MERCATOR LINES LTD

PINC RESEARCH

Initiating Coverage BUY

Sector Shipping & Logistics | CMP Rs 155 | Target Rs255

STOCK DATA

Market Capitalisation	Rs.30.4bn
Book Value per share	Rs.33
Equity Shares O/S (F.V. Rs1)	270mn
Median Volumes ('000)	1,092(BSE+NSE)
52 Week High / Low	Rs.184.95 / 31.25
BSE Scrip Code	526235
NSE Scrip Code	MLL
Bloomberg Code	MRLN IN

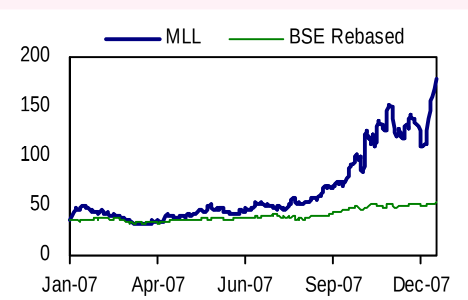
SHAREHOLDING PATTERN (%)

Qtr. Ended	Mar-07	Jun-07	Sep-07
Promoters	43.1	43.1	45.4
MFs/UTI/FIs	1.8	2.5	4.8
FIIs/NRIs/OCBs	16.0	20.3	21.1
PCBs	8.2	5.4	4.9
Indian Public	30.9	28.7	23.8
Eq. Shares (Mn nos)	189.2	189.2	197.2

STOCK PERFORMANCE (%)

	1M	3M	12M
Absolute	26.2	120.7	273.6
Relative	19.1	89.6	150.5

STOCK PRICE PERFORMANCE



MLL is the fastest growing and the second largest private shipping company in India. MLL has quickly built scale with its tonnage growing from less than 0.1mn DWT in FY00 to 2.4 mn Dwt in FY08. With aggressive expansion plans lined up, MLL should see further increase in capacity by FY10.

MLL'S management has demonstrated its ability to fully capitalize on the shipping cycles. MLL has been one of the aggressive players in the recent industry upcycles, though constrained by a relatively small balance sheet till date. With the recent rounds of fund raising (USD300mn) and robust internal accruals (USD100mn p.a.), MLL balance sheet is now large (~USD1.5bn) and strong (net leverage ~1.2x). Thus, MLL is ready for the next phase of expansion (USD1.1-1.5bn) to move up the league as a large regional player. Though aggressive in expansion, MLL's strategy has been to de-risk its business model. Hence, it maintains a judicious mix (50-70%) of long term time charters (3 to 5 years). In order to further de-risk its business model, MLL has chartered out a three pronged strategy to reduce its dependence on shipping. This includes diversification into related and high growth areas of Dredging, Offshore Services and Mining.

MLL's is working on vision to achieve profits of USD500mn by FY12 with 50% coming from non-shipping business. Hence, we initiate coverage on the company with a 'BUY' recommendation, with a price target of Rs255 on a 12 month investment perspective.

INVESTMENT RATIONALE

- MLL's ability to monetize the shipping cycles has resulted in attractive return ratios and in the process created significant wealth for investors, the value unlocking from the listing of Singapore subsidiary being the recent example. MLL is looking at replicating this model across most of its new business initiatives. With Mining & Offshore Services generating significant investor interest and quoting at high multiples, we expect MLL to create significant value from these businesses.
- We expect MLL to report strong earnings growth over FY07-10 based on high revenue visibility from long-term charter contracts in shipping and the ramp up of the dredging business without factoring any revenues from offshore services , mining and any expansion in tanker business. The short term profitability should get additional boost from recent spurt in spot rates in tankers. Thus, we expect MLL's profit to expand from USD31 mn in FY07 to USD186 mn in FY10.

KEY FINANCIALS (CONSOLIDATED) (Rs mn)

Yr Ended (March)	Net Sales	YoY Gr (%)	Op Profits	Op Marg (%)	Net Profits	Eq Capital
2007	11,228	35.9	2,957	26.3	1,349	189
2008E	13,440	19.7	7,280	54.2	4,205	270
2009E	18,800	39.9	11,320	60.2	7,051	270

KEY RATIOS (CONSOLIDATED)

Yr Ended (March)	EPS (Rs.)	ROCE (%)	RONW (%)	P/E (x)	EV/Sales (x)	EV/EBDIT (x)
2007	7.1	13.1	21.5	32.5	4.3	15.0
2008E	15.6	17.3	30.5	10.4	5.0	8.2
2009E	26.1	28.7	28.4	6.2	3.7	5.3

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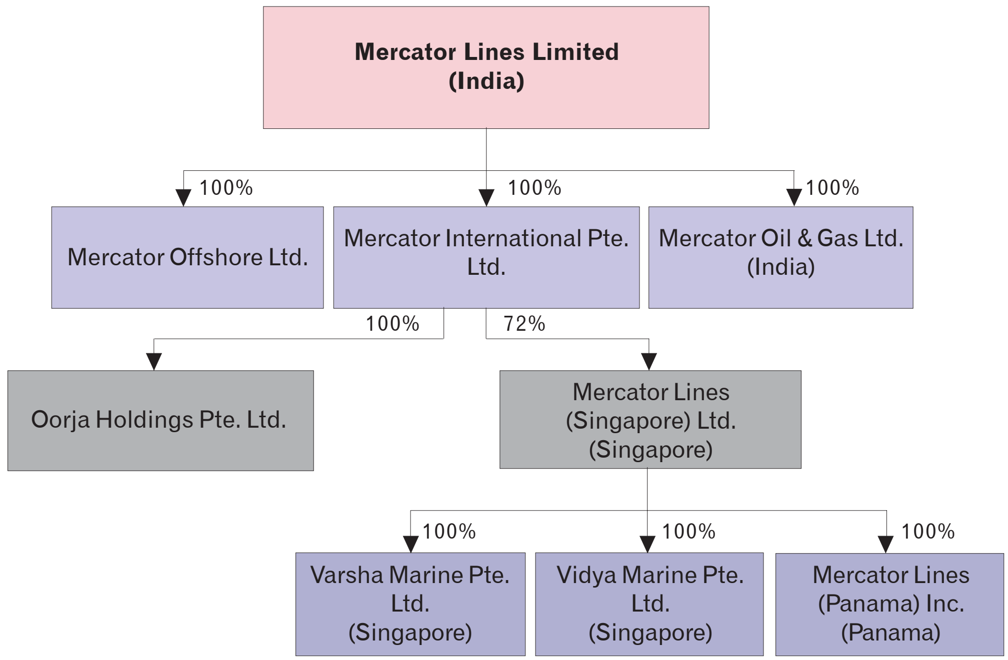
Background

Mercator Lines Ltd (MLL) commenced operations as a private limited company in Nov'83 with tugboat operations. It was taken over in 1988 by Mr. H. K. Mittal, the current promoter of the company. The company ventured into the shipping line with 2 oil tankers. Over the years, MLL has aggressively augmented its fleet by acquiring new vessels and replacing/ scrapping older ships. MLL set up a subsidiary in Singapore, Mercator Lines (Singapore) Ltd at an outlay of USD30mn in CY05 to cater to the dry bulk segment. MLL recently listed this subsidiary on Singapore stock exchange, diluting 28% stake for ~USD215mn.

MLL: Company Structure

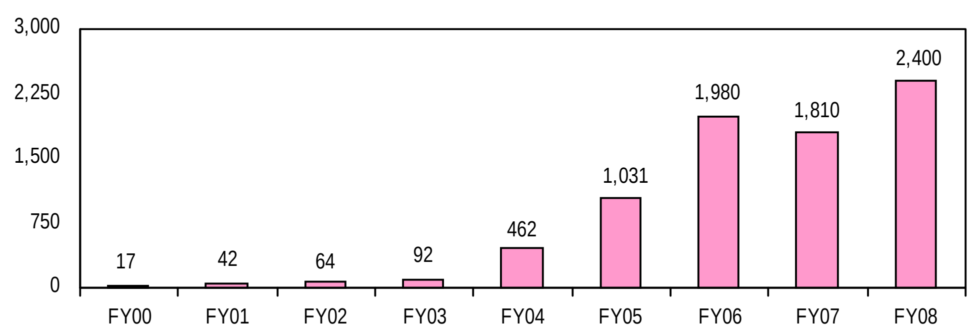
Different business verticals housed in different subsidiaries...



