Mazagon Dock Shipbuilders Ltd

IPO NOTE - SUBSCRIBE

COMPANY PROFILE

Mazagon Dock Shipbuilders Ltd (MDL) is a Defence Public Sector Undertaking under ministry of Defence (MoD). It is one of the India's leading shipyards with a capacity to meet requirements of the Indian Navy. Mazagaon dock was first constructed in 1774 as a small dry dock, which was incorporated as a public limited company in 1934, before being taken over by Govt. of India (GoI) in 1960. The company is wholly owned GoI company, conferred with the 'Mini-ratna-I' status in 2006.

MDL has a maximum shipbuilding and submarine capacity of 40,000 DWT. The company is engaged in the construction and repair of warships and submarines for the MoD for use by the Indian Navy and other vessels for commercial clients. The company is India's only shipyard to have built destroyers and conventional submarines for the Indian Navy.

The business divisions include (i) shipbuilding and (ii) submarine and heavy engineering. Shipbuilding division includes the building and repair of naval ships. Submarine and heavy engineering division includes building, repair and refits of diesel electric submarines. Since 1960, MDL has built 795 vessels including 25 warships, from advanced destroyers to missile boats and three submarines. It has also delivered cargo ships, passenger ships, supply vessels, multipurpose support vessels, water tankers, tugs, dredgers, fishing trawlers, barges and border outposts for various customers in India as well as abroad.

MDL is strategically located on the west coast of India, on the sea route connecting Europe, West Asia and the Pacific Rim, a busy international maritime route. The company is headquartered in Mumbai which is also the headquarters of the Western Naval Command of the Indian Navy. The company is also exploring the possibilities of developing a greenfield shipyard at Nhava, Navi Mumbai with a shiplift, wet basin, workshops, stores and buildings and a ship repair facility spread over an area of 37 acres.

Over the last 18 Fiscals, the company has received orders for reft and repairs of 15 ships and 10 submarines and delivered 27 ships and 5 submarines. As of July 31, 2020 the company had an order book of Rs 540,740mn.

OBJECTS OF THE ISSUE

- Achieve the benefits of listing the Equity Shares on the Stock Exchanges. The company will not receive any proceeds from the Offer and all such proceeds will go to the Selling Shareholder.

BRIEF FINANCIAL DETAILS

Particulars (Rs Mn)	FY17	FY18	FY19	FY20
Revenue	35,191	44,704	46,140	49,777
Total Expenditure	33,933	43,157	43,532	47,097
EBITDA	1,257	1,547	2,608	2,680
EBITDA Margin	3.6%	3.5%	5.7%	5.4%
Other Income	7,558	5,573	5,907	5,577
Finance Cost	93	91	91	93
Depreciation	417	525	643	687
PBT	8,306	6,504	7,781	7,231
Exceptional	-	-	-	123
Tax Expense	2,877	2,568	3,077	3,517
Share of Net Profit/(loss) of associate	554	1,026	621	934
PAT	5,983	4,962	5,325	4,771
EPS (Rs/Share)*	29.7	24.6	26.4	23.7
Share Capital	2,490	2,241	2,241	2,017
ROE %	20.0%	17.5%	16.6%	15.5%

Source RHP, EPS based on post issue outstanding shares.

Particulars	
Issue Size (Rs Cr)	413 – 444
Price Band	135 – 145
Issue Open Date	29 Sep 2020
Issue Closing	01 Oct 2020
Face Value (Rs)	10
Lot Size	103
Shares reserved for employees	345,517

