

India

Overweight (no change)**Highlighted Companies****Bharat Electronics Ltd****ADD, TP Rs140, Rs125 close**

Electronics account for around 40% of modern warfare leading platforms, where BEL is a dominant player in India. Its strong order backlog and the traction in exports, we feel, will drive near-term sales while large orders in the pipeline to aid medium-term growth.

Bharat Dynamics Ltd**ADD, TP Rs1300, Rs1116 close**

BDL has an order pipeline of around Rs400bn over the next two-to-five years on the back of modernization efforts in the armed forces along with indigenization of missile programmes. However, any delay in new order finalization could negatively affect near-term earnings, in our view.

Summary Valuation Metrics

P/E (x)	Mar23-A	Mar24-F	Mar25-F
Bharat Electronics Ltd	30.4	26.8	22.1
Bharat Dynamics Ltd	58.1	25.3	20.6

P/BV (x)	Mar23-A	Mar24-F	Mar25-F
Bharat Electronics Ltd	6.7	5.9	5.1
Bharat Dynamics Ltd	6.4	5.4	4.6

Dividend Yield	Mar23-A	Mar24-F	Mar25-F
Bharat Electronics Ltd	1.4%	1.6%	2.0%
Bharat Dynamics Ltd	0.8%	1.2%	1.19%

Aerospace & Defence

1QFY24 results preview

- We expect a 13-20% yoy growth in 1QFY24F sales for companies in our coverage universe. An improvement in the EBITDA margin is expected primarily due to easing supply chain challenges.
- 1QFY24 witnessed a strong influx of new orders, with BEL and BDL securing orders worth Rs81bn and more than Rs5bn, respectively.
- Our outlook on the sector remains positive, and we maintain our Overweight rating on it. Our preferred stocks in the sector are BEL and BDL.

Bharat Electronics witnesses strong order inflow in 1QFY24

In 1QFY24, Bharat Electronics (BEL) experienced a robust influx of orders amounting to Rs81bn. These orders encompass the Akash weapon system (Rs39bn) from Bharat Dynamics, the long-range guidance kit (Rs22bn), and other substantial orders (Rs20bn). We expect a 13% yoy growth in sales, primarily driven by increased execution of significant orders and alleviation of supply chain challenges. While the EBITDA margin is expected to remain consistent compared to the previous year, the growth in PAT is projected to be subdued due to an exceptional dividend that boosted 1QFY23 PAT. Management commentary on the order pipeline and working capital requirement are key monitorables. BEL's order book as of FY23-end stood at Rs607bn (3.5x FY23 sales).

Bharat Dynamics may surprise positively

Bharat Dynamics (BDL) has secured orders worth Rs5.2bn in Apr-May 2023, and we expect this positive trend to continue throughout FY24F, aided by a robust order pipeline. This bodes well for BDL, and we expect strong execution in 1QFY24F, driven by an improved opening order backlog and the completion of delayed projects from 4QFY23. Also, we expect a robust EBITDA margin of 19% in 1QFY24F, which can be attributed to the alleviation of supply chain challenges. Monitoring management's commentary on realization of large orders for future programs is crucial. As of May 2023-end, BDL's order book stood at Rs203bn (8.3x FY23 sales), including export orders worth Rs26bn.

Hindustan Aeronautics' performance to be driven by R&O revenue

Post Rs265bn order inflow in FY23, its new orders may remain muted in 1HFY24F. 1QFY24F sales may be driven primarily by the Repair and Overhaul (R&O) segment & some manufacturing revenue from platforms such as Advanced Light Helicopters (ALH) & Light Combat Helicopters (LCH). We expect the EBITDA margin at 24%, an improvement yoy from 22.8%. Higher other income yoy due to strong net cash position to lift PAT growth.

Maintain ADD rating on BEL, BDL and HAL

We remain Overweight on the aerospace and defence sector as valuations currently factor in robust growth led by a strong order pipeline on the back of various schemes like Atmanirbhar Bharat, Positive Indigenization List and Defence Modernization Plan which will provide several opportunities for companies going ahead. We have an ADD rating on BEL, BDL and HAL, with their order backlog providing revenue visibility. Delay in order finalization and slower-than-expected execution are key downside risks.

