



India

Defence

Priced on 21st May, 2009

±% potential -20%

Market Data

Beta	0.4845
52Wk hi/lo	1370/545
Marketcap, INR Crore	5525.6
Shares in issue (mn.)	80 mn
Reuters	BAJE.BO
Bloomberg	BHE.IN

Share Holding Pattern (%)

Promoters	75.86
FII	5.32
Domestic Inst. & Corp Body.	14.57
Public & Others	4.15

Bharat Electronics

CMP: Rs. 1319 Target: Rs. 1059

We initiate a sell/ reduce call on Bharat Electronics on basis of its strong price movement in a very short period of time(33% in one week) and lower than estimated earnings for FY09(flat growth.)

The company is presently trading at 13 times to its earnings of Rs.101.90 and 2.6 times to its book value of Rs 499.20. The company has registered sales of 2735 crores, registering a topline growth of 19% while profits of the company stood at registered a growth of 14% in Qtr ended March '09 as compared to last year qtr ended March'08.

Operating profit margins have declined from 31.4% in Q4 FY08 to 30.2% in q4 fy09. BEL's full year net sales grew by 12.5% yoy to Rs4,733.7 Crore in FY2009 while its operating profits increased by 6.4% y-o-y to 1157 crores.

OPM of 24.5% for FY2009 was lower than 25.9% for FY08. The company's FY09 OPM declined due to increase in Raw material costs and staff costs.

The company's order book as of 31st Mar'09 stood at around Rs 10,000 Crore Enough to last next 9 quarters with a healthy order book growth rate. Company has paid Rs.6 (60%) interim dividend to its shareholders for 2008-09.

Outlook:

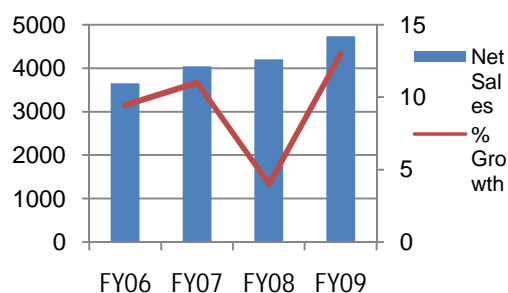
Going forward we expect the company to grow its top line by a compounded growth rate of 12-15% for over next 5 years. Bottom line is expected to rise by a small percentage. We put the company in minimum risk category with beta of 0.485.

While the fundamentals of the company remain strong with an impressive balance sheet and high Return on Equity, the stock price of the company has risen by 130% in almost 6 months since Dec'08 and by 34% in last 4 trading sessions, corresponding to the Sensex return of 58% and 13% in the respective period, thus we believe that the **Short covering can be witnessed in the scrip and we expect a 15-20% dip from these levels. Long term investors with investment horizon of at least 1 year and ideally 3 years can stay invested in the scrip.**

Projections

	FY07	FY08	FY09	FY10E	FY11E	FY12E
Net Sales	4045	4207	4734	5349	6044	6830
% Growth	11	4	13	13	13	13
Net profit	717	816	815	935	1000	1090
(% Net profit)	-	14	0	15	7	9
No. of shares	8	8	8	8	8	8
EPS	89.8	102	101.9	116.9	125.1	136.3
P/E	14.7	12.9	12.9	11.3	10.5	9.7

Source: Fairwealth Research Estimates

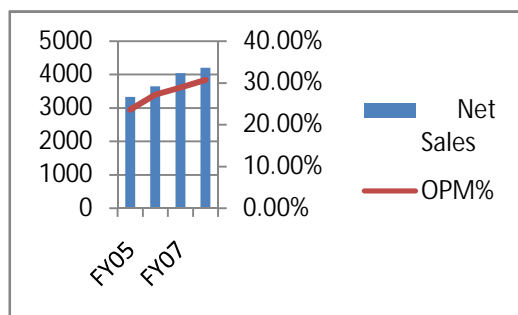


Average Sales growth for the company has been around 12% over last several years, we expect company to witness higher growth rates of around 10% over next 5 years.

