

Prozone Capital Shopping Center Limited

Q2 FY14 Earnings Conference Call

November 18, 2013

Moderator:

Good afternoon ladies and gentlemen, I am Beulah, the moderator for this conference. Welcome to the 2nd Quarter FY2014 Results conference call of Prozone CSC Ltd. organized by Dickinson Seagull IR. We have with us today Mr. Nikhil Chaturvedi – Managing Director, Mr. Bipin Gurnani – President, Mr. J.K. Jain – Finance Department and Mr. Amit Sabharwal from Dickinson Seagull IR. At this moment all participants' are in listen-only mode. Later, we will conduct a question and answer session. At that time if you have a question, please press "*" and "1" on your telephone keypad. Please note that this conference is recorded. I would now like to handover the floor to Mr. Amit Sabharwal. Please go ahead sir.

Amit Sabharwal:

Good afternoon everyone. Thank you for taking out the time for attending the conference call for Prozone CSC. Just before commenting on the results I would like to take this opportunity to brief you everyone about the company. Prozone CSC is promoted by the Provogue Promoters and Participated by Capital Shopping Centers Plc now known as Intu Properties based out of UK. The entire business is basically to set up and create, develop and manage world-class regional shopping centers and associated mixed-use development pan India. The basic strategy is to participate and dominate in the Retail space in tier-2 and tier-3 cities where robust urbanization is set to take place over the next decade. So currently, the promoters hold around 35%; CSC which is now known as Intu Properties hold around 32.3%; and balance is held by the public.

Just to give a brief about Intu Properties – Intu Properties is UK's largest Retail Real Estate Company. Intu Properties Plc is UK's FTSE 100 listed company and owning and managing more than £7 billion of assets. It has around 14 Properties out of which 10 Properties are among the top 25 Properties in the UK representing 38% market share in UK.

Prozone CSC as a company has a fully paid up land bank of 17.7 million square foot in prime locations spread across six cities, out of which 1.2 million square feet is already developed and raised, another 16.5 million square feet yet to be monetized. The business strategy of the company is basically to acquire large land parcels and use the 25% of the land bank into retail asset which is the Build & Lease model, and the other 75% of the land parcel into the Build & Sale model which is Residential and Commercial. The entire objective is to basically facilitate the cash flow from the Build & Sale model to get debt-free Build & Lease model assets.

Also, in the Residential segment, basically, I would like to highlight that the strategy for Prozone CSC is basically to develop the entire infrastructure for the project upfront before the launch of the project. It not only provides credibility to a business but also accelerate the sale

for the project resulting into better cash flows for the company. Due to this the company emerges as one of the strongest and the most credible player in the region, and certainly, Nagpur project where they have developed the entire club house and site infrastructure upfront and have got an overwhelming response over the last six months post the pre-launch of the project. Commenting on to the results highlights – Basically, the total income for the company has increased to Rs.138 million vis-à-vis Rs.115.5 million which is a 19% increase on a quarter-on-quarter basis. At the same time the EBITDA has increased to Rs.45.4 million vis-à-vis Rs.6.8 million, an increase of over 560% on a Q-on-Q basis. The main increase in the income has been because of the revenue recognition taken place in the Saral Bazar in the Build & Sell model as well as there has been a huge reduction in the advertising expenses and some other expenses with the cost control resulting into better efficiencies and productivity for the company.

Commenting on the Mall – basically the rental income has been flat on a Q-on-Q basis at Rs.44 million. However, EBITDA has increased to around Rs.30.5 million vis-à-vis Rs.27.2 million resulting into 12% Q-on-Q basis. However, there has been a strong traction over the last quarter in the Mall with more than 23,000 square feet being added in the Mall and key marquee names such as US Polo, Levi’s, Hyundai Motors have opened their showrooms in the Mall. At the same time another 17,000 square foot is in the fit out stage, thus getting the mall for the first time over and overall occupancy of over more than 82%. We have not been able to realize the same in the income statement as you may see the rental income has been flat; it is mainly because more than 70-80% of the Stores that were opened in the last quarter have opened in the month of September. Therefore, we are yet to see the full contribution from them. Also the Mall operating parameters if you see our retailers’ sales have increased by 6.6% on a Y-o-Y basis as well as the monthly trading density has increased to 11% on a Y-o-Y basis as well as the footfall has 16.5 lakh have increased by 5.3% Y-o-Y basis. Thus, the Mall is performing quite well and the traction seen on the leasing is very promising.

