

## Q1FY22 results review

## Defence

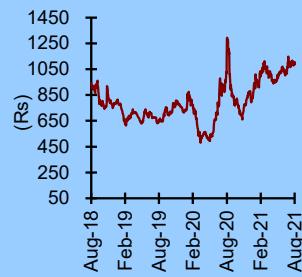
Target price: Rs2,618

## Shareholding pattern

	Dec '20	Mar '21	Jun '21
Promoters	75.2	75.2	75.2
Institutional investors	20.0	21.2	21.5
MFs and others	3.7	4.5	4.7
Banks / Fls	1.1	1.0	1.0
Insurance Cos.	14.9	14.9	14.9
Fls	0.3	0.8	1.0
Others	4.8	3.6	3.3

Source: BSE

## Price chart



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## INDIA

## Hindustan Aeronautics

BUY

Maintain

**Rs1,089**

Hindustan Aeronautics' (HAL) Q1FY22 numbers were muted, with execution impacted by the Covid pandemic. Topline declined 7% YoY while EBITDA declined ~ 29% YoY. There is no apparent risk to FY22E execution guidance given the current orderbook. Management expects to maintain growth path with sufficient workloads in FY22. LCA deliveries are expected to start from March 24. HAL will start seeing double-digit growth from FY24. Orderbook position stood at Rs806.4bn as on 31st March, 2021, of which, manufacturing was Rs655bn, repair & overhaul (ROH) and spares added up to Rs145bn and remaining orders were from development and exports. HAL expects to have a net cash surplus of Rs70-80bn in FY22. We see HAL's potential book to bill at 5x at FY22E-end). We maintain BUY with a target price of Rs2,618/share (~140% upside).

- **Significant opportunities in the helicopter segment.** HAL had recently delivered ALH Dhruv Mk III MR to Indian Coast Guard as part of its 16 ALH Contract. Three ALHs were inducted into Indian Coast Guard in Q1FY22. Indian Coast Guard is also the first service to have performance based logistics management system introduced in aviation to ensure helicopter availability at four bases. HAL is embarking on a new journey of Performance Based Logistics (PBL). The PBL will assure desired levels of availability of ALH MKIII fleet of ICG for six and half years, a unique feature of this contract and a first of its kind in HAL.
- **PBL opening up new revenue opportunities for HAL.** PBL will provide a one stop solution for maintenance of complete helicopter, engine and components which encompasses helicopter/engine servicing task, rotatable repair task (RRT), repair & maintenance spares order (RMSO) etc. As part of PBL, helicopter MRO division of HAL will be extending the support from four bases viz. Bhubaneswar, Porbandar, Chennai and Kochi. All necessary infrastructure, repair facility etc are set up at Bhubaneswar and Porbandar, dedicated LRU/ rotatable floats are stocked and on-site support team is identified towards ensuring the availability of Helicopters. Chennai & Kochi are in the final stages. HAL aviation maintenance Software (HAMS), a web based online platform is developed and deployed by Helicopter MRO Division for real time monitoring and operational visibility of fleet through a dedicated leased line network.
- **HAL and Rolls-Royce (RR) have signed an MoU to establish packaging, installation, marketing and services support for Rolls-Royce MT30 marine engines in India.** This partnership will leverage the experience of HAL's IMGT Division that works on marine gas turbines with Indian shipyards. Further, HAL and RR are also exploring the option of using MT7 marine engine on the hovercraft being planned by the shipyards in India. Derived from the Trent aero engine family, the MT30 has the potential to provide next-generation capabilities to the Indian Navy's future fleet. Previously, HAL and RR has also announced an MoU to establish an Authorized Maintenance Centre at HAL for Adour Mk871 engines to support international military customers and operators. They also announced their intent to expand their supply chain partnerships for Civil and Defence Aerospace, by working towards making Adour Mk871 engine parts in India.