At present, MLL is India's second largest shipping company in terms of fleet tonnage having a consolidated fleet of 27 vessels and aggregate tonnage of 2.4mn DWT. It has a significant presence in both wet and dry bulk segments of shipping & has recently entered the dredging sector in India with 3 dredging vessels.

Trend in Total Tonnage ('000 DWT)

Company has aggressively ramped up capacity after spotting opportunities in the cycle...



Source: Company

MLL's strength has been spotting business cycles in various segments of the shipping industry. Its forte has been to ramp up its capacity aggressively and then deploying vessels with a judicious mix between the long term charter and spot markets. Historically, the company has maintained this balance at 60-70%, in favour of long term charters, with the remainder of the fleet being deployed in the spot markets. In dredging business, its recent foray, MLL has 3 dredgers at present, all of which has let out on long term charter.

Industry

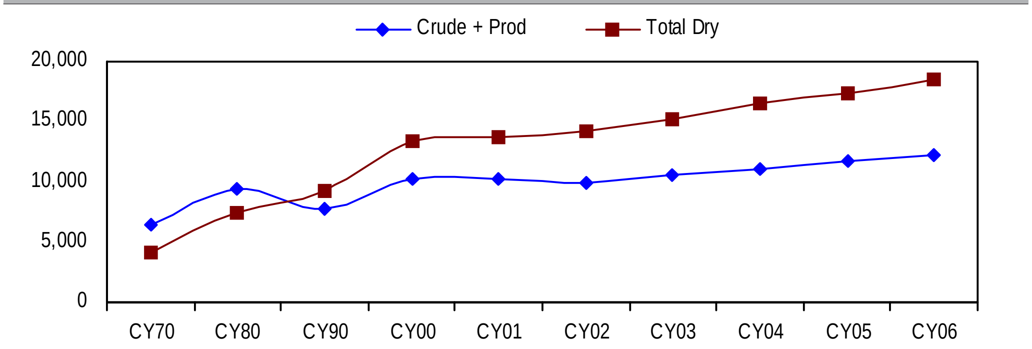
Industry Overview & Outlook

In this segment, we have briefly touched upon the existing scenario and future outlook on several types of the maritime operations viz. shipping, offshore activities and dredging.

Shipping

Shipping plays a vital role in the smooth functioning of the global economy. Its criticality can be judged from the fact the most crucial sector of the global economy viz. energy, is highly dependent on it. Of the total global crude oil demand, ~50% is transported by sea.

Trade in Ton Miles (bn ton-miles)



Source:UNCTAD

Freight rates influenced by numerous factors, thus making shipping industry volatile and cyclical...

The industry has traditionally been highly volatile and cyclical. The freight rates, which are an indicator of the performance of the industry, are governed by diverse factors like geopolitical tensions, world GDP growth, port congestions, and natural calamities. The demand-supply balance for vessels determines the freight rates. While demand for vessels is driven by world trade, GDP growth, trade patterns, supply of vessels is influenced by new ship building activity and scrapping of existing vessels. Hence, there has historically been a high degree of unpredictability in the revenues and performance of the industry.

However, over the past few years, the uniform dissemination of information about variables like economic growth, commodity cycles etc. coupled with advances in meteorological science have helped improve the performance and predictability of the sector.

In CY06, ~ 8.3bn mt of cargo was transported by sea (v/s 6.3bn mt of cargo in CY01, CAGR of 5.7% p.a..). The growth in freight volumes has largely come as a result of the rapidly growing economies of BRIC countries (Brazil, Russia, India and China) along with OECD (Organisation for Co-operation & Economic Development) countries.

Shipping cargo can broadly be differentiated into categories viz. wet & dry.

International Seaborne Trade - UNCTAD

(mn DWT)	1970	1980	1990	2000	2006	CAGR (37 yrs)	CAGR (7 yrs)
Tanker cargo	1,442	1,871	1,755	2,163	2,674	1.7	3.1
Tanker (%)	*56*	*51*	*44*	*36*	*36*		
Dry Cargo	1,124	1,833	2,253	3,821	4,742	4.0	3.1
Dry (%)	*44*	*49*	*56*	*64*	*64*		
Total	**2,566**	**3,704**	**4,008**	**5,983**	**7,416**	**4.0**	**3.1**

Source:UNCTAD

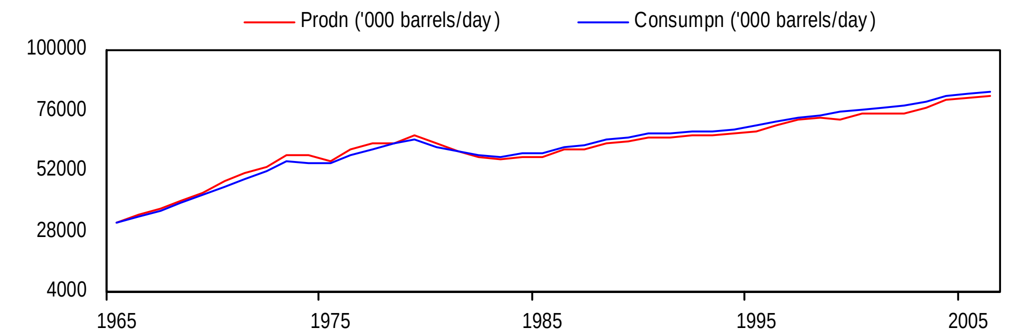
Wet Cargo/ Tanker Segment

50% of global crude requirement is met by the maritime industry...

Wet cargo involves the transportation of crude and petroleum products. On account of the vast geographical distances between the centres of production and consumption, a large quantum of oil and associated products are transported by sea. It is estimated that in CY06, ~ 36% of the freight volumes transported was wet cargo. (Source: UNCTAD)

Currently, ~50% of the global energy requirements are met through oil and ~50% of this requirement is met by seaborne transport. Additionally, 37% of all petroleum products are moved by ship. These metrics thereby underline the importance of the shipping industry.

Global oil production & consumption



Source: BP

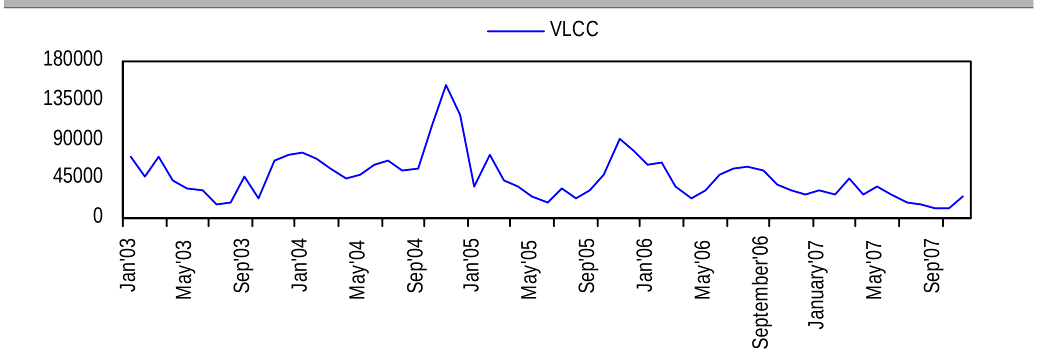
Outlook for Wet Cargo/ Tanker Segment

Incremental demand from China & India, coupled with steady demand from developed economies to drive wet bulk freight rates...

In CY07, the global demand for oil stood at 85.7mbpd (+1.2% v/s CY06). Going forward, the IEA has forecasted oil requirement in CY08 at 87.7mbpd (+2.3% v/s CY07). This jump in consumption would be driven by China & India. Additionally, the setting up of major greenfield refining capacities in conjunction with brownfield expansions at existing locations in China and India is likely generate substantial volumes in outbound shipments for petroleum products. Additionally, steady demand generated from developed economies like US and Japan should see robust demand for crude oil & its derivatives. This, in turn, indicates to sustained demand for crude carriers in the foreseeable future.

