

Varun Shipping limited (VSL): Sailing in Bad Times

1st October, 2009



BSE : 500465
 NSE : VARUNSHIP
 Bloomberg : VRNS IN
 CMP : 61.1
 Sector : Shipping
 View : BUY

Key Metrics

Listing	NSE/BSE
Current Price	61.1
Market Cap (Rs Crores)	923.30
Free Float (%)	53.5
52-Week High (Rs)	70.4
52-Week Low (Rs)	38.25
BETA	0.89
P/B (x)	1.09
Current P/E (x)	8.87
Face Value	10.00
PEG Ratio	NA
Dividend Yield (%)	8.20

Price Performance (%)

Time Period	Stock	Nifty 50
1 Month	1.33%	9.03%
3 Month	8.19%	18.45%
1 Year	6.95%	29.63%

Shareholding Pattern (%)

Promoter	46.5
Pledged	6.3
FII's	14.82
DII's	5.17
Public	27.43
Others	6.08

Company Background:

VSL is an integrated hydrocarbon shipping company, commenced operations in 1973 and currently is the operator of largest LPG fleet under Indian flag. The company is a global player in energy transportation and offshore exploration and production (E&P) support services.

Investment Rationale:

- VSL currently owned LPG carrier fleet of 11 vessels, which is the largest in India in terms of both fleet size and cargo carrying capacity of 319,682 dead weight tons (dwt). The company has a major 86.0 percent of the total LPG tonnage (on dwt basis) under Indian Flag
- The company has delivered value to its shareholders in the form of paying dividends. The company has impressive track records of paying continuous dividends since past 24 years, and at current market price dividend yield's stands over 8.0 percent
- For the financial year FY09, major portion of revenue has clocked from repeat customers, contributing 80.94 percent to total revenue earned by the company, showing faith of the clients towards the VSL business model
- VSL has increased its asset base and business operations in the offshore segment to capitalize the rapidly developing oil and gas exploration and production industry. VSL revenue contribution from offshore segment has increased significantly from 3.55 percent in FY07 to 20.0 percent in FY09

Key Risks:

- It is predominantly in LPG carriers business which accounts 57.72 percent of overall revenues in FY09. Hence any amendments in government policy, new regulatory compliance would affect the company adversely
- VSL debt-to-equity ratio is very high as compared to its peer players, while the interest coverage ratio has also fallen over years to mere 1.86 times in FY09, which remains a cause of concern

Company Background

Varun Shipping Limited (VSL), an integrated hydrocarbon shipping company, commenced operations in 1973 and currently is the operator of largest LPG fleet under Indian flag. The company is a global player in energy transportation and offshore exploration and production (E&P) support services. It provides widespread shipping and logistics solutions in marine, gas, oil, petroleum products, offshore business etc. The company presently owns a well diversified fleet of 21 vessels, of which 11 vessels are of LPG carrier fleet. The 11 vessels of LPG carrier fleet are the largest in India in terms of both fleet size and cargo carrying capacity.

Exhibit: Diversified Fleet

Particulars	Vessel Type	No of Ships	Cargo Capacity (in Cu.m/dwt/bhp)
I	<u>LPG Carriers</u>		(in Cu.m)
	MGC	9	280,772
	LGC	1	57,206
	VLGC	1	76,644
	Total	11	414,622
II	<u>Crude Oil Tankers</u>		(in dwt)
	Aframax	3	319,682
	Total	3	319,682
III	<u>Offshore Support Vessels</u>		(in bhp)
	5200 bhp (60T + bollard pull)	2	10,400
	16000 + bhp (190T + bollard pull)	5	93,040
	Total	7	103,440

