



# BHEL

STOCK INFO. BLOOMBERG  
 BSE Sensex: 16,692 BHEL IN  
 S&P CNX: 4,986 REUTERS CODE  
 BHEL.BO

22 December 2009

Buy

Rs2,287

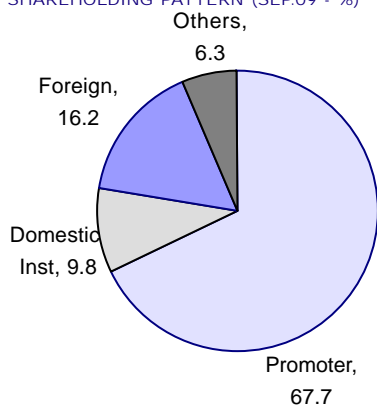
Previous Recommendation: Neutral

|                       |             |
|-----------------------|-------------|
| Equity Shares (m)     | 489.5       |
| 52-Week Range         | 2,550/1,250 |
| 1,6,12 Rel. Perf. (%) | 3/-11/-5    |
| M.Cap. (Rs b)         | 1,120.0     |
| M.Cap. (US\$ b)       | 23.9        |

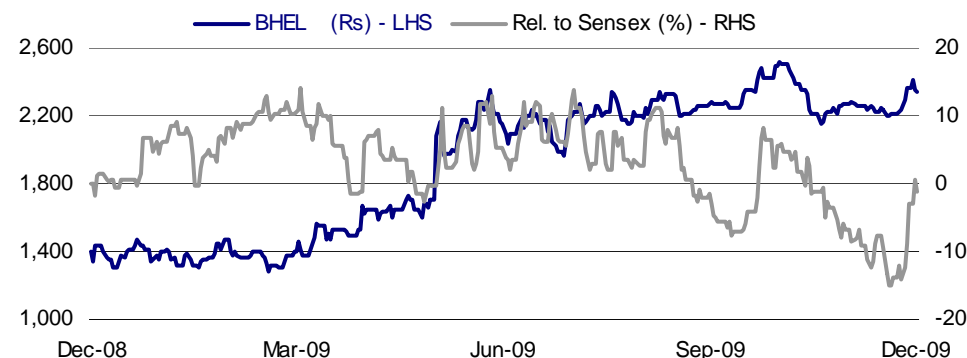
| YEAR   | NET SALES | PAT    | EPS   | EPS    | P/E  | P/BV | ROE  | ROCE | EV/   | EV/    |
|--------|-----------|--------|-------|--------|------|------|------|------|-------|--------|
| END    | (RS M)    | (RS M) | (RS)  | GR (%) | (X)  | (X)  | (%)  | (%)  | SALES | EBITDA |
| 03/09A | 267,880   | 35,594 | 72.7  | 41.8   | 31.5 | 8.7  | 30.0 | 46.9 | 3.9   | 24.1   |
| 03/10E | 332,634   | 42,446 | 86.7  | 19.2   | 26.4 | 7.1  | 29.5 | 51.8 | 3.1   | 16.9   |
| 03/11E | 428,824   | 56,130 | 114.7 | 32.2   | 20.0 | 5.7  | 31.7 | 54.4 | 2.4   | 12.3   |
| 03/12E | 556,479   | 74,842 | 152.9 | 33.3   | 15.0 | 4.6  | 33.9 | 56.7 | 1.8   | 9.1    |

- **Entering a period of strong execution:** We expect accelerated execution (revenue growth 30% CAGR till FY12), given robust book-to-bill ratio of 4.2x TTM revenues, expectations of increased order intake over next 12-18 months and capacity expansion to 15GW by the end of FY10. This should partly address execution concerns.
- **Competitive environment becoming favorable:** The issue of Chinese competition has been largely addressed through visa curbs and efforts to accelerate indigenous manufacturing. The CEA Policy Paper stipulates technical restrictions, mandatory conditions for CPSUs, state entities, UMPPs, Case-2 bids, etc to award projects to companies setting up a manufacturing base in India and fiscal incentives. Supercritical BTG pricing has improved from Rs22.3m-25.4m/MW in mid-FY09 to Rs28.3m-31m/MW. Better pricing and lower commodity prices have led to margin expansion.
- **Expect strong order intake in next 12-18 months:** We expect BHEL to witness robust order intake during the next 12-18 months, driven largely by (i) supportive equity markets, which would enable financial closure for private projects, (ii) 'National Tariff Policy' stipulation that CPSUs and state entities must award projects by January 2011 to be eligible for CERC methodology of tariff determination, (iii) bulk ordering of 11 supercritical sets (660MW each) by NTPC and DVC expected in 1HFY11, and (iv) order award of 6.5-6.9GW from JVs signed by BHEL with state utilities.
- **Earnings CAGR of 28% till FY12; upgrade to Buy:** During FY09-12, we expect BHEL to report earnings CAGR of 28%, in line with revenue CAGR of 28%. We expect adjusted EBITDA margin to expand 167bp during FY09-12, despite 505bp reduction in staff costs (as a percentage of revenues). Other income is likely to grow at a CAGR of just 3.3% till FY12, given decline in customer advances, as execution improves and order intake stagnates. We upgrade the stock to **Buy**, with a price target of Rs2,752/share.
- **Possible stagnation in order intake the key long-term concern:** We are concerned about stagnation/decline in order intake from the power segment. This would impact longer-term (beyond FY13) growth. However, BHEL could have the following mitigants: (i) increased share of supercritical projects, where per unit price is ~15% higher, (ii) greater share of revenues from industry, which contributed 28% of FY09 revenues (down from 44% in FY02) - BHEL is planning foray into new segments like rig manufacturing, defense, wind energy, water desalination, forgings, etc, and (iii) inorganic growth.

