

# BHARAT ELECTRONICS

## Slow start, but robust momentum anticipated

India Equity Research | Engineering and Capital Goods



Bharat Electronics (BEL) reported weak sales and order intake during Q1FY13. While sales dipped on continued deferrals and approval process delays from clients, order intake prospects remain bright for the coming one-two years on back of strong demand. Higher raw material costs coupled with unfavorable sales mix (low value adds items) impacted OPMs, which are expected to improve in balance FY13. Maintain 'BUY'.

### Approval delays hit sales volume; adverse sales mix impacts OPMs

BEL reported 15% YoY decline in revenue for the quarter due to approval delays and slow off take from clients. Management expects balance of FY13 to see decent pick up in both volumes and profitability driven by deliveries for Aakash missiles, Rohini radars and ground-based EW systems, and maintains its FY13 sales growth guidance of 15%. Also, low value add items and higher ToT sales (>20% of sales) impacted profitability. Higher input cost (sharp jump in RM to sales %) during the quarter is expected to come off in the coming quarters as indicated by the management on improved deliveries.

### OI dips 22%, but revenue visibility and FY13-14E prospects good

The company began the year with a quarterly OI of INR8.6bn versus INR11bn in Q1FY12, which is generally a non-material quarter both from execution and fresh awards perspective. Management remains positive on FY13E-14E intake quantum and quality, with sustained proportion of indigenised & DRDO based orders in WLR & EW systems and other missile systems. Also, management expects to form new JVs with a few foreign entities in FY13E which would provide fresh avenues for business wef FY14E & beyond. Company maintains FY13E fresh intake target at INR100bn (up 25 % YoY).

### Outlook and valuations: Attractive; maintain 'BUY'

BEL offers a decent long-term upside potential given its favourable positioning in the domestic defence market. The company has decent revenue growth visibility (book to bill at 3.8x on FY13E sales) and attractive prospects for a sustained order intake growth in the near to medium term with a strong balance sheet and cash in hand of INR65bn plus (67% MCAP). We maintain our 'BUY/SO' with a revised TP of INR 1617 (+33% upside), implying a PE of 9.5x on FY14E earnings.

#### Financials

(INR mn)

Year to March	Q1FY13	Q1FY12	% change	Q4FY12	% change	FY11	FY12E	FY13E
Net rev.	7,969	9,399	(15.2)	22,972	(65.3)	56,160	57,676	65,415
EBITDA	(1,063)	511	(307.9)	3,221	(133.0)	10,386	6,108	8,929
Net profit	193	1,228	(84.3)	3,540	(94.5)	8,615	8,299	9,485
Dilu. EPS (INR)	2.4	15.4	(84.3)	44.2	(94.5)	107.7	103.7	118.6
Dilu. P/E (x)						11.3	11.8	10.3
EV/EBITDA (x)						3.1	5.5	3.7
ROAE (%)						18.4	15.6	15.7

#### EDELWEISS 4D RATINGS

Absolute Rating	BUY
Rating Relative to Sector	Outperformer
Risk Rating Relative to Sector	Low
Sector Relative to Market	Equalweight

#### MARKET DATA (R: BAJE.BO, B: BHE IN)

CMP	: INR 1,222
Target Price	: INR 1,617
52-week range (INR)	: 1,771 / 1,121
Share in issue (mn)	: 80.0
M cap (INR bn/USD mn)	: 98/ 1,760
Avg. Daily Vol.BSE/NSE('000)	: 40.6

#### SHARE HOLDING PATTERN (%)

	Current	Q4FY12	Q3FY12
Promoters %	75.9	75.9	75.9
MF's, FI's & BK's	15.6	15.9	14.4
FII's	3.8	3.8	5.9
others	4.8	4.4	3.9
* Promoters pledged share (% of share in issue)	:		NIL

#### PRICE PERFORMANCE (%)

	Stock	Nifty	EW Capital Goods Index
1 month	(8.9)	(0.7)	5.0
3 months	(17.0)	(0.1)	(13.1)
12 months	(28.9)	(5.0)	(31.4)

