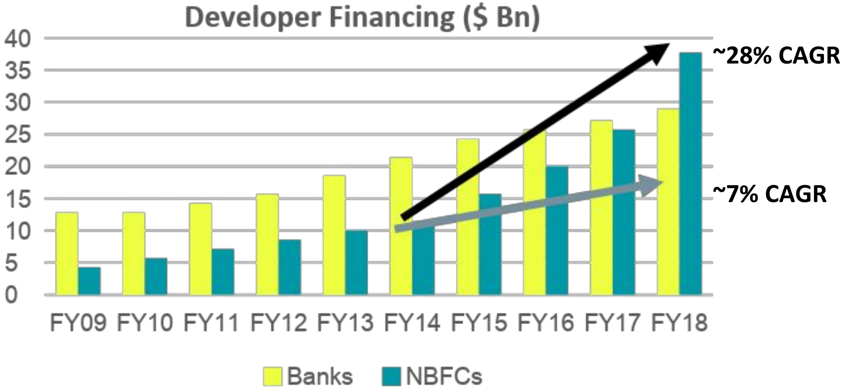
Prestige

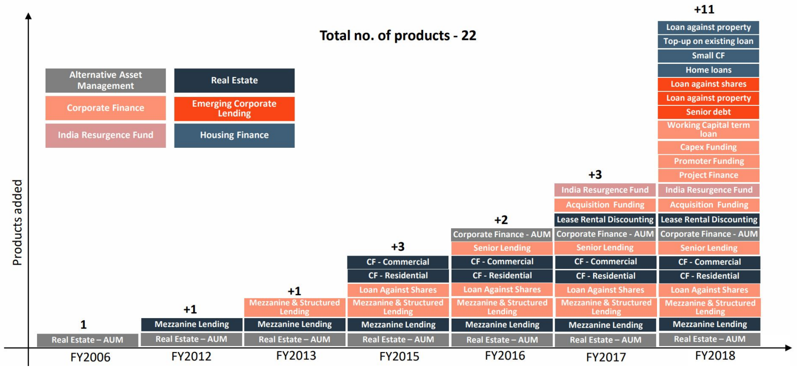
ESTATES

Real Estate: A Sectoral Thesis (1/2)

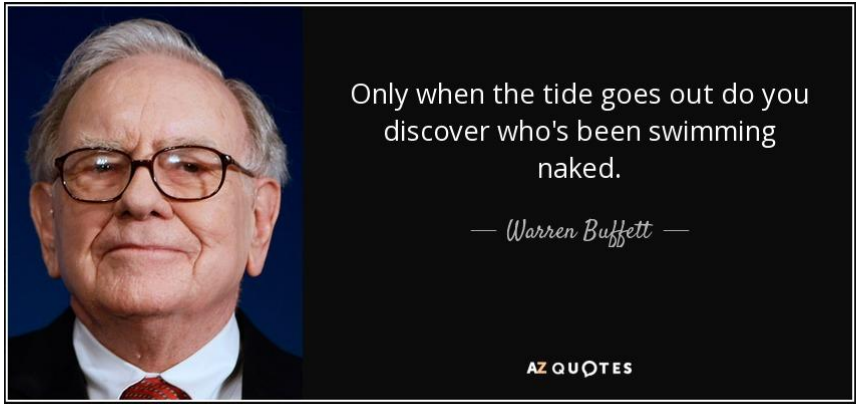


Sectoral concentration of capital: Mispriced Risk

....through consistently expanding product portfolio



As evidenced by Increased Lender Risk Appetite*



Developer Finance focused NBFCs majorly de-rated

Source: HDFC Securities, *Piramal Enterprises Q1FY19 investor presentation

Real Estate: A Sectoral Thesis (2/2)

Asset Base	• Loan Book degrowth (refinance); Reduction in wholesale RE exposure by NBFCs • Tier-2 & 3 Developers left with no access to capital
Liquidity	• ALM Mismatch prompting reduced short-term borrowings = Higher borrowing costs & yield • Smaller developers facing higher borrowing costs thereby squeezing margins
Risk Appetite	• Loss of RE wholesale credit risk appetite by listed NBFCs • Tier-2 developers left with stalled projects; Tier - 1 developers may cherry pick assets
RE Landscape	• Tier 1 developers continue to borrow from banks at historical cost of borrowing • Higher inventory pricing, lower cost of capital, inflow of patient capital in commercial RE and high yield sub-letting opportunities (co-living, co-working) prompting sectoral consolidation

Sectoral Consolidation + Changing Investment Climate (REITs, Subletting etc) + "Blood on the Streets"= BUY

Company Overview

- Prestige Group is a leading real estate development company based in Bangalore, India. Founded by Razack Sattar in 1986, the company has presence in 12 cities including Bangalore, Hyderabad, Chennai, Mangalore, Kochi, MMR and NCR.

- Key biz segments- Residential(~65%), Commercial/ office (~30%), Retail and Hospitality(5%).

