Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Bharat Electronics Limited

Upbeat on prospects ahead

Capital Goods	Sharekhan code: BEL	Company Update

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

\+ Positive = Neutral - Negative

What has changed in 3R MATRIX

	Old		New
RS		↔	
RQ		↔	
RV		↔	

Reco/View	Change
Reco: **Buy**	↔
CMP: **Rs. 151**	
Price Target: **Rs. 190**	↑

↑ Upgrade ↔ Maintain ↓ Downgrade

Company details

Market cap:	Rs. 36,902 cr
52-week high/low:	Rs. 154/56
NSE volume: (No of shares)	10.8 lakh
BSE code:	500049
NSE code:	BEL
Free float: (No of shares)	119.1 cr

Shareholding (%)

Promoters	51.1
FII	10.3
DII	31.3
Others	7.3

Price chart

Price performance

(%)	1m	3m	6m	12m
Absolute	13	33	39	108
Relative to Sensex	12	21	10	76

Sharekhan Research, Bloomberg

Summary

- We retain a Buy rating on Bharat Electronics Limited (BEL) with a revised PT of Rs. 190 modestly increasing our target PE to factor overall rerating in the PSU space and considering BEL execution capabilities.
- BEL is well positioned to benefit from rising defence expenditure supported by a strong manufacturing base, execution track record and continued focus on developing in-house R&D capabilities.
- Strong YTD order inflow, healthy order pipeline and order book offer sustainable revenue visibility.
- With Aatma Nirbhar Bharat and domestic procurement, the entire PSU pack is getting rerated which augurs well for BEL which is trading at the steep discount to the peak 5-year average multiple.

Bharat Electronics (BEL) remains well placed to make the most of upcoming opportunities under the government's Aatmanirbhar Bharat programme and the budgeted defense capex (+19% increase y-o-y). In the recently announced defence budget for FY21-22, the capital expenditure has been increased to Rs 1.35 lakh crore (+19 y-o-y increase) wherein RS 7000 crore reserved for domestic procurement. BEL having a major role to play in defence as it is present in all aspects of the defence sector remains a major beneficiary of the government defence capex. Seeking to ride on the government's thrust on self-reliance, BEL remains confident that the ongoing financial year will be better than the previous year. Recently the government on its part has been swift in issuing directives on the plans laid earlier and the recently concluded Defence Acquisition Council (DAC) meeting approved capital acquisition proposals for various weapons/ platforms/ equipment/ systems required by India's Army, Navy and Air Force at an approximate cost of Rs. 13,000 crore (earlier DAC has approved Rs 27000 crore) wherein BEL can be major beneficiary. Secondly, the government has recently announced that another list that will not be imported and is expected this month. Earlier import embargo placed for 101 defence items where BEL remained at various stages of discussion for manufacturing ~55 items. During Q4, the company signed a contract with the ministry of defense for the procurement of Software Defined Radio (Tactical) worth over Rs 1000 crore for the Indian Navy. Further, BEL also entered into an offset contract with Rosoboronexport, Russia, for setting up industrial facilities for the manufacture of a wide range of aviation hoses at BEL Optronic Devices Limited under the Make in India programme. The active operation of numerous aircraft of the Indian Air Force creates constant demand for aviation hoses, which are consumables in nature.

The order pipeline remains healthy with major orders for Electronic warfare systems, aircraft upgrades, communication systems expected during Q4FY21. Other medium to long term order pipeline prospects include Quick Reaction Surface-to-Air Missile (QRSAM) opportunity order size of ~Rs. 30,000 crore over the next 5-7 years wherein Rs 15,000-20,000 crore of such orders should come through in FY22E-23E). Others include Long Range Surface missiles (Rs 15,000-crore worth of LRSAM missile system order should come in FY22E) and opportunities in Electronics Warfare Systems, Akash Weapon Systems (Army) sensors and drones, etc. Overall order intake for 9MFY21 remains healthy at Rs 9879 crore and given the healthy order pipeline. BEL is well placed to meet the order inflow target of Rs 15000 crore for FY2021. On the export front, BEL has expanded its global footprint with current order book of $182.8 million and management had earlier indicated that it expects the order book to increase to $500 million over three years. The order book remains healthy at Rs 54791 crore (3.9x its TTM revenue) providing sustainable revenue visibility backed with strong execution capabilities. Overall, the management remains confident of its growth opportunities and expects double-digit revenue growth with margins at around 20% in FY2021E. We believe BEL is well positioned to benefit from the rising defence expenditure, supported by a strong manufacturing base, execution track record, and continued focus on in-house R&D capabilities. The stock is trading at reasonable valuations of 17.9x and 15.9x its FY2022E and FY2023E earnings, respectively. With Aatma Nirbhar Bharat and domestic procurement, the entire PSU pack is getting rerated which augurs well for BEL which is trading at a steep discount to the peak PE multiple. The recent defense IPO is coming at premium valuation and we believe that the positive rub off will be seen for BEL. We maintain Buy rating on the stock with modestly increasing our target PE to factor overall rerating in the PSU space to arrive at target price of Rs 190.

