

Embassy Property Developments Ltd

CRISIL IPO Grade 4/5 (Above Average)

October 29, 2010

Grading summary

CRISIL has assigned a CRISIL IPO grade of '4/5' (pronounced "four on five") to the proposed IPO of Embassy Property Developments Ltd (Embassy). This grade indicates that the fundamentals of the IPO are above average relative to other listed equity securities in India. However, this grade is not an opinion on whether the issue price is appropriate in relation to the issue fundamentals. The grade is not a recommendation to buy, sell or hold the graded instrument, its future market price or suitability for a particular investor.

The IPO grade assigned to Embassy reflects its strong position in the Bengaluru real estate development market based on an established brand name supported by high quality of construction. The company has a proven track record of execution, having so far developed ~25 mn sq.ft. of commercial, residential and retail space till date. The company is a market leader with 32% share in Bengaluru's commercial real estate space. Of ~14 mn sq.ft. of owned commercial assets, Embassy has an economic interest of 5.3 mn sq.ft. which provides a steady cash stream. Embassy's clients include IBM, Fidelity, Cognizant, Yahoo and Microsoft who have leased out office space in Embassy's commercial projects; this provides strong cash flow visibility.

The grade has also factored in the large low-cost land bank of ~1,326 acres, of which the company has plans to develop ~818 acres (as per the project status) or ~90 mn sq.ft. over the next few years. This low-cost land bank is expected to cushion the effect of lower lease rentals in the upcoming commercial projects during the downturn. The grade has also taken into account the professional management team and good corporate governance practices followed by the company.

The grade is moderated by the fact that 78% of Embassy's future projects are concentrated in Bengaluru, which exposes it to a single-location risk. Also, since a huge portion of these projects would be commercial in nature, the company is likely to post lower RoE (return on equity) until the assets are monetised.

The company posted consolidated revenues of Rs 3.7 bn with an EBITDA margin of 48.6% and net margin of negative 0.9% during 11MFY10. The net worth of the company as on February 28, 2010 was Rs 14.7 bn and the corresponding debt was Rs 15.7 bn with RoE of negative 0.2%.

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About the company

Embassy Property Development Limited commenced real estate operations in 1993 under the name of Virwani Builders. The promoter has been in the industry for close to three decades. The company has developed 24.5 mn sq.ft. of commercial, residential and retail space till date; the focus has been on the development of commercial space primarily for the IT/ITES sector. After having concentrated on Bengaluru for years, the company is now looking at other geographies like Pune, Chennai and Coimbatore. It has also forayed into the international market with the commencement of operations in Malaysia (JV with Azikaf Sdn Bhd, member of Emkay Group) and Serbia in 2006 and 2007, respectively.

The company has a proven track record of building high-quality projects in accordance with national and international standards. Majority of Embassy's commercial projects are on a built-to-suit basis. Its clients include biggies such as Alcatel–Lucent, Atos Origin, ANZ, Cognizant, Computer Science Corp., Fidelity, Geometric, IBM, LG Soft India, Mercedes–Benz, Microsoft, NetApp, Nokia Siemens Networks, Supervalu, Target, Vodafone, Yahoo and McAfee.

Embassy is promoted by Mr Jitendra Virwani, who owns 100% equity stake in the company by way of 0.4% direct ownership, 91.9% through JV Holding Private Limited - in which he owns 99.99% equity stake - and 7.7% through JV Family Trust.

Issue details

Shares offered to public	Not available at the time of grading
As per cent of post issue equity	Not available at the time of grading
Object of the issue	<ul style="list-style-type: none"> • Finance the construction and development of the company's ongoing projects • Investment in certain subsidiaries and associates for the construction and development of the ongoing/proposed projects • Pre-pay and/or repay loans availed by the company • Investment in certain subsidiaries and associates for prepayment and/or repayment of their loans • General corporate purposes
Amount proposed to be raised	Rs 24,000 mn
Price band	Not available at the time of grading
Lead managers	Citigroup Global Markets India Pvt Ltd, Edelweiss Capital Ltd, UBS Securities India Pvt Limited and Nomura Financial Advisory and Securities Pvt Ltd

Detailed Grading Rationale

A. Business Prospects

- *Embassy has a strong brand name with a proven track record of execution*

Embassy is one of the leading real estate developers in Bengaluru with 32% market share in the commercial real estate market. It has a proven track record of execution, having so far developed ~25 mn sq.ft. of space of which ~19 mn sq.ft. is commercial. Embassy has an established brand name supported by high quality of construction as indicated by low vacancy rate in its projects – the vacancy rate in completed commercial and retail projects as on April 30, 2010 was 5.8% vs. an average of 19% for projects in seven major cities across India as of December 31, 2009. (Source: Cushman & Wakefield Office Marketbeat Reports)

The company follows a model of complete outsourcing and has a long-standing relationship with its service providers like architects (11-year relationship with RSP Design Consultants Private Limited and 21-year relationship with Team 2 Architects & Consulting Engineers), project managers (seven-year relationship with Synergy), civil contractors (eight-year relationship with BL Kashyap and Sons) and others. The outsourcing model is key to the successful development of its projects.

