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HINDUSTAN AERONAUTICS LIMITED

March 15, 2018

SMC Ranking

★★★☆☆ (3/5)

Issue Highlights

Industry	Defence
Offer for sale (Shares)	34,107,525
Employee reservation (Shares)	668,775
Net Offer to the Public	**33,438,750**
Issue Size (Rs. Cr.)	4144-4229
Price Band (Rs.)	1215-1240
Offer Date	16-Mar-18
Close Date	20-Mar-18
Face Value	10
Lot Size	12

Discount offered to Retail & Employee investors Rs. 25

Issue Composition

	In shares
Total Issue for Sale	33,438,750
QIB	16,719,375
NIB	5,015,813
Retail	11,703,563

Shareholding Pattern (%)

Particulars	Pre-issue	Post-issue
Promoters & promoters group	100.00%	89.80%
QIB	0.00%	5.00%
NIB	0.00%	1.50%
Shares held by employee trust	0.00%	0.20%
Retail	0.00%	3.50%
Total	**100.00%**	**100.00%**

*calculated on the upper price band

Objects of the Issue

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

The objects of the Offer are:

- To carry out the disinvestment of 34,107,525 Equity Shares by the Selling Shareholder (President of India) constituting 10% of the Company's pre-Offer paid up Equity Share capital the Company; and
- To achieve the benefits of listing the Equity Shares on the Stock Exchanges.

Book Running Lead Manager

- Axis Capital Limited
- SBI Capital Markets Limited

Name of the registrar Karvy computershare Pvt Ltd

About the Company

Incorporated in 1963, Hindustan Aeronautics Limited (HAL) is a Defence Public Sector Undertakings (DPSU) company engaged in the design, development, manufacture, repair, overhaul, upgrade and servicing of a wide range of products including, aircraft, helicopters, aero-engines, avionics, accessories and aerospace structures. It is the 39th largest aerospace company in the world in terms of revenue. The company has 20 production divisions and 11 R&D centres located across India. Indian Defence Services is the main customer of HAL and account for over 93% of sales. HAL also sells its products and provide services to state governments, para-military forces and corporate. The company has completed a buyback of 27,112,500 Equity Shares of face value Rs. 10 each, being 7.5% of the paid up equity share capital from the President of India acting through Department of Defence Production, Ministry of Defence, in December 2017.

Strength

Long credible history of research, design and development, manufacturing and maintenance, repair and overhaul ("MRO") services: The Company provides support for maintenance, repair and overhaul for these indigenous and licence manufactured aircraft and helicopters, as well as for aircraft and helicopters procured directly by the Indian Defence Services, Mirage 2000, MiG-29 aircrafts (the Indian Air Force procured from third parties) and An-32 aircraft along with the associated engines, accessories and avionics. Most of its Divisions and R&D Centres comply with quality management system accreditations including international standards such as the AS9100C, ISO9001:2008 and ISO14001:2004 certifications, and have the AFQMS certification from the Director General of Aviation Quality Assurance. Its laboratories are accredited by the National Accreditation Board for Testing and Calibration Laboratories (NABL) and its R&D Centres are approved by, among others, the Department of Scientific and Industrial Research (DSIR) and the Center for Military Airworthiness and Certification ("CEMILAC").

Strong design and development capabilities: The Company has directed its development efforts towards innovative technologies designed to expand its product portfolio, particularly for the defence sector. The Company believes that its R&D Centres are capable of developing a wide range of products, upgrading products with combat operational capability and operational performance and maintaining a pipeline of products to meet its future needs. As of December 31, 2017, the Company has owned two trademarks, seven patents, 11 design registrations and 77 copyrights.

Leadership position in the Indian aeronautical industry and strong GoI support: The Company is the largest DPSU in terms of value of production in the Indian defence sector according to the MoD Annual Report 2016-2017. The Company believes that it has a leadership position in the Indian aeronautical industry as a result of its long-standing relationships, particularly with the Indian Defence Services and the DRDO as well as with various academic institutions and regulatory agencies. As a result of its long operating history, the Company has also developed a deep knowledge base and understanding of the aeronautical industry, particularly in India. The Company believes that it derives a strategic advantage from its strong relationship with the GoI.

