Industry Focus

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Indian Real Estate

Key Takeaways from Property Tour in South India

Ashish Jagnani[1]
+91-22-6631-9861
ashish.jagnani@citi.com

Aditya Narain, CFA[1]
+91-22-6631-9879
aditya.narain@citi.com

Karishma Solanki[1]
karishma.solanki@citi.com

- **Our 3-day tour was across 3 cities** — The tour was across Bangalore, Chennai and Hyderabad. We visited some of the emerging development zones: Whitefield, Outer Ring Road in Bangalore; OMR, Sriperembadur in Chennai; Gachibowli, Hi-tech City in Hyderabad. This provided a good overview of different developments (residential, office/IT Parks, retail mall, convention centre) in the region.

- **Key takeaways** — 1) supply across asset classes gets more visible, while most of this is pre-leased/sold; risks remain, 2) residential prices are holding/stabilized after some correction, while rentals are firm/increasing; land prices spiraling, 3) IT/ITES sector the primary demand driver; growth still intact, and 4) significant infrastructure development and pace of construction activity is encouraging.

- **Bangalore, the largest market** — Strong demand for IT space has led to 4-5% increase in rentals (Rs.42-45/sq ft); residential prices (Rs~3500/sqft) are holding with yields of 3-4%, relatively better than 1-2% in North. Potential supply risks, however, remain. We see good progress on infrastructure projects; new airport (Apr'08), peripheral road network (large parts complete) to enhance value ahead.

- **Chennai, multiple demand drivers** — While Chennai is a growing IT destination, Sriperumbudur near Chennai is an emerging manufacturing hub. This has led to land prices spiraling and greater thrust on infrastructure. IT space rentals (Rs.38-42/sq ft) are on the rise; residential prices are also firm at Rs~3600/sqft. Supply risks are relatively lower vs. other southern markets, barring some pockets.

- **Hyderabad, an emerging IT hub** — Madhapur (Hi-Tech City) and Gachibowli are the IT CBD of Hyderabad. Land availability/clear titles and spiraling land prices are key challenges. Potential supply risks have kept IT space rentals (Rs.36-40/sqft) in-check; residential is a relatively (Rs~4000/sq ft) better market. Progress on road/airport projects and the pace of construction is encouraging.

- **We reiterate South is a better market vs. North** — In the current sluggish residential demand environment, we believe South is a relatively better market than North on price environment, demand potential, benefits from on-going infrastructure and supply risks. We prefer Puravankara, a leveraged play on residential and Ascendas India Trust, a good proxy for exposure to office/IT Parks assets.

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

[1]Citigroup Global Markets India Private Limited

Key Takeaways

We visited some of the emerging development zones in Bangalore, Chennai and Hyderabad

Our 3-day tour was across key cities of Bangalore, Chennai and Hyderabad in South India. We visited some of the emerging development zones: Whitefield, Outer Ring Road in Bangalore; OMR, Sriperembadur in Chennai; and Gachibowli, Hi-tech City in Hyderabad. Over the past three days, we visited properties/land parcels of the following developers: Ascendas India Trust, Puravankara, Sobha, IVR Prime Urban Developers (IVR PUDL), K Raheja Group, Hiranandani Group and the UB Group. This provided a good overview of different developments – residential, office/IT Parks, retail mall, convention centre – in the region. Key takeaways are as follows:

- **Increasing supply visibility** – With a large number of projects across asset classes under execution and construction activity having significantly accelerated, there is increased visibility of upcoming supply. While most of these projects are pre-leased/sold, potential supply risks remain.
- **Prices/rentals are holding/firm** – Residential project prices are holding up/have stabilized after some correction in few pockets. Office/IT space and retail mall rentals have been increasing/remain firm.
- **Land prices and availability a challenge** – Land prices have been spiraling across locations; this together with limited availability is influencing asset prices. Progress on infrastructure projects is also contributing towards this.
- **Demand drivers** – IT/ITES sector is the primary demand driver. There appears still no let down in demand for IT space, despite the current scenario of appreciating rupee. Pick-up in manufacturing activity in Chennai is also an additional driver of property demand.
- **Progress on infrastructure projects, encouraging** – We see significant progress on infrastructure projects – new airports and peripheral road network. This we believe will enhance value of development projects.
- **Potential execution delays, possible** – Even though the pace of construction activity is encouraging, given the large scale of construction, shortage of adequate contractors poses risks of delays in execution and cost overruns.

