19th July '24 - Valuing Hindustan Aeronautics. How does our homegrown HAL stand against the likes of Dassault Aviation and Lockheed Martin - My Report.

From the low of 1st January 2024 to the high on 8th July 2024, the Hindustan Aeronautics stock delivered a blockbuster 106.47% return. But when stocks go up like that, Investors look to book profits even on good news and not so surprisingly, HAL stock is down 15.71% from its high of ₹5,674.75 on 8th July.

And what if I tell you that this correction has only created room for more upside and the upcoming earnings and the budget day may spark the next rally.

There's a lot of things to talk about Hindustan Aeronautics and I'm sure to provide you with a very different perspective which I think will really help you in making a better investment decision in this stock. Be sure to read the report completely. It is a lengthy report but it's well researched and that's why it'll be worth your time.

I've been tracking the HAL stock since January 2023. It's not a very long time but I've found some genuine technical patterns.

1. 5th December 2022 to 30th January 2023 - Stock was down 18.20% - This is the 1st price correction.

2. 5th June 2023 to 30th October 2023 - Stock consolidated and was down just 1.19% - This is the 1st time wise correction.

3. 5th January 2024 to 21st March 2024 - Stock consolidated and was down just 1.92% - This is the 2nd time wise correction.

4. 30th April 2024 to 8th May 2024 - Stock corrected 9.04% - This was the 2nd price correction.

5. And now from 8th July 2024 - Stock has already corrected 15.71% - This is the 3rd price correction, currently ongoing.

I’m not recording the ‘election candles’ of 4th and 5th June 2024 because I see them as outliers. I see them as trading days to be forgotten but days where many investors, including me, should have learnt from.

Technically, HAL stock has not corrected more than 18.2% at once since January 2023. Also the chart images below show a very important fibonacci support level at ₹4,620 per share. You can also see an info panel which shows that even a 19.85% correction from the highs of July 2024, the HAL stock would still be priced at ₹4,548.5 per share.

All price corrections have been bought by investors dramatically. You can see the image below for reference but I urge you to be quick here because this isn’t the main thing of the research report.

‘Technical Patterns’ - That's what I call them… You can have a different name to it…

Images updated on 19th July 2024

So this was the technical part of the report on HAL stock. Now coming to the fundamental part.

I've compared Hindustan Aeronautics with Dassault Aviation and Lockheed Martin. Both these companies are HAL's global peers and operate in the Aerospace and Defence industry.

Dassault Aviation and Lockheed Martin are masters in making defence aircrafts and fighter jets. HAL is no laggard yet there's a lot to cover if HAL wants its brand name to be in the ranks like those of Dassault's and Lockheed's.

Below you'll now see 2 spreadsheet images that compare the three companies on many different metrics. These spreadsheet images make the base of all the further arguments in this research report.

Stock	PE Ratio Current PE	1 Year Median PE	3 Year Median PE	PEG Ratio	EV	EV / EBITDA Current	3 Year Median EV Mutliple
HAL (Financial Year is Apr to Mar 20xx) (Period Studied April 2021 to March 2024)	44.2	32.4	15	1.67	₹3,09,000 crore. Roughly $38.62 billion or EUR 34.3 billion	26.55	9.6
Dassault (Financial Year is Jan to Dec 20xx) (Period Studied Jan 2020 to Dec 2023)	19.54	20.92	18.36	1.62	EUR 6.06 billion. Roughly $6 billion	11.36	5.08
Lockheed Martin (Financial Year is Jan to Dec 20xx) (Period Studied Jan 2020 to Dec 2023)	17.41	16.45	15.61	2.6	$130.86 billion	13.31	11.18

1st Spreadsheet Image - Compares PE ratio, PEG ratio, Enterprise Value (EV) and EV / EBITDA ratio of the three companies. The green highlights are 'best numbers'.

Stock	Compounded Revenue Growth Rate TTM	3 Year	Operating Profit Margin Current	3 Years ago	Compounded Net Profit Growth Rate TTM	3 Year	Net Profit Margin Current	3 Years ago	ROE Current	3 Years ago
HAL (Financial Year is Apr to Mar 20xx) (Period Studied April 2021 to March 2024)	13%	10%	32%	23%	31%	33%	25%	14.00%	29%	28%
Dassault (Financial Year is Jan to Dec 20xx) (Period Studied Jan 2020 to Dec 2023)	-30.86%	-4.37%	8.26	6.92%	-3.19%	31.81%	13.23%	8.35%	11.81%	12.28%
Lockheed Martin (Financial Year is Jan to Dec 20xx) (Period Studied Jan 2020 to Dec 2023)	2.40%	1.09%	12.33%	12.92%	20.76%	0.43%	10.24%	10.53%	81.35%	150.69%

2nd Spreadsheet Image - Compares the Compounded Revenue and Net Profit Growth Rate, Operating and Net Profit Margins and Return on Equity of the three companies. The green highlights are 'best numbers'.

