Equities

31 October 2011 | 13 pages

Gujarat Pipavav Port (GPPL.BO)

Time for a Breather; Downgrade to Neutral

- Company Update
- Rating Change
- Target Price Change
- Estimate Change

- **Downgrade to Neutral -** GPPL is up ~18% in the last 6 months, outperforming the index by ~25%. While the 3Q results were ahead of our estimates, we are turning more cautious on the outlook for bulk volumes post the Q3 call and have cut our bulk volume assumptions by 10-11% over 2011/2012. Given the strong stock performance, we believe that there is limited upside from here and downgrade the stock to Neutral.
- **Strong performance in 3Q2011 –** Recurring PAT at Rs132mn was almost twice that of CIRA est. of Rs66mn, driven by a ~550bps margin beat. While revenues at Rs979mn were inline with ests.; lower than expected operating expenses boosted margins.
- **Containers drive growth…. –** GPPL handled ~169,000 TEUs, up 30% YoY and 7% ahead of our ests. Management mentioned that while container growth on India's western coast has slowed down to ~8% due to recent economic slowdown, Pipavav will continue to grow ahead of the market.
- **….but bulk cargo volumes lag –** Bulk cargo fell sharply by 36% YoY and 30% below CIRA est due to lower coal and fertilizer volumes. We believe that this highlights the vulnerability of GPPL in the absence of a resilient revenue stream by way of long-term take or pay agreements. Management indicated that the port was operating at ~80-85% bulk-capacity utilization.
- **Capacity expansion plans on track –** 1) GPPL had recently increased the capacity of its container yard from 650,000 TEUs to 720,000 TEUs. Further expansion to 850,000 TEUs is expected to be completed by end 2011. 2) Pipavav Rail - PRCL is undertaking to facilitate double stacking of high cube containers to capacity of the rail line by ~12%.
- **Cutting ests by 10% in 2011/12, TP to Rs80 -** Our ~10% EPS cut is driven by 1) ~11%/10% cut in our bulk cargo ests. over 2011/2012, 2) ~775/600bps cut in EBITDA margins – due to changes in product mix, higher than expected employee costs, 3) The cut in margins is partly offset by lower than expected interest costs due to repayment of debt as well as higher other income.

Neutral	**2**
from Buy	
Price (31 Oct 11)	Rs72.00
Target price	Rs80.00
from Rs81.00	
Expected share price return	11.1%
Expected dividend yield	0.0%
Expected total return	**11.1%**
Market Cap	Rs30,496M
	US$627M

Price Performance
(RIC: GPPL.BO, BB: GPPV IN)

Statistical Abstract

Year to 31 Dec	Net Profit (RsM)	Diluted EPS (Rs)	EPS growth (%)	P/E (x)	P/B (x)	ROE (%)	Yield (%)
2009A	-1,106	-3.51	-58.2	nm	7.3	-31.8	0.0
2010A	-509	-1.20	65.8	nm	4.1	-9.7	0.0
2011E	490	1.16	196.3	62.2	3.9	6.4	0.0
2012E	1,036	2.45	111.4	29.4	3.4	12.4	0.0
2013E	1,475	3.48	42.4	20.7	2.9	15.3	0.0

Source: Powered by dataCentral

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See Appendix A-1 for Analyst Certification, Important Disclosures and non-US research analyst disclosures.

