

Bharat Electronics

Estimate change	↔
TP change	↔
Rating change	↔

CMP: INR130

TP: INR150 (+16%)

Buy

Execution disappoints, but should catch up in 4Q

EBITDA margin remains strong at 19%+

- Bharat Electronics (BHE)'s 3QFY21 earnings were 21% below our est., with revenue coming in 13% lower. The revenue miss was largely due to muted execution (billing spillover likely in 4Q). EBITDA was up 24% YoY (13% below our est.). The EBITDA margin expansion was largely attributable to the beat on gross margins (lower RM cost). Adj. PAT grew a strong 22% YoY to INR2.6b, but fell short of our expectation (21% miss) – as a follow-through of the revenue miss.
- Margins depend on the sales mix between deliverables and hence they tend to be volatile on a quarterly basis. BHE's current order book is strong at INR548b, with an OB/rev ratio of 4.2x.
- Revenue/EBITDA for 9MFY21 stood flat YoY, with PAT coming in 6% lower. We trim our FY21E EPS by 4%, but maintain our FY22/FY23E earnings estimate, given the company's strong order book position and execution track record. Our TP remains unchanged at INR150 (16x FY23E EPS, on par with its long-term trading multiple). Maintain **Buy**.

Execution-led earnings disappointment; margins remain strong

- Revenue was broadly flat YoY at INR22.9b and 13% below our expectation.
- EBITDA was up 24% YoY to INR4.4b and 13% below our expectation – as a follow-through of the revenue miss.
- The EBITDA margin came in at 19.2% (+360bp YoY).
- Adj. PAT grew 22% YoY to INR2.6b and was 21% below our expectation.

Order book position remains strong

- The order book stood at INR548b, with an OB/rev ratio of 4.2x, providing strong revenue visibility.
- We estimate YTD order inflows at ~INR100b. Key orders won in the current year include ventilators, advanced torpedo defense systems, smart city projects, advanced composite communication systems, electronic warfare systems, naval fire control systems, and 3D surveillance radars. We believe the company is well-placed to meet its FY21E order inflow target of INR140–150b, implying INR40–50b of order inflows in 4QFY21. Our FY21E order inflow estimate stands at INR145b, at the mid-point of the guidance.

Valuation and view

- We forecast a revenue/EBITDA/PAT CAGR of 14%/15%/17% over FY21–23E. We have built in a sufficient margin cushion as we assume an EBITDA margin of 19.2%/19.3% by FY22E/FY23E (v/s 21.1% reported in FY20). Our TP remains unchanged at INR150 (16x FY23E EPS, on par with its long-term trading multiple). At CMP, the stock trades at FY22E/FY23E P/E of just 15x/14x – despite having RoE/RoCE of ~17%/18%, dividend yield of ~3%, and FCF yield of 3.5–6%. Maintain **Buy**. Working capital deterioration is the key risk to our rating.

Bloomberg	BHE IN
Equity Shares (m)	2,437
M.Cap.(INRb)/(USD\$b)	317.5 / 4.4
52-Week Range (INR)	141 / 56
1, 6, 12 Rel. Per (%)	16/12/17
12M Avg Val (INR M)	1506

Financials & Valuations (INR b)

Y/E Mar	2020	2021E	2022E
Sales	129.2	134.0	161.4
EBITDA	27.3	25.6	31.0
PAT	17.9	16.7	20.9
EBITDA (%)	21.1	19.1	19.2
EPS (INR)	7.4	6.8	8.6
EPS Gr. (%)	(6.9)	(7.2)	25.4
BV/Sh. (INR)	40.7	44.8	50.0

Ratios

Net D/E	(0.2)	(0.2)	(0.2)
RoE (%)	18.1	15.2	17.1
RoCE (%)	18.9	16.0	18.1
Payout (%)	42.1	40.0	40.0