Market Cap	Rs364bn/US\$4.9bn	Year to Mar	FY21	FY22E	FY23E	FY24E
Reuters/Bloomberg	HIAE.BO / HNAL IN	Revenue (Rs mn)	227,545	248,262	267,747	299,781
Shares Outstanding (mn)	334.4	EBITDA(Rs mn)	53,494	55,922	63,800	69,192
52-week Range (Rs)	1294/661	Net Income (Rs mn)	32,391	34,639	39,906	43,289
Free Float (%)	24.8	EPS (Rs)	96.9	103.6	119.3	129.5
FII (%)	1.0	P/E (x)	11.5	10.7	9.3	8.6
Daily Volume (US\$'000)	5,583	CEPS (Rs)	132.1	139.8	158.3	171.2
Absolute Return 3m (%)	8.1	EV/E (x)	5.7	5.6	4.3	3.4
Absolute Return 12m (%)	(12.8)	Dividend Yield	2.7	3.0	3.3	3.6
Sensex Return 3m (%)	14.6	RoCE (%)	26.2	24.0	24.1	23.0
Sensex Return 12m (%)	46.2	RoE (%)	21.0	19.5	19.4	18.4

Please refer to important disclosures at the end of this report

Table 1: Q1FY22 result review

(Rs mn)	Q1FY22	Q1FY21	% Chg YoY	Q4FY21	% Chg QoQ
Net Revenue	16,158	17,367	(7.0)	107,387	(85.0)
Growth (%)	-7.0	-47.2		4.8	
Cost of material	10,578	10,844	(2.5)	26,317	(59.8)
Purchase of stock	585.7	515		3,587	
Change in inventory	(13,419)	(13,276)		30,846	
Total cost of materials	(2,255)	(1,916)		60,750	
Cost of material as % of sales	NM	(11.0)		56.6	
Gross Margin	18,414	19,284	(4.5)	46,638	(60.5)
Gross Margin (%)	114.0	111.0		43.4	
Employee Expenses	10,583.2	11,496	(7.9)	10,617	(0.3)
Other expenses	2519	2,697	(6.6)	3801.1	(33.7)
Impairment loss	10.8	51		460.1	
Provisions	3325.7	1,724		7306.3	
Expenses capitalised	(737.1)	(529)		4138.9	
<b>EBITDA</b>	<b>2,712</b>	<b>3,844</b>	(29.4)	<b>28,592</b>	(90.5)
EBITDA margin (%)	16.8	22.1		26.6	
Interest	146.9	1046.4	(86.0)	298.5	
Other Income	1501.3	472.5	217.7	1315	
EBIT	4,067	3,270		29,609	
EBIT margin (%)	25.2	18.8		27.6	
EBIT margin ex other income (%)	15.9	16.1		26.3	
Depreciation	1114.6	1112.8	0.2	6681.1	(83.3)
Exceptional item					
<b>PBT</b>	<b>2,952</b>	<b>2,157</b>	36.9	<b>22,928</b>	(87.1)
Tax	694.2	661.6		5451.2	
<b>PAT</b>	<b>2,258</b>	<b>1,495</b>	51.0	<b>17,477</b>	(87.1)
Share of Profit/(Loss) of Joint Ventures	-23.3	-8.9		46.4	

Source: Company data, I-Sec research

Maintain BUY with a target of Rs 2,618/share

We maintain BUY rating with a target price of Rs2,618/share. This is based on DCF valuation. The implied FY23E P/E and FY24E P/E is ~25x and 22x, respectively. The biggest certainty to our valuation is the orderbook which is expected to cross Rs1,000bn by FY22E – **there are hardly any defence primes in the world which manufacture combat aircraft and have an equivalent book to bill** (e.g. Lockheed Martin has a book to bill of 2.2x based on CY20 order backlog and CY21 sales outlook as shared by the company).

