



Quick Insight

Mazagaon Dock Shipbuilders Ltd (MDL)



Industry Defence

CMP ₹212.35

M Cap ₹42.8bn

Buy Range ₹200-210

Target ₹250-260

Recommendation BUY

Highlights

- MDL is the only domestic yard that has built complex platforms such as Destroyers, Frigates, Corvettes and conventional submarines. Currently, shipbuilding division is engaged in the construction of four- P-15B Destroyers, four- P-17A Stealth Frigates and the repair / refit of one ship for the Indian Navy. The submarine and heavy engineering division is currently engaged in the construction of four- Scorpene-class Submarines under a transfer of technology (ToT) agreement with Naval Group, France and the medium refit and life certification of one submarine for the MoD.
- It is constructing a submarine-launch facility and blasting painting chamber to speed up the launch of future submarine orders. For the shipbuilding division the company is in talks with MbPT to acquire 11 acres of land adjacent to its current shipyard in a bid to expand its current capacity. It is also looking at the possibility of constructing a yard in Nhava, Mumbai, which will largely be used for repairs and outfitting and consequently free up the main yard for the core shipbuilding and submarine building activities..
- MDL's current order book 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).
- MDL (also through GSL) could potentially bid for ₹2.1tn of warship/submarine projects of the Indian Navy in the next 10 years. The company has participated in domestic RFPs worth ₹230bn and ~₹35bn in international market
- As a part of the government's modernisation initiative for the defence sector, MDL believes that many of the active Naval vessels will be scheduled to come in for an overhaul over the next 5-10 years. Given the long gestation period of defence vessels, MDL is currently in the process of reviving its ship building and ship repair activities for commercial vessels in the domestic and international market as Repairs & Overhauls being a high-margin business, the initiative will help increase revenue and margins. In FY20, they restarted the ship repair business, at which time they generated a revenue of ₹1,500mn

Background

Mazagaon Dock Shipbuilders Ltd (MDL) is a defence PSU shipyard with a capacity of 40,000 DWT and is engaged in the construction and repair of warships and submarines for the Ministry of Defence (MoD), along with commercial vessels for other clients. MDL was awarded the “Mini-Ratna-I” status in 2006 and is 1 of the 2 shipyards in India to build submarines.

It operates two divisions – I) shipbuilding and II) submarine and heavy engineering. The shipbuilding division includes all work related to the construction and repair of naval ships. Currently, the division is engaged in the construction of four- P-15B Destroyers, four- P-17A Stealth Frigates and the repair / refit of one ship for the Indian Navy. The submarine and heavy engineering division is currently engaged in the construction of four- Scorpene-class Submarines under a transfer of technology (ToT) agreement with Naval Group, France and the medium refit and life certification of one submarine for the MoD.

Since inception, MDL has built a total of 795 vessels including 25 warships (six- Leander class Frigates, three- Godavari class Frigates, three- Corvettes, four- Missile boats, six- Destroyers and three- Shivalik class Frigates) and four- Diesel-electric Submarines for the Ministry of Defence, seven-offshore patrol vessels for the Indian Coast Guard and a number of commercial vessels such as cargo ships, passenger ships, multipurpose support vessels, water tankers, tugs, dredgers, fishing trawlers, barges and border outposts for the domestic and international market.

Investment Argument

- **Only yard to have built multiple naval platforms –** MDL is the only domestic yard that has built complex platforms such as Destroyers, Frigates, Corvettes and conventional submarines.
 - **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 Dec’00 and was commissioned in Apr’10. The second ship, Satpura was launched in Jun’04 and commissioned in Aug’11. The third and final ship, Sahyadri was launched in May’05 and commissioned in Jul’12.
 - **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 Aug’14. 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).
 - **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.
 - **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 Dec’17.
- **Robust infrastructure –** In 2016, MDL overhauled its infrastructure. The “Mazagaon Modernization Project” augmented production capacity by introducing 2 large cranes, a new retractable-roof to accommodate large vessels, a new 27,000 sq. meter wet basin and a shift from unit-based assembly to block-based assembly. MDL’s capacity increased from 8 warships to 10 and from 6 submarines to 11.
- **Strong revenue visibility –** MDL’s current order book 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).

