

Vascon Engineers Ltd.

25th January 2010

SMC RANKING ★ ★ ★

Issue Highlights

Total Issue Size (in cr.)	178 - 199.8
No. of shares	10800000
Reservation for employees	100000
Net Issue	10700000
Price Band in (Rs.)	165 - 185
Offer Date	27-Jan-10
Close Date	29-Jan-10
Face Value	10
Lot Size	35
Crisil Rating "Grade 3 "	
Indicating average fundamentals	

Issue Composition

No. of shares	10800000
Employee Reservation	100000
Net Issue	10700000
QIB	6420000
NIB	1070000
Retail	3210000

BRLM

Kotak Mahindra Cap. Co. Ltd.

Enam Securities Pvt. Ltd.

Name of the Registrar

Karvy Computershare Pvt. Ltd.

Shareholding Pattern (%)

Particulars	Pre- Issue (%)	Post-Issue (%)
Promoter & Promoter Group	43.81	38.55
QIB	14.66	20.03
NIB	41.53	37.74
Retail	0	3.68
Total	100	100

COMPANY PROFILE

Incorporated in 1986, Vascon Engineers Limited is a pune based player involved in EPC (engineering, procurement and construction) services and real estate development with operations in a number of states and union territories in India. Vascon have significant experience of 23 years in providing EPC services which include, constructing factories, hospitals, office and residential complexes, shopping malls, multiplexes, IT parks etc.

Vascon Engineers third party EPC clients include well-known Indian and multi-national companies such as Cipla Limited, Emcure Pharmaceuticals Limited, Zensar Technologies Limited, Kirloskar Brothers Limited, Okasa Pharma Private Limited, PTC Software (India) Private Limited to name a few. They have also provided EPC services to their Subsidiaries and the Other Development Entities' projects, such as Marigold, Marisoft Annex, Weikfield IT Citi Infopark, Vista and Zircon.

In addition to developing and providing EPC services for real estate projects, Vascon also continue to own or operate certain projects subsequent to their completion. For example, they own the Vista do Rio, the Golden Suites service apartment complex in Pune, and Marigold Premises Private Limited, which owns and operates the Mariplex mall and office complex. Additionally they are involved in developing a multi-level car parking for Delhi International Airport.

As of August 31, 2009, the company completed construction contracts worth Rs 8,804.79 mn, out of which Rs 6,400 mn was for third parties. In terms of saleable area for its real estate development projects, VEL has constructed over 4.58 mn. sq. ft. In 2008-09, the construction business and development business contributed to around 93 per cent and 6 per cent respectively, to the company's total revenues.

STRENGTHS

- **Diversified portfolio of businesses and diverse revenue streams**

VEL commenced its business as an EPC services company and has since, diversified into the real estate development business to synergies between the two businesses. Benefits of having two revenue streams became apparent in the year 2008-09, when the real estate business in India witnessed a significant downturn due to the global economic slowdown while EPC services business, grew substantially for 2008-09 as compared to 2007-08, thereby helping the company to offset the fall in its revenues from the real estate business.

- **Strong order book**

Strong EPC order book provides comfort on revenues and margin front. As of August 31, 2009, the company had completed an aggregate of 179 EPC contracts with a total contract value of Rs 8,804.79 mn. & is engaged in 59 EPC contracts with an estimated total contract value of Rs 33,788.74 mn.

- **Strong track record**

With 23 years of experience in the EPC services business, the company has constructed factories, hospitals, office and residential complexes, shopping malls, multiplexes, IT parks and other buildings. The company's EPC clients include well-known Indian and multinational companies such as Cipla Ltd, Emcure Pharmaceuticals Ltd, Zensar Technologies Ltd, Kirloskar Brothers Ltd to name a few.

- **Effective development structure to optimize resources**

The company's business model of entering into development agreements and/or joint ventures with land owners, in exchange for a pre-determined portion of revenues or profits generated from the projects, enables the company to have development rights to significant parcels of land without having to invest large amounts of money to purchase such land.

