Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Stock Update

Bharat Electronics Limited

Strong quarter, beat on all fronts

Capital Goods	Sharekhan code: BEL	Result Update

3R MATRIX	+	=	-
Right Sector (RS)	✓		
Right Quality (RQ)	✓		
Right Valuation (RV)	✓		

\+ Positive = Neutral - Negative

Reco/View	Change
Reco: **Buy**	↔
CMP: **Rs. 95**	
Price Target: **Rs. 135**	↔

↑ Upgrade ↔ Maintain ↓ Downgrade

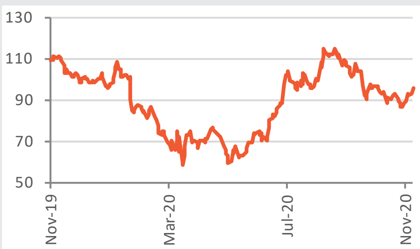
Company details

Market cap:	Rs. 23,245 cr
52-week high/low:	Rs. 118 / 56
NSE volume: (No of shares)	151.3 lakh
BSE code:	500049
NSE code:	BEL
Free float: (No of shares)	119.1 cr

Shareholding (%)

Promoters	51.1
FII	9.6
DII	31.6
Others	7.7

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	3	-10	58	-12
Relative to Sensex	-4	-23	21	-20

Sharekhan Research, Bloomberg

Summary

- We retain our Buy rating on Bharat Electronics Limited (BEL) with an unchanged price target of Rs. 135 considering reasonable valuations and strong execution capabilities.
- BEL reported a strong quarter, better than estimates on all fronts.
- Order book remains healthy at Rs. 52148 crores (4x its TTM revenue), which provides sustainable revenue visibility; expect pickup in order intake during FY2022E.
- BEL is well positioned to benefit from rising defence expenditure supported by strong manufacturing base, execution track record and continued focus on in-house R&D capabilities.

Bharat Electronics (BEL) reported a strong performance which were better than estimates on all fronts. BEL consolidated revenues came at Rs 3195 crore recording a growth of 16.3% y-o-y (much above than estimate) on the back of normalising supply chain, better product mix and improving business operations leading to execution pick-up. Strong revenue growth was led by execution of key orders such as i) Ventilators ii) Part supply of Long Range Surface to Air Missile System, iii) Integrated Air Command and Control System iv) The smart city and homeland security business and v) Thermal imaging cameras. Higher raw material cost and other expenses led to lower operating margins at 19.8% (down 33 bps y-o-y, much better than estimates). Accordingly, the operating profit came at Rs 627 crores (+14% y-o-y). Better execution along with higher other income (up 138% y-o-y), led to 19% growth in net profit to Rs 399.3 crore. The order book remained healthy at Rs. 52,148 crore (4x TTM revenues) though largely a flat q-o-q, while order inflow remained weak at Rs. 1,561 crore (down by 78% y-o-y) during Q2FY21 (generally Q2 is strongest quarter in terms of order inflow) as it was affected by COVID pandemic which led to deferrals of orders. However, the company anticipates some pickup in H2FY2021E owing to expectation of bagging orders such as i) Electronic warfare systems, ii) Akash weapon system (Army), iii) Smart City Business and iv) Avionics package for LCA. Net working capital improved in H1FY21 with NWC to sales at 27% (vs 36% in H1FY20). BEL is well positioned to benefit from rising defence expenditure supported by strong execution track record and a strong order book providing healthy revenue visibility ahead. We have fine-tuned our estimates for FY2021E-FY2022E. The stock is trading at a reasonable valuation of 12.6x and 11.2x its FY2022E and FY2023E earnings, respectively. With improving growth visibility, we retain our Buy rating on the stock with a unchanged price target (PT) of Rs. 135.

Key positives

- Strong revenue growth of 16% y-o-y better than estimates.
- Healthy revenue visibility owing to healthy order book of Rs. 52,148 crore (4x TTM revenue).

Key negatives

- Order inflow remained weak during Q2FY2021 affected by COVID pandemic which led to deferrals of orders but anticipates some pick up in H2FY2021E.

Our Call

Valuation: Maintain Buy with an unchanged PT of Rs 135: BEL is well positioned to deliver strong performance in the coming years given its robust order book and major beneficiary from increasing emphasis on indigenisation. 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 expect revenue and earnings to report CAGR of 11% respectively, during FY2021-FY2023E.The stock is trading at a reasonable valuation of 12.6x and 11.2x its FY2022E and FY2023E earnings, respectively. With the improving growth visibility, we retain our Buy rating on the stock with an unchanged price target (PT) of Rs. 135.

Key Risks

- 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.

