



BHEL

STOCK INFO.	BLOOMBERG
BSE Sensex: 19,784	BHEL IN
	REUTERS CODE
S&P CNX: 5,869	BHEL.BO

30 October 2007

Neutral

Previous Recommendation: Neutral

Rs2,655

Equity Shares (m)	489.5
52-Week Range	2,750/970
1,6,12 Rel. Perf. (%)	19/71/66
M.Cap. (Rs b)	1,299.5
M.Cap. (US\$ b)	33.0

YEAR	NET SALES	PAT	EPS	EPS	P/E	P/BV	ROE	ROCE	EV/	EV/
END	(RS M)	(RS M)	(RS)	GROWTH (%)	(X)	(X)	(%)	(%)	SALES	EBITDA
03/07A	176,427	24,144	49.3	44.0	53.8	14.8	30.0	50.0	7.2	34.5
03/08E	231,408	32,171	65.7	33.2	40.4	11.3	31.8	55.5	5.5	25.8
03/09E	295,118	41,570	84.9	29.2	31.3	8.8	31.8	51.1	4.3	19.6

➤ **Robust 2QFY08 performance:** During 2QFY08, BHEL reported net revenues of Rs39.7b (up 18.7% YoY), EBIDTA of Rs7b (up 52.3% YoY) and reported net profit of Rs6.9b (up 91% YoY). The reported numbers includes income tax refund leading to 1) Increase in other income by Rs2.7b, 2) Increase in interest cost by Rs174m and 3) prior period tax provision of Rs310m. Adjusted for the same, the net profit stood at Rs5.6b (up 56.4% YoY).

➤ **Positive surprises from EBIDTA margin improvement:** The key surprise during 2QFY08 has been the improvement in EBIDTA margins to 17.5% (up 387bps YoY). This compares with 9.6% during 1QFY08 (down 237bp YoY). Power division reported EBIT margins of 23.1% in 2QFY08, up from 21.3% in 2QFY07 while industrial division EBIT margins improved by 187bps to 14.1% vs 12.2% in 2QFY07.

➤ **Robust order book position:** BHEL's order backlog as at September, 2007 stood at Rs726b (up 58.9% YoY) while the order intake for the 2QFY08 was Rs141.7b (vs Rs110b in 1QFY07). The current order backlog represents a book to bill ratio of 4.2x on its FY07 revenue.

➤ **Valuation and view:** We expect BHEL to report a net profit of Rs32.2b for FY08 (up 33.2% YoY, upgrade of 4%) and Rs41.6b in FY09 (up 29.2% YoY, upgrade 4.7%). We expect it to report an EPS of Rs66 for FY08 and Rs85 for FY09. At the CMP of Rs2,655, the stock trades at a P/E of 41x FY08E and 32x FY09E. Maintain **Neutral**.

QUARTERLY PERFORMANCE

Y/E MARCH	FY07				FY08				FY07	FY08E
	1Q	2Q	3Q	4Q	1Q	2Q	3QE	4QE		
Sales	26,564	33,412	43,397	69,197	32,339	39,654	56,330	97,979	172,375	226,302
Change (%)	37.2	33.1	30.5	25.5	21.7	18.7	29.8	41.6	29.7	31.3
EBITDA	3,182	4,563	9,292	15,872	3,107	6,952	12,266	22,597	32,909	44,922
Change (%)	85.5	23.7	54.1	32.8	-2.4	52.3	32.0	42.4	40.7	36.5
As a % Sales	12.0	13.7	21.4	22.9	9.6	17.5	21.4	22.8	19.1	19.9
Depreciation	639	667	662	762	689	694	825	873	2,730	3,082
Interest	131	136	120	47	22	193	100	185	433	499
Other Income	1,201	1,699	1,855	2,860	2,063	5,009	950	968	7,615	8,990
PBT	3,613	5,460	10,365	17,928	4,460	11,074	12,291	22,507	37,366	50,331
Tax	1,246	1,860	3,688	6,419	1,570	4,197	4,302	8,190	13,214	18,259
Effective Tax Rate (%)	34.5	34.1	35.6	35.8	35.2	37.9	35.0	36.4	35.4	36.3
Reported PAT	2,367	3,600	6,677	11,509	2,890	6,877	7,989	14,317	24,152	32,072
Change (%)	85.1	38.4	57.8	32.6	22.1	91.0	19.7	24.4	43.8	32.8
Adj. PAT	2,367	3,600	6,677	11,506	2,890	5,632	7,989	14,317	24,149	32,171
Change (%)	85.1	38.4	57.8	32.6	22.1	56.4	19.7	24.4	43.8	33.2