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Figure 1: 1QFY24F earnings estimates for companies under our coverage

(Rs m)	Revenue	yoy %	qoq %	EBITDA	yoy %	qoq %	Adj. PAT	yoy %	qoq %
Bharat Electronics	35,174	13	-46	5,804	13	-68	4,278	-1	-69
Hindustan Aeronautics	43,470	20	-65	10,476	27	-68	7,005	15	-59
Bharat Dynamics	8,025	16	1	1,525	263	-17	1,160	191	-24

SOURCE: INCRED RESEARCH, COMPANY REPORTS

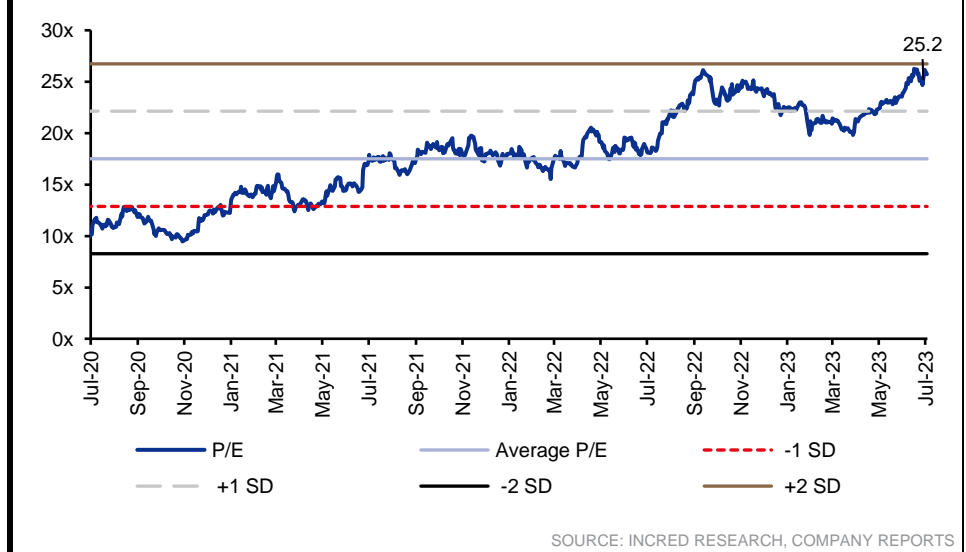
1QFY24 results preview

Figure 2: 1QFY24F estimates for companies under our coverage

Company	1QFY24F	1QFY23	yoy %	4QFY23	qoq %	Comments
Bharat Electronics						We expect 13% yoy rise in sales growth led by execution pick-up for large orders along with easing supply chain issues. EBITDA margin is expected to remain consistent yoy. Management commentary on the order pipeline and working capital requirement are key monitorables.
Sales (Rs m)	35,174	31,128	13.0	64,566	(45.5)	
EBITDA (Rs m)	5,804	5,135	13.0	18,248	(68.2)	
EBITDA margin %	16.5	16.5		28.3		
Adj. PAT (Rs m)	4,278	4,315	(0.8)	13,655	(68.7)	
Hindustan Aeronautics						We expect sales to grow by 20% yoy in 1Q driven by strong execution in services (R&O) segment and some deliveries of manufacturing orders. We expect EBITDA margin of 24%, which is an improvement yoy from 22.8%. Higher other income yoy due to strong net cash position is likely to boost PAT growth.
Sales (Rs m)	43,470	36,225	20.0	1,24,946	(65.2)	
EBITDA (Rs m)	10,476	8,250	27.0	32,424	(67.7)	
EBITDA margin %	24.1	22.8		26.0		
Adj. PAT (Rs m)	7,005	6,067	15.5	17,258	(59.4)	
Bharat Dynamics						We expect a 16% increase in revenue growth yoy in 1Q due to improved opening order backlog. We expect EBITDA margin of 19% in 1Q. Management commentary on realization of large orders of future programs is key monitorable.
Sales (Rs m)	8,025	6,948	15.5	7,982	0.5	
EBITDA (Rs m)	1,525	420	263.1	1,834	(16.9)	
EBITDA margin %	19.0	6.0		23.0		
Adj. PAT (Rs m)	1,160	398	191.3	1,527	(24.0)	

