

15 July 2008 | 8 pages

# Parsvnath Developers (PARV.BO)

 Target price change   
Estimate change 

## Sell: Risk-reward Still Unfavorable

- Target cut to Rs126** — Although the stock has corrected sharply, we see more volatility ahead as pricing and demand risks increase amid rising rates. Parsvnath has a residential-heavy (~60% of landbank) and North India-biased (~70%) model. We believe the risk-reward profile is still unfavorable, and cut our target to Rs126 based on a 40% discount (vs.30% previously) to NAV.
- NAV lowered on higher risks** — We have cut our March 09E NAV by 34% to Rs210 from Rs320. We factor in a higher discount rate of 16% in a rising interest rate environment and delays in project execution on sluggish demand and margin pressures due to higher construction costs. Assuming lower sales and EBITDA margins, we revise down our FY08E EPS 7.5%.
- Scaling up construction, but slowly** — Parsvnath's projects under construction increased to 77m sq ft in 4Q FY08, vs. 76m sq ft in 3Q and 74m sq ft in 1Q. Of this, ~40m sq ft is pre-sold. While it continues to have aggressive plans to launch projects, our checks suggest the pace of pre-sale volumes has slowed.
- What's new?** — 1) Added 1.95m sq ft to landbank (211m sq ft) – 2 bus depot projects in Ahmedabad and a luxury mall at Connaught Place, Delhi; 2) Strong traction in SEZs – land acquired for 7, of which 4 are notified and 2 have formal approval; and 3) raised Rs1.86bn by divesting a 30% stake in a Mumbai BKC project, easing some cash flow pressures.
- Key risks** — Bias towards tier-two and -three cities in North India, and projects across 49 cities raise execution risk.

Sell/High Risk	3H
Price (14 Jul 08)	Rs113.15
Target price	Rs126.00
<i>from Rs224.00</i>	
Expected share price return	11.4%
Expected dividend yield	0.0%
<b>Expected total return</b>	<b>11.4%</b>
Market Cap	Rs20,898M
	US\$489M

### Price Performance (RIC: PARV.BO, BB: PARSV IN)



### Statistical Abstract

Year to	Net Profit	Diluted EPS	EPS growth	P/E	P/B	ROE	Yield
31 Mar	(RsM)	(Rs)	(%)	(x)	(x)	(%)	(%)
2006A	1,070	7.21	62.9	15.7	8.3	70.7	0.0
2007A	2,922	15.82	119.4	7.2	1.4	34.5	2.6
2008E	4,244	22.98	45.2	4.9	1.1	25.1	2.7
2009E	7,452	40.35	75.6	2.8	0.6	26.9	0.0
2010E	9,360	50.68	25.6	2.2	0.4	20.3	0.0

