India Ports Sector

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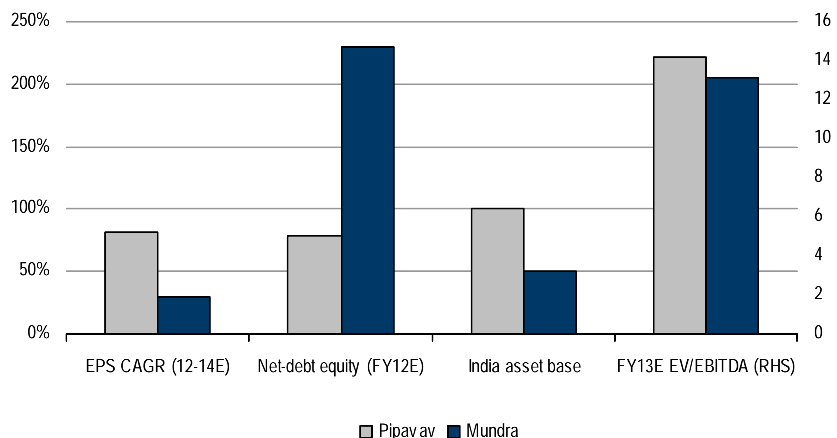
SECTOR REVIEW

Buy the asset, not hype

Figure 1: **Pipavav appears a better play in current environment**



Source: Company data, Credit Suisse estimates

- **The structural story of Gujarat's private ports is attractive:** Minor ports in India are gaining market share as major ports suffer from high capacity utilisation, lack of incentive to improve efficiency due to regulated tariffs, and lack of new investments. Gujarat-based private ports have been able to grow its market share aided by favourable policy framework.
- **However, changing competitive and regulatory landscape pose challenges:** Increasing private sector participation in the ports sector has begun to address capacity constraints, and expansions in operational greenfield ports alone has potential to largely address the growth of bulk cargo segment between FY11 and FY20. We are also beginning to see increasing regulatory headwinds aimed at creating a level-playing field (bring private ports under Tariff Authority of Major Ports (TAMP), corporatise major ports). These in turn potentially risk pricing power and linear volume growth, especially in bulk cargo. Aggressive expansion on the quay-side poses risk of under-utilisation and negative leverage.
- **We prefer stocks with higher entry barriers and lower downside risks:** We initiate coverage on Gujarat Pipavav with an OUTPERFORM rating,as we see high entry barriers in its container business, a stronger balance sheet, exposure to a more industrialised primary hinterland, and lower downside risks in case proposed expansions are delayed. We assume coverage on Mundra Ports with an UNDERPERFORM rating as we anticipate its large Australian acquisition to remain an overhang in the form of refinancing risk, lowers ascribable market premium, dilutes attractive Mundra port ROCE's and is earnings dilutive till FY13E. We also assume coverage on Essar Ports with a NEUTRAL.

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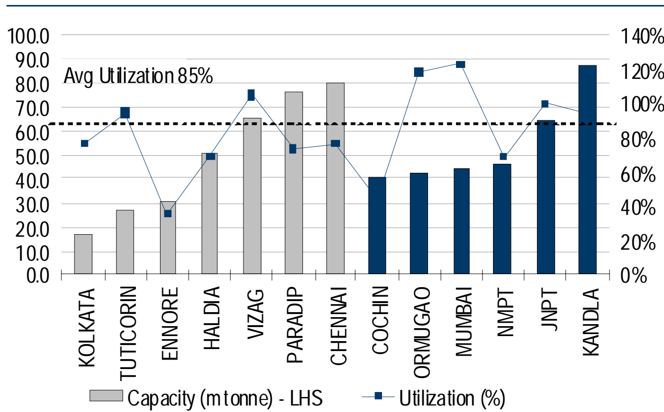
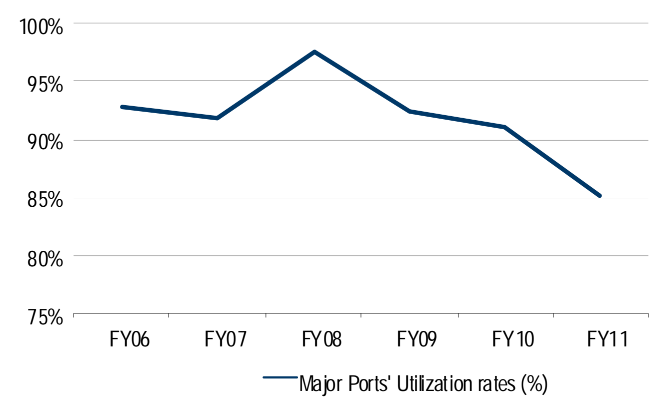
Focus charts

Figure 2: Utilisations at major ports are at 85%



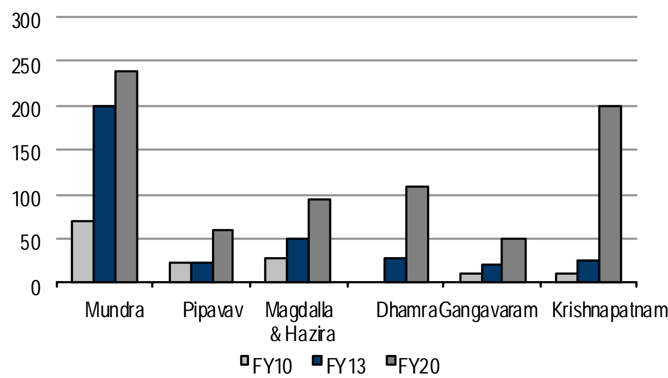
Source: IPA, Credit Suisse estimates

Figure 3: Lack of capacity addition has led to continued high utilisation of major ports



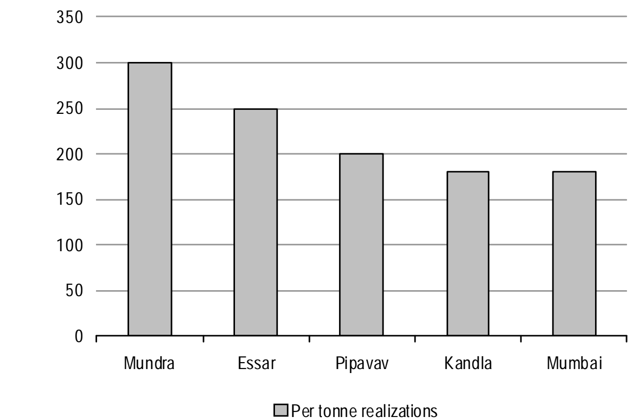
Source: IPA, Credit Suisse estimates

Figure 4: Operational private greenfield ports have ambitious plans and are building large capacities



Source: Company data, Credit Suisse estimates

Figure 5: Regulatory reforms and easing of capacity bottleneck can pressurise avg realisations



Source: Company data, Credit Suisse estimates

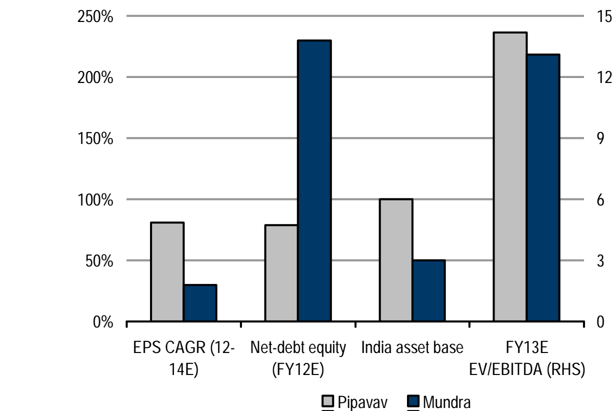
Figure 6: Linear demand growth (bulk cargo) assumptions for large ports such as Mundra appear at risk

mn tonne	FY10A	FY12E	FY15E	FY20E
Gujarat Minor port Capacity (ex-Mundra)	207	237	383	686
Mundra - Capacity (based on mgmt plans)	36	165	240	240
Total capacity (Gujarat minor ports)	**244**	**402**	**623**	**926**
POL demand		142	183	273
Bulk cargo demand		76	121	182
Container traffic demand		30	54	110
Total demand (Gujarat minor ports)	**206**	**248**	**358**	**565**

Source: Shipping Ministry, Credit Suisse estimates

Note - FY10 Mundra capacity as per Shipping Ministry estimate

Figure 7: Pipavav currently appears a better direct play with high entry barriers and lower risk



Source: Company data, Credit Suisse estimates

Investment summary

The structural story for Gujarat's private ports is attractive

Minor ports in India are gaining market share as major ports suffer from high capacity utilisation, lack of incentive to improve efficiency due to regulated tariffs, and lack of new investments. Gujarat-based private ports have been able to grow its market share aided by favourable policy framework, and closer access to northern hinterland which accounts for some 40% of India's industrial production.

Changing competitive and regulatory landscape pose challenges

Increasing private sector participation in the ports sector is beginning to address the large capacity constraints of government-controlled major ports, in our view. Expansions in operational greenfield ports alone can address to a large extent the growth of bulk cargo segment between FY11 and FY20. The container segment appears most favourable, with strong entry barriers and continued capacity constraints.

2011 has also been an important year for the ports sector in terms of regulatory reforms with the Shipping Ministry increasingly looking to create a level-playing field. Measures proposed include bringing private ports under the ambit of TAMP (limiting pricing power), and corporatisation of major ports.

We anticipate the premium pricing enjoyed by private ports can begin to erode as capacity bottlenecks get addressed, and risks exist to linear volume growth assumptions especially on bulk cargo growth.

Aggressive expansion on the quay-side, without sufficient demand visibility could lead to under-utilisation and negative leverage, in our view.

We prefer stocks with higher entry barriers and lower downside risks

We initiate coverage on Gujarat Pipavav with an OUTPERFORM rating and a target price of Rs66 (17% upside) based on sum-of-the-parts valuation (DCF-value of ports is Rs64, and we value the investment in rail at book (Rs2). The company enjoys high entry barriers in its container business, a stronger balance sheet, exposure to a more industrialised primary hinterland, and lower downside risks in case proposed expansions are delayed.

We assume coverage on Mundra Ports with an UNDERPERFORM rating and a target price of Rs112 (11% downside) based on sum of the parts valuation (DCF-value of Indian ports business is Rs.91, Abbot Point contributes Rs12, SEZ is valued at Rs7 and investment in rail at book value of Rs2. We anticipate its large Australian acquisition to remain an overhang in the form of refinancing risk, lowers ascribable market premium, dilutes attractive Mundra port ROCE's and is earnings dilutive till FY13E. Further, we believe downside risks exist to linear volume growth assumptions especially in non-contracted bulk cargo and consensus downgrades are likely to continue to remain an overhang on stock.

We assume coverage of Essar Ports with a NEUTRAL rating and a target price of Rs62. Our target price of Rs62 (13% upside) is based on 8x FY13E EV/EBITDA (premium to Chinese peers and discount to Indian peers).

Sector valuation summary

Figure 8: **Regional valuation comps**

Company	Current price	Target price	M cap US$ bn	Rating	P/E T+1	P/E T+2	P/B T+1	P/B T+2	RoE T+1	RoE T+2	EV/EBITDA T+1	EV/EBITDA T+2
India												
Mundra Port and Special Economic Zone	126.50	112.00	4.80	U	26.1x	18.2x	5.2x	4.3x	23%	28%	17.8x	13.1x
Gujarat Pipavav Port Limited	56.50	66.00	0.45	O	58.9x	26.5x	3.1x	2.8x	5%	11%	16.7x	14.2x
Essar Ports Ltd	54.90	62.00	0.43	N	18.1x	10.6x	1.0x	0.9x	6%	9%	8.8x	7.8x
China												
China Merchant Holdings	24.05	28.00	7.66	O	13.5x	13.1x	1.4x	1.3x	10%	10%	9.7x	9.2x
Cosco Pacific	1.27	1.86	3.44	O	8.7x	7.7x	1.0x	0.9x	11%	12%	7.1x	7.4x
Dalian Port (PDA) Co	1.50	3.08	1.65	N	8.1x	7.0x	0.5x	0.5x	6%	7%	8.4x	5.9x
Tianjin Port Developments Holdings Ltd	1.00	1.99	0.79	N	9.2x	8.6x	0.7x	0.6x	7%	7%	3.8x	3.6x
Shanghai International Port Group	2.59	4.86	8.63	N	11.9x	11.0x	1.4x	1.3x	11%	12%	5.1x	4.7x
Shenzhen Chiwan Wharf Holdings Ltd	9.10	13.36	0.87	O	9.1x	8.1x	1.8x	1.6x	20%	20%	4.2x	3.8x
Others												
Hutchison Port Holdings Trust	0.65	0.68	5.62	U	19.4x	19.8x	0.6x	0.6x	3%	3%	9.6x	9.4x
DP World	9.80	12.48	8.13	N	14.7x	12.8x	1.1x	1.0x	7%	8%	8.7x	7.7x
Sector average (ex-India)					11.8x	11.0x	1.0x	1.0x	10%	10%	7.1x	6.5x
Sector average (Chinese Ports)					10.1x	9.3x	1.1x	1.0x	11%	11%	6.4x	5.8x
Sector average (Indian Ports)					34.4x	18.4x	3.1x	2.7x	11%	16%	14.4x	11.7x

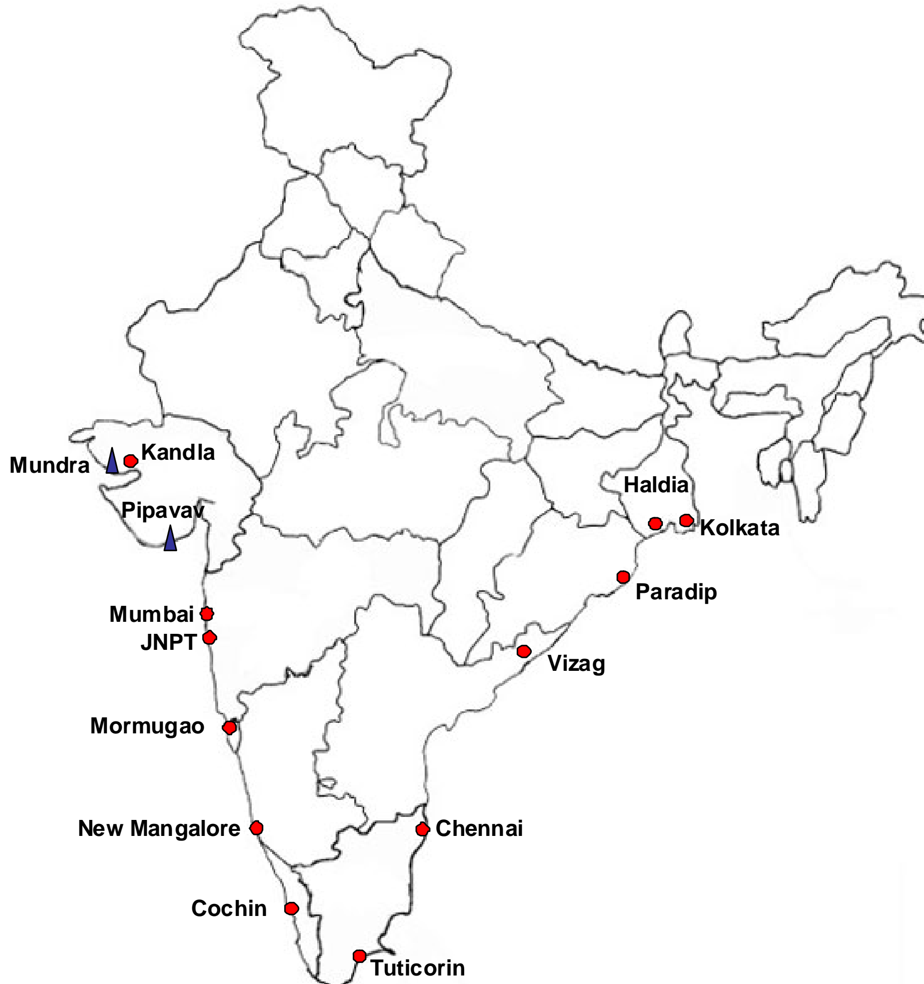
Source: Company data, Credit Suisse estimates

The structural story

The case for strong growth at minor ports

India's seaports carry about 95% of their total trade by volume and 70% by value. India has a vast coastline of 7,500 kms and has 13 major ports which accounted for some 66% of total traffic handled at the ports in FY11.

Figure 9: **India's major ports and Mundra/Pipavav**

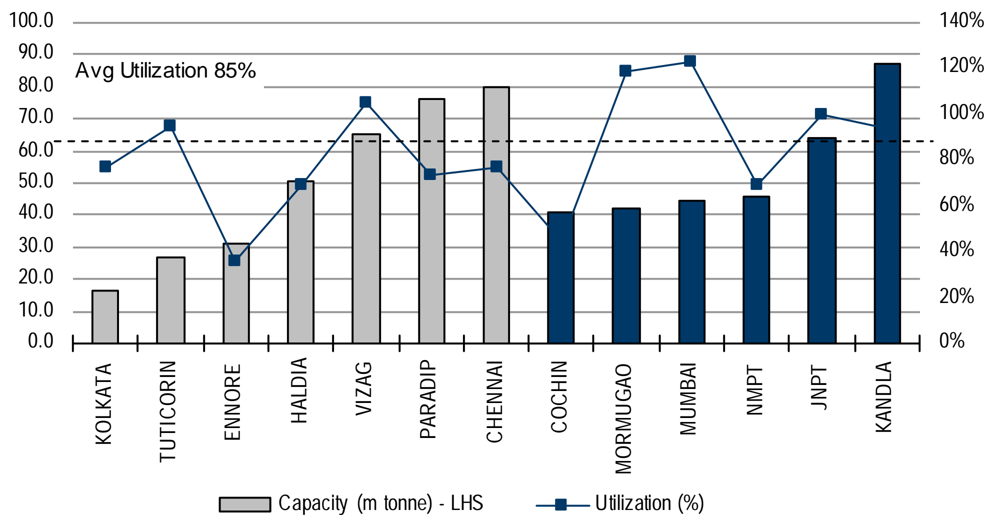


Source: Company data, Credit Suisse estimates

Key major ports are running at high utilisation rates

Of the 13 major ports, six are located on the west coast and six on the east coast. The west coast ports account for about 53% of total traffic handled. Most of the larger ports are running at near-capacity, which suggests strong market share gain potential for the non-major ports (minor ports) over the near-term.

