

Bharat Electronics

Battlefield set.....Victory likely

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

Defense spending at an inflexion point: After years of lull, government announced 15.4% yoy increase in Defense Capital Budget to ₹94,588cr. In our view, we are 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 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) \$47bn worth of projects cleared by Defense Acquisition Council (DAC) in last 19 months, indicating faster clearances in place. Also high expectations are being built from soon to be released Defense Procurement Procedures (DPP). Current bid pipeline, which could lead to strong award activity for next few years, along with above-mentioned factors indicate that good times are ahead for Defense sector.

BEL to emerge as key beneficiary: At the backdrop of higher allocation made towards defense capex with ~\$47bn worth of projects cleared by DAC, we expect good times ahead for defense players, including BEL. BEL in FY2015 had market share of 37% in domestic defense electronics. On considering (1) 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 debt status with potential for further improvement in working capital cycle, all point out that BEL should maintain its strong market positioning in Defense Electronics space. On a whole, we expect BEL to emerge as key beneficiary of the revival in Defense capex cycle.

Outlook & Valuation: At the current market price of ₹1,206/share, BEL is trading at FY2016E and FY2017E P/E multiple of 22.3x and 19.6x, respectively. In the last 5 years, BEL's stock has traded at 1-year forward P/E multiple of 14.0x. We expect BEL to report a 12.4% top-line and 13.7% bottom-line CAGR during FY2015-18E; a similar growth rate is expected to be maintained beyond FY2017E as well. We expect BEL to trade at a premium to its historical valuations on account of the uptick in investment cycle, which indicates strong long-term growth prospects. The current low competitive intensity and the contention of it justifiably commanding a scarcity premium, being the largest listed defense player, make the stock all the more attractive. Considering the long-term growth prospects, which should stretch beyond FY2017E, we assign a 1-year forward P/E multiple of 23.0x to arrive at price target of ₹1,414/share. Given the 17% upside from the current levels, we initiate coverage on the stock with a BUY rating.

Key Financials

Y/E March (₹ cr)	FY13	FY14	FY15	FY16E	FY17E	FY18E
Net Sales	6,273	6,518	7,093	7,737	8,634	10,064
% chg	6.1	3.9	8.8	9.1	11.6	16.6
Net Profit	906	952	1,197	1,296	1,475	1,760
% chg	7.0	5.0	25.8	8.2	13.9	19.3
EBITDA (%)	10.6	14.1	16.6	16.8	17.2	17.6
EPS (₹)	38	40	50	54	61	73
P/E (x)	31.8	30.4	24.2	22.3	19.6	16.4
P/BV (x)	4.5	4.0	3.6	3.2	2.8	2.5
RoE (%)	30.3	20.1	36.8	39.3	45.6	51.8
RoCE (%)	26.6	23.9	30.7	28.5	29.0	30.5
EV/Sales (x)	3.8	3.8	3.3	2.9	2.5	2.0
EV/EBITDA (x)	35.6	26.4	19.5	17.0	14.2	11.2

Source: Company, Angel Research; CMP as of December 17, 2015

BUY

CMP ₹1,206
Target Price ₹1,414

Investment Period 12 Months

Stock Info

Sector	Capital Goods
Market Cap (₹ cr)	28,944
Net debt (₹ cr)	(6,013)
Beta	1.1
52 Week High / Low	1,386/869
Avg. Daily Volume	292,634
Face Value (₹)	10
BSE Sensex	25,804
Nifty	7,844
Reuters Code	BAJE.BO
Bloomberg Code	BHE@IN

Shareholding Pattern (%)

Promoters	75.0
MF / Banks / Indian Fls	14.7
FII / NRIs / OCBs	4.0
Indian Public / Others	6.3

Abs. (%)	3m	1yr	3yr
Sensex	(5.7)	(4.9)	33.3
BEL	1.6	29.9	208.7

3-Year Daily price chart



Source: Company, Angel Research

Yellapu Santosh

022 – 3935 7800 Ext: 6811

santosh.yellapu@angelbroking.com

Investment Rationale

Defense Sector spending at an inflexion point

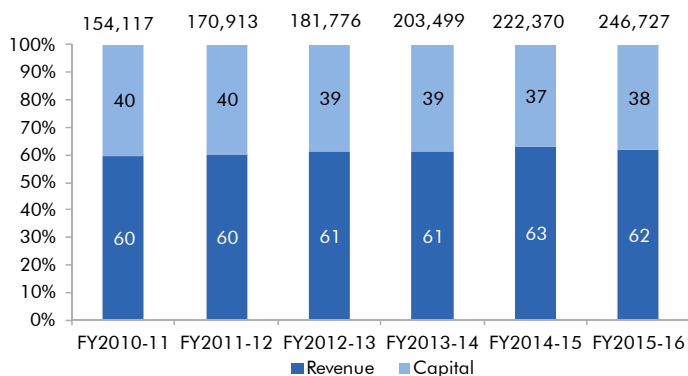
India's Defence spend during FY2010-11 to FY2014-15 has risen at 9.6% CAGR to ₹222,370cr. Notably, Capital expenditure has grown at a slower pace of 7.2% CAGR during the same period (Average of Defense capex during FY2011-12 to FY2015-16 (budgeted), accounts for 38% of the total Defense spends; lower than developed nations spending).

In our view, we are at an inflexion point where the Indian Defense capex cycle is entering a new era, with government spending cycle expected to see long-term uptrend. Our view strengthens on account of following recent developments, (1) Defense sector getting high priority in government's 'Make in India' campaign, where higher emphasis has been laid on the indigenization aspect, (2) increase in Defense sector FDI limit from 26% to 49%, and (3) faster clearance processes put into place (in 19 months after the NDA-led government having come into power, ~\$47bn worth of projects have been cleared by Defense Acquisition Council (DAC)). Amidst high expectations new Defense Procurement Procedures (DPP) are expected to be announced soon.

