

November 23, 2010

<b>Reco</b>	<b>Previous Reco</b>
Reduce	Reduce
<b>CMP</b>	<b>Target Price</b>
Rs 239	Rs 196
EPS change FY11E/12E (%)	NA
Target Price change (%)	NA
Nifty	5,935
Sensex	19,692

### Price Performance

(%)	1M	3M	6M	12M
Absolute	(5)	1	(7)	36
Rel. to Nifty	(3)	(5)	(22)	15

Source: Bloomberg

### Relative Price Chart



Source: Bloomberg

### Stock Details

Sector	Shipbuilding
Bloomberg	BHSL@IN
Equity Capital (Rs mn)	289
Face Value(Rs)	10
No of shares o/s (mn)	29
52 Week H/L	353/151
Market Cap (Rs bn/USD mn)	7/154
Daily Avg Volume (No of sh)	787634
Daily Avg Turnover (US\$m)	4.4

### Shareholding Pattern (%)

	S'10	J'10	M'10
Promoters	41.8	41.8	39.0
FII/NRI	4.2	4.2	6.9
Institutions	11.8	11.9	11.5
Private Corp	13.3	13.7	11.7
Public	28.9	28.4	31.0

Source: Capitaline

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- **Bharati Shipyard plans to acquire controlling 51% stake in Tebma Shipyard at an investment of Rs757.5 mn**
- **Tebma (an offshore vessel manufacturer) has order book of Rs7.5 bn. In FY10, it posted loss of Rs1.9bn, had a networth of Rs(-)0.5 bn and debt of Rs4.3 bn**
- **Expect no positives from the above deal in near-to-medium term in view of (1) un-conducive business environment and (2) deteriorating financial health and (3) strained cash flows**
- **Retain 'Reduce' rating for BSL with target of Rs196/Share (Core shipbuilding: Rs117 + Great Offshore Stake: Rs79); Only caveat is meaningful subsidy disbursement**

### The Event – Bharati Shipyard acquires 51% stake in Tebma Shipyard

Bharati Shipyard (BSL) plans to acquire controlling 51% stake in Tebma Shipyard at an investment of Rs757.5 mn. The details of the deal are as follows:

- BSL plans to acquire 51% stake in Tebma through an investment of Rs757.5 mn through fresh capital infusion. Under the deal, the total equity capital of Tebma is expected to increase from Rs77.8 mn to Rs773.6 mn. Accordingly, BSL's share works out to 39.45 mn equity shares and an average price of Rs19.2/Share.
- Prior to the BSL's acquisition, ICICI Ventures was the largest shareholder with 53% share, followed by the public at 42% and promoters at 4.93%.
- ICICI Ventures will also receive additional 30.13 mn shares, valued at Rs0.57 bn (@ BSL's acquisition price of Rs19.2/Share) – post which ICICI Venture's effective shareholding will come down to 44.27%. The above shares currently stand as 'Share Application Money' in Tebma's books.
- Tebma has a modern offshore yard at Malpe (66 kms from Mangalore) with a capacity to manufacture 10-12 vessels and repair 4 vessels per annum. It also has another small yard at Cochin. It manufactures OSVs, PSVs, MSVs, AHTSVs. Geology Survey vessels, etc. for Indian Navy and domestic & international customers. Tebma has delivered 115 vessels till date. Tebma has an order book of Rs7.5 bn.
- In FY10, Tebma recorded revenues of Rs1.6 bn and posted a net loss of Rs1.86 bn. The net loss includes (1) provisions and write-offs worth Rs0.35 bn and (2) upfront extraordinary expenses of Rs0.83 bn – details not ascertainable. It had a negative net worth of Rs0.5 bn, accumulated losses of Rs1.3 bn and gross debt of Rs4.3 bn as on Mar'10.
- In addition to fresh equity infusion, Tebma will also undergo debt restructuring to improve its financial health and facilitate turn-around.

