RESULT UPDATE

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SHIPPING CORPORATION OF INDIA LTD (SCI)

PRICE: RS.101 **RECOMMENDATION: ACCUMULATE**
TARGET PRICE: RS.110 **FY19E PE: 21.9X**

SCI has reported weak set of numbers for Q2FY18 despite improvement in macroeconomic environment and up-trend in shipping cycle. This is primarily due to poor strategy adopted by the company in placing its ships, improper capex plan and poor bargaining with customers. Sales was reported at Rs 8.08 bn (+6.5% YoY and -6.5% QoQ) with weakness in the key tanker segment despite upcoming winter in the west. This dragged the overall EBIDTA margin to 15.49% (-200 bps QoQ and -380 bps YoY) which is the lowest in the last 8 quarters. Consequently company reported loss of Rs 763 mn against our expectation of profit of Rs 461 mn.

Improving shipping markets should help the company report better numbers in H2FY18, despite lack of aggression and inadequate strategy from the company in a competitive environment. Strategic sale by government is expected to remove government bound constraints and improve management of SCI which should add value to the company. Recommend ACCUMULATE with a decreased TP of Rs 110 (from Rs 125).

Summary table

(Rs mn)	FY17	FY18E	FY19E
Sales	34,618	34,673	38,110
Growth (%)	(16.0)	0.2	9.9
EBITDA	7,570	7,138	8,798
EBITDA margin (%)	21.9	20.6	23.1
PBT	1,776	1,643	3,329
Net profit	1,598	1,479	2,996
EPS (Rs)	3.4	3.2	6.4
Growth (%)	(68.5)	(7.5)	102.6
CEPS (Rs)	15.6	15.0	18.1
Book value (Rs/share)	151.8	155.0	161.4
Dividend per share (Rs)	-	-	1.0
ROE (%)	2.3	2.0	4.0
ROCE (%)	3.1	2.8	4.2
Net cash (debt)	(26,762)	(24,585)	(22,498)
NW Capital (Days)	99.0	98.0	99.0
EV/EBITDA (x)	9.8	10.0	7.9
P/E (x)	29.4	31.8	15.7
P/Cash Earnings	6.5	6.7	5.6
P/BV (x)	0.7	0.7	0.6

Source: Company, Kotak Securities – Private Client Research

Quarterly performance

(Rs mn)	Q2FY17	Q3FY17	Q4FY17	Q1FY18	Q2FY18
Income from Operations	7,587	9,649	8,977	8,648	8,082
YoY growth (%)	-30.1	-2.2	-8.8	2.9	6.5
QoQ growth (%)	-9.7	27.2	-7.0	-3.7	-6.5
Operating expenditure	6,256	7,835	6,691	6,987	6,830
EBIDTA	**1,331**	**1,814**	**2,286**	**1,661**	**1,252**
EBIDTA %	17.54	18.80	25.47	19.21	15.49
Depreciation	1,404	1,349	1,559	1,494	1,527
EBIT	**-73**	**465**	**727**	**167**	**-275**
Interest	418	456	430	445	474
Other income	470	257	506	361	166
Exceptional	0	0	0	0	0
PBT	**-21**	**266**	**803**	**83**	**-583**
Taxes	168	193	-120	150	180
Effective tax rate %	-800.0	72.6	-14.9	180.7	-30.9
PAT	**-189**	**73**	**923**	**-67**	**-763**

Source: Company

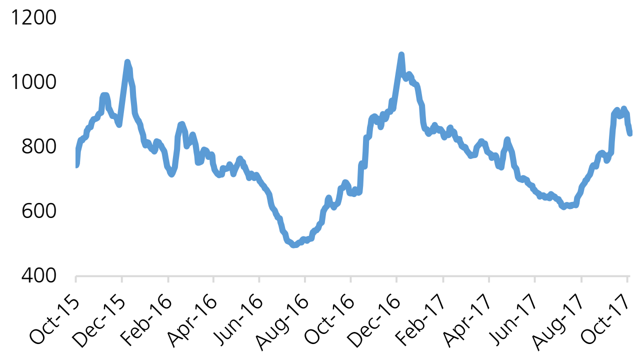
Quarterly highlights

- Weakness was seen in the tanker and the offshore segment, but the bulk segment and the product carrier segment was stable in the quarter
- Sales was reported at Rs 8.08 bn (+6.5% YoY and -6.5% QoQ)
- Surprisingly, tanker segment has reported loss in the quarter at EBIT level (despite upcoming winter in the west) which dragged the overall performance of the company
- Weak performance of the tanker segment dragged the EBIDTA margin to15.49% (-200 bps QoQ and -380 bps YoY) lowest in the last 8 quarters
- Interest and depreciation remains stable for the company
- Consequently company reported loss of Rs 763 mn against our expectation of profit of Rs 461 mn
- We interpret the results as weak

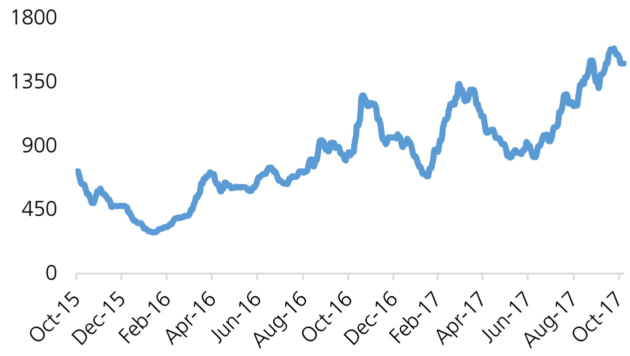
What we believe about the shipping markets?

Till date, the supply side was the source of most of the problems, which as per latest data is showing signs of easing. We see the current levels of shipping market to be the bottom of cycle with improvement expected over the next two financial years

Baltic dirty tanker index



Baltic dry index



Source: Bloomberg

Current fleet of SCI (as on October 2017)

Category	No	DWT
Crude Oil	17	2,175,902
Product	14	908,059
Gas	3	88,705
VLCC	5	1,590,809
Bulk Carriers	16	1,068,088
Liners	4	173,465
Offshore Supply	10	23,502
Passenger-cum-Cargo	1	5,140
Total	69	6,008,424

Source: Company

SCI has hardly added any ship in the last one year primarily due to weak shipping markets. Even the current fleet has been inadequately placed by the company which is impacting the performance of the company.

Many vessels are currently placed in the spot market and are competing with other shipping companies for the same business. These vessels are working at less than 50% utilization. Long term contracts are limited under current environment. We believe that the current fleet has the potential to capture the near term improvement in business and hence we estimate the near term capex to be very small for the company which should lead to improvement in BS quality.

Near term performance expected to improve for SCI

Performance of any shipping company is a function of freight rates, placement of ships (mix of spot and contracted revenues) and bunker prices.

For SCI,

- Freight rates is expected to improve (positive for SCI)
- Company will have a more effective strategy in placing ships in the market (positive for SCI)
- Asset prices have either shown upward movement or stabilized (positive for SCI)
- Increasing bunker (fuel) prices (positive for SCI)

Government may go for a strategic sale in SCI

NITI Aayog has proposed a strategic sale of about 26% stake in Navratna PSU Shipping Corporation of India (SCI). The government currently holds 63.75 % stake in SCI. We estimate that after the sale of 26% stake, the government holding in the company will come down to 37.75 %. The strategic partner would have to give an open offer for another 25% stake which would increase the stake of the strategic player to beyond 50% making it the majority shareholder in the company.

We expect the stake sale to shift control of the company to the strategic player, which is expected to make SCI a) more professional; b) well managed; c) constrain free with PSUs working under severe government restrictions and; d) more profitable. All of the above would be healthy for the minority shareholders of the company.

Recently the cabinet committee on economic affairs (CCEA) mandated a panel headed by finance minister Arun Jaitley to oversee and accelerate strategic disinvestments in central public sector enterprises (CPSEs) and SCI is one of the key CPSE identified by NITI Ayog. We expect the disinvestment of SCI to happen in FY19

Valuation and recommendation

We recommend ACCUMULATE on SCI with a target price of Rs.110

We estimate business environment and sentiments to improve going forward with will lead to improvement in revenues, EBIDTA margin, return ratios and BS for SCI. Strategic sale is estimated to add further value to the company.

In wake of losses in Q2FY18 and the current management continuing with its slow approach in placing ships and bargaining hard with the customers in a globally competitive shipping market, we are lowering our earnings by 38% for FY18 and 11% for FY19.

We continue to value the company based on book value which equates to book value of all the assets minus the liabilities. The current stage and development within the company does not capture the true earnings potential of the company and hence we are not using any earnings metrics. The stock has moved by more than 20% in the last two month and we continue to be positive on the company primarily because we are anticipating disinvestment to change the fortunes of the company.

We are now valuing the stock at 0.67 (earlier 0.75) of its FY19 book value expecting improvement in earnings based on positive change in industry dynamics and improvement in management of the company. The 1/3rd discount to book value reflects the discount required for a cyclical stock in the current state of the shipping cycle. Recommend ACCUMULATE with a decreased TP of Rs 110 (from Rs 125) at an implied PE of 17.1x FY19E. We would give a higher multiple to the stock post certainty over the disinvestment timeline

RATING SCALE

Definitions of ratings

BUY	–	We expect the stock to deliver more than 12% returns over the next 9 months
ACCUMULATE	–	We expect the stock to deliver 5% - 12% returns over the next 9 months
REDUCE	–	We expect the stock to deliver 0% - 5% returns over the next 9 months
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NA	–	Not Available or Not Applicable. The information is not available for display or is not applicable
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