Angel Broking
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Hindustan Aeronautics Limited

Hindustan Aeronautics Limited (HAL) is the largest defence public sector undertakings (DPSU) in terms of value of production in FY2017. HAL is engaged in the design, development, manufacture, repair, overhaul, upgrade and servicing of a wide range of products including aircraft, helicopters, aero-engines, avionics, accessories and aerospace structures.

Niche player in the aerospace – HAL has proven its research, design and development capabilities by indigenously developing military aircraft and helicopters (like Tejas, Ajeet, Marut, HPT-32, Kiran) as well by manufacturing under license with foreign partners (like MiG 21FL/M/BIS, MiG-27, Jaguar, Dornier-228, Su-30MkI, Hawk-k132). With government's continued focus on 'Make in India', the company is likely to benefit from the opportunities in the defense aerospace. It also plans to foray in civil aerospace and ramp up its export business, which could provide positive boost in future.

Robust order book provides revenue visibility - Its order book stood robust at ₹68461cr (~3.8x FY17 revenue) as of December 31, 2017 which generally includes products and services to be manufactured and delivered and excludes anticipated revenues from its joint ventures and subsidiaries. Products forms over 90% of the order book which is to be executed over a period of 3-4 years. Services contract worth ₹ 6000+ cr is to be executed on annual basis.

Advance payment model is boosting other income- Its order execution cycle is fairly long at 3-4 years, for which it receives 85-90% of the order value as advance from its main customer – Government of India. This advance payment model has built up huge cash reserves (₹ 11700 cr at the end of H1FY18) on which HAL earns interest income in excess of ₹1000 cr on annual basis.

Outlook & Valuation: At the upper end of the price band, the P/E multiple works out be 15.8x (current equity base) of FY17 EPS. We expect HAL to maintain a healthy growth trajectory in the coming few years, considering its robust order book, opportunity in the defence space. It is also a good dividend play with over 30% of the yearly earnings mandated to be paid as dividend. **We recommend 'SUBSCRIBE' on the issue for a mid-to-long term period.**

Key Financial

Y/E March (Rs cr)	FY2015	FY2016	FY2017	H1FY2018
Net Sales	**15,939**	**16,758**	**17,952**	**5,173**
% chg		*5.1*	*7.1*	-
Net Profit	**994.0**	**2,004.0**	**2,624.8**	**391.0**
% chg		*101.6*	*31.0*	-
OPM (%)	6.1	14.8	18.2	9.2
EPS (Rs)	**29.7**	**59.9**	**78.5**	**11.7**
P/E (x)	41.7	20.7	15.8	-
P/BV (x)	1.1	1.6	1.4	
RoE (%)	5.9	18.2	20.9	-
RoCE (%)	0.9	14.6	18.9	-
EV/Sales (x)	1.5	1.6	1.7	-
EV/EBITDA (x)	24.0	11.0	9.3	-

*Source: RHP, Angel Research; Note: * at upper end of the price band, equity base post recent buy back*

SUBSCRIBE

Issue Open: March 16, 2018
Issue Close: March 20, 2018

Post Eq. Paid up Capital: ₹334.4cr

Issue size (amount): ₹4,113-4,198 cr

Price Band: *₹1215-1240

Lot Size: 12 shares and in multiple thereafter

Post-issue implied mkt. cap: ₹40,628 – 41,464 cr

Promoters holding Pre-Issue: 100%

Promoters holding Post-Issue: 90%

** discount of ₹25 for retail customers*

Book Building	
QIBs	50% of issue
Non-Institutional	15% of issue
Retail	35% of issue

Post-Issue Shareholding Pattern	
Promoters	90%
Others	10%

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Company background

Incorporated in 1963, Hindustan Aeronautics Limited (HAL) is the largest Defence Public Sector Undertakings (DPSU) in terms of value of production according to the MoD Annual Report 2016-2017. They are the 39th largest Aerospace Company in the world in terms of revenue (in USD million) in 2016 according to Flight International. As of December 31, 2017, HAL owned 2 Trademarks, 7 Patents, 11 Design Registrations and 77 Copyrights. The Indian Defence Sector (IDS) contributed 91.4%, 93.3%, 94.2% and 92.6% of 6 months ended September 30, 2017 and financial year 2017, 2016 and 2015 revenues, respectively. HAL also exports their products and services, primarily spares, to more than 13 countries.

Details of operation

Its operations are organised into five complexes, namely the Bangalore Complex, MiG Complex, Helicopter Complex, Accessories Complex, and Design Complex, which together include 20 production divisions and 11 research and design centres (R&D Centres) located across India. It rely on indigenous research as well as enter into technology transfer and licence agreements to manufacture our products. In addition, it has entered into 13 commercial joint ventures to grow our operations.

