

Result Update

BHEL (BHEL IN)

May 23, 2012

Order impasse to continue

HOLD (CMP: ₹211)

Mkt Cap ₹673bn; USD: 135bn

Decretion of order book has taken away the sheen off an otherwise good set of numbers in FY12. Sales, EBIDTA and PAT for the quarter were in line and while no significant orders were expected during Q4, the 8% sequential fall in order book is disappointing. This depleting order book coupled with the continuing tough outlook for power generation orders has led us to cut our FY13-14E earnings by 11% and 15% respectively, indicating flat earnings growth in FY12-14E. Hence, we reduce our target price to ₹230 as we roll forward to 9x FY13E. We do not see any near-term triggers for a re-rating. While imposition of import duty is taking an indefinite time, we believe it will be difficult for multiples to expand significantly to the levels BHEL has got in the past five years. We maintain our Hold rating and prefer L&T among large-cap engineering stocks.

Order book depletion takes sheen off an otherwise good financial year

BHEL has undergone a structural de-rating due to the slowdown in the power sector on one hand and the increased domestic competition on the other. Decretion of order book has taken away the sheen off an otherwise good set of numbers in Q4 FY12. Sales, EBIDTA and PAT for the quarter were in line. Sales came in at ₹194bn, a growth of 2% yoy. Operating profits were flat, while operating margins fell 360bps to 19.4%, leading to a flat PAT. While no significant orders were expected in the quarter, the sharp 8% fall in order book is disappointing, occurring on account of a large power order getting canceled along with scope changes in other projects totaling to ₹58bn. All these are likely to lead to a trending down of BHEL's margins. The depleting order book coupled with the continuing tough outlook for power generation orders has led us to cut our FY13-14E earnings by 11% and 15%, respectively. Working capital pressures continued with increasing execution and reducing advances due to lack of orders. Cash in books end of FY12 is ₹66bn, a 35% drop from ₹96bn in March 2011.

Power sector woes suggest drying up of orders in the near term

The current stalemate in power capex is because of a combination of policy paralysis by the government as well as rising interest rates that are making projects more expensive. Even existing projects are moving slowly because of challenges, such as land acquisition, environmental clearances, fuel supply availability, etc. This is likely to continue the drying up of orders for BHEL in the near term. The sharp 8% fall in order book is disappointing. The power sector is in a limbo raising concerns on the potential of future order flows and even execution of existing orders, though BHEL is looking at a possible opportunity of 14,000MW in FY13. In a tough customer environment, BHEL also has to fend off competition in the form of home-grown players like L&T-Mitsubishi, Bharat Forge-Alstom, BGR-Hitachi, JSW-Toshiba, etc. These twin impacts of a falling market share and pricing concerns have seen BHEL being de-rated.

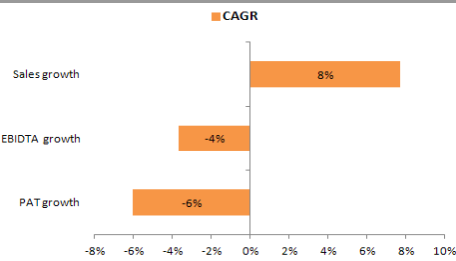
Lack of immediate re-rating triggers; we prefer L&T in this capital goods space

Given the recent stock price correction, the stock is available at 8x FY13E and 8x FY14E, a valuation band never seen in the past five years. We believe that this valuation captures all negatives, but we do not see any near-term triggers for a re-rating. While multiple expansions will happen again, once things get moving in the power sector, we believe it will be difficult for them to expand significantly to the levels BHEL has got in the past five years. We prefer L&T as L&T is more a victim of cyclical de-rating as compared to BHEL, which is a structural de-rating story.

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Industry Capital goods

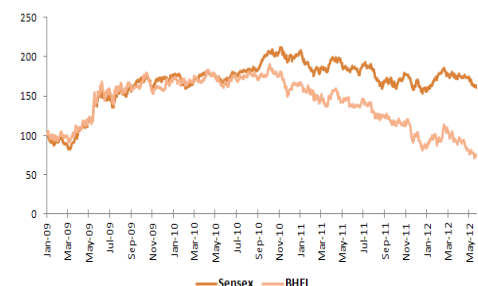


Price	211
Target Price	230
Expected share price return	8%
Expected dividend yield	1%
Expected total return	9%

