)	(70)	(42)	(98)	(168)	(140)
EBIT	1,694	1,560	1,826	3,337	5,206	5,472
EBIT margin%	10.2%	10.7%	10.1%	10.9%	11.0%	10.7%
Capital Goods	128	142		206	235	
Margin	15.6%	11.7%		12.3%	8.8%	
Construction & EPC Contracts	1,593	1,461		3,176	5,103	
Margin	10.1%	10.9%		10.9%	11.4%	
Unallocated	39	17		202	86	
Financial Expenses	(118)	(183)	(168)	(538)	(605)	(589)
Other Income	39	17	30	220	86	99
Other Operating Income	27	44	20	27	133	109
PBT	1,642	1,438	1,709	3,047	4,820	5,091
Tax Expense	(559)	(454)	(581)	(1,037)	(1,578)	(1,705)
Tax Rate %	34.0%	31.6%	34.0%	34.0%	32.7%	33.5%
PAT	1,083	984	1,128	2,010	3,242	3,386
Margin%	6.5%	6.7%	6.2%	6.5%	6.8%	6.6%
% growth YoY	130.6%	-9.2%	4.1%	74.7%	61.3%	68.5%

Source: Citi Investment Research and Analysis estimates

- Debt at the end of FY11 has increased 43% YoY to Rs13.4bn but this is in line with expectations. BGRL had negative cash flow from operations (CFO) of (Rs2.2bn) v/s Rs3.1bn of +ve CFO in FY10.
- Working capital requirement has gone up to Rs13bn from Rs8bn due to an increase in retention money. We were expecting Vijaywada retention money to come in Mar 11 but it has not come in yet. There is no issue with the project and money is likely to come by this month. Retention money on the books is Rs13bn and bank guarantee margin money of Rs4.4bn are included in cash balances.

Figure 2. BGRL – Parent Balance Sheet

Year End Mar31 (Rsmn)	FY10	FY11
- Capital	720	722
- ESOPs	-	0
- Reserves and Surplus	6,312	8,776
Networth	7,032	9,498
Loan Fund	9,326	13,363
DTL	1,589	3,117
Liabilities + Networth	17,947	25,978
Fixed Assets	1,494	1,754
Investments	48	1,368
Inventories	154	384
Days of sales	2	3
Sundry Debtors	19,787	31,572
Days of sales	235	243
Cash Balance	10,234	9,465
Other Current Assets	189	478
Loans and Advances	7,270	8,369
Total CA	37,635	50,268
Liabilities	18,898	23,868
Provisions	2,332	3,544
Total CL	21,230	27,412
NCA	16,405	22,856
Assets	17,947	25,978

Source: Company and Citi Investment Research and Analysis

Guidance for FY12

- The company has given sales growth guidance of 15% YoY, implying sales of Rs54.6bn (v/s CIRA at Rs48.8bn) and a PAT margin guidance of 6.5% implying PAT of Rs3.5bn (v/s CIRA at Rs2.9bn) in FY12. The company expects the order book to improve in 2QFY12/ 3QFY12, which should contribute to FY12 sales.
- For FY11 the company had guided sales of Rs45-50bn (and delivered Rs47.5bn) and a PAT margin guidance of 6.5%, implying PAT of Rs3.1bn (and delivered Rs3.2bn).
- The company has a good track record of achieving sales and PAT guidance. But it is worth noting that, vis-à-vis inflow guidance of Rs150-200bn, the company managed to win only Rs29.4bn of orders in FY11E.

Update on the 2 RRVUNL projects

- The company is confident of winning at least one order. BHEL is the L1 bidder for both projects with bids of Rs61.75bn (Suratgarh) and Rs60.58bn (Chhabra). In the interest of faster execution, RRVUNL has the right to award the order to the L2 bidder, provided it matches the L1 bid.
- BGR is the L2 bidder with ~5% higher bid for both projects - BGR should match both bids, and expects to be awarded the Chhabra project. BGR has maintained good relationships with RRVUNL in terms of timely execution in the Kalisindh project, whereas the three orders bagged by BHEL are being delayed.

- New MD has joined RRVUNL on Apr 11 and the coal linkage issue is being resolved, and it should be in a position to award LOI by fourth week of Jun 11.

BTG manufacturing venture update

- Has acquired the land for plant and some land for ancillaries is under process. Is ordering machinery now and financial closure should happen in the next 3 months. 14-18 months post that the first batch of production will roll out. Invested Rs1.5bn till Mar11 and expects to invest Rs2.5-3bn in FY12.