E: MOST Estimates

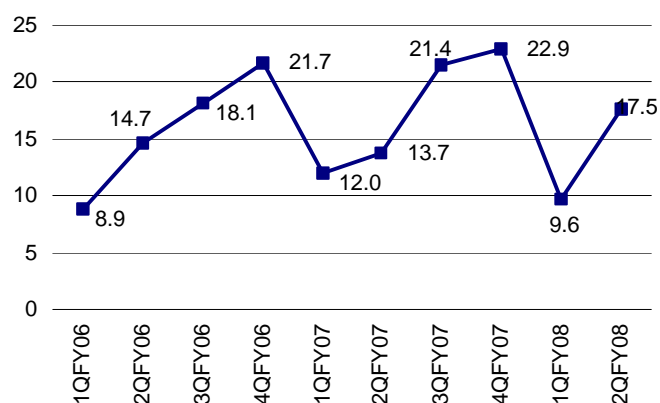
Robust 2QFY08 performance

During 2QFY08, BHEL reported net revenues of Rs39.7b (up 18.7% YoY), EBIDTA of Rs7b (up 52.3% YoY) and reported net profit of Rs6.9b (up 91% YoY). The reported numbers however includes a income tax refund which led to 1) Increase in other income by Rs2.7b, 2) Increase in interest cost by Rs174m and 3) prior period tax provision of Rs310m. Adjusted for the same, the net profit stood at Rs5.6b (up 56.4% YoY). While revenue was lower than our estimate of Rs45.5b, EBIDTA margins at 17.5% was higher than our expectation of 14.3%. Adjusted net profit of Rs5.6b was higher than our estimate of Rs4.7b.

Positive Surprises from EBIDTA margin improvement

During 2QFY08, BHEL's EBIDTA increased 52.3% YoY to Rs7b driven by 387bp YoY improvement in EBIDTA margins to 17.5%. This compares with EBIDTA margin of 9.6% during 1QFY08 (down 237bp YoY). The improvement in the margin was driven largely by scale efficiency and cost reduction measures adopted by the company at its plants. The RM cost as a % to sales declined to 54.6% of revenues as compared to 55.6% in 2QFY07 and staff cost as a % to sales decreased to 15.9% vs 16.9% in 2QFY07. During 1HFY08, BHEL has made a provision of Rs1.6b (Rs800m in 4QFY07) towards incremental staff cost to factor in the possible recommendations of the Sixth Pay Commission. Selling, General and Admn expenses decreased to 12% of revenues as compared to 13.8% in 2QFY07.

TREND IN EBIDTA MARGIN (%)



Source: Company

Segmental performance

Power division reported strong 2QFY08 performance: Revenues at Rs33b, up 21.7% YoY and EBIT of Rs7.6b, up 32% YoY. EBIT margins improved to 23.1% in 2QFY08, from 21.3% in 2QFY07. The industrial division reported revenue growth of 19.5% YoY to Rs12.4b and EBIT of Rs1.8b (vs Rs1.3b in 2QFY07). EBIT margins of the industrial division improved in 2QFY08 by 187bps to 14.1% vs 12.2% in 2QFY07. Industrial division accounted for 27.3% of revenues and 18.6% of EBIT in 2QFY08.

During 1HFY08, the revenue for the power division grew by 23.3% YoY to Rs60.4b and 19.4% YoY for industrial division to Rs21.6b. During the same period, EBIT margins for the power division stood at 21.5% (up 128bp YoY) and for industrial division at 9.7% (up 66bp YoY).

