BGR Energy

Stage is set, execution remains the key

CMP	TARGET	RATING	RISK
Rs 466	Rs 581	BUY	HIGH

BGR Energy (BGR), one of India's leading BoP (balance of plant) companies in the power sector, has recently made a successful transition into full-service EPC (engineering, procurement and construction), winning two turnkey contracts worth Rs 80bn during FY09. It now intends to enter the market of BTG (boiler, turbine, generator) supply by establishing a 4,000–5,000MW manufacturing facility in India. Considering the expanding scope of business and Rs 122bn power project order book, we believe the stock offers multi year growth opportunity. We expect the sales and earnings CAGR of 41% and 40% respectively over FY08-FY11E. Buy.

Strong industry potential: India's power sector harbours significant business opportunities given the quantum leap in generation capacity planned by the government over the next 8–10 years. According to the Ministry of Power (MoP), India has targeted to build ~78GW of power generation capacity in the course of the 11th Five Year Plan from 2007 to 2012, and ~100GW in the subsequent plan ending 2017. This opens up a tremendous market for BGR.

Earning outlook healthy: BGR holds a large order book of Rs 122bn in the power project division, which is 6.3x its FY09 sales. All the necessary project approvals are in place, with term loan and working capital funding tied up. This mitigates the execution risk to a large extent. Considering the industry growth prospects and BGR's strong credentials, we expect order flows in the power project division to remain robust, both in EPC and BoP. This would support a sales and earnings CAGR of 41% and 40% respectively over FY08-FY11E.

Evolving into a full-fledged EPC player: BGR has bagged two major EPC contracts worth Rs 80bn during FY09 – a major breakthrough in the company's drive to evolve from a BoP supply company to a full-service EPC play. At present the company sources its BTGs for EPC contracts from China-based Dong Fang. It now intends to enter the market of BTG supply by establishing a manufacturing base in India through technical tie-ups with global majors. To this end, the company has signed an exclusive 20-year technology transfer agreement with US-based Foster Wheeler for the manufacture of subcritical and supercritical boilers from 100MW to 1,000MW. The company is also scouting for a global partner for its turbine venture.

Initiate with Buy and target of Rs 581: The stock is currently trading at a P/E of 13.6x on FY11E earnings, which is ~40% discount to BHEL's valuation. Considering BGR's expanding BoP and EPC presence in the high-growth power sector, we believe this discount should narrow – we have valued the stock at 17x FY11E earnings, which is a 26% markdown to BHEL. We initiate coverage on BGR with a Buy rating and a target price of Rs 581.

BSE	NSE	BLOOMBERG
532930	BGRENERGY	BGRL IN

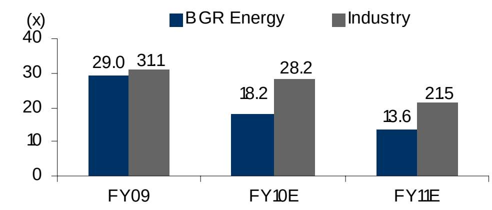
Company data

Market cap (Rs mn / US$ mn)	33,552 / 719
Outstanding equity shares (mn)	72
Free float (%)	18.7
Dividend yield (%)	0.6
52-week high/low (Rs)	550 / 107
2-month average daily volume	117,082

Stock performance

Returns (%)	CMP	1-mth	3-mth	6-mth
BGR Energy	466	(6.5)	4.5	46.9
BSE Cap Gds	14,059	4.6	4.0	6.4
Sensex	17,402	1.2	4.2	21.3

P/E comparison



Valuation matrix

(x)	FY09	FY10E	FY11E	FY12E
P/E @ CMP	29.3	18.2	13.6	11.8
P/E @ Target	36.5	22.7	17.0	14.8
EV/EBITDA @ CMP	20.4	11.0	7.9	6.8

RHH vs consensus

Parameter	FY10E		FY11E	
	RHH	Cons	RHH	Cons
Sales (Rs mn)	31,029	27,416	42,846	39,246
EPS (Rs)	25.6	24.6	34.2	33.4

Financial highlights

(Rs mn)	FY09	FY10E	FY11E	FY12E
Revenue	19,303	31,029	42,846	53,747
Growth (%)	*26.9*	*60.7*	*38.1*	*25.4*
Adj net income	1,156	1,843	2,460	2,834
Growth (%)	*28.7*	*59.4*	*33.5*	*15.2*
FDEPS (Rs)	15.9	25.6	34.2	39.4
Growth (%)	*18.5*	*59.4*	*33.5*	*15.2*

Profitability and return ratios

(%)	FY09	FY10E	FY11E	FY12E
EBITDA margin	10.8	12.4	12.5	11.6
EBIT margin	10.4	12.0	12.0	11.2
Adj PAT margin	6.0	5.9	5.7	5.3
ROE	22.1	28.6	29.8	27.4
ROIC	20.5	19.9	16.1	14.4
ROCE	14.8	17.6	17.0	15.5

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Investment rationale

India's power sector set for a surge

India's power sector harbours significant business opportunities given the quantum leap in generation capacity planned by the government over the next 8–10 years. According to the Ministry of Power (MoP), India plans to build ~78GW of power generation capacity in the course of the 11th Five Year Plan from 2007 to 2012, and ~100GW in the subsequent plan ending 2017. This opens up a tremendous market for BGR Energy (BGR), which is one of the leading BoP players in the country and has recently made a successful transition into full-service EPC.

Power sector outlay of Rs 6,665bn in the 11th plan to build 78GW of capacity

11th plan outlay for power doubled to Rs 6,665bn

India is amongst the world's largest power producing and consuming nations, with a generation capacity of ~154GW as of October '09. However, supply falls woefully short of demand, leaving the country with a severe power deficit, pegged at 12–15% of consumption. In order to sustain the desired pace of economic growth, the Indian government has identified power as a key focus area and earmarked over 30% of budgeted infrastructure spending in its 11th plan for the sector at Rs 6,665bn. Of this, the Centre is expected to contribute 38.3% and States 33.9%. In this way, the government aims to achieve its target of 'Power for All' by 2012 and elevate India's per capita consumption from 704kWh to 1,000kWh. This would still be below the world average.

Capacity addition rate to outpace past plans

India has been slow to augment generation capacity with an average addition rate of 5.6% per year during the past three plan periods. Only 51% of the targeted additions have been made during these three plans, at 56.6GW, against the cumulative goal of 111.9GW. The current plan envisages a massive infusion of fresh capacity totalling 78.7GW by FY12. We expect a stronger achievement run rate this time around given that over 80GW of power projects are already under implementation. We peg additions at 55–60GW during the 11th plan, which would be the highest during any plan period.

Capacity addition run rate dismal at ~51% of targets over past three plans…

Fig 1 - Plan-wise achievement rate for power capacity addition

Plan	Target capacity(MW)	Actual capacity (MW)	Achievement (%)
1st	1,300	1,100	84.6
2nd	3,500	2,250	64.3
3rd	7,040	4,520	64.2
4th	9,264	4,579	49.5
5th	12,499	10,202	81.6
6th	19,666	14,226	72.3
7th	22,245	21,401	96.2
8th	30,538	16,423	53.8
9th	40,245	19,015	47.5
10th	41,110	21,180	51.8

Source: CEA

…but stronger pace set in 11th plan; we expect 70–75% of the target to be met

Fig 2 - Capacity addition programme during the 11th plan

Sector (MW)	Thermal	Hydro	Nuclear	Total
Central	24,840	8,654	3,380	36,874
State	23,301	3,482	-	26,783
Private	11,552	3,491	-	15,043
Total	**59,693**	**15,627**	**3,380**	**78,700**

Source: CEA, RHH

Additions to be back-ended with ramp up in 2011–12

Capacity augmentation has been sluggish during the first two years of the current plan and only 23.5% (18.5GW) of the target has been met so far. However, with the renewed government thrust on the sector and imperatives of economic growth, we expect an accelerated momentum during the final two years of the plan period, translating to the set up of 55–60GW or 70–75% of planned capacity. The ambitious Ultra Mega Power Projects (UMPP) will mainly contribute to capacity augmentation in the 12th plan, when the government aims to add ~100GW (only a few UMPP units likely to be commissioned during the current plan period).

