



INDIA

BHEL IN Neutral

Price 14 Jun 10 Rs2,380.00

12-month target Rs 2,297.00

Upside/Downside % -3.5

Valuation Rs 2,297.00

- PER

GICS sector Capital Goods

Market cap Rsbn 1,165

30-day avg turnover US\$m 4.0

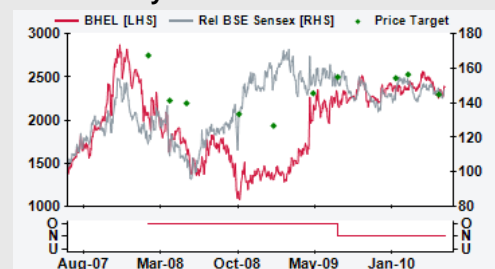
Market cap US\$m 25,007

Number shares on issue m 489.5

Investment fundamentals

Year end 31 Mar		2009A	2010E	2011E	2012E
Total revenue	bn	267.3	335.7	411.4	496.8
EBIT	bn	38.8	58.0	73.6	84.0
EBIT growth	%	12.8	49.3	26.9	14.1
Adjusted profit	bn	31.4	43.1	54.8	62.5
EPS adj	Rs	64.11	88.06	111.86	127.61
EPS adj growth	%	9.8	37.4	27.0	14.1
PER adj	x	37.1	27.0	21.3	18.7
Total DPS	Rs	15.55	21.35	27.13	30.95
Total div yield	%	0.7	0.9	1.1	1.3
ROA	%	10.8	12.9	13.8	13.2
ROE	%	26.5	29.9	30.4	27.8
EV/EBITDA	x	25.3	17.1	13.3	11.5
Net debt/equity	%	-78.6	-60.7	-52.7	-47.8
P/BV	x	9.0	7.3	5.8	4.7

BHEL IN rel BSE Sensex performance, & rec history



Note: Recommendation timeline - if not a continuous line, then there was no Macquarie coverage at the time or there was an embargo period.

Source: FactSet, Macquarie Research, June 2010

(all figures in INR unless noted)

Inderjeetsingh Bhatia

+91 22 6653 3166 Inderjeet.Bhatia@macquarie.com

Abhishek Bhandari

+91 22 6653 3065 Abhishek.Bhandari@macquarie.com

14 June 2010

Bharat Heavy Electricals

Headwinds to continue

Event

- Media reports suggest that NTPC is planning to reinvoke bids for its first bulk tender purchase of supercritical equipment worth Rs250bn. The decision to invite fresh bids could be made at the end of June 2010. We continue to note that competitive intensity is increasing in the boiler, turbine and generator (BTG) equipment space in India. Maintain Neutral rating and target price of Rs2,297 on BHEL.

Impact

- Rebidding may see participation by new players:** NTPC (NATP IN, Rs200, OP, TP: Rs258) may reinvoke bidding for its first bulk purchase of supercritical equipment due to technical issues with the earlier bids. At that time, BHEL and L&T (LT IN, Rs1,704, OP, TP: Rs1,988) were the only bidders. Fresh bids could be invited after NTPC's board meets at June end. Due to this development, the second bulk tender order worth Rs200bn would be delayed.
 - ⇒ **Competition to increase going forward:** We expect new entrants like Thermax (TMX IN, Rs694, Not rated) to participate in the rebidding, leading to an increase in competition. In this context, we note that there were four bidders – BHEL, LT, Thermax and Power Machines (unlisted) – for JSPL's (JSP IN, Rs649, OP, TP: Rs963) tender for two power plants of 1,320MW and 660MW in Jharkhand.
 - ⇒ **Order inflow to remain flat for BHEL:** We believe that order inflow will remain flat for BHEL in FY11 as 60% of 12th plan orders (100GW) have already been awarded. As a result, the order book coverage ratio is likely to decline going forward for BHEL. We highlighted this in our earlier note, <http://macq.wir.jp/l.ut?t=1BVtd1tTD>, dated 27 May.
- Tariff-based bidding in January 2011 may affect margins of BTG manufacturers:** CERC has ruled in favour of tariff-based bidding as of January 2011. Central utilities like NTPC and state generating companies would likely pay attention to capital costs to remain competitive while bidding. This is likely to put pressure on pricing and, hence, margins for BTG equipment companies as they compete to secure new orders.

Earnings and target price revision

- No changes.

