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Company update and
reco change

Defence

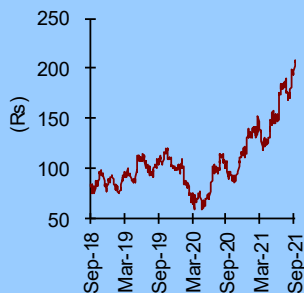
Target price: Rs208

Shareholding pattern

	Dec '20	Mar '21	Jun '21
Promoters	51.1	51.1	51.1
Institutional investors	41.6	41.8	43.0
MFs and others	26.3	25.6	24.6
FIs/Insurance	4.6	4.2	3.9
FII	10.7	12.0	14.5
Others	7.3	7.1	5.9

Source: BSE India

Price chart



Bharat Electronics

HOLD

Downgrade from BUY

Diversification remains integral to strong guidance **Rs210**

Bharat Electronics' (BEL) management highlighted i) potential order inflow of Rs 150-170bn p.a ii) potential revenue growth of 15% p.a in the medium term iii) continuing with its current diversification effort towards rail/metro, smart city projects, home land security etc and iv) service revenues to contribute 25% of revenues in the next few years. We downgrade BEL to HOLD from BUY given ~67% increase in stock price over the past 6 months.

- **Guidance on margins and orderbook.** BEL has ~Rs550bn of order book which will sustain revenue growth for the coming 3-4yrs at ~15%p.a. BEL is targeting ~20~22% EBITDA margins for the next 2-3 yrs. Management expects continuing order inflow at Rs150-170bn p.a. Apart from defence (forming ~80% of current revenues), BEL sees significant opportunity in its current diversification efforts towards rail/metro, smart city projects, home land security etc. Management also highlighted the AMC/ROH revenues to contribute ~25% of topline in the next few years. Despite nominated orders forming ~75% of the current orderbook, management is confident that the margins can be maintained. With increase in revenues, employee cost will moderate towards ~12% of revenues. There was a one-time royalty payment for ToT of ventilators in FY21 (~ Rs1.6bn)
- **On new businesses and their potential revenue contribution.** Ammunition business is expected to contribute revenues of > Rs5bn p.a. Management also expects the ammunition fuse business revenues at ~Rs1-1.5bn p.a. BEL has competed successfully in a global contract for 105mm/155mm fuses. BEL has also participated in a recent RFP for fuses (shortly going under user trials) - a 10 years contract @ 0.5mn fuses p.a. Along with this, BEL also participated in 30mm & 40mm fuses contracts. BEL is also going for the development of shells (got orders for guided bombs, air drop bombs etc.). In the segment of medical electronics, BEL is trying to get into working arrangements with the aggregators (buyers from OEMs and suppliers to various hospitals).
- **Software as a service (SaaS) to become Rs50bn vertical over next 3 years.** BEL has been receiving orders ~Rs500mn-1bn p.a. in the SaaS vertical. Management expects SaaS to be Rs50bn SBU in the coming 3yrs, given requirements from the Government as well as other civilian entities.
- **Capex of Rs18bn over next three years (FY22-24E).** Key capex projects include ~Rs4bn for the first phase of *Defence Sytem Integration Complex* at Palasamudram plant, Rs2bn for Ibrahimpattam plant (land based EW system), Rs2bn for the artillery fuse manufacturing facility in Nagpur and Rs3bn for Nimmaluru plant at Machilipattam for IR Seekers, advanced Night vision devices (NVD) and electro optics. NVD and electro-optics plant is expected to commission by Aug, '22. Nagpur plot registration has recently concluded [Solar Industries (SOIL) does the filling for the BEL's fuse plant in Pune]. DSIC plant at Palasamudram is expected to be complete over the next 2-3 years.

Market Cap	Rs512bn/US\$6.9bn
Reuters/Bloomberg	BAJE.BO/BHE IN
Shares Outstanding (mn)	2,436.6
52-week Range (Rs)	190/87
Free Float (%)	48.9
FII (%)	14.5
Daily Volume (US\$/'000)	30285
Absolute Return 3m (%)	21.1
Absolute Return 12m (%)	115.8
Sensex Return 3m (%)	13.5
Sensex Return 12m (%)	58.8

Year to March	FY20	FY21	FY22E	FY23E
Revenue (Rs mn)	129,677	141,087	158,405	176,755
Net Income (Rs mn)	18,239	20,998	24,250	25,398
Dil. EPS (Rs)	7.5	8.6	10.0	10.4
% Chg YoY	(3.3)	15.1	15.5	4.7
P/E (x)	28.2	24.5	21.2	20.2
CEPS (Rs)	9.0	10.2	11.9	12.5
EV/E (x)	18.1	14.5	12.6	11.4
Dividend Yield (%)	1.3	1.9	1.9	1.9
RoCE (%)	24.5	26.6	25.7	23.9
RoE (%)	18.1	19.0	19.4	18.1

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Downgrade to HOLD

We downgrade BEL to HOLD from BUY with an unchanged target price of Rs208/share. We value the company as 20x FY23E EPS.

Key risks

Being able to achieve/reach close to its targeted execution amidst moderating cashflow pressures is the bull case for BEL.

