NIRMAL BANG
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Institutional Equities

Flying High

PRESTIGE ESTATES

Prestige Estates Projects

9 April 2012

Reuters: PREG.BO; Bloomberg: PEPL IN

Initiating Coverage

Flying High

We recommend Prestige Estates Projects (PEPL) because of its strong presence across segments in Bangalore (71% of its land bank) where the absorption level continues to remain healthy unlike in other markets in India. PEPL's operating cash flow is set to improve over the next two years with improvement in realisation from debtors and higher rental income. We believe an outstanding sum of Rs4.3bn related to Shantiketan (Bangalore) project likely to be received by PEPL over the next three quarters (Rs1bn received in 3QFY12) as the office leasing environment remains conducive in Bangalore. We expect PEPL's yearly rental run rate to show a CAGR of 23% over FY12-14E at Rs2.8bn wherein 25% of incremental supply is pre-committed. Also, most of its projects like White Meadows/Kingfisher Tower/Polygon would cross the threshold limit in coming quarters, thereby driving up revenues. We assign a Buy rating to PEPL with a target price of Rs143.

Absorption level to remain strong in Bangalore: Our interaction with various real estate brokers indicated that absorption in the residential segment will remain strong in 2012, thanks to demand from the IT/ITES sector and better affordability compared to other cities in India. Around 90% of the brokers indicated that residential prices are expected to go up by 10-15% over the next six-nine months from current levels. Though demand in Bangalore is largely dependent on the IT/ITES sector, the recent absorption was driven across sectors, which augurs well for developers. Also, brokers have indicated that Bangalore (East) has a greater potential with respect to absorption on account of upcoming IT/ITES offices. This is a positive for PEPL which has land bank at Whitefield, Sarjapur and Marthahalli, all located in Bangalore (East).

Sufficient cash flow to fund annuity assets, debt obligations: We expect PEPL to maintain its existing pre-sales run rate of Rs20bn in FY13 because of its aggressive new project launch pipeline and steady Bangalore market, also enabling it to maintain the run rate of Rs3bn customer advances/quarter. PEPL's debtors increased by Rs6bn in FY11 on account of the ongoing completion of its Shantiketan and Oasis projects (in Bangalore), which was a major overhang on its stock's performance. However, the company managed to realise Rs2.8bn from Shantiketan and Oasis projects as it focused on handover and also on improvement in leasing activity in the Shantiniketan project. Consequently, we expect PEPL to generate Rs11bn of cash flow from operations over FY11-14E versus Rs5.2bn of negative operating cash flow generated over FY08-11, which would suffice to meet its capex requirement and debt obligations.

Valuation: At the CMP, PEPL trades at 1.3x P/BV and 9.2x P/E on FY14E earnings and at 40% discount to our one-year forward NAV. We assign a Buy rating to PEPL with a TP of Rs143 based on 20% discount to one-year forward NAV from real estate business and assigning 12x FY14E profits to its facilities and management business.

Y/E Mar (Rsmn)	FY10	FY11	FY12E	FY13E	FY14E
Net sales	10,244	15,431	9,735	15,273	20,439
EBITDA	2,234	3,738	3,074	4,749	6,759
Net profit	1,502	1,709	1,409	2,497	3,770
EPS (Rs)	4.6	5.2	4.3	7.6	11.5
EPS growth (%)	*94.3*	*13.8*	*(17.6)*	*77.3*	*50.9*
EBITDA margin (%)	*21.8*	*24.2*	*31.6*	*31.1*	*33.1*
PER (x)	23.2	20.3	24.7	13.9	9.2
P/BV (x)	4.6	1.6	1.6	1.4	1.3
EV/EBITDA (x)	22.0	12.4	15.7	10.5	7.4
RoCE (%)	*21.7*	*11.9*	*6.5*	*10.8*	*14.6*
RoE (%)	*7.6*	*9.6*	*6.2*	*9.6*	*13.0*

Source: Company, Nirmal Bang Institutional Equities Research

BUY

Sector: Real Estate

CMP: Rs106

Target Price: Rs143

Upside: 35%

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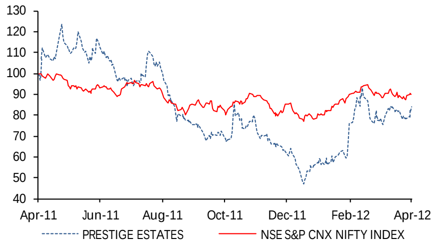
Key Data

Current Shares O/S (mn)	328.1
Mkt Cap (Rsbn/US$mn)	35.1./686.8
52 Wk H / L (Rs)	165/58
Daily Vol. (3M NSE Avg.)	307,530

Share holding (%)	1QFY12	2QFY12	3QFY12
Promoter	80.0	80.0	80.0
FII	17.9	15.5	14.0
DII	1.1	3.2	4.6
Corporate	0.7	0.8	0.8
General Public	0.4	0.5	0.6

One Year Indexed Stock Performance



Price Performance (%)

	1 M	6 M	1 Yr
PEPL	8.4	21.5	(16.1)
Nifty Index	(0.7)	11.5	(9.9)

Source: Bloomberg

Valuation

We assign Buy rating with a target price of Rs143

PEPL is trading at a 40% discount to our NAV which offers attractive risk-reward profile given its rising rental income, healthy balance sheet (0.6x net D/E), less capital intensive JDA (Joint Development Agreement) projects, un-recognised revenue (Rs28bn) and positive operating cash flow. We expect its Bangalore property (contributing 88% to Gross NAV) to continue do well with steady absorption and stable inventory levels, thanks to demand from the IT/ITES sector. The company's stock is trading at 9.2x FY2014E EPS and 1.3x FY2014E P/BV, which is attractive given the 64% earnings CAGR expected over FY12-14E and trading at discount to its historical P/BV average of 1.8x. We assign a Buy rating to PEPL with a target price of Rs143 based on 20% discount to our one-year forward NAV from real estate business to factor in higher exposure to Bangalore market and JDA projects, assigning 12x on FY14E profits to its facilities and management business.

Exhibit 1: Valuation summary

One-year forward NAV	(Rs per share)
Residential	70
Commercial	86
Retail	37
Hospitality	49
Advances paid for land	5
Facilities & maintenance (12x FY14E profits)	9
Total	**258**
Less: Net debt	(54)
Less: Present value of taxes	(28)
NAV/share (Rs)	**177**
Target price (Rs) 20% discount to NAV	**143**

Source: Nirmal Bang Institutional Equities Research

Key Assumptions

- **Residential segment valued at Rs70/share**

  We have assumed average selling price of Rs8,100/sq ft and Rs8,260/sq ft for its Golfshire and White Meadows (Phase I&II) projects, respectively. PEPL has got a strong response for its newly launched project Tranquility (2QFY12) and Bellavista (4QFY12). Over the next three years, revenues of the residential segment would be largely driven by five projects i.e. Golfshire, White Meadows, Tranquility, Kingfisher Tower and Bell Vista. All these five projects contribute 62% to our residential GNAV. We have factored in 7% price escalation in construction costs and 5% increase in capital value from FY13 onwards for all its projects. We have assumed PEPL will develop the entire 33mn sq ft and sell it by FY21. **Consequently, we have valued its residential segment at Rs23,059mn, translating into Rs70/share.**

- **Commercial segment valued at Rs86/share**

  Over the next three years, revenues of the commercial segment would be largely driven by Polygon and Technology Park, for which we have assumed average selling price of Rs9,050/sq ft and Rs 3,840/sq ft, respectively. We expect Cessna B7 block and Exora block 3 will be delivered for fit-outs by end of FY13 and should reach its peak occupancy by end of FY14. We have factored in 7% price escalation in construction costs and 5% increase in capital value from FY13 onwards for all its projects, but we have factored in zero increase in rentals in FY13 with a 5% increase from FY14 onwards. We have assumed PEPL will develop the entire 17mn sq ft by FY21.**Consequently, we have valued its commercial segment at Rs28,128mn, translating into Rs86/share.**