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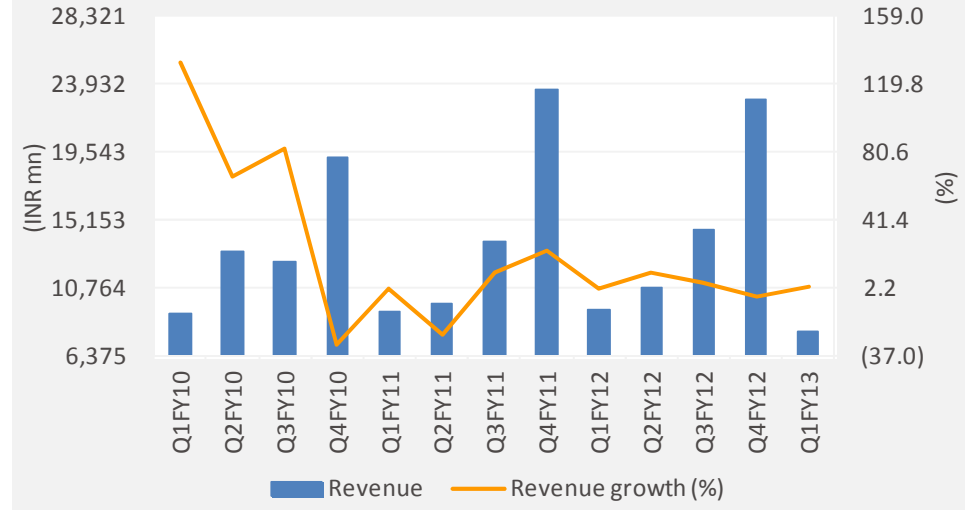
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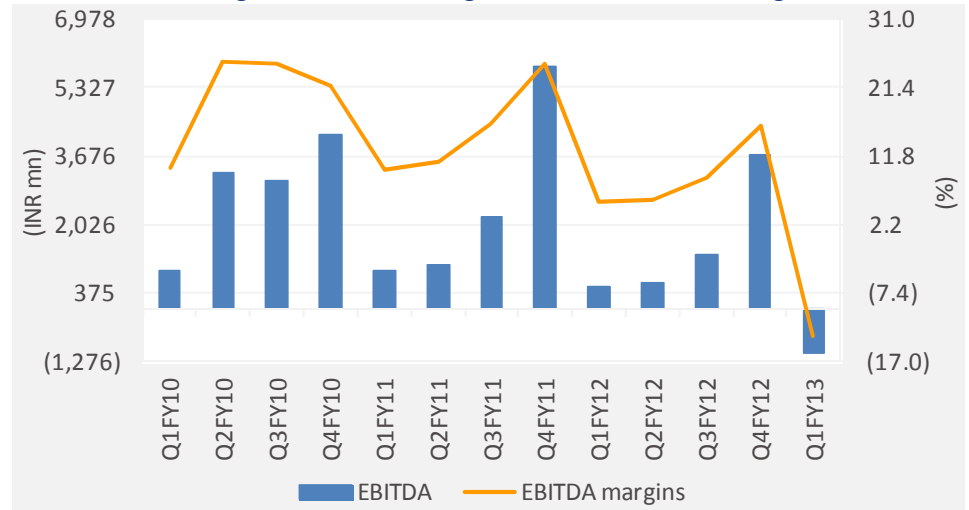
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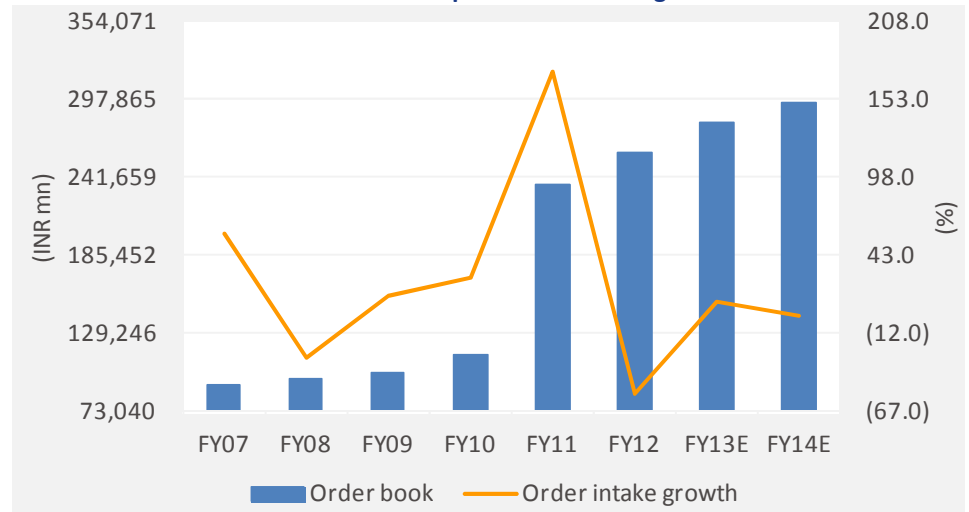
**Chart 1: Revenue growth moment – Q1 is normally very soft for the company**



