

Bharat Electronics (BEL) | Defence*Gem in the defense pack!***LKP****Quarterly results surprised us on positive side**

BEL reported earnings which were better than our expectations at ₹541 mn, against our expectations of a loss. Revenues de-grew by 19.7%/71.4% yoy/qoq to ₹16.4 bn, which were above our expectations as the company executed the ventilators order of ₹4 bn in the quarter. Ex-ventilators, the revenues dropped by 40% yoy. LRSAM, Smart City business, Intelligence Gathering Systems, Thermal Imaging Cameras and Radar repairs were the other revenue contributors in Q1. Reduction in RM to sales at 49.3% led to gross margin expansion at 50.7%. EBITDA margins came in at 8.8% which were down by 780 bps yoy, but were still better than our expectations of operational loss, on gross margin beat. PAT as a result of this came in at ₹541 mn, which was better than street's estimate. In Q1, the company delivered 10,000 ventilators for ₹4bn, while has an order of 20,000 ventilators @ ₹8bn to be supplied in Q2. In Q1, the company's order book was increased by ₹34 bn (72% up yoy), which took the total order book up to ₹538 bn (4.2x FY20 sales).

Order inflow remains strong despite pandemic, order book remains buoyant!

Order inflow during the quarter stood at ₹34.2 bn (+72% YoY), which included ₹12 bn Ventilator order, ₹8 bn Mareech-torpedo decoy system and ₹5 bn of smart city projects. BEL recorded an order inflow of ₹132 bn during FY20 which included the marquee Akash Missiles order worth ₹53.57 bn bagged during Q2 FY20. The company expects execution to commence during fag end of FY21, which would be in addition to the execution of LRSAM order. Along with the expectation of QRSAM/MRSAM orders to flow in over FY21/22 coupled with base orders and incremental orders from ventilator business, order inflow outlook remains sanguine. We are factoring in an order inflow of ₹140bn during FY21 driven by Electronics Warfare Systems, Avionics for LCA, Naval Fire Control system and Radar systems. Order backlog at the end of Q1 FY21 stands at ₹538bn (+4% YoY, 4.2x FY20 revenues) provides revenue visibility of more than 4 years.

Management expects FY21 sales to grow 4%-6% yoy on execution of the ventilator order. This would imply flat to slight decline in like to like sales (ex-ventilator). Issues surrounding disruption in supply chain have largely been resolved. Major orders that will contribute to sales in FY 21 are LRSAM, IACCS, Akash missiles and Homeland security/Smart city. Ventilator order surprised one and all, as it's gross margins are similar to the core business at 49-50% and factoring 15% employee costs and 15% of revenues transfer of technology fees to OEMs, the EBITDA margins are at 15%, higher than expected.

Recent draft by the GOI for an emphasis on 'Make By India' will augur well for BEL

The recently published draft Defence Production and Export Promotion Policy, 2020 suggests a more bottom-up framework to empower system integrators (Defense PSUs) achieve greater scale by expanding role of the private sector, especially MSMEs. Key objectives of the draft include: a) achieving INR1.75tn turnover including ₹350bn exports; b) cutting defence imports; c) entry in the global defence exports value chain, among others. In our view, apart from setting a higher capex spend framework (15% minimum increase over five years), the draft covers a comprehensive

Rating	Buy
Current Market Price (₹)	114
12 M Price Target (₹)	132
Potential upside (%)	16

Stock Data

FV (₹)	1
Market Cap Full (₹ bn)	279
Market Cap Free Float (₹ bn)	125
52-Week High / Low (₹)	122 / 56
BSE Code / NSE Symbol	500049 / BEL
Bloomberg	BHE IN

What's Changed

12 month Price Target (₹)	From 132 to 132
FY21E EPS (₹)	From 5.4 to 7.3
FY22E EPS (₹)	From 9.4 to 9.4

Price Performance (%)

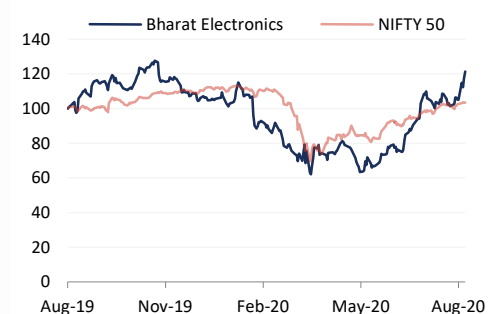
(%)	1M	3M	6M	1YR
BEL	16%	80%	34%	21%
Nifty 50	5%	24%	-7%	3%

* To date / current date : August 13, 2020

Shareholding Pattern (%)

	Jun-20	Mar-20	Dec-19	Sep-19
Promoter (GOI)	51.14	51.14	55.27	55.93
FPIs	7.86	10.71	12.20	11.43
MFs	25.65	25.11	19.69	19.24
FI's / Banks	0.36	0.37	0.37	0.37
Insurance	6.20	4.73	5.22	5.42
Others	8.79	7.94	7.25	7.61

