

Shipping - Large

May 21, 2008

CMP (INR)	115
Sensex	17234

Stock Statistics

Reuters code	MRCT.BO
Bloomberg code	MRLN IN
BSE code	526235
NSE code	MLL
ISIN No.	INE934B01028

Equity Cap (INR mn)	235
Market Cap (INR mn)	27483
Market Cap (\$ mn)*	644
52 Week High/ Low	185 / 41
Avg Daily Vol (6M)	1194103
Face Value (INR)	1

\$ = INR 42.67

Shareholding Pattern (%) - Mar 08

Promoters	32.5
Institution	47.5
Non Institution	19.7
Others	0.3

Relative Price Chart (1 yr)



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Mercator Lines Ltd

Company Update (Buy – F.V. INR 147)

Mercator Lines Limited, India's 2nd largest private sector shipping company, has posted impressive results for the year ended March 2008 (FY 2008). On consolidated basis, the Company has achieved 30% higher income from operations at INR 14.55 bn during FY 2008 as against INR 11.23 bn in FY 2007. Operating Profit (PBIDTA) for FY 2008 has grown by 123% at INR 7.21 bn against INR 3.23 bn in FY 2007.

In spite of 79% increase in financial cost of INR 1.45 bn and 61% higher depreciation of INR 1.67 bn, the **Net Profit (PAT) after minority interest of INR 300 mn has registered impressive growth of 175% at INR 3.70 bn from INR 1.35 bn**. TCE (Time Charter Equivalent) rate per vessel per day increased by 57% to US\$ 38,322 and total no. of vessel operating days increased by 19% to 3820 days in respect of dry carriers, for the year ended 31st March, 08. TCE (Time Charter Equivalent) rate per vessel per day reduced by 8% to US\$ 24,467 and total no. of vessel operating days increased by 16% to 5589 days in respect of tankers, for the year ended 31st March, 08.

MLL owns fleet comprising 9 tankers with a combined capacity of 1,044,273 dwt, 8 dry bulkers with a combined capacity of 612391 dwt and 3 dredgers with a combined capacity of 20,000 CBM as on 31 March, 2008.

New Business Forays

- During the year, the Company has **forayed into dredging by acquiring 3 dredgers**. All the 3 dredgers have been employed with *Dredging Corporation of India*. We believe that **dredging segment has a great future in India due to the increased port development activity**.
- The **delivery of the JACK-UP rig is as scheduled** and the company has already fixed the deployment of the rig for tenure of 3 years.
- As a backward integration process, **the company has forayed into coal mines through its network of subsidiaries and has acquired economic interest in 2 coal licenses in Indonesia and 1 licence in Mozambique**. The coal resources in Indonesia are about 15 mn. tonnes and in Mozambique are about 3 bn tonnes. The work in Indonesia is in an advanced stage and the operating revenues would be generated in the financial year 2008-09.

Shipping Business

The company follows the policy of 70% of vessel days to be deployed in long term charter and 30% vessel days to be deployed in spot market. We expect the policy to continue in future. Average age of ship is 14-15 years for tanker and 2 years for Dry Bulk. The company earned INR 3 bn through the sale of a tanker in 4QFY08. The company expects to add two more dry bulk vessels in FY09 in its Singapore subsidiary and 2 vessels in India. Total capital expenditure for FY09 is pegged at USD 450 mn. NAV for the shipping business is USD 1.2 bn (USD 700 mn for Singapore subsidiary and USD 500 mn for Indian operations). The company is trading at 47% discount to NAV.

New business to be value accretive

....new business to be value accretive in terms of multiples....

We believe foray into **new business** like offshore (rigs), coal mines and dredging will be value accretive as these business **trade a 6-8x 1 year forward EBITDA multiples compared to traditional shipping business trading at 3-4x 1 year forward EBITDA.**

Mining business:

....MLL expects to spend USD 10 mn for the development of Mozambique mines....

MLL has acquired economic interest in 2 coal licenses in Indonesia and 1 licence in Mozambique through its 100% overseas subsidiary. **Economic interest in Indonesian mine is 50% with a reserve of 15 mn MT while economic interest in Mozambique coal mines is 85% with a reserve of 3 bn MT. While, Indonesian mine will start production by July 2008, Mozambique mines will take at least 3-4 years to start production.** The company expects to spend USD 10 mn for the development of Mozambique mine.

...the company expects to sell 1 mn MT of coal from Indonesian mine in FY09...

For our calculation purpose we have taken only Indonesian mines in FY09 and FY10. The company expects to sell coal from these mines at USD 45 per MT while operating cost (including royalty USD 9 per MT) will be approximately USD 22 per MT. **The company expects to sell 1 mn MT of thermal coal in FY09. We believe MLL will be able to sell 1.5 mn MT of coal in FY10.** For our calculation purpose, we have assumed FY10 realisations to be same as FY09 realisations (USD45 per MT).

Offshore business:

....new jack-up rig is expected to earn revenue from April FY09....

