

## Growth visibility remains strong...

**About the stock:** Bharat Electronics (BEL) is a leading aerospace and defence electronics company. It primarily manufactures advanced electronics products

- Multi-product, multi-technology - diverse product range including radar, missile systems, electronic warfare & avionics, anti-submarine warfare, electro-optics, homeland security, civilian products, etc
- FY23 Revenue mix : Defence ~87%, Non-defence ~11% and Exports ~2%

### Key Investment Thesis:

- Increasing requirement of indigenised modern defence platforms provides a massive opportunity in defence electronics:** BEL is favourably positioned to capture the larger pie of huge opportunity in Indian defence & space electronics systems/sub-systems or components industry which is expected to clock 13-14% CAGR over FY22-27 with the share of defence electronics (in total defence production) increasing to 40-42% by FY27 (vs. current share of 36-37%). BEL is expected to be the key beneficiary in this impending opportunity in indigenisation of defence platforms considering its strong technical expertise and capabilities in designing, developing and manufacturing a wide range of strategic electronic products/systems
- Healthy order-book position with robust orders pipeline provides strong visibility:** Post the recent orders of ₹ 8091 crore received in YTD FY24, order backlog is estimated to be at ~₹ 65000 crore at the end of June 2023 (3.7x FY23 revenues) which provides strong revenue visibility. We believe that the company would be able to meet its total order inflow guidance of ~₹ 20000 crore in FY24 (only considering orders with high possibility) considering the strong order pipeline of other electronic warfare & radar systems. We believe that order inflows during FY24 & FY25E will be higher than management's annual guidance of ₹ 20000 crore led by large scale defence projects like QRSAM, MRSAM and non-defence projects

### Rating and Target Price

- Healthy order-backlog with robust order inflows and future pipeline provides strong earnings visibility. Company's strategy to diversify into non-defence, focus on increasing exports & services share would aid long term growth and help de-risk its business. We expect revenue, EBITDA to grow at a CAGR of 17.7%, 15.5%, respectively, in FY23-25E aided by sustained margins at ~22%. Balance sheet remains strong with healthy returns ratios
- We maintain our **BUY** rating on the stock
- We value BEL at ₹ 160 per share (based on 30x FY25 P/E)



### Particulars

| Particular            | Amount         |
|-----------------------|----------------|
| Market Capitalization | ₹ 92834 Crore  |
| Total Debt (FY23)     | ₹ 0 Crore      |
| Cash and Inv (FY23)   | ₹ 7925.9 crore |
| EV (FY23)             | ₹ 84908 Crore  |
| 52 week H/L (₹) (BSE) | 129 / 83       |
| Equity capital        | ₹ 731 Crore    |
| Face value            | ₹ 1            |

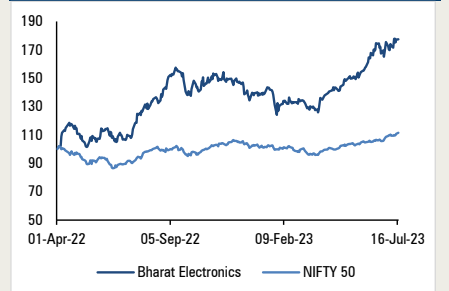
### Shareholding Pattern

|          | Sep-22 | Dec-22 | Mar-23 | Jun-23 |
|----------|--------|--------|--------|--------|
| Promoter | 51.1   | 51.1   | 51.1   | 51.1   |
| FII      | 17.4   | 17.3   | 16.4   | 17.4   |
| DII      | 25.6   | 25.1   | 25.5   | 24.8   |
| Others   | 5.9    | 6.5    | 6.9    | 6.7    |

### Risks to our call

- 1) Dependence on contracts from Ministry of Defence
- 2) Delay in advances from customers
- 3) Dependence on foreign suppliers for some sub-components

