

Estimate change	↓
TP change	↔
Rating change	↔

CMP: INR37 TP: INR22 (-42%) Sell

No likely change in fortunes

Receivables remain elevated; recovery long way off

- n Bharat Heavy Electricals (BHEL)'s 1QFY21 earnings were disappointing as revenue was 26% below our estimates. Higher fixed cost dented operating performance, with almost ~70% loss posted at the PBT level, attributable to under-absorption of costs. The company is yet to show any significant improvement in pending receivables, with total debtors at INR360b. In spite of the company's ongoing efforts, we expect the receivables position to remain elevated in the near future. Order inflows, which declined 62% YoY, were impacted significantly by COVID-led lockdown.
- n We now expect BHEL to report loss in FY21E and have also reduced our FY22E earnings estimate by 21% to factor poor execution and a weak ordering environment. While orders are few and far between, the pricing environment remains highly competitive, limiting scope for margin expansion. While the company has received Expression of Interest (EoI) from three major OEMs regarding its ongoing diversification drive, we believe any material financial impact is still some time away. We maintain our Sell rating, with TP of INR22 (15x FY22E EPS).

Operating losses widen sequentially

- n **1QFY21 earnings summary:** Poor execution led to 56% YoY decline in revenues to INR19.9b (26% below estimate). EBITDA loss stood at INR10.6b (v/s loss of INR2.7b YoY and INR5.6b QoQ) on lower absorption of fixed cost. PBT loss stood at INR11.9b. Bottom-line loss stood at INR8.9b, higher than our estimated loss of INR7.4b.
- n **Segmental highlights: (a) Power:** 1QFY21 revenue was down 68% YoY to INR11.2b. EBIT loss stood at INR5.6b. **(b) Industry:** 1QFY21 revenue was down 15% YoY to INR7.7b. EBIT loss stood at INR2.5b (v/s profit of INR349m in 1QFY20).
- n Order book (OB) was flat YoY at INR1081b, with OB/rev at 5.7x. Segment-wise OB is as follows: Power segment – INR866b, Industry segment – INR134b, and International orders – INR81b.

Management commentary highlights

- n The company is favorably placed in the following orders: 2*660MW NTPC Talcher, FGD and Boiler modification.
- n Tendering is underway at the 2*800MW NTPC Singrauli, 2*800MW NTPC Lara, and 2*660MW Pench thermal power plants. Tenders for ~30GW are under various stages of ordering.
- n With regard to EOIs, BHEL has signed MoUs with three major OEMs in the field of magnet train projects, marine gas turbines for defense applications, and armored trucks equipped with smart technologies.
- n Total receivables remain elevated at ~INR360b, of which 12% are from the private sector, 48% from state entities, 33% from the center, and 7% pertain to the international markets.

Bloomberg	BHEL IN
Equity Shares (m)	3,482
M.Cap.(INRb)/(USD\$b)	129 / 1.8
52-Week Range (INR)	61 / 19
1, 6, 12 Rel. Per (%)	2/26/-33
12M Avg Val (INR M)	1523

Financials & Valuations (INR b)

Y/E Mar	2020	2021E	2022E
Sales	214.9	225.5	267.4
EBITDA	(2.3)	1.7	13.0
PAT	(14.7)	(2.6)	5.0
EBITDA (%)	(1.1)	0.7	4.8
EPS (INR)	(4.2)	(0.8)	1.4
EPS Gr. (%)	(221.9)	NA	NA
BV/Sh. (INR)	83.8	83.1	83.5

Ratios

Net D/E	0.0	0.0	0.0
RoE (%)	(5.0)	(0.9)	1.7
RoCE (%)	(1.1)	0.4	2.8
Payout (%)	(34.3)	-	70.0

Valuations

P/E (x)	(8.8)	(49.3)	25.7
P/BV (x)	0.4	0.4	0.4
EV/EBITDA (x)	(49.4)	76.0	9.7
Div Yield (%)	3.3	-	2.3
FCF Yield (%)	(25.7)	(8.5)	3.6

Shareholding pattern (%)

As On	Jun-20	Mar-20	Jun-19
Promoter	63.2	63.2	63.2
DII	18.1	17.8	18.8
FII	5.1	9.4	12.1
Others	13.6	9.7	5.9

