Equities

4 November 2011 | 10 pages

Prestige Estates Projects Ltd (PREG.BO)

Q2FY12: Topline Disappoints; Record Sales Bookings

- Company Update
- Target Price Change
- Estimate Change

- **Revenue drops 57% YoY** — Revenue fell short of our estimates at ~Rs 1.3bn, down 57% YoY/48% QoQ- with Shantiniketan out and few projects not crossing the recognition hurdle. EBITDA margins improved significantly to 38% (vs 28% in Q1/19% in Q4FY11) given higher-margin revenue mix. Management expects margins to remain in mid 30's going forward. PAT at Rs 263m declined 51% YoY/28% QOQ.
- **Record sales momentum** — Strong sales in Q2- 2.1msf (Rs 7.8bn) sold versus 1.9msf sold in whole of FY11- on track to achieve Rs 15-16b FY12 sales guidance. While traction in premium projects seems relatively slow, mid-income projects are seeing robust bookings - 1.9msf sold in Q2. Also, company pre launched Sunny Side (~0.7msf) – of the 395 units, 43 sold as at 30 Sept and >100 stand sold by 30 Oct.
- **Commercial holding up for now** — Steady performance in Q2 - leased 0.7msf vs ~1.0msf in Q1; rentals remain steady. Management highlighted that impact of global slowdown has not yet been felt - enquiries remain healthy. In fact it indicated that a few large size transactions are in the pipeline and should close soon. In 1H, the company has leased 1.7msf (vs FY12 guidance of 2.8-3.0msf).
- **Other key updates** — (1) Unrecognized revenue of ~Rs 24bn, up by 44% QoQ primarily on the back of good response to recent mid income housing launches, (2) Bellavista (Chennai) and Mayberry (Bangalore) launch expected in Q3, (3) Added ~1.0msf of developable area spread across Bangalore, Chennai and Mysore and further land bank in Bangalore and Goa, (4) Reduced cost of debt by ~65bps (13.6%).
- **Tweak Estimates, Maintain Buy** — We cut our TP/Avg NAV to Rs 128/Rs 160 (vs Rs 133/166 earlier). Positive impact from land bank addition was more than set off by moderation in execution schedule and increased net debt, customer advances. However, our numbers could see some upside as we are yet to incorporate ~1.0msf of new projects. Impressive operating momentum and attractive valuations – Maintain Buy. Risks- Slowdown in IT/ITES, regulatory risks, slow execution.

Buy	**1**
Price (04 Nov 11)	Rs92.50
Target price	Rs128.00
from Rs133.00	
Expected share price return	38.4%
Expected dividend yield	1.3%
Expected total return	**39.7%**
Market Cap	Rs30,347M
	US$617M

Price Performance
(RIC: PREG.BO, BB: PEPL IN)

Statistical Abstract

Year to 31 Mar	Net Profit (RsM)	Diluted EPS (Rs)	EPS growth (%)	P/E (x)	P/B (x)	ROE (%)	Yield (%)
2010A	1,502	5.72	94.5	16.2	3.2	21.7	0.0
2011A	1,709	5.21	-8.9	17.7	1.4	11.9	1.3
2012E	1,811	5.52	5.9	16.8	1.3	8.3	1.3
2013E	2,863	8.73	58.1	10.6	1.2	12.1	1.3
2014E	4,080	12.44	42.5	7.4	1.1	15.3	1.3

Source: Powered by dataCentral

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See Appendix A-1 for Analyst Certification, Important Disclosures and non-US research analyst disclosures.

