

Mazagon Dock Shipbuilders Ltd

IPO valuations are at a deep discount to fair value

INDIA | CAPITAL GOODS | IPO Note

28 September 2020

About Mazagon Dock shipbuilders (MDL)

MDL is India's largest, government owned defence shipyard. It was taken over by the government in 1960 and since then the company has delivered 795 vessels including 25 warships. MDL has been accorded a 'Miniratna' status by the government. MDL has an orderbook of Rs 547bn (FY20) to build eight warships and four submarines. Its Revenue/EBITDA/PAT has grown at 12%/31%/2% over FY17-20.

IPO rationale: Offer for sale by promoters

The IPO is an offer for sale by the government to raise Rs 4.4bn and dilution of its shareholding by 15%. At the IPO price band of Rs 135-145, the stock trades at 5x FY20 PE.

Key positives

- **Only yard to have built multiple naval platforms:** MDL is the only domestic yard that has capability to build complex platforms such as Destroyers, Frigates, Corvettes and conventional submarines.
- **Robust infrastructure:** After its recent capacity expansion, MDL can now build 10 warships and 11 submarines concurrently. In addition, it plans to set up a yard in Naha Sheva; this would help it grow its ship repair business.
- **Strong revenue visibility:** MDL's current orderbook is 11x its FY20 revenues, this offers a runway for revenue growth for the next five years as it achieves the 'bell curve' impact on two of its largest ship building projects viz. Project 15B (Destroyers) and Project 17A (Frigates). In addition, its associate company, Goa Shipyard (47.2% stake), also enjoys a healthy book to bill of 15x TTM sales as it executes order for two advanced frigates.
- **Healthy bid pipeline:** Based on our estimates, MDL (also through GSL) could potentially bid for Rs 2.1tn of warship/submarine projects of the Indian Navy in the next 10 years.

Key risks/concerns

- **Concentration risk:** MDL's current orderbook has very high reliance on a single customer i.e. the Indian Navy. Its revenues are also highly dependent on ship building as relatively higher margin ship repair business accounts for just 3% of sales (FY20).
- **High competitive intensity:** Defence shipbuilding is the most competitive segment of the Indian defence sector. The landscape is occupied by four Ministry of Defence shipyards viz. MDL, GRSE, HSL and GSL. Cochin Shipyard, a Ministry of Shipping entity has begun bidding for defence orders. L&T in the private sector is also a formidable player that is bidding for large submarine and warship projects.
- **Patchy execution record:** The last eight ships delivered by MDL were delayed by 52-78 months. Delays could also be attributable to the lack of preparedness of the Navy. However, MDL has incurred liquidated damages on account of delays.
- **Risk of deterioration in working capital:** Currently MDL runs a negative working capital as it has high customer advances (21% of orderbook). However, as revenues can potentially grow by 2.7x in the next five years, it is unlikely that payments from Navy will be able to keep pace with revenue growth.

Our view: SUBSCRIBE

We are generally wary of the defence shipbuilding business in India due to concerns highlighted above. However, IPO valuations are at 40% discount to theoretical fair value that this business could command. Based on current visibility we expect MDL's Revenue/EBITDA/PAT to grow at 22%/30%/9% CAGR over FY20-25 with ROE's c.19%. At IPO price, investors can earn 55% returns just through dividend yields over FY21-25. In addition, we believe MDL is well positioned to win atleast Rs 1tn of new orders over next 10 years out of Rs 2.1tn opportunity; this should help provide visibility on earnings beyond FY25. While we would not recommend MDL as a core holding for investors looking to play the long term defence thematic, Bharat Electronics is our preferred conduit for the same. However, we advise a **SUBSCRIBE** on MDL IPO due to gross undervaluation of the business.

SUBSCRIBE

COMPANY DATA

ISSUE OPENS	29 th September 2020
ISSUE CLOSES	1 st October 2020
PRE- ISSUE EQUITY SHARES	201.7mn
PRICE BAND	Rs 135 -145
NO OF SHARES OFFERED	30.6mn
ISSUE SIZE	Rs 4.4bn
MKT CAP	Rs 27.2-29.2bn

STANDALONE FINANCIALS

Y/E Mar, Rs bn	FY20	FY21E	FY22E	FY23E
Net Sales	49.78	40.66	74.35	96.05
EBIDTA	2.58	1.06	4.29	6.32
Net Profit	5.77	3.59	5.37	6.19
EPS, Rs.	28.6	17.8	26.6	30.7
PER, x	5.1	8.1	5.5	4.7
EV/EBIDTA, x	nm	nm	nm	0.1
P/BV, x	1.1	1.0	0.9	0.8
ROE, %	21.4	13.1	17.4	18.0

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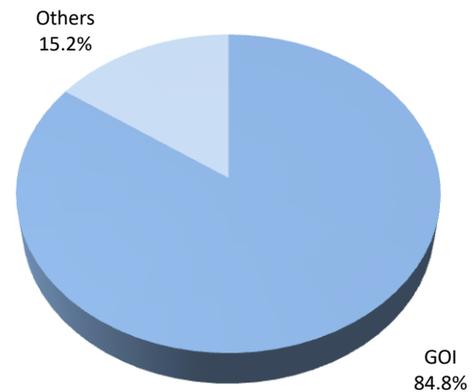
About the IPO

- Rs 4.1-4.4bn issue at a price band of Rs 135-145 per share implying an offering of 30.3mn shares
- Issue includes offer for sale by the promoter Government of India (GOI).
- Post-issue, promoters' shareholding to reduce to 84.8% from 100%
- Market capitalisation at price band: Rs 27-29bn

MDL - Issue details

ISSUE OPENS	29th September 2020
ISSUE CLOSES	1st October 2020
PRE- ISSUE EQUITY SHARES	201.7mn
- LOWER BAND	Rs 135
- UPPER BAND	Rs 145
PRICE BAND	Rs 135 -145
- FRESH ISSUE	Nil
- OFS	30.6mn
NO OF SHARES OFFERED FOR SALE	30.6mn
ISSUE SIZE	Rs 4.1-4.4bn
POST- ISSUE EQUITY SHARES	201.7mn
MKT CAP	Rs 27.2-29.2bn

MDL - Share holding pattern post-issue



Source: RHP, PhillipCapital India Research

Allocation of shares offered in the IPO

Issue allocation	Issue size (Rs bn)	Shares (mn)	% of Net issue
Retail	1.5	10.59	34.6%
Non-institutional	0.7	4.54	14.8%
- Mutual fund	0.1	0.76	2.5%
- All QIBs including MF	2.1	14.37	47.0%
QIBs	2.2	15.13	49.4%
Net Issue (ex-allocation to employee)	4.4	30.25	98.9%
Employees		0.35	1.1%
Total Issue		30.60	100.0%

Source: RHP, PhillipCapital India Research

About the company

Brief history of MDL

Mazagon Dock Shipbuilders Ltd (MDL), incorporated in February 26, 1934, is a public sector shipyard under Ministry of Defence (MoD) with the 'Mini-ratna-I' status. It is engaged in the construction and repair of warships and submarines for the Indian Navy and other vessels for commercial clients. MDL is India's only shipyard to have built destroyers and conventional submarines for the Indian Navy. MDL has a shipbuilding and submarine capacity of 40,000 DWT.

MDL - Journey so far

Year	Major Events
1934	Incorporated as a private company
1960	Acquired by GoI
1972	Delivered the first frigate, INS Nilgiri
1984	Inauguration of undertaking submarine construction
1992	Commissioned first Indian built submarine, INS Shalki
1997	Commissioned first destroyer, INS Delhi
1998	Accredited with ISO certification for shipbuilding
2000	Upgraded to Schedule 'A' status from Schedule 'B'
2006	Awarded Mini Ratna Category-I status
2009	Implementation of enterprise resource planning and systems applications and products
2011	Signed shipbuilding contract for construction and delivery of four P15 B missile destroyers with the MoD
2014	Inauguration of the Mazdock Modernization project.
2015	Launch of first destroyer class ship "Vishakhapatnam" under P15 B project Signed contract for construction and delivery of four frigates with the MoD.
2016	Inauguration of new submarine section assembly workshop at Alcock yard.
2017	Delivery of first Scorpene class submarine "INS Kalvari".

