

Bharat Electronics

Estimate change 

TP change 

Rating change 

CMP: INR210

TP: INR270 (+29%)

Buy

Strong 3QFY22, multi-year opportunities await

Expect minor hiccups due to shortage in 4QFY22

Bloomberg	BHE IN
Equity Shares (m)	2,437
M.Cap.(INRb)/(USD\$b)	511 / 6.8
52-Week Range (INR)	228 / 116
1, 6, 12 Rel. Per (%)	0/3/36
12M Avg Val (INR M)	1937

Financials & Valuations (INR b)

Y/E Mar	2021	2022E	2023E
Sales	140.6	157.7	175.9
EBITDA	31.8	34.3	38.1
PAT	20.7	24.4	26.9
EBITDA (%)	22.6	21.8	21.7
EPS (INR)	8.5	10.0	11.0
EPS Gr. (%)	15.1	18.1	10.1
BV/Sh. (INR)	44.6	50.6	57.3

Ratios

Net D/E	(0.5)	(0.4)	(0.4)
RoE (%)	19.0	19.8	19.3
RoCE (%)	19.9	21.1	20.5
Payout (%)	40.0	40.0	40.0

Valuations

P/E (x)	24.8	21.0	19.0
P/BV (x)	4.7	4.1	3.7
EV/EBITDA (x)	14.5	13.5	12.0
Div Yield (%)	1.6	1.9	2.1
FCF Yield (%)	9.1	1.9	3.0

Shareholding pattern (%)

As On	Dec-21	Sep-21	Dec-20
Promoter	51.1	51.1	51.1
DII	26.8	28.3	31.3
FII	17.2	15.7	10.3
Others	4.9	4.8	7.3

FII Includes depository receipts

- Revenue grew a strong 61% YoY in 3QFY22 and was 21% ahead of our estimate. EBITDA margin continued to surprise, as has been now for many quarters. Adjusted PAT grew 123% YoY to INR5.8b and was 34% ahead of our expectation.
- The current order book is strong at INR566b, with an OB/revenue ratio of 3.6x. The management lowered its FY22 revenue guidance to 10-12% from 17% earlier on account of the semiconductor shortage. However, it reiterated its multi-year revenue growth guidance of 15-17% thanks to the Make in India drive in the Defense space as well as its foray into civil segments like Medical Equipment, e-mobility, Metro, Smart Cities, EVM/VVPAT orders for the upcoming elections, etc. It is also confident of achieving an EBITDA margin of ~22% over the next few years.
- BHE is looking to replicate its strong capabilities in manufacturing and R&D in the Defense space in newer segments over the next few years. It is one of the prime beneficiaries of the government's indigenization drive. On account of its strong 3QFY22 performance, we increase our FY22-24E EPS estimate by 6-8% and our TP to INR270/share from INR250 earlier. We maintain our **Buy** rating.

Positive surprise across all parameters

- 3QFY22 snapshot:** Revenue grew 61% YoY to INR37b and was 21% ahead of our expectation. EBITDA grew 87% YoY to INR8.2b and was 28% ahead of our estimate. Adjusted PAT more than doubled to INR5.8b (+123% YoY) and was 34% ahead of our expectation.
- Order book grew 3% YoY to INR566b, with an OB/revenue ratio of 3.6x. Implied order inflows grew 21% YoY to INR121b.

Highlights from the management commentary

- BHE expects orders inflows of over INR150b in FY22.
- Despite a gross margin decline, EBITDA margin has improved due to lower provisions, cost control over other expenses, etc. As the number of employees are not increasing now, operating leverage is playing out. Due to indigenization, the cost structure mix is changing.
- BHE and HAL are jointly looking at semiconductor manufacturing. Both companies have to submit their proposal in Feb'22. The management said it will have to partner with a foreign player for technology knowhow.

Valuation and view

- On account of its strong 3QFY22 performance, we increase our FY22-24E EPS estimate by 6-8%. We forecast a revenue/EBITDA/PAT CAGR of 11%/10%/13% over FY21-24E. We increase our TP to INR270/share from INR250 earlier (unchanged FY24E target P/E multiple of 22x). At the CMP, the stock trades at 19x/17x FY23E/FY24E P/E, despite a RoE/RoCE of ~19%/20% (FY23E), dividend yield of ~2%, and FCF yield of 3%. We maintain our **Buy** rating. Higher growth in the non-Defense business poses an upside risk to our EPS estimate, while working capital deterioration poses a key downside risk to valuations.