SHAREHOLDING PATTERN (SEP.09 - %)



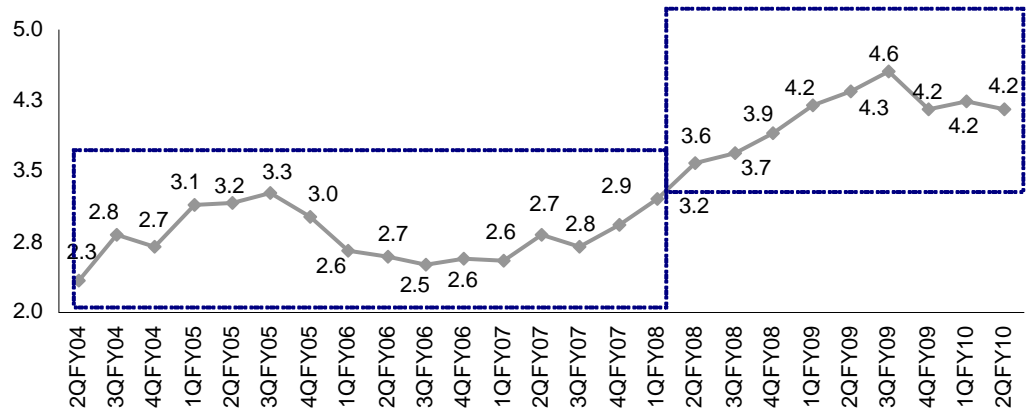
STOCK PERFORMANCE (1 YEAR)



## Entering a period of strong execution

BOOK TO BILL (BTB) RATIO HAS SURGED (X, TTM REVENUES)...

Given the surge in order intake and execution constraints during FY08-10, BTB ratio has expanded to 4.2x (ttm revenues)



Source: Company

For expansion to 20GW, large part of the ordering for machines, etc will be completed by end Mar 2010

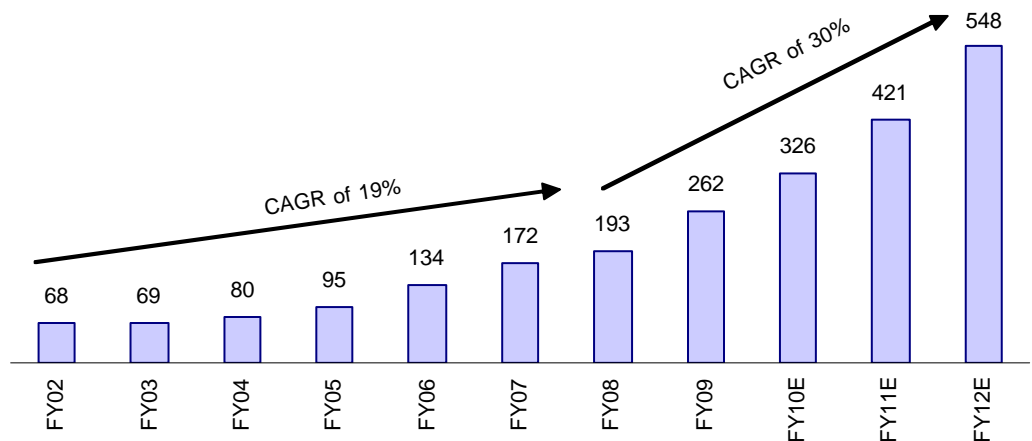
CAPACITY EXPANSION TO PARTLY ADDRESS EXECUTION ISSUES (MW)

|              | MAR-06       | JAN-08        | DEC-09        | DEC-11        |
|--------------|--------------|---------------|---------------|---------------|
| Thermal      | 5,000        | 7,500         | 12,500        | 17,500        |
| Hydro        | 1,000        | 2,500         | 2,500         | 2,500         |
| <b>Total</b> | <b>6,000</b> | <b>10,000</b> | <b>15,000</b> | <b>20,000</b> |

Source: Company

...LEADING TO A PERIOD OF STRONG EXECUTION (RS B)

We expect accelerated execution on back of robust BTB ratio of 4.2x; capacity expansion to 15GW in end FY10 and 20GW by FY12 will partly address execution constraints



Source: Company/MOSL

## Expect strong order intake in next 12-18 months for BHEL

We expect robust order intake during next 12-18 months, driven largely by

- #1. Supportive equity markets, which will enable financial closure for projects in private sector
- #2. 'National Tariff Policy' stipulates that Central and State sector companies to award projects by Jan 11 for being eligible for CERC methodology of tariff determination.
- #3. Bulk ordering of 11 supercritical sets (660MW each) by NTPC and DVC, expected in 1HFY11.
- #4. Order award of 6.5-6.9GW from JVs signed by BHEL with state utilities for setting up power projects.

### FUND RAISING IN FY10 (YTD) BY POWER UTILITIES (RS M)

| COMPANY             | TOTAL          |
|---------------------|----------------|
| Tata Power          | 30,645         |
| Adani Power         | 34,001         |
| Indiabulls Power    | 17,582         |
| PTC                 | 5,000          |
| GVK                 | 7,168          |
| Lanco Infratech     | 7,274          |
| KSK Energy Ventures | 5,159          |
| NHPC                | 40,257         |
| JSW Energy          | 27,000         |
| <b>Total</b>        | <b>174,086</b> |

\* Including Green Shoe

Source: Company/MOSL

### EXPECT ORDER AWARD OF ~28GW+ OF SUPERCRITICAL PROJECTS OVER NEXT 12-18 MONTHS

| S. NO.       | PROJECT                                  | AGENCY        | PROJECT SIZE     |
|--------------|--|---------------|------------------|
| <b>A</b>     | <b>Central Sector</b>                    |               |                  |
| 1            | North Karanpura**                        | NTPC          | 3x660 MW         |
| 2            | Meja*                                    | NTPC-UP JV    | 2x660 MW         |
| 3            | New NabiNagar*                           | NTPC-Bihar JV | 3x660 MW         |
| 4            | Tanda Extn*                              | NTPC          | 2x660 MW         |
| 5            | Sholapur*                                | NTPC          | 2x660 MW         |
| 6            | Raghunathpur*                            | DVC           | 2x660 MW         |
| <b>B</b>     | <b>State Sector</b>                      |               |                  |
| 1            | Suratgarh Extn                           | RVUNL         | 2x660 MW         |
| 2            | Chhabra Extn                             | RVUNL         | 2x660 MW         |
| 3            | Udangudi                                 | TNEB          | 2x800 MW         |
| 4            | Katwa                                    | WBPDC         | 2x660 MW         |
| 5            | Bakreshwar                               | WBPDC         | 1x660 MW         |
| <b>C</b>     | <b>Private Sector (UMPP and Case-II)</b> |               |                  |
| 1            | Ultra Mega Tilaya@                       | Reliance      | 4000 MW          |
| 2            | Ultra Mega Krishnapatnam@                | Reliance      | 4000 MW          |
| 3            | Gidderbha, Punjab                        |               | 2x660 MW         |
| 4            | Shahpura, MP                             |               | 2x660 MW         |
| 5            | Jewargi, Karnataka                       |               | 2x660 MW         |
| <b>Total</b> |  |               | <b>27,420 MW</b> |

