



Prestige Estates Projects Limited

Issue Details

Prestige Estates Projects Limited (PEPL) is proposing to come out with an Initial Public Offer to raise fresh equity of Rs. 1200 Crores, through the book building route. Post the IPO, the shares will be listed on the Bombay Stock Exchange (BSE) and the National Stock Exchange (NSE).

Proposed Use of IPO Proceeds

The IPO proceeds are proposed to be used in the manner as stated in Table 1:

Table 1: PEPL's utilisation of IPO Proceeds

S. No.	Expenditure Items	Amount to be financed through Net Proceeds (in Rs. Crores)
1	Finance ongoing & under development projects	428.8
2	Investment in subsidiaries	193.2
3	Finance acquisition of land	21.4
4	Repay certain loans	280.0
	Sub-Total	923.40
5	General Corporate Purpose	-

Source: RHP

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IPO Grading

ICRA has assigned an IPO Grade 3, indicating average fundamentals, to the proposed Initial Public Offer (IPO) of Prestige Estates Projects Limited (PEPL). ICRA assigns IPO gradings on a five-point scale of IPO Grade 5 through to IPO Grade 1, with Grade 5 indicating strong fundamentals and Grade 1 indicating poor fundamentals.

An ICRA IPO Grade is a symbolic representation of ICRA's current assessment of the fundamentals of the issuer concerned. The fundamental factors assessed include inter alia business and competitive position, financial position and prospects, management quality, corporate governance and history of compliance and litigation.

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Key Grading Considerations

Strengths

- Proven track record in executing projects in Bengaluru with reputation for quality delivery of projects; strong brand positioning
- High level of bookings in the on-going residential projects like “Shantiniketan” provides visibility to near term revenues and cash flows
- Strong in-house project management capability coupled with the company’s practice of using reputed construction entities moderates the execution risk in ongoing projects
- Business model of JDAs with the landowners, which requires lesser capital investment and also limits the downside risk
- Revenues are also supported by sizeable rental income, which is stable source of cash flow

Concerns

- Currently, the company’s operations are largely concentrated in Bengaluru, exposing the group to single market risk; the success of its projects in newer geographies remain to be seen
- Market risks for the company’s commercial and retail development remains high, also the company’s focus on this segment is increasing
- Profitability and return parameters of the company have historically been on the lower side when compared to its peers
- Group’s revenue in near term would be guided by few large scale projects like “Golfshire”, “Shantiniketan” and “White Meadows”, any delay or collection issue in these projects can affect the financials significantly
- Execution risks associated with large scale of projects in next four years

Grading Rationale

The IPO grade assigned by ICRA takes into account PEPL’s proven track record in executing projects in Bengaluru with reputation for quality delivery of the projects; the good market response for PEPL’s ongoing residential projects, reflected by a high level of bookings and customer advances that is expected to result in healthy growth in revenues and profitability going forward; and relatively low commitment in terms of land payments due to its business model of entering into Joint Development Agreements (JDA) with the land owners for most of the projects, which would result in comparatively lower capital intensity for the business. The grading also considers the strong portfolio of rental yielding assets in commercial as well as retail segments that would provide a steady cash flow to the company and the benefits expected from the partnership with CapitaLand Retail India Investments Private Limited for mall developments. ICRA also notes that the revival in sentiments in real estate market esp. in residential segment as indicated by lowering of inventory and steady transactions augurs well for the company.

The grading is, however, constrained by PEPL’s increased exposure to commercial projects in medium term which would result in high funding requirements despite the JDA model and the single market concentration risk as currently group’s operations are largely concentrated in Bengaluru. ICRA notes that PEPL is diversifying into newer geographies like Mangalore, Kochin, Chennai, Mysore and Hyderabad, however its ability to compete and execute projects in these areas, as well as ensure market acceptance for the same, are yet to be demonstrated. ICRA also notes that despite improving sentiments, the sluggish demand in commercial and retail segment can be a potential challenge for the company given that the company has a fairly large portfolio of on-going projects under execution in these segments. Also the company’s profitability ratios and return parameters have historically been low primarily due to some large projects which had comparatively low margins. While ICRA expects profitability to improve going forward due to several premium ongoing projects, the company’s revenue and profitability in the near term would be guided by a few very large scale projects like “Golfshire”, “Shantiniketan” and “White Meadows”. Any delay in executing these projects, or less than anticipated sales and collections could impact the financial performance significantly.

