

Powering ahead

■ Margin growth and backlog growth beats estimates

In 2QFY08, sales grew 21% YoY to Rs44.4bn, EBITDA increased 52% to Rs6.95bn (margins improved 321bps vs. UBSe of 50bps increase), recurring PAT grew 30% to Rs4.68bn (UBSe: Rs4.5bn). Including IT related net write back of Rs2.2bn, reported PAT grew 91% to Rs6.9bn. The order backlog rose 16% QoQ to Rs726bn (UBSe of Rs680bn), as order inflows was Rs146bn during 2Q.

■ Margins expanded on lower raw material and staff costs

The raw material costs declined 192 bps (48.7% of sales in 2QFY08 vs 50.7% of sales in 2QFY07) and staff costs were lower by 126bps in 2QFY08 (14.2% of sales vs. 15.4% in 2QFY07). The power sector sales grew 22% YoY, and industrials by 20%. The PBIT margins of power division came in at 23.1% vs. 21.3% in 2QFY07, and industrials in 2QFY08 at 14.1% vs. 12.2% in 2QFY07.

■ On track for FY08E

1HFY08 recurring net profit is 20% of our full year FY08 estimates, respectively. Despite superior order inflows and margin expansion in 2QFY08, we are not changing our estimates as yet. The key share price driver over the next 6-12 months in addition to earnings momentum would be news flow on supercritical order wins from NTPC and from state boards.

■ Valuation: Under Review

In light of the stock's recent outperformance, we are placing our price target and rating under review. Our price target is based on DCF, with 20% mid-term (FY 10-15E) growth, WACC of 11.2%, and terminal growth of 6%. For BHEL, key risks are competition and execution.

Highlights (Rsm)	03/06	03/07	03/08E	03/09E	03/10E
Revenues	135,043.81	174,203.00	214,559.86	293,936.01	388,200.51
EBIT (UBS)	23,398.45	33,321.20	41,807.60	56,332.72	72,090.16
Net Income (UBS)	16,659.37	24,141.80	31,553.94	41,721.57	52,241.92
EPS (UBS, Rs)	34.03	49.32	64.46	85.23	106.72
Net DPS (UBS, Rs)	7.25	12.25	22.00	26.00	27.00

Profitability & Valuation	5-yr hist av.	03/07	03/08E	03/09E	03/10E
EBIT margin %	13.9	19.1	19.5	19.2	18.6
ROIC (EBIT) %	34.9	98.3	131.2	126.4	96.4
EV/EBITDA (core) x	7.5	13.9	25.1	18.5	14.5
PE (UBS) x	11.4	22.7	37.7	28.5	22.8
Net dividend yield %	1.8	1.1	0.9	1.1	1.1

Source: Company accounts, Thomson Financial, UBS estimates. (UBS) valuations are stated before goodwill, exceptionals and other special items. Valuations: based on an average share price that year, (E): based on a share price of Rs2,431.75 on 26 Oct 2007 23:39 HKT

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India

Industrial, Diversified

12-month rating (UR) **Buy ***
Unchanged

12m price target (UR) Rs2,475.00/US\$62.79
Unchanged

Price Rs2,431.75/US\$61.69

RIC: BHEL.BO BBG: BHEL IN

29 October 2007

Trading data (local/US\$)

52-wk range	Rs2,431.75-977.88/US\$61.86-22.19
Market cap.	Rs1,190bn/US\$30.2bn
Shares o/s	490m (ORD)
Free float	32%
Avg. daily volume ('000)	204
Avg. daily value (Rsm)	396.2

