



Great Offshore

STOCK INFO.	BLOOMBERG
BSE SENSEX: 14,657	GOFF IN
	REUTERS CODE
S&P CNX: 4,414	GOFS.BO

1 August 2008

Buy

Previous Recommendation: Buy

Rs410

Equity Shares (m)	38.1
52-Week Range	1,150/384
1, 6 Rel. Perf. (%)	-33/-35/-46
M. Cap. (Rs b)	15.6
M. Cap. (US\$ b)	0.4

YEAR	NET SALES	PAT	EPS	EPS	P/E	P/BV	ROE	ROCE	EV/	EV/
END	(RS M)	(RS M)	(RS)	YoY (%)	(X)	(X)	(%)	(%)	SALES	EBITDA
03/07A	5,822	1,452	38.1	49.6			23.5	14.1		
03/08A	7,459	1,308	34.3	-9.9	12.0	2.1	27.6	11.7	3.1	7.5
03/09E	9,142	1,996	48.9	42.4	8.4	1.5	19.1	12.1	2.8	6.1
03/10E	11,755	2,186	53.5	9.5	7.7	1.3	17.1	14.3	2.0	4.4

- Sales up 40% YoY; EBITDA margin down 250bps; PAT flat:** Great Offshore standalone sales for 1QFY09 are up 40% YoY to Rs2b. Consolidated sales are at Rs2.24b (expected Rs1.96b). Standalone EBITDA margin at 41.6% is down 250bps YoY. Lower EBITDA margin is disappointing due to two reasons: (1) 1QFY09 had full working of drill barge Badrinath, which was in dry dock in 1QFY08; (2) 1QFY09 should have had significantly lower drydocking charges than 1QFY08. Adjusted for mark-to-market exchange gain/loss on forex liabilities (mainly forex loans and US\$42m FCCBs), standalone PAT is flat at Rs357m.
- Two major developments in 1QFY09:** Firstly, Great Offshore has bagged a Rs2.34b engineering contract for various safety enhancement equipment on ONGC's 79 offshore platforms. We have incorporated into our estimates the contract, which is to be completed by middle of CY10. Secondly, Great Offshore has called off its plans to buy "an overseas company which has on order two harsh-environment, semi-submersible, sixth generation rigs". We believe this is a mild positive, as the rigs would not have come cheap.
- 32% EPS downgrade; stock down 60%:** We have cut our EBITDA margin assumption for FY09 and FY10 by 10% to around 45-46%. We have also cut other income estimate, partly due to the Rs503m share buyback. As a result, our EPS estimates are down 32% – to Rs48.9 for FY09 and Rs53.5 for FY10. Meanwhile, the stock price is down 60% since January 2008.
- Target price of Rs643; Value Buy with a growth option:** At CMP, dividend yield on Great Offshore stock works out to 4%. The NAV of its existing fleet is Rs700-750. Our DCF valuation suggests a target price of Rs643, which works out to a reasonable P/E of 12x FY10E. We recommend Great Offshore as a Value **Buy** with a growth option.

Y/E MARCH	QUARTERLY PERFORMANCE (RS MILLION)									
	FY08				FY09 (Consolidated)				FY08	FY09 E
	1Q	2Q	3Q	4Q	1Q	2QE	3QE	4QE	Cons.	Cons.
Operating Income	1,450	1,523	1,940	1,850	2,248	2,056	2,350	2,488	7,459	9,142
Change (%)	29.2	19.9	30.8	23.9	N.A.	N.A.	N.A.	N.A.	28.1	22.6
Total Expenses	810	801	928	1,120	1,292	1,119	1,279	1,286	4,335	4,977
EBITDA	640	722	1,012	730	955	937	1,071	1,202	3,124	4,165
Change (%)	10.5	15.7	40.2	7.2	N.A.	N.A.	N.A.	N.A.	18.9	33.3
EBITDA Margin (%)	44.1	47.4	52.2	39.5	42.5	45.6	45.6	48.3	41.9	45.6
Depreciation	236	231	263	255	280	310	330	351	986	1,271
Interest	136	145	211	163	179	125	150	100	684	554
Other Income	83	90	58	20	9	50	50	41	114	150
Extraordinary Inc/ (Exp)	207	83	18	180	-236	0	0	0	621	0
PBT	557	519	615	512	269	552	641	792	2,190	2,490
Tax	-4	23	64	88	65	71	82	102	173	319
Tax/PBT (%)	-0.8	4.4	10.4	17.2	12.8	12.8	12.8	12.8	7.9	12.8
Reported PAT	562	496	551	424	204	481	559	691	2,016	2,171
Adjusted PAT *	355	413	533	156	440	481	559	515	1,308	1,996
Change (%)	1.0	6.4	41.8	-47.8	N.A.	N.A.	N.A.	N.A.	-9.9	52.6
PAT Margin (%)	24.4	27.1	27.4	8.4	19.6	23.4	23.8	20.7	17.5	21.8