\* Projects included under bulk tendering with mandatory condition of setting up manufacturing facilities in India; \*\* Bids already invited; @IPP already selected

Source: CEA

*Given improved competitive environment, we expect large part of these orders to be awarded to cos setting up manufacturing base in India*

## BHEL'S SHARE IN PRIVATE SECTOR ORDER INTAKE HAS IMPROVED

| ORDER DATE | OWNER  | CAPACITY (MW) | VALUE<br>(RS M) | VALUE<br>(RS M/MW) |
|------------|--|---------------|-----------------|--------------------|
| 24-Nov-09  | Jaiprakash, UP (Bara)                          | 1980          | 56,000          | 28                 |
| 21-Aug-09  | Monnet Power Company Limited, Orissa           | 1050          | 26,300          | 25                 |
| 7-Aug-09   | Jindal India Thermal Power, Orissa             | 1200          | 26,000          | 22                 |
| 14-Jul-09  | Adhunik Power and Natural Resources, Jharkhand | 270           | 6,400           | 24                 |
| 25-May-09  | Ideal Energy Projects , Maharashtra            | 270           | 7,030           | 26                 |
| 14-May-09  | Korba West Power (Avantha), Chhattisgarh       | 600           | 14,750          | 25                 |
| 29-Dec-08  | Jindal Power, Chhattisgarh                     | 2400          | 50,400          | 21                 |
| 22-Dec-08  | Jaiprakash, UP (Bina)                          | 500           | 11,750          | 24                 |
| 29-Aug-08  | GVK, Punjab (Goindwal Sahib)                   | 540           | 11,500          | 21                 |
| 22-Nov-07  | JV of DVC and Tata Power, Maithon              | 1050          | 21080           | 20                 |

Source: Company

*Private sector accounted for 79% of order intake in 1HFY10 in the power segment for BHEL*

## BHEL HAS SIGNED VARIOUS JVS FOR STAKE IN POWER GENERATION PROJECTS: IMPROVE ORDER INTAKE

|                | CAPACITY (MW)      | CONFIGURATION |
|----------------|--------------------|---------------|
| Tamil Nadu     | 1,600              | 2 X 800MW     |
| Karnataka      | 1,980-2,400        | 3 X 660/800MW |
| Maharashtra    | 1,320              | 2 X 660MW     |
| Madhya Pradesh | 1,600              | 2 X 800MW     |
| <b>Total</b>   | <b>6,500-6,920</b> |               |

Source: Company

*BHEL's Tamil Nadu and Karnataka JV's (BHEL's stake-26%), could award BTG contracts in the next 6-9months*

## Competitive environment becoming favourable for supercritical projects

### #1. Improved realizations + lower commodity prices = Better margins

EQUIPMENT PRICING HAS WITNESSED IMPROVEMENT: SUPERCRITICAL PROJECT AWARDS TILL DATE

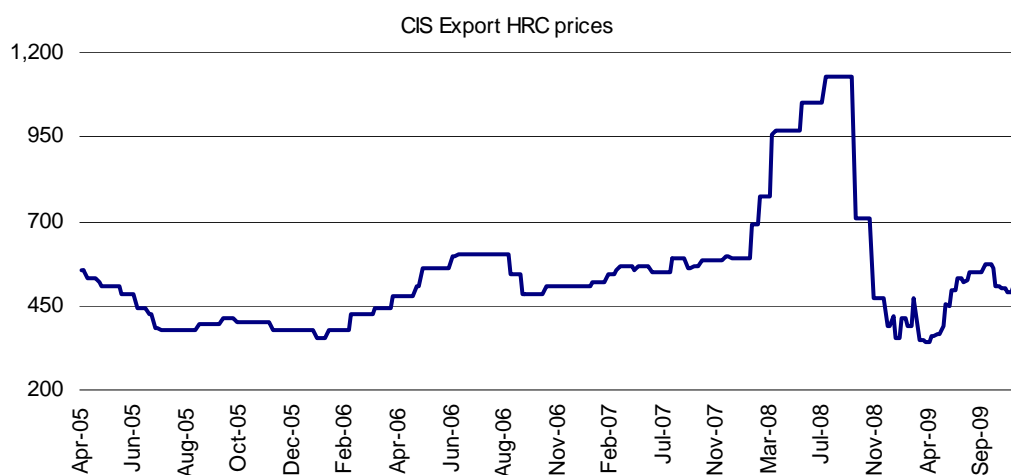
| PROJECT NAME    | COMPANY        | EQUIPMENT SUPPLIER      | CAPACITY (MW) | AWARD YEAR | VALUE (RS M) |         |        | VALUE (RS M/MW) |         |       | ORDER DESCRIPTION  |
|-----------------|----------------|-------------------------|---------------|------------|--------------|---------|--------|-----------------|---------|-------|--|
|                 |                |                         |               |            | BOILER       | TURBINE | TOTAL  | BOILER          | TURBINE | TOTAL |  |
| Sipat Stage 1   | NTPC           | Doosan / Power Machines | 1,980         | 2004       |              |         | 33,494 |                 |         | 16.9  | BTG Package  |
| Barh Stage 1    | NTPC           | Power Machines          | 1,980         | Feb-05     |              |         | 38,923 |                 |         | 19.7  | BTG Package  |
| Mundra UMPP     | Tata Power     | Doosan / Toshiba        | 4,000         | May-07     | 55,632       | 18,240  | 73,872 | 13.9            | 4.6     | 18.5  | BTG Package  |
| Mundra Ph III   | Adani Power    | Sepco III               | 1,320         | Sep-07     |              |         | 42,748 |                 |         | 32.4  | All equipments   |
| Mundra Ph IV    | Adani Power    | Sepco III               | 1,980         | Jan-08     |              |         | 65,279 |                 |         | 33    | All equipments   |
| Tiroda Ph 1 & 2 | Adani Power    | Sichuan Machinery       | 1,980         | Feb-08     |              |         | 38,000 |                 |         | 19.2  | BTG package  |
| Krishnapatnam   | AP Genco       | BHEL / L&T              | 1,600         | Aug-08     | 25,000       | 15,570  | 40,570 | 15.6            | 9.7     | 25.4  | BTG Package  |
| Barh Stage 2    | NTPC           | BHEL                    | 1,320         | Oct-08     | 15,000       | 14,470  | 29,470 | 11.4            | 11      | 22.3  | BTG Package  |
| TNEB            | TNEB - BHEL JV | BHEL                    | 1,600         | Nov-08     |              |         | 87,000 |                 |         | 54.4  | Project cost, incl IDC   |
| Sasan UMPP      | Reliance Power | Chinese                 | 3,960         |            |              |         |        |                 |         |       |  |
| Nigrie          | Jaiprakash     | L&T-MHI                 | 1,320         | Aug-09     | 22,270       | 17,730  | 40,000 | 16.9            | 13.4    | 30.3  | BTG package  |
| Bara            | Jaiprakash     | BHEL                    | 1,980         | Oct-09     |              |         | 56,000 |                 |         | 28.3  | BTG package  |
| Mahagenco       | Mahagenco      | L&T-MHI                 | 1,980         | Oct-09     |              |         | 68,970 |                 |         | 34.8  | BTG package, incl substantial BOP, electricals, controls, instrumentation, and civil works |

