



Equity Research

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**DryShips Inc (DRYS-\$87.37)**

**Rating: BUY**

**Target Price: \$133.00**

**DryShips Poised To Create Significant Value In 2008; Raise Estimates, Target**

EPS	1Q	2Q	3Q	4Q
<b>2006A</b>	0.60A	0.53A	0.48A	0.77A
<b>2007E</b>	1.01A	1.59A	2.38A	4.18E
<i>Prev</i>	1.01A	1.59A	2.93E	3.92E
<b>2008E</b>	4.61E	4.38E	4.37E	4.30E
<i>Prev</i>	3.86E	3.21E	2.66E	3.05E

FY	2006A	2007E	2008E
<b>EPS</b>	2.18A	9.18E	17.65E
<i>Prev</i>	2.18A	9.48E	12.76E
<b>P/E</b>	40.1x	9.5x	5.0x

<b>EBITDA</b>	\$171A	\$454E	\$794E
<i>Prev</i>	\$171A	\$468E	\$634E
<b>EV/EBITDA</b>	23.1x	8.7x	5.0x

*Sum of quarterly EPS may not equal full-year total due to rounding and/or change in share count.*

- We raise our price target to \$133 (from \$114) based on our new 7.0x EV/2008 EBITDA multiple (from 8.0x) to our new 2008 EBITDA estimate of \$794 million (from \$634 million).
- DryShips recently fixed several of its vessels on 12-month charters at attractive rates. We believe this is a prudent strategy by the company given that the contracts were at or above current spot freight rates.
- Despite this, the company has 85% of its fleet operating days unfixed for 2008, which we believe will provide significant accretion to shareholders as the dry bulk outlook for 2008 remains robust.
- We have adjusted our forecast to account for the new charters. We also assume that DryShips' Capesize and Panamax vessels will achieve average spot rates in 2008 of \$111,250 per vessel/day and \$61,250 per vessel/day, respectively. We note that this is a 10-15% discount to current FFA forward rates.
- As such, we raise our 4Q:07 and 2008 estimates. We now expect 4Q:07 and 2008 EPS of \$4.18 and \$17.65 (from \$3.92 and \$12.76), respectively. We look for 2007 and 2008 EBITDA of \$454 million and \$794 million (from \$468 million and \$634 million), respectively.
- While DryShips strategy is generally riskier than other dry bulk operators who fix their vessels under longer-term time charter contracts, the company should also generate greater returns in a strong market, which could then be used to expand the fleet and/or increase distributions to shareholders, in our opinion. We expect DRYS to generate free cash flow of \$20.12 per share in 2008.

**Current Statistics**

<b>Market Cap (\$B)</b>	<b>3.1B</b>	<b>Price to Book Value:</b>	<b>3.9x</b>
<b>Avg. Daily Trading Volume (3 mo.):</b>	<b>3,472,037</b>	<b>Return on Equity (2007E):</b>	<b>53.7%</b>
<b>Shares Out (Mil):</b>	<b>35.490</b>	<b>LT Debt-to-Total Capital (2007E):</b>	<b>53%</b>
<b>Float Shares (Mil):</b>	<b>29.190</b>	<b>Projected 5-Year EPS Growth Rate:</b>	<b>NM</b>
<b>Institutional Holdings:</b>	<b>35.8%</b>	<b>52 Wk. Range</b>	<b>\$131.34-\$13.30</b>
<b>Short Interest (Mil):</b>	<b>0.967</b>	<b>Dividend (2007E):</b>	<b>\$0.80</b>
		<b>Dividend Yield:</b>	<b>0.92%</b>

**Company Description**

*DryShips, Inc ([www.dryships.com](http://www.dryships.com)) provides seaborne transportation of dry bulk commodities via a fleet of 35 dry bulk carriers. Commodities transported by the company consist of major bulks, which include iron ore, coal, and grain, and minor bulks such as bauxite, phosphate and steel products. The company's current fleet has a total carrying capacity of approximately 3.0 million deadweight tons (dwt) and consists of five Capesize carriers, 29 Panamax carriers and two Handymax carrier with an average age of 8.4 years. The company's headquarters are located in Athens, Greece.*

