

Bharat Heavy Electricals Ltd

A good quarter but valuations capped; maintain HOLD

Bharat Heavy Electricals' (BHEL) Q3FY11 results were in line with our expectations with its revenues/EBITDA/PAT growing by 24.8%/32.7%/30.8% to Rs 90.2bn/ Rs 20.7bn/ Rs 14bn. However, revenues/PBT/PAT were overstated by Rs 4.4bn/Rs 880mn/ Rs 600mn in the quarter on account of minor revisions in accounting norms. EBITDA margin expansion of 136bps YoY to 23% was driven by lower material costs, which the management attributed to cost reduction initiatives. Order inflows for the quarter were at Rs 122bn and at Rs 372bn (flat YoY) for 9MFY11. The management expressed confidence to meet its FY11 order inflow guidance of Rs 600bn, as certain key orders are likely to be awarded (8GW–9GW) in Q4FY11. In our view, even as the stock is likely to outperform the sector in the short term on superior revenue visibility, muted growth in order inflows over FY10-FY12E and higher competition are likely to cap valuations in the medium to long term. At our current estimates, the stock trades at a PE of 16.3x/14.1x for FY12E/FY13E. Maintain HOLD.

Minor revision in accounting norms: Revenue recognition norms for completion of trial operations were revised during the quarter. Adjusted for this one-time impact, revenues/PBT/PAT for the quarter grew by 18.7%/ 20.2%/ 25.2% to Rs 85.8bn/Rs 19.8bn/ Rs 13.4bn. Going ahead, 2.5% of revenues will be recognised after the completion of trial operations with a corresponding 2.5% creation of provisions for contractual obligations.

Margin expansion may not sustain: While the management stated the margin expansion in the quarter was due to certain cost reduction initiatives (improvement in procurement practices, lean manufacturing) undertaken over the years, it maintained prior guidance on raw material costs (~59% of sales in FY11E). Other expenses grew by 59% YoY to Rs 7.9bn due to provisions of Rs 1bn created for liquidated damages.

Order inflow pipeline lends visibility: The management stated that the order inflow pipeline is encouraging for Q4FY11E and FY12E. Some of the key projects in the pipeline for FY12E are (a) orders from power utility JVs that the company has formed with the states of Maharashtra, Tamil Nadu and Madhya Pradesh, and (b) 9X 800MW supercritical sets for NTPC to be awarded by Q2FY12E.

Valuation: At our current estimates, the stock trades at a PE of 16.3x/14.1x for FY12E/FY13E. We believe valuations are likely to remain capped over the long term due to concerns on heightened competition and sedate growth in order inflows. Maintain HOLD.

What's New? Target Rating Estimates

CMP	TARGET	RATING	RISK
Rs 2,207	Rs 2400	HOLD	LOW

BSE	NSE	BLOOMBERG
500103	BHEL	BHEL IN

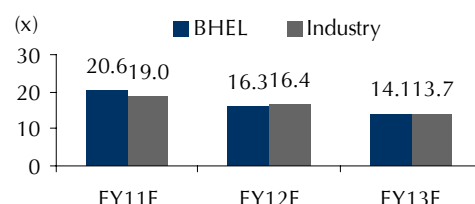
Company data

Market cap (Rs mn / US\$ mn)	1,080,493/26,242
Outstanding equity shares (mn)	26,242
Free float (%)	490
Dividend yield (%)	27.9
52-week high/low (Rs)	1.3
2-month average daily volume	2695 / 2055

Stock performance

Returns (%)	CMP	1-mth	3-mth	6-mth
BHEL	2,207	(5.0)	(13.1)	(8.3)
BSC CG	13,538	(11.6)	(16.0)	(10.6)
Sensex	19,008	(5.2)	(6.2)	5.7

P/E comparison



Valuation matrix

(x)	FY10	FY11E	FY12E	FY13E
P/E @ CMP	25.1	20.6	16.3	14.1
P/E @ Target	27.3	22.4	17.8	15.4
EV/EBITDA @ CMP	15.7	12.8	10.0	8.8

