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Q4FY23 result review
and TP change

Defence

Target price: Rs140

Target price revision

Rs140 from Rs125

Shareholding pattern

	Sep '22	Dec '22	Mar '23
Promoters	51.1	51.1	51.1
Institutional investors	42.3	42.5	42.0
MFs and others	21.2	20.6	20.1
FIs/Insurance	3.6	4.4	5.3
FII	17.5	17.5	16.6
Others	6.6	6.4	6.9

Source: BSE India

ESG disclosure score

Year	2021	2022	Chg
ESG score	35.6	36.2	0.6
Environment	17.6	17.6	0.0
Social	25.5	27.4	1.8
Governance	63.6	63.6	0.0

Note - Score ranges from 0 - 100 with a higher score indicating higher ESG disclosures.

Source: Bloomberg, I-sec research

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INDIA



Bharat Electronics

BUY

Maintained

Rs109

Sweetest play in defence space

Bharat Electronics' (BEL) Q4FY23 performance was ahead of street estimates on all counts. In FY23, management met its guidance for order inflow of Rs205bn, revenue growth of 15% and EBITDA margin of 21-23%. Key points: 1) EBITDA at Rs18.3bn (up 16% YoY) was 8% ahead of street estimates; 2) orderbook at Rs607bn implies bill-to-book ratio of 3.5x; 3) EBITDA margin rose to 28% in Q4FY23 (FY23: 23%); 4) receivable days were stable YoY at 148; cash & equivalents were at Rs3.9bn vs Rs1.3bn in FY22; and 5) cash dividend of Rs1.2/share thus far for FY23, besides, bonus share issue of 2:1 in Sep-22.

Going ahead, management has guided for order inflow of Rs200bn, revenue growth of 17% YoY and EBITDA margin of 21-23% (incl. other income) for FY24. We introduce FY25E numbers at this stage and expect 12.6% EPS (FY23-FY25E) CAGR. In our view, with its finger in the pie in almost all the upcoming orders over the next few years, BEL is the best play in the defence space. We roll-over the valuation to FY25E and maintain BUY rating on the stock with a revised TP of Rs140 (earlier Rs125) on an unchanged 25x FY25E EPS.

- **Performance ahead of estimates; orderbook concerns allayed.** BEL's Q4FY23 performance was ahead of street's estimates and achieved management's guidance for FY23. Key points: 1) Orderbook has risen to the highest-ever level of Rs607bn, implying bill-to-book ratio of 3.5x (ttm); 2) EBITDA margin rose to 28% owing to raw material sourcing efficiencies and higher value of production (VoP)/material cost ratio; 3) other expenses during the quarter rose 46% YoY to Rs7.3bn owing to liquidated damages (LD) charge of Rs3.6bn; 4) working capital for FY23 remained firmly in control with receivable days unchanged YoY at 148 and higher cash balance at Rs3.9bn; and 4) Board recommended second interim dividend of Rs0.6/share. Going ahead, management expects growth momentum to sustain with EBITDA margin at 21-23% and revenue growth of 17% YoY in FY24.
- **Significant opportunities for orderbook accretion.** During Q4FY24 earnings call, the management guided for an order inflow of Rs200bn in FY24, comprising: 1) Rs40bn from Akash 3rd and 4th regiment orders; 2) Rs45bn from long term fuse requirement contract; 3) Rs50-60bn from the recently issued orders of naval platforms; and 4) Rs10bn from Shakti EW system for Indian Navy. In addition, we believe MRSAM, QRSAM and ATGM orders in medium term could add another Rs200bn. In the longer term, we believe orders from Tejas Mk1A and Mk2 as well as next-generation corvettes are likely to keep orderbook robust. In our view, BEL is significantly immune to potential delays or lower spending as it has exposure to most major upcoming orders. Hence, the current bill to book ratio of 3.5x is comforting. Besides, improving indigenisation and fast developing ecosystem for its products imply margins are likely to improve and working capital cycle is expected to remain in check.

