Cochin Shipyard Ltd (CSL)

1st June 2023 | CMP – ₹496.6/- | View – **ACCUMULATE**

Q4FY23 Result Highlights

- **Q4FY23 performance impacted by shifting of revenues and deferral of orders –** Cochin Shipyard Ltd (CSL) reported ₹5.77bn in revenues, down ~52.4% YoY & 8.5% QoQ due to limited order backlog under execution (timing mismatch) in FY23, the reversal of ₹2.8bn of revenues booked in 9MFY23 and some more in Q4FY23 further into FY24 and a deferral in start of orders won in the fag-end of FY22. Deferral/shift of execution in ship-building also led to deferral/shift of profitability into future years. The revenue recognition pattern changed in Q4FY23, leading to lower shipbuilding segment revenue at ₹4.37bn, down 54.5% YoY and 3.5% QoQ. The shipbuilding contract price is split into two parts by the company - the hull and platform. The change in recognition happened in Q4FY23 where revenue recognition from the hull part has been lowered and carried forward into the platform part, which can be seen in Q1FY24, having most of the ship building contracts finishing around the current quarter. Also, the lower revenue is further explained by the low order backlog booked until Dec'22, given ship-building typically takes 11-14 months for order completion. However, order backlog, at ₹214bn is robust with Defence at ₹175bn, (2) Commercial-Domestic at ₹13bn, (3) Commercial-Exports at ₹24bn and (4) Subsidiaries at ₹3bn. The management views ₹48bn in the RFP stage, which includes ₹42bn Next Generation Offshore Patrol Vessels (NGOPV). All put together, CSL sees ₹93 bn in immediate opportunity, which can be contested by five shipyards in the country. The company declared final dividend of ₹3/- per share (F.V ₹10/-) including interim dividends of ₹14/- per share.
- **Competition picking up at high discounts of 20% in ship repair segment –** Few projects from ONGC, which were expected by the company, given its expertise in the segment, was won by the competitors who have priced a minimum 20% lower than the company. Also, one of the large naval projects in Mumbai undertaken by the company had seen a set of difficulties and did not go exactly as it envisaged. Yet, the outlook for FY24 largely remains good at ₹9bn with large projects lined up from the Navy, an MoU between Lakshadweep and Cochin Shipyard, which expired in the past yet returned in the order backlog for FY24.
- In the ship repair segment, CSL is coming up with a new large dry dock and an international ship repair facility, which is being executed by Larsen & Toubro as a turnkey contractor; its big crane would be from Hyundai Korea. The project, Phase – I is expected to be completed by Dec'23 with full commissioning by Dec'24, is expected to generate around ₹2.5bn in the initial 24 months and increase to ₹5-6bn after two years
- **Lease contract cost recognition considered from effective environmental clearance date –** The lease contracts that the company had undertaken were capitalised in entirety for FY23: these were again recognized with an effective date starting from the environmental clearance date, leading to a one-off expenditure of ₹620 mn in other income for Q4FY23.
- **Capital outlay to generate incremental revenue and allow adoption technologically –** CSL is proceeding with the construction of India's first hydrogen fuel cell vessel, which is still not financially conclusive at the moment, but would allow the company to be among the leaders in this technology. This is done through a partnership with a tech company in India to develop the fuel cell, moving forward with an innovative startup, maritime startup fund, implemented through IIT Madras and Indian Institute of Management Kozhikode. The project is expected to be completed by Sep'24, with pilot trails expected to be initiated in the backwaters of Cochin.

Important Statistics

MCAP (₹ bn)	65.3
52week H/L (₹)	687/296
NSE Code	COCHINSHIP
BSE Code	540678

Shareholding pattern	Mar'23 (%)
Promoters	72.9
FII	3.8
DII	6.3
Public & Others	17.0

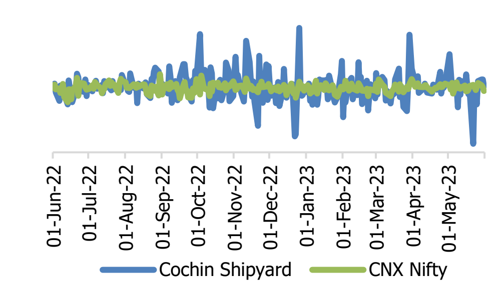
(₹ mn)

Particulars	FY20	FY21	FY22
Net Revenue	**34,194**	**28,189**	**31,900**
EBITDA	**7,088**	**7,198**	**6,305**
EBITDA Margin (%)	*20.7*	*25.5*	*19.8*
Net Profit	**6,377**	**6,102**	**5,866**
EPS (₹)	48.5	46.4	44.6
DPS (₹)	15	15.5	16.8
RoE (%)	18.1	15.6	14.1
RoCE (%)	14.4	19.6	16.6
P/E (x)	10.2	10.7	11.1
EV/EBITDA (x)	7.1	7.1	6.5
P/BV (x)	1.8	1.6	1.5

