BGR Energy Systems (BGRE.BO)

Sell: 2Q12 Results Conference Call Takeaways

- Company Update
- Target Price Change
- Estimate Change

- **Maintain Sell (3H)** — Given: (1) even if orders rebound, we expect margins to decline structurally and BGR, with its weak BS, could find the going tough; (2) structurally declining RoEs FY11 - 39% to FY14E – 16%; (3) EPS decline of 10% over FY11-14E v/s 55% growth over FY08-11 and (4) we expect negative operating CF over the next three years. Increase our target price to Rs272 to factor in our EPS increase.
- **Reason for lower sales** — (1) Materials delayed by clients and consultant approval delays in Kalisindh; (2) engineering issues in Marwa (sorted out now) and (3) severe monsoons. **Reason for higher margins —** (1) Captive orders had good margins and (2) Chandrapur and Marwa projects had a price-variation clause.
- **Reason for increased working capital** — Increase in receivables from Rajasthan and TN because of some certification issues (resolved now), payments should start soon and receivables days will improve. Expect to receive retention money on Kakatiya and one more projects by 1Q13 and retention money on Vijayawada will be released gradually from Nov11 to Mar11.
- **Sales guidance down - But still aggressive** — Sales growth guidance to 2% from 15%. We feel guidance continues to be and factor in sales of Rs40.5bn (15% decline YoY). Management expect sales of >Rs10bn in 3Q12 (v/s CIRA at Rs10.5bn) and Rs20bn in 4Q12 (v/s CIRA at Rs15bn).
- **Expects Rs55-60bn of orders in FY12E** — Won Rs10.1bn of orders 1H12. In the results concall mentioned had visibility for another Rs45-50bn before Mar12 which include: (1) 2X300MW TRN Energy EPC of Rs16.9bn announced post 2Q12 (2) Rs29bn for 4X800MW turbines from NTPC by the Dec11.
- **Update on BTG JV** — Invested Rs2.05bn so far and expect to invest Rs2.5 by FY12E and another Rs3bn in FY13E. Will start recognizing revenues from FY14E.

Sell/High Risk	**3H**
Price (17 Nov 11)	Rs284.70
Target price	Rs272.00
from Rs241.00	
Expected share price return	-4.5%
Expected dividend yield	2.5%
Expected total return	**-2.0%**
Market Cap	Rs20,544M
	US$405M

Price Performance
(RIC: BGRE.BO, BB: BGRL IN)

Statistical Abstract

Year to 31 Mar	Net Profit (RsM)	Diluted EPS (Rs)	EPS growth (%)	P/E (x)	P/B (x)	ROE (%)	Yield (%)
2010A	2,013	27.96	74.4	10.2	2.9	31.7	2.5
2011A	3,234	44.82	60.3	6.4	2.2	39.0	3.5
2012E	2,793	38.70	-13.6	7.4	1.8	26.3	2.5
2013E	2,457	34.05	-12.0	8.4	1.5	19.4	2.5
2014E	2,341	32.44	-4.7	8.8	1.3	16.2	2.5

Source: Powered by dataCentral

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See Appendix A-1 for Analyst Certification, Important Disclosures and non-US research analyst disclosures.