Shaded areas indicate projects awarded on BTG basis

Source: Company/MOSL

COMMODITY PRICES HAVE DECLINED, LEADING TO IMPROVED MARGINS

*Improvement in equipment prices, combined with decline in commodity prices have led to improved margins on new order intake*



Source: Company/MOSL

*Recently, Rajpura Power project was awarded on a Case 2 bid; with various bidders quoting capacity charges of Rs1.4-1.7/unit based on bids from domestic manufacturing companies*

RAJPURA PROJECT (PUNJAB): BID COMPOSITION BY DIFFERENT BIDDERS (RS / UNIT)

| BIDDERS               | LEVELLISED    | LEVELLISED    | QUOTED NSHR |
|-----------------------|---------------|---------------|-------------|
|                       | TOTAL CHARGES | CAPACITY CHGS | (KCAL/KWH)  |
| L&T Power Development | 2.8899        | 1.3756        | 2,268       |
| Welspun Urja          | 2.9475        | 1.3905        | 2,332       |
| Lanco Infratech       | 2.9844        | 1.3797        | 2,403       |
| Adani Power           | 3.098         | 1.362         | 2,600       |
| JSW Energy            | 3.2241        | 1.6878        | 2,301       |
| GMR Energy Limited    | 3.2939        | 1.7536        | 2,307       |

\* NSHR = Net Station Heat Rate

Source: Company/MOSL

## #2. Curbs on visas to Chinese

A change in the visa norms stipulates that Chinese workers coming to India on business visa cannot seek employment; and as per media reports, as many as 3,000+ Chinese technicians have left the country. Thus, this stance taken by the government increases the uncertainty for private developers to award incremental projects on EPC basis to Chinese suppliers.

## #3. CEA's Policy paper for 'Accelerating indigenous manufacturing of Supercritical units' - fiscal incentives and mandatory conditions (Extract)

*Limiting competition by stipulating minimum technical parameters*

**A] Technical restrictions:** CEA regulations for construction of electric plants & electric lines, which have been sent to Ministry of Power for approval, maximum design turbine cycle heat rate of 1,850 kcal/kWhr has been stipulated in case unit is provided with steam turbine driven boiler feed pumps (1,810 kcal/kWhr in case of electrically driven boiler feed pumps). *It is, however, noted that efficiency of some turbine-generators being imported into the country is much lower as the heat rate is of the order of 1,920 kcal/kWhr with steam turbine driven feed pumps. We are advising utilities to keep stipulations in CEA regulations in view while ordering the supercritical units.*

*CEA Policy Paper states technical restrictions, and mandatory conditions for CPSUs, State entities, UMPPs, Case 2 bids, etc to award projects to companies setting up manufacturing base in India*

### **B] Mandatory conditions to award equipment orders to companies setting up manufacturing base in India, as part of the bid documents:**

- *All central and state PSUs may be advised that bids to be invited for boilers and turbine-generators for supercritical projects should have mandatory condition of setting up indigenous manufacturing facilities as per proposal for bulk ordering of 11 units with minimum steam parameters of 246 kg/cm<sup>2</sup> - (g), 565/593 deg C at turbine inlet and design turbine cycle heat rate of 1850 kcal/kWhr (maximum) in case unit is provided with steam turbine driven boiler feed pumps (1810 kcal/kWhr in case of electrically driven boiler feed pumps). ICB of such projects with condition of mandatory indigenous manufacturing should make them eligible for Mega Power benefits.*
- *All supercritical units, to be set up by public/private sector, may be given custom duty and deemed export benefits (as applicable for Mega Power Projects) subject to fulfilling the following conditions*
  - *Orders for supercritical boilers and turbine-generators are placed on Indian companies which are setting up manufacturing facilities for super critical units in India. Such companies should meet the qualification criteria similar to that for the bulk tendering proposal of 11 units*

*Future UMPP's under Case-II bids to be awarded BTG contracts to cos setting up manufacturing base in India*

➤ Steam parameters (minimum): 246 kg/cm<sup>2</sup> (g), 565/593 deg C at turbine inlet; Design turbine cycle heat rate (maximum): 1850 kcal/kWhr in case unit is provided with steam turbine driven boiler feed pumps (1810 kcal/kWhr in case of electrically driven boiler feed pumps).

- For all future UMPPs, matter may be put up to proposed Empowered Group of Ministers for stipulating similar conditions as above in Request for Proposal.
- Similar conditions may also be incorporated in Standard Bid Document for Case-II tariff based competitive bidding for coal based thermal projects.

*Estimated fiscal incentive of Rs65b over the next five years*

**C] Fiscal incentives:** Government may also consider waiving import duty on machinery imported by the Indian manufacturers for setting up manufacturing facilities for supercritical boilers and turbine-generators as most of the machinery will have to be imported. Above dispensations may be allowed for the orders to be placed upto next five years to allow indigenous manufacturing units to absorb the supercritical technology and maximize indigenization of production of the various components.

As already mentioned, fiscal benefits proposed above are already available for Mega Power Projects and UMPPs. As such these benefits would accrue additionally only to units which are not eligible for Mega status. *The likely impact on account of the Custom duty and deemed export benefit to such units has been worked out to about Rs65b presuming that twenty such units are ordered during the next five years.*

#### **Key takeaway: Accelerate Indigenous Manufacturing**

CEA Policy Paper stipulates technical restrictions for steam parameters, etc for all supercritical projects to be set up in India. Also, there are mandatory conditions for all Central and State PSUs; and also for developers of UMPPs, Case 2 bids, etc to award projects to companies setting up manufacturing base in India, as per the proposal for bulk ordering of 11 units. Fiscal incentives are also provided, as all such supercritical units would be given custom duty and deemed export benefits (as applicable for Mega Power Projects). The key intent is to accelerate indigenous manufacturing in India.