**Chart 2: EBITDA margins movement – Negative OPLEV led to the margin decline**



**Chart 3: Order book movement – We expect a 10% inflow growth in FY13**



Source: Company, Edelweiss research

**Financial snapshot**
**(INR mn)**

<b>Year to March</b>	<b>Q1FY13</b>	<b>Q1FY12</b>	<b>% change</b>	<b>Q4FY12</b>	<b>% change</b>	<b>FY11</b>	<b>FY12E</b>	<b>FY13E</b>
Revenues	7,969	9,399	(15.2)	22,972	(65.3)	56,160	57,676	65,415
Materials cost	5,292	5,623	(5.9)	15,184	(65.1)	31,447	35,791	38,922
Staff costs	2,858	2,684	6.5	2,410	18.6	10,419	10,812	11,677
Other expenses	882	581	51.7	2,157	(59.1)	3,909	4,966	5,887
Total expenditure	9,032	8,888	1.6	19,751	(54.3)	45,774	51,569	56,487
EBITDA	(1,063)	511	NM	3,221	NM	10,386	6,108	8,929
Interest	3	0	NM	1	NM	4	6	-
Depreciation	306	293	4.4	300	2.2	1,220	1,208	1,214
Other income	1,632	1,451	12.5	1,472	10.9	2,450	5,855	5,514
PBT	260	1,669	(84.4)	4,393	(94.1)	11,611	10,749	13,229
Tax	67	441	(84.8)	853	(92.2)	2,997	2,450	3,744
Adjusted net profit	193	1,228	(84.3)	3,540	(94.5)	8,615	8,299	9,485
Net profit	193	1,228	(84.3)	3,540	(94.5)	8,615	8,299	9,485
Equity capital	800	800		800		800	800	800
No. of shares (mn)	80	80		80		80	80	80
Adj. diluted EPS (INR)	2.4	15.4	(84.3)	44.2	(94.5)	108	104	119
Diluted P/E (x)						11.3	11.8	10.3
EV/EBITDA (x)						3.1	5.5	3.7
ROAE (%)						18.4	15.6	15.7
<b>as % of net revenues</b>								
Raw material	66.4	59.8		66.1		56.0	62.1	59.5
Staff expenses	35.9	28.6		10.5		18.6	18.7	17.9
Other expenses	11.1	6.2		9.4		7.0	8.6	9.0
EBITDA	(13.3)	5.4		14.0		18.5	10.6	13.6
Net profit	2.4	13.1		15.4		15.3	14.4	14.5

**Change in Estimates**

	<b>FY13E</b>			<b>FY14E</b>			<b>Comments</b>
	<b>New</b>	<b>Old</b>	<b>% change</b>	<b>New</b>	<b>Old</b>	<b>% change</b>	
Net Revenue	65,415	67,867	(3.6)	73,027	76,011	(3.9)	Lowering our growth assumptions owing to weak Q1FY13 sales & OI
EBITDA	8,929	9,854	(9.4)	10,027	11,040	(9.2)	
EBITDA Margin	13.6	14.5		13.7	14.5		We build in impact of operating loss in Q1.
Core profit	9,485	9,982	(5.0)	10,267	10,791	(4.9)	
PAT Margin	14.5	14.7		14.1	14.2		
Capex	1,230	1,230	0.0	1,230	1,230	0.0	

### Company Description

Established by GoI under the Ministry of Defence in 1954 to meet the specialised electronic needs of the Indian defence services, Bharat Electronics Limited (BEL) has grown into a multi-product, multi-technology and multi-unit company, serving the needs of customers in diverse fields in India and abroad. BEL offers products and services in a wide spectrum of technology like radars, military communications, naval systems, electronic warfare systems, telecommunications, sound and vision broadcasting, opto-electronics, tank electronics, solar photovoltaic systems, embedded software and electronic components. The company also provides turnkey systems solutions like command control communication & computer intelligence (C4I), covering the requirements of all three forces.

