Hindustan Aeronautics Ltd (HINAER)

ICICI direct Research

CMP: ₹ 1801 | Target: ₹ 2200 (22%) | Target Period: 12-18 months | BUY

June 29, 2022

Initiating Coverage

Flying high...

About the stock: Hindustan Aeronautics (HAL), the largest defence PSU in India, is engaged in design, development, manufacture, repair, overhaul, upgrade and servicing of a wide range of products including, aircraft, helicopters, aero-engines, avionics, accessories and aerospace structures.

- The company has delivered revenue, EBITDA and PAT CAGR of 7.4%, 12% and 26.5%, respectively, in FY18-22. In FY22, repair & overhaul contributed ~64% to total revenues while manufacturing contributed~30%

Key triggers for future price performance:

- Increasing capital outlay in defence with indigenisation has been the focus area of government considering requirement of armed forces of faster procurement of modern equipment
- HAL caters to a large spectrum of aerospace business, which includes design, development, manufacturing and maintenance, repair & overhaul (MRO) of different types of aircraft/helicopters and engines
- Healthy order-book position at ₹ 82,153 crore (~3.3x FY22 revenues), of which manufacturing segment order backlog is at ₹ 61,564 crore (75% of total OB) led by large scale orders of LCA, LCH and ALH). Strong pipeline of ₹ 1.24 lakh crore worth of orders in manufacturing for the next three to four years led by LUH, LCH and engines for Su-30 & MiG-29
- LCA Tejas MK1A deliveries to IAF will start from FY25E; execution of large order backlog of manufacturing and sustained growth in MRO will drive revenue growth in double digits

What should investors do? We expect HAL to deliver revenue and EBITDA CAGR of 6.8% and 11.8%, respectively, in FY22-24E. PBT is likely to grow at 7.7% CAGR during FY22-24E. Increase in profitability with strong asset turnover is expected to result in healthy return ratios over FY23-24E.

- We initiate coverage with a **BUY** recommendation on the stock

Target Price & Valuation: We value HAL at ₹ 2,200 on 16x P/E on FY24E EPS basis.

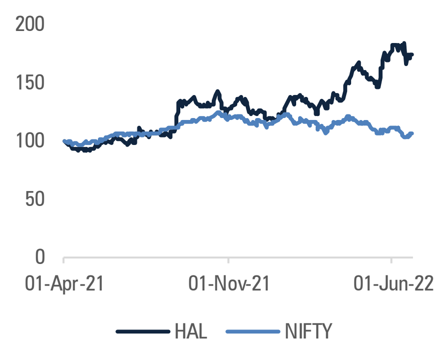
Alternate Stock Idea: Besides HAL, we also like Bharat Electronics (BEL) in the defence space.

- Strong growth in profitability led by well executed healthy order backlog and sustained margins. Strong balance sheet, double digit returns ratios
- BUY with a target price of ₹ 290/share

Particulars

Particular	Amount
Market Capitalisation (₹ Crore)	60,458
Total Debt (FY22 - ₹ Crore)	-
Cash (FY22 - ₹ Crore)	3,079
EV (₹ Crore)	57,379
52 Week H/L (Rs)	1,970 / 1,011
Equity Capital	334
Face Value	10

Share Price Performance



Shareholding Pattern

	Jun-21	Sep-21	Dec-21	Mar-22
Promoter	75.2	75.2	75.2	75.2
FII	1.0	2.3	3.2	4.4
DII	20.5	5.4	18.3	17.0
Others	3.3	17.2	3.4	3.5

Key risks

- Dependence on government contracts
- Dependence on foreign OEMs for key components

Research Analyst

Chirag Shah
shah.chirag@icicisecurities.com

Vijay Goel
vijay.goel@icicisecurities.com

Key Financial Summary

(₹ crore)	FY19	FY20	FY21	FY22	4 Year CAGR (FY19-22)	FY23E	FY24E	2 Year CAGR (FY22-24E)
Revenues	20,008	21,438	22,882	24,620	5.3	26,005	28,077	6.8
EBITDA	4,543	4,896	5,336	5,409	4.5	6,104	6,765	11.8
EBITDA margin (%)	22.7	22.8	23.3	22.0		23.5	24.1	
Profit Before Tax	3,725	3,969	4,283	5,225	8.8	5,454	6,061	7.7
EPS (₹)	69.6	85.9	97.1	151.9		123.6	137.4	
P/E (x)	25.9	21.6	18.6	11.9		14.6	13.1	
EV/EBITDA (x)	14.1	13.4	9.9	8.5		7.7	6.9	
RoCE (%)	24.0	21.9	29.4	27.4		29.7	30.5	
RoE (%)	19.3	21.0	21.0	26.3		22.5	23.2	

Source: ICICI Direct Research, Company *Note: Higher other income & tax refund led to significant jump in net profit in FY22*

ICICI Securities – Retail Equity Research

Company Background

Hindustan Aeronautics (HAL) was incorporated as Aeronautics India Ltd on August 16, 1963. Subsequently, Hindustan Aircraft Ltd, a company incorporated in 1940, was merged with the company and the name of the company was changed to Hindustan Aeronautics Ltd (HAL) with effect from October 1, 1964. HAL is the largest DPSU in terms of value of production and was given Navratna status by the Government of India (GoI) in June 2007.

HAL is engaged in the design, development, manufacture, repair, overhaul, upgrade and servicing of a wide range of products including, aircraft, helicopters, aero-engines, avionics, accessories and aerospace structures. Currently, HAL has 20 production and 10 R&D centres co-located with the production divisions, at nine geographic locations across the country. These divisions are organised into five complexes, viz. Bangalore Complex, MiG Complex, Helicopter Complex, Accessories Complex and Design Complex. Apart from this, a new facility at Tumkur (Karnataka) has been set up and is expected to be operational soon.

