ABG Shipyard (ABGS.BO)

Target price change ☑
Estimate change ☑

Buy: Increasing Target as New Orders Further Improve Visibility

- **Another huge order win** — Following the US$360m new order win from Precious Shipping of Thailand in July, ABG announced yesterday another huge order win from a German shipping company. We view the new US$360m order (12 Handysize bulk carriers, 35K DWT each, 2010-12 deliveries) as extremely positive as it locks in the new upcoming capacities for the next few years.
- **Significant improvement in visibility** — ABG's total order book now stands at Rs71bn (Rs56bn earlier), with the unexecuted portion providing a cover of ~6.7x FY08E sales. This also includes an option for 2 bulk carrier orders worth US$70m, which Essar Shipping has now exercised. The new order wins substantially enhance order and earnings visibility, with shipbuilding capacity at the upcoming Dahej yard now almost completely booked for 3-4 years.
- **Value accretion from WISL acquisition** — The acquisition of Western India Shipyard, a ship and rig repair facility, has received board approval and now awaits other regulatory sanctions. In the absence of financial details of the transaction, we are currently not consolidating WISL with ABG. However, we believe that the acquisition could add a further 7% (Rs161m, Rs3/share) to ABG's FY09E earnings for its c.55% share, which we now build into our TP.
- **TP increased to Rs775** — We are increasing our TP to Rs775 (Rs 560 earlier) as we increase our target multiple to 15x FY09E earnings (12x earlier) to reflect higher visibility of growth (EPS CAGR of 52% over FY08-10E) and the value accretion from the WISL acquisition (Rs47/share). We reiterate Buy(1M) rating.

Buy/Medium Risk	1M
Price (28 Sep 07)	Rs646.90
Target price	Rs775.00
from Rs560.00	
Expected share price return	19.8%
Expected dividend yield	0.3%
Expected total return	**20.1%**
Market Cap	Rs32,941M
	US$832M

Price Performance (RIC: ABGS.BO, BB: ABGS IN)

Statistical Abstract

Year to 31 Mar	Net Profit (RsM)	Diluted EPS (Rs)	EPS growth (%)	P/E (x)	P/B (x)	ROE (%)	Yield (%)
2006A	837	16.44	19.4	39.4	6.8	26.3	0.2
2007A	1,163	22.83	38.9	28.3	5.6	21.7	0.2
2008E	1,552	30.47	33.5	21.2	4.5	23.5	0.3
2009E	2,467	48.45	59.0	13.4	3.4	29.1	0.4
2010E	3,570	70.10	44.7	9.2	2.5	31.6	0.5