Our Call

Valuation: Maintain Buy with a revised PT of Rs. 190: BEL is well-positioned to deliver strong performance in the coming years given its robust order book, as it's a major beneficiary from increasing emphasis on indigenisation and recently announced capex (+19% y-o-y) for defense. 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. The stock is trading at reasonable valuations of 17.9x and 15.9x its FY2022E and FY2023E earnings, respectively. With Aatma Nirbhar Bharat and domestic procurement the entire PSU pack is getting rerated which augurs well for BEL which is trading at the steep discount to the peak multiple. The recent defense IPO is coming at premium valuation and we believe that the positive rub off will be seen for BEL. We maintain Buy rating on the BEL with modestly increasing our target PE to factor overall rerating in the PSU space to arrive at target price of Rs 190.

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.

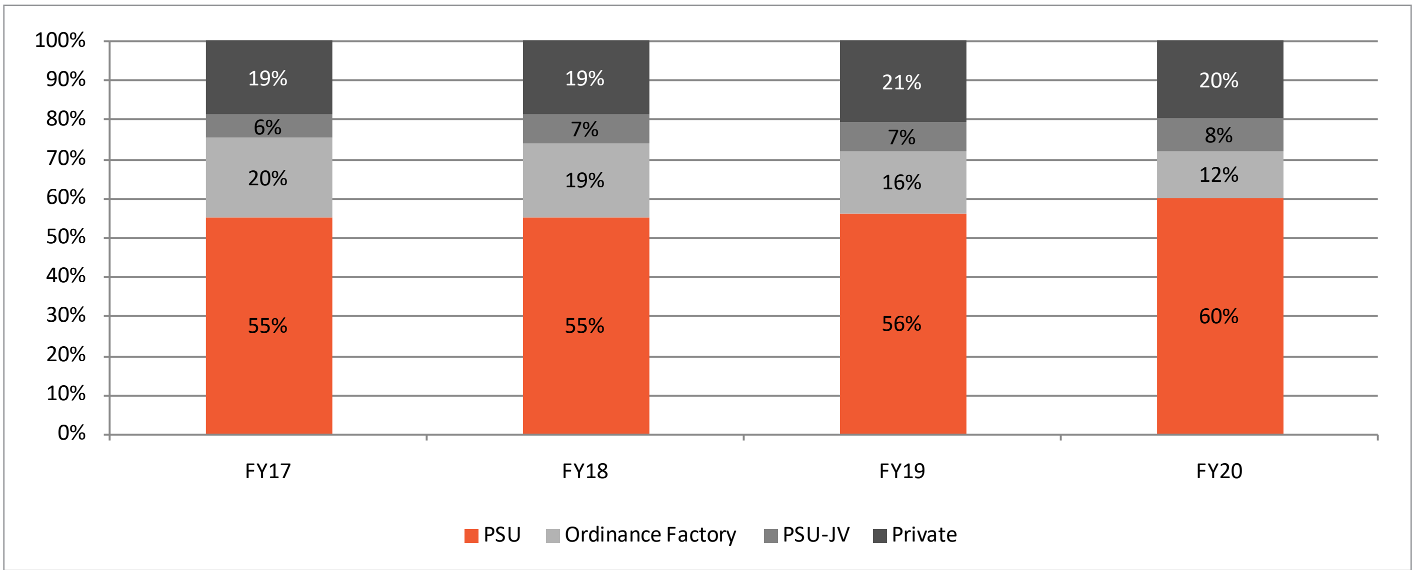
Valuation (Consolidated) Rs cr

Particulars	FY20	FY21E	FY22E	FY23E
Revenue	12,968	14,146	15,490	16,884
OPM (%)	21.2	19.6	19.8	20.0
Adjusted PAT	1,824	1,879	2,057	2,324
% y-o-y growth	(3.3)	3.0	9.5	13.0
Adjusted EPS (Rs.)	7.5	7.7	8.4	9.5
P/E (x)	20.2	19.6	17.9	15.9
P/B (x)	3.7	3.3	3.1	2.8
EV/EBIDTA (x)	14.7	14.5	13.4	12.1
RoNW (%)	18.9	17.8	18.1	18.6
RoCE (%)	20.1	18.4	19.0	21.0

Source: Company; Sharekhan estimates

Major beneficiaries to defence opportunities: Bharat Electronics (BEL) remains well placed to tap on upcoming opportunities under the government's Aatmanirbhar Bharat programme and the budgeted defense capex (+19% increase y-o-y). In the recently announced defence budget for FY21-22, the capital expenditure has been increased to Rs 1.35 lakh crore (+19 y-o-y increase) to purchase new weapons, aircraft, warships and other military hardware. BEL having a major role to play in defence as it is present in all aspects of the defence sector remains major beneficiary from the government defence capex. Seeking to ride on the government's thrust on self-reliance, BEL has remained confident that the ongoing financial year will be better than the previous year. Recently, the Government on its part has been swift in coming out with the directives on the plans laid earlier and the recently concluded Defence Acquisition Council (DAC) meeting approved capital acquisition proposals for various weapons/platforms/equipment/systems required by India's Army, Navy and Air Force at an approximate cost of Rs. 13,000 crore (earlier DAC has approved Rs 27000 crore) wherein BEL can be major beneficiary. Secondly the government has recently announced that another list that will not be imported is expected this month. Earlier import embargo placed for 101 defence items where BEL remained at various stages of discussion for manufacturing ~55 items. During Q4, the company signed a contract with the ministry of defense for procurement of Software Defined Radio (Tactical) worth over Rs 1000 crore for the Indian Navy. Further, BEL also entered into an offset contract with Rosoboronexport, Russia, for setting up industrial facilities for the manufacture of a wide range of aviation hoses at BEL Optronic Devices Limited under the Make in India programme. The active operation of numerous aircraft of the Indian Air Force creates constant demand for aviation hoses, which are consumables in nature. Defence Production and Exports have been a strategic focus of the government in a bid to promote 'Make in India' initiative for the defence sector. The government is aiming at more self-reliance in the defence sector which aims to boost local manufacturing by PSU's, joint ventures and private participation.