Figure 10: Major ports are running at high utilization rates

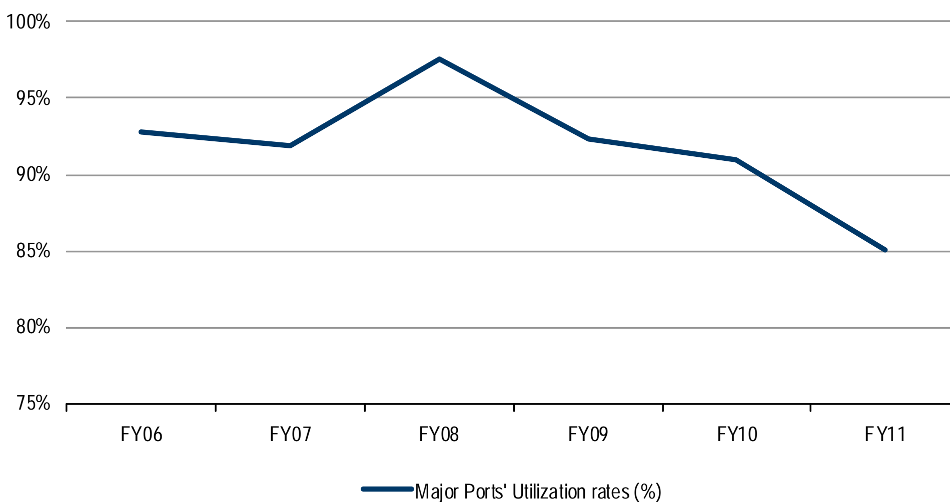


Source: IPA, Credit Suisse estimates

Inefficiencies and regulatory hurdles has slowed down major port expansions

Expansions at major ports have been slow and only about 60% of the XI plan target has been met thus far. The main reason for the slippage is the delay in awarding the public-private partnership projects, which were impacted by absence of proper documents like model concession agreement, request for qualification and request for proposal.

Figure 11: Utilisation rates have historically remained high



Source: IPA, Credit Suisse estimates

Further, the efficiency metrics at major ports in India far lag behind other regional ports. This can be attributed to lower levels of mechanisation, ceiling on tariffs restricted by Tariff Authority of Major Ports (TAMP) on the basis of cost + 16% ROCE which minimises scope for significant efficiency gains and presence of strong labour unions.

Minor ports enjoy more flexibility

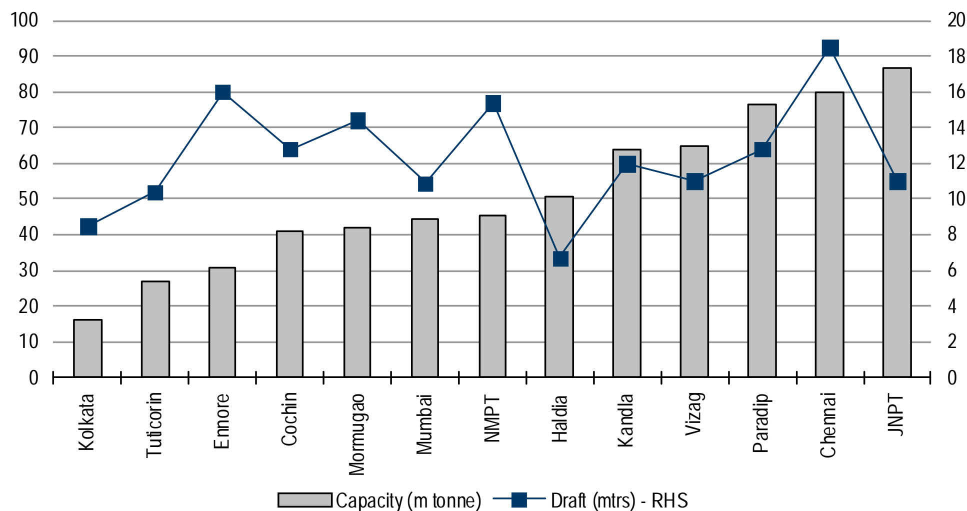
Minor ports come under the purview of respective State Maritime Boards, and are set up on a royalty share basis with freedom to set its own tariffs, which allows the private developers to build in cost pass-throughs unlike private operators in major ports. Further,

since most are greenfield ports, the governments also provide help in land acquisition in addition to waterfront access.

Deeper drafts are in sync with growing needs of shipping lines

Shipping lines globally are beginning to deploy larger ships across key trade routes. These ships require deeper drafts. However, most of the major ports are currently constrained by small drafts as the figure below shows.

Figure 12: **Major ports need to increase the drafts to accommodate larger vessels**



Source: IPA, Credit Suisse estimates

The GDP to trade multiplier is some 1.5x and incremental demand should bode well for private ports

Historically, there has been a strong correlation between GDP growth and trade growth with a multiplier of 1.5x. Hence, while demand continues to increase, growth at major ports has been lagging resulting in the shift in market share to emerging minor ports.

Gujarat has been at the forefront of growth

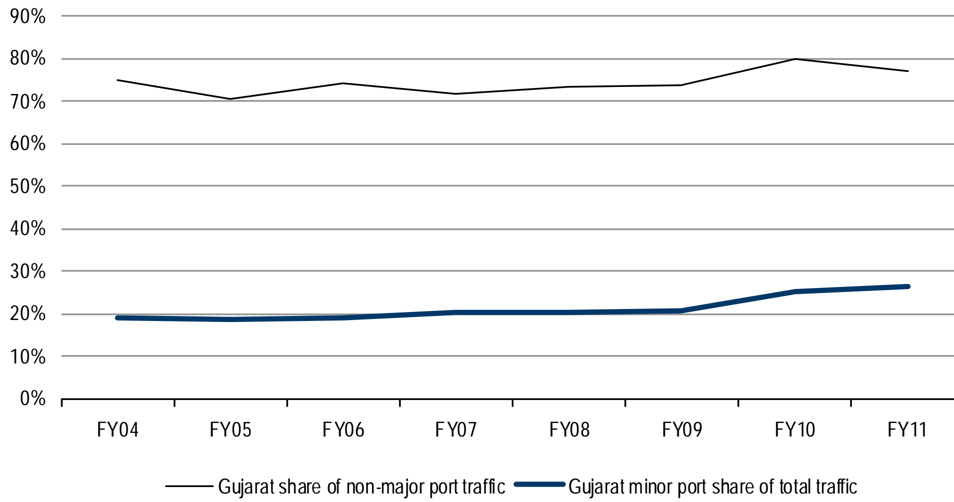
Favourable investment policy framework

Gujarat was one of the earliest to come out with a comprehensive public-private partnership (PPP) model on the basis of Build, Own, Operate and Transfer (BOOT). The typical concession agreements were drawn for a 30-year period, and could be renewed for an additional 20-year period (on revised terms, however).

More importantly, the royalty (or revenue share) agreements were set low to incentivise development.

The resultant growth has led to Gujarat's minor ports now handling nearly 77% of total Indian minor port traffic in FY11 and almost 27% of total cargo handled at all ports.

Figure 13: Gujarat's share of total cargo traffic in India has been increasing



Source: Shipping Ministry, Credit Suisse estimates

Changing competitive and regulatory landscape pose challenges

Minor ports in Gujarat beginning to scale up

Capacity appears to being added well ahead of projections in Gujarat

According to Gujarat Maritime Board, the capacity at its non-major ports will grow 3x from FY11 to FY20E. While we expect Mundra Port to be a key contributor to the capacity growth, investors should also bear in mind that ports tend to have operational leverage, and unused capacity can pressure margins.

Figure 14: **Forecasted demand-supply gap at Gujarat's non-major ports by GMB**

	2007-08	2010-11	2019-20
Demand : Non major ports only	148	226	740
Capacity*@ : Gujarat ports	203	303	990
Total supply at Gujarat Ports(MMTPA)(75% of capacity)	153	227	742
Demand-supply gap	-5	-1	-2

Source: Gujarat Maritime Board

Mundra's aggressive expansion has already put its capacity at 200 mn tonnes, while the Shipping Ministry estimates expect it to reach the same figure by 2020. Non-major ports in Gujarat had an operational capacity of 244 mn tonne as of March 2010, and if we include Mundra's current expansion, total capacity is estimated to be 437 mn tonne.

Figure 15: **Shipping Ministry projection of capacity development at key non-major Gujarat ports**

	FY10 (actual)	FY12	FY13	FY14	FY15	FY16	FY17	FY18	FY19	FY20
Dahej	13.2	16.2	28.2	42.2	42.2	42.2	55.2	55.2	55.2	70.2
Mundra (GAPL)	36.2	66.2	75.2	75.2	80.2	95.2	122.2	132.2	132.2	178.2
Pipavav (GPPL)	23.4	23.4	28.4	33.4	38.4	38.4	38.4	58.4	58.4	80.9
Sikka	104.6	109.6	109.6	109.6	124.6	124.6	124.6	124.6	124.6	124.6
Magdalla & Hazira	27.1	43.1	43.1	58.1	70.1	70.1	70.1	95.1	95.1	95.1
Total Gujarat Ports	**243.6**	**303.6**	**353.6**	**403.6**	**458.6**	**507.6**	**584.6**	**687.7**	**761.0**	**864.0**

Source: Ministry of Shipping – Indian Maritime Agenda 2010-20, Credit Suisse estimates

Figure 16: **Shipping Ministry forecast of demand for non-major Gujarat ports**

mn tonne	FY12	FY13	FY14	FY15	FY16	FY17	FY18	FY19	FY20
POL	142	153	167	183	200	219	239	256	273
Iron Ore	10	11	12	13	15	16	18	20	22
Coal	25	43	48	53	59	66	73	78	83
Fertilizer	4	4	4	5	5	5	5	5	5
Containers	30	39	46	54	64	74	87	98	110
Others	37	43	47	50	53	58	63	66	72
Total	248	293	324	358	396	438	485	523	565

Source: Ministry of Shipping – Indian Maritime Agenda 2010-20, Credit Suisse estimates

Figure 17: **Linear demand growth (bulk cargo) assumptions for large ports such as Mundra appear at risk**

mn tonne	FY10A	FY12E	FY15E	FY20E
Gujarat Minor port Capacity (ex-Mundra)	207	237	383	686
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Total capacity (Gujarat minor ports)	**244**	**402**	**623**	**926**
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Total demand (Gujarat minor ports)	**206**	**248**	**358**	**565**

Source: Shipping Ministry, Credit Suisse estimates

Note - FY10 Mundra capacity as per Shipping Ministry estimate

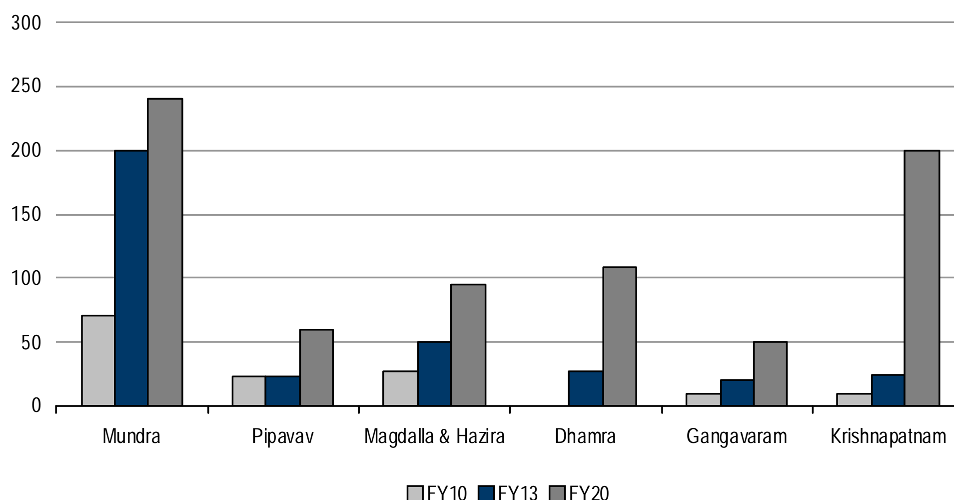
Operational greenfield ports across India are building a fair amount of capacity

We have analysed the capacity expansion plans of the key private players with current operational ports across the east and west coast, which suggest that most are building or have plans to build significant capacity over the coming years.

Further, these ports are targeting deeper drafts (>14.5 m) to handle larger vessels which are expected to come online.

In addition to below operational greenfield ports, there are expansions underway at major ports, as well as plans for new greenfield projects (Vizhinjam trans-shipment terminal) which can further ease congestion at ports.

Figure 18: **Large greenfield private port operators have ambitious growth plans**



Source: Company data, Credit Suisse estimates

Regulatory changes can impact pricing power

Regulating the minor ports

The draft regulatory port bill 2011 has suggested bringing minor ports under the preview of the tariff regulator (TAMP), which can impact pricing as tariffs will be capped on cost +16% ROCE.

While such a move appears unlikely over the near term as it will hurt private investor sentiment, the direction of policy regulations in the sector appear headed in the way of regulating meaningfully large private ports as competition in the sector increases.

Corporatisation of major ports

Government has been exploring the option to corporatise the major ports in order to improve their efficiency. The key opposition to this has been strong labour unions at the major ports, who are opposed to the move.

Further, the mere corporatisation of major ports does not necessarily improve efficiency as is seen in the case of Ennore (a corporatised port) which still regulates tariffs on the basis of TAMP.

Premium pricing and significant volume gains appear at risk

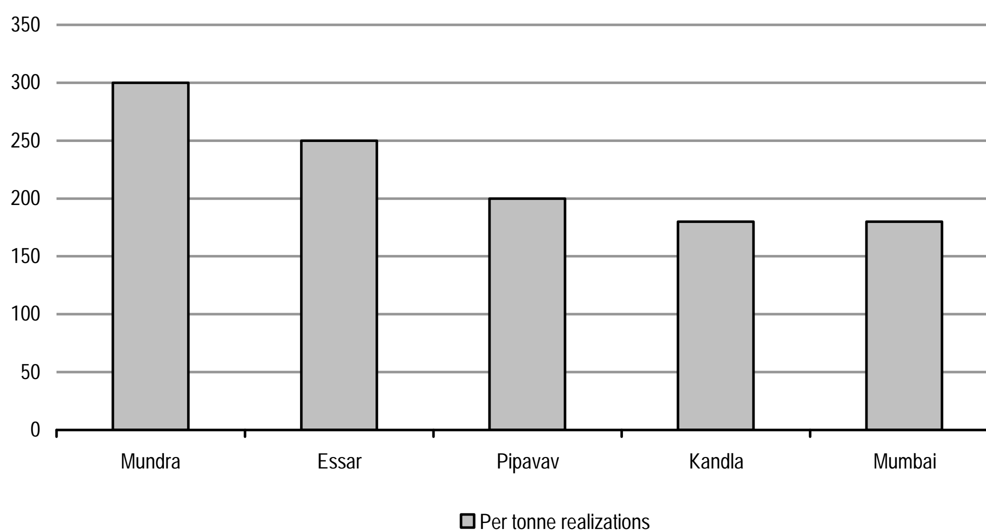
Private ports charge a premium for its services, and mostly due to higher efficiency

Rates charged by Mundra currently are as high as Rs300 per tonne for dry bulk, which is likely to be an impediment to growth of non-contracted volumes, in our view.

We believe the company will have to strike a balance between pricing and volume growth growing forward, especially on bulk cargo.

Our checks with IFFCO (the largest fertiliser importer) suggest that while it imports fertilisers at Kandla, Mundra and Pipavav, a key consideration for it is also the cost per tonne where Pipavav and Kandla appear more competitive.

Figure 19: **Mundra charges a premium to peers—unlikely to sustain in the long-run**



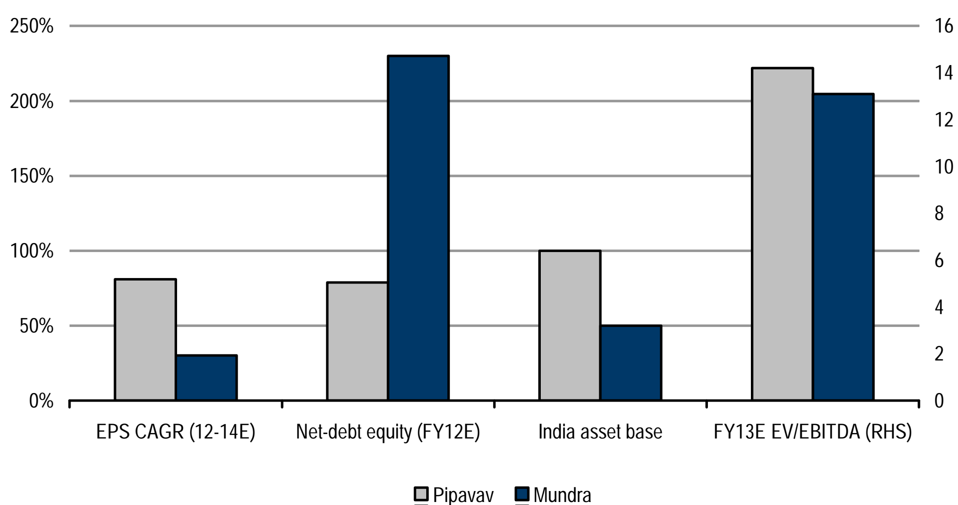
Source: Company data, Credit Suisse estimates

We prefer stocks with higher entry barriers and lower downside risks

We initiate coverage on Gujarat Pipavav with an OUTPERFORM rating and a target price of Rs66 based on sum-of-the-parts valuation (DCF-value of ports is Rs64, and we value the investment in rail at book (Rs2). The company enjoys high entry barriers in its container business, a stronger balance sheet, exposure to a more industrialised primary hinterland, and lower downside risks in case proposed expansions are delayed.

We assume coverage on Mundra Ports with an UNDERPERFORM rating and a target price of Rs112 based on sum-of-the parts valuation (DCF-value of ports business is Rs91, Abbot Point contributes Rs12, SEZ is valued at Rs7 and rail at book value of Rs2). We anticipate its large Australian acquisition to remain an overhang in the form of refinancing risk. It also lowers ascribable market premium, dilutes attractive Mundra port ROCE's and is earnings dilutive till FY13E. Further, we believe downside risks exist to linear volume growth assumptions especially in non-contracted bulk cargo and consensus downgrades are likely to continue.

