



Bharat Electronics Ltd

Pure play on India's defence story

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 Jan 08, 2022				
High Risk				
NEGL	LOW	MED	HIGH	SEVERE
0-10	10-20	20-30	30-40	40+

Source: Morningstar

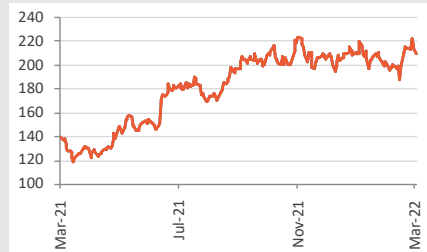
Company details

Market cap:	Rs. 51,169 cr
52-week high/low:	Rs. 228/116
NSE volume: (No of shares)	67.3 lakh
BSE code:	500049
NSE code:	BEL
Free float: (No of shares)	119.1 cr

Shareholding (%)

Promoters	51.1
FII	17.2
DII	26.8
Others	4.9

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	6.9	-0.1	3.6	49.8
Relative to Sensex	6.8	2.7	6.6	38.5

Sharekhan Research, Bloomberg

Capital Goods

Sharekhan code: BEL

Reco/View: Buy

CMP: Rs. 210

Price Target: Rs. 254

Upgrade ↔ Maintain ↓ Downgrade

Summary

- We reiterate Buy on Bharat Electronic Limited (BEL) with an unchanged PT of Rs. 254, given its healthy order book of Rs. 56,568 crore, promising order inflow pipeline, and strong execution capabilities.
- The government's emphasis on 'Make in India' and 'Atmanirbhar Bharat' initiatives in the defence sector provides strong growth opportunity for BEL as it is the leading indigenous aerospace and defence player.
- The current uncertain international (Russia-Ukraine war) as well as domestic (India-China border dispute) geopolitical scenario calls for strengthening of the national security, which should lead to significant rise in India's defence expenditure going forward. This augurs well for BEL's long-term growth.
- BEL has also been focusing on exploring the export potential of defence electronics products and systems, which bodes well for revenue diversification. BEL targets 10-15% revenue contribution from exports.

Over the past few years, India has been among the top importers of defence equipment. To modernise its armed forces and reduce dependency on imports, several initiatives have been taken by the government to encourage 'Make in India' policy. These policy initiatives include 1) Giving top most priority to Indian-IDDM (Indigenously Designed, Developed and Manufactured) equipment; 2) Embargo on the import of 101 items (August 21, 2020) and 108 items (May 31, 2021); 3) Simplification of the 'Make' procedure for procurement of defence products and provision for funding of up to 70% of development cost by the government; 4) Increasing FDI limit to 74% under automatic route. We believe BEL is a pure play on India's defence story, given its indigenisation capabilities, healthy order book, promising order inflow pipeline, and strong execution capabilities.

- Key beneficiary of increasing defence capital outlay:** The Indian government has set an ambitious defence production target at US\$25 billion by 2025 (including US\$5 billion from exports by 2025). Out of the 101 defence equipment items banned for import, BEL has capabilities to produce 55 items, while 23 items are under the advanced stages of indigenisation. Therefore, we believe BEL stands to benefit from increasing defence capital outlay of India as well as emphasis on indigenisation of defence equipment, led by the government's 'Make in India' and 'Atmanirbhar Bharat' initiatives.
- Strong order book and promising order intake pipeline:** BEL boasts of a strong order book at Rs. 56,568 crore, which provides revenue visibility of more than three years. 78% of its revenue is derived from the defence sector, followed by non-defence (14%), other products (5%) and exports (3%). More than 90% of its revenue comes from the government's orders. Moreover, the company has a promising order inflow pipeline (Rs. 15,000 crore-17,000 crore p.a.) 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 term.
- Other revenue streams offer growth potential:** BEL is also focusing on increasing its non-defence revenue by diversifying into civil segments such as smart cities, homeland security, metros, and software as a service (SaaS). The existing metros provide Rs. 7,000 crore opportunity over the next 12-18 months. The company would also be making Rs. 40 crore-50 crore investments in charging infrastructure for 4-5 highways. BEL has also 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 ~3%).

Revision in estimates – We have fine tuned our earnings estimates, factoring in the impact of shortage of semi-conductors on revenue growth in the near term..

