

BHARAT HEAVY ELECTRICALS

INR 1,755

*Provisional results, provisioning blues***BUY**

Bharat Heavy Electrical's (BHEL) FY08 provisional results were below ours and the street's expectations, primarily due to lower-than-expected revenue growth and higher wage provisioning in Q4FY08. While gross revenue grew 15% Y-o-Y to INR 216 bn (vis-à-vis our estimates of INR 236 bn), PAT stood at INR 28.2 bn, up 17% Y-o-Y (vis-à-vis our estimates of INR 33.4 bn). Order booking growth has been robust in FY08 with BHEL reporting 43% Y-o-Y growth to INR 503 bn. However, going forward, we expect order intake growth to taper in the near term with the XIth Plan ordering activity coming to a close. We are revising our earnings estimate for FY09E and FY10E by 7% and 12%, respectively, factoring in slower revenue growth and margin pressures. Our revised EPS now stands at INR 79 and INR 103 for FY09E and FY10E, respectively.

* **Delay in material supply hampers revenue growth**

Gross revenue in Q4FY08 grew a meager 7%, resulting in 15.3% Y-o-Y gross revenue growth for FY08 to INR 216 bn. The management attributed the slow revenue growth to delays in raw material supply (due to tight global commodity markets) and BOP suppliers-related issues. To address this issue, the management is proactively entering into tie-ups with material suppliers. Given that H2FY08 has been soft in revenue growth, we expect execution to catch up in H1FY09. We are marginally revising our revenue estimates for FY09E and FY10E by 2% and 5%, respectively, to INR 271 bn and INR 355 bn, respectively.

* **Higher wage provisioning further dampens the result**

BHEL has been providing ~INR 800 mn for the Pay Commission revision for the past three quarters. As per the management, the total staff costs for FY08 could be ~INR 31 bn. With the Sixth Pay Commission recommending a 40% wage hike, we believe, the extra wage-related provisioning in Q4FY08 to be ~INR 1.3 bn. Q4FY08 earnings which degrew 7% Y-o-Y, is attributable to slower revenue growth and higher wage provisioning. Going forward, we expect staff costs to grow by 23% and 26% for FY09E and FY10E, respectively.

* **Outlook and valuations: DCF value indicates a 35% upside, Maintain 'BUY'**

Since our last report dated March 5, 2008, the stock has corrected sharply by 16%, which in our view adequately factors in the lower-than-expected Q4FY08 and FY08 results. At CMP, the stock is trading at P/E of 22x and 17x our FY09E and FY10E estimates, respectively, on our revised earnings. Factoring in lower earnings for FY09E and FY10E, our multiple-stage DCF-based valuation approach gives us the equity value of INR 2,372/share (earlier DCF equity value of INR 2,607/share), implying an upside of 35% from current levels. Despite soft FY08, higher capacity utilization, BHEL's maiden super-critical project win and a healthy order backlog of ~ INR 850 bn (~ 4x FY08 revenues) leads us to maintain our 'BUY' recommendation.

Financials

Year to March	Q4FY08P	Q4FY07	% change	Q3FY08	% change	FY07	FY08P
Gross revenue (INR mn)	80,702	75,100	7.5	55,289	46.0	187,390	216,080
Reported PAT (INR mn)	10,665	11,504	(7.3)	7,719	38.2	24,150	28,150
Reported EPS (INR)	21.8	23.5	(7.3)	15.8	38.2	49.3	57.5
P/E (x)						35.6	30.5
ROAE (%)						30.0	27.0

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Reuters : BHEL.BO
Bloomberg : BHEL IN

Market Data

52-week range (INR) : 2,925 / 1,084
Share in issue (INR mn) : 489.5
M cap (INR bn/USD mn) : 859 / 21,482
Avg. Daily Vol. BSE/NSE ('000) : 900.7

Share Holding Pattern (%)

Promoters : 67.7
MFs, FIs & Banks : 7.7
FIs : 19.6
Others : 5.0

*** Super-critical debut with Barh II**

Allaying fears on the Street, BHEL bagged its first super-critical project—2x660 MW, Barh II from NTPC. Additionally, the company is also re-bidding for APGENCO's 2x800 MW Krishnapatnam project, where the EPC tender was split into three parts after the initial bidding. BHEL is also in dialogue with a few other state governments to replicate its tie-up with TNEB, where it will pick up minority equity stakes.

