

# Essar Shipping (ESSSHI)

**Rs 120**

## WHAT'S CHANGED...

PRICE TARGET .....	Unchanged
EPS (FY11E) .....	Unchanged
EPS (FY12E) .....	Unchanged
RATING.....	Unchanged

## Demerger of business...

**Essar Shipping Ports and Logistics Ltd (Essar Shipping) announced a demerger plan in which the existing company would be renamed Essar Ports Ltd. It would handle the ports & terminal business while all the remaining businesses would be clubbed under a separate entity Essar Shipping Ltd. Management has stated that the rationale behind the demerger is to create value addition.**

### Demerger of shipping, logistics, onshore and offshore business

Essar Shipping Ports and Logistics Ltd operates in the sea transport, logistics, onshore, offshore and ports & terminal business. Under the new arrangement, the existing company would be named Essar Ports Ltd. It will handle only the ports and terminal business while all the remaining businesses i.e. sea transport, logistics, onshore and offshore businesses would be demerged into a single separate entity, which will be named Essar Shipping. Shareholders would receive 2 shares of Essar Ports Ltd and 1 share of Essar Shipping Ltd. for every 3 shares held in Essar Shipping Ports and Logistics Ltd.

### Demerger rationale

The management has stated that the ports and terminal business has attained significant scale & size with the commissioning of the Vadinar and Hazira port terminals. The remaining businesses i.e. shipping, logistics and oilfield have also ramped up. Hence, shareholders would benefit from the creation of independent companies leading to value unlocking in the long-term.

### Our view

We have valued the ports and terminal business on a DCF basis, which takes into account the potential earnings capability over the long-term. Based on our valuation the stock is fairly priced.

### Exhibit 1: Financial Performance

(Rs. Crore)	Q1FY11	Q1FY11E	Q1FY10	Q4FY10	YoY Gr. (%)	QoQ Gr.(%)
Net Sales	795.1	821.8	676.1	851.6	17.6	-6.6
EBITDA	240.8	312.6	275.6	269.6	-12.6	-10.7
EBITDA Margin (%)	30.3	38.0	40.8	31.7	(1050 bps)	(140 bps)
Depreciation	116.8	118.3	116.6	106.6	0.2	9.6
Interest	158.2	153.6	135.1	144.9	17.1	9.2
Reported PAT	39.5	37.8	6.1	63.5	544.0	-37.8
EPS (Rs)	0.6	0.6	0.1	1.0	544.0	-37.8

Source: Company, ICICIdirect.com Research

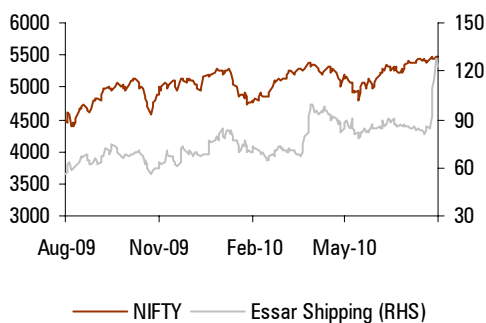
Rating matrix	
Rating	: <b>Reduce</b>
Target	: Rs 112
Target Period	: 12 months
Potential Upside	: -9%

Key Financials				
(Rs crore)	FY09	FY10	FY11E	FY12E
Net Sales	2574.2	2999.4	3222.0	4227.4
EBITDA	834.5	1048.7	1259.8	1656.8
Net Profit	77.2	93.8	167.3	328.5

Valuation summary				
	FY09	FY10	FY11E	FY12E
PE (x)	95.7	78.8	44.2	22.5
Target PE (x)	89.0	73.3	41.1	20.9
EV to EBITDA (x)	16.8	13.3	12.2	9.8
Price to book (x)	0.9	0.9	0.8	0.8
RoNW (%)	1.0	1.1	2.4	4.3
RoCE (%)	3.1	3.9	4.8	6.3