FII Includes depository receipts

Valuation and view

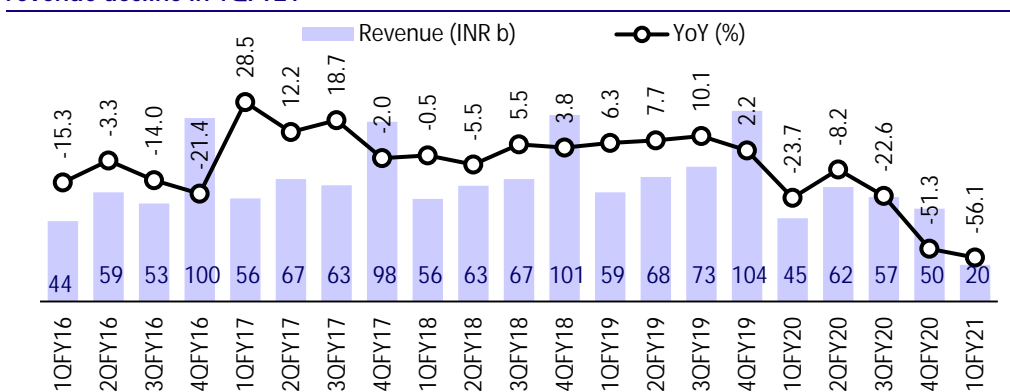
n BHEL continues to struggle on account of: (a) a weak ordering environment in the Power sector, (b) high receivables of ~INR360b, and (c) high FY20 employee cost at ~25% of sales. In FY20, working capital deteriorated to 99% of sales from 65% in FY19 due to higher inventory, slow movement in receivables, and poor execution.

n We now expect BHEL to report loss in FY21E and have also reduced our FY22E earnings estimate by 21% to factor poor execution and a weak ordering environment. While orders are few and far between, the pricing environment remains highly competitive, limiting scope for margin expansion. While the company has received Eols from three major OEMs regarding its ongoing diversification drive, we believe any material financial impact is still some time away. We maintain our Sell rating, with TP of INR22 (15x FY22E EPS).

Quarterly Performance

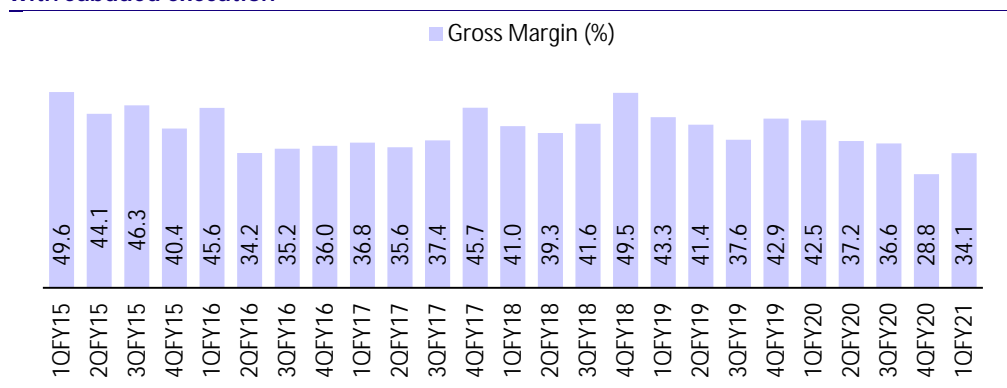
Y/E March	FY20				FY21E				FY20	FY21E	Est 1QE	Var. Vs Est
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q				
Sales (Net)	45,317	62,257	56,794	50,493	19,909	50,632	56,578	98,381	2,14,861	2,25,500	27,000	-26.3%
Change (%)	-23.7	-8.2	-22.6	-51.0	-56.1	-18.7	-0.4	94.8	-29.4	5.0	-40.4	
EBITDA	-2,667	2,669	3,287	-5,617	-10,589	-1,342	1,144	12,446	-2,329	1,660	-8,830	NA
Change (%)	NA	10.8	50.3	-140.3	NA	-150.3	-65.2	NA	-110.9	NA	NA	
As a % Sales	-5.9	4.3	5.8	-11.1	-53.2	-2.7	2.0	12.7	-1.1	0.7	-32.7	
Interest	1,080	1,187	1,391	1,412	1,146	1,200	1,350	1,374	5,070	5,070	1,100	
Depreciation	1,148	1,193	1,145	1,543	1,185	1,250	1,300	1,320	5,029	5,055	1,150	
Other Income	1,455	1,356	1,512	1,482	955	1,250	1,300	1,461	5,806	4,966	1,200	
PBT	-3,440	1,645	2,263	-7,090	-11,964	-2,542	-206	11,213	-6,621	-3,499	-9,880	NA
Tax	-1,277	459	675	8,252	-2,993	-641	-52	2,804	8,109	-881	-2,490	
Effective Tax Rate (%)	37.1	27.9	29.8	-116.4	25.0	25.2	25.2	25.0	-122.5	25.2	25.2	
Reported PAT	-2,162	1,186	1,588	-15,341	-8,972	-1,901	-154	8,408	-14,730	-2,618	-7,390	NA
Change (%)	NA	-36.0	-17.3	-324.7	NA	-260.3	-109.7	NA	NA	NA	NA	
Adj. PAT	-2,162	1,186	1,588	-15,341	-8,972	-1,901	-154	8,408	-14,730	-2,618	-7,390	NA
Change (%)	NA	-36.0	-17.3	-324.7	NA	-260.3	-109.7	NA	NA	NA	NA	