We reiterate that South India is a better market than the North

Factoring in the takeaways from our tour, we reiterate that the South is a relatively better property development market than the North, particularly in the residential segment. This is due to 1) higher demand potential being an IT-hub and higher per-capita income, 2) more reasonable property prices, 3) benefits from on-going infrastructure projects still to be discounted; and 4) relatively lower supply risks and lesser speculative investments in property.

Puravankara and A-iTrust are top picks with exposure to South India

We prefer Puravankara (PPRO.BO - Rs400.90; 1M), a leveraged play on residential in South India. Its quality land bank, mostly within city limits of Bangalore, direct sale model and in-house construction expertise are key differentiators. With stock trading at 29% discount to NAV of Rs564, we find valuation attractive. We reiterate Buy/Medium risk rating with target price of Rs536.

Ascendas India Trust (A-iTrust) (AINT.SI - S$1.38; 1L) is a good proxy for exposure to office/IT Parks assets in South. It is a unique REIT-like business trust offering exposure to 3.6m sq ft of IT/ITES assets located in India with strong DPU CAGR of 28% over FY08-10E. We maintain our Buy/Low risk with target of S$1.75.

Overview of Bangalore

Bangalore peripheral locations getting popular; office supply gets visible but quality the key; strong demand for retail malls; good progress on infra projects to enhance value of developments

- Areas in south and south-east Bangalore such as Marathalli, Whitefield, Sarjapur Outer Ring Road and HSR Layout are becoming popular residential destinations in the suburban areas. Prices in these locations are in the range of Rs3,000-4,000 per sq ft and holding firm and offers better yields as well.
- North Bangalore locations such as Bellary Road and Yelahanka are also witnessing development of several residential projects given their proximity to the new international airport scheduled to be operational in April 2008.
- Supply of ~12m sq ft of office/IT space is expected in Bangalore by 2009, most of which will be in Whitefield and along the outer ring road. While Whitefield has been an IT hub for sometime, the south-east portion of the outer ring road is seeing increased development of IT/ITES space. Increased FSI has also contributed towards increase in supply.
- While average vacancy rate in Bangalore is ~18%, this is largely due to sub-standard and poor quality development of some projects. A-iTrust's IT Park in Whitefield, however, has the highest occupancy levels of 94%-plus and premium rentals over peers; superior and reliable infrastructure, quality development are key reasons
- There is strong demand for retail space in Bangalore with vacancy levels in existing malls as low as 1%. UB City Mall, a high-end retail mall with ~100,000 sq ft in the heart of the city is expected to open by Mar'08. This mall is expected to have average rentals of Rs350-plus/sq ft vs. average Bangalore mall rentals of Rs160/sq ft.
- Bangalore metro rail and development of the outer ring road are key infrastructure projects underway in Bangalore. We see good progress on infrastructure projects; new airport (Apr'08), peripheral road network (large parts complete) to enhance value ahead.

Overview on Chennai

Strong demand for IT space drives rentals on OMR despite upcoming supply; residential demand relatively better; emerging manufacturing hub at Sriperembadur another trigger to development and infra projects

- The IT corridor along OMR (Old Mahabalipuram Road) is witnessing sufficient demand from IT/ITES companies and hence rentals are on the rise despite upcoming supply. A-iTrust's Phase II at ITPC being already 70% pre-leased at 18% higher rentals and other multi-tenant IT Parks on OMR also seeing healthy levels of pre-leasing reflect this. A-iTrust has also received EOIs (Expression of Interest) for the planned Phase III of ITPC, largely from existing tenants.
- Supply of new office space in Chennai is largely concentrated in the suburban areas of OMR and Taramani. Key office space projects expected to become operational in these locations in the near future include phase II of A-iTrust's ITPC and RMZ Millenia. ~12m sq ft of office space is under construction along OMR.

- Several residential projects are coming up along OMR to cater to the large number of people that are expected to be employed in the neighbourhood office space. Average prices for residential projects on OMR are in the range of Rs3000-4,000 per sq ft – demand appears relatively strong. Puravankara's Swanlake project has already sold ~200 units (selling 2-4 units a week) of the ~530 units planned. The project is scheduled to be completed in 2010.

- Sriperembadur near Chennai is an emerging manufacturing hub where MNCs such as Motorola, Nokia, Samsung, Flextronics, Dell and St. Gobain have set-up plants. Mahindra-Renault and Moser Baer along with several other companies are also expected to set up facilities here. There are plans for a proposed new airport (cargo) for which government has begun accumulating land; land prices are Rs20m/acres here. IVR PUDL's Prime Pacific and Celestial and HIRCO's Palace Gardens are the some of the residential projects in the pipeline in the vicinity. There could be strong potential demand as developments progress.

