

BHARAT HEAVY ELECTRICALS

ENGINEERING

BUY

Target Price: Rs 141

Clear signs of recovery; BUY

Q3 order inflow at ~Rs 120 bn was up 7x YoY and order backlog at Rs 1,022 bn was up 4%. **Executable order backlog improved to Rs 810 bn (up 48% from Rs 548 bn YoY)** on clearance of Yadadri project in Oct. Further, BHEL has won orders worth Rs 41 bn so far in Q4. Increase in executable backlog will drive strong execution in FY19.

Order/tender pipeline remains strong: In power segment, BHEL is L1 in ~3.1 GW of orders worth ~Rs 150 bn. Further, it is participating in tenders worth ~8-10 GW. Given strong order pipeline and policy thrust on scrapping old plants, the management expects power market order inflow of 10-12 GW p.a. In industry segment, there are clear signs of improvement and medium-term growth will be driven by T&D products, railways, solar and defence sectors.

CMP : Rs 96
Potential Upside : 48%

MARKET DATA

No. of Shares : 3,671 mn
Free Float : 37%
Market Cap : Rs 350 bn
52-week High / Low : Rs 122 / Rs 81
Avg. Daily vol. (6mth) : 11.0 mn shares
Bloomberg Code : BHEL IB Equity
Promoters Holding : 63%
FII / DII : 13% / 18%

Q3 earnings miss on lower other income: Q3FY18 revenue was up 5% YoY to Rs 66 bn, broadly in line with our/consensus estimates. Gross margin at 41%, up 380 bps YoY, was slightly better than our estimate. EBITDA at Rs 3 bn (margin 4.5%, up 100 bps YoY) was strongly above expectations. Other income was lower at Rs 1.4 bn due to forex loss of Rs 720 mn (vs. Rs 1.8 bn gain QoQ). PAT at Rs 1.5 bn (up 64% YoY) was below expectations on miss in other income.

Operating leverage to kick in, as BHEL's capacity utilization is low at <50% and fixed cost is high at Rs 90 bn p.a. **We expect BHEL's executable order book to increase by 50% YoY to ~Rs 900 bn by FY18 end** (Current = Rs 810 bn + Rs 150 bn finalization of L1 projects – Rs 60 bn execution in power in Q4). Increase in executable order backlog to result in 45% growth in revenue over FY17-21; EBITDA to rise to 4x and PAT to ~6x over the period.

Cut estimates; roll forward TP; maintain BUY: We cut FY18E/19E EPS to Rs 2.1/Rs 5.2 (vs. Rs 2.6/Rs 6.5 earlier) to adjust for delay in clearances of large projects, which would push pick-up in execution to FY20. We roll forward to FY20. Our revised TP stands at Rs 141 (20x FY20E) vs. Rs 130 earlier.

Financial summary (Standalone)

Y/E March	FY17	FY18E	FY19E	FY20E
Sales (Rs mn)	275,876	275,577	325,839	363,604
EBITDA (Rs mn)	11,136	9,829	27,078	37,275
Adj PAT (Rs mn)	4,959	7,526	18,912	25,895
Con. EPS* (Rs.)	-	2.7	4.6	5.2
EPS (Rs.)	1.4	2.0	5.2	7.1
Change YOY (%)	(139.2)	51.8	151.3	36.9
P/E (x)	70.7	46.6	18.5	13.5
RoE (%)	1.6	2.3	5.9	7.9
EV/E (x)	22.1	22.9	6.5	4.1
DPS (Rs)	3.0	3.0	3.0	4.0

Source: *Consensus broker estimates, Company, Axis Capital, Axis Capital, CMP as on 9 Feb 2018

Key drivers

(Rs bn)	FY17	FY18E	FY19E
Order inflow	235	368	451
Backlog	1,052	1,134	1,244
Margin	3.9%	3.5%	8.0%