E: MOST Estimates; * Adjusted PAT is net of extraordinary items and preference dividend (including dividend tax)

Sales up 40%; EBITDA margin down 250bp

Great Offshore standalone sales for 1QFY09 are up 40% YoY to Rs2b. Consolidated sales are at Rs2.24b (expected Rs1.96b).

Standalone EBITDA margin at 41.6% is down 250bps YoY. Lower EBITDA margin is disappointing due to two reasons:

- (1) 1QFY09 had full working of drill barge Badrinath, which was in dry dock in 1QFY08; and
- (2) 1QFY09 should have had significantly lower drydocking charges than 1QFY08.

PAT flat; sharply lower than estimates

Adjusted for mark-to-market exchange gain/loss on forex liabilities (mainly forex loans and \$42m FCCBs), standalone PAT is flat at Rs357m.

Adjusted consolidated PAT is at Rs440m, sharply lower than our estimated Rs727m.

Rs2.34b engineering contract from ONGC

Great Offshore has bagged a Rs2.34b engineering contract for various safety enhancement equipment on ONGC's 79 offshore platforms.

We have incorporated into our estimates the contract, which is to be completed by middle of CY10. We have assumed 24 months duration beginning October 2008, and 15% PBT margin on the same.

Sharp cut in EBITDA margin assumptions; 32% EPS downgrade

1QFY09 standalone margins point to (1) significant cost pressures and/or (2) stiff competition keeping day rates in check despite a buoyant demand environment.

We have cut our EBITDA margin assumption for FY09 and FY10 by 10% to around 45-46%. We have also cut other income estimate, partly due to the Rs503m share buyback. As a result, our EPS estimates are down 32% – Rs48.9 for FY09 and Rs53.5 for FY10.

FY08-10E EPS CAGR of 26%

We see 42% growth in FY09E EPS, adjusted for extraordinary items and preference dividend. FY10 EPS growth should be up only 10%; despite the addition of third rig and new MSV, we expect muted profit growth due to dry-docking of jack-up rig, Kedarnath. FY08-10E EPS CAGR works out to 26%.

Plans to buy deep-water rigs cancelled

Great Offshore has finally called off its plans to buy “an overseas company which has on order two harsh-environment, semi-submersible, sixth generation rigs”. (The order value of the rigs was US\$1.4b.)

We believe this development is a mild positive; the rigs would not have come cheap, given the current demand situation.

Intrinsic value ...

The Great Offshore stock is down 60% since January 2008 to Rs400 levels currently. Great Offshore paid out Rs16 per share as dividend in FY08. Even if it maintains the same for FY09, the dividend yield works out to 4%. The company recently completed a Rs503m buyback program of 881,000 shares. The buyback price limit was placed at Rs750, the claimed NAV of Great Offshore's existing fleet.

... with growth option

Great Offshore has US\$42m worth of FCCB proceeds lying abroad. We believe the company continues to remain on the lookout for right-priced assets. Any announcements on this front will have dual impact –

- (1) improve the company's growth option; and
- (2) provide a trigger for stock price.

Target price of Rs643, 57% upside, Buy

Our DCF valuation suggests a target price of Rs643, which works out to a reasonable P/E of 12x FY10E. Our rating on the stock has been under review ever since the acquisition was announced. We now recommend Great Offshore as a Value **Buy** with a growth option. Our target of Rs643 implies 57% upside from current levels.

Great Offshore: an investment profile

Company description

Great Offshore has a strong fleet of 26 OSVs (offshore support vessels), two drill rigs, one construction barge, one flat cargo carrier and 11 harbour tugs. It provides services across the oil E&P value chain, including drilling, marine construction and offshore logistics.

