

# Bharat Electronics (BHAELE)

## Margin headwinds post FY21E...

We attended the analyst meet of Bharat Electronics (BEL) to get an insight into recent developments along with the future outlook on the Indian defence space. **The management has reiterated its stand of minimal impact on margins (50-200 bps) on the recent defence ministry notification**, which notifies slashing of PBT margins from 12.5% to 7.5% on nomination based orders. This margin impact will be minimal because margins of 7.5% will now be earned on bought-out items vs. 0% earlier. **Additionally, tax rate for BEL is also likely to go up from here as benefits of spend on indigenous R&D are likely to go down from 150% to 0% in coming years. The management has also highlighted that receivable days for BEL are likely to remain elevated at 180-200 days.** BEL has guided for 12-15% topline growth in the next three to four years with EBITDA margins of 17-19%.

### Other important takeaways from analyst meet include:

- For defence public sector units, Ministry of Defence (MoD) has slashed the benchmark margin on prospective contracts awarded on a nomination basis to 7.5% for both value-added as well as bought-out components (vs. 12.5% permitted on value-added earlier). BEL's nominated book stands at ~50% of the total order book. Also, of this 50%, 80% are legacy orders where re-pricing is not likely to happen. Accordingly, management is not expecting significant impact (max impact of 50-200 bps after FY21E) on profitability going forward.
- BEL is expecting revenue growth of 12-15% in FY19-21E. Segments like radar and missile systems, communication and network centric systems, tank electronics, gun upgrades, electro optic systems and electronic warfare & avionics systems will drive BEL's growth in coming years. **Order inflow for FY19 till date are at ₹ 14000 crore.**
- In the non-defence segment, BEL is pursuing business in the field of solar, homeland security, smart city elements, space electronics, satellite integration and cyber security.
- Some of the major projects planned for execution in FY19 are IACCS, tropo upgrade, weapon locating radar, EVM & VVPAT, Cdr TI for T-72, LLTR Radar, EW System-LIC-II, DSP for Port Blair, ground-based mobile ELINT, II-based PNVDS, ALG Communication, LRSAM P15B (4 Ships), Schilka Upgrade, L70 Gun Upgrade, T-90 Stabiliser, etc.

### Elevated receivables, overhang of margin dilution, higher tax-rate

The position of trade receivables as on FY18 works out to ~ 206 days vs. 180 days in FY17. High receivables of 180-200 days over FY19E-20E coupled with capex outflow of ₹ 600-650 crore over the next two to three years is likely to keep liquidity position tight for the company, going forward. Additionally, while we believe the new regime has a limited impact, this regulation has dented margin expectations from BEL after FY21E. Tax rate for BEL is also likely to go up as benefits of spend on indigenous R&D are likely to go down from 150% to nil in coming years. Accordingly, we de-rate the company and also tweak our earnings estimates. We now expect revenue, EBITDA and PAT CAGR of 14.9%, 13.5% and 10.5%, respectively, in FY18-20E. BEL's stock price has witnessed a significant correction of ~45% in the last six months, making it available at reasonable valuation of ~12x FY20E earnings. We now value the company at 15x FY20E earnings to arrive at a target price of ₹ 105/share. We maintain **BUY** rating on the stock.

Rating matrix	
Rating Matrix	
Rating	: Buy
Target	: ₹ 105
Target Period	: 12 - 15 months
Potential Upside	: 24%

What's changed?	
Target	Changed from ₹ 140 to ₹ 105
EPS FY19E	Unchanged
EPS FY20E	Changed from ₹ 7.3 to ₹ 7.1
Rating	Unchanged

Key financials				
₹ Crore	FY17	FY18	FY19E	FY20E
Revenue	8,612	10,322	11,925	13,637
EBITDA	1,762	2,000	2,281	2,575
EBITDA (%)	20.5	19.4	19.1	18.9
Net Profit	1,548	1,399	1,554	1,719
EPS (₹)	6.9	5.7	6.4	7.1

Valuation summary				
(x)	FY17	FY18	FY19E	FY20E
P/E	12.3	14.8	13.3	12.0
Target P/E	15.2	18.3	16.5	14.9
EV / EBITDA	8.6	9.2	7.6	6.5
P/BV	2.5	2.7	2.4	2.2
RoNW (%)	21	18.0	18.0	17.9
RoCE (%)	27.1	24.9	25.2	25.6