Also, just to give an update on the Residential front – on the Nagpur project where we had done the pre-launch basically two quarters before we have sold more than 305 units till date at an average sale price of around Rs.3,642 per square foot resulting into a total sales value of more than Rs.1,850 million which is equivalent around Rs.185 crores. We have not yet recognized any revenue from the Nagpur project since the revenue recognition threshold has not been hit.

Now, I would like to hand over to Mr. Bipin Gurnani to just brief you about the key highlights for all the projects and post that we may continue with the Q&A. Over to you Mr. Bipin.

Bipin Gurnani:

Thank you, Amit. Good afternoon, everyone. I think Amit basically covered most of the highlights in terms of what is happening over the last quarter. Just a little bit on the overall thought process of the company. I think he already mentioned that we are seeing reasonably good positive traction at the Shopping Center in Aurangabad. We have had a number of enquires that we are getting and particularly what is promising and exciting is that we are getting a lot of inquiries from local, regional strong retailers. We recently actually opened one

of the strongest Saree Shops in the region at our center. So I think once we start getting these local, regional partners into the center we expect that there will be a quantum leap jump in terms of footfalls and trading densities at the center.

On the other hand with respect to the Build & Sell model at Aurangabad which is the Prozone Trade Center in the Saral Bazar, because of the general sentiment in the economy at the local level as well we have had delay in terms of recoveries from our buyers with respect to the demand that we have raised. The construction has been slow. However, on the Saral Bazar front, we have actually pushed the whole construction activity and we are scheduled to launch Phase-1 in the month of February-March. We are making sure that once the Saral Bazar is operational, the street market is operational, we will hopefully see a lot more positive action on that front.

On the Offices side we are actually to initiate little more thrust from our end. We are going to start advertising in the month of December offering Office Spaces on lease so that that would support the buyers in terms of the traction. So that is another strategy that we are putting together for the Office Space in Aurangabad. Overall I think Aurangabad for us seems to be coming on track, and we are happy with this quarter in terms of Q2, and let us see how the business is for the next few quarters.

On the Nagpur front, very clearly, we have had a good run, and our focus now is on the execution side. We are now putting everything together in terms of starting work for our towers and that should be in the next 2-3 months. So currently our focus now is making sure that whatever we book we start delivering in terms of the execution of the towers

With respect to the Infrastructure and the Club House, etc. we are almost through will all the works there and I think by January we should be in a position to allow people to start using that Infrastructure.

On the Coimbatore side, Retail front, we had participated in the India Retail Forum about two months back and showcased the project for leasing. We received good response. We have already locked in one anchor and I think very shortly we should be in a position to lock in another four anchors which would mean that effectively we would have preleased the leasable area of the center. Our strategy is that once we have this, we will put the construction activity on a fast track. Currently, we are moving at a slow pace because we want to make sure that we have locked in all the anchors before we get into actual construction of the Retail Center. But we have had a good response. People have approached us and we are in advanced stages on that front.

On the Residential side in Coimbatore we have done a prelaunch about two weeks back just to test the market. We have had a reasonably satisfactory response. Our intent is that Pongal is a big festival in the South. So around 14th of January when we hit Pongal we expect to do the main launch for the Coimbatore Residential. Meanwhile, as our strategy, we are making sure that we complete the infrastructure in all the Club House at Coimbatore as well.

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On other front in Indore, although our Infrastructure and Club House is ready, as a decision, not gone ahead with the launch of Indore, because that is one of the markets where we realize that the absorption has really dropped and we do not want to launch our scheme when the market is extremely at its low. Therefore, we have postponed the launch and we will review around January and see if the market has picked up, and accordingly we will do a prelaunch for Indore. So as a decision we have currently not gone ahead with the main launch although we are fully prepared in terms of the infrastructure in the Club House and ready for launch. Overall, I think we were scheduled to launch Indore in this quarter which is Q3. I think that will probably get pushed to Q4. Rest of it by and large we are on track in terms of what we expected to do and I think that would be something which we are now focusing on which is the execution.

Another update quickly is on the Nagpur Retail. That is another area where we have slightly pushed the start date by a quarter, because we again want to make sure that we lock in all the right anchors before we start any physical activity on the Retail side at the Nagpur project.

So overall I think the next quarter should start looking better and of course the Q4 should be better than the other quarters.

