

VISIT UPDATE

MID CAP

Share Data

Reuters code	BEL.BO
Bloomberg code	BHE IN
Market cap. (US\$ mn)	1,386
6M avg. daily turnover (US\$ mn)	0.5
Issued shares (mn)	80
Target price (Rs)	1,490

Performance (%)	1M	3M	12M
Absolute	(8)	(15)	(12)
Relative	(15)	(20)	(17)

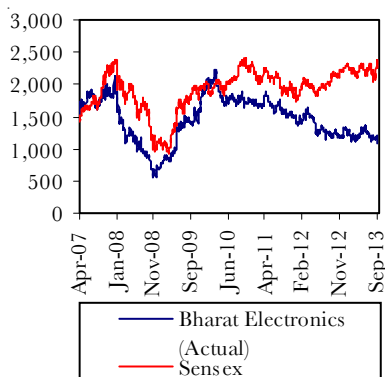
Valuation Ratios

Yr to 31 Mar	FY14E	FY15E
EPS (Rs)	108.5	124.2
+/- (%)	(3.1)	14.5
PER (x)	10.0	8.7
PBV (x)	1.2	1.1
Dividend/Yield (%)	2.3	2.3
EV/EBITDA (x)	3.7	2.2

Major shareholders (%)

Promoters	76
FII's	4
MF's	5
BFSI's	10
Public & Others	5

Relative performance



Bharat Electronics

Maintain BUY

Price: Rs 1,090

BSE Index: 19,901

23 September 2013

Forex fluctuation to impact near term margins, structural drivers intact

We recently met the management of Bharat Electronics (BEL) at its AGM and following are the key takeaways:

Increase in order intake guidance improves the growth visibility - Order intake guidance has been increased from Rs 60 bn to Rs 80-100 bn, majorly due to the expected awarding of ~ Rs 28 bn of tank electronics order for T-90/T-72 and BMP. Weapon locating radar (Rs 20 bn), Multi function thermal image (Rs 11 bn), Varuna, Himsakthi, missile approach warning system and EVMs are other major orders expected in FY14E. Management is confident in achieving the MOU revenue target of Rs 67.5 bn and is successfully progressing with Lynx U2 development with indigenous technology post black listing of Rheinmetall AG.

Forex fluctuation to impact margins, free cash to increase - With the depreciation of rupee, the raw material cost will be higher impacting the overall operating margins of BEL. Company is exposed to currency risk for Exchange rate variation (ERV) orders (~70% of order book) from the bidding to the ordering stage, while completely exposed to currency risk in non-ERV orders. However, expected growth in order intake will improve the free cash flow due to higher advances, additionally, ~Rs 6.5 bn of debtors has been recovered till date in FY14E with a target to reduce receivable days by ~30 days. Completion of delayed BSS and CIDSS orders will reduce the inventory days thereby further boosting the cash flows.

R&D focus to improve indigenization and thereby margins - BEL has budgeted ~ Rs 6.8 bn towards R&D (~10% of revenue) in FY14E versus Rs 5 bn (~8.5% of revenue) in FY13. The company is planning to put up facilities to manufacture components and subsystems in-house to reduce the dependence of import and control cost. This we believe will result in medium to long term reduction of material cost proportion resulting in higher contribution margins.

Given the limited levers in terms of price negotiations, higher proportion of indigenized components and subsystems will be the prudent way to improve the margins going forward. The effective implementation of this strategy will be the key determinant to drive the structural improvement in profitability of BEL. Due to forex exposure the raw material cost proportion is expected to remain at elevated level in the near term, hence, we cut our earnings estimate by 5% for FY14E and FY15E to Rs 108.5 and 124.2, respectively. However, we subscribe to the fact that focus towards R&D and indigenization will support structural margin improvement with lower material cost proportion in a medium to long term perspective. Additionally, the increase in order intake guidance will support growth visibility thereby enhancing margins due to operating leverage. BEL is favorably placed in terms of leadership status in radars with dominant domestic market share and limited private sector participation given the capability gap. Going forward, radars will witness healthy growth (MMRCA, MRSAM, LRSAM etc.) and the company will be a major beneficiary of the same. Private sector has made inroads in the communication equipment and related areas which will result in erosion of certain market share. However, we believe that given the opportunity spectrum,

there is space for all the players in this market and the security and confidentiality aspect will place BEL in better stead compared to private companies. With the firm belief that the company will be able to successfully implement its R&D objectives thereby reducing the material cost proportion and the continuation of the defence capex modernization program by government despite fiscal deficit discomforts as indicated by the management we maintain our BUY rating on the stock with a revised target price of Rs 1,490 (12x FY15E earnings).

