

Recommendation			
Company (Ticker)	CMP (INR)	TP (INR)	Rated
Astra Microwave Product (ASTM)	604	980	Buy
Apollo Micro Systems (APOLLO)	115	156	Buy
Azad Engineering (AZAD)	1,358	2,150	Buy
Bharat Dynamics (BDL)	1,009	1,190	Hold
Bharat Electronics (BHE)	256	370	Buy
Centum Electronics (CTE)	1,288	845	Sell
DCX Systems (DCXINDIA)	262	317	Hold
Data Patterns India (DATAPATT)	1,554	2,450	Buy
Hindustan Aeronautics (HNAL)	3,369	5,000	Buy

\*CMP as on Feb 21, 2025

### Defence PSUs lead the way as private players struggle with supply chain disruptions.

In Q3FY25, defence PSUs outperformed private players across key financial metrics, demonstrating 25.3% YoY revenue growth and an EBITDA margin expansion of 140bps to 32.4%, driven by strategic long-term raw material contracts and effective cost-control measures. PAT increased by 28.7%, with a marginal margin improvement of 56.3bps, despite supply chain disruptions caused by ongoing conflicts in Israel and Russia.

Conversely, private defence companies faced execution delays and supply constraints, resulting in 7.5% YoY and 7.4% QoQ revenue growth, while EBITDA improved by 3.1% YoY and 35.0% QoQ. However, EBITDA margins contracted 88.7bps YoY, improved by 423.7bps QoQ. The quarter underscored the resilience of DPSUs in managing global challenges, while private players struggled with operational inefficiencies and supply chain issues.

### Bolstering Indo-Pacific security through stronger US-India ties:

**Past:** During the US under President Trump's 1.0 tenure, US-India relations witnessed significant advancements in the defence sector, particularly with India's acquisition of 24 MH-60R Seahawk helicopters. Apart from that, his strong anti-China stance bolstered India's strategic position in the Indo-Pacific region. While Trump pursued an isolationist approach in global agreements, he remained committed to India's role in regional security to counter China.

During Trump 1.0, major development was the establishment of the 2+2 Ministerial Dialogue, which facilitated key defence agreements including the COMCASA, ISA, BECA, LEMOA, an extension of the GSOMIA. These agreements enhanced India & US growing strategic relation. And India's active role in maintaining Indo-Pacific stability contributed to strengthening the US & India defence ties.

**Present:** During PM Narendra Modi's recent visit to the US, a key highlight was discussions on the potential sale of advanced defence systems, including F-35 stealth fighter jets, aimed at strengthening India's military capabilities and enhancing interoperability between the two armed forces. Given the complexity of such high-end defence procurements, the F-35 deal is expected to be a long-term process requiring extensive evaluations and strategic alignments. In the near term, co-production of Javelin Anti-Tank Guided Missiles and Stryker Infantry Combat Vehicles is anticipated, reflecting a growing emphasis on joint defence manufacturing and technology transfer between the two nations.

**Future:** India and the US are likely to sign major defence agreements, as countering China's growing military power will necessitate deeper defence cooperation. India's defence exports reached INR 210.8Bn in FY24, with a target of INR 500.0Bn by FY29. The US remains one of the top three destinations for Indian defence products, particularly sub-systems and components supplied to major defence manufacturers such as Boeing and Lockheed Martin, which are significant contributors to the US economy. Given this economic interdependence, it is unlikely that Trump 2.0 would impose additional tariffs on Indian vendors, as such measures could disrupt key American defence firms and disturb favorable power balance. Thus, the shared geo-political and geo-economic interests between the two nations should ensure minimal negative impact on India's trade and strategic engagements. Overall, Trump's tenure is expected to further enhance US-India defence cooperation, fostering a stable and mutually beneficial partnership in the Indo-Pacific region.

- **LEMOA:** Logistics Exchange Memorandum of Agreement.
- **COMCASA:** Communications Compatibility and Security Agreement.
- **BECA:** Basic Exchange and Cooperation Agreement.
- **ISA:** Industrial Security Annex.
- **GSOMIA:** General Security of Military Information Agreement.