### Financial Snapshot

Rs Mn

YE-	Net Sales	EBITDA (Core)	EBITDA (%)	APAT	EPS (Rs)	EPS %Chg	ROE (%)	P/E	EV/ EBITDA	P/BV
Mar										
FY09	9,341	1,896	20.3	1,329	46.5	20.8	20.0	5.1	7.6	0.9
FY10	12,648	2,343	18.5	1,366	47.4	1.9	17.7	5.0	11.5	0.8
FY11E	11,193	2,046	18.3	1,043	32.9	-30.6	11.4	7.2	11.0	0.8
FY12E	3,244	-352	-10.8	-1,216	-38.4	-216.5	-13.4	-6.2	-51.5	0.9

### Our View – Near to medium term pain, But long term positive

We believe that the deal is likely to be beneficial for BSL in the long term in view of the good quality assets acquired. While the deal appears lucrative on equity based valuations, it appears less attractive on EV basis - with debt of Rs4.3 bn. In the near-to-medium term, we give thumbs down to the acquisition. This is in view of (1) un-conducive business environment and (2) deteriorating financial health and (3) strained cash flows for both.

- Tebma's order book has come down from about Rs20 bn in FY08 to Rs7.5 bn currently. Its annual revenue run rate has also come down from 4.4 bn in FY08 to Rs1.6 bn in FY10. Above indicates under-utilization of capacities. Besides, BSL is also experiencing gross under-utilization of own capacities. We believe such under-utilization does not augur well for BSL, especially in view of our negative bias on the shipbuilding industry and no immediate signs of revival therein.
- With high Debt of Rs4.3 bn (DER >10.0) and low order book cover, we believe that Tebma is likely to witness strained cash flows over the next couple of years. Even in a blue sky scenario – with annual revenue run rate of Rs4.0 bn (>0.5X order book), Tebma will generate operating cash flows of about Rs0.8 bn (@ 20% EBITDA margins). After paying interest costs of about Rs0.4 bn, Tebma will generate free cash flows of mere Rs0.4 bn for debt repayment (8.6% of debt). This is likely to compound problems for BSL, which itself has a DER of 2.3X.

### Retain 'Reduce' recommendation

We believe that acquisition of Tebma does not offer any upsides in the near to medium term, being a highly leveraged buy-out. We retain our 'Reduce' recommendation for BSL. This is in view of (1) our negative bias on core shipbuilding business - *however, given the uptick in order inflows in global ship building industry, we will review our call post a re-assessment of the scenario* (2) risks to earning estimates from slow execution of existing order book with deteriorating cover at 1.25X revenues (3) impending debt repayment (4) weak operating cash flow and (5) high DER resulting in need for equity dilution. The only caveat is a meaningful subsidy disbursement in immediate future.

### Order Backlog Details

Rs mn	Q2FY10	Q3FY10	Q4FY10	Q1FY11	Q2FY11	YoY (%)	QoQ (%)
Unexecuted Order Backlog	27,943	24,717	22,510	19,204	15,804	(43.4)	(17.7)
Total Order Backlog	50,655	49,874	50,760	49,979	49,979	(1.3)	-