Fiscal year end 31-Mar	2010	2011	2012E	2013E	2014E
Valuation Ratios					
P/E adjusted (x)	16.2	17.7	16.8	10.6	7.4
P/E reported (x)	16.2	17.7	16.8	10.6	7.4
P/BV (x)	3.2	1.4	1.3	1.2	1.1
Dividend yield (%)	0.0	1.3	1.3	1.3	1.3
Per Share Data (Rs)					
EPS adjusted	5.72	5.21	5.52	8.73	12.44
EPS reported	5.72	5.21	5.52	8.73	12.44
BVPS	29.10	64.46	68.59	75.93	86.97
NAVps ordinary	na	na	na	na	na
DPS	0.00	1.20	1.20	1.20	1.20
Profit & Loss (RsM)					
Net operating income (NOI)	**2,235**	**3,739**	**3,720**	**5,479**	**7,607**
G&A expenses	0	0	0	0	0
Other Operating items	-319	-555	-524	-635	-709
EBIT including associates	**1,916**	**3,183**	**3,196**	**4,844**	**6,899**
Non-oper./net int./except.	-167	-552	-723	-876	-1,241
Pre-tax profit	**1,749**	**2,631**	**2,473**	**3,968**	**5,658**
Tax	-283	-914	-654	-1,097	-1,570
Extraord./Min. Int./Pref. Div.	36	-8	-8	-8	-8
Reported net income	**1,502**	**1,709**	**1,811**	**2,863**	**4,080**
Adjusted earnings	1,502	1,709	1,811	2,863	4,080
Adjusted EBIT	1,744	3,132	3,145	4,793	6,848
Adjusted EBITDA	2,235	3,739	3,720	5,479	7,607
Growth Rates (%)					
NOI	-13.6	67.3	-0.5	47.3	38.8
EBIT adjusted	-20.3	79.6	0.4	52.4	42.9
EPS adjusted	94.5	-8.9	5.9	58.1	42.5
Cash Flow (RsM)					
Operating cash flow	**-2,844**	**-3,856**	**2,544**	**3,402**	**1,801**
Depreciation/amortization	491	606	575	686	760
Net working capital	-5,024	-6,785	-1,041	-1,456	-4,543
Investing cash flow	**-1,213**	**-3,935**	**-2,501**	**-2,906**	**-2,936**
Capital expenditure	-859	-3,078	-2,583	-2,981	-2,981
Acquisitions/disposals	0	0	0	0	0
Financing cash flow	**4,363**	**8,308**	**-1,229**	**168**	**3**
Borrowings	5,099	-2,294	500	2,000	2,000
Dividends paid	0	0	0	0	0
Change in cash	**348**	**1,100**	**-1,186**	**664**	**-1,132**
Balance Sheet (RsM)					
Total assets	**37,201**	**51,590**	**54,238**	**61,015**	**69,818**
Cash & cash equivalent	1,729	3,679	2,485	3,141	2,000
Net fixed assets	11,296	14,167	16,175	18,469	20,690
Total liabilities	**26,842**	**28,208**	**29,501**	**33,872**	**39,051**
Total Debt	16,015	15,175	15,675	17,675	19,675
Shareholders' funds	**10,359**	**23,382**	**24,737**	**27,143**	**30,767**
Profitability/Solvency Ratios					
EBIT margin adjusted (%)	17.0	20.3	25.2	26.5	26.8
ROE adjusted (%)	21.7	11.9	8.3	12.1	15.3
ROA adjusted (%)	4.3	3.9	3.4	5.0	6.2
Net debt to equity (%)	137.9	49.2	53.3	53.5	57.4
Interest coverage (x)	2.9	3.0	2.9	4.0	4.9

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Financial Performance

Revenue fell short of our estimates-declined sharply with Shantiniketan out and a few projects not crossing the recognition hurdle.

EBITDA margins improved significantly given higher-margin revenue mix. Management expects margins to remain in mid 30's going forward.

Figure 1. Q2 & 1H-FY12 Results Snapshot (Standalone, in Rs Millions)

	2QFY11	1QFY12	2QFY12	YoY	QoQ	1HFY12	YoY
Revenues	**2,964**	**2,484**	**1,281**	**-57%**	**-48%**	**3,765**	**-32%**
Operating Costs	2,026	1,795	788			2,583	
EBITDA	**938**	**689**	**493**	**-48%**	**-29%**	**1,182**	**-18%**
EBITDA Margin	*32%*	*28%*	*38%*			*31%*	
Interest Expense	218	232	193	-11%	-17%	426	14%
Other Income	133	126	127	-4%	1%	253	20%
Depreciation	83	80	80	-4%	0%	159	-4%
PBT	**770**	**503**	**347**	**-55%**	**-31%**	**850**	**-24%**
Tax	229	139	84			222	
Effective tax rate (%)	*30%*	*28%*	*24%*			*26%*	
PAT	**541**	**364**	**263**	**-51%**	**-28%**	**627**	**-21%**

Source: Company

Tweak Estimates - New Target Price Rs 128

We revisit our assumptions/estimates based on the macro environment, company disclosures and 1H-FY12 performance. We decrease our base NAV estimate by ~3% to Rs 174/share (vs Rs 179 earlier). We maintain our valuation methodology - assume 40% probability of 15% price cut to arrive at average NAV of Rs 160 (vs Rs 166 earlier). Key changes:

- Built in some moderation in execution schedule given 1H performance
- Based on disclosures as at Sept-11, updated net debt, customer advances, finished good inventory, land bank (with no development plans as yet).
- Cost of Capital of 15.5% vs 15.7% earlier. This incorporates cost of debt (14.3%) and beta of 1.35 based on Bloomberg.