### Investment Theme

BEL, one of India's largest defence public sector undertakings (PSU), specialises in manufacturing defence electronics. It is emerging as a key beneficiary of increase in defence capital expenditure. Further, domestic companies, including BEL, are likely to benefit from key changes in government policies, notably the offset clause (30% of an order must be sub-contracted domestically). Despite the entry of private players, we believe BEL as a defence PSU is poised to benefit from increased defence capital expenditure and the offset policy.

BEL has a strong order book, equivalent to nearly four years of revenues. Its order book is slated to grow over the next few years because of steady demand for its existing product range; potential orders from high value projects (e.g., tactical communication systems) and growth opportunities in the non defence/ export segments. However a higher share of projects instead of products in the sales mix could be margin dilutive, which is a concern.

### Key Risks

#### **Delay/lumpiness in execution of defence contracts**

The defence market is monopsonistic in nature with GoI being the sole buyer of defence equipment, which puts suppliers such as BEL at a disadvantage. Further, defence procurement procedures are complex and past experience suggests that they have tended to move at an extraordinarily slow pace. This has a dual impact: the equipment flow may not occur and it leads to a high degree of lumpiness in the order book.

#### **Increased competition from private players**

The government has shown increased intent of involving private players in the defence procurement process and to develop an active private sector supply to the armed forces. We believe DPSUs have strong competitive advantages over the private sector in the near-to-medium term. However, incremental competition, particularly for offset contracts, could make a negative impact on BEL's margins.

## Financial Statements

### Key assumptions

	FY10	FY11	FY12	FY13E	FY14E
GDP(Y-o-Y %)	8.4	8.4	6.5	6.4	7.0
Inflation (Avg)	3.6	9.9	8.8	7.0	6.0
Repo rate (exit rate)	5.0	6.8	8.5	7.3	6.8
USD/INR (Avg)	47.4	45.6	47.9	53.5	50.0

### Income statement

	(INR mn)				
Year to March	FY10	FY11	FY12E	FY13E	FY14E
Income from operations	53,810	56,160	57,676	65,415	73,027
Materials costs	29,964	31,447	35,791	38,922	43,451
Employee costs	9,168	10,419	10,812	11,677	12,611
Other Expenses	3,580	3,909	4,966	5,887	6,938
Total operating expenses	42,712	45,774	51,569	56,487	63,000
EBITDA	11,097	10,386	6,108	8,929	10,027
Depreciation and amortisation	1,159	1,220	1,208	1,214	1,286
EBIT	9,938	9,165	4,900	7,715	8,741
Other income	1,759	2,450	5,855	5,514	5,498
Interest expenses	5	4	6	-	-
Profit before tax	11,692	11,611	10,749	13,229	14,239
Provision for tax	3,242	2,997	2,450	3,744	3,973
Net profit	8,450	8,615	8,299	9,485	10,267
Extraordinary income/ (loss)	(1,241)	-	-	-	-
Profit After Tax	7,209	8,615	8,299	9,485	10,267
Shares outstanding (mn)	80	80	80	80	80
Diluted EPS (INR)	105.6	107.7	103.7	118.6	128.3
Dividend payout (%)	21.2	22.5	23.3	20.4	18.9

### Common size metrics - as % of net revenues

Year to March	FY10	FY11	FY12E	FY13E	FY14E
Operating expenses	79.4	81.5	89.4	86.4	86.3
EBITDA margins	20.6	18.5	10.6	13.6	13.7
Net profit margins	15.7	15.3	14.4	14.5	14.1

### Growth ratios (%)

Year to March	FY10	FY11	FY12E	FY13E	FY14E
Rev. growth (%)	15.8	4.4	2.7	13.4	11.6
EBITDA	(1.6)	(6.4)	(41.2)	46.2	12.3
EPS growth (%)	2.5	1.9	(3.7)	14.3	8.2