Analyst

Mayank Garg
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Objects of the Issue

Funding construction of EPC contracts and real estate development projects	115.00
Repayment of debt	39.63
General corporate purposes	[•]
Total	[•]

STRATEGY

- **Geographic diversification**

Large concentration of population in the tier II & Tier III cities has led the company to diversify into non metropolitan areas such as Nashik, Coimbatore, Aurangabad, Ahmedabad that offers huge growth opportunity. Given its diversification strategy into non metropolitan areas, the company has reduced its real estate development project holdings from 93.71% to 84.58% in the metropolitan region.

- **Continue its focus on real estate development projects**

The company intends to continue developing a diverse range of projects such as residential and office complexes, shopping malls, multiplexes, hospitality properties, IT parks etc. As of December 31, 2009, the company and its other Development Entities had completed an aggregate of 42 real estate development projects and are in the process of developing 51 Ongoing and Forthcoming Projects.

- **Selectively entering into joint ventures and joint development agreements**

The company intends to continue entering into joint ventures and joint development agreements to increase the amount of land or land development rights available to them for development. The company believes that the model will assist in reducing its working capital investment and effectively utilizing its EPC services, sales and marketing capabilities.

- **Optimize business mix**

The company continues to seek & identify business activities that they consider to be highly growth oriented and will complement its existing business portfolio. The company believes, significant growth opportunities in the Indian economy particularly in infrastructure & other development arenas offers enormous competitive opportunities in the sector.

RISK

- **High concentration of operations in Maharashtra**

The company's real estate development business is primarily concentrated in Maharashtra, especially in-and-around Pune, exposing it to a high level of geographic and price risk. Also, in terms of demand for residential and commercial space, Pune city is to a large extent dependent on the fortunes of the IT/ITeS industry. Therefore, any cutting back of expansion plans by IT/ITeS companies will have negative fallout on VEL's business and financial prospects.

- **Highly regulated environment**

The business environment in which the company operates requires approval of numerous governmental authorities on matters such as land uses, levels of density, the installation of utility services, zoning and building Standards etc. As the regulatory framework in India is evolving, changes could have an adverse effect on the business, results of operations and financial condition.

- **High working capital & CAPEX centric business**

EPC services and real estate development businesses require a significant amount of working capital and capital expenditure. Significant amounts of its working capital are required to finance the purchase of materials and the performance of engineering, procurement, construction and other work on projects before payment is received from clients. Insufficient cash flows to meet required payments on debt, working capital and capital expenditure requirements may poise an adverse effect on the results of operations.

- **Joint ventures or joint development agreements obligation**

The company often requires paying substantial advance payments as security deposits to the land owners in connection with the development of its Ongoing and Forthcoming projects. Moreover, Company's joint ventures and joint development agreements generally require them to obtain consents and approvals in a timely manner to develop our projects. Inability to comply with the necessary consents & approvals in a timely manner could adversely affect company's business prospects along with financial condition & results of operations.

INDUSTRY OVERVIEW

The Indian real estate sector plays a significant role in the country's economy. The real estate sector is second only to agriculture in terms of employment generation and contributes heavily towards the gross domestic product (GDP). Almost five per cent of the country's GDP is contributed to by the housing sector. In the next five years, this contribution to the GDP is expected to rise to 6 per cent.

Residential Real Estate Development

According to CRISIL research the growth in the residential real market is driven by growth in population, migration towards urban areas & rising disposable income. However, the 2005-2008 yr boom in the demand & prices of the real estate was driven by the IT sector. The substantial rise in prices and demand for IT employees attracted developers, which led to considerably greater supply in major urban areas.

However, though the demand- supply scenario has remained positive for the residential segment at large, the segment has witnessed a major correction since then. The major reason being the slowdown in the global economy which led to a decline in the affordability & tight liquidity. This has resulted in oversupply & thereby leading to fall in the prices.