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Investors are advised to refer through important disclosures made at the last page of the Research Report.

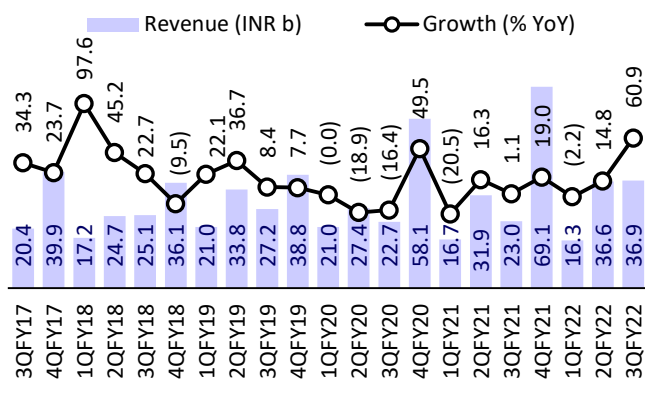
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Quarterly performance

(INR m)

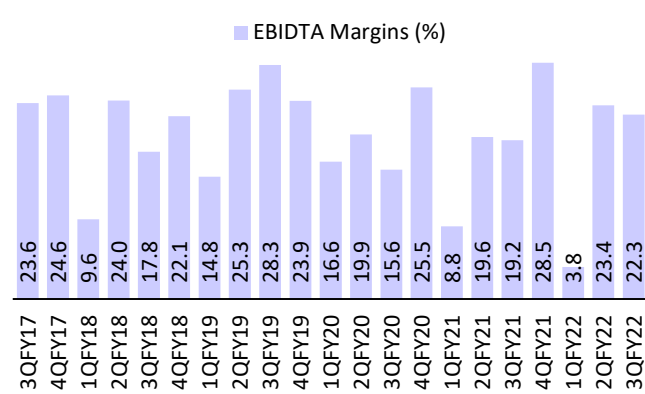
Y/E March	FY21				FY22				FY21	FY22E	FY22E	Var. (%)
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4QE				
Sales	16,706	31,887	22,962	69,083	16,346	36,606	36,937	67,772	1,40,638	1,57,661	30,545	21
Change (%)	(20.5)	16.3	1.1	19.0	(2.2)	14.8	60.9	(1.9)	8.8	12.1	33.0	
EBITDA	1,467	6,235	4,404	19,706	629	8,565	8,221	16,891	31,811	34,306	6,414	28
Change (%)	(57.9)	14.5	24.1	32.9	(57.2)	37.4	86.7	(14.3)	16.5	7.8	45.7	
As a percentage of sales	8.8	19.6	19.2	28.5	3.8	23.4	22.3	24.9	22.6	21.8	21.0	
Depreciation	888	914	945	917	922	941	929	951	3,663	3,744	1,000	
Interest	1	3	2	56	1	5	2	53	61	61	3	
Other Income	184	274	231	572	447	659	593	402	1,261	2,100	400	
PBT	762	5,592	3,688	19,305	152	8,277	7,883	16,289	29,348	32,601	5,811	36
Tax	221	1,622	1,070	5,782	40	2,151	2,050	3,965	8,694	8,206	1,463	
Effective Tax Rate (%)	29.0	29.0	29.0	29.9	26.5	26.0	26.0	24.3	29.6	25.2	25.2	
Reported PAT	541	3,971	2,619	13,524	112	6,126	5,834	12,324	20,654	24,396	4,349	34
Change (%)	(73.6)	17.0	21.7	30.7	(79.4)	54.3	122.8	(8.9)	15.1	18.1	66.1	
Adj. PAT	541	3,971	2,619	13,524	112	6,126	5,834	12,324	20,654	24,396	4,349	34
Change (%)	(73.6)	17.0	21.7	30.7	(79.4)	54.3	122.8	(8.9)	15.1	18.1	66.1	

Exhibit 1: Revenue grew 61% YoY in 3QFY22, 21% ahead of our estimate



Source: MOFSL, Company

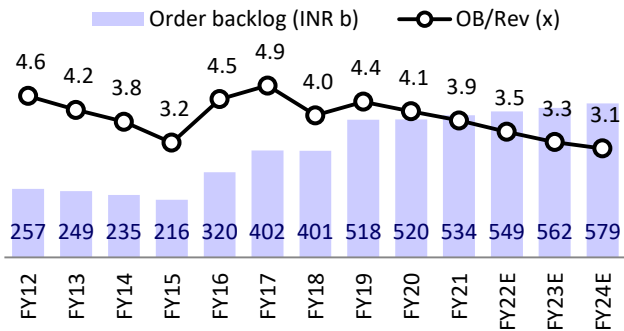
Exhibit 2: EBITDA margin expands largely on higher operating leverage