- PEPL has completed 231 projects covering over 112.67 million sq ft, and currently has 49 ongoing projects spanning 48.73 million sq ft and 37 upcoming projects aggregating to 58.23 million sq ft of real estate space.

- Prestige is the only CRISIL DA1 rated Developer in India and was recently awarded the financial rating of A+ and A1+ by ICRA.

Revenue Streams

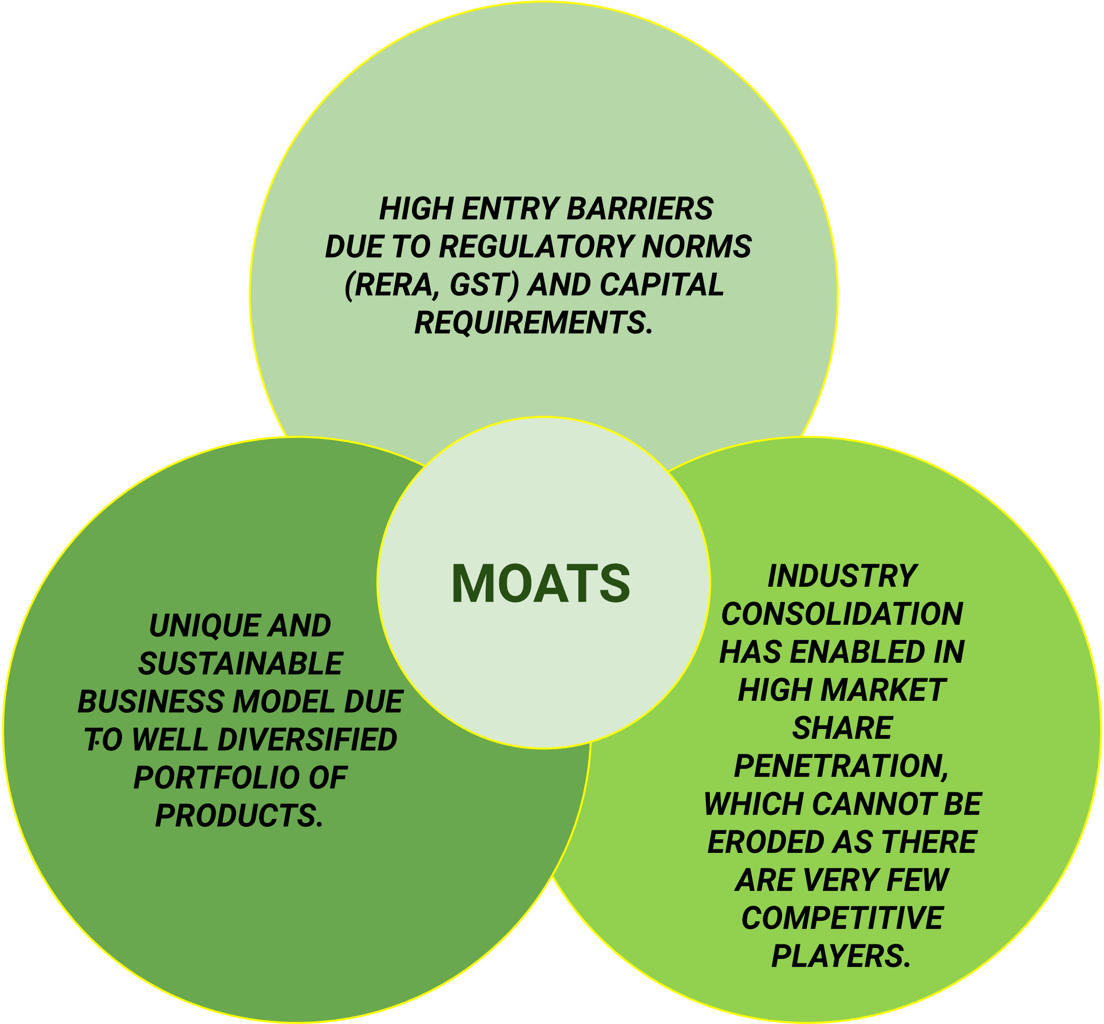
Key channels are:

