

Pick-up in execution to drive earnings...

About the stock: Mazagon Dock Shipbuilders (MDL) is engaged in the construction and repair of warships and submarines for the Ministry of Defence (MoD) to be used by the Indian Navy along with other vessels for commercial clients

- MDL is India's only shipyard to have built destroyers and conventional submarines for the Indian Navy
- Over the last 10 years, MDL's revenue increased at 10.5% CAGR over FY13-22 while EBITDA and PAT increased at 3.6% and 3.9% CAGR, respectively, during the same period due to a fall in operating margins

Key Highlights: H1FY23 profitability was driven by better execution, improvement in margins and higher other income.

- Revenue increased 8.4% YoY to ₹ 1702.4 crore in Q2FY23. However, revenue declined 23.7% sequentially. H1FY23 revenue was up 41.2%
- EBITDA margin improved 149 bps YoY to 6.9% during the quarter. EBITDA increased 38.3% YoY to ₹ 117.8 crore. H1FY23 EBITDA was up by 87.5%
- PAT increased 58.4% YoY to ₹ 213.9 crore; led by better margins and higher other income. H1FY23 PAT increased 85.4%

What should investors do? We expect MDL to deliver earnings CAGR of 24% in FY22-24E led by 18% revenue CAGR (on better execution) and sustainable margins

- We downgrade our recommendation on the stock from BUY to **HOLD**

Target Price & Valuation: We value MDL at ₹ 1025 on 22x P/E on FY24E EPS basis.

Key triggers for future price performance:

- Strong order backlog at ₹ 42000 crore (6.1x TTM revenues) gives strong revenue visibility. The order book comprises three major contracts - Project-17A frigates, Project-15B destroyers and Project-75 submarines
- MDL is well placed to benefit from Indian Navy's big procurement plan for the next three to four years. Indian Navy's major projects in the pipeline are next generation destroyers, frigates, conventional submarines and corvettes. The estimated cost of these four projects is ~₹ 1.8 lakh crore
- DAC has approved the procurement of eight next generation corvettes and RFP for the same is expected to be issued in 2023. The contract value is expected to be ₹ 36000 crore (which will be divided into two shipyards)

Alternate Stock Idea: We like Bharat Electronics (BEL) also in the defence space.

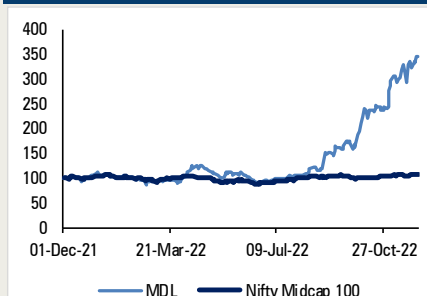
- Strong order book and healthy pipeline in defence electronics offers strong visibility; diversifying into non-defence to help improve margins
- BUY with a target price of ₹ 135/share



Particulars

Particular	Amount
Market Capitalisation (₹ Crore)	18,192
FY22 Debt (₹ Crore)	0
FY22 Cash (₹ Crore)	11,473
EV (₹ Crore)	6,719
52 Week H/L (Rs)	937/224
Equity Capital (₹ Crore)	201.7
Face Value	10

Share Price Performance



Shareholding Pattern

	Dec-21	Mar-22	Jun-22	Sep-22
Promoter	84.8	84.8	84.8	84.8
FII	1.8	2.1	2.5	3.1
DII	1.0	1.0	1.2	0.8
Others	12.4	12.1	11.6	11.4