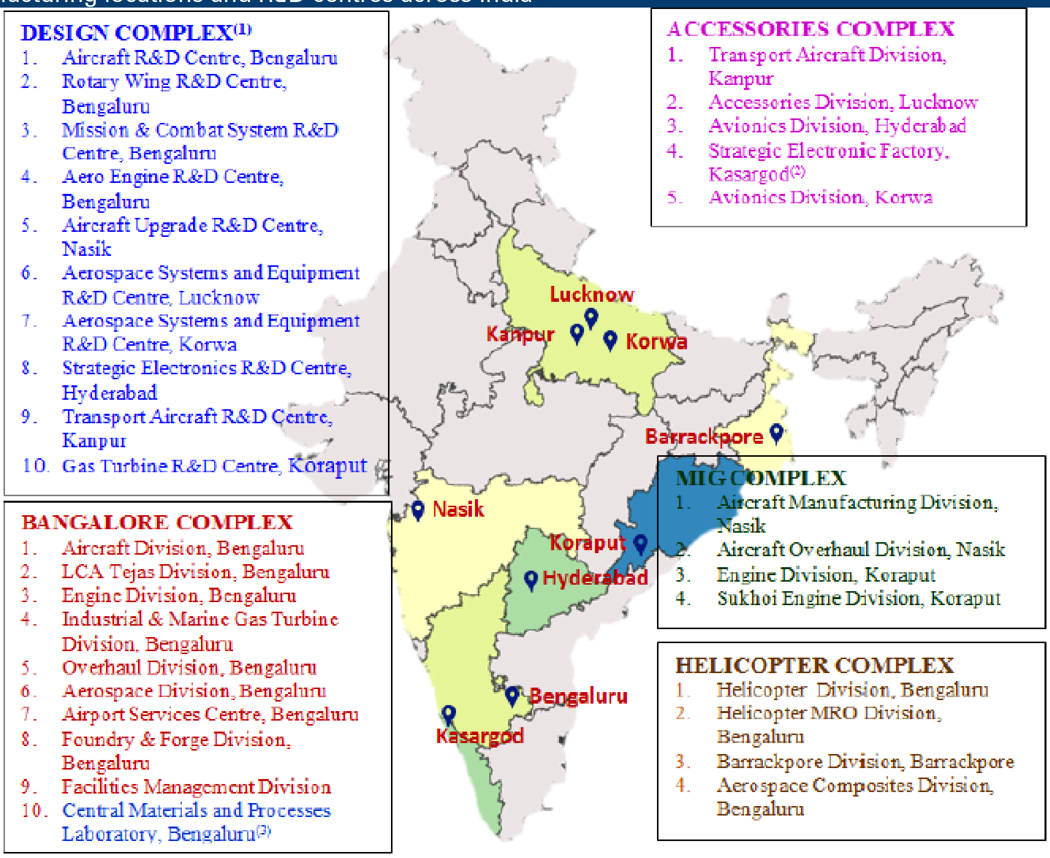
The company has delivered 7.4% revenue CAGR during FY18-22 to ₹ 24,620 crore in FY22. EBITDA and PAT CAGR were at 12.0% and 26.5%, respectively, during the period to ₹ 5,409 crore and ₹ 5,080 crore, respectively, in FY22.

Exhibit 1: HAL's complexes with major operations

Complex	Makor Operations
Bangalore Complex	Production and ROH of Fixed-wing Aircraft and Engines (Indian and Western origin), Spacecraft Structures, Castings, Forgings & Rolled Rings.
MiG Complex	Production and ROH of Fixed wing Aircraft and Engines (mainly Russian origin).
Helicopter Complex	Production and ROH of Helicopters (Indian and Western origin).
Accessories Complex	Production and ROH of Transport Aircraft. Production and ROH of Accessories and Avionics for Fixed-wing and Rotary wing Platforms (Indian, Russian and Western origin). Depot Level Maintenance of UAVs.
Design Complex	Design & Development of Fixed-wing and Rotary-wing Aircraft, Unmanned Aerial Vehicles (UAV), Aero-engines, Avionics and Accessories

Source: ICICI Direct Research, Company

Exhibit 2: Manufacturing locations and R&D centres across India



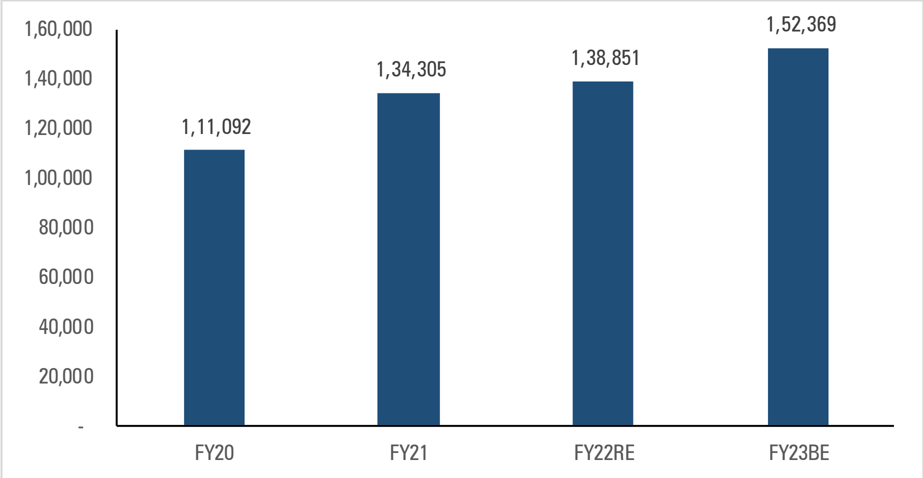
Source: ICICI Direct Research, Company *Note: R&D Centres are presented in blue coloured font*

Investment Rationale

Government focus on increasing defence capital outlay; more towards indigenisation, modernisation of equipment

There was a structural shift in the India defence budget with increased allocation towards modernisation funds. In the FY23E Budget, the government earmarked ₹ 1.52 lakh crore of capital outlay in defence, which has grown at 11% CAGR over FY20-23BE. This capital outlay in defence for FY23E was at ~29% of the total defence budget of ₹ 5.25 lakh crore against ~25% in FY20. The total procurement budget for defence equipment is estimated to be ~₹ 1.24 lakh crore for FY23E.

Exhibit 3: Budgeted defence capital outlay (₹ crore)

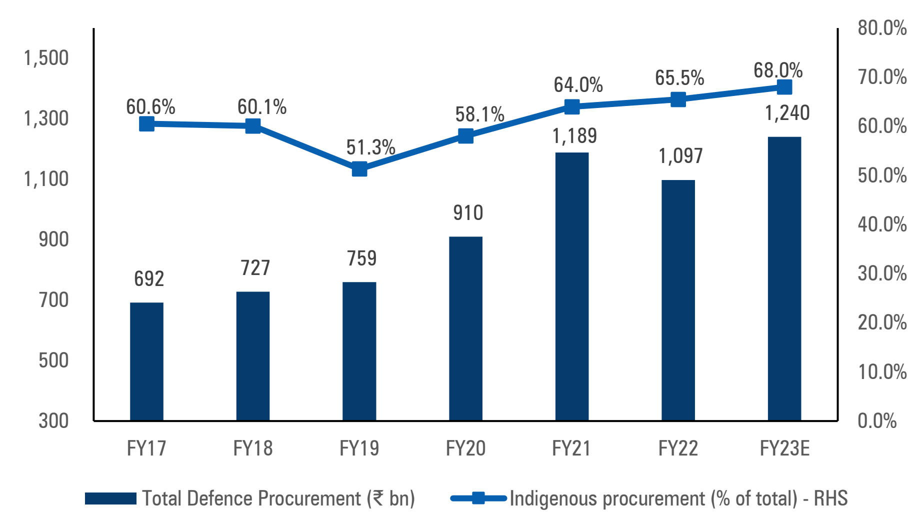


Source: ICICI Direct Research, Company

The government earmarked ₹ 84,598 crore, 68% of the military's capital acquisition budget, for purchasing locally produced weapons and systems to boost self-reliance in the defence sector. The government has notified three lists of total 310 defence items (in the last two years), which will be procured locally in the next three to five years.

These include major equipment/platforms like combat aircraft, submarines, armoured vehicles, light weight tanks, helicopters, missiles, radars, howitzers, sensors, simulators, torpedoes, unmanned aerial vehicles, etc. Out of these 310 items, 90 are planned to be indigenised by December 2022 only. Moreover, the Defence Ministry has also notified two lists of 458 items (in the last six months) for indigenisation manufacturing (that includes sub-systems, assemblies, components).

