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IPO Note – MTAR Technologies Ltd

03-March-2021

RETAIL RESEARCH

MTAR Technologies Ltd

Issue Snapshot:
Issue Open: March 03 – March 5, 2020

Price Band: Rs. 574 - 575

Issue Size: 10,372,419 eq shares
(Fresh issue 2,148,149 + Offer for sale of 8,224,270 eq sh)

Issue Size: Rs. 595.38 - 596.41 cr

Reservation for:

QIB	Upto 50% eq sh
Non Institutional	atleast 15% eq sh
Retail	Upto 35% eq sh

Face Value: Rs 10

Book value: Rs 91.78 (December 31, 2020)

Bid size: - 26 equity shares and in multiples thereof

100% Book built Issue

Capital Structure:

Pre Issue Equity:	Rs. 28.61 cr
Post issue Equity:	Rs. 30.76 cr

Listing: BSE & NSE

Book Running Lead Manager: JM Financial Limited, IIFL Securities Limited

Registrar to issue: KFin Technologies Private Limited

Shareholding Pattern

Shareholding Pattern	**Pre issue %**	**Post issue %**
Promoter and Promoter Group	62.24	50.25
Public & Employee	37.76	49.75
Total	100.0	100.0

Source for this Note: RHP
* = assuming pricing at higher end of band

Background & Operations:

MTAR Technologies Limited (MTL) was incorporated on November 11, 1999. The company is a leading precision engineering solutions company engaged in the manufacture of mission critical precision components with close tolerances (5-10 microns), and in critical assemblies, to serve projects of high national importance, through their precision machining, assembly, testing, quality control, and specialized fabrication competencies, some of which have been indigenously developed and manufactured.

MTL primarily serves customers in the nuclear, space and defence, and clean energy sectors. Since inception, they have strived to grow continually, contributing to the Indian civilian nuclear power programme, Indian space programme, Indian defence and aerospace sector, global defence and aerospace sector, as well as to the global clean energy sector. In addition, they also focus on clean energy as one of their key customer sectors and are accordingly, involved in the manufacture of power units, specifically hot boxes, and in the development and manufacture of hydrogen boxes and electrolyzers, to serve Bloom Energy Inc., United States (“Bloom Energy”) with which, they have been associated with, for over 9 years.

MTL lays special emphasis on research and development (“R&D”) of their manufacturing processes as it allows them to evolve their own process technologies thereby enabling them to achieve design specifications with accuracy irrespective of the size of the products. They have also recently established an engineering cell that works on cycle time reductions to enhance cost-effective manufacturing solutions in niche engineering segment. Given their operations are specialized, their manufacturing facilities also employ extensive and stringent quality control mechanism at various stages including that of material issue and manufacturing process, to ensure that their finished product conforms to the quality and traceability requirements of their customers. Owing to the critical end applications of their products and such stringent quality requirements, it becomes very difficult for new players to get qualified for the projects they undertake. Various awards such as the ‘Best Quality Supplier Award’, ‘Defence Technology Absorption Award’, ‘INS Industrial Excellence Award’ and the ‘Award for Excellence in Aerospace Indigenization’ received by them in the past bear testimony to the faith their customers have in them and their ability to successfully serve and meet their requirements.

MTL is also a key supplier of mission critical components to customers within the space and defence sectors for their programs of national importance. Through their long-standing relationships of over three decades and 4 decades with customers such as the Indian Space Research Organisation (“ISRO”) and the Defence Research and Development Organisation (“DRDO”), they have been able to supply specialized products to the Indian space programme and the Indian missile programme, respectively. For instance, their offerings to ISRO comprised a wide variety of mission critical components and critical assemblies such as liquid propulsion engines, components and assemblies for cryogenic engines, specifically turbo pumps, booster pumps, gas generators and injector heads for such engines, and electro-pneumatic modules to serve its space launch vehicles. Within the defence sector, they undertook complex assemblies for the DRDO, including such as the base shroud assembly (for Agni missiles), and the assembly of secondary injection thrust vector control (“SITVC”) valves and hydraulic fin tip control (“HFTC”) valves. In addition, they also supplied critical defence products such as aluminium weldments and other machined components to their international customers including, an Israeli defense technology company.

