

Analyst:

Abhishek Gupta
abhishekg@bajajcapital.com

Reviewed by:

Alok Agarwala
aloka@bajajcapital.com

BUY

CMP (09.04.09) : Rs. 928.55
Target : Rs. 1147.00
Upside Potential : 23.5%
Horizon : 12 mths

Bharat Electronics Limited

Bharat Electronics Limited (BEL) was established by the Government of India under the Ministry of Defence in 1954 to meet the specialized electronic needs of the Indian defence services. Over the years, it has grown into a multi-product, multi-technology, multi-unit company. Today BEL, a government owned **Navratna Company**, is the leading defence electronics major in India. It is engaged in the design, development and manufacture of sophisticated state-of-the-art electronics equipment/ components for the use of defence services, para-military organizations and other infrastructure providers in the telecom sector. BEL has also played a significant role in the Civilian 'Professional Electronics' sector of the country particularly for the Ministry of Information and Broadcasting by supplying bulk of its infrastructure requirements for Radio and TV Broadcasting, like Studio Equipment, Transmitters, Satellite Uplinks, OB Vans etc. With its 9 production units and 31 manufacturing divisions spread across 7 states, the company's focus on Research and Development to generate business using the 'state-of-the-art' manufacturing and testing facilities, has been well recognized. BEL is the prime Defence electronics company for the Government of India and enjoys near-monopoly status with regard to the supply of high-tech Defence products. **Servicing a priority sector gives the company a bullish outlook; the current weak economic scenario may not impact the order inflow growth much.**

Key Investment Arguments

Joint Ventures: BEL has established a **joint venture with GE Medical Systems, USA** for X-ray tubes and has entered into a Memorandum of Understanding (MoU) with **Boeing US** to develop an analysis and experimentation centre. The centre is expected to enable customers, including India's Defence forces, to make more informed decisions in their efforts to modernize. BEL also has a subsidiary in Pune called **BEL Optronics Devices**, which conducts research and develops and manufactures image intensifier tubes and associated high voltage power supply units for use in military, security and commercial systems. Bharat Electronics has also signed an outline **agreement with the Finmeccanica subsidiary, SELEX Galileo** to explore possible collaboration in the electronic warfare sector. This tie-up will provide significant new market opportunities for both companies as SELEX Galileo has global expertise in electronic warfare equipment development.

BEL has already floated a number of joint ventures with firms in technology areas. It is also looking for JVs with companies having technology related to infra-red seekers and missile electronics, thermal imagers, RF and microwave subsystems, TI detectors, airborne electronic warfare systems, ATM radars, solar photovoltaic cells, training simulators, software house for C41 and computational platforms for radars, sonars and EW systems. These JV's will help the company in expanding its product line as well as technological know how.

Contract manufacturing for Exports: Besides its traditional exports, the management is exploring contract manufacturing opportunity and expects decent order flows in the near term. It has set up a fully modernized facility for contract manufacturing at

As on 09th Apr 2009

Price Performance

	CMP	(1M)	(3M)	(12M)
S&P CNX				
Nifty	3342.1	2617.5	2993.1	4733.0
Bharat Ele. (Rs.)	930.5	837.0	768.1	1159.9

Absolute Returns (%)

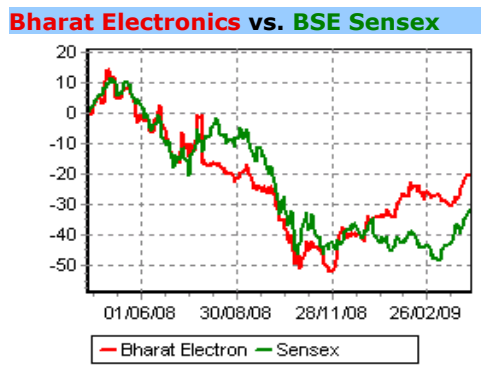
Bharat Elect.	11.2	21.2	-19.8
S&P CNX Nifty	27.7	11.7	-29.4

Brief Profile

Industry	Electronics	
House	Govt of India	
CMP - 09.04.09 (Rs)	928.6	
Mkt. Cap (Rs cr)	7428.4	
Face Value (Rs.)	10.0	
52 week (Rs)	High	1371.0
	Low	545.4
Book value (Rs)	404.1	
P/BV (ttm)	2.3	
P/E Ratio (ttm)	10.1	
Last Dividend (%)	207.0	
Avg. daily volume	15008	

