Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Stock Update

Result Update

Bharat Electronics Ltd

Growth momentum to sustain

Capital Goods	Sharekhan code: BEL
Reco/View: Buy ↔	CMP: Rs. 130
Price Target: Rs. 151 ↑	

↑ Upgrade ↔ Maintain ↓ Downgrade

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 31.21

Updated Jul 08, 2023

High Risk

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

Source: Morningstar

Company details

Market cap:	Rs. 95,027 cr
52-week high/low:	Rs. 132/87
NSE volume: (No of shares)	153 lakh
BSE code:	500049
NSE code:	BEL
Free float: (No of shares)	357.4 cr

Shareholding (%)

Promoters	51.1
FII	17.4
DII	24.8
Others	6.7

Price chart

Price performance

(%)	1m	3m	6m	12m
Absolute	7.5	25.5	34.9	39.7
Relative to Sensex	3.0	16.2	23.3	21.0

Sharekhan Research, Bloomberg

Summary

- BEL's Q1FY24 performance was remarkable on all fronts, as healthy execution led to solid sales and operating profit growth. Higher other income helped net profit growth of ~47% y-o-y.
- Order backlog stands strong at ~Rs. 65,356 crore (up 18% y-o-y). YTD order intake has been Rs. 8,100-9,000 crore and expectations of ~Rs. 20,000 crore for the year may exceed if QRSAM/MRSAM orders kick in.
- We believe the increase in R&D expenditure and capacity expansion would enhance its execution capabilities. BEL also aims to increase non-defence revenue and exports contribution in exports.
- BEL boasts a promising order inflow pipeline, strong cash balance and healthy return ratios. Following a good quarter, we retain a Buy on BEL with a revised PT of Rs. 151.

BEL's Q1FY24 consolidated revenue was in line with our estimates but exceeded our estimates on OPM and net profit fronts. Sales grew by 12.5% y-o-y to Rs. 3,533 crore. GPM expanded by 164 bps y-o-y to 43.7%, given the decline in raw material cost. Operating profit grew by ~29% y-o-y to Rs 673 crore, and OPM rose by 240 bps y-o-y at 19% (vs our expectation of 18.6%). Net profit jumped by ~47% y-o-y to Rs. 539 crore, driven by strong operating performance and aided by higher other income, which grew by 71% y-o-y. Order backlog stood firm at Rs. 65,356 crore (up 18% y-o-y), led by strong order inflow in Q1.

Key positives

- Order backlog at ~Rs. 65,356 crore (~3.7x TTM revenue).
- Beat on OPM and net profit estimates.
- The company maintained order inflow guidance of over Rs 20,000 crore for FY2024. There is also a possibility of bagging a few large orders like QRSAM and MRSAM projects towards the end of FY24.
- GPM increased by 164 bps y-o-y to 43.7%. OPM increased by 240 bps y-o-y to 19%, and net profit increased by ~47% y-o-y, supported by a 71% y-o-y rise in other income.
- The total announced YTD order inflow has been Rs. 8,100- 9,000 crore.

Key negatives

- Exports' share in revenue is still minuscule at ~2.5%.
- Non-defence share in the order book is low at ~6%.

Revision in estimates – We have marginally tweaked our estimates for FY2024-FY2025E.

Management Commentary

- Revenue growth would be in the range of 15-17% in FY24.
- The company maintained its order inflow guidance at Rs.20,000 crore in FY24. However, the company is not factoring in many big-ticket programs like QRSAM and MRSAM projects which are in the pipeline and may be awarded towards the end of the year.
- The company would incur a capex of Rs 700-800 crore in FY24.
- The company expects gross margins to be at ~40 - 42% for FY24, while OPM would also be broadly in the 21-23% range.
- Exports revenue in Q1FY24 came in at US$10 mn or Rs. 87 crore and BEL is targeting US$ 90 mn in exports in FY24.
- R&D spend would be ~6-7% of revenues in FY24.
- The receivables are around Rs. 7,000 crore, while the cash position is also healthy.
- The other income increase is attributable to an increase in interest income to Rs. 132 crore vs Rs. 78 crore in Q1FY23.

Our Call

Valuation – Maintain Buy with a revised PT of Rs. 151: BEL's Q1FY24 performance has been good, with a beat on OPM and net profit estimates. Further, the order intake has been vital on a YTD basis. BEL's guidance for order book, execution and future order pipeline is also promising. Further, the company could exceed its guidance if large orders like QRSAM or MRSAM are awarded in FY24. We believe BEL would play a significant role in successfully implementing the government's Make in India and AtmaNirbhar Bharat initiatives as it is a key defence and aerospace player. 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. 151, valuing it on FY25E EPS.

Key Risks

- Delayed order execution and slower pace of fresh orders can affect revenue growth.
- Higher raw-material prices and shortage of critical components may affect margins going forward.

