Mishra Dhatu Nigam (MISDHA)

CMP: ₹ 383 | Target: ₹ 465 (+21%) | Target Period: 12 months | BUY

August 18, 2023

Conviction Idea

Opportunities galore; execution set to pick-up…

About the stock: Mishra Dhatu Nigam (Midhani) is the manufacturer of High performance alloys, special steels and stainless steels, super alloys (nickel base, iron base and cobalt base), varieties of titanium alloys etc

- The Company has two state of the art manufacturing facilities - Hyderabad (Telangana) and Rohtak (Haryana)
- Consolidated revenue has grown by 6.9% CAGR in the last 3 years during the period FY20-23 while EBITDA have grown by 9.2% CAGR over the same period. PAT CAGR during the period FY20-23 have remained flattish. During FY23, company reported revenues of ₹ 871.9 crore (+1.4% YoY) while EBITDA at ₹ 257.5 crore (-1.8% YoY) with EBITDA margin at 29.5%. FY23 PAT was at ₹ 156.3 crore (-11.5% YoY)

Key Investment Thesis:

- **Strong capabilities in manufacturing & development of wide-range of strategic materials; Focus on product indigenisation**: Midhani, the prime production partner for high value strategic material products in defence & space, has core competence to develop and manufacture wide range of these materials & superalloys for these sectors. With focus on indigenisation and strong capabilities backed by advanced & unique metallurgical facilities at Hyderabad & Rohtak, the company is well positioned to benefit substantially from increasing requirements of these strategic materials
- **Strong orders prospects in defence, space provides Healthy visibility; Substantial opportunities from other segments too**: The Company's order backlog stood at ₹ 1622 crore as of July 2023 end (~1.9x of FY23 revenues), which gives strong revenue growth visibility over the next 2 years given the short execution cycle for large part of this order book . Moreover, we believe that there is a healthy growth visibility in the longer term considering the orders pipeline in defence, space and other segments like energy, railways, civil aviation etc, led by certain requirement of company's products (superalloys, titanium alloys etc) in major platforms in these segments

Rating and Target Price

- Midhani is set to benefit substantially from increasing capital outlay across its target segments – defence, space, railways, energy etc. With focus on improving execution, developing product portfolio and exports, we believe company's operational and financial performance would improve considerably in the coming period. We estimate revenue and PAT to grow at ~20% and ~18% CAGR over FY23-25E
- We maintain our **BUY** rating on Midhani. We value the stock at ₹ 465 per share (based on 40x FY25 EPS)

Particulars

Particular	Amount
Market Capitalisation (₹ Crore)	7,175
FY23 Gross Debt (₹ Crore)	387
FY23 Cash (₹ Crore)	14
EV (₹ Crore)	7,548
52 Week H/L (Rs)	398 / 171
Equity Capital	187.3
Face Value	10.0

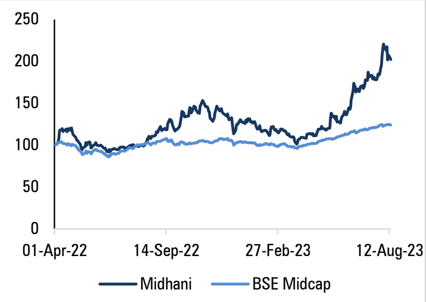
Shareholding Pattern

	Sep-22	Dec-22	Mar-23	Jun-23
Promoter	74.0	74.0	74.0	74.0
FII	0.5	0.5	0.6	1.0
DII	15.6	13.8	13.8	13.1
Others	9.9	11.7	11.6	11.9

Risks to our call

1) Primarily dependent on government contracts
2) Availability of imported raw materials
3) Emerging competition from private sector

Price Performance



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ICICI Securities – Retail Equity Research

Key Financial Summary

(₹ crore)	FY20	FY21	FY22	FY23	3 Year CAGR (FY20-23)	FY24E	FY25E	2 Year CAGR (FY23-25E)
Revenues	713	813	859	872	6.9	1,042	1,246	19.5
EBITDA	198	245	262	258	9.2	298	360	18.2
EBITDA margin (%)	27.7	30.2	30.5	29.5		28.6	28.9	
Net Profit	158	166	177	156	(0.4)	178	217	17.9
EPS (₹)	8.4	8.9	9.4	8.3		9.5	11.6	
P/E (x)	45.4	43.1	40.6	45.9		40.4	33.0	
EV/EBITDA (x)	36.4	29.5	28.1	29.3		25.1	20.9	
RoCE (%)	19.1	19.3	17.9	14.5		15.3	17.2	
RoE (%)	16.5	15.5	14.8	12.2		12.4	13.9	

