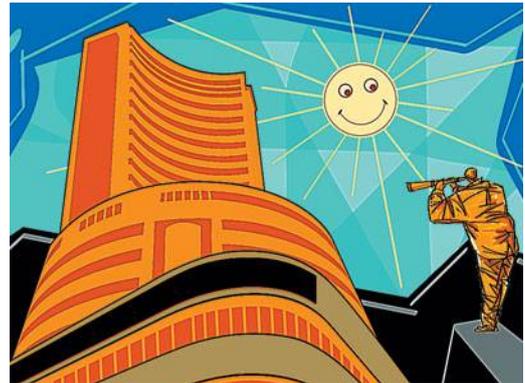


Modi government likely to fire up reforms in defence sector; top stock bets

NEW DELHI: The Narendra Modi government is committed to carry out reforms in defence procurement, which is likely to increase efficiency and encourage domestic industry, including the private sector, to have a larger share in design and production of defence equipment.

The development agenda of the new government is expected to remove the bottlenecks presently stifling the growth in India and is likely to bring in organic FDI, i.e. foreign, most likely, US-based and Israel-based companies that will set up subsidiaries in India, say experts.

"Companies in defence-related business will also be benefited if the new government alters new favorable policies for the sector and if the capital expenditure picks up, more overseas projects will fall in the Indian companies' kitty," said Ajit Mishra, AVP - Equity Retail Research, Religare Securities Ltd.



"Also, these steps would encourage foreign manufactures to set up defence manufacturing here and that in turn would also lead to increased business opportunity for domestic players," he added.

President Pranab Mukherjee in his speech earlier this month emphasised on the fact that the government will introduce policies to strengthen technology transfer, including through liberalised FDI in defence production.

India can emerge as a global platform for defence manufacturing, including software, which will strengthen our defence and spur industrial development as well as exports, he said.

"I think the announcement should be taken as much broader sense than possible stake sale in defence companies to foreign investors. It is likely to bring in organic FDI, i.e. foreign, most likely, US-based and Israel-based companies that will setup subsidiaries in India," said Dr. Vikas Gupta, Executive Vice President, Arthveda Fund Management Pvt Ltd.

"Further, many will form joint ventures with Indian companies. I think the companies which are likely to get offers for JVs are definitely the following, but also, Mahindra Group, Tata Group, Walchandnagar," he added.

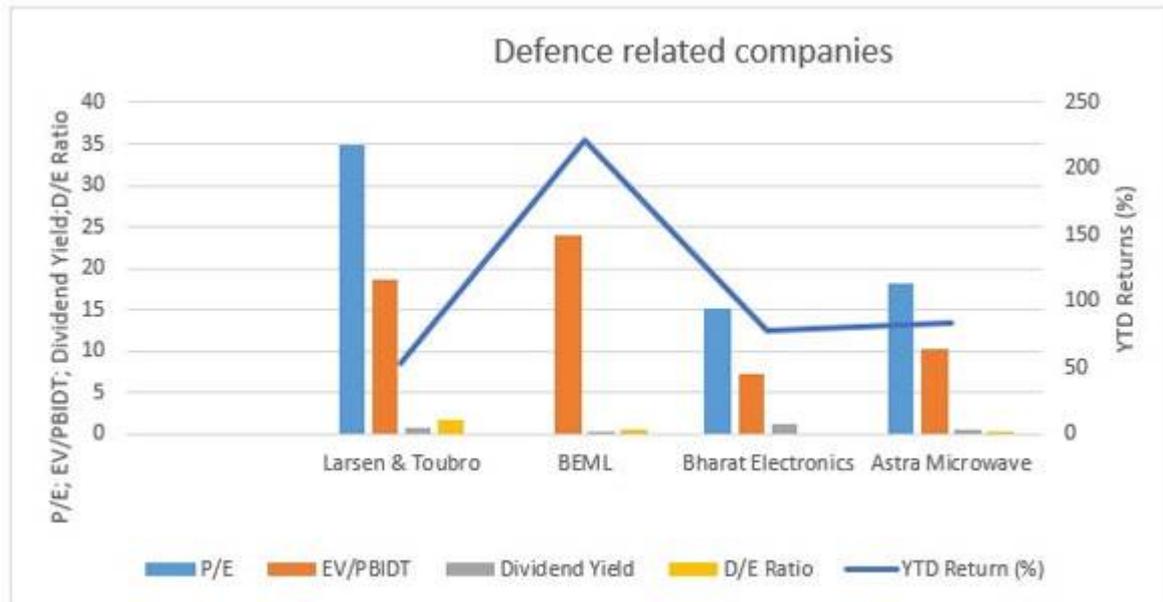
There are four prime companies which are likely to benefit from the government's change in policy stance on defence, which include names like BEML, L&T, Bharat Electronics and Astra Microwave Products.

Company Name	P/E	EV/PBIDT	Dividend Yield	D/E Ratio	YTD Return (%)
Larsen & Toubro	34.84	18.59	0.71	1.74	54
BEML	NA	24.02	0.31	0.52	221
Bharat Electronics	15.26	7.29	1.23	Debt Free	78
Astra Microwave	18.12	10.32	0.44	0.28	84

Source: ArthVeda, YTD Returns till 16 June, 2014

Trailing 12 months (TTM) for BEML is irrelevant because the company has reported losses during the first two quarters of FY14

Any change in FDI policy could be a strong positive trigger for given stocks, say experts. The order book in defence division of business would increase significantly and revenue visibility will become strong, they say.



From the valuation perspective, Bharat Electronics is the cheapest of the lot on most parameters. Bharat Electronics is debt free with a net cash of several thousand crore rupees. Further, the debt to equity for L&T is very high with a barely adequate interest cover.

"All the above-mentioned stocks have gained more than 3-4 times in the last six months. So it's advisable to wait for some dip and buy in a staggered manner with mid-long term investment horizon," said Mishra of Religare Securities Ltd.

India is the country which is well known for its huge defence budget in proportion to its annual spending. However, most of the money we spend on defence goes to foreign countries due to our dependency on imports.

"The FDI policy in defence could be a chance for these companies to design, develop and showcase their engineering strength," said Tushar Pendharkar, Equity Strategist- Right Horizons Financial Services.

"All the stocks mentioned here are not over valued fundamentally and in my view, no significant impact is going to happen with these stocks," he added. Pendharkar would suggest investors to buy and hold these stocks for long terms, because there seems to be no reason of downside.

Related companies to benefit more?

According to experts, apart from the above-given companies, groups like Mahindra, Tatas and Walchandnagar might also reap the benefits of government initiative. In addition to that, Pipapav Defense and Offshore Engineering should benefit as well.

Gupta of ArthVeda is of the view that Mahindra and Tatas are some of the groups which could benefit. Apart from that, ABB, Siemens, Thermax and other cap goods companies, and some industrials, could also benefit from the move, he added.

Pendharkar of Right Horizons Financial Services is of the view that M&M and Tata Motors are the two other stocks which have the capability to take benefit out of policy change.

"Both have division for defense equipment manufacturing and have also showcased their engineering excellence. Tata Motors develop and export armoured vehicles and artillery guns, while M&M is expanded into defence systems such as sea mines, armoured vehicles, surveillance solutions, weapons, ammunitions, etc.," he added.