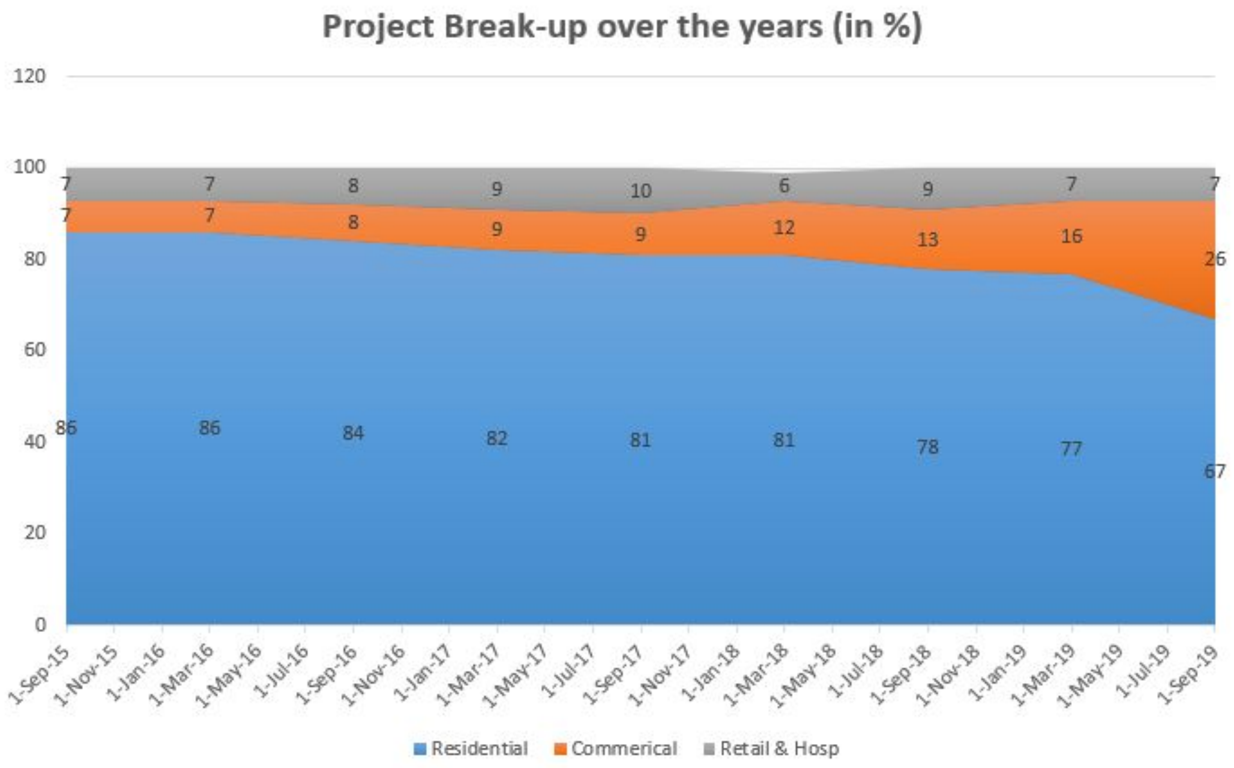
- **Residential Segment-** includes apartments, villas, integrated townships and plotted developments.
- **Commercial Segment**- (**Prestige Exora Business Parks Limited**) includes real estate comprising office spaces, built-to-suit campuses, SEZs (Special Economic Zones) and IT parks, etc.
- **Retail segment**- (**Prestige Retail Ventures Limited**) includes malls, logistics and food court developments.
- **Hospitality segment** - (**Prestige Hospitality Ventures**) includes hotels, resorts, convention centres and serviced apartments. The Group is also a **trusted partner for Hilton, Marriott, Starwood and Banyan and other illustrious brands**. **Services segment** of Prestige include Sub-Leasing & Fit-Out Services, Interior Design & Execution, Facilities & Property Management and Project & Construction Management Services.

Value Proposition

- **Established player in the South Indian Markets** (especially Bangalore) which **continues to exhibit strong fundamentals in both Residential and Commercial** RE**.**
- PEPL has **strong project execution capabilities** proven by its **track record** of project completions and delivery.
- Well **diversified business model** with consistent **cash in-flows from leased properties helps in times of adversities** (eg. recent economic slowdown, NBFC crisis) as it does not depend on project sales alone for revenue.
- **Good and Services Tax (GST) and Real Estate (Regulation and Development) Act, 2016 (RERA)** have changed industry dynamics and paved way for **consolidation in favour of established, organised and compliant players like Prestige.**
- **Consumer demand has been rising in favour of developers with credibility** and established track record of timely delivery. H2 FY 20 Prestige had 41% presales.
- **Mid-income housing platform with HDFC Capital** along with Govt push for affordable housing.

- Rapid urbanisation of India’s cities, coupled with large scale of commercial investments has led to strong absorption of office spaces in Indian cities and is expected to continue in the near term. **Single digit vacancies in cities like Bangalore (5.3%), Hyderabad (7.2%), Chennai (8.7%) and Pune (5.3%) due to sturdy demand for grade A office spaces is especially notable. Rentals growing between 4%-8% on a y-o-y basis.**
- With successful launch of **Embassy Parks Office REIT**, more companies are following the REIT route. Prestige has announced **plans to list its commercial portfolio in FY 21- providing a sustainable capital raising avenue and lowering leverage**.
- The company is gradually **shifting focus to Commercial RE** with the increase in demand for commercial office spaces (see graph next slide). At **present overall occupancy across all its leased assets is >95%**, generating **annualised rental income~ Rs 940 crore** (has grown five times since listing). Moreover, this segment provides financial flexibility being moderately leveraged with **debt-to-annual rental income of 4.4 times.**
- **Government measures to revive real estate** with recent **relief fund of 25000 Cr** and emphasis on affordable housing is improving buyer sentiment which may drive overall demand in next few quarters. More measures in the FY 21 Budget could boost demand.


