

September 22, 2017

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Rating	<b>BUY</b>
Price	Rs188
Target Price	Rs214
Implied Upside	13.8%
Sensex	32,370
Nifty	10,122

(Prices as on September 21, 2017)

#### Trading data

Market Cap. (Rs bn)	150.6
Shares o/s (m)	800.0
3M Avg. Daily value (Rs m)	698.5

#### Major shareholders

Promoters	68.19%
Foreign	7.61%
Domestic Inst.	16.69%
Public & Other	7.51%

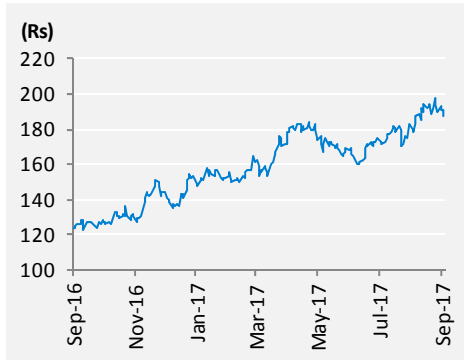
#### Stock Performance

(%)	1M	6M	12M
Absolute	5.1	18.1	50.9
Relative	1.5	8.3	37.4

#### How we differ from Consensus

EPS (Rs)	PL	Cons.	% Diff.
2018	7.5	7.3	1.9
2019	8.6	8.4	1.9

#### Price Performance (RIC: BAJE.BO, BB: BHE IN)



Source: Bloomberg

We attended BEL's analyst meet and returned confident of maintaining our bullish stance on the company as the prospects remain firm in the near/medium term. The company expects order inflow to remain healthy at ~Rs150bn for next 2-3 years, given the healthy pipeline of orders. BEL is investing in capex to support execution of strong order book. It is also looking at stepping up R&D spend further, from 8.8% in FY17 to ~10% of sales in FY18 to maintain technological edge and retain leadership position in strategic electronics. BEL is targeting sales of Rs100bn and restricts margin dip to only 100bps despite increased wage provision and higher non-defence revenue contribution expected in FY18. BEL is a key beneficiary of increasing focus in modernization of current fleet and procurement of new capital equipment by government. We continue to believe BEL offers good investment opportunities to investors who want to invest in the Indian Defence sector with a long-term view. We expect stock to deliver earnings CAGR of 14.5% over FY16-19E. Maintain '**BUY**' with a TP of Rs214.

■ **Strong pipeline provides multi-year inflow visibility:** Order book at the end of Q1FY18 stood at ~Rs410.5bn, ~up 28% YoY. BEL expects order inflow run-rate of ~Rs150bn per annum for the next few years. Major orders expected in FY18 include Akash Missile Systems, Long range surface to air missile for P17A, Commander TI sight, Mobile Cellular Communication System, EW systems, Avionics Package for LCA (Light Combat Aircraft) etc. Other large opportunities include QRSAM, BMP upgrade, software defined radio for navy, TCS prototype etc. Radars, Missile Systems, Communication and Network Centric Systems, Tank Electronics, Gun Upgrades, Electro-Optic Systems, Electronic Warfare and Avionics Systems are the key areas that will drive BEL's growth in the medium term. BEL is pursuing business opportunities in Space Electronics, Solar Energy, Homeland Security, Smart Cards and Telecom.

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Key financials (Y/e March)	2016	2017	2018E	2019E
Revenues (Rs m)	73,279	86,119	99,099	113,963
Growth (%)	7.1	17.5	15.1	15.0
EBITDA (Rs m)	13,718	17,617	19,127	21,989
PAT (Rs m)	13,074	15,476	16,693	19,108
EPS (Rs)	5.4	6.9	7.5	8.6
Growth (%)	(62.7)	27.2	7.9	14.5
Net DPS (Rs)	1.1	1.5	1.6	1.8

Profitability & Valuation	2016	2017	2018E	2019E
EBITDA margin (%)	18.7	20.5	19.3	19.3
RoE (%)	15.8	19.0	18.0	17.4
RoCE (%)	13.5	17.5	18.1	17.4
EV / sales (x)	5.4	3.9	3.3	3.0
EV / EBITDA (x)	28.7	19.1	17.4	15.8
PE (x)	34.6	27.2	25.2	22.0
P / BV (x)	5.2	5.6	3.8	3.8
Net dividend yield (%)	0.6	0.8	0.8	1.0