Also, continued strength in order inflows from the base business (Indian defence) can help future execution and reduce the necessity for diversification.

Cause of concern is the extent of cashflow pressures. We expect these pressures to moderate in the medium term with ease in defence budgetary allocation.

Financial summary

Table 1: Profit & Loss statement

(Rs mn, year ending March 31)

	FY20	FY21	FY22E	FY23E
Operating Income	129,677	141,087	158,405	176,755
Operating Expenses	102,132	108,982	122,501	138,899
EBITDA	27,545	32,105	35,904	37,856
<i>% margins</i>	21.2	22.8	22.7	21.4
Depreciation & Amortisation	3,719	3,873	4,674	5,074
Gross Interest	36	64	18	18
Other Income	994	1,250	873	873
Recurring PBT	24,784	29,418	32,085	33,638
Less: Taxes	6,858	8,724	8,060	8,453
Add: Share of profit from associates	321	304	263	263
Recurring Net Income	18,239	20,998	24,250	25,398

Source: Company data, I-Sec research

Table 2: Balance sheet

(Rs mn, year ending March 31)

	FY20	FY21	FY22E	FY23E
Assets				
Total Current Assets	187,381	237,156	259,762	296,736
<i>of which cash & cash eqv.</i>	16,809	50,000	62,887	83,612
Total Current Liabilities & Provisions	142,120	184,092	191,837	212,391
Net Current Assets	45,261	53,064	67,925	84,345
Investments	1,621	1,899	1,899	1,899
<i>Strategic/Group</i>	1,621	1,899	1,899	1,899
<i>Other Marketable</i>	-	-	-	-
Net Fixed Assets	27,126	26,521	25,848	24,774
<i>Capital Work-in-Progress</i>	8,280	8,827	8,918	9,010
Goodwill	19,076	20,517	20,555	20,605
Total Assets	101,364	110,827	125,145	140,633
Liabilities				
Borrowings	507	82	82	82
Deferred Tax Liability	-	-	-	-
Government Grants	-	-	-	-
Minority Interest	142	150	188	239
Equity Share Capital	2,437	2,437	2,437	2,437
Reserves & Surplus				
Net Worth	98,279	108,159	122,438	137,876
Total Liabilities	101,364	110,827	125,145	140,633

Source: Company data, I-Sec research

Table 3: Cashflow statement

(Rs mn, year ending March 31)

	FY20	FY21	FY22E	FY23E
Operating Cashflow	22,646	28,884	27,844	29,403
Working Capital Changes	3,058	22,048	(1,974)	4,305
Capital Commitments	(7,466)	(4,693)	(4,091)	(4,091)
Free Cashflow	18,238	46,240	21,779	29,617
Investing Cashflow	(6,490)	(25,952)	(3,218)	(3,218)
Issue of Share Capital	-	-	-	-
Buyback of shares	-	-	-	-
Inc (Dec) in Borrowings	(250)	(469)	-	-
Others	(9,835)	(10,289)	(9,765)	(9,765)
Extraordinary Items	-	-	-	-
Chg. in Cash	9,130	14,223	12,887	20,725

Source: Company data, I-Sec research

Table 4: Key ratios

(Year ending March 31)

	FY20	FY21	FY22E	FY23E
Per Share Data (in Rs.)				
EPS(Basic Recurring)	7.5	8.6	10.0	10.4
Diluted Recurring EPS	7.5	8.6	10.0	10.4
Recurring Cash EPS	9.0	10.2	11.9	12.5
Dividend per share (DPS)	2.8	4.0	4.0	4.0
Book Value per share (BVPS)	41.3	45.4	51.2	57.6
Growth Ratios (%)				
Operating Income	6.6	8.8	12.3	11.6
EBITDA	(5.2)	16.6	11.8	5.4
Recurring Net Income	(3.3)	15.1	15.5	4.7
Valuation Ratios (x)				
P/E	28.2	24.5	21.2	20.2
P/CEPS	23.4	20.7	17.8	16.9
P/BV	5.1	4.6	4.1	3.7
EV / EBITDA	18.1	14.5	12.6	11.4
EV / FCF	27.3	10.0	20.7	14.5
Operating Ratios (%)				
Raw Material/Sales	54.7	55.5	57.1	58.8
SG&A/Sales	8.0	7.9	7.2	7.2
Other Income / PBT	4.0	4.2	2.7	2.6
Effective Tax Rate	27.7	29.7	25.1	25.1
NWC / Total Assets	0.4	0.5	0.5	0.6
Inventory Turnover	1.8	1.6	1.5	1.5
Asset Turnover	1.3	1.3	1.3	1.3
Net D/E Ratio (x)	(0.2)	(0.5)	(0.5)	(0.6)
Return/Profitability Ratios (%)				
Recurring Net Income Margins	14.1	14.9	15.3	14.4
RoCE	24.5	26.6	25.7	23.9
RoNW	18.1	19.0	19.4	18.1
Dividend Pay-out Ratio	37.4	46.4	40.2	38.4
EBITDA Margins	21.2	22.8	22.7	21.4

Source: Company data, I-Sec research

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