HIGH ENTRY BARRIERS DUE TO REGULATORY NORMS (RERA, GST) AND CAPITAL REQUIREMENTS.
MOATS
UNIQUE AND SUSTAINABLE BUSINESS MODEL DUE TO WELL DIVERSIFIED PORTFOLIO OF PRODUCTS.
INDUSTRY CONSOLIDATION HAS ENABLED IN HIGH MARKET SHARE PENETRATION, WHICH CANNOT BE ERODED AS THERE ARE VERY FEW COMPETITIVE PLAYERS.



The project composition of Prestige estates has made a drastic shifts in the latest quarters where 10% of composition has shifted from Residential to Commercial, in a market where demand for offices has been been peaking.

Source: Investor Presentations

Associated Risks

- For organised players, **government's resolve to revive stuck projects may slacken market share consolidation towards organised players.**
- General sentiment towards the sector is as a whole is negative.
- **Property prices still remained elevated**, restricting volume-led demand. **NBFC funding and liquidity are still constrained and balance-sheet deleveraging is not yet visible.**
- **High level of unsold inventory in some high-end projects** - The sales velocity has remained low in some of the premium projects with high ticket sizes. The high value of the project's unsold stock, which are experiencing relatively slow sales, is impeding the company's capital.
- PEPL's liquidity profile is supported by cash balances of close to Rs. 800 crore as on September-2019. However, any **failure of payment obligations** from buyers could lead to **liquidity problems**.
- **Expansion to MMR and NCR where there is existing unsold inventory**- however, JVs without making direct investments in land could be helpful- Eg Aerocity.

	Sep-19	Jun-19	Mar-19	Dec-18	Sep-18	Jun-18	Mar -18	Dec -17	Sep-17	Jun-17	Mar-17	Dec 16	Sep-16	Jun-16
Rental Securitisation Loans	45	35	32	32	31	31	30	31	26.9	35.5	38.8	39.4	39.3	38.2
Project Debt Residential	21	40	44	43	43	38	35	29	35.5	26.9	25.2	25.6	25.8	31.8
Receivables Discounting Loans	19	9	10	11	12	16	17	20	18.4	18.4	18.4	17.9	18.7	16.1
Office Capex	6	5	3	3	3	4	4	6	5.6	5.6	5.4	5.5	5.3	3.5
Hospitality Capex	9	10	10	9	10	10	11	12	11.9	11.9	11.5	10.1	9.6	9.4
Retail Capex	0	1	1	2	2	2	2	2	1.6	1.6	1.5	1.4	1.4	1.1
DER	1.91	1.86	1.75	1.79	1.82	1.77	1.3	1.21	1.19	1.15	1.11	1.11	1.13	1.13

Latest results posted in Sept 2019, show a significant decline in Project debt to 21% from 41% in June 2019. Rental securitisation debt has increased 10% over the quarter.

***Despite the debt to equity ratio rising significantly since FY 19, due to IND AS 115 the ratios are not directly comparable to FY 18.**

Company Leverage

- 43% of this debt is pertaining to the **residential segment** . The company is expected to receive 1700cr from buyers upon completion of upcoming projects in the coming years.

- Debt is largely being backed by Rent securitization (45%) /Receivable discounting (19%) - both of which are a favourable due to low interest levels, hence the company **does not have to find liquidity to service debt levels.**

- PEPL plans to bring down residential debt to **0%** over the next quarters.

- **Capital churning in retail and hospitality** - Launches during the first half of FY20 were tilted towards commercial projects, with 6.2mn out of 7.9m sqft. The company plans to launch 10-12mn sqft of residential and commercial space in FY 20; these are essential to the companies target of reaching a **D/E of 1.4.x for FY 20.** By tapping new geographies lile Mumbai, Pune, NCR and Goa, the company plans to monetise under development commercial properties.

- Future collections (collection target of Rs 45-50bn for FY20 of which 49% is achieved in first half of FY20) to help reach targeted D/E.

Increase in debt is attributed to two factors:

Increase in debt is attributed to two factors:

1. Application of Ind AS

During the year, Ind AS 115 became applicable for the Group, and this resulted in revenue recognition from real estate activities on completion basis and has thus reversed revenue to the extent of 74,656 mn with consequential reduction in retained earnings by 10,119 mn.

2. Acquisition of CapitaLand's stake in SPVs

The Company completed acquisition of CapitaLand's stake in various SPVs for `3,420 mn. This resulted in increase in overall debt by `2,844 mn due to consolidation.

IND AS 115

- In Indian real estate sector had been calculating revenue on the basis of a **'Percentage Completion Method'** and not the **'Project Completion Method'**. In the former, the **developers treated payments received from the home buyers for purchase of under-construction flats, as turnover of the company** and the net income generated from such projects, was treated as profit.
- However, with the **Indian Accounting Standard IND AS 115** coming into effect from **April 1, 2018**, **real estate developers are now being forced to show the payments made by home buyers in an ongoing project, as loans and not as income from sales.**
- Developers can **no longer book profits on the 'Percentage Completion Method' and it has to be accounted as per the 'Project Completion Method' in accordance with global standards.** Any **buyer in an under-construction project can exit and seek a refund**.
- Standard business accounting, calculates any payment received before the transaction as an advance payment or loan. Henceforth, **buyers' payments in under-construction projects, would be treated as loans**.

