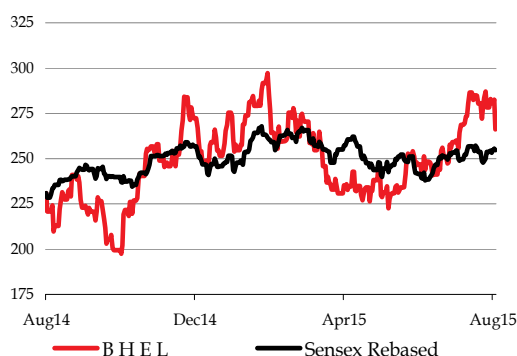


August 7, 2015

**SELL****BHEL****Target Price (INR) 193****Tripped by approval delays****Company Update**

<b>Last Price (INR)</b>	<b>266.2</b>
Bloomberg code	BHEL IN
Reuters code	BHEL.BO
Avg. Vol. (3m)(mn)	3.59
Avg. Val.(3m)(INRmn)	914
52-wk H/L (INR)	300 / 194
Sensex	28,236
MCAP (INRbn/USDbn)	651.43 / 10.20

Shareholding (%)	03/15	06/15
Promoters	63.1	63.1
MFs, FIs, Banks	17.3	17.3
FIs	16.1	16.1
Public	2.3	2.2
Others	1.3	1.3

**Stock Chart (Relative to Sensex)**

Stock Perfm. (%)	1m	3m	1yr
Absolute	2.8	16.4	15.3
Rel. to Sensex	2.5	10.2	4.9

Financials (INRmn)	03/15	03/16f	03/17f
Sales	301,830	295,385	363,645
YoY (%)	-23	-2	23
EBITDA (%)	8.2	9.0	12.3
A.PAT	14,852	17,640	31,132
Sh o/s (diluted)	2,448	2,448	2,448
A.EPS (INR)	6.1	7.2	12.7
YoY (%)	-57	19	76
D/E (x)	-0.4	-0.4	-0.4
P/E (x)	43.9	36.9	20.9
EV/E (x)	21.4	19.0	11.1
RoCE (%)	5	5	9
RoE (%)	4	5	8

Quarterly Trends	09/14	12/14	03/15	06/15
Sales (INRmn)	61,440	61,980	126,860	43,617
PAT (INRmn)	1,248	2,126	9,512	339

New orders bagged recently have taken more time to start execution, which explains the continuing revenue deceleration and profit dip in Q1. Excluding forex income of INR1.7bn, the PAT is also in the red. Revenue contribution from new orders is likely to start from Q3. Apart from 4GW order booked in Q1, it is L1 in another 5GW worth of orders. Our forecasts are unchanged and assume 18GW of orders over FY16f-17f. Delays in redressal of the distribution side problems threatens to spill over at some point and impact the continuity of order flows. Stranded project status is unchanged and likely to remain so in the foreseeable future. Maintain Sell with TP of INR193/share at 15x P/E.

**Lower revenue and operating de-leverage lead to EBITDA level loss**

The 15% y-o-y revenue deceleration in Q1 was similar to the Mar15 level. Execution has not improved in-line with the improved order backlog in the past one-year. This was on account of lack of traction in execution of new orders due to delays in clearances for the projects. Accordingly, there was delay in delivery of materials despite them being ready at the company's factories. The lower revenue was primarily responsible for the -4.8% EBITDA margin during the quarter. Gross margins at 45.5% were better than the 43.9% reported in FY15. Management expects execution to pick up from Q3. Forex gains of INR1.7bn boosted the other income and PAT in Q1.

**Order prospects secure with L1 of 5GW worth of projects**

Q1 order inflow was strong on booking of 4GW of project order from the Telangana SEB (as already announced). Further, the company is L1 in another 5GW worth of projects from NTPC and other SEBs. There is a 2x660MW tender coming up in Bangladesh. The management expects 15-20 GW worth of orders to be finalised during FY16 and FY17 each. Further, tenders for guns for navy, 15 high speed trains and diesel/electric locomotives are also expected to be finalised in the current fiscal.