Exhibit 1: Execution hurdles, impact on supply chain, and COVID-led shutdown lead to 56% revenue decline in 1QFY21



Source: MOFSL, Company

Exhibit 2: Gross margin declines YoY in 1QFY21 due to rise in raw material cost, coupled with subdued execution

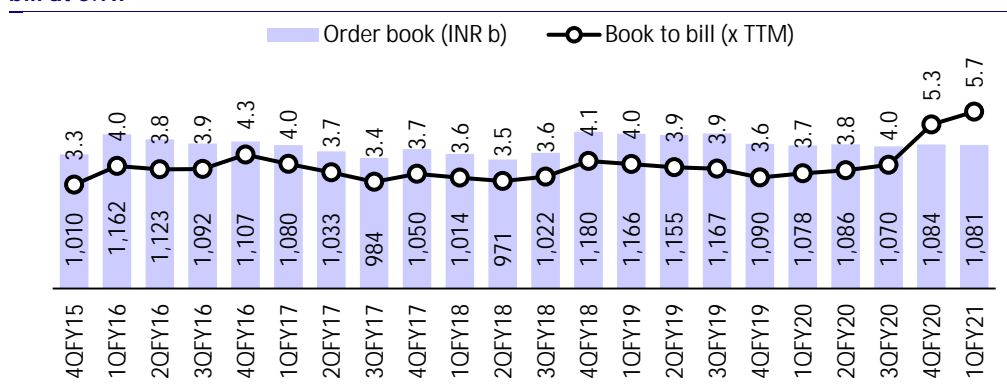


Source: MOFSL, Company

Order book at INR1.1t, book to bill at 5.7x in 1QFY21

n The order book stood flat YoY at INR1.1t. Segment-wise OB is as follows: Power segment – INR866b, Industry segment – INR134b, and International orders – INR81b.

Exhibit 3: Although order book remains flat YoY, lower execution leads to rise in book to bill at 5.7x



Source: MOFSL, Company

Segmental performance: Revenues hit across segments; Power segment's profitability most impacted

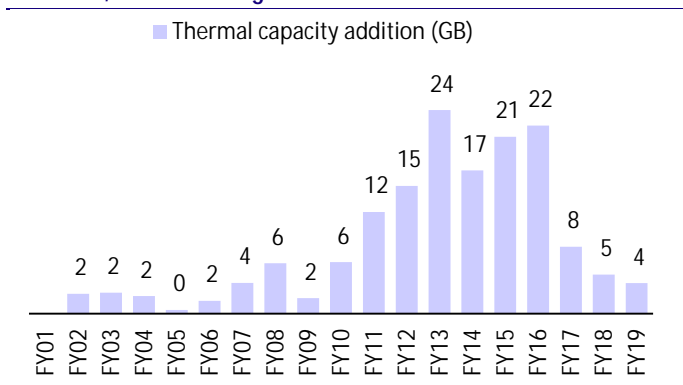
- n **Power segment:** 1QFY21 revenue was down 68% YoY to INR11.2b. EBIT loss stood at INR5.6b.
- n **Industry segment:** 1QFY21 revenue was down 15% YoY to INR7.7b. EBIT loss stood at INR2.5b (v/s profit of INR349m in 1QFY20).

Exhibit 4: Segmental revenues and margins

INR m	FY19				FY20				FY21
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q	1Q
Revenues	57,901	66,069	71,157	98,365	44,103	60,290	54,578	45,936	18,966
Power	46,362	51,532	55,123	81,034	34,915	42,215	40,727	31,747	11,194
Growth (%)	6.9	1.7	2.9	(2.5)	(24.7)	(18.1)	(26.1)	(60.8)	(67.9)
Industry	11,539	14,538	16,035	17,331	9,188	18,075	13,851	14,189	7,772
Growth (%)	(9.2)	31.7	40.8	14.0	(20.4)	24.3	(13.6)	(18.1)	(15.4)
EBIT	5,463	4,953	6,479	15,600	-193	4,883	5,085	-3,791	-8,210
Power	4,878	4,257	5,921	13,066	-541	4,337	4,326	-79	-5,680
Growth (%)	11.2	(36.4)	(23.6)	43.7	(111.1)	1.9	(26.9)	NA	NA
Industry	585	696	557	2,534	349	546	759	-3,712	-2,530
Growth (%)	(27.1)	3,810.1	37.8	343.4	(40.3)	(21.5)	36.1	NA	NA
EBIT margin (%)	9.4	7.5	9.1	15.9	-0.4	8.1	9.3	-8.3	-43.3
Power	10.5	8.3	10.7	16.1	-1.6	10.3	10.6	-0.2	-50.7
Industry	5.1	4.8	3.5	14.6	3.8	3.0	5.5	-26.2	-32.5

