

# Garware Offshore Services

**CMP: Rs 195**
**Target: Rs 239**
**BUY**

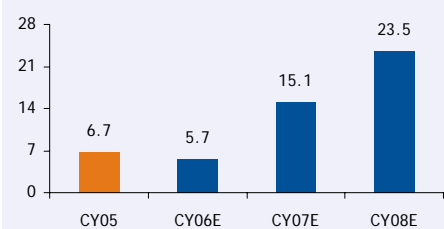
BSE Code 501848

## Financial Summary

(Rs mn)	CY06E	CY07E	CY08E
Sales	534.1	1,031.7	1,739.6
Growth(%)	73.0	93.2	68.6
Net Profit	134.4	358.6	557.3
Growth(%)	27.0	166.9	55.4
EPS(Rs)	5.7	15.1	23.5
Growth(%)	(15.6)	166.9	55.4
PER(x)	34.5	12.9	8.3
ROE(%)	13.1	21.8	24.7
EV/EBITDA(x)	8.0	3.5	1.9

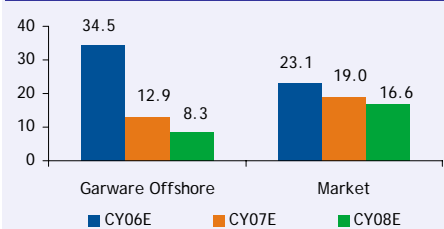
Source: Company; Brics PCG Research

## Annual EPS Trend (Rs)



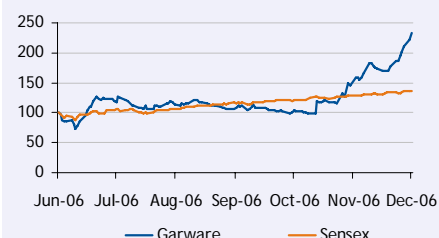
Source: Brics PCG Research

## Current P/E Multiples (x)



Source: Brics PCG Research

## Price Chart (Relative to Sensex)



Source: Capitaline

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## Smooth sailing

### Excellent Q3 results; we upgrade our price target

Garware Offshore's (GOL) Q3CY06 results have been spectacular, surpassing our expectations. Against our estimated EPS of Rs 2.1, GOL closed the quarter with an EPS of Rs 2.4 in Q3CY06. The management has now unveiled a new aggressive growth roadmap which involves ramping up its fleet from 5 vessels to 13 by the end of CY09, as against 10 previously planned. In view of the expansion, we are raising our earnings estimates for CY07 and CY08 by 29.9% and 68.5% respectively. We strongly reiterate our BUY call on the stock, revising our price target upwards by 61% to Rs 239. At this price, the stock is valued at a P/E of 10.2x on CY08, which we believe is reasonable.

## Estimated Vs Actual performance (Q3CY06)

(Rs mn)	Actual	Estimated	Variance (%)
Net sales	134.9	130.6	3.3
EBIDTA	73.7	71.6	2.9
EBIDTA margin (%)	54.6	54.8	-
PAT	44.2	39.2	12.8
PAT margin (%)	32.8	30.0	-
EPS (Rs)	2.4	2.1	12.8

Source: Company, Brics PCG Research

## Q3CY06 Financial summary

(Rs mn)	Q3CY06	Q2CY06	QoQ Growth (%)	Q3CY05	YoY Growth (%)
Sales	134.9	130.5	3.4	73.5	83.5
EBITDA	73.7	72.8	1.2	31.9	131.0
EBITDA Margin (%)	54.6	55.8	-	43.4	-
PAT	44.2	41.3	7.0	25.8	71.3
PAT Margin (%)	32.8	31.6	-	35.1	-
EPS (Rs)	2.4	2.3	4.8	1.8	31.8
Cash EPS (Rs)	3.2	3.1	-	2.3	42.9
Core EPS (Rs)	2.2	2.2	(1.6)	1.7	27.4

Source: Company

## Vessel acquisition in December '05 boosted revenue growth

GOL's Q3CY06 revenues delivered strong growth of 83.5% YoY on account of a fleet addition in December 2005 (a platform supply vessel built on the Rolls-Royce UT 755 model). This vessel is deployed with BG Exploration and Production (I) Ltd.

