14th Aug '24 - HAL's Q1FY25 Earnings and Updated Fair Valuation

Key Highlights *(Sourced from various digital news articles. Cross checked from screener.in)*

- HAL reported revenue vs estimates. Comparison on a YoY basis. *(estimates sourced from a report published on 31st July on Benzinga)*

HAL reported Revenue	11% up to ₹4,347 crore
Antique Broking (estimate)	10% up to ₹4,307 crore
Equirus Securities (estimate)	30% up to ₹5,044 crore
Nirmal Bang (estimate)	19.5% up to ₹4,678 crore

- EBITDA up 13% to ₹994 crore, higher than estimates of ₹967 crore.
  EBITDA Margins were up 39 bps YoY to 22.9%, contributed by lower employee costs, higher than the estimates of a 40 bps decline.

- Profit before Tax up 45% YoY to ₹1,584 crore.

- HAL reported net profit vs estimates. Comparison on a YoY basis. *(estimates sourced from a report published on 31st July on Benzinga)*

HAL reported Net Profit	77% up to ₹1,437 crore
Antique Broking (estimate)	2% fall to ₹795 crore
Equirus Securities (estimate)	₹948 crore
Nirmal Bang (estimate)	38% up to ₹1,124 crore

  Net Profit up 77% to ₹1,437 crore aided by an 80% increase in Other Income. According to one such digital news article, excluding the other income, HAL's Net Profit would have been lower on a YoY basis. *(see my argument below)*

- At ₹4,665 per share, HAL trades at a 1 year forward PE of 34x, well above its 5 year average of 15x.

Business Updates and Corporate Actions *(Sourced from various digital news articles)*

- There's uncertainty to meet the delivery timeline of the Tejas. This is because General Electric (GE) has temporarily reduced its engine deliveries to HAL.

- There's a final dividend of ₹13 / share and an interim dividend of ₹22 / share recommended to the board.

- Last fiscal (FY24), HAL received new manufacturing orders worth ₹19,000 crore and ROH (Repair & Overhaul) contracts worth ₹16,000 crore.

- Analysts had noted earlier that steady aircraft and engine maintenance demand and strong realizations from manufacturing contracts would likely aid HAL's earnings in the seasonally weak quarter.

- However, while HAL's earnings growth "came in-line" according to Elara Capital's Harshit Kapadia, gross margins - which fell to 3.02 per cent, from 4.8 per cent a year earlier - "reported a bigger-than-expected fall".

HAL Chairman and MD, C B Ananthakrishnan predicts India's annual arms exports to rise to ₹50,000 crore, aligning with the government's vision to bolster defense capabilities. Initiatives focus on indigenizing defense equipment, reducing imports, and involving the private sector in R&D. Schemes like iDEX (Innovation for Defence Excellence) and TDF (Technology Development Fund) nurture innovation. The envisions a future where both Defence PSUs and private industry players contribute significantly to a self-reliant defense ecosystem. These reforms aim to build a self-sustaining defense industry, enhancing national security and strategic autonomy.

(The above text is sourced from idrw.org i.e. Indian Defence Research Wing. This version of the text is shortened using AI and has been checked for any errors.)

Fair Valuation *(all figures sourced from screener.in until mentioned)*

This report on HAL has a lot of data sharing and referencing from the previous report on HAL. I recommend you read the previous report before going further.

This time I'll start with HAL's ROCE and ROE. They sit comfortably at the highest ever figures, i.e. 38.9% and 28.9% respectively. These figures are quite rare and high for a PSU, especially a Defence PSU. This alone should tell you about the improved operating efficiencies of HAL.

Operating efficiency comes from a stable management that is ambitious to achieve a goal. Here, the goal is to make and export a record ₹50,000 crore worth of defence equipment. I believe India's indigenous Tejas fighter jet should make a decent chunk of this vision. And guess what, HAL's only hiccup to build and deliver the Tejas is the engine that is being sourced from a US company named General Electric. Now, by no means this report is supposed to have a political / geopolitical angle, but you know the things.

In answer, HAL is making airframes for 16 Tejas fighters and the engines, when available, will be fitted at a later stage. This is HAL's operating efficiency. Yes, this alone can't deliver the Tejas aircraft but I believe this is the second best they could do. The best is undoubtedly making an engine indigenously.

