Bharat Heavy Electricals Limited

June 27, 2020

Ratings

Facilities/ Instruments	Amount (Rs. crore)	Rating[1]	Rating Action
Bank facilities – Fund-based – LT – Cash Credit	6,000	**CARE AA; Stable [Double A; Outlook: Stable]**	Revised from AA+; Stable [Double A Plus; Outlook: Stable]
Bank facilities – Non-fund-based – LT/ST – BG/LC	54,000	**CARE AA; Stable/CARE A1+ [Double A; Outlook: Stable/ A One Plus]**	Revised from AA+; Stable/ CARE A1+ [Double A Plus; Outlook: Stable/ A One Plus]
Total Facilities	**60,000 (Rupees Sixty Thousand crore only)**		
Commercial Paper issue*	8,000	**CARE A1+ [A One Plus]**	Reaffirmed

Details of instruments/facilities in Annexure-1
**Rs.3,000 crore can be carved out of fund based working capital limits of the company.*

Detailed Rationale & Key Rating Drivers

The revision in the long term ratings of BHEL takes into account the sharp decline in the execution of orders and, consequently, in the company's revenues in FY20, primarily on account of slow execution of projects in the thermal power sector, its main customer segment. These impediments were further aggravated in Q4FY20 with the outbreak of Covid-19, with the ensuing nationwide lockdown disrupting its supply chains. The ratings also factor in the deterioration in operating margins in FY20. The consequent decline in operating profits has resulted in a sharp deterioration in interest coverage in FY20. Notwithstanding persistent initiatives of the company to rationalize its overheads, the margins are likely to remain under pressure in FY21. The rating also takes into cognizance the difficulties BHEL is expected to face in terms of execution in FY21 of account of the labour migration and logistics issues in the aftermath of the lockdown. It also considers the subdued profitability during execution of orders in few 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 of orders, which is partly mitigated by 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 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 its healthy order book position providing medium-term revenue visibility, its comfortable capital structure with strong liquidity position.

Rating Sensitivities

Positive Factors

- Turnaround in thermal power sector, with improved capacity utilization rates leading to significant margin expansion
- Reduction in average collection (including contract assets) days to 300 days on sustained basis.

Negative Factors

- Continued sluggish execution in order with further deteriorations in collection.
- Further deterioration in gross margin and overhead expenses.

Detailed description of the key rating drivers

Key Rating Strengths

Majority ownership by GoI

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, 2020, 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.

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

Established position in power and industrial equipment segments

BHEL commenced operations in 1964 and had established its position over the years in building India's capability in heavy electrical equipment manufacturing. The company has been involved in the installation of more than 185 GW power generating capacity in India and abroad since its inception. In transmission sector, it has supplied equipment of more than 630,000 MVA in the past. More than 50% of traction equipment in locomotives and EMUs of Indian Railways have been supplied by BHEL. BHEL has presence in 83 countries through project execution. The overseas installed base is 17 GW and has ongoing projects of roughly 6 GW.

The order inflow from the industrial equipment segment has been increasing over the years, with highest inflow clocked in FY20. This was driven by defence and solar segments. The company is focussing on growing its order book in transportation, defence and aerospace sector going forward.

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

BHEL has the capability to provide a wide range of product and end-to-end solution for various segments in infrastructure and industry. Owing to its significant business integration, especially in power equipment, it can deliver capacity of up to 20 GW in a year. BHEL 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.

Healthy order book position with medium-term revenue visibility

BHEL has a healthy outstanding order book position of Rs. 1,08,443 cr as on March 31, 2020 (PY: Rs. 1,09,000 cr). Out of this, the executable order book was Rs. 88,300 cr as on March 31, 2020 (PY: Rs. 86,953 cr). The FY20 executable order book is 4.31x the FY20 revenue from order execution (PY: 2.96x) 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 capital structure, although witnessed moderation recently

BHEL continues to have a comfortable capital structure characterized by a low overall gearing (adjusted for mobilization advances) which moderated to 0.39x as on March 31, 2020 (PY: 0.27x). The company has a large net worth which stood at Rs. 29,103 crore as on March 31, 2020, providing financial flexibility. BHEL continued to maintain a healthy net cash balance over its borrowing.

Liquidity: Strong

BHEL has a healthy liquidity position as exhibited by robust cash and bank balance of Rs. 6,419 cr as on March 30, 2020. The company's liquidity position derives comfort from its working capital limits and commercial paper (CP) which together had average utilization of 44.3% over the trailing 12 months ended May 2020. BHEL has not availed moratorium for its debt obligation which was allowable as per RBI special Covid'19 regulatory package announced on March 27, 2020. The company does not have any long term debt and hence no repayment obligations.