Fiscal year end 31-Mar	2010	2011	2012E	2013E	2014E
Valuation Ratios					
P/E adjusted (x)	10.2	6.4	7.4	8.4	8.8
EV/EBITDA adjusted (x)	6.4	4.6	6.0	9.3	12.8
P/BV (x)	2.9	2.2	1.8	1.5	1.3
Dividend yield (%)	2.5	3.5	2.5	2.5	2.5
Per Share Data (Rs)					
EPS adjusted	27.96	44.82	38.70	34.05	32.44
EPS reported	27.96	44.82	38.70	34.05	32.44
BVPS	98.09	131.93	162.47	188.36	212.64
DPS	7.00	10.01	7.00	7.00	7.00
Profit & Loss (RsM)					
Net sales	30,734	47,498	40,542	47,634	55,966
Operating expenses	-27,395	-42,309	-35,366	-42,523	-50,641
EBIT	**3,339**	**5,190**	**5,176**	**5,111**	**5,326**
Net interest expense	-538	-605	-1,182	-1,611	-1,997
Non-operating/exceptionals	250	223	128	128	128
Pre-tax profit	**3,051**	**4,808**	**4,122**	**3,628**	**3,457**
Tax	-1,037	-1,577	-1,329	-1,171	-1,116
Extraord./Min.Int./Pref.div.	-1	4	0	0	0
Reported net income	**2,013**	**3,234**	**2,793**	**2,457**	**2,341**
Adjusted earnings	2,013	3,234	2,793	2,457	2,341
Adjusted EBITDA	3,442	5,363	5,379	5,361	5,616
Growth Rates (%)					
Sales	59.2	54.5	-14.6	17.5	17.5
EBIT adjusted	65.8	55.4	-0.3	-1.3	4.2
EBITDA adjusted	64.8	55.8	0.3	-0.3	4.7
EPS adjusted	74.4	60.3	-13.6	-12.0	-4.7
Cash Flow (RsM)					
Operating cash flow	**3,101**	**-2,130**	**-4,745**	**-1,766**	**-4,911**
Depreciation/amortization	103	173	203	250	290
Net working capital	180	-7,060	-8,007	-4,708	-7,765
Investing cash flow	**-629**	**-1,455**	**-4,718**	**-23,316**	**-16,175**
Capital expenditure	-629	-1,455	-4,718	-23,316	-16,175
Acquisitions/disposals	0	0	0	0	0
Financing cash flow	**396**	**5,012**	**7,708**	**17,422**	**24,637**
Borrowings	985	5,299	7,553	16,894	23,980
Dividends paid	-590	-842	-589	-589	-589
Change in cash	**2,868**	**1,427**	**-1,754**	**-7,659**	**3,551**
Balance Sheet (RsM)					
Total assets	**38,006**	**54,006**	**61,477**	**84,231**	**111,504**
Cash & cash equivalent	9,019	10,449	8,695	1,035	4,587
Accounts receivable	19,803	31,580	35,021	41,147	48,345
Net fixed assets	1,557	2,840	7,354	30,420	46,305
Total liabilities	**30,914**	**43,967**	**48,490**	**68,258**	**92,532**
Accounts payable	11,028	16,274	13,313	15,955	18,976
Total Debt	8,075	13,373	20,926	37,820	61,800
Shareholders' funds	**7,092**	**10,039**	**12,987**	**15,973**	**18,971**
Profitability/Solvency Ratios (%)					
EBITDA margin adjusted	11.2	11.3	13.3	11.3	10.0
ROE adjusted	31.7	39.0	26.3	19.4	16.2
ROIC adjusted	25.5	24.4	15.0	8.7	6.0
Net debt to equity	-13.3	29.1	94.2	230.3	301.6
Total debt to capital	53.2	57.1	61.7	70.3	76.5

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Maintain Sell – Target price increase to Rs272

- Maintain Sell given: (1) even if orders rebound, we expect margins to decline structurally going forward and BGRL, with its weak balance sheet (BS), could find the going tough; (2) structurally declining RoEs from 39% in FY11 to 16% by FY14E; (3) EPS decline of 10% over FY11-14E v/s 55% growth over FY08-11 and (4) similar to FY11, we expect negative operating cash flows over next three years. We increase our target price to Rs272 to factor in our EPS increase.

- Revise up our EPS estimates for FY12E-14E by 7-16% to factor in (1) 7-16% higher sales and (2) 43 to 64bps higher EBITDA margins. Our estimates are 9-28% below consensus over the next three years.

Figure 1. BGRL EPS – CIRA v/s Consensus

	FY12E	FY13E	FY14E
CIRA	38.70	34.05	32.44
Consensus	42.55	41.82	45.12
Change	-9%	-19%	-28%

Source: Bloomberg and CIRA estimates

Figure 2. BGR Consolidated EPS Revision Table

	FY12E	FY13E	FY14E
Sales			
Old	35,042	43,798	52,553
New	40,542	47,634	55,966
Change	15.7%	8.8%	6.5%
EBITDA			
Old	4,801	5,146	5,611
New	5,379	5,361	5,616
Change	12.1%	4.2%	0.1%
Margin %			
Old	13.7%	11.7%	10.7%
New	13.3%	11.3%	10.0%
Change	-43	-49	-64
PAT			
Old	2,403	2,175	2,180
New	2,793	2,457	2,341
Change	16.2%	13.0%	7.4%
EPS			
Old	33.30	30.14	30.21
New	38.70	34.05	32.44
Change	16.2%	13.0%	7.4%

Source: Citi Investment Research and Analysis estimates

2Q12 PAT down 34% YoY

- Despite a 267bps margin expansion, BGRL's 2Q12 PAT was down 34% YoY at Rs514m which was 29% below CIRA at Rs726m on account of (1) 32% YoY decline in sales and (2) an 118% YoY increase in interest costs.