### Price Performance



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### Key Financial Summary

| (₹ crore)         | FY20   | FY21   | FY22   | FY23   | 3 Year CAGR (FY20-23) | FY24E  | FY25E  | 2 Year CAGR (FY23-25E) |
|-------------------|--------|--------|--------|--------|-----------------------|--------|--------|------------------------|
| Revenues          | 12,921 | 14,064 | 15,368 | 17,734 | 11.1                  | 20,980 | 24,573 | 17.7                   |
| EBITDA            | 2,730  | 3,181  | 3,341  | 4,086  | 14.4                  | 4,653  | 5,450  | 15.5                   |
| EBITDA margin (%) | 21.1   | 22.6   | 21.7   | 23.0   |                       | 22.2   | 22.2   |                        |
| Net Profit        | 1,794  | 2,065  | 2,400  | 2,986  | 18.5                  | 3,325  | 3,880  | 14.0                   |
| EPS (₹)           | 2.5    | 2.8    | 3.3    | 4.1    |                       | 4.5    | 5.3    |                        |
| P/E (x)           | 51.8   | 44.9   | 38.7   | 31.1   |                       | 27.9   | 23.9   |                        |
| EV/EBITDA (x)     | 33.4   | 27.6   | 25.5   | 20.8   |                       | 18.1   | 15.1   |                        |
| RoCE (%)          | 24.6   | 26.6   | 25.8   | 28.4   |                       | 28.0   | 28.8   |                        |
| RoE (%)           | 17.8   | 18.7   | 19.5   | 21.5   |                       | 21.1   | 21.7   |                        |

## Company Background

Bharat Electronics (BEL), established in 1954, is an Indian government-owned aerospace and defence electronics company. BEL is one of nine PSUs under the Ministry of Defence (MoD) of India and has been granted Navratna status by the government of India. It primarily manufactures advanced electronic systems/sub-systems for aerospace, naval, ground and underwater defence platforms

Company's state-of-the-art products and systems are in the areas of Radars & Fire Control Systems, Missile Systems, Communication & C4I systems, Electronic Warfare & Avionics, Naval Systems & Antisubmarine Warfare Systems, Electro Optics, Tank Electronics & Gun Upgrades, and Strategic Components etc

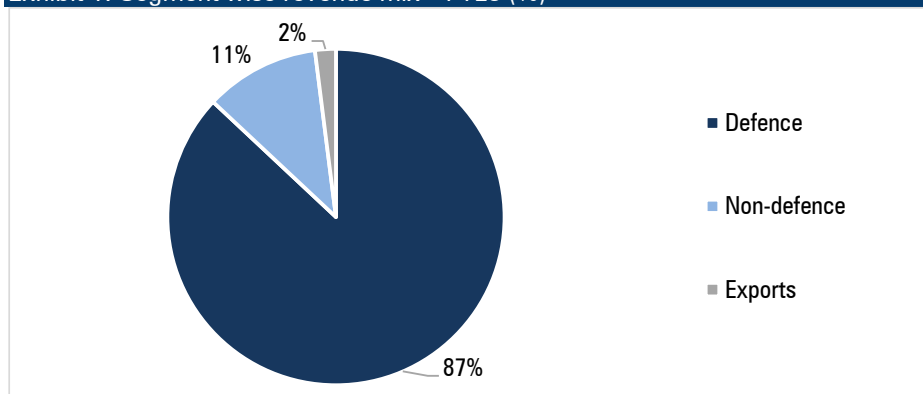
BEL also aims to increase its non-defence share in the overall business. Some of the areas the company is focussing on include solutions for the Civil Aviation sector, Anti Drone Systems, Satellite Assembly & Integration, Solar, Railway & Metro solutions, Network & Cyber Security solutions, Energy Storage products for Electric Vehicles, Homeland Security & Smart Cities, Medical Electronics, Artificial Intelligence, etc.

The company's headquarter is at Bengaluru and the manufacturing units are located at Bengaluru, Ghaziabad, Pune, Machilipatnam, Panchkula, Chennai, Kotdwar, Hyderabad, Navi Mumbai. The company has one product development and innovation centre at Bengaluru with two central research laboratories at Bengaluru and Ghaziabad

BEL is also expanding its global presence through tapping new export markets. In a bid to develop new markets in the Indian Ocean Region (IOR) and friendly foreign countries (FFCs), BEL has operationalised overseas offices at USA (New York), Singapore, Oman, Vietnam, Sri Lanka and Myanmar

Consolidated revenue of the company has grown by ~11% CAGR in the last 5 years during the period FY18-23 while EBITDA and PAT have grown by ~15% and ~16% CAGR respectively over the same period. During FY23, company reported revenues of ₹ 17734 crore which increased by 15.4% YoY. EBITDA grew by 22.3% YoY to ₹ 4086 crore while PAT increased by 24.4% YoY to ₹ 2986 crore in FY23

