Powered by the Sharekhan 3R Research Philosophy

Bharat Electronics Ltd

Tepid order inflows, healthy long-term outlook

Capital Goods		Sharekhan code: BEL	
Reco/View: Buy	↔	CMP: Rs. 93	Price Target: Rs. 120 ↓

↑ Upgrade ↔ Maintain ↓ Downgrade

Summary

- Q3FY2023 performance was a mixed bag with in-line sales but a miss on OPM and profitability.
- Order backlog was at ~Rs. 50,116 crore (~2.9x TTM revenue). Order intake has been muted so far, but defence order awards can be lumpy and hence BEL maintained order inflow guidance at ~Rs 20,000 crore for FY2023.
- BEL is expediting efforts to increase non-defence revenue to diversify its business. Further, any breakthrough on the exports front could be a key growth catalyst.
- BEL has a promising order inflow pipeline, large order book and attractive valuation. We retain a Buy on BEL with a revised PT of Rs. 120, rolling forward our estimates to FY2025E EPS and factoring in revised revenue and margin guidance.

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 Dec 08, 2022

High Risk

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

Source: Morningstar

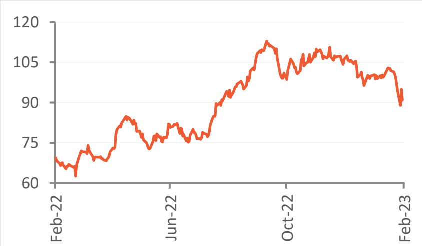
Company details

Market cap:	Rs. 67,981 cr
52-week high/low:	Rs. 115/62
NSE volume: (No of shares)	157.3 lakh
BSE code:	500049
NSE code:	BEL
Free float: (No of shares)	119.1 cr

Shareholding (%)

Promoters	51.1
FII	17.3
DII	25.1
Others	6.5

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	-9.1	-16.2	-3.6	31.4
Relative to Sensex	-7.2	-13.9	-6.3	30.0

Sharekhan Research, Bloomberg

Consolidated results were a mixed bag, wherein sales came in line with expectations but OPM and profitability were below expectations. Sales grew by ~12% y-o-y to Rs 4,153 crore (vs our estimate of Rs 4,079 crore). Gross profit margins (GPM), improved y-o-y by 102 bps to 41.7% in Q3FY23 as raw material costs declined. However, operating profit grew at a slow pace of 4% y-o-y to Rs 863 crore due to sharp increase in other expenses. As a result, OPM dropped to 20.8% (vs our expectation of 23%) and down 161 bps y-o-y and 113 bps q-o-q.Net profit grew at a slower pace of 2.9% y-o-y to Rs 613 crore. Order backlog stood at Rs. 50,116 crore (down 11%/5% on y-o-y/q-o-q basis) indicating that order inflow in Q3 has not been very strong.

Key positives

- Order backlog at ~Rs. 50,116 crore (~2.9xTTM revenue)
- The company maintained order inflow guidance of Rs 20,000 crore despite poor order intake in 9MFY23.
- GPM increased by 102 bps y-o-y to 41.7%.

Key negatives

- Muted order intake.
- High interest cost/discount charge of Rs. 10 crore on account of increase in receivables.
- Decline of 161 bps and 134 bps on y-o-y basis in OPM and NPM.

Revision in estimates – We have tweaked our estimates to build in higher revenue growth and lowered our margin estimates as per company's guidance for FY2023-FY2025E.

Our Call

Valuation – Maintain Buy with a revised PT of Rs. 120: BEL's Q3FY2023 performance has not been as per expectations but the company hopeful of an improved performance in Q4FY2023. 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 a tremendous export potential for engineering services and components sourcing from India, which bodes well for BEL. BEL has strong manufacturing and R&D base, robust order book, healthy order prospects, diversifying revenue stream, and strong balance sheet with improving return ratios. We retain a Buy on the stock with a revised price target (PT) of Rs. 120, valuing it on FY2025E EPS.

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 affect margins going forward.