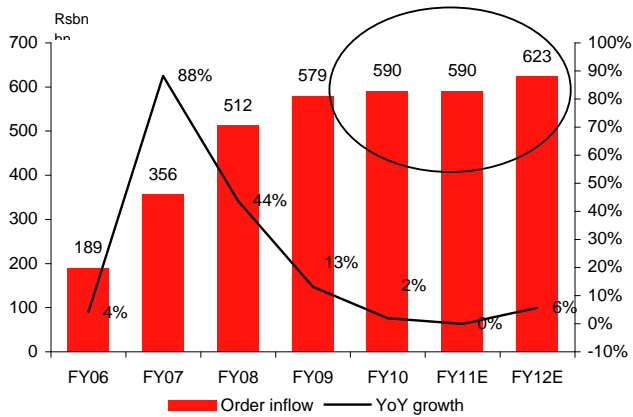
Price catalyst

- 12-month price target: Rs2,297.00 based on a PER methodology.
- Catalyst: Rebid for bulk order tender for supercritical equipment by NTPC.

Action and recommendation

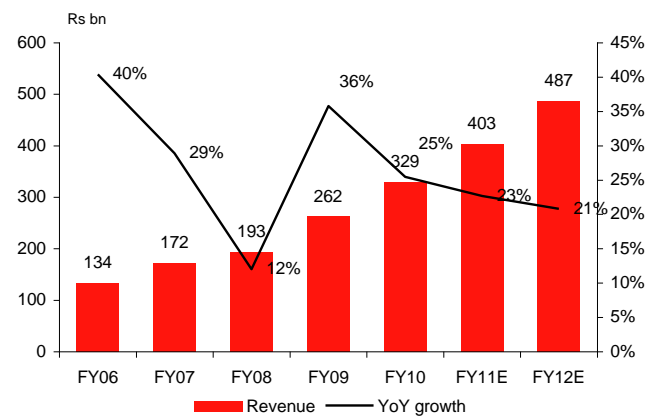
- Long-term earnings growth trajectory under threat:** If the order inflow stagnates at current levels, order book growth could decline in coming years. This, in turn, could lead to revenue growth moderating. Margins may peak in FY11, and increasing competition could affect margins in the future. We believe earnings growth for the next 2–3 years after FY11 could be 15%. Given moderate earnings growth, current valuations of 21x FY11E and 19x FY12E earnings leave no room for upside, in our view. Maintain Neutral on BHEL with a target price of Rs2,297.

Fig 1 We expect order inflow to stay flat in FY11...



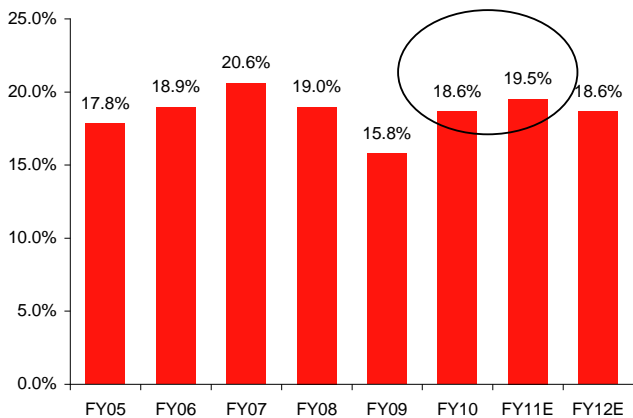
Source: Company data, Macquarie Research, June 2010

Fig 2 ...leading to moderate revenue growth going forward



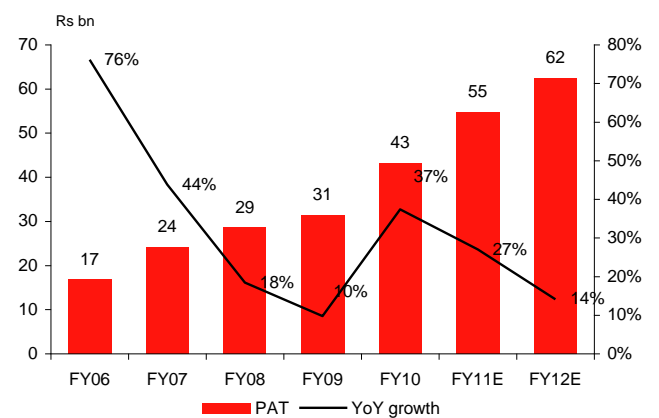
Source: Company data, Macquarie Research, June 2010