Exhibit 4: Total 68% of FY23E defence procurement budget kept for indigenous industry



Source: ICICI Direct Research, Budget documents, Standing Committee on Defence

The R&D budget for DRDO was at ₹ 11982 crore for FY23E, which has also grown at 11% CAGR over FY20-23BE. Recently, 18 major platforms have also been identified by the Ministry of Defence for industry led design & development under various routes. Moreover, 30 transfer of technology (ToT) agreements have been signed by DRDO with 25 domestic players while handing over 21 technologies.

As per government estimates, ~₹ 5 lakh crore contracts will be placed for the defence platforms, equipment, components in the next five years. The domestic industry is expected to get orders worth ~₹ 3.5 lakh crore during the period (considering 68% indigenisation content target).

Strong capabilities across segments - Production of aircraft/helicopters, engines, repair & overhaul

HAL caters to a large spectrum of aerospace business, which includes manufacturing and maintenance, repair & overhaul (MRO) of the fixed-wing, rotary-wing, aero-engines, line replaceable units (LRUs) and airborne systems.

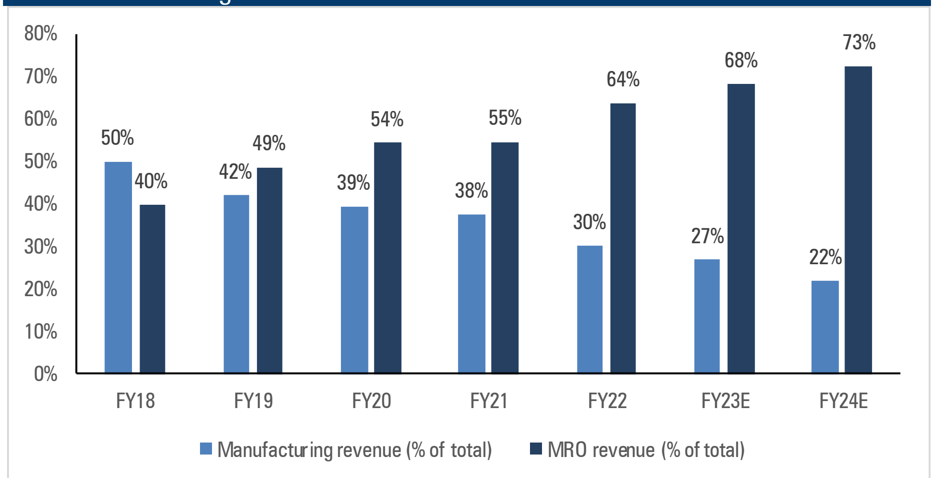
Apart from the indigenous designed aircraft/helicopters manufactured by HAL (such as Ajeet, Marut, HPT-32, Kiran, Tejas LCA and advanced light helicopters, the company has also manufactured aircraft under licence (such as the MiG 21FL/M/BIS, MiG-27, Avro, Jaguar, Dornier 228, Su-30 MkI, Hawk Mk 132) and helicopters under licence (such as the Cheetah and Chetak) along with associated engines, accessories and avionics to meet the demand of Indian defence customers.

The company's expertise also lies in aircraft upgrade for defence customers, which includes major changes like re-engining (replacing or upgrading engines), avionics upgrade and weapon system integration. It has upgraded several aircraft including the MiG-21 BIS, MiG-27 upgrade and Jaguar to enhance their combat capabilities and performance.

In addition, HAL provide support for maintenance, repair and overhaul for these indigenous and licence manufactured aircraft and helicopters, as well as for aircraft and helicopters procured directly by the Indian Defence Services along with the associated engines, accessories and avionics.

MRO contributed ~64% to total revenues of the company in FY22, which has increased from ~40% in FY18 while the share of revenues from manufacturing declined to ~30% in FY22 from ~50% in FY18. This was mainly due to lack of orders in manufacturing segment as lot of products were in the development stage, which led to a decline in revenues from manufacturing. However, MRO revenues continued to increase led by repair & overhaul activities in Russian & western origin aircraft along with engines.

Exhibit 5: Increasing trend of MRO revenue share to continue

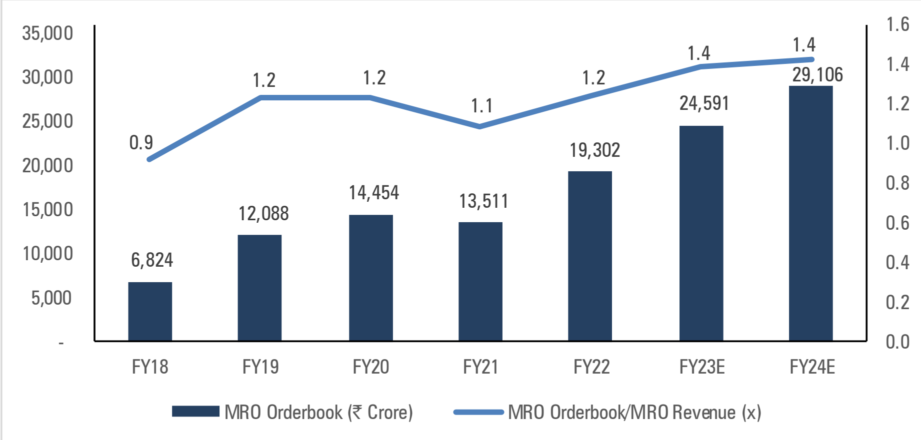


Source: ICICI Direct Research, Company

The HAL management said MRO activities on any aircraft/helicopter and engines depends on their utilisation level and generally requires MRO after about 2,000 hours of flying or eight to 10 years of service. However, only repair is also sometimes required in case of any emergency problems. Thus, since the Indian Air Force has a large inventory of aircraft/helicopters, at present, and is in the process of procuring more, HAL would continue to get orders for MRO support.

The management also said that though MRO orders expectation for the next two to three years is already known the company shows order backlog for only about next one year.

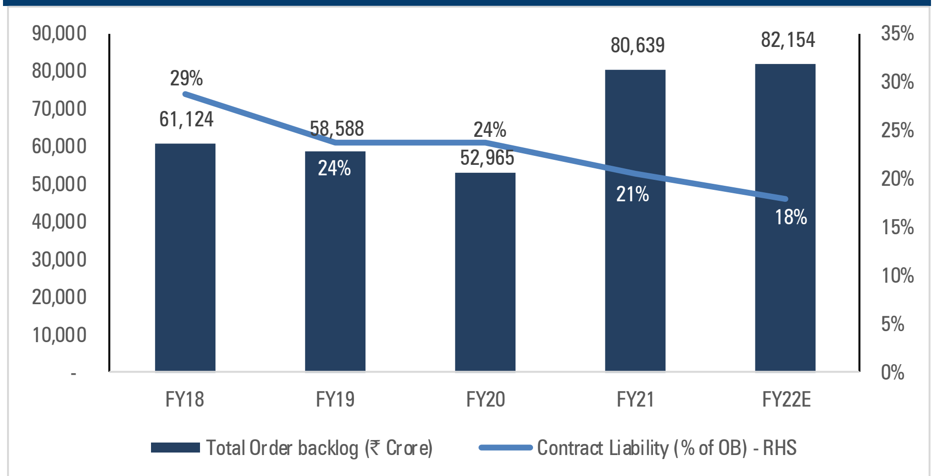
Exhibit 6: MRO order-book/revenues at 1.1-1.2x over last four years



Source: ICICI Direct Research, Company

Advances from customers play a major role in working capital support and, thus, execution of manufacturing and MRO contracts. Total contract liability is at ~23% (on an average of last five years) of the closing order book.

