



## 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

Updated July 08, 2022

34.56

## High Risk

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

Source: Morningstar

## Company details

Market cap:	Rs. 79,433 cr
52-week high/low:	Rs. 334/183
NSE volume: (No of shares)	82.4 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	15.7	33.9	36.0	85.9
Relative to Sensex	15.0	27.5	36.3	76.7

Sharekhan Research, Bloomberg

## Bharat Electronics Ltd

## Promising long-term bet

## Capital Goods

## Sharekhan code: BEL

## Reco/View: Buy



CMP: Rs. 326

Price Target: Rs. 390



Upgrade



Maintain



Downgrade

## Summary

- We reiterate Buy on Bharat Electronic Limited (BEL) with a revised PT of Rs. 390, as its healthy order book of Rs. 55,450 crore, promising order inflow pipeline, and increasing indigenisation would drive the company's long-term performance.
- The government's emphasis on 'Make in India' and 'Atmanirbhar Bharat' initiatives in the defence sector and production target of \$25 billion by 2025 through indigenisation and higher exports in defence bodes well for a player like BEL.
- BEL is focused on diversifying its revenue base by pursuing non-defence opportunities in homeland security, smart city, energy storage products, solar, space electronics, network, and cyber security. Further, growing exports (~60% CAGR over FY2022-FY2024E) shall also aid revenue growth.
- We are bullish on BEL, given its strong manufacturing and R&D base, growing indigenisation, and strong balance sheet with healthy return ratios.

Over the past few years, India has been among the top importers of defence equipment. India is the third-largest military spending country globally and has accounted for almost 3.7% of global military spending. India's defence sector is undergoing major reforms as the government is keen on strengthening the nation's defence prowess by reducing dependence on imports. As a result, India has significantly reduced its reliance on imports through encouraging indigenous design and manufacturing of defence equipment by various state-owned companies such as Bharat Electronics Limited (BEL), Hindustan Aeronautics Limited (HAL), and private players. The Indian government has set an ambitious defence production target at US\$25 billion by 2025 (including US\$5 billion from exports by 2025). Measures such as simplification of the 'Make' procedure for procurement of defence products, provision for funding of up to 70% of product development, and ban on import of many key components have encouraged indigenisation. We believe BEL is a formidable play on India's defence story, given its indigenisation capabilities, healthy order book, promising order inflow pipeline, and strong execution capabilities.

**Strong order book and promising order intake pipeline:** BEL boasts of a strong order book of Rs. 56,450 crore, which provides revenue visibility of more than three years. Over 90% of its revenue comes from the government's defence orders. Moreover, the company has a promising order inflow pipeline (Rs. 20,000 crore order inflow expected in FY2023E) and has guided for ~15% revenue growth for FY2023. Since August 2020, the government has notified more than 300 items comprising various complex defence systems and equipment, to be procured only from Indigenous manufacturers. Hence, the total opportunity size has increased to Rs. 2 lakh crore for the next five to six years. BEL, which has indigenised 78% of its revenue, stands to benefit from increasing defence capital outlay of India as well as emphasis on indigenisation of defence equipment.

**Non-defence businesses/exports offer strong growth potential:** BEL has ventured into several non-defence areas such as homeland security, smart city, energy storage products, solar, space electronics, network and cyber security, and healthcare solutions. BEL has scaled up its operations from cell/module manufacturing to execution of solar power plant projects under engineering procurement construction (EPC)/developer mode. The company also aims to increase revenue share in the services business (currently ~10%) through new business models such as OPEX, GOCO, leasing, and product support services. BEL has also been focusing on exploring exports (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 ~2%) going forward. Currently, the exports order book stands at US\$272 million. The company received order intake of \$179 million in FY2022. We expect BEL's exports to post a CAGR of ~60% over FY2022-FY2024E.

**Cost-control measures, recent developments:** As per the FY2022 annual report, BEL has focused on cost-control measures and extensive indigenisation efforts to improve profitability. In the past five years, it met its entire working capital needs through internal accruals. The company's cash flow from operations has grown from Rs. 108 crore in FY2017 to Rs. 4,160 crore in FY2022. Further, despite significant topline growth, its inventory turnover has declined from 206 days in FY2017 to 133 days in FY2022. Similarly, receivable turnover has reduced from 180 days to 148 days during the same period. Moreover, BEL has signed an MoU with UK-based Smiths Detection, a global leader in threat detection and security inspection technologies, for offering advanced, high-energy scanning systems to the Indian market. NHPC Ltd. has signed an MOU with BEL for setting up a 1,000 MW solar manufacturing unit in India. BEL has signed another MoU with Defense Initiatives (DI), Belarus, and Defense Initiatives Aero Pvt. Ltd., India (a subsidiary of DI Belarus), for the supply of Airborne Defense Suite (ADS) for Indian Air Force's helicopters. ADS is used for providing protection to helicopters. The MoU also aims to explore various business opportunities for India and global markets for ADS.

