Khambatta Securities Ltd.
MEMBER OF EQUITY & DERIVATIVE SEGMENTS DEPOSITORY PATICIPANT
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Karda Constructions Limited

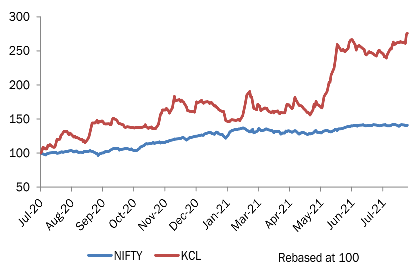
29 July 2021

Re-rating justified for Nashik's real estate star

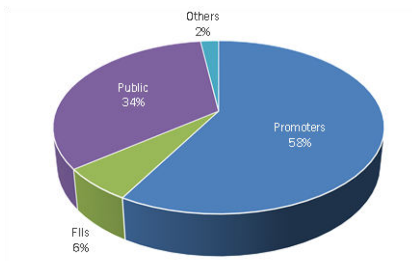
BUY

Sector	: Real Estate
Target Price	: ₹253
Last Closing Price	: ₹195
Market Cap	: ₹1,197 crore
52-week High/Low	: ₹203/70
Daily Avg Vol (12M)	: 1,43,868
Face Value	: ₹2
Beta	: 0.58
Pledged Shares	: 0.0%
Year End	: March
BSE Scrip Code	: 541161
NSE Scrip Code	: KARDA
Bloomberg Code	: KARDA IN
Reuters Code	: KARD.NS
Nifty	: 15,778
BSE Sensex	: 52,653
Analyst	: Research Team

Price Performance



Shareholding Pattern



Initiating Coverage

Investment Summary

- With over two and a half decades' experience in Nashik, Karda Construction Limited (KCL) has a competitive advantage as a leading developer in its home turf where it is strongly positioned to cash in on the growth of the real estate market.
- The Nashik real estate market presents robust opportunities, given its location and robust infrastructure. The presence of projects across all key micro-markets in Nashik enables KCL to significantly benefit from the growth in the city's real estate market.
- KCL is a prominent player in the affordable housing segment which is currently witnessing the fastest movement in inventory due to brisk uptake as a result of its affordability and strong demand in the market.
- The joint development route (44% of KCL's real estate projects) allows KCL to conceptualise and launch projects more quickly and allocate greater bandwidth to project execution. Further, the developer does not need to put out upfront capital for land acquisition in joint development projects, which positively affects project working capital and cash flows.
- The civil contracting division, the revenue contribution of which has increased to almost 30% from only under 5% in three years, is an important component of KCL's overall business due to the opportunities that exist in the market and its ability to de-risk the company's business model.
- Under-construction and pipeline projects in real estate along with strong civil contract order book offer robust revenue and earnings visibility.
- We believe the robust growth potential and the imminent bonus share issue position KCL as a credible case for re-rating. Based on a P/E of 35.0x FY24E EPS, we rate KCL a BUY with a target price of Rs 253 and an upside potential of 30%.

Key Financial Metrics

Rs lakh	FY19A	FY20A	FY21A	FY22E	FY23E	FY24E
Net operating revenue	10,530	11,412	12,092	14,680	19,201	21,640
Growth		*8.4%*	*6.0%*	*21.4%*	*30.8%*	*47.4%*
EBITDA	2,988	2,731	3,497	4,333	5,829	6,626
EBITDA margin	*28.4%*	*23.9%*	*28.9%*	*29.5%*	*30.4%*	*30.6%*
PAT	1,202	956	2,018	2,999	3,883	4,444
PAT margin	*11.4%*	*8.4%*	*16.7%*	*20.4%*	*20.2%*	*20.5%*
Diluted EPS (Rs)	9.78	1.55	3.28	4.88	6.31	7.23

Source: Company data; Khambatta Research

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Company Profile

Founded in 1994, the Karda Group is a reputed real estate developer in Nashik

The Karda Group is a reputed real estate developer in Nashik. Founded 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. With the incorporation of Karda Construction Limited (KCL) in 2007, the group embarked on a mission to corporatise its business. The company has successfully delivered over 31 lakh square feet of carpet area in aggregate, most of them under the "Hari" brand name. KCL caters to all residential segments, i.e. low, medium and premium.