Source: Powered by dataCentral

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

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Fiscal year end 31-Mar	2006	2007	2008E	2009E	2010E
Valuation Ratios					
P/E adjusted (x)	39.4	28.3	21.2	13.4	9.2
EV/EBITDA adjusted (x)	22.4	16.8	14.1	9.4	7.0
P/BV (x)	6.8	5.6	4.5	3.4	2.5
Dividend yield (%)	0.2	0.2	0.3	0.4	0.5
Per Share Data (Rs)					
EPS adjusted	16.44	22.83	30.47	48.45	70.10
EPS reported	16.44	22.83	30.47	48.45	70.10
BVPS	94.74	115.44	143.57	189.10	255.10
DPS	1.20	1.50	2.00	2.50	3.50
Profit & Loss (RsM)					
Net sales	5,433	7,061	10,295	17,946	26,022
Operating expenses	-4,060	-5,166	-7,679	-13,720	-20,006
EBIT	**1,373**	**1,895**	**2,616**	**4,226**	**6,015**
Net interest expense	-167	-267	-315	-752	-1,108
Non-operating/exceptionals	61	53	50	50	50
Pre-tax profit	**1,267**	**1,681**	**2,351**	**3,524**	**4,958**
Tax	-430	-518	-799	-1,057	-1,388
Extraord./Min.Int./Pref.div.	0	0	0	0	0
Reported net income	**837**	**1,163**	**1,552**	**2,467**	**3,570**
Adjusted earnings	837	1,163	1,552	2,467	3,570
Adjusted EBITDA	1,409	1,955	2,696	4,394	6,253
Growth Rates (%)					
Sales	44.2	30.0	45.8	74.3	45.0
EBIT adjusted	54.3	38.1	38.0	61.5	42.3
EBITDA adjusted	53.0	38.7	37.9	63.0	42.3
EPS adjusted	19.4	38.9	33.5	59.0	44.7
Cash Flow (RsM)					
Operating cash flow	**1,064**	**-4,593**	**-1,340**	**-269**	**-68**
Depreciation/amortization	36	60	80	168	238
Net working capital	190	-5,815	-2,972	-2,903	-3,875
Investing cash flow	**-617**	**-1,481**	**-3,400**	**-3,000**	**-3,000**
Capital expenditure	-617	-1,481	-3,400	-3,000	-3,000
Acquisitions/disposals	0	0	0	0	0
Financing cash flow	**2,731**	**3,009**	**3,331**	**2,851**	**2,791**
Borrowings	267	3,099	3,450	3,000	3,000
Dividends paid	-70	-89	-119	-149	-209
Change in cash	**3,567**	**-2,651**	**-777**	**387**	**749**
Balance Sheet (RsM)					
Total assets	**10,267**	**16,391**	**22,464**	**33,318**	**45,674**
Cash & cash equivalent	4,053	1,402	375	762	1,511
Accounts receivable	61	81	118	206	299
Net fixed assets	1,560	2,963	6,283	9,115	11,878
Total liabilities	**5,443**	**10,512**	**15,153**	**23,689**	**32,684**
Accounts payable	2,378	4,141	5,775	10,476	15,386
Total Debt	997	4,096	7,546	10,546	13,546
Shareholders' funds	**4,824**	**5,878**	**7,311**	**9,629**	**12,990**
Profitability/Solvency Ratios (%)					
EBITDA margin adjusted	25.9	27.7	26.2	24.5	24.0
ROE adjusted	26.3	21.7	23.5	29.1	31.6
ROIC adjusted	40.2	22.2	14.0	16.7	18.4
Net debt to equity	-63.3	45.8	98.1	101.6	92.6
Total debt to capital	17.1	41.1	50.8	52.3	51.0

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Incorporating WISL acquisition

We now incorporate value accretion from the Western India Shipyard (WISL) acquisition into our valuation. However, as we await financial details of the transaction, we are currently not consolidating the same into our earnings estimates for ABG.

WISL is one of India's largest ship and rig repair facilities situated in Goa with state-of-the-art machinery and equipment. ABG would acquire c.55% in the company following the transaction (given that the acquisition of shares is under a restructuring arrangement between the lenders and ABG, the latter is not mandated to make an open offer). Based on our discussions with management, WISL is likely to contribute c.Rs1.5bn, on a conservative basis, to revenues in FY09E (peak revenues envisaged at c.Rs2bn). Given the high operating margins of the business (c.40%), the net income attributable to ABG is likely to be Rs161m or Rs3/share (7% of FY09E ABG-ex WISL earnings) on our estimates.

Figure 1. Western India Shipyard Assumptions

Rs m	**FY09E**
Sales	1,500
EBITDA	600
EBITDA margin	*40%*
Interest	108
Depreciation	48
PBT	444
Tax	151
Tax rate	*34%*
PAT	293
ABG's share (c.55%)	161
% of FY09E standalone PAT	**6.5%**
EPS accretion (Rs/share)	**3.2**

Source: Citi Investment Research estimates

Upgrading standalone earnings

We are increasing our FY09-10E earnings for ABG (ex-WISL) by 4-7% to factor in the strong order book, timely execution of the Dahej expansion, and contribution from Vipul Shipyard, a shipyard adjacent to the Surat facility which was acquired a few months back. The company plans to spend c.Rs1bn for modernization of the newly acquired yard, which we also build into our forecasts. Though the new order wins itself do not meaningfully change our forecasts, given that we were already building into our estimates receipt of orders in future, earnings visibility improves markedly, with the unexecuted order book providing a cover of ~6.7x FY08E sales. Key to note here is that the recent orders that have been won by the company are also eligible for subsidy, given that the contracts were signed in July, prior to the expiry of the scheme in August. Hence, there should be no risk to estimates over our forecast horizon even if the scheme is not extended.