- Key reasons for sales decline were (1) some materials were delayed by clients and consultant approval delays in Kalisindh for Rs1.50bn for BTG, (2) engineering issues in Marwa (which have now been sorted out) and (3) 2Q12 is peak of monsoon season, which delayed civil construction.

- The key reason for high EBITDA margins were (1) captive orders had good margins and (2) Chandrapur and Marwa projects had a price-variation clause.

Figure 3. BGRL 2QFY12 Results Review

Year End Mar31 (Rsmn)	Q111	Q112	Q211	Q212	Q212E
Backlog	93,971	75,000	105,000	72,700	na
Total Sales	**9,054**	**7,312**	**11,337**	**7,706**	**10,203**
% growth YoY	*191.1%*	*-19.2%*	*143.3%*	*-32.0%*	*-10.0%*
EBITDA	**1,025**	**931**	**1,304**	**1,093**	**1,296**
EBITDA margin%	**11.3%**	**12.7%**	**11.5%**	**14.2%**	**12.7%**
Change bps	*(225)*	*141*	*(80)*	*267*	*119*
Depreciation	(31)	(37)	(33)	(40)	(39)
EBIT	**994**	**894**	**1,272**	**1,053**	**1,257**
EBIT margin%	**11.0%**	**12.2%**	**11.2%**	**13.7%**	**12.3%**
Financial Expenses	(116)	(180)	(138)	(302)	(210)
Other Income	26	0	26	0	0
Other Operating Income	12	30	19	9	37
PBT	**917**	**743**	**1,178**	**761**	**1,084**
Tax Expense	(312)	(241)	(400)	(247)	(358)
Tax Rate %	34.0%	32.4%	34.0%	32.5%	33.0%
PAT	**605**	**503**	**778**	**514**	**726**

Source: Company and Citi Investment Research and Analysis estimates

Significant balance sheet deterioration

- BGRL seems to be facing severe working capital (WC) stress with debtor days ballooning up to 478 days of sales end 2Q12 from 258 days end 2Q11. WC intensity (NCA – Cash days of sales) is up to 289 days end 2Q12 from 119 days end 2Q11. Cash flow from operations (CFO) was -Rs9.1bn in 1HFY12 v/s -Rs5.4bn in 1HFY11. The debt equity ratio has ballooned up 2.2x end 2Q12 from 1.7x from end 2Q11. With more equity commitments for the BTG JV with Hitachi over the next 12-18 months, we expect the balance sheet to deteriorate even further.

- Increase in receivables from Rajasthan and TN because of some issues with certification, which have been resolved now and payments should start trickling in soon and receivables days will improve post that. BGR expect to receive retention money on Kakatiya and one more project by 1Q13, and retention money on Vijayawada will be released gradually from Nov11 to Mar11.

Figure 4. BGRL – Deteriorating Balance Sheet

Year End Mar31 (Rsmn)	1HFY10	FY10	1HFY11	FY11	1HFY12
Debtor Days of Sales	300	235	258	243	478
(NCA – Cash) Days of Sales	112	73	119	103	289
D/E	1.4	1.3	1.7	1.4	2.2
Net Debt/ Equity	(0.2)	(0.1)	0.7	0.4	1.3

Source: Citi Investment Research and Analysis

Figure 5. BGRL – Cash Flow From Operations

Year End Mar31 (Rsmn)	1HFY11	1HFY12
PAT	1,383	1,016
Depreciation	64	77
Change in DTL	294	187
Change in WC	(7,141)	(10,353)
CFO	**(5,400)**	**(9,073)**

Source: Citi Investment Research and Analysis

Guidance revised down but still seems aggressive

- Management has revised down sales growth guidance to 2% from 15% earlier. However, we feel the guidance continues to be on the aggressive side and factor in sales of Rs40.5bn (15% decline YoY)
- Management expects sales of >Rs10bn in 3Q12 (v/s CIRA at Rs10.5bn) and Rs20bn in 4Q12 (v/s CIRA at Rs15bn).

Figure 6. BGR Guidance For FY12E

	FY11	FY12G (Post FY11)	FY12G (Post 1Q12)	FY12G (Post 2Q12)	CIRA
Sales	47,498	54,623	54,623	48500	40,542
Growth		*15.0%*	*15.0%*	*2.1%*	*-15%*
EBITDA Margin	0.1129	11-12%	12-13%	12-13%	13.3%
PAT Margins	6.8%	6.50%	6.50%	6.50%	6.9%

Source: Company and Citi Investment Research and Analysis estimates

Expects to win Rs55-60bn of orders in FY12E

After winning a mere Rs29.4bn of orders in FY11, BGRL has managed to cobble together Rs10.1bn of orders 1H12. The company in the post results conference call mentioned it has visibility for another Rs45-50bn of orders before Mar 12, which include:

- EPC order to the tune of Rs16.9bn from TRN Energy for a 2X300MW power plant (at Rs28.3mn/MW) announced post 2Q12 results, and
- Rs29bn order for 4X800MW turbines from NTPC by Dec 11.