Management Profile

KCL is led by a top leadership team comprising promoters with robust experience in the real estate and construction spaces.

Chairman Mr. Naresh Karda, a civil engineer, has over 26 years of experience in real estate and construction

Naresh Karda, Chairman & Managing Director: Mr. Naresh Karda is the promoter of KCL. A diploma holder in civil engineering from Pravara Nagar Polytechnic, Maharashtra, he has over 26 years of experience in real estate and construction and has completed more than 40 projects successfully in Nashik. Mr. Karda was awarded "Business Icon of Nasik" by Lokmat in 2014, having received the award from the then Chief Minister Mr. Devendra Phadavnis. Besides providing overall leadership in the company, Mr. Karda, with his rich experience in the real estate market, also leads the initiative to improve the brand equity of the company.

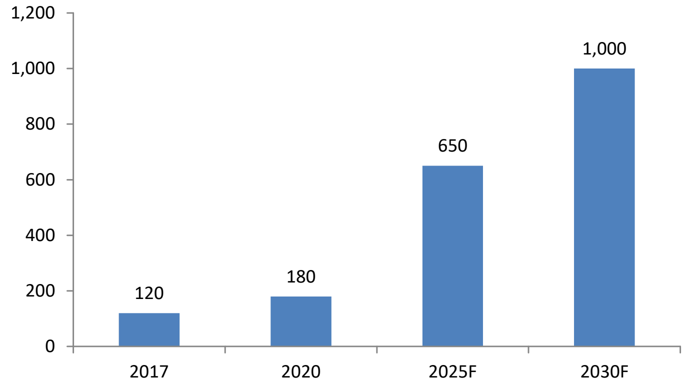
Manohar Karda, Whole Time Director: Mr. Manohar Karda has over 24 years of experience in family businesses, out of which 9 years are in real estate and construction. He plays a crucial role in purchase management while managing other critical business functions.

Disha Karda, Director: Mrs. Disha Karda has overall experience of 10 years. A graduate from Gujarat University and BEd from Annamalai University, she is responsible for day-to-day operations of the company including people management and development of business plans in collaboration with the Board of Directors. Mrs. Karda is also responsible for compliance relating to contracts, insurance requirements and safety standards.

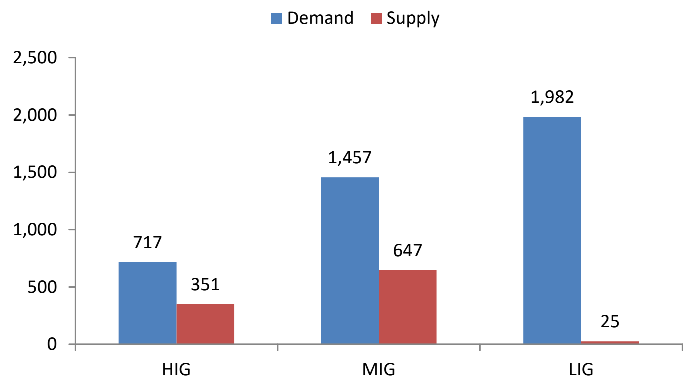
Industry Overview

Only second to agriculture, real estate is the largest employment generator in India's industrial sector. While India's housing need demands the construction of 5 houses per 1,000 people each year, only 3 houses per 1,000 people are actually built according to the Economic Times Housing Finance Summit. With an estimated urban housing shortage of approximately 1 crore units, urban India's growing housing need will necessitate the construction of an additional 2.5 crore affordable homes by 2030.

