

Bharat Electronics (BEL)

Performance Highlights

Quarterly highlights - Standalone

Y/E March (₹ cr)	1QFY17	1QFY16	% chg (yoy)
Net sales	847	1,071	(20.9)
EBITDA	(71)	(21)	<i>nmf</i>
PAT	36	77	(52.9)

Source: Company, Angel Research; Note- *nmf*- Not Meaningful

Bharat Electronics Ltd (BEL) reported bad set of numbers for 1QFY2017. Its top-line declined by 20.9% yoy to ₹847cr, which is below our estimate. For the quarter, BEL reported below than expected negative EBITDA of ₹71cr. Negative operating leverage in our view led to EBITDA de-growth. In-line with EBITDA de-growth, PAT de-grew 52.9% yoy to ₹36cr. PAT margins were down 290bps yoy to 4.3%, which is below our expectation.

For 1QFY2017, BEL reported order inflows of ₹1,003cr, which includes Homeland Security, Navigational Complex System, and Next generation Main Automatic Exchange order wins. Post these wins, order book as of 1QFY2017-end stood at ₹32,139cr. Order book/ last twelve month (LTM) sales ratio as of 1QFY2017-end stood at 4.5x.

Valuation: Despite disappointing quarterly results, we maintain our positive view towards the stock. Considering the delays in clearance from customer side, there exists possibility of better 2Q revenue booking. On the back of continuous order wins and strong order book, there exists some scope for the company delivering favorable performance going forward.

On the back of strong market positioning, large order book, debt free status, we expect BEL to report increased traction in sales and earnings growth, going forward. **We recommend BUY on the stock with price target of ₹1,414.**

Key Financials (Consolidated)

Y/E March (₹ cr)	FY13	FY14	FY15	FY16	FY17E	FY18E
Net Sales	6,273	6,518	7,093	7,549	8,137	9,169
% chg	6.1	3.9	8.8	6.4	7.8	12.7
Net Profit	906	951	1,197	1,394	1,410	1,499
% chg	7.0	5.0	25.8	16.5	1.1	6.3
EBITDA (%)	10.6	14.1	16.6	20.4	16.8	17.2
EPS (₹)	38	40	50	58	59	62
P/E (x)	32.5	31.1	24.7	21.3	21.0	19.7
P/BV (x)	4.6	4.1	3.6	3.3	3.0	2.8
Adj. RoE (%)	30.3	20.1	36.8	66.4	44.6	46.3
RoCE (%)	26.6	23.9	30.7	34.1	28.2	27.7
EV/Sales (x)	3.9	3.9	3.4	3.0	2.7	2.4
EV/EBITDA (x)	36.6	27.1	20.1	14.3	15.7	13.8

Source: Company, Angel Research; CMP as of August 10, 2016; Reported as per Ind AS, FY2016 numbers & other remaining quarters continue to be reported as per Indian GAAP; It needs to be noted that yoy growth for FY2017E is not comparable as FY2016 continues to be reported under Indian GAAP

BUY

CMP	₹1,232
Target Price	₹1,414

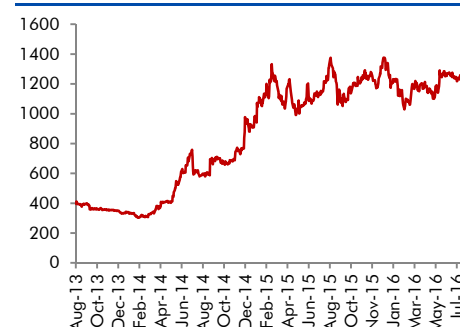
Investment Period	12 Months
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Stock Info	
Sector	Capital Goods
Market Cap (₹ cr)	29,572
Net debt (₹ cr)	(7,524)
Beta	1.1
52 Week High / Low	1,417/983
Avg. Daily Volume	330,665
Face Value (₹)	10
BSE Sensex	27,775
Nifty	8,575
Reuters Code	BAJE.BO
Bloomberg Code	BHE@IN

Shareholding Pattern (%)	
Promoters	75.0
MF / Banks / Indian Fls	14.7
FII / NRIs / OCBs	3.9
Indian Public / Others	6.4