Figure 20: Pipavav currently appears a better direct play with high entry barriers and lower risk



Source: Company data, Credit Suisse estimates

Asia Pacific / India
Marine Ports & Services

Mundra Port and Special Economic Zone (MPSE.BO / MSEZ IN)

Rating	(from Outperform) UNDERPERFORM*
Price (05 Jan 12, Rs)	126.50
Target price (Rs)	(from 162.00) 112.00[1]
Chg to TP (%)	-11.5
Market cap. (Rs mn)	253,429
Enterprise value (Rs mn)	377,295
Number of shares (mn)	2,003.39
Free float (%)	23.0
52-week price range	164.4 - 114.6

*Stock ratings are relative to the relevant country benchmark.
[1]Target price is for 12 months.

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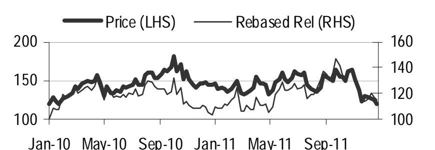
An increasingly risky place to hide

- **A stretched balance sheet limits growth prospects:** We assume coverage of Mundra Port with an UNDERPERFORM rating and a target price of Rs112 (11% downside). We believe Mundra's aggressive expansion has begun to stretch its balance sheet especially post the Abbot Point acquisition in Australia. We believe Abbot Point was an expensive buy and will be earnings dilutive till FY13E. Further, consolidated gearing will now rise to 2.3x in FY12E, limiting future growth prospects. Ex-Mundra asset additions contribute 50% to balance sheet but provide only 10% of value, which will depress return profile over the longer term. We believe strong cash flow generation of core Mundra asset is priced in.
- **Mundra – Great port asset, but yet to price in potential risks:** Consensus and CS estimates factor some 88 mn tonne and 99 mn tonne of traffic handling at Mundra Port in FY13E and FY14E (of which 42% is driven by contracts). According to Shipping Ministry estimates, total coal demand across non-major ports in Gujarat is estimated at 53 mn tonne in FY15E, and management estimates alone factor Mundra to contribute 80%, which appears aggressive considering operational capacity across Gujarat ports. Any decline in anticipated off-take could amplify downside due to operational leverage. We believe risks exist to Mundra's premium pricing and linear volume growth assumptions over FY12-14E. Further, we are less bullish on industrialisation prospects at the SEZ driven by common settlement problems (fresh water availability, etc).
- **Scarcity premium to reduce, initiate coverage with UNDERPERFORM:** The stock has outperformed the Sensex over 12 months driven by visibility of core Mundra asset. We believe the street's DCF-valuations factor a blue-sky scenario for Mundra's projects including the extension of BOOT concession on current terms post 2031 which contributes nearly 20% of target price (we treat it as option value). Consensus downgrades of estimates is yet to catch up especially for FY13 estimates. Additional risks include pending litigations which include ministry of environment's ruling on mangrove deforestation.

Share price performance



The price relative chart measures performance against the BSE SENSEX IDX which closed at 15857.08 on 05/01/12
On 05/01/12 the spot exchange rate was Rs52.82/US$1

Performance Over	1M	3M	12M
Absolute (%)	-1.8	-18.9	-19.7
Relative (%)	3.8	-16.6	2.2

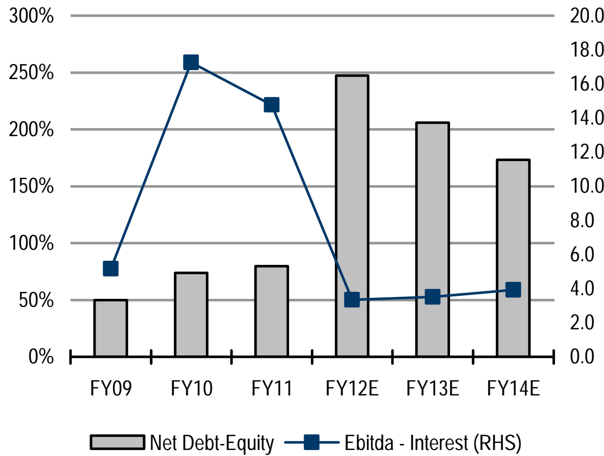
Financial and valuation metrics

Year	3/11A	3/12E	3/13E	3/14E
Revenue (Rs mn)	20,001.1	31,999.0	43,775.8	53,977.0
EBITDA (Rs mn)	12,994.0	21,212.9	28,754.2	35,433.3
EBIT (Rs mn)	10,606.5	16,311.0	22,845.4	29,147.4
Net income (Rs mn)	9,181.4	9,726.6	13,956.6	16,427.2
EPS (CS adj.) (Rs)	4.58	4.86	6.97	8.20
Change from previous EPS (%)	n.a.	-22.9	-23.8	
Consensus EPS (Rs)	n.a.	5.7	8.3	10.4
EPS growth (%)	35.8	5.9	43.5	17.7
P/E (x)	27.6	26.1	18.2	15.4
Dividend yield (%)	0.7	1.0	1.4	1.6
EV/EBITDA (x)	22.1	17.8	13.1	10.7
P/B (x)	6.0	5.2	4.3	3.6
ROE (%)	24.0	21.4	25.8	25.3
Net debt/equity (%)	77.9	247.4	206.4	173.4

Source: Company data, Thomson Reuters, Credit Suisse estimates.

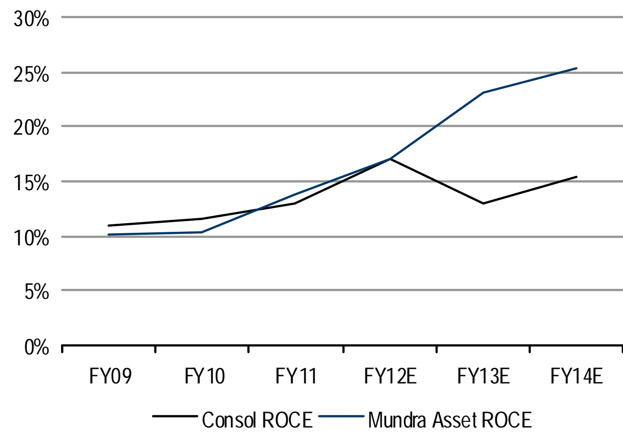
Focus charts

Figure 21: **Stretched balance sheet likely to limit growth**



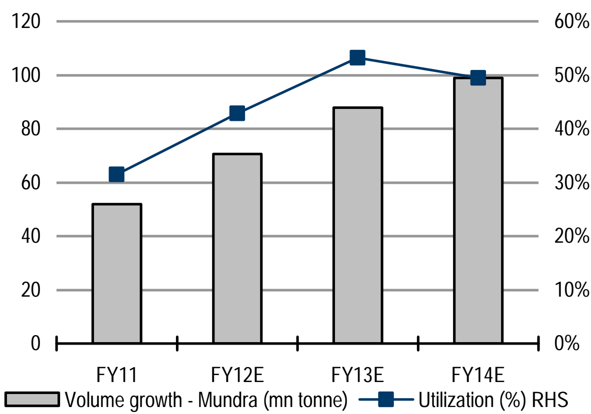
Source: Company data, Credit Suisse estimates

Figure 22: **Returns impacted by non-Mundra assets**



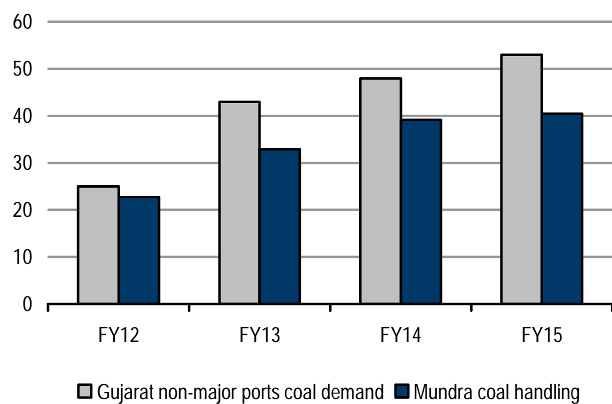
Source: Company data, Credit Suisse estimates

Figure 23: **Low utilisations despite volume ramp-up can hurt margins due to leverage**



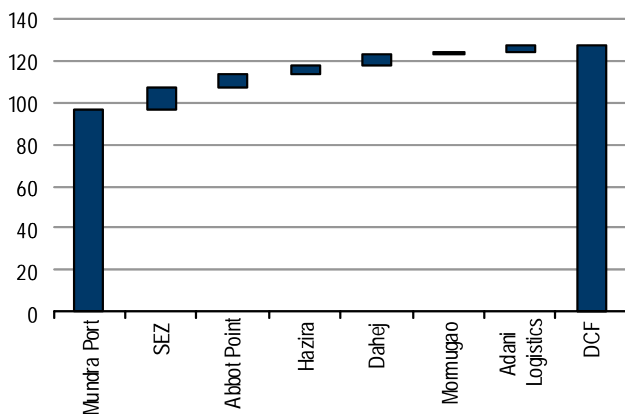
Source: Company data, Credit Suisse estimates

Figure 24: **We see risk to linear demand growth assumption for non-contracted coal and dry bulk cargo**



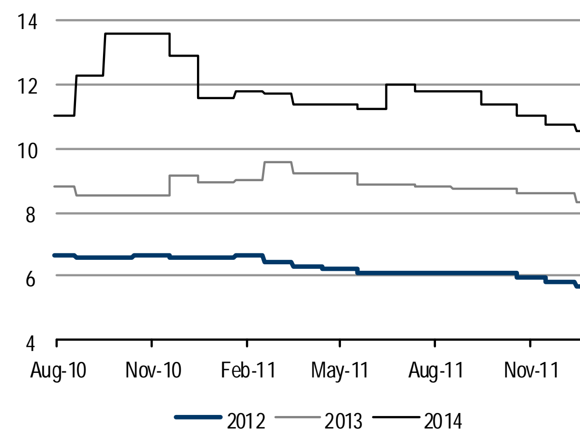
Source: Shipping Ministry, Company data, Credit Suisse estimates

Figure 25: **Mundra contributes 75% of DCF-value**



Source: Company data, Credit Suisse estimates

Figure 26: **Consensus downgrades to continue**



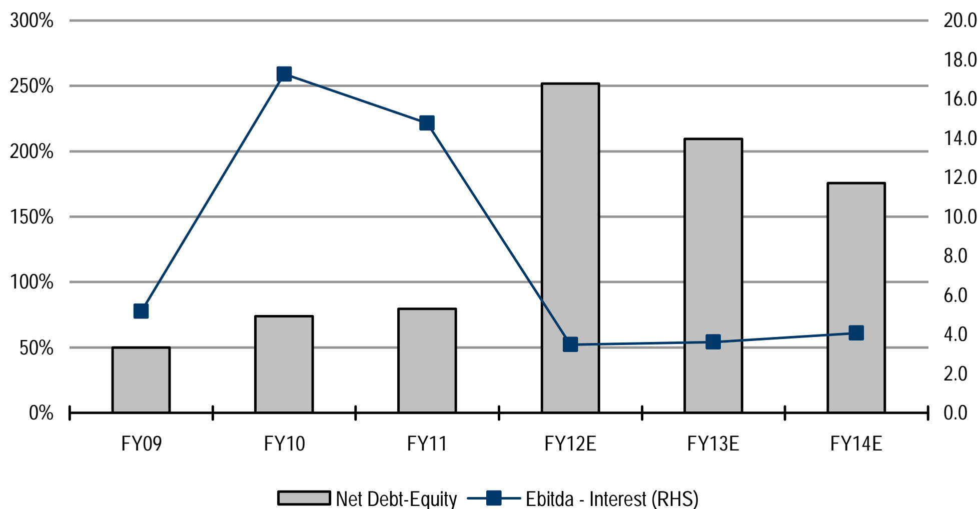
Source: Company data, Credit Suisse estimates

Stretched balance sheet limits growth

Abbot Point acquisition has considerably stretched MPSEZ balance sheet

Mundra Port's debt-funded acquisition of Abbot Point Coal Terminal in Australia in June 2011 for A$1.83 bn raises consolidated FY12E gearing to 2.5x from 0.8x, decreases interest cover from 14x to 3.5x, is anticipated to dilute consolidated earnings in FY12E and FY13E by 18% and 8% respectively, and limits ability to tap into new growth over the near term.

Figure 27: **Consolidated gearing set to increase due to Abbot Point acquisition**



Source: Company data, Credit Suisse estimates

We appreciate the strategic intent, but not the right vehicle and price

Adani Group's strategic intent to own Abbot Point is due to its proximity to Galillee basin from where it expects to start mining coal in 2016. The Abbot Point acquisition was done at a premium to its book value of A$1.6 bn. This is in comparison to other port deals such as Brisbane Port (November 2010) which was done at 0.9x book, making the acquisition look expensive.

The entire transaction has been funded by bridge financing (LIBOR + 300 bp) and will come up for refinancing by June 2012. In an environment, where asset values are under pressure, and liquidity remains tight, we anticipate refinancing risk to remain an overhang on the stock.

Only a pure debt-funded deal can justify the buy – a risky move given the size

The deal is value accretive only if it is wholly debt-funded, which is a risky move in our view, as returns are regulated in government controlled coal terminals in Australia. While there is visibility till 2016E through take-or-pay contracts, utilisation of the capacity post the period remains unclear (potentially Adani Group can utilise the same when take-or-pay contracts begin to expire).

Further, the asset is likely to see returns getting capped (ROCE equal to WACC, currently around 8% in Australia), which implies that the company is unlikely to be able to command significant pricing power over the long term. The government-owned coal terminals (such as Abbot Point) operate and conform with competition policy requirements and open-access provisions.

Expansion beyond 50 mn current capacity is still unclear

According the North Queensland Bulk Ports authority (NQBP), the original plan was to expand the X50 Terminal (currently leased by Adani) to 80 mtpa and 110 mtpa. Instead, these have been offered as separate terminals to BHP Billiton and Hancock, and a further expansion to 270 mn tonne is also under review.

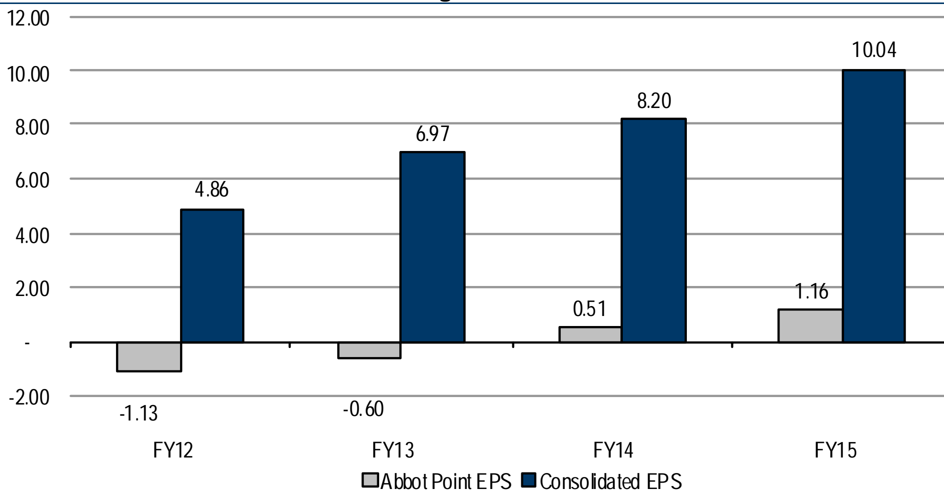
MPSEZ management has maintained that it has an option to increase its capacity to 80 mn tonne, which currently remains unclear.

Depresses overall return ratios

Earnings dilutive till FY13E – not worth the risk

The consolidation of Abbot Point earnings will likely depress overall return ratios for Mundra Port till FY13E. We anticipate FY12E and FY13E earnings to be impacted by 18% and 8%, respectively.

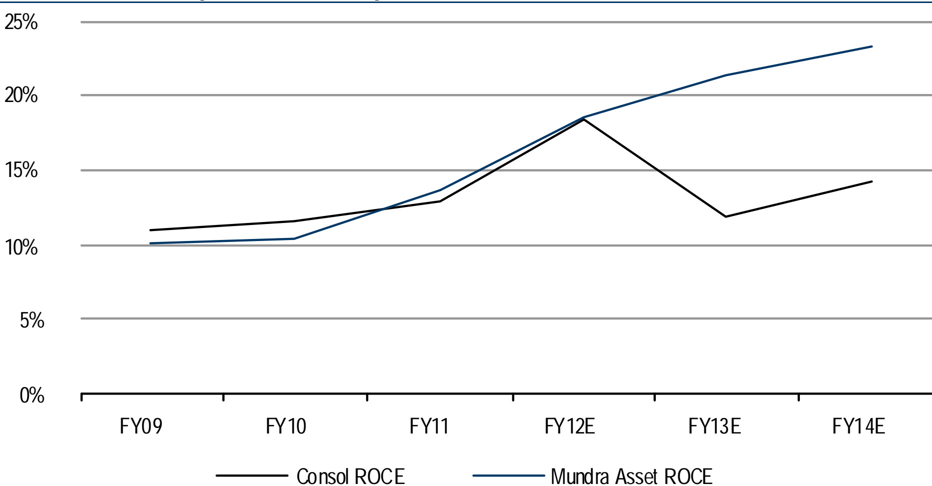
Figure 28: **Abbot Point deal will be earnings dilutive till FY13E**



Source: Company data, Credit Suisse estimates

Further, investors who earlier had exposure to core Mundra asset (Indian ports' growth story) and attractive returns (Mundra ROCEs expected to improve to 23% by FY13E) now own assets in multiple geographies with lower return profiles.