Indian real estate market size (US$ bn)



Housing demand-supply in top 8 cities, 2016-20 ('000 units)



Source: IBEF

The real estate sector faced several challenges during 2014 to 2020 leading to an oversupply situation, resulting from cheap money invested into the sector with many projects of poor quality launched. The 2018 NBFC crisis led to a liquidity crunch, causing a reduction in fund availability and consequently consolidation within the sector. The situation clearly favoured the bigger developers with deep pockets. Offering better quality projects coupled with their capacity of timely delivery, consumer preference shifted towards the bigger reputed developers.

During 1Q CY21, the Mumbai Metropolitan Region (MMR) and Pune cumulatively accounted for 53% of total sales in the top seven Indian cities, according to ANAROCK Property Consultants. While initially the first wave of covid-19 negatively impacted real estate sales and operations, the momentum progressively improved following the easing of restrictions and lifting of the lockdown. In the residential segment, Mumbai recorded sales growth of 51% y-o-y from 9,120 units in 1Q CY20 to 13,750 units during 1Q CY21 while witnessing an 8% y-o-y fall in total unsold inventory as of 31 March 2021, the highest annual decline in 7 years. Favourable policy such as the lowering of GST rate in 2019 (from 8% to 1% for affordable housing and 12% to 5% for other housing) and low interest rates are factors contributing to increasing housing affordability and consequently an increase in demand. On the other hand, a sharp decline in inventory paves the way for potential price appreciation.

Home sales volumes in 4Q FY21 recovered to cross 90% of 4Q FY20 levels across the top seven cities

Sales volume of residential units across eight major Indian cities increased sharply by 84% q-o-q to 61,593 units during Oct-Dec 2020 as demand recovered strongly following the lifting of covid-related curbs. Residential sales in the top seven cities expanded by 29% y-o-y as new launches rose 51% y-o-y in 4Q FY21 with lower interest rates and offers from developers driving strong revival of demand. Home sales volumes in 4Q FY21 recovered to over 90% of 4Q FY20 levels across the top seven cities as Delhi-NCR, Mumbai, Bengaluru and Pune together accounted for 83% sales during the quarter. The micro-markets of Noida and Gurgaon in the Delhi-NCR region

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witnessed a double-digit price appreciation of 11% and 13% in 4Q FY21. *(Source: ANAROCK)*

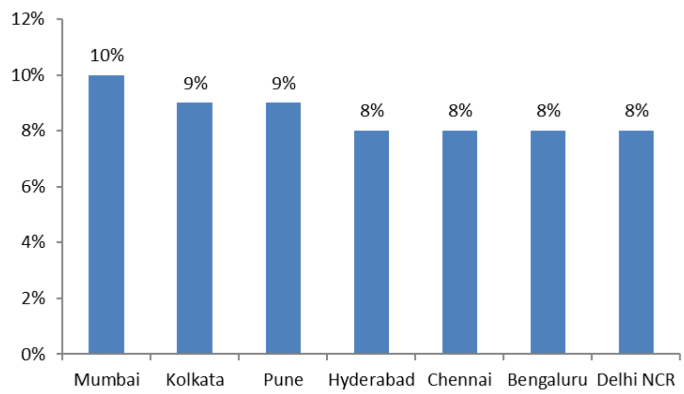
The construction sector attracts the third-highest FDI inflow in India. The sector (including construction development and construction activities) received FDI to the tune of US$ 43 bn between April and September 2020. The Indian real estate is projected to see robust FDI inflows of up to US$ 8 bn by FY22. *(Source: IBEF)*

The Government of India (GoI) announced policy initiatives over the past few years with the objective of supporting the real estate sector. In 2015, the government approved 100 Smart City projects while also raising FDI limits for townships and settlements development projects to 100%. Real estate projects within SEZs have been allowed 100% FDI. Further, the government released draft guidelines for investment by Real Estate Investment Trusts (REITs) in the non-residential segment.