- **Retail segment valued at Rs37/share**

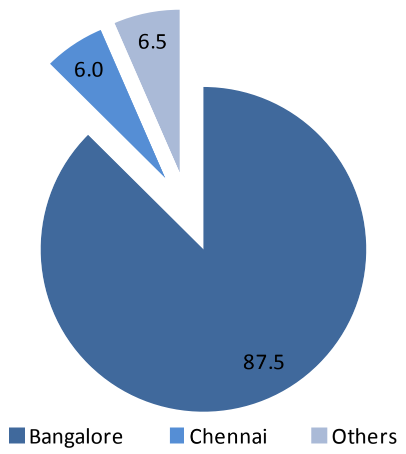
  We expect only one additional mall to get operational over the next one year i.e. Forum Vijaya in Chennai with average rental of Rs70/sq ft and expect it to touch peak occupancy by the end of FY14. Over the next two years, rentals would be largely driven by its three operational malls. We have factored in 7% escalation in construction costs and 5% increase in capital value from FY13 onwards for all its projects, but we have factored in zero increase in rentals in FY13 with 5% increase from FY14 onwards. We have assumed PEPL will develop the entire 8.6mn sq ft by FY21. **Consequently, we have valued its retail segment at Rs12,153mn, translating into Rs37/share.**

- **Hospitality segment valued at Rs49/share**

  We expect FVM service apartment and Golf club house to be operational over the next two years, which is likely to contribute Rs122mn of rental income as peak occupancy is reached. Over the next two years, rentals will be largely driven by three operational properties. We have factored in 7% escalation in construction costs and 5% increase in capital value from FY13 onwards for all its projects. We have assumed PEPL will develop the entire 2.4mn sq ft by FY21. **Consequently, we have valued its retail segment at Rs15,931mn, translating into Rs46/share.**

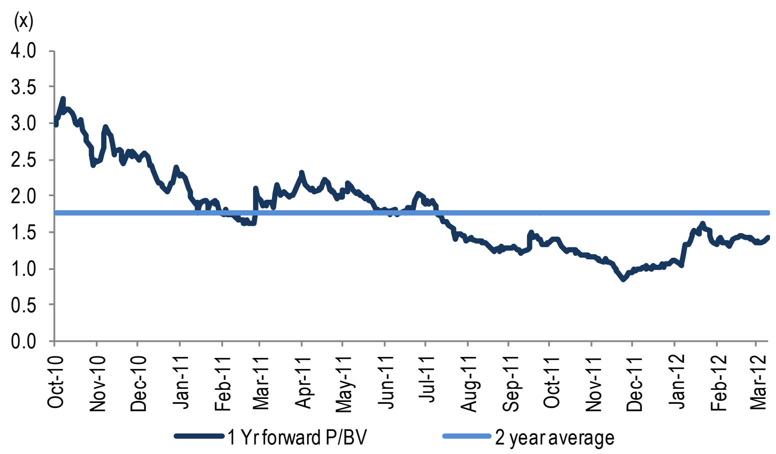
- **We have assigned 15% cost of equity and 10% capitalisation rate.**
- **We have assumed tax rate of 28% from FY13 onwards.**

Exhibit 2: Geographical break-up of GNAV (%)



Source: Nirmal Bang Institutional Equities Research

Exhibit 3: Trading at a discount to its historical average P/BV



Source: Bloomberg, Nirmal Bang Institutional Equities Research

Exhibit 4: Our estimates versus consensus

	NBIE estimates		Bloomberg estimates		*Deviation (%)*	
(Rsmn)	**FY13E**	**FY14E**	**FY13E**	**FY14E**	***FY13E***	***FY14E***
Net sales	15,273	20,439	19,171	24,305	*(20.3)*	*(15.9)*
EBITDA	4,749	6,759	5,903	7,661	*(19.6)*	*(11.8)*
EBITDA margin (%)	*31.1*	*33.1*	*30.8*	*31.5*	*30bp*	*155bp*
PAT	2,497	3,770	2,908	3,876	*(14.1)*	*(2.7)*

Source: Bloomberg, Nirmal Bang Institutional Equities Research

Exhibit 5: Comparative valuation

	Market capitalisation		NAV	Discount/(Premium) To NAV	FY13E (x)		*RoE (%)*	
Company	**Rsbn**	**US $bn**	**(Rs/share)**	***(%)***	**P/BV**	**P/E**	***FY12E***	***FY13E***
DLF	348	6.8	217	*5.8*	1.2	19.3	*4.9*	*6.5*
Godrej Properties	48	0.9	503	*(23.0)*	3.0	28.3	*9.0*	*11.2*
HDIL	36	0.7	122	*28.7*	0.3	4.4	*6.7*	*7.8*
Oberoi Realty	92	1.8	268	*(4.5)*	2.1	14.6	*12.4*	*15.8*
Sobha Developers	31	0.6	324	*2.8*	1.4	13.5	*8.5*	*11.0*
Prestige Estates	35	0.7	176	*39.8*	1.4	13.9	*6.5*	*10.8*

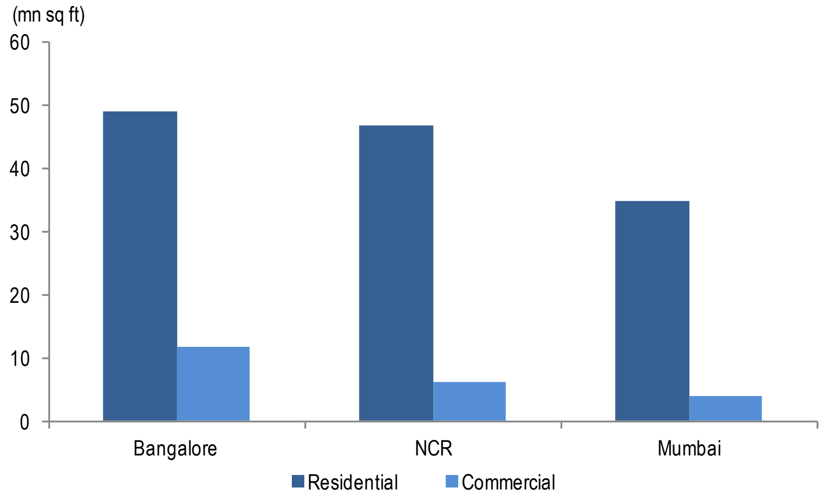
Source: Bloomberg, Nirmal Bang Institutional Equities Research

Investment Arguments

Bangalore leads the way in absorption

The Bangalore residential market had a positive run in 2011, which extended into early 2012 as well. The first two months of 2012 witnessed the launch of several projects by reputed developers and this momentum is expected to continue in coming months, thanks to the demand from the IT/ITES sector and better affordability as compared to other cities in India. The average residential real estate price in Bangalore is 20-25% lower as compared with Delhi and Mumbai. Bangalore has seen absorption of 49mn sq ft of residential property in 2011, more than in any other Indian city (4% and 40% higher than NCR and Mumbai respectively). Further, it reported 15% YoY increase in absorption in CY11 in commercial space as compared to 8% increase and 9% decline in absorption in NCR and Mumbai, respectively.

Exhibit 6: Bangalore led in absorption level in CY11

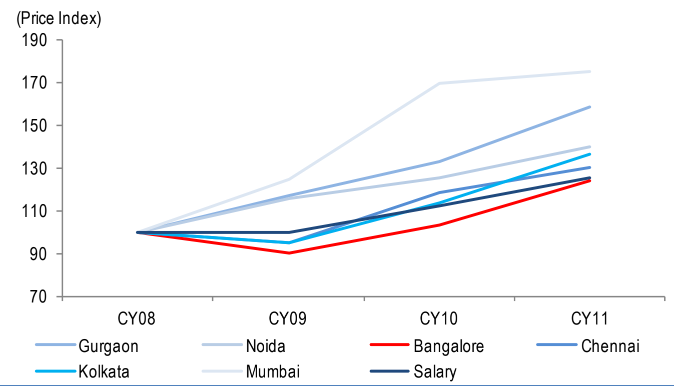


Source: Industry, Nirmal Bang Institutional Equities Research

We did an extensive survey with 25 real estate brokers about sustainability of the current absorption rate in Bangalore property market. The findings are as follows:

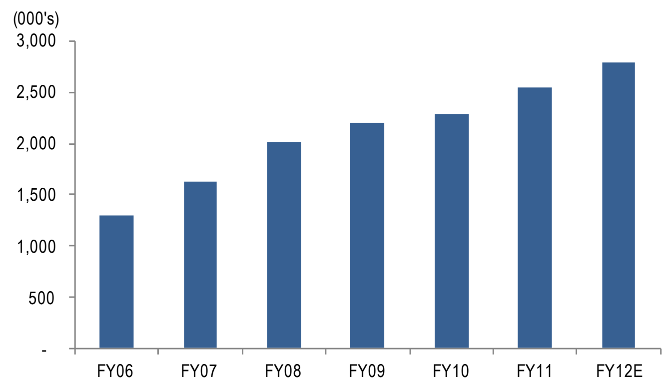
Brokers remain optimistic: There was a consensus among brokers that absorption in the residential segment in Bangalore will continue to remain strong in 2012. Further, brokers indicated that the recent absorption was driven across sectors i.e. IT/ITES and non-IT/ITES. We believe residential capital values in Bangalore are not above their 2008 peak, unlike NCR and Mumbai markets, thereby providing high affordability quotient. Also, hiring across the IT/ITES space is on an upswing despite global uncertain economic environment, which would keep office space absorption rate stable n CY12. All this augurs well for Bangalore property market, which is highly dependent on IT/ITES sectors.

