INDIA

5 July 2011

CENTRUM

Shipping & Offshore services

Q1FY12 Results Preview

Diversified presence to ride down-cycle

Indian shipping companies are diversifying their operations into offshore support and drilling services to ride the downturn in the shipping cycle. Great Eastern Shipping (GE Shipping), which bought its second jack-up in Q4FY11, has an order book of 8 offshore vessels, including a third jack-up rig. The company also sold-off 3 of its large crude tankers on order to redeploy cash to offshore segment. Shipping Corp of India (SCI) also plans to increase its fleet size of offshore support vessels. It has a total of 31 ships (2.02 mn dwt) on order, including 10 offshore vessels. We maintain our positive view on tanker-based Indian shipping operators with a Buy on GE Shipping and SCI.

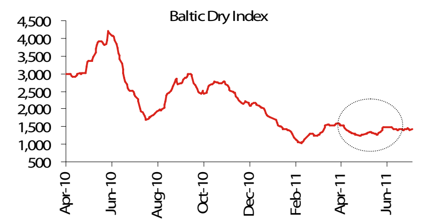
- **Bunker costs up 43% YoY; container segment and spot charter market to take a hit:** Price of bunker oil (fuel for shipping vessels) rose to record levels of $660 per barrel during Q1FY12 vs. $460/bbl last year. We believe this would impact shipping companies and lead to increase in cost of operation. SCI, which is present in the container liner segment, would be most impacted. Its bunker costs increased 39.5% in Q4FY11 to Rs2.4bn leading to a 527bp decline in operating margins to 11.6%.

- **Offshore oil services (drilling) industry remains under pressure:** The offshore drilling industry continued to remain under pressure during Q1FY12 with low rig utilisation (76%) globally. Offshore rig day rates remained at their lows, while jack-up market continued to face pricing pressures. Utilisation of jack-up was at 76% vs. 80.6% recorded last year. However, demand for deepwater rigs was strong globally, as fleet utilisation for Semi-subs remained above 80%.

- **Diversified presence to help Indian shipping companies:** We believe Indian shipping operators are better placed compared to global peers due to their large presence in the tanker and offshore segments and strong under-leveraged balance sheets which is likely to help them take advantage of current downturn and increase fleet at lower costs.

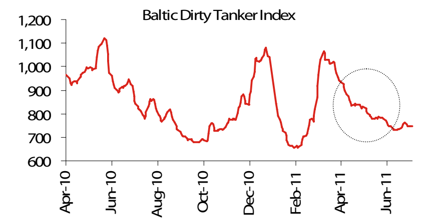
- **Maintain Buy on GE Shipping and SCI; Sell on Aban:** GE Shipping is our top pick in the shipping space with a Buy rating and a target of Rs410. We also maintain Buy on SCI with a target of Rs124 (0.8x FY13 P/BV). We maintain Sell on Aban Offshore as concerns persist with its assets coming for re-negotiations at the bottom of the day-rate cycle, over-leveraged balance sheet and high exposure in the Iranian region.

Baltic Dry Index (BDIY)



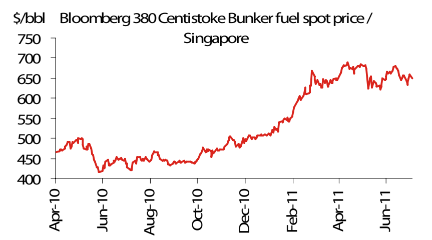
Source: Bloomberg, Centrum Research

Baltic Dirty Tanker Index (BIDY)



Source: Bloomberg, Centrum Research

Bunker Fuel price Index (BUNKSI38)



Source: Bloomberg, Centrum Research

Price Performance (%)

	1M	6M	1Yr
GE Shipping	(1.5)	(14.3)	0.0
SCI	0.9	(20.1)	(32.3)
Aban	(6.2)	(32.3)	(34.0)
NIFTY	2.1	(7.4)	7.5

Source: Bloomberg, Centrum Research as on 4 July 2011

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Summary Financials – Consolidated

Y/E Mar	Net Sales (Rsmn)				EBITDA (Rsmn)				EBITDA Margin (%)		Adj. PAT (Rsmn)			
(Rsmn)	Q1FY12E	*YoY (%)*	*QoQ (%)*	FY12E	Q1FY12E	*YoY (%)*	*QoQ (%)*	FY12E	*Q1FY12E*	*Q1FY11*	Q1FY12E	*YoY (%)*	*QoQ (%)*	FY12E
GE Shipping	7,005	*8.7*	*16.4*	28,515	3,036	*0.6*	*29.7*	13,308	*43.3*	*46.9*	1,900	*10.6*	*96.9*	7,276
SCI	9,060	*(0.1)*	*4.7*	37,477	1,661	*(25.5)*	*65.0*	7,632	*18.3*	*24.6*	635	*(66.8)*	*NM*	2,966
Aban	7,930	*(5.9)*	*(11.8)*	31,461	4,981	*(4.2)*	*(3.3)*	19,764	*62.8*	*61.7*	1,073	*(47.8)*	*(55.6)*	4,204

