Company

24 July 2009 | 13 pages

# Mundra Port And Special Economic Zone (MPSE.BO)

Equity ☑
Rating change ☑
Target price change ☑
Estimate change ☑

## Sell: Bullish on Port; Bearish on SEZ; Increase TP to Rs474

- **Getting bullish on port business:** Macro envt. seems to be recovering; traffic at India's 12 major ports grew 8.6% YoY in Jun09. We raise our cargo est. by 15-18% over FY10E-11E driven by 1) higher general cargo growth est. of 17% CAGR over FY10E-12E (vs. 5% earlier). According to mgmt; MPSEZ has been doing ~3-3.5mmt cargo/month in Q1FY10E implying growth of 13%-32% over Q109; 2) higher coal terminal throughput; and 3) higher car exports.
- **But remain bearish on near-term outlook for SEZ**: Despite a pickup in macro envt, we do not expect meaningful corporate capex recovery in the near term and do not foresee any significant pickup in land volumes at the SEZ. For the SEZ business, we cut our 1) volume assumptions by 22%-44%; 2) revs by 14%-40%; and 3) earnings est. by 13%-41% for FY10E- FY11E.
- **Increasing TP to Rs474:** on the back of 1) -5%/+19% change in our estimates over FY10E-11E driven by higher cargo assumptions and lower SEZ volumes; & 2) reduced discount rates for the port at 13% vs. 13.5% earlier due to improving fundamentals & for SEZ at 14% vs. 15% earlier; in-line with other real estate companies in our coverage universe. We reduce our risk rating for MPSEZ to Medium from High earlier to reflect improving volumes at the port.
- **Great asset, but still rich. Maintain Sell:** MPSEZ is currently trading at PE of 38xFY10E and at an 18% premium to its NAV. The stock is up 66% YTD and has outperformed the Sensex by 16% on the back of expectations of a broader economic revival. While improved cargo volumes will be positive for the stock; we believe positive developments on SEZ land will be key catalysts.

| **Sell/Medium Risk** | **3M** |
|---|---|
| *from Sell/High Risk* | |
| Price (23 Jul 09) | Rs558.50 |
| Target price | Rs474.00 |
| *from Rs291.00* | |
| Expected share price return | -15.1% |
| Expected dividend yield | 0.5% |
| **Expected total return** | **-14.6%** |
| Market Cap | Rs223,779M |
| | US$4,622M |

**Price Performance (RIC: MPSE.BO, BB: MSEZ IN)**


**Deepal Delivala**
+91-22-6631-9857
deepal.delivala@citi.com

**Venkatesh Balasubramaniam**
+91-22-6631-9864
venkatesh.balasubramaniam@citi.com

**Atul Tiwari**
+91-22-6631-9866
atul.tiwari@citi.com

**Figure 1. Statistical Abstract**

| Year to 31-Mar | Net Profit (Rs Mn) | Diluted EPS (Rs) | EPS growth (%) | P/E (x) | P/B (x) | ROE (%) | Yield (%) |
|---|---|---|---|---|---|---|---|
| 2007A | 1,889 | 5 | 203% | 118 | 30 | 28% | 0.2% |
| 2008A | 1,776 | 4 | -6% | 126 | 9 | 11% | 0.3% |
| 2009E | 3,747 | 9 | 111% | 60 | 8 | 14% | 0.5% |
| 2010E | 5,867 | 15 | 57% | 38 | 7 | 19% | 0.5% |
| 2011E | 10,710 | 27 | 83% | 21 | 5 | 28% | 1.0% |

