Prabhudas Lilladher

Pipavav Shipyard

Expensive and risky

September 14, 2009

Rating	AVOID
Price Band	Rs55-60
Care IPO Grading	3/5

(Grade 5/5 indicates strong fundamentals and grade 1/5 indicates poor fundamentals)

IPO Fact Sheet	
Opening Date:	September 16, 2009
Closing Date:	September 18, 2009
BRLM's:	JM Financial, Citigroup Global, Enam Securities, SBI Capital Market
Issue Size (Rs bn):	Rs 4.69 – 5.12bn

Issue Details (m shares)	
Pre-issue equity	58.35
Shares offered	85.45
Offer for Sale	NA
Fresh Issue	55.45
Of which	
Employee Reservation	0.60
QIBs	50.91
Retail	25.45
Non-institutional	8.48
Post-issue equity	665.79

Share Holding (%)	Pre Issue	Post Issue
Promoters	45.4	39.6
Foreign Investors	28.6	25.0
Indian FIs / Banks	16.1	14.0
Other Corporate Bodies	7.9	6.9
Others	2.0	1.7
Public	-	12.8

Source: RHP

IPO Note

- **Issue details:** The IPO consists of a fresh issue of 85.45m shares, resulting in equity dilution and free-float of 12.83%. The price band of the offering is Rs55-60. At the lower end of the price band, Pipavav Shipyard (PSL) will raise Rs4.7bn implying a market capitalization of Rs36.6bn. While at the upper end of the band, the company will raise Rs5.1bn, translating to a market capitalization of Rs39.9bn.
- **World-class facility, tax benefits in place:** PSL is setting up the country's largest state-of-the-art private sector shipyard in Gujarat for construction and repairs of a range of vessels. The total amount to be invested in the yard stands at Rs25bn, of which Rs19.8bn has already been invested. The block building and fabrication unit is located within a notified Special Economic Zone (SEZ) and hence, will avail SEZ benefits. Besides, the yard has also been certified at an Export Oriented Unit (EOU).
- **No experience of shipbuilding:** The promoters of PSL have vast experience in development of infrastructure projects. However, they have not ventured into anything connected to shipbuilding in the past. Since this is their first venture in this space, we are apprehensive of their ability to win orders against their entrenched and highly experienced competitors.
- **Order book position is dismal:** As compared to the large facility that the company has put up, which in our opinion should have a revenue-generating capacity of Rs60-70bn annually, the order book position appears quite dismal. The company's reported order book currently stands at Rs44.5bn, but 48% percentage of these orders are under renegotiation or arbitration. In the last two years, the company has won orders worth just US$111.8m.
- **Expensive valuations:** As compared to ABG and Bharati Shipyards, PSL looks expensive on almost all parameters such as P/E, P/BV and EV/EBITDA, etc. Even on a replacement cost basis, the company looks expensive as the market capitalization/replacement cost stands at 2.4x. But there is no denying that in the event of a recovery in demand for ships and offshore vessels (OSVs), PSL will be best placed to take advantage on account of its large under-utilized capacity. Given the weak current fundamentals, contingent risk factors and expensive valuations, we advise to **'Avoid'** investing in this offering.

Key financials (Y/e March)	FY09	FY10E	FY11E	FY12E
Revenues (Rs m)	-	3,576	15,823	15,511
Growth (%)	-	-	*342.5*	*(2.0)*
EBITDA (Rs m)	(393)	644	3,273	3,302
PAT (Rs m)	47	83	3,094	2,977
EPS (Rs)	0.08	0.13	4.65	4.47
Growth (%)	*(1.0)*	*53.5*	-	*(3.8)*

Source: Company Data; PL Research

Profitability & valuation	FY09	FY10E	FY11E	FY12E
EBITDA margin (%)	-	*18.0*	*20.7*	*21.3*
RoE (%)	*0.4*	*0.5*	*13.2*	*11.3*
RoCE (%)	*0.5*	*4.1*	*11.7*	*10.6*
P/BV (x)	2.5	2.1	1.6	1.4
PE (x)	675.4	439.9	11.8	12.3

Source: Company Data; PL Research

Note: Estimates for FY10, FY11 and FY12 are very rough-cut in nature, prepared only out of information contained in the RHP.

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The Issue

PSL's IPO consists of a fresh issue of 85.45m shares, of which the employee reservation portion is 0.6m shares which results in a net issue to the public of 84.8m shares. This will result in a post issue equity dilution of 12.83%.

The price band of the offering is Rs55-60. At the lower end of the price band, the company will raise Rs4.7bn, implying a market capitalization of Rs36.6bn. While at the upper end of the band, the company is likely to raise Rs5.1bn, translating to a market capitalization of Rs39.9bn.