Issue break-up	(%)
QIB	50
NIB	15
Retail	35

Shareholding Pattern (Post Issue)	(%)
Promoters & Promoters Group	85
Others	15

Book Running Lead Managers

Axis Capital, Yes Securities, IDFC Sec, Edelweiss Financial, JM Financial

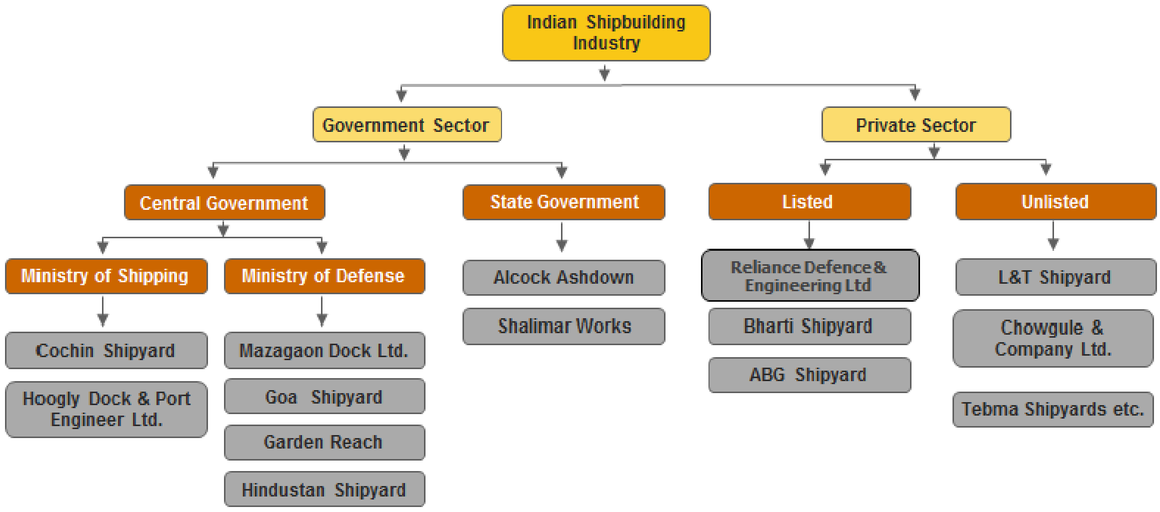
Issue Details

Offer for sale of up to 30,599,017 Equity Shares.

Post Issue Market Cap

Rs 2,723cr – Rs 2,925cr.

Brief overview of the Indian Shipbuilding Industry



Source RHP

According to the Statistics of India's Ship Building and Ship Repair Industry of 2015-16, as of March 2016, public sector shipyards accounted for around one-third of the total shipbuilding order book in terms of number of ships with outstanding orders for 104 ships amounting to a combined tonnage of 173 thousand DWT. The private sector accounted for around two-thirds of the total shipbuilding order book in terms of the number of ships with outstanding orders for 192 ships amounting to a combined tonnage of 2,569 thousand DWT. During 2011-12 to 2015-16 the ship building capacity of public sector shipyards remained fairly stable while private sector grew by 3% CAGR. The shipbuilding order book declined during 2013-14 to 2015-16, due to minimal new orders on account of persistent supply overhang and weak global trade.

However, over the last few years, major private players like Reliance Defence and Engineering Ltd, ABG Shipyard, Bharati Defence & Infrastructure Ltd etc. have had to opt for corporate debt restructuring (CDR) due to stressed financial positions. Additionally, the decline in global trade and a liquidity crunch have impacted performance of these shipyards.

Equipment costs constitute 50-55% of shipbuilding cost. Indian shipbuilders import 65-70% of equipment, including steel, due to absence of ancillary companies manufacturing the equipment in the country. This increases the cost burden of the shipbuilders. Labour is another major cost, accounting for about 10-15% of total cost. Lower labour cost compared with China, South Korea and Japan could aid in increasing competitiveness ahead of greater indigenisation.

Naval shipbuilding is a key segment of the Indian shipbuilding industry. It is characterised by value addition of 65% during construction of ships, which is contributed by ancillary industries such as steel producers, main engine builders, and equipment suppliers. Growth of the domestic shipbuilding sector, which imports 45% of its input requirement, can provide a major trigger for large-scale indigenisation of heavy-engineering products and ancillaries.

The domestic shipbuilding industry primarily caters to two sub-segments: the Indian Navy and Indian Coast Guard. Currently, its fleet consists of aircraft carriers, amphibious transport dock, landing ship tanks, destroyers, frigates, nuclear-powered attack submarine, conventionally powered attack submarines, corvettes, mine countermeasure vessels (MCMVs), large offshore patrol vessels, fleet tankers and various auxiliary vessels and small patrol boats. The Indian Coast Guard's fleet comprises patrol vessels, patrol boats, patrol craft and a hovercraft.