Nifty	13,749
Sensex	46,974
Key Stock Data	
CMP	₹212.35
Market Cap (₹)	₹42.8bn
52W High/Low	₹227.9/164
Shares o/s (mn)	201.7
Daily Vol. (1M NSE Avg.)	1,521,454
Shareholding pattern (%) Sep’20	
Promoter	84.8
DII	3.6
FII	1.7
Public & Others	9.9

Source: Company Data, Way2Wealth Inst Equity

Particulars	FY19	FY20	1HFY21
Net Revenue	46,140	49,780	14,830
EBITDA	2,610	2,680	890
EBITDA Margin (%)	5.7	5.4	6.0
Net Profit	5,320	4,830	1,900
EPS (₹)	27	24	9
DPS (₹)	5	11	
RoE (%)	17	16	
P/E (x)	7.9	8.8	
P/BV (x)	1.4	1.2	

Source: Company Data, Way2Wealth Inst Equity

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* which will be the largest destroyer to be operated by Indian Navy. The first ship is expected to be commissioned in 2021

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

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 industry studies, MDL (also through GSL) could potentially bid for ₹2.1tn of warship/submarine projects of the Indian Navy in the next 10 years. The company has participated in domestic RFPs worth ₹230bn and ~₹35bn in international market. As a part of the government's modernisation initiative for the defence sector, MDL believes that many of the active Naval vessels will be scheduled to come in for an overhaul over the next 5-10 years. With Repairs & Overhauls being a high-margin business, the initiative will help increase its revenue and margins
- **Competition** – In the competitive landscape, MDL competes with three other PSU shipyards which come under the purview of the Ministry of Defence – Hindustan Shipyard, Goa Shipyard and Garden Reach Shipbuilders.
 - **Hindustan Shipyard (HSL)** is the only other shipyard in the country that has built a submarine for the MoD and the only shipyard in India to have built the Arihant class nuclear-powered submarine.
 - **Garden Reach Shipbuilders (GRSE)** is currently engaged in building three-P-17A missile Frigates for the Indian Navy and has delivered three- Corvettes for the Indian Navy before.
 - **In a first-of-a-kind order, Goa Shipyard (GSL)**, which usually constructs small patrol vessels, was recently awarded an order to construct two-Talwar-class Frigates. MDL has a ~47% stake in Goa Shipyard.
 - **Similarly, Cochin Shipyard (CSL)**, which comes under the purview of Ministry of Shipping and is known for building commercial vessels, is set to deliver its first Indian Aircraft Carrier to the Navy.
 - In 2018, the insolvent **Reliance Naval & Engineering Ltd**, along with **Larsen & Tubro** and **Bharat Heavy Electric Ltd** were the only public / private companies to have been issued a government license to construct warships and armaments. However, things changed significantly vide a government circular issued in January 2019, which stated that the license required to build warships was being removed from the Arms Act, 1959 and instead will be issued under the Industries (Development and Regulation – IDR) Act, 1951. The move is likely to ease the criteria, thereby allowing more private players to bid, for warship-manufacturing projects
- **Drivers of Growth**
 - **Capacity Expansion** - In the submarine and heavy engineering division, MDL is constructing a submarine-launch facility and blasting painting chamber to speed up the launch of future submarine orders. For the shipbuilding division the company is in talks with MbPT to acquire 11 acres of land adjacent to its current shipyard in a bid to expand its current capacity. It is also looking at the possibility of constructing a yard in Nhava, Mumbai, which will largely be used for repairs and outfitting and consequently free up the main yard for the core shipbuilding and submarine building activities. Currently, the project's viability is being studied. It is estimated that the project will incur a cap-ex of ₹15-18bn over a period of 5 years that will be self-funded.

