Sharekhan by BNP PARIBAS

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Stock Update

Result Update

Bharat Electronics Ltd

Muted Quarter, Robust growth prospects

Capital Goods	Sharekhan code: BEL
Reco/View: Buy ↔	CMP: **Rs. 186** / Price Target: **Rs. 220** ↑

↑ 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		↔	

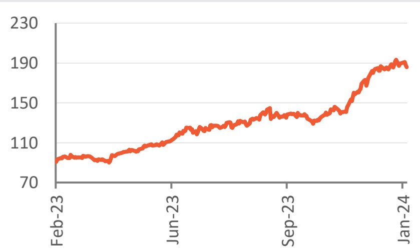
Company details

Market cap:	Rs. 1,35,852 cr
52-week high/low:	Rs. 196 / 88
NSE volume: (No of shares)	166 lakh
BSE code:	500049
NSE code:	BEL
Free float: (No of shares)	357.2 cr

Shareholding (%)

Promoters	51.1
FII	17.8
DII	23.4
Others	7.7

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	0	34	42	104
Relative to Sensex	1	25	35	84

Sharekhan Research, Bloomberg

Summary

- The company's consolidated PAT was 14% below the consensus estimate, as a revenue miss of 25% was partially offset by a beat in OPM. Lower-than-expected revenue was primarily because of lower execution and revenue spillover of Rs. 400-500 crore to Q4FY2024.
- Despite an underwhelming quarter, the company has maintained its FY24 growth guidance of 15% revenue growth and expects strong growth in Q4FY24. Management has upgraded EBITDA margin guidance to 23% (vs 21-23% earlier).
- Order backlog stands strong at ~Rs. 76,217 crore (up 52% y-o-y). The company has a robust YTD order intake of Rs. 27,647 crores, expecting additional orders worth ~Rs. 50,000 crores over the next 2 years.
- BEL boasts a promising order inflow pipeline, strong cash balance, and healthy return ratios. We retain Buy with a revised PT of Rs. 220.

BEL's Q3FY2024 consolidated PAT was 14% below the consensus estimate, as a revenue miss of 25% was partially offset by a beat in OPM. The company reported lower-than-expected revenue, primarily because of lower execution and a revenue spillover of Rs. 400-500 crore to Q4FY2024. Sales grew by 1.2% y-o-y to Rs. 4,009 crores, below our expectation of Rs. 4,630 crore. GPM expanded by 705 bps y-o-y to 48.8%, given the decline in raw material cost. Operating profit grew by ~24% y-o-y to Rs1073cr, and OPM came in higher by 498 bps y-o-y at 25.8% (vs our consensus expectation of 23.6%). Net profit jumped by ~40% y-o-y to Rs. 860 crores, driven by strong operating performance and aided by higher other income, which grew by 186% y-o-y. Order backlog stood strong at Rs. 76,217 cr (up 52% y-o-y) led by a strong order inflow of 27,647 crores in 9MFY24.

Key positives

- Order backlog at ~Rs. 76,217 crore (~4.2x TTM revenue).
- Beat on OPM due to better gross profit margin.

Key negatives

- Miss in revenue on account of lower execution.

Management Commentary

- The company has maintained the revenue guidance of ~15% y-o-y for FY24, despite delay in dispatches due to the Israel – Hamas war in Q3FY24. Usually, the company's report strong numbers in Jan-march quarter, hence management remains confident of achieving ~15% y-o-y revenue growth for FY24.
- Company's total orders where it has exposure/dependency on Israel are around Rs 4000 to Rs 4500 crores for FY24 & FY25.
- For the next two years (FY26 &FY26), management expects order inflow of Rs 50,000 crore which includes QRSAM order worth ~20,000 crore.
- Over the long term, the company expects to generate ~15-20% of revenue from non-defense business.
- Others: 1) The Company plans to incur an annual capex of Rs 700- 800 crores for FY25 and FY26. 2) Company plans to maintain its working capital ratio going forward (current asset/current liability ~1.5x) 3) Company generated export revenue of Rs 200 crore for 9MFY24.