With regards to revenue recognition which Amit mentioned we clearly are looking at following percentage completion. Since the projects are very large it would not prudent to follow only project completion. At the same time, we want to make sure that we hit the threshold and we have an efficient recognition to ensure efficient tax implication. That is something also which we are working very closely with our consultants to ensure that. Once we start recognizing the revenue we are able to have a tax-efficient model.

I think we will be open to taking on any questions that you may have. Thank you.

Moderator:

Thank you sir. Ladies and gentlemen, we will now begin the question-and-answer session. If you have a question please press '*' and '1' on your telephone keypad and wait for your turn to ask the question. If you would like to withdraw your request you may do so by pressing "*" and "1" again. First question is from Mr. Abhishek Bhandari from Macquarie Securities. Please go ahead.

Abhishek Bhandari:

Just to summarize, Nagpur Residential is on track, Indore is pushed by one quarter, and Coimbatore, we are looking to launch again in the fourth quarter of this fiscal year, is that right?

Bipin Gurnani:

That is right. Coimbatore is already scheduled to be launched in Q4. So basically we would be on track with that. Only Indore we have pushed by a quarter because we realized that the current market environment was not conducive to doing a very big launch because we have not had a response and I think when you start a project launch and if you have a weak response that sort of sends our very mixed signals. So as a decision we have pushed that launch by a quarter.

Abhishek Bhandari: But it has not anything to do with the approvals given the elections there or is it only because of the demands?

Bipin Gurnani: We have all the required approvals and completion that we expected to do for us to be able to go out.

Abhishek Bhandari: Also about the Malls like what is the status of construction in Coimbatore?

Bipin Gurnani: Coimbatore, we have already completed about 60% of the excavation work. The reason we have not gone at very fast pace as I expressed earlier is that as a board decision we have decided that till we do not have 30% of the leasable area pre-lease we would not like to start the physical. We expect to lock in most of the 30% in the next four weeks. Therefore, January onwards, we should ensure that the mobilization of the main civil contractors' is done and we will start major construction activity for the Retail center.

Moderator: Next question is from Sanjay Nigam who is an individual investor. Please go ahead.

Sanjay Nigam: My question is regarding the Aurangabad Mall. Good to see that we have added six new stores this quarter and good brands like US Polo, Samsung, Hyundai, etc. So just wanted to understand if we are witnessing any kind of upward improvement in the monthly rentals as we are adding new store entities?

Bipin Gurnani: I will tell you what is the objective. The objective for us is to ensure that we get the right offering first. Therefore, we are trying to get all the key brands into the center. That necessarily may not mean that we will get very high rentals from there. The intent is to bring them in into the center, lock them in for a period of three years, give them sort of incentive to make sure that they launch with us. As you would know in Retail normally whenever you start a Store in any Mall the larger growth comes in the second and the third year. So what we are doing is that the first objective is to fill in the center, get the right brands and the right category mix. Also what has happened is that this quarter that we have actually seen this positive signals, and therefore it is too early for other brands to start reacting or for us to go back and say look, "You know we get better rentals." I think for this next 12-month period again the focus will be to make sure that we achieve a 95% occupancy, and then once that is stabilized that is when the churn in terms of getting in all the brands that may not have been doing well, you start churning them out.

Sanjay Nigam: Sir another question on the advertisement expenses. Given that the company has rationalized the expenses in the second quarter, so wanted to understand where did the company cut back and what would be the strategy going forward on advertising and marketing?

Bipin Gurnani: One of the reasons why the advertising spend was high in the earlier quarter was because at that time we had started advertising for the Saral Bazar which obviously we have achieved the sales target and now we are not advertising it because at the moment what we are focusing on is delivering what we have sold. So that is a big chunk of advertising which obviously you will

not see because that was a one-time advertising cost. On the other hand we have also started improving efficiency in terms of other areas of the center since now we have completed the three years on 8th October, we have rationalized in terms of all the other facilities without affecting the quality of the facilities that we provide. We have started to implement certain corrections in terms of cost saving. The other aspect now is that we have started including the brand. And I am saying that look why do not you all come in and advertise with us. So we have to sharing the advertising cost with the brands so that for them also it becomes effective marketing reach and for us also our costs come down. For example, if I plan a full page now, I invite at least two brands with us to advertise in that full page where the cost gets shared and all of us get the required reach and the noise that we want to make.

Sanjay Nigam: I understand that in the next two quarters that is Q3 and Q4 two of our Residential projects would be getting launched and also for the Nagpur Mall you are looking for anchor tenants. So is it that in these two quarters there should be some increase in the advertising expenses?

