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IPO REPORT

“Subscribe with Caution” to Mindspace Business Parks REIT

Investible asset class, but the real estate sector marred by mid term pain

Salient features of the IPO:

- Mindspace Business Parks REIT (MBP REIT)**, backed by K Raheja Corp. (KRC) and Blackstone Group is planning to raise up to Rs. 45,000mn through an REIT IPO, which will open on 27th Jul. and close on 29th Jul. 2020. The price band is Rs. 274 - 275 per share.
- It has already received commitment worth Rs. 11,250mn (proposed subscription of 40.9mn units at Rs. 275 per unit) from a group of strategic investors, which includes names like Capital Income Builder, GIC Pvt. Ltd., Fidelity Investment Trust, Smallcap World Fund Inc. etc.
- The issue is a combination of fresh and OFS. The trust will not receive any proceeds from the OFS portion. Of the net proceeds from the fresh issue, Rs. 9,000mn will be utilized for the repayment/prepayment of certain debt availed by the asset SPVs. Rest amount i.e. Rs. 337mn will be used to purchase non-cumulative redeemable preference shares held by certain KRC group persons.
- On 26th Jun. 2020, MBP REIT has been assigned a corporate credit rating of "Provisional CCR AAA/Stable" by Crisil Ltd.

Key competitive strengths:

- Portfolio with significant scale
- Diversified and quality tenant base with long-standing relationships
- Stable cash flows and strong growth potential
- Strong industry fundamentals
- Presence in four key office markets of India
- Experienced management team backed by the KRC group

Risk and concerns:

- Uncertainties related to Covid-19 pandemic
- Continued subdued global economic outlook
- Inability to maintain the desired occupancy levels
- Unfavorable rental rates
- Delay in the execution of under construction areas
- Unfavorable interest/finance costs
- Unfavorable change in government policies & regulations
- Intense competition

Peer comparison and valuation: At the higher price band of Rs. 275 per share, MBP REIT's unit is valued at 87.1% of its net asset value (NAV), as compared to Embassy Office Parks (EOP) REIT, which is trading at 98.1% of its NAV. Thus, the issue seems to be attractive.

Below are few key observations of the issue: (continued in next page)

- Over the last two decades, India has emerged as a leading hub for technology and corporate services due to its favorable demographics, large talent pool and competitive cost advantage in providing high value-added services. This has led to an increased demand for quality office space from multinational as well as large domestic corporations.
- MBP REIT owns a quality office portfolio located in four key office markets (Mumbai, Hyderabad, Pune and Chennai region) of India. Its portfolio has total leasable area of 29.5msf (million sq. ft.) and is one of the largest Grade-A office portfolios in India. As of 31st Mar. 2020, the portfolio comprised of 23msf of completed area, 2.8msf of under construction area and 3.6msf of future development area. Of the under construction area, around 2.6msf is likely to be delivered by FY22.

Recommendation	Subscribe with Caution (Not for retail investors)
Price band	Rs. 274 - 275 per Share
Net asset value (as on 31 st Mar. 2020)	Rs. 319.5 per unit
Units for fresh issue	36.4 - 36.5mn units (Rs. 10,000mn)
Units for OFS issue	127.3 - 127.7mn units (Rs. 35,000mn)
Total issue size	163.6 - 164.2mn units (Rs. 45,000mn)
Bidding Date	27 th Jul. - 29 th Jul. 2020
Enterprise value	Rs. 234,588mn
Post-issue equity value	Rs. 163,080mn
Trustee	Axis Trustee Services Ltd.
Sponsors	Cape Trading LLP and Anbee Constructions LLP
Manager	K Raheja Corp Investment Managers LLP
Book Running Lead Manager	Morgan Stanley India Company Pvt. Ltd., Axis Capital Ltd., DSP Merrill Lynch Ltd., Citigroup Global Markets India Pvt. Ltd., JM Financial Ltd., Kotak Mahindra Capital Company Ltd., CLSA India Pvt. Ltd., Nomura Financial Advisory and Securities (India) Pvt. Ltd., UBS Securities India Pvt. Ltd., Ambit Capital Pvt. Ltd., HDFC Bank Ltd., IDFC Securities Ltd. and ICICI Securities Ltd.
Registrar	KFin Technologies Pvt. Ltd.
Sector/Industry	Investment companies

Issue structure details	
Institutional investors	122.7 - 123.2mn units (75% of the Issue)
Non-institutional portion	40.9 - 41.1mn units (25% of the Issue)
Application money at higher cut-off price per lot	
Number of Shares per Lot	200
Application Money	Rs. 55,000 per Lot
Analyst	
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Financial snapshot	FY18	FY19	FY20	FY21 ⁽¹⁾	FY22 ⁽¹⁾	FY23 ⁽¹⁾
Revenue from operations	12,631	14,316	15501 ⁽¹⁾	17,141	21,080	24,023
Net operating income	9,923	11,162	12,257	13,487	17,074	19,514
EBITDA	7,858	10,133	11,116	13,733	15,512	17,643
Cash flow from operating activities	7,590	9,338	9,266	12,255	14,822	16,150
Net distributable cash flow				5739 ⁽²⁾	12,231	13,061

Note: 1: Excluding Facility management income; 2: For H2 FY21; Source: Choice Broking Research

Peer comparison and valuation (Contd...):