Source: MOFSL, Company

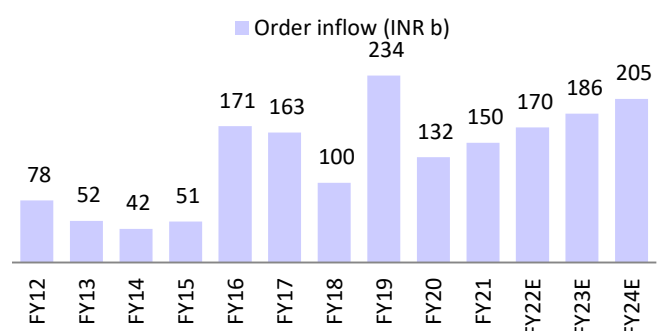
Story in charts

Exhibit 3: Strong order book position with a healthy order book-to-revenue ratio



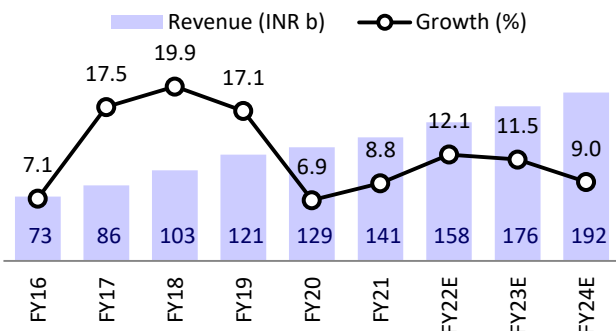
Source: MOFSL, Company

Exhibit 4: Order inflows to gradually scale up over FY21-24E, aided by growing non-Defense business



