# Valuation Alert!
## 3 min read. Updated: Feb 17 2023, 12:00 am


We are starting a **new series** where we write about stocks which are **close to lower end of the historical valuation band** and the **near term business outlook** is decent. This will be an infrequent report. Certainly not the report we want to write too frequently. The first stock we want to highlight is **The Great Eastern Shipping Company Ltd (NSE Code GESHIP; Mkt Cap Rs8200cr**).

**Best valuation metric** for shipping companies is **Price to Net Asset Value** (NAV). The logic here is simple, ships are highly liquid assets and can be sold at a click of a button. And shipping companies get a 3rd party report on the valuation of their ships every quarter. So unlike most sectors, here one has a fair idea about worth of the assets. The other aspect of NAV is cash profits which impact the cash on books/ debt. So NAV is influenced by current value of ships which can move up or down depending on the freight outlook and cash profits already earned.

**Based on this, GE Shipping stock is now trading at 0.54x Price to NAV. This is 1sd below the historical average and significant discount to market value of ships.**

So if stock is trading at such a steep discount ,so let's study individual components of NAV and see what are the risks that market is seeing.

**NAV = Value of Assets + Cash**

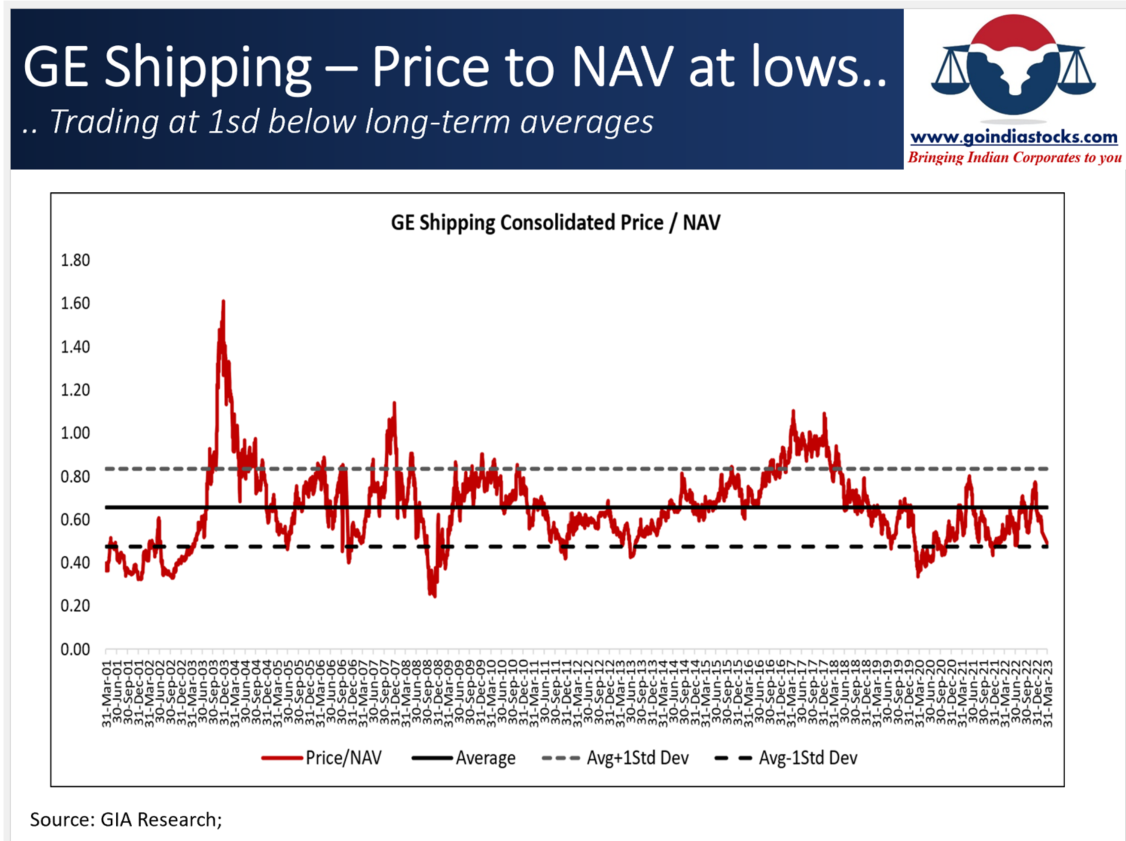
As of Dec'22,

**NAV = Rs1048/sh** (Reported is a range of Rs1014-1082/sh, so we take a mid point Rs1048/sh)

**Net cash = Rs34/sh** (Net cash on books is Rs486cr)

**So effective value of assets = Rs1014/sh** (NAV – net cash)

**And based on current share price of Rs570/sh, market is valuing these assets at Rs536/sh, at 48% discount!**



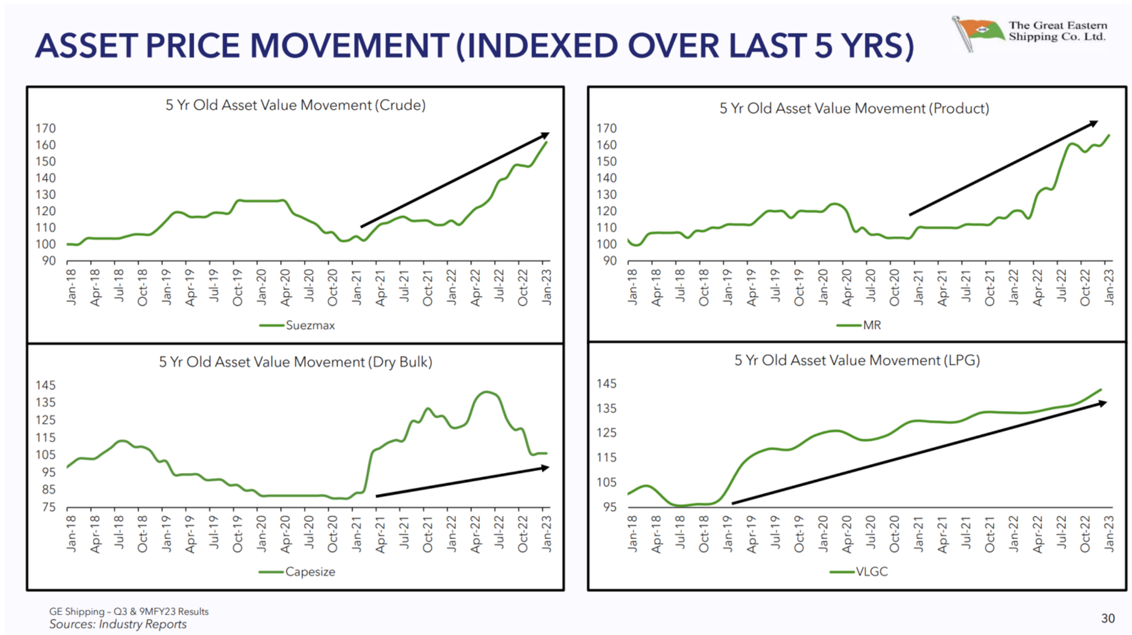

**Risk 1: Value of ships go down**

This is quite possible, current asset prices are running very high and in most cases trending between 1.2-1.6x of the last 5year bottom. So let's assume heavens were to fall apart tomorrow and all this premium vanishes overnight, the asset value of GE Shipping's assets will fall to covid lows. The NAV value of assets we had calculated in first para to be around Rs1014/sh. **So applying the 37.5% haircut, we come to a value of Rs634/sh!**

Another sanity check comes in when we look at the Net Fixed Asset Block value . GE Shipping management is well known for conservative purchase of assets. So assuming that GE Shipping has done a great job, the **net fixed**

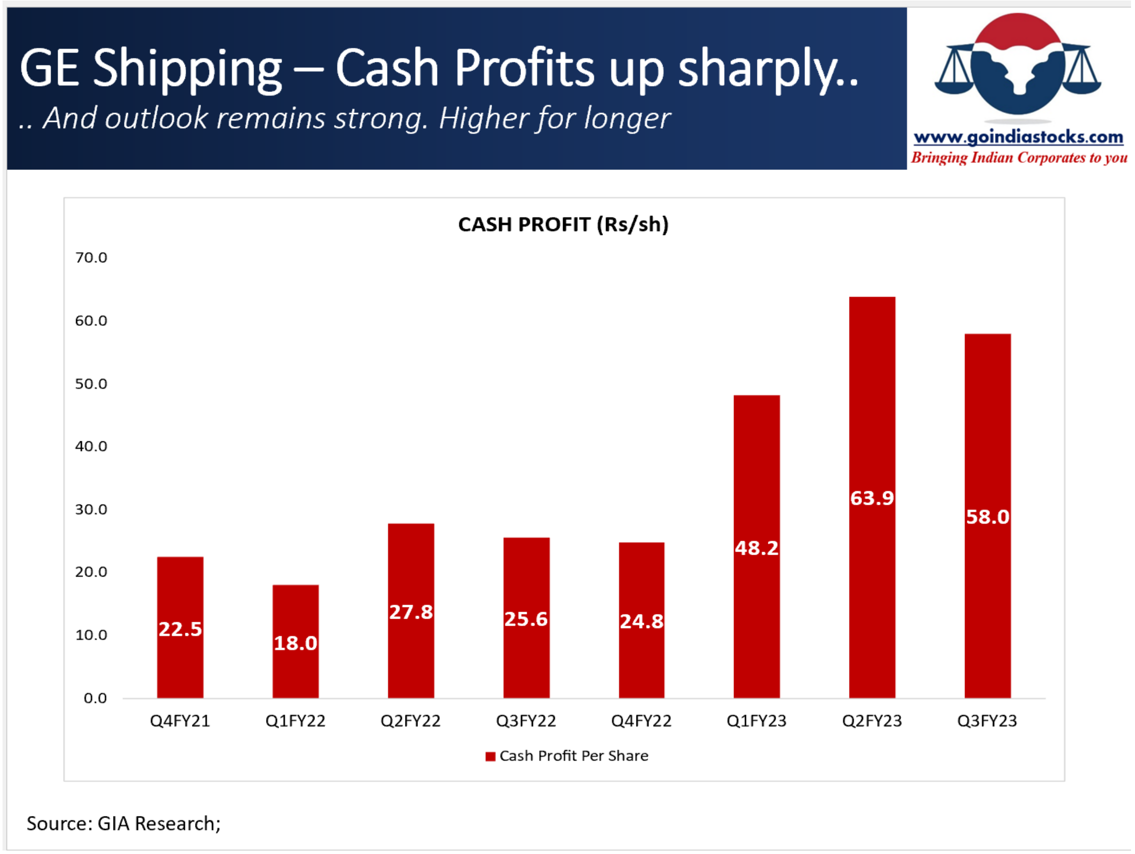
**asset block value stands at Rs621/sh!**