Revision in estimates – We maintain our FY2024-FY2025 earnings estimates.

Our Call

Valuation – Maintain Buy with a revised PT of Rs. 220: BEL has already exceeded FY24 order intake guidance and future order pipeline is also promising as large orders like QRSAM or MRSAM are expected to be awarded over next few quarters. 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. 220.

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	FY23	FY24E	FY25E	FY26E
Net Sales	17,734	20,717	23,660	26,648
Operating Profit Margin (%)	23.0	23.1	23.6	23.6
Adjusted PAT	2,984	3,421	4,021	4,537
y-o-y Growth (%)	24.4	14.6	17.5	12.8
Adjusted EPS (Rs.)	4.1	4.7	5.5	6.2
P/E (x)	45.5	39.7	33.8	29.9
EV/EBITDA (x)	34.2	29.5	25.1	22.2
RoCE (%)	20.3	20.6	20.9	20.6
RoE (%)	22.7	22.7	23.0	22.2

Source: Company; Sharekhan estimates

BEL Q3FY2024 conference call highlights

- **Revenue Guidance:** The company has maintained the revenue guidance of ~15% y-o-y for FY24, despite the delay in dispatches due to the Israel – Hamas war. Traditionally, the company's Jan-March quarter is strong. Hence, management remains confident of achieving ~15% y-o-y revenue growth for FY24.
- **Revenue spillover:** Many companies' dispatches could not reach their destination on time due to disturbances, which resulted in a revenue spillover of around Rs. 400 - 500 crore to Q4FY2024 from Q3FY2024. The company's total orders where it has exposure/dependency on Israel are around Rs 4000 to Rs 4500 crores for FY24 & FY25.
- **Order Inflow Guidance:** For the next two years (FY26 &FY26), management expects an order inflow of Rs 50,000 crore, including aan order inflow of Rs 50,000 crore, which includes QRSAM orders worth ~20,000 crore.
- **Margin Guidance:** The Company expects a fall in both gross & EBITDA margins in the fourth quarter due to the composition of the product mix and expects FY24 gross margin to be 42% and EBITDA to be 23% (vs earlier guidance of 21-23% of EBITDA margin for FY24).
- **Non-defense revenue:** During 9MFY2024, the company generated ~20% of its revenue from non-related products, including sales of EVM and VVPAT. Over the long term, the company expects to generate ~15-20% of revenue from non-defense business.
- **New strategic business unit:** The company has established a new strategic business unit for cybersecurity. The company is currently working on ramping up this new cybersecurity segment and currently a lead from Ministry of Health. The company is also working offering solution for IT infrastructure and smart city projects.
- **Others:** 1) Company's inventory stood at ~ Rs 7000 crore, the contact asset stood at Rs 5600 crores & Cash balance stood at INR8000 crores at the end of Q3FY24 2) Company plans to incur annual capex of Rs 700- 800 crores for FY25 and FY26. 3) The company plans to maintain its working capital ratio going forward (current asset/current liability ~1.5x). 4) The company generated export revenue of Rs 200 crore for 9MFY24.

Results (Consolidated) Rs cr

Particulars	Q3FY24	Q3FY23	Y-o-Y (%)	Q2FY24	Q-o-Q (%)
Net sales	**4,162**	**4,153**	**0.2**	**4,009**	**3.8**
Operating expenditure	3,090	3,290	(6.1)	2,995	3.2
Operating profit	**1,073**	**863**	**24.2**	**1,014**	**5.8**
Other income	167	59	185.5	137	22.2
Interest	1	9.7	(94.8)	2	(66.2)
Depreciation	107	106	1.3	108	(0.7)
PBT	1,132	806	40.4	1,041	8.7
Tax	284	203	39.7	260	9.1
Reported PAT	848	603	40.6	781	8.6
Adjusted PAT	**860**	**613**	**40.2**	**790**	**8.8**
Adjusted EPS (Rs.)	1.18	0.84	40.2	1.1	8.8
Margin(%)			**BPS**		**BPS**
GPM (%)	48.8	41.7	705	49.0	(24)
OPM (%)	25.8	20.8	498	25.3	47
NPM (%)	20.7	14.8	589	19.7	95
Effective tax rate (%)	25.1	25.2	(13)	25.0	9

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 took 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, the 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.