**Revision in estimates** – We have revised our earnings estimates upwards, factoring in better revenue growth and profitability.

## Our Call

**Valuation – Maintain Buy with a revised PT of Rs. 390:** BEL would play a significant role in the successful implementation of the government's Make in India and Atmanirbhar Bharat initiatives as it is one of the key defence and aerospace players. Further, global defence companies are tying up with indigenous players, as there is tremendous export potential for engineering services and components sourcing from India, which bodes well for BEL. BEL continues to invest heavily on capex (Rs. 750 crore capex expected in FY2023) and has considerable expenditure in research and development (R&D, 6-7% of revenue). Further, the company plans to set up a semiconductor fabrication plant in consortium with Hindustan Aeronautics Limited (HAL) and other companies, which would further reduce dependency on imports in the long term. BEL has strong manufacturing and R&D base, robust order book, healthy order prospects, diversifying revenue stream, and strong balance sheet with good return ratios. We retain Buy on the stock with a revised price target (PT) of Rs. 390.

## 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 such as semi-conductors could affect execution and earnings going forward.

## Valuation (Consolidated)

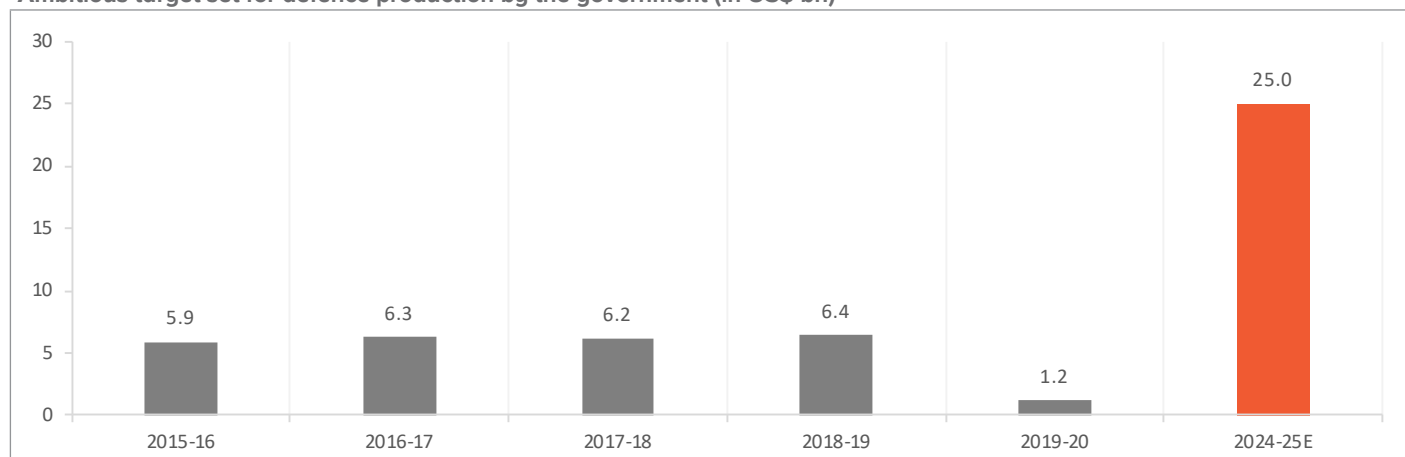
Particulars	FY21	FY22	FY23E	FY24E
Net Sales	14,109	15,368	17,599	19,677
Operating Profit Margin (%)	22.8	21.7	21.6	23.8
PAT	2,099	2,399	2,684	3,317
y-o-y growth	15.1	14.3	11.9	23.6
EPS (Rs.)	8.6	9.8	11.0	13.6
P/E (x)	37.8	33.1	29.6	24.0
EV/EBITDA (x)	26.0	25.1	22.4	18.0
RoCE (%)	18.6	17.8	17.8	19.1
RoE (%)	19.9	20.6	20.5	22.1

