

Garden Reach Shipbuilders & Engineers Ltd

BUY

CMP Rs151

Target Rs265

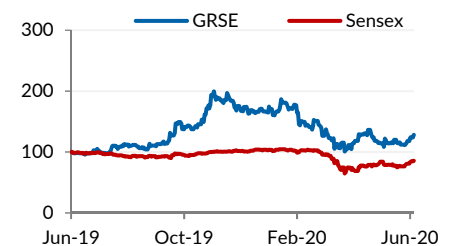
Upside 75%

HIGHLIGHTS	<ul style="list-style-type: none"> ✓ GRSE's revenues declined 6.6% yoy to Rs4.6bn as it lost Rs0.8-0.9bn due to COVID-19. EBITDA margin improved by 120bps yoy to 7.6% led by stage of execution & gross margin expansion. Adjusted PAT was up 79% yoy led by lower tax rate. GRSE reported robust operating cash flow of Rs6.3bn driven by favorable changes in net working capital. ✓ Adjusted EBITDA margins was at 4.3% in FY20, excluding the liquidated damages (LDs) impact of Rs240mn. GRSE expects no major impact of LDs in medium term as it has completed delivery of legacy projects in FY20. ✓ Healthy order book at Rs265.4bn, 19x FY20 sales. ✓ Catch-up plan is being finalized to cover-up the delay occurred during the lockdown. Mgmt. expects labor availability to return normal within next 2months.
Our View	<ul style="list-style-type: none"> ✓ Though GRSE lost 2months of execution, we are building in flat earnings growth in FY21 as, i) Q1 is seasonally weak quarter forming only 11-13% of annual sales, ii) P17A's execution is ahead of schedule with launch of 1st frigate in Dec'20 ✓ We see sharp jump in revenues from FY22 with revenues of Rs60bn+ by FY24 driven by peak execution of strong OB. ✓ We believe GRSE's ROE can touch to its historical trends of 25%+ by FY23E driven by 1) strong execution, 2) margins expansion of ~200bps and 3) better profitability. ✓ GRSE has robust balance sheet including net cash of Rs26.7bn (~90% attributed by stage payments). Healthy increase in order inflows resulted in proportionate increase in stage payments received for these orders, thus resulting in negative NWC.
Valuation	<ul style="list-style-type: none"> ✓ At CMP, the stock is attractively trading at 6x FY22E EPS. We retain 'BUY' rating with DCF based TP of Rs265, implying P/E of 10.5x on FY22 estimates.
Risk to our call	<ul style="list-style-type: none"> ✓ Prolonged impact of disruptions related to COVID-19 on GRSE's execution beyond H1FY21.

Stock data (as on June 09, 2020)

Sensex:	33,957
52 Week h/l (Rs)	249/102
Market cap (Rs/USD mn)	17,664/234
Outstanding Shares	115
6m Avg t/o (Rs mn):	40
Div yield (%):	7.4
Bloomberg code:	GRSE IN
NSE code:	GRSE

Stock performance



	1M	3M	1Y
Absolute return	5%	4.1%	38.9%

Shareholding pattern (As of Mar'20 end)

Promoter	74.5%
FII+DII	18.1%
Others	7.3%

Δ in earnings estimates

	FY21e	FY22e
EPS (New)	14.9	25.3
EPS (Old)	19.3	27.8
% change	(22.6%)	(9.0%)

Exhibit 1: Financial Summary

Y/e 31 Mar (Rs mn)	FY18	FY19	FY20	FY21E	FY22E
Revenues	13,446	13,864	14,333	14,620	29,700
yoy growth (%)	45.9	3.1	3.4	2.0	103.1
EBITDA	(148)	421	404	582	1,778
EBITDAM (%)	(1.1)	3.0	2.8	4.0	6.0
Adjusted PAT	868	1,121	1,741	1,711	2,899
yoy growth (%)	30.0	87.2	60.2	36.1	36.1
EPS (Rs)	7.6	9.8	15.2	14.9	25.3
P/E (x)	19.9	15.4	9.9	10.1	6.0
P/BV (x)	1.7	1.7	1.7	1.5	1.3
EV/EBITDA (x)	NA	36.3	37.9	26.3	8.6
Net D/E (x)	(1.0)	(1.9)	(2.6)	(2.5)	(3.0)
ROE (%)	8.3	10.9	16.8	15.6	23.3
ROCE (%)	8.3	10.4	15.5	14.5	21.8

