

BSE Code: 500049

NSE Code: BEL

Reuters Code: BAJE.NS

Bloomberg Code: BHE:IN

Established in 1954 under the Ministry of Defence (MoD) to meet the specialised electronic needs of the Indian defence services, Bharat Electronics Ltd (BEL) stands to be a multi-product, multi-technology, and multi-unit company, serving the needs of customers in diverse fields in India and abroad. BEL is among an elite group of public sector undertakings, which have been conferred the Navratna status by the Government of India. BEL offers defence products including defence communication equipment, radars, sonars, naval systems, opto-electronics, electronic warfare systems, tank electronics, and simulators. The company also provides nondefense products, such as switching equipment, TV and broadcast, direct-to-home television (DTH), telecom, simputer, electronic voting machine and electronic components, including passive components, small signal transistors, power devices, integrated circuits and silicon detectors, and professional broadcast and communication equipment.

Investment Rationale

Strong order backlog provides earnings visibility: BEL possesses a robust order backlog of ₹220,770 mn, to be executed over the next four years, which provides a healthy and steady revenue visibility. Backed by a healthy order book, we expect BEL to surpass the revenue of ~₹70,000 mn during FY15E. Moreover, with the steady demand of its existing product range; potential orders from high value projects and growth opportunities in the non-defence/export segments, we expect BEL's order book to increase progressively over the next few years.

Recent Government initiatives bolster order outlook for the company: In the Union budget 2015-16, the Government has increased the country's annual defence outlay by 7.5% to ₹2.5 trillion. The higher budget allocation will result in increase in order flow as BEL is one of the largest manufacturers of defence equipment in India. Further, the domestic companies, including BEL, are likely to benefit from the Government's increased focus on the development of more defence equipment domestically, notably due to the offset clause (30% of an order must be sub-contracted domestically). Further the government's emphasis on 'Make in India' will not only cater to domestic needs but needs but also add to the export potential of the company.

Revenue to grow at a CAGR of ~6.1% over FY14-16E: BEL witnessed a 3.9% YoY growth in revenue at ₹65,179.0 mn in FY14 due to a strong order book driven by rising defence expenditures. During FY14, EBITDA margins of the company improved by ~357 basis points to 14%, due to lower employee cost and execution of the high-margin Akash Missile System (AMS) order. We expect the company could sustain its growth trajectory in FY15E and FY16E, as it is to deliver six units of AMS in FY15E and expected improvement in the pace of orders, given the government's mandate to quicken piled-up defence deals.

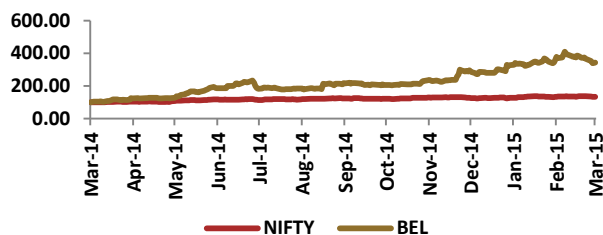
Market Data

| | |
|-------------------------|---------------|
| Rating | BUY |
| CMP (₹) | 3,296 |
| Target (₹) | 3,917 |
| Potential Upside | ~19% |
| Duration | Long Term |
| Face Value (₹) | 10.0 |
| 52 week H/L (₹) | 4,144.5/970.0 |
| Adj. all time High (₹) | 4,144.5 |
| Decline from 52WH (%) | 20.5 |
| Rise from 52WL (%) | 239.8 |
| Beta | 0.7 |
| Mkt. Cap (₹bn) | 263.7 |
| Enterprise Value (₹bn) | 217.7 |

Fiscal Year Ended

| Y/E | FY13A | FY14A | FY15E | FY16E |
|------------------|-------|-------|-------|-------|
| Revenue (₹bn) | 62.7 | 65.2 | 70.5 | 77.9 |
| EBITDA (₹bn) | 6.6 | 9.2 | 10.3 | 11.7 |
| Net Profit (₹bn) | 9.1 | 9.5 | 10.2 | 11.6 |
| EPS (₹) | 113.8 | 118.9 | 128.1 | 145.1 |
| P/E (x) | 29.0 | 27.7 | 25.7 | 22.7 |
| P/BV (x) | 4.1 | 3.7 | 3.3 | 3.0 |
| EV/EBITDA (x) | 31.7 | 23.6 | 21.5 | 19.2 |
| ROCE (%) | 16.4 | 15.5 | 15.1 | 15.5 |
| ROE (%) | 14.0 | 13.2 | 12.9 | 13.3 |