Source: Company; Sharekhan estimates

## Solid order book and order pipeline would drive future growth

BEL boasts of a strong order book of Rs. 55,450 crore, which provides revenue visibility of more than three years. In addition, the company envisages order inflow of at least Rs 20,000 crore in FY2023E as the order pipeline is quite promising. The company expects orders of LRSAM (new variant), Akash Missile (for Army and NG variant), MRSAM, QRSAM, naval equipment, and EW systems. Since August 2020, the government has notified more than 300 items comprising various complex defence systems and equipment to be procured only from indigenous manufacturers. Hence, the total opportunity size has increased to Rs. 2 lakh crore for the next five to six years. BEL, which has indigenised 78% of its revenue, stands to benefit from increasing defence capital outlay of India as well as emphasis on indigenisation of defence equipment to reduce dependency on imports, led by the government's 'Make in India' and 'Atmanirbhar Bharat' initiatives. The company plans to spend Rs. 750 crore towards various expansion initiatives, while over Rs. 1,000 crore would be spent on R&D in FY2023. The company has 28.69% of total workforce dedicated towards R&D. We expect a revenue CAGR of ~13% over FY2022-FY2024E.

### Ambitious target set for defence production by the government (in US\$ bn)



Source: [www.ibef.org](http://www.ibef.org), Sharekhan Research

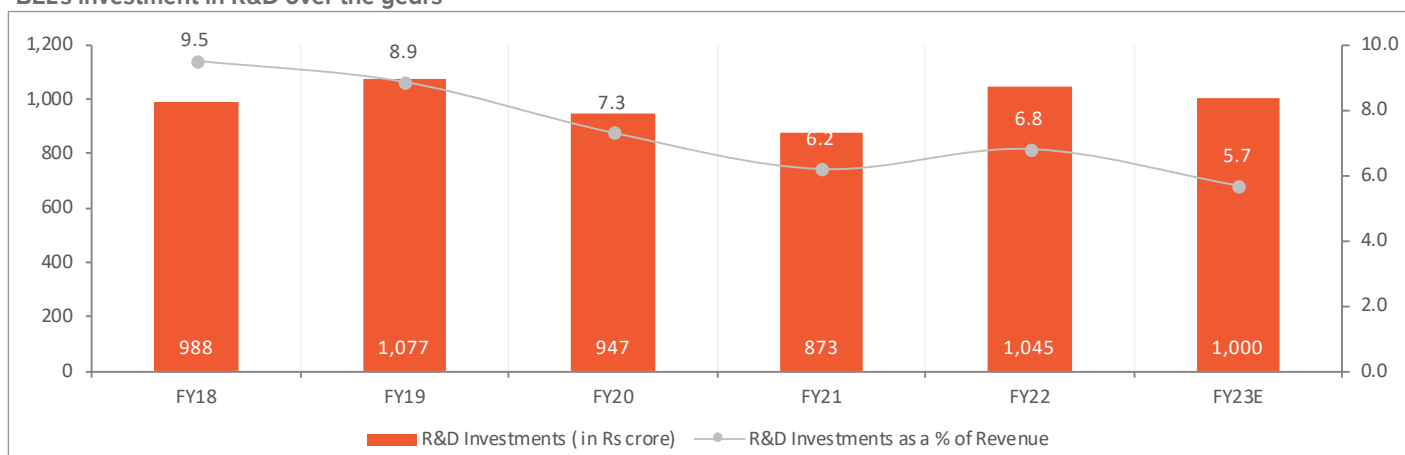
Major Orders Received during FY22	Rs crore	Major Orders Executed during FY22	Rs crore
Avionics Package for LCA	1,868	Long Range Surface-to-Air Missile (LRSAM) ADSN 2,439	2,439
Advanced EW Suite for Fighter Aircraft	1,689	Akash Missile System (7 Sqdn) MS 2,212	2,212
Instrumented Electronic Warfare Range (IEWR)	940	Integrated Air Command and Control System (IACCS)	823
CDR TI cum Day Light Sights	911	AFNET	698
Electronic Voting Machines	755	CSS Phase II	405

Source: Sharekhan Research, Company Presentation

Major Projects planned during FY23	Rs crore
LRSAM (Long Range Surface to Air Missile) System	2,639
Akash Missile System (7 Sqdn)	2,085
Integrated Air Command & Control System	802
VVPAT	704
EVM BU & CU M3	604