Source: Company Data; PL Research

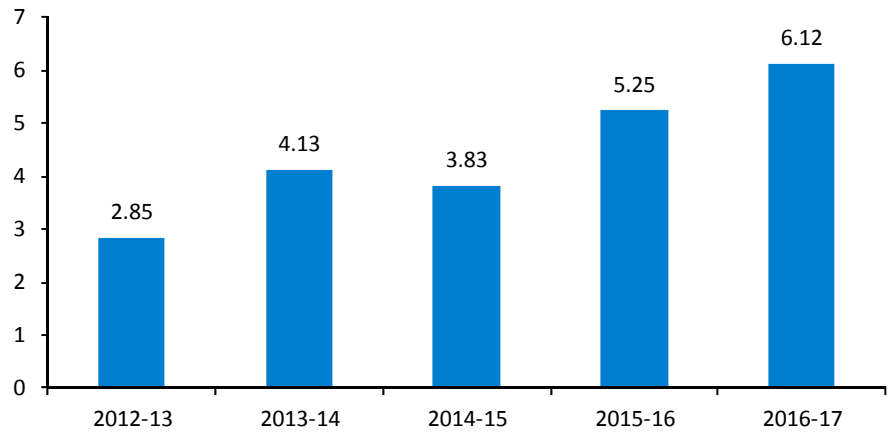
- **Stepping up capex and R&D spend:** BEL plans a capex of ~Rs20bn over the next five years which includes Defence System Integration Complex, Product development centre, Opto-Electronic manufacturing facility etc. BEL currently spends 8-8.5% of sales on R&D and aspires to take it to between 10% of sales.
- **Outlook and Valuation:** The stock is trading at 22x FY19E earnings. We believe BEL will be the prime beneficiary of government's focus on modernization of current fleet and procurement of new capital equipment. Increased focus on R&D, move towards being system integrator and increased focus on outsourcing are the steps in the right direction to increase long-term sustainability of business. We continue to believe BEL offers good investment opportunities to investors who want to invest in the Indian Defence sector with a long-term view. Strong cash generation, zero debt makes us remain positive on the stock. We are revising our target price upwards to Rs214. We expect stock to deliver earnings CAGR of 14.5% over FY16-19E. Maintain "**BUY**".

Exhibit 1: Business Segments



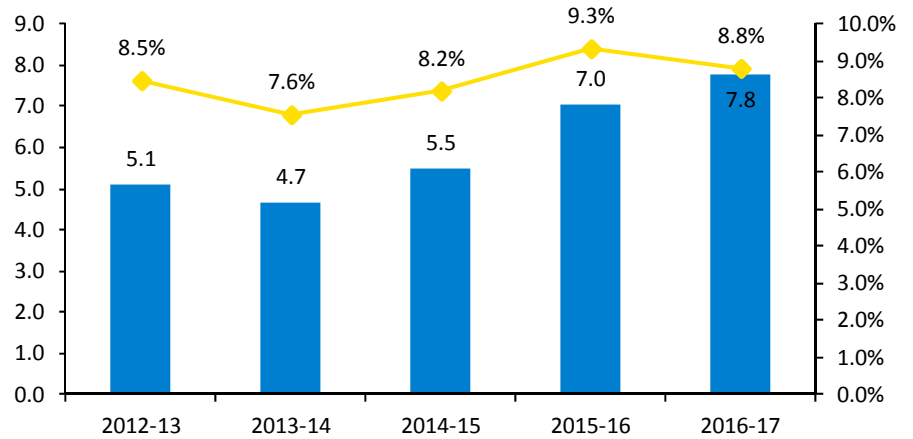
Source: Company Data, PL Research

**Exhibit 2: Capex over the years (Rs bn)**



Source: Company Data, PL Research

**Exhibit 3: R&D Expenses (Rs bn) and as a % of Turnover**



Source: Company Data, PL Research

**Exhibit 4: Major Projects planned during 2017-18**

- Integrated Air Command Control System
- Weapon Locating Radar
- Hand Held Thermal Imager with Laser Range Finder
- Fire Control System
- Akash Weapon System
- Low Level Transportable Radar
- L70 Gun Upgrade
- Ship Borne EW System – Varuna
- Ground Based Mobile ELINT

- Electronic Fuzes
- Schilka Tank Upgrade
- Electronic Voting Machines & VVPAT
- Homeland Security

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*Source: Company Data, PL Research*