Stock data	
Stock Data	
Average Volumes (shares)	332000
Market Capitalization	₹ 18985.8 Crore
Total Debt (FY18)	₹ 67.6 Crore
Cash and Investments (FY18)	₹ 739 crore
EV (FY18)	₹ 18314.4 Crore
52 week H/L (₹) (BSE)	192 / 74
Equity capital	₹ 223.4 Crore
Face value	₹ 1
MF Holding (%)	13.9
FII Holding (%)	6.1
Promoter Holding (%)	66.0

Price performance				
Return (%)	1M	3M	6M	12M
Bharat Electronics	(35.1)	(30.3)	(45.6)	(53.7)
Astra Microwave	14.8	(2.2)	(13.8)	(31.7)
Centum Electronics	(10.4)	(17.4)	9.7	(30.8)

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### Other takeaways

- BEL has signed an MoU with Thales, France for integration of the air borne radar EW suite for Rafale aircraft contracted by Dassault Aviation to Indian Air Force. Six modules have been ordered by Thales for necessary qualification. This is expected to be ramped up quickly in coming years
- BEL is planning to spend around ₹ 2,500 crore in the next three to four years as part of capex and modernisation of its facilities in line with growth plans. Some major projects include Defence Systems Integration Complex at Palasamudram, EO manufacturing facility at Nimmaluru and land based EW Systems at Ibrahimpatnam, seeker manufacturing facility, etc. The company is also in the process of acquiring land near Devanahalli, Bengaluru and Nagpur to pursue new business opportunities
- On the export front, the order book as on April 1, 2018 is US\$92 million including offset orders of US\$35 million. BEL is planning to open new marketing offices in Myanmar, Sri Lanka and Oman for increasing exports. It has already opened office in Vietnam in FY18
- Defence Systems Integration Complex at Palasamudram, in Ananthpur district of Andhra Pradesh will be largest such facility in India once it is commissioned, covering an area of over 900 acres
- BEL recently received an order valuing ~₹ 9200 crore for supplying 'long range surface to air missile' (LRSAM). This is the highest ever single value order for BEL. With this, the order backlog has reached an all-time high of over ~₹ 50,000 crore. Going forward, we estimate large inflows will continue even in FY19E and FY20E also. We estimate order inflows in the range of ₹ 12000-15000 crore in FY19E, FY20E. This is on the back of large orders like Akash missile systems of ₹ 5000 crore, tactical communication systems of ₹ 10000 crore, etc. Order backlog in FY15 was at ~₹ 21600 crore. Thus, the order backlog has grown at a commendable growth of 23.9% CAGR in FY15-19E. With strong competencies in execution, BEL is likely to deliver a superior topline and bottomline growth in FY18-20E

### Recommendation history vs. consensus



Source: Bloomberg, Company, ICICI Direct Research, Initiated coverage on January 27, 2016

### Key events

Date/Year	Event
Dec-12	BEL signs an MoU with Israel Aerospace Industries (IAI) for cooperation on future Long Range Surface to Air Missile (LRSAM) Ship-defence Systems
Sep-14	BEL establishes a Joint Venture Company (JVC) with M/s. Thales Air Systems SA, France and M/s. Thales India Pvt. Ltd in Radar Business Area.
Nov-15	BEL delivers L70 upgraded guns to Indian Army
Feb-15	Ministry of Defence selects BEL - Rolta consortium as a Development Agency for the Battlefield Management System Project
Mar-15	BEL issues bonus shares in the ratio of 2:1
Oct-15	BEL signs ₹ 8000 crore IACCS (Integrated Air Command and Control System) deal with Indian Air Force
Mar-16	BEL, Rosoboronexport sign defence offset partnership agreement
May-16	BEL and HAL sign deal to co-develop avionics
May-16	BEL registers highest-ever order inflow of ₹ 17,094 for FY16.
May-16	BEL inaugurates 8.4 MW wind energy power plant at Harappannahalli, Karnataka. With this wind energy plant, 90% of BEL's energy requirement will be met through renewable energy resources.
Jan-17	BEL announces split, new face value at ₹ 1 per share, from existing ₹ 10 per share
Feb-17	BEL order book touches all-time of ₹ 40000 crore