Particulars	FY23P	FY24E	FY25E
Net Revenue	23,305	36,198	49,072
EBITDA	2,651	5,207	6,898
EBITDA Margin (%)	*11.4*	*14.4*	*14.1*
Net Profit	3,345	4,599	5,597
EPS (₹)	25.4	35.0	42.6
DPS (₹)	17.0	18.0	20.0
RoE (%)	7.6	9.8	12.1
RoCE (%)	8.5	10.1	11.9
P/E (x)	19.5	14.2	11.7
EV/EBITDA(x)	9.7	4.0	2.8
P/BV (x)	1.5	1.4	1.3

Source: Company,Way2Wealth

Relative Performance



Source: Company,Way2Wealth

W2W Lighthouse - A Quick Perspective

- **Looking at healthy order growth from Europe** – CSL believes that the current Commercial Exports order book of ₹24bn is expected to grow to ₹60bn in the next 2-3 years, which is attributable to the recent Commissioning Service Operation Vessels (CSOV) contracts and zero emission feeder container vessels, which the company took part of, is an emerging space. A possibility for replacement of 2,000 to 2,500 vessels in Europe, in the next 10 years, at the backdrop of green energy transition and regulations Europe is undergoing at the moment.
- **Fast-growing European green vessel market may yield 20% business share –** CSL stated that it is well-placed from the perspective of the growing European market for short-sea green vessels. Against about 50 vessels in all supplied to Western Europe over the past two decades by CSL, it shared replacement opportunity of 2,000-2,500 vessels in Europe over the next decade. The changing regulatory environment would make the dominant share of share replacements to happen for green vessels. The company has recently received good references in this area (autonomous vessels supplied to the leading grocery chain in Norway) and has long-standing relationships with more than 100 customers in Europe for short-sea vessels. Such commercial businesses from Europe account for ~12% of the backlog (negligible share of revenues) and CSL expects this to become 20% of business over time.
- **Encouraging regulatory environment for growth –** CSL views that the enhancement of the ship-building financial assistance scheme to 30% for promotion of green shipping would be largely good for it to get in more orders for green ships. A new policy, Green Tug Transition, where the ports are to procure tugs made only in India is also expected to benefit the company. The subsidiary company Udupi Cochin Shipyard Limited has already secured four contracts from the Indian private sector, which are to be ultimately deployed in Indian ports.
- **INS Vishal (IAC-2) likely to replace INS Vikramaditya,** commissioned in late 2013, would be nearing retirement by the time IAC-2 gets inducted (before 2035). CSL restricted its view to publicly available news on IAC-2. Usually, IAC requires 4-5 years from Acceptance of Necessity (AoN) to crystallize in a Letter of Offer and Acceptance (LoA). Thereby, even if India aims to start construction in 2028-assuming seven years for construction and commissioning by 2035-AoN for INS Vishal should be out in 2023. To put that in context, the French future class aircraft carrier, PANG, is expected to begin construction by 2025 and aims for full completion in 2038. India, moreover in the 2035+ era, cannot risk its defence strategy with one aircraft carrier, as aircraft carriers are known for blocking operations during long maintenance period.
- **China, Pakistan's A2/AD capability pose a serious threat to IAC-2 order inflow –** Anti-access/ area denial (A2/AD) is essentially a multi-layered defensive strategy that employs long-range ballistic and cruise missiles, attack drones, and cyber weapons (deployed in coastal areas), warships, submarines, and fast attack craft to deter enemy carrier operations. To illustrate, US Navy considered China's evolved A2/AD strategy a serious threat to its fleet of some 11 advanced 100,000-tonne nuclear-powered aircraft carriers.
- CSL guided for FY24 around ₹9bn revenues from its ship repair segment and ₹30bn revenues from its ship-building segment, whereas the EBITDA margins on the same are expected to be 18-19% for ship repair and 12-13% for ship building, with a 14-15% overall. The decline in margin is majorly attributable to the competitive bidding process taking place in the naval projects. International projects are negotiable, but still largely are competitive, in a broader sense, international projects are expected to generate higher margins, whereas the ship-building segment where higher volumes are there, margins are expected to be 12-13%.