Strength of its Order book: Company's order book as on December 31, 2017 stands at Rs. 68,461 crore, which includes products and services to be manufactured and delivered and excludes anticipated revenues from their joint ventures and subsidiaries. HAL has a sound track record of profitability and has been consistently paying dividend for the last 40

years. Besides, in order to reduce dependence of defence products, company plans to increase the revenue share of other business segments such as from the civil aircraft and helicopter segments in the coming fiscals.

Cyclicality in Product Delivery and Revenue Recognition: The Company experiences significant cyclicality in its business, which is attributable to the timing of delivery of its products and corresponding revenue recognition. The company recognises sales upon acceptance of the product by customers and issuance of a signalling out certificate by them. Its sales are dependent on the certification process, which needs to be completed before its customers can take deliveries. The certification process regarding acceptance and delivery of aircraft and helicopter by the customers typically takes place in the third and fourth quarter of each Financial Year due to favourable weather conditions for flight tests during this period. This leads to bunching up of sales during the third and fourth quarters of each Financial Year and consequently, its revenue varies significantly between the first and second half of the year.

Strategies

Expand its operations through partnerships or collaboration: The Company may enter into partnerships or joint ventures with partners in developed as well as emerging markets to strengthen its sales and marketing presence. Also apart from foreign OEMs, the Company is jointly working with leading Indian research and development organisations and institutions such as DRDO laboratories, IITs and IISc to support India in achieving self-reliance in the aviation industry.

Diversify through expansion in new growth areas: The Company has conducted an analysis of its product portfolio and identified opportunities in its product portfolio which are expected to grow in the future to become a potential revenue lines for its Company. These include opportunities in the indigenous aircraft and helicopter aero-engine, helicopter for military and civil roles, UAVs and civil transport aircraft sectors.

Develop in-house capabilities to design and develop specialised products including aero-engines: The Company continuously seeks to design, develop and deliver new products to meet its customers' evolving needs while also upgrading its existing product line. The Company has received requests for proposal in December 2017 on nomination basis from the Ministry of Defence for (i) the procurement of 83 LCA Mk1A aircraft; and (ii) the procurement of 15 LCH limited series production helicopters from the Ministry of Defence, for which the Company has yet to submit its proposal.

Leverage Existing Cost Advantage: The Company plans to explore and use the most efficient sources of production, whether through its own manufacturing facilities or through third-party manufacturers who are identified and trained by the company in order to maintain product quality. The Company also intends to continue to invest in operational infrastructure, which it believes will allow it to increase its sales volumes and lower its manufacturing costs as a result of economies of scale. The Company will also seek to improve labour productivity at its manufacturing facilities by improving production techniques and enhanced training.

Developing Human Capital: The Company intends to continue to focus on the development of knowledge, skills and capabilities of its manpower in order to enhance its human capital. The Company believes initiatives for capability building play a crucial role in its drive to achieve improved productivity in the context of an industry that has undergone revolutionary changes both in terms of applicable concepts and technologies.

Enhancing customer satisfaction: In order to realise its strategy to enhance customer satisfaction, the Company intends to continue to focus on improving its customers' fleet serviceability. The Company also intends to assist its customers to realise "Zero AOG" (or aircraft operationally grounded) by providing solutions that would help their logistical and other operations. In the coming years, the Company intends to enter into agreements with customers to provide complete maintenance support for their fleet, allowing its customers to stay focused on the operations of their fleet.

Optimising operations towards becoming a lead integrator of aircraft platforms: The Company had revised its existing outsourcing procedures and had also framed a new outsourcing policy with a view to becoming a lead integrator of aircraft platforms, which the Company believes it will allow it to align its strategies with the Government's "Make in India" initiative and to harness the indigenous talent pool available in the aerospace sector. In order to achieve this goal, the Company has devised a tiered outsourcing structure to achieve higher levels of outsourcing, with the aim of developing Tier-II suppliers and, gradually, Tier-I suppliers over a period of time while retaining its core competency as a lead integrator. The Company intends to implement this tiered outsourcing structure by encouraging participation comprising "risk sharing and competent" partners as well as "non-risk sharing and dependent" partners.

