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Bloomberg Code: DCIL: IN

Incorporated in 1976, Dredging Corporation of India (DCI) is the largest public sector player providing dredging services in India. It commands ~75% of the total dredging market. It caters to India's major ports, non-major ports, the Indian Navy and ship yards in the form of maintenance dredging, capital dredging, reclamation, hydrographic surveys and beach nourishment. Government of India (GoI) holds ~78.5% interest in the company.

Investment Rationale

Revenue expected to grow at a CAGR of 14.4% by FY17E: We expect DCI to be a major beneficiary of the increasing maintenance dredging requirements in India (expected to increase by 55% to 405 MCM by 2017) as it commands 60% of the maintenance dredging market. Over FY12-FY15, DCI has witnessed 50% rise in the total dredged area that grew from 49.5 million cubic meters (MCM) to 74.0 MCM. The dredging realisations stand close to Rs. 10.0/Cu.M. We expect the dredged area to grow by 10% in both FY16E and FY17E and factoring in the changing fleet profile arrive at a realisation of Rs. 9.9/Cu. M. At this realisation, we estimate the revenues to grow at a CAGR of 14.4% by FY17E.

Declining costs to drive EBITDA growth: Fuel cost forms ~50% of the total expenditure and ~39% of the total sales. DCI uses High Flash High Speed diesel (HFHSD) as a fuel for its dredgers. As crude oil constitutes ~60% of the total cost of production of HFHSD, the price movement is mostly in line with the movement of crude. Over last two years, the crude prices have fallen from ~\$100/b to ~\$56/b. The same has been reflected in the company's numbers with the EBITDA increasing despite a fall in the top-line as reduced operational costs aided margins. We expect the crude prices to hover in a range of \$50-\$60/b going forward; hence, expect a CAGR of 15.0% in EBITDA by FY17E.

Foray into overseas market: DCI plans to foray into the foreign market during FY16 with an aim to become a nodal agency for execution of integrated port infrastructure projects which include construction of berths and marine facilities. With the increasing thrust on inland waterways, the company will be entering the inland dredging market from this year for waterways projects at Ganga, Godavari.

NWC concerns expected to sooth: DCI has debtors worth ~Rs. 800 Crores on its books from various ports. Sethusamudram alone is liable for Rs. 309 Crores. The company expects to recover this amount in FY16 as a result of the intervention of MoS, to appoint a sole arbitrator for realization of its outstanding dues payable by SCL. This would improve the liquidity profile going forward. Owing to this, the Net Working Capital Days are expected to decline to 159 by FY17E.

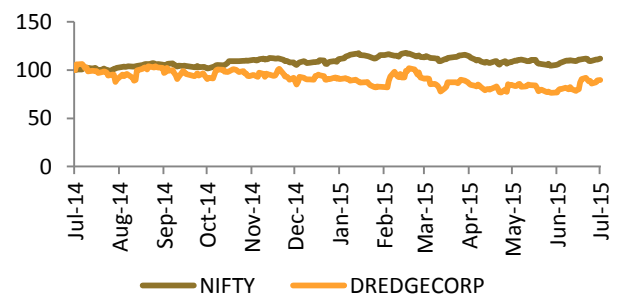
Market Data

Rating	BUY
CMP (Rs.)	410
Target (Rs.)	480
Potential Upside	~17%
Duration	Long Term
Face Value (Rs.)	10
52 week H/L (Rs.)	490.0/341.5
Adj. all time High (Rs.)	491
Decline from 52WH (%)	16.3
Rise from 52WL (%)	19.9
Beta	1.4
Mkt. Cap (Rs.Cr)	1,148.0
Enterprise Value (Rs.Cr)	1,885.4

Fiscal Year Ended

Y/E	FY14A	FY15A	FY16E	FY17E
Revenue (Rs.Cr)	770.4	735.0	862.5	962.5
Net profit (Rs.Cr)	35.3	51.4	64.2	84.1
EPS (Rs.)	12.6	18.7	22.9	30.0
P/E (x)	18.1	21.1	17.9	13.6
P/BV (x)	0.4	0.8	0.7	0.7
ROE (%)	2.5	3.6	4.3	5.3

One year Price Chart



Shareholding Pattern

	Jun-15	Mar-15	Chng.
Promoters	78.6	78.6	0.0
FII	0.6	0.8	(0.2)
DII	9.8	10.0	(0.2)
Others	11.0	10.6	0.4

Dredging Corporation Ltd. (DCI) is India's largest and only public sector company providing integrated dredging services.