Financial highlights

(Rs mn)	FY10	FY11E	FY12E	FY13E
Revenue	335,728	404,834	504,512	577,805
Growth (%)	25.6	20.6	24.6	14.5
Adj net income	43,106	52,391	66,159	76,463
Growth (%)	37.9	21.5	26.3	15.6
FDEPS (Rs)	88.1	107.0	135.2	156.2
Growth (%)	37.9	21.5	26.3	15.6

Profitability and return ratios

(%)	FY10	FY11E	FY12E	FY13E
EBITDA margin	18.6	19.0	19.4	19.3
EBIT margin	17.3	17.7	18.3	18.2
Adj PAT margin	12.8	12.9	13.1	13.2
ROE	29.9	29.4	29.8	27.5
ROIC	39.8	40.0	41.3	37.7
ROCE	40.0	40.2	41.4	37.8





Result highlights

Fig 1 - Actual vs estimated performance

(Rs mn)	Actual	Estimated	% Variance
Net sales	90,233	89,727	0.6
EBITDA	20,717	19,497	6.3
Adj net income	14,032	13,489	4.0
FDEPS (Rs)	28.7	27.6	4.0

Source: Company, RCML research

Fig 2 - Quarterly performance

(Rs mn)	Q3FY11	Q3FY10	% Chg YoY	Q2FY11	% Chg QoQ	Q3FY11E	Variance (%)
Net sales	90,233	72,292	24.8	84,907	6.3	89,727	0.6
Less: Direct Cost	48,098	39,416	22.0	49,641	(3.1)	49,817	
Staff Cost	13,487	12,269	9.9	12,641	6.7	14,559	
Other Expenses	7,932	4,990	59.0	6,301	25.9	5,853	
Expenditure	69,516	56,675	22.7	68,583	1.4	70,230	
Operating profit	20,717	15,617	32.7	16,324	26.9	19,497	6.3
Other income	1,529	1,933	(20.9)	1,620	(5.6)	2,138	
Interest	145	69	109.7	59	144.0	210	
Depreciation	1,447	1,038	39.4	1,341	7.9	1,360	
PBT	20,655	16,443	25.6	16,544	24.9	20,064	
Tax	6,623	5,717	15.8	5,121	29.3	6,575	
Reported PAT	14,032	10,726	30.8	11,423	22.8	13,489	4.0
Adj. PAT	14,032	10,726	30.8	11,423	22.8	13,489	4.0
EBITDA margin (%)	23.0%	21.6%	136 bps	19.2%	373 bps	21.7%	123 bps
EPS (Rs)	28.7	21.9	30.8	23.3	22.8	27.6	4.0

Source: Company, RCML research

Adjusting for accounting changes, PAT was at Rs 13.4 bn in line with expectations

Adjusting for accounting changes Revenues/PAT grew by 18.7%/25.2% YoY respectively

