

MARG CONSTRUCTION

INR 436

Diversified player

NOT RATED



We met the management of Marg Construction (Marg), a Chennai-based real estate and infrastructure developer. The company operates in port, real estate, and Special Economic Zone (SEZ) segments. Following are the key takeaways of the meeting:

Real estate business: Currently, Marg has six ongoing real estate projects under various stages of development, primarily in the Old Mahabalipuram Road (OMR). These include residential projects, individual resorts, mall & multiplexes, service apartments & villas. The six projects will generate buildup and saleable area of ~ 3.7 mn sq ft on a 127 acre plot over the next 4-5 years.

SEZ business: Marg, through its SPV New Chennai Township, is developing two SEZs at Seekinakupam, 88 km from Chennai. Both the SEZs will generate saleable area of ~ 31 mn sq ft over the next 7-8 years. The company has already acquired the required land for both the SEZs and construction will commence once official notification from the central government is received. The management expects to get the notification in the next two months.

Port business: The company, through its wholly owned subsidiary Karaikal Port Pvt. Ltd, is setting up a port project at Karaikal. Marg won the project through a competitive bidding process from the government of Pondicherry for a period of 30 years and has signed the concession agreement in January 2006. The project is likely to get extended for a further period of twenty years.

* Outlook and SOTP valuation

We have done some-of-the-parts valuation of the company which works out to INR 16.7 bn. On the diluted capital (post warrant conversion of 3.4 mn shares) the valuation works out to INR 655 per share. The potential upside not captured in the valuation exists in the form of company's JV with HUDCO for the upcoming infrastructure projects and undeveloped land bank. On a relative valuation basis, the stock is currently trading at a P/E(x) of 37.1 FY07 earnings. The stock is currently not under our coverage universe.

	Project value (NR mn)	Equity value (NR mn)	Price per share (NR)
Real estate & SEZ	11,830	11,539	452.51
Port	6600	5,160	202.35
Total	18,430	16,699	655

Financials

Year to March	FY05	FY06	FY07
Revenue	159	576	1,242
Rev. growth (%)	(79.2)	263.4	115.5
EBITDA (INR mn)	47	135	295
Net profit	15	83	300
Shares outstanding (mn)	25.5	25.5	25.5
EPS	0.5	3.2	11.7
EPS growth (%)	(97.2)	511.2	265.2
P/E (x)	827.8	135.4	37.1
EV/ EBITDA	240.6	83.6	34.8
ROE (%)	0.2	52.6	34.6
ROCE (%)	0.1	21.6	22.8

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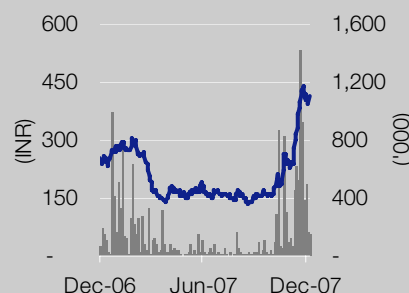
Reuters : MARG.BO
Bloomberg : MRGC IN

Market Data

52-week range (INR) : 448 / 133
Share in issue (mn) : 227.5
M cap (INR bn/USD mn) : 99.1 / 2,508.5
Avg. Daily Vol. BSE ('000) : 105.4

Share Holding Pattern (%)

Promoters : 50.3
MFs, FIs & Banks : 0.0
FII's : 14.7
Others : 35.0



* Real estate business

Currently, Marg has six ongoing real estate projects under various stages of development, primarily in the OMR. These include residential projects, individual resorts, mall & multiplexes, service apartments & villas. The six projects in all will generate buildup and saleable area of ~ 3.7 mn sq ft on a 127 acre plot over the next 4-5 years.