## Engineering and Capital Goods

Balance sheet					(INR mn)
As on 31st March	FY10	FY11	FY12E	FY13E	FY14E
Equity capital	800	800	800	800	800
Reserves & surplus	42,657	49,226	55,678	63,226	71,555
Shareholders funds	43,457	50,026	56,478	64,026	72,355
Borrowings	7	4	-	-	-
<b>Sources of funds</b>	<b>43,464</b>	<b>50,030</b>	<b>56,478</b>	<b>64,026</b>	<b>72,355</b>
Gross block	17,022	18,428	19,628	20,828	22,028
Depreciation	12,122	13,343	14,550	15,764	17,050
Net block	4,900	5,086	5,078	5,064	4,979
Capital work in progress	314	341	491	521	551
Deferred tax asset	1,567	1,806	1,806	1,806	1,806
Investments	120	120	120	120	120
Inventories	24,487	24,608	27,723	30,367	32,832
Sundry debtors	21,684	29,032	29,816	33,817	37,752
Cash and equivalents	35,783	65,192	64,110	63,931	68,623
Loans and advances	4,333	5,553	7,818	9,582	10,490
Total current assets	86,287	124,385	129,468	137,696	149,698
Sundry creditors and others	44,310	75,974	76,099	75,503	78,890
Provisions	5,415	5,736	4,387	5,681	5,910
Total current liabilities & provisions	49,725	81,710	80,486	81,184	84,800
Net current assets	36,563	42,676	48,982	56,513	64,898
<b>Uses of funds</b>	<b>43,464</b>	<b>50,030</b>	<b>56,478</b>	<b>64,026</b>	<b>72,355</b>
Book value per share (INR)	543.2	625.3	706.0	800.3	904.4

Free cash flow					(INR mn)
Year to March	FY10	FY11	FY12E	FY13E	FY14E
Net profit	7,209	8,615	8,299	9,485	10,267
Depreciation	1,159	1,220	1,208	1,214	1,286
Deferred tax	(629)	-	-	-	-
Others	401	-	-	-	-
Gross cash flow	8,139	9,835	9,507	10,699	11,552
Less: Changes in WC	(4,157)	(23,296)	7,388	7,711	3,693
Operating cash flow	12,297	33,131	2,119	2,988	7,860
Less: Capex	1,197	1,433	1,350	1,230	1,230
<b>Free cash flow</b>	<b>11,099</b>	<b>31,697</b>	<b>769</b>	<b>1,758</b>	<b>6,630</b>

Cash flow metrics					
Year to March	FY10	FY11	FY12E	FY13E	FY14E
Operating cash flow	12,297	33,131	2,119	2,988	7,860
Investing cash flow	(1,223)	(1,433)	(1,350)	(1,230)	(1,230)
Financing cash flow	1,761	(2,288)	(1,850)	(1,938)	(1,938)
Net cash flow	12,834	29,410	(1,081)	(180)	4,692
Capex	(1,197)	(1,433)	(1,350)	(1,230)	(1,230)
Dividends paid	(1,750)	(1,938)	(1,938)	(1,938)	(1,938)

**Profitability & efficiency ratios**

Year to March	FY10	FY11	FY12E	FY13E	FY14E
ROAE (%)	20.7	18.4	15.6	15.7	15.1
ROACE (%)	24.4	19.7	9.2	12.8	12.8
Inventory day	208	196	185	188	183
Debtors days	151	165	186	178	179
Payable days	366	480	538	490	447
Cash conversion cycle (days)	(7)	(119)	(167)	(125)	(85)
Current ratio	1.7	1.5	1.6	1.7	1.8
Debt/EBITDA	-	-	-	-	-

**Operating ratios**

Year to March	FY10	FY11	FY12E	FY13E	FY14E
Total asset turnover	1.3	1.2	1.1	1.1	1.1
Fixed asset turnover	11.2	11.2	11.3	12.9	14.5
Equity turnover	1.3	1.2	1.1	1.1	1.1

**Valuation parameters**

Year to March	FY10	FY11	FY12E	FY13E	FY14E
Diluted EPS (INR)	105.6	107.7	103.7	118.6	128.3
Y-o-Y growth (%)	2.5	1.9	(3.7)	14.3	8.2
CEPS (INR)	128.0	122.9	118.8	133.7	144.4
Diluted PE (x)	11.6	11.3	11.8	10.3	9.5
Price/BV (x)	2.2	2.0	1.7	1.5	1.4
EV/Sales (x)	1.1	0.6	0.6	0.5	0.4
EV/EBITDA (x)	5.6	3.1	5.5	3.8	2.9

