Bharat Electronics

BSE SENSEX	S&P CNX
32,575	10,115

Bloomberg	BHE IN
Equity Shares (m)	2,234
M.Cap.(INRb)/(USDb)	397.6/6.2
52-Week Range (INR)	187 / 119
1, 6, 12 Rel. Per (%)	7/0/30
Avg Val, INRm	664
Free float (%)	31.8

Financials & Valuations (INR b)

Y/E Mar	2017	2018E	2019E
Net Sales	86.1	110.1	122.8
EBITDA	17.6	19.9	21.4
NP	15.5	16.6	18.5
EPS (INR)	6.9	7.4	8.3
EPS Gr. (%)	27.2	7.3	11.2
BV/Sh (INR)	33.6	43.6	48.8
RoE (%)	20.6	17.0	16.9
RoCE (%)	18.9	19.3	17.9
P/E (x)	23.1	22.2	21.5
P/BV (x)	4.8	3.8	3.6

Estimate change

TP change

Rating change

CMP: INR179 TP: INR210 (+16%) Buy

Robust execution leads to better than expected performance

- **1QFY18 operational results ahead of estimates:** BHE reported revenue of INR17.2b (+98% YoY; our estimate: INR12b) and operating profit of INR1.6b (v/s loss of INR0.5b in 1QFY17; our estimate: loss of INR0.2b). Net profit rose 247% YoY to INR1.3b. Exports were USD4.4m (INR286m).
- Key projects executed during 1QFY18 include integrated air command and control systems, advance composite communication system, integrated communication system, weapon locating radar, Akash weapon system (Indian Army), ship-borne EW system, and L70 gun upgrade.
- **EBITDA margin at 9.5%; improvement driven by better operating leverage:** Operating profit for the quarter was INR1.6b as against a loss of INR0.5b in 1QFY17. EBITDA margin was 9.5% in 1QFY18 as against -5.4% in 1QFY17. Margin expansion was driven by better operating leverage. Net profit was INR1.3b v/s INR0.4b in 1QFY17. Other income declined 48% to INR0.7b from INR1.4b in 1QFY17, as the company utilized its cash reserves for share buyback.
- **Robust order backlog provides strong revenue visibility:** Order backlog of INR411b as at the end of 1QFY18 provides strong revenue visibility of 4.3x its TTM revenue. Order inflow grew 142% YoY to INR24b. For FY18, the management has guided sales of INR100b (+15% YoY), +/-100bp YoY change in EBITDA margin, and orders of INR130b-140b.
- **Maintain Buy; TP: INR210:** We raise our estimates by 3% for FY18 and by 2% for FY19 to factor in improvement in execution. We retain our **Buy** rating and marginally raise our target price to INR210 (25x FY19E EPS, which is its peak historical valuation multiple) to factor in improved pace of decision making in the defense sector, and better order visibility and execution.

