

Monopoly play in Indian defence space, with robust order book giving ~5 Years of revenue visibility & stable margin of 20% make us bullish on BEL; Initiate with Buy with TP of Rs 134

CMP: Rs 109

Rating: Buy

Target: Rs 134

(CMP as on Nov 7, 2019)

Stock Info

INDEX	
BSE	500049
NSE	BEL
Bloomberg	BHE IN
Reuters	BAJE.BO
Sector	Engineering
Face Value (Rs)	1
Equity Capital (Rs Mn)	2437
Market Cap (Rs Mn)	265,589
52w H/L (Rs)	122 /73
Avg Weekly Vol (BSE+NSE)	40,097,680

Shareholding Pattern %

(As on Sept, 2019)	
Promoters	55.9
Public & Others	44.1

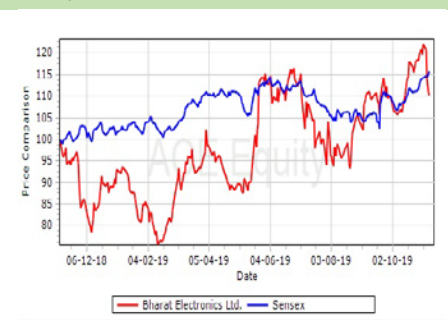
Source: NSE, Arihant Research

Stock Performance (%)

	3m	6m	12m
BEL	14.8	25.7	14.0
SENSEX	10.8	6.2	15.4

Source: ACE Equity, Arihant Research

BEL v/s SENSEX



Source: ACE Equity, Arihant Research

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Bharat Electronics (BEL) has shown steady performance above the years with near monopoly status in the Indian defence space. We like BEL due to its robust order book giving nearly 5 years of revenue visibility, which will help BEL to clock 12.8% revenue CAGR over FY19-21E. Also with easing concerns on margin due to new pricing policy, we expect BEL to maintain stable margin of 19-20% over FY19-21E. With India's ever-increasing budget allocation in defence, BEL will continue to enjoy its near monopoly status and will be able to maintain its steady growth rate. We initiate coverage on BEL with a Buy rating and a target price of Rs 134 per share.

Investment Rationale

■ **Robust order book to provide revenue visibility**

BEL's order book has grown at a CAGR of 33.8% over the past 4 years. The current order book of BEL stands at Rs 562 bn, which is 4.6x its FY19 sales, thereby providing strong revenue visibility for next 4-5 years. We believe BEL will continue to maintain its order book strength and expect its order book to grow at 11.6% CAGR over the next 2 years.

■ **Higher R&D spend will help BEL to diversify into new segments**

Over last 10 years, BEL increased its R&D spend at a CAGR of 25% and currently spends about 9% of its revenues (5% in FY09) on development of new products. We believe, increased R&D expenditure will help BEL to diversify into new segments; thereby aiding its revenue stream.

■ **Revenue to grow at a CAGR of 12.8% over FY19-21E with stable margin**

We expect BEL to report revenues of Rs 130,631 mn and Rs 153,644 mn respectively in FY20E and FY21E, which implies revenue CAGR of 12.8% over FY19-21E period. BEL management expects to maintain stable margin of 19-20% and expects the impact on margins from new pricing policy for nomination orders to be limited to 200 bps only. Also BEL targeting higher share of non-defence revenue (40% of sales from current 23%), will help the company to clock higher margin going forward.

Valuations

At CMP of Rs 109, BEL is trading at FY20E and FY21E, P/E multiples of 15.8x and 13x respectively, which is attractive considering the near monopoly status of BEL in the Indian defence space and strong revenue visibility over next 4-5 years by virtue of its robust order book. We have valued BEL at a target P/E multiple of 16x its FY21E estimates, which yields a target price of Rs 134 per share. **We initiate coverage on BEL with a BUY rating and a target price of Rs 134, which gives an upside potential of 22.9%.**