Source: Citi Investment Research and Analysis

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

| Fiscal year end 31-Mar | 2007 | 2008 | 2009E | 2010E | 2011E |
|---|---|---|---|---|---|
| **Valuation Ratios** | | | | | |
| P/E adjusted (x) | 118.4 | 126.0 | 59.7 | 38.1 | 20.9 |
| EV/EBITDA adjusted (x) | na | 42.9 | 31.8 | 23.2 | 15.6 |
| P/BV (x) | 30.2 | 8.6 | 7.6 | 6.6 | 5.3 |
| Dividend yield (%) | 0.2 | 0.3 | 0.5 | 0.5 | 1.0 |
| **Per Share Data (Rs)** | | | | | |
| EPS adjusted | 4.72 | 4.43 | 9.35 | 14.64 | 26.73 |
| EPS reported | 4.68 | 5.33 | 11.51 | 14.64 | 26.73 |
| BVPS | 18.48 | 65.20 | 73.24 | 84.50 | 105.06 |
| DPS | 0.90 | 1.50 | 3.00 | 3.00 | 5.35 |
| **Profit & Loss (RsM)** | | | | | |
| Net sales | 5,814 | 8,182 | 10,952 | 14,306 | 20,405 |
| Operating expenses | -3,476 | -3,834 | -5,325 | -6,076 | -7,567 |
| **EBIT** | **2,338** | **4,348** | **5,627** | **8,231** | **12,839** |
| Net interest expense | -631 | -1,062 | -2,194 | -2,564 | -2,229 |
| Non-operating/exceptionals | 57 | 24 | 842 | 200 | 100 |
| **Pre-tax profit** | **1,765** | **3,310** | **4,276** | **5,867** | **10,710** |
| Tax | 125 | -1,534 | -529 | 0 | 0 |
| Extraord./Min.Int./Pref.div. | -15 | 358 | 864 | 0 | 0 |
| **Reported net income** | **1,874** | **2,134** | **4,611** | **5,867** | **10,710** |
| Adjusted earnings | 1,889 | 1,776 | 3,747 | 5,867 | 10,710 |
| Adjusted EBITDA | 3,145 | 5,354 | 7,000 | 9,660 | 14,423 |
| **Growth Rates (%)** | | | | | |
| Sales | na | 40.7 | 33.9 | 30.6 | 42.6 |
| EBIT adjusted | na | 85.9 | 29.4 | 46.3 | 56.0 |
| EBITDA adjusted | na | 70.2 | 30.7 | 38.0 | 49.3 |
| EPS adjusted | na | -6.0 | 111.0 | 56.6 | 82.5 |
| **Cash Flow (RsM)** | | | | | |
| **Operating cash flow** | **2,751** | **5,386** | **6,372** | **8,828** | **13,599** |
| Depreciation/amortization | 807 | 1,006 | 1,372 | 1,430 | 1,585 |
| Net working capital | -2,535 | 388 | 847 | 433 | -37 |
| **Investing cash flow** | **-5,408** | **-19,506** | **-4,055** | **-13,163** | **-5,586** |
| Capital expenditure | -5,846 | -9,469 | -1,322 | -11,200 | -5,586 |
| Acquisitions/disposals | 438 | -10,037 | -2,734 | -1,963 | 0 |
| **Financing cash flow** | **2,284** | **22,087** | **2,076** | **-2,453** | **-6,641** |
| Borrowings | 3,204 | 6,245 | 5,000 | 697 | -2,607 |
| Dividends paid | -360 | -601 | -1,202 | -1,173 | -2,142 |
| **Change in cash** | **-387** | **8,327** | **5,257** | **-6,788** | **1,373** |
| **Balance Sheet (RsM)** | | | | | |
| **Total assets** | **30,312** | **57,283** | **64,053** | **68,869** | **74,730** |
| Cash & cash equivalent | 569 | 8,896 | 14,153 | 7,365 | 8,738 |
| Accounts receivable | 3,456 | 2,963 | 2,360 | 2,533 | 2,674 |
| Net fixed assets | 24,014 | 32,477 | 32,426 | 42,196 | 46,197 |
| **Total liabilities** | **22,907** | **31,158** | **34,705** | **35,010** | **32,635** |
| Accounts payable | 2,021 | 2,554 | 2,231 | 2,535 | 2,985 |
| Total Debt | 12,822 | 19,067 | 24,067 | 24,764 | 22,157 |
| **Shareholders' funds** | **7,405** | **26,125** | **29,348** | **33,859** | **42,095** |
| **Profitability/Solvency Ratios (%)** | | | | | |
| EBITDA margin adjusted | 54.1 | 65.4 | 63.9 | 67.5 | 70.7 |
| ROE adjusted | na | 10.6 | 13.5 | 18.6 | 28.2 |
| ROIC adjusted | na | 9.1 | 14.8 | 21.2 | 28.2 |
| Net debt to equity | 165.5 | 38.9 | 33.8 | 51.4 | 31.9 |
| Total debt to capital | 63.4 | 42.2 | 45.1 | 42.2 | 34.5 |

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# Getting bullish on the port business…..

