

March 2, 2021

MTAR Technologies, a precision engineering solutions company, was founded in 1970. The company manufactures hi-precision indigenous components, subsystems and assemblies having components with close tolerances (5-10 microns). Currently, the company has seven manufacturing units in Hyderabad with more than 400 machines, 891 permanent employees and 248 contractual workmen. At the helm of affairs is Promoter and Managing Director, Parvat Srinivas Reddy. MTAR Technologies operates in three segments viz. nuclear, space & defence and clean energy and manufactures 14 products in the nuclear sector, six in space & defence and three in the clean energy sector.

Higher share from Bloom, new product launches to aid growth

MTAR's total order book was at ₹ 336 crore as on December 2020. Part of this is ₹ 80 crore, which comes from Clean Energy segment (Bloom Energy). Currently, the company makes hot boxes for Bloom Energy. MTAR is in the process of development and manufacture of hydrogen boxes and electrolysers to serve Bloom. Going ahead, the fuel cell market is expected to grow at a CAGR of 14-15%. This coupled with Bloom's tie up with Gail to deploy fuel cell technology is expected to augur well for the company. Further, the company is also in the process of establishing a new manufacturing facility at Adibatla in Hyderabad that will enable it to take sheet metal jobs for Bloom Energy, Isro and certain other customers.

Huge opportunity in nuclear, space & defence segments

India has 22 operational nuclear reactors with a capacity of 6.3 GW. The country plans to double its nuclear capacity to 11.5 GW. Hence, seven new reactors are expected to come into operation in the next five years. This will create a huge opportunity for MTAR in the large refurbishment and maintenance market that is also expected to increase 1.6x. The recent ban on 101 defence based items, thrust towards indigenisation and policy initiatives towards making India an export hub for defence products will further widen the scope and addressable opportunity for MTAR.

Key risk & concerns

- High concentration of revenue towards Bloom Energy
- Limited number of customers
- High working capital

Priced at P/E of 56.5x (post issue) FY20 on upper band

Taking cognisance of the huge growth opportunities for MTAR and a high margin business that would aid flow of profitability to the bottomline, we recommend **SUBSCRIBE** rating on the issue. The company is available at a P/E of 56.5x (post issue basis) on FY20 PAT.



Particulars

Issue Details	
Issue Opens	3rd March 2021
Issue Closes	5th March 2021
Issue Size (₹ crore)	~ ₹ 596 crore
Issue Type	Fresh Issue/OFS
Price Band	₹ 574-575
Market Lot	26
Face Value	₹ 10

Shareholding

	Shareholding %	
	Pre-issue	Post-issue
Promoters	62%	50%
Public	38%	50%
Total	100%	100%

Objects of issue

Objects of the issue	(₹ crore)
Repayment/Prepayment in full or in part, of borrowings	63.0
Funding working capital	95.0
General Corporate purpose	NA

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Key Financial Summary

₹ crore	FY18	FY19	FY20	9MFY21	CAGR FY18-20
Revenue	159.6	183.7	213.8	177.3	15.7
EBIDTA	31.9	53.7	58.0	53.0	34.9
EBIDTA margin	20.0%	29.2%	27.1%	29.9%	
Net Profit	5.4	39.2	31.3	28.1	140.3
EPS (₹) (Post issue)	1.8	12.7	10.2	NA	
PE (x) (Post issue)	326.1	45.1	56.5	NA	
RoCE (%)	9.9%	19.0%	21.6%	NA	
RoE (%)	2.6%	16.7%	13.9%	NA	

Source: ICICI Direct Research, RHP

Industry Overview

Precision engineering can be described as a sub-discipline of other forms of engineering (electrical, software, electronics, etc) concerned with design and manufacture of structures or items that have exceptionally low tolerance (5-10 microns in MTAR's case) and are required to perform consistently over longer period cycles. The process includes designing, manufacturing and assembling an equipment of perfect dimension and size. Given the fact that the end product is complex in nature and is critical to functioning of a larger process/system, accuracy and margin of error become extremely important.