Quarterly Result Round up:

	Q3 FY09	Q3 FY08	Y-o-Y Growth (%)	Q2 FY09
Net Sales	2753.48	2305.15	19.4	670.91
Other Income	854.63	771.99	10.7	206.23
Operating				
Total Income	31%	33.4%	-2.4%	30.73%
Operating Profit	29.55	55.24	-46.5	45.63
OPM Margin (%)	854.63	771.99	10.7	206.23
Interest	27.7	26.94	2.8	26.95
PBDT	851.02	771.92	10.2	206.19
Depreciation	823.32	744.98	10.51	179.24
PBT	0	14.39	0	0
Tax	823.32	730.59	12.69	122.77
PAT	263.88	240.15	9.9	56.47
Extra-Ordinary	559.44	504.83	10.8	122.77
PAT	279.72	252.41	10.8	61.38
EPS	2753.48	2305.15	19.4	670.91

Source: Company Data, Capital Line



Source: Company data

Although Margins have grown from 2005 to 2008, rate of growth of the margins has declined and there is a sharp drop in the same in 2009.

Result Analysis:

Bharat Electronics recorded a 14 per cent increase in net profits while revenue grew by 19 per cent for the quarter ended March 2009, as against a year ago numbers.

Topline and bottomline numbers for Bharat Electronics have become increasingly skewed over the years.

Q4 sales were 60% of total sales for FY09 and Q4 profits were 70% of total profits.

Full year performance:

Full year performance was worse than our expectation, while rest of the PSU's have given strong Y-o-Y performance, BEL has failed to impress its shareholders, consequently doesn't deserve the kind of premium deserved by Navratna like BHEL.

While sales have grown by 9% profits for the company have been absolutely flat for FY09.

Consequently, Net Profit Margin for the company has dropped by 170 bps from 19.5% to 17.8%.

Company Description

Bharat Electronics Limited (BEL) is a defense equipment company in India catering to the electronic requirement of defense services. It was incorporated in 1954 in Bangalore to meet the special sized need of Indian Defence services.

BEL enjoys near monopoly status in supplying high-tech defense products like radars, sonars, communication equipment, electronic warfare equipment, etc. Over the years company has grown as multi product multi-technology company serving diverse needs of Defence sector and other sectors as well.

Products:

Radars & Sonars: Used for short range and long range surveillance and fire control. BEL also offers networking solutions.

Communication equipment: Includes mobile and stationary devices (in High, Very High and Ultra High Frequency, and in microwave bands), such as transmitters, trans-receivers and radios, networking solutions and encryption/decryption software.

Opto Electronics: Night vision products, laser range finders.

Outlook and Valuation

BEL has a sizable order book of Rs.96 bn which provides revenue visibility for the company.

In a recessionary scenario such as the current one, defense expenditure is highly unlikely to be curtailed if not increased in the future.

Various initiatives taken by the company to diversify into the civilian segment are also expected to benefit the company. Additionally, BEL is well placed to take advantage of the defense offset opportunity.

At CMP of 1319 the stock trades at a P/E of 12.9 and 11.3 its EPS of 102 in FY09 and 117 in FY 10E.

Having said all that recent spurt in stock price has more than priced in all expectations in the Company's revenues. Stock price has touched a new high of 1385 this week and has started coming off since then.

Investment Advice:

Short Term Trader: Sell BEL with Strict stop loss of 1400

Risk Averse Investor: Sell 1 lot of BEL, buy 1 lot of Nifty

Long Term Investor: Hold if holding period atleast 1 year.