Stock data	
Market Cap.	Rs. 7390 crore
Debt( FY10)	Rs. 7508 crore
Cash (FY10)	Rs. 281 crore
EV	Rs. 14617 crore
52 week H/L	Rs. 136 / 54
Equity capital	Rs.615.8 crore
Face value	Rs.10
MF Holding (%)	0.2
FII Holding (%)	8.3

### Price movement



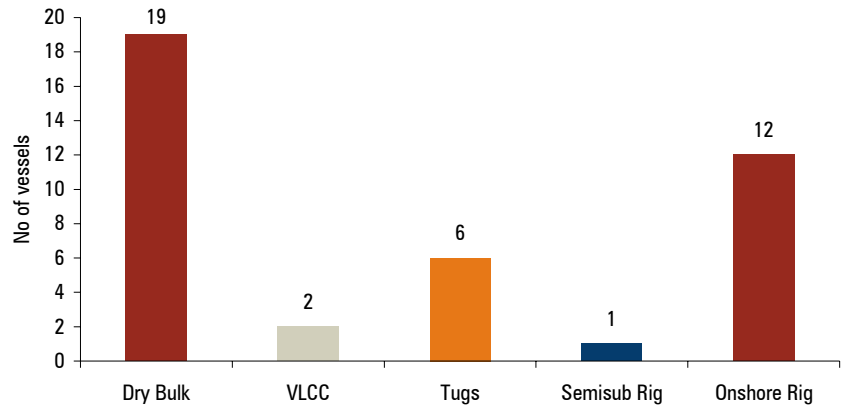
### Analyst's name

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The current fleet consists of 40 vessels, which includes 19 bulk carriers, two VLCCs, six tugs, one semi submersible rig and 12 onshore rigs

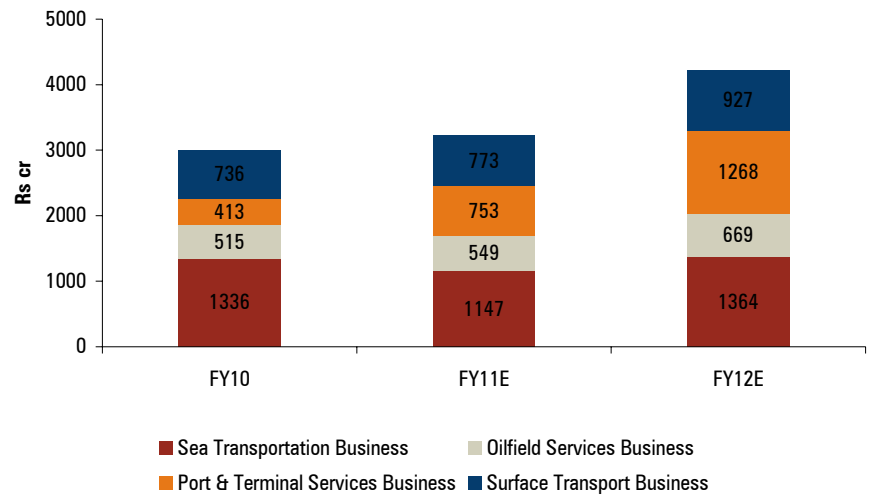
**Exhibit 2: Current fleet profile**



Source: Company, ICICIdirect.com Research

The contribution from the ports and terminal business is expected to get ramped up significantly over the next two years as additional port capacities get commissioned

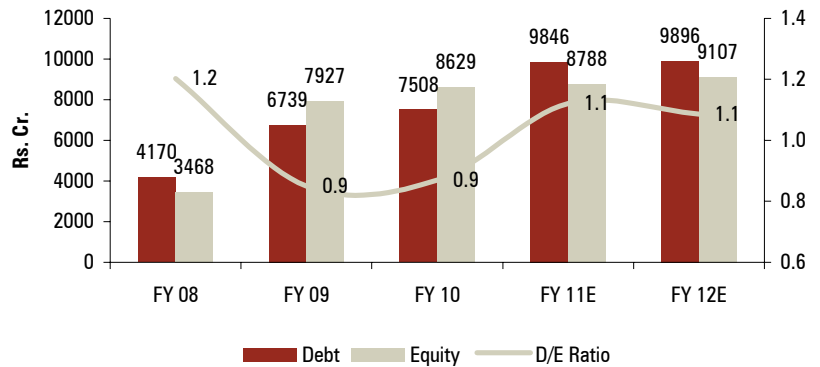
**Exhibit 3: Revenue contribution of various business divisions from FY10 - FY12**