One year Price Chart



Shareholding Pattern

| | Dec'14 | Sep'14 | Diff. |
|-----------|--------|--------|--------|
| Promoters | 75.0 | 75.0 | 0.0 |
| FII | 2.3 | 18.5 | (16.2) |
| DII | 17.8 | 2.6 | 15.2 |
| Others | 4.9 | 3.9 | 1.0 |

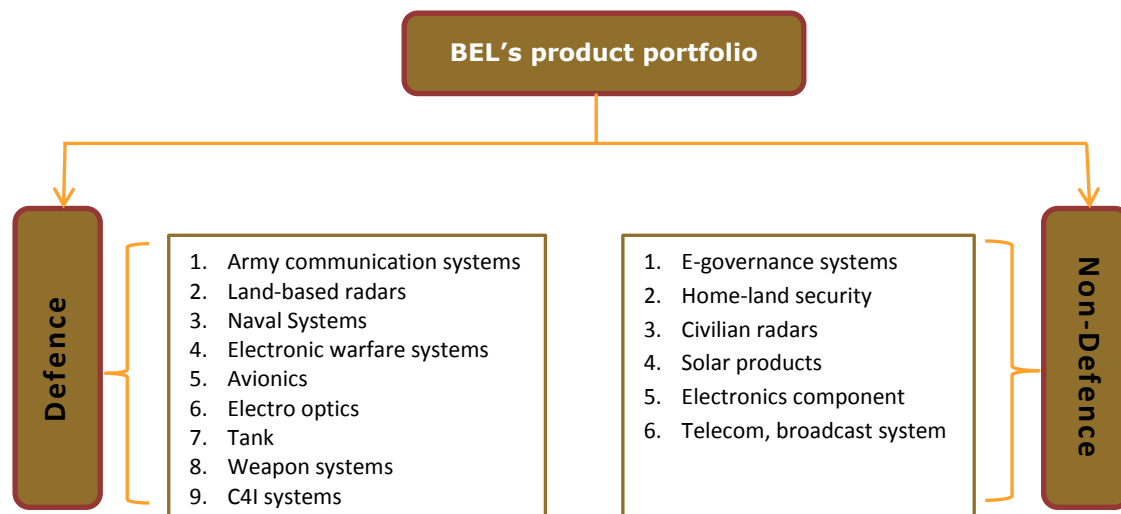
BEL is a multi-product, multi-technology, and multi-unit company, serving the needs of customers in diverse fields in India and abroad. BEL is among an elite group of public sector undertakings, which have been conferred the Navratna status by the GoI.

BEL, a major defence equipment supplier

Established in 1954 as an arm of the Ministry of Defence (MoD) to meet the specialised electronic needs of the Indian defence services, 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 is among an elite group of public sector undertakings, which have been conferred the Navratna status by the GoI. BEL offers defence products including defence communication equipment, radars, sonars, naval systems, opto-electronics, electronic warfare systems, tank electronics, and simulators. The company also provides nondefence products, such as switching equipment, TV and broadcast, direct-to-home television (DTH), telecom, simputer, electronic voting machine and electronic components, including passive components, small signal transistors, power devices, integrated circuits and silicon detectors, and professional broadcast and communication equipment.

Defence being the mainstay of the company, has contributed 83% of sales revenue in FY14, with the balance 17% was contributed by the civilian sector. The company has 9 manufacturing units and 2 Research and Development (R&D) units. BEL has a three-layer R&D setup comprising Development and Engineering (D&E) Divisions at its 9 Units, Central D&E supporting other D&E divisions, and Central Research Labs (CRLs) at Bangalore and Delhi for carrying out futuristic, cutting-edge research. BEL maintains technological leadership with its strong in-house R&D and in association with development agencies such as DRDO, ISRO, CSIR, C-DOT, C-DAC and leading academic institutions such as IITs, IISc and NITs.

