IDFC SSKI

INDIA RESEARCH

15 June 2009

BSE Sensex: 14876

Sector report

Real Estate

Beginning of a new dream?

Indian realty majors finally have a foot in the door with life-line received from the government and RBI as also banks, and focus has now shifted from 'surviving' to 'thriving'. Earnestness is evident in the redrawn strategies – capital-intensive projects have been scrapped/ deferred and 'affordable housing' has become the buzz word. Players are working on deleveraging through asset monetization and equity stake sales. With prices down ~30% from the peak, genuine buyers are returning to the market, albeit only in the housing segment. In the last three months, Unitech and DLF have sold 3.2msf and 2.5msf of launched properties. Demand is bound to accelerate over the next 12 months as the economy revives and interest rates stay soft, though commercial demand would come only after the oversupply is absorbed. We expect leading players like DLF and Unitech to be the key beneficiaries of the upturn. Reiterate Outperformer on Unitech (SOTP-based target price of Rs128) and initiating coverage on DLF with Outperformer (Rs421).

Head above the water; developers now deleveraging: Developers are free from the noose of short-term debt, and have rolled over repayments due by end-FY09. They have been looking to raise funds from all possible avenues. Equity stakes are being diluted, non-core assets sold and some assets monetized. Also, focus has turned to affordable projects in the residential segment, where there is secular demand. With improved sentiment, liquidity is also easy.

Demand trickling in; affordable houses find takers: Unitech has launched 13.9msf and sold 3.2msf while DLF has sold 2.5msf of the properties launched in the last three months. This underlines that structural demand for housing is intact, but currently only at the right price and from actual users. With benign interest rates and economic revival, we expect demand to accelerate over the next 12 months. However, demand for commercial properties would take longer to come as oversupply has to first get absorbed.

Bet on larger players as they can 'deliver': Leading real estate developers like Unitech and DLF have proven track record of delivery and this infuses confidence on execution of planned projects. They also possess quality land banks that we expect to be monetized at progressively higher rates in line with the improving demand. Having delivered ahead of our estimates, we maintain Outperformer on Unitech and we initiate coverage on DLF with Outperformer.

Key valuation metrics

Companies	Price (Rs)	Mkt Cap (Rs bn)	Recommendation	EPS growth FY10-11E (%)	FY10E PE(x)	FY10E EV/EBITDA (x)	Target (Rs)	Upside (%)
Unitech	87	177.8	Outperformer	23.7	16	12	128	47.7
DLF	352	597.4	Outperformer	36	26.9	23	421	19.6

Price as on 15th June,2009

Ramnath S
ramnaths@idfcsski.com
91-22-6638 3380

Rajeev Desai
rajeev@idfcsski.com
91-22-6638 3231

IDFC - SSKI Securities Ltd.
701-702 Tulsiani Chambers,
7th Floor (East Wing),
Nariman Point, Mumbai 400 021.
Fax: 91-22-2204 0282

CONTENTS

INVESTMENT ARGUMENT

With the global financial meltdown destroying domestic real estate demand, developers found themselves stuck in a debt quagmire as capital-flow completely dried up for them. However, the risk of rampant defaults has receded with the RBI allowing a one-time restructuring of debt, and revival in capital markets allowing large developers to raise equity capital. The revamped strategy of cutting prices by 25-30% and downsizing apartment sizes as also specifications has brought to the fore the huge (but unaddressed) demand for affordable housing. Further, multiple measures to shore up balance sheets, monetization of non-core assets, selling part of non-core land bank and deferment of work on commercial projects have started yielding results. We see a stable government as a key positive for the sector with further support from falling interest rates. However, we believe demand for commercial property will revive with a lag; the current oversupply has to be exhausted first before fresh demand accrues from corporates.

REAL ESTATE DEVELOPERS: PAYING FOR PAST EXCESSES

"Financial institutions [in this case, real estate players] acted as if the economic cycle was a thing of the past, as if the longer the good times lasted the more they could be regarded as permanent".