Source: Company

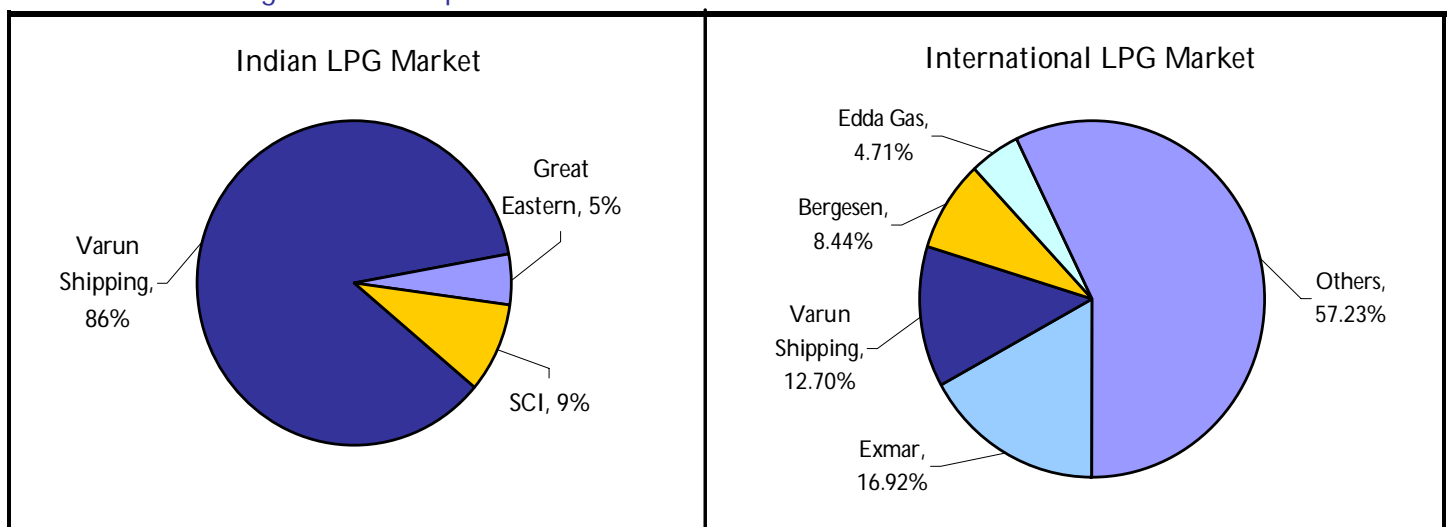
Investment Rationale

Leadership in the Indian LPG market:

VSL currently owned LPG carrier fleet of 11 vessels, which is the largest in India in terms of both fleet size and cargo carrying capacity of 319,682 dwt. The company has a major 86.0 percent of the total LPG tonnage (on dwt basis) under Indian Flag, followed by GE Shipping which has 5.0 percent market share while SCI accounts for 9.0 percent share. In June 2007, VSL acquired a very large gas carrier (VLGC), which is the largest LPG carrier in Indian fleet with a cargo carrying capacity of 76,644 cubic metres (cbm) and transported approximately 72 percent of all PSU controlled LPG cargoes brought into India during the financial period FY09.

VSL is the second largest global player in the mid-sized fully-refrigerated LPG carrier fleet with a 12.70 percent market share on cu. m basis. During the FY08, the VSL has secured its first long term contract to transport LPG in a VLGC to the newly commissioned 'Cavern Storage' at Vizag. The company is the fourth largest in the world in terms of number of LPG vessels and sixth largest in the world in terms of cbm i.e. cargo carrying capacity.