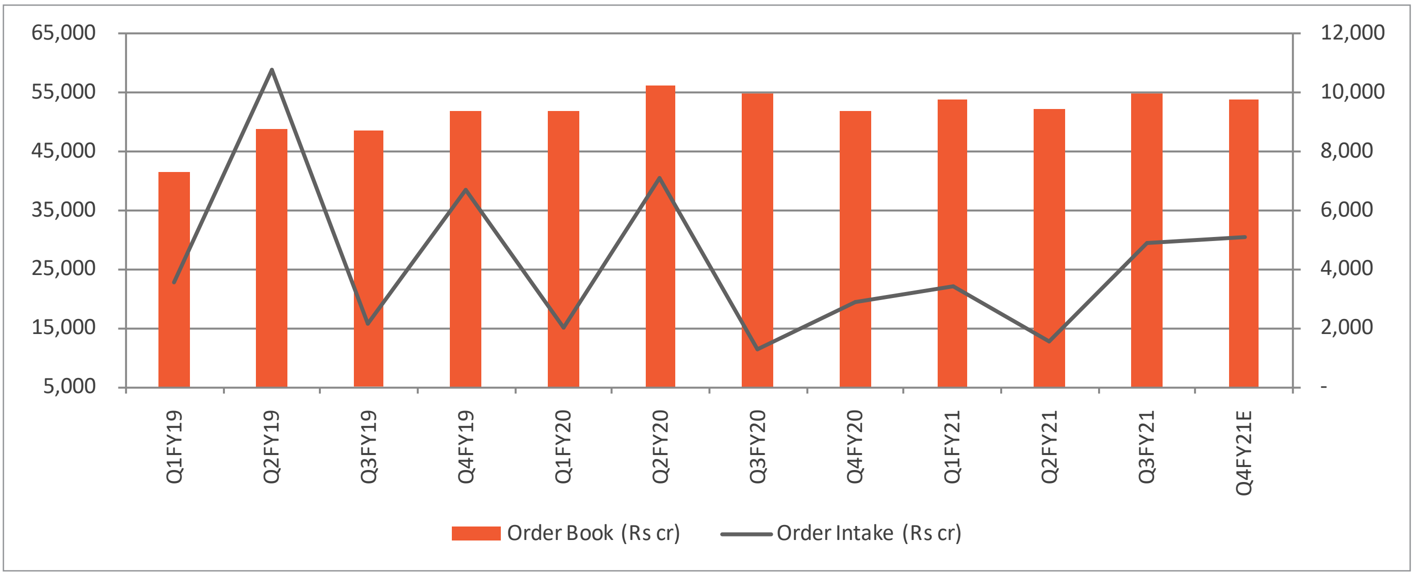
Defence Production



Source: Ministry of Defence, India Budget Documents

Order inflow pipeline stays strong: The order pipeline remains healthy with major orders for electronic warfare systems, aircraft upgrades, communication systems expected during Q4FY21. Other medium to long terms order pipeline prospects include Quick Reaction Surface-to-Air Missile (QRSAM) opportunity order size of ~Rs. 30,000 crore over the next 5-7 years wherein Rs 15,000-20,000 crore of such orders should come through in FY22E-23E). Others include Long Range Surface missiles (Rs 15,000-crore worth of LRSAM missile system order should come in FY22E) and opportunities in Electronics Warfare Systems, Akash Weapon Systems (Army) sensors and drones, etc. Overall order intake for 9MFY21 remains healthy at Rs 9879 crore and given the healthy order pipeline BEL is well placed to meet the order inflow target between 15000 crore for FY2021. On the export front, BEL has expanded its global footprint with current order book of $182.8 million and management had earlier indicated that it expects the order book to increase to $500 million over three years. The order book remains healthy at Rs 54791 crore (3.9x its TTM revenue) providing sustainable revenue visibility backed with strong execution capabilities.