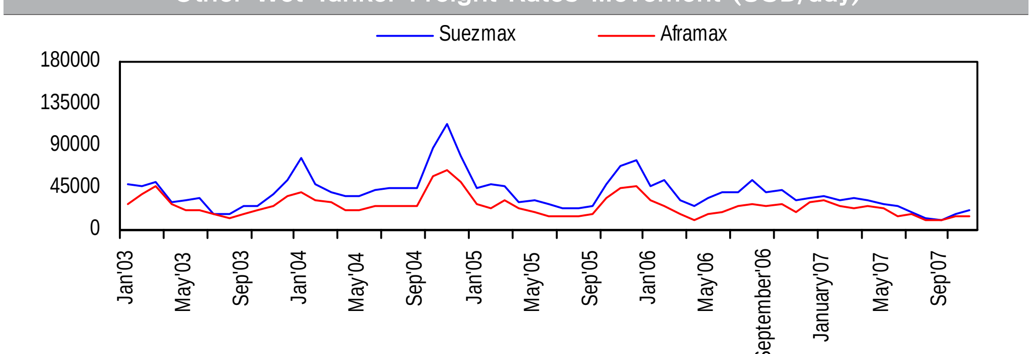
Currently, rates for VLCC have climbed up from USD34k/day in mid November to USD212k/day by mid December (Source: Clarksons). Going forward, we expect wet freight rates to remain stable to positive bias due to the increasing oil consumption and large scale conversion to dry bulkers. Further, scrapping of single hull tankers as per IMO regulations is expected to gain momentum as we approach CY10. This inventory of ~36mn DWT is likely to balance out the expected addition to global fleet tonnage in the wet tanker segment, thereby signalling firm rates over the medium-to-long term.

VLCC Tanker Freight Rates Movement (USD/day)



Source: Clarksons

Other Wet Tanker Freight Rates Movement (USD/day)



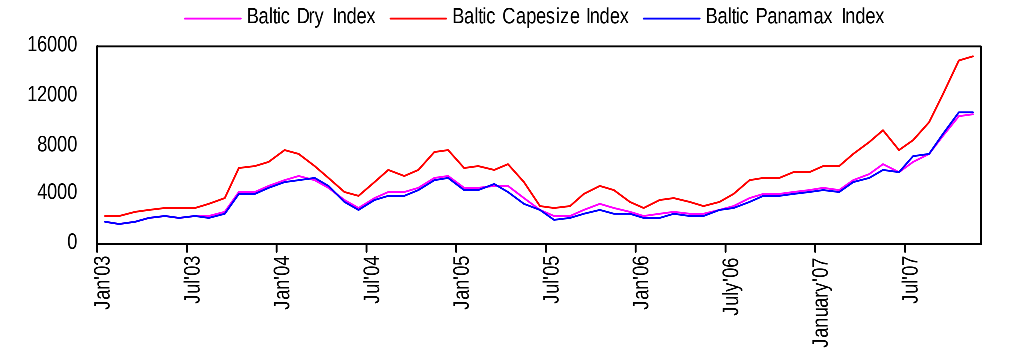
Source: Clarksons

Heightened commodity trade boosting dry bulk freight rates world-over...

Dry Bulk Segment

Dry bulk can further be broken down into major bulk cargo and minor bulk cargo. Major dry bulk involves transportation of dry commodities such as coking and thermal coal, iron-ore, grain, steel, while minor bulk consists of forest products, scrap etc. ~54% of the cargo transported by sea is dry cargo.

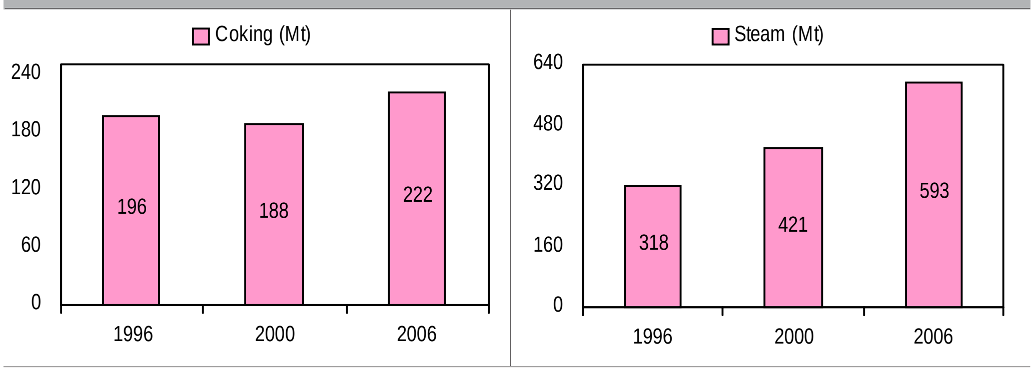
Dry Bulk Indices Movement



Source: Clarksons

During CY00-06, dry bulk trade registered an increase at a CAGR of 5.3% from 3.8bn mt to 2.8bn mt, thereby generating huge demand for dry bulk carriers. As a result, dry bulk freight rates almost doubled in CY07. The demand for dry bulk vessels is primarily driven by iron ore, coal and grains. The emerging economies of Indian and China have generated substantial demand for commodities such as iron ore and steam coal, in their drive to boost steel and power production triggering the increase in dry bulk freight rates.

International Hard Coal Trade

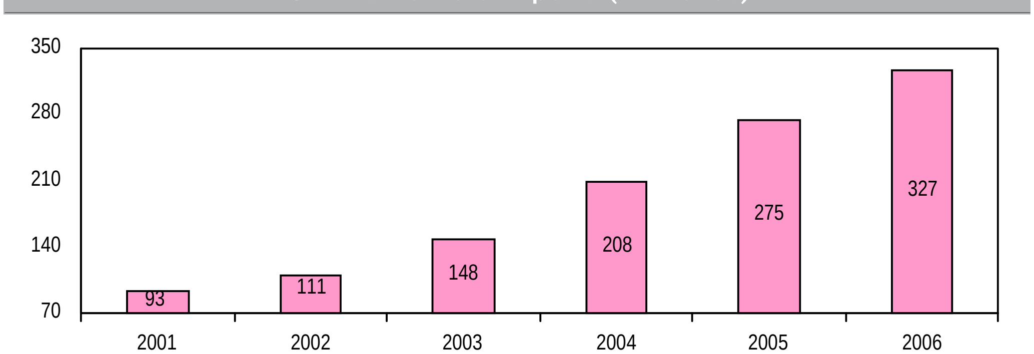


Source: World Coal Institute

Port congestion directly constricting supply of dry bulk carriers...

Another important factor affecting dry bulk rates is port congestion. While H1CY07 witnessed short waiting times at ports, in H2CY07, throughput requirements far exceeded port capacities, which resulted in increased turnaround time for vessels. This generated pressure on availability of vessels, thereby boosting freight rates in the spot market.

China's iron-ore imports (Mn Tones)



Source: Drewry

Heightened demand from steel sector in Asia to boost demand for imports for iron ore & coking coal...

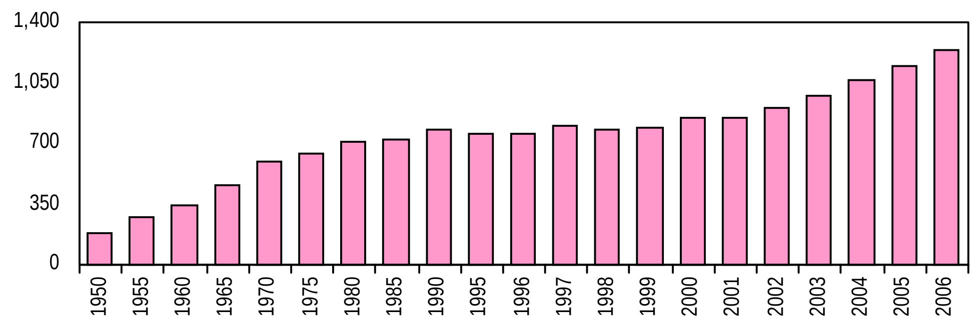
Power sector and grain trade provide for visibility of firm global dry bulk rates...

Outlook for Dry Bulk Segment

The present upswing in the capex cycle of BRIC economies bodes well for dry bulk freight rates. The planned addition to capacities in steel manufacturing in Asia, particularly China & India is expected to generate further demand for raw materials like iron ore and coking coal, which should boost demand for bulk carriers in the region in the near term.

On the other hand, the huge investments being made in power generation in several global economies, especially in India in the next five years, will necessitate the large scale import of steam coal from these economies. Simultaneously, the growing importance attached to food security is likely to nurture the existing business of grain trade, at the global level.

World Crude Steel Production (mn mt)



Source: www.worldsteel.org

While concerns do exist on the negative impact of potential supply of bulk carriers in the near future, we expect the demands of commodity trade to outstrip marine handling capacity. The existing lack of adequate port infrastructure will also serve to ensure rise in ton-mile demand, thereby contributing to a firming up of dry bulk freight rates.