Precision engineering products find application in critical & complex sectors such as aviation, aerospace, space, defence and nuclear power plants or any other such areas wherein a small error can cause a greater damage. For example, a small error or a failure of any small component in space or nuclear sector might lead to a catastrophic damage. To avoid such mishaps and error, precision engineering is very critical for strategic sectors such as defence, nuclear, space, aviation and others

Exhibit 1: Precision engineering products

End-use Sectors	Products
Automobiles	Engine parts - piston and piston parts, fuel injection equipment and carburetors, powertrain components, engine bearings and valves, gaskets and liners Suspension and braking parts Drive transmission and steering parts - axle assembly, axle pins and clutch assembly Other parts – sheet metal parts, ball and roller bearings
Power	Hydro-turbines, pumps and valves
Wind turbines	Generator parts for gearless wind turbines
Defence	Artillery systems, land and naval weapon systems, fire control systems, naval equipment and systems, underwater platforms, Unmanned Aerial Vehicles, Remotely Piloted Vehicles, missile systems etc
Aerospace	Radar systems, missile carriers and launchers, hull equipment, and steering gear systems, spacecraft components, blades, fins, spars, aerospace structural components, complex mechanical components, and soft-turned bearings, ball screws as electro-mechanical actuator Catalyst baskets for nitric acid plants
Plant and Industrial	Hydraulic fittings High precision machine spare parts Hydro-processing reactors, high-pressure heat exchangers components, gasifiers, pressure vessels, process plant internals and other critical equipment for process plants
Other Engineering & Capital Goods	Steel plant and machinery, Textile machinery – drawing and texturing operations, Material handling equipment, cement machinery, agro-based machinery, Tooling machine parts and components, etc.
Nuclear Power	Steam generators, reactor components (end shield assembly and fittings) and pressurisers
Railways	Diesel and electric locomotives
Space	Satellite and launch systems parts and components, ball screws as electro-mechanical actuator
Fuel Cell (Clean energy)	Electrolyser, Electrodes, fuel cell membrane, Bipolar plates, Anode and Cathode seal, stacks

Source: RHP, Crisil Research, ICICI Direct Research

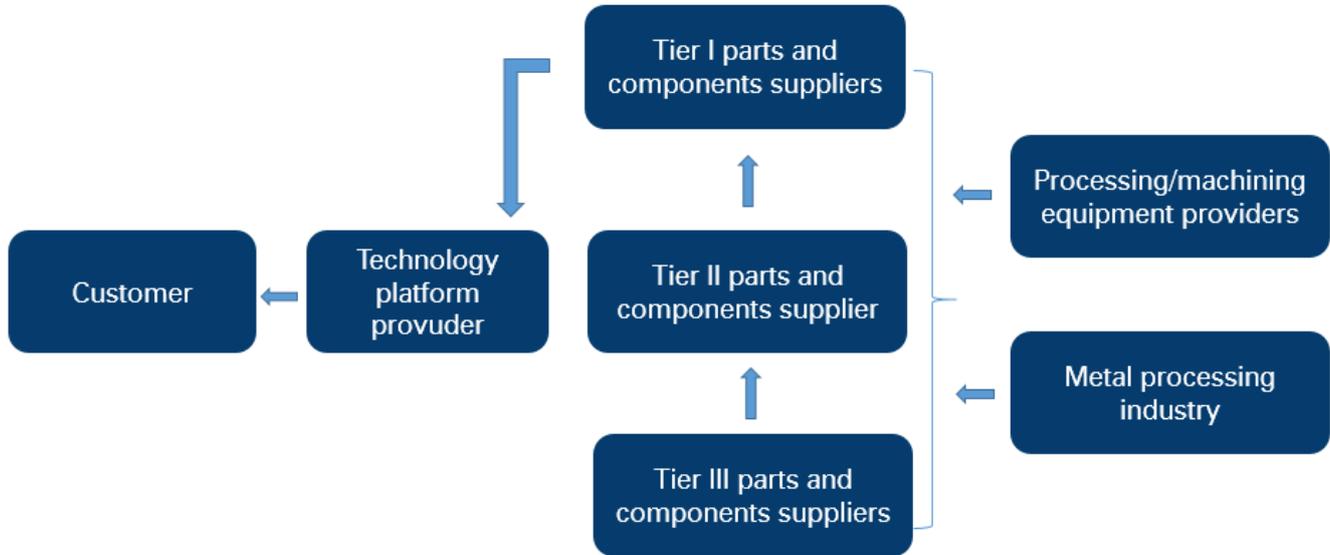
Niche players with developed expertise in that space