Key risks

- Dependence on government contracts
- Dependence on OEMs for key components

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Key Financial Summary

(₹ crore)	FY20	FY21	FY22	3 Year CAGR (FY19-22)	FY23E	FY24E	2 Year CAGR (FY22-24E)
Revenues	4,918	4,048	5,733	7.5	7,298	8,028	18.3
EBITDA	260	224	435	18.6	542	733	29.8
EBITDA margin (%)	5.3	5.5	7.6		7.4	9.1	
Net Profit	471	514	611	4.7	803	940	24.0
EPS (₹)	23.4	25.5	30.3		39.8	46.6	
P/E (x)	38.1	29.9	29.3		22.7	19.4	
EV/EBITDA (x)	47.7	45.8	15.5		15.4	9.7	
RoCE (%)	24.5	21.5	20.0		22.9	23.5	
RoE (%)	15.6	17.7	16.1		18.2	18.5	

Key Highlights

- Revenue from operations for Q2FY23 increased by 8.4% YoY to ₹ 1702.4 crore. However, revenue declined 23.7% sequentially as execution during the quarter remained slower than expected. H1FY23 revenue growth was at 41.2% YoY; mainly led by strong execution seen during Q1FY23
- Gross margin was at 30.3% during the quarter, contracting by 407 bps YoY as the total raw material cost has increased 15.1% YoY
- EBITDA margin improved by 149 bps YoY to 6.9% in Q2FY23; better than our estimate of 5.5%. This was primarily on account of lower-than-expected others cost, which declined 23.1% YoY. However, margins contracted 87 bps on a sequential basis
- EBITDA increased 38.3% YoY to ₹ 117.8 crore during the quarter (vs. I-direct estimate of ₹ 103.6 crore) led by growth in revenues with improvement in EBITDA margins. H1FY23 EBITDA was up 87.5% YoY led by strong revenue growth during the period with margin improvement (H1FY23 EBITDA margin improved by 183 bps YoY)
- Other income in Q2FY23 increased 81.6% YoY to ₹ 163.6 crore (higher than our estimate). PAT increased 58.4% YoY to ₹ 213.9 crore (against our estimate of ₹ 136.3 crore) led by strong growth in EBITDA and other income. H1FY23 PAT was up 85.4% YoY
- The order book was at ₹ 42000 crore as of September 2022 (6.1x TTM revenues), which comprises three major contracts like Project-17A frigates, Project-15B destroyers and Project-75 submarines
- The company delivered a second destroyer ship under P-15B named INS Mormugao to Indian Navy on Nov 24, 2022. It is expected to be commissioned in December 2022. The first destroyer (INS Vishakhapatnam) was already commissioned in November 2021. The other two destroyers under P-15B have also been launched and are expected to be commissioned in 2024 and 2025
- Under Project-75, the fifth submarine (INS Vagir) is also expected to be delivered to Indian Navy in December 2022/January 2023. The sixth and last submarine (INS Vagsheer) was already launched in April 2022 and is expected to be delivered in 2023. First frigate ship under P-17A (INS Nilgiri) is expected to be delivered in 2023
- The management, in a media interaction, has given the revenue guidance of 25-30% growth for FY23E. They said the current order-backlog of ₹ 42000 crore will get executed over the next three to three and a half years
- DAC has approved the procurement of eight next generation corvettes and RFP for the same is expected to be issued in 2023. The contract value is expected to be ₹ 36000 crore. The contract will be divided into two shipyards (₹ 22500 crore for L1 and ₹ 13500 crore for L2). MDL is expected to be one of the shipyards to get this contract
- Additional projects that are in the pipeline are five next generation destroyers (contract value is expected at ₹ 50000 crore), six AIP powered conventional submarines (contract value is expected at ₹ 43000 crore), six high speed landing crafts and other contracts including different types of vessels

