

Stock Update

Correction presents an attractive buying opportunity

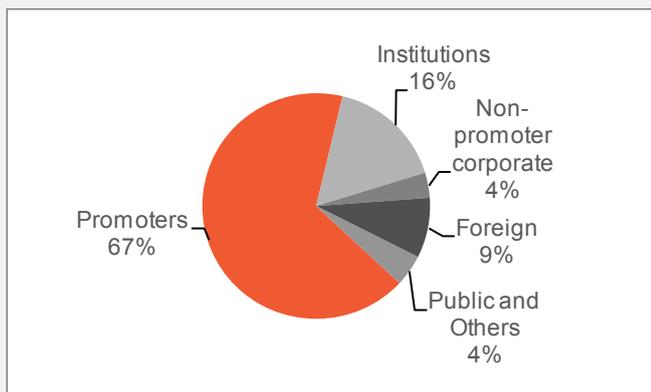
Bharat Electronics

Reco: Buy | CMP: Rs145

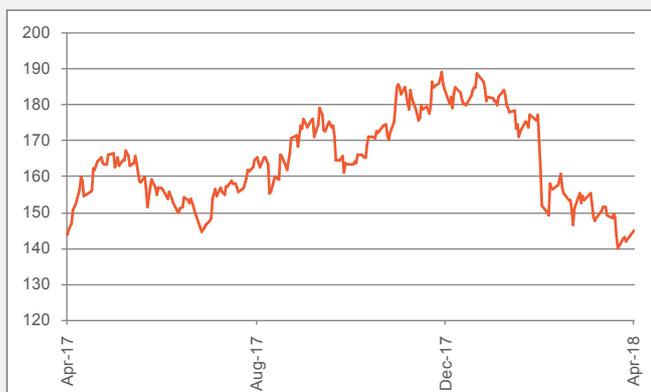
Company details

Price target:	Rs180
Market cap:	Rs35,245 cr
52-week high/low:	Rs192/ 138
NSE volume: (No of shares)	44.1 lakh
BSE code:	500049
NSE code:	BEL
Sharekhan code:	BEL
Free float: (No of shares)	79.7 cr

Shareholding pattern



Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	-8.4	-21.6	-12.2	0.9
Relative to Sensex	-5.1	-19.1	-17.0	-10.5

Key points

- Multiple headwinds resulted in underperformance of stock:** The stock price of Bharat Electronics Limited (BEL) has corrected sharply by ~22% over the past three months due to earnings contraction in Q3FY2018 coupled with delay in order booking of Akash Missile System (Rs. 6,000 crore) and long-range surface-to-air missile for P17A (Rs. 9,000 crore). Further, subdued market conditions and recent lacklustre listing of smaller peers such as Hindustan Aeronautics Ltd. (HAL) and Bharat Dynamics Ltd. (BDL), largely attributed to lack of active participation from institutional investors (domestic and foreign) owing to lesser disclosure levels (as both the companies deal with national defence space, management has restricted disclosures), have dampened the sentiments for defence sector's stocks.
- Order backlog remains healthy, but two big orders delayed:** At the end of Q3FY2018, total order book of BEL stood at Rs. 40,469 crore (4.6x FY2017 revenue), up 20% y-o-y. During the quarter, the company acquired total orders worth Rs. 1,146 crore, taking YTD intake of Rs. 6,736 crore vs. Rs. 6,219 crore during 9MFY2017. During 9MFY2018, order inflows continued to remain robust with 8.3% y-o-y growth. Further, management had earlier indicated at expectation of closure of one of the two big orders – Akash Missile System and LRSM – by March 2018, which would take year-end order wins closer to the anticipated level of Rs. 13,000 - Rs. 14,000 crore. Order book estimates stand at around Rs. 14,000 crore on an annual basis over the next couple of years (vs. management guidance of Rs. 13,000 crore - Rs. 15,000 crore). BEL has closed FY2018E with revenue excess of Rs. 10,000 crore (broadly in-line with our expectations).
- Margins to taper off in FY2019E, will witness pick up in FY2020:** BEL is expected to witness cost pressures in FY2019E, attributed to the recent wage revision (completed for officer grade employees) and enhancement in gratuity ceiling. The wage revision is pending for non-officer grade employees, which is likely to be done in FY2019. Further, the increase in civil contracts work to 17-18% in FY2019E from usual 12-13% would impact margins. We have assumed operating margin of 19% in FY2019 and 20% in FY2020E. Further, reduction in cash balance owing to buyback programme (would lead to lower other income) and increased tax rate would impact overall profitability.

- ♦ **Valuations: Price target revised downwards to Rs. 180; Maintain Buy:** We have revised our earnings estimates for FY2018/FY2019/FY2020E to factor lower margin assumptions coupled with reduction in other income and higher tax rate. We expect earnings CAGR of 19.5% over FY2018-FY2020E. Given the steep correction, the current risk reward for the

stock looks favourable for investments. BEL continues to remain our preferred pick in the domestic defence play on account of its strong manufacturing and R&D capabilities, growing indigenisation and strong balance sheet with improving return ratios. We maintain our Buy rating on the stock with a revised price target (PT) of Rs. 180.

Valuations				Rs cr
Particulars	FY17	FY18E	FY19E	FY20E
Net sales	8,654.0	10,954.9	12,586.3	14,465.0
EBIDTA Margin	20.5	18.5	19.0	20.0
Net profit	1,497.0	1,470.4	1,742.5	2,099.5
EPS (Rs)	6.1	6.0	7.2	8.6
P/E	23.1	24.0	20.2	16.8
Price/BV (x)	3.4	3.3	3.1	2.8
EV/EBIDTA(x)	14.1	12.2	10.2	8.0
RoCE (%)	19.4	18.7	21.1	23.2
RoNW (%)	14.8	13.7	15.2	16.7

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