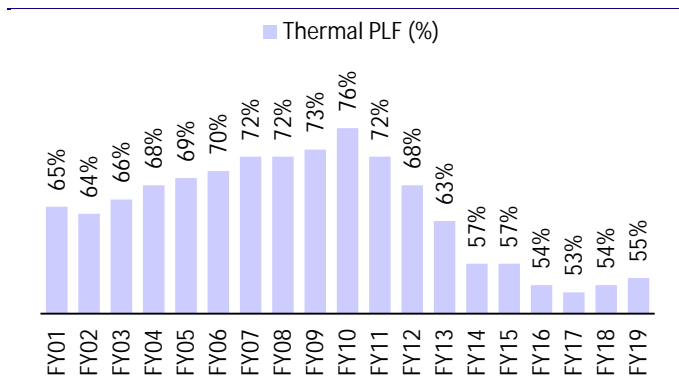
Source: Company, MOFSL

Exhibit 5: Thermal capacity averages around 18GW between FY12–16, before falling to 4GW in FY19



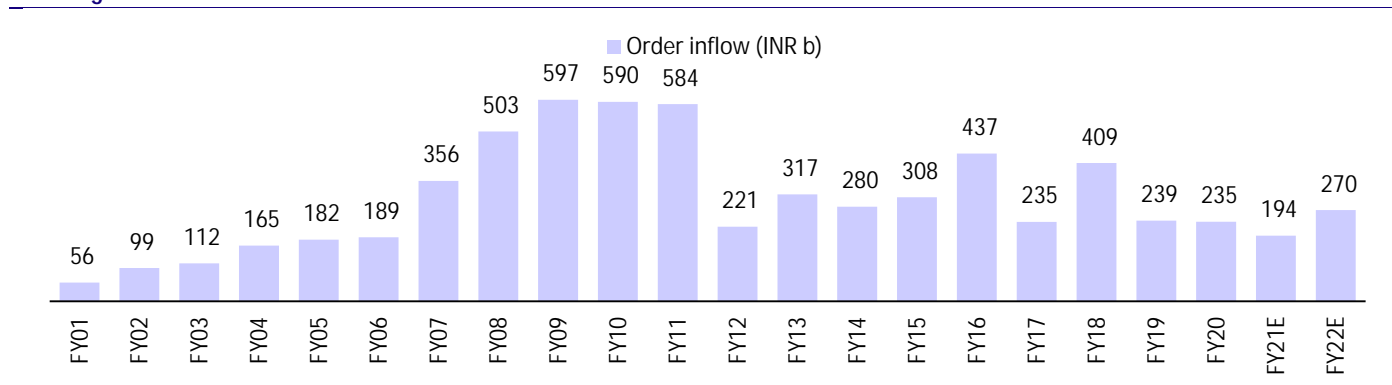
Source: MOFSL

Exhibit 6: Thermal PLF on rapid decline post FY10, indicating lower order inflows for BHEL



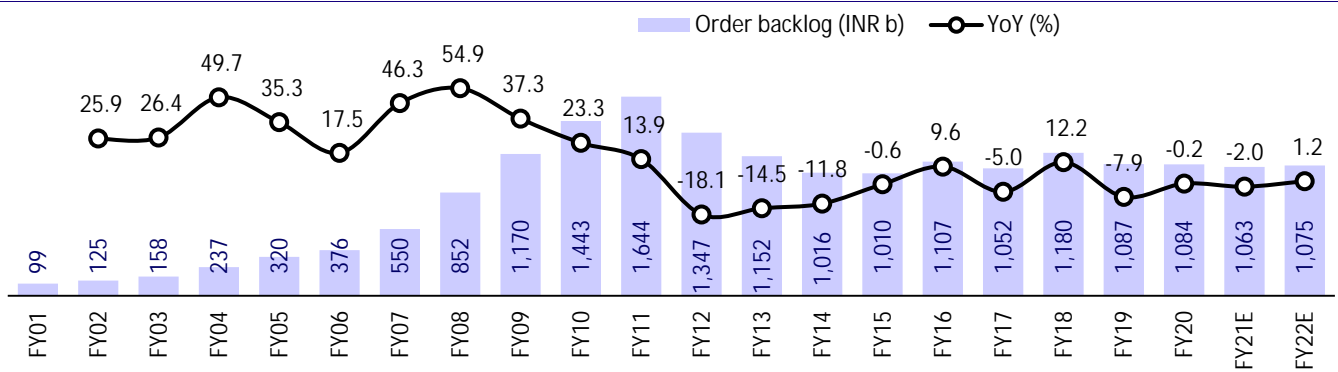
Source: MOFSL

Exhibit 7: Order inflows average at INR550b between FY08–11, while lower thermal PLF leads to significant decline in ordering thereafter



