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IPO Review

Pipavav Shipyard

Issue Opens	Issue Close
16/09/2009	18/09/2009

Order book concerns...

Pipavav Shipyard (PSL), promoted by SKIL infrastructure and Punj Lloyd, is targeting a rapid ramp up in its order book by focusing on the defence and offshore business. PSL's shipyard has become partly operational from April 2009 and should be fully operational by Q3FY10. Though the yard would be India's largest in terms of capacity with the capability to build various kinds of vessels, the current order book quality does not instil confidence. The order book is highly skewed in favour of dry bulk carriers, with more than 1/3 of the order book under renegotiation/arbitration process.

Planning to focus on business from defence sector

The Indian government's drive to go indigenous in the defence sector provides a huge opportunity for PSL. According to the company, the opportunity in the defence sector is about Rs 1,94,000 crore over the next five years. PSL has received enquiries from defence departments to the tune of Rs 15,000 crore.

Leveraging opportunities from Punj Lloyd's offshore business

As a co-promoter, Punj Lloyd has agreed to conduct all its offshore business (excluding the construction and fabrication of sub-sea pipelines) through PSL in India. This will enable PSL to leverage on Punj Lloyd's present and future business opportunities and grow rapidly in the offshore segment.

Large scale capacities and flexible product mix

Pipavav Shipyard is expected to have the largest dockyard in India of approximately 662 metres. The yard is expected to have the capacity to handle a wide array of vessels ranging from very large crude carriers to offshore supply vessels and naval defence vessels.

Concerns

- **Out of PSL's order book of 34 vessels, eight are under renegotiations while four are under arbitration**
- There are some court proceedings against PSL and its promoters, which can negatively impact the company if they are not decided in their favour

Valuations

At the lower band of the pricing range, PSL would trade at 14.4x FY11E earnings of Rs 3.8. Indian yards like ABG Shipyard and Bharati Shipyard trade at 6.9x and 3.3x FY11E earnings, respectively. On a price/book value basis, PSL would trade at 1.9x, whereas ABG trades at 0.9x and BSL trades at 0.6x FY11E book value. PSL has a larger yard capacity and modern equipment enabling faster execution of order book. However, we believe the issue is expensive considering the quality of the order book with 1/3 of the vessels to be built being under renegotiations/arbitration proceedings. At present, the risk-reward ratio for investors seems unfavourable, considering that companies in similar businesses are available at much more attractive valuations.

Exhibit 1: Key Financials

	FY09	FY10E	FY11E
Revenues	0.0	693.0	1748.3
EBITDA	-39.3	145.5	454.5
PAT	4.7	10.5	254.5

Source: Company, ICICIdirect.com Research

Price Band
Rs 55-60

AVOID

Analyst's Name

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Fact sheet

	Pre issue	Post issue
Equity (no of shares in cr)	58.0	66.6
Promoters (%)	45.4	39.6
Others (%)	9.9	21.5
Institution (%)	44.7	38.9

Issue details

Issue size (Rs crore)	470-513
No of shares on offer	85,450,225
QIB (60%)	50,910,135
Non-institutional (10%)	8,485,022
Retail (30%)	25,455,068
Minimum lot size	
Market cap (post issue) (Rs cr)	3663-3996

Comparison with other companies

Stock return (%)	3M	6M	12M
ABG Shipyard	19.6	264.4	-28.6
Bharati Shipyard	23.6	348.2	-21.2

