

# BHART ELECTRONICS

MARCH2016

BEL													
Rating	Accumulate												
Price	Rs 1100												
Target Price	Rs 1300												
Implied upside	18%												
Shareholders													
<table border="1"> <caption>Shareholders Data</caption> <thead> <tr> <th>Category</th> <th>Percentage</th> </tr> </thead> <tbody> <tr> <td>Promoters</td> <td>75%</td> </tr> <tr> <td>Foreign</td> <td>4%</td> </tr> <tr> <td>Domestics</td> <td>15%</td> </tr> <tr> <td>Public &amp; Other</td> <td>6%</td> </tr> </tbody> </table>				Category	Percentage	Promoters	75%	Foreign	4%	Domestics	15%	Public & Other	6%
Category	Percentage												
Promoters	75%												
Foreign	4%												
Domestics	15%												
Public & Other	6%												
Stock Performance													
%	1m	6m	12m										
Absolute	-6.1	-1.80%	8.1										
Relative	0	9.10%	25.3										
How we differ from consensus													
EPS	PL	Cons	% diff.										
2016	57.5	60.8	-5.3										
2017	64.3	67.3	-4.5										

**Strong margins:** Bharat Electronics (BEL) revenues disappointed while margins surprised on the positive side. BEL reported sales of Rs15.2bn, down 5.7% YoY (PLe: Rs18.5bn). The weak execution was due to a combination of delayed vendor dispatches as well as inventory increases due to delay in pick up by few clients. Major projects supplied during the quarter include Akash Missile System( Airforce, Army), Fire control System, 3D Tactical Control Radar, Low Level Light Weight radar, Gigabit Ethernet based Ship Data Network, L band Radar for exports. BEL reported EBITDA of Rs2.9bn, up 5.2% YoY (PLe: Rs2.8bn) and margins improved by 200bps to 19.3% due to better mix. Other income was up 19% YoY to Rs1.4bn and Adj. PAT was up 8.8% YoY to Rs2.9bn (PLe: Rs2.5bn).

**Strong order book provides visibility:** Order book at the end of Q3FY16 stood at ~Rs323bn, up 47% YoY. Export order book stood at ~US\$158m. Order inflow for Q3FY16 stood at Rs127.7bn, up 67% YoY. Major orders acquired during Q3FY16 include Integrated Air Command Control System (Rs 79bn), Weapon Locating Radar, USHUS-2, Sub Systems for T-90, Shakti EW Systems. Major orders expected to be further finalized in FY16 include, Long range surface to Air Missile and Hand held Thermal Imager. FY17 could also see order

inflow as few large orders like Akash Missile (~Rs50bn), Integrated communication and control system (~Rs60bn) etc are likely to be finalized in FY17. Radars, Missile Systems, Communication and Network Centric Systems, Tank Electronics, Gun Upgrades, Electro-Optic Systems, Electronic Warfare and Avionics Systems are the key areas that will drive BEL's growth in the medium term.

## Expect sales CAGR of 8-10% over the next five years:

BEL has guided for sales growth of 8-10% for FY16 and expects to grow at a similar CAGR over the next five years. We believe that the long execution cycle of order book and long approval/clearance process restricts company's ability to grow at a faster pace.

## BEL expects stable margins over few years:

BEL expects margins to be stable atv FY15 levels. BEL will be focusing on core areas and increase outsourcing. The company is looking at increasing proportion of outsourcing from the present levels of 32% to 36% in the next five years. Procurement from MSMEs will also increase in the medium term from 8% in FY15 (4.73% in FY14). In line with this strategy, BEL is looking to add 800 indigenous vendors annually. The company believes that benefits derived from cost-cutting initiatives will help negate the increased employee cost from 7th pay commission implementation.

BEL further highlighted that it is not significantly impacted by increased participation of private players in the defense industry as most players are entering businesses such as ship building, gun manufacturing, etc, which is not the domain area of BEL.

#### Outlook and Valuation:

The stock is trading at 21.3x FY17E earnings. We believe BEL will be the prime beneficiary of government focus on modernization of current fleet and procurement of new capital equipments. Increased focus on R&D, move towards being system integrator and increased focus outsourcing are steps in right direction to increase long term sustainability of business. We continue to believe BEL offers good investment opportunities to investors who want to invest in the Indian Defense sector with a long-term view. We expect stock to deliver earnings CAGR of 12% over FY14-17E. Maintain 'Accumulate'.

Y/E MARC	FY15	FY16E	FY17E	FY18E
Sales	68427	72620	81335	91095
EBITDA rs	11433	11982	14640	15942
Adj PAT	11655	12458	15909	17098
con EPS	0	53.9	60.8	67.3
EPS	48.6	51.9	66.3	71.2
Change yoy	25.8	6.9	27.7	7.5
p/e	25.4	23.7	18.6	17.3
roe	15.6	15	17.2	16.69
ev/e	20.7	19	14.6	12.9
dps	11.4	17.6	23.4	25.7

