

ONE YEAR OUTLOOK

BUSINESS & EARNINGS ▼

- We retain our negative stance on the stock. We expect BHEL's revenue to be flat yoy in FY18E. Revenue run-rate is expected to remain well below historical levels due to low order book levels (Rs. 1tn, including ~Rs. 200bn of slow moving orders) with little recovery in order inflow momentum
- EBITDA margin (5.3% in FY18E) should remain capped due to execution of low margin orders secured among intense competition, increasing input costs and lack of operating leverage (relatively higher employee costs inspite of retirements)
- We expect order inflow to remain capped at ~240bn in FY18 at best. We expect only NTPC to contribute towards major orders and activity from SEBs and private players to remain muted.
- Working capital position is expected to remain at elevated levels on the back of payment delays from customers, lower order advances and slow pace of execution.

VALUATION MULTIPLES ◀▶

- Considering the subdued inflow outlook and low growth prospects, we maintain our Sell stance and value the stock at 18x Sept-FY19E earnings arriving at a target price of Rs. 83. Near term triggers continue to be absent

FINANCIAL SUMMARY

Year	Sales (Rs. mn)	EBITDA (Rs. mn)	PAT (Rs. mn)	EPS (Rs.)	P/E (x)	RoE(%)
FY17	282,224	8,314	4,959	1.4	70.3	1.5%
FY18E	284,078	14,977	7,469	2.0	46.7	2.3%
FY19E	316,770	26,512	15,206	4.1	22.9	4.6%
FY20E	336,158	28,184	18,523	5.0	18.8	5.5%

THREE YEAR OUTLOOK

BUSINESS & EARNINGS ◀▶

- We have a muted 3 year outlook on BHEL. Sizeable recovery in order inflow in unlikely in the near term as pace of ordering is yet to see significant improvement (~5-6GW currently vs. 25-30GW in FY10-FY11). Competitive intensity also continues to remain high thereby reducing order inflow opportunity.
- Lack of operating leverage, relatively high employee costs (including 7th pay commission expenses) and execution of orders secured in highly competitive environment are expected to keep margins under pressure going forward. We believe EBITDA margin is unlikely to increase beyond 8.5% even in the long term.
- In our view, BHEL's effort to diversify into other business such as manufacturing of solar panels, metro coaches etc. is unlikely to yield any positive results due to heavy price competition in solar panels (from China) and from both foreign and domestic players in metro coaches
- We expect company's cash generation profile to improve given the reduced capex requirements leading to FCF/EBITDA conversion of 40% over FY18E-FY21E vs 12% over FY12-FY17.

VALUATION MULTIPLES ◀▶

- We expect returns over 3-period to be subdued at 16% for BHEL assuming an exit multiple of 18x FY21E EPS and a cumulative dividend of Rs. 6.0/share.

KEY ESTIMATES REVISION

	FY18E			FY19E		
	Old	New	Change	Old	New	Change
Revenue	302,504	284,078	-6.1%	320,359	316,770	-1.1%
EBITDA	24,162	14,977	-38.0%	30,373	26,512	-12.7%
Margin (%)	8.0%	5.3%	-272 bps	9.5%	8.4%	-111 bps
PAT	13,576	7,469	-45.0%	17,774	15,206	-14.4%
Margin (%)	4.5%	2.6%	-186 bps	5.5%	4.8%	-75 bps
EPS	3.7	2.0	-45.0%	4.8	4.1	-14.4%

All figures in Rs. mn except EPS, which is in Rs.

OUTLOOK REVIEW 2QFY18 08 NOV 2017

Industry	Capital Goods		
CMP	Rs. 95		
Target Price	Rs. 83		
Key Stock Data			
Bloomberg	BHEL IN		
Shares o/s	3,671mn		
Market Cap	Rs. 349bn		
52-wk High-Low	Rs. 122-77		
3m ADV	Rs. 956mn		
Index	BSE 30		
	Mar'16	Jun'17	Sep'17
Promoters	63.1	63.1	63.1
Institutions	32.3	32.4	31.5
Public	4.6	4.5	5.4
Pledge			

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Quarterly Financial Statement