Valuations

P/E (x)	17.7	19.0	15.2
P/BV (x)	3.2	2.9	2.6
EV/EBITDA (x)	11.0	11.6	9.5
Div Yield (%)	2.4	2.1	2.6
FCF Yield (%)	5.7	3.4	3.4

Shareholding pattern (%)

As On	Dec-20	Sep-20	Dec-19
Promoter	51.1	51.1	55.3
DII	31.3	31.6	25.3
FII	10.3	9.6	12.2
Others	7.3	7.7	7.2

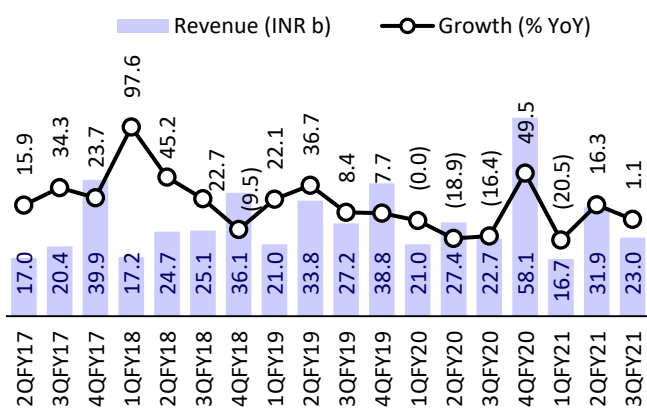
FII Includes depository receipts

Quarterly Performance

(INR m)

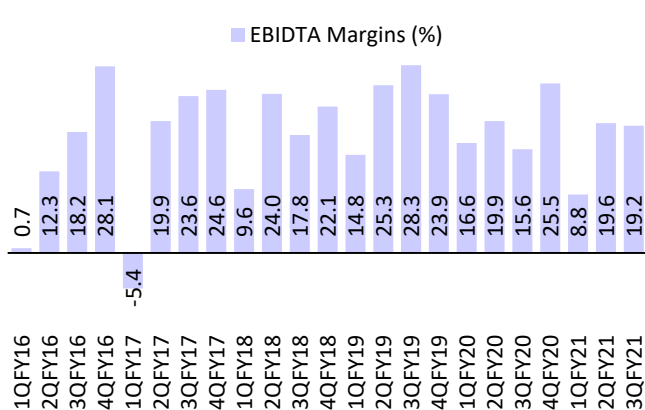
Y/E March	FY20				FY21E				FY20	FY21E	MOSL 3QE	Var (%)
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q				
Sales	21,015	27,427	22,710	58,058	16,706	31,887	22,962	62,476	1,29,211	1,34,031	26,300	(13)
Change (%)	(0.0)	(18.9)	(16.4)	49.5	(20.5)	16.3	1.1	7.6	6.9	3.7	15.8	
EBITDA	3,481	5,447	3,547	14,826	1,467	6,235	4,404	13,454	27,301	25,560	5,089	(13)
Change (%)	12.1	(36.2)	(53.8)	59.6	(57.9)	14.5	24.1	(9.2)	(4.6)	(6.4)	43.5	
As of % Sales	16.6	19.9	15.6	25.5	8.8	19.6	19.2	21.5	21.1	19.1	19.3	
Depreciation	828	857	861	950	888	914	945	1,021	3,496	3,768	950	
Interest	3	12	1	16	1	3	2	27	33	33	9	
Other Income	254	150	332	283	184	274	231	361	1,019	1,050	300	
PBT	2,904	4,729	3,017	14,142	762	5,592	3,688	12,767	24,792	22,810	4,430	(17)
Tax	857	1,334	866	3,797	221	1,622	1,070	3,246	6,853	6,159	1,116	
Effective Tax Rate (%)	29.5	28.2	28.7	26.8	29.0	29.0	29.0	25.4	27.6	27.0	25.2	
Reported PAT	2,047	3,395	2,151	10,345	541	3,971	2,619	9,521	17,938	16,651	3,314	(21)
Change (%)	13.9	(40.6)	(57.6)	54.7	(73.6)	17.0	21.7	(8.0)	(6.9)	(7.2)	54.1	
Adj PAT	2,047	3,395	2,151	10,345	541	3,971	2,619	9,521	17,938	16,651	3,314	(21)
Change (%)	13.9	(40.6)	(57.6)	54.7	(73.6)	17.0	21.7	(8.0)	(6.9)	(7.2)	54.1	