Quarterly Performance **(INR Million)**

Y/E March	FY17				FY18				FY17	FY18	MOSL	Var
	1QE	2Q	3QE	4QE	1QE	2QE	3QE	4QE			3QE	Var
Sales	**8714**	**17033**	**20867**	**39877**	**17248**	**20921**	**24775**	**47166**	**86119**	**110110**	**11715**	**47.2**
Change (%)	-20.8	15.9	37.2	23.7	97.9	22.8	18.7	18.3	17.5	27.9	34.4	
EBITDA	**-467**	**3349**	**4828**	**9796**	**1633**	**2932**	**3823**	**11534**	**17617**	**19922**	**-195**	**-935.8**
Change (%)	-699	85	74	8	-450	-12	-21	18	28	13	-58	
As of % Sales	-5.4	19.7	23.1	24.6	9.5	14.0	15.4	24.5	20.5	18.1	-1.7	
Depreciation	435	455	455	571	561	550	520	550	1915	2180	460	
Interest	0	3	106	9	3	0	0	47	118	50	0	
Other Income	1387	1714	776	909	723	850	1200	1227	4710	4000	1150	
Exceptional items (reported)	0	0	0	0	0	0	0	0	0	0	0	
PBT	**486**	**4606**	**5043**	**10125**	**1793**	**3232**	**4503**	**12164**	**20294**	**21692**	**495**	**262.5**
Tax	125	1178	1307	2208	540	711	991	2844	4818	5085	109	
Effective Tax Rate (%)	25.7	25.6	25.9	21.8	30.1	22.0	22.0	23.4	23.7	23.4	22.0	
Reported PAT	**361**	**3427**	**3735**	**7917**	**1253**	**2521**	**3513**	**9321**	**15476**	**16607**	**386**	**224.9**
Change (%)	-52.9	66.5	33.3	6.3	247.2	-26.5	-6.0	17.7	18.4	7.3	6.9	
Adj PAT	**361**	**3427**	**3735**	**7917**	**1253**	**2521**	**3513**	**9321**	**15476**	**16607**	**386**	**224.9**
Change (%)	**-52.9**	66.5	33.3	6.3	**247.2**	-26.5	-6.0	17.7	18.4	7.3	6.9	

E: MOSL Estimates

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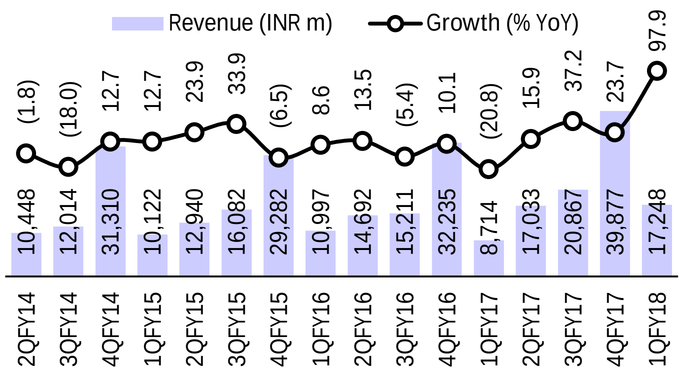
1QFY18 operational performance meaningfully above estimates

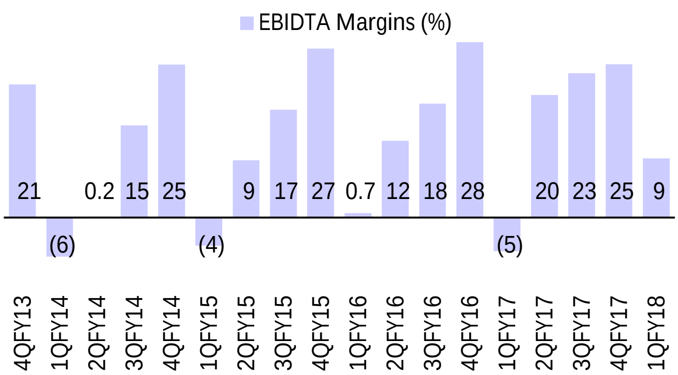
- BHE reported revenue of INR17.2b (+98% YoY; our estimate: INR12b) and operating profit of INR1.6b (v/s loss of INR0.5bin 1QFY17; our estimate: loss of INR0.2b). Net profit rose 247% YoY to INR1.3b. Exports during the quarter stood at USD4.4m (INR286m)
- Key projects executed during 1QFY18 include integrated air command and control systems, Advance composite communicate system, Integrated communication system, weapon locating radar, Akash Weapon system (Army) Shipborne EW system and L70 gun upgrade.
- Operating profit for the quarter stood at INR1.6b as against a loss of INR0.5b in 1QFY17. EBITDA margin stood at 9.5% in 1QFY18 as against -5.4% in 1QFY17. Margin improvement was driven by better operating leverage. Net profit was INR1.3b v/s INR0.4b in 1QFY17. Other income declined 48% to INR0.7b from INR1.4b in 1QFY17, as the company utilized its cash reserves for buyback of its shares.
- Order backlog of INR411b as on 1QFY18 end provides strong revenue visibility of 4.3x its TTM revenue. For FY18, management guides to sales of INR100b (+15% YoY), EBITDA margins to be in +/-100bps YoY and orders of INR130-140b.