Only 23.5% of the planned 78.7GW added so far but we see ramp up in last two years of the current plan

Fig 3 - Capacity addition so far (October '09)

Sector (MW)	Target (MW)	Actual (MW)	Achievement (%)
2007-08	16,335	9,263	56.7
2008-09	11,061	3,454	31.2
2009-10*	14,507	5,767	39.8
Total	**41,903**	**18,484***	**44.1***

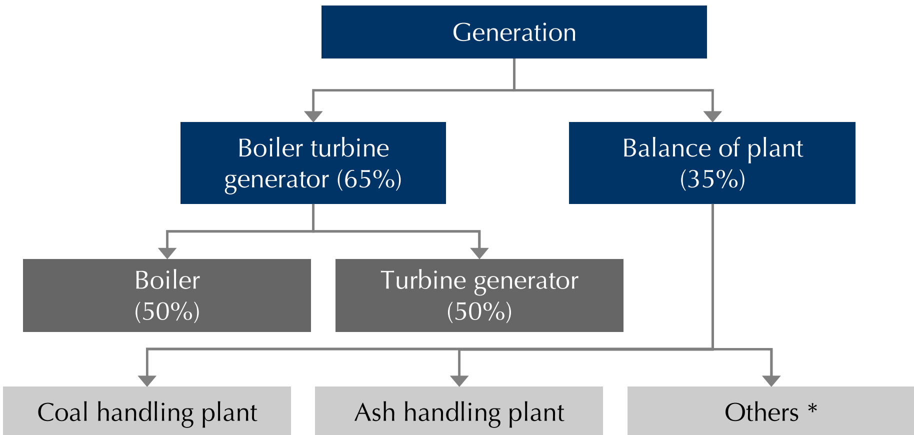
Source: CEA, RHH ** Achievement till October 2009*

BoP market size estimated at Rs 1,320bn–1,509bn in 11th plan

With ~35–40% of the cost of constructing a power plant coming from BoP, the total market size for this segment stands at ~Rs 1,320bn–1,509bn during the 11th plan and ~Rs 1,750bn during the 12th plan. The private sector is expected to execute 19.1% (15GW) of power projects during the 11th plan and a sizeable proportion during the 12th plan. Unlike the central or state utilities, private players prefer to give out full BoP/EPC contracts as they seek to avoid dealing with multiple vendors.

BOP opportunity stands at Rs 1,320bn–1,509bn during 11th plan

Fig 4 - Generation system components



Source: Crisil **Note: Others includes condensers, cooling towers, boiler feed pumps, hot well, HP-LP heaters, etc*

BGR Energy – Strong credentials in BoP

BGR is one of India's leading suppliers of BoP components for the power sector. BoP accounts for ~35–40% of power plant components and includes coal and ash handling plants, condenser cooling towers and boiler feed pumps amongst others. A shortage of vendors with BoP capabilities is the principal reason for frequent power plant commissioning delays in India. BGR's track record and credentials in this space make it one of the preferred suppliers to power producers.

Manufactures 40–50% of BoP products in-house – a clear cost and quality advantage over rivals

Wide breadth of services lends a competitive edge

BGR has the expertise and infrastructure to execute ~40–50% of power plant BoP packages requirement in-house. Proficiency across a range of BoP segments serves as a key advantage over competitors as it minimises dealings with multiple vendors or sub-vendors, enabling BGR to meet stringent timelines and ensure quality standards. For clients as well, BGR's status as a multi-package supplier makes it an attractive choice as vendor. Over the years, the company has demonstrated its capability to manage contracts ranging from 23MW to 600MW, besides being qualified to undertake big-ticket power projects.

Competitive landscape in BOP space

Segment	Key competitors
BoP EPC	BHEL, Punj Lloyd, Tata Projects, Reliance Infra
Chimney and cooling towers	Gammon India, Paharpur Cooling
Coal handling plants	L&T, Elecon Engineering
Ash handling plants	Indure
Demineralised water and water PT plants	Driplex Water

Source: CEA, RHH

Fig 5 - BoP product portfolio (in-house systems) – BGR

Sr.	BoP Packages	Sr.	BoP Packages
1	Design & Engineering of Civil, Electrical and Mechanical Systems	11	Effluent Treatment Plant
2	Civil Works – Chimney and Natural & Induced Draft Cooling Tower	12	Demineralisation Plant
3	On-line Condenser Tube Cleaning System	13	Coal Handling System
4	Desalination Plant including RO System	14	Ash Handling System
5	Fabrication of Columns & Structures	15	Plant Piping System
6	Rubber Cleaning Balls for Condenser	16	Air Cooled Condenser
7	Gas Conditioning & Metering Skid	17	Welded Finned Tubes
8	Heat Recovery Steam Generator	18	Air Fin Cooler
9	Condensate Polishing Plant	19	Debris Filter
10	Substation and Switchyard	20	Deaerator

Source: Company, RHH

Five projects worth close to Rs 58bn under execution

BGR is currently executing five BoP projects valued at Rs 57.5bn. It recently completed the 500MW thermal power station at Vijaywada, Andhra Pradesh while another 500MW facility at Kakatiya in Andhra Pradesh is nearing completion. Two other projects – a 500MW plant at Khaperkheda in Maharashtra and the 500MW Kothagudem unit in Andhra Pradesh – are also progressing well. BGR is looking at completing its scope of work by July and September '10 respectively.

Bagged two BoP contracts worth Rs 32.6bn in Q2FY10

In the past quarter, the company has bagged two new contracts at Chandrapur in Maharashtra and Marwa in Chhattisgarh worth Rs 16.3bn each. The 2x500MW Chandrapur project was awarded in July '09 for turnkey EPC of BoP and is to be completed in 33 months. BGR won this contract amid stiff competition from other major BoP players. The 2x500MW Marwa project in Chhattisgarh was awarded in August '09 and includes a price variation clause. The project also witnessed competition from other major BoP players.

Fig 6 - Turnkey EPC of BoP portfolio

Sr	Customer	Project	State	Value (Rs mn)
1	CSPGCL	2x500MW Marwa TPP	Chhattisgarh	16,330
2	Maha Genco	2x500MW Chandrapur TPP	Maharashtra	16,320
3	Maha Genco	1x500MW Khaperkheda TPP	Maharashtra	9,980
4	AP Genco	1x500MW Kothagudem TPP	Andhra Pradesh	7,930
5	AP Genco	1x500MW Kakatiya TPP	Andhra Pradesh	6,949
	Total			**57,509**

Source: Company, RHH

BGR capable of handling seven projects concurrently, which can be scaled up

With a workforce of more than 1,600 employees, BGR is capable of handling seven projects concurrently (BoP and full-service EPC), which can be increased as required. The company will augment its workforce by as much as 30% over the next two years to expand its order intake capabilities.

12% of project awards under 11th plan still pending

BoP awards of 12% pending in 11th plan

Thermal power projects under construction in the 11th plan are estimated to generate a total of 615 BoP orders. As on May '09, 540 contracts (88%) have been awarded while 75 (12%) BoP orders are still pending. The largest number of orders was secured by Paharpur Cooling (50), followed by Gammon India (46), BHEL (35), BGR (27), and L&T (21). BGR and BHEL have fairly diverse portfolios, while Paharpur Cooling and Gammon dominates the cooling tower and chimney space respectively. With significant capacity additions envisaged in the 12th plan as well, we see a multi-year growth opportunity for BGR.

