

Cochin Shipyard Ltd

A safe harbor for investments

Cochin Shipyard (CSL) is the largest Indian public sector shipyard and it received "Miniratna" status in 2008. CSL operates a shipyard that provides shipbuilding and ships repair services in both defence and non-defence spaces. CSL generates 74% from shipbuilding and 26% from ship repair.

Healthy order book indicates strong revenue visibility: CSL's current order book stands at ₹3,078cr (1.5x FY2017 revenue), this provides revenue visibility in the near term. Defence sector consists of ~80% of order book (~70% for ship building and ~10% for ship repair). CSL has received order for Indigenous Aircraft Carrier (IAC) for the Indian Navy on nomination basis which shows its capability of execution. It also participated in several tenders (~₹12000cr) of defence, and GOI flagship project .i.e. Sagarmala, Inland Waterways Transport.

Ship repair segment to improve margins: CSL's ship repair revenue has grown by healthy CAGR of 17.5% over FY2013-17 and its contribution to total revenue has also increased from 17% in FY2013 to 26.4% in FY2017. Ship repair business has 2x margins than ship building and CSL is the market leader in the ship repair segment with 39% market share.

Setting up Dry Dock and international ship repair: CSL is in the process of setting up two new docks 'ship repair dock' and 'ship building dock'. This would require capex of ~₹2,700cr in next 3 years. Strong liquidity position, IPO proceeds and approvals in process would help them to finish expansion plan on time.

Strong financial performance coupled with healthy Balance sheet: Despite slowdown in shipbuilding industry CSL's revenue and PAT grew at a CAGR of 11% and 19%, respectively over FY2007-17. Margin has also expanded from 7.9% in FY2007 to 18.4% in FY2017. Its liquidity position is best amongst the listed players with negligible debt (₹228cr) and cash & equivalent of ~₹2,000cr as of FY2017. CSL has reported superior return ratios over FY2012-17 (reported average RoEs, ROCEs of 15.3%, 16.6% respectively).

Outlook & Valuation: In terms of valuation, pre- issue works out to 15.7x of FY2017 EPS (at the upper end of the issue price band), which is reasonably priced on the back of – (1) healthy order book with execution capability and experienced management; (2) Average RoE & ROCE for last 5 years +15%; (3) Despite cyclical business it has maintained net cash positive balance sheet; (4) easing working capital cycle from >195 days in FY2012 to current 59 days. **Considering the past financial performance of CSL and strong visibility on future growth, we rate this issue as SUBSCRIBE.**

Key Financials

Y/E March (₹ cr)	FY2014	FY2015	FY2016	FY2017
Net Sales	1,798	1,583	1,990	2,059
% chg	7	(12)	26	3
Net Profit	282	69	292	312
% chg	6	(75)	321	7
EBITDA (%)	23.2	5.6	19.7	18.5
EPS (Rs)	25	6	26	28
P/E (x)	17	71	17	16
P/BV (x)	3	3	3	2
RoE (%)	19	4	16	15
RoCE (%)	21	3	17	15
EV/EBITDA	11	63	15	15

Source: RHP, Angel Research; Note: Valuation ratios based on pre-issue outstanding shares and at upper end of the price band

SUBSCRIBE

Issue Open: Aug 1, 2017
 Issue Close: Aug 3, 2017

Issue Details

Face Value: ₹10
Present Eq. Paid up Capital: ₹113.28cr
Offer for Sale: **1.13cr Shares
Fresh issue: ₹979cr
Post Eq. Paid up Capital: ₹135.9cr
Issue size (amount): *₹1416r -**1468 cr
Price Band: ₹424-432
Lot Size: 30 shares and in multiple thereafter
Post-issue implied mkt. cap: *₹5764cr - **₹5872cr
Promoters holding Pre-Issue: 100%
Promoters holding Post-Issue: 75%

*Calculated on lower price band

** Calculated on upper price band

Book Building

QIBs	50% of issue
Non-Institutional	15% of issue
Retail	35% of issue

Post Issue Shareholding Pattern

Promoters	75%
Others	25%

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Company background

Cochin Shipyard Ltd is the largest public sector shipyard in India in terms of dock capacity, as of March 31, 2015, according to a CRISIL Report. The company caters to clients engaged in the defence sector in India and in the commercial sector worldwide. In addition to ship building and ship repair, CSL also offers marine engineering training.