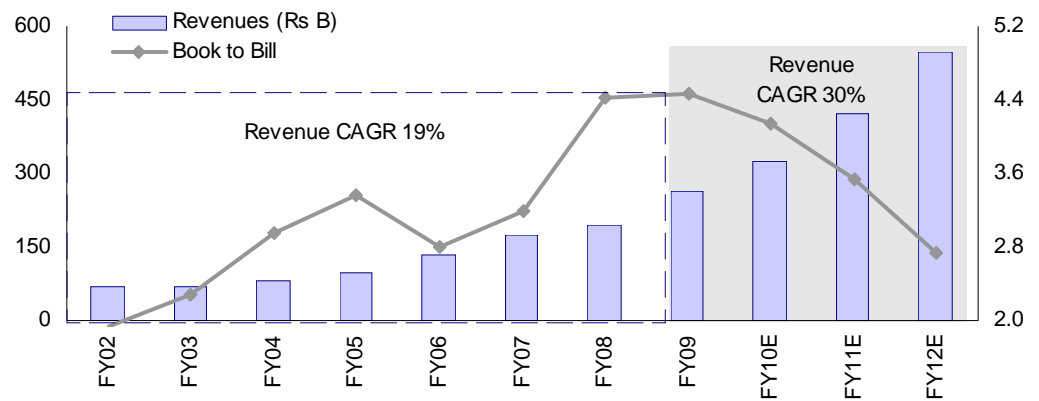
## Earnings CAGR of 28% till FY12

For FY09-12, we expect BHEL to report earnings CAGR of 28%, in-line with revenue CAGR of 28%. For FY12, we estimate net profit at Rs74.8b, (14% above consensus).

- **Expect revenue CAGR of 28% given:** Robust book to bill ratio of 4.2x ttm revenues, expectations of increased order intake over next 12-18 months and capacity expansion to 15GW in end FY10 (vs current ~10GW) which will partly address execution concerns.
- Adjusted EBIDTA margin expansion of 167bp during FY09-12. This is despite a 505bp reduction in staff costs as a percentage of revenues, thus we have factored in possible liquidated damages, impact due to lower margins on initial supercritical projects, etc.
- Other income CAGR of only 3.3% till FY12, given decline in customer advances as execution improves and order intake stagnates. We have calculated working capital at 13.4% of revenues in FY12, vs (-6.7%, FY09); largely given lower customer advances.

EXPECT ROBUST REVENUE CAGR, GIVEN INCREASED EXECUTION

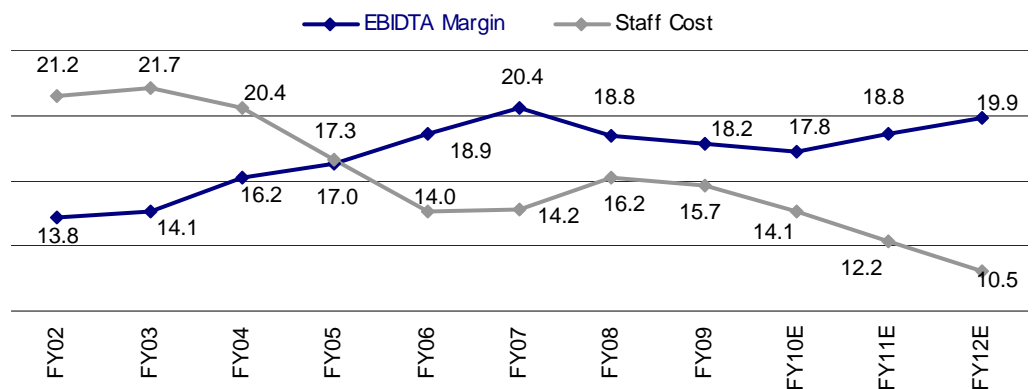
*Expect revenue CAGR of 28% given: robust book to bill ratio of 4.2x ttm revenues, expectations of increased order intake over next 12-18 months and capacity expansion to 15GW in end FY10 (vs current ~10GW) which will partly address execution concerns*



Source: Company/MOSL

EXPECT ADJUSTED EBIDTA MARGIN EXPANSION OF 167BP

*We expect adjusted EBIDTA margin expansion of 167bp during FY09-12. This is despite 505bp reduction in staff costs as a % of revenues, and thus we have factored in possible liquidated and related damages, impact due to lower margins on initial supercritical projects, etc*