Exhibit 7: Affordability remains attractive in Bangalore



Source: ICICI HFC, Cushman & Wakefield

Exhibit 8: Trend in IT/ITES employee hiring across India



Source: Nasscom

Expect residential prices to go up: Around 90% of brokers expect residential prices in Bangalore to go up by 10-15% in CY12 from the current levels. To cite an example, PEPL has hiked prices by 14% and 11% over the past two months for its projects Parkview and Tranquility, respectively, launched in 2QFY12. Raw material prices are also likely to go up with respect to labour and steel post service tax and excise duty hike in the recent budget, while brokers have also highlighted scarcity of sand. Consequently, residential prices will remain stable in CY12 in a worst case scenario. We have factored in a 10% increase in prices for PEPL's upcoming projects in CY12.

Expect commercial rentals to remain firm: Around 80% of the brokers expect commercial rentals to remain firm in CY12 from current levels, as there are still vacant spaces available. We believe Bangalore is likely to witness cautious delivery of projects in 2012 due to global economic uncertainty impacting expansion of IT/ITES offices. We have factored in zero increase in rentals in FY13 for PEPL's upcoming projects.

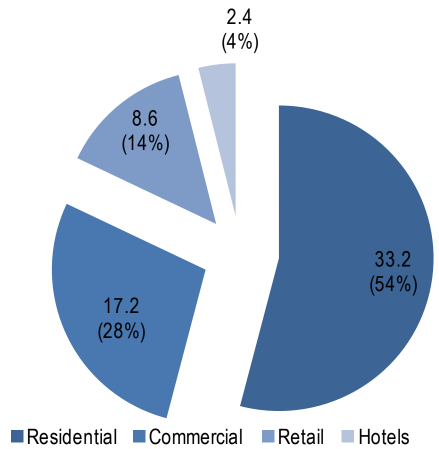
Rupee depreciation induces Non-resident Indian (NRI) investors: Around 50% of the brokers indicated that rupee depreciation may be one of the reasons behind rising absorption level in the residential segment in CY11, inducing NRIs to make investment in property. Our in-house call for the rupee remains weak and expect it to the average of Rs54.5 against the US dollar in FY13, thereby keeping NRIs interested in Bangalore property market.

Bangalore (East) likely to witness launch of more new projects: Around 60% of the brokers are betting on strong absorption rate in Bangalore (East) areas i.e. Whitefield, Sarjapur and Marathalli with more offices coming up in this region and thereby providing opportunities for offering various amenities and services. This augurs well for PEPL which has land bank in Whitefield, Sarjapur and Marthahalli. (***Please refer to annexure for detailed analysis on Bangalore property market)***

Strong brand with a presence across verticals differentiates PEPL from peers

PEPL has a superior track record in execution of 46mn sq ft of projects over the past 25 years across verticals in Bangalore. It has also developed a number of iconic edifices like UB City, Forum Mall, Shantiketan and Cessna Business Park. PEPL has been foremost and ahead of its times by launching Bangalore's first integrated township (Prestige Shantiketan) and retail project (Forum Mall), thereby transforming locations into landmarks. This resulted in a strong client base like Cisco, JP Morgan, IBM, and Microsoft. We believe PEPL's presence across verticals unlike its peer group adds flexibility to the business model, thereby allowing it to adapt its offerings by changing land development plans according to market requirements.

Exhibit 9: Total developable area (mn sq ft)



Source: Company, Nirmal Bang Institutional Equities Research

Less capital-intensive JDA model

PEPL's 65% of land bank (61.3mn sq ft) comes under the JDA model, which involves less upfront capital investment and helps the company to utilise its cash flow in annuity business. Further, it enables PEPL to have better access to prime land and bargaining power with landowners under JDA having strong brand and timely execution record. Some of such JDA deals include Kingfisher Tower, White Meadows and Royal Wood which are value accretive and likely to enjoy better OPM than its historical margins. The JDA model comes with a caveat as PEPL has to bear the entire construction costs, which can hurt margins in the event of higher rise in raw material prices. We have factored in 7% YoY increase in construction costs, in line with the current inflationary trend. However, the recent announcement by Karnataka government to reduce stamp duty to 1% from 6% in respect of JDA projects will reduce land costs for PEPL.

Exhibit 10: Better access to prime land

Project	Location	Total area (mn sq ft)	*PEPL share (%)*	Initial upfront payment (Rsmn)
Kingfisher Tower	Vittal Mallya Road, Bangalore	0.77	*46*	162
White Meadows	Whitefield, Bangalore	1.97	*80*	429
Royal wood	Kismatpur, Hyderabad	0.63	*50*	100
Technopolis	Mari Gowda Road, Bangalore	0.33	*57*	20
Jacob land	Bellary Road, Bangalore	1.10	*74*	230

Source: Company, Nirmal Bang Institutional Equities Research

Residential segment accounts for 54% of total developable area

Aggressive new launches to drive pre-sales over FY11-14E

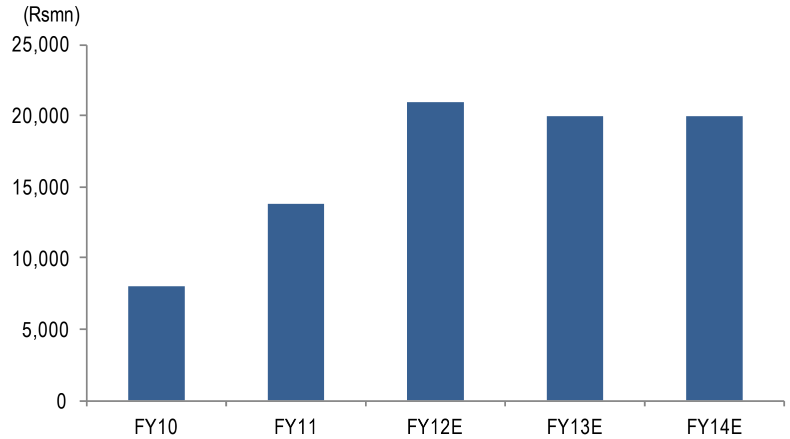
PEPL's residential segment accounts for 54% of its overall developable area. On the back of strong new project launches so far in FY12, where it launched more than 11.7mn sq ft (up 37% YoY), it capitalised buoyant markets of Bangalore and Chennai. This resulted in pre-sales of Rs14.6bn (up 28.8% YoY) for the 9MFY12 period. Further, the recent launch of Bella Vista (5mn sq ft) in Chennai in January 2012 generated a strong response whereby the company managed to clock in 1.2mn sq ft of sales so far. The un-recognised revenue of Rs28bn (3x FY12E sales) as of 3QFY12 provides strong visibility over the next two-three years. PEPL has lined up aggressive new project launches of 11mn sq ft in FY13 which would drive pre-sales going forward. We expect PEPL to maintain its annual pre-sales run rate of Rs19-20bn annually over FY12-14E, thanks to steady Bangalore property market.