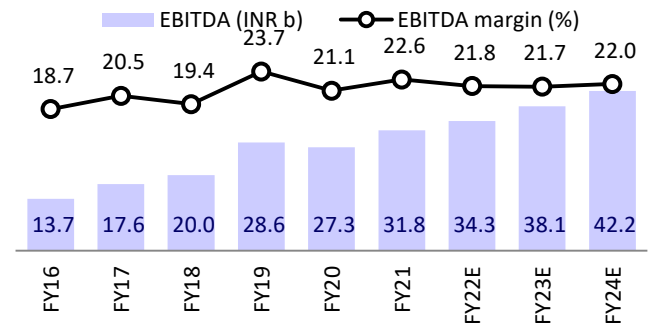
Source: MOFSL, Company

Exhibit 5: Expect 11% revenue CAGR over FY21-24E



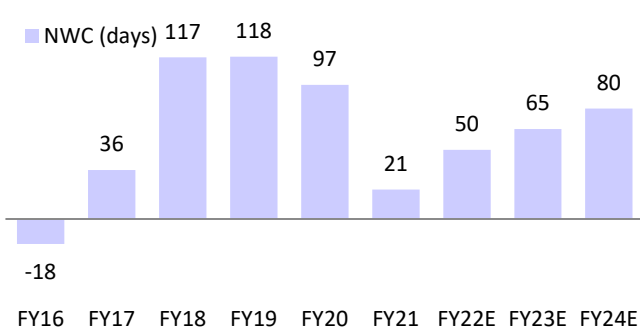
Source: MOFSL, Company

Exhibit 6: Factor in stable margin of ~22% over FY21-24E



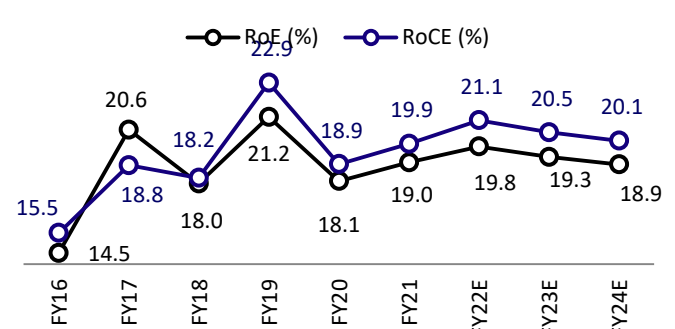
Source: MOFSL, Company

Exhibit 7: Trend in net working capital days



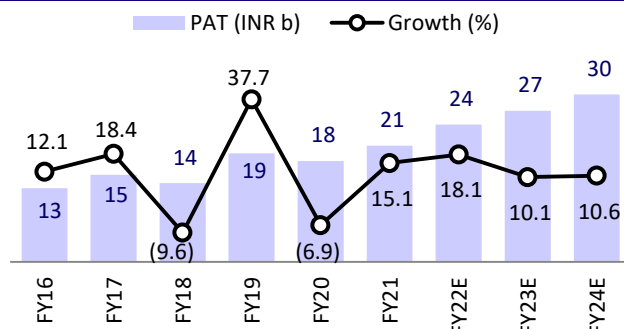
Source: MOFSL, Company

Exhibit 8: BHE enjoys superior return ratios



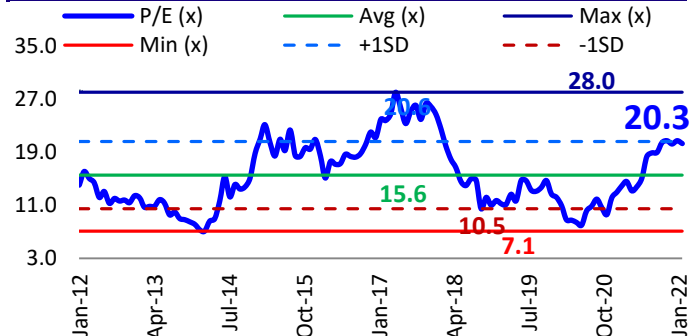
Source: MOFSL, Company

Exhibit 9: Expect 10% PAT CAGR over FY21-24E



Source: MOFSL, Company

Exhibit 10: BHE trades at a one-year forward P/E of 20.3x, above its historical average of ~15.6x



Source: MOFSL

Highlights from the management commentary

Order book and order inflows

- Order inflows have been strong in YTD. Export orders have started to flow in.
- Export orders for IoT devices to the US have just begun, with a preliminary order worth USD73m. These are the company's own designs and are to be implemented across 5G networks in the US.
- The QRSAM order (INR300-400b) is a big ticket one and should be completed over the next 2-3 years.
- Sonar orders, which were earlier outsourced to foreign countries, will now be manufactured in India.
- Civil orders like metros are an area of focus for the management.
- e-mobility: BHE is working on fast charges, medium fast charges, and normal charges. It is also working on e-mobility infrastructure.
- The company is also working on battery packs.
- Smart City solutions: It is focusing on just being an integrator in this space.

Execution update

- FY22 revenue breakup: Non-Defense/Services will constitute 14-15%/10-11% and the rest will be Defense.
- BHE is facing a shortage of semiconductors and is trying to address the same.
- The management said it may not meet its 17-18% revenue growth guidance for FY22. However, it expects to grow on a YoY basis in 4Q and achieve 12-13% in FY22.
- It has guided at a 15-17% revenue growth in FY23. It expects to sustain this growth rate over the next few years, as large ticket size orders are lined up over the next two-to-three years.

Margin

- The management has guided at an EBITDA margin of 22% for FY22.
- Margin would remain strong on account of indigenization programs (like Akash).
- Despite a gross margin decline, EBITDA margin has improved due to lower provisions, cost control over other expenses, etc. As the number of employees are not increasing now, operating leverage is playing out. Due to indigenization, the cost structure mix is changing.
- R&D should continue at INR10b in absolute terms.
- Provisions – Warranty provision of INR400m on ventilators has been withdrawn and some of the bad debts, which turned good, have also been reversed.

Other takeaways

- BHE and HAL are jointly looking at semiconductor manufacturing. Both companies have to submit their proposal in Feb'22. The management said it will have to partner with a foreign player for technology knowhow.

Exhibit 11: Earnings change summary

Earnings change INR m	Old estimate			New estimate			Change (%)		
	FY22E	FY23E	FY24E	FY22E	FY23E	FY24E	FY22E	FY23E	FY24E
Revenue	1,57,661	1,74,775	1,91,710	1,57,661	1,75,870	1,91,685	0	1	-0
EBITDA	33,398	36,483	39,869	34,306	38,115	42,231	3	4	6
EBITDA margin	21.2%	20.9%	20.8%	21.8%	21.7%	22.0%	0.6	0.8	1.2
Adjusted PAT	23,106	25,153	27,425	24,396	26,861	29,718	6	7	8