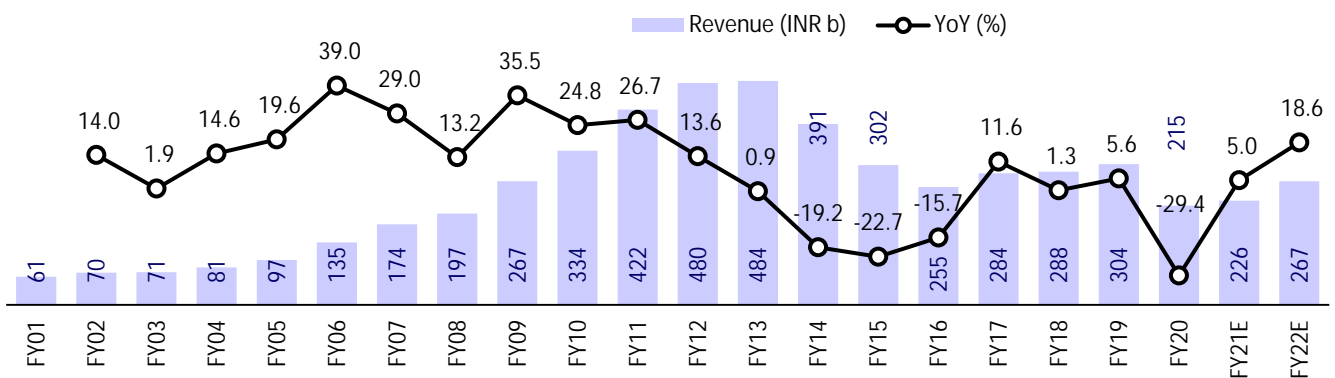
Source: MOFSL, Company

Exhibit 8: Order backlog declines post FY11 on lower order inflows; currently stands at INR1.1t in FY20 from peak of INR1.6t in FY11



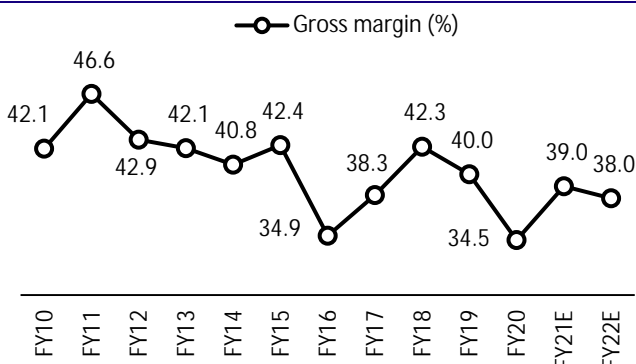
Source: MOFSL, Company

Exhibit 9: Revenue CAGR stands at -10% over FY14–20 due to lower order inflow and weak order book



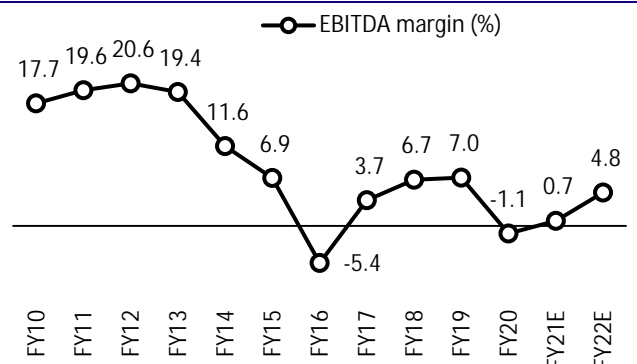
Source: MOFSL, Company

Exhibit 10: Gross margins on the decline again since FY18...



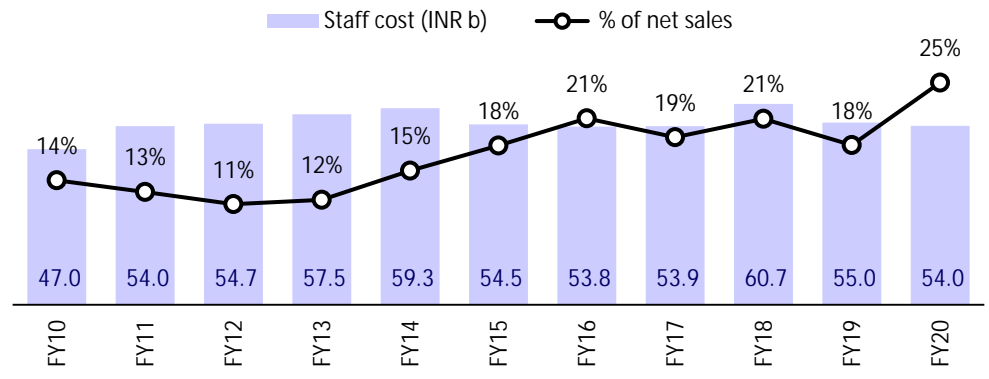
Source: MOFSL, Company

Exhibit 11: ...with lower absorption of fixed costs leading to decline in FY20 EBITDA margin