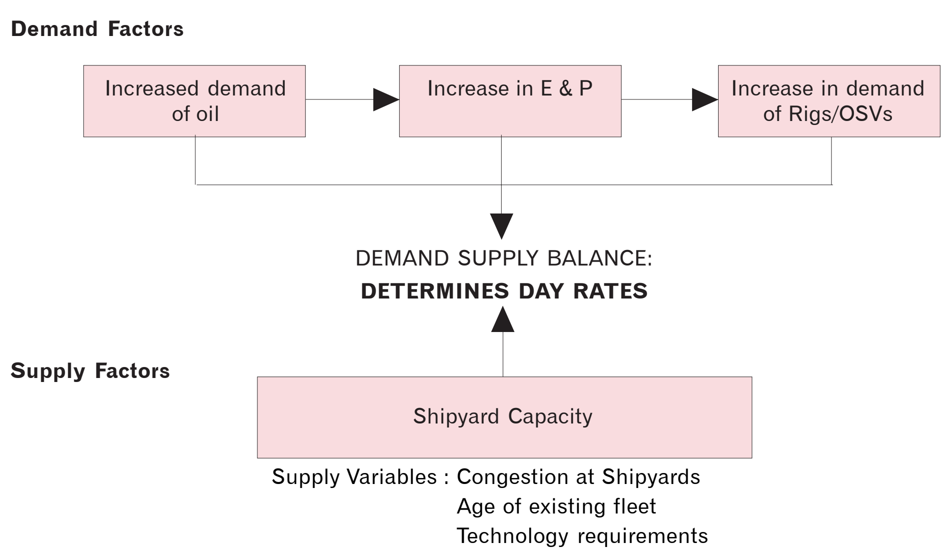
Offshore Services

E&P spend is a key factor influencing demand demand in offshore sector...

Offshore Services consists of rigs and offshore supply/support vessels (OSVs). The demand for such vessels arises from exploration & production (E&P) activities carried out by the oil & gas industry. The lack of new discoveries, declining global inventories of oil, the surge in oil prices and the depleting age of fleet due to non-addition in last few years has led to frenetic activity in this sector, thereby generating immense demand offshore service vessels.

Details of some of the vessels and equipment used in the offshore space are given overleaf.

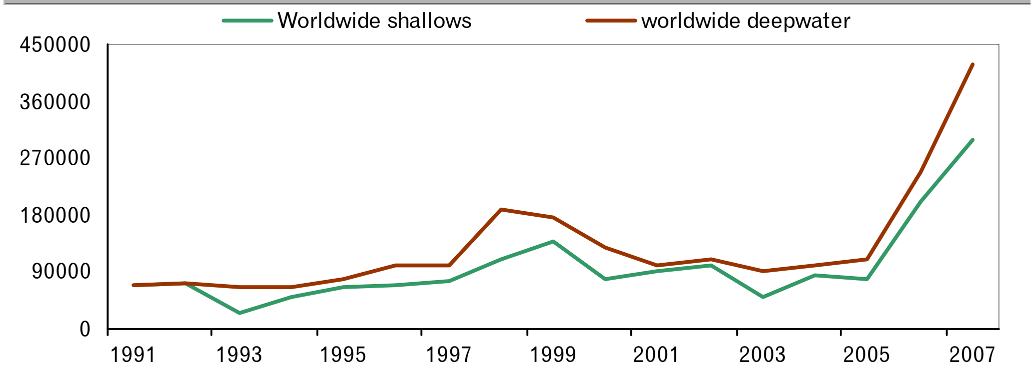
Variables of Offshore vessel demand



Offshore Rigs/ Platforms

Offshore rigs/platforms are structures that are used to house machinery and personnel needed to drill and produce hydrocarbons from the ocean bed. Depending on circumstances, the platform could be attached to the ocean floor, consist of an artificial island or be a floating vessel. Some of the most widely types of rigs/platforms are:

Global dayrates for semi submersible rigs



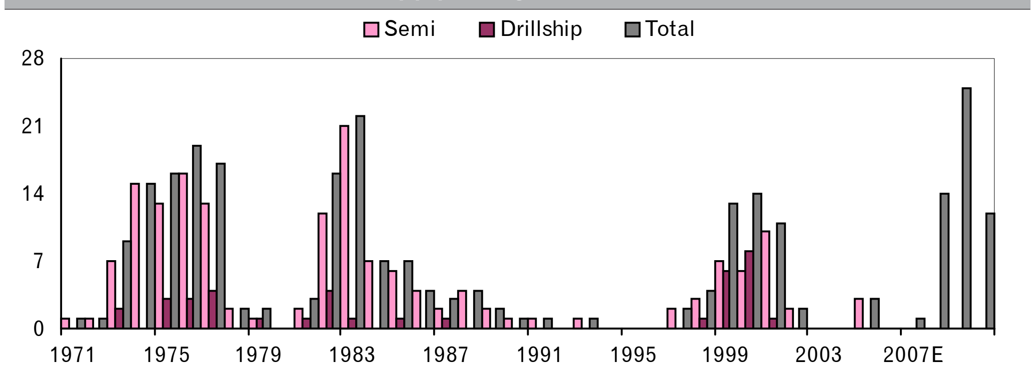
Source: Oslo Shipping Forum

Jack up Rigs: These are platforms that can be jacked up above the sea using legs which can be lowered like jacks. These platforms, used in relatively low depths, are designed to move from place to place, and then anchor themselves by deploying the jack-like legs.

Semi-submersible Platforms: These have legs of sufficient buoyancy to cause the structure to float. These rigs can be moved from place to place, ballasted up or down by altering the amount of flooding in buoyancy tanks and are generally anchored by cables during drilling operations, though they can also be kept in place by the use of dynamic positioning. Semi-submersible rigs can be used from 600 to 6,000 feet (180 to 1,800 m).

The heightened pace of drilling activities has generated a huge demand for offshore rigs. There has not been any significant rig addition in the decade even though there has been an increase in demand from ~407 in CY96 to ~562 in CY06 (Source: Rig Zone)

Supply of rigs in market



Source: Oslo Shipping Forum

Miniscule rig addition and periodic scrapping leading to high rig utlisation rates...

However only 51 rigs were added in the last decade with ~10 rigs scrapped annually, resulting in rig supply shrinking by 81 from 681 to 600 in the same period. This narrowing of the supply demand gap has resulted in the sharp rise in operating rates in the industry from CY04-CY06. Going forward, operating day rates are expected to remain at current levels, if not move up marginally. Industry estimates put rig utilisation rates at 91% in CY09 and 94% in CY10. This would indicate sustained strength in day rates going forward.

Offshore Supply Vessels (OSVs)

Level of offshore drilling activity detrmines demand for OSVs...

OSVs perform support functions like transportation of equipment, provisions, personnel etc for offshore E&P activities. At present, the global market for OSVs is witnessing buoyancy, on account of the higher incidence of offshore E&P activities and the increasing complexity of such operations. Another factor influencing demand is the shortage of OSVs due to high average age of vessels in operation, which automatically disqualifies some vessels for specific operations, thereby generating a supply crunch in the system.

Dredging Industry

Dredging is the process of removal, transportation, placement and often treatment of soil from a marine environment, using specialized equipment, in order to initiate infrastructural and/or ecological improvements. In a nutshell, it is the process of removing soil or rock from below water using dredgers.

Dredging necessary for maritime operations in the economy...

The main objective of dredging is the creation of deeper and wider waterways to improve navigation of ships and is hence required while construction of green field ports as also a regular activity to maintenance the channel depth.

At present, the market in India for dredging operations is valued at ~Rs6.5bn. However, the outlook for the sector is bright on account of high volumes of capital dredging in the country on account of development of greenfield port facilities on the eastern and western seaboards.

