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Bharat Electronics Limited

Focus remains on sustainable growth

Capital Goods	Sharekhan code: BEL	Analyst Meet Update

Stock Update

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.
- Management expects double digit revenue growth with margins to be around 20% for FY2021E. Reiterate FY2021 order inflow target of Rs. 15,000 crore.
- Order book remains healthy at Rs. 52,148 crore (4x its TTM revenue), which provides good revenue visibility.
- 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 Limited (BEL) in its analyst conference call highlighted on opportunities arising in terms of order inflow in the upcoming years, guidance on revenue and margins as well opportunities in the diversified sectors it is present. Management believes BEL is well placed to tap on upcoming opportunities on Aatmanirbhar Bharat programme and the recent ban on import of 101 defence items (various stages of discussion for manufacturing ~55 items). Further, more than 1,000 equipment list is ready and is to be made in India. On the order pipeline front, management is looking for decent orders from the defence segment such as Quick Reaction Surface-to-Air Missile (QRSAM, opp. size ~Rs. 30,000 crore over the next 5-7 years), Long Range Surface missiles (LRSAM ~Rs. 50,000 crore order over the next few years), Electronics Warfare Systems, Akash Weapon System (Army) etc. Based on healthy pipeline, management is confident of achieving an order inflow of Rs. 15,000 crore (~Rs. 5,000 crore already bagged in H1) for FY2021. On the export front, BEL has expanded its global footprint with current order book of $200million. Management expects the order book to increase to $500million over three years. Despite the pandemic, management continues to invest heavily in capex and has maintained its guidance of capex of Rs. 550 crore (Rs. 150 crore already invested in H1FY2021) for FY2021. The company is setting up new facilities in AP (~1,000-acre land) and Telangana (~100acre). Construction at both the facilities is progressing well and is expected to commence by FY2023. During the first half of FY2021, execution was driven by ventilators orders (include 13,000 ventilators manufactured and delivered), although the company does not expect large orders as requirements of the same have come down. Moreover, during H1, there has been rise in inventory levels for defence projects and management expects to liquidate inventory in H2FY2021. Due to challenges faced by Ministry of Defence and various government authorities, there has been a rise in trade receivables. Management expects the payment cycle to improve and trade receivables to reduce by 70%-80% by FY2021 end. Apart from defence, Smart City and Homeland are other focus areas for the company. Smart City and Homeland contributed 10% in order book and 7% in revenue and are expected to reach 15% in the next three years for the civilian segment. Other areas such as critical medical equipment manufacturing, ventilators, and services are also being evaluated. Overall, management remained confident of its growth opportunities and expects around double-digit revenue growth with margins at around 20% in FY2021E and reiterated order inflow target of Rs. 15,000 crore. 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 12.2x and 10.8x its FY2022E and FY2023E earnings, respectively. With improving growth visibility, we retain our Buy rating on the stock with an unchanged price target (PT) of Rs. 135.

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, 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 expect earnings to report CAGR of 11% during FY2021-FY2023E. The stock is trading at reasonable valuations of 12.2x and 10.8x its FY2022E and FY2023E earnings, respectively. With improving growth visibility, we retain our Buy rating on the stock with an unchanged PT of Rs. 135.

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.

Valuations (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)	13.8	13.4	12.2	10.8
P/B (x)	2.5	2.3	2.1	1.9
EV/EBIDTA (x)	10.2	10.3	9.6	8.6
RoNW (%)	18.9	17.8	18.0	18.5
RoCE (%)	18.0	15.4	15.7	15.9

Source: Company; Sharekhan estimates

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. 103**	
Price Target: **Rs. 135**	↔

↑ Upgrade ↔ Maintain ↓ Downgrade

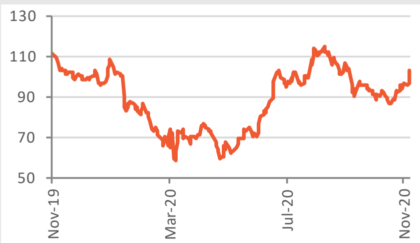
Company details

Market cap:	Rs. 25,121 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	14	-13	66	-7
Relative to Sensex	7	87	21	-17