- *Impressive client cluster; strong customer relationships with multinationals*

Embassy has a very impressive cluster of clients in the commercial space. Its client list, occupying a sizeable proportion of Embassy's leased space, includes prominent MNCs such as IBM, Fidelity, ANZ, Cognizant, Nokia Siemens Networks, 24/7 Customer and Yahoo!, Alcatel-Lucent, LG Soft India, Microsoft and NetApp.

MNCs typically have high standards and expect superior quality service, and repeat business from them depends on these factors. Embassy has been successful in establishing long-term relationships with its clients by continuously meeting their requirements. For example, since 2003 IBM has occupied 4.5 mn sq.ft. of gross leasable area spread over 15 projects across three business parks in Bengaluru and Pune. As on April 30, 2010, 52.4% of the gross leasable area of its commercial completed projects, including new space already committed to, was lease renewals for clients who had previously leased out space in its commercial completed projects.

- *Sizeable amount of leased assets provides steady stream of cash flows*

Embassy has a sizeable amount of leased commercial assets in its portfolio. The company owns ~14 mn sq.ft of leased assets of which it has an economic interest of 5.3 mn sqft which will continue to deliver a steady stream of cash flows. In addition, all these assets are strategic assets and the average lease rentals from these assets are significantly lower than the current market rates which may provide a huge upside potential to the cash flows once the lease agreement will be renewed in the future. Also if its asset base appreciates, it will have the option of divesting such assets to benefit from capital appreciation.

- *Large portfolio of low-cost land bank*

Embassy has a large land bank of ~1,326 acres. Of this, the company has plans to develop ~818 (as per the project status) acres over the next few years. The total development plan on 818 acres is ~90 mn sq.ft. The company acquired land at a very low cost which will likely cushion the effect of lower lease rentals in the upcoming commercial projects during the downturn.

- *Large development plan in the pipeline; proportion of residential has increased*

The company has a development plan of ~90 mn sq.ft of which ~49 mn sq.ft is part of the ongoing projects. Of the ~49 mn sq.ft, 32.3 mn sq.ft. is in Bengaluru (7.8 mn sq.ft. is residential) and the rest in Chennai, Pune, Coimbatore, Malaysia and Serbia. Going ahead, the company plans on developing more residential space than previously. Of the 24.5 mn sq.ft previously developed by the company, residential share was ~20%; of the ~90 mn sq.ft. under planned development now, residential share is ~32%. Also, 2.34 mn sq.ft. of ongoing projects has been pre-committed to by the existing tenants pursuant to the terms of the lease agreements.

- *Moving into new markets; JD/JV will help the company understand these markets*

After having concentrated on Bengaluru for years, the company is now looking at other geographies like Pune, Chennai and Coimbatore. It has also made a global foray into Malaysia and Serbia. Of the total proposed development of ~90 mn sq.ft., 22% is outside Bengaluru. Of ~90 mn sq.ft., ongoing development is 50 mn sq.ft., of which ~17 mn sq.ft. (~35%) is outside Bengaluru. The strategy is to reduce over-dependence on Bengaluru and to follow clients into new markets. The aforementioned cities are increasingly becoming popular as IT/ITES destinations, hence attractive to clients.

- *IT/ITES sector recovery improves demand, but supply concerns curb price rise*

Commercial and residential real estate in Bengaluru continues to be primarily driven by the IT/ITES sector. With a sharp recovery in the economy, the IT/ITES sector has picked up considerably over the past year leading to an improvement in demand for commercial space as the companies have started expanding again. As per CRISIL Research, the total hiring in the IT/ITES sector is expected to be ~207,000 in FY11 and ~340,000 in FY12. Also, the IT exports market is expected to grow at a CAGR of ~15% over the next five years. Although the demand in the IT/ITES sector has picked up, CRISIL Research expects 23.7 mn sq.ft. of commercial space supply to come in the Bengaluru market between FY2010 and FY12. Given the backdrop of such huge upcoming commercial supply the office lease rentals will be under pressure and would restrict any sharp escalation in prices.

