

BGR Energy

BSE SENSEX
18,210

S&P CNX
5,488

CMP: INR408
TP: INR527
Buy

Bloomberg	BGRL IN											
Equity Shares (m)	72.0											
52-Week Range (INR)	871/402	03/10A	30,779	2,016	28.0	74.2	-	-	31.7	22.8	-	-
1,6,12 Rel. Perf. (%)	-8/-32/-44	03/11A	47,632	3,230	44.8	59.9	9.1	3.1	39.0	24.3	0.7	5.9
M.Cap. (INR b)	29.4	03/12E	53,403	3,565	49.4	10.4	8.3	2.4	32.8	21.6	0.7	5.7
M.Cap. (USD b)	0.7	03/13E	59,217	3,801	52.7	6.6	7.7	1.9	27.4	19.4	0.7	5.7

- **PAT in line, revenue below estimates:** BGR Energy Systems (BGRL) posted 1QFY12 revenue of INR7.3b (down 19% YoY) below our estimate of INR8.2b (down 9% YoY). PAT of INR503m (down 17% YoY) was in line with our estimate of INR504m (down 17% YoY). Profit growth was boosted by better EBITDA margins supported by a favorable revenue mix. EBITDA margin was 13.1%, up 164bp YoY ahead of our estimate of 11.1%.
- **EBITDA margins improve, interest up, debt higher:** EBITDA margins improved due to a favorable mix, driven by higher (YoY) contribution from BOP contracts (40% of power segment sales) relative to EPC contracts (60%). However, interest costs rose 55% YoY and were 2.5% of sales in 1QFY12 against 1.3% of sales in 1QFY11. BGR's debt rose to INR18b at the end of 1QFY12, from INR13.4b in FY11. Average cost of borrowing was about 8.5 - 9%, due to low cost buyer's credit (INR5b).
- **Strong execution of EPC contracts boosts revenue growth:** BGRL is executing two EPC projects in Rajasthan (2 x 600MW, INR49b) and Tamil Nadu (1 x 300MW, INR31b). The projects are 75% complete and have been driving revenue growth in recent quarters. BGRL also received an INR22b BoP (for 2 x 660MW) contract from Gayatri Projects in Andhra Pradesh in 3Q FY11. The projects will drive FY12 revenue.
- **Order book depleting but BGRL favorably placed in select projects:** The order backlog was INR75b (INR79b at the end of FY11, INR94b as at 1QFY11). BGR is L2 (BHEL is L1) in two projects of 2 x 660 MW each of the Rajasthan SEB, one of which BGRL expects to be awarded (at an L1 price of INR61b). BGR is also in the fray for boiler packages of NTPC's 11 x 660MW bulk tender along with BHEL and L&T. The price bids are expected to open, after the Supreme Court hears Gammon's plea over its disqualification, over the next few days. BGRL has also prequalified for NTPC bulk tender 2 (9 x 800MW), among other prospective projects.
- **Estimates cut; Maintain Buy with a revised target price of INR527:** Success in the forthcoming tenders is critical for BGRL's growth in FY13. BGRL needs to book new orders worth INR80b-100b in FY12 to grow by 15% in FY13. We cut our FY13 earnings estimate by 11% due to poor revenue visibility. Our EPS estimates are INR49.4 (up 10%) and INR52.7 (up 7%) for FY12 and FY13 respectively. Our revised target price is INR527 (earlier INR708). Delay in finalization of the orders will hit FY13 earnings.

