

## Bharat Electronics (BHAELE)

₹ 1260

### Reiterate; proxy play on emerging defence sector

We attended the analyst meet of Bharat Electronics (BEL) to get an insight into the pace of development in the Indian defence space. The management acknowledged that the pace of decision making has improved over the past several months. The same is also visible from BEL's order inflows of ₹ 17,094 crore in FY16, which is a significant 79% increase over last year (order backlog ₹ 21,617 crore in FY15). The management sounded positive on the order inflows in FY17E and guided at order inflows of ₹ 10000-12000 crore for the year. Other important takeaways from the analyst meet include:

- The management has guided sales growth of 10-12% in FY17 and 8-10% over the next five years. However, we believe there is a strong likelihood of the company surpassing this estimate, both in FY17E and over the next five years. We believe this was on account of strong order inflows expected over the next few years. Some these large orders include tactical communication systems: ₹ 10000 crore, Akash Missile systems ₹ 5000 crore, Electronic Warfare systems ~₹ 7000 crore, LRSAM & QRSAM ₹ 5000-10000 crore, battlefield management system ~₹ 30000 crore
- The company has guided raw material to sales ratio (RM/sales) of 50-60% (our estimate: 56% in FY17E). We believe the same would depend on the mix of indigenous and imported content in the sales. In FY16, RM/sales stood at 53%. The management has indicated it is most likely to be on the higher side. However, the same can change on the basis of execution
- The management has guided at FY17E EBITDA margin of ~100 bps of the FY16 EBITDA margin of 20% (our estimate: 16.7%). We have estimated margins on the lower side to account for the provision that needs to be made in Q4FY17 for the coming employee pay revisions. Also, as revenue contribution to the topline is gradually increasing from the system integration side, we believe margins are likely to remain on the lower side
- BEL is an R&D-focused company. Its R&D spending in FY16 was ₹ 704 crore, 9.4% of sales. This, we believe, gives companies like BEL strong competitive advantage over any upcoming local and foreign completion. The management has guided that R&D spend is likely to rise to 12% of sales in the coming few years. This, we believe, will enable the company to indigenise a number of imported technologies while also developing new IPRs

### Accelerated order inflows, consistent track record, strong revenue visibility; maintain BUY

BEL also has a strong balance sheet with near nil debt and cash balance of ₹ 7332 crore. Accelerated order inflows and BEL's consistent track record in execution, give us reasonable confidence on the robust prospects of the company. Accordingly, we expect BEL to deliver sales and PAT CAGR of 19.1% and 5%, respectively, in FY16-18E. We value BEL at ₹ 1560 i.e. 25x P/E on FY18E EPS of ₹ 62.4 and retain **BUY** recommendation on the company.

#### Rating Matrix

Rating Matrix	
Rating	: Buy
Target	: ₹ 1560
Target Period	: 12 - 15 months
Potential Upside	: 24%

#### What's changed?

Target	Unchanged at ₹ 1560
EPS FY17E	Unchanged at ₹ 57.8
EPS FY18E	Unchanged at ₹ 62.4
Rating	Unchanged

#### Key Financials

₹ Crore	FY15	FY16	FY17E	FY18E
Revenue	6,843	7,295	8,851	10,350
EBITDA	1,143	1,461	1,475	1,674
EBITDA (%)	16.7	20.0	16.7	16.2
Net Profit	1,167	1,358	1,386	1,498
EPS (₹)	48.6	56.6	57.8	62.4

#### Valuation Summary

(x)	FY15	FY16	FY17E	FY18E
P/E	25.9	22.3	21.8	20.2
Target P/E	32.1	27.6	27.0	25.0
EV / EBITDA	21.3	15.7	15.7	13.4
P/BV	3.8	3.5	3.2	2.9
RoNW (%)	15	15.5	14.5	14.3
RoCE (%)	19.6	22.0	19.9	19.6