Source: Company, YES Sec - Research

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CON-CALL HIGHLIGHTS

Strong order book; Sharp jump in execution expected from FY22

- ✓ Orderbook as on FY20 was Rs265.4bn of which shipbuilding was Rs252.8bn.
- ✓ GRSE was successful in delivering 105 ships till date
- ✓ GRSE completed the handing of the last FPV (part of the 5 FPV project) to the Indian Coast Guard (ICG). Ship was planned to deliver in the month of March, but got delayed due to Covid-19 lockdown. The 4th ship from the FPV project was marked for the export to a friendly foreign country by the government. Hence, GRSE expects an order of an additional FPV (6th FPV vessel) from the ICG under same terms and conditions
- ✓ GRSE completed the delivery of the last ASW Corvette ship in Feb'20 to the Indian Navy (IN). That marked the end of the ASW Corvette project
- ✓ GRSE is currently handling 4 projects for the Indian Navy:
 - 1 project is for the Landing Craft Utilities (LCUs). GRSE was given a contract of 8 LCUs from the IN of which 7 ships were already delivered. The 7th ship was commissioned on May 14th in Port Blair. The 8th ship which was planned to be delivered in the end of May, was delayed due to lockdown and Mgmt. expects it to deliver it by the end of Aug'21
 - GRSE is also handling the largest project of P 17A Frigates (3 in nos) Rs192.6bn+ in cost. 1st ship hull construction is going on in good speed, no work could happen in the lockdown. The 2nd ship keel has been laid, and 3rd ship production commenced in the beginning of Q4FY20. Mgmt. is planning to launch the first ship by the end of FY21 which would be ahead of schedule
 - The 3rd project would be the Survey vessels (SVs) (4 in nos). 1st ship keel was laid at GRSE, 2nd ship the production was commenced in L&T Kattupalli in December'19. GRSE has outsourced the construction of hull for SV project to L&T Shipyard. 3rd ship production will commence in the beginning of Q2FY21
 - GRSE had received the order for construction of 8 ASWSWCs from the IN (Rs63.1bn). it is a complex weapon platform hence a lot of design efforts are required for the same. This project is currently at designing stage. Mgmt. expects the commencement of production by Q4FY21
- ✓ GRSE has been doing a lot of R&D in the engineering segment to develop a double lane portable steel bridge (width of 7.5m and length of 160ft) which can carry a load of 100mt. GRSE has successfully completed the load trials inhouse and will be given to the BRO on NCNC basis shortly. GRSE has also designed a new single lane bridge (190 ft in length and 4.25m wide) which was supplied to the BRO. GRSE was also successful in developing the portable assault bridge and mgmt. believes that this could be of a good export potential
- ✓ FY20 revenue breakup: Out of the total revenues of Rs14.3bn for FY20, shipbuilding contributed to Rs12.5bn and the rest was from engineering and engine segment. LCUs contributed around Rs610mn, P 17A contributed to Rs7.5bn, FPV contributed to Rs790mn, ASW Corvettes contributed Rs2.7bn & Survey vessels contributed Rs750mn

Impact of Covid-19 on operations

- ✓ Covid lockdown started for GRSE from 24th March. Due to the lockdown, GRSE faced a lot of production difficulties and also delayed deliveries. The FPV vessel to ICG got delayed, components of bridges which were supposed to be sent across to the Indian Army, BRO & in Nagaland, could not be delivered because the trucks were stopped. Last 8-10 days of Q4FY20 had an impact on GRSE revenues. All the production units of GRSE were shut during the lockdown period. 2-3 units partially opened up from 1st June and the operations fully started from 8th June in all units. GRSE is currently facing labour shortages due to the impact

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of Covid-19. As shipbuilding is a manpower intensive business, and GRSE depended on a lot of migrant labour as well, mgmt. expects that it might take a while for the conditions to normalize.

- ✓ The company lost ~Rs800-900mn in revenues in terms of VOP in Q4FY20. Mgmt. expects the same to be realized in Q1FY21
- ✓ Total workforce of GRSE pre-covid was 2,000 people of which 1,500 were workers and the rest were officers and supervisors. 3,500 people were working from outsourced contractors. Post covid, the company has around 60% of the workforce working in 2 shifts (of 30% each). Contractor workforce will be considerably less for the next 2 months
- ✓ Mgmt. is looking towards involvement of automation in the business. As shipbuilding is majorly manpower intensive, GRSE would require labour but, in the areas of inspection, the mgmt. is looking to involve automation