Risk Factors

Depends heavily on MoD contracts: The Company depends heavily on MoD contracts. A decline or reprioritisation of funding in the Indian defence budget, that of customers including the Indian Army, Indian Air Force and Indian Navy (the "Indian Defence Services"), Indian Coast Guard, Border Security Force, Central Reserve Police Force and Paramilitary forces or delays in the budget process could adversely affect its ability to grow or maintain its sales, earnings, and cash flow.

The GoI has significant influence over its actions: The GoI has significant influence over its actions, which may restrict its ability to manage its business. Any change in GoI policy could have a material adverse effect on its financial condition and results of operations.

Current order book may not necessarily translate into future income in its entirety: Its current order book may not necessarily translate into future income in its entirety. As of December 31, 2017, its order book was Rs.68461 Crore, which generally includes products and services to be manufactured and delivered and excludes anticipated revenues from its joint ventures and subsidiaries. Some of its current orders or requests for proposal which it has received may be modified, cancelled, delayed, put on hold or not fully paid for by its customers, which could adversely affect its results of operations.

Risk from Rapid technological change: The markets in which it competes are characterised by rapid technological change, which requires it to develop new products and product enhancements, and could render its existing products obsolete. Its inability to keep pace with the technological changes or devote resources for new product development, could affect its market share, revenues and profits.

Peer comparison

As per the RHP, there are no listed companies in India that are directly comparable to the business carried on by the Company.

Valuation

Considering the P/E valuation on the upper price band of Rs.1240 EPS and P/E of FY2017 are Rs.78.49 and 15.80 multiple respectively and at a lower price band of Rs. 1215, P/E multiple is 15.48. Looking at the P/B ratio on the upper price band of Rs.1240. , book value and P/B of FY17 are Rs.387.08 and 3.20 multiple respectively and at a lower price band of Rs. 1215 P/B multiple is 3.14. No change in pre and post issue EPS and Book Value as the company is not making fresh issue of capital.

Industry Over view

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. The opening up of the defence sector for private sector participation is helping foreign OEMs to enter into

strategic partnerships with Indian companies and leverage opportunities in the domestic market as well as global markets. The Union budget of the Government of India for 2017-18 allocates ₹262390 crore for defence expenditures excluding pension, which represents an increase of 5.3% from ₹249099 crore 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 ₹175861 crore for revenue expenditure and ₹86529 crore for capital expenditure. This allocation for revenue expenditure and capital expenditure increased by 8.1% and 0.2% over the previous year's allocations. The Indian civil aviation sector is amongst the fastest growing market and is expected to become the third largest by 2020 and the largest by 2030. Presently, India is the world's ninth largest civil aviation market. The total passenger traffic registered in India in 2016-17 is approximately ₹26.50 crore which grew by 18.5% from ₹22.36 crore in 2015-16. Passenger traffic in India has expanded at a CAGR of 12.39% during 2006-17 to 2016-17. Total freight traffic in India grew by a CAGR of 7.95% from 2006-07 to 2016-17. In addition, freight traffic in India is expected to be ₹1.14 crore ton by year 2032. Growth in Indian imports and exports will be the key driver for growth in freight traffic as 30% of total trade is undertaken by airways.

Outlook

The company has a sustained track record of profitability and paid dividends every year for over four decades. As of December 31, 2017, HAL's order book was ₹68461 crore which generally includes products and services to be manufactured and delivered and excludes anticipated revenues from joint ventures and subsidiaries. The business is cyclical in nature and the company sees strong sales during the third and fourth quarters of each Financial Year. However, this is the first opportunity of an investment in a defence sector PSU Navrathna company, having niche play in aeronautics with a good track record. Investors may consider investment for long term.