Source: Company, ICICIdirect.com Research

The company is appropriately leveraged as its debt equity ratio has hovered close to 1.0 in the last three years. We expect the debt-equity ratio to inch up higher to 1.1 levels over the next two years as it expands its offshore oilfield presence with the acquisition of two jack-up rigs and also aggressively expands its ports and terminal business with the establishment of new port at Salaya in Gujarat and two berths in Orissa (CQ3 and Coal)

**Exhibit 4: Debt-equity ratio analysis**



Source: Company, ICICIdirect.com Research

**Exhibit 5: Port profile - Vadinar**

Project Details	Vadinar Terminal
Capacity	58 mtpa
Cargo	Crude & Refined petroleum products
Clients	Essar Oil
Contract period	30 years
Project Cost	Rs 4530 crores
Financial Status	Financial closure achieved for 53 mtpa
Project Status	Operational
Present capacity	46 mtpa
Apr-13	58 mtpa
Connectivity	Rail connectivity Road connectivity Subsea and cross country pipelines

Source: Company, ICICIdirect.com Research

**Exhibit 6: Port profile - Hazira**

Project Details	Hazira Bulk Terminal
Capacity	50 mtpa
Cargo	Iron ore pellets, coal, limestone & finished steel products
Clients	Essar Steel
Contract period	20 years
Project Cost	Rs 1773 crore
Financial Status	Financial closure achieved for 30 mtpa
Project Status	Operational
Present capacity	30 mtpa
Oct-11	50 mtpa
Connectivity	Road connectivity Conveyor system

Source: Company, ICICIdirect.com Research

**Exhibit 7: Port profile - Salaya**

Project Details	Salaya Bulk Terminal
Capacity	20 mtpa
Cargo	Coal and pet coke
Clients	Essar Power
Contract period	30 years
Project Cost	Rs 1370 crore
Financial Status	Financial closure achieved for 12 mtpa
Project Status	Under construction
Present capacity	NIL
Sep-11	20 mtpa
Connectivity	Road connectivity Conveyor system

Source: Company, ICICIdirect.com Research

**Exhibit 8: Port profile – Paradip CQ3 Berth**

Project Details	Paradip CQ3 Berth
Capacity	16 mtpa
Cargo	Coal and iron ore
Clients	Essar Steel
Contract period	10 years
Project Cost	Rs 435 crore
Financial Status	Financial closure achieved
Project Status	Under construction
Present capacity	NIL
Oct-11	16 mtpa
Connectivity	Road connectivity Conveyor system

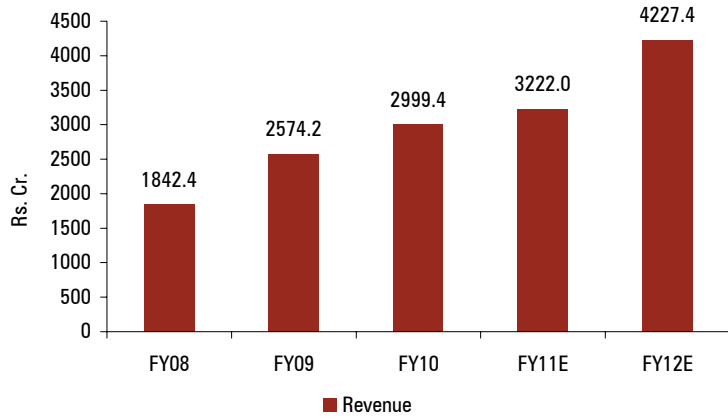
Source: Company, ICICIdirect.com Research

**Exhibit 9: Port profile – Paradip Coal Berth**

Project Details	Paradip Coal Berth
Capacity	14 mtpa
Cargo	Coal
Clients	Merchant Port
Concession agreement period	30 years
Project Cost	Rs 550 crores
Financial Status	Financial closure achieved
Project Status	Under Construction
Present capacity	NIL
Oct-12	14 mtpa
Connectivity	Road connectivity Conveyor system

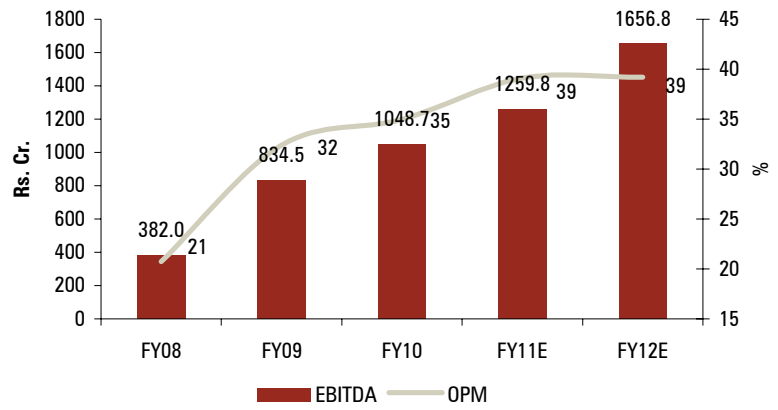
Source: Company, ICICIdirect.com Research

**Exhibit 10: Revenue expected to steadily rise**



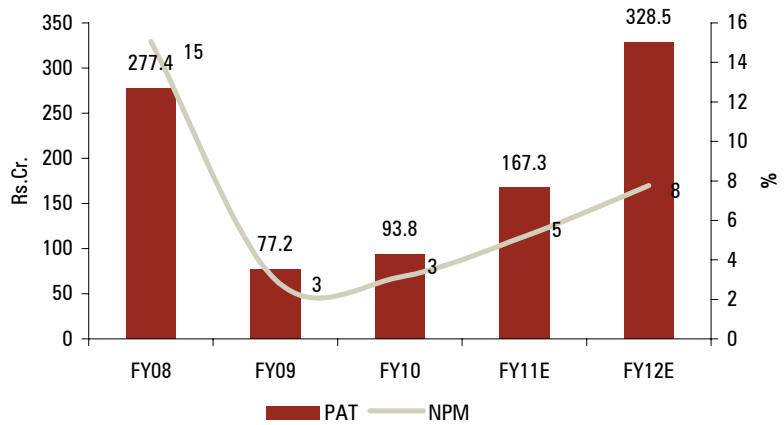
Source: Company, ICICIdirect.com Research

**Exhibit 11: Operating margin expected to inch up gradually**



Source: Company, ICICIdirect.com Research

**Exhibit 12: PAT and net profit margin to improve**



Source: Company, ICICIdirect.com Research

Essar Shipping offered a unique play in the Indian shipping space on account of the breadth of operations i.e. shipping, logistics and ports. Integration of various businesses into a single entity also provided significant synergies. However, the management's decision to split the company and separate the ports & terminals business from the remaining business has come as a surprise.

We also believe the demerger may not be a very good idea on account of the following factors:

1. The uniqueness of the company in terms of the breadth of operations would be lost post de merger.
2. Port projects are currently under the implementation/expansion stage. Vadinar is being ramped up from 46 MTPA to 58 MTPA, Hazira is being ramped up from 30 MTPA to 50 MTPA, Salaya a 20 MTPA port is being constructed and two new berths (16 MTPA and 14 MTPA) are being developed at Orissa. Demerging of the port business after a couple of years could have created more value as the capex would have been completed, ports commissioned while volumes would also have got ramped up significantly.
3. Further, the company also does not have any immediate funding requirements as it just concluded its FCCB issue of \$ 280 million, which is adequate to meet the equity requirements of all its projects. The company has also achieved financial closure for all its projects except Vadinar Phase III and Hazira Phase II, which it intends to implement subsequently
4. Lastly, we have valued the ports and terminal business on a DCF basis. This takes into account the potential earnings capability over the long-term. Based on our valuation, the stock is fairly priced.

