

## Muted performance owing to lower execution

Bharat Electronics (BEL) reported a revenue decline owing to lower execution and high base of EVM order in Q2FY19. During Q2FY20, revenues came in at ₹ 2743 crore, down 18.9% YoY. EBITDA margins came in at 19.9% vs. 14.8% YoY, down ~540 bps owing to relatively higher raw material cost, higher employee cost (up 8.1%, YoY) and lower-than-expected execution. Overall, PAT declined 40.6% YoY to ₹ 339.5 crore impacted by slower pace of execution. New initiatives like Smart City projects, etc, contributed ~20% to revenue.

## Healthy order book, execution pick-up to drive performance

During Q2FY20, BEL bagged significant orders such as the Akash Missile System (seven squadron), upgrade of EW system & sonar system, etc. The company continues to have strong order book and order inflows. Q2FY20 order inflows came in at ₹ 7088 crore while H1FY20 order inflows were at ₹ 9073 crore. At present, the export order book as on Q2FY20 was at \$158.5 million. Major orders expected in H2FY20 include coastal surveillance systems worth around ₹ 2000 crore. Going ahead, traction in execution and a favourable product mix is expected to help BEL maintain EBITDA margins at round 20% levels.

## Working capital, operating performance under control

IACCS execution has impacted working capital while the management's persistent focus on receivables has led to controlled working capital position. Strong execution in FY19-21E coupled with steady capex of ₹ 600-650 crore in the over two to three years is likely to keep a tight leash on liquidity position for BEL. BEL has not migrated to the new tax regime considering likely tax benefits from indigenous R&D expenses. However, the benefit is likely to go down from 150% to 0% in coming years. Accordingly, we estimate effective tax rate in the range of 28-29% in FY19-21E. The management is confident of achieving 10-12% revenue growth for FY20E.

## Valuation & Outlook

Going ahead, BEL continues to focus on and derive incremental contribution from non-defence segment like homeland security, cyber security and smart cities, which are expected to contribute ~20% to the revenue albeit with lower margins over the next three to five years. The orders from this segment are roughly around 8-10% of the order book. Overall strong order book of ₹ 56,178 crore provides good revenue visibility. We expect BEL to report revenue, EBITDA and PAT CAGR of 12.9%, 3.6%, 1.8% (base impacted on account of lower accrual of other income), respectively, in FY19-21E. We value the company at 16x P/E on FY21E EPS to arrive at a target price of ₹ 130 per share and maintain **BUY** rating.



### Particulars

Particular	Amount
Market Capitalization	₹ 27777 Crore
Total Debt (FY19)	₹ 30.6 Crore
Cash and Inv (FY19)	₹ 828.8 crore
EV (FY19)	₹ 26979 Crore
52 week H/L (₹) (BSE)	122 / 72
Equity capital	₹ 243.7 Crore
Face value	₹ 1

### Key Highlights

- Healthy order book and expected execution pick-up in execution is likely to translate into accelerated top line growth over FY19-21E
- New opportunities like homeland security, cyber security and smart cities expected to contribute ~20% to revenue. Currently, it contributes ~8-10% to order book
- We maintain BUY on BEL with a target price of ₹ 130

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### Key Financial Summary

(₹ crore)	FY17	FY18	FY19	FY20E	FY21E	CAGR (FY19-21E)
Revenues	8,612	10,322	12,085	13,414	15,402	12.9
EBITDA	1,762	2,000	2,862	2,680	3,074	3.6
EBITDA margin (%)	20.5	19.4	23.7	20.0	20.0	
Net Profit	1,548	1,399	1,927	1,760	1,997.1	1.8
EPS (₹)	6.9	5.7	7.9	7.2	8.2	
P/E (x)	16.3	19.7	14.3	15.6	13.8	
EV/EBITDA (x)	13.5	13.4	9.3	9.7	8.3	
RoCE (%)	27.1	25.0	30.0	24.9	25.8	
RoE (%)	20.6	18.0	21.4	17.8	18.3	