Our Call

Valuation – Maintain Buy with an unchanged PT of Rs. 254: BEL has a number of opportunities with the government's 'Make in India' and 'Atmanirbhar Bharat' initiatives. The company continues to invest heavily on capex (~Rs. 600 crore per annum) and has considerable expenditure in R&D (6-7% of revenue). BEL remains our preferred pick in the defence sector on account of its strong manufacturing and research and development (R&D) base, strong order book and order inflow pipeline, growing indigenisation, and strong balance sheet. We retain our Buy rating on the stock with an unchanged price target (PT) of Rs. 254.

Key Risks

- Delay in award of fresh orders could affect revenue growth.
- Higher raw-material prices could adversely impact margins.

Valuation

Particulars	FY21	FY22E	FY23E	FY24E
Net Sales	14,109	15,851	17,313	18,995
Operating Profit Margin (%)	22.8	20.5	20.6	21.0
PAT	2,099	2,275	2,490	2,810
y-o-y growth	15.1	8.4	9.4	12.8
EPS (Rs.)	8.6	9.3	10.2	11.5
P/E (x)	23.3	21.5	19.6	17.4
EV/EBITDA (x)	16.5	16.4	15.1	13.6
RoCE (%)	18.6	17.2	17.1	17.2
RoE (%)	19.9	20.0	20.1	20.3

Source: Company; Sharekhan estimates

Promising order pipeline to drive future growth

BEL boasts of a strong order book at Rs. 56,568 crore, which provides revenue visibility of more than three years. 78% of its revenue is derived from the defence sector, followed by non-defence (14%), other products (5%), and exports (3%). More than 90% of its revenue comes from government orders. Therefore, we believe BEL 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 has a promising order inflow pipeline (Rs. 15,000 crore-17,000 crore p.a.) and expects big ticket size orders such as QRSAM, MRSAM, Air Defence Fire Control Radar-ATULYA, mountain radars, and electronic warfare systems.

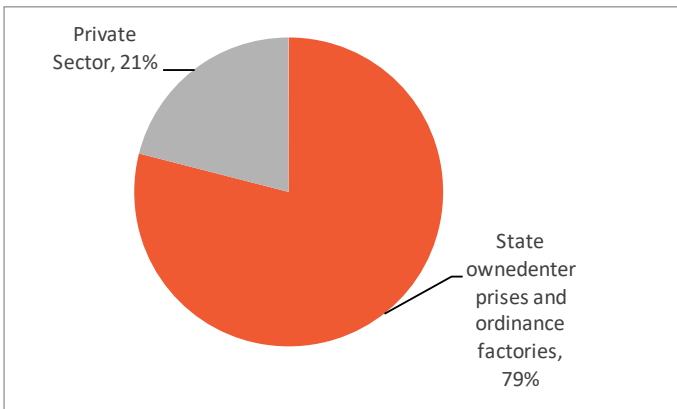
Non-defence segments also offer growth potential

BEL is also focusing on increasing its non-defence revenue by diversifying into civil segments such as smart cities, homeland security, metros, and SaaS. The existing metros provide a Rs. 7,000 crore opportunity over the next 12-18 months. The company would also be making Rs. 40 crore-50 crore investments in charging infrastructure for 4-5 highways. BEL has also 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 ~3%).

Cautious guidance for the near term

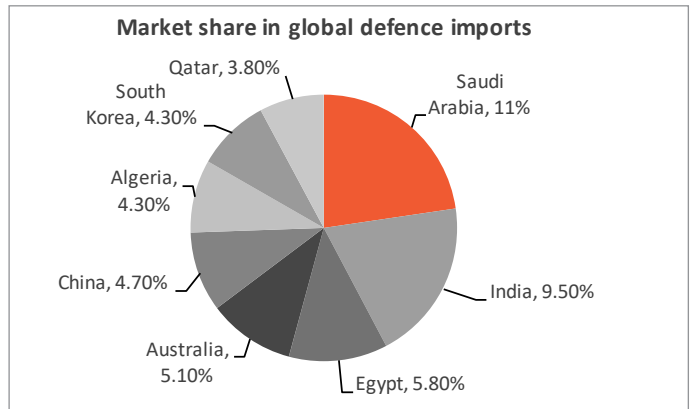
The company expects semi-conductor shortage to impact Q4FY2022 execution, which may lead to lower than 15-17% revenue growth for FY2022. Therefore, BEL has cut revenue target to 10-12% growth for FY2022 with 20-22% operating margin. However, management expects to achieve higher revenue growth of 15-17% in FY2023, given the robust order book and promising order pipeline for the near to medium term. Order pipeline in Q4FY2022 is expected at Rs. 3,000 crore-4,000 crore. The company plans to incur capex of ~Rs. 2,000 crore over three years.