Source: Company, ICICI Direct Research

### Top 10 Shareholders

Rank	Name	Latest Filing Date	O/S	Position	Position Change	Shareholding Pattern					
						(in %)	Jun-17	Sep-17	Dec-17	Mar-18	Jun-18
1	Government of India	30-06-2018	66.01%	1,608.44M	-18.93M	Promoter	68.2	67.9	66.7	66.7	66.0
2	Life Insurance Corporation of India	30-06-2018	3.61%	87.92M	0	FII	7.6	8.1	8.6	6.4	6.0
3	ICICI Prudential Asset Management Co. Ltd.	30-06-2018	2.41%	58.60M	+26.22M	DII	16.8	16.1	16.5	17.9	18.3
4	Aditya Birla Sun Life AMC Limited	31-03-2018	2.17%	52.98M	+2.76M	Others	7.4	7.8	8.2	9.0	9.7
5	HDFC Asset Management Co., Ltd.	30-06-2018	1.88%	45.78M	+3.31M						
6	Goldman Sachs Asset Management (India)	31-03-2018	1.32%	32.18M	+4.85M						
7	SBI Funds Management Pvt. Ltd.	30-06-2018	1.26%	30.62M	+0.00M						
8	Reliance Nippon Life Asset Management Lir	30-06-2018	1.19%	28.99M	-3.20M						
9	Kotak Mahindra Asset Management Compa	30-06-2018	0.97%	23.67M	0						
10	L&T Investment Management Limited	30-06-2018	0.90%	21.98M	+0.19M						

Source: Reuters, ICICI Direct Research

### Recent Activity

Buys			Sells		
Investor name	Value	Shares	Investor name	Value	Shares
ICICI Prudential Asset Management Co. Ltd.	+41.61M	+26.22M	Government of India	-30.05M	-18.93M
Goldman Sachs Asset Management (India) Private Ltd.	+10.53M	+4.85M	Reliance Nippon Life Asset Management Limited	-5.08M	-3.20M
HDFC Asset Management Co., Ltd.	+5.26M	+3.31M	William Blair Investment Management, LLC	-4.71M	-2.77M
Mirae Asset Global Investments (India) Pvt. Ltd.	+4.80M	+2.83M	DSP BlackRock Investment Managers Pvt. Ltd.	-4.03M	-2.38M
Aditya Birla Sun Life AMC Limited	+6.00M	+2.76M	Calamos Advisors LLC	-5.09M	-2.15M

Source: Reuters, ICICI Direct Research

## Financial summary (Standalone)

Profit and loss statement		₹ Crore			
(₹ Crore)	FY17	FY18	FY19E	FY20E	
Net Sales	8,296	10,007	11,578	13,240	
Other operating income	316	316	347	397	
Revenue	8,612	10,322	11,925	13,637	
% Growth	25.9	19.9	15.5	14.4	
Other income	471.0	200.4	185.0	215.0	
Total Revenue	9,109	10,543	11,925	13,637	
% Growth	24.4	15.7	13.1	14.4	
Total Raw Material Costs	4,413	5,515	6,391	7,335	
Employee Expenses	1,548	1,772	2,049	2,350	
other expenses	889	1,035	1,204	1,377	
Total Operating Expenditure	6,850	8,323	9,644	11,062	
Operating Profit (EBITDA)	1,762	2,000	2,281	2,575	
% Growth	54.1	13.5	14.1	12.9	
Interest	12	1	2	4	
PBDT	2,221	2,199	2,464	2,787	
Depreciation	192	251	274	314	
PBT before Exceptional Items	2,029	1,948	2,189	2,473	
Total Tax	482	549	635	754	
PAT before MI	1,548	1,399	1,554	1,719	
Minority Interest	-	-	-	-	
PAT	1,548	1,399	1,554	1,719	
% Growth	32.6	(9.6)	11.1	10.6	
EPS	6.9	5.7	6.4	7.1	