Consolidated Financial Result								
Rs. mn\Period	30-Sep-17	30-Sep-16	YoY Growth	30-Jun-17	QoQ Growth	FY16	FY17	YoY Growth
Revenues	63,849	66,012	-3.3%	55,056	16.0%	254,826	282,224	63,849
Material cost	38,252	42,901	-10.8%	32,954	16.1%	165,876	175,606	38,252
Employee cost	13,988	14,644	-4.5%	14,088	-0.7%	53,798	53,999	13,988
Other expenditure	12,564	6,916	81.7%	8,897	41.2%	48,818	44,305	12,564
Operating Expenses	64,803	64,461	0.5%	55,939	15.8%	268,492	273,910	64,803
EBITDA	-954	1,551	-161.5%	-883	NA	-13,665	8,314	-954
EBITDA margin (%)	-1.5%	2.4%	-384 bps	-1.6%	11 bps	-5.4%	2.9%	-1.5%
Depreciation	1,872	2,080	-10.0%	2,001	-6.5%	9,357	8,488	1,872
Other income	4,850	1,961	147.4%	4,622	4.9%	14,978	9,959	4,850
EBIT	2,025	1,432	41.4%	1,738	16.5%	-8,045	9,784	2,025
Interest	552	50	995.6%	657	-16.0%	3,595	3,506	552
PBT	1,472	1,382	6.6%	1,080	36.3%	-11,640	6,278	1,472
Tax	318	292	9.2%	272	17.0%	-4,546	1,320	318
Effective tax rate	21.6%	21.1%		25.2%		39.1%	21.0%	21.6%
PAT	1,154	1,090	5.9%	808	42.8%	-7,094	4,959	1,154
PAT margin (%)	1.8%	1.7%	16 bps	1.5%	34 bps	-2.8%	1.8%	1.8%
EPS (Rs.)	0.3	0.3	5.9%	0.2	42.8%	(1.9)	1.4	0.3

Financial Summary

Abridged Financial Statements									
Rs. mn	FY12	FY13	FY14	FY15	FY16	FY17	FY18E	FY19E	FY20E
Profit & Loss									
Revenue	479,789	484,247	391,088	301,830	254,826	282,224	284,078	316,770	336,158
Gross profit	198,944	204,091	159,524	127,627	88,950	106,618	114,500	127,411	133,443
EBITDA	99,069	93,898	45,198	20,986	(13,665)	8,314	14,977	26,512	28,184
Depreciation	8,000	9,534	9,829	10,773	9,357	8,488	8,713	9,018	9,323
EBIT	91,069	84,364	35,369	10,213	(23,023)	(175)	6,264	17,493	18,861
Other Income	12,656	11,217	16,160	12,204	14,978	9,959	8,473	8,879	9,304
Interest expense	513	1,253	1,326	917	3,595	3,506	3,506	3,506	100
Exceptional items	0	0	0	(101)	0	0	0	0	0
PBT	103,211	94,329	50,203	21,399	(11,640)	6,278	11,231	22,866	28,066
Reported PAT (after minority interest)	70,396	66,143	34,608	14,192	(7,094)	4,959	7,469	15,206	18,523
Adj PAT	70,396	66,143	34,608	14,293	(7,094)	4,959	7,469	15,206	18,523
EPS (Rs.)	19.2	18.0	9.4	3.9	(1.9)	1.4	2.0	4.1	5.0
Balance Sheet									
Net Worth	253,732	304,441	330,132	340,846	321,811	322,944	326,130	332,770	338,444
Deferred Tax	(15,462)	(15,507)	(19,690)	(22,207)	(36,592)	(38,414)	(38,414)	(38,414)	(38,414)
Total debt	1,859	14,152	26,548	610	1,263	896	672	504	378
Other liabilities and provisions	297,961	272,825	270,257	242,097	235,544	195,059	200,216	205,630	211,315
Total Network and liabilities	538,090	575,911	607,248	561,345	522,025	480,486	488,604	500,490	511,723
Gross Fixed assets	97,915	109,446	121,440	126,661	134,072	137,840	142,840	147,840	152,840
Net fixed assets	42,968	44,966	47,131	41,578	39,632	34,911	31,198	27,180	22,857
Capital work-in-progress	13,476	11,335	6,220	5,005	3,154	1,595	1,595	1,595	1,595
Goodwill	0	0	0	0	1,457	1,136	1,136	1,136	1,136
Investments	4,617	4,292	4,202	4,177	6,643	6,614	6,614	6,614	6,614
Cash and bank balances	66,720	77,320	118,729	98,127	100,860	104,918	118,441	108,355	103,612
Loans & advances and other assets	31,624	31,344	34,435	36,187	33,130	32,357	33,867	34,501	35,147
Net working capital	378,684	406,653	396,531	376,271	337,149	298,954	295,753	321,109	340,763
Total assets	538,090	575,911	607,248	561,346	522,025	480,485	488,604	500,490	511,723
Capital Employed	240,129	303,087	336,991	319,249	286,481	285,426	288,388	294,860	300,408
Invested Capital (CE - cash - CWIP)	159,933	214,431	212,042	216,117	182,467	178,913	168,352	184,910	195,201
Net debt	(64,861)	(63,168)	(92,181)	(97,517)	(99,597)	(104,022)	(117,770)	(107,851)	(103,234)
Cash Flows									
Cash flows from Operations (Pre-tax)	23,696	51,023	66,490	18,054	6,523	11,510	30,299	14,814	22,874
Cash flows from Operations (post-tax)	(8,136)	18,648	45,177	7,755	3,469	5,620	26,536	7,154	13,332
Capex	(13,072)	(9,885)	(6,697)	(4,568)	(5,484)	(3,556)	(5,000)	(5,000)	(5,000)
Free cashflows	(21,208)	8,763	38,480	3,187	(2,015)	2,064	21,536	2,154	8,332
Free cashflows (post interest costs)	-21,706	7,538	37,214	2,174	-2,269	1,428	18,030	-1,352	8,232
Cash flows from Investing	(3,297)	(3,381)	(1,681)	4,643	884	3,136	(5,000)	(5,000)	(5,000)
Cash flows from Financing	(18,149)	(4,667)	(2,092)	(33,000)	(1,239)	(4,699)	(8,013)	(12,240)	(13,075)
Total cash & liquid investments	66,720	77,320	118,729	98,127	100,860	104,918	118,441	108,355	103,612