The table below ("DAC cleared projects under various stages of awarding [on page no. 3]) highlights that ~₹244,089cr worth of Defense projects are at awarding stages, and Defense companies like BEL could emerge as the biggest beneficiaries of any such revival in the awarding activity.

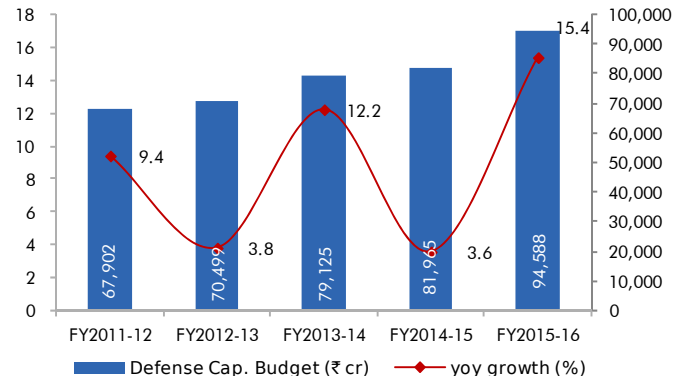
Recent Defense Acquisition Council (DAC) clearances and positive Defense Ministry announcements, indicate strong emerging bid pipeline for next few years, which in our view are multi-thousand crore opportunity. Given that Defense projects take longer time to materialize and are executed over 2-3 year periods, capex commitments for given year also capture part payments for equipments purchased earlier, thereby leaving lower budgeted spending towards purchase of new equipments. Accordingly, we can see some short-term delays in awarding activity, but long-term capex spending cycle is on an uptrend.

Exhibit 1: Defense Expenditure break-up...



Source: Company, Angel Research

Exhibit 2: Defence Cap. Exp Budget



Source: Company, Angel Research

Exhibit 3: DAC cleared projects under various stages of awarding

Sl. No.	Orders in the pipeline	Approx. value (₹ cr)	Comments
1	30 Weapon Locating Radars (Swati)	1,605	Cleared by DAC; to be awarded soon
2	2 French Airbus A-330 Aircrafts	5,100	Cleared by DAC; Radars mounted on the Aircraft would be made by DRDO
3	Ground based Mobile Electronic Intelligence System	NA	Cleared by DAC; BEL is the only domestic company to have worked on such project earlier; project to be awarded soon
4	36 Rafale Fighter Jets	60,000	Cleared by DAC; Govt. to soon sign agreement with French Govt. on this deal; 1 fighter Jet to be supplied within 3 years of signing the deal
5	8 Chetak Utility Helicopters	322	Cleared by DAC; To be ordered to HAL
6	4 Air Traffic Control (ATC) Radars (at Avantipur, Bhita, Panagarh and Purnia)	228	Cleared by DAC; to be awarded to BEL sooner
7	Handheld Thermal Imager with Laser Range Finders	4,000	Cleared by DAC; to be awarded to BEL sooner
8	Upgrade 428 L70 and Zu 23mm guns for the Army (Acceptance of Necessity)	16,900	Cleared by DAC; BEL and Punj Lloyd cleared technical evaluation round; Already executing ₹575cr project from Indian Army; final bid to be opened sooner
9	4 P81 Aircrafts	4,380	Cleared by DAC;
10	Upgrade of Weapon and Sensor suite of Delhi and Talwar Class Ships	2,900	Cleared by DAC;
11	4 large Survey Vessels for the Navy	2,324	Cleared by DAC; RFP to be announced sooner
12	Integrated Submarine Sonar - USHUS	NA	Cleared by DAC; BEL has the capabilities as it has earlier worked on such projects earlier
13	7 Akash-2 Surface-to-Air Squadrons (14 units) for Indian Airforce	4,790	Cleared by DAC; BEL being the lead vendor and integrator for IAF will be given the main contract under 'repeat order'; BEL manufactures surveillance radar, tracking radar, flight control centre, support systems and integrates the software; We expect BEL's share of the project to be ~₹850cr
14	6 P 751 Submarine (Diesel Engine)	64,000	Cleared by DAC; 8-member panel has inspected all the facilities; RFP to be soon invited; L&T, Mazgaon Dock and Pipavav Defense are strong contenders; BEL and DRDO could get small chunk of API/ Sonar related works, given the proximity to 5 shipyards identified by the 8-member panel
15	48 Mi 17 V-5 Choppers for Indian Airforce	6,966	DAC having negotiations with Russian entity
16	110 Naval Utility Helicopters	5,000	Cleared by DAC; 94 of the 110 are to be made in India; Companies other than BEL could emerge as the key beneficiaries as 11 JV's/ companies have shown interest
17	600 Unmanned Aerial Vehicles (UAVs)	NA	Director General of Infantry has already issued a Request for Information (RFI), to be followed by Request for Proposals (RFPs); 4 Foreign players (along with India JV partners) have participated in the RFI; BEL already is working on UAVs and is one of the JV bidders at the RFI stage;
18	10 metre Short Span Bridges (Vehicle Mounted)	490	Cleared by DAC; DRDO to benefit from this project
19	Mobile Integrated Electronic Warfare System, Samyukta	1,682	Cleared by DAC; BEL has already sold ~₹2,000cr worth of Electronic Warfare Systems to Indian Army over the years; Developed Samyukta along with DRDO; Expected to win this project as 'repeat order'; Could see competition from Tata Power SED
20	P-7 Heavy Drop Platform (used for Military Logistics)	402	Cleared by DAC;
21	Battlefield Management Systems	50,000	This order at very early stages; Awarding would happen only in FY2017
22	Tactical Communication Systems	13,000	This order at very early stages; Awarding would happen only in FY2017
		244,089	

Source: Media Articles, Company, Angel Research

Government machinery as well as media in various stances, have highlighted that various types of Defense Equipments currently used are either outdated or are obsolete. Government has taken due note of this and started addressing them one-by-one. Government in its recent budget allocated 15.4% yoy increase in Defense capital expenditure to ₹94,588cr.