Issue Details

Equity shares offered by the company through the issue	85,450,225 Equity Shares
Of which:	
Employee Reservation Portion	Up to 600,000 Equity Shares
Therefore,	
Net Issue to the Public	84,850,225 Equity Shares
Of which:	
QIB Portion	At least 50,910,135 Equity Shares
Of which:	
Mutual Fund Portion	2,545,507 Equity Shares
Balance for all QIBs including Mutual Funds	48,364,628 Equity Shares
Non-Institutional Portion	Not less than 8,485,022 Equity Shares available for allocation
Retail Portion	Not less than 25,455,068 Equity Shares available for allocation
Equity shares outstanding prior to the Issue	580,348,163 Equity Shares
Equity shares outstanding after the Issue	665,798,388 Equity Shares

Source: Company RHP

Investment Highlights

State-of-the-art shipbuilding facility

PSL is in the process of setting up a world class shipyard on the West coast of India in the state of Gujarat. The company will be the largest private sector shipyard in the country, spanning over 490 acres of land. The yard 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.

The facility consists of the following:

- An inland block building and fabrication facility which will help in reducing the usage of the dry-dock
- The largest dry-dock in the country, measuring 662 meters in length and 65 meters in width. The dry-dock will be able to accommodate vessels up to 400,000 DWT.
- Dedicated offshore yard
- Two goliath cranes, having a lifting capacity of 600 tonnes

The shipyard is likely to be completed by October 2009, while the company's offshore yard is scheduled to be completed by March 2010. The company has, however, commenced operations at the yard since April 2009.

The total project cost, including margin for the working capital, stands at Rs29.9bn, while the total amount spent by the company up to July 15, 2009 stands at Rs20.8bn.

Object 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	25.66	19.84	1.79
Margin for working capital	4.29	1.02	2.44
Total	**29.95**	**20.86**	**4.23**

Source: Company RHP

SEZ and EOU status in place

PSL's block building and fabrication unit is located within a notified SEZ and hence, will avail SEZ benefits. Besides, the yard has also been certified at an EOU, the benefits of which will be available till AS 2011-2012.

The company has an order for 22 Panamax vessels which are eligible for 30% shipbuilding subsidy by the Central government. However, the Government of India issued a notification in March 2009 which stated that the total benefits accruing to shipyards located in SEZs from the subsidy plus any other benefits and incentives from the Government of India available to shipyards would be capped at 30% instead of the shipyards being entitled to a 30% subsidy in addition to any other available benefits and incentives. This would mean that the subsidy benefit on the 22 Panamax vessels would decrease by the extent of the SEZ benefit available on the same.

Dismal order book position

PSL's reported order book currently stands at Rs44.5bn. This includes orders for 22 Panamax vessels from foreign companies and 12 OSVs from ONGC. However, as per our understanding from the company's RHP, a large percentage of these orders are under renegotiation or arbitration.

Of the orders for the 22 Panamax vessels, 10 are firm order agreements. Two of these are under renegotiation to grant customer option to take delivery of vessels. Another six are under renegotiation to grant customer unilateral right to terminate obligation to take delivery of vessel if it is unable to arrange funding and another four are subject to arbitration. The ONGC order for 12 OSVs has been awarded. However, the definitive agreement is yet to be entered into; we consider it a firm order. Therefore, of the order book of Rs44.5bn, firm orders stand at Rs23.2bn.

Based on an asset turnover of approximately 2-2.3 times (average asset-turnover for shipyards), PSL is expected to do an annual turnover of Rs60-70bn. As compared to this, we find that the company's order book is extremely miniscule. Further, we remain concerned about the order book accretion on account of the large amount of capacity that stands idle in the Korean and Chinese yards. Besides, although the naval orders are a large opportunity for PSL, the process of getting defence orders takes extremely long.

On a comparative basis, the order book of PSL's peers; ABG Shipyard and Bharati Shipyard stands at 4.4x EV and 2.3x EV, respectively, whereas on the same measure, PSL's order book stands at 0.98x EV.

Order Book / EV (FY10E)

ABG Shipyard	4.40
Bharati Shipyard	2.34
Pipavav Shipyard	0.98

Source: PL Estimates

**Lower end of Price Band considered*

No experience in or even related to shipbuilding

The promoters of PSL have long experience in the construction of infrastructure projects. However, PSL is their first venture in the shipbuilding space. The company was originally envisaged to be a ship-dismantling unit and was later converted to a shipbuilding yard. The lack of experience in or even anything relating to the shipbuilding arena makes us apprehensive of its ability to win new orders against highly experienced incumbents.