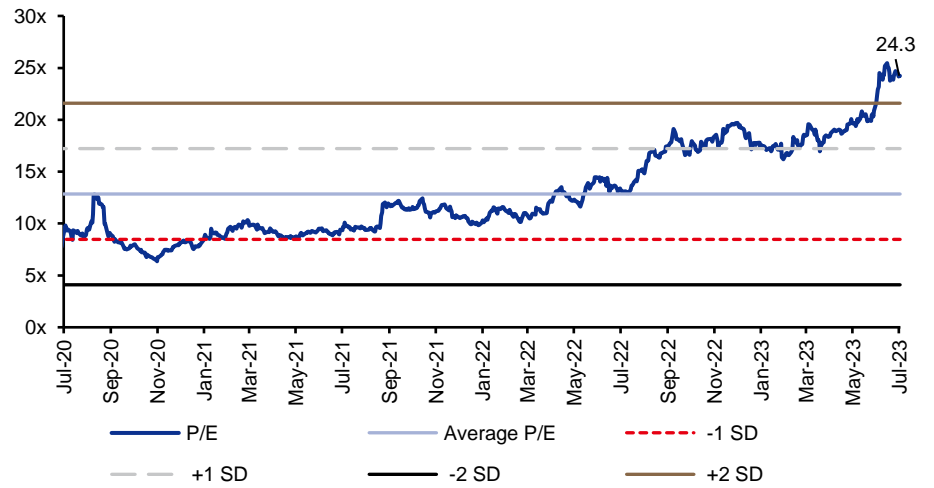
SOURCE: INCRED RESEARCH, COMPANY REPORTS

Figure 3: BEL's one-year forward P/E



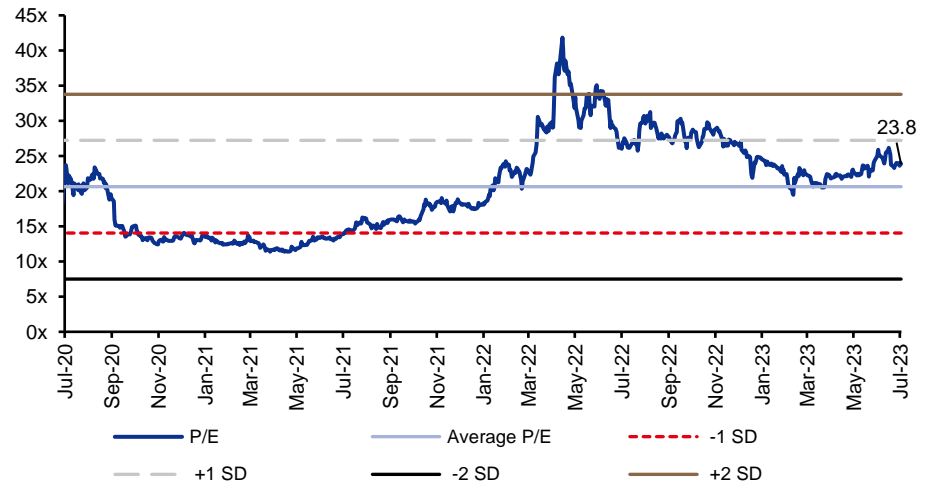
SOURCE: INCRED RESEARCH, COMPANY REPORTS

Figure 4: HAL's one-year forward P/E



SOURCE: INCRED RESEARCH, COMPANY REPORTS

Figure 5: BDL's one-year forward P/E



SOURCE: INCRED RESEARCH, COMPANY REPORTS

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