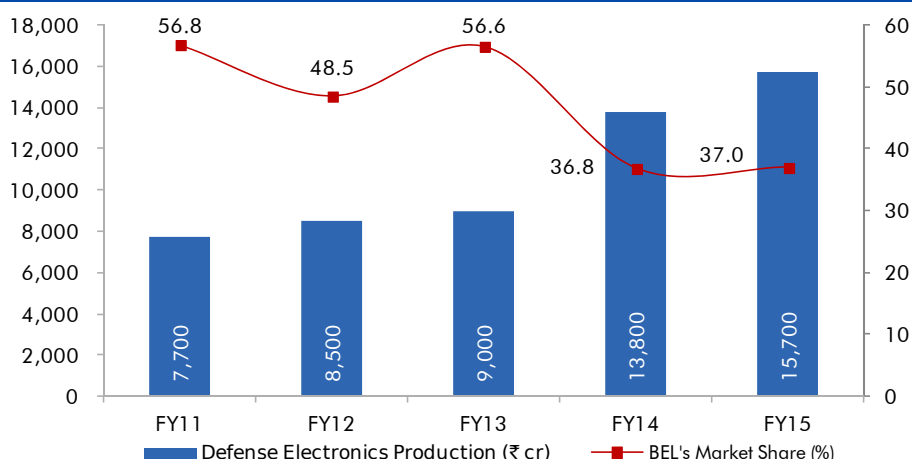
In addition to higher budgetary allocation, government has laid increased emphasis on domestic indigenization. The current bid pipeline focuses on domestic indigenization up to the extent of 75% of project value.

Higher budgetary allocation towards Defense sector (in the back-drop of ageing/ obsolete Defense Equipments), when coupled with government's thrust towards indigenization, strengthen our view that we are at inflexion point of multi-year increase in government spending towards Defense capex cycle. Based on order pipeline and projects cleared by DAC (Defense minister highlighted that ~\$35bn worth of projects would get cleared in FY2016), we estimate strong uptick in the domestic Defense capex cycle for next 2-3 years, post FY2016E.

Market share currently stands at ~37%....

Defense Electronics market, where BEL enjoys strong market positioning was gradually opened for private sector participation in FY2006-07. L&T, Astra Microwave, and Tata Power SED are the key domestic players in this space, which have their own manufacturing facilities. Even though the sector has been open for private sector participation, given the limited competition in Defense industry, BEL has reported its market share in the 37-57% range during FY2011-15.

Exhibit 4: Defense Electronic Production & BEL market share



Source: Dept. of Electronics & Information Technology, Angel Research

With government's increasing Defense sector capex allocation, new private players entered the Defense space using JV route and tying-up with foreign players. Most of the JV's that have shaped in the recent past have been formed with a focus on win 'platform'-based orders from emerging opportunities. Given that BEL focuses only on Defense Electronics space, which is less crowded, we do not see any major loss of market share for the company, going forward.

Exhibit 5: Recent Joint Ventures formed

JV Details	Segment
L&T (74%) & EADS (26%)	Defense Electronics Equipment
L&T (74%) & Thales (26%)	Avionics
BEL (74%) & Thales (26%)	Civilian & Defense Radars
Axis Aerospace & Tech. (74%) & Rosoboronexport (26%)	Avionics
Mahindra & Mahindra (74%) & Telephonics (26%)	Radar, Surveillance & Communication Systems

Source: Angel Research

Notably, 5 JV's have been formed in Defense Electronics space, Avionics and Radars and Surveillance space, the areas where BEL operates. Within areas where BEL operates, management highlighted that they are facing more competitive intensity across communications and night vision space than the traditional Radars and Defense Electronics space. Further, management clarified that 80-90% of contracts are won on nomination-basis. Considering all above-mentioned points, BEL's strong execution track record, when coupled with multi-fold growth in the bid pipeline, we are optimistic that the emerging competition would not eat much in to the growth prospects of BEL, for the next few years.

Order Inflows set to explode...

BEL during FY2013-15 has reported average yearly Order Inflows to the tune of ~₹5,000cr. The huge order inflows seen during FY2011-12 is on account of large order wins for Akash Missiles. Based on our interaction with BEL management, BEL is optimistic of winning projects north of ₹10,000cr in FY2016E itself. These are the projects where DAC has given the clearances, and BEL is either well placed to win them or get repeat orders for works done earlier.

Following table below highlights that, projects over ₹6,000cr are likely to be awarded to BEL in next few months:

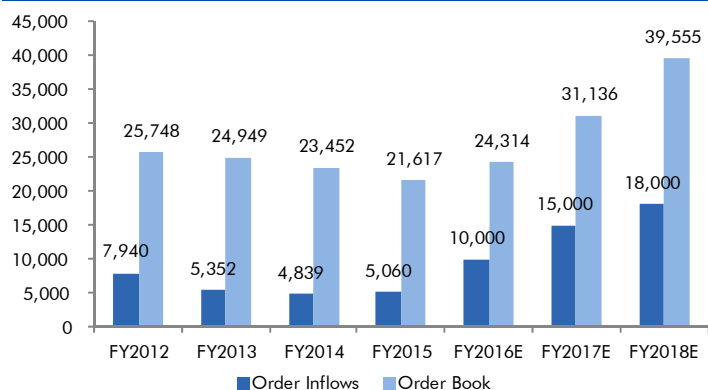
Exhibit 6: Near-term potential Order Inflows for BEL