Dredging Corporation of India Ltd.-A 'Mini-Ratna' company

Incorporated in 1976, Dredging Corporation Ltd. (DCI) is India's largest and only public sector company providing integrated dredging services. It holds 75% of the total dredging market in India. It caters to India's major ports, non-major ports, the Indian Navy and ship yards in the form of maintenance dredging, capital dredging, reclamation, hydrographic surveys and beach nourishment. DCI has ~60% market share in maintenance dredging. Nevertheless, majority of the capital dredging is carried out by international players in which the company has ~2% market share.

The Company operates a diverse dredging fleet which is the largest in India in terms of capacity. The Company has 12 Trailer Suction Hopper Dredgers (TSHDs), 3 Cutter Suction Dredgers (CSDs), 3 Survey launches and one Back Hoe Dredger apart from other ancillary crafts. The size, versatility and technical capabilities of the fleet improve its competitiveness as it allows DCI to select the appropriate equipment for a particular maintenance dredging job. To maintain the value and effectiveness of fleet, the Company emphasizes preventive maintenance so as to reduce the downtime, increase profitability, and enhance the vessel life.

Apart from consolidation in the Indian dredging market, the company is now making forays in the foreign dredging market. During the FY14, it undertook international dredging assignment at Kankasanturai harbour, Sri Lanka under the aegis of Ministry of External Affairs, GoI as per a bilateral arrangement with the Government of Sri Lanka.

Fleet Profile of the company

Trailer suction Hopper Dredger (TSHD)	Hopper Capacity (cu. m)	Pumping Capacity (cu.m/hr)
DCI Dredge VI	3770	0
DCI Dredge VIII	6500	0
DCI Dredge IX	4500	0
DCI Dredge XI	4500	0
DCI Dredge XII	4500	0
DCI Dredge XIV	4500	0
DCI Dredge XV	7400	0
DCI Dredge XVI	7400	0
DCI Dredge XVII	7400	0
DCI Dredge XIX	5500	0
DCI Dredge XX	5500	0
DCI Dredge XXI	5500	0
Cutter suction Hopper Dredger (CSD)		
DCI Dredge VII	0	1000
DCI Dredge Aquarius	0	2000
DCI Dredge-XVIII	0	2000
Back Hoe Dredger		
DCI Dredge-BH1	0	0

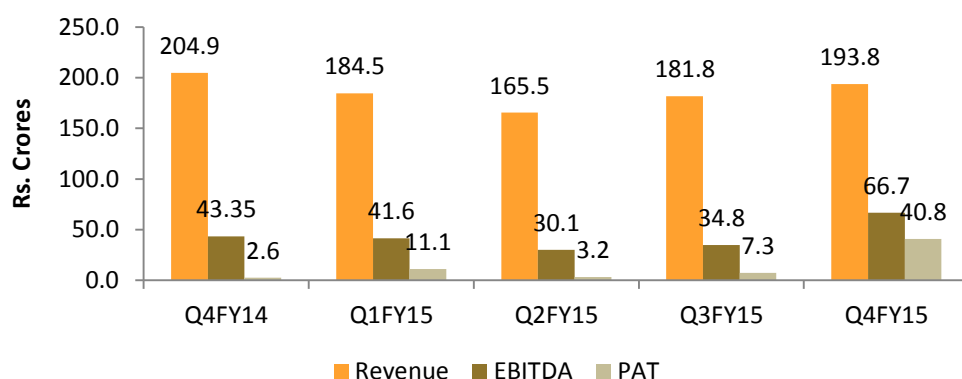
The company reported an increase in the PAT from Rs. 2.6 Crores in Q4FY14 to Rs. 40.8 Crores in Q4FY15 owing to declining costs.

Despite a fall in the top-line, the company the EBITDA of the company stood at Rs. 173.2 Crores as compared to Rs. 185.9 Crores increasing by 6.8% primarily due to declining top-line.