Source: RHP, PhillipCapital India Research

Current Management

Name	Designation	Age (years)	Qualification
Vice Admiral Narayan Prasad (IN Retd)	Chairman & Managing Director	57	<ul style="list-style-type: none"> Joined MDL as CMD on December 30, 2019. Prior to MDL, he was associated with Indian Navy for 36 years B.Tech (Mechanical) from Jawaharlal Nehru University Masters in Mechanical Engineering (Marine) from University of Pune He is recipient of Ati Vishisht Seva Medal and Nav Sena Medal for his service to the Indian Navy
Cdr. Jasbir Singh, (IN Retd)	Director (Submarine & Heavy Engineering)	53	<ul style="list-style-type: none"> Associated with MDL since 2010. prior to MDL, he was associated with Indian Navy for 22 years Bachelors in Mechanical Engineering from Jawaharlal Nehru University, New Delhi MBA from the Faculty of Management Studies, New Delhi
Sanjeev Singhal	Director (Finance) & CFO	55	<ul style="list-style-type: none"> Joined MDL in January 2020. Prior to MDL he was associated with Mishra Dhatu Nigam Limited as Director (finance). He has over 32 years of experience in Finance & Accounting Bachelors in Commerce from University of Mumbai and is a costs accountant from the Institute of Costs Accountants of India
Rear Admiral Anil K Saxena, (IN Retd)	Director (Shipbuilding)	59	<ul style="list-style-type: none"> Associated with MDL since March 2018. Prior to joining MDL, he was associated with Indian Navy for 35 years. Bachelors in engineering from Nagpur University. MBA from Osmania University and Masters in Ship Design from Naval Academy, St. Petersburg
Commodore T V Thomas, (IN Retd)	Director (Corporate Planning and Personnel)	59	<ul style="list-style-type: none"> Joined MDL in May 2013, Prior to MDL, he was associated with Indian Navy for 28 years B. Tech (Mechanical) from Jawaharlal Nehru University, New Delhi M.Tech (Production) from IIT, Bombay

Source: RHP, PhillipCapital India Research

Its capabilities

MDL is the only domestic yard that has capability to build complex platforms such as Destroyers, Frigates, Corvettes and conventional submarines.

Warships	
	<p>Project P 17:</p> <ul style="list-style-type: none"> Project 17 is a class of multi-role frigates in service with Indian Navy. They are the first stealth warships built in India. The construction of the lead ship, Shivalik commenced in December 2000 and was commissioned in April 2010. The second ship, Satpura was launched in June 2004 and commissioned in August 2011. The third and final ship, Sahyadri was launched in May 2005 and commissioned in July 2012.
	<p>Project P 15A:</p> <ul style="list-style-type: none"> Project 15A is a class of stealth guided missile destroyers constructed for the Indian Navy. The class comprises three ships – Kolkata, Kochi and Chennai. The first ship, INS Kolkata was commissioned on August 2014.
	<p>Multipurpose Support Vessel:</p> <ul style="list-style-type: none"> Two multipurpose support vessels designed for diesel fuel, fresh water and deck cargo carriage, ROV operations and for azimuth thruster operation were constructed and delivered to export clients (Mexico)
	<p>Project P 15B:</p> <ul style="list-style-type: none"> The Visakhapatnam class (Project 15B) is a class of stealth guided missile destroyers currently under construction for the Indian Navy. The class comprises four ships - Visakhapatnam, Mormugao, Imphal and Porbandar and will be the largest destroyer to be operated by Indian Navy. The first ship is expected to be commissioned in 2021
	<p>Project P 17A:</p> <ul style="list-style-type: none"> The Nilgiri-class frigate or Project 17A is follow-on of the Project 17 Shivalik-class frigate for the Indian Navy. This class will improve upon the earlier class in terms of stealth. The weapon platform in the P17A ships will be compact and they will be armed with the Barak 8 and BrahMos. The first ship INS Nilgiri is expected to be commissioned in 2022
Submarines	
	<p>Project S46 and S47:</p> <ul style="list-style-type: none"> INS Shalki (S46) and INS Shankul (S47) are Shishumar class diesel electric submarine of Indian Navy INS Shalki was the first ever submarine to be built in India. It was launched in 1987.
	<p>Project P75:</p> <ul style="list-style-type: none"> The Project P75 is a class of diesel-electric attack submarines based on the Scorpène-class submarine. The submarine is capable of offensive operations across the entire spectrum of naval warfare including anti-surface warfare, anti-submarine warfare, intelligence gathering, mine laying and area surveillance. The first submarine, INS Kalvari was commissioned in December 2017.

Its past track record

Since 1960 the company has delivered 795 vessels including 25 warships

Projects	Client	(Nos)
Key projects delivered		
Destroyers	Navy	6
Leander class frigates	Navy	6
Godavari class frigates	Navy	3
Shivalik class frigates	Navy	3
Corvettes	Navy	3
Missile boats	Navy	4
Submarines	Navy	5
Offshore petrol vessels	ICG	7
Total		37
Under construction		
P-15B destroyers	Navy	4
P-17A stealth frigates	Navy	4
Scorpene class submarines	Navy	4

Source: RHP, PhillipCapital India Research

Its infrastructure

After its recent expansion project, MDL can now build 10 warships and 11 submarines concurrently. In addition, it plans to set up a yard in Naha Sheva; this would help it grow its ship repair business.

MDL's shipbuilding infrastructure

Activity/Asset	Capacity	Nos
Shipbuilding:		
Fabrication	1500 tn/pa	
Slipways	27000 DWT	3
Wet Basin	5 warships and 2 submarines simultaneously	2
Dry docks	41.15 x 10.06 x 2.75M, 129.87 x 16.76 x 4.89M, 216 x 18.9 x 5.49M	3
Production shop		1
Assembly shop	4500 sqm; 2xEOT cranes; 40tn units 3000sqm, 2xEOT cranes; 60tn units	2
Module shop with painting chamber for integrated construction	6000sqm; 2xEOT cranes, 1xGoliath crane 300tn	1
Sheet metal shop		1
Pipe shop		1
Machine and fitting shop		1
Electric repair and instrumentation shop		1
Submarine:		
Workshop A - Fabrication unit	3xcranes; 5/20/40tn	1
Workshop B - Construction & Outfitting	3x weld stations; 2xcranes; 10/60tn	1
Workshop C - Outfitting & Boot together	Power house, 3xcranes; 5/16/90tn	1
Workshop D - Cradle painting & Outfitting	2xcranes; 3/10tn	1
Cradle assembly shop	2xcranes; 10/60tn	1
Submarine assembly shop	Pressure testing chamber 6xcranes; 10/20/30/60/150tn	1
Alcock yard shop	Plate rolling, Acoustic chamber	1

Source: RHP, PhillipCapital India Research

Mazagon Dock Shipyard facility


Source: Company

MDL has a capacity to manage ships upto 4000DWT

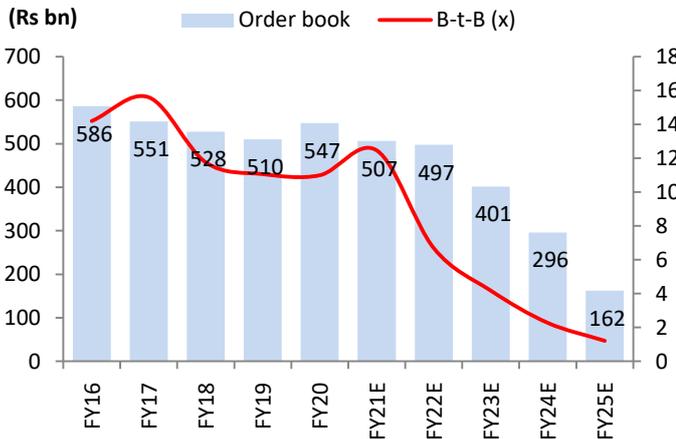
Shipbuilding capacity of major players	Type	Length (mtr)	Width (mtr)	Depth (mtr)	Capacity ('000 DWT)
Public shipyards					
CSL	Public	250.0	38.0	5.5	110.0
HSL	Public	195.0	38.0	17.0	80.0
MDL	Public	180-200	22-27	3.5-10	40.0
Alcock Ashdown (AAL)	Public	130.0	20.0	8.7	15.0
GSL	Public	130.0	20.0	5.0	4.5
GRSE	Public	125.6	14.4	4.1	4.0
Hoogly, CSL	Public	90.0	16.0	4.5	3.0
Shalimar Works	Public	65.0	12.0	3.5	0.1
Private shipyards					
RDEL - Pipavav	Private	350.0	63.0	na	400.0
Bharti Shipyard	Private	250.0	45.0	5.5	70.0
Sembmarine Kakinada (SKL)	Private	200.0	40.0	8.5	50.0
L&T	Private	200.0			30.0
ABG Shipyard	Private	150.0	22.0	8.5	20.0
Chowgule & Co	Private	120.0	20.0	3.3/6	8.0
Titagarh Wagons	Private	150.0	20.0	3.0	8.0
Timblo Drydock	Private	120.0	20.0	4.5	7.5