Exhibit: Revenue Segment Break-Up

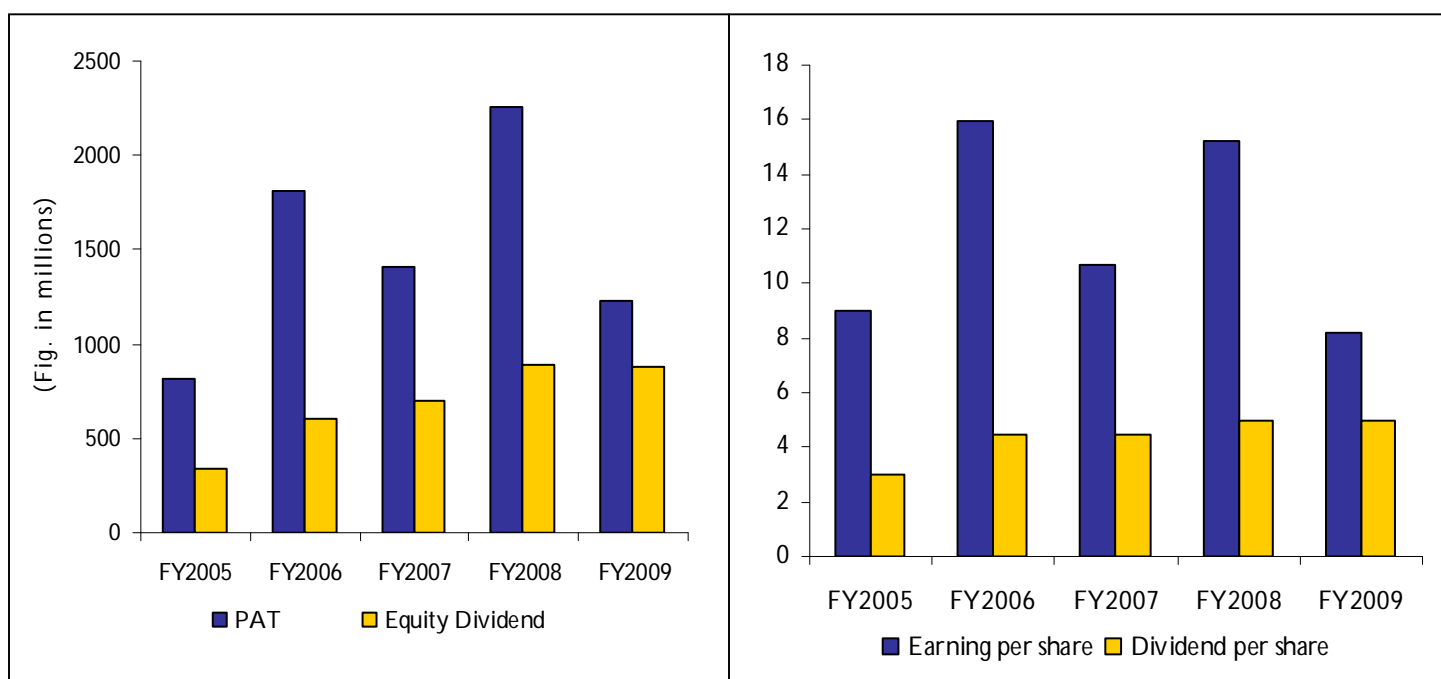


Source: Company

Delivering value to share holders:

The company has delivered value to its shareholders in the form of paying dividends. The company has impressive track records of paying continuous dividends since past 24 years, despite of cyclic nature of the business. For the last 4 years company has maintained a dividend pay-out in excess of 40 percent. For FY09, company has paid a dividend of 50 percent, thereby delivering a current dividend yield of more than 8 percent. Going forward, we believe the company would continue to pay high dividends, which would enhance overall returns of the shareholders.

Exhibit: Trend in total equity dividend and dividend per share

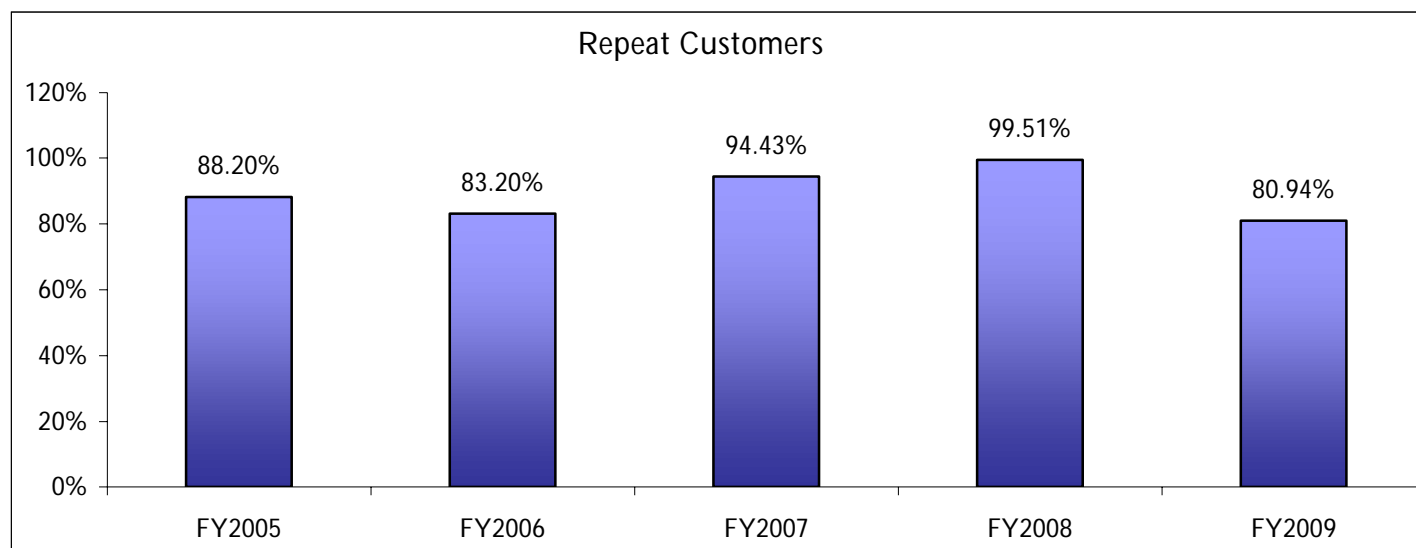


Source: Company

Effective customer retention:

For the financial year FY09, major portion of revenue has clocked from repeat customers, contributing 80.94 percent to total revenue earned by the company. Contribution to total revenue by repeat customers in FY2006 was 83.2 percent, which over a period of three years has decreased marginal to 80.94 percent, showing faith of the clients towards the VSL business model. In the long term, the diversified expansion plan into high end sectors and expansion of fleet would not only retain existing customers but is likely to bring into more clients for the company. Therefore, the company believes in adapting to customer's requirements by expanding and diversifying their shipping product range and offering customer's a comprehensive shipping and services solution across the entire hydrocarbon chain.

Exhibit: Contribution to Total Revenue by Repeat Customers

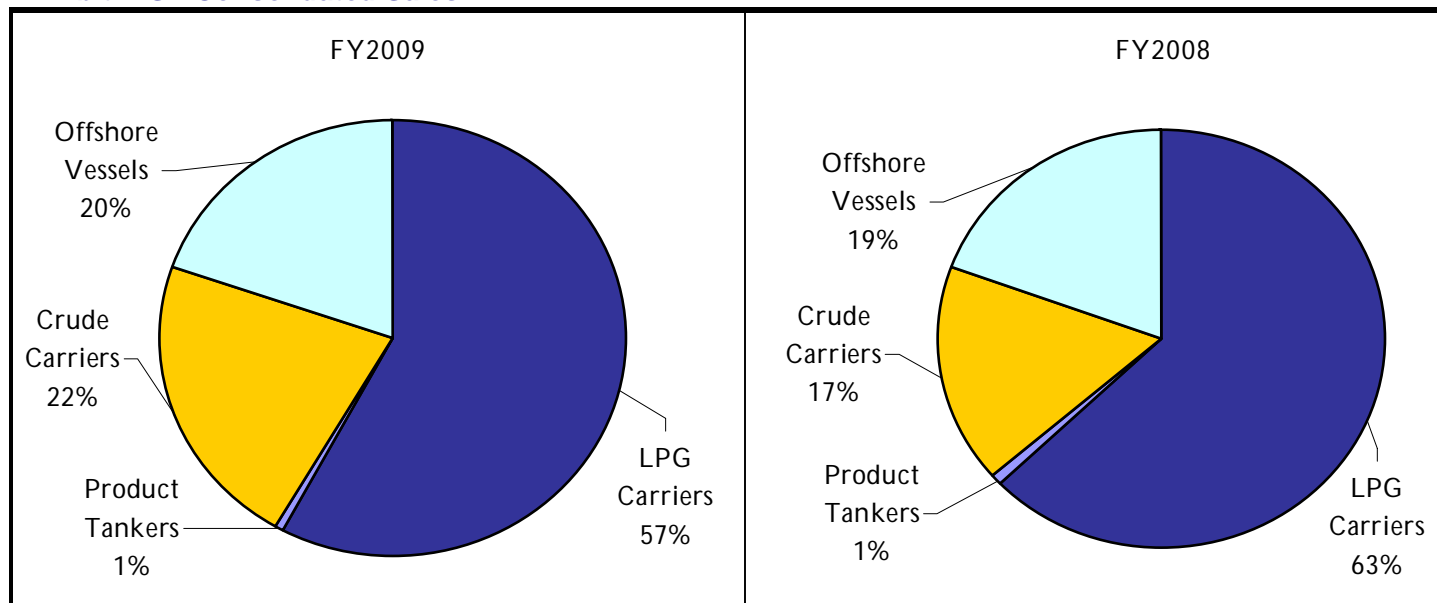


Source: Company

Scaling up Offshore Vessel business:

VSL has increased its asset base and business operations in the offshore segment to capitalize the rapidly developing oil and gas exploration and production industry. In 2009, the company has acquired two large, modern Anchor Handling Towing and supply (AHTS) vessels each with over 16,000 BHP, the most powerful AHTS vessel under Indian Flag. In March 2008, VSL acquired AHTS vessel with BHP of 16,085. With all these acquisition the company has a fleet of seven AHTS vessels with five being the most powerful AHTS vessels (AHTS positioning > 15,000 BHP) having highest bollard pull under Indian flag and the first Indian company operating AHTS in North Sea. VSL revenue contribution from offshore segment has increased significantly from 3.55 percent in FY07 to 20.0 percent in FY09. Going forward we expect the VSL revenue contribution from offshore segment to be more on account of better margins versus the other segments.