The company has forayed into offshore business through entering into rig operation. **MLL's first jack up rig is expected to be delivered in March 2009 and will be commissioned in April 2009. The company has already fixed the deployment of the rig for tenure of 3 years.** Gross rentals are expected to be USD 145,000 per day and Net rentals (excluding operating cost) are to the tune of USD 110,000 per day. Current market for rig rentals command day rate of 150,000 USD per day for long term contract and USD 250,000 per day for spot contracts.

...We expect EBITDA of INR 1,320 mn in FY10 from offshore business...

For our calculation purpose, we have taken total working days for rig at 300 days and INR/USD rate at INR 40 per dollar. **We expect MLL to earn core EBITDA of INR 1,320 mn in FY10 from offshore business.**

Dredging business:

...the company currently has a portfolio of 4 dredgers deployed on long term contract....

During the year, the Company has forayed into dredging by acquiring 3 dredgers. All the 3 dredgers have been deployed with Dredging Corporation of India. **The company bought one more dredger in the month of April and all 4 dredgers are now deployed with Dredging Corporation of India.** Day rates for dredgers are to the tune of USD 25000 per day while operating cost is USD 8000 per day.

...Rentals are USD 25,000 per day while operating profit is USD 17,000 per day...

For our calculation purpose we have taken 4 dredgers working in FY09 for 300 days. **We have also assumed that 4 more dredgers will join the fleet in FY09 which will start giving revenue in FY10. We expect dredging rentals to be USD 25,000 per day and operating cost of USD 8,000 per day to be constant for FY09 and FY10.** INR/USD rate is expected to INR 41 per USD in FY09 and INR 40 per USD in FY10.

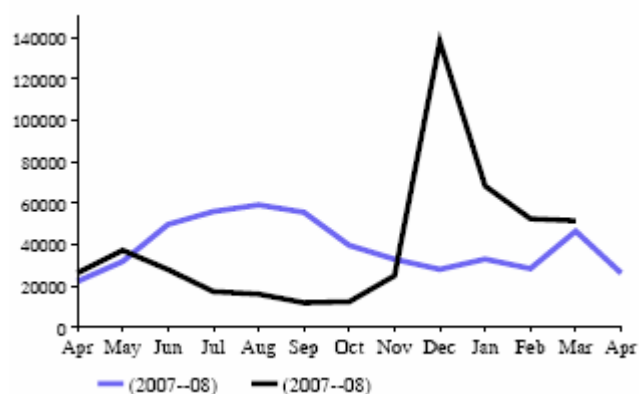
Shipping business outlook

....Higher demand growth, order cancellations in dry bulk and phase out of single hull tanker to keep rates firm for next 2 years....

The company expects shipping rates to be stable for till FY10 as large deliveries in Dry Bulk is expected only in 2010. **There have been events of order cancellation in new shipyards which might keep the rate firm. As far as tanker market is concerned, phase out of single hull tankers by 2010 will keep the tanker market buoyant for next 2 years.**

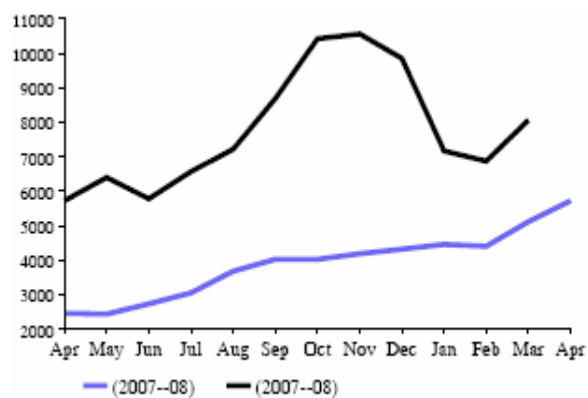
The company expects average day rate for dry bulk carriers to be to the tune USD 45,000 per day and tanker rates to the tune of USD 30,000 per day in FY09. Cumulative vessel operating days is expected to 12000 in FY09 as compared to 9700 days in FY08. We expect MLL shipping business to grow at 20% per annum till FY10 with stable operating margins.

Tanker Freight Rates : VLCC (USD/day)



Source:CMIE, Tower Research

Dry Bulk Freight Rates (Baltic Dry Index in points)



Particular	Day Rate(USD)	Operating Cost	Sales (INR mn)		EBITDA (INR mn)	
			FY09E	FY10E	FY09E	FY10E
4 Dredger FY09	25000	8000	1230	2400	836.4	1632
8 Dredger FY10*						
Rig Rates	145000	35000		1740		1320
Coal mine	45USD per MT	22USD per MT	923	1350	460	690
Shipping biz			17460	20952	8652	10382
*Assuming 4 more dredgers in FY10, Dollar rate 41 for FY09 and 40 for FY10 Working days for rigs and dredgers taken as 300 days We expect Normal shipping business to grow by 20% per annum till FY10 We expect Operating margins to remain stable till FY10 in shipping business						

Valuations

We expect New business to trade at 6x EBITDA of FY10 in line with Industry
We expect Shipping business to trade at 3x EBITDA of FY10 in line with Industry

Particulars	Valuation Multiple	EV/INR mn
New business	6 x FY10 EBITDA	21852
Shipping business	3 x FY10 EBITDA	31147
Total EV		52999
Net Debt FY08	as per management	12500
Fair market cap		40499
FD Equity Cap		275
Fair value		147

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