In December 2015, the Cabinet approved the new shipbuilding policy, which aims to provide financial assistance to shipbuilders and grant infrastructure status for the industry. The government has set aside Rs 40bn to implement the scheme over 10 years. The Government has also provided exemption from customs and central excise duties on all raw materials and parts, used in manufacture of ships/vessels/tugs and pusher crafts. Simultaneously, the requirement of manufacturing ships/vessels/tugs and pusher craft in a custom-bonded warehouse for availing of customs and excise duty exemptions has also been done away with.

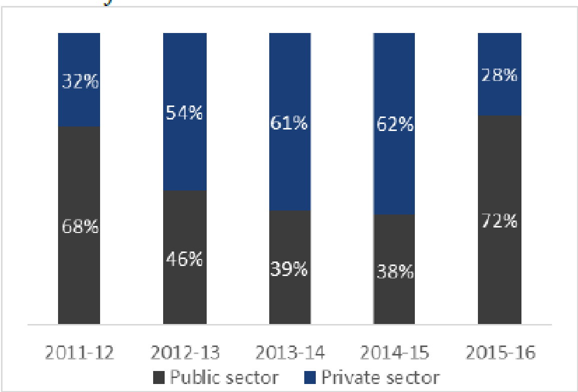
The Indian government has taken steps to encourage defence shipbuilding in the country. According to PIB, in June 2016, Foreign Direct Investment (FDI) Policy in defence sector has been reviewed. As per the updated policy, FDI of up to 49% is allowed under automatic route and above 49% under Government route wherever it is likely to result in access to modern technology or for other reasons to be recorded. To further the ease of process of approvals, the Government has abolished Foreign Investment Promotion Board (FIPB).

According to the Statistics of India's Ship Building and Ship Repair Industry of 2015-16, the Global Ship repair industry was estimated to be around USD 12bn in 2016. Shipyards in Singapore, Bahrain, Dubai and Middle East account for a major share of this market. These locations have achieved a dominant position despite higher cost of ship repair services compared to other Asian countries, largely because of availability of skilled workforce and latest technology. The Indian Ship repair industry was estimated around USD 1.5bn in 2016.

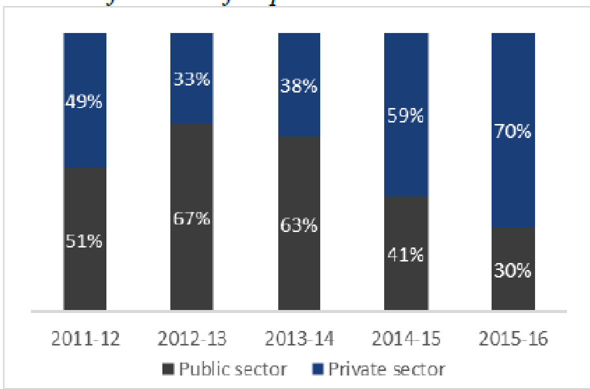
India's strategic position along the east bound and west bound international trade routes offers an opportunity to cater to vessels plying on these routes. A main container route connecting America and Europe to the East passes very close to the Indian coastline, presenting a major opportunity for repairs.

As per the national perspective plan of Sagarmala project, coastal and inland waterways traffic is expected to shoot up 15 times over the next 20 years. Similarly, capacity augmentation is expected to result in a five times rise in traffic capacity, from the existing 350 million tonnes. This is expected to bring in additional ship repairbusiness.

Sector-wise breakup of ship repairs in India, in terms of value



Sector-wise breakup of ships repaired in India, in terms of number of ships



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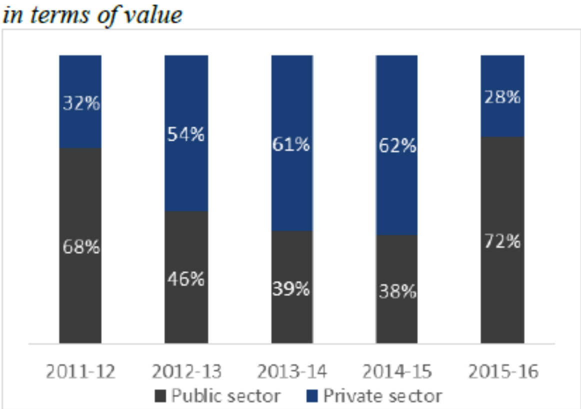

