

## Strong growth visibility on healthy orders flow...

**About the stock:** Hindustan Aeronautics (HAL), the largest defence PSU in India, is engaged in design, development, manufacture, repair, overhaul, upgrade and servicing of a wide range of products including, aircraft, helicopters, aero-engines, avionics, accessories and aerospace structures

- The company has delivered revenue, EBITDA and PAT CAGR of 7.4%, 12% and 26.5%, respectively, in FY18-22. In FY22, repair & overhaul contributed ~64% to total revenues while manufacturing contributed ~30%

**Q2FY23 Result:** Margins improved YoY led by higher share of repair & maintenance.

- Revenue declined 7.3% YoY to ₹ 5144.8 crore on account of higher base. Execution has been more uniform in H1FY23 as compared to H1FY22 (which was impacted due to lockdown)
- EBITDA margin improved by 919 bps YoY to 31.5% on lower others cost; which led to 30.8% YoY growth in EBITDA to ₹ 1621.6 crore
- PAT increased 44.2% YoY to ₹ 1221.2 crore

**What should investors do?** We expect HAL to deliver revenue and EBITDA CAGR of 10.3% and 14.7%, respectively, over FY22-25E. PAT is likely to grow at 14.2% CAGR (FY21-25E). Increase in profitability with strong asset turnover is expected to result in healthy return ratios over FY23-25E.

- We continue to remain positive and retain our **BUY** rating on the stock

**Target Price and Valuation:** We value HAL at ₹ 3300 i.e. 20x PE on FY25E EPS.

**Key triggers for future price performance:**

- Healthy order-book position (₹ 83800 crore; ~3.2x TTM revenues) led by large scale orders in manufacturing aircraft/helicopters (LCA, LCH, ALH)
- Continuous order inflows in MRO (maintenance, repair & overhaul) with strong order pipeline of in manufacturing for next three to four years (led by LUH, LCH, ALH, Dornier, HTT-40 and engines for Su-30 & MiG-29)
- LCA Tejas MK1A, largest order in manufacturing, deliveries to IAF expected from FY24E end. Moreover, execution of other key orders and sustained growth in MRO will drive revenue growth in double digits from FY25E

**Alternate Stock Idea:** We also like Bharat Dynamics (BDL) in the defence space.

- Strong earnings growth of ~25% CAGR expected over FY22-24E led by execution of existing strong order-book primarily comprising manufacturing various types of indigenous missiles & torpedoes
- BUY with a target price of ₹ 1200/share



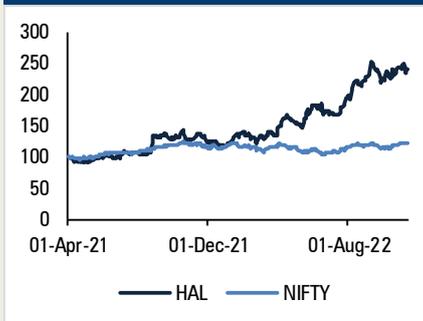
### Particulars

Particular	Amount
Market Capitalisation (₹ Crore)	85,938
Total Debt (FY22 - ₹ Crore)	-
Cash (FY22 - ₹ Crore)	14,356
EV (₹ Crore)	71,582
52 Week H/L (Rs)	2425 / 1181
Equity Capital	334
Face Value	10

### Shareholding pattern

	Dec-21	Mar-22	Jun-22	Sep-22
Promoter	75.2	75.2	75.2	75.2
FII	3.2	4.4	5.6	6.9
DII	18.3	17.0	15.7	13.5
Others	3.4	3.5	3.6	4.5

### Price Chart



### Key risks

- Government contract dependence
- Dependence on foreign OEMs for key components

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### Key Financial Summary

(₹ crore)	FY20	FY21	FY22	3 Year CAGR (FY19-22)	FY23E	FY24E	FY25E	3 Year CAGR (FY22-24E)
Revenues	21,438	22,882	24,620	5.3	26,227	28,556	33,034	10.3
EBITDA	4,896	5,336	5,409	4.5	6,425	7,039	8,164	14.7
EBITDA margin (%)	22.8	23.3	22.0		24.5	24.7	24.7	
Profit Before Tax	3,969	4,283	5,225	8.8	5,856	6,396	7,310	11.8
EPS (₹)	85.9	97.1	151.9		132.7	145.0	165.0	
P/E (x)	30.9	26.5	16.9		19.4	17.7	15.6	
EV/EBITDA (x)	18.7	14.8	13.2		11.3	10.1	8.7	
RoCE (%)	21.9	29.4	27.4		30.5	30.1	30.8	
RoE (%)	21.0	21.0	26.3		23.1	22.8	23.3	