Sl. No.	Orders in the pipeline	Approx. value (₹ cr)
1	30 Weapon Locating Radars (Swati)	1,605
2	Ground based Mobile Electronic Intelligence System	NA
3	4 Air Traffic Control (ATC) Radars	228
4	Handheld Thermal Imager with Laser Range Finders	4,000
5	Integrated Submarine Sonar - USHUS	NA
6	7 Akash-2 Surface-to-Air Squadrons for Indian Airforce	850
Total Value of projects in the pipeline		6,683

Source: Company, Angel Research

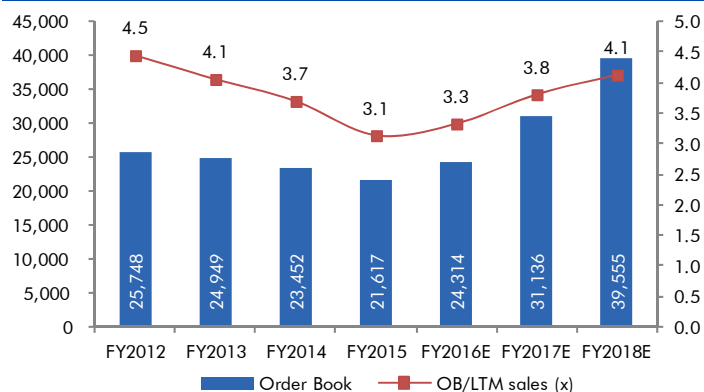
Our above estimates do factor works from the ₹4,790cr, 7 Akash-2 Surface-to-Air Squadrons (14 units) project, where BEL's scope of work in our view could be north of ~₹850cr. DAC has already cleared this project.

Exhibit 7: Order Inflow & Order Book movement



Source: Company, Angel Research

Exhibit 8: Order Book split to grow 1.8x by FY2018E



Source: Company, Angel Research

Again management has maintained optimism that they are strong contenders for the ₹50,000/13,000cr Battlefield Management System/ Tactical Communication System projects, which could be awarded in FY2017E.

On a whole, the strong bid pipeline and faster clearance process comforts us that Order Inflow scenario would improve sharply from here-on and companies like BEL should emerge as key beneficiaries. Accordingly, we expect BEL to report ~₹10,000/15,000cr worth of new orders during FY2016/2017E.

Defense order wins do not translate to immediate execution, as BEL has to get approval for Bulk Production Clearance (BPC) from its clients before it can go for commercial production. Hence, management had given a conservative revenue growth guidance of 8-10% for next few years. We have maintained our revenue growth estimate of 9.1%/11.6% for FY2016/17E, respectively. Our FY2017E revenue growth estimate is slightly ahead of management guidance, as we are optimistic that as execution cycle improves management would revise-up its revenue growth guidance for FY2017E.

As of 2QFY2016-end, BEL is sitting on an order book (OB) of ₹21,648cr (~3.1x OB/LTM revenues). We expect OB of the company to grow 1.8x during FY2015-18E to ₹39,555cr by FY2018-end.

12.4% revenue and 13.7% PAT CAGR during FY2015-18E...

Given that BEL has to get BPC before starting commercial production of Defense Equipments from its client, despite almost doubling of the Order Inflows, we expect BEL to report 12.4% revenue CAGR over FY2015-18E, majorly supported by execution of projects in their Order Book, esp. the Akash Missile project.

Few large ticket projects, including the ~₹6,500cr Akash Missiles project (won in FY2011-12) got delayed. Recent successful tests by the Indian Air Force (IAF) and receipt of BPC, gives better execution visibility of this project, now. Already ₹630cr of revenues have been booked from this project YTD FY2016.

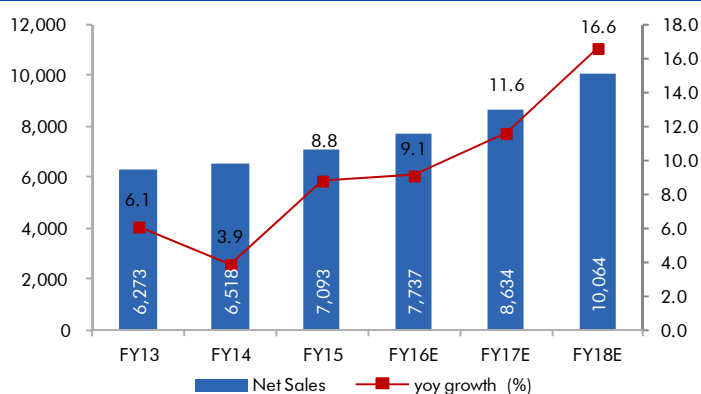
We expect BEL to report 12.4% revenue CAGR during FY2015-18E to ₹10,064cr (ahead of management's conservative 8-10% revenue growth outlook for next few years).

Even though BEL has evolved as Systems Integrator over last few years, by focusing more on R&D and increasing its focus on out-sourcing the non-core activities, we sense that their 2 major cost heads, employee costs and raw material costs, would continue to grow slightly behind revenue growth, thereby leaving some scope for EBITDA margin expansion from here-on.

We estimate raw material cost assumption, in-line with management commentary, that raw material costs is very much dependent on the product mix and it should remain in 55-60% range of revenues. On the employee's side, BEL every year has added 200-350 staff in last few years, mainly engineers/ scientists. At the same time BEL has reduced its staff strength from 11,545 employees in FY2010 to 9,703 employees in FY2015. We expect employee expenses as % of sales to decline from 18.1% in FY2015 to 15.5% by FY2018E.