Source: Housing.com

QUANTITATIVE ANALYSIS

Prestige Share - Sales Area And Value Trend (Rs mn)	1QFY18	2QFY18	3QFY18	4QFY18	1QFY19	2QFY19	3QFY19	4QFY19	1QFY20	2QFY20
Overall Pre-Sales - PS (msf)	**0.69**	**0.8**	**0.78**	**1.55**	**1.11**	**1.33**	**1.21**	**2.08**	**1..31**	**1.18**
Overall Sales Value - PS (Rs mn)	***4,510***	***5,278***	***5,231***	***10,482***	***7,638***	***7,974***	***9368***	***11222***	***8614***	***8296***
Realisation (Rs/sf)	**6,536**	**6,598**	**6,706**	**6,763**	**6,881**	**5,995**	**7742**	**5395**	**7119**	**7031**
Collections - PS (Rs mn)	**10,050**	**6,588**	**9,469**	**8,363**	**7,546**	**8,493**	**9334**	**9906**	**9058**	**8679**
Rental Income - PS (Rs mn)	**1,480**	**1,504**	**1,641**	**1570**	**1838**	**1817**	**1874**	**1958**	**2062**	**2229**
Leasing Volume - OA(mn sqft)	**0.1**	**0.27**	**0.35**	**0.18**	**0.33**	**0.24**	**0.33**	**0.42**	**0.32**	**0.31**

Important to note that 40% of sales from completed projects (RS 8.3 bn in 2QFY20)

Annuity Rentals Growth Trajectory PEPL share	FY13	FY14	FY15	FY16	FY17	FY18	FY19	FY20E
Rental Income (Rs mn)	2,541	2,495	3,264	4,468	5,429	6,194	7,487	8,460
Leaseable Area (mn sqft)	4.5	5.3	6.5	8.5	9.6	10.7	11.3	12.3
Rental/sqft/ Month	47.1	39.2	41.8	43.8	51.9	53.1	56.1	63.0

** Key points on next slide*

Prestige's strategy of shifting project types t**owards commercial and retail projects** has paid off well; recognising the increasing demand for office and retail spaces in India, company has still experienced increasing rental income even during times of consumer demand slowdown. Company continues to increase leasable area YoY

Improved pipeline of development projects

Annuity portfolio continues to generate strong cash flows

Income trends (YoY and QoQ)

Income Statement (Rsmn)	2QFY20	1QFY20	QoQ (%)	2QFY19	YoY (%)	2QFY20E
Net sales	19229	15387	25	12984	48.1	17624
Cost of goods	(10,844)	(7,643)	41.9	(7,266)	49.2	(10,882)
Employee benefits expenses	(1,103)	(1,007)	9.5	(1,049)	5.1	(1,089)
Other expenses	(1,183)	(1,460)	(19.0)	(1,009)	17.2	(1,059)
EBITDA	6099	5277	15.6	3660	66.6	4593
EBITDAM (%)	31.7	34.3	-	28.2	-	26.1
Depreciation and amortisation	(1,609)	(1,632)	(1.4)	(759)	112	(1,028)
EBIT	4490	3645	23.2	2901	54.8	3565
EBITM (%)	23.4	23.7	-	22.3		20.2
Other income	398	287	38.7	403	(1.2)	150
Interest expenses	(2,640)	(2,407)	9.7	(1,870)	41.2	(2,003)
Extraordinary/Exceptional Items	-	380	-	-	-	-
Profit before tax	2248	1905	18	1434	56.8	1712
Tax expense	(728)	(711)	2.4	(506)	43.9	(590)
Effective tax rate (%)	32	37	-	35	-	34
PAT	1520	1194	27.3	928	63.8	1122
Minority interest	466	86	441.9	54	(963.0)	-
Share of profit from associates	52	45	15.6	94	(44.7)	76
Adjusted net profit	1106	1153	(4.1)	968	14.3	1198

Key trends and takeaways

Profit growth of 64% YoY was driven by:
(1) Revenue growth of 48% and
(2) EBITDA margin expansion

2QFY20 Revenue of Rs. 19229 Mn up 48% YoY.
This was driven by PEPL's increase in share of commercial leasable area by 6% and retail leasable area up 32%

