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UPDATE

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Residential price stability reduces estimation risk. PropEquity released residential pricing data for 2HCY09 and the observations are consistent with our view of a stable pricing environment in most locations except Mumbai. Mumbai has seen a price increase of >20% in 2HCY09. We see a pick-up in pricing of premium projects in established locations like Gurgaon and Mumbai. We believe affordability is going to depend on the direction of selling prices and a stable pricing environment will result in higher confidence in NAVs.

Prices stable in most locations except Mumbai

PropEquity has released a pricing study of 2,435 projects in India across West (1,030), South (996), North (264) and East (145). The observations are consistent with our view of a stable pricing environment in most locations except Mumbai region—where prices have risen by more than 20% in 2HCY09. We give a summary of city-wise price movements below:

- ▶ **Mumbai, Navi Mumbai and Thane.** We observe that developers have increased prices by 20%+ in 2HCY09 after a solid recovery in volumes in 1HCY2009. Price increases is generally higher in the case of ongoing/completed projects than in newly launched projects.
- ▶ **NCR (Gurgaon/Noida/Greater Noida/Ghaziabad).** Prices have remained stable in NCR in 2HCY09. We believe prices have remained stable on account of the large number of launches in this region. With heavy competition, we observe most new projects using low prices to attract customers. We had highlighted in our note 'Plenty of new launches in NCR, more in pipeline' that Gurgaon and Noida alone had seen launches of more than 34 mn sq. ft in Jan-Sep CY2009.
- ▶ **South India (Bangalore, Chennai, Hyderabad).** Prices have remained stable in South India as well in 2HCY10. Sales have picked up in Bangalore in 2HCY10 as Sobha reported sales volumes of 0.8 mn sq. ft (total 431 units or average 140 units/month) in 3QFY10 versus 0.4 mn sq. ft in 2QFY10 and 0.25 mn sq. ft in 1QFY10. However, we are yet to see any meaningful pick-up in launches in South India.

We model flat pricing in FY2011E and 5% growth thereafter. Growth of 5% in selling prices, which is possibly lower than near-term inflation, is quite reasonable in our view.

NCR market has seen pricing improvement in premium housing

Exhibit 1 indicates that there has been some pricing improvement in premium housing in NCR. We believe the price pick-up is on account of demand for premium housing accruing to established locations while there is an emergence of new locations for affordable housing. We observe a price increase of 6% in Gurgaon for premium housing vis-à-vis 2% for affordable housing. PropEquity classifies premium projects as projects where the units are priced upwards of Rs7 mn.

Volume recovery sustainable in a stable price environment

Residential demand has shown a robust pick up in CY2009 as affordability increased by 35-40%. However, we believe going forward affordability will depend on the direction of selling prices since the impact of a likely increase in interest rates will be offset by an increase in salaries. Affordability will likely decrease wherever prices are increased, which we believe would result in a decline in volumes. Exhibit 3 highlights that as prices and interest rates dropped, affordability improved by 40% during Jan-May 2009, triggering the sharp pick-up in demand.

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Higher confidence in NAV estimates can result in better P/NAV matrix

NAV can be defined as a function of land bank quantity and quality, initial selling prices, capitalization rates, phasing, construction costs and WACC. As NAVs become more stable and confidence in NAV calculations increase, stocks can trade at better P/NAV multiples. We observe stability in most parameters as discussed below.

Selling prices. Residential selling prices have corrected 25-30% from peak and we expect stability at current levels. Correction in certain pockets will likely be balanced by appreciation in other pockets. Our view is corroborated by PropEquity data, which indicates a slight increase in pricing in most locations. We model flat pricing in FY2011 and 5% growth thereafter. Growth of 5% in selling prices, which is possibly lower than near-term inflation, is quite reasonable in our view.

Capitalization rates. We model a post-tax capitalization rate of 9% for commercial and 10% for retail real estate. Implied capitalization rates from REITs traded in Singapore are in the 7-10% bracket. The biggest beneficiaries of the lower cap. rate are DLF, IBREL and PHNX, in our view.

Construction costs. We estimate construction costs to grow at 5% CAGR, in line with our growth rate in selling prices. The biggest beneficiaries from lower construction costs are PVKP and Sobha since they operate with the lowest EBITDA margins.

Land bank phasing. Most companies have started including land banks which are either fully paid for or have limited outstandings.

WACC. Upward trend for interest rates will likely be balanced by lower risk perception for realty companies. We have taken a WACC of 14% with cost of equity and debt at 15%. We believe that there is a possibility for lowering WACC by 50-100 bps and upside risk to WACC is limited.

