19 February 2010 | 7 pages

# DLF (DLF.BO)

Equity

## Key Takeaways from Management Meeting

- **Traction seen in pre-sales and execution, as construction ramps up** — DLF is looking at ~3.5msf pre-sales in 4Q (vs 3.1 msf in 3Q & 2.7msf in 2Q), targeting ~12msf for FY10. Further, ramp-up in construction is generating faster cash-flows across its projects and is likely to see big step-up in 4Q (~4msf vs 2msf in 3Q) largely on account of SBM, Delhi commencing construction.
- **4Q launch pipeline looking strong** — DLF launched apartments in Panchkula, Chandigarh at Rs3000/sf and has plans to launch city-centre projects in Chennai and Hyderabad in the first week of March; it expects good responses to these projects. Value housing launch schedule has been pushed to 1Q FY11 (vs. 4Q FY10 earlier) beginning with markets of Gurgaon, Chennai and Bangalore, while keeping attractive ticket sizes per apartment.
- **Commercial showing more promising signs of recovery** — Management expects to lease ~1msf in 4Q, with enquiries continuing to pick up. It presently has ~0.5msf of ready inventory and ~2msf of space ready for delivery in 6 months. While leasing rates have stabilized, the company is still not looking at ramping up construction in commercial properties (~presently 17msf).
- **De-Leveraging remains a priority** — O/S net-debt as of Dec 09 stood at Rs128bn (~Rs27bn is due till Mar'11 & ~Rs10bn due in Dec'10) and integration with Caraf-DAL is expected to add ~Rs30bn, taking the total leverage (post 4Q repayments) to ~Rs132bn with average cost ~10.5%. That said, it is focusing on de-leveraging through its non-core asset sales and by increasing operating cash flows; to bring down overall leverage and average cost to ~10% (vs. 12% earlier) by 2H FY11.
- **Other updates** — 1) Thoughts on Mumbai: Management mentions no aggressive plans; priority remains NTC Mills project, Lower Parel where configuration is still getting crystallized; expect more visibility by 1Q FY11. 2) Non-core asset sales: Expects Rs12.5bn in 4Q through govt refund and land sales, another Rs12-15bn in FY11; in addition to Dwarka project refund (Rs8.0bn) and sale proceeds from wind-power (Rs10bn) - though there is lack of timing visibility. 3) DAL–DLF integration: It is to be completed by the end of FY10. With a consol. strong rental annuity of Rs15bn by FY11E (of which ~Rs7bn is currently securitized), the company continues to explore possibilities of potential DAL listing in 1H FY11.
- **Our top pick; key reasons** — 1) Pre-sales momentum and construction activities ramping up; 2) Increased visibility on new launches; 3) Comm leasing recovery, looking more promising now, will act as a boon; 4) DAL-DLF integration seeing some direction remains a potential catalyst; and 5) Given the recent correction, valuations look attractive at a 47% discount to estimated NAV.

| Buy/Low Risk | 1L |
|---|---|
| Price (19 Feb 10) | Rs290.75 |
| Target price | Rs464.00 |
| Expected share price return | 59.6% |
| Expected dividend yield | 0.0% |
| **Expected total return** | **59.6%** |
| Market Cap | Rs493,511M<br>US$10,669M |

**Price Performance (RIC: DLF.BO, BB: DLFU IN)**


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See Appendix A-1 for Analyst Certification and important disclosures.

