STALLION ASSET
CREATING ALPHA

Puravankara

CMP: Rs. 145 Weight: 5%

24/01/2018

PURAVANKARA

STOCK DATA

Market Cap(Rs. cr)	3438
Debt	1707
Cash	97
Enterprise Value	5048
Promoters Holding	75%
52 week high/low	182/44.55
Shares outstanding	23.71

KEY FINANCIALS (Rs. in Cr)

Y/E March	2014	2015	2016	2017
Revenue	1313	1690	1605	1428
Operating exp	835	1291	1244	1001
EBITDA	478	399	361	427
Depreciation	8	15	16	16
Interest Expense	227	224	217	250
Associates Share	0	(5)	(1)	5
PBT	243	155	127	166
Taxes	84	23	44	38
PAT	159	132	83	128

Conclusion – We believe Organized Real Estate is exactly at the same spot where NBFC's were in FY2014, the smart and aggressive real estate Builders can scale their operations a lot with competition from unorganized space struggling after RERA, GST and Demonetization. The Model has changed from low ROCE land bank to High ROCE Joint Development model which is a game changer.

PURAVANKARA LTD.

Thesis –

At Stallion Asset we have a consistent Philosophy of buying companies that can:

1) **Grow at more than 25%**
2) **Huge Opportunity Size**
3) **High Return on equity**
4) **Smart and Ethical Management**

Puravankara is a leading south based residential Real estate developer with major presence in Bengluru, Chennai, Hyderabad, Kochi. Company works under two brands "Purvankara" and "Provident". While premium apartments are sold under the former (50-150 lakhs) and affordable projects under the latter (25 to 50 lakhs).

Why Puravankara?

- Change in Industry dynamics due to RERA and GST
- Focus on Affordable Housing
- Shift in business model towards Asset Light, High ROCE Joint development model
- Strong cash flow expected in next few quarters
- Best margins in the Industry
- Leader of affordable housing in South India.

Organized Real Estate is exactly at the same position where private sector banks were in 2014, wherein they had a market share of 20% whereas Public sector banks had a share of 80%. Since PSU had started balance sheet clean up the growth between 2014-2017 was just 3%, where private sector banks and NBFC's were growing at 20-40%.

Here again in Real Estate 70-75% market share is dominated by unorganized players wherein they do not have the ability to build the next project as they are not able to sell their inventory in pre-booking as the customers don't trust them neither they can raise capital at cheap prices, add to this stringent RERA laws which make them uncompetitive.

About the industry

Real estate market is struggling with high inventory, negative growth in new launches and reducing price realisations. Demand is seen in selective pockets and we believe that affordable housing is going to be the major growth driver for the industry. **According to Cushman and Wakefield report, in 2017, overall new launches declined by 35% yoy whereas affordable housing segment grew by 6%.**

Category	2016	2017	% Change
Affordable	**29410**	**31241**	**6%**
Mid-Range	70915	37441	-47%
High End	11607	4943	-57%
Luxury	1112	331	-70%
Total	113044	73956	-35%

What falls under affordable?

Affordable is a very relative term and differs from location to location. To be eligible under PMAY scheme and avail the tax benefits, affordable housing includes units up to 30 square meters (carpet area) within the municipal limits of top 4 metro cities (Mumbai, Delhi, Chennai and Kolkata) and 60 sq. meters for other areas. Since 100% of the upcoming Provident Projects fall under this category it will benefit Puravankara in two ways i.e. it will not only get tax benefits (17% Tax Rate v/s 35 Currently) but will be able to sell its flats faster as majority of home buyers fall in this category.

Why are we bullish on the real estate industry?

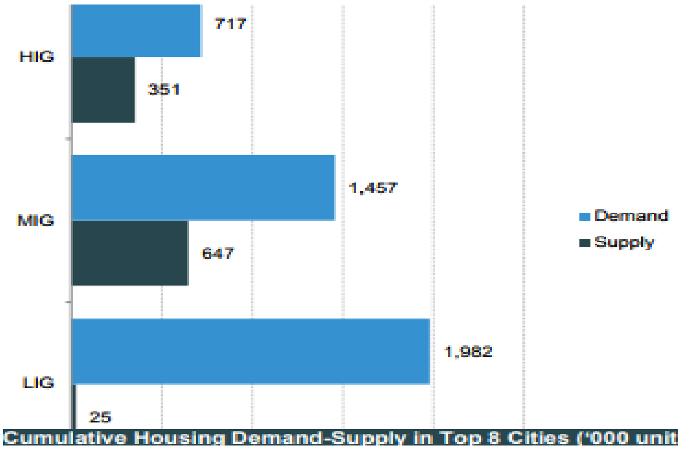
- **Major Reforms -** Real Estate sector had many hiccups like Demonetisation, RERA, GST only to emerge stronger. New launches have got affected severely because of the above-mentioned reforms but we strongly believe that it is a big positive for the organised real estate players like Puravankara specially the affordable housing projects under PMAY scheme as discussed later in the report.