Fig 7 - Status of BoP orders based on 11th plan targets (as on May '09)

BoP	Required	Placed	To be placed
Coal Handling Plant (CHP)	67	56	11
Ash Handling Plant (AHP)	68	59	9
Demineralised (DM) Water Plant	71	58	13
Cooling Tower	143	133	10 (21)
Chimney	116	109	7 [15]
Fuel Oil (FO) System	74	62	12
PT Plant	76	63	13
Total	**615**	**540**	**75**

Source: CEA   ** () = number of Cooling Tower' [] = number of Chimneys*

Fig 8 - Tentative requirement of BoP in 12th plan.

Name of BOP	Required
Coal Handling Plant (CHP)	70
Ash Handling Plant (AHP)	70
Demineralised (DM) Water Plant	70
Cooling Tower	70(148)
Chimney	77[148]
Fuel Oil (FO) System	70
PT Plant	70

Source: CEA, RHH   ** () = number of Cooling Tower' [] = number of Chimneys*

Fig 9 - Break-up awarded BoP packages in the 11th plan

Company	Coal Handling Plant	Ash Handling Plant	Demineralised Water Plant	Cooling Tower	Chimney	Fuel Oil System	Water PT Plant	Total BoP Plants
Alstom Projects			1	1	2	1	1	6
BGR Energy	2	3	5	4 (4)	4 [4]	4	5	27
BHEL	1	1	3	2 (4)	3 [9]	15	2	35
Driplex Water Engg			10				9	19
Elecon Engg	5							5
Gammon India				17 (30)	13 [16]			46
Hamon Sriram Cottrel				2				2
Indure	1	12		1				14
ION Exchange			5				4	9
Kirloskar Bros			1				3	4
L&T	7		2	2 (4)	3 [6]		2	21
Mcnally Bharat	1	3			1 [1]			5
NBCC				2	10			12
Paharpur Cooling				25 (49)	1 [1]			50
Punj Lloyd	1	1	1	1 (2)	1 [1]	1	1	8
Reliance Infrastructure	1	1	1	1 (2)		1	1	7
Siemens			1	1	1	1	1	5
Simplex Infra					6 [6]			6
Sunil Hitech	2							2
Techno Electric						4		4
Thermax			4				4	8
TPL	3	3	2	2	2	2	2	16
TRF	2							2
Triveni Engg			3				3	6
Others								221
Total								**540**

Source: CEA, RHH

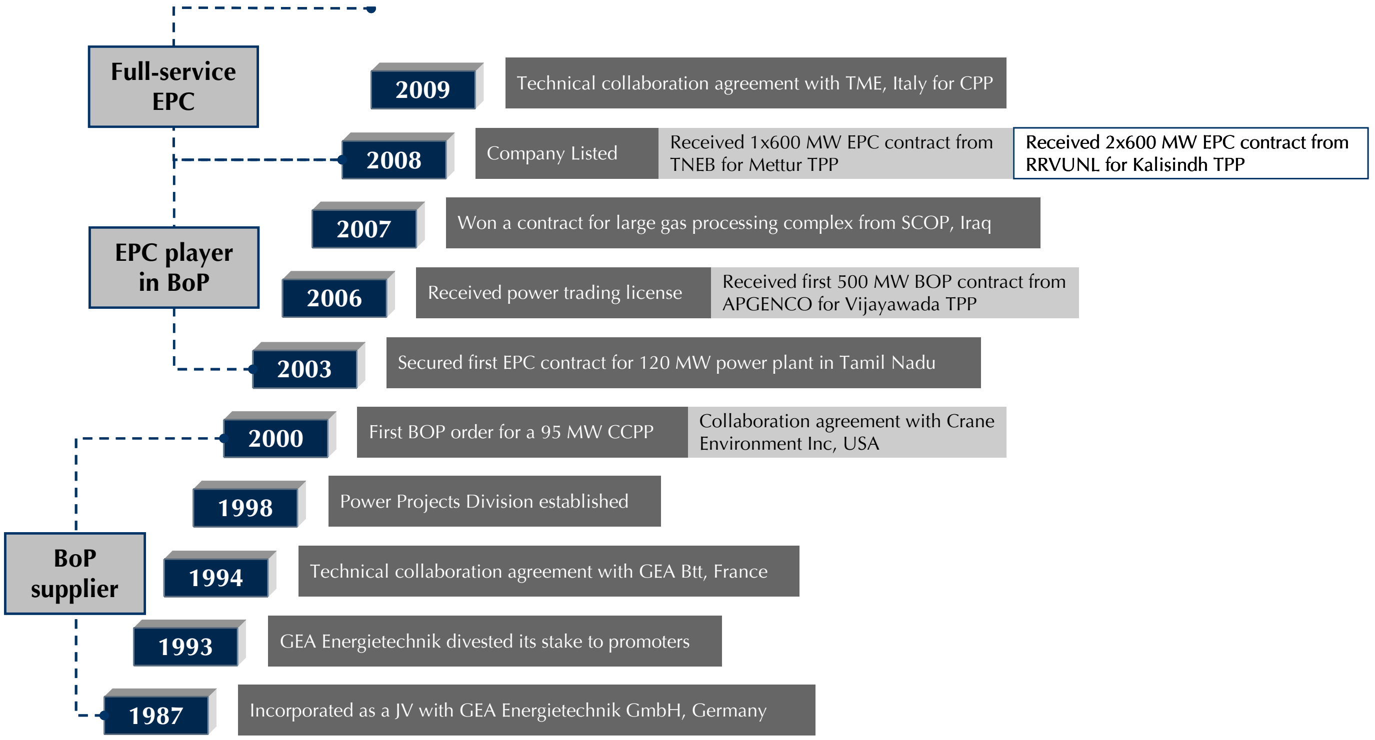
** Number in ( ) indicates number of Cooling Towers while number in [ ] indicates number of Chimneys*

Full-service EPC – the next leg of growth

Graduating from BoP to EPC of BoP to full-service EPC

BGR started operations as a single product manufacturing unit. From there it graduated to multi product manufacturing, but began to move up the value chain from 2003 onwards by undertaking turnkey erection, procurement and construction (EPC) works. In FY09, the company achieved a major breakthrough in its bid to evolve from EPC in BoP to full-service EPC, winning two prominent contracts in the segment worth Rs 80bn. While it has outsourced the boiler turbine generator (BTG) orders for these contracts, the company is planning to develop in-house manufacturing capabilities for the same over the next couple of years.

Fig 10 - BGR – key milestones



Source: Company

Breakthrough in FY09 with two major full-service EPC orders worth Rs 80bn

FY09 orders to be executed in next three years

The two turnkey EPC orders secured in FY09 comprise a 1x600MW contract at Mettur, Tamil Nadu worth Rs 31bn and a 2x600MW project at Jalawar, Rajasthan worth Rs 49bn. Both are to be executed over a period of 39–42 months. BGR has placed the BTG orders for these projects with China's Dong Fang, and set up an office in China to monitor progress on this front.

Many of the existing power projects are expected to start generating revenues from the current year. We expect the revenue from power projects to make up 92.4% (Rs 28.5bn) and 93.9% (Rs 40.2 bn) of the company's topline during FY10 and FY11 respectively. This will be driven by EPC contributing Rs 20bn and Rs 27bn respectively.

Technology transfer agreement with Foster for BTG foray

Foray into BTG manufacture on the cards

In order to gear its in-house capabilities towards full-service EPC, the group intends to enter the business of BTG manufacturing. It has drawn up plans for a 4,000–5,000MW boiler manufacturing capacity likely in southern India at a equity capex of Rs 6bn–7bn, with an estimated construction timeframe of 18–24 months. To facilitate this foray, an exclusive 20-year licence agreement has been signed with US-based Foster Wheeler for transfer of technology related to the manufacture of subcritical and supercritical boilers ranging from 100MW to 1,000MW.

