

BL KASHYAP & SONS

INR 1,860

*Real value in store*

BUY

We met the management of BL Kashyap & Sons (BLK) to understand the company's prospects and to get details about the real estate plans of its subsidiary, Soul Space Projects (SSPL). Key takeaways from our interaction are:

* **Gearing for big growth ahead in contracting**

BLK expects substantial order intake in the near future which will lead to rapid build-up of its order book. In such a scenario, enhanced execution skills will be of paramount importance. BLK's management, known for its strong credentials and sound execution track record, is preparing for this next stage of growth. As a result, the company has been going slow on the order accretion front in the past quarter and its order book, which was at INR 19 bn at Q2FY08 end, has declined to INR 18.5 bn by December 2007 end and is expected to rebound to ~ INR 21 bn by end FY08E. In the interim, BLK has been focusing on expanding its execution capabilities by building systems, manpower, and asset base.

* **Strong value to accrue from real estate**

BLK's real estate subsidiary SSPL is currently executing real estate development projects spanning across 11.8 mn sq ft of saleable area. Its offerings include residential, retail, and commercial spaces. These real estate plans are likely to contribute revenues of over INR 26 bn between FY09E and FY12E on an outright sale model basis.

* **Outlook and valuations: Compelling; maintain 'BUY'**

We value BLK's short duration quality contracting order book (operating RoCE of ~ 43% in FY09E) at INR 40.0 bn; we value the real estate business (held as 97.5% stake in SSPL) at INR 10.8 bn, thereby valuing BLK at ~ INR 51 bn. This, when compared to a current market cap of INR 38.2 bn (CMP of INR 1,860), indicates a strong upside and highlights that current valuations do not capture any upside from the real estate business.

We remain positive on the company's prospects and reiterate our 'BUY' recommendation on the stock.

Financials

Year to March	FY07	FY08E	FY09E	FY10E
Revenue (INR mn)	8,081	15,329	23,872	36,963
Rev. growth (%)	73.6	89.7	55.7	54.8
EBITDA (INR mn)	924	1,811	2,892	4,663
Net profit (adjusted) (INR mn)	556	1,165	1,717	2,642
Shares outstanding (mn)	10	21	21	21
EPS (INR)*	27.1	56.7	83.6	128.6
EPS growth (%)	97.5	109.5	47.4	53.9
P/E (x)	68.7	32.8	22.2	14.5
EV/ EBITDA	41.9	21.4	13.8	9.1
ROAE (%)	20.6	33.4	35.6	38.4
ROACE (%)	25.3	36.7	40.8	41.6

* EPS calculated on no of outstanding shares post split

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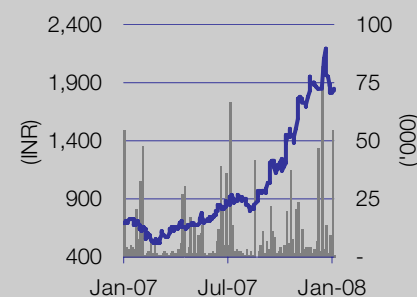
Reuters : NA
Bloomberg : KASH IN

Market Data

52-week range (INR) : 2,300/ 494
Share in issue (mn) : 20.5
M cap (INR bn/USD mn) : 38.1 / 1,155.5
Avg. Daily Vol. BSE/NSE ('000) : 12.2

Share Holding Pattern (%)

Promoters : 70.8
MFs, Fls & Banks : 6.2
Fls : 16.3
Others : 6.7



Contracting space: Witnessing traction

* Building up scale

BLK has been steadily preparing for a new phase of growth in its businesses which will propel it to the next league of contractors. To achieve this, it has been going slow on the order accretion front, in spite of abundant opportunities available in its operational segments of mainly commercial and residential real estate. As a result, the company's order book, which was at INR 19 bn at Q2FY08 end, has declined to INR 18.5 bn by December 2007 end and is expected to rebound to INR 21 bn by end FY08E.

It is using this breathing space to put in place systems and processes required to manage the expected growth ahead. BLK has been implementing an ERP system connecting all its sites with regional and head offices to automate its systems. It is also bulking up on the manpower (employee strength of more than 2,300 currently against ~1,600 in March 2007) and equipment fronts (capex of INR 600 mn in FY08E and INR 1 bn in FY09E). We believe this strategy of "managing" its growth is crucial for BLK to maintain its track record of timely delivery and execution in face of the imminent surge of orders which it is likely to garner.

