

Mercator Lines (MERLIN)

Rs 46

WHAT'S CHANGED...

PRICE TARGET	Changed from Rs 74 to Rs 61
EPS (FY11E)	Changed from Rs 3.6 to Rs 1.3
EPS (FY12E)	Changed from Rs 7.2 to Rs.5.0
RATING.....	Unchanged

Steep correction gives appropriate entry point...

Mercator Lines (MLL) ended FY10 on a subdued note with an **18.2% decline in revenue and 85.8% decline in PAT**. Weakness in freight rates led to a deterioration in the operating performance. Freight rates for both dry bulk as well as tankers have come off their lows and are expected to gradually recover. This will result in an improved performance in FY12. After the steep correction in stock price, MLL is trading at less than half its FY10 book value of Rs 97, which not only provides an appropriate entry point but also sufficient margin of safety for long-term investors.

■ Muted results

MLL reported a 2.0% rise in topline in Q4FY10 at Rs 482.0 crore as against Rs 472.8 crore in Q3FY10. On a YoY basis, revenues declined by 10.3% mainly due to weakness in freight rates. Rise in coal trading (low margin volume play) led to a decline in the overall operating margin for the company from 29.9% in Q3FY10 to 29.0% in Q4FY10. MLL reported a consolidated PAT of Rs 9.6 crore in Q4FY10 compared to Rs 1 crore in Q3FY10.

Valuation

Going ahead, we expect tanker rates to improve while dry bulk freight rates are expected to be range bound. This would lead to an improvement in performance in FY12. In addition, MLL is trading at a significant discount to its global peers as well as its historical valuation levels. This provides an appropriate entry point for long-term investors. We have valued MLL on a P/BV and P/E multiple basis to arrive at a price target of Rs 61 with **STRONG BUY** recommendation.

Exhibit 1: Performance Highlights

	Q4FY10	Q4FY10E	Q4FY09	Q3FY10	YoY Gr. (%)	QoQ Gr.(%)
Net Sales	482.0	504.3	537.4	472.8	-10.3	2.0
EBITDA	139.7	151.4	282.6	141.2	-50.6	-1.0
EBITDA Margin (%)	29.0	30.0	52.6	29.9	-44.9	-2.9
Depreciation	75.2	85.7	75.7	84.9	-0.6	-11.4
Interest	52.4	53.7	63.9	48.7	-18.0	7.5
Reported PAT	9.6	18.3	110.6	1.0	-91.4	856.0
EPS (Rs)	0.4	0.8	4.7	0.0	-91.4	856.0

Source: Company, ICICIdirect.com Research

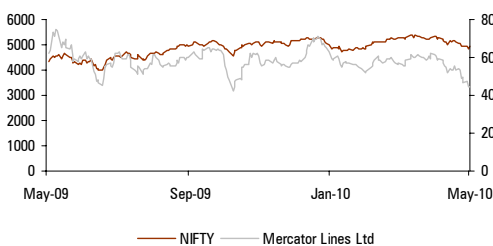
Rating matrix	
Rating	: Strong Buy
Target	: Rs 61
Target Period	: 12 months
Potential Upside	: 33%

Key financials				
(Rs Crore)	FY09	FY10	FY11E	FY12E
Net Sales	2210.5	1808.7	1826.2	2103.8
EBITDA	949.3	644.9	601.7	701.8
Net Profit	376.5	53.3	31.1	120.6

Valuation summary				
	FY09	FY10	FY11E	FY12E
PE (x)	2.9	20.8	35.6	9.2
Target PE (x)	3.8	27.6	47.2	12.2
EV to EBITDA(x)	3.2	4.9	4.7	3.3
Price to book (x)	0.5	0.5	0.5	0.4
RoNW (%)	16.5	2.3	1.3	4.9
RoCE (%)	12.6	5.2	4.6	6.4

Stock data	
Market Cap.	Rs. 1085 crore
Debt(FY10E)	Rs. 3116 crore
Cash (FY10E)	Rs. 1055 crore
EV	Rs. 3146 crore
52 week H/L	Rs. 77 / 42
Equity capital	Rs. 24.10 crore
Face value	Rs. 1
MF Holding (%)	8.6
FII Holding (%)	18.4

Price movement (Stock vs. Nifty)