Y/E March (Rsmn)	FY18	FY19	FY20E	FY21E	FY22E
Net sales	54986	51719	60971	63566	67380
Growth YoY (%)	15.2	-5.9	7	4.3	6
COGS	38582	21873	37648	39600	41580
Operating costs	5464	15308	5710	5953	6394
EBITDA	10940	14538	17613	18013	19406
EBITDA growth (%)	18.9	32.9	4.8	2.3	7.7
EBITDA margin (%)	19.9	28.1	28.9	28.3	28.8
Depreciation	1547	3229	3664	3774	3963
EBIT	9529	11616	14113	14420	15642
EBIT (%)	17.3	22.5	23.1	22.7	23.2
Net interest expenses	3321	7228	4734	5159	5210
Other income	173	1122	512	512	512
Exceptional Items	-	894	-	-	-
Earnings before tax	6381	6404	9892	9773	10944
Tax- total	2135	1985	2490	2460	2755
Rate of tax (%)	33.5	31	25.2	25.2	25.2
Net profit	4246	4419	7402	7313	8190
Less: Minority interest	(533)	(263)	(263)	(263)	(263)
Adjusted net profit	3713	4156	7139	7050	7927
EPS Fully Diluted	9.9	11.1	19	18.8	21.1
EPS Growth (%)	40	12	72	-1	12

The rise in EBITDA margin on YoY basis is attributable to:

(1) Rental income rising by 23% YoY to Rs2,229mn and

(2) Lower cost of goods sold which is due to decline in land purchase cost 54% YoY to rs 2,823 mn in 2QFY20