Source: BSE

BEL vs Nifty 50

YE Mar	FY 19	FY 20	FY 21E	FY 22E
Total Sales (₹ bn)	120.8	129.2	137.6	155.0
EBITDA Margins (%)	23.7%	21.1%	19.0%	21.0%
PAT Margins (%)	15.9%	13.9%	12.7%	14.5%
EPS (₹)	8.0	7.5	7.3	9.4
P/E (x)	14.2	15.2	15.6	12.2
P/BV (x)	3.0	2.8	2.5	2.3
EV/EBITDA (x)	9.3	9.4	10.0	7.8
ROE (%)	21.4%	18.2%	16.3%	18.9%
ROCE (%)	25.4%	21.4%	18.6%	21.9%
Dividend yield (%)	2.0	3.6	3.2	4.1

range of conventional bottlenecks (testing infrastructure, local outsourcing by PSUs, liquidity for vendors, etc) and also raises expectations from local manufacturers—PSU and private—on capability/efficiency front. Even as we await the draft's fine print, we believe its success, to a great extent, will hinge on scale up by the private sector. We envisage strong structural opportunities for efficient/scalable system integrators like BEL with a robust tier II/sub-systems vendor base. Additionally, GOI also recently cleared proposal to develop several defense projects worth ₹311 bn to be procured from Indian defense industry. This will further aid BEL's prospects.

Quarterly Financial Snapshot

All fig in ₹ mn	Q1 FY21	Q4 FY20	% qoq	Q1 FY20	% yoy
Total net sales	16,706	58,058	-71.2%	21,015	-20.5%
RM cost	8,234	33,130	-75.1%	10,565	-22.1%
Employee cost	5,117	5,747	-11.0%	5,242	-2.4%
Other expenses	1,888	4,356	-56.7%	1,728	9.3%
EBITDA	1,468	14,826	-90.1%	3,481	-57.8%
EBITDA Margins %	8.8%	25.5%	(1670 bps)	16.6%	(780 bps)
Other income	184	283	-35.0%	254	-27.7%
Depreciation	888	950	-6.6%	828	7.2%
Interest	0.7	16.1	-95.7%	3.2	-78.1%
PBT	763	14,142	-94.6%	2,904	-73.7%
Tax	221	3,797	-94.2%	857	-74.2%
PAT	542	10,345	-94.8%	2,047	-73.5%
PAT margins %	3.2%	17.8%	-81.8%	9.7%	-66.7%
Exceptional items	-	-	N/A	-	N/A
Adjusted PAT	5,117	5,747	-11.0%	5,242	-2.4%
APAT margins %	-2.4%	30.0%	-107.9%	10.9%	-121.9%

Outlook and Valuation

Q1 reported better than expected numbers on the back of a surprise element coming from ventilator margins. It was a major concern from investors' side, which got well addressed in the quarter. In addition, BEL managed its NWC despite a weak operating environment. We raise our FY21 estimates as we incorporate higher margins for the ventilator project and keep our FY22E estimates unchanged as the ventilator order delivery will be done in Q2 FY21. We continue to build in elevated Net Working Capital (NWC) intensity in FY21-22, ~31% of sales, but believe strongly that BEL will not take on debt to fund its working capital. Also, we believe that despite wafer thin earnings in Q1 (v/s street's expectations of loss), numbers will keep on increasing sequentially and just like FY20, BEL's financial performance should be back-ended in FY21 as well.

Current valuations assume the negative impact of Covid on defence spending in FY21 but do not price in any major order inflows as an offshoot from the recent geopolitical issues. The government's revived stand on domestic procurement of defense equipments will however have its share of positivity on the stock price. The stock currently looks quite undervalued as it trades at 12.2x P/E FY22E, materially lower than its long term average of 16x. This is after demonstrating its ability to secure orders, ramp up of execution, maintain margins of 19-20% after accounting for 8% of R&D expenses, manage cash flows despite poor finances of the government and achieve ROE's of close to ~18% in the past three years. We maintain BUY rating on the stock and target price of ₹132, based on 14x P/E FY22E. We believe BEL's diversified product portfolio and strong opportunity pipeline will keep it ahead of its peers.

Consolidated Financial

Income Statement

YE Mar (₹ mn)	FY 19	FY 20	FY 21E	FY 22E
Total Revenues	120,846	129,211	137,600	155,000
Raw Material Cost	59,477	71,052	75,680	82,150
Employee Cost	18,791	20,575	23,392	25,575
Other Exp	13,957	10,283	12,384	14,725
EBITDA	28,621	27,301	26,144	32,550
EBITDA Margin(%)	23.7%	21.1%	19.0%	21.0%
Depreciation	3,162	3,496	3,848	3,803
EBIT	25,459	23,805	22,296	28,747
EBIT Margin(%)	21.1%	18.4%	16.2%	18.5%
Other Income	1,695	1,019	1,000	1,200
Interest	122	33	20	15
PBT	27,032	24,792	23,276	29,932
PBT Margin(%)	22.4%	19.2%	16.9%	19.3%
Tax	7,759	6,853	5,819	7,483
Adjusted PAT	19,273	17,938	17,457	22,449
APAT Margins (%)	15.9%	13.9%	12.7%	14.5%
Exceptional items	0	0	0	0
PAT	19,273	17,938	17,457	22,449
PAT Margins (%)	15.9%	13.9%	12.7%	14.5%

