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Independent Equity Research

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Important disclosure on the last page

Ashiana Housing Ltd

Consistent cash-flow generation throughout business cycle is a rarity in real estate development & construction sector. Ashiana is one such rarity. With real estate cycle turned up in FY11, Ashiana is our best stock pick from the sector. We expect strong cash-flow generation over the next three years. The immense potential in mid-income affordable housing makes it a long-term investment pick.

DCF Value (1-year out) Rs.350 | **Current Price Rs.153** | **Potential 2.3x**

At current price, stock trades at 6.5 times FY11 EPS of Rs.23.37 with expected earnings growth of 28% over next three years – a very attractive PEG of 0.23x. The company has always been a zero net-debt company. At our fair value of Rs.350, the stock will trade at 12x FY12 EPS and 9x FY13 EPS. RoE is expected to remain at ~28%.

Key Data

Market Cap	Rs.285 Cr US$63mn
Shares Outstanding	18.6mn
52 wk Hi-Lo	191 – 110
Avg Trading Vol	No. of shares
1 month	17500
3 months	7500
1 year	6100
BSE Scrip Code	523716
BSE Group	B
NSE	Ashiana
Shareholding %	**30Jun11**
Promoters	66.12
FIIs	0.19
DIIs	0.83
Others	19.71
Valuation	**FY12E**
EV/ OCF	5.7x
Market Cap/Sales	1.6x
P/E	5.3x

Products

Real Estate (Housing) development & Construction

Key Investment Points

- Operates in mid-income housing segment with huge potential for coming decades. Expanding to new geographies.
- Ashiana is one among only three consistent operating cash flow generators in development &/or construction. The other two trade at significantly high valuations.
- Self-sustainable model – customer advances entirely funds projects.
- Real estate cycle turned up in FY11, to remain in uptrend till FY14.
- No land banking – pure development business makes it less cyclical. Mid-income affordable housing business in non-metros is less cyclical than other segments of housing are.
- Compressing construction cycle through mechanisation & design changes. To enhance asset turnover and returns.
- In house construction, marketing & maintenance give it an extra edge over other developers. It commands premium pricing over competition due to timely delivery, quality construction & maintenance.
- Very conservative accounting. Shifting to project completion-based revenue recognition. Unlike many other companies, MAT payment is being expensed instead of carrying as an asset.

Value Kickers

- Ashiana is expected to generate significant cash over next three years. Sagacious deployment of this cash can improve fair value further.
- Better disclosures of partnership financials can improve valuation further.

Watch out for

- Downturn in real estate cycle earlier than expected (FY15)
- Any further investment in capital-intensive & sub-optimal return businesses like hotels & retail.
- Protracted delay at Lavasa project

Introduction

Ashiana Housing Ltd has been in housing development & construction for over 25 years. It is primarily in mid-income housing in tier 2 & 3 cities and active senior living (housing exclusively for senior citizens) closer to tier 1 cities. It has been the first organized developer in Patna, Jamshedpur, Bhiwadi, and Neemrana. It is pioneer in active senior living in India. It currently has projects under development at Bhiwadi, Jamshedpur, Jodhpur, Jaipur and Lavasa. It has constructed 10mn sqft so far and 7mn sqft is under development.

Active Senior Living (Utsav)

Branded as Utsav, ASL has been a pioneering development form Ashiana. These are housing designed exclusively for seniors (55 years plus) keeping their special needs in mind. These have facilities like safety, security, basic medical, recreation & dining within the complex. It also provides basic care services to ASL residents. The first such project at Bhiwadi currently houses 300 families. ASL currently contributes 14-15% to Ashiana's business. ASL projects at Jaipur and Lavasa are currently under development. This is a niche area with very little competition at present.

Investment Arguments

Consistent cash flow generator: a rarity in real estate business

In real estate business or any project business (where projects take multiple years to complete), operating cash flow (OCF) along-with its composition is a better indicator of financial performance than the usual earnings statement.