| Fiscal year end 31-Mar | 2008 | 2009 | 2010E | 2011E | 2012E |
|---|---|---|---|---|---|
| **Valuation Ratios** | | | | | |
| P/E adjusted (x) | 6.3 | 10.7 | 24.8 | 20.4 | 15.1 |
| P/E reported (x) | 6.3 | 10.7 | 24.8 | 20.4 | 15.1 |
| P/BV (x) | 2.6 | 2.2 | 2.0 | 1.8 | 1.6 |
| Dividend yield (%) | 1.4 | 0.0 | 0.0 | 0.0 | 0.0 |
| **Per Share Data (Rs)** | | | | | |
| EPS adjusted | 45.82 | 27.28 | 11.73 | 14.26 | 19.20 |
| EPS reported | 45.82 | 27.28 | 11.73 | 14.26 | 19.20 |
| BVPS | 109.92 | 134.09 | 145.82 | 160.08 | 179.28 |
| NAVps ordinary | na | na | na | na | na |
| DPS | 4.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| **Profit & Loss (RsM)** | | | | | |
| **Net operating income (NOI)** | **100,148** | **59,472** | **33,603** | **40,684** | **54,028** |
| G&A expenses | -2,998 | -4,592 | -4,821 | -5,786 | -6,943 |
| Other Operating items | -636 | -2,566 | -2,988 | -3,262 | -3,699 |
| **EBIT including associates** | **96,514** | **52,315** | **25,793** | **31,637** | **43,386** |
| Non-oper./net int./except. | -636 | 1,394 | 747 | 641 | 65 |
| **Pre-tax profit** | **95,878** | **53,708** | **26,540** | **32,278** | **43,451** |
| Tax | -17,391 | -7,115 | -6,635 | -8,069 | -10,863 |
| Extraord./Min. Int./Pref. Div. | -367 | -302 | 0 | 0 | 0 |
| **Reported net income** | **78,120** | **46,292** | **19,905** | **24,208** | **32,588** |
| Adjusted earnings | 78,120 | 46,292 | 19,905 | 24,208 | 32,588 |
| Adjusted EBIT | 96,250 | 52,525 | 25,793 | 31,637 | 43,386 |
| Adjusted EBITDA | 97,151 | 54,881 | 28,781 | 34,898 | 47,085 |
| **Growth Rates (%)** | | | | | |
| NOI | 527.9 | -40.6 | -43.5 | 21.1 | 32.8 |
| EBIT adjusted | 572.2 | -45.4 | -50.9 | 22.7 | 37.1 |
| EPS adjusted | 259.6 | -40.5 | -57.0 | 21.6 | 34.6 |
| **Cash Flow (RsM)** | | | | | |
| **Operating cash flow** | **-26,960** | **-4,560** | **85,691** | **11,454** | **20,688** |
| Depreciation/amortization | 901 | 2,355 | 2,988 | 3,262 | 3,699 |
| Net working capital | -105,815 | -51,290 | 62,797 | -16,016 | -15,599 |
| **Investing cash flow** | **-60,142** | **-42,020** | **-16,540** | **-2,816** | **-10,591** |
| Capital expenditure | -47,678 | -39,450 | -17,065 | -2,816 | -10,591 |
| Acquisitions/disposals | 0 | 0 | 0 | 0 | 0 |
| **Financing cash flow** | **104,368** | **37,880** | **-78,201** | **-7,000** | **-7,000** |
| Borrowings | 23,177 | 41,890 | -78,201 | -7,000 | -7,000 |
| Dividends paid | -7,979 | -4,010 | 0 | 0 | 0 |
| **Change in cash** | **17,266** | **-8,700** | **-9,050** | **1,638** | **3,097** |
| **Balance Sheet (RsM)** | | | | | |
| **Total assets** | **396,065** | **489,320** | **433,827** | **467,966** | **510,354** |
| Cash & cash equivalent | 21,421 | 11,956 | 5,000 | 6,639 | 9,735 |
| Net fixed assets | 100,031 | 136,006 | 150,082 | 149,636 | 156,529 |
| **Total liabilities** | **195,287** | **241,445** | **166,048** | **175,979** | **185,778** |
| Total Debt | 122,771 | 163,201 | 85,000 | 78,000 | 71,000 |
| **Shareholders' funds** | **200,778** | **247,874** | **267,779** | **291,987** | **324,576** |
| **Profitability/Solvency Ratios** | | | | | |
| EBIT margin adjusted (%) | 66.7 | 52.3 | 39.5 | 37.0 | 39.0 |
| ROE adjusted (%) | 73.2 | 22.3 | 8.4 | 9.3 | 11.3 |
| ROA adjusted (%) | 27.1 | 10.5 | 4.3 | 5.4 | 6.7 |
| Net debt to equity (%) | 50.5 | 61.0 | 29.9 | 24.4 | 18.9 |
| Interest coverage (x) | 31.3 | 15.4 | 10.5 | 19.5 | 28.7 |