With a recovery in the overall economy and the IT/ITES sector in particular, demand for residential property in Bengaluru has improved in the first half of 2010. Although capital values have recorded a marginal rise in June 2010 compared with the second half of 2009, micro markets such as Hosur Road, Electronic City, Whitefield Road and Hebbal with excess supply continue to witness high vacancy levels. As per CRISIL Research, capital values in Bengaluru are expected to remain stable in the third quarter and rise marginally in the last quarter of 2010.

- *Concentration in Bengaluru is a risk*

Embassy's concentration in Bengaluru (~79% development off the total 24.5 mn sq.ft. developed so far) exposes it to competition from larger local players which could lower realisations and margins going ahead. Even though the company is diversifying into other markets, ~78% of future development would be in Bengaluru (65% of ongoing projects and 93% of proposed projects). Further, Bengaluru is dependent on the IT/ITES sector and any downturn in the global economy may have an adverse impact on the overall real estate market in the city.

B. Financial Performance

Embassy's revenues logged a healthy CAGR of 55% between FY05 (Rs 487 mn) and FY09 (Rs 2,833 mn) largely driven by strong commercial lease rentals and the sale of certain land parcels during this period. EBITDA margin improved from 32.5% in FY05 to 45.7% in FY09 due to increased contribution from leased assets. PAT margin increased from 18.9% in FY05 to 20.0% in FY08. It fell to negative 1.9% in FY09 due to losses made by certain subsidiaries which were merged in FY09 and where the commercial assets are still under development and will start yielding rental cash flows once they are operational.

In 11MFY10, the company posted Rs 3,710 mn revenues with an EBITDA margin of 48.6% and net margin of negative 0.9%. Higher EBITDA margin was mainly due to 28.6% increase in the lease rental revenue (including the property management consultancy business) to Rs 1.8 bn compared to Rs 1.4 bn in FY09 and Rs 511 mn profit on sale of undeveloped land in Bengaluru (sold for Rs 732 mn). During this period, leased assets contributed 49% to overall revenues followed by residential sales at 32% and land sales at 19%. The finance charges during the 11-month period were Rs 1.6 bn compared to Rs 1.3 bn in FY09. The net worth of the company as on February 28, 2010 was Rs 14.7 bn and the corresponding debt was Rs 15.7 bn.

Financial performance snapshot

		11MFY10	FY09	FY08	FY07
		Actual	Actual	Actual	Actual
		11 months	12 months	12 months	12 months
Revenues from residential projects	Rs mn	1902	1439	534	956
Revenues from leased projects	Rs mn	1808	1394	405	496
Total operating income	Rs mn	3710	2833	938	1452
EBITDA margins	%	48.6	45.7	37.5	37.6
Net profits	Rs mn	-34	-53	188	254
Net margins	%	-0.9	-1.9	20	17.5
RoCE	%	NA	6.2	6.3	14
RONW	%	NA	-0.7	26	65.2
Basic EPS	Rs	-13.1	20.8	73.4	99.1
Diluted EPS	Rs	-13.1	20.8	73.4	99.1
No. of equity shares	Mn	2.6	2.6	2.6	2.6
Net worth	Rs mn	14660	14717	929	516
Book value (FV Rs 10)	Rs	5728.6	5751.0	363.1	201.5
Debt-equity ratio	Times	1.10	1.00	5.03	6.04

* Note1: Numbers have been re-classified as per CRISIL standards; RoCE and RONW are annual figures

Source: DRHP

C. Management Capabilities and Corporate Governance

Promoter has strong acumen and experience in Bengaluru real estate market

Mr Jitendra Virwani has been in the real estate industry for close to three decades. He joined the family business in 1986, at the age of 20, as a liaison executive. He has been the managing director of the company since incorporation. He is a member of the Young Presidents' Organisation since 1996 and also a member of the Equestrian Federation of India since 2000.

Strong and professional management

Embassy's executive directors are experienced professionals with an average of 20 years of experience in real estate development. The second line consists of specialists in their respective business functions such as operations, finance, marketing, legal, human resources and business development. Mr K.Y. Gopi Krishnan, CEO, has over 15 years of experience in the real estate and property development sector and has been with the company for over 13 years. Mrs Sharon Rodrigues, vice president - corporate business, an expert in business development and sales has been with the company for over a decade.

Professionally-run, not completely promoter- driven

Embassy is not completely promoter- driven. The CEO, Mr Gopi Krishnan (not from the promoter family), plays an important role in making decisions. There is a strong integration between departments which helps the company in making well-informed decisions. Due to the independence in operations and decision-making, key managerial personnel have stayed with the company for a long period.