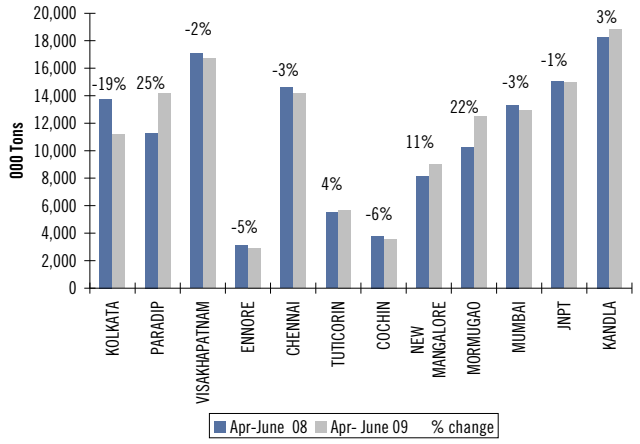
We are becoming increasingly bullish on MPSEZ's port business. The macro environment seems to be recovering from the bottom, and overall port traffic volumes at major ports seem to suggest that a bottom has been created.

**Our discussions with MPSEZ management suggest that the port has clocked a run-rate of 3-3.5mmt of cargo per month over the last 3 months, implying growth of 13%-32% over Q109**

Traffic at India's 12 major ports grew 8.6% YoY in June 2009, according to the latest data released by the Indian Ports Association. Traffic grew at 10 out of 12 ports; up from 7 ports in May, with highest growth at Kandla, Paradip and Mormugao, which grew 25% YoY, 36% YoY and 48% YoY, respectively. The only large ports where traffic fell YoY were Kolkata and Ennore (18% and 15% YoY declines respectively).

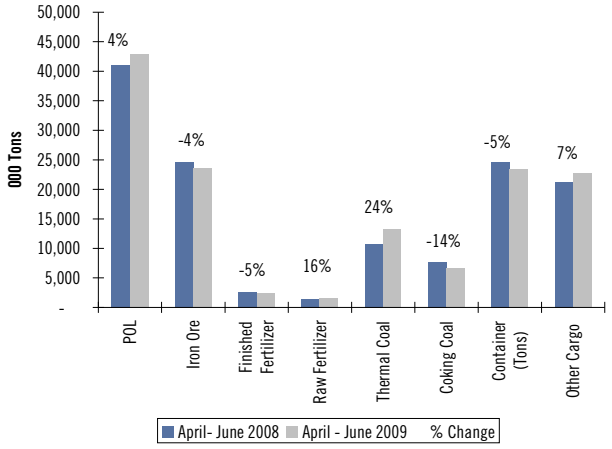
Our discussions with MPSEZ management suggest that volumes have bounced back from the lows of H209, and the port has clocked a run-rate of 3-3.5mmt of cargo per month over the last 3 months, implying growth of 13%-32% over Q109.

