SBICAP Securities Limited

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Initiating Coverage

Shipbuilding

Overweight

13 July, 2007

Indian Shipyards Sailing High,
Set to leverage the current oil boom

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Shipbuilding Industry

Background

India ranks 8th in terms of order book globally

India has 32 shipbuilding yards belonging to the public and private sectors. The major public sector yards are the Cochin Ship Yard, Hindustan Shipyard and AAGL, while the large private shipyards include ABG, Bharati, ASL and Chowgule. Only Cochin Shipyard has the proven capability to produce larger conventional vessels. However, with ABG and Bharati planning new facilities one could expect some of the private players to produce bigger conventional ships in the future.

Today, India ranks 8th in terms of order book globally. About 46% of the Indian order book is geared towards the offshore segment, for private players we believe the percentage is higher.

India- Output of Top Shipyards

SHIPYARD	NUMBER	DWT	AVG SIZE	TYPE
Bharati	44	26,373	613	Private
ABG	29	37,718	1,347	Private
Cochin	27	31	1	PSU
Hindustan	21	87	8	PSU
Mazgaon	20	42,853	2,142	Defence
Hooghly	12	3,466	315	PSU
Garden Reach	8	74,013	9,251	Defence
ASL	8	4,000	500	Private
Chowgule	4	14,400	3,600	Private
Goa	4	3,174	793	Defence
Others	5	590		

Source: Industry

Till date the Indian shipbuilding industry has delivered 182 vessels with net output of 1.3 mn DWT. The industry has historically been hampered initially by the inflexibilities of a planned economy and then the long downturn in the shipping cycle. Indian shipyards produce a fraction of global output; however, we believe the Indian shipbuilding sector is poised for growth.

Government Initiatives for the sector

The Government of India is committed to strengthen the ship building sector - as it can generate employment and foreign exchange earnings.

Government wants to make Indian shipyard sector internationally competitive

Key government Initiatives include:

1. Subsidy of 30% is given to shipbuilding companies for export orders of all sizes and domestic orders in case of vessels of lengths 80 m and above (effective till August 2007).The government has already in principle approved extension of subsidy for another 5 years to keep the Indian shipyards at par with global counterparts.

2. Tonnage tax benefit extended to the Indian owners leading to cash availability for vessel acquisition to Indian shipping companies.

3. "Sagar Mala" Project announced by GOI involves a massive investment of Rs 1,000 billion over a period of 8-10 years, aims at developing new ports, modernisation and expansion of existing ports, and connecting all major ports with the National Highways Development Project. It is estimated that the project will result in additional demand for around 2,400 ships.
4. 100% Foreign Direct Investment (FDI) in shipbuilding and ship repair activity allowed.
5. Automatic approval is now given for acquisition of all categories of ships.

The government's attitude towards shipbuilding sector is favourable and would continue to be favourable

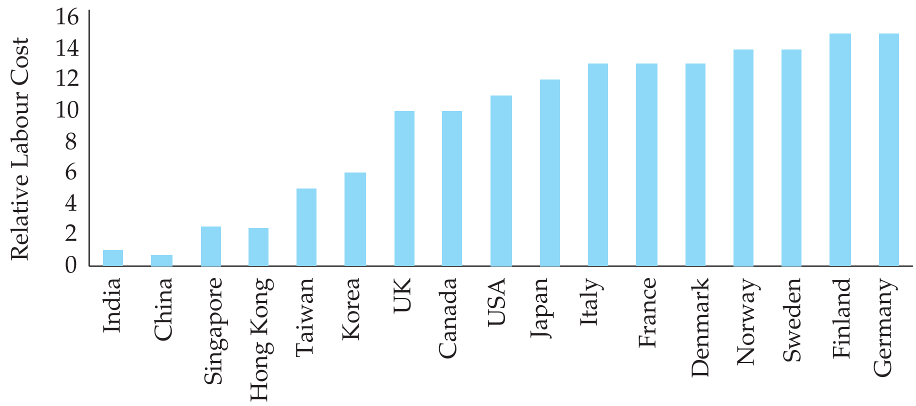
The Indian advantage

Availability of low cost and technically qualified manpower

The Indian labour is skilled and cost effective

Indian labour is among the cheapest in the world. Labour constitutes 15-25% of the total cost of a ship depending on the ship type. Indian private sector shipyards have been capitalizing on this key advantage.

Labour Advantage



Source: I maritime

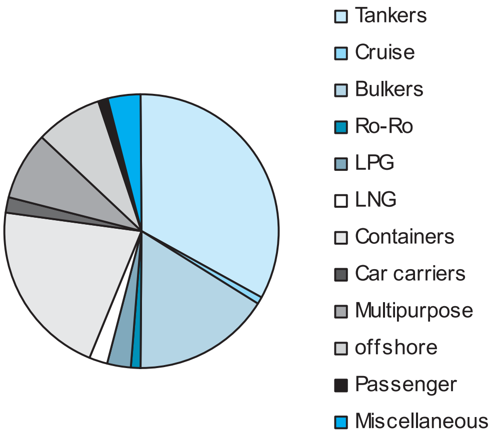
Niche in construction of Offshore Supply Vessel (OSV)

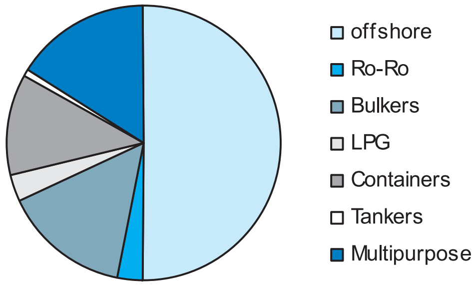
OSV construction is the domain of Indian shipyards

Indian Shipyards especially private sector shipyards have developed a niche for themselves in construction of OSVs. About 70% of Bharati's and ABG's order book is geared towards the oil & gas sector. Globally India has one of the largest OSV order book. OSVs typically require a higher degree of technological skill than vessels in tanker/bulk segments and Indian shipyards are leveraging one of India's key advantages -cost effective skilled labour.

Also the yards at major shipbuilding countries such as Korea and Japan have capacities that make production of OSVs uneconomical forcing the shift towards countries such as India.

Global order book as on Dec.'06 **Indian order book as on Dec.'06**

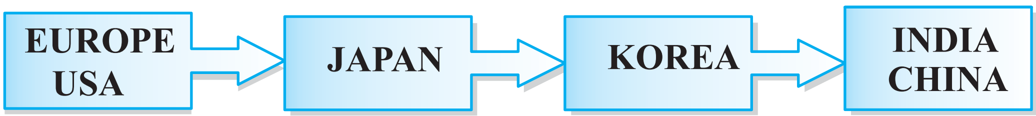




Source: Industry

Transition to Indian yards

India set to become a shipbuilding hub



Source: Industry

The choice of Indian yard marks an interesting transition in shipbuilding orders. The transition is mainly on account of:

- Reputation that Indian yards have earned for timely and quality building
- Decent reputation that Indian private shipyards have earned in overseas market considering 70% of the order book is from repeat customers and 50% is export order book
- Availability of low cost and technically qualified manpower
- Ability of Indian yards now to handle much complex work which earlier they were not capable of.
- Shift towards building higher tonnage vessels- it can be seen in their capacity expansion programs
- Conducive environment created by the government
- Inability of major shipbuilders mainly located in Korea and Japan to accept new orders for deliveries in the next few years

India's share in world market has gone from an insignificant low of 0.1% in 2002 to 1.3% in 2006.

The shift was impending and going forward we expect the more and more global orders coming to Indian yards especially to private sector yards thereby benefiting Bharati and ABG.

Vast costline encourages shipping activities

Vast coastline

Fortunes of the shipbuilding industry are closely tied to that of the shipping industry. With its vast coastline of over 6000 kms, 11 major ports and several intermediate and minor ports, shipping occupies an important position in the country's trade and commerce. Today 95% of India's export trade by volume and 75% by value are carried through the sea route. With the economy booming the vast coastline acts as a demand driver for Indian shipbuilding companies.

Global Drivers for Indian Shipyards

Growth in exploration & production (E&P) activities

Heightened activity in oil & gas exploration Industry in coming years would be one of the drivers of growth for the company.