We scanned the entire universe of 126 listed real estate development & construction companies and 20 unlisted companies from this sector (including Raheja Universal, Kalpataru, BPTP, Emmar MGF & Embassy Property). There are only three companies that have consistently generated OCF over an entire cycle. It is so rare to find an excellent business in this space. Ashiana is one among them. The other two are Oberoi Realty and Ashoka Buildcon but both trade at a significantly higher valuation than that of Ashiana.

Company	FY11 OPCF Rs.Mn	FY11 RoE	D/E	P/E	EV/OCF
Ashiana Housing	417	25%	-	6.0	6
Oberoi Realty	1760	16%	-	13.1	163
Ashoka Buildcon	400	14%	1.2	14.3	62

Ashiana's business model is self-sustainable. It funds construction cost entirely by way of advances from customers. Advance from customers have always been more than construction WIP. About 70% of its customers pay entire price in advance, balance goes for progress-linked payments. On an average, customer advances have been 200% of WIP. These advances not only fund WIP but also provide additional funds for projects. The customer advances fluctuate widely through the business cycle. It was at 275% of WIP at the end of FY07 and only 98% at end of FY10. It was 134% at the end of FY11. We expect it to go back to 275% by the end of FY14, which our model suggests to be an intermediate peak year in the business cycle.

Ashiana has been a zero net-debt company all throughout – again a rarity in real estate business. This not only reduces risk but gives it immense holding power during bad times like 2008. It not only maintained prices during the severe downturn of 2008 but continued project construction

Real Estate cycle turned up in FY11

Our business cycle identification model suggests that real estate cycle turned up in FY11 and the current up cycle is likely to peak in FY14. The best time to invest in a cyclical business is at the beginning of an up-cycle and Ashiana is the best stock to invest in this space.

No land banking (read land trading) – pure development business

Ashiana's strategy is to make money by converting land to homes and not by land-banking. It targets land inventory sufficient for one project cycle (3-4 years). Going forward, it intends to increasingly enter into JVs for lands rather than buying lands. This means lower capital requirement and less chance of losing on land price fluctuations. Land banking is akin to land trading. By buying land and holding it for years, developers try to capture appreciation in lands. However, this can backfire. Ask those who bought land during the real-estate boom of 2007! If a developer stretches its balance sheet to build land bank and market goes into down cycle, nothing can be worse than this for a developer.

It enters into JVs/partnerships mainly for lands. It currently has partnership projects going on at Jaipur and Jodhpur. In 2010, it launched its largest project so far (Rangoli Gardens-25 lakh sqft) in Jaipur in partnership. In its stronghold Bhiwadi (NCR), it currently has 100 acres land (of this 40 acres was bought recently). Even these lands are at various stages of approval for development. At other places, it has no land bank.

Operates in locations where land cost is not significant in proportion to home prices

Ashiana operates in areas where land cost is less than 20% of total cost. This keeps it from vulnerability to land price fluctuations. This also keeps home prices affordable. While there is news of slowdown from various markets in general, there is no slowdown where affordability is under check.

Huge potential for mid-income housing

Ashiana is currently developing houses in the range of Rs.1-5mn (750-2000sqft). There is a huge potential for houses in this price range in tier 2 & 3 cities. Middle-class urban households are estimated to quadruple over the next two decades and all these households will require a house. This business has long term potential but there will be cycles within the long term super-cycle. We estimate the next intermediate cyclical peak to occur in FY14. Having said that, the impact of cylces will be less pronounced in case of Ashiana, as it focuses on mid-income housing and does not indulge in land banking.

Ashiana plans to capitalize on this potential through a volume-led strategy. Its strategy has been to grow through volume rather than through price increases. It enters cities that benefit from migration and this strategy has stood it in good stead.

In-house engineering, construction & marketing

Ashiana is a fully integrated developer. Many developers do only development or development & marketing. Most developers outsource engineering & construction. Ashiana does engineering & construction and marketing in-house. This enables it to keep project schedule, cost, and construction quality in check. Besides, it captures construction contractors' and marketing agents' margins. Only 2-3% of its sales are through brokers/agents. This also enables it to adapt quickly to market dynamics.