Exhibit 1: Revenue growth supported by pick up in execution of orders in hand



Source: MOSL, Company

Exhibit 2: Margin improvement driven by better operating leverage



Source: MOSL, Company

Key orders executed during 1QFY18

Integrated Air Command and Control System
Advances Composite Communicate System
Integrated Communication System
L70 Gun Upgrade
Weapon Locating Radar
Akash Weapon System (Army)
Ship Borne EW systems

Order book stands healthy at INR411b, potential pipe line looks healthy

- BHE's order book as on 1QFY18 end stands healthy at INR411b, BTB at 4.3x. During 1QFY18 orders worth INR24b (up 142% YoY) got finalized. Key orders like Voter verifiable paper audit trail (VVPAT), Network File Server (NFS) satcom terminal and Passive night vision devices.
- For FY18 Key orders like Akash missile system (7 Sqdn), mobile cellular communication system, commander TI Sights, Long range surface to air missile for P17A, commander T1 sight, mobile cellular communication system EW systems are supposed to be finalized. BHE's addressable defence electronic market seems to be picking up.

Exhibit 3: Key orders acquired by BHE in 1QFY18

1QFY17	Homeland Security
1QFY17	Navigational complex systems
1QFY17	Next gen Main Automatic Exchange
2QFY17	Electronic Warfare Suite - Shakti and Nayan
2QFY17	Advanced Compositie Communication System
2QFY17	Ship data Network
2QFY17	AMC for Rohini Radar
3QFY17	Advanced landing ground communication terminal
3QFY17	Shipborne Signal Intelligence Systems
3QFY17	Voter Verified paper audit trail
3QFY17	AMC for Rukmani System
4QFY17	LR SAM ($1b - INR64b)
4QFY17	L Banf Troop Upgrade
4QFY17	Handheld Thermal Image
1QFY18	Voter Verifiable Paper Audit Trail (VVPAT)
2QFY18	Network File Server (NFS) Satcom Terminal
3QFY18	Passive Night Vision Devices

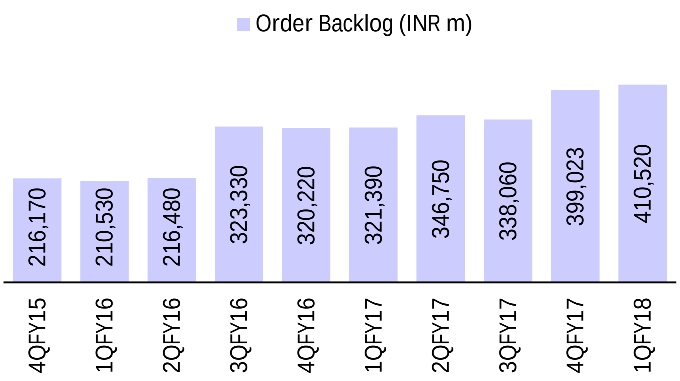
Source: MOSL, Company

Exhibit 4: BHE's order expectation to be finalized during FY18

FY16	FY17	FY18
Weapon Locating Radar	Akash Missile system	Akash Missile Systems (7 Squadron)
Hand held thermal imager	Tactical communication system	Long Range surface to air missile for P17A
Mobile Electronic intelligence system	Mobile cellular communication system	Commander T1 sight
Integrated air command control system	Electronic warfare systems	Mobile cellular communication system
	Advanced composite communication system	EW Systems
	Commander TI sights	