Heightened activity in oil & gas exploration to create demand for OSVs and Offshore rigs

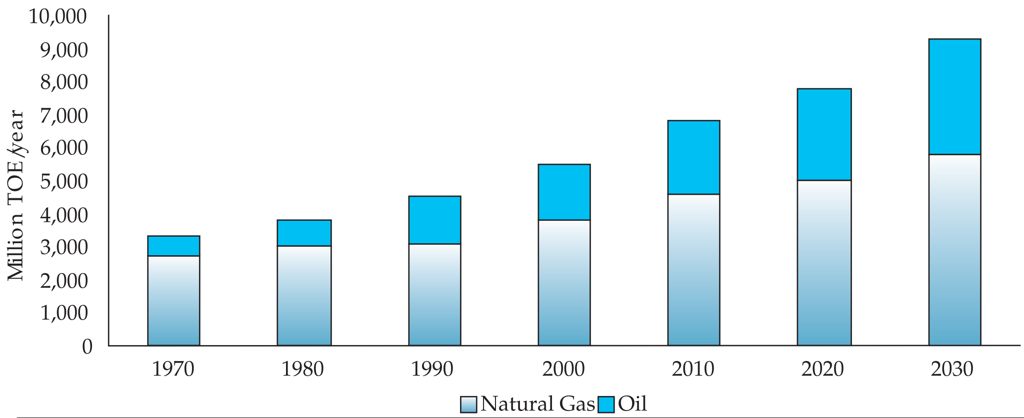
As on June 2006	Oil Billion barrels	Natural gas trillion Cubic feet
Proven reserves	1,293	6,124

Source: International Energy Agency

	FY04	FY05	FY06	FY07	FY08E	FY09E
Oil Brent US $	30	40	59	62	70	75

Source: SBICAP Research

Outlook for energy demand



Source: International Energy Agency

The proven reserves would suffice global energy requirements only till 2030. With global crude prices estimated to increase most of the Global and Indian oil majors are investing heavily in Oil and Gas exploration in search of new reserves. IEA estimate cumulative global investment in the oil industry at around US$ 3 trillion over the period 2003-2030, or around US$ 105 billion per year and exploration and development to dominate oil-sector investment, accounting for over 70% of total investments.

This would benefit Bharati and ABG to a great extent as they are primarily catering to the oil and gas market and also their new yards would be involved in construction of off shore rig.

There would be strong replacement demand in the next 5 to 10 years

Ageing global OSV fleet- demand for OSVs

The typical lifespan of an OSV is about 20 years. As the table shows about 73% of the anchor handling tugs (AHTS) fleet and 62% of the platform support vehicle (PSV) fleet is over 20 years old - these vessels were ordered in the oil boom of 1979-1980.Between the late 1980s and late 1990s virtually no OSVs were ordered. Hence the skewed age profile. The age profile clearly indicates impending strong replacement demand and is a huge demand driver for Bharati and ABG.

Global OSV fleet

Age in years	0-5	5-10	10-15	15-20	20-25	25-30	30+
AHTS	10	5	3	9	31	23	19
PSV	19	15	2	2	32	19	11

Source: Industry

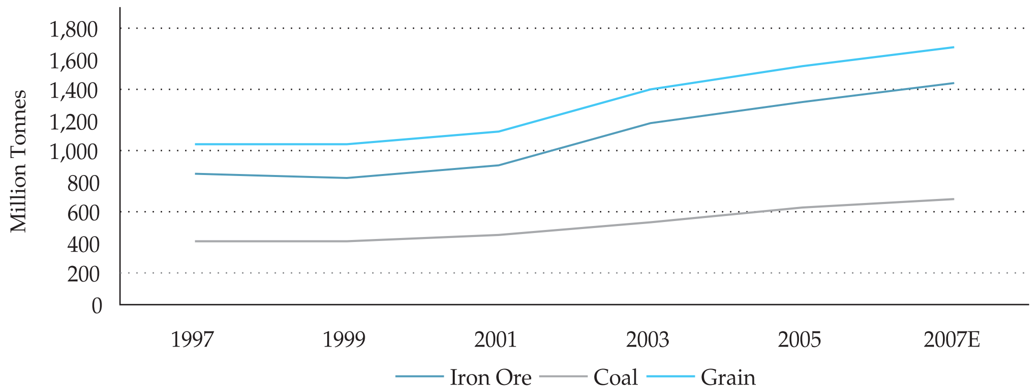
Growth in global dry bulk sea borne trade

Global GDP and Trade growth

Year	2003	2004	2005	2006	2007 E
GDP %	4	5.1	4.3	4.3	4.2
World trade %	5.4	10.3	7	7.4	7.5

Source: Industry

Global Dry Bulk sea borne trade for major comodities



Source: World Trade Organisation

Global sea borne trade is 90 % of total global trade and three major dry bulk cargoes constitute 90 % of total sea borne trade

Average global trade growth was around than 6% in the last 6 years and in the same period average growth in global sea bome trade in the three major dry bulk cargoes rose by an estimated 6.5% .

China today accounts for more than 20% of all seaborne imports of iron ore, coal and grain compared with 7% in 2000. This, in turn, has pushed Asia's share of the dry bulk market above 60%. With India and China growing at more than 8 % p.a, we expect the global dry bulk sea borne trade to continue to grow at more than 6% p.a which would lead to demand for bulk and containers thereby benefiting Bharati and ABG as they are also involved in construction of bulk carriers and containers.

Subsidy for the industry - A Brief discussion

In 2002, the government announced a policy of providing subsidies to private shipbuilding companies. The policy guidelines however, came through only in mid-2003. The policy was introduced for a five-year period ending August 2007. The government was to provide 30% of the sale price on all ships for foreign orders. Ships on domestic orders would however be eligible for subsidy if: 1) The vessels were a minimum of 80 meters in length; and 2) The orders are won through a global tendering process.

Subsidy by the Government creates a level playing field

While technically the sales price of the ship value is to be used for the subsidy calculation; the sales price is evaluated by a DGCA committee. This committee evaluates the sale price and may alter the ship value before awarding in principle approval. Historically in-principle approval has been marginally below the sales price. For private players the subsidy payment is made only after the delivery of the ship; while the payment to the public sector yards is stage based.

Following the in-principle approval a budget is sanctioned after which final payout is made. It is noteworthy that no private player has actually received any subsidy till date. They are just overstating the profits of these shipyards

Such delay in payments could increase the company's working capital requirements over a period of time and effect cash flows. Hence timely payment of subsidies assumes a lot of importance

The tremendous margin growth of private players since 2005 has largely been due to subsidies. Hence the continuation of subsidies beyond August 2007 assumes significance. The industry expects that the subsidy is likely to extend beyond 2007 till at least 2012. Further subsidy is available on all ships contracted before 2007 - hence the current order book which will power growth in FY08 and FY09 will receive the subsidy benefit.

Offshore rigs is new area for Indian private shipbuilders

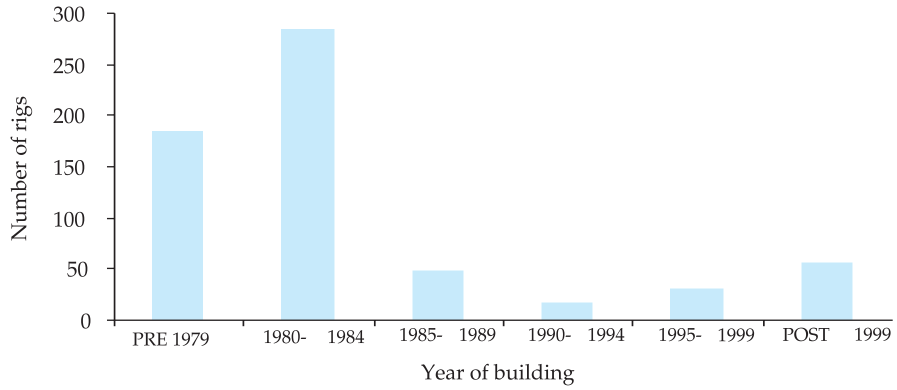
Jack up rigs is a new area for Indian shipbuilders - notably ABG and Bharati shipyard - have entered. They are also a direct play on the E&P cycle. The fleet development of rigs has been similar to that of OSVs with deliveries peaking during the boom of the 1980s and the sudden fall in demand immediately later. As pointed out, the newer oil rigs (4th and 5th generation) are 3-4 times faster than older drilling rigs so the replacement demand will also be higher.

Rig Boom- a boon for the Indian private sector shipyards

High oil and natural gas prices have brought billions of dollars into the coffers of oil and gas companies and spurred them to increase their exploration and development efforts. These companies are desperately searching for new oil supplies needed to meet rampant oil demand from the US, Europe, China and Japan. This has lead to a demand for offshore rigs which is at near record levels, which has in its turn caused a new wave of offshore rig construction. With a total of 94 Mobile Offshore Drilling Units (MODU) currently under construction or on order, the offshore rig fleet is poised to experience its largest growth spurt in over 20 years.

Graphs below show demand for offshore rigs would be very robust:

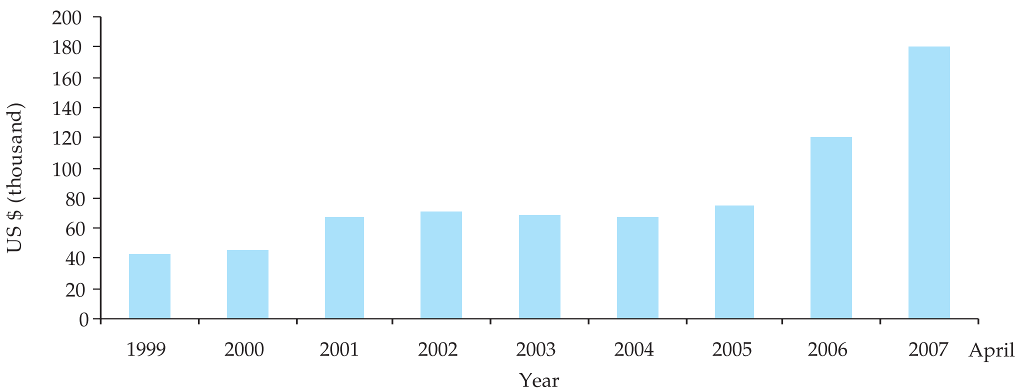
Age profile of rigs in operation



Source: Industry, SBICAP Research

The typical lifespan of an oil rig is about 25 years. As the graph shows about 73% of the rigs are over 20 years old - these rigs were ordered in the oil booms of 1979. Also these rigs are unlikely to service new exploration frontiers indicating a strong replacement demand for oil rigs in the current oil boom.

