Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Bharat Electronics Limited

Firing strongly on all cylinders

Capital Goods	Sharekhan code: BEL	Result 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. 168**	
Price Target: **Rs. 196**	↑

↑ Upgrade ↔ Maintain ↓ Downgrade

Company details

Market cap:	Rs. 41,020 cr
52-week high/low:	Rs. 170/81
NSE volume: (No of shares)	162.9 lakh
BSE code:	500049
NSE code:	BEL
Free float: (No of shares)	119.2 cr

Shareholding (%)

Promoters	51.1
FII	11.6
DII	30.2
Others	7.1

Price chart

Price performance

(%)	1m	3m	6m	12m
Absolute	6.9	37.8	28.8	102.1
Relative to Sensex	3.5	6.4	8.2	47.6

Sharekhan Research, Bloomberg

Summary

- We retain a Buy rating on Bharat Electronics Limited (BEL) with a revised PT of Rs. 196 considering reasonable valuations and strong execution capabilities.
- Q4FY21 was operationally strong; net profit beat estimates handsomely
- Order book is strong at 3.8x FY2021 revenues while FY22 order inflow target is pegged at Rs. 15,000-17,000 crore. Company has seen healthy order accretion in healthcare segment.
- The management guides for topline growth of 15-17% y-o-y for FY2022 with EBITDA margin of 20-22%.

Bharat Electronics Limited's (BEL's) net profitability strongly beat estimates led by much higher-than-expected OPM and better-than-expected execution. Consolidated revenues came in at Rs 6,917 crore, rising 18% y-o-y (beating our estimates by 7%) led by higher execution. OPM rose ~900 bps y-o-y and 300 bps q-o-q to 29%, despite pressure on gross margins (lower by almost 800 bps y-o-y & 204 bps q-o-q) led by low base and operating leverage. Consequently, operating profit came in at Rs. 1,981 crore (up 33% y-o-y). Strong operational performance and higher other income (+101% y-o-y), led a to 31% growth in net profit to Rs 1,356 crore (higher than estimates). Order book remained healthy at Rs. 53,434 crore (3.8x FY21 revenue). The management has guided for a 15-17% revenue growth and 20-22% OPM for FY2022. The company has an order acquisition target of Rs 15,000-17,000 crore, which is the same as FY21. BEL would be targeting new orders across various segments viz. Army (Rs. 4000-5000 crore), Navy (Rs. 4,000-5,000 crore), Air Force (Rs. 8000-10000 crore) and non-defence (Rs. 3000 crore) in FY2022. BEL would continue to spend ~10% of revenues on R&D (Rs. 870 crore in FY2020). It is undertaking a capex of Rs. 800 crore (Rs. 200 crore each on four factories) over the next two years. In the healthcare segment, BEL received order of 25,000 oxygen concentrators from ONGC while it has partnered with Renalyx, to build and market new dialysis machines. As per management, higher commodity prices would not materially impact margins due to its product range and rising indigenization vis-à-vis import contents. On exports front, the company has order book of Rs. 1200 crore and would target $60 million in export revenues for FY2022 ($51.81 million in FY2021). The services sector's contribution would remain at 10-12% (10% in FY2021). The company has a major role to play in defence as it is present in all aspects of the sector and the government on its part has been swift in coming out with the directives on plans laid earlier. The company's strong execution track record and a strong order book provide healthy revenue visibility going ahead. We introduce FY2024E estimates in this note. We have revised our estimates upwards for FY2022E-FY2023E. The stock is trading at a reasonable valuation of 13.9x and 13.0x its FY2023E and FY2024E earnings, respectively. With improving growth visibility, we retain a Buy rating on the stock with a revised price target (PT) of Rs. 196.

Key positives

- Strong outperformance in OPM and better than expected execution.
- The management guides for 15-17% y-o-y revenue growth for FY2022 with OPM at 20-22%.
- Strong order prospects for FY2022 along with healthy order backlog

Key negatives

- Gross margins remained under pressure due to increased raw material costs.

Our Call

Valuation – Maintain Buy with a revised PT of Rs. 196: BEL has lots of opportunities with government's AatmaNirbhar Bharat programme and ban on import of 101 Defence items, the company is well placed to tap them. Despite the COVID-19 pandemic, the management continues to invest heavily in capex and has maintained its capex guidance to the tune of ~Rs. 500 crore for FY22. Management iterated its stands on investment in R&D and would invest 10% of revenues going ahead. 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 13.9x and 13.0x its FY2023E and FY2024E earnings, respectively. With improving growth visibility, we retain our Buy rating on the stock with an unchanged PT of Rs. 196.

