

Cochin Shipyard Ltd

BUY

CMP Rs338

Target Rs429

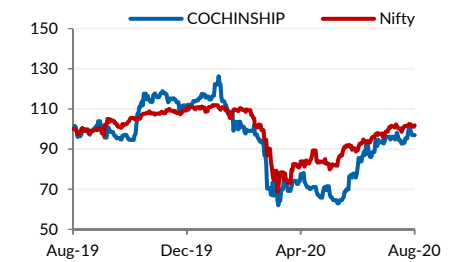
Upside 27%

HIGHLIGHTS	
✓	Though Cochin Shipyard delivered weak Q1FY21 results owing to Covid-19 led disruptions, mgmt. seems confident of achieving flat top line growth with EBITDA margins of 19% in FY21E.
✓	It has healthy shipbuilding order book of Rs139bn (5.5x TTM sales). Order pipeline of ~Rs150bn includes, i) New Generation Missile Vessels, ii) Multi-purpose Vessels & iii) Offshore Patrol Vessels. Large ship-repair order of INS Vikramaditya (aircraft carrier) is expected to come either in FY22 or FY23.
✓	Est. FY21 sales mix, i) IAC: Rs20bn, ii) ASW SWC: Rs1.5bn, iii) Non-defence vessels: Rs6-7bn & iv) Ship-repairing: Rs5-5.5bn.
✓	CSL doesn't expect significant impact on margins for ASW SWC as risk of unfavorable currency would be mitigated through increase in localization.
Our View	
✓	CSL is targeting for shiprepairing revenues of Rs10bn+/Rs25bn+ with sustainable margins of 25% by FY23E/ FY30E as new facilities (Mumbai, Kolkata and A&N) commence operations and commission of ISRF frees up capacity at the existing ship repair dock to undertake largescale ship repair work.
✓	Given healthy order backlog, CSL has shipbuilding revenue growth visibility till FY23 with planned execution of Rs65bn from IAC. It stands to benefit from indigenous defence manufacturing, which would result in faster clearances & timely executions of new projects. Government's focus on development of inland and coastal waterways infra is expected to spur demand of ships for CSL over the long term.
✓	Expect EBITDA growth of 18% in FY21E-23E, however higher depreciation & lower other income would lead to 7% EPS CAGR.
Valuation	
✓	We expect CSL to yield benefits in long term from ongoing investments of ~Rs28bn. Our estimates remain unchanged. Retain BUY with DCF based TP of Rs429 (Assumptions: Sales CAGR of 4.5% over FY20-FY30, NOPAT margin: 9.3%, CoE: 12%, Invested capital turns: 2x).
Risk to call	
✓	Delay in new order inflows & cancellation of IAC-2 project.

Stock data (as on August 17, 2020)

Nifty:	11,247
52 Week h/l (Rs)	492 / 209
Market cap (Rs/USD mn)	44428 / 593
Outstanding Shares	132
6m Avg t/o (Rs mn):	149
Div yield (%):	4.4
Bloomberg code:	COCHIN IN
NSE code:	COCHINSHIP

Stock performance



	1M	3M	1Y
Absolute return	0.9%	35.6%	(2.7)

Shareholding pattern (As of Jun'20 end)

Promoter	72.9
FII+DII	15.1
Others	12.0

Δ in earnings estimates

	FY21e	FY22e	FY23e
EPS (New)	39.1	42.5	45.0
EPS (Old)	39.2	42.4	42.8
% change	0%	0%	5%

Exhibit 1: Financial Summary

Y/e 31 Mar (Rs mn)	FY19	FY20	FY21E	FY22E	FY23E
Revenues	29,622	34,225	31,261	36,749	43,384
yoy growth (%)	25.8	15.5	(8.7)	17.6	18.1
EBITDA	5,692	7,065	5,849	7,109	8,167
EBITDAM (%)	19.2	20.6	18.7	19.3	18.8
Adjusted PAT	4,778	6,320	5,138	5,594	5,925
yoy growth (%)	20.6	32.3	(18.7)	8.9	5.9
EPS (Rs)	36.3	48.0	39.1	42.5	45.0
P/E (x)	9.3	7.0	8.7	7.9	7.5
P/BV (x)	1.3	1.2	1.1	1.0	0.9
EV/EBITDA (x)	3.5	3.4	4.1	4.2	4.0
Net D/E (x)	(0.7)	(0.6)	(0.5)	(0.3)	(0.2)
ROE (%)	14.5	17.9	13.3	13.3	12.9
Core ROIC (%)	74.6	31.4	17.4	15.6	13.4

Source: Company, YES Sec - Research

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CON-CALL HIGHLIGHTS

FY21 Guidance:

- ✓ CSL is aiming for flat top line growth with EBITDA margins of 19% in FY21E.