Table 1: Real estate projects description

Project name	Classification	Location	Land area (acres)	Built up area (sft)
Riverside mall	Mall & Multiplex & Business class Hotel	Karapakkam, OMR	7.28	1,265,070
Oakwood	Serviced apartment	Kazhipathur, OMR	3.84	325,000
El paradiso	Apartments	Kalavakkam, OMR	4.34	316,245
Tranquil cove	Villas	Seekinakkuppam, ECR	34.32	1,495,014
Tapovan	Individual Resort	Pavanjur	77	263,120
Ram lakshmi enclave	Residential Apartment	Tenali ,Andhra Pradesh	1.06	97,000
			128	3,761,449

Source: Company

Total cost, including land and construction cost, for these projects will be INR 8.9 bn. We believe the company will be able to earn a net margin of 25% and based on that our net profit for the project comes to INR 2.2 bn. We have discounted the same at 10.3% WACC rate and over 3.5-4 years against management's expectation of 2-2.5 years. Our NPV of the six projects comes to INR 1.8 bn.

Table 2: NPV of real estate business

Project name	Project cost	Net revenue	NPV
Riverside mall	4,425	1,106	909
Oakwood	1,450	363	298
El paradiso	638	160	131
Tranquil cove	1,314	329	270
Tapovan	954	239	196
Ram lakshmi enclave	127	32	26
	8,908	2,227	1,830

Source: Company, Edelweiss research

It has another three rent earning properties on its books. The valuation of the same, as indicated by the management, is INR 3.4 bn.

Table 3: NPV of rent earning properties

Property	Valuation (INR mn)
Marg Square Property	1,400
Digital Zone - I	1,400
Digital Zone - II	600
	3,400

Source: Company, Edelweiss research

* SEZ business

Marg, through its SPV New Chennai Township, is developing two SEZs at Seekinakupam, 88 km from Chennai.

1. Multi sector SEZ (MSS): 300 acres.
2. Light engineering SEZ (LES): 312 acres.

The multi sector SEZ spread over 300 acres will support various segments of the services sector like BPO, KPO, animation, healthcare, R&D, publishing, IT infrastructure support, hospitality, education, etc.

The light engineering SEZ is spread over 312 acres and aims to attract the export-based auto and auto components industry, which has the potential to attract significant FDI and create massive employment potential, leading to significant investments in plant and machinery as well as technology.

The company has already acquired the required land for both the SEZs and construction will commence once they receive the official notification from the central government. The management is expecting to get the notification in the next two months.

The SEZs together will generate saleable area of ~ 31 mn sq ft over the next 7-8 years. The management expects the total cost, including land cost, to be approximately INR 46 bn. The area for the SEZ is not very large and not much of it will be leased as plain plots. We believe that only in the processing zone, plain plots will be given on lease for industrial activities, where as the remaining area will work on the build and lease model. Though the management expects to complete the entire project in the next five years, we have assumed 7–8 years of total completion time for our valuation.

The NPV from SEZ business works out to INR 6.6 bn.

Table 4: SEZ business valuation

Type	Leaseable area (mn sft)	Lease rentals	
		INR/ sq ft/ month	INR mn
Industrial	5.0	7.5	3,000
IT/Office building	12.0	20	28,800
Residential	13.0	15	23,400
Service apartments	0.2	20	360
Shopping mall and multiplex	1.0	20	2,400
		Total Revenue	57,960
		Cost of project	45,729
		PBT	12,231
		Tax	2,446
		PAT	9,785
		DF	4
		NPV	6,601

Source: Company, Edelweiss research

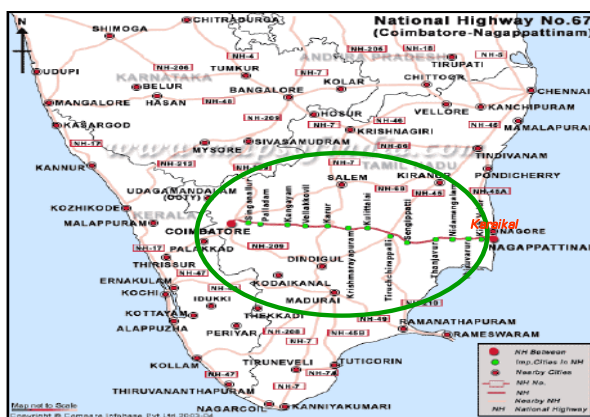
Karaikal port project

Marg, through its wholly owned subsidiary Karaikal Port, is setting up a port project at Karaikal. The company won the project through a competitive bidding process from the government of Pondicherry for a period of 30 years and has signed the concession agreement in January 2006. The project is likely to get extended for a further period of twenty years.