Exhibit 11: Aggressive new launches in the pipeline

Launches in FY12 so far	Location	Total developable area	*PEPL share (%)*	PEPL share (mn sq ft)
Tranquility	Bangalore	4.6	*100*	4.6
Sunnyside	Bangalore	0.7	*100*	0.7
Park View	Bangalore	0.9	*66*	0.6
The Forum	Mysore	0.5	*100*	0.5
Bella Vista	Chennai	5.0	*60*	3.0
Silvercrest	Bangalore	0.3	*100*	0.3
Hillside Retreat	Bangalore	0.1	*75*	0.1
Total		**12.1**		**9.7**
Launches over next 1 year				
Falcon city	Bangalore	7.1	*33*	2.3
Mayberry	Bangalore	0.5	*58*	0.3
Summerfield	Bangalore	1.2	*44*	0.5
Jacob Land	Bangalore	1.1	*74*	0.8
Casabella	Bangalore	0.0	*50*	0.0
TM Square	Cochin	0.3	*50*	0.2
Sea Shore villas	Chennai	0.4	*27*	0.1
Total		**10.7**		**4.3**

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 12: Steady pre-sales over next two years



Source: Company, Nirmal Bang Institutional Equities Research

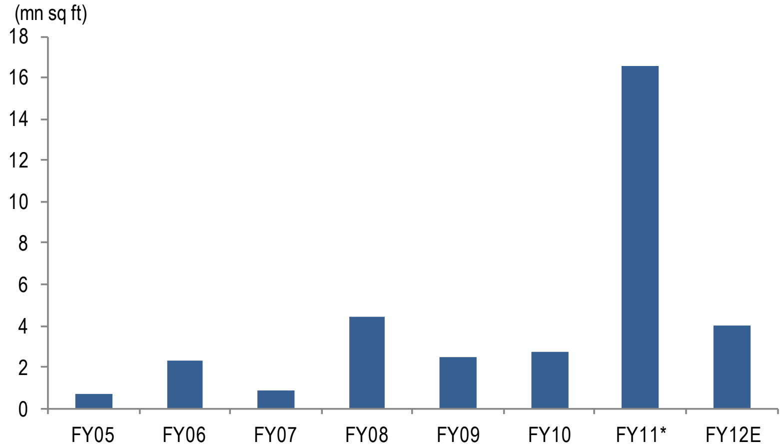
More residential projects to cross threshold limit in coming quarters

PEPL follows a conservative method of 30% threshold limit of construction costs (excluding land) for booking revenues. Most of the projects launched over the past one year have yet to cross the threshold limit which resulted in a 41% YoY decline in revenues for the 9MFY12 period. Further, there was delay in getting Occupancy Certificate for its Neptune courtyard project (resulting in delay in booking of revenues), which will be handed over in 4QFY12. Our recent visit at few of its project sites and discussions with the management indicates that four of its projects i.e. White Meadows (1.5mn sq ft), Kingfisher Tower (0.35mn sq ft), Silver Oak (0.21mn sq ft) and Royal Woods (0.32mn sq ft) in the residential segment will cross the threshold limit over the next two-three quarters, thereby driving revenues over the next two years. Further, its luxury villa Golfshire (1.75mn sq ft, 228 villas) project, which was launched in FY09, has been sold only to the extent of 25% so far. However, in January 2012, PEPL opened the membership of its golf course to the general public, which should witness its golf course project moving at a faster pace. The management has indicated sale of five units/month. The three projects (Kingfisher Tower, Golfshire and White Meadows) are expected to contribute 39% and 38% to our overall revenue estimates in FY13 and FY14, respectively.

Timely execution is vital

PEPL has a decent track record of project execution, with 25 years of experience and 46mn sq ft of delivery. However, in the current environment, timely project execution is a key challenge for developers where labour shortage and rising raw material prices can play spoilsport. The company does have a healthy balance sheet to combat rising raw material prices, but is trying to overcome labour shortage by having a multipronged strategy. Earlier, PEPL used to give one project entirely to one civil contractor and expect him to deliver, especially the larger ones like Shantiniketan. Going forward, PEPL intends to split it up block-wise and give two-three blocks to each contractor, which will fasten up project execution. Further, it has introduced new technology like Mivan Shuttering which will speed up the work and ensure timely delivery. We have assumed its entire land bank to get developed by FY21; however two years of delay in execution from our assumption will impact our NAV by 6%.

Exhibit 13: Trend in project execution



Source: Company, Nirmal Bang Institutional Equities Research
Note: Sharp jump in delivery in FY11 is on account of handover related to its flagship project Shantiniketan

Commercial segment accounts for 28% of total developable area

Strong client base

PEPL's commercial segment accounts for 28% of its overall developable area (17.2mn sq ft) out of which it intends to sell 25% and lease out the rest. Some of its landmark commercial projects are UB City, Cessna Park and Tech Park. PEPL's strong client base and the relationship nurtured with MNCs have played a major role in its commercial area sales and rental income. It has tied up with Cisco for a built-in suit model SEZ for its India expansion plan, wherein it will develop 14 towers consisting of 4.3mn sq ft (1.7mn sq ft has been constructed so far). Similarly, the company has developed office space for JP Morgan, Reliance Industries, Oracle and Nokia.

Steady pre-sales in commercial segment to continue

PEPL has sold 0.96mn sq ft of commercial space since April 2010 at an average realisation of ~Rs5,000/sq ft, largely led by Technology Park Phase III, Technopolis, Polygon and Shanitiketan. In FY13, PEPL intends to launch 0.3mn sq ft of commercial space for sale. We expect pre-sales to pick up at its ongoing projects such as Polygon and Technology Park Phase III as the construction activity picks up. We expect Rs5bn of pre-sales in the commercial space segment over FY12-14E.

Exhibit 14: Pre-sales to pick up at its ongoing projects

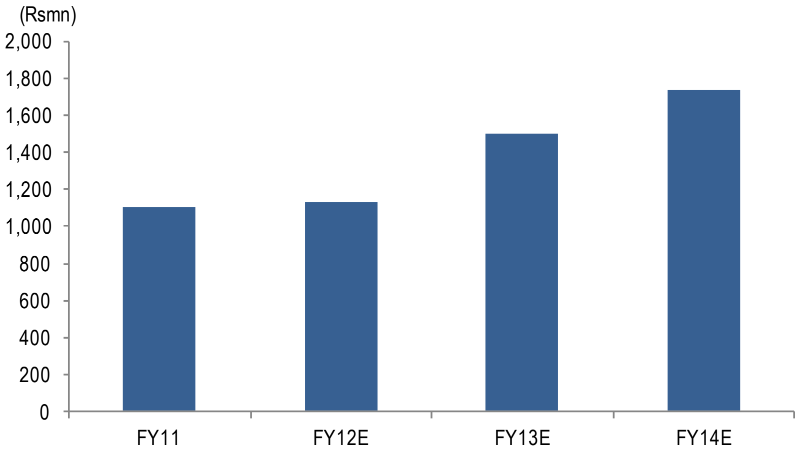
(Rsmn)	Total area (PEPL share-mn sq ft)	*Area sold (%)*	*Construction completed (%)*	Expected pre-sales over FY12-14E
Polygon	0.32	*36*	*47*	1,825
Khoday Tower	0.08	*100*	*39*	0
Technopolis	0.19	*6*	*7*	492
Technology Park -Phase 3	0.72	*44*	*14*	1,670

Source: Company, Nirmal Bang Institutional Equities Research

Growing commercial portfolio to boost annuity income

PEPL has generated Rs1,100mn of rental income in FY11 from the commercial segment, with total area under lease at 3.1mn sq ft in FY11. Recent handovers in Cessna B6 block /Exora were in fit-out stage/rent-free period, which got delayed by six months, but our site visit and management interaction indicated that rentals from Exora (0.23mn sq ft) and Cessna B6 block (0.2mn sq ft) should start coming in by 4QFY12. The company has ~3mn sq ft of commercial assets as ongoing construction, which should be ready for fit-outs over the next three-four years. We expect Cessna B7 block and Exora block 3 will be delivered for fit-outs by end of FY13 and should reach its peak occupancy by end of FY14. Further, the management has indicated signing of two LOIs (Letters of Intent) for 0.35mn sq ft and 0.25mn sq ft (Exora Block 3) in office space wherein fit-outs will be given after 15 months, indicating strong commercial demand in Bangalore. We expect healthy 17% CAGR in rental annuity from the commercial segment over FY11-14E, at Rs1,743mn by FY14E.

