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Q1FY23 conference call
takeaways

Defence

Target price: Rs2,665

Target price revision

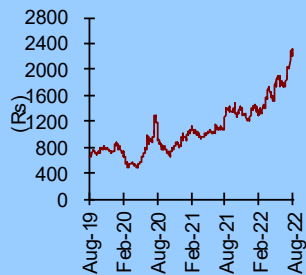
Rs2,665 from Rs2,618

Shareholding pattern

	Dec '21	Mar '22	Jun '22
Promoters	75.2	75.2	75.2
Institutional investors	21.4	21.3	21.3
MFs and others	6.0	7.8	7.4
Banks / FIs	0.0	0.0	0.0
Insurance Cos.	0.3	0.3	0.1
FIs	15.0	13.2	13.8
Others	3.4	3.5	3.5

Source: BSE

Price chart



Hindustan Aeronautics

BUY

Maintained

Strong order visibility and competitive positioning **Rs2,289**

Hindustan Aeronautics (HAL) highlighted visibility on orders worth ~Rs1,500bn over next three years, with Rs450bn of manufacturing orders expected in FY23-H1FY24. Management is confident of maintaining 24-25% EBITDA margins. Supply chain of Russian spares has been managed effectively and the company is looking at ~Rs130bn of Repair and overhaul (ROH) revenues in FY23. Management highlighted its internal target of Rs25bn in export revenues by FY25. Current orderbook stands at ~Rs850bn including a fresh order of ~Rs60bn in Q1FY23. Current surplus cash balance stands at ~Rs140bn. Maintain BUY with a target price of Rs2,655/share (previous target of Rs2,618/share).

- ▶ **Rs450bn-worth potential manufacturing order inflow over next 1 year.** Order pipeline for the next 1 year comprises: 70 HTT40, 75 ALH for Indian Army, 6 LTA-Dornier, 12 LUH, 12 Sukoi30 and 240 AL31SP engines for the Sukoi30. The aggregate value of these orders stands at Rs450bn and is expected to take the current orderbook position to >Rs1,000bn. There are other orders in the pipeline – e.g. 80 RD33 engines, 145 LCH, 175 LUH, 60 UHF and LCA Mk2 programs – which will further add Rs600bn-700bn. The orders will take 3-5 years to be signed. The contract for 15 LCHs has already been signed in Mar'21 (HAL has delivered 6 LCHs to date and the rest 9 will be delivered in FY23). Company is expecting an order for 147 LCHs which amounts to Rs250bn and will take around 2-3 years to materialise. 80 RD33 engines order for Mig29 is under process with RFP expected soon and will be tendered in FY24. RFP has been issued for 240 AL31FP engines for Su-30 MKI and the tender is expected to conclude in FY23.
- ▶ **Key new initiatives.** Production of Light Utility Helicopter (LUH) Mk1 has started and is ready for rollout from the new greenfield helicopter factory at Tumakuru. Light transport aircraft (LTA) Dornier attained civil certification from DGCA in May'22. In GAGANYAN project HAL has delivered crew model ferrying and truck transportation structure to ISRO in Aug'22. First flight of Light Combat Aircraft (LCA) Mk1A has been completed and deliveries would start from Feb'23. HAL has signed an MoU with Safran for a JV intended for internal development, production and sales of helicopter, and support for helicopter engines for India as well as the global market. Company also entered into an MoU with Israel Aerospace Industries (IAI) in Mar'22 to convert civil passenger aircraft into multi-mission tanker aircraft.
- ▶ **Significant strides in indigenisation.** During FY22, of the 34 new platforms that were manufactured and delivered, 30 were indigenously designed and developed. All the major platforms of HAL – such as LCA, LTA-Dornier, LCH, LUH, etc. – are part of the positive list notified by MoD. Recently, the third positive indigenisation list (containing ~780 LRUs, systems + sub-systems, and components) has ~50% from HAL platforms. HAL has increased its contribution to R&D reserve from ~10% to ~15% of operating PAT.