The company also takes up maintenance and overhaul services to cover the life cycle requirement of all the old and new products. Presently, 13 types of aircraft/ helicopters and 17 types of engines are being overhauled. In addition, facilities exist for repair/ overhaul of various accessories and avionics fitted on aircraft of Russian, Western and Indigenous designs.

Current programs under progress

The current programs under progress at HAL are production of SU-30 MKI, Hawk-AJT, Light Combat Aircraft (LCA), DO-228 Aircraft, Dhruv-ALH and Cheetal Helicopters, Repair Overhaul of Jaguar, Kiran MkI/IA/II, Mirage, HS-748, AN-32, MiG 21, Su-30MKI, DO-228 aircraft and ALH, Cheetah / Chetak helicopters.

Issue Details

This IPO is an offer for sale of up to 3.41 cr equity shares of face value of Rs10 each by the Selling Shareholders. Issue would be worth ₹4113-4198 cr.

Exhibit 1: Pre and post-IPO shareholding pattern

	No of shares (Pre-issue)	%	No of shares (Post-issue)	%
Promoter	33,43,87,500	100%	30,02,79,975	89.8%
Public			3,41,07,525	10.2%
Total	33,43,87,500	100%	33,43,87,500	100.0%

Source: RHP, Angel Research

Objects of the offer

This IPO intends to achieve the benefits of listing the equity shares on the stock exchanges via sale of equity shares by the selling shareholders.

Key Management Personnel

Brief profiles of our Directors

Mr. T. Suvarna Raju was appointed as Chairman of the company with effect from March 5, 2015. Subsequently, he was re-designated as Chairman & Managing Director (CMD) with effect from April 1, 2015. He joined HAL as a management trainee in 1980 and thereafter worked in various capacities. He holds a bachelor's degree in mechanical engineering from Andhra University, master's degree in business administration from Bangalore University and masters' of philosophy in defence and strategic studies from the University of Madras.

Mr. V. M. Chamola is Director (Human Resources) with effect from July 27, 2011. He holds a bachelor of science degree and a masters degree in economics from Garhwal University, Bachelor of Laws from Avadhesh Pratap Singh University, Rewa, and a master's degree in business administration from the Indira Gandhi National Open University.

Mr. C.V. Ramana Rao is the Director (Finance) with effect from February 1, 2016 and also the Chief Financial Officer. He joined HAL as Assistant Systems Audit Officer in 1985. He holds bachelor of arts degree from Bangalore University. He is a qualified Chartered Accountant. Prior to joining our Company, he was associated with M/s K.P. Rao & Co., Bangalore. He has more than 35 years of work experience in the field of finance.

Mr. Damal Kannan Venkatesh is the Director (Engineering and Research and Development) of the Company with effect from November 27, 2015. He joined Company as a Management Trainee in 1980. Besides holding a bachelor of engineering degree in mechanical engineering from the South Gujarat University, he also holds a post-graduate diploma in management from the Indira Gandhi National Open University. He has over 37 years of work experience in the aerospace industry.

Key risks

Volatility in earnings

Despite long execution period of 3-4 years for aircrafts, the company recognizes revenues only on delivery of aircrafts. This could lead to high volatility in revenues and earnings in the event of delays in deliveries.

Dependence on government

The company derives major chunk of revenue from government. Hence any delay in budget approval, change in procurement and payment policy of government could negatively affect its revenue offtake and profitability.

Changing technology

Aerospace industry is heavily R&D driven and since the product execution cycle is long, any major technological changes in the aerospace could disrupt its business prospects.

Consolidated Profit & Loss Statement

Y/E March (Rs cr)	FY2015	FY2016	FY2017	H1FY2018
Total operating income	**15,939**	**16,758**	**17,952**	**5,173**
% chg		*5*	*7*	
Total Expenditure	**14,967**	**14,285**	**14,689**	**4,694**
Raw Material	8,917	9,120	9,744	2,120
Personnel	3,403	3,274	3,570	1,798
SGA Expenses	197	234	252	-
Others Expenses	2,448	1,657	1,123	777
EBITDA	**972**	**2,474**	**3,263**	**478**
% chg		*154*	*32*	
(% of Net Sales)	*6*	*15*	*18*	*9*
Depreciation& Amortisation	822	863	713	258
EBIT	**150**	**1,611**	**2,550**	**221**
% chg		*976*	*58*	-
(% of Net Sales)	*1*	*10*	*14*	*4*
Interest & other Charges	15	6	16	1
Other Income	1,651	1,608	1,059	389
(% of PBT)	*92*	*50*	*29*	*64*
Share in profit of Associates	-	-	-	1
Recurring PBT	**1,786**	**3,213**	**3,592**	**610**
% chg		*80*	*12*	
Tax	792	1,209	967	219
(% of PBT)	*44*	*38*	*27*	*36*
PAT (reported)	**994**	**2,004**	**2,625**	**391**
Extraordinary Items	-	-	-	-
ADJ. PAT	**994**	**2,004**	**2,625**	**391**
% chg		*102*	*31*	
(% of Net Sales)	*6*	*12*	*15*	*8*
Basic EPS (Rs)*	**29.7**	**59.9**	**78.5**	**11.7**
% chg		*102*	*31*	

