Stock Update

Result Update

Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

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		↔	

ESG Disclosure Score NEW

ESG RISK RATING 34.56

Updated Jan 08, 2022

High Risk

NEGL	LOW	MED	HIGH	SEVERE
0-10	10-20	20-30	30-40	40+

Source: Morningstar

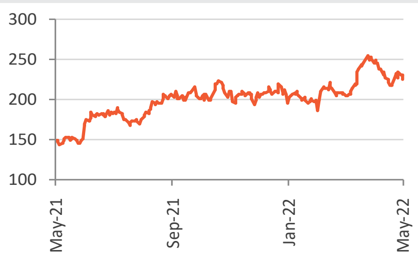
Company details

Market cap:	Rs. 55,067 cr
52-week high/low:	Rs. 260/140
NSE volume: (No of shares)	77.9 lakh
BSE code:	500049
NSE code:	BEL
Free float: (No of shares)	119.1 cr

Shareholding (%)

Promoters	51.1
FII	16.8
DII	26.7
Others	5.4

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	-9.8	13.0	6.9	51.5
Relative to Sensex	-3.5	16.7	15.5	45.3

Sharekhan Research, Bloomberg

Bharat Electronics Ltd

Profit below estimates, bright future outlook

Capital Goods	Sharekhan code: BEL

Reco/View: Buy ↔	CMP: Rs. 226	Price Target: Rs. 268 ↑

↑ Upgrade ↔ Maintain ↓ Downgrade

Summary

- Bharat Electronics Limited (BEL) reported mixed Q4FY2022 performance as sales were in-line with expectations. However, OPM and net profit lagged estimates despite better gross margin.
- Order inflows during FY2022 grew by ~20% y-o-y to Rs. 18,000 crore with order book closing at Rs. 57,570 crore at ~3.8x its FY22 revenue.
- The current uncertain international (Russia-Ukraine war) as well as domestic (India-China border dispute) geopolitical scenario calls for strengthening of the national security, which could furtherpush India's defence expenditure. Moreover,the government's emphasis on Make in India/Atmanirbhar Bharat initiatives and favorable policies for indigenous players in the defence sector provides strong growth opportunity for BEL.
- We retain our Buy rating on BEL with a revised PT of Rs. 268, considering its strong revenue and order inflow guidance for FY2023, backed by its strong order book and promising order pipeline in both defence and non-defence verticals.

Bharat Electronics Limited's (BEL) consolidated results lagged our expectations on the profitability front. The company's sales declined by ~8% y-o-y to Rs. 6,340crore. It is noteworthy that gross margins have improved to 42% (from 41.2% in Q4FY2021) due to lower raw-material cost.However, operating profit declined by 20.4% to Rs. 1,578 crore (versus our estimate of Rs. 1,664crore) on account of higher employee cost and other expenses. Operating profit margin (OPM) declined by 375 bps y-o-y to 24.9% (versus our expectation of 26.1%). Consequently, net profit declined by 16% y-o-y to Rs. 1,154 crore (versus our expectation of Rs. 1,252 crore). Order backlog as of April 1, 2022, stood at Rs. 57,570 crore, providing strong revenue visibility of ~3.8 years.

Key positives

- Positive surprise on GPM despite steep rise in commodity prices and supply chain challenges.
- Order intake remained strong during Q4 at ~Rs. 6,000 crore, thereby leading to total order inflows of ~Rs.18,000 crore in FY2022.

Key negatives

- OPM contracted by 375bps y-o-y to 24.9% due to 21% and ~30% rise in employee cost and other expenses, respectively.
- Receivable days have increased from 303 days in FY2021 to 327 days in FY2022.

Revision in estimates – We have fine-tuned our earnings estimates to factor in better execution in FY23E in-line with the guidance provided by the company.

Our Call

Valuation –Maintain Buy with a revised PT of Rs. 268: BEL has a number of opportunities with the government's Make in India and Atmanirbhar Bharat initiatives. The company continues to invest heavily on capex (Rs. 500-600 crore per annum) and has considerable expenditure in research and development (R&D, 6-7% of revenue). Further, the company plans to set up a semi-conductor fabrication plant in consortium with Hindustan Aeronautics Limited (HAL) and other companies, which would further reduce dependency on imports. BEL remains our preferred pick in the defence sector on account of its strong manufacturing and R&D base, robust order book, order inflow pipeline, growing indigenisation, and strong balance sheet with net cash position of over ~Rs. 1,200 crore. The stock is trading at reasonable valuation of ~17x its FY2024E earnings. We retain our Buy recommendationon the stock with a revised price target (PT) of Rs. 268.

