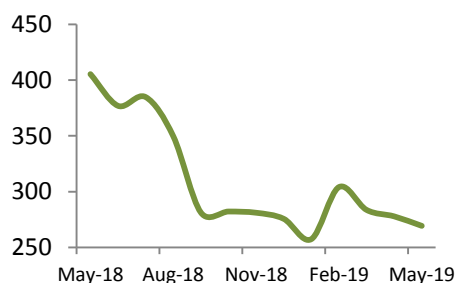


Recommendation	BUY
CMP	Rs. 264
Target Price	Rs. 343
Sector	PSU - Defense

**Stock Details**

BSE Code	541143
NSE Code	BDL
Bloomberg Code	BDL IN
Market Cap (Rs. Cr)	4,866
Free Float (%)	12%
52 week High/Low (Rs.)	425/225
Avg. volume (BSE+NSE)	1,33,066
Face Value (Rs.)	10
Dividend (FY18)	120%
Shares o/s (Crs)	18.33

Relative Performance	1M	3M	1Yr
<b>BDL</b>	-12%	17%	-30%
<b>Rel. to Sensex</b>	-7%	14%	-34%

**Shareholding Pattern** 30<sup>th</sup> Mar 2019

Promoters Holding	87.8%
Institutional (Incl. FII)	7.5%
Public & others	4.7%

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**The PSU Outlier - Heads You Win; Tails You Don't Lose Much**

With an eye on outcome of the upcoming LS elections on 23<sup>rd</sup> May 2019, we believe PSU stocks in industries like defense and railways would stand to be big winners if the incumbent government returns to power. In a scenario where the incumbent government loses, these businesses would underperform, however current trough valuations would restrict any major decline in the stocks of these companies.

Upon analyzing the deeply undervalued PSU stocks from defense & railway industries, we identify Bharat Dynamics as a clear outlier. With the company beating all other PSUs on most parameters, we believe the stock presents a good entry opportunity with a favorable risk-reward ratio considering the company's cheap valuations at 7.8x FY19E P/E and 4.7x FY19E EV/EBITDA on one hand and superior proven track record of growth, ROE, free cash flow generation on the other. We value the company at 10.3x FY19E EPS in line with the PSU defense and railway basket & arrive at a TP of Rs. 343 for the stock.

**Key Business Strengths**

















































**Presence in most missile and torpedo systems; Sole manufacturer from India for SAMs and ATGMs:** BDL is the sole manufacturer in India for SAMs (Surface to Air Missiles) and ATGMs (Anti-Tank Guided Missiles). It has presence in most of the missiles and torpedo systems. It is also engaged in the business of refurbishment and life extension of missiles manufactured. Further, BDL is the co-development partner with the DRDO for next generation of ATGMs and SAMs. BDL has also entered into technology transfer agreements with established global players such as Thales.

**Domestic defense industry presents a huge opportunity for BDL:** The Stockholm International Peace Research Institute (SIPRI) Arms Transfer Database indicates that India has remained the largest importer of defense equipment in the 2012-16 timeframe with its share in global arms imports increasing from 9.7 % in 2007-11 to 12.8 % in 2012-16. Recognizing this, the government is now adopting a multi-pronged approach towards indigenization consisting of a slew of measures including the new DPP 2016. The Indian Guided Missile and Torpedo market landscape consists of two main types of suppliers at present - DPSUs with indigenous R&D & manufacturing capabilities and foreign players which export their missile systems to India. Frost & Sullivan forecasts a cumulative market size of USD 24.49 Bn in the 2017-26 time frame for guided missiles and torpedoes. The market size of SAM (Surface to Air Missiles) for the same period stands at a huge USD 9.79 Bn while that for ATGMs (Anti-Tank Guided Missiles) stands at USD 1.71 Bn.





**Strong order book and established financial track record of delivering growth:** As on Q3FY19, BDL had a strong order book of Rs. 14,836 Cr ensuring sales visibility (Order book-to-Sales of 3.7x). BDL has delivered consistent growth over the last five financial years both in terms of financial and operational metrics. Its revenue from operations and EBITDA has increased from Rs. 2841 Cr and Rs. 275 Cr respectively, in FY15 to Rs. 4577 Cr and Rs. 887 Cr, respectively in the TTM period; being mainly driven by orders of Akash missiles. BDL's clientele includes Ministry of Defense, other defense PSUs and Government bodies under the MoD, India and other countries.

