



<b>Buy Range</b>	<b>₹3000 – 3100</b>
<b>Target</b>	<b>₹3900 – 4000</b>
<b>Recommendation</b>	<b>BUY</b>

<b>Highlights</b>	<ul style="list-style-type: none"> <li>○ <b>Strong collaboration with the Armed Forces</b> – Since inception, the company has delivered over 4,000 aircrafts and 5,000 aero-engines, while it has overhauled 11,550 aircrafts and 34,600 aero-engines for the Indian Armed Forces and for foreign-friendly countries. The company is integral to the Indian Armed Forces because it provides support to approximately 75% of the aerial fleet, including aircrafts produced by other OEMs.</li> <li>○ <b>Shift from imports to domestic production to provide strong impetus</b> – The government has taken several policy initiatives in the recent years and brought in reforms to encourage indigenous design, development, and manufacture of defense equipment in the country in lieu of importing them from foreign OEMs, thereby expanding production of indigenous defense equipment. Among these initiatives, the release of four positive indigenization lists (PILs) for indigenization of 4,600+ components is significant as it cements the government's commitment with definite, actionable guidelines.</li> <li>○ <b>R&amp;D continues to be a key moat</b> – HAL's R&amp;D business has been at the centre of various successful aeronautical systems including the latest LCA Tejas Mk-1 / Mk-1A platforms. The government has liberalized defence based R&amp;D for industrial players, start-ups, and for academia with 25% of defense R&amp;D budget earmarked to promote development of defense technology in the country. This has allowed HAL to leverage the R&amp;D capabilities and competencies so as to deliver better and stronger platforms.</li> <li>○ <b>Manufacturing Orders to Keep Engagement Elevated</b> – The IAF has strongly indicated its intention to upgrade its squadrons and expand its fleet with new aircrafts as well. While HAL's manufacturing order book of ₹820bn+ will be executed over the next 4-5 years, it's pipeline includes orders worth ₹480bn which will keep the machine churning for a large part of this decade.</li> <li>○ <b>Change in scope and better efficiency to offset price and margin cuts</b> – D-PSUs receive cash and recognize revenue at pre-defined milestones. Since most of HAL's orders are on a nomination basis, which has a PBT margin of ~7.5%, it receives an advance of 15% of contract value at the time of contract signing. This ensures a smooth working capital execution cycle throughout the lifecycle of the order and enables HAL to generate strong bottomline numbers.</li> </ul>
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**HINDUSTAN AERONAUTICS LTD (HAL)**
**Company Background**

**Hindustan Aeronautics Ltd (HAL)** is a “Navratna” conferred Defence Public Sector Undertaking (DPSU) involved in the design, development, manufacture, repair, overhaul, upgrade and servicing of a wide range of aero products and platforms, including aircrafts, helicopters, aero-engines, avionics, accessories and aerospace structures. HAL caters primarily to platforms and components for defence and military applications, with 90-95% of the order book comprising orders from one customer – Ministry of Defence.

**These are developed either indigenously or under license with foreign OEMs.**

**Indigenously designed and developed platforms include:**

- Aircraft platforms such as LCA Tejas (Mk1 and Mk1A), HAL Ajeet, HF-24 Marut, HPT-32 Deepak HJT-16 Kiran.
- Helicopter platforms such as ALH (Advanced Light Helicopter), LCH (Light Combat Helicopter), LUH (Light Utility Helicopter)

**Platforms and products produced under license from foreign OEMs include:**

- The MiG-21 (Mikoyan), MiG-27, Avro-748 (Avro), Jaguar (SEPECAT), Dornier 228 (Dornier GmbH), Su-30 Mk1 (Sukhoi), Hawk Mk132 (BAE Systems), Cheetah (Aérospatiale) and Chetak (Sud Aviation).
- Many of these foreign OEMs also collaborate with HAL for the design, development, repair and overhaul of their aero engines – many of which do duty on the IAF fleet as well.