Prices have remained stable in most cities except Mumbai

Change in prices in 2HCY09 (%)

Location	Change in H2 CY2009 (%)		
	Affordable	Mid segment	Premium
Mumbai	23.4	8.6	9.2
Thane	21.1	11.6	12.8
Navi Mumbai	8.6	9.6	10.1
Pune	4.9	4.6	2.2
Kolkata	3.4	2.6	1.4
Chennai	2.4	2.0	0.7
Bangalore	2.3	1.8	2.4
Gurgaon	2.1	4.2	6.3
Ghaziabad	-1.0	-0.5	2.5
Hyderabad	-1.2	-1.0	-1.4
Noida	-2.0	3.6	-0.8
Faridabad	-3.4	-2.3	-0.6
Greater Noida	-3.4	-1.8	-3.3

Note:

Affordable: Refer to dwelling units priced between Rs0.5-3 mn

Mid-segment: Refer to dwelling units priced between Rs3-7 mn

Premium: Refer to dwelling units priced upwards of Rs7 mn

Source: PropEquity, Kotak Institutional Equities

Mumbai has shown the highest increase in prices in the affordable segment

	2HCY2009 (%)				
	Share of Projects Recording Price Increase		Share of Projects Recording Price Decrease		Change (%)
	Increase	Avg increase	Decrease	Avg decrease	
Mumbai	74	32	3	10	23.4
Thane	88	24	0	0	21.1
Navi Mumbai	96	9	0	0	8.6
Pune	55	10	8	7	4.9
Kolkata	36	12	10	9	3.4
Chennai	48	6	11	4	2.4
Bangalore	35	9	17	5	2.3
Gurgaon	41	9	12	13	2.1
Ghaziabad	20	5	25	8	-1.0
Hyderabad	15	9	32	8	-1.2
Noida	25	2	50	5	-2.0
Faridabad	8	8	25	16	-3.4
Greater Noida	25	6	38	13	-3.4

Source: PropEquity, Kotak Institutional Equities

Affordability to depend on direction of selling prices

Measurement of affordability of housing in India, March fiscal year-ends, 1999-2010E

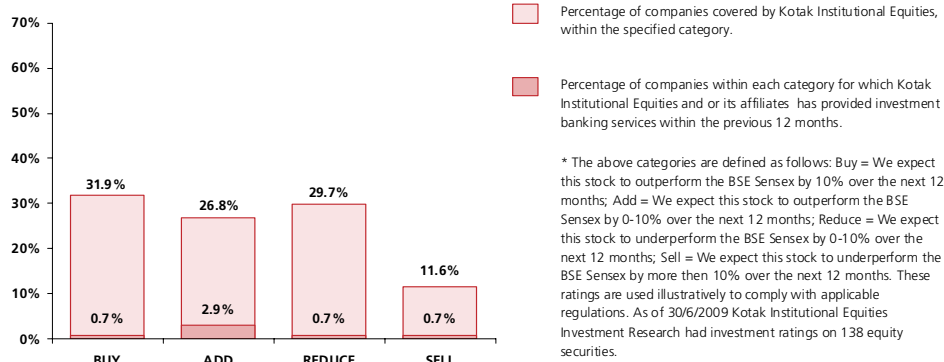
	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	May-09	Current
Housing loan interest rates (%)	14.5	13.9	12.8	12.1	10.4	8.9	8.0	8.5	9.5	10.5	10.5	8.50
EMI per Rs100,000 on 20 yr loan (Rs)	1,366	1,240	1,160	1,110	995	895	836	868	932	998	998	850
Avg annual household income (for households with annual income > Rs200,000)		577,201	606,061	636,364	668,182	701,591	736,671	788,238	843,414	902,453	947,576	947,576
Income growth (%)			5.0%	5.0%	5.0%	5.0%	5.0%	7.0%	7.0%	7.0%	5.0%	0.0%
Taxes		115,440	121,212	127,273	133,636	140,318	147,334	157,648	168,683	180,491	142,136	142,136
Post tax income		461,761	484,849	509,091	534,546	561,273	589,337	630,590	674,731	721,963	805,439	805,439
Selling prices decline by 10% each in FY2009E and FY2010E												
Capital price in Koramangala, Bangalore		1,900	1,800	1,750	1,900	2,350	2,800	4,500	4,750	4,750	3,600	3,600
Price of 1,500 sq. ft house (Rs mn)		2.9	2.7	2.6	2.9	3.5	4.2	6.8	7.1	7.1	5.4	5.4
EMI payable assuming 70% LTV		24,738	21,924	20,396	19,850	22,084	24,578	41,013	46,484	49,775	37,724	32,130
Price/income ratio (X)		4.9	4.5	4.1	4.3	5.0	5.7	8.6	8.4	7.9	5.7	5.7
Affordability Index (assuming FY2000 as 100)		64	54	48	45	47	50	78	83	83	56	48
Affordability Index (assuming FY2000 as 100)		100	84	75	69	73	78	121	129	129	87	74
Capital price in Bandra, Mumbai		7,992	8,791	8,000	8,500	8,500	10,000	13,000	16,000	20,000	14,000	17,000
Affordability Index (assuming FY2000 as 100)		100	98	81	74	63	66	83	103	129	81	84

Source: Kotak Institutional Equities estimates

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Source: Kotak Institutional Equities

As of June 30, 2009

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