

## Company update and TP change

## Defence

Target price: Rs102

## Target price revision

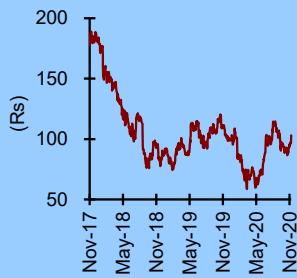
Rs102 from Rs95

## Shareholding pattern

	Mar '20	Jun '20	Sep '20
Promoters	51.1	51.1	51.1
Institutional investors	40.9	40.1	40.2
MFs and others	25.1	25.6	25.6
FIs/Insurance	5.1	6.6	5.6
FII	10.7	7.9	11.0
Others	8.0	8.8	7.7

Source: BSE India

## Price chart



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## INDIA

**Bharat Electronics****HOLD**

Maintained

**Rs103****Diversifying into multiple revenue streams**

Strategy to diversify revenue streams away from a constrained domestic defence budget – was a key takeaway from Bharat Electronics' (BEL) analyst meet. BEL does not mind additional capex to achieve the same (10-15% YoY capex growth p.a. from the likely Rs5.5bn in FY21). The idea, if properly executed, can allow BEL to maintain double-digit revenue growth in the foreseeable future; it also underlines the limited headroom the base business offers for continuation of growth, given scale. Maintain HOLD with a revised target price of Rs102.

- ▶ **Onus is on execution.** BEL targets: i) civilian segment (including medical equipments) to move from 7% of topline to 15% in the next 2-3 years; ii) to increase the current 10% revenue contribution from service sector (including AMCs); iii) capture the revenue expenditure budget of the Armed Forces via entry into electronic fuses, RF seekers (new complex in Machilipatnam to be commissioned next year); and iv) gain share in the base business, i.e. integration of missile complex (Palasamudram; another separate SBU for QRSAM in Bengaluru), entry into ammunitions, etc.
- ▶ **Key operational guidance.** BEL hopes to manage double-digit topline growth in the foreseeable future. Order inflow for FY21 will certainly exceed FY20 inflow of Rs130bn (mentioned Rs150bn of possible inflow). **Management hopes to maintain EBITDA margins of 20+-1% even without any favourable policy review of cost-plus margins in nominated orders.** Capex guidance for FY21 remains Rs5.5bn with a strong outlook to capture multiple opportunities. R&D spend has been finalised at 8-10% of profit, with an eye for return as tax benefits are no longer available.
- ▶ **Near-term order opportunities.** BEL has already accounted for execution of avionics related to LCA Mk 2, as HAL has received LoI for the same. Key elements of the avionics package for LCA Mk 2 include Fly by Wire Digital Flight Control Computer (DFCC). Future opportunities include Jammer for LCA. Also, LUH and LCH (helicopters) may allow BEL sensors (MAWS and counter-measure dispensers along with HMDS) and weapons to significantly augment BEL's avionics revenue. Yet, order inflow for FY21 seems dependent on the electronics orders from Akash squadrons that have accrued to BDL.
- ▶ **Despite LRSAM execution and increasing % of nominated orders under revised margins, management expects to maintain ~20% EBITDA margin in FY21.** LRSAM execution will begin in FY21 and the first four systems have limited (~40%) work share for BEL. Company has been able to indigenise majority of the work orders, thereby helping margin profile. To offset the possible weakness because of LRSAM execution, BEL will try to deliver the first Akash squadron in FY21. BEL will also be executing IACCS over next two years, the project has matured thereby yielding enhanced margins.