Exhibit 15: Rental income from commercial projects

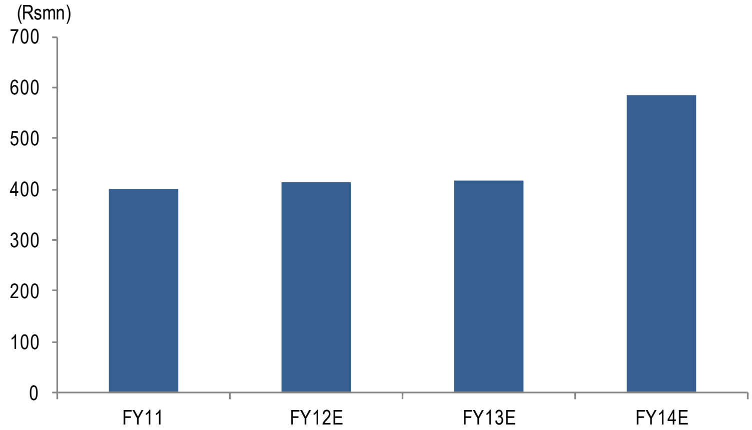


Source: Company, Nirmal Bang Institutional Equities Research

Retail segment accounts for 14% of total developable area

PEPL's retail segment accounts for 14% of its overall developable area (8.6mn sq ft), out of which it intends to lease out the entire portfolio. It generated Rs400mn of rental income in FY11 with 0.4mn sq ft of area operational in prime locations. It had a similar run rate in the 9MFY12 period with zero additional assets getting operational. Its flagship project, Forum Mall, is one of the largest malls in Bangalore with three anchor tenants (PVR, Landmark and Westside) and 73 retail stores. The mall has 95% occupancy rate as company lacks competition in nearby vicinity. PEPL has 1.34mn sq ft of retail assets under construction, which should be ready for fit-outs over the next three-four years. We expect only 0.35mn sq ft of additional retail assets to get operational over the next one year (end of FY13E) i.e. Forum Vijaya Mall in Chennai wherein 63% of construction has been completed. Consequently, we expect 13% CAGR in rental annuity income from retail the segment at Rs587mn by FY14E.

Exhibit 16: Rental income from retail projects

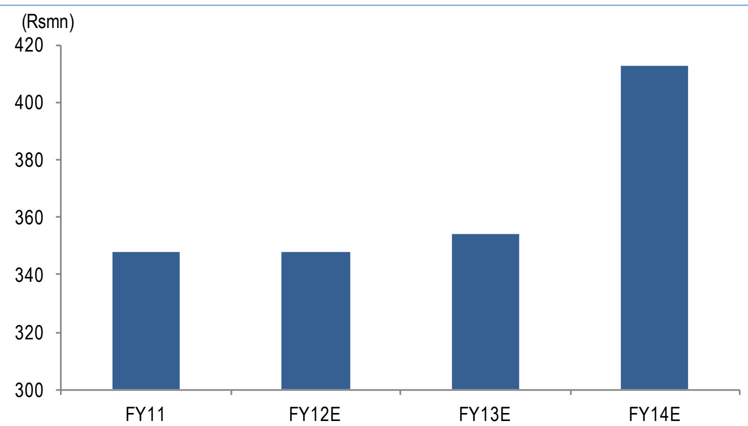


Source: Company, Nirmal Bang Institutional Equities Research

Hospitality segment accounts for 4% of total developable area

PEPL's hospitality segment accounts for 4% of its overall developable area (2.4mn sq ft), which comprises hotels, resorts, spas and service apartments. It has strategically tied up with Marriot, Hilton, and Starwood to operate and manage its hospitality business. Currently, PEPL has three hotels operational with 458 keys generating Rs348mn of revenue in FY12E. The company plans to aggressively expand its presence in the segment while popularising the spa concept in Bangalore and focus on self-owned and managed properties. PEPL has 1.3mn sq ft of retail assets under construction which should be operational over the next four-five years, thereby adding more than 800 keys. We expect Golfshire club house (0.16mn sq ft) and FVM service apartments (0.06mn sq ft) to get operational by 1QFY13 and 1QFY14, respectively. Consequently, we expect moderate 6% CAGR in hospitality income at Rs 413mn by FY14E.

Exhibit 17: Rental income from hospitality projects

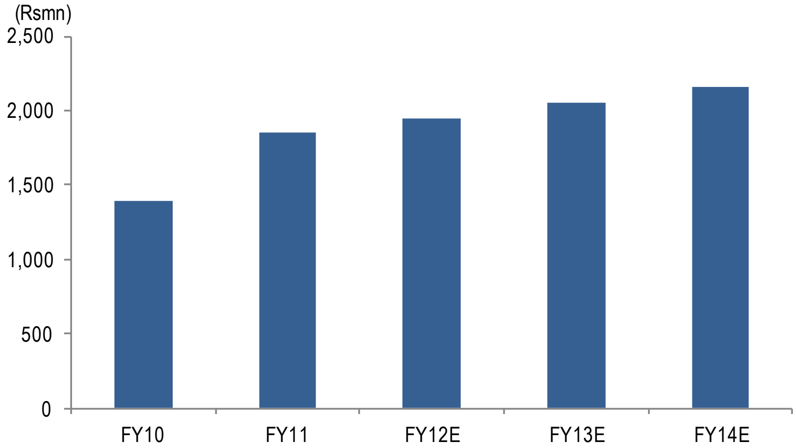


Source: Company, Nirmal Bang Institutional Equities Research

Value added after sales service

PEPL offers an array of after sale services such as sub-leasing, civil and electrical maintenance, interior design and facility management services, which enhances resale value of property in secondary market and thereby fosters a strong relationship with customers. As PEPL's assets under management are increasing (projects under execution) manifold, it will enhance its property and facilities income. The company reported 1,851mn of revenue in FY11 under this segment (12% of total revenue) and it operates at 12% net margin in this segment. We expect the company to report 8-10% YoY growth in revenues over FY11-14E from the property and facilities segment on account of 30mn sq ft of assets under management.

Exhibit 18: Rising PEPL assets will help after-sales service



Source: Company, Nirmal Bang Institutional Equities Research

Sufficient cash flow to fund capex, debt obligations

Healthy balance sheet

PEPL's net consolidated debt stood at Rs12.1bn as of end 3QFY12, translating into 0.55x net D/E. Its net debt increased by Rs2.5n in the 9MFY12 period on account of land acquisition (Rs2.1bn) in an effort to replenish its land bank and investments made towards annuity assets. However, ~46 % of the company's debt includes rental securitisation (39%) and receivables discounting loans (7%). Further, PEPL's consolidated debt is done on line-by-line basis as per Accounting Standard 21, which includes subsidiary's share also. Adjusting for this and cash of Rs2bn, debt on development business is just Rs 4.5bn, which is manageable. PEPL's average cost of debt stays at 13.5% in FY12, a marginal dip of 30bps YoY, and has mandatory debt repayment of Rs3.5bn in FY13E. However, we expect its net debt to increase marginally over the next two years on account of its ongoing investments in annuity assets.

Exhibit 19: Debt break-up

(Rsmn)	Standalone	Consolidated
Secured loans	10,250	15,760
Project debt (residential & commercial)	6,368	7,070
Capex loans	478	1,340
Rental securitisation	2,231	6,176
Receivables discounting loans	1,173	1,173
Unsecured loan	177	177
Gross debt	10,427	15,937
Less cash bank	1,568	1,865
Net debt*	**8,859**	**14,072**

Source: Company, Nirmal Bang Institutional Equities Research
Note: PEPL consolidated net debt stands at Rs12,134 adjusting for subsidiary share

Operating cash flow to improve

We expect PEPL to maintain its existing pre-sales run rate of Rs19-20bn in FY13, thanks to its aggressive new project launch pipeline and steady Bangalore market, thereby enabling it to maintain its run rate of Rs2.5-3bn customer advances/quarter. PEPL's debtors increased by Rs5.7bn in FY11 on account of the ongoing completion of its Shantiketan and Oasis projects, which was a major overhang on its stock's performance. However, the company managed to realise Rs2.3bn and Rs0.5bn from Shantiketan and Oasis projects, respectively, as the company focused on handover. We expect reduction in debtors of Rs4.6bn over FY11-14E, which would improve its cash flow. We expect PEPL to generate Rs11bn of cash flow from operations over FY11-14E, thanks to reduction in debtors and strong pre-sales as against Rs5.2bn of negative operating cash flow generated over FY08-11, which would suffice to meet its capex requirement on annuity assets.