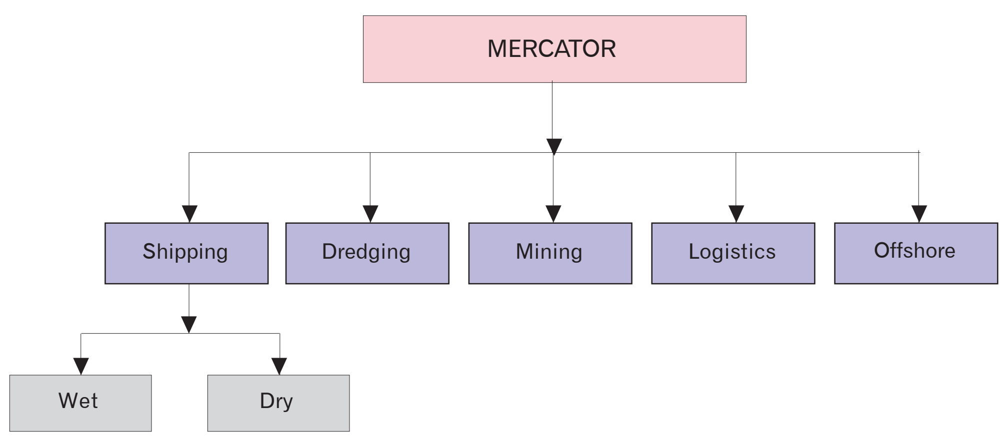
Simultaneously, the major Indian ports where massive maintenance dredging work is due to be undertaken are Kandla, JNPT, Mormugao, Kochi, Tuticorin, Chennai, Ennore, Visakhapatnam, Paradip and Kolkata (including Haldia). The estimated value of these jobs is several billions of rupees.

Ambitious plans to scale up maritime operations to generate demand for dredging sector...

Furthermore, GOI's announcement of the Sagar Mala & Sethusamudram projects for the development of ports and inland waterways at an outlay of Rs1,000 bn is expected to generate significant demand for inland dredging services. The National Waterways too need to be dredged adequately to improve their navigability. Hence, the outlook for demand in the dredging sector is robust and any further buildup in the same is likely to push operating rates and prices in this sector further north.

Business profile

MLL: Business Verticals



Dry bulk carriers under Singapore entity while wet bulk, dredging operations under Indian parent...

Shipping: At present, MLL's shipping fleet consists of 13 tankers, housed in the parent company in India, with a combined tonnage of 1.5mn DWT. The company owns 10 of these vessels, while the remaining 3 are in-chartered. The average age of 90% of the owned fleet is above 15 years. MLL also operates 11 dry bulkers through its Singapore subsidiary, which have combined tonnage of 0.8mn DWT. The company owns 7 of these vessels, while 4 are in-chartered. By tonnage, ~0.6mn DWT is owned, with average age of the owned fleet ~2 years.

In an effort to de-risk its business model, MLL deploys ~60-70% of its fleet on long-term time charter basis, from 3-5 years. Most of the long term time charter in the tanker segment are signed with marquee clients like British Gas, IOC, MRPL etc. In the dry bulk segment, major clients for time charter include Arcelor-Mittal, Tata Power, SAIL etc.

The remainder 30-40% of the fleet is deployed in the spot market to take advantage of the prevailing market rates. Through this fine balance, it tries to capitalize on the spurt in the spot rates and simultaneously, maintain base cash flows by keeping a big chunk of its fleet locked in at fixed rates. .

Business Profile

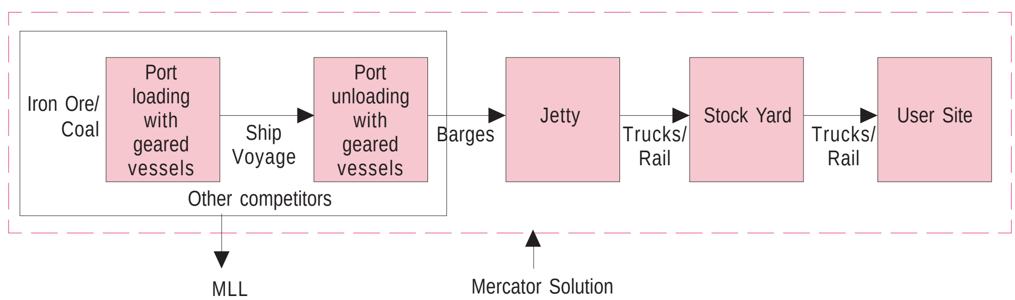
MLL Fleet Size			
Vessel Type Mercator Lines	**Number**	**Average age (in years)**	**'000 DWT**
VLCC	2	14	553
Suezmax	1	19	148
Aframax	7	16	709
Panamax	9	6	651
MR Tankers	2	10	1,000
Chemical Tanker	1	1	13
Kamsarmax	3	1	247
Grand Total	**25**	**10**	**2,437**

Dredging capacity to be ramped up aggressively over next 12 months...

Its recent move into the dredging business is not only a measure of diversification of revenue streams but also a play on the upcoming opportunity in the sector. At present, the company has 3 dredgers which it has chartered out on a long term basis. This move is aimed at securing steady cash flows from the business.

In logistics, MLL offers fully integrated and tailor made logistics solutions to customers, right from the load port to the point of delivery thereby serving the entire value chain. It has leading blue chip companies amongst its customers including Tata Power, MSEB, Torrent etc. While the business is still in its infancy, we believe that going forward, MLL will bring newer customers into its fold, assuring earnings visibility and further de-risking the business model.

Complete Logistics Solutions- Dilivering Added Value to Customers

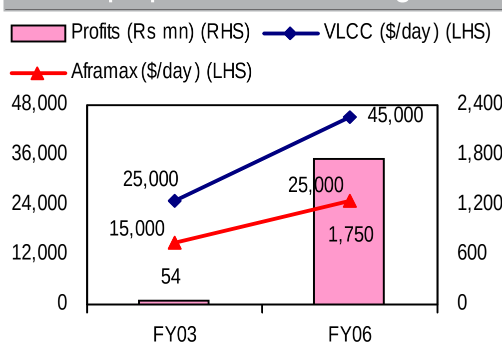


Investment Argument

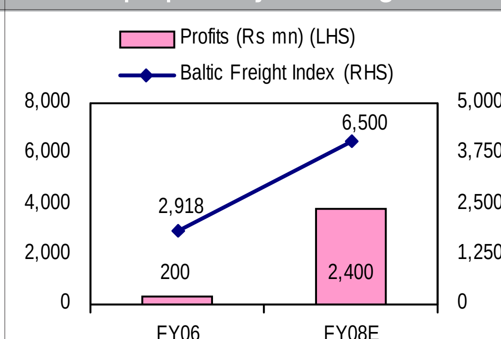
Total capex of USD150mn in dredging business...

MLL , India's second largest private shipping company has built scale quickly, with tonnage growing from 0.1mn DWT in FY00 to 2.4 Mn DWT in FY08. This has been achieved on back of management's ability to fully capitalize on the shipping cycles. Hence, MLL has been one of the MOST aggressive players in the recent industry upcycles. It has set the base for the next phase of expansion (~USD1.5bn) on back of fund raising (USD300mn), coupled with robust internal accruals (~USD100mn p.a.) With its balance sheet now being large (~USD1.5bn) and strong (net leverage ~1.2x), MLL is set to move up the league as a large regional player.

Ramp up in Wet Tanker Segment



Ramp up in Dry Bulk Segment



Source: PINC Research

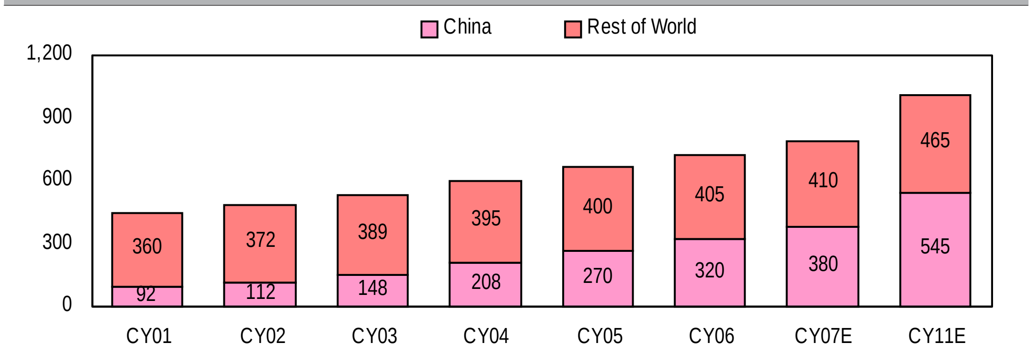
Though aggressive in fleet acquisition, MLL has prudently maintained a healthy mix of long term charters (60-70%) and spot deployment (30-40%), thereby ensuring predictable cash flows.

The outlook for dry bulk, the major contributor to MLL's consolidated profits, continues to be extremely strong. This is on account of the continuing surge in iron ore imports by China and the expected surge in coal imports from India.

Chinese steel production to push demand for iron ore in the near future...