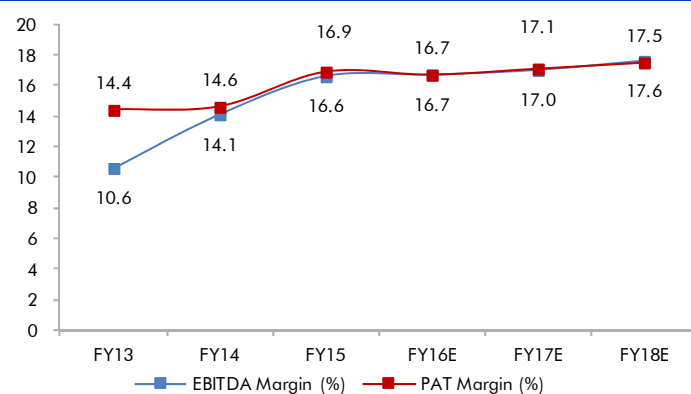
On a whole, we expect PAT margins to expand from 16.9% in FY2015 to 17.5% by FY2018E.

Exhibit 9: Revenue growth on uptrend...



Source: Company, Angel Research

Exhibit 10: EBITDA & PAT Margins (%) to expand...

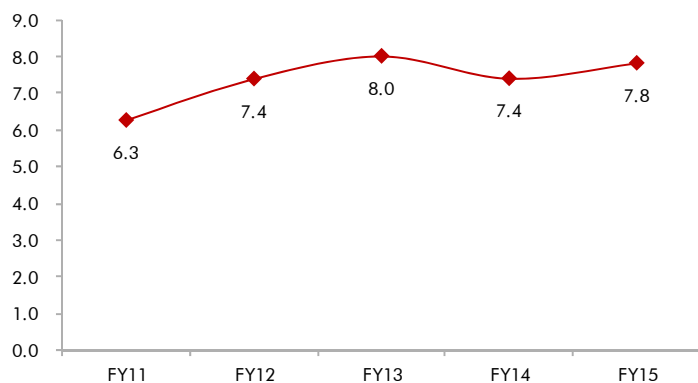


Source: Company, Angel Research

BEL to continue increasing its focus on R&D activities....

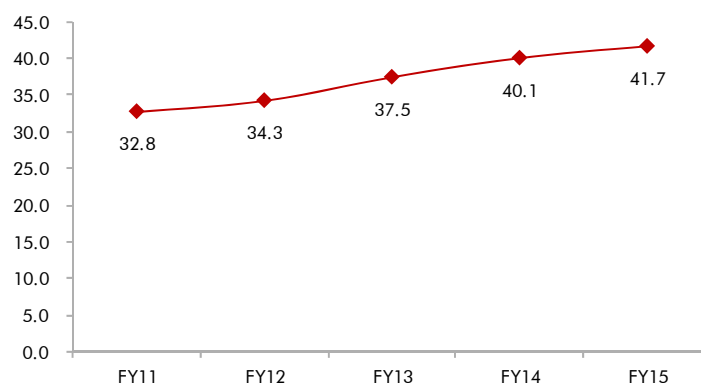
BEL is one of the exceptions to general perception that Public Sector Undertakings (PSU's) in India do not focus on technology upgrades. R&D spends as % of BEL's standalone sales increased from sub-5% levels in FY2007 (3.6%) to 7.8% by FY2015. Same time, mix of Scientist/ Engineers to total employees increased from 29.6% in FY2010 to 41.7% in FY2015.

Exhibit 11: R&D spend as % of Standalone Sales...



Source: Company, Angel Research

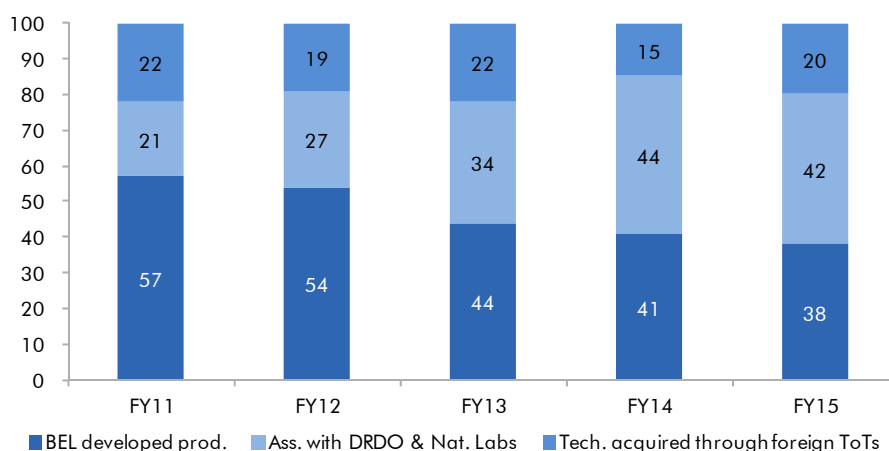
Exhibit 12: Scientist/Engineers as % of Employees...



Source: Company, Angel Research

Higher in-house R&D spends, strong tie-ups with National Laboratories (including Defense Research and Development Organization) and increased in-house dependency on Scientists/ Engineers has helped BEL lower its revenue dependency on foreign transfer of technology (ToTs) agreements. This can be seen from the below table that revenues derived from technology acquired through foreign ToTs has been stable at ~20% levels.

Exhibit 13: Higher contribution from indigenously developed products..



Source: Company, Angel Research

This strategy of maintaining lower dependency on foreign ToTs, should avoid any major volatility in earnings of the company. BEL management has maintained that it would continue to pursue its strategy of increasing its focus on R&D and outsource the non-core works. Management highlighted that they intend to set-up a new R&D centre in Bangalore and further increase their R&D spends as % of sales to ~10%, going forward.

