

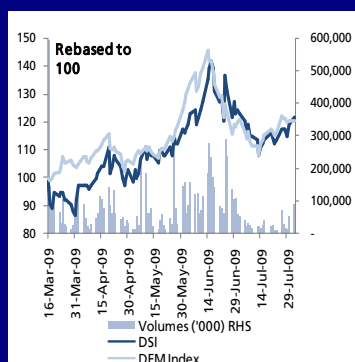
August 04, 2009

SICO
Research

Current Price AED 0.93
Target Price AED 1.22
52 wk Hi/Low AED 1.08/0.64
Rating
Short-term Positive
Long-term Buy
Risk Profile Medium

See last page for definitions

Sector Construction
Market Cap USD 551mn
Primary Exchg DFM
Other Exchg -NA-
Reuters DSI.DU
Bloomberg DSI UH

**VALUATION RATIOS**

	2008A	2009E
P/E x	9.6	7.4
P/BV x	0.91	0.83
EV/EBITDA x	4.7	4.65
Div Yld x	0.0	2.2

TRADING DATA*

Daily Vol (6M Avg '000)	81,555
Daily T/o (6M Avg US\$'000)	18,807
Issued Shares (mn)	2173
*Since listing on March 16-2009.	
Price as on 03 August 2009	

Drake & Scull International (DSI)**2Q09 Result Update**

DSI reported a 4.9% increase in revenues (AED 512mn) and 12.2% growth in net profits (AED 86.5mn) for 2Q09 compared to the previous quarter, with gross margins improving to 21.3% from 17.9% in the first quarter. We believe lower construction costs and completion of projects in 1H09 have helped the company to achieve higher margins for the second quarter. Interest Income, which is more than 95% of other income, contributed more than 20% to the company's net profits as it yet to deploy the bulk of the AED 1.2bn IPO proceeds it raised in July 2008.

Exhibit 1: 2Q09 highlights and comparison

AED ('000)	2Q09	1Q09	QoQ
Total Revenues	512,033	488,091	4.9%
Cost of Revenue	403,221	400,709	0.6%
Gross profit	108,812	87,382	24.5%
Gross Margins	21.3%	17.9%	
SG & A	33,502	25,358	32.1%
Management fees	3,700	3,700	0.0%
Operating Profit	71,610	58,324	22.8%
OPM	14.0%	11.9%	
Other Income	21,139	24,228	-12.7%
NP (after MI)	86,555	77,169	12.2%
Net margins (after MI)	16.9%	15.8%	

Source: Company data, SICO Research

Note: SG&A = Selling, General and Administration expenses, OPM = Operating Profit Margin

Payment delays to worsen cash conversion cycle

Like most other contractors operating in Dubai, DSI is facing difficulty in getting timely payments from its clients. At the end of 2Q09, its total receivables (including due from related parties) increased by AED 244mn (30%) QoQ while its total payables (including due to related parties) remained at similar levels on a Quarter to Quarter basis. We do not see this as a concern currently for DSI as it has a healthy cash balance of more than AED 1bn. additionally, the company has a strong balance sheet with a total debt to capital ratio of 5.8%, which it can leverage comfortably if required.

Consistent backlog addition – a key positive

DSI added close to AED 1.4bn to its backlog in 2009 across MEP, IWP and Civil segments, which brings the total existing backlog to AED 2.9bn, as of 2Q09 end. The new order additions during 1H09 were more than the revenue recognised by the company during the period implying a net addition to the order backlog. We expect DSI to soon confirm an additional AED 250mn civil contract for its subsidiary Gulf Technical Construction Company (GTCC) to build town houses in Jumeirah, Dubai. Additionally, there is a very high probability of DSI getting projects in Thailand, Libya and Jordan in the near term. In the current challenging environment, it is encouraging to see DSI win projects in Dubai and also across the MENA region. We have assumed order additions of AED 1.1bn during the period August-December 09 in addition to the AED 1.4bn awarded to the company to date.

Gross contract margins to decrease but still to be at higher levels

DSI reported a 2Q09 gross contract margin of 21.3% which we do not think is sustainable in the current environment. Current retention receivables declined by AED 94mn i.e. 35% QoQ which is generally associated with completion of projects. Contractors usually book higher revenues relative to contract costs at the time of contract completion and this may have led to higher gross margins

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in 2Q09. We expect margins to contract to 19.2% for 2H09 from 19.6% in 1H09, which is higher than our earlier estimate of 16.8% for FY09.

The company's current backlog has 38% of IWP projects which has higher gross margins (20%+) compared to MEP (16-17%) and Civil (13%). In 2Q09, approximately 20% of the revenues came from IWP projects. Gross margins will be under pressure during FY10-11 due to increasing competition and renegotiation of few of the existing contracts. However, as we expect IWP projects contribution to total revenues to increase in future, the company will be able to sustain gross margins at above 17% for the forecast period (FY09-12).

Higher management fees to dent net profits till FY10

DSI has to pay AED 74mn over three years (FY08-10) in management fees to the Drake and Scull Group. The company has so far paid AED 22.2mn during the last six quarters as fees leaving an additional AED 51.8mn to be paid in the coming six quarters. On an equalised basis, this will imply an additional expense of AED 8.6mn per quarter (10% of 2Q09 profits) and will adversely affect its net margins.

Utilisation of IPO proceeds

DSI has kept more than AED 1bn from IPO proceeds currently in interest generating time deposits. The company has plans to do acquisitions (4 companies) in Saudi Arabia, Kuwait and Qatar in the near future and has allocated a budget of AED 500mn for the same. We currently have not assumed any upside from expected acquisitions in our valuations. DSI also plans to buy back 10% of its outstanding capital and has already purchased close to 9.6mn shares out of 2.1bn shares outstanding at the end of 2Q09.