Typically, precision engineering companies have a specific or a select field wherein they have done R&D over the years and developed expertise in that space. R&D spend in the industry is relatively higher given the need to constantly keep up with technology as well as the general nature of the complex industry. Applications such as defence and aerospace, nuclear, aviation and marine that have requirements of high material performance and special material properties are serviced by suppliers who have developed expertise for these niche applications. Other industrial end-use segments are catered to by technology providers and respective suppliers.

Value chain

Value chain in the industry comprises three broad segments of suppliers – automotive, industrial and niche applications (defence, nuclear, aviation and marine).

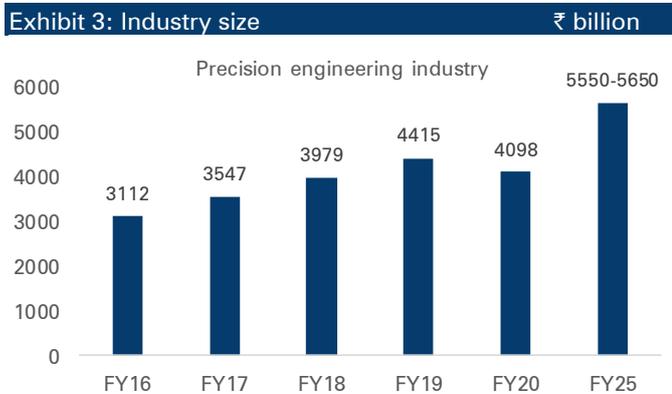
Exhibit 2: Industry value chain



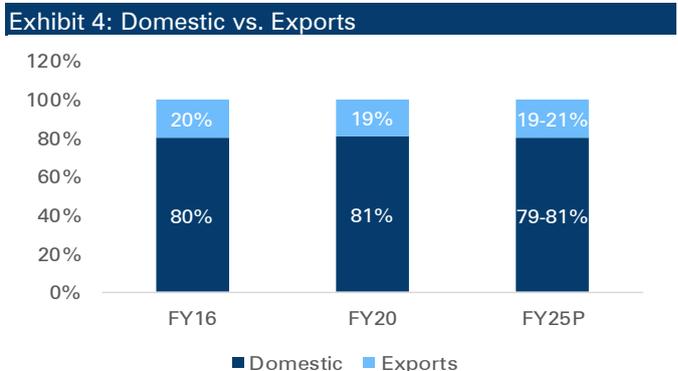
Source: RHP, Crisil Research, ICICI Direct Research

Precision engineering contributes 3-4% of total manufacturing output

The industry size is pegged at ~ ₹ 4.09 lakh crore (Crisil Research) and mainly caters to automobile components, industrial plant and equipment segments. The industry contributes an estimated 3-4% of overall manufacturing output and is expected to grow at ~6-7% CAGR in FY20-25. India’s thrust on localisation and making India a global factory, rise in penetration of high technology machinery, growth in auto-components, export demand combined with favourable government policies for manufacturing and engineering sectors are expected to boost the industry.



Source: RHP, Crisil Research, ICICI Direct Research



Source: RHP, Crisil Research, ICICI Direct Research

Competitive landscape

Given the fact that the industry operates in a very niche and complex area, the competitive landscape is very fragmented. Hence, it is difficult for any new player to enter given years of technological expertise in different fields have created high entry barriers, especially in sectors such as defence, aerospace, nuclear and aviation