## Stacking up the PSU basket

In order to gauge superior companies within the PSU basket, we analyze them on various financial parameters viz. – past execution capabilities, quality of earnings (return ratios), cash flows, order books and valuations. Most of the companies are available at cheap valuations with an average TTM PE of 10.3x and EV/EBITDA of 5.8x. **We observe that only Bharat Dynamics (BDL) stands out as an outlier having demonstrated superior performance on all parameters. Apart from BDL, we also observe that BEL has performed consistently and is a large listed company with a decent track record.**

Particulars (Rs. Cr)	BEL	HAL	BDL	Cochin Shipyard	Garden Reach	RVNL	RITES	IRCON
<b>Past Execution</b>								
Revenue (TTM)	10485	18624	4577	2355	1344	7597	1663	4027
Revenue CAGR FY15-18	14%	5%	18%	8%	-16%	30%	18%	10%
EBITDA CAGR FY15-18	15%	-5%	30%	19%	+ to -	6%	8%	-14%
Score								
<b>Quality of Earnings</b>								
PBIT Margin	22%	19%	23%	27%	10%	8%	33%	15%
Asset Turnover	1.4	1.5	1.9	0.8	1.3	1.2	0.8	0.6
ROCE TTM	30%	28%	44%	22%	13%	10%	26%	9%
ROE TTM	22%	18%	30%	14%	9%	12%	17%	11%
Score								
<b>Cash Flow Conversion</b>								
W.Cap Days	277	477	61	64	33	42	83	21
CFO/EBITDA (FY14-18)	68%	15%	111%	18%	- to +	-215%	156%	47%
FCFE/PAT (FY14-18)	21%	-35%	35%	-12%	42%	-202%	121%	15%
Score								
<b>Order Book/Sales</b>								
Score								
<b>Valuations</b>								
EV/EBITDA TTM	7.5	5.3	5.0	3.9	6.6	15.1	2.8	4.7
PE TTM	11.7	10.2	8.2	10.4	15.3	8.6	12.5	9.3
Dividend Yield	3%	5%	6%	4%	5%	4%	3%	10%
Score								
<b>Overall Score</b>								

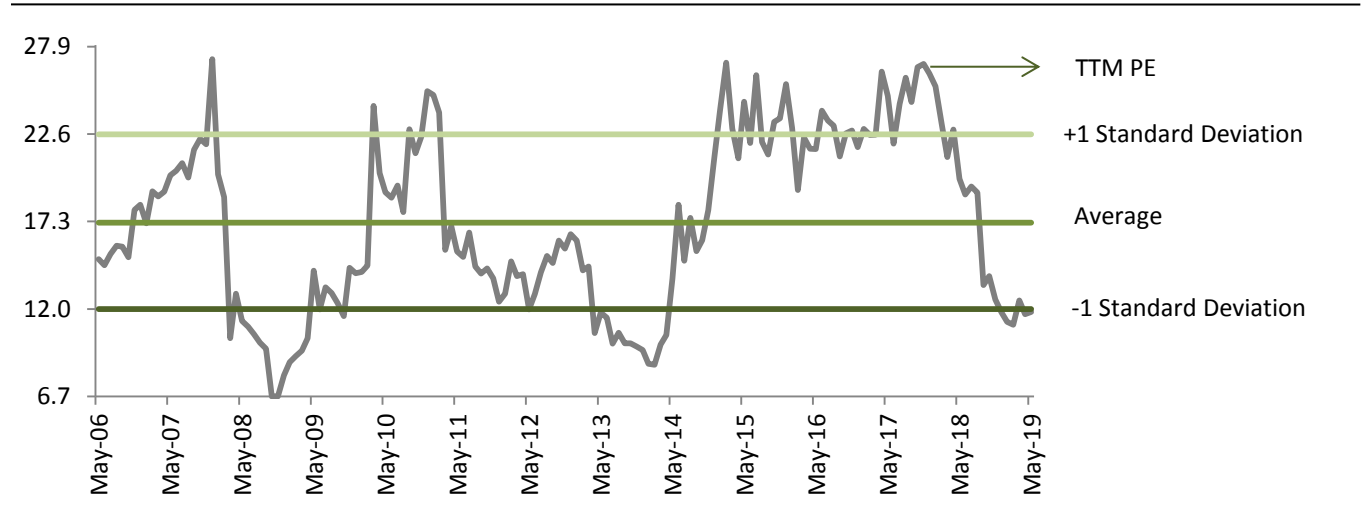
Source: Company Data, Nirmal Bang Research. All data is TTM