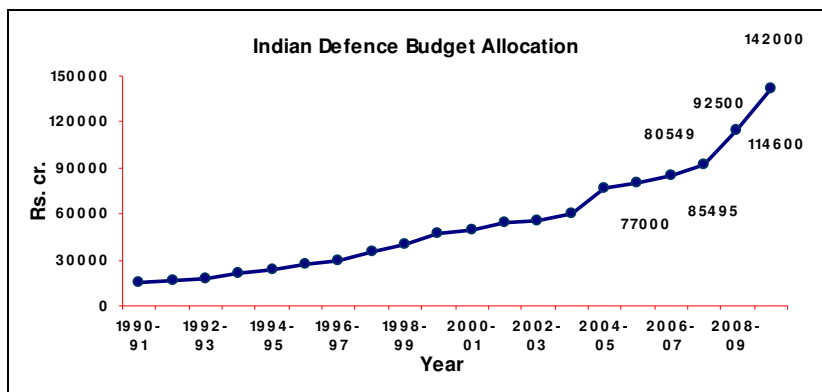
Panchkula (Haryana) which will enable large scale production of electronic modules.

Defence Expenditure: India’s defence expenditure has increased significantly from Rs. 60066cr in FY03 to Rs. 1,14,600cr for FY08-09, a CAGR of 13.8% and stands at Rs. 1,42,000cr as per the interim budget estimates for FY10. The defence budget for FY10 thus marks a 23.7% rise over last year’s Revised budget of Rs. 1,14,600cr. India is among the top 10 spenders on military equipments in the world. BEL is the prime defence electronics company for the Government of India. It enjoys near monopoly status in supplying high-tech defence products and has a strong base in R&D and manufacturing skills. Hence, it is likely to benefit from higher defence outlays thereby ensuring steady growth in its order book.



Defence Budgets - 2008-09 and 2009-10	2008-09	2009-10
Defence Budget (Rs. cr) (budgeted figures)	105600	141703
Growth in Defence Budget (%)	10.0	34.2
Revenue Expenditure (Rs. cr)	57593	86879
Share of Revenue Expenditure in Defence Budget (%)	54.5	61.3
Capital Expenditure (Rs. cr)	48007	54824
Share of Capital Expenditure in Defence Budget (%)	45.5	38.7
Growth in Capital Expenditure (%)	14.5	14.2

There is a growth in the revenue expenditure due to implementation of the recommendations of the sixth pay commission. Total budget for pay and allowances for 2009-10 has more than doubled to Rs. 44500.7cr. The share of capital expenditure in the defence budget has therefore seen a fall of 6.8% in FY10, though in absolute terms it went up by Rs. 6817cr yoy.



Defence Offset Policy: Indian Defence offset policy will encourage FDI and intensify Research and development in Defence sector. Broadly, this offset policy makes it mandatory for any foreign defence equipment supplier to enter into a JV with an Indian company for supplying equipments. It also stipulates a transfer of technology to the JV and hence the Indian company. The policy is meant to develop in-house Defence manufacturing capability over a period of time. India will spend \$ 30 billion for acquisition of military hardware and software during the 11th five year plan and almost \$100 billion by 2020. The Offset policy is likely to bring in \$10 billion of business during the 11th five year plan (ending in 2012). BEL is confident of bagging 25% of the total Defence offset business.

Indigenization of product portfolio: BEL is focusing to indigenize the Defence equipment business as much as possible, technologically as well as economically. Over years the company has been able to indigenize its product portfolio by 83%. It has a strong Research

laboratory of 800 engineers and it spends approx. 4-5% of its turnover on R&D.

Shareholding Pattern

	31-Dec-08 (%)
Promoters	75.9
Indian	75.9
Foreign	0.0
Non Promoters	24.1
FII/DFI	5.4
FI/MF	14.5
Public	4.2
Total	100.0

Modernization of Indian Forces: Indian forces are on a modernization drive. The country is expected to buy virtually all types of weapons and systems which include fighter aircraft, armored vehicles, radars, missiles, naval vessels etc. Out of the total capital expenditure of Rs. 54824cr for FY10, 30% of capital budget is expected to be used for new weapons and systems. Therefore substantial amount is available for procurement. BEL is likely to be a prime beneficiary in this case.