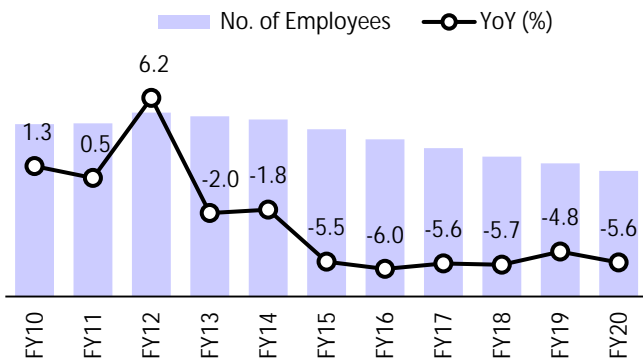
Source: MOFSL, Company

Exhibit 12: Staff costs as % of sales stand at 25%, indicating key challenge for company



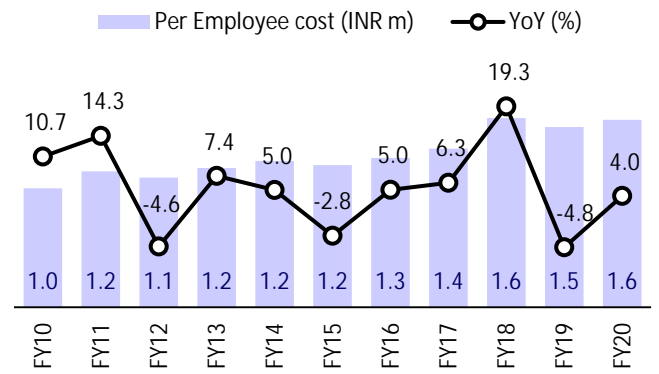
Source: MOFSL, Company

Exhibit 13: Number of employees on steady decline since FY12...



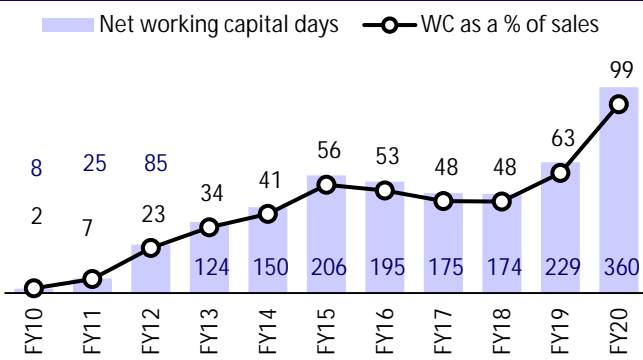
Source: MOFSL, Company

Exhibit 14: ...however, wage inflation leads to rise in per employee cost from FY15



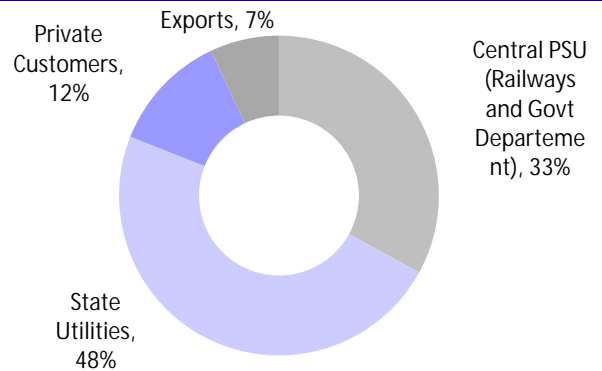
Source: MOFSL, Company

Exhibit 15: Rise in debtors leads to elongated working capital cycle...



Source: MOFSL, Company

Exhibit 16: ...with state utilities forming 48% of total debtors (~INR360b) at the end of 1QFY21



Source: MOFSL, Company

Management commentary highlights

Strategy to mitigate downturn in Power segment

- n The company is looking to diversify into various sectors (Oil & Gas, Railways, and Defence sectors to mitigate downturn in the Power sector).
- n In Power, it seeks higher efficiency power plants, Industry 4.0 solutions for maintenance at existing power plants, and emission-control instruments.

On diversification strategy

- n **MoU:** This is a preliminary MoU, and BHEL would have more rounds of discussion to address this opportunity. This mainly pertains to the Defence and Transportation sectors. Discussions in the Transportation sector are expected to materialize quickly, while the Defence opportunity would take time. Primary discussions regarding the MoU would be around technology parameters.

Working capital

- n Of the total receivables of ~INR360b, collectible receivables stood at INR118b and INR235b were contract assets.
- n Retention amount stood at INR154b.
- n Higher receivables are largely attributable to unfavorable payment terms from clients. Non-current contract assets form 60% of total contract assets. For example, in the NTPC Patratu project, advance is 5% and 30% is received against dispatches. Hence, more than 50% of the payment would come after project completion, which elongates the receivables cycle.

