

KEYNOTE

I P O A N A L Y S I S

BGR Energy Systems Ltd.

Price Band	: Rs425 - 480 per share	December 5, 2007
Issue open during	: December 5 - 12, 2007	
Recommendation	: Subscribe with a medium term view	
Book Running Lead Managers	: SBI Capital, Kotak, UBS, CLSA	
To List on	: NSE and BSE	
Market Cap post-listing	: Rs34.5Bn or \$876mn (based on the cap price)	

IPO of 9.4mn equity shares of Rs 10 each, comprising of fresh issue of 4.32mn shares (Rs207Cr) and offer for sale of 4.82mn shares by promoters (Rs231Cr), aggregating to Rs438Cr or \$111mn at the cap price

Shareholding Pattern

Shareholder Categories	Pre-issue		Post-issue	
	No. of shares	% Holding	No. of shares	% Holding
Promoters	6,48,00,000	100.0%	5,85,44,000	81.3%
Pre-IPO investors				
- CVCIGP II *	-	-	28,80,000	4.0%
- Reliance Capital #	-	-	14,40,000	2.0%
QIBs excluding Mutual Funds	-	-	49,22,520	6.8%
Mutual Funds	-	-	2,59,080	0.4%
Non Institutional Investors	-	-	8,63,600	1.2%
Public	-	-	30,90,800	4.3%
Total	6,48,00,000	100.0%	7,20,00,000	100.0%

* fresh issue and # sale by promoters, both on November 6, 2007

Recommendation - **Subscribe with a medium term view**

- BGR Energy Systems Ltd. (BESL) is an engineering construction major which executes Balance of Plant (BOP) and EPC contracts in the power sector. It manufactures air fin coolers for oil and gas industry and deaerators, desalination plants, water treatment plants and effluent treatment plants, which have applications in power and process plants and other industrial plants.
- India is witnessing a great boom in the power sector due to demand and supply mismatch. Though power generating capacities are being ramped up aggressively, we believe that they will still fall far short of the demand over next few years. In our view, engineering and infrastructure companies with strong project management capabilities would be ideally placed to capture the opportunities.
- India requires power generation capacity of 1210 BU to meet the demand. Since equipment costs constitute 75-80% of the total cost of a thermal plant, this coupled with India's requirement of power, opens up huge opportunities for engineering companies.
- In our view, BESL is one of the few players which can tap the opportunities in the power sector. BESL has already executed BOP as well as EPC projects for power sector ranging from 95 MW to 330 MW and is in the process of executing 3 power projects of 500 MW each. Though risk of timely execution remains, we believe if BESL is able to deliver on these projects, it will be able to get more such projects.
- Healthy order book of Rs33Bn, of which 81% constitutes power projects (incl. captive power projects), expected to be executed over the next 3 years.
- The company has a strong visibility of earnings growth, since a major chunk of the order book will likely be executed over the next 2 years. We expect revenues and earnings to grow at CAGR of 96.2% and 136.7% respectively, over FY07-09.
- While the company has been in operation since 1993 and has been into air fin coolers and environmental engineering since 1994 and 1996 respectively, it entered the more exciting power projects business only in FY01 by securing its first contract for BOP from BHEL. The relatively short track record in key business segments of power projects and captive power projects is in our view a major concern.

- The other concerns would be execution of large-sized projects and managing the proposed manufacturing facilities in Bahrain and China.
- Recent (pre-IPO) placements comprise of (i) issue of 2.88mn shares to CVC @ Rs450 per share or final IPO price, whichever is lower and (ii) transfer of 1.44mn shares from promoters to Reliance Capital @ Rs450 per share.
- The IPO pricing (31.2x FY08E and 22.7x FY09E earnings) is attractive vis-à-vis peers. However, in view of its rather short track record in key businesses and smaller-than-peers size, we feel the valuation is reasonable. Accordingly we recommend subscribing with a medium term view.

Company Background

Incorporated in 1985 as GEA Energie Systems India Pvt Ltd., as a JV between GEA Energietechnik GmbH, Germany and Mr BG Raghupathy to produce and sell on-line condenser tube cleaning systems, debris filters and rubber cleaning balls used in thermal and nuclear power plants.

