MUNDRA PORT AND SEZ

INR 400-440

Emerging asset class

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Strong growth in Indian port traffic to continue

With Indian merchandise export and import registering healthy double digit growth, the Indian port traffic has grown at a CAGR of 8.7%, reaching 463 mn tonnes in 2006-07. This growth momentum is expected to continue and the traffic is expected to reach 980 mn tonnes (at CAGR of 12%) over 2011-12. Considering the massive infrastructure rollout happening, we expect INR 392 bn of contribution from private sector, out of INR 603 bn of investment in the port sector.

Mundra port – preferred destination with a well-diversified product profile

Mundra port and special economic zone (MPSEZ) is one of the leading non-captive private sector ports in India, providing services for bulk cargo, container cargo, crude oil cargo, value-added port services, including rail services. Along with diversifying its service offerings, MPSEZ has developed access to rail, road, and pipeline network across India, which has helped it tie up strategic arrangements with customers.

SEZ development and allied port services to strengthen business model

MPSEZ is developing the first port-based multi-product SEZ in India. Currently, it possesses 15,665 acres of land and another 16,688 acres of land is in the process of transfer to the company With close proximity to the industrial area and SEZ providing captive traffic to the port, the business streams will be able to compliment each other.

Increased capacity expansion and new services to provide next level of growth

MPSEZ is expanding its capacity by setting up container terminal II. It is setting up a terminal for coal and other cargo to cater to the upcoming ultra mega power projects (UMPPs) and Adani Power and building a solid cargo port terminal at Dahej. These new initiatives, along with the SEZ, container train and ICD operations, will fuel the next level of growth for MPSEZ.

Financials and valuations

MPSEZ has experienced a healthy volume CAGR of 55% during FY04-07, to reach 19.3 mn tonnes. With strong capacity expansion through setting up of bulk, container, coal, and cargo terminals, we expect its volume CAGR to be 32-35% over the next five years. This will drive the revenue and EPS CAGR by 60-70% for the company in the coming years. We valued the MPSEZ business through discounted cash flow valuation at INR 210 bn or INR 526 per share. Given the strong business model and potential upsides we recommend 'SUBSCRIBE' rating to the issue

Reuters	:	NA
Bloomberg	:	NA

Market Data

52-week range (INR)	:	NA
Post IPO share (mn)	:	400.7
M cap (INR bn/USD mn)	:	NA
Avg. Daily Vol. BSE/NSE ('000)	:	NA

Share Holding Pattern Post IPO (%)

Promoter	:	81.3
Non-Promoter	:	18.7

Financials

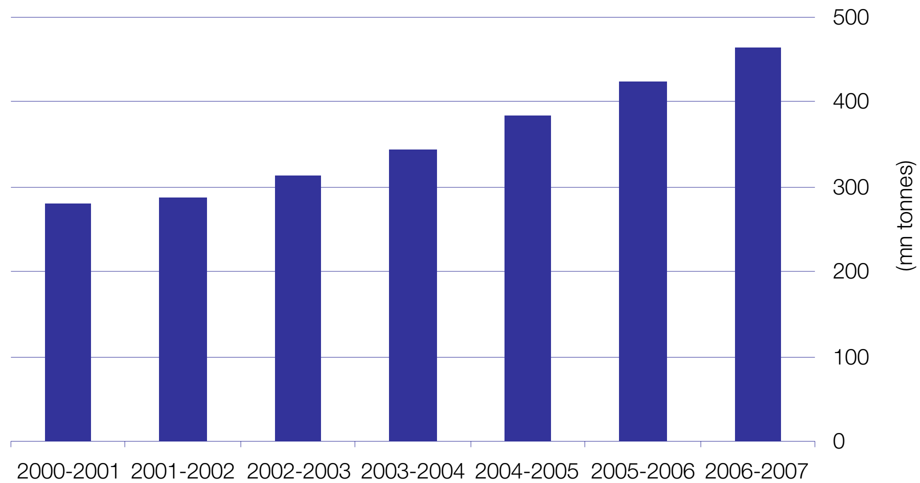
Year to March	FY04	FY05	FY06	FY07
Revenue (INR mn)	1,677	2,641	3,845	5,797
Rev. growth (%)		*57.5*	*45.6*	*50.8*
EBITDA (INR mn)	905	1,601	2,112	3,076
Net profit	60	663	672	1,874
Shares outstanding (mn)	180	180	180	360
Cons EPS	0.3	3.7	3.7	5.2
EPS growth (%)		*1,007.9*	*1.5*	*39.4*
P/E (x)	1,326.0	119.7	117.9	84.6
EV/ EBITDA	188.9	106.7	80.9	55.5
ROE (%)	1.7	12.4	11.5	27.8
ROCE (%)	7.1	12.2	11.8	13.5

