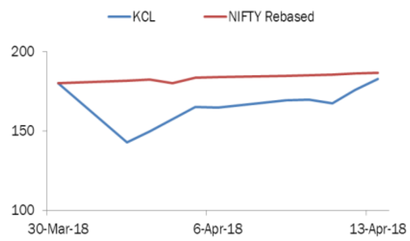
Karda Construction Limited

13 April 2018

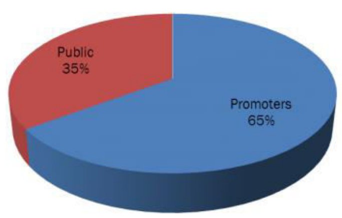
Strong execution capacity in high-potential Nashik market key to success — BUY

Sector	: Real Estate
Target Price	: Rs 260
Current Market Price	: Rs 183
Market Cap	: Rs 226 crore
52-week High/Low	: Rs 184/144
Daily Avg. Volume	: 296,119
Face Value	: Rs 10
Beta	: 0.33
Pledged Shares	: N/A
Year End	: March
BSE Scrip Code	: 541161
NSE Scrip Code	: KARDA
Bloomberg Code	: KARDA IN
Reuters Code	: N/A
Nifty	: 10,481
BSE Sensex	: 34,193
Analyst	: Ritwik Bhattacharjee

Price Performance



Shareholding Pattern



Initiation Report

INVESTMENT SUMMARY

- Karda Construction Limited (KCL) has an experience of two and a half decades in Nashik which we believe is a competitive advantage for the company to cash in on the growth potential of the local real estate market.
- Nashik's emergence as a hub for the industrial and service sectors, infrastructure development in the area and affordability of real estate present strong potential for the city's property market in terms of both investment and end-use demand.
- KCL has strong execution capacity which is showcased by its quick turnaround time on projects. On average, the company has taken a little over 2 years to construct a project comprising 71 units with a carpet area of over 67,000 sq ft.
- KCL has a strong project pipeline of 13 ongoing and 3 planned projects with an aggregate carpet area of approximately 17.6 lakh sq ft. Further, its experience in affordable housing puts it at an advantageous position considering the government's initiatives in the segment.
- KCL has ventured into contract construction services which we view positively in terms of de-risking of the company's business model.
- KCL's large landbank and strategy of acquiring land in areas with potential for future growth are amongst its key strengths as a developer.
- The KCL stock currently trades at 17.1x FY19E EPS and 12.7x FY20E EPS. Based on a target P/E multiple of 18.0, we value KCL at Rs 260 with an upside potential of 42% and informing a BUY rating.

Key Financial Metrics

Rs lakh	FY16A	FY17A	FY18E	FY19E	FY20E
Operating revenue	10,072	10,531	11,725	15,048	18,080
Growth		*4.6%*	*11.3%*	*28.3%*	*20.2%*
EBITDA	2,149	2,628	3,007	3,243	4,122
EBITDA margin	*21.3%*	*25.0%*	*25.7%*	*21.6%*	*22.8%*
PAT	637	803	1,008	1,318	1,774
PAT margin	*6.3%*	*7.6%*	*8.6%*	*8.8%*	*9.8%*
Diluted EPS (Rs)	12.75	8.92	8.20	10.72	14.43

Source: Company data; Khambatta Research

COMPANY OVERVIEW

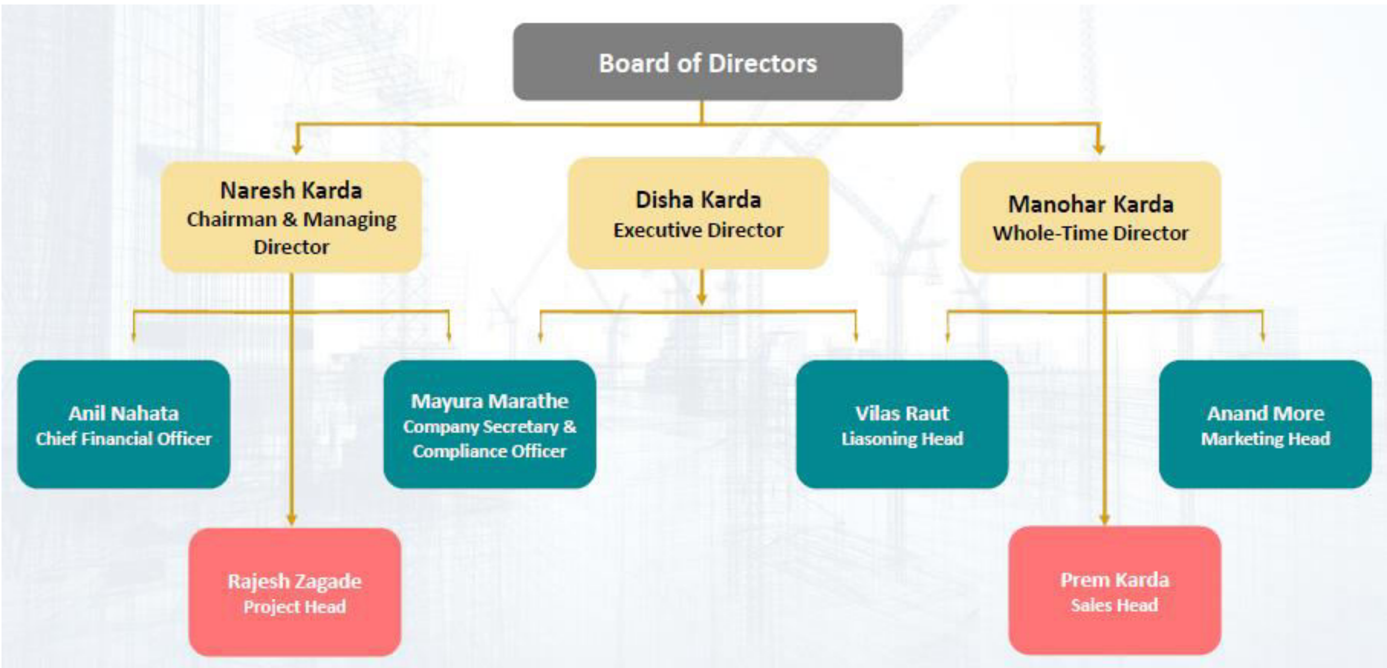
KCL has an experience of having successfully completed and delivered 15 projects totaling over 1 million sq.ft carpet area

Incorporated in 2007, Karda Construction Limited (KCL) is a real estate company which develops and sells residential and residential-cum-commercial projects in Nashik, India. KCL has successfully completed 15 projects of over 1 million square feet carpet area in aggregate, most of them under the "Hari" brand name such as Hari Smruti, Hari Amantran, Hari Shrushti, Hari Kunj, Hari Niwas, Hari Niketan and Hari Sankalp. In its 15 completed projects, the company has delivered a total of 1072 units, comprising 1,009 residential units and 63 shops. Currently the company has 13 ongoing (of 15.7 lakh sq ft carpet area) and 3 planned projects with an estimated overall carpet area of 17,59,017 sq ft.

