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Not Rated

Great Offshore Ltd

August 27, 2008

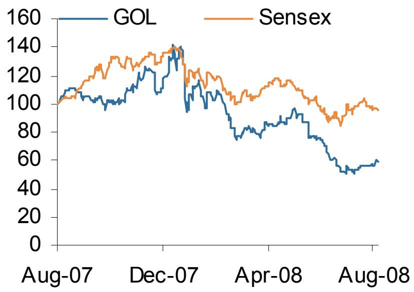
Sector: Oil-Allied Services

Sensex:	14,297
CMP (Rs):	457
52 Week h/l (Rs):	1,150/384
Market cap (Rscr) :	1,746
6m Avg vol ('000Nos):	137
No of o/s shares (mn):	38.1
FV (Rs):	10
Bloomberg code:	GOFF IN
Reuters code:	GOFS.BO
BSE code:	532786
NSE code:	GTOFFSHORE

Shareholding pattern

June 2008	(%)
Promoters	20.3
Foreign & institutions	34.8
Non promoter corp hold	8.0
Public & others	36.9

Share price trend



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We met the management of Great Offshore Ltd (GOL) and came back with a positive view on its business prospects. The company has increased its fleet size from 33 vessels in FY06 to 41 vessels presently and recently diversified into the marine engineering and construction business. In spite of strong operational performance and potential 26% PAT CAGR over the next three years, the stock plunged by 59% from its January 2008 high. Apart from deteriorating market valuations, other factors contributing to this decline include falling through of the proposed deal to acquire a company (Sea Dragon as per media reports) and crude receding from its highs.

Rising E&P investments lead to higher demand for allied services

At the end of 2007, India's crude oil reserves were at 5.5bn barrels, only 0.4% of global reserves. At the current rate of production, the country's crude oil reserves are likely to last for only 18.7 years. With more than 80% of the Indian sedimentary basin still under-explored, huge potential is left untapped. Majority of the offshore blocks offered in the first six rounds of National Exploration Licensing Programme (NELP) are either in exploration or development stage, leaving scope for further investments. This would lead to increased demand for offshore support services and GOL would be a major beneficiary.

Charter rates for offshore vessels likely to remain firm

Improved technology along with higher crude oil prices has made deepwater exploration economically viable. This would translate into increased investments in the offshore sector, leading to higher demand for offshore vessels. Although significant additions to the global fleet are expected in the near term, incremental supply would be absorbed by the industry. Ageing of existing fleet will tighten the demand-supply gap, keeping charter rates firm.

Company expansion well-timed

GOL has expanded its fleet size from 33 vessels in FY06 to 41 vessels currently. Two more vessels are currently on order, inclusive of one rig and one multi-support vessel. With asset prices surging over the past year, GOL's acquisitions have proved to be well-timed. The company's current debt-equity ratio stands at 1.1x, which is lower than that for global peers. This provides further room for expansion through acquisition of assets or companies.

Valuation summary

Period to (Rs mn)	FY07 (12)	FY08 (12)	FY09E (12)	FY10E (12)
Revenues	5,822	7,459	9,737	11,457
yoy growth (%)	49.9	28.1	30.5	17.7
Operating profit	2,628	3,124	4,934	5,819
OPM (%)	45.1	41.9	50.7	50.8
PAT	1,452	2,016	2,519	2,920
yoy growth (%)	49.6	38.9	24.9	15.9
EPS (Rs)	38.1	52.9	60.4	70.0
P/E (x)	12.0	8.6	7.6	6.5
P/BV (x)	2.8	2.0	1.5	1.3
EV/EBITDA (x)	9.2	7.6	5.4	4.2
ROE (%)	23.5	22.9	20.5	20.1
ROCE (%)	14.6	15.7	16.9	19.7

Source: Company, India Infoline Research

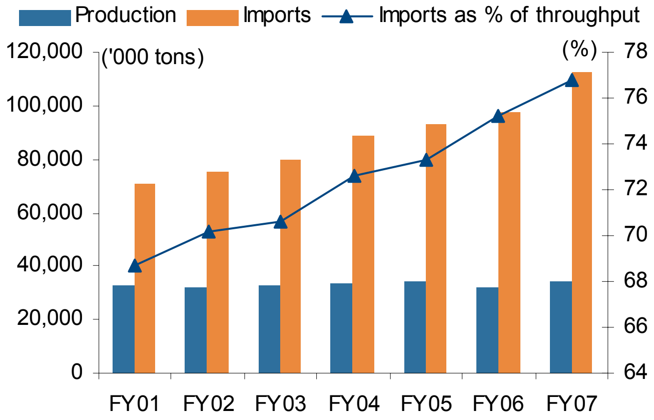
Investment rationale

Increased E&P spend to drive demand for oil-allied services

India derives almost 30% of its primary energy requirement from crude oil. However, the maximum available crude oil reserves in India are estimated at around 5.5bn barrels, or 0.4% of global reserves. This is extremely low, considering India shelters around 16% of the world's population. At the current rate of production, the country's crude oil reserves would likely last only for 18.7 years, as against 41.6 years globally. The current per-capita consumption of crude oil for the Indian population stands at 0.8bbl, which is significantly less than China (1.5bbl), Brazil (3.5bbl), Mexico (6bbl) and USA (25bbl).

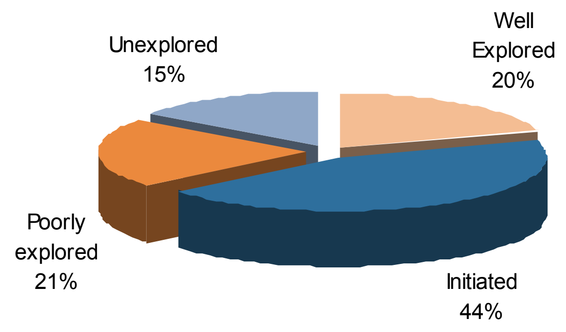
Currently, India imports more than 75% of its annual crude oil demand. With growing energy needs, investment in search for new oil reserves is an essential. Through NELP, the Government has made a conscious effort to draw investments from the private sector into the Indian E&P space. In the first six rounds of NELP, commitments of US$12bn have been made. The bidding process for the seventh round commenced in December 2007. These investments will spur demand for oil-allied services. GOL, with its integrated services product profile for the offshore segment of the E&P industry, is well poised to leverage on the opportunity.

Trend in production and import of crude oil in India



Source: Ministry of Petroleum & Natural Gas

Exploration status of the Indian sedimentary basin

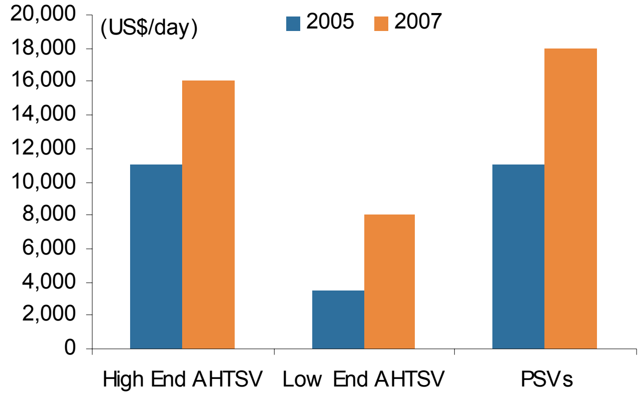


Source: Directorate General of Hydrocarbons

Charter rates to remain firm

Over the last couple of years, crude oil prices have galloped, and demand for offshore vessels has increased substantially. However, with no major supply of assets coming in, charter rates for these vessels have increased considerably. With crude oil prices hovering around US$120/bbl after touching a high of US$148/bbl, E&P activities have gained further momentum. Improved technology coupled with higher crude prices has made deepwater and ultra deepwater exploration economically viable. This would translate into increased investments in the offshore sector, leading to higher demand for offshore vessels. Although additions to global fleets are expected in the next couple of years, we believe incremental supply would be absorbed by the industry. Ageing of existing fleet will lead to tightening of demand-supply gap, which should keep charter rates for offshore vessels firm.