Compressing construction cycle

Ashiana is compressing construction period from 30 months to 21-24 months using mechanization, engineering & design changes. This will mean faster turnaround of projects and higher returns.

Plans to expand to more geographies

Besides consolidating at its existing locations (Bhiwadi, Jamshedpur, Jodhpur, Jaipur, and Lavasa), it plans to enter three new states in three years (West Bengal, Gujarat, TamilNadu). It also plans to enter into more locations in Maharashtra.

Conservative accounting

MAT credit not accounted for resulting in understatement of profits and reserves. We expect it to continue to pay MAT till FY13. From FY14, while tax provision may be higher than MAT but cash outflow will be restricted to MAT. At the end of FY11, it had MAT credit of Rs.239mn. Revenue recognition on project completion is conservative way of recognizing revenue. It changed revenue recognition policy from current year to project completion.

Maintenance & Management of completed properties

It's been maintaining & managing its completed properties for 19 years with over 6000 units currently under management. Though revenues from this activity are meager, it provides valuable feedback on construction, planning, second sale rates, rental rates, occupancy etc.

Gets Premium over competition

Ashiana is a quality developer. In its target segment, it commands premium price over its competitors. For example, currently in Bhiwadi, Ashiana is selling a project at Rs.2400/sqft. At the same location, Omaxe is selling at Rs.1700/sqft.

Risks / Concerns

Change in revenue recognition policy to impact results in the interim

Ashiana has changed its revenue recognition policy from percentage completion to project completion (on-possession). Phases of projects, where revenue has already been recognized on percentage completion till FY11, will continue to be recognized on percentage completion. On other phases of current projects and new projects, revenue is going to be recognized only on possession. This means lower revenues and profits in the interim and volatility in quarterly financials.

This change will, however, have only positive impact on cashflows. Tax liability too will be deferred along with revenue recognition. Ultimately, cashflows matter more than profits and more so in a real estate business.

This may also mean volatility in stock price if investors remain fixated on profits and not on cashflows. If the management provides quarterly cash-flow or balance-sheet along with quarterly results, it may reduce unnecessary volatility. This will also imply better valuation by way of reduction in stock's Beta.

In FY12, revenues will be recognized predominantly on percentage completion. FY13 will see very little percentage completion. In the current year, no revenues will be recognized on new projects/phases launched during the year, as possession will not happen this year.

An early downturn in real estate cycle

We expect current real estate up cycle to peak in FY14. An early peaking of the cycle is a risk to our fair value estimate. We will track the stage of cycle and keep our clients updated.

Data disclosure galore but lack of meaningful data

Ashiana discloses plethora of data. Many of these are of no use in estimating future cashflows. We had to extensively reconstruct its financials using approximate & indirect estimations.

As JVs & partnerships have become significant proportion of Ashiana's business now and are going to remain significant proportion, lack of line-by-line consolidation (or lack of disclosure of partnerships/JVs financials) is a major handicap in estimating consolidated cashflows and its composition. For example, while share of profit from partnerships is part of EBIT/NOPLAT, there is no corresponding net working capital (NWC) to arrive at OCF.

While line items in financials are for Ashiana alone, the area figures (constructed, booked) are disclosed alongwith that of entire areas (not just Ashiana's share) of partnerships/JVs. For partnerships/JVs, share of profit is the only line item in financials.

Area booked & constructed are good leading indicators. However, these do not correspond with any values in financials. Volume figures that correspond to financial values and can be meaningful in cash flow estimation are equivalent area for which revenue was recognized and area for which possession was handed over.

Foray into Hotel & Retail

Ashiana has invested in hotel & Retail at Bhiwadi and Jamshedpur. These are capital-intensive businesses and earn sub-optimal returns over a business cycle. Any further investment in such businesses will be viewed negatively by investors.