Source: PhillipCapital India Research, MoS

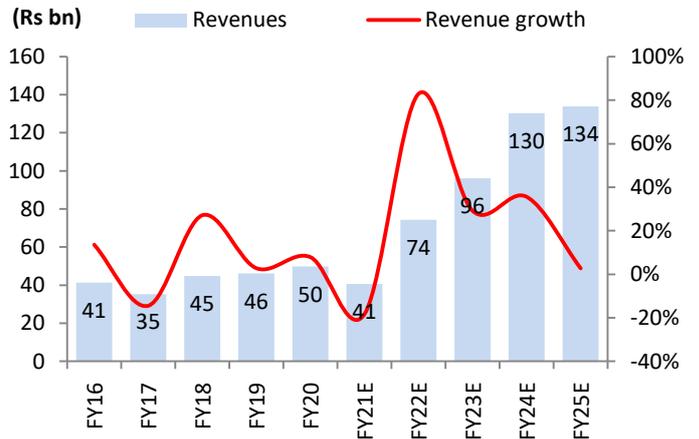
Current orderbook offers revenue visibility

MDL’s current orderbook is 11x its FY20 revenues, this offers a runway for revenue growth for the next five years as it achieves the ‘bell curve’ impact on two of its largest ship building projects viz. Project 15B (Destroyers) and Project 17A (Frigates). In addition, its associate company, Goa Shipyard (47.2% stake), also enjoys a healthy book to bill of 15x TTM sales as it executes order for two advanced frigates.

MDL’s FY20 orderbook is 11x TTM sales...



...thus providing revenue growth visibility for next five years

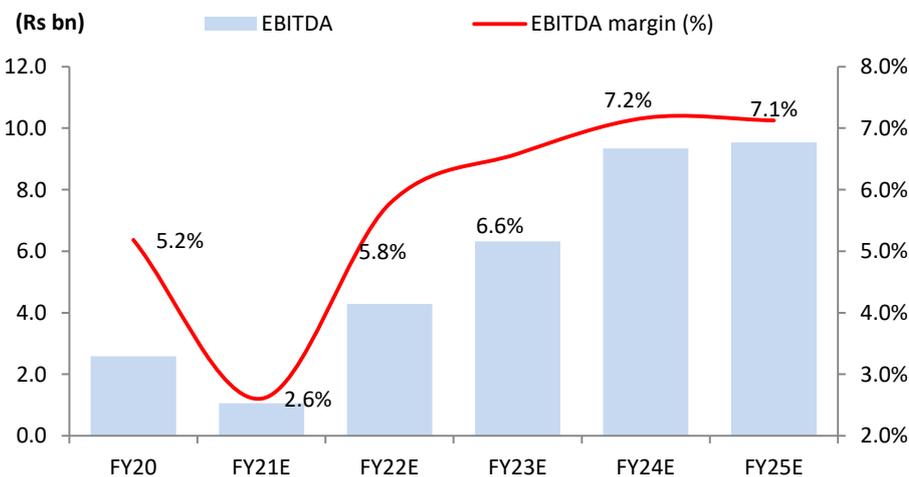


Source: RHP, PhillipCapital India Research

Operating leverage benefits margins

As we expect MDL’s revenues to grow 2.7x over FY20-25, this should also lead to operating leverage gains to its EBITDA margins. Hence we expect MDL’s EBITDA margins to expand 200 bps over FY20-25.

EBITDA margins to expand 200bps over FY20-25



Source: RHP, PhillipCapital India Research

Healthy bid pipeline

Based on our estimates, MDL (or GSL) could potentially bid for Rs 2.1tn of warship/submarine projects of the Indian Navy in the next 10 years. In addition MDL should also benefit from refit opportunities of the Sishumar and Scorpene class submarines of the Navy.

We expect MDL could bid for Rs 2.1tn of projects of the Indian Navy

Project	Nos	Value (Rs bn)	Timeline	Likely bidders
P-75i AIP Submarines	6	420	FY24-25	MDL, L&T
Next Gen Missile Vessels	6	130	FY21-22	GRSE, CSL, MDL, L&T
Next Gen Offshore Patrol Vessels	6	50	FY22-23	L&T, GSL (MDL Associate)
Next Gen Corvettes	7	300	FY24-25	GRSE, MDL, L&T
Next Gen Destroyers (P-18)	6	400-500	FY28-30	MDL, L&T
Next Gen Frigates	6	300	FY28-30	MDL, GRSE, L&T
Mine Sweepers	6	300	On hold	GSL (MDL Associate)
Landing Platform Docks	4	200	On hold	L&T, MDL
Total order opportunity FY21-30	47	2,100		

Source: PhillipCapital India Research

MRLC opportunity for Sishumar class of submarines

Sishumar class of submarines	Value (Rs bn)	Timeline
S-44	13	Order won in FY19
S-45	15	FY24
S-46	15	FY26
S-47	15	FY28
Total	58	

Source: PhillipCapital India Research

Key risks/concerns

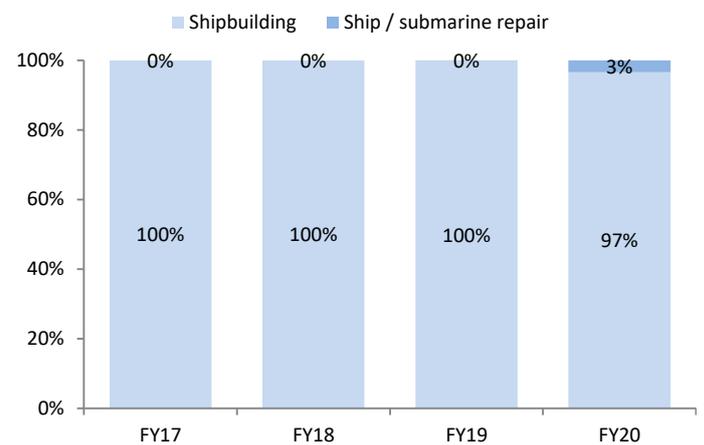
Concentration risk

MDL's current orderbook has very high reliance on a single customer i.e. the Indian Navy. Its revenues are also highly dependent on ship building as relatively higher margin ship repair business accounts for just 3% of sales (FY20).

Order book concentration: 100% of order book is from Indian Navy projects

	Client	(Rs bn)
P-15B Destroyers	Navy	266.1
P-17A Stealth frigates	Navy	236.6
P 75 - Scorpene submarine	Navy	32.9
Submarine refit / ship repair	Navy	11.5
Total		547.1

Revenue concentration: Ship building accounts for 97% of revenues



Source: RHP, PhillipCapital India Research

High competitive intensity

Defence shipbuilding is the most competitive segment of the Indian defence sector. The landscape is occupied by four Ministry of Defence shipyards viz. MDL, GRSE, HSL and GSL. Cochin Shipyard, a Ministry of Shipping entity has begun bidding for defence orders. L&T in the private sector is also a formidable player that is bidding for large submarine and warship projects.

Navy and Coast guard projects won by other ship yards in the past three years

Project	Rs bn	L1 bidder
Pollution control vessel	6	GSL
Floating docks	10	HSL
4 Navy Survey Vessels	21	GRSE
2 Midget Delivery Vehicle	20	HSL
2 Diving Support Vessels	20	HSL
16 - Shallow water Corvettes	120	CSL & GRSE
Total	197	

Source: Media reports, PhillipCapital India Research

Poor execution track record

The last eight ships delivered by MDL were delayed by 52-78 months. Delays could also be partly attributable to the lack of preparedness of the Navy. However, MDL has incurred liquidated damages on account of delays.