Exhibit 1: Segment wise revenue mix – FY23 (%)



Source: Company, ICICI Direct Research

## Investment Rationale

### Strong sector tailwinds; Increasing requirement of indigenised modern defence platforms provides a massive opportunity

Defence sector looks strongly placed in terms of increasing domestic procurements by the government for our armed forces. We have been witnessing a structural shift in the defence budget with increased allocation for modernised indigenous platforms. The current government is looking very committed on this, which is very clear from the recent announcement of increasing domestic procurement budget share to 75% for FY24 from 68% for FY23. This implies growth of ~19% against 8% growth budgeted for total capital outlay. With imports coming down, the risk of supply chain issues is also receding in this sector, eventually helping in faster execution of projects

We understand that there is an increasing requirement for induction of strong & modern warfare technologies and combat defence platforms into the armed forces, pushing the demand for defence electronics. This creates a strong demand outlook for products/systems like electronic warfare, radars, communication systems, navigation systems etc in defence platforms across aerospace, missiles, naval warships, underwater weapons like torpedoes and ground based defence platforms.

As per the industry reports, the Indian defence electronics industry is expected to clock 13-14% CAGR over FY22-27 to reach ₹ 650-700 billion by FY27. Improving technology is demanding increased usage of electronics, expanding the share of defence electronics in total defence production. The share of defence electronics is projected at 40-42% of total defence production by FY27 as against current share of 36-37%.

We believe that Bharat Electronics (BEL) is favourably positioned to capture the larger pie of impending huge opportunity in defence electronics systems/sub-systems or components industry. BEL, as defence PSU, is set to be the key significant beneficiary of this opportunity led by the indigenisation drive and the Make in India programme considering its capital-intensive infrastructure with high technical expertise or strong capabilities in designing, developing, manufacturing and supplying a wide range of strategic electronic products/systems including those involving emerging technologies.

Moreover, company's growing presence in the civilian/non-defence and exports segments (which contribute ~13% to sales at present) also provides strong prospects for BEL in terms of tapping this opportunity, aiding long-term growth and de-risk its business model

### Healthy order-book position with robust orders pipeline provides strong visibility

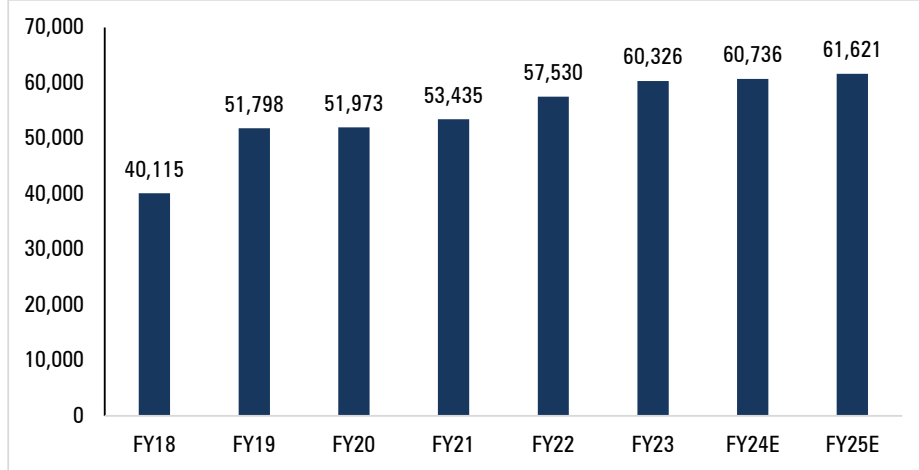
BEL has already received orders worth ₹ 8,091 crore in first four months of FY24 (vs. the full year guidance of ~₹ 20000 crore) which includes major contract like two regiments of improved Akash Weapon System (AWS) from Bharat Dynamics (BDL) worth ₹ 3914 crore. The other contracts received by the company in YTD FY24 include Electronic Warfare (EW) systems, radar systems, communication systems and other electronic sub-systems for aero, naval and ground platforms

Order backlog is estimated to be at ~₹ 65000 crore at the end of June 2023 post these contracts. We believe that the company would be able to meet its total order inflow guidance of ~₹ 20000 crore in FY24 considering the order pipeline in defence & non-defence segments. Management also highlighted in Q4FY23 earnings call that order inflow guidance is based on the expected orders with high prospects and there is a possibility of upward revision in the same. The contracts from other large scale projects which are in pipeline like Quick reaction surface to air missile (QRSAM) & Medium Range surface to air missile (MRSAM) are expected to be placed in FY24-25, provides healthy orders pipeline.