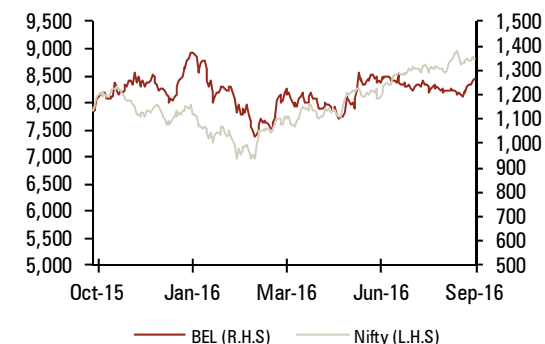
#### Stock Data

Average Volumes (shares)	37000
Market Capitalization	₹ 30240 Crore
Total Debt (FY16)	₹ 6.2 Crore
Cash and Investments (FY16)	₹ 7332 crore
EV (FY16)	₹ 22914.3 Crore
52 week H/L (₹)	1416 / 983
Equity capital	₹ 240 Crore
Face value	₹ 10

#### Price Performance

Return (%)	1M	3M	6M	12M
Bharat Electronics	2.8	(0.7)	5.5	14.8
Astra Microwave	1.5	(1.5)	(3.6)	(26.3)
Centum Electronics	0.8	(3.3)	6.7	6.5

#### Price Movement



#### Research Analysts

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#### Other key takeaways from analyst meet

- The company has planned a capex of ₹ 2300 crore in the next five years
- Electronic voting machines have potential to be big business, going forward
- Tank upgrade and gun upgrade programmes can be significant drivers of business ahead
- Working capital days of the company improved from 207 days in FY15 to 180 days in FY16. This was due to continuous efforts by the company to improve its internal systems in addition to faster decision making from the government
- Employees in the R&D department constitute 50% of the executive workforce. Approximately, 2200 engineers of the total 5000 engineers work in the R&D department

## Financial summary (Standalone)

Profit and loss statement					₹ Crore				
(₹ Crore)	FY15	FY16	FY17E	FY18E					
Net Sales	6,675.5	7,154.1	8,677.4	10,146.6					
Other operating income	167.1	141.1	173.5	202.9					
Total Revenue	6,842.6	7,295.2	8,851.0	10,349.5					
Other income	477.9	532.2	587.6	581.0					
Total	7,320.6	7,827.3	9,438.6	10,930.6					
Total Raw Material Costs	3,780.6	3,790.8	4,859.3	5,682.1					
Employee Expenses	1,263.5	1,301.8	1,605.3	1,927.9					
other expenses	655.3	741.1	911.1	1,065.4					
Total Operating Expenditure	5,699.3	5,833.7	7,375.8	8,675.3					
Operating Profit (EBITDA)	1,143.3	1,461.4	1,475.2	1,674.2					
Interest	1.4	4.5	6.0	7.5					
PBDT	1,619.9	1,989.1	2,056.8	2,247.7					
Depreciation	154.0	168.9	196.3	223.3					
PBT before Exceptional Items	1,465.9	1,820.2	1,860.5	2,024.5					
Total Tax	299.4	455.3	474.4	526.4					
PAT before MI	1,166.5	1,364.9	1,386.1	1,498.1					
Minority Interest	-	-	-	-					
PAT	1,167.2	1,357.7	1,386.1	1,498.1					
EPS	48.6	56.6	57.8	62.4					

Source: Company, ICICIdirect.com Research

Balance sheet					₹ Crore				
(₹ Crore)	FY15	FY16	FY17E	FY18E					
Equity Capital	80.0	240.0	240.0	240.0					
Reserve and Surplus	7,805.0	8,493.8	9,337.0	10,261.3					
Total Shareholders funds	7,885.0	8,733.8	9,577.0	10,501.3					
Minority Interest	-	-	-	-					
Other Non Current Liabilities	1.1	2.1	7.1	12.1					
Total Debt	9.1	6.2	250.0	275.0					
Total Liabilities	7,895.2	8,742.1	9,834.0	10,788.4					
Gross Block	2,485.2	2,841.4	3,271.1	3,721.1					
Acc: Depreciation	1,714.0	1,883.0	2,079.2	2,302.5					
Net Block	771.1	958.4	1,191.9	1,418.6					
Capital WIP	139.8	429.7	500.0	550.0					
Total Fixed Assets	910.9	1,388.1	1,691.9	1,968.6					
Non Current Assets	427.1	447.3	447.3	447.3					
Inventory	3,369.4	4,167.9	4,364.9	5,103.9					
Debtors	3,786.1	3,711.9	5,456.1	6,379.9					
Loans and Advances	752.0	599.1	796.6	828.0					
Other Current Assets	53.5	58.1	70.8	82.8					
Cash	5,881.5	7,332.0	7,358.3	8,136.2					
Total Current Assets	13,842.6	15,868.9	18,046.6	20,530.7					
Current Liabilities	6,527.8	8,118.3	9,699.7	11,342.0					
Provisions	776.7	1,161.8	970.0	1,134.2					
Net Current Assets	6,538.1	6,588.8	7,377.0	8,054.6					
Total Assets	7,895.2	8,742.2	9,834.0	10,788.4					