As of May 31, 2017, the company has two docks – dock number one, primarily used for ship repair (“Ship Repair Dock”) and dock number two, primarily used for ship building (“Ship building Dock”). The Ship Repair Dock is one of the largest in India and enables it to accommodate vessels with a maximum capacity of 125,000 DWT. Further, Ship building Dock can accommodate vessels with a maximum capacity of 110,000 DWT. CSL is also currently building India's first Indigenous Aircraft Carrier (“IAC”) for the Indian Navy

CSL’s diversified offerings to the Indian clients engaged in the defence sectors and commercial sectors worldwide, has allowed it to successfully adapt to the cyclical fluctuations of the industry.

Exhibit 1: Revenue mix

Activity	FY15	FY16	FY17
Ship building (% of Grand Total)	87	82	74
Defence sector	1231	1503	1363
Commercial sector	133	118	151
Total	1364	1621	1514
Ship repair (% of Grand Total)	13	18	26
Defence sector	54	282	379
Commercial sector	144	82	165
Total	198	364	544
Grand Total	1562	1985	2057

Source: RHP, Angel Research

Issue Details

The company is raising ₹979cr through a fresh issue of equity shares in the price band of ₹424-432. The fresh issue will constitute ~16.67% of the post-issue paid-up equity share capital of the company, assuming the issue is subscribed at the upper end of the price band. The company is offering 1.133cr shares that are being sold by Government of India (GOI).

Exhibit 2: Pre and Post-IPO shareholding pattern

	No of shares (Pre-issue)		No of shares (Post-issue)	
		%		%
Promoter (GOI)	11,32,80,000	100%	10,19,52,000	75%
Other	0	0%	3,39,84,000	25%
	11,32,80,000	100%	13,59,36,000	100%

Source: RHP, Angel Research; Note: Calculated on upper price band

Objects of the offer

- Setting up of a new dry dock within the existing premises of the Company ("Dry Dock"); Out of the proceeds, ₹443cr would be used for Dry dock.
- Setting up of an international ship repair facility at Cochin Port Trust area ("ISRF"); Out of the proceeds ₹229.5cr would be used for Dry dock.
- General corporate purpose.

Key Management Personnel

Mr. Madhu S. Nair – Chairman and Managing Director, Mr. Nair is with the company since 1988 and had joined as a management trainee. He holds Bachelors of Technology in naval architecture and ship building from Cochin University of Science and Technology, India, and a degree in naval architecture and ocean engineering from Osaka University, Japan.

Mr. D. Paul Ranjan – Mr Paul is the director of finance & CFO, since May 1, 2014. He holds Bachelors of Commerce and is a Chartered Accountant. He had joined CSL as an executive trainee in December 17, 1984. He has approximately 32 years of work experience with the Company.

Mr. Suresh Babu N. V – Mr.Suresh is the Director (Operations) since April 26, 2016. He holds Bachelor of Engineering (Mechanical) from the University of Kerala. He joined CSL as an executive trainee in February 1, 1985. He has approximately 31 years of work experience with CSL

Healthy order book indicates strong revenue visibility

CSL's current order book stands at ₹3,078cr (1.5x FY2017 revenue), this provides revenue visibility in the near term. Defence sector consists of ~80% of order book (~70% for ship building and ~10% for ship repair). CSL has received order for Indigenous Aircraft Carrier (IAC) for the Indian Navy on nomination basis, which shows its capability of execution. Additionally, it also participated in several tenders (~₹12,000cr) of defence, and GOI flagship project i.e. Sagarmala, Inland Waterways Transport.