Key Ratios

YE Mar	FY 19	FY 20	FY 21E	FY 22E
Per Share Data (₹)				
Adj. EPS	8.0	7.5	7.3	9.4
CEPS	9.4	8.9	8.9	11.0
BVPS	37.7	41.1	44.8	49.5
DPS	2.3	4.1	3.6	4.7
Growth Ratios(%)				
Total revenues	17.1%	6.9%	6.5%	12.6%
EBITDA	23.7%	21.1%	19.0%	21.0%
EBIT	70.2%	-6.5%	-6.3%	28.9%
PAT	37.7%	-6.9%	-2.7%	28.6%
Valuation Ratios (X)				
PE	14.2	15.2	15.6	12.2
P/CEPS	12.2	12.7	12.8	10.4
P/BV	3.0	2.8	2.5	2.3
EV/Sales	2.2	2.0	1.9	1.6
EV/EBITDA	9.3	9.4	10.0	7.8
Operating Ratios (Days)				
Inventory days	133.3	110.5	112.0	107.0
Receivable Days	162.2	190.2	190.0	170.0
Payables day	74.6	92.0	90.0	85.0
Net Debt/Equity (x)	0.00	0.00	0.00	0.00
Profitability Ratios (%)				
ROCE	25.4%	21.4%	18.6%	21.9%
ROE	21.4%	18.2%	16.3%	18.9%
Dividend payout ratio (%)	28.3%	54.6%	50.0%	50.0%
Dividend yield(%)	2.0	3.6	3.2	4.1

Source: Company, LKP Research

Balance Sheet

YE Mar (₹ mn)	FY 19	FY 20	FY 21E	FY 22E
Equity and Liabilities				
Equity Share Capital	2,437	2,437	2,437	2,437
Reserves & Surplus	87,753	96,093	104,822	116,046
Total Network	90,189	98,530	107,258	118,483
Total debt	0	0	0	0
Long term provisions	9,214	11,606	11,606	11,606
Deferred tax assets/liabilities	616	689	689	689
Other long term liabilities	353	507	506	507
Current Liab & Prov				
Trade payables	24,713	32,567	33,929	36,096
Short term prov+ borrowings	4,606	3,196	3,196	3,196
Other current liabilities	74,942	92,018	89,018	93,018
Total current liab and provs	104,262	127,780	126,142	132,309
Total Equity & Liabilities	204,634	239,111	246,201	263,593
Assets				
Net block	20,598	24,966	26,119	28,316
Capital WIP	2,751	1,994	2,094	3,094
Intangible assets under devt	4,708	5,064	5,064	5,064
Non current investments	10,875	12,233	12,233	12,233
Long term loans and advances	5,124	5,500	5,500	5,500
Other non current assets	2,555	3,408	3,408	3,408
Total fixed assets	46,609	53,165	54,418	57,615
Cash and cash equivalents(i)	7,219	15,577	11,496	20,660
Bank deposits other than (i)	1,621	1,606	1,606	1,606
Inventories	44,137	39,102	42,222	45,438
Trade receivables	53,692	67,329	71,627	72,192
Other current assets	29,845	33,573	36,073	37,323
Short term loans and advances	21,511	28,759	28,759	28,759
Total current Assets	158,025	185,946	191,784	205,978
Total Assets	204,634	239,111	246,201	263,593

Cash Flow

YE Mar (₹ mn)	FY 19	FY 20	FY 21E	FY 22E
PBT	27,032	24,792	23,276	29,932
Depreciation	3,162	3,496	3,848	3,803
Interest	122	30	20	15
Chng in working capital	(7,797)	3,008	(11,541)	1,137
Tax paid	(7,669)	(5,684)	(5,819)	(7,483)
Other operating activities	(575)	(317)	0	0
Cash flow from operations (a)	14,659	25,324	9,768	27,404
Capital expenditure	(7,057)	(7,272)	(5,100)	(7,000)
Chng in investments	(1,014)	(1,140)	0	0
Other investing activities	(467)	2,023	0	0
Cash flow from investing (b)	(8,538)	(6,389)	(5,100)	(7,000)
Free cash flow (a+b)	6,122	18,935	4,668	20,404
Inc/dec in borrowings	(333)	(250)	0	0
Dividend paid (incl. tax)	(5,463)	(9,793)	(8,729)	(11,225)
Interest paid	(122)	(30)	(20)	(15)
Other financing activities	(367)	(520)	0	0
Cash flow from financing (c)	(6,285)	(10,593)	(8,733)	(11,240)
Net chng in cash (a+b+c)	(163)	8,342	(4,065)	9,164
Closing cash & cash equivalents	7,219	15,561	11,496	20,660

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