Higher R&D spends in our view, would bridge the gaps in their current product offerings and make them more efficient to the private players product offerings.

To continue capex to strengthen their product offerings...

BEL during FY2012-2015 has spent on an average of ₹300cr yearly towards the capex. With improved visibility on the defense investment cycle, and government

increasingly emphasizing on upgrading the Defense technologies, BEL acknowledging their product gaps (at the technology level), identified the need to strongly further pursue the capex. Accordingly, the company has announced to pursue ₹400-500cr of yearly capex for the next 3-5 years.

Exhibit 14: Capex pipeline for the next few years

Capex details	Location, State	Comments
New Missile Integration Range	Anantapur, A.P.	To be set-up across 950 acres of land; proposed capex to the tune of ₹500cr; would take at least 3 years for operations to commence;
Test bed for Missile Systems	Bangalore, Karnataka	Spread across 14 acres, this facility has started operations in Sep-2015
Sonar Transducer Integration & Testing Facility	Bangalore, Karnataka	BEL is supporting Atlas Elektronik on supply of 6 Sonars (as part of contract, technology would be transferred to BEL); Expect ramp-up in capex towards this facility from FY2017 onwards;
Additional Near Field Test Range (NFTRs)	Bangalore, Karnataka & Ghaziabad, U.P.	
Manufacture Zinc Sulphide (ZnS) Domes		
Highly Accelerated Life Test & Stress Screening Facility		
Tactical Communication System (TCS) Test Bed		
Battlefield Management System (BMS) Test Bed		
Robotic Welding Facility		
50MW Solar Power Plant		
Wind Energy Power Plant		

Source: Company, Angel Research

Test bed for Missile Systems, Bangalore commenced operations in Sep-2015. Whereas, Sonar Integration & Testing facility, Bangalore and Missile Integration Range facility, Anantapur would not commence operations before FY2017E.

With roll-out of these modernization as well as expansion projects, we expect BEL to strengthen its product portfolio in the long-run, which in turn should help them support their key domestic client requirements. This on whole should lead to better revenue growth visibility in the long-run.

Strong BS, Adj. RoE's to expand to ~52% by FY2018E...

BEL is a cash rich company, sitting on net cash (adj. for debt, consol.) of ₹6,103cr. Noticeably, this cash rich position is despite the point that debtors and inventory position of BEL has deteriorated over the last few years. Management attributed payment delays and bureaucratic functioning, as key reasons for working capital cycle deterioration.

In our view, stretch in working capital cycle is also attributable to BEL's transition from being pure play products supplier to Systems Integrator (material costs increased sharply owing to high proportion of bought-out items for a project).

BEL in our view has reached later stages of the transition process from being a products developer to Systems Integrator. Our view stems from the point that (1) BEL works with ~800 indigenous vendors in the domestic markets, and (2) intends to further increase its R&D spends to 10% going forward. These pointers put BEL as India's largest Systems Integrator in the Defense space.

In the back-drop of higher budgetary allocation towards Defense capex, strong bid-pipeline emerging, where BEL should see strong order inflow growth, roll-out of new simplified Defense Procurement Procedure (DPP) in next few months, comfort us that BEL's Working Capital cycle should gradually improve, going forward.

Considering uptick in earnings growth, improvement in working capital cycle, we expect BEL to report improvement in its Adj. Return on Equity (RoE) levels from 20.1% in FY2014 to 51.8% by FY2018E. On a whole, BEL should continue to report expansion in its Adj. RoEs during FY2016-18E.

BEL management has announced that it is pursuing yearly capex of ~₹400-500cr for next 3-5 years. We expect BEL to generate over ₹1,100cr of yearly cash flow from operations, which should support their yearly capex plans of ₹400-500cr. Going forward, we do not see BEL depending on debt to pursue its proposed capex.

About the Company

Bharat Electronics Ltd. (BEL) is 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 over the years has grown to be 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 their current Order Book contribution coming-in from their largest business segment- Radars, Sonars & Weapons Systems.

Exhibit 15: 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 16: 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

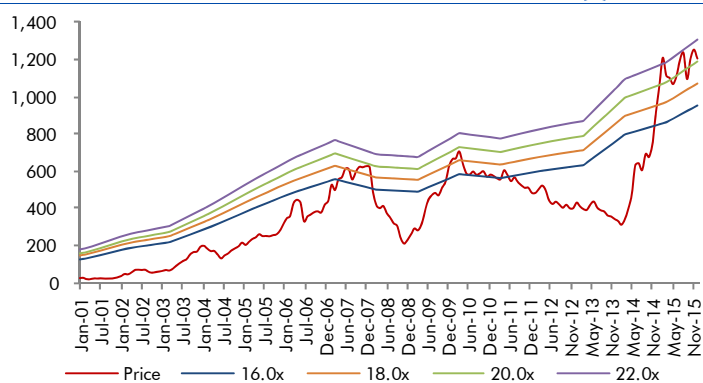
Valuation

BEL in our view is expected to emerge as the key beneficiary of (1) increase in the long-term defence spending and (2) government's indigenization push (as can be seen from their Make-in-India drive). Also, these positives when coupled the strong market positioning within the niche area where BEL operates comforts us that good days are ahead for BEL stock. We expect BEL to report doubling of the order inflows to ₹10,000cr in FY2016E and to further accentuate to ₹15,000cr in FY2017E. Accordingly, the OB of the company would increase from ₹21,648cr (OB/TTM sales ratio of 3.1x) to ₹39,555cr (OB/TTM sales ratio of 4.1x). Despite the strong ordering trends, given that longer time taken to get bulk production clearances from the clients, management has given conservative 8-10% top-line growth for next few years. We are optimistic, that BEL management would revise upwards the revenue growth numbers as defense processes get more streamlined and visibility on the execution front improves.