Market Data

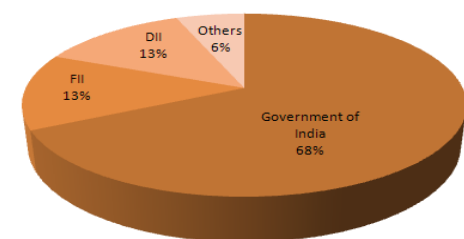
Market Cap.	₹673bn/ US\$135bn
Share Cap. (mn)	489.52
52 Wk High/Low	463/225
Avg. Vol. (Weekly)	5806164

(Price Performance (RIC: BHEL.BO, BB: BHEL IN))



Shareholding Pattern

(As on Mar 31st, 2012) (%)



Financials (₹ Mn)	FY11	FY12F	FY13F
Revenue	415,661	479,789	526,244
Expenses	336,610	380,910	434,888
EBIDTA	79,051	98,879	91,356
Profit before tax	90,056	103,022	94,011
Net profit	60,111	70,399	62,987
EPS	24.6	28.8	25.7
P/E	8.6	7.3	8.2
RoE %	33.3	30.9	27.1
RoCE %	49.8	45.4	39.2

Table 1: Quarterly trend in BHEL

₹ mn	Jun-10	Sep-10	Dec-10	Mar-11	Jun-11	Sep-11	Dec-11	Mar-12
Net Sales/Income from operations	67,428	86,325	90,233	183,805	72,715	105,455	106,586	195,889
(Increase)/Decrease in Stock in trade	(1,253)	(3,932)	(2,759)	6,669	(4,306)	(4,479)	(4,745)	5,298
RM Consumption	39,346	53,572	50,857	82,932	45,806	65,658	64,882	106,052
Personnel Expenses	13,378	12,641	13,486	14,599	13,010	13,491	13,377	14,781
Other Expenses	4,889	6,301	7,932	36,669	7,073	11,192	12,723	20,387
Operating income	11,068	17,742	20,717	42,936	11,132	19,592	20,350	49,372
Operating margins	16.4%	20.6%	23.0%	23.4%	15.3%	18.6%	19.1%	25.2%
Other Income	1,635	1,620	1,530	1,634	2,487	2,199	2,415	3,989
PBIDT	12,703	19,362	22,247	44,570	13,619	21,791	22,765	53,361
- Interest	38	59	145	305	88	96	145	183
- Depreciation	1,269	1,341	1,447	1,384	1,709	1,888	1,861	2,541
Profit Before Tax	11,396	17,962	20,655	42,881	11,822	19,806	20,758	50,637
Provision for Tax	3,301	5,121	6,623	14,901	3,667	5,686	6,432	16,838
Net Profit	8,095	12,841	14,032	27,980	8,155	14,120	14,326	33,798

Source: Company, Systematix Research

Table 2: Segmental Trend in BHEL

₹ mn	Jun-10	Sep-10	Dec-10	Mar-11	Jun-11	Sep-11	Dec-11	Mar-12
Segment Revenues								
Power	53,999	69,650	72,820	151,444	57,803	77,973	87,115	155,738
Industry	14,763	18,577	21,430	37,091	16,529	29,603	23,668	46,789
- Total of Reportable Segments	68,762	88,227	94,250	188,535	74,332	107,576	110,783	202,527
Segmental profits								
Power	10,701	14,731	16,321	41,362	9,518	13,159	16,560	42,601
Industry	1,704	3,055	4,542	9,851	3,733	8,004	7,486	14,201
- Total of Reportable Segments	12,405	17,786	20,863	51,213	13,251	21,163	24,046	56,803
- (Add) / Less - Interest	38	59	145	305	88	96	145	183
- Other unallocated expenditure net	2,390	1,183	63	8,027	1,341	1,261	3,143	5,983
- Total Profit Before Tax and Extraordinary Item	9,978	16,544	20,655	42,881	11,822	19,806	20,758	50,637
PBIT margins								
Power	19.8%	21.2%	22.4%	27.3%	16.5%	16.9%	19.0%	27.4%
Industry	11.5%	16.4%	21.2%	26.6%	22.6%	27.0%	31.6%	30.4%
Total	18.0%	20.2%	22.1%	27.2%	17.8%	19.7%	21.7%	28.0%