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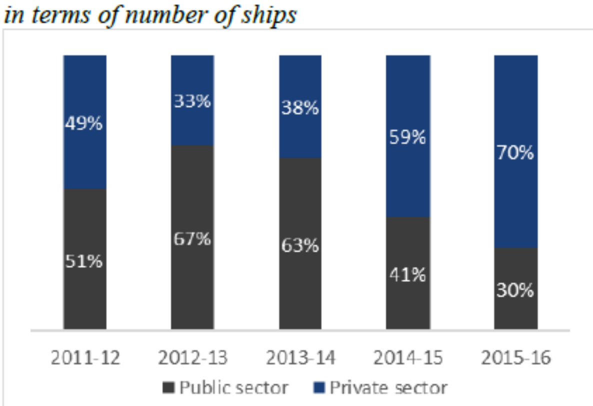

Source RHP

India's commercial order book is expected to grow 1-3% CAGR during FY17-22 led by the non-cargo segment which is expected to grow by 4-6% in the same period. Defence shipbuilding order book is estimated to grow by 8-10% CAGR during FY17-22. Indian shipbuilding industry's order book is expected to receive a boost on account of Indian Navy and Coast Guard's ambitious ship acquisition plans – the forces plan to have fleets of 200 ships each till 2020-21. However, constrained capacities of the defence public sector undertakings and weak financial position of private players having defence shipbuilding licenses can prove to be an impediment to the execution of this plan.

Ship orders from the navy are expected to have a larger share of this order book in terms of DWT, compared with the Indian Coast Guard. In case of the Indian Navy, the orders expected are: warship vessels like corvettes, submarines, etc. as well as patrol vessels and crafts. The category-wise vessel composition of both the Indian Navy and the Indian Coast Guard fleet is expected to remain constant over the next five years.

The indigenisation plan is expected to encourage all sectors of the industry to come forward and participate in indigenous development of weapons, sensors, and other high end equipment for the Indian Navy, which will further improve repair and maintenance revenue in the long run.

Competitive Strengths of MDL

Only public sector defence shipyard constructing conventional submarines

MDL has built destroyers and conventional submarines for the Indian Navy which has enhanced its capability in handling construction of conventional submarines. The company has also entered into a technology transfer agreement with Naval Group, France for Scorpene submarines which are currently manufactured by them. The company along with the Naval Group have trained its workforce in relation to the construction of such submarines. The management believes that the personnel associated with submarine construction process are now adept with the nuances of submarine technology.

World class infrastructure capable of serving the requirements of the Ministry of Defence

The infrastructure and facilities available at MDL's shipyard combined with its vast expertise gives it a significant edge over its domestic peers. The facilities currently comprise of three dry docks, two wet basins, three slipways, production shops, assembly shops, module shop with painting chamber for integrated construction, sheet metal shop, pipe shop, machine and fitting shop, ship dry dock and dredging, electrical repair shop and instrumentation shop for the shipbuilding division. The submarine division's infrastructure includes shops for fabrication of frame, sub-section assembly and section formation, cradle assembly shop for structural and equipment outfitting and final assembly, one dry dock and submarine section assembly shop.

Post completion of the modernization project, the capacity of outfitting warships increased from 8 warships to 10 warships since 2014 and submarine capacity has increased from six submarines to 11 submarines since 2016. The company also has a shore integration facility which enables it to complete combat system integration off-site prior toon board installation. It has also constructed a submarine assembly workshop which comprises of two bays and is equipped with two levels of EOT cranes as well as semi goliath cranes.

Location of facilities promotes closer association with our vendors and customers

The management believes that the location provides a strategic competitive advantage over peers. MDL is strategically located in Mumbai on the west coast of India, on the sea route connecting Europe, West Asia and the Pacific Rim, a busy international maritime route. Its customers, being the MoD and Indian Coast Guard and its vendors are based in Mumbai which it believes results in closer co-ordination and greater efficiencies. Further, a majority of its subcontractors are based in and around Mumbai which provides an easy access to labour.

Increase in indigenisation of vessels and implementation of the "Make in India" campaign

In order to address the issues related to imports of equipment, a dedicated department of indigenisation was set up in November 2015. The entire indigenisation process and the list of systems, equipment and items along with the necessary technical details which are to be indigenised have been identified. MDL has successfully indigenised certain equipment. The company has also introduced an indigenization clause in all the tenders where bidders have to indicate their progressive indigenization plan. The indigenous content in warships built by MDL has increased in the past five years. Increase in indigenisation has enabled it to reduce its reliance on third party component manufacturers

Experienced board and senior management team and skilfully trained workforce

MDL has a diversified Board with directors having several years of experience in the shipbuilding as well as submarine division and each of the senior management team is experienced in the industry and have been with the Company for an average of more than two decades. The company has been successful in attracting experienced senior management team with operational and technical capabilities, management skills, business development experience and financial management skills.