At the current market price of ₹1,206/share, BEL stock is trading at FY2016E and FY2017E P/E multiple of 22.3x and 19.6x, respectively. Historically, in the last 5 years, BEL's stock has traded at a 1-year forward P/E multiple of 14.0x.

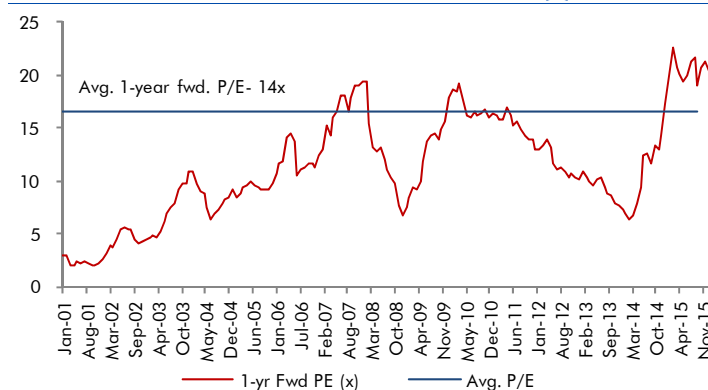
We expect BEL to report 12.4% top-line and 13.7% bottom-line CAGR during FY2015-18E, with such strong growth expected to sustain beyond FY2017 as well. We expect BEL to trade at premium to its historical valuations on account of the uptick in the investment cycle, which indicates strong long-term growth outlook with lesser competitive business threat and scarcity premium it enjoys being the largest listed defense player. Considering the long-term growth prospects, which should stretch beyond FY2017E, we have assigned 1-year forward P/E multiple of 23.0x.

Exhibit 17: 1-year forward P/E multiple band (x)



Source: Angel Research

Exhibit 18: 1-year forward Avg. P/E band (x)



Source: Angel Research

Our target multiple of 23.0x captures, (1) strong business uptick in FY2016/17E, which is expected to last for few years, (2) strong market positioning amidst increasing competitive intensity, (3) debt free company with adj. RoE expansion potential (to expand to 51.8% by FY2018E). On assigning 23.0x P/E multiple to our FY2017E EPS estimate of ₹61/share, we arrive at price target of ₹1,414/share. **Given the 17% upside from current levels, we initiate coverage on BEL stock with Buy rating.**

ANNEXURE
Exhibit 19: Major Orders executed in FY2015

Sl. No.	Particulars of Orders executed
1	Akash Weapon System
2	Passive Night Vision Devices
3	3D Tactical Control Radar
4	Missile Warning System
5	Schilka Gun Tank Upgrade
6	Laser Range Finder
7	Hull Mounted Sonar
8	Shipborne EW System (Sanket)
9	Fire Control Systems
10	Electronic Voting Systems

Source: Company

Exhibit 20: Major Projects planned during FY2016

Sl. No.	Particulars of Orders executed
1	Akash Missile System
2	3D Tactical Control Radar
3	Low level Light Weight Radar
4	Handheld Thermal Imagers
5	Schilka Gun Tank Upgrade
6	L70 Gun Upgrade
7	New Generation Hull Mounted Sonar
8	Gigabyte Ethernet based Ship Data Network
9	Combat Management System
10	Shipborne Electronic Warfare System
12	Fire Control Systems
13	Electronic Voting Systems

Source: Company

Risks to our Estimates

- To increase indigenization in the defense sector, Government of India (GoI) increased the FDI limit in Defense sector to 49% in Jul-2014. Till now, recent developments/ announcements have failed to attract any major international defense players in to India. With more positive announcements expected and 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 assumptions.
- Last few years have seen sluggish ordering activity from the Defense sector. Even though Defense sector in the last few months has seen positive announcements, any further delays in the awarding activity, could act as risk to our estimates.
- Management highlighted that it is working on improvising some areas of the technology part, which are a gap currently. BEL's management's inability to form tie-ups with international MNC's or absorb the technology from foreign vendors could impact its financials, going forward.
- 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 delaying the 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.
- Defense Ministry has been asked by government to set-up 300MW of power plants. In line with this broader goal, BEL has decided to set-up 50MW of solar power plant. This is an area of unrelated business entry for BEL (even though BEL claims that it makes voltaic modules amongst other parts).

Profit and Loss Statement

Y/E March (₹ cr)	FY13	FY14	FY15	FY16E	FY17E	FY18E
Net Sales	6,273	6,518	7,093	7,737	8,634	10,064
% Chg	6.1	3.9	8.8	9.1	11.6	16.6
Total Expenditure	5,610	5,596	5,918	6,440	7,153	8,289
Raw Materials Consumed	3,156	3,344	3,495	3,870	4,384	5,141
Purchase of stock-in-trade	760	444	440	467	515	580
Employee benefits Expense	1,125	1,046	1,281	1,343	1,406	1,564
Other Expenses	569	762	702	760	847	1,004
EBITDA	663	922	1,175	1,297	1,481	1,775
% Chg	4.3	39.1	27.4	10.4	14.2	19.8
EBITDA %	10.6	14.1	16.6	16.8	17.2	17.6
Depreciation	136	150	166	193	216	239
EBIT	526	772	1,008	1,104	1,265	1,537
% Chg	3.2	46.6	30.6	9.4	14.6	21.4
Interest and Financial Charges	1	4	3	3	3	3
Other Income	625	437	507	544	611	709
EBT before Excep. & prior-period items	1,151	1,205	1,513	1,645	1,874	2,242
Exceptional Items & Prior period Items	(9)	1	1	0	0	0
EBT	1,142	1,206	1,513	1,645	1,874	2,242
Tax Expenses	236	254	316	349	398	482
% of PBT	20.7	21.1	20.9	21.2	21.2	21.5
PAT before Minority Interest	906	952	1,197	1,296	1,476	1,760
Minority Interest	0	0	(0)	0	0	1
PAT	906	951	1,197	1,296	1,475	1,760
% Chg	7.0	5.0	25.8	8.2	13.9	19.3
PAT %	14.4	14.6	16.9	16.7	17.1	17.5
Diluted EPS	114	119	150	54	61	73
% Chg	7.6	4.4	25.8	8.2	13.9	19.3