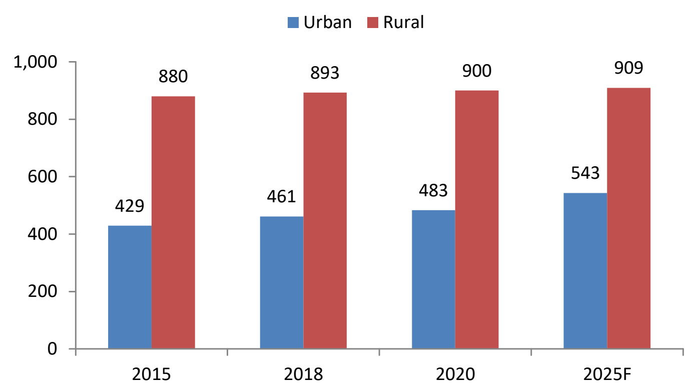
The Housing Ministry has recommended reduction of stamp duty on property transactions to the states

The GoI's Housing for All initiative is expected to bring in investments to the tune of US$ 1.3 tn to the country's housing sector by 2025. The Pradhan Mantri Awas Yojana – Urban (PMAY-U) scheme is expected to push affordable housing and boost the Indian real estate sector. The GoI approved the development of Affordable Rental Housing Complexes (AHRCs) for urban migrants and poor as a sub-scheme under PMAY-U. As of December 2019, 1.12 crore houses were sanctioned in urban areas under PMAY-U, which has a potential to create 1.2 crore jobs. The Ministry of Housing and Urban Affairs has recommended all states to consider reducing stamp duty on property transactions to increase the affordability of real estate and help drive the sector.

Household income growth (2019)



Urban-rural population (million)



Source: IBEF

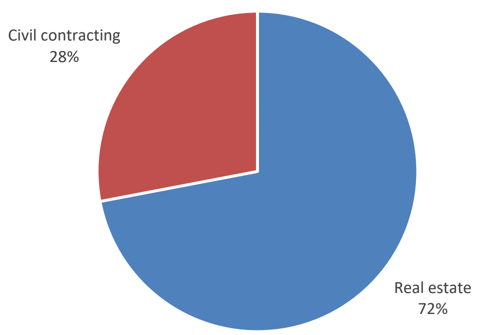
The Indian real estate market is forecast to grow from Rs 12,000 crore (US$ 1.7 bn) in 2019 to Rs 65,000 crore (US$ 9.3 bn) by 2040. The real estate sector is expected to generate a total value of US$ 1 tn by 2030, up from US$ 120 bn in 2017, as it is expected to contribute 13% of GDP by 2025. Besides the housing segment, retail, hospitality and commercial real estate are expected to witness robust growth in the long term, driving further demand for residential real estate in turn. Rapid urbanisation, rising household income and continued emergence of nuclear families will be the key growth drivers across all segments of Indian real estate. *(Source: IBEF)*

Investment Thesis

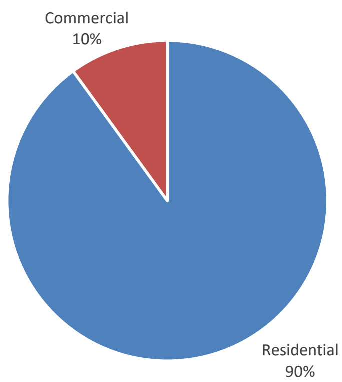
In its 26 years' operating history, the Karda Group has successfully delivered over 31 lakh sqft of developed area

KCL is a leading developer in the Greater Nashik market with a robust track record and solid execution capacity. The Karda Group is a leading developer in Nashik's real estate market. Founded in 1994, the group focused on development of affordable homes as it ventured into the commercial segment in 2001. With the incorporation of KCL in 2007, the group embarked on a mission to corporatise its business. In its 26 years' operating history, the Karda Group has successfully delivered over 31 lakh sqft of developed area.

Revenue split by business segment



Real estate business mix by market segment



Source: Company

KCL's projects carry the brand name 'Hari', which have gained considerable popularity and a strong recall factor in the Greater Nashik market. With the experience of operating in Nashik for over two and a half decades, the company has solid knowledge of the local real estate market. Knowledge of the local real estate 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 sector.