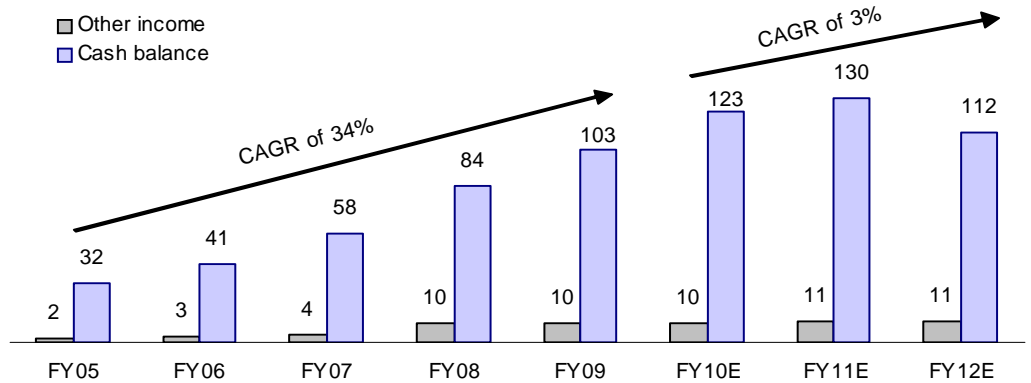


Source: Company/MOSL



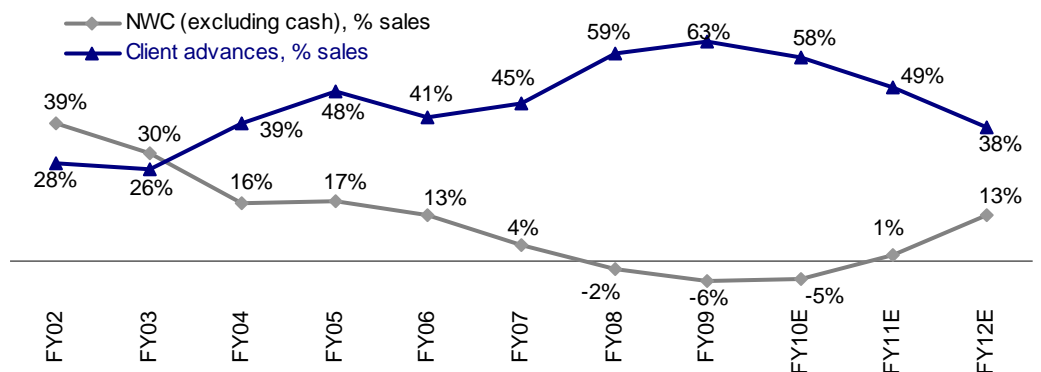
OTHER INCOME CAGR OF ONLY 3.3%, GIVEN STAGNANT CASH BALANCE DURING FY09-12

Other income CAGR of only 3.3% till FY12, given decline in customer advances as execution improves and order intake stagnates



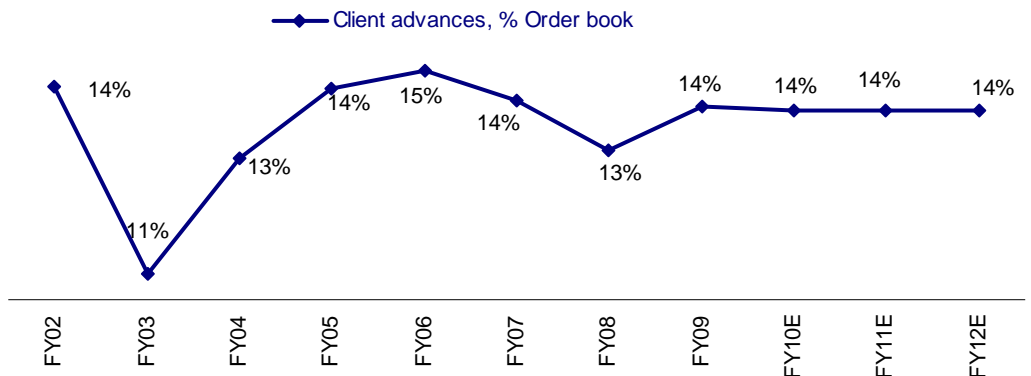
WORKING CAPITAL DETERIORATION GIVEN STABLE ORDER INTAKE; INCREASED EXECUTION

We calculate working capital at 13.4% of revenues in FY12, vs negative 6.7% in FY09; largely given lower customer advances



CUSTOMER ADVANCES AS % OF ORDER BOOK TO REMAIN STABLE

Customer advances as % of order book has remained stable at 14% of revenues



Source: Company/MOSL

MOSL EPS ESTIMATES VS CONSENSUS (RS/SHARE)

|      | MOSL  | CONSENSUS | VAR (%) |
|------|-------|-----------|---------|
| FY10 | 86.7  | 91.3      | -5      |
| FY11 | 114.7 | 114.0     | 1       |
| FY12 | 152.9 | 133.6     | 14      |

Source: Bloomberg

## Possible stagnation in order intake is the key long term concern

We are concerned about stagnation / decline in order intake from power segment for BHEL, which would impact the longer term (beyond FY13) growth profile. The concern is due to the following factors.

- Average order intake of 15.4GW pa during FY08-10.
- Targeted Twelfth Plan (FY13-17E) capacity addition at 100GW, of which BHEL's market share expected at 50-60%. Thus order intake per annum should stabilize at 10-12GW in FY12/13; and possibly grow in line with electricity consumption thereafter.

We also note that BHEL possibly could have following mitigants. However, the quantum of success will depend on several factors, many of which are in very early stages to comment:

- Increased share of super critical projects in order mix, where the per unit price is ~15% higher than sub-critical. Also, super-critical projects are targeted to account for 60% of Twelfth Plan capacity additions and 100% of Thirteenth Plan additions.
- Increased share of revenues from industry segment, which contributed 28% of revenues in FY09 (down from 44% in FY02). Industry comprises of international orders, captive power plants, T&D equipments, railways, motors, compressors, etc. Many of these segments provide interesting growth opportunities, like its planned foray in segments like rig manufacturing, defence, wind energy, water desalination, forgings, etc.
- Inorganic growth, both in India and overseas also provides opportunities to improve the skill sets and target new segments / geographies. In past, BHEL has acquired Bharat Heavy Plates (FY08) for industrial boilers and had bid for Skoda Power (though unsuccessful).

*80% of nuclear power in India is through BHEL sets; 70% of Indian Railways is equipped with traction equipment built by BHEL*

### Increased competition

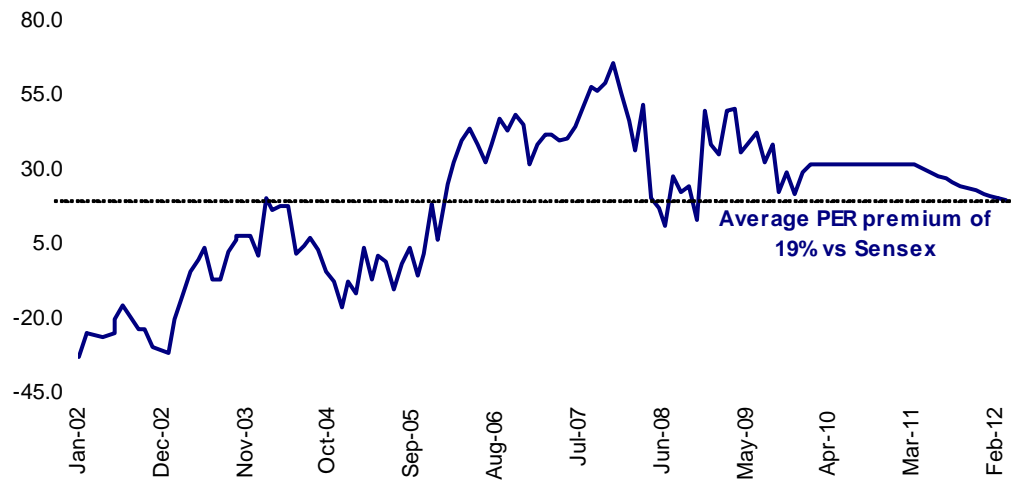
L&T - Mitsubishi thermal power equipment JV has witnessed strong traction, with reported order intake till date of BTG 3.3GW and Turbine Generator 1.6GW. The order intake stands at Rs150b [BTG comprising of Jaiprakash Nigrie (1.32GW) and Mahagenco Koradi project (1.98GW)]. Further, we expect order award for Rajpura Power Project (1.32GW, on development basis by L&T) to be booked in 4QFY10, as the PPA is expected to be signed in January 2010. Thus, super critical power equipment should account for Rs200b of order intake till end FY10.