Other expenses increased due to extra provisioning of Rs 1 bn

Accounting changes pushed up PBT by Rs. 880 mn and PAT by Rs 600 mn

Margin expansion on lower raw material and employee cost



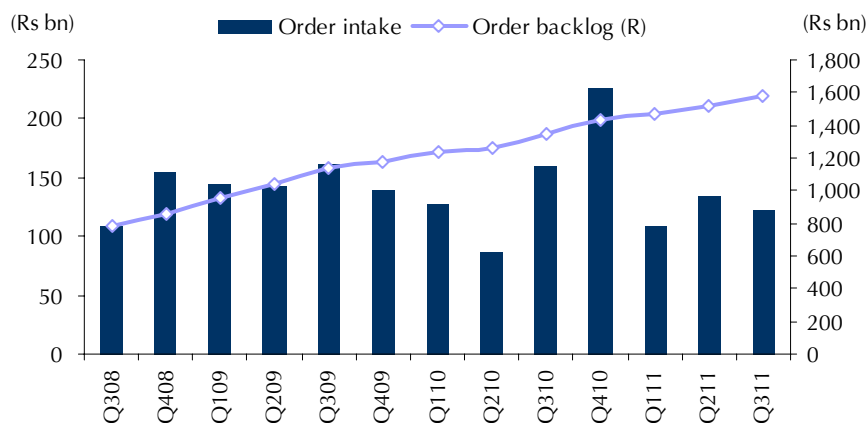
Fig 3 - Segmental performance

Year to March	Q3FY11	Q3FY10	Q2FY11	FY10
Revenues (Rs mn)				
Power	72,820	57,087	69,650	268,607
Industry	21,429	18,020	18,577	78,790
EBIT (Rs mn)				
Power	16,321	13,086	14,731	63,170
Industry	4,542	4,051	3,055	16,425
Revenue Mix (%)				
Power	77.3	76.0	78.9	77.3
Industry	22.7	24.0	21.1	22.7
Revenue Growth (Y-o-Y %)				
Power	27.6	18.5	28.3	25.8
Industry	18.9	2.8	16.4	8.7
EBIT margin (%)				
Power	22.4	22.9	21.2	23.5
Industry	21.2	22.5	16.4	20.8
EBIT mix (%)				
Power	78.2	76.4	82.8	79.4
Industry	21.8	23.6	17.2	20.6

Source: Company, RCML research

Revenue growth robust in Industry segment in Q3FY11

Fig 4 - Orderbook tracker



Source: Company, RCML research

Order inflow guidance for FY'11E at maintained at Rs 600 bn



Consolidated financials

Profit and Loss statement

Y/E March (Rs mn)	FY10	FY11E	FY12E	FY13E
Revenues	335,728	404,834	504,512	577,805
Growth (%)	25.6	20.6	24.6	14.5
EBITDA	62,583	76,968	98,054	111,642
Growth (%)	48.3	23.0	27.4	13.9
Depreciation & amortisation	4,580	5,161	5,895	6,335
EBIT	58,003	71,807	92,159	105,307
Growth (%)	49.3	23.8	28.3	14.3
Interest	335	495	495	495
Other income	8,239	9,289	10,119	12,823
EBT	65,907	80,601	101,783	117,635
Income taxes	22,800	28,210	35,624	41,172
Effective tax rate (%)	34.6	35.0	35.0	35.0
Extraordinary items	-	-	-	-
Min into / inc from associates	-	-	-	-
Reported net income	43,106	52,391	66,159	76,463
Adjustments	-	-	-	-
Adjusted net income	43,106	52,391	66,159	76,463
Growth (%)	37.9	21.5	26.3	15.6
Shares outstanding (mn)	489.5	489.5	489.5	489.5
FDEPS (Rs) (adj)	88.1	107.0	135.2	156.2
Growth (%)	37.9	21.5	26.3	15.6
DPS (Rs)	23.3	25.3	29.3	29.3

Cash flow statement

Y/E March (Rs mn)	FY10	FY11E	FY12E	FY13E
Net income + Depreciation	47,687	57,551	72,054	82,798
Non-cash adjustments	3,131	(3,131)	-	-
Changes in working capital	(24,495)	18,048	(3,724)	(1,374)
Cash flow from operations	26,322	72,469	68,329	81,424
Capital expenditure	(17,756)	(15,007)	(10,000)	(5,000)
Change in investments	(275)	-	-	-
Other investing cash flow	-	-	-	-
Cash flow from investing	(18,031)	(15,007)	(10,000)	(5,000)
Issue of equity	-	-	-	-
Issue/repay debt	(216)	(4)	-	-
Dividends paid	(13,344)	(14,490)	(16,781)	(14,343)
Other financing cash flow	23	255	0	0
Change in cash & cash eq	(5,246)	43,224	41,549	62,081
Closing cash & cash eq	97,901	141,125	182,673	244,754