Fig 11 - Capacity augmentation in supercritical BTG space

Company / JV	Boiler (MW)	Turbine (MW)
BHEL	10,000	10,000
L&T – Mitsubishi Heavy Industries	4,000	4,000
Bharat Forge – Alstom	-	5,000
JSW – Toshiba	-	3,000
GB Engineering – Ansaldo	2,000	-
BGR	4,000	4,000
Total	**20,000**	**26,000**

Source: Infraline, Company, RHH

NTPC bulk tenders a key opportunity

Domestic manufacturing a must to bid for NTPC's bulk tenders

Out of the 43 supercritical units ordered so far, Indian companies have bagged only 4 with Chinese companies securing the lion's share at 26 units. In order to reverse this trend, the government has made domestic manufacturing a mandatory qualification for participation in bulk tenders invited by NTPC worth Rs 210bn–250bn. Accordingly, a number of foreign entities have tied up with domestic players to gain eligibility. With delays in the bid process for bulk tenders, BGR is looking forward to participating in these tenders. Further, NTPC is expected to float another lot of bulk tenders for five units of 800MW each by March '10 which BGR would pursue.

Fig 12 - Supercritical order status

Sector	Total	Boiler (MW)					Turbine (MW)			
		India	China	Korea	Russia	Italy	India	China	Japan	Russia
Central	8	2	-	3	3	-	2	-	-	6
State	2	2	-	-	-	-	2	-	-	-
Private	33	-	26	5	-	2	-	26	5	2
Total	**43**	**4**	**26**	**8**	**3**	**2**	**4**	**26**	**5**	**8**

Source: Infraline, RHH

L&T's boiler facility to be operational by December '09

L&T is likely to be the first amongst the prospective manufacturers to start operations, with its boiler facility scheduled for commencement in December '09, while its turbine manufacturing facility is expected to start operations in the next 6–9 months.

Strong order book and project pipeline

Order book of Rs 122bn with power projects accounting for a 95% share

BGR holds a cumulative order book of Rs 122bn (6.3x FY09 revenue) to be executed over the next 3–4 years. The power projects division accounts for 95% of the orders, and has all the necessary project approvals in place, with term loan and working capital funding tied up. This mitigates the execution risk to a large extent. Considering the large investments planned in India's power sector, we expect order inflow momentum to remain robust, both in the EPC and BoP space. This would support a sales and earnings CAGR of 41% and 40% respectively for BGR over FY08-FY11E.

Cumulative order book of Rs 121.8bn

Apart from power projects, BGR operates in the oil & gas equipment, air fin cooler, electrical project and environment engineering segments. The company's order book is bifurcated as follows: Rs 115.8bn in power projects (BoP and full-service EPC combined), Rs 4.9bn in oil & gas equipment and ~Rs 1.1bn from other divisions. The strong order book position enables BGR to place bids selectively and ensure that margins are not compromised.

Domestic contracts comprise a 96% share (Rs 116.9bn) with the balance coming from exports. The company is now looking to expand its overseas business, where it has a track record of executing over 150 contracts in 45 overseas markets.

Orders largely concentrated in domestic market

Fig 13 - Order book position as on 30 September 2009

Division (Rs mn)	Domestic	International	Total
Power Projects	115,819	-	115,819
Oil & Gas Equipment	43	4,876	4,919
Air Fin Cooler	650	41	691
Electrical Projects	340	-	340
Environment Engineering	24	0	24
Total	**116,876**	**4,917**	**121,793**

Source: Company, RHH

Fig 14 - Projects under execution

Sr	Division	Customer	Project details	Value (Rs mn)	Scope
1	Power projects	RRVUNL	2x600MW Kalisindh TPP, Jalawar, Rajasthan	49,000	EPC of power plant
2	Power projects	TNSEB	1x600MW Mettur TPP, Tamil Nadu	31,000	EPC of power plant
3	Power projects	CSPGCL	2x500MW Marwa TPP, Chhattisgarh	16,330	Turnkey EPC of BoP
4	Power projects	Maha Genco	2x500MW Chandrapur TPP, Maharashtra	16,320	Turnkey EPC of BoP
5	Power projects	Maha Genco	1x500MW Khaperkheda TPP, Maharashtra	9,980	Turnkey EPC of BoP
6	Power projects	AP Genco	1x500MW Kothagudem TPP, Andhra Pradesh	7,930	Turnkey EPC of BoP
7	Power projects	AP Genco	1x500MW Kakatiya TPP, Andhra Pradesh	6,949	Turnkey EPC of BoP
8	Oil & Gas	SCOP, Iraq	Akas & Al-Mansuria Gas Processing Projects	3,864	EPC & supply of gas gathering station
9	Oil & Gas	SCOP, Iraq	New Najaf Oil Depot	979	EPC & supply of oil storage tanks
10	Oil & Gas	SCOP, Iraq	New Aumara Oil Products Depot	446	EPC & supply of oil products storage tanks
11	Oil & Gas	SCOP, Iraq	Karbala Oil Products Depot	411	EPC & supply of oil storage tanks
12	Electrical Projects	VA Tech Hydro	Teesta Low Dam III, West Bengal	351	Design, manufacture, supply, erection & commissioning
13	Electrical Projects	NPCIL	Kalpakkam – Power Distribution	270	Design, engineering, supply, erection, testing & commissioning
14	Electrical Projects	NPCIL	Kalpakkam – Power Distribution	255	Design, engineering, supply, erection, testing & commissioning
15	Electrical Projects	Karnataka Power	Substation & Transmission lines	209	Supply & erection on partial turnkey basis including civil work
	Total			**144,294**	

Source: Company, RHH

Robust pipeline of new projects

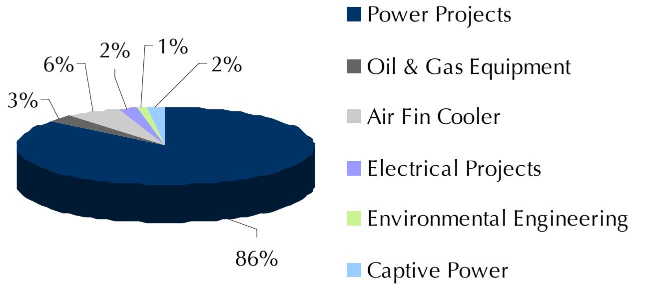
The company deals with major state electricity boards (SEB) like Andhra Pradesh, Tamil Nadu, Rajasthan, Maharashtra, Chhattisgarh and Madhya Pradesh. Recently, BGR won two contracts at Chandrapur in Maharashtra and Marwa in Chhattisgarh, notching up a combined value of Rs 32.6bn. New projects are expected to be tendered by SEB's in Rajasthan, AP etc over the next few months. In the air fin cooler division, three orders worth Rs 600mn, which had been delayed by 3–6 months, were bagged by the company recently.

Expect revenue CAGR of 62% in power division over FY08-FY11 to Rs 40.2bn

Buoyant growth outlook

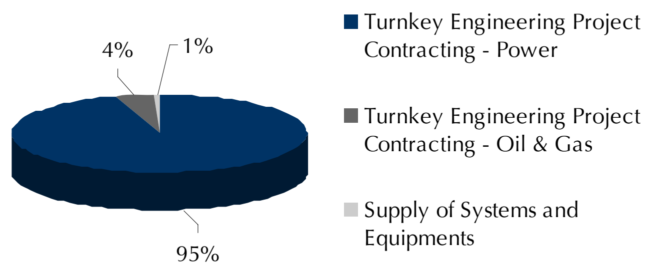
With its order book at 6.3x FY09 sales, BGR will concentrate heavily on project execution and be very selective in taking up further projects. Most of its contracts are with SEBs where projects have financial closure. We expect the power projects division to register a strong revenue CAGR of 63.2% over FY08–FY11E to Rs 40.2bn led by the full-service EPC business.