Recommendation – Maintain 'BUY', target price revised to AED 1.22 per share

We maintain our long term 'Buy' rating for DSI based on our revised fair value target price of AED 1.22 per share from (earlier AED 1.09 per share), an upside potential of 31% from current market price of AED 0.93 per share. We revise our revenue estimate to AED 1.8bn from AED 1.3bn previously with gross margins at 19.4% for FY09. The increase in revenue estimates is due to 1) increase in assumed additions to order book in FY09 from AED 1.9bn earlier to approximately AED 2.5bn based on the trend in backlog additions and management discussions, and 2) orderly execution of projects (on an overall basis) in the current backlog compared to severe delays assumed by us previously. Accordingly we have made our revenue realisation from current projects in line with the current speed of execution.

We also have a "Positive" short term rating for the stock as we expect announcement of new orders awarded to the company in the near term to act as short term triggers.

Financial Statement and Key Ratios

Drake and Scull - Income Statement

AED mn	2008A	2009E	2010E	2011E	2012E
Revenue	1,720	1,803	1,931	2,191	2,487
Contract costs	1,396	1,454	1,585	1,809	2,052
Gross Profit	324	349	346	382	435
SG&A	168	117	132	169	163
Management fees	15	25	35	0	0
Operating Profit	141	207	179	214	273
Other Income	36	9	10	16	19
Finance Costs	9	13	6	5	4
Interest income	44	76	54	49	44
Profit before tax	212	280	237	274	331
Tax	0	1	1	3	7
Profit after tax	212	279	236	271	324

Drake and Scull - Balance Sheet

AED mn	2008A	2009E	2010E	2011E	2012E
Inventories	278	366	393	359	366
Contract & Ret. Receivables	657	901	869	881	875
Due from related parties	18	13	18	15	17
Prepayments & other receivables	101	152	171	161	166
Bank balances and cash	1,399	997	1,191	1,462	1,844
Other current assets	83	38	38	38	38
Total Current Assets	2,537	2,467	2,680	2,916	3,306
PP&E (net)	172	188	197	200	208
Goodwill	830	830	830	830	830
AFS investments	13	13	13	13	13
Total Assets	3,552	3,497	3,720	3,959	4,357
Accounts Payable	582	586	672	735	806
Due to related parties	15	10	12	12	14
Adv. from customers	317	277	222	182	232
Short term loans	310	87	70	57	55
Excess billings	54	36	39	44	50
Total Current Liabilities	1,277	997	1,015	1,030	1,157
Total long term debt	8	6	3	1	-
Other liabilities	21	34	51	72	99
Minority Interests	10	18	25	34	42
Total Shareholders Equity	2,235	2,443	2,625	2,822	3,060
Total Liabilities and Equity	3,552	3,497	3,720	3,959	4,357

Drake and Scull - Cash Flow Statement

AED mn	2008A	2009E	2010E	2011E	2012E
Net Income	212	279	236	271	324
Depreciation	23	23	41	54	73
Other Adjustments	(44.48)	(50.66)	(31.25)	(22.75)	(13.13)
Working Capital changes	(251.89)	(434.66)	15.90	62.61	121.04
Cashflow from Operations	(61.34)	(183.21)	260.99	365.10	504.86
Capital Expenditure	(96.96)	(36.76)	(46.28)	(52.80)	(75.29)
Other inv. Activities	42.22	66.99	54.81	49.50	44.88
Cashflow from Investing	(54.74)	30.24	8.53	(3.30)	(30.42)
Equity raised	1,198.00	-	-	-	-
Debt raised/repaid	189.42	(225.18)	(19.48)	(16.09)	(2.53)
Dividends	-	(54.37)	(45.60)	(65.67)	(79.24)
Other financing activities	95.64	29.79	(9.74)	(9.71)	(10.87)
Cash flow from financing	1,483.07	(249.75)	(74.82)	(91.47)	(92.65)
Net chg in Cash	1,366.99	(402.72)	194.70	270.33	381.80

Year ending 31 Dec.	2008A	2009E	2010E	2011E	2012E
Liquidity Ratios					
Current Ratio	1.99	2.47	2.64	2.83	2.86
Quick Ratio	1.77	2.11	2.25	2.48	2.54
Operating Cashflow ratio	-0.05	-0.18	0.26	0.35	0.44
Cash conversion Cycle	-1	93	86	48	25
Operating performance ratios					
Gross margins	18.8%	19.4%	17.9%	17.5%	17.5%
Operating profit margins	8.2%	11.5%	9.3%	9.8%	11.0%
Net Income Margins	12.3%	15.5%	12.2%	12.4%	13.0%
Return Ratios					
ROAA	8.1%	7.9%	6.5%	7.1%	7.8%
ROAE	13.7%	11.6%	9.0%	9.6%	10.8%
ROCE	7.8%	8.7%	7.0%	7.9%	9.1%
Solvency Ratios					
Interest Coverage Ratio	18.9	16.6	31.9	49.6	72.2
Debt/Capital	12.5%	3.7%	2.7%	2.0%	1.8%
Total Assets/total Liabilities	2.7	3.3	3.4	3.5	3.4
Valuation Ratios					
EPS (AED)	0.096	0.125	0.105	0.121	0.146
BVPS (AED)	1.03	1.12	1.21	1.30	1.41
P/BV	0.91	0.83	0.77	0.71	0.66
P/E	9.6	7.4	8.8	7.7	6.4
EV/Ebitda	4.70	4.65	3.92	2.16	0.63
EV/Sales	0.55	0.62	0.47	0.28	0.09
Dividend yield	0.0%	2.7%	2.3%	3.3%	3.9%

NOTES

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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)

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