We have yet to incorporate ~1.0msf of developable area introduced in Q2 and our numbers could see some upside on account of the same.

Figure 2. Valuation Snapshot (in Rs/share)

Base NAV	**174**
NAV -15% price cut	141
Probability	40%
Blended NAV	**160**
Avg Disc to NAV	20%
Target Price	**128**

Source: Citi Investment Research and Analysis

Figure 3. Prestige – Base NAV Summary (in Rs Millions)

Gross NAV Residential	26,295
Gross NAV Non-Residential	17,450
Total Gross NAV	**43,745**
Less: Amt outstanding for land	351
Less: Tax payable @ 28%	12,150
less Net debt outstanding	12,992
less customer adv	5,400
Add: Land upon which there is no present development	13,640
Add: Value of leased portfolio (comm+retail)	17,539
Add: Value of Finished inventory	3,146
Add: Value of Project Mgmt Business	2,847
Add: Value of hotel portfolio	6,896
Net NAV	**56,921**
No. of shares	328
Base NAV	**174**

Source: Citi Investment Research and Analysis

Change in Earnings

Based on 1HFY12 performance, our conversation with the company and the current macro environment, we have cut our revenue assumptions as we moderate the execution schedule. *With this 12% revenue cut in FY12E and 2% in FY13E, we are now 24% and 13% below consensus.*

On the other hand, we make marginal changes on the positive side to our operating margin, interest costs, depreciation and tax (FY12) assumptions. Overall, PAT estimates have been cut by 8%/2% for FY12/13E. As we push out revenue recognition of FY12-13 projects, FY14 estimates have benefited to some extent.

Figure 4. Prestige – Change in Earnings Estimates

	FY12E			FY13E			FY14E		
	New	**Old**	**Change**	**New**	**Old**	**Change**	**New**	**Old**	**Change**
Total Revenues (Rs m)	12,503	14,264	-12%	18,102	18,424	-2%	25,557	23,723	8%
EBITDA (Rs m)	3,720	3,977	-6%	5,479	5,428	1%	7,607	7,202	6%
Net Profit (Rs m)	1,811	1,973	-8%	2,863	2,930	-2%	4,080	3,915	4%
EPS (Rs)	5.52	6.01	-8%	8.73	8.93	-2%	12.44	11.94	4%

Source: Citi Investment Research and Analysis estimates

Prestige Estates Projects Ltd

Company description

Prestige Estates Projects Ltd (PEPL) is one of the largest developers in South India. It enjoys a strong brand franchise with an impressive execution track record. In the past 24 years of real estate development business, it has developed/delivered ~44 msf of diversified real estate space across 157 projects (an avg. of ~5.0msf pa in the last 5-years) as at Mar-11. Some of its landmark projects in Bangalore City are UB City in Central Bangalore, Shantiniketan in Whitefield (14.6msf project), and the Forum Mall in Koramangala. It has a total well-diversified development product of >62 msf. The company is largely Bangalore-centric (>80%) and has some exposure to Chennai, Cochin, Hyderabad, Mangalore and Mysore. Prestige has a growing rental annuity portfolio, and in FY11 11% of revenue came from rentals earned. The company was listed on Indian stock exchanges in late 2010, where the promoters, the Razack family, diluted ~20% of their stake in the company.

Investment strategy

We rate Prestige Buy (1). Backed by a strong execution track record, it has impressive growth plans in varied real estate segments, with a focus on residential and commercial. It has attractive geographic exposure to Bangalore (>80% of portfolio) and several South India cities, which have been more resilient as seen in the last downturn. Prestige has a growing rental annuity portfolio. In FY11, 11% of revenue came from rentals earned. The company looks attractive as it offers: a) revenue growth of ~18% CAGR over FY11-14E and average EBITDA growth of ~27%, as margins improve with product mix shift; b) D/E ranging between 0.59-0.62 despite increased traction in the commercial segment; and c) ROEs in the range of 8%-14% through the next three years.