Fig 15 - Revenue breakup for FY09



Source: Company, RHH

Fig 16 - Order backlog as on 30 September 2009



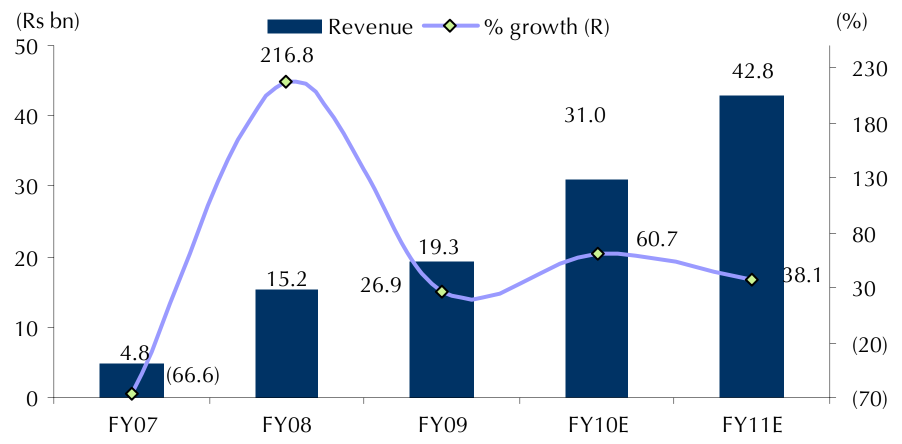
Source: Company, RHH

Financial overview

Expect sales and earnings CAGR of 41% and 40% respectively over FY08-FY11E

BGR has registered impressive sales CAGR of 100% from Rs 4.8bn FY07 to Rs 19.3bn in FY09. This was mainly driven by a scale-up in the project divisions, which saw a sales CAGR of 130% from Rs 3.3bn to Rs 17.3bn during the same period. The product business has clocked a modest CAGR of 35.6% to Rs 1.9bn in FY09. We expect this pattern of growth to continue, with a 46.1% CAGR from the projects business and a 3.4% growth in the products business over FY08-FY11E. The transition from BoP supplier to full-service EPC player will underpin growth in the project segment. We expect the company to register a sales and earnings CAGR of 41% and 40% respectively over FY08-FY11.

Fig 17 - Revenue growth



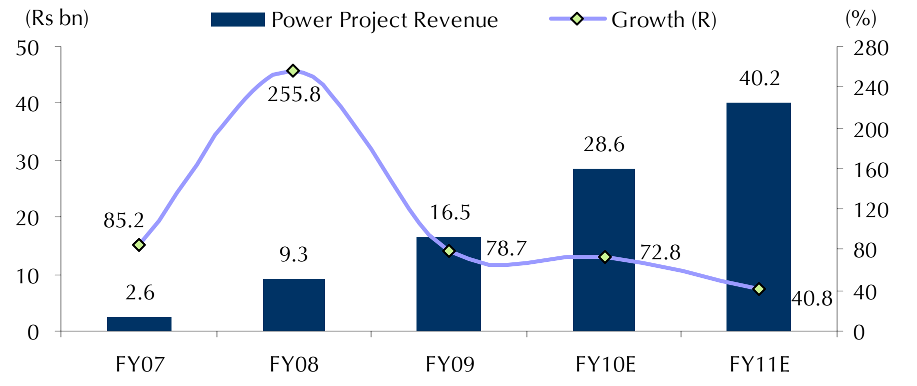
Source: Company, RHH *FY07 nos are adjusted to 12 month period

Power projects to lead the way

BGR's power projects division contributed 86% of total revenue (FY09) and 95% of the order book. Revenues from this division have increased at a 151% CAGR over FY07-FY09 as BGR graduated from small CPP (captive power projects) to large BoP contracts. The company won its first 500MW BoP job in 2006 followed by its first EPC contract during FY09. It currently has five BoP and two EPC contracts under execution in this division.

Scale up from small CPP to large BoP contracts led to revenue surge

Fig 18 - Revenues from power project division



Source: Company, RHH **FY07 nos are adjusted to 12 month period*

The power projects division is expected to clock revenue CAGR of 63.2% over FY08-FY11E. This will be driven by large EPC contracts which are estimated to deliver revenues of ~Rs 20bn in FY10 and ~Rs 27.2bn in FY11. On the BoP side, we expect significant revenue to accrue from the Rs 10bn Khaperkheda project in Maharashtra and the Rs 7.9bn Kothagudem project in Andhra Pradesh during FY10E and Rs 16bn Chandrapur in Maharashtra and Rs 16.3bn Marwa project in Chattissgrah FY11E respectively.

Oil & Gas equipment division holds promise

The company's oil & gas equipment division delivered revenue CAGR of 204.5% over FY07-FY09 and currently contributes 4% (Rs 4.9bn) of the total order book. At present, BGR is executing four projects in Iraq worth Rs 5.7bn for State Company for Oil Projects (SCOP). These are mainly EPC works along with orders for oil storage tanks. The execution timeline for its current orders of Rs 4.9bn is 18–24 months.

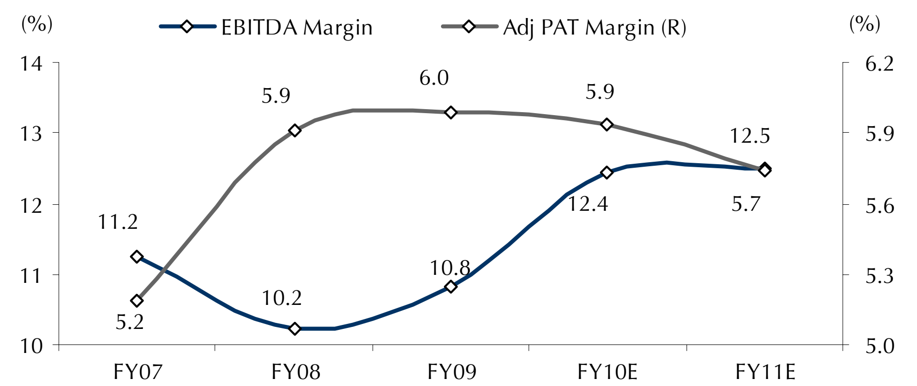
Accelerating demand for oil & gas in India along with a huge gas discovery by Reliance Industries off the Andhra Pradesh coast would create significant gas infrastructure requirements (storage tanks, gas transportation pipelines), benefiting players like BGR. With proven expertise in executing projects, BGR can tap into this segment in a big way.

Overall margins to improve

Benefits of softer commodity prices to improve margin performance

The company had seen a contraction in EBITDA margin over the last two years mainly on account of a declining revenue contribution from the product business, from 21.7% in FY07 to 10.0% in FY09. The concurrent ramp up in the projects division coincided with a phase of increasing commodity prices; this took a toll on margins as the division largely operates on fixed price contracts. We expect margins to improve substantially in FY10E as large orders such as the Kalisindh and Mettur were won when commodity prices were high. Now that prices have cooled off, the company stands to benefit. BGR has tied up ~70% of the raw material supply for major projects.

Fig 19 - Margin movement

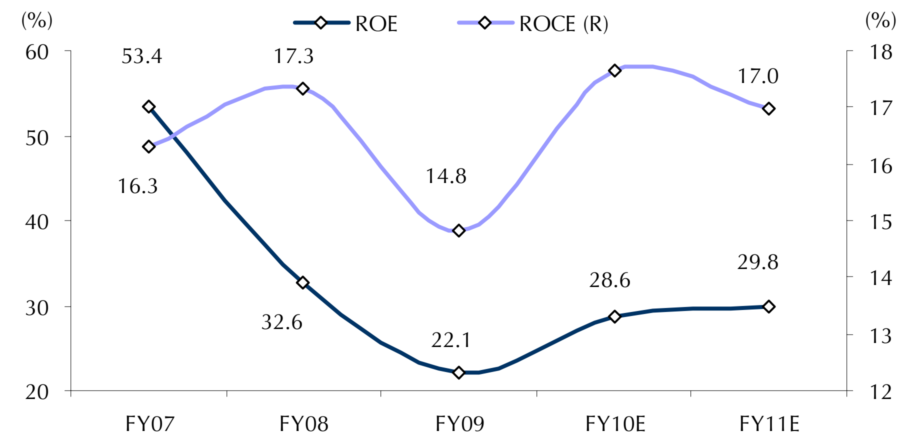


Source: Company, RHH

Return ratios to remain stable

BGR had come out with an IPO in December 2007. The company had raised Rs 4.3bn through the IPO. The fund raising diluted return rations in FY08 and FY09. We expect RoE to improve on the back of improved margin and better execution.