## Q2FY23 Result – Key Highlights

- Revenue for the quarter came in at ₹ 5144.8 crore (down 7.3% YoY); lower than our estimate of ₹ 5822.3 crore. The YoY decline was on account of higher base (Q2FY22 revenue jumped sharply on a QoQ basis as Q1FY22 was impacted badly due to lockdown). Sequentially, the Q2FY23 revenue has increased by 42% as execution has been more uniform this time compared to H1FY22. H1FY23 revenue was up 22.3% YoY as the revenue increased significantly in Q1FY23 (+124.2% YoY) due to lower base
- Gross margins improved significantly by 1130 bps YoY to 64.2% (better than our estimate of 51.5%) on account of lower raw material cost, which declined 29.7% YoY
- EBITDA margins came in at 31.5% (vs. estimate of 22.3%); improving by 919 bps YoY led by a decline in raw material and others cost. Margins improved significantly YoY led by lower provision of liquidated damages during the quarter [led by lower share of manufacturing contracts and higher share of repair & overhaul (RoH) contracts]. Sequentially also, EBITDA margins improved 871 bps on higher share of RoH contracts and operating leverage benefits. H1FY23 EBITDA margin was also up 724 bps YoY at 27.9%
- EBITDA increased 30.8% YoY (+96.3% QoQ) to ₹ 1621.6 crore (I-direct estimate of ₹ 1296.5 crore) led by better margins. H1FY23 EBITDA increased by 65.2% YoY to ₹ 2447.9 crore
- PAT came in at ₹ 1221.2 crore (up 44.2% YoY) led by a sharp improvement in margins. Other income was up 88.6% YoY to ₹ 259.1 crore, which also supported the bottomline. H1FY23 PAT was up 76.8% YoY to ₹ 1841.4 crore

## Key Highlights from Q2FY23 Earnings Call

- The order book was at ₹ 83858 crore as of September 2022 end. Order inflows were at ₹ 10251 crore during H1FY23 of which ₹ 8496 crore worth of orders were received in the RoH segment, ₹ 860 crore in manufacturing and ₹ 742 crore in development
- Manufacturing order inflow of ₹ 860 crore during H1FY23 was from the recent consortium order (with L&T) from NewSpace India for production of five polar satellite launch vehicles (PSLVs). The management expects more opportunities in launch vehicles segment in the coming period
- HAL also received ₹ 6800 crore for 70 HTT-40 from IAF in October 2022
- Key orders in the pipeline for the next one to one and a half years include 25 advanced light helicopters (ALH) for Army, six Dornier aircraft, 12 light utility helicopters (LUH) and 12 Su-30 and 240 AL-31 engines (for Sukhoi-30 MKI aircraft)
- RFP for 240 AL-31 engines (for Sukhoi-30 MKI aircraft) and 80 RD-33 engines (for MiG-29 aircraft) have been received and HAL is in the process of submitting the bid. Order for 80 RD-33 is expected to come in FY24E
- HAL has received an Lol for nine more ALH Mk-III from Indian Coast Guard after completing delivery of all 16 ALH on November 15, 2022
- These projects in aircraft, helicopters and engines are in advanced stages of finalisation with total estimated cost of these orders at ₹ 50000 crore
- Apart from these contracts, some key orders in the pipeline for the next three years are 140 LCH, 170 LUH, 60 marine ALH, 36 HTT-40
- HAL is undergoing development programmes like LCA Tejas MK1A, Tejas MK2, TEDBF (twin engine deck based fighter), advanced medium combat

fighter (AMCA), Indian Multi Role Helicopter (IMRH), Combat Air Teaming System (CATS)

- Overall revenue for FY23 is expected to grow 7-8% YoY. RoH revenues are expected to grow 10-12% over the next two to three years
- EBITDA margin improved during Q2FY23 led by high proportion of RoH revenues (as lower manufacturing revenue led to lower provision for liquidated damages and warranty). EBITDA margin is expected at 26-27% for FY23E
- Capacity for helicopter manufacturing will reach 60 helicopters per annum post commissioning of the Tumkur Facility
- Total delivery target for FY23 is 24 aircraft, which includes 2 LCA MK1 FOC, four LCA MK1 trainers, nine ALH and nine LCH. For FY24, expected deliveries are - three LCA Tejas MK1A, four LCA MK1 trainer, 12 LUH and 12 upgraded Su-30
- HAL has aircraft manufacturing capacity of 16 aircraft. In addition to this, the company has outsourced manufacturing to four companies, which will take the total manufacturing capacity to 24 aircraft by next year
- The company is in the process of increasing procurement from domestic private players and MSMEs for many LRUs and key components
- The company is exploring exports opportunity for platforms like LCA Tejas MK1A, LCH and ALH. Countries like Argentina and Philippines have shown interest in these platforms
- In unmanned aerial vehicles category, HAL & DRDO are in the process of developing Medium Altitude Long Endurance (MALE) UAVs – Rustom and Tapas. The prototype for Tapas UAV is expected soon post which flight testing will commence

