15th September 09

PIPAVAV SHIPYARD LIMITED - IPO Analysis

Issue details

Category	No. of Share
Fresh Issue	85,450,225
Employee Reservation	600,000
Public Issue	84,850,225
QIBs	50,910,135
Non Institutional	8,485,022
Retail	25,455,068

Equity Shares outstanding prior to the Issue	214,004,400
Equity Shares outstanding after the Issue	240,454,382
Issue opens on	16 September 09
Issue closes on	18 September 09
Price Band (Rs.)	55-60

Issue objective

The objects of the Issue are the following:

- Construction of facilities for shipbuilding, ship repair and the Offshore Business;
- Margin for working capital; and
- General corporate purposes.

The details of the project cost are summarised in the table below:

Objects of the Issue	Total Cost	Amount spent until July 15, 2009*	Cost to be financed from the Net Proceeds
Construction of facilities for shipbuilding, ship repair and the Offshore Business	25,661.43	19,844.12	1,792.67
Margin for working capital	4,290.38	1,016.29	2,440.38
General corporate purposes	-	-	[●]
Total	**29,951.81**	**20,860.41**	**[●]**

* As certified by GPS & Associates, Chartered Accountant, pursuant to their certificate dated August 4, 2009. (Rs. in mn)

Business overview

PSL was established in 1997, originally developed as a ship-dismantling facility, in order to meet anticipated demand arising from International Maritime Organization ("IMO") regulations that were expected to be implemented in 2002 (which would have resulted in an increased rate of retirement of older tankers by ship-owners) and which was subsequently deferred, they decided to convert the ship-dismantling facility then under construction into a shipyard in order to meet expected increase in demand for new vessels. PSL is located on the west coast of India adjacent to major sea lanes between Persian Gulf and Asia. Upon completion of construction of Pipavav Shipyard it will be capable of ship construction and repairs for a range of vessels of different sizes and types, including naval vessels and coast guard vessels, as well as the fabrication and construction of products such as offshore platforms, rigs, jackets and vessels (but excluding sub-sea pipelines) for oil and gas companies, which they intend to offer in Offshore Business ("Offshore Business Products").

The construction of the Pipavav Shipyard includes:

- Conversion of one of the two existing wet docks into a dry dock measuring 662 meters in length and 65 meters in width, and which is capable of accommodating ships of up to 400,000 DWT and/or multiple combinations of smaller vessels including vessels catering to offshore activities such as offshore supply vessels ("OSV"), anchor handling tug supply vessels and multi-purpose support vessels.
- The construction of a fabrication and block assembly facility for shipyard operations;
- The establishment of dedicated facilities comprising an offshore yard with load out facilities for Offshore Business Products; and
- The installation of two Goliath cranes, each having a lifting capacity of up to 600 tonnes, including fit out berths, for building and repairing vessels, including naval vessels and coast guard vessels.

The table below shows a break down of the status of orders:

Terms of Agreement	Name of Customer	Type of Vessel	Total aggregate value of vessels
Firm order agreements	Golden ocean AVGI	Panamax bulk-carriers of 74,500 DWT	US$ 373.52 million (Rs. 17,880 million)
Firm order agreements subject to renegotiation to grant customer option to take delivery of vessel (option exercisable until December 31, 2010)	Golden Ocean	Panamax bulk carriers of 74,500 DWT	US$ 71.26 million (Rs. 3,411 million)
Firm order agreements subject to renegotiation to grant customer unilateral right to terminate obligation to take delivery of vessel if it is unable to arrange funding	AVGI	Panamax bulk carriers of 74,500 DWT	US$ 231 million (Rs. 11,058 million)
Firm order agreements subject to arbitration	Setaf	Panamax bulk-carriers of 74,500 DWT	US$ 144 million (Rs. 6,893 million)
Notification of award of contract for construction	ONGC	OSV	US$ 111.85 million (Rs. 5,354 million)

Strengths

Four Pillar business strategy

PSL intends to continue to diversify business by focusing on opportunities across a range of areas besides commercial shipbuilding. PSL plans to engage in areas like.

