

12 August 2011

Buy

Target price
Dh1.15

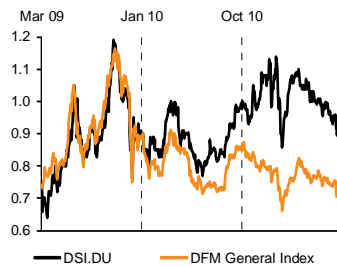
Price
Dh0.90

Short term (0-60 days)
n/a

Market view
No Weighting

Price performance

	(1M)	(3M)	(12M)
Price (Dh)	1.00	1.07	0.82
Absolute (%)	-9.6	-15.9	9.6
Rel market (%)	-4.4	-7.6	11.0
Rel sector (%)	-9.6	-15.9	9.6



Market capitalisation
Dh1.96bn (€374.40m)

Average (12M) daily turnover
Dh9.28m (US\$2.58m)

Sector: European-DS Tot Mrkt
RIC: DSI.DU, DSI UH
Priced Dh0.90 at close 11 Aug 2011.
Source: Bloomberg

Analysts

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Drake & Scull

Strong growth momentum continues

Solid 2Q results beat both our revenue and earnings forecasts, maintaining the strong growth momentum that began in 4Q10. We raise our FY11-14F revenue by an average of 10%, but keep our earnings forecasts as we reduce our gross margins forecasts by 130bp on increasing contribution from the civil segment.

Key forecasts

	FY09A	FY10A	FY11F	FY12F	FY13F
Revenue (Dhm)	1,917	1,855	2,840 ▲	2,967 ▲	3,095 ▲
EBITDA (Dhm)	263.9	183.5	270.5	280.2	284.2
Reported net profit (Dhm)	260.7	154.6	204.6	214.5	230.2
Normalised net profit (Dhm)	260.7	154.6	204.6	214.5	230.2
Normalised EPS (Dh)	0.12	0.07	0.10	0.10	0.11
Dividend per share (Dh)	0.07	0.00	0.00	0.00	0.00
Dividend yield (%)	7.78	0.00	0.00	0.00	0.00
Normalised PE (x)	7.48	12.50	9.44	9.00	8.39
EV/EBITDA (x)	6.61	13.00	7.94	7.05	6.14
EV/invested capital (x)	0.76	0.80	0.73	0.66	0.58
ROIC - WACC (%)	0.00	0.00	0.00	0.00	0.00

Accounting standard: IFRS
Source: Company data, Rasmala forecasts

year to Dec, fully diluted

Solid 2Q results

DSI reported 2Q11 revenue of Dh739m (up 15% qoq and 80% yoy), beating our estimate of Dh670m (Bloomberg consensus: Dh668m) by 10% as the company maintained its strong growth momentum that began in 4Q10. Net income of Dh51m (up 12% qoq and 5% yoy) was 8% above our estimate of Dh48m (consensus: Dh49m). Gross margin of 14.2% was 140bp below our estimate due to the revenue mix shift towards the civil segment. However, SG&A expense was 60bp below our estimate of 7.6%, thereby partially offsetting the impact of lower gross margins on earnings.

Secured Dh3,263m in contracts in 1H11

After securing contracts worth Dh2,610m in 1Q11, the company secured a further Dh653m in contracts during 2Q11, taking the total contracts secured in 1H11 to Dh3,263m. The company ended the quarter with a total backlog of Dh7.5bn. Saudi remained the major contributor to the backlog, contributing 47%, followed by Abu Dhabi at 15%, Dubai at 13% and others at 25%. The company started its operations in Algeria during the quarter and is further planning to expand into new geographies such as India, Iraq, Vietnam and Djibouti.

Raise our revenue forecasts by 10%, but maintain earnings forecast on lower margins

We raise our annual revenue forecasts by an average 10% for 2011-14 because we expect the company to maintain its strong growth trajectory during the foreseeable future. Management expects gross margin to rise during 2H11, as it expects the revenue mix to shift towards the higher-margin IWP segment. However, we believe with the lower-margin civil segment contributing 45% to the current backlog and the IWP segment contributing only 12%, the rise in margins would be unsustainable. Hence, we revise our gross margin estimate downwards by an average 130bp during our forecast period. However, we maintain our earnings forecasts as our lower gross margin forecasts offset the impact of our higher revenue forecasts. We see an upside to our earnings forecasts if margins are better than we expect. We reiterate our Buy rating and price target of Dh1.15 per share.

Important disclosures can be found in the Disclosures Appendix.