Abs. (%)	3m	1yr	3yr
Sensex	8.5	(1.2)	46.6
BEL	6.5	(5.6)	211.6

3-Year Daily Price Chart



Source: Company, Angel Research

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Exhibit 1: Quarterly Performance (Standalone)

Particulars (₹ cr)	1QFY17*	1QFY16*	% chg (yoy)
Net Sales	847	1,071	(20.9)
Total Expenditure	918	1,092	(15.9)
Cost of materials consumed	673	683	(1.5)
Purchases of stock-in-trade	(203)	10	nmf
Employee benefits Expense	316	295	7.4
Other Expenses	132	104	27.1
EBITDA	(71)	(21)	nmf
EBITDA %	(8.4)	(2.0)	
Depreciation	43	41	6.7
EBIT	(115)	(62)	85.8
Interest and Financial Charges	0	0	nmf
Other Income	163	163	0.5
PBT before Exceptional Items	49	101	(51.8)
Exceptional Items	0	0	
PBT after Exceptional Items	49	101	(51.8)
Tax	13	24	(48.0)
% of PBT	25.7	23.9	7.7
PAT from ordinary items	36	77	(52.9)
Other Comprehensive Items	13	13	
Total Comprehensive Income	23	63	(63.5)
PAT %	4.3	7.2	
Dil. EPS (after extra-ord. Items)	1.50	3.20	(53.1)

Source: Company, Angel Research; Note: nmf- Not meaningful; *Reported as per Ind AS, FY2016 numbers & other remaining quarters continue to be reported as per Indian GAAP; It needs to be noted that yoy growth for FY2017E is not comparable as FY2016 continues to be reported under Indian GAAP

Revenue reports 20.9% yoy sales de-growth

BEL reported 20.9% yoy sales de-growth in 1QFY2017 to ₹847cr, which is below our expectation. Management attributed delays in customer clearances, to be the key reason for miss on expected revenues front. Majority of the revenues for the quarter has been from 3D Tactical Control Radar, Akash Weapons System for the Indian Army.

Exhibit 2: Projects contributing to 1QFY2017 revenues

3D Tactical Control Radar
Akash Weapon System (Army)
New Generation Hull Mounted Sonar
L70 Gun Upgrade
Fire Control Systems

Source: Company, Angel Research

Management expects better revenue booking from 2QFY17 onwards, and has maintained its 10% yoy top-line growth target for FY2017E.

Exports for 1QFY2017 grew ~47% yoy to \$17mn (₹116cr) in 1QFY2017.

Reports negative operating margins

For the quarter, BEL reported below than expected, negative EBITDA of ₹71cr. Negative operating leverage led to yoy EBITDA de-growth. EBITDA was impacted on account of 27.1% yoy increase in other expenses to ₹132cr.

Operating performance restricts PAT growth

In-line with EBITDA de-growth, PAT de-grew 52.9% yoy to ₹36cr. PAT margins on yoy basis were down 290bps to 4.3%, which is below our expectation. PAT margin was also impacted on account of (1) just 0.5% yoy increase in other income to ₹163cr, (2) 6.7% increase in depreciation expenses to ₹43cr, (3) higher effective tax rate of 25.7%.

1QFY2017 Order Inflows at ₹1,003cr

BEL in 1QFY2017 reported ₹1,003cr of order inflows, which include Homeland Security, Navigational Complex System, and Next generation Main Automatic Exchange order wins.

We maintain our view that BEL would report order inflows of ₹18,000cr/₹20,000cr for FY2017/18E, respectively, considering the strong emerging bid pipeline. Amongst the projects in the pipeline, we expect the company to report order wins from Akash Missile Systems (7 sqdn), Tactical Communication System, Early Warning Suite for Fighter Aircraft, Mobile Cellular Communication System, Ship Data Network, Commander TI sights and Advanced Composite Communication Systems.

The order book as of 1QFY2017-end stood at ₹32,139cr which gives revenue visibility for the next two years. The order book/LTM sales ratio at 1QFY2017-end stood at 4.5x.

Valuation

Despite weak quarterly numbers, we expect BEL to report strong financial performance in the coming quarters (revenue booking post project clearance to be seen in 2QFY2017). We expect BEL to report strong order inflows and revenues, on the back of strong market positioning, large Order Book (which gives visibility for next few quarters).