View

CSL saw very weak Q4FY23 due to deferral and shifting of past execution that would only boost execution in FY24. The management highlighted healthy order backlog and strong order pipeline, comforting on execution in FY25. Growing the European green short-sea vessel market and supportive policy for indigenization in India bode well for CSL. Such a move to a more balanced Defense: Non-Defense business mix (60/55%:45/40%) will lead to a power sustainable margin. The ₹240bn order backlog (9.2x FY23 revenue) should translate into ₹40-50bn revenue in a normal year. However, Next Generation Missile Vessel (NGMV) is slated to begin in FY25. Similarly, supply chain issues deterred ASW Corvette execution. Earlier, IAC with a higher hull led to higher EBIT margin, which is now a thing of the past. Yet CSL aims for 14-15% in ship-building EBIT margin going forward. Additional big ticket order wins like IAC-2 or stronger inroads in to dredging and allied verticals should boost revenue, margins and profitability. **Hence, we continue to maintain our *ACCUMULATE* stance with the stock trading at P/E 11.7x FY25E EPS of ₹42.6**.

1st June 2023 CMP – ₹496.6/- View – **ACCUMULATE**

FINANCIAL PERFORMANCE

(₹ mn)

Particulars	Q4FY23	Q4FY22	YoY(%)	Q3FY23	QoQ (%)	FY23	FY22	YoY (%)
Revenue	5,770	12,114	(52.4)	6,309	(8.5)	23,305	31,900	(26.9)
EBITDA	(662)	2,992	(122.1)	1,539	(143.0)	2,651	6,289	(57.8)
EBITDA Margin (%)	*(11.5)*	*24.7*	*(3,617)*	*24.4*	*(3,586)*	*11.4*	*19.7*	*(834)*
Net Profit	473	2,841	(83.3)	1,184	(60.0)	3,345	5,866	(43.0)
EPS (₹)	3.6	21.6	(1,800)	9.0	(540)	25.4	44.6	(1,917)

Source: Company, Way2Wealth

SEGMENTAL PERFORMANCE

(₹ mn)

Revenue	Q4FY23	Q4FY22	YoY (%)	Q3FY23	QoQ(%)	FY23	FY22	YoY (%)
Ship Building	4,366	9,591	(54.5)	4,523	(3.5)	17,665	25,114	(29.7)
Ship Repair	1,404	2,523	(44.4)	1,786	(21.4)	5,640	6,786	(16.9)
EBIT								
Ship Building	(878)	2,331	(137.7)	1,158	(175.8)	2,078	5,775	(64.0)
% Margin	*(20.1)*	*24.3*	*(4,442)*	*25.6*	*(4,572)*	*11.8*	*23.0*	*(1,123)*
Ship Repair	209	730	(71.4)	580	(64.0)	955	1205	(20.8)
% Margin	*14.9*	*28.9*	*(1,405)*	*32.5*	*(1,759)*	*16.9*	*17.8*	*(83)*

Source: Company,Way2Wealth

FINANCIALS & VALUATIONS

(₹ mn)

Particulars	FY19	FY20	FY21	FY22	FY23P	FY24E	FY25E
Net Revenue	**29,622**	**34,194**	**28,189**	**31,900**	**23,305**	**36,198**	**49,072**
EBITDA	**5,717**	**7,088**	**7,198**	**6,289**	**2,651**	**5,207**	**6,898**
EBITDA Margin (%)	*19.3*	*20.7*	*25.5*	*19.7*	*11.4*	*14.4*	*14.1*
Net Profit	**4,812**	**6,377**	**6,102**	**5,866**	**3,345**	**4,599**	**5,597**
EPS (₹)	36.6	48.5	46.4	44.6	25.4	35.0	42.6
DPS (₹)	13	15	15.5	16.8	17.0	18.0	20.0
RoE (%)	14.6	18.1	15.6	14.1	7.6	9.8	12.1
RoCE (%)	18.6	14.4	19.6	16.6	8.5	10.1	11.9
Cash Balances	25,772	21,952	22,089	32,127	46,718	44,823	48,032
FCF	(7,322)	(2,100)	3,122	11,908	17,226	11,091	9,937
P/E (x)	13.6	10.2	10.7	11.1	19.5	14.2	11.7
EV/EBITDA(x)	7.4	7.1	7.1	6.5	9.7	4.0	2.8
P/BV (x)	2.0	1.8	1.6	1.5	1.5	1.4	1.3

Source: Company,Way2Wealth

Disclosure of Interest Statement Cochin Shipyard Ltd. as on 01st June 2023

Name of the Security	Cochin Shipyard Ltd.
Name of the analyst	Jayakanth Kasthuri
Analysts' ownership of any stock related to the information contained Financial Interest Analyst : Analyst's Relative : Yes / No Analyst's Associate/Firm : Yes/No	NIL No No No
Conflict of Interest	No
Receipt of Compensation	No
Way2Wealth ownership of any stock related to the information contained	NIL
Broking relationship with company covered	NIL
Investment Banking relationship with company covered	NIL