On an average ship/submarine deliveries have been delayed by 52-78 months...

Project	Award date	Original Schedule	Actual delivery	Months since award	Months delayed	Balance months
P-17 Frigates						
P-17 - 1	Jan-98	Dec-05	Mar-10	149	52	-
P-17 - 2	Jan-98	Dec-06	Jul-11	165	55	-
P-17 - 3	Jan-98	Dec-07	Jun-12	176	55	-
P-15A Destroyers						
P15-A - 1	Jun-01	Mar-08	Jul-14	160	76	-
P15-A - 2	Jun-01	Mar-09	Sep-15	174	78	-
P15-A - 3	Jun-01	Mar-10	Aug-16	186	78	-
P-75 Scorpene submarines						
P-75 - 1	Oct-05	Dec-12	Sep-17	146	58	-
P-75 - 2	Oct-05	Dec-13	Sep-19	170	70	-
P-75 - 3	Oct-05	Dec-14	na	182	70	-
P-75 - 4	Oct-05	Dec-15	na	182	58	-
P-75 - 5	Oct-05	Dec-16	na	182	45	-
P-75 - 6	Oct-05	Dec-17	na	182	33	-
P-15B Destroyers						
P-15B - 1	Jan-11	Jul-18	na	118	26	-
P-15B - 2	Jan-11	Jul-20	na	118	2	-
P-15B - 3	Jan-11	Jul-22	na	118	-	22
P-15B - 4	Jan-11	Jul-24	na	118	-	47
P-17A Stealth frigates						
P-17A - 1	Feb-15	Aug-22	na	68	-	24
P-17A - 2	Feb-15	Aug-23	na	68	-	36
P-17A - 3	Feb-15	Aug-24	na	68	-	48
P-17A - 4	Feb-15	Aug-25	na	68	-	60

Source: PhillipCapital India Research

...this has warranted MDL to provide for liquidated damages

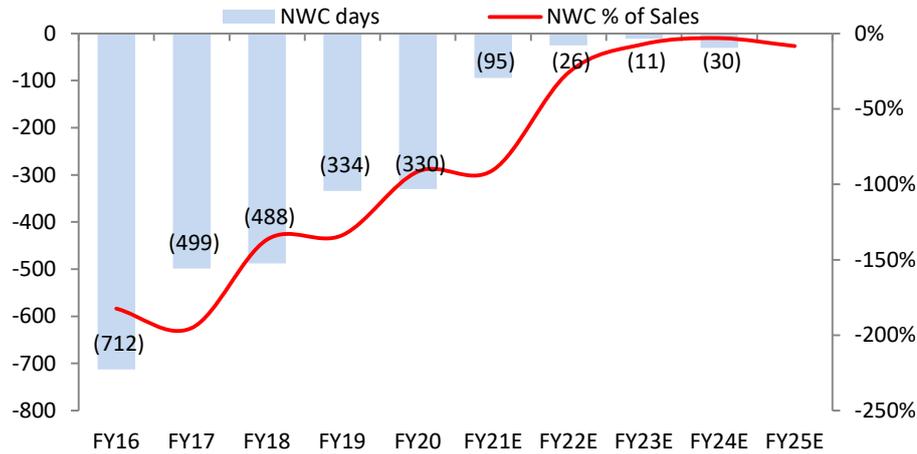
Rs mn	FY17	FY18	FY19	FY20
LD collected from vendors & payable to customer	889	169	409	251
Liquidated damages Provisions o/s	10,241	10,241	10,241	10,241

Source: RHP, PhillipCapital India Research

Risk of deterioration in working capital

Currently MDL runs a negative working capital as it has customer advances/milestone payments (21% of orderbook). However, as revenues can potentially grow by 2.7x in the next five years, it is unlikely that payments from Navy will be able to keep pace with revenue growth.

Net NWC days of sales...



Source: PhillipCapital India Research

Peer comparison

MDL versus other domestic yards

	FY16	FY17	FY18	FY19	FY20
Order book to sales (x)					
MDL	14.2	15.6	11.8	11.1	11.0
CSL	6.3	5.4	4.0	4.9	4.3
GRSE	13.5	23.4	15.1	15.7	18.6
GSL	3.0	3.2	1.5	18.1	16.2
Revenue size (Rs bn)					
MDL	41.3	35.3	44.9	46.1	49.8
CSL	19.9	20.6	23.6	29.7	34.2
GRSE	16.6	9.2	13.5	13.9	14.3
GSL	7.6	10.6	13.7	9.1	9.3
Gross margins (%)					
MDL	27.7%	32.2%	27.4%	25.8%	25.2%
CSL	38.2%	36.2%	39.4%	36.5%	36.8%
GRSE	27.7%	30.7%	30.7%	31.9%	32.7%
GSL	42.3%	38.0%	43.8%	52.6%	47.3%
Employee costs % of Sales					
MDL	18.3%	20.6%	19.7%	14.9%	16.1%
CSL	11.4%	10.6%	11.0%	9.4%	8.9%
GRSE	17.6%	31.0%	22.2%	21.0%	20.7%
GSL	18.9%	14.7%	14.6%	19.4%	18.9%
Other expenses % of Sales					
MDL	4.2%	8.3%	4.4%	5.2%	3.9%
CSL	9.0%	7.0%	8.2%	7.8%	7.2%
GRSE	5.2%	19.2%	9.6%	7.9%	9.1%
GSL	10.7%	7.2%	7.8%	13.5%	8.0%

MDL versus other domestic yards

	FY16	FY17	FY18	FY19	FY20
EBITDA margin (%)					
MDL	5.3%	3.3%	3.3%	5.7%	5.2%
CSL	17.8%	18.6%	20.2%	19.3%	20.7%
GRSE	4.9%	-19.4%	-1.1%	3.0%	2.8%
GSL	12.7%	16.0%	21.5%	19.7%	20.4%
PBT margin (%)					
MDL	22.5%	23.7%	15.5%	17.9%	15.4%
CSL	21.1%	24.0%	26.2%	25.3%	25.2%
GRSE	14.1%	1.4%	9.5%	13.1%	16.4%
GSL	14.5%	16.8%	24.1%	23.2%	28.4%
Revenue to Gross block (x)					
MDL	7.3	5.6	6.1	5.0	4.7
CSL	3.8	4.9	5.3	6.1	4.7
GRSE	4.5	2.4	3.1	3.2	3.5
GSL	1.4	1.5	1.6	1.0	0.9
NWC % of Sales					
MDL	-182%	-195%	-137%	-134%	-92%
CSL	-28%	-23%	-35%	-4%	1%
GRSE	-103%	-175%	-117%	-99%	-138%
GSL	-23%	-54%	-59%	-124%	-114%
RoE					
MDL	27.3%	22.2%	17.9%	20.1%	21.4%
CSL	16.1%	16.7%	15.3%	14.6%	18.1%
GRSE	14.2%	0.6%	8.8%	10.9%	16.5%
GSL	9.5%	15.8%	25.2%	15.0%	20.4%

Source: RHP, PhillipCapital India Research

Comparison with Indian Defence peers

Company name	Price (INR)	Mkt cap (Rs bn)	PE (x)			PBV (x)			RoE (%)			EBITDA margin (%)			CAGR (FY20-23E)		
			FY21E	FY22E	FY23E	FY21E	FY22E	FY23E	FY21E	FY22E	FY23E	FY21E	FY22E	FY23E	Sales	EBITDA	PAT
HAL*	779	260	12.0	8.1	7.8	1.8	1.5	1.4	15.6%	20.4%	18.6%	21.1%	22.9%	22.2%	5%	4%	7%
BEL	90	220	13.3	10.4	9.8	2.1	1.8	1.7	16.1%	18.6%	17.8%	18.9%	20.8%	20.0%	9%	7%	8%
BDL	292	54	13.5	11.8	8.3	1.9	1.7	1.5	14.5%	15.2%	19.2%	19.4%	19.9%	21.2%	8%	5%	6%
Midhani*	189	35	24.5	21.0	17.1	3.3	3.0	2.7	14.2%	14.9%	16.5%	25.5%	26.2%	27.3%	14%	13%	9%
CSL	313	41	7.6	6.9	10.6	1.0	0.9	0.9	13.8%	13.8%	8.4%	19.3%	18.6%	14.9%	2%	-8%	-15%
GRSE*	170	19	12.2	10.0	7.1	1.6	1.5	1.3	14.4%	15.6%	19.2%	4.6%	5.6%	6.5%	44%	91%	17%
MDL*	140	28	7.9	5.3	4.6	1.0	0.9	0.8	13.1%	17.4%	18.0%	2.6%	5.8%	6.6%	24%	35%	2%
Average		130	15.2	13.2	12.0	2.1	1.9	1.7	14.2%	14.6%	14.7%	20.1%	20.0%	19.3%	6%	1%	-2%