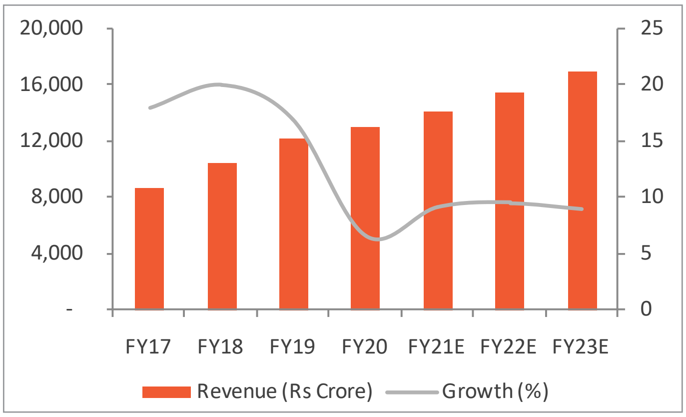
Order inflow and order book trend



Source: Company, Sharekhan

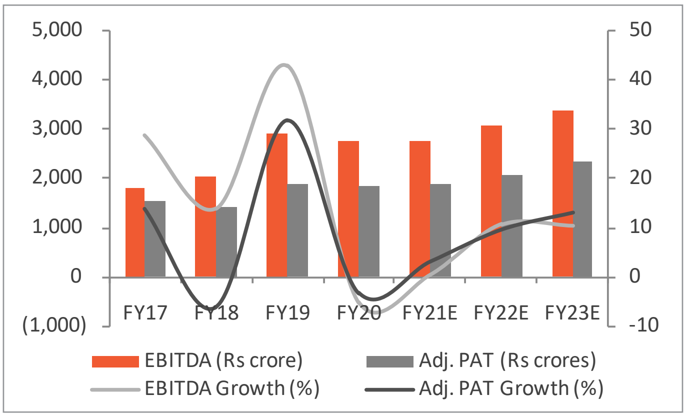
Financials in charts

Revenue and growth trend



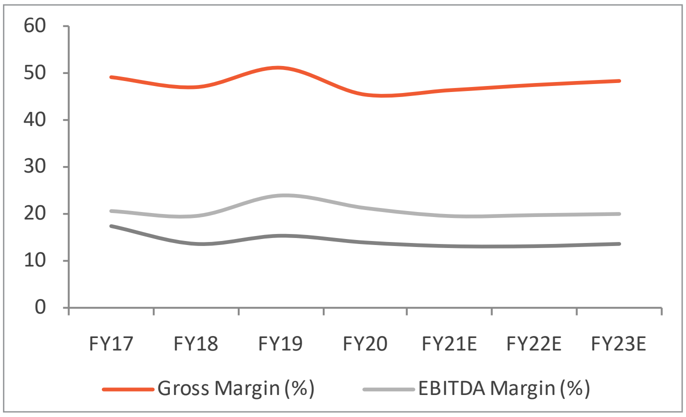
Source: Company, Sharekhan Research

OPM and net profit trend



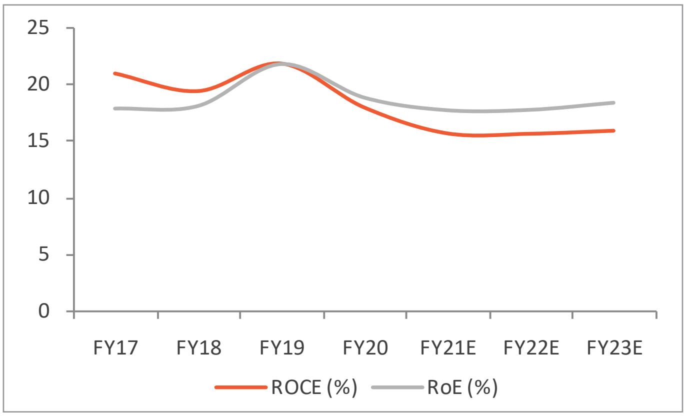
Source: Company, Sharekhan Research

Margin trend



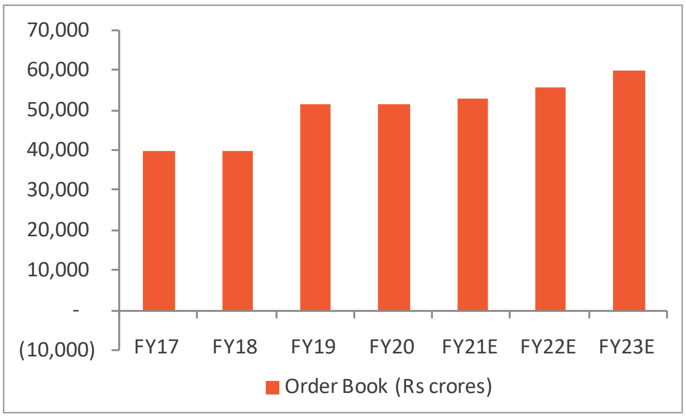
Source: Company, Sharekhan Research

Return ratios



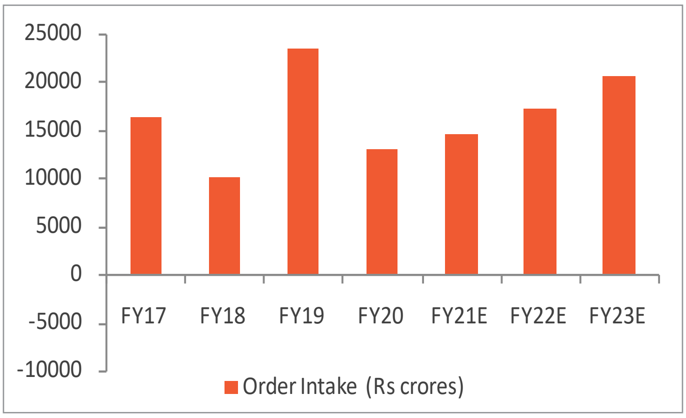
Source: Company, Sharekhan Research

Order book trend



Source: Company, Sharekhan Research

Order inflow trend



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 to boost the Aatmanirbhar Bharat programme in the defence sector and create a level-playing field for private players, including MSMEs. To open up the defence sector further, the government is also planning to corporatize ordinance factory boards shortly. Completion of the defence project takes longer 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, the government has increased FDI to 74% through the automatic route to boost investments in this space. Now foreign players in the defence sector would look at setting up joint ventures to establish a 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 a naval utility, a helicopter has been taken up for consideration.