**Exhibit 5: 'Make in India' – Expansion & Modernization initiatives**

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- Defence Systems Integration Complex, Anantapur
- Micro Channel Plate Technology for NVDs
- Product Development and Innovation Centre, Bengaluru
- Cooled Thermal Imager – Technology
- New infrastructure augmentation planned
- Solar Power Plants at OFB locations
- Opto–Electronics Manufacturing facility, Machilipatnam
- Image Intensifier Tube – XR5 Technology
- Centre for High Power Laser, Pune
- EW Range Ibrahimpatnam, Hyderabad
- Space Grade Solar Cell facility, Bengaluru

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*Source: Company Data, PL Research*

**Exhibit 6: World class Manufacturing & Test facilities**

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- Super Components Facility
- Test set-up for Missile System
- Antenna Test Range Facility
- High Roof Hangar for Radar & Antenna Integration
- Modern Production setup for Airborne applications
- Environmental Test Facilities

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*Source: Company Data, PL Research*

## New products launched in 2016-17

### Exhibit 7: Product Launches



Weapon Locating Radar



Voter Verifiable Paper Audit Trail Mk 2



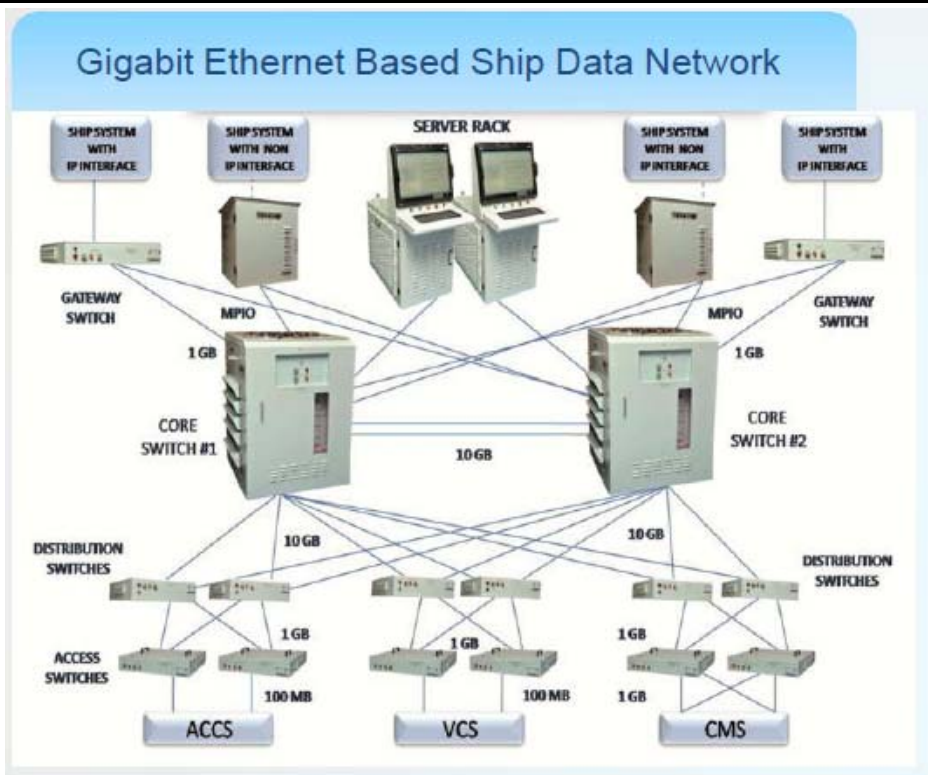
Beacon Mk III



Missile Two Way Data Link

Source: Company Data, PL Research

Exhibit 8: Network Devices



Source: Company Data, PL Research

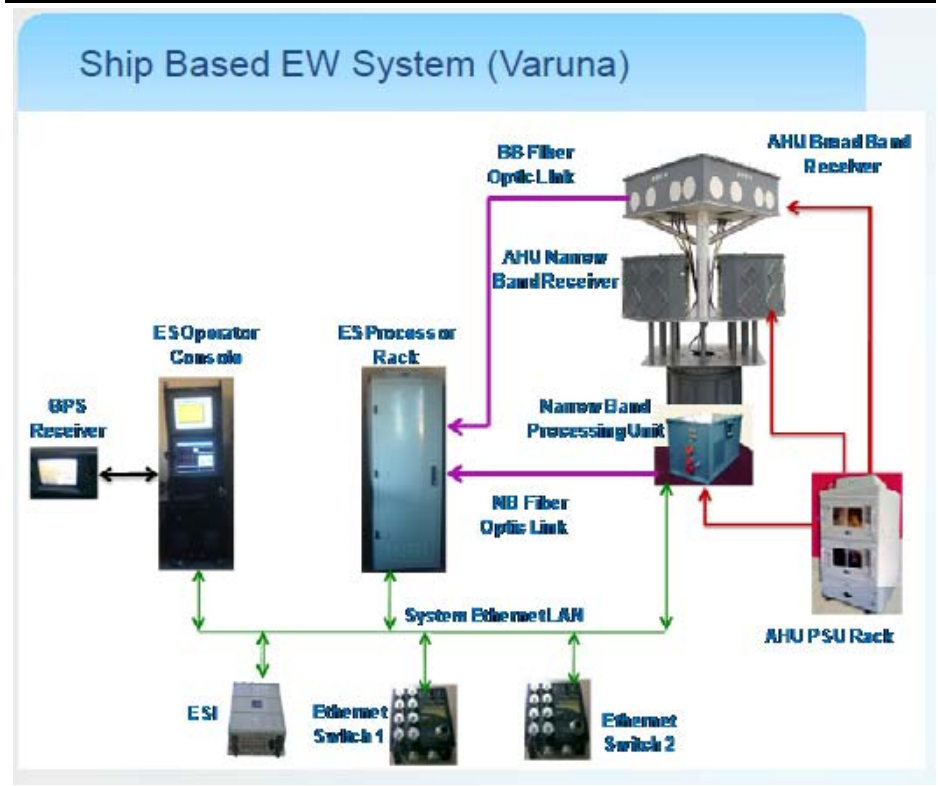
Exhibit 9: Communication Systems



Source: Company Data, PL Research



Exhibit 10: EW Systems



Source: Company Data, PL Research

Exhibit 11: Surveillance Systems



Source: Company Data, PL Research



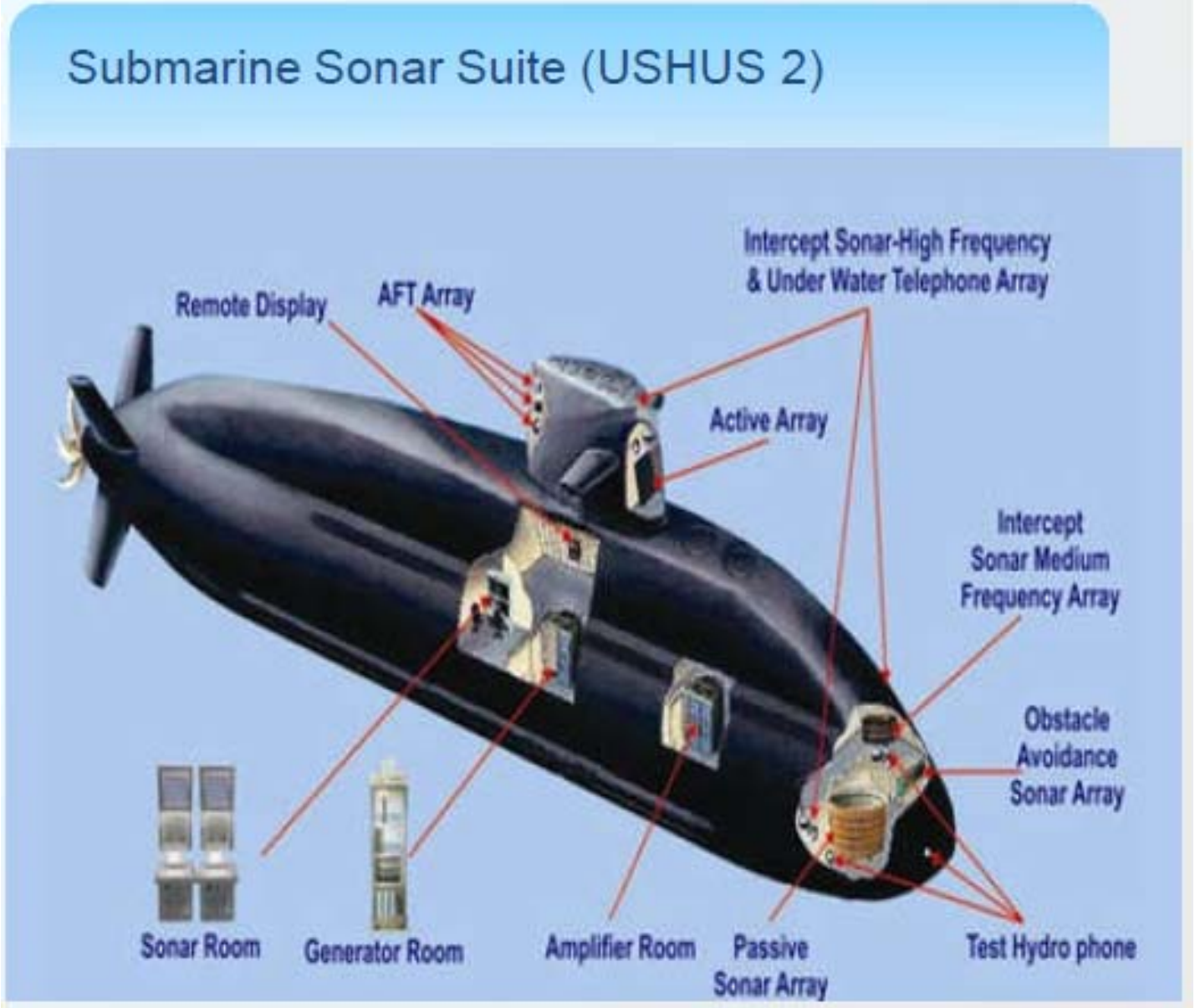
Exhibit 12: Hull Mounted Sonar

## Hull Mounted Sonar (New Generation)

- Hull / Bow mounted single array medium range, low frequency SONAR system
- Cylindrical transducer array to panoramic search capability
- Dual frequency of operation
- Simultaneous active/passive search and track capability
- Advanced detection and classification features
- Automatic target tracking up to 8 targets in both active and passive modes with map overlay

Source: Company Data, PL Research

Exhibit 13: Sonar Suite



Source: Company Data, PL Research

**Income Statement (Rs m)**

Y/e March	2016	2017	2018E	2019E
<b>Net Revenue</b>	<b>73,279</b>	<b>86,119</b>	<b>99,099</b>	<b>113,963</b>