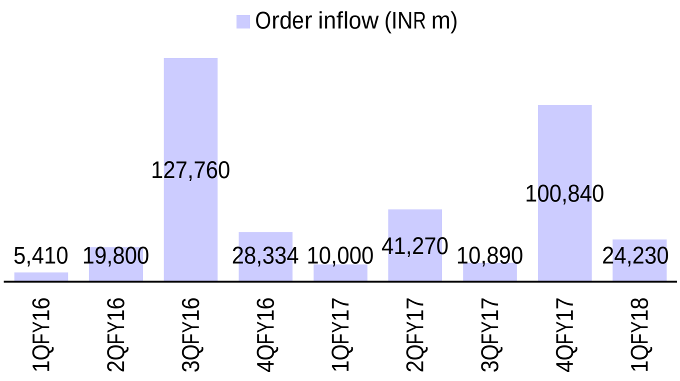
Source: Company, MOSL

Exhibit 5: Order book stands at INR411b providing a revenue visibility of 4.3x its TTM revenue



Source: MOSL, Company

Exhibit 6: order inflow of INR24b in 1QFY18 up 140% YoY led by finalization of key orders



Source: MOSL, Company

Valuation and rating

- BHE is well positioned to benefit from the rising defense expenditure supported by a) strong manufacturing base (Capacity utilization of ~60%) and execution track record, b) relationship with defense and government agencies, c) strategic collaboration with foreign technology partners for new products development d) in-house R&D capabilities (R&D spend at 9.4% of revenues) and e) Increased focus on exports to friendly countries.

- We expect BEL to report EPS of INR7.4/8.3 in FY18/FY19. Maintain **Buy** with a revised TP of INR210 (25x FY19E), which is its peak historical valuation to factor in improved pace of decision making in defense sector.
- BHE's export revenue has increased meaningfully from INR824m in FY09 to INR4.3b in FY17. Export order book stands at $82m giving strong visibility for FY18.

Change in estimates

Maintain Buy, TP: INR210. We marginally raise our estimates for FY18/19 by 3/2% to factor in improvement in execution. We retain our BUY rating and marginally revise upwards our target price to INR210 (25x FY19E EPS), which is its peak historical valuation to factor in improved pace of decision making in defense sector, improved order visibility and execution.

Exhibit 7: Change in forecast (INR m)

Description	New Estimates			Old Estimates		Change to estimates (%)	
	FY17	FY18E	FY19E	FY18E	FY19E	FY18E	FY19E
Sales	86,119	110,110	122,809	106,500	119,612	3%	3%
EBITDA	17,617	19,922	21,379	18,519	20,503	8%	4%
Margin(%)	20.5%	18.1%	17.4%	17.4%	17.1%	0.0%	0.2%
PAT	15,476	16,607	18,459	16,017	18,196	4%	1%
EPS	*6.4*	*7.4*	*8.3*	*7.2*	*8.1*	3%	2%