Movement in average day rate per rig

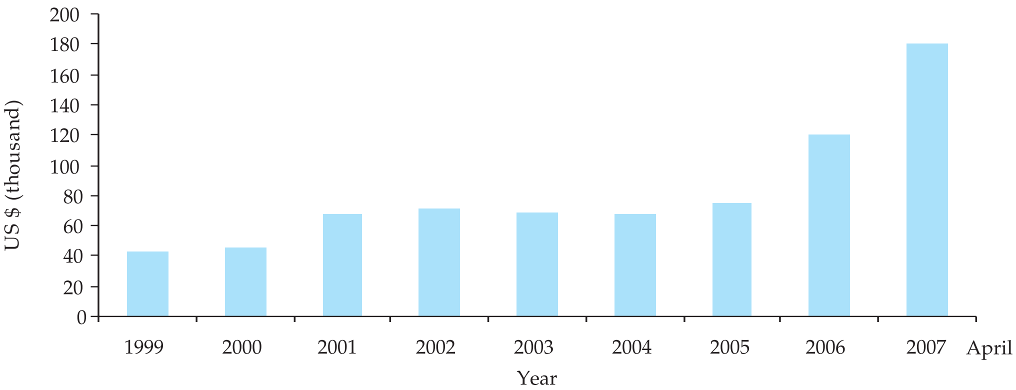


Source: Industry, SBICAP Research

Rig utilisation has remained consistently high at around 90% for the past three years while day charter rates for various types of rigs have soared to unprecedented levels indicating poor supply and strong demand for offshore rigs.

Offshore drilling companies have raised rig prices further after India (world's second-biggest market for offshore equipment) completed the biggest auction of offshore blocks in Jan 2007 under NELP. India had offered 55 exploration areas this month and announces a new round for more in August 07.

Effective utilisation rate of offshore rigs



Source: Industry, SBICAP Research

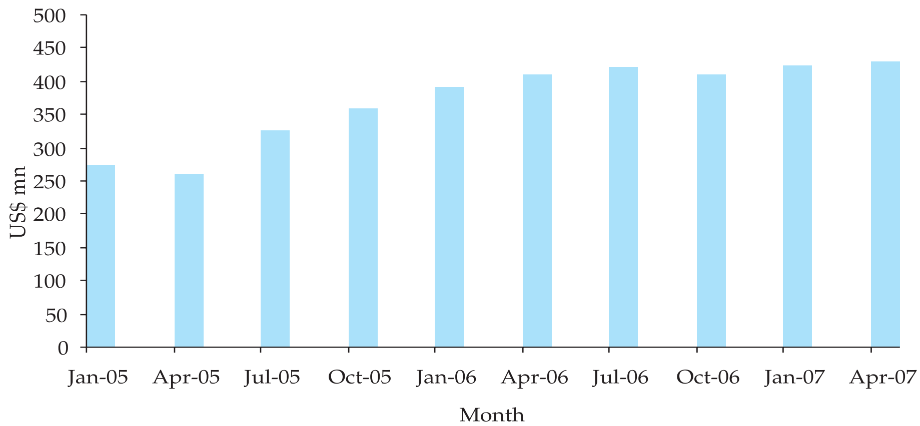
Drilling contractors are busy putting rigs to work - reactivating, building, upgrading pushing the effective utilization for 2006 at about 100% in almost all regions across all rig types indicating a strong demand for rigs.

Demand running away from supply

Global offshore rig demand	2004	2005	2006	2007E	2008E	2009E	2010E	2011E
Floater	133	155	163					
Jack up	322	342	342					
Total	**455**	**497**	**505**					
Global offshore rig supply	**2004**	**2005**	**2006**	**2007E**	**2008E**	**2009E**	**2010E**	**2011E**
Floater	148	158	164	166	181	200	206	207
Jack up	345	345	353	373	402	414	415	415
Total	**493**	**503**	**517**	**539**	**583**	**614**	**621**	**622**

Source: Petrodata

Movement in average contract value of jack up rigs



Source: Industry

Global rig builders are booked till CY10 while demand remains robust on the back of increasing oil prices and energy requirements. Also the strong replacement demand would absorb the new supply. We expect the demand for rigs to exceed supply from 2007 and remain robust in years to come. This would be good news for Bharati and ABG as they are venturing into rig construction.

There are only nine rig manufacturers in the world. The existence of few companies in this line would ensure healthy order flow for Bharati and ABG.

New facilities by ABG and Bharati, also diversifying into Bulk carriers and Tankers in a big way

Any economy develops through 3 stages viz. stage 1-preindustrial stage, stage 2-transtional stage and stage 3-matured stage. India has already crossed stage 1, and currently is in stage 2 (a transitional economy).As the economy transits from stage 2 to stage 3 the demand for raw materials such as iron ore, coal, non ferrous metal ores, and forest products increases as industrial infrastructure is built-up. If raw materials are not locally available, they are imported and paid for by exports of semi-manufacturers and any primary exports, which are available. More than 90% of the trade is sea borne. This leads to demand for bulk carriers. With new facilities put up by both ABG and Bharati and product mix changing are greatly poised and have properly integrated their business model into India's trade development cycle.

India's merchandise trade

Source RBI , SBICAP Research

Bulk carrier new building boom is expected to grow.

Dry bulk trade volume growth

2007E	2008E	2009E
5.6	5.5	5.4

Source- Clarkson

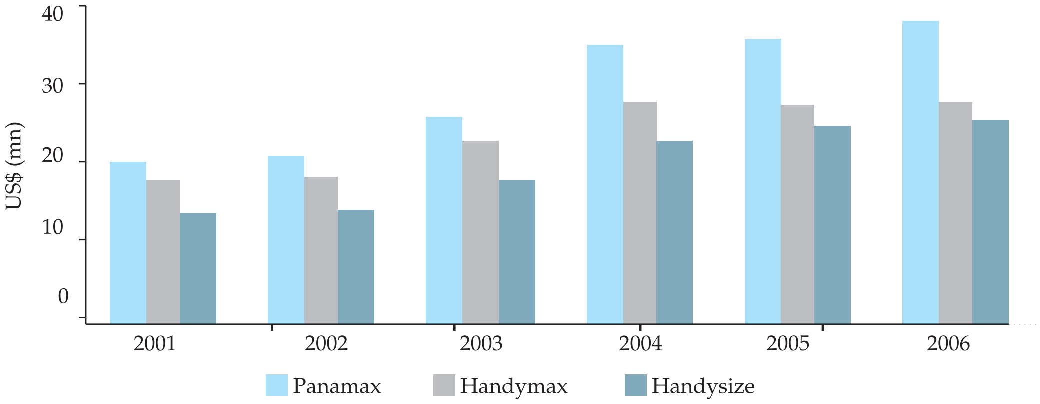
Global dry bulk carrier shipping tonnage growth

2007E	2008E	2009E
4.7	3.9	3.6

Source- Clarkson

Also the increase in prices and demand for bulk carriers justify the Dahej facility (ABG) and Mangalore facility (Bharati).

Prices of bulk carriers in Mn $



Source - Industry

CMP Rs.530 | Bharati Shipyard Ltd | Buy

We initiate coverage on Bharati Shipyard Ltd with a BUY rating and a price target of Rs 660.

Investment positives

Government initiatives

The government has initiated an array of measures to promote the shipyard industry and make it internationally competitive. We expect the government's attitude to remain favourable towards the industry.

Strong order book

Bharati had a healthy order book of 38,500 mn as on July 8, 2007 which is one the highest amongst the private sector shipyards in India. These orders are expected to be executed by FY10. We expect the order book to continue to remain strong in the coming years.

Mangalore Facility

The Company has undertaken a new Greenfield shipbuilding facility at Mangalore. The new yard will have a capacity to build ships with capacity of 60,000 DWT and facility to manufacture jack-up rigs. The cost for the project is about Rs 4.5bn with completion expected by the end FY08. We expect Mangalore facility to contribute more than 50% of the revenues from FY09.

Demand for offshore vessels to remain robust

Offshore vessels (AHTS, PSVs and rigs) remain the mainstay of Bharati Shipyard limited - comprising about 70 % of the order book. Bharati has developed a niche for itself in this segment. With global offshore capex likely to remain strong and the fleet age exceptionally high (60% of the offshore vessels are over 20 years old) we expect demand to remain robust.