Promoter not involved in real estate development business in their personal capacity outside Embassy

Though the promoters have group companies, none are engaged in real estate development. The only substantial business that the promoter has is an international school and a horse riding school. The promoters have also shown their intent to avoid any conflict of interest by signing a non-compete agreement with the company. Under the agreement, the promoters will not undertake any real estate development in their personal capacities.

Prominent executives employed on the board

Embassy has three independent directors including prominent names such as Mr Kishore Biyani (CEO, Future Group) and Mr Vaidyanathan (chairman, City Union Bank). All of them are highly experienced and qualified in their respective fields; they were appointed on June 2, 2010. The company currently has three committees (audit, remuneration and investor grievances) in place and all comprise independent directors and executive directors.

Annexure I Business Profile

Embassy is a Bangalore- based real estate developer focused primarily on commercial projects. Recently, it has started focusing on the residential segment as well. The company has developed 24.5 mn sq.ft. of commercial, residential and retail space till date.

Summary of completed, ongoing and proposed projects

Project type (mn sq.ft.)	Completed projects			Ongoing projects			Proposed projects		
	Developable area	Gross leasable area	Embassy's economic interest	Developable area	Gross leasable area	Embassy's economic interest	Developable area	Gross leasable area	Embassy's economic interest
Commercial	18.7	17.8	7.4	36.9	36.9	22.4	20.2	20.2	19.1
Retail	0.5	0.5	0.3	0.9	0.9	0.4	1.6	1.6	1.4
Hospitality	-	-	-	1.2	1.2	0.5	0.4	0.4	0.4
Residential	5.3	5.3	1.6	10.6	10.1	4.5	18.0	17.7	14.1
Total	24.5	23.6	9.3	49.6	49.1	27.8	40.2	39.9	35.0

Source: DRHP, As on April 30,2010

Commercial segment

In the commercial segment, Embassy focuses on the development of business parks for the IT / ITeS sector, SEZs and corporate offices. Till date, majority of its completed projects were built-to-suit and fit-out developments undertaken for specific clients. The company has completed 62 domestic and international commercial projects comprising a developable area of 18.7 mn sq.ft. (Embassy's interest is 7.4 mn sq. ft.).

Residential segment

In the residential segment, Embassy develops projects ranging from luxury apartments and villas to townships and affordable housing for the middle and upper income segments. The company has completed 19 residential projects comprising a developable area of 5.3 mn sq.ft. (Embassy's interest is 1.6 mn sq.ft.).

The company has a strong pipeline of ongoing and proposed projects, and is currently developing ~90 mn sq.ft of developable area across 76 ongoing and 12 proposed projects.

Type of development	Area (mn sq.ft.)	No of projects
Commercial	57.2	67
Residential	28.6	13
Retail	2.5	5
Hospitality	1.7	3
Total	90	88

Source: DRHP

Management and Board Profile

Embassy is promoted by Mr Jitendra Virwani, who owns 100% equity stake in the company by way of 0.4% direct ownership, 91.9% through JV Holding Private Limited - in which he owns 99.99% equity stake - and 7.7% through JV Family Trust. He is a member of the Young Presidents' Organisation since 1996 and also a member of the Equestrian Federation of India since 2000. He owns one of India's largest private riding schools situated in Bengaluru. He also founded the Stonehill International School, Bengaluru in 2008. He is responsible for overall management of Embassy.

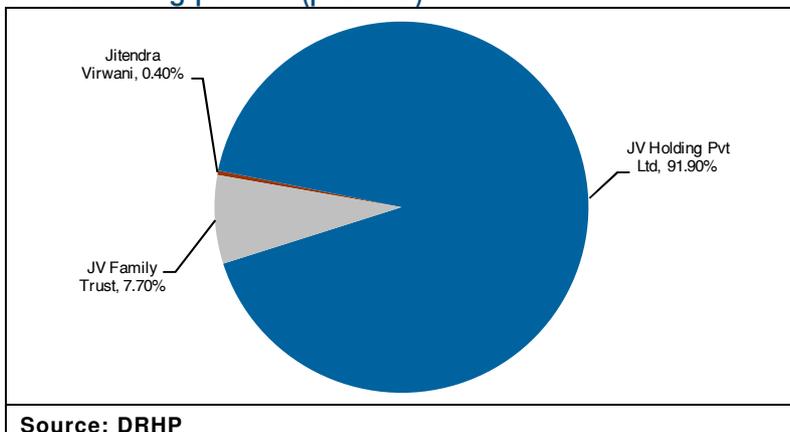
Mr K.Y. Gopi Krishnan is director and CEO of the company. He has over 15 years of experience in real estate and property development. He holds a Bachelor degree in Mechanical Engineering from the University of Kerala and joined Embassy on June 3, 1997 as a vice president, businessdevelopment. He is responsible for all operations of Embassy.