The Karda Group is a well-established real estate developer in Nashik having presence in the construction industry for more than two decades. Founded by Mr. Naresh Karda in 1994, the group initially concentrated on developing affordable housing. The group diversified into the commercial segment in 2001 to meet the growing demand for commercial real estate. At present, the company caters to all residential segments (low, medium and premium).

Mr. Naresh Karda, the promoter and Chairman & Managing Director of KCL has 23 years' experience in the real estate and construction sector during which he has completed 36 projects and delivered 2,500 homes in Nashik. He is a diploma-holder in civil engineering from Pravara Nagar Polytechnic, Maharashtra.

Management Structure



Source: Company presentation

INDUSTRY OVERVIEW

Indian real estate sector

Real estate sector's share of GDP is estimated to increase from 6% in 2016 to 13% in 2025

Real estate is a key sector of the Indian economy, especially in urban India. The sector's contribution in the country's GDP is expected to increase from a little over 6% in 2016 to close to 13% in 2025. In line with the higher GDP share, employment in real estate is projected to increase from 9.2 million to 17.2 million over the same period. *(Source: CREDAI-CBRE research, 2017).* The Indian construction industry, on the other hand, ranks third amongst 14 major economic sectors with respect to direct, indirect and induced effects across the economy.

The real estate sector can be broadly divided into four segments based on the end markets: residential, commercial, retail and hospitality. SEZ is sometimes considered a unique sector, separate from commercial. The growth of the real estate sector is expected to be driven by expansion of the service sector as well as industrial activity, growing personal income and spending power, consumerism, and urbanization. The annual real estate supply in India is projected to increase from 3.6 billion sq. ft. in 2013 to 8.2 billion sq. ft. in 2025 according to a CREDAI-CBRE study.

The Indian real estate market is fragmented with a large number of local and regional players. There are a few large pan-India developers such as DLF and Unitech. Parsvnath and Tata Housing too have projects across many states. Interest in Indian real estate amongst non-resident Indian (NRI) communities is increasing. Bengaluru is seen as the most favoured destination amongst diaspora Indians, followed by Ahmedabad, Pune, Chennai, Goa, Delhi and Dehradun.

Some recent major land deals include DLF's acquisition of an 11.76 acre land parcel in February 2018 for Rs 1,496 crore in Udyog Vihar, Gurugram for a mixed-use development project; Brigade Enterprises' purchase of a 12.95 acre land parcel in north Bengaluru's Yeshwantpur area for Rs 218 crore in January 2018; and Lodha Developers' Rs 376 crore deal for 5 acres of land in Mumbai's Jogeshwari suburb last November.

DLF's acquisition of a 12 acre land parcel in Gurugram for Rs 1,500 crore is amongst the largest land deals in recent times

Recent key foreign investments in the Indian real estate sector include Japanese conglomerate Sumitomo Corporation's US$ 2 bn partnership with Krishna Group to develop real estate projects, announced in February 2018; Singapore's sovereign fund GIC's acquisition of a 33% stake in DLF's rental arm DLF Cyber City Developers for Rs 8,900 crore in December 2017; and KKR India Asset Finance's investment of over US$ 500 mn in residential real estate projects during 2017, taking KKR's total investments in Indian real estate projects to US$ 1 bn.

Residential real estate segment

Residential real estate is a key segment of the Indian real estate sector, accounting for 80% of the overall market. The number of residential

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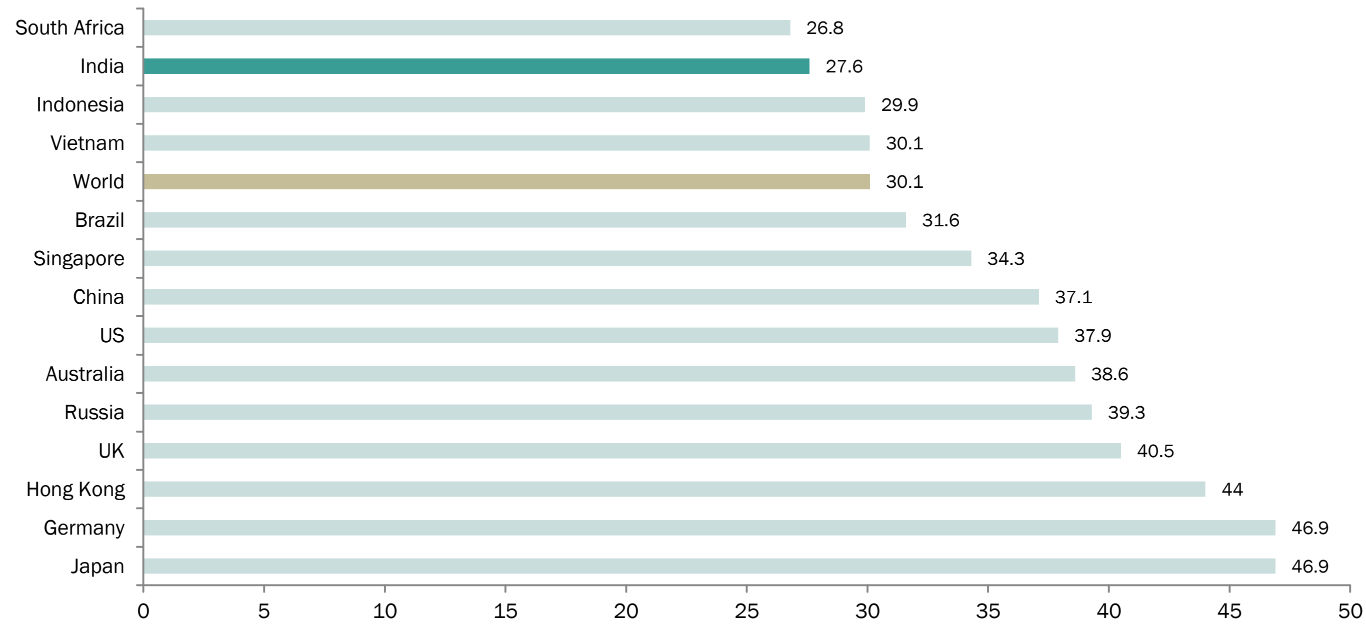
India ranks ninth in terms of annual increase in Knight Frank's Global House Price Index amongst 55 international markets

units launched during FY17 was 108,200. Going forward, the residential market is expected to be driven by an increasing population of potential home buyers, urbanization, growth in household income, expansion of workforce, nuclearization of families and increased availability of housing finance. India's demographics, characterized by a high percentage of working-age population, set the stage for continued high demand for housing from end users for years to come. India ranked ninth in terms of annual increase in property prices amongst 55 international markets in Knight Frank's Global House Price Index with a 10% y-o-y rise as of June 2017. As a matter of fact, the Indian residential market recorded the maximum increase in prices in the Asia Pacific region over the last five years with home prices increasing by 70% between 2Q FY12 and 2Q FY17.

