

September 6, 2010

Rating	Not Rated
Price	Rs182
Target Price	NA
Implied Upside	NA
Sensex	18,221

(Prices as on September 3, 2010)

### Trading Data

Market Cap. (Rs bn)	16.4
Shares o/s (m)	90.0
Free Float	61.45%
3M Avg. Daily Vol ('000)	260.6
3M Avg. Daily Value (Rs m)	44.6

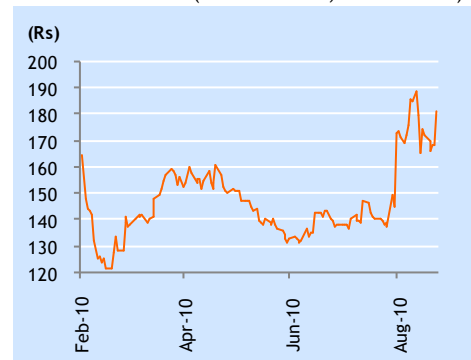
### Major Shareholders

Promoters	38.55%
Foreign	1.23%
Domestic Inst.	4.75%
Public & Others	55.47%

### Stock Performance

(%)	1M	6M	12M
Absolute	32.5	42.2	NA
Relative	30.7	33.4	NA

Price Performance (RIC: VASC.BO, BB: VSCN IN)



Source: Bloomberg

- **Steady growth in EPC Business:** Vascon Engineers (Vascon) has a fairly strong presence in the EPC services business, with an order backlog of Rs32bn. Its forte has been constructing factories, hospitality projects, malls, and multiplexes, residential and other buildings. Further, the company has bid for another Rs10bn worth of orders where it expects a success rate of 30-40%.
- **Establishing its presence in Real estate segment:** Largely through the JV/JDA model, Vascon has garnered a land bank of 56.8m sq.ft, of which ~31m sq.ft is attributable to the company. Its major presence is in Pune and Thane and has also dotted other cities like Nashik, Coimbatore, Ahmadabad and several others. Of the company's ~1.1m sq.ft launched in Q1FY11, it sold 0.6m sq.ft. For FY11, planned launches stand at ~1.5m sq.ft.
- **Extending to hospitality:** As an extension of its Real estate business, Vascon has also created a presence across the hospitality segment, with three operational 3-star properties. Further, two more 5-star properties are expected to commence operations by the end of the calendar year.
- **Financials & Valuations:** Over the FY10-12 period, company's revenues and PAT are likely to grow at a CAGR of 37% and 57%, respectively. We have valued the company's EPC business at 7x FY12 PAT which translates to Rs65.9/share. Our first cut estimate of the company's real estate NAV, where we have discounted the company's cash flows using a WACC of 16% assuming execution of its land bank over a 15 year period, stands at Rs231.5. Further, we are attributing a 25% discount to NAV and thereby, valuing the real estate business at Rs173.6/share. The total value of the business, thereby, translates to Rs240 which gives us an upside of 32%.

### Key financials (Y/e March)

	FY08	FY09	FY10
Revenues (Rs m)	5,904	5,195	7,548
Growth (%)	-	(12.0)	45.3
EBITDA (Rs m)	1,080	630	941
PAT (Rs m)	639	187	532
EPS (Rs)	8.8	2.5	5.9
Growth (%)	-	(72.0)	139.9
Net DPS (Rs)	-	-	-

Source: Company Data; PL Research

### Profitability & valuation

	FY08	FY09	FY10
EBITDA margin (%)	18.3	12.1	12.5
RoE (%)	20.4	5.3	10.1
RoCE (%)	12.6	6.0	8.9
EV / sales (x)	2.6	3.1	2.4
EV / EBITDA (x)	14.2	25.5	19.2
PE (x)	20.7	73.9	30.8
P / BV (x)	4.2	3.5	2.5
Net dividend yield (%)	-	-	-