The company currently operates through 7 manufacturing facilities, including an export-oriented unit (“EOU”). These manufacturing facilities, each of which is situated in Hyderabad, Telangana, employ advanced equipment to undertake precision machining, assembly, testing and quality control, specialized fabrication, brazing and heat treatment, and other specialized processes, leading to them being a one-stop solutions company for their customers. Over the years, they have made investments in processes, infrastructure and systems, and in specialized training to their technical team to become a leading player in nuclear and space and defence sectors. They have also implemented various information technology solutions including for assisting in their designing and manufacturing operations, and enterprise resource planning (“ERP”) solutions to integrate key areas of their operations.

The company was originally promoted by Late P. Ravinder Reddy, Late K. Satyanarayana Reddy and P. Jayaprakash Reddy. They are now led by one of their Promoters, and their Managing Director, Parvat Srinivas Reddy, who has over 29 years of work experience. Through his experience, he has been able to establish relationships with not just the domestic customers but also the global customers. In addition, they also have an experienced management team which has brought in organizational and operational changes in the company over the past few years. This team is backed by a core technical team that has substantial experience in manufacturing and the technical know- how to manufacture niche engineering products. The commitment and the level of engagement of their employees to create complex manufacturing technologies is further demonstrated by the current average employee tenure with the company, which is approximately 15 years, with a low attrition rate of about 6% in the last 3 years.

Company Product Offerings:

Clean Energy Sector: Power Units

Nuclear Sector: Fuel machining head, Bridge and column, Grid plate, Sealing plug, shielding plug, liner tubes and end fittings, Drive Mechanisms, Top hatch cover beams and deck plate assembly, CHAS, Ball screws and water lubricated bearings

Space and Defense Sectors: Base shroud assembly and air Frames, Actuator assembly Components, Components for LCA, Various missile parts, Valves, Electro-pneumatic modules, Liquid propulsion engines, Cryogenic engines, Ball screws and water lubricated bearings

Surface treatment, Heat treatment and Special processes facilities: Various surface treatment activities such as nitriding, anodization, hard chrome plating, nickel plating, induction hardening, electro polishing, pickling, passivation, zinc plating and painting, among others and Heat treatment such as gas carbonizing, through their various furnaces. Special processes facilities such as painting and plating are also available in-house.

Objects of Issue:

The Offer consists of the Fresh Issue and the Offer for Sale.

Offer for Sale

The proceeds from the Offer for Sale (net of Offer related expenses of the Selling Shareholders) shall be received by the Selling Shareholders and MTAR Tech shall not receive any proceeds from the Offer for Sale.

Fresh Issue

MTL proposes to utilise the Net Proceeds towards funding the following objects:

- Repayment or pre-payment, in full or part, of certain borrowings of MTL. (Rs.630 mn)
- Funding working capital requirements; (Rs.950 mn)
- General corporate purposes

Competitive Strengths

Precision engineering expertise with complex product manufacturing capability: Legacy of over 50 years of manufacturing a wide range of mission critical precision components and assemblies with currently over 145 engineers on roll. Ability to manufacture within 5-10 micron tolerance product through precision machining, assembly, specialized fabrication, heat treatment, surface treatment & others. Extensive & stringent testing & quality control mechanism undertaken at each stage through high precision quality inspection equipment. Experienced personnel who undertake procedures and inspections at their non-destructive testing facilities and their capability in measuring and maintaining quality and measurement records at each level of the process is a key enabler. Extensive R&D for cycle time reduction, development of manufacturing processes & design specifications to achieve accuracy irrespective of size. As of December 31, 2020, they employed 14 engineers, 6 designers, and 4 technicians in process planning and methods team.

Wide product portfolio leading to long-standing relationships with the customers: As on December 31, 2020, the company's major product portfolio includes 3 kinds of products in the clean energy sector, 14 kinds of products in the nuclear sector and 6 kinds of products in the space and defense sectors. They strive to understand their customers' specific business needs and provide products to meet their requirements and accordingly, their ability to provide quality products as per the customer specification, and their consistent customer servicing standards, have enabled them to increase their customers' dependence on them. Within the nuclear sector, their long standing relationship of over 16 years with NPCIL bears testimony to their ability to manufacture and supply specialized products. Within the space sector, they have established relationship with ISRO to whom they have been supplying a wide variety of mission critical components and critical assemblies for its various missions, for over 3 decades. They have also invested in the development of roller screws, which is an import substitute, and are involved in developing the associated technology. Once this development has been completed, they will, in India, be the first manufacturer of roller screws, while this product shall be used for a wide variety of applications in the nuclear, space and defense sectors.