Fig 20 - Return ratio trend



Source: Company, RHH

Fig 21 - Return ratios

	FY08	FY09	FY10E	FY11E
PAT	898	1,156	1,843	2,460
Net worth	4,739	5,701	7,169	9,338
Average Net worth	2,751	5,220	6,435	8,253
RoE (based on average NW)	**32.6%**	**22.1%**	**28.6%**	**29.8%**
RoE (year end basis)	**19.0%**	**20.3%**	**25.7%**	**26.3%**
PAT + Interest x (1 – t)	1,125	1,671	2,902	3,821
Debt	5,027	7,090	11,063	14,903
Net worth	4,739	5,701	7,169	9,338
Capital employed	9,766	12,791	18,231	24,241
Average Capital employed	6,497	11,278	15,511	21,236
RoCE(based on average Capital Employed)	**17.3%**	**14.8%**	**18.7%**	**18.0%**
RoCE (year end basis)	**11.5%**	**13.1%**	**15.9%**	**15.8%**

Source: RHH

Fig 22 - Segmental break up

	Q1FY08	Q2FY08	Q3FY08	Q4FY08	Q1FY09	Q2FY09	Q3FY09	Q4FY09	Q1FY10	Q2FY10
Sales Mix										
Capital goods (%)	5.1	11.9	15.9	16.7	13.8	13.4	6.9	13.9	5.5	8.9
EPC (%)	94.9	88.1	84.1	83.3	86.2	86.6	93.1	86.1	94.5	91.1
Total sales (Rs mn)	**2,324**	**3,111**	**3,828**	**5,786**	**3,068**	**4,246**	**4,724**	**7,183**	**3,111**	**4,660**
EBIT Margin										
Capital goods (%)	(8.0)	9.0	20.1	21.0	16.7	15.4	19.3	3.7	10.8	13.0
EPC (%)	12.2	10.4	8.1	6.5	9.2	10.2	10.3	12.4	13.3	12.2

Source: RHH, Company

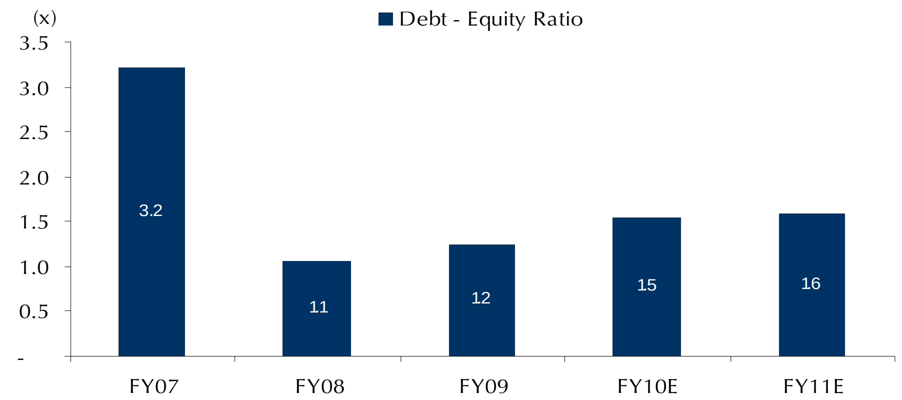
The revenue mix is shifting towards EPC due to huge order book in the EPC side. We expect the trend to continue as EPC order form bulk of the order book.

Gearing to increase as projects move into the advanced stages of execution

Debt/equity ratio to peak at 1.6x

In January '08, BGR raised Rs 4.3bn through its initial public offer. This equity infusion caused the debt/equity ratio to drop from 3.2x in FY07 to 1.1x in FY08. In FY09, gearing rose to 1.2x as more projects moved into the advanced stages of execution, thereby warranting increased working capital. Given the working capital intensive nature of business, we expect a further rise in leverage to 1.5x and 1.6x in FY10E and FY11E respectively.

Fig 23 - Debt/equity ratio



Source: Company, RHH

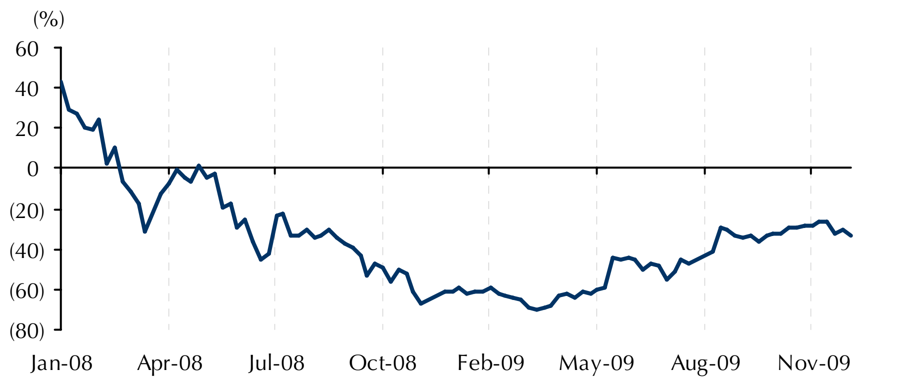
Valuation

Trading at average discount of ~36% to BHEL over past two years

Since its listing in January '08, BGR has been trading at an average discount of ~36% to its largest competitor, BHEL over the last 23 months (since BGR listing). The company listed at a premium of ~43% to BHEL which was subsequently erased. The discount to BHEL peaked during March '09, when it touched ~70%. It is currently trading at ~55% discount to BHEL's valuation. Considering BGR's expanding BoP and EPC presence in the high-growth power sector, we believe this discount should narrow – we have valued the stock at 17x FY11E earnings, which is a 26% markdown to BHEL. We initiate coverage on BGR with a Buy rating and a target price of Rs 581

We value BGR at a 26% discount to BHEL

Fig 24 - Premium / Discount to BHEL

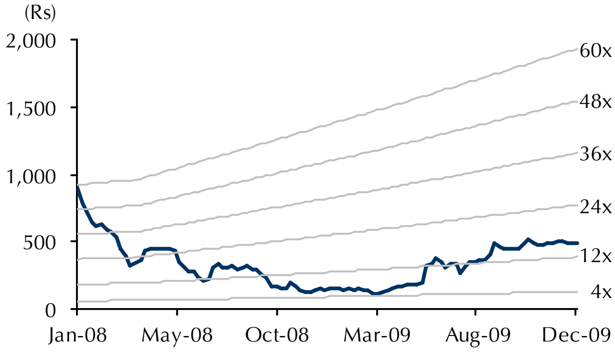


Source: RHH, Company

The RHH Infrastructure & Capital goods mid cap universe is trading at a PER of 14.3x FY11E earnings. The RHH universe is expected to have an earning CAGR of 19% over FY08-11E with a RoE and RoCE of 17% and 13% respectively in FY11E. Given the higher earning growth (40% over FY08-11E) and superior return ratios the stock deserves a premium.