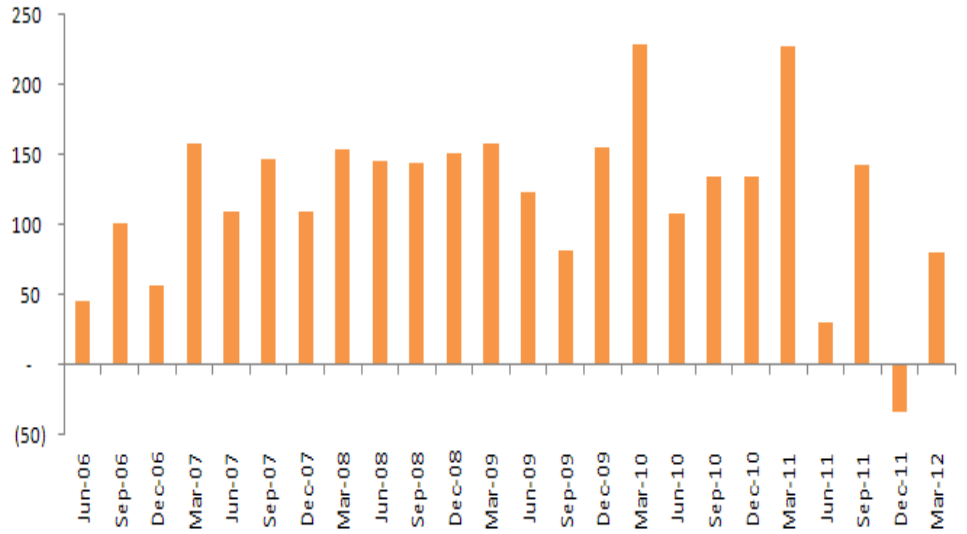
Source: Company, Systematix Research

Table 3: Change in estimates

₹ m	FY13			FY14		
	Old	New	% chg	Old	New	% chg
Sales	526244	526244	0.0%	556763	556763	0.0%
EBIDTA	94154	91356	-3.0%	97378	91734	-5.8%
PAT	71447	62987	-11.8%	73992	62196	-15.9%
EPS	29.2	25.7	-11.8%	30.2	25.4	-15.9%

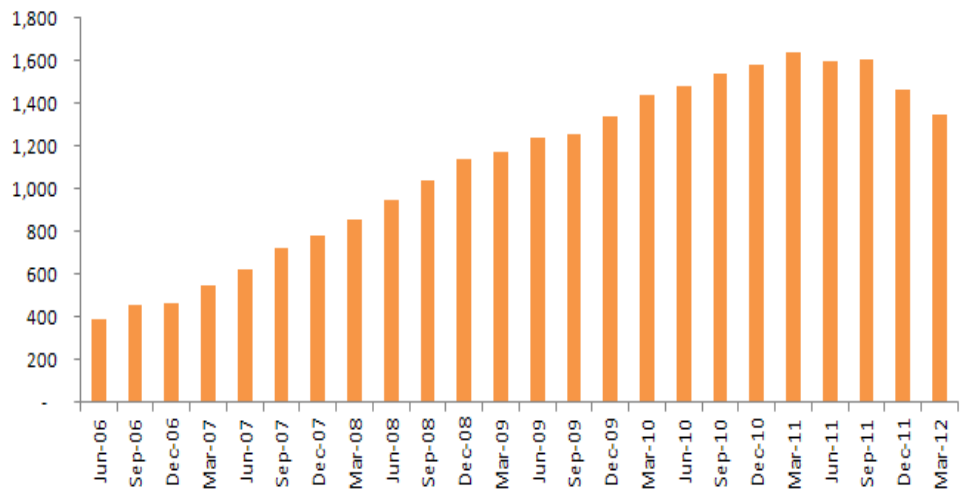
Source: Company, Systematix Research

Chart 1: Order inflow trend (₹ b)



