Company Flash

16 January 2008 | 6 pages

Great Offshore (GOFS.BO)

Buy: Plans to Acquire High Spec Deepwater Drilling Assets

- **Acquisition announced** — Great Offshore has announced that it has made an offer to acquire an overseas company that has two semi-submersible offshore drilling rigs on order. The value of the rigs is US$1.4bn.

- **High spec assets** — While the company has not divulged details of the transaction, media reports (*Economic Times*) indicate that the target company in question is UK-based SeaDragon, which is the owner of two 6th generation, semi-subs that are now under construction and slated for delivery in 4Q09 and 3Q10. The company also has an option for a third semi-sub. The first semi sub, capable of drilling in up to 10,000' water depth, has already won a US$958m contract for 5 years from PEMEX at a day rate of ~US$540K.

- **Prima facie positive** — In the absence of details on the assets, financing, etc., access to premium deepwater drilling assets in a tight offshore market is a prima facie positive, in our view. Assuming the abovementioned media reports are true and based on details from SeaDragon's website, we estimate that the acquisition could have a payback of ~6 years and be 6-16% EPS accretive in the first full year of operation of both assets (assuming 50-75% debt financed – refer to Figure 1 for details).

- **Maintain Buy** — As we highlighted earlier, leveraging the balance sheet (D/E 1.0x in FY08E) and using cash flow generated for value accretive acquisitions could be key to driving future growth and share price performance, in our view. We, however, await further details of the acquisition. Reiterate Buy/Medium risk on the stock with an Rs1195 target price.

Buy/Medium Risk	1M
Price (16 Jan 08)	Rs1,100.00
Target price	Rs1,195.00
Expected share price return	8.6%
Expected dividend yield	1.2%
Expected total return	**9.8%**
Market Cap	Rs41,930M US$1,068M

Price Performance (RIC: GOFS.BO, BB: GOFF IN)

Statistical Abstract

Year to 31 Mar	Net Profit (RsM)	Diluted EPS (Rs)	EPS growth (%)	P/E (x)	P/B (x)	ROE (%)	Yield (%)
2006A	971	25.47	na	43.2	8.4	na	0.5
2007A	1,452	38.09	49.6	28.9	6.8	26.0	0.7
2008E	2,253	53.99	41.7	20.4	5.3	32.0	1.1
2009E	2,548	61.06	13.1	18.0	3.8	26.4	1.2
2010E	3,566	85.46	40.0	12.9	3.1	28.0	1.6

Source: Powered by dataCentral

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See Appendix A-1 for Analyst Certification and important disclosures.

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Figure 1. Great Offshore – Sensitivity analysis for the potential acquisition

	Scenario I	Scenario II	Scenario III
Debt as a % of total acqn value	75%	50%	25%
Cost of the two assets (US$m)	1,400	1,400	1,400
Day rate (US$)	550,000	550,000	550,000
Margin	*65%*	*65%*	*65%*
EBITDA (US$m)	250.3	250.3	250.3
Payback period (years)	5.6	5.6	5.6
Interest (US$m)	105.0	70.0	35.0
Depreciation (US$m)	56.0	56.0	56.0
PBT (US$m)	89.3	124.3	159.3
PAT (US$m)	58.0	80.8	103.5
PAT (Rs m)	2,320.5	3,230.5	4,140.5
Estimated EPS post acqn, post dilution@	126.1	115.7	108.7
EPS accretion/dilution	**15.7%**	**6.3%**	**-0.2%**

Source: Citi Investment Research estimates. @ Assuming the balance amount is fully financed by raising additional equity (i.e., no internal accruals), which is most conservative.

Great Offshore

Company description

Great Offshore is an integrated offshore oilfield services provider offering services to upstream oil and gas producers to carry out offshore exploration and production (E&P) activities. Great Offshore began operations in 1983 as the offshore division of Great Eastern Shipping but was demerged in October 2006. Great Offshore currently owns and operates a fleet of 40 vessels comprising 2 drilling assets, 18 offshore supply vessels, 7 platform supply vessels, 11 harbour tugs, an MSV, and a construction barge, with 2 more vessels to be delivered over the next 2 years.