Product Portfolio of BEL

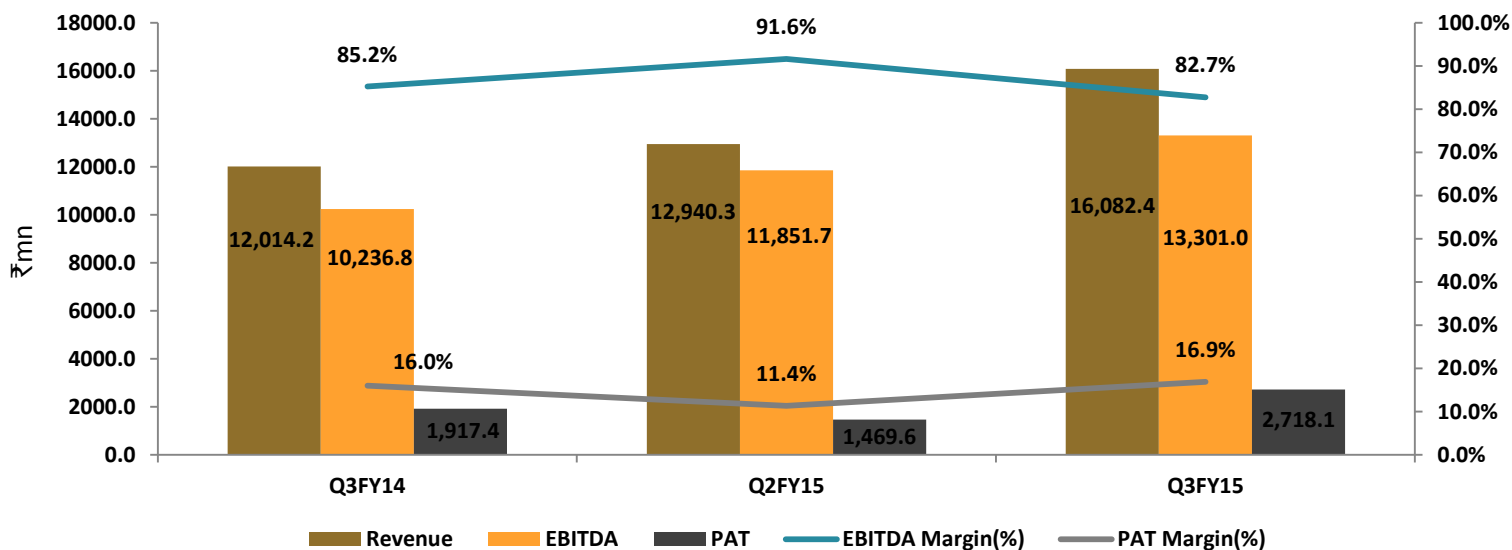


The company managed to rope in higher revenues for Q3FY15 riding high on better execution and increasing exports.

Healthy numbers in Q3FY15

BEL reported a top-line of ₹16,082.4 mn, gaining 33.9% YoY, on a standalone basis, for the quarter ended December 2014, primarily because of healthy execution chiefly in missile systems, radar systems and night vision devices. The company's exports that increased by 68% also aided the top-line growth. The expenses of the company surged by 29.9% YoY driven by an increase in raw material costs by 20% YoY signifying better execution at the company's end. However, rising expenses did not affect the EBITDA adversely and it grew by 56.5% YoY. The EBITDA margins posted an increase of 250 basis points (bps) led by operating leverage despite rising costs. PAT jumped by 41.8% YoY from ₹ 1,917.4 mn in Q3FY14 to ₹2,718.1 mn in Q3FY15.

Quarterly Performance Trend



BEL's comfortable order backlog provides revenue visibility for the next four to five years.

Healthy order book provides strong revenue visibility & greater opportunity ahead

BEL had a strong order book of ₹220,770 mn at the end of Q3FY15, which is to be executed over the next four years, providing strong revenue visibility. Despite the order inflow during Q3FY15 reduced by 18.1% YoY to ₹7,630 mn, the backlog remains healthy. Major orders acquired during the quarter include Mobile communication terminal and Combat management systems. The major order executed during Q3FY15 includes; Akash Missile System, Passive Night Vision Devices, Missile Warning System and Shipborne Electronic Warfare System, etc. However, the company is lined up with other major orders to be executed during FY15 includes; Weapon Locating Radar, Ground Based Elint, L70 Gun Upgrade and Mobile Cellular Communication System.

Major orders at the end of Q3FY15

| Major supplies during Q3FY15 | Major orders acquired during Q3FY15 | Major orders expected during FY15E |
|-----------------------------------|--|--------------------------------------|
| Akash Missile System | Gigabit Ethernet based Ship Data Network | Weapon Locating Radar |
| Passive Night Vision Devices | Advanced Composite Communication System | Ground Based Elint |
| Electronic Support Measure System | Compact Multi-Purpose Advanced Stabilized System | L70 Gun Upgrade |
| Central Acquisition Radar | Strategic Communication | Mobile Cellular Communication System |
| Fire control system | - | - |
| Schilka Air Defence System | - | - |
| Stabilized Optronic Pedestal | - | - |
| Tactical Control Radar | - | - |
| Modular Communication System | - | - |

BEL continues to stress on developing new products and systems through joint venture efforts with DRDO labs, other research institutions and academic institutions as well as niche technology companies.

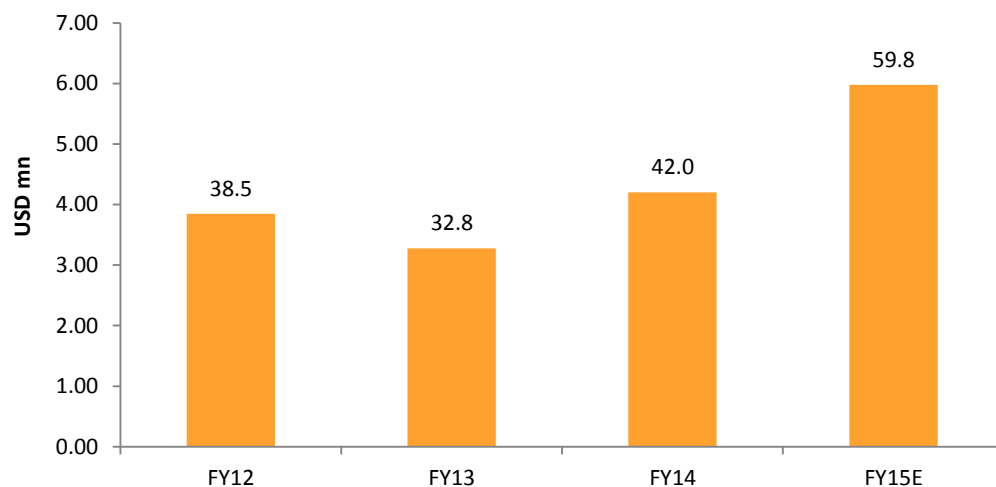
The recently acquired offers include Gigabit Ethernet based Ship Data Network, Advanced Composite Communication System, Compact Multi-Purpose Advanced Stabilized System and Strategic Communication. Further, the export order of the company stood at USD 208.1 mn. The company sees long term order pipeline of ~₹400,000-500,000 mn including big ticket orders like Tactical Communication System (TCS) and Battlefield Management System (BMS). We anticipate an improvement in the pace of orders from the armed forces, given the government's mandate to quicken piled-up defence deals. The improving order outlook, places BEL in a sweet spot.

New product launches to provide better opportunity ahead

BEL continues to remain technologically advanced and develops new products regularly. The company has developed several new products in FY14 includes, Bharani - a Low Level Light weight Radar (LLLR), Hull Mounted Sonar - for detecting, localizing and tracking surface & sub-surface targets in both active and passive modes, Electronic Voting Machine with advance features, and Radio for LIC EW system - a Printing attachment to the Electronic Voting Machine (EVM). With the government emphasis on Indigenisation, BEL derived 85% of turnover from indigenously designed and developed products. We perceive BEL to be a lead defence supplier over the next three to five years, despite rising interest from private sector players, given its focused positioning in core areas like missile systems, radars etc. The company is also increasing its thrust towards non-defence products. The company has a high dependence on the defence segment, from which it derives almost 80% of its revenues.

The company is also laying greater emphasis on developing new products and systems through joint venture efforts with DRDO labs, other research institutions and academic institutions as well as niche technology companies. Besides, leveraging its capabilities and strengths in the Defence business, the company is also looking to enter into new technology areas viz; Critical Infrastructure Protection, Ammunition fuses, Indigenous SAM systems, ATM Radars and Satcom terminals. The company is planning to develop these products in collaboration with reputed foreign OEMs/defence labs. This in turn has enabled the company to reduce costs due to the availability of technology in India at a significantly lower cost. Recently, the company has received an approval from FIPB to form JV with Thales for design, development, marketing, supply & support of civilian and select defence radars.

