

Sector: Capital Goods
Company Update

	Change
Reco: Buy	↔
CMP: Rs. 112	
Price Target: Rs. 135	↑
↑ Upgrade ↔ No change ↓ Downgrade	

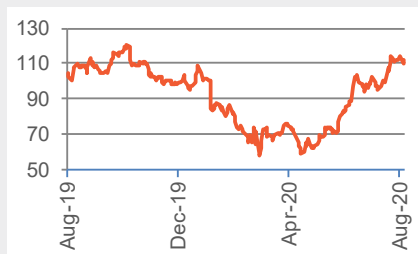
Company details

Market cap:	Rs. 27,302 cr
52-week high/low:	Rs. 122/56
NSE volume: (No of shares)	173.2 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	15	62	51	7
Relative to Sensex	13	40	48	1

Sharekhan Research, Bloomberg

Bharat Electronics Limited (BEL), a leading player in the domestic defence space, is expected to be the key beneficiary given the government's increasing thrust on Aatmanirbhar Bharat initiative in the defence sector. There is increasing emphasis on indigenisation in the defence sector to make the country self-reliant in defence production. Further, the government's recent series of reform measures such as import ban of 101 military items (to be implemented between 2020 and 2024), development of two defence corridors, and 74% FDI under the automatic route would open up future growth avenues, aligned to the government's 'Make In India' initiative. Hence, defence contracts worth Rs. 4 lakh crore are expected to be awarded in the next 6-7 years. Large projects are being implemented under the strategic partnership model under which firms are being roped in to build submarines (is expected to start this year) and fighter jets in India in partnership with original equipment makers. BEL has launched fully indigenised Maarech integration facility for manufacturing, integration, and testing of Anti-Torpedo Defence System Maarech. With healthy order book position of Rs. 53,752 crore (as on July 1, 2020), BEL expects to clinch major 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. The MOU between BEL and the Airport Authority of India is expected to help BEL to foray into the domestic as well as the Southeast Asian, African, and Latin American civil aviation markets. We believe the company's continued focus on enhancing its R&D capability would enhance its capabilities to participate in new business opportunities in the defence space.

Our Call

Valuation: Major beneficiary, limited competition: We expect BEL to deliver strong performance in the coming years given its robust order book, major beneficiary from increasing emphasis on indigenisation, and limited competition. 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. We have introduced FY2023E numbers in this note. At the CMP, the stock is trading at a reasonable valuation of 16.1x/15.0x/13.4x its FY2021E/FY2022E/FY2023E earnings, respectively. With improving growth visibility, we retain our Buy rating on the stock with a revised price target (PT) of Rs. 135.

Key Risks

- ◆ Heightened competition, delayed order execution, 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				
	FY19	FY20	FY21E	FY22E	FY23E
Revenue	12,164	12,968	13,438	14,614	16,258
OPM (%)	23.9	21.2	18.8	18.5	18.5
Adjusted PAT	1,886	1,824	1,691	1,818	2,044
% YoY growth	31.8	(3.3)	(7.3)	7.5	12.4
Adjusted EPS (Rs.)	7.7	7.5	6.9	7.5	8.4
P/E (x)	14.5	15.0	16.1	15.0	13.4
P/B (x)	3.0	2.7	2.5	2.3	2.1
EV/EBITDA (x)	10.2	11.0	12.1	11.5	10.4
RoNW (%)	21.9	18.9	16.1	15.9	16.3
RoCE (%)	21.8	18.0	14.3	13.9	14.2

Source: Company; Sharekhan estimates

Aatmanirbhar Bharat initiative to boost defence manufacturing in India: The government is emphasising on creating an environment so as to boost the Aatmanirbhar Bharat programme in the defence sector and create a level playing field for private players including MSME. The first step in the direction was introducing an import embargo list 1 comprising 101 military items (to be progressively implemented between 2020 and 2024). The embargo list not only comprises simple parts but also includes high-technology weapon systems such as artillery guns, assault rifles, corvettes, sonar systems, transport aircraft, light combat helicopters (LCHs), radars etc. The government is also considering release of a second negative list consisting of advanced technology items by next year, and intends to put the aerospace industry on the negative list on a priority basis. To open up the defence sector further, the government is also planning to corporatise Ordnance Factory Boards shortly. Completion of the defence project takes longer time than envisaged earlier and, hence, the government is planning to incorporate a cost escalation clause and provide incentives to vendors based on enhanced productivity and performance.

