

17 November 2011

Drake & Scull

Continue to remain constructive

Buy

Target price
Dh1.15

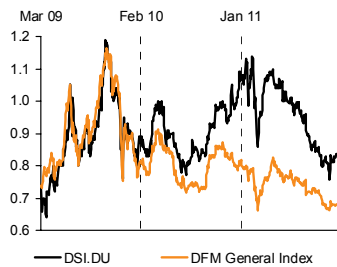
Price
Dh0.83

Short term (0-60 days)
n/a

Market view
No Weighting

Price performance

	(1M)	(3M)	(12M)
Price (Dh)	0.83	0.89	0.95
Absolute (%)	0.0	-6.7	-13.0
Rel market (%)	-0.2	-1.4	6.1
Rel sector (%)	n/a	n/a	n/a



Market capitalisation
Dh1.81bn (€364.18m)

Average (12M) daily turnover
Dh8.61m (US\$2.42m)

Sector: European-DS Tot Mrkt
RIC: DSI.DU, DSI.UH
Priced Dh0.83 at close 16 Nov 2011.
Source: Bloomberg

Analysts

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We maintain our Buy rating on the continuation of strong growth momentum that began in 4Q10 and results outperforming our expectations over the last three quarters.

Key forecasts

	FY09A	FY10A	FY11F	FY12F	FY13F
Revenue (Dhm)	1,917	1,855	3,036	3,342	3,601
EBITDA (Dhm)	263.9	183.5	264.4	291.3	297.2
Reported net profit (Dhm)	260.7	154.6	208.3	217.6	227.7
Normalised net profit (Dhm)	260.7	154.6	208.3	217.6	227.7
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 (%)	8.43	0.00	0.00	0.00	0.00
Normalised PE (x)	6.89	11.50	8.55	8.18	7.82
EV/EBITDA (x)	6.03	12.20	8.21	6.71	5.91
EV/invested capital (x)	0.69	0.75	0.70	0.63	0.56
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 3Q11 results

DSI reported total revenue of Dh847m (up 15% qoq and 96% yoy), beating our estimate of Dh701m by 21% and consensus estimate of Dh668m by 27%. The revenue beat was mainly due to better-than-expected execution. The company's annualised backlog to revenue conversion rate of 45% was 700bp ahead of our estimate. Gross margin moved up 30bp qoq to 14.6% after falling from 18.6% in 2010 to 14.3% in 2Q11 and was 30bp ahead of our estimate. The EBIT margin of 6.5% was also better than our estimate of 6.1%. Overall net profit of Dh58m (up 12% qoq and 89% yoy) beat both our forecast and consensus estimate of Dh49m by 18%.

We increase our 2011-14F revenue by an average 14% but maintain our 2011-14F EPS

We increase our 2011-14F revenue by an average of 14% as we expect execution of Dh3.6bn of projects secured during 9M11 to pick up momentum. Also DSI further expects to secure projects worth Dh1bn during 4Q11. We cut our 2011-14F EBIT margin by an average 40bp per year as we expect contribution of the relatively lower margin civil segment to total revenue to move up from 36% in 3Q11 to 43% by end-2014. We revise down our 2011-14F net interest income by 10% as total debt increased by 22% qoq to Dh733m and DSI expects to raise further debt of Dh73m in 4Q11. Overall we maintain our 2011-14F EPS as we expect the increase in revenue to be offset by declines in EBIT margin and net interest income.

We maintain our Buy rating with a target price of Dh1.15 per share

We remain positive on DSI on the back of it maintaining its strong growth momentum that began in 4Q10 and consistently beating our expectations over the last three quarters. On the other hand Arabtec underperformed our expectations over the last three quarters. Also DSI's gross margin both for TTM and 3Q11 was better than Arabtec by 250bp and 450bp, respectively. We expect this margin differential to be sustained as DSI's backlog quality remains relatively better with the higher margin MEP (Mechanical, Electrical and Plumbing) segment constituting 45% of the total backlog and Saudi being the major contributor at 45%, followed by the UAE at 29%. This compares to Arabtec's backlog, which is primarily civil centric, with the UAE remaining the key contributor at 40%, followed by Saudi at 35%.