Exhibit 7: Advances from customers at 20-30% of order-book

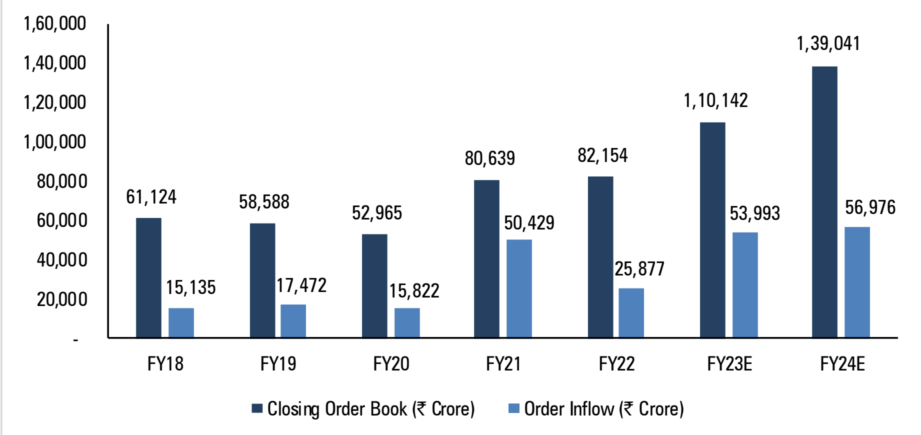


Source: ICICI Direct Research, Company

Strong order-book; healthy pipeline provides visibility

HAL's FY22 closing order book was at ₹ 82,513 crore. The company received orders worth ₹ 76,306 crore in the last two years (FY21 & FY22), of which over 50% i.e. ₹ 40,263 crore of orders were from manufacturing segment (led by order received in FY21 for 83 Tejas LCA MK1A and 15 light combat helicopters in FY22). Repair & overhaul segment order inflows were at ₹ 27,996 crore in the last two years while ₹ 2,774 crore worth of orders received from development segment during the period.

Exhibit 8: Order inflows, closing order book trend

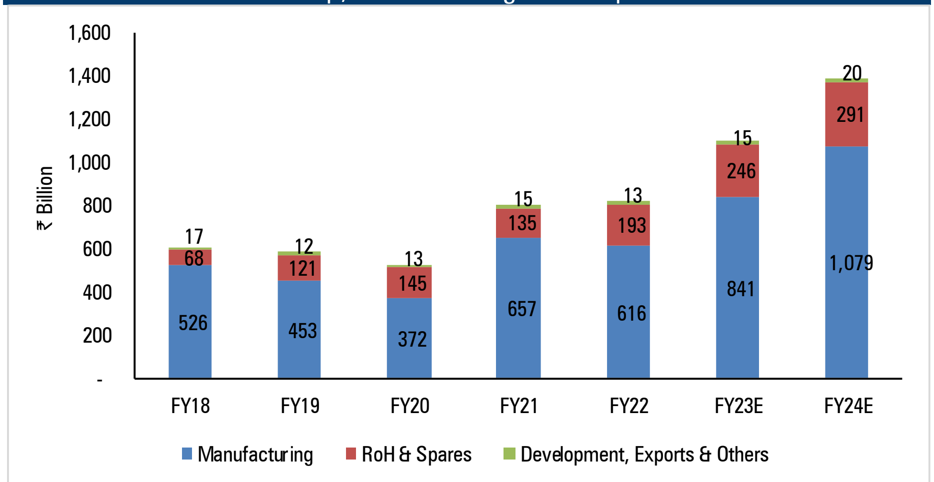


Source: ICICI Direct Research, Company

The company produced 44 aircraft/helicopters in FY22 (same as FY21) and expects to produce 40 aircraft/helicopters in FY23. Among pending orders of HAL, which comprises current order backlog of manufacturing segment, the company has eight LCA – trainers order, 15 LCH order, nine ALH order, 83 LCA Tejas MK1A order along with engine manufacturing.

Revenues from manufacturing are expected to come down in FY23-24E as the major order of LCA Tejas MK1A will also start production by FY25E and will be executed over the next six years starting from FY25E. However, the other pending orders of LCA trainers, ALH, LCH, LUH will be completed over the next two to three years. The management said the manufacturing capacity of Tejas LCA is eight per annum at present and is expected to increase to 16 by FY25E and 20, thereafter, by the time production of 83 LCAs kicks in.

Exhibit 9: Order book breakup; manufacturing makes up 75% of total OB



Source: ICICI Direct Research, Company

Manufacturing segment order-book, which makes up ~75% of the total order-book at present, is expected to remain at this level in the next two to three years. Among major orders in the pipeline and expected over the next one year are: 12 light utility helicopters (LUH), ₹ 33,000 worth of contracts for engines for Sukhoi-30 and MiG-29, 12 Su-30 MKI, ₹ 7,000 crore order for HTT-40 and 25 advanced light helicopters (ALH). Post the initial orders for LCH and LUH, HAL expects the main orders of 140 LCH and 168 LUH by FY25-26E.

The capex for the new facility at Tumkur (Karnataka) phase -1 & 2 is already done and capacity utilisation is expected to be ramped up gradually. Light utility helicopters (LUH) will be produced at this facility (once the order gets placed) with the first helicopter production expected in July 2022.

Exhibit 10: Total ~₹ 1.24 lakh crore of orders in pipeline for next three to four years

Orders in Pipeline	Quantity	Estimated Value (₹ Crore)	Expected
Light Combat Helicopter (LCH)	140	30,800	FY25-26E
Light Utility Helicopters (LUH)	12	2,040	FY23E
Light Utility Helicopters (LUH)	168	28,560	FY25-26E
Advanced Light Helicopters (ALH)	25	5,000	FY23E
Su-30 MKI	12	12,000	FY23/24E
HTT-40	108	7,000	FY23E
Naval Utility Helipcopters	40	6,000	FY24E
Engines for Su-30 and Mig-29		33,000	FY23-24E
Total		**1,24,400**	