Exhibit 5: Competitive landscape

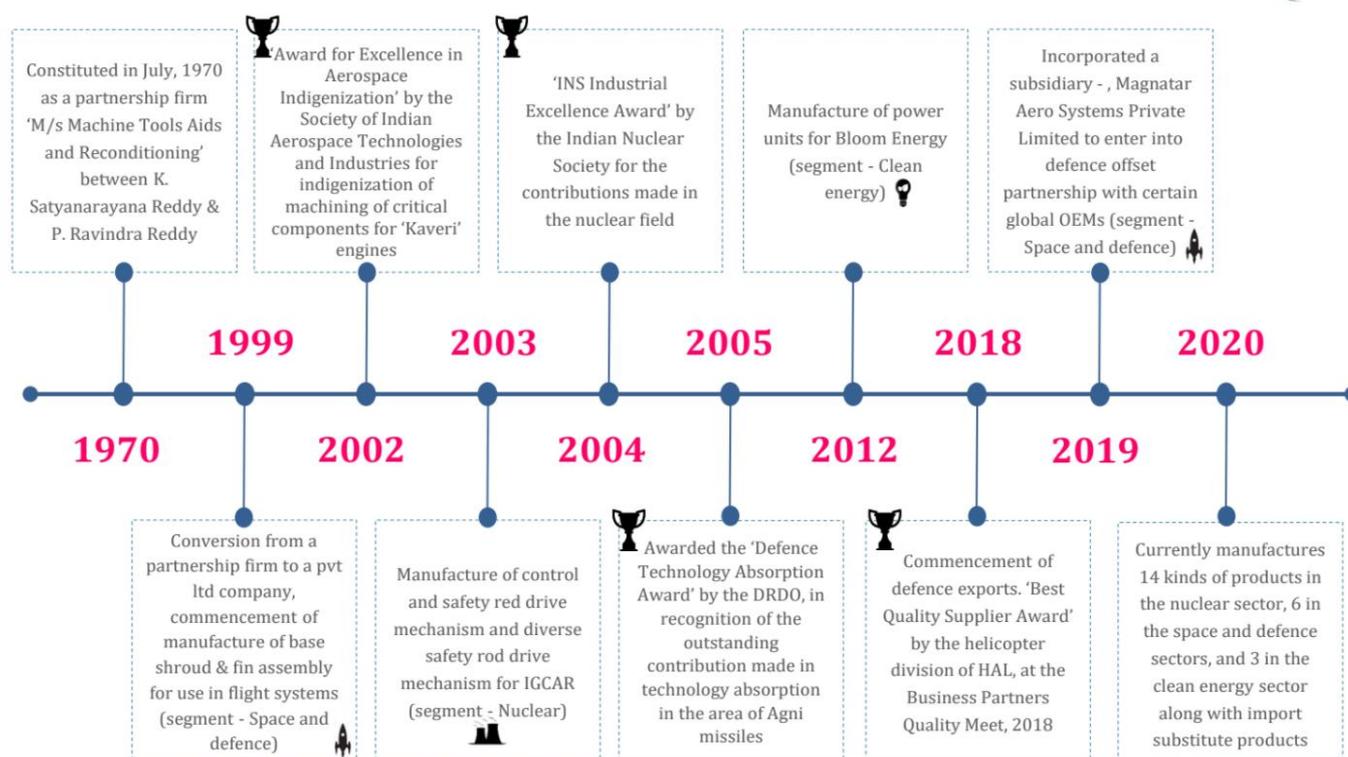
Company	Year of establishment	Location	Business description
MTAR Technologies	1999	Hyderabad	Nuclear equipment, defence and aerospace equipment, fabrication facilities, Fuel cells manufacturing
Mahindra Defence system	2012	Mumbai	Armoured solutions for military and paramilitary forces, and aircraft mobile surveillance, and modern defence equipment for the army, navy and air force
Alpha Design Technologies	2003	Bengaluru	Defence electronics, avionics and space satellite systems
Vem Technologies	1993	Hyderabad	Manufacturing parts and systems for missiles, bombs, UAVs, helicopters, aircrafts, and radar
CIM Tools	1997	Bengaluru	Manufacturing aircraft parts and equipment
Sika Interplant systems	1985	Bengaluru	Manufacturing engineering products and systems for aerospace and defence - Aircraft landing gear, hydraulic LRUs/assemblies, and actuators
Schaeffler India	1962	Mumbai	Ball bearings and roller bearings
SKF India	1961	Mumbai	Manufacturing bearings and its components
Timken India	1966	Bengaluru	Manufacturing bearings, components and accessories
Shanthi Gears	1972	Coimbatore	Manufacture of gearboxes and geared motors
Godrej & Boyce	1932	Mumbai	Diversified product profile in consumer appliances, office and home furniture, storage solutions, locks and security equipment, aerospace, construction, process equipment, tooling and precision engineering
L&T	1946	Mumbai	Engineering and construction segment such as infrastructure, power, hydrocarbons, heavy engineering, defence engineering, electrical and automation, information technology and technology services, metallurgical and material handling, and machinery and industrial products