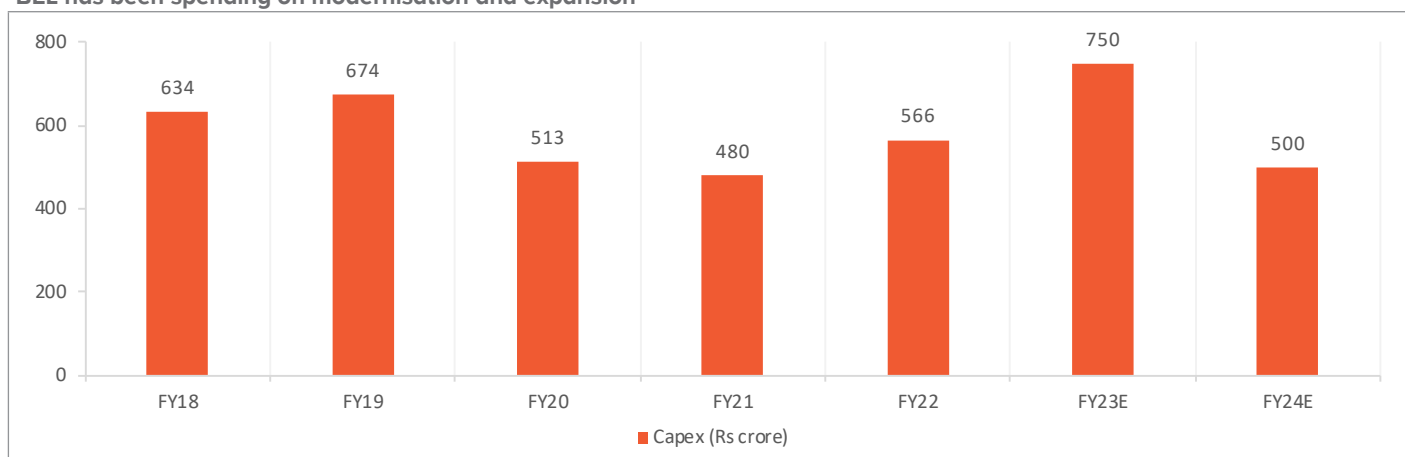
Source: Sharekhan Research, Company Presentation