Source: Company, ICICI Direct Research

Company Background

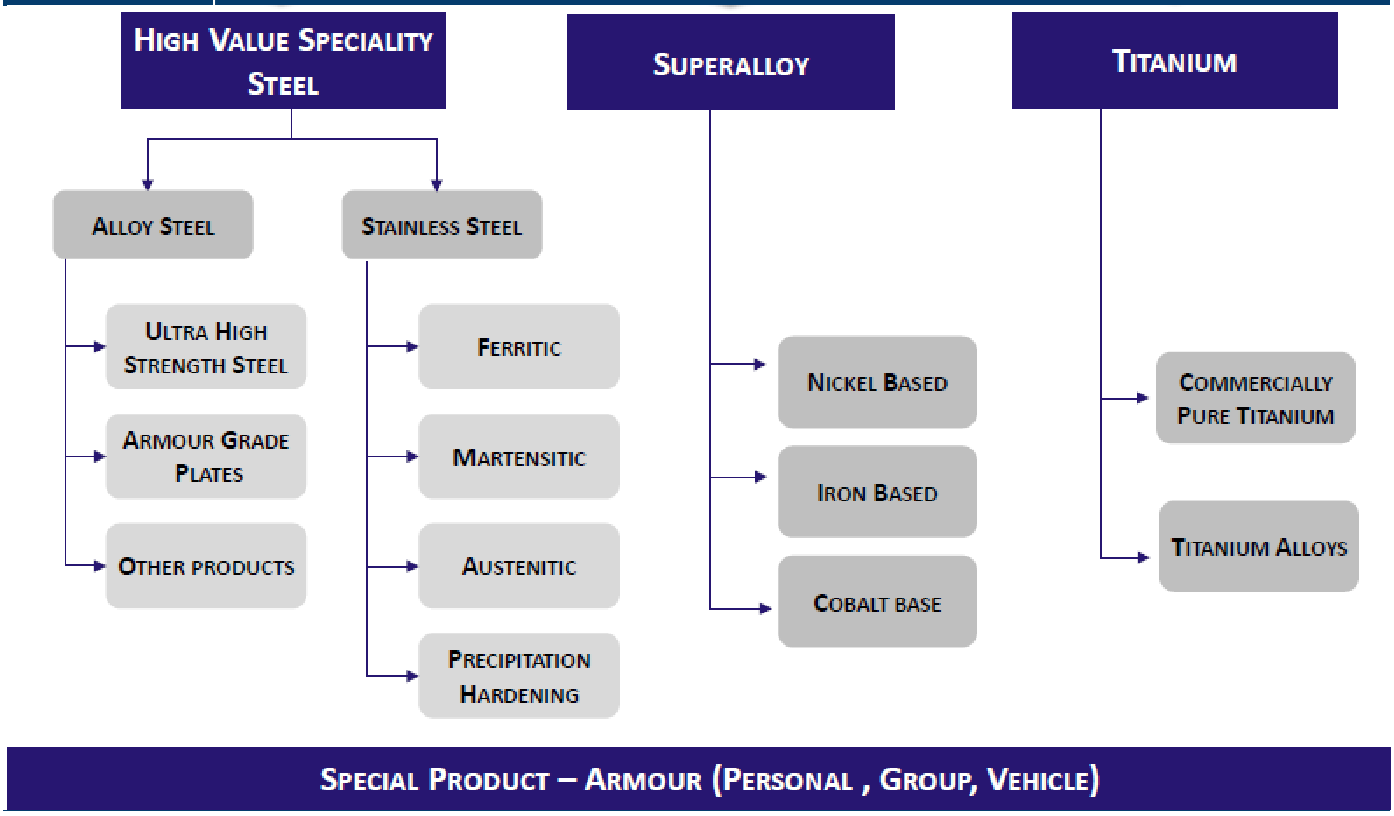
Mishra Dhatu Nigam (Midhani) was established in 1973 at Hyderabad as a government of India enterprise under the ministry of defence. The company is the manufacturer of high value special steels like ultra-high strength steel, armour grade plates, martensitic steel, austenitic steel and precipitation hardening steel, super alloys (nickel base, iron base and cobalt base) and varieties of titanium alloys