Source: RHP post buy back*

Consolidated Balance Sheet

Y/E March (₹ cr)	FY2015	FY2016	FY2017	H1FY2018
SOURCES OF FUNDS				
Equity Share Capital	482	362	362	361.5
Reserves& Surplus	16,322	10,671	12,198	12582
Shareholders' Funds	**16,804**	**11,032**	**12,559**	**12,944**
Equity Share Warrants	-	-	-	
Total Loans	165	-	950	
Other Liabilities	10,286	12,034	12,441	13,318
Deferred Tax Liability	-	-	-	
Total Liabilities	**27,255**	**23,067**	**25,950**	**26,262**
APPLICATION OF FUNDS				
Gross Block	11,665	11,770	12,635	16076
Less: Acc. Depreciation	4,299	4,845	5,381	7733
Net Block	**7,366**	**6,925**	**7,253**	**8,342**
Capital Work-in-Progress	235	1,025	1,487	535.8
Investments	570	916	994	1018.8
Others				1938.3
Current Assets	54,943	45,726	40,170	42,008
Inventories	25,188	23,982	21,321	22,184
Sundry Debtors	6,292	4,837	4,210	4,255
Cash	17,768	13,303	11,153	11,699
Loans & Advances	5,695	3,604	3,485	107
Other Assets	-	-	-	3,763
Current liabilities	35,471	32,650	24,642	26621
Net Current Assets	**19,472**	**13,075**	**15,528**	**15,387**
Deferred Tax Asset	**(1,614)**	**(815)**	**(960)**	**(960)**
Mis. Exp. not written off	1,226	1,940	1,647	-
Total Assets	**27,255**	**23,067**	**25,950**	**26,262**

Source: RHP

Consolidated Cash Flow Statement

Y/E March (₹ cr)	FY2015	FY2016	FY2017	H1FY18
Profit before tax	3191	3223	3601	600
Depreciation	821	863	713	258
Interest / Dividend (Net)	(1614)	0	10	1
Direct taxes paid	(902)	(861)	(1037)	(384)
Change in Working Capital+others	(10379)	(77)	(3692)	1441
Cash Flow from Operations	**(8883)**	**3148**	**(405)**	**1915**
(Inc.)/ Dec. in Fixed Assets	(885)	(312)	(312)	(395)
(Inc.)/ Dec. in Investments	1595	1659	3327	(141)
Cash Flow from Investing	**710**	**1347**	**3014**	**(536)**
Interest / Dividend (Net)	(15)	(5266)	940	(951)
Others	(1259)	(614)	(1104)	0
Cash Flow from Financing	**(1274)**	**(5880)**	**(164)**	**(951)**
Inc./(Dec.) in Cash	(9447)	(1385)	2446	428
Opening Cash balances	**11238**	**1729**	**344**	**2790**
Closing Cash balances	**1791**	**344**	**2790**	**3219**

Source: RHP

Key Ratios

Y/E March	FY2015	FY2016	FY2017
Valuation Ratio (x)*			
P/E (on FDEPS)	41.7	20.7	15.8
P/CEPS	9.9	6.3	5.4
P/BV	1.1	1.6	1.4
EV/Sales	1.5	1.6	1.7
EV/EBITDA	24.0	11.0	9.3
EV / Total Assets	0.9	1.2	1.2
Per Share Data (₹)			
EPS (Basic)	29.7	59.9	78.5
EPS (fully diluted)	29.7	59.9	78.5
Cash EPS	54.3	85.7	99.8
Returns (%)			
ROCE	0.9	14.6	18.9
Angel ROIC (Pre-tax)	(10.9)	(50.5)	187.2
ROE	5.9	18.2	20.9
Turnover ratios (x)			
Asset Turnover (Gross Block)	1.4	1.4	1.4
Inventory / Sales (days)	577	522	434
Receivables (days)	144	105	86
Current liabilities (days)	1,868	1,572	972
Working capital cycle (ex-cash) (days)	(1,147)	(944)	(453)

*Source: RHP, Angel Research * post buy back*

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