Asia Pacific | India
Real Estate Management & Development | Real Estate/Property

Company In-Depth

4 May 2007 | 11 pages

Parsvnath Developers (PARV.BO)

Sell: Aggressive Development Plans, but Priced in

- Initiate at Sell (3H) — We initiate coverage on Parsvnath with a Sell/High Risk rating with a target price of Rs295 based on a 10% discount to our NAV estimate of Rs328, implying 11% downside.
- Key concerns — We attribute the 10% discount to: 1) concentration in Tier II and III cities where creating sufficient jobs to meet potential supply is difficult, 2) high exposure to the NCR (43%) where risk of near-term prices softening is high; 3) an increased share of plotted development that lacks pricing power, and 4) high execution risks given aggressive plans to develop ~134m sq. ft.
- Growth catalysts — 1) Low-risk develop-sell model for large part of development portfolio, 2) forays into new segments such as Delhi Metro Rail projects, multiplexes, IT Parks and hotels. We forecast strong earnings CAGR over FY07-09E on the back of higher volumes and some gains from land holdings acquired in the past, but believe NAV is the most appropriate valuation method.
- High-priced land acquisitions — A significant part of Parsvnath's landbank was acquired relatively recently when property prices were at their peak. Given the current scenario of softening real estate prices, we forecast only a marginal improvement of 210bps in Parsvnath's operating margins from FY07E to FY09E.
- Upsides priced in — With the stock appreciating significantly over the last one month and trading close to our NAV compared to our expectation of a 10% discount, we believe the potential upside is priced in.

Sell/High Risk	3H
Price (03 May 07)	Rs331.15
Target price	Rs295.00
Expected share price return	-10.9%
Expected dividend yield	0.0%
Expected total return	**-10.9%**
Market Cap	Rs60,140M
	US$1,465M

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

See Appendix A-1 for Analyst Certification and important disclosures.

Figure 1. Statistical Abstract

Year to 31-Mar	Net Profit (Rs m)	EPS (Rs)	P/E (x)	ROCE (%)
FY05	657	4	74.8	43%
FY06	1,070	7	45.9	33%
FY07E	3,229	17	18.9	22%
FY08E	6,810	37	9.0	24%
FY09E	12,484	68	4.9	32%

Source: Citigroup Investment Research

Figure 2. Parsvnath Landbank by Segment

Segment	Area (m sq. ft.)	% of Total
Plot	40.5	30%
Residential	72.5	54%
Commercial/Retail	11.1	8%
DMRC	1.8	1%
Hotels	2.7	2%
IT Parks	6.0	4%
Total	**134.6**	**100%**