Figure 29: **Abbot acquisition has depressed overall returns**



Source: Company data, Credit Suisse estimates

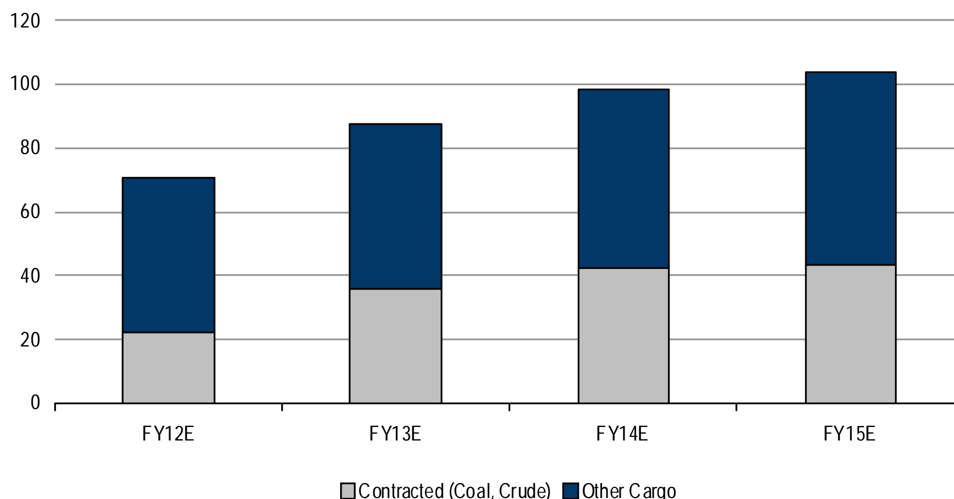
Uses 50% of balance sheet and only contributes 10% to equity value

Consolidation of Abbot Point will double MPSEZ's balance sheet from Rs95 bn to Rs186 bn. However, in terms of overall equity value, it contributes only 10% (we value at Rs.12 per share). Further, the entire debt-funded acquisition has increased consolidated gearing (net-debt to equity) to almost 2.5x, which can limit its ability to pursue Indian growth opportunities (especially on the east coast), in our view.

Mundra Asset – sufficient capacity, but is there enough demand?

The key volume drivers for Mundra Port are coal, crude and containers. The visibility on the volume stream is high for coal and crude due to dedicated client facilities which have been set up at the port. However, these contribute only 22% of the total capacity of 200 mn tonnes leaving the rest vulnerable to market forces.

Figure 30: Share of non-contracted cargo increases post FY13E



Source: Credit Suisse estimates

Growth beyond FY13E dependent on non-contracted cargo—not a linear growth story

We estimate contracted bulk cargo will contribute approximately 42% of Mundra Port's volumes in FY13E and FY14E. These include long-term contracts with Adani Power, Tata Power, IOCL and HPCL.. Even in these, the IOCL crude component has shown variability (plant shutdown) in the past leading to variability in off-takes.

Non-contracted cargo growth will be dependent on Adani Group's coal trading outlook, container growth at MICT and AICT, fertilisers and iron and steel requirements, which can be bulky. The bull case for the growth in coal imports is deficit seen in other power projects in the Western and Northern region.

Management forecasts appear to out-run government's demand estimates

According to the shipping ministry's report, Indian Maritime Agenda 2010-20, total demand projections for coal handling across non-major ports in Gujarat is expected to be 43 mn tonnes in FY13E growing to 59 mn tonnes by FY16E.

Figure 31: **Linear volume growth assumptions of Mundra are a key risk**

Mundra volume assumptions	FY11	FY12E	FY13E	FY14E	FY15E
Coal	**15**	**23**	**33**	**39**	**41**
- Contracted	1	8	17	23	23
- Other	14	15	16	17	18
Containers	15	16	17	19	20
Crude	**13**	**21**	**25**	**26**	**28**
- IOCL + HPCL	7	14	19	20	21
- Others	6	6	6	7	7
Fertilizers	**3**	**3**	**4**	**4**	**4**
Other Dry Bulk	6	7	9	10	11
Total	**52**	**71**	**88**	**99**	**104**

Source: Ministry of Shipping – Indian Maritime Agenda 2010-20, Credit Suisse estimates

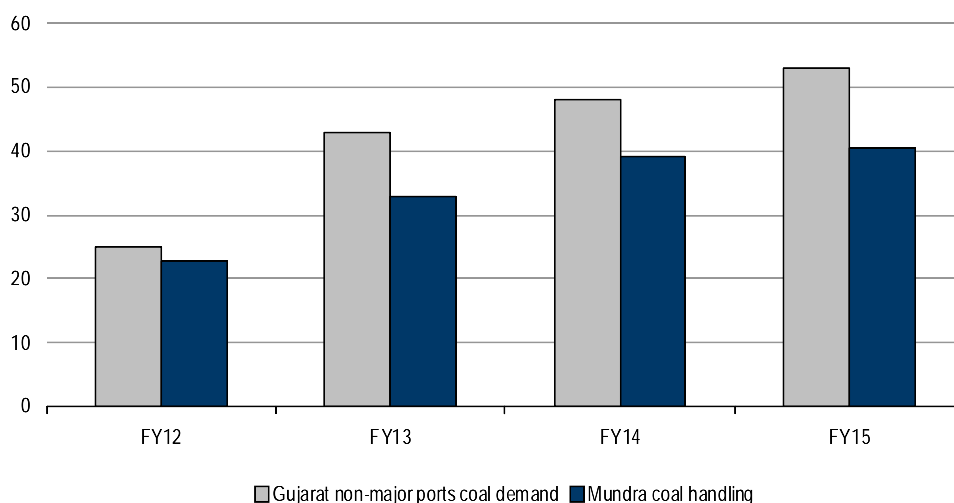
Figure 32: **Total non-major ports demand forecast for Gujarat ports by Shipping Ministry**

mn tonne	FY12	FY13	FY14	FY15	FY16	FY17	FY18	FY19	FY20
POL	142	153	167	183	200	219	239	256	273
Iron Ore	10	11	12	13	15	16	18	20	22
Coal	25	43	48	53	59	66	73	78	83
Fertilizer	4	4	4	5	5	5	5	5	5
Containers	30	39	46	54	64	74	87	98	110
Others	37	43	47	50	53	58	63	66	72
Total	248	293	324	358	396	438	485	523	565

Source: Ministry of Shipping – Indian Maritime Agenda 2010-20, Credit Suisse estimates

However, current estimates for Mundra alone factor 33 mn and 40 mn tonnes for FY13E and FY14E, implying almost 78% and 83% of total forecast, which does not appear sustainable, as there are several competing operational minor ports (especially captive) in Gujarat.

Figure 33: **Management guidance for Mundra volumes appear at risk**



Source: Shipping Ministry, Credit Suisse estimates

There also appears no credible case for volumes shifting from Kandla to Mundra as coal handling projections for Kandla are minimal.

Significant volume gains and premium pricing unlikely to sustain in long-run

Rising competition among non-major ports in Gujarat

Mundra's aggressive expansion has already put its capacity at 200 mn tonnes, while the Shipping Ministry estimates expect it to reach the same figure by 2020. Non-major ports in Gujarat had an operational capacity of 244 mn tonne as of March 2010, and if we include Mundra's current expansion, total capacity is estimated to be 437 mn tonne.

Figure 34: **Government projection of capacity development at key non-major Gujarat ports**

	FY10 (actual)	FY12	FY13	FY14	FY15	FY16	FY17	FY18	FY19	FY20
Dahej	13.2	16.2	28.2	42.2	42.2	42.2	55.2	55.2	55.2	70.2
Mundra (GAPL)	36.2	66.2	75.2	75.2	80.2	95.2	122.2	132.2	132.2	178.2
Pipavav (GPPL)	23.4	23.4	28.4	33.4	38.4	38.4	38.4	58.4	58.4	80.9
Sikka	104.6	109.6	109.6	109.6	124.6	124.6	124.6	124.6	124.6	124.6
Magdalla & Hazira	27.1	43.1	43.1	58.1	70.1	70.1	70.1	95.1	95.1	95.1
Total Gujarat Ports	**243.6**	**303.6**	**353.6**	**403.6**	**458.6**	**507.6**	**584.6**	**687.7**	**761.0**	**864.0**

Source: Ministry of Shipping – Indian Maritime Agenda 2010-20, Credit Suisse estimates

Increasing risk of de-regulation at major ports and regulation of minor ports

On the regulatory front, we have seen increasing developments that seek to create a level playing field between major ports (which are regulated) and minor ports (which have flexibility with pricing). The Draft Port Regulatory Authority Bill 2011 has been made public and the MoS has sought comments on the draft from various stakeholders.

The Bill, inter alia, seeks to bring the functions of tariff setting and performance monitoring for the non-major ports under the ambit of the respective State port regulatory authorities. Thus, if enacted, the Bill would have significant implications particularly for the non-major ports as they would lose the flexibility to set tariffs (currently a function of capital costs, operational capabilities, and market competiveness) and may have to follow a cost-plus-return-based approach (which the major ports do) or some other approach specified by the regulator.

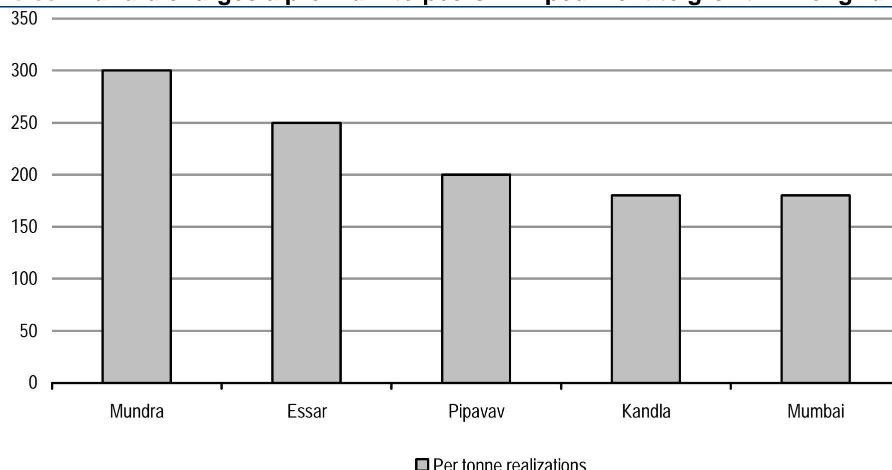
Private ports charge a premium for its services, and mostly due to higher efficiency

Rates charged by Mundra currently are as high as Rs300 per tonne for dry bulk, which is likely to be an impediment to growth of non-contracted volumes, in our view.

We believe the company will have to strike a balance between pricing and volume growth growing forward, especially on bulk cargo.

Our checks with IFFCO (the largest fertiliser importer) suggest that while it imports fertilisers at Kandla, Mundra and Pipavav, a key consideration for them is also the cost per tonne where Pipavav and Kandla appear more competitive.

Figure 35: **Mundra charges a premium to peers— impediment to growth in long-run**

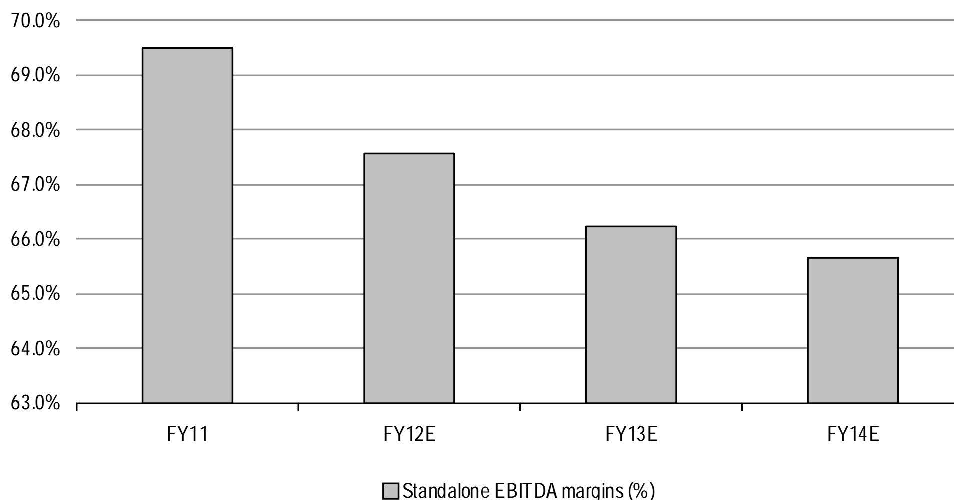


Source: Company data, Credit Suisse estimates

We anticipate standalone EBITDA margins to remain muted on changing product mix and idle capacity

We anticipate EBITDA margins of Mundra Port to decline by about 100 bp as overall cargo profile shifts from liquid to dry bulk and containers. Further, capacity utilisations are also expected to be only 49% in FY14E due to addition of fresh coal capacity (40 mn tonne).

Figure 36: **We anticipate standalone EBITDA margins to decline till FY14E**



Source: Company data, Credit Suisse estimates

Mundra SEZ—still too early to factor growth

Mundra Port has a notified Special Economic Zone (SEZ) which comprises of 6,568 hectares (16,223 acres) of land.

Consensus estimates value the SEZ between Rs10 and Rs20 per share implying a valuation of Rs20-40 bn (US$400-800 mn). The key argument for a high valuation is large-scale industrialisation of the region, which will lead to significantly higher demand for real estate. We are less bullish on large-scale industrialisation prospects in Mundra due to the following reasons.

Lack of clarity on extent of mangroves

The Gujarat High Court has directed an enquiry into the alleged destruction of mangroves by the Adani group companies in Mundra. An enquiry into destruction of mangroves by Mundra Port is currently on by the Ministry of Environment and a final verdict on the case is still pending.

Clarity remains low on area occupied by mangroves as well as on outcome of the case related to mangrove deforestation. .

Common settlement problems appear to be overlooked

Availability of fresh water in an arid region

Kutch is an arid region. Currently, most of the industries and residential settlements based in the region utilise water from the Sardar Sarovar Project which is available at a nominal sum of Rs10 per 1,000 litres.

Water supply for industrial purposes in the district can be obtained from three main sources, viz Gujarat Water Supply and Sewerage Board (GWSSB), the Irrigation Canal and Sardar Sarovar Project.

However, increased industrial activity is likely to lead to more reliance on desalination plants.

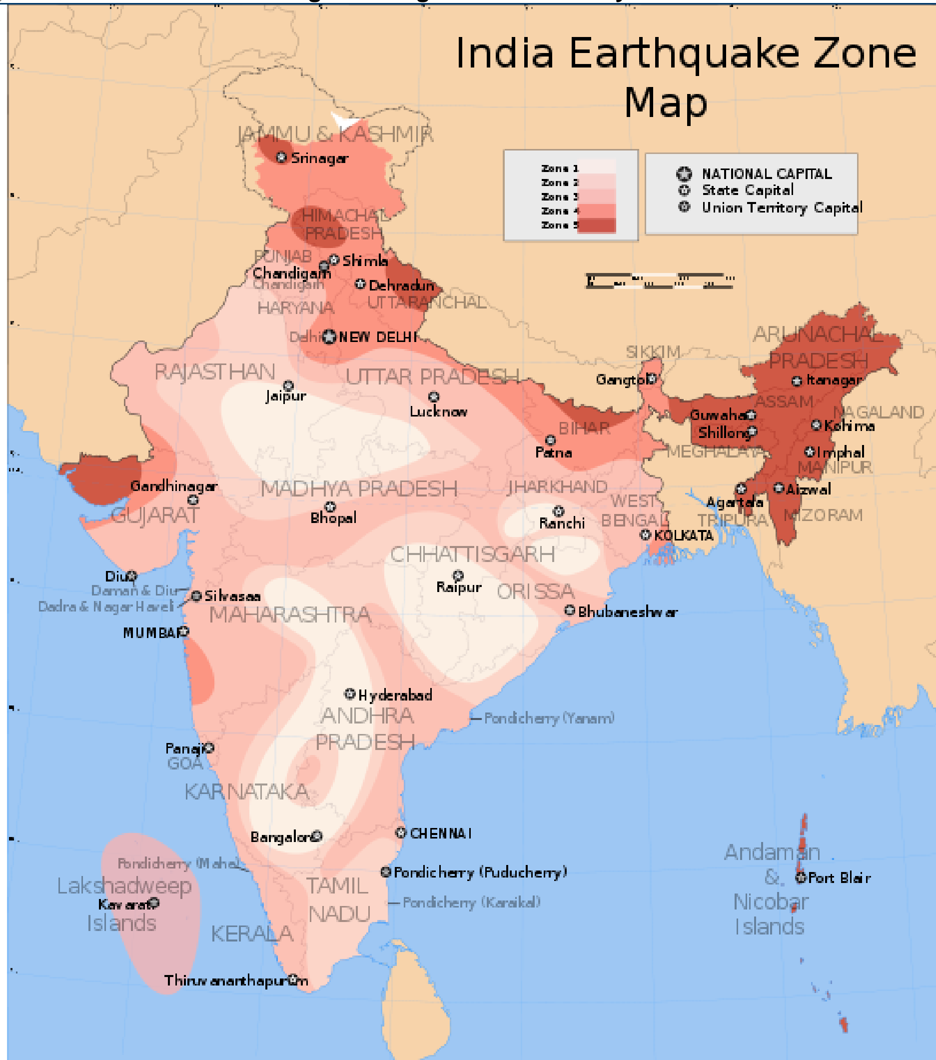
Environmental lobbies suggest desalination plants are a potential threat to marine ecosystem

The Mundra coast has been seen as an ecologically sensitive zone by environmental lobbies (prior existence of corals, mangroves, etc). De-salination which has been cited as a key solution to address the water problem in the region could potentially increase salinity (through discharge) of the marine waters and affect the coast. .

Kutch is in seismic zone 5 – an area having high level of seismicity

Kutch region is in Zone 5 of seismic mapping in the country. Places situated in such zones have a higher probability of earthquake occurrences and of higher magnitude.