* Next level of growth beckons through partnerships and bigger ticket size

BLK, reputed for timely and high quality execution, is ready for the next wave of orders in the near future. It is being wooed by several leading real estate developers to enter into long term contracting arrangements spanning multiple years and projects, spread across millions of sq ft. The terms, pricing, and upfront deposit fees for these contracts, however, are yet to be worked out. These projects will be a win-win proposition for both parties as the real estate developers will enjoy exclusive arrangements with BLK to create infrastructure, bypassing the tendering process, while BLK will get assured business along with higher margins driven by economies of scale.

BLK, currently, is focusing on enhancing ticket size per mn sq ft through its integrated offering of furnishing and electro-mechanical works etc., instead of only increasing its deliverable capacity (~40 mn sq ft currently). This strategy will prove to be value accretive in the long run, thereby helping the company emerge as an integrated construction solutions provider. It is also trying to increase the ticket size of orders, targetting order size of INR 1 bn for new clients and INR 400 mn for existing clients. We believe orders like the INR 1.8 bn Delhi International Airport departure terminal order from GMR is proof that BLK is succeeding in its endeavor.

* Commercial real estate will continue to be thrust area

Commercial real estate projects with faster turnaround, better margins (vis-à-vis residential projects), and better utilization of equipment (asset turnover of ~ 8-10x, unlike ~ 5x for residential projects) has been BLK's favoured area of operation. This trend is expected to be maintained in the future, with the company predicting enhanced demand in segments like industrial sheds and buildings (due to growth in SEZs) and warehousing facilities (due to incentives to backward areas, entry of foreign companies in the country to set up production facilities and to provide logistic support facilities to the spate of organized retail chains which are in the process of scaling up). BLK expects an industry growth of 20-25% and anticipates strong demand in real estate contracting work in the years ahead.

Soul Space projects: Cherry on the cake

BLK's real estate subsidiary SSPL has steadily built an impressive portfolio covering the entire spectrum of real estate development—residential (plotted development, villas, flats, and apartments), retail (malls on sale/lease basis), and commercial spaces. The real estate plans, aggregating to 11.8 mn sq ft, are spread across Bangalore, Pune, Amritsar, and Bikaner.

* Participating in real estate boom on own terms

A common thread that runs across SSPL's various projects is that most of them are in the form of JVs with entities which are usually individuals or corporates with access to land bank. BLK's contribution to the project comes in the form of its contracting skills, thus limiting the requirement of ownership of land for BLK and consequently, the downsides from any downturn in the real estate cycle are much less. On the other hand, BLK gets to maintain the potential upside from the current real estate boom by virtue of the contracting operations, its core competence.

These projects are mostly on a revenue sharing arrangement. BLK has carefully selected its projects, choosing locations (such as Bangalore and Pune), where the company enjoys a contracting presence, while keeping in mind project viability.

* Independent real estate set up

BLK has built a separate team of qualified professionals with experience in the real estate sector for SSPL. This 78 member team is fully equipped to handle issues of land acquisition, joint development, project management, and marketing functions for properties across the country. SSPL has a partially common board with BLK, thus lending both experience and quality to operations of the new firm.

The company has ensured that SSPL carries forward its parent's legacy of delivering good quality projects with timely execution. To ensure this, contracting work for various projects of SSPL will be awarded at an arms length basis to BLK or a third party contractor, depending on the skills and competencies required for each project.

Capital required for real estate operations will also be raised in SSPL and not BLK. Any equity stake sale in SSPL will not only provide funds, but also help in establishing a reasonable valuation benchmark.

* Real estate operations poised to take off

BLK's real estate subsidiary SSPL is currently executing real estate development projects spanning across 11.8 mn sq ft of saleable area. Its offerings include residential, retail, and commercial spaces.

These real estate plans are likely to contribute revenues of over INR 26 bn between FY09E and FY12E on an outright sale model basis. This, coupled with the strong growth likely in the contracting space, reinforces our belief in the company.

BLK Lifestyle: Scaling up slowly

BLK Lifestyle is the furnishing arm of BLK and third-party developers with an order book of ~ INR 200 mn in hand currently. It has a manufacturing set-up for pre-polished hardwood wooden floorings and modular kitchens at Baddi as well as fabrication units for UPVC (unplasticized poly vinyl chloride) doors and windows at Pune, Bhiwadi and Bangalore.

While the Baddi plant became operational in October 2007, the fabrication units for doors and windows which will be marketed under the brand 'Viewscapes' will become operational by March 2008 with BLK enjoying an exclusive contract with Rebau of Germany from where BLK will source the extrusions. Hence, while this subsidiary is likely to make a modest revenue contribution of around INR 50 mn in FY08E, it is likely to slowly scale up in the future. This subsidiary is an integral part of BLK's vision of emerging as an integrated turnkey construction service provider.