Source: Company Reports and CIR

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Fiscal year end 31-Mar	2005	2006	2007E	2008E	2009E
Valuation Ratios					
P/E adjusted (x)	74.8	45.9	18.9	9.0	4.9
P/E reported (x)	74.8	45.9	18.9	9.0	4.9
P/BV (x)	48.4	24.4	3.7	2.6	1.7
Dividend yield (%)	0.0	0.0	0.0	0.0	0.0
Per Share Data (Rs)					
EPS adjusted	4.43	7.21	17.48	36.87	67.59
EPS reported	4.43	7.21	17.48	36.87	67.59
BVPS	6.85	13.56	89.74	126.61	194.20
NAVps ordinary	na	na	na	na	na
DPS	0.00	0.00	0.00	0.00	0.00
Profit & Loss (RsM)					
Net operating income (NOI)	**779**	**1,708**	**9,298**	**18,274**	**31,494**
G&A expenses	-55	-268	-4,594	-8,204	-13,407
Other Operating items	-20	-42	-135	-205	-235
EBIT including associates	**704**	**1,398**	**4,569**	**9,865**	**17,852**
Non-oper./net int./except.	26	72	-85	-273	-270
Pre-tax profit	**730**	**1,470**	**4,484**	**9,592**	**17,583**
Tax	-73	-400	-1,256	-2,782	-5,099
Extraord./Min. Int./Pref. Div.	0	0	0	0	0
Reported net income	**657**	**1,070**	**3,229**	**6,810**	**12,484**
Adjusted earnings	657	1,070	3,229	6,810	12,484
Adjusted EBIT	704	1,398	4,569	9,865	17,852
Adjusted EBITDA	724	1,440	4,704	10,070	18,087
Growth Rates (%)					
NOI	220.7	119.1	444.5	96.5	72.4
EBIT adjusted	257.4	98.5	226.9	115.9	81.0
EPS adjusted	256.7	62.9	142.4	110.9	83.3
Cash Flow (RsM)					
Operating cash flow	**265**	**-2,035**	**-10,213**	**-2,882**	**326**
Depreciation/amortization	20	42	135	205	235
Net working capital	-392	-2,163	-13,577	-9,897	-12,393
Investing cash flow	**-173**	**-452**	**-3,044**	**903**	**297**
Capital expenditure	-133	-414	-134	-377	-113
Acquisitions/disposals	0	0	0	0	0
Financing cash flow	**722**	**2,058**	**19,001**	**645**	**-1,160**
Borrowings	722	1,152	7,667	645	-1,160
Dividends paid	0	0	0	0	0
Change in cash	**815**	**-429**	**5,744**	**-1,334**	**-537**
Balance Sheet (RsM)					
Total assets	**5,586**	**9,496**	**32,665**	**41,488**	**55,812**
Cash & cash equivalent	841	412	6,156	4,823	4,285
Net fixed assets	155	529	528	699	577
Total liabilities	**4,570**	**7,485**	**16,091**	**18,104**	**19,944**
Total Debt	1,207	2,359	10,025	10,670	9,510
Shareholders' funds	**1,016**	**2,012**	**16,574**	**23,384**	**35,868**
Profitability/Solvency Ratios					
EBIT margin adjusted (%)	23.2	21.7	26.9	28.9	29.3
ROE adjusted (%)	94.2	70.7	34.7	34.1	42.1
ROA adjusted (%)	18.1	14.2	15.3	18.4	25.7
Net debt to equity (%)	36.0	96.7	23.3	25.0	14.6
Interest coverage (x)	68.7	53.6	19.2	21.7	36.2

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Company Background

Parsvnath Developers is among the largest real estate developers in north India with dominance in residential projects (~54% of total development). Focus is on enhancing presence in Tier-II and Tier-III cities across the country, presently concentrated in the NCR. Management has 15-years of experience in the real estate business and it completed 3.8mn sq.ft of development in the last five years. Its ability to identify and aggregate large parcels of land and development rights will drive growth in the future. The company is in the process of building a diversified real estate portfolio and has aggressive plans for developing ~134mn sq.ft over the next 3-4 years, with development rights/land that it has already acquired. The company raised Rs10bn through an IPO at Rs300 per share in Nov'06 for funding its growth plans. Promoters control and manage the company with an 80% stake.

Investment Thesis

We initiate coverage on Parsvnath Developers with a Sell/High Risk (3H) rating with a 12-month price target of Rs295, based on 10% discount to our NAV estimate of Rs328 per share. This implies about 11% downside over the next 12-months. We attribute the discount to: 1) a concentration in Tier-II and III cities, 2) its exposure to NCR (43% of development) where the risk of property prices softening in the near-term is high, and 3) high share of plotted development (30% of total development), which is a low value add business.

Parsvnath has aggressive plans to develop ~134mn sq.ft over the next 4-5 years – land/development rights for which it has already acquired. The company's strategy to operate on a develop-and-sell model and capital raised through recent IPO will provide it with requisite cash flows for funding growth, the key challenge is execution. Management plans to diversify to new segments – commercial, retail, IT/ITES Park, DMRC) projects, hotels and multiplexes; and enhance presence in 250 cities by 2010 vs. 46 cities today, but this does raise execution and market risk levels. While we forecast strong revenue and earnings CAGRs of 89% and 97%, respectively, for FY07-09E on the back of increased volumes and higher margins – this is likely to moderate significantly in the future as the high cost of land is recognized. We believe NAV value will be the primary driver for stock performance. The stock has appreciated by 17% over last two-months and is trading close to NAV levels. With concentration in the North, a market where speculative build up is high and property prices are likely to soften, we believe a 10% discount to NAV is fair value.