Exhibit 20: Strong generation of operating cash flow

(Rsmn)	FY10	FY11	FY12E	FY13E	FY14E
EBIT	1,744	3,132	2,457	4,041	5,927
Add: Depreciation	491	606	617	708	833
Less: Working capital	(5,024)	(6,785)	(64)	(947)	(182)
Less: Taxes	(139)	(12)	(493)	(942)	(1,437)
Operating cash flow	**(2,928)**	**(3,059)**	**2,517**	**2,860**	**5,140**
Less capex for annuity assets	(1,544)	(3,189)	(3,346)	(3,692)	(3,816)
FCF	**(4,472)**	**(6,248)**	**(830)**	**(832)**	**1,324**

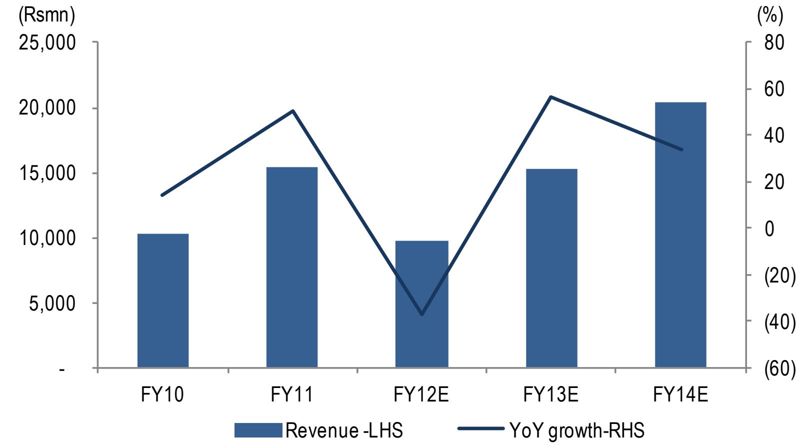
Source: Company, Nirmal Bang Institutional Equities Research

Financials

Revenue to improve as more projects cross threshold limit

PEPL reported 40.9% YoY revenue decline for the 9MFY12 period as most of the projects launched over the past one year were yet to cross 30% threshold limit, which is more of a timing issue. Further, there was delay in getting OC for its Neptune courtyard project in Kochi, which is expected to be handed over in 4QFY12. PEPL has reported strong pre-sales over the past three-four quarters, which will boost revenue as most of projects will cross threshold limit in the coming quarters. Our interaction with the management and channel checks indicated that some of its higher revenue potential projects like White Meadows, Polygon and Kingfisher Tower will get booked from FY12/13 onwards. **Consequently, we expect PEPL to report 44.9% revenue CAGR over FY12-14E.**

Exhibit 21: Revenue trend

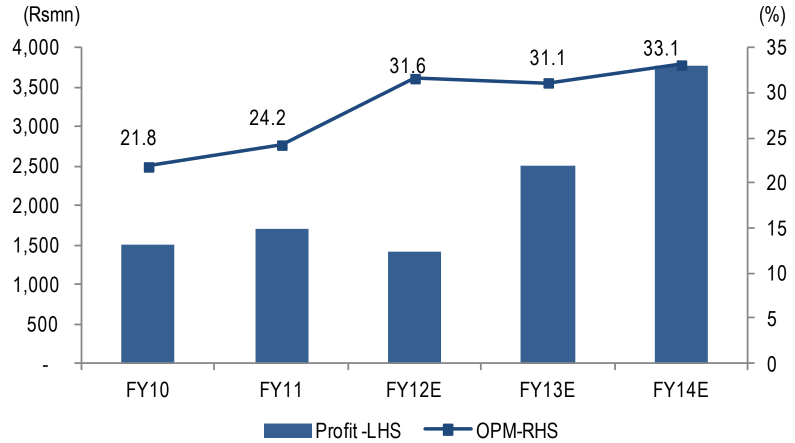


Source: Company, Nirmal Bang Institutional Equities Research

Margin expansion to drive earnings

PEPL's margins were in mid-20s in FY10/FY11 on account of its low margin flagship project Shantiketan, which will be out of its books by the end of 1QFY13. The signs of recovery in margins were visible in the 9MFY12 period, as it reported 517bps YoY improvement. Further, we expect increase in revenue contribution from better margin residential projects like Golfshire, Kingfisher Tower and White Meadows (Bangalore), which should drive further 210bps increase in OPM over FY12-14E. The management has guided for maintaining OPM in the range of ~30-35% going forward. **Consequently, we expect PEPL to report earnings 63.6% earnings CAGR over FY12-14E.**

Exhibit 22: Trends in margin, profit



Source: Company, Nirmal Bang Institutional Equities Research

Key concerns

Higher concentration of land bank in Bangalore

As much as 71% of PEPL's land bank is located in Bangalore, which is an IT/ITES hub and thereby a major demand driver for residential and commercial properties. We have witnessed strong absorption level across segments in FY12 in Bangalore market, despite economic slowdown in the US/Europe. This was visible in aggressive new project launches and pre-sales of Bangalore-based companies like Sobha Developers and PEPL. Going forward, we expect demand and inventory levels to remain stable. However, higher concentration in Bangalore market exposes PEPL to slowdown in the IT/ITES sectors and change in policy-related risk, which could severely impact the pricing and volume of PEPL projects.

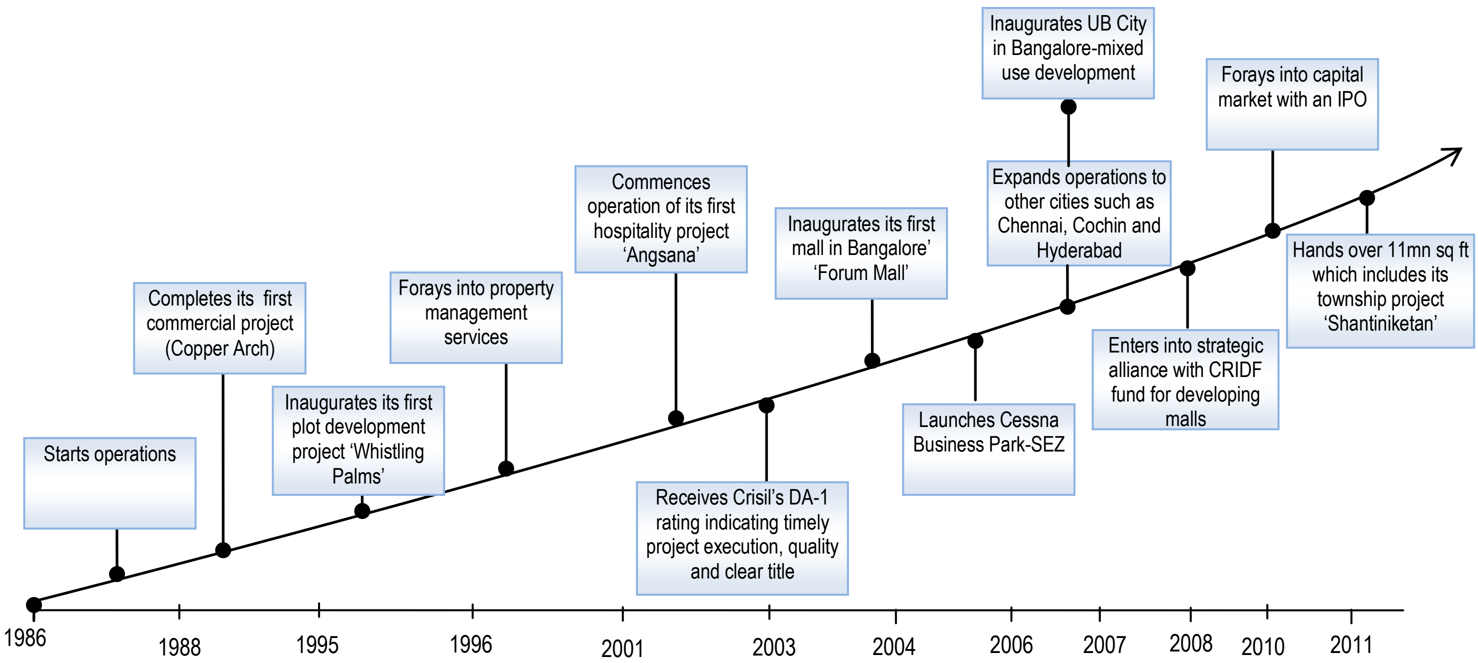
JDA model poses litigation and margin risk

PEPL's 65% of land bank (61.3mn sq ft) comes from JDA projects, which involve less upfront capital investment and helps the company to utilise its cash flow in annuity business. However, under the JDA model the company has to absorb the entire construction costs which may impact margins in case of higher commodity prices. We have factored in 7% YoY price escalation in construction costs of all its projects, in line with the current inflationary trend. Any further increase can impact our margins and thereby our estimates.