Figure 37: **Mundra falls in a region of high seismic activity**



Source: Company data, Credit Suisse estimates

Valuations price most upside

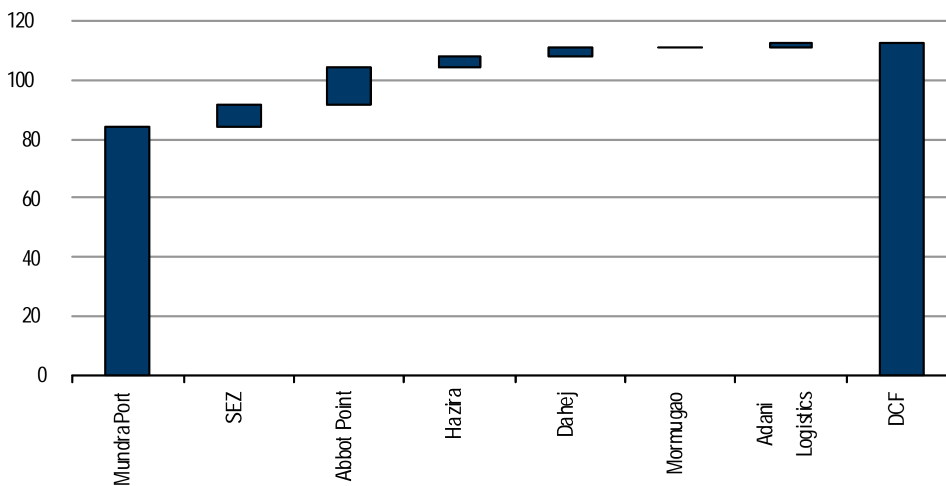
Consensus DCF valuations appear to factor a blue-sky scenario

Extension of BOOT period (beyond 2031) should be an option value in our view

Consensus appears to be building a blue-sky scenario for the Mundra asset which is the key valuation driver contributing 75% to our DCF value. A key assumption is the treatment at the end of the BOOT concession period (2031) where the street appears to be factoring that the concession will be extended. We estimate the DCF-value will be impacted by Rs30 per share if the extension is not provided and believe it is prudent to apply the extension as an option value than include the same.

Our target price of Rs112 is based on sum-of-the-parts valuation (DCF-value of ports business is Rs91, Abbot Point contributes Rs12, SEZ is valued at Rs7 and rail at book value of Rs2).

Figure 38: **Mundra Port is key value driver of MPSEZ**

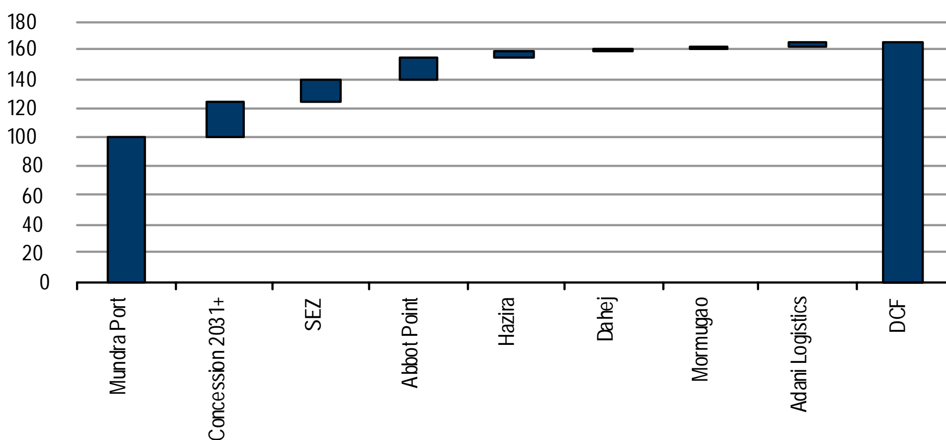


Source: Company data, Credit Suisse estimates

Further, investors should note that even if the concession were extended, it would mostly be done at higher revenue sharing basis (thus capping ROCE's).

The key reason for our argument is that Mundra will become one of the biggest operational ports by 2031, and it will be in government's own interest to operate it by then.

Figure 39: **Consensus appears to be factoring a blue-sky scenario**



Source: Company data, Credit Suisse estimates

Downside risks exist even to our conservative DCF estimates

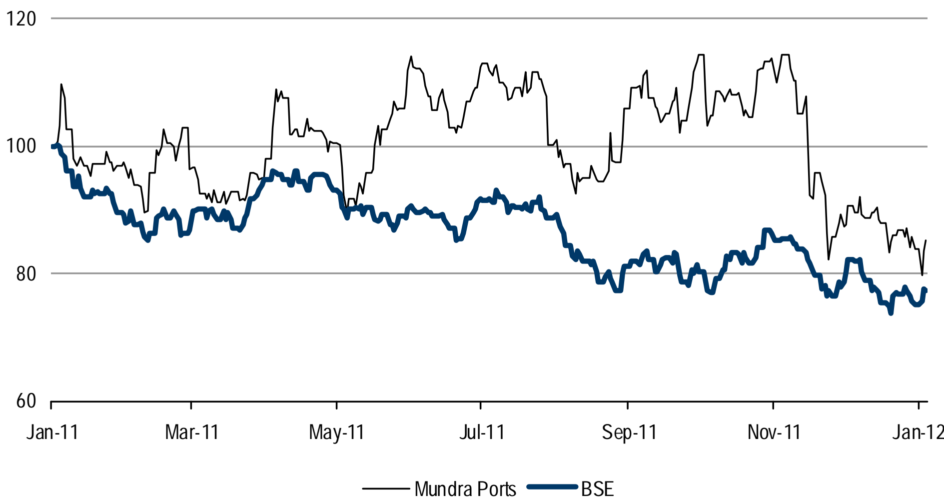
Any equity infusion into Abbot Point can potentially erode value and put at risk approximately 10% of our target price.

Any adverse ruling by the Ministry of Environment can potentially impact capacity leading to lower DCF valuations.

Stock outperformance likely to reverse as street downgrades start

Mundra has outperformed the benchmark index over a 12-month horizon driven by perceived stability to its cash flows. We believe downside risks to consolidated numbers are high especially in FY13E as the full impact of Abbot Point acquisitions and lower standalone margins begin to hurt results.

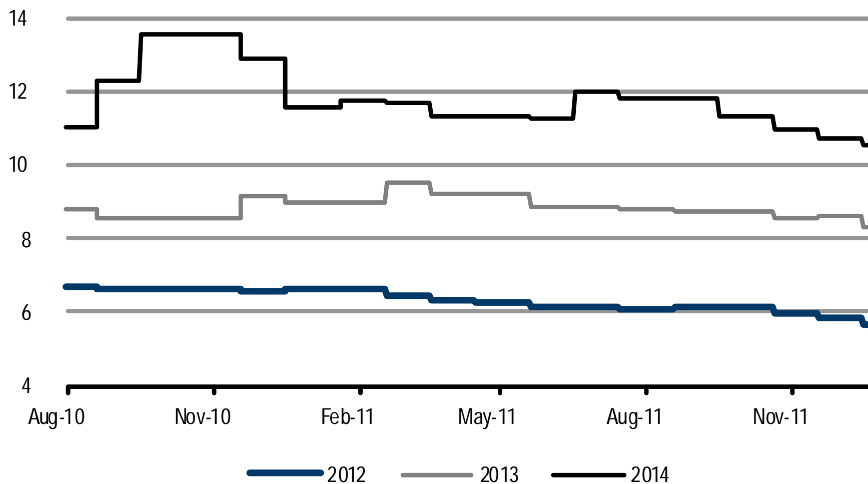
Figure 40: **Mundra Port's outperformance is unlikely to sustain going forward**



Source: Company data, Credit Suisse estimates

Our estimates are significantly below street (FY12E, FY13E and FY14E below by 17%, 19% and 28% respectively).

Figure 41: **Consensus downgrades likely to continue**



Source: Company data, Credit Suisse estimates

Stock remains expensive to local and regional peers

MPSEZ currently trades at 13x FY13E EV/EBITDA and FY13E PE of 18x versus regional peers at 7x FY13E EV/EBITDA and 11x FY13E P/E. With Australian asset (Abbot Point) becoming 50% of its balance sheet, we believe the premium is likely to contract further.

Figure 42: **Regional valuation comps**

Company	Current	Target	M cap		P/E		P/B		RoE		EV/EBITDA	
	price	price	US$ bn	Rating	T+1	T+2	T+1	T+2	T+1	T+2	T+1	T+2
India												
Mundra Port and Special Economic Zone	126.50	112.00	4.80	U	26.1x	18.2x	5.2x	4.3x	23%	28%	17.8x	13.1x
Gujarat Pipavav Port Limited	56.50	66.00	0.45	O	58.9x	26.5x	3.1x	2.8x	5%	11%	16.7x	14.2x
Essar Ports Ltd	54.90	62.00	0.43	N	18.1x	10.6x	1.0x	0.9x	6%	9%	8.8x	7.8x
China												
China Merchant Holdings	24.05	28.00	7.66	O	13.5x	13.1x	1.4x	1.3x	10%	10%	9.7x	9.2x
Cosco Pacific	1.27	1.86	3.44	O	8.7x	7.7x	1.0x	0.9x	11%	12%	7.1x	7.4x
Dalian Port (PDA) Co	1.50	3.08	1.65	N	8.1x	7.0x	0.5x	0.5x	6%	7%	8.4x	5.9x
Tianjin Port Developments Holdings Ltd	1.00	1.99	0.79	N	9.2x	8.6x	0.7x	0.6x	7%	7%	3.8x	3.6x
Shanghai International Port Group	2.59	4.86	8.63	N	11.9x	11.0x	1.4x	1.3x	11%	12%	5.1x	4.7x
Shenzhen Chiwan Wharf Holdings Ltd	9.10	13.36	0.87	O	9.1x	8.1x	1.8x	1.6x	20%	20%	4.2x	3.8x
Others												
Hutchison Port Holdings Trust	0.65	0.68	5.62	U	19.4x	19.8x	0.6x	0.6x	3%	3%	9.6x	9.4x
DP World	9.80	12.48	8.13	N	14.7x	12.8x	1.1x	1.0x	7%	8%	8.7x	7.7x
Sector average (ex-India)					11.8x	11.0x	1.0x	1.0x	10%	10%	7.1x	6.5x
Sector average (Chinese ports)					10.1x	9.3x	1.1x	1.0x	11%	11%	6.4x	5.8x
Sector average (Indian ports)					34.4x	18.4x	3.1x	2.7x	11%	16%	14.4x	11.7x

Source: Company data, Credit Suisse estimates

Financial summary

Mundra Port & SEZ – Income statement

Figure 43: **Income statement**

Year-end Mar 31 (Rs mn)	FY09	FY10	FY11	FY12E	FY13E	FY14E
Revenue	11,949	14,955	20,001	31,999	43,776	53,977
Expenses	4,393	5,293	7,007	10,786	15,022	18,544
EBIDTA	7,557	9,663	12,994	21,213	28,754	35,433
Depreciation	1,468	1,868	2,388	4,902	5,909	6,286
EBIT	6,089	7,795	10,606	16,311	22,845	29,147
Interest expense	1,014	239	571	5,773	7,646	8,383
Profit before tax	5,075	7,556	10,036	10,538	15,200	20,765
Income tax	533	601	874	922	1,272	4,244
Profit before minority	4,542	6,955	9,162	9,616	13,928	16,521
Minority/ associates	217	195	(20)	(111)	(29)	94
Extraordinary items						
PAT	4,325	6,760	9,181	9,727	13,957	16,427
EPS	2.2	3.4	4.6	4.9	7.0	8.2
Dividend per share	0.6	0.8	0.9	1.2	1.7	2.0

Source: Company data, Credit Suisse estimates

Mundra Port & SEZ – Balance sheet

Figure 44: **Balance sheet**

Year-end Mar 31 (Rs mn)	FY09	FY10	FY11	FY12E	FY13E	FY14E
Assets						
Cash	12,951	9,997	2,515	9,825	12,268	16,599
Receivables	2,293	1,764	2,849	4,558	6,236	7,689
Inventories	267	316	423	677	927	1,142
Other current assets	1,770	5,114	3,645	6,946	8,380	9,622
Current liabilities	3,469	4,754	5,736	9,807	13,802	17,263
Provisions	470	740	1,050	1,050	1,050	1,050
Net current assets	13,343	11,698	2,647	11,150	12,958	16,740
Fixed assets	50,574	66,594	84,683	180,829	190,840	203,297
Investments	1,907	2,219	666	666	666	666
Goodwill	1,218	1,118	437	437	437	437
Total assets	71,076	87,123	95,219	203,939	219,754	239,454
Liabilities						
Share capital	4,007	4,007	4,007	4,007	4,007	4,007
Reserves	25,261	30,504	37,864	45,187	55,061	66,683
Shareholder funds	29,296	34,539	41,899	49,194	59,068	70,690
Debt	28,957	37,062	35,925	133,690	135,963	140,786
Other long-term liabilities	8,781	9,206	9,623	9,323	9,023	8,723
Minority interest	102	822	987	876	848	942
Total liabilities	71,076	87,123	95,219	203,939	219,754	239,454

Source: Company data, Credit Suisse estimates

CREDIT SUISSE

Asia Pacific / India
Marine Ports & Services

Gujarat Pipavav Port Limited

(GPPL.BO / GPPV IN)

Rating	OUTPERFORM*
Price (05 Jan 12, Rs)	56.50
Target price (Rs)	66.00[1]
Chg to TP (%)	16.8
Market cap. (Rs mn)	23,931
Enterprise value (Rs mn)	30,063
Number of shares (mn)	423.56
Free float (%)	57.0
52-week price range	73.3 - 49.6

*Stock ratings are relative to the relevant country benchmark.
[1]Target price is for 12 months.

Research Analysts

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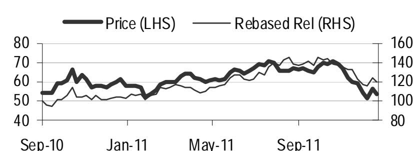
A domestic play; better risk-reward

- **Attractive structural theme, and well placed to benefit:** We initiate coverage on Gujarat Pipavav Ports (GPPV) with an OUTPERFORM rating and a target price of Rs66. GPPV is leveraged to the fastest growing cargo segment in India—containers, and is highly exposed to the Asia trade route. A strong parent in Maersk lines provides it a critical mass of volume (nearly 30% of revenue), and increasing deployment of new services, provides volume visibility. Proximity to Gujarat's industrial zones, northern hinterland, and capacity-constraints at India's largest container terminal JNPT port (100% utilisation, no new capacity additions till FY14) are key competitive advantages.
- **Container business enjoys high barriers to entry in India:** Private sector participation in container ports business has been limited to expansion projects in major ports which tend to be less profitable due to a high revenue share. Further, unlike bulk, container ports serve as gateways rather than destinations, and hence, supporting rail and road connectivity to the hinterland in crucial, which is a long gestation process in India given problems with land acquisition.
- **Look beyond near-term macro weakness:** The recent disappointing manufacturing and trade numbers point to potential near-term weakness in container volume growth. However, investors should note that Gujarat Pipavav is growing from a low base and has been adding new services on intra-Asia line which is a more resilient trade lane. Our estimates anticipate GPPV to grow its container business at 15% over the next two years. However, despite the modest top-line growth, high leverage still translates into a strong net income CAGR of 81%.
- **Initiate with OUTPERFORM, TP of Rs66:** Our target price of Rs66 implies 17% upside from current levels. We value the port business at Rs64 based on DCF methodology using a 11% WACC, and value its investment in rail at book (Rs2). Key risks are consolidation of services of shipping lines, slowdown in trade, liquidity risks (FIIs need RBI permission to buy).

Share price performance



The price relative chart measures performance against the BSE SENSEX IDX which closed at 15857.08 on 05/01/12
On 05/01/12 the spot exchange rate was Rs52.82/US$1

Performance Over	1M	3M	12M
Absolute (%)	-5.8	-16.6	-6.8
Relative (%)	-0.1	-14.3	15.0

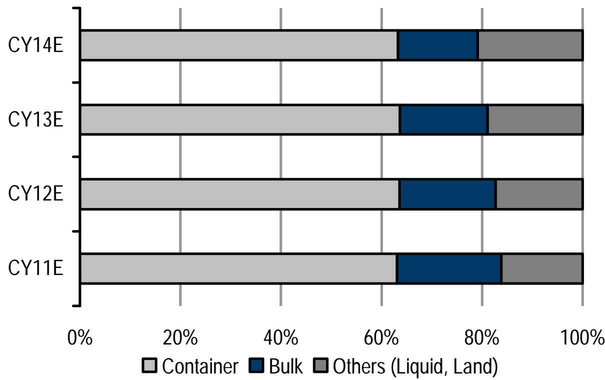
Financial and valuation metrics

Year	12/10A	12/11E	12/12E	12/13E
Revenue (Rs mn)	2,920.0	3,815.2	4,457.8	5,285.2
EBITDA (Rs mn)	1,107.3	1,797.8	2,098.7	2,522.7
EBIT (Rs mn)	614.3	1,283.7	1,607.9	2,012.8
Net income (Rs mn)	-618.7	406.1	903.4	1,335.9
EPS (CS adj.) (Rs)	-1.46	0.96	2.13	3.15
Change from previous EPS (%)	n.a.			
Consensus EPS (Rs)	n.a.	1.16	2.66	3.95
EPS growth (%)	n.m.	n.m.	122.5	47.9
P/E (x)	-38.7	58.9	26.5	17.9
Dividend yield (%)	0	0	0	0
EV/EBITDA (x)	27.1	16.7	14.2	11.5
P/B (x)	3.3	3.1	2.8	2.4
ROE (%)	-11.9	5.4	11.0	14.3
Net debt/equity (%)	81.8	79.0	67.6	49.6

Source: Company data, Thomson Reuters, Credit Suisse estimates.