In 1993, GEA Energietechnik GmbH divested its stake to the promoters pursuant to the expiry of JV agreement. Since then the company has established itself in the power projects, turnkey engineering projects businesses.

Promoters

Mr. B.G. Raghupathy, CMD, has over 33 years of experience in the fields of marketing, sales and management.

Industry Overview

Indian power sector

According to CRIS-INFAC, construction investment in the power sector is expected to be around Rs450Bn from FY06 to FY10. This includes the capacity additions mainly in the thermal power.

As per National Electricity Policy (NEP), India's per capita electricity consumption is set to increase to 1000 units by FY12, which requires a generation growth of 9.5% p.a. for utilities. Given the poor track record of capacity additions (CAGR of 5.1% in power generation in 10th plan period), we expect massive investments into power generation to lead to a major thrust to the engineering construction segment.

Oil & Gas sector

Demand for engineering construction services in the oil and gas industry is dependent on the level of exploration, production, storage, refining and transportation activity in the oil and gas industry and the corresponding capital spending by energy industry conglomerates. Construction projects in the oil and gas industry generally include exploration rigs and platforms, refineries and other processing facilities, tanks and terminals for storage of oil and gas and derivative products and pipelines for transportation of such products.

India is expected to receive significant capital expenditure in the energy industry. The IEA has estimated that India will receive investment in the energy industry of approximately US\$900 billion over the next 25 years.

Business Overview

BESL is an engineering construction major which executes turnkey engineering projects and supplies systems and equipments to the power and process industries. It caters to the demand of power, oil & gas, refining and petrochemicals, and infrastructure sectors.

Systems and Equipment business

The company manufactures systems and equipments required for the power, oil & gas, refining, petrochemical and process industries.

Turnkey Engineering projects

In the turnkey engineering project business, it executes projects for the power and oil & gas sector, wherein it takes turnkey responsibility to supply a range of equipment

and services, including the civil works required for a project and other work as may be required under the contract for such a project.

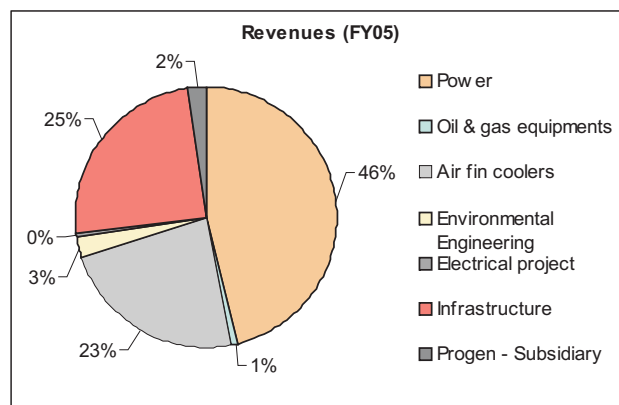
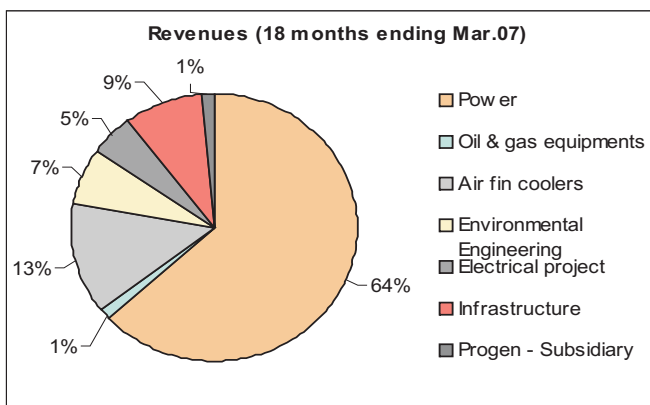
Its business is broadly categorized into 4 segments

- Power business wherein it provides turnkey EPC and balance of plant (BOP, i.e. items other than the boiler, turbine and generator) services to coal and gas based power projects.
- Equipment manufacturing wherein the company manufactures various equipments required for the oil & gas industry, refining, petrochemicals and environmental engineering sectors.
- Electrical projects business wherein it designs and supplies electrical systems and equipment for power stations, refineries, and petrochemical plants.
- Infrastructure business which includes construction of roads and industrial buildings.