SEGMENT WISE ANALYSIS (RS M)

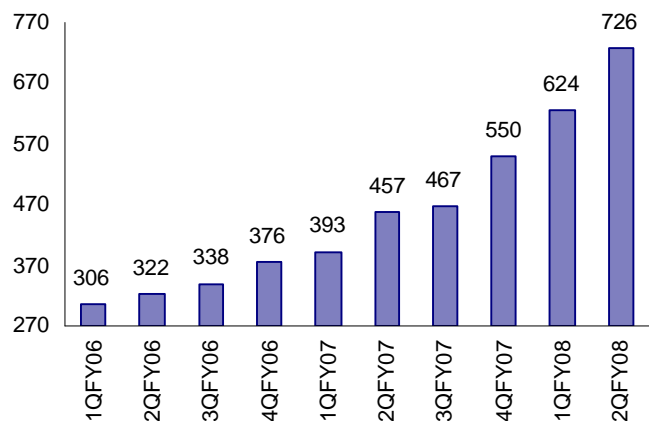
	1QFY07	2QFY07	3QFY07	4QFY07	1QFY08	2QFY08
Revenue						
Power	21828	27141	35387	54220	21,828	33,039
% Chg. YoY	36.0	29.0	29.0	23.0	35.7	21.7
% of Total	73.9	72.3	73.5	70.3	73.9	72.7
Industrial	7708	10399	12741	22917	7,708	12,422
% Chg. YoY	33.0	35.0	33.0	30.0	33.5	19.5
% of Total	26.1	27.7	26.5	29.7	26.1	27.3
Intersegment	661	886	1029	1377	661	1,068
Total	28875	36654	47099	75760	28,875	44,393
EBIT						
Power	4089	5789	8457	17479	5315	7643
Margin (%)	18.7	21.3	23.9	32.2	19.4	23.1
% of Total	91.9	82.0	84.4	75.8	94.0	81.4
Industrial	362	1268	1565	5577	342	1747
Margin (%)	4.7	12.2	12.3	24.3	3.7	14.1
% of Total	8.1	18.0	15.6	24.2	6.0	18.6

Source: Company

Robust order book position

BHEL's order backlog as at September, 2007 stood at Rs726b (up 59% YoY) while the order intake for the 2QFY08 was Rs141.7b (vs Rs110b in 1QFY07). The current order backlog represents a book to bill ratio of 4.2x on its FY07 revenue. The average execution cycle for the power division is 24-36 months while for the industrial division, it is 12-18 months.

TREND IN ORDER BACKLOG (RS B)



Source: Company/Motilal Oswal Securities

Phase 1 of capacity (to 10,000 MW) to be completed by Dec-07

BHEL is investing Rs16b to expand its capacity from 6000MW to 10000MW. Of the 10000MW expanded capacity, coal / nuclear will be 6500MW, Hydro 2500MW and gas based 1000MW. The increased capacity is expected to be fully operational by December 2007. The management

indicated that they have already spent a sizable amount (60%+) of the above capex, and the balance amount would be invested by mid FY08. The company has also started taking various initiatives to develop vendor base and sub-contractor network with a view to outsourcing simple fabrication work and utilizing its own facilities for high value added jobs.

In next phase of expansion, the company is already working on plans to increase capacity to 15,000 MW by FY09. The capex envisaged in this phase is expected at Rs32b (of which Rs25b is for expansion and Rs7b for modernization).

Valuation and view

We expect BHEL to report a net profit of Rs32.2b for FY08 (up 33.2% YoY, upgrade of 4%) and Rs41.6b in FY09 (up 29.2% YoY, upgrade 4.7%). We expect it to report an EPS of Rs66 for FY08 and Rs85 for FY09. At the CMP of Rs2,655, the stock trades at a P/E of 41x FY08E and 32x FY09E. Maintain **Neutral**.

BHEL: an investment profile

Company description

BHEL is India's dominant producer of power and industrial machinery and a leading EPC company, established in the late 1950s as the government's wholly-owned subsidiary. Post divestment, the government currently has an equity stake of 67.7%. The company has 14 manufacturing divisions, 8 service centers, 4 power sector regional centers besides project sites spread across all over India and abroad. It has an annual installed capacity of 6,000MW. It has formed a tie-up with Alstom and an alliance with Siemens for the manufacture of super-critical 800MW boilers and turbines respectively.

Key investment arguments

- ✍ Order backlog at end 2QFY08 stands at Rs726b, a book to bill ratio of 4.2x FY07.
- ✍ Increasing investments in country's power sector especially to build 68,000MW generating capacity in the XIth five year plan will ensure higher order intake.
- ✍ Technology transfer agreement with Alstom and Siemens for super critical boilers has enabled the company to plug the technology gaps from the product portfolio.

