



# Hindustan Aeronautics Limited IPO Analysis

*By- Arohi V. Deore*

# **Hindustan Aeronautics Limited**

**Opening Date – 16<sup>th</sup> March 2018**

**Closing Date – 20<sup>th</sup> March 2018**

**Band Price – ₹1215-₹1240**

**Special Discount of ₹25 to retail Investors**

**Objective of the Offer** - The objects of the Offer are:

1. To carry out the disinvestment
2. To achieve the benefits of listing the Equity Shares on the Stock Exchanges.

The company will not receive any proceeds from the Offer and all proceeds shall go to the Selling Shareholder

## **Industry Overview**

India has the third largest military in the world and is the sixth largest spender in defence. India is also one of the largest importers of conventional defence equipment and spends approximately 30% of its total defence budget on capital acquisitions. 60% of Indian's defence-related requirements are currently met through imports. In addition, the 'Make in India' initiative by the Government is focusing its efforts on increasing indigenous defence manufacturing with the aim of becoming self-reliant. Opening up of defence sector has helped foreign OEMs manufacture to build strategic alliances with Indian manufacturer which is helping them to leverage opportunities in foreign and domestic markets.

India's focus on indigenous manufacturing in the defence sector has yielded certain benefits as the MoD over the last two years unveiled several products manufactured in India including the LCA Tejas, the composites sonar dome, a portable telemedicine system for the armed forces, penetration-cum-blast and thermobaric ammunition specifically designed for the Arjun tanks, the Varunastra heavyweight torpedo manufactured with 95% locally sourced parts and medium-range surface-to-air missiles.

The Defence Acquisition Council under the MoD cleared defence sector transactions with a value of more than ` 820 billion under the 'Buy and Make (Indian)' and 'Buy Indian' categories. These transactions include the procurement of Light Combat Aircraft, T-90 tanks, mini UAVs and light combat helicopters.

The Union budget of the Government of India for 2017-18 allocates ` 2,623,900 million for defence expenditures excluding pension, which represents an increase of 5.3% from

2,490,990 million for 2016-2017 (Budgetary Estimate). However, this allocation represents a decrease to 1.6% in the allocation as a percentage of GDP for 2017-18 from 1.7% for 2016-17 and constitutes the lowest allocation as a percentage of GDP since 2000-01. The current budgeted allocation of defence expenditures include ` 1,758,610 million for revenue expenditure and ` 865,290 million for capital expenditure. This allocation for revenue expenditure and capital expenditure increased by 8.1% and 0.2% over the previous year's allocations.

## **Private Companies**

Private sector defence companies are limited in India and have only been permitted to produce defence sector products and technologies since 2001. However, private companies engaged in the defence sector are subject to certain guidelines and government approvals regarding licencing for the production of arms and ammunition. FDI policy in defence sector was last reviewed under Press Note No. 5 (2016 Series) on June 24, 2016. As per the current FDI policy, foreign investment up to 49% is permitted under the automatic route, foreign investment beyond 49% and up to 100% is permitted through Government approval, wherever it is likely to result in access to modern technology or other specified reasons. FDI in the defence sector requires an industrial licence under the Industries (Development & Regulation) Act, 1951.

A number of provisions are applicable which are aimed to ensure that India's national security will not be adversely affected by the FDI policy, although the Government has not made a formal assessment of any such effects. Operating under the FDI policy requires an industrial licence which is granted by the Licensing Committee of the Department of Industrial Policy and Promotion, after taking into account the security clearance of the Ministry of Home Affairs. In addition, the industrial license is conditioned on complying with a security manual issued by Licenced Defence Companies.

## Company overview

Hindustan Aeronautics Limited (HAL) is an Indian state-owned aerospace and defence company based in Bangalore, Karnataka. It is governed under the management of the Indian Ministry of Defence. The government-owned corporation is primarily involved in the operations of the aerospace industry. These include manufacturing and assembly of aircraft, navigation and related communication equipment and airports operation. HAL built the first military aircraft in South Asia. It is currently involved in the design, fabrication and assembly of aircraft, jet engines, helicopters and their spare parts. It has several facilities spread across India. The locations where the manufacturing plants are operated by HAL include Nasik, Korwa, Kanpur, Koraput, Lucknow, Bangalore and



Hyderabad. The German engineer Kurt Tank designed the HAL HF-24 Marut fighter-bomber, the first fighter aircraft made in India.