Order book: BEL currently has an order book in excess of Rs.10000 cr. One of the major projects bagged by BEL this year is the Akash Defence System which is to be delivered in 36 months. Two squadrons of Akash are to be supplied to IAF. The order value is Rs. 1,221 cr.

Capital Expenditure: BEL is expected to incur a capital expenditure of Rs 570cr in the next two years to modernize its manufacturing plants, which in turn would increase realization. BEL plans to increase its R&D expenditure from the current 5% to 8–10% of sales in the coming years in order to increase self-reliance.

Quarterly Results: BEL Q3FY09 revenue was up by 1.1% yoy to Rs. 671cr, compared to a 10.1% yoy growth in Q2FY09. Operating profit shot up 29.2% yoy to Rs 134cr compared to Rs 103.5cr in the similar quarter of corresponding year. The revenues of the company have grown at a 10 year CAGR of 12.7%. Going forward, with increasing Defence needs and unstable geopolitical environment, the company is likely to maintain a better growth rate on the back of rising order flows.

Strong earnings visibility: BEL has an order book Rs. 10000cr, nearly 2.5 times its FY08 revenues, thereby providing strong earnings visibility for the company. Defence contributes 83% of its sales. BEL plans to diversify itself in future and expects 25% of its sales to come from civilian and export markets.

Key Concerns

- Capital expenditure for defence has increased substantially over years but the country has not been able to spend the same year on year which has lead to under-utilization of allocated funds. Under-utilization has increased by over 4 times during last 4 years. However in recent years Ministry of Defence has tried to improve the acquisition procedure and is likely to be more active after the recent terror attacks.

Latest Announcements

- BEL and Astra Microwave signed a MoU to explore formation of a joint venture company for **design and manufacture of Microwave components & assemblies**. These products will cater to the requirements of the Indian Defence, Paramilitary, Government establishments, and other civilian and international customers.

Conclusion

On the basis of our research, we feel that this is a good stock to buy at the current market price of Rs. 928.55. If everything goes well, the price is likely to appreciate to Rs.1147, within 12 months, translating into a gain of about 23.5%.

Financials

(Rs. in crore)

	9M 200812	200803	200703	200603	200503	200403	200303	5 yr CAGR %
Share Capital	80.0	80.0	80.0	80.0	80.0	80.0	80.0	
Networth		3233.1	2592.2	2042.5	1593.3	1248.6	1021.7	
Revenues	1835.5	4059.5	3889.0	3500.8	3183.1	2736.2	2465.4	10.5
EBITDA	450.7	1267.7	1141.3	962.9	769.0	538.7	457.2	22.6
APAT	249.0	809.6	717.6	582.8	464.7	349.1	265.4	25.0
Operating Cash Flows		506.8	377.9	682.7	87.5	890.6	236.2	
Dividend %		207.0	180.0	146.0	112.0	100.0	70.0	
CEPS (Rs.)		111.4	97.4	80.8	63.2	46.0	38.6	23.6
EPS (Rs.)*	31.1	99.8	86.8	70.8	54.2	38.2	31.7	25.8
Debt-Equity Ratio		0.00	0.00	0.01	0.02	0.03	0.07	
Interest Coverage Ratio	52.4	315.9	249.2	31.4	60.3	72.0	25.5	
RoNW %		28.4	31.0	32.1	31.4	30.8	28.4	
EBITDA Margin %	24.6	31.2	29.3	27.5	24.2	19.7	18.5	
APAT Margin %	13.6	19.9	18.5	16.6	14.6	12.8	10.8	
Total Asset Turnover Ratio		0.6	0.7	0.7	0.8	0.8		
Fixed Asset Turnover Ratio		10.2	10.3	10.2	10.5	10.5		
Price/Sales	1.8							
PE Multiple	10.1							
P/BV Ratio	2.3							

* EPS for Nine months ended 200812 is absolute and not annualized.

Information Sources

1. ISI Emerging Markets
2. Capitaline Plus

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Bajaj Capital Centre for Investment Research
Bajaj Capital Ltd
97, Bajaj House, Nehru Place
New Delhi 110019
Tel 4169 3000, 4169 2900, Ext. 1516

Email: bccir@bajajcapital.com