Exhibit 3: CSL's Ship building order book

Project/Vessel	Client
FPV	Indian Coast Guard
Confidential	GoI
IAC	Indian Navy
500 passenger cum 150 MT cargo vessel	A&N Administration
500 passenger cum 150 MT cargo vessel	A&N Administration
1200 passenger cum 1000 MT cargo vessel	A&N Administration
1200 passenger cum 1000 MT cargo vessel	A&N Administration
Double ended Ro Ro Ferry	Kochi Municipal Corporation
Double ended Ro Ro Ferry	Kochi Municipal Corporation
Revenue to be recognized in future (in Cr)	3,078.33

Source: RHP, Angel Research

Strong execution with ability to cater to commercial as well defence sectors

CSL's ability to cater to commercial as well defence ship building and repair, has kept the company afloat since 2011 despite slowdown in commercial shipyard business. We believe that CSL's emphasis on quality of construction and timely delivery have are the key factors to attract new customers and to retain existing customers. For example, it recently delivered seven FPVs for the Indian Coast Guard ahead of the contractual delivery schedule. The final FPV (in a series of 20) was delivered on December 30, 2016, ahead of the scheduled delivery date of March, 2017. Moreover, CSL has built two of India's largest double hull oil tankers, each of 92,000 DWT for SCI.

Exhibit 4: Client Wise revenue

	FY15	FY16	FY17
Defence sector	82.3	89.9	84.6
Commercial sector	17.7	10.1	15.4

Source: RHP, Angel Research

Government initiatives to support shipbuilding industry

Make in India Initiative

Gas Authority of India has signed contracts to buy LNG from suppliers in the US. Transporting this gas will require large specialized LNG carriers. As part of the 'Make in India' campaign, the Government of India is keen that one-third of the total number of ships should be built by Indian shipyards.

Sagarmala Project

According to the national perspective plan, the Sagarmala project aims to transform existing ports and create new ones with world-class technology and infrastructure. The project is also expected to integrate ports with industrial clusters and the hinterland through rail, road, inland and coastal waterways. The government is expected to invest US\$16 billion for the project's completion. The project is expected to tackle underutilised ports by focussing on port modernisation, efficient evacuation, and coastal economic development.

Development of inland waterways transport

Inland waterways transport will be an alternative for the existing mode of transportation. The proposed 101 inland waterways will require an estimated investment of US\$5.5 billion over the next two years. Inland waterways account for only 3% of India's total transport, compared with 47% in China and 44% in the European Union. The government's initiative to develop inland waterways is a big business opportunity for the Indian ship building industry in the form of future orders building dredgers and small bulk carrier vessels.

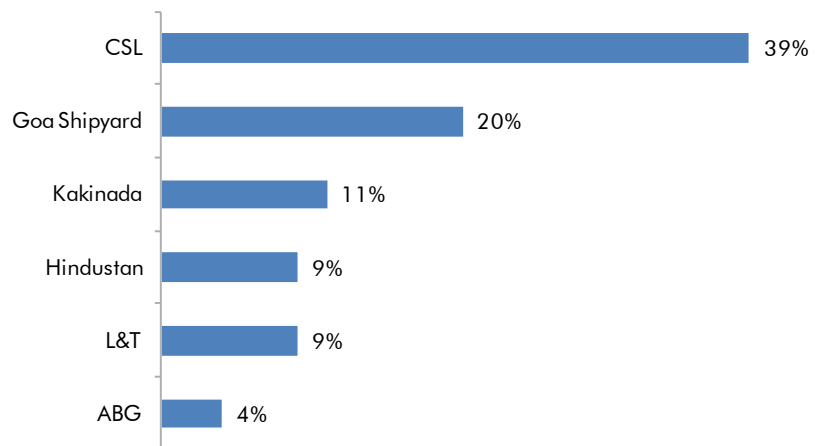
Defence sector liberalisation

The Indian government has taken steps to encourage the domestic defence ship building industry. In August 2014, the foreign direct investment limit was increased from 26% to 49% to cut imports by indigenising defence production. India is among the top ten defence spenders in the world and such a move to encourage domestic manufacturing bodes well for Indian ship builders with a defence presence.