Important disclosures can be found in the Disclosures Appendix.

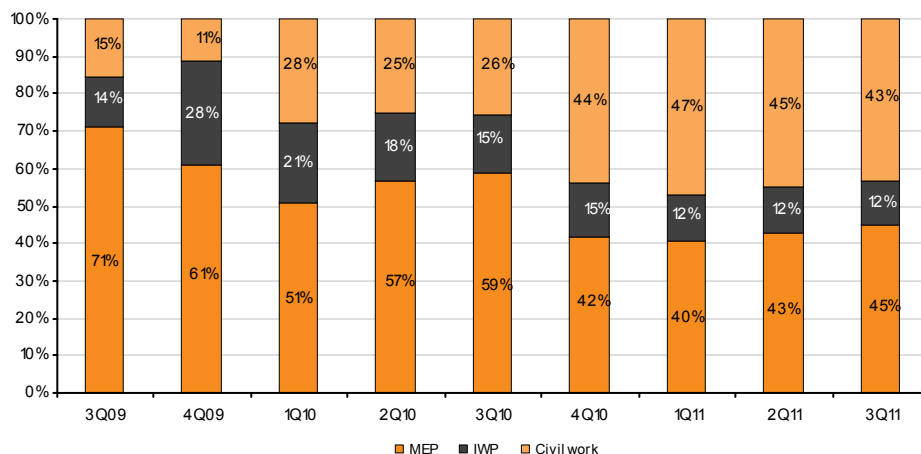
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Table 1 : Forecast revisions

(Dhm)	2011F			2012F			2013F			2014F		
	Old	New	Change	Old	New	Change	Old	New	Change	Old	New	Change
Revenue	2,840	3,036	7%	2,967	3,342	13%	3,095	3,601	16%	3,287	3,886	18%
Net profit	205	208	2%	214	218	2%	230	228	-1%	242	238	-2%