**Exhibit 1: Variance Analysis**

	Q2FY23	Q2FY23E	Q2FY22	YoY (%)	Q1FY23	QoQ (%)	Comments
Operating Income	5,144.8	5,822.3	5,551.2	-7.3	3,622.5	42.0	Revenue declined YoY on higher base, muted growth in manufacturing contracts
Other income	259.1	160.0	137.4	88.6	191.6	35.2	
Total Revenue	5,403.9	5,982.3	5,688.5	-5.0	3,814.1	41.7	
Raw materials costs	1,841.0	2,823.8	2,617.4	-29.7	1,015.3	81.3	
Employees Expenses	1,144.7	1,020.0	1,074.1	6.6	1,017.8	12.5	
Other Expenses	537.5	682.0	620.0	-13.3	763	-29.6	
Total Expenditure	3,523.2	4,525.8	4,311.5	-18.3	2,796	26.0	
EBITDA	1,621.6	1,296.5	1,239.7	30.8	826.3	96.3	
EBITDA margins (%)	31.5	22.3	22.3	919 bps	22.8	871 bps	Higher share of repair and maintenance contracts led to improvement in margins
Interest	0.4	0.0	0.6		0.2		
Depreciation	252.0	262.3	243.1	3.7	208.2	21.0	
Tax	409.4	289.0	289.5	41.4	202.1	102.6	
PAT	1,221.2	905.2	846.7	44.2	620.1	96.9	

Source: Company, ICICI Direct Research

**Exhibit 2: Change in estimates**

	FY22	FY23E			FY24E			FY25E
	Actual	Old	New	% Change	Old	New	% Change	New
(₹ Crore)								
Revenue	24,620	26,227	26,227	0.0	28,556	28,556	0.0	33,034
EBITDA	5,409	6,425	6,425	0.0	7,039	7,039	0.0	8,164
EBITDA Margin (%)	22.0	24.5	24.5	0 bps	24.7	24.7	0 bps	24.7
PAT	5,080	4,380	4,439	1.3	4,784	4,848	1.3	5,519
EPS (₹)	151.9	131.0	132.7	1.3	143.1	145.0	1.3	165.0

Source: ICICI Direct Research

## Financial Summary

Exhibit 3: Profit and loss statement				
	₹ crore			
(₹ Crore)	FY22	FY23E	FY24E	FY25E
Revenue	24,620	26,227	28,556	33,034
% Growth	7.6	6.5	8.9	15.7
Other income	984.9	650.0	700.0	700.0
Total Revenue	25,613	26,883	29,265	33,750
% Growth	10.2	5.0	8.9	15.3
Total Raw Material Costs	10,001	12,458	13,564	15,691
Employee Expenses	4,604	4,721	4,997	5,781
other expenses	4,606	2,623	2,955	3,398
Total Operating Expenditure	19,211	19,802	21,516	24,871
Operating Profit (EBITDA)	5,409	6,425	7,039	8,164
% Growth	1.4	18.8	9.6	16.0
Interest	58	1	1	1
PBDT	6,335	7,074	7,738	8,862
Depreciation	1,111	1,233	1,342	1,553
PBT before Exceptional Items	5,225	5,841	6,396	7,310
Total Tax	145	1,417	1,548	1,791
PAT before MI	5,080	4,439	4,848	5,519
Minority Interest	-	-	-	-
PAT	5,080	4,439	4,848	5,519
% Growth	56.5	(12.6)	9.2	13.8
EPS	151.9	132.7	145.0	165.0