Source: ICICI Direct Research, Company

Strong design and development capabilities

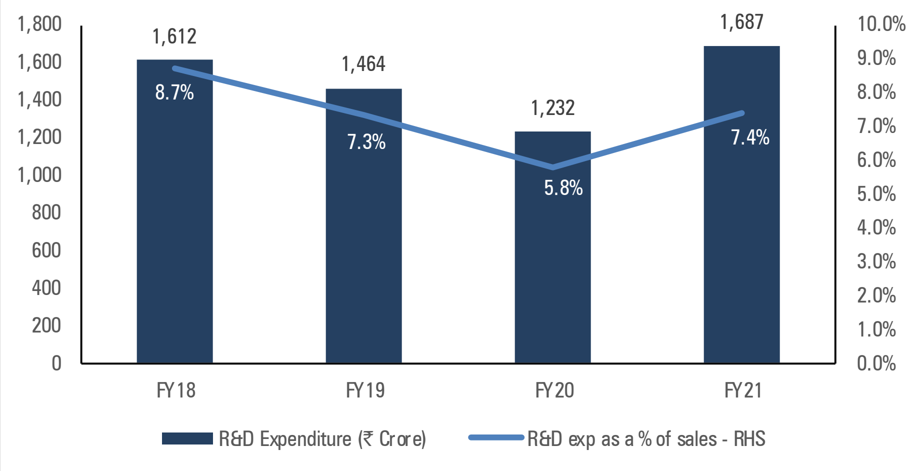
R&D has been the main focus area of the company for increasing indigenisation and value addition in its products/systems. Over the years, HAL has showcased its research, design and development capabilities with the successful development of indigenous military aircraft and helicopters such as the Ajeet, Marut, HPT-32, Kiran, Tejas LCA and advanced light helicopter, which were manufactured by the company post approvals. The company has directed its development efforts towards innovative technologies designed to expand its defence products portfolio.

With 10 dedicated R&D centres, HAL is capable of developing a wide range of products, upgrading products with combat operational capability and operational performance and maintaining a pipeline of products to meet the future needs of armed forces. These R&D centres are co-located with the production divisions, which provide operational efficiencies in terms of reduction in overall time required to develop, manufacture and deliver the products/services.

HAL has successfully completed transfer of technology (ToT) absorption and production of aircraft & helicopters like Jaguar, Hawk, MiG-21, MiG-27, Su-30MKI, Cheetah and Chetak Helicopters.

The company has also been involved in design & development of a wide range of utility and combat helicopters platforms like light combat helicopters (LCH), light utility helicopters (LUH), advanced light helicopters (ALH) that have been offered to the customers. Towards the progress of the R&D efforts, HAL incurred a total expenditure of ₹ 1,687 crore in FY21 (7.4% of sales).

Exhibit 11: R&D expenditure incurred over the years



Source: ICICI Direct Research, Company

HAL has achieved significant progress in various R&D/development projects viz. basic trainer aircraft (HTT-40), LUH, LCA- MK1A, Jaguar Darin III Upgrade, Hawk-i and Development of Engines. Prototype of LCA Tejas MK1A is ready and type certification of all the systems expected in the next one and a half years.

During FY21, among key developments, HAL entered into MoU with Aeronautical Development Agency (ADA) for design and development of advanced medium combat aircraft (AMCA), which is a twin engine multi role aircraft with fifth generation capabilities and is being developed by ADA for the IAF. Also, an MoU was signed between HAL and DRDO for ToT for production that designated HAL as lead system integrator of UTTAM radar, an active electronically scanned array (AESA) radar, designed & developed by DRDO for LCA Mk1 & Mk1A.

HAL continues to invest in developing differentiated products and services, required in future to make the systems more agile, effective and cost efficient. The futuristic projects on the anvil like LCA MkII, Advance Medium Combat Aircraft (AMCA), Indian multirole helicopter (IMRH), twin engine deck based fighter (TEDBF), aero engines development, etc, will ensure technological lead of the company in the years to come. HAL is also focusing on meeting UAV requirements of the Indian defence forces through indigenous efforts and business collaboration with global OEMs.

Exports opportunity

Currently, HAL's exports revenue is just 0.6% of total revenues but the company expects it to increase over the coming years as it has a wide range of products/aircraft across categories like transport, trainers, fighters in aircraft/helicopters. It continues to look for export opportunity for some of its products including LCA Tejas MK1A, Trainers or utility aircraft & helicopters along with MRO activities.

The management believes HAL has the competitive strength in exports considering the lower cost given economies of scale and expertise in providing MRO support.

The company is looking at Indian ocean region countries like Malaysia, Philippines, Indonesia and Vietnam. Apart from this, HAL is exploring MENA region (Middle East & North Africa) for exports.

Recent news indicates that India has emerged as the frontrunner for an export order from Malaysia for 18 Light Combat Aircraft (LCA) given its low acquisition cost and high technical ratings. If India gets this order, HAL will manufacture these LCAs for Malaysia and will also offer MRO support for their fleet of 18 Sukhoi-30 jets along with this fleet of Tejas LCA MK1A.

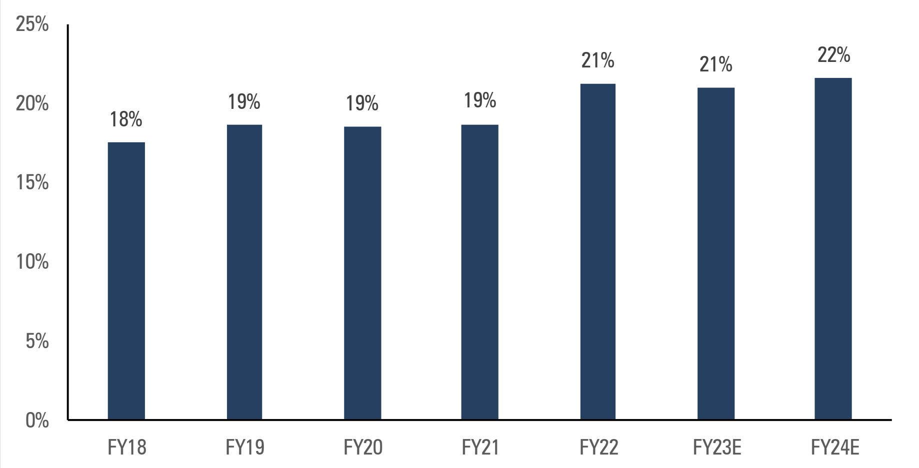
India's defence exports have grown by six times to ₹ 12000 crore in FY22 since FY14. The Government of India has set an ambitious annual export target of around ₹ 36,500 crore by 2025.

India has offered to set up production facilities for manufacturing LCA as well as helicopters in Egypt as it pursues export opportunities in the MENA region. According to media sources, Egyptian Air Force has a requirement of about 70 light combat jets, with focus on local production and technology transfer. Besides the Tejas LCA Mk1A, indigenous choppers manufactured by HAL like ALH and LCH have also been offered.

Margins better than benchmark margins from MoD

Though the benchmark margins (PBT margin) are fixed for nomination contracts from Ministry of Defence (MoD) (7.5% for manufacturing contracts and 10% for repair & overhaul contracts), HAL earns much better PBT margins (~20-21%) despite having all contracts on a nomination basis. This is led by better operational efficiencies like strategic located R&D and manufacturing facilities, improved productivity of manpower, economies of scale and better bargaining power with vendors.

Exhibit 12: PBT margins at 19-21%; much better than MoD benchmark margins



Source: ICICI Direct Research, Company

The contract nature and pricing policy of HAL also supports operating margins as the company gets a fixed price quotation for manufacturing and MRO activities where the base year verification is done and for the subsequent period (which could be as long as seven years). The company keeps getting the new pricing, which takes care of the escalation parameters. Moreover, exchange rate variation also gets reimbursed by customers.