**Peer comparison valuation**

Name of the companies	CMP	Market cap (USD mn)	PE (x)		P/BV (x)		ROE (%)	
			2013E	2014E	2013E	2014E	2013E	2014E
BEML	323	13,462	14.4	11.8	0.6	0.6	4.3	5.0
L&T	1,381.0	15,203	16.6	14.2	2.5	2.2	16.3	16.6
BEL	1219	1,757	10.3	9.5	1.5	1.3	15.7	15.1

Source: Bloomberg, Edelweiss research

Company	Absolute reco	Relative reco	Relative risk	Company	Absolute reco	Relative reco	Relative Risk
ABB India	REDUCE	SU	L	Bajaj Electricals	BUY	SO	M
BGR Energy Systems	HOLD	SP	M	Bharat Electronics	BUY	SO	H
Bharat Heavy Electricals	HOLD	SP	L	Crompton Greaves	BUY	SO	M
Cummins India	HOLD	SP	L	Havells India	BUY	SO	M
Jyoti Structures	HOLD	SP	M	Kalpataru Power Transmission	HOLD	SP	M
KEC International	HOLD	SP	M	Larsen & Toubro	BUY	SO	M
Siemens	BUY	SO	L	Sterlite Technologies	HOLD	SP	H
Techno Electric & Engineering	BUY	SO	M	Thermax	HOLD	SP	L
Voltamp Transformers	REDUCE	SU	M	Voltas	HOLD	SP	L

**ABSOLUTE RATING**

Ratings	Expected absolute returns over 12 months
Buy	More than 15%
Hold	Between 15% and - 5%
Reduce	Less than -5%

**RELATIVE RETURNS RATING**

Ratings	Criteria
Sector Outperformer (SO)	Stock return > 1.25 x Sector return
Sector Performer (SP)	Stock return > 0.75 x Sector return
	Stock return < 1.25 x Sector return
Sector Underperformer (SU)	Stock return < 0.75 x Sector return

Sector return is market cap weighted average return for the coverage universe within the sector

**RELATIVE RISK RATING**

Ratings	Criteria
Low (L)	Bottom 1/3rd percentile in the sector
Medium (M)	Middle 1/3rd percentile in the sector
High (H)	Top 1/3rd percentile in the sector

Risk ratings are based on Edelweiss risk model

**SECTOR RATING**

Ratings	Criteria
Overweight (OW)	Sector return > 1.25 x Nifty return
Equalweight (EW)	Sector return > 0.75 x Nifty return
	Sector return < 1.25 x Nifty return
Underweight (UW)	Sector return < 0.75 x Nifty return

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**Coverage group(s) of stocks by primary analyst(s): Engineering and Capital Goods**

ABB India, BGR Energy Systems, Bharat Electronics, Bharat Heavy Electricals, Bajaj Electricals, Crompton Greaves, Havells India, Jyoti Structures, KEC International, Cummins India, Kalpataru Power Transmission, Larsen & Toubro, Siemens, Sterlite Technologies, Techno Electric & Engineering, Thermax, Voltamp Transformers, Voltas

**Recent Research**

Date	Company	Title	Price (INR)	Recos
01-Aug-12	<b>Cummins INC</b>	Beats estimates; positive on India growth; <i>Global Pulse</i>		Not Rated
30-Jul-12	<b>Havells India</b>	Mixed bag; <i>Result Update</i>	555	Buy
30-Jul-12	<b>Crompton Greaves</b>	ZIV buyout: Consolidating systems portfolio; <i>Company Update</i>	115	Buy

**Distribution of Ratings / Market Cap**

Edelweiss Research Coverage Universe

	Buy	Hold	Reduce	Total
Rating Distribution*	104	60	18	183
* 1 stocks under review				
	> 50bn	Between 10bn and 50 bn	< 10bn	
Market Cap (INR)	114	58	11	

**Rating Interpretation**

Rating	Expected to
<b>Buy</b>	appreciate more than 15% over a 12-month period
<b>Hold</b>	appreciate up to 15% over a 12-month period
<b>Reduce</b>	depreciate more than 5% over a 12-month period

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