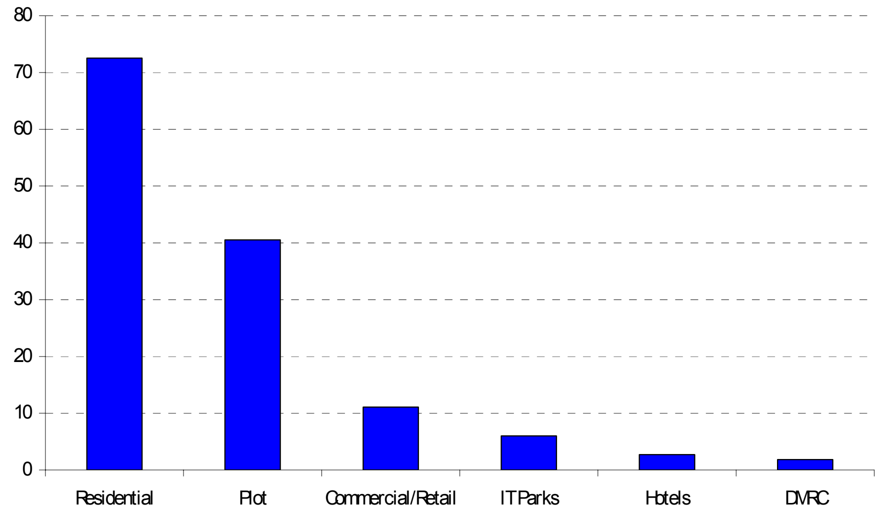
Strategy ahead

Aggressive development plans

Plans to build ~134m sq. ft in 4-5 years including 21 townships

Parsvnath has aggressive development plans to build ~134mn sq.ft. in the next 4-5 years. Most of the development plans are concentrated on township developments – plans to develop 21 townships with a diversified portfolio of projects. The required landbank and development rights for this are already acquired. While a large part is focused on residential projects, a mix of plotted development and housing projects it is also diversifying to other segments – commercial, retail, IT/ITES Park, Delhi Metro Rail Corp (DMRC) projects, hotels and multiplexes – all spread across 46 cities. Given that the company has developed ~3.8mn sq.ft over the last five years, these plans are aggressive and raise execution risks and market risks, in our view.

Figure 3. Parsvnath Landbank by Segment (Million sq. ft.)



Source: Company Reports and Citigroup Investment Research

Develop-Sell model

Develop-and-sell model for large part of development including residential

The company operates in a develop-and-sell mode for the large part of its projects, particularly the residential segment. This approach provides it with cash flows to develop projects with better returns. A portion (~30%) of its commercial, retail, hotel and IT/ITES Park assets are owned, leased in initial years and then sold, which provides the company with leasing income. We assume a capitalization model for non-residential development in calculation of our NAV.

Core focus on Tier II and Tier III cities

Plans to expand footprint to 250 cities by 2010 vs 46 cities today

Most of Parsvnath's development is based in the North, with ~43% in the NCR. It is, however, making efforts to increase its footprint in Tier II and Tier III cities across the country – it plans to enhance its presence in 250 cities by 2010 vs 46 cities today. Management believes these micro markets offer strong demand potential and a better pricing environment for real estate development. While this strategy differs from some of the large developers focusing on Tier I locations, job creation to provide sufficient income levels to support current high prices will be critical to the success of this strategy.

High price land acquisitions

Recent high-price land acquisitions result in relatively higher land cost

Parsvnath's latest land deals in Noida are expected to add to the company's land costs significantly - in Noida it bought 72acres at Rs6bn and in Ranchi, Jharkhand, it bought 8.3 acres for Rs525mn. Similarly, it has also recently bought land in Mumbai and other locations at prevailing market prices, which are substantially higher than its average land cost, thereby pushing up the prices of properties. We believe any correction in real estate prices would exert pressure on operating margins.