Exhibit 1: Revenue stood flat YoY in 3QFY21



Source: MOFSL, Company

Exhibit 2: EBITDA margin declined 30bp YoY to 19.6%



Source: MOFSL, Company

Story in charts

Exhibit 3: Strong order book position with healthy OB/rev

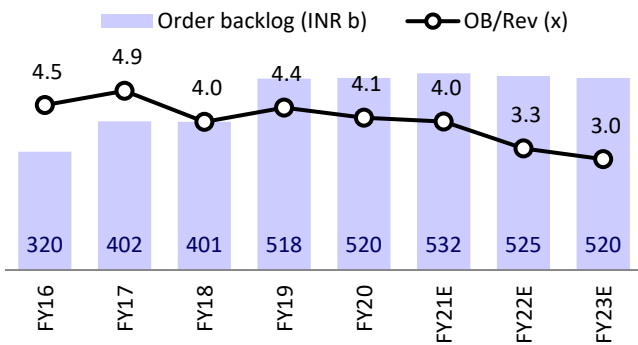


Exhibit 4: Robust order inflow trend

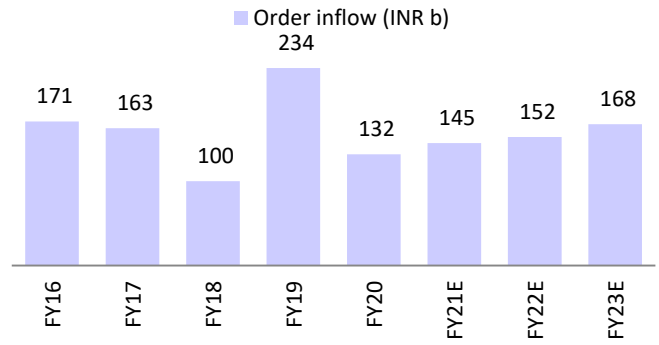


Exhibit 5: Estimate revenue CAGR of 14% over FY21-23E

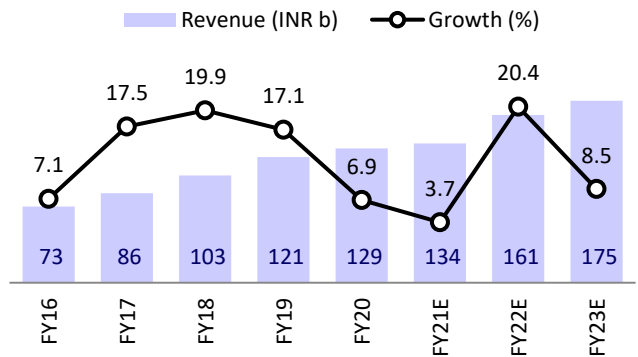


Exhibit 6: Factor in stable margins of ~19% over FY21-23E

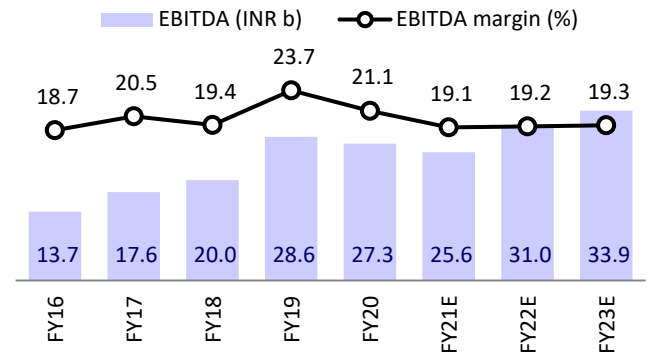


Exhibit 7: Net working capital days trend

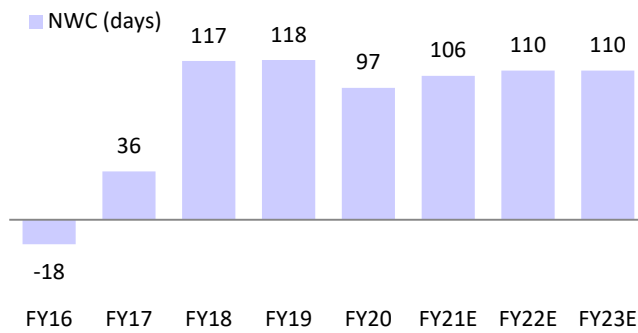


Exhibit 8: BHE enjoys superior return ratios

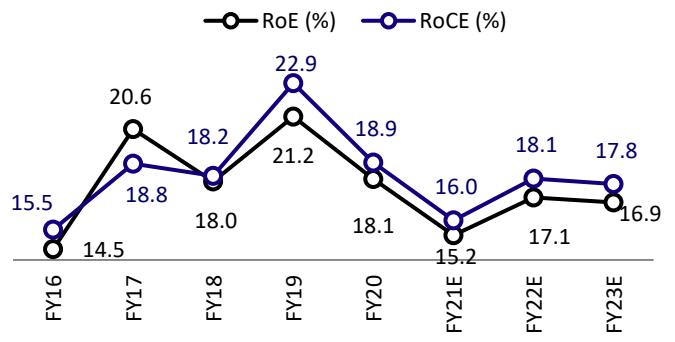


Exhibit 9: PAT growth expected at 17% CAGR over FY21-23E

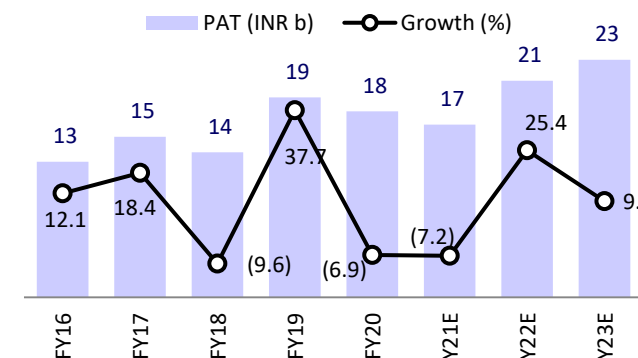
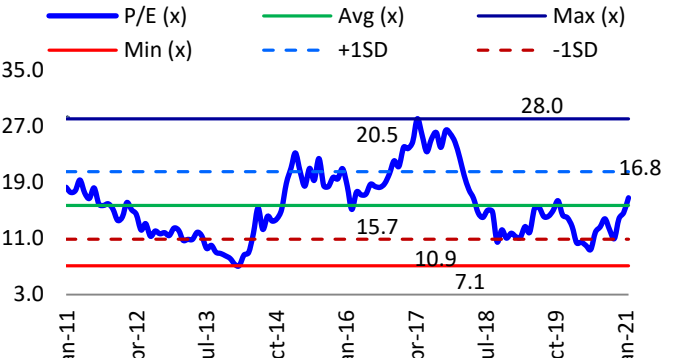


Exhibit 10: BHE trades at one-year forward P/E of 16.8x, above historical average of ~16x



Source: MOFSL, Company

Source: MOFSL

Valuation and view

- **Best play in India's Defense industry:** BHE is well-positioned to benefit from rising defense expenditure, supported by (a) a strong manufacturing base and execution track record, (b) its relationship with defense and government agencies, (c) strategic collaboration with foreign technology partners for new product development, (d) in-house R&D capabilities (R&D spend at > 9.0% of revenues), and (e) an increased focus on exports to friendly countries.
- **Strong order book position provides robust revenue visibility:** BHE had a robust order backlog of INR548b as of 9MFY21, translating to an OB/rev ratio of 4.2x. This offers the company superior revenue visibility.
- **Maintain estimates:** We forecast a revenue/EBITDA/PAT CAGR of 14%/15%/17% over FY21–23E. We have built in a sufficient margin cushion as we assume an EBITDA margin of 19.2%/19.3% by FY22E/FY23E (v/s 21.1% reported in FY20).
- **Maintain Buy, with TP of INR150:** Given BHE's current order backlog and revenue visibility, we maintain our estimates with TP of INR150 (16x FY23E EPS, on par with its long-term trading multiple). Maintain **Buy**.