**Key Financials****Income Statement**

Y/E, Mar (Rs. mn)	FY09	FY10	FY11E	FY12E
<b>Net Sales</b>	<b>9,341</b>	<b>12,648</b>	<b>11,193</b>	<b>3,244</b>
<i>Growth (%)</i>	<i>45.5</i>	<i>35.4</i>	<i>(11.5)</i>	<i>(71.0)</i>
<b>Expenditure</b>	<b>7,445</b>	<b>10,305</b>	<b>9,147</b>	<b>3,596</b>
Materials Consumed	5,097	7,041	6,197	1,756
Employee Cost	1,251	1,603	1,451	1,155
Manufacturing Exp	381	783	659	191
Other Exp	716	879	840	494
<b>EBITDA</b>	<b>1,896</b>	<b>2,343</b>	<b>2,046</b>	<b>-352</b>
<i>Growth (%)</i>	<i>44.5</i>	<i>23.6</i>	<i>(12.7)</i>	<i>(117.2)</i>
<b>EBITDA margin (%)</b>	<b>20.3</b>	<b>18.5</b>	<b>18.3</b>	<b>(10.8)</b>
Depreciation	101	153	368	368
<b>EBIT</b>	<b>1,795</b>	<b>2,190</b>	<b>1,678</b>	<b>-720</b>
<b>EBIT margin (%)</b>	<b>19.2</b>	<b>17.3</b>	<b>15.0</b>	<b>(22.2)</b>
Other Income	830	1,254	1,963	826
Interest expenses	625	1,371	2,061	1,321
<b>PBT</b>	<b>2,000</b>	<b>2,073</b>	<b>1,580</b>	<b>-1,216</b>
Tax	671	707	537	0
<i>Effective tax rate (%)</i>	<i>33.5</i>	<i>34.1</i>	<i>34.0</i>	<i>-</i>
<b>Adjusted PAT</b>	<b>1,329</b>	<b>1,366</b>	<b>1,043</b>	<b>-1,216</b>
<i>Growth (%)</i>	<i>20.8</i>	<i>7.0</i>	<i>(24.0)</i>	<i>(216.5)</i>
<b>Net Margin (%)</b>	<b>14.2</b>	<b>10.8</b>	<b>9.3</b>	<b>(37.5)</b>
E/O items	50	-	-	-
<b>Reported PAT</b>	<b>1,333</b>	<b>1,373</b>	<b>1,043</b>	<b>-1,216</b>
<i>Growth (%)</i>	<i>20.8</i>	<i>7.0</i>	<i>(24.0)</i>	<i>(216.5)</i>

**Cash Flow**

Y/E, Mar (Rs. mn)	FY09	FY10	FY11E	FY12E
<b>PBT</b>	1,954	2,080	1,580	-1,216
Depreciation	101	153	368	368
Interest Provided	625	1,371	2,061	1,321
Other Non-Cash items	182	13	0	0
Chg in working cap	-3,000	-4,265	2,746	5,406
Tax paid	-144	-369	-537	0
<b>Operating Cashflow</b>	<b>-282</b>	<b>-1,017</b>	<b>6,218</b>	<b>5,880</b>
Capital expenditure	-4,536	-2,356	500	0
<b>Free Cash Flow</b>	<b>-4,818</b>	<b>-3,373</b>	<b>6,718</b>	<b>5,880</b>
Other income	0	0	0	0
Investments	-1	-7,708	250	0
<b>Investing Cashflow</b>	<b>-1</b>	<b>-7,708</b>	<b>250</b>	<b>0</b>
Equity Capital Raised	0	205.923	288.9698	0
Loans Taken / (Repaid)	5,717	12,900	-3,775	-6,400
Interest Paid	-625	-1,371	-2,061	-1,321
Dividend paid (incl tax)	-97	-97	-95	-95
Income from investments	0	0	0	0
Others	0	0	0	0
<b>Financing Cashflow</b>	<b>4,995</b>	<b>11,638</b>	<b>-5,643</b>	<b>-7,816</b>
<b>Net chg in cash</b>	<b>176</b>	<b>556</b>	<b>1,325</b>	<b>-1,937</b>
Opening cash position	2,262	2,280	2,819	4,145
<b>Closing cash position</b>	<b>2,438</b>	<b>2,836</b>	<b>4,145</b>	<b>2,208</b>