This spreadsheet analysis is aimed at finding answers to the following questions.

1. Are these ratios correctly factor in the ‘outpacing growth’ of the Indian Defence Industry?
2. Do these metrics make a fairground of comparison?
3. What was the performance and valuation of US defence stocks when the US defence industry was booming?
4. How are the current sentiments for the Indian defence industry similar to the past sentiments of the US defence industry?
5. What is the nature of the Indian defence industry? And is the Indian defence industry really in a sweet spot?

The answers to the above questions will help you to determine the factors that are leading to the ‘premium’ valuation of the HAL stock. I’ve used many different charts, existing reports and analysis and even AI in order to find and cross check the answers to all the above questions.

1. Answer to the first question:
   Yes. The ratios factor in the ‘outpacing growth’ of the Indian defence industry. The only doubt is if it factors in correctly or not. We’ll find out soon.

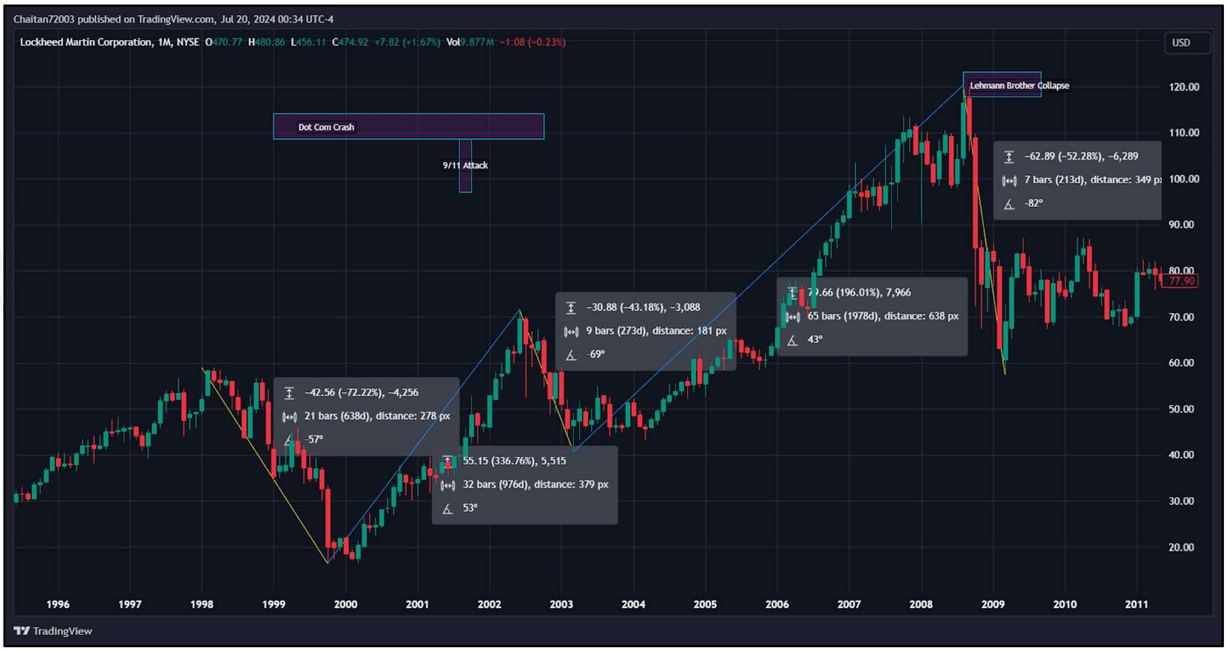
2. Answer to the second question:
   I don’t think these metrics make a fairground of comparison. especially the Enterprise Value. Comparing companies solely based on Enterprise Value (EV) converted to a single currency can be misleading, especially for companies in different countries with distinct economic and defense ecosystems.

   The next questions answer how we can make a fairground of comparison by finding correlations.

3. Answer to the third question:
   This is a very complicated answer. I’ve used AI to answer this question. In order to stay on topic, I’ll skip the conversation I had with AI to answer this question but [you can read my conversation with Gemini AI here.]

