Bharat Heavy Electricals Limited

June 24, 2021

Ratings

Facilities	Amount (Rs. crore)	Rating[1]	Rating Action
Long Term Bank Facilities	6,000.00	CARE AA-; Stable (Double A Minus; Outlook: Stable)	Revised from CARE AA; Stable (Double A; Outlook: Stable)
Long Term / Short Term Bank Facilities	54,000.00	CARE AA-; Stable / CARE A1+ (Double A Minus ; Outlook: Stable/ A One Plus)	Revised from CARE AA; Stable / CARE A1+ (Double A ; Outlook: Stable / A One Plus)
Total Bank Facilities	**60,000.00 (Rs. Sixty Thousand Crore Only)**		
Commercial Paper	5,000.00	CARE A1+ (A One Plus)	Reaffirmed
Commercial Paper (Carved out)*	3,000.00	CARE A1+ (A One Plus)	Reaffirmed
Total Short Term Instruments	**8,000.00 (Rs. Eight Thousand Crore Only)**		

Details of instruments/facilities in Annexure-1

** Carved out of the sanctioned working capital limits of the Company*

Detailed Rationale & Key Rating Drivers

The revision in the long-term ratings of BHEL takes into account a lower-than-expected execution of orders in FY21 primarily due to the lockdown due to Covid-19 pandemic, resulting in significant decline in total operating income and operating loss for the company, and a consequent deterioration in the company's debt protection metrics. Notwithstanding persistent initiatives of the company to rationalize its overheads, the margins are likely to remain under pressure in FY22 also.

The revision in the ratings also factors in the diminishing order inflow both in "power" as well as "industry" segments. Furthermore, the ratings continue to factor in the company's elongated working capital cycle as a result of increasing contract assets given the adverse payment terms in its orders, which is partly offset by an improved collection of trade receivables. Besides, the rating continues to factor in higher concentration of order in the thermal power segment that is beset with abiding systemic challenges like overcapacity, declining competitiveness and weak financial profile of state power utilities.

The ratings, however, continue to derive strength from BHEL's status as a Maharatna, the majority ownership of the company by the Government of India (GoI) and the resulting financial flexibility. The ratings continue to favourably factor in BHEL's established position in the power equipment market – especially its deep penetration among the Government sector entities – and its growing share in industrial equipment segment as well. The ratings factor in the strong manufacturing and engineering base with availability of experienced resources for execution of orders on a very large scale. The ratings continue to account for the company's healthy order book position providing medium-term revenue visibility, its comfortable capital structure with strong liquidity position.

<u>Rating Sensitivities</u>

Positive Factors - Factors that could lead to positive rating action/upgrade:

- Reduction in average collection period (including contract assets) to 300 days on sustained basis.
- Turnaround in thermal power sector leading to higher-than-projected execution and significant gross margin expansion.

Negative Factors- Factors that could lead to negative rating action/downgrade:

- Continued sluggish execution of orders with further deterioration in collections.
- Further deterioration in gross margin and overhead expenses.
- Further deterioration of net cash over debt position.
- Material reduction in GoI shareholding in BHEL to below 50%.

[1]*Complete definition of the ratings assigned are available at www.careratings.com and other CARE publications*

Detailed description of the key rating drivers

Key Rating Strengths

Established position in power and industrial equipment segments

BHEL has established its position in building India's capability in heavy electrical equipment manufacturing over almost five decades. BHEL's involvement in power generation, transmission, floating solar EPC and in railway traction has been significant over the years. It also has a sizable share in the supply of equipment across the country for thermal projects under implementation.

Strong manufacturing and engineering base with adequate availability of resources for executing large orders

Considering its significant business integration and a wide range of products, especially in power equipment, BHEL has a capacity to deliver up to 20 GW in a year. The company has the infrastructure and resources to operate in more than 150 project sites in India and abroad. It has presence across India through its 16 manufacturing units, two repair centres and eight service centres. BHEL's strength in project execution is also driven by its large competent and experienced workforce. BHEL has been spending sizable amount for research and development (R&D) – a critical area for better product design thus increasing acceptance, cost reduction and efficiency in the competitive electrical equipment EPC landscape – in the past.

Diminished yet healthy order book position with medium-term revenue visibility

The aggregate and executable order book has declined by 5.9% and 7.0% respectively to Rs. 1,02,090 cr and Rs. 82,097 cr respectively during FY21. This is on account of operational challenges and fewer business opportunities due to Covid-19 pandemic. The FY21 executable order book is 5.04x the FY21 revenue from order execution (PY: 4.31x) which provides long term revenue visibility of the company. The average execution period of the order book range from 3-5 years. The order book is diversified in terms of clients as well as geography.