- **Shift from unorganised to organised –** Almost 70% of the flats sold by Puravankara are first time buyers which means it is a necessity for them and these buyers normally spend 5-10x their annual earning to buy real estate. The most important thing for the customer is Trust and Timely delivery of project. As the cash component of the real estate market has reduced considerably due to RERA and demon, the small builders will not be able to survive for long. **In this scenario, the organised players with execution capabilities, good balance sheet strength and good cash flows will benefit the most.**

- **Cost of Capital –** The Cost of Debt Capital for unorganized players is 24% whereas for organized real estate players is at 8-11%.

H1FY2018	Cost of Debt
Puravankara	10.68%
Sobha	9.88%
Prestige	9.51%
Oberoi	less than 9%
Godrej	8.10%

- **Huge unmet demand on the affordable segment –** According to Cushman and Wakefield Report, between 2016-2020 the demand for MIG and LIG segment is 1.4 million and 1.98 million units respectively whereas supply been nowhere near to it.



Cumulative Housing Demand-Supply in Top 8 Cities ('000 units)

- **Changes post RERA -**
  1) **Better Execution**- Under RERA, builders must deposit 70% of the collected amount in escrow account so that the funds don't get utilised for any other project.

  2) **Reduced Probability of delay in Projects –** Under RERA, the company cannot book flats unless it has got all clearances and permissions in place. Under the pretext of booking flats, it was a common practice to block the home buyers money for longer duration. This practice will cease to exist.

  3) **Game Changed is that joint development Model after Demonetisation and RERA–** Joint Development model is extremely asset light model where in the builder tie –up with the land owner to jointly develop the land in a joint venture. The advantages to builders is that they save on legal costs, lower initial investment, which results in huge ROCE.

Let's take an Example of a 'Class A' Builder who can do Joint Land Development v/s Class B Builder who has to buy Land. The Class A Builder doesn't buy initial land but promises the land owner to give him 20-40% of Profits, hence there was no Initial Investment. The Class A builder now starts working on getting permission for next 6 months, remember there is no equity involved yet. After the builder gets the permission, they start marketing the Project and sell upto 50% of the project just by showing a photo of it, since Class A builder is a big brand, people are ready to trust it. The company gets enough money to fund the cost of construction and as the slabs are build the Class A builder keeps getting money from the Housing Finance company directly.

The Builder has made huge ROCE in this project without spending a penny on large capex for land. The New way of real estate is more scalable. This is not only good for the Builder but also the Land owner as he couldn't possibly sell a huge large parcel as the market is weak.

The Unorganized Builder on the other side has to borrow money at 20-24% and buy land, he is very unsure if he can get pre-bookings as people don't trust him, he is not a brand, and on top of that he has to comply with RERA norms which don't allow him to remove 70% of the money which he collects from clients as its kept in the escrow account.

About the Company – Purvankara

Puravankara is one of leading south based real estate company with 42% of the projects located in Bengaluru. It sells projects under two brands names i.e. 'Puravankara' for premium segment with average ticket size between 50 lakhs and 150 lakhs and 'Provident' for affordable segment with average ticket size between 25 lakhs to 50 lakhs.

Project Pipeline – This is what Attracted us most to Puravankara i.e. the confidence of the management to launch 9.23 Million Sq Feet in 6 months i.e. 3.16 million sq feet under Purvankara (Premium Brand) and 6.07 Million under affordable housing Brand. The Most Interesting thing here is that in last 6 years (april 2011 to September 2018) the total launch in affordable housing brand provident has been just 6.58 Million Sq feet and now that company is expected to launch the same amount in next 6 months, this will bring about Strong Accelerated Earnings Growth as affordable housing projects finish in 2.5 years historically from start date.