Exhibit 1: Variance Analysis

	Q2FY23	Q2FY23E	Q2FY22	YoY (%)	Q1FY23	QoQ (%)	Comments
Operating Income	1,702.4	1,884.1	1,570.1	8.4	2,230	-23.7	Revenue was lower than estimate due to slower execution
Other income	163.6	100.0	90.1	81.6	136	20.2	
Total Revenue	1,866.0	1,984.1	1,660.2	12.4	2,366.5	-21.1	
Raw materials costs	1,186.9	1,300.1	1,030.8	15.1	1,577	-24.7	
Employees Expenses	203.9	197.8	202.1	0.9	182	12.2	
Other Expenses	193.8	282.6	252.1	-23.1	298	-34.9	
Total Expenditure	1,584.6	1,780.5	1,485.0	6.7	2,057	-23.0	
EBITDA	117.8	103.6	85.1	38.3	173.7	-32.2	
EBITDA margins (%)	6.9	5.5	5.4	149 bps	7.8	-87 bps	Margin came better than expectations led by lower than expected others cost
Interest	1.5	2.0	1.9		1.5		
Depreciation	18.5	20.0	17.3	6.7	18.4	0.4	
Tax	66.5	45.4	30.5	117.6	73.0	-8.9	
PAT	213.9	136.2	135.0	58.4	224.8	-4.8	

Source: ICICI Direct Research, Company

Exhibit 2: Change in Estimates

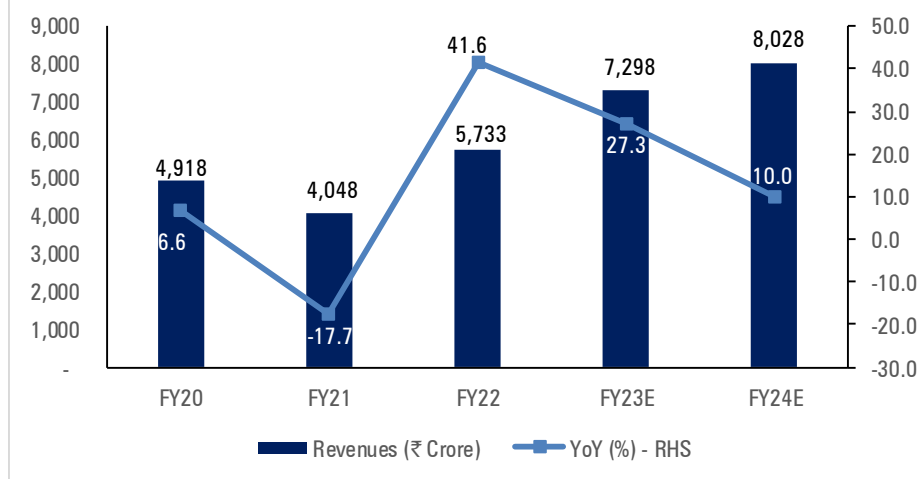
(₹ Crore)	FY23E			FY24E		
	Old	New	% Change	Old	New	% Change
Revenue	6,508	7,298	12.1	8,005	8,028	0.3
EBITDA	469	542	15.5	731	733	0.3
EBITDA Margin (%)	7.2	7.4	22 bps	9.1	9.1	0 bps
PAT	628	803	27.8	809	940	16.2
EPS (₹)	31.2	39.8	27.8	40.1	46.6	16.2

Source: ICICI Direct Research, Company

Financials

Revenues expected to grow at 18.3% CAGR over FY22-24E

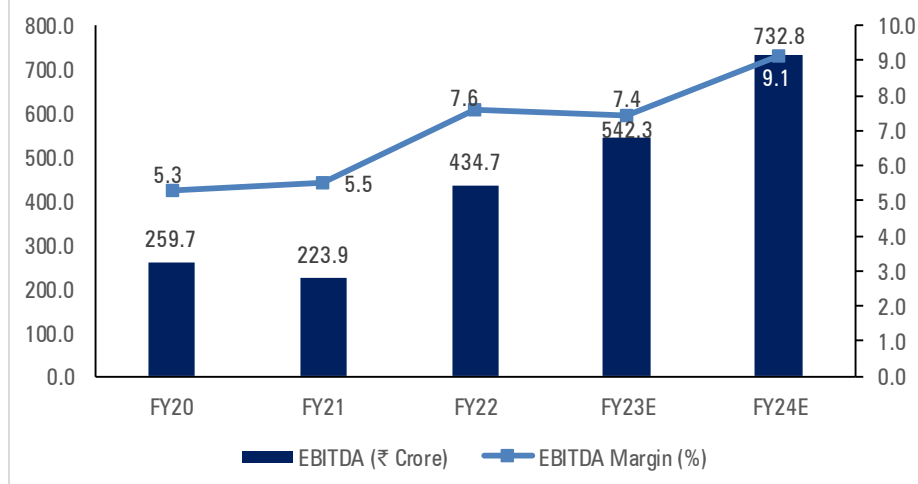
Exhibit 3: Revenue to grow at ~18% CAGR on strong execution