Source: Company, ICICIdirect.com Research

Cash flow statement					₹ Crore				
(₹ Crore)	FY15	FY16	FY17E	FY18E					
Profit after Tax	1,167.2	1,357.7	1,386.1	1,498.1					
Depreciation	154.0	168.9	196.3	223.3					
Interest	1.4	4.5	6.0	7.5					
Cash Flow before WC changes	1,322.6	1,531.1	1,588.3	1,728.9					
Changes in inventory	(70.7)	(798.5)	(197.0)	(739.0)					
Changes in debtors	342.4	74.2	(1,744.2)	(923.8)					
Changes in loans & Advances	464.4	152.9	(197.5)	(31.4)					
Changes in other current assets	12.8	(4.6)	(12.7)	(12.0)					
Net Increase in Current Assets	748.8	(575.9)	(2,151.3)	(1,706.2)					
Changes in creditors	(363.2)	1,590.5	1,581.3	1,642.3					
Changes in provisions	177.2	385.1	(191.8)	164.2					
Net Increase in Current Liabilities	(186.0)	1,975.6	1,389.5	1,806.5					
Net CF from Operating activities	1,885.4	2,930.8	826.5	1,829.2					
Changes in deferred tax assets	(38.3)	(34.5)	-	-					
(Purchase)/Sale of Fixed Assets	(217.0)	(646.2)	(500.0)	(500.0)					
Net CF from Investing activities	(263.9)	(964.2)	(495.0)	(495.0)					
Dividend and Dividend Tax	(281.0)	(489.6)	(507.3)	(543.8)					
Net CF from Financing Activities	(304.3)	(516.2)	(305.2)	(556.3)					
Net Cash flow	1,317.1	1,450.4	26.3	777.9					
Opening Cash/Cash Equivalent	4,564.4	5,881.5	7,332.0	7,358.3					
Closing Cash/ Cash Equivalent	5,881.5	7,332.0	7,358.3	8,136.2					

Source: Company, ICICIdirect.com Research

Key ratios				
(Year-end March)	FY15	FY16	FY17E	FY18E
Per Share Data				
EPS	48.6	56.6	57.8	62.4
Cash per Share	245.1	305.5	306.6	339.0
BV	328.5	363.9	399.0	437.6
Dividend per share	9.7	17.0	17.6	18.9
Dividend payout ratio	0.2	0.3	0.3	0.3
Operating Ratios				
EBITDA Margin	17.1	20.4	17.0	16.5
PAT Margin	17.5	19.0	16.0	14.8
Return Ratios				
RoE	14.8	15.5	14.5	14.3
RoCE	19.6	22.0	19.9	19.6
RoIC	68.4	242.4	83.7	87.7
Valuation Ratios				
EV / EBITDA	21.3	15.7	15.7	13.4
P/E	25.9	22.3	21.8	20.2
EV / Net Sales	3.6	3.1	2.6	2.2
Sales / Equity	0.9	0.8	0.9	1.0
Market Cap / Sales	4.4	4.1	3.4	2.9
Price to Book Value	3.8	3.5	3.2	2.9
Turnover Ratios				
Asset turnover	3.4	5.2	3.2	3.5
Debtors Turnover Ratio	1.7	1.9	1.9	1.7
Creditors Turnover Ratio	1.0	1.0	1.0	1.0
Solvency Ratios				
Debt / Equity	0.0	0.0	0.0	0.0
Current Ratio	1.1	0.9	1.0	1.0
Quick Ratio	0.6	0.5	0.6	0.6

Source: Company, ICICIdirect.com Research

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