Figure 2. ABG Shipyard – Earnings Revision

Year to	Net Profit (Rs Mils.)		Diluted EPS (Rs)			Div. Per Share (Rs)	
31-Mar	Old	New	Old	New	% Chg	Old	New
2008E	1,560	1,552	30.64	30.47	-0.5%	2.0	2.0
2009E	2,381	2,467	46.75	48.45	3.6%	2.5	2.5
2010E	3,344	3,570	65.67	70.10	6.8%	3.5	3.5

Source: Citi Investment Research estimates

Increasing target price to Rs775

We are increasing our target price to Rs775 (Rs560 earlier) on the back of: (1) increase in our FY09E target PE multiple from 12x to 15x, (2) incorporation of value accretion from the WISL acquisition, and (3) earnings upgrade in FY09-10E.

The increase in our target multiple is primarily driven by the significant increase in earnings visibility following the two US$360m orders that the company has announced over the last two months. The total order book now stands at Rs71bn, with the unexecuted portion providing a cover of ~6.7x FY08E sales. This also includes an option for 2 bulk carrier orders worth US$70m, which Essar Shipping has now exercised. With these new orders, the company has now tied in orders for the upcoming Dahej yard for the construction of 33 vessels in all, with capability to receive orders for another ~4-5 vessels.

Receipt of these vessel orders would result in the Dahej facility being almost completely booked out for the next three to four years, enhancing earnings visibility considerably and reducing the uncertainty in what has otherwise been a typical cyclical industry. This is the primary reason for the increase in our target multiple from 12x to 15x. Our target multiple is at a slight premium to other similar-sized Singapore shipyards, justifiably so, in our view, given the marked difference in earnings growth over the next few years (9-22% vs. 52% for ABG over FY08-10E). We believe the target multiple is, however, at a reasonable discount to Keppel Corp and SembCorp Marine, which are much larger and have strong capabilities in design and construction of rigs and other offshore structures and vessels (ABG is also planning to enter the rig building segment, though it has not received any order as yet).

Figure 3. Singapore Shipyards – Valuations

Company Name	RIC Code	Rating	Mkt. cap. (US$m)	P/E (2008E)	P/E (2009E)	EPS CAGR (07-09E)
Jaya Holdings	JAYA.SI	NR	1,016	11.6	10.4	9.7%
Labroy Marine Ltd	LABR.SI	NR	1,342	13.0	11.1	21.9%
Pan-United Marine Ltd	PAUM.SI	NR	427	11.9	na	18.7%*
ASL Marine Holdings Ltd	ASLM.SI	NR	281	9.7	8.5	8.7%
Average				**11.5**	**10.0**	
Keppel Corp	KPLM.SI	1L	15,160	17.7	15.5	19.7%
SembCorp Marine	SCMN.SI	1L	6,412	21.4	18.1	24.6%

Source: I/B/E/S and Citi Investment Research estimates. *CY07-08E EPS growth.

The target multiple of 15x FY09E earnings also compares favorably with the imputed target P/E of Korean shipyards (average 22.1x CY08E, 15.1x CY09E), which though much larger in scale (catering primarily to vessels such as large crude carrier, containerships, and LNG tankers), have similar earnings growth over the next few years. On our target price, the imputed P/B multiple for ABG would also be at a substantial discount to the Korean shipbuilders, as illustrated in Figure 4 below.