Order pipeline & Order book

- ✓ Break up of current order book (Rs144bn)

Shipbuilding: Rs139bn

- IAC: Rs63bn (Fixed Cost: Rs24.7bn & Cost Plus: Rs38bn)
- ASW SWC: Rs63bn
- Non-defence vessels: Rs13bn

Ship-repairing: Rs5bn

- ✓ CSL has also submitted bid for Next Generation Missile Vessels (6 nos) project. GRSE, MDL, L&T are the other players in contention. They have also submitted bids for 2 more projects namely, Multipurpose missile vessels & Offshore Patrol Vessels. Combined order value for all three projects would be ~Rs130bn.
- ✓ Import embargo list of 101 items will not have material impact on the company's business prospects. Most of items mentioned in the list are already procured from domestic markets.
- ✓ Mgmt. targeting for ship-repairing revenues of Rs10bn+ within 3 years & also expect it to reach at Rs25bn by FY30. Margins are expected to remain strong at 25%.
- ✓ CSL has ~40% market share in Indian ship-repairing market. ISRF could handle around 70-72 vessels a year which could generate revenues of ~Rs5bn. CSL is targeting for 50%+ market share in next 2-3 years through further penetration by leveraging its competitive advantage & experience.

Execution & Margins

- ✓ Revenues from operations de-grew 55% yoy to Rs3.3bn (-31% vs our est.) owing to the operational shutdown & COVID-19 pandemic.
- ✓ Shipbuilding revenues were down 47% yoy to Rs3.1bn as company had production loss till May 05, 2020 during the quarter.
- ✓ Ship repairing revenues dropped by 88% yoy to Rs164mn as operations were severely affected from the lockdown.
- ✓ EBITDA margins came in at 5.1%, -1410bps yoy on the account of negative operating leverage & lower ship-repairing revenues.
- ✓ Shipbuilding EBIT margin stood at 20%, +300bps yoy.
- ✓ Ship-repairing business reported EBIT loss of Rs89mn in Q1FY21 vs EBIT profit of Rs412mn in Q1FY20.
- ✓ Q1FY21 revenues break-up
 - IAC: Rs2.6bn (Fixed cost: Rs0.75bn & Cost Plus: Rs1.86bn)
 - Non-defence vessels: Rs0.6bn
 - Ship-repairing: Rs164mn

- ✓ Execution of IAC phase-III got impacted due to COVID-19, hence mgmt. expect delivery to defer by 4-5 months now. Revenue of Rs10-15bn would be recognized post-delivery up to FY24. Indigenization level for IAC-1 is around 50-60%. The management expects revenues of Rs20-30bn for FY21/FY22/FY23 each from IAC project.
- ✓ Anti-Submarine Warfare Shallow Water Craft (ASW SWC) Project is currently in design phase. CSL would start fabrication work in Q3FY21. Management expects revenues of around Rs1.5bn/Rs9-10bn from ASW SWC in FY21E/FY22E.
- ✓ Despite Q1 washout, management is expecting revenues of Rs5-5.5bn from ship repair altogether in FY21E.
- ✓ Non-IAC shipbuilding contracts revenues target are at Rs8-9bn for FY21E.
- ✓ Generally, for nomination based shipbuilding projects, cost plus contracts have EBITDA margins of ~12% while fixed cost contracts carry relatively higher margins. Going forward, Indian Navy would award all the projects on competitive bidding process, where margins would relatively lesser than IAC contract.
- ✓ Ongoing projects don't have exposure towards Euro so no impact of INR depreciation. However, for ASW SWC project the Company would be importing some RM in Euro so unfavorable currency may impact on operating profitability, which company wants to mitigate through Bharat Electronics in terms of higher localization.