Track record

Segments	Years	Established
Airfin Cooling	13	1994
Environment Engg.	11	1996
Power	6	2001
Oil & Gas Equipment	6	2001
Electrical Projects	4	2003
Infrastructure	3	2004

Revenue structure

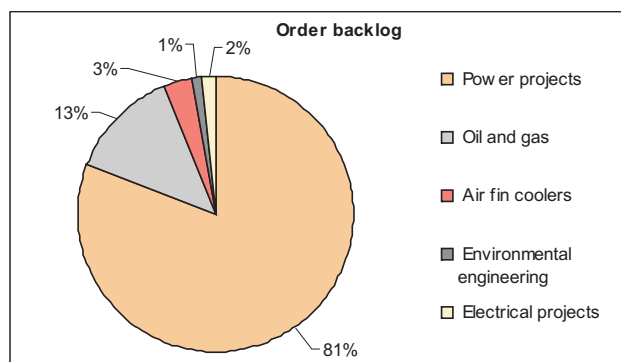


Investment View

High growth visibility stemming from a healthy order book

The company has an order backlog of Rs33Bn to be executed over the next 2-3 years. We expect the dominance of power projects in the order book to help it sustain EBITDA margin.

Segment wise order book



Expansion project to improve profitability, though in a small way

BESL is establishing manufacturing set ups at Mundra SEZ and in Bahrain and China. The facility at Mundra SEZ would fetch benefits only from FY10 while the facilities in Bahrain and China would have limited positive impact on EBITDA margin as exports constitute only 3.6% of total revenue. We estimate improvement in EBITDA margin by around 20-40 bps over next two years.

Expansion project (RsCr)

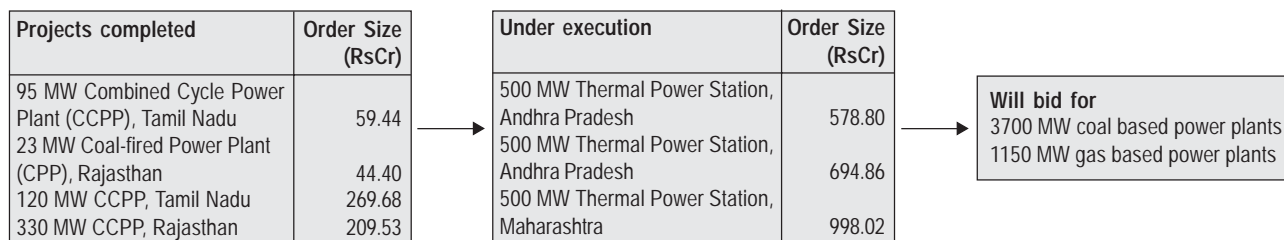
	Total Cost	From IPO
Augmenting Long term working capital	214.5	125.00
Establishing manufacturing & assembly facilities	82.6	80.00
General Corporate purposes	[-]	2.00
Total	[-]	207.00

The difference between total cost and the amount from public issue would be met through internal accruals and / or debt.

Execution capabilities is the main concern

The company is moving into a league of bidding for large size contracts. The company, currently, has orders of execution of 3x500 MW power plants (BOP based contracts) while the company had executed projects ranging from 95 MW to 330 MW. It is also bidding for 3700 MW of coal based and 1150 MW of gas based power projects from January 2008. We believe as the company is aggressively moving into the league of large sized orders the risks also increases in terms of execution, manpower availability etc.

Moving into the league of large size orders



The company is setting up manufacturing facilities in China and Bahrain to tap Middle East and Far East markets. In our view, managing facilities overseas would be a difficult challenge; also the exports constitutes only 3.6% to the total revenue which raises the question of the viability of setting such facilities.

Pre-IPO Placements

The company made pre-IPO placements on November 6, 2007 to CVCIGP II Employee Rosehill Ltd., CVCIGP II Client Rosehill Ltd. and others for 2.88mn equity shares @ Rs450 per share or the IPO price, whichever is less. Promoters transferred 1.44mn equity shares to Reliance Capital @ Rs450 per share. These transactions will be completed after the IPO.