Valuations (Consolidated) Rs cr

Particulars	FY20	FY21E	FY22E	FY23E
Revenue	12,968	13,471	14,818	16,485
OPM (%)	21.2	18.8	18.5	18.5
Adjusted PAT	1,824	1,695	1,847	2,076
% y-o-y growth	*(3.3)*	*(7.0)*	*9.0*	*12.4*
Adjusted EPS (Rs.)	7.5	7.0	7.6	8.5
P/E (x)	12.7	13.7	12.6	11.2
P/B (x)	2.3	2.1	2.0	1.9
EV/EBIDTA (x)	9.5	10.4	9.9	8.9
RoNW (%)	18.9	15.6	15.9	16.6
RoCE (%)	18.0	14.3	14.2	14.8

Source: Company; Sharekhan estimates

Strong quarter performance: Bharat Electronics (BEL) reported a strong performance which were better than estimates on all fronts. BEL consolidated revenues came at Rs 3,195 crore recording a growth of 16.3% y-o-y (much above than estimate) on the back of normalising supply chain, better product mix and improving business operations leading to execution pick-up. Strong revenue growth was led by execution of key orders such as i) Ventilators ii) Part supply of Long Range Surface to Air Missile System, iii) Integrated Air Command and Control System iv) The smart city and homeland security business and v) Thermal imaging cameras. Higher raw material cost and other expenses led to lower operating margins at 19.8% (down 33 bps y-o-y, much better than estimates). Accordingly operating profit came at Rs 627 crores (+14% y-o-y). Better execution along with higher other income (up 138% y-o-y), led to 19% growth in net profit to Rs 399.3 crore.

Order book remains healthy despite slower order intake: Order book remained healthy at Rs. 52,148 crore (4x its TTM revenue) though largely flat q-o-q, while order inflow remained weak at Rs. 1,561 crore (down by 78% y-o-y) during Q2FY21 (generally Q2 is strongest quarter in terms of order inflow) as it was affected by COVID pandemic which led to deferrals of orders. However, the company anticipates some pickup in H2FY2021E owing to expectation of bagging orders such as i) Electronic warfare Systems, ii) Akash weapon system (Army), iii) Smart City Business and iv) Avionics package for LCA.

Quarterly Results (Consolidated) Rs cr

Particulars	Q2FY21	Q2FY20	YoY%	Q1FY21	QoQ%
Net Sales	3,195.2	2,748.3	16.3	1,675.6	-
Operating expenditure	2,568	2,200	16.7	1,530	67.9
Operating profit	627.3	548.7	14.3	146.1	-
Other income	27	12	138.2	16	66.6
Interest	0	1	-	0	-
Depreciation	97	91	6.0	94	2.8
PBT	558	468	19.2	68	-
Tax	162	133	22.0	21	-
Reported PAT	396	335	18.1	48	-
Adj PAT	399	335	19.1	53.8	-
EPS (Rs)	1.6	1.4	19.1	4.3	-
			BPS		**BPS**
OPM (%)	19.6	20.0	(33.3)	8.7	-
NPM (%)	12.4	12.2	19.6	2.8	-
Tax Rate (%)	29.0	28.3	-	30.6	-

Source: Company; Sharekhan Research

Outlook and Valuation

■ Sector view – 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. To open up the defence sector further, the government is also planning to corporatise Ordinance 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. Further increased FDI to 74% though the automatic route to boost investments in space. 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.