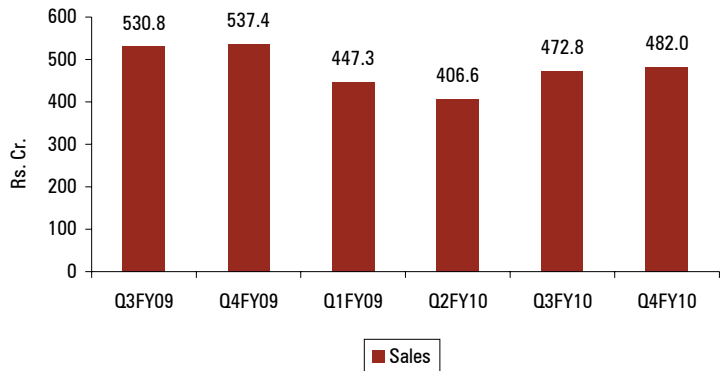
Analyst's name

Bharat Chhoda
 bharat.chhoda@icicisecurities.com

Jehangir Master
 jehangir.master@icicisecurities.com

Revenues rose by 1.9% on a QoQ basis to Rs 482.0 crore in Q4FY10

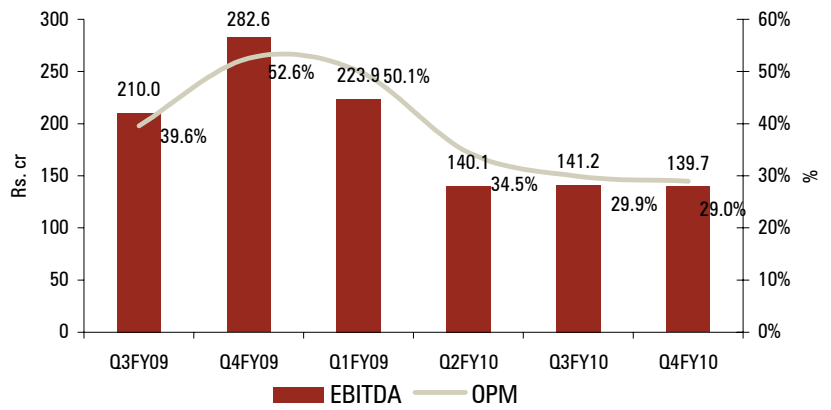
Exhibit 2: Revenue reports marginal rise



Source: Company, ICICIdirect.com Research

MLL reported a marginal decline in the operating margin in Q4FY10 at ~ 29.0% with EBITDA at Rs 139.7 crore. The decline in margin can be mainly attributed to the rising share of coal mining and trading business to the overall revenues of the company. Being a low margin business, the operating margin has taken a hit and the trend is likely to continue, going forward

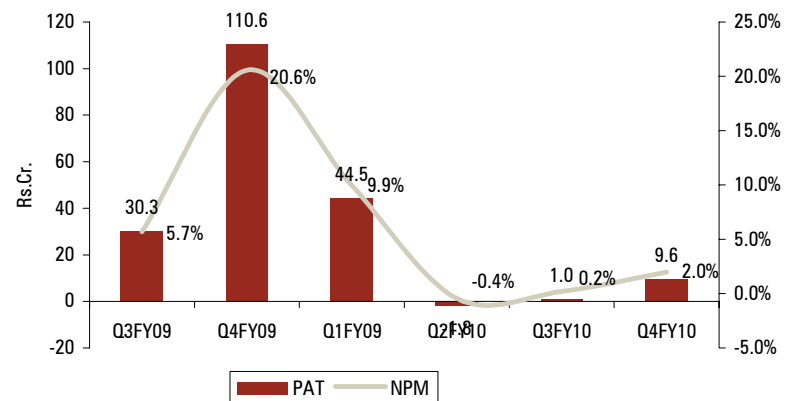
Exhibit 3: Operating margin stabilises



Source: Company, ICICIdirect.com Research

MLL reported a consolidated PAT of ~ Rs 9.6 crore in Q4FY10 compared to Rs 1 crore in Q3FY10

Exhibit 4: PAT posts modest recovery



Source: Company, ICICIdirect.com Research

MLL reported an 18.2% drop in revenue to Rs 1808.7 crore in FY10. This was despite a sharp rise in revenue from coal trading and mining, which increased from Rs 76.9 crore in FY09 to Rs 377.4 crore in FY10