**Figure 2. Major Ports - Overall Cargo Growth – April 09-June 09**



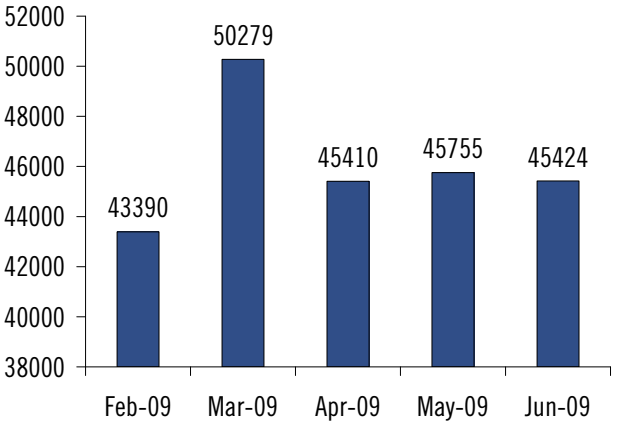

Source: IPA Citi Investment Research and Analysis

**Figure 3. Major Ports - Cargo Growth – Commodity wise– April 09-June 09**



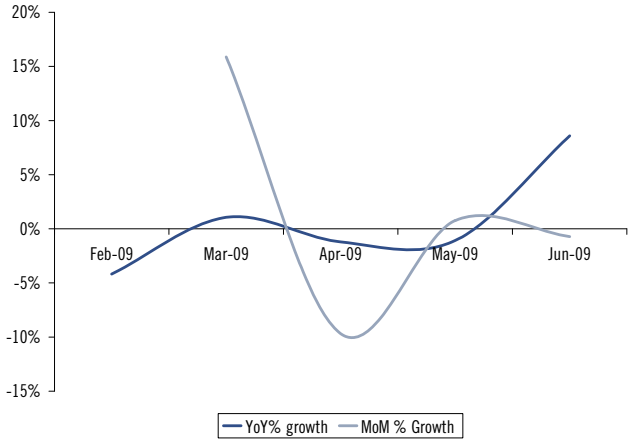

Source: IPA Citi Investment Research and Analysis

**Figure 4. Traffic at major ports ('000mt)**




Source: Citi Investment Research and Analysis

**Figure 5. Traffic at major ports**




Source: Citi Investment Research and Analysis

**Figure 6. Total Cargo**

| Total Cargo | FY10E | FY11E |
|---|---|---|
| Old | 41 | 51 |
| New | 48 | 59 |
| **% Change** | **18%** | **15%** |

Source: Citi Investment Research and Analysis

## Increasing cargo estimates by 15-18% over FY10E-11E

We have increased our cargo estimates by 15-18% on the back of:

- **Increase in general cargo growth assumptions:** We have increased our general cargo growth assumptions from 5% CAGR over FY10E-12E to 17% CAGR. Our discussions with the company suggest that the port has been doing a run-rate of ~3-3.5mmt of cargo per month in Q1FY10E implying growth of 13%-32% over Q109.

- **Increase in coal off-take due to earlier than expected commissioning of the coal-based power plants.** Based on information made publicly available by Adani Power Ltd; Adani Power Ltd's coal-based power plant at Mundra is expected to have a commissioning schedule as given below. We are thus increasing our coal terminal throughput estimates to 7mt for FY11E vs. 4mt earlier.

**Figure 7. Adani Power Ltd: Mundra based coal-fired power plants.**

| | Jul-09 | Feb-10 | Jan-11 | Jun-11 | Aug-11 | Apr-12 |
|---|---|---|---|---|---|---|
| Total capacity (MW) | 330 | 1320 | 1980 | 2640 | 3300 | 4620 |

Source: Adani Power Ltd - draft DRHP

- **Improvement in car exports:** Maruti Suzuki and Nissan motors have been exporting cars (A Star and Pixo respectively) from Mundra port. Specific car carriers like NYK, K Line & Hoegh Autoliners are operating out of Mundra Port. The port has handled ~35,500 cars in the first 5 months of the car export operations.

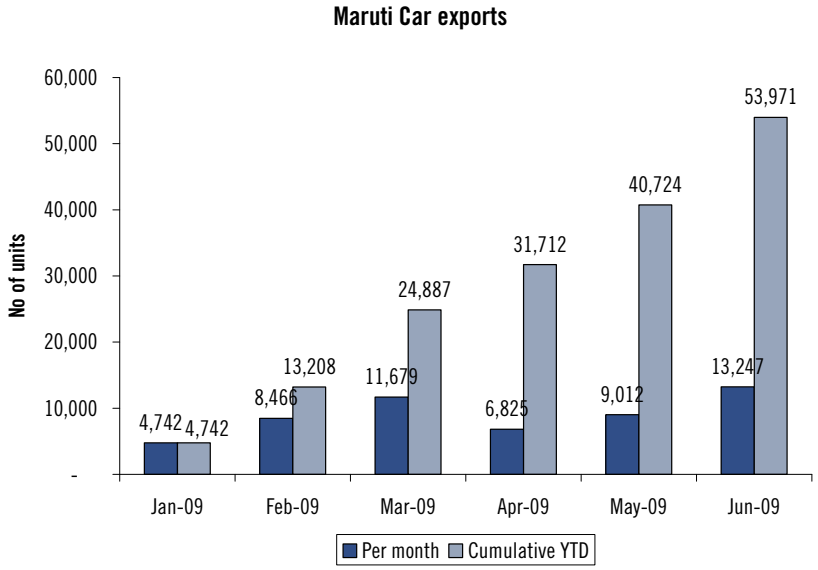
**Figure 8. Car export facility**

Source: Company

**Figure 9. NYK shipping line operating at Mundra Port**


Source: Company

**Figure 10. Maruti Car exports**




Source: Company

# But remain a bear on the SEZ part

While there has been a general pickup in the overall macro environment; we still do not believe that the corporate capex cycle will recover in any meaningful manner in the near term. We do not foresee any significant pickup in land volumes at the SEZ. The company has not had any land transactions in Q409, and we do not expect any meaningful volumes in H1FY10E.