Fiscal year end 31-Dec	2009	2010	2011E	2012E	2013E
Valuation Ratios					
P/E adjusted (x)	nm	nm	62.2	29.4	20.7
EV/EBITDA adjusted (x)	74.7	32.1	21.0	15.9	12.3
P/BV (x)	7.3	4.1	3.9	3.4	2.9
Dividend yield (%)	0.0	0.0	0.0	0.0	0.0
Per Share Data (Rs)					
EPS adjusted	-3.51	-1.20	1.16	2.45	3.48
EPS reported	-3.70	-1.29	1.16	2.45	3.48
BVPS	9.88	17.37	18.53	20.98	24.46
DPS	0.00	0.00	0.00	0.00	0.00
Profit & Loss (RsM)					
Net sales	2,207	2,839	3,735	4,568	5,480
Operating expenses	-2,162	-2,158	-2,556	-2,894	-3,158
EBIT	**45**	**681**	**1,179**	**1,675**	**2,322**
Net interest expense	-1,157	-1,271	-828	-786	-860
Non-operating/exceptionals	-51	43	140	147	154
Pre-tax profit	**-1,163**	**-547**	**490**	**1,036**	**1,617**
Tax	-1	0	0	0	-141
Extraord./Min.Int./Pref.div.	0	0	0	0	0
Reported net income	**-1,164**	**-547**	**490**	**1,036**	**1,475**
Adjusted earnings	-1,106	-509	490	1,036	1,475
Adjusted EBITDA	503	1,174	1,697	2,225	2,926
Growth Rates (%)					
Sales	31.8	28.6	31.5	22.3	20.0
EBIT adjusted	118.3	nm	73.0	42.1	38.7
EBITDA adjusted	307.9	133.5	44.6	31.1	31.5
EPS adjusted	-58.2	65.8	196.3	111.4	42.4
Cash Flow (RsM)					
Operating cash flow	**-381**	**997**	**2,072**	**2,379**	**2,908**
Depreciation/amortization	458	493	519	550	603
Net working capital	-889	-258	235	7	-31
Investing cash flow	**-3,217**	**-414**	**-1,000**	**-1,650**	**-2,750**
Capital expenditure	-3,217	-414	-1,000	-1,650	-2,750
Acquisitions/disposals	0	0	0	0	0
Financing cash flow	**2,753**	**606**	**-2,047**	**673**	**-901**
Borrowings	3,476	-2,918	-1,219	1,459	-41
Dividends paid	0	0	0	0	0
Change in cash	**-902**	**1,151**	**-975**	**1,402**	**-743**
Balance Sheet (RsM)					
Total assets	**15,527**	**16,585**	**15,992**	**18,504**	**19,952**
Cash & cash equivalent	798	1,949	973	2,375	1,632
Accounts receivable	217	295	153	188	225
Net fixed assets	12,986	12,907	13,388	14,488	16,635
Total liabilities	**12,417**	**9,226**	**8,143**	**9,619**	**9,592**
Accounts payable	0	0	84	96	105
Total Debt	10,891	7,973	6,754	8,213	8,172
Shareholders' funds	**3,111**	**7,359**	**7,849**	**8,885**	**10,360**
Profitability/Solvency Ratios (%)					
EBITDA margin adjusted	22.8	41.3	45.4	48.7	53.4
ROE adjusted	-31.8	-9.7	6.4	12.4	15.3
ROIC adjusted	0.4	5.5	9.3	12.5	14.6
Net debt to equity	324.5	81.9	73.7	65.7	63.1
Total debt to capital	77.8	52.0	46.3	48.0	44.1

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3Q2011 Results – Well Ahead

- **Recurring PAT of Rs132mn -** Gujarat Pipavav reported a strong set of results, underscoring the ongoing turnaround at the company. Recurring PAT at Rs132mn was 2x of CIRA expectations of Rs66mn, driven by a ~550bps margin beat due to lower than expected operating expenses. Revenues at Rs979mn, up 21% YoY, were inline with expectations. The company saw a 20%YoY jump in its average realizations, 10% higher than our expectations.

- **Containers drive growth –** GPPL handled ~169,000 TEUs, up 30% YoY and 7% ahead of our estimates. Management mentioned in the conference call that the port did not gain or lose any significant volumes due to the recent congestion at JNPT. Presently, the Maersk line forms ~50-55% of container volumes.

- **But bulk cargo volumes lag –** Bulk cargo fell sharply by 36% YoY and 30% below CIRA est. The company highlighted lower coal and fertilizer volumes due to regulatory constraints. We believe that this highlights the vulnerability of GPPL in the absence of a resilient revenue stream by way of long-term take or pay agreements. In the conference call, management indicated that the port was operating at ~80-85% bulk -capacity utilization.