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**WE EXPECT DRYS TO GENERATE SIGNIFICANT CASH FLOW IN 2008; VIEW RECENT SHARE PULLBACK AS BUYING OPPORTUNITY**

DryShips recently fixed several of its vessels on 12-month charters at attractive rates. While this could be taken as a bearish signal for the dry bulk market, we don't necessarily believe this is the case. We note that not only did the chartered vessels represent a small fraction of the company's vessel operating days, the contracts were signed at rates that were at or above the spot market at the time. As such, we believe this was a prudent decision since it allowed DryShips to effectively lock-in the current market strength, while at the same time reducing risk. Despite this, the company has 85% of its fleet operating days unfixed for 2008, which we believe will provide significant accretion to shareholders as the dry bulk outlook for 2008 remains robust.

We have adjusted our forecast to account for the new charters. Additionally, we also assume that DryShips' Capesize and Panamax vessels will achieve average spot rates in 2008 of \$111,250 per vessel/day and \$61,250 per vessel/day, respectively. We note that this is a 10-15% discount to current FFA forward rates. As such, we raise our 4Q:07 and 2008 estimates. We now expect 4Q:07 and 2008 EPS of \$4.18 and \$17.65 (from \$3.92 and \$12.76), respectively. We look for 2007 and 2008 EBITDA of \$454 million and \$794 million (from \$468 million and \$634 million), respectively. Based on our assumptions, we now expect DryShips to generate free cash flow (cash flow from operations less maintenance capital expenditures and dividends) of \$717 million in 2008, or \$20.12 per share. This represents a free cash flow yield of 23% based on the current stock price.

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**RISKS AND UNCERTAINTIES**

- (1) While analysis of commodity supply and demand factors can help provide near-term guidance, market conditions are difficult to predict and single events often affect the price, demand, production, and transport of commodities. As such, dry bulk rates can fluctuate dramatically over short periods of time.
- (2) Our positive rate outlook for 2007 and 2008 would change if vessel supply increases resulting from a sizeable orderbook and minimal scrapping activity significantly outweighed demand increases for dry cargo transport.

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**RAISE PRICE TARGET TO \$133 (FROM \$114); MAINTAIN BUY RATING**

DRYS currently trades at 8.7x to our new 2007 EBITDA estimate of \$454 million (from \$468 million) and 5.0x to our new 2008 EBITDA estimate of \$794 million (from \$634 million), below the dry bulk carrier peer group average 2007 EV/EBITDA multiple of about 7.0x. We continue to view DryShips as a growth company that is well positioned to take advantage of a potential reduction in asset values during temporary rate declines, particularly in view of our expectation that the company should generate substantial free cash flow in 2007 and 2008. Furthermore, we note that the current spot rate environment remains robust and we expect it to remain so over the remainder of 2007 and 2008, driven by positive industry fundamentals. While we note that the company does have one of the highest debt-to-capital ratios among its peer group and has significant exposure to the often volatile spot market, we also expect the company to generate significant free cash flow. Due to the volatile nature of the company's revenues, as well as the fact that 2008 is expected to be a record year for dry bulk rates, we are slightly lowering our 2008 valuation multiple in order to be more conservative. As such, we apply a new 7.0x EV/EBITDA multiple (from 8.0x) to our new 2008 EBITDA estimate of \$794 million, which results in our new price target of \$133 (from \$114). We reiterate our BUY rating.