Key Rating Weaknesses

Sharp decline in execution of orders in FY20

A sharp decline in execution of orders led to a 28.9% decline in BHEL's total operating income in FY20 on a year-on-year (y-o-y) basis, which was at a 4-year low and lower than envisaged as per CARE's last review. Q4 tend to drag up the BHEL's revenues, reflected from billing of more than 30% of the annual revenue in the past. However, in FY20 the Q4FY20 revenue contribution was much lower. The disruption of supply from local and overseas vendors impacted purchases and delivery on site. In terms of order inflow in FY20, it has remained almost stagnant due to fewer orders from the power sector, which have been offset by increased orders from industry sector.

Declining profitability, however cost rationalization initiatives undertaken by management

PBILDT margin sharply declined from 9.21% in FY19 to 1.58% in FY20, largely due to lower gross margin on account of higher competition and under-recovery of overheads on account of lower execution of orders. Gross margin has deteriorated from 53%-56% in the past to around 40% in FY20.

BHEL has been taking several initiatives to rationalize overheads. Despite the wage revisions and inflation, the cost per employee has remained stagnant in the past thus containing further losses upon sharp decline in order execution.

Elongated working capital cycle
The gross operating cycle has significantly increased in FY20, largely attributable to higher inventory and contract assets despite lower revenue, marginally compensated by an improved collection of trade receivables. BHEL continued to report negative cash flow from operations in FY20, however to a lesser extent. Adverse payment term (i.e higher back-loading) on new orders arising out of competitive pressures has resulted in a continuous increase in contract assets over the years. Moreover, logistics issue during lockdown impacted dispatches, resulted in higher inventory holding. The trade receivables continued to reduce as on March 31, 2020 compared to previous year level. This has led to 7-yr high collection to billing ratio in FY20. BHEL, through continuous effort, has managed to curb receivables from its top 10 debtors.

Structural challenges in power sector
BHEL has a strong foothold in the EPC/ machinery supply space for power sector in India in the past, which has resulted in a high concentration of orders from power sector. Around 80% of the total outstanding order book, as on March 31, 2020, is from power sector. However, the order inflow in this segment has continued to witness decline over the last three years, on account of lower capacity addition in the thermal power sector, which may be attributable to lower power demand and increasing competitiveness of renewable power.

Majority of the slow moving orders of BHEL pertain to those from the thermal power sector (94%). This is largely on account of issues related to land acquisition, environmental clearances and funding issues faced by its clients. The weak financial profile of state utilities brings additional pressure in terms of working capital requirement for the bidders.
The boiler-turbine-generator market sees intense competition with Chinese and domestic players quoting aggressive prices. Besides, as most of the business is tender-driven, the incumbent players have less advantage due to aggressive bidding. However, BHEL has much stronger market share in comparison to its peers. The Flue Gas De-sulfurization (FGD) equipment space has lower margin and the competition is moderate. BHEL commands ~40% of the market share in terms of tender already awarded. Till the time the company forays strongly into railway, defence and energy storage segment, the prospects are likely to continue to hinge upon the conventional power sector.

Analytical approach: Standalone

Applicable Criteria
[Definition of Default]
[Rating Outlook and Credit Watch]
[Short Term Instruments]
[Manufacturing Companies]
[Rating methodology for Construction]
[Financial Ratios – Non financial Sector]
[Liquidity Analysis of Non-financial sector entities]
[Consolidation and factoring linkages in rating]

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)	FY19 (A)	FY20 (A)
Total operating income	31,038	22,067
PBILDT	2,858	348
PAT	1,215	(1,473)
Overall gearing (times)	0.09	0.17
Interest coverage (times)	7.59	0.69

A: Audited, FY20 is based on abridged financial

Status of non-cooperation with previous CRA: Not Applicable

Any other information: Not Applicable

Rating History for last three years: Please refer Annexure-2

Annexure-1: Details of Instruments/Facilities

Name of the facilities/ 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	-	-	-	6,000.00	CARE AA; Stable
Non-fund-based - LT/ ST-BG/LC	-	-	-	54,000.00	CARE AA; Stable / CARE A1+
Commercial Paper Issue	-	-	7-364 days	8,000.00	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 2020-2021	Date(s) & Rating(s) assigned in 2019-2020	Date(s) & Rating(s) assigned in 2018-2019	Date(s) & Rating(s) assigned in 2017-2018
1.	Fund-based - LT-Cash Credit	LT	6000.00	CARE AA; Stable	-	1)CARE AA+; Stable (03-Sep-19)	1)CARE AA+; Stable (19-Feb-19) 2)CARE AA+; Stable (05-Apr-18)	1)CARE AA+; Stable (26-May-17)
2.	Non-fund-based - LT/ ST-BG/LC	LT/ST	54000.00	CARE AA; Stable / CARE A1+	-	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)	1)CARE AA+; Stable / CARE A1+ (26-May-17)
3.	Commercial Paper	ST	8000.00	CARE A1+	-	1)CARE A1+ (03-Sep-19) 2)CARE A1+ (10-Jul-19)	1)CARE A1+ (19-Feb-19)	-

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

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