Financials and valuations

Income Statement						(INR m)
Y/E March	2018	2019	2020	2021E	2022E	2023E
Total Revenues	1,03,223	1,20,846	1,29,211	1,34,031	1,61,370	1,75,111
Change (%)	19.9	17.1	6.9	3.7	20.4	8.5
Raw Materials	60,257	67,002	74,570	80,419	97,629	1,05,942
Staff Cost	17,723	18,791	20,575	21,097	24,729	26,734
Other Expenses	5,246	6,433	6,765	6,956	8,039	8,583
EBITDA	19,997	28,621	27,301	25,560	30,974	33,852
% of Total Revenues	19.4	23.7	21.1	19.1	19.2	19.3
Depreciation	2,510	3,162	3,496	3,768	4,542	5,017
Interest	13	122	33	33	33	33
Other income	2,004	1,695	1,019	1,050	1,500	1,800
PBT	19,478	27,032	24,792	22,810	27,899	30,602
Tax	5,486	7,759	6,853	6,159	7,022	7,702
Rate (%)	28.2	28.7	27.6	27.0	25.2	25.2
Adjusted PAT	13,992	19,273	17,938	16,651	20,876	22,899
Reported PAT	13,992	19,273	17,938	16,651	20,876	22,899
Change (%)	-9.6	37.7	-6.9	-7.2	25.4	9.7

Balance Sheet						(INR m)
Y/E March	2018	2019	2020	2021E	2022E	2023E
Share Capital	2,437	2,437	2,437	2,437	2,437	2,437
Reserves	75,512	88,393	96,824	1,06,815	1,19,340	1,33,080
Net Worth	77,949	90,830	99,261	1,09,251	1,21,777	1,35,517
Loans	334	0	0	0	0	0
Deferred Tax Liability	-4,312	-4,712	-4,974	-4,974	-4,974	-4,974
Capital Employed	73,971	86,118	94,287	1,04,277	1,16,803	1,30,543
Gross Fixed Assets	26,572	34,595	42,815	47,815	52,815	57,815
Less: Depreciation	6,127	9,288	12,784	16,552	21,094	26,112
Net Fixed Assets	20,445	25,307	30,030	31,263	31,720	31,703
Capital WIP	3,955	2,751	1,994	1,994	1,994	1,994
Investments	9,032	10,193	12,233	12,233	12,233	12,233
Curr. Assets	1,47,167	1,61,672	1,89,879	2,00,586	2,32,734	2,50,681
Inventory	47,755	44,548	39,628	41,106	49,490	53,704
Debtors	57,046	53,692	40,055	41,549	50,024	54,284
Cash & Bank Balance	7,387	8,840	15,562	19,766	22,194	31,807
Loans & Advances	730	729	400	415	499	542
Other Assets	34,249	53,864	94,235	97,750	1,10,527	1,10,344
Current Liab. & Prov.	1,06,627	1,13,804	1,39,850	1,41,798	1,61,879	1,66,069
Current Liabilities	94,023	1,00,008	1,25,091	1,26,489	1,43,446	1,46,066
Provisions	12,604	13,796	14,759	15,310	18,433	20,002
Net Current Assets	40,540	47,868	50,029	58,787	70,855	84,612
Application of Funds	73,971	86,118	94,287	1,04,277	1,16,803	1,30,543