Financial Performance

YE March (Rs Mn)	Net Sales	EBITDA	PAT	EPS (Rs)	EBITDA Margin %	RoE (%)	P/E (x)
FY18	103,223	19,997	13,993	5.7	19.4	18.0	19.0
FY19	120,846	28,621	19,273	7.9	23.7	21.4	13.8
FY20E	130,631	25,473	16,822	6.9	19.5	18.0	15.8
FY21E	153,644	30,729	20,397	8.4	20.0	20.0	13.0

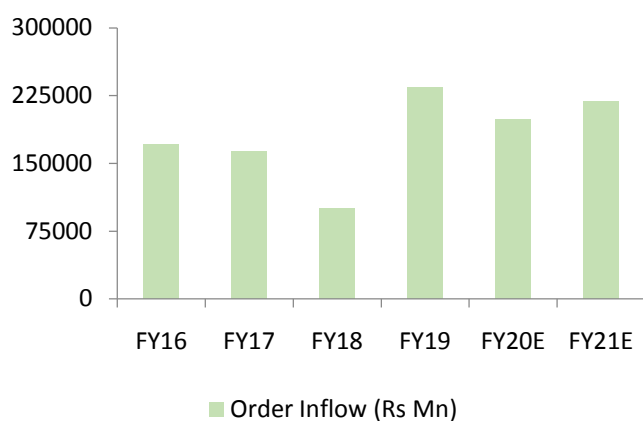
Source: Company, Arihant Research

Investment Rationale

■ Robust order book provides revenue visibility for next 4-5 years

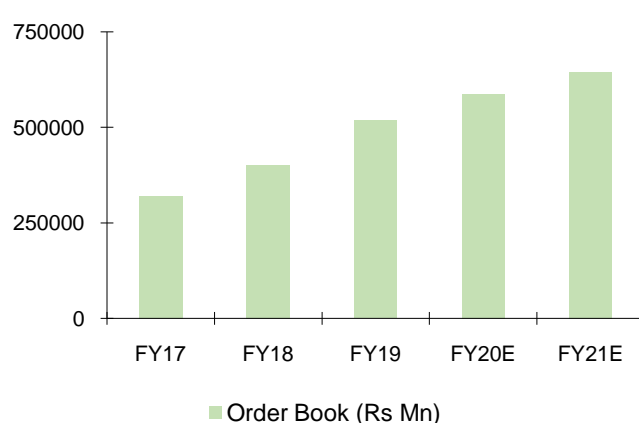
BEL's order book has grown at a CAGR of 33.8% over the past 4 years. In FY20E, till H1FY20 BEL has secured new orders worth Rs 90.7 bn against its full year guidance of Rs 150 bn, which includes recently secured Akash missile order worth Rs 53.6 bn. The current order book of BEL at the end of H1FY20 stands at Rs 562 bn, which is 4.6x its FY19 sales, thereby providing strong revenue visibility for next 4-5 years. With some key big ticket orders in the pipeline, including naval project order (Rs 25-30 bn), coastal surveillance order (Rs 25 bn) and homeland security orders (Rs 10 bn), we believe BEL will continue to maintain its order book strength and have estimated its order book to grow at 11.6% CAGR over the next 2 years.

BEL's order inflow trend over the years



Source: Company, Arianth Research

BEL's order book trend over the years



Source: Company, Arianth Research

Major projects planned during FY20E

Some of the major projects that BEL is planning to execute in FY20E are,---

- Integrated Air Command & Control System
- LRSAM (Long Range Surface to Air Missile)
- Smart City Business
- Upgrade of Communication Equipment
- Ground based Mobile Electronic Intelligence System
- Naval Equipment
- Radars
- Avionics Package for LCA
- Low Intensity Conflict Electronic Warfare System
- Delhi CCTV