Raw Material Expenses	38,266	44,131	55,793	65,643
Gross Profit	35,013	41,988	43,306	48,320
Employee Cost	12,573	15,483	18,580	19,323
Other Expenses	8,722	8,888	5,599	7,009
<b>EBITDA</b>	<b>13,718</b>	<b>17,617</b>	<b>19,127</b>	<b>21,989</b>
Depr. & Amortization	1,722	1,915	2,008	2,108
Net Interest	45	118	41	47
Other Income	5,371	4,710	5,178	5,643
<b>Profit before Tax</b>	<b>17,322</b>	<b>20,294</b>	<b>22,257</b>	<b>25,478</b>
Total Tax	4,248	4,818	5,564	6,369
<b>Profit after Tax</b>	<b>13,074</b>	<b>15,476</b>	<b>16,693</b>	<b>19,108</b>
Ex-Od items / Min. Int.	—	—	—	—
<b>Adj. PAT</b>	<b>13,074</b>	<b>15,476</b>	<b>16,693</b>	<b>19,108</b>
<b>Avg. Shares O/S (m)</b>	<b>2,400.0</b>	<b>2,233.6</b>	<b>2,233.6</b>	<b>2,233.6</b>
<b>EPS (Rs.)</b>	<b>5.4</b>	<b>6.9</b>	<b>7.5</b>	<b>8.6</b>

**Cash Flow Abstract (Rs m)**

Y/e March	2016	2017	2018E	2019E
C/F from Operations	28,946	17,391	18,701	21,217
C/F from Investing	(2,919)	(3,619)	(2,002)	9,092
C/F from Financing	(149)	(150)	(150)	1,369
Inc. / Dec. in Cash	25,878	13,622	16,549	31,678
Opening Cash	60,516	86,395	127,251	104,908
Closing Cash	86,395	127,251	104,908	141,542
FCFF	26,947	42,625	(22,192)	30,556
FCFE	29,858	27,142	(22,192)	30,556