TECHNICAL OUTLOOK: Bharat Electronics

BHARAT ELEC. [N101] 975.00, 1370.00, 940.00, 1318.00, 1173303 37.95%



Bharat Electronics has reached an important 50% retracement level of the down move from 2164 to 544. So one could sell the stock at current levels or reduce their position in the stock & enter at lower levels of around 1100 with a stop loss at 1400

Source: MetaStock

Key Risks:

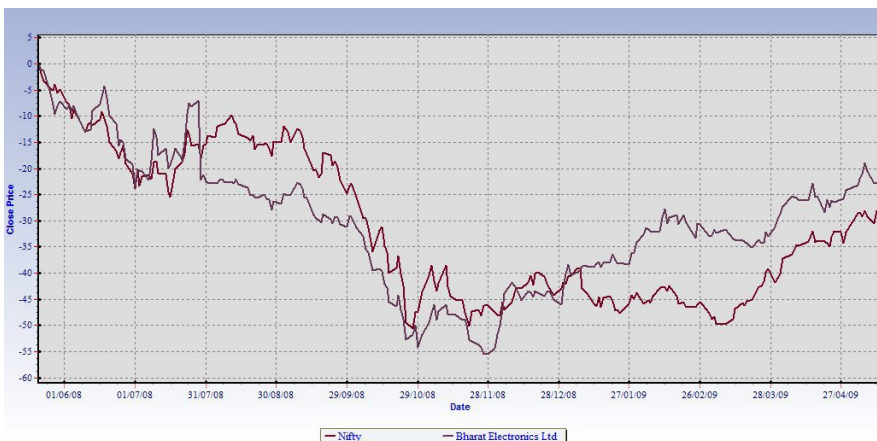
Upside risk to the valuation

1. **Rising Defense Expenditure:**
2. **Emphasis on Indigenization:**
3. **Benefits from the Defense Offset Policy:**
4. **Diversification in the civilian and export market order Book**
5. **India's Defense spending growing at an 11.3% CAGR.**
6. **India's Defense Budget for 2008-09**
7. **Strong product pipeline**
8. **New Areas for Development:**

Although there are number for upside risks for the company, however our estimates project that most of these upsides have been priced and also we do not estimate that defence spending will increase by too much in the next 3 years as India's Fiscal Deficit as percentage of GDP (approx), along with unsupportive trade balance. is becoming an Increasing burden for the new government.

Biggest risk to our advice of going short in the counter is sharp movement in the main index or event based price movement, in which case we would recommend investors to exit from their positions or take a fresh call.

Price Performce



Source: Capital Line

Bharat electronics is low risk low return stock which has historically underperformed Index.

However it has outperformed index by more than 60%(123% for BEL versus 56% for Nifty) over last 6 months and by more than 20% in last 4 trading sessions(33% for BEL versus 14% for Nifty).

We believe that such huge outperformance is highly unjustified for a company whose fundamentals are not event based, and margins for which have not increased over last 5 years.

Hence we reiterate our sell call based on both fundamentals as well as technical's for the stock.

Risk averse investors can short one lot of BEL and long 1 lot of Nifty.

Annexure:

	2008 (12)	2007 (12)	2006(12)	2005(12)
INCOME :				
Net Sales:	4205.97	4045.05	3653.77	3337.88
Other Income	268.25	199.37	123.21	120.57
Stock Adjustments	2.12	64.46	-89.68	20.34
Total Income	4476.34	4308.88	3687.3	3478.79
EXPENDITURE :				
Raw Materials	2123.13	2221.81	1927.64	1841.31
Power & Fuel Cost	34.75	36.03	36.08	36.35
Employee Cost	654.64	512.42	422.13	476.63
Other Manufacturing Expenses	121.19	114.59	98.09	98.22
Selling and Administration Expenses	92.53	83.9	73.14	78.28
Total Expenditure	3184	3139.12	2694.59	2691.54
Operating Profit	1292.34	1169.76	992.71	787.25
Interest	3.92	4.54	28.65	13.34
Gross Profit	1288.42	1165.22	964.06	773.91
Depreciation	100.72	93.33	89.2	78.43
Profit Before Tax	1187.7	1071.89	874.86	695.48
Total Tax	342.73	358.13	281.86	266.73
Net Profit before Minority Interest	837.35	732.14	598.91	454.5
Minority Interest	0.08	0.59	0.43	0.33
EO	17.13	0.57	0.24	-18.44
Adj. Net Profit	820.14	730.98	598.24	472.61
EPS (Adj)	101.14	88.46	72.72	55.17
Adj Book Value (Unit Curr.)	417.76	336.31	266.03	208.23