### BEL's investment in R&D over the years



Source: Sharekhan Research, Company Presentation

### BEL has been spending on modernisation and expansion

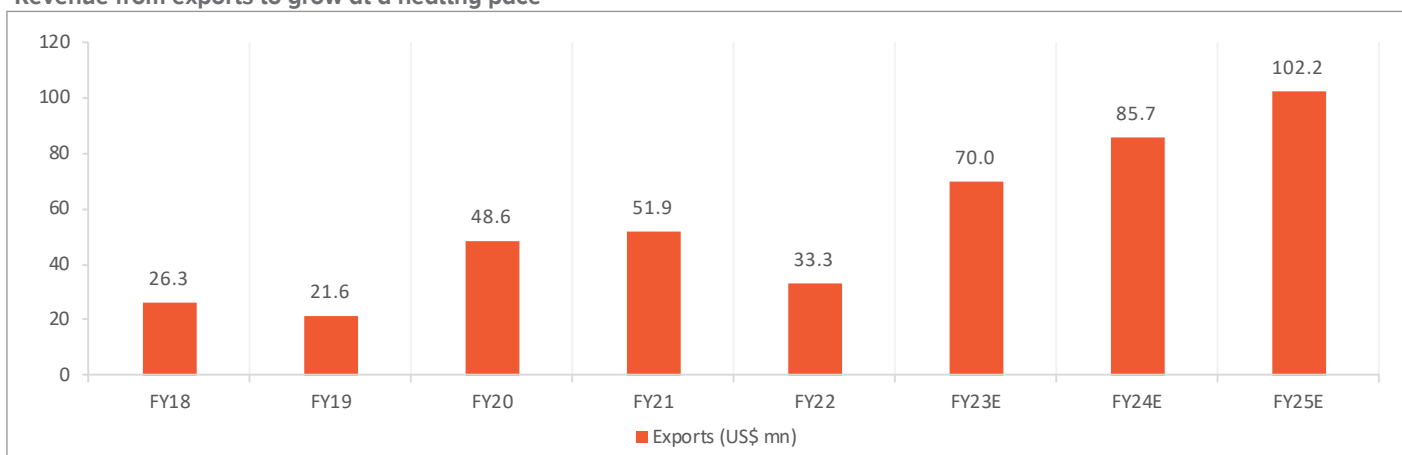


Source: Sharekhan Research, Company Presentation

### Non-defence businesses/exports offer strong growth potential

BEL has ventured into several non-defence areas such as homeland security, smart city, energy storage products, solar, space electronics, network and cyber security, railways and metro solutions, composites, medical electronics, and healthcare solutions. BEL has scaled up its operations from a cell/module manufacturing to execution of solar power plant projects under the EPC/developer mode. The company also aims to increase revenue share in the services business (currently ~10%) through new business models such as OPEX, GOCO, leasing, and product support services. BEL has also been focusing on exploring exports (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 ~2%) going forward. Currently, exports order book stands at US\$272 million. The company has received order intake of \$179 million in FY2022. The company has been collaborating with partners in Chile, Suriname, Argentina, Peru, Columbia, Panama, Malaysia, Nepal, ASEAN, Bangladesh, and US. We expect BEL's exports to report a CAGR of ~60% over FY2022-FY2024E.

#### Revenue from exports to grow at a healthy pace



Source: Sharekhan Research, Company Presentation

#### 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. Currently, the proposal is under scrutiny and will take about four years to be operational once approvals are received. It is likely to entail capex of Rs. 1,000 crore-1,300 crore for BEL. We believe setting up of an indigenous plant would reduce dependency on imports and lead to significant cost saving in the long term.

#### Recently signed MoUs would lead to revenue diversification

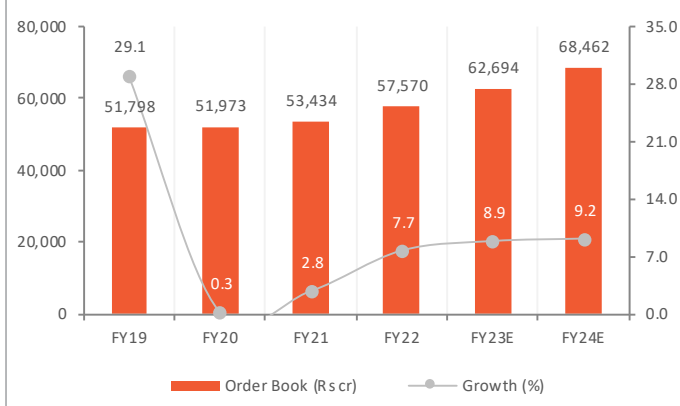
- ◆ BEL has signed an MoU with UK-based Smiths Detection, a global leader in threat detection and security inspection technologies, for offering advanced, high-energy scanning systems to the Indian market. The MoU will leverage the high-end, technological capabilities of both the firms to meet India's domestic security needs. The MoU will be in line with the Indian Government's 'Make in India' initiative, which seeks to increase manufacturing activities in India. BEL will handle front-end requirements in the market, supporting localisation of projects. Smiths detection will provide its state-of-the-art screening technology and technological expertise for the project. The MoU is for a period of five years and can be extended further by mutual consent. BEL has been continuously exploring opportunities in non-defence and, therefore, it is a positive development for the stock.
- ◆ NHPC Ltd. has signed an MOU with BEL for setting up a 1,000 MW solar manufacturing unit in India. NHPC is currently building four solar power plants with a combined capacity of 1,040 MW to be completed during 2022-2024. For BEL, it is a positive development as the company is looking to increase its share of non-defence revenue from 10-12% currently to 20% in the next few years.
- ◆ BEL has recently signed an MoU with DI, Belarus, and Defense Initiatives Aero Pvt. Ltd., India (a subsidiary of DI Belarus), for the supply of ADS for Indian Air Force's helicopters. ADS is used for providing protection to helicopters. BEL will be the prime contractor and will be supported by DI with manufacturing and maintenance for the supply of advanced Electronic Warfare (EW) suites for helicopters under the 'Make in India' category. The MoU also aims to explore various business opportunities for India and global markets for ADS.

### **Focusing on cost control and better working capital management**

As per the FY2022 annual report, BEL has focused on cost-control measures and extensive indigenisation efforts to improve profitability. In the past five years, its high productivity and efficiency in managing operational expenses has provided the company with significant operating leverage. In the past five years, it met its entire working capital needs through internal accruals. The company's cash flow from operations has grown from Rs. 108 crore in FY2017 to Rs. 4,160 crore in FY2022. Further, despite significant topline growth, its inventory turnover has significantly declined from 206 days in FY2017 to 133 days in FY2022. Similarly, receivable turnover has reduced from 180 days to 148 days during the same period.