Investment Rationale

✻ Rapid growth in trade to increase pressure on existing port capacities

In FY07, traffic handled at Indian ports grew 9.6% Y-o-Y, to 463.8 mn tonnes. Of this, the major ports handled ~75%. Based on the rising trend of traffic growth, India is expected to handle 978 mn tonnes of cargo by 2011-12.

Chart 1: Growth in port traffic in India



Source: IPA, Ministry of Shipping

To keep pace with its GDP growth of 7-8%, India needs to quickly ramp up its port capacities in the next few years. As the global and Indian trade grows at a pace of 9-11% per annum, congestion at major ports will depress port performance, unless sufficient capacity is created.

✻ Container traffic growth is the fastest, but capacity lags

Over 80% of the total traffic volume handled by the Indian ports is in the form of dry and liquid bulk, while the remaining is general cargo, including containers. The fastest growth in port traffic during the last decade was in container traffic, up 15% per annum in the five years up to FY06. However, even though the growth is superb, it is still lags larger international ports. Container penetration in India is only 47% compared to the world average of 60%.

Chart 2: Growth in container traffic

Source: IPA, Ministry of Shipping

Indian ports – lack adequate draft requirement

The Indian ports lack adequate draft[1] requirements. Low channel depth at many of the non-major ports means that large vessels cannot enter them. Besides, these ports lack adequate berthing facilities, alongside drafts, proper handling facilities, and storage sheds. Labour productivity, equipment intensification, modernisation, and upgradation of these ports are some additional factors that need to be addressed for the Indian ports to attain world-class standards.

Another major development globally, is the evolution of a 'hub-and-spoke model', which has developed between major ports on the East-West global shipping route. This route passes through the southern tip of India, providing a significant opportunity to develop a strong hub port there. The East-West shipping route carries 40% of the total global traffic and nearly 26% of its container traffic is within Asia. Unless major Indian ports align themselves in terms of infrastructure facilities, this opportunity will slip away.

NMDP to provide strong port infrastructure creation

In view of the infrastructure bottlenecks faced by ports and rapid growth in trade, the government is in the process of implementing the National Maritime Development Programme (NMDP) that envisages an investment of INR 603 bn till FY14.

[1] *draft is the number of feet that the hull of a ship is beneath the surface of the water)*

Table 1: Proposed investment in ports

	Existing FY04	Proposed FY14	Proposed Investments (INR bn)
Kolkata Dock System	9.8	21.6	47.2
Haldia Dock System	34.1	73.8	15.2
Paradip	39.0	92.3	24.0
Vishakapatnam	49.2	130.0	35.4
Chennai	41.9	61.6	21.7
Tuticorin	15.8	45.8	30.0
Cochin	15.5	58.5	78.9
New Mangalore	30.3	55.9	71.5
Mormugao	23.5	57.2	8.1
Mumbai	40.4	58.8	19.5
JNPT	33.1	94.9	158.8
Ennore	12.0	61.8	43.2
Kandala	42.0	105.6	49.9
Total	389.5	917.6	603.4

Source: IPA, Ministry of Shipping

Out of the estimated investment of INR 603 bn, ~65% will come from the private sector, budgetary support will contribute 19%, internal resources 8.5%, while the remaining 7.5% will come from rail and road connectivity projects.