Table 2: HAL DCF valuation table

(Rs mn)	FY22E	FY23E	FY24E	FY25E	FY26E	FY27E	FY28E	FY29E	FY30E
Sales	248,262	267,747	299,781	331,344	366,238	404,816	447,465	474,711	496,933
EBITDA	55,922	63,800	69,192	79,006	84,516	96,263	109,423	111,401	110,134
Tax	11,100	12,787	13,872	16,029	17,142	19,769	22,738	22,994	22,462
PAT	34,639	39,906	43,289	50,022	53,495	61,692	70,958	71,756	70,097
NOPAT	44,822	51,013	55,320	62,977	67,374	76,495	86,685	88,407	87,672
<b>Working Capital Change</b>	<b>(32,523)</b>	<b>7,210</b>	<b>10,781</b>	<b>6,495</b>	<b>301</b>	<b>7,079</b>	<b>7,753</b>	<b>(216)</b>	<b>(305)</b>
Capex	(12,000)	(12,000)	(12,000)	(12,000)	(12,000)	(12,000)	(12,000)	(12,000)	(12,000)
FCF	299	46,223	54,101	57,472	55,675	71,574	82,438	76,192	75,367
Terminal Value									845,786
Total FCF	299	46,223	54,101	57,472	55,675	71,574	82,438	76,192	921,153
Cost of Equity	12%								
WACC	10%								
Terminal Growth	2%								
<b>NPV of FCFF (FY23E)</b>	<b>781,454</b>								
Net Debt at FY23E	(93,837)								
Net Equity value	875,290								
<b>Value per share</b>	<b>2,618</b>								

Source: I-Sec research

**The key risk** to our understanding is lack of diversification. As cashflow accumulates, we are witnessing a trend of vertical integration (latest two examples are Lockheed acquisition of Aerojet Rocketdyne and merger between Raytheon and UTC). HAL may also have to think about business diversification sooner or later. Faster ramp-up of unmanned vehicles through the IAI, Dynamatic JV, focused entry into civilian space with LUH offering, trying to enter into MRO for civilian space, trying to leverage the knowledge of propulsion systems to move towards integration of the same in hypersonic missiles – those are some of the potential areas of diversification for HAL, apart from increasing the production rate of the existing platforms.

**Other key risks –** Global aerospace defence primes like Lockheed Martin is rated in high risk category (Score of 30.6) by Sustainalytics with industry group rank of 15 out of 91. Similarly, we see Lockheed not selected in S&P 500 ESG index and the reason for exclusion shown as 'involved in controversial weapons' – similar predicaments for Boeing. MSCI on the other hand has assigned an A rating on Lockheed Martin, with 17% of the MSCI AWCI constituents in aerospace and defence getting an A rating. HAL is currently not rated by any agency.

## Financial summary

**Table 3: Profit & loss statement**

(Rs mn, year ending March 31)

	FY21	FY22E	FY23E	FY24E
<b>Operating Income</b>	<b>227,545</b>	<b>248,262</b>	<b>267,747</b>	<b>299,781</b>
<b>Operating Expenses</b>	174,052	192,340	203,947	230,589
<b>EBITDA</b>	<b>53,494</b>	<b>55,922</b>	<b>63,800</b>	<b>69,192</b>
% margins	23.5	22.5	23.8	23.1
Depreciation & Amortisation	11,783	12,105	13,029	13,953
Gross Interest	2,592	278	278	278
Other Income	3,582	2,100	2,100	2,100
<b>Recurring PBT</b>	<b>42,770</b>	<b>45,739</b>	<b>52,693</b>	<b>57,161</b>
Less: Taxes	10,379	11,100	12,787	13,872
<b>Recurring Net Income</b>	<b>32,391</b>	<b>34,639</b>	<b>39,906</b>	<b>43,289</b>

Source: Company data, I-Sec research

**Table 4: Balance sheet**

(Rs mn, year ending March 31)