Immense scope for private sector growth in defence



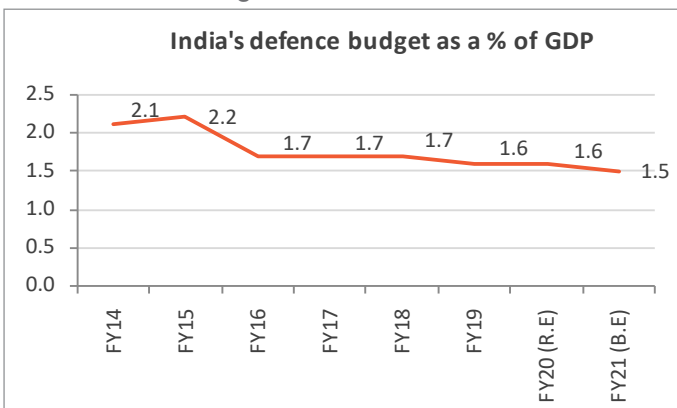
Source: www.ibef.org, Sharekhan Research

India was the second largest importer of arms between 2016-2020



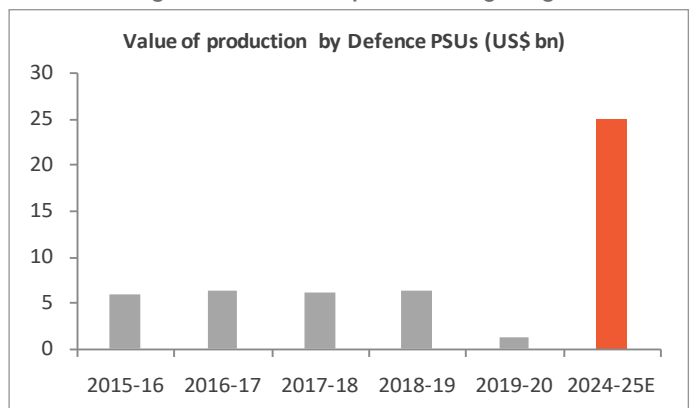
Source: www.statista.com, Sharekhan Research

Share of defence budget in GDP needs to increase



Source: www.indiabudget.gov.in, Industry Reports, Sharekhan Research

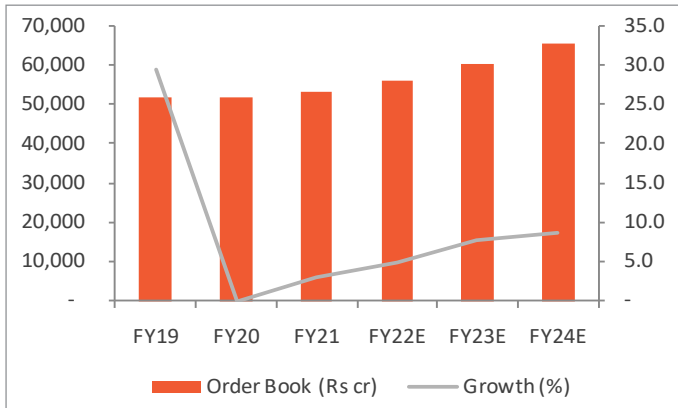
Ambitious target set for defence production by the government