Source: Company, MOSL

Exhibit 8: Key operating metrics

INR M	FY13	FY14	FY15	FY16	FY17E	FY18E	FY19E
Order book	249,490	234,520	216,170	320,220	402,420	457,520	491,882
Y-o-Y growth	-3.1%	-6.0%	-7.8%	48.1%	25.7%	13.7%	7.5%
Order inflow	52,425	42,300	51,300	170,940	163,000	163,000	154,850
Y-o-Y growth	-32.7%	-19.3%	21.3%	233.2%	-4.6%	0.0%	-5.0%
Execution	59,905	61,223	66,755	71,737	82,961	107,900	120,488
Y-o-Y growth	6.0%	2.2%	9.0%	7.5%	15.6%	30.1%	11.7%
Book to bill ratio (x)	4.2	3.8	3.2	4.5	4.9	4.2	4.1
Revenues	**59,905**	**61,223**	**66,755**	**71,737**	**82,961**	**107,900**	**120,488**
Defence	51,882	52,087	56,075	59,541	68,028	87,399	97,596
Non Defence	9,156	10,668	10,681	12,195	14,933	20,501	22,893
Revenues							
Indigeniously developed	NA	41.0%	38.0%	39.0%			
In association with DRDO, etc	NA	44.0%	42.0%	47.0%			
Total Indigenous	**78.0%**	**85.0%**	**80.0%**	**86.0%**			
ToT from Foreign OEM's	22.0%	15.0%	20.0%	14.0%			
Revenues							
Domestic	58,340	59,232	63,111	66,042	75,558	98,275	107,977
Exports	1,782	2,510	3,645	5,695	7,404	9,625	12,512
Exports, % of Total	3.0%	4.1%	5.5%	7.9%	8.9%	8.9%	10.4%
Cost structure (% of Revenues)							
Raw material cost	62.4	57.9	55.2	52.2	51.2	56.2	57.5
Employee Cost	18.2	16.4	18.5	17.2	18.0	16.9	16.3
Other Expenses	6.0	6.3	6.0	7.7	6.5	5.5	5.5
Provisions/write off	2.9	5.4	3.6	4.3	4.1	3.3	3.3
R&D Expenses (INR M)	5099	4670	5489	7043			
R&D Expenses % to Sales	8.4	7.4	8.0	9.6			
Net cash/(Debt) (INR M)	53,025	45,644	58,815	38,000	37,900	50,854	60,942
Core NWC (Days)	396	418	346	525	377	379	379
Customer Advances	353	307	265	314	267	267	267
Reported NWC (Days)	**43**	**111**	**81**	**211**	**109**	**112**	**112**

Financials and valuations

Income statement							(INR Million)
Y/E March	**2013**	**2014**	**2015**	**2016**	**2017**	**2018E**	**2019E**
Net Sales	**61,038**	**62,755**	**68,427**	**73,279**	**86,119**	**110,110**	**122,809**
Change (%)	5.8	2.8	9.0	7.1	17.5	27.9	11.5
Manufacturing Expenses	41,739	40,241	41,937	43,895	49,455	67,938	77,370
Staff Cost	11,108	10,304	12,635	12,573	15,483	18,580	20,014
Office & Site Establishment Exps	1,767	3,299	2,422	3,093	3,563	3,670	4,046
EBITDA	**6,425**	**8,911**	**11,433**	**13,717**	**17,617**	**19,922**	**21,379**
% of Net Sales	10.5	14.2	16.7	18.7	20.5	18.1	17.4
Depreciation	1,307	1,421	1,540	1,722	1,915	2,180	2,318
Interest	8	34	14	45	118	50	50
Other Income	6,100	4,285	4,780	5,371	4,710	4,000	5,100
PBT	**11,210**	**11,741**	**14,659**	**17,321**	**20,294**	**21,692**	**24,111**
Tax	2,248	2,431	2,994	4,248	4,818	5,085	5,652
Rate (%)	20.1	20.7	20.4	24.5	23.7	23.4	23.4
Adjusted PAT	**8,962**	**9,310**	**11,665**	**13,073**	**15,476**	**16,607**	**18,459**
EO Income (Net of Expenses)	-64	6	8	0	0	0	0
Reported PAT	**8,898**	**9,316**	**11,672**	**13,073**	**15,476**	**16,607**	**18,459**
Change (%)	7.2	4.7	25.3	12.0	18.4	7.3	11.2