Widening of highways has reduced the travel time between Nashik and Mumbai/Pune from 5 hours to under 3 hours

The Nashik real estate market presents robust opportunities, given its location and infrastructure. Nashik enjoys a natural locational advantage owing to its proximity to the two major metro cities of Mumbai and Pune. With the completion of the road-widening projects to expand the highways connecting the city to the two neighbouring metros, the travel time between them and Nashik has come down from 5 hours to under 3 hours. This has led to increased attractiveness of Nashik's property market amongst investors from Mumbai and Pune. The city is also part of the 'Golden Triangle' industrial corridor, which includes Pune, Mumbai and Nashik. The Delhi-Mumbai Industrial Corridor Project (DMIC) and the under-construction Mumbai-Nagpur Super Communication Expressway passing through Nashik

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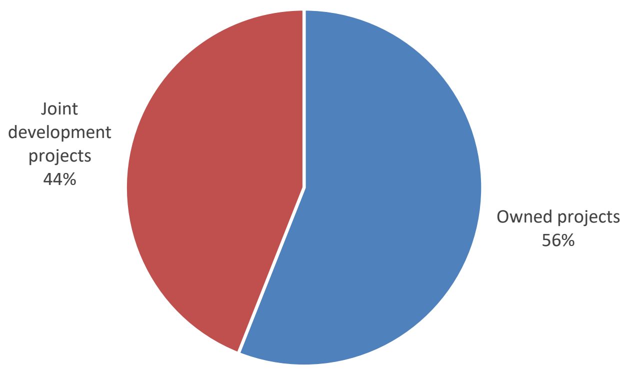
will produce a major developmental impetus for Nashik city and its suburbs and satellite towns such as Igatpuri, Deolali and Ozar. The restart of commercial operations at Nashik Airport in Ozar and the planned Nashik-Pune Metro project will provide further momentum to Nashik's real estate sector. There are 6 MIDC industrial zones in the Greater Nashik region with the presence of sectors such as textile, auto, electric, engineering, food processing, biotechnology and IT-ITeS. Popularly known as the "wine capital of India" and the "vegetable basket of the country, Nashik is also a major weekend getaway and a horticulture hub. In addition to these, a pleasant climate and a robust social infrastructure make the city a favourite real estate investment destination. Positively on the flip side, real estate prices in Nashik are much more affordable compared other cities in the region, which presents strong headroom for growth. The presence of projects across all key micro-markets in Nashik enables KCL to significantly benefit from the growth in the city's real estate market.

Restart of commercial operations at Nashik Airport will provide momentum to Nashik's real estate sector

Prominent presence in affordable housing bodes well for KCL, given the untapped demand and availability of financing options. The affordable segment comprises nearly 40% of KSL's residential real estate development. The affordable housing segment has witnessed strong traction in the last few years driven by strong untapped demand and policy initiatives. Further, housing finance companies have launched affordable housing-focused products which has simplified and enhanced the availability of home loans to the segment. The affordable segment is currently witnessing the fastest movement in inventory due to brisk uptake as a result of its affordability and considerable demand in the market.

The affordable segment comprises 40% of KSL's residential real estate development

Project development model mix



Source: Company

With strong execution capacities, nearly one half of KCL's projects is in the joint development model. With approximately 44% of KCL's overall real estate development executed under joint development agreements (JDAs), the company is not overly dependent on an acquired land bank. The JDA route allows KCL to conceptualise and launch projects more quickly and allocate greater bandwidth to project execution. Further, the developer does not need to put out upfront capital for land acquisition in joint development projects, which positively affects project working capital and cash flows. That said, a significant 56% of KCL's development pool include owned projects. 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 as it looks to gain the first-mover advantage by acquiring land at cheaper rates.