Sustained margins

The company is expected to operate at sustained operating margins of 17 % (excluding subsidy) in future. This is on account of company's raw material policy, state of the art technology and repeat orders.

Concerns

Fall in global crude prices

Bharati is primarily into construction of OSVs and its order book is geared towards the oil & gas sector. Any slump in crude oil prices would curb or at least defer investment in E & P activity affecting Bharati a lot as this would cause a slowdown in the demand for OSVs.

Key Financials

(Rs. mn)

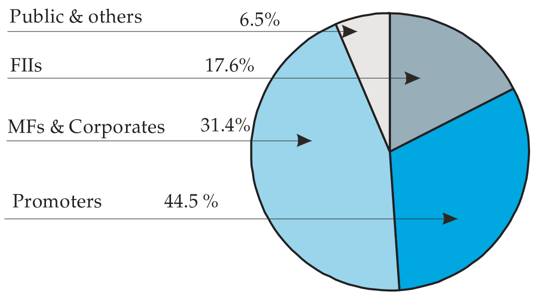
Y/E Mar.	FY06	FY07	FY08E	FY09E
Net Sales	2,608	3,599	6,808	10,347
EBIDTA (excludes subsidy)	543	662	1,187	1,756
EBIDTA (%)	20.8	18.4	17.4	17.0
Net Profit	502	732	1,236	1,649
EPS (Rs.)	22.3	32.5	38.6	51.5
P/E (x)	23	16	14	10
ROE (%)	31.0	31.3	21.5	17.1

Key Ratios	FY06	FY07	FY08E	FY09E
ROCE (%)	19.5	16.6	19.7	19.0
EV/EBIDTA (x)	19.5	13.3	8.4	6.3
EV/SALES (x)	6.7	4.8	2.6	1.7
Price/BV (x)	6.1	4.2	1.9	1.6

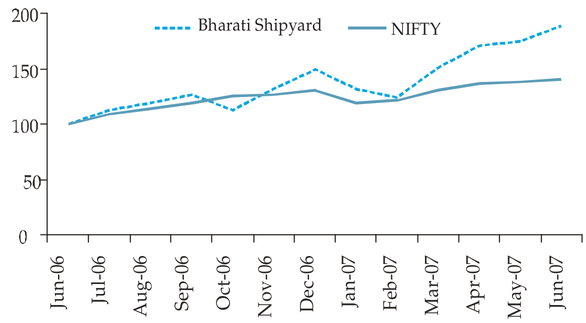
Key Data

Face Value (Rs)	10
Shares O/S (mn)	32
Market Cap (Rs mn)	11,800
52-Week Range(H/L)	572/248
Nifty	4446
Reuters Code	532609.NS
Bloomberg Code	BHART@IN
Year End	*March*

Share Holding Pattern



Relative Stock Perfomance



Subsidy eludes Bharati

By FY08, Bharati estimates to book at least Rs.2000 mn as subsidy. These transactions have been accounted as revenues, but Bharati has yet to receive the payment in terms of subsidies. Such delay in payments could increase the company's working capital requirements over a period of time and effect cash flows.

Valuation

Going forward Bharati is likely to show a robust growth. The stock, at the current price of Rs 530 trades at a FY08 PER of 14x and at a FY09 PER of 10x. In terms of EV/EBIDTA it trades at 8.4x FY08E and 6.3 FY09E. At our target price of Rs 660, the stock would be trading at PER of 17x its FY08E, thus providing an upside potential of 24% from current levels.

Brief Background

Bharati is one of the largest private sector shipyards in the country

Bharati Shipyard is a private sector Indian shipyard engaged in design and construction of various types of sea-going, coastal, harbour and inland crafts and vessels. Its product range has been upgraded from the simple inland cargo barges to deep-sea trawlers and dredgers to maneuverable and power-packed ocean-going tractor tugs, cargo ships, tankers and vessels required by the offshore industry. The company specializes in vessels required for offshore industry (OSVs), Rigs, Maneuverable and power packed ocean going tractor tugs, Cargo ships, Tankers, Dredgers, etc

The company has pioneered in the building of various types of ships and provided ship repair services in the private sector from its shipyards located at Ratnagiri and Ghodbunder (Thane), along India's West coast .It is coming up with a Greenfield shipbuilding facility at Mangalore.

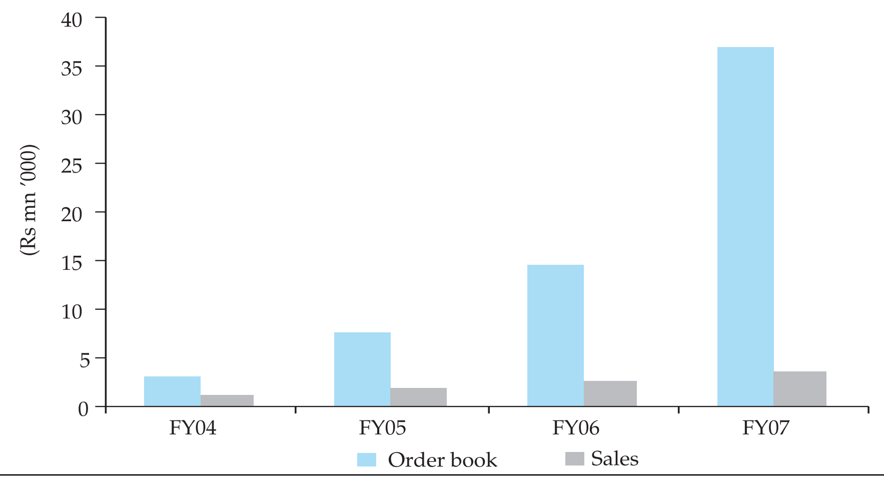
Investment Positives

Strong order book

As on July 8, 2007 Bharati had an order book of Rs 38,500 mn, a backlog of more than 5 times FY08E sales. These orders are expected to be executed by FY10. The order book will be backed by capacity expansion with a new yard in Mangalore.

Order book to remain robust backed by capacity expansion with a new yard in Mangalore

Balloning order book



Source: Company

Mangalore facility

The Company has undertaken a new Greenfield shipbuilding facility at Mangalore capable of building ships with a capacity of 60,000 DWT and jack-up rigs. The cost for the project is about Rs 4.5bn with completion expected by the end FY08.

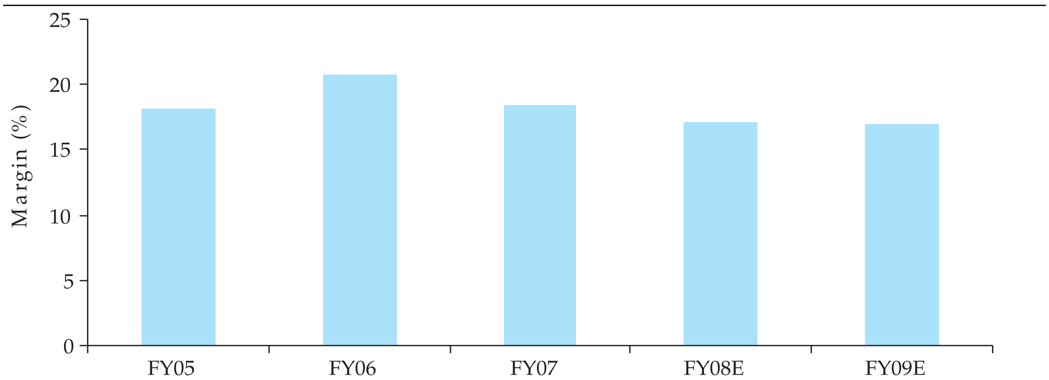
There are only nine rig manufacturers in the world and Bharati Shipyard will be the tenth offshore rig manufacturer globally and the only domestic shipyard. The existence of few companies in this line would ensure healthy order flow for Bharati. It has already received an order for supply of jack up oil rig from GE shipping worth Rs.7500 million to be delivered by October, 09.We expect Mangalore facility to contribute more than 50% of the revenues from FY09.

The company would also be constructing bulk carriers, containers, tankers etc. at the Mangalore yard. This is a key step for the company in getting into newer classes of ships

Sustained margins

The company has margins of 17% (excluding subsidy) on a yearly basis. Going forward we expect Bharati to sustain the margins. This is due to the company's policy of covering raw material purchases on a back to back basis (so as to hedge against any volatility in the prices of raw materials), state of the art technology, status of SEZ to Mangalore plant and orders.

Sustained margins



Source:SBICAP Research

Acquisition of Swan hunter

Bharati shipyard has recently acquired all the shipyard machinery and equipments of Swan Hunter (Tyneside) Shipyard Ltd for an undisclosed amount

Through this acquisition the Company acquires fully automated panel lines quayside traveling gantry cranes upto 180T capacity, 30 overhead travelling cranes upto 60T capacity, plate bending rolls of 2000 ton capacity, bending presses, robotic profiling machines, CNC plasma burning equipment, etc. These equipments will be used by the Company at its existing yards as well as for its Greenfield projects. The Company has also acquired the 20,000-ton lift capacity floating dock of Swan Hunter Shipyard, which will add a lot of value to its existing operations.