Figure 7. BGR Order Inflows On FY12

Date	Client	Details	Rsmn
By Dec11	NTPC	4X800MW Turbine (Not Yet Awarded)	28,160
17-Nov-11	TRN Energy	EPC Order for 2X300MW at Nawapara Village, Chhattisgarh	16,980
NA	NA	Won in 2Q12	5,270
29-Aug-11	NPCIL	Main Plant Electricals with island electricals, Kota (2X700MW) & Kakrapara, 2X700MW)	4,445
NA	NA	Capital goods segment	400

Source: Company and Citi Investment Research and Analysis

Status of the order pipeline

- BGR is banking on central/ state utilities as IPPs are going slow (IPPs prefer Chinese power plants and BGR will bid for BOP portion). In Orissa, 2x660MW of Rs60bn orders (BOP + BTG) are expected to be bid out by Mar 12-Apr 12.

- Gas based projects of 1500MW amounting to Rs35-40bn are being talked about where tendering in progress. NTPC might tender out large EPC orders in at least one or two sites and Mahagenco will tender out a 600MW Bhusaval order.

Status on Rajasthan order

- There have been some issues on environmental clearances. Recently the coal block has been cleared but it is now waiting for formal MOEF approval for coal block (which will come possibly in one to two months).

- Rajasthan does not have a problem in terms of funding capex lending by PFC and REC. The problem is on the working capital side.

Update on BGR-Hitachi JV

- So far Rs2.05bn has been invested and it expects to invest Rs2.5bn by FY12E end and another Rs3bn in FY13E. This entity will start recognizing revenues from FY14E. The JV is in process of tying up debt from banks and has in principle sanctions from lead banks.

- The construction of factories will start from mid Jan 12. Most of the land acquisition is complete with only government land pending (was waiting for elections to be over). It has finalized the architect and placed orders for long-lead equipment. Construction is to take 12 months for the boiler factory and 18 months for the turbine factory.

BGR Energy Systems

Company description

BGRL was incorporated in 1985 as a joint venture (JV) between GEA Energietechnik GmbH, Germany (40% stake) and Mr. B.G. Raghupathy (60% stake). It was initially in the business of supplying condensate tube-cleaning systems and debris filters, with a turnover of ~Rs100m. In 1993, GEA's stake was bought out by B.G. Raghupathy. Around FY00, BGR decided to approach clients with an integrated power equipment offering, rather than multiple divisions of BGRL approaching the same set of clients. BGRL then also tied up with BHEL to provide BOP solutions to clients. It won BOP orders for 95MW Valuthur CCPP from TNEB and for 23MW captive plant from Aditya Cements in Rajasthan. In FY01, BGRL won the EPC contract from Aban for a 120MW gas power plant in TN. Following an IPO, BGRL listed on the stock exchanges on January 3, 2008. The company won its first 600MW EPC contract from TNEB in FY09. BGRL has also announced collaboration with Hitachi Power Europe GmbH, Germany (660MW, 800MW, 1,000MW and 1,100MW) for supercritical boilers and with Hitachi, Japan (660MW, 700MW, 800MW and 1,000MW) for supercritical turbines and generators.

Investment strategy

We rate BGR Energy Sell/High Risk. As India's Infrastructure and Industrial capex decelerated from FY09 ownwards, the overall opportunity pie growth has not kept pace with 1) the rise of multiple new players across subsectors; 2) influx of Koreans and Chinese in India; and 3) companies bidding and diversifying across subsectors. Over the last year problems have compounded in the power EPC, BTG and BOP markets on account of: 1) Coal India's production cuts putting the power sector's growth in jeopardy; 2) Deteriorating SEB finances leading to question marks about payment security; and 3) Since SEB finances are deteriorating, it is not picking up enough power and resorting to load shedding. This has led to a correction in merchant prices. Even if orders rebound we expect margins to decline structurally going forward and BGRL with its weak balance sheet could find the going tough.

Valuation

Our Rs272 target price is based on a target P/E multiple of 8x Mar13E EPS (BGRL has traded in a P/E multiple band of 4x to 58x post listing) which is at a discount to the historical average P/E multiple of 14x given (1) structurally declining RoEs from 39% in FY11 to 16% by FY14E (2) EPS decline of 10% over FY11-14E v/s 55% growth over FY08-11 and (3) similar to FY11 we expect the operating cash flows to be negative over the next 3 years.