**We maintain forecasts, wage impact to constrain FY18f earnings**

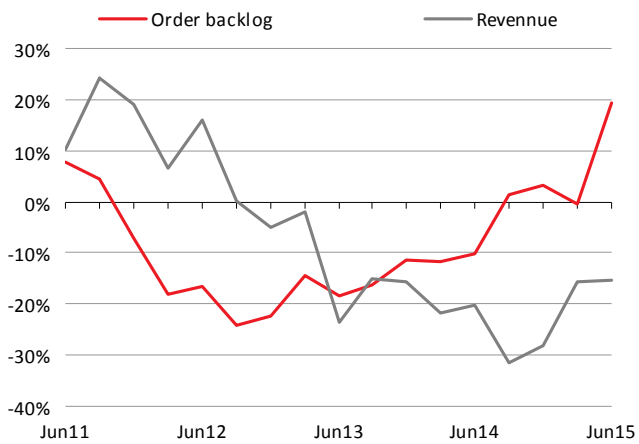
There was no change in status of stranded projects that amount to 10GW, constituting INR240bn (21%) of BHEL's order backlog and INR33bn (9%) of its receivables. Our forecasts are maintained. We do not expect any significant earnings pick-up in FY18f after factoring in wage revision impact due in Jan17.

**Sell with TP of INR193/share; large risks to the sector continue**

We rollover our TP to Jun16 and raise it to INR193/share (from INR191) based on 15x P/E. Recent surge in orders have eased order inflow concerns while margins concerns have increased on reports of aggressive price bidding. We remain sceptical of any further improvement in the order run rate over our forecast considering the slow pace of resolution of problems relating to the distribution losses, fuel availability and private developers' financial health. Increased competition from other players/solar pose further challenges to BHEL's business. We maintain a Sell rating. Higher coal availability, higher margins and execution are the key risk factors.

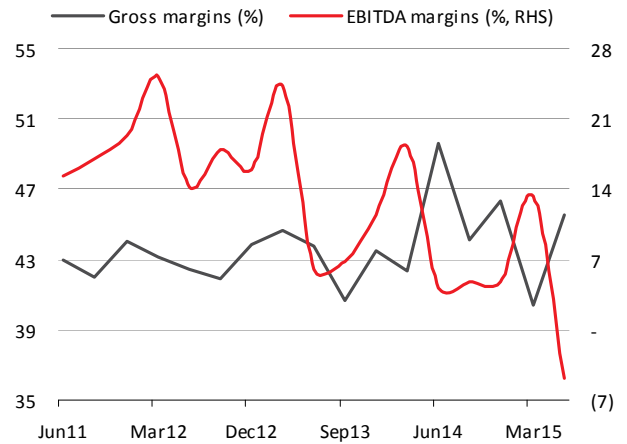
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Exhibit 1: Qtrly growth trend in backlog and revenue (%)



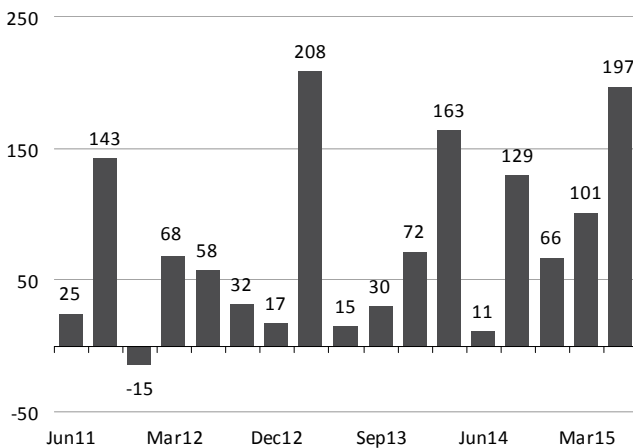
Source: Company, IL&FS Institutional Equities

Exhibit 2: Qtrly trend in margins



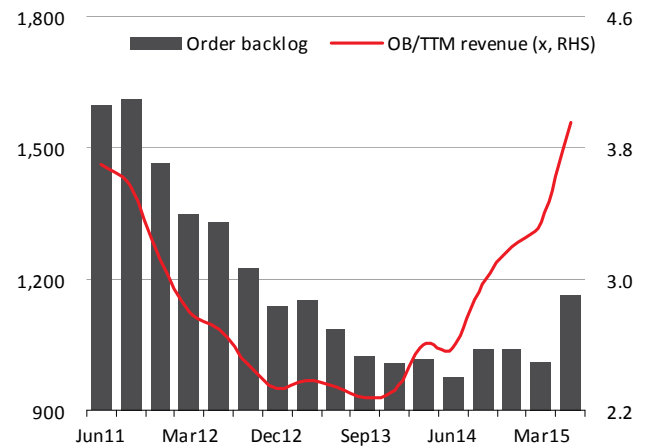
Source: Company, IL&FS Institutional Equities