Median Age of Population

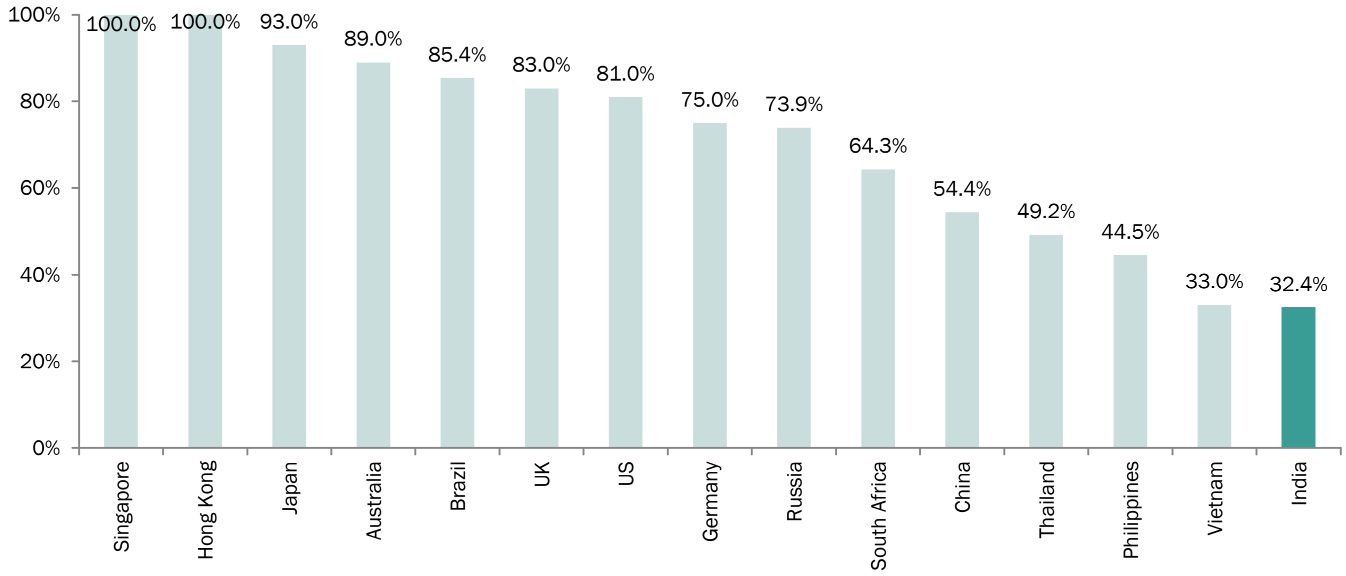


Source: KPMG, 2017

Residential property prices increased by more than two times from 2007 to 2016 in India

The Indian residential real estate market generated returns which are comparable to those of Hong Kong and Brazil over the last ten years while outperforming many other global markets. Residential property prices increased by more than 2x from 2007 to 2016 in India. However, the growth in real estate valuations outpaced income growth, thereby making property ownership progressively less affordable. Residential property prices accelerated strongly from 2007 to 2013 after which some correction came through with prices bottoming out by the end of 2014. Valuations have increased moderately since. Between 2009 and 2015, while the house price-to-income ratio has come down in the US and the UK, India along with other emerging markets such as China, Brazil and Indonesia as well as Singapore and Hong Kong saw property prices increasing at a rate higher than income growth.

Global Urbanization Rates (percentage of population living in urban areas)



Source: KPMG, 2017

Inventory levels in the residential segment peaked in 2014 at 720,000 units

Inventory levels in the residential segment peaked in 2014 at 720,000 units leading to a slowdown in new project launches as developers focused on offloading the built-up inventory. Consequently unsold inventory levels fell by 24% between 2H CY15 and 2H CY17 in spite of weak demand. 2017 saw the decade's highest percentage decline in supply volumes in the residential real estate market. Current annual supply has dropped to a fourth of 2015 levels with the NCR being the most affected market with an annual supply volume of 7% of its decadal high. The slowdown in supply has, however, positively affected relative demand. 230,000 units were sold during 2017 (-7% y-o-y) compared to 100,000 units launched. Mumbai and Pune recorded marginal growth in sales in 2017 helped by price drops of 5% and 7%, respectively. Consumer confidence in these cities was also boosted by the implementation of RERA with Maharashtra having the maximum number of RERA-registered projects in the country.

Residential sales in NCR and Mumbai increased by 21% y-o-y and 19% y-o-y, respectively in 2H CY17, though sales numbers remained below 2H CY15 and 2H CY14 levels. The growth during July to December of 2017 was helped by the weak sales during 2H CY16 due to the demonetization.

From 2014 to 2017, residential property prices in India's top eight cities grew at a rate below retail inflation

Between 2014 and 2017, residential property prices across India's top eight cities largely grew at a rate below retail inflation resulting in increased affordability of housing. Average ticket sizes of residential property in most cities have moved closer or below the Knight Frank Affordability Benchmark of 4.5x annual household income.

The decline in residential property prices will be a key driver of market recovery besides a reduction in unit sizes, both of which will improve the affordability factor. Further, policy initiatives such as RERA and Housing for All will help boost demand for housing in the medium term.

(Data Sources: KPMG; Knight Frank)

RERA

RERA will regulate the real estate sector and function as an adjudicating body for speedy dispute redressal

The Real Estate (Regulation and Development) Act, 2016 or RERA seeks to protect the interests of property buyers and regulate the realty sector by making developers more accountable in terms of pricing, and timely completion and quality of projects. Under the law, each state has to establish a Real Estate Regulatory Authority which will regulate the real estate sector in the state and function as an adjudicating body for speedy redressal of disputes. The Act is expected to improve transparency, increase consumer confidence and help formalize the realty sector, thereby boosting demand and attracting more institutional investment to the sector. The bill was passed on 10 March 2016 by the Rajya Sabha and the Act became effective from 1 May 2016.

Some key features of RERA are:

- Commercial and residential real estate projects measuring over 500 sq m or having more than eight apartments are required to register themselves with their respective state RERA authority before they are launched. Further, real estate agents are also required to register.
- Developers of real estate projects have to set aside a minimum of 70% of the funds raised for a project from buyers and investors in an escrow account. This money can be used only for project construction activities and payment for land, and cannot be channelled elsewhere with developers requiring to furnish information regarding the use of funds received from allottees.
- Developers need to disclose the carpet area of the units being sold and quote prices based on carpet area (as opposed to builtup- or super builtup-based prices).
- Submission of original approved project plans has been made mandatory. Further, developers cannot alter the approved plan of a project without the consent of at least two-thirds of the allottees of a project.