Company background

PEPL, incorporated in 1986, is a real estate developer based in Bangalore which has firmly established itself as one of South India's most successful developers. Over the past 25 years, the company has successfully executed 46mn sq ft of projects and efficiently transformed locations into landmarks such as Forum Mall, Shantiniketan, and UB City. It has ~1,000 acres of land, with 71% of its land bank located in Bangalore and a presence across segments. PEPL has developed strategic partnership with CapitaLand (for retail projects), Oakwood, Marriott, Starwood and Hilton (for hospitality projects), and Red Fort Capital (as an SPV-level financial partner). Further, it has acquired majority stake in Team United Engineers (India) Pvt Ltd as a strategy towards backward integration in order to render project construction services.

Exhibit 23: Chronology of Events



Source: Company, Nirmal Bang Institutional Equities Research

Annexure

Steady Bangalore property market

Bangalore is the largest commercial market and third largest residential market in India. The city has typically been preferred by home buyers because of its favorable socio-economic conditions and a salubrious climate. In recent years, Bangalore has attracted a large influx of population engaged in the thriving IT sector. City residential demand is more end-user driven with moderate price appreciation. The average residential real estate price in the city is 20-25% lesser than in Delhi and Mumbai. In the recent National Housing Bank Residex, the index indicating property prices across key cities in India, Bangalore witnessed a mere 1% YoY fall in residential prices in 3QFY12. Mumbai saw a 11.6% YoY jump in home prices, while Delhi witnessed 35.8% YoY increase during 3QFY12. The city witnessed tremendous growth in terms of population and the number of companies setting up offices there. Thus, the ongoing projects such as Bengaluru metro rail project, various flyovers and the under-pass construction activities in Outer Ring Road (ORR), CNR and BHEL circles would ease the congestion and provide better connectivity for all commuters. This will boost real estate demand in and around Bangalore city.

Positive run in residential market to continue

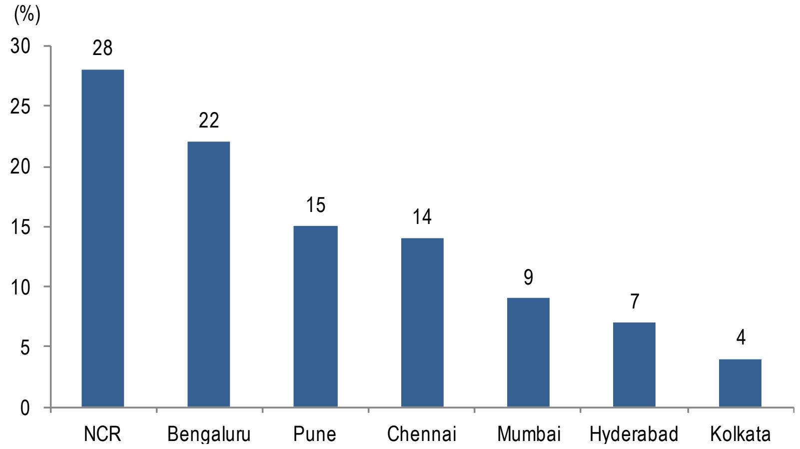
Bangalore residential market had a positive run in 2011, which has extended to early 2012 as well. The first two months of 2012 have witnessed several project launches by reputed developers and this momentum is expected to remain in the coming months. As per Knight Frank, Bangalore residential market saw the launch of around 90 projects in 9MFY12, translating to an incremental supply of over 30,000 units. The favorable sales traction may be primarily attributed towards stable pricing during the year. High inventory levels and availability of large tracts of developable land in the suburban and peripheral locations have also aided in maintaining consistency in the residential prices in those regions. Price appreciation in most micro-markets was observed to have been in the range of 5-12% during the year. We expect capital values for residential properties in the city to record marginal growth of 5-10%. The slow pace of growth is attributed to sustained price hikes witnessed in the past four quarters and rising interest rates.

Exhibit 24: Surge in new project launch to continue

Projects	Location	Launch Date	Price (Rs/sq ft)
Prestige Sunnyside	Sarjapur	3QFY12	4,300
Prestige Hillside Retreat	Nandi Hills	4QFY12	6,300
Prestige Silver crest	Marathahalli	4QFY12	4,350
Sobha Habitech	Whitelfield	4QFY12	5,887
Vaswani Brentwood	Brookfields	4QFY12	4,500
'Brigade Orchards'	Devanahalli	4QFY12	6,000
Hoysala Race	Sahakar nagar	4QFY12	5,250
Purva Seasons	Raman Nagar	4QFY12	5,950
Mahaveer Rhyolite	Bannerghatta Road	4QFY12	2,850
Assetz East Point	Marathahalli	4QFY12	4,000
Silver Springfield	Hessarghatta Road	4QFY12	3,250

Source: Industry, Nirmal Bang Institutional Equities Research

Exhibit 25: Bangalore accounted for second-highest new residential project launch in 2QCY11



Source: Industry, Nirmal Bang Institutional Equities Research

Exhibit 26: Residential prices over last one year

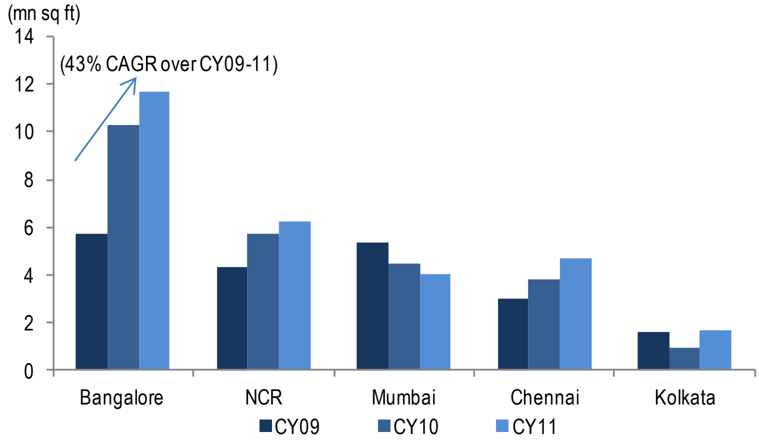
Capital values as on 4QCY11		Price hike (%)	
High segment	(Rs 000)	**3 months**	**1 year**
Central	14-18	0	3
South	6.5-10	0	6
Off central	6-8.5	0	21
East	6.8-8	0	6
North	6.5-8	0	16
Mid-income segment			
Central	6-7.5	0	8
South	5-6.5	0	6
Off central	4.5-6.7	0	10
East	3.2-3.8	0	21
North	3-4.8	0	8

Source: Cushman & Wakefield, Nirmal Bang Institutional Equities Research

Bangalore leads the way in absorption in the commercial segment

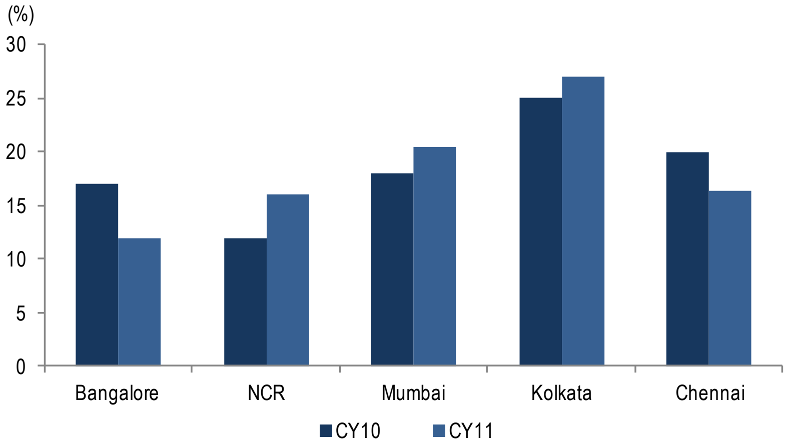
Bangalore's commercial market exhibited resiliency with comparatively high demand levels despite the discomfort in the market on account of global uncertainty. Though commercial property demand in Bangalore is largely dependent on IT/ITES sectors, the share of manufacturing is increasing at a faster pace and thereby giving further boost to office space demand. According to real estate consultancy firm Knight Frank, the manufacturing sector witnessed a quantum leap as its share of absorption increased from 3% in 4QCY10 to 23% in 4QCY11. The absorption of commercial space has gone up from 5mn sq ft/quarter in CY09 to 7mn sq ft/quarter in CY11, thanks to sustained demand for Bangalore commercial space which witnessed 43% CAGR in absorption level over CY09-11. Subdued supply during the first two quarters of 2011 coupled with high absorption level has substantially lowered the vacancy level in the city (bringing it down from 17% in CY10 to 12% in CY11). With the expansion of existing operations in the IT sector and the entry of newer sectors due to renewed optimism in the market, we expect the level of absorption of office space to remain stable.