Key Risks

- Delayed order execution and slower pace of fresh orders can affect revenue growth.
- Higher raw-material prices and shortage of some key components could adversely impact margins going forward.

Valuation (Consolidated) Rs cr

Particulars	FY21	FY22	FY23E	FY24E
Net Sales	14,109	15,848	17,523	19,188
OPM (%)	22.8	21.7	21.6	23.2
PAT	2,099	2,399	2,711	3,188
Yoy growth	15.1	14.3	13.0	17.6
EPS (Rs.)	8.6	9.8	11.1	13.1
P/E (x)	26.2	23.0	20.3	17.3
EV/EBITDA (x)	18.4	17.8	17.1	14.2
RoCE (%)	18.6	17.8	15.7	15.0
RoE (%)	19.9	20.6	20.7	21.3

Source: Company; Sharekhan estimates

Cost pressures mar Q4 performance

BEL's consolidated results lagged our expectations on the profitability front. Sales declined by ~8% y-o-y to Rs. 6,340 crore. It is noteworthy that gross margins have improved to 42% in Q4FY2022 (from 41.2% in Q4FY2021) due to lower raw-material cost. However, operating profit declined by 20.4% to Rs. 1,578 crore (versus our estimate of Rs. 1,664 crore) on account of higher employee cost and other expenses. OPM declined by 375 bps y-o-y to 24.9% (versus our expectation of 26.1%). Consequently, net profit declined by 16% y-o-y to Rs. 1,154 crore (versus our expectation of Rs. 1,252 crore). Order backlog as of April 1, 2022, stood at Rs. 57,570 crore, providing strong revenue visibility of ~3.8 years.

Strong future outlook

BEL boasts of a strong order book at Rs. 57,570 crore, which provides revenue visibility of more than three years. 78% of its revenue is derived from the defence sector, followed by non-defence (14%), other products (5%), and exports (3%). More than 90% of its revenue comes from government orders. Moreover, the company has a promising order inflow pipeline and expects big ticket size orders such as Quick Response Surface to Air Missile (QRSAM), Medium Range Surface to Air Missile (MRSAM), Air Defence Fire Control Radar-ATULYA, mountain radars, andelectronic warfare systems in the near term. BEL is also focusing on increasing its non-defence revenue by diversifying into civil segments such as smart cities, homeland security, metros, and software as a service (SaaS). The existing metros provide Rs. 7,000 crore opportunity over the next 12-18 months. The company would also be making Rs. 40 crore-50 crore investments in charging infrastructure for 4-5 highways. BEL has also been focusing on exploring the export (primarily non-defence currently) potential of defence electronics products and systems, which bodes well for revenue diversification. The company targets 10-15% revenue contribution from exports (currently ~3%).

Key takeaways from Media interaction and Investor presentation

- **Update on revenue and FY2023 guidance:** Revenue growth was impacted by Covid-19 pandemic and global chip shortage. ~78% of revenue was derived from indigenous technology and defence business contributed ~88% to total revenue.Some of the major orders executed during the year include long range surface to air missile, Akash weapon system, fire control system, integrated air command and control system, and coastal surveillance system among others. The company expects revenue growth of 15% y-o-y in FY2023.
- **Exports:** Exports sales declined by 36% y-o-y to US$33.3 million. Exports in FY2022 were impacted by geopolitical crisis and supply chain issues, which led to delay in dispatches of certain consignments. Total exports order book stands healthy at US$269 million and the company acquired orders worth US$179 million in FY2022. Expecting the spill over effect of some of the orders, the company expects to double its export sales to US$70 million in FY2023.
- **Margin guidance for FY2023:** OPM is expected to be at 20-22% in FY2023. Raw-material cost as a percentage of sales is expected to be ~57%. Given higher raw-material prices, suppliers have increased prices. However, most of BEL's orders are fixed priced contracts. Hence, the company expects margin to be range bound in the near term on account of cost inflation.
- **Order inflow guidance:** The company achieved order inflow of ~Rs. 18,000 crore during FY2022. Some of the key orders include: avionics package for light combat aircraft (LCA), advanced electronic warfare (EW) suite for fighter aircraft, instrumented electronic warfare range (IEWR) etc. For FY2023, the company aims to achieve an order intake of Rs. 20,000 crore (up 11-12% y-o-y). Order book stands at Rs. 57,570 crore (up ~8% y-o-y) in FY2022.
- **Recent initiatives to boost growth:** The company aims to enhance its manufacturing portfolio by increasing empanelment as a global supply chain partner with original equipment manufacturers (OEMs). It is also getting into a strategic alliance with Indian platform manufacturers and with foreign OEMs to address global markets.BEL is focusing more on core areas and R&D to retain IP, while all non-core areas are being outsourced to Indian industries including MSMEs.