Developers now have to quote prices based on carpet area

- The construction timelines for a project needs to be approved by an authorized architect, engineer or chartered accountant.
- The project developer has to give five years' warranty against structural flaws.

- Details of all registered projects, builders' track records, litigation and other important details are to be put up on a website for public access.

- The Act also mandates the establishment of appellate tribunals under the respective state regulators. The primary objective of the tribunals is speedy resolution of grievances and complaints.

Urban affordable housing

The Pradhan Mantri Awas Yojana seeks to provide housing for all by the year 2022

The Pradhan Mantri Awas Yojana (Urban) (PMAY-U) was introduced by the Indian government in 2015 as an initiative towards providing affordable housing to the urban poor. The programme has a mission of providing housing for all by the year 2022.

The programme's primary objective is to provide affordable housing in cities and towns using eco-friendly construction methods. The beneficiaries, who should be women sole or joint owners, are also eligible for interest subsidy on home loans under the Credit Linked Subsidy Scheme. The key features of PMAY are:

- Coverage of all urban areas in the country which includes 4,041 statutory towns to be executed in 3 phases with a priority to 500 Class I cities

- Interest rate subsidy of 6.5% (maximum) on housing loan for a maximum period of 20 years

- Use of sustainable and eco-friendly technologies for construction

- Preferential allocation of ground floor units to physically-challenged and senior citizens

The scope of PMAY-U has been widened over time to bring middle income groups (MIGs) under its ambit with the government looking to attract both middle- and low-income households to this segment. Last September, the government extended the interest subsidy benefit for households belonging to the MIGs. Originally scheduled to end in December, the scheme has now been extended until March 2019. Subsequently in November, the carpet area of houses eligible for interest subsidy under PMAY was increased. While home buyers from the economically weaker section (EWS) and low income group (LIG) are eligible for an interest subsidy of 6.5% for a tenure of up to 20 years, the subsidy limits for MIG-I and MIG-II are 4% and 3%, respectively.

In November, the carpet area of houses eligible for interest subsidy under PMAY was increased

2017 saw further amendments in PMAY-U guidelines to encourage more young people to invest in property. Now unmarried children of a household are also eligible to apply for loans under PMAY even if their parents own a house.

The granting of infrastructure status to affordable housing is expected to be an additional driver for the segment

With limited participation from private players historically, the policy push for urban affordable housing is expected to drive increased participation of developers in the affordable housing market which, in turn, will help accelerate growth for the overall residential real estate segment. The granting of infrastructure status to the affordable housing segment is an additional driver for the segment as it will lower borrowing costs for developers, provide tax concessions and increase capital flow to the segment. The Ministry of Housing and Urban Affairs has introduced 8 public-private-partnership options to promote private investments in affordable housing.

Smart Cities Mission

The Smart Cities Mission is an urban renewal programme of the Government of India with the mission to develop 100 cities across the country and making them citizen-friendly and sustainable. The Union Ministry of Housing and Urban Affairs is the implementing agency, working in collaboration with the state governments of the respective cities. The objective of the mission is to develop the cities' core infrastructure with the objective of providing a good quality of life to its citizens, a clean and sustainable environment and the application of "smart solutions". The programme focuses on sustainable and inclusive development within a compact area and creating a model which can be replicated by other aspiring cities.

Some of the key features of the smart city include inclusive housing, creation of walking infrastructure, preservation and development of open spaces, improvement of transport infrastructure, citizen-friendly and cost-effective governance, and the application of smart solutions to infrastructure and services. Central to the smart city development objectives will be the application of technology with the aim to offer smart and cost-effective solutions to the citizens.

The "100 Smart Cities Mission" was launched by Prime Minister Narendra Modi in June 2015. A total of Rs 98,000 crore has been approved by the union cabinet for the development of 100 smart cities and the rejuvenation of 500 others. This includes an allocation of Rs 48,000 crore for the Smart Cities Mission and a funding of Rs 50,000 crore for the Atal Mission for Rejuvenation and Urban Transformation (AMRUT).

India ranked third in the ranking of the top 10 countries for Leadership in Energy and Environmental Design certified buildings with 20 million sq m of certified projects

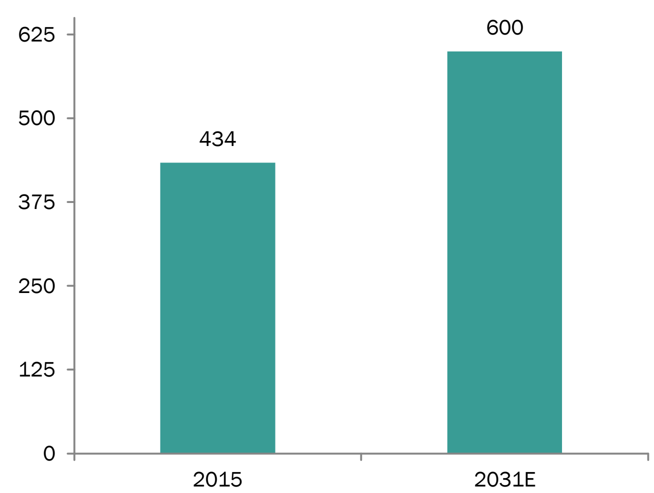
India ranked third in the US Green Building Council's (USGBC's) ranking of the top 10 countries for Leadership in Energy and Environmental Design (LEED) certified buildings with 752 LEED-certified projects extending over 20 million sq m of area. The Smart Cities Mission is further expected to spur demand for green buildings and boost property markets in the selected smart cities, thereby emerging as a key growth driver for the Indian real estate sector in the coming years.

Outlook

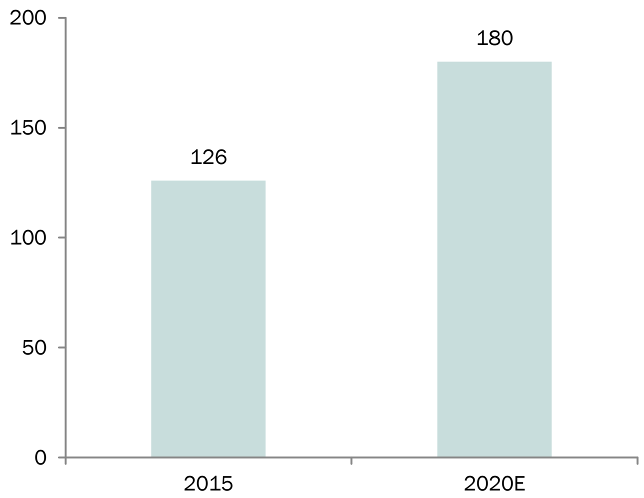
Demand for 2 and 3 BHKs has increased as the market revival is led by end users