Figure 4. ABG vs. Korean Shipyards – Valuation Comparisons

			Target P/E		Target P/B		EPS CAGR
Company Name	**RIC Code**	**Rating**	**CY08E**	**CY09E**	**CY08E**	**CY09E**	**(CY07-09E**
ABG Shipyard	ABGS.BO	1M	16.0	11.1	4.1	3.0	51.7%
Hyundai Heavy Industries	009540.KS	1M	22.9	16.7	7.7	5.6	47.1%
Hyundai Mipo Dockyard	010620.KS	1M	21.5	16.8	5.1	4.1	13.2%
Daewoo Shipbuilding & Marine Engineering	042660.KS	1L	21.4	13.0	8.0	5.3	86.3%
Samsung Heavy Industries	010140.KS	1L	22.8	14.0	6.7	4.8	68.6%
Korean Average			**22.2**	**15.1**	**6.9**	**4.9**	

Source: Citi Investment Research estimates

ABG also compares favorably with the Chinese shipyards in terms of earnings growth, as shown in Figure 5 below. However, the extent of ABG's discount (~70%) to the valuations of Chinese shipyards appears unwarranted.

Figure 5. Chinese Shipyards – Valuations

Company Name	RIC Code	Rating	Mkt. cap. (US$m)	P/E (2008E)	P/E (2009E)	EPS CAGR (07-09E)
Guangzhou Shipyard International	600685.SS	NR	3,777	42.5	35.2	23.3%
China State Shipbuilding Co	600150.SS	NR	24,619	48.1	39.2	49.2%
Yangzijiang Shipbuilding Holdings	YAZG.SI	NR	4,541	23.7	17.0	58.5%
Average				**38.1**	**30.4**	

Source: I/B/E/S

Near-term catalysts

Key catalysts for the stock over the next few months, in our view, could be:

1. Announcement of an order for the construction of a rig – Though this would be a big-ticket item, it may not immediately come through, given that the yard would only be commissioned by end-08E.

2. Approval of SEZ status for the Dahej facility – This would essentially provide tax incentives and consequently neutralize the impact of subsidy on revenues from the Dahej yard.

3. Extension of the subsidy scheme – Though the scheme expired in August 2007, there is still no clarity on either extension or termination of the scheme. However, according to industry participants and media reports (Economic Times), it appears likely that the scheme may be extended by another few years, though the quantum of subsidy may be reduced from the current 30%. We note that almost the entire order book of the company is currently eligible for subsidy, as all contracts were signed before the expiry of the scheme in August 2007.

4. New orders, albeit smaller-sized, for the Surat yard, catering primarily to the offshore segment.

ABG Shipyard

Company description

ABG Shipyard, the largest private sector yard in India, has built more than 90 ships since 1990. It has a shipbuilding facility in Magdala, near Surat in Gujarat, which is focused on the offshore support vessel market. It is now setting up a new shipyard at Dahej besides expanding its capacity at Surat. The first phase of the Dahej shipyard, being constructed at a cost of c.Rs4bn, 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 rigs, a big-ticket profitable segment.

Investment strategy

ABG Shipyard is India's leading private shipbuilder and has one of the world's largest AHTS (Anchor Handling Tug) order books. The company has a robust order book of Rs71bn, providing strong earnings visibility for the next 3-4 years. Fundamentals for Indian shipbuilders remain robust, driven by: (1) continued tightness in the global shipbuilding sector and (2) the robust E&P cycle ensuring demand in the OSV segment. ABG has expanded its existing yard at Surat and is building a new greenfield yard at Dahej, which will likely be commissioned in April 2008. The Dahej yard will have capability to produce ships up to 120,000 DWT and is targetted at the fast growing dry-bulk segment. In its second phase of expansion, the yard would also have a rig-building facility. This should increase the order book execution rate and provide an entry into new shipbuilding segments. Further, we view the recent acquisition of Western India Shipyard as a key positive, giving the company a strong presence in the high margin ship and rig repair business.

Valuation

We rate ABG Shipyard Buy/Medium Risk (1M). We value ABG at Rs775, which is 15x FY09E earnings, at a slight premium to other similar profiled Singapore shipyards that have significantly lower earnings growth, but in line with our target multiples for the Korean shipyards. Given ABG's superior earnings CAGR of 52% over FY08-10E and an order book that provides a cover of ~6.7x FY08E sales, we believe the stock deserves to trade at a slight premium to its Singapore peers, subsidy concerns notwithstanding. Our target price also includes Rs47/share as the value accretion to ABG following the recent acquisition of Western India Shipyard.