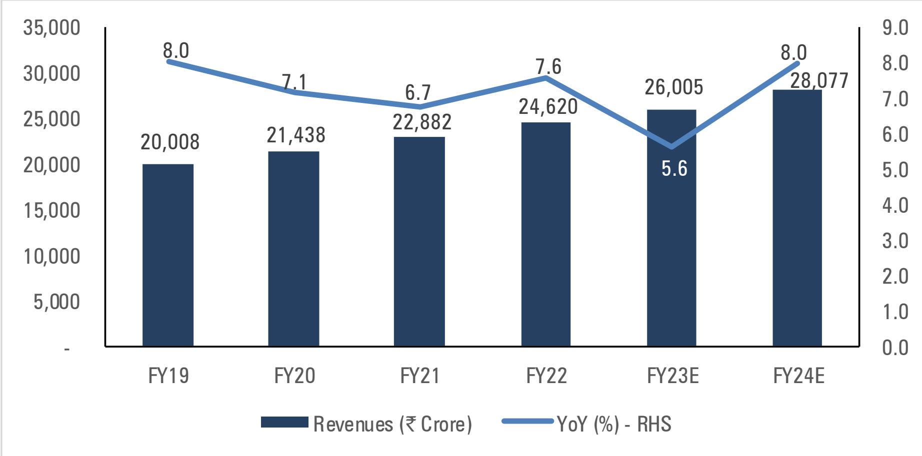
The management said the company gets ~₹ 6000 crore revenue through the Russian platforms and their support system. Though the supply has been impacted a bit, the company does not expect any major problems as it maintains inventory level of about six months for production. Moreover, there are no Russian parts involved in the production of LCA Tejas MK1A and trainers except one, which comes from Ukraine. HAL has alternative sources available and will explore these so that the production of LCAs does not get impacted.

In terms of employee cost, it was at 18-19% of sales during FY21-22, which has come down from 21-22% of sales during FY19-20. HAL employs about 26,000 employees and aims to cut down to 22,000-23,000 as it looks to outsource some activities and focus more on assembling, design & development and delivery. The management expects the overall employee cost (as percentage of sales) to come down further and aims to reach 16% by FY25E. Going ahead, we expect PBT margins to remain better at 21-22% in FY23-24E led by higher proportion of MRO revenues, reduction in employee cost.

Financials

Revenues expected to grow at 6.8% CAGR over FY22-24E

Exhibit 13: Sustained strong growth in repair & overhaul to drive revenues



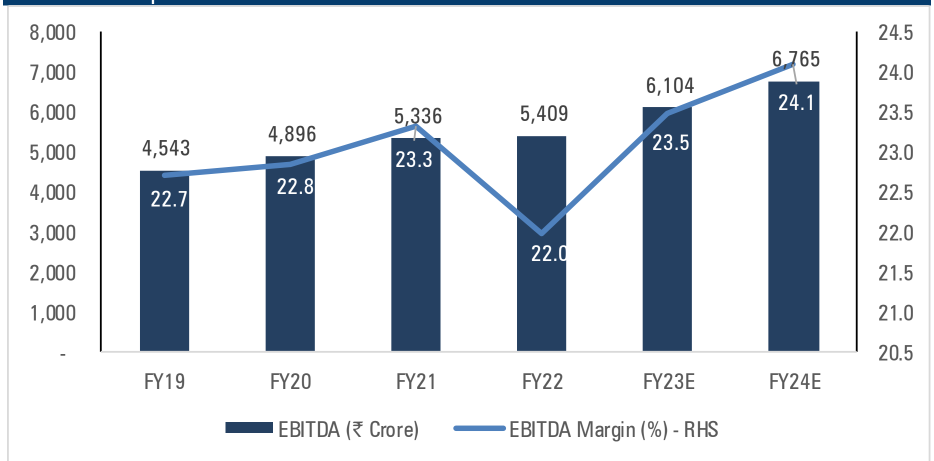
Source: ICICI Direct Research, Company

HAL revenues grew at 7.4% CAGR over FY18-22; mainly led by ~20% CAGR in maintenance, repair & overhaul (MRO segment). Revenues from manufacturing segment saw a decline over the same period due to muted order inflow in FY18-20

FY23-24E is also expected to see a fall in revenue share from manufacturing segment as the largest order (LCA Tejas MK1A will only start delivery from FY25E. Overall, we expect 6.8% revenue CAGR over FY22-24E led by ~14% CAGR in MRO

EBITDA margins expected at 23-24% over FY22-24E

Exhibit 14: Operational efficiencies to drive EBITDA at 12% CAGR over FY22-24E



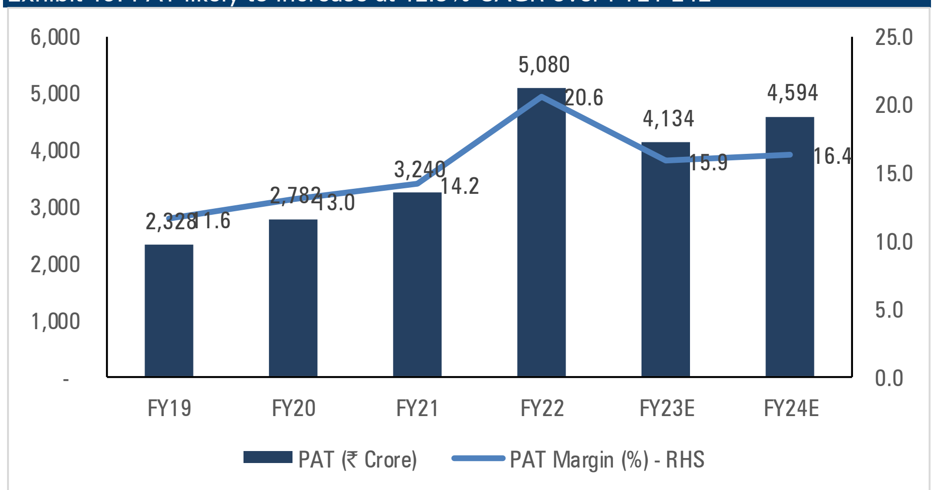
Source: ICICI Direct Research, Company

EBITDA margin was at 22% in FY22, down from 23.3% in FY21 mainly due to higher other costs. We expect margins at 23.5% in FY23E and 24.1% in FY24E led by increasing proportion of MRO revenues, operational efficiencies and reduction in employees cost (as percentage of sales)

Subsequently, we expect EBITDA CAGR of 11.8% over FY22-24E against 12.0% CAGR seen over FY18-22