- Merchant shipbuilding of sizes and specifications other than Panamax bulk carriers;
- Offshore Business;
- Shipbuilding and repair for navy and coast guard vessels; and
- Ship repair

This would help mitigate the effects of the cyclical nature of commercial shipbuilding going forward.

Largest dockyard

PSL will have the largest dockyard in India, with a capacity to build and repair ships of up to 400,000 DWT including very large crude carriers (VLCCs) and large naval and coast guard vessel, together with facilities for fabrication / assembly of products for the offshore sector.

Advanced shipbuilding technology

PSL will manufacture vessels of different sizes and types and provide offshore structures utilizing technologically advanced design and production systems, including automation systems and digital technology. PSL have also executed a technical assistance agreement with SembCorp Marine Limited (Singapore) and Korea Maritime Consultants Co. Limited (korea).

Order Book

PSL have firm orders for the construction of 10 Panamax bulk carriers of 74,500 DWT each along with options to construct additional Panamax vessels. PSL also received notification of award of contract for construction of 12 OSVs.

Strategic Location

PSL enjoys strategic located advantages and favourable marine conditions along the west coast of India on the busy international sea route connecting the Persian Gulf to Asia, and is approximately 150 nautical miles from Mumbai, that is suitably located for the ship repair business.

RISK FACTORS

High indebtness

Their substantial indebtedness and the conditions and restrictions imposed by their financing and other agreements could adversely affect their ability to conduct their business, financial condition and operations. They have rescheduled some of their debt obligations.

Insufficient Cash flows

PSL only commenced commercial production on April 1, 2009, and have no operating history from which its ability to generate cash flow can be evaluated. PSL currently do not generate sufficient cash flow for debt service and it may not be able to generate sufficient cash flow to meet debt service obligations.

Contract cancellation, renegotiations, modification

Many of their customers have sought to cancel, renegotiate, arbitrate or otherwise modify contracts for vessels in their order book following the global economic downturn, which could materially harm their cash flow position, financial conditions and results of operations.

Limited No. of customer

PSL depends on a small customer base. Operations of the PSL would be adversely effected if they are unable to establish or maintain relationships with customers. There can be no such assurance that they will be able to re-establish a customer base or replace customers that they may loose.

Currency Fluctuation

Substantial portion of sales revenues are expected to be generated and paid in U.S. dollars and a significant part of PSL's costs are incurred in Rupees, appreciation of the Rupee versus the U.S. dollar will result in lower revenues in Rupee terms, which could adversely affect profitability.

Outlook

PSL is well positioned to take advantage of factors like

- Diversified and cost competitive business model
- Expected surge in sea-borne trade
- Strong capex lined up in the Offshore and Defence Sectors.

However PSL commenced commercial operations from April 2009 with the construction of four Panamax vessels. It will deliver its first vessel post April 2010 with subsequent deliveries are expected at regular intervals of one to three months thereafter. Pipavav will start booking Revenues FY2010 onwards instead of following percentage completion method as only the trial runs have begun till FY2009. Given limited duration of its commercial operations it is pointless to compare its valuation on financial parameters like P/E, P/BV etc. with its peers like ABG Shipyards and Bharti Shipyard.

We believe that PSL should be able to achieve efficiency and cost competitiveness in manufacturing process through economies of scale and develop effective shipbuilding techniques, but PSL is still in its nascent stage.

As we do not expect any immediate gains on listing of stock on bourses, it would be advisable for very short term retail investors to refrain applying in this IPO. This company considering its diverse nature of business (shipbuilding, Offshore Business, Shipbuilding and repair for navy and coast guard vessels, Ship repair) does not have any parallel/peers of its nature and size in the Indian corporate universe. Its various business segments when operational can unlock true value of the organization, albeit with a 3 to 5 years time frame. Once the huge orders start flowing in, the company would overcome cashflow problems and will generate growth going ahead.

Investors with 3-5 years horizon can look forward for subscribe the IPO

Disclaimer: