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16 Jan 2003

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Mercator Lines Ltd

Result Update – QE Dec 03

We had recommended Mercator Lines at Rs.158 two months back. The stock is up 82% since then. The company has reported net profit of Rs.139mn for the December quarter as compared to Rs.84mn in QE Sep-03 and Rs.17mn in QE Dec-02. The aframax market has further strengthened in the last two months.

Fair Value Rs.460

Price Rs.285

+62%

The stock currently **trades at mere 2.2 times diluted EPS (Rs.132) for FY05**. We expect its **earnings to grow more than seven-fold this year and 100% plus next year** driven largely by buoyant aframax market and vessel acquisitions. We estimate DCF fair value at around Rs.460 (revised upwards from Rs.354 in Oct-03). The DCF value takes into account dilution from the proposed preferential issue of equity shares and warrants. On trailing diluted EPS, Mercator currently trades at 9 times (6 times undiluted trailing EPS). As against this, other shipping companies trades at much higher multiple of trailing undiluted EPS – Varun Shipping at 9.9 times, G E Shipping at 11.8 times, SCI at 13.3 times, and Essar Shipping at 13.8 times.

During the quarter, revenues and EBITDA increased four fold due to new **tanker acquisitions and buoyant freight market**. Mercator had acquired a tanker each in April, July, and Sep-03. It acquired another aframax tanker in QE Dec-03 and this tanker has been deployed effective Jan-04.

PAT for the quarter and 9 months ended Dec-03 **increased eight-fold and six-fold** respectively due to lower than commensurate growth in depreciation and interest costs.

Promoters' shareholding came down a little from 48.54% at end Sep-03 to 45.82% at end Dec-03. **Institutional investors raised their stake from 2.51% at end Sep-03 to 7.13%** at end Dec-03. Promoters and institutional investors' shareholding is likely to increase post a preferential issue, which was approved by the company board yesterday. The preferential issue of shares and warrants will not be at a price less than Rs.275.

We expect the **performance in QE Mar-04 to improve further** as freight rates for aframax tankers have strengthened further. This led to an upward revision in the World Scale (WS) effective Jan-04. Revenue from its existing contracts are linked to WS. Even if the tanker market corrects from the current levels, the redeployment is likely at higher rates than the currently contracted rates. The current spot rates are significantly higher than the rates on existing contracts.

Revenues, and depreciation & interest costs will be higher in the QE Mar-04 due to deployment of one more tanker effective Jan-04. **PAT is likely to rise more than 12-fold YoY for the QE Mar-04. We estimate total after tax profit of over Rs.400mn for FY04.**

Please refer our report of 22 Oct 03 for detailed analysis.



Financial Table: Mercator Lines Ltd						
Rs.mn	Dec-03	Dec-02	Change	Dec-03	Dec-02	Change
No. of months	3	3	%	9	9	%
Income from Operations	725	183	295.9%	1,465	488	200.5%
Total Expenditure	518	133	290.0%	1,030	350	194.6%
EBIDTA	207	50	311.5%	435	138	215.3%
Depreciation	27	21	29.2%	87	58	49.9%
EBIT	180	30	509.8%	348	80	334.4%
Other income	1	0	235.2%	3	1	158.1%
Interest	29	12	133.6%	64	32	101.5%
PBT	152	17	774.9%	288	50	478.2%
Tax	13	0		35	7	
PAT	139	17	708.5%	252	42	493.7%
Adjusted PAT	139	17	708.5%	252	42	493.7%
Equity Capital	55	55		55	55	
Annualized EPS (Rs)	101.28	12.51	708.5%	61.16	10.30	493.7%
EBITDA Margin (%)	28.5%	27.5%	1.08%	29.7%	28.3%	1.40%
EBIT Margin (%)	24.8%	16.1%	8.71%	23.8%	16.5%	7.33%
Adj PAT Margin (%)	19.2%	9.4%		17.2%	8.7%	
Other Income/PBT (%)	0.4%	1.2%		1.0%	2.2%	
Tax/PBT (%)	8.3%	0.6%		12.3%	14.6%	
Operating Exp % of Income	476 65.6%	118 67.4%	304.0%	960 65.5%	321 65.9%	198.8%
Staff Costs % of Income	18 2.4%	3 1.6%	497.2%	35 2.4%	7 1.5%	383.6%
Loss on sales of Assets % of Income	20 2.8%	7 3.6%	208.6%	20 1.4%	7 1.4%	506.5%
Other Costs % of Income	5 0.6%	6 0.0%	-17.2%	15 1.0%	15 1.8%	1.9%



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