

Sector: Capital Goods

Result Update

	Change
Reco: Buy	↔
CMP: Rs. 97	
Price Target: Rs. 110	↔
↑ Upgrade ↔ No change ↓ Downgrade	

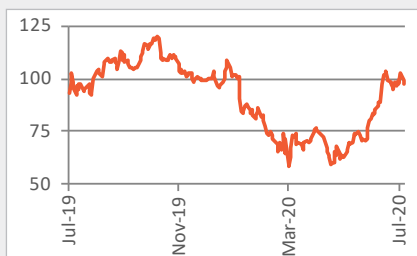
Company details

Market cap:	Rs. 23,672 cr
52-week high/low:	Rs. 122/56
NSE volume: (No of shares)	166.7 lakh
BSE code:	500049
NSE code:	BEL
Sharekhan code:	BEL
Free float: (No of shares)	119.1 cr

Shareholding (%)

Promoters	51
FII	32
DII	8
Others	9

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	14	33	-3	5
Relative to Sensex	4	15	3	2

Sharekhan Research, Bloomberg

Bharat Electronics reported a decline of 21.1% y-o-y decline in revenues at Rs 1676 crores (8.7% below our expectation of Rs 1836 crore). This, we believe is owing to lower execution led by COVID-19 crisis despite having major supplies undertaken during the quarter such as i) Ventilators, ii) Part supply of Long Range Surface to Air Missile System, iii) Spares & Services (various projects), iv) Smart City Business, v) Intelligence Gathering System, vi) Thermal Imaging Cameras, vii) Radars Repairs. Ease in input cost pressures and a product mix change led to gross margin expansion of 91 bps y-o-y to 50.9%. However, adverse operating leverage resulted in 800 bps y-o-y contraction in EBITDA margin at 8.7% (222 bps higher than our estimate of 6.5%). Employee expenses increased by 584 bps y-o-y to 30.8% of sales and other expense increased by 297 bps y-o-y to 11.3% of sales. PAT witnessed a substantial decline of 74.5% y-o-y to Rs 54 crore owing to lower operating profit coupled with lower other income and higher depreciation. The order book position stood at Rs 53752 crore as on 1st July 2020 a marginal increase of 3.9% y-o-y and 3.4% qoq. During the quarter, the company bagged orders worth Rs 3,419 crores which is an increase of 72.2% y-o-y and 19.3% q-o-q. The key orders received during the quarter were i) Ventilators, ii) Advance Torpedo Defence Systems and iii) Smart City Projects. The company expects to clinch key orders such as i) Electronics Warfare Systems, ii) Avionics Package for Light Combat Aircraft, iii) Naval Fire Control System and iv) Radar Systems in FY2021E. Also, the MOU signed with the Airport Authority of India to tap emerging business opportunities in the global civilian airport business will open up new opportunities for the company.

Key positives

- Order intake up by 72.2% y-o-y and 19.3% q-o-q to Rs 3,419 crores.
- Order book remains healthy at Rs. 53,752 crore and provides revenue visibility.

Key negatives

- COVID-19 led crisis leads to lower execution.
- Performance adversely impacted as revenue, EBITDA and PAT being lower by 21%/59%/75% y-o-y.

Our Call

Valuation: Maintain Buy with 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 CMP, the stock is trading at 14.0x and 13.0xits FY2021E and FY2022E earnings, respectively. Given the strong order book of Rs. 53,752 crore which provides healthy revenue visibility, we expect execution pace to pickup in coming months as the COVID-19 crisis eases further. Hence, we retain our Buy rating on the stock with 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 Particulars	Rs cr				
	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)	16.5	12.5	13.0	14.0	13.0
P/B (x)	3.0	2.6	2.4	2.2	2.0
EV/EBITDA (x)	12.6	8.9	9.7	10.6	10.2
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 Research

COVID-19 crisis leads to poor show: Bharat Electronics reported a 21.1% y-o-y decline in revenues at Rs 1676 crores (8.7% below our expectation of Rs 1836 crore). This we believe is owing to lower execution led by COVID-19 crisis despite having major supplies undertaken during the quarter such as i) Ventilators, ii) Part supply of Long Range Surface to Air Missile System, iii) Spares & Services (various projects), iv) Smart City Business, v) Intelligence Gathering System, vi) Thermal Imaging Cameras, vii) Radars Repairs. Ease in input cost pressures and product mix change led to gross margin expansion of 91 bps y-o-y to 50.9%. However, adverse operating leverage resulted in 800 bps y-o-y contraction in EBITDA margin at 8.7% (222 bps higher than our estimate of 6.5%). Employee expense increased by 584 bps y-o-y to 30.8% of sales and other expense increased by 297 bps y-o-y to 11.3% of sales. PAT witnessed a substantial decline of 74.5% y-o-y to Rs 54 crore largely owing to lower operating profit coupled with lower other income and higher depreciation.

