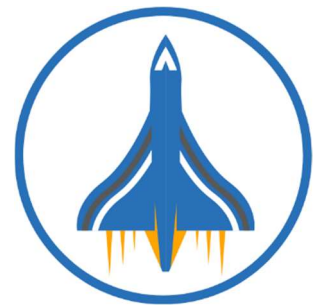




One Year Update - Live Since Jan 7, 2021

Omni Bharat Defence

An Attacking Portfolio For The Growing Defense Theme



Enhance Safety, Enhance Growth, Enhance Returns



Omni Bharat Defense

An Attacking Portfolio For The Growing Defense Theme

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“\$73 billion – Indian Defense budget – No. 3 in the World.”



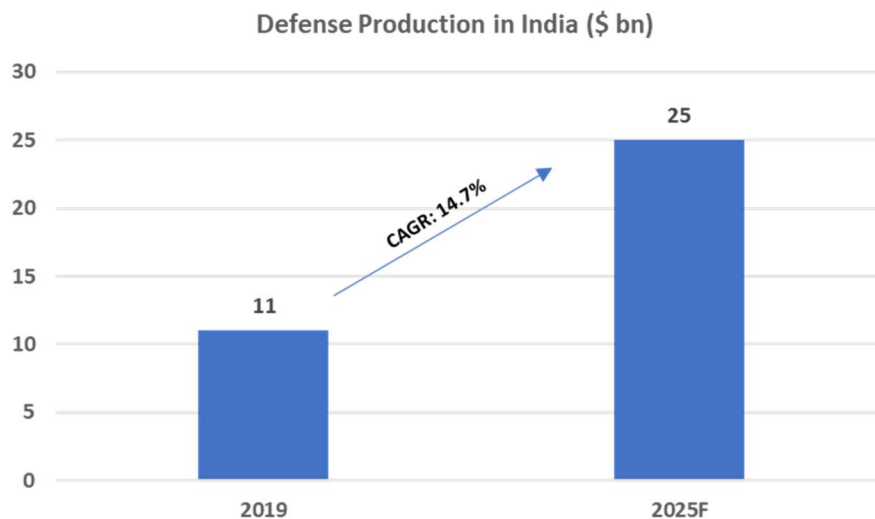
With \$73 billion annually, India has the third-largest defense budget in the world, and with ever rising concerns for national security in the wake of India's proximity to China and Pakistan, there seems no reason for the sector not to significantly grow further in future. The government has also taken numerous initiatives to improve the country's self-reliance in defense, with the Defense Production & Export Promotion Policy 2020 (DPEPP 2020) targeting to raise domestic defense production to INR 175,000 crores in 2025 from the current domestic production of INR 80,000 crores. We believe this confluence of an ever-growing demand as well as an impetus towards self-reliance through the policy of Aatmanirbhar Bharat make the Indian defense industry a lucrative investment opportunity in the coming decade.

This theme provides exposure to companies that develop and manufacture equipment for the Indian defense sector, including military aircraft, aircraft carriers, submarines, missiles and defense systems, among others.

Indian Defense Sector: An Overview

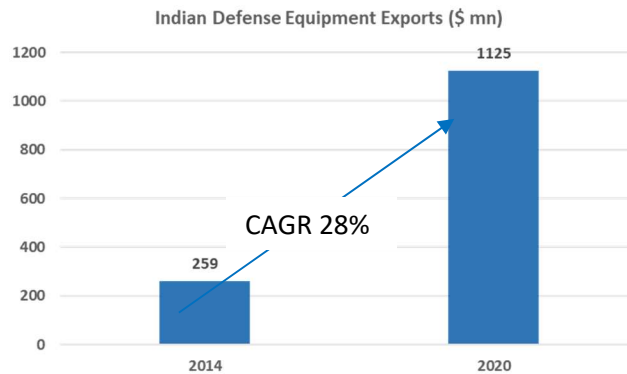


The favorable regulatory and policy environment is set to offer major incentives to domestic manufacturers of defense equipment, with a targeted annual growth rate of ~15% from 2019-25 for domestic manufacturing.



