

Sector: Capital Goods
Result Update

	Change
Reco: Buy	↔
CMP: Rs. 113	
Price Target: Rs. 140	↔

↑ Upgrade ↔ No change ↓ Downgrade

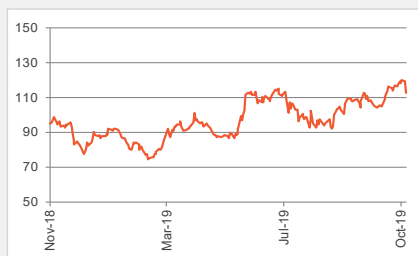
Company details

Market cap:	Rs. 27,412 cr
52-week high/low:	Rs. 122/73
NSE volume: (No of shares)	113.3 lakh
BSE code:	500049
NSE code:	BEL
Sharekhan code:	BEL
Free float: (No of shares)	107.4 cr

Shareholding (%)

Promoters	56
DII	25
FII	11
Others	8

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	13.9	27.6	37.6	30.5
Relative to Sensex	6.3	17.3	31.8	11.9

Sharekhan Research, Bloomberg

Bharat Electronics (BEL) reported weak Q2 as standalone revenue was lower by 18.9% y-o-y to Rs 2,743 crore (below our expectation of Rs 3,447 by 20%) owing to the absence of significant EVM order which was in the base quarter. Input cost pressures coupled with a change in product mix led to significant margin contraction of 541 bps to 19.9% (below our expectation of 22.5%). Tax rate remained at elevated levels of 28.2% similar to Q2FY2019. BEL reported a steep decline in PAT; down by 41% y-o-y owing to lower operating profit coupled with higher depreciation partly offset by increased other income. Order intake received a boost up by 257% q-o-q to Rs 7,088 crore, as the company bagged Akash Missile System (7 Sqdn) order of Rs 5357 crore during the quarter. The total cumulative order book remained robust at Rs 56,178 crore up by 14.7% y-o-y (up by 8.6% on q-o-q basis) and provides a healthy revenue visibility of 4.6x FY2019 revenues. The company expects to bagged a significant order i.e. Coastal Surveillance Systems during the remaining part of FY2020.

Key positives

- ♦ Akash Missile System (7 Sqdn) order boosts order intake to Rs 7,088 crore up by 257.1% q-o-q.
- ♦ The order book remains robust at Rs 56,178 crore and provides healthy revenue visibility.

Key negatives

- ♦ Revenue and PAT witnessed a decline of 19% and 41% y-o-y respectively.
- ♦ Operating margin contracted significantly by 541 bps y-o-y to 19.9%.

Our Call

Valuation: Maintain Buy with PT of Rs 140: We expect revenue and earnings to clock CAGRs of 14.4% and 7.7% (owing to a high base effect led by execution of EVM order in FY2019), respectively during FY2019-2021E. At the CMP, the stock is trading at 13.6x and 12.5x FY2020E and FY2021E earnings. Given a strong order book and expectation of healthy order intake pipeline, we maintain our Buy rating on the stock with a price target (PT) of Rs. 140.

Key Risks

- ♦ Heightened competition, delayed execution of orders and slower pace of fresh order intake might affect revenue growth.
- ♦ Higher raw material prices and increased competitive intensity might put pressure on margins.

Valuation (consolidated)

Particulars	Rs cr				
	FY17	FY18	FY19	FY20E	FY21E
Revenues	8,668	10,401	12,164	13,989	15,912
OPM (%)	20.6	19.6	23.9	21.9	21.2
Adjusted PAT	1,515	1,432	1,886	2,011	2,188
% YoY growth	13.9	(6.0)	31.8	6.6	8.8
Adjusted EPS (Rs.)	6.8	5.9	7.7	8.3	9.0
P/E (x)	16.5	19.1	14.5	13.6	12.5
P/B (x)	3.2	3.4	3.0	2.7	2.4
EV/EBITDA (x)	11.9	14.5	10.2	9.7	8.8
RoNW (%)	17.9	18.2	21.9	20.7	20.2
RoCE (%)	21.0	19.4	21.8	20.5	20.3

Source: Company; Sharekhan Research

Poor show during the quarter: Bharat Electronics standalone revenue was lower by 18.9% y-o-y to Rs 2,743 crore (below our expectation of Rs 3,447 by 20%) owing to absence of significant EVM order which was there in base quarter due to General Assembly Elections in Q1FY2019. Input cost pressures led to gross margin contraction of 533 bps y-o-y to 46.8%. This coupled with higher employee cost up by 462 bps y-o-y to 18.5% of sales, partly offset by lower other operating expense down by 454 bps y-o-y to 8.4% of sales resulted in Operating margin contraction of 541 bps to 19.9% (below our expectation of 22.5%). This led to a significant drop in EBITDA by 36.2% y-o-y to Rs 545 crore. Lower operating profit coupled with higher depreciation (up by 15% y-o-y) was partly offset by higher other income (up by 5% y-o-y). This resulted in steep decline of 40.6% y-o-y in PAT to Rs 339 crore. The company continues to pay taxes at a higher rate of 28.2% (28.1% in Q2FY19 and 29.5% in Q1FY20) and has not opted as of now for lower corporate tax rate of 25.17%.