#### What is the 2+2 Ministerial Dialogue? Why is it important?

- Apart from India, the United States has signed the 2+2 Dialogue framework with a select group of strategic partners, including Japan, South Korea, Australia, and NATO allies, reflecting a shared commitment to global security and stability.
- The 2+2 dialogue is a high-level diplomatic and defence meeting where the Foreign Ministers and defence Ministers of both countries meet to discuss strategic and security issues. This format enhances defence cooperation, military interoperability, intelligence sharing, and diplomatic coordination.
- Defence agreements like LEMOA, COMCASA, ISA, and BECA are vital for enhancing military cooperation, technology access, intelligence sharing, and strategic alliances. They strengthen defence capabilities, improve interoperability, boost surveillance, and support domestic defence industries, ensuring regional stability and deterrence against threats.

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## Our Top Pick's

*The sector is anticipated to witness substantial investments, acquisitions of advanced platforms, and modernization of existing systems, leading to increased production and dispatches.*

## Outlook :

The defence sector is poised for significant growth as it transitions from a purely strategic domain to a key economic driver, contributing to national development. The Atmanirbhar Bharat initiative has played a crucial role in reducing dependence on foreign OEMs by promoting indigenous procurement of defence equipment. Over the next 5-10 years, continued government support for defence PSUs and private players is expected to foster a self-sustaining defence industry.

We anticipate that during Trump's tenure, GE is likely to prioritize the delivery of the GE F404-IN20 variant engine, which is currently more than a year behind schedule. This delay has hindered the growth potential of HNAL, leading to a revision in market expectations. However, once the GE engine issue is resolved, it could significantly expand the order book and drive long-term growth for the Indian Defence companies. While most defence companies maintain a robust order backlog, execution remains a key concern. Premium valuations, driven by stretched multiples, continue to be a challenge, though recent market corrections provide some cushion. Additionally, pure industrial plays may face further downgrades if earnings or order inflows fail to meet expectations.

## Bharat Electronics Ltd. | Rating: BUY | Target Price: INR 370

## Outlook:

Bharat Electronics Limited (BHE) maintains strong revenue visibility with an order pipeline of INR 711Bn (3.1x TTM sales) and has set a target of INR 250Bn in order wins for FY25. As of 9MFY25, it has secured INR 110Bn in orders, with 85-90% originating from the defence sector, positioning it well to achieve its target. Looking ahead, BHE anticipates significant growth, with new orders ranging between INR 300-400Bn in FY26. Key upcoming projects include the QR-SAM project worth INR 250-300Bn (expected by March 2026), MR-SAM, MF-STAR, and NGC Corvettes valued at INR 140-150Bn (expected in FY26), and Akash Prime along with smaller projects exceeding INR 50Bn. Additionally, its diversification into non-defence sectors, such as metro projects, civil aviation and IT infrastructure, further strengthens growth prospects. We maintain a positive outlook on BHE, supported by a robust order backlog, the government's focus on defence indigenization, strong financials, improving return ratios, and consistent margin growth. Accordingly, we have revised our FY26/27E EPS estimates by 3.4%/4.3% and maintain a 'BUY' rating with a revised target price of INR 370, valuing the company at 40x FY27E EPS.

Key Financials					
INR Mn	FY23	FY24	FY25E	FY26E	FY27E
Revenue	2,975	3,716	5,760	8,064	10,887
YoY Growth (%)	22.3	24.9	55.0	40.0	35.0
EBITDA	641	839	1,354	1,911	2,613
EBITDAM (%)	21.5	22.6	23.5	23.7	24.0
Adjusted PAT	187	311	630	987	1,470
EPS	9.0	1.2	1.9	2.6	3.9
ROE %	4.9	6.0	4.5	6.6	9.0
ROCE %	8.5	9.3	5.8	7.6	9.5
PE(x)	14.2	102.9	65.9	49.1	32.9
Price to BV (x)	6.9	7.0	3.0	3.2	2.9

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**CHOICE RATING DISTRIBUTION & METHODOLOGY**

BUY	The security is expected to generate upside of 15% or more over the next 24 months
HOLD	The security is expected to show upside or downside returns by 14% to -5% over the next 24 months
SELL	The security expected to show downside of -5% or more over the next 24 months

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