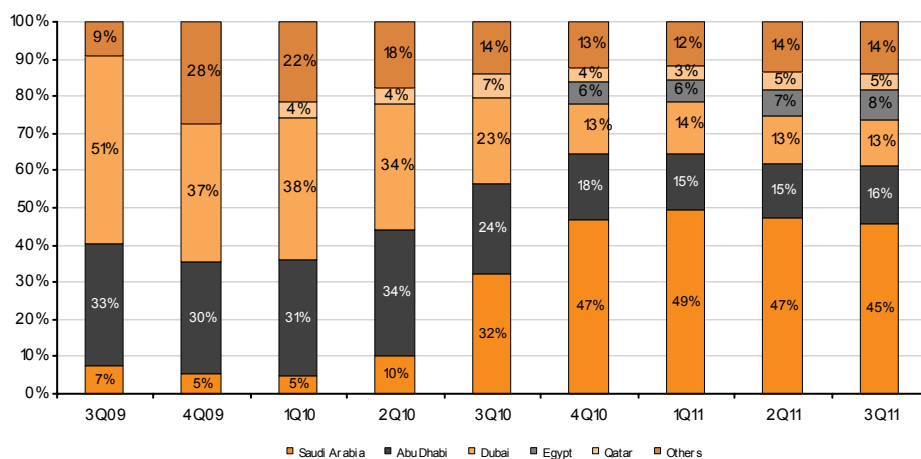
Source: Rasmala forecasts

Chart 1 : Backlog decomposition by business segments



Source: Company data

Chart 2 : Backlog decomposition by geographies



Source: Company data

DSI's total backlog declined to Dh6.7bn in 3Q11 from Dh7.5bn in 2Q11 and the company secured projects worth Dh318m during the quarter compared to Dh3,263m in 1H11. Projects secured during the quarter were:- Abu Dhabi-MEP: Dh170m, Al Ain-IWP (Infrastructure, Water and Power): Dh75m and Kuwait-MEP: Dh73m. The Rotana Gardenia Hotel project in Syria worth Dh79m was discontinued during the quarter and the Al Jawahara tower project in Saudi was scaled down by Dh172m to Dh115m. The total value of projects discontinued/scaled down was about 3.7% of end-3Q11 backlog. However the company expects to secure projects worth Dh1bn during 4Q11, which, based on our estimates, would take total backlog up to Dh6.9bn by end-2011. The company is looking to resume its operations in Libya from 1Q12 and also planning to expand into India, Iraq, Vietnam, Djibouti and other parts of Africa. The MEP segment contributed 45% to the total backlog, followed by civil at 43% and IWP at 12%. Geography-wise Saudi Arabia remained the major contributor to the total backlog comprising 45% of the total backlog, followed by Abu Dhabi at 16%, Dubai at 13%, Egypt at 8% and others at 19%.

In 3Q11 MEP remained the primary contributor to the total revenue at 45%. However, contribution of the civil segment to total revenue moved up from 17% in 2010 to 36% in 3Q11 which was mainly on the back of the contribution of the civil segment to the total backlog moving up from 26% in 3Q10 to 45% in 2Q11. We believe this is also the main reason behind the decline in gross margin from 18.6% in 2010 to 14.6% in 3Q11 as civil is a lower margin business compared to MEP and IWP. During 9M11, UAE remained the key contributor to the total revenue at 42%, followed by Saudi at 39% and others at 19%. However, going forward this trend is expected to change as Saudi is now the primary contributor to the total backlog.

Table 2 : DCF valuation breakdown

	Value (Dhm)	Value per share (Dh)
PV of free cash flow	893	0.41
PV of terminal value	1,271	0.58
Other Assets	303	0.14
Enterprise value	2,466	1.13
Net debt	-112	-0.05
Other Liabilities	-44	-0.02
Minority interest	-80	-0.04
Equity value	2,232	1.02
One year price target		1.15

Source: Company data, Rasmala estimates

We use a DCF approach to derive our target price of Dh1.15. We use a WACC of 10.3%, based on a cost of debt of 5.0% and a cost of equity of 11.8%. We derive our cost of equity using a risk-free rate of 4.0%, an equity market risk premium of 6% and a beta of 1.3.

Key risks to our target price include project delays in the UAE that may reduce robust growth expectations from 2011 onward. Also, we believe the company may need to reduce management's five-year earnings 25% CAGR expectations.

Income statement

Dhm	FY09A	FY10A	FY11F	FY12F	FY13F
Revenue	1917	1855	3036	3342	3601
Cost of sales	-1529	-1510	-2590	-2874	-3119
Operating costs	-123.8	-160.9	-181.8	-176.6	-185.3
EBITDA	263.9	183.5	264.4	291.3	297.2
DDA & Impairment (ex gw)	-83.0	-66.5	-75.7	-99.4	-109.0
EBITA	180.9	117.1	188.7	191.9	188.2
Goodwill (amort/impaird)	0.00	0.00	0.00	0.00	0.00
EBIT	180.9	117.1	188.7	191.9	188.2
Net interest	28.7	13.7	21.6	10.1	22.4
Associates (pre-tax)	0.00	0.00	0.00	0.00	0.00
Other pre-tax items	57.6	25.3	17.4	33.4	36.0
Reported PTP	267.2	156.1	227.7	235.5	246.6
Taxation	-0.86	5.38	-4.40	-3.30	-3.45
Minority interests	-5.60	-6.89	-15.0	-14.5	-15.5
Other post-tax items	0.00	0.00	0.00	0.00	0.00
Reported net profit	260.7	154.6	208.3	217.6	227.7
Tot normalised items	0.00	0.00	0.00	0.00	0.00
Normalised EBITDA	263.9	183.5	264.4	291.3	297.2
Normalised PTP	267.2	156.1	227.7	235.5	246.6
Normalised net profit	260.7	154.6	208.3	217.6	227.7