Source: PhillipCapital India Research, *Not rated

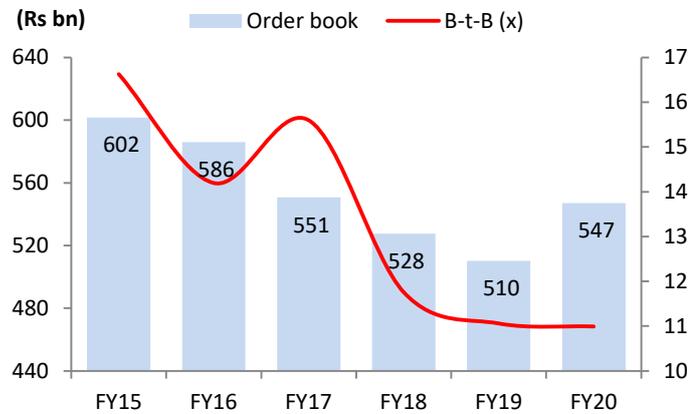
Comparison with global shipbuilding peers

23-Sep-20 Company name	Price (LC)	Mkt cap (USD bn)	PE (x)			PBV (x)			RoE (%)			EBITDA margin (%)		
			FY21E	FY22E	FY23E	FY21E	FY22E	FY23E	FY21E	FY22E	FY23E	FY21E	FY22E	FY23E
Yangzijiang Shipbuilding	1.0	2.8	7.2	7.2	7.2	0.6	0.5	0.5	8.3	8.0	7.2	18.7	18.7	17.3
Keppel Corp Ltd	4.2	5.4	59.4	10.0	8.6	0.7	0.7	0.6	0.0	6.7	7.4	9.0	15.9	17.7
Sembcorp Marine Ltd	0.2	1.3	na	na	35.5	0.2	0.2	0.2	(9.5)	(3.1)	(0.6)	0.1	7.3	10.4
China Shipbuilding Industr-A	4.4	14.5	90.2	78.7	na	1.1	1.1	na	1.3	1.4	na	4.4	4.9	na
CSSC Offshore And Marine E-A	27.9	4.1	na	110.7	na	4.1	4.0	na	2.1	3.7	na	3.3	4.0	na
Daewoo Shipbuilding & Marine	22,800	2.0	7.6	10.9	8.8	0.6	0.6	0.5	7.8	5.0	5.7	7.0	5.9	6.4
Korea Shipbuilding & Offshore	81,200	4.8	24.1	20.6	15.2	0.5	0.5	0.5	1.9	2.2	2.9	4.7	5.0	5.3
Samsung Heavy Industries	5,200	2.8	na	na	372.6	0.7	0.7	0.7	(16.2)	(2.6)	0.1	(4.0)	3.8	4.9
Mitsubishi Heavy Industries	2,469	7.7	na	15.4	10.8	0.7	0.7	0.7	0.1	4.4	6.0	5.6	7.7	7.9
Fincantieri Spa	0.6	1.1	na	9.8	6.1	1.1	1.1	1.0	(4.5)	6.4	14.2	5.0	6.5	7.4
Average			18.0	10.5	12.6	1.1	1.0	0.6	6.5	7.6*	6.8*	7.3	8.8	10.6

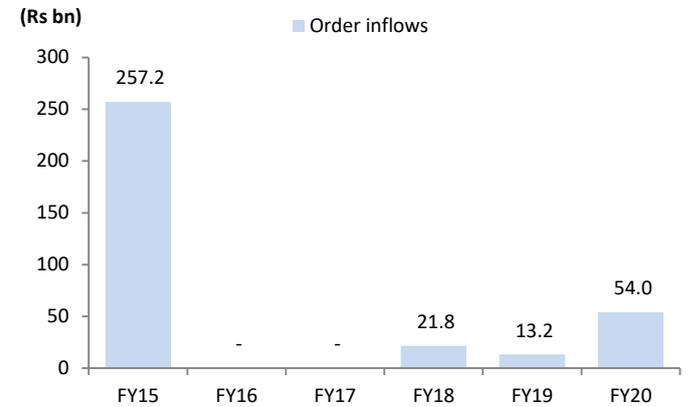
Source: Bloomberg, PhillipCapital India Research