- **Diversification of Revenue** - Given the long gestation period of defence vessels, MDL is currently in the process of reviving its ship building and ship repair activities for commercial vessels in the domestic and international market. Commercial vessels have a relatively shorter turnaround time and a higher margin which will help improve the company's profitability. In FY-20, they restarted the ship repair business, at which time they generated a revenue of ₹1500mn
- **Indigenisation** - The large "Make in India" impetus from the government will be a big boost for MDL and the shipbuilding sector overall. Currently, 25-30% of the components in large vessels like the P-17A Frigate and the P-15B Destroyer are imported. Nearly 50-60% of the components that go into the weapons and sensors are imported. The indigenization of these components will reduce costs and the overall turnaround time thus helping realize better margins at a faster pace. The government's embargo on 101 defence items positively impacts MDL as the embargo encourages local manufacturing of components for various vessels (*such as the Next-Gen Missile Vessel, ASW Water Craft*) and for various weapons (*such as anti-submarine rockets and rocket launchers, ship-borne medium range guns, etc*).

Key Risks

- **Concentration Risk** – MDL's current order book has very high reliance on a single customer i.e. the Indian Navy orders worth ₹547.1bn. Its revenues are also highly dependent on ship building as relatively higher margin ship repair business accounts for just 3% of sales
- **High competition 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.
- **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 Indian Navy. However, MDL has incurred liquidated damages on account of delays.
- **Risk of deterioration of Working Capital** – Currently MDL runs a negative working capital as it has customer advances/milestone payments (21% of order book). However, as revenues can potentially grow by 2.5-3x in the next five years, it is unlikely that payments from Navy will be able to keep pace with revenue growth

Outlook

MDL's order book is likely to be executable over 5-6 years which even without considering order inflows provides strong revenue visibility. It has sufficient capacity in place and is exploring additional development which can help cater to any uptick in orders. MDL intends to increase its ship repair revenues from ~3% of overall revenues (FY20) to 15-20% gradually which bodes well from profitability perspective. Increasing retention of cost savings and potential ~50bps increase in margins under revised acquisition procedures are key margin drivers. **Debt free company with good balance sheet strength, revenue visibility, good dividend yield of ~6% and government impetus on indigenisation in defence equipment makes it a strong BUY with Target price range of ₹250-260.**

Financials

(₹mn)

Particulars	FY17	FY18	FY19	FY20	1HFY21	1HFY20
Revenue	35,190	44,700	46,140	49,780	14,830	20,640
(-) Direct Expenses	33,930	43,160	43,530	47,100	13,950	19,230
EBITDA	1,260	1,550	2,610	2,680	890	1,410
% Margin	3.6	3.5	5.7	5.4	6.0	6.8
(+) Other Income	7,560	5,570	5,910	5,580	2,050	2,900
PBT	8,310	6,500	7,780	7,480	2,640	3,910
PAT	5,980	4,960	5,320	4,830	1,900	1,880
% margin	17.0	11.1	11.5	9.7	12.8	9.1
EPS (₹)	30	25	27	24	9	9
DPS (₹)	10	12	5	11	N/A	N/A
Payout Ratio (%)	33	49	19	45	N/A	N/A
Equity Capital	2,490	2,240	2,240	2,020	2,020	N/A
Reserves & Surplus	27,410	26,100	29,930	28,670	29,410	N/A
Net Worth	29,900	28,340	32,170	30,690	31,430	N/A
Total Borrowings	-	-	-	-	-	N/A
RoE (%)	20	18	17	16	12	N/A
Working Capital	25,210	19,270	18,540	16,270	14,650	
Cash/ Bank Balance	83,630	71,900	74,700	57,980	72,060	N/A
Inventories	40,290	37,860	37,900	46,230	53,920	N/A
Receivables	8120	11,130	14,730	14,590	15,010	N/A
Payables	9260	23,910	29,170	47,710	54,320	N/A

Source: Company Data, Way2Wealth Inst Equity

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Name of the Security	Mazagon Dock Shipbuilders Ltd
Name of the analyst	Jayakanth Kasthuri
Analysts' ownership of any stock related to the information contained	NIL
Financial Interest	
Analyst :	No
Analyst's Relative : Yes / No	No
Analyst's Associate/Firm : Yes/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

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