Trend in offshore vessel charter rates

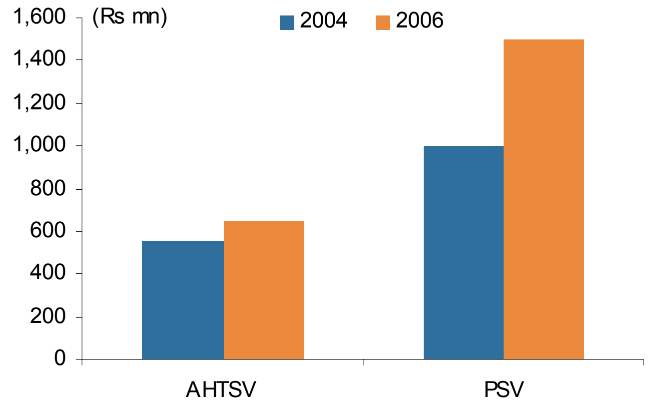


Source: Company

Well-timed fleet expansion

GOL has expanded its fleet from 33 vessels in FY06 to 41 vessels at present. This has proved to be a well-timed expansion, as asset prices have jumped over the last couple of years on the back of rising demand. In a scenario of rising day rates, lead time to breakeven for these newly acquired assets would decline. GOL has two vessels under construction—one jack-up rig and one multi-support vessel (MSV). The jack-up rig is expected to be delivered in January 2009 and the MSV in April 2009. The total outlay for these assets is US$225mn. These acquisitions would lower the average age of GOL's fleet and will reduce dependence on its existing assets. The new assets would result in margin expansion, as maintenance and repair costs for the new assets will be lower as compared to the old assets.

Increase in cost of new builds



Source: Industry

GOL's fleet expansion

Particulars	FY07	FY08	FY09E	FY10E
Offshore supply vessels				
High-end AHTSV	8	9	9	9
Low-end AHTSV	9	9	9	9
Platform supply vessels	7	7	7	7
Multi-role vessel	1	1	1	2
Rigs				
Jack-up rig (Kedarnath)	1	1	2	2
Drilling barge (Badrinath)	1	1	1	1
Harbour tugs	11	11	11	11
Cargo carrier	-	1	1	1
Construction barge	1	1	1	1
Total	**39**	**41**	**42**	**43**

Source: Company

Entry into marine construction provides huge opportunity

With huge investments expected in offshore oil and gas exploration, there will be increased demand for EPC contractors for oil platforms. Further, existing deepwater wells of ONGC are pretty old and require building up of new platforms. Thus, going ahead, EPC contractors would witness robust order flow. GOL, with its diversified fleet base and rich experience in the offshore business, aims to set a strong foothold in the EPC business. The company recorded total revenue of Rs250mn in FY08 and Rs210mn in Q1 FY09. Recently, it bagged an order worth Rs2.34bn from ONGC, to be executed in 24 months. Operating margin for the segment is 15%.

Increasing share of contract business: good revenue visibility

GOL's contractual business contributed about 75% of the company's revenue in FY08, up from 66% in FY06. This has improved the company's revenue visibility. GOL has been able to tie up its fleet at attractive charter rates over the last couple of years. With charter rates likely to remain firm in the near term, any renewals of contract would be further higher charter rates.

Recent deal called off, but low leverage gives scope for acquisitions

In January 2008, GOL had announced that it was close to acquiring a company (Sea Dragon as per media reports) having two sixth-generation semi-submersible drilling rigs at different stages of construction. The deal was pegged at US$1.4bn. However, the deal has been called off and the company is sitting on a cash balance of Rs3.2bn. GOL's debt-equity ratio stands at 1.1x, which is significantly lower as compared to global peers. This leaves further scope for acquisition of new vessels or asset-owning companies. Acquisition of a company would be a better bet compared to ordering new vessels, as lead time for deliveries is running high.

Strong growth in revenue and profit

Over the next couple of years, we believe that GOL will see robust growth both organically and inorganically. We expect GOL to register a CAGR of 25.3% and 26.2% in its revenue and profits respectively over FY08-10E. Increasing contribution of rigs and new assets to total revenue will lead to a sharp improvement in operating margins in the current year.

Concerns

- GOL's existing assets have aged considerably, causing repairing and dry-docking expenses to rise. The company expects to dry-dock 6-7 vessels every year.
- The company has two vessels on order. Any delay in deliveries of these vessels will affect GOL's future profitability and cash-flow earning capabilities.

Company background

GOL is one of India's leading integrated offshore oilfield services providers, offering a broad spectrum of services to upstream oil and gas producers to carry out offshore exploration and production (E&P) activities. From drilling services to marine and air logistics, from marine construction to port/terminal services and beyond, GOL meets a wide gamut of the offshore requirements of an E&P operator.

Since commissioning its operations in 1983, GOL has serviced major E&P operators in India as well as in the international waters of the North Sea, the Middle East, South Africa and South East Asia with its state-of-the-art vessels that include exploratory rigs, offshore support vessels, anchor-handling tug supply vessels and a construction barge. The company also provides port and terminal support services through a fleet of harbour tugs.