## Offer price decision

Particulars <sup>(1)</sup>	Six month period ended September 30	Financial Year		
	2017	2017	2016	2015
	(₹ in millions except percentages)			
Revenue from operations (net of excise duty)	51,725	179,515	167,585	156,475
Exports	1,542	4,650	4,461	4,941
EBITDA <sup>(2)</sup>	8,683	43,148	40,761	25,642
EBITDA margin <sup>(3)</sup> (%)	16.8%	24.0%	24.3%	16.4%
Profit before tax	6,096	35,917	32,133	16,727
Profit after tax	3,910	26,247	20,043	9,941

## Qualitative Factors

### *Competitive Strengths*

- Long credible history of research, design and development, manufacturing and maintenance, repair and Overhaul services
- Established track record in offering product lifecycle support extending to periods beyond four decades.
- Strong design & development capabilities
- Leadership Position in the Indian Aeronautical industry and strong GoI support
- Diversified product portfolio
- Strong financial track record
- Experienced management team and operating team

## Quantitative Factors

### **1. Basic and Diluted Earnings per shares, as adjusted for changes in Capital:**

Period	Basic EPS (₹)	Diluted EPS (₹)	Weight
Fiscal 2017	73	73	3
Fiscal 2016	42	42	2
Fiscal 2015	21	21	1
<b>Weighted Average</b>	54	54	
Six month period ended September 30, 2017*(Not Annualised)	11	11	

### **2. Industry P/E Ratio:**

As there are no listed companies in India that are directly comparable to the business carried on by the

Company, no comparison of Price Earnings Ratio with industry peers is available.

Based on criteria mentioned company has come up with following proposal

<b>Issue price / Floor Price (Rs)</b>	<b>1215.00-1240.00</b>
<b>Application per share (Rs)</b>	1,240.00
<b>Minimum investment amount (Rs)</b>	14,880.00
<b>Minimum bid (no of shares)</b>	12
<b>Maximum Shares for Retail</b>	156

### Key strengths of HAL

- Long credible history of research design and development, manufacturing and maintenance, repair and overhaul services
- Established track record in offering product lifecycle support extending to periods beyond four decades
- Strong development and design capabilities
- Leadership position in the Indian aeronautical industry and strong GoI support

### Reason to invest in HAL IPO

- Good revenues growth from Rs. 7,362 Cr in FY15 to Rs. 19,596 Cr in FY 17
- Increasing margins YoY
- IPO is available at cheap price
- For retail investors there is 25 Rs discount in share price

### Risk Factors

- Its profit dropped for the 6 months period ended on Sep-2017
- They depend heavily on MoD contracts. The ability to generate sales, earnings and maintain cash flows is heavily dependent on GoI budget allocation to various defence departments.
- As a matter of national security certain information in relation to its business aspects is classified and not accessible
- The MoD contracts are not fully funded initially and subject to termination
- Company is not in compliance with certain provisions of company act/ SEBI guidelines

- Ongoing disclosure of information in relation to company after listing of the equity shares may be limited
- GoI has significant influence over its actions which may restrict the ability to manage the business
- There have been negative cash flows in past
- MoD gives rights many rights to GoI which will be hazardous to financial operations
- The basic intent of HAL going public is to liquidate GoI's share in it as a part of national disinvestment programme it will not attract major public attention initially.

### Growth Prospect

After 3 decades now defence sector companies have come again to offer. The valuations of HAL are pretty modest and offer good price to buy. For retail investors there is an additional discount of ₹25 per share. The company has robust order book worth Rs68,461crore (translating into 3.8 times FY17 net revenues) offering decent revenue visibility. Company also holds a large amount of cash and has negative working capital as it takes advances before the commencement of the project.

But investor should not look for stellar return from their investments as the company's growth strategies and expansion plan are not that good. Around 90% of company's revenue come from GOI, which is a risk as mere delay in process can hurt its financials.

The company may give better results in future as government policies and demand for defence equipment will be in favour of the company giving it competitive edge over other players or new entrants. An investor looking for stable financials and has long-term goal can invest.

### Subscription status after day 1

	Number of Times Subscribed (BSE + NSE)				
As on Date & Time	QIB	NII	RII	Employee	Total
Shares Offered / Reserved	16,719,374	5,015,813	11,703,563	668,775	34,107,525
Day 1 - Mar 16, 2018 17:00 IST	0.4300	0.0100	0.0700	0.0300	0.2400

24% subscription was done on first day which is moderate

### References:

1. DHRP - <http://www.cmlinks.com/pub/dp/dp12030.pdf>
2. <https://economictimes.indiatimes.com/markets/stocks/news/hindustan-aeronautics-ipo-kicks-off-will-this-fighter-jet-maker-fly-high-on-dalal-street/articleshow/63326939.cms>
3. <http://www.livemint.com/Money/AmlufUCZP8wRUKGpN5e8zJ/HAL-IPO-Modest-valuations-but-what-about-growth.html>

**Disclosure:**

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