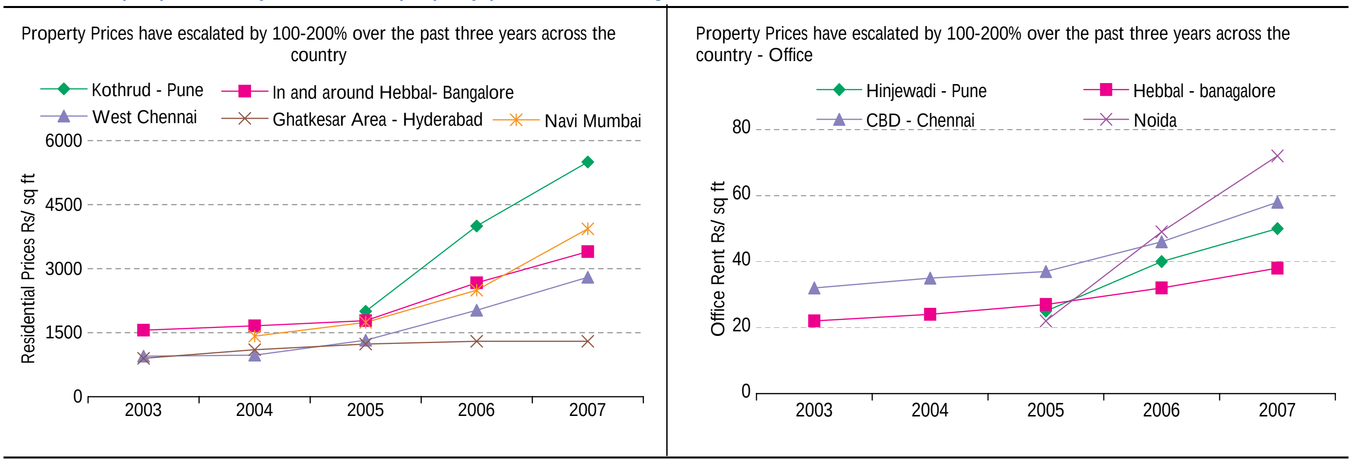
Time – issue dated 13 October 2008

❑ FY05-08 – all indicators headed in one direction…up!

Prices of residential, office and commercial properties had shot up to dizzy heights by FY08

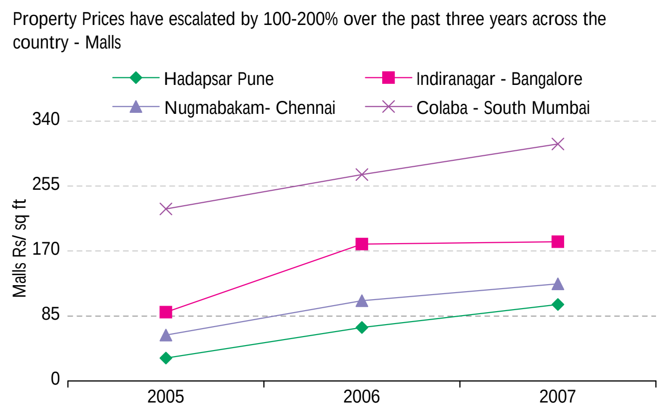
The Indian real estate sector, estimated to be a ~USD 45bn market, grew at a scorching pace of 40-45% per annum over FY05-08. Demand for real estate jumped across segments led by a booming economy (three consecutive years of 8%+ growth in GDP), favorable demographics (increasing affluence and expanding base of young and productive population) as also liberalization on the policy front (relaxed foreign direct investment regulations). In this backdrop, prices of residential, office and commercial properties shot up to dizzy heights (up 100-200%) from the levels prevailing in 2005.

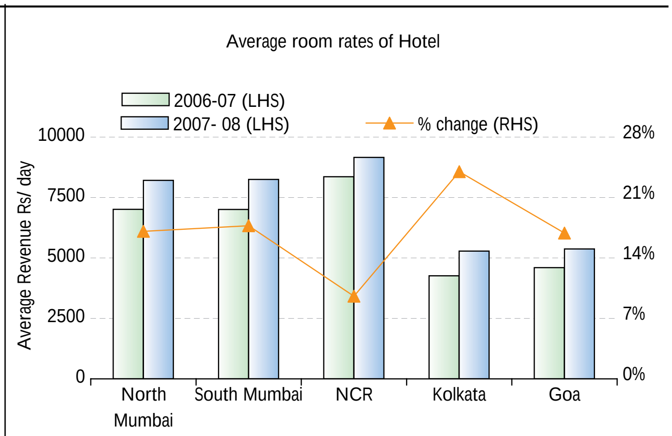
Exhibit 1: Up, up and away… indicative property prices across segments



Source: Cushman & Wakefield, Crisil Research, IDFC-SSKI Research

Exhibit 2: Up, up and away… indicative property prices across segments





Source: Cushman & Wakefield, Crisil Research, IDFC-SSKI Research

Widespread demand destruction, but realtors stuck to their ambitious development plans

❑ But what goes up…must come down

Reality struck as India entered 2008 and got singed by the global 'shock-waves' as the year progressed. Also, with the economy hitting growth moderation (a function of high interest rates and the global meltdown), many corporates put expansion plans on hold, which meant no demand for commercial/ retail real estate projects.