Despite increased competition, we expect BHEL to maintain ~50%+ market share in India's thermal power capacity addition in the medium term; as we believe that new entrants will likely occupy the space vacated by overseas players. Post capacity expansion to 20GW by end FY12, BHEL will control ~10% of global thermal capacity addition; and BHEL's capacity will be at par with many of the Chinese players. This will provide sizeable cost advantages, which will be difficult for a new player to replicate in the initial periods. This we believe will enable BHEL to sustain / improve margins in the medium term.

### Upgrade to Buy, with price target of Rs2,752/sh (upside of 20%)

Based on our earnings estimate, BHEL quotes at PER of 26.4x FY10E, 20x FY11E and 15x FY12E. We upgrade the stock to **Buy** with a price target of Rs2,752/sh (18x FY12E).

BHEL: AVERAGE PREMIUM/DISCOUNT TO SENSEX



| INCOME STATEMENT       |                | (Rs Million)   |                |                |                |  |
|------------------------|----------------|----------------|----------------|----------------|----------------|--|
| Y/E MARCH              | 2008           | 2009           | 2010E          | 2011E          | 2012E          |  |
| <b>Total Income</b>    | <b>197,652</b> | <b>267,880</b> | <b>332,634</b> | <b>428,824</b> | <b>556,479</b> |  |
| Change                 | 12.0           | 35.8           | 24.4           | 29.1           | 30.0           |  |
| Staff Cost             | 31,197         | 41,127         | 46,125         | 51,469         | 57,335         |  |
| Mfg. Expenses          | 98,465         | 147,777        | 177,409        | 230,171        | 299,249        |  |
| Selling Expenses       | 30,576         | 36,785         | 49,865         | 66,382         | 89,270         |  |
| <b>EBITDA</b>          | <b>37,414</b>  | <b>42,190</b>  | <b>59,235</b>  | <b>80,802</b>  | <b>110,625</b> |  |
| Change                 | 3.8            | 12.8           | 40.4           | 36.4           | 36.9           |  |
| % of Net Sales         | 18.9           | 15.7           | 17.8           | 18.8           | 19.9           |  |
| Depreciation           | 2,972          | 3,343          | 4,014          | 4,908          | 5,756          |  |
| Interest               | 354            | 307            | 355            | 550            | 550            |  |
| Other Income           | 10,225         | 9,829          | 10,434         | 11,009         | 10,823         |  |
| Extra-ord. Items (net) | -9             | 119            | 0              | 0              | 0              |  |
| <b>PBT</b>             | <b>44,304</b>  | <b>48,489</b>  | <b>65,301</b>  | <b>86,354</b>  | <b>115,142</b> |  |
| Tax                    | 15,711         | 17,106         | 22,855         | 30,224         | 40,300         |  |
| Rate (%)               | 35.5           | 35.3           | 35.0           | 35.0           | 35.0           |  |
| <b>Reported PAT</b>    | <b>28,593</b>  | <b>31,383</b>  | <b>42,446</b>  | <b>56,130</b>  | <b>74,842</b>  |  |
| <b>Adjusted PAT</b>    | <b>25,095</b>  | <b>35,594</b>  | <b>42,446</b>  | <b>56,130</b>  | <b>74,842</b>  |  |
| Change                 | 3.9            | 41.8           | 19.2           | 32.2           | 33.3           |  |

| BALANCE SHEET                  |                | (Rs Million)   |                |                |                |  |
|--------------------------------|----------------|----------------|----------------|----------------|----------------|--|
| Y/E MARCH                      | 2008E          | 2009           | 2010E          | 2011E          | 2012E          |  |
| Share Capital                  | 4,895          | 4,895          | 4,895          | 4,895          | 4,895          |  |
| Reserves                       | 102,846        | 124,493        | 153,033        | 190,775        | 241,099        |  |
| <b>Net Worth</b>               | <b>107,742</b> | <b>129,388</b> | <b>157,929</b> | <b>195,671</b> | <b>245,995</b> |  |
| Loans                          | 952            | 1,494          | 1,500          | 1,500          | 1,500          |  |
| Differed Tax Liability         | -13,379        | -18,403        | -18,403        | -18,403        | -18,403        |  |
| <b>Capital Employed</b>        | <b>95,314</b>  | <b>112,479</b> | <b>141,026</b> | <b>178,768</b> | <b>229,092</b> |  |
| Gross Fixed Assets             | 44,435         | 52,249         | 66,539         | 80,329         | 93,119         |  |
| Less: Depreciation             | 34,622         | 37,545         | 41,647         | 46,554         | 52,310         |  |
| <b>Net Fixed Assets</b>        | <b>9,813</b>   | <b>14,704</b>  | <b>24,892</b>  | <b>33,774</b>  | <b>40,808</b>  |  |
| Capital WIP                    | 6,580          | 11,570         | 10,000         | 7,500          | 2,500          |  |
| Investments                    | 83             | 523            | 773            | 773            | 773            |  |
| <b>Curr. Assets</b>            | <b>277,047</b> | <b>369,011</b> | <b>412,745</b> | <b>491,945</b> | <b>579,677</b> |  |
| Inventory                      | 57,364         | 78,370         | 88,635         | 107,479        | 139,330        |  |
| Debtors                        | 119,749        | 159,755        | 169,213        | 214,958        | 278,660        |  |
| Cash & Bank Balance            | 83,860         | 103,147        | 123,192        | 130,179        | 111,741        |  |
| Loans & Advances               | 11,863         | 24,237         | 28,202         | 35,826         | 46,443         |  |
| Other Current Assets           | 4,211          | 3,502          | 3,502          | 3,502          | 3,502          |  |
| <b>Curr. Liab. &amp; Prov.</b> | <b>198,208</b> | <b>283,329</b> | <b>307,385</b> | <b>355,225</b> | <b>394,667</b> |  |
| Creditors                      | 44,240         | 58,529         | 68,047         | 88,285         | 114,780        |  |
| Other Liabilities              | 121,525        | 175,045        | 201,637        | 222,653        | 226,231        |  |
| Provisions                     | 32,444         | 49,756         | 37,700         | 44,288         | 53,655         |  |
| <b>Net Current Assets</b>      | <b>78,838</b>  | <b>85,682</b>  | <b>105,360</b> | <b>136,720</b> | <b>185,010</b> |  |
| <b>Appli. of Funds</b>         | <b>95,314</b>  | <b>112,479</b> | <b>141,026</b> | <b>178,768</b> | <b>229,092</b> |  |