Source: Company Report, Capital Line

Fund Flow Statement:

	2008	2007	2006	2005
SOURCES OF FUNDS :				
Share Capital	80	80	80	80
Reserves Total	3262	2611	2048	1586
Total Shareholders' Funds	3342	2691	2128	1666
Minority Interest	2	2	2	1
Secured Loans	2	1	2	1
Unsecured Loans	0	1	8	15
Total Debt	2	2	9	16
Total Liabilities	3346	2695	2139	1683
APPLICATION OF FUNDS				
Net Block	437	414	404	358
Capital Work in Progress	35	35	22	49
Investments	0	0	0	0
Current Assets, Loans & Advances				
Inventories	1441	1349	1127	1142
Sundry Debtors	2082	1703	1038	710
Cash and Bank	2462	2093	1858	1349
Loans and Advances	1580	973	813	763
Total Current Assets	7565	6117	4836	3964
Less : Current Liabilities and Provisions				3313.95
Current Liabilities	1519	1164	950	754
Provisions	4833	4023	3249	2808
Total Current Liabilities	2732	2095	1587	1156
Net Current Assets	3314	2859	2298	2054
Net Deferred Tax	1519	1164	950	754
Total Assets	3346	2695	2139	1683
Contingent Liabilities	407	336	244	219

Cash Flow Statement:

	2008	2007	2006	2005
Cash and Cash Equivalents at Beginning of the year	978	576	521	1017
Net Cash from Operating Activities	501	368	677	96
Net Cash Used in Investing Activities	-248	176	-487	-431
Net Cash Used in Financing Activities	-188	-142	-136	-161
Net Inc/(Dec) in Cash and Cash Equivalent	66	402	55	-496
Cash and Cash Equivalents at End of the year	1044	978	576	521

Source: Company Report, Capital Line

Coverage:

Our Stock coverage and Returns:

BUY REPORTS:

Stock	Target	Price as on Call date	Price on 26th may	% return absolute	% return Relative to Sensex			
	Set Date	Target Price	Stock	Sensex	Stock	Stock	Sensex	
Educomp	22-Jan-09	2750	1715	8814	2,861.10	66.83%	57.85%	8.98%
Havells	30-Jan-09	280	115	8325	281	144.35%	67.12%	77.22%
Jaiprakash Associates	12-Feb-09	110	73	9466	185.6	154.25%	46.98%	107.27%
Lupin	03-Feb-09	780	630	8607	862.6	36.92%	61.65%	-24.73%
Tata Steel	06-Mar-09	250	152	8325	368.7	142.57%	67.12%	75.44%
M&M	12-Mar-09	440	345	8344	633.8	83.71%	66.74%	16.97%
Unitech	25-Mar-09	51	34	9667	77.15	126.91%	43.92%	82.99%
Punj Lloyd	30-Mar-09	120/145	85	9549	179.8	111.53%	45.70%	65.83%
Sintex Industries	16-Apr-09	240	137	10,947	218.5	59.49%	27.09%	32.39%
Alok Industries	26-Apr-09	28	14	11,371	21	50.00%	22.36%	27.64%

SELL REPORTS:

Stock	Target	Price as on Call date	Price on 26th may	% return absolute	% return Relative to Sensex
Bharat Electronics Ltd	21-May-09	1059	1319	13,736	1,343.55

Note: Based on 25th May 2009 Sensex closing of 13,913

Note: All calls are initial/ first time calls

Note: All reports can be accessed on our website under <http://www.fairwealth.in/Research.aspx>

Note:

Fundamental and Technical reports are independently given and investors are advised to take their decision based on their investment profile and holding periods.

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