Table 2: Investment break up

Investments	(INR bn)
Budgetary support	114.5
Internal resources	50.8
Private sector	392.4
Rail & road connectivity	45.8
- Ministry of railways	19.0
- Dept. of road transport & highways	10.7
- JVOPorts, NHAI, State Govts	16.0
Total investment	603.4

Source: IPA, Ministry of Shipping

Mundra port and special economic zone – diversified cargo profile

MPSEZ is among the leading non-captive private sector ports in India and enjoys the natural and locational advantage, including a deep water draft ranging from 15-32 meters that helps it service larger vessels like very large rude carriers (VLCCs) and container vessels of over 8,000 TEUs. It provides services for bulk cargo, container cargo, crude oil cargo, value-added port services, including rail services. With strong GDP growth and maritime trade, product profile of MPSEZ is likely to expand at 8-10% CAGR, going forward. We expect the company's volume growth to be higher on account of its competitive advantages and capacity expansion in place.

Table 3: Growth in cargo category

In mn tones	2000-01	2001-02	2002-03	2003-04	204-05	2005-06	CAGR
POL	108.3	103.3	109.6	122.2	126.4	142.1	5.6
Iron Ore	40.5	45.2	50.6	58.8	76.2	79.2	14.4
Fertilizer	9.1	9.6	8.6	7.5	9.7	12.2	5.9
Coal	48.1	46.4	48.2	48.8	52.6	58.8	4.1
Container	32.2	37.2	43.7	51.0	54.8	62.0	14.0
Others	42.8	45.9	52.9	56.5	64.1	69.4	10.1
Total	281.1	287.6	313.6	344.8	383.7	423.6	8.5

Source: IPA, Ministry of Shipping

* Proximity to maritime trade routes and hinterland connectivity

MPSEZ enjoys proximity to the northern and industrial regions of India as well as major maritime trade routes. Nearly half of India's trade in commodities such as crude oil, coal, fertilizers, foodgrains, and container cargo is represented by north and north-west India. The proximity of MPSEZ to the hinterland of northern India makes it well-positioned to handle the increased imports and exports in that region. Its location near the entrance of the Gulf of Kutch on the north-west coast of India places it near major maritime trade routes, making it an important hub for foreign trade, involved in importing and exporting with the Middle East, Asia, Africa, and other destinations.

Over the years, MPSEZ has developed good hinterland connectivity to the inland regions of the western and northern India through rail, road and pipelines. It is connected to the Indian Railways (IR) network through a broad gauge link, constructed between Mundra and Adipur. A four-lane approach road also connects the port to national and state highways. A crude pipeline, owned and operated by IOCL, connects MPSEZ directly to IOCL's refinery in Panipat. Another pipeline, owned and operated by HPCL connects the port to northern India.

* Port-based multi-product SEZ – complimentary services

MPSEZ has received approval as a developer of a multi-product SEZ at Mundra port and its surrounding areas. Currently, it possesses 15,665 acres of land, while approximately 16,688 acres of land is at various stages of transfer. MPSEZ will be the master developer for the SEZ and has plans to work with third-party developers to develop services such as power generation, distribution, water supply, and telecommunication. To leverage the captive cargo from the port and SEZ, MPSEZ is also venturing into running container rains and setting up ICDs across India.

* Capacity expansion and new initiatives

MPSEZ is expanding capacity for handling bulk cargo by constructing a bulk terminal that can have a maximum capacity of ~20 mn tonnes. The number of berths is expected to go up from four currently to eight in FY08. It is also constructing a container terminal to increase its container handling capacity from 1.25 mn TEUs to 2.5 mn TEUs by FY08.

- Coal and other cargo terminal

MPSEZ has signed a port services agreement with Coastal Gujarat Power, to provide port and cargo-handling services for a 4,000 MW UMPP at Mundra. The terminal is expected to have a capacity of 20 mn tonnes per annum. Additionally, Adani Power is also setting up a 2,640 MW imported coal-based power project in the vicinity of Mundra port. The assured coal cargo-handling for UMPP and Adani will ensure optimum capacity utilisation for MPSEZ's coal terminal.