However, revenue from its core shipping operations declined from Rs 2133.6 crore in FY09 to Rs 1431.3 crore in FY10 on account of weakness in dry bulk as well as tanker freight rates

We expect a marginal rise in revenue in FY11 with a gradual recovery in freight rates with a sizeable recovery only in FY12

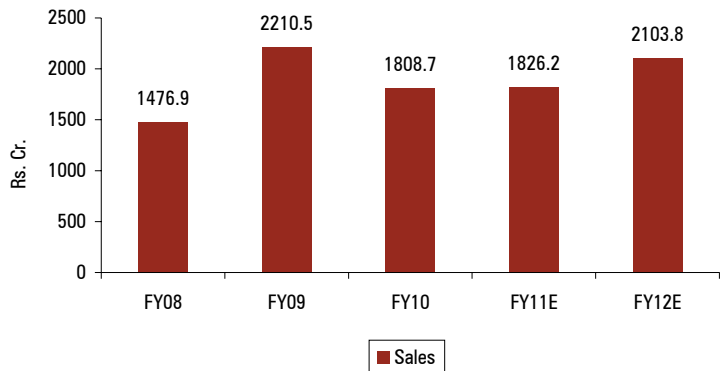
MLL also reported a sharp dip in EBITDA and also contraction in operating margin from 42.9% to 35.7% in FY10. The two major reasons for contraction in operating margin were weakness in freight rates and the rising share of coal trading activities, which is a low margin business in the overall revenue mix for the company

Going forward, we expect the operating margin to be in the range of ~34% for the next two years

MLL reported a consolidated PAT of ~ Rs 9.6 crore in Q4FY10 compared to Rs 1 crore in Q3FY10

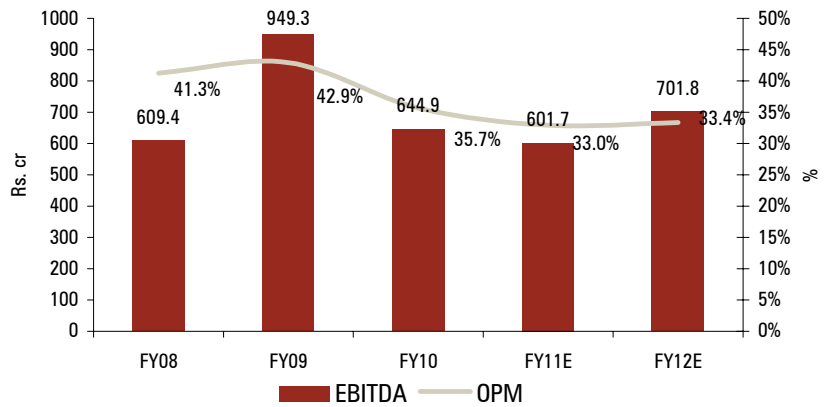
We also expect the company to post a significant recovery in PAT in FY12

Exhibit 5: Recovery on the cards



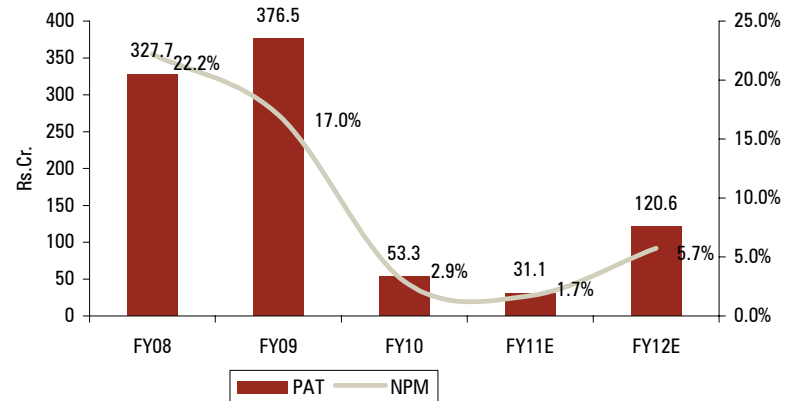
Source: Company, ICICIdirect.com Research