Source: Company, ICICI Direct Research

Exhibit 4: Cash flow statement				
	₹ crore			
(₹ Crore)	FY22	FY23E	FY24E	FY25E
Profit after Tax	5,080	4,439	4,848	5,519
Depreciation	1,111	1,233	1,342	1,553
Interest	58	1	1	1
Cash Flow before WC change	6,249	5,673	6,192	7,073
Changes in inventory	2,326	(1,101)	(1,372)	(3,996)
Changes in debtors	1,027	(388)	(447)	(1,311)
Changes in loans & Advances	(0)	-	-	-
Changes in other current asse	(1,413)	(76)	29	(448)
Net Increase in Current Asset	2,562	(2,764)	(3,136)	(7,305)
Changes in creditors	302	173	242	647
Changes in provisions	1,121	(552)	400	1,068
Net Inc in Current Liabilities	(382)	1,913	2,157	4,626
Net CF from Operating activiti	8,429	4,823	5,212	4,394
Changes in deferred tax asset	(513)	-	-	-
(Purchase)/Sale of Fixed Ass	(1,118)	(1,200)	(1,200)	(1,200)
Net CF from Investing activitie	123	(970)	(1,239)	(1,275)
Dividend and Dividend Tax	(1,338)	(1,471)	(1,605)	(1,839)
Net CF from Financing Activiti	(1,375)	(4,613)	(2,802)	(3,036)
Net Cash flow	7,178	(760)	1,171	84
Opening Cash/Cash Equivalen	7,178	14,356	13,596	14,767
Closing Cash/ Cash Equivalen	14,356	13,596	14,767	14,851

Source: Company, ICICI Direct Research

Exhibit 5: Balance Sheet				
	₹ crore			
(₹ Crore)	FY22	FY23E	FY24E	FY25E
Equity Capital	334.4	334.4	334.4	334.4
Reserve and Surplus	18,979	18,844	20,892	23,376
Total Shareholders funds	19,313	19,178	21,226	23,710
Other Non Current Liabilities	12,262.4	12,500.0	12,500.0	12,500.0
Total Debt	-	-	-	-
Total Liabilities	33,369	33,497	35,545	38,029
Gross Block	10,628	11,827	13,027	14,227
Acc: Depreciation	4,700	5,933	7,275	8,828
Net Block	5,928	5,894	5,752	5,399
Capital WIP	949	950	950	950
Total Fixed Assets	9,239	9,244	9,102	8,749
Non Current Assets	2,797	2,829	2,868	2,942
Inventory	14,347	15,449	16,821	20,816
Debtors	4,642	5,030	5,476	6,788
Loans and Advances	8	8	8	8
Other Current Assets	2,809	2,885	2,856	3,303
Cash	14,356	13,596	14,767	14,851
Total Current Assets	44,994	46,997	51,305	58,694
Current Liabilities	2,558	2,730	2,973	3,620
Provisions	1,263	1,265	1,265	1,265
Total Current Liabilities	25,023	26,936	29,092	33,719
Net Current Assets	19,971	20,062	22,213	24,975
Total Assets	33,369	33,497	35,545	38,029

Source: Company, ICICI Direct Research

Exhibit 6: Key ratios				
(Year-end March)	FY22	FY23E	FY24E	FY25E
EPS	151.9	132.7	145.0	165.0
Cash per Share	429.3	406.6	441.6	444.1
BV	577.6	573.5	634.8	709.1
Dividend per share	40.0	44.0	48.0	55.0
Dividend payout ratio	26%	33%	33%	33%
EBITDA Margin	22.0	24.5	24.7	24.7
PAT Margin	20.6	16.9	17.0	16.7
RoE	26.3	23.1	22.8	23.3
RoCE	27.4	30.5	30.1	30.8
RoIC	86.7	93.0	88.2	74.6
EV / EBITDA	13.2	11.3	10.1	8.7
P/E	16.9	19.4	17.7	15.6
EV / Net Sales	2.9	2.8	2.5	2.2
Sales / Equity	1.3	1.4	1.3	1.4
Market Cap / Sales	3.5	3.3	3.0	2.6
Price to Book Value	4.4	4.5	4.0	3.6
Asset turnover	1.3	1.4	1.3	1.4
Debtors Turnover Ratio	4.8	5.4	5.4	5.4
Creditors Turnover Ratio	10.2	9.9	10.0	10.0
Debt / Equity	-	-	-	-
Current Ratio	2.1	2.4	2.4	2.5
Quick Ratio	0.7	0.8	0.8	0.8

Source: Company, ICICI Direct Research

Exhibit 7: ICICI Direct coverage universe (Capital Goods)

