

Oberoi Realty: Our top pick in real estate

(OBER IN, mcap US\$1,553mn, BUY, TP ₹271, 17% upside)

Analyst: Rakshit Ranjan, CFA, rakshitranjan@ambitcapital.com, Tel: +91 22 3043 3201

Stress on developers balance sheet continues to increase due to a combination of increasing financing cash flow requirements from high interest rates and low deteriorating operating cash flow prospects due to sluggish demand for residential properties (residential property registrations in Mumbai dropped 22% YoY in September 2011). As a result, we continue to see developers opting for changes in strategies including: a) sale of land banks (DLF being a key example); b) focus on affordable housing projects (for instance DLF's launch in Bangalore recently); c) players like Godrej Properties putting their commercial projects on hold whilst increasing focus on residential projects; d) increase in funding from private equity and HNIs at average interest rates of 20-25%.

Amidst such weakening market dynamics, Oberoi Realty continues to remain our top pick in the real estate sector with a debt-free balance sheet, over ₹12bn in surplus cash, ₹6.1bn of "advance received from customers" which is yet to go through the P&L and most importantly, continued strong run-rate of unit sales on its residential projects (see table below). We believe that Oberoi is best placed in the sector to monetise its balance sheet strength through a combination of timely execution of ongoing projects and acquisition of new land bank. Our base case scenario for project based DCF valuation of Oberoi conservatively assumes sluggish demand for the group's properties, no appreciation in realization rates over the next two years, 8% p.a. cost inflation and 1x valuation for surplus capital. Using a cost of equity of 15% and perpetuity growth rate of 4%, this scenario generates an SOTP valuation of ₹271, 17% upside.

Exhibit 1: Oberoi's 2QFY12 unit sales

	2QFY12	1QFY12	FY12E
Esquire	52	70	220
Exquisite	9	7	32
Spendor Grande	17	15	45
Splendor	3	3	12
Seven	1	0	0

Source: Company, Ambit Capital research

Institutional Equities Team

Saurabh Mukherjea, CFA Managing Director – Institutional Equities – (022) 30433174 saurabhmukherjea@ambitcapital.com

Research

Analysts	Industry Sectors	Desk-Phone	E-mail
Aadesh Mehta	Banking / NBFCs	(022) 30433239	aadeshmehta@ambitcapital.com
Anand Mour	FMCG	(022) 30433169	anandmour@ambitcapital.com
Ankur Rudra, CFA	Technology / Education Services	(022) 30433211	ankurrudra@ambitcapital.com
Ashvin Shetty	Automobile	(022) 30433285	ashvinshetty@ambitcapital.com
Bhargav Buddhadev	Power / Capital Goods	(022) 30433252	bhargavbuddhadev@ambitcapital.com
Chandrani De, CFA	Metals & Mining	(022) 30433210	chandranide@ambitcapital.com
Chhavi Agarwal	Construction / Infrastructure	(022) 30433203	chhaviagarwal@ambitcapital.com
Dayanand Mittal	Oil & Gas	(022) 30433202	dayanandmittal@ambitcapital.com
Gaurav Mehta	Derivatives Research	(022) 30433255	gauravmehta@ambitcapital.com
Hardik Shah	Technology / Education Services	(022) 30433291	hardikshah@ambitcapital.com
Krishnan ASV	Banking	(022) 30433205	vkrishnan@ambitcapital.com
Nitin Bhasin	Construction / Infrastructure / Cement	(022) 30433241	nitinbhasin@ambitcapital.com
Pankaj Agarwal, CFA	NBFCs	(022) 30433206	pankajagarwal@ambitcapital.com
Parita Ashar	Metals & Mining / Media / Telecom	(022) 30433223	paritaashar@ambitcapital.com
Puneet Bambha	Power / Capital Goods	(022) 30433259	puneetbambha@ambitcapital.com
Rakshit Ranjan, CFA	Mid-Cap	(022) 30433201	rakshitranjan@ambitcapital.com
Ritika Mankar	Economy	(022) 30433175	ritikamankar@ambitcapital.com
Ritu Modi	Cement	(022) 30433292	ritumodi@ambitcapital.com
Shariq Merchant	Consumer	(022) 30433246	shariqmerchant@ambitcapital.com

Sales

Name	Regions	Desk-Phone	E-mail
Deepak Sawhney	India / Asia	(022) 30433295	deepaksawhney@ambitcapital.com
Dharmen Shah	India / Asia	(022) 30433289	dharmenshah@ambitcapital.com
Dipti Mehta	India / Europe	(022) 30433053	diptimehta@ambitcapital.com
Pramod Gubbi, CFA	India / Asia	(022) 30433228	pramodgubbi@ambitcapital.com
Sarojini Ramachandran	UK	+44 (0) 20 7614 8374	sarojini@panmure.com

Production

Sajid Merchant	Production	(022) 30433247	sajidmerchant@ambitcapital.com
Kausalya Vijapurkar	Editor	(022) 30433284	kausalyavijapurkar@ambitcapital.com
Praveen Mascarenhas	Database	(022) 30433251	praveenmascarenhas@ambitcapital.com

Explanation of Investment Rating

Investment Rating	Expected return (over 12-month period from date of initial rating)
Buy	>5%
Sell	≤5%

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Ambit Capital Pvt. Ltd.

Ambit House, 3rd Floor
449, Senapati Bapat Marg, Lower
Parel, Mumbai 400 013, India.
Phone: +91-22-3043 3000
Fax: +91-22-3043 3100