**Balance Sheet**

Y/E, Mar (Rs. mn)	FY09	FY10	FY11E	FY12E
Equity share capital	276	289	317	317
Reserves & surplus	6,746	8,219	9,428	8,118
<b>Net worth</b>	<b>7,022</b>	<b>8,508</b>	<b>9,745</b>	<b>8,435</b>
Secured Loans	6,979	15,029	16,629	12,729
Unsecured Loans	3,049	7,899	2,523	23
<b>Loan Funds</b>	<b>10,028</b>	<b>22,928</b>	<b>19,153</b>	<b>12,753</b>
Net deferred tax liability	-345	-419	-419	-419
<b>Total Liabilities</b>	<b>16,705</b>	<b>31,017</b>	<b>28,479</b>	<b>20,768</b>
Gross Block	2,898	4,260	9,760	9,760
Less: Depreciation	380	539	907	1,275
<b>Net block</b>	<b>2,519</b>	<b>3,721</b>	<b>8,853</b>	<b>8,485</b>
Capital work in progress	6,157	7,151	1,151	1,151
<b>Investment</b>	<b>34</b>	<b>562</b>	<b>312</b>	<b>312</b>
<b>Current Assets</b>	<b>19,947</b>	<b>32,969</b>	<b>30,191</b>	<b>17,501</b>
Inventories	8,478	12,311	9,227	3,627
Sundry debtors	282	218	221	64
Cash & bank balance	2,280	2,819	4,145	2,208
Loans & advances	8,908	17,621	16,599	11,602
Other current assets	0	1	2	3
<b>Current lia &amp; Prov</b>	<b>11,282</b>	<b>12,558</b>	<b>11,200</b>	<b>5,853</b>
Current liabilities	9,770	10,413	9,055	3,708
Provisions	1,512	2,145	2,145	2,145
<b>Net current assets</b>	<b>8,665</b>	<b>20,411</b>	<b>18,991</b>	<b>11,649</b>
Misc. exp	20	10	10	10
<b>Total Assets</b>	<b>17,395</b>	<b>31,855</b>	<b>29,317</b>	<b>21,606</b>

**Key Ratios**

Y/E, Mar	FY09	FY10	FY11E	FY12E
<b>Profitability (%)</b>				
EBITDA Margin	20.3	18.5	18.3	-10.8
Net Margin	14.2	10.8	9.3	-37.5
ROCE	12.9	8.9	5.5	-2.8
ROE	20.0	17.7	11.4	-13.4
RoIC	25.0	14.5	7.5	-3.5
<b>Per Share Data (Rs)</b>				
EPS	46.5	47.4	32.9	-38.4
CEPS	50.2	52.7	44.5	-26.7
BVPS	254.7	294.0	307.5	266.2
DPS	2.5	3.0	3.0	3.0
<b>Valuations (x)</b>				
PER	5.1	5.0	7.2	-6.2
P/CEPS	4.8	4.5	5.4	-8.9
P/BV	0.9	0.8	0.8	0.9
EV / Sales	1.5	2.1	2.0	5.6
EV / EBITDA	7.6	11.5	11.0	-51.5
Dividend Yield (%)	1.1	1.3	1.3	1.3
<b>Gearing Ratio (x)</b>				
Net Debt/ Equity	1.1	2.3	1.5	1.2
Net Debt/EBITDA	4.1	8.3	7.2	-29.1
Working Cap Cycle (days)	288.0	419.5	642.4	1,723.5

**Recommendation History: Bharati Shipyard – BHSL IN**

Date	Reports	Reco	CMP	Target
12/11/2010	<a href="#">Bharati Shipyard Q2FY11 Result Update</a>	Reduce	254	196
12/08/2010	<a href="#">Bharati Shipyard Q1FY11 Result Update</a>	Reduce	236	196
07/05/2010	<a href="#">Bharati Shipyard Q4FY10 Result Update</a>	Reduce	268	235
01/02/2010	<a href="#">Bharati Shipyard Q3FY10 Result Update</a>	Reduce	302	235

**Recent Research Reports**

Date	Reports	Reco	CMP	Target
03/11/2010	<a href="#">Blue Star Q2FY11 Result Update</a>	Accumulate	456	543
02/11/2010	<a href="#">Punj Lloyd Q2FY11 Result Update</a>	Hold	125	132
29/10/2010	<a href="#">BHEL Q2FY11 Result Update</a>	Buy	2,446	3,030
28/10/2010	<a href="#">Thermax Q2FY11 Result Update</a>	Buy	796	943

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