Economic Value Added (EVA) analysis

Y/E March	FY10	FY11E	FY12E	FY13E
WACC (%)	12.7	12.7	12.7	12.7
ROIC (%)	39.8	40.0	41.3	37.7
Invested capital (Rs mn)	160,451	198,603	247,982	310,102
EVA (Rs mn)	4,350,469	5,420,452	7,084,270	7,763,026
EVA spread (%)	27.11	27.29	28.57	25.03

Balance sheet

Y/E March (Rs mn)	FY10	FY11E	FY12E	FY13E
Cash and cash eq	97,901	141,125	182,673	244,754
Accounts receivable	206,888	252,402	314,548	360,244
Inventories	92,355	111,869	138,085	158,145
Other current assets	32,205	39,834	49,642	56,854
Investments	798	798	798	798
Gross fixed assets	65,801	95,406	105,406	110,406
Net fixed assets	24,154	49,295	53,401	52,066
CWIP	15,296	-	-	-
Intangible assets	-	-	-	-
Deferred tax assets, net	15,272	18,403	18,403	18,403
Other assets	-	-	-	-
Total assets	484,868	613,727	757,551	891,265
Accounts payable	280,237	311,449	368,926	401,314
Other current liabilities	-	-	-	-
Provisions	44,180	103,674	140,643	179,849
Debt funds	1,278	1,274	1,274	1,274
Other liabilities	-	-	-	-
Equity capital	4,895	4,895	4,895	4,895
Reserves & surplus	154,278	192,434	241,813	303,933
Shareholder's funds	159,174	197,330	246,708	308,828
Total liabilities	484,868	613,727	757,551	891,265
BVPS (Rs)	325.2	403.1	504.0	630.9

Financial ratios

Y/E March	FY10	FY11E	FY12E	FY13E
Profitability & Return ratios (%)				
EBITDA margin	18.6	19.0	19.4	19.3
EBIT margin	17.3	17.7	18.3	18.2
Net profit margin	12.8	12.9	13.1	13.2
ROE	29.9	29.4	29.8	27.5
ROCE	40.0	40.2	41.4	37.8
Working Capital & Liquidity ratios				
Receivables (days)	199	207	205	213
Inventory (days)	161	153	148	151
Payables (days)	486	444	402	393
Current ratio (x)	1.3	1.3	1.3	1.4
Quick ratio (x)	0.7	0.7	0.7	0.7
Turnover & Leverage ratios (x)				
Gross asset turnover	5.7	5.0	5.0	5.4
Total asset turnover	2.3	2.3	2.3	2.1
Interest coverage ratio	173.1	145.2	186.3	212.9
Adjusted debt/equity	0.0	0.0	0.0	0.0
Valuation ratios (x)				
EV/Sales	2.9	2.4	2.0	1.7
EV/EBITDA	15.7	12.8	10.0	8.8
P/E	25.1	20.6	16.3	14.1
P/BV	6.8	5.5	4.4	3.5



Quarterly trend

Particulars	Q3FY10	Q4FY10	Q1FY11	Q2FY11	Q3FY11
Revenue (Rs mn)	72,292	139,447	66,010	84,907	90,233
YoY growth (%)	17.6	28.5	16.4	26.2	24.8
QoQ growth (%)	7.5	92.9	(52.7)	28.6	6.3
EBIT (Rs mn)	14,579	27,081	8,381	14,983	19,270
EBIT margin (%)	20.2	19.4	12.7	17.6	21.4
Adj net income (Rs mn)	10,726	19,096	6,677	11,423	14,032
YoY growth (%)	35.7	41.7	41.9	33.1	30.8
QoQ growth (%)	25.0	78.0	(65.0)	71.1	22.8

DuPont analysis

(%)	FY09	FY10E	FY11E	FY12E	FY13E
Tax burden (Net income/PBT)	64.6	65.4	65.0	65.0	65.0
Interest burden (PBT/EBIT)	124.5	113.6	112.2	110.4	111.7
EBIT margin (EBIT/Revenues)	14.5	17.3	17.7	18.3	18.2
Asset turnover (Revenues/Avg TA)	223.1	230.5	225.5	225.9	207.1
Leverage (Avg TA/Avg equitiy)	101.0	101.0	100.7	100.6	100.5
Return on equity	26.4	29.9	29.4	29.8	27.5

Company profile

BHEL is the leading BTG equipment manufacturer and contractor in India. The company currently has a capacity of 15 MW, which is expected to increase to 20 MW at the end of March 2012.