The Indian real estate sector witnessed some key developments in 2017 leading to a change in the prevailing market dynamics. The demonetisation of high-value currency notes in November 2016 affected the sector as a significant portion of real estate dealings took place in cash. Land deals were affected more severely due to the involvement of an even higher proportion of cash driving a decline in land prices which, in turn, made constructed property relatively more affordable. Subsequently in the first half of 2017, the introduction of RERA resulted in further inertia as both buyers and developers waited to get a clearer idea regarding the notification of rules by the respective state regulatory authorities. With buyers holding back bookings in anticipation of the regulatory changes, there was a slowdown in property sales during a major part of 2017. However, with the economy recovering from the temporary demonetization-led slowdown, the sector is witnessing changes in terms of standards of delivery, accountability and transparency following the implementation of RERA. There is a perceived change in consumer preference as demand for RERA-compliant ready-to-move-in properties have increased with buyers more inclined to pay a premium for projects constructed by reputed developers. Further, the demand for 2 and 3 BHKs has increased as the gradual revival of the market is led by consumers as opposed to investors, a direct fallout of demonetization and the consequent decline in cash transactions.

Urban Population of India (million)



Indian Real Estate Market (US$ bn)



Source: IBEF

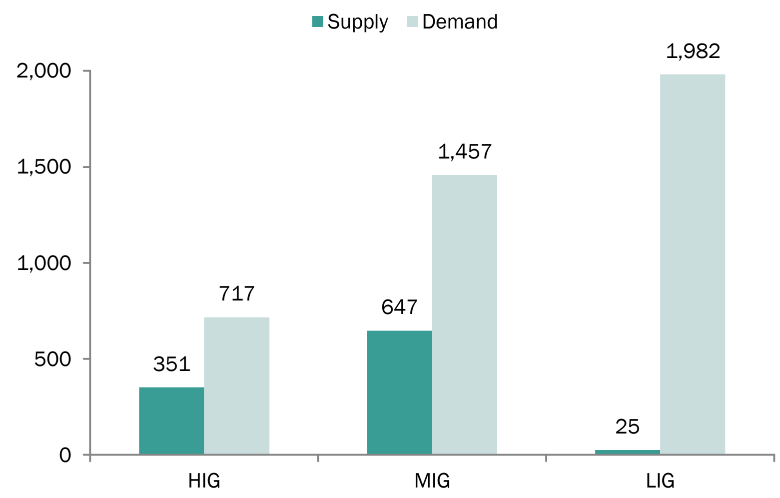
The government's thrust on affordable housing and the conferring of infrastructure status to the segment along with various tax incentives will drive a realignment of the product portfolio as major developers look to capture a share of this market. The increase in carpet area of affordable units to 120 sq m and 150 sq m and interest subsidy of 4% and 3% for MIG-I (income bracket of Rs 6-12 lakhs per annum) and MIG-II (Rs 12-18 lakhs per annum), respectively will benefit the overall market. While there will be more options for buyers, developers will gain from faster reduction of the existing inventory.

The realty market is expected to see some consolidation with financially distressed developers being acquired by bigger players

There will also be an increasing interest in niche categories such as holiday properties, townships, gated communities and plotted developments. Consequently certain players may emerge as specialists in some of these niche segments.

The recent policy initiatives of the government will continue to give direction to the real estate sector towards a more organized and professional industry structure. Going forward, the market is expected to see some consolidation with financially distressed developers being acquired by bigger players as well as more joint ventures and joint development of projects. Until inventory levels come down further, completion of existing projects will remain a priority while new project launches will be dominated by the more reputed developers.

Housing Supply Gap in Top 8 Indian Cities, 2016-20 ('000 units)



Source: IBEF

By 2020, the Indian real estate market is projected to reach US$ 180 bn with the residential segment contributing 11% of GDP. Between FY08 and FY20, the residential market is estimated to grow by 11% CAGR. *(Source: IBEF)*. The commercial, retail and hospitality segments too are expected to witness strong growth rates going forward, driven by an accelerating economy and rapid urbanization.

Office space absorption in the top 8 cities during the first nine months of 2017 was 18 million sq ft

IT-BPM, consulting, retail and e-commerce are amongst the sectors that have been witnessing strong demand for office space lately. Office space absorption in the top 8 cities during the nine months to September 2017 was 18 million sq ft. Private equity inflow in the office space category of the commercial segment grew by 1.5x between 2014 and 2017. The

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supply of new retail space was 6.4 million sq ft in 2017 while 20 million sq ft is expected to come up in 2019. *(Source: IBEF)*

The Indian construction development sector received equity FDI of US$ 25 bn from April 2001 to December 2017

Department of Industrial Policy and Promotion (DIPP) data shows that the Indian construction development sector received cumulative equity FDI of nearly US$ 25 bn from FY01 to December 2017. Private equity investment in real estate is estimated to grow to US$ 100 billion by 2026 with a majority of it expected to be channelled to tier 1 and 2 cities, according to IBEF.

Nashik: Infrastructure, economy and real estate

Nashik is Maharashtra's fourth largest city with a total metropolitan population of 1.6 million people (based on the 2011 Census). Popularly known as India's "wine city" due to the presence of a number of vineyards and wineries in the area, this Tier 2 city is located approximately 190 km from the metropolises of Mumbai and Pune. It is also one of the 8 cities from Maharashtra selected for the Smart Cities Mission. Nashik is witnessing increasing interest from a large number of property buyers and investors due to its strong infrastructure, temperate climate, good quality of life and affordable real estate valuations. The city and its adjoining areas have well-established industrial facilities in the auto, engineering and electrical goods sectors. The Nashik region is also known for its agricultural produce of onion, tomato and other vegetables.

Rapid urbanization and growing industrialization of Nashik and surrounding areas are luring many to shift base to the city. There is a large migrant population in the industrial belt comprising Ozar, Ambad, Sinnar and Satpur which is driving realty demand. Its proximity to the megacity of Mumbai and the IT and auto hub of Pune gives Nashik a strong locational advantage. Property prices in the city are, however, lower compared to its more expensive neighbours, thereby offering stronger potential for appreciation. Infrastructure development projects such as the widening of Mumbai-Nashik Highway to four lanes and the planned widening of the Pune-Nashik Highway will drive real estate valuation in the city going forward. The airport at Ozar which has been recently upgraded with an air cargo terminal as well as the proposed international airport at Shirdi will further strengthen connectivity to the city. The Greater Nashik Metro project has been proposed to connect areas of greater Nashik such as Ozar, Deolali, Igatpuri, Sinnar and Nashik city. The fastest growing city in Maharashtra and the fourth fastest in the country, the demand for real estate in Nashik is set to grow substantially going forward driven by industrialization and infrastructure development.