Coming to the numbers, HAL currently trades at a PE ratio of 38 and an EV / EBITDA of 23.6. Its 3 year median PE stands at 15.4 and 3 year median EV / EBITDA stands at 9.9

These 3 year medians don't capture all the positive developments that have happened in the Indian defence sector in the recent years. This is decently similar to the situation with the Indian railways sector. If you haven't already read my 'Joint Report on Titagarh Rail Systems and Jupiter Wagons', I recommend you read that report only if you want to catch the essence of what I'm talking about when mentioning the 'positive developments that have happened in the recent years'. Continuing with the report ahead.

Having said that HAL's 3 year medians don't completely capture the positive developments of the recent years, it is safe to assume that the historical growth adjusted ratios should be much higher than what they are right now.

Now, here's the first reference to HAL's previous report.
I had estimated HAL's Q1FY25 revenue and net profit growth rates which should support my fair valuation calculation for HAL stock at ₹4,550 per share.
The growth rates were 8% for revenue and 24.5% for net profit. Happily speaking, HAL comfortably beat these growth figures.

In the previous report, I valued HAL's fair price at 40 PE multiple after factoring all the positives that I could. Today HAL comfortably trades at 38 PE multiple and also factors in the Q1 earnings surprise and the recent concerns over the delivery of the Tejas fighter jets.

The PEG ratio stands at just 1.43 which stood at 1.67 during my observation while making the previous report. Such is the staggering growth rate.

Apart from all these, I believe the analysts or brokerages who mentioned the following statement may be trying to misguide the investors by inciting fear to lower down valuations even further.
The statement is *'Net Profit up 77% to ₹1,437 crore aided by an 80% increase in Other Income. According to one such digital news article, excluding the other income, HAL's Net Profit would have been lower on a YoY basis.'*

Here's what I have to say as an argument to the above statement.

Quarterly Results

Standalone Figures in Rs. Crores / View Consolidated

	Mar 2022	Jun 2022	Sep 2022	Dec 2022	Mar 2023	Jun 2023	Sep 2023	Dec 2023	Mar 2024	Jun 2024
Sales +	11,558	3,623	5,145	5,666	12,495	3,915	5,636	6,061	14,769	4,348
Expenses +	9,063	2,798	3,535	4,680	9,252	3,036	4,107	4,627	8,872	3,354
Operating Profit	**2,495**	**825**	**1,610**	**986**	**3,242**	**880**	**1,529**	**1,434**	**5,896**	**994**
OPM %	22%	23%	31%	17%	26%	22%	27%	24%	40%	23%
Other Income +	503	192	261	497	722	411	471	460	557	738
Interest	42	0	0	2	55	0	0	0	31	0
Depreciation	382	208	252	269	1,055	201	349	212	644	149
Profit before tax	**2,574**	**809**	**1,619**	**1,212**	**2,854**	**1,089**	**1,650**	**1,681**	**5,778**	**1,582**
Tax %	-21%	25%	25%	5%	0%	25%	25%	25%	26%	9%
Net Profit +	**3,102**	**607**	**1,209**	**1,154**	**2,841**	**814**	**1,235**	**1,254**	**4,292**	**1,436**
EPS in Rs	46.38	9.07	18.08	17.25	42.48	12.17	18.47	18.74	64.18	21.47
Raw PDF										

Image 1 - HAL quarterly results from Screener.in

You see, in the above image, the average income from ‘Other Income’ sources for HAL is near ₹500 crore. Precisely as per a normal mathematical calculation, the average for ‘Other Income’ for HAL comes out to be ₹481.2 crore for the last 10 quarters.

Now if I substitute Q1’s other income of ₹738 crore with ₹481 crore, the profit before tax (PBT) comes out at ₹1,325 crore. And if I deduct 9% tax from ₹1,325 crore, I’d get a Net Profit (PAT) of ₹1,206 crore. This is still 48% higher YoY.

During my research, I found no details / further breakdown regarding 'Other Income' of HAL.

The point is why should investors see the net profit figures of HAL after excluding the other income if it contributes nearly a similar amount every quarter?
I'll leave the responsibility to answer this question to the analysts, if any read my report.

What's more important for Investors to analyse is the Operating Profit and the Operating Profit Margins. HAL has recorded double digit growth in its operating profit and also expanded its margins and I think any margin expansion is welcomed.

Overall, I believe that HAL has reported a great set of numbers which clearly beats many expectations.

The HAL stock currently trades at an attractive and valuation comforting price level. I upgrade my fair valuation for the HAL stock at ₹4,914 per share while maintaining the fair valuation PE multiple at 40 times.

I hope you found this research report interesting and enjoyed reading and understanding it. Kindly give your feedback on this report using the Contact Us form on my website guruspakes.com/markets