Market Cap	Rs765bn/US\$9.6bn	Year to Mar	FY21	FY22	FY23E	FY24E
Reuters/Bloomberg	HIAE.BO / HNAL IN	Revenue (Rs mn)	227,545	246,200	261,813	293,135
Shares Outstanding (mn)	334.4	EBITDA(Rs mn)	53,494	54,086	60,306	65,658
52-week Range (Rs)	2315/1211	Net Income (Rs mn)	32,391	50,799	42,145	45,562
Free Float (%)	13.8	EPS (Rs)	96.9	151.9	126.0	136.3
FII (%)	13.8	P/E (x)	15.6	9.9	12.0	11.1
Daily Volume (US\$'000)	23,679	CEPS (Rs)	132.1	185.1	160.3	173.0
Absolute Return 3m (%)	28.2	EV/E (x)	8.2	6.8	6.1	5.2
Absolute Return 12m (%)	71.3	Dividend Yield	2.0	2.6	2.9	3.2
Sensex Return 3m (%)	6.3	RoCE (%)	26.2	21.7	21.6	20.9
Sensex Return 12m (%)	4.6	RoE (%)	21.0	26.3	19.1	18.2

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- ▶ **Export possibilities.** HAL has inquiries from a number of countries including Malaysia, Philippines, Argentina, Egypt, etc. for the supply of new platforms as well as support their existing fleet. Company is also concentrating on international certification to increase its export possibility. LCA Tejas is one of the top contenders in Malaysian tender for 18 aircrafts. HAL is already in the process of establishing its office in Malaysia to facilitate consultations over South Asian countries. Company further plans to open its offices in Egypt, Middle East and North America. **Management highlighted internal targets of Rs25bn of export revenues by FY25.**
- ▶ **New opportunities.** HAL has hired BCG for consultation to identify areas of potential diversification, business strategy, internal restructuring and improving operational efficiency. Some of the areas of diversification are civil MRO, passenger-to-freight conversion of aircraft, UAV simulators, etc. for capturing additional revenues.

Table 1: Q1FY23 result review*(Rs mn)*

	Q1FY23	Q1FY22	% Chg YoY	Q4FY22	% Chg QoQ
Net Revenue	36,225	16,158	124.2	1,15,611	(68.7)
Growth	124.2%	-7.0%		7.7%	
Cost of material	12,449	10,578	17.7	35,770	(65.2)
Purchase of stock	681	586		2,841	
Change in inventory	(2,977)	(13,419)		7,762	
Total cost of materials	10,153	(2,255)		46,373	
<i>Cost of material as % of sales</i>	28	NM		40.1	
Gross Margin	26,072	18,414	41.6	69,239	(62.3)
<i>Gross Margin (%)</i>	72.0	114.0		59.9	
Employee Expenses	10,178	10,583	(3.8)	14,027	(27.4)
Other expenses	3,824	2,519	51.8	3,640	5.1
Impairment loss	33	11		1,661	
Provisions	4,602	3,326		26,092	
Expenses capitalised	(829)	(450)		(1,178)	
EBITDA	8,263	2,425	240.8	24,998	(66.9)
<i>EBITDA margin (%)</i>	22.8	15.0		21.6	
Interest	2	147	(98.4)	421	
Other Income	1,916	1,501	27.6	5,007	
EBIT	10,177	3,779		29,584	
<i>EBIT margin (%)</i>	28.1	23.4		25.6	
<i>EBIT margin ex other income (%)</i>	22.8	14.1		21.3	
Depreciation	2,082	1,115	86.8	3,825	(45.6)
Exceptional item	-	-		0	
PBT	8,095	2,664	203.8	25,759	(68.6)
Tax	2,021	694		(5,281)	
PAT	6,074	1,970	208.3	31,040	(80.4)
Share of Profit/(Loss) of Joint Ventures	128	(23)		11	

