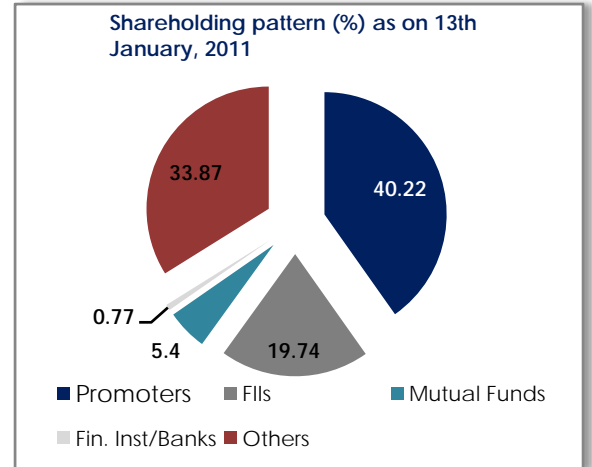




INVESTOR'S DELIGHT

7TH APRIL, 2011

COMPANY	MERCATOR LINES
Industry	Shipping
NSE Code	MLL
BSE Code	526235
FV	Re.1
Equity Capital (Rs in mn)	236
Market Capitalization (Rs in mn)	10,596
CMP	Rs. 45
Target Price	Rs. 55
Upside	22 %



FINANCIAL SUMMARY

INCOME STATEMENT (Rs. in mn.)

Particulars	FY09	FY10	FY11E*	FY12E*
Net sales	22,105	18,087	27,500	36,500
Operating Profit	9,493	6,449	6,650	7,300
OPM (%)	42.9	35.7	24.2	20
Reported PAT	3,789	533	1,155	1,825
PAT (%)	21.2	5.8	4.2	5
Outstanding shares (mn)	236	236	236	236
EPS	16.1	2.3	4.9	7.7
P/E(x)	3	20	9	6
P/BV(x)	0.47	0.50	0.47	0.45
ROE(%)	16.7	2.5	5	7.5
ROCE(%)	13.9	5.7	7	8.5

Source: Company, Ajcon Research, *Note: Projected figures for FY11E and FY12E are street estimates

ABOUT THE COMPANY

Background

Incorporated in 1983, the company has evolved from a lighter age operator to a fully integrated shipping company. Today, it is the second largest private sector company in India (by aggregate fleet tonnage capacity with global presence through its subsidiaries). It was in 1989, that the current promoter of the company took charge of the operations and entered into the tanker and dry bulk segments. The company along with its subsidiaries has diversified interests in Tankers, Bulk Carriers, Dredgers, Offshore drilling, Coal Mines and Logistics.

Its current fleet comprises of 30 vessels, which includes 17 dry bulk carriers, seven crude/product tankers, four dredgers and two floating storage units. The company's consolidated shipping fleet

capacity was ~3.47 mn DWT (dead weight tones) as on March 2010. The company also owns coalmines in Indoneasia and Mozambique.

The group caters to Indian/International oil majors, large thermal based power plants and steel companies. The group has established relationships with its reputed end user customers such as Indian Oil Corporation, BG Exploration and Production, Major Ports in India, Vale, Tata Power, Arcelor Mittal Group, COSCO group and Afren PLC.

Employing a large part of its fleet on long term contracts, specifically time charters and contracts of affreightment ("COAs")/consecutive voyage ("CV") has been the group's strategy. Its long term fixed rate contracts, ranging from 11 months to five years and above, ensures revenue visibility and cash flow stability.

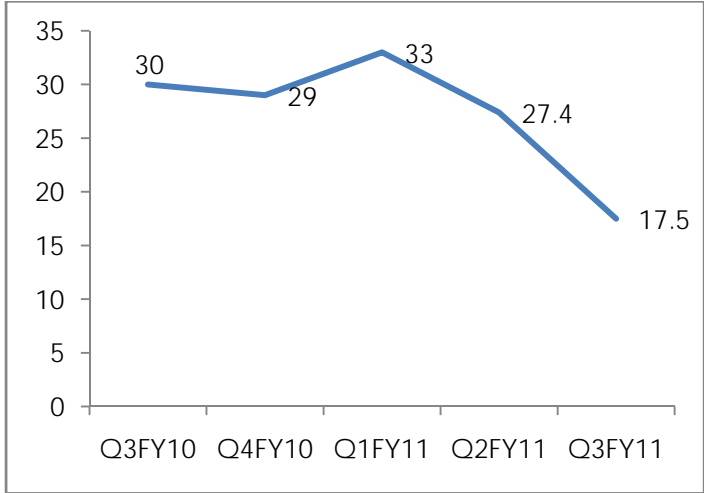
INVESTMENT RATIONALE

Q3FY11 Result update

On a yoy basis, revenues of the company witnessed yoy growth of 65.8% to touch Rs. 7,754mn. This was mainly on account of coal division contributing more than 50% of topline in Q3FY11. Coal division witnessed a yoy increase of 171% and 52% on qoq basis to touch Rs. 4,212 mn.