Market Cap	Rs251bn/US\$3.4bn	Year to March	FY19	FY20	FY21E	FY22E
Reuters/Bloomberg	BAJE.BO/BHE IN	Revenue (Rs mn)	121,642	129,677	121,331	135,256
Shares Outstanding (mn)	2,436.6	Net Income (Rs mn)	18,864	18,239	14,365	17,682
52-week Range (Rs)	115/58	Dil. EPS (Rs)	7.7	7.5	5.9	7.3
Free Float (%)	48.9	% Chg YoY	31.8	(3.3)	(21.2)	23.1
FII (%)	11.0	P/E (x)	13.3	13.8	17.5	14.2
Daily Volume (US\$/'000)	18,554	CEPS (Rs)	9.1	9.0	7.8	9.3
Absolute Return 3m (%)	(7.0)	EV/E (x)	8.4	8.5	10.7	8.5
Absolute Return 12m (%)	(4.7)	Dividend Yield (%)	3.3	2.7	2.7	2.7
Sensex Return 3m (%)	13.1	RoCE (%)	28.5	24.5	17.4	19.5
Sensex Return 12m (%)	9.0	RoE (%)	20.5	18.1	13.3	14.9

- ▶ Despite LRSAM execution and increasing % of nominated orders under revised margins, management expects to maintain ~20% EBITDA margin in FY21 (cont'd). ... To add to the margin tailwinds are annual maintenance contracts for Navy. New projects execution would also involve SDR for Army, Smart City projects (two have gone live), and electronic fuses.
- ▶ Future orders (base business) that BEL banks on. Management is particularly hopeful of QRSAM orders, which have gone for user trials post development. Orders can accrue after 18 months and the management expects ~Rs300bn of order inflows over next 10-12 years. IACCS phase-III too is expected to accrue; there are also export opportunities from the same. Management expects Akash NG (next-generation) and Akash with Seeker orders. BEL is targeting electro-optics as a major source of order inflow for the next few years. There is also an attempt to capture revenue expenditure of the Armed Forces through supply of RF and IR seekers and the new facility in Nimmaluru will cater to it.

## Maintain **HOLD**

Maintain **HOLD** with a revised target price of Rs102/share. We value BEL at 14x FY22E EPS (vs 13x earlier). Any disappointment on the topline can significantly impact our valuation.

**Being able to achieve/reach close to its targeted execution amidst moderating cashflow pressures is the bull case for BEL and the key risk to our HOLD call. Also, what causes concern is the extent of cashflow pressures – part of which can be observed from H1FY21 consolidated cashflows.**

## Financial summary

**Table 1: Profit & Loss statement**

(Rs mn, year ending March 31)

	FY19	FY20	FY21E	FY22E
<b>Operating Income</b>	<b>121,642</b>	<b>129,677</b>	<b>121,331</b>	<b>135,256</b>
<b>Operating Expenses</b>	92,579	102,132	98,563	107,759
<b>EBITDA</b>	<b>29,062</b>	<b>27,545</b>	<b>22,768</b>	<b>27,496</b>
% margins	23.9	21.2	18.8	20.3
Depreciation & Amortisation	3,381	3,719	4,647	5,047
Gross Interest	128	36	18	18
Other Income	730	994	751	873
<b>Recurring PBT</b>	<b>26,283</b>	<b>24,784</b>	<b>18,854</b>	<b>23,304</b>
Less: Taxes	7,803	6,858	4,724	5,847
Add: Share of profit from associates	386	321	263	263
<b>Recurring Net Income</b>	<b>18,864</b>	<b>18,239</b>	<b>14,365</b>	<b>17,682</b>

Source: Company data, I-Sec research

**Table 2: Balance sheet**

(Rs mn, year ending March 31)

	FY19	FY20	FY21E	FY22E
<b>Assets</b>				
Total Current Assets	158,744	187,381	168,436	182,690
of which cash & cash eqv.	8,200	16,809	7,642	16,815
Total Current Liabilities &				
Provisions	115,605	142,120	114,312	116,976
<b>Net Current Assets</b>	<b>43,140</b>	<b>45,261</b>	<b>54,124</b>	<b>65,714</b>
<b>Investments</b>	<b>1,302</b>	<b>1,621</b>	<b>1,621</b>	<b>1,621</b>
Strategic/Group	1,302	1,621	1,621	1,621
Other Marketable	-	-	-	-
<b>Net Fixed Assets</b>	<b>22,977</b>	<b>27,126</b>	<b>29,479</b>	<b>28,432</b>
Capital Work-in-Progress	8,490	8,280	4,371	4,463
Goodwill	16,693	19,076	19,104	19,143
<b>Total Assets</b>	<b>92,602</b>	<b>101,364</b>	<b>108,699</b>	<b>119,372</b>
<b>Liabilities</b>				
Borrowings	353	507	507	507
Deferred Tax Liability	-	-	-	-
Government Grants	-	-	-	-
Minority Interest	133	142	170	208
Equity Share Capital	2,437	2,437	2,437	2,437
Reserves & Surplus	89,678	98,279	105,586	116,220
<b>Net Worth</b>	<b>92,115</b>	<b>100,715</b>	<b>108,022</b>	<b>118,657</b>
<b>Total Liabilities</b>	<b>92,601</b>	<b>101,364</b>	<b>108,699</b>	<b>119,372</b>