- MBP REIT's portfolio has five integrated business parks with superior infrastructure and amenities (such as restaurants, crèches and outdoor sports arenas) and five quality independent offices. Its assets provide a community-based ecosystem and have been developed to meet the evolving standards of tenants and the demands of "new age businesses", which makes them among the preferred options for both multinational and domestic corporations.
- MBP REIT's portfolio markets represent approximately 58% of total Grade-A net absorption in the top-six Indian markets in FY20. These markets have demonstrated favorable long term demand supply dynamics, resulting in low vacancy and rental growth. Between 2014 and Q1 2020, net absorption was 100.3msf, while supply was 96.4msf in these markets. During the same period, vacancy levels declined steadily from 17.2% in 2014 to 10.4% in Q1 2020. Rentals in these markets increased by 8.1% CAGR in Hyderabad, 7.5% in Chennai, 7.1% in Pune and 1.7% in the Mumbai region. However, during the same period the combined rentals in the portfolio markets have grown from Rs. 79.3 per sq. ft. (psf) per month to Rs. 96.8 psf per month.
- Over FY16-20, the completed area increased by 7.5msf, of which 3.3msf was added in FY20. Consequently, its portfolio size (completed portion) has increased by 8.8% CAGR to stand at 23msf in FY20. In-place rental has increased by 6.2% CAGR over the same period.
- As of 31st Mar. 2020, MBP's portfolio is well diversified with 172 tenants and no single tenant contributed more than 7.7% of its gross contracted rentals. Furthermore, approximately 84.9% of its gross rentals are derived from leading multinational corporations and approximately 39.4% from Fortune 500 companies. The tenant base comprises a mix of multinational and Indian corporates, including affiliates of Accenture, Qualcomm, BA Continuum, JP Morgan, Amazon, Schlumberger, UBS, Capgemini, Facebook, Barclays and BNY Mellon.
- As of 31st Mar. 2020, MBP REIT has occupancy of 92% and weighted average lease expiry (WALE) of 5.8 years, which provides long-term business visibility. According to the management, its portfolio is well positioned to achieve further organic growth through a combination of rent commencement from leased out space which is contracted but not generated any rental income in FY20, contractual rent escalations, lease-up of vacant space, re-leasing at market rents etc.
- MBP REIT did not face any significant disruptions in its operations from COVID-19 led lockdown. It collected 99.4% of the gross rentals in the month of Mar. 2020, while the same was at 97.8% and 95.2%, respectively in Apr. and May 2020. It has also not availed deferments or moratoriums on any financial obligations. On a positive side it leased 0.7msf of area since the start of current fiscal, where the weighted average rent was higher than the market rents estimated in those areas.
- During the Covid-19 led lockdown, most of the industries were negatively impacted. The ones that have been severely impacted by this pandemic include aviation, education, entertainment and events, food and beverage, co-working, and hospitality. According to the management, rental from these industries was around 1% of the gross rental (during Mar. - May 2020).
- The trust has reported a short financial history. Over FY18-20, rental income increased by 11.6% CAGR, while income from maintenance services increased by 8.5% CAGR. These income streams contributed an average of 73.8% and 17.8%, respectively, to the top-line during the period. Consequently, top-line increased by 18.2% CAGR over FY18-20 to Rs. 17,660mn in FY20. Net operating income (NOI) and EBITDA increased by 11.1% and 18.9% CAGR, respectively, with an average margin of 75.3% and 65.3% during the period. Reported PAT improved by 78.9% CAGR to Rs. 4,747mn in FY20. Cash flow from operating activities (CFO) increased by 10.5% CAGR over FY18-20 with an average CFO of Rs. 8,731.3mn.
- Based on the projections provided in the RHP, top-line is likely to increase by 15.7% CAGR, while NOI and EBITDA are expected to increase by 16.8% and 16.6%, respectively, over FY20-23. CFO is also forecasted to rise by 20.3% CAGR during the period. Incremental business growth over FY20-23 is likely to be aided by - income from already leased areas, contractual escalations, lease-up of vacant & under construction areas and MTM benefits.
- As per the valuer, the pre-issue fair value of the assets is around Rs. 177,846mn. This is an indicative value of the asset and would be realized if it is monetized. Post-issue, after utilizing the net proceeds, net asset value comes around to Rs. 187,180mn. Consequently, post-issue NAV comes to around Rs. 315.6 per unit. At higher price band, the MBP REIT issue is at 87.1% of its NAV, as compared to EOP REIT, which is trading at 98.1% of its NAV. Thus, the issue seems to be attractive.
- Based on the projected distribution schedule, pre-tax yield comes out to be 6.5% in FY22E and 7% in FY23. Considering, already the subdued interest rate in the economy and anticipating further decline in the rates, the projected yield from this REIT seems to be attractive. However, there are certain risks associated - like uncertainty on the aftereffects of the Covid-19 pandemic on economy, falling real estate prices etc. All these issues might impact the future rental income of MBP REIT.
- EOP REIT was the first REIT to be listed in the domestic market and the issue price was Rs. 300 per unit. Before Covid-19, it was trading above Rs. 430 per unit (i.e. around 40% higher from the issue price). However, the gains reduced with the emergence of the Covid-19 pandemic. Currently, it is trading 22.5% above the issue price.
- On taxation front, investors incur tax only on the interest component of the REIT distribution. There is no tax on REIT distributions in the form of dividends.

Considering the above observations, we assign a **"Subscribe with Caution"** rating for the issue.

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