

10<sup>th</sup> December 2020

CMP – ₹358.2/-

View – BUY

**Company Background**

Cochin Shipyard Ltd (CSL) was incorporated in the year 1972 as a fully owned Government of India company. In the last three decades the company has emerged as a forerunner in the Indian Shipbuilding & Ship-Repair industry. This yard can build and repair the largest vessels in India. It can build ships upto 110,000 DWT and repair ships upto 125,000 DWT. The yard has delivered two of India's largest double hull Aframax tankers each of 95,000 DWT. CSL has secured shipbuilding orders from internationally renowned companies from Europe & Middle East and nominated to build the country's first indigenous Air Defense Ship INS Vikrant. Shipyard commenced ship repair operations in the year 1982 and has undertaken repairs of all types of ships including upgradation of ships of oil exploration industry as well as periodical layup repairs and life extension of ships of Navy, Coast Guard, Fisheries and Port Trust besides merchant ships of SCI & ONGC. The yard has, over the years, developed adequate capabilities to handle complex and sophisticated repair jobs. The Company has built a variety of vessels ranging from bulk carriers, tankers and passengers ships to offshore support vessels and port crafts. The Shipyard also trains graduate engineers to marine engineers who later join ships both Indian and foreign as 5th Engineers. 100 people are trained every year. The stock debuted at ₹435 on BSE on 11 August 2017 a premium of 0.69% compared to the IPO price of ₹432 per share. After the successful completion of the IPO Government of India's stake in the company declined to 75% from 100%. On 10 October 2017 CSL announced that it has received communication from the Integrated Headquarters Ministry of Defence (Navy) New Delhi that the company has emerged as the L1 bidder for 16 Nos. ASW-SWC Project for the Indian Navy. The contract for eight vessels was worth ~₹54bn. The order was bagged against a competitive tender issued by the Ministry of Defence in which both private and public sector yards had participated. Cochin Shipyard Limited (CSL) announced that it will begin the work on its ₹9.7bn International Ship repair Facility (ISRF) at Cochin Port Trust on 17 November 2017. The facility can repair up to 85 vessels and CSL will thereby be almost doubling the number of ships that can be repaired per year. On 11 January 2018 Cochin Shipyard Limited (CSL) signed an MOU with Mumbai Port Trust (MbPT) for management and operation of the Ship repair Facilities at Mumbai Port trust. As per the terms of the MOU MbPT and CSL are to associate with each other for utilizing the Indira Dock facility at Mumbai Port to set up a Professional Ship Repair Eco system that would be beneficial for the commercial as well as Defence Ship Repair Industry in India. The MOU also provides for expansion of the Ship repair capacity within the Indira Dock that may include setting up of a Floating Dry-Dock (FDD) and upgrading existing facility at HDD thereby enhancing the existing Ship repair Capacity in Mumbai Area. This would serve the increasing Ship Repair demands in Mumbai area being one of the key ports of India that connect internationally. On 29 January 2018 Cochin Shipyard signed contracts for construction of 16 Nos. Tuna Long Lining & Gillnetting Fishing Vessels under the diversification of trawl fishing boats from palk bay into deep sea fishing boats under Blue Revolution Scheme with financial assistance from Government of India and the Government of Tamil Nadu. On 02 February 2018 CSL and Joint Stock Company United Shipbuilding Corporation (USC) Russia signed a Memorandum of Understanding (MoU) to collaborate and engage in Design Development and Execution of High-End State-of-Art vessels for Inland and Coastal Waterways. USC a Joint Stock company is the largest shipbuilding holding in Russia incorporating about 40 enterprises including shipyards with more than 300 years' experience which have been key contributors to the growth of Inland Waterways in Russia. CSL & USC target to associate in development of High-Speed Vessels River-Sea Cargo Vessels Passenger Vessels Hovercrafts and other watercrafts predominantly for the Indian Waterways.