The company also has a large pool of experienced naval architects, engineers and draftsmen. The management believes that the employees and blue-collar workforce are instrumental to the company's success including for the quality of products and services and ability to operate in a cost-efficient manner, helping the company achieve a continuous profit margins, efficient operations, short delivery schedules, relatively lower attrition and fewer employee disputes.

Strategies of MDL

The objective of MDL is to enhance its market position by expanding capabilities, capitalising on opportunities both in domestic and international markets and to enhance competitiveness. The company has the following business strateiges:-

Export of products to the international markets

MDL primarily caters to the domestic market. However, the company is looking to revive exports to Latin America, Africa, South East Asia, Middle East and Scandinavian regions. The company has entered into agency agreements with sales agents in order to procure customers for our products which it proposes to sell in the identified markets of Europe, Far East, South East Asia, Middle East, Indian Ocean Rim countries, Latin America and Africa regions. In the past, the company had exports to Mexico, France, Bahamas and Yemen. The company intends to increase its global presence by establishing an international marketing team.

Focus on ship repair

In order to diversify revenue streams, MDL intends to increase ship repair activities in the future as such activites are for a shorter period of time and result in the early booking of revenues. The company in the past has undertaken ship repairs for its clients in the defence and commercial sectors. This will help generate more revenues, increase client base and reduce dependency on the MoD for future orders.

The company is also exploring the possibilities of developing a greenfield shipyard at Nhava, Navi Mumbai with a shiplift, wet basin, workshops, stores and buildings and a ship repair facility spread over an area of 37 acres which will be suitable for construction and repair of warships and commercial ships with larger dimensions. The company has also entered into a contract for the repair, refit and services of a ship. The management believes that the revival of ship repair operations will result in augmentation of revenues and profitability.

Augmentation of infrastructure and enhancing our manufacturing capacity

MDL is currently undertaking capital expenditure for submarine and heavy engineering division by way of construction of the submarine launch facility and blasting painting chamber. The company is also leveraging the latest construction methods in order to speed up the construction of warships. It is planning to dredge the water front to a depth of 3.5 metres below chart datum and create a navigation channel from Angre wet basin to the offshore container terminal of MbPT which will enable the company to move the vessels without depending on the tidal conditions throughout the year. It is also exploring acquiring additional land adjacent to the current facility, belonging to MbPT for setting up of new facilities. The management believes that augmentation of existing facilities and developments of future facilities will enable the company to deliver products on or before the scheduled date of delivery and also enable to cater to future orders.

Current Order Book

Shipbuilding			
Particulars	**Nos**	**Client**	**Rs Mn**
P15B Destroyers	4	MoD	263,850
P17A Stealth Frigates	4	MoD	236,490
Repair, refit and services of a ship	1	MoD	110
Submarine and heavy engineering			
Particulars	**Nos**	**Client**	**Rs Mn**
P75 Scorpene Submarines	4	MoD	32,020
Medium Refit and Life Certification (MRLC) of a submarine	1	MoD	8,270
Total Order Book			**540,740**

Source RHP

Construction and delivery of a vessel can generally range between 60 to 90 months depending on the type of ship. MDL constructs the vessels on a fixed price basis with a variable component with respect to weapons / sensors.

Some of the Vessels delivered by MDL in the last 18 years

Name of the ship	Year of delivery	Name of the ship	Year of delivery
P15 A Destroyers		***Pontoon***	
INS Kolkata	2014	SLB	2002
INS Kochi	2015	Vahak	2007
INS Chennai	2016	Vivan	2014
P17 Frigates		Varenya	2016
INS Shivalik	2010	***Floating Border outpost***	
INS Sahyadri	2012	Seema Prahari Dwarka	2003
INS Satpura	2011	Seema Prahari Sagar	2003
Multisupport vessel		Seema Prahari Kamakhya	2003
Hercules -I	2012	Seema Prahari Somnath	2004
Go-Surf	2014	Seema Prahari Shakti	2004
Dredger		Seema Prahari Bajarang	2004
BBMB Dredger	2004	Seema Prahari Durga	2004
Jalangi	2004	Seema Prahari Pratap	2004
Mahananda	2004	Seema Prahari Trishul	2004
Tizu	2004	***Missile Boat***	
DCI dredger XVIII	2009	Prabal	2002

Source RHP

Construction and delivery of a submarine can generally range between 72 to 96 months.