Source: MOFSL, Company

Valuation and view

- **Best play in India's Defense industry:** BHE is well-positioned to benefit from India's rising defense expenditure, aided by: a) a strong manufacturing base and execution track record, b) its relationship with government agencies, c) strategic collaboration with foreign technology partners for the development of new products, d) its in-house R&D capabilities (R&D spend over 9% of revenue, with the aim to scale this up to 10%), and e) its higher focus on exports to friendly countries.
- **Strong order book position provides robust revenue visibility:** BHE had a robust order backlog of INR566b as of 3QFY22-end, translating into an OB/revenue ratio of 3.6x. This offers the company superior revenue visibility.
- **Maintain Buy with a TP of INR270/share:** On account of its strong 3QFY22 performance, we increase our FY22-24E EPS estimate by 6-8%. We forecast a revenue/EBITDA/PAT CAGR of 11%/10%/13% over FY21-24E. We increase our TP to INR270/share from INR250 earlier (unchanged FY24E target P/E multiple of 22x). At the CMP, the stock trades at 19x/17x FY23E/FY24E P/E, despite a RoE/RoCE of ~19%/20% (FY23E), dividend yield of ~2%, and FCF yield of 3%. We maintain our **Buy** rating. Higher growth in the non-Defense business poses an upside risk to our EPS estimate, while working capital deterioration poses a key downside risk to valuations.

Financials and valuations

Income Statement							(INR m)
Y/E March	FY18	FY19	FY20	FY21	FY22E	FY23E	FY24E
Total Revenue	1,03,223	1,20,846	1,29,211	1,40,638	1,57,661	1,75,870	1,91,685
Change (%)	19.9	17.1	6.9	8.8	12.1	11.5	9.0
Raw Material	60,257	67,002	76,984	85,875	98,962	1,09,864	1,18,401
Staff Cost	17,723	18,791	20,575	19,407	20,571	23,113	25,958
Other Expenses	5,246	6,433	4,351	3,546	3,822	4,778	5,094
EBITDA	19,997	28,621	27,301	31,811	34,306	38,115	42,231
As a percentage of Total Revenue	19.4	23.7	21.1	22.6	21.8	21.7	22.0
Depreciation	2,510	3,162	3,496	3,663	3,744	4,159	4,657
Interest	13	122	33	61	61	61	61
Other income	2,004	1,695	1,019	1,261	2,100	2,000	2,200
PBT	19,478	27,032	24,792	29,348	32,601	35,896	39,714
Tax	5,486	7,759	6,853	8,694	8,206	9,035	9,996
Rate (%)	28.2	28.7	27.6	29.6	25.2	25.2	25.2
Adjusted PAT	13,992	19,273	17,938	20,654	24,396	26,861	29,718
Reported PAT	13,992	19,273	17,938	20,654	24,396	26,861	29,718
Change (%)	-9.6	37.7	-6.9	15.1	18.1	10.1	10.6

Balance Sheet							(INR m)
Y/E March	FY18	FY19	FY20	FY21	FY22E	FY23E	FY24E
Share Capital	2,437	2,437	2,437	2,437	2,437	2,437	2,437
Reserves	75,512	88,393	96,824	1,06,331	1,20,969	1,37,085	1,54,916
Net Worth	77,949	90,830	99,261	1,08,768	1,23,405	1,39,522	1,57,352
Loans	334	-	-	-	-	-	-
Deferred Tax Liability	(4,312)	(4,712)	(4,974)	(4,634)	(4,634)	(4,634)	(4,634)
Capital Employed	73,971	86,118	94,287	1,04,134	1,18,771	1,34,888	1,52,718
Gross Fixed Assets	26,572	34,595	42,815	45,103	50,103	56,103	63,103
Less: Depreciation	6,127	9,288	12,784	16,448	20,191	24,350	29,006
Net Fixed Assets	20,445	25,307	30,030	28,655	29,912	31,753	34,097
Capital WIP	3,955	2,751	1,994	3,507	3,507	3,507	3,507
Investments	9,032	10,193	12,233	13,668	13,668	13,668	13,668
Curr. Assets	1,47,167	1,61,672	1,89,879	2,40,068	2,62,960	2,92,099	3,18,245
Inventory	47,755	44,548	39,628	49,547	55,544	61,959	67,530
Debtors	57,046	53,692	40,055	41,869	46,937	52,358	57,066
Cash and Bank Balance	7,387	8,840	15,562	50,085	49,981	54,522	59,304
Loans and Advances	730	729	400	-	-	-	-
Other Assets	34,249	53,864	94,235	98,568	1,10,498	1,23,261	1,34,345
Current Liab. and Prov.	1,06,627	1,13,804	1,39,850	1,81,764	1,91,274	2,06,138	2,16,798
Current Liabilities	94,023	1,00,008	1,25,091	1,64,265	1,71,657	1,84,256	1,92,947
Provisions	12,604	13,796	14,759	17,499	19,617	21,883	23,851
Net Current Assets	40,540	47,868	50,029	58,304	71,685	85,960	1,01,447
Application of Funds	73,971	86,118	94,287	1,04,134	1,18,771	1,34,888	1,52,718

