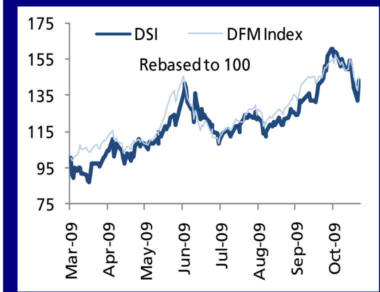
GCC Equities

SICO Research

Current Price	AED 1.06
Target Price	AED 1.23
52 wk Hi/Low	AED 1.22/0.64
Rating	
Short-term	Neutral
Long-term	Add
Risk Profile	Market

See last page for definitions

Sector	Construction
Market Cap	USD 625mn
Primary Exchg	DFM
Other Exchg	-NA-
Reuters	DSI.DU
Bloomberg	DSI UH



VALUATION RATIOS

	2008A	2009E
P/E x	11.0	7.4
P/BV x	1.03	0.93
EV/EBITDA x	6.11	4.9
Div Yld x	0.0	2.7

TRADING DATA*

Daily Vol (6M Avg '000)	59,535
Daily T/o (6M Avg US$'000)	15,884
Issued Shares (mn)	2177

*Since listing on March 16, 2009.
Price as on 02 Nov 2009

www.sicobahrain.com

Nishit Lakhotia, CFA
Tel. (973)1751 5000 (ext 5084)
nishit.lakhotia@sicobahrain.com

بنك استثماري Investment Bank sico

November 03, 2009

Drake & Scull International (DSI)

Result Update 3Q09

DSI reported a 22% decline in revenues (AED 400 million) and a 20% drop in net profits (AED 86.5 million) for 3Q09 on a QoQ basis. The top-line was in line with our estimates but bottom-line was higher than our estimates primarily due to higher gross margins. Gross margins in 3Q09 were 22.7% versus our forecast of 19%; emphasising that the company is benefitting from lower construction costs and has not faced any significant renegotiation of existing contracts.

Operating margins declined to 13.1% in 3Q09, from 14% in 2Q09, due to higher selling and administrative expenses (SG&A). DSI had AED 1 billion cash (IPO proceeds) in time deposits as of 3Q09, generating AED 20.2 million in interest income both in 3Q09 and in 2Q09. Interest income contributed 28.6% to the total net profits for the company in 3Q09. DSI intends to use most (AED 500 million) of the IPO proceeds for acquisitions. Management confirmed the finalisation of one acquisition and alluded to its plans for more acquisitions in the next two to three quarters.

Interest income should accordingly decline in FY10 once DSI starts deploying its IPO proceeds for acquisition financing; which may result in lower net profits in FY10 for the company depending on the earnings profile of the acquired companies.

Exhibit 1: 3Q09 highlights and comparison

AED ('000)	3Q09	2Q09	QoQ
Total Revenues	399,709	512,033	-22%
Cost of Revenue	309,074	403,221	-23%
Gross profit	90,635	108,812	-17%
Gross Margins	22.7%	21.3%	
SG & A	34,759	33,502	4%
Operating Profit	52,176	71,610	-27%
OPM	13.1%	14%	
Finance costs	2,332	2,612	-11%
Other Income	20,932	21,139	-1%
Net Profit	70,776	90,137	-21%
Net Profit Margin	17.7%	17.6%	
Minority Interests (MI)	1,812	3,582	-49%
NP (after MI)	68,964	86,555	-20%

Source: Company data, SICO Research
Note: SG&A = Selling, General and Administration expenses, OPM = Operating Profit Margin

Cash conversion cycle improved marginally but receivables still a concern

DSI's total receivables declined marginally by 3% to AED 1,076 million but total payables also declined by 4.6% to AED 803 million on a QoQ basis. Inventory declined by 5.5% in 3Q09 to AED 260 million resulting in a marginal improvement in cash conversion for the company. DSI has approximately 61.5% of its total receivables as past due. The company has not made any provisions on its receivables and the bottom-line may get adversely impacted in FY10 in case the company is not able to realise its receivables.