Source: Company data, I-Sec research

**Table 3: Cashflow statement**

(Rs mn, year ending March 31)

	FY19	FY20	FY21E	FY22E
<b>Operating Cashflow</b>	<b>23,073</b>	<b>22,646</b>	<b>18,043</b>	<b>21,649</b>
Working Capital Changes	(7,934)	3,058	(18,029)	(2,417)
Capital Commitments	(7,292)	(7,466)	(3,091)	(4,091)
<b>Free Cashflow</b>	<b>7,847</b>	<b>18,238</b>	<b>(3,077)</b>	<b>15,141</b>
<b>Investing Cashflow</b>	<b>(8,959)</b>	<b>(6,490)</b>	<b>(2,340)</b>	<b>(3,218)</b>
Issue of Share Capital	-	-	-	-
Buyback of shares	-	-	-	-
Inc (Dec) in Borrowings	(470)	(250)	-	-
Others	(5,790)	(9,835)	(6,841)	(6,841)
Extraordinary Items	-	-	-	-
<b>Chg. in Cash</b>	<b>(81)</b>	<b>9,130</b>	<b>(9,167)</b>	<b>9,173</b>

Source: Company data, I-Sec research

**Table 4: Key ratios**

(Year ending March 31)

	FY19	FY20	FY21E	FY22E
<b>Per Share Data (in Rs.)</b>				
EPS(Basic Recurring)	7.7	7.5	5.9	7.3
Diluted Recurring EPS	7.7	7.5	5.9	7.3
Recurring Cash EPS	9.1	9.0	7.8	9.3
Dividend per share (DPS)	3.4	2.8	2.8	2.8
Book Value per share (BVPS)	37.8	41.3	44.3	48.7
<b>Growth Ratios (%)</b>				
Operating Income	17.0	6.6	(6.4)	11.5
EBITDA	42.8	(5.2)	(17.3)	20.8
Recurring Net Income	31.8	(3.3)	(21.2)	23.1
<b>Valuation Ratios (x)</b>				
P/E	13.3	13.8	17.5	14.2
P/CEPS	11.3	11.4	13.2	11.0
P/BV	2.7	2.5	2.3	2.1
EV / EBITDA	8.4	8.5	10.7	8.5
EV / FCF	31.0	12.9	(79.2)	15.5
<b>Operating Ratios (%)</b>				
Raw Material/Sales	48.9	54.7	52.2	52.5
SG&A/Sales	11.7	8.0	11.4	10.6
Other Income / PBT	2.8	4.0	4.0	3.7
Effective Tax Rate	29.7	27.7	25.1	25.1
NWC / Total Assets	0.5	0.4	0.5	0.6
Inventory Turnover	1.3	1.8	1.3	1.4
Asset Turnover	1.3	1.3	1.1	1.1
Net D/E Ratio (x)	(0.1)	(0.2)	(0.1)	(0.1)
<b>Return/Profitability Ratios (%)</b>				
Recurring Net Income Margins	15.5	14.1	11.8	13.1
RoCE	28.5	24.5	17.4	19.5
RoNW	20.5	18.1	13.3	14.9
Dividend Pay-out Ratio	43.9	37.4	47.5	38.6
EBITDA Margins	23.9	21.2	18.8	20.3

Source: Company data, I-Sec research

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