Key investment arguments

- Great Offshore has aggressively added 11 new assets in the last two years in a rising day-rate scenario.
- It has placed orders for its third rig which is due for delivery in early 2009. The rig is already contracted for five years with ONGC, implying visibility of cash flows till 2014.
- High cash flow visibility coupled with comfortable debt-equity (zero net debt by FY11) makes it well-placed to grow its earnings through the acquisition route.

Key investment risks

- Day rates could plateau, depending on the supply of vessels.
- Great Offshore's fleet includes assets over 20 years, which increase the risk of frequent dry-docking leading to loss of revenue and higher expenditure.
- Any sharp appreciation in the rupee is a potential dampener to Great Offshore's earnings.

COMPARATIVE VALUATIONS

		GREAT OFFSHORE	ABAN OFFSHORE
P/E (x)	FY09E	8.4	6.5
	FY10E	7.7	5.0
P/BV (x)	FY09E	1.5	3.9
	FY10E	1.3	2.2
EV/Sales (x)	FY09E	2.8	4.1
	FY10E	2.0	3.5
EV/EBITDA (x)	FY09E	6.1	6.1
	FY10E	4.4	5.1

SHAREHOLDING PATTERN (%)

	JUN-08	MAR-08	JUN-07
Promoter	20.3	20.1	26.1
Domestic Institutions	21.8	23.1	20.5
FII/ FDI	13.0	13.0	8.5
Others	44.9	43.8	44.9

Recent Developments

- July 2008: Called off the deal to "acquire controlling interest in an overseas company, which has under construction two high-end, semi-submersible rigs at a cost of US\$1.4b."
- January 2008: Announced acquisition of a flat cargo carrier for US\$6m (US\$14m including cost of modification and upgradation).

Valuation and view

- Valuation is non-demanding at 12x FY08 and 8x FY09E. FY08-10E EPS CAGR is 26%, and dividend payout is over 30%. DCF-based target price is Rs643, 57% upside from current levels.
- We recommend Great Offshore as a Value Buy with a growth option.

Sector view

- The oil drilling and related services sector is currently enjoying peak revenue and profitability due to high oil E&P activity globally.
- Though shipyards are overflowing with orders for new builds, the demand-supply situation continues to remain favourable for asset owners.
- We have a positive view on the sector for the next five years at least.

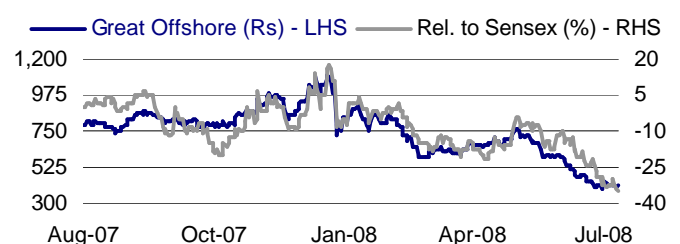
EPS: MOST FORECAST VS CONSENSUS (RS)

	MOST FORECAST	CONSENSUS FORECAST	VARIATION (%)
FY09	48.9	62.5	-21.8
FY10	53.5	87.1	-38.6

TARGET PRICE AND RECOMMENDATION

CURRENT PRICE (RS)	TARGET PRICE (RS)	UPSIDE (%)	RECO.
410	643	57	Buy

STOCK PERFORMANCE (1 YEAR)



INCOME STATEMENT		(Rs Million)				
Y/E MARCH	2006	2007	2008	2009E	2010E	
Net Sales	3,885	5,822	7,459	9,142	11,755	
Change (%)		49.9	28.1	22.6	28.6	
EBITDA	1,618	2,628	3,124	4,165	5,342	
Change (%)		62.5	18.9	33.3	28.2	
Depreciation	449	709	986	1,271	2,005	
EBIT	1,169	1,919	2,139	2,894	3,337	
Interest	173	361	684	554	905	
Other Income	31	79	114	150	200	
PBT	1,027	1,638	1,569	2,490	2,631	
Tax (incl FBT, def. tax)	56	186	173	319	446	
Tax/PBT (%)	5.4	11.3	11.1	12.8	16.9	
Reported PAT	971	1,452	1,396	2,171	2,186	
PAT after Pref. Div.	971	1,452	1,308	1,996	2,186	
Change (%)		49.6	38.9	7.7	0.7	
EBITDA Margin (%)	41.7	45.1	41.9	45.6	45.4	
PAT Margin (%)	25.0	24.9	17.5	21.8	18.6	