Lavasa project is currently held up by status-quo order of MoEF

Ashiana's active senior living project in Lavasa, part of the new township being developed by HCC Ltd, is currently on hold. Construction is stopped in entire Lavasa township project since Dec-10 by status quo order of Ministry of Environment & Forests. We see this as a temporary hurdle. The company continues to lose Rs.15-20 lakh per month. Next hearing at High Court is scheduled on 29th July 2011. Despite the work stoppage, there has been no cancellation of bookings at Ashiana's Lavasa project. The company has, however, already recognized part of the revenue on the project based on percentage completion.

Ownership & Management

Ashiana is 67% owned by promoters. Mr OP Gupta founded the business. Now his three sons are executive directors. They are supported by an experienced team of management & consultants. Management has built reputation of timely delivery, quality construction and quality maintenance.

Valuation and key underlying assumptions

We estimate one-year out fair value per share to be around Rs.350 by discounting free cash flows. Key assumptions are 17% NOPLAT growth and 39% ROIC over the next two business cycles. These figures were 43% and 51% in the last business cycle.

We calculated Ashiana's beta over multiple time frames and against multiple indices. Ashiana has the highest beta (1.34) against BSE-midcap index over two-year timeframe. We chose to use this to build conservatism in our valuation. Over longer timeframe (3-6 years), Ashiana's beta is only around 0.50.

Financials

Income Statement

Rs. Mn.	FY11	FY12E	FY13E
Revenues	1513	1836	2303
EBIT	536	616	854
PBT	559	665	940
PAT-Adj.	435	532	752
EPS Rupees	23.37	28.6	40.42

Ratios

%	FY11	FY12E	FY13E
Revenue Gr%	29.6	9.0	31.3
EPS Growth %	20.1	22.4	41.3
RoE %	28.2	26.4	28.9
D/E x	-	-	-
Ready inventory days	74	60	50
Customer Advance/WIP %	134	181	228
WIP - days	130	120	110

Balance Sheets

Rs. Mn.	31Mar11	31Mar12	31Mar13
Assets			
Net Block	420	445	475
Partnerships	664	876	1139
Net Curr. Assets	324	268	169
Surplus Funds	405	711	1207
Liabilities			
Equity Capital	186	186	186
Reserves	1563	2042	2719
Debt	7	-	-
Non-Current Liab	57	72	85

Interim Performance

Rs.Mn.	Jun10	Sep10	Dec10	Mar11
Months	**3**	**3**	**3**	**3**
Revenues	417	284	256	528
EBITDA	138	88	83	219
EBIT	134	83	77	213
PBT	143	91	84	239
PAT-Adjusted	119	79	72	169
Eq Capital	184	184	184	186
EPS Rs.	6.36	4.29	3.91	9.09
EBIT Margin %	32.1	29.2	30.1	40.3
Other income/PBT %	7.7	11.0	9.5	11.3
Tax/PBT %	18.2	13.2	14.3	29.3

Multiple Valuation

	FY11	FY12E	FY13E
EV/EBITDA x	4.3	3.8	2.8
EV/EBIT x	4.5	4.0	2.8
Mkt. Cap/Sales x	1.9	1.6	1.2
P/E x	6.5	5.3	3.8
Price/Book x	1.6	1.3	1.0

Free Cash Flow

Rs. Mn.	FY11	FY12E	FY13E
NOPLAT	421	492	683
Change in Net Working Capital	3	65	55
Operating Cash Flows	**417**	**427**	**628**
Net Capex & others	58	116	148
Free Cash Flow	**359**	**311**	**480**
Non-opr. Cash flow	23	40	69
Cash Flow to Investors	**382**	**351**	**549**

Financing Cash Flow

Rs. Mn.	FY11	FY12E	FY13E
Post-tax Interest	5	-	-
Repayment/ (issue) of Debt	73	7	-
Equity Share Dividend	33	38	53
Equity Buyback/(issue)	(51)	-	-
Inc / (Dec) in surplus cash/Investments	323	306	496
Financing Cash Flow	**382**	**351**	**549**

DCF Valuation

Key Assumptions	%
Terminal Growth Rate	4.0
WACC	18.8
Cost of Equity	18.8
Terminal ROIC	22.8
Outcome	**Rs.**
Fair Value Per Share (Rs.)-1 year out	**350**

Important Disclosure

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