

March 31, 2020

Baking in Covid-19 impact...

Real estate players (like all major sectors) have faced the brunt of Covid-19, which is apparent from the stocks having seen a sharp correction in the past month. Segment wise, mall developers would be the first casualty with closure of malls and invocation of *Force Majeure* by at least some tenants. Similarly, home buyers' demand as well as construction stoppage will impact the residential segment. On the other hand, office segment cash flows remain protected. We expect the ground level situation to remain operationally challenging for all companies in our coverage universe amid the 21-day nationwide lockdown announced by the government with downside risk being extension of the lockdown for a longer duration.

Residential RE – Only leaner balance sheets to survive

The residential sales momentum could decline in the near term during the lockdown and even post that since customers could defer their purchase decisions. Also, with several auspicious festivals (*Gudi Padwa, Yugadi, etc*) falling during the lockdown period, there is expected to be a steep volume loss/deferral for real estate players since new launches and sales could get deferred. The second order impact will be construction delays as resumption hinges on labourers returning to sites. We note that a lot of them have returned to their homes. **Under these circumstances, balance sheet strength is a key screener with Oberoi Realty fitting the bill.**

Commercial & retail segment – Prefer Brigade & Phoenix

The retail segment could take the biggest hit since malls across states have been completely shut down. While there is a minimum guarantee clause in their agreements, to maintain good business relations, mall operators stand to either lose rental on account of *Force Majeure* or could participate in loss sharing with the lessees. However, clarity on this front is still awaited. On a positive note, office portfolio would not see any meaningful impact since these assets would continue to receive their cash flows. However, new office space leasing could get deferred. Hotels pain will be extended as global travel will be hit in medium term given Covid-19 scare. **We prefer companies like Brigade Enterprises, Phoenix Mills that have exposure to office assets.**

Building materials – near term demand challenges

Demand during, as well as immediately post lockdown, is expected to remain challenging given the discretionary nature of the product, which could impact sales volumes in H1FY21E. On the financials front, the recent sharp fall in crude prices could help companies mitigate fuel costs. However, this benefit could be offset by realisations that could fall, going ahead, due to intensifying competition. **Kajaria Ceramics remains our top pick in the sector with leanest balance sheet and leadership assuring higher market share grab from unorganised segment post disruption but we would await fructification of such market gains before turning constructive.**

Valuation & Outlook

We incorporate the weakness in our rental/sales volumes estimates and assign a 15-20% discount to residential & commercial NAV to account for uncertain demand scenario. We have a **BUY** rating on **Oberoi Realty** (lean net debt equity of 0.2x), **Phoenix Mills** (net debt equity of 1.1x, majority of debt for operational assets) and **Brigade Enterprise** (net debt/equity of 0.9x, strong operational asset portfolio). We have a **HOLD** rating on **Kajaria Ceramics**.

Rating Matrix		
	Rating	
	Old	New
Phoenix Mills	Buy	Buy
Brigade Enterprises	Buy	Buy
Oberoi Realty	Hold	Buy
Kajaria Ceramics	Hold	Hold

	CMP	Target price (₹)		Upside
		Old	New	
Phoenix Mills	555	1020	740	33%
Brigade	127	275	160	26%
Oberoi Realty	340	580	450	32%
Kajaria	364	560	420	15%

