Rating Rationale

CRISIL RATINGS

March 09, 2016
Mumbai

Bharat Heavy Electricals Limited

Long-term rating downgraded to 'CRISIL AA+/Negative' ; short-term rating reaffirmed

Total Bank Loan Facilities Rated	**Rs.600000 Million**
Long Term Rating	**CRISIL AA+/Negative (Downgraded from 'CRISIL AAA/Negative')**
Short Term Rating	**CRISIL A1+ (Reaffirmed)**

(Refer to Annexure 1 for Facility-wise details)

CRISIL has downgraded its rating on the long-term bank facilities of Bharat Heavy Electricals Limited (BHEL) to **'CRISIL AA+/Negative'** from 'CRISIL AAA/Negative'. The rating on the company's short-term bank facilities has been reaffirmed at 'CRISIL A1+'.

The downgrade reflects CRISIL's belief that BHEL's business risk profile will remain constrained over the medium term by continued weak profitability and stretch in working capital cycle.

Low capacity utilisation, competitive pressures, and higher material costs continue to weigh in on profitability. Operating loss-at Rs.23.22 billion (including provision of Rs.11.86 billion towards receivables and inventory) in the nine months through December 2015-exceeded expectations. Overcapacity in the domestic boiler-turbine-generator (BTG) segment and sluggish demand have constrained capacity utilisation, and led to under-absorption of fixed cost. Competitive pressures and higher material costs especially for super-critical projects with higher import component, have also weakened profitability this fiscal. Given the difficult market conditions and intense competition, profitability is expected to remain under pressure over the near to medium term as well.

Working capital requirements have remained sizeable over the past four years, with receivables (including deferred debt) of Rs.320-400 billion (Rs.322.5 billion, net of provisions, as of December 2015). Slowdown in order execution due to delays in obtaining clearances, and weak financial position of customers have led to stretch in receivables. Pressure on working capital may, therefore, continue over the medium term. Despite stringent measures adopted, including stoppage of supplies, close monitoring of outstanding dues, and liaison with banks and financial institutions to ensure collection of payments, traction in reducing receivables will be a key monitorable.

The ratings continue to reflect BHEL's leading position in the power and industrial electrical equipment markets in India, healthy order book, and strong financial risk profile. These rating strengths are partially offset by high receivables, declining sales and profitability from exposure to intense competition and structural issues in execution of power sector orders.

BHEL is the leading player in India's power and industrial electrical equipment markets accounts for 66 percent of the country's installed capacity. It has commissioned or synchronised power plant equipment of more than 10,000 MW annually over the last three years (11,941 MW in 2014-15). Order book is sizeable, with projects of around Rs.1092 billion as of December 2015 (including projects of around Rs.350 billion coming in this fiscal) awaiting execution. Given the company's market leadership, it is well poised to benefit from structural recovery in the power sector. However, given the ongoing challenges in operating environment, timely execution of orders will be critical over the medium term.

Financial risk profile is strong, backed by large networth, low debt and robust liquidity. Financial flexibility also benefits from status as a 'Maharatna' public sector undertaking. The adjusted consolidated debt and gearing were low at an estimated Rs.2 billion (excluding debt of power project joint ventures) and 0.01 time, respectively. Cash and bank balance was substantial at Rs.78.12 billion as of December 2015. Strong balance sheet and moderate capital expenditure are expected to help maintain a robust financial risk profile over the medium term.

For arriving at the ratings, CRISIL has consolidated BHEL's subsidiaries due to the business and financial integration. CRISIL has also proportionately consolidated BHEL's joint ventures, except those set up for the execution of power projects: Raichur Power Corporation Ltd, Latur Power Company Ltd, and Dada Dhuniwale Khandwa project. This is because of the BHEL management's policy of extending limited support to these projects, and the low fungibility of cash flows to them.

Outlook: Negative

CRISIL believes BHEL's profitability will remain under pressure, and its working capital stretched over the medium term on account of the challenging operating environment in the power sector. The rating may be further downgraded if project execution is slower than expected and costs remain high, leading to continued losses and a high receivable position. Conversely, the outlook may be revised to 'Stable' if profitability improves, backed by a structural revival in the power sector, translating into faster project execution, and improvement in working capital position.

About the Company

BHEL is an integrated power plant equipment manufacturer. The Maharatna central public sector enterprise is one of the largest engineering and manufacturing companies in India. The Government of India holds 63.06 percent of equity in BHEL.

BHEL has operations in the power and industry segments. The power group supplies power plant equipment, such as turbine generators, boilers, turbines, and accessories, and offers erection services. The industry group caters to diverse sectors such as process industries, transportation, power transmission and distribution, and defense. BHEL designs, engineers, manufactures, constructs, tests, commissions and services a wide range of products. It has 17 manufacturing units, six joint ventures and a subsidiary, and exports to over 79 countries.

For 2014-15 (refers to financial year, April 1 to March 31), BHEL's consolidated profit after tax and net sales reduced to Rs.14.10 billion and Rs.309.25 billion, respectively from Rs.35.02 billion and Rs.395.84 billion, for 2013-14.

Annexure 1 - Details of various bank facilities

Current facilities			Previous facilities		
Facility	**Amount (Rs.Million)**	**Rating**	**Facility**	**Amount (Rs.Million)**	**Rating**
Cash Credit	**37500**	**CRISIL AA+/Negative**	**Cash Credit**	**37500**	**CRISIL AAA/Negative**
Letter of credit & Bank Guarantee	**523750**	**CRISIL A1+**	**Letter of credit & Bank Guarantee**	**523750**	**CRISIL A1+**
Proposed Cash Credit Limit	**12500**	**CRISIL AA+/Negative**	**Proposed Cash Credit Limit**	**12500**	**CRISIL AAA/Negative**
Proposed Letter of Credit & Bank Guarantee	**26250**	**CRISIL A1+**	**Proposed Letter of Credit & Bank Guarantee**	**26250**	**CRISIL A1+**
Total	**600000**	**--**	**Total**	**600000**	**--**

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