Source: Powered by dataCentral

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Fiscal year end 31-Mar	2006	2007	2008E	2009E	2010E
<b>Valuation Ratios</b>					
P/E adjusted (x)	15.7	7.2	4.9	2.8	2.2
P/E reported (x)	15.7	7.2	4.9	2.8	2.2
P/BV (x)	8.3	1.4	1.1	0.6	0.4
Dividend yield (%)	0.0	2.6	2.7	0.0	0.0
<b>Per Share Data (Rs)</b>					
EPS adjusted	7.21	15.82	22.98	40.35	50.68
EPS reported	7.21	15.82	22.98	40.35	50.68
BVPS	13.56	80.77	102.31	197.36	302.74
NAVps ordinary	na	na	na	na	na
DPS	0.00	2.92	3.00	0.00	0.00
<b>Profit &amp; Loss (RsM)</b>					
<b>Net operating income (NOI)</b>	<b>1,708</b>	<b>4,511</b>	<b>6,541</b>	<b>18,397</b>	<b>25,172</b>
G&A expenses	-268	-337	-396	-7,320	-11,323
Other Operating items	-42	-143	-239	-235	-258
<b>EBIT including associates</b>	<b>1,398</b>	<b>4,031</b>	<b>5,905</b>	<b>10,842</b>	<b>13,591</b>
Non-oper./net int./except.	72	49	267	117	175
<b>Pre-tax profit</b>	<b>1,470</b>	<b>4,080</b>	<b>6,172</b>	<b>10,959</b>	<b>13,765</b>
Tax	-400	-981	-1,928	-3,507	-4,405
Extraord./Min. Int./Pref. Div.	0	-176	0	0	0
<b>Reported net income</b>	<b>1,070</b>	<b>2,922</b>	<b>4,244</b>	<b>7,452</b>	<b>9,360</b>
Adjusted earnings	1,070	2,922	4,244	7,452	9,360
Adjusted EBIT	1,398	4,031	5,905	10,842	13,591
Adjusted EBITDA	1,440	4,174	6,145	11,077	13,849
<b>Growth Rates (%)</b>					
NOI	119.1	164.2	45.0	181.3	36.8
EBIT adjusted	98.5	188.4	46.5	83.6	25.3
EPS adjusted	62.9	119.4	45.2	75.6	25.6
<b>Cash Flow (RsM)</b>					
<b>Operating cash flow</b>	<b>-2,035</b>	<b>-13,537</b>	<b>-5,809</b>	<b>-18,010</b>	<b>-13,039</b>
Depreciation/amortization	42	143	239	235	259
Net working capital	-2,163	-16,128	-10,609	-35,795	-32,760
<b>Investing cash flow</b>	<b>-452</b>	<b>-1,175</b>	<b>-1,376</b>	<b>-318</b>	<b>-349</b>
Capital expenditure	-414	-721	-1,766	-311	-342
Acquisitions/disposals	0	0	0	0	0
<b>Financing cash flow</b>	<b>2,058</b>	<b>19,756</b>	<b>5,956</b>	<b>16,319</b>	<b>14,139</b>
Borrowings	1,152	9,337	6,510	16,319	14,139
Dividends paid	0	-540	-554	0	0
<b>Change in cash</b>	<b>-429</b>	<b>5,045</b>	<b>-1,229</b>	<b>-2,009</b>	<b>751</b>
<b>Balance Sheet (RsM)</b>					
<b>Total assets</b>	<b>9,496</b>	<b>36,283</b>	<b>49,933</b>	<b>85,037</b>	<b>121,100</b>
Cash & cash equivalent	412	5,458	4,228	2,219	2,970
Net fixed assets	529	1,106	2,649	2,724	2,807
<b>Total liabilities</b>	<b>7,485</b>	<b>21,365</b>	<b>31,022</b>	<b>48,586</b>	<b>65,186</b>
Total Debt	2,359	11,695	18,205	34,524	48,663
<b>Shareholders' funds</b>	<b>2,012</b>	<b>14,918</b>	<b>18,911</b>	<b>36,451</b>	<b>55,914</b>
<b>Profitability/Solvency Ratios</b>					
EBIT margin adjusted (%)	21.7	26.7	33.3	32.6	31.2
ROE adjusted (%)	70.7	34.5	25.1	26.9	20.3
ROA adjusted (%)	14.2	12.8	9.8	11.0	9.1
Net debt to equity (%)	96.7	41.8	73.9	88.6	81.7
Interest coverage (x)	53.6	21.6	15.7	21.1	27.7

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## Key Points

### Higher risk prompts us to cut NAV

With the operating environment getting tougher, we see higher pricing and demand risks for tier-two developers such as Parsvnath. The company offering an EMI reimbursement scheme as an incentive to boost sales of its recently launched 'Parsvnath Preston' in Sonapat reflects these pressures. We cut our NAV estimate by 34% to Rs210, factoring in: 1) a higher discount rate of 16% (vs. 14% previously); 2) potential delays in project launches and execution given subdued demand and oversupply risks, especially in North India; and 3) increased construction costs in an inflationary environment.

### Pace of construction is slowing down

Despite several new launches, the company's area under construction increased only marginally to 77m sq ft in 4Q FY08, vs. 76m sq ft in 3Q FY08 and 74m sq ft in 1Q FY08. We believe this reflects the weak underlying demand. While Parsvnath has already pre-sold ~40m sq ft of these projects under construction and continues to aggressively launch new projects across various markets, our channel checks suggest that the pace of pre-sales volumes, which we believe is critical for the company's cash flows and growth ahead, has slowed.

### New developments

- **More additions to landbank:** The company added 1.95m sq ft in 4Q FY08, taking its total landbank to ~211m sq ft (2 bus depot projects in Ahmedabad totaling 1.78m sq ft and a luxury mall project at Connaught Place in Delhi with developable area of 0.17m sq ft).
- **Stake sale in Mumbai BKC project to ease some cash flow pressure:** The company has sold a 30% stake in its BKC bus depot project to Yatra Capital and Saffron India Real Estate Fund for Rs1.86bn.
- **Growing its contractual business; but margins could be lower:** In 4Q FY08 the company won an order worth Rs1.25bn to construct buildings, multi-level car parks and external development with an area of 0.29m sq ft at Buddha Smriti Udhyaan in Patna. The total value of projects in the contractual business is Rs2.63bn; however, we expect this business to yield lower margins.
- **Strong traction in SEZs, visibility on execution is key:** Parsvnath has acquired land for 7 SEZs. Four SEZs have been notified – 3 IT/ITES SEZs at Indore, Gurgaon and Dehradun and one Pharma SEZ at Nanded, while formal approval has been received for an IT/ITES SEZ at Kochi and a Biotech SEZ at Hyderabad. Further, land has been acquired for an IT/ITES SEZ at Mysore, which awaits notification. Construction on notified SEZs is to begin shortly — visibility on execution is crucial.