Order book

- n The executable order book stood at INR880b as of 1QFY21, while INR202b was non-executable.
- n FGD orders formed INR145b in total OB.

Valuation and view

- n **Weak ordering outlook:** BHEL draws ~75% of its revenue from the Power segment. The awarding run-rate in power equipment has fallen from an annual ~15GW to 4–5GW currently. The outlook on awarding remains weak, with surplus power capacity in India. Note that thermal PLF was at 55% in FY19. Thus, we expect BHEL to continue operating at low capacity utilization.
- n **Slow-moving receivables:** BHEL's receivables stand at ~INR360b currently and their realization remains slow. Of the total receivables, state players account for 48%, the center 33%, private players 12%, and exports for the remaining 7%. Due to slow-moving receivables and sluggish revenue, the working capital as a percentage of sales stood high at 99% in FY20 (from 63% of sales in FY19).
- n **Huge employee base to dent margins:** BHEL has an employee base of ~34k, and employee cost formed 18%/25% of sales in FY19/FY20. While we appreciate that the company has been able to bring down the employee base from 46k in FY10, wage inflation has negated the benefit of the same. Also, declining revenue implies lower absorption of fixed costs and hence dents margins. Thus, BHEL posted EBITDA-level loss in FY20 from 16–20% EBITDA margins in the good years (FY04–13).

- n **Maintain Sell:** We now expect BHEL to report loss in FY21E and also reduce our FY22E earnings estimate by 21% to factor poor execution and a weak ordering environment. While orders are few and far between, the pricing environment remains highly competitive, limiting scope for margin expansion. While the company has received Eols from three major OEMs regarding its ongoing diversification drive, we believe any material financial impact is still some time away. We maintain our Sell rating, with TP of INR22 (15x FY22E EPS).

Exhibit 17: Earnings change table

Earnings Change INR m	Old		New		Change	
	FY21E	FY22E	FY21E	FY22E	FY21E	FY22E
Revenue	2,54,354	2,81,185	2,25,500	2,67,378	-11%	-5%
EBITDA	10,177	13,718	1,660	12,966	-84%	-5%
EBITDA margin	4.0%	4.9%	0.7%	4.8%	-3.3%	0.0%
Adj. PAT	3,638	6,366	-2,618	5,026	-172%	-21%

Source: MOFSL, Company

Financials and valuations

Income Statement						(INR m)
Y/E March	2018	2019	2020	2021E	2022E	2023E
Total Revenues	2,88,130	3,04,227	2,14,861	2,25,500	2,67,378	2,73,810
Change (%)	1.3	5.6	-29.4	5.0	18.6	2.4
Staff cost	60,673	55,016	54,035	51,333	51,205	51,077
Manufacturing expenses	1,66,360	1,82,582	1,40,644	1,37,555	1,65,774	1,69,762
Other Expenses	41,780	45,310	22,511	34,953	37,433	36,964
EBITDA	19,317	21,320	-2,329	1,660	12,966	16,007
Change (%)	82.0	10.4	-110.9	NA	681.3	23.5
Margin (%)	6.7	7.0	-1.1	0.7	4.8	5.8
Depreciation	7,864	4,748	5,029	5,055	5,289	5,523
Interest	2,546	2,873	5,070	5,070	5,070	5,070
Other income	6,943	6,776	5,806	4,966	4,110	4,126
PBT	15,850	20,475	-6,621	-3,499	6,717	9,540
Tax	7,784	8,389	8,109	-881	1,691	2,401
Rate (%)	49.1	41.0	-122.5	25.2	25.2	25.2
Reported PAT	8,066	12,087	-14,730	-2,618	5,026	7,139
Adjusted PAT	8,066	12,087	-14,730	-2,618	5,026	7,139
Change (%)	62.7	49.8	-221.9	NA	NA	42.0