Revenues from the civil contracting segment increased from 4% of total revenues to 28% in 3 years

The civil contract segment's revenue share has grown steeply in the last 4 years, leading to diversification and de-risking of KCL's business model. KCL ventured into civil construction services 4 years ago with the intention of leveraging its expertise in project execution and diversifying its business model. The company executes civil construction work as a contractor on both government and private projects. Revenues from the segment progressively increased from 4% of total revenues in FY18 to 28% in FY21. KCL follows a strategy of filing tenders for projects where it has a high probability of winning the contract due to its robust construction experience, strong execution capabilities, and a highly-skilled and experienced engineering team. The company's civil construction order book currently comprises 11 projects including contracts from Maharashtra State Police Housing Welfare Corporation and Maharashtra State Road Transport Corporation. The civil contracting business is an important component of KCL's overall business due to the opportunities that exist in the market and its ability to de-risk the company's business model.

KCL's execution pipeline comprises 10 real estate and 11 civil contract projects

Under-construction and pipeline projects in real estate along with strong civil contract order book offer robust revenue and earnings visibility. KCL has a robust pipeline of ongoing and upcoming projects that provide strong revenue and earnings visibility. The company currently has 10 under-construction and planned real estate projects in Greater Nashik while in the civil contract segment, it has 11 projects across locations such as Nashik, Pune, Shahpur, Buldhana and Goa. These projects will be the key drivers of revenue and earnings growth over the next couple of years with incremental contribution from potential new project launches.

Peer Comparison

KCL's closest listed peer is Thakkers Developers

KCL has a number of competitors/peers that are not listed such as Roongta Developers, Samrat Builders & Developers, Shreeji Developers, Nirman Builders & Developers and Deepak Builders & Developers. For the purpose of this report, we compare KCL with the following listed real estate / civil contractor companies. Thakkers Developers is KCL's closest listed peer.

Peer Comparison: Key Financials Metrics, FY21

Rs crore	KCL	Anant Raj	PSP Projects	Vascon Engineers*	Thakkers Developers
Operating revenue	120.9	249.7	1,240.9	482.9	25.7
EBITDA	35.0	35.4	134.9	53.9	9.5
EBITDA margin	*28.9%*	*14.2%*	*10.9%*	*11.2%*	*36.9%*
PAT	20.2	12.8	81.5	39.7	10.9
PAT margin	*16.7%*	*5.1%*	*6.6%*	*8.2%*	*42.4%*
Diluted EPS (Rs)	3.28	0.43	22.65	2.21	12.13
ROCE	20.4%	0.4%	26.3%	9.5%	N/A
ROE	16.4%	0.5%	16.5%	5.6%	N/A
Current market cap	1,197	1,955	1,701	398	67

**FY20 financials as the company reported losses in FY21*
Source: Company data; Bloomberg; Khambatta Research

Valuation

At 35.0x FY24E EPS, we rate KCL a BUY with a target price of Rs 253 and an upside potential of 30%. With robust experience and thorough knowledge of Greater Nashik's real estate sector, KCL has a competitive advantage in a market which has a high growth potential with relatively cheaper valuations compared to other cities in western India. Further, the civil contracting division, the revenue contribution of which has increased to almost 30% from only under 5% in three years, is an important component of KCL's overall business due to the opportunities that exist in the market and its ability to de-risk the company's business model. The KCL stock currently trades at an attractive forward P/E level of 26.9x FY24E EPS, which is lower than its historical average P/E. We believe the robust growth potential and the imminent bonus share issue position KCL as a credible case for re-rating. Based on a P/E of 35.0x FY24E EPS, we rate KCL a BUY with a target price of Rs 253 and an upside potential of 30%.