The contours of the Indian real estate sector have been swiftly redefined in the last one year as demand evaporated at 'unaffordable' prices and external funding for developers too disappeared. Customers for residential property, in anticipation of price cuts by developers, judiciously adopted a wait and watch strategy and deferred purchase decisions. However, most developers – drawing unfounded confidence from a few stray deals struck on at prevailing prices during this period – refused to acknowledge the slowdown. Also, developers were increasingly positioning real estate as a quasi-inflation play – citing rising input costs (inflationary pressures), higher TDR and high land prices as the key premise to stick to higher prices.

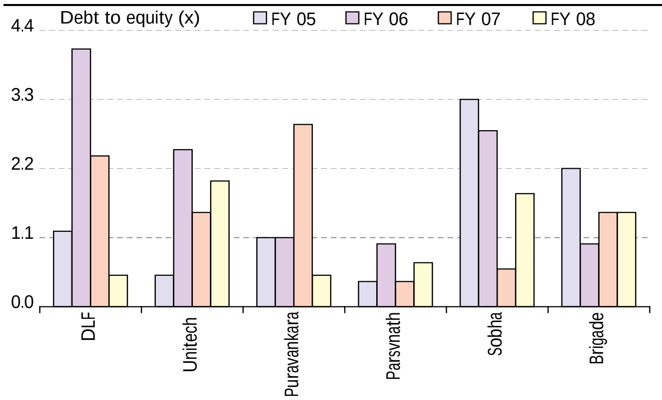
Land banks accreted with short term debt availed of at extremely high rates

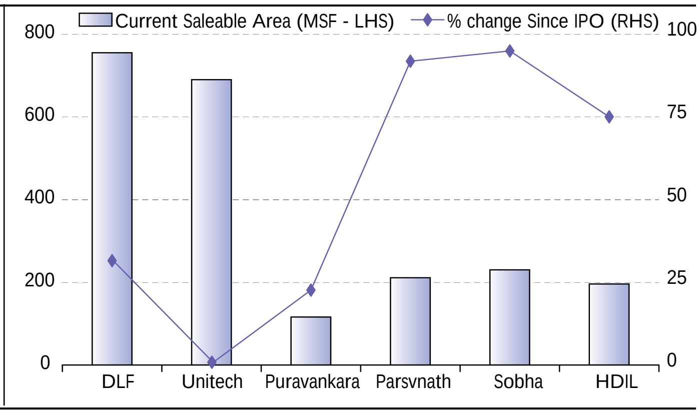
❑ Developers' chimera – huge land banks, at high prices…

Real estate developers never had it so good – besides strong cash flows from projects, funds were also forthcoming from external quarters. Capital markets were on an upswing, which meant that real estate paper found enough takers. Over CY05-07, around 20 real estate and construction companies are estimated to have raised US$4.35bn from the public. Construction activity was in full swing to meet the strong demand, and this led to a mad rush for acquiring land banks. That capital markets were valuing real estate companies (i.e. assigning NAV) based on their land bank was another reason that pushed developers to accumulate land. While developers were clamouring for land, prices shot up by 100-150% over CY05-07.

Notably, land bank accretion – to build a solid inventory as also shore up valuation – was funded through short-term debt, that too at exorbitantly high interest rates (12-14%).