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Income statement

Dhm	FY09A	FY10A	FY11F	FY12F	FY13F
Revenue	1917	1855	2840	2967	3095
Cost of sales	-1529	-1510	-2423	-2539	-2660
Operating costs	-123.8	-160.9	-147.0	-147.0	-150.6
EBITDA	263.9	183.5	270.5	280.2	284.2
DDA & Impairment (ex gw)	-83.0	-66.5	-104.3	-109.4	-115.4
EBITA	180.9	117.1	166.1	170.8	168.8
Goodwill (amort/impaird)	0.00	0.00	0.00	0.00	0.00
EBIT	180.9	117.1	166.1	170.8	168.8
Net interest	28.7	13.7	13.4	14.9	31.8
Associates (pre-tax)	0.00	0.00	0.00	0.00	0.00
Other pre-tax items	57.6	25.3	40.9	42.4	44.3
Reported PTP	267.2	156.1	220.4	228.2	244.9
Taxation	-0.86	5.38	-0.90	0.00	0.00
Minority interests	-5.60	-6.89	-14.9	-13.7	-14.7
Other post-tax items	0.00	0.00	-0.00	0.00	0.00
Reported net profit	260.7	154.6	204.6	214.5	230.2
Tot normalised items	0.00	0.00	0.00	0.00	0.00
Normalised EBITDA	263.9	183.5	270.5	280.2	284.2
Normalised PTP	267.2	156.1	220.4	228.2	244.9
Normalised net profit	260.7	154.6	204.6	214.5	230.2

Source: Company data, Rasmala forecasts

year to Dec

Balance sheet

Dhm	FY09A	FY10A	FY11F	FY12F	FY13F
Cash & market secs (1)	878.4	358.9	793.9	966.9	1197
Other current assets	2240	2915	3263	3368	3434
Tangible fixed assets	211.5	249.7	511.9	554.7	596.7
Intang assets (incl gw)	821.8	1149	1182	1149	1115
Oth non-curr assets	249.0	198.0	165.1	165.1	165.1
Total assets	4401	4871	5916	6203	6509
Short term debt (2)	503.5	787.2	740.0	740.0	740.0
Trade & oth current liab	1157	1488	2109	2168	2229
Long term debt (3)	159.9	2.15	242.1	242.1	242.1
Oth non-current liab	64.3	51.2	58.3	58.3	58.3
Total liabilities	1885	2329	3150	3209	3270
Total equity (incl min)	2515	2542	2766	2994	3239
Total liab & sh equity	4401	4871	5916	6203	6509
Net debt	-215.0	430.4	188.3	15.2	-215.3

Source: Company data, Rasmala forecasts

year ended Dec

Cash flow statement

Dhm	FY09A	FY10A	FY11F	FY12F	FY13F
EBITDA	263.9	183.5	270.5	280.2	284.2
Change in working capital	-450.8	-347.6	25.9	-45.9	-102.5
Net interest (pd) / rec	-58.8	-0.90	-3.38	-5.13	-9.66
Taxes paid	-1.39	3.80	0.00	0.00	0.00
Other oper cash items	73.4	30.4	113.3	47.6	150.5
Cash flow from ops (1)	-173.7	-130.8	406.3	276.8	322.5
Capex (2)	-16.2	-61.5	-253.4	-118.7	-123.8
Disposals/(acquisitions)	1.75	1.37	0.80	0.00	0.00
Other investing cash flow	-418.9	-242.3	91.2	69.9	86.8
Cash flow from invest (3)	-433.4	-302.4	-161.4	-48.7	-37.0
Incr / (decr) in equity	0.00	0.00	0.00	0.00	0.00
Incr / (decr) in debt	263.5	64.5	183.0	0.00	0.00
Ordinary dividend paid	0.00	-151.4	0.00	0.00	0.00
Preferred dividends (4)	0.00	0.00	0.00	0.00	0.00
Other financing cash flow	-240.3	-178.7	-47.0	-55.0	-55.0
Cash flow from fin (5)	23.2	-265.6	136.0	-55.0	-55.0
Forex & disc ops (6)	-2.95	-4.26	-0.77	0.00	0.00
Inc/(decr) cash (1+3+5+6)	-586.8	-703.1	380.2	173.1	230.5
Equity FCF (1+2+4)	-189.9	-192.3	152.9	158.1	198.7

Source: Company data, Rasmala forecasts

year to Dec

Recommendation structure

Absolute performance, long term (fundamental) recommendation: The recommendation is based on implied upside/downside for the stock from the target price and only reflects capital appreciation. A Buy/Sell implies upside/downside of 10% or more and a Hold less than 10%.

Performance parameters and horizon: Given the volatility of share prices and our pre-disposition not to change recommendations frequently, these performance parameters should be interpreted flexibly. Performance in this context only reflects capital appreciation and the horizon is 12 months.

Market or sector view: This view is the responsibility of the strategy team and a relative call on the performance of the market/sector relative to the region. Overweight/Underweight implies upside/downside of 10% or more and Neutral implies less than 10% upside/downside.

Target price: The target price is the level the stock should currently trade at if the market were to accept the analyst's view of the stock and if the necessary catalysts were in place to effect this change in perception within the performance horizon. In this way, therefore, the target price abstracts from the need to take a view on the market or sector. If it is felt that the catalysts are not fully in place to effect a re-rating of the stock to its warranted value, the target price will differ from 'fair' value.

Valuation and risks to target price

Drake & Scull (RIC: DSI.DU, Rec: Buy, CP: Dh0.90, TP: Dh1.15): We value DSI using a DCF methodology, from which we derive our target price. Key risks to our target price include project delays in the UAE that may reduce robust growth expectations from 2011 onward. Also, the company may need to reduce management's five-year earnings CAGR expectations.

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