On the back of increase in order inflows, we are optimistic that the company should see increased traction in sales and earnings growth, going forward. Since our initiation report, the stock has attained our then recommended target price of ₹1,414 but has thereafter corrected. Post the correction seen in the stock price, the valuations has turned attractive. **We maintain BUY on the stock with price target of ₹1,414.**

Company background

BEL is a Bangalore based public sector undertaking (PSU) established in 1954 under the control of Ministry of Defence (MoD) to cater to specialised electronic needs of the Indian Defense. BEL, a Nava-Ratna company, has over the years grown to be a multi-segment, multi-technology company servicing a diverse range of clients across India and in the international markets.

Business segments

BEL operates across 8 business segments, with ~20-30% of its current order book contributed by its largest business segment- Radars, Sonars & Weapons Systems.

Exhibit 3: Business Segments

Radars, Sonars & Weapon Systems
Communication
Electronic Warfare
Network Centric Systems
Anti Submarine Warfare
Electro-Optics
Tank Electronics
Civilian Products (such as EVM machines)

Source: Company, Angel Research

Details of Manufacturing Plants

To-date BEL has set-up 9 manufacturing plants across Bangalore (headquarters), Chennai, Machilipatnam (post take-over of Andhra Scientific Company in 1983), Hyderabad, Pune, Navi Mumbai, Panchkula, Kotdwara, and Ghaziabad, which are into manufacture of entire range of defense products offered by the company.

Exhibit 4: Details of Manufacturing facilities

Production Facilities (since)	Production details
Bangalore (1966)	Military Communication Equipment, Network Centric Systems, Military Radars, Naval Systems, Electronic Warfare (Air-force), Avionics, Weapon Management System, Telecom and Broadcast System, Components, Coastal Surveillance System, Electronic Voting Machines, Solar Products, Traffic Signals, Security Systems, Microwave Super Components
Chennai	Tank Electronics, Gun Upgrades, Multi-purpose Advanced Stabilized systems
Machilipatnam (1983)	Electro-Optics (Night Vision Devices)
Hyderabad	Electronic Warfare Systems
Pune (1981)	X-ray Tubes, Batteries, Laser Products
Navi Mumbai	Shelters, Masks
Panchkula	Military Communication Equipment, Encryption Products
Kotdwara	Telecommunication Systems, Military Communication Systems
Ghaziabad	Network Centric Systems, Radars, Satcom (Defense), Microwave components

Source: Company AR's, Angel Research

Investment Arguments

BEL is a PSU and a leader in the domestic defense electronics space, with a major proportion of its revenue coming in from the Indian Navy and Army.

Defense spending at an inflexion point: After years of lull, the government announced a 6.9% yoy increase in Defense Capital Budget to ₹69,705cr. In our view, the company is at an inflexion point where Indian Defense capex cycle, led by government spending is entering new era of growth. Our view strengthens on account of the following developments, (1) Defense sector getting high priority in government's 'Make in India' campaign, with increased emphasis on the indigenization aspect, (2) increase in FDI limits in defense from 26% to 49%, and (3) \$50bn worth of projects cleared by Defense Acquisition Council (DAC) since the new government has come to power, indicating faster clearances in place. Also the recently released Defense Procurement Procedures (DPP) is good for the industry. The current bid pipeline, which could lead to strong award activity for the next few years, along with above-mentioned factors indicate that good times are ahead for the Defense sector.

BEL to emerge as key beneficiary: At the backdrop of higher allocation made towards defense capex with ~\$50bn worth of projects cleared by DAC, we expect good times ahead for defense players, including for BEL. BEL in FY2016 had a market share of ~35% in domestic defense electronics. (1) A bid-pipeline dominated by Indian Airforce and Navy's platform projects, which have high Defense Electronics components requirement, (2) BEL's in-house R&D capabilities, (3) tie-up with Thales, France for product development, and (4) zero net debt status with potential for further improvement in working capital cycle, all point out that BEL would be able to maintain its strong market positioning in the Defense Electronics space. On the whole, we expect BEL to emerge as a key beneficiary of the revival in the defense capex cycle.

