Cochin Shipyard

Monopoly in Ship repair in India
Longtime & Credible Ship builder

Ganesh Raao
Disc: Not invested

Background

- A pioneer in defence shipbuilding and ship repair. A well known player in the global shipbuilding front.
- Incorporated in 1972 and fully owned by the GoI.
- Now a publicly listed company with the majority owner being the govt(~72%). Listed in Aug’17. It has the ‘Miniratna’ status.
- Has built and repaired some of the largest ships in India.
- Second largest ship repair capacity in India.

Niche - Moat

1. The only yard in India to have undertaken the repairs of Aircraft carriers, CSL has proven track record in ship building and ship repair.
2. The only commercial shipyard in the country that has the ability to repair defence ships and its facilities are routinely used to carry out repairs and maintenance work of various defence ships.
3. Technology (autonomous - ASKO won)
4. Capacity and Infrastructure.
5. While many of its competitors are struggling to stay afloat or in bankruptcy, the company continues to post good results consistently.
6. 20-30% of the revenue is from commercial shipbuilding, which is highly cyclical, which is counterbalanced by steady defence work revenue.

IAC - Indian Aircraft Carrier

1. In a first, the Government of India (GoI) in May 1999 approved the construction of a first indigenous aircraft carrier of around 40,000 tonnes displacement at Cochin Shipyard (CSL), Kochi.
    a. After several delays in decision making and material procurements, the project finally took off in April 2005.
    b. In June 2015, the giant ship was finally undocked marking the end of Phase - I of the project. The ship will now undergo a series of fitment and trial processes before it is ready for induction into the Navy.
2. It is planned that the INS Vikrant would be floating out in 2017/18, with sea trials in 2018-19 and commissioning in late 2019/early 2020.

3. Expected to be inducted in to the navy by end of 2021.

4. Currently doing Basin trails as it in Phase 3. Phase 2 delivery has concluded.

IAC - Phase 2 and the phase 3 was a slightly different thing because that is one single project even though technically we are calling it phase 1, phase 2, phase 3.

Essentially, we know very clearly that the project is an old project and it is only for the comfort and practical reasons that the fixed prices is being divided into 3 and the Cost Plus go seamless. Phase 3 - The phase III contract includes operational and harbour acceptance trials of various equipment and systems installed and also the Sea Trials of the Carrier.

Revenue recognition of IAC

IAC has two components to it:

Fixed - This component relates to executing internally - labor overhead and profit#
- this provides higher margin yields.

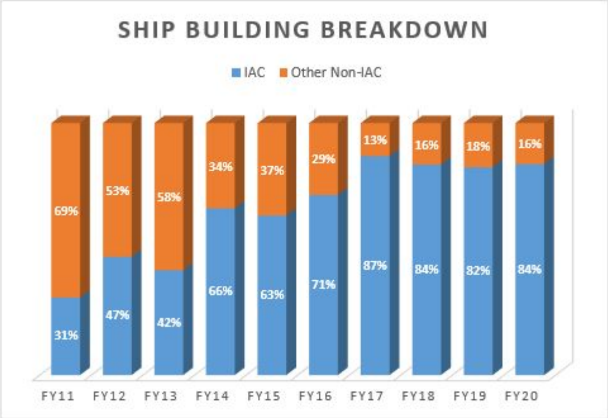
Cost Plus - all the materials required for the IAC project are included in this component. If there is any escalation of price to any of the raw materials needed (Raw materials consumed are: Steel, Pipe, paint and Bought out components), it will be covered and be ‘paid up’ accordingly. Margin here is around 12.5%