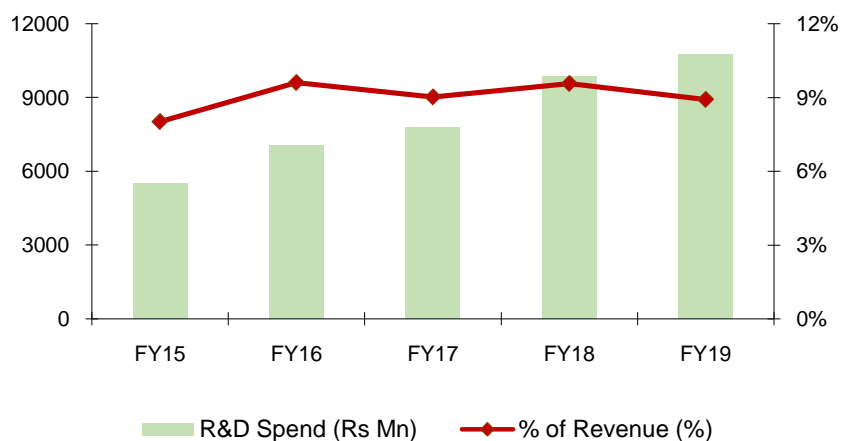
■ **BEL has strong R&D capabilities which will help the company to diversify into new segments; thereby aiding its revenue stream**

The company has strong R&D capabilities and apart from its own R&D facilities, BEL is the largest production partner of DRDO (Defence Research and Development Organization) and undertakes joint development with it. Over the years, BEL has developed many new products in areas of surveillance radars, communication equipment, electronic warfare products, homeland security etc.



Source: Company, Arianth Research

BEL has an impressive track record of complex project execution and over the years has continuously increased its R&D spend. Over the past 10 years, BEL has increased its R&D expenditure at a CAGR of 25% and currently spends about 9% of its revenues (5% in FY09) on development of new products. We believe, increased R&D expenditure will help the company to diversify into new segments; thereby aiding its revenue stream.

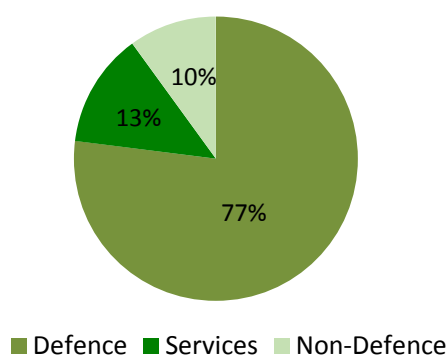


Source: Company, Arianth Research

- **BEL aims to increase the share of non-defence revenue going forward**

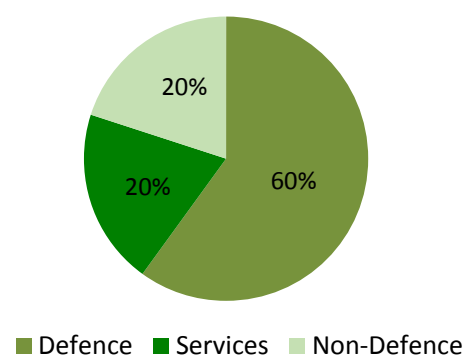
BEL's order book is defence heavy and consists of mostly defence related orders. Over the past few years, 75%-80% of BEL's revenues have come from defence related products. For FY19, defence constituted 77% of BEL's revenue while services and non-defence revenue share were 13% and 10% respectively. BEL management is aiming to increase the share of its non-defence revenues to 40% from 30% currently in next 4-5 years. We believe with increasing complexity of new products/projects there is enough scope for BEL to increase its service revenue share as these products/projects are bound by AMCs (annual maintenance contracts) which require servicing throughout the product/project lifecycle.

BEL's Revenue Mix in FY19



Source: Company, Arianth Research

BEL's Target Revenue Mix



Source: Company, Arianth Research

- **BEL management is taking steps to contain the margin pressure arising out of new pricing policy of government**

Over last few months, BEL's stock price was under pressure, as investors feared severe margin erosion for BEL under new pricing policy for nomination orders from DRDO, which stipulates reduced mark-up margins (7.5% PBT margin v/s 12.5% earlier). However, BEL management is of the opinion that impact on margins from the new policy change will be limited to 200 bps only for the nomination orders effective FY22E.