Source: Company Data, Way2Wealth

**Investment Rationale**
**1. Monopoly in Aero Defence-Platform Production**

- HAL is the country's sole design-to-production aircraft platform manufacturer. Since inception, it has delivered over 4,150 aircrafts and 5,250 aero-engines and has also overhauled 11,550 aircrafts and 34,600 aero-engines for the Indian Air Force and for foreign-friendly countries.
- Currently, the company provides support services, such as MRO (Maintenance, Repair and Overhaul) services to ~75% of India's aero-fleet, including all of the Army's and Coast Guard's helicopters, ~90% of the fighters and 39% of the helicopters in the IAF.
- However, this relationship is poised to get significantly stronger as the Armed Forces look to replace the aging fleet of Cheetah and Chetak helicopters with HAL's ALH and LUH helicopters, and replace the aging MiG-21 aircrafts with HAL's Tejas aircrafts.
- As a part of its vision to make India a “US\$ 5 trillion economy by 2025 / US\$ 7 trillion economy by 2030”, the government has decided to increase its investment in defense programs. This Make in India initiative coupled with various geopolitical issues has propelled the growth for locally-produced platforms.
- The high-tech and complex nature of the defence-aerospace industry results in high-entry barriers. HAL thus enjoys a natural monopoly and becomes a significant benefactor of the Make in India program.

**Important Data**

Nifty	18,626
Sensex	62,883
Key Stock Data	
CMP	₹3272.9
Market Cap (₹ tn)	1.09
52W High/Low	₹3,281/1,699
Shares o/s (cr)	33.4
Daily Vol. (3M NSE Avg.)	4,659,789
BSE Code	541154
NSE Code	HAL
Bloomberg Code	HNAL:IN

**Shareholding Pattern (%) – Mar'23**

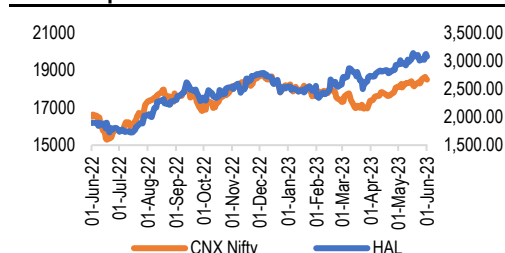
Promoter	71.65
DII's	9.07
FII's	13.93
Public & Others	5.35

**Financials & Valuations**

	FY20	FY21	FY22
<b>Operating Revenue</b>	<b>21,520</b>	<b>22,755</b>	<b>24,620</b>
<b>EBITDA</b>	<b>4,927</b>	<b>5,349</b>	<b>5,409</b>
<b>Margin (%)</b>	<b>23</b>	<b>24</b>	<b>22</b>
<b>Net Profit</b>	<b>2,770</b>	<b>3,239</b>	<b>5,080</b>
EPS	83	97	152
DPS	33	30	50
RoE (%)	21	21	26
RoCE (%)	22	29	22
P/E (x)	39.4	33.7	21.5
P/BV (x)	22.9	19.2	17.7
EV / EBITDA (x)	8.3	7.2	5.7

	FY23P	FY24E	FY25E
<b>Operating Revenue</b>	<b>26,928</b>	<b>28,185</b>	<b>31,587</b>
<b>EBITDA</b>	<b>6,680</b>	<b>7,425</b>	<b>8,619</b>
<b>Margin (%)</b>	<b>24.8</b>	<b>26.3</b>	<b>27.3</b>
<b>Net Profit</b>	<b>5,828</b>	<b>5,381</b>	<b>6,277</b>
EPS	174	161	188
DPS	40	52	57
RoE (%)	25	20	21
RoCE (%)	20	23	25
P/E (x)	18.8	20.3	17.4
P/BV (x)	13.4	11.9	10.2
EV / EBITDA (x)	4.6	4.2	3.7