Contingent risks and liabilities are a real concern

There are certain proceedings against the company and its promoters/directors which could have negative implications in case they do not go in their favour. Further, there are certain SEBI investigations in companies where the promoters are either directors or/and have controlling stakes. Pipavav has also given refund guarantees to customers to the tune of Rs5bn which could materialize in case of order cancellations.

Expensive valuations; Avoid

We have compared PSL to the listed private sector shipyards, ABG Shipyard and Bharati Shipyard on various different parameters, which include PER, P/BV and EV/EBITDA. Based on all these parameters, PSL looks very expensive. In most cases, company's trade at a premium to peers on account of strong future growth, visibility or a strong reputation in the field, none of which are particularly present in this case.

Comparative Valuation

		ABG Shipyard	Bharati Shipyard	Pipavav Shipyard
PER-With Subsidy	FY10	6.9	3.5	439.9
	FY11	5.8	2.6	11.8
PER-Without Subsidy	FY10	10.2	6.3	(38.4)
	FY11	7.3	4.5	29.8
P/BV-With Subsidy	FY10	1.2	0.7	2.1
	FY11	1.0	0.5	1.6
P/BV-Without Subsidy	FY10	2.0	1.0	2.2
	FY11	1.6	0.9	1.9
EV/EBITDA-With Subsidy	FY10	5.5	5.9	70.4
	FY11	3.9	4.2	12.7
EV/EBITDA-Without Subsidy	FY10	6.2	3.7	72.2
	FY11	4.6	2.5	13.9
Order book/EV	FY10	4.40	2.34	0.98

Source: PL Estimates

**All valuations for PSL are at the lower end of the band*

Further, we have also used replacement cost to value the company, as its order book is quite small as compared to its capacity and therefore, will result in substantially lower earnings than its actual potential.

Till date, the company has invested Rs19.84bn in the shipyard and is further likely to invest additional Rs5.82bn, resulting in total investment of Rs25.66 in the yard. The total debt on the company's books stands at Rs11.5bn. We are assuming that the entire working capital requirement of Rs1bn till date has been met through debt finance and are therefore, deducting the same from the total debt drawn. Hence, the debt towards the facility stands at Rs10.5bn. The replacement cost for the yard, therefore, works out to Rs15.1bn, translating to Rs22.74/share. The market capitalization/replacement cost also stands at a high 2.4:1.

Although, we do acknowledge that the company has put up a state-of-the-art facility, based on the current weak fundamentals, contingent risk factors, poor order book and expensive valuations, we rate the IPO **'Avoid'**.

However, we find it necessary to mention that in the event of a recovery in demand for ships and OSVs, PSL, on account of its large under utilized capacity, will be one of the best placed companies to take advantage of the momentum in orders.

About the company

PSL was originally promoted by SKIL and Grevek Investments. The SKIL Group, which has been joined by Punj Lloyd through its acquisition of 129.36 equity shares of the company, represents approximately a 22.29% interest as of the date of RHP.

SKIL has a track record of promoting infrastructure projects in India, and is experienced in owner-managed construction of infrastructure projects including the Pipavav Port, the Pipavav Railway and the Pipavav Link Road.

Punj Lloyd is an engineering and offshore construction company in India providing integrated design, engineering, procurement, construction and project management services for energy and infrastructure projects.

PSL is envisaged to be the largest private sector shipyard in the country. It is located on the West coast of India adjacent to major sea lanes between the Persian Gulf and Asia. The shipyard is still under construction and is likely to be completed by October 2009. However, the company has commenced commercial operations at the shipyard on April 1, 2009. PSL 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

Shareholding Pattern **(m)**

	Pre Issue		Post Issue	
	No. of Equity Shares	%	**No. of Equity Shares**	%
Promoters				
SKIL	121.7	*21.0%*	121.7	*18.3%*
Grevek Investments	12.3	*2.1%*	12.3	*1.9%*
Total	134.0	*23.1%*	134.0	*20.1%*
Punj Lloyd	129.4	*22.3%*	129.4	*19.4%*
Total Promoter Holding	**263.4**	*45.4%*	**263.4**	*39.6%*
Promoter group				
SKIL Shipyard Holding Pvt. Ltd	0.0	*0.0%*	0.0	*0.0%*
Total Promoter group holding	0.0	*0.0%*	0.0	*0.0%*
Foreign Investors	**166.2**	*28.6%*	**166.2**	*25.0%*
Indian Financial Institutions/Banks	**93.2**	*16.1%*	**93.2**	*14.0%*
Other Corporate Bodies	**46.0**	*7.9%*	**46.0**	*6.9%*
Others	**11.6**	*2.0%*	**11.6**	*1.7%*
Public	**-**		**85.5**	*12.8%*
Total	**580.3**	*100.0%*	**665.8**	*100.0%*