Mr Narpat Singh Choraria is a director of the company. He has over 25 years of experience in real estate and property development. He holds a Bachelor degree in Commerce from Calcutta University. He has been with Embassy since its incorporation and held the office of CFO from 2000 to 2005. He is currently responsible for handling investor relationships and land issues at Embassy.

The second line of management includes Mr Ramakrishnan P.R. (president – finance), Mr Rajesh R.Bajaj (VP – corporate affairs), Mrs Sharon Rodrigues (VP – corporate business), Mr A.B. Mandanna (VP – legal & liaison), Mr Sandeep Subramanya (GM – corporate finance) and Mr J. Veerraju (company secretary).

The company's board comprises six directors, of whom three are independent - well experienced and qualified in their respective fields. Mr Kishore Biyani, CEO of Future Group and the founder and managing director of Pantaloon Retail (India) Limited, has over 25 years of experience in the field of manufacturing and retailing. He joined the board on June 2, 2010. Mr P. Vaidyanathan, is a chartered accountant, company secretary and cost and works accountant. He has over three decades of experience in the financial services sector and also held position of part-time non-executive chairman of City Union Bank, India. He is also a member of the Disciplinary Action Committee of NSDL. He joined Embassy's board on June 2, 2010. Mr S. Chandra Das is a Bachelor in Economics from the University of Singapore and held office of MD of Intraco Ltd, chairman of several public companies like The Polyolefin Company (S) Pte Ltd, Jurong Shipyard Ltd and others.

Shareholding pattern (pre-IPO)



Annexure II: Profile of the Directors

Name of Directors	Designation	Age	Qualification	Exp. (yrs)	Previous Employment	Directorships / partnership in other entities
Mr Jitendra Virwani	Managing Director	44		23+		<p>Domestic companies Coromandel Engineering Company Private Ltd Dynasty Holding Private Ltd Manyata Infrastructure Developments Private Ltd Span Venture Private Ltd Neptune Real Estate Pvt Ltd</p> <p>Offshore companies Aquarius International, Dubai Dynasty International Embassy Group International Partnership Firms Havelock Development Corporation Global Facade Solutions</p> <p>Trusts Embassy Education & Welfare Trust JV Family Trust Dynasty Developers Employees' Gratuity Trust</p>
Mr Narpat Singh Choraria	Director	56				JEM Cements Pvt Ltd JV Holdings Pvt Ltd Concord India Pvt Ltd Stonehill Education Foundation Ditrita Developers Pvt Ltd Soloman David Holdings Pvt Ltd Dynasty Properties Pvt Ltd
Mr K. Y. Gopi Krishnan	Director & CEO	44	Bachelor in Mechanical Engineering, Kerala	15+	HCL Limited	<p>Domestic companies Blue Lagoon Real Estate Pvt Ltd Concord India Pvt Ltd DM Estates Pvt Ltd DNR Estates Pvt Ltd Swire Holdings Pvt Ltd</p> <p>Offshore companies Dynasty Business Parks Sdn Bhd MK Embassy Land Sdn Bhd Embassy Mapletree Trust Management Ltd</p> <p>Partnership firms Kuppuswamy Holdings</p>
Mr P. Vaidyanathan	Independent Director	62	Chartered accountant, company secretary, cost and works accountant	35+		City Union Bank Ltd Hatsun Agro Product Ltd Economist Communications Ltd Suja Shoel Industries Ltd

Mr S. Chandra Das	Independent Director	70	Bachelor degree in Economics (Hons.), Singapore			Ascott Residence Trust Management Ltd Capital Mall Trust Management Ltd Cougar Logistics Corporation Ltd Goodpack India Pte Ltd Hongguo International Holdings Ltd Myanmar Singapore Plantation Ltd Nera Telecommunications Ltd Yeo Hiap Seng Ltd
Mr Kishore Biyani	Independent Director	49	Bachelor in Commerce, Mumbai PG in Marketing, New Delhi	25+		Domestic companies Fame India Ltd Future Capital Holdings Ltd Jagran Prakashan Ltd Pantaloon Retail (India)Ltd Retailers Association of India Galaxy Entertainment Corporation Ltd Kumar Urban Development Ltd Indian Merchant Chambers Partnerships BLB Trading & Investment Consultants Sole Proprietorship A B Investment &Securities

Disclaimer

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