- Solid cargo port terminal (SCPT) at Dahej

MPSEZ is planning to acquire a 74% stake in Adani Petronet Port, a joint venture company with Petronet LNG, to develop a solid cargo port terminal at Dahej in a phased manner, to have a capacity of 15 mn tonnes of cargo. It expects to serve primary inland regions of south Gujarat, upper Maharashtra, and parts of central India. We believe that presence in a strong industrial area of Bharuch and Surat, and connectivity to the key routes by road and rail, augurs well for the SCPT.

- Container rail and inland container depot operations

MPSEZ has entered into container train business through 50% equity stake in Adani Logistics (ALL); ALL has acquired the license to run container trains across India. MPSEZ initially proposes to procure 20 rakes for its operations and is expected to commence operations by September 2007. The company also plans to invest in the business of developing, operating, and maintaining rail-linked inland container depots across India, catering to EXIM as well as domestic trade. It plans to develop approximately 14 ICDs in NCR and cargo centers such as Ahmedabad, Mumbai, Kolkata, Chennai, Bangalore, Coimbatore, and Nagpur. With container terminals, container rail operations, and presence across ICDs, MPSEZ will be able to place itself as an end-to-end container logistics player.

Issue Details

✻ Issue size

MPSEZ's initial public offering (IPO) is of 40.25 mn shares at a price band of INR 400-440 per share. Consequently, at the lower end of the band, the company will raise INR 16.1 bn, while at the upper end it will raise INR 17.7 bn. Post IPO, the market cap at lower and upper band will be INR 160.2 bn and INR 176.2 bn. The issue will open on November 1 and close on November 7.

Table 4: Issue details

	At lower band	At upper band
Issue size (# shares in mn)	40.3	40.3
Post issue number of share (mn)	400.7	400.7
Dilution %	10.0	10.0
Price band (INR)	400.0	440.0
Proceeds to be raised from fresh issue (INR bn)	16.1	17.7
Market capitalization (INR bn)	160.3	176.3

Source: Company

✻ Objects of the issue

MPSEZ proposes to fund its new initiatives viz the proposed SEZ at Mundra, coal terminal project, Dahej terminal and container train, and ICD venture through a mix of debt and equity. Its proposed funding is outlined below:

Table 5: Objects of the issue

INR bn

	SEZ project	Coal terminal project	Investment in APPPL	Investment in ALL	Investment in ICPL	Total
Total funds required	7.0	20.0	2.5	0.5	1.6	31.6
Funding						
Already deployed	0.0	0.0	0.5	0.3	1.0	1.7
Proceeds of the issue	7.0	4.5	2.1	0.2	0.5	14.4
Debt financing	0.0	12.0	0.0	0.0	0.0	12.0
Internal acruals	0.0	3.5	0.0	0.0	0.0	3.5
Total	7.0	20.0	2.5	0.5	1.6	31.6

Source: Company

Key Risks

* **Risk of unfavourable government regulations**

  MPSEZ operates its businesses as concessions from various government and quasi government organisations like Gujarat Maritime Board. Cancellation, termination, or non-renewal of such concession agreements could impact MPSEZ's business.

* **High capital investment requirements and long gestation projects**

  MPSEZ's various projects like SEZ, container terminal II, coal terminal, solid cargo port terminal at Dahej, and venture into container train business and ICDs are capital intensive and long gestation projects. Any delay or adverse competitive pressure on any of these projects could impact the company's performance.

* **Lack of clarity on SEZ regulation**

  Any unfavourable regulation regarding working of SEZs could severely hamper MPSEZ's valuations, as SEZ is one of the key growth drivers for the company.

* **Situation of oversupply on west coast of India**

  Significant capacities are expected to come up on the west coast of India, catering to the container traffic. This includes setting up of container terminal at JNPT (IV terminal) and Mumbai Port. This, in turn, could create pricing pressure on MPSEZ.

Company Description

Mundra Port and Special Economic Zone (MPSEZ) is one of the leading non-captive private sector ports in India, providing services for bulk cargo, container cargo, crude oil cargo, value-added port services, including rail services.

Bulk cargo services:

MPSEZ provides handling and storage of dry and liquid bulk, marine services to bulk cargo vessels including piloting, wharfage, and other port-related services. The bulk cargo handled by MPSEZ has registered a CAGR of 31.5% during FY04-07.

