# Mercator Lines Limited (MLL)

16th August, 2008

**BUY** **CMP: Rs 82**

| | |
|---|---|
| BSE Code | 526235 |
| NSE Code | MLL |

## Key Data

| | |
|---|---|
| Sensex | 14724.18 |
| 52 week H/L (Rs) | 184.95/49.50 |
| Jul month H/L (Rs) | 99.50/81.55 |
| Market Cap (Rs Cr) | 1862.76 |
| Avg. daily vol. (6m) | 1473910 |
| Face Value (Rs) | 1 |

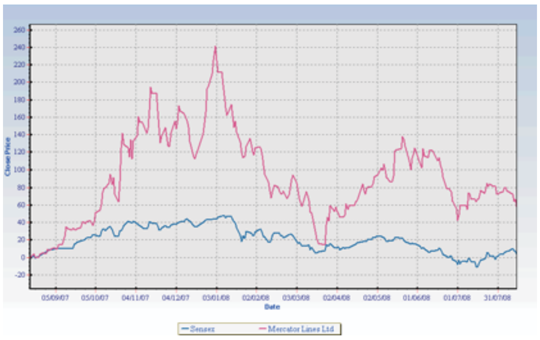
Source: Capitaline

## Shareholding Pattern (%)

| | |
|---|---|
| Promoters | 37.94 |
| Institution | 13.62 |
| Foreign holding | 19.59 |
| Non-promoter corp. holding | 7.4 |
| Public & Others | 21.45 |

Source: Capitaline

## One-Year Performance (Rel. to Sensex)




Source: Capitaline

**Analysis: Team Anagram**
**equity@anagram.co.in**

## Background and Business

Mercator Lines Limited (MLL) was incorporated in 1983 and is one of the largest private sector shipping company in India. Since inception MLL has aggressively grown and now it is well poised to capture the upside from the firm freight rates in tanker, dry bulk and offshore segment.

MLL has timely and rightly taken steps to enhance its fleet size and is on a huge expansion mode. During FY07 MLL increased its tonnage from nearly 1.98 million DWT to 2.45 million DWT, showing an increase of 23%.

At present MLL's fleet size stands at 27 vessels *(2 VLCC, 1 Suezmax, 6 Aframax, 2 MR Tanker, 1 Chemical tanker, 12 Bulk Carriers and 3 Dredgers)* and has a robust capex plan of $450 million for FY09. The average fleet age of tankers would be around 14-15 years while the average age of dry bulk carriers will be 2 years.

During the year, the company has floated Mercator Lines (Singapore) as its wholly owned subsidiary in Singapore. Of the total 27 vessels, 7 are chartered by subsidiary and they own 7.

MLL has recently forayed into offshore business and is rightly reaping the benefits of the boom in the offshore segment. It has placed an order for construction of a new offshore jack up rig at a cost of Rs 810 crore with Keppel, which is on a 3 year long term charter contract.

Having an efficient management has well reflected in its operative style as well the financial structure. For the FY08, Total sales rose to Rs 1454 crore from Rs 1122 crore showing a year-on-year growth of 30%. Its operating profit too rose to Rs 587.3 crore from Rs 322.92 crore, showing a year-on-year growth of 99%. Similarly its net profit rose to Rs 327.6 crore from Rs 134.9 crore in Q4FY08, a growth of 143% year-on-year.

## Investment Triggers

**"FIRM'' freight rates in near term:**

**VLCC Rates have peaked to $1,00,000/ days from $85,000/day in the Q4FY08 from a low of nearly $25,000 in Q2FY08. Rates are expected to stabilize at approximately US$50-60,000/day.**

**Tanker Rates:**

Tanker freight rates are expected to firm up on back of increasing movement of crude and limited availability of tankers. Along with lower level of inventory as compared to CY07 and compliance to IMO guideline of phasing out all the single hull vessels by FY10 has added to increased vessel demand.

Rates would also be impacted positively on account of scrapping of old tankers with more than 20 years of age. Around 40% of the tankers, representing 14% of total tonnage are above the age of 20 years. Additional are likely to take place over the next three-four years. Therefore we expect demand for tankers to be high for the Fy09.

**Dry bulk rates will remain pressured on back of ample supply/ availability.**

**Dry Bulk Index:**

We have seen robust increase in dry bulk index over last 1-2 years but now we believe that due to ample vessel supply/over supply would lead downward pressure on freight rates.