On the margin front, OPM witnessed a decline of 1,270 bps to touch 17.5% in Q3FY11, while on qoq basis OPMs registered a decline of 993 bps. This was mainly attributable to increase in operating expenses and higher vessel charges.

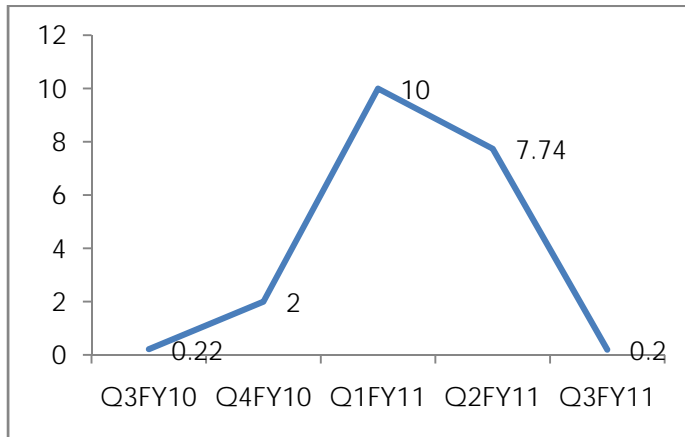
Trend of OPM Performance (Rs in mn)



Source: Company, Ajcon Research

PAT witnessed yoy growth of 56% to touch Rs. 16 mn, whereas on qoq basis, PAT registered a decline of 97%. PAT margin was under pressure and registered a decline of 759 bps on qoq basis to touch 0.2% in Q3FY11.

Tend in PAT margin (in %)



Source: Company, Ajcon Research

Key development in Q3FY11

It has contracted to sell its jack up rig to Greatship Ltd., which is a subsidiary of GE shipping. With this event, the company has completely exited the offshore business as it intends to focus and scale up its floating production and storage business.

Inherent advantages

a) Diversified revenue stream

Segment	Contribution to revenues (FY10)	Activities	Clients	Operating days (FY10)	Time charter equivalent (FY10)
Dry Bulk Segment	37%	Transportation of Coal	Vale, Arcelor Mittal, Tata Power, COSCO	5,038	US\$26,310
Coal Segment	24%	Coal Mining, Coal Trading, Coal transportation and logistics for Thermal Power Stations	BSES	-	-
Tankers Segment	25%	Transportation of Crude and Oil Products	IOC, MRPL, Reliance, British Gas, Chevron	3,541	US\$14,684
Dredging Segment	5%	-	-	1,090	US\$13,557
Offshore Drilling Segment	9%	-	-	-	-

Source: Company



Segment contribution in Q3FY11 and 9MFY11

Segment	Contribution to revenues (Q3FY11)	Contribution to revenues (9MFY11)	EBIT Margin (%) Q3FY11	EBIT Margin (%) 9MFY11
Shipping	41.1	70.6	(0.28)	15.5
Offshore	4.9	8	74.3	74.3
Coal	54	21.4	8.85	20.6

Source: Company

Long term charter contracts

The company has long term contracts in the dry bulk segment thus insulating it from any volatility in the dry bulk rates.

Coal business to drive growth

The company expects to trade ~10 MTPA of coal in FY12E as compared to 4MTPA in FY10. The coal division contributed 54.3% in Q3FY11 with an EBIT margin of 8.85%.

Key concern

Promoters have pledged 33.4% of their stake in the company

OUTLOOK AND VALUATION

At the CMP, the stock is valued at 6x at consensus estimated FY12 EPS. As per consensus estimates, the company is expected to witness revenue CAGR of 42% and earnings CAGR of 85% over the period FY10-12E.

We believe freight rates to be volatile given the uncertainty in global oil demand after the recent quake in Japan, which would affect the operating performance of the tanker division. Considering rising oil prices due to political tensions in MENA (Middle East –North Africa) region, its OPM would be affected due to higher bunker costs. As evident from Q3FY11 results, the company has increased its focus on low margin coal trading and mining activities, leading to decline in overall margin of the company in the next few years.

However, with due consideration to factors like a) diversified revenue stream, b) long term contracts, c) favorable debt: equity ratio of 1.44x as on H1FY11 and d) cheap valuation, we recommend **'BUY'** with a target price of Rs. 55(0.6x estimated FY12 Book Value) for investors with a horizon of 6-9 months.



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