Balance sheet data 03/08E

Shareholders' equity	Rs107bn
P/BV (UBS)	11.1x
Net Cash (debt)	Rs73.7bn

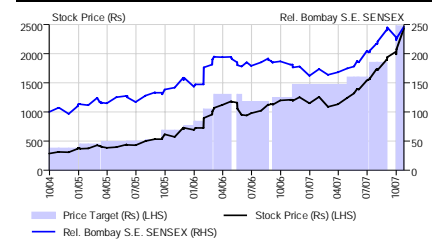
Forecast returns

Forecast price appreciation	+1.8%
Forecast dividend yield	0.5%
Forecast stock return	+2.3%
Market return assumption	11.9%
Forecast excess return	-9.6%

EPS (UBS, Rs)

	03/08E		03/07 Actual
	UBS	Cons.	
Q1E	-	-	4.83
Q2E	-	-	7.35
Q3E	-	-	13.64
Q4E	-	-	27.91
03/08E	64.46	64.46	
03/09E	85.23	85.23	

Performance (Rs)



Source: UBS

www.ubs.com/investmentresearch

■ **Bharat Heavy Electricals Limited**

BHEL focuses on the Indian power equipment business, which accounted for 65% of revenue and 79% of PBIT for FY04. Its main customer is National Thermal Power Corporation (NTPC), accounting for over 50% of revenue. BHEL also services the power transmission, captive power plant, industrial equipment, and the transportation segments. Actual/deemed exports accounted for 24% of revenue in FY04, and the company has added several new markets to its portfolio. It is 68%-owned by the Government of India.

■ **Statement of Risk**

We believe the key risks from BHEL are, 1) Execution related, 2) Increasing Competition and, 3) Earnings disappointment

■ **Analyst Certification**

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UBS Investment Research: Global Equity Rating Allocations

UBS 12-Month Rating	Rating Category	Coverage ¹	IB Services ²
Buy	Buy	55%	40%
Neutral	Hold/Neutral	36%	35%
Sell	Sell	9%	22%
UBS Short-Term Rating	Rating Category	Coverage ³	IB Services ⁴
Buy	Buy	0%	29%
Sell	Sell	0%	0%

1:Percentage of companies under coverage globally within the 12-month rating category.

2:Percentage of companies within the 12-month rating category for which investment banking (IB) services were provided within the past 12 months.

3:Percentage of companies under coverage globally within the Short-Term rating category.

4:Percentage of companies within the Short-Term rating category for which investment banking (IB) services were provided within the past 12 months.

Source: UBS. Rating allocations are as of 30 September 2007.

UBS Investment Research: Global Equity Rating Definitions

UBS 12-Month Rating	Definition
Buy	FSR is > 6% above the MRA.
Neutral	FSR is between -6% and 6% of the MRA.
Sell	FSR is > 6% below the MRA.
UBS Short-Term Rating	Definition
Buy	Buy: Stock price expected to rise within three months from the time the rating was assigned because of a specific catalyst or event.
Sell	Sell: Stock price expected to fall within three months from the time the rating was assigned because of a specific catalyst or event.

KEY DEFINITIONS

Forecast Stock Return (FSR) is defined as expected percentage price appreciation plus gross dividend yield over the next 12 months.

Market Return Assumption (MRA) is defined as the one-year local market interest rate plus 5% (a proxy for, and not a forecast of, the equity risk premium).

Under Review (UR) Stocks may be flagged as UR by the analyst, indicating that the stock's price target and/or rating are subject to possible change in the near term, usually in response to an event that may affect the investment case or valuation.

Short-Term Ratings reflect the expected near-term (up to three months) performance of the stock and do not reflect any change in the fundamental view or investment case.

EXCEPTIONS AND SPECIAL CASES

US Closed-End Fund ratings and definitions are: Buy: Higher stability of principal and higher stability of dividends; Neutral: Potential loss of principal, stability of dividend; Reduce: High potential for loss of principal and dividend risk.

UK and European Investment Fund ratings and definitions are: Buy: Positive on factors such as structure, management, performance record, discount; Neutral: Neutral on factors such as structure, management, performance record, discount; Reduce: Negative on factors such as structure, management, performance record, discount.