**Important Statistics**

|                |            |
|----------------|------------|
| MCAP (₹bn)     | 47.12bn    |
| 52week H/L (₹) | 491.2/209  |
| NSE Code       | COCHINSHIP |
| BSE Code       | 540678     |

**Financials**

| (₹ mn)            |        |        |        |
|-------------------|--------|--------|--------|
| Particulars       | FY19   | FY20   | 1HFY21 |
| Net Revenue       | 29,656 | 34,225 | 9,899  |
| EBITDA            | 5,726  | 7,093  | 1,428  |
| EBITDA Margin (%) | 19.3   | 20.7   | 14.4   |
| Adjusted PAT      | 4,812  | 6,377  | 1,510  |
| EPS (₹)           | 36.6   | 48.5   | 11.5   |
| DPS (₹)           | 13.0   | 16.6   |        |
| RoE (%)           | 14.6   | 18.1   |        |
| RoCE (%)          | 18.6   | 14.4   |        |
| P/E (x)           | 10.1   | 7.6    |        |
| EV/EBITDA(x)      | 3.6    | 3.4    |        |
| P/BV (x)          | 1.4    | 1.3    |        |

Source: Company Data, Way2Wealth Inst Equity

| Shareholding pattern (%) | Sep'20 |
|--------------------------|--------|
| Promoter holding         | 72.9   |
| FII                      | 9.3    |
| DII                      | 1.8    |
| Public & Others          | 16.0   |

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On 13 July 2018 CSL announced that it has signed shipbuilding contract with Inland Water Authority of India (IWAI) for Design Construction and Supply of Ten Ro-Ro Vessels. The total contract value was ₹1.03bn. The vessels are conceptualized and fully designed by CSL. On 25 September 2018 CSL and the Andaman & Nicobar Administration entered into an MoU whereby CSL shall take up the 'Operation & Maintenance of the Marine Dry-Dock' at Port Blair. Under the ambit of this MoU, CSL shall assist the Administration in (a) Setting up of Ship repair Eco-system at A&N islands (b) Augmentation & Modernization of Marine Dockyard and (c) Skill Development & Training schemes for A&N Islands. The Board of Directors of the company at its meeting held on 16 October 2018 unanimously approved a proposal for buyback of 4.4mn equity shares representing 3.23% of the total outstanding number of equity shares in the paid-up share capital of the company at a price of ₹455 per equity share from the shareholders of the company through the Tender Offer route. CSL signed an MOU with Kolkata Port Trust to take over their Netaji Subhas Dock on lease basis in FY19.

### Investment Arguments

- **COVID related restriction impacted in execution** – Net sales declined 32% YoY to ₹6.6bn, as ship building revenues reported a decline of 29% YoY in Q2FY21. Revenue booking lagged in projects like Technology Demonstration Vessel (TDV) and pax/cargo vessel, as COVID-19 induced travel restrictions on overseas service engineers, led to delay in launch of sea-trials. Shipbuilding (SB) revenue fell 28.5% YoY to ₹5,635mn while Shiprepair (SR) segment contracted 14.3% YoY to ₹938mn. SB, SR segments contributed 85.7%, 14.3% to the topline, respectively. Operating margins declined by 210bps YoY to 19.1%, as gross margins improved to 38.9% (+340bps), due to higher share of IAC fixed price execution. However, a onetime provision of ₹250mn led to a sharp increase (+230bps) in other expenses, besides negative operating leverage. Ship building segment reported margin decline of only 40bps to 21.7%, while ship repair segment margins declined to 27.4%, - 370bps YoY due to lower execution. Overall, EBITDA declined 39% YoY to ₹2,062mn. Net profit declined 48% YoY to ₹1,084mn.
- **IAC successfully completed basin trials on 30 November 2020** – Long expected IAC basin trials was done successfully on 27 November 2020 whereas delivery for the same is expected by Dec'21. If things fall in place, as they should, we expect FY22 revenue to bump up on account of IAC execution. During Q2FY21, IAC execution was ₹4,910mn (Cost plus Margin-₹2,830mn, Fixed price- ₹2,070mn). Also, Phase-3 order book of IAC was at ₹22,440mn.
- **Management expects revenues to decline by ~10% YoY in FY21 as execution of ship building projects will continue to face headwinds** – Revenues for FY21 are expected to be ₹30bn, of which ship-repair will be ₹5.5bn. It expects Ship repair revenues to decline by only 5% YoY. However, it expects FY22 revenues to rebound 30% YoY to ₹40bn as the ASW corvette project starts (execution of ASW corvette order will start in Dec-21) contributing to sales and new ship repair facilities in Mumbai, Kolkata and Port Blair commence operations. Active bids of ₹150-160bn are expected to be awarded in next year. Outlook for new orders to remain weak as there is likelihood of stiff competition in next generation missiles vessels (NGMV) contract (80% of order pipeline), while new aircraft carrier plans have been put on hold due to budgetary reasons.