* Outlook and valuations: Compelling; maintain 'BUY'

We value BLK's short duration quality contracting order book at (operating RoCE of ~ 43% in FY09E) at INR 40.0 bn. We value the real estate business (held as a 97.5% stake in SSPL) at INR 10.8 bn, thereby valuing BLK at ~ INR 51 bn. This, when compared to current market cap of INR 38.2 bn (CMP of INR 1,860), indicates a strong upside and indicates that current valuations do not capture any upside from the real estate business. We remain positive on the company's prospects and reiterate our 'BUY' recommendation on the stock.

Company Description

BLK is focused on civil/industrial construction, design and building of turnkey projects, and interior and furnishing work. It primarily caters to the northern and southern markets in India and is now building its presence in other markets as well. BLK has two subsidiaries in the furnishings and real estate development space, BLK Lifestyle and Soul Space Projects, respectively. These subsidiaries have helped BLK transform itself into a comprehensive one-stop solution provider for office buildings and residential complexes. The subsidiary operations are gathering steam, thus helping BLK diversify its business model.

Investment Theme

We maintain our positive outlook on BLK as a significant player in the urban infrastructure space with a reputation for delivering high-quality structures in the commercial, residential, and industrial arena on or ahead of time. Its high-growth, low-risk strategy of faster project execution coupled with its presence in low capital intensive, high margin value-added product segment is likely to enable it to sustain its growth momentum in the future. The company has aggressive plans for its real estate subsidiary in which the company is following a strategy of developing projects on its own land bank as well as through joint development mechanisms, thus keeping its balance sheet risk profile in check while providing opportunities to benefit from the real estate boom. In addition, its furnishing subsidiary provides end-to-end solutions to BLK's existing building contracting solutions portfolio. Given the huge growth in residential construction, this strategy of providing value-added housing solutions boost margins.

Key Risks

A slowdown in the real estate cycle may lead to slowdown in project ramp-ups affecting BLK's order intake and revenue growth. This assumes more significance now with the ramp-up in operations of its real estate subsidiary.

A slower pace of orders will likely, in such a case, reduce the pricing power of players like BLK pressurizing profitability. Also, with majority of the company's orders having a comparatively shorter execution period as compared to industry standards, a consistent inflow of new orders is imperative for sustained growth.

Financial Statements (Standalone)

Income statement						(INR mn)
Year to March	FY06	FY07	FY08E	FY09E	FY10E	
Income from operations	4,655	8,081	15,329	23,872	36,963	
Direct costs	3,741	6,310	11,908	18,545	28,530	
Employee costs	124	282	506	716	1,109	
Other expenses	314	565	1,104	1,719	2,661	
Total operating expenses	4,180	7,157	13,518	20,980	32,301	
EBITDA	476	924	1,811	2,892	4,663	
Depreciation and amortisation	43	100	144	239	374	
EBIT	433	825	1,667	2,654	4,289	
Interest expenses	41	50	126	201	410	
Other income	33	80	224	149	124	
Profit before tax	425	854	1,764	2,602	4,003	
Provision for tax	143	298	599	885	1,361	
Reported profit	282	556	1,165	1,717	2,642	
Adjusted net profit	282	556	1,165	1,717	2,642	
Shares outstanding	10.3	10.3	20.5	20.5	20.5	
Dividend per share	3.1	3.7	4.2	5.2	6.2	
Dividend payout (%)	11.1	6.7	7.3	6.2	4.8	

Common size metrics- as % of net revenues

Year to March	FY06	FY07	FY08E	FY09E	FY10E
Operating expenses	89.8	88.6	88.2	87.9	87.4
Depreciation	0.9	1.2	0.9	1.0	1.0
Interest expenditure	0.9	0.6	0.8	0.8	1.1
EBITDA margins	10.2	11.4	11.8	12.1	12.6
Net profit margins (adjusted)	6.1	6.9	7.6	7.2	7.1

Growth metrics (%)

Year to March	FY06	FY07	FY08E	FY09E	FY10E
Revenues	48.7	73.6	89.7	55.7	54.8
EBITDA	91.7	94.2	96.0	59.7	61.2
PBT	108.1	101.0	106.5	47.5	53.9
Net profit	133.7	97.5	109.5	47.4	53.9
EPS	133.7	97.5	109.5	47.4	53.9