- Shortage of quality retail mall space exists as the average vacancy rate for retail space in Chennai is less than 1% given the huge demand. Currently there very few malls operational in Chennai but several projects are in the pipeline, key being DLF's mall and Marg's Riverside Mall.

Overview on Hyderabad

Hi-tech city and Gachibowli the emerging IT CBD; potential supply keep rentals in check; spiraling land prices keeps residential prices firm; many retail malls in pipeline

- Most of the ITITES space in Hyderabad is located in Hi-tech city and Gachibowli, which is the IT corridor of the city. This part of the city is expected to see supply of ~6-7m sq ft of office space in 2008.

- Gachibowli is largely dominated by captive campus facilities of IT majors such as Infosys and Microsoft, while most multi-tenant office and IT/ITES space is concentrated in Hi-tech city in Madhapur. That said DLF and IVR PUDL are developing IT/ITES space in Gachibowli.

- Current office rentals in Hi-tech city are in the range Rs36-40/sq ft and have remained more or less stable in Hi-tech city with demand being balanced by sufficient supply.

- Land prices in Hi-tech city have increased substantially to over Rs200m/acre. However, clear land titles are a major cause for concern.

- New residential construction is also concentrated in Hi-tech city and Gachibowli where most jobs are expected to be generated in the next few years. Key residential projects expected to come up in this region include Lanco Infratech's Lanco Hills projects. Prices in these locations are in the range of Rs4,000-5,500/ sq ft. Recently, Puravankara acquired 30acres in Hi-tech city for Rs6.3bn and plans mixed development with high-end residential.

- There is strong potential for retail space in Hi-tech city and Gachibowli given that there are currently no malls operational in these locations. Retail malls in the pipeline include K Raheja Group's Inorbit mall in Hi-tech city and IVR PUDL's Hill Ridge mall in Gachibowli.

Puravankara Projects

Valuation

Our target price of Rs536 is based on a 5% discount to an estimated core NAV of Rs564. We believe an NAV-based valuation methodology is most appropriate for developers, as it factors the varied development projects and spread out time frame. Our NAV estimate of Rs564 is based on the following assumptions: 1) current market prices will persist, without any price inflation; 2) development volume will be 105.3m sq ft (as ~1.5m is already recognized as revenue in FY07); 3) a cap rate of 9% for commercial/IT Park, IT SEZs in Bangalore and Chennai and 10% for other locations; 4) all projects undertaken by Puravankara will be completed largely on schedule; 5) an average cost of capital of 14%; and 6) a tax rate of 25%. We expect Puravankara, a quality mid-scale developer, to trade at a 5% discount to NAV. We ascribe the discount to the following factors: 1) Puravankara's concentration risk in Bangalore (73% of total development), where the potential supply could be large; 2) the company's residential-heavy business model, exposing its business to demand/price risks; 3) possible execution delays, given the large development; and 4) risk of slower than expected sales, given its direct sales model could push back cash flows.

Risks

We rate Puravankara Medium Risk, as opposed to the Speculative Risk rating assigned by our quantitative risk-rating system to stocks that have less than 260-day trading history. The key reasons for assigning a Medium Risk rating include: 1) the company's integrated model with in-house construction expertise and direct marketing channel; 2) relatively healthy cash flows, at a time when most developers are facing fund constraints; and 3) the company's large exposure to South India, which we believe is a relatively less speculative market and has strong demand potential. The main downside risks to our target price include: 1) Concentration in the Bangalore region (73% of development), where excess supply over the next 2-3 years could adversely impact our price realization assumptions; 2) Delays in the execution of projects and planned developments would impact the company's reputation and our NAV assumptions; and 3) A rapidly changing property market environment could lead to property price-demand risks, regulatory risks and potential supply risks.

Ascendas India Trust

Valuation

Our target price of S$1.75 is based on the DDM method and ascribing S$0.19 per unit towards the 24-acre land bank held by the trust for future development. We believe this should provide attractive yields of 4% for FY08E and 5% for FY09E. We have made the followings assumptions in deriving our DDM-based value of S$1.56 per unit and landbank value of S$0.19 per unit: A) DPU CAGR of 28% over FY08E-10E, building for 1) moderate base rental growth of 5% per annum; 2) additional lease volume of 2.4m sq.ft. available from development pipeline; 3) forward cover at Rs29.00 to S$1.00 for FY08-10E, and 4) adjustment for 50% of Trustee-Manager's base fee and 100% of performance fee being paid in Units.