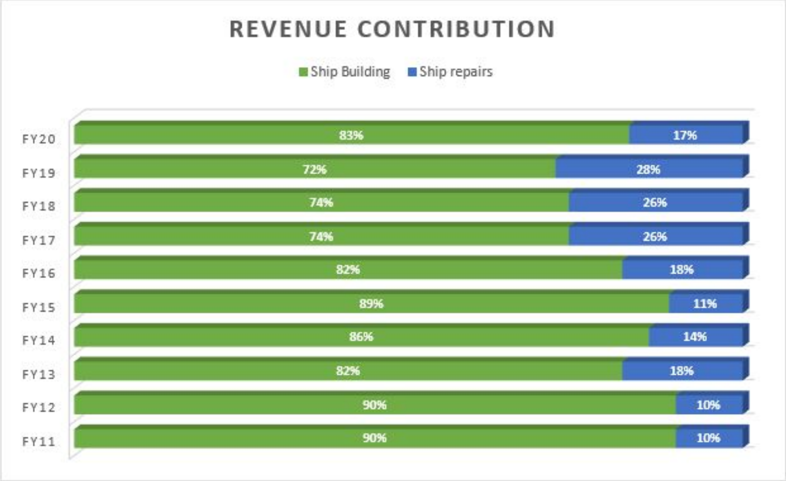
As of Aug 17, 2020 - Remaining to be delivered - Cost plus is 3,800 crore and fixed price is around 2,470. So total unexecuted = 6,270 crores.

Revenue Breakdown

Revenue Sources	FY11	FY12	FY13	FY14	FY15	FY16	FY17	FY18	FY19	FY20
IAC	401	597	529	933	1039	1159	1315	1443	1757	2378
Other Non-IAC	902	674	742	476	603	462	199	284	373	462
IAC	31%	47%	42%	66%	63%	71%	87%	84%	82%	84%
Other Non-IAC	69%	53%	58%	34%	37%	29%	13%	16%	18%	16%
Ship Building	1303	1271	1271	1409	1642	1621	1514	1727	2130	2840
Ship repairs	142	145	287	228	196	367	543	623	834	570
Total	1,445	1,416	1,558	1,637	1,838	1,988	2,057	2,355	2,966	3,422

Segments	FY11	FY12	FY13	FY14	FY15	FY16	FY17	FY18	FY19	FY20
Ship Building	90%	90%	82%	86%	89%	82%	74%	74%	72%	83%
Ship repairs	10%	10%	18%	14%	11%	18%	26%	26%	28%	17%





Employee cost

CSL can execute projects efficiently due to its system of subcontracting, whereby majority of the workforce are daily subcontract workers, which allows it to maintain flexible workforce. CSL has a very efficient employee cost structure where employee cost accounted for only 9% of its FY20 sales which is very low compared to other public sector yards.

Cash Mgmt

CSL will have cash on its balance sheet due to capital advance from major defence contracts, which is typical for defence shipbuilding due to the high working capital requirement of the industry. While valuing and analyzing this company, it would be prudent to exclude the Other income component and perform our due diligence.

One of the lowest sales to employee cost

Cochin Shipyard | Chart | Analysis | Peers | Quarters | Profit & Loss | Balance Sheet | Cash Flow | Ratios | Investors | Documents

Profit & Loss

PRODUCT SEGM

Consolidated Figures in Rs. Crores / View Standalone

	Mar 2018	Mar 2019	Mar 2020	TTM
Sales +	2,355	2,966	3,422	2,703
Expenses -	**1,891**	**2,394**	**2,711**	**2,201**
Material Cost %	51%	51%	52%	
Manufacturing Cost %	13%	15%	13%	
Employee Cost %	12%	9%	9%	
Other Cost %	5%	5%	5%	
Operating Profit	**464**	**571**	**711**	**502**
OPM %	20%	19%	21%	19%
Other Income	189	226	245	207

Weaknesses:

(a) Virtually non-existent indigenous ancillary industries and consequently non-availability of major equipment/ raw materials in India;

(b) Infrastructure constraints due to non-availability of large sized dock to build and repair ships beyond 1,10,000 DWT and 1,25,000 DWT respectively. (This will be overcome with the proposed new dry-dock);

(c) Difficulty to arrange long term project finance to ship owners which is offered by other overseas shipbuilding countries; and

(d) Comparatively higher social and employee overheads and certain restrictive labour practices especially for contracting labour.