Company	CMP			M Cap (₹ Cr)	EPS (₹)			P/E (x)			RoCE (%)			RoE (%)		
	(₹)	TP(₹)	Rating		FY22	FY23E	FY24E	FY22	FY23E	FY24E	FY22	FY23E	FY24E	FY22	FY23E	FY24E
L&T (LARTOU)	1,996	2,355	Buy	280079	56.8	66.1	76.7	35.1	30.2	26.0	8.9	9.3	11.6	12.1	12.9	13.6
Siemens Ltd	2,850	3,660	Buy	101494	29.5	36.7	50.5	96.7	77.6	56.4	13.9	15.7	19.2	10.1	11.6	14.2
AIA Engineering (AIAENG)	2,674	3,239	Buy	25221	64.6	89.8	92.5	41.4	29.8	28.9	16.5	19.9	17.9	13.2	15.8	14.3
Thermax (THERMA)	2,255	2,536	Hold	26870	36.5	51.7	61.0	61.8	43.6	37.0	14.6	18.3	18.7	11.4	14.3	14.4
KEC International (KECIN)	429	515	Buy	11030	12.9	15.4	30.3	33.2	27.8	14.2	11.9	13.8	20.5	10.6	10.7	17.9
Greaves Cotton (GREAVE)	153	209	Buy	3537	0.7	3.9	3.6	216.2	39.4	42.8	2.5	10.4	10.6	1.3	7.5	7.7
Elgi Equipment (ELGEQU)	509	520	Hold	16121	7.2	9.4	11.4	71.1	54.2	44.6	19.0	21.4	22.0	19.8	21.3	21.1
Bharat Electronics (BHAELE)	107	135	Buy	78215	3.2	3.8	4.5	33.4	28.2	23.8	26.1	28.4	30.0	19.5	21.2	22.4
Cochin Shipyard (COCSHI)	675	745	Buy	8876	42.9	38.6	42.8	15.7	17.5	15.8	10.9	10.5	10.6	12.7	11.0	11.3
SKF (SKFIND)	4,865	5,215	Buy	24052	77.0	108.7	130.3	63.2	44.8	37.3	26.0	30.7	31.3	20.6	23.3	23.4
Timken India (TIMIND)	2,935	3,561	Buy	22077	43.5	61.3	71.2	67.5	47.9	41.2	25.3	36.2	42.0	19.7	27.9	32.2
NRB Bearing (NRBBEA)	147	220	Buy	1429	7.8	9.2	12.1	18.9	16.0	12.2	15.0	15.3	19.2	12.6	12.6	14.8
Action Construction (ACTCON)	333	365	Buy	3965	8.8	15.1	19.2	37.8	22.1	17.3	23.0	25.6	26.7	13.9	18.3	18.9
Data Patterns (DATPAT)	1397	1,555	Buy	7250	18.1	22.0	30.4	77.2	63.6	46.0	23.8	24.9	28.4	16.4	18.2	21.0
HAL (HINAER)	2,570	3,300	Buy	85938	151.9	132.7	145.0	16.9	19.4	17.7	27.4	30.5	30.1	26.3	23.1	22.8
ABB (ABB)	3,020	3,275	Buy	63996	25.5	38.9	43.7	118.6	77.7	69.1	45.0	49.2	64.9	11.2	13.0	17.6
Ador Welding (ADOWEL)	860	890	Buy	1169	33.2	37.5	49.3	25.9	22.9	17.4	19.9	23.8	26.8	13.6	17.1	19.3
Bharat Dynamics (BHADYN)	924	1,200	Buy	16935	27.3	33.0	42.7	33.9	28.0	21.7	24.6	24.7	27.9	17.3	17.7	20.0
Mazagon Dock (MAZDOC)	841	562	Buy	16964	30.3	31.2	40.1	27.8	27.0	21.0	20.0	18.1	20.9	16.1	14.6	16.6
Solar Industries India (SOLIN)	4,050	4,701	Buy	36648	48.8	76.6	99.7	83.1	52.9	40.6	22.5	32.5	34.6	23.9	29.0	28.8
Anup Engineering (THEANU)	890	1,085	Buy	881	62.7	49.5	72.3	14.2	18.0	12.3	15.3	16.6	19.4	12.2	12.5	14.5
Control Prints (CONTROLPR)	414	520	Buy	676	24.7	28.7	34.6	16.7	14.4	12.0	17.9	21.4	23.4	13.8	15.4	16.3
KSB Ltd. (KSBPUM)	1,964	2,180	Buy	6835	43.7	50.0	62.2	44.9	39.3	31.6	15.7	16.0	18.3	14.7	14.9	15.9

Source: Bloomberg, ICICI Direct Research

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Hold: -5% to 15%;

Reduce: -15% to -5%;

Sell: <-15%



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