Chinese steel production currently stands at ~400-420 mn mt and is expected to rise to 500-525 mn mt in the next 5 years. This could create incremental demand of 200-225 mn mt of iron ore, coming mostly from Australia and Brazil since India itself is ramping up steel production capacity and hence may not be able to meet much of the incremental Chinese iron ore demand. This would imply incremental demand of ~20-22mn DWT. Similarly, though China has huge coal reserves, considering its mega capacity expansion and the logistical problems involved in extracting and transporting the same, Chinese imports of steam coal rise could multiply from the current 20mn mt to 60-80mn mt.

Iron Ore Trade (mn mt)

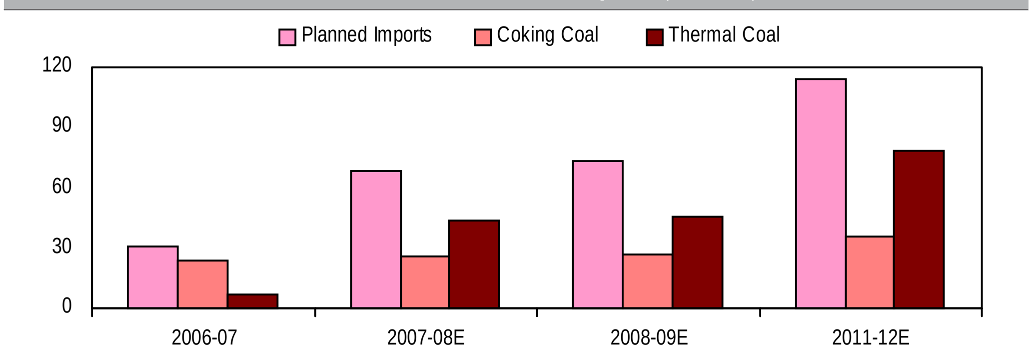


Source: Industry

Indian coal imports for steel production and power generation to rise exponentially...

Indian steel production is expected to increase by 75mn mt in next 5 years with most of the coke/ coking coal being imported from long haul destinations like Australia. This could trigger incremental dry bulk tonnage demand of 6-7mn DWT. Similarly India's plans of adding 50k MW of coal based power generation capacity, which would rely largely on imported coal, could create incremental imports of 75-80mn DWT. With most short haul destinations like Indonesia not equipped to meet this huge requirement, a significant chunk of imports will have to come from long haul destinations like Africa, Russia & Australia. Thus the incremental dry bulk tonnage demand could also be ~7-8mn DWT. Furthermore, the huge surge in volumes could generate further port congestion thereby soaking up inventory from the system.

India's estimated coal import (mn mt)



Source: Industry

MSL, MLL's 72% Singapore subsidiary, is looking to further expand its fleet of 11 vessels with 0.8 mn DWT by buying another 10 -12 vessels. It has outlines capex of ~USD600-700mn towards the same, over the next 24 months.

Investment Argument

In line with its strategy of further de-risking its business model, MLL has chartered out a three pronged strategy to expand into related and high growth areas like dredging, offshore services and mining.

Mindful the huge capex planned in greenfield ports as well as plans of existing ports to deepen their channels, India's dredging market is set to grow exponentially from the present Rs6.5bn p.a.

MLL plans to capitalise on the same by investing USD150mn for 7 dredgers. Most of these are expected to be deployed on long term charters of 2-3 years, thus providing immense stability and predictability to cash flows of MLL's Indian operations. While the company has already purchased and deployed 3 dredgers on long term charters (2 years), it expects to take delivery of 4 more dredgers over the next 2-3 quarters.

One of the major dry bulk commodities transported by MLL today is steam coal, prices of which have more than doubled over the last one year. As part of its strategy aimed at backward integration and providing integrated logistics solutions to its customers, MLL has recently forayed into the mining space.

Outlay for 4 coal mines. set at USD200mn...

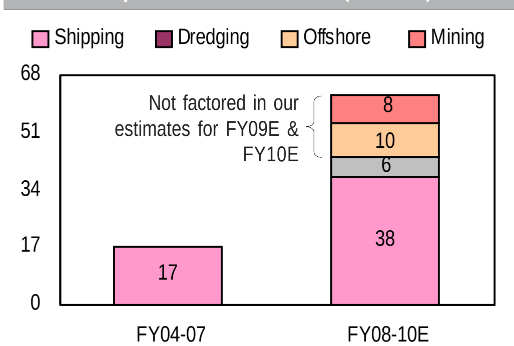
It recently acquired participating interest in 3 coal mines in Indonesia & 1 coal mine in Africa (Mozambique). The same stands at 51% and 85% respectively. The proven coal reserves in Indonesia are ~50mn mt though the probable reserves could be much higher. In case of Mozambique, the survey of the asset is currently underway and MLL's management estimates reserves of the asset at ~400-500mn mt. We expect more clarity on the subject to emerge over the next 1-2 months. The total investment by MLL in these mines would be ~USD200mn. MLL is looking at extracting ~1-2mn mt in FY08 and scale up the same to ~6-7mn mt in FY10, with net margins of USD20-30/mt.

Offshore business to be set up for USD250mn...

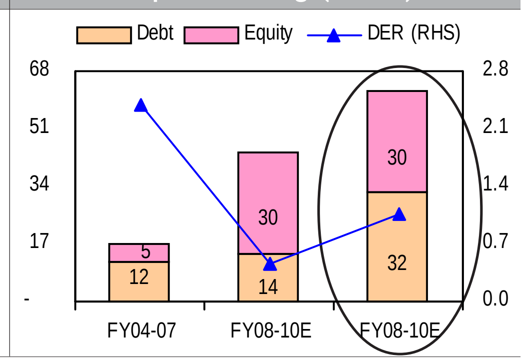
In offshore services, MLL has committed capex of ~USD250mn for 1 jack up rig and 4 OSVs, with delivery expected between Dec'08 to Jun'09. The company expects to earn rentals of USD140-150k /day with OPM of ~70%. Further MLL is looking at building at fleet here and the capex in the next three years could exceed USD2bn a large part of this would be by inorganic growth.

This capex, totaling USD1.5bn is scheduled to take place from FY08-10. Since our estimates only include revenues and profits from the shipping and dredging segments, we have we have factored not in the capex for the offshore and mining business. However, the company's balance sheet should be able to absorb the requisite gearing to fund these expansions.

Capex on Verticals (Rs bn)



Capex Funding (Rs bn)

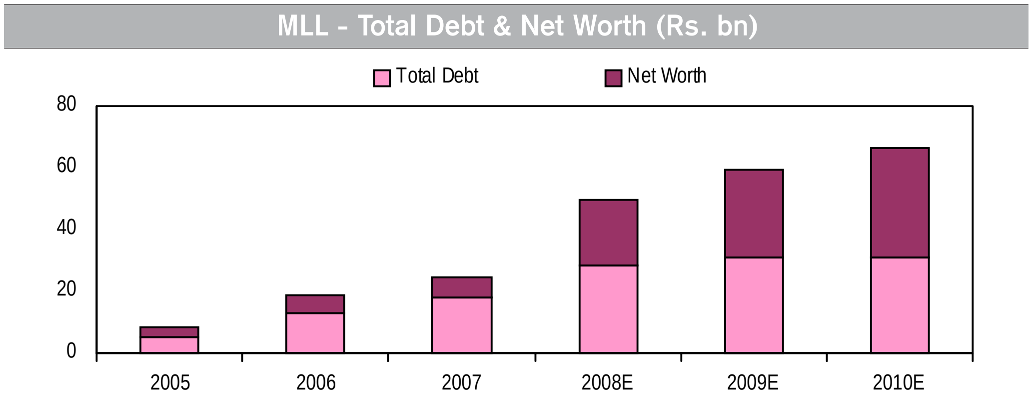


Source: PINC Research

Note: The encircled portion denotes the possible scenario arising after funding of capex in offshore & mining and the comfortable gearing ratio of 1.1x that the company can maintain.

The key sources of equity contribution would be the recently concluded MSL IPO (~USD150mn) and internal accruals (consolidated~USD500mn). Considering a debt equity mix of 70:30, MLL would have room for another ~USD400-500mn of expansion. The same could materialize in any segment depending on the future opportunities. It is pertinent to note that we have not factored in any capex on tanker business.

Our View



Source: PINC Research

MLL's ability to monetize the shipping cycles has resulted in attractive return ratios and in the process created significant wealth for investors, the value unlocking from the listing of Singapore subsidiary being the recent one. MLL is looking at replicating the Singapore subsidiary model across most of its new business initiatives once they achieve critical size. With business like mining & offshore services generating significant investor interest and quoting at high multiples, we expect MLL to unlock significant value from these businesses.