Impressive Q4FY15 performance

For the quarter ended Q4FY15, DCI's operating revenue reported at Rs. 193.8 Crores declining by 5% and up by 3% on YoY and QoQ basis respectively. The decline in the revenue was predominantly on the back of lower utilisation of fleet due to dry docking and subdued dredging demand. Contrary to the top-line decline, EBITDA reported at Rs. 66.7 Crores saw a massive jump by 54% and 91% on YoY and QoQ basis respectively. This rise was primarily a result of the drop in the repair and maintenance costs by 94% and 99% on YoY and QoQ basis respectively. The EBITDA margin jumped 1,326 bps YoY to reach 34.4%. In the line with the growing EBITDA, PAT registered significant growth to Rs. 40.8 Crores. PAT Margin was reported at 21.03%.

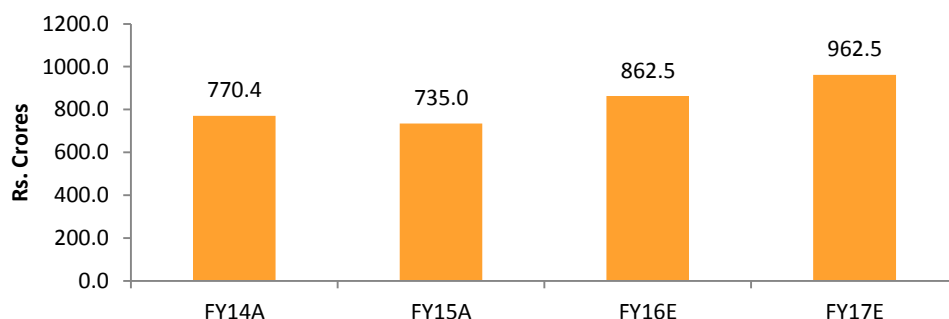
Quarterly performance trend



Declining costs aided bottom-line in FY15

In FY15, DCI reported a marginal decline in the revenue by 4% at Rs. 743.8 Crores due to dry-docking of three vessels out of which one had the highest capacity of 7400 mcm. This affected the utilisation levels of the company. Moreover, investments in Sethusamudram project worth Rs. 300-400 Crores were stalled due to environment and political issues, resulting in a subdued FY15. The EBITDA of the company stood at Rs. 173.2 Crores as compared to Rs. 185.9 Crores decreasing by 6.8% primarily due to declining top-line. EBITDA margin too declined from 24.1% in FY14 to 23.6% in FY15. However, the company reported a growth in its EBIT due to declining depreciation charges. The depreciation expenses reduced from Rs. 138.3 Crores in FY14 to Rs. 92.1 Crores in FY15 due to change in accounting policy of the company. The PAT stood at Rs. 51.3 Crores growing by 46% over FY14.

Revenue trend going further



Maintenance dredging to catalyse revenue growth

DCI caters to ~65% of the total annual maintenance (110 mcm) required by the ports in India. Two major ports Haldia and Kolkata that the company has been associated with for over 30 years require yearly maintenance owing to continuous deterioration of draft. These ports constitute ~55% of the total revenues of DCI. Going forward, as per Ministry of Shipping, the maintenance requirements at Indian ports are expected to increase by 55% to 405 MCM by 2017 creating room for more dredging activities. Notably, Kolkata port is expected to be the biggest beneficiary as it accounts for the highest share (~34%) in the annual maintenance dredging exercises of the country. Also, the government has earmarked a budget of ~Rs. 1000 Crores for funding the maintenance dredging on the Kolkata port. Due to a strategic alliance with Kolkata Port Trust, DCI receives assured business from this port and is expected to churn out huge revenue from the aforementioned developments. Moreover, provisions under the central government's 'Maritime Agenda 2020' bode well for the company as the government focuses on introducing new policies for dredging and strengthening DCI via new acquisition of dredgers.