Key risk

- Delayed execution of orders and slower pace of fresh order intake can affect revenue growth.
- Higher raw-material prices to put pressure on margins.

Valuations (Consolidated) Rs cr

Particulars	FY21	FY22E	FY23E	FY24E
Revenue	14,109	15,398	16,938	18,462
OPM (%)	23%	23%	22%	22%
Adjusted PAT	2,099	2,518	2,655	2,844
% y-o-y growth	*15.1*	*20.0*	*5.5*	*7.1*
Adjusted EPS (Rs.)	8.6	10.3	10.9	11.7
P/E (x)	17.6	14.7	13.9	13.0
P/B (x)	3.3	3.4	3.1	2.5
EV/EBITDA (x)	12.8	11.5	11.2	10.5
RoNW (%)	19.9	21.9	21.0	20.0
RoCE (%)	18.6	18.6	17.6	16.9

Source: Company; Sharekhan estimates

Strong beat on net earnings led by better than expected OPM supported by higher execution: Bharat Electronics Limited's (BEL's) net profitability strongly beat estimates led by much higher-than-expected OPM and better-than-expected execution. Consolidated revenues came in at Rs 6,917 crore, rising 18% y-o-y (beating our estimates by 7%) led by higher execution. OPM rose ~900 bps y-o-y and 300 bps q-o-q to 29%, despite pressure on gross margins (lower by almost 800 bps y-o-y & 204bps q-o-q) led by low base and operating leverage. Consequently, operating profit came in at Rs. 1,981 crore (up 33% y-o-y). Strong operational performance and higher other income (+101% y-o-y), led a to 31% growth in net profit to Rs 1,356 crore (higher than estimates).

Strong outlook led by healthy order prospects: The management has guided for a 15-17% revenue growth and 20-22% OPM for FY2022. The company has an order acquisition target of Rs 15,000-17,000 crore, which is the same as FY21. BEL would be targeting new orders across various segments viz. Army (Rs. 4000-5000 crore), Navy (Rs. 4,000-5,000 crore), Air Force (Rs. 8000-10000 crore) and non-defence (Rs. 3000 crore) in FY2022. BEL would continue to spend ~10% of revenues on R&D (Rs. 870 crore in FY2020). It is undertaking a capex of Rs. 800 crore (Rs. 200 crore each on four factories) over the next two years. In the healthcare segment, BEL received order of 25,000 oxygen concentrators from ONGC while it has partnered with Renalyx, to build and market new dialysis machines. As per management, higher commodity prices would not materially impact margins due to its product range and rising indigenization vis-à-vis import contents. On exports front, the company has order book of Rs. 1200 crore and would target $60 million in export revenues for FY2022 ($51.81 million in FY2021). The services sector's contribution would remain at 10-12% (10% in FY2021). The company has a major role to play in defence as it is present in all aspects of the sector and the government on its part has been swift in coming out with the directives on plans laid earlier. The company's strong execution track record and a strong order book provide healthy revenue visibility going ahead.

Key Conference call takeaways

- **Guidance:** The management has guided for topline growth of 15-17% and EBITDA margin of 20-22% in FY22. The company has an order acquisition target of Rs 15,000-17,000 crore which is the same as FY21.
- **Capex & R&D:** The capex for FY21 stood at Rs. 460 crore and R&D expenses stood at Rs. 870 crore. The management has mentioned that they will continue to spend 10% of the revenues on R&D going ahead.
- **Healthcare:** In healthcare segment, BEL has received order of 25,000 oxygen concentrators from ONGC of which the first lot is expected to be delivered at the end of this month while the remaining order is expected to be completed in the next two months.
- **New partnerships:** The company has partnered with Renalyx, a start-up that is into renal health, to build and market new dialysis machines.
- **Akash missile order:** The management mentioned that first deliveries of Akash missile have been completed before March 21 and they have targeted to complete a minimum of two squadrons.
- **LRSAM:** Good amount of deliveries done last year, this year 45% indigenisation expected on the deliveries
- **Exports:** In FY21, exports contributed $51.81mn to the topline whereas the management has targeted $60mn in revenues from exports in FY22. Currently, order book from exports is Rs. 1,200 crore and expect revenue from exports to grow by 15-20% y-o-y.