Update on order pipeline

- ✓ Many RFP responses have been submitted by GRSE to the government. GRSE did not win the Pollution control vessel project by the ICG. GRSE had submitted a bid for 12 Air cushion vehicles (ACVs). GRSE also submitted a response to RFP for construction of 8 FPVs (Rs7-8bn) for ICG. GRSE also submitted a response for construction of 6 new generation missile vessels for Indian Navy (Rs120bn+). The company will also submit the bid for 2 multipurpose vessels for the IN on 14th June. GRSE has also received the RFIs for construction of 6 OPVs

No LD Provisioning for FY21

- ✓ Liquidated damages (LD) for FY20 was Rs240mn (Rs220mn was for the last ASW corvette vessel and Rs20mn was for engineering division). Mgmt. indicates that there would be no LD coming up for FY21. The SV and P17A delivery periods are far away, hence for FY21 GRSE is not looking at any LD provisioning

Mgmt. expects significant revenues from P 17A Frigate for FY21 & FY22

- ✓ Mgmt. expects to book good revenues from the 1st ship of P17A project for FY21 & FY22 as well because once the project is launched, the equipment starts going onboard ship and better revenues will be booked
- ✓ The 2nd ship is lagging by 1 year as per the contractual provisions, so progress in the hull is happening accordingly. So the 2nd ship will realise its peak revenues in FY23 while 3rd ship will recognise revenues in FY24

Other Highlights

- ✓ The cash position of the company stood at Rs26.7bn
- ✓ Mgmt. has planned the capex of Rs530mn for FY21

Exhibit 2: Result table

(Rs mn)	Q4 FY20	Q4 FY19	% yoy	Q3 FY20	% qoq
Total sales	4,567	4,892	(6.6)	3,696	23.6
EBITDA	345	311	10.9	(12)	-
EBITDAM (%)	7.6	6.4	119.5	(0.3)	788.0
Depreciation	(79)	(67)	18.5	(75)	5.4
Interest	4	(14)	(125.4)	(11)	(132.2)
Other income	528	500	5.7	512	3.0
PBT	798	730	9.2	415	92.4
Tax	(195)	(394)	(50.6)	(120)	62.7
Adjusted PAT	603	336	79.2	295	104.4
Exceptional item	(106)	0		0	
Reported PAT	497	336	47.8	295	68.4
PATM (%)	10.9	6.9	400.7	8.0	290.0
EPS (Rs)	5.3	2.9	79.2	2.6	104.4

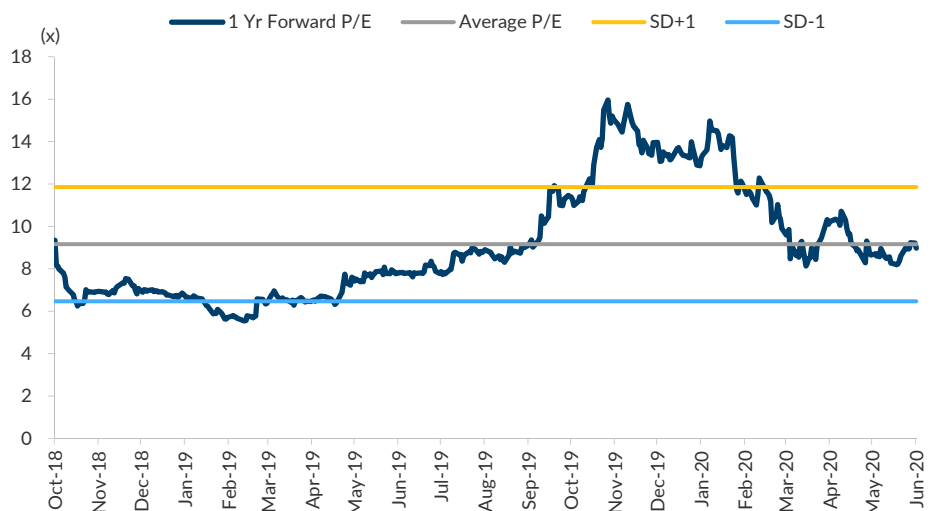
Source: Company, YES Sec – Research

Exhibit 3: Cost analysis

As a % of net sales	Q4 FY20	Q4 FY19	bps yoy	Q3 FY20	bps qoq
COGS	60.6	68.1	(744)	65.8	(514)
Employee cost	16.1	14.7	133	20.4	(430)
Other expenses	15.8	10.8	492	14.2	156
Total costs	92.4	93.6	(120)	100.3	(788)