Risks

We rate ABG Shipyard Medium Risk, which differs from our 260-day quantitative rating of High Risk. We believe the lower rating is justified given the strong order book cover of ~6.7x FY08E sales driven by the continued tightness in global shipbuilding and strong demand from the offshore segment. Being a small shipyard in the global context, ABG is subject to industry-wide risk factors that include a rise in raw material costs and a steep rise in global ship building capacity. Other key risks include: 1) removal of subsidies; 2) declining oil prices; and 3) execution risk. If the impact on the company from any of these factors proves to be greater than we anticipate, the stock will likely have difficulty achieving our price target.

Appendix A-1

Analyst Certification

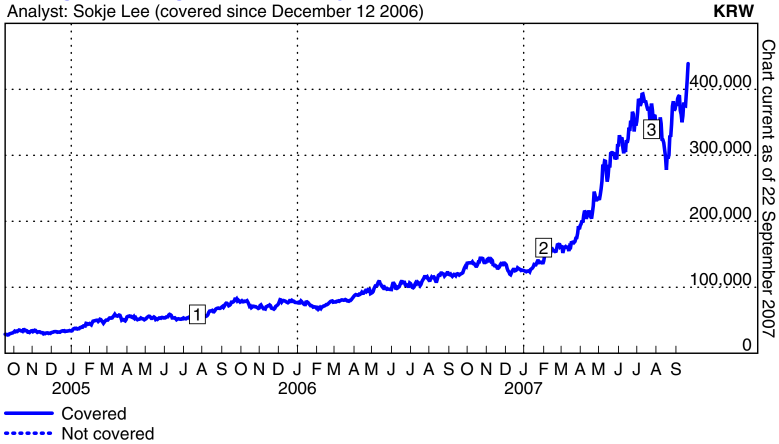
Each research analyst(s), strategist(s) or research associate(s) responsible for the preparation and content of this research report hereby certifies that, with respect to each issuer or security that the research analyst, strategist or research associate covers in this research report, all of the views expressed in this research report accurately reflect their personal views about those issuer(s) or securities. Each research analyst(s) strategist(s) or research associate(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, strategist or research associate in this research report.

IMPORTANT DISCLOSURES

Hyundai Heavy Industries (009540.KS)

Ratings and Target Price History - Fundamental Research

Analyst: Sokje Lee (covered since December 12 2006)



#	Date	Rating	Target Price	Closing Price
1:	25 Jul 05	*3M	32,500.00	55,900.00
2:	1 Feb 07	*1L	*235,000.00	139,500.00
3:	25 Jul 07	*1M	*840,000.00	378,500.00

*Indicates change.

Samsung Heavy Industries (010140.KS)

Ratings and Target Price History - Fundamental Research

Analyst: Sokje Lee (covered since December 12 2006)

#	Date	Rating	Target Price	Closing Price
1:	25 Jul 05	*3M	6,100.00	10,900.00
2:	24 Apr 07	*1L	*33,000.00	30,300.00
3:	25 Jul 07	1L	*101,000.00	51,900.00

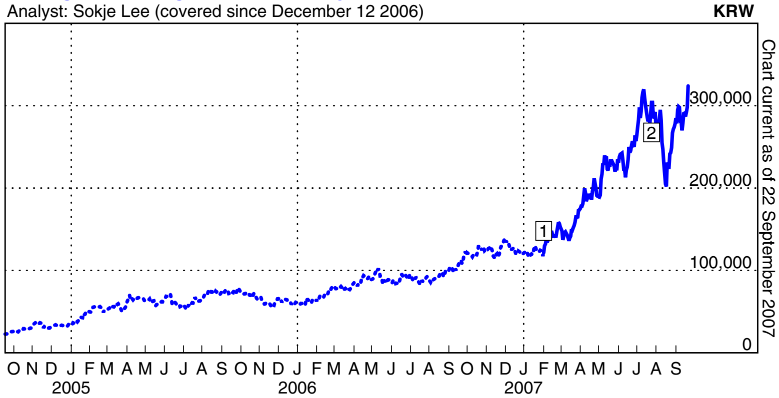
*Indicates change.