Sharekhan Research, Bloomberg

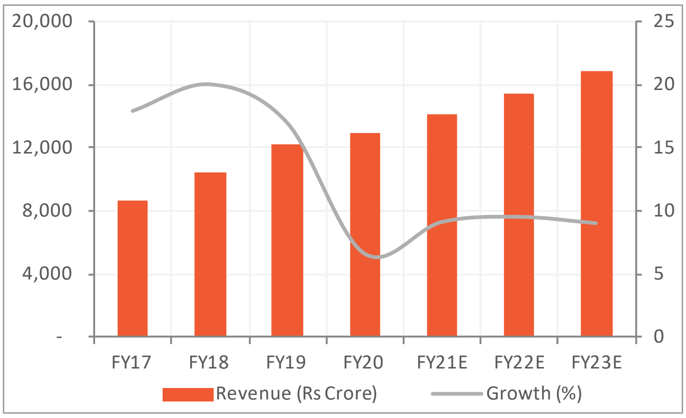
Order inflow pipeline remains strong: On the order pipeline front, management is looking for decent orders from the defence segment such as Quick Reaction Surface-to-Air Missile (QRSAM, opp. size ~Rs. 30,000 crore in 5-7 years), Long Range Surface missiles (LRSAM ~Rs. 50,000 crore order over the next few years), Electronics Warfare Systems, Akash Weapon System (Army) Coastal Surveillance System, Avionics package for LCA, etc. Based on its healthy order pipeline, management is confident of achieving an order inflow of Rs. 15,000 crore (~Rs. 5,000 crore already bagged in H1) for FY2021. On the export front, BEL has expanded its global footprint with current order book of $200million. Management expects the order book to increase to $500million over three years. BEL expects bunching of a good number of orders in the next two-and-a-half year as a greater number of projects in the trial phase are likely to come up for ordering (Mega orders greater than Rs. 5,000 crore each lined up for FY2022-FY2025). The company's order book remains healthy at Rs. 52,148 crore (4x its TTM revenue), which provides sustainable revenue visibility.

BEL Analyst Meet KTA's

- **Guidance:** Management expects double-digit revenue growth with margins at 20%-21% in FY2021E. Management has reiterated FY2021 order inflow target of Rs. 15,000 crore. Mega orders (>Rs. 5,000 crore each) are lined up for FY2022-FY2025.
- **Opportunities arising from the recent import ban on defence:** In terms of opportunities, the government's focus on Aatmanirbhar Bharat programme and the recent ban on import of 101 defence items, management believes BEL is well placed to tap on the upcoming opportunities. Out of 101 items, BEL is already in various stages of discussion for manufacturing ~55 items highlighted in the list.
- **Order pipeline:** Management is looking for decent orders from the defence segment such as QRSAM (opp. size ~Rs. 30,000 crore), LRSAM (~Rs. 50,000 crore), Electronics Warfare Systems, Akash Weapon System (Army), Coastal Surveillance system, Avionics package for LCA, etc.
- **Other areas of interest/services:** Smart City and Homeland are other focus areas for the company. Smart City and Homeland contributed 10% to order book and 7% to revenue and are expected to reach 15% in the next three years for the civilian segment. Other areas such as critical medical equipment manufacturing, ventilators, services, etc. are also being evaluated.
- **Export Segment:** BEL has expanded its global footprint with the current order book of $200million. Management expects the order book to increase to $500million over three years.
- **Order inflow guidance:** Based on its healthy order pipeline, management is confident of achieving an order inflow of ~Rs. 15,000 (~Rs. 5,000 crore already bagged in H1) for FY2021.
- **R&D investments:** Management has iterated its stand on investment in R&D and would invest 8%-10% of revenue going ahead.
- **Capex:** Despite the pandemic, management continues to invest heavily in capex and has maintained its guidance of capex of Rs. 550 crore (Rs. 150 crore already invested in H1) for FY2021. The company is setting up new facilities in AP (~1,000 acre land) and Telangana (~100 acre). Construction at both facilities is progressing well and is expected to commence by FY2023.
- Further, the company is expecting an order from Indian Army for which capex would be ~Rs. 180 crore for 100 acres land in Hyderabad. The construction activity on the site is expected to start soon as initial tendering for construction is completed. The construction activity at Nimaluru plant is in advanced stage and is expected to be commissioned by July 2021.
- **Ventilators execution:** For H1, execution was driven by ventilators orders (include 13,000 ventilators manufactured and delivered), although the company does not expect large orders as requirements of the same have come down.
- **Diversification:** (1) Batteries and cells – signed MOU with DRDO labs for naval applications; (2) Innovation cell in IIT Chennai for start-ups/incubators; (3) Issued EoI for 55 items under Make in India – 195 items identified for indigenisation. Further, software centres upgraded to CMM level 5 – for future electronics development.
- **Inventory:** During H1, there has been a rise in inventory levels for defence projects and management expects to liquidate the inventory in 2H.
- **Receivables:** Due to challenges faced by the Ministry of Defence and various government authorities, there has been a rise in trade receivables. Management expects the payment cycle to improve and trade receivable to reduce by 70%-80% by FY2021 end.