Company has two state of the art manufacturing facilities at Hyderabad (Telangana) and Rohtak (Haryana). Hyderabad plant is the oldest facility of company where it has been manufacturing a wide range of superalloys, titanium alloys, special steel etc. During Dec 2022, the company had set up 'Wide Plate Mill' at this existing Hyderabad Plant for rolling of slabs of various alloys. At Rohtak, Midhani had set up a greenfield facility during for 2021 for armour products like bullet-proof vests and armoured personal vehicles. The company is also in the process of setting up another facility at Nellore (Andhra Pradesh) for manufacture of high-end aluminium alloy products under a joint venture with National Aluminium Company (NALCO)

Consolidated revenue of the company has grown by 6.9% CAGR in the last 3 years during the period FY20-23 while EBITDA have grown by 9.2% CAGR over the same period on account of improvement in margins. PAT CAGR during the period FY20-23 have remained flattish as increase in interest cost (due to increase in debt) negated the impact of margins improvement. During FY23, company reported revenues of ₹ 871.9 crore which increased marginally by 1.4% YoY while EBITDA declined by 1.8% YoY to ₹ 257.5 crore with EBITDA margin stood at 29.5% vs 30.5% in FY22. PAT was at ₹ 156.3 crore in FY23 which was down by 11.5% YoY

Company's order book position as of July 2023 end stood at ₹ 1622 crore with order inflows during YTDFY24 stands at ₹ 542 crore. The order backlog at the end of FY23 was at ₹ 1331 crore, of which defence segment was the largest contributor at ~63% followed by space segment at ~25% and energy & others at ~12%

Exhibit 1: Product portfolio



Source: Company, ICICI Direct Research

Investment Rationale

Strong capabilities in manufacturing & development of wide-range of strategic materials; Focus on product indigenisation

Midhani is the prime production agency for high value strategic material products which cater to niche end user segments in defence, space and energy sectors. The company is one of the leading manufacturers of high value speciality steel products (like alloy steel, stainless steel), superalloys (nickel based, iron based and cobalt based), titanium alloys and other special armour products for bullet-proof vests & armoured personal vehicles. The company has emerged as a 'National Centre for Excellence' in advanced metallurgical production for supplying critical alloys and products of national security and strategic importance

With its superlative advanced & unique metallurgical facilities at Hyderabad (Telangana) & Rohtak (Haryana), the company has strong competence of developing and manufacturing customized alloys tailor-made to suit the specific requirements of customers for their critical applications. With focus on product indigenisation, company had set up a 'Wide Plate Mill' facility in Dec 2022 at its existing Hyderabad plant with an investment of ~₹ 500 Crore. This new facility, which has the capability of rolling ultra-high strength steel to very low thickness, would meet the present & future requirements of special steel plates for national strategic programs and facilitate substitution of imports

Strong orders prospects in defence, space provides Healthy visibility; Substantial opportunities from other segments too

The Company's order backlog stood at ₹ 1622 crore as of July 2023 end (~1.9x of FY23 revenues), which gives strong revenue growth visibility over the next 2 years. Moreover, we believe that there is a healthy growth visibility in the longer term too considering the orders pipeline in defence, space and other segments like energy, railways, civil aviation etc, led by certain requirement of company's products in the major platforms or projects under these segments

The defence segment, which contributes ~65% to the company's order backlog, is well positioned in terms of increasing domestic procurements by the government for our armed forces. A structural shift in defence sector is clearly visible with increasing allocation for modernised indigenous platforms (domestic procurement budget share increased to 75% for FY24 from 68% for FY23), which implies ~19% growth as against 8% growth for total budgeted capital outlay. With focus on reducing imports and increasing indigenisation through procurement of raw materials, components, sub-systems, the overall execution would improve as the risk of supply chain issues recedes and thus presents strong case for strong orders opportunity for Midhani's strategic material products in the coming period