Valuation

Our target price of Rs128 is based on a weighted average discount of 20% (based on various operating segments) to our Sept-12E blended NAV of Rs160. Given the weak global/macro environment, we believe it is reasonable to assign a 40% probability of potential 15% price cuts to arrive at our TP. This is in line with our valuation methodology for the sector. Our Sept-12E base NAV (ex-price cut) of Rs174 is based on: 1) development portfolio of ~28msf (its economic stake); 2) rental assets of ~4.0msf (its economic stake); 3) additional land bank of ~390 acres at current market price; 4) project management business at 10.0x one year fwd earnings; 5) cap rate of 11%-12% for commercial space and retail malls; 6) average cost of capital of ~15.4% (assuming 14.3% cost of debt); and 7) a tax rate of 28%.

Risks

The key risks to our investment thesis on Prestige Estates are: (1) projects could suffer execution delays or cost overruns due to a significant scale-up in operations (2) a slowdown in IT/ITES and global macro factors could impact its commercial segment plans (3) geo-political risks are higher given >80% exposure towards a single city - Bangalore (4) interest rate tightening cycle (5) a slowdown in capital inflows or measures to regulate FDI in the real estate sector. If any of these risk factors has a greater downside impact than we anticipate, the share price will likely have difficulty attaining our target price.

Appendix A-1

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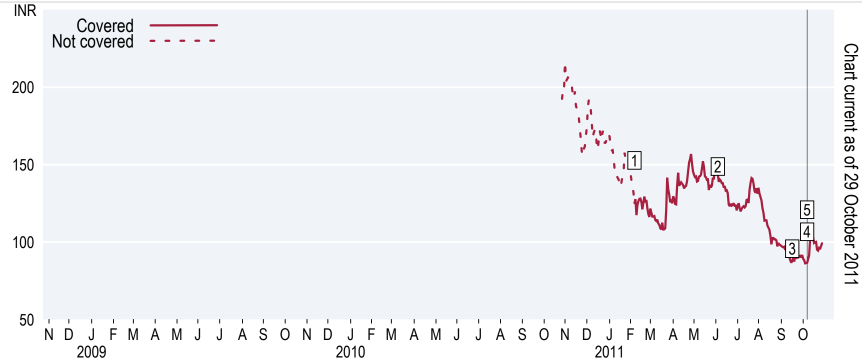
IMPORTANT DISCLOSURES

Prestige Estates Projects Ltd (PREG.BO)

Ratings and Target Price History
Fundamental Research

Analyst: Surendra Goyal, CFA
Covered since February 7 2011



	Date	Rating	Target Price	Closing Price
1	7-Feb-11	*1M	*170.00	125.20
2	3-Jun-11	1M	*174.00	143.40
3	16-Sep-11	1M	*133.00	87.80
4	7-Oct-11	Stock rating system changed		
5	7-Oct-11	*1	133.00	86.55

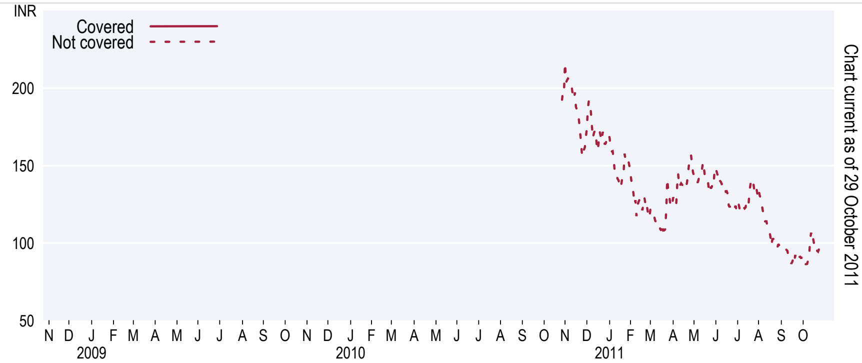
* Indicates change

Rating/target price changes above reflect Eastern Standard Time

Prestige Estates Projects Ltd (PREG.BO)

Ratings and Target Price History
Best Ideas Research
Relative Call (3 Month)

Analyst: Surendra Goyal, CFA
Covered since February 7 2011



* Indicates change

Rating/target price changes above reflect Eastern Standard Time

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Data current as of 10 Oct 2011	**Buy**	**Hold**	**Sell**	**Buy**	**Hold**	**Sell**
Citi Investment Research & Analysis Global Fundamental Coverage	59%	34%	7%	10%	79%	10%
% of companies in each rating category that are investment banking clients	45%	42%	37%	50%	43%	46%

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