Source: Company, ICICI Direct Research

**Exhibit 1: Variance Analysis**

	Q2FY20	Q2FY20E	Q2FY19	YoY (%)	Q1FY20	QoQ (%)	Comments
Operating Income	2,743	3,574	3,381.4	-18.9	2,102	30.5	Revenue declined due to lower execution YoY
Other income	15	50	14.3	5.5	25	-40.9	
Total Revenue	2,758	3,624	3,395.7	-18.8	2,127.0	29.7	
Raw materials costs	1,460	1,818	1,619.6	-9.9	1,056	38.2	
Employees Expenses	507	524	469.2	8.1	524	-3.2	
Other Expenses	231	419	438.1	-47.3	173	33.6	
Total Expenditure	2,198	2,761	2,527.0	-13.0	1,753	25.4	
EBITDA	544.7	812.6	854.4	-36.2	348.1	56.5	
EBITDA margins (%)	19.9	22.7	25.3	-541 bps	16.6	330 bps	Consequently, margins are impacted, mostly due to relatively higher raw material cost and employee cost
Interest	1.2	0.0	0.0		0.3		
Depreciation	85.7	81.0	74.3	15.2	82.8	3.4	
Tax	133.4	203.3	223.0	-40.2	85.7	55.7	
Other Income	15.0	50.1	14.3	5.5	25.4	-40.9	
PAT	339.5	578.5	571.3	-40.6	204.7	65.8	

Source: Company, ICICI Direct Research

**Exhibit 2: Change in estimates**

	FY18	FY19	FY20E			FY21E		
(₹ Crore)	Actual	Actual	Old	New	% Change	Old	New	% Change
Revenue	10,322	12,085	13,487	13,414	-0.5	15,901	15,402	-3.1
EBITDA	2,000	2,862	2,763	2,680	-3.0	3,180	3,074	-3.3
EBITDA Margin (%)	19.4	23.7	20.5	20.0	-52 bps	20.0	20.0	-4 bps
PAT	1,399	1,927	1,800	1,760	-2.2	1,996.0	1,997	0.1
EPS (₹)	5.7	7.9	7.4	7.2	-2.4	8.2	8.2	0.0

Source: Company, ICICI Direct Research

## Key takeaways – Q2FY20

**Strong order book:** The order book at the end of Q2FY20 was at ₹ 56,178 crore. Orders received in Q2FY20 is 7088 crore and cumulative for H1FY20 were at ~₹ 9073 crore.

### Major orders received in Q2FY20

- Akash Missile system (7 squadron)
- Upgrade of EW system
- Sonar systems

The export order book as on October 1, 2019 was at US\$158.5 million. Export turnover for Q2FY20 was US\$7.89 million.

### Major supplies during Q2FY20

- Part supply of long range surface to air missile system (LRSAM)
- Intelligence Gathering System
- Upgrade of Communication equipment
- Smart City business
- Integrated Air Command and Control System
- Radar System

### Major orders expected in H2FY20

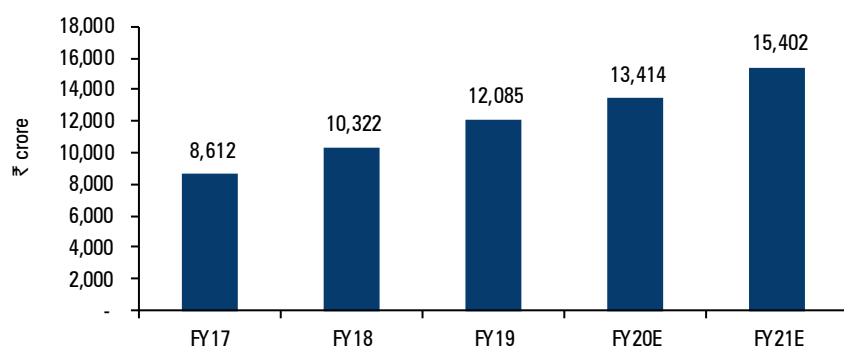
- Coastal Surveillance Systems

New addressable opportunities/ business, which BEL plans to capitalise on:

- **Homeland security solutions:** BEL is planning to address the border management solution requirements as part of the homeland security business. It is already providing security solutions for parliament, critical ONGC instalments, border perimeter solutions, etc
- **Smart Cities:** In this segment, BEL will provide smart lighting, smart signalling, and integrated electrical control systems for large cities. It is already implementing solutions for large cities like Agra, Belgaum (Karnataka), etc
- **Solar:** BEL is setting up utility scale solar power plants for captive consumption in the estates of ordnance factories at 17 locations across eight states for total capacity of 150 MW. The commissioning of the first solar power plant of 15 MW capacity is expected to happen soon at ordnance factory, Medak. In the near future, this sector is expected to contribute significantly to BEL's business
- **Space:** BEL is exploring a collaboration with Indian Space Research Organisation (Isro) leveraging their technological capabilities in design and development of various products/systems for possible use in defence applications

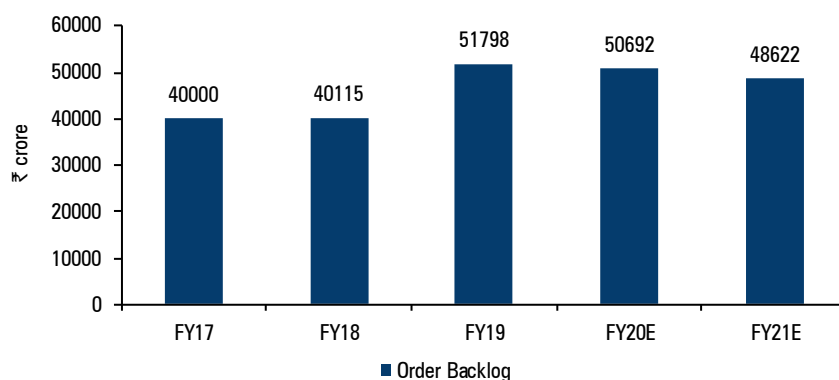
## Financial story in charts

**Exhibit 3: Revenue trend**



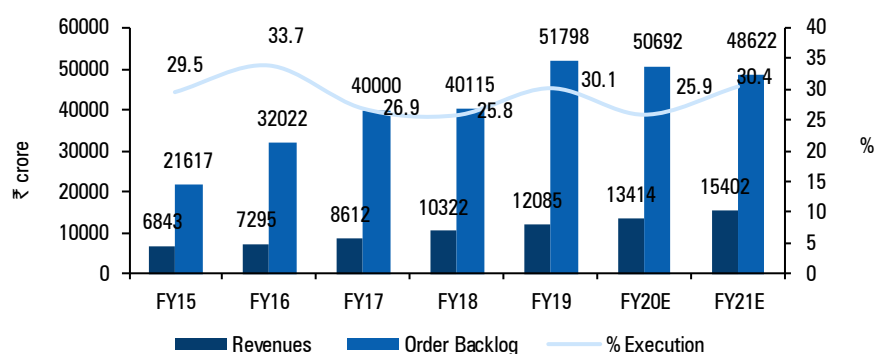
Source: Company, ICICI Direct Research

**Exhibit 4: Order backlog trend**



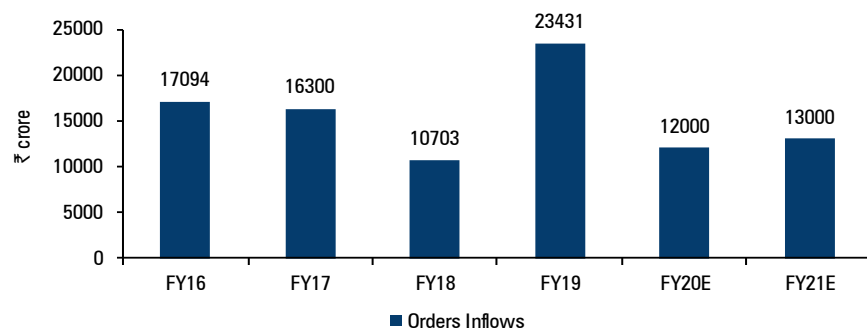
Source: Company, ICICI Direct Research

**Exhibit 5: Order backlog and percent execution**



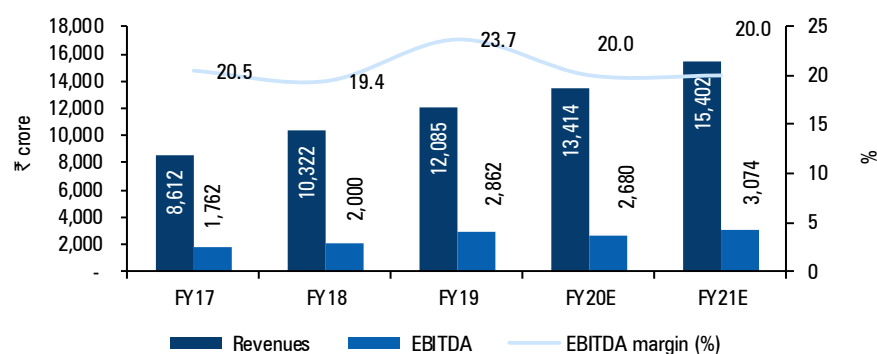
Source: Company, ICICI Direct Research