Quarterly Results (Consolidated) Rs cr

Particulars	Q4FY21	Q4FY20	YoY%	Q3FY21	QoQ%
Net Sales	**6,917.5**	**5,816.8**	**18.9**	**2,320.4**	**198.1**
Operating expenditure	4,937	4,323	14.2	1,864	164.8
Operating profit	**1,980.9**	**1,494.0**	**32.6**	**456.2**	**334.2**
Other income	58	29	100.8	24	144.6
Interest	6	2	190.2	0	-
Depreciation	97	101	(3.7)	100	(2.9)
PBT	**1,936**	**1,420**	**36.3**	**380**	**410.1**
Tax	580	381	52.2	109	430.2
PAT before Associate income	1,356	1,039	30.5	270	401.9
Exceptional item	-	-	-	-	-
Adj PAT	**1,368.2**	**1,047.0**	**30.7**	**278.5**	**391.3**
EPS (Rs)	5.6	4.3	30.7	4.3	30.7
Margins(%)			**BPS**		**BPS**
OPM (%)	28.6	25.7	295.3	19.7	897.5
NPM (%)	19.6	17.9	173.8	11.6	795.7
Tax Rate (%)	30.0	26.8	313.0	28.8	114.0

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 corporatize ordinance factory boards shortly. Completion of defence projects takes longer than envisaged earlier and hence, the government is planning to incorporate cost escalation clauses and provide incentives to vendors based on enhanced productivity and performance. Further, a hike in FDI to 74% though the automatic route would boost investments in the sector. 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 defence manufacturing bases 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.

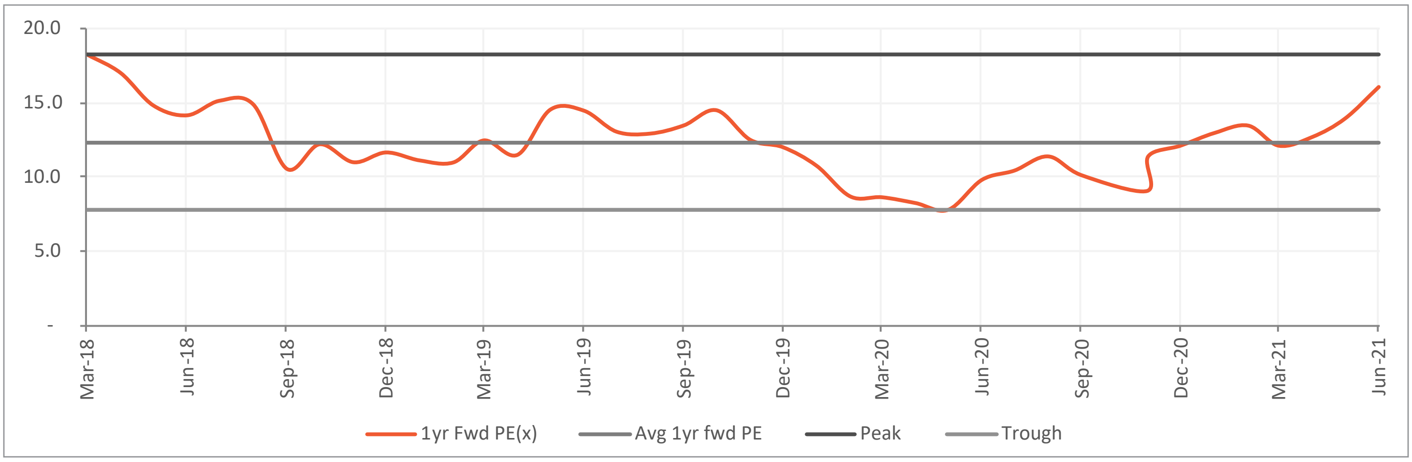
■ Company Outlook – Continues to focus on sustainable growth plans

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 orders, 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. 196

BEL has lots of opportunities with government's AatmaNirbhar Bharat programme and ban on import of 101 Defence items, the company is well placed to tap them. Despite the COVID-19 pandemic, the management continues to invest heavily in capex and has maintained its capex guidance to the tune of ~Rs. 500 crore for FY22. Management iterated its stands on investment in R&D and would invest 10% of revenues going ahead. 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 13.9x and 13.0x its FY2023E and FY2024E earnings, respectively. With improving growth visibility, we retain our Buy rating on the stock with an unchanged PT of Rs. 196.

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 strong balance sheet with improving return ratios.

Key Risks

- Delayed execution of orders and slower pace of fresh order intake can affect revenue growth.
- Higher raw-material prices to 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	5.6
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	3.2
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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