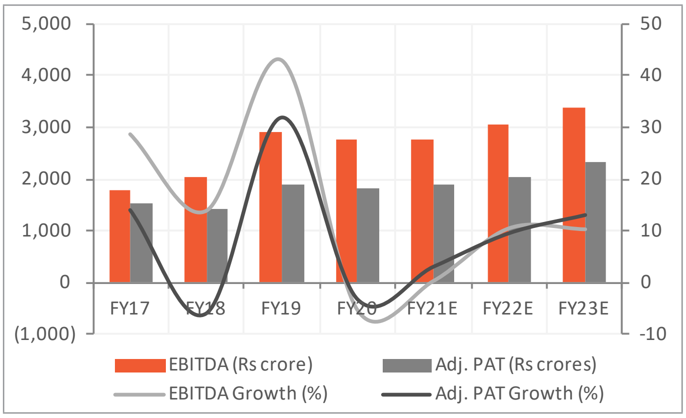
Financials in charts

Revenue and growth trend



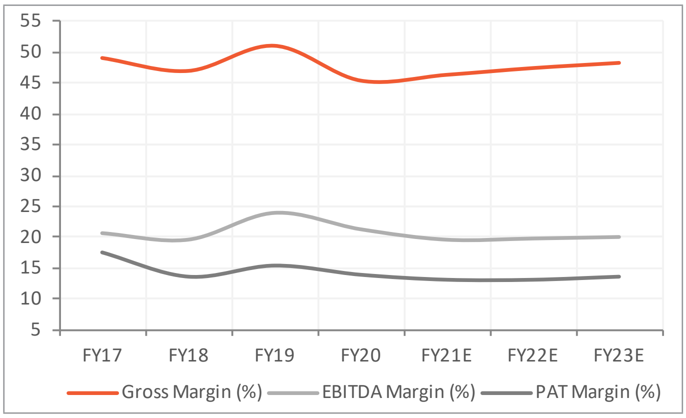
Source: Company, Sharekhan Research

OPM and net profit trend



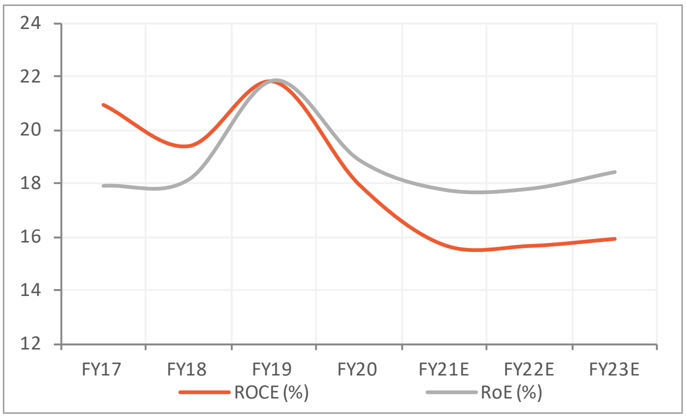
Source: Company, Sharekhan Research

Margin trend



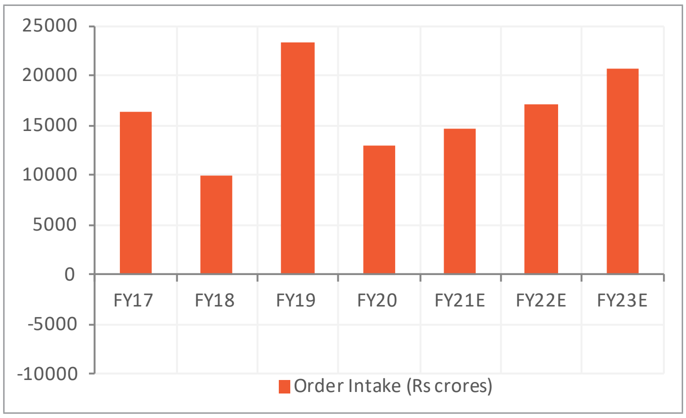
Source: Company, Sharekhan Research

Return ratios



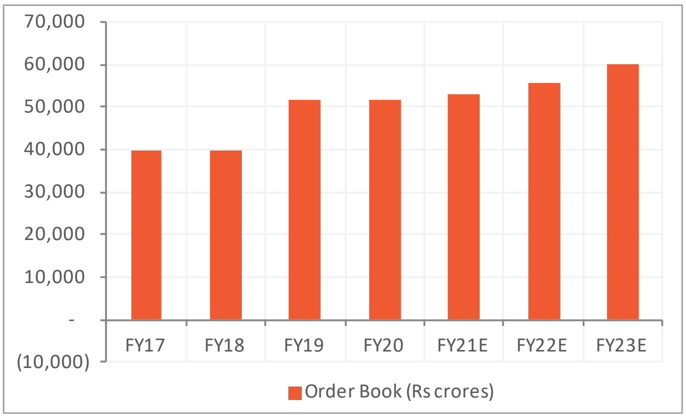
Source: Company, Sharekhan Research

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 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, the government has increased FDI to 74% through the automatic route to boost investments in this 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 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 naval utility, a helicopter has been taken up for consideration.

