

## Equity Research Desk



## ALPHA

01 JUL 2022

## HAL – Largest Defence Company

Market Data	
CMP	Rs. 1738
Date	01-Jul-22
Target Price	Rs. 2085
Upside Potential	20.00%
52 Week High/Low	1973/1010
Market Cap	Large Cap
Sector	Aerospace & Defence
Rating	Buy

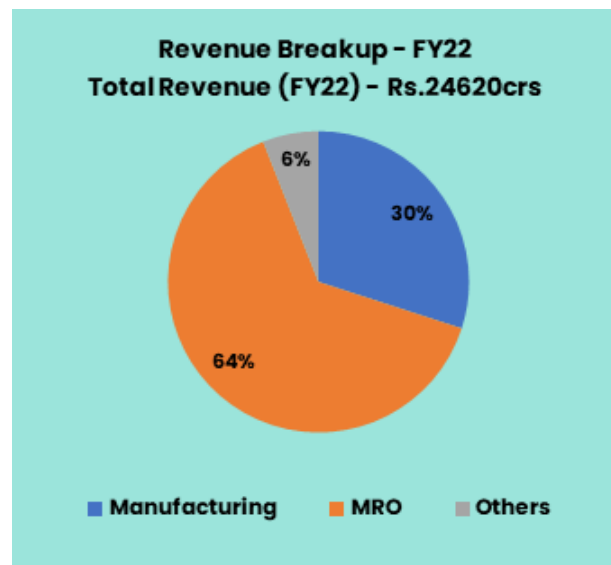
Hindustan Aeronautics Ltd. (HAL) was incorporated as Aeronautics India Ltd on August 16, 1963. Subsequently, Hindustan Aircraft Ltd, a company incorporated in 1940, was merged with the company and the name of the company was changed to Hindustan Aeronautics Ltd (HAL) with effect from October 1, 1964. HAL is the largest DPSU in terms of value of production and was given Navratna status by the Government of India (GoI) in June 2007. Currently, HAL has 20 production and 10 R&D centres co-located with the production divisions, at nine geographic locations across the country. These divisions are organised into five complexes, viz. Bangalore Complex, MiG Complex, Helicopter Complex, Accessories Complex and Design Complex. Apart from this, a new facility at Tumkur (Karnataka) has been set up and is expected to be operational soon.



**Products & Services:** HAL's products portfolio includes fighter aircraft, trainer aircraft, transport aircraft, military helicopter and civil helicopters and their engines, avionics and accessories (such as special test equipment and ground handling equipment and ground support equipment), which are both indigenously designed or manufactured under license.

SHP	Mar - 22 (%)	Dec - 21 (%)	Change
Promoters	75.15	75.15	0.00
FPI	4.37	3.15	1.22
DII	17.00	18.25	-1.25
Public & Others	3.48	3.45	0.03
Pledged	0.00	0.00	0.00

**Subsidiaries:** As on 31st Mar 2022, the company has a total of 2 subsidiaries and 9 Joint Ventures.



Margins - FY22	
Gross	59%
EBITDA	22%
PAT	21%



## Key Rationale

- **Long Track Record** – Over the years, HAL has showcased its research, design and development capabilities with the successful development of military aircraft and helicopters such as the Ajeet, Marut, HPT-32, Kiran and Advanced Light Helicopter. The company also manufactures aircrafts under license such as the MiG-21, MiG-27, Avro, Jaguar, Dornier 228, Su-30 MKI and Hawk Mk 132 and helicopters such as the Cheetah and Chetak. The company also provides MRO (Maintenance, Repair and Overhaul) services for these indigenous and license manufactured aircraft and helicopters, as well as for aircraft and helicopters procured directly by the Indian defence services. The company faces limited competition from the private sector due to the high capital intensity and long gestation periods for developing manufacturing capabilities in the sector. While competition from the private sector is likely to intensify in the long-term, HAL's long-standing relationship with the Indian defence forces and the DRDO, established manufacturing facilities, and experienced manpower base will continue to be strong mitigating factors.
- **Export Division** – Currently, HAL's exports revenue is just 0.6% of total revenues but the company expects it to increase over the coming years as it has a wide range of products/aircraft across categories like transport, trainers, fighters in aircraft/helicopters. It continues to look for export opportunity for some of its products including LCA Tejas MK1A, Trainers or utility aircraft & helicopters along with MRO activities. The management believes HAL has the competitive strength in exports considering the lower cost given economies of scale and expertise in providing MRO support.
- **Order Book** – HAL's FY22 closing order book was at Rs.82,513 crs. The company received orders worth Rs.76,306 crs in the last two years (FY21 & FY22), of which over 50% i.e. Rs.40,263 crs of orders were from manufacturing segment (led by order received in FY21 for 83 Tejas LCA MK1A and 15 light combat helicopters in FY22). Repair & overhaul segment order inflows were at Rs.27,996 crs in the last two years while Rs.2,774 crs worth of orders received from development segment during the period.
- **Financial Performance** – HAL revenues grew at 7.4% CAGR over FY18-22; mainly led by ~20% CAGR in maintenance, repair & overhaul (MRO segment) and PAT grew at 14% CAGR over the same period. HAL earns much better PBT margins, which were at 20-21%. This is led by better operational efficiencies like strategically located R&D and manufacturing facilities, lower employee costs and economies of scale. The Balance sheet is strong with a zero debt position and a cash & equivalents of around Rs.15600 crs (more than 25% of the M.cap).

