

Company update

Defence

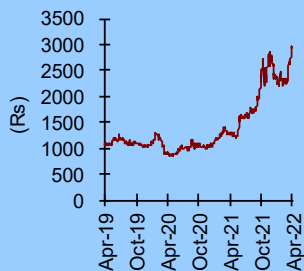
Target price: Rs2,850

Shareholding pattern

	Jun '21	Sep '21	Dec '21
Promoters	73.2	73.2	73.2
Institutional investors	22.1	22.0	21.8
MFs and other	16.0	15.6	15.2
FIs/Insurance	0.6	0.6	0.2
FIs	5.5	5.8	6.4
Others	4.7	4.8	5.0

Source: BSE India

Price chart



Solar Industries

HOLD

Maintain

Rs2,945

Strategic investment in UAS start-up

Solar Industries (SOIL) surprised with an investment (undisclosed amount) in an unarmed aerial solutions (UAS) company ZMotion Autonomous (ZM) incorporated in CY18. This is the second announced start-up investment by SOIL after a strategic stake (Rs175mn) into Skyroot – a space start-up helping ISRO with propulsion systems (SOIL incidentally also received ToT on 7th Apr'22 (propellant casting for Dual Pulse propulsion system). The rationale for the strategic investment has been shown as “will strengthen SOIL’s initiative to introduce weaponised unmanned aerial vehicle (UAVs) for offensive and counter drone system for defensive roles”. ZM will become an associate company after the investment (45% stake by Mar'25; 25.11% upfront acquisition, rest through investment in CCPS). We hosted Mr. Ankit Mehta, CEO and cofounder of Ideaforge to discuss the developing UAV space in India. We are sharing some of the key takeaways in this report. This in our view, sufficiently addresses, the scope and opportunity of investment in the domain. **Maintain HOLD on SOIL.**

- **Scale of the market.** Revenue from the sector (drone manufacturing) was Rs600mn in FY21 and is expected to reach Rs3,000-5,000mn in FY22E. Revenues are expected to increase further.
- **Ordering till date.** Of the 5-6 large contracts given to Indian companies by Indian armed forces (all contracts being given to Indian companies), 3 went to Ideaforge and rest to individual players developing swarming and loitering munitions capability. Local value addition is 70-80% for Idea Forge. Ankit's estimate for indigenisation across the country was 40-50%. He mentioned that Ideaforge doesn't use engines.
- **Explicit import ban** underway. Earlier there has been an influx of Chinese and other small drones in the country. India is signatory to Wassenaar arrangement where export of drones is controlled (China is not). Hence, China is seeing increasing import bans from across countries.
- **Larger drones and loitering munitions imported.** India has continued to import larger drones from Israel (Heron) and also loitering munitions like Harop in the past. India manufacturing is largely for micro and mini drones. Only HAL is trying with larger UAVs i.e. Rustam.
- **Budgeting and scope.** Two of the contracts which Ideaforge received were under the emergency procurement and emergency powers granted after Galwan incident. The other contracts were from the capital budget. Contract which the company has recently won from Indian Army (US\$20mn for Switch UAV - TOW of 7kg) was serving only 1/3rd of IA's original envisioned scale. Management expects more procurement for the balanced scale. Beyond 3x numbers as per IA's own envisioned requirement, Ankit highlighted the possibility of another 4-5x growth in numbers as more procurement starts to happen only for the platforms that Ideaforge received the contract for (**cont'd**).

Market Cap	Rs272bn/US\$3.6bn
Reuters/Bloomberg	SOIL.BO/SOIL IN
Shares Outstanding (mn)	90.5
52-week Range (Rs)	3005/1209
Free Float (%)	26.8
FII (%)	6.4
Daily Volume (US\$/'000)	2,756
Absolute Return 3m (%)	28.0
Absolute Return 12m (%)	129.6
Sensex Return 3m (%)	(0.3)
Sensex Return 12m (%)	20.7

Year to March	FY21	FY22E	FY23E	FY24E
Revenue (Rs mn)	25,156	39,222	39,685	52,987
Net Income (Rs mn)	2,764	3,824	4,940	7,103
Dil. EPS (Rs)	30.5	42.3	54.6	78.5
% Chg YoY	3.3	38.4	29.2	43.8
P/E (x)	95.0	68.6	53.1	36.9
CEPS (Rs)	5.1	32.3	25.9	36.5
EV/E (x)	52.2	40.0	31.4	21.3
Dividend Yield (%)	0.21	0.21	0.21	0.23
RoCE (%)	16.0	20.3	22.1	27.5
RoE (%)	17.5	21.9	23.2	26.6

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- ▶ **Budgeting and scope (Cont'd).** The other types of platform, meant for company and platoon level deployment and personal reconnaissance, will have a large scale requirement. The systems for long range reconnaissance and surveillance (MALE and HALE category) scale will be few dozens of number but will be higher value. At each scale and size of the drone market, the size is very similar.

Maintain HOLD; valuation methodology and key risks

We value SOIL on a consolidated P/E of 35x on FY24E. We maintain HOLD with a target price of Rs2,850/share. Despite strong volumes for Q3FY22, we see earnings downgrade for FY22/23E as we rebase margins given the margin loss for 9MFY22. We hope SOIL to make it up eventually in FY24E.