Order inflows expected to rise as budgetary allocation for defence enhanced: The Ministry of Defence (MoD) has also bifurcated the capital item procurement budget for FY2020-FY2021 between domestic and foreign capital item procurement, wherein a separate budget head has been created with an outlay of ~Rs. 52,000 crore for domestic capital item procurement. The amount is expected to be increased by 15% every year. Contracts worth Rs. 3.5 lakh crore were awarded during the past five years and it is expected that contracts worth Rs. 4 lakh crore will be placed in the next 6-7 years with domestic manufacturers. Of the 4 lakh crore orders, it is expected that contribution from army and air force will be Rs. 1.3 lakh crore each, while navy will contribute Rs. 1.4 lakh crore. However, projects having contract value below Rs. 100 crore are being reserved for the MSME sector.

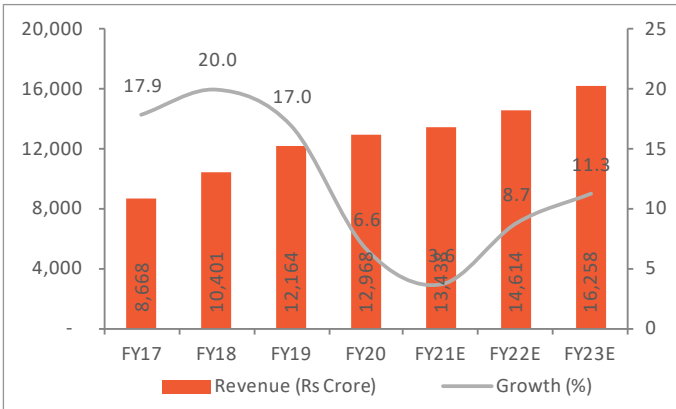
Increased FDI to 74% though the automatic route to boost investments in space: The government has taken a decision to permit upto 74% FDI in the defence manufacturing space through the automatic route (earlier 49%). This is likely to boost investments in the space as foreign players in the defence sector would look at setting up joint ventures to establish defence manufacturing base in India considering the large opportunity under play with the opening up of the defence sector. The government is looking at creating a strategic partnership model and hopes that the same will be started for submarines this year, while for naval utility, a helicopter has been taken up for consideration.

Company's order book remains healthy: Order book position stood at Rs. 53,752 crore as on July 1, 2020, providing healthy revenue visibility over the next few years. Moreover, 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 FY2021E. Hence, we believe order intake visibility should also improve going forward. The company scouts for bagging new opportunities and, hence, in this regard had signed an MOU with the Airport Authority of India to tap emerging business opportunities in the global civilian airport business, which will open up new opportunities for the company.

Continues to focus on sustainable growth plans: The company has been continuously focusing on sustainable growth plans; and in this regard, 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.