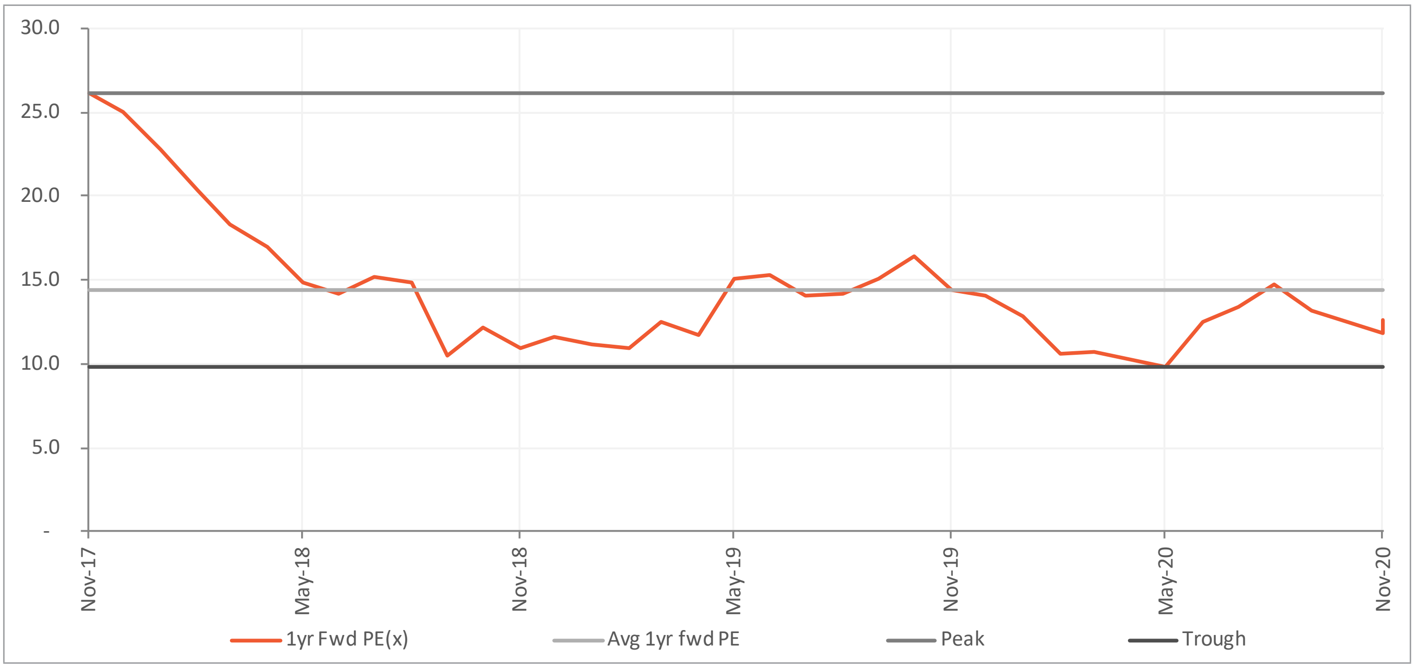
■ Company outlook - Continues to focus on sustainable growth plans

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.

■ Valuation - Maintain Buy with an unchanged PT of Rs 135

BEL is well positioned to deliver strong performance in the coming years given its robust order book and major beneficiary from increasing emphasis on indigenisation. 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 expect revenue and earnings to report CAGR of 11% respectively, during FY2021-FY2023E.The stock is trading at a reasonable valuation of 12.6x and 11.2x its FY2022E and FY2023E earnings, respectively. With the improving growth visibility, we retain our Buy rating on the stock with an unchanged price target (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

- 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
AnandiRamalingam	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 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

Understanding the Sharekhan 3R Matrix

Right Sector	
Positive	Strong industry fundamentals (favorable demand-supply scenario, consistent industry growth), increasing investments, higher entry barrier, and favorable government policies
Neutral	Stagnancy in the industry growth due to macro factors and lower incremental investments by Government/private companies
Negative	Unable to recover from low in the stable economic environment, adverse government policies affecting the business fundamentals and global challenges (currency headwinds and unfavorable policies implemented by global industrial institutions) and any significant increase in commodity prices affecting profitability.
Right Quality	
Positive	Sector leader, Strong management bandwidth, Strong financial track-record, Healthy Balance sheet/cash flows, differentiated product/service portfolio and Good corporate governance.
Neutral	Macro slowdown affecting near term growth profile, Untoward events such as natural calamities resulting in near term uncertainty, Company specific events such as factory shutdown, lack of positive triggers/events in near term, raw material price movement turning unfavourable
Negative	Weakening growth trend led by led by external/internal factors, reshuffling of key management personal, questionable corporate governance, high commodity prices/weak realisation environment resulting in margin pressure and detoriating balance sheet
Right Valuation	
Positive	Strong earnings growth expectation and improving return ratios but valuations are trading at discount to industry leaders/historical average multiples, Expansion in valuation multiple due to expected outperformance amongst its peers and Industry up-cycle with conducive business environment.
Neutral	Trading at par to historical valuations and having limited scope of expansion in valuation multiples.
Negative	Trading at premium valuations but earnings outlook are weak; Emergence of roadblocks such as corporate governance issue, adverse government policies and bleak global macro environment etc warranting for lower than historical valuation multiple.

Source: Sharekhan Research

Sharekhan

by BNP PARIBAS

Know more about our products and services

For Private Circulation only

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

---

Registered Office: Sharekhan Limited, 10th Floor, Beta Building, Lodha iThink Techno Campus, Off. JVLR, Opp. Kanjurmarg Railway Station, Kanjurmarg (East), Mumbai – 400042, Maharashtra. Tel: 022 - 61150000. Sharekhan Ltd.: SEBI Regn. Nos.: BSE / NSE / MSEI (CASH / F&O / CD) / MCX - Commodity: INZ000171337; DP: NSDL/CDSL-IN-DP-365-2018; PMS: INP000005786; Mutual Fund: ARN 20669; Research Analyst: INH000006183;