Historical financials in charts

MDL currently has orderbook of Rs 547bn

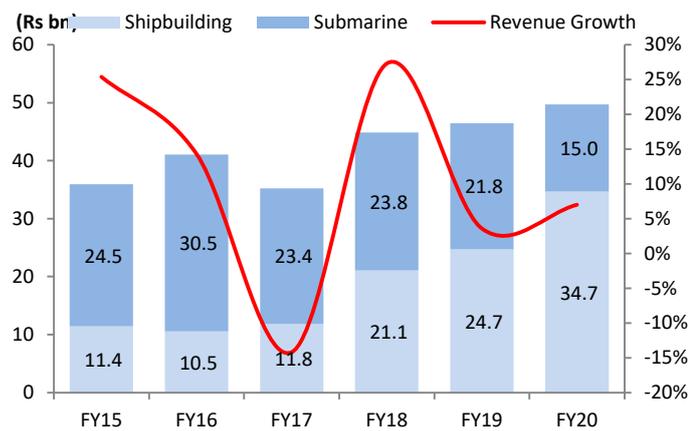


Order inflow trends FY15-20

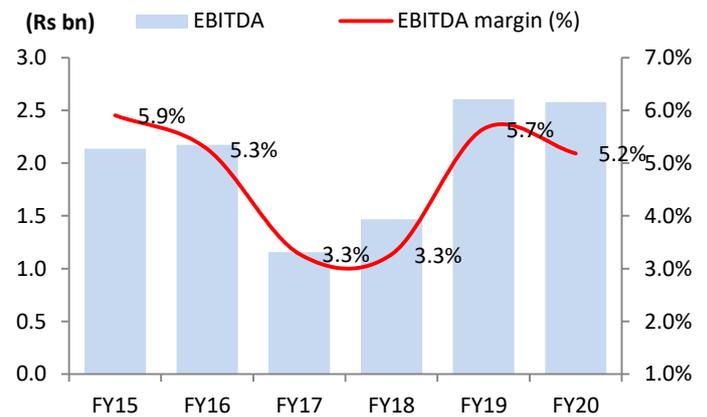


Source: RHP, PhillipCapital India Research

Revenue break up between ship and submarine building

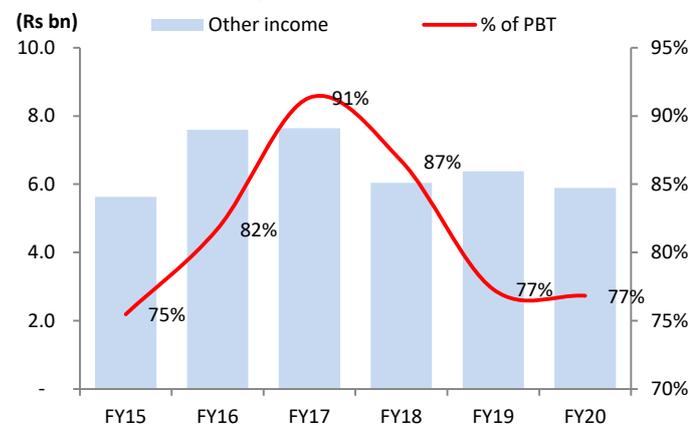


EBITDA margin trends

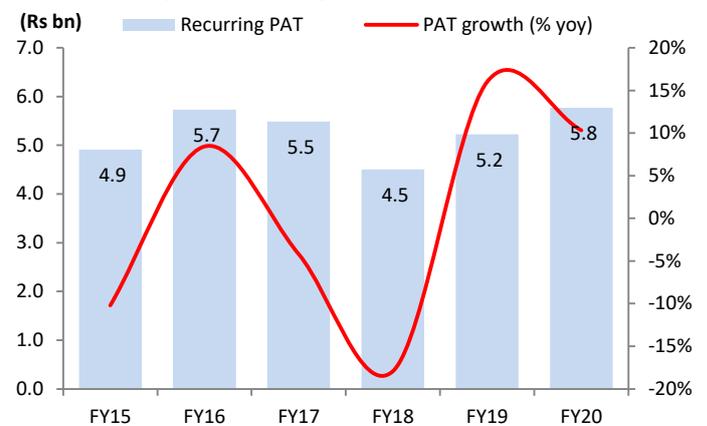


Source: RHP, PhillipCapital India Research

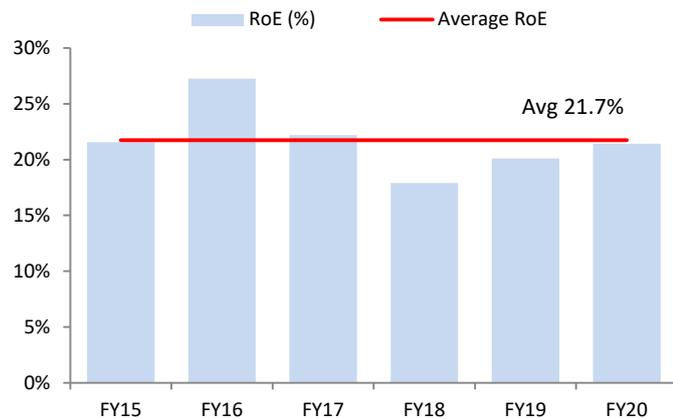
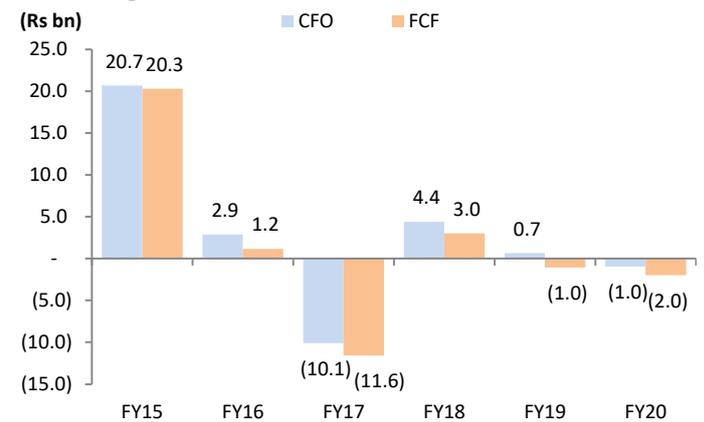
Other income currently accounts 77% of PBT...



...and has supported earnings



Source: RHP, PhillipCapital India Research

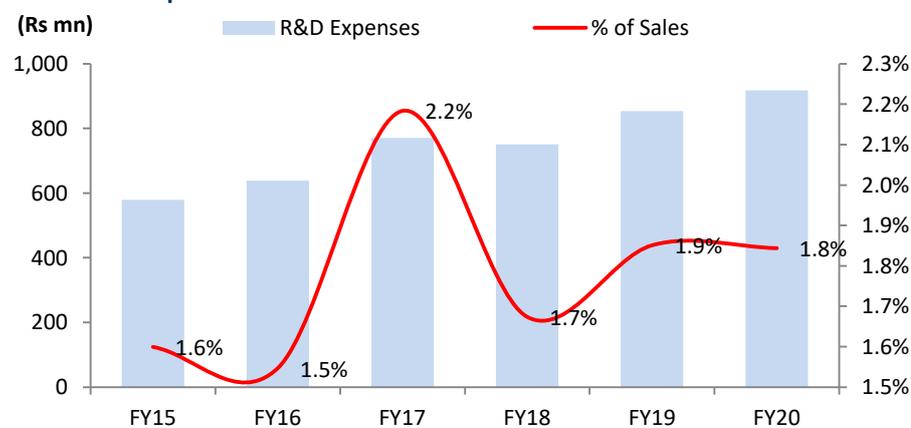
Healthy ROE's despite high cash balance on high asset turns due to a depreciated infrastructure

Cash flow generation is linked to customer advances...


Source: RHP, PhillipCapital India Research

...MDL currently runs a negative working capital as it has customer advances accounting for 21% of its orderbook

Net working capital (Rs bn)	FY15	FY16	FY17	FY18	FY19	FY20
Inventory	185	42	40	38	38	46
Trade receivables	8	17	19	19	24	15
Other receivables	35	29	35	48	53	72
Trade payables	7	11	9	24	29	48
Customer advances	270	137	139	125	131	116
Other liabilities	4	3	2	3	3	2
Provisions	2	13	13	13	13	13
Net working capital ex-cash	(55)	(75)	(69)	(61)	(62)	(46)
Working capital cycle (days)						
Inventory days	1,870	375	417	308	300	339
Trade receivables days	81	152	199	152	189	112
Other receivables days	357	256	364	386	418	527
Trade payables days	72	98	97	196	232	351
Customer advances days	2,725	1,214	1,441	1,016	1,037	847
Other liabilities days	44	26	20	25	23	16
Provisions days	23	111	134	108	103	98
NWC days	(555)	(666)	(712)	(499)	(488)	(334)

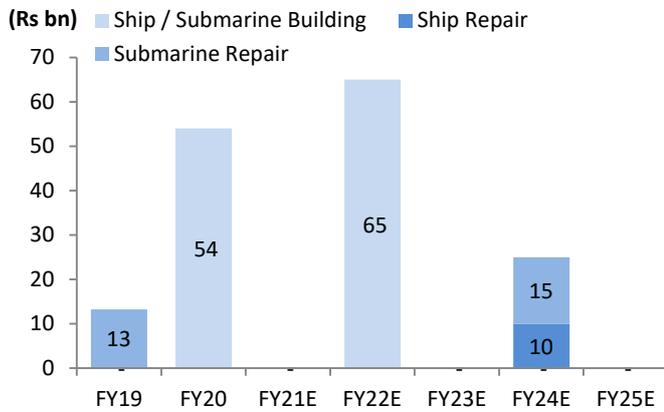
Source: RHP, PhillipCapital India Research

MDL's R&D expenditure is c.2% of sales


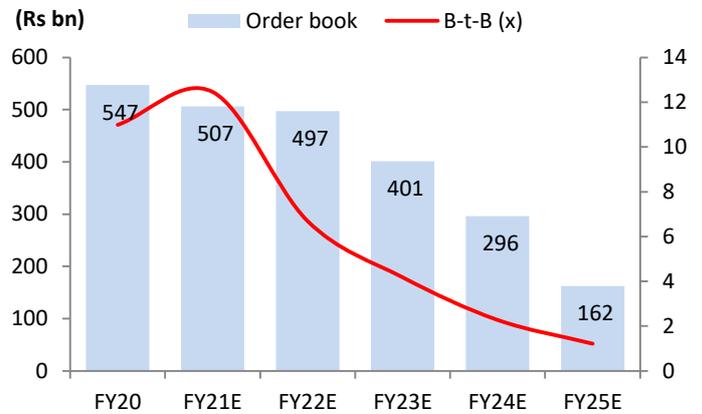
Source: RHP, PhillipCapital India Research

Financial outlook in charts

We assume Rs 90bn of new orders over FY21-25...

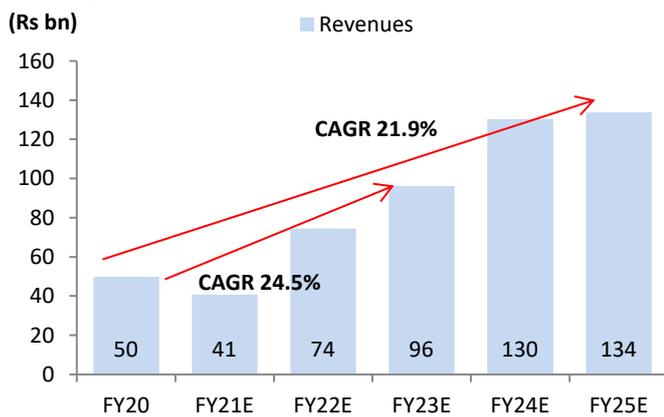


Orderbook to decline as MDL executes orders on hand...

