Cochin Shipyard Ltd – IPO Analysis

Cochin Shipyard (CSL) is the largest Indian public sector shipyard and it received “Miniratna” status in 2008. It is one of the lucrative IPO listing on basis of its competitive advantages.

Industry Analysis: Ship building Industry

Shipbuilding Industry has shifted from Europe to Asia in past decade due to cheap labour, competitive manufacturing and increase in supply of raw materials like steel. Ship building raw materials such as steel and other components constitute more than 50% of cost. Increase in price of raw materials cannot be passed to customers because of fixed price contracts. Ship building industry can be divided into 3 segments:-

1) public sector shipyards
2) Defence shipyard
3) Private sector shipyards

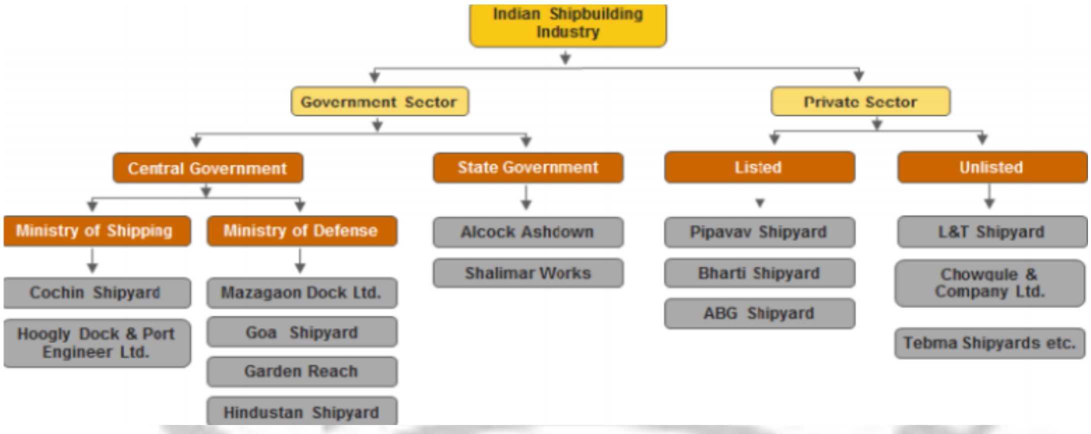
Within public sector, Cochin Shipyard is maximum ship building capacity with 1, 10,000 Deadweight tonnage (DWT). There are other players like Goa Shipyard Limited, Mazagon Dock Shipbuilders Limited in public sector shipyard. As this industry is capital intensive, there are only few players in private sector shipyards. Reliance Defence (RDEL) has maximum capacity in private sector shipyard with 4, 00,000 DWT followed by Bharati Defence and Infrastructure Ltd with 70,000 DWT. There is increase in private ship building capacity in last 5 years because of new entrants such as Larsen& Turbo(30,000DWT) Sembmarine Kakinada (50,000 DWT). Commercial shipbuilding industry is cyclical in nature and is sensitive to nature of industries it serves. However, Defence and others are much resilient

Ship repair Industry

Ship repair Industry is 2X more profitable when compared with ship building industry. Global ship repair market is approximately US$ 12 billion and Indian ship repair industry has market potential of approximately US $ 1.5 billion. Industry is expected to grow at CAGR of 8-10% between FY16-21. Hindustan Shipyard has 80,000 DWT in public sector after Cochin shipyard in this segment. Below figure shows the key competitors in each segment and their financial performance

Segment wise competition from several players

Area of competition		
Ship Building		
Defence	Governement	Mazagon Dock Shipbuilders Limited, Goa Shipyard Limited, Garden Reach Shipbuilders and Engineering Limited
	Private	L&T Shipyard, Reliance Defence and Engineering Ltd
Commercial	Private	Bharati Shipyard, ABG Shipyard, Reliance Defence and Engineering and L&T Shipyard.
Ship Repair		
Defence	Governement	Hindustan Shipyard
	Private	L&T Shipyard, Reliance Defence and Engineering Limited
Commercial	Foreign	Colombo dockyard, Dubai dry dock, Arab ship repair yard and Keppel, Singapore



Peer performance comparison

2017 (Rs in Cr)	Sales	EBITDA	Margins	PAT	EPS	P/E	EV/EBITDA	ROE
Reliance Defence	563.3	34.2	6.1%	-577.2	-7.8	-8.0	393.9	-39.9%
Bharat Electronics Ltd	7,548.5	1,481.3	19.6%	1,387.1	6.2	28.6	26.9	15.1%
Cochin Shipyard	2059.5	380.2	18.5%	312.2	23.0	18.8	10.5	15.4%

Source: Nirmal Bang Retail Research

About Cochin Shipyard Limited

- Largest public sector (PSU) shipyard in India (by capacity) – Miniratna status (2008)
- Strong customer base with strong order book (Rs. 30 bn approx.)
- Only commercial shipyard to have undertaken repair work of Indian Navy's aircraft carriers, the INS Viraat and INS Vikramaditya
- Modern infra & other facilities
- 39% Market share in Ship repairing – Market leader
- FY 17 EPS = Rs. 22.97
- P/E – 15 to 20 (different analysts' reports), EV/EBITDA – 10.5