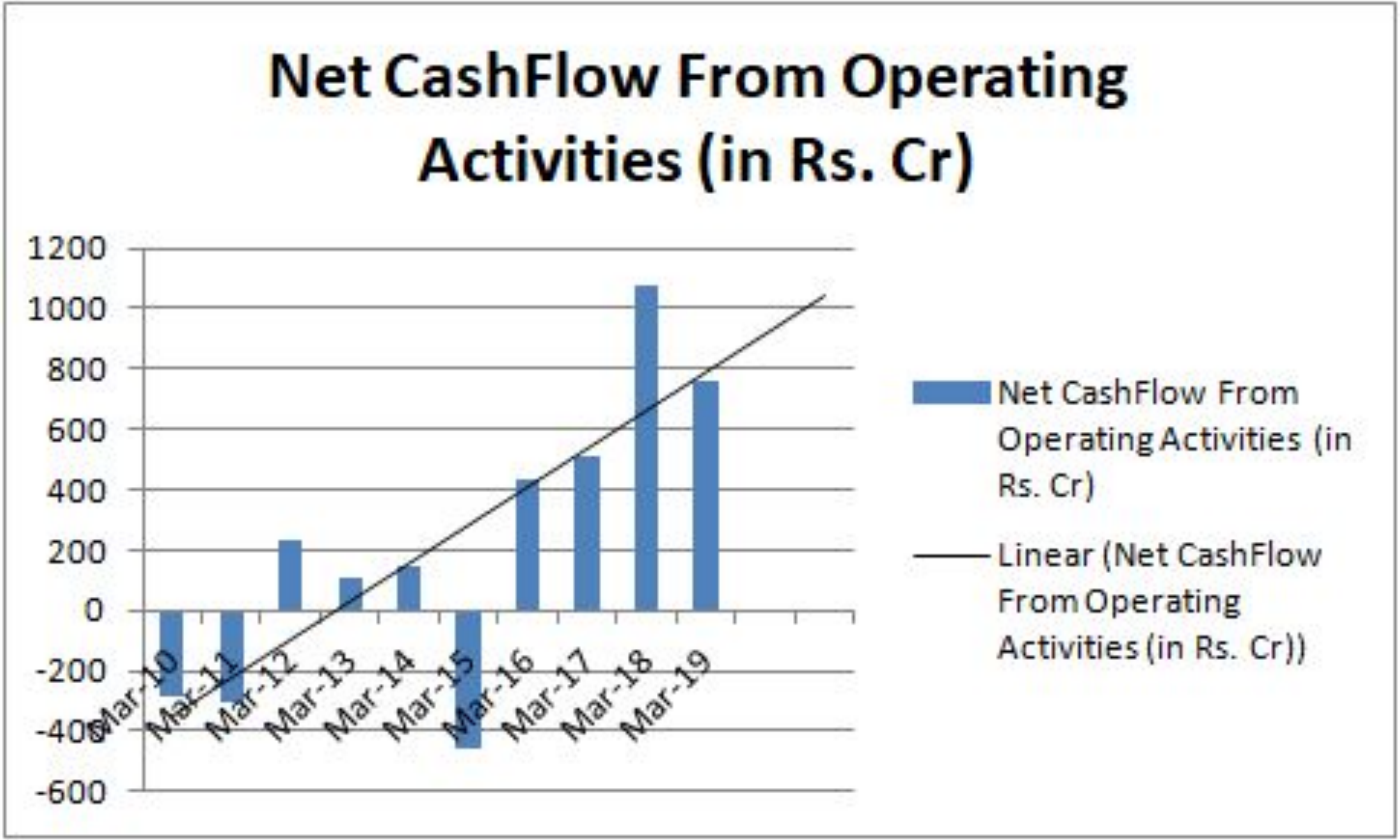
RATIOS

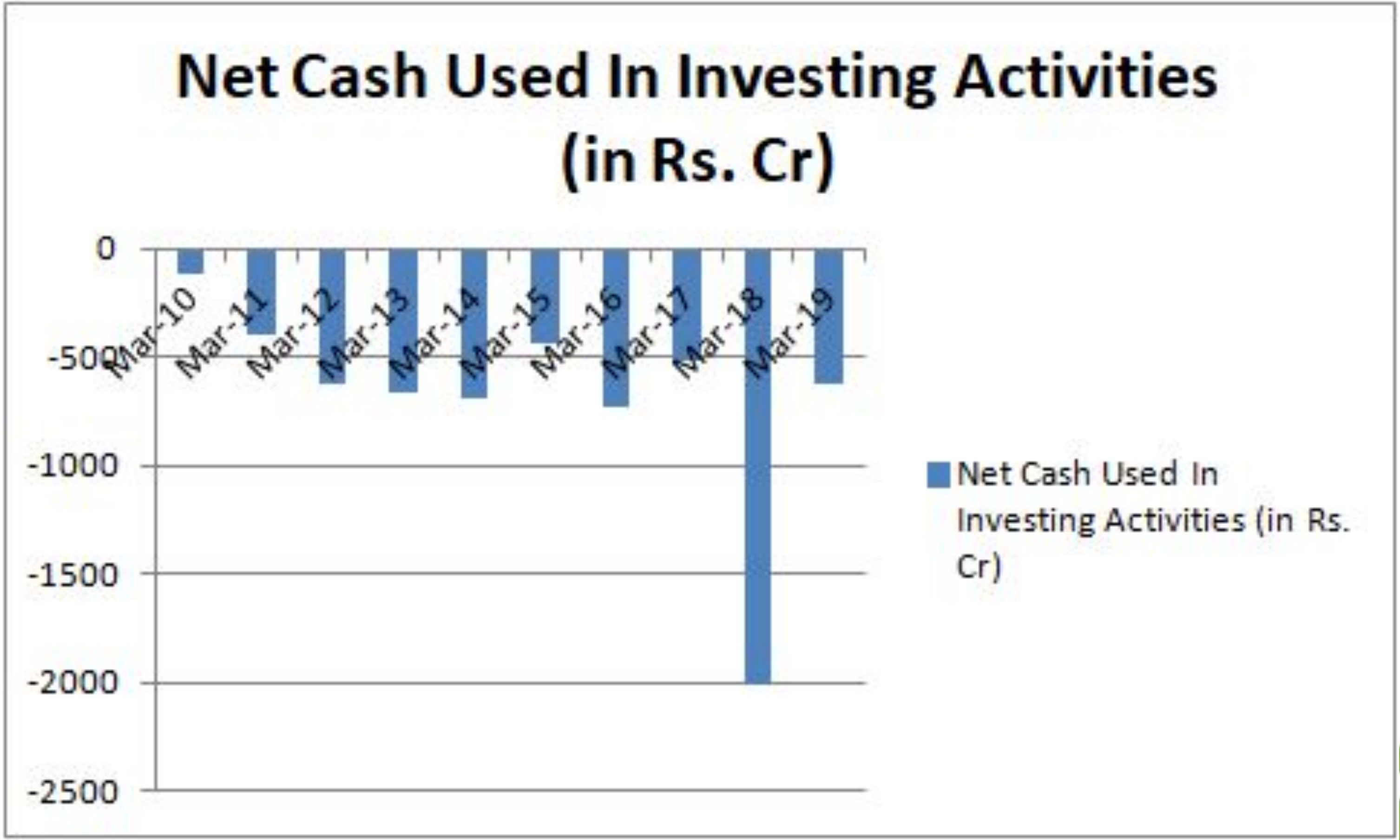
Y/E March (Rsmn)	FY18	FY19	FY20E	FY21E	FY22E
Profitability and return ratios					
EBITDA margin (%)	19.9	28.1	28.9	28.3	28.8
EBIT margin (%)	17.1	21.9	23.1	22.7	23.2
Net profit margin (%)	7.7	8.5	11.7	11.1	11.8
RoE (%)	9	10.5	11.9	10.6	10.6
RoCE (%)	8	9.8	9.5	8.8	9.2
Working capital & liquidity ratios					
Receivables (days)	64	117	75	75	75
Inventory (days)	540	2194	600	600	600
Payables (days)	128	124	128	128	128
Current ratio (x)	1.5	1.1	1.8	1.8	1.8
Valuation ratios					
EV/sales (x)	3.4	3.7	3.3	3.3	3.1
EV/EBITDA (x)	16.9	13	11.3	11.5	10.6
P/E (x)	30.4	27.2	15.8	16	14.2
P/BV (x)	2.4	2.7	1.8	1.6	1.5