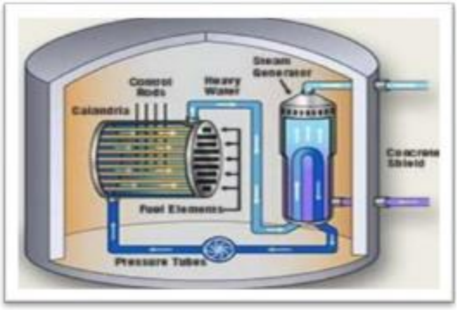
In space segment also, which contributes ~25% to the order backlog, Midhani and Indian Space Research Organisation (ISRO) have enjoyed a fruitful partnership for over four decades, with company's materials being integral to ISRO's space missions since inception. In the recent launch of Chandrayaan-3 mission, the company has also played a vital role in developing and supplying critical materials (like cobalt base alloys, nickel base alloys, titanium alloys, and special steels for various components) for the LVM3/M4, a three-stage heavy lift launch vehicle used in the lunar mission. Moreover, company will also be a key contributor to ISRO's ambitious Gaganyaan mission and other pioneering programs in future

Company has also been focused on maximizing installed capacities and diversifying into other sectors like energy, railways, civil aviation etc through broadening of its product portfolio. These sectors presents sizable opportunity for Midhani considering the increasing usage of superalloys/titanium alloys in various programmes/projects. Exports (~5% of sales at present) also shows strong prospects considering the opening up of Indian market for the world. Company has already developed many new alloys and supplied to overseas customers like Pratt & Whitney, Rafael Advanced Defense Systems (Israel), GE Healthcare, Rolls Royce etc.

Exhibit 2: Midhani's contribution in some defence and space platforms

Space launch material – PSLV, GSLV, LVM3-M3

Missiles material – Agni, Aakash



Material for power plant

Tank material – T-72/T-90

Armouring : Bullet Proof Jacket, Vehicle Armouring

Source: Company, ICICI Direct Research

Exhibit 3: Midhani's contribution in space sector

Heavy Lift Rocket GSLV MkIII nicknamed as 'Bahubali'

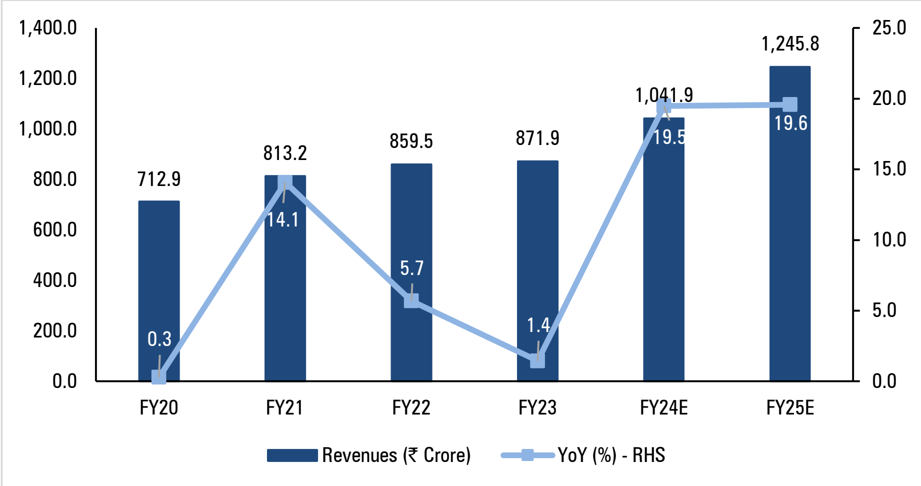
Supplied Ultra High Strength Steel, Superco605,Titanium Alloy & Special steel Rings, Plates, Bars, Strips & Investment Castings

Source: Company, ICICI Direct Research

Revenue growth expected at ~20% CAGR over FY23-25E

Midhani's consolidated revenue grew at 6.9% CAGR over the last 3 years (FY20-23). However, over the next two years, revenue growth is expected to be stronger at 19.5% CAGR over FY23-25E led by execution of strong order backlog and healthy inflows during the period. Moreover, the ramping up of new capacities at Rohtak and Hyderabad would add substantially to the revenues over FY24E and FY25E