Cash flow statement

Cash flow statement						(INR mn)
Year to March	FY06	FY07	FY08E	FY09E	FY10E	
Net profit	281.7	556.3	1,165.4	1,717.4	2,642.3	
Add: Depreciation	42.7	99.5	144.1	238.6	374.3	
Add: E.O.Adjustments	63.6	(16.4)	(16.0)	(16.0)	-	
Add: Deferred tax	(2.2)	3.7	-	-	-	
Gross cash flow	385.8	643.1	1,293.6	1,940.0	3,016.6	
Less: Dividends	31.3	37.5	85.3	105.8	126.3	
Less: Changes in W. C.	333.2	959.0	1,445.4	2,322.2	3,954.5	
Operating cash flow	21.3	(353.4)	(237.1)	(488.0)	(1,064.3)	
Less: Change in investments	1,388.8	49.3	(800.0)	(400.0)	-	
Less: Capex	266.4	363.9	600.0	1,000.0	1,300.0	
Free cash flow	(1,633.9)	(766.6)	(37.1)	(1,088.0)	(2,364.3)	

Balance sheet					(INR mn)
As on 31st March	FY06	FY07	FY08E	FY09E	FY10E
Equity capital	103	103	103	103	103
Reserves & surplus	2,339	2,852	3,922	5,521	8,022
Shareholders funds	2,442	2,955	4,025	5,624	8,125
Secured loans	195	932	1,182	2,182	4,682
Borrowings	195	932	1,182	2,182	4,682
Sources of funds	2,637	3,887	5,207	7,806	12,806
Gross block	557	921	1,521	2,521	3,821
Depreciation	129	221	366	604	978
Net block	428	700	1,155	1,917	2,843
Total fixed assets	428	700	1,155	1,917	2,843
Investments	1,405	1,454	654	254	254
Sundry debtors	882	1,979	3,066	4,578	7,089
Work in progress	576	1,158	2,197	3,421	5,298
Cash and equivalents	395	385	620	551	673
Loans and advances	431	1,126	2,136	3,391	5,251
Total current assets	2,284	4,648	8,018	11,942	18,311
Sundry creditors	645	1,110	2,100	3,270	5,063
Others	612	1,324	1,824	2,224	2,624
Provisions	270	508	708	808	908
Total CL & provisions	1,527	2,943	4,632	6,302	8,596
Net current assets	757	1,706	3,386	5,639	9,715
Net Deferred tax	(16)	(20)	(20)	(20)	(20)
Misc. Expenses not written off	64	47	31	15	15
Uses of funds	2,637	3,887	5,207	7,806	12,806
Book value per share (BV) (INR)	119	144	196	274	395

Ratios

Year to March	FY06	FY07	FY08E	FY09E	FY10E
ROAE (%)	21.6	20.6	33.4	35.6	38.4
ROACE (%)	28.9	25.3	36.7	40.8	41.6
Operating RoACE(%)	54.8	45.0	47.7	43.8	42.7
Current ratio	1.5	1.6	1.7	1.9	2.1
Debtors (days)	69	89	73	70	70
Inventory (days)	45	52	52	52	52
Creditors (days)	51	50	50	50	50
Fixed assets t/o (x)	8.4	8.8	10.1	9.5	9.7
Average working capital t/o (x)	10.1	6.6	6.0	5.3	4.8
Average capital t/o (x)	3.1	2.5	3.4	3.7	3.6
Net debt/ Equity	(0.1)	0.2	0.1	0.3	0.5
Gross debt/Equity	0.1	0.3	0.3	0.4	0.6

Valuations parameters

Year to March	FY06	FY07	FY08E	FY09E	FY10E
EPS (INR) *	13.7	27.1	56.7	83.6	128.6
Y-o-Y growth (%)	133.7	97.5	109.5	47.4	53.9
CEPS (INR)	15.8	31.9	63.7	95.2	146.8
P/E (x)	135.6	68.7	32.8	22.2	14.5
Price/BV(x)	15.6	12.9	9.5	6.8	4.7
EV/Sales (x)	8.2	4.8	2.5	1.7	1.1
EV/EBITDA (x)	79.9	41.9	21.4	13.8	9.1

* EPS calculated on no of outstanding shares post split

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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.

BL Kashyap



Recent Research

Date	Company	Title	Price (INR)	Recos
19-Dec-07	Ahluwalia Contracts	Total construction solutions; 343 <i>Visit Note</i>		Not Rated
10-Dec-07	Gayatri Projects	Value in store; <i>Visit Note</i>	375	Not Rated
07-Nov-07	B L Kashyap	Power packed performance; <i>Result Update</i>	1,413	Buy
31-Oct-2007	Simplex Infra	Marching ahead <i>Result Update</i>	518	Buy

Distribution of Ratings / Market Cap

Edelweiss Research Coverage Universe

	Buy	Accumulate	Reduce	Sell	Total
Rating Distribution*	108	44	16	3	188

* 12 stocks under review / 5 rating withheld

	> 50bn	Between 10bn and 50 bn	< 10bn
Market Cap (INR)	103	66	19

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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