Financials and valuations

Ratios

Y/E March	FY18	FY19	FY20	FY21	FY22E	FY23E	FY24E
Basic (INR)							
Adj. EPS	5.7	7.9	7.4	8.5	10.0	11.0	12.2
Cash EPS	6.8	9.2	8.8	10.0	11.5	12.7	14.1
Book Value	32.0	37.3	40.7	44.6	50.6	57.3	64.6
DPS	2.0	2.1	3.1	3.4	4.0	4.4	4.9
Payout (incl. Div. Tax.)	35	27	42	40	40	40	40
Valuation (x)							
P/E	36.6	26.5	28.5	24.8	21.0	19.0	17.2
Cash P/E	31.0	22.8	23.9	21.0	18.2	16.5	14.9
EV/EBITDA	25.2	17.6	18.2	14.5	13.5	12.0	10.7
EV/Sales	5.0	4.3	3.9	3.3	3.0	2.6	2.4
Price/Book Value	6.6	5.6	5.2	4.7	4.1	3.7	3.3
Dividend Yield (%)	1.0	1.0	1.5	1.6	1.9	2.1	2.3
Profitability Ratios (%)							
RoE	18.0	21.2	18.1	19.0	19.8	19.3	18.9
RoCE	18.2	22.9	18.9	19.9	21.1	20.5	20.1
RoIC	32.4	30.8	26.7	39.1	51.7	44.3	40.3
Turnover Ratios							
Debtors (Days)	202	162	113	109	109	109	109
Inventory (Days)	169	135	112	129	129	129	129
Asset Turnover (x)	3.8	3.4	2.9	3.1	3.1	3.1	3.0
Leverage Ratio							
Net Debt/Equity ratio (x)	(0.1)	(0.1)	(0.2)	(0.5)	(0.4)	(0.4)	(0.4)

Cash Flow Statement

Y/E March	FY18	FY19	FY20	FY21	FY22E	FY23E	FY24E
							(INR m)
PBT before EO Items	19,478	27,032	24,792	29,348	32,601	35,896	39,714
Depreciation	2,510	3,162	3,496	3,663	3,744	4,159	4,657
Interest and other	(1,434)	(69)	(292)	750	61	61	61
Direct Taxes Paid	6,512	7,669	5,684	5,323	8,206	9,035	9,996
(Inc.)/Dec. in WC	(21,929)	(7,796)	3,013	22,597	(13,485)	(9,734)	(10,705)
CF from Operations	(7,885)	14,660	25,325	51,035	14,715	21,346	23,731
(Inc.)/Dec. in FA	(7,779)	(7,054)	(7,264)	(4,664)	(5,000)	(6,000)	(7,000)
Free Cash Flow	(15,665)	7,606	18,062	46,371	9,715	15,346	16,731
(Pur.)/Sale of Investments	(2,844)	132	(731)	(1,094)	-	-	-
CF from Investments	(10,623)	(6,922)	(7,995)	(5,758)	(5,000)	(6,000)	(7,000)
(Inc.)/Dec. in net worth	(3,723)	(333)	(250)	(83)	-	0	-
(Inc.)/Dec. in Debt	167	-	(13)	(16)	-	-	-
Interest Paid	259	489	552	428	61	61	61
Dividend Paid	8,192	5,463	9,793	10,227	9,758	10,744	11,887
CF from Fin. Activity	(12,006)	(6,285)	(10,608)	(10,754)	(9,819)	(10,805)	(11,948)
Inc./Dec. in Cash	(30,515)	1,453	6,722	34,522	(104)	4,541	4,783
Add: Beginning Balance	37,902	7,387	8,840	15,562	50,085	49,981	54,522
Closing Balance	7,387	8,840	15,562	50,085	49,981	54,522	59,304

NOTES

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

*In case the recommendation given by the Research Analyst is inconsistent with the investment rating legend for a continuous period of 30 days, the Research Analyst shall within following 30 days take appropriate measures to make the recommendation consistent with the investment rating legend.

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