The Ozar airport has been recently upgraded with an air cargo terminal

The development of technology parks and SEZs demonstrate Nashik's emergence as an IT and industrial hub. Nashik district's Igatpuri and Sinnar regions are part of the Delhi-Mumbai Industrial Corridor which makes them ideal for real estate developments. The city's continued emergence as a hub for both the industrial and service sectors is illustrated by the Sinnar SEZ, which is at an advanced stage of completion, and the recently-announced 200 acre facility of IT major Accenture.

HAL's aircraft manufacturing plant, situated 16 km from Nashik city, employs over 7,000 people

Companies that have set up manufacturing plants in the Nashik MIDC area include ABB, L&T, Siemens, Jindal Steel, Thyssenkrupp, Mahindra and Mahindra, Bosch India, Kirloskar, CEAT, Schneider Electric, Crompton Greaves, Atlas Copco, Epcos, Lear Corporation, GlaxoSmithKline, Coca Cola, Shalimar Paints and Cipla. Hindustan Aeronautics Limited's aircraft manufacturing plant, situated 16 km from Nashik city, employs over 7,000 people. Indiabulls Power's plant in Sinnar and the Nashik Thermal Power Station are the two thermal power plants powering Nashik. Further, a wind power park set up by Suzlon Energy supplies electricity to Nashik.

Nashik is increasingly being seen as a favourable destination for property investment as the city's emerging real estate market offers a comparatively higher ROI vis-à-vis some other options in Maharashtra and western India. As a result, the city draws many second home buyers. The development of infrastructure and increasing commercial activity in and around the city as well as the presence of many educational institutions makes Nashik a good choice for end users too. This is attracting reputed developers looking to exploit the growing housing demand in the city, especially in the affordable and MIG segments. Some neighbourhoods of Nashik offering strong potential are Pathardi Phata, Pune Road, Gangapur Road, Indira Nagar, Govind Nagar, Dwarka Corner, Makhmalabad and Anandwalli. While property values have grown in these areas over the last few years, they still a good scope for further upside.

PEER COMPARISION

The real estate sector comprises few national-level players, some regional players and many local players specializing in their local markets. For the purpose of comparison, we have included the following companies in our peer group for KCL which includes real estate developers primarily focusing on their local markets.

Kolte-Patil Developers: Kolte-Patil is Pune's largest real estate company, having delivered 1.5 crore sq ft of developments in Pune and Bengaluru. The company is also present in Mumbai with some upscale redevelopment projects.

Vascon is a Pune-based EPC and real estate company with projects in Nashik

Vascon Engineers: Vascon is a Pune-headquartered EPC and real estate company. It has delivered over 50 million sq ft across 200 projects in residential, commercial and industrial segments. The company has constructed homes, factories, hospitals, hotels, offices and malls including government projects. Vascon has developed real estate projects in Nashik too.

Arihant Superstructures: Arihant Superstructures is a real estate developer from Navi Mumbai focusing on affordable housing. Its under-construction projects include studio apartments, 1-4 BHK apartments, luxury apartments, bungalows, row houses and land across various locations in Mumbai, Navi Mumbai, Badlapur, Thane, Panvel, Kharghar, Vashi, Khopoli, Karjat, Taloja and Jodhpur, Rajasthan.

Prerna Infrabuild: Prerna Infra develops commercial and residential real estate projects in Ahmedabad. Doctor House, Prerna Tirth and Prerna Darshan are amongst some of its flagship projects in the city. The company's private safe deposit locker, Prerna Safe Vaults has over 1,500 clients.

Peer Comparison: FY17 key financials

Rs crore	KCL	Kolte-Patil	Vascon	Arihant Super	Prerna Infrabuild
Total operating revenue	105.3	965.6	490.2	184.8	24.7
Operating expenses	79.0	725.6	497.1	121.9	23.3
EBITDA	26.3	240.0	(6.9)	62.9	1.4
EBITDA margin	*25.0%*	*24.9%*	*-1.4%*	*34.0%*	*5.5%*
D&A	0.3	14.9	15.6	1.0	0.1
PBIT	30.7	233.4	35.4	63.3	1.5
Finance cost	18.3	86.0	32.7	10.1	0.0
PBT	12.5	147.3	2.7	53.2	1.5
Tax expenses	4.4	62.4	1.5	17.3	0.4
PAT	8.0	87.2	1.2	32.7	1.1
PAT margin	*7.6%*	*9.0%*	*0.2%*	*17.7%*	*4.5%*
Diluted EPS (Rs)	8.92	11.51	0.07	7.94	0.92

Source: Company data; moneycontrol.com; Khambatta Research

INVESTMENT THESIS

Strong presence and track record in Nashik

KCL has has completed 15 projects in Nashik between 2008 and 2016

The Karda Group is an established name in Nashik's real estate sector. Founded in 1994, it initially focused on development of affordable housing. The group ventured into the commercial segment in 2001. With the incorporation of KCL in 2007, the group embarked on a mission to corporatize its business. The company has completed 15 projects in Nashik between 2008 and 2016 while it is currently executing 13 projects and has another 3 projects in the pipeline. The names of all of KCL's projects start with the word 'Hari' and this has helped the Hari brand gain in terms of popularity and recall factor. Having operated in Nashik for two and a half decades, the company has a robust experience and solid knowledge of the local real estate market. Knowledge of the local market is also a critical factor in successfully carrying out land acquisitions. We believe this is a competitive advantage that KCL enjoys in its home turf and the company is well-positioned to cash in on the growth of Nashik's real estate market.

Solid execution capacity and quick turnaround of projects lends credibility in the market

On average, KCL takes a little over 2 years to construct a carpet area of 67,000 sq ft

KCL has successfully developed 15 projects in Nashik within the residential and commercial segments of the real estate market. Between August 2008 and June 2016, the company completed the development of 1,072 units (1,009 flats and 63 shops) with an area of more than 10 lakh sq ft over 418 months. On average, the company has taken a little over 2 years to construct a project comprising 71 units with a carpet area of over 67,000 sq ft. Some of the company's projects delivered in the quickest turnaround time include Hari Sankul Phase II where 93 units measuring 81,500 sq ft were completed in 13 months; Hari Om Phase I where 218 units with a carpet area of 2,75,000 sq ft were delivered in 3 years; and Hari Niketan (54 units with a carpet area of 54,000 sq ft) in one and a half years. The company is currently developing 13 projects while another 3 projects are planned. Through these 16 projects, KCL expects to deliver over 17 lakh sq ft of developed property. The developer has successfully registered all its ongoing projects under RERA which confers further credibility to it. We believe the company's robust execution capacity and the ability to deliver projects timely will stand it in good stead, especially in a post-RERA market.

KCL has adopted an outsourcing model in design and construction by establishing relationships with key service providers such as architects and contractors. This allows the company to maintain a greater focus on its core business activities of identifying and acquiring land, project development, and marketing and sale of the developed properties. On the other hand, the company can rope in the best service providers for high-quality design and construction.