Source: Company Data; PL Research

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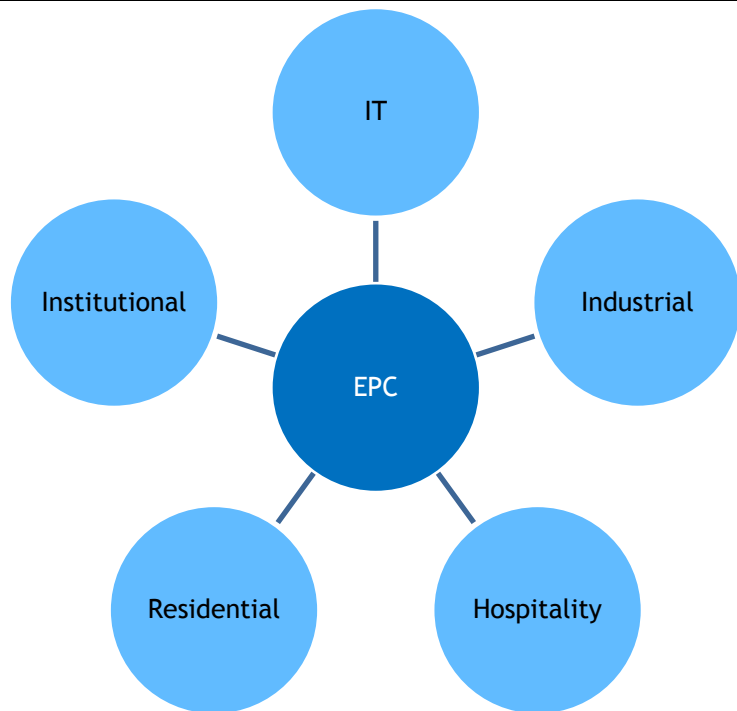
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### EPC business steadily growing

Vascon has a large amount of experience in the business of EPC services business which it has been providing for the last 25 years. The company's forte has been in constructing factories, hospitals, hospitality properties, office and residential complexes, shopping malls, multiplexes, IT parks and other buildings.

#### EPC business verticals

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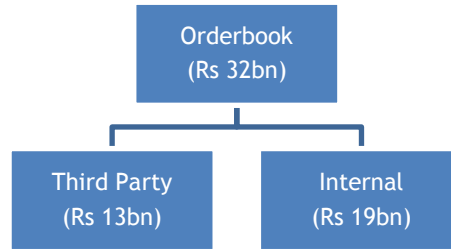


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*Source: Company*

Its current order backlog in this business stands at Rs32bn as of June 30, 2010, of which Rs13bn is contributed through third-party contracts, while the remaining Rs19bn is on account of its internal order book from its Real estate division. Its third-party order book has a shorter execution time cycle of 8-18 months, while the internal order book shall be executed over a 2-3 year period. The fresh order intake during Q1FY11 stood at Rs3bn.

**Order Book**



Source: Company, PL Research

**Ongoing EPC Contracts**

Project	Location
Tamil Nadu State Assembly Complex Block(B)	Chennai
Ruby Mills	Dadar, Mumbai
HDIL Commercial Complex	Vidyavihar, Mumbai
Neelkanth Palacia Mall & Business Centre	Mumbai
Kondhwa Realty	Pune
Savitrabai Phule Shikshan Prasarak Mandal	Pandharpur
North Town	Chennai
Sinhagad Technical Education Society	Ambegaon,Pune

Source: Company Data

**New EPC orders in Q1 FY11**

Project	Location	Type
Legrand factory	Nashik	-
Gopaldas Vishram Pharma Plant	Mumbai	-
Bharti Realty	Ludhiana	Commercial
North Town	Chennai	Residential
Amby Valley	Lonavala	Residential
Tata Housing	Lonavala	Residential
Kondhwa Realty	Pune	Residential
SMCC-Yamazaki Mazak	Pune	Commercial

Source: Company Data, PL Research

Additionally, Vascon has bid for another Rs10bn worth of orders where as per the management, its success rate stands at 30-40%.