COVID-19 impact on operations:

- ✓ The Company had production loss from March 23, 2020 to May 05, 2020. The lock-down period was effectively utilized to undertake dredging activities of the CSL Jetties to facilitate berthing of vessels.
- ✓ It had execution disruptions in Q1FY21 owing to reduction in outsourced manpower, material unavailability, restricted working arrangements and logistic issues.
- ✓ All permanent employees of the Company are reporting to work from May 06, 2020 onwards in two shifts i.e, Shift A from 07:00 hrs to 12:45 hrs. and Shift B from 13:15 hrs. to 19:00 hrs. The normal shift was 08:15 hrs to 17:00 hrs. Each shift contains not more than 50% of the total strength. To catch up with the lost production days, the second and fourth Saturdays which were closed holidays have now been declared as normal working days until further notice.
- ✓ Delays in Capex projects in Kochi, Mumbai, Kolkata, Port Blair as well as subsidiaries of company viz. Hooghly Cochin Shipyard Limited and Tebma Shipyard Limited which was acquired by bidding at NCLT in March 2020 and consequent Loss of production

Balance Sheet & Capex

- ✓ Construction on new dry dock facility & ISRF is expected to be completed by Dec'22 & Dec'21 respectively. The company has spent Rs5.6bn on new dry dock project (out of Rs18bn) & Rs4.4bn on ISRF (out of Rs9bn).
- ✓ Temba shipyard takeover process is likely to be completed in next 1 month. Revenue booking would start only after 4-5months.
- ✓ Capex guidance for FY21: Rs2.9bn (Rs1.2bn for ISRF)
- ✓ CSL expects delay in cash payments from Indian Navy in FY21. 80% of payments due for Q1FY21 got delayed to Q2FY21. Cash position at Rs19.5bn as on 30th June, 2020.
- ✓ CSL has seen improvement in payments from Indian Navy in June-July 2020 over April-May. It has received Rs9bn for IAC project. It is not facing any liquidity crunch as of now.

Exhibit 2: Result table (Standalone)

(Rs mn)	Q1FY21	Q1FY20	% yoy	Q4FY20	% qoq	Q1FY21 Yes Sec	vs. our est.
Total sales	3,325	7,369	(54.9)	8,167	(59.3)	4,854	(31.5)
EBITDA	170	1,417	(88.0)	1,630	(89.5)	522	(67.3)
EBITDAM (%)	5.1	19.2	(1,410.1)	20.0	(1,483.4)	10.7	(562.0)
Depreciation	(121)	(121)	(0.3)	(122)	(0.9)	(144)	(16.2)
Interest	(114)	(111)	2.3	(111)	2.3	(110)	3.4
Other income	646	680	(5.0)	450	43.6	450	43.6
PBT	582	1,865	(68.8)	1,847	(68.5)	718	(18.9)
Tax	(156)	(662)	(76.5)	(459)	(66.1)	(181)	(13.8)
Adjusted PAT	426	1,202	(64.5)	1,388	(69.3)	537	(20.6)
Exceptional item	0	0		0		0	
Reported PAT	426	1,202	(64.5)	1,388	(69.3)	537	(20.6)
PATM (%)	12.8	16.3	(349.1)	17.0	(416.5)	11.1	176.9
EPS (Rs)	3.2	9.1	(64.5)	10.5	(69.3)	4.1	(20.6)

Source: Company, YES Sec – Research

Exhibit 3: Cost analysis (Standalone)

As a % of net sales	Q1FY21	Q1FY20	bps yoy	Q4FY20	bps qoq	Q1FY21 Yes Sec	vs. our est.
COGS	64.2	56.0	821.6	48.3	1,586.6	60.0	419.0
Employee cost	21.0	9.5	1,147.5	10.6	1,046.5	20.0	102.3
Other expenses	9.7	15.3	(559.0)	21.2	(1,149.7)	9.3	40.7
Total costs	94.9	80.8	1,410.1	80.0	1,483.4	89.3	562.0

Source: Company, YES Sec – Research

Exhibit 4: Healthy shipbuilding order book of Rs139bn (5.5x TTM shipbuilding sales)

Sr No	Project	Client	No of vessels	Balance orders (Rs bn)
Shipbuilding				
1	Indigenous Aircraft Carrier	Indian Navy	1	62.7
2	Orders from GoI, MOS	GOI, MOS	6	5.7
3	Orders from GoI, MOD & MHA	GOI, MOD, MHA	4	2.8
4	Fishing vessels (TN Govt) & Other smaller vessels	TN Govt	-	0.1
5	Small passenger ferry (KMRL) & mini cargo vessels (Jindal Steel)	KMRL, Jindal Steel	27	4.8
6	ASW SCW Corvette	Indian Navy	8	63.1
Ship repairing				5.0
Total				143.9