Rs mn	15-Dec	14-Dec	% Chg	15-Sep	% chg	FY16E	FY15	% Chg
Net sales	15172	16082	-5.7	14677	3.4	72620	68427	6.1
EBITDA	2926	2781	5.2	1754	66.8	11982	11433	4.8
Other income	1355	1135	19.3	1375	-1.5	5408	4767	13.4
PBIDT	4281	3917	9.3	3129	36.8	17390	16201	7.3
Depreciation	414	374	10.7	403	2.8	1617	1540	5
Interest	1	0	0	3	-47.5	4	14	-71.1
PBT	3865	3542	9.1	2723	41.9	15770	14647	7.7
Tax	908	824	10.1	656	38.4	3312	2992	10.7
Adjusted PAT	2957	2718	8.8	2068	43	12458	11655	6.9
No of shares	240	240	0	240	0	240	240	0
EBITDA Margin%	19.3	17.3	0	12	0	16.5	16.7	0
PBIDT Margin%	28.2	24.4	0	21.3	0	23.9	23.7	0
EPS	12.3	11.3	8.8	8.6	43	51.9	48.6	6.9

Profit and loss				
Y/E March	FY15	FY16E	FY17E	FY18E
Net sales	68427	72620	81335	91095
other operating income	0	0	0	0
total operating income	68427	72620	81335	91095
cost of goods sold	-37806	-41030	-45547	-51013
gross profit	30621	31590	35787	40082
gross margin%	44.8	43.5	44	44
total operating expenses	-19188	-19607	-21147	-24140
EBITDA	11433	11982	14640	15942
EBITDA Margin	16.7	16.5	18	17.5

depreciation	-1540	-1617	-1697	-1782
EBIT	9894	10366	12943	14159
Net interest	-14	-4	-5	-5
other income	4767	5408	7200	7489
profit before tax	14647	15770	20138	21643
total taxation	-2992	-3312	-4229	-4545
tax rate	20.4	21	21	21
profit after tax	11655	12458	15909	17098
minorities	0	0	0	0
profit/loss associate	0	0	0	0
adjusted net profit	11655	12458	15909	17098
adj PAT Margin	17	17.2	19.6	18.8
net non recurring items	0	0	0	0
Reported net profit	11655	12458	15909	17098

Balance sheet				
Y/E March	FY15	FY16E	FY17E	FY18E
Paid up capital	800	2400	2400	2400
reserves and surplus	78050	84696	94989	105910
net worth	78850	87096	97389	108310
borrowings	0	0	0	0
other non current liabilities	-3378	-3378	-3378	-3378
total liabilities	148619	170044	190577	212154
gross fixed assets	24853	29853	34853	39853
Less:depreciation	-17140	-18757	-20455	-22237
net fixed assets	7712	11096	14398	17616
Add:capital WIP	1397	1001	1002	1002
Total fixed assets	9109	12097	15400	18618
Total investment	191	191	191	191
Inventory	33694	34818	38996	43676
debtors	37861	39792	40110	44923
cash and bank	58815	68146	80878	89744
Loans and advances	0	0	0	0
current liabilities	73147	86326	96566	107222
net current assets	66172	71431	78420	86123
other non current assets	0	0	0	0
Total assets	148619	170044	190577	212154
Cash flow				
Y/E March	FY15	FY16E	FY17E	FY18E
Profit before tax	14647	15770	20138	21643
depreciation and amortisation	-1540	-1617	-1697	-1782
chg in working capital	3807	4072	5743	1163
cash flow from operations	12037	13138	16153	12559
capital expenditure	-2586	-5000	-5000	-5000
cash flow from investing	2110	408	2200	2489
equity raised /repaid	0	0	0	0
debt raised/repaid	0	0	0	0

dividend paid	-961	-4212	-5616	-6178
cash flow from financing	-975	-4216	-5621	-6183
net chg in cash	13172	9330	12732	8865

Key ratios				
Y/E March	FY15	FY16E	FY17E	FY18E
<b>OPERATIONAL</b>				
FDEPS	48.6	51.9	66.3	71.2
CEPS	55	58.6	73.4	78.7
DPS	11.4	17.6	23.4	25.7
Dividend payout ratio	23.5	33.8	35.3	36.1
<b>GROWTH</b>				
Net sales	9	6.1	12	12
EBITDA%	28.3	4.8	22.2	8.9
Adj net profit	25.8	6.9	27.7	7.5
FDEPS	25.8	6.9	27.7	7.5
<b>PERFORMANCE</b>				
ROE	15.6	15	17.2	16.6
ROCE%	20.6	19.8	22.7	21.8
<b>EFFICIENCY</b>				
Asset turnover	3.1	3.8	4.6	5.3
sales/total assets	0.5	0.5	0.5	0.5
working capital /sales	0.1	0.1	0	0
Receivable days	202	200	180	180
inventory days	215.8	209.6	213.4	212.1
payable days	72.8	83.8	85.4	84.8
<b>FINANCIAL STABILITY</b>				
Total debt/equity	0	0	0	0
net debt/equity	-0.8	-0.8	-0.9	-0.9
current ratio	1.9	1.8	1.8	1.8
interest cover	715	2591.4	2588.5	2831.8
<b>VALUATION</b>				
PE	25.4	23.7	18.6	17.3
EV/EBITDA	20.7	19	14.6	12.9
EV/Net sales	3.5	3.1	2.6	2.3
PB	3.7	3.4	3	2.7
Dividend yield	0.9	1.4	1.9	2.1
free cash flow yield	3.2	2.8	3.8	2.6

RAYRC

Ray Research & Consulting Pvt Ltd