In the medium to longer term, there is an impending large scale requirement of electronic warfare or radar systems in defence platforms like future combat aircrafts (like Tejas Mk1A, Tejas Mk2, AMCA - advanced medium combat aircraft, TEDBF - twin-engine deck based fighter, MMRCA – medium multi-role combat aircrafts), transport/utility aircrafts, trainer aircrafts, utility & combat helicopters (like light combat aircrafts, light utility aircrafts, advanced light aircrafts, Indian multi-role helicopters), unmanned ariel vehicles for both combat and utility/surveillance purpose) etc, gives longer term visibility in terms of strong order inflows for BEL

Moreover, In non-defence or civil, company is focusing on getting orders from areas like Homeland Security, Smart City, Energy Storage Products, Solar, Space Electronics, Network & Cyber Security, Railways & Metro solutions, Composites, Medical Electronics & Healthcare Solutions, Software Solutions etc

Exhibit 2: Order Book position

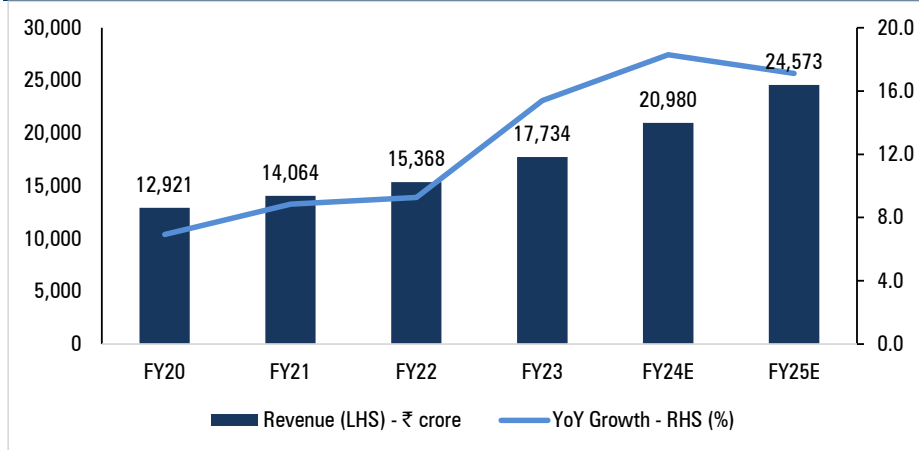


Source: Company, ICICI Direct Research

## Revenue growth expected at ~18% CAGR over FY23-25E

BEL's consolidated revenue grew at 11.4% CAGR over the last 5 years (FY18-23). However, revenue growth in the next two years is expected to be substantially better than the last five years growth, considering the better execution of the existing backlog and expected orders primarily led by increasing indigenisation of sub-components. We expect revenue to grow at 17.7% CAGR over FY23-25E