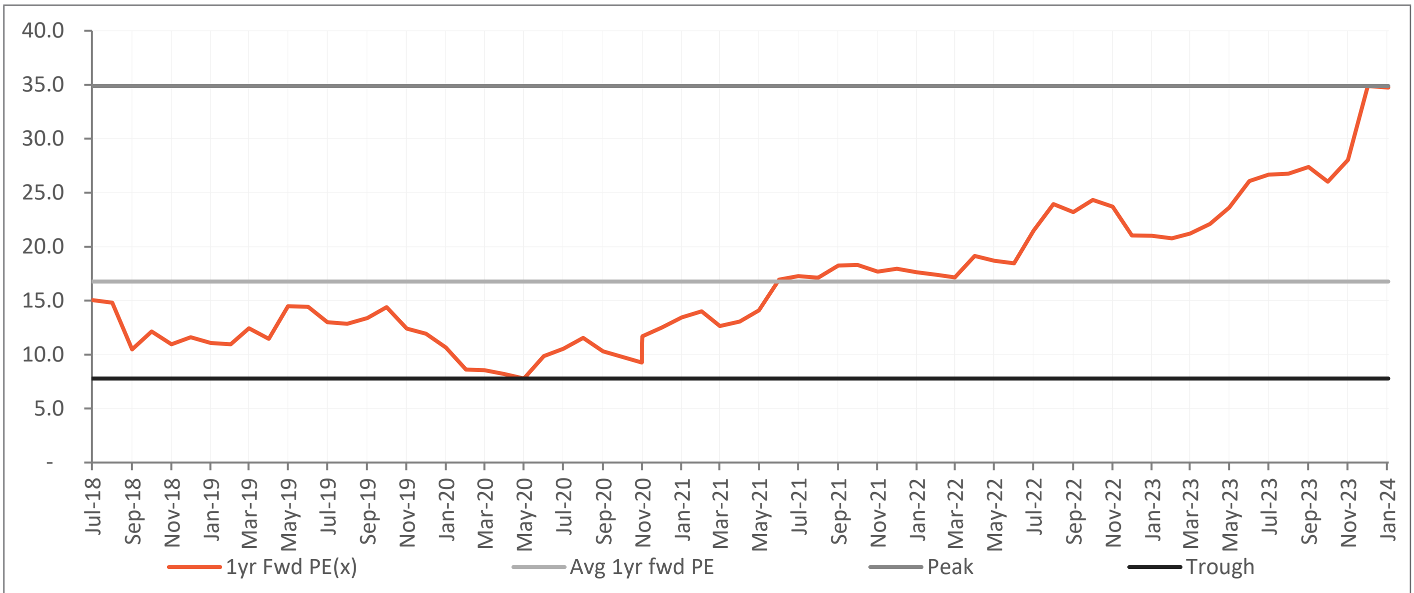
■ Company Outlook – Diversification and a strong order pipeline would boost growth.

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 and 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. 220

BEL has already exceeded FY24 order intake guidance and future order pipeline is also promising as large orders like QRSAM or MRSAM are expected to be awarded over next few quarters. 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. 220.

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

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

Source: Company Website

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Nippon Life India Asset Management	3.79
2	Kotak Mahindra Asset Management Co	3.39
3	HDFC Asset Management Co Ltd	2.13
4	Vanguard Group Inc/The	1.95
5	BlackRock Inc	1.91
6	FMR LLC	1.24
7	Canara Robeco Asset Management Co	1.23
8	DSP Investment Managers Pvt Ltd	1.03
9	ICICI Prudential Asset Management	0.85
10	UTI Asset Management Co Ltd	0.82

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

Sharekhan

by BNP PARIBAS

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