Order intake guidance revised upwards to Rs 80 - 100 bn

Major order awards expected during FY14E are

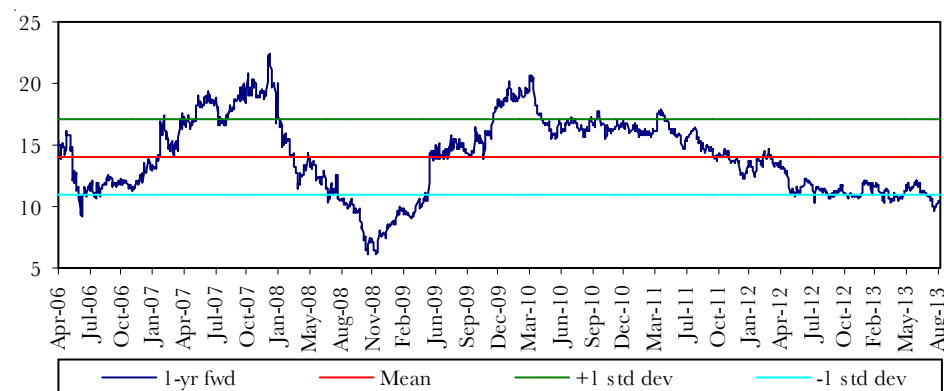
Details	Approximate value (Rs mn)
Tank electronics for T-90/T-72/BMP	28,000
Weapon locating radar	20,000
Multi function thermal imager	11,000
Varuna upgrade	6,000
Himsakthi	17,500
Missile approach warning system	3,000
Electro voting machines	1,000
Total	86,500

Order book as on July 2013 was Rs 247 bn.

Change in estimates

(Rs mn)	Old estimates		New estimates		Change (%)	
	FY14E	FY15E	FY14E	FY15E	FY14E	FY15E
Revenue	66,494	73,143	66,201	72,822	(0.4)	(0.4)
YoY (%)	11.0	10.0	10.5	10.0	—	—
EBIDTA	8,391	10,179	7,810	9,296	(6.9)	(8.7)
Margin (%)	12.4	13.7	11.6	12.6	—	—
Other income	4,800	4,829	4,787	5,040	(0.3)	4.4
PAT	9,125	10,439	8,681	9,938	(4.9)	(4.8)
EPS (Rs)	114.1	130.5	108.5	124.2	(4.9)	(4.8)
YoY (%)	2.5	14.4	(3.1)	14.5	—	—

One-year forward PER Band



Source: B&K Research

Income Statement

Period end (Rs mn)	Mar 12	Mar 13	Mar 14E	Mar 15E
Net sales	56,500	59,905	66,201	72,822
Growth (%)	3.3	6.0	10.5	10.0
Operating expenses	(51,530)	(54,613)	(59,364)	(64,549)
Operating profit	4,970	5,291	6,837	8,273
Other operating income	1,176	1,134	973	1,023
EBITDA	6,146	6,425	7,810	9,296
Growth (%)	(37.8)	4.5	21.6	19.0
Depreciation	(1,209)	(1,307)	(1,461)	(1,589)
Other income	5,855	6,100	4,787	5,040
EBIT	10,792	11,217	11,136	12,748
Finance cost	(6)	(8)	(7)	(7)
Profit before tax	10,786	11,210	11,129	12,741
Tax (current + deferred)	(2,450)	(2,248)	(2,448)	(2,803)
P/(L) for the period	8,337	8,962	8,681	9,938
Reported Profit/(Loss)	8,337	8,962	8,681	9,938
Adjusted net profit	8,337	8,962	8,681	9,938
Growth (%)	(0.9)	7.5	(3.1)	14.5

Balance Sheet

Period end (Rs mn)	Mar 12	Mar 13	Mar 14E	Mar 15E
Share capital	800	800	800	800
Reserves & surplus	55,569	62,428	68,779	76,386
Shareholders' funds	56,369	63,228	69,579	77,186
Non-current liabilities	3,074	3,527	3,150	3,151
Other non-current liabilities	3,074	3,527	3,150	3,151
Current liabilities	89,136	77,705	81,816	88,597
Other current liabilities	89,136	77,706	81,817	88,597
Total (equity and liab.)	148,579	144,461	154,546	168,934
Non-current assets	10,373	11,507	11,740	12,248
Fixed assets (net block)	6,237	7,369	7,292	7,712
Non-current investments	120	120	120	120
Long-term loans and adv.	1,734	1,303	1,612	1,701
Other non-current assets	2,282	2,716	2,716	2,716
Current assets	138,200	132,954	142,805	156,686
Cash & current investment	67,725	53,025	57,729	66,283
Other current assets	70,478	79,929	85,077	90,403
Total (assets)	148,579	144,461	154,546	168,934
Capital employed	59,443	66,755	72,729	80,337

