

DREDGING CORPORATION

INR 565

On a slow track

BUY



Dredging Corporation of India's (DCI) Q3FY07 results were below our expectations with net sales increasing by only 6.7% Y-o-Y (INR 1.3 bn) and net profits declining by 31.9% (INR 229 mn). DCI has been grappling with nearly flattish volume growth for the last few quarters on account of no addition of new dredgers to its fleet. Higher fuel costs on the recently chartered dredger and additional environmental costs on start up of Sethusamudram Ship Canal Project saw EBITDA de growth of 23.5% Y-o-Y and EBITDA margin decline by 890 bps.

DCI has already received capital dredging contract (~ INR 1.5-2 bn) from the SCCP for dredging 82.5 mn cu.m. This order has the potential to double the volumes for DCI. The company has always been slow on addition of dredgers due to non-availability of quality dredgers and the lead time involved for procurement of these dredgers. To counter the issue, DCI has already taken on charter a trailer suction hopper dredger of 4700 cu.m hopper capacity in Q2FY07 end and has also chartered a new dredger of 9300 cu.m. capacity for the SCCP contract to be deployed in Q4FY07. Till date DCI has dredged only 8 mn. Cu.m and the remaining quantity is expected to be dredged over a two-three year period.

We are revising our FY07E and FY08E revenue estimates downwards by 7.5% and 6.1% respectively, factoring in the lower volume growth in the financial year. We expect DCI to register net sales of INR 5.2bn in FY07E and INR 5.7 bn in FY08E. Our EPS estimates for FY07E and FY08E are also revised downwards by 11.9% and 4.8% respectively. On the revised EPS of INR 52.9 and INR 60.1 for FY07E and FY08E, respectively, the stock is trading at 10.7x FY07E and 9.4x FY08E earnings. Based on the strong cash position (INR 168.6/share), dividend yield of 2.1% and attractive valuations, we maintain our 'BUY' recommendation.

Key highlights

- Net revenues grew by only 6.7% Y-o-Y to INR 1.3 bn due to no new addition of dredgers in the existing fleet.
- EBITDA declined by 23.5% Y-o-Y to INR 297 mn and EBITDA margin stood at 22.5% of sales as against 31.4% in Q3FY06 and 30.2% in Q2FY07.

Financials

Year to March	Q3FY07	Q3FY06	% change	Q2FY07	% change	FY06	FY07E
Sales (INR mn)	1,320	1,237	6.7	1,309	0.9	5,035	5,234
EBITDA (INR mn)	297	389	(23.5)	395	(24.8)	1,710	1,996
Net profit (INR mn)	229	336	(31.9)	360	(36.4)	1,715	1,482
EPS (INR)	12.9	16.1	(20.1)	11.9	8.2	61.3	52.9
P/E (x)						9.0	10.7
EV/ EBITDA						6.0	5.8
ROE (%)						19.0	14.2

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Market Data

52-week range (INR) : 690 / 460
Share in issue (mn) : 28.0
M cap (INR bn/USD mn) : 15.8 / 358.0
Avg. Daily Vol. BSE/NSE ('000) : 21.5

Share Holding Pattern (%)

Promoters : 78.6
MFs, FIs & Banks : 13.7
FIs : 3.8
Others : 4.0

- ◆ Other expenses increased by 28.1% Y-o-Y.
 - This is on account of DCI bearing the fuel cost for the charter dredgers.
 - Also, DCI is expected to take daily samples for testing of water and soil for the SCCP contract and has incurred additional cost of INR 6 mn on account of that. This cost is expected to be recovered at a later stage as SCCP contract is on a cost plus basis.
- ◆ Depreciation charges increased by 39.8% on a Y-o-Y basis. This is due to the fact that one of the dredgers (Acquarius) incurred additional cost on account of enhancement of cutter power. DCI has absorbed the additional cost in this quarter itself.
- ◆ PBT decreased by 33.5% Y-o-Y to INR 269 mn in Q3FY07 and net profit fell by 31.9% Y-o-Y to INR 229 mn. Net profit margin stood at 16.1% as against 24.9% in Q3FY06 and 25.4% in Q2FY07.