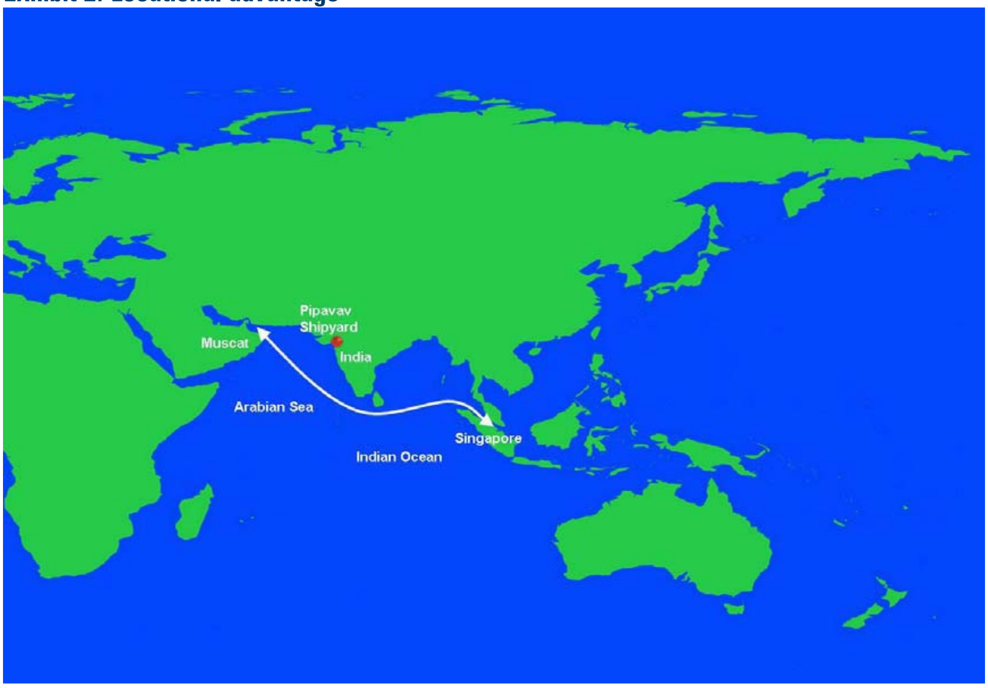
Company background

Pipavav Shipyard has been promoted initially by the SKIL group and Grevek Investments. Punj Lloyd later joined the bandwagon by picking up a stake of 22.29%.

SKIL and Punj Lloyd are renowned companies from the infrastructure segment. SKIL has executed prestigious projects like Pipavav Port and Pipavav Railway, while Punj Lloyd is a major name in engineering and offshore construction providing design, engineering, construction and project management services for various infrastructure projects.

PSL, post its full completion, will be the largest private sector shipyard in India. The shipyard was made partially operational in April 2009 and is expected to be fully commissioned in Q3FY10. The yard is located on the west coast of India near the Persian Gulf. The yard has the capacity to build very large and complex vessels from very large crude carriers (VLCC) to naval defence vessels and warships.

Exhibit 2: Locational advantage



Source: Company, ICICIdirect.com Research

Business model

PSL's yard is divided into two facilities. The yard has a separate facility for fabrication, which will have a peak capacity of 1,44,000 tonnes of steel. Apart from this, the yard has the largest dry dock in India with a width of 662 metres. PSL employs a modular approach to ship building, whereby the major parts are first assembled and then taken to the dry dock. PSL is planning to reduce the time spent in manufacturing a ship by reducing its time in the dry dock, thereby increasing the ship churn. It has a dedicated transport corridor to take the assembled blocks from the site to the dry dock.

Objects of the issue

- Construction of facilities for shipbuilding, ship repair and offshore business.
- Margin for working capital
- General corporate purpose

Pipavav Shipyard is ideally situated between Dubai and Singapore adjacent to some of the busiest shipping lanes in the world

Key Highlights

Planning to focus on business from defence sector

The Indian government's drive to go indigenous in the defence sector provides a huge opportunity for PSL. According to the company, the opportunity in the defence sector is about Rs 1,94,000 crore over the next five years. The company has received enquiries from defence departments to the tune of Rs 15,000 crore. PSL has bid for building two cadet ships and five naval offshore vessels each costing around Rs 1000 crore with a total tender value of about Rs 7000 crore.

Leveraging opportunities from Punj Lloyd's offshore business

As a co-promoter, Punj Lloyd has agreed to conduct all its offshore business (excluding the construction and fabrication of sub-sea pipelines) in India through PSL. This will enable PSL to leverage on Punj Lloyd' present and future business opportunities and grow rapidly in the offshore segment. Punj Lloyd is expected to provide PSL with access to opportunities in the offshore business industry, which includes business opportunities in the fabrication and construction of offshore platforms, rigs, jackets and vessels for the oil and gas industry.