*** Power and Beyond**

In our earlier report we had highlighted that the railways could play an important role in BHEL's growth plans, going ahead. The management said that it is looking at international tie-ups to manufacture electronic signaling equipments. BHEL is in talks with the Delhi Metro Railway Corporation to supply coaches. In order to capitalize on the dedicated freight corridor (DFC) opportunity, BHEL is already in talks with Bombardier, Toshiba, and other international firms either for a joint venture or for a manufacturing consortium for freight locomotives, which are of a higher horse-power (it already manufactures electric locomotives of up to 5,000 hp for the Indian Railways).

Financial Statements

Income statement					(INR mn)
Year to March	FY06	FY07	FY08P	FY09E	FY10E
Income from operations	136,509	176,143	203,153	271,859	355,446
Direct costs	79,895	102,598	116,546	155,619	205,621
Employee costs	18,785	23,690	30,995	38,084	47,817
Other expenses	11,971	13,805	19,210	25,707	33,275
Total operating expenses	110,652	140,092	166,752	219,410	286,713
EBITDA	25,857	36,051	36,402	52,449	68,733
Dep. and amortisation	2,459	2,730	3,007	3,811	4,465
EBIT	23,398	33,321	33,394	48,638	64,268
Interest expenses	587	433	214	253	253
Other income	2,797	4,468	8,757	11,097	12,417
Profit before tax	25,608	37,355	41,937	59,482	76,431
Provision for tax	8,852	13,214	15,095	20,759	25,987
Extraordinary items	(35)	(5)	(1,316)	0	0
Reported profit	16,791	24,147	28,157	38,723	50,445
Adjusted net profit	16,756	24,142	26,841	38,723	50,445
Shares outstanding	245	245	490	490	490
Dividend per share	7.3	7.3	9.3	11.3	13.3
Dividend payout (%)	10.6	7.4	16.9	14.2	12.9

Common size metrics- as % of net revenues

Year to March	FY06	FY07	FY08P	FY09E	FY10E
Operating expenses	81.1	79.5	82.1	80.7	80.7
Depreciation	1.8	1.5	1.5	1.4	1.3
Interest expenditure	0.4	0.2	0.1	0.1	0.1
EBITDA margins	18.9	20.5	17.9	19.3	19.3
Net profit margins (adjusted)	12.3	13.7	13.2	14.2	14.2

Growth metrics (%)

Year to March	FY06	FY07	FY08P	FY09E	FY10E
Revenues	37.2	29.0	15.3	33.8	30.7
EBITDA	55.2	39.4	1.0	44.1	31.0
PBT	59.9	45.9	12.3	41.8	28.5
Net profit	72.1	44.1	11.2	44.3	30.3
EPS	72.1	44.1	11.2	44.3	30.3

Cash flow statement

Cash flow statement					(INR mn)
Year to March	FY06	FY07	FY08P	FY09E	FY10E
Net profit	16,791	24,147	28,157	38,723	50,445
Add: Depreciation	2,459	2,730	3,007	3,811	4,465
Add: Deferred tax	(1,554)	0	0	0	0
Gross cash flow	17,696	26,877	31,165	42,534	54,910
Less: Changes in W. C.	1,576	(10,428)	(4,880)	(1,194)	(4,611)
Operating cash flow	16,121	37,305	36,045	43,727	59,521
Less: Change in invt.	(7)	0	0	0	0
Less: Capex	2,732	3,974	15,000	10,000	12,000
Free cash flow	13,395	33,331	21,045	33,727	47,521