Balance sheet							(INR Million)
Y/E March	**2013**	**2014**	**2015**	**2016**	**2017**	**2018E**	**2019E**
Share Capital	800	800	800	2,400	2,234	2,234	2,234
Reserves	62,429	69,498	78,141	87,436	72,852	95,246	106,704
Net Worth	**63,229**	**70,298**	**78,941**	**89,836**	**75,085**	**97,480**	**108,938**
Loans	0	0	0	0	0	0	0
Deffered Tax Liability	-2,716	-2,995	-3,378	-4,608	-5,323	-3,000	-3,000
Capital Employed	**60,513**	**67,304**	**75,565**	**85,228**	**69,763**	**94,480**	**105,938**
Gross Fixed Assets	20,732	22,267	24,852	32,145	39,114	42,114	43,314
Less: Depreciation	14,978	15,757	17,140	18,082	19,998	22,178	24,496
Net Fixed Assets	**5,755**	**6,509**	**7,712**	**14,063**	**19,116**	**19,936**	**18,818**
Capital WIP	1,614	1,969	1,398	0	0	2,000	2,000
Investments	120	120	191	0	0	120	120
Curr. Assets	**134,257**	**133,680**	**139,319**	**162,569**	**147,122**	**192,338**	**218,743**
Inventory	32,711	33,701	34,269	41,775	49,050	52,793	58,881
Debtors	33,347	41,508	38,180	69,594	43,550	60,334	67,293
Cash & Bank Balance	53,025	45,644	58,815	38,000	37,900	50,854	60,942
Loans & Advances	14,382	12,164	7,520	4,000	3,132	27,150	30,282
Other Current Assets	792	663	535	9,201	13,490	1,207	1,346
Current Liab. & Prov.	**81,233**	**74,974**	**73,056**	**91,406**	**96,476**	**119,913**	**133,743**
Liabilities	74,071	68,979	65,289	82,234	83,473	107,847	120,285
Provisions	7,162	5,995	7,767	9,172	13,003	12,067	13,459
Net Current Assets	**53,024**	**58,705**	**66,263**	**71,163**	**50,646**	**72,424**	**85,000**
Misc. Expenses	0	0	1	0	0	0	0
Application of Funds	**60,513**	**67,303**	**75,565**	**85,227**	**69,762**	**94,480**	**105,938**

E: MOSL Estimates

Financials and valuations

Ratios							
Y/E March	**2013**	**2014**	**2015**	**2016**	**2017**	**2018E**	**2019E**
Adjusted EPS	**3.7**	**3.9**	**4.9**	**5.4**	**6.9**	**7.4**	**8.3**
Growth (%)	7.2	4.7	25.3	12.0	27.2	7.3	11.2
Cash EPS	4.3	4.5	5.5	6.2	7.8	8.4	9.3
Book Value	26.3	29.3	32.9	37.4	33.6	43.6	48.8
DPS	0.7	0.8	1.0	1.7	2.3	2.4	2.7
Payout (incl. Div. Tax.)	20	20	20	31	32	32	32
Valuation (x)							
P/E (standalone)	10.3	9.8	31.1	27.8	23.1	22.2	21.5
Cash P/E	9.0	8.5	27.5	24.5	20.5	19.6	19.1
EV/EBITDA	6.1	5.2	26.6	23.7	18.1	15.9	15.7
EV/Sales	0.6	0.8	4.6	4.5	3.9	2.9	2.8
Price/Book Value	1.5	1.3	4.6	4.0	4.8	3.8	3.6
Dividend Yield (%)	1.9	2.0	0.6	1.1	1.4	1.5	1.5
Profitability Ratios (%)							
RoE	14.2	13.2	14.8	14.6	20.6	17.0	16.9
RoCE	15.0	14.0	15.6	15.5	18.9	19.3	17.9
RoIC	-89.4	46.9	45.3	29.0	30.3	37.0	34.6
Turnover Ratios							
Debtors (Days)	199	241	204	347	185	200	200
Inventory (Days)	196	196	183	208	208	175	175
Fixed Asset Turnover (x)	2.9	2.7	2.7	2.2	2.1	2.6	2.8