Exhibit 3: Healthy revenue growth ahead

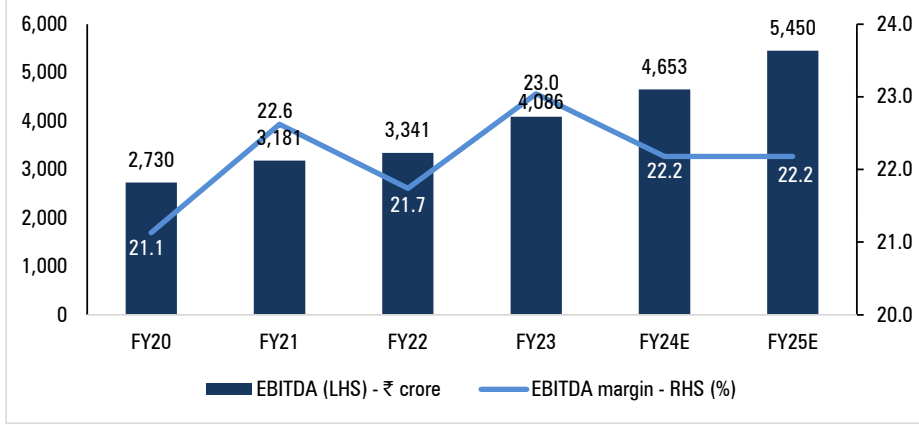


Source: Company, ICICI Direct Research

### EBITDA margins expected to sustain at ~22% in FY24-25E

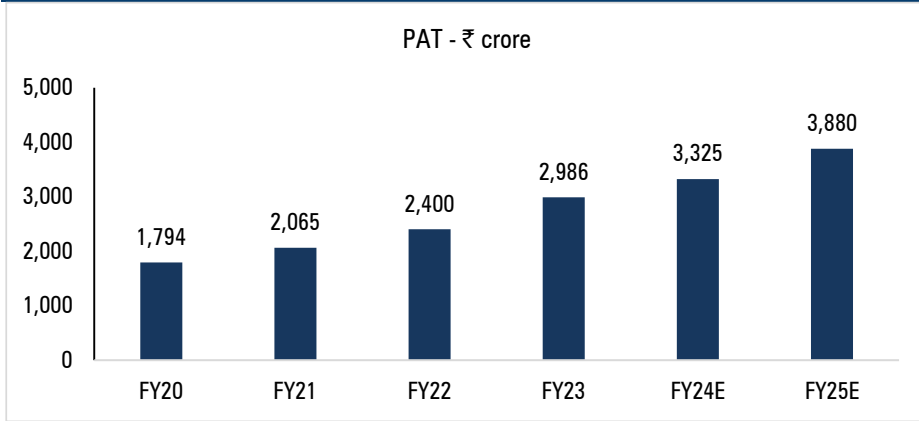
EBITDA margin remained in the range of 21-23% over the last 4 years (FY20-23) depending upon the contract and product mix during any particular year. During this period, EBITDA increased at 15.4% mainly led by increase in revenues. Going ahead during FY23-25E, we expect EBITDA margins to sustain at ~22% with EBITDA CAGR of 15.5% led by operational efficiencies and positive operating leverage which would negate the impact increase in research & development (R&D) expenses

Exhibit 4: EBITDA & EBITDA margin trend



Source: Company, ICICI Direct Research

Exhibit 5: PAT trend

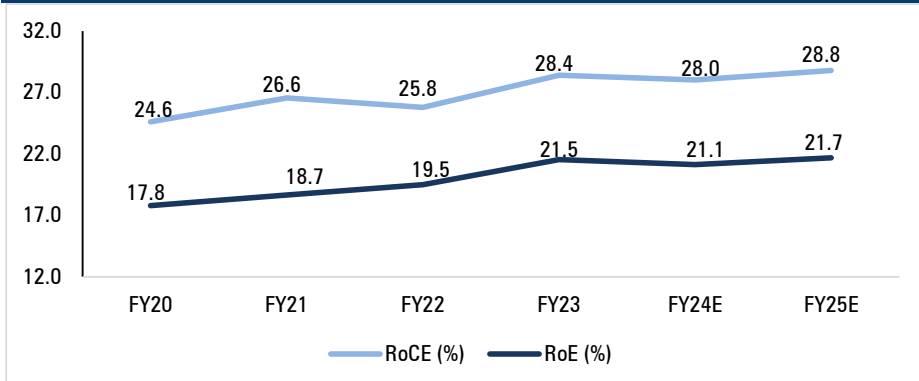


Source: Company, ICICI Direct Research

### Healthy return ratios

Return ratios have improved gradually in the last 4 years led by prudence in capital allocation and increase in profitability. RoCE (Return on Capital Employed) stood at 28.4% in FY23 as against 24.6% in FY20 while RoE (Return on Equity) improved to 21.5% in FY23 vs 17.8% in FY20. Going ahead by FY25E, we expect return ratios to sustain at healthy levels with RoCE at 28.8% and RoE at 21.7% in FY25E

Exhibit 6: Return ratios



Source: Company, ICICI Direct Research

## Key risk and concerns

### Primarily dependent on contracts from Ministry of Defence

BEL is primarily dependent on MoD, the Indian armed forces and DRDO for its contracts under defence electronic systems, sub-systems. Any decline, delay or re-prioritisation of funding under the Indian defence budget could adversely affect the company's ability to grow or maintain its sales, earnings and cash flow

### Delay in advances from customers may impact execution

BEL gets significant advances from customers at the beginning of a project. Any delay in these advances or lower disbursement can impact execution of the project and, thus, profitability and cash flows.