Risks & Concerns

- To increase indigenization in the defense sector, the Government of India (GoI) increased the FDI limit in the Defense sector to 49% in Jul-2014. Till now, recent developments/ announcements have failed to attract any major international defense players into India. With more positive announcements expected and a fast growing bid pipeline, international defense giants could be compelled to forge partnership with domestic players at the time of bidding. This could possibly lead to loss of market share for BEL, which we have not incorporated in to our estimates.
- Last few years have seen sluggish ordering activity from the Defense sector. Even though the Defense sector in the last few months has seen positive announcements, any further delays in the awarding activity, could act as a risk to our estimates.
- Defense is a highly technology focused sector. BEL would have to continuously spend on R&D to regularly upgrade its product profile. Any shift away from the R&D could make their products unattractive (vs the peers), resulting in loss of market share and further delays in execution.

- Any government announcement to de-list the products manufactured by BEL could open up the competition and further impact their market positioning within the domestic markets, which again acts as a risk to our market share assumptions and threatens our earnings growth estimates.

Profit & Loss Statement (Consolidated)

Y/E March (₹ cr)	FY13	FY14	FY15	FY16	FY17E	FY18E
Net Sales	6,273	6,518	7,093	7,549	8,137	9,169
% Chg	6.1	3.9	8.8	6.4	7.8	12.7
Total Expenditure	5,610	5,596	5,918	6,008	6,773	7,589
Raw Materials Consumed	3,156	3,344	3,495	3,578	4,146	4,658
Purchase of stock-in-trade	760	444	440	339	423	452
Employee benefits Expense	1,125	1,046	1,281	1,323	1,406	1,564
Other Expenses	569	762	702	768	798	915
EBITDA	663	922	1,175	1,541	1,364	1,579
% Chg	4.3	39.1	27.4	31.2	(11.5)	15.8
EBIDTA %	10.6	14.1	16.6	20.4	16.8	17.2
Depreciation	136	150	166	200	218	243
EBIT	526	772	1,008	1,341	1,145	1,337
% Chg	3.2	46.6	30.6	33.0	(14.6)	16.7
Interest and Fin. Charges	1	4	3	6	7	7
Other Income	625	437	507	533	653	668
EBT before Excep & prior-period items	1,151	1,205	1,513	1,869	1,791	1,997
Excep. & Prior period Items	(9)	1	1	0	0	0
EBT	1,142	1,206	1,513	1,869	1,791	1,997
Tax Expenses	236	254	316	475	381	498
% of PBT	20.7	21.1	20.9	25.4	21.3	24.9
PAT before Minority Interest	906	952	1,197	1,394	1,410	1,499
Minority Interest	0	0	(0)	(1)	0	1
PAT	906	951	1,197	1,394	1,410	1,499
% Chg	7.0	5.0	25.8	16.5	1.1	6.3
PAT %	14.4	14.6	16.9	18.5	17.3	16.3
Diluted EPS	38	40	50	57.8	58.7	62.5
% Chg	7.6	4.4	25.8	15.9	1.6	6.3

Reported as per Ind AS, FY2016 numbers & other remaining quarters continue to be reported as per Indian GAAP; It needs to be noted that yoy growth for FY2017E is not comparable as FY2016 continues to be reported under Indian GAAP

Balance Sheet (Consolidated)

Y/E March (₹ cr)	FY13	FY14	FY15	FY16E	FY17E	FY18E
Sources of Funds						
Equity Capital	80	80	80	240	240	240
Reserves & Surplus	6,407	7,140	8,037	8,746	9,579	10,444
Networth	6,487	7,220	8,117	8,986	9,819	10,684
Total Debt	0	0	25	29	30	35
Minority Interest & Govt. Grants	163	224	207	182	181	181
Other Long-term Liab. & Prov.	386	365	435	517	536	553
Total Liabilities	7,037	7,809	8,784	9,713	10,567	11,454
Application of Funds						
Gross Block	2,106	2,366	2,894	3,254	3,659	4,082
Accumulated Depreciation	1,506	1,671	1,821	2,021	2,239	2,482
Net Block	600	695	1,073	1,233	1,420	1,600
Cap. WIP & Intan. Assets under Develop.	328	458	140	432	305	300
Investments	0	0	0	242	242	242
Current Assets						
Inventories	3,255	3,340	3,424	4,213	4,077	4,356
Sundry Debtors	3,364	4,156	3,805	3,741	3,966	4,431
Cash and Bank Balance	5,331	4,605	6,038	7,553	8,125	7,867
Loans & Advances	1,378	1,190	684	487	500	680
Other Current Asset	81	69	54	59	57	59
Current Liabilities	7,814	7,166	6,941	8,811	8,704	8,693
Net Current Assets	5,594	6,192	7,064	7,242	8,021	8,700
Other Assets	515	464	506	565	580	612
Total Assets	7,037	7,809	8,784	9,713	10,567	11,454