Market Cap	Rs795bn/US\$9.6bn
Reuters/Bloomberg	BAJE.BO/BHE IN
Shares Outstanding (mn)	7,309.8
52-week Range (Rs)	113/75
Free Float (%)	48.9
FII (%)	16.6
Daily Volume (US\$/'000)	17,651
Absolute Return 3m (%)	14.9
Absolute Return 12m (%)	43.5
Sensex Return 3m (%)	4.2
Sensex Return 12m (%)	15.9

Year to March	FY22	FY23	FY24E	FY25E
Revenue (Rs mn)	1,53,682	1,77,344	2,07,365	2,42,406
Net Income (Rs mn)	24,002	29,862	33,705	40,755
Dil. EPS (Rs)	3.3	1.4	4.6	5.6
% Chg YoY	14.3	(58.5)	238.6	20.9
P/E (x)	33.2	80.0	23.6	19.6
CEPS (Rs)	3.8	1.6	5.3	6.3
EV/E (x)	20.9	55.9	14.9	12.2
Dividend Yield (%)	-	-	3.7	3.7
RoCE (%)	25.7	21.2	23.6	27.0
RoE (%)	19.5	21.5	23.6	26.4

Please refer to important disclosures at the end of this report

- **Outlook and valuation: Robust potential-** We believe BEL is set to gain both from steady execution and orderbook accretion. We maintain **BUY** on BEL stock with a revised TP of Rs140/share (earlier Rs125) on 25x FY25E EPS. Slower-than-expected orderbook build up is the key risk to our thesis.

Table 1: Q4FY23 result review (standalone)

(Rs mn)	Q3FY22	Q4FY22	Q1FY23	Q2FY23	Q3FY23	Q4FY23	% Chg YoY	% Chg QoQ
Net Sales	36,937	63,249	31,128	39,458	41,310	64,566	2.1	56.3
Other Operating income	379	1,242	492	496	849	1,291	3.9	52.1
Sales Ex Other Op income	36,558	62,007	30,636	38,962	40,461	63,275	2.0	56.4
Gross Margin	14,935	26,439	13,043	17,076	17,153	31,101	17.6	81.3
Gross Margin (%)	40.4	41.8	41.9	43.3	41.5	48.2		
Gross Margin ex Other Op Income	14,556	25,196	12,551	16,580	16,304	29,810	18.3	82.8
Gross Margin ex Other Op Income (%)	39.8	40.6	41.0	42.6	40.3	47.1		
Employee Costs	5,039	5,778	5,764	5,955	5,674	5,584	(3.3)	(1.6)
EBITDA	8,221	15,678	5,135	8,558	8,535	18,248	16.4	113.8
EBITDA Margin (%) on net sales	22.3	24.8	16.5	21.7	20.7	28.3		
EBITDA Ex Other Op Income	7,842	14,436	4,643	8,062	7,686	16,957	17.5	120.6
EBITDA Ex Other Op Income (%)	21.5	23.3	15.2	20.7	19.0	26.8		
PAT	5,834	11,418	4,315	6,111	5,988	13,654	19.6	128.0

Source: Company data, I-Sec research

Table 2: Q4FY23 result review (consolidated)