E: MOSL Estimates

| RATIOS                   |             |             |             |              |              |  |
|--------------------------|-------------|-------------|-------------|--------------|--------------|--|
| Y/E MARCH                | 2008        | 2009        | 2010E       | 2011E        | 2012E        |  |
| <b>Basic (Rs)</b>        | <b>51.3</b> | <b>72.7</b> | <b>86.7</b> | <b>114.7</b> | <b>152.9</b> |  |
| EPS                      | 3.9         | 41.8        | 19.2        | 32.2         | 33.3         |  |
| Change (%)               | 57.3        | 79.5        | 94.9        | 124.7        | 164.6        |  |
| Cash EPS                 | 220.1       | 264.3       | 322.6       | 399.7        | 502.5        |  |
| Book Value               | 15.3        | 17.0        | 24.3        | 32.1         | 42.8         |  |
| DPS                      | 29.7        | 26.5        | 28.0        | 28.0         | 28.0         |  |
| Payout (incl. Div. Tax.) |             |             |             |              |              |  |
| <b>Valuation (x)</b>     | <b>44.6</b> | <b>31.5</b> | <b>26.4</b> | <b>20.0</b>  | <b>15.0</b>  |  |
| P/E                      | 39.9        | 28.8        | 24.1        | 18.3         | 13.9         |  |
| Cash P/E                 | 27.7        | 24.1        | 16.9        | 12.3         | 9.1          |  |
| EV/EBITDA                | 5.4         | 3.9         | 3.1         | 2.4          | 1.8          |  |
| EV/Sales                 | 10.4        | 8.7         | 7.1         | 5.7          | 4.6          |  |
| Price/Book Value         | 0.7         | 0.7         | 1.1         | 1.4          | 1.9          |  |
| Dividend Yield (%)       |             |             |             |              |              |  |
| <b>Return Ratio</b>      | <b>25.7</b> | <b>30.0</b> | <b>29.5</b> | <b>31.7</b>  | <b>33.9</b>  |  |
| RoE                      | 51.1        | 46.9        | 51.8        | 54.4         | 56.7         |  |
| RoCE                     |             |             |             |              |              |  |
| <b>Turnover Ratios</b>   | <b>204</b>  | <b>208</b>  | <b>210</b>  | <b>210</b>   | <b>210</b>   |  |
| Debtors (Days)           | 108         | 109         | 110         | 105          | 105          |  |
| Inventory (Days)         | 84          | 81          | 0           | 0            | 0            |  |
| Creditors. (Days)        | 19.7        | 17.8        | 13.1        | 12.5         | 13.4         |  |
| Asset Turnover (x)       |             |             |             |              |              |  |
| <b>Leverage Ratio</b>    | <b>0.0</b>  | <b>0.0</b>  | <b>0.0</b>  | <b>0.0</b>   | <b>0.0</b>   |  |
| Debt/Equity (x)          |             |             |             |              |              |  |

| CASH FLOW STATEMENT          |                | (Rs Million)   |                |                |                |  |
|------------------------------|----------------|----------------|----------------|----------------|----------------|--|
| Y/E MARCH                    | 2008           | 2009           | 2010E          | 2011E          | 2012E          |  |
| <b>PBT bef. EO Items</b>     | <b>44,313</b>  | <b>48,370</b>  | <b>65,301</b>  | <b>86,354</b>  | <b>115,142</b> |  |
| Add: Depreciation            | 2,972          | 3,343          | 4,014          | 4,908          | 5,756          |  |
| Interest                     | 354            | 307            | 355            | 550            | 550            |  |
| Less: Direct taxes paid      | 15,711         | 17,106         | 22,855         | 30,224         | 40,300         |  |
| (Inc)/Dec in WC              | 13,361         | 12,443         | 367            | -24,373        | -66,728        |  |
| <b>CF from Operations</b>    | <b>45,290</b>  | <b>47,356</b>  | <b>47,181</b>  | <b>37,215</b>  | <b>14,421</b>  |  |
| EO Income                    | -9             | 119            | 0              | 0              | 0              |  |
| <b>CF from Operations in</b> | <b>45,281</b>  | <b>47,475</b>  | <b>47,181</b>  | <b>37,215</b>  | <b>14,421</b>  |  |
| (Inc)/dec in FA              | -6,452         | -13,223        | -12,633        | -11,290        | -7,790         |  |
| <b>CF from Investments</b>   | <b>-6,452</b>  | <b>-13,664</b> | <b>-12,883</b> | <b>-11,290</b> | <b>-7,790</b>  |  |
| (Inc)/Dec in Network         | -4,028         | -5,024         | 0              | 0              | 0              |  |
| (Inc)/Dec in Debt            | 59             | 542            | 6              | 0              | 0              |  |
| Less: Interest Paid          | 354            | 307            | 355            | 550            | 550            |  |
| Dividend Paid                | 8,734          | 9,736          | 13,905         | 18,388         | 24,518         |  |
| <b>CF from Fin. Activity</b> | <b>-13,058</b> | <b>-14,525</b> | <b>-14,254</b> | <b>-18,938</b> | <b>-25,068</b> |  |
| <b>Inc/Dec of Cash</b>       | <b>25,771</b>  | <b>19,286</b>  | <b>20,045</b>  | <b>6,987</b>   | <b>-18,438</b> |  |
| Add: Beginning Balance       | 58,089         | 83,860         | 103,147        | 123,192        | 130,179        |  |
| <b>Closing Balance</b>       | <b>83,860</b>  | <b>103,147</b> | <b>123,192</b> | <b>130,179</b> | <b>111,741</b> |  |

**N O T E S**



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**BHEL**

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|---|----|
| 1. Analyst ownership of the stock                       | No |
| 2. Group/Directors ownership of the stock               | No |
| 3. Broking relationship with company covered            | No |
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