Hyundai Mipo Dockyard (010620.KS)

Ratings and Target Price History - Fundamental Research

Analyst: Sokje Lee (covered since December 12 2006)

KRW



Covered
Not covered

#	Date	Rating	Target Price	Closing Price
1:	1 Feb 07	1M	245,000.00	121,500.00
2:	25 Jul 07	1M	*660,000.00	304,000.00

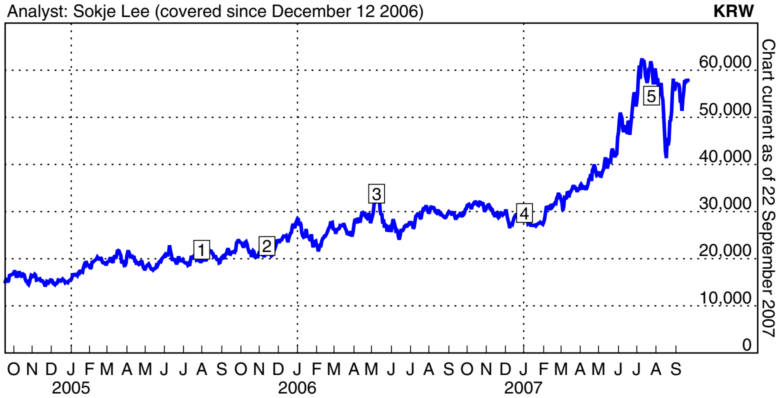
*Indicates change.

Daewoo Shipbuilding & Marine Engineering (042660.KS)

Ratings and Target Price History - Fundamental Research

Analyst: Sokje Lee (covered since December 12 2006)

KRW



Covered
Not covered

#	Date	Rating	Target Price	Closing Price
1:	1 Aug 05	*2M	*22,900.00	20,900.00
2:	14 Nov 05	2M	*24,000.00	21,650.00
3:	9 May 06	*3M	24,000.00	31,900.00
4:	2 Jan 07	*1M	*42,000.00	29,700.00
5:	25 Jul 07	*1L	*120,000.00	61,200.00

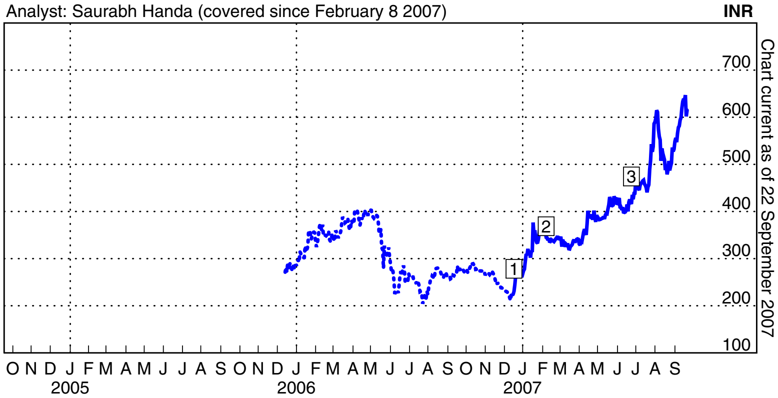
*Indicates change.

ABG Shipyard (ABGS.BO)

Ratings and Target Price History - Fundamental Research

Analyst: Saurabh Handa (covered since February 8 2007)

INR



Covered
Not covered

#	Date	Rating	Target Price	Closing Price
1:	18 Dec 06	1M	291.00	230.10
2:	7 Feb 07	1M	*430.00	345.15
3:	25 Jun 07	1M	*560.00	416.00

*Indicates change.

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Data current as of 19 July 2007	**Buy**	**Hold**	**Sell**
Citi Investment Research Global Fundamental Coverage (3320)	47%	39%	14%
% of companies in each rating category that are investment banking clients	71%	70%	70%

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