Exhibit 27: City-wise absorption levels



Source: Cushman & Wakefield, Nirmal Bang Institutional Equities Research

Exhibit 28: Vacancy level in key cities



Source: Cushman & Wakefield, Nirmal Bang Institutional Equities Research

Exhibit 29: Distribution of office space across sectors in Bangalore

Sector (%)	4QCY10	4QCY11
BFSI	1	2
IT/ITES	82	70
Manufacturing	3	23
Other service sectors	15	5

Source: Knight Frank, Nirmal Bang Institutional Equities Research

Financials

Exhibit 30: Income statement

Y/E March (Rsmn)	FY10	FY11	FY12E	FY13E	FY14E
Net Sales	10,244	15,431	9,735	15,273	20,439
% growth	*14.1*	*50.6*	*(36.9)*	*56.9*	*33.8*
Construction cost	7,033	10,479	5,298	8,844	11,800
Staff	490	548	633	764	858
Adm cost	486	666	730	916	1,022
Total Expenditure	8,010	11,693	6,661	10,524	13,680
EBITDA	2,234	3,738	3,074	4,749	6,759
% growth	*(13.7)*	*67.3*	*(17.8)*	*54.5*	*42.3*
EBITDA margin (%)	*21.8*	*24.2*	*31.6*	*31.1*	*33.1*
Other income	616	682	546	491	442
Interest	783	1,234	1,176	1,167	1,237
Gross Profit	2,068	3,187	2,444	4,073	5,964
% growth	*44.7*	*54.1*	*(23.3)*	*66.7*	*46.4*
Depreciation	491	606	617	708	833
Profit Before Tax	1,577	2,580	1,827	3,364	5,131
% growth	*53.0*	*63.6*	*(29.2)*	*84.1*	*52.5*
Tax	283	914	493	942	1,437
Effective tax rate (%)	*17.9*	*35.4*	*27.0*	*28.0*	*28.0*
Net Profit	1,294	1,667	1,334	2,422	3,695
% growth	*83.0*	*28.7*	*(20.0)*	*81.6*	*52.5*
Profit in Associates	207	43	75	75	75
Minority Interest	36	(8)	0	0	0
Reported Net Profit	1,538	1,701	1,409	2,497	3,770
PAT margin	15.0	11.0	14.5	16.4	18.4
% growth	*88.8*	*10.6*	*(17.2)*	*77.3*	*50.9*
DPS (Rs)	-	1.2	1.2	1.2	1.2
Payout (%)	-	*23.0*	*27.9*	*15.8*	*10.4*

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 32: Balance Sheet

Y/E March (Rsmn)	FY10	FY11	FY12E	FY13E	FY14E
Equity	2,625	3,281	3,281	3,281	3,281
Reserves	5,013	17,862	18,812	20,850	24,160
Net worth	7,638	21,142	22,092	24,131	27,441
Short term loans	4,000	4,000	6,000	3,500	3,500
Long-term Loans	12,015	11,175	10,175	13,675	14,675
Total Loans	16,015	15,175	16,175	17,175	18,175
Deffered tax Liability	2	78	78	78	78
Minority Interest	2,721	2,240	2,240	2,240	2,240
Liabilities	**26,376**	**38,636**	**40,586**	**43,624**	**47,935**
Gross Block	11,307	13,163	15,516	18,214	21,435
Depreciation	2,065	2,971	3,588	4,296	5,129
Net Block	9,242	10,192	11,928	13,918	16,306
Capital work-in-progress	2,054	3,975	4,968	5,962	6,558
Goodwill	1,098	1,078	1,078	1,078	1,078
Long-term Investments	1,600	2,415	2,415	2,415	2,415
Inventories	12,502	14,275	15,241	18,521	19,904
Debtors	3,627	9,347	7,196	6,306	5,220
Cash	1,729	3,679	2,839	1,947	3,092
Liquid investments	9	264	264	264	264
Other Current assets	5,336	6,362	8,253	8,663	9,093
Total Current assets	23,203	33,927	33,794	35,700	37,573
Creditors	1,825	2,094	1,998	2,631	3,420
Customer advances	6,433	4,616	5,354	6,573	6,195
Other	2,563	6,241	6,245	6,245	6,379
Total current liabilities	10,821	12,951	13,597	15,449	15,995
Net current assets	12,382	20,976	20,197	20,251	21,578
Total Assets	**26,376**	**38,636**	**40,586**	**43,624**	**47,935**

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 31: Cash flow

Y/E March (Rsmn)	FY10	FY11	FY12E	FY13E	FY14E
EBIT	1744	3132	2457	4041	5927
(Inc.)/Dec in working capital	(5,024)	(6,785)	(64)	(947)	(182)
Cash flow from operations	(3,280)	(3,653)	2,394	3,093	5,745
Other income	616	682	546	491	442
Depreciation	491	606	617	708	833
Interest paid (-)	(783)	(1,234)	(1,176)	(1,167)	(1,237)
Tax paid (-)	(139)	(12)	(493)	(942)	(1,437)
Dividends paid (-)	0	(23)	(456)	(459)	(459)
Net cash from operations	**(3,095)**	**(3,634)**	**1,431**	**1,725**	**3,886**
Capital expenditure (-)	(859)	(3,078)	(3,346)	(3,692)	(3,816)
Net cash after capex	**(3,954)**	**(6,713)**	**(1,915)**	**(1,968)**	**70**
Inc./(Dec.) in short-term borrowing	(15,367)	(7,903)	0	0	0
Inc./(dec.) in long-term borrowing	21,031	5,608	1,000	1,000	1,000
Inc./(dec.) in borrowings	5,664	(2,294)	1,000	1,000	1,000
(Inc.)/Dec. in investments	(438)	(1,678)	0	0	0
Equity issue/(Buyback)	1	11,480	0	0	0
Cash from Financial Activities	**5,227**	**7,507**	**1,000**	**1,000**	**1,000**
Others	(954)	1,156	75	75	75
Opening cash	1,410	1,729	3,679	2,839	1,947
Closing cash	1,729	3,679	2,839	1,947	3,092
Change in cash	**320**	**1,950**	**(840)**	**(893)**	**1,145**

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 33: Key Ratios

Y/E March	FY10	FY11	FY12E	FY13E	FY14E
Per Share Data (Rs)					
EPS	4.6	5.2	4.3	7.6	11.5
Cash EPS	6.1	7.1	6.2	9.8	14.0
DPS	-	1.2	1.2	1.2	1.2
Book Value	23.3	64.4	67.3	73.6	83.6
Du pont Analysis					
Profit margin	14.7	11.1	14.5	16.4	18.4
Financial Leverage	5.0	3.1	2.4	2.4	2.4
Asset turnover (x)	0.3	0.3	0.2	0.3	0.3
ROE (%)	21.7	11.9	6.5	10.8	14.6
Returns (%)					
RoE	21.7	11.9	6.5	10.8	14.6
RoCE	7.6	9.6	6.2	9.6	13.0
Dividend Payout	-	23.0	27.9	15.8	10.4
Valuation Ratio (x)					
P/E	23.2	20.3	24.7	13.9	9.2
P/E (Cash EPS)	17.5	15.0	17.2	10.8	7.6
P/BV	4.6	1.6	1.6	1.4	1.3
EV / EBITDA	22.0	12.4	15.7	10.5	7.4
EV/Sales	4.8	3.0	4.9	3.3	2.4
Turnover Ratio (x)					
Asset turnover ratio	0.9	1.3	0.7	0.9	1.0
Debtor days	109	153	310	161	103
Inventory days	397	317	553	403	343
Creditor days	95	61	112	80	81
Solvency ratio (x)					
Debt-equity	2.1	0.7	0.7	0.7	0.7
Interest coverage	2.2	2.5	2.1	3.5	4.8

Source: Company, Nirmal Bang Institutional Equities Research

Disclaimer

Stock Ratings Absolute Returns

BUY > 15%

HOLD 0-15%

SELL < 0%

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