Acquisition of equipment from Swan Hunter will enable the company to manufacture ships of larger tonnage (upto 100, 000 DWT). This acquisition would help the Company to save cost and lead-time, which would have otherwise been spent in procuring the new machineries and equipments

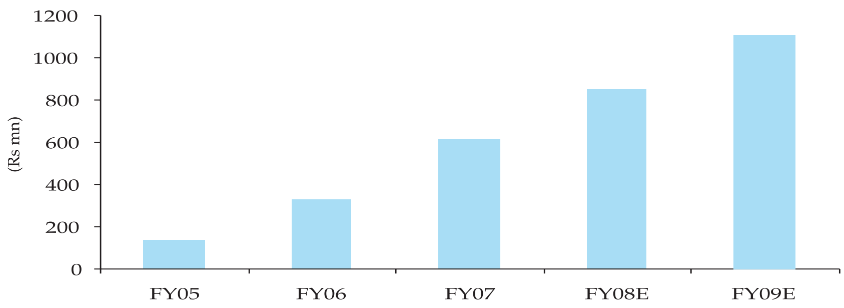
Concerns

Subsidy eludes Bharati shipyard limited

Shipbuilding companies are eligible for subsidies on the orders received for ships after October 2002.Accordingly Bharati has been booking subsidy for ships delivered. Till FY08 Bharati estimates to book at least Rs.2000 mn as subsidy. These transactions have been accounted as revenues, but Bharati has yet to receive the payment in terms of subsidies. In fact none of the private sector shipyard has received any subsidy payment yet. They are just overstating the profits of these shipyards

Such delay in payments could increase the company's working capital requirements over a period of time and effect cash flows. Hence timely payment of subsidies assumes a lot of importance.

Subsidies booked



Source: Company and SBICAP research

Fall in crude prices

A slump in crude oil prices would affect Bharati

About 70% of Bharati's order book is geared towards the oil & gas sector and is booked till FY10.Historically though crude oil prices have a shown an upward trend and estimated to increase in the future. But any slow down in the global economy, some huge crude discovery or migration to alternate source of energy could lead to a slump in crude oil prices thereby curbing or at least deferring investment in E & P activity. This would affect Bharati a lot as this would cause a slowdown in the demand for OSVs and Bharati is primarily into construction of OSVs

Valuation

Year	FDEPS	Price	P/E
FY05	12.16	160	13.2
FY06	22.3	384	17.2
FY07	22.83	348	15.2

Source: SBICAP Research

We expect Bharati to show robust growth in years to come. Bharati is currently trading at a relatively lower price/earning (PE) of 14x its FY08 earnings and of 10x its FY09 earning as compared to the average historic PE of 15x. In terms of EV/EBIDTA it trades at 8.4x FY08E and 6.3 FY09E. At our target price of Rs 660, the stock would be trading at PER of 17x its FY08E, thus providing an upside potential of 24% from current levels. We rate this stock a BUY.

Income Statement (*Rs mn*)

Y/E 31st March	FY06	FY07	FY08E	FY09E
Net sales	**2,608**	**3,599**	**6,808**	**10,347**
- Operating expenses	2,065	2,937	5,621	8,591
Operating profit	**543**	**662**	**1,187**	**1,756**
+ Other income	350	649	886	1,021
- Depreciation	22	50	163	228
- Interest	98	151	205	308
- Tax	271	378	468	592
PAT	**502**	**732**	**1,236**	**1,649**
+ (Associates-Minorities)	-	-	-	-
Consolidated PAT	**502**	**732**	**1,236**	**1,649**

Balance Sheet (*Rs mn*)

Y/E 31st March	FY06	FY07E	FY08E	FY09E
Networth	1,916	2,762	8,735	10,587
Debt	5,475	5,070	2,776	4,761
Minority interests	-	-	-	-
Capital employed	**7,391**	**7,833**	**11,511**	**15,349**
Fixed Assets	1,088	2,538	6,225	8,497
Investments	10	10	10	10
Working capital	1,571	2,988	3,703	4,926
Cash	4,722	2,296	1,573	1,916
Capital deployed	**7,391**	**7,833**	**11,511**	**15,349**

Cash Flow Statement (*Rs mn*)

Y/E 31st March	FY06	FY07E	FY08E	FY09E
Consolidated PAT	**502**	**732**	**1,236**	**1,649**
+ Non-cash items	175	175	393	520
Cash profit	**677**	**906**	**1,629**	**2,169**
- Inc. in working capital	283	1,417	715	1,223
Operating cash flow	**394**	**(511)**	**914**	**945**
- Capital expenditure	915	1,500	3,850	2,500
Free cash flow	**(521)**	**(2,011)**	**(2,936)**	**(1,555)**
- Dividends	64	59	83	83
+ Equity raised	(6)	-	4,590	(5)
+ Debt raised	5,245	(405)	(2,294)	1,985
+ Inc. in minority interests	-	-	-	-
- Investments	(55)	-	-	-
- Miscellaneous items	(5)	(49)	-	-
Net cash flow	**4,715**	**(2,426)**	**(723)**	**342**
+ Opening cash	7	4,722	2,296	1,573
Closing cash balance	**4,722**	**2,296**	**1,573**	**1,916**

Ratio

Y/E 31st March	FY06	FY07	FY08E	FY09E
Topline growth (%)	45.5	38.0	89.2	52.0
Bottomline growth (%)	83.7	45.6	68.9	33.5
Operating margins (%)	20.8	18.4	17.4	17.0
FDEPS (Rs/share)	22.3	32.5	38.6	51.5
CEPS (Rs/share)	29.7	40.7	50.9	67.8
DPS (Rs/share)	2.9	2.6	2.6	2.6
BV (Rs/share)	85.1	122.8	273.0	330.9
PER (x)	23.3	16.0	13.5	10.1
P/C (x)	17.5	12.8	10.2	7.7
Dividend yield (%)	0.5	0.5	0.5	0.5
P/B (x)	6.1	4.2	1.9	1.6
EV/Sales (x)	6.7	4.8	2.6	1.7
EV/ EBITDA (x)	19.5	13.3	8.4	6.3
Debt/Equity (x)	2.9	1.8	0.3	0.4
Working capital turn (days)	200.0	231.2	179.4	152.2
Dividend payout (%)	12.8	8.0	6.7	5.1

Dupont Analysis

Y/E 31st March	FY06	FY07E	FY08E	FY09E
EBIT margins (%)	33.4	35.0	28.0	24.6
Capital turn (x)	0.6	0.5	0.7	0.8
RoCE (%)	**19.5**	**16.6**	**19.7**	**19.0**
Leveraging factor (x)	2.8	3.3	1.7	1.4
Interest impact (x)	0.9	0.9	0.9	0.9
Tax break (x)	0.6	0.7	0.7	0.7
Consolidation factor (x)	1.0	1.0	1.0	1.0
RoE (%)	**31.0**	**31.3**	**21.5**	**17.1**

Source: Company, SBICAP Reseravh

CMP Rs. 450 | **ABG Shipyard Ltd (ABG)** | **BUY**

We initiate our coverage on ABG Shipyard Ltd.with a BUY rating and a price target of Rs. 560.

INVESTMENT POSITIVES

Government Initiatives

The government has initiated an array of measures to promote the shipyard industry and make it internationally competitive. We expect the government's attitude to remain favourable towards the industry.

Strong order book

ABG had a healthy order book of Rs 40740 mn as on June 25, 2007 which is the highest amongst the private sector shipyards in India. These orders are expected to be executed by, November 2011. It gives us a clear visibility of sales for years to come. With the company venturing into rig manufacturing we expect the order book to continue to remain strong in the coming years.

Demand for offshore vessels to remain robust

Offshore vessels (AHTS, PSVs and rigs) remain the mainstay of ABG Shipyard limited - comprising about 70 % of the order book. ABG has developed a niche for itself in this segment. With global offshore capex likely to remain strong and the fleet age exceptionally high (60% of the offshore vessels are over 20 years old) we expect demand to remain robust.

New facility at Dahej

Company's Dahej facility is expected to be commissioned in FY09. The new facility will consist of two dry docks capable of accommodating eight bulk carriers up to a maximum weight of 120,000 DWT. The company has already started accepting orders for the same. The company would be leveraging this facility to build jack up rigs as there is demand in E&P activities worldwide.

Sustained margins

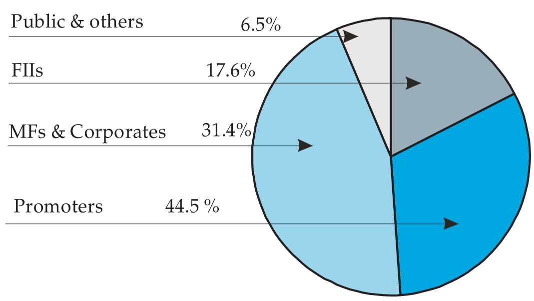
The company is expected to operate at sustained operating margins of 17 % (excluding subsidy) in future. This is on account of company's raw material policy, state of the art technology and repeat orders.