 : Strong,  : Above average,  : Average,  : Weak

**Annexure: Valuations of Bharat Electronics Ltd as a reference point**

As most companies have listed recently, historical valuation ranges are not available for them. However, if we trace BEL's valuations over the past 13 years, we observe that the company is available at trough valuations with TTM PE of 11.7x i.e. at -1 Standard Deviation. The previous instances when BEL was available at -1 Standard Deviation and below, were between May 2008 to May 2009 and between April 2013 to April 2014.

**BEL TTM PE**



Source: Company, NBRR

## Financials

P&L (Rs. Cr)	FY15	FY16	FY17	FY18	FY19E	Balance Sheet (Rs. Cr)	FY15	FY16	FY17	FY18	FY19E
Revenues	2841	4079	4833	4588	4214	Share Capital	115.0	97.8	122.2	183.3	183.3
<b>% Growth</b>		<b>44%</b>	<b>18%</b>	<b>-5%</b>	<b>-8%</b>	Reserve & Surplus	1,538	1,753	2,090	1,773	2,103
COGS	2000	2818	3222	2854	2471	<b>Networth</b>	<b>1,653</b>	<b>1,851</b>	<b>2,212</b>	<b>1,956</b>	<b>2,286</b>
<b>% of Revenues</b>	<b>70.4%</b>	<b>69.1%</b>	<b>66.7%</b>	<b>62.2%</b>	<b>58.6%</b>	<b>Total Loans</b>	-	-	-	-	-
Employee Cost	312	326	448	530	588	Long term provisions	2	1	18	-	-
<b>% of Revenues</b>	<b>11.0%</b>	<b>8.0%</b>	<b>9.3%</b>	<b>11.6%</b>	<b>14.0%</b>	Other long term Liab	83	184	171	410	610
Other expenses	253	421	393	536	268	Trade payable	514	1,343	1,495	1,012	1,011
<b>% of Revenues</b>	<b>8.9%</b>	<b>10.3%</b>	<b>8.1%</b>	<b>11.7%</b>	<b>6.4%</b>	Customer Advances	5,714	5,507	3,550	1,936	1,839
<b>Adjusted EBITDA</b>	<b>275</b>	<b>513</b>	<b>769</b>	<b>667</b>	<b>887</b>	Other Current Liab	243	381	530	618	630
<b>EBITDA Margin</b>	<b>9.7%</b>	<b>12.6%</b>	<b>15.9%</b>	<b>14.5%</b>	<b>21.0%</b>	Short term provisions	202	373	625	666	700
<b>% Growth</b>		<b>87%</b>	<b>50%</b>	<b>-13%</b>	<b>33%</b>	<b>Total Current Liab.</b>	<b>6,674</b>	<b>7,604</b>	<b>6,200</b>	<b>4,232</b>	<b>4,180</b>
Depreciation	67	53	62	63	74	<b>Total Equity &amp; Liab.</b>	<b>8,412</b>	<b>9,641</b>	<b>8,601</b>	<b>6,598</b>	<b>7,077</b>
Other Income	439	385	230	173	114	Fixed Assets & CWIP	660	823	897	998	1,136
Interest	3	4	4	3	4	Deferred Tax Asset	40	77	151	192	227
<b>PBT</b>	<b>644</b>	<b>841</b>	<b>933</b>	<b>773</b>	<b>923</b>	Investments & L&A	29	9	13	87	102
Tax	200	279	242	246	313	Other non Curr. assets	87	89	83	3	5
<b>Tax rate</b>	<b>31%</b>	<b>33%</b>	<b>26%</b>	<b>32%</b>	<b>34%</b>	Bank	3,545	3,010	1,692	327	520