Cash Flow Statement (Consolidated)

Y/E March (₹ cr)	FY13	FY14	FY15	FY16E	FY17E	FY18E
Profit before tax	1,147	1,206	1,513	1,869	1,791	1,997
Dep. & Other Non-cash Charges	(338)	(336)	(163)	(417)	(238)	(238)
Change in Working Capital	(2,104)	(1,237)	436	1,338	(207)	(938)
Interest & Financial Charges	1	4	3	6	7	7
Direct taxes paid	(245)	(206)	(356)	(475)	(381)	(498)
Cash Flow from Operations	(1,540)	(569)	1,434	2,320	972	331
(Inc)/ Dec in Fixed Assets	(353)	(369)	(225)	(650)	(278)	(418)
(Inc)/ Dec in Invest. & Oth. Adj.	2,106	1,128	(614)	(141)	438	142
Cash Flow from Investing	1,753	759	(839)	(791)	160	(277)
Issue/ (Buy Back) of Equity	0	0	0	160	0	0
Inc./ (Dec.) in Borrowings	0	(0)	25	4	2	5
Dividend Paid (Incl. Tax)	(157)	(209)	(220)	(504)	(555)	(610)
Interest Expenses & Oth. Adj.	(1)	(4)	(14)	(6)	(7)	(7)
Cash Flow from Financing	(157)	(213)	(209)	(347)	(560)	(613)
Inc./ (Dec.) in Cash	56	(23)	386	1,182	572	(558)
Opening Cash balances	1,752	1,809	1,786	2,171	3,353	3,925
Closing Cash balances	1,809	1,786	2,171	3,353	3,925	3,367

Key Ratios (x)

Y/E March	FY13	FY14	FY15	FY16E	FY17E	FY18E
Valuation Ratio (x)						
Adj. P/E (on FDEPS)	32.5	31.1	24.7	21.3	21.0	19.7
Adj. P/E (on FDEPS)	28.2	26.9	21.7	18.6	18.2	17.0
Dividend yield (%)	1.7	1.6	1.3	0.7	0.6	0.6
EV/Sales	3.9	3.9	3.4	3.0	2.7	2.4
EV/EBITDA	36.6	27.1	20.1	14.3	15.7	13.8
EV / Total Assets	3.4	3.2	2.7	2.3	2.0	1.9
Per Share Data (₹)						
Adj. EPS (fully diluted)	38	40	50	58	59	62
Cash EPS	44	46	57	66	68	73
DPS	7.4	7.8	9.7	18.0	19.8	21.7
Book Value	270	301	338	374	409	445
Returns (%)						
RoCE (Pre-tax)	26.6	23.9	30.7	34.1	28.2	27.7
Angel RoIC (Pre-tax)	35.8	35.0	36.4	62.4	60.4	50.1
Adj. RoE	30.3	20.1	36.8	66.4	44.6	46.3
Turnover ratios (x)						
Asset Turnover (Gross Block) (x)	2.9	2.8	2.6	2.4	2.3	2.3
Inventory / Sales (days)	178	190	179	189	191	172
Receivables (days)	180	217	211	187	177	171
Payables (days)	541	489	435	479	472	418
WC (days)	(183)	(82)	(45)	(103)	(104)	(76)
Leverage Ratios (x)						
D/E ratio (x)	0.0	0.0	0.0	0.0	0.0	0.0

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Bharat Electronics

1. Financial interest of research analyst or Angel or his Associate or his relative	No
2. Ownership of 1% or more of the stock by research analyst or Angel or associates or relatives	No
3. Served as an officer, director or employee of the company covered under Research	No
4. Broking relationship with company covered under Research	No

Ratings (Based on expected returns over 12 months investment period):

Buy (> 15%)

Accumulate (5% to 15%)
Reduce (-5% to -15%)

Neutral (-5 to 5%)
Sell (< -15)