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 Valuthur 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

As India's Infrastructure and Industrial capex decelerated from FY09 onwards, the overall opportunity pie growth has not kept pace with (1) the rise of multiple new players across subsectors (2) influx of Koreans and Chinese in India and (3) companies bidding and diversifying across subsectors. Over the last year problems have compounded in the power EPC, BTG and BOP markets on account of:

- (1) Coal India's production cuts putting the power sector's growth in jeopardy;
- (2) Deteriorating SEB finances leading to question marks about payment security;
- (3) Since SEB finances are deteriorating, it is not picking up enough power and resorting to load shedding. This has led to a correction in merchant prices.

We have sell recommendations on ABB, Thermax, Punj Lloyd and BGR and Hold recommendations on BHEL, Areva and L&T.

Valuation

Our Rs470 target price is based on a target P/E multiple of 12x Sep12E EPS which is at a discount to the historical average P/E multiple of 14x given the limited order inflow in FY11E (BGRL has traded in a P/E multiple band of 4x to 58x post listing). This is at a ~20% discount to BHEL and ~14% discount to Thermax, given their superior cash flow from operations (CFO), PAT margins, RoE, order backlog and longer execution track records.

Risks

Our quantitative risk-rating system, which tracks 260-day historical share price volatility, assigns a Medium Risk rating to BGRL. Key upside risks include: (1) Better-than-expected order inflows; (2) Better-than-expected margins; (3) Better-than-expected execution.

Appendix A-1

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IMPORTANT DISCLOSURES

BGR Energy Systems (BGR.E.BO)

Ratings and Target Price History Fundamental Research

Analyst: Venkatesh Balasubramaniam
Covered since July 7 2010

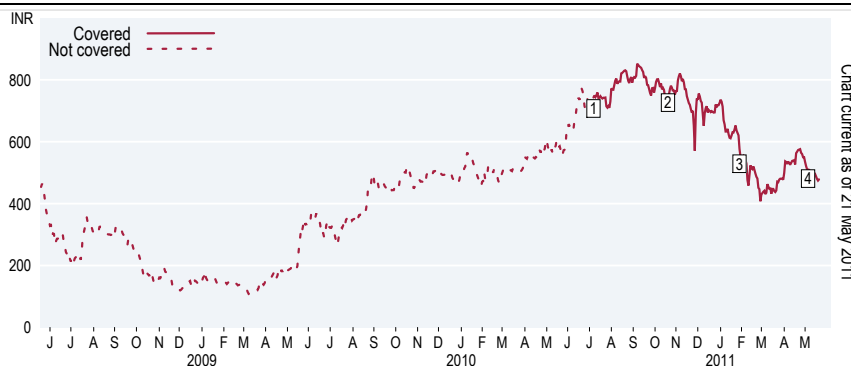


Chart current as of 21 May 2011

	Date	Rating	Target Price	Closing Price
1	7-Jul-10	*1M	*884.00	742.80
2	20-Oct-10	1M	*934.00	731.70

	Date	Rating	Target Price	Closing Price
3	28-Jan-11	1M	*727.00	576.55
4	5-May-11	*3M	*470.00	507.20

* Indicates change

Rating/target price changes above reflect Eastern Standard Time

BGR Energy Systems (BGR.E.BO)

Ratings and Target Price History Best Ideas Research Relative Call (3 Month)

Analyst: Venkatesh Balasubramaniam
Covered since July 7 2010

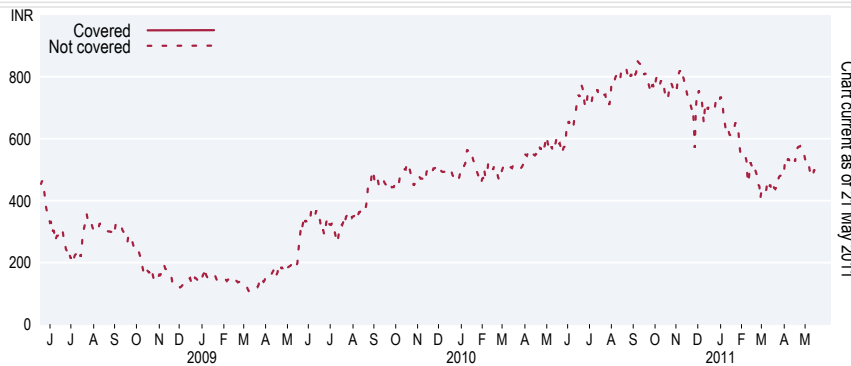


Chart current as of 21 May 2011

* Indicates change

Rating/target price changes above reflect Eastern Standard Time

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12 Month Rating			Relative Rating		
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52%	37%	11%	9%	82%	9%
43%	41%	41%	51%	41%	45%

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