## Cutting volumes; increasing realizations

We are cutting our SEZ land transactions volume assumptions by 44% for FY10E and by 22% for FY11E. However, our discussions with the company suggest that the discussions taking place with potential clients are at higher realizations/sqmt than our estimates. We are increasing our realizations by 13%-19% for FY10E-11E.

**Figure 11. SEZ – estimate changes**

| | FY10 | FY11 |
|---|---|---|
| Old Land volumes | 900 | 900 |
| New Land volumes | 500 | 700 |
| **% change** | **-44%** | **-22%** |
| | | |
| Old realizations (Rs/sqm) | 750 | 787.5 |
| New realizations (Rs/sqm) | 850 | 935 |
| **% change** | **13%** | **19%** |

Source: Citi Investment Research and Analysis

## Adjusting earnings estimates by -5%/+19% for FY10E-11E

- **Port Business:** We are increasing our port revenue assumptions by 7%-17% over FY10E-11E on the back of an increase in cargo growth assumptions. We are increasing our port earnings estimates by 15%-31% driven by the increase in cargo growth assumptions and increase in container throughput at CT2- resulting in higher realizations.

- **SEZ business:** We are cutting our SEZ land transactions volume assumptions by 44% for FY10E and by 22% for FY11E but are increasing our realizations by 13%-19% for FY10E-11E. Consequently, we are reducing our SEZ revenue assumptions by 40% for FY10E and 14% for FY11E and are cutting our earnings estimates by 41% for FY10E and 13% for FY11E.

**Figure 12. MPSEZ – Change in estimates**

| | FY10E | FY11E |
|---|---|---|
| Total Cargo Old | 41 | 51 |
| Total Cargo New | 48 | 59 |
| **% Change** | **18%** | **15%** |
| **Revenues** | | |
| Port revenues old | 12,058 | 15,529 |
| Port revenues new | 12,905 | 18,149 |
| **% change** | **7%** | **17%** |
| SEZ revenues old | 2,322 | 2,610 |
| SEZ revenues new | 1,401 | 2,256 |
| **% change** | **-40%** | **-14%** |
| Total revenues old | 14,380 | 18,139 |
| Total revenues new | 14,306 | 20,405 |
| **% change** | **-1%** | **12%** |
| **Profits** | | |
| **Port Profits** | | |
| Old | 4,005 | 6,600 |
| New | 4,589 | 8,617 |
| **% change** | **15%** | **31%** |
| **SEZ profits** | | |
| Old | 2,155 | 2,393 |
| New | 1,278 | 2,093 |
| **% change** | **-41%** | **-13%** |
| **Total Profits** | | |
| Old | 6,160 | 8,993 |
| New | 5,867 | 10,710 |
| **% change** | **-5%** | **19%** |

Source: Citi Investment Research and Analysis

## Increasing TP to Rs474; Reducing Risk Rating to Medium

We are increasing our TP to Rs474 on the back of the changes in our estimates as discussed above. We have also reduced our cost of equity assumptions for the port operations to 13% from 13.5% earlier on the back of improving fundamentals and for SEZ to 14% vs. 15% earlier; in-line with other real estate companies in our coverage universe. We are reducing our risk rating for MPSEZ to Medium from High earlier to reflect improving volumes at the port.