Export volumes trend



With the Central Government's thrust on Make in India, the domestic manufacturers will add to the growing exports.

The company is focusing on R&D by leveraging its capabilities and strengths in the defence business to develop more critical technologies/systems.

Aims to achieve export sales of USD 59.75 mn in FY15E

BEL has achieved an all-time high export sales of USD 9.6 mn in Q3FY15, registering a growth of 129% over the previous year's export turnover of USD 4.2mn. On the export front, the company has bagged orders worth USD 208.1 mn in Q3FY15. BEL for the first time exported state-of-the-art Sonar systems and also successfully commenced manufacturing of aircraft cable looms for M/s Pilatus of Switzerland. To give thrust to exports, BEL is eyeing export sales of USD 59.8 mn in FY15E, besides aiming to increase the share of export sales to total sales turnover ratio to 7% by FY19E from the current contribution of 4%.

BEL also remains optimistic of gaining further more orders in future on account of "Offset" policy in defence procurements as well as high budget allocation in the Union Budget along with government's thrust on 'Make in India'. BEL is also in talks with various foreign companies, like Elbit Systems, Boeing, Lockheed Martin, Raytheon, Northrop Grumman, BAE Systems, SAAB, Thales, and IAI for possible offset business arising out of various proposals issued by MoD India.

Recent amendment to DPP to increase competition from private players

The Defence Procurement Procedure (DPP) – 2013 is aimed at mostly indigenization of the defence procurements and also provides a level playing field between the defence public sector undertakings (DPSUs) and the private defence companies. For instance, now maintenance transfer of technology from foreign vendors will not go to an ordnance factory nominated by the defence ministry; instead, the foreign vendor can choose the Indian partner that it believes will best discharge the maintenance responsibility that the contract specifies. So far maintenance, repairs and overhaul contracts have largely been the preserve of ordnance factories and defence public sector undertaking (DPSUs). This remains a concern for BEL as it would increase competition from the private sector. However, in order to deal with the increasing competitiveness and productivity, the company is focusing on enhancing value addition by leveraging its capabilities and strengths in the Defence business, which in turn would open more avenues for JV with foreign Original Equipment Manufacturers (OEMs).

Company's thrust on R&D; likely to roll out more new developed products

BEL remains committed towards the indigenous development of products and systems and also towards value addition in its products/systems, which has led the company to achieve 85% of the turnover from the indigenous products. The company continues to invest in R&D and has invested 7.56% of the total turnover in FY14, which is one of the highest among the defence PSUs. This is clearly visible from the fact that in FY14, BEL has filed for 9 Patents in the areas of x-ray baggage scan images, radar scan converter, the gradient estimate for adaptive analog beam, accurate target bearing using digital compass, multiple voice streams in the packet based transmission, wide band switch limiter and monocyte impulse generator. Approximately 41% of BEL's turnover is from products developed in-house, 44% from products developed in collaboration with DRDO, and 15% from products based on overseas technologies. With the government emphasis on Indigenisation, we believe the company to play a greater role in the indigenous development of critical technologies/systems and strategic systems required for Indian defence, which is restricted to the DRDO, given BEL's technological tie-up with DRDO. In order to achieve this, the company is looking to increase its R&D spend from the current 7% to between 8% and 10% in the coming years

Balance Sheet (Consolidated)