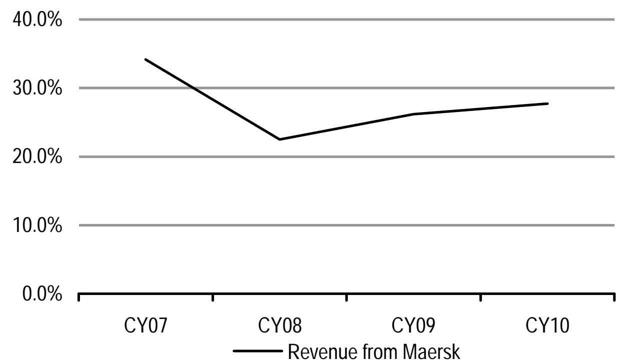
Focus charts

Figure 45: **Containers are the key revenue driver**



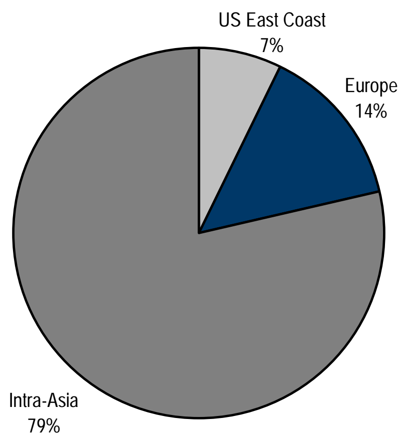
Source: Company data, Credit Suisse estimates

Figure 46: **Maersk lines provides a critical mass**



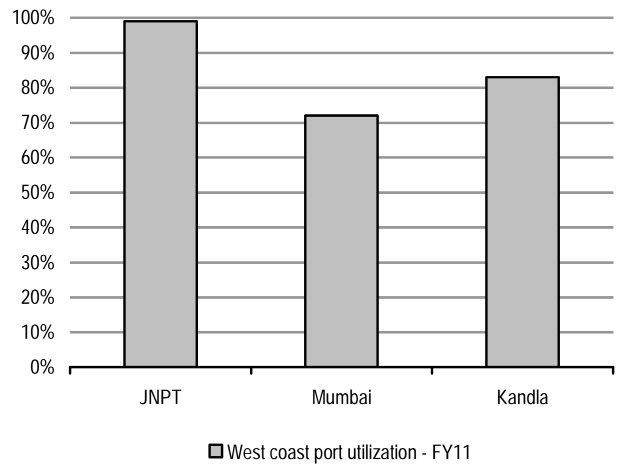
Source: Company data, Credit Suisse estimates

Figure 47: **High exposure to intra-Asia trade lanes limits downside risks**



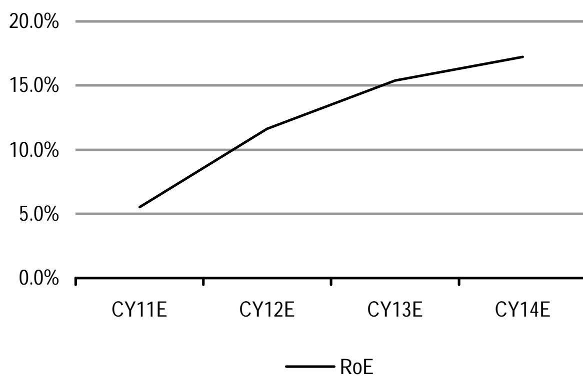
Source: Credit Suisse estimates

Figure 48: **Major ports in west coast running near capacity**



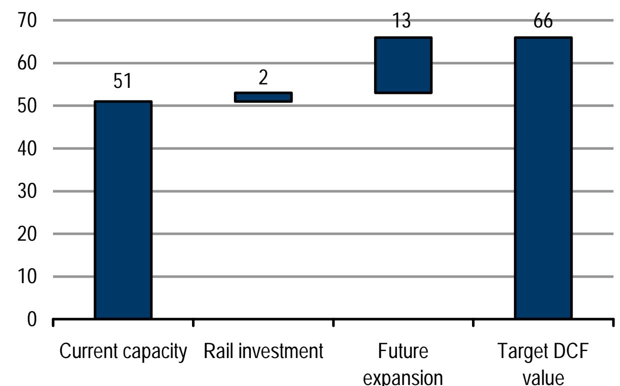
Source: IPA, Credit Suisse estimates

Figure 49: **Leverage and growth set to reflate RoEs**



Source: Credit Suisse estimates

Figure 50: **Current stock price only factors existing capacity and rail investment**



Source: Credit Suisse estimates

Structural long-term drivers in place

Gujarat Pipavav Port (GPPL) is the developer and operator of APM Terminals Pipavav, India's first private-sector port. GPPL is promoted by APM Terminals (part of AP Moller Maersk Group), one of the largest container-terminal operators in the world.

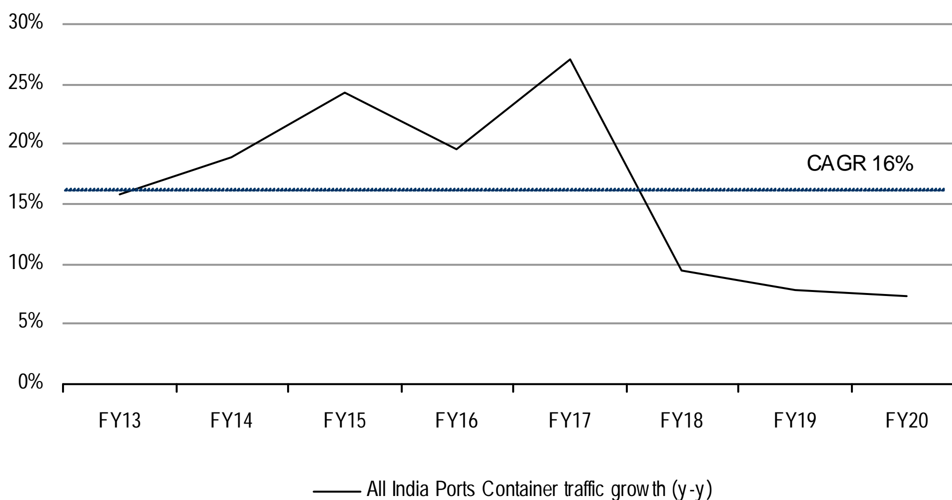
GPPL is promoted by APM Terminals (part of AP Moller Maersk Group)

Containers are the fastest growing cargo segment

Container growth in India has clocked 14% between FY02 and FY11, and according to estimates of National Maritime Development Programme (NMDP), it is expected to remain the fastest growing and expected to grow at a CAGR of 16% between FY12 and FY20. Even during the recessionary phase of FY09, positive container growth was witnessed in India.

Growth in the Indian container industry can largely be attributed to the robust economic growth and increasing penetration of containers into the general cargo market.

Figure 51: **Container is expected to be the fastest growing cargo segment in India**



Source: Shipping Ministry, Credit Suisse estimates

High entry barriers in the container business for greenfield ports

Access to hinterland – Road and rail 'last mile' connectivity and ICD connectivity

While private sector capacity additions at greenfield ports have been rapid in the bulk segment, the same has been limited in the container segment. This is because attracting traffic to new container ports from shipping lines is a key challenge especially as evacuation ability remains limited.

Despite congestion at major ports such as JNPT, shipping lines tend to stick to the same as ability to evacuate cargo is better. Further, major ports have a marked advantage in the number of rakes run from Inland Container Depots.

Figure 52: **Connectivity to key ICDs in North India remain an impediment**

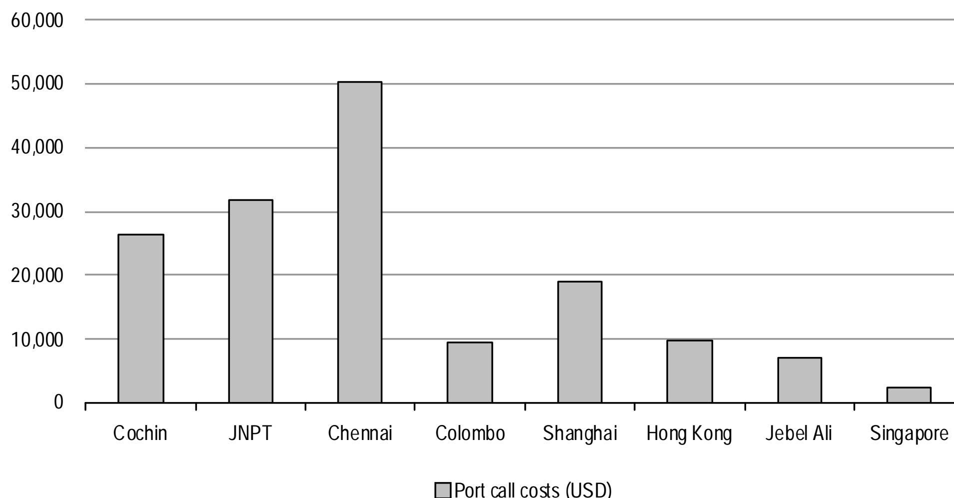
	Pipavav	Mundra	JNPT / NSICT
ICD Sabarmati	1 train / week	1 train / week	1.5 rakes/ day
ICD Kota	On demand	1 train / week	2 trains / week
ICD TKD	3 train / week	2 train / week	3-4 rakes / day
ICD DDL (Ludhiana)			
ICD Dadri	1 train / week	1 train / week	4 rakes / day
ICD Nagpur			Daily
ICD Daulatabad			1 / week
ICD Bhusawal			2 / week
ICD Mandideep			3 / week

Source: CONCOR, Credit Suisse estimates

High port calling costs in India prevent multiple calls

India has one of the highest port calling costs in the world, which is a key factor preventing shipping lines from calling on multiple ports despite congestion. According to a report by Ministry of Shipping, port call costs in India vary between US$26,330 and US$50,634 depending on the region.

Figure 53: **India has the highest port call costs**



Source: Shipping Ministry, Credit Suisse estimates

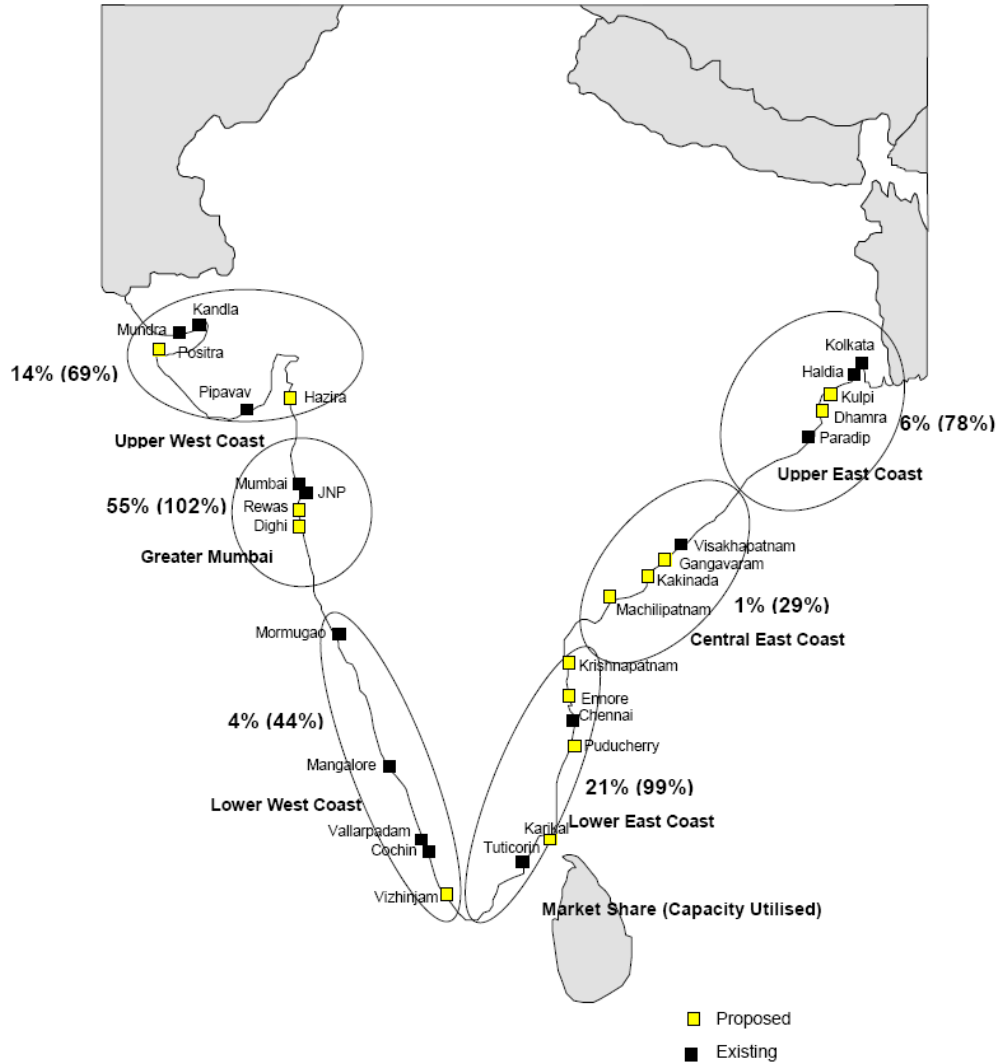
Development of container capacity remains weak in India

Reforms and capacity adds at major ;ports has been slow

Despite the increasing level of private sector participation in India at major ports for container capacity development, new capacity additions have run into significant delays due to regulatory bottlenecks (delays in awarding projects,and unviable tariffs based on historical costs).

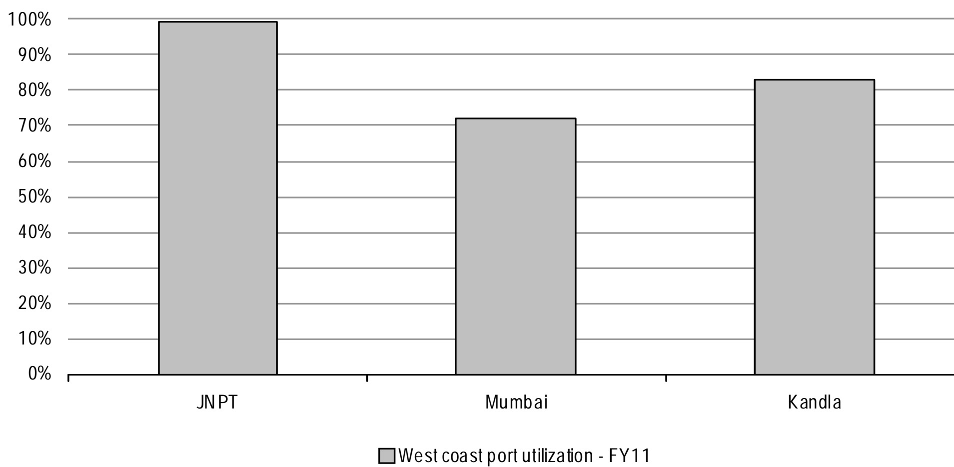
As a consequence, JNPT which is India's largest container port and is running at above 100% capacity is unlikely to see any incremental capacity addition till FY14E.

Figure 54: **Existing and proposed container capacity additions**



Source: Drewry, Credit Suisse estimates

Figure 55: **West coast major ports are running at high utilisation levels**

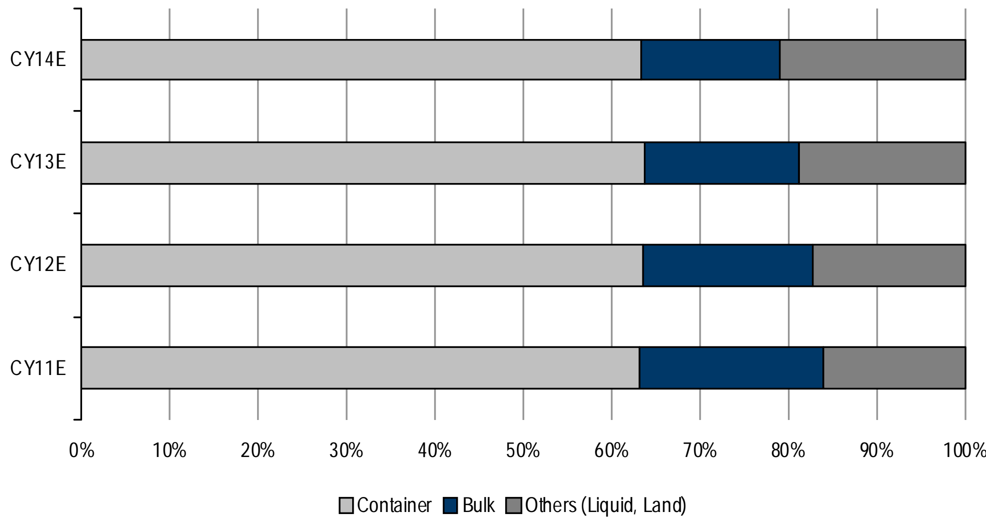


Source: IPA, Credit Suisse estimates

Pipavav is favourably positioned as a container play

GPPL derives approximately 62% of its revenues from the container segment. It has a total container capacity of 0.85 mn TEU (10.2 mn tonnes) on the land-side and 1.3 mn TEU capacity on the quay-side (waterfront) and currently operates at an utilisation rate of 70%.

Figure 56: **Containers contribute approximately 62% to total FY11E revenue**



Note: Fiscal year-end of GPPV is December

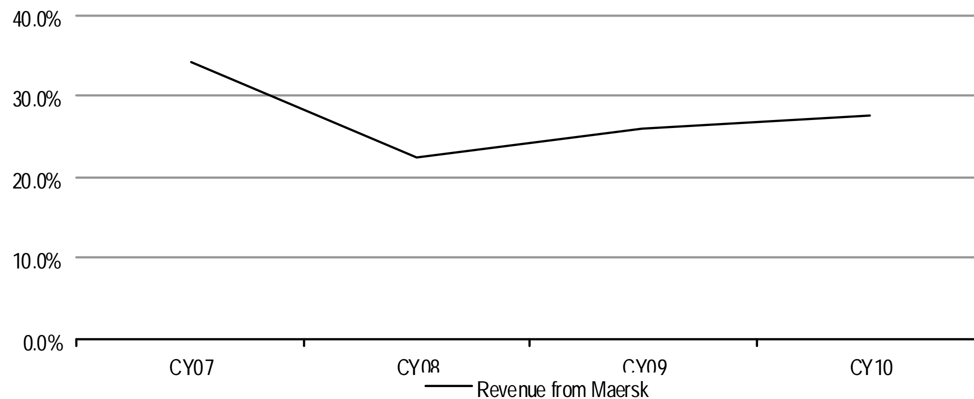
Source: Company data, Credit Suisse estimates

Maersk lines provide a critical mass

Maersk lines operate two services on its Asia-Europe route, and one each on Asia – North America and Intra-Asia lines from Pipavav. For FY10, the group contributed approximately 28% of total revenues.

Maersk Lines provides Pipavav a crucial critical mass (of volume) which is essential in the container shipping industry. Further, Maersk continues to dominate the market share among key shipping lines in India and commands approximately 20% market share, which is a key factor when industry consolidation starts.

Figure 57: **Maersk provides a critical mass to GPPV's container terminal**



Source: Company data, Credit Suisse estimates

Deep draft positions it well to address industry consolidation to bigger ships

GPPV has a draft of 14 metres which can accommodate ships of upto 80,000 DWT. We believe deep drafts are key as it can start handling the mother ships on the major trade routes.