**Figure 13. Mundra Port and SEZ – Valuation table**

| Asset | Methodology | Value | % value | Old Value | Methodology | % change |
|---|---|---|---|---|---|---|
| Mundra Port | DCF, COE 13% | 417 | 88% | 262 | DCF, COE 13.5% | 60% |
| SEZ | DCF, COE 14%, 30% discount to NAV | 49 | 10% | 22 | DCF, COE 15%, 50% discount to NAV | 120% |
| **Total** | | **467** | **99%** | **284** | | **64%** |
| **Investments in subsidiaries** | | | | | | |
| Adani Petronet Dahej Pvt. Ltd. | At book Value | 2 | 0% | 2 | | 0% |
| Adani Logistics | At book Value | 2 | 0% | 2 | | 0% |
| Inland Conware Pvt. Ltd. | At book Value | 3 | 1% | 3 | | 0% |
| **Total Value per share** | | **474** | **100%** | **291** | | **63%** |

Source: Citi Investment Research and Analysis

**Figure 14. Mundra Port Price performance**

| | YTD |
|---|---|
| MSEZ | 66% |
| Sensex | 50% |
| Outperformance | 16% |

Source: Citi Investment Research and Analysis

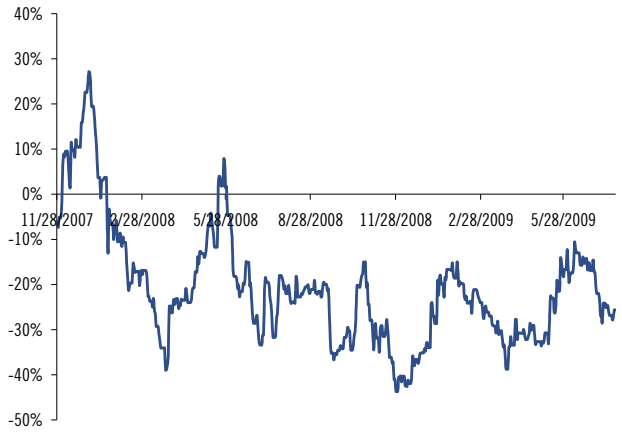
## Maintain Sell.

We maintain our Sell rating on MPSEZ. The stock is up 66% YTD, and has outperformed the Sensex by 16% on the back of expectations of a broader economic revival.

While we believe that improved cargo volumes will be positive for the stock, we believe positive news flow on SEZ land transactions will be the driver for valuations.

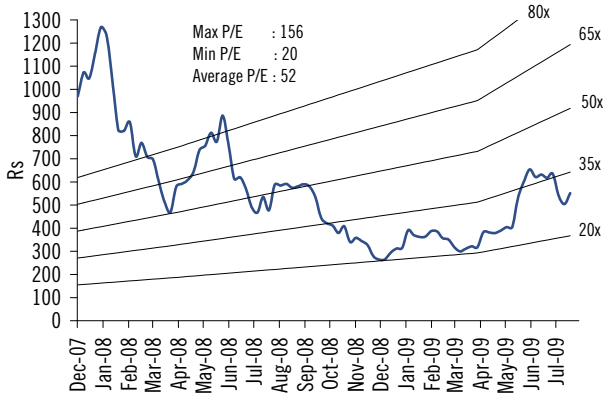
We do not believe that the corporate capex cycle will recover in any meaningful manner in the near term and hence do not foresee any significant pickup in land volumes at the SEZ, at least in H1FY10E. We expect land volumes to pick up meaningfully only in FY11E.

**Figure 15. MPSEZ price performance relative to SENSEX**




Source: Citi Investment Research and Analysis

**Figure 16. MPSEZ PE Chart**




Source: Citi Investment Research and Analysis

# Mundra Port And Special Economic Zone

## Company description

Mundra Port (MPSEZ) is a private port located in Gujarat, one of India's most industrialized, investor-friendly and commercially successful states. MPSEZ provides a convenient international trade gateway to Europe, Africa, America and the Middle East. Gujarat ports have good road connectivity to Delhi and Mumbai. MPSEZ has 2 bulk cargo terminals and 2 container cargo terminals with an effective handling capacity of 50-55mtpa per year. It also has a SPM terminal for crude imports. Cargo growth at Mundra Port has outpaced growth at major ports in India. MPSEZ is developing a ~32000-acre SEZ near Mundra Port that should support volume growth

## Investment strategy

We rate Mundra Port Sell/Medium Risk with Rs474 target price. The company has strong growth and returns, low gearing, and a strong balance sheet. Over FY09-11E, we expect compound growth of 28% in cargo volumes, 36% in revenues and 69% in profits. We expect margins to expand by 677bps over FY09-11E and ROE to improve to 28% from 14% in FY09. Capex is well funded, and net D/E of 0.3x gives headroom to leverage further. However, the economic downturn has hit trade volumes worldwide. While MPSEZ posted robust volumes in FY09 (up 24% YoY), overall trade volumes for India's major ports grew by only 2.1% in FY09.