Investment strategy

We rate Great Offshore as Buy/Medium risk with a target price of Rs1,195, which captures the robust 30% EPS CAGR that we expect the company to deliver over FY07-11E, driven by the strong day rate environment, high utilizations, sustainable business model, strong visibility of earnings, and revenue contribution from the new and upcoming fleet. With a well-timed expansion, Great Offshore looks well positioned to capitalize on the strong cyclical uptrend in the global offshore services industry, which we expect to continue to be driven by the enduring growth prospects of the deepwater market as well as the shallow-water replacement market. In addition, domestic E&P spending is on the rise, with India still remaining relatively unexplored and recent world class discoveries that will drive a sharp increase in development capex over the next decade. Further, a robust balance sheet and strong cash flow generation as contribution from new assets starts kicking in make Great Offshore well positioned to pursue inorganic growth opportunities. Value accretive acquisitions hold the key to drive future growth and share price performance, in our view.

Valuation

Our target price of Rs1,195 is based on our DCF fair value for Sep-08E. Our DCF is based on 5 years of explicit cash flow forecasts and the following key assumptions: relatively flat day rates for most vessels over the forecasts horizon; newbuild jackup and MSV to start contributing in FY10E at day rates of US$146K and US$90K respectively; operating costs to increase at 5% annually; dry docking of 11-12 vessels per year; construction business revenues to increase progressively from Rs0.6bn to Rs1.6bn over FY08-12E; WACC of 10.5% (risk free of 8%, risk premium of 6%, beta of 0.7x, target D/E of 30%). On a P/E basis, Great Offshore would trade at nearly 11x FY11E earnings on our target price. We prefer looking at fully evolved FY11E earnings by which time all the assets of the company, recently acquired as well as under construction, would contribute fully to earnings. The multiples are in line with similar multiples for global peers.

Risks

We rate Great Offshore Medium Risk, in line with our quantitative risk-rating system which tracks 260-day historical share price volatility. Key risks that could prevent the share price from reaching our target price are:

- E&P activity decline – our estimates and TP are dependent on the level of E&P activity, which could be affected by adverse changes in oil and gas prices.
- Delays in deliveries – Any delay in the delivery of the newbuild jackup and MSV could result in the assets going on day rates later than expected, which could result in lower than expected earnings.
- Repricing risks – Great Offshore's mix of contracts is skewed toward long-term contracts with ONGC. However, long-term day rates would vary with the demand-supply scenario in the rest of the world.
- High dependence on one client – Great Offshore derives a significant (c.50%) part of revenues from ONGC. This makes Great Offshore susceptible to an unanticipated decline in ONGC's overall offshore spend.
- Currency fluctuations – many of Great Offshore's contracts are US$-denominated which expose the company to adverse fluctuations in the exchange rate.
- Value destructive acquisitions – Great Offshore is actively pursuing inorganic opportunities to grow its fleet size. Value destructive acquisitions pose a risk to our TP.

Upside risks include value accretive acquisitions and continued tightness in the offshore market leading to an increase in day rates.

If any of these risk factors have a greater impact than we anticipate, the share price will likely have difficulty attaining our target price.

Appendix A-1

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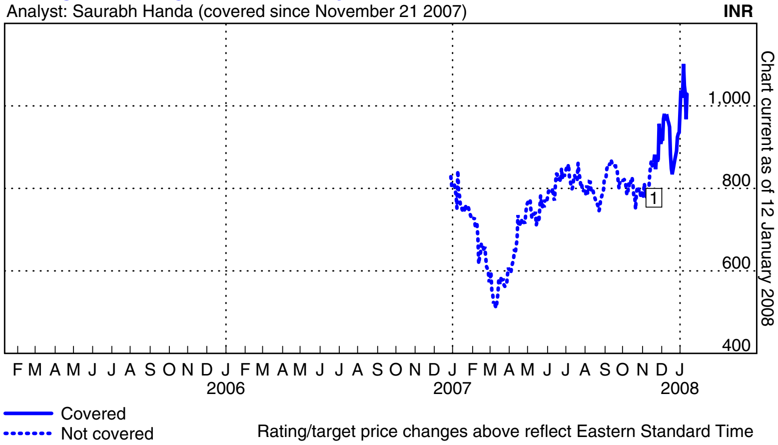
Great Offshore (GOFS.BO)

Ratings and Target Price History - Fundamental Research

Analyst: Saurabh Handa (covered since November 21 2007)



#	Date	Rating	Target Price	Closing Price
1:	20 Nov 07	1M	1,195.00	867.35

*Indicates change.

Rating/target price changes above reflect Eastern Standard Time

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