Quarterly Performance (Standalone)

									(INR Million)	
Y/E March	FY11				FY12				FY11	FY12E
	1Q	2Q	3Q	4Q	1Q	2QE	3QE	4QE		
Sales	9,067	11,356	12,569	14,616	7,342	13,351	16,021	16,690	47,608	53,403
Change (%)	191.5	143.7	97.9	-11.8	-19.0	17.6	27.5	14.2	55.1	12.2
EBITDA	1,038	1,323	1,472	1,674	961	1,454	1,766	2,235	5,507	6,416
Change (%)	145.7	122.0	106.1	-4.5	-7.4	9.9	19.9	33.5	58.2	16.5
As of % Sales	11.4	11.7	11.7	11.5	13.1	10.9	11.0	13.4	11.6	12.0
Depreciation	31	33	34	70	37	45	45	59	168	187
Interest	116	138	168	183	180	166	201	371	605	918
Other Income	26	26	17	17	0	28	18	3	86	50
PBT	917	1,178	1,287	1,438	743	1,271	1,538	1,809	4,820	5,361
Tax	312	400	411	454	241	426	515	614	1,578	1,796
Effective Tax Rate (%)	34.0	34.0	32.0	31.6	32.4	33.5	33.5	34.0	32.7	33.5
Reported PAT	605	778	876	984	503	846	1,023	1,195	3,242	3,565
Change (%)	199.2	154.5	108.9	-9.2	-17.0	8.7	16.8	21.5	61.3	10.0
Adj PAT	605	778	876	984	503	846	1,023	1,195	3,242	3,565
Change (%)	199.2	154.5	108.9	(9.2)	(17.0)	8.7	16.8	21.5	61.3	10.0

E: MOSL Estimates

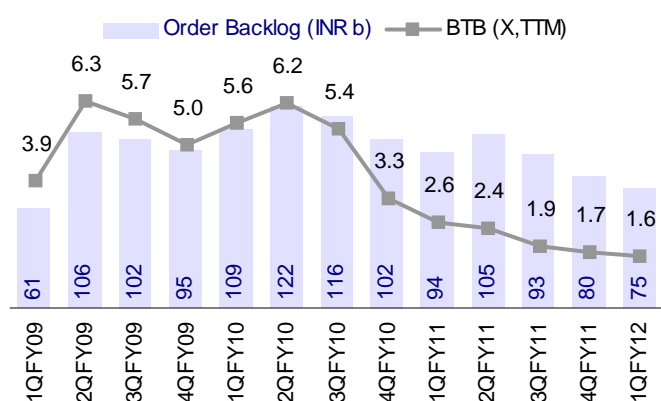
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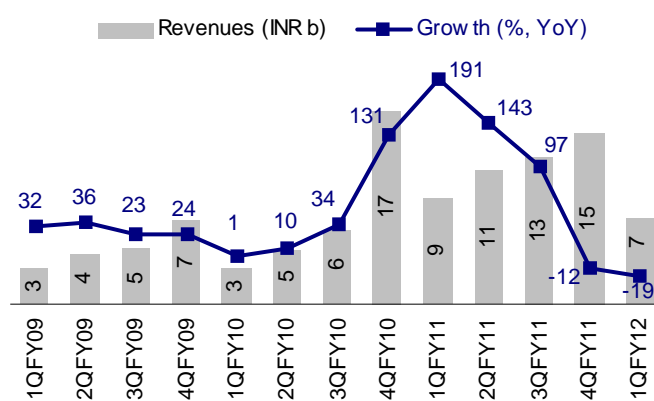
BGR Energy PAT in line; Revenue below estimates; Order inflow crucial to earnings visibility