COMPARATIVE VALUATIONS

		BHEL	L&T	CROMPTON
P/E (x)	FY08E	40.4	49.1	41.3
	FY09E	31.3	38.7	28.3
P/BV (x)	FY08E	11.3	17.4	17.3
	FY09E	8.8	14.0	13.2
EV/Sales (x)	FY08E	5.5	5.1	3.5
	FY09E	4.3	4.1	2.8
EV/EBITDA (x)	FY08E	25.8	42.2	30.7
	FY09E	19.6	33.6	23.5

SHAREHOLDING PATTERN (%)

	SEP-07	JUN-07	SEP-06
Promoter	67.7	67.7	67.7
Domestic Inst	7.7	8.1	7.4
Foreign	20.0	19.6	22.0
Others	4.6	4.6	2.9

Key investment risks

- ✍ The key challenge is to meet execution deadlines and improve cost efficiencies.
- ✍ Intensified competition from Chinese, Korean, etc suppliers.

Recent developments

- ✍ Incorporated a JV with NTPC to take up EPC work for the power project in and outside India.

Valuation and view

- ✍ We expect BHEL to report a net profit of Rs32.2b for FY08 (up 33.2% YoY, upgrade of 4%) and Rs41.6b in FY09 (up 29.2% YoY, upgrade 4.7%).
- ✍ The stock trades at a P/E of 41x FY08E and 32x FY09E. Maintain **Neutral**.

Sector view

- ✍ We expect ramp up in power sector investments, across segments – generation, transmission and distribution.
- ✍ We maintain our positive view on the sector.

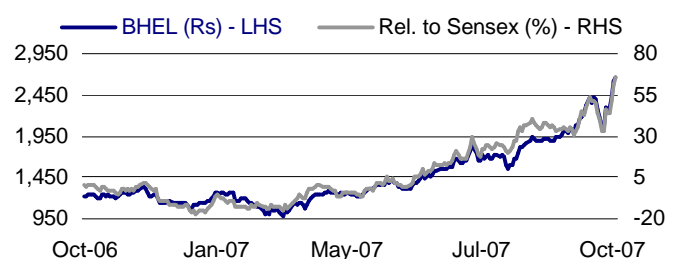
EPS: MOST FORECAST VS CONSENSUS (RS)

	MOST FORECAST	CONSENSUS FORECAST	VARIATION (%)
FY08	65.7	64.7	1.5
FY09	84.9	84.0	1.0

TARGET PRICE AND RECOMMENDATION

CURRENT PRICE (RS)	TARGET PRICE (RS)	UPSIDE (%)	RECO.
2,655	-	-	Neutral

STOCK PERFORMANCE (1 YEAR)



