Sharekhan
by BNP PARIBAS

Bharat Electronics

Strong performance, beats estimates

Sector: Capital Goods
Result Update

	Change
Reco: **Buy**	↔
CMP: **Rs. 89**	
Price Target: **Rs. 110**	↑

↑ Upgrade ↔ No change ↓ Downgrade

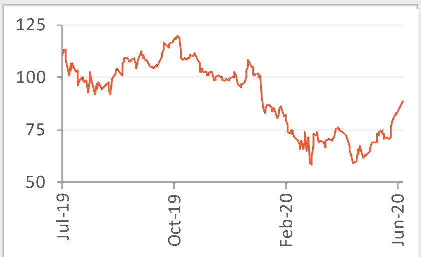
Company details

Market cap:	Rs. 21,613 cr
52-week high/low:	Rs. 122/56
NSE volume: (No of shares)	151.9 lakh
BSE code:	500049
NSE code:	BEL
Sharekhan code:	BEL
Free float: (No of shares)	119.1 cr

Shareholding (%)

Promoters	51
DII	30
FII	11
Others	8

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	28.1	28.5	-11.4	-20.0
Relative to Sensex	18.9	3.2	2.9	-9.3

Sharekhan Research, Bloomberg

Bharat Electronics Limited's (BEL) revenue grew at a robust pace of 49.2% y-o-y to Rs. 5,817 crore,owing to product mix change, healthy execution, and certain backlog of projects being carried over from Q3FY2020 (highest quarterly run rate till now).Strong revenue growth was led by execution of key orders such as i) Part supply of Long Range Surface to Air Missile System, ii) Integrated Air Command and Control System, and iii) Radar Systems and its revenue booking thereof. Input cost pressures led to gross margin contraction of 718 bps y-o-y to 43.2%, however gross profit increased by 27.9% y-o-y to Rs. 2,513 crore owing to healthy revenue increase. Despite higher employee cost, economies of scale resulting in lower other expenses helped EBITDA margin to expand by 112 bps y-o-y to 25.7%, resulting in 56.0% y-o-y growth in EBITDA to Rs. 1,494 crore. Higher operating profit coupled with lower tax incidence of 26.8% as against 32.6% in Q4FY2019 resulted in robust growth of 74.3% y-o-y in PAT to Rs. 1,047 crore (ahead of our expectation of Rs. 782 crore). Order book remained healthy at Rs. 51,970 crore (4xits FY2020 revenue) though largely unchanged, while order intake remained weak at Rs. 13,200 crore (down by 44%) during FY2020 but anticipates some pickup in FY2021E owing to expectation of bagging orders such as i) EW Systems, ii) Avionics Package for Light Combat Aircraft, and iii) Smart City Business. Net working capital cycle improved to 19 days as compared to 31 days in FY2019, while higher capex intensity increased gross debt by Rs. 818 crore and net debt by Rs. 626 crore.

Key positives

- Strong operating performance led to robust growth of 49%/56%/74% in revenue/EBITDA/PAT,respectively.
- Healthy revenue visibility owing to healthy order book of Rs. 51,970 crore (4x FY2020 revenue).

Key negatives

- Gross margin impacted adversely by 718 bps to 43.2%
- Quantum of order intake remains weak in FY2020 and expects to be muted in FY2021E.

Our Call

Valuation: Maintain Buy with a revised PT of Rs 110: We expect revenue and earnings to report CAGR of 6.8% and 3.3%, respectively, during FY2020-FY2022E (expect 180 bps margin contraction) owing to current crisis environment led by COVID-19.At the CMP, the stock is trading at12.8x and 11.9xits FY2021E and FY2022E earnings, respectively. Though order intake is expected to be muted in FY2021E, given the strong order book of Rs. 51,970 crore coupled with cash and cash equivalents of Rs. 1400+ crore, we believe the company trades at reasonable valuations.Hence, weretain our Buy rating on the stock with a revised price target (PT) of Rs. 110.

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) Rs cr

Particulars	FY18	FY19	FY20	FY21E	FY22E
Revenue	10,401	12,164	12,968	13,438	14,614
OPM (%)	19.6	23.9	21.2	18.8	18.5
Adjusted PAT	1,432	1,886	1,824	1,691	1,818
% YoY growth	(6.0)	31.8	(3.3)	(7.3)	7.5
Adjusted EPS (Rs.)	5.9	7.7	7.5	6.9	7.5
P/E (x)	15.1	11.5	11.9	12.8	11.9
P/B (x)	2.7	2.3	2.1	2.0	1.8
EV/EBITDA (x)	11.6	8.2	9.0	9.8	9.4
RoNW (%)	18.2	21.9	18.9	16.1	15.9
RoCE (%)	19.4	21.8	18.0	14.3	13.9

Source: Company; Sharekhan estimates

Robust performance in Q4FY2020; beats estimates: BEL's revenue grew at a robust pace of 49.2% y-o-y to Rs. 5,817 crore (ahead of our expectation of Rs. 5,377 crore) owing to healthy execution and certain backlog of projects being carried over from Q3FY2020. Input cost pressures led to gross margin contraction of 718 bps y-o-y to 43.2%; however, gross profit increased by 27.9% y-o-y to Rs. 2,513 crore owing to healthy revenue increase. Despite higher employee cost (up 30%y-o-y), economies of scale led to lower other expense (down 22%) and helped EBITDA margin to expand by 112 bps y-o-y to 25.7% (beating our expectation of 21.9%), resulting in 56.0% y-o-y growth in EBITDA to Rs. 1,494 crore. Higher operating profit coupled with lower tax incidence of 26.8% as against 32.6% in Q4FY2019 resulted in robust growth of 74.3% y-o-y in PAT to Rs. 1,047 crore (ahead of our expectation of Rs. 782 crore).

Order book remains healthy despite slower order intake in FY2020: During FY2020, the company received major orders such as i) Akash Missile System (7 Sqdn), ii) Coastal Surveillance System - Phase II, iii) Upgrade of EW System, iv) Annual Maintenance Contracts, v) Software Defined Radios, and vi) Smart City Business. Hence, total order intake during FY2020 stood at Rs. 13,200 crore. The major orders executed and supplied by the company during FY20202 were i) Part supply of Long-Range Surface to Air Missile System, ii) Smart City and Homeland Security Business, iii) Integrated Air Command and Control System, iv) Radar Systems, and v) Thermal Imaging Cameras. Accordingly, the company registered total turnover of Rs. 12,608 crore during FY2020, wherein export turnover stood at US$48.59 million. The company's order book as on April 1, 2020, stood at Rs. 51,970 crore and management anticipates key orders such as i) EW Systems, ii)Avionics Package for Light Combat Aircraft, iii) Smart City Business, and iv) Spares/Services to be bagged by the company during FY2021. The company during the year also received order inflow of Rs. 1,200 crore in respect of providing ventilators, which is considered to be an additional source of revenue during FY2021E.

Higher capex intensity increases debt, while net working capital cycle improves: The company's net working cycle improved to 19 days in FY2020 as compared to 31 days in FY2019. Cash flow from operations stood at Rs. 1,166 crore during the year almost similar to FY2019 level, however free cashflow generation during FY2020 stood at Rs. 168 crore as compared to Rs. 429 crore owing to higher capex intensity and increased investments. Gross debt stood at Rs. 3,338 crore, an increase of Rs. 818 crore, while net debt stood at Rs. 1,882 crore, anincrease of Rs. 626 crore. Cash and cash equivalents increased by Rs. 192 crore to Rs. 1,457 crore at the end of FY2020.

Focus on sustainable growth plans: The company has been continuously focusing on sustainable growth plans;and in this regards, the company has taken various initiatives such as i) focus on enhancing the R&D capability to introduce futuristic products to bag new businesses, ii) enhance manufacturing capabilities through timely modernisation and expansion of facilities, iii) enter into joint ventures in existing and emerging businesses to enhance business visibility, thereby providing impetus on Make in India initiative, and iv) focus on increasing defense exports to enhance foreign exchange earnings.

Results Rs cr

Particulars	Q4FY20	Q4FY19	YoY (%)	Q3FY20	QoQ (%)
Revenue	5,817	3,899	49.2	2,278	155.3
EBITDA	1,494	958	56.0	357	318.8
Other Income	29	36	(20.0)	33	(14.2)
Depreciation	101	99	1.2	92	9.7
Interest Expense	2	11	(83.1)	0	1,508.3
PBT	1,420	883	60.9	298	376.1
Tax Expense	381	288	32.3	86	344.6
PAT	1,047	601	74.3	223	370.1
EPS (Rs.)	4.3	2.5	74.3	0.9	370.1
%			YoY (BPS)		QoQ (BPS)
EBITDA Margin (%)	25.7	24.6	112	15.7	1,003
PAT Margin (%)	18.0	15.4	259	9.8	822