**Key Financial Metrics**

Y/e March	2016	2017	2018E	2019E
<b>Growth</b>				
Revenue (%)	7.1	17.5	15.1	15.0
EBITDA (%)	19.9	28.4	8.6	15.0
PAT (%)	12.0	18.4	7.9	14.5
EPS (%)	(62.7)	27.2	7.9	14.5
<b>Profitability</b>				
EBITDA Margin (%)	18.7	20.5	19.3	19.3
PAT Margin (%)	17.8	18.0	16.8	16.8
RoCE (%)	13.5	17.5	18.1	17.4
RoE (%)	15.8	19.0	18.0	17.4
<b>Balance Sheet</b>				
Net Debt : Equity	(0.7)	(1.1)	(0.8)	(0.7)
Net Wrkng Cap. (days)	(132)	(233)	(226)	(256)
<b>Valuation</b>				
PER (x)	34.6	27.2	25.2	22.0
P / B (x)	5.2	5.6	3.8	3.8
EV / EBITDA (x)	28.7	19.1	17.4	15.8
EV / Sales (x)	5.4	3.9	3.3	3.0
<b>Earnings Quality</b>				
Eff. Tax Rate	24.5	23.7	25.0	25.0
Other Inc / PBT	31.0	23.2	23.3	22.2
Eff. Depr. Rate (%)	6.2	6.5	6.3	6.3
FCFE / PAT	228.4	175.4	(132.9)	159.9

Source: Company Data, PL Research.

**Balance Sheet Abstract (Rs m)**

Y/e March	2016	2017	2018E	2019E
Shareholder's Funds	87,401	75,085	110,103	110,103
Total Debt	15,483	—	—	—
Other Liabilities	—	(5,323)	(5,323)	(5,323)
<b>Total Liabilities</b>	<b>102,884</b>	<b>69,763</b>	<b>104,780</b>	<b>104,780</b>
Net Fixed Assets	13,881	11,206	11,200	37,283
Goodwill	—	—	—	—
Investments	3,179	1	120	120
Net Current Assets	66,617	50,646	93,460	67,377
<i>Cash &amp; Equivalents</i>	<i>73,319</i>	<i>84,583</i>	<i>88,504</i>	<i>73,761</i>
<i>Other Current Assets</i>	<i>86,119</i>	<i>62,540</i>	<i>137,652</i>	<i>149,870</i>
<i>Current Liabilities</i>	<i>92,822</i>	<i>96,476</i>	<i>132,696</i>	<i>156,253</i>
Other Assets	—	—	—	—
<b>Total Assets</b>	<b>83,678</b>	<b>61,854</b>	<b>104,780</b>	<b>104,780</b>

**Quarterly Financials (Rs m)**

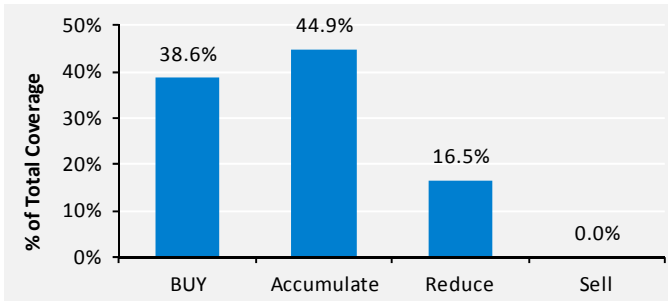
Y/e March	Q2FY17	Q3FY17	Q4FY17	Q1FY18
<b>Net Revenue</b>	<b>17,946</b>	<b>20,421</b>	<b>39,877</b>	<b>17,248</b>
<b>EBITDA</b>	<b>3,384</b>	<b>4,828</b>	<b>9,796</b>	<b>1,633</b>
<i>% of revenue</i>	<i>18.9</i>	<i>23.6</i>	<i>24.6</i>	<i>9.5</i>
Depr. & Amortization	455	455	571	561
Net Interest	3	106	9	3
Other Income	1,714	776	909	723
<b>Profit before Tax</b>	<b>4,641</b>	<b>5,043</b>	<b>10,125</b>	<b>1,793</b>
Total Tax	1,178	1,307	2,208	540
<b>Profit after Tax</b>	<b>3,463</b>	<b>3,735</b>	<b>7,917</b>	<b>1,253</b>
<b>Adj. PAT</b>	<b>3,463</b>	<b>3,735</b>	<b>7,917</b>	<b>1,253</b>

Source: Company Data, PL Research.

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<b>Accumulate</b>	:	Outperformance to Sensex over 12-months
<b>Reduce</b>	:	Underperformance to Sensex over 12-months
<b>Sell</b>	:	Over 15% underperformance to Sensex over 12-months
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