Diversifying to new areas, but benefits back ended

To reduce dependence on the residential segment, the company is diversifying to new growth opportunities. It expects these to contribute towards incremental revenues, however, most of this will be back ended as a large part of the development will come up in phases, post 2009.

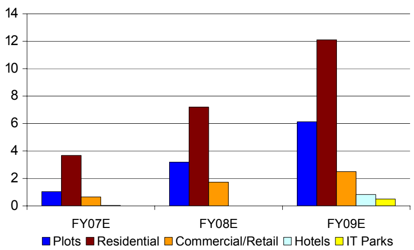
BOT agreements for 12 DMRC projects with lease ranging from 12-30 years; 5 projects already executed

- DMRC Projects: Parsvnath has entered into 12-30 year lease to develop retail malls (~1.8 mn sq.ft) at 11 stations owned by the DMRC on a build operate & transfer (BOT) basis. As per the agreement, the company will earn lease rental income for the lease period on payment of upfront fee and nominal lease rent/month for the lease period, after which the property will devolve to DMRC. Five projects are complete and completion on the balance is scheduled by 2010. The company recently bagged lease rights to develop a new DMRC station with integrated mall and commercial complex (0.37m sq.ft) at Games Village, near the Akshardham Temple in the NCR, with completion targeted for 2010.

Plans to develop 17 hotels and 114 multiplex screens; MOU signed with Movietime Cineplex for 100 screens

- Hotels and Entertainment projects: The company plans to develop 17 hotels, 2396 rooms (~2.7m sq.ft) across key Tier II cities – some being part of the township development. It plans to retain ownership and lease management to international franchisees – completion of most projects is due in 2010. Additionally, it is developing 114 multiplex screens and has signed a MoU with Movietime Cineplex for leasing ~100 screens at Rs48.5/sq.ft for an initial period of nine years with 15% escalation after every three years. We expect this to contribute cash flows of ~Rs420m per annum.

Figure 4. Parsvnath Sales Volumes (M sq. ft.)



Source: CIR Estimates

Financial Analysis

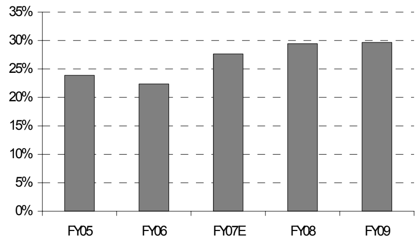
We expect by 4-5x increase in volumes over FY07-09E, primarily on account of plotted and housing projects to drive rapid revenue growth of 89% CAGR over FY07-09E. We are not factoring in any substantial contribution from the retail and IT projects, as we believe the development is likely to take time; most of the retail malls and IT Parks will be ready only post 2009E. As per the company policy, revenues are recognized on a percentage completion method for all projects on proportionate basis, subject to actual costs incurred being 30% or more of the total estimated costs of the projects.

Figure 5. Revenue Mix (Rs Millions)

	FY07E	FY08E	FY09E
Plots	564	1,663	3,149
Residential	11,883	20,358	32,726
Commercial/Retail	4,570	12,161	22,044
IT Parks	0	0	3,023
Total	**17,016**	**34,183**	**60,942**

Source: CIR Estimates

Figure 6. Parsvnath EBITDA Margins (F05-FY09E



Source: CIR Estimates

EBITDA margins are likely to improve from 22% in FY06 to 30% levels in FY09E – but this is likely to be lower than peers due to higher land costs. Factoring this, low gearing levels following fresh capital raised, interest costs capitalized for most projects, we forecast strong earnings CAGR of 97% for FY07-09E.

