

BHEL

Urmik Chhaya (urmik.chhaya@karvy.com)

Buy

Rs231.90

We met C Srinivasan, Director (Finance) of Bharat Heavy Electricals Limited (BHEL). Key takeaways from this meeting are as follows:

On a Q4-Q4 comparison (provisional for FY03 V Audited FY02), PBT has been almost flat at Rs5.81bn (Rs5.62bn), despite a lower VRS write off and lower interest outgo (estimated at Rs157mn in Q4FY03 as against Rs254mn in Q4FY03). Also in Q4FY03, I-T refund and Interest income on surplus cash deployed contributed Rs120mn and Rs200mn, respectively. However, the key factor dragging PBT has been employee cost (as was reflected in Q3FY03) and increase in provisions.

Employee Cost

- In FY02, LTC encashment was not allowed by the Central Government for its employees. It was allowed in FY03 and hence encashment by employees -primarily in Q4 (to adjust for TDS)- resulted in additional liability of Rs350mn.
- The lower interest rates resulted in additional gratuity provision of Rs180mn.
- Hike in Dearness Allowance (Wage settlement does not cover hike in DA) accounted for Rs300mn.

Impact of lower interest cost has been factored in the Employee cost. On Q3FY03 level (per quarter), Employee cost will remain flat.

Provisions

Net negative incremental provision (primarily for contractual obligation) is Rs500mn. Unlike the last year, write back of provisions for the projects completed has not cushioned the impact.

Change in Accounting Policy

In compliance with the revised AS-7, for orders received from April 2003 (Libya Contract is taken in FY03), profit booking will start on dispatch and not on 30% completion, as was the case till FY03. This could result in positive aberration in Bottomline for 2 years. But, it is more of an accounting impact.

Debt Restructuring

BHEL's primary debt is the Bonds issued at 8.85% p.a. coupon rate. In the present rates scenario, buy-back is possible only at a premium and not at par value. BHEL has resorted to Interest Rate Swap (estimated amount deployed: Rs2bn) primarily for hedging and risk management. This has resulted in net savings in interest rate of 2% p.a. The gross interest outgo for the year is Rs510mn.

Libyan contract

For this contract, Lol has been issued and the contract will be signed by end of April'03 (the concerned official has been invited by the Libyan Government to sign the contract and is in that country). Advance will be recd. on signing the contract. The completion schedule is Unit I: 22 months and Unit II: 28 months.

Steel price hike impacts BHEL adversely

Hike in steel prices affect BHEL negatively. But, all the NTPC contracts have an in-built price variation clause (PVC). For fixed price contracts, the anticipated hike is factored in. BHEL is also trying to import steel from cheaper sources such as the CIS countries (subject to quality control approval) as also modify designs to consume less steel without compromising on quality of equipment.

BHEL still lowest bidder for Maithon

For Maithon, BHEL is still L1 (lowest bidder) and the validity has been extended to May'03 (from December'02). EMD is by way of Bank Guarantee. Hence, no cash outgo is involved. The management is confident that the order will be awarded and that a fresh validity extension will not be needed.

Iraq Impact

Equipment worth Rs1.34bn is ready for shipment subject to availability of ship and clearance by the buyer. This includes the turbine lying at Jebel Ali Port, the value of equipment not installed is in excess of Rs2bn. However, value of the unit lying at Jebel Ali Port is reflected in the company's topline for FY03. The UN has continued the Food for Oil Programme and Electricity has been considered as an essential commodity as it is also required to pump water. Hence, the sale and payment for the turbine presently lying at Chennai is also not an issue.

Pricha Project

The advance is 15% against the normal 10% and the terms of payment are such that on completion of contract, the concerned SEB will retain only 2%. BHEL intends to apply the same payment policy to other SEBs with a poor payment record.

Debtor Days

Net of provisions (for bad and doubtful debts), in FY03, the reduction is of 10 days compared to last year.

Central Plan Assistance

BHEL's receivables (from SEBs) are not covered under the tripartite agreement. Hence, BHEL avails benefit of the Central Plan Assistance (CPA). The total CPA is Rs2.25bn but only Rs720mn has been adjusted and rest of the amount will be adjusted in Q1FY04. Hence, effectively the payment for Rs1.53bn has been secured but gets reflected as Debtors in FY03.

EIL

Due diligence has been completed but no final decision has been taken on whether bidding would be through a joint venture with ONGC.

Our View

Our EPS estimate for FY04 and FY05 is Rs27.19 and Rs36.35 (without adding back VRS), respectively. **This is on the conservative side because the tax rate has been assumed to be the highest ignoring the 20% write off each year for VRS. But, if the VRS tax benefit were factored in, then EPS for FY04 and FY 05 would be higher by Rs1.90 and Rs1.05, respectively.** Based on a normal trading range our 12 months target price is Rs320/share. EV/E for FY04 and FY05 (EBIDTA is net of VRS write off) is 4.37x and 3.54x, respectively. We maintain **BUY**.



03 April 2003
Visit Note

Stock Ratings Absolute Returns

Buy : > 25%
Out Performer : 16 - 25%
Market Performer : 0 - 15%
Under Performer : < 0%

Karvy Stock Broking Limited

131, Andheri Industrial Estate, Off Veera Desai Road, Andheri (W), Mumbai – 400 053. India.
Voice: (91-22) 56923724; 5693 6346 – 47

Disclaimer :

The information and views presented in this report are prepared by Karvy Stock Broking Limited. The information contained herein is based on our analysis and up on sources that we consider reliable. We, however, do not vouch for the accuracy or the completeness thereof. This material is for personal information and we are not responsible for any loss incurred based upon it.

The investments discussed or recommended in this report may not be suitable for all investors. Investors must make their own investment decisions based on their specific investment objectives and financial position and using such independent advice, as they believe necessary. While acting upon any information or analysis mentioned in this report, investors may please note that neither Karvy nor any person connected with any associated companies of Karvy accepts any liability arising from the use of this information and views mentioned in this document.

The author, directors and other employees of Karvy and its affiliates may hold long or short positions in the above-mentioned companies from time to time. Every employee of Karvy and its associated companies are required to disclose their individual stock holdings and details of trades, if any, that they undertake. The team rendering corporate analysis and investment recommendations are restricted in purchasing/selling of shares or other securities till such a time this recommendation has either been displayed or has been forwarded to clients of Karvy. All employees are further restricted to place orders only through Karvy Stock Broking Ltd