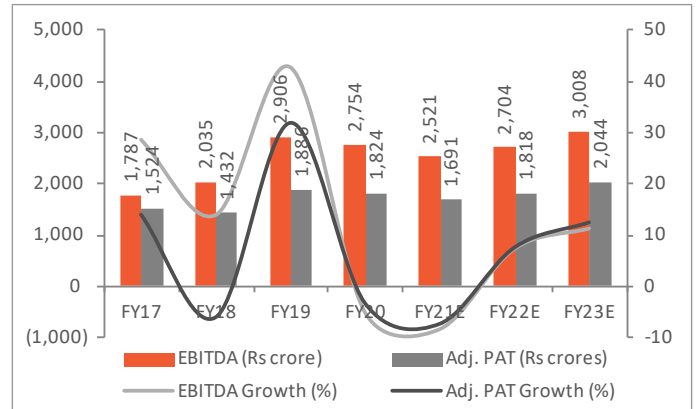
Financials in charts

Growth momentum to improve



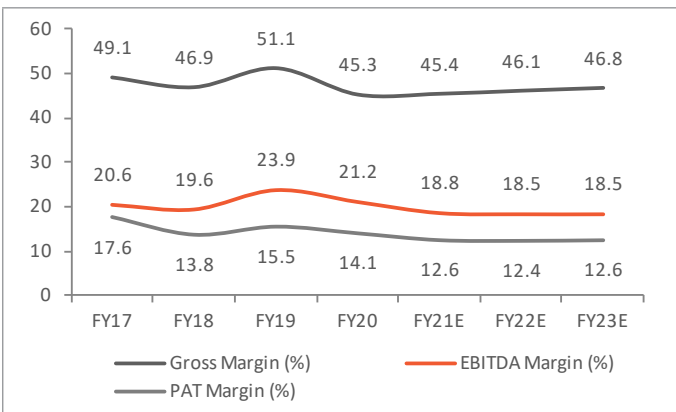
Source: Company, Sharekhan Research

Profit to grow at a steady pace



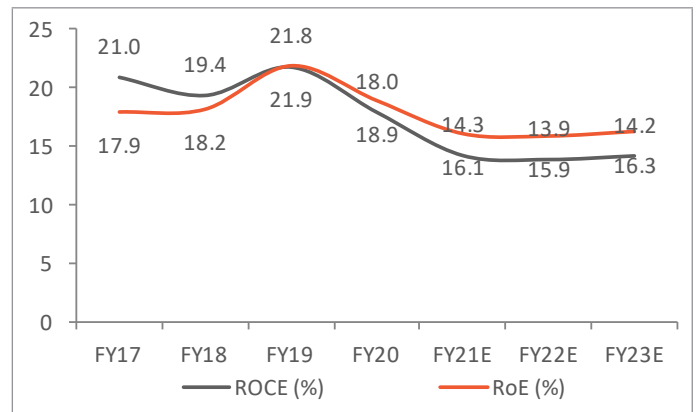
Source: Company, Sharekhan Research

Operating at healthy margins



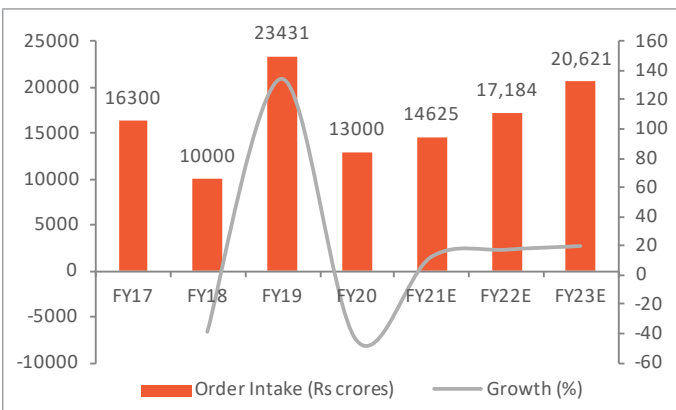
Source: Company, Sharekhan Research

Return ratios to moderate



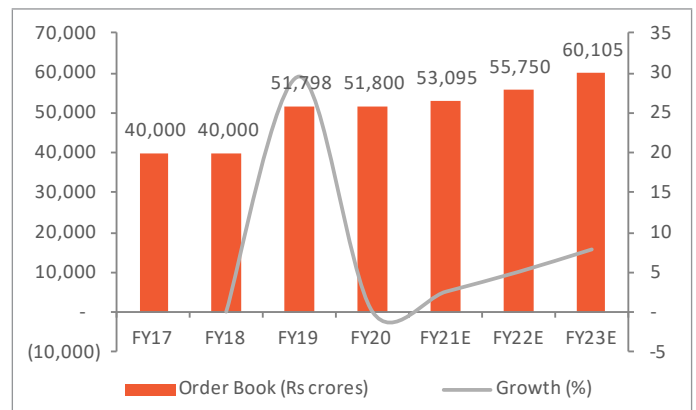
Source: Company, Sharekhan Research

Order intake to improve



Source: Company, Sharekhan Research

Order book remains healthy



Source: Company, Sharekhan Research

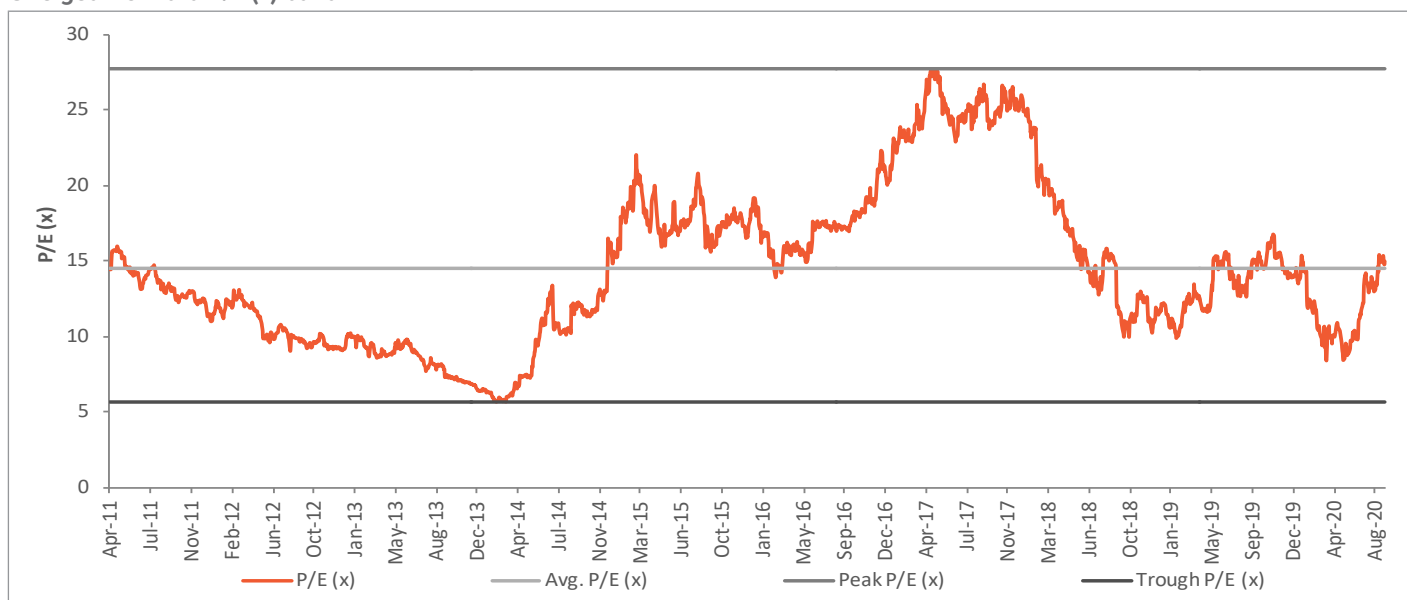
Outlook

Robust order book of Rs. 53,752 crore (4.2x FY2020 revenue) provides growth visibility: The government’s thrust and strong focus on increasing defence manufacturing in India and providing a boost to defence exports augur well for the company. Management also stated that the government through the ‘Make in India’ and ‘Aatmanirbhar Bharat’ initiatives wants to enhance the manufacturing of value-added products in the defence sector, which fetches higher margins rather than relying much on outsourcing play, which has a lower margin profile. Management expects 10% revenue growth (including ventilators) and margins at 20-21% for FY2021E.

Valuation

Major beneficiary, limited competition: We expect BEL to deliver a strong performance in the coming years given its robust order book, major beneficiary from increasing emphasis on indigenisation, and limited competition. 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. We have introduced FY2023E number in this note. At the CMP, the stock is trading at a reasonable valuation of 16.1x/15.0x/ 13.4x its FY2021E/FY2022E/FY2023E earnings, respectively. With improving growth visibility, we retain our Buy rating on the stock with a revised PT of Rs. 135.

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 and Aatmanirbhar Bharat initiatives along with 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
Dinesh Kumar Batra	Executive Director & Chief Financial Officer
S Sreenivas	Company Secretary & Compliance office

Source: Company Website

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	HDFC Asset Management Co Ltd	5.60
2	CPSE ETF	4.85
3	Reliance Capital Trustee Co Ltd	4.84
4	Life Insurance Corporation of India	3.32
5	Kotak Mahindra Asset Management Co Ltd	3.20
6	Mirae Asset Global Investments	2.81
7	SBI Equity Hybrid Fund	2.22
8	ICICI Prudential Asset Management Co Ltd	1.53
9	Aditya Birla SunLife Trustee Co Pvt Ltd	1.25
10	Aditya Birla SunLife Management Co Ltd	1.12

Source: Bloomberg

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