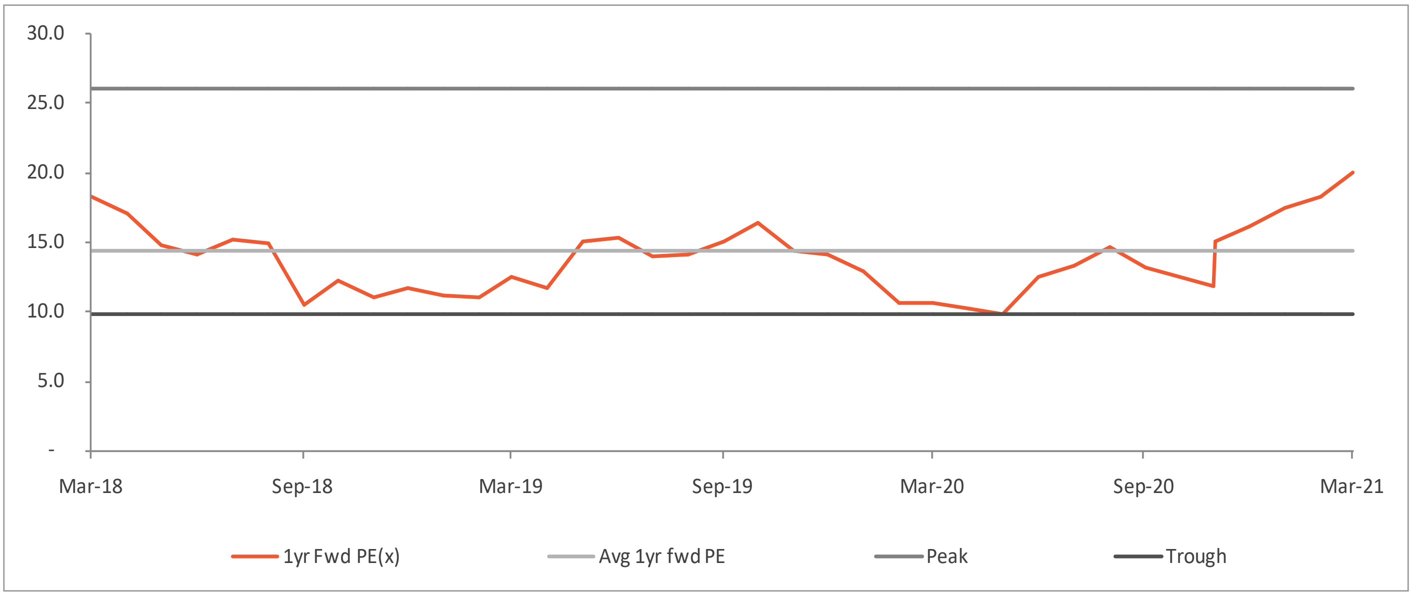
■ Company outlook - Continues to focus on sustainable growth plans

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 defence exports to enhance foreign exchange earnings.

■ Valuation - Maintain Buy with a revised PT of Rs. 190

BEL is well-positioned to deliver strong performance in the coming years given its robust order book, major beneficiary from increasing emphasis on indigenisation and recently announced capex (+19% y-o-y) for defense. 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. The stock is trading at reasonable valuations of 17.9x and 15.9x its FY2022E and FY2023E earnings, respectively. With Aatmanirbhar Bharat and domestic procurement the entire PSU pack is getting rerated which augurs well for BEL which is trading at the steep discount to the peak multiple. The recent defense IPO is coming at premium valuation and we believe that the positive rub off will be seen for BEL. We maintain Buy rating on the BEL with modestly increasing our target PE to factor overall rerating in the PSU space to arrive at target price of Rs 190.

One-year forward P/E (x) band



Source: Sharekhan Research

Peer Comparison

Particulars	P/E (x)		EV/EBITDA (x)		RoE	
	FY22E	FY23E	FY22E	FY23E	FY22E	FY23E
Bharat Electronics	17.9	15.9	18.1	18.6	18.1	18.6
Hindustan Aeronautics*	11.7	10.6	7.5	6.9	19.1	18.5
BEML*	34.2	25.5	20.1	16.2	6.6	8.5
L&T	28.9	21.9	14.7	11.8	12.7	15.5

**Bloomberg Estimates*

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 robust 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: Bloomberg

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

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

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