Details of IPO

IPO	No. of Shares	(RsCr)	Per share (Rs)
Offer for Sale	4,816,000	231.17	480
Fresh Issue	4,320,000	207.36	480

Peer valuation model

Peers	Revenue Estimates		EPS Estimates		Price	M-Cap	P/E		P/S		
	FY08	FY09	FY08	FY09	4-Dec-07	4-Dec-07	FY08	FY09	FY08	FY09	
BHEL	22562.72	29626.01	65.75	87.75	2815.40	137819.46	42.8	32.1	6.1	4.7	India
L&T	23586.97	30650.77	69.71	89.68	4229.45	123161.58	60.7	47.2	5.2	4.0	India
Crompton Greaves	7258.66	8944.13	11.19	15.33	420.65	15418.93	37.6	27.4	2.1	1.7	India
Thermax	3231.11	4224.97	24.59	32.71	889.95	10603.75	36.2	27.2	3.3	2.5	India
BESL	1530.00	2019.60	15.36	21.18	480.00	3456.00	31.2	22.7	2.3	1.7	India
ABB	6231.50	8635.04	24.41	35.14	1602.30	33952.74	65.6	45.6	5.4	3.9	MNC
Siemens	11807.66	15224.56	48.22	66.49	1865.85	31458.23	38.7	28.1	2.7	2.1	MNC
Areva T&D	1936.73	2480.54	42.79	54.81	2737.50	13090.73	64.0	49.9	6.8	5.3	MNC
Alstom Projects	1266.30	1599.20	11.20	17.80	1033.65	6927.52	92.3	58.1	5.5	4.3	MNC

Keynote Capitals's estimates for BESL and consensus estimates for others

Keynote Capitals's Earnings estimates and valuation

	FY08 E	FY09 E
Net Sales (RsCr)	1530.00	2019.60
EBITDA (RsCr)	185.13	250.43
Net Profit (RsCr)	110.60	152.50
EBITDA margin	12.1%	12.4%
EPS (Rs)	15.36	21.18
P/E (x)	31.2	22.7

Why our estimates may be off the mark

- We have not considered the company's bidding for large sized power projects (3700 MW coal based and 1150 MW gas based power projects) winning of which would be a positive surprise.
- We have not factored in acquisitions, which are very common to the engineering companies for the purposes of scale, technology, and increasing penetration.
- BESL's capability of timely execution of projects.
- Competition.

Peer-group comparison

(RsCr)

Company Name	L&T	Areva T&D	Thermax	Alstom Projects	BESL	
					18 M FY07	Annualised
Sales Turnover	20371.81	1583.44	2804.73	1367.70	786.80	958.5
Adjusted Net Profit	1769.54	153.79	247.85	108.20	40.81	69.94
Paid-up Equity Capital	58.24	47.82	23.83	67.02	72.00	72.00
Price (4-Dec-2007)	4229.45	2737.50	889.95	1033.65	480.00	480.00
Market Cap	123162	13091	10604	6928	3456	3456
EPS (Rs)	60.77	32.16	20.80	16.14	3.78	6.48
Book Value (Rs)	211.96	79.84	48.61	49.48	76.78	19.18
P/E (x)	69.6	85.1	42.8	64.0	127.0	74.1
P/B (x)	20.0	34.3	18.3	20.9	6.3	25.0
P/S (x)	6.0	8.3	3.8	5.1	4.4	3.6
EBITDA margin	11.0%	15.9%	12.7%	9.8%	11.2%	12.3%
52 Week High (Rs)	4670	3280	968	1070	-	-
52 Week Low (Rs)	1350	903	341	369	-	-
FVPS (Rs)	2	10	2	10	10	10

Data for trailing twelve months

BESL data is annualized based on the Q1 FY08 numbers

EPS and Market Cap numbers are based on diluted equity

Profit & Loss Statements

(RsCr)