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- **Order inflows** – Cochin has signed contracts for construction and supply of 2 nos. Autonomous Electric Ferry for ASKO Maritime AS, Norway. There is no update on the IAC 2 project from the Indian Navy.
- **Update on key tenders** – Cochin had bid for 5 projects totaling ₹160bn namely 1) 8 fast patrol vessels for Coast Guard 2) 12 air-cushion vessels for Coast guard 3) 6 Next-gen missile vessels (NGMV) for Indian Navy 4) 2 Multi-purpose vessels and 5) 3 cadet training ships of the Indian Navy. Bids for 8 Fast patrol vehicles (FPVs) and 12 air cushion vessels were undertaken in Oct-Nov'19 and the results for the same should be visible next year. Bids for NGMV were done prior to lockdown, Multi- Purpose Vessel (MPV) in Jun'20 and Cadet training ships in Nov'20.
- **MoU with Fincantieri, Italy** – Cochin has signed an umbrella MoU for manufacturing of high-end defence vessels like next-gen missile vessels and next-gen patrol vessels, to localise manufacturing of equipment under AtmaNirbhar Bharat initiative, in-order to increase indigenisation, support for tankers as Fincantieri has supplied large numbers worldwide and training of CSL employees at Fincantieri's facilities.
- **NWC negative due to large advance** – NWC was negative (-191 days v/s 5 days at Mar'20), mainly due to a 90% increase in other current liabilities to ₹22bn as ₹6-7bn of advances were booked for the ASW corvette. Inventories increased from 33 to 52 days, while debtors also increased from 31 to 43 days. Gross cash stood at ₹34.4bn, of which ₹14bn is the free cash balance, while balance pertains to advances. Other contract liabilities of ₹21.8bn include ₹12bn from IAC and ₹6-7bn from ASW corvettes. Capex for FY21 likely to be ₹1.4bn towards ISRF, ₹2bn towards the new dry-dock and for FY22 likely to be ₹1.3bn towards ISRF and ₹2bn towards the new dry-dock.

(₹ mn)

| Current Order book |   | Total          |
|--------------------|---|----------------|
| 1                  | Order from Indian Navy (IAC & ASW Corvette) | 1 120,620      |
| 2                  | Orders from GOI, MOS                        | 4 5,550        |
| 3                  | Orders from GOI,MOD &MHA                    | 10 3,080       |
| 4                  | Small passenger ferry (KMRL) & Others       | 30 4,370       |
| 5                  | Ship repair orders                          | 5,000          |
| <b>TOTAL</b>       |   | <b>138,620</b> |

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View – **BUY**

**Q1FY21 Performance** – Topline declined 55% YoY to ₹3.3bn, as ship building revenues reported a decline of 48% YoY to ₹6,029mn. CSL faced a production loss of 45 days in Q1FY21 and post opening up in May'20 only 50% of labour was available due to migration. Majority of suppliers invoked force majeure clause, which led to supplies for equipment getting stalled. Ship repair saw a decline of 88% YoY, as execution planned in Q1FY21 got cancelled or deferred on account of liquidity constraints with clients and international restrictions on travel. Non-IAC shipbuilding contracts revenues target are at ₹8-9bn for FY21. Despite Q1 washout, management is expecting revenues of ₹5-5.5bn from ship repair altogether in FY21. Operating margins plummeted 1,410bps YoY to 5.1%, as ship repair segment posted a loss of ₹89mn v/s profit of ₹415mn in Q1FY20 (EBIT margins of 31%). Ship building segment reported a 300bps increase in EBIT margins to 19.8%. Gross margins improved to 35.8% (+230bps), due to higher share of IAC fixed price execution. Staff cost remained similar over Q1FY20 thereby impacting margins. Other expenses (% of sales) increased 500bps YoY to 9.7%. Overall, EBITDA declined 88% YoY. Tax rate stood at 26.8%. Net profit declined 65% YoY to ₹426mn, primarily led by EBITDA decline.