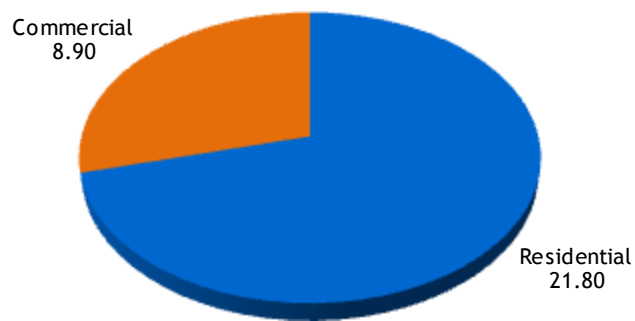
Further, it plans to venture into sub-contracting for road projects with the ultimate objective of undertaking road BOTs over the next couple of years.

Vascon’s EPC revenues grew by 33% in FY10 to Rs6bn and further are likely to double by FY12. As per the management, blended EPC margins are likely to stand at 13% at an EBITDA level and 6% at the PAT level. The company’s gross block in the EPC business stands at Rs0.9bn and is likely to increase by 15-20% over the course of the year.

### Strong focus on Real estate business

Over the last 10 years, Vascon has acquired a total land bank of 56.8m sq.ft of which 31m sq.ft is attributable to the company. A large part of this land has been acquired through the JV and JDA model. It has spent a total of Rs4bn in acquiring the land which translated to Rs140/sq.ft. The entire cost of the land has been fully paid for. As of March 2010, the company has completed 42 real estate projects translating to ~5m sq.ft.

#### Segment wise break-up of land bank (in m sq.ft)



Source: Company

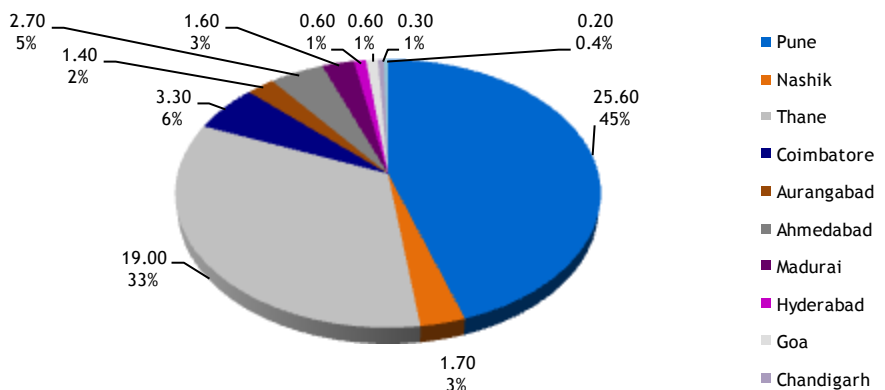
#### Projects completed up to March 2010

State	No. of Projects	Area (m sq.ft)
Maharashtra	40	4.68
Goa	2	0.31
<b>Total</b>	<b>42</b>	<b>4.99</b>

Source: Company

Over 50% of its land is located in Pune, and Thane, too accounts for more than 20%. Other cities, where the company has ventured, include Nashik, Coimbatore, Ahmadabad and several others. The company's strategy as far as its real estate business is concerned is to enter a particular market via EPC contracts and later acquire land for its own real estate development as and when they gain comfort.

**Geographical break-up of Land Bank (in m sqft)**



Source: Company, PL Research

During Q1FY11, Vascon has launched ~1.1m sq.ft, of which it sold ~0.6m sq.ft. Two of these projects are located in Pune, one in Nashik and one in Coimbatore. Further during the year, Vascon has planned launch of Phase 2 at its Coimbatore project as well as four more project launches in Pune which includes one high-end launch in Koregaon Park of 0.32m sq.ft residential space and 0.1m sq.ft of commercial space. This project is likely to generate revenues of ~Rs15,000/sq.ft.