Valuation

Our target price of Rs295 is based on 10% discount to Parsvnath's NAV of Rs328. While the level of NAV discount will be a matter of subjective assessment, we believe that a 10% discount to the NAV is fair. This discount is largely attributable to - 1) the company's concentration in Tier II and Tier III cities, where creating sufficient jobs and income levels to meet potential supply is difficult, 2) the size of its exposure to NCR (43% of development), where the risk of softening in property prices is high, and 3) high share of plotted development (30% of total development), a low value-add business

We believe a NAV-based valuation methodology is most appropriate as it factors the varied development projects and spreads out time frames. Our estimates for the NAV involve the following key assumptions: a) current market prices to remain at this level with no price inflation; b) development volume of 127.3m sq.ft (as ~1.9m and 5.4m is already recognized as revenue in FY06 and FY07 respectively), c) all projects undertaken by Parsvnath will be completed as per schedule provided by management, though given the scale of the roll-out, we expect a sizeable risk of delays, d) an average cost of capital of 14%, and e) marginally lower tax rate of 27%.

Figure 7. NAV Summary - Mar '07 (Rupees in Millions)

Gross NAV of Residential Development	52,287
Gross NAV of Non-Residential Development	40,527
Gross Total NAV	**92,814**
Less: Tax @ 27%	25,060
Less: Amt outstanding for land & govt. dues	0
Less: Debt Outstanding	10,000
Less: Net Customer Advances	-2,800
Net NAV	**60,555**
No. of Shares Outstanding (Millions)	184.7
NAV Per Share (Rupees)	**328**

Source: CIR Estimates

Figure 8. NAV Sensitivity

Price Change	**0%**	**+ 5 %**	**+ 10 %**
NAV (Rs)	328	363	398
Cost of Capital	**13%**	**14%**	**15%**
NAV (Rs)	339	328	317
Project Delays	**3 months**	**6 months**	**12 months**
NAV (Rs)	316	305	283

Source: Citigroup Investment Research

Figure 9. Premium/Discount to NAV

Source: Citigroup Investment Research

The stock has been highly volatile. After listing in Nov'06, the stock traded at a significant premium to its IPO price of Rs300 per share, later correcting significantly and moving to a discount to our NAV. It now trades close to our NAV estimate. This volatility is largely on the back of news flow on rising interest rates and expected softening in property prices of NCR, a domain market for Parsvnath. We not foresee any major catalysts to take the stock to a premium and believe a 10% discount to NAV is fair, thus implying 11% downside.

Risks

We rate Parsvnath High Risk. This is different from the Speculative Risk rating assigned by our quantitative risk rating system (which measures the stock's volatility over a 260-day period) to stocks that have less than one year's trading history.

The key reasons for our assignment of a High Risk rating include: 1) the company's concentration in the NCR where risk of excess supply over the next 2-3 years is high, 2) aggressive development plans, which raises sizeable risk of execution delays, and 3) evolving regulatory and political risks for the sector's growth. The main risks to our investment thesis and target price are:

- Any positive developments on execution of SEZ projects, particularly the four IT/ITES SEZs that have received formal government approvals, could enhance the company's NAV and valuations
- Timely execution on on-going projects, which would demonstrate the company's ability to execute on its aggressive development plans
- Any downward revision in interest rates for housing projects, which would benefit the company, given its high leverage in the residential segment

If any of these risk factors has a greater impact than we expect, the share price would likely move above our target price.

Figure 10. Income Statement, FY05-09E (Rupees in Millions)

Year to 31 Mar	FY05	FY06	FY07E	FY08E	FY09E
Total Revenues	3,032	6,438	17,016	34,183	60,942
YoY Growth (%)	170%	112%	164%	101%	78%
EBITDA	**724**	**1,440**	**4,704**	**10,070**	**18,087**
Margin (%)	23.9%	22.4%	27.6%	29.5%	29.7%
Depreciation & Amortization	(20)	(42)	(135)	(205)	(235)
Other income	36	99	160	192	230
EBIT	**741**	**1,497**	**4,729**	**10,057**	**18,083**
Interest income(expense)	(11)	(27)	(245)	(465)	(500)
Profit before tax	**730**	**1,470**	**4,484**	**9,592**	**17,583**
Tax	(73)	(400)	(1,256)	(2,782)	(5,099)
Net Income	**657**	**1,070**	**3,229**	**6,810**	**12,484**

Source: Company Reports and CIR Estimates

Figure 11. Balance Sheet, FY05-09E (Rupees in Millions)