Source: Company data, Rasmala forecasts

year to Dec

Balance sheet

Dhm	FY09A	FY10A	FY11F	FY12F	FY13F
Cash & market secs (1)	878.4	358.9	442.4	659.0	858.6
Other current assets	2240	2915	3448	3580	3707
Tangible fixed assets	211.5	249.7	424.8	492.7	561.3
Intang assets (incl gw)	821.8	1149	1181	1148	1114
Oth non-curr assets	249.0	198.0	94.0	94.0	94.0
Total assets	4401	4871	5590	5974	6335
Short term debt (2)	503.5	787.2	638.9	638.9	638.9
Trade & oth current liab	1157	1488	1986	2137	2255
Long term debt (3)	159.9	2.15	167.3	167.3	167.3
Oth non-current liab	64.3	51.2	62.5	62.5	62.5
Total liabilities	1885	2329	2854	3006	3124
Total equity (incl min)	2515	2542	2736	2968	3211
Total liab & sh equity	4401	4871	5590	5974	6335
Net debt	-215.0	430.4	363.8	147.2	-52.4

Source: Company data, Rasmala forecasts

year ended Dec

Cash flow statement

Dhm	FY09A	FY10A	FY11F	FY12F	FY13F
EBITDA	263.9	183.5	264.4	291.3	297.2
Change in working capital	-598.8	-347.6	-358.7	18.7	-105.0
Net interest (pd) / rec	-58.8	-0.90	-2.57	-4.03	-6.99
Taxes paid	-1.39	3.80	-0.81	-0.85	-0.91
Other oper cash items	221.4	30.4	31.0	35.0	137.0
Cash flow from ops (1)	-173.7	-130.8	-66.7	340.1	321.3
Capex (2)	-16.2	-61.5	-141.8	-133.7	-144.0
Disposals/(acquisitions)	1.75	1.37	4.94	0.00	0.00
Other investing cash flow	-418.9	-242.3	140.4	45.6	61.1
Cash flow from invest (3)	-433.4	-302.4	3.56	-88.1	-83.0
Incr / (decr) in equity	0.00	0.00	0.00	0.00	0.00
Incr / (decr) in debt	263.5	64.5	75.5	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	182.6	-35.5	-38.7
Cash flow from fin (5)	23.2	-265.6	258.2	-35.5	-38.7
Forex & disc ops (6)	-2.95	-4.26	-6.43	0.00	0.00
Inc/(decr) cash (1+3+5+6)	-586.8	-703.1	188.6	216.5	199.7
Equity FCF (1+2+4)	-189.9	-192.3	-208.6	206.4	177.3