### Significant improvement in EBITDA margin

The operating profit margin expanded significantly to 54.6% in Q3CY06 from 43.4% in Q3CY05, mainly due to relatively lower staff and administrative expenses as a percentage of revenues. As a result, the operating profit has shot up 131% YoY to Rs 73.7mn.

### Strong earnings growth

GOL's net profit increased 71.3% YoY to Rs 44.2mn in Q3CY06, despite the inflated depreciation and interest costs.

### Fleet expansion programme

#### Seven vessels to join fleet by CY09

GOL currently operates one platform supply vessel (PSV) and four anchor handling tug supply vessels (AHTSV). The four AHTSVs are deployed with ONGC till May 2007. The company is likely to purchase four additional AHTSVs, two of them to be delivered in CY08 and the rest in CY09.

GOL has just completed the acquisition of a new PSV, which will shortly leave for India from a Norwegian shipyard. This PSV will be deployed with TransOcean on a three-year contract that will fetch an additional Rs 250mn annually from CY07. One of the old PSVs may also be sold in due course.

The company is further expecting another four PSVs to join the fleet, of which the first two will be delivered in April 2007 and September 2007 respectively. It is already in talks with Transocean and ONGC to contract a third PSV. The fourth PSV would either be contracted to ONGC or chartered in the spot market of the North Sea.

#### Strategic decision to target PSV time charter market

The North Sea spot market rates for PSVs are currently in the range of US\$20,000-\$25,000 per day which is substantially higher than the rates earned by GOL on its time charter contract with British Gas. However, the management has made a strategic decision to gain a foothold in the time charter market in Indian waters before venturing into the North Sea spot market where the operating conditions are much harsher and the company stands a risk of lowered utilisation rate on its vessels.

#### Expansion to be funded through a mix of equity and debt

We have estimated the total cost of the five PSVs at Rs 4.5bn and the four AHTSVs at Rs 3.2bn. Thus the company must mobilise Rs 7.7bn in all over the next three years to fund its fleet expansion. It proposes to do so via debt of around Rs 5.7bn, an equity issue of Rs 836mn (shares, warrants and fixed convertible debentures) and internal accruals for the balance.

#### Sources and uses of funds

(Rs mn)	CY06E	CY07E	CY08E	CY09E
Capital expenditure	900.0	2,600.0	2,400.0	1,700.0
Equity raised	454.3	346.1	18.0	18.0
Debt raised	372.5	2,101.3	1,951.2	1,275.0
Internal accruals	73.2	152.7	430.8	407.0