We have valued each of the divisions of ESPLL on a DCF basis and arrived at our SOTP price target of **Rs 112**.

#### Exhibit 13: Valuation parameters

Business	DCF/Rs.
<b>Sea and Surface Transport Business</b>	<b>23</b>
<b>Oilfield Services Business</b>	<b>21</b>
<b>Ports &amp; Terminal</b>	
VOTL & VPTL	18
Hazira Bulk Terminal	33
Salaya Bulk Terminal	11
Paradip CQ3 Berth	3
Paradip Coal Berth	3
<b>Total Value</b>	<b>68</b>
<b>Total SOTP Valuation</b>	<b>112</b>

Source: Company, ICICIdirect.com Research

## ICICIdirect.com coverage universe (Shipping)

				Sales (Rs. Crore)	EPS (Rs.)	PE (x)	EV/EBITDA (x)	RoNW (%)	RoCE (%)	
<b>ESPLL</b>										
<b>Idirect Code</b>	ESSSHI	<b>CMP (Rs.)</b>	120	<b>FY10</b>	2999.4	1.5	78.8	13.3	1.1	3.9
		<b>Target (Rs.)</b>	112	<b>FY11E</b>	3222.0	2.7	44.2	12.2	2.4	4.8
<b>MCap</b>	7389.6	<b>% Upside</b>	-7	<b>FY12E</b>	4227.4	5.3	22.5	9.8	4.3	6.3
<b>G.E Shipping</b>										
<b>Idirect Code</b>	GESHIP	<b>CMP (Rs.)</b>	313	<b>FY10</b>	2856.5	33.7	9.3	8.8	9.0	4.8
		<b>Target (Rs.)</b>	334	<b>FY11E</b>	3194.7	36.7	8.5	7.5	9.1	6.5
<b>MCap</b>	4757.6	<b>% Upside</b>	7	<b>FY12E</b>	3687.5	45.4	6.9	5.9	10.4	8.7
<b>Mercator Lines</b>										
<b>Idirect Code</b>	MERLIN	<b>CMP (Rs.)</b>	52	<b>FY10</b>	1808.7	2.2	23.5	5.0	2.3	5.3
		<b>Target (Rs.)</b>	56	<b>FY11E</b>	2180.3	3.6	14.4	3.9	3.6	6.2
<b>MCap</b>	1227.2	<b>% Upside</b>	8	<b>FY12E</b>	2570.5	7.8	6.7	2.5	7.2	8.0
<b>SCI</b>										
<b>Idirect Code</b>	SCI	<b>CMP (Rs.)</b>	168	<b>FY10</b>	3463.1	8.9	18.9	13.5	3.5	1.6
		<b>Target (Rs.)</b>	162	<b>FY11E</b>	3771.8	9.2	18.3	14.9	2.5	1.6
<b>MCap</b>	7114.8	<b>% Upside</b>	-4	<b>FY12E</b>	4004.9	5.9	28.4	12.8	0.8	1.7
<b>Varun Shipping</b>										
<b>Idirect Code</b>	VARSHI	<b>CMP (Rs.)</b>	43	<b>FY10</b>	666.2	0.8	51.4	14.0	1.5	0.1
		<b>Target (Rs.)</b>	36	<b>FY11E</b>	636.7	-	-	12.9	-	-
<b>MCap</b>	645.0	<b>% Upside</b>	-16	<b>FY12E</b>	749.7	-	-	8.7	-	3.8
<b>Aban Offshore</b>										
<b>Idirect Code</b>	ABALLO	<b>CMP (Rs.)</b>	880	<b>FY10</b>	3358.7	71.5	12.3	8.4	14.3	10.0
		<b>Target (Rs.)</b>	947	<b>FY11E</b>	3553.0	87.9	10.0	6.8	15.2	12.0
<b>MCap</b>	3326.4	<b>% Upside</b>	8	<b>FY12E</b>	3679.8	199.7	4.4	6.0	26.1	12.9
<b>Garware Offshore</b>										
<b>Idirect Code</b>	GARSHI	<b>CMP (Rs.)</b>	147	<b>FY10</b>	163.2	17.8	8.3	9.1	15.4	7.9
		<b>Target (Rs.)</b>	182	<b>FY11E</b>	232.3	17.4	8.5	7.8	16.2	9.3
<b>MCap</b>	349.9	<b>% Upside</b>	24	<b>FY12E</b>	234.7	21.1	7.0	7.4	14.4	9.2
<b>Great Offshore</b>										
<b>Idirect Code</b>	GREOFF	<b>CMP (Rs.)</b>	406	<b>FY10</b>	1165.6	54.0	7.5	6.9	18.1	11.6
		<b>Target (Rs.)</b>	476	<b>FY11E</b>	1246.7	59.0	6.9	6.1	16.7	10.7
<b>MCap</b>	1506.3	<b>% Upside</b>	17	<b>FY12E</b>	1507.6	76.8	5.3	4.2	18.0	12.8
<b>ABG Shipyard</b>										
<b>Idirect Code</b>	BHASHI	<b>CMP (Rs.)</b>	258	<b>FY10</b>	1812.4	42.8	6.0	7.1	0.3	19.6
		<b>Target (Rs.)</b>	239	<b>FY11E</b>	2334.8	45.3	5.7	6.3	0.1	17.5
<b>MCap</b>	712.1	<b>% Upside</b>	-7	<b>FY12E</b>	2721.2	50.6	5.1	5.6	0.1	16.6
<b>Bharati Shipyard</b>										
<b>Idirect Code</b>	BHASHI	<b>CMP (Rs.)</b>	246	<b>FY10</b>	1349.0	47.4	5.4	8.3	16.0	10.3
		<b>Target (Rs.)</b>	327	<b>FY11E</b>	1334.1	55.6	4.6	7.6	10.1	10.1
<b>MCap</b>	679.0	<b>% Upside</b>	33	<b>FY12E</b>	1287.2	74.5	3.5	7.4	8.4	9.7