Source: Company; Sharekhan Research

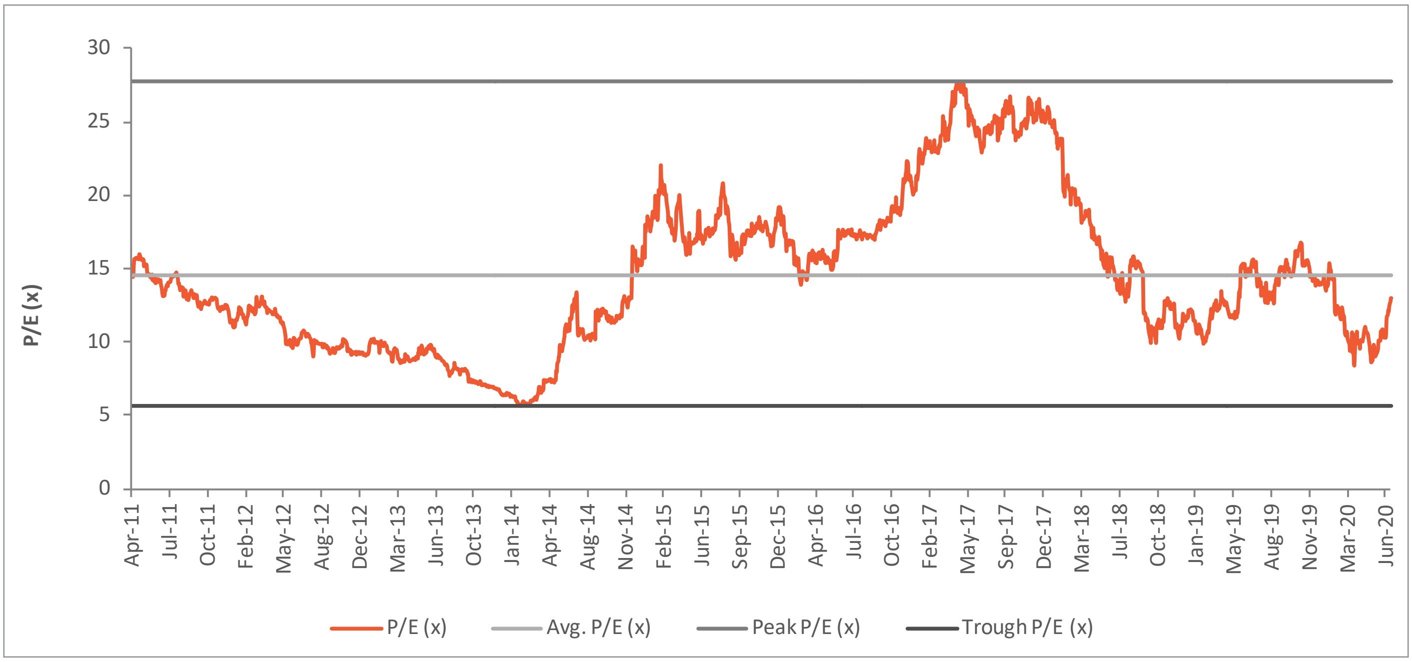
Outlook

Robust order book of Rs. 51,970 crore (4x FY2020 revenue) provides growth visibility: We believe 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% overthe next 3-5 years, to mitigate margin volatility, should reap benefits gradually. Management also stated that the government through the 'Make in India' initiative wants to enhance the manufacturing value-added products, which fetches higher margins rather than relying much on outsourcing play, which has lower margin profile.Management expects 10% revenue growth (including ventilators) and margins to be in 20-21% range for FY2021E.Order intake is expected to be muted in FY2021E, considering the ongoing situation led by COVID-19, however it is expected to improve in FY2022E owing to strong focus on increasing defence manufacturing in India and providing a boost to defence exports.

Valuation

Maintain Buy with a revised PT of Rs. 110: We expect revenue and earnings to report CAGR of 6.8% and 3.3%, respectively, during FY2020-FY2022E (expect 180 bps margin contraction) owing to current crisis environment led by COVID-19.At the CMP, the stock is trading at12.8x and 11.9xits FY2021E and FY2022E earnings, respectively. Though the order intake is expected to be muted in FY2021E, given the strong order book of Rs. 51,970 crore coupled with cash andcash equivalents of Rs. 1,400+ crore, we believe the company trades at reasonable valuations. Hence, we retain our Buy rating on the stock with a revised PT of Rs. 110.

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



Source: Sharekhan Research

About company

BEL is a PSU having strong manufacturing and R&D capabilities and has robust cost-control measures. The company 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 players with strong research and manufacturing capabilities in the defence space in the country. A robust order bookprovides strong revenue and earnings visibility. 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
Shikha Gupta	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: Company Website

Top shareholders

Sr. No.	Holder Name	Holding (%)
1	CPSE ETF	4.89
2	HDFC Midcap Opportunities Fund	4.86
3	Kotak Standard Multicap Fund	3.27
4	Mirae Asset Large Cap Fund	3.26
5	Aditya Birla SunLife Frontline Equity Fund	2.26
6	Bharat 22 ETF	1.82
7	SBI Blue Chip Fund	1.45
8	Life Insurance Corporation of India	2.36

Source: Bloomberg

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