- BGR Energy Systems (BGRL) posted 1QFY12 revenue of INR7.3b (down 19% YoY) below our estimate of INR8.2b (down 9% YoY) and PAT was INR503m (down 17% YoY), in line with our estimate of INR504m (down 17% YoY). Profit growth was boosted by better EBITDA margins, supported by a favorable revenue mix. EBITDA margin was 13.1%, up 164bp YoY ahead of our estimates of 11.1%.
- BGRL is at an advanced stage of execution of two power projects: (1) a 1,200MW project in Rajasthan and (2) a 600MW project in Tamil Nadu. BGRL booked ~INR66b in the projects, which have a total cost of INR82b. The remaining INR16b will be booked over the rest of FY12.
- EBITDA margins improved due to a favorable mix, driven by higher (YoY) contribution from BOP contracts (40% of power segment sales) relative to EPC contracts (60% of power segment sales). RM/sales declined 252bp YoY and employee costs as a percentage of sales increased 106bp YoY.
- Interest costs rose 55% YoY, partially offsetting margin gains. Interest cost as a percentage of sales increased 120bp to 2.5% of sales in 1QFY12 from 1.3% of sales in 1QFY11. Average cost of borrowing was 8.5-9%, due to cheaper cost of buyer's credit (INR5b of total debt of INR18b).
- BGRL had debt of INR18b at the end of 1QFY12, rising from INR13.4b at the end of FY11. The rise in debt is attributable to a rise in working capital in 1QFY12. Debtors went up to INR34b, up from INR31.6b at the end of FY11. Debtors include INR12b of retention money and BGRL expects retention money of INR2b to be released in FY12.
- An exhausting order book is a major concern for BGRL. The current order backlog is INR75b (INR79b at the end of FY11, INR94b as at 1QFY11). BGRL is L2 (BHEL is L1) in two projects of 2 x 660MW each of the Rajasthan SEB, one of which BGRL expects to be awarded (at L1 price of INR61b). BGRL is also in the fray for boiler packages of NTPC's 11 x 660MW bulk tender along with BHEL and L&T. The price bids are expected to open, after the Supreme Court hears a plea by Gammon for its disqualification (due in next few days). BGRL is also prequalified for NTPC bulk tender 2 (9 x 800MW), among other prospective projects. We believe BGRL is a strong contender to receive some of the prospective contracts, especially the Rajasthan contract.

BTB ratio at 1.6x TTM offers revenue visibility in FY12

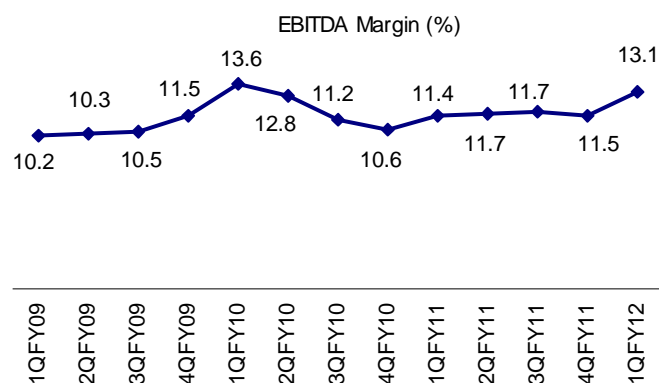


BGR revenue growth falls due to a declining order book

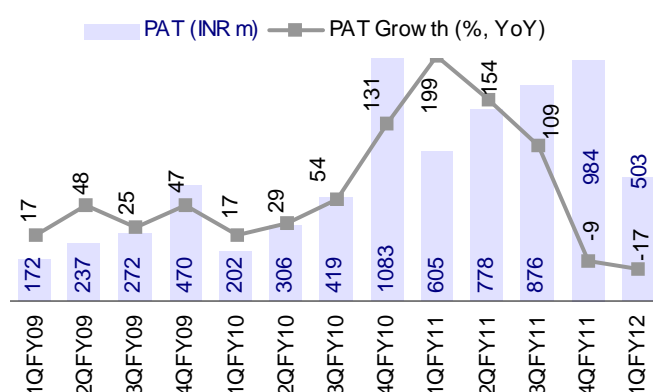


Source: Company/MOSL

BGR margins improved



BGR's improved margins boosted PAT



Source: Company/MOSL

Higher weight of BOP contract execution results in fall in material cost in 1QFY12 (%)

	1QFY09	2QFY09	3QFY09	4QFY09	1QFY10	2QFY10	3QFY10	4QFY10	1QFY11	2QFY11	3QFY11	4QFY11	1QFY12
RM Costs	82.7	82.5	82.8	81.0	75.0	80.3	78.2	83.4	81.3	81.9	80.7	85.0	78.8
Staff Costs	4.3	4.5	4.6	2.7	7.0	5.1	5.0	2.9	3.6	3.0	3.3	2.4	4.7
Other Expenditure	2.8	2.8	2.1	4.9	4.5	2.2	5.6	3.3	3.8	3.6	4.6	1.4	3.9