Price performance

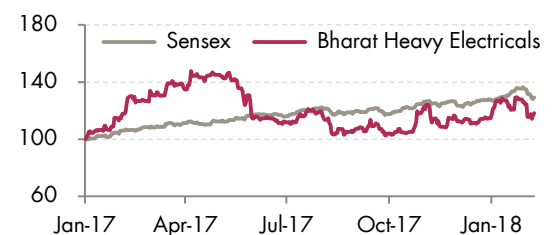
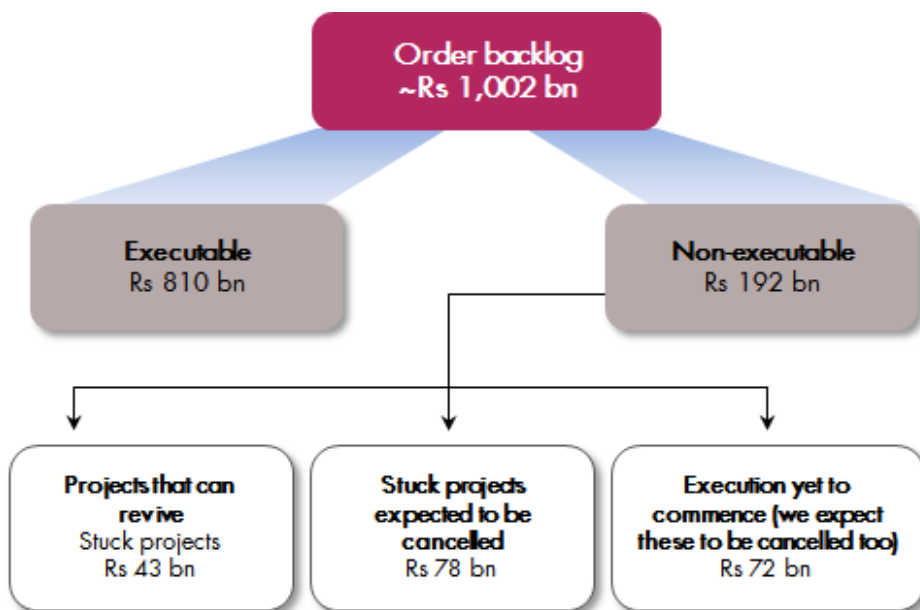


Exhibit 1: Results update

(Rs mn)	Quarter ended					12 months ended		
	Dec-17	Dec-16	% Chg	Sep-17	% Chg	FY18E	FY17	% Chg
Net Sales/Income form op	66,264	63,210	4.8	63,849	3.8	285,663	285,046	0.2
EBIDTA	2,954	2,239	32.0	(954)	(409.7)	9,829	11,136	(11.7)
Other income	1,375	1,358	1.3	4,850	(71.7)	10,340	7,137	44.9
PBIDT	4,329	3,596	20.4	3,896	11.1	20,169	18,273	10.4
Depreciation	1,820	2,088	(12.8)	1,872	(2.7)	7,735	8,488	(8.9)
Interest	610	263	131.8	552	10.5	2,400	3,506	(31.5)
PBT	1,898	1,246	52.4	1,472	28.9	10,034	6,278	59.8
Tax	367	310	18.2	318	15.1	2,509	1,320	90.1
Adjusted PAT	1,532	935	63.8	1,154	32.7	7,526	4,959	51.8
No. of shares (mn)	2,448	2,448	-	2,448	-	3,671	3,671	-
EBIDTA margin (%)	4.5	3.5	-	(1.5)	-	3.4	3.9	-
PBIDT margin (%)	6.5	5.7	-	6.1	-	7.1	6.4	-
EPS (Rs.)	0.6	0.4	63.8	0.5	32.7	2.0	1.4	51.8

Source: Company, Axis Capital

Exhibit 2: Order backlog breakup


Source: Company, Axis Capital

Financial summary (Standalone)

Profit & loss (Rs mn)

Y/E March	FY17	FY18E	FY19E	FY20E
Net sales	275,876	275,577	325,839	363,604
Other operating income	9,169	10,086	11,095	12,204
Total operating income	285,046	285,663	336,934	375,809
Cost of goods sold	(177,809)	(171,473)	(199,370)	(222,604)
Gross profit	107,237	114,191	137,564	153,205
<i>Gross margin (%)</i>	<i>38.9</i>	<i>41.4</i>	<i>42.2</i>	<i>42.1</i>
Total operating expenses	(96,102)	(104,361)	(110,485)	(115,930)
EBITDA	11,136	9,829	27,078	37,275
<i>EBITDA margin (%)</i>	<i>4.0</i>	<i>3.6</i>	<i>8.3</i>	<i>10.3</i>
Depreciation	(8,488)	(7,735)	(8,001)	(8,221)
EBIT	2,647	2,094	19,077	29,053
Net interest	(3,506)	(2,400)	(2,400)	(2,400)
Other income	7,137	10,340	10,340	10,340
Profit before tax	6,278	10,034	27,017	36,993
Total taxation	(1,320)	(2,509)	(8,105)	(11,098)
<i>Tax rate (%)</i>	<i>21.0</i>	<i>25.0</i>	<i>30.0</i>	<i>30.0</i>
Profit after tax	4,959	7,526	18,912	25,895
Minorities	-	-	-	-
Profit/ Loss associate co(s)	-	-	-	-
Adjusted net profit	4,959	7,526	18,912	25,895
<i>Adj. PAT margin (%)</i>	<i>1.8</i>	<i>2.7</i>	<i>5.8</i>	<i>7.1</i>
Net non-recurring items	-	-	-	-
Reported net profit	4,959	7,526	18,912	25,895