Source: Company, Way2Wealth

**Relative performance**


Source: Company Data, Way2Wealth

**Analyst**

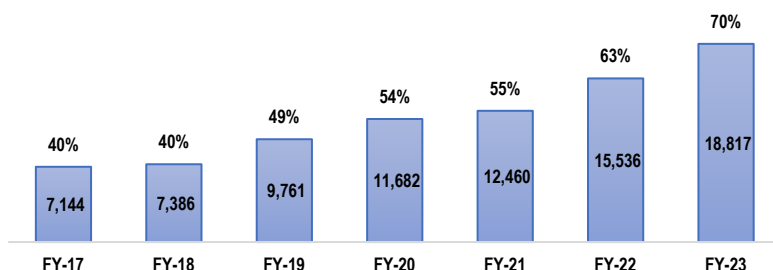
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## 2. Large Order book, Pipeline to provide Tailwinds

- (i) 90-95% of HAL's order book comprises of orders from one customer – Ministry of Defence (India). The order book, as on Mar' 23, stood at ₹820bn
- (ii) In Feb, 2021 HAL secured an order worth ₹470bn for 83 units of its latest LCA Tejas Mk-1A platform (₹380bn towards production, ₹90bn towards ground and support equipment). This paved the way for orders of its other recently developed platforms. In recent years, HAL has received multiple orders for its latest platforms including an order for 70 units of its HTT-40 trainer aircraft worth ₹70bn, 15 units of LCH (Light Combat Helicopter) worth ₹39bn, 12 units of LUH (Light Utility Helicopter) as a Limited Series Production and 25 units of its ALH Mk-III for ₹39bn.
- (iii) During FY-24, HAL expects ₹480bn worth of manufacturing order accretion, lead by 240 units of AL31-FP engines worth ₹260bn, 80 units of RD-33 engines worth ₹45bn, 25 units of ALH worth ₹35bn, 12 units of LUH worth ₹25bn and 12 units of Su-30 worth ₹120bn.
- (iv) In the long term, the success of these LCH and LUH orders will provide the basis for the government placing future larger orders (145 units of LCH and 175 units of LUH) as the Armed Forces phase out the older Chetak and Cheetah fleet with these new platforms.
- (v) HAL in collaboration with ADA (Aeronautical Development Agency) is currently developing a multi-role successor to LCA Tejas-Mk1A, dubbed LCA Tejas Mk2, in addition to the country's first Fifth Generation combat aircraft – AMCA (Advanced Medium Combat Aircraft). As a fifth-generation fighter, the AMCA is expected to have the most advanced technologies, avionics, defence and offence systems built into it. Currently, only few countries have proven the ability to produce their own fifth-generation aircraft. With the roll out of AMCA, India too will become a part of this elite list of countries.
- (vi) It is also developing a versatile helicopter (IMRH) to replace the current fleet of Mi-17. Currently in various stages of design and development, these upcoming platforms will likely see the light of day after 3-5 years, but will ensure that the future of HAL remains bright for the coming decade.
- (vii) On the non-defence front, HAL works closely with ISRO and recently won a ₹8.6bn order for 5 units of PSLV (Polar Satellite Launch Vehicles). Its Hindustan-228 aircraft has received type certification from the DGCA making it eligible for civilian/commercial operations.

## 3. Growth in the MRO Segment - A High Margin, Annuity Business

- (i) HAL provides maintenance, repair and overhaul (MRO) services for various aero platforms, including its indigenously designed platforms, foreign-licensed platforms and for aero-defence platforms procured directly from foreign OEMs. Given the elongated life of the country's aero fleets, MRO becomes a significant tool in ensuring that the fleet remains air and combat worthy.
- (ii) Compared to its Manufacturing segment, HAL's MRO business is able to generate higher margins due to better contractual rates and greater operating leverage.
- (iii) The Armed Forces have a large inventory of aircraft/helicopters, at present, which are in need of MRO support, providing a strong tailwind to this segment for the foreseeable future. While the company has a 2-3 year visibility of the MRO orders, its order book consists of MRO orders that are executable over the coming 12 months only. Currently, HAL estimates annual MRO execution to be ~₹18,000-19,000cr, for the coming years. We estimate billings in this segment will continue to move upwards as efficiencies and execution timelines continue to improve.