Our View

We estimate MLL's consolidated earnings to grow sharply over FY07-10. The key driver for this would be MSL, where profits are expected to see a sharp improvement on back of the following:

1) Escalation in long-term charter contract renewals over the next 2-3 quarters.

2) Benefits from robust increase in spot rates for ~30% of the dry bulk fleet

3) 100% growth in tonnage over the next 24 months.

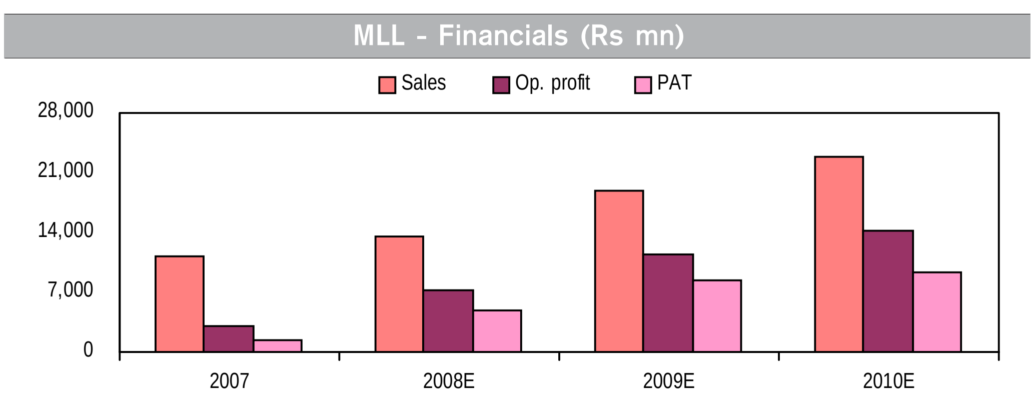
For vessels deployed in the spot market, we have factored rates which are at 30-40% discount to current market rates as the dry bulk freight rates have been on a secular uptrend since last 18-24 months and are expected to remain firm.

In India, the key revenue driver would be scaling up in the dredging operations.In wet tanker segment, though rates have jumped significantly in the past month, we have factored the same only in our Q3 & Q4 FY08 estimates since majority of them have been tied up till Mar'08 at higher rates. For FY09-10, we have assumed close to 5 year averages into our calculations as we would like to observe the trend in the freight rates before factoring them into our estimates.

High dry bulk rates, steady wet tanker rates & dredging business to provide fillip to revenues & profits...

On the other hand, given the potential demand for dredgers in the country in foreseeable future, the ramp up in the dredging business not only provides for long term visibility of revenues but also de-risks them from the cyclical business of shipping.

We have not factored in any revenues and profits from the offshore and mining streams and have simultaneously not factored any capex in the wet bulk segment.



Source: PINC Research

Our View

On a consolidated basis, we estimate the MLL to end FY08 with revenues of Rs13bn. This would be on back of fleet growth and higher TCY rates. Stable operating costs coupled with spiralling dry bulk rates should see operating leverage kick into the company's favour. Op. profits at ~Rs7.3bn and OPM at 54% (+31% points v/s FY07). Capital charges will be higher in FY08 due to the company's enhanced asset base as well as aggressive gearing for expansions. Profits (after minority interest) should settle at Rs4.2bn (+294% v/s FY07).

Earnings potential from mining and offshore verticals not captured in our estimates...

In FY09 & FY10, we expect MLL to notch up revenues of Rs19bn & Rs23bn resp (CAGR of 30%) on back firm dry and wet tanker rates as well complete deployment of its full complement of 7 dredgers. In the face of stable operational expenditure, we expect MLL to register margins of ~60% in FY09 & FY10. However, growth in operating profits would be moderated by the higher incidence of interest and depreciation. We expect the company to earn profits (after minority interest) of Rs8.4bn and Rs9.5bn resp in CY09 and CY10 resp. On a fully diluted equity base of Rs270mn, this translates into an EPS of Rs26.1 & Rs27.6 resp in FY09 and FY10.

Valuations

We are positive on the growth prospects of MLL as it is currently operating in a favourable macro environment and simultaneously expanding its capacities in segments with high growth potential. Moreover, its management ability to spot opportunities and capitalise on the same through aggressive expansion inspires confidence about the company's growth potential.

At the CMP of the Rs155, MLL is trading at PER and EV/EBITDA of 5.6x & 4.4x resp of its FY10E earnings. Given the fact that its global and Indian peers are trading at average earnings multiple of 10x and EV/EBITDA multiple of 5.8x, we feel the company is undervalued given the long term visibility of revenues, diversification and de-risking of revenue streams and potential unlocking of value in subsidiaries in the medium term. Also, as the table shows, the company lags behind its closest Indian competitor and all global peers in terms of earnings valuations.

MLL undervalued on all parameters against most Indian & global peers...

Peer Comparison

	P/E	EV/EBITDA	P/BV	PAT (Adjusted) $ Mn
Varun Shipping (FY09)	6.9	6.3	1.4	58
Teekay Corporation (CY08)	13.9	10.6	1.3	267
Frontline Ltd. (CY08)	15.9	NA	6.1	215
Overseas Ship holding group Inc (CY08)	10.9	7.1	1.1	195
Danaos Corporation (CY08)	13.1	11.6	2.0	109
Eagle bulk shipping Inc (CY08)	13.7	c11.7	2.2	80

(Source : Bloomberg)

On the basis of its management's proven track record, ability to ride various cycles in the shipping industry and its imminent foray into related and high profile verticals, we prefer to value MLL at the higher end of the band of 8-10x that is accorded globally, to the shipping industry. At an earnings multiple of 10x FY10E, we arrive at a fair value of Rs276/sh.

We have also sought to value MLL on different parameters viz. Sum of Total Parts (SOTP), EV/ EBITDA and Price to Book average.

EV/EBITDA Multiple

MLL EV/EBIDTA Valuations for FY10E

	FY10E
EBITDA (Rs mn)	14,680
Mkt Cap (Fully Diluted) (Rs mn)	41,729
Debt (Rs mn)	30,680
Cash (Rs mn)	10,152
EV (Rs mn)	63,728
Global EV/EBITDA Avge (x)	5.8
MLL Mkt Cap (Fully Diluted) (as per global avge)	64,616
Equity sh. (mn)	270
Price (Rs/sh)	**239**
CMP (Rs/sh)	155
Upside (%)	*55*

Source: PINC Research

Our View

Hence, as per global benchmarks, we arrive at a fair value of Rs239/sh, which represents an upside of 55% from the CMP of Rs155.

P/BV Multiple

MLL P/BV Valuations for FY10E

	FY10E
Consolidated Equity (Rs mn)	670
Consolidated Reserves (Rs mn)	35,124
Consolidated Networth (Rs mn)	**35,794**
No. of shares (mn)	270
BV/sh (Rs)	**133**
CMP (Rs)	155
CMP/BV (x)	1.2
Global P/BV Average (x)	1.8
MLL sh (As per global multiple) (Rs)	**239**
Upside (%)	*54*

Source: PINC Research

By equating the company's FY10E book value to the global benchmark of 5.8x that is awarded to companies of similar scale, we arrive at a fair value of Rs239/sh, which represents a potential upside of 54% from the CMP of Rs155.

Sum of Total Parts (SOTP)

While we haven't built in revenues and profits from the mining and offshore divisions into our EPS estimates, we feel that the true earnings upside from these verticals can be captured in a SOTP calculation.

SOTP method captures true earnings potential and hidden value of MLL...

MLL SOTP Valuations for FY10E

	PAT (Rs mn)	Multiple (x)	Discounting (%)	Value/sh (Rs)
Mining	1,200	13	25	33
Dredging	1,541	13	20	47
Offshore	972	23	25	46
Shipping	5,600	9	15	135
Total				**260**
CMP				155
Upside (%)				*68*

Source: PINC Research

Our SOTP valuation exercise (overleaf) yields a fair value of Rs260/sh, which represents an upside of 68% from the CMP of Rs155.

Average Target Price

By taking an average of the prices derived by the four different methods, viz. multiples of EV/EBIDTA, P/BV, P/E and SOTP, we get an average price of Rs255.

Simple Average of per share value derived from all methods presents a balanced value per share...