Comfortable financial risk profile, despite moderation

BHEL has a large net worth, despite erosion in FY20 and FY21 due to net loss, which provides financial flexibility. The company's capital structure remained comfortable characterized by a low overall gearing (adjusted for mobilization advances and group co advances) which moderated to 0.45x as on March 31, 2021 (PY: 0.40x). Its financial risk profile witnessed moderation due to operating loss leading to deterioration in interest cover and total debt/ gross cash accrual (TD/GCA).

Liquidity: Strong

BHEL has a healthy liquidity position as exhibited by robust cash and bank balance of Rs. 6,701 cr as on March 30, 2021. The company's liquidity position derives comfort from its working capital limits and commercial paper (CP) which together had an average utilization of less than 50% over the trailing 12 months ended April 2021. BHEL logged surplus cash flow from operation after several years due to better collection and lower inventory. Current ratio of the company continued to be healthy. The company does not have any long-term debt and hence no repayment obligations.

Majority ownership by GoI and benefits accruing from Maharatna status

BHEL is one of the largest engineering and manufacturing companies in India serving core sectors of its economy for more than five decades, with majority stake held by GoI. As on March 31, 2021, GoI's stake in the company stood at 63.17%. The company enjoys the status of Maharatna that permits greater autonomy to Central Public Sector Enterprises (CPSEs) in their investment and capital expenditure decisions.

GoI has fair representation in the board of directors through two nominated members (who hold secretarial position in relevant administrative ministries). The independent directors are also selected by the administrative ministries.

Key Rating Weaknesses

Lower-than-expected execution of orders in FY21

BHEL's execution of orders in FY21 was lower than envisaged levels with the onset of the Covid-19 pandemic disrupting supply chains from Q4FY20 onwards, and the ensuing nation-wide lockdown creating conditions of site unavailability and shortage of labour particularly during H1FY21. Moreover, the financial position of the customers (which are primarily state generating utilities) had also deteriorated particularly during lockdown. Although the execution trend had gradually improved from Q3FY21 onwards and Q4FY21 being higher than Q4FY20 level, it remained lower than historical levels. Execution headwinds led to a 21.3% decline in BHEL's total operating income in FY21 on a year-on-year (y-oy) basis, which was at a 4-year low.

Diminishing order inflow due to the Covid-19 pandemic and concentration of orders from the power sector

BHEL's total order inflow has been continuously declining since FY19. It has declined sharply by 42.8% in FY21 to Rs. 13,472 cr. Order inflows are still concentrated in power sector with the segment contributing ~67% (PY: 58%) of new orders. BHEL had strong foothold in the EPC/ machinery equipment space for power sector in India in the past. The company has high concentration of orders from power sector – which stood at 77% and 79% of the executable order book of the company as on March 31, 2020 and March 31, 2021 respectively. BHEL has been focusing on new growth opportunities in Industry and International operations by utilizing its expertise and manufacturing capacity. The company is focusing on growing its order book in transportation, defense and energy storage sector going forward.

Declining profitability, however cost rationalization initiatives undertaken by management
BHEL's PBILDT margin has been declining continuously in the past, with weakening gross margin in highly competitive new businesses coupled with lower execution of orders leading to under-recovery of fixed overheads. The company has been taking several initiatives to rationalize overheads. Despite the wage revisions and inflation, the cost per employee has remained stable in the past thereby containing further losses upon sharp decline in order execution. The company is also focussing on higher margin sub-segments within the industry segment. The ability of the company to diversify its non-power order book (given the subdued thermal power scenario) along with expansion in margin remains to be seen.

Despite improvement, working capital continues to be intensive
The company's gross current assets and net operating cycle, though improved in FY21 from FY20, continues to be high. This is attributable to significant receivables, contract assets and inventory required to be maintained for working at various projects simultaneously. The percentage of non-current receivables and contract assets of total have been increasing over the years, indicating longer time for realization.
However, the overall receivables and contract assets have decreased as on March 31, 2021 as compared to the levels in the past. The company has been focussing on higher cash conservation over last 18 months, reflected from reducing trade receivables and stabilizing the level of contract assets. More than 65% of the receivables and contract assets are due from large central/ state PSUs which provides comfort. Moreover, the inventory level has also reduced to pre-Covid-19 levels in FY21.

Competition in power sector and new business segments
The boiler-turbine-generator (BTG) market has witnessed intense competition from foreign and domestic players on account of significant unutilized manufacturing capacity among all the players and subdued addition to thermal power capacity in India over the past few years and planned going forward. In power equipment and emission control equipment space, BHEL has a larger market share in comparison to its peers. Till the time the company establishes itself in railway, defence and energy storage segments, the company's prospects are likely to continue to hinge upon the conventional power sector.

Analytical approach: Standalone. BHEL does not have any substantial business operation through its subsidiary/ JV nor have significant investment commitment in future. Given the majority shareholding by GoI in BHEL, the rating factors in linkages with strong parent i.e GoI.