**Exhibit 6: Order inflow trend**



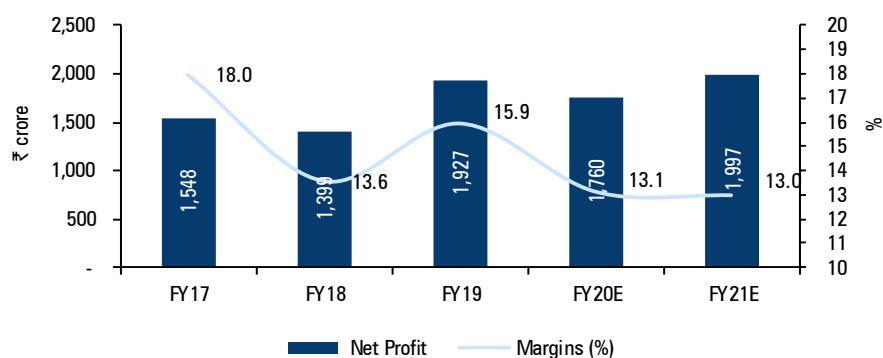
Source: Company, ICICI Direct Research

**Exhibit 7: EBITDA and EBITDA margin**



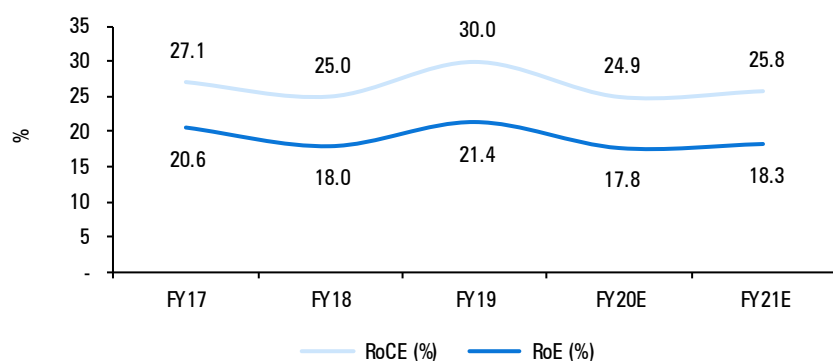
Source: Company, ICICI Direct Research

**Exhibit 8: PAT trend and margins**

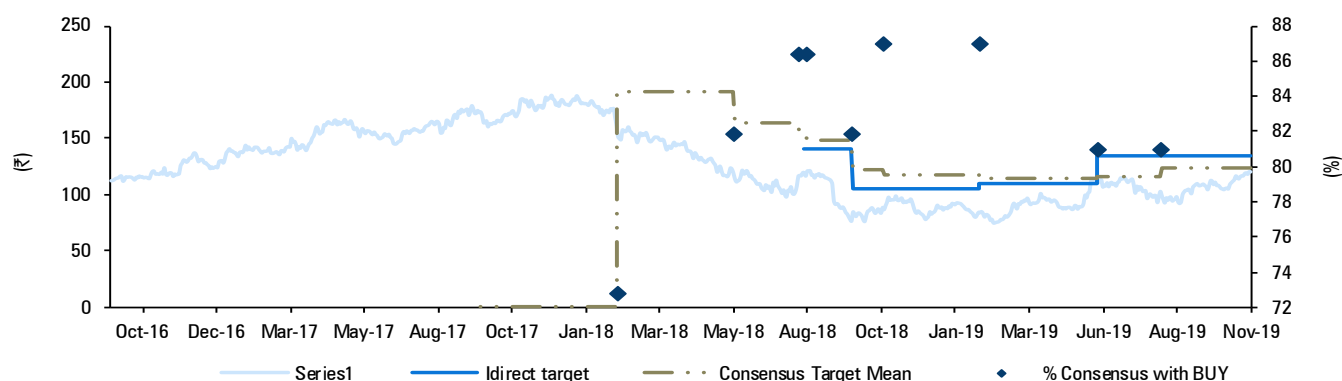


Source: Company, ICICI Direct Research

**Exhibit 9: RoE and RoCE trend**



Source: Company, ICICI Direct Research

**Exhibit 10: Recommendation History vs. Consensus**


Source: Bloomberg, Company, ICICI Direct Research

**Exhibit 11: Top 10 Shareholders**

Rank	Name	Filing Date	O/S	Position	Change
1	Government of India	10-10-2019	55.27%	1,346.74M	-16.15M
2	Reliance Nippon Life Asset Management Limited	04-12-2018	6.20%	151.14M	+101.80M
3	Goldman Sachs Asset Management (India) Private L	30-09-2019	4.08%	99.50M	+32.05M
4	HDFC Asset Management Co., Ltd.	30-09-2019	3.98%	97.04M	+37.13M
5	Life Insurance Corporation of India	30-09-2019	3.52%	85.84M	+5.91M
6	Kotak Mahindra Asset Management Company Ltd.	30-09-2019	2.35%	57.28M	+4.03M
7	Aditya Birla Sun Life AMC Limited	30-09-2019	2.06%	50.31M	-6.09M
8	ICICI Prudential Asset Management Co. Ltd.	30-09-2019	1.61%	39.22M	-4.04M
9	L&T Investment Management Limited	30-09-2019	1.37%	33.30M	+5.24M
10	SBI Funds Management Pvt. Ltd.	30-09-2019	1.01%	24.51M	-2.00M

Source: Reuters, ICICI Direct Research

**Exhibit 12: Recent Activity**

Buys			Sells		
Investor name	Value	Shares	Investor name	Value	Shares
HDFC Asset Management Co., Ltd.	+56.92M	+37.13M	Government of India	-25.34M	-16.15M