	FY21	FY22E	FY23E	FY24E
<b>Assets</b>				
Total Current Assets	402,175	452,069	506,236	582,490
of which cash & cash eqv.	71,774	62,876	98,884	141,555
Total Current Liabilities & Provisions	267,174	284,968	302,368	333,628
<b>Net Current Assets</b>	<b>135,001</b>	<b>167,101</b>	<b>203,868</b>	<b>248,862</b>
Investments	10,555	10,555	10,555	10,555
Net fixed assets (including CWIP)	95,689	95,584	94,554	92,601
Other non -current assets	11,040	11,040	11,040	11,040
<b>Total Assets</b>	<b>252,285</b>	<b>284,280</b>	<b>320,018</b>	<b>363,058</b>
<b>Liabilities</b>				
<b>Borrowings</b>	5,047	5,047	5,047	5,047
Advance from customers	93,077	101,551	109,521	122,625
Equity Share Capital	3,344	3,344	3,344	3,344
Reserves & Surplus	150,779	174,299	202,067	232,004
<b>Net Worth</b>	<b>154,123</b>	<b>177,643</b>	<b>205,411</b>	<b>235,347</b>
<b>Total Liabilities</b>	<b>252,285</b>	<b>284,280</b>	<b>320,018</b>	<b>363,058</b>

Source: Company data, I-Sec research

**Table 5: Cashflow statement**

(Rs mn, year ending March 31)

	FY21	FY22E	FY23E	FY24E
Net Profit before tax	32,391	34,639	39,906	43,289
Depreciation	11,783	12,105	13,029	13,953
Working Capital Changes	91,682	(32,523)	7,210	10,781
Taxes Paid	(7,186)	(11,100)	(12,787)	(13,872)
<b>Cash flow from Operating Activities</b>				
Capital Commitments	152,627	14,499	60,423	68,301
Free Cash Flow	(13,173)	(12,000)	(12,000)	(12,000)
Other investing cashflow	139,454	2,499	48,423	56,301
<b>Cash flow from Investing Activities</b>				
Inc (Dec) in Borrowings	(12,710)	(12,000)	(12,000)	(12,000)
Other financing activities	(58,628)	-	-	-
<b>Cash flow from Financing Activities</b>				
Chg. in Cash & Bank balance	(12,622)	(11,396)	(12,416)	(13,630)
	68,668	(8,897)	36,007	42,671

Source: Company data, I-Sec research

**Table 6: Key ratios**

(Year ending March 31)

	FY21	FY22E	FY23E	FY24E
<b>Per Share Data (Rs)</b>				
Basic EPS	96.9	103.6	119.3	129.5
Diluted EPS	96.9	103.6	119.3	129.5
Cash EPS (Fully Diluted)	132.1	139.8	158.3	171.2
OCF per share (Fully Diluted)	45.7	456.4	43.4	180.7
Book Value per share (Fully Diluted)	460.9	531.2	614.3	703.8
Dividend	30.0	33.0	36.3	39.9
<b>Growth YoY (%)</b>				
Net Sales	6.1	9.1	7.8	12.0
EBITDA	6.0	6.0	6.0	12.0
PAT	12.7	6.9	15.2	8.5
<b>Valuation ratios</b>				
P/E	11.5	10.7	9.3	8.6
P/CEPS	8.4	7.9	7.0	6.5
P/BV	2.4	2.1	1.8	1.6
EV / EBITDA	5.7	5.6	4.3	3.4
EV / FCF	67.9	2.1	125.4	5.7
<b>Operating Ratios (%)</b>				
Raw Material/Sales	48.5	48.0	47.0	46.5
Other Income / PBT	8.4	4.6	4.0	3.7
Effective Tax Rate	24.3	24.3	24.3	24.3
NWC / Total Assets	26.0	29.4	32.8	35.7
Inventory Turnover	69.3	69.3	69.3	69.3
Asset Turnover	43.8	43.6	43.0	43.0
Net D/E Ratio (x)	(0.4)	(0.3)	(0.5)	(0.6)
<b>Profitability Ratios (%)</b>				
Rec. Net Income Margins	14.2	14.0	14.9	14.4
RoCE	26.2	24.0	24.1	23.0
RoNW	21.0	19.5	19.4	18.4
Dividend Payout	32.1	30.4	30.8	29.4
Dividend Yield	2.7	3.0	3.3	3.6
EBITDA Margins	23.5	22.5	23.8	23.1

Source: Company data, I-Sec research

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