Order book visibility

Current Orderbook is 14,400 Crores - visibility for next 2-3 years

Vessels	Total in hand	FY21	Fy22	FY23	FY24
IAC	6,500	~2500	2000	1200	800
ASW	6,500	150	2000	2000	2000

Potential projects tendered: 13,000 Crores

Capacity expansion

Q4 FY20 - "CSL is probably the key ship repair player in India and we are doing vast majority of the ship repairs that are happening in India, but again currently where we are, we are actually unable to squeeze in anymore. We are actually doing much more than we can actually chew even now. So that is precisely why we are going in for these CAPEX projects, the ISRF which is the International Ship Repair Facility and the new Dry Dock. And once these two are in place, we get more infrastructure available so we can take more ship. "

With a single dry dock - unable to cater to other opportunities. INS Vikramaditya docked, lost opportunities#.

ISRF: International ship repair facility

- Can help cater to ~180 from current 80-100 ships.
- Can help add another 300 crores to the top line with in a couple of year.

Dry Dock: increases ship building and repair capacity essentially required to tap the market potential of building specialized and technologically advanced vessels such as LNG Carriers, Aircraft Carriers of higher capacity, jack up rigs, drill ships, large dredgers and repairing of offshore platforms and larger vessels.

Hooghly-HCSL	Ship building, east coast
TSL	Fishing vessels
Mumbai RU	Ship repair Units (RU)
Kolkata RU	Ship repair Units (RU)
A&N RU	Ship repair Units (RU)

Tailwinds & Optionality

- Indian Navy (@137) & Indian coastal guard (@120) plans to increase its fleet from to 200 each by 2027
    - They get advance payments - have cash in hand!
- Inland waterways demand for National Waterways - IWAI - Hooghly - HCSL
- Commercial Shipbuilding & Ship repair (capacity constraints) - 15% market share as of this year for SR.
- Govt. Incentives:
    - Financial assistance scheme
    - Infrastructure status - meaning cheaper long term financing
    - Permitting 100% FDI
    - Right of 1st refusal to indian shipyards for govt. Procurement.
- 101 items banned by govt. from import - Make in India - AtmaNirbhar
- Fishing vessels - low value high volume - *(Separate unit acquired from NCLT - Temba Shipping Ltd.)*

Tailwinds & Optionality - Contd.

- Ship repair is a recurring revenue stream. Once a ship is built, maintenance, refit, etc are part and parcel of the ships lifecycle.
    - For example for IAC within$^{\%}$:
        - 1.5 years - short servicing, 50 cr
        - 3^{rd} year - 100 cr
        - 5^{th} year - normal servicing, 250 crores
        - 7^{th} year - medium term servicing, 500 crores
    - Add to this the capacities being added with Mumbai and Kolkata facilities coming to play.
- IMO - Global fuel - Sulphur Cap enforce a new 0.5% global sulphur cap on fuel content from January 01, 2020, lowering from the old 3.5% limit.
- **Talks about building the IAC 2, which CSL would stand to gain in my opinion

Competitor(s)

The only listed player to whom we can compare and play this is Garden Reach Shipbuilders Engg.(GRSE). Look at the margins, Return metrics, i would personally prefer to play CSL for the long term.