Exhibit 4: Healthy revenue growth ahead



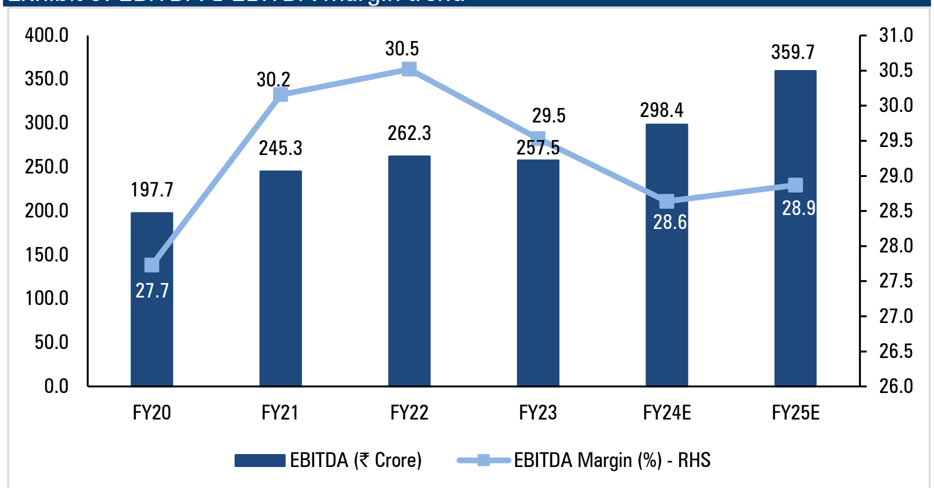
Source: Company, ICICI Direct Research

EBITDA margins expected to sustain over FY23-25E; EBITDA expected at ~18% CAGR

With ~7% revenue CAGR over FY20-23 and EBITDA margin improvement to 29.5% in FY23 from 27.7% in FY20, EBITDA grew by 9.2% CAGR during the period. Going ahead, we expect EBITDA margin to sustain at 28-30% levels, mainly led by benign commodity prices, improving product mix and positive operating leverage

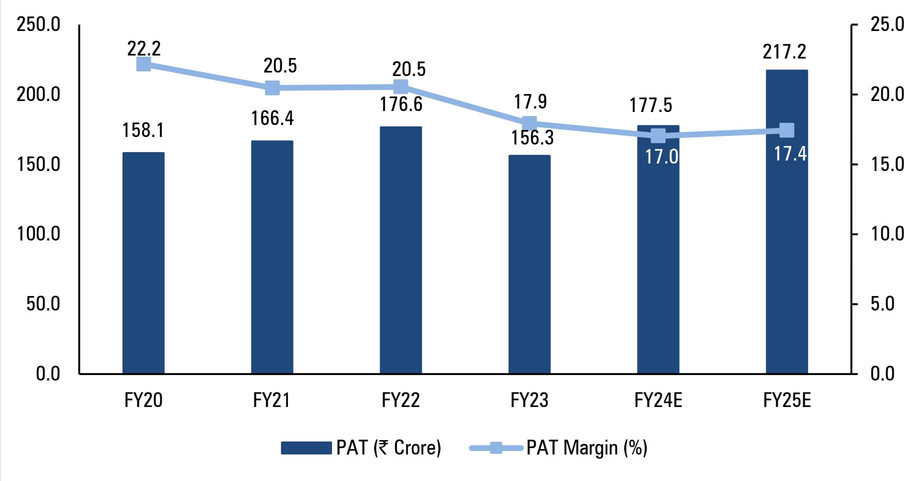
Thus, on account of increase in revenues and margins, EBITDA is expected to grow at 18.2% CAGR over FY23-25E