**Offshore segment looks promising on back of high oil prices and increased focus on E&D.**

**Strong Offshore scenario:**

The outlook for the offshore services sector is positive at least for the next three years and the key driver for the sector is the secular increase in exploration and development expenditure globally, which we expect to continue due to a demand-supply imbalance, coupled with high oil prices.

**Dredging players are few in India and dredger are expected to have huge demand due to congestion and lack of maintenances of ports.**

**Dredging:**

India has a vast coastal line that is highly congested thus the requirement for activities like dredging becomes very important. Therefore more activities for both capital and maintenance is very crucial and of great demand for the next 10-12 years in India.

## Foray into new segments:

**Offshore segment**:

MLL has recently forayed into offshore business and its new offshore jack up rig has been delivered and has been chartered for a long-term contract for 3 years. MLL is also planning to acquire/order for a second rig as well.

We expect the current buoyancy in the offshore segment to continue on the back of ever-Increasing demand for energy across the globe, offshore exploration for oil and gas will remain an important activity for offshore and marine businesses. We believe that company will benefit from a growing demand for oil rigs.

The charter rates in this segment are expected to display sustained firmness. (A charter rate of high specification jack-up rigs has shot up 77% to USD 230, 000/ day in last 8-9 months from USD 130, 000 / day. The rate was at USD100, 000 /day a year before.)

**New initiatives**:

MLL has new Joint venture for Coal mines and also has aggressive plans to under taken activities like Ship building and Oil fields. These investments will remain strategic in nature.

## Diversified business model:

**Diversification of Revenues:** MLL has diversified fleet portfolio and is entering into new segments that will de-risk its business model and lessen effect of the cyclical shipping industry.

**Prudent company strategy for years:**

MLL deploys its tonnage between time and spot charter in order to counter market fluctuation as far as possible and at the same time take advantage of good spot rates, Time charter contract is long term contract ranging from 6 months to 5 years and reduces the risk of volatility in earnings. On an average MLL keeps 60 to 70%of vessels on long-term contract.

**Additional services on logistics:**

MLL is also provides end-to end logistic services to TATA Power and SAIL. This could be a future growth strategy to grow on.

## Benefiting from Singapore foray:

MLL opened a subsidiary in Singapore (MLS) to charter the vessels where the conditions are far more favorable for the growth of a shipping company in the tax matters. In terms of better tax structure as regards other taxes, which hurt Indian shipping companies like - service tax, fringe benefit tax, dividend distribution tax, minimum alternate tax on profit/loss on sale of ships, seafarer's tax and withholding tax on interest paid to foreign lenders.

## Key Highlights:

- Revenue increased by 72% in FY08 due to
  - 55% increase in vessel day rates to USD 37440/day
  - 23.0% increase in number of total operating days to 3507 days

- Maintaining approximately 70% of fleet on fixed rate contracts, with remaining 30% deployed on spot market. This strategy is aimed at bringing stability and visible cash flows.

- Market value of all dry bulk vessels is USD 767.0 million.

- Strong cash and cash balances of USD 186.3 million

- MLS is planning to add 3 more dry bulk vessels, one VLOC and 2 Panamax vessels by 2009.

**Fleet details:**

| Particulars | FY08 | FY07 |
|---|---|---|
| Owned Vessels | 7 | 2 |
| In Chartered Vessels | 5 | 11 |
| Operating days | 3,507.0 | 2,848.0 |
| Fleet Utilization | 99.7% | 97.6% |
| TCY/Day (US$) | 37,440.0 | 24,138.0 |

## Q4FY08 Highlights:

- MLL has bought 3 Dredgers, 2 dredgers have already been contracted with DCI at sethusamudram with day rates of USD 30000/day for the next 3 years, with an opex of USD 4000 to USD 5000/day. Payback period is less than 3 years. The 3rd is still being negotiated with DCI and offers from Middle East at the same rate are being received. They wish to add 2 more dredgers by Dec 2008. Two are under inspection at the moment.

- Dredger rates are more stable than tankers or Dry bulk rates and visibility is good for the next ten years.

- 3 senior people have been employed in the dredging business to understand it better and to take on project management in future.

- DCI has internal guidelines that they cannot buy second hand dredgers. They normally buy Dutch dredgers, which is 4x costlier as compared to the ones bought by MLL.

(The aim is to get into a lucrative, more visible business and then move up the value chain into project management. Listing of this entity after obtaining critical mass is a possibility.)