Source: Company data, I-Sec research

Table 2: Update on key projects

Product	Update
Basic Trainer Aircraft (HTT-40)	<ul style="list-style-type: none"> A total of 3 prototypes have been built, which includes two flying prototype and one Structural Test Specimen (STS). In February, 2021, Request for Proposal (RFP) for HTT-40 aircraft received from IAF and response has been submitted in April 2021 which is presently under evaluation.
Light Combat Aircraft (LCA) Mk 1A	<ul style="list-style-type: none"> LCA Mk1A is an improved variant of the indigenously developed LCA MK1, currently being developed by HAL. It has additional features and improvements such as Self Protection Jammer, Active Electronically Scanned Array (AESA) RADAR, Beyond Visual Range (BVR) missile. Contract for the supply of 83 LCA Mk1A to IAF was signed during Aero India 2021 and production activities have been launched.
Light Utility Helicopter (LUH)	<ul style="list-style-type: none"> The LUH is a single engine, 3-ton weight class helicopter having glass cockpit with multi-function displays. The helicopter is capable of flying at 220kmph; service ceiling of 6.5km and a range of 350km with 500kg payload. Three flying prototypes have been built and were extensively flight-tested. Initial Operational Clearance (IOC) for LUH IAF Version was accorded on 7th Feb'20 and for the Indian Army Version on 5th Feb'21. During the year, hot and high altitude flight trials with new tail rotor system to further improve performance requirement, was completed at Leh. Company received letter of intent for 12 helicopters and production activities have commenced. The greenfield helicopter factory at Tumakuru for manufacturing of LUH is also in place.
Indian Multi Role Helicopter (IMRH)	<ul style="list-style-type: none"> Currently, the preliminary design phase is in progress. HAL has completed phase-1 of wind tunnel testing of IMRHIAF scaled model and results are satisfactory. Phase-2 of wind tunnel testing is in progress. In a significant boost to Prime Minister's vision on <i>Aatmanirbhar Bharat Abhiyan</i>, 18 major platforms have been identified by the ministry of defence for industry-led R&D under various routes, wherein private industry will be encouraged to take up design and development of military platforms and equipment. The Indian Multi Role Helicopter (IMRH) is identified as one of these 18 platforms to be taken up through the special purpose vehicle (SPV) model. Accordingly, HAL issued the expression of interest (Eoi) in Apr'22 for selection of SPV partner.

Source: Company data, I-Sec research

Maintain **BUY** with a target price of Rs2,665/share

We value HAL using the DCF methodology. Maintain **BUY** with a target price of Rs2,618. The biggest certainty to our valuation is the orderbook, which is expected to cross Rs1,000bn by FY22/FY23E – **there are hardly any defence primes in the world which manufacture combat aircraft and have an equivalent book-to-bill ratio.**

Table 3: DCF valuation table yields target price of Rs2,665/share

(Rs mn)	FY22	FY23E	FY24E	FY25E	FY26E	FY27E	FY28E	FY29E	FY30E
Sales	246,200	262,134	283,105	305,754	342,444	383,537	429,562	457,360	488,208
EBITDA	54,086	65,682	70,002	76,714	86,031	96,268	107,497	110,211	115,105
Tax	1,447	14,810	15,654	15,890	17,947	20,228	22,749	23,204	24,188
PAT	50,799	46,217	48,852	49,588	56,008	63,124	70,993	72,412	75,482
NOPAT	52,639	50,872	54,348	60,824	68,084	76,040	84,748	87,007	90,918
Working Capital Change									
Capex	12,654	(24,173)	(2,027)	8,003	(19,832)	5,382	5,414	1,552	744
	(7,993)	(12,000)	(12,000)	(12,000)	(12,000)	(12,000)	(12,000)	(12,000)	(12,000)
FCF									
Terminal Value	57,300	14,699	40,321	56,827	36,252	69,422	78,162	76,559	79,662
Total FCF									902,833
Cost of Equity	12%								
WACC	11%								
Terminal Growth	2%								
NPV of FCFF (FY23E)	715,228								
Net Debt at FY23E	(175,923)								
Net Equity value	891,152								
Value per share	2,665								