Exhibit 3: Companies acquired sizable land banks over the last three years funded by debt





Source: Capitaline, Company, IDFCSSKI

'Affordability' took a major hit as property prices rose to unprecedented levels

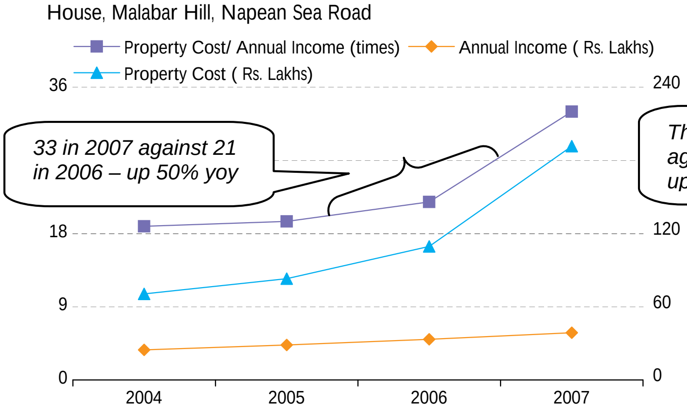
❑ …and overestimation of demand – a costly mistake

Besides favourable demographics, demand in the residential segment is also influenced by 'affordability' (property cost/ minimum annual household income). Rising income levels/ disposable income curves of a growing middle class as also an expanding base of nuclear families have been in place, but 'affordability' took a major hit as property prices rose to unprecedented levels. Also, developers gravitated towards more premium projects (generating higher margins), which further limited the choice for mass customers. Meanwhile, income levels did not rise commensurately for the middle class – the largest component of housing demand. At the same time, consumer sentiment turned weak due to the runaway inflation and rising interest rates (and thus EMIs). The economic slowdown, and ensuing uncertainty, following the global meltdown was the last nail in the coffin. In the commercial property segment, lease rentals sky-rocketed, impacting economics of businesses like retail and ITeS – the key drivers of demand for modern offices, warehouses, hotels and shopping malls.

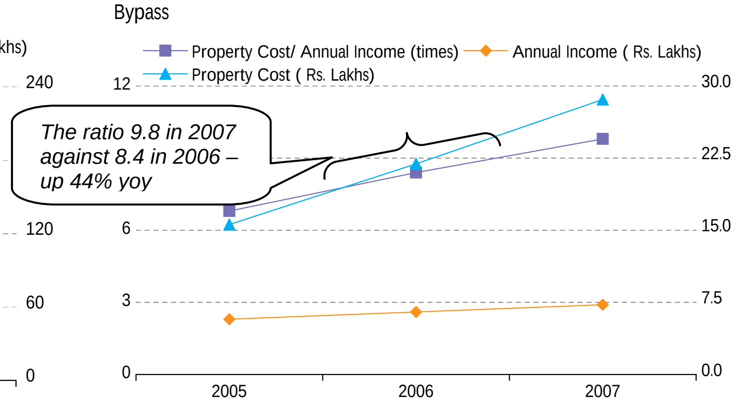
For example: In locations around Kolkata Municipal Corporation (KMC), affordability ratio increased significantly by 44%yoy in 2007 to 9.8% (property cost of Rs2.86m divided by minimum annual household income of Rs0.29m). A lower ratio of property costs to annual income suggests higher affordability.

Exhibit 4: Steep rise in property prices impaired affordability (property cost/ annual income ratio)

South Mumbai- Colaba, Cuffe Parade, Byculla, Nariman Point, Opera House, Malabar Hill, Napean Sea Road



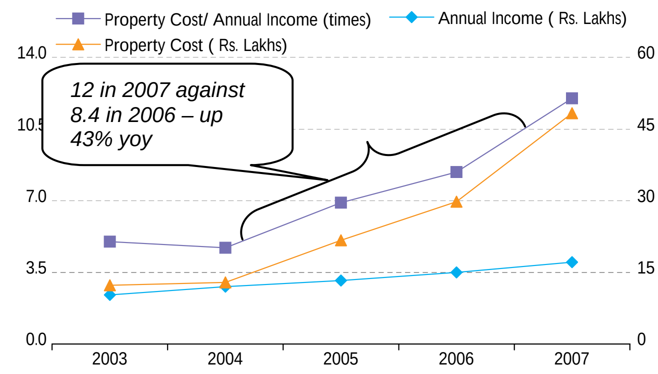
KMC – Around CBD, Around Salt Lake, Around Eastern Metropolitan Bypass