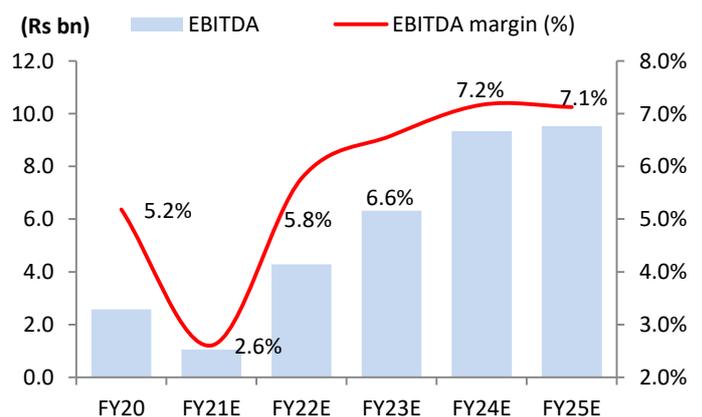


Source: PhillipCapital India Research

...driving a 22% CAGR in FY20-25 revenues...

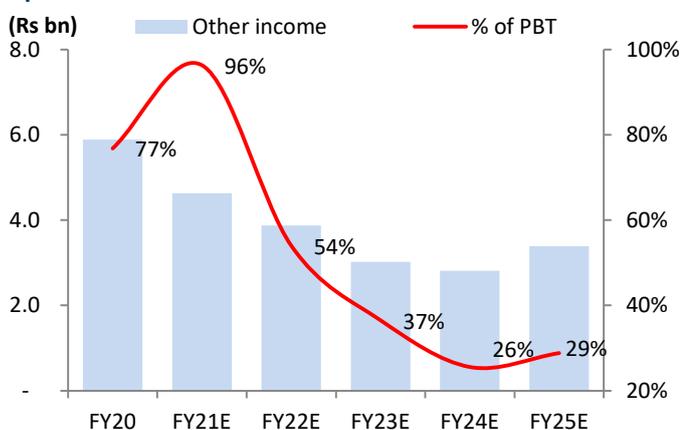


...and 30% CAGR in EBITDA

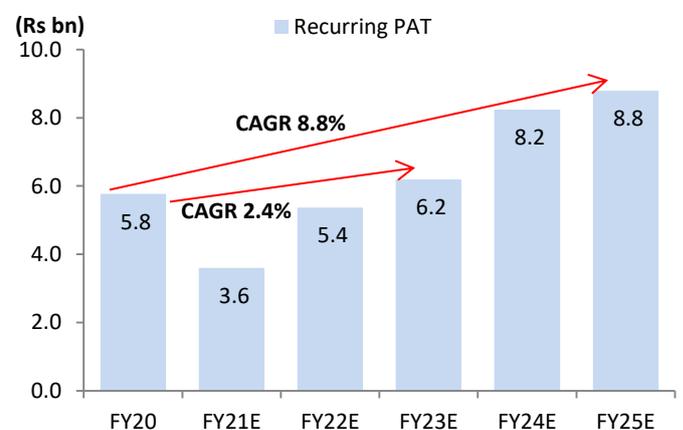


Source: PhillipCapital India Research

However, other income should decline on higher working capital



Leading to 9% CAGR in earnings over FY20-25E

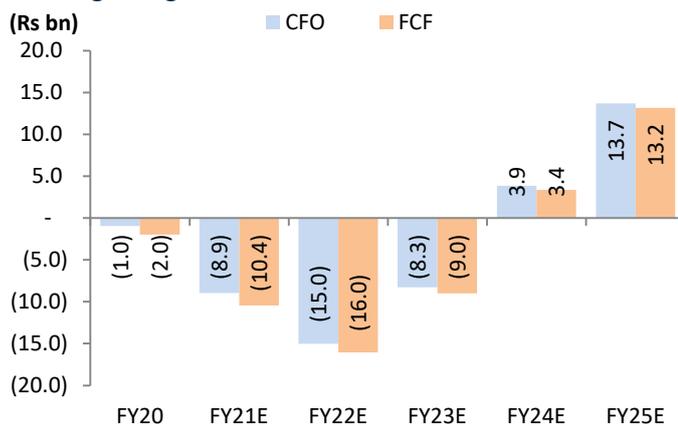


Source: PhillipCapital India Research

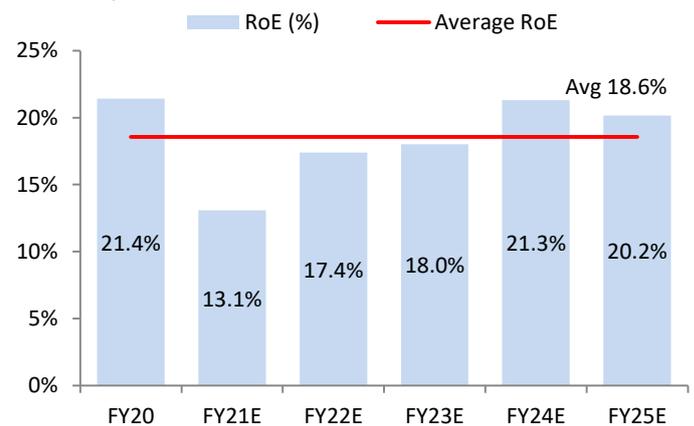
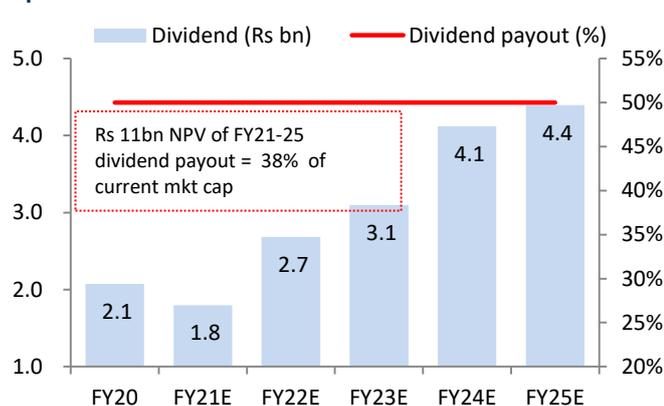
Payments from Navy will not be able to keep pace with revenue growth

Net working capital (Rs bn)	FY20	FY21E	FY22E	FY23E	FY24E	FY25E
Inventory	46	37	70	83	92	95
Trade receivables	15	21	41	54	77	81
Other receivables	72	65	64	69	82	59
Trade payables	48	37	63	72	100	102
Customer advances	116	109	109	112	118	106
Other liabilities	2	2	4	5	6	6
Provisions	13	12	19	24	31	32
Net working capital ex-cash	(46)	(37)	(19)	(7)	(4)	(11)
Working capital cycle (days)						
Inventory days	339	328	346	314	259	259
Trade receivables days	112	188	201	206	216	221
Other receivables days	527	584	314	264	229	161
Trade payables days	351	328	308	275	279	279
Customer advances days	847	978	537	427	332	288
Other liabilities days	16	19	18	18	17	17
Provisions days	98	105	94	91	88	88
NWC days	(334)	(330)	(95)	(26)	(11)	(30)

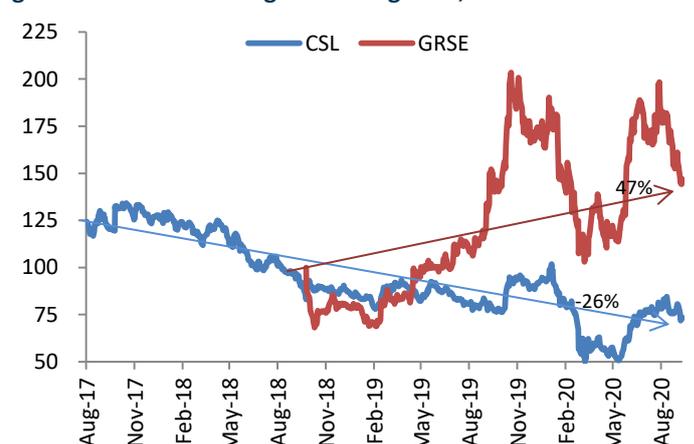
Source: PhillipCapital India Research

Resulting in negative cash flows in the near term


Source: PhillipCapital India Research

However, MDL should be able to earn c.19% ROE's

NPV of likely dividend payout over FY21-25 = 38% of market cap


Source: PhillipCapital India Research

Price performance of GRSE – representing strong revenue growth and CSL – facing an earnings cliff, since their IPO's