Flexible product mix and locational advantage

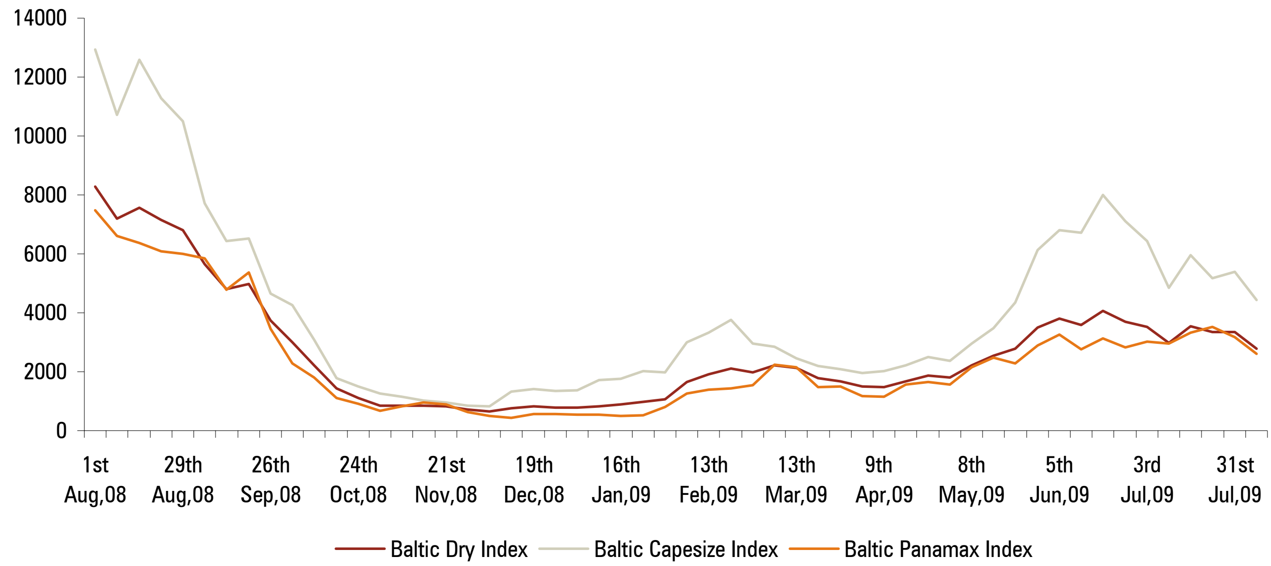
Pipavav Shipyard is expected to have the largest dockyard in India of approximately 662 metres. The yard is expected to have the capacity to handle a wide array of vessels ranging from very large crude carriers to offshore supply vessels and naval defence vessels. PSL with its large dockyard will have the capacity to build and repair ships of up to 400,000 DWT together with facilities for fabrication/assembly of products for the offshore sector. PSL is strategically located on the west coast of India adjacent to major sea lanes between the Persian Gulf and Asia. This would result in lower overhead expenses on logistics, etc. Also, being adjacent to one of the busiest trade routes, the company can look forward to capitalise on its ship repair capabilities.

Key concerns

Order book concerns

PSL has an order book of about Rs 4500 crore. The order book is skewed in favour of the dry bulk segment with 22 of the 34 vessels on the order book being dry bulk panamax vessels. Dry bulk freight rates and vessel values have both crashed in the last few months. The dry bulk index has come down from its peak of around 11,000 to 2,400 levels. Out of PSL's order book of 34 vessels, eight panamax vessels are under renegotiations while four panamax vessels are under arbitration. If any of these orders are cancelled or their prices are negotiated at substantial discounts then it would impact the revenue of PSL.

Exhibit 3: Fall in Baltic dry index



Source: Industry, ICICIdirect.com Research

Exhibit 4: Asset values

Asset Class		Current (USD Mn)		1 M Change (%)		3 M Change(%)		1Yr. Change(%)	
Tankers	**Size DWT**	**NB Contract**	**5Yr.**	**NB Contract**	**5Yr.**	**NB Contract**	**5Yr.**	**NB Contract**	**5Yr.**
VLCC/ULCC	300,000	110.0	76.0	0.9	0.0	0.9	-1.3	-28.7	-52.2
SUEZMAX	150,000	71.5	60.0	-7.1	0.0	-5.9	0.0	-24.1	-40.3
AFRAMAX	105,000	51.0	40.5	-3.8	-3.6	-15.7	-11.0	-32.0	-46.1
PANAMAX	70,000	45.2	37.0	-3.8	0.0	-13.1	-2.6	-37.7	-41.3
MR TANKERS	47,000	39.5	29.0	0.0	-3.3	-1.3	-9.4	-23.7	-45.0
Bulk	**Size DWT**								
CAPESIZE	170,000	64.0	50.5	-1.5	1.0	12.3	11.2	-32.5	-66.9
PANAMAX	74,000	39.4	34.0	-2.7	3.0	9.4	21.4	-28.0	-61.1
SUPRAMAX	52,000	32.0	27.0	0.0	0.0	6.7	8.9	-32.1	-62.5

Source: Industry, ICICIdirect.com Research

Financials

PSL is scheduled to deliver four ships by April 2010. We expect the company to report revenues of Rs 693 crore and Rs 1748.3 crore in FY10E and FY11E, respectively. The EBITDA margin is expected to improve from 21% in FY10E to 26% in FY11E. The company's PAT is expected to improve substantially from Rs 10.5 crore in FY10E to Rs 254.5 crore in FY11E.