Balance Sheet						(INR m)
Y/E March	2018	2019	2020	2021E	2022E	2023E
Share Capital	7,343	6,964	6,964	6,964	6,964	6,964
Reserves	3,18,668	3,07,354	2,84,848	2,82,230	2,83,738	2,85,879
Net Worth	3,26,011	3,14,318	2,91,812	2,89,194	2,90,702	2,92,843
Loans	572	25,272	50,088	50,088	50,088	50,088
Deferred Tax Liability	-36,259	-34,974	-27,562	-27,562	-27,562	-27,562
Capital Employed	2,90,324	3,04,616	3,14,338	3,11,719	3,13,227	3,15,369
Gross Fixed Assets	56,344	59,962	63,313	66,313	69,313	72,313
Less: Depreciation	25,573	30,292	35,172	40,227	45,517	51,040
Net Fixed Assets	30,771	29,670	28,141	26,085	23,796	21,273
Capital WIP	1,945	2,354	3,140	3,140	3,140	3,140
Investments	6,907	6,694	6,695	6,695	6,695	6,695
Curr. Assets	5,61,299	5,69,705	5,47,176	5,60,023	6,16,604	6,29,377
Inventory	62,588	77,973	89,055	93,464	73,254	75,017
Debtors	1,75,013	1,57,960	1,23,781	1,29,910	1,53,834	1,57,535
Cash & Bank Balance	1,11,759	75,033	64,186	53,116	53,328	52,550
Loans & Advances	2,279	2,403	2,182	2,290	2,715	2,780
Other Assets	2,09,661	2,56,336	2,67,974	2,81,243	3,33,473	3,41,496
Current Liab. & Prov.	3,10,598	3,03,807	2,70,815	2,84,225	3,37,008	3,45,116
Creditors	1,10,659	1,20,781	98,999	1,03,901	1,23,196	1,26,160
Other Liabilities	1,12,880	1,03,539	88,519	92,903	1,10,156	1,12,806
Provisions	87,059	79,487	83,297	87,421	1,03,656	1,06,150
Net Current Assets	2,50,700	2,65,898	2,76,362	2,75,799	2,79,596	2,84,261
Application of Funds	2,90,324	3,04,616	3,14,338	3,11,719	3,13,227	3,15,369

Financials and valuations

Ratios						
Y/E March	2018	2019	2020	2021E	2022E	2023E
Basic (INR)						
Adj EPS	2.2	3.5	-4.2	-0.8	1.4	2.1
Cash EPS	4.3	4.8	-2.8	0.7	3.0	3.6
Book Value	88.8	90.3	83.8	83.1	83.5	84.1
DPS	1.3	1.9	1.2	0.0	0.8	1.2
Payout (incl. Div. Tax.)	72.3	65.1	-34.3	0.0	70.0	70.0
Valuation (x)						
P/E	16.9	10.7	-8.8	-49.3	25.7	18.1
Cash P/E	8.6	7.7	-13.3	53.0	12.5	10.2
EV/EBITDA	1.3	3.7	-49.4	76.0	9.7	7.9
EV/Sales	0.1	0.3	0.5	0.6	0.5	0.5
Price/Book Value	0.4	0.4	0.4	0.4	0.4	0.4
Dividend Yield (%)	3.6	5.1	3.3	0.0	2.3	3.2
Profitability Ratios (%)						
RoE	2.5	3.8	-5.0	-0.9	1.7	2.4
RoCE	3.2	4.5	-1.1	0.4	2.8	3.5
RoIC	3.4	4.4	-6.8	-1.0	2.3	3.1
Turnover Ratios						
Debtors (Days)	222	190	210	210	210	210
Inventory (Days)	79	94	151	151	100	100
Creditors (Days)	140	145	168	168	168	168
Asset Turnover (x)	8.8	9.5	6.9	7.7	9.9	11.2
Leverage Ratio						
Net Debt/Equity (x)	-0.3	-0.2	0.0	0.0	0.0	0.0

Cash Flow Statement						(INR m)
Y/E March	2018	2019	2020	2021E	2022E	2023E
PBT before EO Items	15,850	20,475	-6,621	-3,499	6,717	9,540
Depreciation	7,864	4,748	5,029	5,055	5,289	5,523
Direct Taxes Paid	-431	4,207	3,219	-881	1,691	2,401
(Inc)/Dec in WC	-32,738	-75,892	-26,195	-10,506	-3,585	-5,443
CF from Operations	9,906	-38,556	-28,910	-7,966	7,690	8,162
(Inc)/Dec in FA	-2,698	-4,146	-4,252	-3,000	-3,000	-3,000
Free Cash Flow	7,207	-42,702	-33,162	-10,966	4,690	5,162
(Pur)/Sale of Investments	6,341	6,389	5,617	4,966	4,110	4,126
CF from Investments	3,643	2,243	1,365	1,966	1,110	1,126
(Inc)/Dec in Networth	3	-16,454	80	0	0	0
(Inc)/Dec in Debt	-504	24,862	24,767	0	0	0
Dividend Paid	5,833	7,870	5,046	0	3,518	4,997
CF from Fin. Activity	-6,707	-412	16,696	-5,070	-8,588	-10,067
Inc/Dec of Cash	6,841	-36,725	-10,848	-11,069	212	-778
Add: Beginning Balance	1,04,918	1,11,759	75,033	64,186	53,116	53,328
Closing Balance	1,11,759	75,033	64,186	53,116	53,328	52,550

Explanation of Investment Rating	
Investment Rating	Expected return (over 12-month)
BUY	>=15%
SELL	< - 10%
NEUTRAL	< - 10 % to 15%
UNDER REVIEW	Rating may undergo a change
NOT RATED	We have forward looking estimates for the stock but we refrain from assigning recommendation

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