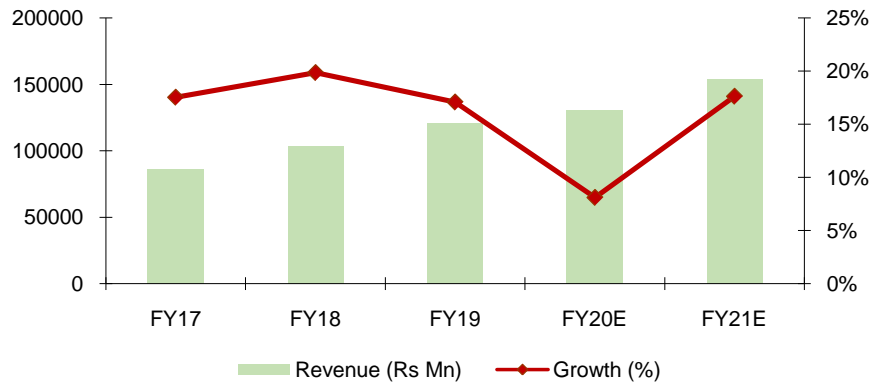
We believe under the new pricing policy, BEL's recently secured order of Akash Missile (Rs 53.6 bn) will be the only order, which will get impacted, while BEL's remaining order book will largely remain unaffected by the new pricing policy. BEL management in its last held AGM (Sept, 2019) expressed confidence of clocking higher margin in the Akash order than the stipulated 7.5%, due to supply chain efficiency. Also the fact that proportion of nomination orders in the order book are on a declining trend and BEL management's initiative to mitigate the impact of the new policy by increasing non-defence and services revenues will help the company to clock higher margin going forward. We believe BEL will be able to maintain its EBITDA margin at 19-20% level over FY20-21E due to efficiency gains.

Financial Performance Analysis

■ **Revenue to grow at a CAGR of 12.8% over FY19-21E**

BEL has strong revenue visibility over the next few years due to its robust order book and impressive pipeline of orders. BEL management has trimmed down its revenue growth guidance from 12-15% earlier to 7% for FY20E due to muted execution in H1FY20. However, since the company is consistently maintaining a steady growth rate for the last 4-5 years, we believe BEL will be able to tide over this slowdown by virtue of its robust order book once the economy picks up steam. We expect BEL to report revenues of Rs 130,631 mn and Rs 153,644 mn respectively in FY20E and FY21E, which implies a revenue CAGR of 12.8% over FY19-21E period.

Revenue growth trend of BEL over the years

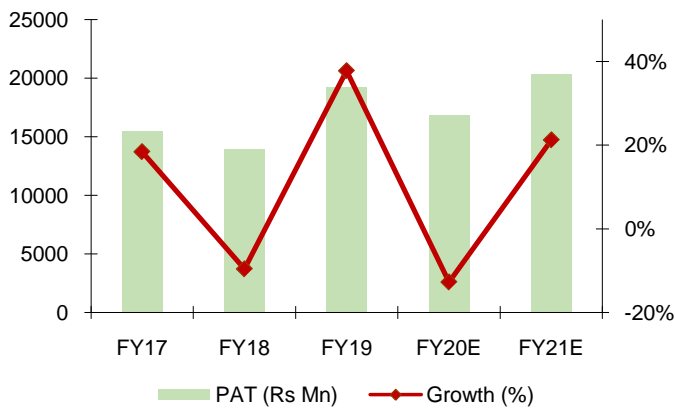


Source: Company, Arianth Research

■ **PAT to grow at 2.9% CAGR over FY19-21E with stable margin of 19-20%**

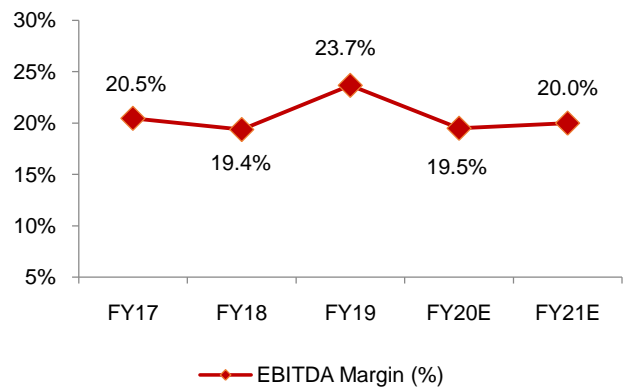
We believe, going forward, BEL’s 12.8% CAGR revenue growth coupled with stable EBITDA margin profile would help the company to ramp up its earnings over the next few years. We expect BEL to grow its PAT by 2.9% CAGR over FY19-21E with stable EBITDA margin of 19-20%.