Offshore drilling

Great Offshore provides charter hire of drilling services with two offshore drilling units, Kedarnath and Badrinath. These assets are operated by a team of dedicated and experienced personnel with an excellent safety and maintenance record.

Kedarnath is an independent leg jack-up rig, built by Marathon LeTourneau in Brownsville, Texas. She is capable of operating in 300 feet of water with a drilling depth of up to 20,000 feet. She has drilled several exploratory wells, the deepest of which was 4,234 meters in the Bombay High oil field. The average downtime of the rig in the last seven years is less than 0.5%. With her experienced crew and strict compliance with the company's QHSE policy, Kedarnath has serviced major national and international oil companies such as ONGC, Hardy Exploration & Production, Mosbacher and Cairn Energy. At present Kedarnath is involved in a prestigious project with ONGC Videsh Ltd.

Badrinath is a drilling barge built by FELS in Singapore. She can operate in up to 600 feet of water with a drilling depth of up to 20,000 feet. Badrinath has drilled several exploratory wells on both the East and West coasts of India. The deepest well drilled by Badrinath was 4,991 meters. On one occasion, Badrinath drilled 2,900 meters in one month—one of the highest figures amongst all the rigs operating for ONGC. She has also drilled a horizontal section of 1,400 meters—one of the longest ever drilled by any rig in India. Badrinath has also undertaken re-entry and activation of wells on the East coast of India.

Offshore Logistics Support Services

GOL owns and operates a fleet of 26 Offshore Support Vessels—seven platform supply vessels, two fire-fighting support vessels, one offshore supply vessel, 12 anchor-handling tug supply vessels, one MSV and three anchor-handling tugs. GOL was the first Indian company to own and operate a platform supply vessel and the first to own and operate a fire fighting support vessel. The platform supply vessel fleet consists of seven UT755 design vessels with deadweights ranging from 2,600 to 3,300 tons.

GOL, with its offshore support vessels, undertakes production support, diving support, supply duties for personnel and materials, anchor handling, towing, mooring, rig moving, emergency response/rescue and fire fighting operations.

Marine Construction Projects and Services

GOL owns and operates construction barge Gal Constructor with a complementing anchor handling tug, designed to provide a complete package service to the offshore construction industry.

Gal Constructor can accommodate more than 240 personnel and has an onboard crane with lifting capacity of 120 tons capable of performing activities like hook-up and modification work, installation, maintenance and repairs to offshore structures, platform marine growth removal and inspection, riser Installation, inspection and repairs, harbor construction support services, sub sea pipeline and cable tie-ins, pipeline repair, pile driving, SBM installation and clamp-on projects.

Gal Constructor has successfully undertaken various types of projects both in India and internationally, with customers such as L&T, ONGC, SMOE, Iranian Offshore Engineering Construction Co, Mubarak Marine LLC and Hyundai Engineering.

GOL also undertakes lumpsum turnkey / EPC projects for the offshore oil & gas industry. These activities include project management, pre-engineering surveys, design & detailed engineering, procurement, fabrication, transportation, offshore installation and hook-up & commissioning. GOL also specialises in execution of brownfield projects specifically pertaining to process and structural revamping.

Port and Terminal Support Services

GOL was the first Indian operator of harbour tugs in India, with a presence in almost all major ports. These tugs have excellent maneuvering capabilities: eight of them are fitted with azimuth propulsion systems; one with a Voith system, one with a Z-propeller system and one is a conventionally propelled tug.

The fleet of 11 harbour tugs operates in major ports such as Jawaharlal Nehru Port Trust, Mumbai Port Trust, Kolkata Port Trust, Tuticorin Port Trust, New Mangalore Port Trust as well as in private ports like Gujarat Pipavav Port Ltd, Gujarat Adani Port Ltd, Hazira Port Pvt. Ltd and Mundra Port. The tugs provide round-the-clock service at ports for berthing/unberthing, towing of vessels, emergency fire fighting and all other harbour operations.