Modern technology at state-of-the-art manufacturing facilities: The company operates through seven state-of-the-art manufacturing facilities, including one EOU, each of which, is situated in Hyderabad, Telangana and is one of the key centers for defense research and development in the country. They have consistently undertaken expansion of their manufacturing facilities through internal accruals, in the pas with a view to capture increasing demand in the future. Their manufacturing facilities enable them to expand their operations with ease to meet future demand at minimized cost of expansion. The presence of major defense organizations in Hyderabad not only provides them access to the critical R&D and high-volume projects, but also allows for ease of coordination, specifically in terms of collaborative R&D efforts, as well as for subsequent close monitoring of manufacture and quality control processes, thereby giving them an advantage over the other players located in other regions. They have also designed and built, with in-house expertise, certain sophisticated special purpose machines instead of importing comparable machines.

Strong and diversified supplier base for sourcing of raw materials: MTL has over the years, developed a robust supply chain for the sourcing of a wide variety of specialized raw materials used in the manufacture of mission critical precision products. They source materials from third party suppliers depending upon the requirement of a project that they undertake, in certain instances, especially involving the critical and sensitive raw material and bought out items for the manufacture of certain products are directly procured and supplied by their customers, mostly belonging to the space and defense sectors. The materials utilized for products catered to the clean energy and nuclear sectors, and other consumables and bought outs are mostly sourced from third party suppliers, both domestic and global. Raw material expenses constitute a significant portion of overall cost of the company, they benefit majorly from a strong, spread out and diversified supplier base. This enables them to negotiate favorable terms and even avail better discounts. Additionally, the company believes that diversified supplier base helps them in minimizing supplier risk on account of low supplier dependency.

Experienced and qualified management team: MTL is primarily led by Parvat Srinivas Reddy, who has over 29 years of work experience. The company’s technical and corporate management team has substantial experience in the sectors which they serve, which enables them to capture market opportunities, formulate and execute business strategies, manage client expectations as well as proactively respond to changes in the market conditions. As on December 31, 2020, they had 891 permanent employees, including 150 engineers comprising 16.84% of their total employees, and 248 contractual workmen. The current average employee tenure with the Company is approximately 15 years, with a low attrition rate of about 6% in the last three years, which further demonstrates the level of engagement of workforce.

Business Strategy:

Strengthen existing product portfolio and diversify into products with attractive growth and profitability prospects: Enhance capabilities and grow value chains to supply critical and differentiated engineered products. Develop roller screws for which they will be the first manufacturer in India. Establishment of new capabilities such as sheet metal facilities and enhancement of existing specialized fabrication capabilities. Intend to supply electrolysers, which can produce methane free hydrogen to generate power to existing customers.

Capitalize on upward trend of nuclear sector in India, increasing indigenization and policy initiatives in the defense sector, and commercialization of Indian space sector: Capitalize on the large opportunity in terms of upcoming Nuclear sectors reactors being one of the few companies capable of handling the product complexity and manufacturing capacities. Exponential growth expected for Indian players in Space sector given ISOR’s plan to commercialize the Indian space sector and offer its products and services to other countries. Take advantage of Government focus on indigenization of various defense technologies and import substitution and contribute to the ‘Atma- Nirbhar Bharat’ initiative by Government of India.

Focus on deepening and strengthening relationships with existing customers as well as catering to new customers: Develop new relationships with customers, both in India & abroad, to capture lucrative opportunity in the Nuclear, Space & defense and clean energy sectors. The company believes that it shall be one of the preferred suppliers for any potential defense offset transaction that any current international customers may be a part of. Continue to participate in seminars & international expos to build & develop network with leading foreign multi-national companies.