**New launches Q1FY11**

Project	Type	Location	Total saleable area (m sq.ft)	Area sold (m sq.ft)	No of bldgs	Total flats/rooms
Forest County, Phase 1	Residential	Pune	0.69	0.58	9	386
Willows, Phase 2	Residential	Pune	0.24	0.04	3	126
Vista, Phase 2	Residential	Nasik	0.11	0.04	4	112
Tulip, Phase 1	Residential	Coimbatore	0.07	0.07	2	48
<b>Total</b>			<b>1.11</b>	<b>0.74</b>	<b>18</b>	<b>672</b>
<b>Hotels</b>						
Four points	Hotel	Pune	-	-	-	232
Novotel	Hotel	Pune	-	-	-	320
<b>Total</b>			<b>-</b>	<b>-</b>	<b>-</b>	<b>552</b>

Source: Company, PL Research

**Forthcoming Launches**

Project	Type	Location	Total saleable area (m sq.ft)
Windermere, Koregaon Park	Residential	Pune	0.33
Windermere, Koregaon Park	Commercial	Pune	0.10
Nature Spring, Talegaon	Mix	Pune	-
Xotech, Hinjewadi	Residential	Pune	0.10
Rosebay, Hadapsar	Residential	Pune	0.10
Tulips Phase 2	Residential	Coimbatore	0.20
<b>Total</b>			<b>0.83</b>

Source: Company, PL Research

Going forward, the company plans to gradually scale-up its real estate launches and acquire land in places where it gains comfort on account of its EPC business.

### Gradually scaling up its hospitality business

Currently, the company has three operational 3 star category hotels, two of which are located in Goa and one in Pune, translating to a total of 177 keys. Vascon holds 100% stake in one of its Goa properties and 43.8% in the other and 50% stake in the Pune property. The hotel business is operated at an SPV level as currently generates revenues to the tune of ~Rs200m annually.

#### Operational Hotels

Name	Location	Category	Vascon's Holding	No. of Keys
Vista Do Rio	Goa	3 Star	100%	41
Galaxy resorts	Goa	3 Star	43.83%	65
Golden Suits	Pune	3 Star	50%	71

Source: Company

Further, the company has minority stakes in two more hotel projects in pipeline, both of which are in the 5 star category located in Pune. One of them is a management contract with *Holiday Inn*, while other is with *Hyatt Regency*. Both put together would be an additional 580 keys for the company.

Vascon's stake in the *Holiday Inn* property stands at 27.5% and the total investment in the same is Rs1.2bn. Its stake in *Hyatt Regency* hotel stands at 26% and the total investment in the project is Rs3.8bn. Overall in both projects put together, the company has invested a total of Rs1.35bn. Revenues from these properties shall not be consolidated in Vascon's books on account of its minority stakes.

Licenses for these hotel projects are in place and are likely to commence operations over the next 3-4 months.

It also has one more hotel project in Coimbatore which it is likely to start work on shortly.

#### Upcoming Hotels

Name	Location	Category	Vascon's Holding	No. of Keys
Holiday Inn	Pune	5 star	33%	187
Hyatt Residency	Pune	5 star	26%	306
Airport Hotel	Coimbatore	4 star	70%	107

Source: Company Data

## Undertaking acquisition for backward integration

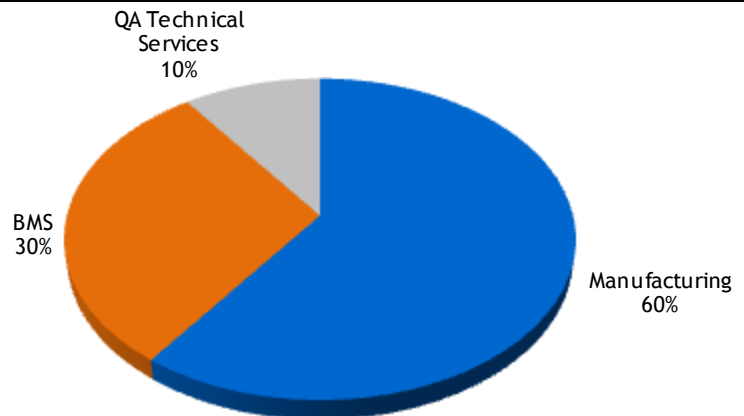
Vascon has acquired 90% in a company called **GMP Technical Solutions** at a cost of Rs626m. The acquisition will be funded through Vascon's internal accruals and is likely to help the company to backward integrate its EPC business. The company has 3 main business segments:

- **Manufacturing:** Clean rooms, office partitions, door sets, storage racks
- **Integrated business management services (BMS),** UD FDA compliant for pharma industry
- **QA technical Services:** Validation and certification of weights and measures.