### Dependent on foreign suppliers for sub-systems

The company is dependent on foreign suppliers for sub-systems to be fitted on defence platforms across aerospace (combat aircrafts, transport/utility aircrafts, trainer aircrafts, combat and utility helicopters, unmanned ariel vehicles for both combat and utility/surveillance purpose), missiles, naval warships, underwater weapons like torpedoes and ground based defence platforms. Any change in preference of these suppliers or any disturbance in the global supply chain may impact the company's execution and, thus, earnings and cash flows

## Financial summary

| (₹ Crore)                   | FY22   | FY23   | FY24E  | FY25E  |
|-----------------------------|--------|--------|--------|--------|
| Net Sales                   | 15,085 | 17,404 | 20,590 | 24,116 |
| Other operating income      | 283    | 330    | 391    | 458    |
| Revenue                     | 15,368 | 17,734 | 20,980 | 24,573 |
| % Growth                    | 9.3    | 15.4   | 18.3   | 17.1   |
| Other income                | 231.5  | 280.8  | 310.0  | 340.0  |
| Total Revenue               | 15,368 | 17,734 | 20,980 | 24,573 |
| % Growth                    | 8.2    | 15.4   | 18.3   | 17.1   |
| Total Raw Material Costs    | 8,897  | 9,828  | 11,736 | 13,746 |
| Employee Expenses           | 2,128  | 2,317  | 2,615  | 3,063  |
| other expenses              | 1,002  | 1,504  | 1,977  | 2,315  |
| Total Operating Expenditure | 12,027 | 13,649 | 16,328 | 19,124 |
| Operating Profit (EBITDA)   | 3,341  | 4,086  | 4,653  | 5,450  |
| % Growth                    | 5.0    | 22.3   | 13.9   | 17.1   |
| Interest                    | 5      | 15     | 5      | 5      |
| PBDT                        | 3,567  | 4,352  | 4,958  | 5,785  |
| Depreciation                | 401    | 429    | 556    | 639    |
| PBT before Exceptional Item | 3,166  | 3,923  | 4,402  | 5,146  |
| Total Tax                   | 812    | 983    | 1,122  | 1,312  |
| PAT before MI               | 2,354  | 2,940  | 3,279  | 3,834  |
| PAT                         | 2,400  | 2,986  | 3,325  | 3,880  |
| % Growth                    | 16.2   | 24.4   | 11.4   | 16.7   |
| EPS                         | 3.3    | 4.1    | 4.5    | 5.3    |

Source: Company, ICICI Direct Research

| (₹ Crore)                     | FY22   | FY23   | FY24E  | FY25E  |
|-------------------------------|--------|--------|--------|--------|
| Equity Capital                | 243.7  | 731.0  | 731.0  | 731.0  |
| Reserve and Surplus           | 12,059 | 13,128 | 15,001 | 17,155 |
| Total Shareholders funds      | 12,302 | 13,859 | 15,732 | 17,886 |
| Other Non Current Liabilities | 72.1   | 64.5   | 64.5   | 64.5   |
| Total Debt                    | -      | -      | -      | -      |
| Total Liabilities             | 14,330 | 14,905 | 16,778 | 18,932 |
| Gross Block                   | 4,549  | 5,163  | 5,851  | 6,351  |
| Acc: Depreciation             | 2,040  | 2,469  | 3,025  | 3,664  |
| Net Block                     | 2,509  | 2,694  | 2,826  | 2,687  |
| Capital WIP                   | 446    | 361    | 500    | 500    |
| Total Fixed Assets            | 3,681  | 3,818  | 4,088  | 3,949  |
| Non Current Assets            | 2,703  | 1,425  | 1,869  | 2,103  |
| Inventory                     | 5,592  | 6,448  | 7,674  | 8,988  |
| Debtors                       | 6,108  | 7,300  | 8,909  | 10,435 |
| Loans and Advances            | 1      | 1      | 2      | 2      |
| Other Current Assets          | 7,781  | 7,846  | 9,231  | 10,812 |
| Cash                          | 7,564  | 7,926  | 8,818  | 10,487 |
| Total Current Assets          | 27,294 | 30,027 | 35,140 | 41,230 |
| Current Liabilities           | 3,369  | 3,660  | 4,598  | 5,386  |
| Provisions                    | 1,805  | 845    | 845    | 845    |
| Total Current Liabilities     | 19,581 | 20,565 | 24,520 | 28,551 |
| Net Current Assets            | 7,713  | 9,462  | 10,620 | 12,679 |
| Total Assets                  | 14,330 | 14,905 | 16,778 | 18,932 |