Another positive development in the industry has been a significant rise in defense exports from India, growing at a CAGR of 28% from 2014 to 2020. Defense exports should continue to enjoy robust growth aided by the government's push for promoting indigenous design and development of defense equipment. Some notable recent developments include:

- Evaluation of RFP (Request for Proposal) for acquiring 36 Tejas jets by the Royal Malaysian Air Force (RMAF)
- Philippines poised to acquire Dhruv Advanced Light Helicopters and Dornier aircraft in a contract worth INR 3,000 crores; to be India's largest ever export of defense equipment
- An aerospace and defense electronics company received its largest ever export order to date with Airbus for the manufacture and supply of Radar Warning Receiver (RWR) and Missile Approach Warning System
- Philippines has ordered BrahMos shore-based Anti-Ship Missile System worth \$375 million for its Navy



We believe there are various factors at work that create a favorable investment environment for the Indian Defense industry in the coming decade, driven by a consistent and secular growth in demand, as well as an ever-growing contribution of players that have strong technology specializations in their respective fields (aviation systems, missiles, torpedoes, submarines etc.)

Growing Demand

- Demand likely to accelerate as national security concerns rise
- Critical and urgent need to develop and manufacture technological capabilities to counter ongoing territorial disputes with Pakistan and China

Ease of Investments

- Automatic FDI route limit in Defense sector changed to 74%
- FDI up to 100 per cent by Government Route
- GoI has opened the industry to Private Sector Participation
- Two Defence industrial corridors (DICs) in UP & Tamilnadu

Favorable Policies

- Defense Acquisition Council (DAC): \$1.1 billion for modernization & operational needs of the Armed Forces
- Restructuring of Ordnance Factory Board (OFB): Form 7 PSUs dedicated towards higher autonomy & growth
- DPEPP 2020 policy: Increase autonomy & self-reliance for the industry

Joint Agreements & Partnerships

- Proactive approach by GoI towards forming new bilateral and regional joint agreements with countries such as US, UAE and Kazakhstan;
- Increased potential for domestic manufacturers through newer defense contracts such as BEL with Airbus & Saudi Arabia's PDTC



Why Omni Bharat Defense?

Omni Bharat Defense provides exposure to the Indian Defense Industry via a curated portfolio of defense companies with strong technology moats. The companies range from specialists in building stealth destroyers, conventional and nuclear submarines, Missile and torpedoes, aircraft carriers, combat aircraft, radar and missile defense systems, specialty metals and alloys, and command and control systems. These aforementioned products and technologies are extremely rare capabilities and a very select group of companies from a select group of countries across the world enjoy them. For example, most of these capabilities are housed in specialized defense companies from US, France, UK, China and Russia. These technologies are very closely guarded and are not shared with others.



The Indian armed forces have ambitious plans to upgrade their capabilities over the next several decades. This provides strong visibility and a large and growing total addressable market (TAM) to the companies in the Omni Bharat Defense portfolio.

The export market for selling to friendly and neutral nations is also potentially very large. Here the competition is with companies from the developed nations which are far more expensive. Indian firms have only recently begun to focus on export possibilities. The success of this initiative is visible from the wins in the sales process as cited in the previous section. Once an organized and systematic effort is put in place to export specific products to targeted countries, the export market for Indian defense products can be developed to a much larger size.

The portfolio aims to capitalize on the further growth in the industry in future, particularly domestic manufacturers which enjoy a high degree of monopoly, provide rich cash flows, and continue to benefit from the "Make in India" based policies and initiatives.



Key Portfolio Developments

In the last quarter, there have been numerous developments within the companies in the Omni Bharat Defense portfolio, namely in the form of significant contracts and orders and opening new business lines, which reaffirms the growth story for the sector. Some notable developments include:

- A leading defense company that develops and manufactures missiles and torpedoes, signed a contract worth INR 171 crores for the design, manufacturing and supply of Counter Measures Dispensing System (CMDs) to the Indian Armed Forces. It also signed a contract worth INR 471 crore for refurbishment of IGLA-1M missiles. The company now has new orders worth INR 1,331 crore for this financial year.
- India's leading manufacturer and supplier of military aircraft signed a contract worth INR 357 crore with the government for imparting training to pilots of Jaguar fighter jets. It includes the procurement of 2 Fixed Base Full Mission Simulators (FBFMS) for Jaguar aircraft along with a 5-year comprehensive AMC.
- An infrastructure & construction conglomerate which came out as the lowest bidder for construction of 3 buildings of Common Central Secretariat as part of Central Vista Project. The co. also recently designed, developed & launched SOV400, a mini-submarine with subsurface mission capabilities for the Indian Navy.
- An Indian aerospace and defense electronics company bagged its largest export order yet for the supply of Radar Warning Receiver (RWR) and Missile Approach Warning System for Airbus. The company has also signed an agreement with Power for Defense Technologies, a Saudi Arabian firm, to promote defense and aerospace technologies in both countries.
- India's first indigenous aircraft carrier (IAC) Vikrant, built by one of the country's leading shipbuilding companies, undertook another set of sea trials to carry out complex maneuvers in high seas, as the Indian Navy focuses further on significantly bolstering its overall capabilities in view of China's growing efforts to increase its military presence in the Indian Ocean Region.
- One of the leading naval manufacturers delivered the INS Vishakhapatnam to the Indian Navy. This is the first ship, out of four, of Project15B (Stealth guided-missile destroyers ships). The same firm also delivered Vela, the fourth submarine of Project-75.
- Another naval manufacturer delivered Sandhayak the first of four large survey vessels.

Omni Bharat Defense: Fundamentals & Valuations

The Omni Bharat Defense portfolio utilizes our proprietary Scientific Investing Framework to select companies which satisfy our primary criteria of “Enhanced Safety, Enhance Growth, Enhanced Returns”, picking the most undervalued companies in the sector with robust, profitable business models, sizeable order books for the future, and moats that help them outperform the market in the long run.

One can see that the RoE and RoCE of the portfolio companies is significantly higher than the Nifty 500 companies. This is a manifestation of the specialized capabilities of the firms which result in persistent competitive advantages, informally termed “moats” by the investment community. The relatively low sales to asset turns actually shows that, in all likelihood, there is significant capacity available which can be utilized for growth without needing further capacity enhancements.

The strong gross debt is nil in most cases and the net debt is negative. The negative net debt indicates strong cash on the books. This signifies strong balance sheets which can power investments and growth.

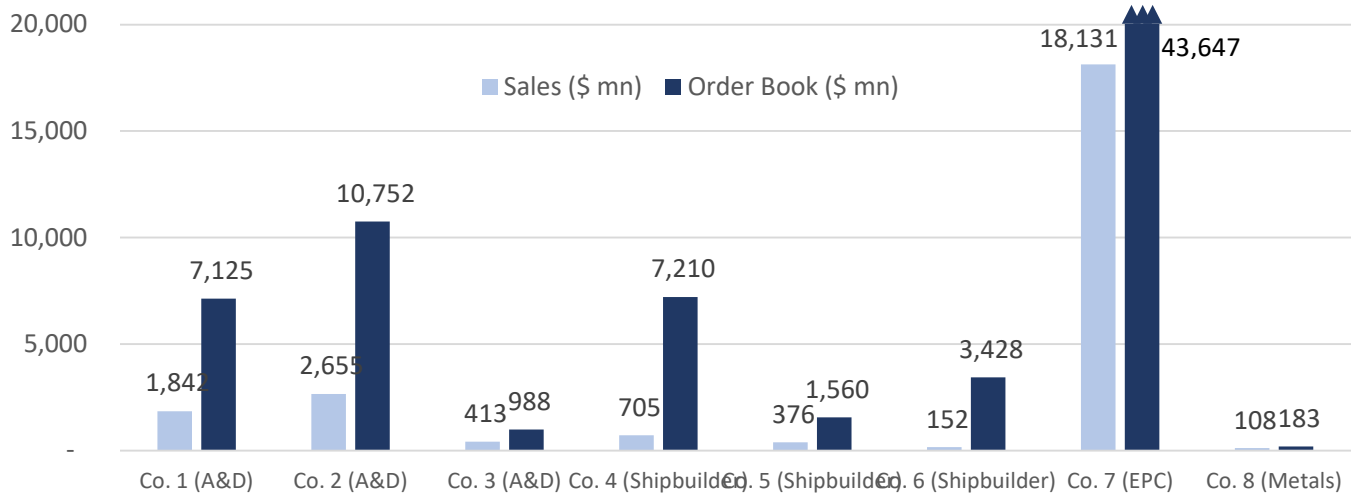
Most important from an investment perspective is whether the company is available at a significant discount to its intrinsic value. The relatively lower PE, PB and EV/EBITDA for the companies shows that they are all available at significantly lower valuation ratios compared to the Nifty 500 even though they enjoy superior RoEs.