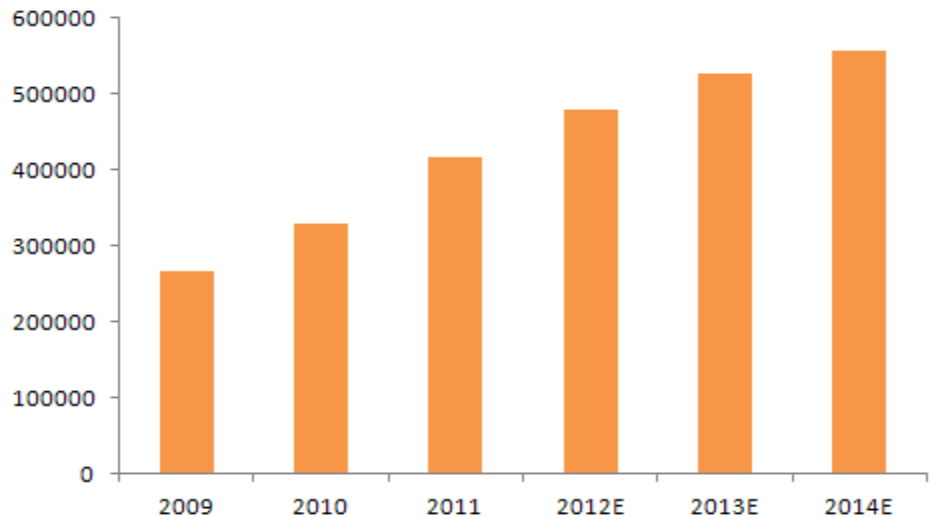
Source: Company

Chart 2: Order book trend (₹ b)



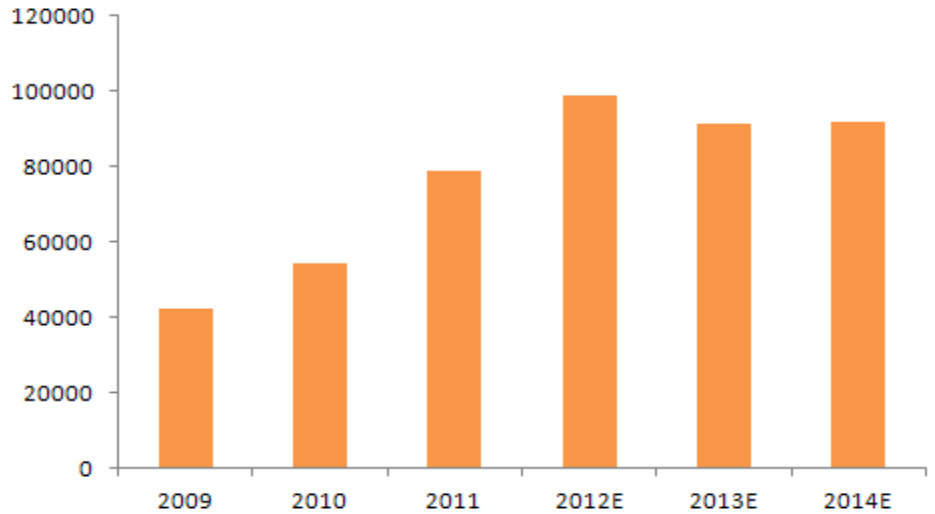
Source: Company

Chart 3: Revenue trend (₹ m)



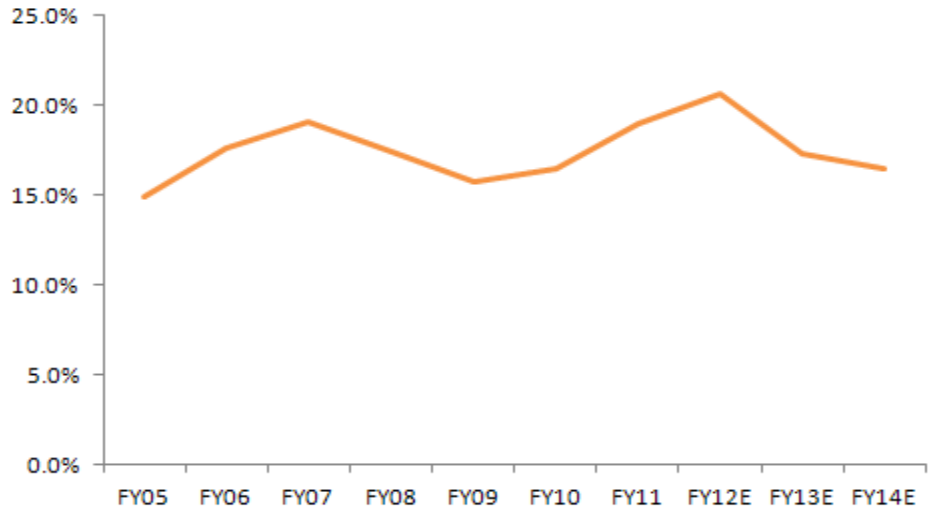
Source: Company

Chart 4: EBIDTA trend (₹ m)