Expand international presence including through increase in exports: Continue to expand international operations to enhance global presence in the sectors the company currently cater. Growth in support for Hydrogen based clean energy solution along with expansion plans of Bloom Energy outside of US in South Korea, provides significant opportunity. Looking to cater into defense offset partnerships with certain global OEMs and have incorporated a Subsidiary, Magnatar Aero Systems Private Ltd.

Grow manufacturing capacity and increase market share through organic and inorganic routes: Upgrade existing facilities by implementing new technology and releasing release bottlenecks in production capacity. In the process of establishing a sheet metal manufacturing facility at Adibatla, Hyderabad which is expected to become operational in Fiscal 2022 to undertake sheet metal jobs for ISRO, Bloom Energy & certain other customers. Selectively look at inorganic opportunities to enhance engineering competence, increase market share, achieve operating leverage in key markets and strengthen cost competitiveness in the market.

Continue to strive for operational efficiencies, supply chain rationalisation and effective planning: Continue to maintain or improve upon benchmarks for cost structure through economies of scale, employment of earnings acquired in manufacturing end components and a robust supply chain for sourcing of raw materials. Cycle time reduction by adopting advanced technologies, thereby increasing capacity to undertake more no. of projects. Leverage technologies for effective utilisation of machinery through digital solutions.

Industry Overview:

Precision Engineering Industry:

India's engineering sector is divided into two segments: heavy and light engineering. The classification is based on the nature of the product and the technology used for processing. Heavy engineering includes manufacturing and assembly of industrial machinery and plant equipment for various end-use sectors. Equipment are designed and manufactured to suit end-use applications for process industries such as fertiliser, textile, chemical, refinery, petrochemical, and oil & gas, as well as for the thermal and nuclear power sector. On the other hand, light engineering includes sub-sectors, manufacturing everything from basic to sophisticated equipment. Light engineering products (components, parts and small equipment) find application in automobiles, industrial machinery, power, oil and gas, fertilisers, steel, refineries, petrochemicals, cement, and railways sectors; and also serve as inputs for the heavy engineering and capital goods sectors.

Global Nuclear Equipment Industry:

Currently, nuclear power plants account for 10% of the world's total generated power. This is supplied by about 440 reactors across the globe. Around 50 more nuclear reactors are also under construction, which equals to 15% of the world's current capacity. In the past two decades, the share of nuclear power has been dwindling, largely on account of rising capital cost, safety concerns (post the Fukushima disaster in Japan in 2011), long construction cycle and greater focus on low- cost renewable sources. However, some developing countries such as India, China, the UAE, etc., have continued to focus on their nuclear power programmes. Thus, their share in the overall nuclear power pie has been on the rise.

Defense Equipment Industry:

The defence expenditure to GDP multiplier essentially denotes the criticality of defence in India. With the multiplier majorly growing in greater than 1 multiples indicates that defence spending has been taken up on priority by the country its growth outperforms the overall GDP growth. Over the past 9 years, the defence expenditure to GDP multiple has dropped to less than 1 (0.5) only once in fiscal 2016. It was compensated by a surge in expenditure to 2.5x in FY17. This indicates that the lack of spends in FY16 was countered by front loading defence spends in the subsequent year. Consistent threats from neighbours viz. Pakistan and China has led to rising military expenditure by the country to improve its strategic defence capability.

The budgeted defence expenditure is expected to witness constraints in FY21 largely due the wide spread COVID- 19 pandemic in India. The government is expected to face financial crunch amid the spread of coronavirus as majority funds are expected to be diverted towards upscaling of the poor quality health infrastructure to fight the pandemic. This is expected to limit the expenditure on various key industries including defence. However, this cut back in defence spend seems to be temporarily and shall witness a V-shaped recovery in the years ahead as national security is considered to be the top priority of the government amidst rising terrorism and cross-border threats from China and Pakistan.

Over the next 5 years, we expect India's defence expenditure to witness a robust growth on back of rising strategic high-tech defence procurement plans (for modernization of armed forces) in addition to steps taken for promotion of local manufacturing of defence products. We expect a healthy defence expenditure to GDP multiplier over the next 5 years to the tune of 1.7-1.9. In such case where the India's GDP is expected to grow at a 4-5% CAGR, the growth in defence expenditure is forecasted to post 7-9% rise to reach at nearly INR 6,000-6,500 Bn by 2025.