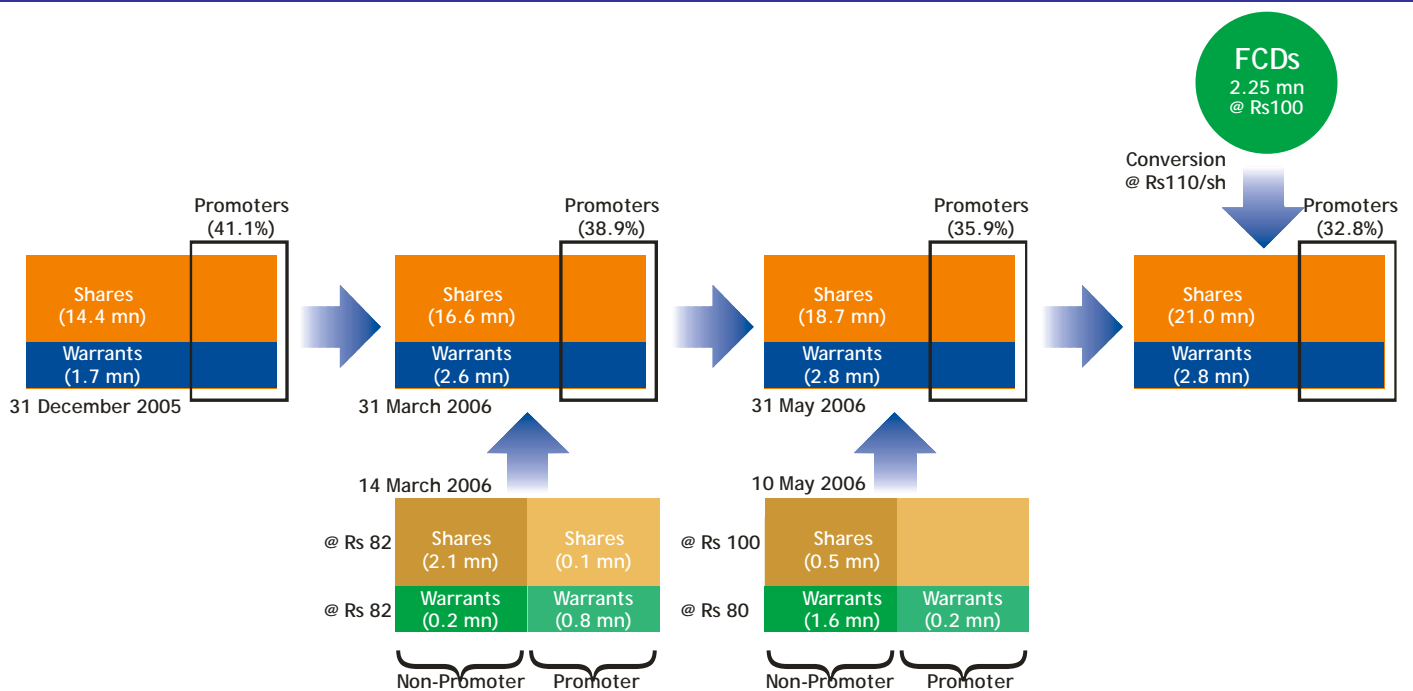
Source: Company; Brics PCG Research

GOL will be raising foreign currency debt at LIBOR plus 2.5% for funding the October 2006 and April 2007 PSV purchases. For the September 2007 purchase, GOL is in talks with a Norwegian bank for a loan at LIBOR plus 0.5%.

#### Promoter holding to change from 41% in CY05 to 33% by CY06

We have prepared an illustrative diagram explaining GOL's equity dilution process. We have also included warrants held while calculating the promoter holding in the company. The equity (including warrants) post-dilution would be Rs 235.4mn as compared to Rs 157.8mn as at December 31, 2005. This includes the conversion of the fixed convertible debentures into equity shares at the conversion price of Rs 125 per share. However, it does not include the planned FCCB issue of US\$25mn since the conversion price is not known.

#### Garware Offshore Services: Equity dilution (No. of shares/warrants)



Source: Company; Brics PCG Research

### Foray into management service contracts

GOL has recently signed an MoU with Havyard Leirvik AS wherein it will act as the latter's exclusive representative for the supply of vessels to Indian shipping companies and for the supply of Havyard designs to Indian shipyards. With this forward integration, the company has submitted a technical expression of interest to ONGC for the construction of 28 offshore supply vessels on behalf of Havyard Leirvik. The size of this deal is estimated to be in the range of Rs 16bn. We expect GOL to earn a commission of 3-5% of the contract value on such deals.

### Financial outlook

#### Profitability set to improve

After accounting for the additional PSV inductions into the company fleet in the next two years, we expect GOL's revenues to grow from Rs 309mn in CY05 to Rs 1.7bn in CY08 at a three-year CAGR of 78%. The four AHTSVs are earning an operating profit of about US\$1,700 per day per vessel currently. After the new PSV contracts commence, operating margins are expected to improve dramatically on account of the infusion of

US\$10,000 per day in operating profits from each of the new PSVs. This will support an expansion in operating margins from 44.3% in CY05 to an estimated 58.1% in CY08.