Robust project pipeline provides earnings visibility

KCL has a strong project pipeline comprising 13 ongoing and 3 planned projects with an aggregate carpet area of approximately 17.6 lakh sq ft. 12 ongoing and 3 planned projects in the residential segment will deliver a carpet area of 13.3 sq ft while another ongoing residential-cum-commercial project will supply 4.3 lakh sq ft of saleable carpet area. Out of the 13 ongoing projects, 6 are expected to be completed before the end of 2018 while another 2 projects are likely to be concluded in 2019. The company, like most real estate developers, charge a portion of the property's price as down payment at the time of booking while the remaining payments are linked to construction milestones. KCL normally starts the sales process for a project around the time of commencing construction. As on 31 March 2017, the developer had received advance payments of over Rs 58 crore from bookings.

As on 31 March 2017, KCL had received advance payments of Rs 58 crore

KCL will benefit from its experience in affordable housing

KCL is an early entrant in the affordable housing segment with a proven track record. Its experience in the category puts it at an advantageous position considering the Government of India's push for affordable

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KCL has won four government contracts worth Rs 23 crore

housing as part of its "Housing for All" initiative. Further, Nashik being an emerging hub for the industrial and service sectors, it is expected to attract an increasing number of young blue- and white-collar workers which will drive the demand for affordable housing in the city and its adjoining areas going forward.

Entry into construction services de-risks KCL's business model

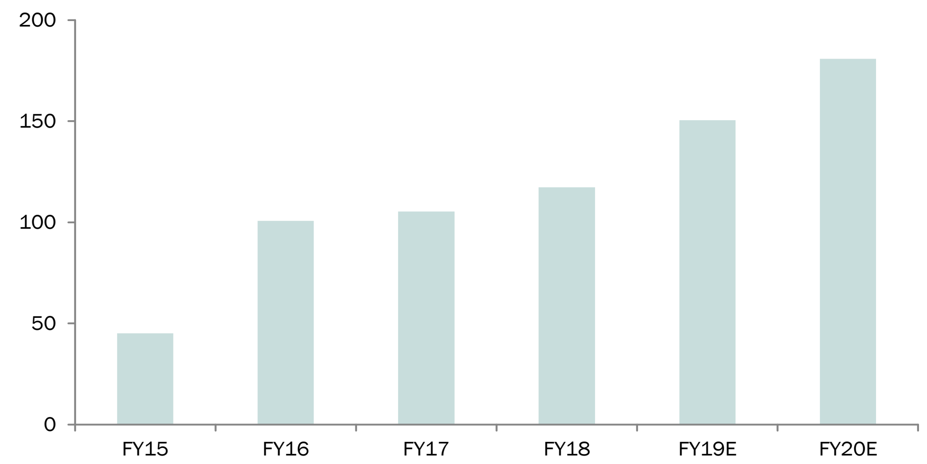
KCL has ventured into contract construction services with the intention of diversifying its business model. The company undertakes construction contracts for both government and private projects. It has won four government contracts worth Rs 22.85 crore, out of which three are from the Goa government while one is from the Maharashtra government (located in Nashik). Besides these, it has also acquired a private sector contract for Rs 16.17 crore relating to the construction of residential and industrial facilities in Ambernath (West), Thane. We view the entry into construction services as a positive for the company and believe it will contribute to the de-risking of its business model.

Land acquisition strategy and a large land bank are key to KCL's success

KCL has a land bank of 3 lakh square feet in Nashik city and neighbouring areas

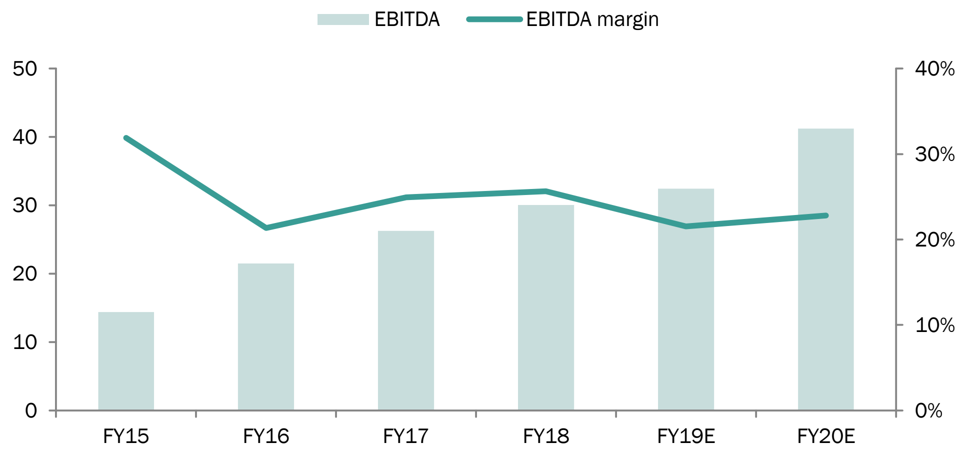
KCL has a land bank of 3 lakh square feet in Nashik city and neighbouring towns such as Igatpuri and Deolali. Accomplishing successful land deals in and around Nashik has been a key element of the company's ability to launch and deliver projects consistently. KCL's land acquisition strategy involves actively identifying and acquiring available land parcels in areas with strong future development potential. Towards this end, the developer looks to discover relatively underdeveloped locations with the objective of gaining the first mover advantage by acquiring land at cheaper rates.

Revenue Performance (Rs crore)



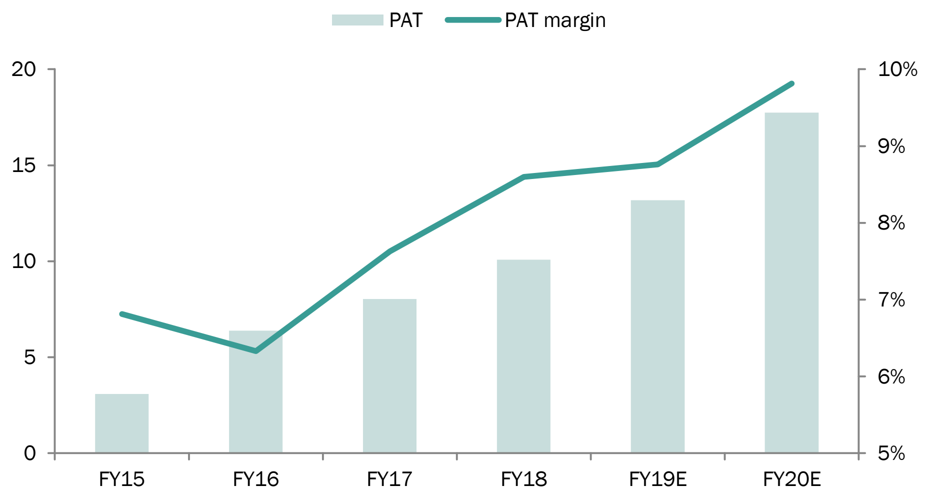
Source: Company data, Khambatta Research