Source: ICICI Direct Research, Company

EBITDA margins expected to improve in FY24E

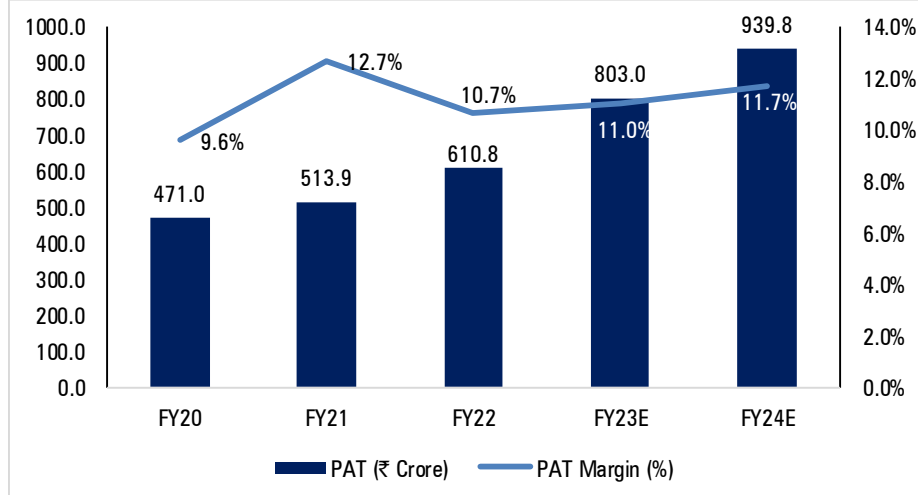
Exhibit 4: Better operating leverage to drive EBITDA at 29.8% CAGR over FY22-24E



Source: ICICI Direct Research, Company

PAT margins expected to be 11-12% over FY22-25E

Exhibit 5: PAT likely to increase at 24% CAGR over FY22-24E



Source: ICICI Direct Research, Company

Financial Summary

(₹ Crore)	FY21	FY22	FY23E	FY24E
Revenue	4,048	5,733	7,298	8,028
% Growth	(17.7)	41.6	27.3	10.0
Other income	574.1	410.3	550.0	550.0
Total Revenue	4,604	5,733	7,298	8,028
% Growth	(15.9)	24.5	27.3	10.0
Total Raw Material Costs	2,460	3,607	4,869	5,310
Employee Expenses	653	799	887	975
other expenses	711	893	1,000	1,010
Total Operating Expenditure	3,824	5,299	6,755	7,295
Operating Profit (EBITDA)	224	435	542	733
% Growth	(13.8)	94.2	24.8	35.1
Interest	8	7	7	7
PBDT	790	838	1,086	1,276
Depreciation	60	75	82	90
PBT before Exceptional Items	730	763	1,004	1,186
Total Tax	150	186	251	297
PAT before MI	453	563	753	890
PAT	514	611	803	940
% Growth	9.1	18.9	31.5	17.0
EPS	25.5	30.3	39.8	46.6