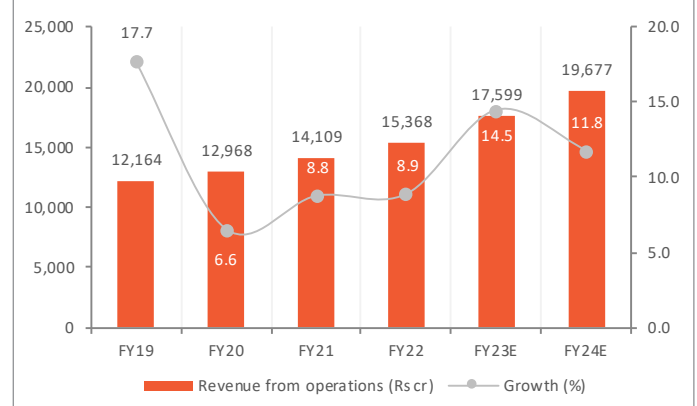
## Financials in charts

### Order book growth trend



Source: Sharekhan Research

### Revenue growth trend



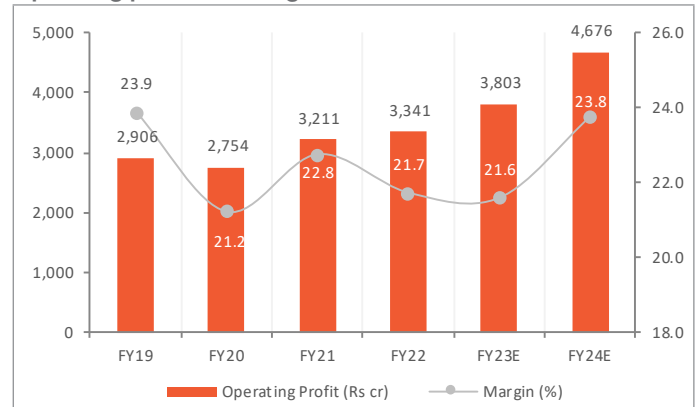
Source: Sharekhan Research

### Order Book to Revenue ratio



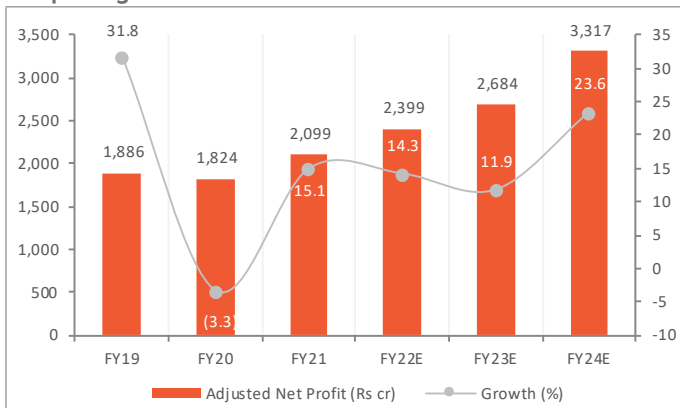
Source: Sharekhan Research

### Operating profit and margin trend



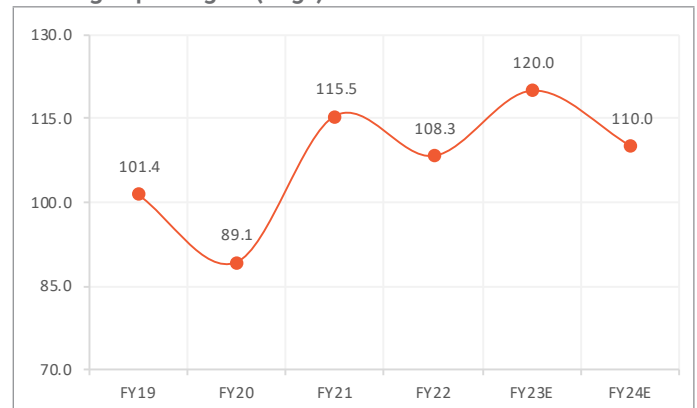
Source: Sharekhan Research

### Net profit growth trend



Source: Sharekhan Research

### Working capital cycle (days)



Source: 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 *AatmaNirbhar 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, hike in foreign direct investment (FDI) to 74% through 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 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.