Location	City	Development Model	Development Type	Developable Area Msft	PPL Share in JD	Saleable Area Msft	Expected Launch Date
	Puravankara						
Lalbagh	Bengaluru	Joint Development	Residential	0.23	55%	0.12	Q3FY18
Thanisandra	Bengaluru	Joint Development	Residential	1.51	88%	1.32	Q4FY18
Bellary Road	Bengaluru	Joint Development	Residential	1.05	70%	0.73	Q4FY18
Kanakapura	Bengaluru	Joint Development	Residential	0.22	64%	0.14	Q3FY18
Kanakapura	Bengaluru	Joint Development	Commercial	0.70	60%	0.42	Q1FY19
Bhandup	Mumbai	Joint Development	Residential	0.20	45%	0.09	Q1FY19
Indiranagar	Bengaluru	Joint Development	Residential	0.17	50%	0.08	Q3FY19
Bavdhan	Pune	Joint Development	Residential	0.31	84%	0.26	Q1FY19
			Total	**4.39**		**3.16**	
	Provident						
Mallasandra	Bengaluru	Joint Development	Residential	1.88	87.50%	1.64	Q4FY18
Thirumazhsai	Chennai	Joint Venture	Residential	3.81	25%	0.95	Q4FY18
Sampigehalli	Bengaluru	Owned	Residential	0.22	100%	0.22	Q4FY18
Thane	Mumbai	Joint Development	Residential	1.50	64%	0.95	Q1FY19
Goa	Goa	Joint Development	Residential	1.82	86%	1.56	Q4FY18
Kondwa	Pune	Joint Development	Residential	1.09	70%	0.75	Q1FY19
	Total		**Total**	**10.32**		**6.07**	
			Grand Total	**14.71**		**9.23**	

Mega Launches in 6 months

6.07 Mln Sq Feet in Provident

All Projects under Asset light Joint Development

Why Puravankara?

1) Strong cash flow expected

Cash Flow (In Cr)	Purvankara	Provident
Inventory Open for sale	**3445**	**839**
Balance cost	1095	284
Surplus	3296	957
Inventory not open for sale	**1548**	**878**
Total Estimated Surplus*	4993	1717

*Surplus for residential projects only

Residential projects form 95% of the total projects. The expected surplus from inventory open for sale of Puravankara and Provident together is 4253 Cr. We believe that most of the surplus will come by FY19 end which they can use for starting new projects. The management has guided to launch 14 new projects in next 12-15 months for a cost of 3200 Cr out of which 10 million sq ft will be under Provident Brand. This cost will be funded by the cash flows coming for complete and near completion projects.

2) Focus on Affordable Housing

Company sells residential units under two brand names namely Puravankara for premium segment(50-150 lakhs) and Provident for affordable segment (25-50 lakhs). **Company intends to launch 10 million sq ft of new projects under Affordable segment brand i.e. Provident in FY19. Only 15-18% of the current Provident Projects can avail 80-IB benefit but in the latest con call, management has said that going forward 100% Provident Projects will fall under 80-IB as those projects were launched before the scheme was announced.**

What is 80-IB?

Under this section of the Income tax act, the property developer gets 100% deduction on the income from a project which is launched between June 2016 and March 2019 and is completed within 3 years from its starting date and hence there will be accelerated launch of project in FY2019 as developers were waiting in FY2017-2018 to get clarity on Demonetization, RERA and GST.

Purvankara	Q2FY18	Q1FY18	Q4FY17	Q3FY17	Q2FY17	Q1FY17	Q4FY16	Q3FY16
Area Sold (Msft)	0.53	0.32	0.41	0.29	0.35	0.32	0.2	0.23
Sale Value (In Cr.)	326	177	239	175	211	187	75	127
Sales realizations (Rs. In psf)	6281	5685	5759	5917	5849	5839	4626	5326

Provident	Q2FY18	Q1FY18	Q4FY17	Q3FY17	Q2FY17	Q1FY17	Q4FY16	Q3FY16
Area Sold (Msft)	0.27	0.18	0.18	0.22	0.11	0.1	0.56	0.14
Sale Value (In Cr.)	112	76	76	99	50	39	126	45
Sales realizations (Rs. In psf)	4143	4055	3989	4341	4343	4033	3355	3310

As on Q2FY18, company has total 4.81 msqft of inventory under near completion and under construction projects. The Company has been launching most of the new projects in Joint Development model under its affordable brand provident. The Company is super confident on provident and will be launching 9.23 Million Sq Feet in next 6 months.

In MnSqft	Completed Projects	Ongoing Projects	Upcoming Projects	Land Bank
H2FY18	**34.06**	**21.64**	**23.11**	**50.43**
FY17	30.72	24.92	19.44	53.32
FY16	27.23	23.64	22.35	61.73
FY15	24.4	24.01	22.73	59.3
FY14	20.39	28.43	23.54	58.17
FY13	16.52	28.04	22.96	58.61

	Booking Sq Feet	Value in Crores	Average Realization/Sq Ft
H1FY2018	1.38	736	5333
FY2017	2.15	1168	5433
FY2016	2.02	907	4490
FY2015	2.94	1471	5003
FY2014	3.57	1590	4454
FY2013	3.91	1493	3818
FY2012	2.36	842	3568

Inflection Pt.

Poor Demand

We believe that in FY18 their sales value of total bookings will cross 1600 Crores which was the peak in last 6 years (FY14) and this uptick will continue at a faster pace with expected sales bookings of 2000-2200 Cr plus in FY19.