Goldman Sachs Asset Management (India) Private L	+49.14M	+32.05M	Aditya Birla Sun Life AMC Limited	-9.34M	-6.09M
CI Investments Inc.	+17.74M	+10.87M	ICICI Prudential Asset Management Co. Ltd.	-6.19M	-4.04M
Life Insurance Corporation of India	+9.06M	+5.91M	Mirae Asset Global Investments (India) Pvt. Ltd.	-4.89M	-3.19M
L&T Investment Management Limited	+8.04M	+5.24M	SBI Funds Management Pvt. Ltd.	-3.07M	-2.00M

Source: Reuters, ICICI Direct Research

**Exhibit 13: Shareholding Pattern**

(in %)	Sep-18	Dec-18	Mar-19	Jun-19	Sep-19
Promoter	66.1	61.9	58.8	58.8	55.9
FII	4.9	7.1	7.5	8.9	11.4
DII	19.2	20.8	22.9	21.9	25.0
Others	9.8	10.3	10.8	10.4	7.6

Source: Company, ICICI Direct Research

## Financial summary

Exhibit 14: Profit and loss statement ₹ crore				
(₹ Crore)	FY18	FY19	FY20E	FY21E
Net Sales	10,007	11,789	13,106	15,070
Other operating income	316	295	308	332
Revenue	10,322	12,085	13,414	15,402
% Growth		17.1	11.0	14.8
Other income	200.4	169.5	165.0	155.0
Total Revenue	10,523	12,271	13,414	15,402
% Growth		16.6	9.3	14.8
Total Raw Material Costs	5,515	5,948	7,090	8,259
Employee Expenses	1,772	1,879	2,018	2,185
other expenses	1,035	1,396	1,625	1,884
Total Operating Expenditure	8,323	9,223	10,734	12,327
Operating Profit (EBITDA)	2,000	2,862	2,680	3,074
% Growth		43.1	(6.4)	14.7
Interest	1	12	15	18
PBDT	2,199	3,019	2,830	3,211
Depreciation	251	316	369	414
PBT before Exceptional Items	1,948	2,703	2,461	2,797
Total Tax	549	776	701	800
PAT before MI	1,399	1,927	1,760	1,997
Minority Interest	-	-	-	-
PAT	1,399	1,927	1,760	1,997
% Growth		37.7	(8.7)	13.5
EPS	5.7	7.9	7.2	8.2