Declining costs to drive EBITDA growth

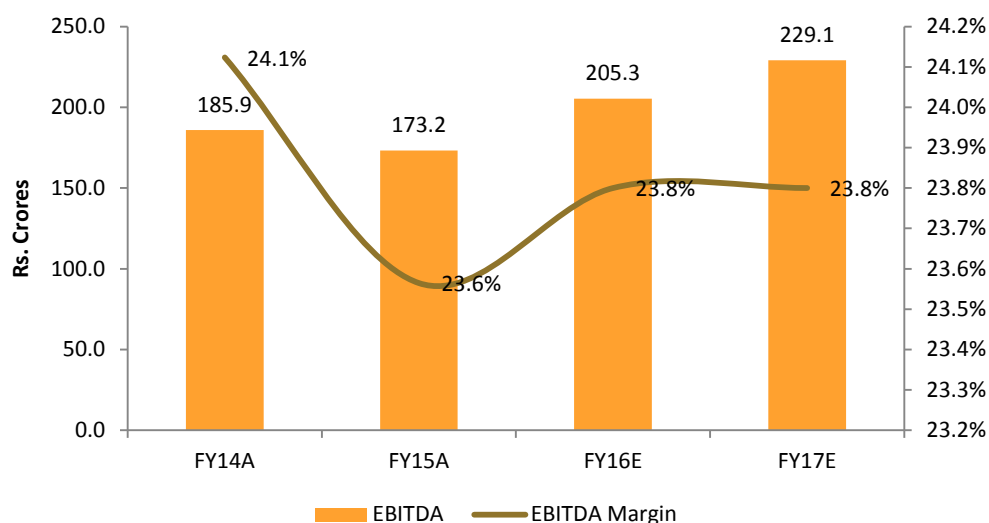
Power and fuel costs constitute a major chunk of DCI's operational cost forming ~50% of the total expenditure and ~39% of sales. DCI uses High Flash High Speed diesel (HFHSD) as a fuel for its dredgers. As crude oil constitutes ~60% of the total cost of production of HFHSD, its price is mostly in line with the movement of crude. Over last two years, the crude prices have declined from ~\$100/b to ~\$56/b. Consequently, the EBITDA of the company has increased despite a fall in the top-line. We expect the crude prices to hover in a range of \$50-\$60/b going forward, hence expect EBITDA to register a CAGR of 15.0% by FY17E.

Moreover, the company is planning to undertake refurbishment for its middle-age vessels having an average age of 15 years to augment the capacity and efficiency of the dredgers. It added three new dredgers to its fleet that improved the daily realisations to Rs. 4 mn/day in FY15 as compared to Rs. 2.4 mn/ day in FY14. These dredgers are also fuel efficient hence expected to drive growth in EBITDA.

Growing maintenance dredging requirements in the country bode well for the top-line of the company owing to its dominance in the dredging market.

DCI is expected to witness a growth in the EBITDA owing to sustained crude prices.

EBITDA Growth



Given the government's efforts towards increasing emphasis in the foreign markets, the company is expected to get dual advantage of overseas footprint and revenue hedge.

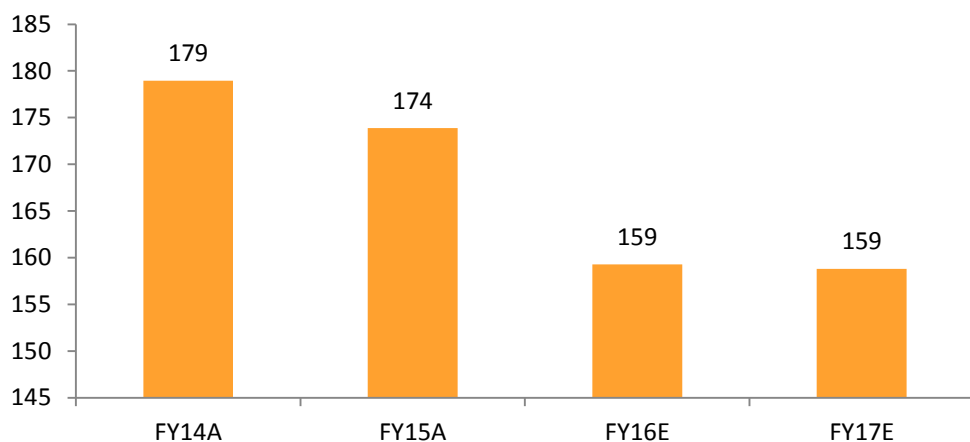
Setting foot in foreign waters

Dredging Corporation of India plans to foray into the foreign market in the current fiscal. The company has rich experience of over a decade in taking up projects in Dubai, Abu Dhabi and other places. It aims to execute integrated port infrastructure projects which include construction of berths and marine facilities with its increasing emphasis on diversification of its operations to achieve the target. As part of diversification, DCI would offer project management consultancy and lay stress on indigenisation of import-substitute products. Almost 80% of specialised precision machinery is imported. DCI will develop the design and encourage vendors to build the products as part of 'Make in India' campaign. Moreover, this diversification will give the company dual advantage of dollar revenue which will act as a natural hedge on forex exposure as the company has borrowed through ECBs (External Commercial Borrowings) for acquisition of Dredgers.