Source: RHP, Crisil Research, ICICI Direct Research

Company background

MTAR Technologies, a precision engineering solutions company, was founded in 1970. The company manufactures hi-precision indigenous components, subsystems and assemblies having components with close tolerances (5-10 micros). The company operates in projects of high national importance and has long standing relations with NPCIL, Isro & DRDO. MTAR has supplied engine for the PSLV-C25, which launched the Mars Orbiter Mission spacecraft. Further the company has also been integral for GSLV Mark III engine for the Chandrayan II mission. Currently, the company has seven manufacturing units in Hyderabad with more than 400 machines, 891 permanent employees including 150 engineers and 248 contractual workmen. At the helm of affairs is Promoter and Managing Director, Parvat Srinivas Reddy. MTAR Technologies operates in three segments viz. nuclear, space & defence and clean energy and manufactures 14 products in the nuclear sector, six in space & defence and three in the clean energy sector.

Exhibit 6: Historical journey of MTAR Technologies



Source: Company, ICICI Direct Research

The order book as on December 2020 was at ₹ 336 crore out of which clean energy sector, nuclear and space & defence sector comprised ₹ 80.1 crore, ₹ 93.18 crore and ₹ 160.6 crore, respectively. During FY20, the company had a turnover of ₹ 213.8 crore, which comprised of 68% exports. One of the key customers for the company is Bloom Energy that contributed 49.14%, 61.43% & 64.53% in sales for FY18, FY19 & FY20, respectively.

Nuclear Segment

Major three areas in nuclear segment where the company operates are new reactors, refurbishment of old reactors & maintenance of reactors. The company manufactures components such as fuel machining head, drive mechanisms, bridge column, coolant channels, ball screws & water lubricated bearings. Customers in the segment are Nuclear Power Corporation of India (NPCIL) and Indira Gandhi Centre for Atomic Research. Nuclear segment's revenue was ₹ 30.5 crore in FY20 with a revenue share of 14%. The order book was at ₹ 93.2 crore as on December 2020.

Space & defence segment

The company manufactures components such as liquid propulsion rocket engines, cryogenic engines base shroud & fin assembly and various missile parts. Customers in the segment are Indian Space Research Organisation (Isro), Hindustan Aeronautics (HAL) and DRDO. Segmental revenue for FY20 was ₹ 39.3 crore with a revenue share of 18%. The Order book was at ₹ 160.6 crore as on December 2020.

Clean energy segment

Clean energy is one of the major growth segments for the company with fuel cells market growing at 15% CAGR. Major product of the segment is hot boxes, which it manufactures for Bloom Energy. MTAR is in the process of development and manufacture of hydrogen boxes and electrolysers to serve Bloom. The company's only customer in the segment is Bloom Energy. Revenue for FY20 in the segment was ₹ 137.5 crore with a revenue share of 64%. Order book was at ₹ 80.2 crore as on December 2020.

Investment Rationale

Huge opportunity in nuclear space

India has 22 operational nuclear reactors with a capacity of 6.3 GW. The country plans to double its nuclear capacity to 11.5 GW. Hence, seven new reactors are expected to come into operation in the next five years. This will create a huge opportunity for the large refurbishment and maintenance market that is also expected to increase 1.6x.