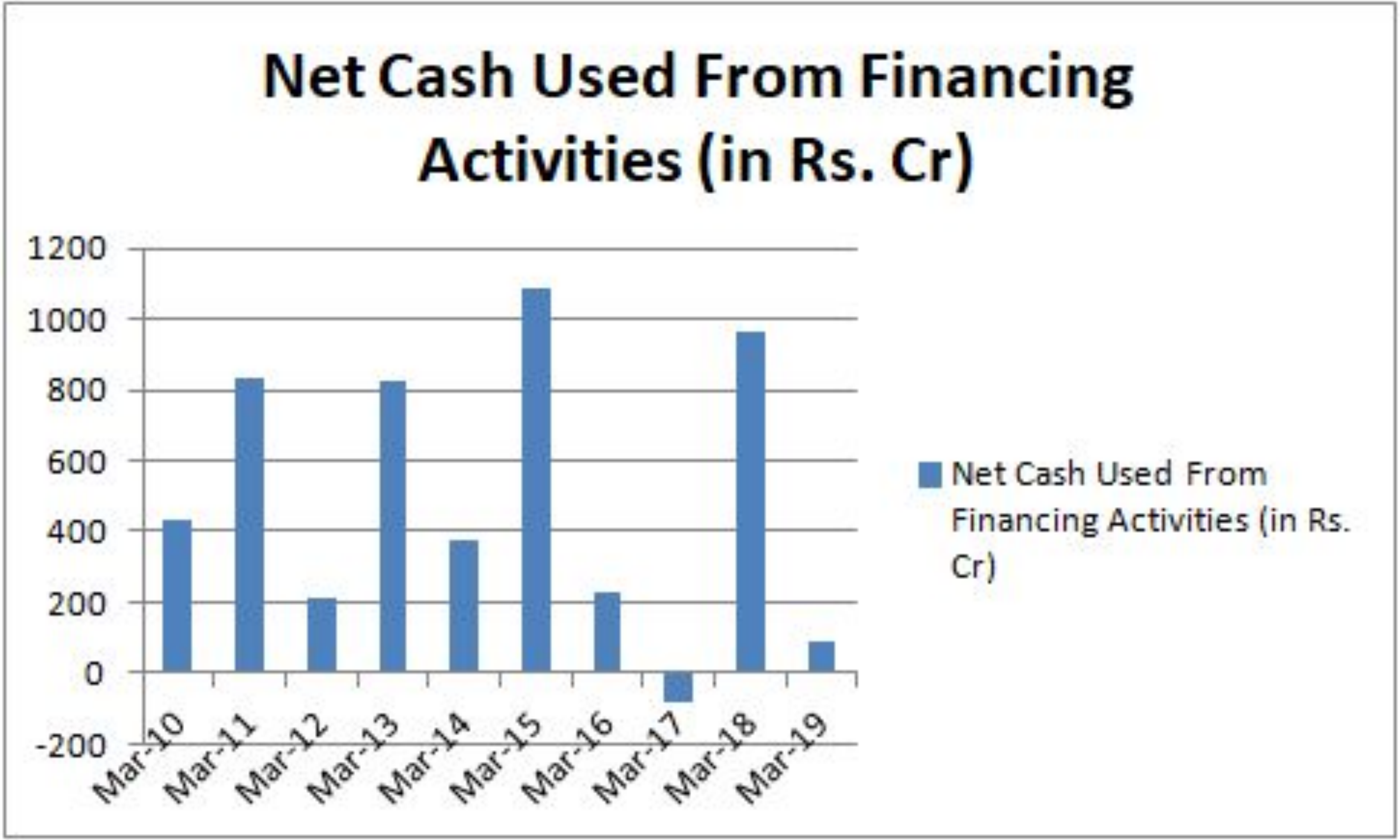
***Estimates sourced from Nirmal Bang PEPL research report**

Cash Flow Statement Analysis

- Cash from operations is consistently growing since the past 4 years.
- Linear forecast for cash from operations shows growth.
- A steep decline in cash from operations of Mar’15 is owed to a significant rise in inventories along with other current assets such as trade receivables and loans given.
- There is a sharp and abnormal increase in cash flow from investing activities for Mar’18 because the company under consideration acquired subsidiaries.
- There is no regular trend for financing activities.
- Whenever cash is generated from financing activities, it is majorly owed to the secured loans availed.


Net CashFlow From Operating Activities (in Rs. Cr)
1200
1000
800
600
400
200
0
-200
-400
-600
Mar-10
Mar-11
Mar-12
Mar-13
Mar-14
Mar-15
Mar-16
Mar-17
Mar-18
Mar-19
Net CashFlow From Operating Activities (in Rs. Cr)
Linear (Net CashFlow From Operating Activities (in Rs. Cr))


Net Cash Used In Investing Activities
(in Rs. Cr)
0
-500
-1000
-1500
-2000
-2500
Mar-10
Mar-11
Mar-12
Mar-13
Mar-14
Mar-15
Mar-16
Mar-17
Mar-18
Mar-19
Net Cash Used In Investing Activities (in Rs. Cr)


Net Cash Used From Financing Activities (in Rs. Cr)
1200
1000
800
600
400
200
0
-200
Mar-10
Mar-11
Mar-12
Mar-13
Mar-14
Mar-15
Mar-16
Mar-17
Mar-18
Mar-19
Net Cash Used From Financing Activities (in Rs. Cr)

Current Price: Rs 375.10

Market Capitalisation: Rs 14066 Cr

Analyst Take: BUY

Date: 20/01/2020

Analysts: Maria, Tarush and Vibhav