The large dividend yields compared to Nifty 500 also indicate that the companies are being mispriced by Mr. Market.

COMPANY	CO. 1	CO. 2	CO. 3	CO. 4	CO. 5	CO. 6	CO. 7	CO. 8	OMNI	NIFTY
SECTOR	A&D	A&D	A&D	Shipbuilder	Shipbuilder	Shipbuilder	EPC	Metals	BHARAT DEFENCE	500
VALUATION RATIOS										
P/E RATIO	24.8	13.2	22.6	8.7	7.4	14.6	31.5	18.1	14.0	33.1
P/B RATIO	4.6	2.8	2.8	1.5	1.1	2.4	3.6	3.0	2.2	3.7
EV/EBITDA	15.9	8.0	10.9	NA	3.0	2.3	17.5	14.1	4.5	16.9
DIVIDEND YIELD (%)	2.8%	2.7%	1.9%	1.3%	6.0%	2.2%	1.0%	1.7%	2.5%	1.1%
PERF. RATIOS										
SALES TO ASSETS	0.5	0.4	0.4	0.2	0.4	0.2	0.5	0.3	0.3	0.7
ROE (%)	18.7%	21.0%	12.3%	17.4%	14.9%	16.2%	11.4%	16.7%	16.0%	11.3%
ROCE (%)	23.2%	17.2%	12.9%	17.7%	18.6%	20.0%	11.1%	13.9%	16.3%	11.9%
LEVERAGE RATIOS										
GROSS DEBT-TO-EQ.	0.0	0.0	0.0	0.0	0.0	0.0	1.3	0.0	0.1	0.6
NET DEBT-TO-EQ.	0.0	-0.5	-0.9	-0.3	-0.5	0.0	0.7	-0.1	-0.3	0.4
INTEREST COVERAGE	457.1	18.5	128.8	94.5	17.9	82.5	6.3	28.6	22.0	4.7



OMNI BHARAT DEFENSE: Sales vs. Order Books



The companies enjoy large order books which are several times (2 to 10 times) their annual turnovers. This provides visibility of their revenues for several years in the future. Further, these order books are continuously replenished every year with new orders in the order pipeline.

Investment Thesis & Risks

As mentioned at the beginning of the report, the \$73 billion Indian defence market provides rich opportunities. Further, the DPEPP 2020 and Make in India initiative (Atmanirbhar Bharat) provides ample opportunities for the Indian defence manufacturers to not only replace foreign defence manufacturers providing supplies to Indian armed forces, but also to focus on exports to other friendly or neutral countries. This provides a large TAM.

These companies have persistent competitive advantages because of highly specialized capabilities, strong, cash-rich balance sheets to power their growth, ample cash flows and are available at significant discount to their intrinsic values. This is a SuperNormal Portfolio of defence companies.

The risks are that the defence policy changes in the future which is highly unlikely since this policy has evolved over several decades under different governments. Another risk is that the defence budget is reduced, which also is unlikely.

However, these risks are unlikely—of course, equity risks apply (read the disclaimer below)—and to us this is a strong portfolio providing exposure to the multidecadal defence opportunity. The portfolio is available on the smallcase platform.

Omni Bharat Defence: To Know more visit – https://omniscience.smallcase.com/smallcase/OMNNM_0002



OmniInsight

"Most market participants chase alpha but get risks, while one could chase safety and get alpha"

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OmniScience Capital is a joint initiative of Team OmniScience and the financial services conglomerate Asit C Mehta Group (35+ years, AUM: 3000 crores) to bring Scientific Investing to Indian and Global investors. [Read more...](#)

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