The company's topline in FY10 stood at Rs1.2bn, with a PAT of Rs0.2bn. 60% of the company's business comes from its manufacturing business, 30% from the BMS division and 5-10% from the QA technical Services division.

### GMP Technical Solutions business divisions

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Source: Company Data, PL Research

Vascon is likely to consolidate the business from September 2010 onwards. However, we have not included the same in our financial projections

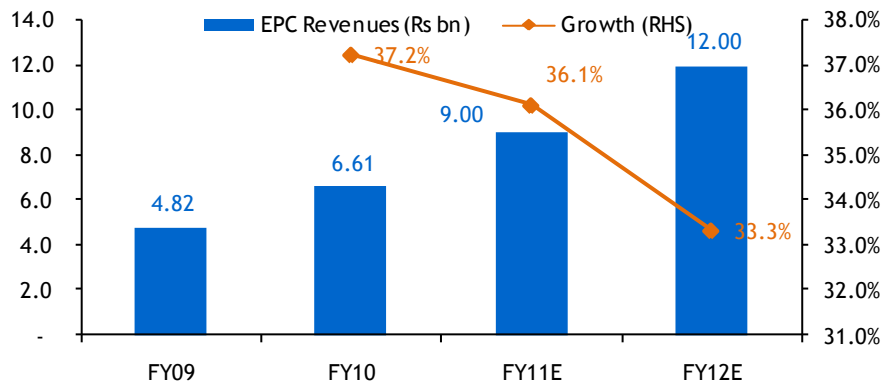
## Promoter Background

The company is promoted by Mr R Vasudevan, a civil engineer from the Pune University. He started his career with MIDC and after working in various other marquee organizations, he started the company in 1986. He has 32 years of experience in the construction industry.

## Financials

Vascon’s EPC business is likely to grow at a CAGR of 35% over the period FY10-12, i.e. from Rs6.6bn to Rs12bn, with EBITDA margins of ~13% and PAT margins of 6-7%.

### EPC business



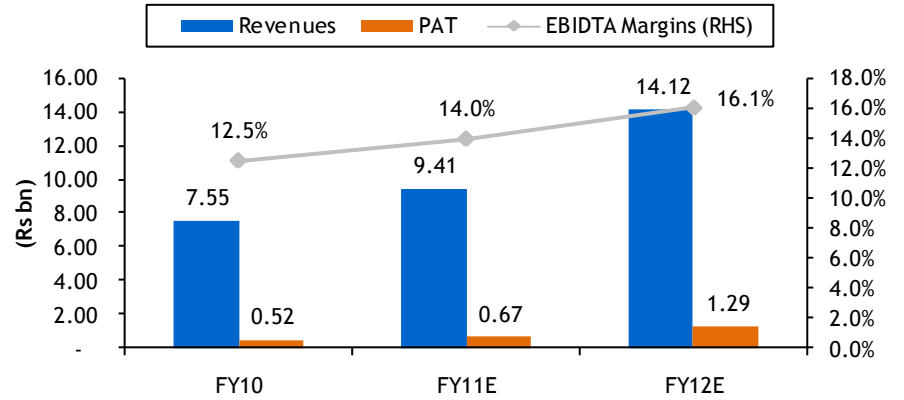
Source: Company, PL Research

On the real estate side, the company books revenues on a project completion method; therefore, revenue booking in FY13 is likely to be extremely strong as a number of projects are scheduled for completion then. Real estate revenues for FY11 and FY12 are expected at Rs0.3m and Rs2bn, respectively. As per our discussion with the management, EBITDA margins in the real estate business are expected at ~33%.

The company’s consolidated revenues are likely to grow from Rs7.5bn in FY10 to Rs9.4bn in FY11 and Rs14.1bn in FY12. Margins are likely to firm up from 12.5% in FY10 to 16.1% in FY12 on account of an increase in real estate revenues. Correspondingly, the company’s PAT is likely to increase from Rs0.52bn in FY10 to Rs0.67bn and Rs1.29bn in FY11 and FY12, respectively.

