RESULTS REVIEW

Share Data

Market Cap	Rs. 1,246.2 bn
Price	Rs. 2,545.75
BSE Sensex	20,686.89
Reuters	BHEL.BO
Bloomberg	BHEL IN
Avg. Volume (52 Week)	0.2 mn
52-Week High/Low	Rs. 2,925 / 1,301
Shares Outstanding	489.52 mn

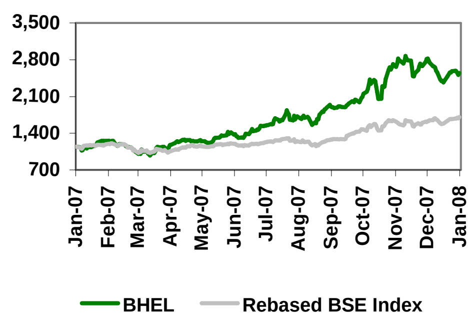
Valuation Ratios (Consolidated)

Year to 31 March	2008E	2009E
EPS (Rs.)	66.3	87.3
+/- (%)	33.7%	31.7%
PER (x)	38.4x	29.1x
EV/ Sales (x)	5.1x	4.0x
EV/ EBITDA (x)	24.0x	18.2x

Shareholding Pattern (%)

Promoters	68
FIIs	20
Institutions	8
Public & Others	5

Relative Performance



Bharat Heavy Electricals Limited — Hold

Key challenge is to prolong margin improvement

Bharat Heavy Electricals Limited (BHEL) reported revenue growth of 18.8% yoy in Q2'08 to Rs. 39.7 bn driven by 21.7% revenue growth in the power segment and 19.5% revenue growth in the industry business. EBITDA increased by 52.4% yoy and margin went up by 386 bps due to improved operating performance. Adjusted net profit (excluding the income tax refund of Rs. 3.2 bn) rose by 30.2% yoy to Rs. 4.7 bn.

In order to keep pace with the planned capacity addition in the XI plan, BHEL has chalked out plans to increase its manufacturing capacity from 10,000 MW by Dec 07 to 15,000 MW by Dec 09. The Company's Memorandum of Understanding (MOU) with Tamil Nadu Electricity board (TNEB) to set up the first two 800 MW super critical power project places the Company in a better position to face the stiff competition from the Chinese manufacturers. Moreover, BHEL is in talks with other state governments to replicate the TNEB model which will further augment BHEL's super critical order inflow. Hence, we believe that super critical orders will become the key growth driver for BHEL. Though, the operating margins have considerably improved during this quarter, we believe that it will be difficult for the Company to maintain this momentum given the possibility of slowdown in the order execution rate and the levy of penalties associated with the same. Further, another key challenge will be to keep off margin pressures in the wake of increased competition.

Currently, the stock is trading at a P/E of 38.4x FY08E and 29.1x FY09E. Our DCF based valuation does not indicate any major upside from the current levels; hence we maintain our Hold rating.

Key Figures (Standalone)

Quarterly Data	Q2'07	Q1'08	Q2'08	YoY%	QoQ%	H1'07	H1'08	YoY%
(Figures in Rs mn, except per share data)								
Net Sales	33,381	32,339	39,654	18.8%	22.6%	59,975	71,993	20.0%
EBITDA	4,563	3,107	6,952	52.4%	123.8%	7,745	10,059	29.9%
Net Profit	3,600	2,889	4,686	30.2%	62.2%	5,967	7,575	26.9%
Margins(%)								
EBITDA	13.7%	9.6%	17.5%			12.9%	14.0%	
NPM	10.8%	8.9%	11.8%			9.9%	10.5%	
Per Share Data (Rs.)								
EPS	7.4	5.9	9.6	30.3%	62.3%	12.2	15.5	26.9%

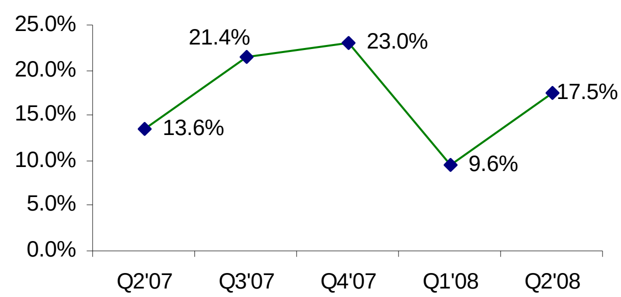
Result Highlights

The healthy revenue growth of 21.7% yoy in the power segment and 19.5% yoy in the industry segment led to 18.8% yoy increase in overall net sales in Q2'08. The contribution of both the segments in the total sales remained flat with Rs. 33 bn revenue from the power segment and Rs. 12.4 bn from the industry segment.