## Coal

- Maximum investment will be USD 10 million for equity stake. The mines will always be operated by local people as it local expertise and understanding.

- Looking at mines in Indonesia and Mozambique. The latter will take a longer time. The Indonesia mine has an economic interest of 50% and that of Mozambique has 85%.

- Initial contribution of USD 1 million is expected for the year.

- The aim is not to run the mine but provide a total solution for 'COAL' for their clients. They already provide end-to-end solution for Tata Power.

## Oil Rigs:

- New offshore jack up rig cost is USD165 million. Additional investment of USD25mn for additional fittings, which will be delivered in the first quarter of 2009, current market value is USD 250 million.
- Current day rate is USD 140000/day with an opex of~USD30000/day.

## Client concentration:

- Key customers are Tata Power (2 Vessels), Arcellor Mittal (2 Vessels) and some Chinese companies (2 Vessels) and 2 vessels are on spot.
- MLL has a long-term contract with Tata Power till Oct-09 with the TCY of USD 26000/day.

## Finance:

- Sold one single hull vessels with a profit of USD 9mn.
- USD 50mn FCCB already convert at the rate of Rs59/share, 10mnFCCB due for conversion.
- Day rates difference between single hull and double hull is 20%.

## Valuation

MLL has well turned out after a crutial year of asset expansion and we see better revenue visibility and profitability going forward. Management has agressively molded MLL as one of the largest player in the indian shipping space.  It has a capex plan of US$450 miilion for FY09. Its new diversified iniatives and step towards being a total logistic provider will be firmly rooted as time passes.

Going forward, we expect better performance by MLL on back of dry-docking assets joining the fleet.  There will be no more dry docking expenses in current year which stood at Rs 28 cr in Q1FY09.  In the current quarter MLL also incurred Forex loss of Rs13.9 cr as rupee moved from 40 to 42 by June end.

Company has already started coal mining operations and contracted one consignment of 50 tons. Currently realizations stood at US$53 per tonne against avge cost of US$25 a ton. Production is expected to scale up to beyond 2 million tons which will get exhausted in next 5 to 6 years.  MLL has also been allotted two onshore blocks under NELP VII

At the CMP of Rs 83/- the stock trades at 4.8x its FY09E earngings of Rs 17.5/-and 1.25x its FY09E bookvalue of Rs 66.3/- and also  trading lower than its NAV. We recommend to "Buy" this stock taking long-term perspective.

## Financial Snapshot

Annual Performance

Profit and loss account

| Particulars ( Rs. Crore) | FY06 | FY07 | FY08 | FY09E |
|---|---|---|---|---|
| Net Sales | 8,26.3 | 11,22.8 | 14,54.8 | 20,30.1 |
| % growth | | 36% | 30% | 40% |
| Total Expenditure | 4,78.1 | 8,27.1 | 8,67.4 | 10,57.5 |
| Operating Profit | 3,48.1 | 2,95.6 | 5,87.3 | 9,72.6 |
| % growth | | (0.2) | 1.0 | 66% |
| Other income | 17.0. | 27.2 | 1,34.1 | - |
| Operating Profit (incl. Other Income) | 3,65.1 | 3,22.9 | 7,21.4 | 9,72.6 |
| Interest | 70.7 | 80.7 | 1,44.6 | 1,75.7 |
| Gross Profit | 2,94.4 | 2,42.1 | 5,76.8 | 7,96.9 |
| Depreciation | 93.6 | 1,03.0 | 1,67.5 | 2,56.8 |
| Profit Before Tax & EO Items | 2,00.7 | 1,38.3 | 4,09.3 | 5,40.0 |
| Extra Ordinary Exps/ (Income) | - | - | 427.9 | - |
| Profit Before Tax | 2,00.7 | 1,38.3 | 4,09.3 | 5,40.0 |
| Tax | 2.71 | 3.41 | 9.0 | 13.5 |
| Minority Int | | | 29.8 | 53.5 |
| Net Profit (After Minority Int) | 1,98.3 | 1,34.9 | 3,27.6 | 4,73.0 |
| % growth | | -32% | 143% | 44% |
| EPS | 10.5 | 7.1 | 13.9 | 17.5 |



**RATING INTERPRETATION**
**Outperformer** Expected to appreciate more than 20% over a 12-month period
**Accumulate** Expected to appreciate up to 20% over a 12-month period
**Neutral** Expected to remain in a narrow range
**Underperformer** Expected to depreciate more than 10% over a 12-month period