Figure 1. Gujarat Pipavav 3Q2011 Results – Well Ahead

Income Statement	3Q10	3Q11	3Q11E	Comments
Net Sales/ Income from Operations	754	925	952	
Other Operating Income	54	54		
Total Income	**808**	**979**	**952**	**3% ahead of CIRA expectations**
% Growth	**23.9%**	**21.2%**	**17.9%**	
Operating Expenses	(339)	(372)	(421)	12% below expectations
Employee Cost	(59)	(80)	(75)	
Administrative and Other Expenses	(61)	(76)	(70)	
EBITDA	**349**	**450**	**385**	
EBITDA Margin%	**43.2%**	**46.0%**	**40.5%**	**552bps above expectations**
Depreciation	(123)	(131)	(134)	
Finance Cost	(362)	(211)	(215)	
Other Income	38	24	30	
PBT	(98)	132	66	
Tax Expenses	0	0	0	
Recurring PAT	**(98)**	**132**	**66**	**99% above expectations**
Recurring PAT Margin%	**-12.2%**	**13.5%**	**7.0%**	

Source: Company Filings, Citi Investment Research and Analysis

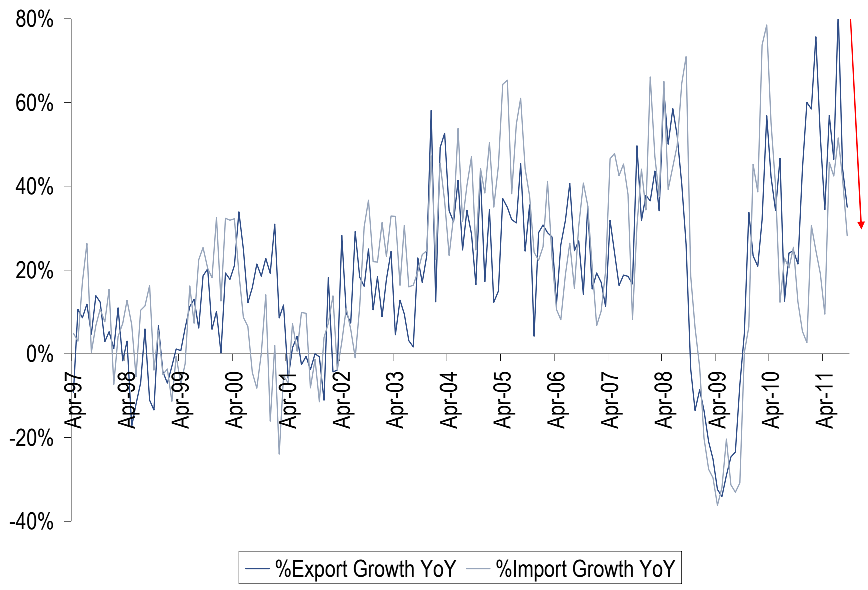
Management Meeting Takeaways

We had recently met the management of Gujarat Pipavav to get an update on the business and visibility on key catalysts for the stock.

Update on container trade – Growth rates slowing down

- **Trade growth is slowing down –** India's exports and imports seem to be slowing down, as suggested by the September trade figures. Growth in exports has slowed down to ~35% from the ~82% levels seen in July. In the 3Q2011 conference call, management mentioned that GPPL is also witnessing a gradual shift towards higher import cargo volumes (52% vs. 48% earlier) largely from China and South East Asia. The port is seeing a relatively sedate growth in its export volumes to US and Europe.

Figure 2. Trade growth slowing down



Source: Ministry of Commerce, Citi Investment Research and Analysis

- **Deteriorating Efficiencies at Major Ports –** According to the Economic Survey 2010-11, the average turnaround time of major Indian ports has risen to 4.38 days in 2009-10 compared with 3.87 days in 2008-09. There has also been a rise in the average pre-berthing waiting time from 9.55 hours to 11.67 hours. Container traffic at major ports on the western coast has grown at just ~2% YoY for YTD FY11.