Balance sheet					(INR mn)
As on 31st March	FY06	FY07	FY08P	FY09E	FY10E
Equity capital	2,448	2,448	4,895	4,895	4,895
Reserves & surplus	70,566	85,435	106,039	138,553	181,684
Shareholders funds	73,013	87,883	110,935	143,448	186,580
Secured loans	5,000	0	1,000	1,000	1,000
Unsecured loans	583	893	893	893	893
Borrowings	5,583	893	1,893	1,893	1,893
Sources of funds	78,596	88,776	112,828	145,341	188,473
Gross block	38,221	41,351	59,083	69,083	81,083
Accumulated depreciation	28,528	31,171	34,178	37,989	42,454
Net block	9,693	10,180	24,905	31,094	38,629
Capital work in progress	1,976	2,733	0	0	0
Total fixed assets	11,668	12,913	24,905	31,094	38,629
Investments	83	83	83	83	83
Inventories	37,444	42,177	53,277	71,295	88,777
Sundry debtors	71,681	96,958	111,826	149,645	195,655
Cash and equivalents	41,340	58,089	75,029	102,547	142,755
Loans and advances	12,844	13,406	16,704	22,554	29,489
Total current assets	163,308	210,630	256,835	346,041	456,676
Sundry creditors and others	88,077	118,979	132,376	167,684	208,805
Provisions	15,123	25,222	45,971	73,545	107,462
Total CL & provisions	103,200	144,201	178,347	241,229	316,267
Net current assets	60,108	66,429	78,488	104,812	140,409
Add/(Less): Def. tax asset/ liability	6,737	9,352	9,352	9,352	9,352
Uses of funds	78,596	88,776	112,828	145,341	188,473
Book value per share (BV) (INR)	149	180	227	293	381

Ratios

Year to March	FY06	FY07	FY08P	FY09E	FY10E
ROAE (%)	25.1	30.0	27.0	30.4	30.6
ROACE (%)	32.4	39.8	33.1	37.7	38.5
Current ratio	1.6	1.5	1.4	1.4	1.4
Debtors (days)	192	201	201	201	201
Fixed assets t/o (x)	11.7	13.6	8.2	8.7	9.2
Average working capital t/o (x)	2.5	2.8	2.8	3.0	2.9
Average capital employed t/o (x)	1.9	2.1	2.0	2.1	2.1
Gross debt/Equity	0.1	0.0	0.0	0.0	0.0

Valuations parameters

Year to March	FY06	FY07	FY08P	FY09E	FY10E
EPS (INR)	34.2	49.3	54.8	79.1	103.0
Y-o-Y growth (%)	72.1	44.1	11.2	44.3	30.3
CEPS (INR)	78.5	109.8	61.0	86.9	112.2
P/E (x)	51.3	35.6	32.0	22.2	17.0
Price/BV (x)	11.8	9.8	7.7	6.0	4.6
EV/Sales (x)	5.9	4.6	3.9	2.9	2.3
EV/EBITDA (x)	31.0	22.2	22.0	15.3	11.7

Note: FY08P indicates financials projected based on provisional results

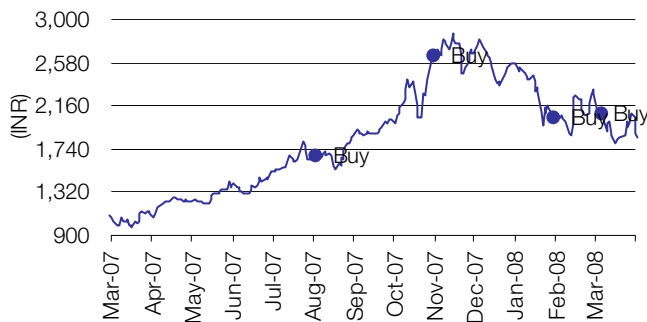
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BHEL



Recent Research

Date	Company	Title	Price (INR)	Recos
10-Mar-08	Larsen & Toubro	Hedging blues; <i>Event Update</i>	2,729	Buy
05-Mar-08	BHEL	Empowering India; <i>Company Update</i>	2,081	Buy
20-Feb-08	ABB India	Minor blip; <i>Result Update</i>	1,270	Accumulate
1-Feb-08	Elecon Engineering	Flat results; but strong order book; <i>Result update</i>	200	Buy

Distribution of Ratings / Market Cap

Edelweiss Research Coverage Universe

	Buy	Accumulate	Reduce	Sell	Total
Rating Distribution*	104	57	10	1	192

* 15 stocks under review / 5 rating withheld

	> 50bn	Between 10bn and 50 bn	< 10bn
Market Cap (INR)	85	76	31

Rating Interpretation

Rating	Expected to
Buy	appreciate more than 20% over a 12-month period
Accumulate	appreciate up to 20% over a 12-month period
Reduce	depreciate up to 10% over a 12-month period
Sell	depreciate more than 10% over a 12-month period

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