Now I'll come straight to the conclusion of this answer. With all the data available, I've found the business performance of Lockheed Martin from 2000 to 2005 and the two images below show the overall financial performance and the stock's reaction.

Lockheed Martin's	Growth Revenue, Profit, EPS, Debt and ROIC from 2000 to 2005							
In USD millions	2000	2001	2002	2003	2004	2005	CAGR	
Revenue	24,541	23,990	26,578	31,824	35,526	37,213	8.60%	
Profit (Loss)	-519	-1,046	500	1,053	1,266	1,825	23.42%	from 2002
Diluted EPS (Loss)	-1.29	-2.42	1.11	2.34	2.83	4.1		
Debt	9,959	7,511	7,582	6,208	5,119	4,986		
ROIC				9.60%	10.80%	14.50%		

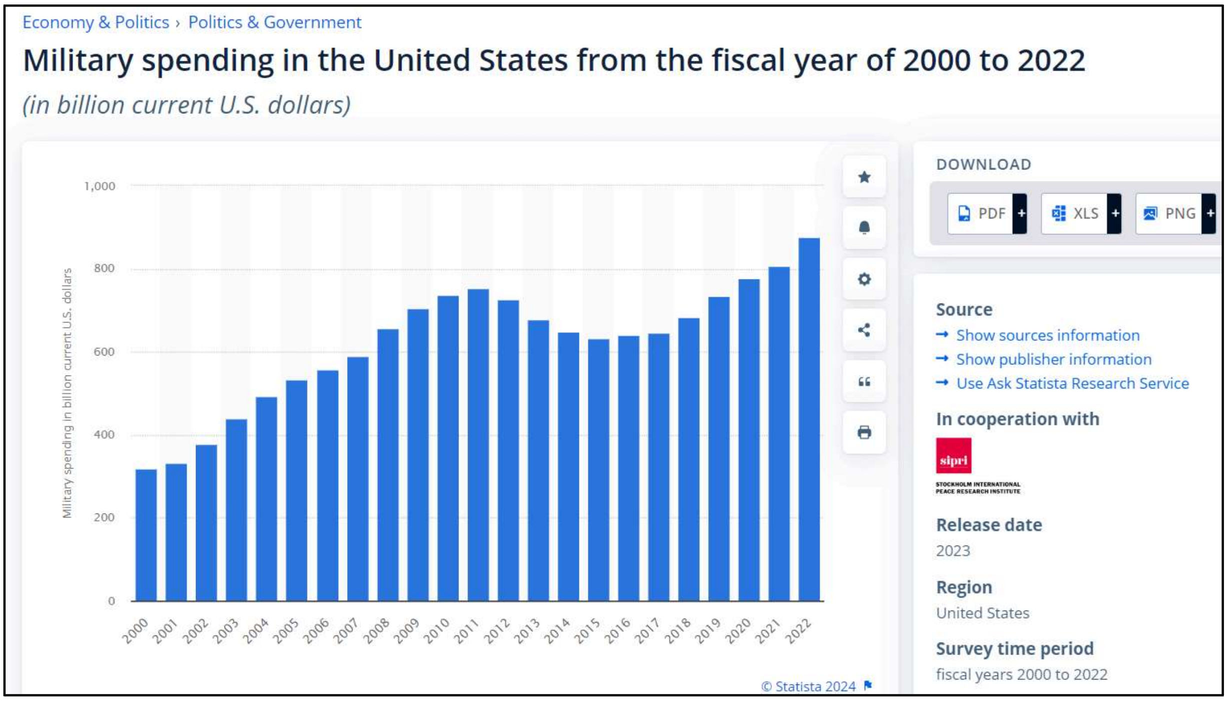


Lockheed Martin stock (LMT stock) gave nearly 330% returns from the low of early 2000 to the high of mid 2002 before crashing around 40% during mid 2002 to early 2003 and then gave another astonishing rally of nearly 200%

Cumulatively, LMT stock gave more than 600% returns from the low of early 2000 to the high of 2008.

During this time period, US defence spending (% of GDP) was increased by 100 bps. See images below.

Source - https://data.worldbank.org/indicator/MS.MIL.XPND.GD.ZS?end=2022&locations=US&skipRedirection=true&start=1995&view=chart



Source - https://www.statista.com/statistics/272473/us-military-spending-from-2000-to-2012/

Now you can compare the financial performance of LMT and the performance of its stock in accordance with the business environment during 2000 to 2005. Also don't forget that by this time, the US economy is already developed and the US market has become very mature.