**So probably the risk of value of ships going down is real, but even in worst case scenario, the value of ships is likely to be atleast 10% higher than current stock price.**




## Risk 2: Cash earnings

The second part of the equation is what is the cashflow from these assets. On TTM basis cash profits has been around Rs190-200/sh. Even in weaker quarters, the cash profit is around Rs80-90/sh annually. For the current quarter, 50% of shipping capacity is already committed. So high probability that we see strong cash profit in Q4 too.




In any case let's see what outlook management has to say regarding it's various segments.

1. **Crude/Product tankers:** GE Shipping has benefitted from the bull run in this segment. All of their ships where on spot rate. Outlook remains fairly supportive as supply crunch will continue into near future.
2. **Dry Bulk:** This segment has been hitting new lows and earnings have been muted. Reopening of China and revival in metal demand likely to help this segment recover. Freight rates have kind of hit rock bottom now.

3. **LPG Carrier:** Spot prices are on a high around US$100000/day rates but GE Shipping had their ships on long term charter so were making closer to US$30000/day. These come up for repricing in Mar'24. So some upticks possible.
4. **Jack Up Rigs:** Market is turning tight with capacity utilisation running at 90%. One jack up rig has been repriced by GE Shipping at 75% higher. Remaining 2 Jack up rigs will come up for renewal in FY25 and one in FY26. Here contracts are 3-5years long so expect sustained bullishness.

Cash profits outlook remains extremely benign and a stronger for longer theme is in play.

| GE Shipping Commentary Q3FY23 Earning Call | | |
|---|---|---|
| **Segment** | **Comments by Management** | **Segment Outlook** |
| **SHIPPING SEGMENT** | | |
| **Crude/Product Tankers** (4 Suezmax, 3 Aframax, 2LR2, 4LR1, 12MR) | "We've had exceptionally strong product tanker markets since early in the year. So, that outperformed for a significant period. The Suezmaxs took some time to catch up, but they had a very good Q4 of calendar 2022". | Fundamentals remain strong inspite of seasonal spot rate decline plus Tanker market is tight on the supply side |
| **Dry Bulk (2 Capesize, 7 Kamsarmax, 5 Supramax)** | "Looking at dry bulk, the dry bulk was a different story; we had a very strong period in FY'22 especially for the smaller vessels, which is the Supramax/Kamsarmax, this year has been quite poor, the capesizes have suffered a lot versus the previous year." | Positive Steel Demand Growth and with Chinese Economy Opening Up Dry Bulk segment will start improving |
| **LPG Carrier** (1 MGC, 3 VLGC) | "LPG earnings have been strong again. We don't get much affected by the spot market, because we are on time charter...Of course, if the spot market is strong when our ships come up for repricing, that comes into the pricing that we receive. " | Significant Trade growth should take up more LPG ship even if they are not on spot market; Contract will be repriced in March'24. Spot rates are 2-3x of our contract rates |
| **OFFSHORE SEGMENT** | | |
| **Jack Up Rigs** (4 units) | "there's a lot of demand for jack up rigs there. So, Saudi Arabia and UAE have taken in a lot of rigs. They have publicized their targets for increasing production capacity, and they are taking in rigs in order to try to meet those targets. " | One rig has been repriced at around 75% higher than previous contract. 2 rigs will come up for renewal in FY25. Support vessels are getting repriced at 30-60% higher |

**In conclusion, GE Shipping valuations are scrapping the bottom. Not only the current valuations not even covering the worst case asset valuation, it is kind of assuming that there is no profits to be made at all from these assets. A fry cry from historic profits company is making currently. GE Shipping has delivered NAV growth of 18% cagr in last 5years and outlook looks extremely strong. Worth sailing in this ship!**

You may also want to have a look at our other notes on GE Shipping which give a good perspective on their business segments.

High Tide, Good Vibes
Don't miss the peak!
Which business will you buy?

Please feel free to reach out to us, if you will like to learn more about this fantastic business.

**Happy Investing!**

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