- **Faster growth than the industry –** GPPL management mentioned in our meeting that the container trade growth on India's western coast is ~8%. With the high levels of capacity utilization and turnaround times at major ports, the company expects privately owned ports like Pipavav to capture a share of this incremental traffic and post higher growth rates than the industry average.

Update on Bulk Trade

- **Fertilizer volumes under pressure -** In the 2Q2011 conference call, management had mentioned that there was a deferment of fertilizer procurement by the Government of India. Management mentioned in the 3Q2011 call that the situation had not improved and that volumes continued to remain subdued –

however they mentioned that they believed that volumes could recover in 4Q2011.

- **High ratio of trading coal volumes -** GPPL has high volumes of trading coal, which are spot trades in nature and are not sticky in nature. The company is in advanced stages of discussion with anchor clients (captive power plants) like Videocon to add resilience to the cargo profile.

- **Good visibility in Liquid cargo –** In 2Q2011, GPPL entered into an arrangement with IMC for liquid cargo. Under the arrangement, GPPL will provide land on lease to IMC which will set up tank farms and pipelines. Management mentioned that the land lease has commenced and that IMC has sought government approvals for the same. Management mentioned in the Q32011 conference call that construction of the tank farms is expected to commence in 1-2 quarters after receipt of the regulatory approvals and that the farms are expected to be ready by end-2012.

Capacity expansion plans on track

- **Yard capacity expansion by end 2011 –** GPPL had recently increased the capacity of its container yard from 650,000 TEUs to 720,000 TEUs. Management mentioned that the container yard expansion to 850,000 TEUs was in full swing, and is expected to be completed by end 2011.

- **Pipavav Rail - Double stacking of high cubes –** PRCL is undertaking to facilitate double stacking of high cube containers, with a height of 9.5’ compared to 8.5’ regular containers. This increases the capacity of the rail line by ~12%. The project is expected to be completed by mid 2012.

Other Key Takeaways

GPPL has current outstanding debt of ~Rs6.8bn with an average cost of debt under 12%. Management indicated that the first installment is due in June 2012. The company has seen a hike in certain cost components such as equipment rental and fuel prices.

Cut in TP to Rs80, Downgrade to Neutral

Cutting Estimates by ~10% over 2011/2012

Our ~10% change in EPS estimates is driven by –

1) ~11%/10% cut in our bulk cargo assumptions over 2011/2012

2) ~775/600bps cut in EBITDA margins – due to changes in product mix and higher than expected employee costs

3) The cut in margins is partly offset by lower than expected interest costs due to repayment of debt as well as higher other income.

4) We marginally increase our revenue assumptions driven by higher "other operational income" and higher than expected realizations for container cargo.

Figure 3. Gujarat Pipavav – Change in Estimates

Estimate Change	2011	2012	2013
Bulk Cargo (MT)			
Earlier Estimates	4,180,500	4,784,765	5,058,467
Revised Estimates	3,723,400	4,318,680	4,534,349
%Change	-11%	-10%	-10%
Container Cargo (TEUs)			
Earlier Estimates	629,286	849,537	950,663
Revised Estimates	615,302	842,964	950,663
%Change	-2%	-1%	0%
Operational Income (Rs mn)			
Earlier Estimates	3,630	4,557	5,501
Revised Estimates	3,735	4,568	5,480
%Change	3%	0%	0%
EBITDA Margin (%)			
Earlier Estimates	53.2%	54.7%	58.7%
Revised Estimates	45.4%	48.7%	53.4%
Change in bps	(775)	(604)	(534)
EPS (Rs)			
Earlier Estimates	1.29	2.71	3.70
Revised Estimates	1.16	2.45	3.48
%Change	-10%	-10%	-6%

Source: Citi Investment Research and Analysis estimates

Cut in TP to Rs80

We cut our TP to Rs80 driven by (1) slower than expected ramp-up of bulk cargo; (2) more gradual expansion in EBITDA margins. We also roll forward our DCF by 4 months.