Source: Company RHP

Financials

Income Statement (Rs m)

Y/e March	FY08	FY09	FY10E	FY11E	FY12E
Sales	**-**	**-**	**3,576**	**15,823**	**15,511**
Ship Building	-	-	3,576	13,323	12,511
Ship Repairs	-	-		2,500	3,000
Expenditure					
Total Expenses	160	393	2,932	12,549	12,209
EBITDA	**(160)**	**(393)**	**644**	**3,273**	**3,302**
EBITDA Margin (%)	*0.0%*	*0.0%*	*18.0%*	*20.7%*	*21.3%*
Depreciation	2	2	699	1,073	1,160
Other Income	277	618	275	200	250
Subsidy	-	-	1,037	1,868	1,675
EBIT	**116**	**224**	**1,256**	**4,268**	**4,067**
Less: Interest	1	130	1,173	1,173	1,090
PBT	**115**	**94**	**83**	**3,094**	**2,977**
Tax	68	47	-	-	-
Effective Tax Rate (%)	*58.7%*	*49.7%*	*-*	*-*	*-*
PAT	**48**	**47**	**83**	**3,094**	**2,977**

Note: Estimates for FY10, FY11 and FY12 are very rough-cut in nature, prepared only out of information contained in the RHP.

Balance Sheet (Rs m)

Y/e March	FY08	FY09	FY10E	FY11E	FY12E
Source of Funds					
Equity Share Capital	5,797	5,803	6,658	6,658	6,658
Reserves & Surplus	6,662	6,744	10,672	13,766	16,743
Net Worth	12,459	12,547	17,413	23,519	26,377
Total Debt	3,925	11,536	13,036	13,036	12,111
TOTAL	**16,384**	**24,083**	**30,449**	**36,555**	**38,489**
Application Of Funds					
Gross Block	382	711	26,000	29,000	29,000
Less: Depreciation	51	81	780	1,853	3,013
Depreciation for the year	9	29	699	1,073	1,160
Net Block	330	630	25,220	27,147	25,987
CWIP	12,480	22,739	3,000		
Investments	1,759	485	485	485	485
Current Assets, Loans & Advances	**10,164**	**11,406**	**15,168**	**24,598**	**29,467**
Inventories	571	3,183	7,000	9,000	10,500
Sundry Debtors			1,350	4,350	7,850
Cash & Bank Balance	8,449	6,618	4,318	8,048	7,617
Loans & Advances	1,144	1,605	2,500	3,200	3,500
Less: Current Liabilities & provisions	**8,354**	**11,182**	**13,423**	**15,675**	**17,450**
Creditor	8,282	11,061	13,273	15,500	17,250
Others	-	-	-	-	-
Provisions	73	122	150	175	200
Net Working Capital	1,810	224	1,745	8,923	12,017
Intangible assets	4	6	-	-	-
TOTAL	**16,384**	**24,083**	**30,449**	**36,555**	**38,489**

Note: Estimates for FY10, FY11 and FY12 are very rough-cut in nature, prepared only out of information contained in the RHP.

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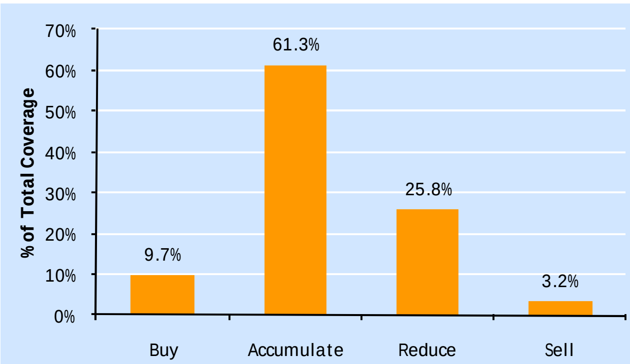
Rating Distribution of Research Coverage



PL's Recommendation Nomenclature

BUY	:	Over 15% Outperformance to Sensex over 12-months	**Accumulate**	:	Outperformance to Sensex over 12-months
Reduce	:	Underperformance to Sensex over 12-months	**Sell**	:	Over 15% underperformance to Sensex over 12-months
Trading Buy	:	Over 10% absolute upside in 1-month	**Trading Sell**	:	Over 10% absolute decline in 1-month
Not Rated (NR)	:	No specific call on the stock	**Under Review (UR)**	:	Rating likely to change shortly