Source: Company, Centrum Research Estimates

Great Eastern Shipping (Buy; Target Price: Rs401)

- Q1FY12 consolidated revenue is likely to increase 8.7% YoY and 16.4% QoQ to Rs7,005mn, primarily driven by the improvement in tanker freight rates. Operating profit is expected to grow 29.7% QoQ (flat YoY) to Rs3,036mn on the back of improvement in freight rates leading to a decline in operating costs.
- EBITDA margin is likely to improve QoQ (up 442bp) but decline YoY (down 352bp) to 43.3% on the back of improvement in the tanker business' profitability.
- Adjusted net profit is expected to increase 10.6% YoY, but improve sharply by 97% QoQ, to Rs1,900mn, led by higher profit from sale of ship and other income.
- During the quarter, the company took delivery of one new build Kamsarmax (80,700 dwt) dry bulk carrier. It also sold (scrapped) its 1989-built suezmax crude carrier "Jag Lakshya" (152,000 dwt) leading to the profit from sale of ship during the quarter.

Shipping Corp. of India (Buy; Target Price: Rs124)

- We expect SCI's Q1FY12 revenues to remain flat YoY and increase 4.7% QoQ to Rs9,060mn, led by improvement in the liner business and higher freight rates in the tanker segment.
- Operating profit is expected to grow 65.0% QoQ (but decline 25.5% YoY) to Rs1,661mn, while operating margin is likely to expand 670bp QoQ to 18.3% in Q1FY12 vs. 24.6% in Q1FY11.
- Net profit, expected at Rs635mn will be a positive from losses in Q4FY11, but down 66.8% YoY from the Rs1,915mn net profit recorded last year. Apart from lower profit from sale of ships, higher interest cost will impact this quarter vs. last year. Net profit margin will in effect contract to 7.0% in Q1FY12 vs. 21.1% last year.
- During the quarter, SCI contracted to buy two resale Supramax Bulk Carriers from Grand Yard Investments of 57,000 dwt each. The company also scrapped a product tanker "m.t. Bharatidasan" (29,755 DWT).

Aban Offshore (Sell; Target Price: Rs560)

- Aban's Offshore's consolidated revenue is expected to decline 5.9% YoY and 11.8% QoQ to Rs7,930mn, driven by lower day rates for new rig contracts. The current market rates for jack-ups have dropped significantly since the peak in 2008 on the back of lower rig utilisation globally.
- Operating profit is expected to decline 4.2% YoY and 16.1% QoQ to Rs4,981mn, while operating margin is likely to expand 107bp YoY (but decline 324bp QoQ) to 62.8% on the back of lower admin costs.
- Adjusted consolidated PAT is likely to decline 47.8% YoY and 55.6% QoQ, to Rs1,073mn due to lower operating profits. Also extraordinary income in previous quarters had inflated net profits. Adjusted net profit margin in effect will contract to 13.5% vs. 24.4% last year and 26.9% in Q4FY11.
- During Q1, Aban re-contracted two of its older jack-up rigs (Aban III & IV) to ONGC at US$64,000/day (a steep discount to their earlier rates of US$156,000/day.

Summary valuations

Y/E Mar (Rsmn)	Rating	Target Price (Rs)	CMP (Rs) (4-Jul-11)	Mkt Cap (Rsmn)	EPS (Rs)			P/BV (x)			RoCE (%)			P/E (x)		
					FY11	FY12E	FY13E	FY11	FY12E	FY13E	FY11	FY12E	FY13E	FY11	FY12E	FY13E
GE Shipping	Buy	401	292	44,469	36.4	47.8	48.0	0.78	0.65	0.60	*6.7*	*7.5*	*7.3*	8.4	6.1	6.1
SCI	Buy	124	107	49,841	12.2	6.4	7.0	0.70	0.69	0.67	*6.0*	*3.2*	*3.3*	8.8	16.8	15.2
Aban	Sell	560	537	23,368	133.1	96.6	107.3	1.91	0.96	0.81	*2.4*	*7.2*	*7.3*	6.0	5.6	5.0

Source: Company, Centrum Research Estimates

Appendix A

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