Figure 4. Gujarat Pipavav – SOTP Valuation

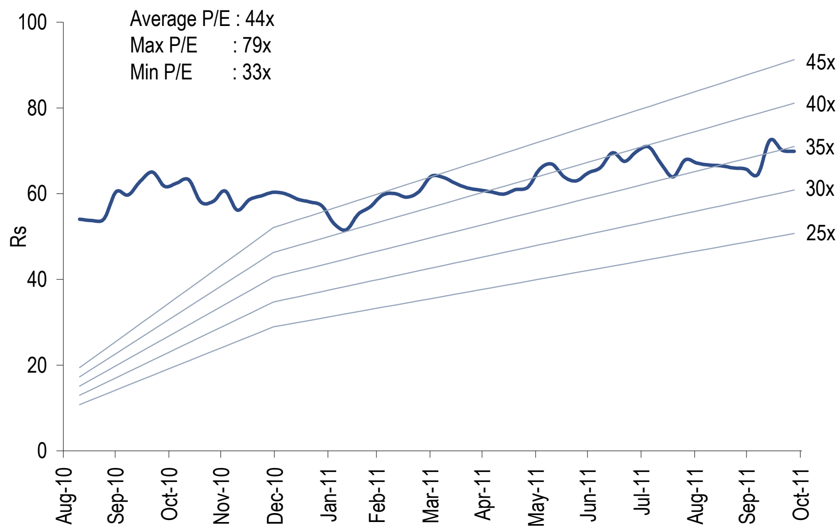
Method	Current Methodology	Value	Earlier Methodology	Old Value
DCF Valuation - FCFE	DCF, WACC 13.5%	60	DCF, WACC 13.5%	61
Depreciated Replacement Value	50% probability	8	50% probability	8
Extension of concession agreement	50% probability	10	50% probability	10
38.8% Share in PRCL	At Book value	2	At Book value	2
SOTP Value		**80**		**81**

Source: Citi Investment Research and Analysis

Downgrade to Neutral

GPPL is up ~16% in the last 6 months, outperforming the index by ~23% on the back of the strong operating performance and the turnaround in the company's financials. We believe that the stock has limited upside from current levels and downgrade the stock to Neutral.

Figure 5. Gujarat Pipavav – PE Chart



Source: Citi Investment Research and Analysis

Figure 6. Gujarat Pipavav – Relative Performance

	1 Week	1 Month	3 Months	6 Months	Since IPO
GPPL	4.2%	10.6%	1.0%	18.0%	16.4%
Sensex	4.5%	7.6%	-2.2%	-6.8%	-2.8%
Relative to Sensex	-0.3%	3.0%	3.2%	24.8%	19.2%

Source: Citi Investment Research and Analysis

Gujarat Pipavav Port

Company description

GPPL is the developer and operator of India's first private sector port at Pipavav, in Gujarat on the west coast of India. The multi-user port currently has facilities to handle up to 0.6mn TEUs of container cargo annually and ~5mn tones of bulk cargo. The A.P.Moller Maersk Group owns a ~43% stake in the company.

Investment strategy

We have a Neutral rating on GPPL, one of the top 5 ports in India and the third-largest on the western coast for handling container cargo. We believe GPPL is well placed to leverage on a 38% CAGR in container trade in India's minor ports over FY10-17 (per Ministry of Shipping est). However, we are turning more cautious on the outlook for bulk volumes and given the strong stock performance recently, we believe that there is limited upside from here.

Valuation

Our target price for GPPL of Rs80 is based on a sum-of-parts approach. Using a DCF of FCFE (applying a cost of equity of 13.5%), we derive a value for GPPL Rs60/share. To this we add a combined Rs18/share, comprising fair values based on 50% probabilities of two outcomes at the end of the concession period: Rs8/share assuming the asset is transferred at Depreciated Replacement Value, and Rs10/share assuming the concession period is extended. GPPL's investments in PRCL are included at book value - or Rs2/share.

Risks

Key downside risks that could prevent the shares from reaching our target price include: 1) Liabilities arising due to traffic guarantee agreement with PRCL; 2) Longer term for traffic guarantee agreement than the concession agreement; 3) Lower-than-expected traffic growth; 4) Delay in the coal-based power projects planned at Pipavav; and 5) Customer concentration.