Source: Company, YES Sec – Research

Exhibit 4: GRSE is trading attractively at 6x FY22 earnings



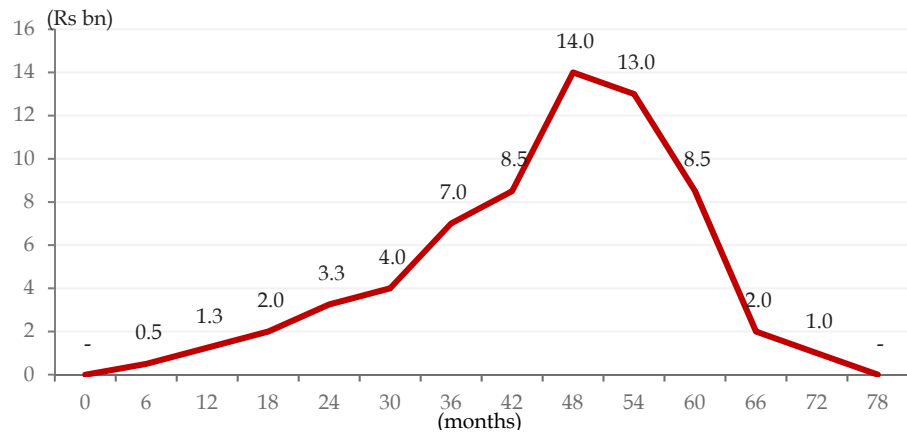
Source: Company, YES Sec – Research

Exhibit 5: Status of P17-A (stealth frigate) project (66% of OB)

Type of vessel	Yard	Start production	Keel laying	Launching	Contractual delivery date	Delivery (Actual/Expected)
P-17A (Stealth Frigate)	3022	25.08.17	10.11.18	Dec-20	Aug-23	Aug-23
	3023	30.01.19	Apr-20	Aug-22	Aug-24	Aug-24
	3024	Aug-20	Apr-21	Aug-23	Aug-25	Aug-25

Source: Company, YES Sec - Research

Exhibit 6: Estimated VOP movement of P17-A frigate during build period



Source: Company, YES Sec - Research

Exhibit 7: Status of survey vessel project (9% of OB)

Type of vessel	Yard	Start production	Keel laying	Launching	Contractual delivery date	Delivery (Actual/Expected)
Survey Vessel	3025	12.03.19	08.11.19	Sep-20	Oct-21	Oct-21
	3026	29.11.19	Feb-20	Mar-21	Apr-22	Apr-22
	3027	Jan-20	Jul-20	Sep-21	Oct-22	Oct-22
	3028	Jul-20	Feb-21	Mar-22	Apr-23	Apr-23

Source: Company, YES Sec - Research

Exhibit 8: Status of ASW SWC project (23% of OB)

Type of vessel	Yard	Start production	Keel laying	Launching	Contractual delivery date	Delivery (Actual/Expected)
ASW SWC	3029	Aug-20	Nov-20	Jul-21	Oct-22	Oct-22
	3030	Apr-21	Aug-21	Apr-22	Oct-23	Oct-23
	3031	Apr-21	Aug-21	Apr-22	Oct-23	Oct-23
	3032	Apr-22	Aug-22	Apr-23	Oct-24	Oct-24
	3033	Apr-22	Aug-22	Apr-23	Oct-24	Oct-24
	3034	Apr-23	Aug-23	Apr-24	Oct-25	Oct-25
	3035	Apr-23	Aug-23	Apr-24	Oct-25	Oct-25
	3036	Apr-24	Aug-24	Apr-25	Oct-26	Oct-26

Source: Company, YES Sec - Research

FINANCIALS

Exhibit 9: Income statement

Y/e 31 Mar (Rs mn)	FY18	FY19	FY20	FY21E	FY22E
Total operating revenues	13,446	13,864	14,333	14,620	29,700
Growth (%)	45.9	3.1	3.4	2.0	103.1
EBITDA	(148)	421	404	582	1,778
EBITDA margin (%)	(1.1)	3.0	2.8	4.0	6.0
Growth (%)	-	-	(4.1)	44.1	205.3
Depreciation & amortization	290	271	301	271	282
EBIT	(438)	150	103	311	1,496
EBIT margin (%)	(3.3)	1.1	0.7	2.1	5.0
Interest	77	51	13	24	20
Other income	1,792	1,712	2,255	2,000	2,400
Profit before tax	1,277	1,812	2,345	2,287	3,876
Tax	409	690	604	576	977
Associate income	0	0	0	0	0
Minority interest	0	0	0	0	0
Reported net profit	868	1,121	1,741	1,711	2,899
Extraordinary items	0	22	106	0	0
Adjusted net profit	868	1,099	1,635	1,711	2,899
Adjusted net margin (%)	6.5	7.9	11.4	11.7	9.8
Diluted EPS (Rs)	7.6	9.8	15.2	14.9	25.3
Growth (%)	656.9	29.2	55.2	(1.7)	69.4