Risks

We rate BGR Energy High Risk due to increasing competitive intensity in the industry and concerns about future order inflows.

Key upside risks to our target price include: (1) Better-than-expected order inflows; (2) Better-than-expected margins; (3) Better-than-expected execution.

Appendix A-1

Analyst Certification

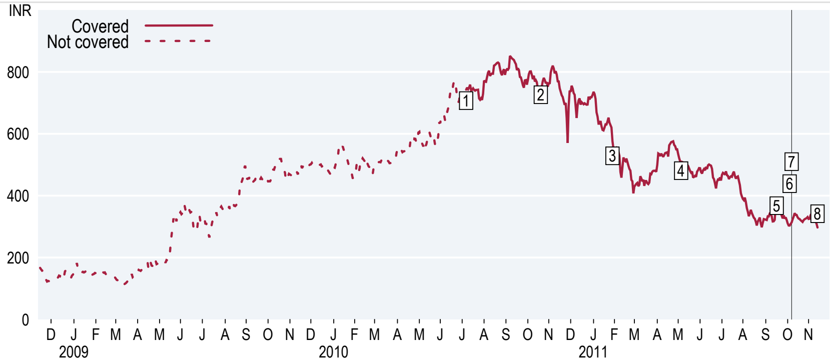
The research analyst(s) primarily responsible for the preparation and content of this research report are named in bold text in the author block at the front of the product except for those sections where an analyst's name appears in bold alongside content which is attributable to that analyst. Each of these analyst(s) certify, with respect to the section(s) of the report for which they are responsible, that the views expressed therein accurately reflect their personal views about each issuer and security referenced and were prepared in an independent manner, including with respect to Citigroup Global Markets Inc and its affiliates. No part of the research analyst's compensation was, is, or will be, directly or indirectly, related to the specific recommendation(s) or view(s) expressed by that research analyst in this report.

IMPORTANT DISCLOSURES

BGR Energy Systems (BGRE.BO)

Ratings and Target Price History
Fundamental Research

Analyst: Venkatesh Balasubramaniam
Covered since July 7 2010



	Date	Rating	Target Price	Closing Price
1	7-Jul-10	*1M	*884.00	742.80
2	20-Oct-10	1M	*934.00	731.70
3	28-Jan-11	1M	*727.00	576.55
4	5-May-11	*3M	*470.00	507.20
5	16-Sep-11	3M	*387.00	362.00
6	5-Oct-11	*2H	*350.00	303.40
7	7-Oct-11	Stock rating system changed		
8	14-Nov-11	*3H	*241.00	297.05

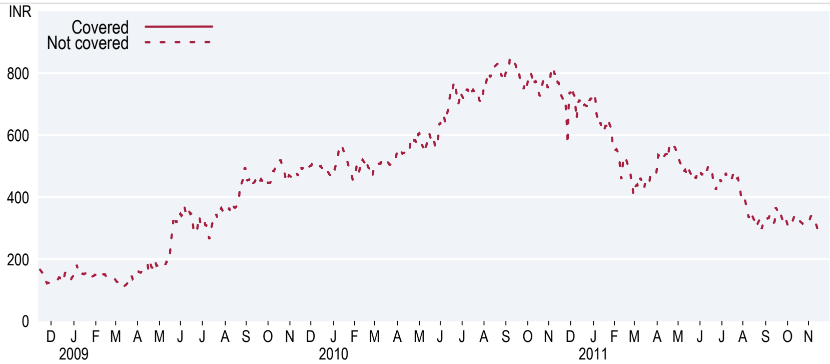
* Indicates change

Rating/target price changes above reflect Eastern Standard Time

BGR Energy Systems (BGRE.BO)

Ratings and Target Price History
Best Ideas Research
Relative Call (3 Month)

Analyst: Venkatesh Balasubramaniam
Covered since July 7 2010



* Indicates change

Rating/target price changes above reflect Eastern Standard Time

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Citi Investment Research & Analysis Ratings Distribution

	12 Month Rating			*Relative Rating*		
Data current as of 10 Oct 2011	**Buy**	**Hold**	**Sell**	**Buy**	**Hold**	**Sell**
Citi Investment Research & Analysis Global Fundamental Coverage	59%	34%	7%	10%	79%	10%

% of companies in each rating category that are investment banking clients	45%	42%	37%	50%	43%	46%

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