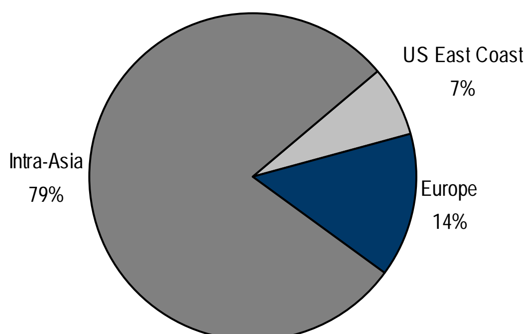
Further, according to Sam Lee, our Asia Transportation Head, delivery of larger ships has begun for the container shipping lines, which is likely to lead to consolidation of services especially for the larger players (using bigger ships).

A re-configuration of the current berth structure is however likely to be necessitated, as currently only one berth can accommodate larger vessels (quay length).

High exposure to APAC trade route

We estimate that nearly 79% of Pipavav's services target the Intra-Asia trade lane, which has been the fastest growing shipping lane in India. While the key service provider is Maersk, we are seeing increasing participation from other key larger shipping lines such as Emirates, OOCL and APL, which is encouraging.

Figure 58: Pipavav Port has high exposure to the Intra-Asia trade lane



Source: Credit Suisse estimates

Figure 59: Key weekly calls made by shipping lines at Pipavav

Yr started	Shipping line	Service	Trade lane
2006	Maersk Line	MECL	Asia-US
2006	Maersk Line	ME1	Asia-Europe
2006	Mitsui OSK	KEX Service	Intra-Asia
2006	Hyundai Merchant Marine	CIX Service	Intra-Asia
2006	NYK, RCL, Hapag Lloyd	PIX Service	Intra-Asia
2008	TSK (NYK)	ICS Service	Intra-Asia
2008	Emirates	Hyper Galex	Intra-Asia
2009	Maersk Line	ME3 service	Asia-Europe
2010	OOCL / YML	CPX Service	Intra-Asia
2010	Maersk / CMA-CGM	CIMEX 2 service	Intra-Asia
2011	NYK / Hanjin / EMC	WIN Service	Intra-Asia
2011	Emirates	KIS Service	Intra-Asia
2011	APL / OOCL	CIX Service	Intra-Asia
2011	OOCL / YML	CIX-2	Intra-Asia
2011	NYK	Hercules	Intra-Asia

Source: Credit Suisse estimates

According to Drewry, a shipping research agency, the far-east trade lane has grown driven by import volumes. China, South Korea, Malaysia, Singapore, Thailand, Japan and Indonesia are the major countries involved on this trade lane. Primary export commodities are cotton yarn, textiles, food products, steel, stones and seafood, whereas major import commodities are machinery, chemicals, electrical & electronic goods, steel, automobile and auto components, fabrics, newsprint and paper.

Figure 60: **Far-East Asia trade lane remains important and more resilient**

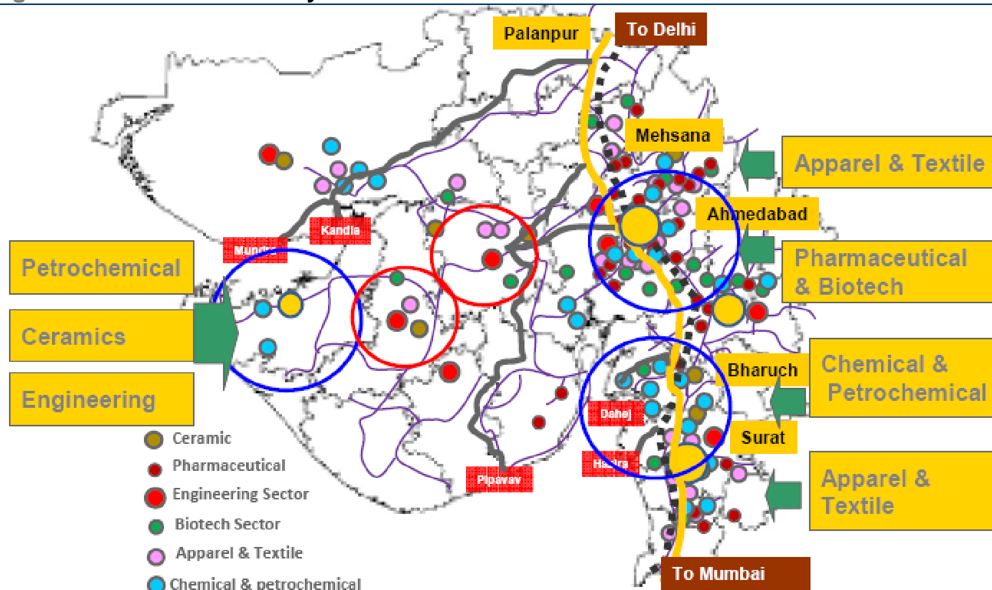
(%)	2005-08 growth rate	Market share - 2008
Far East Asia	38	31
Europe	13	27
North America	7	13
Intra-Gulf	18	17

Source: Drewry, Credit Suisse estimates

Pipavav's primary hinterland is more industrialised than Mundra

Pipavav has more immediate access to an industrialised primary hinterland in Gujarat (compared to Mundra). We believe this provides the port with a minimum scale of volume and opportunity to tap JNPT volumes (in case of congestion).

Figure 61: **Ports connectivity to Industrial Clusters**



Source: GIDB, Credit Suisse estimates

Scope for bulk volume off-take is improving

The demand for bulk cargo at Pipavav is likely to remain steady due to the industrialised primary hinterland and key products handled, which include coal, fertilizers and liquid cargo.

Major capacity addition plans will be required to be undertaken at Pipavav if the proposed power plants (Videocon, Torrent, Sintex) begin to materialise (visibility is still low). Videocon Industries is planning to set up a power plant on imported coal at Pipavav and the financial closure for the project has been achieved and equipment orders placed with BHEL. However, its construction progress has been delayed.

Sufficient rail capacity—key to future growth

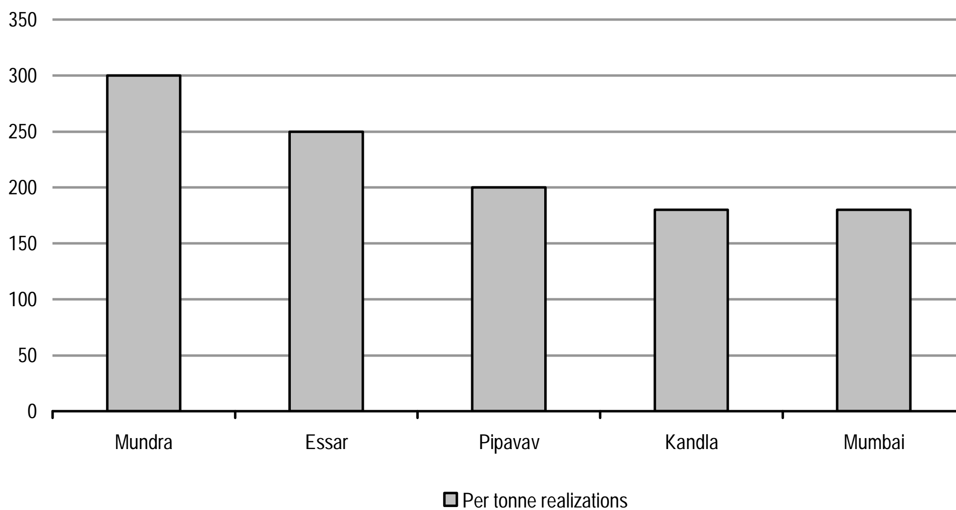
Container ports serve as gateways and hence, sufficient rail and road connectivity is crucial to long-term success of the port. Pipavav through its 50-50 joint venture with Indian Railways has succeeded in providing last-mile connectivity to the port.

The 271 km broad gauge line connects Pipavav to Surendranagar on the national grid and has a line capacity of 21 trains per day (each way) with a total annual freight capacity of 26 mn tonne.

Competitive pricing

Pipavav's pricing is more competitive in comparison to Mundra, partly due to the presence of its parent – Maersk Lines which supports 30% of its revenues. We believe a sustainable and competitive long-term pricing strategy is essential to Pipavav's long-term growth outlook.

Figure 62: **Pipavav remains competitive when it comes to pricing**



Source: Company data, Credit Suisse estimates

Opportunity for market share gains for Pipavav

JNPT currently handles bulk of the container traffic and accounts for approximately 52% of market share. The average share of Maharashtra and Gujarat ports in container traffic has increased to 69%.

Further, proximity to northern hinterland which accounts for 40% of total industrial production in India provides Gujarat and Maharashtra with significant advantage in terms of time and cost (freight).

Pipavav is favourably positioned to tap the incremental growth, which cannot be addressed by JNPT due to its capacity constraints, since Pipavav has close proximity to JNPT (8 hours steaming time).

Valuations are accomodative given strong growth potential

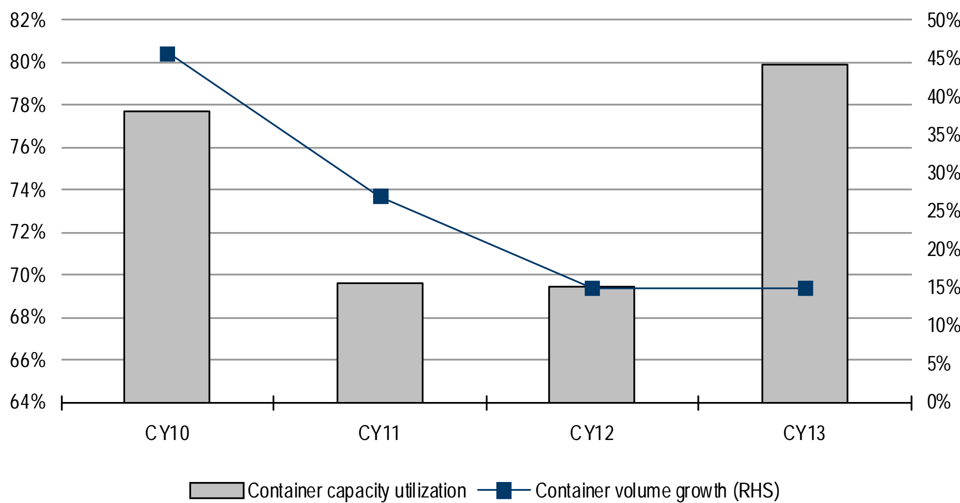
ROEs to reflate driven by higher utilisation

Pipavav is at an operating inflection point and is expected to report its first profitable year of operations in CY2011.

We anticipate overall ROEs to increase to 16% by FY13E driven by higher utilisation and leverage (operational + financial), which should help improve EBITDA margins and net profit.

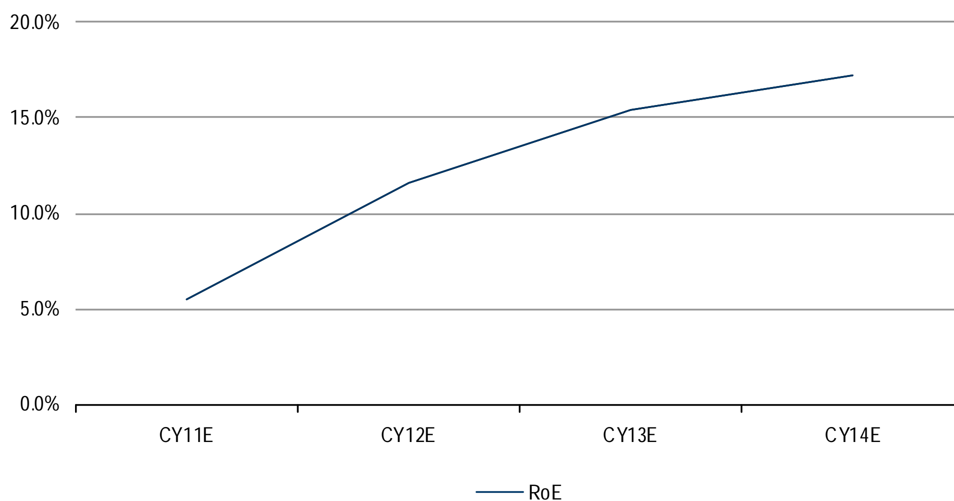
Further, given the tough macro-environment, our estimates conservatively forecast Pipavav's container volume growth to average 15% (in-line with market) till FY14E and currently we have not factored any growth beyond that.

Figure 63: **Higher capacity utilisation is anticipated to improve margins**



Source: Company data, Credit Suisse estimates

Figure 64: **RoEs to improve due to leverage**



Source: Company data, Credit Suisse estimates

Current valuations price in only the existing capacity

We believe current valuations factor in just the existing capacity and no growth in volumes beyond FY14E. We expect utilisations to reach 90% from current 70% by FY14E. Further, we anticipate Pipavav to grow its capacity on the container side from 1 mn TEU to approximately 1.4 mn TEU post 2014.

Our estimates currently do not factor any incremental bulk capacity (current 5 mn tonnes), which is likely to materialise post 2014. We prefer to provide an option value of Rs4 per share for the expansion as clarity on same is low.

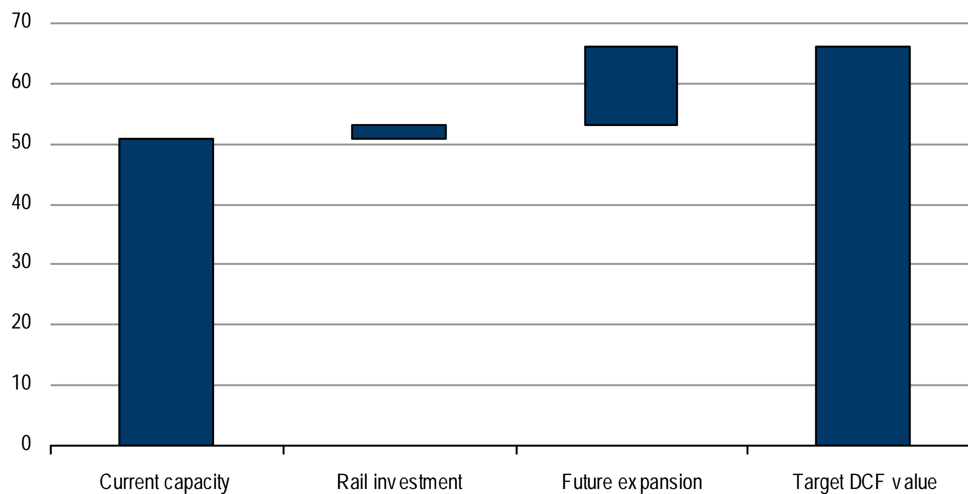
Ascribe value till end of concession period in 2028 – clarity on extension low

Concession agreement till 2028

Under the concession agreement with the Gujarat Maritime Board and the government of Gujarat, GPPL has exclusive rights to develop and operate the port until September 2028. Under the BOOT (Build, Own, Operate and Transfer) policy, GMB can provide an extension for an additional 20 years, under revised terms and conditions (revenue share). Else, the asset is transferred at the depreciated replacement value (DRV).

We do not factor any upside from renewal of concession agreement (similar to Mundra) and the option value for the same is Rs10 per share.

Figure 65: **Existing capacity and rail investment provide a fair value of Rs.53**



Source: Company data, Credit Suisse estimates

Investment risks

Liquidity risks

Gujarat Pipavav's FII limit has been reached and any new purchases by foreign investors can only be made with permission from the RBI. Further, the promoters (APM Terminals) have pledged their stake in GPPL to secure one of the credit lines and significant price correction may require the promoter to put additional margin to avoid pledged shares being sold in the market.

Revenue concentration risks

The company generates nearly 30% of its revenue from Maersk lines. Loss of business from the group can hurt earnings signficantly. Further, high revenue concentration from a single group also deteriorates pricing power for the company.

Policy risks

The ports industry in India is highly regulated and minor ports such as Pipavav come under the purview of the Gujarat Maritime Board. Any significant change in the ports policy in the form of capping tariffs, can hurt earnings. Furthermore, any unfavourable changes in the export-import policy of the government

Demand risks

Any deterioration of trade across the Intra-Asia trade lanes can impact Pipavav's volumes negatively as it has high exposure to the same.