An Indicative timetable in respect of the Issue is set out below:

EVENT	INDICATIVE DATE (On or about)
Bid/Offer Opens Date	March 16, 2018
Bid/Offer Closing Date	March 20, 2018
Finalisation of Basis of Allotment with the Designated Stock Exchange	March 26, 2018
Initiation of refunds (if any, for Anchor Investors)/unblocking of funds from ASBA Account	March 27, 2018
Credit of Equity Shares to depository accounts of Allottees	March 27, 2018
Commencement of trading of the Equity Shares on the Stock Exchanges	March 28, 2018

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Annexure

Consolidated Financials

Profit & Loss

Rs. in Cr.

Particulars	Period ended 30-Sep-17 (6 Months)	Period ended 31-Mar-17 (12 Months)	Period ended 31-Mar-16 (12 Months)
Total Operating Income	5,277.00	18,554.90	17,158.60
management fees			
Total expenditure	4,997.90	15,906.80	15,026.60
Operating Profit	**279.10**	**2,648.10**	**2,132.00**
OPM%	5.29	14.27	12.43
Other Income	587.90	1,650.00	1,932.20
PBDIT	**867.00**	**4,298.10**	**4,064.20**
Depreciation	257.50	712.90	862.80
PBIT	**609.50**	**3,585.20**	**3,201.40**
Interest	1.20	10.20	0.00
PBT	**608.30**	**3,575.00**	**3,201.40**
Share of profit	1.30	16.70	11.90
PBT after exceptional items	**609.60**	**3,591.70**	**3,213.30**
Tax	217.30	967.00	1,197.10
Profit After Tax	**391.00**	**2,624.70**	**2,004.30**

Balance sheet is on next page

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Balance Sheet

Rs. in Cr.

Particulars	As on 30-Sep-17	As on 31-Mar-17	As on 30-Sep-16
Non-current assets			
Property, plant and equipment	5922.30	5784.50	5444.40
Property, plant and equipment customer funded	79.90	55.30	0.00
Intangible assets	1392.70	1413.60	1480.80
Intangible assets under development	947.40	866.30	650.00
Capital work-in-progress	535.80	621.10	375.40
investments joint ventures	204.40	204.60	190.10
Investments	814.40	789.40	725.70
Trade receivables	10.20	10.20	0.00
loans	56.90	58.90	52.00
Other Non-Current Assets	1508.00	1210.70	1486.20
others financial assets	363.20	367.50	401.40
Total non-current assets	**11835.20**	**11382.10**	**10806.00**
Current assets			
Inventories	22184.40	21321.30	23981.70
Trade receivables	4254.90	4210.30	4836.90
Cash and bank balances	11699.20	11153.30	13303.40
Other bank balances	2474.10	2581.60	2208.80
Loans	106.50	98.70	98.10
Current assets net	284.30	114.90	0.00
Other current assets	1004.50	690.10	1297.00
Total current assets	**42007.90**	**40170.20**	**45725.90**
Total Assets	**53843.10**	**51552.30**	**56531.90**
Non-current liabilities			
Trade Payables	192.60	192.60	0.00
Other financial liabilities	369.20	371.60	397.30
Deferred tax liabilities	960.10	959.90	814.80
Other non current Liabilities	10835.60	9847.20	9154.60
Long term Provisions	1920.80	2029.80	2482.50
Total non-current liabilities	**14278.30**	**13401.10**	**12849.20**
Current liabilities			
Short term borrowings	0.00	950.00	0.00
Trade Payables	1898.00	1604.70	2151.20
Other Financial Liabilities	927.90	1097.60	976.90
Provisions	3061.20	2878.40	2637.60
Income tax liabilities	0.00	0.00	97.20
Other current liabilities	20734.10	19061.40	26787.40
Total current liabilities	**26621.20**	**25592.10**	**32650.30**
Total	**40899.50**	**38993.20**	**45499.50**
NET Worth	**12943.60**	**12559.10**	**11032.40**
Net worth represented by:			
Share capital	361.50	361.50	361.50
Other Equity	12582.10	12197.60	10670.90
Net Worth	**12943.60**	**12559.10**	**11032.40**

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RANKING METHODOLOGY

WEAK	★
NEUTRAL	★★
FAIR	★★★
GOOD	★★★★
EXCELLENT	★★★★★

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