Reduced cost resulted in margin improvement

Despite soft revenue growth and the expected wage revision provisions, EBITDA recorded a sharp growth of 52.4% yoy to Rs. 7 bn and margin improved by 386 bps to 17.5%. The reason accountable to the growth is favourable operating performance driven by reduced other expenditure (down 172 bps), decreased staff cost (down 108 bps) and lower cost of raw materials (down 106 bps) reflecting the cost reduction measures adopted by BHEL.

EBITDA margin trend



Source: Company data, Indiabulls research

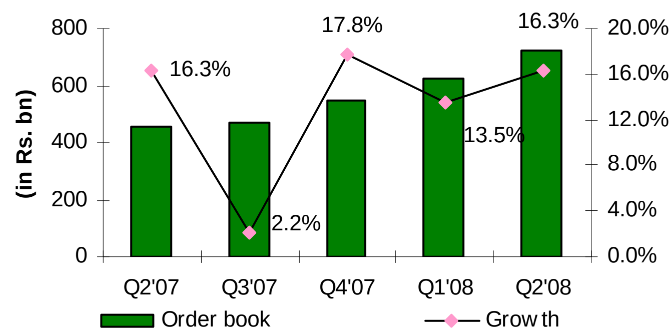
This quarter's healthy performance is also reflected in the EBIT margin improvement of 180 bps in the power business to 23.1% (based on gross sales) and 187 bps in the industry segment to 14.1% (based on gross sales). Improved margin performance by both the segments' resulted in overall EBIT margin of 15.8% (up 411 bps).

In absolute terms, adjusted net profit grew by 30.2% yoy to stand at Rs. 4.7 bn and margin advanced by 103 bps to 11.8%. The adjustment was on account of: (a) income tax refund of Rs. 2,675 mn recorded in other income, (b) Rs. 174 mn in associated interest expense, and (c) Rs. 310 mn related to prior period taxes.

Outstanding order book grew by 58.9% yoy

The outstanding order book as at the end of the quarter stands at Rs. 726 bn (up 58.9% yoy), which translates into the 4.2x FY07 revenues reflecting an execution cycle of approximately 4 years.

Order book growth



Source: Company data, Indiabulls research

Key Events

- BHEL inked an MOU with the Tamil Nadu Electricity board (TNEB) to form a JV to establish two 800 MW supercritical thermal power projects. With the capital outlay of Rs. 85 bn it will be the first supercritical power project in the country.
- BHEL emerged as the sole bidder for the Andhra Pradesh government's 1,600 MW power project at Krishnapattnam, worth Rs. 7 bn.
- The Government has approved BHEL's proposal to acquire Bharat Heavy Plate & Vessels Ltd (BHPV), Visakhapatnam, as a subsidiary. BHEL has to initially invest Rs. 2.7 bn as capex apart from investing Rs. 340 mn as equity in the company.
- Outbidding the Chinese equipment suppliers BHEL bagged an order worth Rs. 21 bn to supply steam generators and turbines for the upcoming Maithon Right Bank thermal power project.

Key Risks

Increased competition especially from Chinese manufacturers, delays in execution of projects, fluctuations in prices of raw materials, and failure of projects involving super critical technology (considering BHEL's relative inexperience in this field) are the potential risks which may impact our rating.

Outlook

Super critical orders to be the key growth driver

BHEL's MOU with TNEB to set up the first two 800 MW super critical power project, places the Company in a better position to face the stiff competition from Chinese manufacturers. Additionally, the government is now planning to relax the norms related to fiscal incentives under the mega power policy, which would facilitate BHEL in getting bulk orders for the 800 MW super critical thermal power plants. Considering the Indian government's strong support, we believe that super critical orders will become the key growth driver for BHEL in the long run. Further, BHEL's acquisition of BHPV, will help it to expand capacity and support the Company's objective of achieving Rs. 450 bn in revenue by FY12. Though, the operating margins have considerably improved during this quarter, we believe that it will be difficult for the Company to maintain this momentum given the possibility of slowdown in the order execution rate and the levy of penalties associated with the same. Further, another key challenge will be to hive-off margin pressures in the wake of increased competition.

Currently, the stock is trading at a P/E of 38.4x FY08E and 29.1x FY09E. Our DCF based valuation does not indicate any major upside from the current levels; hence we maintain our Hold rating.

Key Figures (Consolidated)

Year to March	FY05	FY06	FY07	FY08E	FY09E	CAGR (%)
(Figures in Rs mn, except per share data)						(FY07-09E)
Net Sales	95,271	133,740	172,375	231,000	298,065	31.5%
EBITDA	16,683	25,986	36,053	49,552	65,279	34.6%
Net Profit	9,856	16,779	24,277	32,457	42,758	32.7%
Margins(%)						
EBITDA	16.8%	19.0%	20.5%	21.1%	21.6%	
NPM	9.9%	12.3%	13.8%	13.8%	14.2%	
Per Share Data (Rs.)						
EPS	20.1	34.3	49.6	66.3	87.3	32.7%
PER (x)	19.1x	32.8x	51.3x	38.4x	29.1x	

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