Source: www.ibef.org, Sharekhan Research

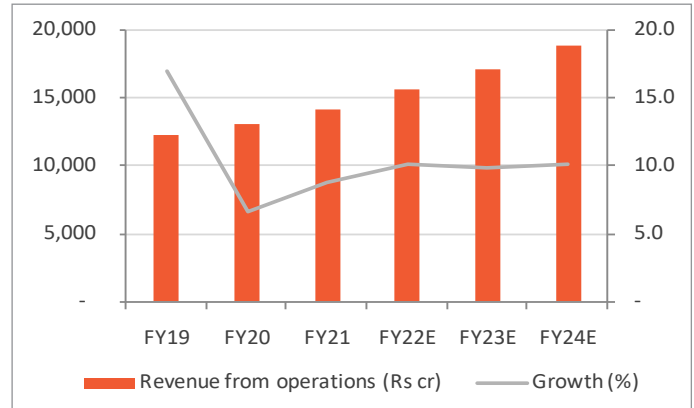
Financials in charts

Order book growth trend



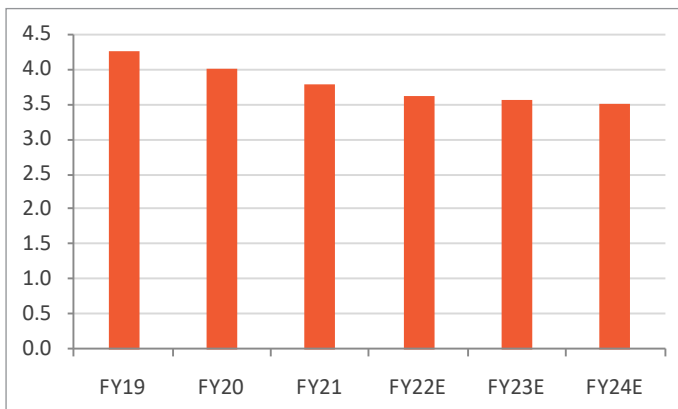
Source: Company, Sharekhan Research

Revenue growth trend



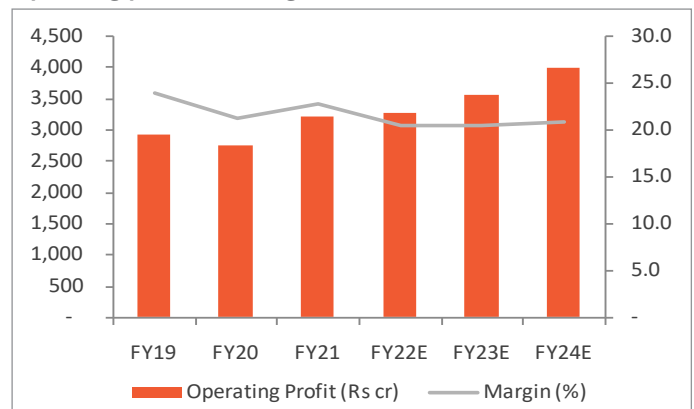
Source: Company, Sharekhan Research

Order Book to Revenue ratio



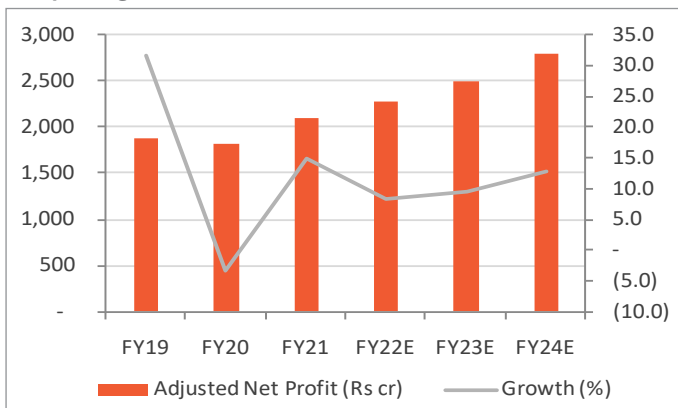
Source: Company, Sharekhan Research

Operating profit and margin trend



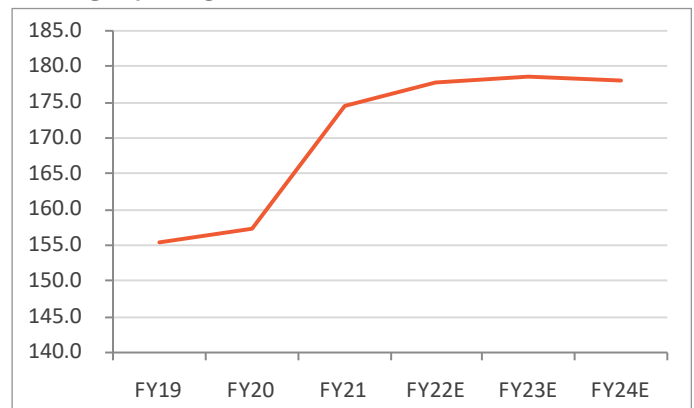
Source: Company, Sharekhan Research

Net profit growth trend



Source: Company, Sharekhan Research

Working capital cycle



Source: Company, Sharekhan Research

Outlook and Valuation

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

The government is emphasising on creating an environment to boost the Aatma Nirbhar 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, a 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 under play 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.