**Dryships, Inc. - Income Statement**

	2006	1Q07	2Q07	3Q07	4Q07E	2007E	1Q08E	2Q08E	3Q08E	4Q08E	2008E
<b>Voyage Revenue</b>	<b>\$248,431</b>	<b>\$86,650</b>	<b>\$112,521</b>	<b>\$150,011</b>	<b>\$216,795</b>	<b>\$565,977</b>	<b>\$236,530</b>	<b>\$229,558</b>	<b>\$230,755</b>	<b>\$229,962</b>	<b>\$926,805</b>
Voyage expenses	15,965	5,270	6,987	9,522	10,840	32,619	10,948	10,959	10,937	10,959	43,803
Vessel operating expenses	47,889	13,789	15,228	15,279	15,904	60,200	16,832	16,940	17,271	17,321	68,364
Depreciation & amortization	61,605	16,854	18,743	20,826	20,003	76,426	20,637	20,961	21,352	21,627	84,576
General & administrative	5,931	1,888	2,007	3,016	3,122	10,033	3,119	3,153	3,229	3,829	13,330
Management fees	6,609	2,196	2,445	2,416	2,500	9,557	2,500	2,500	2,500	2,500	10,000
Loss/(gain) on FFA's	22,473	-	-	-	-	-	-	-	-	-	-
(Gain)/loss on sale of vessels	(8,583)	(30,497)	(53,786)	(19,229)	(31,000)	(134,512)	-	-	-	-	-
<b>Total operating expenses</b>	<b>137,999</b>	<b>39,997</b>	<b>45,410</b>	<b>51,059</b>	<b>52,368</b>	<b>188,834</b>	<b>54,036</b>	<b>54,513</b>	<b>55,289</b>	<b>56,236</b>	<b>220,073</b>
<b>Operating income</b>	<b>110,432</b>	<b>46,653</b>	<b>67,111</b>	<b>98,952</b>	<b>164,427</b>	<b>377,143</b>	<b>182,494</b>	<b>175,046</b>	<b>175,466</b>	<b>173,726</b>	<b>706,732</b>
Interest expense, net	(40,025)	(10,748)	(12,174)	(12,125)	(13,944)	(48,991)	(15,478)	(15,632)	(15,789)	(15,868)	(62,766)
Other, net	214	(1)	1,514	(2,508)	-	1,513	-	-	-	-	-
<b>Net income</b>	<b>70,621</b>	<b>35,904</b>	<b>56,451</b>	<b>84,319</b>	<b>150,483</b>	<b>327,157</b>	<b>167,017</b>	<b>159,413</b>	<b>159,677</b>	<b>157,859</b>	<b>643,966</b>
<b>EPS - operating</b>											
<b>Diluted</b>	<b>\$2.18</b>	<b>\$1.01</b>	<b>\$1.59</b>	<b>\$2.38</b>	<b>\$4.18</b>	<b>\$9.18</b>	<b>\$4.61</b>	<b>\$4.38</b>	<b>\$4.37</b>	<b>\$4.30</b>	<b>\$17.65</b>
<b>EPS - GAAP</b>											
Diluted	\$1.75	\$1.87	\$3.11	\$2.92	\$5.04	\$12.96	\$4.61	\$4.38	\$4.37	\$4.30	\$17.65
Dividend	\$0.27	\$0.07	\$0.07	\$0.07	\$0.07	\$0.27	\$0.07	\$0.07	\$0.07	\$0.07	\$0.27
<b>Shares outstanding</b>											
<b>Diluted</b>	<b>32,332</b>	<b>35,490</b>	<b>35,490</b>	<b>35,490</b>	<b>36,022</b>	<b>35,623</b>	<b>36,203</b>	<b>36,384</b>	<b>36,565</b>	<b>36,748</b>	<b>36,475</b>
<b>Selected Ratios</b>											
Gross Profit	184,577	67,591	90,306	125,210	190,051	473,158	208,750	201,659	202,547	201,682	814,638
EBITDA	171,004	63,507	85,854	119,778	184,429	453,568	203,131	198,006	197,818	195,353	794,308
<b>Margin</b>											
Gross margin	74.3%	78.0%	80.3%	83.5%	87.7%	83.6%	88.3%	87.8%	87.8%	87.7%	87.9%
Operating income (EBIT)	44.5%	53.8%	59.6%	66.0%	75.8%	66.6%	77.2%	76.3%	76.0%	75.5%	76.3%
<b>Growth</b>											
YoY Net revenue	10.2%	58.1%	106.3%	150.2%	174.1%	127.8%	173.0%	104.0%	53.8%	6.1%	63.8%
YoY EBITDA	-2.7%	67.9%	132.8%	193.8%	232.1%	165.2%	219.9%	130.6%	65.2%	5.9%	75.1%
YoY EPS	-43.3%	70.0%	199.3%	396.4%	440.1%	320.5%	356.0%	175.5%	83.8%	2.8%	92.2%