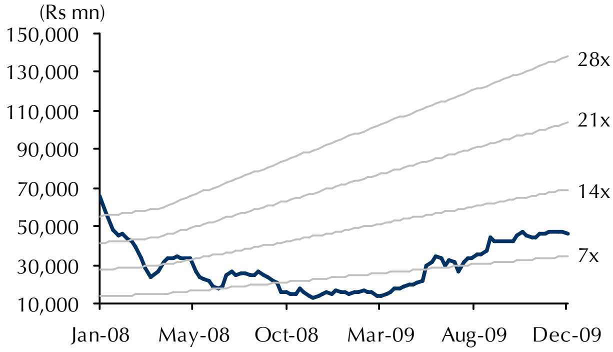
Valuation band analysis

1-year fwd P/E



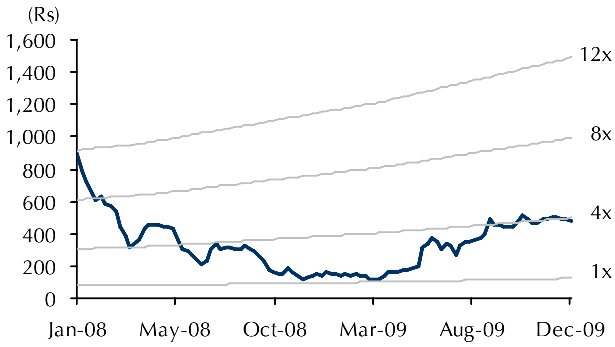
- Company listed at hefty valuations of 58.7x
- Re-rated upon entry in to full service EPC space from being a BOP player in July '08
- Heightened concerns of execution due to liquidity crisis led to the steep de-rating in the stock till February '09
- Continued order inflows resulting in increased visibility led to re-rating of the stock from March '09

1-year fwd EV/EBITDA



- With increasing raw material prices and fixed priced contract of the company led to de-rating due to margin concerns
- Similarly, the falling raw material prices led to the re-rating of the company from March '09

1-year fwd P/BV



- Historically, the stock has traded at an average of 3.5x one-year forward P/BV.
- At our target price, the stock would trade at 4.5x FY11E P/BV.

Key concerns

Execution delays could impact revenue

A majority of BGR's order book comes from three large projects. Any delay in execution timelines of these projects could impact the overall revenue outlook for the company in a significant way.

BTG manufacturing – capital intensive

BGR is looking at entering into the manufacture of BTG equipment which is highly capital intensive. It has already entered into a technological agreement for boilers and is scouting for partner for turbines. We expect the company to spend Rs 6bn–7bn for the equity portion for this purpose.

High working capital required

EPC is a high working capital business. BGR is required to block its capital for the purchase of equipment and advances towards civil work, among others. Further, most of BGR's contracts are with SEBs which usually have back-ended payment terms coupled with a retention amount.

Company profile

Leading player in BoP

Established in 1985, BGR is one of the leading players in BoP and EPC services for power projects. The company has in-house manufacturing facilities for many of the products used as part of BoP. It has divided its various businesses into seven divisions, with power projects in the forefront followed by the oil & gas equipment division.

Power projects

Power projects contribute 86% of the company's revenue (Rs 16.4bn in FY09) and 95% of the current order book. This division provides turnkey EPC and BoP services for coal-based thermal power plants and gas-based combined cycle plants, typically over 100MW. BGR completed its first contract in 2002 and was one of the pioneers of the BoP concept. It manufactures 40–50% of the products required for BoP projects in-house, providing a clear cost and quality advantage over its competitors. Its BoP business has developed over the years to the point where BGR is able to send bids directly to power generation companies in some cases. As an EPC contractor, the company began with a 120MW gas-based power plant for Aban Power Company in 2005. Since then, it has successfully completed several medium and large sized power projects.

Fig 25 - Completed projects

Sr	Customer	Project details	Value (Rs mn)	Scope
1	Aditya Cements	23MW at Chittorgarh, Rajasthan	444	BoP of power plant
2	Tamil Nadu SEB	95 MW – Ph I at Valuthur, Tamil Nadu	594	BoP of power plant
3	Tamil Nadu SEB	92.2 MW – Ph II at Valuthur, Tamil Nadu	3,553	EPC of power plant
4	Aban Power Co.	120 MW at Karuppur, Tamil Nadu	2,697	EPC of power plant
5	Rajasthan SEB	330 MW at Dholpur, Rajasthan	2,095	BoP of power plant
6	Andhra Pradesh SEB	500 MW at Vijayawada, Andhra Pradesh	5,788	BoP of power plant

Source: Company, RHH

Captive power projects

This division was carved out of the power projects division to address the specific market of captive power up to 150MW. It can build coal-based, combined cycle and biomass power plants, catering to the power needs of various industries such as steel, cement, textiles, paper, pharmacy, refineries, chemicals, and petrochemicals.

Oil and Gas equipment

This division has been successful in securing orders for oil & gas equipment from Indian and overseas clients. It is currently executing four contracts from State Company for Oil Projects (SCOP) in Iraq with orders totalling US$ 113mn. These are mainly EPC works along with orders for oil storage tanks. The division has an order backlog of Rs 4.9bn at present.

Fig 26 - Scope of oil and gas division

Process Equipment Package and Systems	
Indirect Water Bath Heater	Filter Separators / Dry Gas Filters
Gas Conditioning	Pipeline Equipment - Pig Launchers/Receivers
Regulating & Metering Systems	Compressor Packaging
Knockout Drums / Scrubbers	Storage Tanks

Source: Company, RHH

Air fin coolers

The air fin cooler division supplies air cooled heat exchangers for oil & gas processes and the power sector. It clocked revenues of Rs 1bn during FY09 and has a current order backlog of Rs 691mn. BGR has turnkey capabilities in design, manufacture, supply, erection and commissioning of air fin coolers, tube bundles and finned tubes. Its factory is equipped with state-of-the-art finning machines from McElroy, USA with a capacity of over 2.1mn metres of finned tubes and over 950 tube bundles per annum. BGR can manufacture all three variations of finned tubes – embedded, extruded and welded. The key markets for this division include India, the Middle East, Southeast Asia and North Africa.

Environmental engineering

Environment engineering deals with water treatment products including deaerators and RO-based desalination plants. The division clocked revenues of Rs 212mn during FY09 and has an order backlog of Rs 24mn. BGR is the market leader in India for deaerators – it has supplied the largest deaerator ever manufactured in India to the 2*500MW Tarapur Atomic Power Station. The division is currently executing four large textile effluent treatment and recycling plants at Tiruppur, which would be the largest in India for treating dye effluents.

The division counts renowned OEMs and EPC contractors among its clients including Alstom, Siemens, L&T, Foster Wheeler, Ansaldo, Babcock Engineering, Jurong Engineering, and Daewoo Engineering & Construction.

Electrical projects

This division provides a portfolio of value-added services in electrical contracting and customised solutions to electrical utilities. It has an order backlog of Rs 340mn and clocked revenues of Rs 381mn during FY09. Through in-house expertise and strategic tie-ups, BGR offers complete solutions to utilities, generating stations and other industries, covering their requirements for EHV substations, transmission lines and plant electricals. It also provides single-point solutions through its BoP electrical package from concept to commissioning to clients implementing hydro or thermal power projects.