The KCL stock currently trades at an attractive forward P/E level of 26.9x FY24E EPS

Relative Valuation: Price-to-Earnings

	High	Low	Average	Current
Karda Constructions	85.8	7.3	29.0	59.3
Anant Raj	60.8	5.6	13.5	824.9
PSP Projects	38.7	8.6	20.0	20.9
Vascon Engineers	105.0	3.1	39.8	8.4
Thakkers Developers	54.5	3.4	20.1	18.1

Note: Multiples since FY17 or listing; normalised by excluding upper-end outliers
Source: Bloomberg; Khambatta Research

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Profit & Loss Account

Rs lakh	FY19A	FY20A	FY21A	FY22E	FY23E	FY24E
Revenue from operations	**10,530**	**11,412**	**12,092**	**14,680**	**19,201**	**21,640**
Growth		*8.4%*	*6.0%*	*21.4%*	*30.8%*	*12.7%*
Cost of development	6,477	7,081	7,763	9,542	12,452	14,001
Gross profit	4,053	4,331	4,329	5,138	6,749	7,639
Gross margin	*38.5%*	*38.0%*	*35.8%*	*35.0%*	*35.2%*	*35.3%*
Operating cost	1,065	1,600	832	805	920	1,013
EBITDA	**2,988**	**2,731**	**3,497**	**4,333**	**5,829**	**6,626**
EBITDA margin	*28.4%*	*23.9%*	*28.9%*	*29.5%*	*30.4%*	*30.6%*
Depreciation & amortization	28	18	11	31	34	38
PBIT	3,304	3,135	4,240	5,131	6,665	7,502
Interest expense	1,708	1,785	1,456	999	1,318	1,386
PBT	1,596	1,257	2,785	4,132	5,347	6,117
Tax expense	394	301	767	1,133	1,463	1,673
PAT	**1,202**	**956**	**2,018**	**2,999**	**3,883**	**4,444**
PAT margin	*11.4%*	*8.4%*	*16.7%*	*20.4%*	*20.2%*	*20.5%*
Diluted EPS (Rs)	**9.78**	**1.55**	**3.28**	**4.88**	**6.31**	**7.23**

Source: Company data; Khambatta Research

Abridged Balance Sheet

Rs lakh	FY19A	FY20A	FY21A	FY22E	FY23E	FY24E
Total shareholders' equity	9,424	10,318	12,304	15,304	19,187	23,631
Long-term debt	4,698	3,708	1,700	1,717	1,735	1,752
Short-term debt	2,674	1,927	2,171	2,192	2,214	2,236
Current liabilities	**10,861**	**8,819**	**10,604**	**10,728**	**10,855**	**10,982**
Total equity & liabilities	**26,546**	**29,059**	**31,376**	**34,586**	**38,683**	**43,343**
Fixed assets	188	108	123	112	96	78
Inventory	15,468	16,401	15,166	16,683	18,351	20,186
Cash & cash equivalents	650	37	37	164	254	661
Current assets	**22,812**	**26,399**	**28,161**	**31,119**	**34,944**	**39,306**
Total assets	**26,546**	**29,059**	**31,376**	**34,586**	**38,683**	**43,343**

Source: Company data; Khambatta Research

Ratio Analysis

	FY19A	FY20A	FY21A	FY22E	FY23E	FY24E
ROA	4.5%	3.3%	6.4%	8.7%	10.0%	10.3%
ROCE	21.1%	15.5%	20.4%	21.5%	24.0%	23.2%
ROE	12.8%	9.3%	16.4%	19.6%	20.2%	18.8%
Debt-to-equity ratio	0.78x	0.55x	0.31x	0.26x	0.21x	0.17x

Source: Company data; Khambatta Research

Key Risks

- Real estate is a highly regulated and policy-driven sector. Any significant changes in policy, regulations or administered prices can potentially affect our outlook and forecast.
- Continued high inventory levels will keep real estate prices subdued, which, in turn, will negatively affect the sector's growth.
- Further severe waves of COVID-19 or it remaining around for an extended period of time, especially in urban India can potentially have a negative impact on the housing sector.

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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.

Stock ratings

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%.

Sell recommendations are expected to improve up to 5% or deteriorate, based on consideration of the fundamental view and the currency impact (where applicable).

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I/We, Research Analysts and authors, hereby certify that all of the views expressed in this research report accurately reflect our views about the subject securities. We also certify that no part of our compensation was, is, or will be directly or indirectly related to the specific recommendation(s) or view(s) in this report.

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