Bipin Gurnani: Nagpur, yes, do the main launch and also Coimbatore. Indore as I said we will review prior to Q4 and assess out the market environment before we actually go in for the launch. Yes, if we are launching these residential colonies there would be obviously a higher advertising spend that would kick in but that will also be commensurated hopefully with the sales that would happen on the Residential Project.

Moderator: Next question is from Ms. Tashu from Arshiya Capital. Please go ahead.

Tashu: My question is that there has been a slowdown in your payment collection in PTC Phase-1. So could you please brief us upon the current environment, how does it look like?

Bipin Gurnani: As of now, for Office Space the environment is fairly sluggish. Normally what happens is that the Office Spaces are normally investment levels are booked by investors. Therefore they are currently hesitating to make payments and we are requesting for some raise in terms of payment schedules. On the other hand...

Tashu: Are there any cancellations happening?

Bipin Gurnani: No, we have not received any cancellation beyond what we have already have but the fact is that if we create too much of a push people are willing say that "I would like to return my unit in that case because I do not have the ability to meet your demand as of today. So can you please look at our request for giving us at least 3-6 months more to make the payment?" That is why deliberately what we have done is we have paced the construction of the Office Space to align with the collections that we are making in that area. The choice is with us. We can become little aggressive on selection, but we might have to face some cancellations. As on today's market, the Commercial Office space being sluggish, we do not want to take that aggressive position and we are trying to speak with the buyers and making sure that they somehow are making some payment, and we are able to make some headway with them. But overall, if you see there is a delay in terms of receiving payments.

- Moderator:** The next question is from Pankaj Chopra from Shanti Asset Management. Please go ahead.
- Pankaj Chopra:** In some sense you represent the demand situation in Tier-2 and Tier-3 markets. Could you give us a sense how you feel on the Real Estate space? And secondly, you mentioned in your presentation about Retailer Sales. The question is whether your income is linked to that in some sense or is it just a sense of giving the indication of demand?
- Bipin Gurnani:** Let me first address your question on the retailers' side. Definitely, our arrangement with most retailers is where we have a minimum rental guarantee with them or a percentage of their sale whichever is higher. The moment they start doing better the possibility of us getting a better revenue from them is even more, but that depends on whether the sales are good enough for us to get turnover end from them. One of the brands I can mention which is Croma has been hitting turnover rent clause consistently for the last about 8-9 months now. So that is one of the good brands where we have had that the percentage of their turnover is higher than the minimum guaranteed rentals.
- Pankaj Chopra:** So that is the sale of services line in your income, is it?
- Bipin Gurnani:** That comes, yes. That gets captured in the income segment. So basically both ways. One is in a way it gives you an outlook of how the market is improving, and also it has a direct impact on our income if most tenants are hitting turnover end, obviously, positively impact our income at the center level. To answer your other question on how do we see the Tier-2 markets it would be for us to respond to the extent of the cities in which we are representing because we do not follow any other city as closely as we would where we have our projects. Nagpur, the demand has obviously been slow, but because of the fact that our project has had a positive response from two perspectives; one is that the Infrastructure and the Club House and all is virtually ready and people can see that when they visit the project; second thing is that over lining and location and all those aspects have also been viewed as an advantage for us. So whilst the overall market is slow perhaps within that absorption we are getting a larger chunk of the bookings. Coimbatore, we are yet to see and understand how the market will react but the prelaunch that we did, if that is any indication, then we did have a good launch, and we hope that in Coimbatore we will get a better response. Overall, I can only say that the absorptions are low but it also depends on your project and project-to-project. So, we hope that because of the fact that we develop the Infrastructure, the Club House, Associated Amenities upfront and the fact that our design and the way our layouts are, people will appreciate the project and that we would get a larger portion of the absorption that is happening within the city.
- Pankaj Chopra:** So if I may what I understand is that reset of slowing economy is actually affecting you as well even though you may be doing better than the others, is that a correct assessment?
- Bipin Gurnani:** Absolutely. We cannot remain isolated to what is happening in the economy. We are insulated only to the extent of the fact that we have good projects. We have taken certain strategic initiatives that support the fact that we perhaps may do slightly better than the market and that is the strategy that we are implementing. So you are absolutely right. We cannot remain

isolated to what is happening around us, but definitely, we are slightly more insulated with what we have done in terms of our strategic decisions.