For the period to	30.6.02	30.6.03	30.6.04	30.6.05	31.3.07	31.6.07
Net Sales	125.23	158.29	270.66	295.76	786.80	239.63
Expenditure						
Raw materials	78.19	106.62	203.44	204.74	556.71	171.51
Staff costs	8.79	8.99	10.99	14.56	32.82	21.37
Other Mfg Exps	11.99	15.83	21.95	31.21	71.38	10.29
Selling & dist Exps	0.49	0.82	0.73	1.26	2.49	0.40
Gen. & Admin. Exps	10.44	10.18	12.40	15.11	35.17	6.57
Misc. Exp. w/o	0.21	0.19	0.20	0.39	0.40	0.00
Total Expenditure	110.10	142.62	249.70	267.25	698.97	210.14
EBITDA	15.12	15.66	20.96	28.51	87.83	29.48
Other Income	0.17	0.41	0.23	-0.15	0.30	0.62
Interest	5.18	4.72	4.73	6.13	17.97	3.54
PBDT	10.12	11.35	16.46	22.23	70.16	26.57
Depreciation	1.73	1.77	2.09	3.25	8.88	1.32
Profit Before Tax	8.38	9.58	14.36	18.99	61.28	25.25
Tax	1.98	2.04	3.19	5.44	21.31	7.77
Profit After Tax	6.40	7.55	11.18	13.55	39.96	17.48
Extra ordinary items	0.07	0.10	-0.01	-0.11	0.85	0.00
Adjusted Profits	6.47	7.65	11.17	13.44	40.81	17.48
EBITDA margin	12.1%	9.9%	7.7%	9.6%	11.2%	12.3%
EPS (Rs)	11.98	14.16	10.34	12.45	25.20*	16.19
Book Value (Rs)	32.97	44.55	30.31	40.39	76.78	92.04

*annualised

Balance Sheets

(RsCr)

As at,	30.6.02	30.6.03	30.6.04	30.6.05	31.3.07	31.6.07
Sources of Funds						
Share Capital	5.40	5.40	10.80	10.80	10.80	10.80
Reserves & Surplus	12.40	18.66	21.94	32.82	72.12	88.61
Share holders Funds	17.80	24.06	32.74	43.62	82.92	99.41
Minority Interest	0.05	0.10	0.15	0.23	1.54	2.14
Secured Loans	40.57	47.14	50.52	83.15	240.47	261.83
Unsecured Loans	5.47	5.82	5.70	5.76	5.94	5.91
Total Debt	46.03	52.96	56.22	88.90	246.42	267.74
Total Liabilities	63.89	77.11	89.10	132.76	330.88	369.29
Applications of Funds						
Goodwill	0.47	0.47	0.47	0.47	0.46	0.59
Gross Block	29.45	30.23	38.56	49.59	63.32	65.15
Less: Acc. Depr.	10.02	11.75	14.02	16.58	24.92	21.82
Net Block	19.43	18.49	24.55	33.01	38.40	43.33
CWIP	0.00	0.00	0.18	0.55	3.02	1.01
Investments	0.10	0.10	0.10	0.10	0.28	0.53
Curr. Assets, Loans & Ad.						
Inventories	8.48	11.64	12.34	18.73	29.33	25.75
Sundry Debtors	57.34	75.53	75.46	118.13	368.80	421.00
Cash and Bank	6.62	7.32	22.88	18.50	92.90	106.46
Other Current Assets	0.74	0.62	1.06	2.78	7.95	10.82
Loans and Advances	7.55	6.90	18.30	23.57	84.23	118.49
Total Current Assets	80.74	102.00	130.04	181.71	583.22	682.51
Current Liabilities	31.40	36.85	56.45	70.66	266.95	323.42
Provisions	5.44	7.10	9.79	12.43	27.56	35.25
Current Liab. & Prov	36.84	43.95	66.24	83.09	294.51	358.67
Net Current Assets	43.90	58.06	63.80	98.62	288.71	323.84
Misc. Exp. Not w/o	0.00	0.00	0.00	0.00	0.00	0.00
Net Deferred Tax	0.00	0.00	0.00	0.00	0.00	0.00
Total Assets	63.89	77.11	89.10	132.76	330.87	369.29

Keynote Capitals Ltd.

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Subscribe with a medium term view	:	stock can deliver only over 6-8 months after listing
Subscribe with a long term view	:	value can only be realised over 12-18 months
Await listing	:	good fundamentals; consider valuations on listing

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