The net profit is expected to grow five-fold from Rs 106mn in CY05 to Rs 492mn in CY08, a three-year CAGR of 74%. Net margins are likely to remain at the same levels due to the higher depreciation charge and interest expense that the company would incur.

## Valuation

December 2007 target Rs 239

At the current market price, the stock is trading at P/E multiples of 12.9x and 8.3x on CY07E and CY08E respectively. We have used the average CY07E P/E multiples of global offshore service companies as a benchmark to value GOL. This has been applied to GOL's CY08E EPS since this will reflect the full upside potential from the higher realisation rates and the new assets coming on stream. The resultant value is then discounted back to CY07E using 16% cost of equity.

We reiterate our **BUY** call on the stock with a target of Rs 239, upgraded from Rs 148 earlier, to build in the impact of the company's fleet expansion plans.

### Garware Offshore: P/E-based valuation

	(Rs)
GOL's CY08E EPS	23
Avg CY08E P/E x for global offshore companies	12
GOL's 2-year forward share value	277
Cost of equity (%)	16
Target share price (December 2007)	239

Source: Brics PCG Research

### Valuations of global offshore service companies

Peer comparison

	—P/E—		—EPS (US\$)—		CMP (\$)
	CY06	CY07	CY06	CY07	
Helix Energy Solution Group	12.3	10.5	2.9	3.4	35.6
FMC Technologies	21.0	19.6	2.9	3.1	60.9
Global Santa Fe	16.4	10.4	3.7	5.8	60.6
Nabros Industries	9.2	7.9	3.6	4.2	33
Noble Corp	14.7	11.0	5.4	7.2	79.3
Precision Drilling Trust	6.3	7.8	4.6	3.7	29
Rowan Cos	12.2	8.5	2.9	4.2	35.5
Tidewater	9.6	12.2	5.6	4.4	53.6
TODCO	13.8	8.0	2.9	5	39.9
Transocean	27.2	13.2	2.9	6	79
Dril-Quip	20.6	18.8	2.1	2.3	43.2
Aban Offshore (Rs)	52.8	14.0	22	83	1162
Global average	18.0	11.8	—	—	—

Source: Bloomberg; Brics PCG Research

## Financials

### Profit & Loss Statement

Year-end Dec (Rs mn)	CY05	CY06E	CY07E	CY08E
Revenues	308.6	534.1	1,031.7	1,739.6
% change yoy	(3.2)	73.0	93.2	68.6
EBITDA	136.6	244.7	552.6	1,010.2
% change yoy	(1.5)	79.2	125.8	82.8
Depreciation	35.7	72.4	104.7	191.4
EBIT	100.8	172.3	447.9	818.8
% change yoy	(7.0)	70.9	159.9	82.8
Interest	5.4	56.4	107.5	279.7
Other Income	18.6	18.6	18.6	18.6
EBT	114.1	134.5	358.9	557.6
% change yoy	8.6	17.9	166.9	55.4
Tax	8.2	0.1	0.3	0.3
as % of EBT	7.2	0.1	0.1	0.1
Net Income (adjusted)	105.8	134.4	358.6	557.3
% change yoy	(14.4)	27.0	166.9	55.4
Shares (mn)	15.8	23.8	23.8	23.8
EPS(Rs)	6.7	5.7	15.1	23.5
DPS(Rs)	1.3	1.1	1.2	1.7
CEPS(Rs)	1.9	36.9	4.3	40.7