Table 6: Bulk cargo break up

	2004	2005	2006	2007
Bulk dry cargo				
Coal and coke	0.6	2.0	2.6	3
Fertliser and raw materials	0.3	0.6	1.6	1.4
Minerals	0.7	0.6	0.5	0.5
Iron and steel	0.6	0.9	1.5	1.6
Foodgrains	0.7	0.6	0.1	2.7
Others	0.5	0.5	0.8	0
Bulk liquid cargo				
Edible oils	0.6	0.5	0.5	0.3
Petroleum products	0.2	0.2	0.2	0.2
Chemicals	0.2	0.2	0.3	0.3
Total	4.4	6.1	8.1	10

Source: Company

Container services:

The container services at Mundra port includes loading, unloading, and storage of containers, provided by the Container Sub-concessionaire; MPSEZ receives only royalties for the same. The container volumes at MPSEZ have experienced robust growth of 121% to reach 521,000 TEUs in FY07. The terminal is expected to have a capacity of 1.25 mn TEUs and the volume growth is expected to be strong with the container terminal II being set up.

Crude oil services

MPSEZ has set up a single-point mooring (SPM) facility for handling crude oil for IOC through the pipeline to storage tank area. MPSEZ receives fixed annual payments from IOCL for developing and maintaining the SPM facility. It also entered into a long-term contract with GGSRL, a subsidiary of HPCL, for single-point mooring facilities.

Railway services

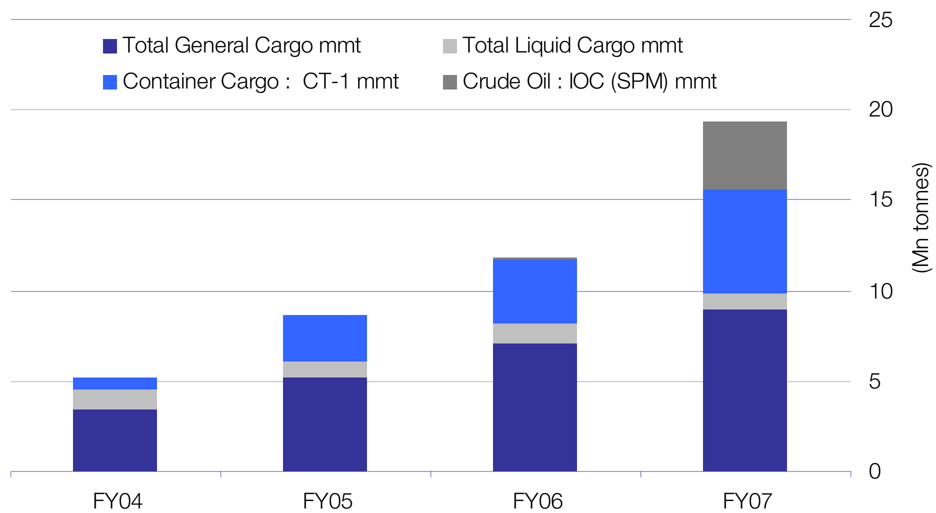
MPSEZ provides services for rail movement of cargo, bulk and container, on the rail sidings in the port and on the Mundra-Adipur railway, connecting the port to the IR network. MPSEZ constructed the Mundra Adipur rail link and received a portion of freight revenues generated by cargo movement by railway to-and-fro from the Mundra port. It has also entered into an arrangement with CONCOR to provide railway haulage services for container cargo at Mundra port.

Financial and Valuations

Robust volume growth to drive EPS CAGR

MPSEZ, with its natural locational advantage and proximity to the maritime trade routes as well as northern hinterland, has experienced a healthy volume CAGR of 55% during FY04-07, to reach 19.3 mn tonnes. With strong capacity expansion through setting up of bulk, container, coal, and cargo terminals, we expect its volume CAGR to be 32-35% over the next five years. This will drive the revenue and EPS CAGR by 60-70% for the company in the coming years.