(Rs mn)	Q4FY23	Q4FY22	%Chg YoY	Q3FY23	%Chg QoQ	FY23	FY22	%Chg YoY
Net Sales / Income from Operations	63,447	62,122	2.1	40,649	56.1	1,59,133	1,38,429	15.0
Total Income	64,791	63,398	2.2	41,531	56.0	1,77,344	1,53,682	15.4
Expenditure								
Change in Stock	340	268		(190)		(3,933)	(2,803)	
Consumption of Material	31,005	33,993	(8.8)	21,840	42.0	93,930	80,934	16.1
Purchase of traded goods	2,176	2,520	(13.7)	2,546	(14.5)	8,279	10,535	(21.4)
Employee Costs	5,636	5,828	(3.3)	5,723	(1.5)	23,173	21,280	8.9
Other Expenditure	7,316	5,013	45.9	2,978	145.6	15,037	10,021	50.0
Total Expenditure	46,473	47,623	(2.4)	32,897	41.3	1,36,486	1,20,273	13.5
EBITDA	18,318	15,775	16.1	8,634	112.2	40,859	33,409	22.3
<i>EBITDA Margin (%)</i>	28.3	24.9	13.6	20.8		23.0	21.7	
Other Income	662	639	3.5	586	12.8	2,808	2,315	21.3
Depreciation	1,140	1,061	7.4	1,061	7.5	4,288	4,011	6.9
Interest and Finance Costs	25	43	(42.1)	97	(74.7)	150	51	196.0
PBT	17,816	15,311	16.4	8,062	121.0	39,229	31,662	23.9
Tax Expense	4,152	3,846	7.9	2,032	104.3	9,826	8,118	21.0
MI and Profit from associates	156	86	82.0	105	49.0	459	458	0.3
PAT	13,820	11,551	19.6	6,135	125.3	29,862	24,002	24.4

Source: Company data, I-Sec research.

Q4FY23 concall takeaways

- **Orderbook.** BEL's orderbook is ~Rs606.90bn as on March 31, 2023 with an order inflow of Rs206.9bn in FY23. BEL expects orderbook inflow of Rs200bn in FY24 (excluding any big ticket programmes such as QRSAM).
- **Topline growth.** Topline growth guidance of 17% YoY for FY24 considering the execution cycle of the current orderbook. FY24's topline guidance is based on the commitment to customers.
- **EBITDA margin.** Management has guided for EBITDA margin of 21-23% for FY24 (including other income).
- **Order inflow.** BEL expects order inflow of ~Rs200bn. This includes: i) Akash Missile System (ground support system equipment) worth Rs40bn, ii) long term fuse requirements of Indian Army worth ~Rs45bn (spread over ten years), iii) shipbuilding contracts (on the basis of ordering already done) worth Rs50-60bn, iv) EW Shakti programme for ships worth ~Rs10bn, besides others.
- **Provisions and other expenses.** Higher other expenses in Q4FY23 mainly on account of higher liquidated damages provision due to supply-chain issues. In FY23, BEL booked Rs3.6bn LD provisions. However, the company also received Rs880mn worth of penalty waivers, pertaining to prior periods. Other expenses also rose owing to LD provisioning.
- Cash balance (including current investments) has increased to Rs80bn and receivables days are almost in line with last year (~148 days).
- **MRSAM programme.** Confirmatory trials are over. Evaluation programme is expected to complete next month.
- **Non-defence portfolio.** In FY23, defence portfolio was 87% and the remaining was non-defence. **Revenue mix for FY24:** Defence at 85%, non-defence at 15%.
- **Capacity building.** 1) Nagpur (Maharashtra), for ammunition at capex of Rs2bn; 2) Ibrahimpatnam (Telangana), for land-based EW systems (Rs3bn); 3) Nimmaluru (Andhra Pradesh), for advanced night vision equipment; 4) Hyderabad (Telangana), for super components at an investment of Rs1bn; and 5) Anantapur (Andhra Pradesh), for manufacturing and integration of big systems for defence and paramilitary segments. These facilities will be commissioned in next 2-3 years. Advance electro-optics facility in Andhra Pradesh is expected to be commissioned in CY24.
- **Capex.** BEL has been incurring capex of ~Rs5bn every year. For FY24, the company is targeting Rs7-8bn of capex owing to increased business needs.
- **UVA and anti-drone system.** BEL is working on high-end UAV platforms in partnership with DRDO. Besides, it is also working on anti-drone systems.
- **Lead integrator.** In Akash missile system for Army, BEL is the lead integrator and for Air Force, BEL is the main integrator, based on capability. For QRSAM, BEL is the lead integrator.
- **Destroyers/frigate.** Out of the total contract value of Destroyers/Frigates, typically ~30% value of equipment are supplied by BEL.
- **EV tie-up, hydrogen fuel cell tie ups etc.** Has supplied one set of battery to Triton which is under evaluation. It will take time to build up momentum.
- **Electronic fuse.** BEL expects Rs4.5-Rs5bn of orders every year (already executing Rs1-1.5bn of fuse orders). The company is expanding its existing capacity to cater to the increased requirement. This is graded indigenisation product and the company has to make significant indigenisation progress in line with contract terms. Initially, indigenisation content requirement is 20-30% but it increases gradually as the contract progresses.