Exhibit 3: Order booking trend (INRbn)



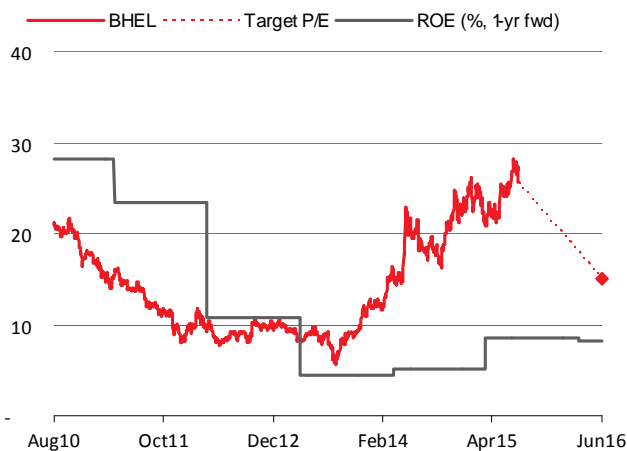
Source: Company, IL&FS Institutional Equities

Exhibit 4: Order backlog trend (INRbn)



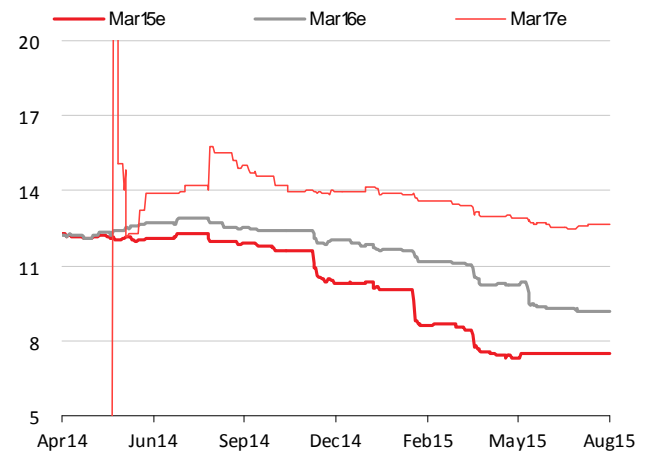
Source: Company, IL&FS Institutional Equities

Exhibit 5: 1-yr fwd P/E on consensus estimates (x)



Source: Bloomberg, IL&FS Institutional Equities

Exhibit 6: Consensus EPS revision trend



Source: Bloomberg, IL&FS Institutional Equities

## Exhibit 7: Quarterly results snapshot

(INRmn)	Jun14	Sep14	Dec14	Mar15	Jun15	y-o-y (%)	q-o-q (%)
<b>Net Revenue</b>	<b>51,550</b>	<b>61,440</b>	<b>61,980</b>	<b>126,860</b>	<b>43,617</b>	<b>-15</b>	<b>-66</b>
<b>Y-o-y</b>	<b>-20%</b>	<b>-32%</b>	<b>-28%</b>	<b>-16%</b>	<b>-15%</b>		
Total operating expenses	49,371	58,525	59,042	110,042	45,710	-7	-58
Inc/Dec in stock	-6,038	-3,193	-3,739	9,589	-4,514	-25	-147
RM costs	32,004	37,531	37,031	66,017	28,266	-12	-57
Staff costs	15,771	15,956	13,622	9,152	14,615	-7	60
Other expenses	7,634	8,231	12,128	25,285	7,343	-4	-71
<b>EBITDA</b>	<b>2,179</b>	<b>2,915</b>	<b>2,938</b>	<b>16,818</b>	<b>-2,093</b>	<b>-196</b>	<b>-112</b>
<b>Y-o-y</b>	<b>-44%</b>	<b>-52%</b>	<b>-70%</b>	<b>-38%</b>	<b>-196%</b>		
Other income	3,478	1,961	2,741	160	4,924	42	2,974
Depreciation	2,725	2,662	2,565	2,821	2,425	-11	-14
EBIT	2,932	2,214	3,114	14,157	406	-86	-97
Interest	473	126	52	265	33	-93	-88
Recurring PBT	2,459	2,088	3,062	13,892	373	-85	-97
Net extra ordinary items	-	-	-	(101)	-		
PBT (reported)	2,459	2,088	3,062	13,790	373	-85	-97
Tax	524	840	936	4,907	34	-93	-99
PAT (reported)	1,935	1,248	2,126	8,884	339	-82	-96
<b>Adj. Net Income</b>	<b>1,935</b>	<b>1,248</b>	<b>2,126</b>	<b>9,512</b>	<b>339</b>	<b>-82</b>	<b>-96</b>
<b>Y-o-y</b>	<b>-58%</b>	<b>-79%</b>	<b>-69%</b>	<b>-48%</b>	<b>-82%</b>		
Adj. EPS (INR)	0.8	0.5	0.9	3.9	0.1	-82	-96
<b>Ratios (%)</b>							
Gross margin	49.6	44.1	46.3	40.4	45.5		
EBITDA margin	4.2	4.7	4.7	13.3	(4.8)		
EBIT margin	5.7	3.6	5.0	11.2	0.9		
Other income/PBT	141.4	93.9	89.5	1.2	1,320.1		
Effective Tax rate	21.3	40.2	30.6	35.6	9.1		
PAT margin	3.8	2.0	3.4	7.5	0.8		