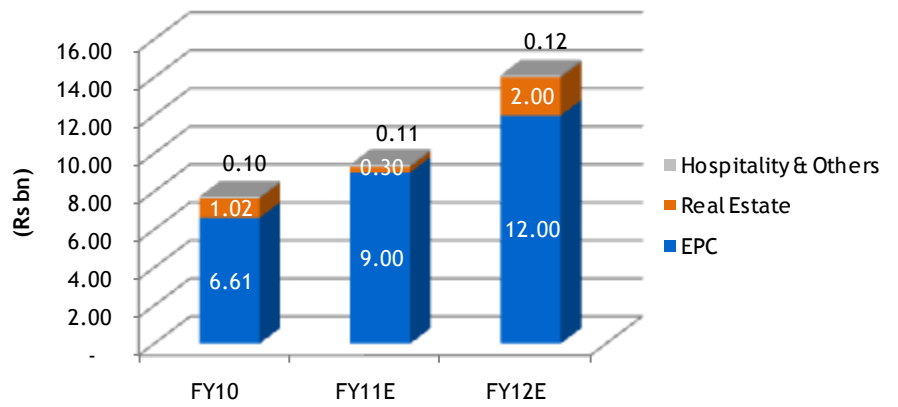


**Consolidated financials**



Source: Company Data, PL Research

**Break-up of revenues**



Source: Company Data, PL Research

## Valuations

We are valuing Vascon's EPC business at 7x FY12 PAT which works out to Rs65.9/share.

Further, we have undertaken a broad valuation of the company's real estate land bank of 31m sq.ft which we have assumed will be developed over a 15 year period. We have discounted cashflows from its real estate projects, using a discount rate of 16%. Based on these assumptions, gross NAV of its real estate project is estimated at Rs22.5bn. After deducting company's net debt of Rs1.68bn, the company's net asset value stands at Rs20.84bn which translates to Rs231.5/share. Further, we are attributing a 25% discount to NAV and thereby, valuing the real estate business at Rs173.6/share. The total value of the business, thereby, translates to Rs240 which gives us an upside of 32%.

First-Cut Valuations	(Rs bn)
Value of EPC Business (7x FY12 PAT)	5.93
Value of EPC business/Share (Rs)	65.9
Gross NAV of Real Estate Business	22.52
Less: Net Debt	1.68
Net Asset Value	20.84
No. of Shares (m)	90.00
NAV/Share (Rs)	231.55
Discount to NAV	25%
Value/Share of the real estate business (Rs)	173.66
<b>Total Value of Business/Share (Rs)</b>	<b>240</b>

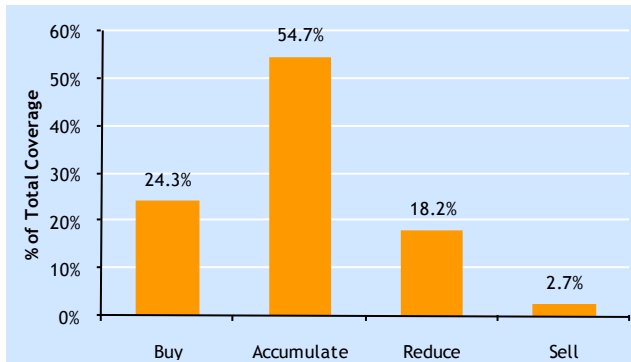
Source: PL Research

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#### Rating Distribution of Research Coverage



#### PL's Recommendation Nomenclature

<b>BUY</b>	: Over 15% Outperformance to Sensex over 12-months	<b>Accumulate</b>	: Outperformance to Sensex over 12-months
<b>Reduce</b>	: Underperformance to Sensex over 12-months	<b>Sell</b>	: Over 15% underperformance to Sensex over 12-months
<b>Trading Buy</b>	: Over 10% absolute upside in 1-month	<b>Trading Sell</b>	: Over 10% absolute decline in 1-month
<b>Not Rated (NR)</b>	: No specific call on the stock	<b>Under Review (UR)</b>	: Rating likely to change shortly

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