Exhibit 5: EBITDA & EBITDA margin trend



Source: Company, ICICI Direct Research

Exhibit 6: PAT expected to grow at ~18% CAGR over FY23-25E

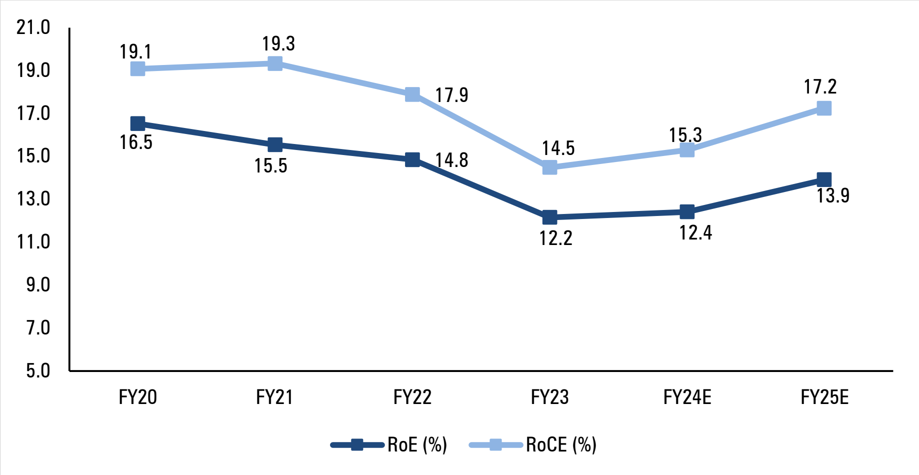


Source: Company, ICICI Direct Research

Return ratios to improve over FY24-25E

Going forward, on account of increase in margins & profitability and asset turnover ratio, return ratios are set to improve over the period FY23-25E. RoCE (Return on Capital Employed) is expected to improve to 17.2% by FY25E from 14.5% in FY23 while Return on Equity (RoE) to improve to 13.9% in FY25E from 12.2% in FY23

Exhibit 7: Return ratios



Source: Company, ICICI Direct Research

Key risk and concerns

Primarily dependent on government contracts

Midhani is primarily dependent on government and government agencies (Ministry of Defence, DRDO, ISRO, Indian Armed forces, Indian Railways etc) for its contracts. Any decline, delay or re-prioritisation of funding under the budget of these segments could adversely affect the company's ability to grow or maintain its sales, earnings and cash flow. Also, any delays in procurement, nomination or any other decision making by the government or government agencies may result in time and cost overruns in completion of the company's projects, which may have an adverse effect on its business, financial condition and results of operations

Emerging competition from private sector

We understand that government's strong focus on indigenisation of defence platforms would only be possible through increase in private sector participation. In order to give a push to domestic defence industry, the Government has taken several policy initiatives in the past few years and brought in reforms to encourage the private sector. Thus, emerging competition from private sector entities in India can be a risk to company's operations and growth and thus profitability and cash flows

Availability of imported raw materials and volatility in its prices

The company is dependent on some imported raw materials for its products (materials, alloys etc). Any change in preference from these foreign suppliers or any disturbance in the global supply chain may impact the availability of these raw materials and company's execution and, thus, earnings and cash flows. Also, any increase in prices of these raw materials may impact margins and profitability

Financial summary

Exhibit 8: Profit and loss statement ₹ crore

(₹ Crore)	FY22	FY23	FY24E	FY25E
Net Sales	837	850	1,020	1,224
Other operating income	23	22	22	22
Revenue	**859**	**872**	**1,042**	**1,246**
% Growth	*5.7*	*1.4*	*19.5*	*19.6*
Other income	31.3	37.8	38.0	40.0
Total Revenue	859	872	1,042	1,246
% Growth	*1.5*	*1.4*	*19.5*	*19.6*
Total Raw Material Costs	191	163	214	257
Employee Expenses	123	126	138	152
other expenses	284	326	391	477
Total Operating Expenditure	597	614	743	886
Operating Profit (EBITDA)	**262**	**258**	**298**	**360**
% Growth	*7.0*	*(1.8)*	*15.9*	*20.5*
Interest	21	26	32	35
PBDT	272	270	304	365
Depreciation	33	53	58	64
PBT before Exceptional Items	239	217	246	301
Total Tax	63	61	69	84
PAT before MI	176	156	177	217
PAT	**177**	**156**	**178**	**217**
% Growth	*6.1*	*(11.5)*	*13.6*	*22.3*
EPS	**9.4**	**8.3**	**9.5**	**11.6**