Clients

- Defence sector – in India – 72.67% revenue share in the past 3 FYs (80% in last 5 FYs)
- Commercial sector – worldwide
- Indian navy + Indian coast guard = 85-90% of revenue share (last 3 FYs)
- SCI, ONGC, Port Trust, NPCC and others

Growth Potential

- Govt. push for indigenous defence equipment – 1/3rd of total ships should be build by Indian shipyards ('Make in India' initiative)
- Engaged in building 1st indigenous aircraft carrier (IAC) for Indian navy – highly probable of being awarded the Phase III of IAC in 2018-19

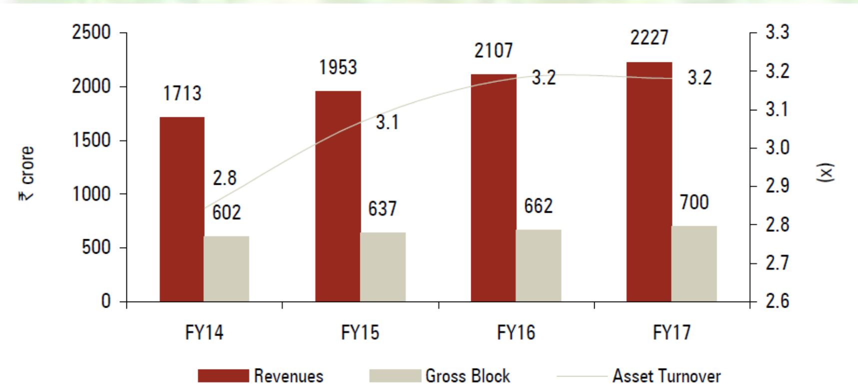
- Opportunity in building inland waterways – demand for dredgers, small bulk carrier vessels & commercial vessels
- Its revenue mix is changed more from shipbuilding to ship repair in last two years. It reflects the improvement in profitability of company because profitability in ship repair
  Thus it is increasing focus on ship repairing for higher GP
  Ship repair's share in revenue – 12% (FY 15), 18% (FY 16), 26% (FY 17)

Financial Performance

- Revenue CAGR (last 3 FYs) – 14%
- Profit-making & Dividend-paying track record

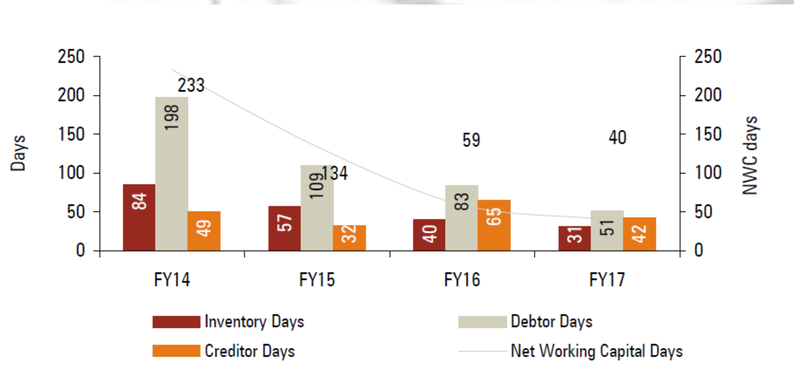
Ratio	Average Range in last 3 FYs
EBITDA Margin	18-20%
PAT	~15%
ROE & ROCE	15-18%
Debt-to-Equity	~0.05

- Asset turnover is increased from 2.8 in 2014 to 3.2 in 2017



Working capital cycle performance (days)

Cochin Shipyard working capital cycle has improved over last 4 years from 233 days to 40 days. Thus it reflects the improvement in efficiency of organization



Future Use of equity

- Setting up a dry dock – Rs. 4500 mn (2 dry docks already exists) – Est. time for completion is 3 years – it will help to build & repair rigs apart from higher-capacity ships
- International Ship Repair Facility – Rs. 2295 mn
- Both of the above will help to increase vessel capacity by 60-70%
- General corporate purposes – Rs. 3062 mn (approx.)

Concerns

- Loss of co.'s major customers & operations (revenue & profit) of the customers
- Signing of IAC Phase III – delays will impact the order book
- Timely commissioning of the new projects (Dry dock & ISRF)
- Global economic conditions – price & demand
- Too much dependence on single location – expansion is limited
- Dependence on global trade activities
- International orders are drying up

As per the data from Indian Express, Cochin Shipyard Limited is going to trade at premium of Rs 140/share. Thus, in secondary market it will be listed around Rs. 572/share and my trade higher later stage.

HDFC Securities, ICICI Securities, Angel Broking and 3 more broking houses have a 'subscribe' rating for the IPO on the back of defence orders, a strong order book. Its valuations are good as pre- issue works out to 15.7x of FY2017 EPS while average ROE and ROCE is above 15%, easing working capital cycle from 233 days in FY2012 to current 40 days and net cash positive cash flows during cyclical business.

By the end of second day, institutional investors bid for 3.41 times the portion of Cochin Shipyard shares reserved for them. while those reserved for high net-worth individuals and retail investors saw 82% and four times subscriptions, respectively