**MRO Revenue (₹ Cr) & % of Total Revenue**


Source: Company Data, Way2Wealth

#### 4. Increased Operational Efficiency

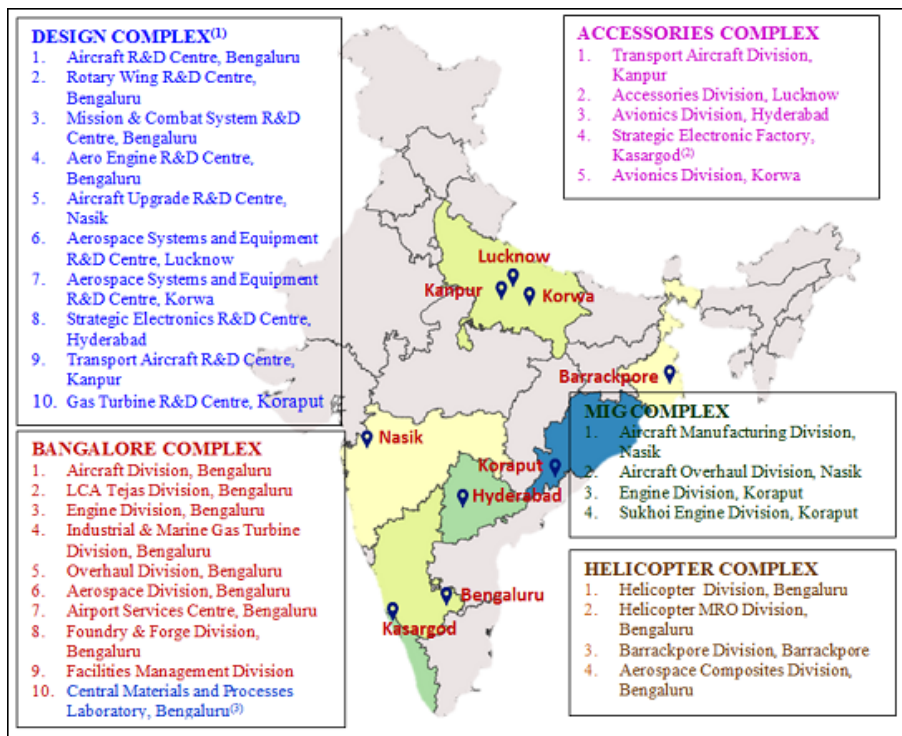
- (i) HAL will begin the production of the new Tejas Mk-1A iteration in FY-24. To expedite production, it plans to outsource a substantial part, while continuing to be the final integrator of all the components.
- (ii) With the old LCA Tejas Mk-1 orders coming to a close, the company's production lines will be able to take this up. HAL also plans to setup another production line at its Nagpur centre for the platform.
- (iii) Eventually, the pace of production will ramp up to 16 aircrafts per year vs. the pace of 6-7 aircrafts per year witnessed during the previous Tejas Mk-1 order.
- (iv) The new Helicopter facility at Tumkur, Bangalore which can produce 3-12 ton helicopters, will be used to produce the current and future units of the LUH, LCH and ALH orders, thus ensuring simultaneous, seamless and swift execution of all orders.