Financials and valuations

Ratios						
Y/E March	2018	2019	2020	2021E	2022E	2023E
Basic (INR)						
Adj EPS	5.7	7.9	7.4	6.8	8.6	9.4
Cash EPS	6.8	9.2	8.8	8.4	10.4	11.5
Book Value	32.0	37.3	40.7	44.8	50.0	55.6
DPS	2.0	2.1	3.1	2.7	3.4	3.8
Payout (incl. Div. Tax.)	35	27	42	40	40	40
Valuation (x)						
P/E	22.6	16.4	17.7	19.0	15.2	13.8
Cash P/E	19.2	14.1	14.8	15.5	12.5	11.4
EV/EBITDA	15.5	10.8	11.0	11.6	9.5	8.4
EV/Sales	3.1	2.6	2.4	2.2	1.8	1.6
Price/Book Value	4.1	3.5	3.2	2.9	2.6	2.3
Dividend Yield (%)	1.5	1.6	2.4	2.1	2.6	2.9
Profitability Ratios (%)						
RoE	18.0	21.2	18.1	15.2	17.1	16.9
RoCE	18.2	22.9	18.9	16.0	18.1	17.8
RoIC	32.4	30.8	26.7	23.6	26.3	26.2
Turnover Ratios						
Debtors (Days)	202	162	113	113	113	113
Inventory (Days)	169	135	112	112	112	112
Asset Turnover (x)	3.8	3.4	2.9	2.8	3.0	3.0
Leverage Ratio						
Net Debt/Equity (x)	(0.1)	(0.1)	(0.2)	(0.2)	(0.2)	(0.2)

Cash Flow Statement						(INR m)
Y/E March	2018	2019	2020	2021E	2022E	2023E
PBT before EO Items	19,478	27,032	24,792	22,810	27,899	30,602
Depreciation	2,510	3,162	3,496	3,768	4,542	5,017
Interest & other	-1,434	-69	-292	33	33	33
Direct Taxes Paid	6,512	7,669	5,684	6,159	7,022	7,702
(Inc)/Dec in WC	-21,929	-7,796	3,013	-4,555	-9,640	-4,144
CF from Operations	-7,885	14,660	25,325	15,897	15,811	23,806
(Inc)/Dec in FA	-7,779	-7,054	-7,264	-5,000	-5,000	-5,000
Free Cash Flow	-15,665	7,606	18,062	10,897	10,811	18,806
(Pur)/Sale of Investments	-2,844	132	-731	0	0	0
CF from Investments	-10,623	-6,922	-7,995	-5,000	-5,000	-5,000
(Inc)/Dec in Network	-3,723	-333	-250	0	0	0
(Inc)/Dec in Debt	167	0	-13	0	0	0
Interest Paid	259	489	552	33	33	33
Dividend Paid	8,192	5,463	9,793	6,660	8,351	9,160
CF from Fin. Activity	-12,006	-6,285	-10,608	-6,693	-8,383	-9,192
Inc/Dec of Cash	-30,515	1,453	6,722	4,204	2,428	9,613
Add: Beginning Balance	37,902	7,387	8,840	15,562	19,766	22,194
Closing Balance	7,387	8,840	15,562	19,766	22,194	31,807

Explanation of Investment Rating	
Investment Rating	Expected return (over 12-month)
BUY	>=15%
SELL	< - 10%
NEUTRAL	< - 10 % to 15%
UNDER REVIEW	Rating may undergo a change
NOT RATED	We have forward looking estimates for the stock but we refrain from assigning recommendation

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Registered Office Address: Motilal Oswal Tower, Rahimtullah Sayani Road, Opposite Parel ST Depot, Prabhadevi, Mumbai-400025; Tel No.: 022 71934200/ 022-71934263; Website www.motilaloswal.com.CIN no.: L67190MH2005PLC153397. Correspondence Office Address: Palm Spring Centre, 2nd Floor, Palm Court Complex, New Link Road, Malad(West), Mumbai-400 064. Tel No: 022 7188 1000.

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