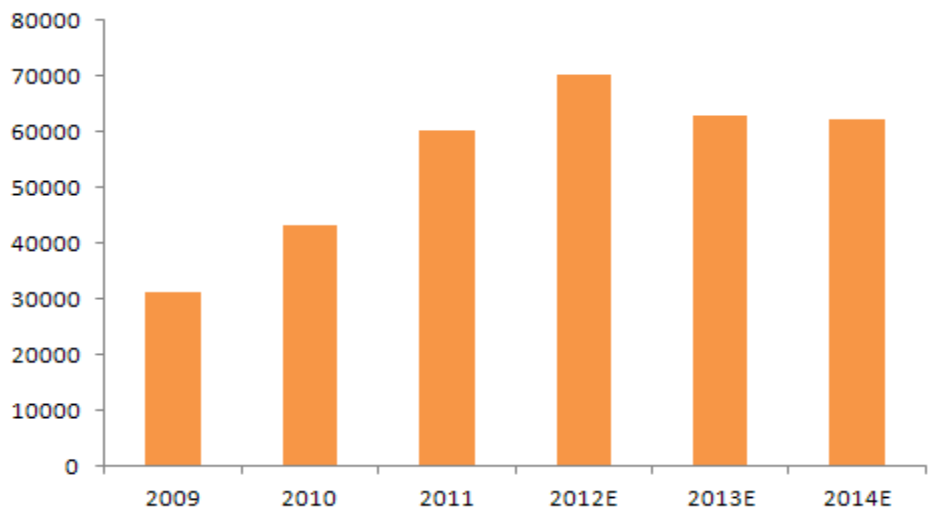
Source: Company

Chart 5: EBIDTA margin has moved in a 15-20% band



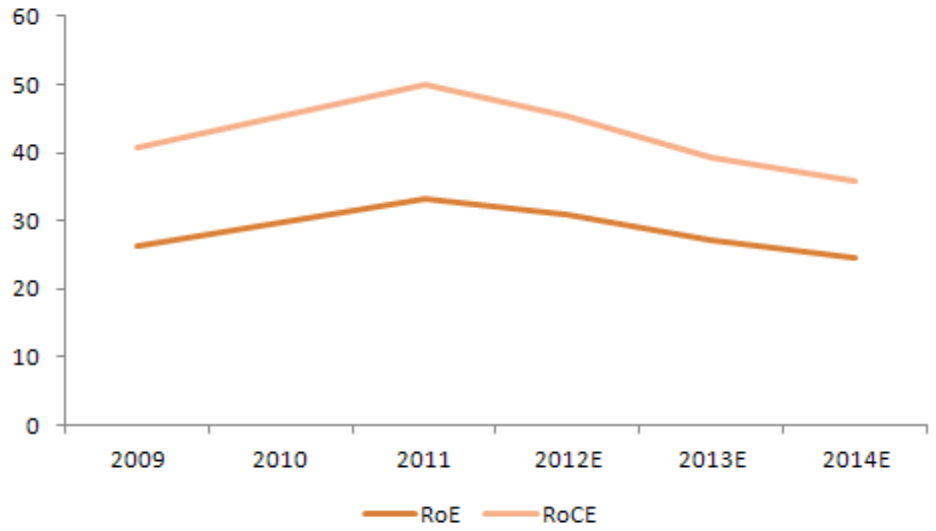
Source: Company

Chart 6: PAT trend (₹ m)



Source: Company

Chart 7: Trend in RoE, RoCE %



Source: Company

PROFIT & LOSS STATEMENT

Income Statement ₹ m	2009	2010	2011	2012E	2013E	2014E
Revenue	267,268	328,614	415,661	479,789	526,244	556,763
Expenses	225,078	274,353	336,610	380,910	434,888	465,029
EBIDTA	42,190	54,262	79,051	98,879	91,356	91,734
Depreciation & amortisation	(3,343)	(4,580)	(5,441)	(8,000)	(8,400)	(8,820)
EBIT	38,847	49,682	73,610	90,879	82,956	82,914
Interest expense	(307)	(335)	(547)	(513)	(335)	(335)
Other income	9,829	16,486	17,011	12,656	11,390	10,251
Other extraordinary items	119	73	(18)	-	-	-
Profit before tax	48,488	65,906	90,056	103,022	94,011	92,830
Income tax	(17,106)	(22,800)	(29,945)	(32,623)	(31,024)	(30,634)
Net profit	31,381	43,105	60,111	70,399	62,987	62,196