Valuation (Consolidated) Rs cr

Particulars	FY22	FY23	FY24E	FY25E
Net Sales	15,368	17,734	20,717	23,660
OPM (%)	21.7	23.0	23.1	23.6
PAT	2,399	2,984	3,421	4,021
YoY growth	14.3	24.4	14.6	17.5
EPS (Rs.)	3.3	4.1	4.7	5.5
P/E (x)	39.9	32.1	28.0	23.8
EV/EBITDA (x)	29.9	24.4	21.2	18.0
RoCE (%)	17.8	20.3	20.6	20.9
RoE (%)	20.6	22.7	22.7	23.0

Source: Company; Sharekhan estimates

Strong execution drives the performance.

BEL's Q1FY24 consolidated revenue was in-line with our estimates but exceeded our estimates on OPM and net profit fronts. Sales grew by 12.5% y-o-y to Rs. 3,533 crore. GPM expanded by 164 bps y-o-y to 43.7%, given decline in raw material cost. Operating profit increased by ~29% y-o-y to Rs673cr, and OPM came in higher by 240 bps y-o-y at 19% (vs our expectation of 18.6%). Net profit jumped by ~47% y-o-y to Rs. 539 crore, driven by strong operating performance and aided by higher other income, which grew by 71% y-o-y. Order backlog stood firm at Rs. 65,356 cr (up 18% y-o-y), led by strong order inflow in Q1.

BEL Q1FY24 conference call highlights

Order intake guidance maintained at Rs. 20,000 crore: The company's YTD order inflow has been strong at Rs. 8,100- 9,000 crore of orders which is 40% of the total order intake guidance of Rs. 20,000 crore for FY24. The company continued to maintain the order intake guidance. The company may receive orders for naval platforms and fuses from the Indian army in the next six months. Further, electronic warfare for ship-based systemsthe systems (Rs. 1,000 – 1,500 crore) and Rs. 6,000 crore worth of orders from the maritime sector will likely be awarded this year.

Receivables at Rs. 7,000 crore: The receivables are around Rs. 7,000 crore, while the cash position is also healthy.

Opportunities in non-defence business and exports: In non-defence, there are opportunities in CBTC and Super SCADA systems which are likely to come in a phased manner. Non-defence order book comprises 6% of the total order book. The company is targeting export revenue of US$ 90 million. For Q1FY24, the export numbers were at US$10mn or Rs. 87 crore. The company has received orders for TR modules from Telestrons, USA in exports. The company is also in talks with companies in the USA, Vietnam, Brazil and Nigeria for future collaborations.

Update on Integrated Air Command and Control System (IACCS) and Akash orders: For IACCS, out of the total order size of Rs. 8,000 crore, the pending order is ~Rs.2,000 crore, which will be executed over some time. For Akash missile systems, the pending value is small out of a total of Rs. 5,300 crore and the same will be executed in Q2FY24.

Capex guidance and R&D expenditure: BEL would incur a capex of Rs 700-800 crore in FY24 which will be both maintenance and growth capex. The company would spend on advance electro-optics in Andhra Pradesh, an EW factory in Ibrahimpatnam, a defence system integration complex in Nagpur and an explosives facility in Pune. R&D expenditure will continue to be around 6- 7%.

Margin guidance maintained: The company expects gross margin to be at ~40 - 42% for FY24, while OPM would also be broadly in the 21-23% range.

Employee cost: The increase in employee cost is a result of average increase of dearness allowance and some contract labor which have been roped in and increase in salaries by an average of 8%.

Increase in other income: The other income increase is attributable to an increase in interest income to Rs. 132 crore vs Rs. 78 crore in Q1FY23.

Results (Consolidated) Rs cr

Particulars	Q1FY24	Q1FY23	YoY %	Q4FY23	QoQ %
Net sales	**3,533**	**3,141**	**12.5**	**6,479**	**(45.5)**
Operating expenditure	2,860	2,618	9.3	4,647	(38.4)
Operating profit	**673**	**522**	**28.7**	**1,832**	**(63.3)**
Other income	140	82	70.6	66	112.0
Interest	1	1	4.9	2	(56.5)
Depreciation	109	99	9.7	114	(4.4)
PBT	**703**	**504**	**39.4**	**1,782**	**(60.6)**
Tax	174	148	17.6	415	(58.1)
Reported PAT	529	356	48.4	1,366	(61.3)
Adjusted PAT	**538**	**366**	**47.3**	**1,382**	**(61.0)**
Adjusted EPS (Rs.)	**0.74**	**0.50**	**47.3**	**1.9**	**(61.0)**
Margin (%)			**BPS**		**BPS**
GPM	43.7	42.0	164	48.3	(460)
OPM	19.0	16.6	240	28.3	(924)
NPM	15.2	11.6	360	21.3	(609)
Tax rate	24.8	29.4	(459)	23.3	147

Source: Company, Sharekhan Research

Outlook and Valuation

■ Sector view - AatmaNirbhar Bharat initiative to boost defence manufacturing in India

The government emphasises creating an environment to boost the AatmaNirbhar Bharat programme in the defence sector and create a level-playing field for private players, including MSMEs. Completing defence projects takes longer than envisaged earlier and, hence, the government plans 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 increase 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 ample 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 reduce the import dependency.