Exhibit 6: Operating margin to stabilise at FY10 levels



Source: Company, ICICIdirect.com Research

Exhibit 7: Significant improvement in PAT to be visible in FY12

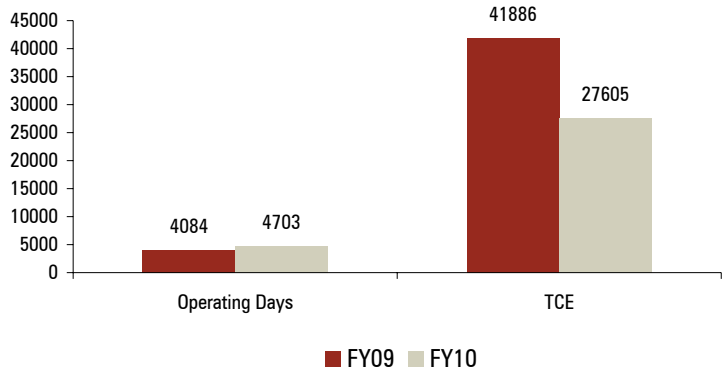


Source: Company, ICICIdirect.com Research

Operating days in the dry bulk segment reported a substantial rise in FY10 to 4,703 days from 4,084 days in FY09 on account of a rise in inchartering

However, TCE for the dry bulk segment declined from \$41,886 in FY09 to \$27,605 in FY10

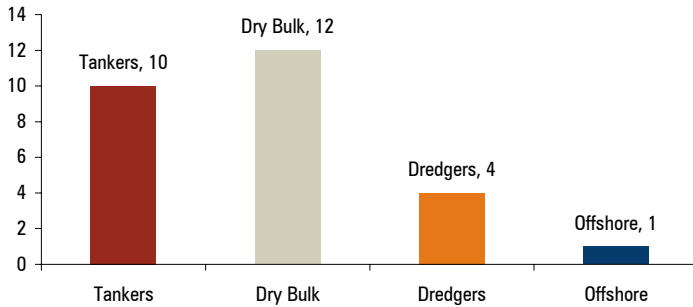
Exhibit 8: Operational matrix for dry bulk segment



Source: Company, ICICIdirect.com Research

MLL's fleet excluding inchartered vessels consists of 10 tankers, 12 dry bulk carriers, four dredgers and one jack-up rig

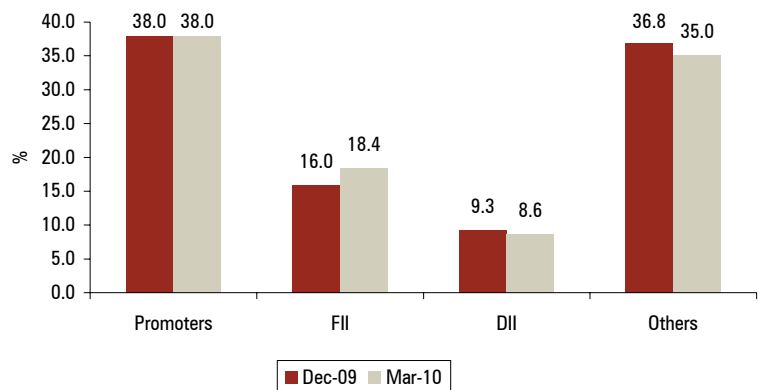
Exhibit 9: Fleet profile (excluding inchartered vessels)



Source: Company, ICICIdirect.com Research

FII holding in MLL has increased from 16.0% in December 2009 to 18.4% in March 2010 with Kotak Mahindra MF adding 1,32,300 shares and Franklin Templeton adding 4,50,200 shares to their respective portfolio in January 2010

Exhibit 10: Significant FII interest in stock



Source: Company, ICICIdirect.com Research

Despite the turbulence in the shipping industry on account of volatile and uncertain freight rates we expect the company to sail through smoothly on account of its diversified fleet profile, long term contracts and strong management capabilities

Further, the steep correction in the stock price provides an appropriate entry point for long-term investors

We recommend **STRONG BUY** on the stock with a price target of Rs 61

Detailed valuation

MLL's operating performance reported a sharp drop in FY10 mainly on account of the depressed global freight rate environment. Going ahead, we expect tanker rates to improve while dry bulk freight rates are expected to be range bound, which would lead to an improvement in performance in FY12. In addition, MLL is trading at a significant discount to its global peers as well as its historical valuation levels, which provides an appropriate entry point for long-term investors. We have valued MLL on P/BV and P/E multiple basis to arrive at a price target of Rs 61 and continue to maintain our **STRONG BUY** rating on the stock.