#### 5. Established Relationships with Foreign OEMs

- (i) Initially, HAL began as an aircraft design and development company, manufacturing 150 aircrafts in 1951. However, at the time, the country had decided to import the latest version of global Fighter Aircrafts & Helicopters in order to have a military advantage. Thus, HAL's business model shifted to assembling and repairing based on a transfer of technology (ToT) basis. While this limited its flexibility to innovate, it allowed the company's R&D unit to upgrade its competency and expertise in aircraft design and development, while establishing strong relationships with foreign OEMs.
- (ii) HAL is now capitalizing on these relationships under the "Make in India" banner, tying up with various foreign OEMs as an engine and component maker. HAL continues to be one of the few enterprises which has an MRO license for Russia's Su-30 MK aircraft. This license provides a strong leverage for potential export orders to foreign friendly countries with a fleet of Su-30 aircrafts.
- (iii) HAL recently contracted fresh tie-ups with:
  - (iv) Rollys Royce, UK for Adour, Orpheus, Avon, DART and Gnome series engines.
  - (v) Garrett engines of Honey Well Co., USA,
  - (vi) Safran Helicopter Engines (aka. Turbomeca), France for the development of engines to be used in the IMRH and for the Artouste and Arden engine series which are doing duty in the current fleet of Dhruv Mk-3, Rudra, Cheetah, Lancer and Chetak helicopters.

**6. Strong R&D Capabilities Integrated With Pan-India Manufacturing Facilities**

- (i) HAL's R&D business has been at the centre of various successful aeronautical systems including the Ajeet, Marut, HPT-32, Kiran, Tejas LCA and ALH. The R&D centre is currently working on developing new aircraft platforms such as the touted fifth-generation aircraft system – AMCA (Advance Medium Combat Aircraft) and a heavy-class multi-role helicopter – IMRH (Indian Multi-Role Helicopter).
- (ii) The centre has also developed 2 aero-engines recently, the HTFE-25 - a 25 KW turbo-fan engine being developed for trainer aircrafts, small business jets and drones weighing up to 5 tons and the HTSE-1200 –a 1200 KW turbo-shaft engine for helicopters weighing between 3 and 6.5 tons.
- (iii) HAL has ~11 dedicated R&D centres across the country which allow the company to develop a wide range of new and innovative products, upgrade existing products with combat operational capability and develop a pipeline of products for future needs.
- (iv) The funding for the research, design and development activities is sourced either through customer-funded contracts or internal accruals – 10% of the operating net profit of the preceding year is allocated towards R&D expenses.
- (v) HAL's operations are split across five complexes, which together house its 11 R&D centres and 20 production divisions.



Source- Company, Way2Wealth

- (vi) HAL's operations can be classified into five broad-based segments:
- (vii) The Aircraft segment comprises of the manufacturing of the company's portfolio of indigenous and under-license aircrafts such as the Sukhoi Su-30 MKI, MiG 21/27M, Hawk Mk 132, Dornier 228 / Hindustan-228, LCA Tejas (Mk1 / Mk1A), Jaguar and Mirage 2000.
- (viii) The Helicopter segment includes the production, maintenance, repair and overhaul facilities, and caters to the ALH (Advanced Light Helicopter) Mk III "Dhruv", ALH Mk IV "Rudra", Light Combat Helicopter ("LCH"), Cheetal helicopter, Cheetah, Chetak and Lancer.
- (ix) The Engines segment pertains to the manufacturing, repair, overhaul and servicing of aero-engines and related components, including critical discs, shafts, blades,

forgings and castings. The portfolio includes Adour Mk 871- 07 / Mk 804E/811, AL-31FP, Shakti 1H1, Garrett TPE-331-5, Artouste IIIB and PTAE-7.

(x) Under the Navigation and communication equipment segment, the company designs and manufactures various avionic equipment such as airborne radars, communication and navigation equipment, on-board computers and display systems such as the Advanced Communication System (ACS-235), VHF Omni Range and Instrument Landing System (VOR/ILS) and Tactical Air Navigation (TACAN).

(xi) These systems are either developed indigenously (usually in collaboration with other D-PSUs such as BEL) or under license from foreign OEMs.