Current fleet profile

Asset	Construction year	Age (yrs)
Drilling		
Badrinath	1973	35
Kedarnath	1975	33
PSVs		
Malaviya 16	2002	6
Malaviya 18	2002	6
Malaviya 19	2004	4
Malaviya 20	2004	4
Malaviya 24	2005	3
Malaviya 29	2006	2
Malaviya 30	2006	2
AHTSVs		
Malaviya 1	1983	25
Malaviya 2	1983	25
Malaviya 3	1984	24
Malaviya 4	1984	24
Malaviya 5	1982	26
Malaviya 6	1981	27
Malaviya 10	1999	9
Malaviya 21	2005	3
Malaviya 23	2007	1
Malaviya 28	2006	2
Malaviya 33	1978	30
Malaviya 34	1984	24
Fire Fighting		
Malaviya 25	2006	2
Malaviya 27	2006	2
MSV		
Malaviya 36	1987	21
AHTs		
Gal Beaufort Sea	1982	26
Gal Ross Sea	1982	26
Sangita	1994	14
Supply vessel		
Malaviya 12	1989	19
Harbour tugs		
Anasuya	1997	11
Rishabh	1985	23
Malini	1987	21
Jyotsna S.	1989	19
Kanti	1998	10
Kumari Tarini	1998	10
Sudhir Mulji	1998	10
Vahbiz	1999	9
Ananya	2000	8
Purnima	2000	8
Birsingha	2001	7
Construction Barge		
Gal Constructor	1978	30
Average Age		15

Source: Company

Financials

Income statement

Period to (Rs mn)	FY07 (12)	FY08 (12)	FY09E (12)	FY10E (12)
Net sales	5,822	7,459	9,737	11,457
Operating exp	(3,194)	(4,335)	(4,803)	(5,638)
Operating profit	2,628	3,124	4,934	5,819
Other income	79	735	150	150
PBIDT	2,707	3,859	5,084	5,969
Interest	(361)	(684)	(651)	(528)
Depreciation	(709)	(986)	(1,489)	(1,672)
Profit before tax	1,638	2,190	2,944	3,769
Tax	(186)	(173)	(426)	(849)
Profit after tax	1,452	2,016	2,519	2,920

Balance sheet

Period to (Rs mn)	FY07 (12)	FY08 (12)	FY09E (12)	FY10E (12)
Sources				
Share capital	381	381	417	417
Preference share		1,500	1,500	1,500
Reserves	5,795	6,934	10,386	12,629
Net worth	6,176	8,815	12,303	14,546
Loan funds	7,466	9,461	9,000	7,300
Total	**13,641**	**18,277**	**21,303**	**21,846**
Uses				
Gross block	13,789	14,972	22,625	25,405
Accd dep	(4,120)	(4,974)	(6,463)	(8,135)
Net block	9,669	9,998	16,162	17,269
Capital WIP	3,221	3,906	2,000	1,000
Total fixed assets	12,890	13,905	18,162	18,269
Investments	1	182	185	185
Total CA	2,291	6,583	6,098	7,080
Total CL	(1,573)	(2,460)	(3,222)	(3,788)
Net working cap	718	4,124	2,876	3,292
Def tax assets	33	66	80	100
Total	**13,641**	**18,277**	**21,303**	**21,846**

Key ratios

Period to	FY07 (12)	FY08 (12)	FY09E (12)	FY10E (12)
Per share ratios (Rs)				
Earning per share	38.1	52.9	60.4	70.0
Dividend per share	8.0	16.0	18.0	20.0
Book value per share	162.0	231.3	295.0	348.8
Valuation ratios (x)				
P/E	12.0	8.6	7.6	6.5
P/BV	2.8	2.0	1.5	1.3
EV/sales	4.2	3.2	2.7	2.1
EV/ PBIT	12.2	8.2	7.4	5.7
EV/PBIDT	9.0	6.1	5.2	4.1
Profitability ratios (%)				
OPM	45.1	41.9	50.7	50.8
PAT	24.9	27.0	25.9	25.5
ROCE	19.8	21.1	23.9	27.3
RONW	23.5	22.9	20.5	20.1
Liquidity ratios				
Current ratio	1.5	2.7	1.9	1.9
Debtors days	77.7	85.5	90	90
Inventory days	4.0	3.8	4.0	4.0
Creditors days	80.6	72.3	80.0	80.0
Leverage ratios				
Debt / Total equity	1.2	1.1	0.7	0.5
Component ratios (% of net income)				
Hire charges	5.3	0.6	5.8	5.6
Repairs	12.6	11.6	9.0	8.3
Staff cost	19.0	20.2	18.7	18.5
Other expenditure	18.1	25.8	15.8	16.8
Payout ratios (%)				
Dividend payout	23.9	36.1	26.9	29.8
Tax payout	11.3	7.9	14.5	22.5

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