Entity Profile

Prestige Estates Projects Limited (PEPL) is the flagship company of Prestige Group¹ - a leading real estate developer of South India, engaged in development of integrated townships, hotels, resorts, spa, industrial parks, golf course, retail malls, high-end residential & commercial complexes, etc. The Prestige group was founded in 1986 by Mr. Razack Sattar. The company commenced operations as a partnership and later was registered as a private limited company with the name Prestige Estates Projects Private Limited. Finally the company was converted into a public limited company on November 10, 2009 with the name Prestige Estates Projects Limited.

Prestige Group has over 24 years of experience in real estate development, and is one of the leading real estate development companies in south India. Prestige Group has completed 150 real estate projects aggregating to approximately 34.23 million sq. ft of built-up space. It has developed a diversified portfolio of real estate development projects focusing on projects in the residential (including apartments, villas, plotted developments and integrated townships), commercial (including corporate office blocks, built-to-suit facilities, technology parks and campuses and SEZs), hospitality (including hotels, resorts and serviced accommodation) and retail (including shopping malls) segments of the real estate industry. The Group currently owns or holds development rights for 57.36 million sq. ft. of developable area, which includes 28.43 million sq. ft. of saleable area and 11.04 million sq. ft. of leasable area

Promoters and Management

The company commenced operations as a partnership firm name of Prestige Estates and Properties. The partners of the firm were the Late S. Razack, Irfan Razack, Rezwan Razack and Sameera Noaman. The partnership firm was reconstituted on March 31, 1997 between Late S. Razack, Irfan Razack, Rezwan Razack, Sameera Noaman, Noaman Razack, Rabia Razack, Badrunissa Irfan and Almas Rezwan. The name of the firm was changed to Prestige Estates Projects by a supplementary deed of partnership dated May 12, 1997. The firm was registered as a private limited company with the name Prestige Estates Projects Private Limited Later the company was converted into a public limited company on November 10, 2009 with the name Prestige Estates Projects Limited.

The promoters have been associated with the real estate business since 1981. Its Board of Directors has six Directors, of whom four are Independent Directors. Mr. Irfan Razack is the Managing Director of PEPL while Mr. Rezwan Razack is the Joint Managing Director of PEPL.

Table 2: Shareholding Pattern

SL. NO.	NAME OF THE SHAREHOLDER	NO. OF SHARES HELD	% OF HOLDING
1	Irfan Razack	6,5625,000	25%
2	Rezwan Razack	6,5625,000	25%
3	Noaman Razack	6,5625,000	25%
4	Sameera Noaman	1,6406,250	6.25%
5	Badrunissa Irfan	1,6406,250	6.25%
6	Almas Rezwan	1,6406,250	6.25%
7	Other	1,6406,250	6.25%
	TOTAL	26,2500,000	100%

Source: DRHP

Corporate Governance

PEPL's Board has six Directors and the Chairman of the Board of Directors is Mr. Irfan Razack. The Board consists of four independent directors. Also the company has constituted committees such as Audit Committee, Investors Grievance Committee and Remuneration/compensation committee to comply with corporate governance requirements.

¹ The Group refers to PEPL, its subsidiaries and other entities in which company or promoters have significant interest, while PEPL consolidated includes PEPL and its subsidiaries.

Business and Competitive Position

Demonstrated capability in developing residential and commercial projects; Completed projects are largely concentrated in Bengaluru

PEPL develops a wide range of residential projects, from luxury apartments and villas to townships, focussing on the middle and upper income segments of the residential property market. It also builds commercial projects such as corporate office space, SEZs, technology parks and built-to-suit facilities for both outright sales as well as for lease. Prestige Group has completed 150 real estate projects of aggregating to approximately 34.23 million sq. ft of built –up space in past twenty five years. It has developed a diversified portfolio of real estate development projects with projects in the residential, commercial, hospitality and retail segment.