Financial summary

Gujarat Pipavav Ports Ltd – Income statement

Figure 66: **Income statement**

Year-end Dec 31 (Rs mn)	FY09	FY10	FY11E	FY12E	FY13E	FY14E
Revenue	2,245	2,920	3,815	4,458	5,285	6,162
Expenses	(1,751)	(1,666)	(2,017)	(2,359)	(2,762)	(3,231)
EBIDTA	494	1,254	1,798	2,099	2,523	2,931
Depreciation	(458)	(493)	(514)	(491)	(510)	(528)
EBIT	36	761	1,284	1,608	2,013	2,403
Interest expense	(1,157)	(1,271)	(878)	(704)	(677)	(677)
Profit before tax	(1,121)	(510)	406	903	1,336	1,726
Income tax	(1)	-	-	-	-	-
Profit before minority	(1,122)	(510)	406	903	1,336	1,726
Minority/ Associates						
Extraordinary items	(55)	(38)	-	-	-	-
PAT	(1,177)	(548)	406	903	1,336	1,726
EPS	26.2	10.1	9.6	7.9	9.7	13.3
Dividend per share	2.0	2.0	2.0	1.6	1.9	2.7

Source: Company data, Credit Suisse estimates

Gujarat Pipavav Ports Ltd – Balance sheet

Figure 67: **Balance sheet**

Year-end Dec 31 (Rs mn)	FY09	FY10	FY11E	FY12E	FY13E	FY14E
Assets						
Cash	798	1,949	522	296	1,188	2,492
Receivables	217	295	335	397	478	581
Inventories	52	75	71	84	99	117
Loans and advances	682	530	530	530	530	530
Other current assets	33	0	0	0	0	0
Current liabilities	1,183	868	870	825	967	1,138
Provisions	326	385	390	390	390	390
Net current assets	272	1,596	197	91	937	2,192
Fixed assets	12,712	12,603	13,089	13,598	14,088	14,560
Capital WIP	156	304	304	304	304	304
Investments	830	830	830	830	830	830
Goodwill						
Deferred tax asset (liability)	-	-	-	-	-	-
Total Assets	13,970	15,333	14,420	14,824	16,159	17,886
Liabilities						
Share capital	3,149	4,236	4,236	4,236	4,236	4,236
Reserves	(70)	3,124	3,530	4,434	5,769	7,496
Shareholder funds	3,079	7,360	7,766	8,670	10,005	11,732
Debt	10,891	7,973	6,654	6,154	6,154	6,154
Minority Interest						
Total liabilities	13,970	15,333	14,420	14,824	16,159	17,886

Source: Company data, Credit Suisse estimates

Gujarat Pipavav Ports Ltd – Cash flow statement

Figure 68: **Cash flows**

Year-end Dec 31 (Rs mn)	FY09	FY10	FY11E	FY12E	FY13E	FY14E
Profit before tax	-1,176	-547	406	903	1,336	1,726
Depreciation	458	493	514	491	510	528
Taxes paid	(49)	-	-	-	-	-
Non-cash & Non-operating adjustments	1,167	400	507	334	306	493
Change in working capital	(570)	(355)	(28)	(120)	46	50
Operating cash flow	(169)	(9)	1,399	1,608	2,199	2,797
Change in fixed assets	(3,245)	(1,000)	(500)	(1,000)	(1,000)	(1,000)
Change in investments	123	311	(129)	371	371	184
Investment cash flow	(3,122)	(689)	(629)	(629)	(629)	(816)
Change in debt	3,461	(1,968)	(1,319)	(500)	-	-
Change in equity	239	5,033	-	-	-	-
Interest income/(expenses)	(1,311)	(1,271)	(878)	(704)	(677)	(677)
Dividend paid	-	-	-	-	-	-
Financing cash flow	2,389	1,794	(2,197)	(1,204)	(677)	(677)
Total cash flow	(902)	1,096	(1,427)	(226)	892	1,304
Beginning of year cash	1,700	798	1,949	522	296	1,188
Year end cash	798	1,949	522	296	1,188	2,492

Source: Company data, Credit Suisse estimates

CREDIT SUISSE

Asia Pacific / India
Marine Ports & Services

Essar Ports Ltd

(ESRS.BO / ESRS IN)

Rating	(from Outperform) **NEUTRAL* [V]**
Price (05 Jan 12, Rs)	54.90
Target price (Rs)	(from 162.00) 62.00[1]
Chg to TP (%)	12.9
Market cap. (Rs mn)	22,534
Enterprise value (Rs mn)	77,371
Number of shares (mn)	410.46
Free float (%)	16.3
52-week price range	170.6 - 48.9

*Stock ratings are relative to the relevant country benchmark.
[1]Target price is for 12 months.
[V] = Stock considered volatile (see Disclosure Appendix).

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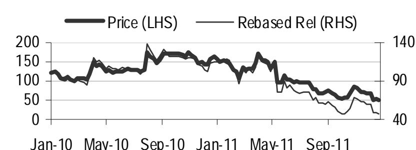
Cheap, but clarity on telecom key

- **We assume coverage of Essar Ports with a NEUTRAL rating:** Essar Ports is second largest private port company with an existing capacity of 88 mn tonnes, centered around Vadinar (58 mn of POL) and Hazira (30 mn of dry bulk). The company is promoted by the Essar Group (83.7% stake). The outcome of the 2G investigation in which the promoters have been chargesheeted remains inconclusive, and will continue to weigh on the stock.
- **Revenue visibility through take-or-pay contracts but all within Essar group:** Essar Ports currently derives 98% of its income through contracts with Group companies (Essar Steel at Hazira, Essar Oil at Vadinar) and cargo growth is directly aligned to the respective group companies' expansion plans. The commissioning of new ports (Salaya, Paradip) and expansion of capacity at Hazira is anticipated to improve third-party revenue contribution to 25% by FY15-16E.
- **Gearing likely to remain elevated:** Essar Ports' gearing as of Sep 2011 was 2.2x driven by continued investments in new capacity additions at existing ports, and development of Salaya and Paradip which are expected to be operational only by FY14E. Near-term interest coverage is low (1.3x EBITDA/Interest as of FY12E), which is a concern. However, ramp up in volumes at Hazira from FY13E due to commissioning of Essar steel plant in FY12E should improve the debt service profile of the company.
- **Cheapest among Indian ports, but promoter overhang exists:** Essar Ports remains the cheapest among Indian ports trading at 7.8x FY13E EV/EBITDA versus other Indian peers at 13.5x respectively. However, significant exposure of income stream to group companies and lack of clarity on the 2G telecom case are key overhangs. Our target price of Rs62 (13% upside) is based on 8x FY13E EV/EBITDA (premium to Chinese peers and discount to Indian peers).

Share price performance



The price relative chart measures performance against the BSE SENSEX IDX which closed at 15857.08 on 05/01/12
On 05/01/12 the spot exchange rate was Rs52.82/US$1

Performance Over	1M	3M	12M
Absolute (%)	-21.6	1.8	-65.6
Relative (%)	-15.9	4.1	-43.7

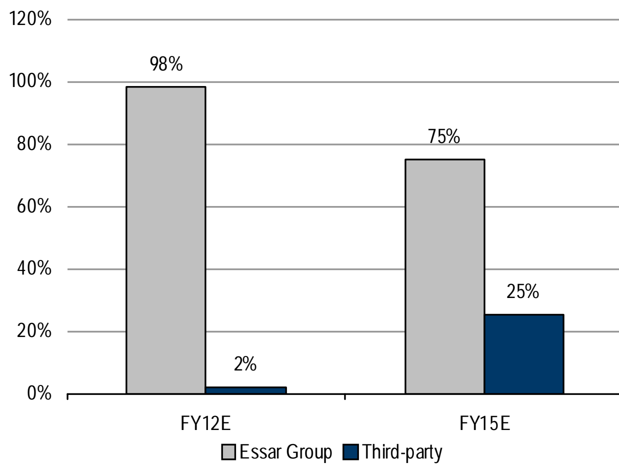
Financial and valuation metrics

Year	3/11A	3/12E	3/13E	3/14E
Revenue (Rs mn)	7,056.0	11,768.9	15,169.9	16,340.2
EBITDA (Rs mn)	5,319.0	8,757.0	11,136.0	11,983.0
EBIT (Rs mn)	3,614.0	6,434.2	8,586.7	9,021.9
Net income (Rs mn)	301.0	1,245.0	2,124.8	2,249.1
EPS (CS adj.) (Rs)	0.73	3.03	5.18	5.48
Change from previous EPS (%)	n.a.	-45.2	-57.9	
Consensus EPS (Rs)	n.a.	3.10	6.42	8.76
EPS growth (%)	n.a.	313.6	70.7	5.9
P/E (x)	74.9	18.1	10.6	10.0
Dividend yield (%)	0	0	0	0
EV/EBITDA (x)	12.4	8.8	7.8	7.9
P/B (x)	1.0	1.0	0.9	0.8
ROE (%)	1.4	5.5	8.6	8.4
Net debt/equity (%)	192.7	223.7	240.6	249.0

Source: Company data, Thomson Reuters, Credit Suisse estimates.

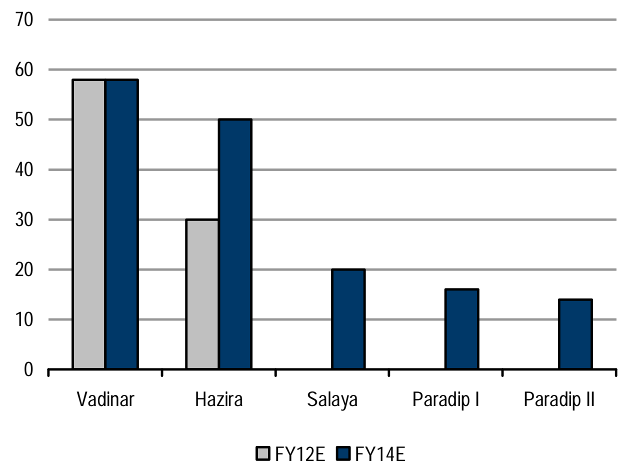
Focus charts

Figure 69: **Essar Ports derives bulk of its revenues from Essar Group companies**



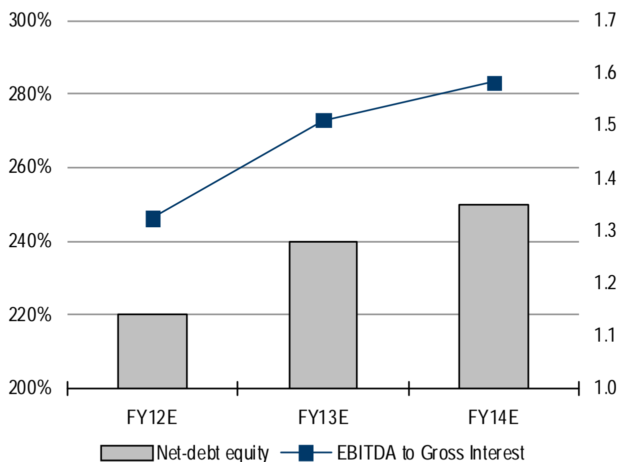
Source: Company data, Credit Suisse estimates

Figure 70: **Ambitious capacity expansion plans targeted to complete by FY14E**



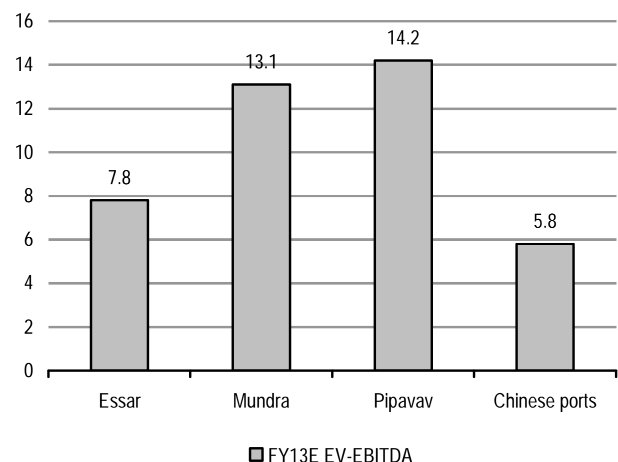
Source: Company data, Credit Suisse estimates

Figure 71: **Leverage likely to remain high due to proposed expansions**



Source: Company data, Credit Suisse estimates

Figure 72: **Stock is at huge discount to Indian peers due to telecom and leverage overhang**



Source: Company data, Credit Suisse estimates

Financial summary

Figure 73: **Income statement**

Year-end Mar 31 (Rs mn)	FY11	FY12E	FY13E	FY14E
Revenue	7,056	11,769	15,170	16,340
Expenses	1,737	3,012	4,034	4,357
EBIDTA	5,319	8,757	11,136	11,983
Depreciation	1,705	2,323	2,549	2,961
EBIT	3,614	6,434	8,587	9,022
Interest expense	3,052	4,632	5,532	5,681
Profit before tax	562	1,802	3,054	3,341
Income tax	134	324	596	736
Profit before minority	428	1,479	2,458	2,605
Minority/ Associates	127	234	333	356
Extraordinary items				
PAT	301	1,245	2,125	2,249
EPS	0.7	3.0	5.2	5.5
Dividend per share	-	-	-	-

Source: Company data, Credit Suisse estimates

Figure 74: **Balance sheet**

Year-end Mar 31 (Rs mn)	FY11	FY12E	FY13E	FY14E
Assets				
Cash	1,569	305	212	424
Receivables	832	2,942	3,792	3,877
Inventories	226	82	82	82
Other current assets	3,752	4,129	4,129	4,129
Current liabilities	7,016	5,597	5,597	5,597
Provisions	166	433	433	433
Net current assets	-804	1,428	2,185	2,482
Fixed assets	53,438	63,732	74,027	83,960
Investments	11	121	121	121
Goodwill	14,611	14,611	14,611	14,611
Total Assets	67,256	79,893	90,945	101,174
Liabilities				
Share capital	4,285	4,285	4,285	4,285
Reserves	17,520	19,386	21,438	23,667
Shareholder funds	21,806	23,671	25,723	27,952
Debt	44,815	55,142	64,142	72,142
Other LT liabilities	2	234	234	234
Minority Interest	634	846	846	846
Total liabilities	67,256	79,893	90,945	101,174

Source: Company data, Credit Suisse estimates

Companies Mentioned *(Price as of 05 Jan 12)*
Essar Ports Ltd (ESRS.BO, Rs52.55, NEUTRAL [V], TP Rs62.00, MARKET WEIGHT)
Gujarat Pipavav Port Limited (GPPL.BO, Rs56.85, OUTPERFORM, TP Rs66, OVERWEIGHT)
Mundra Port and Special Economic Zone (MPSE.BO, Rs122.60, UNDERPERFORM, TP Rs112.00)

Disclosure Appendix

Important Global Disclosures

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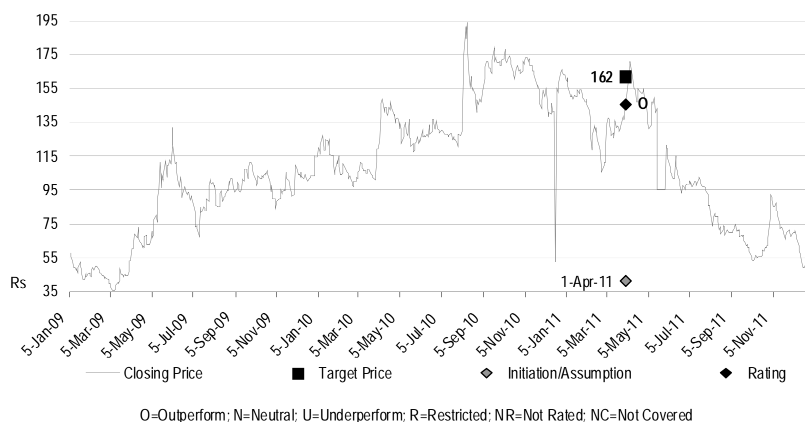
3-Year Price, Target Price and Rating Change History Chart for ESRS.BO

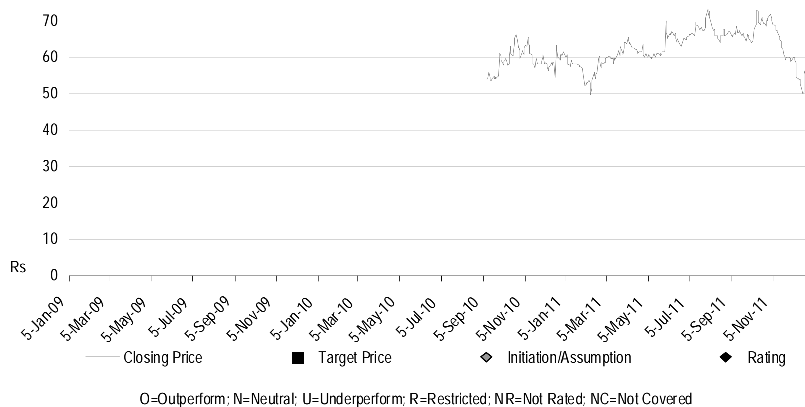
ESRS.BO Date	Closing Price (Rs)	Target Price (Rs)	Rating	Initiation/ Assumption
1-Apr-11	145.5	162	O	X



O=Outperform; N=Neutral; U=Underperform; R=Restricted; NR=Not Rated; NC=Not Covered

3-Year Price, Target Price and Rating Change History Chart for GPPL.BO

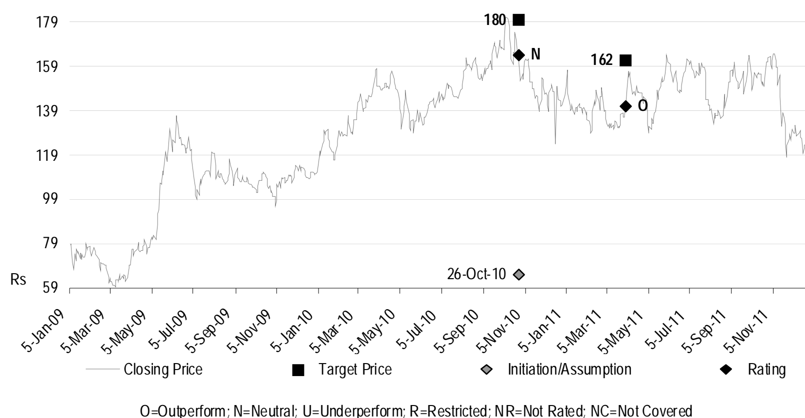
GPPL.BO Date	Closing Price (Rs)	Target Price (Rs)	Rating	Initiation/ Assumption



O=Outperform; N=Neutral; U=Underperform; R=Restricted; NR=Not Rated; NC=Not Covered

3-Year Price, Target Price and Rating Change History Chart for MPSE.BO

MPSE.BO Date	Closing Price (Rs)	Target Price (Rs)	Rating	Initiation/ Assumption
26-Oct-10	164	180	N	X
1-Apr-11	141	162	O	



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Price Target: (12 months) for (ESRS.BO)
Method: Our target price of Rs.62 is based on 8x FY13E EV/EBITDA (premium to Chinese peers and discount to Indian peers).
Risks: Risks to our target price include 1) Delay in approvals in port expansion: Clearances are pending for Salaya and Paradip coal terminals and Hazira Phase II expansion. 2) Take or pay contracts not yet tested: Volume ramp up at both Vadinar and Hazira ports depends on expansion at Essar oil and Essar steel. Any delay in expansions at group companies would impact volumes at Essar ports. Although the contracts are take or pay, they have not been tested so far.
Price Target: (12 months) for (GPPL.BO)
Method: Our TP of Rs.66 is based on SOTP valuation. We have valued the port assets at Rs.64 based on DCF methodology and the investment in pipavav rail at book value of Rs.2 per share
Risks: Risks to our TP include slower than anticipated capacity utilization and expansion, decline in overall trade growth, and loss of business from parent - Maersk lines
Price Target: (12 months) for (MPSE.BO)
Method: Our target price of INR112 is based on sum of the parts valuation (DCF-value of Indian ports business is Rs.91, Abbot Point contributes Rs.12, SEZ is valued at Rs.7 and investment in rail at book value of Rs.2).
Risks: Risks to our target price of Rs 112 include higher than anticipated volume off-take especially in bulk, stronger pricing power, extension of contract by Gujarat Maritime Board with Mundra port beyond FY31 and addition of new value accretive port projects in India.

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