SOTP based target price derivation: We ascribe a 8x PE to September 2022 earnings, our target multiple is at a 60% premium to IPO valuations

Business	Stake (%)	EPS (Rs) / PAT (Rs bn)				CAGR FY20-23E	EPS/PAT Sept-2022	Target multiple (x)	Total Value (Rs bn)	MDL's value	
		FY20	FY21E	FY22E	FY23E					(Rs bn)	(Rs / sh)
MDL EPS ex-GSL dividend	100%	27.0	16.3	25.0	29.2	3%	27.1	8.0	44	44	217
Goa Shipyard (PAT)	47%	1.98	1.68	1.93	2.32	5%	2.1	8.0	17	8	40
Target price									61	52	257

Source: PhillipCapital India Research

Financials

Income Statement

Y/E Mar, Rs mn	FY20	FY21E	FY22E	FY23E
Net sales	49,777	40,655	74,349	96,051
Growth, %	7.9	(18.3)	82.9	29.2
Raw material expenses	(37,232)	(29,669)	(57,178)	(75,495)
Employee expenses	(8,029)	(8,403)	(8,790)	(9,190)
Other Operating expenses	(1,936)	(1,525)	(4,089)	(5,043)
EBITDA (Core)	2,580	1,059	4,292	6,324
Growth, %	(1.0)	(59.0)	305.3	47.4
Margin, %	5.2	2.6	5.8	6.6
Depreciation	(711)	(797)	(881)	(938)
EBIT	1,870	262	3,411	5,386
Growth, %	(4.8)	(86.0)	1,201.7	57.9
Margin, %	3.8	0.6	4.6	5.6
Interest paid	(93)	(85)	(112)	(129)
Other Income	5,890	4,629	3,874	3,023
Pre-tax profit	7,667	4,806	7,173	8,281
Tax provided	(1,900)	(1,211)	(1,808)	(2,087)
PAT pre-minority	5,767	3,595	5,365	6,194
Others (minority, associates)	-	-	-	-
Net Profit (recurring)	5,767	3,595	5,365	6,194
Growth, %	10	(38)	49	15
Net Profit (reported)	4,150	3,595	5,365	6,194
Unadj. shares (m)	202	202	202	202
Wtd avg shares (m)	202	202	202	202

Balance Sheet

Y/E Mar, Rs mn	FY20	FY21E	FY22E	FY23E
Cash & bank	58,017	51,656	37,582	28,810
Debtors	14,744	12,809	22,407	30,263
Inventory	46,227	36,579	70,494	82,734
Other assets	72,431	73,125	82,581	93,468
Total current assets	1,91,419	1,74,170	2,13,064	2,35,274
Investments	60	60	60	60
Gross fixed assets	11,130	12,630	13,630	14,330
Less: Depreciation	(2,647)	(3,443)	(4,324)	(5,262)
Add: Capital WIP	800	800	800	800
Net fixed assets	9,283	9,986	10,106	9,868
Total assets	2,00,762	1,84,216	2,23,229	2,45,202
Current liabilities	1,65,551	1,47,585	1,75,689	1,89,369
Provisions	13,418	11,705	19,046	23,828
Total current liabilities	1,78,969	1,59,290	1,94,735	2,13,197
Deferred tax liabilities, net	(4,117)	(4,117)	(4,117)	(4,117)
Borrowings	-	-	-	-
Non-current liabilities	(4,117)	(4,117)	(4,117)	(4,117)
Minority Interest	-	-	-	-
Total liabilities	1,74,853	1,55,173	1,90,619	2,09,081
Paid-up capital	2,017	2,017	2,017	2,017
Reserves & surplus	23,892	27,026	30,594	34,105
Shareholders' equity	25,909	29,043	32,611	36,122
Total equity & liabilities	2,00,762	1,84,216	2,23,229	2,45,202

Source: Company, PhillipCapital India Research Estimates

Cash Flow

Y/E Mar, Rs mn	FY20	FY21E	FY22E	FY23E
Pre-tax profit	7,667	4,806	7,173	8,281
Depreciation	711	797	881	938
Chg in working capital	(1,660)	(8,791)	(17,522)	(12,521)
Total tax paid	(2,082)	(1,211)	(1,808)	(2,087)
Cash flow from operating activities	(955)	(8,943)	(15,038)	(8,284)
Capital expenditure	(1,017)	(1,500)	(1,000)	(700)
Chg in investments	-	-	-	-
Cash flow from investing activities	4,537	3,129	2,874	2,323
Free cash flow	(1,972)	(10,443)	(16,038)	(8,984)
Equity raised/(repaid)	(2,779)	-	-	-
Debt raised/(repaid)	-	-	-	-
Dividend (incl. tax)	(2,618)	(462)	(1,797)	(2,683)
Other financing activities	(649)	(85)	(112)	(129)
Cash flow from financing activities	(6,046)	(547)	(1,909)	(2,811)
Net chg in cash	(2,464)	(6,361)	(14,074)	(8,772)

Valuation Ratios

	FY20	FY21E	FY22E	FY23E
Per Share data				
EPS (INR)	28.6	17.8	26.6	30.7
Growth, %	22.6	(37.7)	49.3	15.4
Book NAV/share (INR)	128.5	144.0	161.7	179.1
FDEPS (INR)	28.6	17.8	26.6	30.7
CEPS (INR)	32.6	21.8	31.0	35.4
DPS (INR)	10.3	8.9	13.3	15.4
Return ratios				
Return on assets (%)	2.9	1.9	2.7	2.7
Return on equity (%)	21.4	13.1	17.4	18.0
Return on capital employed (%)	26.6	15.7	20.4	20.8
Turnover ratios				
Asset turnover (x)	(1.1)	(1.3)	(4.1)	(31.9)
Sales/Total assets (x)	0.2	0.2	0.4	0.4
Sales/Net FA (x)	6.0	4.6	8.0	10.5
Working capital/Sales (x)	(0.9)	(0.9)	(0.3)	(0.1)
Working capital days	(334.1)	(330.2)	(94.5)	(25.6)
Liquidity ratios				
Current ratio (x)	1.1	1.1	1.1	1.1
Quick ratio (x)	0.8	0.9	0.7	0.7
Interest cover (x)	20.2	3.1	30.5	41.9
Dividend cover (x)	2.8	2.0	2.0	2.0
Total debt/Equity (%)	-	-	-	-
Net debt/Equity (%)	(2.2)	(1.8)	(1.2)	(0.8)
Valuation				
PER (x)	5.1	8.1	5.5	4.7
PEG (x) - y-o-y growth	0.2	nm	0.1	0.3
Price/Book (x)	1.1	1.0	0.9	0.8
Yield (%)	7.1	6.1	9.2	10.6
EV/Net sales (x)	nm	nm	nm	0.0
EV/EBITDA (x)	nm	nm	nm	0.1

Rating Methodology

We rate stock on absolute return basis. Our target price for the stocks has an investment horizon of one year. We have different threshold for large market capitalisation stock and Mid/small market capitalisation stock. The categorisation of stock based on market capitalisation is as per the SEBI requirement.

Large cap stocks

Rating	Criteria	Definition
BUY	>= +10%	Target price is equal to or more than 10% of current market price
NEUTRAL	-10% > to < +10%	Target price is less than +10% but more than -10%
SELL	<= -10%	Target price is less than or equal to -10%.

Mid cap and Small cap stocks

Rating	Criteria	Definition
BUY	>= +15%	Target price is equal to or more than 15% of current market price
NEUTRAL	-15% > to < +15%	Target price is less than +15% but more than -15%
SELL	<= -15%	Target price is less than or equal to -15%.

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