Source: Company, ICICI Direct Research

Balance sheet		₹ Crore			
(₹ Crore)	FY17	FY18	FY19E	FY20E	
Equity Capital	223.4	243.7	243.7	243.7	
Reserve and Surplus	7,285	7,517	8,416	9,376	
Total Shareholders funds	7,509	7,761	8,659	9,620	
Minority Interest	-	-	-	-	
Other Non Current Liabilities	14.7	10.4	10.4	10.4	
Total Debt	25	68	45	45	
Total Liabilities	7,549	7,839	8,714	9,675	
Gross Block	1,616	2,216	3,031	3,656	
Acc: Depreciation	361	612	886	1,200	
Net Block	1,255	1,604	2,145	2,457	
Capital WIP	657	835	500	500	
Total Fixed Assets	1,912	2,440	2,645	2,957	
Non Current Assets	1,406	1,625	1,625	1,625	
Inventory	4,905	4,776	6,142	7,024	
Debtors	4,355	7,870	7,514	7,846	
Loans and Advances	81	-	-	-	
Other Current Assets	608	792	859	982	
Cash	3,790	739	1,804	2,175	
Total Current Assets	13,838	14,427	16,569	18,277	
Current Liabilities	1,347	2,248	2,222	2,541	
Provisions	1,300	1,260	1,555	1,778	
Net Current Assets	4,231	3,775	4,445	5,093	
Total Assets	7,549	7,839	8,714	9,675	

Source: Company, ICICI Direct Research

Cash flow statement		₹ Crore			
(₹ Crore)	FY17	FY18	FY19E	FY20E	
Profit after Tax	1,548	1,399	1,554	1,719	
Depreciation	192	251	274	314	
Interest	12	1	2	4	
Cash Flow before WC changes	1,751	1,652	1,831	2,036	
Changes in inventory	(737)	129	(1,367)	(882)	
Changes in debtors	(643)	(3,516)	356	(332)	
Changes in loans & Advances	519	81	-	-	
Changes in other current assets	(549)	(184)	(67)	(123)	
Net Increase in Current Assets	(1,511)	(3,640)	(1,078)	(1,337)	
Changes in creditors	185	901	(26)	319	
Changes in provisions	139	(40)	295	223	
Net Inc in Current Liabilities	314	1,045	1,472	1,059	
Net CF from Operating activities	554	(943)	2,226	1,758	
Changes in deferred tax assets	(160)	101	-	-	
(Purchase)/Sale of Fixed Assets	(546)	(634)	(625)	(625)	
Net CF from Investing activities	(1,173)	(857)	(625)	(625)	
Dividend and Dividend Tax	(741)	(587)	(655)	(724)	
Net CF from Financing Activities	(3,016)	(1,106)	(681)	(762)	
Net Cash flow	(3,634)	(2,906)	920	371	
Opening Cash/Cash Equivalent	7,424	3,790	884	1,804	
Closing Cash/ Cash Equivalent	3,790	884	1,804	2,175	

Source: Company, ICICI Direct Research

Key ratios		(Year-end March)			
	FY17	FY18	FY19E	FY20E	
Per Share Data					
EPS	6.9	5.7	6.4	7.1	
Cash per Share	17.0	3.0	7.4	8.9	
BV	33.6	31.9	35.5	39.5	
Dividend per share	2.8	2.0	2.2	2.5	
Dividend payout ratio	0.4	0.3	0.4	0.4	
Operating Ratios					
EBITDA Margin	20.5	19.4	19.1	18.9	
PAT Margin	18.7	14.0	13.4	13.0	
Return Ratios					
RoE	20.6	18.0	18.0	17.9	
RoCE	27.1	24.9	25.2	25.6	
RoIC	41.9	24.7	29.1	30.2	
Valuation Ratios					
EV / EBITDA	8.6	9.2	7.6	6.5	
P/E	12.3	14.8	13.3	12.0	
EV / Net Sales	1.8	1.8	1.4	1.2	
Sales / Equity	1.1	1.3	1.4	1.4	
Market Cap / Sales	2.2	1.8	1.6	1.4	
Price to Book Value	2.5	2.7	2.4	2.2	
Turnover Ratios					
Asset turnover	1.1	1.3	1.4	1.4	
Debtors Turnover Ratio	2.1	1.7	1.6	1.8	
Creditors Turnover Ratio	6.9	5.7	5.3	5.7	
Solvency Ratios					
Debt / Equity	0.0	0.0	0.0	0.0	
Current Ratio	3.8	3.8	3.8	3.7	
Quick Ratio	1.9	2.5	2.2	2.0	

Source: Company, ICICI Direct Research

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