* Hinterland connectivity and distance from major ports augur well for the project

Karaikal port is located on a 600 km stretch between two major ports of India viz., Chennai and Tuticorin. In terms of hinterland, the port caters to the central region of Tamilnadu and has hinterland connectivity through NH-45A and NH-67 and a broad gauge railway line between Nagore and Karaikal enables it to provide better infrastructure facilities.

Fig. 1: Catering to hinterland of central Tamilnadu



Source: Company

* Project to be developed in phases

The Karaikal port project will be developed as a multi purpose port to cater to diversified cargo of solid bulk, liquid, and container. The port, to be completed in three phases at an estimated cost of INR 9.6 bn, is expected to have 10 mn tonnes capacity.

Table 5: Project capex and its funding pattern

INR mn	Phase I	Phase II	Phase III	Total
Project cost	4,162	1,229	4,212	9,604
Means of finance				
Equity	1,145	369	1,158	2,672
Debt	3,018	860	3,054	6,932
Total	4,163	1,229	4,212	9,604

Source: Company

Table 6: Capacity expansion plan

	2008-09	2009-10	2010-11	2011-12	2012-13
Phase I	3.0	3.5	4.0	4.0	4.0
Phase II	0.8	2.4	3.0	4.0	4.0
Phase III	-	-	2.6	3.5	3.5
Total	3.8	5.9	9.6	11.5	11.5

Source: Company

* Karaikal port valuations

Given the long gestation infrastructure projects and steady cash flows arising from them, we have valued the Karaikal port project by the discounted cash flow (DCF) methodology at a cost of equity of 13%.

Table 7: Assumptions

Royalty to GoP (%)	2.6	
Terminal Ops & Maint	40.0	(INR/MT)
Equipment Maintenance Costs (%)	2.0	of the capital expenditure
Pilotage	8.0	(INR/MT)
Maintenance Dredging	60.0	(INR/cu.m for 400,000 cu.m per annum
Admin Exp per year	20.0	(INR mn)
Throughput Charges (INR/MT)		
with annual escalation		
Coal / Liquid	200	
G.Cargo	225	

Source: Company, Edelweiss research

Table 8: NPV of port project

PV of free cash flow to equity (INR mn)	5,160
Terminal value	Nil
Total value to equity (INR mn)	5,160
Cost of equity calculation	
Risk free rate (%)	8.0
Beta	1
Risk premium (%)	5.0
Cost of equity (%)	13.0

Financial Statements

Income statement		(INR Mn)		
Year to March	FY05	FY06	FY07	
Income from operations	159	576	1,242	
Direct costs	105	420	869	
Other expenses	7	21	79	
Total operating expenses	112	441	947	
EBITDA	47	135	295	
Depreciation and amortisation	11	19	19	
EBIT	36	117	276	
Interest expenses	19	38	66	
Other income	1	26	176	
Profit before tax	18	105	386	
Provision for tax	4	22	86	
Reported profit	15	83	300	
Adjusted net profit	15	83	300	
Shares outstanding	25.5	25.5	25.5	
Dividend per share	-	-	-	
Dividend payout (%)	-	-	-	

Common size metrics- as % of net revenues

Year to March	FY05	FY06	FY07
Operating expenses	70.4	76.5	76.2
Depreciation	6.7	3.2	1.5
Interest expenditure	12.0	6.6	5.3
EBITDA margins	29.6	23.5	23.8
Net profit margins	9.1	14.5	24.2

Growth metrics (%)