Increasing indigenisation, policy initiatives in defence

The Government of India (GoI) has recently announced an import ban on 101 defence based items that will allow a widespread opportunity in defence products. Further policy initiatives to make India a global factory and increase exports will also augur well for the company. MTAR is looking to enter into a defence offset partnership with certain global OEMs and has incorporated a subsidiary, Magnatar Aero Systems Pvt Ltd in this regard. The company has also jointly, with a global partner, bid for the first of a two-part tender, for design, development, preparation of 233 design documents and analysis report, procurement of raw material, manufacture, fabrication, assembly, inspection, testing, qualification, quality surveillance, supply to site and supervision during installation of spent fuel storage racks, for away from reactor spent fuel storage facility at site, and separately entered into a collaboration agreement with such partner.

Clean energy segment – Growth engine

The global fuel cell market is expected to register a CAGR of 14-15% between FY20 and FY25. The market size is expected to reach US\$5.2–US\$5.5 billion. Further, MTAR is in the process of development and manufacture of hydrogen boxes and electrolysers to serve Bloom. Going ahead, new customer addition and Bloom's tie up with Gail to deploy fuel cell technology is expected to augur well for the company.

Niche business with strong entry barrier

Precision engineering requires years of R&D and expertise in a specific field that can only be developed over the years. Hence, the entry barrier remains high in the industry. MTAR's key strength lies in its engineering capabilities. It has a robust and diversified product portfolio with long standing relations with esteemed organisations such as Nuclear Power Corporation of India, Indian Space Research Organisation and Defence Research and Development Organisation. This enables the company to get repeat businesses. Further, MTAR has end to end in-house capabilities (e.g. surface & heat treatment, specialised fabrication unit, assembly and testing) of developing customised high quality complex products for customers.

Premium margins

Given the nature of the industry, the company enjoys very high margins on its products. Gross margins have been consistently over 60% in the last three years whereas the company registered EBIDTA margin of 20%, 30% and 29% in FY18, FY19 and FY20 respectively. MTAR is provided an annual forecast of demand from customers and, hence, ties up for raw material for the year based on that. Hence, margins are insulated from raw material price fluctuations over the year.

Expanding international presence

One of the longstanding major client for MTAR has been Bloom Technology. The company is currently involved in the manufacture of power units, specifically hot boxes, and in the development and manufacture of hydrogen boxes and electrolysers, to serve Bloom energy. Further, the company has recently acquired a new international customer operating in the clean energy sector. The company has previously supplied critical defence products to international customers. MTAR intends to continue expanding its international presence and identify markets where they can provide cost and operational advantages to their clients. During FY20, the company made a turnover of ₹ 213.8 crore which comprising 68% exports

Key Risk

High concentration of revenue towards Bloom Energy

Bloom Energy's revenue contribution was 49.1%, 61.43% & 64.53% in FY18, FY19 & FY20, respectively. A greater portion of topline is dependent on Bloom Energy. The loss of business or orders from Bloom Energy can lead to significant reduction in order book and thereby revenue. Further, disruption in Bloom Energy's business will directly impact MTAR's performance.

Limited number of customers

MTAR has high dependence on limited number of customers. The company significantly depends on orders from NPCIL, Isro and DRDO. A decline or reprioritisation of funding in the Indian budget towards the respective departments of the Government of India under which these customers operate, or delays in the budget process could adversely affect MTAR's ability to grow or maintain our sales, earnings, and cash flow. Further, the liberalisation of the defence or space sectors to allow the entry of private and foreign companies may increase the level of competition it faces. There is no assurance that MTAR shall be able to compete effectively.

High Working Capital

Given the complex nature of business and requirement of multiple testing of the products, the inventory days of MTAR remain above 200 days. Further the debtor days are also above 100 days.

Error in critical application

Precision engineering requires manufacturing components with close tolerance levels that of 5-10 microns. If the company fails to deliver on the quality standards, then the company may face certain liabilities on the performance guarantee part or may even lose customers. Further, the components manufactured are used in sectors of national importance.

Exchange rate fluctuations

Exports contribute more than 50% share in the topline. Hence any fluctuations in currency can have significant impact on MTAR's profitability. More importantly, appreciation or depreciation of the rupee against the US dollar and other foreign currencies may affect MTAR's operations.

Failure to keep technological knowledge confidential

Given the nature of the Industry, the company's revenue is highly dependent on its technical knowledge, which it has gained through experience and R&D over the years. Consequently, a failure to keep technical knowledge confidential could erode MTAR's competitive advantage.