Space Equipment Manufacturing Industry:

Currently, the global space economy is estimated to be valued at about $360 billion. The global space economy includes various aspects such as consumer TV, consumer radio, consumer broadband, fixed satellite services, mobile satellite services, earth observation services, ground equipment, satellite manufacturing, satellite launch, non-satellite launch industry and second order impacts.

The market studied consists of two segments. One is satellite manufacturing (includes design, testing and production) and the second is the launch systems (includes launch fee and vehicle development cost). The market is sized from the revenue standpoint. Revenue is estimated at the country level, where demand is generated.

There was an increase in the demand for satellites in the review (2016-19) and forecast (2020-25) periods on account of reducing costs and improved satellite and launch technology. The CAGR for the forecast period is estimated at 9.0-10.0% that of the review period was 0.59%. The low CAGR was largely on account of the decline in market revenue (against increasing demand) across the global industry in 2019 owing to a lower number of launches. This was primarily due to advancement in technology since a higher number of satellites were deployed on a single launch vehicle.

Cost optimisation and increased use of reusable rockets has led to increased global competition and rising dominance of players such as SpaceX. Players such as ISRO (Indian Space Research Organisation) are also gaining ground on the back of cost-competitive and reliable products and services. This has compelled industry players to reduce their prices to attract further business. This trend was especially prevalent in the military and government segment (negative CAGR was registered in the review period) which is the largest spender and the key demand driver. On the other hand, the commercial segment registered a consistent rise during the review period on account of demand from increasing infrastructure of satellite applications and services (GPS, satellite- based internet, etc.). It delivered 5.51% CAGR during the review period. The 2020 rise is on account of large number of launches by US players towards the development of satellite constellations.

Key Concerns:

- MTL is dependent on Bloom Energy Inc. ("Bloom Energy") and a limited number of other customers for a significant portion of revenue. The loss of one or more of top three customers or a significant reduction in demand for products from such top three customers would result in failure to succeed in tendering for projects for them in the future.
- A decline of funding in Indian Budget towards respective departments or liberalisation of defence or space sectors to allow the entry of private and foreign companies may increase the level of competition which in turn would affect MTL as it depends significantly on orders from the NPCIL, ISRO and DRDO.
- MTL relies on purchase orders to govern the volume and other terms of the sales of products. MTL do not have long-term supply agreements with customers. So, if customers choose not to source their requirements or start manufacturing such products in-house, than it would affect business adversely.
- Any failure to comply with strict quality standards may lead to cancellation of existing and future orders, which would adversely affect reputation, financial conditions, cash flows and results of operations.
- Prediction of business and results of operations are difficult to predict as The COVID-19 pandemic and resulting deterioration of general economic conditions has impacted MTL's business and will depend on future developments.
- Failure or Delay of supply of raw materials from suppliers could adversely affect business, financial condition and results of operations.
- Integration costs to make investments and acquisitions in future may lead to affect the expected benefits of such growth.
- Delays or Defects in respect of precision components and equipment would lead to claims and occurrence of additional rectification costs. This would affect to secure new contracts, if unable to requisite performance guarantees.
- Legal Proceedings or regulatory actions in relation to missing corporate records would impact financial condition and reputation.
- Pricing pressure from customers would adversely affect margins, profitability and ability to increase prices, which in turn would materially adversely affect business, results of operations and financial condition.
- Equipment costs leads to increased fixed costs, which would affect cash flows adversely and impact operations.
- MTL's business would adversely affect if any failure or disruption of IT or ERP system occurs.
- Stringent labour laws or other industry standards and any strike, labour unrest, work stoppage or increased wage demand by employees or any other kind of disputes could adversely affect business, financial condition, results of operations and cash flows.
- The outbreak of COVID-19 or any other severe communicable disease or occurrence of natural or man-made disasters could have a potential impact on business, financial conditions and operations.
- Financial instability in other countries may cause increased volatility in Indian Financial Markets.
- Any regulatory, economic, social and political uncertainties and other factors are not under control.
- Profit margins would be affected, if inflation and rises and MTL is unable to increase prices of services.