Year to 31 Mar	FY05	FY06	FY07E	FY08E	FY09E
Source of Funds					
Equity Share Capital	82	989	1847	1847	1847
Reserves	933	1022	14727	21537	34021
Net Worth	1016	2012	16574	23384	35868
Long Term Debt	1170	2105	6925	10220	9105
Short Term Debt	37	254	3100	450	405
Total Debt	1207	2359	10025	10670	9510
Capital Employed	**2223**	**4370**	**26599**	**34054**	**45378**
Application of Funds					
Gross Block	205	446	753	1130	1243
Depreciation	50	90	225	430	665
Net Fixed Assets	155	356	528	699	577
Capital WIP	0	173	0	0	0
Investments	42	80	2990	1710	1300
Inventories	2471	3894	11061	21193	35956
Sundry Debtors	434	638	3063	3418	4875
Other Current Assets	1642	3942	8868	9645	8818
Cash and Bank	841	412	6156	4823	4285
Current Assets	5388	8887	29148	39079	53934
Current Liabilities	(3362)	(5126)	(6066)	(7434)	(10434)
Net Current Assets	2026	3760	23081	31645	43501
Total Net Assets	**2223**	**4370**	**26599**	**34054**	**45378**

Source: Company Reports and CIR Estimates

Figure 12. Key Ratios, FY05-09E

Year to 31 Mar	FY05	FY06	FY07E	FY08E	FY09E
EPS (Rs)	4.4	7.2	17.5	36.9	67.6
EPS YoY Gr. (%)	257%	63%	142%	111%	83%
Book value (Rs)	6.8	13.6	89.7	126.6	194.2
Debt/Equity (x)	1.19	1.17	0.60	0.46	0.27
ROE (%)	65%	53%	19%	29%	35%
ROCE (%)	43%	33%	22%	24%	32%

Source: Citigroup Investment Research

Appendix A-1

Analyst Certification

We, Ashish Jagnani and Aditya Narain, CFA, research analysts and the authors of this report, hereby certify that all of the views expressed in this research report accurately reflect our personal views about any and all of the subject issuer(s) or 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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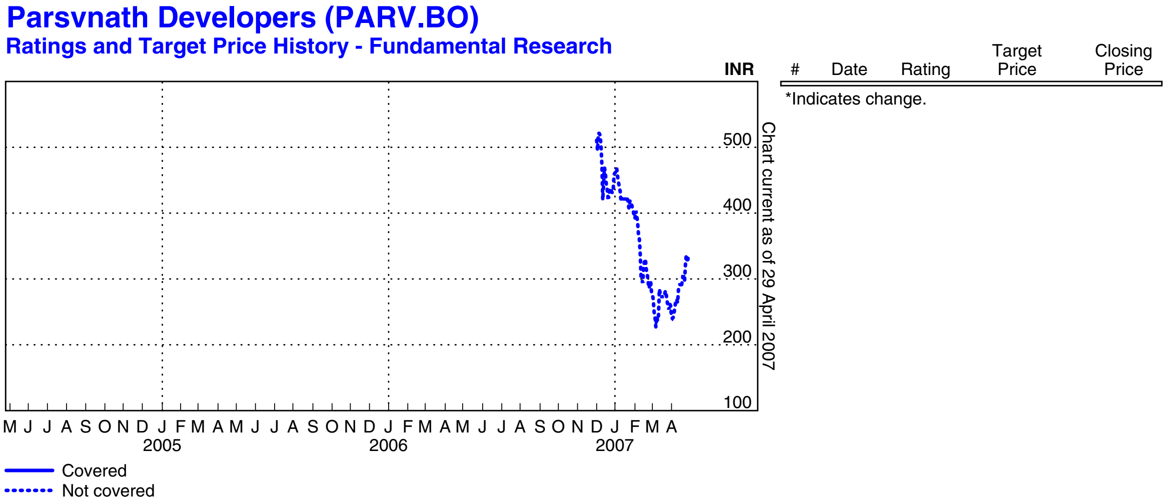

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