Commercial Development

The unprecedented growth in the IT & ITES sectors in India during the 2005-2008 has led to a huge demand for the office space across India. The commercial real estate demand is essentially driven by the performance of the economy, infrastructure developments & government policies. However the recent global economic slowdown has curtailed the expansion plans of many industries particularly IT sector.

PEER COMPARISON

Particulars	MCAP	CMP(Rs.)	EPS	P/E	Book value	P/B
Mahindra Lifespace Developers	1643.42	402.7	17.89	22.51	217.34	1.85
Parsvanath DevelopersLtd.	2552.36	128.55	4.53	28.38	105.14	1.22
Sobha Developers Ltd.	2798.14	285.35	5.6	50.96	164.84	1.73
Brigade enterprises Ltd.	1709.57	152.3	0.52	292.88	88.63	1.72
Vascon Engineers Ltd.	1665.3	185	5.22	35.43	73.7	2.51

VALUATION

The stock trades at a P/BV of Rs.2.82 on the lower side of the band and 3.16 on the higher side of the band of its Quarter Ending Sep09 book value Rs.58.52. Looking at the post issue valuation, the stock trades at a P/BV of Rs.2.24 on the lower side of the band and Rs2.51 on the higher side of the band of its post issue book value of Rs.73.70. Considering the P/E valuation, the company is trading at a P/E of 27.81x times on the lower side of the price band and 31.18x times on the higher side of the price band of its annualised FY10 EPS of Rs.5.93. Looking at post issue valuation, the company is trading at a P/E of 31.60x times on the lower side and 35.43x times on the higher side of its post issue annualised FY10 EPS of Rs5.22.

OUTLOOK

The company's EPC business has helped it to get through last year's downturn witnessed in the real estate market. However despite the company's healthy order book from its EPC business the concern remain on its regional presence, high dependence on the Pune real estate market & company's ability to scale up the real estate business.

Profit & Loss

(in Rs. Cr.)

Particulars	40430	40246	40245	40244	40243
Total Operating Income	354.69	519.47	616.86	394.82	138.45
Total expenditure	308.64	456.47	494.28	324.61	115.59
Operating Profit	46.05	63	122.58	70.21	22.87
OPM%	1.3	1.21	1.99	1.78	1.65
Other Income	7.35	5.28	3.67	4.43	4.61
PBDIT	53.4	68.28	126.25	74.64	27.47
Interest	12.81	28.48	18.43	3.93	3.1
PBDT	40.59	39.8	107.82	70.71	24.37
Depreciation	3.91	8.19	6.66	2.77	1.89
PBT	36.68	31.61	101.17	67.94	22.48
Tax	13.18	12.35	41.66	21.32	9.78
Net Profit	23.5	19.26	59.51	46.62	12.7

Balance Sheet

(in Rs. Cr.)

Particulars	9-Sep	9-Mar	8-Mar	7-Mar	6-Mar
Net Block	61.54	74.2	68.35	33.88	17.42
Capital WIP incl. Capital Advances	19.32	13.46	5.34	24.92	0.06
Net Fixed Assets	80.85	87.65	73.69	58.8	17.47
Goodwill	20.48	20.55	3.71	1.17	0
Investments	83.7	80.68	101.11	46.78	5.75
Current assets, Loans & Advances	938.43	878.77	791.88	503.65	242.88
Total Assets	1123.46	1067.65	970.39	610.4	266.1
Liabilities & provisions	659.87	677.54	661.48	375.23	215.16
Net Worth	463.59	390.11	308.92	235.17	50.94
Represented by:					
Share Capital	79.22	75.92	72.62	35.48	30.16
Reserves & Surplus	384.38	314.2	236.3	199.69	20.79
Total	463.591	390.11	308.917	235.172	50.945

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RANKING METHODOLOGY

WEAK	★
NEUTRAL	★ ★
FAIR	★ ★ ★
GOOD	★ ★ ★ ★
EXCELLENT	★ ★ ★ ★ ★

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