Source: Company, YES Sec – Research

Exhibit 5: Segment Financials

	FY19				FY20				FY21
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1
Revenue									
SB (Rs mn)	4,544	4,621	5,521	6,617	6,021	7,894	7,474	7,126	3,161
yoy gr. (%)	14.1	9.4	35.4	31.4	32.5	70.9	35.3	7.7	(47.5)
SR (Rs mn)	2,043	3,373	1,644	1,259	1,334	1,834	1,487	1,041	164
yoy gr. (%)	29.3	109.7	(20.7)	29.7	(34.7)	(45.6)	(9.7)	(17.3)	(87.7)
Unallocated (Rs mn)	576	558	497	650	679	796	549	450	646
yoy gr. (%)	48.4	(8.9)	(2.5)	70.6	18.0	42.7	10.1	(30.8)	(4.9)
Total (Rs mn)	7,163	8,552	7,662	8,526	8,034	10,525	9,510	8,617	3,971
yoy gr. (%)	20.4	32.7	15.0	33.5	12.2	23.1	24.0	1.1	(50.6)
EBIT & EBITM									
SB (Rs mn)	775	796	1,070	1,810	1,012	1,751	1,752	2,132	625
yoy gr. (%)	(20.0)	60.0	(18.9)	33.0	30.5	120.1	63.9	17.8	(38.2)
Margin (%)	17.1	17.2	19.4	27.4	16.8	22.2	23.4	29.9	19.8
SR (Rs mn)	438	1,351	654	(71)	412	570	199	290	(89)
yoy gr. (%)	105.9	114.4	127.8	(140.3)	(5.9)	(57.8)	(69.7)	(510.9)	(121.5)
Margin (%)	21.4	40.0	39.8	(5.6)	30.9	31.1	13.4	27.8	(54.2)
Unallocated (Rs mn)	431	208	272	(77)	552	416	458	(464)	159
yoy gr. (%)	73.5	(44.2)	47.9	(18.2)	28.1	100.1	68.8	498.8	(71.1)
Margin (%)	74.8	37.2	54.8	(11.9)	81.3	52.2	83.5	(103.1)	24.7
Total (Rs mn)	1,644	2,354	1,996	1,662	1,976	2,737	2,409	1,958	696
yoy gr. (%)	15.0	57.0	11.5	15.3	20.2	16.3	20.7	17.8	(64.8)
Margin (%)	23.0	27.5	26.1	19.5	24.6	26.0	25.3	22.7	17.5

Source: Company, YES Sec – Research

Growth drivers for Shipbuilding business

- ✓ **Inland and coastal water segment:** The government's focus on development of inland and coastal waterways infrastructure is expected to spur demand of ships for this sector. The Government is investing substantially to improve the infrastructure in the major waterways. This will spur the demand for such vessels in the inland water segment. It is estimated that the vessels required to meet the demand by 2030 will triple which may be around 3000+ vessels. CSL is working closely with Inland Water Authority of India (IWAI) and other potential customers to provide efficient product solutions in this segment
- ✓ **Special purpose vessels:** Various agencies are looking for modern and efficient vessels to equip and upgrade the assets to meet the operational demands. This gives an opportunity to CSL for custom made vessels such as Polar Research Vessels, Well Stimulation Vessel, Cement Carriers, etc.
- ✓ **Fishing segment:** Government of India (GoI) has got an ambitious plan under the "Blue Revolution" to equip the segment with more modern and efficient fishing vessels. This segment is presently managed by unregulated players and gives a good opportunity for CSL to focus and position itself as a quality player. CSL is working closely with Tamil Nadu Fisheries by providing custom made solution to the fishermen and has contracted for the construction of 16 vessels as a pilot project. The total requirement for the department for fishermen is about 2000 vessels. In addition to the above there are also potential requirements for bigger and sophisticated vessels in this segment for the domestic and international market.
- ✓ The Indian Navy's perspective plan aims to increase the Navy's fleet from the present 137 to 200 nos. by 2027. This is expected to provide a spurt in the indigenous shipbuilding.

Besides, the Indian Navy's indigenization plan is also expected to give a fillip to the growth of ancillaries and generally improve the shipbuilding environment in the country.