- **R&D and capex:** R&D expenditure as a percentage of revenue was ~6.9% in FY2022 (6.3% in FY2021). During FY2022, the company spent around Rs. 465 crore as part of investment towards modernisation of plant and machinery, test instruments, R&D investments, and infrastructure upgradation etc. The company plans capex of Rs.500-600 crore p.a. in the coming years.
- **Plans to set up a semi-conductor plant:** BEL intends to set up a semi-conductor fabrication plant in consortium with HAL and some private companies under the production linked incentive (PLI) scheme. If the plan is approved by the government, it would entail total capex of Rs. 1,000 crore-1,300 crore.
- **Indigenisation efforts:** BEL is focusing on import substitution of critical sub-systems through in-house/ domestic vendor development. BEL is also providing its test facilities to private vendors to encourage domestic manufacturing.

Results (Consolidated) Rs cr

Particulars	Q4FY22	Q3FY21	YoY %	Q3FY22	QoQ %
Revenue	6,339.8	6,917.5	(8.4)	3,701.7	71.3
Operating expenditure	4,762.3	4,936.6	(3.5)	2,872.3	65.8
Operating profit	1,577.5	1,980.9	(20.4)	829.3	90.2
Other income	63.9	57.5	11.2	59.9	6.7
Interest	4.3	5.6	(24.1)	0.2	2,261.1
Depreciation	106.1	96.8	9.6	98.2	8.0
PBT	1,531.1	1,936.0	(20.9)	790.9	93.6
Tax	384.6	580.2	(33.7)	206.0	86.7
Reported PAT	1,146.5	1,355.7	(15.4)	584.9	96.0
Adj PAT	1,154.2	1,368.1	(15.6)	595.9	93.7
EPS (Rs)	4.7	5.6	(15.6)	2.4	93.7
Margin (%)					
GPM (%)	42.0	41.2	81.6	40.7	126.1
OPM (%)	24.9	28.6	(375)	22.4	248
NPM (%)	18.1	19.6	(151)	15.8	228
Tax Rate (%)	25.1	30.0	(485)	26.0	(92)

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 to boost the Aatma Nirbhar Bharat programme in the defence sector and create a level playing field for private players, including MSME. 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 foreign direct investment (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 has also established defence corridors in Tamil Nadu and Uttar Pradesh, which have helped in reducing the dependency on imports.