Execution of IAC phase-III got impacted due to COVID-19. Revenue of ₹10-15bn would be recognized post-delivery up to FY24. Indigenization level for IAC-1 is around 50-60%. The management expects revenues of ₹20-30bn for FY21/FY22/FY23 each from IAC project.

Delays in Capex projects in Kochi, Mumbai, Kolkata, Port Blair as well as subsidiaries of company i.e. Hooghly Cochin Shipyard Limited and Tebma Shipyard Limited which was acquired by bidding at NCLT in Mar'20 led to consequent loss of production.

#### View

Given healthy order backlog of ~₹139bn, CSL has shipbuilding revenue growth visibility till FY23 with planned execution of ₹65bn 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. CSL is targeting for ship-repairing revenues of+ ₹10bn/+₹25bn with sustainable margins of 25% by FY23/ FY30 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 large scale ship repair work. Recent tie-up with Fincantieri, Italy would help gain technological inputs, design support & collaboration in high end/new generation defence vessels. Further, a healthy cash balance of ₹14bn (ex-advances) and robust order pipeline provides growth visibility for the company. **A growing company, with high dividend pay-out & debt free balance sheet makes it an attractive BUY bet with fair value of ₹430-440.**

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## Financial Performance

(₹ mn)

| Particulars       | Q2FY21 | Q2FY20 | YoY (%) | Q1FY21 | QoQ (%) | 1HFY21 | 1HFY20 | YoY (%) |
|-------------------|--------|--------|---------|--------|---------|--------|--------|---------|
| Revenue           | 6,574  | 9,729  | (32.4)  | 3,325  | 97.7    | 9,899  | 17,097 | (42.1)  |
| EBITDA            | 1,258  | 2,062  | (39.0)  | 170    | 640.0   | 1,428  | 3,478  | (58.9)  |
| EBITDA Margin (%) | 19.1   | 21.2   |         | 5.1    |         | 14.4   | 20.3   |         |
| Net Profit        | 1,084  | 2,076  | (47.8)  | 426    | 154.5   | 1,510  | 3,278  | (53.9)  |
| EPS (₹)           | 8.2    | 15.8   | (48.1)  | 3.2    | 156.3   | 11.5   | 24.9   | (53.8)  |

Source: Company Data, Way2Wealth Inst Equity

## Segmental Performance

(₹ mn)

| Revenue           | Q2FY21 | Q2FY20 | YoY (%) | Q1FY21 | QoQ (%) | 1HFY21 | 1HFY20 | YoY (%) |
|-------------------|--------|--------|---------|--------|---------|--------|--------|---------|
| Ship Building     | 5,635  | 7,894  | (28.6)  | 3,161  | 78.3    | 8,797  | 13,924 | (36.8)  |
| Ship Repair       | 939    | 1,834  | (48.8)  | 164    | 472.6   | 1,102  | 3,174  | (65.3)  |
| <b>EBIT (₹mn)</b> |        |        |         |        |         |        |        |         |
| Ship Building     | 1,225  | 1,751  | (30.0)  | 625    | 96.0    | 1,850  | 2,762  | (33.0)  |
| % Margin          | 21.7   | 22.2   |         | 19.8   |         | 21.0   | 19.8   |         |
| Ship Repair       | 257    | 570    | (54.9)  | (89)   | 388.8   | 168    | 985    | (82.9)  |
| % Margin          | 27.4   | 31.1   |         | (54.3) |         | 15.2   | 31.0   |         |

Source: Company Filing, Way2wealth Research



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**Disclosure of Interest Statement Cochin Shipyard Ltd. as on December 10<sup>th</sup>, 2020**

|  |                      |
|--|----------------------|
| Name of the Security   | Cochin Shipyard Ltd. |
| Name of the analyst  | Jayakanth Kasthuri   |
| Analysts' ownership of any stock related to the information contained  | NIL                  |
| Financial Interest   |                      |
| Analyst :  | Yes                  |
| Analyst's Relative : Yes / No  | No                   |
| Analyst's Associate/Firm : Yes/No                                      |                      |
| Conflict of Interest   | No                   |
| Receipt of Compensation  | No                   |
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