Financial summary

Exhibit 7: Profit and loss statement				
	₹ crore			
₹ crore	FY18	FY19	FY20	9MFY21
Revenue	159.6	184	214	177
Other Income	0.9	2	4	1
Total Income	160.5	186	218	178
% Growth		16%	17%	
Cost of Materials consumed	59.9	63	72	68
Employee cost	44.6	44	52	37
Depreciation	11.2	11	12	9
Finance cost	4.5	4	5	5
Other expenses	23	24	32	18
EBIDTA	31.9	54	58	53
EBIDTA %	20%	29%	27%	30%
PBT	17.2	40	46	40
Exceptional Items		1		
Tax	11.7	2	14	12
PAT	5.4	39	31	28

Source: Company, ICICI Direct Research

Exhibit 8: Cash flow statement				
	₹ crore			
₹ crore	FY18	FY19	FY20	9MFY21
PBT	17.2	42	46	40
Add				
Depreciation	11.2	11	12	9
Finance costs	4.5	4	5	5
Other	0.2	(0)	(1)	(1)
CFO before WC changes	33.0	57	61	53
Changes in WC	(16.1)	(6)	3	(51)
Cash from operations	17.0	52	63	2
Tax	2.5	9	7	9
Net CFO	14.4	42	56	(6)
Purchase of Assets	(2.1)	(27)	(12)	(16)
Sale of Assets	0.1	3		
Other	0.7	(8)	(0)	0
Net CFI	(1.3)	(33)	(12)	(16)
Dividend & Buyback		(10)	(35)	(14)
Borrowings	(9.3)	9	(0)	38
Finance costs	(4.5)	(6)	(6)	(4)
Net CFF	(13.8)	(7)	(41)	20
Net increase/decrease in cash	(0.7)	2	3	(3)
Exchange diff	(0.0)	(0)	-	0
Opening cash balance	9.8	9	11	14
Closing cash	9.1	11	14	11

Source: Company, ICICI Direct Research

Exhibit 9: Balance sheet				
	₹ crore			
₹ crore	FY18	FY19	FY20	9MFY21
Non Current Assets	171.5	196	175	188
Fixed Assets	152.2	162	155	155
CWIP	1.8	6	12	19
Intangibles	0.0	0	0	1
Other Non-current Assets	17.4	28	8	13
Current Assets	109.5	109	172	194
Inventory	41.9	41	75	79
Trade Receivables	49.0	50	62	73
Cash & Bank	9.1	11	23	22
Other Current Assets	9.6	7	11	20
Total Assets	281.0	305	346	382
Equity	205.5	235	225	246
Equity Share Capital	28.2	28	27	27
Other Equity / Reserves	177.3	207	198	219
Non-Current Liabilities	11.8	1	8	20
Current Liabilities	63.7	70	114	116
Borrowings	19.8	29	29	58
Trade Payables	13.6	6	31	15
Provisions	1.3	1	3	3
Other Current Liabilities	29.0	34	50	40
Total Liabilities	281.0	305	346	382

Source: Company, ICICI Direct Research

Exhibit 10: Key ratios			
Year end March	FY18	FY19	FY20
EPS	1.92	13.89	11.70
EPS (Post issue)	1.76	12.74	10.18
BV	72.84	83.29	84.11
Cash per share	3.22	3.82	8.69
Book value	72.84	83.29	84.11
Gross Margin	62%	66%	66%
EBIDTA Margin	20%	29%	27%
PAT Margin	3%	21%	14%
RoE	3%	17%	14%
RoCE	10%	19%	22%
RoIC	3%	17%	15%
PE (Post issue)	326	45	56.5
Sales/E equity	0.78	0.79	0.97
Mcap/Sales	11.02	9.51	8.11
Debt/E equity	0.15	0.12	0.16
Current Ratio	1.72	1.57	1.51
Debtor Days	111.99	100.19	105.24
Creditor Days	83.04	34.89	154.54
Inventory days	255.49	242.13	294.69
No of Shares	2.82	2.82	2.68

Source: Company, ICICI Direct Research, Calculated

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