(xii) **Aircraft accessories**

**1) Major accessories for aircraft, helicopters and aero-engines manufactured by us are as follows:**

- i. Hydraulic Systems and Power Control
- ii. Environment Control Systems
- iii. Engine Fuel Systems
- iv. Instruments
- v. Electrical Power Generation and Control Systems
- vi. Landing Gear Systems

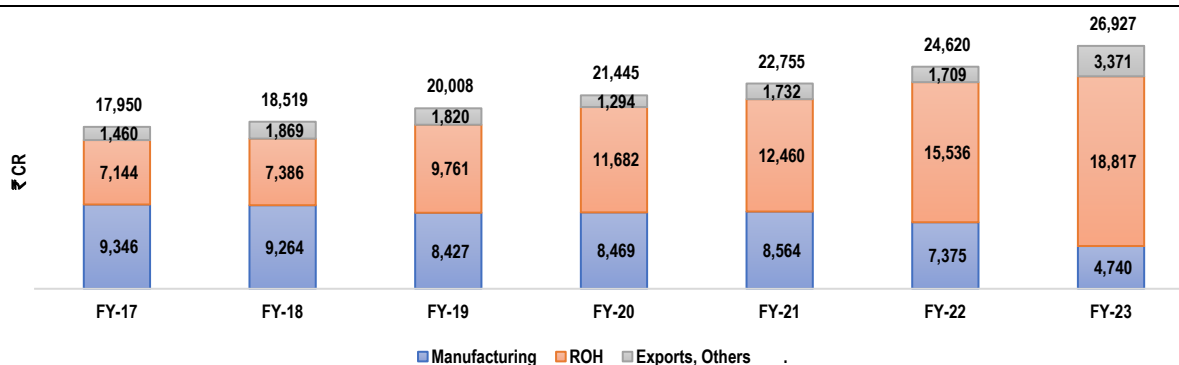
(xiii) HAL undertakes R&D across all five segments, developing newer platforms, combat vehicles, aerial defence systems, aero-engines and related components.

## Risks

- (i) Development of new aircrafts / avionics witnesses a long gestation period as these require multiple approvals at every stage, even before an order is placed.
- (ii) The recent spat of crashes of the new ALH Mk-III "Dhruv" helicopter across all the branches of the Armed Forces and the speculation around sub-standard material being used has sown the seed of doubt towards HAL's capabilities to deliver world-class platforms.
- (iii) HAL is the main Indian OEM which provides MRO services for various Russian aircrafts, such as the MiGs and Su-30 MKI, which make up a significant part of the IAF's fleet.
- (iv) Given the economic sanctions placed on Russia, as a consequence of the war, the import of spares and supplies for these aircrafts has been hindered, limiting HAL's ability to perform repair, upgrade and other MRO services on these aircrafts.
- (v) HAL's internal policy to maintain 6 months worth of MRO inventory along with various inter-government strategies to maintain continuous trade of products and services has been key in the smooth sailing of the MRO business. However, we remain vigil towards any change that may negatively impact the business.

## View

- (i) HAL's strong order visibility on both fronts – manufacturing and ROH – provides comfort in the firm's ability to generate marquee products for the armed forces.
- (ii) With the previous LCA Tejas Mk-1 orders nearing completion and production lines freeing up, HAL will go all out on the manufacturing of its recent orders, such as the LCA Tejas Mk-1A and the recently awarded LUH and ALH orders. Pipeline orders to the tune of ₹480bn will keep order book levels elevated for the foreseeable future. HAL's next generation aerial combat vehicles such as LCA Tejas-Mk II, AMCA and IMRH, which are currently under development, have strong domestic and export use case.
- (iii) In addition to this, HAL will continue to execute its MRO (Maintenance, Repair and Overhaul) orders at an average pace of ₹180bn per year. The high-margin ROH segment will continue to be the bellwether for profitability.
- (iv) As new foreign trade avenues are being undertaken by the govt., HAL will tide over the issue around sanctions on Russian imports.
- (v) Fundamentally, its monopolistic position, strong integration with the armed forces and its ability to remain profitable with surplus cash while delivering world-class defence platforms and solutions has made it a marquee stock in our books and **we recommend investors to BUY at the current level with target range ₹3900 – 4000.**