INCOME STATEMENT						RATIOS					
(Rs Million)											
Y/E MARCH	2006	2007	2008E	2009E	2010E	Y/E MARCH	2006	2007	2008E	2009E	2010E
Total Income	136,873	176,427	231,408	295,118	386,124	Basic (Rs)					
Change	40.4	28.9	31.3	27.7	31.0	EPS	68.5	49.3	65.7	84.9	118.5
Staff Cost	18,785	23,690	29,795	35,068	41,252	Change (%)	73.7	44.0	33.2	29.2	39.5
Mfg. Expenses	69,424	86,393	110,649	143,682	193,637	Cash EPS	78.6	109.8	72.0	92.7	128.6
Selling Expenses	22,806	30,293	42,979	53,381	62,600	Book Value	298.3	179.5	234.3	300.6	393.0
EBITDA	25,858	36,051	47,985	62,987	88,635	DPS	14.5	8.0	13.1	17.0	23.7
Change	52.3	39.4	33.1	31.3	40.7	Payout (incl. Div. Tax.)	23.3	17.8	22.0	22.0	22.0
% of Net Sales	18.9	20.4	20.7	21.3	23.0	Valuation (x)					
Depreciation	2,459	2,729	3,082	3,805	4,954	P/E		53.8	40.4	31.3	22.4
Interest	587	433	499	750	750	Cash P/E		24.2	36.9	28.6	20.6
Other Income	2,797	4,468	7,764	5,522	6,314	EV/EBITDA		34.5	25.8	19.6	13.7
Extra-ordinary Items (net)	35	5	0	0	0	EV/Sales		7.2	5.5	4.3	3.2
PBT	25,644	37,361	52,169	63,954	89,245	Price/Book Value		14.8	11.3	8.8	6.8
Tax	8,852	13,214	18,259	22,384	31,236	Dividend Yield (%)		0.3	0.5	0.6	0.9
Rate (%)	34.5	35.4	35.0	35.0	35.0	Return Ratio					
Reported PAT	16,792	24,148	33,910	41,570	58,009	RoE	25.2	30.0	31.8	31.8	34.2
Adjusted PAT	16,769	24,144	32,171	41,570	58,009	RoCE	39.6	50.0	55.5	51.1	54.4
Change	73.7	44.0	33.2	29.2	39.5	Turnover Ratios					
BALANCE SHEET	(Rs Million)					Debtors (Days)	228	231	229	227	224
Y/E MARCH	2006	2007	2008E	2009E	2010E	Inventory (Days)	19	10	10	10	10
Share Capital	2,448	2,448	4,895	4,895	4,895	Creditors. (Days)	89	84	81	80	81
Reserves	70,566	85,435	109,819	142,244	187,491	Asset Turnover (x)	13.6	17.4	14.8	9.7	8.0
Net Worth	73,014	87,883	114,715	147,139	192,387	Leverage Ratio					
Loans	5,582	893	5,000	5,000	5,000	Debt/Equity (x)	0.1	0.0	0.0	0.0	0.0
Differed Tax Liability	-6,737	-9,352	-9,352	-9,352	-9,352	CASH FLOW STATEMENT	(Rs Million)				
Capital Employed	71,859	79,424	110,363	142,788	188,035	Y/E MARCH	2006	2007	2008E	2009E	2010E
Gross Fixed Assets	38,221	41,351	48,741	67,156	89,571	PBT before EO Items	25,608	37,356	52,169	63,954	89,245
Less: Depreciation	28,398	31,463	33,452	37,257	42,211	Add : Depreciation	2,459	2,729	3,082	3,805	4,954
Net Fixed Assets	9,823	9,887	15,288	29,899	47,359	Interest	587	433	499	750	750
Capital WIP	1,846	3,025	2,000	4,000	4,000	Less : Direct taxes paid	8,852	13,214	18,259	22,384	31,236
Investments	83	83	150	150	150	(Inc)/Dec in WC	-1,576	10,428	-19,690	-10,187	-7,016
Curr. Assets	163,308	210,630	273,825	338,399	435,661	CF from operations	18,228	37,733	17,800	35,938	56,698
Inventory	37,444	42,177	60,075	77,656	100,603	EO Income	35	5	0	0	0
Debtors	71,681	96,958	125,013	159,984	205,185	CF from Operations in	18,263	37,739	17,800	35,938	56,698
Cash & Bank Balance	41,340	58,089	64,895	70,523	91,294	(Inc)/dec in FA	-2,732	-3,974	-7,457	-20,415	-22,415
Loans & Advances	11,999	11,409	21,845	28,239	36,583	CF from investments	-2,726	-3,973	-7,524	-20,415	-22,415
Other Current Assets	845	1,997	1,997	1,997	1,997	(Inc)/Dec in Networth	-1,697	-7,585	0	0	0
Current Liab. & Prov.	103,200	144,201	180,901	229,660	299,136	(Inc)/Dec in Debt	213	-4,689	4,107	0	0
Creditors	28,041	35,390	44,277	56,554	74,071	Less : Interest Paid	587	433	499	750	750
Other Liabilities	60,037	83,589	103,312	131,959	172,832	Dividend Paid	3,904	4,308	7,078	9,145	12,762
Provisions	15,123	25,222	33,312	41,146	52,233	CF from Fin. Activity	-5,976	-17,016	-3,470	-9,895	-13,512
Net Current Assets	60,108	66,428	92,925	108,739	136,526	Inc/Dec of Cash	9,561	16,750	6,806	5,628	20,771
Misc. Expenses	0	0	0	0	0	Add: Beginning Balance	31,779	41,340	58,089	64,895	70,523
Application of Funds	71,859	79,424	110,363	142,788	188,035	Closing Balance	41,340	58,089	64,895	70,523	91,294

E: MOST Estimates



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Disclosure of Interest Statement

BHEL

1. Analyst ownership of the stock	No
2. Group/Directors ownership of the stock	No
3. Broking relationship with company covered	No
4. Investment Banking relationship with company covered	No

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