COCHIN SHIPYARD LTD	Mar-17	Mar-18	Mar-19	Mar-20
Gross Margin =Gross Profit/Sales	51.01%	50.51%	49.28%	47.52%
EBIT/Sales	24.56%	26.19%	25.86%	26.68%
EBITDA/Sales	26.43%	27.78%	27.01%	28.10%
Op Profit (Ex Other Income)/Sales	18.72%	19.75%	19.34%	20.87%
Net Margin =PAT/Sales	15.62%	16.85%	16.23%	18.63%
Op Cash Flow/Sales	10.31%	26.84%	-15.12%	7.38%
Free Cash Flow/Sales	6.98%	23.58%	-24.77%	-17.67%
EPA/Sales	3.46%	0.04%	2.82%	6.42%
Sales/Invested Capital =Capital Turns	0.96	0.70	0.87	0.90
Sales/Fixed Assets= Fixed Asset Turns	5.56	6.75	7.92	4.53
Sales/Total Assets= Asset Turns	0.62	0.43	0.57	0.53
Net Margin*Asset Turns= RoA	9.68%	7.24%	9.17%	9.95%
Margin*Asset Turn*Fin Leverage= RoE	15.85%	12.19%	14.44%	17.09%
RoCE	23.50%	18.25%	22.19%	23.68%
Margin*Cap Turns*(1-Tax rate)= RoIC	15.31%	12.03%	14.47%	17.79%

EN REACH SHIPBUILDERS & ENGINEER	Mar-11	Mar-18	Mar-19	Mar-20
Gross Margin =Gross Profit/Sales	#DIV/0!	80.86%	44.29%	47.96%
EBIT/Sales	#DIV/0!	10.06%	13.28%	15.71%
EBITDA/Sales	#DIV/0!	12.21%	15.23%	17.81%
Op Profit (Ex Other Income)/Sales	#DIV/0!	-1.10%	2.92%	2.58%
Net Margin =PAT/Sales	#DIV/0!	6.86%	7.93%	11.41%
Op Cash Flow/Sales	#DIV/0!	-5.50%	-8.05%	43.80%
Free Cash Flow/Sales	#DIV/0!	-37.73%	-5.05%	40.39%
EPA/Sales	#DIV/0!	-1.83%	-0.81%	3.22%
Sales/Invested Capital =Capital Turns	#DIV/0!	1.32	1.34	1.45
Sales/Fixed Assets= Fixed Asset Turns	#DIV/0!	3.46	4.59	4.72
Sales/Total Assets= Asset Turns	#DIV/0!	0.31	0.33	0.27
Net Margin*Asset Turns= RoA	#DIV/0!	2.14%	2.62%	3.03%
Margin*Asset Turn*Fin Leverage= RoE	#DIV/0!	9.05%	10.59%	15.72%
RoCE	#DIV/0!	13.26%	17.73%	21.65%
Margin*Cap Turns*(1-Tax rate)= RoIC	#DIV/0!	9.59%	10.91%	16.68%

Risks

1. Govt. changes and new rules are passed - hampering growth.
2. Revenues not converted to Cash due to delay in payments by govt. dept.
3. Beyond the big ticket item (IAC) - revenue growth? - Uncertainty!
4. Oil prices if trends lower sustainably - might impact new ship requests.
5. Competition from private sector driving margins down.
6. Defence budget for the future if reduced, might impact growth rate for CSL.

Valuation

1. Current PE of ~9.5 (with current depressed earnings due to COVID)
2. Dividend Yield of ~5%
3. ROIC of ~ 22.5
4. ROE of ~ 18

Heads you win, tails you don't lose much - based on your appetite and opportunity cost hurdle, this could be play on rerating with margin expansion.

Worst case, say for 3 years you don’t get too much in return terms, at least you walk away with close to FD type of returns from dividends.

Appendix


INS Viraat - Post Repair


Oil Rigs, Jack Rigs


Oil Tankers


Floating Border Outpost Vessels


Bulk Carrier

RoRo Ships

ISRF

Expected FY 21-22 completion - 750 Crores

The International Ship Repair Facility (ISRF) will modernise and expand the existing ship repair facility in CSL. The ISRF includes 6000T shiplift for ships upto 130 x 25 m with six work stations and allied facilities. Total outfitting berth of 1500 meters approx.

Dry Dock

Expected FY 21-22 completion - 1600 Crores

Opportunities lost with IAC docked and being built.

ASWC - Anti-Submarine Warfare Corvettes