Key risks

Key upside risks: i) Higher volume growth driven by better-than-expected domestic demand revival, ii) higher margins, iii) better-than-expected ramp-up in overseas and defence operations and iv) valuation surprise at Skyroot.

Key downside risks: i) Expected trends in domestic demand continue, ii) ramp-up in overseas operations getting delayed and iii) no meaningful traction witnessed in defence revenues apart from the MMHG order that's already received.

Financial summary

Table 1: Profit & loss statement

(Rs mn, year ending March 31)

	FY21	FY22E	FY23E	FY24E
Operating Income	25,156	36,860	39,685	52,987
Operating Expenses	20,010	30,112	31,161	40,817
EBITDA	5,146	6,748	8,524	12,170
% margins	20.5	18.3	21.5	23.0
Depreciation & Amortisation	935	1,069	1,219	1,302
Gross Interest	454	472	469	487
Other Income	214	243	245	220
Recurring PBT	3,971	5,450	7,081	10,601
Add: Extra ordinarys	-	-	-	-
Less: Taxes	1,090	1,423	1,845	2,756
Less: Minority	117	202	297	742
Recurring Net Income	2,764	3,824	4,940	7,103

Source: Company data, I-Sec research

Table 2: Balance sheet

(Rs mn, year ending March 31)

	FY21	FY22E	FY23E	FY24E
Assets				
Total Current Assets	12,257	15,824	20,164	29,836
of which cash & cash eqv.	1,812	665	2,633	11,070
Total Current Liabilities & Provisions	4,718	6,887	7,965	10,687
Net Current Assets	7,539	8,937	12,199	19,149
Investments	10	10	10	10
Strategic/Group	10	10	10	10
Other Marketable	0	0	0	0
Net Fixed Assets	15,459	17,540	18,972	19,270
Capital Work-in-Progress	2,929	2,929	2,929	2,929
Goodwill	96	96	96	96
Total Assets	24,877	28,357	33,051	40,299
Liabilities				
Borrowings	7,994	7,991	7,991	7,991
Deferred Tax Liability	461	461	461	461
Minority Interest	627	829	1,126	1,869
Equity Share Capital	181	181	181	181
Face Value per share (Rs)				
Reserves & Surplus*	15,613	18,894	23,291	29,797
Net Worth	15,794	19,075	23,472	29,978
Total Liabilities	24,877	28,357	33,051	40,299

Source: Company data, I-Sec research

Table 3: Cashflow statement

(Rs mn, year ending March 31)

	FY21	FY22E	FY23E	FY24E
Operating Cashflow ex WC	4,620	5,325	6,679	9,414
Working Capital Changes	(1,053)	(2,545)	(1,294)	1,486
Capital Commitments	(2,758)	(3,151)	(2,651)	(1,600)
Free Cashflow	809	(372)	2,734	9,301
Cashflow from Investing Activities				
Issue of Share Capital	-	-	-	-
Inc (Dec) in Borrowings	810	(3)	-	-
Dividend paid	543	543	543	597
Chg. in Cash & Bank balance	774	(1,147)	1,968	8,437

Source: Company data, I-Sec research

Table 4: Key ratios

(Year ending March 31)

	FY21	FY22E	FY23E	FY24E
Per Share Data (in Rs.)				
EPS(Basic Recurring)	30.5	42.3	54.6	78.5
Diluted Recurring EPS	30.5	42.3	54.6	78.5
Recurring Cash EPS	40.9	54.1	68.1	92.9
Dividend per share (DPS)	6.0	6.0	6.0	6.6
Growth Ratios (%)				
EBITDA	18.5	31.1	26.3	42.8
Recurring Net Income	3.3	38.4	29.2	43.8
Diluted Recurring EPS	3.3	38.4	29.2	43.8
Diluted Recurring CEPS	5.1	32.3	25.9	36.5
Valuation Ratios (x)				
P/E	95.0	68.6	53.1	36.9
P/CEPS	70.9	53.6	42.6	31.2
P/BV	16.6	13.8	11.2	8.8
EV / EBITDA	52.2	40.0	31.4	21.3
EV / Operating Income	60.7	45.6	35.5	23.4
EV / FCF	316	(726)	98	28
Operating Ratios (%)				
Raw Material/Sales	53.5	57.2	52.8	55.2
SG&A/Sales	-	-	-	-
Other Income / PBT	5.4	4.5	3.5	2.1
Effective Tax Rate	27.5	26.1	26.1	26.0
NWC / Total Assets	0.3	0.3	0.4	0.5
Inventory Turnover (days)	133.6	133.6	133.6	133.6
Receivables (days)	66.1	66.1	66.1	66.1
Payables (days)	32.1	32.1	32.1	32.1
Net D/E Ratio (x)	0.39	0.38	0.23	(0.10)
Return/Profitability Ratios (%)				
Recurring Net Income Margins	11.0	10.4	12.4	13.4
RoCE	16.0	20.3	22.1	27.5
RoNW	17.5	21.9	23.2	26.6
Dividend Payout Ratio	19.6	14.2	11.0	8.4
EBITDA Margins	20.5	18.3	21.5	23.0

Source: Company data, I-Sec research

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