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Established in 1997, Pipavav Defence and Offshore Engineering company Limited (PIPAVAVDOC) erstwhile Pipavav Shipyard Limited is India's biggest ship manufacturer. The company primarily deals in 3 business segments defence, Offshore Oil & Gas sector assets and commercial sector with an order book of US\$1,023 mn, US\$180 mn and US\$656 mn respectively. In January 2013, it has delivered India's biggest dry bulk carrier 74,500 DWT Panamax bulk carrier namely 'The Golden Brilliant' to Golden Ocean Group Ltd.

### Investor's Rationale

☞ Making a notable development in offshore division, PIPAVAVDOC has received a project from European client to built specialized offshore vessels valued at ₹5.9 bn with option to supply 2 more specialized offshore ships worth ₹12 bn. With this, it has crossed US\$2 bn order book mark and is eyeing 3 more contracts in Offshore and Naval segment by next 6 months. Moreover, the firm plans to raise market share in offshore segment by the next one year as it has received interest from the European investor for investment in the company.

☞ The first Indian private firm, PIPAVAVDOC has been selected for a joint venture (JV) with Mazagon Dock Ltd (MDL), a Government enterprise to liquidate MDL's huge order book of ~ ₹900 bn. We expect that the JV will aid the company in bagging Indian Navy projects. Moreover, foreign naval orders coupled with JV with MDL are expected to provide stability to the order book and will further highlight the execution in FY13-14. The operation once started will show results in the form of improvement in top line which we expect to be at ₹36.2 bn by FY'15

☞ PIPAVAVDOC proving its expertise has received oil rig repair and maintenance contract from ONGC worth ₹4 bn during Q3FY'13 beating global competitors. Earlier, it has secured highly prestigious contracts for dry docking and maintenance of critical oil rigs and gas from Swiss-based conglomerate Transocean and Noble. The company with the expectation of few more similar contracts in the near future is likely to uphold its revenue book.

☞ On industrial front, worldwide ~68% of rigs, 73% of anchor handling tug, and 62% of the platform supply vessels are more than 20 years old and needs quick handling. This necessity will decode into huge potential to service and revamp large number of these assets by Indian private shipyards, hence creating tremendous opportunities for PIPAVAVDOC, being the key player.

### Key risk

**Debt burden:** The company's consolidated debt of ₹11.4 bn continues to remain stressed which in turn raised interest costs to ₹3.9 bn during FY'13, denting the net profit. However, the company is continuously scouting opportunities, entering into alliances to raise fresh equity to slash the debt.

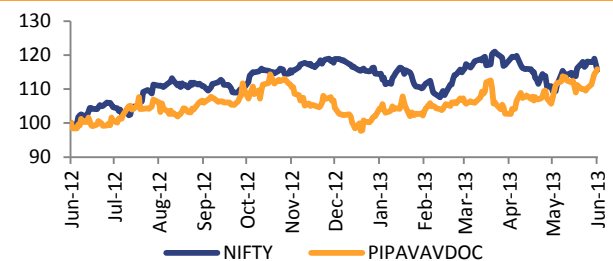
### Market Data

Rating	<b>BUY</b>
CMP (₹)	69
Target (₹)	<b>82</b>
Potential Upside	~19%
Duration	Long Term
Face Value (₹)	10
52 week H/L (₹)	98.3 / 52.6
Adj. all time High (₹)	14.8
Decline from 52WH (%)	29.8
Rise from 52WL (%)	30.9
Beta	0.1
Mkt. Cap (₹bn)	4.8
Enterprise Value	89.4

### Fiscal Year Ended

Y/E	FY12A	FY13A	FY14E	FY15E
Revenue (₹bn)	18.9	26.1	30.8	36.2
EBITDA (₹bn)	4.4	5.7	6.2	6.8
Net Profit (₹bn)	0.2	0.3	0.4	0.5
Adj EPS (₹)	0.3	0.4	0.6	0.7
P/E (x)	220.2	155.5	118.6	98.3
P/BV (x)	2.4	2.3	2.3	2.2
EV/EBITDA (x)	16.2	15.7	15.5	15.6
ROCE (%)	6.7	6.3	6.1	5.8
ROE (%)	1.1	1.5	1.9	2.3

### One year Price Chart



### Shareholding Pattern

Shareholding Pattern	Jun'13	Mar'13	Diff.
Promoters	44.48	45.63	(1.15)
FII	2.20	3.08	(0.88)
DII	15.53	16.31	(0.78)
Others	37.79	34.98	2.81

*PIPAVAVDOC is the country's biggest ship building company serving numerous facilities via its 3 segments namely defence, offshore and commercial sector .*

*The company has India's longest and World's second longest Dry Dock facility with capacity to manufacture ships upto 400,000 DWT.*

### PIPAVAVDOC- India's largest shipbuilding company

Pipavav Defence and Offshore Engineering company Ltd (PIPAVAVDOC) is India's leading company in the Defence sector. It is involved in the business of naval shipbuilding, repair & dry-docking and has the capability to build all types of assets required by the Indian Navy and the Indian Coast Guard. It has mainly 3 business segments defence, Offshore Oil & Gas sector assets and commercial sector with an order book of US\$1,023 mn, US\$180 mn and US\$656 mn respectively.

Spread across 491.53 acres of land on the Gujarat coast, PIPAVAVDOC built India's largest dry dock 662 meters long and 65 meters wide that can accommodate vessels measuring upto 400,000 DWT. Looking forward, the company foresees a robust order book build-up and is also constructing its second dry dock (~750mx90m), capable of building ships upto 1 mn DWT. The Company has fully tied up the debt for the 2<sup>nd</sup> dry dock and is likely to get started by 2015.

In 2013, it has efficiently demonstrated its execution capabilities by delivering 74,500 DWT Panamax bulk carrier "The golden brilliant" to Golden Ocean Group Ltd. Consequently, in 2012 it has delivered 2 vessels namely Golden Bull and Golden Suek - the largest vessels of their class ever built in India (224.9m x 32.25m x 19.7m) to the same client.

#### Pipavav-Current business segments

Segment	Business drivers	Order book as on January 2013
Defence	<ul style="list-style-type: none"> <li>India's naval modernisation programme : One of the world's largest naval build-ups.</li> <li>JV with Mazagon Dock Limited</li> <li>Strategic &amp; technology partnership with global defence players.</li> <li>Increased exports and defence offset opportunity.</li> </ul>	US \$1,023 mn
Offshore	<ul style="list-style-type: none"> <li>Increased exploration and production activity, particularly in the western coast of India (BombayHigh) to cater to the high oil &amp; gas demand.</li> <li>Pipavav's facility are strategically located near the major offshore Indian and Middle East oil &amp; gas rigs.</li> </ul>	US \$180 mn
Commercial shipbuilding	<ul style="list-style-type: none"> <li>Increased trading activity between India and other markets.</li> </ul>	US \$656 mn

### Diversified order book to succeed greater heights

The company having huge order book (aggregate) worth US \$1,859 mn during 31 January 2013 has further bagged various prominent and novel orders. Highlighting some of its recent orders:

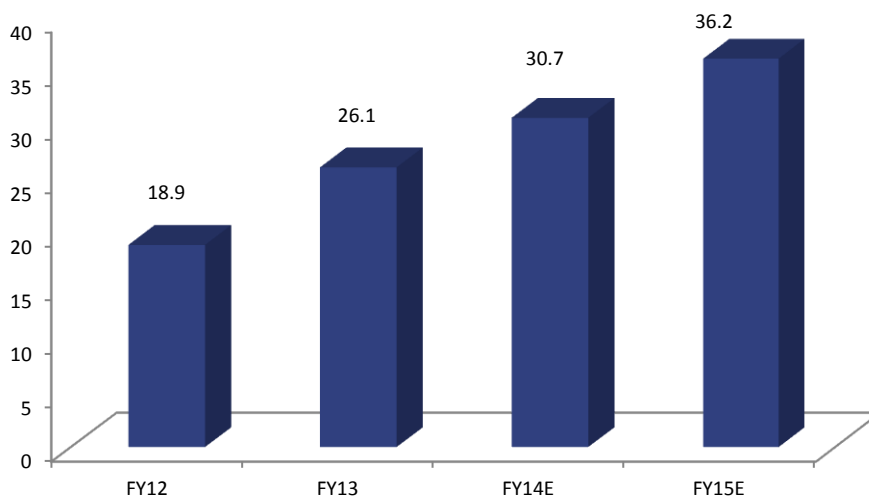
*During FY'13, the company has bagged orders from major customers including ONGC and European client worth ₹4.0 bn and ₹12.0 bn respectively.*

*PIPAVAVDOC with its unique business model has kept bull's eye to upgrade its order book and is continuously focusing on securing profitable and cash positives order.*

- It has secured contract for maintaining and dry docking of deep water draft oil rigs valued at ₹2.5 bn. We expect that with this deal and other negotiations with several large oil & gas players globally to enter into long term contracts will strengthen its presence in the sector, worldwide.
- Bagged an order from the European client for delivering specialised offshore vessels worth ₹12.0 bn which will help the firm to complete its target of raising its market share in the offshore segment substantially over the next 4 quarters.
- ONGC awarded a project to PIPAVAVDOC in order to repair, maintain and dry dock of one of its oil rigs namely Sagar Laxmi valued at ₹4.0 bn. With this coupled with few more orders expected to come in near future will surely add to its top line which again will contribute in huge investment plans, going ahead. Notably, the company has already handed over two vessels built by it to ONGC.

***PIPAVAVDOC's focus on building, maintaining, refurbishing, converting and dry docking of Oil platforms, Deep water draft rigs and other speciality oil & gas assets for global clients which in turn will drive the company to earn foreign exchange as all its recent orders are majorly from best overseas markets.***

#### Net Sales growth trend (values in ₹ bn)



*xThe company is in advanced talk to finalize its negotiation with DCNS of France to manufacture the modern warships.*

*PIPAVAVDOC in a bid to hone its technological expertise has signed partnership agreements with prestigious foreign clients like SAAB of Sweden, Babcock of UK and Northrop Grumman of USA.*

### Strategic foreign tie-ups under a big umbrella to extend global reach

PIPAVAVDOC is continuously adding foreign tie ups in its acquisition basket. A year back it has done some strategic partnerships and alliances with global defence players including DCNS of France, SAAB of Sweden, Babcock of UK and Northrop Grumman of USA. Further, PIPAVAVDOC is in advanced talk with the French company, DCNS, a world renowned warship and submarine builder for technology transfer to build the most modern assets, including modern warships for the Indian Navy and the Coast-Guard. We expect that this deal once finalized will help the company to upgrade its technologies, methods and skills in improving its product as well as work quality, hence strengthening the brand respect outside India.

Besides, the firm's race to become India's leading integrated defence company is emphasizing primarily on defence production. PIPAVAVDOC eyed Sweden as a potential market and signed a technology partnership agreement with SAAB, Sweden-based defence major in Q3FY'13. Accelerating the deal it has allotted over 2.01 bn shares to Swedish defence major in 2013. With this, it is expected that the agreement is likely to take along world class military technology to cater the needs of Indian armed forces. Besides, we expect that the deal will further provide the opportunities to better understand the European market.

Apart from this, it has also signed an agreement with its European client, for specialised offshore vessels. It is believed that the total demand for similar specialised offshore ships in the global market is nearly US\$10 bn per year. PIPAVAVDOC's offshore division is constantly increasing the clientele in the global market and expect that the deal will support the ambitious plans of the company to manufacture military hardware for India and other responsive nations.

**The above mentioned partnership with some of the top notch global companies makes it clear that PIPAVAVDOC is not going to stop in attaining its aggressive plans to expand its businesses in various regions as well as the several areas of the sector.**

### Government's initiative to propel shipbuilders



*Government of India's recent moves of raising FDI, exemption of excise duty in defence sector will provide a big relaxation to the industry as well as the allied players.*

*The finance minister has optimistically decided to establish 2 new major ports in West Bengal and in Andhra Pradesh with an estimated investment of ₹75 bn.*

*On industrial front, Government of India is proactively taking initiatives in promoting and improving the ship building services.*

Indian government brought some cheer on defence sector via raising foreign direct investment (FDI) to 49% from 26%, decided earlier. The defence major, PIPAVAVDOC welcomed the FDI with open arms, as its plans to go global will get a big push. The synergies linked with hike in FDI are as follows:

- Help in examining and alleviating the steadily expanding deficiency in defence modernization.
- Improve self-reliance, bring more players and increase the level of technology.
- Encourage global players to build manufacturing facilities and integration of systems in India that will help the country to eradicate import dependence.

Further, the government to boost the shipping industry has announced the exemption of ships and vessels from excise duty in its budget 2013-14 and consequently, no Countervailing Duty (CVD) on imported ships and vessels. Earlier the excise duty and CVD stood at 10% and 26.85% respectively. With this we expect that the move will provide a level playing field to domestic ship builders and hence the PIPAVAVDOC.

Separately, the government planned to establish 2 new major ports - in Sagar, West Bengal and in Andhra Pradesh that will add 100 million tonnes of capacity. Further, it is also mulling to set up a new outer harbour at Thoothukkudi, Tamil Nadu through public-private partnership (PPP) at an estimated cost of ₹75 bn. Once fully executed the facility is supposed to add 42 million tonnes of capacity.

## Industry Outlook

The shipping industry is considered to be a major catalyst for economic development, as it facilitates 90% of world trade. In the Union Budget FY'14, the Finance Minister allocated ₹2,036.7 bn for defence spending, representing over 2% of Gross Domestic Product (GDP) of the country. The industry has lined-up various projects which needs strong execution to accomplish on time. The present fleet of the Indian Navy that consists of 132 ships including submarines has planned to go for a capex of ~US\$90 bn during FY12-FY22 for manufacturing ~100 ships of different varieties and strategic asset acquisition in over 2 decades. With this we expect that PIPAVAVDOC concentrating primarily on defence sector (contributes ~ 52% of its order book) will benefit the most.

The company is also lured by the Government's plans to offer USD \$250 bn worth of contracts over the following 5 years in defence hardware.

Demand for crude oil in the world is expected to rise to 95 million barrels per day by 2015 driven by surge in consumption of petroleum products (India consumes about 3.1 million barrels per day). The country, being the 4th largest oil consumer in the world will soon see itself on 3rd position surpassing Japan and Russia as it generates only 20% of its total crude oil requirement. In order to fulfill the demand supply gap, the government has offered 33 oil and gas exploration blocks. PIPAVAVDOC well-equipped to fabricate offshore structures is all set to cater to the demand.

**The government's major initiatives to boost the industry milieu make it crystal clear that India's ship building industry that currently holds ~1.5% share in global ship building market will rise to ~5% by 2017.**

*Rise in competition, sluggish growth in the international and domestic markets, foreign exchange fluctuation etc are some of the major hurdles blocking the company's growth. However, it has framed different strategies to solve it as well.*

### **PIPAVAVDOC's impasses to growth & its attempt to mitigate the risks**

PIPAVAVDOC grabbing continuous opportunities is equally focused in mitigating both the certain and uncertain risk. The Company on industrial front face risks such as high raw material cost, strong competition, uncertainties in the international and domestic markets, foreign exchange fluctuation risk etc.

The management examine these hurdles via following prudent business and risk management practices. The firm's Judicious buying of raw material and the ability to pass on raw material price increases help to minimise the risk relating to the volatility in raw material prices. The forex volatility is curtailed via natural hedging. Further, it has framed a judicious processes to identify, assesses and mitigates risks that could materially impact the Company's performance in achieving its business objectives.

### **Posted robust revenue growth in FY'13**

Fuelled by its huge orders book of over US\$1.5 bn, PIPAVAVDOC notched 79.0% YoY growth in sales against of 77.5% in FY'12. In FY'13, the company has bagged contract to build two specialised Offshore vessels for its European client of ₹5.9 bn and its all time large export order from ONGC worth 4 bn. Moreover, it was a challenging year for the company with the problems of economic slowdown and unfavourable exchange rate regimes.

PIPAVAVDOC's 18 ships are at advanced stage of completion which is going to boost the turnover. On the capex front, the conversion from wet dock to dry dock is 50% complete and is likely to be ready by FY15, thereby increasing scalability further. Besides, the prices of major inputs are showing the signs of firming up, as a result the EBITDA of the company grew by 28.4% YoY in FY'13.

Despite higher depreciation and interest cost the bottom-line was up by 43.6% YoY to ₹0.3 bn in FY'13. Consequently, consolidated debt shot up by ₹11.4 bn as against ₹9.8 bn, a year ago.

Looking at the positive side, the firm loaded with huge projects coupled with the other orders coming on way are likely to shoot up the top line as well as bottom line to ₹30.7 bn and ₹0.4 bn respectively during FY'14.

**Balance Sheet (Consolidated)**

Y/E (₹mn)	FY12A	FY13A	FY14E	FY15E
Share Capital	6,912	7,012	7,012	7,012
Reserve and surplus	12,572	13,563	13,970	14,462
Money received against Convertible Warrants	399	204	205	204
<b>Net Worth</b>	<b>19,883</b>	<b>20,779</b>	<b>21,187</b>	<b>21,678</b>
Loan funds	27,251	44,857	52,931	62,459
Long term provisions	236	2,490	2,714	2,986
Current Liabilities	9,849	11,431	13,717	16,461
Deferred tax liability (net)	672	810	809	809
Other long term liabilities	1,994	1,474	1,179	944
<b>Total Equity &amp; Liabilities</b>	<b>59,883</b>	<b>81,843</b>	<b>92,540</b>	<b>105,339</b>
Fixed Assets	29,171	50,480	59,883	71,325
Goodwill on Consolidation	102	102	102	102
Investments	108	63	50	40
Loans & Advances	8,458	8,426	8,595	8,766
Current Assets	22,044	22,772	23,910	25,106
<b>Total Assets</b>	<b>59,883</b>	<b>81,843</b>	<b>92,540</b>	<b>105,339</b>

**Key Ratios (Consolidated)**

Y/E	FY12A	FY13A	FY14E	FY15E
EBITDA Margin (%)	23.5	21.8	20.3	18.8
EBIT Margin (%)	17.7	17.0	15.6	14.3
NPM (%)	1.1	1.2	1.3	1.4
ROCE (%)	6.7	6.3	6.1	5.8
ROE (%)	1.1	1.5	1.9	2.3
Adj EPS (₹)	0.3	0.4	0.6	0.7
P/E (x)	220.2	155.5	118.6	98.3
BVPS (₹)	28.8	29.6	30.2	30.9
P/BVPS (x)	2.4	2.3	2.3	2.2
EV/Operating Income (x)	3.9	3.5	3.2	3.0
EV/EBITDA (x)	16.2	15.7	15.5	15.6
EV/EBIT (x)	21.6	20.2	20.2	20.5

**Profit & Loss Account (Consolidated)**

Y/E (₹mn)	FY12A	FY13A	FY14E	FY15E
<b>Total Operating Income</b>	<b>18,914</b>	<b>26,130</b>	<b>30,759</b>	<b>36,229</b>
Operating Expenses	14,468	20,422	24,506	29,408
<b>EBITDA</b>	<b>4,446</b>	<b>5,708</b>	<b>6,252</b>	<b>6,821</b>
Depreciation	1,102	1,272	1,443	1,638
<b>EBIT</b>	<b>3,344</b>	<b>4,436</b>	<b>4,809</b>	<b>5,183</b>
Interest	2,576	3,987	4,227	4,480
<b>PBT</b>	<b>766</b>	<b>448</b>	<b>582</b>	<b>701</b>
Tax	552	137	175	210
<b>Profit after tax</b>	<b>214</b>	<b>311</b>	<b>407</b>	<b>491</b>
Share of Profit & Loss of Associate	2	0	0	0
<b>Net Profit</b>	<b>216</b>	<b>311</b>	<b>407</b>	<b>491</b>

**Valuation and view**

PIPAVAVD0C with major orders and strong business segment is likely to post a sustainable growth rate both in its top line as well as in EBITDA level.

Looking ahead, the company's joint venture with Mazgaon Dock (MDL) would provide cushion in terms of the order book as MDL has an unexecuted order book of around ₹1 lakh crore. The company expects orders to flow from MDL in the near future, which would enhance the revenue visibility.

At a current market price (CMP) of ₹68.9, the stock trades at 118.6x FY14E and of 98.3x FY15E, earnings. We recommend 'BUY' with a target price of ₹82, which implies potential upside of ~19% to the CMP from 1 year perspective.



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