Source: Company, IL&amp;FS Institutional Equities

## Financials and valuations (standalone)

### Income statement (INRmn)

Fiscal year ending	03/15p	03/16f	03/17f	03/18f
<b>Total operating income</b>	<b>301,830</b>	<b>295,385</b>	<b>363,645</b>	<b>442,176</b>
<b>Total operating expenses</b>	<b>276,979</b>	<b>268,697</b>	<b>318,883</b>	<b>396,872</b>
<b>EBITDA</b>	<b>24,851</b>	<b>26,688</b>	<b>44,762</b>	<b>45,304</b>
Other income	8,340	11,128	14,038	15,489
Depreciation	10,773	11,215	12,062	13,091
<b>EBIT</b>	<b>22,418</b>	<b>26,601</b>	<b>46,739</b>	<b>47,701</b>
Interest	917	273	273	273
Recurring PBT	21,501	26,329	46,466	47,428
Net extra ordinary items	-101	-	-	-
PBT (reported)	21,400	26,329	46,466	47,428
Total taxes	6,649	8,688	15,334	15,651
PAT (reported)	14,751	17,640	31,132	31,777
(+) Share in assoc. earnings	-	-	-	-
Less: Minority interest	-	-	-	-
Prior period items	-558	-	-	-
Net income (reported)	14,193	17,640	31,132	31,777
<b>Adj. net income</b>	<b>14,852</b>	<b>17,640</b>	<b>31,132</b>	<b>31,777</b>
Shares outstanding (mn)	2,448	2,448	2,448	2,448
Adj. dil. shares (mn)	2,448	2,448	2,448	2,448
<b>Adj. EPS (INR)</b>	<b>6.1</b>	<b>7.2</b>	<b>12.7</b>	<b>13.0</b>

### Growth ratios (%)

Total operating income	-22.8	-2.1	23.1	21.6
EBITDA	-45.0	7.4	67.7	1.2
EBIT	-56.5	18.7	75.7	2.1
Recurring PBT	-57.2	22.5	76.5	2.1
Adj. net income	-56.8	18.8	76.5	2.1
Adj. EPS	-56.8	18.8	76.5	2.1

### Operating ratios (%)

EBITDA margin	8.2	9.0	12.3	10.2
EBIT margin	7.4	9.0	12.9	10.8
Net profit margin	4.8	5.8	8.2	6.9
Other income/PBT	38.8	42.3	30.2	32.7
Effective Tax rate	31.1	33.0	33.0	33.0

### Balance sheet (INRmn)

Fiscal year ending	03/15p	03/16f	03/17f	03/18f
Equity capital	4,895	4,895	4,895	4,895
Preference capital	-	-	-	-
Reserves and surplus	335,951	350,727	373,268	396,454
<b>Net worth</b>	<b>340,846</b>	<b>355,622</b>	<b>378,164</b>	<b>401,350</b>
Minority interest	-	-	-	-
Total debt	610	610	610	610
Deferred tax liability	-22,207	-22,734	-23,663	-24,612
<b>Total liabilities</b>	<b>319,249</b>	<b>333,499</b>	<b>355,110</b>	<b>377,348</b>
Gross block	125,932	130,611	145,310	154,163
less: Acc. depreciation	84,349	95,563	107,625	120,717
Net block	41,583	35,047	37,685	33,446
CWIP	5,000	9,000	5,000	7,000
Goodwill	-	-	-	-
Investments	4,177	4,177	4,177	4,177
Cash	98,127	123,343	133,571	135,869
Inventories	101,017	105,206	119,554	121,144
Debtors	376,373	371,840	404,519	446,699
Loans and advances	36,187	38,130	46,731	56,823
less: Current liabilities	232,811	235,221	264,693	284,804
less: Provisions	110,404	118,022	131,434	143,006
Net working capital	268,489	285,275	308,249	332,725
<b>Total assets</b>	<b>319,249</b>	<b>333,499</b>	<b>355,110</b>	<b>377,348</b>