Y/E Mar.	FY06	FY07	FY08E	FY09E
Net Sales	4,672	6,221	9,182	13,618
EBIDTA (excludes subsidy)	573	1,130	1,538	2,417
EBIDTA %	12.3	18.2	16.8	17.7
Net Profit	836	1,163	1,684	2,543
FDEPS (Rs.)	16.4	22.8	33.1	50.0
P/E (x)	27	20	14	10
ROE (%)	22.9	18.7	21.5	25.2

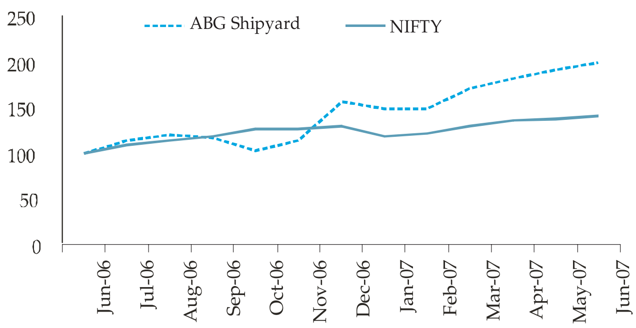
Key Ratios	FY06	FY07	FY08E	FY09E
ROCE (%)	30.8	24.1	23.5	25.0
EV/EBIDTA (x)	13.9	9.9	7.0	4.8
EV/SALES (x)	4.2	3.2	2.2	1.5
Price/BV (x)	4.2	3.3	2.6	2.0

Key Data	
Face Value (Rs)	10
Shares O/S (mn)	50.9
Market Cap (Rs mn)	22,680
52-Week Range(H/L)	478/199
Nifty	4446
Reuters Code	ABGS.NS
Bloomberg Code	ABGS@IN
Year End	*March*

Share Holding Pattern



Relative Stock Perfomance



CONCERNS

Fall in global crude prices

ABG is primarily into construction of OSVs and its order book is geared towards the oil & gas sector. Any slump in crude oil prices would curb or at least defer investment in E & P activity affecting ABG a lot as this would cause a slowdown in the demand for OSVs

Subsidies booked, but payment eludes ABG

ABG has accounted subsidy totaling Rs 2,070 mn till date of which the company has received an in principle clearance for Rs 400 mn only. Such delay in payments increase the company's working capital requirements and affect cash flows.

VALUATION

Going forward ABG is likely to show a robust growth. The stock, at the current price of Rs 450 trades at a FY08 PER of 14x and at a FY09 PER of 9. In terms of EV/EBIDTA it trades at 7x FY08E and 4.8 FY09E. At our target price of Rs 560, the stock would be trading at PER of 17x its FY08E, thus providing an upside potential of 24% from current levels.

COMPANY BACKGROUND

ABG Shipyard Ltd, the flagship company of ABG group, is the largest private sector shipbuilding yard in India with satisfied customer base all around the world. The company is an established manufacturer of a variety of marine ships, including bulk carriers, deck barges, interceptor boats, anchor handling supply ships, diving support ships, tugs and offshore vessels. The company derives a small amount of its revenue from ship repairs and construction of windmill towers.

The company's shipyard is located at Magdala, near Surat spread across 35 acres on the banks of the river Tapi. The yard can simultaneously build on modular basis and repair up to 23 ships. Currently, the yard can construct ships of a maximum length of 155 meters and up to a maximum weight of 20,000 DWT.

ABG Shipyard has built over 95 ships since its inception in 1990. Of this nearly 50% of the deliveries have taken place in the last five years.

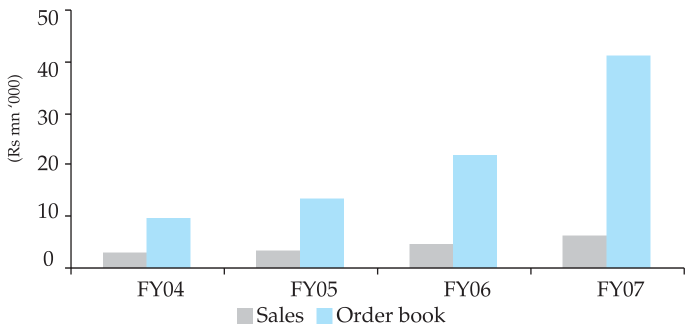
Company is coming up with a new facility at Dahej which is expected to be commissioned in FY09E. The new facility will consist of two dry docks measuring 400 meters in length, 45 meters in breadth and 10 meters in depth. The two dry docks will be able to accommodate bulk carriers up to the weight of 120,000 DWT. In addition, the company would be leveraging this facility to build jack up rigs as there is demand in E&P activities worldwide.

INVESTMENT POSITIVES

Strong order book

As on June 25 , 2007 ABG had an order book of Rs 40740 mn, the highest among private sector shipyards in India .These orders are expected to be executed by the end of October 2010.The order book also suggest an order book to FY07 sales ratio of 6 giving us a clear visibility of sales for years to come

Ballooning Order book



Source:

Dahej facility

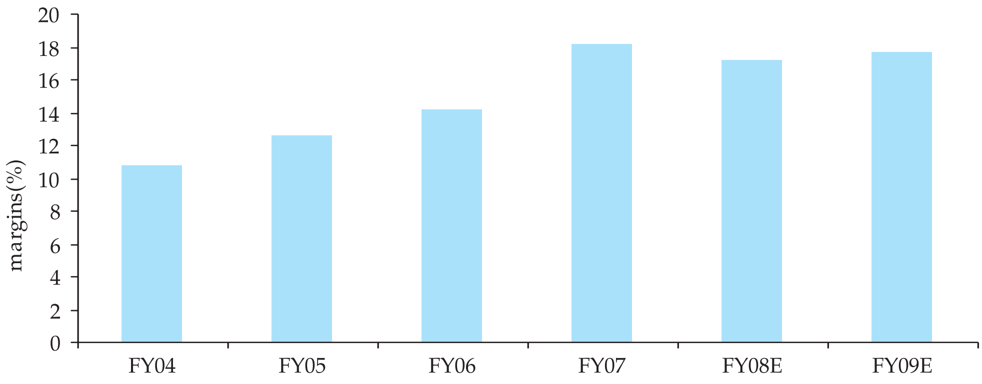
Company is coming up with a new facility at Dahej which is expected to be commissioned in FY09E. The new facility will consist of two dry docks measuring 400 meters in length, 45 meters in breadth and 10 meters in depth. The two dry docks will be able to accommodate bulk carriers up to the weight of 120,000 DWT.

In addition, the company would be leveraging this facility to build jack up rigs as there is demand in E&P activities worldwide

Sustained margins

The company has margins of 17% (excluding subsidy) on a yearly basis. Going forward we expect ABG to sustain the margins. This is due to the company's policy of covering raw material purchases on a back to back basis (so as to hedge against any volatility in the prices of raw materials), state of the art technology, probable status of SEZ to Dahej plant and repeat orders.

Sustained EBIDTA margin (excludes subsidy)



Source: Company and SBICAP research

Acquisition of Vipul Shipyard

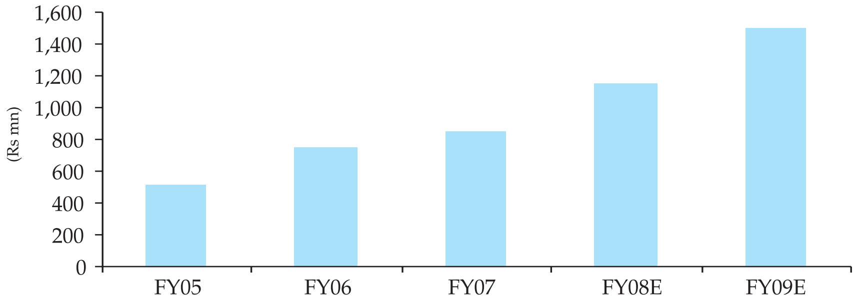
ABG Shipyard has signed a Memorandum of Understanding (MoU) for the acquisition of Vipul Shipyard situated adjacent to the company's existing shipyard at Magdalla Port in Surat, Gujarat. Post this acquisition, the company would be able to increase its capacity by about 25% from its current 32 vessels built on modular basis to 40 vessels. This acquisition will aid the company to reduce the lead time for the expansion which otherwise would have taken around 24 months. The company has acquired the Shipyard at the right time to take advantage of the growth in the shipbuilding activities. This acquisition will facilitate optimal use of resources in the company's existing shipyard and new facility to synergize productivity and achieve economies of scale. The company would incur Rs 1 billion towards the cost of acquisition and modernisation of Vipul Shipyard, which would be funded through internal accruals. Vipul yard is expected to contribute about Rs 1000 mn to the revenues from FY08.