PAT margins expected at 15-16% over FY22-24E

Exhibit 15: PAT likely to increase at 12.3% CAGR over FY21-24E



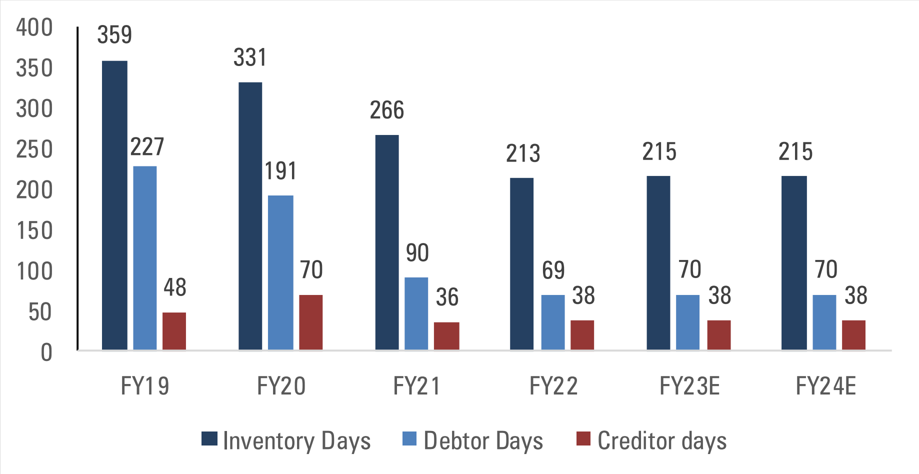
Source: ICICI Direct Research, Company

HAL earns much better PBT margins, which were at 20-21%. This is led by better operational efficiencies like strategically located R&D and manufacturing facilities, lower employee costs and economies of scale

PAT is expected to grow at 12.3% CAGR over FY21-24E led by improvement in operating margins

Improving working capital position, return ratios

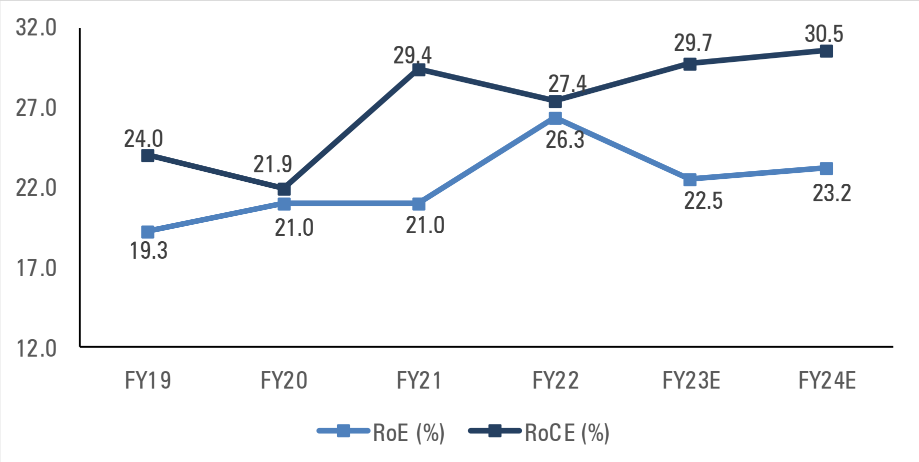
Exhibit 16: Working capital position expected to improve



Source: ICICI Direct Research, Company

The company's working capital position improved significantly over the last two years led by sharp reduction in inventory and debtor days. Inventory days declined to 213 days in FY22 from 359 days in FY19. Debtors days also declined sharply to 69 days in FY22 from 227 days in FY19

Exhibit 17: Return ratios to remain better over FY23-24E



Source: ICICI Direct Research, Company

RoE improved sharply in FY22 to 26.3% led by significant higher profitability during the year aided by one-off other income and lower tax rate. We expect RoE to remain at 22-23% over FY23-24E led by improvement in profitability margins and asset turnover. RoCE is expected at ~30% over FY23-24E

Valuation & Outlook

Hindustan Aeronautics will benefit significantly from the government's indigenisation push in the defence sector. Considering the country's need for spending more on defence modernisation and faster procurement of defence equipments through indigenisation, increase in capital outlay in defence is necessary, which is also visible through government actions.

HAL, the only defence PSU present in manufacturing of indigenous aircraft & helicopters and providing MRO support for the same, is expected to see a lot of opportunities in the coming years in terms of large scale of orders from MoD or the armed forces. We believe the company's focus on indigenous design & development of defence platforms/components would drive faster execution of projects in the years to come.

Current order-book at ₹ 82,154 already provides healthy visibility (3.3x FY22 revenues). Moreover, orders worth ₹ 1.24 lakh crore in the pipeline gives much comfort over the longer term. Stellar execution of the strong order backlog with a focus on operational efficiencies would lead to sustainable and better operating margins. We expect revenue and EBITDA to grow at 6.8% and 11.8% CAGR, respectively, over FY22-24E.

At the CMP, the stock is trading at attractive valuations of 13.x on FY24E earnings which is over 30% discount to Bharat Electronics (BEL) valuations. Though we believe BEL's premium valuations are justified considering strong growth over the next two years, the 30%+ discount, which HAL gets over BEL, is unwarranted and is expected to narrow down as HAL would start delivering double digit revenue growth from FY25E onwards. Moreover, healthy balance sheet, improvement in working capital cycle and strong return ratios make HAL an attractive investment. We initiate coverage on the stock with a **BUY** rating with a target price of ₹ 2,200/ share based on 16x FY24E earnings.

Exhibit 18: Peer Valuations

	Mcap	EPS		P/E (x)		EV/EBITDA (x)		RoE (%)	
Company	₹ Crore	FY23E	FY24E	FY23E	FY24E	FY23E	FY24E	FY23E	FY24E
Hindusatan Aeronautics	60,231.5	123.6	137.4	14.6	13.1	7.7	6.9	22.5	23.2
Bharat Electronics	57,588.9	11.0	12.2	21.5	19.5	14.5	12.5	20.9	20.9
Bharat Dynamics*	13,176.1	39.1	47.0	18.4	15.3	11.7	9.7	17.2	14.8
Cochin Shipyard	4,125.1	38.6	42.3	8.1	7.4	4.1	3.8	10.8	11.1

Source: ICICI Direct Research, Company **Bharat Dynamics estimates are consensus estimates from Bloomberg*

Key risks

Heavily dependent on contracts from GoI, associated entities

HAL derives a significant portion of total sales from contracts with Government of India (GoI) entities (~92% of total sales in FY21) and will continue to cater to GoI entities. Any decline or re-prioritisation of funding in the Indian defence budget, that of customers including the Indian Army, Indian Air Force and Indian Navy, Indian Coast Guard, Border Security Force, Central Reserve Police Force and Paramilitary forces or any delays in the budget process can impact the company's profitability and cash flows. The company is also exposed to various risks like stricter regulatory requirements from the government.

Delay in advances from customers may impact execution

HAL gets advances from customers in the range of 20-25% of the contract value at the beginning of project. Any delay in these advances or lower disbursement can impact execution of the project and, thus, profitability and cash flows.

Evolving technologies risks in evaluation of future prospects

Military aircraft, helicopters and other technologies that the company offers are sold in new and rapidly evolving markets. Accordingly, HAL's business and future prospects are difficult to evaluate considering the evolving technologies and markets.

Dependent on key technology licensors, OEMs, suppliers, sub-contractors

HAL substantially relies on licence of technology from domestic and international licensors and OEMs such as the Aeronautical Development Agency (ADA) in case of domestic technology, BAE Systems, Rolls Royce and others in the case of western technology and Rosoboronexport in case of Russian technology. The company depends on these prime contractors, supplying agency and OEM relationships for technical know-how to manufacture aircraft, helicopters and engines and MRO for the products manufactured under license. HAL's business can be impacted by the price, quality, availability and timely delivery of the component parts that are used to manufacture the products, which further can impact execution of contracts and, thus, profitability and cash flows.