Source: Company, ICICI Direct Research

Exhibit 16: Balance sheet ₹ crore				
(₹ Crore)	FY18	FY19	FY20E	FY21E
Equity Capital	243.7	243.7	243.7	243.7
Reserve and Surplus	7,517	8,775	9,652	10,648
Total Shareholders funds	7,761	9,019	9,896	10,891
Other Non Current Liabilities	8.8	4.8	4.8	4.8
Total Debt	36	31	31	31
Total Liabilities	7,838	9,116	9,993	10,988
Gross Block	2,220	2,697	3,448	4,118
Acc: Depreciation	613	613	982	1,396
Net Block	1,607	2,084	2,467	2,723
Capital WIP	835	721	620	600
Total Fixed Assets	2,442	2,806	3,087	3,323
Non Current Assets	1,662	1,814	1,814	1,814
Inventory	4,776	4,455	4,961	5,697
Debtors	5,705	5,600	7,166	8,439
Loans and Advances	27	1,370	1,370	1,370
Other Current Assets	1,531	1,830	966	1,109
Cash	731	829	1,464	1,939
Total Current Assets	14,419	15,844	17,688	20,314
Current Liabilities	2,248	2,474	2,746	3,153
Provisions	1,260	1,380	1,531	1,758
Total Current Liabilities	10,685	11,348	12,596	14,463
Net Current Assets	3,734	4,496	5,092	5,852
Total Assets	7,838	9,116	9,993	10,988

Source: Company, ICICI Direct Research

Exhibit 15: Cash flow statement ₹ crore				
(₹ Crore)	FY18	FY19	FY20E	FY21E
Profit after Tax	1,399	1,927	1,760	1,997
Depreciation	251	316	369	414
Interest	1	12	15	18
Cash Flow before WC changes	1,652	2,256	2,144	2,429
Changes in inventory	129	321	(506)	(735)
Changes in debtors	(1,350)	105	(1,566)	(1,273)
Changes in loans & Advances	53	(1,343)	-	-
Changes in other current asset	(923)	(299)	864	(143)
Net Increase in Current Assets	(3,640)	(1,327)	(1,209)	(2,152)
Changes in creditors	901	226	272	407
Changes in provisions	(40)	119	152	227
Net Inc in Current Liabilities	1,078	663	1,248	1,867
Net CF from Operating activities	(911)	1,592	2,183	2,145
Changes in deferred tax assets	101	(40)	-	-
(Purchase)/Sale of Fixed Asset	(782)	(680)	(650)	(650)
Net CF from Investing activities	(1,010)	(807)	(650)	(650)
Dividend and Dividend Tax	(587)	(997)	(848)	(962)
Net CF from Financing Activities	(1,138)	(686)	(898)	(1,020)
Net Cash flow	(3,059)	98	636	475
Opening Cash/Cash Equivalent	3,790	731	829	1,464
Closing Cash/ Cash Equivalent	731	829	1,464	1,939

\*calculated, Source: Company, ICICI Direct Research

Exhibit 17: Key ratios ₹ crore				
(Year-end March)	FY18	FY19	FY20E	FY21E
EPS	5.7	7.9	7.2	8.2
Cash per Share	3.0	3.4	6.0	8.0
BV	31.9	37.0	40.6	44.7
Dividend per share	2.0	3.4	2.9	3.3
Dividend payout ratio	0.3	0.4	0.4	0.4
EBITDA Margin	19.4	23.7	20.0	20.0
PAT Margin	14.0	16.3	13.4	13.3
RoE	18.0	21.4	17.8	18.3
RoCE	25.0	30.0	24.9	25.8
RoIC	24.7	31.0	27.3	29.6
EV / EBITDA	13.4	9.3	9.7	8.3
P/E	19.7	14.3	15.6	13.8
EV / Net Sales	2.6	2.2	1.9	1.7
Sales / Equity	1.3	1.3	1.4	1.4
Market Cap / Sales	2.7	2.3	2.1	1.8
Price to Book Value	3.5	3.1	2.8	2.5
Asset turnover	1.3	1.3	1.4	1.4
Debtors Turnover Ratio	2.1	2.1	2.1	2.0
Creditors Turnover Ratio	5.7	5.1	5.1	5.2
Debt / Equity	0.0	0.0	0.0	0.0
Current Ratio	3.4	3.4	3.4	3.4
Quick Ratio	2.1	2.3	2.2	2.2