**FINANCIALS**


Particulars	Q4FY23	Q4FY22	Y-o-Y	FY23	FY22	Y-o-Y
Revenue	12,495	11,561	8%	26,927	24,620	9%
EBITDA	3,246	2,500	30%	6,679	5,409	23%
% Margin	26%	22%		25%	22%	
PBT	2,857	2,576	11%	6,507	5,225	25%
PAT	2,831	3,105	-9%	5,828	5,080	15%
% Margin	23%	27%		22%	21%	
EPS (₹)	85	93	(9)%	174	152	15%
RoE (%)	48%	64%	-25%	25%	26%	-6%
RoCE (%)	49%	54%	-9%	28%	27%	2%

Source – Company, Way2Wealth

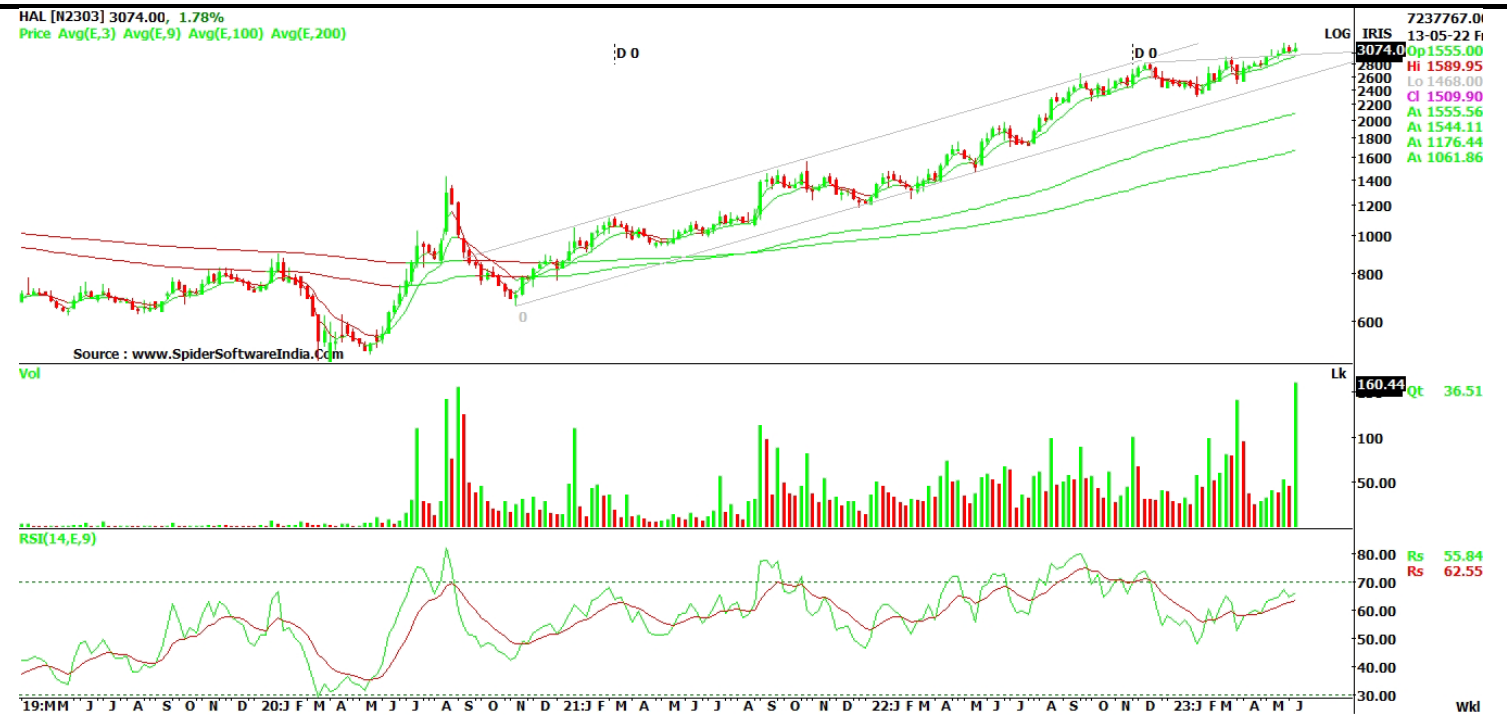
Particulars	FY20	FY21	FY22	FY23P	FY24E	FY25E
Revenue	21,520	22,755	24,620	26,927	28,185	31,567
Raw Mat Cost	9,463	11,044	10,001	10,102	10,000	11,680
% of Revenue	44%	49%	41%	38%	32%	37%
Op-ex	16,594	17,405	19,211	20,248	20,760	22,948
EBITDA	4,927	5,349	5,409	6,679	7,425	8,619
Margin	23%	24%	22%	25%	26%	27%
EBIT	3,928	4,171	4,298	4,894	6,125	7,269
(+) Other Income	294	358	985	1,670	1,050	1,100
PBT	3,874	4,270	5,225	6,507	7,175	8,369
PAT	2,770	3,239	5,080	5,825	5,381	6,277
Margin	13%	14%	21%	22%	19.1%	20%
Net Worth	13,249	15,188	19,313	23,572	26,263	29,401
EPS	82.9	97.0	151.9	174.2	161.1	187.9
DPS	33	30	50	40	52	57
RoE	21%	21%	26%	25%	20%	21%
RoCE	22%	29%	22%	21%	23%	25%
Net Worth	13,249	15,188	19,313	23,572	26,263	29,401
Receivable Days	191	90	69	64	60	60
Inventory Days	335	270	266	443	255	245
Cash Balances	3,166	7,177	14,348	20,317	21,410	22,585
FCF	147	13,945	8,532	7,049	2,682	2,793
Net D/E (x)	0.5	(0.4)	(0.7)	(0.8)	(0.8)	(0.7)
P/E (x)	39.4	33.7	21.5	18.8	20.3	17.4
EV/EBITDA (x)	22.9	19.2	17.7	13.4	11.9	10.2
P/BV (x)	8.3	7.2	5.7	4.6	4.2	3.7