Consolidated financials

Profit and Loss statement

Y/E March (Rs mn)	FY09	FY10E	FY11E	FY12E
Revenues	**19,303**	**31,029**	**42,846**	**53,747**
Growth (%)	*26.9*	*60.7*	*38.1*	*25.4*
EBITDA	**2,089**	**3,859**	**5,356**	**6,257**
Growth (%)	*34.5*	*84.7*	*38.8*	*16.8*
Depreciation & amortisation	75	125	202	250
EBIT	2,014	3,734	5,154	6,008
Growth (%)	*34.5*	*85.4*	*38.0*	*16.6*
Interest	579	1,190	1,529	1,845
Other income	317	248	104	131
EBT	1,752	2,792	3,728	4,294
Income taxes	596	950	1,268	1,460
Effective tax rate (%)	*34.0*	*34.0*	*34.0*	*34.0*
Extraordinary items	-	-	-	-
Min into / inc from associates	12	14	15	16
Reported net income	1,144	1,829	2,446	2,817
Adjustments	(12)	(14)	(15)	(16)
Adjusted net income	**1,156**	**1,843**	**2,460**	**2,834**
Growth (%)	*28.7*	*59.4*	*33.5*	*15.2*
Shares outstanding (mn)	72.0	72.0	72.0	72.0
FDEPS (Rs) (adj)	**15.9**	**25.6**	**34.2**	**39.4**
Growth (%)	*18.5*	*59.4*	*33.5*	*15.2*
DPS (Rs)	3.0	3.8	5.1	5.6

Balance sheet

Y/E March (Rs mn)	FY09	FY10E	FY11E	FY12E
Cash and cash eq	6,151	2,064	1,034	1,310
Accounts receivable	12,788	19,978	25,825	32,395
Inventories	140	255	352	442
Other current assets	6,610	9,664	12,114	15,176
Investments	5	5	5	5
Gross fixed assets	1,245	2,045	3,295	3,695
Net fixed assets	977	1,652	2,700	2,850
CWIP	54	54	54	54
Intangible assets	41	41	41	42
Deferred tax assets, net	(747)	(987)	(1,309)	(1,636)
Other assets	27	565	1,231	728
Total assets	**26,046**	**33,292**	**42,048**	**51,367**
Accounts payable	4,413	7,332	9,315	11,922
Other current liabilities	8,138	6,520	6,860	7,793
Provisions	677	1,181	1,606	1,811
Debt funds	7,090	11,063	14,903	18,446
Other liabilities	27	27	27	27
Equity capital	720	720	720	720
Reserves & surplus	4,981	6,449	8,618	10,649
Shareholder's funds	5,701	7,169	9,338	11,369
Total liabilities	**26,046**	**33,292**	**42,048**	**51,367**
BVPS (Rs)	79.2	99.6	129.7	157.9

Cash flow statement

Y/E March (Rs mn)	FY09	FY10E	FY11E	FY12E
Net income + Depreciation	1,219	1,954	2,648	3,067
Non-cash adjustments	529	14	15	547
Changes in working capital	(1,528)	(9,058)	(6,072)	(6,182)
Cash flow from operations	220	(7,090)	(3,409)	(2,568)
Capital expenditure	(523)	(800)	(1,250)	(400)
Change in investments	1,509	-	-	-
Other investing cash flow	(43)	-	-	-
Cash flow from investing	942	(800)	(1,250)	(400)
Issue of equity	-	-	-	-
Issue/repay debt	2,063	3,973	3,840	3,543
Dividends paid	(144)	(170)	(211)	(299)
Other financing cash flow	(1)	-	-	-
Change in cash & cash eq	3,081	(4,087)	(1,030)	276
Closing cash & cash eq	6,151	2,064	1,034	1,310

Financial ratios

Y/E March	FY09	FY10E	FY11E	FY12E
Profitability & Return ratios (%)				
EBITDA margin	10.8	12.4	12.5	11.6
EBIT margin	10.4	12.0	12.0	11.2
Net profit margin	6.0	5.9	5.7	5.3
ROE	22.1	28.6	29.8	27.4
ROCE	14.8	17.6	17.0	15.5
Working Capital & Liquidity ratios				
Receivables (days)	190	193	195	198
Inventory (days)	4	3	4	4
Payables (days)	101	100	103	103
Current ratio (x)	2.0	2.3	2.4	2.5
Quick ratio (x)	1.5	1.6	1.7	1.7
Turnover & Leverage ratios (x)				
Gross asset turnover	20.1	18.9	16.0	15.4
Total asset turnover	0.9	1.0	1.1	1.2
Interest coverage ratio	3.5	3.1	3.4	3.3
Adjusted debt/equity	1.2	1.5	1.6	1.6
Valuation ratios (x)				
EV/Sales	2.2	1.4	1.0	0.8
EV/EBITDA	20.4	11.0	7.9	6.8
P/E	29.3	18.2	13.6	11.8
P/BV	5.9	4.7	3.6	3.0

Economic Value Added (EVA) analysis

Y/E March	FY09	FY10E	FY11E	FY12E
WACC (%)	11.9	11.4	11.4	11.3
ROIC (%)	20.5	19.9	16.1	14.4
Invested capital (Rs mn)	7,340	17,371	24,835	30,338
EVA (Rs mn)	635	1,480	1,183	925
EVA spread (%)	8.6	8.5	4.8	3.0

Quarterly trend

Particulars	Q2FY09	Q3FY09	Q4FY09	Q1FY10	Q2FY10
Revenue (Rs mn)	4,246	4,724	7,183	3,111	4,660
YoY growth (%)	*36.5*	*23.4*	*24.1*	*1.4*	*9.7*
QoQ growth (%)	*38.4*	*11.3*	*52.0*	*(56.7)*	*49.8*
EBITDA (Rs mn)	438	495	836	422	574
EBITDA margin (%)	*10.3*	*10.5*	*11.6*	*13.6*	*12.3*
Adj net income (Rs mn)	237	272	470	203	306
YoY growth (%)	*47.7*	*24.6*	*47.3*	*17.3*	*29.1*
QoQ growth (%)	*37.2*	*14.8*	*72.8*	*(56.9)*	*51.0*

DuPont analysis

(%)	FY08	FY09	FY10E	FY11E	FY12E
Tax burden (Net income/PBT)	68.6	66.0	66.0	66.0	66.0
Interest burden (PBT/EBIT)	87.4	87.0	74.8	72.3	71.5
EBIT margin (EBIT/Revenues)	9.9	10.4	12.0	12.0	11.2
Asset turnover (Revenues/Avg TA)	143.3	94.0	104.6	113.7	115.1
Leverage (Avg TA/Avg equtiy)	385.6	393.5	461.1	456.4	451.1
Return on equity	**32.6**	**22.1**	**28.6**	**29.8**	**27.4**

Company profile

Established in 1985, BGR is one of the leading players in Balance of Plant (BoP) and EPC services for power projects. The company has in-house manufacturing facilities for many of the products used as part of BoP. The company has divided its various businesses into seven divisions, with power projects in the forefront followed by the oil & gas equipment division and other product manufacturing divisions.

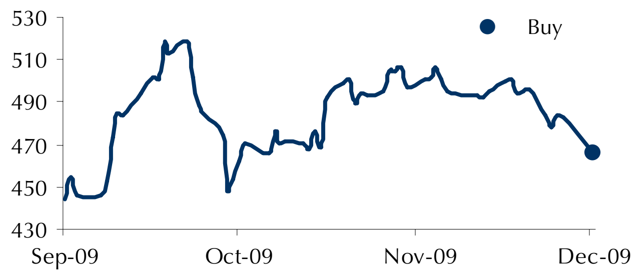
Shareholding pattern

(%)	Mar-09	Jun-09	Sep-09
Promoters	81.3	81.3	81.3
FIIs	1.2	1.5	1.9
Banks & FIs	5.4	6.0	5.5
Public	12.1	11.2	11.3

Recommendation history

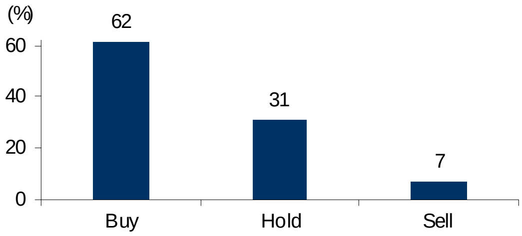
Date	Event	Reco price	Tgt price	Reco
30-Dec-09	Initiating Coverage	466	581	Buy

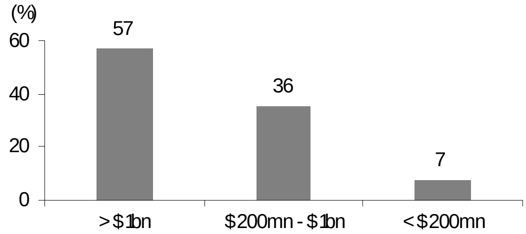
Stock performance



Coverage Profile

By recommendation	By market cap (US$)





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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Disclaimer