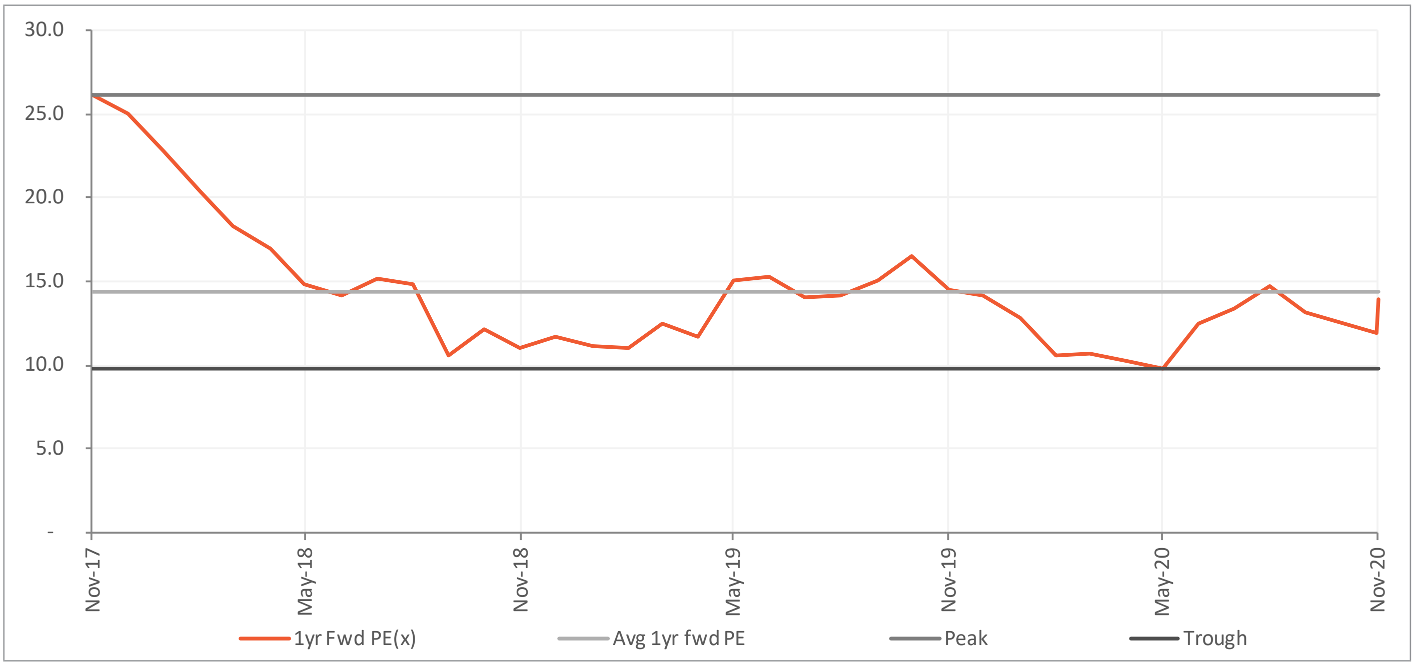
- **Company outlook - Continues to focus on sustainable growth plans:**

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 an unchanged PT of Rs. 135:**

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 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 expect earnings to report CAGR of 11% during FY2021-FY2023E. The stock is trading at reasonable valuations of 12.2x and 10.8x its FY2022E and FY2023E earnings, respectively. With improving growth visibility, we retain our Buy rating on the stock with an unchanged 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 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: 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

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