In our valuations, we have assumed payment issues to persist until FY10 and DSI to borrow short term to fund its working capital.

Addition of AED 530 million to backlog

DSI added close to AED 530 million to its order backlog in 3Q09, winning an AED 130 million mechanical, electrical, and plumbing (MEP) contract for a luxury condominium development in Thailand, and an AED 400 million MEP development contract for a mixed-use project in Abu Dhabi. According to management, backlog as on 3Q09 is approximately AED 3 billion.

DSI was awarded AED 2 billion in new orders and generated revenues of close to AED 1.4 billion YTD, translating to a net addition of AED 600 million to its backlog in FY09. However, management stated that district-cooling project at Durrat Al Bahrain (AED 596 million) may be cancelled. If this is the case, then the current backlog reduces to approximately AED 2.4 billion, which is 1.4x its FY08 revenues.

Although possible cancellation of Durrat al Bahrain's district cooling project is a concern, we expect company to maintain the pace of growth of new order wins in the next two quarters. DSI has submitted tenders for 5 to 6 projects in Saudi Arabia, and expects to win projects in Jordan and Libya in the next two quarters. These order wins will improve the revenue visibility for the company.

Recommendation – 'Add' for long term

We assign long-term 'Add' rating for DSI based on our target price of AED 1.23 per share, which translates into an upside of 17% from current market price of AED 1.06 per share. Based on 9M09 EPS of AED 0.11 per share, the company is currently trading at an annualised PE of 7.2x, at a discount to the sector median PE of 11.2x. We have a "Neutral" short-term rating for the stock as the current volatility in broader markets, uncertainty on the company's contract in Durrat Al Bahrain project and overall negative sentiment on Dubai's construction sector may limit the stock's upside move.

NOTES

Contact Details

BMB Centre, 1st Floor
P.O Box 1331,
Diplomatic Area
Manama
Kingdom of Bahrain

Investment Research
research@sicobahrain.com

Head of Research
Jithesh K Gopi, CFA
Tel: (Direct): +973 – 17515021

Head of Brokerage
Bassam A. Khoury
Tel: (Direct): +973 – 17515202

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Securities & Investment Company BSC

Analyst Stock Rating Definitions

Time horizon	
Short term	SICO Research issues a Short term outlook if the analyst feels that there are factors which might affect the short-term performance of the stock during the immediate six months after issuing a rating. This might be due to both quantitative and qualitative factors which the analyst think can affect the price Performance in the short- term. Short term outlook can be different from the long term rating and the estimated up side or down side from the current price based on the fair value estimate for the company
Long term	SICO Research's Long-term rating is based on the fair value target price (given below) calculated by the analyst. The fair value is arrived at using both fundamental and comparative valuation methods based on the detailed Financial models developed by analysts incorporating current expectations and analyst's assumptions.
	Fair value for a stock is calculated as of the valuation date
Recommendation (Short term)	
Positive	Analyst expect positive triggers/events in the short term which might affect current price positively
Neutral	Analyst does not expect any short term triggers/events
Negative	Analyst expect negative triggers/events in the short term which might affect current price adversely
Recommendation (Long term)	
Buy	Fair value estimate exceeds 25% from the current share price.
Add	Fair value estimate exceeds 10% but less than 25% from the current share price.
Neutral	Fair value estimate is between +/- 10% from the current share price.
Reduce	Fair value estimate is lower by more than 10% but less than 25% from the current share price.
Sell	Fair value estimate is lower by more than 25% from the current share price.
Risk	
High	Share price movements are more volatile compared to market, 6 months beta more than 1.2.
Market	Share price movements are as volatile as the market, 6 months beta between 0.8 and 1.2.
Low	Share price movements are less volatile compared to market, 6 months beta less than 0.8.
	Beta is calculated with reference to the respective country benchmark index (Source: Bloomberg)