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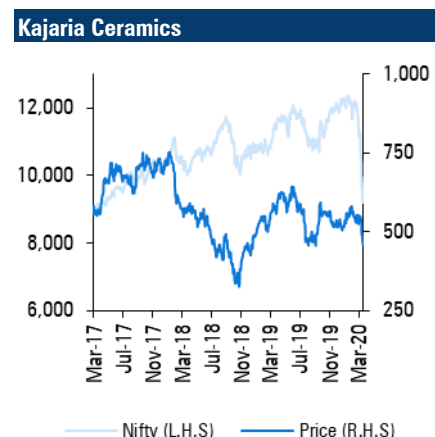
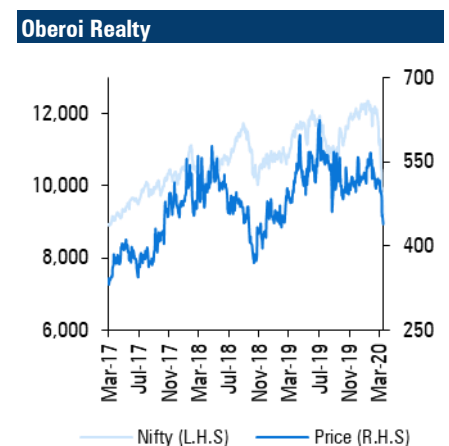
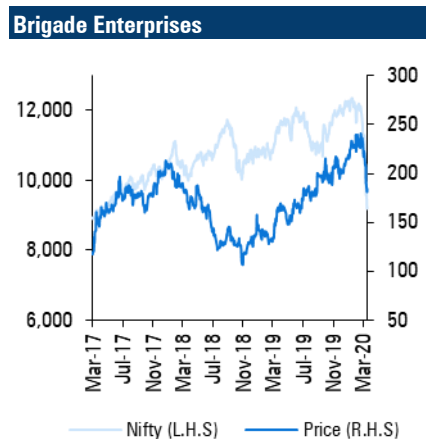
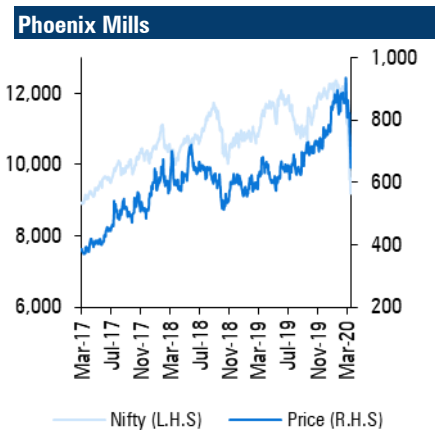
Company wise impact

Exhibit 1: Company wise impact

Company	Impact	Valuations/ Estimates Changes
Phoenix Mills	Mall closures (atleast for month since mid March in Mumbai/Pune/Bangalore coupled with furthermore risk if the same lock down is extended) is likely to result in loss of some rental income. In terms of hotels, occupancies to be impacted significantly post Covid-19 scare. Residential demand uptake could face near to mid term challenge. Commercial projects nearing completion could face challenges given construction delays	Lower the rental income estimates across malls cutting it by upto 20% in specific projects. Bake in lower trading density, as the covid scare could impact purchasing power. Occupancies as well as target multiple of Hotels cut down. Residential volumes estimates have been cut with major recovery deferred to FY22. Build in longer completion timelines, given the construction delays. Incorporate a 15-20% discount to Residential/Commercial & Retail NAV to account for uncertain demand scenario
Brigade Enterprises	Orion Mall rental revenues to be impacted given mall closures. Residential demand uptake could face near to mid term challenge. Commercial projects nearing completion could face challenges given construction delays	Lower the rental income estimates of Orion Mall by 20% in FY21. Residential volumes estimates have been cut with major recovery deferred to FY22. Build in longer completion timelines, given the construction delays. Incorporate a 15-20% discount to Residential/Commercial & Retail NAV to account for uncertain demand scenario
Oberoi Realty	Oberoi Mall to lose some rental revenues during lockdown. With lock down impacting major season of Gudi Padwa, the residential demand will be impacted. The pain will be faced more so in premium projects.	Lower the rental income estimates of Oberoi Mall by 20% in FY21. Residential volumes estimates have been cut with major recovery deferred to FY22. Incorporate a 15-20% discount to Residential/Commercial & Retail NAV to account for uncertain demand scenario
Kajaria Ceramics	Given the descretionary nature of product, demand challenges to be faced in near term. Extended lockdown, however, could virtually destroy unorganised segment, thereby resulting in higher market share grab in long term	Bake in volume decline of 10% in FY21 vs. ~10% growth estimates earlier. Earnings cut of ~20% in FY21E while target multiple cut to 26x vs. 28x, earlier.

Source: Company, ICICI Direct Research

Price Charts



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Hold: -5% to 15%;

Reduce: -15% to -5%;

Sell: <-15%



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