Source: Company data, Rasmala forecasts

year to Dec

Standard ratios	Drake & Skull					Arabtec Holding			Sorouh Real Estate		
Performance	FY09A	FY10A	FY11F	FY12F	FY13F	FY11F	FY12F	FY13F	FY11F	FY12F	FY13F
Sales growth (%)	11.4	-3.24	63.7	10.1	7.75	-13.2	11.4	13.4	n/a	n/a	n/a
EBITDA growth (%)	59.0	-30.5	44.1	10.2	2.01	-31.1	9.18	12.4	8.95	23.8	16.1
EBIT growth (%)	14.5	-35.3	61.2	1.73	-1.93	-56.5	48.0	20.6	10.5	27.1	16.9
Normalised EPS growth (%)	15.9	-40.1	34.7	4.50	4.61	-56.2	72.3	22.4	7.03	4.63	25.2
EBITDA margin (%)	13.8	9.90	8.71	8.72	8.25	10.5	10.3	10.2	12.4	15.1	13.7
EBIT margin (%)	9.44	6.31	6.21	5.74	5.23	3.89	5.17	5.50	11.2	13.9	12.7
Net profit margin (%)	13.6	8.34	6.86	6.51	6.32	2.84	4.39	4.74	10.8	11.1	10.9
Return on avg assets (%)	6.12	3.18	3.86	3.84	3.59	2.80	4.26	5.14	2.86	3.30	4.35
Return on avg equity (%)	11.1	6.25	8.05	7.73	7.50	4.87	7.86	8.85	5.61	5.56	6.56
ROIC (%)	15.6	5.26	6.23	6.11	5.96	5.64	8.99	10.3	5.38	5.88	6.35
ROIC - WACC (%)	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
				year to Dec			year to Dec			year to Dec	
Valuation											
EV/sales (x)	0.83	1.21	0.72	0.58	0.49	0.39	0.28	0.19	1.18	1.22	0.73
EV/EBITDA (x)	6.03	12.2	8.21	6.71	5.91	3.70	2.77	1.82	9.52	8.09	5.33
EV/EBITDA @ tgt price (x)	8.68	16.0	10.8	9.10	8.25	3.25	2.36	1.45	9.65	8.20	5.42
EV/EBIT (x)	8.80	19.1	11.5	10.2	9.32	9.95	5.50	3.37	10.6	8.76	5.73
EV/invested capital (x)	0.69	0.75	0.70	0.63	0.56	0.61	0.50	0.37	0.49	0.48	0.38
Price/book value (x)	0.73	0.72	0.66	0.61	0.57	0.73	0.68	0.62	0.40	0.38	0.36
Equity FCF yield (%)	-10.6	-10.8	-11.7	11.6	9.96	14.2	16.1	18.9	-23.6	-7.51	36.8
Normalised PE (x)	6.89	11.5	8.55	8.18	7.82	15.45	8.97	7.32	7.39	7.06	5.64
Norm PE @ tgt price (x)	9.55	16.0	11.8	11.3	10.8	13.8	8.00	6.53	7.54	7.21	5.75
Dividend yield (%)	8.43	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
				year to Dec			year to Dec			year to Dec	
Per share data	FY09A	FY10A	FY11F	FY12F	FY13F	Solvency	FY09A	FY10A	FY11F	FY12F	FY13F
Tot adj dil sh, ave (m)	2166	2145	2145	2145	2145	Net debt to equity (%)	-8.55	16.9	13.3	4.96	-1.63
Reported EPS (AED)	0.12	0.07	0.10	0.10	0.11	Net debt to tot ass (%)	-4.89	8.84	6.51	2.46	-0.83
Normalised EPS (AED)	0.12	0.07	0.10	0.10	0.11	Net debt to EBITDA	-0.81	2.35	1.38	0.51	-0.18
Dividend per share (AED)	0.07	0.00	0.00	0.00	0.00	Current ratio (x)	1.88	1.44	1.48	1.53	1.58
Equity FCF per share (AED)	-0.09	-0.09	-0.10	0.10	0.08	Operating CF int cov (x)	-1.93	-148.7	-24.7	85.6	47.1
Book value per sh (AED)	1.14	1.15	1.26	1.36	1.47	Dividend cover (x)	1.72	0.00	0.00	0.00	0.00
				year to Dec						year to Dec	

Priced as follows: DSI.DU - Dh0.83; ARTC.DU - Dh1.39; SOR.AD - Dh0.98
Source: Company data, Rasmala forecasts

Valuation methodology

	Value (Dhm)	Value per share (Dh)
PV of free cash flow	893	0.41
PV of terminal value	1,271	0.58
Other assets	303	0.14
Enterprise value	2,466	1.13
Net debt	-112	-0.05
Other Liabilities	-44	-0.02
Minority interest	-80	-0.04
Equity value	2,232	1.02
Target price		1.15