Source: ICICI Direct Research

(₹ Crore)	FY21	FY22	FY23E	FY24E
Profit after Tax	514	611	803	940
Depreciation	60	75	82	90
Interest	8	7	7	7
Cash Flow before WC changes	582	693	891	1,036
Changes in inventory	(1,266)	(1,811)	(297)	(1,240)
Changes in debtors	467	(39)	(394)	(140)
Changes in loans & Advances	(0)	2	-	-
Changes in other current assets	(873)	1,051	(773)	(657)
Net Increase in Current Assets	(1,783)	(993)	(1,666)	(2,086)
Changes in creditors	1,544	(106)	(68)	940
Changes in provisions	(56)	44	23	21
Net Inc in Current Liabilities	4,233	4,484	(258)	2,700
Net CF from Operating activities	3,032	4,184	(1,033)	1,650
Changes in deferred tax assets	(9)	(23)	-	-
(Purchase)/Sale of Fixed Assets	(30)	(239)	(110)	(110)
Net CF from Investing activities	(743)	(456)	(371)	(127)
Dividend and Dividend Tax	(155)	(176)	(242)	(277)
Net CF from Financing Activities	(150)	(192)	(249)	(284)
Net Cash flow	2,140	3,536	(1,653)	1,240
Opening Cash/Cash Equivalent	5,798	7,938	11,473	9,821
Closing Cash/ Cash Equivalent	7,938	11,473	9,821	11,060

Source: ICICI Direct Research

(₹ Crore)	FY21	FY22	FY23E	FY24E
Equity Capital	201.7	201.7	201.7	201.7
Reserve and Surplus	3,230	3,656	4,217	4,879
Total Shareholders funds	3,432	3,858	4,419	5,081
Other Non Current Liabilities	163.5	158.1	158.1	158.1
Total Debt	-	-	-	-
Total Liabilities	4,356	4,586	5,147	5,810
Gross Block	1,072	1,293	1,405	1,515
Acc: Depreciation	277	336	418	508
Net Block	795	957	987	1,007
Capital WIP	80	87	85	85
Total Fixed Assets	887	1,052	1,080	1,100
Non Current Assets	2,167	2,189	2,451	2,467
Inventory	5,889	7,700	7,998	9,237
Debtors	966	1,005	1,400	1,540
Loans and Advances	2	-	-	-
Other Current Assets	6,846	5,795	6,568	7,225
Cash	7,938	11,473	9,821	11,060
Total Current Assets	21,994	26,522	26,536	29,862
Current Liabilities	6,272	6,166	6,098	7,038
Provisions	730	565	565	565
Total Current Liabilities	20,693	25,177	24,919	27,619
Net Current Assets	1,301	1,345	1,617	2,243
Total Assets	4,356	4,586	5,147	5,810

Source: ICICI Direct Research

(Year-end March)	FY21	FY22	FY23E	FY24E
EPS	25.5	30.3	39.8	46.6
Cash per Share	393.6	568.9	486.9	548.4
BV	170.1	191.3	219.1	251.9
Dividend per share	7.2	8.7	12.0	13.8
Dividend payout ratio	28%	29%	30%	30%
EBITDA Margin	5.5	7.6	7.4	9.1
PAT Margin	12.7	10.7	11.0	11.7
RoE	17.7	16.1	18.2	18.5
RoCE	21.5	20.0	22.9	23.5
RoIC	(3.6)	(4.7)	(8.5)	(10.8)
EV / EBITDA	45.8	15.5	15.4	9.7
P/E	29.9	29.3	22.7	19.4
EV / Net Sales	2.5	1.2	1.1	0.9
Sales / Equity	1.2	1.5	1.7	1.6
Market Cap / Sales	4.5	3.2	2.5	2.3
Price to Book Value	5.3	4.7	4.1	3.6
Asset turnover	1.2	1.5	1.7	1.6
Debtors Turnover Ratio	3.4	5.8	6.1	5.5
Creditors Turnover Ratio	0.7	0.9	1.2	1.2
Debt / Equity	-	-	-	-
Current Ratio	2.1	2.2	2.5	2.4
Quick Ratio	1.2	1.1	1.2	1.2

Source: ICICI Direct Research

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Sell: <-15%



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