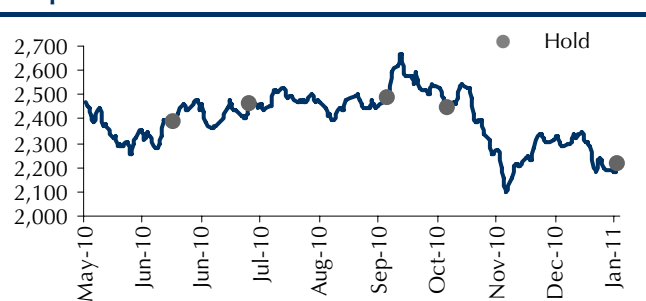
Shareholding pattern

(%)	Jun-10	Sep-10	Dec-10
Promoters	67.7	67.7	67.7
FIs	15.0	14.8	14.1
Banks & FIs	11.3	11.2	12.0
Public	6.0	6.3	6.2

Recommendation history

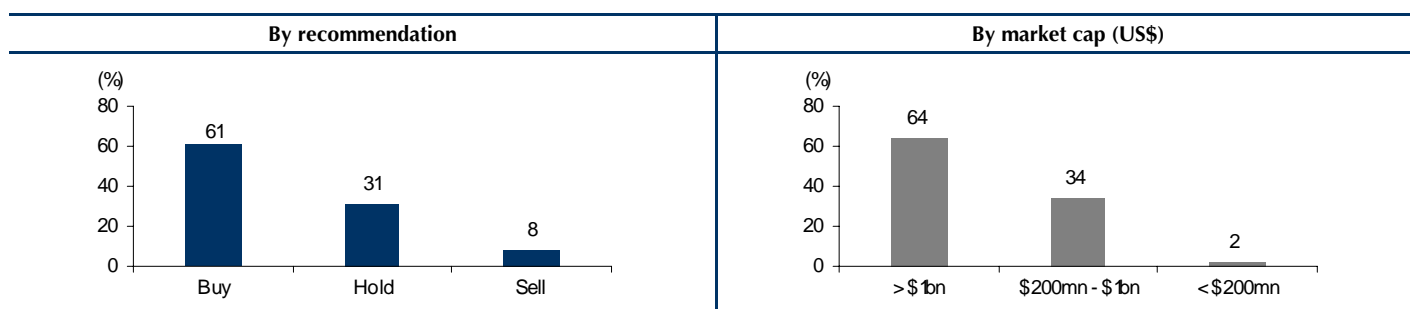
Date	Event	Reco price	Tgt price	Reco
21-Jun-10	Initiating Coverage	2,383	2,400	Hold
23-Jul-10	Results Review	2,460	2,400	Hold
6-Oct-10	Company Update	2,649	2,400	Hold
29-Oct-10	Results Review	2,446	2,400	Hold
21-Jan-11	Results Review	2,207	2,400	Hold

Stock performance





Coverage Profile



Recommendation interpretation

Recommendation	Expected absolute returns (%) over 12 months
Buy	More than 15%
Hold	Between 15% and -5%
Sell	Less than -5%

Recommendation structure changed with effect from March 1, 2009

Expected absolute returns are based on share price at market close unless otherwise stated. Stock recommendations are based on absolute upside (downside) and have a 12-month horizon. Our target price represents the fair value of the stock based upon the analyst's discretion. We note that future price fluctuations could lead to a temporary mismatch between upside/downside for a stock and our recommendation.

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