Financial snapshot

(INR mn)

Year to March	Q3FY07	Q3FY06	% change	Q2FY07	% change	FY06	FY07E	FY08E
Net sales	1,320	1,237	6.7	1,309	0.9	5,035	5,234	5,769
Total expenditure	1,023	849	20.6	913	12.0	3,325	3,238	3,508
EBITDA	297	389	(23.5)	395	(24.8)	1,710	1,996	2,262
Other income	104	114	(8.5)	108	(3.7)	353	473	524
Depreciation	127	91	39.8	90	40.9	372	448	528
EBIT	274	411	(33.4)	413	(33.7)	1,691	1,548	1,734
Interest (net)	5	7	(27.5)	6	(9.1)	29	28	28
PBT	269	404	(33.5)	408	(34.0)	1,662	1,993	2,230
Taxes	40	69	(41.3)	48	(15.9)	(53)	362	375
Adjusted PAT	229	336	(31.9)	360	(36.4)	1,715	1,482	1,684
Tax rate (%)						(17.0)	18.1	16.8
%								
Employee expense	11.6	13.7		12.1		11.6	3.7	4
Other expense	65.9	54.9		57.7		54.4	55.9	55
Operating profit	22.5	31.4		30.2		34.0	38.1	39
Net profit	16.1	24.9		25.4		31.8	28.3	29

Company Background

DCI is the dominant player in the Indian Dredging Maintenance market with a market share of 87%. Maintenance dredging contracts provides for more than 90% of DCI's revenue thus creating a near monopoly situation for DCI. It has in operation 10 Trailer Suction Hopper dredgers (TSHD) and 2 Cutter Suction dredgers (CSD). It has a dredging capacity of 80 Mn Cu.M and has historically operated at nearly 100% capacity utilization. Its customer base includes major and non-major ports, private ports, Indian Navy and shipyard.

Investment Theme

To cater to the expected traffic growth of at least 8% CAGR during the next ten years ending FY14, the National Maritime Development Programme (NMDP) has envisaged an investment of INR 600 bn till 2014 for the port sector. Typically, 10% of a port project is involved in dredging costs. Thus, this is likely to create an INR 60 bn capital dredging opportunity over the next 6-8 years. In addition to the large Indian opportunity, huge opportunities are opening up in the South East Asia and Middle East on account of huge cash from rising oil prices.

Key Risks

The major concern that exists for DCI is in terms of slow capacity addition. Entry of new players leading to fierce competitive scenario could also hurt the business prospects of DCI going forward.

Financial Statements

Income statement					(INR mn)
Year to March	FY05	FY06	FY07E	FY08E	FY09E
Income from operations	5,248	5,069	5,234	5,769	6,576
Employee costs	595	586	195	214	236
Other costs	2,600	2,881	2,925	3,167	3,610
Total operating expenses	3,195	3,145	3,238	3,508	3,981
EBITDA	2,008	1,924	1,996	2,262	2,595
Depreciation and amortisation	503	371	448	528	671
EBIT	1,506	1,553	1,548	1,734	1,923
Interest expenses	37	29	28	28	28
Other income	258	360	473	524	444
Profit before tax	1,726	1,884	1,993	2,230	2,339
Provision for tax	613	(46)	362	375	332
Extraordinary items		165	149	171	203
Reported profit	1,114	1,765	1,482	1,684	1,804
Adjusted net profit	1,114	1,765	1,482	1,684	1,804
Shares outstanding	28	28	28	28	28
Dividend per share	12.0	18.7	15.7	17.8	19.1
Dividend payout (%)	30.2	29.7	29.7	29.7	29.7

Common size metrics- as % of net revenues

Year to March	FY05	FY06	FY07E	FY08E	FY09E
Operating expenses	60.9	62.1	61.9	60.8	60.5
Depreciation	9.6	7.3	8.6	9.1	10.2
Interest expenditure	0.7	0.6	0.5	0.5	0.4
EBITDA margins	38.3	37.9	38.1	39.2	39.5
Net profit margins	21.2	34.8	28.3	29.2	27.4

Growth metrics (%)