Source: I-Sec research

Table 4: Old valuation table

(Rs mn)	FY22	FY23E	FY24E	FY25E	FY26E	FY27E	FY28E	FY29E	FY30E
Sales	246,200	261,813	293,135	328,311	367,709	411,834	461,254	491,078	515,397
EBITDA	54,086	60,306	65,658	76,872	82,279	95,901	111,382	114,000	113,603
Tax	1,447	13,505	14,600	15,929	17,037	20,139	23,692	24,123	23,823
PAT	50,799	42,145	45,562	49,708	53,166	62,846	73,934	75,281	74,344
NOPAT	52,639	46,801	51,058	60,944	65,242	75,762	87,690	89,877	89,780
Working Capital Change									
Capex	12,654	(30,126)	(3,003)	10,435	(26,836)	8,284	9,178	859	(5,391)
	(7,993)	(12,000)	(12,000)	(12,000)	(12,000)	(12,000)	(12,000)	(12,000)	(12,000)
FCF									
Terminal Value	57,300	4,675	36,055	59,378	26,406	72,046	84,868	78,735	72,389
Total FCF									922,958
Cost of Equity	12%								
WACC	11%								
Terminal Growth	2%								
NPV of FCFF (FY23E)	716,441								
Net Debt at FY23E	(93,738)								
Net Equity value	810,179								
Value per share	2618								

Source: I-Sec research

The key risk to our understanding is lack of diversification. As cashflow accumulates, we are witnessing a trend of vertical integration (latest two examples are Lockheed acquisition of Aerojet Rocketdyne and merger between Raytheon and UTC). HAL may also have to think about business diversification sooner or later. Faster ramp-up of unmanned vehicles through the IAI, Dynamatic JV, focused entry into civilian space with

LUH offering, trying to enter into MRO for civilian space, trying to leverage the knowledge of propulsion systems to move towards integration of the same in hypersonic missiles – those are some of the potential areas of diversification for HAL, apart from increasing the production rate of the existing platforms.

Other key risks: Global aerospace defence primes like Lockheed Martin are rated in high-risk category (Score of 30.6) by Sustainalytics with industry group rank of 15 out of 91. Similarly, we see Lockheed not selected in S&P 500 ESG index and the reason for exclusion shown as ‘involved in controversial weapons’ – similar predicaments for Boeing. MSCI on the other hand has assigned an ‘A’ rating on Lockheed Martin, with 17% of the MSCI AWC constituents in aerospace and defence getting an ‘A’ rating. HAL is currently not rated by any agency.

Financial summary

Table 5: Profit & Loss statement

(Rs mn, year ending March 31)

	FY21	FY22	FY23E	FY24E
Operating Income	227,545	246,200	261,813	293,135
Operating Expenses	174,052	192,115	201,507	227,478
EBITDA	53,494	54,086	60,306	65,658
% margins	23.5	22.0	23.0	22.4
Depreciation & Amortisation	11,783	11,105	11,441	12,281
Gross Interest	2,592	582	315	315
Other Income	3,582	9,849	7,000	7,000
Recurring PBT	42,770	52,245	55,650	60,162
Less: Taxes	10,379	1,447	13,505	14,600
Recurring Net Income	32,391	50,799	42,145	45,562

Source: Company data, I-Sec research

Table 6: Balance sheet

(Rs mn, year ending March 31)