Source: Crisil, IDFC SSKI

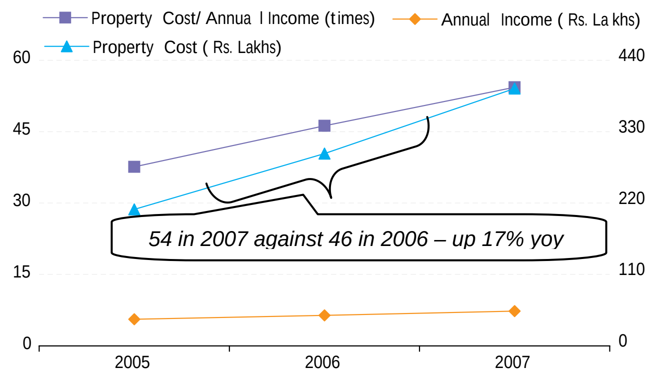
Exhibit 5: Chennai

Central Chennai - Nungambakkam, T Nagar, Mylapore, R A Puram and Adyar



Delhi

South Delhi, Chanakyapuri



Source: Crisil, IDFC SSKI

To capitalize on a booming economy, most realtors forayed into unrelated businesses

❑ Non-core diversifications – a move that backfired

Healthy cash flows, along with easy access to capital and debt, prompted most developers to diversify their revenue base across non-real estate businesses like power, telecom, wind-mills, managing hotels, building SEZs, amusement parks, etc. Companies looked to attain scale in these areas and divest the businesses at high valuations, thereby creating incremental value. Again, these projects were funded primarily through borrowed money from banks/ mutual funds. However, the global liquidity crunch meant acute fund shortage not only for these ventures but even for the core operations.

Exhibit 6: Developer's foraying into non core business

Company	Diversifying into non-core businesses
DLF BUILDING INDIA	Wind mill, power generation from dual turbine, infrastructure and financial services
unitech	Telecom, industrial parts, manufacturing of power equipment
Indiabulls REAL ESTATE	Developing and generating power from thermal and hydro power plants

Source: IDFC SSKI Research

IT/ ITeS companies, key customers for commercial property, the first casualty of global meltdown…

❑ Huge asset-liability mismatch – developers left high and dry

While life-time high crude prices had set inflation on fire, a volley of bad news triggered by the sub-prime crisis through to extinction of some of the world's strongest banks threw a spanner in the works of many a fast-growing economies. Real estate was among the worst hit sectors, and India was no exception. The extent of demand collapse was so pronounced that over Oct-Dec '08, there were zero bookings for most developers in the residential segment. In the commercial real estate segment too, demand vanished overnight as India Inc put its expansion plans on hold. Among key customers, IT/ ITeS companies were already witnessing a slowdown and retailers were finding the exorbitantly high lease rentals economically unviable. These factors led to a spate of lease cancellations. But despite the negative trends, development activity (Apr-Oct '08) continued full-swing as developers anticipated that demand would return by Q3FY09.

…developers further hit due to tight lending norms by banks and widespread cancellations by buyers

The demand destruction over Oct-Dec '08 stemmed cash flows for most developers while on the liability side they were saddled with land payment dues, payments due to creditors/ suppliers as also huge short-term debt repayment obligations. To add to their woes, many projects witnessed wide-spread cancellations with customers queuing up for refund of advances made. With no recourse to funding, equity or debt, the industry found itself in a bind and developers faced huge asset-liability mismatch. Leading developers like Unitech, DLF, Sobha, etc were saddled with obligations due for payment in H2FY09 towards short-term debt and land – now an illiquid asset.

Exhibit 7: Debt due for repayment in H2FY09

Rs mn	Debt			Short term debt due for
	FY08	H1FY09	FY09	repayment by Mar'09
DLF	122,773	146,730	163,500	23,000
Unitech	85,524	100,000	84,075**	26,300

*Source: Company, IDFC SSKI Research; ** Debt declined due to transfer of debt of Rs21bn to Unitech Wireless*

DEVELOPERS: SCRAMBLING OUT FROM UNDER…

With a severe liquidity crunch due to non-availability of funds, ballooning debt and depressed demand, there was a systemic risk of defaults by developers on loans from banks/ mutual funds. To help the industry stand back on its two feet, a life-line was thrown to developers. While the government went on to announce a much-needed relief package targeted at real estate sector, the RBI did its bit by allowing one-time restructuring of short-term debt.

❑ Stimulus package by government aimed to boost demand

Relief measures provide relief on mortgage rates and raw material costs

Two fiscal stimulus packages were doled out in Oct'08 and Jan'09 to India Inc as also the real estate sector. On government orders, public sector banks extended special interest rates for housing loans in two categories – 8% interest rates for loans up to Rs0.5m and 9.25% for loans between Rs0.5m-2m. Also, a 4% ad-valorem duty cut on steel and cement products reduced raw material costs for developers. These measures were aimed to boost demand by providing cheaper loans for housing and lower construction costs so as to enable developers to cut prices, and thereby boost demand.