Core Banding Exceptions (CBE): Exceptions to the standard +/-6% bands may be granted by the Investment Review Committee (IRC). Factors considered by the IRC include the stock's volatility and the credit spread of the respective company's debt. As a result, stocks deemed to be very high or low risk may be subject to higher or lower bands as they relate to the rating. When such exceptions apply, they will be identified in the Companies Mentioned or Company Disclosure table in the relevant research piece.

Company Disclosures

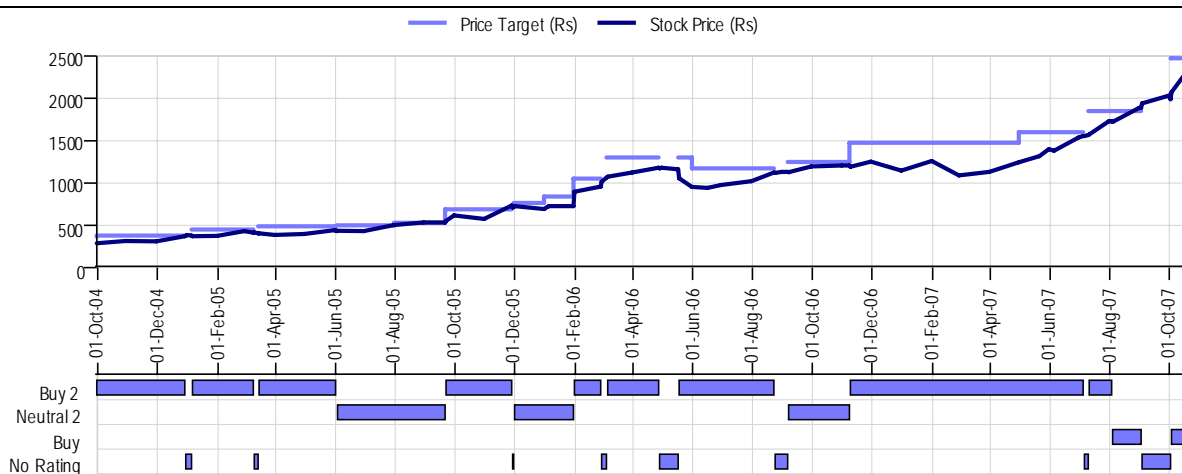
Company Name	Reuters	12-mo rating	Short-term rating	Price	Price date
Bharat Heavy Electricals Limited	BHEL.BO	Buy (UR)	N/A	Rs2,431.75	26 Oct 2007

Source: UBS. All prices as of local market close.

Ratings in this table are the most current published ratings prior to this report. They may be more recent than the stock pricing date

Unless otherwise indicated, please refer to the Valuation and Risk sections within the body of this report.

Bharat Heavy Electricals Limited (Rs)



Source: UBS; as of 26 Oct 2007

Note: On August 4, 2007 UBS revised its rating system. (See 'UBS Investment Research: Global Equity Rating Definitions' table for details). From September 9, 2006 through August 3, 2007 the UBS ratings and their definitions were: Buy 1 = FSR is > 6% above the MRA, higher degree of predictability; Buy 2 = FSR is > 6% above the MRA, lower degree of predictability; Neutral 1 = FSR is between -6% and 6% of the MRA, higher degree of predictability; Neutral 2 = FSR is between -6% and 6% of the MRA, lower degree of predictability; Reduce 1 = FSR is > 6% below the MRA, higher degree of predictability; Reduce 2 = FSR is > 6% below the MRA, lower degree of predictability. The predictability level indicates an analyst's conviction in the FSR. A predictability level of '1' means that the analyst's estimate of FSR is in the middle of a narrower, or smaller, range of possibilities. A predictability level of '2' means that the analyst's estimate of FSR is in the middle of a broader, or larger, range of possibilities. From October 13, 2003 through September 8, 2006 the percentage band criteria used in the rating system was 10%.

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