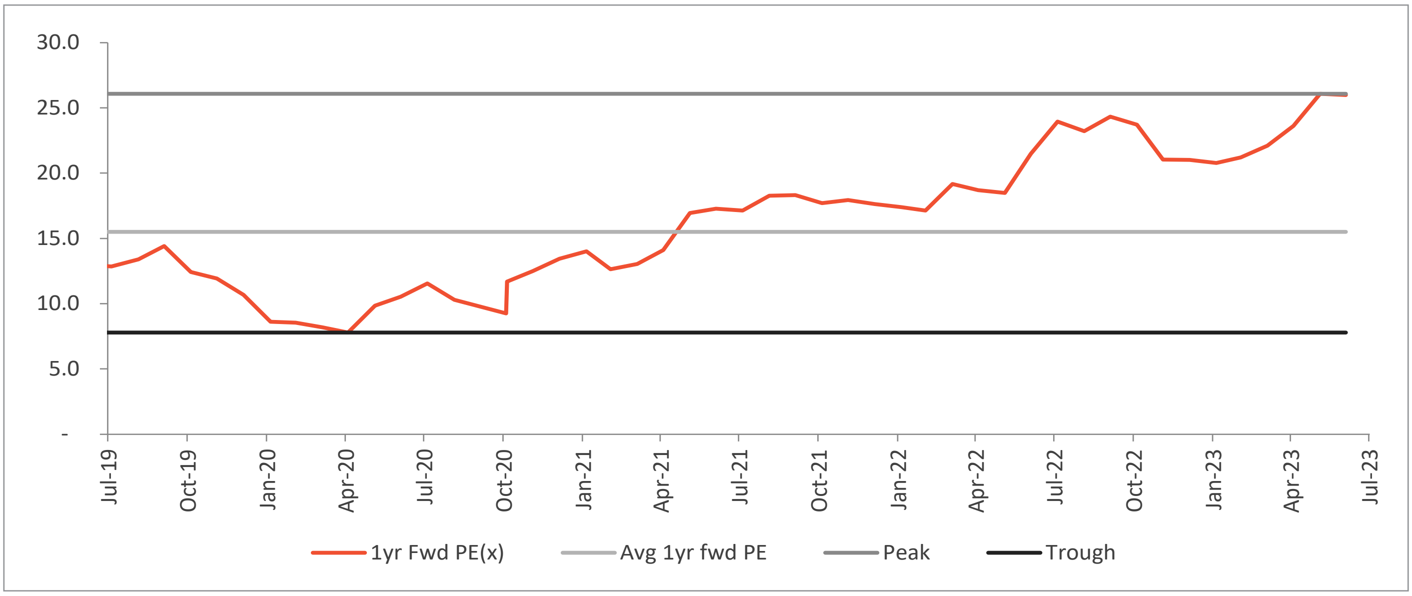
■ Company outlook - Diversification and a strong order pipeline would boost growth

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. Long-term order pipeline includes high value orders such as Medium Range Surface - To - Air Missile (MRSAM)- Rs. 15,000 - 20,000 crore, Quick Reaction Surface-to-Air Missile (QRSAM) – Rs. 20,000 crore. 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% revenue contribution from exports (currently ~2%) in the long term.

■ Valuation - Maintain Buy with a revised PT of Rs. 151

BEL's Q1FY2024 performance has been good with a beat on OPM and net profit estimates. Further, the order intake has been strong on YTD basis. BEL's guidance for order book, execution and future order pipeline is also promising. Further, the company could exceed its guidance if large orders like QRSAM or MRSAM are awarded in FY24. We believe BEL would play a significant role in successfully implementing the government's Make in India and AtmaNirbhar Bharat initiatives as it is a key defence and aerospace player. 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. 151, valuing it on FY25E 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 benefits 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 spending 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 plays well in the defence sector because of its strong manufacturing and R&D base, good margin trajectory, cost efficiency, 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 critical components such as semiconductors could affect execution and earnings.

Additional Data

Key management personnel

Mr. Bhanu Prakash Srivastava	Executive Director-Chairperson-MD
Mr. Vinay Kumar Katyal	Executive Director
Mr. Damodar S Bhattad	Director (Finance) & Chief Financial Officer (CFO)

Source: Company

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Nippon Life India Asset Management	4.06
2	Kotak Mahindra Asset Management	3.49
3	HDFC Asset Management	2.76
4	BlackRock Incorporation	1.59
5	Vanguard Group Incorporation	1.57
6	FMR LLC	1.31
7	Canara Robeco Asset Management	1.30
8	DSP Investment Managers	1.08
9	Mirae Asset Global Investments	0.84
10	ICICI Prudential Asset Management	0.83

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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