Exhibit 11: Valuation parameters

Valuation based on	Global average	Target multiple	Target price(Rs)
PE multiple (x)	11.12	6.00	30
EV/EBITDA	7.31	-	-
Price to book value (x)	1.20	0.90	92
Average target price (Rs.)			61
Current market price (Rs)			46
Upside (%)			33

Source: ICICIdirect.com Research

Exhibit 12: Valuations

	Sales (Rs. cr)	Sales Growth (%)	EPS (Rs.)	EPS Growth (%)	PE (x)	EV/EBITDA (X)	RoNW (%)	RoCE (%)
FY10	1808.7	-18.2	2.2	-86.3	20.8	4.9	2.3	5.2
FY11E	1826.2	1.0	1.3	-41.5	35.6	4.7	1.3	4.6
FY12E	2103.8	15.2	5.0	287.5	9.2	3.3	4.9	6.4

Source: Company, ICICIdirect.com Research

Exhibit 13: Revised estimates

	Old		New	
	FY11E	FY12E	FY11E	FY12E
Sales	1978.8	2152.6	1826.2	2103.8
EBITDA	674.0	748.2	601.7	701.8
Net Profit	87.1	174.2	31.1	120.6
EPS	3.6	7.2	1.3	5.0

Source: ICICIdirect.com Research

ICICIdirect.com coverage universe

Domestic Peers

ESPLL			Sales (Rs. Crore)	EPS (Rs.)	PE (x)	EV/EBITDA (x)	RoNW (%)	RoCE (%)
Idirect Code	ESSHI CMP (Rs.)	82 FY10E	2731.9	0.0	-3304.7	0.0	-1.9	0.5
	Target (Rs.)	92 FY11E	3184.5	0.0	-	0.0	-	0.9
MCap	5049.6 % Upside	12 FY12E	4478.6	0.0	-	1847.4	-	3.2
G.E Shipping			Sales (Rs. Crore)	EPS (Rs.)	PE (x)	EV/EBITDA (x)	RoNW (%)	RoCE (%)
Idirect Code	GESHIP CMP (Rs.)	297 FY10E	2856.5	33.7	8.8	8.5	8.8	4.7
	Target (Rs.)	387 FY11E	3232.9	37.9	7.8	6.6	10.1	6.2
MCap	4514.4 % Upside	30 FY12E	3800.8	54.9	5.4	4.7	12.9	8.4
Mercator Lines			Sales (Rs. Crore)	EPS (Rs.)	PE (x)	EV/EBITDA (x)	RoNW (%)	RoCE (%)
Idirect Code	MERLIN CMP (Rs.)	46 FY10E	1808.7	2.2	20.8	4.9	2.3	5.2
	Target (Rs.)	61 FY11E	1826.2	1.3	35.6	4.7	1.3	4.6
MCap	1085.6 % Upside	33 FY12E	2103.8	5.0	9.2	3.3	4.9	6.4
SCI			Sales (Rs. Crore)	EPS (Rs.)	PE (x)	EV/EBITDA (x)	RoNW (%)	RoCE (%)
Idirect Code	SCI CMP (Rs.)	163 FY10E	3485.6	7.9	20.6	15.7	5.3	5.9
	Target (Rs.)	159 FY11E	3590.9	8.5	19.1	14.5	5.6	6.0
MCap	6903.1 % Upside	-2 FY12E	3738.8	7.3	22.4	11.2	4.7	5.4
Varun Shipping			Sales (Rs. Crore)	EPS (Rs.)	PE (x)	EV/EBITDA (x)	RoNW (%)	RoCE (%)
Idirect Code	VARSHI CMP (Rs.)	44 FY10E	666.2	-90.2	53.7	13.0	1.5	0.1
	Target (Rs.)	36 FY11E	638.6	-	-	10.8	-	1.2
MCap	660.0 % Upside	-18 FY12E	686.8	-1.1	-40.5	8.5	-	3.2
Aban Offshore			Sales (Rs. Crore)	EPS (Rs.)	PE (x)	EV/EBITDA (x)	RoNW (%)	RoCE (%)
Idirect Code	ABALLO CMP (Rs.)	716 FY10E	3358.7	71.5	10.0	8.0	14.3	10.0
	Target (Rs.)	884 FY11E	3617.3	127.1	5.6	6.7	20.6	11.4
MCap	2706.5 % Upside	23 FY12E	3610.1	165.9	4.3	6.4	21.5	11.0
Garware Offshore			Sales (Rs. Crore)	EPS (Rs.)	PE (x)	EV/EBITDA (x)	RoNW (%)	RoCE (%)
Idirect Code	GARSHI CMP (Rs.)	141 FY10E	163.2	17.8	7.9	9.1	15.4	7.9
	Target (Rs.)	182 FY11E	232.3	17.4	8.1	7.8	16.2	9.3
MCap	335.6 % Upside	29 FY12E	234.7	21.1	6.7	7.4	14.4	9.2
Great Offshore			Sales (Rs. Crore)	EPS (Rs.)	PE (x)	EV/EBITDA (x)	RoNW (%)	RoCE (%)
Idirect Code	GREOFF CMP (Rs.)	451 FY10E	1172.7	50.8	8.9	7.0	20.9	11.7
	Target (Rs.)	468 FY11E	1155.3	34.2	13.2	6.4	12.8	10.0
MCap	1673.2 % Upside	4 FY12E	1420.8	68.0	6.6	4.4	20.8	14.2
Bharati Shipyard			Sales (Rs. Crore)	EPS (Rs.)	PE (x)	EV/EBITDA (x)	RoNW (%)	RoCE (%)
Idirect Code	BHASHI CMP (Rs.)	244 FY10E	1349.0	47.4	5.2	8.3	16.0	10.3
	Target (Rs.)	327 FY11E	1334.1	55.6	4.4	7.6	10.1	10.1
MCap	673.4 % Upside	34 FY12E	1287.2	74.5	3.3	7.4	8.4	9.7