Table 3: Break up of completed projects

Type of property	Since Inception		In last 5 years	
	Approximate Developed Area (million sq. ft.)	% of Developed Area as per Type of Property	Approximate Developed Area (million sq. ft.)	% of Developed Area as per Type of Property
Residential	21.71	63.41%	11.52	58.46%
Commercial	10.59	30.94%	7.14	36.26%
Hospitality	0.55	1.62%	0.35	1.79%
Retail	1.38	4.03%	0.69	3.49%
Total	34.23	100%	19.70	100%

Source: RHP

Some of the more well known projects build by the Group include “Prestige Shantiniketan” , an integrated township development in Bengaluru; “UB City”, a large mixed-use development in Bengaluru's Central Business District and The Forum Mall in Bengaluru,

Business model of entering into Joint Development Agreements (JDA) with the land owners for most of the projects, which results in comparatively lower capital intensity for the business

PEPL, as a part of its business model, enters into joint development agreements with the landowners to acquire development rights on land in exchange for a pre-determined portion of revenues/profits or built-up area generated from the project. This strategy provides PEPL access to development rights on the land parcels without having to invest large amount of money as would have been the case in outright purchase, thereby resulting in lower capital intensity and decreasing its risk profile as well. PEPL’s responsibility includes the complete designing, development, marketing and selling of the project whereas the landowner’s contribution is the unencumbered land with a clear title on which the project will be developed. Generally the ratio of share between PEPL and the landowner is fixed at the time of the agreement by valuing the land and estimating the potential value of the project to be developed on that land parcel. In some cases, PEPL has option to buy back land owner’s share which can provide upside to company if it expects realisation to be higher.

Table 4: Some key projects through JDA/JV route

Project	Developable Area	JD Ratio/Economic Interest
Atrium	171,540	50%
Shantiniketan	5,311,909	83.20%
Cessna Business Park B5 to B11	5,279,031	60%
Cyber Towers	688,460	72%
Polygon	659,499	60%
Exora Business Park	2,961,164	55%
Valdel	1,787,404	60%
White Meadows -2	1,163,411	62.50%

Source: RHP

Management focussed on diversifying into newer geographies like Mangalore, Kochin and Hyderabad, however its ability to compete and execute projects in these areas, as well as ensure market acceptance for the same, are yet to be demonstrated

PEPL's real estate development activities have been focused in Bengaluru, and a major portion of the ongoing projects are also in Bengaluru. The company is, however, in the process of geographically diversifying and expanding the business into the south Indian cities of Cochin, Hyderabad, Chennai, Mangalore and Mysore. It has a total of 15 projects outside Bangalore accounting for almost 27 % of the total ongoing, under development and forthcoming projects floor area. While the entry in other geographical areas will help the company to reduce its current concentration in Bengaluru market, its ability to compete with established players in other markets is still to be demonstrated. Nevertheless, its strong brand name and proven track record of timely completion and quality construction is expected to help the company in these places also.

Significant scale-up of operations planned; execution risk partly mitigated by partial in-house construction capability, and company's strategy to outsource work to reputed contractors and project management companies

The group currently own or hold development rights for 57.36 million sq. ft. of Developable Area², which includes 28.43 million sq. ft. of Saleable Area and 11.04 million sq. ft. of Leasable Area. The following table sets out the number of Ongoing Projects, Projects under Development and Forthcoming Projects Company has in cities across south India as at August 31, 2010:

Table 5: Project pipeline – ongoing, under-development & forthcoming projects

City	No. Of Ongoing, Under Development & Forthcoming Projects	Developable Area (in million sq. Ft.)
Bangalore	39	41.789
Chennai	6	7.95
Cochin	4	2.74
Hyderabad	2	2.12
Mysore	2	1.9
Mangalore	1	0.76
TOTAL	51	57.36

Source: RHP

These projects will be executed over the next three to four years horizon and thus the scale of operation is expected to significantly increase going forward. This exposes the company to significant execution risks, as part of its efforts to enhance its execution capabilities; PEPL in 2009 acquired 75% of Team United, a construction company in South India, with the aim of developing in-house construction capability. Team United is engaged in over five of the ongoing projects and the company aims to strengthen this construction unit going forward. Nevertheless, its reliance on various sub-contractors or specialist agencies to construct and develop projects remains high.