	FY21	FY22	FY23E	FY24E
Assets				
Total Current Assets	402,175	449,918	500,400	572,263
of which cash & cash eqv.	71,774	143,477	140,224	166,880
Total Current Liabilities & Provisions	267,174	262,855	278,687	305,291
Net Current Assets	135,001	187,064	221,713	266,972
Investments	10,555	13,627	13,627	13,627
Net fixed assets (including CWIP)	95,689	92,388	92,947	92,666
Other non-current assets	11,040	27,961	27,961	27,961
Total Assets	252,285	321,040	356,249	401,226
Liabilities				
Borrowings	5,047	5,247	5,247	5,247
Advance from customers	93,077	122,624	130,401	146,001
Equity Share Capital	3,344	3,344	3,344	3,344
Reserves & Surplus	150,779	189,787	217,219	246,597
Net Worth	154,123	193,131	220,563	249,941
Total Liabilities	252,285	321,040	356,249	401,226

Source: Company data, I-Sec research

Table 7: Cashflow statement

(Rs mn, year ending March 31)

	FY21	FY22	FY23E	FY24E
Net Profit before tax	32,391	50,799	42,145	45,562
Depreciation	11,783	11,105	11,441	12,281
Working Capital Changes	91,682	12,654	(30,126)	(3,003)
Taxes Paid	(7,186)	(10,532)	(13,505)	(14,600)
Cash flow from Operating Activities	152,627	100,328	23,775	55,155
Capital Commitments	(13,173)	(15,006)	(12,000)	(12,000)
Free Cash Flow	139,454	85,323	11,775	43,155
Other investing cashflow	463	(112,589)	-	-
Cash flow from Investing Activities	(12,710)	(127,595)	(12,000)	(12,000)
Inc (Dec) in Borrowings	(58,628)	(91)	-	-
Other financing activities	(12,622)	(13,399)	(15,028)	(16,499)
Cash flow from Financing Activities	(71,249)	(13,491)	(15,028)	(16,499)
Chg. in Cash & Bank balance	68,668	(40,757)	(3,253)	26,655

Source: Company data, I-Sec research

Table 8: Key ratios

(Year ending March 31)

	FY21	FY22	FY23E	FY24E
Per Share Data (Rs)				
Basic EPS	96.9	151.9	126.0	136.3
Diluted EPS	96.9	151.9	126.0	136.3
Cash EPS (Fully Diluted)	132.1	185.1	160.3	173.0
OCF per share (Fully Diluted)	45.7	456.4	300.0	71.1
Book Value per share (Fully Diluted)	460.9	577.6	659.6	747.5
Dividend	30.0	40.0	44.0	48.4
Growth YoY (%)				
Net Sales	6.1	8.2	6.3	12.0
EBITDA	6.0	6.0	12.0	12.0
PAT	12.7	56.8	(17.0)	8.1
Valuation ratios				
P/E	15.6	9.9	12.0	11.1
P/CEPS	11.4	8.2	9.4	8.7
P/BV	3.3	2.6	2.3	2.0
EV / EBITDA	8.2	6.8	6.1	5.2
EV / FCF	88.9	3.0	4.0	31.4
Operating Ratios (%)				
Raw Material/Sales	48.5	40.6	46.0	46.0
Other Income / PBT	8.4	18.9	12.6	11.6
Effective Tax Rate	24.3	2.8	24.3	24.3
NWC / Total Assets	26.0	32.0	34.9	37.8
Inventory Turnover	69.3	72.9	72.9	72.9
Asset Turnover	43.8	42.2	41.2	41.5
Net D/E Ratio (x)	(0.4)	(0.7)	(0.6)	(0.6)
Profitability Ratios (%)				
Rec. Net Income Margins	14.2	20.6	16.1	15.5
RoCE	26.2	21.7	21.6	20.9
RoNW	21.0	26.3	19.1	18.2
Dividend Payout	26.3	34.9	35.5	35.8
Dividend Yield	2.0	2.6	2.9	3.2
EBITDA Margins	23.5	22.0	23.0	22.4

Source: Company data, I-Sec research

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