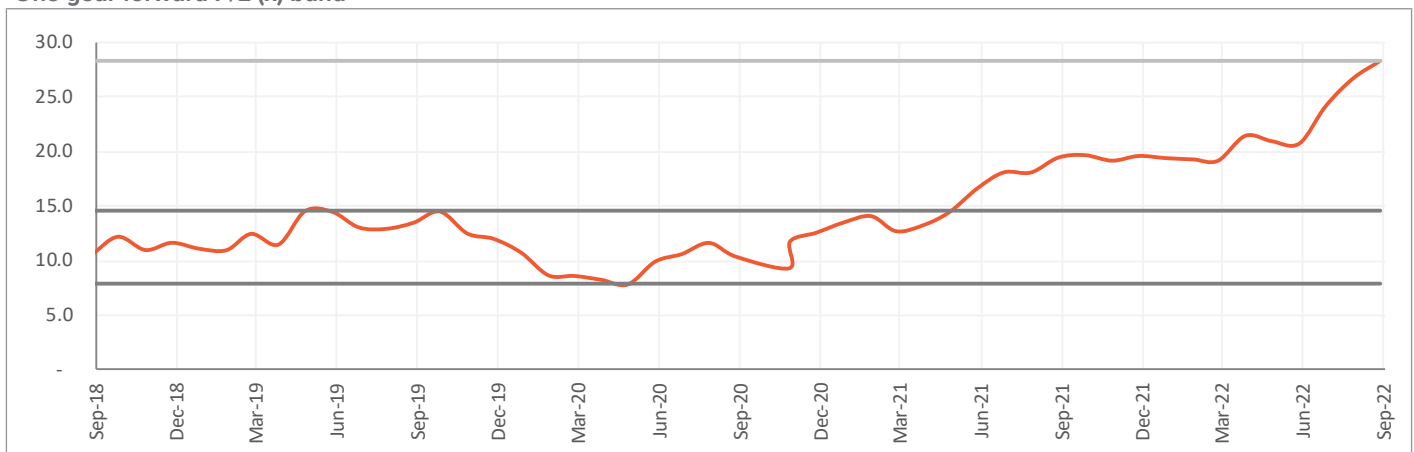
### ■ Company Outlook – Continues to focus on sustainable growth plans

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 ~2%).

### ■ Valuation – Maintain Buy with a revised PT of Rs. 390

BEL would play a significant role in the successful implementation of the government's Make in India and Atmanirbhar Bharat initiatives as it is one of the key defence and aerospace players. Further, global defence companies are tying up with indigenous players, as there is tremendous export potential for engineering services and components sourcing from India, which bodes well for BEL. BEL continues to invest heavily on capex (Rs. 750 crore capex expected in FY2023) and has considerable expenditure in research and development (R&D, 6-7% of revenue). Further, the company plans to set up a semiconductor fabrication plant in consortium with Hindustan Aeronautics Limited (HAL) and other companies, which would further reduce dependency on imports in the long term. BEL has strong manufacturing and R&D base, robust order book, healthy order prospects, diversifying revenue stream, and strong balance sheet with good return ratios. We retain Buy on the stock with a revised PT of Rs. 390.

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 is a good play on 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 orders can affect revenue growth.
- ◆ Higher raw-material prices and shortage of some key components such as semi-conductors could affect execution and earnings going forward.

## Additional Data

### Key management personnel

Mr. Dinesh Kumar Batra	Interim Chairman and Managing Director, Director (Finance)
Mr. Vinay Kumar Katyal,	Interim Director (R&D), Director (Bangalore Complex)
Mr. S Sreenivas	Secretary/Compliance Officer

Source: Company Website

### Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Nippon Life India Asset Management (CPSE ETF)	4.6
2	HDFC Asset Management Co. Ltd.	4.6
3	Kotak Mahindra Asset Management Co. Ltd.	3.6
4	Vanguard Group Inc.	1.7
5	BlackRock Inc.	1.5
6	FMR LLC	1.3
7	Life Insurance Corp. of India	1.3
8	Mirae Asset Global Investments	0.9
9	Canara Robeco Asset Management Co. Ltd.	0.9
10	DSP Investment Managers Ltd.	0.9

Source: Bloomberg

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## 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 deteriorating 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

# Sharekhan

by BNP PARIBAS

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