Source: Company, ICICI Direct Research

Exhibit 9: Cash flow statement ₹ crore

(₹ Crore)	FY22	FY23	FY24E	FY25E
Profit after Tax	177	156	178	217
Depreciation	33	53	58	64
Interest	21	26	32	35
Cash Flow before WC changes	231	235	268	316
Changes in inventory	(291)	(133)	(202)	(228)
Changes in debtors	80	(9)	(61)	(74)
Changes in loans & Advances	-	-	-	-
Changes in other current assets	(45)	27	(40)	(43)
Net Increase in Current Assets	(259)	(113)	(304)	(345)
Changes in creditors	90	(17)	32	37
Changes in provisions	(12)	(2)	6	7
Net Inc in Current Liabilities	80	(81)	86	89
Net CF from Operating activities	**52**	**41**	**50**	**60**
Changes in deferred tax assets	(0)	5	0	-
(Purchase)/Sale of Fixed Assets	(126)	(78)	(90)	(90)
Net CF from Investing activities	**(111)**	**(122)**	**64**	**31**
Dividend and Dividend Tax	(59)	(63)	(71)	(86)
Net CF from Financing Activities	**27**	**34**	**(64)**	**(121)**
Net Cash flow	**(31)**	**(48)**	**50**	**(30)**
Opening Cash/Cash Equivalent	94	63	14	65
Closing Cash/ Cash Equivalent	**63**	**14**	**65**	**35**

Source: Company, ICICI Direct Research

Exhibit 10: Balance sheet ₹ crore

(₹ Crore)	FY22	FY23	FY24E	FY25E
Equity Capital	187.3	187.3	187.3	187.3
Reserve and Surplus	1,002	1,098	1,243	1,374
Total Shareholders funds	1,190	1,285	1,430	1,561
Other Non Current Liabilities	642.6	585.5	739.3	860.2
Total Debt	268	387	387	387
Total Liabilities	**2,217**	**2,382**	**2,681**	**2,933**
Gross Block	1,094	1,221	1,310	1,400
Acc: Depreciation	157	210	268	332
Net Block	937	1,011	1,042	1,069
Capital WIP	132	80	80	80
Total Fixed Assets	1,070	1,095	1,126	1,153
Non Current Assets	10	3	3	3
Inventory	1,091	1,225	1,427	1,655
Debtors	306	316	377	451
Other Current Assets	206	179	219	262
Cash	63	14	65	35
Total Current Assets	1,678	1,744	2,098	2,413
Current Liabilities	176	159	191	229
Provisions	2	2	2	90
Total Current Liabilities	562	481	567	656
Net Current Assets	1,116	1,263	1,531	1,756
Total Assets	**2,217**	**2,382**	**2,681**	**2,933**

Source: Company, ICICI Direct Research

Exhibit 11: Key ratios

(Year-end March)	FY22	FY23	FY24E	FY25E
EPS	9.4	8.3	9.5	11.6
Cash per Share	3.3	0.8	3.5	1.9
BV	63.5	68.6	76.4	83.3
Dividend per share	3.1	3.4	3.8	4.6
Dividend payout ratio	33%	40%	40%	40%
EBITDA Margin	30.5	29.5	28.6	28.9
PAT Margin	21.1	18.4	17.4	17.7
RoE	14.8	12.2	12.4	13.9
RoCE	17.9	14.5	15.3	17.2
RoIC	16.4	12.3	13.7	15.5
EV / EBITDA	28.1	29.3	25.1	20.9
P/E	40.6	45.9	40.4	33.0
EV / Net Sales	8.6	8.7	7.2	6.0
Sales / Equity	0.7	0.7	0.7	0.8
Market Cap / Sales	8.3	8.2	6.9	5.8
Price to Book Value	6.0	5.6	5.0	4.6
Asset turnover	0.6	0.5	0.6	0.6
Debtors Turnover Ratio	2.5	2.8	3.0	3.0
Creditors Turnover Ratio	6.6	5.2	5.9	5.9
Debt / Equity	0.2	0.3	0.3	0.2
Current Ratio	5.0	5.8	6.0	6.2
Quick Ratio	1.6	1.7	1.8	1.9

Source: Company, ICICI Direct Research

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Buy: >15%

Hold: -5% to 15%;

Reduce: -15% to -5%;

Sell: <-15%

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