Strong portfolio of rental yielding assets in commercial as well as retail segments that would provide a steady cash flow to the company;

The company has two broad sources of rental income – revenue from operation of malls & other retail space, revenues from operation of hospitality establishments and rental income for the lease of commercial projects & fit out for office projects. PEPL, on consolidated basis - had booked ~ Rs 105 Cr of income from these two or three sources. With addition of some of the large commercial properties like “Exora”, “Cessna” & “Valdel”, and new Forum Malls, the rental income will increase significantly going forward. Also the property management and maintenance related income will proportionately increase as more and more yielding assets are added to the portfolio. This steady and stable source of cash is strength for the company.

Further, PEPL has entered into joint venture with CapitaRetail India Development Fund Investments (Mauritius) Limited (CRIDF), an associate of CapitaMalls Asia for all future projects for development of retail malls. CapitaMalls Asia is one of the largest listed “pure-play” shopping mall owners, developers and managers in Asia by total property value of assets and by geographic reach. The joint venture with CRIDF is aimed at developing retail projects in south India in cities such as Bengaluru, Mysore, Mangalore, Hyderabad and Cochin. The total Developable Area and Leasable Area under these joint

² The developable area includes the JDA portion as well

venture projects will be approximately 5.61 mn sq. ft. and 1.83 million sq. ft., respectively. This JV would further strengthen the company's execution and property management capability and will provide increased visibility on rental income from retail properties.

Market risks for the company's commercial and retail development remains high, also the company's focus on this segment is increasing

Of 34.23 million sq. ft of developable area built by Prestige group since inception, 37% comprise non residential segment – commercial, retail & hospitality. The share of non-residential segment has been high in past five years (41% of total developed area in past five years). Company's increased focus in commercial and retail/hospitality segment in medium term is signified by 55% share of this segment in total developable area across all ongoing projects. Given this scenario where company has a fairly large portfolio of on-going projects under execution in these segments, ICRA notes that, despite improving sentiments, the sluggish demand in commercial and retail segment can be a potential challenge for the company.

Land reserves

The company has a stated objective of acquiring more land as it considers land reserves critical to increasing market penetration across the various market segments. The total land reserves as on October 31, 2009 stand at approximately 831.36 acres, aggregating to approximately 53 million sq. ft. of Developable Area. Out of the total land reserves, 41% is registered in the name of the company and its subsidiaries; for 9% of land, company has acquired sole development rights and approximately 25% of land reserves are expected to be developed under joint development agreements with land owners either directly or through subsidiaries & joint ventures. This developable area through joint development route accounts for ~58% of the total 53msf developable area. PEPL has also entered into Memorandum of Understanding (MoU) with some of the private parties for the development of the land owned by them and it constitutes 25% of total land reserves, subject to private acquisition.

Financial position

Operating Income has shown healthy growth while profitability ratios and return indicators of the company have been on lower side in past compared to its listed peers

Table 6: Financial Summary - consolidated

In Rs Crore	FY10	FY09	FY08	FY07
Operating Income	1024.44	895.26	965.23	410.00
OPBDIT	223.62	256.05	127.35	83.08
OPBDIT / OI (%)	21.8%	28.6%	13.2%	20.3%
PAT	129.44	70.73	54.16	39.06
PAT / OI (%)	12.6%	7.9%	5.6%	9.5%
ROCE (%)	11.4%	12.2%	13.5%	15.2%
RONW (%)	12.5%	8.4%	10.6%	20.9%

Note: OPBDIT – Operating Profit before Depreciation, Interest and Tax, PAT – Profit after Tax, ROCE – Return on Capital Employed, RONW – Return on Net Worth