Cash conversion cycle to strengthen following expected collections

A major concern surrounding DCI is its current level of net working capital (NWC) days. Its NWC days have been very high standing at 179 days in FY14 and 174 days in FY15 due to the company's inability to ensure faster collections. Various domestic ports owe DCI a total of Rs. 489 Crores. Kolkata port alone owes it ~Rs. 160 Crores. Adding the dredging dues worth Rs. 309 Crores from the Sethusamudram project takes the total dues to ~Rs. 800 Crores. The dredging was done to link the palk bay and the Gulf of Mannar by creating shipping canal. The project was under litigation after environmental concerns were raised against it. For the project, DCI has incurred huge expenses which are still payable by SCL. However, DCI is expecting to recover its dues from Sethusamudram Corporation Ltd (SCL) consequent to its request to MoS, to appoint a sole arbitrator for realization of its outstanding dues payable by SCL. This would improve the liquidity profile of the company going forward. We believe the NWC days to decline to 159 by FY17E.

NWC Days to stabilize



Other risks

- Increasing cost of fuels might affect the operating margins of the company as power and fuel costs comprise ~40% of the revenue
- Higher dependence on a single major port i.e. the Kolkata port imposes client risk concentration
- Increasing dry docking due to old age of the vessels drags the utilisation rate

Balance Sheet (Standalone)

Y/E (Rs.Cr)	FY14A	FY15A	FY16E	FY17E
Share Capital	28.0	28.0	28.0	28.0
Reserve and surplus	1,395.4	1,446.3	1,509.5	1,592.7
Net Worth	1,423.4	1,474.3	1,537.5	1,620.7
Total Debt	1,257.4	924.4	924.4	924.4
Other non-current liabilities	6.3	7.2	7.0	7.0
Capital Employed	2,687.1	2,405.9	2,468.9	2,552.0
Fixed Assets	2,187.7	1,871.3	1,816.9	1,753.5
Investments	30.0	30.0	30.0	30.0
Net Current Assets	434.3	468.0	585.6	732.1
Other non-current assets	35.0	36.6	36.6	36.6
Capital Deployed	2,687	2,406	2,469	2,552

Profit & Loss Account (Standalone)

Y/E (Rs.Cr)	FY14A	FY15A	FY16E	FY17E
Net Sales	770.4	735.0	862.5	962.5
Expenses	584.6	561.8	657.2	733.4
EBITDA	185.9	173.2	205.3	229.1
Depreciation	138.3	92.1	111.6	113.4
EBIT	47.5	81.1	93.7	115.7
Net Interest cost	11.0	25.7	25.9	26.8
Profit Before Tax	36.5	55.4	67.8	88.9
Tax	1.3	3.0	3.6	4.7
Extraordinary exp	0.0	1.0	0.0	0.0
Net Profit	35.3	51.4	64.2	84.1

Key Ratios (Standalone)

Y/E	FY14A	FY15A	FY16E	FY17E
EBITDA Margin (%)	24.1	23.6	23.8	23.8
EBIT Margin (%)	6.2	11.0	10.9	12.0
NPM (%)	4.6	7.0	7.4	8.7
ROCE (%)	2.0	3.2	3.9	4.6
ROE (%)	2.5	3.6	4.3	5.3
EPS (Rs.)	12.6	18.7	22.9	30.0
P/E (x)	18.1	21.1	17.9	13.6
P/BVPS (x)	0.4	0.8	0.7	0.7
EV/Operating Income (x)	57.4	58.4	59.4	60.4
EV/EBITDA (x)	9.7	10.9	8.9	7.5

Valuation and view

DCI is expanding in terms of both capacity and efficiency and we expect the impact of the same to be reflected in the company's performance in the years to come. It is well placed to see growth on account of strong economic developments in the country in terms of increase in exports, setting up of new ports, expansion of existing ports, etc.

We expect DCI's net profit to grow at a CAGR of ~28% during FY15-FY17E. The RoCE and RoE are expected to improve to 4.6% and 5.3% by FY17E. At the current market price (CMP) of Rs. 410, the stock trades at a P/E of 17.9x FY16E and 13.6x FY17E. We assign a forward P/E of 16x for FY17E and recommend 'BUY' with a target price of Rs.480, which implies a potential upside of ~17% to the CMP from 12 months perspective.

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