Applicable Criteria
Definition of Default
Factoring Linkages Government Support
Financial Ratios – Non-financial Sector
Liquidity Analysis of Non-financial sector entities
Rating Outlook and Credit Watch
Short Term Instruments
Rating Methodology - Construction
Manufacturing Companies

About the company
BHEL is an integrated power plant equipment manufacturer and one of the largest engineering and manufacturing company in India. The company is engaged in the design, engineering, manufacture, construction, testing, commissioning and servicing of a wide range of products and services for the core sectors of the economy. BHEL has played an important role for India's heavy electrical equipment industry since its incorporation in 1964.

Brief Financials (Rs. crore)	FY20 (A)	FY21 (Abr.)
Total operating income	22,453	17,678
PBILDT	403	-2,765
PAT	-1,473	-2,717
Overall gearing (times)*	0.39	0.43
Interest coverage (times)	0.66	NM

*A: Audited; Abr.: Abridged; *adjusted for mobilization advance and group company investments*

Status of non-cooperation with previous CRA: NA
Any other information: NA
Rating History for last three years: Please refer Annexure-2

Annexure-1: Details of Instruments/Facilities

Name of the Instrument	Date of Issuance	Coupon Rate	Maturity Date	Size of the Issue (Rs. crore)	Rating assigned along with Rating Outlook
Fund-based - LT-Cash Credit	-	-	-	6000.00	CARE AA-; Stable
Non-fund-based - LT/ ST-BG/LC	-	-	-	54000.00	CARE AA-; Stable / CARE A1+
Commercial Paper-Commercial Paper (Standalone)	-	-	7-365 days	5000.00	CARE A1+
Commercial Paper-Commercial Paper (Carved out)	-	-	7-365 days	3000.00	CARE A1+

Annexure-2: Rating History of last three years

Sr. No.	Name of the Instrument/Bank Facilities	Current Ratings			Rating history			
		Type	Amount Outstanding (Rs. crore)	Rating	Date(s) & Rating(s) assigned in 2021-2022	Date(s) & Rating(s) assigned in 2020-2021	Date(s) & Rating(s) assigned in 2019-2020	Date(s) & Rating(s) assigned in 2018-2019
1.	Fund-based - LT-Cash Credit	LT	6000.00	CARE AA-; Stable	-	1)CARE AA; Stable (27-Jun-20)	1)CARE AA+; Stable (03-Sep-19)	1)CARE AA+; Stable (19-Feb-19) 2)CARE AA+; Stable (05-Apr-18)
2.	Non-fund-based - LT/ ST-BG/LC	LT/ST	54000.00	CARE AA-; Stable / CARE A1+	-	1)CARE AA; Stable / CARE A1+ (27-Jun-20)	1)CARE AA+; Stable / CARE A1+ (03-Sep-19)	1)CARE AA+; Stable / CARE A1+ (19-Feb-19) 2)CARE AA+; Stable / CARE A1+ (05-Apr-18)
3.	Commercial Paper-Commercial Paper (Standalone)	ST	5000.00	CARE A1+	-	1)CARE A1+ (27-Jun-20)	1)CARE A1+ (03-Sep-19) 2)CARE A1+ (10-Jul-19)	1)CARE A1+ (19-Feb-19)
4.	Commercial Paper-Commercial Paper (Carved out)	ST	3000.00	CARE A1+	-	-	-	-

Annexure 3: Detailed explanation of covenants of the rated instrument / facilities – NA

Annexure 4: Complexity level of various instruments rated for this company

Sr. No.	Name of the Instrument	Complexity Level
1.	Commercial Paper-Commercial Paper (Carved out)	Simple
2.	Commercial Paper-Commercial Paper (Standalone)	Simple
3.	Fund-based - LT-Cash Credit	Simple
4.	Non-fund-based - LT/ ST-BG/LC	Simple

Note on complexity levels of the rated instrument: *CARE has classified instruments rated by it on the basis of complexity. Investors/market intermediaries/regulators or others are welcome to write to care@careratings.com for any clarifications.*

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About CARE Ratings:
CARE Ratings commenced operations in April 1993 and over two decades, it has established itself as one of the leading credit rating agencies in India. CARE is registered with the Securities and Exchange Board of India (SEBI) and also recognized as an External Credit Assessment Institution (ECAI) by the Reserve Bank of India (RBI). CARE Ratings is proud of its rightful place in the Indian capital market built around investor confidence. CARE Ratings provides the entire spectrum of credit rating that helps the corporates to raise capital for their various requirements and assists the investors to form an informed investment decision based on the credit risk and their own risk-return expectations. Our rating and grading service offerings leverage our domain and analytical expertise backed by the methodologies congruent with the international best practices.

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