Valuation (Consolidated) Rs cr

Particulars	FY22	FY23E	FY24E	FY25E
Net Sales	15,368	17,599	20,443	23,463
OPM (%)	21.7	21.7	22.4	22.8
PAT	2,399	2,724	3,219	3,771
YoY growth	*14.3*	*13.5*	*18.2*	*17.2*
EPS (Rs.)	3.3	3.7	4.4	5.2
P/E (x)	28.3	25.0	21.1	18.0
EV/EBITDA (x)	21.6	18.8	16.0	14.0
RoCE (%)	17.8	18.8	19.7	19.4
RoE (%)	20.6	20.8	21.6	22.0

Source: Company; Sharekhan estimates

Mixed bag quarter; poor order intake

Consolidated results were a mixed bag wherein sales came in-line with expectations but OPM and profitability were below expectations. Sales grew by ~12% y-o-y to Rs 4,153 crore (vs our estimate of Rs 4,079 crore). The gross profit margins (GPM), improved y-o-y by 102 bps to 41.7% in Q3FY23 due to decline in material cost. However, operating profit grew at a slow pace of 4% y-o-y to Rs 863 crore due to sharp increase in other expenses. As a result, OPM came in lower at 20.8% (versus expectations of 23%) and down 161 bps y-o-y and 113 bps q-o-q. Net profit grew at a slower pace of 2.9% y-o-y to Rs 613 crore. Order backlog stood at Rs. 50,116 crore (down 11%/5% on y-o-y/q-o-q basis) implying that order inflows in Q3 have not been very strong.

Strong order book, non-defence orders and exports to drive future growth

BEL has a healthy order book of Rs. 50,116 crore, which provides revenue visibility of about three years. More than 90% of its revenue comes from government orders. 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, and electronic warfare systems in the near to medium term. The company aims to increase share of non-defence verticals like civil, railways and metro rail in total revenues. The exports order book is of Rs 2,000 crore. BEL is trying to get a breakthrough in the exports with countries like Egypt, Malaysia; etc and is hopeful of increasing its export share in total revenue.

BEL conference call highlights

- **Order inflow guidance:** The company has received order inflows of Rs 3,600 crore up to 9MFY2023. Also, Rs 12,000 crore worth of orders have been concluded and the company has submitted another bid of Rs 3,500 crore. Hence, the company is confident of achieving order inflow guidance of ~Rs 20,000 crore.
- **Revenue guidance:** Revenue growth is expected to be 15% in FY2023 and the company expects run rate of 15-20% (with a bias towards the upper end of the range) revenue growth from FY2024 onwards. The company would provide a clear guidance in Q4FY2023.
- **Revenue mix:** The company has 75-80% of revenue coming from nomination-based contracts. Share of outsourcing to private sector has remained constant at 31% since last year. Share of services, which currently is 10% of revenues would increase gradually on a higher base as lot of equipments would require maintenance and repair services.
- **Margin guidance:** The company expects gross margins to be at current levels of ~42% for FY23, while OPM would also be broadly at the same level of FY22.
- **Broad mix of order backlog:** Defence comprises 80% of the order book while the rest comes from the civil segment. Going forward, the order mix may change from 80:20 to 75:25. The current order backlog has Rs 1,400 crore of EVM-VVPAT orders.
- **Working capital update:** The company has ~Rs 7,500 receivables, cash & bank balance of Rs 3,000 crore and inventory of Rs 6,500 crore. The company expects most of the current receivables to be converted into cash in Q4FY2023.
- **Update on exports:** The exports order book currently stands at Rs 2,000 crore. The company is leveraging its product strength and is in talks with Egyptian and Malaysian governments. The company remarked that export orders are largely government to government and therefore finalisation of orders take time.

- **Key orders secured:** The company has secured orders for electronic equipments, communication systems, warfare equipments and marine related products.
- **Status of the recently signed MoUs:** The company stated that MoUs are for long-term business development. It has also signed an MoU with Munitions India Limited (MIL), to address requirements of Indian defence and export markets in the areas of ammunition, explosives and related systems. In non-defence, the company is bullish on its MoU with Delhi metro for indigenization of some of the imported systems. BEL is working with airport authority of India to indigenize the air traffic management system and radar system.
- **Capex guidance:** The company would incur a capex of Rs 600-800 crore in FY2023/FY2024. Apart from regular capex, the company is developing a defence system integration complex in Nagpur. It is building an arms & ammunition facility for Rs. 200 crore in Hyderabad.

Results (Consolidated) Rs cr

Particulars	Q3FY23	Q3FY22	YoY%	Q2FY23	QoQ%
Net sales	**4,153**	**3,702**	**12.2**	**3,962**	**4.8**
Operating expenditure	3,290	2,872	14.5	3,093	6.3
Operating profit	**863**	**829**	**4.1**	**868**	**(0.6)**
Other income	59	60	(2.1)	74	(20.5)
Interest	10	0.2	5,300.0	2	455.4
Depreciation	106	98	8.0	109	(3.1)
PBT	806	791	1.9	831	(3.0)
Tax	203	206	(1.3)	216	(5.9)
Reported PAT	603	585	3.1	615	(1.9)
Adjusted PAT	**613**	**596**	**2.9**	**624**	**(1.7)**
Adjusted EPS (Rs.)	0.84	0.82	2.9	0.9	(1.7)
Margin (%)			**BPS**		**BPS**
GPM	41.7	40.7	102	43.6	(184)
OPM	20.8	22.4	(161)	21.9	(113)
NPM	14.8	16.1	(134)	15.7	(98)
Effective tax rate	26.0	26.0	(4)	26.0	-

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 to boost the AatmaNirbhar Bharat programme in the defence sector and create a level-playing field for private players, including MSMEs. 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.