Source: Company/MOSL

BGRL segmental performance (INR m)

	1QFY11	2QFY11	3QFY11	4QFY11	1QFY12	YoY (%)
Revenues						
Construction & EPC	8,786	10,791	11,878	13,359	6,730	-23.4
Capital Goods	268	546	632	1,213	582	116.6
Total	9,054	11,337	12,511	14,573	7,312	-19.2
EBIT						
Construction & EPC	1,004	1,250	1,388	1,461	900	-10.4
Capital Goods	2.2	40.6	50.1	142.3	23.7	997.2
Total	1,007	1,291	1,438	1,603	923	-8.3
EBIT Margin (%)						
Construction & EPC	11.4	11.6	11.7	10.9	13.4	194bp
Capital Goods	0.8	7.4	7.9	11.7	4.1	327bp
Total	11.1	11.4	11.5	11.0	12.6	151bp

Source: Company/MOSL

Success in NTPC tender to improve outlook for manufacturing JVs

- BGRL will spend INR44b over 3.5 years to set up a boiler and turbine manufacturing facility with super-critical capability in 660, 700, 800 and 1,000MW ranges through a JV with Hitachi, Japan.
- The debt/equity structure for the JV at 3.5:1 looks steep but the management is confident that with cash flows from current operations, debt/equity will not go above 2:1.
- The JV will be held by BGRL and Hitachi in the ratio of 74:26 for the turbine JV (INR30b investment) and 70:30 for the boiler JV (INR14b investment). The total equity commitment for BGRL stands at INR9.5b.
- Success in the NTPC's boiler package for an 11 x 660MW bulk tender (under arbitration; price bids due) is critical for the growth of BGRL's manufacturing JVs.

Outlook and valuation

- Success in the forthcoming tenders is critical for BGRL's growth in FY13. BGR needs to book new orders worth INR80b-100b in FY12, to grow by 15% in FY13.
- We cut our FY13 earnings estimate by 11% due to poor revenue visibility. Our EPS is now INR49.4 (up 10%) and INR52.7 (up 7%) for FY12 and FY13 respectively. We expect BGR to post revenue and earnings CAGR of 12% and 9% over FY11-13. Our FY13 estimates are based on the success in forthcoming tenders, particularly the Rajasthan SEB.
- Our revised target price is INR527 (earlier INR708). A delay in finalization of the orders will hit FY13 earnings.
- At its CMP, BGRL trades at 8.3x FY12E and 7.7x FY13E.

BGR Energy: an investment profile

Company description

BGR Energy Systems (BGRL) is one of the India's growing engineering companies in the power sector. BGRL carries the business in two segments namely the supply of systems and equipment and turnkey engineering project contracting. It was incorporated in 1985 as a JV between JV Energie Technik GmbH and Mr BG Raghupathy. BGRL employs about 1,700 people with 84% of them being engineers and the rest in support functions.

Key investment arguments

- BGRL, a strong BOP contractor, entered the power plant EPC business over the past two years. It is well-placed to capitalize on a growing shortage of power plant contractors in India. BGRL has a JV with Hitachi to make boilers and turbine-generators, which could be a huge long-term growth driver.
- We believe BGRL is well placed for over INR150b worth of orders. Success in one or two EPC projects will drive strong earnings growth beyond FY12.

Key investment risks

- Margin compression is possible due to the entry into the super-critical BTG due to high initial import content (18-20%).

- Higher working capital days due to a large share of EPC projects in the revenue mix going forward can compress return ratios and cash flows.

Recent developments

- BGRL will spend INR44b over 3.5 years to set up a boiler and turbine manufacturing facility with super-critical capabilities of up to 1,000MW through a JV with Hitachi. It has acquired requisite land for this purpose.
- The Rajasthan SEB is due to award two BTG contracts of INR61b each (1,320MW each) in which BHEL is L1 and BGR is L2. BGR is confident of matching the L1 price in at least one of the orders.