Balance Sheet

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	8,852	9,975	11,348
Networth	6,487	7,220	8,117	9,092	10,215	11,588
Total Debt	0	0	25	0	0	0
Minority Int. & Govt. Grants	163	224	207	203	202	202
Other Long-term Liab. & Prov.	386	365	435	441	476	483
Total Liabilities	7,037	7,809	8,784	9,736	10,893	12,273
Application of Funds						
Gross Block	2,106	2,366	2,894	3,276	3,681	4,104
Accumulated Depreciation	1,506	1,671	1,821	2,014	2,230	2,469
Net Block	600	695	1,073	1,262	1,451	1,635
Capital WIP & Intan. Assets Dev.	328	458	140	110	105	100
Investments	0	0	0	0	0	0
Current Assets						
Inventories	3,255	3,340	3,424	3,664	3,864	4,244
Sundry Debtors	3,364	4,156	3,805	4,146	4,707	5,476
Cash and Bank Balance	5,331	4,605	6,038	6,901	7,938	9,042
Loans & Advances	1,378	1,190	684	750	800	780
Other Current Asset	81	69	54	55	57	59
Current Liabilities	7,814	7,166	6,941	7,663	8,547	9,589
Net Current Assets	5,594	6,192	7,064	7,852	8,818	10,012
Other Assets	515	464	506	512	520	525
Total Assets	7,037	7,809	8,784	9,736	10,893	12,273

Cash Flow Statement

Y/E March (₹ cr)	FY13	FY14	FY15	FY16E	FY17E	FY18E
Profit before tax	1,147	1,206	1,513	1,645	1,874	2,242
Dep. & Other Non-cash Chrg.	(338)	(336)	(163)	(266)	(218)	(225)
Change in Working Capital	(2,104)	(1,237)	436	75	71	(90)
Interest & Financial Charges	1	4	3	3	3	3
Direct taxes paid	(245)	(206)	(356)	(349)	(398)	(482)
Cash Flow from Operations	(1,540)	(569)	1,434	1,108	1,332	1,448
(Inc)/ Dec in Fixed Assets	(353)	(369)	(225)	(351)	(400)	(418)
(Inc)/ Dec in Inv. & Oth. Adj.	2,106	1,128	(614)	302	238	142
Cash Flow from Investing	1,753	759	(839)	(49)	(162)	(277)
Issue/ (Buy Back) of Equity	0	0	0	0	0	0
Inc./ (Dec.) in Borrowings	0	(0)	25	(25)	0	0
Dividend Paid (Incl. Tax)	(157)	(209)	(220)	(301)	(331)	(364)
Interest Expenses & Oth. Adj.	(1)	(4)	(14)	(3)	(3)	(3)
Cash Flow from Financing	(157)	(213)	(209)	(329)	(334)	(367)
Inc./ (Dec.) in Cash	56	(23)	386	730	837	804
Opening Cash balances	1,752	1,809	1,786	2,171	2,901	3,738
Closing Cash balances	1,809	1,786	2,171	2,901	3,738	4,542

Key Ratios

Y/E March	FY13	FY14	FY15	FY16E	FY17E	FY18E
Valuation Ratio (x)						
P/E (on FDEPS)	31.8	30.4	24.2	22.3	19.6	16.4
P/CEPS	27.6	26.3	21.2	19.4	17.1	14.5
Dividend yield (%)	1.6	1.6	1.2	1.1	1.0	0.9
EV/Sales	3.8	3.8	3.3	2.9	2.5	2.0
EV/EBITDA	35.6	26.4	19.5	17.0	14.2	11.2
EV / Total Assets	3.4	3.1	2.6	2.3	1.9	1.6
Per Share Data (₹)						
EPS (fully diluted)	38	40	50	54	61	73
Cash EPS	44	46	57	62	70	83
DPS	7.4	7.8	9.7	10.7	11.8	13.0
Book Value	270	301	338	379	426	483
Returns (%)						
RoCE (Pre-tax)	26.6	23.9	30.7	28.5	29.0	30.5
Angel RoIC (Pre-tax)	35.8	35.0	36.4	41.4	45.4	51.4
RoE	30.3	20.1	36.8	39.3	45.6	51.8
Turnover ratios (x)						
Asset Turnover (Gr. Block) (x)	2.9	2.8	2.6	2.4	2.4	2.5
Inventory / Sales (days)	178	190	179	172	163	150
Receivables (days)	180	217	211	193	192	189
Payables (days)	541	489	435	414	414	399
WC (days)	(183)	(82)	(45)	(50)	(59)	(61)
Leverage Ratios (x)						
D/E ratio (x)	0.0	0.0	0.0	0.0	0.0	0.0

Research Team Tel: 022 - 39357800

 E-mail: research@angelbroking.com

 Website: www.angelbroking.com

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Disclosure of Interest Statement

	BEL
1. Analyst ownership of the stock	No
2. Angel and its Group companies ownership of the stock	No
3. Angel and its Group companies' Directors ownership of the stock	No
4. Broking relationship with company covered	No

Note: We have not considered any Exposure below ₹1 lakh for Angel, its Group companies and Directors

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)