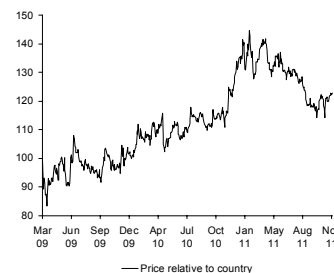
Source: Company data, RBS forecasts

Company description

Drake & Scull International PJSC (DSI) is one of the largest integrated construction companies in the United Arab Emirates (UAE) by market cap. The company was formed through the merger of an electrical company (Drake and Gorham) and a plumbing company (Arthur Scull & Son) in 1964. DSI was established in Abu Dhabi in 1966, and in Dubai, where it is currently headquartered, in 1976. It was listed on the Dubai Financial Market (DFM) in March 2009. At end-2009, DSI reported about 12,000 employees. DSI is a vertically integrated company specialising in engineering solutions in the following business segments: Mechanical, Electrical and Plumbing (MEP) Services; Civil Contracting Services; and Infrastructure, Water and Power (IWP) Services.

Buy

Price relative to country



Strategic analysis

Average SWOT company score:

3

Revenue breakdown, 2011F

Strengths

DSI has a vertically integrated model with solid geographic diversification, including declining Dubai exposure. Its direct presence in the Saudi Arabia market strengthens its business model in the long run.

4

Weaknesses

DSI's dependence upon the UAE remains high, as the country still accounts for about 29% of its september 2011 end estimated backlog.

2

Opportunities

These include expanding into growth markets such as Saudi Arabia and Egypt. The Abu Dhabi infrastructure may be a growth catalyst, although we remain cautious of opportunity timing given the high degree of competition.

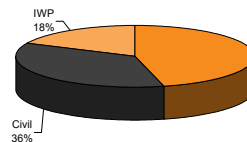
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Threats

Project delays cannot be ruled out in the UAE, and in particular could have a direct impact on backlog and growth expectations.

2

Scoring range is 1-5 (high score is good)



Source: Rasmala estimates

Market data

Headquarters

Drake and Scull Building, Dubai Investment Park, UAE

Website

www.drakescull.com

Shares in issue

2177.8m

Freefloat

55%

Majority shareholders

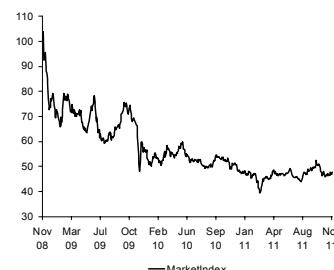
KRT2 Limited (9%), KRT3 Limited (9%), Khalidoun Rashid Tabari (8%)

Country view: United Arab Emirates

Country rel to M East & Africa

MENA markets are showing characteristics of a text book case of loss aversion. This is expected given the magnitude of losses investors experienced since 2008, with 2009 lagging emerging markets by a fairly wide margin. Rising oil prices and budget surpluses drove asset prices across the region higher resulting in a real-estate bubble that has negatively impacted speculators and the banking system. Bubbles do pop and recover over time if there is a legal system in place that enables the transfer of assets. The bad news is such a mechanism did not exist. The good news is that with the creation or RERA and the possibility of Strata Law, this could change and facilitate the transfer of properties from speculators to real investors.

The country view is set in consultation with the relevant company analyst but is the ultimate responsibility of the Strategy Team.



Competitive position

Average competitive score:

3+

Broker recommendations

Supplier power

Low - DSI makes payments in line with its cash inflows from end customer, hence working capital risk is limited.

2-

Barriers to entry

High - DSI's need to develop regional relationships and raise funding in a down market will likely pose strong headwinds for new entrants.

3+

Customer power

Medium - Transaction activity is low as market sentiment remains soft.

2-

Substitute products

Low - DSI's integrated portfolio of MEP, IWP and Civil positions it well across various contracting businesses.

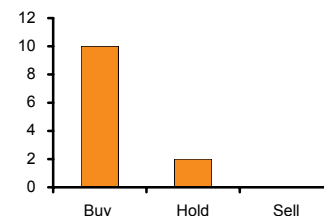
4+

Rivalry

High - Contracting has become a competitive market with both local and foreign players bidding for down-scoped opportunities.

3+

Scoring range 1-5 (high score is good) Plus = getting better Minus = getting worse



Source: Bloomberg

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: Dh0.83, 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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