MLL Average Target Price for FY10E

	(Rs)
As per global BV average multiple	239
As per global EV/EBITDA average multiple	239
As per discounted SOTP earnings	260
As per global earnings average	276
Average Target Price (Rounded off)	**255**
CMP	155
Upside (%)	*65*

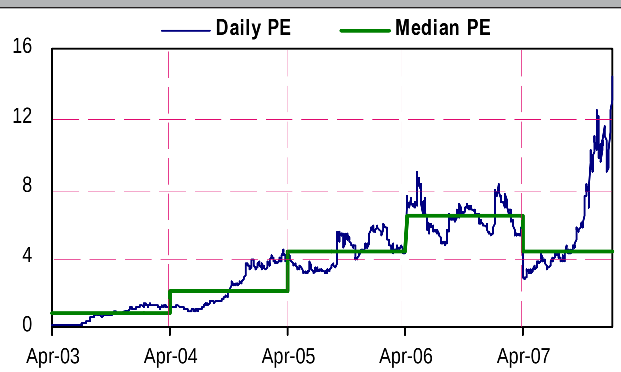
Source: PINC Research

Looking ahead, we have a positive outlook for MLL's revenue and profit growth, on account of the robust outlook for its shipping operations, ambitious plans for diversification of revenues, strong balance sheet and impeccable execution skills. The management's impressive track record and a positive macro outlook for its existing and future business verticals also inspire confidence about MLL's future performance. Hence, we initiate coverage on the company with a 'BUY' recommendation and target price of Rs255 with a 12 month investment horizon.

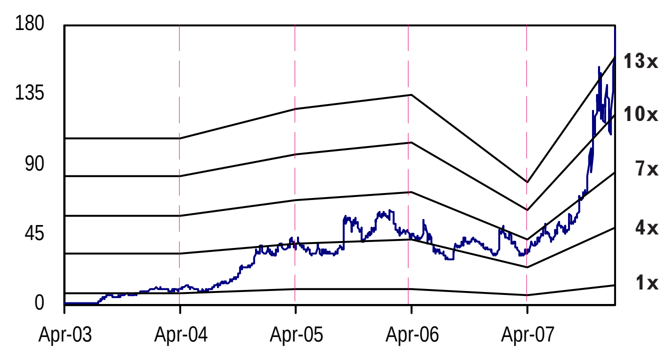
Financial Results for the quarter & half year ended Sep'30, 2007 (Consolidated)

Particulars (Rs Mn)	Quarter Ended			Half Year Ended			Year Ended
	30/09/07	30/09/06	Gr %	30/09/07	30/09/06	Gr %	31/03/07
Net Sales	3,631	2,211	64.2	6,304	3,975	58.6	11,228
Expenditure	2,315	1,509	53.5	4,057	2,766	46.7	8,271
Operating expenses	2,136	1,414		3,747	2,418		7,399
Dry-docking expenses	85	45	52.2	115	261	44.2	548
Staff Cost	60	22	168.8	131	47	176.5	148
Other expenditure	35	27	26.9	65	40	61.7	176
Operating profit	1,315	703	87.2	2,247	1,209	85.8	2,957
Other Income	437	6		778	107		273
PBDIT	1,752	709		3,025	1,316		3,229
Interest	362	153	136.0	616	304	102.5	808
Depreciation	441	254	73.7	747	517	44.5	1038
PBT	949	301	215.0	1,662	495	235.9	1,383
Ext. Ord. Expenses (Net)	18	69		18	69		-
Provision for current tax	25	17		35	27		33
Provision for fringe benefit tax	-	-		1	-		1
Net Profit	905	215	320.7	1,608	398	303.7	1,349
Equity Capital(F.V of Rs.1)	197	189		197	189		189
Prefernce Share Capital	400	400		400	400		400
Reserves (excl. rev. res.)	-	-		-	-		5,694
EPS for the period (Rs)	4.6	1.1		8.2	2.1		7.1
Book Value (Rs)	-	-		-	-		33.2
OPM (%)	36.2	31.8		35.6	30.4		26.3
NPM (%)	24.9	9.7		25.5	10.0		12.0
Exp. (% of Net Sl.)	63.8	68.2		64.4	69.6		73.7
Raw materials (adj.)	61.2	66.0		61.3	67.4		70.8
Staff costs	1.7	1.0		2.1	1.2		1.3
Other expenses	1.0	1.2		1.0	1.0		1.6

Median PE v/s Daily PE



PE Band



Year Ended March (Figures in Rs Mn)

Income Statement	2007	2008E	2009E	2010E
Revenues	**11,228**	**13,440**	**18,800**	**22,840**
Growth (%)	*35.9*	*19.7*	*39.9*	*21.5*
Total Expenditure	**8,271**	**6,160**	**7,480**	**8,560**
Operating Profit	2,957	7,280	11,320	14,280
Interest & dividend income	273	920	1,800	400
EBIDT	**3,230**	**8,200**	**13,120**	**14,680**
(-) Interest	808	1,680	2,080	2,000
(-) Depreciation	1,038	1,560	2,600	3,200
PBT & extraord. items	**1,384**	**4,960**	**8,440**	**9,480**
(-) Tax provision	34	80	40	40
PAT	**1,350**	**4,880**	**8,400**	**9,440**
(-) Minority Interest	1	675	1,349	1,982
PAT after Min. Int.	**1,349**	**4,205**	**7,051**	**7,458**
Growth (%)	*-31.9%*	*261.5*	*72.1*	*12.4*
Fully dil. Eq. sh. O/s (mn)	189.2	270.0	270.0	270.0
Book Value (Rs)	33.2	91.2	122.4	157.3
Basic EPS (Rs)	7.1	15.6	26.1	27.6
Diluted EPS (Rs)	**5.0**	**15.6**	**26.1**	**27.6**

Cash Flow Statement	2007	2008E	2009E	2010E
PBT & Extraord. items	**1,383**	**4,968**	**8,446**	**9,474**
Depreciation	1,038	1,560	2,600	3,200
Interest & dividend inc.	(315)	(920)	(1,800)	(400)
Interest paid	808	1,680	2,080	2,000
Adj. for Minority Interest	-	(675)	(1,349)	(1,982)
Misc Expenses	(4)	-	-	-
Tax paid	(34)	(80)	(40)	(40)
(Inc) / Dec in working capital	755	(286)	(148)	(308)
Cash from operations	**3,630**	**6,247**	**9,789**	**11,944**
Net capital expenditure	(5,402)	(27,242)	(11,548)	(7,200)
Net investments	136	400	(920)	(80)
Interest recd	62	920	1,800	400
Cash from inv. act.	**(5,203)**	**(25,922)**	**(10,668)**	**(6,880)**
Issue of eq. shares	-	10,710	40	40
Change in debt	5,244	10,560	2,680	(520)
Adjustment (Minority Interst)	(0)	3,307	1,349	1,982
Dividend paid	(258)	-	-	-
Interest paid	(808)	(1,680)	(2,080)	(2,000)
Cash from fin. act.	**4,179**	**22,897**	**1,989**	**(498)**
Inc/Dec. in cash	**2,606**	**3,222**	**1,110**	**4,566**

Balance Sheet	2007	2008E	2009E	2010E
Equity Share Capital	189	270	270	270
Pref. Share Capital	400	400	400	400
Warrants	49	-	-	-
Reserves & Surplus	5,646	20,653	27,716	35,124
Net worth	**6,284**	**21,323**	**28,386**	**35,794**
Total Debt	18,347	28,520	31,200	30,680
Minority Interest	-	3,307	4,656	6,638
Capital Employed	**24,631**	**53,138**	**64,242**	**73,112**
Fixed Assets	17,848	43,160	52,080	56,090
Net current assets	5,912	8,178	9,442	14,222
Investments	871	1,800	2,720	2,800
Total Assets	**24,631**	**53,138**	**64,242**	**73,112**

Key Ratios	2007	2008E	2009E	2010E
EBIDT (%)	23.2	54.2	60.2	62.5
ROACE (%)	13.1	17.3	20.7	21.4
ROANW (%)	21.5	30.5	28.4	23.2
Sales/Total Assets (x)	0.5	0.3	0.3	0.3
Debt:Equity (x)	2.9	1.3	1.1	0.9
Current Ratio (x)	3.7	8.4	7.6	9.8
Debtors (days)	62	57	48	47
Inventory (days)	8	8	6	5
Net working capital (days)	62	55	46	44
EV/Sales (x)	4.3	5.0	3.7	2.8
EV/EBIDT (x)	15.0	8.2	5.3	4.4
P/E (x)	30.9	9.9	5.9	5.6
P/BV (x)	4.7	1.7	1.3	1.0

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