Chart 3: Cargo break up



Source: Company

Valuations methodology

Given the long gestation infrastructure projects and steady cash flows arising from them, we tried to value MPSEZ by discounted cash flow (DCF) methodology.

- Mundra port: Mundra port is expanding its capacity on bulk and container cargo from existing 10 mn tones of bulk handling and 1.25 mn TEUs of conatienr crgo to 20 mn tones of bulk and another container terminal with 1.25 mn TEUs. It is also expnsing its capacity for liquid bulk cargo to 25 mn tones and is expending to set up a coal terminal with a capacity of 30 mn tones. Given the lower risk on account of Mundra port being operational and availability of captive cargo for the upcoming coal terminal, we have discounted the cash flows at cost of equity of 13% and assigned a value of INR 70.16 bn.

- Port based multi product SEZ

MPSEZ has acquired and notified 15,665 acres of land. Another 16,688 acres of land is in the process of being transferred to MPSEZ. We have tried to value only 15,665 acres of land and at a land price (present value of rentals) assumption of INR 102 per sq.ft, the NPV value for the SEZ projct comes at INR 90.1 bn.

- Container terminal II

With container traffic in India expected to register 15-17% CAGR over the next couple of years, we believ container terminal at Mundra is in a sweet spot to capture the growth. The discounted cash flow value for the terminal comes at INR 37.6 bn.

- Solid cargo port terminal at Dahej

MPSEZ is planning to acquire a 74% stake in Adani Petronet Port, a joint venture company with Petronet LNG, to develop a solid cargo port terminal at Dahej in a phased manner, to capture the hinterland area of Ahmadabad, maharsahtra and Madhya Pradesh. The terminal is expected

- Container rail and inland container depot operations

With full capacity at 2.5 mn TEUs from the two container terminals, we believe that container rail operations, and presence across ICDs will help MPSEZ position itself as an end-to-end container logistics player. We have valued the two business at INR 7.9 bn.

Table 7: MPSEZ SOTP valuation

INR bn	Buisness value	Stake	MPSEZ value	Per share value (INR)
Mundra Port	70.2	100%	70.2	175.1
CT2	37.6	100%	37.6	93.9
SEZ	90.2	100%	90.2	225.0
Dahej Terminal	6.5	74%	4.8	12.1
Container Rail	2.8	50%	1.4	3.5
ICD	13.1	50%	6.5	16.3
Total	220.4		210.7	526.0

Source: Company, Edelweiss research

Financial Statements

Income statement

Year to March	FY04	FY05	FY06	FY07
Income from operations	1,677	2,641	3,845	5,797
Direct costs	496	746	1,068	1,944
Employee costs	63	65	88	148
Other expenses	213	229	578	630
Total operating expenses	772	1,040	1,734	2,721
EBITDA	905	1,601	2,112	3,076
Depreciation and amortisation	376	437	614	807
EBIT	528	1,164	1,497	2,269
Interest expenses	514	343	507	668
Other income	56	134	124	164
Profit before tax	70	954	1,114	1,765
Provision for tax	9	286	489	(125)
Extraordinary items	(2)	(6)	48	(16)
Reported profit	60	663	672	1,874
Adjusted net profit	60	663	672	1,874
Shares outstanding	180	180	180	360
Dividend per share	-	-	2.0	1.0
Dividend payout (%)	-	-	53.6	19.2

Common size metrics- as % of net revenues

Year to March	FY04	FY05	FY06	FY07
Operating expenses	46.1	39.4	45.1	46.9
Depreciation	22.4	16.6	16.0	13.9
Interest expenditure	30.7	0.1	0.1	0.1
EBITDA margins	53.9	60.6	54.9	53.1
Net profit margins	3.6	25.1	17.5	32.3

Growth metrics (%)

Year to March	FY04	FY05	FY06	FY07
Revenues		57.5	45.6	50.8
EBITDA		77.0	31.9	45.7
PBT		1257.6	16.7	58.5
Net profit		1007.9	1.5	178.8
EPS		618.3	(7.2)	141.6

Cash flow statement (INR mn)