Key upside risks that could prevent the shares from reaching our target price include: 1) Higher-than-expected traffic growth; 2) Quicker ramp-up of coal-based power projects planned at Pipavav; and 3) Higher shift of container lines from major ports to Pipavav.

Appendix A-1

Analyst Certification

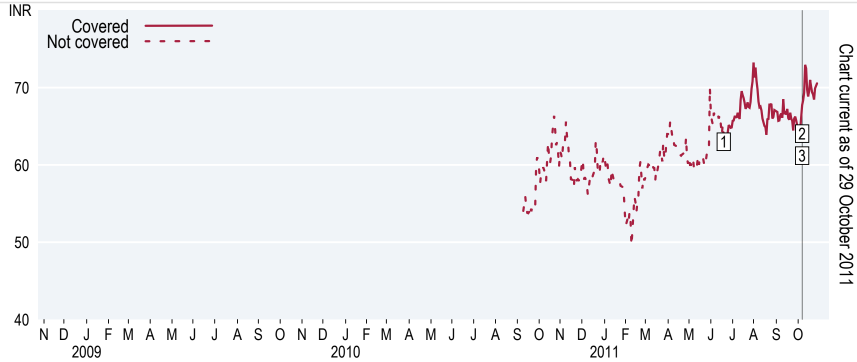
The research analyst(s) primarily responsible for the preparation and content of this research report are named in bold text in the author block at the front of the product except for those sections where an analyst's name appears in bold alongside content which is attributable to that analyst. Each of these analyst(s) certify, with respect to the section(s) of the report for which they are responsible, that the views expressed therein accurately reflect their personal views about each issuer and security referenced and were prepared in an independent manner, including with respect to Citigroup Global Markets Inc and its affiliates. No part of the research analyst's compensation was, is, or will be, directly or indirectly, related to the specific recommendation(s) or view(s) expressed by that research analyst in this report.

IMPORTANT DISCLOSURES

Gujarat Pipavav Port (GPPL.BO)

Ratings and Target Price History
Fundamental Research

Analyst: Deepal Delivala
Covered since June 19 2011



	Date	Rating	Target Price	Closing Price
1	19-Jun-11	*1L	*81.00	65.25
2	7-Oct-11	Stock rating system changed		
3	7-Oct-11	*1	81.00	67.75

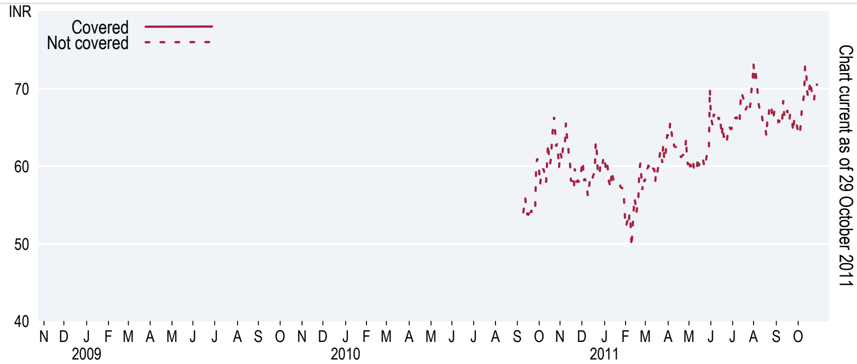
* Indicates change

Rating/target price changes above reflect Eastern Standard Time

Gujarat Pipavav Port (GPPL.BO)

Ratings and Target Price History
Best Ideas Research
Relative Call (3 Month)

Analyst: Deepal Delivala
Covered since June 19 2011



* Indicates change

Rating/target price changes above reflect Eastern Standard Time

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	12 Month Rating			*Relative Rating*		
Data current as of 9 Oct 2011	**Buy**	**Hold**	**Sell**	**Buy**	**Hold**	**Sell**
Citi Investment Research & Analysis Global Fundamental Coverage	59%	34%	7%	10%	79%	10%
% of companies in each rating category that are investment banking clients	45%	42%	37%	50%	43%	46%

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