Financial Summary

Exhibit 19: Profit and loss statement ₹ crore

(₹ Crore)	FY20	FY21	FY22	FY23E	FY24E
Revenue	21,438	22,882	24,620	26,005	28,077
% Growth		*6.7*	*7.6*	*5.6*	*8.0*
Other income	293.9	357.5	984.9	650.0	700.0
Total Revenue	21,732	23,247	25,613	26,661	28,785
% Growth		*7.0*	*10.2*	*4.1*	*8.0*
Total Raw Material Costs	9,387	11,191	10,001	12,612	13,477
Employee Expenses	4,778	4,305	4,604	4,681	4,913
other expenses	2,377	2,049	4,606	2,608	2,922
Total Operating Expenditure	16,542	17,546	19,211	19,901	21,312
Operating Profit (EBITDA)	4,896	5,336	5,409	6,104	6,765
% Growth		*9.0*	*1.4*	*12.9*	*10.8*
Interest	348	259	58	-	-
PBDT	4,842	5,435	6,335	6,754	7,465
Depreciation	999	1,158	1,111	1,300	1,404
PBT before Exceptional Items	3,843	4,277	5,225	5,454	6,061
Total Tax	1,096	1,038	145	1,320	1,467
PAT before MI	2,873	3,246	5,080	4,134	4,594
Minority Interest	-	-	-	-	-
PAT	2,873	3,246	5,080	4,134	4,594
% Growth		*13.0*	*56.5*	*(18.6)*	*11.1*
EPS	85.9	97.1	151.9	123.6	137.4

Source: ICICI Direct Research

Exhibit 20: Cash Flow Statement ₹ crore

(₹ Crore)	FY20	FY21	FY22	FY23E	FY24E
Profit after Tax	2,873	3,246	5,080	4,134	4,594
Depreciation	999	1,158	1,111	1,300	1,404
Interest	348	259	58	-	-
Cash Flow before WC change	4,220	4,663	6,249	5,434	5,998
Changes in inventory	228	2,763	2,326	(971)	(1,220)
Changes in debtors	1,223	5,567	1,027	(346)	(397)
Changes in loans & Advances	8	12	(0)	-	-
Changes in other current asse	81	(105)	(1,413)	209	(207)
Net Increase in Current Assets	(1,553)	7,877	2,562	(2,306)	(3,172)
Changes in creditors	1,455	(1,828)	302	150	216
Changes in provisions	548	(1,106)	1,121	(590)	356
Net Inc in Current Liabilities	1,064	163	(382)	1,708	1,918
Net CF from Operating activitie	3,731	12,703	8,429	4,836	4,745
Changes in deferred tax asset	(211)	418	(513)	-	-
(Purchase)/Sale of Fixed Asse	(1,243)	(586)	(1,118)	(1,200)	(1,200)
Net CF from Investing activitie	(2,983)	1,658	(11,123)	(966)	(1,235)
Dividend and Dividend Tax	(1,340)	(1,003)	(1,604)	(1,766)	(1,926)
Net CF from Financing Activiti	(489)	(7,484)	(1,375)	(5,114)	(3,121)
Net Cash flow	259	6,877	(4,068)	(1,244)	389
Opening Cash/Cash Equivalent	11	270	7,146	3,079	1,834
Closing Cash/ Cash Equivalent	270	7,146	3,079	1,834	2,223

Source: ICICI Direct Research

Exhibit 21: Balance Sheet ₹ crore

(₹ Crore)	FY20	FY21	FY22	FY23E	FY24E
Equity Capital	334.4	334.4	334.4	334.4	334.4
Reserve and Surplus	12,904	15,090	18,979	18,036	19,509
Total Shareholders fu	13,239	15,424	19,313	18,371	19,844
Other Non Current Lia	7,056.5	9,171.3	12,262.4	12,500.0	12,500.0
Total Debt	5,887	9	-	-	-
Total Liabilities	28,027	26,360	33,369	32,689	34,162
Gross Block	8,861	9,674	10,270	12,285	13,485
Acc: Depreciation	3,324	4,048	5,159	6,459	7,863
Net Block	6,351	6,222	5,928	5,826	5,623
Capital WIP	860	663	949	950	950
Total Fixed Assets	9,400	9,115	9,239	9,176	8,973
Non Current Assets	1,493	1,150	2,797	2,825	2,860
Inventory	19,436	16,673	14,347	15,318	16,538
Debtors	11,235	5,668	4,642	4,987	5,385
Loans and Advances	19	8	8	8	8
Other Current Assets	1,291	1,396	2,809	2,600	2,808
Cash	270	7,146	3,079	1,834	2,223
Total Current Assets	41,347	40,347	33,716	34,778	38,339
Current Liabilities	4,084	2,256	2,558	2,707	2,923
Provisions	1,289	1,256	1,263	1,265	1,265
Total Current Liabilitie	25,241	25,404	25,023	26,731	28,649
Net Current Assets	16,106	14,943	8,694	8,048	9,690
Total Assets	28,027	26,360	33,369	32,689	34,162

Source: ICICI Direct Research

Exhibit 22: Ratio Analysis ₹ crore

(Year-end March)	FY20	FY21	FY22	FY23E	FY24E
EPS	85.9	97.1	151.9	123.6	137.4
Cash per Share	9.2	214.7	429.3	392.1	403.7
BV	395.9	461.3	577.6	549.4	593.4
Dividend per share	33.2	30.0	40.0	44.0	48.0
Dividend payout ratio	0.4	0.3	0.3	0.4	0.3
EBITDA Margin	22.8	23.3	22.0	23.5	24.1
PAT Margin	13.5	14.2	20.6	15.9	16.4
RoE	21.0	21.0	26.3	22.5	23.2
RoCE	21.9	29.4	27.4	29.7	30.5
RoIC	20.7	50.4	26.5	29.0	30.4
EV / EBITDA	13.4	9.9	8.5	7.7	6.9
P/E	21.6	18.6	11.9	14.6	13.1
EV / Net Sales	3.1	2.3	1.9	1.8	1.7
Sales / Equity	1.6	1.5	1.3	1.4	1.4
Market Cap / Sales	2.8	2.6	2.4	2.3	2.1
Price to Book Value	4.5	3.9	3.1	3.3	3.0
Asset turnover	1.1	1.5	1.3	1.4	1.4
Debtors Turnover Rati	1.8	2.7	4.8	5.4	5.4
Creditors Turnover Ra	6.4	7.2	10.2	9.9	10.0
Debt / Equity	0.4	0.0	-	-	-
Current Ratio	2.6	2.8	2.1	2.3	2.4
Quick Ratio	1.0	0.8	0.7	0.8	0.8

Source: ICICI Direct Research

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Pankaj Pandey | **Head – Research** | **pankaj.pandey@icicisecurities.com**

ICICI Direct Research Desk,
ICICI Securities Limited,
1st Floor, Akruti Trade Centre,
Road No 7, MIDC,
Andheri (East)
Mumbai – 400 093
research@icicidirect.com

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