Financial Summary

	FY12	FY13	FY14	FY15	FY16	FY17	FY18E	FY19E	FY20E
Growth ratios									
Revenue	13.6%	0.9%	-19.2%	-22.8%	-15.6%	10.8%	0.7%	11.5%	6.1%
EBITDA	15.4%	-5.2%	-51.9%	-53.6%	-165.1%	-160.8%	80.2%	77.0%	6.3%
Adj PAT	23.6%	-6.0%	-47.7%	-59.0%	-150.0%	-169.9%	50.6%	103.6%	21.8%
Margin ratios									
Gross	41.5%	42.1%	40.8%	42.3%	34.9%	37.8%	40.3%	40.2%	39.7%
EBITDA	20.6%	19.4%	11.6%	7.0%	-5.4%	2.9%	5.3%	8.4%	8.4%
Adj PAT	14.7%	13.7%	8.8%	4.7%	-2.8%	1.8%	2.6%	4.8%	5.5%
Performance ratios									
Pre-tax OCF/EBITDA	23.9%	54.3%	147.1%	86.0%	-47.7%	138.4%	202.3%	55.9%	81.2%
OCF/IC (%)	-5.1%	8.7%	21.3%	3.6%	1.9%	3.1%	15.8%	3.9%	6.8%
RoE (%)	30.9%	23.7%	10.9%	4.3%	-2.1%	1.5%	2.3%	4.6%	5.5%
RoCE (%)	33.6%	24.7%	11.1%	4.5%	-1.6%	2.7%	3.4%	6.0%	6.2%
RoCE (Pre-tax)	49.3%	35.2%	16.1%	6.8%	-2.7%	3.4%	5.1%	9.0%	9.5%
RoIC (Pre-tax)	80.2%	45.1%	16.6%	4.8%	-11.6%	-0.1%	3.6%	9.9%	9.9%
Fixed asset turnover (x)	5.4	4.7	3.4	2.4	2.0	2.1	2.0	2.2	2.2
Total asset turnover (x)	1.0	0.9	0.7	0.5	0.5	0.6	0.6	0.6	0.7
Financial stability ratios									
Net Debt to Equity (x)	(0.3)	(0.2)	(0.3)	(0.3)	(0.3)	(0.3)	(0.4)	(0.3)	(0.3)
Net Debt to EBITDA (x)	(0.7)	(0.7)	(2.0)	(4.6)	7.3	(12.5)	(7.9)	(4.1)	(3.7)
Interest cover (x)	(15.9)	14.9	34.1	8.5	1.0	1.6	7.6	2.0	133.3
Cash conversion days	288	307	370	455	483	387	380	370	370
Working capital days	85	124	150	206	193	176	166	173	179
Valuation metrics									
Fully Diluted Shares (mn)	3,671	3,671	3,671	3,671	3,671	3,671	3,671	3,671	3,671
Market cap (Rs.mn)							348,783		
P/E (x)	5.0	5.3	10.1	24.4	(49.2)	70.3	46.7	22.9	18.8
P/OCF(x)	(42.9)	18.7	7.7	45.0	100.5	62.1	13.1	48.8	26.2
EV (Rs.mn) (ex-CWIP)	283,922	285,615	256,602	251,266	249,186	244,761	231,013	240,932	245,549
EV/ EBITDA (x)	2.9	3.0	5.7	12.0	(18.2)	29.4	15.4	9.1	8.7
EV/ OCF(x)	(34.9)	15.3	5.7	32.4	71.8	43.5	8.7	33.7	18.4
FCF Yield	-6.1%	2.5%	11.0%	0.9%	-0.6%	0.6%	6.2%	0.6%	2.4%
Price to BV (x)	1.4	1.1	1.1	1.0	1.1	1.1	1.1	1.0	1.0
Dividend pay-out (%)	33.4%	20.0%	20.0%	19.9%	-20.7%	57.8%	49.2%	48.3%	59.5%
Dividend yield (%)	6.7%	3.8%	2.0%	0.8%	0.4%	0.8%	1.1%	2.1%	3.2%

Crystal Ball Gazing

Over FY17-21E, BHEL to grow revenue by a subdued 7% CAGR due to muted order inflow growth. Lack of recovery in the BTG/EPC market in the foreseeable future and heavy competition are expected to limit growth and margin recovery prospects. Operating leverage to help register a PAT CAGR of 44% (from a low earnings base) over the same period.