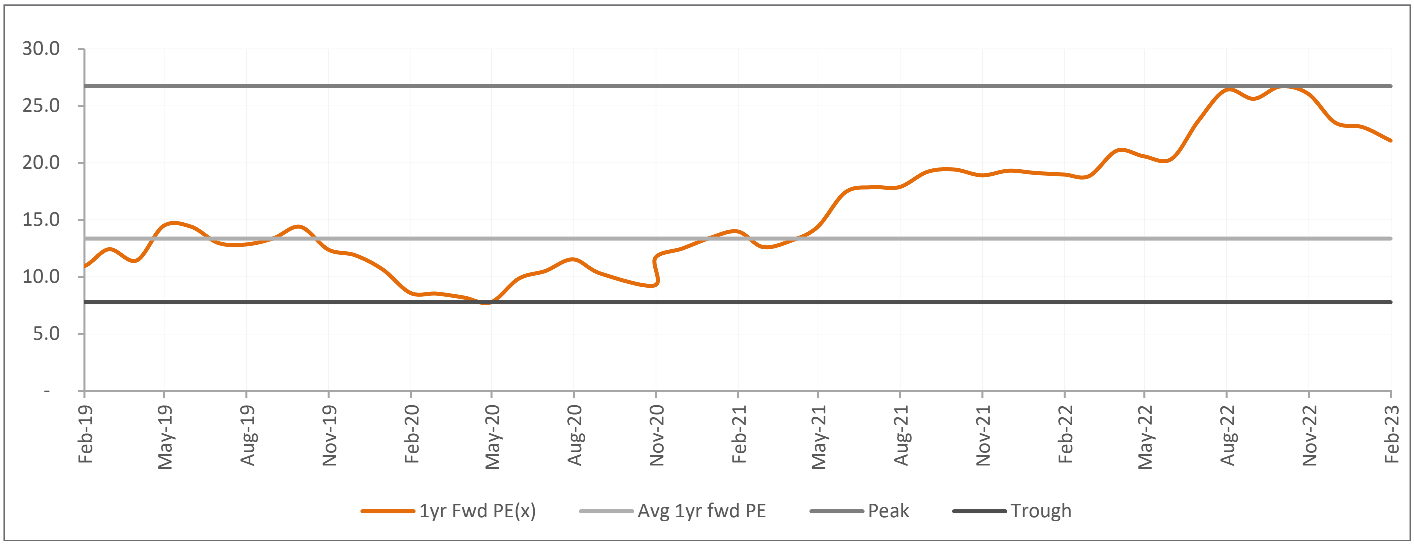
■ Company Outlook – continues to focus on sustainable growth plans

BEL has been continuously focusing on sustainable growth plans and has taken various initiatives such as i) Focusing on enhancing its R&D capability; ii) Enhancing manufacturing capabilities through timely modernisation and expansion of facilities; and iii) Entering into joint ventures in existing and emerging businesses to enhance business visibility. The 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. 120

BEL's Q3FY2023 performance has not been as per expectations but the company hopeful of an improved performance in Q4FY2023. 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 a tremendous export potential for engineering services and components sourcing from India, which bodes well for BEL. BEL has strong manufacturing and R&D base, robust order book, healthy order prospects, diversifying revenue stream, and strong balance sheet with improving return ratios. We retain a Buy on the stock with a revised price target (PT) of Rs. 120, valuing it on FY2025E EPS.

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. Bhanu Prakash Srivastava	Executive Director-Chairperson-MD
Mr. Vinay Kumar Katyal	Executive Director
Mr. Damodar S Bhattad	Chief Financial Officer

Source: Company Website

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Nippon Asset Life India Management Ltd	4.16
2	Kotak Mahindra Asset Management Co Ltd	3.48
3	HDFC Asset Management Co Ltd	3.37
4	Vanguard Group Inc	1.74
5	Blackrock Inc	1.54
6	Canara Robeco Asset Management Co Ltd	1.20
7	MIRAE Asset Global Investments Co Ltd	1.00
8	ICICI Prudential Asset Management Co Ltd	0.88
9	UTI Asset Management Co Ltd	0.82
10	DSP Investment Managers Pvt Ltd	0.74

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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