Some of the submarines built by us in the past and delivered to the MoD for use by the Indian Navy

Name of the Submarine	Year of delivery
INS Shalki	1992
INS Shankul	1994
INS Kalvari	2017
INS Khanderi	2019

Source RHP

MDL has carried out the medium refit of the following Shishumar class submarines

Name of the Submarine	Year of delivery
INS Shishumar	2000
INS Shankhush	2005
INS Shalki	2009
INS Shankul	2011

Source RHP

Financial Overview

During FY17-20, the Revenues for the company has registered a CAGR of 12%, while its EBITDA margin improved by 181bps in the same period. The company has adopted lower rate of corporate tax in FY20 as a result of which the deffered tax outgo was Rs 1,703mn in FY20 compared to Rs 298mn in FY19. The net cash flow from operating activites during FY17/18/19/20 were Rs -10,027mn/4,908mn/652mn/-956mn respectively. The Dividend Payout ratio for the company during FY17/18/19/20 has been 33%/49%/19%/46% respectively. The dividend per share for FY20 was Rs 10.8/share. The dividend yield at the higher price band of Rs 145 per share comes to 7.4%.

Impact of COVID – 19

MDL's business operations were temporarily disrupted on account of the temporary shutdown of offices and the shipyard (with the exception of maintenance of essential services) with effect from March 21, 2020 to June 07, 2020 pursuant to the directives from the central/local authorities. Further, the travel restrictions and closure of the shipyard is expected to have an impact on the company's ability to operate and achieve business goals primarily on account of lower capacity utilisation. The spread of COVID-19 caused the company to modify business practices (including employee travel, employee work locations (including implementation of work from home regime for key executives, to the extent possible), and cancellation of physical participation in meetings, events and conferences). The company may take further actions as may be required by government authorities or that it determines are in the best interests of employees, customers, partners, and suppliers. During the period of the lockdown, the company continued paying salaries/wages to all employees including outsourced manpower.

MDL resumed operations from June 08, 2020 in a phased manner as per the Government of India and state government's directives after making arrangements to meet the government's requirements on santization, people movement and social distancing including maintaining roster system and implementing different shifts for the workers and employees at the shipyard.

Risks

MDL's order book has high reliance on Indian Navy. The orders have been awarded on a nomination basis there is no guarantee that the company will be selected for future defence orders on a nomination basis.

Imposition of liquidated damages and invocation of performance bank guarantees / indemnity bonds by the customers could impact results of operations. For the Financial Years 2020, 2019, 2018 and 2017, the liquidated damages collected from vendors and payable to customer were Rs 251mn, Rs 409mn, Rs 169mn and Rs 889mn respectively. Similarly provisions for liquidated damages outstanding for FY20/19/18/17 were Rs 10,241.5mn for each fiscal.

Delays in procurement, nomination etc made by customers and collaborators might result in time and cost over runs.

The company has pending tax proceeding to the tune of Rs 14,459mn. In event of any adverse outcome MDL may be required to pay the disputed amounts along with applicable interest and penalty.

There is a high competition in the sector with presence of established incumbents.

The future growth of the MDL depends on expansion of facilities as the company is currently operating from a single location.

Given the importance of the defence industry to the Indian economy, the GoI could require MDL to take actions designed to serve the public interest and not necessarily to maximise its profits.

CONCLUSION

MDL has priced its issue at Rs 135 - Rs 145 per share which is 6.1 times (at the upper price band) of its FY20 EPS of Rs 23.7 per share which is at a discount to its listed peers such as Cochin Shipyard Ltd (P/E of 6.6x FY20 EPS) and Garden Reach Shipbuilders & Engineers Ltd (P/E of 12.1x FY20 EPS). Considering the company's debt free balance sheet, consistent dividend payment, healthy order book and cheap valuations we recommend SUBSCRIBE on the IPO.

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