| Y/E (₹mn) | FY13A | FY14A | FY15E | FY16E |
|-----------------------------|------------------|------------------|------------------|------------------|
| Share Capital | 800.0 | 800.0 | 800.0 | 800.0 |
| Reserve and surplus | 64,074.7 | 71,402.6 | 78,542.8 | 86,397.1 |
| Minority Interest | 34.1 | 37.7 | 37.7 | 37.7 |
| Loans | 2.2 | 2.7 | 2.9 | 3.2 |
| Other long term liabilities | 367.8 | 75.8 | 75.8 | 75.8 |
| Government Grants | 1,596.8 | 2,205.8 | 2,867.6 | 3,727.8 |
| Provisions | 3,490.5 | 3,568.4 | 3,759.9 | 4,154.6 |
| Current Liabilities | 78,143.0 | 71,664.1 | 65,198.1 | 60,623.3 |
| Capital Employed | 148,509.0 | 149,757.0 | 151,284.8 | 155,819.6 |
| Fixed assets | 9,281.9 | 11,529.6 | 12,314.6 | 13,256.3 |
| Long term loans & advances | 1,607.4 | 687.3 | 756.0 | 846.7 |
| Deferred tax Assets | 2,739.8 | 3,015.2 | 3,015.2 | 3,015.2 |
| Current Assets | 134,081.4 | 133,587.7 | 134,186.8 | 137,587.9 |
| Other non-current assets | 798.6 | 937.3 | 1,012.3 | 1,113.5 |
| Capital Deployed | 148,509.0 | 149,757.0 | 151,284.8 | 155,819.6 |

Key Ratios (Consolidated)

| Y/E | FY13A | FY14A | FY15E | FY16E |
|-------------------------|-------|-------|-------|--------|
| EBITDA Margin (%) | 10.6 | 14.1 | 14.6 | 15.0 |
| EBIT Margin (%) | 18.4 | 18.5 | 18.4 | 18.9 |
| NPM (%) | 14.5 | 14.6 | 14.5 | 14.9 |
| ROCE (%) | 16.4 | 15.5 | 15.1 | 15.5 |
| ROE (%) | 14.0 | 13.2 | 12.9 | 13.3 |
| EPS (₹) | 113.8 | 118.9 | 128.1 | 145.1 |
| P/E (x) | 29.0 | 27.7 | 25.7 | 22.7 |
| BVPS(₹) | 810.9 | 902.5 | 991.8 | 1090.0 |
| P/BVPS (x) | 4.1 | 3.7 | 3.3 | 3.0 |
| EV/Operating Income (x) | 3.4 | 3.3 | 3.1 | 2.9 |
| EV/EBITDA (x) | 31.7 | 23.6 | 21.5 | 19.2 |

Profit & Loss Account (Consolidated)

| Y/E (₹mn) | FY13A | FY14A | FY15E | FY16E |
|-------------------------|-----------------|-----------------|-----------------|-----------------|
| Total Income | 62,727.3 | 65,178.6 | 70,528.4 | 77,886.1 |
| Operating Expenses | 56,097.9 | 55,963.2 | 60,231.2 | 66,203.1 |
| EBITDA | 6,629.4 | 9,215.4 | 10,297.1 | 11,682.9 |
| Other Income | 6,254.1 | 4,372.8 | 4,285.3 | 4,713.9 |
| Depreciation | 1,364.9 | 1,498.7 | 1,588.7 | 1,684.0 |
| EBIT | 11,518.6 | 12,089.4 | 12,993.8 | 14,712.8 |
| Interest | 8.4 | 35.2 | 29.9 | 25.4 |
| PBT | 11,510.2 | 12,054.2 | 12,963.9 | 14,687.3 |
| Tax | 2,362.6 | 2,544.0 | 2,722.4 | 3,084.3 |
| Exceptional Items | 25.6 | 0.0 | 0.0 | 0.0 |
| PAT | 9,173.2 | 9,510.2 | 10,241.5 | 11,603.0 |
| Minority Interest | 4.2 | 3.6 | 3.8 | 3.9 |
| Prior period adjustment | (61.2) | 6.5 | 6.5 | 6.5 |
| Net Profit | 9,107.8 | 9,513.1 | 10,244.2 | 11,605.5 |

Valuation and view

Holding a dominant position in the Indian defence industry with ~60% market share in defence electronics in India, we believe the growth opportunity for BEL is large, given the increased focus of the new government on defence spending, both for capital equipments and modernization of technologies. Further, we believe BEL will be amongst the key beneficiaries of opening up of the defence sector. Thrust on R&D by the company will continue with roadmaps drawn for future products and key technologies. We maintain a positive view on the company considering its strong order book, which is about 3.7 times its FY14 revenue, provides growth visibility of two to three years. Further, healthy cash reserve, which reflects the company's balance sheet strength.

At the CMP of ₹3,296, BEL is attractively placed at EV/EBITDA of ~19x FY16E. Considering the above aspects, we rate the stock as 'BUY' at a target price of ₹3,917, with a potential upside of ~19% for the coming 12 months.

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