The liquidity crunch has forced private sector companies to push back or cancel investments, which will not only impact trade volumes but also demand for land at the SEZ. We believe positive news flow on SEZ land transactions will be the driver for valuations. We do not believe that the corporate capex cycle will recover in any meaningful manner in the near term and hence do not foresee any significant pickup in land volumes at the SEZ at least in H1FY10E.

## Valuation

Our target price for MPSEZ is Rs474. Mundra Port is valued at Rs417/share on a discounted cash flow to equity basis, using a cost of equity of 13%. The SEZ is valued at Rs49/share, using a cost of equity of 14% and then assigning a 30% discount to the calculated NAV (consistent with how we value the smaller Indian real estate companies). We value the investments in subsidiaries at book value (a combined Rs7/share).

## Risks

We have a Medium Risk rating on MPSEZ, to reflect improving cargo volumes at the port. The key upside risks to our Sell recommendation and target price include: 1) better-than-expected traffic growth; 2) better-than-expected demand for the land at the SEZ; 3) higher-than-expected lease income for the SEZ; and 4) extension of the concession period.

# Appendix A-1

## Analyst Certification

**Each research analyst(s) principally responsible for the preparation and content of all or any identified portion of this research report hereby certifies that, with respect to each issuer or security or any identified portion of the report with respect to an issuer or security that the research analyst covers in this research report, all of the views expressed in this research report accurately reflect their personal views about those issuer(s) or securities. Each research analyst(s) also certify that no part of their compensation was, is, or will be, directly or indirectly, related to the specific recommendation(s) or view(s) expressed by that research analyst in this research report.**

## IMPORTANT DISCLOSURES

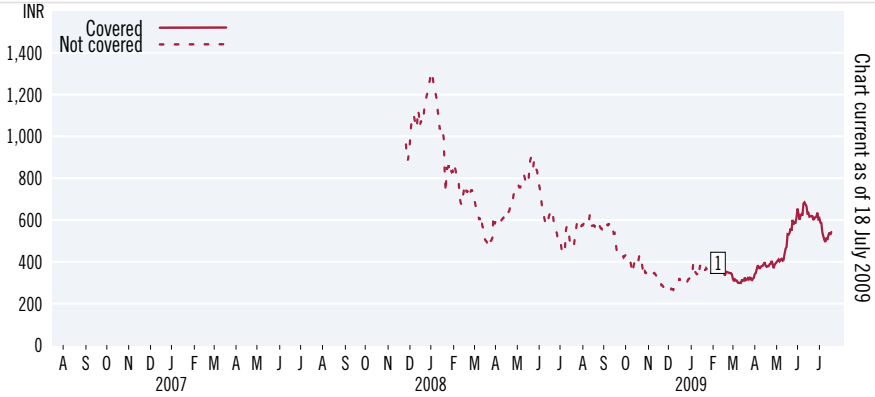
**Mundra Port And Special Economic Zone (MPSE.BO)**

**Ratings and Target Price History**

**Fundamental Research**

Analyst: Deepal Delivala

Covered since February 9 2009




| | Date | Rating | Target Price | Closing Price |
|---|---|---|---|---|
| 1 | 9-Feb-09 | *3H | *291.00 | 385.65 |

* Indicates change

Rating/target price changes above reflect Eastern Standard Time

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| ***Data current as of 30 Jun 2009*** | **Buy** | **Hold** | **Sell** |
|---|---|---|---|
| Citi Investment Research Global Fundamental Coverage | 41% | 38% | 21% |
| *% of companies in each rating category that are investment banking clients* | 46% | 45% | 39% |

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Investment ratings are determined by the ranges described above at the time of initiation of coverage, a change in investment and/or risk rating, or a change in target price (subject to limited management discretion). At other times, the expected total returns may fall outside of these ranges because of market price movements and/or other short-term volatility or trading patterns. Such interim deviations from specified ranges will be permitted but will become subject to review by Research Management. Your decision to buy or sell a security should be based upon your personal investment objectives and should be made only after evaluating the stock's expected performance and risk.

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