Valuation and view

- Success in the forthcoming tenders is critical for BGRL's growth in FY13. BGRL needs to book orders worth INR80b-100b in FY12 to grow by 15% in FY13. We cut our FY13E EPS by 11% due to poor revenue visibility. Our EPS is INR49.4 (up 10%) and INR52.7 (up 7%) for FY12 and FY13 respectively. We expect BGR to post revenue and earnings CAGR of 12% and 9% respectively over FY11-13.
- The stock trades at 8.3x FY12E earnings and hence valuations are favorable. We recommend a **Buy** on the stock, with a target price of INR527 (10x FY13E EPS).

Sector view

- We are positive about the sector.

Comparative valuations

		BGR	BHEL	L&T
P/E (x)	FY12E	8.3	15.6	20.3
	FY13E	7.7	11.8	15.9
P/BV (x)	FY12E	2.4	4.5	4.3
	FY13E	1.9	3.3	3.7
EV/Sales (x)	FY12E	0.7	2.0	2.0
	FY13E	0.7	1.4	1.6
EV/EBITDA (x)	FY12E	0.7	9.1	16.8
	FY13E	0.7	6.7	13.8

Shareholding pattern (%)

	Mar-11	Dec-10	Mar-10
Promoter	81.1	81.2	81.3
Domestic Inst	4.5	4.5	7.3
Foreign	5.8	8.6	5.9
Others	8.5	5.7	5.5

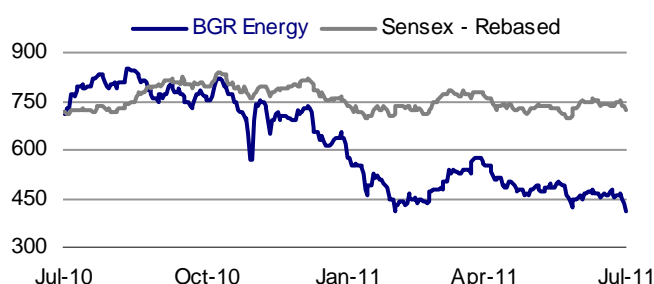
EPS: MOSL forecast v/s consensus (INR)

	MOSL Forecast	Consensus Forecast	Variation (%)
FY12	49.4	47.3	4.5
FY13	52.7	52.2	1.0

Target price and recommendation

Current Price (INR)	Target Price (INR)	Upside (%)	Reco.
408	527	29.1	Buy

Stock performance (1 year)



Financials and Valuation

Income Statement				(INR Million)	
Y/E March	2009	2010	2011	2012E	2013E
Total Income	19,355	30,779	47,632	53,403	59,217
Change (%)	27.3	59.0	54.8	12.1	10.9
Raw Material Cost	13,522	21,870	39,131	39,249	43,701
Staff Cost	744	1,262	1,431	1,789	2,326
Other Mfg. Expenses	2,948	4,161	1,573	5,949	6,242
EBITDA	2,140	3,487	5,496	6,416	6,949
Change (%)	37.8	62.9	57.6	16.7	8.3
% of Net Sales	11.1	11.3	11.5	12.0	11.7
Depreciation	75	103	173	187	222
Interest	579	538	605	918	1,066
Other Income	266	205	89	50	56
PBT	1,752	3,051	4,808	5,361	5,716
Tax	596	1,037	1,577	1,796	1,915
Rate (%)	34.0	34.0	32.8	33.5	33.5
Reported PAT	1,156	2,015	3,230	3,565	3,801
Adjusted PAT	1,157	2,016	3,230	3,565	3,801
Change (%)	29.2	74.2	60.3	10.4	6.6