Year to March	FY05	FY06	FY07
Revenues		263.4	115.5
EBITDA		188.7	117.9
PBT		481.2	267.3
Net profit		475.2	259.7
EPS		511.2	265.2

Cash flow statement		(INR Mn)		
Year to March	FY05	FY06	FY07	
Net profit	13	82	299	
Add: Depreciation	11	19	19	
Add: Misc expenses written off				
Add: Deferred tax				
Gross cash flow	24	101	318	
Less: Dividends	-	-	-	
Less: Changes in W. C.	(31)	214	1,000	
Operating cash flow	56	(113)	(682)	
Less: Change in investments	(5)	8	1,285	
Less: Capex	47	(35)	24	
Free cash flow	13	(86)	(1,990)	

Balance sheet		(INR Mn)		
As on 31st March	FY05	FY06	FY07	
Equity capital	40	100	166	
Reserves & surplus	31	141	1,320	
Shareholders funds	71	241	1,486	
Secured loans	472	517	1,034	
Unsecured loans	4	4	675	
Borrowings	476	520	1,709	
Sources of funds	547	761	3,195	
Gross block	513	586	588	
Depreciation	31	50	48	
Net block	482	536	540	
Capital work in progress	54	0	0	
Goodwill	0	0	0	
Total fixed assets	536	536	540	
Investments	16	23	1,308	
Inventories	9	83	304	
Sundry debtors	24	185	505	
Cash and equivalents	5	18	258	
Loans and advances	178	211	1,134	
Other current assets	0	0	0	
Total current assets	216	497	2,201	
Sundry creditors and others	214	268	732	
Provisions	1	13	102	
Total CL & provisions	215	281	834	
Net current assets	1	216	1,367	
Net Deferred tax	(5)	(14)	(20)	
Others	0	0	0	
Uses of funds	547	761	3,195	
Book value per share (BV)	3	9	58	

Ratios

Year to March	FY05	FY06	FY07
ROE (%)	0.2	52.6	34.6
ROCE (%)	0.1	21.6	22.8
Current ratio	1.0	1.8	2.6
Debtors (Days)	55	117	148
Fixed assets t/o (x)	0.3	1.1	2.3
Debt/Equity	6.7	2.1	1.0

Valuations parameters

Year to March	FY05	FY06	FY07
EPS (INR)	2.0	3.8	11.8
Y-o-Y growth (%)		511.2	265.2
CEPS (INR)	6.3	10.2	19.2
P/E (x)	219.7	113.6	37.0
Price/BV(x)	156.7	46.1	7.5
EV/Sales (x)	71.2	19.6	8.3
EV/EBITDA (x)	240.6	83.6	34.8

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Coverage group(s) of stocks by primary analyst(s): Construction:

BL Kashyap & Sons, Gammon India, Hindustan Construction, IVRCL Infrastructures & Projects, JMC Projects (India), Madhucon Projects, Nagarjuna Construction, Patel Engineering and Simplex Infrastructures.

Marg Construction



Recent Research

Date	Company	Title	Price (INR)	Recos
10-Dec-07	Gayatri Projects	Valut in store; Visit Note	375	Not Rated
07-Nov-07	B L Kashyap	Power packed performance; Result Update	1,413	Buy
25-Oct-07	Hindustan Construction	Lavasa gets going on; Result Update	198	Under Review
17-Oct-07	Patel Engineering	Real estate sweetener; Result Update	712	Under Review

Distribution of Ratings / Market Cap

Edelweiss Research Coverage Universe

	Buy	Accumulate	Reduce	Sell	Total
Rating Distribution*	103	47	22	3	190

* 13 stocks under review / 2 rating withheld

	> 50bn	Between 10bn and 50 bn	< 10bn
Market Cap (INR)	96	65	29

Rating Interpretation

Rating	Expected to
Buy	appreciate more than 20% over a 12-month period
Accumulate	appreciate up to 20% over a 12-month period
Reduce	depreciate up to 10% over a 12-month period
Sell	depreciate more than 10% over a 12-month period

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