B) Risk-free rate of 3%, similar to that in Singapore, as the trust is likely to raise debt in Singapore for investment/acquisition of more assets in India.
C) Equity risk premium of 6% (compared to 5% in Singapore), similar to what we assume for cost of capital in Indian equities.
D) Higher Beta of 0.80 compared to 0.5 average for Singapore REITs and sister REIT i.e. A-REIT, which offer steady income and are defensive in nature. Our high beta assumption factors in increased risk of currency arbitrage given the cross-country structure, evolving regulatory risks on forex repatriation and higher asset cycle risks associated with real estate market.
E) Terminal growth of 2%.
F) Presently, we have not included any growth in distributable income from potential acquisitions or SEZ development in our DDM-based value; this could provide further upside.
G) We have ascribed value of Rs170m per acre for valuing the 24-acre land bank in ITPB, Bangalore - similar to the land valuation of Cushman & Wakefield for ITPB Bangalore at the time of primary offering. This translates to S$0.19 per unit taking forex rate of Rs29 to S$1.

Risks

While a-iTrust units have only a brief trading history, we still prefer to rate them Low Risk given: 1) High-quality asset portfolio consisting of four IT parks with 3.6m sq ft of leasable area. 2) Growth opportunities through built-in development pipeline. 3) Strong management and execution capabilities.

The main downside risks to our investment thesis which could prevent the shares from reaching our target price include: (1) Any changes in regulations relating to repatriation of funds and share buy-back norms. (2) Depreciation of the India rupee against the Singapore dollar, which could adversely impact distribution income. (3) Higher-than-anticipated supply of commercial/IT space in cities in South India. (4) Any slowdown in growth of the IT/ITES sector, which would result in rental declines and higher vacancies for the assets.

Appendix A-1

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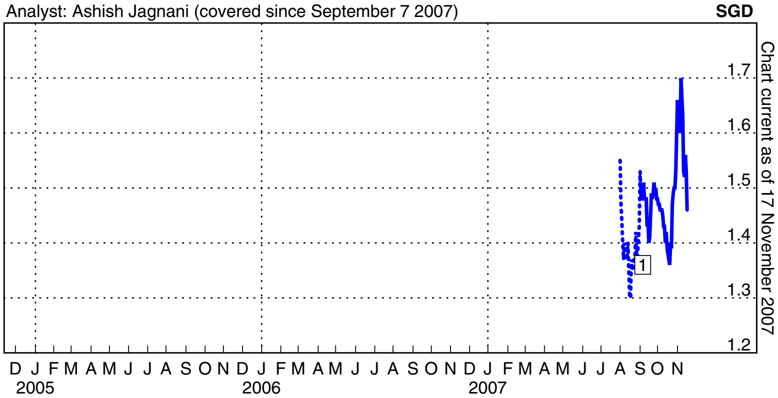
Ascendas India Trust (AINT.SI)

Ratings and Target Price History - Fundamental Research

Analyst: Ashish Jagnani (covered since September 7 2007)



#	Date	Rating	Target Price	Closing Price
1:	6 Sep 07	1L	1.75	1.48

*Indicates change.

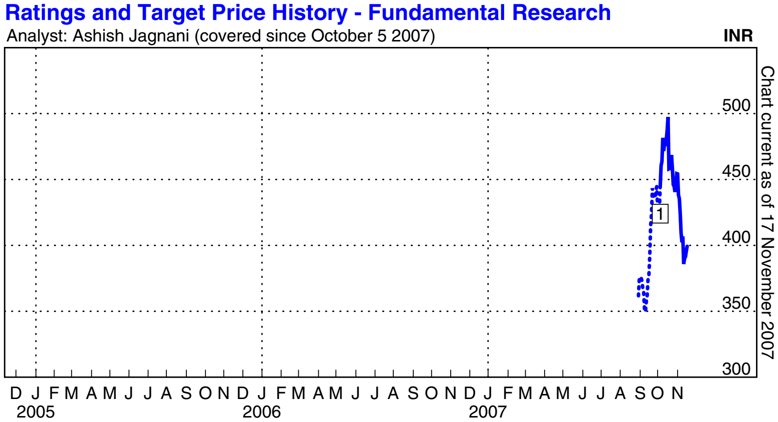
Covered
Not covered

Rating/target price changes above reflect Eastern Standard Time

Puravankara Projects (PPRO.BO)

Ratings and Target Price History - Fundamental Research

Analyst: Ashish Jagnani (covered since October 5 2007)



#	Date	Rating	Target Price	Closing Price
1:	4 Oct 07	1M	536.00	444.50

*Indicates change.

Covered
Not covered

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