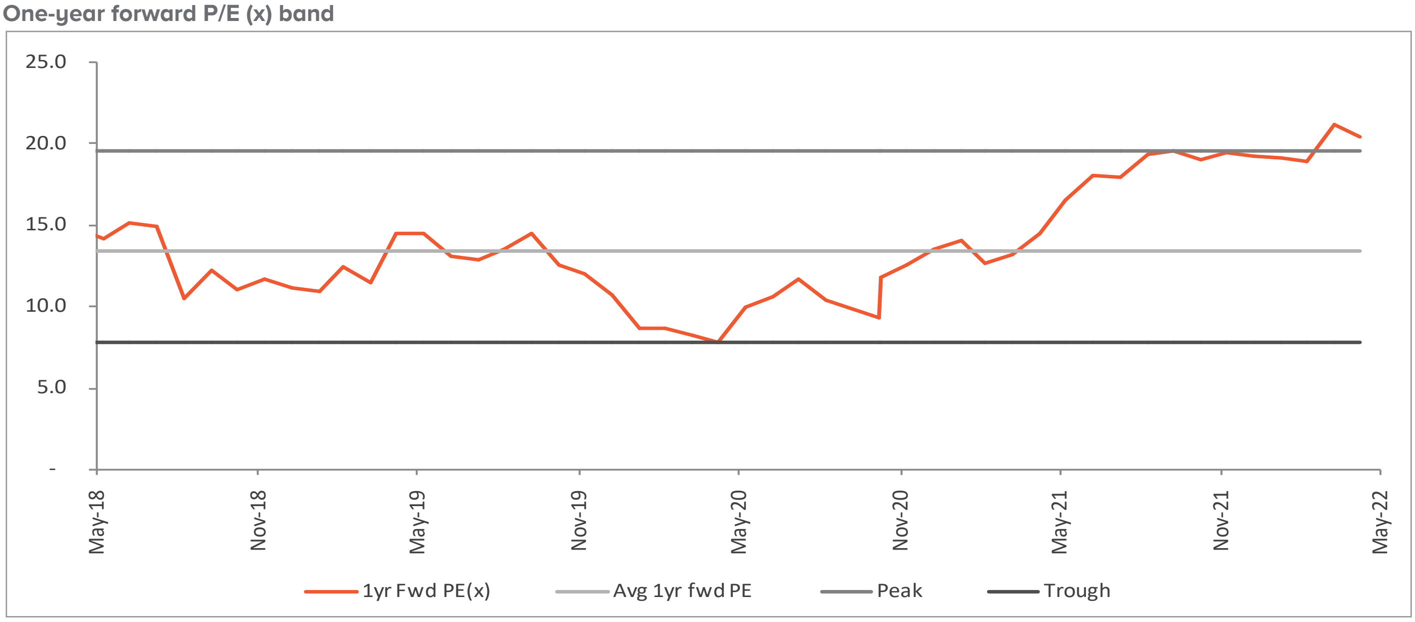
■ Company outlook - Continues to focus on sustainable growth plans

The company has been continuously focusing on sustainable growth plans and has taken various initiatives such as i) focus on enhancing its R&D capability; ii) enhancing manufacturing capabilities through timely modernisation and expansion of facilities; and iii) enter into joint ventures in existing and emerging businesses to enhance business visibility. The company's order pipeline includes orders for Akash missile system, long-range surface-to-air missile systems, naval equipment, and radar systems. BEL is also into project execution for the development of smart cities and manufacturing of electronic voting machines. In addition, BEL has been focusing on exploring the export (primarily non-defence currently) potential of defence electronics products and systems, which bodes well for revenue diversification. The company targets 10-15% revenue contribution from exports (currently ~3%).

■ Valuation - Maintain Buy with a revised PT of Rs. 268

BEL has a number of opportunities with the government's Make in India and Atmanirbhar Bharat initiatives. The company continues to invest heavily on capex (Rs. 500 crore-600 crore per annum) and has considerable expenditure in research and development (R&D, 6-7% of revenue). Further, the company plans to set up a semi-conductor fabrication plant in consortium with Hindustan Aeronautics Limited (HAL) and other companies, which would further reduce dependency on imports. BEL remains our preferred pick in the defence sector on account of its strong manufacturing and R&D base, robust order book, order inflow pipeline, growing indigenisation, and strong balance sheet with net cash position of over ~Rs. 1,200 crore. The stock is trading at reasonable valuation of ~17x its FY2024E earnings. We retain our Buy recommendation on the stock with a revised PT of Rs. 268.

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 Aatma Nirbhar 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.

Key Risks

- Delayed order execution and slower pace of fresh order intake can affect revenue growth.
- Higher raw-material prices may put margin pressure.

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 officer

Source: Company

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	HDFC Asset Management Co. Ltd.	5.1
2	Nippon Life India Asset Management	4.7
3	Kotak Mahindra Asset Management Co. Ltd.	3.8
4	BlackRock Inc.	1.5
5	Mirae Asset Global Investments	1.5
6	Vanguard Group Inc.	1.5
7	FMR LLC	1.3
8	Life Insurance Corp. of India	1.3
9	Canara Robeco Asset Management Co. Ltd.	0.8
10	Franklin Resources Inc.	0.8

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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