Expect revenue to grow by CAGR 7% over FY17-FY21E



Return metrics to remain subdued



Muted order inflow visibility limits the scope for further multiple expansion

	FY05-FY11	FY12-FY14	FY15-FY17	FY18-FY21E
Revenues CAGR	26.8%	-2.5%	-10.3%	6.5%
Gross Margin	43.0%	41.5%	38.3%	39.8%
EBITDA CAGR	26.4%	-19.3%	-43.1%	31.0%
EBITDA margin	18.4%	17.2%	1.5%	7.7%
EPS CAGR	31.5%	-16.8%	-47.7%	43.8%
Total Asset Turnover (x)	1.0	0.8	0.5	0.6
Total WC days	19	120	192	175
Pre-tax OCF/EBITDA (%)	103.0%	75.1%	58.9%	104.2%
Post Tax OCF as a % of IC	-120%	8%	3%	8%
Debt/EBITDA	(1.7)	(1.1)	(3.3)	(4.6)

	FY07-FY11	FY12-FY14	FY15-FY17	FY18-FY21E
RoE (%)	25.3%	21.8%	1.2%	4.7%
RoCE (%)	27.3%	23.1%	1.9%	5.7%
RoIC (%)	298.5%	32.6%	-1.3%	5.7%
Average 1 yr fwd				
PE (x)	20.6	10.3	23.7	23.4
EV/EBITDA (x)	14.0	6.3	14.6	12.1
Peak 1 yr fwd				
PE (x)	36.4	16.3	35.7	27.5
EV/EBITDA (x)	23.5	10.5	24.5	16.5

P/E multiple	FY21E EPS (mn)	Price target
18.0x	5.8	104
20.0x	5.8	116

Entry = Rs. 95 @ 23x
FY19E EPS



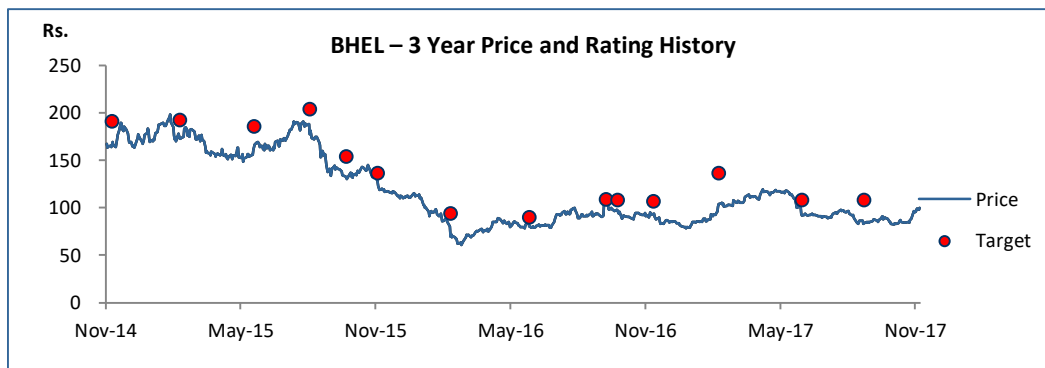
Cumulative Dividends of
Rs. 6.0/share



PAT CAGR of ~44%, exit
multiple of 18x on FY21E
EPS



Spark Recommendation History



Absolute Rating Interpretation

BUY	Stock expected to provide positive returns of >15% over a 1-year horizon
ADD	Stock expected to provide positive returns of >5% – <15% over a 1-year horizon
REDUCE	Stock expected to provide returns of <5% – -10% over a 1-year horizon
SELL	Stock expected to fall >10% over a 1-year horizon

Symbol Interpretation

◀▶ No Change | ▼ Downgrade | ▲ Upgrade

Report Date	Price	Target	Reco.
22/Aug/17	124	108	Sell
31/May/17	138	108	Sell
08/Feb/17	154	137	Sell
10/Nov/16	135	107	Sell
26/Sep/16	146	108	Sell
08/Sep/16	156	109	Sell
30/May/16	128	90	Sell
15/Feb/16	105	94	Sell
09/Nov/15	190	137	Sell
28/Sep/15	200	154	Sell
10/Aug/15	266	204	Sell
27/May/15	241	186	Sell
13/Feb/15	267	193	Sell
17/Nov/14	242	191	Sell

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