

## Management meet update

# Mercator Lines (MERLIN)

<b>Current price</b> Rs 58	<b>Target price</b> Rs 85
<b>Potential upside</b> 47%	<b>Time Frame</b> 12-15 months

**OUTPERFORMER**

## Sailing high ...

We recently met the management of Mercator Lines, the second largest private sector shipping company in India. Following are the key takeaways:

### ▪ Focused fleet expansion

Mercator Lines Ltd (MLL) has embarked on a focused expansion of its fleets in the booming dry bulk segment through its Singapore subsidiary. MLL has chartered out an expansion plan of Rs 1,000 crore for acquiring dry bulk carriers through its Singapore subsidiary. We expect MLL to benefit from the rising dry bulk charter rates and expect the rates to remain firm mainly on account of sustained momentum in commodity movement from developing economies of China and India.

### ▪ Foray into off-shore business

To benefit from the upturn in the off-shore segment, MLL has placed an order for construction of a new offshore rig at a cost of Rs 810 crore, which is expected to be delivered in Q1FY09. With ever increasing demand for energy across the globe, offshore activity for oil and gas exploration is likely to remain at a high. The charter rates for oilrigs are likely to remain firm and a rig can be deployed at rates ranging from US\$200,000 to US\$230,000 per day.

### Listing of Singapore subsidiary to add value

The management has consciously set up its subsidiary Mercator Lines Singapore Pte Limited (MLS) to take advantage of the favorable growth environment for shipping companies in Singapore. Shipping companies in Singapore enjoy favorable business environment compared to Indian shipping companies, which are hit by a multi-fold taxation regime. We believe that MLS is at the core of MLL's future growth plans. MLL has already raised \$5.1 crore in the Singapore subsidiary through an issue of convertible bonds. Mercator is in the process of diluting 30%-40% stake in MLS to raise funds for its expansion plans. We expect the listing process to be completed in Q2FY08.

### Exhibit 1: Key Financials (Consolidated)

Year to March 31	FY06	FY07	FY08E	FY09E
<b>Net sales (Rs crore)</b>	826.25	1122.76	1346.00	1650.00
<b>Net Profit (Rs crore)</b>	198.03	134.93	235.55	330.00
<b>Shares in issue (rore)</b>	1.89	1.89	2.32	2.32
<b>EPS (Rs)</b>	10.15	6.91	10.1	14.2
<b>% Growth</b>	4.1%	31.9%	46.7%	40.1%
<b>P/E (x)</b>	5.7	8.4	5.7	4.1

Source: ICICIdirect Research

### Bharat Chhoda

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<b>Promoters holding</b>	43.08%
<b>Market Cap</b>	Rs972 crore
<b>52 Week H/L</b>	58 / 30
<b>Sensex</b>	15,015
<b>Average volume</b>	624,623

### Comparative return metrics

Stock return	3 M	6M	12M
G E Shipping	29%	60%	32%
Shipping Corp of India	-13%	-3%	41%
Mercator Lines	22%	22%	53%

**We are positive on the ability of MLL management to deliver aggressive growth as it has charted out a business model that enables it to grow in size along with derisking revenue flow by having a balanced spread across various segments.**

- **The management has consciously planned a presence in both the crude carriers as well as the dry bulk segment. This will bring stability to its revenues and derisk the business by reducing the impact of movement in crude prices on its business.**
- **The management is business savvy and resorts to a prudent mix of hiring its vessels on spot and time charter. The company is looking at deploying 60-70% of its vessels on long-term contracts and the balance in the spot markets. The presence in both time and spot charter enables the company to have better stability and predictability of the revenues as well as to be in a position to take advantage of opportunities that may arise in the shorter duration in the spot market.**

We expect the company to improve its operating margins going ahead from 26% in FY07 to 33-35% in FY08E and FY09E. On fully diluted equity of Rs 23.23 crore, we expect MLL to report a consolidated EPS of Rs 10.1 for FY08E and Rs 14.2 for FY09E.

We had covered the company in our pick of the week, the target for which has been achieved and we will be coming up with a detailed report on the company soon.

MLL trades at 4.1x its FY09E consolidated earnings and is available at a significant discount to peers like Shipping Corporation of India and Great Eastern Shipping. MLL having received delivery of new assets is in a position to transition itself from asset acquiring phase to the revenue generation phase in the next 2-3 years. With judicious mix of time and spot charter, Mercator would be able to derive benefits of the stability from the time charter segment and better charter rates from the spot segment. Better visibility and lower variability of revenues warrant a re-rating for Mercator. We expect it to trade at 6x its FY09E earnings with a target price of Rs 85.

#### **Exhibit 2 : Peer Group Valuation**

	FY08E		FY09E	
	EPS	P/E	EPS	PE
SCI*	26.8	7.3	24.1	8.1
G E Shipping*	44.5	7.6	39.0	8.7
Mercator	10.1	5.7	14.2	4.1

**Source: ICICIdirect Research**

**\* Reuters consensus estimates**

## **RATING RATIONALE**

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**Outperformer:** 20% or more;

**Performer:** Between 10% and 20%;

**Hold:** +10% return;

**Underperformer:** -10% or more.

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