All these findings make it very clear that Lockheed Martin saw one of its biggest bull runs during 2000 to 2005. LMT stock generated 600% returns while the company's revenue and earnings CAGR was 8.6% and 23.42% over the same time period.

Please remember the Earnings CAGR of LMT stock and the Returns it generated. These two figures are of heavy importance.

4. Answer to the fourth question:
   The current sentiments for the Indian defence industry are very similar to the past sentiments of the US defence industry.

   There's an increase in defence spending, stricter security norms and growing investments in research and development. Apart from these factors, India is going aggressive in import substitution and wants to increase its defence exports to a record ₹50,000 crore by 2030.

5. Answer to the fifth and final question:
   a. The Indian defence industry is dependent heavily on the government for orders. Defence companies have an order book lead model and participate in tenders.
   b. It is a high working capital requirement business because deliveries of defence equipment can take years to complete and this causes a delay in cash inflows to the company and hence the cash flows can be lumpy.
   c. Normally the Q4 (Quarter 4) is the best quarter for defence companies because major orders get delivered during the last quarter of the fiscal.

   So these are a few things you need to evaluate before making an investment in any defence company. HAL is no exception.

Now coming back to the HAL stock.

The second spreadsheet image shows that the Revenue and Net Profit growth rate of Hindustan Aeronautics is staggering when compared to the other two companies. This clearly makes HAL one of the very few defence companies in the world with such high growth rates.

While Dassault's 3 year revenue growth stands at -4.37% and Lockheed Martin's 3 year revenue growth rate stands at 1.09%, HAL's 3 year Revenue growth rate stands at 10%, even surpassing Lockheed Martin's past revenue growth rate of 8.6%

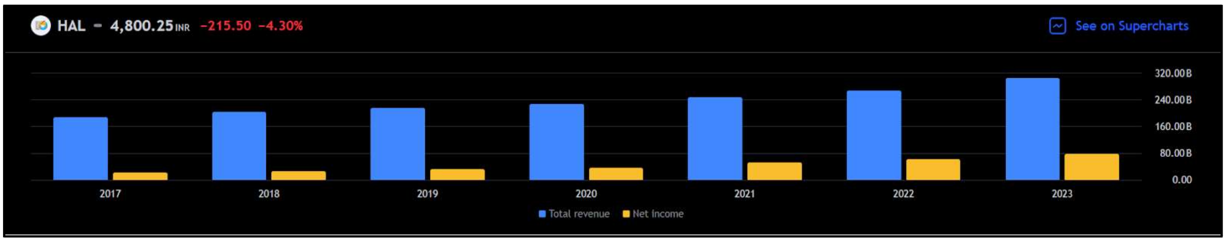
The 3 year net profit growth rate of Dassault and Lockheed Martin stands at 31.81% and 0.43% respectively. While HAL's 3 year net profit growth rate stands at 33% which again surpasses Lockheed Martin's past net profit growth rate of 23.42%

If you compare the net profit margins of the three companies over a period of 3 years, you'll see an expansion of 1100 bps in HAL's margins, an increase of 488 bps in Dassault's margins and a decrease of 29 bps in Lockheed Martin's margins.

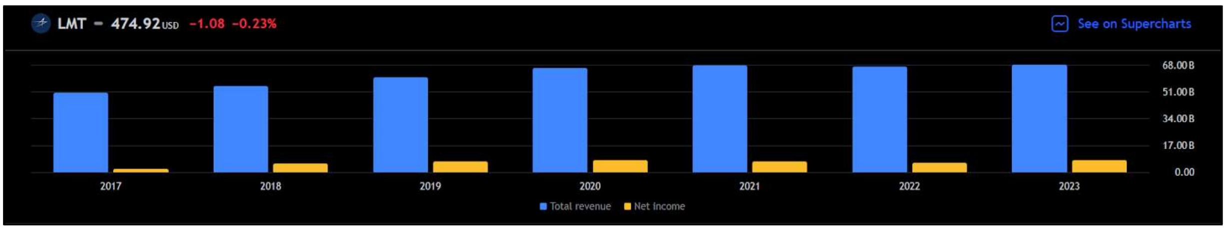
Additionally, the PEG ratio of all the three stocks is a surprise. If I only compare the stocks based on PEG ratio, I'd skip Lockheed Martin completely. The PEG ratio of Lockheed Martin is 2.6, Dassault's is 1.62 and HAL's is 1.67.
(PEG ratio here, the lower the better)

Yes, HAL's PEG ratio at 'high valuations' is 1.67 which clearly indicates and itself speaks for the staggering growth rates it has generated.