Potential opportunity for Ship repairing business in India

- ✓ India's share in global ship repair market is less than 1%, while around 7-9% of global trade is passing within 300 NM of its coastline. India's strategic position along the east bound and west bound international trade routes offers an opportunity to cater to vessels plying on these routes. A main container route connecting America and Europe to the East passes very close to the Indian coastline presenting a major opportunity. for repairs. This presents huge untapped potential which is valued around Rs35-40bn.
- ✓ As per the AT Kearney report, India has a market potential of Rs26bn from repair of domestic fleet out of which only 15% share is currently captured. The report has further highlighted that India can grow its ship repair industry to Rs90bn in the next 10 years through infrastructure and process improvement. The report has highlighted low levels of process efficiency, lack of infrastructure to service vessels above 10,000DWT and weak ancillary landscape as road blocks for developing the industry. A key recommendation of the report was to lease out the repair facilities at major ports to specialist to augment revenue opportunity.
- ✓ MOU with the Mumbai Port Trust & Kolkata Port Trust for operations and management of respective ship repair facilities would be beneficial for CSL. It shall utilize these facilities for ship repair and allied services and for the growth of ship repair in the region.
- ✓ CSL has also signed a MoU with Andaman & Nicobar (A&N) Administration for setting up its unit at Port Blair in September 2018. The agreement with A&N is in the administrative phase and is expected to be cleared in FY20. By entering into this arrangement with A&N Administration, CSL shall be developing an integrated ship repair ecosystem at A&N islands that includes modernization of facilities, maintenance of Administration owned vessels and skill development for the islanders.
- ✓ CSL is planning to increase the throughput of a profitable business through International Ship Repair Facility (ISRF). This Facility will allow CSL to increase its repair throughput by 60-70% as it includes a ship-lift and transfer system. CSL will be able to repair 80 additional ships in the new ISRF and an additional 12 in the new dry dock.

FINANCIALS

Exhibit 6: Income statement

Y/e 31 Mar (Rs mn)	FY19	FY20	FY21E	FY22E	FY23E
Total operating revenues	29,622	34,225	31,261	36,749	43,384
Growth (%)	25.8	15.5	(8.7)	17.6	18.1
EBITDA	5,692	7,065	5,849	7,109	8,167
EBITDA margin (%)	19.2	20.6	18.7	19.3	18.8
Growth (%)	22.7	24.1	(17.2)	21.5	14.9
Depreciation & amortization	342	489	551	1,030	1,445
EBIT	5,350	6,576	5,299	6,079	6,722
EBIT margin (%)	18.1	19.2	16.9	16.5	15.5
Interest	143	449	414	400	400
Other income	2,268	2,451	1,996	1,800	1,600
Profit before tax	7,475	8,577	6,881	7,479	7,922
Tax	2,697	2,257	1,743	1,885	1,996
Reported net profit	4,778	6,320	5,138	5,594	5,925
Extraordinary items	0	0	0	0	0
Adjusted net profit	4,778	6,320	5,138	5,594	5,925
Adjusted net margin (%)	16.1	18.5	16.4	15.2	13.7
Diluted EPS (Rs)	36.3	48.0	39.1	42.5	45.0
Growth (%)	20.6	32.3	(18.7)	8.9	5.9

Exhibit 7: Balance sheet

Y/e 31 Mar (Rs mn)	FY19	FY20	FY21E	FY22E	FY23E
SOURCE OF FUNDS					
Share capital	1,315	1,315	1,315	1,315	1,315
Reserve & Surplus	31,971	35,913	38,993	42,529	46,397
Total shareholder's funds	33,286	37,229	40,309	43,845	47,712
Minority Interest	53	0	0	0	0
Debt	1,230	1,230	1,319	1,319	1,319
Deferred tax liabilities/(assets)	270	4,047	3,958	3,958	3,958
TOTAL	34,839	42,506	45,586	49,122	52,989
APPLICATION OF FUNDS					
Gross block	7,714	12,079	15,079	23,079	32,079
Less: Depn. and amort.	3,953	4,443	4,993	6,023	7,468
Net block	3,760	7,636	10,086	17,056	24,611
Capital WIP	3,424	7,993	7,500	6,500	1,000
Long term investments	1	1	0	0	0
Other long term assets	4,097	4,147	4,640	6,640	9,140
Inventories	2,834	3,134	2,912	3,524	4,160
Debtors	3,923	2,882	3,854	4,229	4,754
Cash & cash equivalents	25,772	21,952	21,990	15,948	12,926
Loans & advances	8,649	16,322	14,137	16,491	19,187
Total current liabilities	17,622	21,561	19,534	21,266	22,789
Net current assets	23,557	22,730	23,360	18,926	18,238
TOTAL	34,839	42,506	45,586	49,122	52,989