Source – Company, Way2Wealth



**TECHNICAL VIEW**

HAL moved up sharply on heavy volumes above its critical resistance level of 2807. It now faces a resistance at 3400 and 3550 levels and should have a minimum upside till that level. Technically, the trend indicator ADX indicates the current trend is expected to witness further upside. Our argument is further validated after the stock gave an upside breakout from 2914 as the price broke through the top of a trading range. The oscillators are picking up momentum, with RSI showing good strength above 50 levels with expecting some kind of higher-level profit booking. The daily chart structure looks positive in near term. With good volume support seen, a break above 3185-3200 levels will signify a continuing strength amongst the bulls and we could see the stock testing 3550 and 3600 levels in short to medium term. Going forward, **Overall, we advocate to Buy and Accumulate HAL around 3000-3100 range. Add on dips till 2760 for a first level 3600 and a decisive move above this level can take it to our above mentioned target of ₹4000 around. On the downside 2600 would act as strong support and slip below that would negate above positive view.**



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**Disclosure of Interest Statement in HINDUSTAN AERONAUTICS LTD (HAL) as on 5<sup>th</sup> June 2023**

Name of the Security	HINDUSTAN AERONAUTICS LTD (HAL)
Name of the analyst	Jayakanth Kasthuri
Analysts' ownership of any stock related to the information contained	NIL
Financial Interest	
Analyst :	No
Analyst's Relative : Yes / No	No
Analyst's Associate/Firm : Yes/No	No
Conflict of Interest	No
Receipt of Compensation	No
Way2Wealth ownership of any stock related to the information contained	NIL
Broking relationship with company covered	NIL
Investment Banking relationship with company covered	NIL

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Investment in securities market are subject to market risks. Read all the related documents carefully before investing.

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