Source: Company, ICICI Direct Research

| (₹ Crore)                        | FY22    | FY23    | FY24E   | FY25E   |
|----------------------------------|---------|---------|---------|---------|
| Profit after Tax                 | 2,400   | 2,986   | 3,325   | 3,880   |
| Depreciation                     | 401     | 429     | 556     | 639     |
| Interest                         | 5       | 15      | 5       | 5       |
| Cash Flow before WC changes      | 2,806   | 3,430   | 3,886   | 4,523   |
| Changes in inventory             | (624)   | (856)   | (1,226) | (1,314) |
| Changes in debtors               | 454     | (1,192) | (1,609) | (1,526) |
| Changes in loans & Advances      | 0       | -       | (0)     | (0)     |
| Changes in other current assets  | (867)   | (65)    | (1,385) | (1,581) |
| Net Increase in Current Assets   | (1,090) | (2,372) | (4,220) | (4,421) |
| Changes in creditors             | 70      | 291     | 938     | 787     |
| Changes in provisions            | 74      | 204     | 62      | 118     |
| Net Inc in Current Liabilities   | 2,751   | 984     | 3,954   | 4,031   |
| Net CF from Operating activities | 4,467   | 2,043   | 3,620   | 4,134   |
| Changes in deferred tax assets   | (157)   | 117     | -       | -       |
| (Purchase)/Sale of Fixed Assets  | (473)   | (529)   | (750)   | (500)   |
| Net CF from Investing activities | (726)   | (200)   | (1,194) | (734)   |
| Dividend and Dividend Tax        | (1,023) | (1,316) | (1,462) | (1,718) |
| Net CF from Financing Activities | (1,252) | (1,480) | (1,534) | (1,730) |
| Net Cash flow                    | 2,490   | 362     | 892     | 1,670   |
| Opening Cash/Cash Equivalent     | 5,074   | 7,564   | 7,926   | 8,818   |
| Closing Cash/ Cash Equivalent    | 7,564   | 7,926   | 8,818   | 10,487  |

Source: Company, ICICI Direct Research

| (Year-end March)         | FY22 | FY23 | FY24E | FY25E |
|--------------------------|------|------|-------|-------|
| EPS                      | 3.3  | 4.1  | 4.5   | 5.3   |
| Cash per Share           | 10.3 | 10.8 | 12.1  | 14.3  |
| BV                       | 16.8 | 19.0 | 21.5  | 24.5  |
| Dividend per share       | 1.4  | 1.8  | 2.0   | 2.4   |
| Dividend payout ratio    | 43%  | 44%  | 44%   | 44%   |
| EBITDA Margin            | 21.7 | 23.0 | 22.2  | 22.2  |
| PAT Margin               | 15.9 | 17.2 | 16.2  | 16.1  |
| RoE                      | 19.5 | 21.5 | 21.1  | 21.7  |
| RoCE                     | 25.8 | 28.4 | 28.0  | 28.8  |
| RoIC                     | 62.0 | 61.6 | 59.3  | 65.0  |
| EV / EBITDA              | 25.5 | 20.8 | 18.1  | 15.1  |
| P/E                      | 38.7 | 31.1 | 27.9  | 23.9  |
| EV / Net Sales           | 5.5  | 4.8  | 4.0   | 3.4   |
| Sales / Equity           | 1.2  | 1.3  | 1.3   | 1.4   |
| Market Cap / Sales       | 6.0  | 5.2  | 4.4   | 3.8   |
| Price to Book Value      | 7.5  | 6.7  | 5.9   | 5.2   |
| Asset turnover           | 1.2  | 1.3  | 1.3   | 1.4   |
| Debtors Turnover Ratio   | 2.4  | 2.6  | 2.6   | 2.5   |
| Creditors Turnover Ratio | 4.6  | 5.0  | 5.1   | 4.9   |
| Debt / Equity            | -    | -    | -     | -     |
| Current Ratio            | 4.1  | 4.1  | 4.1   | 4.2   |
| Quick Ratio              | 2.9  | 2.9  | 2.9   | 3.0   |

Source: Company, ICICI Direct Research

## RATING RATIONALE

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Hold: -5% to 15%;

Reduce: -15% to -5%;

Sell: <-15%



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