BALANCE SHEET		(Rs Million)				
Y/E MARCH	2006	2007	2008E	2009E	2010E	
Share Capital	381	381	381	408	408	
Reserves	4,618	5,795	6,934	10,960	12,381	
Net Worth	4,999	6,176	7,315	11,369	12,790	
Preference capital	0	0	1,500	0	0	
Total debt	3,812	7,466	9,461	12,521	10,564	
Net Deferred Tax	29	-33	-66	-66	-66	
Capital Employed	8,839	13,609	18,211	23,825	23,289	
Gross Fixed Assets	9,403	13,789	14,973	22,607	25,438	
Less: Acc. Depreciation	3,414	4,120	4,974	6,245	8,250	
Net Fixed Assets	5,988	9,669	9,999	16,362	17,187	
Capital WIP	1,829	3,221	3,906	2,320	0	
Investments	0	0	182	0	0	
Curr. Assets	2,100	2,291	6,583	7,821	9,269	
Inventory	73	63	78	80	90	
Debtors	764	1,240	1,748	2,143	2,755	
Cash & Bank	1,024	576	3,194	3,682	3,961	
Loans, Adv. & Others	240	412	1,563	1,916	2,463	
Curr. Liabilities	1,081	1,573	2,460	2,679	3,168	
Creditors	608	896	1,478	1,697	2,187	
Other Liabilities	438	650	493	493	493	
Provisions	35	27	489	489	489	
Net Curr. Assets	1,020	718	4,123	5,142	6,101	
Total Assets	8,839	13,609	18,211	23,825	23,289	

E: MOST Estimates

RATIOS						
Y/E MARCH	2006	2007	2008E	2009E	2010E	
Basic (Rs)						
EPS	25.5	38.1	34.3	48.9	53.5	
Cash EPS	37.2	56.7	76.4	80.0	102.6	
Book Value	131.1	162.0	191.9	278.3	313.1	
Dividend per share	5.1	8.0	16.0	16.0	16.0	
Payout incl. Div. Tax. (%)	22.7	23.9	35.4	35.2	35.0	
Valuation (x)						
P/E			12.0	8.4	7.7	
Cash P/E			5.4	5.1	4.0	
Price/Book Value			2.1	1.5	1.3	
EV/Sales			3.1	2.8	2.0	
EV/EBITDA			7.5	6.1	4.4	
Dividend Yield (%)			3.9	3.9	3.9	
Profitability (%)						
RoE	19.4	23.5	27.6	19.1	17.1	
RoCE	13.2	14.1	11.7	12.1	14.3	
Turnover Ratios						
Debtors (days of sales)	72	78	86	86	86	
Inventory (days of sales)	7	4	4	3	3	
Creditors (days of exp.)	98	102	124	124	124	
Asset Turnover (x)	0.4	0.4	0.4	0.4	0.5	
Leverage Ratio						
Debt/Equity (x)	0.8	1.2	1.5	1.1	0.8	
Net debt-equity	0.6	1.1	1.1	0.8	0.5	

CASH FLOW STATEMENT		(Rs Million)				
Y/E MARCH	2007	2008E	2009E	2010E		
PBT excl. Extraordinary items	1,638	1,569	2,490	2,631		
Add: Depn & Amortization	711	986	1,271	2,005		
Interest paid	361	684	554	905		
Less: Direct Taxes Paid	-247	-206	-319	-446		
(Incr)/Decr in WC	-146	-788	-530	-680		
CF from Operations	2,316	2,244	3,466	4,416		
CF including EO items	2,316	2,244	3,466	4,416		
(Incr)/Decr in FA	-5,781	-2,001	-6,048	-511		
CF from Investing Activity	-5,781	-2,183	-5,866	-511		
Incr/(Decr) in Net worth	72	545	2,823	0		
Incr/(Decr) in Debt	3,654	1,996	3,060	-1,957		
Interest Paid	-361	-684	-554	-905		
Dividend Paid (incl. div. tax)	-348	-714	-765	-765		
CF from Financing Activity	3,018	2,556	2,889	-3,627		
Incr/(Decr) of Cash	-448	2,617	489	279		
Add: Opening Balance	1,024	576	3,194	3,682		
Closing Balance	576	3,194	3,682	3,961		

N O T E S



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Great Offshore

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|---|-----|
| 1. Analyst ownership of the stock | No |
| 2. Group/Directors ownership of the stock | No |
| 3. Broking relationship with company covered | No |
| 4. Investment Banking relationship with company covered | Yes |

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