## Parsvnath Developers

### Company description

Parsvnath Developers is among the largest real estate developers in North India with dominance in residential projects (c.60% of total development). Its focus is on enhancing presence in tier-two and -three cities across the country, though it is concentrated in the NCR. Management has 15 years of experience in the real estate business and has completed over 5m sq ft of development in the last five years. The company is in the process of building a diversified real estate portfolio and has aggressive plans of developing c.211m sq ft over the next 4-5 years (development rights/land is already acquired). Promoters control and manage the company with an 80% stake.

### Investment strategy

We rate Parsvnath Sell/High Risk (3H) with a target price of Rs126. Parsvnath has aggressive plans to develop c.211m sq ft over the next 6-7 years, for which it has already acquired land/development rights. The company's strategy to operate on a develop-and-sell model. The biggest challenge is execution. Management plans to diversify into new segments — commercial, retail, IT/ITES Park, DMRC projects, hotels, multiplexes and SEZs — and enhance its presence in 250 cities by 2010 vs. 49 cities today. The company's aggressive development plans raise execution and market risks, in our view. Although the stock has corrected sharply over the past 3 months, we see limited upside potential in the current environment and believe the risk/reward is unfavorable.

### Valuation

Our target price of Rs126 is based on a 40% discount to our NAV estimate of Rs210. We accord a discount because: 1) The company is concentrating on tier-two and -three cities; 2) execution risk is high given the company's presence across 49 cities; and 3) demand and pricing risks exist given that Parsvnath's residential-heavy business model could result in liquidity constraints. We believe an NAV-based valuation methodology is most appropriate for valuing Parsvnath, as it factors in the company's varied development projects and spread-out time frames. Our NAV estimate assumes: a) current market prices; b) development volume of 167m sq ft after elimination of c44m recognized as revenue until FY09E and some area representing collaborators' share; c) average cost of capital of 16%; and d) a tax rate of 27%.

**Figure 1. Parsvnath NAV Summary (Rs Million)**

Gross NAV of Residential Development	45,352
Gross NAV of Non-Residential	43,963
<b>Gross Total NAV</b>	<b>89,314</b>
Less: Amt outstanding for land	13,730
Less: Tax @ 27%	20,408
Less: Debt Outstanding	18,205
Less: Customer Advances	2,450
Add: Cash	4,228
<b>Net NAV</b>	<b>38,750</b>
No. of Shares Outstanding (Millions)	185
<b>NAV Per Share (Rs)</b>	<b>210</b>

Source: Citi Investment Research

### Risks

The key reasons for rating Parsvnath High Risk include: 1) the company's concentration in the NCR, where the risk of excess supply over the next 2-3 years is high; 2) aggressive development plans, which raises the risk of execution delays; and 3) evolving regulatory and political risks for the sector's growth. Our High Risk rating is in line with our quantitative risk-rating system, which tracks 260-day historical share price volatility. The main upside risks to

our investment thesis and target price include: 1) Any positive developments on execution of the 9 SEZ projects would enhance the company's NAV and valuations; 2) The company is exploring opportunities to monetize some of its assets through stake sale to private equity funds. If this materializes, it would provide sizeable cash flows and boost stock sentiment; 3) Any downward revision in interest rates for housing projects would benefit the company, given its high leverage to the residential segment.

# Appendix A-1

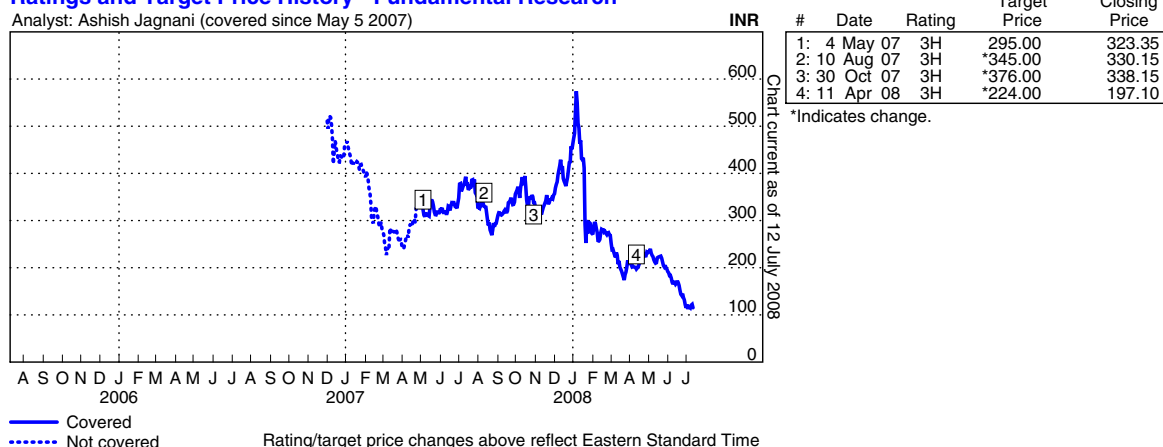
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Analyst: Ashish Jagnani (covered since May 5 2007)



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