### Cash flow statement (INRmn)

Fiscal year ending	03/15p	03/16f	03/17f	03/18f
Net profit	14,193	17,640	31,132	31,777
Depreciation	10,773	11,215	12,062	13,091
Deferred tax	-2,518	-527	-929	-949
Working capital changes	-9,315	8,430	-12,746	-22,178
Less: Other income	8,340	11,128	14,038	15,489
<b>Cash flow from operations</b>	<b>4,794</b>	<b>25,630</b>	<b>15,481</b>	<b>6,253</b>
Capital expenditure	-4,006	-8,679	-10,699	-10,853
Strategic investments	25	-	-	-
Marketable investments	-	-	-	-
Change in other loans & adv.	-	-	-	-
Goodwill paid	-	-	-	-
Other income	8,340	11,128	14,038	15,489
<b>Cash flow from investing</b>	<b>4,359</b>	<b>2,449</b>	<b>3,339</b>	<b>4,636</b>
Equity raised	-	-	-	-
Change in borrowings	-25,938	0	0	0
Dividends paid (incl. tax)	-3,322	-2,864	-8,591	-8,591
Others	-496	0	0	0
<b>Cash flow from financing</b>	<b>-29,755</b>	<b>-2,864</b>	<b>-8,591</b>	<b>-8,591</b>
<b>Net change in cash</b>	<b>-20,602</b>	<b>25,216</b>	<b>10,229</b>	<b>2,298</b>

### Key Ratios

Fiscal year ending	03/15p	03/16f	03/17f	03/18f
<b>Valuation ratios (x)</b>				
P/E (on Adj. EPS)	43.9	36.9	20.9	20.5
P/E (on basic, reported EPS)	43.9	36.9	20.9	20.5
P/CEPS	25.4	22.6	15.1	14.5
P/BV	1.9	1.8	1.7	1.6
Dividend yield (%)	0.4	0.4	1.1	1.1
Market cap. / Sales	2.2	2.2	1.8	1.5
EV/Sales	1.8	1.7	1.4	1.1
EV/EBITDA	21.4	19.0	11.1	10.9
Net Cash / Market cap.	15.1	18.9	20.5	20.9
<b>Per share ratios (INR)</b>				
Adj. EPS	6.1	7.2	12.7	13.0
EPS (Basic, reported)	5.8	7.2	12.7	13.0
Cash EPS	10.5	11.8	17.6	18.3
Book Value	139.3	145.3	154.5	164.0
Dividend per share	1.2	1.0	3.0	3.0
Total assets / equity (x)	1.0	0.9	0.9	0.9
<b>Return ratios (%)</b>				
ROCE	4.7	5.5	9.1	8.7
ROIC	7.2	8.5	15.0	14.2
ROE	4.4	5.1	8.5	8.2
ROA	4.5	5.4	9.0	8.7
OCF/Sales	1.8	8.7	4.3	1.4
FCF/Sales	0.5	5.7	1.3	-1.0
<b>Turnover ratios (x)</b>				
Asset turnover (x)	0.9	0.9	1.1	1.2
Gross asset turnover	2.4	2.3	2.5	2.9
Inventory / Sales (days)	120.3	127.4	112.8	99.3
Receivables (days)	469.1	462.3	389.6	351.3
Payables (days)	539.8	525.2	451.6	404.6
Working capital cycle (days)	200.4	205.3	168.9	153.3
<b>Solvency ratios (x)</b>				
Gross debt to equity	-0.1	-0.1	-0.1	-0.1
Net debt to equity	-0.4	-0.4	-0.4	-0.4
Net debt to EBITDA	-4.8	-5.5	-3.5	-3.5
Interest Coverage (on EBIT)	24.4	97.5	171.3	174.8

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The following analyst(s) is(are) primarily responsible for this report and, certifies(y) that the opinion(s) on the subject company(ies) and its security(ies) and any other views or forecasts expressed herein accurately reflect their personal view(s): Devang Patel

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<b>Buy:</b> more than +15%	<b>Add:</b> +5% to +15%	<b>Reduce:</b> -5% to +5%	<b>Sell:</b> less than -5%
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