Key order executed and received during Q2FY2019: During the quarter, the company executed project such as i) Part supply of Long Range Surface to Air Missile System (LRSAM) ii) Intelligence Gathering System iii) Thermal Imager Sights iv) Upgrade of Communication equipment v) Smart City Business vi) Integrated Air Command and Control System v) Radar Systems. However some of these seem to be low value and low margin businesses which impacted the performance during the quarter.

The company had a total order intake of Rs 7,088 crore though up by 257.1% q-o-q but lower by 34.1% y-o-y as it bagged key orders such as i) Akash Missile System (7 Sqdn) ii) Upgrade of EW System iii) Sonar Systems during Q2FY2020.

The total cumulative order book stood at Rs 56,178 crore up by 14.7% y-o-y (up by 8.6% on q-o-q basis) which reflects 4.6x FY2019 revenues, hence provides healthy revenue visibility. The company expects to bag a significant order i.e. Coastal Surveillance Systems in the remaining part of FY2020.

The export contribution in overall revenue and share of overseas orders in overall order book is trivial. However, it witnessed an increase of 76.5% y-o-y to Rs US\$ 7.89 million and 51.7% y-o-y to US\$ 158.5 million respectively during the quarter.

Results					Rs cr	
Particulars	Q2FY20	Q2FY19	YoY %	Q1FY20	QoQ %	
Revenue	2,743	3,381	(18.9)	2,102	30.5	
EBITDA	545	854	(36.2)	348	56.5	
Other Income	15	14	5.5	25	(40.9)	
Depreciation	86	74	15.2	83	3.4	
Interest Expense	1	-	-	0	-	
PBT	473	794	(40.5)	290	62.8	
Tax Expense	133	223	(40.2)	86	55.7	
PAT	339	571	(40.6)	205	65.8	
EPS (Rs)	1.4	2.3	(40.6)	0.8	65.8	
%			YoY (BPS)		QoQ (BPS)	
EBITDA Margin	19.9	25.3	(541)	16.6	330	
PAT Margin	12.4	16.9	(452)	9.7	264	