**Ratios - FY22**

ROE	26%
ROCE	27%
Div. Yield	2.27%
PE Ratio	11.00
Face Value	10.00
EPS	Rs. 152.11

**Industry Analysis**

The Indian Defence sector, the second largest armed force is at the cusp of revolution. The Government has identified the Defence and Aerospace sector as a focus area for the 'Aatmanirbhar Bharat' or Self-Reliant India initiative, with a formidable push on the establishment of indigenous manufacturing infrastructure supported by a requisite research and development ecosystem. The vision of the government is to achieve a turnover of \$25 bn including export of \$5 bn in Aerospace and Defence goods and services by 2025. India is positioned as the 3rd largest military spender in the world, with its defence budget accounting for 2.15% of the country's total GDP. Over the next 5-7 years, the Government of India plans to spend \$130 Bn for fleet modernisation across all armed services. As per Union Budget 2022-23, \$70.6 billion was allocated to the Ministry of Defence. In line with the self-reliant India initiative, the share of domestic capital procurement, which was earmarked at 64% in 2021-22 has been enhanced to 68% of the Capital Acquisition Budget of the Defence Services for FY 2022-23.

**Growth Drivers**

In the FY23E Budget, the government earmarked Rs.1.52 lakh crore of capital outlay in defence, which has grown at 11% CAGR over FY20-23BE.

The R&D budget for DRDO was at Rs.11982 crore for FY23E, which has also grown at 11% CAGR over FY20-23BE.

The Government of India opened the defence industry for private sector participation to provide impetus to indigenous manufacturing.



## Peer Analysis

**Competitors:** Bharat Electronics Ltd., Bharat Dynamics Ltd., etc.

Direct comparisons between the three companies – HAL, BDL and BEL is inevitable, even though they each address completely distinct opportunities in the defence ecosystem. But, in terms of Indian listed space these three marks a special place in defence systems and HAL is easily the strong contender in terms of fundamentals. The attractive valuation with strong numbers gives HAL an easy win among the others.

Company	CMP	Mcap.	ROE	ROCE	Gross Margin	P/E	EPS
HAL	1738	58107	26.00%	27.00%	59.00%	11	152.11
BEL	230	55969	19.00%	25.00%	42.00%	23	9.85
BDL	668	12243	17.00%	25.00%	58.00%	24	27.28

## Outlook

Hindustan Aeronautics will benefit significantly from the government's indigenisation push in the defence sector. Considering the country's need for spending more on defence modernization and faster procurement of defence equipments through indigenisation, increase in capital outlay in defence is necessary, which is also visible through government actions. HAL caters to a large spectrum of aerospace business, which includes design, development, manufacturing and maintenance, repair & overhaul (MRO) of different types of aircraft/helicopters and engines. Healthy order-book position at Rs.82,153 crs (~3.3x FY22 revenues), of which manufacturing segment order backlog is at Rs.61,564 crs (75% of total OB) led by large scale orders of LCA, LCH and ALH). Strong pipeline of Rs.1.24 lakh crs worth of orders in manufacturing for the next three to four years led by LUH, LCH and engines for Su-30 & MiG-29. LCA Tejas MK1A deliveries to IAF will start from FY25E; execution of large order backlog of manufacturing and sustained growth in MRO will drive revenue growth in double digits.



## Valuation

We believe the company's focus on indigenous design & development of defence platforms/components would drive faster execution of projects in the years to come. At CMP, the stock trades at 12x of FY24E EPS. We recommend a BUY rating in the stock with the target price (TP) of Rs.2085, 15x FY24E EPS.

## Risks

- **Concentration Risk** – More than 90% of the revenue of the company is derived from sales to the Indian defence forces. These contracts depend on the budgetary support extended to MoD, which in turn allocates the amounts to the various Indian Defence Forces.
- **Execution Risk** – HAL gets advances from customers in the range of 20-25% of the contract value at the beginning of project. Any delay in these advances or lower disbursement can impact execution of the project and, thus, profitability and cash flows.
- **Supplier Risk** – HAL's business can be impacted by the price, quality, availability and timely delivery of the component parts that are used to manufacture the products, which further can impact execution of contracts and, thus, profitability and cash flows.

Source – Tickertape, Company's Website, BSE Website.

Thanks & Regards

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