

January 30th, 2012

BHEL

HOLD

Bharat Heavy Electricals Ltd (BHEL), the PSU power equipment major, announced its Q3FY12 numbers, which was in line with street expectations on the back of healthy revenue growth of 19% at Rs. 105bn and muted PAT growth of 2% at Rs. 14.3bn on Y-o-Y basis.

Key Highlights-

- EBITDA margins contracted to 19.4% Y-o-Y on the back of 65% jump in other expenses, which was largely on account of higher freight costs and higher selling expenses.
- The company reported order cancellation of ~ Rs. 58.5bn from a private sector player on account of proposed change in government policy of denying fuel linkage to sub-critical plants. Overall order inflow situations remained weak as the company managed to get mere Rs. 24.7bn of order flow. We believe this order cancellation and weak order flow shows the weak undercurrent in the industry and will hamper the performance of the company in the upcoming quarters.
- Working capital cycle is getting impacted because of lot of projects being executed and higher levels of debtors. Weak order flows are impacting advances from customers and in turn hampering the net cash balance.
- Power segment revenue stood at Rs. 87bn (+58% Y-o-Y) and industry segment revenue stood at Rs. 23.7bn (-37% Y-o-Y). Power segment accounted for nearly 79% of the sales while the balance 21% was contributed by industry segment.
- The order book of the company consists of 80% from power sector; 13% from industry sector and remaining from exports. Total order book stood at ~ Rs. 1.47tn

Based on a standalone FY13 P/E multiple of 10.15, the fair value for the company works out to Rs 272.

Financial Snapshot

Projections (Rs. Mn)	Q2FY11	Q2FY12	% chg	FY10A	FY11A	% chg	FY12E	FY13E
Net Revenue	83,284	102,986	24%	333,027	421,915	27%	453,030	497,270
Total Income	86,526	107,654	24%	352,965	433,824	23%	473,099	518,193
EBIDTA	17,944	21,791	21%	70,820	96,043	36%	89,741	105,459
EBIDTA %	21.5%	21.2%		21.3%	22.8%		19.8%	21.2%
PAT	11,423	14,120	24%	43,104	60,087	39%	55,649	65,734
NPM %	13.7%	13.7%		12.9%	14.2%		12.3%	13.2%
EPS Rs	3.3	3.9	18%	17.6	24.5	39%	22.7	26.9
BVPS Rs				65.0	82.3	27%	88.2	96.5
ROE %				27.1%	29.8%		25.8%	27.8%
PER x							10.8	9.1
P/B Ratio							2.8	2.5

Recommendations	<= 1 year	1 - 2 yrs	2 - 5 yrs
Strong Buy			
Buy			
Hold			
Reduce			
Sell			

Strong Buy – Expected Returns > 20% p.a.

Buy – Expected Returns from 10 to 20% p.a.

Hold – Expected Returns from 0% to 10% p.a.

Reduce – Expected Returns from 0% to 10% p.a. with possible downside risk

Sell – Returns < 0%

STOCK DATA

BSE / NSE Code	500103 / BHEL
CMP Rs (30th Jan'12)	245
Market Cap (Rs mn)	600,029
52 Week High-low	475.8 / 225

STOCK RETURN (%)

	30D	3M	6M	1Y
BHEL	3%	-25%	-33%	-43%
Sensex	9%	-5%	-7%	-8%
Nifty	10%	-5%	-7%	-8%

Other expenses jumped by 65% to Rs. 13bn on account of higher freight costs and higher selling expenses

In Q3FY12, the company reported order cancellation of ~ Rs. 58.5bn from a private sector player on account of proposed change in government policy of denying fuel linkage to sub-critical plants

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OTHER HIGHLIGHTS

In Q3FY12, industry segment reported 101% jump in the operating profits which came in at Rs. 7.5bn on Y-o-Y basis and power segment reported decline of 3% which stood at Rs. 16.6bn on Y-o-Y basis.

In the power segment, there has not been any major change in order flows. In the month of January, the company got the letter of award from Abhijit Industries for 300 megawatt BTG sets for about Rs. 6.3bn and also received letter of intent from ONGC for 6 numbers of oil rigs based on AC drilling technology worth Rs. 7.7bn. Though the management did not guided on order inflow for FY12 due to FPO restrictions, we are of the view that the company will struggle to meet the guidance of Rs 665bn shared at the end of FY11 for FY12 due to lackluster investment activity and high competition.

Steep rise of 65% in the other expenses (Rs. 13bn) impacted the operating margins. The other expenses rose on account of higher selling expenses (+121%), higher freight expenses (+67%) and higher provisioning (+47%). Due to multiple negative factors affecting the business of BHEL, such as rising working capital needs, declining order book and operating margins, cancellation of orders and lack of triggers on the earning front, we believe coming quarters will be challenging for the company and hard to maintain the profitability and earnings growth.

We expect BHEL's revenues to grow at a CAGR of 8.6% over FY2011-13 to Rs 497bn. We further estimate that PAT would grow at a CAGR of 4.6% over FY2011-13 to Rs 6.7bn. Considering the current concerns (slower execution, uncertainty of order inflows in the next few quarters, higher interest rate scenario and uncertainty on FPO pricing), we apply a 40% discount to the five year average 2 year forward P/E multiple of 16.9.

In Q3FY12, operating profit jumped 101% in industry segment; however declined 3% in power segment

Order book during the quarter stood at Rs 1.47tn, against 1.6tn in the previous quarter

So, based on a standalone FY13 P/E multiple of 10.15, the fair value for the company works out to

Rs 272. We downgrade our recommendation from 'BUY' to 'HOLD'.

Financial Analysis and Projections

Particulars (Rs Mn)	FY09A	FY10A	FY11A	FY12E	FY13E
Net Revenue	265,901	333,027	421,915	453,030	497,270
Other Income	10,511	12,072	10,635	13,921	13,907
Total Income	287,928	352,965	433,824	473,099	518,193
Operating Expenditure	235,791	282,145	337,781	383,358	412,734
Depreciation	3,343	4,580	5,441	5,919	6,483
EBIT	48,794	66,240	90,602	83,822	98,976
EBIT Margin (%)	18%	20%	21%	19%	20%
Interest	307	335	547	454	499
Profit Before Tax	48,487	65,905	90,054	83,368	98,476
Less: Tax	17,105	22,799	29,942	27,719	32,743
Profit After Tax	31,337	43,104	60,087	55,649	65,734
PAT Margin (%)	12%	13%	14%	12%	13%
ROE (%)	24%	27%	30%	26%	28%
EPS (Rs)	13	18	25	23	26.9
BVPS (Rs)	53	65	82	88	96
Valuation Ratios (x)				FY12E	FY13E
P/E				10.8	9.1
P/B				2.8	2.5

Outlook: -

- We are of the view that the company will struggle to meet the order inflow guidance of Rs 665bn shared at the end of FY11 for FY12 due to lackluster investment activity and high competition.
- The upcoming FPO overhang is expected to persist for some time and will impact the share price in the near term.

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