Exhibit 5: Profit & Loss A/c **Rs Crore**

	FY09	FY10E	FY11E
Revenues	0.0	630.0	1575.0
Subsidy	0.0	63.0	173.3
Total Revenue	**0.0**	**693.0**	**1748.3**
Total Expenses	**39.3**	**547.5**	**1293.7**
EBITDA	-39.3	145.5	454.5
EBITDA (%)		**21**	**26**
Depreciation	0.2	70.0	110.0
Interest expense	13.0	100.0	120.0
Other Income	61.8	35.0	30.0
PBT	**9.4**	**10.5**	**254.5**
Tax	4.7	0.0	0.0
PAT	**4.7**	**10.5**	**254.5**
EPS (Rs)	**0.1**	**0.2**	**3.8**

Source: Company, ICICIdirect.com Research

Exhibit 6: Balance sheet **Rs Crore**

	FY09	FY10E	FY11E
Share Capital	580.3	665.8	665.8
Reserves & Surplus	674.4	1058.9	1313.5
Net worth	**1254.7**	**1724.7**	**1979.3**
Total Debt	1153.6	1453.6	1603.6
TOTAL	**2408.3**	**3178.3**	**3582.9**
Gross Block	71.1	2638.7	2705.1
Less : Depreciation	8.1	92.4	108.2
Net Block	**63.0**	**2546.3**	**2596.9**
CWIP	2273.9	300.0	150.0
Investments	48.5	48.5	48.5
Net Working Capital	22.3	283.5	787.5
Intangible assets	0.6	0.0	0.0
TOTAL	**2408.3**	**3178.3**	**3582.9**

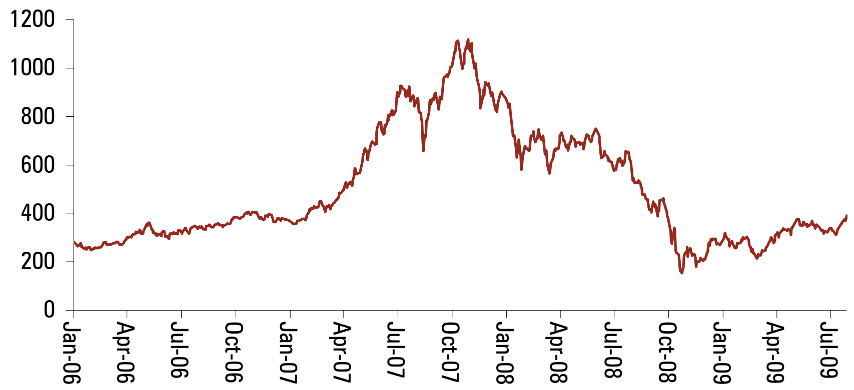
Source: Company, ICICIdirect.com Research

The estimates for FY10E and FY11E are quick estimates based on the information available in the prospectus

Valuations

The current scenario for shipbuilding has been gloomy on account of a fall in world trade. This has resulted in a vast number of orders for various vessels being cancelled and/or postponed or being renegotiated. The vessel values across categories have declined, with dry bulk carriers new build vessel values being down by 30-40% YoY. PSL's present order book is skewed in favour of dry bulk carriers. PSL has an order book of 22 Panamax vessels, out of which eight are under renegotiation and four are under arbitration. Any reduction in value of contract or cancellation could result in a lower order book value. The shipbuilding activity across the globe has declined considerably from its peak and has remained muted in recent times as can be seen from the BPR Asia Pacific Shipbuilding Index.

Exhibit 7: BPR Asia Pacific Shipbuilding Index



Source: Company, ICICIdirect.com Research

At the lower band of the pricing range, PSL would trade at 14.4x FY11E earnings of Rs 3.8. Indian yards like ABG Shipyard and Bharati Shipyard trade at 6.9x and 3.3x FY11E earnings, respectively. On a price/book value basis, PSL would trade at 1.9x, whereas ABG trades at 0.9x and BSL trades at 0.6x FY11E book value. PSL has a larger yard capacity and modern equipment, which will lead to faster execution of order book and enable it to capitalise on opportunities in the sector when the scenario improves. However, we believe the issue is expensive considering the quality of order book with 1/3 of vessels to be built being under renegotiations/arbitration proceedings. At present, the risk reward ratio for investors seems unfavourable, considering that companies in similar businesses are available at much more attractive valuations.

Exhibit 8: Peer valuation FY11E

	ABG Shipyard	Bharati Shipyard	Pipavav Shipyard
Revenues (Rs Cr)	2068.5	1550.2	1748.3
PAT (Rs Cr)	215.3	178.6	254.5
EPS (Rs)	39.2	64.4	3.8
Price Earning Ratio (x)	6.9	3.3	14.4
Price/Book Value (x)	0.9	0.6	1.9

Source: Company, ICICIdirect.com Research

RATING RATIONALE

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Outperformer (OP): 20% or more;
Performer (P): Between 10% and 20%;
Hold (H): ±10% return;
Underperformer (U): -10% or more;

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