Fig 3 We think margins will peak at 19.5% in FY11



Source: Company data, Macquarie Research, June 2010

Fig 4 We expect earnings growth to moderate to 14-15% after FY11



Source: Company data, Macquarie Research, June 2010

Important disclosures:

Recommendation definitions

Macquarie - Australia/New Zealand

Outperform – return >5% in excess of benchmark return
Neutral – return within 5% of benchmark return
Underperform – return >5% below benchmark return

Macquarie – Asia/Europe

Outperform – expected return >+10%
Neutral – expected return from -10% to +10%
Underperform – expected return <-10%

Macquarie First South - South Africa

Outperform – expected return >+10%
Neutral – expected return from -10% to +10%
Underperform – expected return <-10%

Macquarie - Canada

Outperform – return >5% in excess of benchmark return
Neutral – return within 5% of benchmark return
Underperform – return >5% below benchmark return

Macquarie - USA

Outperform (Buy) – return >5% in excess of Russell 3000 index return
Neutral (Hold) – return within 5% of Russell 3000 index return
Underperform (Sell) – return >5% below Russell 3000 index return

Recommendations – 12 months

Note: Quant recommendations may differ from Fundamental Analyst recommendations

Volatility index definition*

This is calculated from the volatility of historical price movements.

Very high-highest risk – Stock should be expected to move up or down 60–100% in a year – investors should be aware this stock is highly speculative.

High – stock should be expected to move up or down at least 40–60% in a year – investors should be aware this stock could be speculative.

Medium – stock should be expected to move up or down at least 30–40% in a year.

Low-medium – stock should be expected to move up or down at least 25–30% in a year.

Low – stock should be expected to move up or down at least 15–25% in a year.

* Applicable to Australian/NZ/Canada stocks only

Financial definitions

All "Adjusted" data items have had the following adjustments made:

Added back: goodwill amortisation, provision for catastrophe reserves, IFRS derivatives & hedging, IFRS impairments & IFRS interest expense
Excluded: non recurring items, asset revals, property revals, appraisal value uplift, preference dividends & minority interests

EPS = adjusted net profit / epowa*

ROA = adjusted ebit / average total assets

ROA Banks/Insurance = adjusted net profit / average total assets

ROE = adjusted net profit / average shareholders funds

Gross cashflow = adjusted net profit + depreciation

*equivalent fully paid ordinary weighted average number of shares

All Reported numbers for Australian/NZ listed stocks are modelled under IFRS (International Financial Reporting Standards).

Recommendation proportions – For quarter ending 31 March 2010

	AU/NZ	Asia	RSA	USA	CA	EUR	
Outperform	50.55%	62.20%	42.25%	42.39%	62.16%	46.74%	(for US coverage by MCUSA, 6.53% of stocks covered are investment banking clients)
Neutral	36.63%	19.02%	47.89%	50.35%	31.89%	34.78%	(for US coverage by MCUSA, 9.62% of stocks covered are investment banking clients)
Underperform	12.82%	18.78%	9.86%	7.27%	5.95%	18.48%	(for US coverage by MCUSA, 0.00% of stocks covered are investment banking clients)

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Asia Research

Head of Equity Research

John O'Connell (Global Co – Head)	(612) 8232 7544
David Rickards (Global Co – Head)	(44 20) 3037 4399
Chris Hunt (Asia – Head)	(852) 3922 1119
Tim Smart (Asia – Deputy Head)	(852) 3922 3565

Automobiles/Auto Parts

Leah Jiang (China)	(8621) 2412 9020
Clive Wiggins (Japan)	(813) 3512 7856
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Linda Huang (Taiwan)	(8862) 2734 7521

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Jal Irani (India)	(9122) 6653 3040
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Leah Jiang (China)	(8621) 2412 9020

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Alex Pomento (Philippines)	(632) 857 0899
Linda Huang (Taiwan)	(8862) 2734 7521

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Sunaina Dhanuka (Malaysia)	(603) 2059 8993
David Gambrell (Thailand)	(662) 694 7753

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Makarim Salman (Japan)	(813) 3512 7421
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Kenneth Yap (Indonesia)	(6221) 515 1555
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Christina Lee (Hong Kong)	(852) 3922 3571
Jal Irani (India)	(9122) 6653 3040
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Shawn Park (Korea)	(822) 3705 8669
Edward Ong (Malaysia)	(603) 2059 8982
Sunaina Dhanuka (Malaysia)	(603) 2059 8993
Linda Huang (Taiwan)	(8862) 2734 7521
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Proptech