CONCERNS

Payment of Subsidies eludes ABG shipyard

Shipbuilding companies are eligible for subsidies on the orders received for ships after October 2002. Accordingly, ABG has been booking subsidies for the ships delivered. ABG has booked subsidy of Rs 510 million for FY05, Rs 745 million for FY06 and Rs 815 for FY07 which breaks figure of totally Rs2070 million of which the company has received an in principle clearance for Rs 400 million and Rs 1670 million to be reviewed. These transactions have been accounted as revenues, but ABG has yet to receive the payment in terms of subsidies; such delay in payments could increase the company's working capital requirements over a period of time and effect cash flows.

Subsidies booked



Source: Company and SBICAP research

Fall in crude prices

A slump in crude oil prices would affect Bharati

About 70% of ABG's order book is geared towards the oil & gas sector and is booked till November, 2011.Historically though crude oil prices have a shown an upward trend and estimated to increase in the future. But any slow down in the global economy, some huge crude discovery or migration to alternate source of energy could lead to a slump in crude oil prices thereby curbing or at least deferring investment in E & P activity. This would affect ABG a lot as this would cause a slowdown in the demand for OSVs and Bharati is primarily into construction of OSVs.

Valuation

Year	FDEPS	Price	P/E
FY06	16.4	378	23
FY07	22.8	341	15

Source:

Under the current scenario we expect ABG to show robust growth in years to come. ABG is currently trading at a relatively lower price/earning (PE) of 14x its FY08 earnings and of 9x its FY09 earning as compared to the average historic PE of 18x. In terms of EV/EBIDTA it trades at 7x FY08E and 4.8x FY09E. At our target price of Rs 560, the stock would be trading at PER of 17x its FY08E, thus providing an upside potential of 24% from current levels. We rate this stock a BUY.

Income Statement (*Rs mn*)

Y/E 31st March	FY06	FY07	FY08E	FY09E
Net sales	**4,672**	**6,221**	**9,182**	**13,618**
- Operating expenses	4,099	5,091	7,644	11,201
Operating profit	**573**	**1,130**	**1,538**	**2,417**
+ Other income	853	878	1,281	1,694
- Depreciation	36	59	101	176
- Interest	124	267	305	381
- Tax	430	519	729	1,011
PAT	**836**	**1,163**	**1,684**	**2,543**
+ (Associates-Minorities)	-	-	-	-
Consolidated PAT	**836**	**1,163**	**1,684**	**2,543**

Balance Sheet (*Rs mn*)

Y/E 31st March	FY06	FY07E	FY08E	FY09E
Networth	5,492	6,950	8,728	11,447
Debt	997	2,748	4,721	6,608
Minority interests	-	-	-	-
Capital employed	**6,489**	**9,698**	**13,449**	**18,055**
Fixed Assets	1,559	5,065	8,469	10,387
Investments	7	7	7	7
Working capital	872	2,841	3,968	5,862
Cash	4,051	1,784	1,004	1,798
Capital deployed	**6,489**	**9,698**	**13,449**	**18,055**

Cash Flow Statement (*Rs mn*)

Y/E 31st March	FY06	FY07E	FY08E	FY09E
Consolidated PAT	**836**	**1,163**	**1,684**	**2,543**
+ Non-cash items	446	491	380	586
Cash profit	**1,282**	**1,654**	**2,064**	**3,129**
- Inc. in working capital	(190)	1,969	1,127	1,894
Operating cash flow	**1,472**	**(315)**	**937**	**1,235**
- Capital expenditure	636	3,601	3,537	2,124
Free cash flow	**836**	**(3,916)**	**(2,600)**	**(889)**
- Dividends	70	101	153	204
+ Equity raised	2,534	-	-	-
+ Debt raised	267	1,751	1,973	1,887
+ Inc. in minority interests	-	-	-	-
- Investments	7	-	-	-
- Miscellaneous items	-	-	-	-
Net cash flow	**3,560**	**(2,266)**	**(780)**	**794**
+ Opening cash	491	4,051	1,784	1,004
Closing cash balance	**4,051**	**1,784**	**1,004**	**1,798**

Ratio

Y/E 31st March	FY06	FY07	FY08E	FY09E
Topline growth (%)	43.5	33.2	47.6	48.3
Bottomline growth (%)	86.2	39.1	44.8	51.0
Operating margins (%)	12.3	18.2	16.8	17.7
FDEPS (Rs/share)	16.4	22.8	33.1	50.0
CEPS (Rs/share)	24.8	32.1	40.2	61.2
DPS (Rs/share)	1.2	1.7	2.6	3.2
BV (Rs/share)	107.8	136.5	171.4	224.8
PER (x)	27.4	19.7	13.6	9.0
P/C (x)	18.2	14.0	11.2	7.4
Dividend yield (%)	0.3	0.4	0.6	0.7
P/B (x)	4.2	3.3	2.6	2.0
EV/Sales (x)	4.2	3.2	2.2	1.5
EV/ EBITDA (x)	13.9	9.9	7.0	4.8
Debt/Equity (x)	0.2	0.4	0.5	0.6
Working capital turn (days)	75.5	108.9	135.3	131.7
Dividend payout (%)	8.4	8.7	9.1	8.0

Dupont Analysis

Y/E 31st March	FY06	FY07E	FY08E	FY09E
EBIT margins (%)	29.8	31.3	29.6	28.9
Capital turn (x)	1.0	0.8	0.8	0.9
RoCE (%)	**30.8**	**24.1**	**23.5**	**25.0**
Leveraging factor (x)	1.2	1.3	1.5	1.6
Interest impact (x)	0.9	0.9	0.9	0.9
Tax break (x)	0.7	0.7	0.7	0.7
Consolidation factor (x)	1.0	1.0	1.0	1.0
RoE (%)	**22.9**	**18.7**	**21.5**	**25.2**

Comparative Valuation

Singapore yards- niche in OSVs

Parameter	EV/ EBIDTA		PE	
Company	CY07E	CY08E	CY07E	CY08E
Keppel	16.3	13.3	19	16
Labroy	13.0	10.6	20	15
Semb corp	17.8	14.6	22	18

Source-Bloomberg Estimates

Korean and Japanese yards-niche in tankers, containers and bulk carriers

Parameter	EV/ EBIDTA		PE	
Company	CY07E	CY08E	CY07E	CY08E
Hyundai	11.4	9.2	16	13
Samsung	12.0	7.6	23	14
Daewoo	17.0	14.0	24	20

Source-Bloomberg Estimates

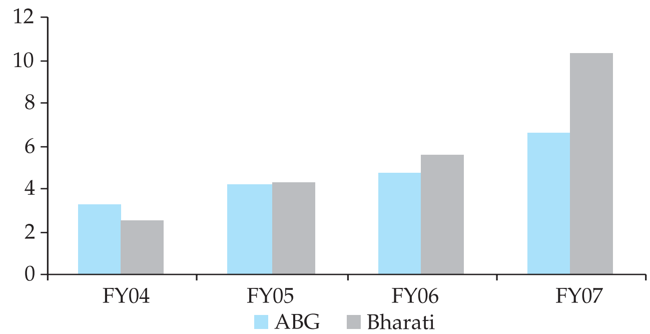
We have compared Bharati and ABG with select global companies- few of them are primarily into manufacturing of OSVs (Singapore based companies) and few primarily into construction of bulk carriers and tankers (Japanese and Korean companies). The table clearly indicates that both Bharati and ABG are available at a discount.

Korean and Japanese yards have an Order book to TTM Sales ratio of about 4 while for Indian private sector yards it is more than 6. This gives us a clear visibility of earnings for years to come. Also these shipyards are venturing into the booming offshore rig construction business

With strong growth prospects of both the companies we feel that both stocks deserve much better valuation.

Peer Comparison

Order book to sales ratio (X)

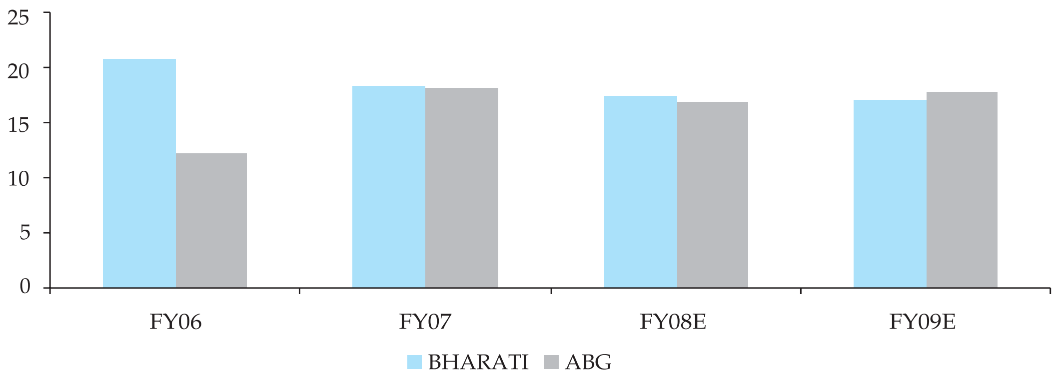


Source: SBICAP Research

Both ABG and Bharati had a healthy order book -a backlog of more than five times there FY08E sales. The order book would continue to be strong backed by capacity expansion with a new yard in Mangalore (Bharati) and in Dahej (ABG). This provides us a clear earning visibility for years to come

ABG hasn't started accepting orders for offshore rigs for which Bharati already has an order from GE Shipping. With ABG starting to accept rig orders we expect ABG to catch up with Bharati in order book to sales ratio. ABG is already in process for finalising contracts for supply of jack up rig which it expects to construct at Dahej yard from FY10.