<b>PAT</b>	<b>444</b>	<b>562</b>	<b>691</b>	<b>528</b>	<b>610</b>	Cash	124	233	93	30	77
<b>Adj. PAT Margin</b>	<b>15.6%</b>	<b>13.8%</b>	<b>14.3%</b>	<b>11.5%</b>	<b>14.5%</b>	Inventories	1,476	2,058	2,251	1,926	1,804
<b>% Growth</b>		<b>27%</b>	<b>23%</b>	<b>-24%</b>	<b>16%</b>	Debtors	335	145	356	529	520
<b>EPS (Post Issue)</b>	<b>24.2</b>	<b>30.7</b>	<b>37.7</b>	<b>28.8</b>	<b>33.3</b>	Short term Advances	741	1,488	1,729	2,193	2,303
<b>Performance Ratio</b>	<b>FY15</b>	<b>FY16</b>	<b>FY17</b>	<b>FY18</b>	<b>FY19E</b>	Other Current assets	1,375	1,710	1,335	313	382
EBITDA Margin (%)	9.7%	12.6%	15.9%	14.5%	21.0%	<b>Total Assets</b>	<b>8,412</b>	<b>9,641</b>	<b>8,601</b>	<b>6,598</b>	<b>7,077</b>
PAT Margin (%)	15.6%	13.8%	14.3%	11.5%	14.5%	<b>Cash Flow (Rs. Cr)</b>	<b>FY15</b>	<b>FY16</b>	<b>FY17</b>	<b>FY18</b>	<b>FY19E</b>
ROE (%)	27%	30%	31%	27%	27%	EBITDA	275	513	769	667	887
ROCE (%)	39%	46%	42%	40%	41%	Prov for exp & others	92	110	(30)	137	153
Net D/E (x)	-0.1	-0.1	0.0	0.0	0.0	<b>Op. profit before WC</b>	<b>367</b>	<b>623</b>	<b>739</b>	<b>804</b>	<b>1,040</b>
Sales Growth (%)		44%	18%	-5%	-8%	Change in WC	(747)	(61)	(555)	426	(479)
EBITDA Growth (%)		87%	50%	-13%	33%	Less: Tax	(220)	(278)	(350)	(254)	(313)
PAT Growth (%)		27%	23%	-24%	16%	<b>CF from operations</b>	<b>(599)</b>	<b>284</b>	<b>(166)</b>	<b>977</b>	<b>248</b>
<b>Turnover Ratios</b>	<b>FY15</b>	<b>FY16</b>	<b>FY17</b>	<b>FY18</b>	<b>FY19E</b>	Addition to assets	(291)	(216)	(46)	(169)	(138)
Debtors Days	43	13	27	42	45	Int recd / Invst in MF	353	365	139	(102)	(68)
Inventory Days	190	184	170	153	156	<b>CF from Investing</b>	<b>62</b>	<b>149</b>	<b>93</b>	<b>(271)</b>	<b>42</b>
Creditor Days	94	174	169	129	149	Change in share capita	-	(199)	-	-	-
Asset Turnover (x)	1.7	2.2	2.2	2.3	1.8	Tax on Sh Buyback	-	-	(42)	(97)	-
<b>Valuation Ratio</b>	<b>FY15</b>	<b>FY16</b>	<b>FY17</b>	<b>FY18</b>	<b>FY19E</b>	Dividend / Buyback	(59)	(123)	(22)	(670)	(280)
Price/Earnings (x)					7.8	Interest paid	(2)	(2)	(2)	(2)	(4)
EV/EBITDA (x)					4.7	<b>CF from Financing</b>	<b>(61)</b>	<b>(324)</b>	<b>(66)</b>	<b>(769)</b>	<b>(243)</b>
Price/BV (x)					2.1	<b>Net Change in cash</b>	<b>(598)</b>	<b>109</b>	<b>(139)</b>	<b>(63)</b>	<b>47</b>
Mkt cap/Sales (x)					1.9	Cash at beginning	722	124	233	93	30
EV/Sales (x)					1.7	Cash at end	124	233	93	30	77

Source: Company Data, Nirmal Bang Research

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