Order book remains healthy while order intake improves and likely to continue: The order book position stood at Rs 53752 crore as on 1st July 2020 a marginal increase of 3.9% y-o-y and 3.4% q-o-q. During the quarter, the company bagged orders worth Rs 3,419 crores which is an increase of 72.2% y-o-y and 19.3% q-o-q. The key orders received during the quarter were i) Ventilators, ii) Advance Torpedo Defence Systems and iii) Smart City Projects. The company expects to clinch key orders such as i) Electronics Warfare Systems, ii) Avionics Package for Light Combat Aircraft, iii) Naval Fire Control System and iv) Radar Systems in the remaining part of the year FY2021E.

Continues to focus on sustainable growth plans: The company has been continuously focusing on sustainable growth plans; and in this regard, 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	Q1FY21	Q1FY20	YoY(%)	Q4FY20	QoQ(%)
Revenue	1,676	2,125	(21.1)	5,817	(71.2)
EBITDA	146	355	(58.9)	1,494	(90.2)
Other Income	16	26	(36.2)	29	(42.5)
Depreciation	94	88	6.4	101	(6.5)
Interest Expense	0	0	(78.1)	2	(96.4)
PBT	68	292	(76.6)	1,420	(95.2)
Tax Expense	21	86	(75.7)	381	(94.5)
PAT	54	211	(74.5)	1,047	(94.9)
EPS (Rs)	0.2	0.9	(74.5)	4.3	(94.9)
%			bps		bps
EBITDA Margin	8.7	16.7	(800)	25.7	(1,697)
PAT Margin	3.2	9.9	(671)	18.0	(1,478)

Source: Company; Sharekhan Research

Outlook

Robust order book of Rs. 53,752 crore (4.2x FY2020 revenue) provides growth visibility: The government thrust and strong focus on increasing defence manufacturing in India and providing a boost to defence exports augurs well for the company. The management also stated that the government through the 'Make in India' initiative wants to enhance the manufacturing of value-added products in defence sector, which fetches higher margins rather than relying much on outsourcing play, which has a lower margin profile. The 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 management expects to bag certain key orders like i) Electronics Warfare Systems, ii) Avionics Package for Light Combat Aircraft, iii) Naval Fire Control System and iv) Radar Systems during the remaining part of the year FY2021E. Also the MOU signed with the Airport Authority of India to tap emerging business opportunities in the global civilian airport business will open up new opportunities for the company.

Valuation

Maintain Buy with 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 CMP, the stock is trading at 14.0x and 13.0x its FY2021E and FY2022E earnings, respectively. Given the strong order book of Rs. 53752 crore which provides healthy revenue visibility, we expect the execution pace to pickup in coming months as the COVID-19 crisis eases further. Hence, we retain our Buy rating on the stock with price target (PT) of Rs. 110.

One-year forward P/E (x) band



Source: Sharekhan Research

About company

BEL is a PSU with strong manufacturing and R&D capabilities and 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 book provides 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	HDFC Midcap Opportunities Fund	5.61
2	CPSE ETF	4.85
3	Kotak Standard Multicap Fund	3.38
4	Life Insurance Corporation of India	3.32
5	Mirae Asset Large Cap Fund	3.30
6	SBI Equity Hybrid Fund	2.32
7	Bharat 22 ETF	1.53
8	Aditya Birla SunLife Frontline Equity Fund	1.25
9	HDFC Midcap Opportunities Fund	5.61

Source: Bloomberg

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Compliance Officer: Mr. Joby John Meledan; Tel: 022-61150000; email id: compliance@sharekhan.com;

For any queries or grievances kindly email igc@sharekhan.com or contact: myaccount@sharekhan.com

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