Source: Company, Systematix Institutional Research

BALANCE SHEET

Balance Sheet ₹ m	2009	2010	2011	2012E	2013E	2014E
Assets						
Cash	103,147	97,901	96,301	66,720	34,229	25,863
Receivables	159,755	206,888	273,546	362,296	409,677	448,191
Inventories	78,370	92,355	109,630	155,270	176,585	186,746
Other current assets	27,739	32,205	35,469	48,221	60,572	77,281
Accounts payable	233,573	280,237	313,466	403,159	437,052	470,696
Other current liabilities	49,756	44,180	75,968	78,382	76,660	76,465
Net current assets	85,682	104,931	125,514	150,967	168,648	192,991
Fixed assets	14,704	24,154	34,009	43,357	49,899	54,692
Capital WIP	11,570	15,296	17,622	17,622	17,622	17,622
Investments	523	798	4,392	19,392	34,392	49,392
Deferred tax asset	18,403	15,272	21,636	21,636	21,636	21,636
Total Assets	130,882	160,451	203,172	252,972	292,196	336,332
Liabilities						
Share capital	4,895	4,895	4,895	4,895	4,895	4,895
Reserves	124,493	154,278	196,643	248,811	285,560	329,451
Shareholder funds	129,388	159,174	201,538	253,706	290,455	334,346
Debt	1,494	1,278	1,634	1,530	1,741	1,986
Total liabilities	130,882	160,451	203,172	255,236	292,196	336,333

Source: Company, Systematix Institutional Research

CASH FLOW

Cash Flow ₹ m	2009	2010	2011	2012E	2013E	2014E
Profit before tax	48,369	65,833	90,074	103,023	94,011	92,830
Depreciation	3,343	4,580	5,441	8,000	8,400	8,820
Non-cash adjustments	(26,628)	(38,951)	(46,408)	(44,766)	(42,079)	(40,550)
Change in working capital	12,444	(24,495)	(22,182)	(55,034)	(48,876)	(31,936)
Operating cashflow	37,527	6,966	26,925	11,223	11,457	29,165
Change in fixed assets	(12,983)	(17,549)	(17,163)	(15,700)	(13,700)	(12,700)
Change in investments	(441)	(275)	(3,593)	(15,000)	(15,000)	(15,000)
Investment cashflow	(13,423)	(17,824)	(20,756)	(30,700)	(28,700)	(27,700)
Change in debt	542	(216)	356	(103)	211	245
Change in equity	0	0	0	0	0	0
Interest & dividend	(214)	2,807	(1,284)	(6,089)	(4,120)	(3,966)
Financing cashflow	328	2,590	(928)	(6,192)	(3,909)	(3,721)
Other items	(5,145)	3,020	(6,841)	(3,912)	(5,372)	(14,606)
Total cashflow	19,287	(5,246)	(1,600)	(29,581)	(25,215)	(13,069)
Beginning of year cash	83,860	103,147	97,901	96,301	66,720	38,932
Year end cash	103,147	97,901	96,301	66,720	34,229	25,863

Source: Company, Systematix Institutional Research

RATIOS

Key Ratios	Units	2009	2010	2011	2012E	2013E	2014E
Revenue growth	%	35.8	25.4	26.5	13.6	9.2	5.8
EBITDA margin	%	15.8	16.5	19.0	20.6	17.4	16.5
PAT margin	%	11.7	13.1	14.5	14.7	12.0	11.2
EPS growth	%	9.4	37.6	39.7	17.1	(10.5)	(1.3)
P/E	x	25.0	18.2	13.0	11.1	12.4	12.6
EV/EBIDTA	x	16.4	12.8	8.8	7.2	5.3	4.1
RoAE	%	26.4	29.8	33.3	30.9	27.1	24.7
RoACE	%	40.6	45.4	49.8	45.4	39.2	35.7
Book value per share	₹	53	65	82	104	125	151

Source: Company, Systematix Institutional Research

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Stock Ratings

BUY (B)	The stock's total return is expected to exceed 20% over the next 12 months.
ACCUMULATE (A)	The stock's total return is expected to be within 10-20% over the next 12 months.
HOLD (H)	The stock's total return is expected to be within 0-10% over the next 12 months.
SELL (S)	The stock's total return is expected to give negative returns over the next 12 months.
NOT RATED (NR)	The analyst has no recommendation on the stock under review.

Industry Views

ATTRACTIVE (AT)	Fundamentals/Valuations of the sector are expected to be attractive over the next 12-18 months.
NEUTRAL (NL)	Fundamentals/Valuations of the sector are expected to neither improve nor deteriorate over the next 12-18 months.
CAUTIOUS (CS)	Fundamentals/Valuations of the sector are expected to deteriorate over the next 12-18 months.

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