Though the average realisations are expected to fall as the majority bookings will come from Provident segment i.e. Affordable segment.

3) Debt to equity

Debt is the most important component after cash flows for the real estate players. Total debt on the balance sheet shows the strength of the company and ability to take up more projects. Historically all the big real estate developers of the country like DLF had huge land parcels.

FY17	Debt to equity	Debt	Land Bank Exposure
Puravankara	**0.78**	**2066**	**Medium**
Sobha	0.84	2222	High
Prestige	1.29	5739	Medium
Kolte	0.88	761	Low
Oberoi	0.15	869	Low
Godrej	1.99	3499	High

Huge land bank and High Debt goes hand in Hand. Post RERA, we have seen a major change in the business model of the real estate players. The new trend which we will see in the next 5 years is the Joint development model. This means that the company ties up with the land owner to jointly develop that piece of land in a predetermined JV ratio. The biggest advantage is that the intial investment will reduce drastically. **Puravankara's all upcoming Projects are going to be under Joint Development in micro markets of Bengaluru, Hyderabad, Kochi, Pune, and Goa.**

The Company sold its 19acres land worth 450 Crores to cut down its debt in March 2017. The company used the proceedings to cut down its debt. Since Puravankara is using Joint Development model for future projects we will the debt/Equity position will stay at a comfortable level of 1x Debt to Equity.

4) Best Margins in the Industry

FY17	EBITDA (In Cr.)	EBITDA Margin (%)
Puravankara	467	33.19%
Sobha	471	21.13%
Prestige	1019	21.34%
Kolte	248	25.67%
Oberoi	617	55.39%
Godrej	400	25.27%

Ebitda Margins of Puravankara are among the best in the Industry after Oberoi. The reason Oberoi has better margins is because part of its business comes from rental incomes (from commercial properties) which typically have high EBITDA margins.

We expect the margins to remain at 25% as more launches are expected on the Affordable housing side which has lower realisations of 3500-4500 depending on whether it is completed or ongoing project. The cost of construction per sq ft is Rs 2500.

Valuation – Valuation of Real Estate is a Tough Task as most analyst use NAV, others use Land bank, some say free cash flows and lately some people have used P/B as well as EV/EBITDA in their forecast.

	FY19 NAV	CMP	CMP/NAV
Puravankara	**225**	**145**	**64.4%**
Oberoi	472	508	107.6%
Godrej	741	855	115.4%
Prestige	377	319	84.6%
Phoenix Mills	719	629	87.5%
Sobha	543	592.5	109.1%
Brigade	365	298	81.6%
Kolte Patil	335	380	113.4%
Sunteck realty	481	421	87.5%
Average			94.6%

***Analyst Estimates**

Puravankara is trading at a discount to NAV, whereas the average of the sector is 95%, Puravankara trades at 64.4% NAV. NAV is calculated using the Surplus cash a developer will achieve post expenses. We believe Puravankara should trade at premium to NAV as for next 2-3 years as they are working a high ROCE Joint Development model whereas except Godrej all other companies are still working on Lower ROCE land bank model.

FY2017	EV/EBITDA	ROCE (%)
Puravankara	**12**	**7.40%**
Oberoi	30	6.08%
Godrej	54	4.83%
Prestige	17	4.79%
Phoenix Mills	15	7.47%
Sobha	16	5.53%
Brigade	11	7.64%
Kolte Patil	14	8.27%
Sunteck realty	19	9.73%
Average	21	6.86%

The ROCE of the Industry has been just 7%, whereas the average EV/EBITDA Multiple is 21 for FY2017. Purvankara trades at Discount Multiples to Industry average though Oberoi and Godrej trade at premium due to their strong brands. We don't think EV/EBITDA is the right way to value real estate companies, but this is just to showcase that as the Brands Name of a company increases, so does it valuations.

Purvankara is Expected to generate strong free cashflow as all future projects are done under joint development model and we expect ROCE to improve materially as the tax rate are just MAT rates of 17% in all provident projects which will be booster to the prospects of the company.

Conclusion – We believe Organized Real Estate is exactly at the same spot where NBFC's were in FY2014, the smart and aggressive real estate Builders can scale their operations a lot with competition from unorganized space struggling after RERA, GST and Demonetization. The risk of black money in Real Estate Builder i.e. siphoning off money has reduced sustainably as majority of houses are bought by first-time home buyers on home loans, so the revenue is fully white, and the best part is that they don't have to pay a lot of taxes under Section 80IB, so taking on black money just doesn't make any sense. We believe the best is going to come in FY2020 for these real estate players and expect asymmetric gains here.

Analyst Position- Amit Jeswani and Family have no Positions.
Juhi Shah-no positions

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