Operating Performance (Rs crore and percentage)



Source: Company data, Khambatta Research

PAT-level Performance (Rs crore and percentage)



Source: Company data, Khambatta Research

VALUATION

Our valuation informs a BUY rating with a target price of Rs. 260

Based on a target P/E multiple of 18, our target price represents an upside potential of 42%

We expect KCL to record strong revenue growth over FY19 and FY20 aided by its ongoing projects and strong pipeline. While ROE is naturally expected to decline at the end of FY18 after the recently concluded IPO, we estimate it to increase over the next couple of years. The company is expected to register strong ROCE on the back of increasing profits at the operating level. Debt-to-equity ratio is forecast to come down after equity infusion from the IPO and subsequent part-repayment of debt. The KCL stock currently trades at 17.1x FY19E EPS and 12.7x FY20E EPS. Based on a target P/E multiple of 18.0, we derive a target price of Rs 260 which represents a 42% upside from current levels, informing a BUY rating.

Profit & Loss Account

Rs lakh	FY15A	FY16A	FY17A	FY18E	FY19E	FY20E
Total revenue	**4,514**	**10,072**	**10,531**	**11,725**	**15,048**	**18,080**
Growth		*123.1%*	*4.6%*	*11.3%*	*28.3%*	*20.2%*
Operating expenses	3,074	7,922	7,902	8,717	11,805	13,957
EBITDA	**1,440**	**2,149**	**2,628**	**3,007**	**3,243**	**4,122**
EBITDA margin	*31.9%*	*21.3%*	*25.0%*	*25.7%*	*21.6%*	*22.8%*
Depreciation & amortization	21	22	27	27	28	33
PBIT	1,558	2,649	3,073	3,390	3,636	4,560
Interest expense	1,114	1,713	1,826	1,790	1,753	2,025
PBT	443	934	1,247	1,600	1,883	2,535
Tax expense	135	296	444	592	565	760
PAT	**308**	**637**	**803**	**1,008**	**1,318**	**1,774**
PAT margin	*6.8%*	*6.3%*	*7.6%*	*8.6%*	*8.8%*	*9.8%*
Diluted EPS (Rs)	**6.15**	**12.75**	**8.92**	**8.20**	**10.72**	**14.43**

Source: Company data; Khambatta Research

Selected Balance Sheet Items

Rs lakh	FY15A	FY16A	FY17A	FY18E	FY19E	FY20E
Total shareholders' funds	1,626	2,255	3,035	8,183	9,501	11,276
Total debt	6,438	10,157	11,204	9,026	10,449	11,679
Total equity & liabilities	**23,305**	**24,961**	**24,854**	**26,651**	**30,440**	**33,364**
Cash & cash equivalents	717	113	221	227	362	422
Inventory	18,328	18,803	17,108	17,756	20,508	22,541
Total assets	**23,305**	**24,961**	**24,854**	**26,651**	**30,440**	**33,364**

Source: Company data; Khambatta Research

Abridged Cash Flow Statement

Rs lakh	FY15A	FY16A	FY17A	FY18E	FY19E	FY20E
Operating cash flow	(2,526)	488	4,061	830	91	1,135
Investing cash flow	(762)	928	(933)	(135)	833	344
Financing cash flow	3,685	(2,020)	(3,021)	(689)	(789)	(1,420)
Net change in cash	**397**	**(604)**	**107**	**6**	**135**	**60**

Source: Company data; Khambatta Research

Ratio Analysis

	FY15A	FY16A	FY17A	FY18E	FY19E	FY20E
ROA	1.3%	2.6%	3.2%	3.8%	4.3%	5.3%
ROCE	7.7%	14.5%	18.2%	17.4%	16.9%	19.0%
ROE	18.9%	28.3%	26.5%	12.3%	13.9%	15.7%
Debt-to-equity ratio	4.0x	4.5x	3.7x	1.1x	1.1x	1.0x

Source: Company data; Khambatta Research

Valuation: Price-to-Earnings

	5Y High	5Y Low	Average	Current	FY18F	FY19F
Karda Construction	N/A	N/A	N/A	20.5	22.3	17.1
Kolte-Patil Developers	28.7	3.5	13.8	27.5	21.3	18.3
Vascon Engineers	504.1	21.1	39.3	465.4	N/A	N/A
Arihant Superstructures	143.9	11.8	59.4	17.3	N/A	N/A
Prerna Infrabuild	48.6	10.4	26.1	20.3	N/A	N/A

Source: Bloomberg; company data; Khambatta Research

KEY RISKS

- The real estate market has been witnessing a downtrend over the last few years. While some early signs of recovery are visible, if the market falls back into a slowdown phase again, the company may underperform our expectations

- Our expectations and forecasts are based on KCL's strong presence in Nashik's real estate market and robust execution capacity. The inability of the company to live up to our expectations in these areas is likely to negatively affect its financial performance

- Any unfavourable developments which cannot be anticipated presently could negatively affect the company leading to underperformance of our estimates

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Guide to Khambatta's research approach

Valuation methodologies

We apply the following absolute/relative valuation methodologies to derive the 'fair value' of the stock as a part of our fundamental research:

DCF: The Discounted Cash Flow (DCF) method values an estimated stream of future free cash flows discounted to the present day, using a company's WACC or cost of equity. This method is used to estimate the attractiveness of an investment opportunity and as such provides a good measure of the company's value in absolute terms. There are several approaches to discounted cash flow analysis, including Free Cash Flow to Firm (FCFF), Free Cash Flow to Equity (FCFE) and the Dividend Discount Model (DDM). The selection of a particular approach depends on the particular company being researched and valued.

ERE: The Excess Return to Equity (ERE) method takes into consideration the absolute value of a company's return to equity in excess of its cost of equity discounted to the present day using the cost of equity. This methodology is more appropriate for valuing banking stocks than FCFF or FCFE methodologies.

Relative valuation: In relative valuation, various comparative multiples or ratios including Price/Earnings, Price/Sales, EV/Sales, EV/EBITDA, Price/Book Value are used to assess the relative worth of companies which operate in the same industry/industries and are thereby in the same peer group. Generally our approach involves the use of two multiples to estimate the relative valuation of a stock.

Other methodologies such as DuPont Analysis, CFROI, NAV and Sum-of-the-Parts (SOTP) are applied where appropriate.

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Buy recommendations are expected to improve, based on consideration of the fundamental view and the currency impact (where applicable) by at least 15%.

Hold recommendations are expected to improve, based on consideration of the fundamental view and the currency impact (where applicable) between 5% and 15%.

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