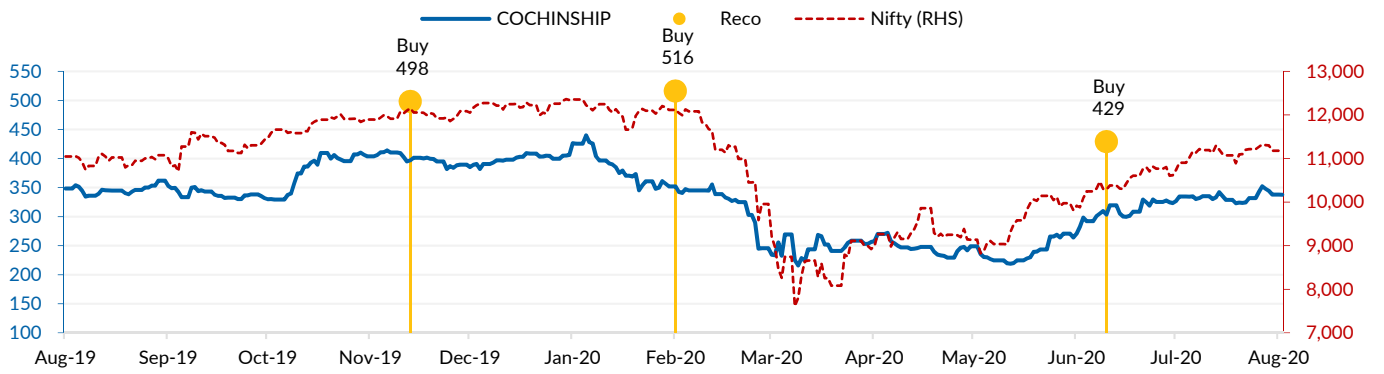
Exhibit 8: Cash flow statement

Y/e 31 Mar (Rs mn)	FY19	FY20	FY21E	FY22E	FY23E
PBT	7,475	8,577	6,881	7,479	7,922
Depreciation	342	489	551	1,030	1,445
Others	(1,809)	(1,180)	0	0	0
Tax Paid	(2,006)	(1,809)	(1,743)	(1,885)	(1,996)
Changes in Working Capital	(8,514)	(3,551)	(592)	(1,608)	(2,335)
Net Cash from Operations	(4,512)	2,527	5,096	5,016	5,036
Capex	(2,868)	(4,948)	(3,001)	(9,000)	(6,000)
Change in Investment	11,418	2,282	1	0	0
Others	2,189	1,693	(0)	0	0
Net Cash from Investing	10,739	(974)	(3,000)	(9,000)	(6,000)
Change in debt	0	3	89	0	0
Change in Equity	(2,023)	0	0	0	0
Others	(2,067)	(3,094)	(2,147)	(2,058)	(2,058)
Net Cash from Financing	(4,090)	(3,091)	(2,058)	(2,058)	(2,058)
Net Change in Cash	2,137	(1,538)	38	(6,042)	(3,022)

Exhibit 9: Ratio analysis

Y/e 31 Mar (Rs mn)	FY19	FY20	FY21E	FY22E	FY23E
PROFITABILITY RATIOS					
EBITDA Margin (%)	19.2	20.6	18.7	19.3	18.8
Adjusted net margin (%)	16.1	18.5	16.4	15.2	13.7
Return on invested capital (%)	74.6	31.4	17.4	15.6	13.4
Return on equity (%)	14.5	17.9	13.3	13.3	12.9
EFFICIENCY RATIOS					
Asset Turnover	4.1	2.2	1.8	1.6	1.7
Debt to equity	0.0	0.0	0.0	0.0	0.0
Net debt to equity	(0.7)	(0.6)	(0.5)	(0.3)	(0.2)
Interest coverage	37.4	14.6	12.8	15.2	16.8
Debtor days	48.3	30.7	45.0	42.0	40.0
Inventory days	34.9	33.4	34.0	35.0	35.0
Payable days	84.2	85.1	85.0	85.0	85.0
PER SHARE DATA					
Diluted EPS (Rs)	36.3	48.0	39.1	42.5	45.0
BVPS (Rs)	253.1	283.0	306.4	333.3	362.7
DPS (Rs)	13.0	15.0	13.0	13.0	13.0
VALUATION RATIOS					
P/E	9.3	7.0	8.7	7.9	7.5
P/BV	1.3	1.2	1.1	1.0	0.9
EV/EBITDA	3.5	3.4	4.1	4.2	4.0
Dividend Yield (%)	3.8	4.4	3.8	3.8	3.8

Recommendation Tracker



DISCLAIMER

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