Source: DryShips, Inc. and Cantor Fitzgerald forecasts

## Disclosures Appendix

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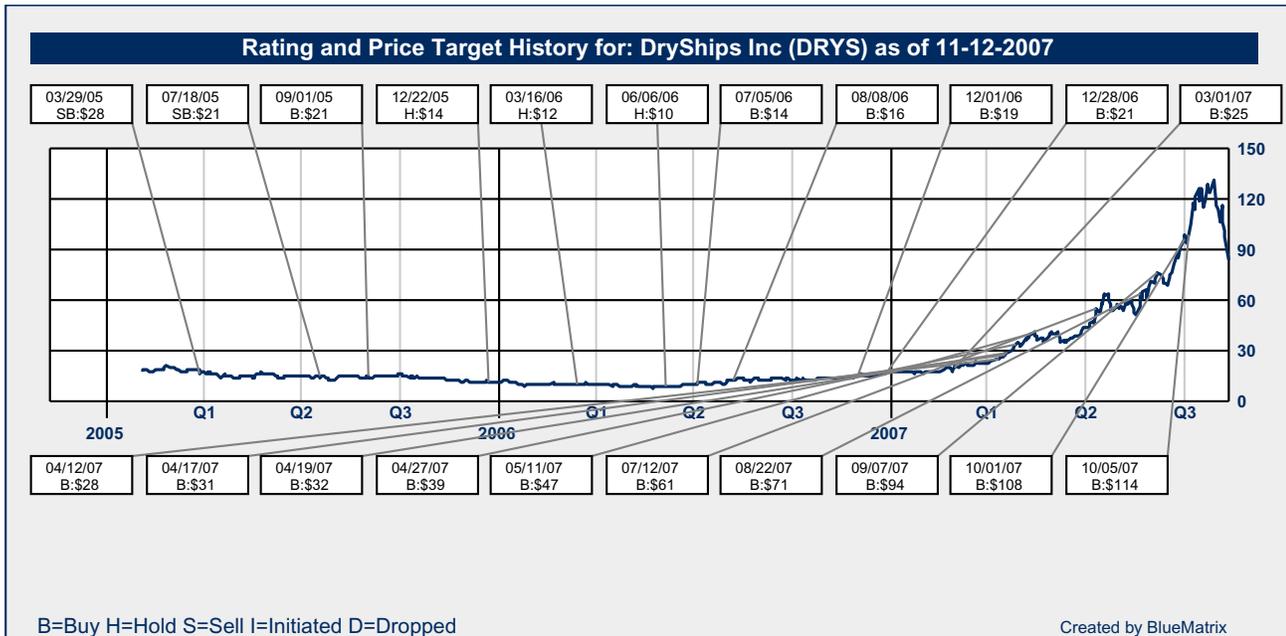
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Rating	Count	Percent	IB Serv./Past 12 Mos.	
			Count	Percent
BUY [B]	66	74.16	15	22.73
HOLD [H]	22	24.72	3	13.64
SELL [S]	1	1.12	0	0.00

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