BEL’s PAT trend over the years



Source: Company, Arianth Research

EBITDA margin trend of BEL



Source: Company, Arianth Research

Q2FY20 and H1FY20 Financial Performance

Rs Mn (standalone)	Q2FY20	Q1FY20	Q2FY19	Q-o-Q	Y-o-Y	H1FY20	H1FY19	Y-o-Y
Net Revenue	27,427	21,015	33,814	30.5%	-18.9%	48,442	54,835	-11.7%
Raw Material Cost	14,599	10,565	16,196	38.2%	-9.9%	25,164	27,268	-7.7%
Employee cost	5,073	5,242	4,692	-3.2%	8.1%	10,315	9,421	9.5%
Other Expenses	2,308	1,728	4,381	33.6%	-47.3%	4,035	6,497	-37.9%
EBITDA	5,447	3,481	8,544	56.5%	-36.2%	8,929	11,649	-23.4%
EBITDA margin %	19.9%	16.6%	25.3%	+330bps	-541bps	18.4%	21.2%	-281bps
Other Income	150	254	143	-40.9%	5.5%	405	231	75.0%
Depreciation	857	828	743	3.4%	15.2%	1,685	1,432	17.6%
EBIT	4,741	2,907	7,944	63.1%	-40.3%	7,648	10,448	-26.8%
Finance cost	12	3	-	-	-	15	3	470.4%
Exceptional Item	-	-	-	-	-	-	-	-
PBT	4,729	2,904	7,944	62.8%	-40.5%	7,633	10,446	-26.9%
Tax Expense	1,334	857	2,230	55.7%	-40.2%	2,191	2,935	-25.4%
Effective tax rate %	28.2%	29.5%	28.1%	-129bps	+13bps	28.7%	28.1%	+60bps
PAT	3,395	2,047	5,713	65.8%	-40.6%	5,442	7,510	-27.5%
PAT margin %	12.4%	9.7%	16.9%	+264bps	-452bps	11.2%	13.7%	-246bps
EPS (Rs)	1.4	0.8	2.3	65.8%	-40.6%	2.2	3.1	-27.5%

Source: Company, Arianth Research

Valuations

At CMP of Rs 109, BEL is trading at FY20E and FY21E, P/E multiples of 15.8x and 13x respectively, which is attractive considering the near monopoly status of BEL in the Indian defence space and strong revenue visibility over next 4-5 years by virtue of its robust order book. We have valued BEL at a target P/E multiple of 16x its FY21E estimates, which yields a target price of Rs 134 per share. We initiate coverage on BEL with a BUY rating and a target price of Rs 134, which gives an upside potential of 22.9%.

■ Company Background

Bharat Electronics Limited (BEL) was set up at Bangalore in 1954 by the Government of India under the Ministry of Defence (MoD), to meet the specialised electronic needs of the Indian defence services. BEL produces a wide range of state-of-the-art equipment in fields such as Defence Communication, Radars, Naval Systems, C4I Systems, Weapon Systems, Homeland Security, Telecom & Broadcast Systems, Electronic Warfare, Tank Electronics, Electro Optics, Professional Electronic Components and Solar Photovoltaic Systems. BEL has 9 manufacturing units across the country, in Bangalore, Ghaziabad, Machilipatnam, Panchkula, Kotdwara, Hyderabad, Chennai, Pune and Navi Mumbai. It has 9,612 employees as on FY19 end.

■ Business Segments

Over the years, BEL has grown into a multi-product, multi-technology company with diverse product range serving the needs of customers in various fields in India and abroad. The company operates in the following business segments.



Source: Company, Arianth Research

BEL also has world-class manufacturing and testing facilities to facilitate its expansion and modernisation plans.