Cash flow statement							(Rs Million)
Y/E March	**2013**	**2014**	**2015**	**2016**	**2017**	**2018E**	**2019E**
PBT before Extraordinary Items	**11,209**	**11,740**	**14,659**	**17,321**	**20,294**	**21,692**	**24,111**
Add : Depreciation	1,307	1,421	1,540	1,722	1,915	2,180	2,318
Interest	8	34	14	45	118	50	50
Less : Direct Taxes Paid	2,248	2,431	2,994	4,248	4,818	5,085	5,652
(Inc)/Dec in WC	-19,994	-13,062	5,614	-25,715	20,417	-8,825	-2,488
CF from Operations	**-9,717**	**-2,298**	**18,831**	**-10,875**	**37,927**	**10,013**	**18,340**
Extra-ordinary Income	-64	6	8	0	0	0	0
CF from Operations after EOI	**-9,781**	**-2,292**	**18,839**	**-10,875**	**37,927**	**10,013**	**18,340**
(Inc)/Dec in FA	-2,439	-2,530	-2,171	-6,675	-6,968	-5,000	-1,200
Free Cash Flow	**-12,220**	**-4,822**	**16,667**	**-17,550**	**30,958**	**5,013**	**17,140**
(Pur)/Sale of Investments	0	0	-71	191	0	-120	0
CF from Investments	**-2,439**	**-2,530**	**-2,242**	**-6,485**	**-6,968**	**-5,120**	**-1,200**
(Inc)/Dec in Networth	-389	-344	-684	1,503	-25,072	14,409	0
(Inc)/Dec in Debt	0	0	0	0	0	0	0
Less : Interest Paid	8	34	14	45	118	50	50
Dividend Paid	2,083	2,181	2,728	4,911	5,870	6,299	7,001
CF from Fin. Activity	**-2,481**	**-2,559**	**-3,427**	**-3,453**	**-31,060**	**8,060**	**-7,051**
Inc/Dec of Cash	**-14,700**	**-7,381**	**13,170**	**-20,812**	**-101**	**12,953**	**10,088**
Add: Beginning Balance	67,725	53,025	45,644	58,815	38,000	37,900	50,854
Closing Balance	**53,025**	**45,644**	**58,813**	**38,003**	**37,899**	**50,853**	**60,942**

E: MOSL Estimates

Corporate profile

Company description

Bharat Electronics Limited (BHE) was established at Bangalore, India, by the Government of India under the Ministry of Defence in 1954 to meet the specialized electronic needs of the Indian defence services. Over the years, it has grown into a multiproduct, multi-technology, multi-unit company servicing the needs of customers in diverse fields in India and abroad.

Exhibit 1: Sensex rebased

Source: MOSL/Bloomberg

Exhibit 2: Shareholding pattern (%)

	Jun-17	Mar-17	Jun-16
Promoter	68.2	68.2	75.0
DII	16.7	17.7	15.0
FII	7.6	6.7	3.9
Others	7.5	7.4	6.1

Note: FII Includes depository receipts Source: Capitaline

Exhibit 3: Top holders

Holder Name	% Holding
LIFE INSURANCE CORPORATION OF INDIA	3.8
CPSE ETF	1.1

Source: Capitaline

Exhibit 4: Top management

Name	Designation
M V Gowtama	Chairman & Managing Director
Anandi Ramalingam	Director (Marketing)
S Sreenivas	Company Secretary

Source: Capitaline

Exhibit 5: Directors

Name	Name
Girish Kumar	Nataraj Krishnappa
Ajit T Kalghatgi	Bhaskar Ramamurthi
R K Shevgaonkar	Sharad Sanghi
Usha Mathur	C A Krishnan
Kusum Singh	

*Independent

Exhibit 6: Auditors

Name	Type
Badari Madhusudhan& Srinivasan	Statutory
Malani Somani Chandak & Associates	Branch
P S V & Associates	Cost Auditor
Rao & Narayan	Branch
Ved & Co	Branch

Source: Capitaline

Exhibit 7: MOSL forecast v/s consensus

EPS (INR)	MOSL forecast	Consensus forecast	Variation (%)
FY18	7.4	7.2	3.4
FY19	8.3	8.2	0.8

Source: Bloomberg

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