Source: Company, ICICI Direct Research

**Exhibit 18: ICICI Direct coverage universe (Capital Goods)**

Exhibit 10: Total Direct coverage universe (Capex Goods)																
Company	CMP			M Cap	EPS (₹)			P/E (x)			RoCE (%)			RoE (%)		
	(₹)	TP(₹)	Rating	(₹ Cr)	FY19	FY20E	FY21E	FY19	FY20E	FY21E	FY19	FY20E	FY21E	FY19	FY20E	FY21E
L&T (LARTOU)	1440	1,740	Buy	202061	48.1	60.6	64.5	29.7	23.6	22.2	11.8	11.5	12.0	12.7	14.5	14.1
Bhel (BHEL)	56	60	Hold	19569	3.5	3.2	3.8	17.2	19.0	15.7	6.9	6.0	7.0	3.9	3.5	4.2
AIA Engineering (AIAENG)	1703	1,785	Hold	16059	54.4	57.8	63.8	31.2	29.4	26.6	18.8	18.3	18.8	14.6	13.9	13.9
Thermax (THERMA)	1142	1,245	Hold	13608	23.1	32.0	38.5	49.2	35.6	29.7	18.0	16.7	17.9	11.2	12.5	13.5
KEC International (KECIN)	272	345	Buy	7001	19.2	25.0	30.4	15.1	11.6	9.5	24.8	24.5	25.0	20.1	21.7	21.7
Kalpataru Power(KALPOW)	437	600	Buy	6704	26.1	35.4	41.7	17.3	13.2	11.2	19.6	19.1	19.5	12.7	14.4	14.6
Greaves Cotton (GREAVE)	137	145	Buy	3346	6.9	8.0	8.8	17.0	14.8	13.5	27.4	27.7	29.5	18.7	19.1	20.4
Elgi Equipment (ELGEQU)	275	300	Buy	4361	6.1	6.5	7.2	38.1	36.0	32.4	14.3	13.8	15.1	14.1	13.4	13.6
Bharat Electronics (BHAELE)	113	130	Buy	27534	7.9	7.2	8.2	14.3	15.6	13.8	30.0	24.9	25.8	21.4	17.8	18.3
Engineers India (ENGIND)	114	105	Hold	6509	5.9	6.7	7.7	17.6	15.4	13.4	21.3	23.4	23.9	16.3	18.1	19.8
VaTech Wabag (VATWAB)	190	260	Hold	1477	19.2	18.8	23.8	14.2	14.5	11.4	14.6	17.7	20.1	9.5	9.2	10.8
Cochin Shipyard (COCSHI)	407	440	Buy	5,354	36.3	37.0	40.1	9.4	9.2	8.5	18.8	17.0	16.4	14.4	13.7	13.7
SKF (SKFIND)	2164	1,840	Reduce	10699	67.9	65.6	70.9	32.1	33.2	30.8	29.4	22.3	21.3	19.8	16.7	15.9
Timken India (TIMIND)	863	940	Buy	6491	19.8	24.9	28.9	39.9	31.6	27.3	15.7	17.5	17.9	11.1	12.4	12.7
NRB Bearing (NRBBEA)	106	95	Reduce	1026	11.2	3.9	6.4	9.8	27.9	17.1	21.0	9.5	12.3	19.5	7.7	11.4
Grindwell Norton (GRINOR)	610	635	Buy	6753	15.1	16.7	19.3	35.0	31.7	27.5	23.3	23.4	24.7	15.2	15.6	16.5

Source: Company, ICICI Direct Research



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Buy: >15%

Hold: -5% to 15%;

Reduce: -15% to -5%;

Sell: <-15%



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