Source: Company; Sharekhan Research

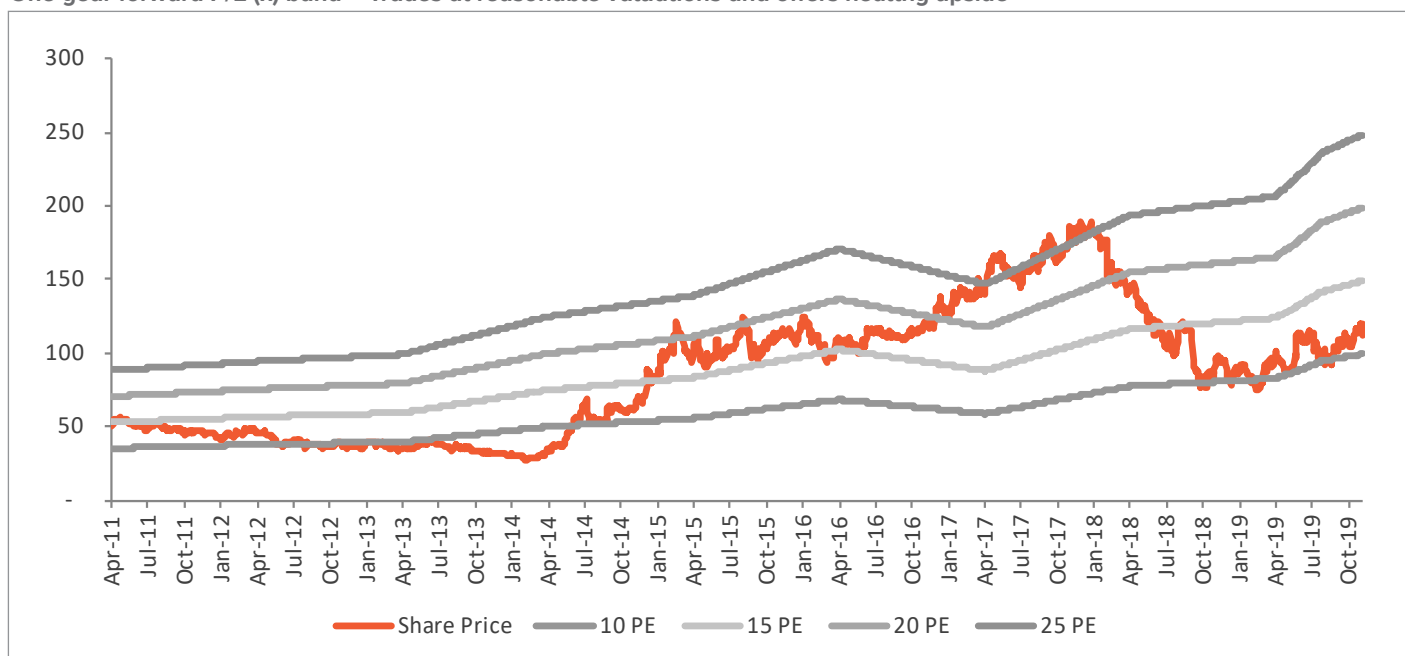
Outlook

Robust order book of Rs. 56,178 crore (4.6x FY19 revenue) provides growth visibility: We believe that the management’s strategy of focusing on project management to eliminate lumpiness in quarterly revenue in a fiscal (Q4 is usually the strongest, while Q1 is the weakest) along with targets to increase services revenue share from 8-10% to 15-20% in the next 3-5 years, to mitigate margin volatility, is reaping benefits gradually. Though Q2FY19 performance has not been encouraging, we believe that the ramp-up in execution will boost performance in H2FY2020. Also the company expects to bag a significant order i.e. Coastal Surveillance Systems during the remaining part of FY2020 apart from the Akash Missile System (7 Sqdn) already bagged in Q2FY2020.

Valuation

Maintain Buy with PT of Rs 140: We expect revenue and earnings to clock CAGRs of 14.4% and 7.7% (owing to high base effect led by execution of EVM order in FY2019), respectively during FY2019-2021E. At CMP, the stock is trading at 13.6x and 12.5x FY2020E and FY2021E earnings. Given strong order book and expectation of healthy order intake pipeline, we maintain our Buy rating on the stock with a price target (PT) of Rs. 140.

One-year forward P/E (x) band – Trades at reasonable valuations and offers healthy upside



Source: Sharekhan Research

About company

Bharat Electronics Limited (BEL) is a PSU having strong manufacturing and R&D capabilities and has robust cost control measures. It manufactures electronics, communication and defence equipment and stands to benefit from enhanced budgetary outlay for strengthening and modernising India's security.

Investment theme

The government's 'Make in India' initiative and rising spends for modernising defence equipment will support earnings growth in the coming years, as BEL is one of the key player with strong research and manufacturing capabilities in the defence space in the country. A robust order book provides strong revenue and earnings visibility. The management is hopeful of bagging certain large orders such as Akash Missile System (7 Sqdn) order during FY2020. BEL remains our preferred pick in the defence sector on account of its strong manufacturing and R&D base, good cost control, growing indigenisation and strong balance sheet with improving return ratios.

Key Risks

- ◆ Heightened competition, delayed execution of orders and slower pace of fresh order intake might affect revenue growth.
- ◆ Higher raw material prices and increased competitive intensity might put pressure on margins.

Additional Data

Key management personnel

Venkateswara Gowtama Mannava	Executive Chairperson
Amit Sahai	Non-Executive - Non Independent Director
Manjula Jillellamudi	Non-Executive - Non Independent Director
Nataraj Krishnappa	Executive Director
Anandi Ramalingam	Executive Director
Mahesh Venkatachaliah	Executive Director
Vinay Kumar Katyal	Executive Director
Shivakumaran Madaiah Kariyanakatte	Executive Director
Koshy Alexander	Executive Director & Chief Financial Officer
S Sreenivas	Company Secretary & Compliance office

Source: Bloomberg

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Republic of India	55.27
2	Reliance Capital Trustee Co Ltd	4.06
3	HDFC Asset Management Co Ltd	3.98
4	Life Insurance Corp of India	3.28
5	CPSE ETF	2.77
6	Aditya Birla Sun Life Trustee Co P	2.75
7	Aditya Birla Sun Life Asset Management	2.07
8	Kotak Mahindra Asset Management Co	2.06
9	ICICI Prudential Asset Management	1.78
10	L&T Mutual Fund Trustee Ltd/India	1.27

Source: Bloomberg

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