Ship repair segment to improve margins

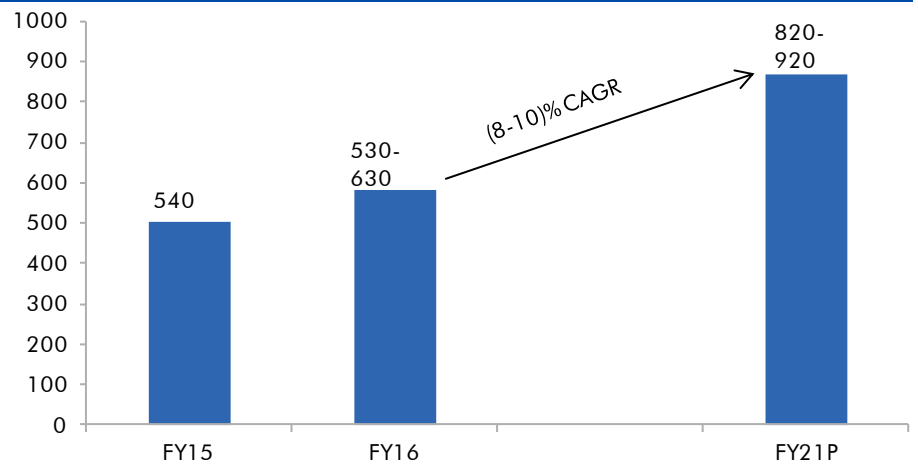
CSL's ship repair revenue has grown by healthy CAGR of 17.5% over FY2013-17; ship repair contribution to revenue has also increased from 17% in FY2013 to 26.4% in FY2017. Ship repair business has 2x margins than ship building and CSL is the market leader in ship repair business with 39% market share which is 2x of its closest peer Goa Shipyard.

Exhibit 5: Market Share of ship repair is ~2x of the closest peer



Source: RHP,, Angel Research

Exhibit 6: Market that is expected to grow at ~10% (₹ in Cr)



Source: RHP, CRISIL Research, Angel Research

Setting up Dry Dock and international ship repair (ISRF)

CSL is in the process of setting up two new docks i.e. 'ship repair dock' and 'ship building dock'. Once developed, we believe that these new facilities for shipbuilding will expand CSL's existing capabilities significantly and help it build and repair a broader variety of vessels including new generation aircraft carriers and oil rigs, which are expected to be key growth drivers in the short to near long term and ISRF will allow the company to undertake repair of a broader range of vessels. Currently, it undertakes repairs of almost all categories of ships (including air craft carriers - INS Viraat and INS Vikramaditya).

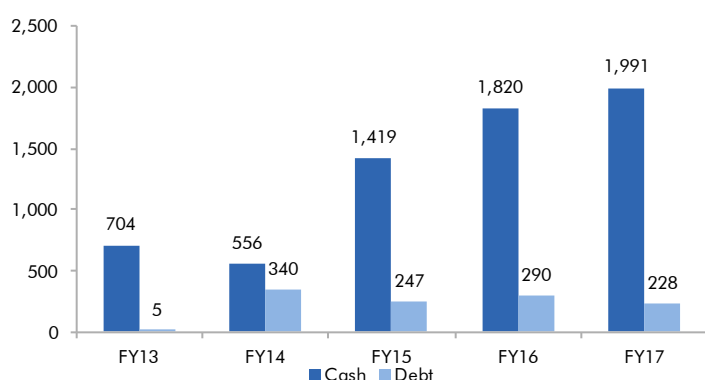
This would require capex of ~₹2,700cr in the next 3 years. Strong liquidity position, IPO proceeds and approval in process would help CSL to finish expansion plans on time.