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Elaine Cheong (Singapore)	(65) 6231 2839
Corinne Jian (Taiwan)	(8862) 2734 7522
Patti Tomaitrichitr (Thailand)	(662) 694 7727

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Andrew Dale (Asia)	(852) 3922 3587
YeeMan Chin (China)	(852) 3922 3562
Graeme Train (China)	(8621) 2412 9035
Christina Lee (Hong Kong)	(852) 3922 3571
Rakesh Arora (India)	(9122) 6653 3054
Adam Worthington (Indonesia)	(852) 3922 4626
Riaz Hyder (Indonesia)	(6221) 2598 8486
Polina Diyachkina (Japan)	(813) 3512 7886

Technology

Michael Bang (Asia)	(822) 3705 8659
Patrick Yau (Hong Kong)	(852) 3922 1264
Zona Chen (Hong Kong)	(852) 3922 3578
Nitin Mohta (India)	(9122) 6653 3050
Damian Thong (Japan)	(813) 3512 7877
David Gibson (Japan)	(813) 3512 7880
George Chang (Japan)	(813) 3512 7854
Michiko Kakiya (Japan)	(813) 3512 7868
Yukihiro Goto (Japan)	(813) 3512 5984
Daniel Kim (Korea)	(822) 3705 8641
Abraham Leu (Taiwan)	(8862) 2734 7511
Chia-Lin Lu (Taiwan)	(8862) 2734 7526
Daniel Chang (Taiwan)	(8862) 2734 7516
James Chiu (Taiwan)	(8862) 2734 7517
Jeffrey Su (Taiwan)	(8862) 2734 7512
Samson Yu (Taiwan)	(8862) 2734 7532
Jimmy Hsu (Taiwan)	(8862) 2734 7533

Telecoms

Shubham Majumder (Asia)	(9122) 6653 3049
Bin Liu (China)	(852) 3922 3634
Tim Smart (China)	(852) 3922 3565
Riaz Hyder (Indonesia)	(6221) 2598 8486
Nathan Ramler (Japan)	(813) 3512 7875
Prem Jearajasingam (Malaysia)	(603) 2059 8989

Regional Heads of Sales cont'd

Sheila Schroeder (San Francisco)	(1 415) 762 5001
Angus Kent (Thailand)	(662) 694 7601
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Charles Nelson (UK/Europe)	(44) 20 3037 4832
Rob Fabbro (UK/Europe)	(44) 20 3037 4865
Nick Ainsworth (Generalist)	(852) 3922 2010

Sales Trading

Adam Zaki (Asia)	(852) 3922 2002
Mike Keen (Europe)	(44) 20 3037 4905
Yat Quan Tan (Hong Kong)	(852) 3922 2028
Stanley Dunda (Indonesia)	(6221) 515 1555
Mario Argyrides (Korea)	(822) 3705 8610
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ES Kwak (Korea)	(822) 3705 8644
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Utilities

Adam Worthington (Asia)	(852) 3922 4626
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Alex Pomento (Philippines)	(632) 857 0899

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Max Layton	(4420) 3037 4273
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George Platt (Australia)	(612) 8232 6539
Patrick Hansen (Japan)	(813) 3512 7876

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Michael Kurtz (Asia)	(8621) 2412 9002
Daniel McCormack (Asia)	(852) 3922 4073
Mark Matthews (Asia)	(852) 3922 3585
Rakesh Arora (India)	(9122) 6653 3054
Ferry Wong (Indonesia)	(6221) 515 7335
David Gibson (Japan)	(813) 3512 7880
Peter Eadon-Clarke (Japan)	(813) 3512 7850
Chan Hwang (Korea)	(822) 3705 8643
Prem Jearajasingam (Malaysia)	(603) 2059 8989
Edward Ong (Malaysia)	(603) 2059 8982
Alex Pomento (Philippines)	(632) 857 0899
Patrick Yau (Singapore)	(65) 6231 2835
Daniel Chang (Taiwan)	(8862) 2734 7516
Alastair Macdonald (Thailand)	(662) 694 7741

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Sales Trading cont'd

Chris Reale (New York)	(1 212) 231 2616
Michael Santos (Philippines)	(632) 857 0813
Matthew Ryan (Singapore)	(65) 6231 2888
Isaac Huang (Taiwan)	(8862) 2734 7582
Dominic Shore (Thailand)	(662) 694 7707
Phil Sellaroli (Tokyo)	(813) 3512 7837

Alternative Strategies

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