1	Super Components Facility	5	High Roof hangar for Radar & Antenna Integration
2	Test set up for missile system	6	Modern Production setup for Airborne applications
3	Secured manufacturing facility for EVM/VVPAT	7	Near Field Test Range and EMI/EMC Test Facility
4	Antenna test range facility	8	New factories planned at Devanahalli & Machilipatnam

Source: Company, Arianth Research

■ Key Risks

- **Delay in order execution**
Any potential delays in execution of orders could have an adverse impact on revenues and profits for BEL. Besides, some of its contracts may also include potential damage claims on delays, which could result in negative earnings surprises and de-rating of stock valuations.
- **Higher competitive intensity**
While historically the domestic defence industry has been dominated by PSUs, going forward we expect higher participation from private players, with government's focus on 'Make In India' initiative. This in turn will increase competitive intensity for BEL.
- **Late payment from customers leading to stretched WC cycle**
Potential delays or change in payment norms from customers could have an adverse impact on cash flows and earnings of BEL. With overall slowdown in the economy, there seem to be some pressures on customer budgets, which might stretch the working capital (WC) cycle of BEL. Also with rising share of competitively bid projects, the company needs to factor in the financing cost aspect before it bids for projects. Any adverse changes to the above factors could stress working capital and put pressure on cash flow profile for BEL.
- **Rising raw material costs could put pressure on margins**
With rising share of longer duration project execution cycle, we believe BEL is exposed to higher raw material price risks and with rising raw material costs, margins could become more volatile going forward in the event where contracts do not have inbuilt price variation clauses.

Standalone Financials

Income Statement

Y/E March (Rs Mn)	FY17	FY18	FY19	FY20E	FY21E
Revenues	86,119	1,03,223	1,20,846	1,30,631	1,53,644
<i>Change (%)</i>	17.5%	19.9%	17.1%	8.1%	17.6%
Raw materials	48,600	45,691	52,863	65,316	78,358
Stock Adjustments	0	4,153	-1,322	0	0
Employee costs	15,483	17,723	18,791	20,901	25,351
Other expenses	4,419	10,315	13,957	18,942	19,206
Total Expenses	68,502	83,226	92,225	1,05,158	1,22,915
EBITDA	17,617	19,997	28,621	25,473	30,729
Other Income	4,710	2,004	1,695	1,959	2,305
Depreciation	1,915	2,510	3,162	3,287	3,776
Interest	118	13	122	115	120
PBT	20,294	19,478	27,032	24,031	29,138
Extra-ordinary	0	0	0	0	0
PBT after ext-ord.	20,294	19,478	27,032	24,031	29,138
Tax	4,818	5,486	7,759	7,209	8,741
<i>Rate (%)</i>	23.7%	28.2%	28.7%	30.0%	30.0%
PAT	15,476	13,993	19,273	16,822	20,397
<i>Change (%)</i>	18.4%	-9.6%	37.7%	-12.7%	21.3%

Source: Company, Arianth Research

Balance Sheet

Y/E March (Rs Mn)	FY17	FY18	FY19	FY20E	FY21E
Sources of Funds					
Share Capital	2,234	2,437	2,437	2,437	2,437
Reserves & Surplus	72,937	75,174	87,753	91,017	99,546
Net Worth	75,171	77,610	90,189	93,454	1,01,983
Loan Funds	167	333	0	0	0
Deferred Tax & other liabilities	0	440	969	969	969
Capital Employed	75,338	78,383	91,159	94,423	1,02,952
Application of Funds					
Gross Block	19,094	26,571	34,597	40,597	46,597
Less: Accumulated Depreciation	3,617	6,127	9,289	12,576	16,351
Net Block	15,477	20,444	25,308	28,021	30,245
CWIP	3,639	3,955	2,751	2,751	2,751
Other non current assets	2,523	2,532	2,555	2,555	2,555
Deferred tax assets	2,800	4,312	4,712	4,712	4,712
Net fixed assets	24,439	31,242	35,325	38,039	40,263
Investments	4,598	9,032	10,193	10,193	10,193
Debtors	43,549	50,495	53,692	53,684	63,141
Inventories	49,050	47,391	44,548	44,737	53,670
Cash & bank balance	37,902	7,387	8,840	9,883	6,308
Loans & advances & other CA	12,025	39,681	52,037	62,632	73,665
Total current assets	1,42,526	1,44,954	1,59,117	1,70,935	1,96,785
Current liabilities	83,222	94,241	99,680	1,10,947	1,30,492
Provisions	13,003	12,604	13,796	13,796	13,796
Net current assets	46,301	38,109	45,641	46,192	52,496
Total Assets	75,338	78,383	91,159	94,423	1,02,952