Source: DRHP & Annual Report

The operating income of the company has grown at a Cumulative Annual Growth Rate (CAGR) of 35.7% over the last four years largely because of revenue booking from large projects like “Prestige Shantiniketan”, “Prestige Wellington Park” and “Prestige Tech Park”. Residential & commercial segment are the mainstay as far as operating income (OI) is concerned, accounting for 81% of OI in FY2009 – the rest contributed by Facilities, rental & maintenance Income and Property rental income. Margins, however, have remained on the lower side because of the lower profitability from a few large projects, for instance “Prestige Shantiniketan”. Launched in 2005, this project saw significant booking at the time of launch; however, there was a steep rise in construction cost, which has resulted in pressure on margin. However, ICRA is of the opinion that margins could improve with the launch of premium projects like “White mEadows”, “Goldshire” and “UB mansion provided they are executed as per timelines and without any cost overruns. Also the company has changed its strategy of booking entire project at the time of launch and intends to keep 30-35% of stock to get higher realisation as project nears completion, which could provide upside on case the property markets were to recover further.

Negative free cash flows has resulted in increase in debt levels and gearing; IPO proceeds are likely to improve capital structure going forward

PEPL’s negative free cash flows are attributable mainly to the increase in its inventories, loans and advances towards acquisition of land development rights and expenses for development of commercial projects. The funding gap was met largely through debt resulting in PEPL’s total debt increasing from Rs. 247.8 Crore in FY06 to Rs.1483.6 Crore in FY10.

Table 7: Cash Flow Summary

In Rs Crore	FY10	FY09	FY08	FY07	FY06
Fund Flow from Operations (FFO)	(321.22)	(0.79)	9.69	(196.17)	(39.83)
Gross Cash Flows	(329.49)	(39.55)	(10.38)	(199.45)	(32.89)
Retained Cash Flows	(329.49)	(39.55)	(10.38)	(199.45)	(32.89)
Free Cash Flows	(484.52)	(186.92)	(696.71)	(368.76)	(93.92)
Financing Surplus / (Requirements)	(667.58)	(259.15)	(540.17)	(406.31)	(98.19)

Source: DRHP & Annual report

Table 8: Capital Structure

In Rs Crore	FY10	FY09	FY08	FY07	FY06
Total Debt	1483.61	906.61	669.42	552.01	247.81
Net Worth	881.65	683.79	546.25	172.65	114.71
Total Debt / Net Worth	1.68	1.33	1.23	3.20	2.16

Source: DRHP & Annual report

PEPL's consolidated gearing as on March 31, 2010 stood at ~1.7 times as compared to 1.23 times in FY08. The gearing is showing an increasing trend because of significant portion of commercial and retail property that are under execution currently which necessarily involves reliance on borrowed funds in the absence of customer advances. Since company is proposing to use Rs 280 Crores from the net IPO proceeds to repay certain loans, the gearing is expected to reach to comfortable level post issue. Although the proceeds from the proposed IPO would partly meet its funding requirements while increasing its financial flexibility to raise additional funds, dependence on borrowings is likely to continue given the planned increase in its scale of operations.

Table 9: Contingent Liabilities

As on Mar 31, 2010	Amount (in Rs Crore)
<i>Performance Guarantee</i>	35.64
<i>Financial Guarantee</i>	1.85
<i>Corporate Guarantee given on behalf of the Company under the same management</i>	395.26
<i>Capital Commitment net of advances</i>	69.36

Source: Annual Report

Barring performance & corporate guarantees, the amount of contingent liabilities is not significant in relation to the size and net worth of the company.

Compliance and Litigation History

Accounting Policy

The company follows the Percentage of Completion method for the purpose of revenue recognition. The percentage completion method is applied on a capital basis in each accounting period to the current estimates of contract revenue and contract costs, when the stage of completion of each project reaches a significant level, which is estimated to be at least 30% of the total estimated costs of the project. While PEPL continues to increase the amount of outstanding debtors by the revenues booked from the projects in a particular year, the amount received from the customers is added to the advances and is netted off against the debtors outstanding only upon completion of the project.

Litigations

There are certain civil proceedings and litigations pending against the company and its directors. There are some tax related litigations also pending against company, subsidiaries and promoters. Overall, the monetary exposure to PEPL from these litigations is not expected to be significant.

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