Balance sheet (Rs mn)

Y/E March	FY17	FY18E	FY19E	FY20E
Paid-up capital	4,895	4,895	4,895	4,895
Reserves & surplus	318,049	312,688	318,713	327,427
Net worth	322,944	317,583	323,609	332,322
Borrowing	896	896	896	896
Other non-current liabilities	-	-	-	-
Total liabilities	323,840	318,479	324,504	333,217
Gross fixed assets	137,795	143,478	147,478	151,478
Less: Depreciation	(101,836)	(109,571)	(117,572)	(125,794)
Net fixed assets	35,959	33,907	29,906	25,685
Add: Capital WIP	1,683	-	-	-
Total fixed assets	37,642	33,907	29,906	25,685
Total Investment	6,614	6,614	6,614	6,614
Inventory	73,724	75,500	89,271	99,618
Debtors	318,633	307,636	280,013	281,260
Cash & bank	104,918	126,131	174,528	197,671
Loans & advances	51,485	49,075	58,026	64,751
Current liabilities	288,462	299,261	336,172	367,287
Net current assets	279,584	277,958	287,984	300,919
Other non-current assets	-	-	-	-
Total assets	323,840	318,479	324,504	333,217

Source: Company, Axis Capital

Cash flow (Rs mn)

Y/E March	FY17	FY18E	FY19E	FY20E
Profit before tax	6,278	10,034	27,017	36,993
Depreciation & Amortisation	8,488	7,735	8,001	8,221
<i>Chg in working capital</i>	<i>(24,497)</i>	<i>22,839</i>	<i>38,371</i>	<i>10,208</i>
Cash flow from operations	(7,544)	40,500	67,684	46,725
<i>Capital expenditure</i>	<i>(3,345)</i>	<i>(4,000)</i>	<i>(4,000)</i>	<i>(4,000)</i>
Cash flow from investing	(6,831)	(6,400)	(6,400)	(6,400)
<i>Equity raised/ (repaid)</i>	-	-	-	-
<i>Debt raised/ (repaid)</i>	<i>(367)</i>	-	-	-
<i>Dividend paid</i>	<i>(12,887)</i>	<i>(12,887)</i>	<i>(12,887)</i>	<i>(17,182)</i>
Cash flow from financing	(14,502)	(12,887)	(12,887)	(17,182)
Net chg in cash	(28,877)	21,213	48,397	23,143

Key ratios

Y/E March	FY17	FY18E	FY19E	FY20E
OPERATIONAL				
FDEPS (Rs)	1.4	2.0	5.2	7.1
CEPS (Rs)	3.7	4.2	7.3	9.3
DPS (Rs)	3.0	3.0	3.0	4.0
Dividend payout ratio (%)	222.1	146.4	58.2	56.7
GROWTH				
Net sales (%)	10.6	(0.1)	18.2	11.6
EBITDA (%)	(166.8)	(11.7)	175.5	37.7
Adj net profit (%)	(139.2)	51.8	151.3	36.9
FDEPS (%)	(139.2)	51.8	151.3	36.9
PERFORMANCE				
RoE (%)	1.6	2.3	5.9	7.9
RoCE (%)	3.1	3.9	9.2	12.0
EFFICIENCY				
Asset turnover (x)	1.3	1.3	1.9	2.5
Sales/ total assets (x)	0.4	0.4	0.5	0.5
Working capital/ sales (x)	0.6	0.6	0.4	0.3
Receivable days	421.6	407.5	313.7	282.3
Inventory days	98.2	99.9	105.2	107.4
Payable days	261.9	274.4	287.7	296.9
FINANCIAL STABILITY				
Total debt/ equity (x)	-	-	-	-
Net debt/ equity (x)	(0.3)	(0.4)	(0.5)	(0.6)
Current ratio (x)	2.0	1.9	1.9	1.8
Interest cover (x)	0.8	0.9	7.9	12.1
VALUATION				
PE (x)	70.7	46.6	18.5	13.5
EV/ EBITDA (x)	22.1	22.9	6.5	4.1
EV/ Net sales (x)	0.9	0.8	0.5	0.4
PB (x)	1.1	1.1	1.1	1.1
Dividend yield (%)	3.1	3.1	3.1	4.2
Free cash flow yield (%)	-	0.1	0.2	0.1

Source: Company, Axis Capital

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Research Team

Sr. No	Name	Designation	E-mail
1	Pankaj Bobade	Research Analyst	pankaj.bobade@axissecurities.in
2	Kiran Gawle	Associate	kiran.gawle@axissecurities.in

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SELL	Less than -10%

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