Source: Company; Brics PCG Research

### Cash Flow

Year-end Dec (Rs mn)	CY05	CY06E	CY07E	CY08E
EBIT	119.4	190.9	466.4	837.3
Depreciation	35.7	72.4	104.7	191.4
Other income	—	—	—	—
Chg in working capital	5.3	(74.3)	(193.9)	(256.3)
Operating cash flow	160.5	189.0	377.2	772.5
Tax	8.2	0.1	0.3	0.3
Cash flow fm operations	146.9	132.5	269.4	492.4
Capex	(809.5)	(920.2)	(2,720.0)	(2,200.0)
(Inc)/dec in investments	(0.3)	0.0	0.0	0.0
Int/Div received	0.0	0.0	0.0	0.0
Cash flow from investing	(809.8)	(920.2)	(2,720.0)	(2,200.0)
Dividend paid	(19.8)	(25.4)	(29.4)	(39.7)
Interest paid	—	—	—	—
Proceeds fm equity	86.0	454.3	348.1	18.0
Incr/(decr) in debt	779.6	1,197.8	1,357.5	2,592.3
Cash flow fm financing	845.8	1,626.7	1,676.3	2,570.6
Change in cash	182.9	839.1	(774.3)	863.0

Source: Company; Brics PCG Research

### Balance Sheet

Year-end Dec (Rs mn)	CY05	CY06E	CY07E	CY08E
Cash and cash equivalents	29.2	877.5	101.3	964.2
Accounts receivable	146.0	241.3	466.2	767.0
Inventories	31.1	52.3	82.6	119.8
Others*	130.0	93.0	75.1	57.2
Current assets	336.3	1,264.1	725.2	1,908.1
LT investments	4.6	4.6	4.6	4.6
Net fixed assets	1,223.8	2,051.3	4,546.6	6,755.2
CWIP	59.8	80.0	200.0	0.0
Total assets	1,624.5	3,400.1	5,476.4	8,668.0
Payable	31.3	54.2	92.3	144.6
Others	36.6	43.9	49.1	60.7
Current Liabilities	67.9	98.1	141.5	205.3
LT debt	810.8	2,008.6	3,366.1	5,958.4
Other Liab(deferred tax)	0.0	0.0	0.0	0.0
Share capital	157.9	215.5	235.5	235.5
Reserves	587.9	1,093.7	1,749.1	2,284.6
Networth	745.8	1,309.2	1,984.5	2,520.1
Total Liabilities	1,624.5	3,415.9	5,492.1	8,683.8
BVPS(Rs)	102.9	145.1	233.2	368.8

Source: Company; Brics PCG Research

\* Others include loans & advances, other current assets & miscellaneous expenditure

### Ratios Analysis

Year-end Dec (Rs mn)	CY05	CY06E	CY07E	CY08E
EBITDA margin(%)	44.3	45.8	53.6	58.1
Net profit margin(%)	34.3	25.2	34.8	32.0
EPS growth(%)	(35.6)	(15.6)	166.9	55.4
Receivables(days)	169.8	209.0	217.3	202.0
Inventory(days)	4.6	5.6	6.4	7.5
Payables (days)	4.6	5.8	7.2	9.1
Current ratio(x)	5.0	12.9	5.1	9.3
Interest coverage(x)	18.8	3.1	4.2	2.9
Debt/equity ratio (x)	1.1	1.5	1.7	2.4
Sales/Gross fixed assets(x)	0.2	0.3	0.3	0.5
ROE(%)	16.0	13.1	21.8	24.7
ROCE(%)	8.8	6.8	10.1	11.5
EV/Sales(x)	6.3	3.6	1.9	1.1
EV/EBITDA(x)	14.3	8.0	3.5	1.9
Price to earnings(x)	29.1	34.5	12.9	8.3
Price to book value(x)	1.9	1.4	0.8	0.5
Price to cash earnings(x)	105.3	5.3	44.8	4.8

Source: Company; Brics PCG Research

## Recommendation history

SN	Date	Event	Target	Reco
1	18/01/06	Initiating Coverage	151	BUY
2	16/02/06	Target revised	148	BUY
3	06/12/06	Target revised	239	BUY

Source: Brics PCG Research



Source: Bloomberg

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**Definition:** Large Cap = MCap > Rs30bn;

Mid Cap = MCap Rs5bn < Rs30bn;

Small Cap = MCap < Rs5bn

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