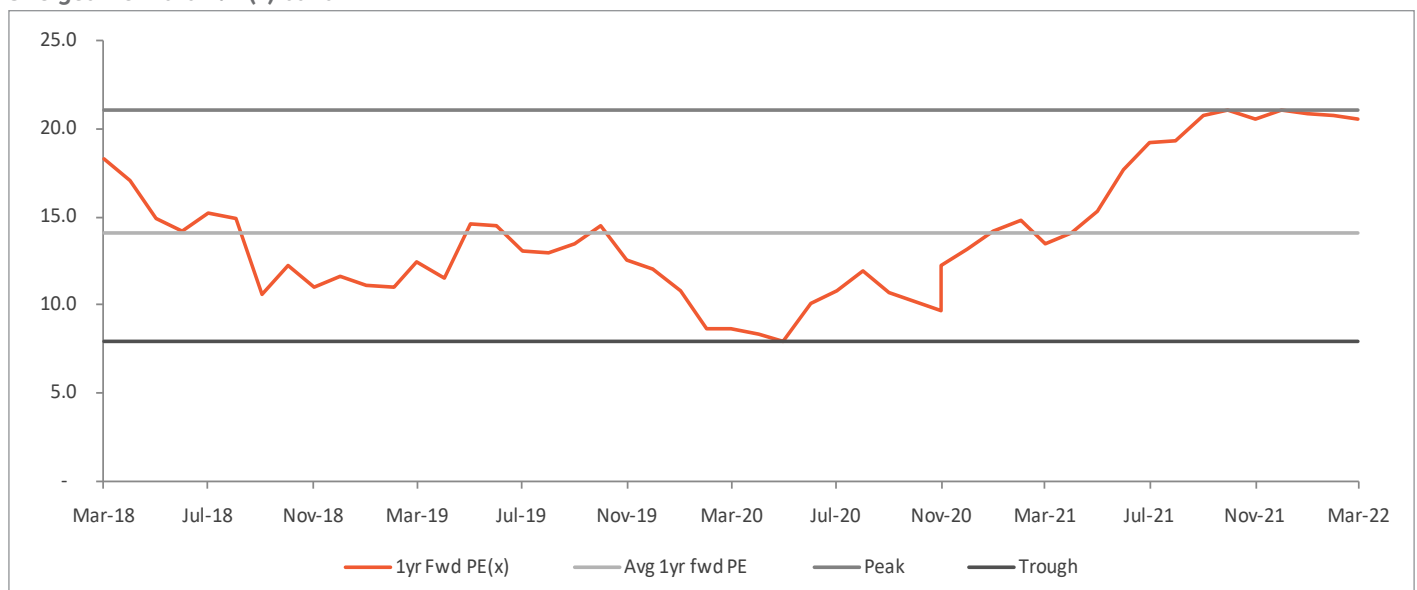
■ Company outlook - Continues to focus on sustainable growth plans

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 ~3%).

■ Valuation - Maintain Buy with an unchanged PT of Rs. 254

BEL has a number of opportunities with the government's 'Make in India' and 'Atmanirbhar Bharat' initiatives. The company continues to invest heavily on capex (~Rs. 600 crore per annum) and has considerable expenditure in R&D (6-7% of revenue). BEL remains our preferred pick in the defence sector on account of its strong manufacturing and research and development (R&D) base, strong order book and order inflow pipeline, growing indigenization, and strong balance sheet. We retain our Buy rating on the stock with an unchanged PT of Rs. 254.

One-year forward P/E (x) band



Source: Sharekhan Research

About company

BEL is one of the nine PSUs under the Ministry of Defence of India. The company has 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 Aatma Nirbhar 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 remains our preferred pick in the defence sector on account of its strong manufacturing and R&D base, good cost control, growing indigenization, and strong balance sheet.

Key Risks

- ◆ Delayed execution of orders and slower pace of fresh order intake can affect revenue growth.
- ◆ Higher raw-material prices may put pressure on margins.

Additional Data

Key management personnel

Venkateswara Gowtama Mannava	Executive Chairperson and Managing Director
Amit Sahai	Non-Executive - Non-Independent Director
Manjula Jillellamudi	Non-Executive - Non-Independent Director
Shikha Gupta	Executive Director
Anandi Ramalingam	Executive Director
Mahesh Venkatachaliah	Executive Director
Vinay Kumar Katyal	Executive Director
Shivakumaran Madaiah Kariyanakatte	Executive Director
Koshy Alexander	Executive Director & Chief Financial Officer

Source: Company

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	HDFC Asset Management Co. Ltd.	5.6
2	CPSE ETF	4.9
3	Reliance Capital Trustee Co. Ltd.	4.8
4	Life Insurance Corporation of India	3.3
5	Kotak Mahindra Asset Management Co. Ltd.	3.2
6	Mirae Asset Global Investments	2.8
7	SBI Equity Hybrid Fund	2.2
8	ICICI Prudential Asset Management Co. Ltd.	1.5
9	Aditya Birla SunLife Trustee Co. Pvt. Ltd.	1.3
10	Aditya Birla SunLife Management Co. Ltd.	1.1

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

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