Exhibit: VSL Consolidated Sales Mix



Source: Company

Strong promoters in the business:

The company has a highly professional and well qualified team of management in the area of technical and commercial operations, finance, secretarial and legal functions, information technology and human resources. Mr. Arun Metha and Mr. Dilip D. Khatau the Chairman and Managing Director of the company are having an experience of about 25 years in the mentioned field. This has come out as a positive issue for the company. Due to their prolonged stay in this particular sector, any positive or negative movement in the sector are well sensed and most of the times, the promoter is able to come up with well-fabricated investment techniques either to reap the benefits of good times or to mitigate the risks in bad times. Moreover, a highly experienced and committed management team is responsible for all areas of operations and creating wealth for the investors.

Recent Developments

- In April 2009, VSL acquired Suchandra, a 2009 built, 16,320 BHP Anchor Handling Towing and Supply (AHTS) vessel, built in Norway. This is a specialized vessel which is used for deep sea oil exploration activity going on in areas like North Sea, KG basin and Atlantic Ocean off the coasts of Nigeria, Brazil and Mexico. With this acquisition, the company is further consolidating its position as a leading Asian deep water anchor handling company, operating in global markets
- In January 2009, the company acquired its fourth 2008 built 16,100 BHP AHTS. This is a specialized vessel which is used for deep sea oil exploration activity going on in areas like North Sea, KG basin and Atlantic Ocean off the coasts of Nigeria, Brazil and Mexico.

SWOT Analysis

Strength:

- § VSL is an integrated hydrocarbon marine transportation and services company operating in high technology sectors and is also flexible as per customer needs
- § The company is the global leader player in the LPG shipping sector and is also a leading player in the Asian high-end offshore AHTS sector
- § VSL is having a highly experienced and committed management team responsible for all areas of operation

Weakness:

- § Shipping industry being global and cyclical in nature, any softening of the freight rates would impact the earnings and margins of the VSL
- § The Baltic Dry Index, a measure of shipping costs for commodities, continued with negative momentum on signs of slowing Chinese raw material demand, it fell 28% m-o-m (August) and is expected to remain weak on account of inventory pile up & a correction in the commodity prices
- § It is predominantly in LPG carriers business which accounts 57.72 percent of overall revenues. Hence any amendments in government policy, new regulatory compliance would affect the company adversely

Opportunities:

- § The Energy Information Administration ("EIA") estimates that non-OECD Asia (including China and India) will account for 43% of the total increase in global oil use over the next 20 years, thus the increase in demand for the offshore vessels
- § The company is well poised to reap the benefits of global slowdown as acquisition of vessels (newly built as well as second hand vessels) would be done at cheaper prices owing to the current economic meltdown coinciding with increased shipping demand in India
- § Growing opportunities will be available in countries such as Indonesia for LPG business and increase business opportunities available in deepwater blocks in Asia, Africa and South America in the offshore sector

Threats:

- § Global economic slowdown and Baltic Dry index collapse has led to lower charter rates
- § Lower oil prices and difficulty in obtaining credit has meant that some oil companies have pushed back project plans
- § Shipping industry concern is that it is likely to face with overcapacity in FY10 & FY11 and slowdown in the international trade would lead to potential drop in freight rates

Financials

Exhibit : Financial Analysis

Figures in Crores

Particulars	FY2009	FY2008	FY2007
Total Income	992.67	932.56	684.49
EBIDTA	541.19	573.13	382.39
EBIT	269.99	361.14	219.49
PBT	124.51	221.63	100.39
Reported PAT	122.97	225.89	145.02
Earning Per Share	8.19	15.05	10.16
BVPS	56.30	63.00	52.70
P/E (x)	5.12	4.76	5.12
P/B (x)	0.75	1.14	0.99
EBIDTA (%)	54.52	61.46	55.86
EBIT (%)	27.20	38.73	32.07
NPM (%)	12.39	24.22	21.19
ROE (%)	14.21	27.56	23.59
ROCE (%)	3.62	8.02	6.54
Interest Coverage Ratio	1.86	2.59	1.84
Debt To Equity Ratio	3.37	2.33	2.39
Current Ratio	1.79	1.00	1.89

Source: Company

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