- Nearly 75% products are with indigenous design, of which 45-50% are done in collaboration with DRDO. Transfer of Technology (ToT) accounts for the remaining products.
- **Exports.** US\$48mn (Rs3.94bn) in FY23 (Rs3.94bn). In FY24, the company has targeted ~US\$94mn of export revenue.
- **Pay revision.** Next due in Jan 2027. Normal increment and DA increment will follow every year.
- **R&D expenditure in FY23.** Nearly 6.25% of revenue (Rs11bn) in FY23.

Maintain BUY

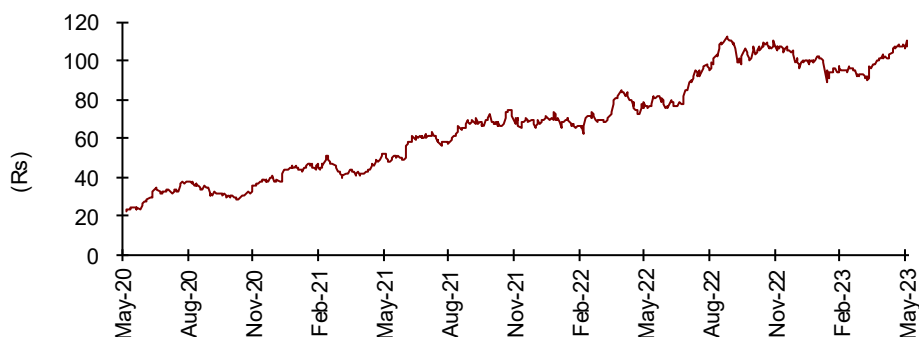
We maintain **BUY** on BEL with a revised TP of Rs140/share (earlier Rs125). We value the company at 25x FY25E EPS. BEL is one of the strategic DPSUs which is set to receive >Rs1,100bn of order inflow over the next 5 years in our view.

Key risks

Slower-than-expected orderbook build up and delay in execution could lead to lower revenue/margin.

Cashflow pressures can be a downside risk. We expect these pressures to moderate in medium term with ease in defence budgetary allocation. Also, lower-than-expected accretion in defence capital budget is a key risk – we believe the probability is low given the heightened external threat perception.

Price chart



Source: Bloomberg

Financial summary

Table 3: Profit and loss statement

(Rs mn, year ending March 31)

	FY22	FY23	FY24E	FY25E
Operating Income	1,53,682	1,77,344	2,07,365	2,42,406
Operating Expenses	1,20,273	1,36,486	1,61,303	1,86,693
EBITDA	33,409	40,859	46,062	55,712
% margins	21.7	23.0	22.2	23.0
Depreciation & Amortisation	4,011	4,288	5,054	5,477
Gross Interest	51	150	153	153
Other Income	2,315	2,808	3,856	4,049
Recurring PBT	31,662	39,229	44,711	54,131
Add: Extraordinary	-	-	-	-
Less: Taxes	8,118	9,826	11,206	13,563
Less: Minority Interest	-	-	63	78
Add: Share of profit from associates	458	459	263	264
Recurring Net Income	24,002	29,862	33,705	40,755

Source: Company data, I-Sec research

Table 4: Balance sheet

(Rs mn, year ending March 31)