Cash Flow Statement

Period end (Rs mn)	Mar 12	Mar 13	Mar 14E	Mar 15E
Profit before tax	10,786	11,210	11,129	12,741
Depreciation	1,209	1,307	1,461	1,589
Change in working capital	(2,526)	(20,002)	(2,342)	1,277
Total tax paid	(2,921)	(2,682)	(1,836)	(2,714)
Others	(5,735)	(5,846)	(4,710)	(4,963)
Cash flow from oper. (a)	813	(16,014)	3,702	7,929
Capital expenditure	(2,011)	(2,092)	(1,375)	(1,998)
Others	5,720	5,507	4,707	4,960
Cash flow from inv. (b)	3,709	3,416	3,332	2,962
Free cash flow (a+b)	4,522	(12,598)	7,034	10,891
Debt raised/(repaid)	(1)	(0)	0	0
Dividend (incl. tax)	(1,934)	(2,083)	(2,330)	(2,330)
Others	(45)	(26)	(0)	(6)
Cash flow from fin. (c)	(1,980)	(2,110)	(2,330)	(2,336)
Net chg in cash (a+b+c)	2,542	(14,708)	4,704	8,555

Key Ratios

Period end (%)	Mar 12	Mar 13	Mar 14E	Mar 15E
Adjusted EPS (Rs)	104.2	112.0	108.5	124.2
Growth	(0.9)	7.5	(3.1)	14.5
CEPS (Rs)	119.3	128.4	126.8	144.1
Book NAV/share (Rs)	704.4	790.1	869.5	964.6
Dividend/share (Rs)	20.8	22.3	25.0	25.0
Dividend payout ratio	23.2	23.2	26.8	23.4
EBITDA margin	10.7	10.5	11.6	12.6
EBIT margin	19.1	18.7	16.8	17.5
Tax rate	22.7	20.1	22.0	22.0
RoCE	19.3	17.8	16.0	16.7
Net debt/Equity (x)	(1.2)	(0.8)	(0.8)	(0.9)
Du Pont Analysis - ROE				
Net margin	14.8	15.0	13.1	13.6
Asset turnover (x)	0.4	0.4	0.4	0.5
Leverage factor (x)	2.6	2.5	2.3	2.2
Return on equity	15.7	15.0	13.1	13.5

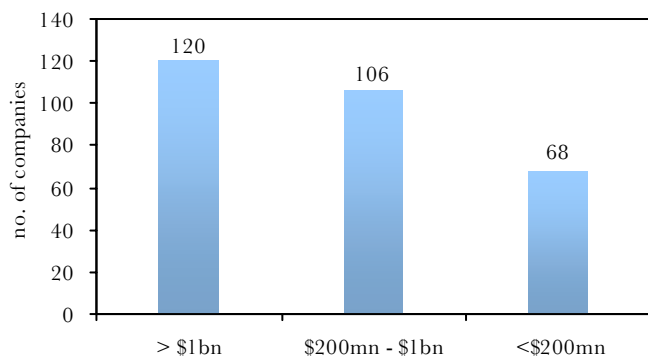
Valuations

Period end (x)	Mar 12	Mar 13	Mar 14E	Mar 15E
PER	14.6	10.3	10.0	8.7
PCE	12.8	9.0	8.6	7.5
Price/Book	2.2	1.5	1.2	1.1
Yield (%)	1.4	1.9	2.3	2.3
EV/EBITDA	8.8	6.1	3.7	2.2

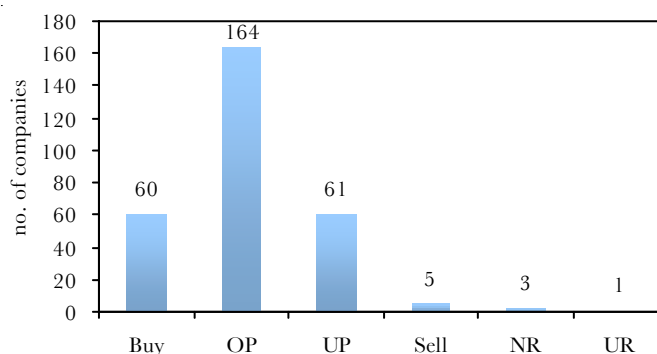
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B&K Universe Profile

By Market Cap (US\$ mn)



By Recommendation



B&K Securities is the trading name of Bativala & Karani Securities India Pvt. Ltd.

B&K Investment Ratings

- | | |
|--|---|
| 1. BUY: Potential upside of > +25% (absolute returns) | 3. UNDERPERFORMER: 0 to -25% |
| 2. OUTPERFORMER: 0 to +25% | 4. SELL: Potential downside of < -25% (absolute returns) |

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