Strong financial performance, healthy Balance sheet

Despite global slowdown in commercial ship building, CSL has reported good set of numbers during this period. It registered revenue and PAT CAGR of 11% and 19% respectively over FY2007-17. Margin has also expanded from 7.9% in FY2007 to 18.4% in FY2017. Its liquidity position is best amongst the listed player with negligible debt (₹228cr) and cash & equivalent of ~₹2,000cr as of FY2017. CSL has posted superior return ratios over FY2012-17 (reported average RoEs, ROCEs of 15.3%, 16.6% respectively).

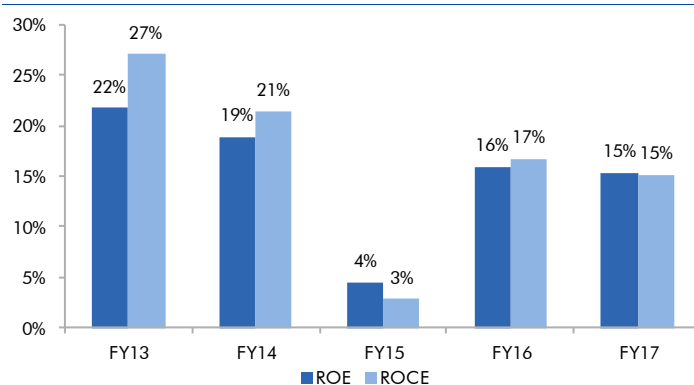
However, private shipyards remain uncertain due to the stressed financial position of major shipyards like ABG Shipyard, RDEL Shipyard and Bharati Defence and Infrastructure Ltd.

Exhibit 7: Healthy Balance sheet (₹in cr)



Source: RHP, Company

Exhibit 8: Return ratios



Source: RHP, Company

Outlook & Valuation

In terms of valuation, pre- issue works out to 15.7x of FY2017 EPS (at the upper end of the issue price band), which is reasonably priced on the back of – (1) healthy order book with execution capability and experienced management; (2) Average RoE & ROCE for last 5 years +15%; (3) Despite cyclical business it has maintained net cash positive balance sheet; (4) easing working capital cycle from >195 days in FY2012 to current 59 days. **Considering the past financial performance of CSL and strong visibility on future growth, we rate this issue as SUBSCRIBE.**

Key Risk

High dependence on defence related projects

CSL's defence related projects have contributed 87.7%, 82.5%, 89.9% and 73.2% to its revenues from operations in FY14, FY15, FY16 and H1FY17 respectively. Further, CSL is currently building India's first Indigenous Aircraft Carrier for the Indian Navy.

Cyclical nature of commercial ship building

Worldwide demand and pricing in the commercial ship building industry are highly dependent upon global economic conditions. If the global economy fails to grow at an adequate pace, it may adversely impact the commercial shipbuilding industry, which may negatively affect CSL's business, financial condition and growth prospects.

Operations are based at a single shipyard at Kochi

The loss of, or shutdown of, operations at company's shipyard in Kochi will have a material adverse effect on the business, financial condition and results of operations.

Volatility in price of raw materials

The major components of CSL's expenditure include raw materials such as steel and other materials, equipment and other components such as pumps, propellers and engines. Any price escalation in the above materials may impact margin of CSL.

Income Statement

Y/E March (₹ cr)	FY2014	FY2015	FY2016	FY2017
Total operating income	1,798	1,583	1,990	2,059
% chg	7	(12)	26	3
Total Expenditure	1,381	1,494	1,598	1,679
Raw Material	990	1,141	1,230	1,314
Personnel	209	213	209	217
Others Expenses	182	140	159	148
EBITDA	417	89	392	380
% chg	18	(79)	339	(3)
(% of Net Sales)	23	6	20	18
Depreciation & Amortization	25	38	37	39
EBIT	391	52	355	342
% chg	17	(87)	588	(4)
(% of Net Sales)	22	3	18	17
Interest & other Charges	19	18	12	11
Other Income	61	77	107	149
(% of PBT)	14	70	24	31
Extraordinary Items	0	0	0	0
Share in profit of Associates	-	-	-	-
Recurring PBT	433	110	450	480
% chg	9	(74)	307	7
Tax	151	41	158	168
PAT (reported)	282	69	292	312
% chg	6	(75)	321	7
(% of Net Sales)	16	4	15	15
Basic & Fully Diluted EPS (Rs)	25	6	26	28
% chg	6	(75)	321	7