Source: Company, Arianth Research

Cash Flow Statement

Y/E March (Rs Mn)	FY17	FY18	FY19	FY20E	FY21E
PBT	20,294	19,478	27,032	24,031	29,138
Depreciation	1,915	2,510	3,162	3,287	3,776
Interest & others	-4,592	-1,991	-1,573	-1,844	-2,185
Cash flow before WC changes	17,617	19,997	28,621	25,473	30,729
(Inc)/dec in working capital	-1,203	-22,323	-6,079	492	-9,879
Operating CF after WC changes	16,414	-2,326	22,542	25,966	20,850
Less: Taxes	-4,818	-5,486	-7,759	-7,209	-8,741
Operating cash flow	11,596	-7,811	14,783	18,756	12,108
(Inc)/dec in F.A + CWIP	-6,970	-6,803	-4,083	-6,000	-6,000
(Pur)/sale of investment	-1,406	-4,434	-1,161	0	0
Cash flow from investing	-8,376	-11,237	-5,244	-6,000	-6,000
Free cash flow (FCF)	4,626	-13,094	11,123	12,756	6,108
Loan raised/(repaid)	167	166	-333	0	0
Equity raised	0	203	0	0	0
Interest & others	-30,681	-4,282	2,235	-4,370	-2,340
Dividend	-6,457	-7,554	-9,987	-7,344	-7,344
Cash flow from financing activities	-36,971	-11,467	-8,086	-11,713	-9,683
Net inc /(dec) in cash	-33,751	-30,515	1,453	1,043	-3,575
Opening balance of cash	71,653	37,902	7,387	8,840	9,883
Closing balance of cash	37,902	7,387	8,840	9,883	6,308

Source: Company, Arianth Research

Key Ratios

Y/E March (Rs Mn)	FY17	FY18	FY19	FY20E	FY21E
Per share (Rs)					
EPS	6.9	5.7	7.9	6.9	8.4
CEPS	7.8	6.8	9.2	8.3	9.9
BVPS	33.7	31.9	37.0	38.4	41.9
DPS	0.0	2.6	3.4	2.5	2.5
Payout (%)	0.0%	44.9%	43.0%	36.2%	29.9%
Valuation (x)					
P/E	15.7	19.0	13.8	15.8	13.0
P/CEPS	14.0	16.1	11.8	13.2	11.0
P/BV	3.2	3.4	2.9	2.8	2.6
EV/EBITDA	11.7	12.9	9.0	10.0	8.4
Dividend Yield (%)	0.0%	2.4%	3.1%	2.3%	2.3%
Return Ratio (%)					
EBIDTA Margin	20.5%	19.4%	23.7%	19.5%	20.0%
PAT Margin	18.0%	13.6%	15.9%	12.9%	13.3%
ROE	20.6%	18.0%	21.4%	18.0%	20.0%
ROCE	20.8%	22.3%	27.9%	23.5%	26.2%
Leverage Ratio (%)					
Total D/E	0.0	0.0	0.0	0.0	0.0
Net D/E	-0.5	-0.1	-0.1	-0.1	-0.1
Turnover Ratios					
Asset Turnover (x)	1.1	1.3	1.3	1.4	1.5
Inventory Days	368	313	273	250	250
Receivable Days	185	179	162	150	150
Payable days	408	378	343	310	310

Source: Company, Arianth Research

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Stock Rating Scale**Absolute Return**

BUY	>20%
ACCUMULATE	12% to 20%
HOLD	5% to 12%
NEUTRAL	-5% to 5%
REDUCE	-5% to -12%
SELL	<-12%

Research**Analyst****Contact****Website****Email Id****Registration No.**

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