Unconsolidated Balance Sheet

(Rs in million)

Particulars	9MFY21	FY20	FY19	FY18
Assets				
Non-current assets	**1880.7**	**1747.5**	**1961.9**	**1715.0**
Property, plant and equipment	1550.26	1549.61	1620.45	1522
Capital work-in-progress	188.63	117.34	56.17	18.44
Intangible assets	8.74	1.39	1.43	0.31
Financial assets				
Investments	0.1	0.1	0.1	0.1
Other financial assets	71.97	32.98	226.57	113.2
Non-current tax assets (net)	14.67	6.19	15.76	22.77
Other non-current assets	46.3	39.88	41.4	38.17
Current Assets	**1938.4**	**1715.1**	**1089.7**	**1095.3**
Inventories	791.5	754.6	410.7	419.3
Investments				
Trade receivables	731.19	616.37	504.17	489.66
Cash and cash equivalents	110.2	135.44	107.67	90.68
Other bank balances	105.2	96.98	0	0.13
Other financial assets	28.07	16.66	23.72	47.34
Other assets	172.25	95.08	43.43	48.2
Total Assets	**3819.0**	**3462.6**	**3051.6**	**2810.3**
Equity & Liabilities				
Equity	**2456.2**	**2250.8**	**2349.8**	**2055.2**
Equity share capital	267.59	267.59	282.14	282.14
Other equity	2188.63	1983.18	2067.68	1773.1
Non-Current Liabilities				
Financial liabilities	**204.2**	**76.9**	**5.9**	**117.8**
Borrowings				
Provisions	71.7	0	0	0
Deferred tax liabilities	32.99	23.81	5.57	29.92
Current Liabilities	99.47	53.07	0.32	87.89
Financial liabilities	**1158.8**	**1135.1**	**695.9**	**637.3**
Borrowings				
Lease Liabilities	582.98	291.33	287.31	197.86
Total outstanding due to creditors other than micro enterprises and small enterprises	145.25	305.55	59.8	136.28
Other financial liabilities	23.72	2.13	0	0
Provisions	25.67	34.34	8.26	13.42
Current tax liabilities (net)	0	9.23	11.7	0
Other current liabilities	381.14	492.48	328.8	289.71
Total Equity & Liabilities	**3819.0**	**3462.6**	**3051.6**	**2810.3**

Unconsolidated Profit & Loss

(Rs in million)

Particulars	9MFY21	FY20	FY19	FY18
Revenue from Operations	1772.7	2137.74	1836.71	1595.97
Other Income	7.23	43.68	22.39	9.48
Total Income	**1779.9**	**2181.4**	**1859.1**	**1605.5**
Total Expenditure	**1290.7**	**1605.6**	**1344.2**	**1321.8**
Cost of materials consumed	748.07	872.55	655.32	659.77
Changes in inventories of work-in- progress	-64.1	-150.88	-29.7	-90.49
Excise duty on sale of goods	0	0	0	29.77
Employee benefits expense	374.37	516.26	435.08	446.09
Finance costs	48.29	47.53	44.6	44.61

Other expenses	184.07	320.15	238.85	232.08
PBDT	**489.2**	**575.8**	**515.0**	**283.6**
Depreciation and Amortisation	93.25	120.48	112.34	112.07
PBT	**396.0**	**455.3**	**402.6**	**171.6**
Exceptional items	0.0	0.0	12.9	0.0
Tax (incl. DT & FBT)	**115.3**	**142.2**	**23.6**	**117.3**
Tax	70.94	78.11	92.13	43.37
Deferred Tax	44.33	62.6	-89.47	73.94
Short/(excess) provision for tax relating to prior year	0.0	1.4	20.9	0.0
Reported Profit After Tax before Minority Interest	**280.7**	**313.2**	**392.0**	**54.2**
Share of profit/(loss) of equity accounted investees	5.04	-23.97	4.63	-24.45
Adj. Profit	285.7	289.2	396.6	29.8
EPS (Rs.)	10.49	11.11	13.89	1.92
Equity	26.76	26.76	28.21	28.21
Face Value	10	10	10	101
OPM (%)	27.2	24.9	26.8	17.2
PATM (%)	10.5	11.1	13.9	1.9