



Company Update

Drake & Scull
International

RATING: Outperform
Target Price: AED 1.23

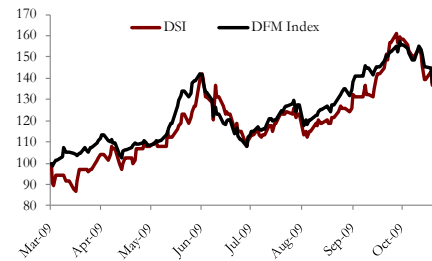
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Challenges Ahead But Growth Story Remains Strong

- **3Q 09 Results Weak but No Surprises; Seasonality + Holiday Period Impacted Productivity.** DSI 3Q 09 turnover of AED 400mn was lower than our estimate of AED 429mn; however net income of AED 68.9mn came in slightly over our estimate of AED 66.2mn. MEP continues to be the largest contributor to revenues (59%), followed by Civil (23%) and IWP (18%). We do not expect the revenue mix to change until 2011, with 80% of the revenues coming from MEP and Civil.
- **Attractive 2009 Margins Beat Our Estimates. However we foresee 2010 & 2011 margin sustainability to be a concern.** Due to the cyclical nature of the business, we expect DSI's growth to slow down and margins to soften in line with the market trend especially affecting contractors in the region. As a result of the lag impact of a solid 9m 2009 turnover & generous margins, we feel the firm is likely to close FY 09 with turnover growth 7% yoy, gross margins >20% and net margin > 15.3%. However, considering the increasingly difficult and competitive nature of the business in DSI's domestic market as well as across the region, we believe margin sustainability will be concern in the near future. We expect the gross margins to decline to 17% and 15.4% in 2010 & 2011 respectively.
- **2009 Net Margin Cushioned by Interest Income on Unused IPO Funds (AED 1.1bn); Cash Management Crucial for DSI.** The 9m 2009 net margin is 16.6% (ex-interest earned on the cash of AED 1bn; the net margin is 12.06%). Management indicated earlier that a portion of the funds are likely to be used for funding the planned acquisition and approximately AED 300mn will be put into a risk free investment to generate interest income.
- **Backlog Burn Rises while Contract Awards Slow Down; Backlog Replenishment to be a Key Stock Catalyst.** From the current outstanding backlog as of Oct 2009, we analyze that in 2007 and 2008 DSI's contracts awarded were ~70-80% higher than the revenues generated in those periods. However, for 9m 2009 the contracts awarded are 2% less than the revenues recorded implying that backlog burn rate is higher than the backlog replenishment rate. Therefore, we believe that securing new orders with credit-worthy clients is a key stock challenge in the near term.
- **Growth Story Remains Strong.** Presently, the outstanding backlog of AED 2.5bn (ex-Bahrain) reflects a revenue stream up until mid 2011 and if the company continues to secure orders at the same rate as it burns the backlog, the company is well positioned to deal with the economic slowdown.
- **Seeking Acquisitions to Further Enhance Growth Profile.** DSI's much promised acquisitions are crucial for the company to enhance its top line growth pattern. We believe that M&A activity likely to result in geographic expansion and/or revenue diversification as well as backlog enhancement is likely to be a valuable stock catalyst, although subject to economically practical valuations.
- **Revising Target Price & FY 09 forecasts; Retain Rating.** We revise our FY 09 revenue target as per management's guidance to be AED 1.83bn & net margin to 15.3%. While raise the target price to AED 1.23, we retain our outperform rating on the stock.

Equity Data		Financial Data (AED, mn)					
Price, AED	1.01						
Target Price, AED	1.23						
Upside %	21.9%						
Hi-Lo, AED	1.22 - 0.64						
Performance, Until Date	34.7%						
Market Cap (AED, mn)	2,199.56						
EV (AED, mn)	1,411.92						
Bloomberg	DSI UH						
Except per share data		2008A	2009E	2010E	1Q 09	2Q 09	3Q 09E
Revenue		1,720.48	1,835.38	1,767.11	488.09	512.03	399.71
Gross Margin %		18.8%	20.1%	17.0%	17.9%	21.3%	22.7%
EBITDA		183.01	272.98	212.87	67.25	82.69	67.74
EBITDA Margin %		10.6%	14.9%	12.0%	13.8%	16.1%	16.9%
Net Profit After Min Int		209.90	280.97	215.69	77.17	86.56	68.96
Net Margin %		12.2%	15.3%	12.2%	15.8%	16.9%	17.3%
EPS		0.10	0.13	0.10	0.04	0.04	0.03
P/E		10.48	7.83	10.20	7.13	6.72	7.09
EV/EBITDA		6.73	5.03	6.55	4.57	4.31	4.55



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