Year to March	FY04	FY05	FY06	FY07
Net profit	60	663	672	1,874
Add: Depreciation	376	437	614	807
Add: Deferred tax	-	215	389	(133)
Gross cash flow	436	1,315	1,676	2,548
Less: Dividends	-	-	360	360
Less: Changes in W. C.	(2,794)	(1,641)	(1,132)	(2,345)
Operating cash flow	3,230	2,956	2,447	4,533
Less: Change in investments	192	(1,545)	(2,832)	(1,744)
Less: Capex	3,001	4,250	4,532	6,621
Free cash flow	**38**	**252**	**747**	**(344)**

Balance sheet (INR mn)

As on 31st March	FY04	FY05	FY06	FY07
Equity capital	1,830	1,830	1,830	3632.4
Reserves & surplus	3,173	3,849	4,179	3,843
Shareholders funds	5,003	5,679	6,009	7,475
Secured loans	4,027	5,899	8,919	12,813
Unsecured loans	363	345	699	9
Borrowings	4,391	6,244	9,618	12,822
Sources of funds	9,394	11,923	15,627	20,298
Gross block	11,452	12,212	16,458	22,331
Depreciation	535	943	1,599	2,509
Net block	10,917	11,269	14,858	19,822
Capital work in progress	1,785	4,369	4,117	4,179
Total fixed assets	12,703	15,638	18,975	24,001
Investments	0	320	1,228	790
Inventories	26	31	46	104
Sundry debtors	197	412	767	3,449
Cash and equivalents	118	306	957	569
Loans and advances	1,647	583	747	1,260
Other current assets	276	215	217	235
Total current assets	2,263	1,547	2,734	5,618
Amounts under infrastructure agreements	4,553	4,583	4,635	7,415
Current liabilities	1,009	616	1,394	2,012
Provisions	9	75	589	178
Total CL & provisions	1,018	691	1,983	2,189
Net current assets	1,244	856	751	3,428
Net deferred tax	0	(308)	(692)	(507)
Uses of funds	9,394	11,923	15,627	20,298

Ratios

Year to March	FY04	FY05	FY06	FY07
ROE (%)	1.7	12.4	11.5	27.8
ROCE (%)	7.1	12.2	11.8	13.5
Current ratio	2.2	2.2	1.4	2.6
Debtors (days)	43	57	73	217
Fixed assets t/o (x)	0.1	0.2	0.2	0.3
Debt/Equity	0.9	1.1	1.6	1.7

Valuations parameters

Year to March	FY04	FY05	FY06	FY07
Cons EPS (INR)	0.3	3.7	3.7	5.2
Y-o-Y growth (%)		*1,007.9*	*1.5*	*39.4*
CEPS (INR)	2.4	6.1	7.1	7.4
P/E (x)	1,326.0	119.7	117.9	84.6
Price/BV(x)	15.8	14.0	13.2	21.2
EV/Sales (x)	101.9	64.7	44.4	29.5
EV/EBITDA (x)	188.9	106.7	80.9	55.5

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Coverage group(s) of stocks by primary analyst(s): Logistics:

Allcargo, Concor, Dredging Corp Of India, Gateway Distriparks, Gati, SICAL and Transport Corporation of India

Recent Research

Date	Report	Title	Price (INR)	Recos
22-Oct-07	Gateway Distriparks	Robust volume growth; *Result Update*	134	Buy
18-Oct-07	Gati	Softer quarter; *Result Update*	106	Buy.
12-Oct-07	Container Corporation	A bad patch; *Result Update*	1,954	Buy
14-Sep-07	Sical Logistics	Value unlocking; *Event Update*	239	Buy

Distribution of Ratings / Market Cap

Edelweiss Research Coverage Universe

	Buy	Accumulate	Reduce	Sell	Total
Rating Distribution*	101	44	24	6	183

* 6 stocks under review / 2 rating withheld

	> 50bn	Between 10bn and 50 bn	< 10bn
Market Cap (INR)	86	66	31

Rating Interpretation

Rating	Expected to
Buy	appreciate more than 20% over a 12-month period
Accumulate	appreciate up to 20% over a 12-month period
Reduce	depreciate up to 10% over a 12-month period
Sell	depreciate more than 10% over a 12-month period