Exhibit 10: Balance sheet

Y/e 31 Mar (Rs mn)	FY18	FY19	FY20	FY21E	FY22E
SOURCE OF FUNDS					
Share capital	1,146	1,146	1,146	1,146	1,146
Reserve & Surplus	9,014	9,238	9,257	10,350	12,202
Total shareholder's funds	10,159	10,383	10,402	11,495	13,348
Minority Interest	0	0	0	0	0
Debt	0	0	0	0	0
Deferred tax liabilities/(assets)	801	832	969	969	969
TOTAL	10,961	11,215	11,371	12,465	14,317
APPLICATION OF FUNDS					
Fixed assets	4,723	4,125	4,440	5,040	5,440
Less: Depn. and amort.	832	1,102	1,403	1,674	1,957
Net block	3,892	3,023	3,037	3,366	3,484
Capital WIP	160	342	515	515	515
Long term investments	0	0	0	0	0
Other long term assets	14,038	2,821	2,213	2,213	2,213
Inventories	5,131	3,496	4,410	3,805	14,647
Debtors	2,021	2,199	5,353	2,403	4,882
Cash & cash equivalents	10,222	19,912	26,653	28,292	39,649
Loans & advances	7,727	10,108	11,660	4,715	17,278
Total current liabilities	32,230	30,684	42,470	32,845	68,350
Net current assets	(7,130)	5,030	5,606	6,371	8,105
TOTAL	10,960	11,215	11,371	12,465	14,317

Exhibit 11: Cash flow statement

Year ending March	FY18	FY19	FY20	FY21E	FY22E
PBT	1,277	1,790	2,239	2,287	3,876
Depreciation	290	271	301	271	282
Others	(943)	870	366	0	0
Tax Paid	(369)	(1,259)	(1,246)	(576)	(977)
Changes in Working Capital	(995)	(2,788)	4,619	875	9,623
Net Cash from Operations	(740)	(1,117)	6,278	2,857	12,804
Capex	(502)	(525)	(674)	(600)	(400)
Change in Investment	1,513	1,111	1,979	0	0
Others	1,663	1,392	1,144	0	0
Net Cash from Investing	2,674	1,978	2,449	(600)	(400)
Change in debt	(250)	0	0	0	0
Change in Equity	(955)	0	0	0	(0)
Others	(728)	(888)	(1,528)	(618)	(1,047)
Net Cash from Financing	(1,933)	(888)	(1,528)	(618)	(1,047)
Net Change in Cash	0	(26)	7,200	1,639	11,357
Free cash flow (FCF)	1,986	893	8,738	2,275	12,419

Exhibit 12: Ratio analysis

Year ending March	FY18	FY19	FY20	FY21E	FY22E
PROFITABILITY RATIOS					
EBITDA Margin (%)	(1.1)	3.0	2.8	4.0	6.0
Adjusted net margin (%)	6.5	8.1	12.1	11.7	9.8
Return on invested capital (%)	8.3	10.4	15.5	14.5	21.8
Return on equity (%)	8.3	10.9	16.8	15.6	23.3
EFFICIENCY RATIOS					
Asset Turnover	3.3	4.1	4.0	3.8	7.4
Debt to equity	0.0	0.0	0.0	0.0	0.0
Net debt to equity	(1.0)	(1.9)	(2.6)	(2.5)	(3.0)
Interest coverage	(5.7)	2.9	7.7	13.0	74.8
Debtor days	54.9	57.9	136.3	60.0	60.0
Inventory days	139.3	92.0	112.3	95.0	180.0
Payable days	187.0	97.4	139.2	120.0	140.0
PER SHARE DATA					
Diluted EPS (Rs)	7.6	9.8	15.2	14.9	25.3
Book value per share (Rs)	88.7	90.6	90.8	100.4	116.5
DPS (Rs)	1.9	7.0	7.1	4.5	7.6
VALUATION RATIOS					
P/E	19.9	15.4	9.9	10.1	6.0
P/BV	1.7	1.7	1.7	1.5	1.3
EV/EBITDA	(103.1)	36.3	37.9	26.3	8.6
Dividend Yield (%)	1.3	4.6	4.7	3.0	5.0

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ADD: Potential return +5% to +15% over 12 months

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