Balance Sheet				(INR Million)	
Y/E March	2009	2010	2011	2012E	2013E
Share Capital	720	720	722	722	722
Reserves	4,919	6,343	8,798	11,521	14,733
Net Worth	5,639	7,063	9,520	12,243	15,455
Loans	7,090	9,336	13,373	17,221	21,526
Differed Tax Liability	775	1,580	3,594	2,055	1,286
Capital Employed	13,504	17,979	26,488	31,519	38,266
Gross Fixed Assets	1,245	1,819	3,145	3,326	3,892
Less: Depreciation	268	365	506	692	915
Net Fixed Assets	977	1,454	2,639	2,634	2,977
Capital WIP	54	104	200	350	350
Goodwill	6	6	6	6	6
Investments	5	5	5	3,045	6,066
Curr. Assets	25,690	37,699	51,153	58,781	65,414
Inventory	140	162	411	1,203	1,338
Debtors	12,789	19,803	31,580	35,017	38,831
Cash & Bank Balance	6,152	10,280	10,449	9,993	11,308
Loans & Advances	6,432	7,273	8,400	12,249	13,583
Other Current Assets	178	181	313	320	354
Curr. Liab. & Prov.	13,229	21,289	27,516	33,297	36,547
Creditors	4,413	11,028	11,544	12,873	14,320
Other Liabilities	8,138	7,928	13,553	17,786	19,723
Provisions	677	2,334	2,419	2,638	2,505
Net Current Assets	12,462	16,410	23,637	25,484	28,867
Appli. of Funds	13,504	17,979	26,487	31,519	38,266

E: MOSL Estimates

Ratios		2009	2010	2011	2012E	2013E
Basic (Rs)						
EPS		16.1	28.0	44.8	49.4	52.7
Growth (%)		29.2	74.2	59.9	10.4	6.6
Cash EPS		17.1	29.4	47.3	52.1	55.9
Book Value		78.3	98.1	132.2	170.0	214.6
DPS		3.0	7.0	10.0	10.0	7.0
Payout (incl. Div. Tax.)		21.8	29.3	26.1	23.6	15.5
Valuation (x)						
P/E				9.1	8.3	7.7
Cash P/E				8.6	7.8	7.3
EV/EBITDA				5.9	5.7	5.7
EV/Sales				0.7	0.7	0.7
Price/Book Value				3.1	2.4	1.9
Dividend Yield (%)				2.5	2.5	1.7
Return Ratio						
RoE		22.3	31.7	39.0	32.8	27.4
RoCE		19.7	22.8	24.3	21.6	19.4

Turnover Ratios						
Debtors (Days)		241	235	242	239	239
Inventory (Days)		1	1	1	2	2
Creditors (Days)		23	36	24	24	24
Asset Turnover (x)		1.4	1.7	1.8	1.7	1.5
Leverage Ratio						
Debt/Equity (x)		1.3	1.3	1.4	1.4	1.4

Cash Flow Statement				(INR Million)	
Y/E March	2009	2010	2011	2012E	2013E
PBT bef. EO Items	1,752	3,051	4,808	5,361	5,716
Add : Depreciation	75	103	173	187	222
Interest	579	538	605	918	1,066
Less : Direct taxes paid	596	1,037	1,577	1,796	1,915
(Inc)/Dec in WOC	-1,292	180	-7,058	-2,303	-2,068
CF from Operations	519	2,835	-3,050	2,367	3,021
CF from Op. Incl. EO Item	519	2,835	-3,050	2,367	3,021
(Inc)/dec in FA	-568	-629	-1,455	-331	-566
(Pur)/Sale of Investments	1,509	0	0	-3,040	-3,021
CF from Investments	941	-629	-1,455	-3,371	-3,587
(Inc)/Dec in Net Worth	391	804	2,084	-1,539	-769
(Inc)/Dec in Debt	2,063	2,246	4,037	3,847	4,305
Less : Interest Paid	579	538	605	918	1,066
Dividend Paid	253	590	842	842	590
CF from Fin. Activity	1,622	1,923	4,674	548	1,881
Inc/Dec of Cash	3,081	4,129	168	-456	1,315
Add: Beginning Balance	3,070	6,152	10,280	10,449	9,993
Closing Balance	6,152	10,280	10,449	9,993	11,308

N O T E S

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BGR Energy

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3. Broking relationship with company covered
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