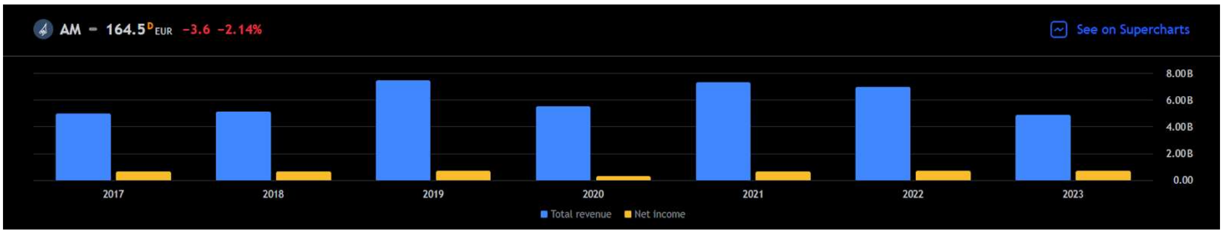
Also, the revenue and net profit of HAL are more predictable today than those of Dassault and Lockheed Martin. You can clearly see the trend in the below images.



Hindustan Aeronautics (HAL) - Revenue and Net Profit trends. Source - TradingView



Lockheed Martin (LMT) - Revenue and Net Profit trends. Source - TradingView



Dassault Aviation (AM) - Revenue and Net Profit trends. Source - TradingView

Now if LMT stock generated 600% returns while the company's revenue and earnings CAGR was 8.6% and 23.42%, why can't HAL generate such returns in the future while it grows its revenue and earnings at a CAGR of 10% and 33% ?

Clearly if we combine all these factors and say that HAL commands a premium over some of the biggest and the most mature defence businesses of the world, it shouldn't be wrong.

Now the final question comes.
How much is the current premium? And how much premium is justified?

At the time of this writing, HAL stock trades at ₹5,015.75 per share at a PE of 44.2 which is nearly three times its 3 year Median PE ratio. Also it is more than double the current PE ratio of Dassault and Lockheed Martin.

Not so surprisingly, in FY24 HAL stock EPS was 113.57 which is approximately 2.3 times its FY21 EPS. (FY21 HAL stock EPS was 48.44)

Again, not so surprisingly, Dassault and Lockheed Martin are mature businesses and don't always offer high growth rates but HAL does and thus it'll continue to attract investors.

Moreover if I factor in the expectations of a good budget and an increase in the Q1FY25 earnings on a YoY period, the gap between the market price and the intrinsic price should reduce naturally. However the current market price of over ₹5,000 may still not be justified until and unless the earnings growth stays intact and the budget offers big contracts and orders to the company. And this is the foremost reason why the Union Budget 2024 and HAL Earnings Report of Q1FY25 are such important events for the stock.

Q1 or the June Quarter is the weakest quarter for HAL. And I expect the Q1FY25 earnings report of HAL to be as follows.

All figures in INR crore.

	Q1FY22	Q1FY23	Q1FY24	Q1FY25 (based on expectations of similar growth)
Revenue	1,616	3,623 up 124%	3,915 up 8%	4,228 up 8%
Net Profit	199	607 up 205%	814 up 34%	1.014 up 24.5%

Now if HAL trades at a multiple of 40 after factoring in all the positives that I've mentioned in this report, the price of ₹4,550 per share is completely justified but I think if HAL posts its Q1FY25 earnings report and records a similar growth trajectory, then I think HAL should continue to trade over a PE multiple of 40 that is above ₹4,550 per share.

Lastly, here's a quick overview of the most important takeaways from this report which has led to the finding of HAL's possibly justified price of ₹4,550 per share.

1. Technically, HAL stock has not corrected more than 18.2% at once since January 2023. The charts show a very important fibonacci support level at ₹4,620 per share. And even a 19.85% correction from the highs of July 2024, the HAL stock would still be priced at ₹4,548.5 per share, which is the same price that I've calculated and noted as a 'possibly justified price'.

2. Today, HAL is a high growth business because of the various factors that are already mentioned above in the report. The company has recorded outpacing growth as compared to its global peers in the past 3 years.

3. The Indian defence industry is witnessing similar positive contribution factors which led to the high growth of the US defence industry.

4. LMT stock generated 600% returns while the company's revenue and earnings CAGR was 8.6% and 23.42%, why can't HAL generate such returns in the future while it grows its revenue and earnings at a staggering CAGR of 10% and 33% ?

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