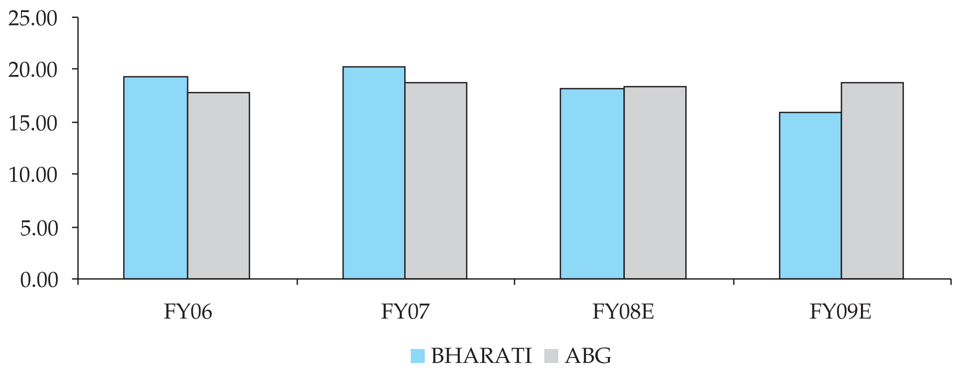
EBIDTA margins (%)



Source: SBICAP Research

We estimate the operating margins to be at around 17% (excluding subsidy).With sustained margin we expect both Bharati and ABG to leverage the current oil boom, strong replacement demand and growth in global sea borne trade and exhibit robust growth.

PAT margins (%)



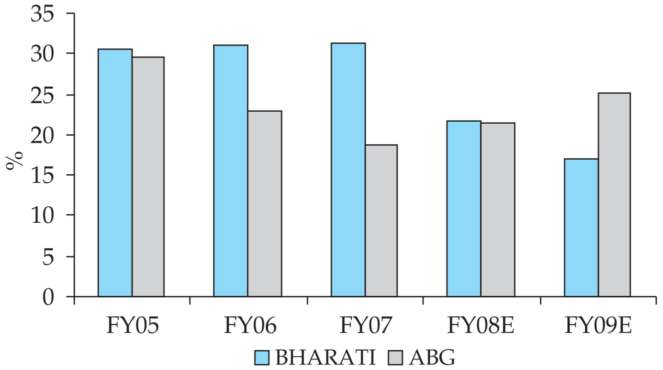
Source: SBICAP Research

As far as margins are concerned there is little to choose between the two companies.

The new yard of Bharati at Mangalore is situated in a SEZ .Also ABG's new yard at Dahej may get the SEZ status. Hence all export orders executed through these yards would be tax free. We expect the tax burden rate to fall progressively for both the companies.

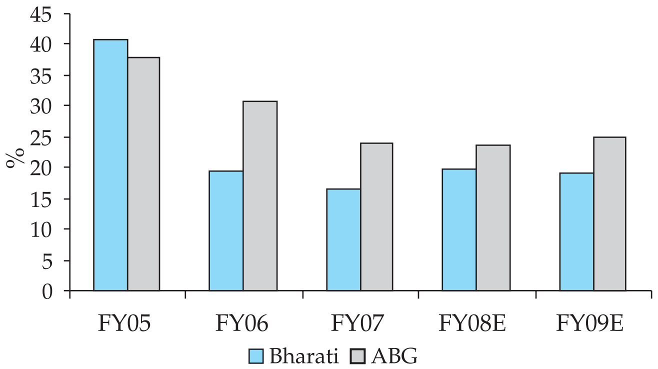
We expect the present shipbuilding subsidy scheme (due to expire in August 2007) to be extended by the government. We, however, factor in subsidy as a proportion of shipbuilding revenues to decline from 17% to 12% by FY09E and decline further going ahead. This would be primarily due to a higher percentage of domestic order books, SEZ status to the new yards and rig building contracts which are not eligible for subsidy.

ROE



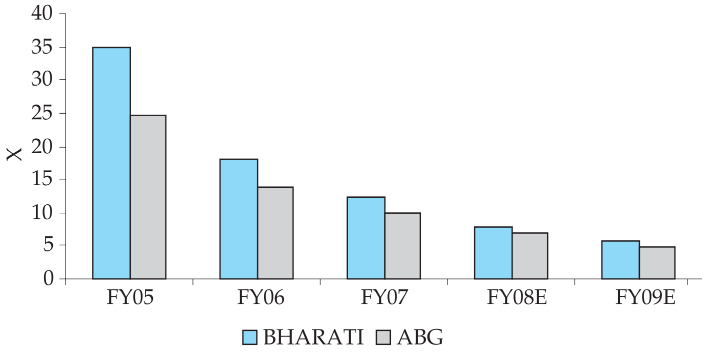
Source: SBICAP Research

ROCE



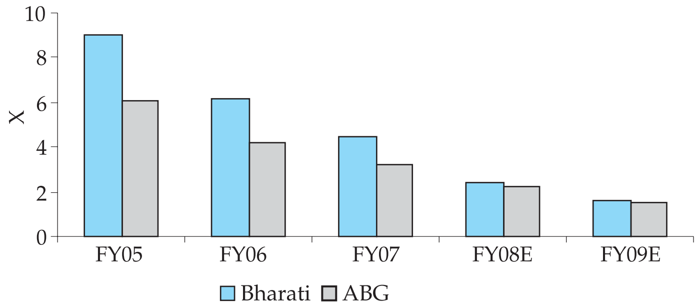
Source: SBICAP Research

EV/EBIDTA



Source: SBICAP Research

EV/SALES



Source: SBICAP Research

Bharati has already raised the requisite finance via FCCBs to completely build their new yard at Mangalore where it would be constructing higher tonnage vessels upto 75000 DWT and also constructing shallow water jack up rigs for which it has already received an order form GE shipping. The FCCB issue of 450 crore has diluted the equity of the company by almost 50% issue has diluted which would effects its ROE in near future

The construction of Dahej shipyard of ABG is ahead of schedule. The company has already started accepting orders for the same and expect revenues from the yard form FY09.It has being constructed at a cost of Rs400 crores financed through the IPO proceeds and can build ships with capacity of up to 120,000 DWT, targeted at the dry-bulk segment.

The company also plans to set up a facility at Dahej to manufacture deep sea jack up rigs, a big ticket profitable segment. Company would be doing capex in a phase manner through a mix of debt and internal accruals for the same.

		Market Cap	Sales FY08E	Current Order Book	EV/EBITDA(X)		P/E (X)	
	(Rs/share)	(Rs mn)	(Rs mn)	(Rs mn)	FY08E	FY09E	FY08E	FY09E
Bharati shipyard ltd	530	11,000	6,808	38,500	7.8	5.8	12.3	9.1
ABG shipyard ltd.	450	22,340	9,182	41,000	6.5	4.5	12.7	9.2

Source: SBICAP Research

Going Forward

Bharati and ABG on the verge of ecoming internationally competitive

We believe the production of OSVs would be a stepping stone for Bharati and ABG in building higher tonnage vessels. India lacks a strong reputation for shipbuilding. Once Bharati shipyard and ABG shipyard earns a reputation for timely and quality building we expect them to migrate towards higher tonnage ships. Both Bharati and ABG has already earned a decent reputation for itself in overseas market considering 70% of the order book is from repeat customers and 60% is export order book. In fact, this impending shift towards building higher tonnage vessels can be seen in the capacity expansion programs of Bharati and ABG. They looking to expand its capacities substantially and make themselves internationally competitive in all segments of shipbuilding.

Even as the Indian shipbuilding industry is witnessing an unprecedented boom and the current players are unable to meet the increasing demand, a number of new players, including construction major L&T and Adani Group, have forayed into shipbuilding. L&T, which has received orders worth Rs.440 crores from Dutch major, Zadeko Ship, could pose a serious threat in the long run to ABG and Bharati, given its reputation in the construction business. L&T is planning to build a shipyard at Ennore near Chennai at a cost of Rs.2000 crores. Another player, Sea King International Ltd., which has received orders worth Rs.290 crores, is coming up with a shipyard spread across 200 acres at Pipavav, Gujarat

NOTES

Key to investment Ratings: Guide to the expected return relative to market over the next 12 months. 1=Buy (expected to outperform the market by 15 or more percentage points); 2=Outperform (expected to outperform the market by 5-15 percentage points); 3=Marketperform (expected to perform in line with the market); 4=Underperform (expected to underperform the market) by 5-15 percentage points); 5=Sell (expected to underperform the market by 15 or more percentage points)

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