Year to March	FY05	FY06	FY07E	FY08E	FY09E
Revenues	0.8	(3.4)	3.3	10.2	14.0
EBITDA	(18.0)	(4.2)	3.8	13.3	14.7
PBT	(25.1)	9.1	5.8	11.9	4.9
Net profit	(50.3)	58.5	(16.0)	13.6	7.2
EPS	(33.4)	55.7	(16.0)	13.6	7.2

Cash flow statement

Cash flow statement					(INR mn)
Year to March	FY05	FY06	FY07E	FY08E	FY09E
Net profit	1,133	1,765	1,482	1,684	1,804
Add: Depreciation	471	371	448	528	671
Add: Deferred tax	(109)	(229)	-	-	-
Gross cash flow	1,495	1,907	1,930	2,211	2,476
Less: Dividends	336	523	440	499	535
Less: Changes in W. C.	(330)	271	(504)	67	(168)
Operating cash flow	1,489	1,112	1,994	1,646	2,109
Less: Change in investments	10	45	-	-	-
Less: Capex	16	262	448	2,750	3,000
Free cash flow	1,463	806	1,546	(1,104)	(891)

Balance sheet					(INR mn)
As on 31st March	FY05	FY06	FY07E	FY08E	FY09E
Equity capital	280	280	280	280	280
Reserves & surplus	8,364	9,650	10,693	11,877	13,146
Shareholders funds	8,644	9,930	10,973	12,157	13,426
Unsecured loans	626	464	464	464	464
Borrowings	626	464	464	464	464
Sources of funds	9,271	10,394	11,437	12,621	13,890
Gross block	8,334	8,488	8,935	11,685	14,685
Depreciation	4,783	5,153	5,601	6,128	6,800
Net block	3,550	3,335	3,335	5,557	7,886
Capital work in progress	138	244	244	244	244
Total fixed assets	3,688	3,579	3,579	5,801	8,130
Investments	10	55	55	55	55
Inventories	135	105	105	105	105
Sundry debtors	1,426	1,962	1,422	1,567	1,786
Cash and equivalents	4,027	4,721	7,097	5,993	5,102
Loans and advances	600	882	926	972	1,021
Other current assets					
Total current assets	6,187	7,670	9,550	8,637	8,014
Sundry creditors and others	795	1,246	1,308	1,373	1,442
Provisions	428	494	440	499	867
Total CL & provisions	1,223	1,740	1,747	1,873	2,309
Net current assets	4,965	5,930	7,803	6,765	5,706
Net deferred tax	(229)	0	0	0	0
Uses of funds	8,434	9,564	11,437	12,621	13,890
Book value per share (BV)	309	355	392	434	480

Ratios

Year to March	FY05	FY06	FY07E	FY08E	FY09E
ROE (%)	13.7	19.0	14.2	14.6	14.1
ROCE (%)	19.2	18.6	16.6	16.8	15.9
Current ratio	5.1	4.4	5.5	4.6	3.5
Debtors (days)	99	99	99	99	99
Fixed assets t/o (x)	1.3	1.4	1.5	1.2	0.9
Debt/Equity	0.1	0.0	0.0	0.0	0.0

Valuations parameters

Year to March	FY05	FY06	FY07E	FY08E	FY09E
EPS (INR)	39.8	63.0	52.9	60.1	64.4
Y-o-Y growth (%)	(33.4)	55.7	(16.0)	13.6	7.2
CEPS (INR)	57.7	76.3	68.9	79.0	88.4
PE (x)	14.2	9.0	10.7	9.4	8.8
Price/BV(x)	1.8	1.6	1.4	1.3	1.2
EV/Sales (x)	2.4	2.3	2.2	2.0	1.8
EV/EBITDA (x)	6.2	6.0	5.8	5.1	4.5

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RATING INTERPRETATION

Buy	Expected to appreciate more than 20% over a 12-month period	Reduce	Expected to depreciate up to 10% over a 12-month period
Accumulate	Expected to appreciate up to 20% over a 12-month period	Sell	Expected to depreciate more than 10% over a 12-month period
Trading Buy	Expected to appreciate more than 10% over a 45-day period	Trading Sell	Expected to depreciate more than 10% over a 45-day period

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