Pankaj Chopra: So these are the only places where you have land parcels, or are there any others which you have kept?

Bipin Gurnani: We have land parcels in Jaipur and Mysore as well, but those are still at nascent stage, where we have acquired the land, but we have not started any planning on those yet.

Pankaj Chopra: Could you give me a sense of, you initially mentioned that you would mark for sale 75% of what you produce and 25% goes in for creating annuity incomes. By when do we see free cash flow position happening in terms of your investments or whatever gets generated out of the business is enough or little more than what is needed for further business expansion and investment?

Bipin Gurnani: Currently, if you see even this quarter although we have got a loss but if you were to take our depreciation we have a cash profit. What we are actually saying is that instead of going out there and trying to recognize revenue very early, then start paying tax on it whilst we are still in investment mode, not be the best prudent efficient finance. So what we are doing in each of the projects is that we have taken a certain size of the project, which we feel that is at least a credible size for which certain percentage coming. So I am saying that based on what we have taken is our 1st Phase of the projects on the Residential side. Hopefully, Q1 FY15 is when we will start seeing the revenue recognized from these Residential asset classes, and that is when you will see a positive cash flow.

Pankaj Chopra: I can understand that you are generating on PAT level.

Bipin Gurnani: You can say under advances or CWIP and the money advances that we have already got. So if we were to have that recognized you obviously would have had positive cash flow.

Pankaj Chopra: No, on an operational perspective, yes, possibly you would be, but you would still be investing a large part of that into the business in developing in terms of CAPEX or rather of the...?

Bipin Gurnani: That free cash flow will be used to plough back into development of these assets.

Amit Sabharwal: Pankaj, basically we would be using the cash flow from the Residential Projects to fund the Retail Projects. The two Retail Projects that are going on are basically Coimbatore and Nagpur. Aurangabad is already operational. By FY16 is where basically all the three Retail Malls would be operational and we would be having a huge amount of free cash flow from the Residential Projects.

Pankaj Chopra: FY16 is what you are saying?

Amit Sabharwal: FY16 is basically where we have the three annuity Retail Projects which are on the Build & Lease model which would be operational as well as all the Residential Projects that we will be

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developing would be throwing up the free cash that we can use and deploy somewhere else or whether we can give it to the shareholders is what we would be looking to do.

Pankaj Chopra: Let me just put this same question in a little different way. Can I ask you which quarter or may be which period do you see the debt of the company actually coming off? That probably would answer my question in a big way.

Bipin Gurnani: Actually, you are going to see both sides. One, we have currently a debt in Aurangabad at an operational mall level which is obviously getting reduced by about Rs.19-20 crores every year. On the other hand, we have got a debt that we have just got sanctioned for our Coimbatore Retail Center which we will start drawing, and hopefully we will not end up drawing the entire sanctioned amount because of the free cash flows that Amit just mentioned will start coming in from the Residential. So effectively if you want to understand when will the company be debt-free?

Pankaj Chopra: No. Sir I just want to know when your total debt numbers starts coming down, that is really is.

Bipin Gurnani: I think that is something which is we are at growth stage, so you will not see that happening because in one project at a consolidated level you will not see that, because at one project it will reduce, the other project we would be taking debt. So effectively you will not see at a consolidated level a reduction. Although I must add that currently, our debt levels are very low almost Rs. 130-odd crores in Aurangabad, and roughly about Rs. 30 crores in Coimbatore. So as a company it is relatively quite low leveraged.

Moderator There are no further questions. Now I hand over the floor to Mr. Amit for closing comments.

Amit Sabharwal: Thank you everyone for participating in the call. Basically, just to summarize, as we say, for the company, basically this year has been the most important year because we have seen the launch for the Nagpur project, and we would also be seeing the launch for the Coimbatore project. So the two Residential Projects getting launched completely. At the same time, our Aurangabad Mall is already operational and doing fairly well where the Occupancy level has increased to around 82% as on date. Also, the delivery for the construction work is in full swing for the Saral Bazar, which is again a Build & Sale model where we would be delivering the Phase-1 for Saral Bazar by Q4 FY14. It looks very promising for the company for the next 2-3 quarters, and we will keep you updated on the progress that we make for each and every project. Thank you, everyone for participating in the call.

Moderator Thank you, sir. Ladies and gentlemen, this concludes your conference for today. Thank you for your participation and for using Door Sabha’s Conference Call Service. You may now disconnect your lines now. Thank you and have a pleasant evening.