Balance Sheet

Y/E March (₹ cr)	FY2014	FY2015	FY2016	FY2017
SOURCES OF FUNDS				
Equity Share Capital	113	113	113	113
Reserves & Surplus	1376	1441	1711	1918
Shareholders Funds	1490	1554	1824	2031
Total Loans	340	247	290	228
Other Liab & Provision	18	19	19	21
Total Liabilities	1847	1820	2133	2280
APPLICATION OF FUNDS				
Net Block	370	370	370	371
Capital Work-in-Progress	8	13	24	54
Investments	0	0	0	0
Current Assets	2155	2305	2506	2485
Inventories	396	303	232	186
Sundry Debtors	1203	583	454	307
Cash	556	1419	1820	1991
Loans & Advances	356	114	180	321
Other Assets	98	89	268	86
Current liabilities	1140	1071	1216	1036
Net Current Assets	1015	1234	1291	1448
Other Non Current Asset				
Total Assets	1847	1820	2133	2280

Cash Flow Statement

Y/E March (₹ cr)	FY2014	FY2015	FY2016	FY2017
Profit before tax	433	110	450	480
Depreciation	22	35	34	36
Change in Working Capital	(496)	738	173	362
Interest / Dividend (Net)	(51)	(54)	(99)	(131)
Direct taxes paid	(88)	(75)	(133)	(150)
Others	(404)	(92)	(385)	(385)
Cash Flow from Operations	(584)	663	40	212
(Inc.)/ Dec. in Fixed Assets	(151)	(35)	(35)	(40)
(Inc.)/ Dec. in Investments	166	50	81	105
Cash Flow from Investing	15	16	47	65
Issue of Equity	-	-	-	-
Inc./(Dec.) in loans	123	-	-	-
Others	148	(235)	(32)	(113)
Cash Flow from Financing	271	(235)	(32)	(113)
Inc./(Dec.) in Cash	(298)	444	55	165
Opening Cash balances	311	13	457	511
Closing Cash balances	13	457	511	676

Key Ratio

Y/E March	FY2013	FY2014	FY2015	FY2016	FY2017
P/E (on FDEPS)	18.4	17.4	70.6	16.8	15.7
P/CEPS	17.2	15.9	45.7	14.9	14.0
P/BV	4.0	3.3	3.1	2.7	2.4
EV/Sales	2.5	2.6	3.6	3.0	2.8
EV/EBITDA	11.9	11.2	63.2	15.3	15.2
EV / Total Assets	3.4	2.5	3.1	2.8	2.5
Per Share Data (₹)					
EPS (Basic)	23.5	24.9	6.1	25.8	27.6
EPS (fully diluted)	19.6	20.7	5.1	21.5	23.0
Cash EPS	25.2	27.1	9.4	29.0	31.0
DPS	1.5	1.5	1.5	1.5	1.6
Book Value	108.2	131.5	137.2	161.0	179.3
Returns (%)					
ROCE	27.1	21.4	2.9	16.8	15.1
Angel ROIC (Pre-tax)	82	30	13	123	146
ROE	21.7	18.9	4.5	16.0	15.4
Turnover ratios (x)					
Inventory / Sales (days)	77	80	70	42	33
Receivables (days)	149	244	134	83	54
Payables (days)	30	35	39	38	29
Working capital cycle (ex-cash) (days)	195	290	165	87	59

Note: Valuation ratios based on pre-issue outstanding shares and at upper end of the price band

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