	FY22	FY23	FY24E	FY25E
Assets				
Total Current Assets	2,33,495	3,00,477	3,17,976	3,37,525
of which cash & cash eqv.	98,317	1,53,502	1,58,364	1,64,980
Total Current Liabilities & Provisions	1,76,112	1,69,219	1,85,399	1,93,156
Net Current Assets	57,384	1,31,259	1,32,578	1,44,369
Investments	16,035	6,770	6,770	6,770
Strategic/Group	16,035	6,770	6,770	6,770
Other Marketable	-	-	-	-
Net Fixed Assets	26,753	29,629	29,970	29,493
Capital Work-in-Progress	10,060	8,549	10,910	11,001
Goodwill	13,321	9,486	9,486	9,486
Total Assets	1,23,552	1,85,693	1,89,713	2,01,120
Liabilities				
Borrowings	515	46,871	46,562	46,562
Deferred Tax Liability	15	29	29	29
Government Grants	-	-	-	-
Minority Interest	163	178	241	319
Equity Share Capital	2,437	7,310	7,310	7,310
Reserves & Surplus	1,20,423	1,31,307	1,35,572	1,46,901
Net Worth	1,22,859	1,38,616	1,42,882	1,54,211
Total Liabilities	1,23,552	1,85,693	1,89,713	2,01,120

Source: Company data, I-Sec research

Table 5: Cashflow statement

(Rs mn, year ending March 31)

	FY22	FY23	FY24E	FY25E
Operating Cashflow	26,733	33,447	34,856	42,148
Working Capital Changes	15,339	(20,779)	3,544	(5,176)
Capital Commitments	(5,546)	(5,905)	(7,756)	(5,091)
Free Cashflow	36,527	6,764	30,644	31,881
Investing Cashflow	(48,717)	26,908	(3,836)	(964)
Issue of Share Capital	-	-	-	-
Buyback of shares	-	-	-	-
Inc (Dec) in Borrowings	(18)	-	(309)	-
Others	(10,253)	(12,541)	(29,393)	(29,393)
Extraordinary Items	-	-	-	-
Chg. in Cash	(16,916)	27,037	4,862	6,616

Source: Company data, I-Sec research

Table 6: Key ratios

(Year ending March 31)

	FY22	FY23	FY24E	FY25E
Per Share Data (in Rs.)				
EPS(Basic Recurring)	3.3	1.4	4.6	5.6
Diluted Recurring EPS	3.3	1.4	4.6	5.6
Recurring Cash EPS	3.8	1.6	5.3	6.3
Dividend per share (DPS)	-	-	4.0	4.0
Book Value per share (BVPS)	16.8	6.3	19.5	21.1
Growth Ratios (%)				
Operating Income	8.9	15.4	16.9	16.9
EBITDA	4.1	22.3	12.7	21.0
Recurring Net Income	14.3	24.4	12.9	20.9
Valuation Ratios (x)				
P/E	33.2	80.0	23.6	19.6
P/CEPS	28.4	70.0	20.6	17.2
P/BV	6.5	17.2	5.6	5.2
EV / EBITDA	20.9	55.9	14.9	12.2
EV / FCF	19.1	337.6	22.4	21.3
Operating Ratios (%)				
Raw Material/Sales	57.7	55.4	57.6	58.2
SG&A/Sales	6.7	8.5	8.0	7.7
Other Income / PBT	7.3	7.2	8.6	7.5
Effective Tax Rate	25.6	25.0	25.1	25.1
NWC / Total Assets	0.5	0.7	0.7	0.7
Inventory Turnover	1.6	1.5	1.6	1.6
Receivable (days)	-	-	0.1	0.1
Payable (days)	127.9	113.2	105.8	95.6
Asset Turnover	1.3	1.0	1.1	1.2
Net D/E Ratio (x)	(0.8)	(0.8)	(0.8)	(0.8)
Return/Profitability Ratios (%)				
Recurring Net Income Margins	15.6	16.8	16.3	16.8
RoCE	25.7	21.2	23.6	27.0
RoNW	19.5	21.5	23.6	26.4
Dividend Pay-out Ratio	40.6	97.9	86.8	71.7
EBITDA Margins	21.7	23.0	22.2	23.0

Source: Company data, I-Sec research

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