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# DLF

## Company description

DLF is one of India's oldest real estate developers. Established in Delhi in 1946, it has continued to expand and diversify its real estate businesses, and is among the largest developers in India. It has historically built its businesses in Delhi and adjoining areas, known as the National Capital Region (NCR). DLF has diversified into other geographic locations over the past few years. These expansions are spread across India, with a focus on the Northern India belt, Kolkata, Mumbai, Chennai, and a number of other large and rapidly growing cities. DLF enjoys a strong brand franchise with a good track record in execution and delivery. This is the flagship company of the KP Singh family, with the founders holding a 78.6% stake. It is one of India's largest developers, with a diversified asset portfolio and an emerging pan-India presence.

## Investment strategy

We rate DLF Buy/Low Risk (1L), with a target price of Rs464. DLF's proactive measures to address receivable worries, boost pre-sales by cutting prices/launching city centre projects along with steps to ensure liquidity has differentiated itself. Further, promoters bringing in additional capital to address liquidity concerns without dilution augur well and remove concerns about high receivables from DLF Assets (DAL). While risks to the company's business model are on the rise in this tough environment, given DLF's execution track record, growing rental income and geographic-asset mix, we believe it's strongly positioned vs. peers. We recommend a Buy rating for the stock and believe the stock should be a core holding for exposure to the Indian real estate sector.

## Valuation

Our target price of Rs464 is based on a 15% discount to our Mar'10E NAV of Rs546. Our NAV includes Rs455 for the development portfolio and Rs91 for other asset holdings and new JV businesses (Rs73/share for the existing 11m sq ft of leased assets and 7.2m sq ft of plots and Rs18/share for DLF's share in the hotel JV). The lower discount vs. peers (30-35%) is attributed to: 1) relatively healthy balance sheet vs. peers; 2) superior business model, strong execution track record; and 3) relatively better disclosure standards. We believe an NAV-based valuation methodology is most appropriate for developers, as it factors in the varied development projects and the spread-out time frame. Our March 2010E NAV is based on: 1) 20% decline in prices from peak levels; 2) development volume of 397msf ; 3) cap rate of 10% for commercial/IT Park, IT SEZs in Super Metros and Metros, and 11% for other locations; 4) average cost of capital of 13% given tight liquidity; and 5) a tax rate of 25%.

## Risks

We rate DLF Low Risk since with the funds from recent stake sale by promoters being invested in DAL, visibility of DLF's cash flows improves substantially. The main downside risks to our investment thesis and target price include: 1) The company's asset sale strategy remains contingent on capital flows; 2) Response to DLF's new mid-income project launches in FY10 is crucial for growth ahead; 3) Slowdown in the IT/ITES industry could lead to a decline in demand for commercial real estate; and 4) Slowdown in capital inflows or measures to regulate FDI in the real estate sector.

# Appendix A-1

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**Fundamental Research**

Analyst: Ashish Jagnani
Covered since August 11 2007


| | Date | Rating | Target Price | Closing Price |
|---|---|---|---|---|
| 1 | 10-Aug-07 | *1M | *725.00 | 584.45 |
| 2 | 12-Nov-07 | 1M | *1,046.00 | 871.20 |
| 3 | 11-Apr-08 | 1M | *846.00 | 598.00 |
| 4 | 15-Jul-08 | 1M | *585.00 | 426.95 |
| 5 | 2-Nov-08 | 1M | *340.00 | 220.25 |
| 6 | 1-Feb-09 | 1M | *240.00 | 177.20 |
| 7 | 1-Jun-09 | *1L | *464.00 | 414.85 |

* Indicates change

Rating/target price changes above reflect Eastern Standard Time

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|---|---|---|---|
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