## Global Valuation (Shipping)

Company	Country	P/BV (x)			P/E (x)			EV/EBITDA (x)			ROE (%)		
		CY09	CY10E	CY11E	CY09	CY10E	CY11E	CY09	CY10E	CY11E	CY09	CY10E	CY11E
<b>Dry Bulk/Tankers</b>													
Teekay Corp.*	USA	0.9	0.9	0.9	-	29.6	17.6	11.9	9.0	8.6	-	4.6	6.2
Diana Shipping*	USA	1.0	0.9	0.9	8.0	7.7	8.0	6.1	5.7	5.7	13.5	11.5	10.2
Genco Shipping*	USA	0.6	0.5	0.4	3.5	3.7	6.2	5.5	5.2	5.9	18.0	13.1	7.0
Dry Ships*	USA	0.4	0.4	0.4	3.9	5.0	3.6	7.1	6.3	4.8	7.2	6.2	9.9
Frontline Ltd*	Norway	3.2	2.8	2.6	21.3	9.5	9.4	10.1	7.8	7.7	14.9	29.5	24.2
ESPLL#	India	0.6	0.6	0.6	139.2	87.4	21.4	12.4	11.8	9.0	0.5	0.9	3.2
G.E Shipping#	India	0.8	0.8	0.7	9.4	8.6	6.9	8.8	7.5	5.9	9.0	9.1	10.4
Mercator Lines#	India	0.5	0.5	0.4	21.7	13.3	6.1	5.0	3.9	2.5	2.3	3.6	7.2
SCI#	India	1.1	1.0	1.0	18.3	17.7	27.6	13.5	14.9	12.8	3.5	2.5	0.8

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