Source: Company, ICICIdirect.com Research

Global Peers

Company	Country	P/BV (x)			P/E (x)			EV/EBITDA (x)			ROE (%)		
		CY09	CY10E	CY11E	CY09	CY10E	CY11E	CY09	CY10E	CY11E	CY09	CY10E	CY11E
Dry Bulk/Tankers													
Teekay Corp.*	USA	0.8	0.8	0.8	-	40.1	18.0	11.6	9.1	8.5	-	3.1	5.3
Diana Shipping*	USA	1.1	1.0	0.9	9.1	8.9	9.2	6.7	6.3	6.4	13.5	10.9	9.4
Genco Shipping*	USA	0.8	0.6	0.6	4.7	5.3	10.3	6.2	6.2	7.9	18.0	12.5	5.3
Dry Ships*	USA	0.6	0.6	0.6	5.5	6.6	4.5	7.5	6.5	4.8	7.2	7.6	11.4
Frontline Ltd*	Norway	3.6	3.2	3.1	23.8	12.7	13.5	11.0	8.9	9.0	14.9	24.5	21.3
ESPLL#	India	0.6	0.6	0.6	139.2	87.4	21.4	12.4	11.8	9.0	4.0	3.8	3.9
G.E Shipping#	India	8.4	6.7	4.7	9.0	7.2	5.0	8.5	6.6	4.7	8.8	10.1	12.9
Mercator Lines#	India	0.5	0.5	0.4	20.8	35.6	9.2	4.9	4.7	3.3	2.3	1.3	4.9
SCI#	India	1.0	1.0	0.9	18.5	17.1	20.0	15.7	14.5	11.2	5.3	5.6	4.7

*consensus

With regards to Indian companies, three year data represents FY10, FY11 and FY12 (financial year ending in March)

Source: Company, ICICIdirect.com Research

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Strong Buy: 20% or more;
 Buy: Between 10% and 20%;
 Add: Up to 10%;
 Reduce: Up to -10%
 Sell: -10% or more;

Pankaj Pandey

Head – Research

pankaj.pandey@icicisecurities.com

**ICICIdirect.com Research Desk,
 ICICI Securities Limited,
 7th Floor, Akruti Centre Point,
 MIDC Main Road, Marol Naka
 Andheri (East)
 Mumbai – 400 093**

research@icicidirect.com

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