❑ Policy initiatives by RBI helped developers to reschedule debt

A slew of measures by the RBI have helped real estate developers to avail of financing from banks on easy terms and restructure/ reschedule their loans due for payment before Q1FY10.

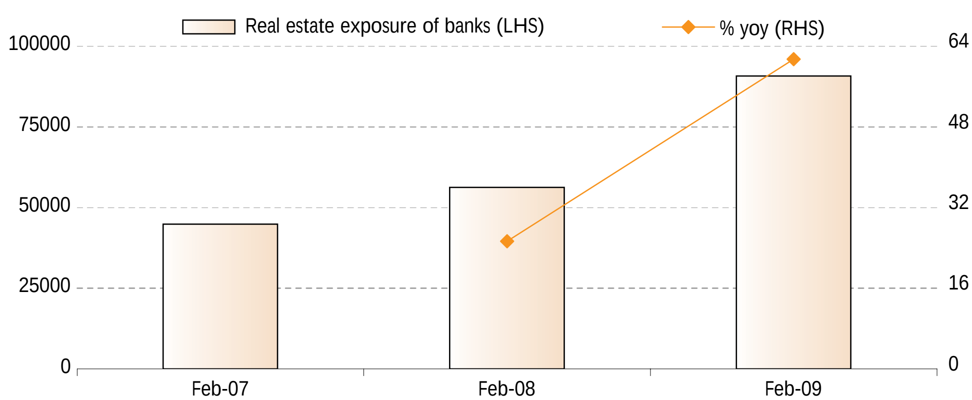
Exhibit 8: Slew of favorable measures from RBI

	Policy measure	Comments
1	RBI extended concessional treatment to sector till Q1FY10 – if a real estate loan is restructured, it will not be downgraded to NPA and will retain its asset classification	Underlying intent was to encourage banks to refinance loans to real estate developers; maintaining banks' NPA levels and balance sheets
2	RBI revised risk weight for commercial real estate loans from 150% to 100%	Measure aimed at reducing capital requirements for banks on such loans and thus increase flow of credit to the sector
3	RBI reduced general provisions required against standard real estate loans from 2% earlier to 0.4%	To increase liquidity of banks to provide additional funds flow to the sector
4	Interest rates on home loans reduced significantly by PSU banks – 8% interest rates for loans up to Rs0.5m and rates slashed to 9.25% for loans between Rs0.5m-2m	Aimed at encouraging people to buy housing properties, and consequently revive demand

Source: Media Reports, IDFC-SSKI Research

The RBI initiatives, coupled with a significant drop of ~200bp in home loan rates (especially in the up to Rs2m category) over the last five months, have supported the industry at a very critical time. Leading developers across the country have successfully refinanced/ rescheduled a substantial amount of short-term debt into long-term – a much-needed breather. Also, RBI data shows that banks' fresh loans to real estate companies registered ~61% yoy increase to Rs345bn in 11 months of FY09, compared to ~27% growth a year ago. Notably, half of these loans have been raised between Dec'08 and Feb'09.

Exhibit 9: Banks' total lending to the real estate sector – yoy growth



Source: Business Standard, IDFC-SSKI Research

...AND SURVIVING THE SLUMP

Equity dilution, asset sales and price discounts – a common theme across the sector

With developers getting a breather on the debt repayment front, deleveraging has assumed top priority to improve balance sheet health. As a result, strategies like equity dilution, asset sales and price discounts are now a common theme across companies. Also, to drive sustainable demand growth, most developers have started catering to the 'affordable' housing segment by slashing prices. Also, apartment sizes (and amenities/ specifications) are being reduced to further bring down the cost of property. At lower price points, genuine buyers are shopping again, which translates into better cash flows for developers.

Exhibit 10: Strategies to overcome the crisis

Asset monetization	Sell non core assets and restrict further investments into these assets
Realignment of land bank	Sell non core land parcels and buy land for mid-low income housing projects
Launch of residential properties	More focus on mid-income and affordable housing projects
Commercial segment	Develop only presold/ pre leased properties and focus on build and sell model

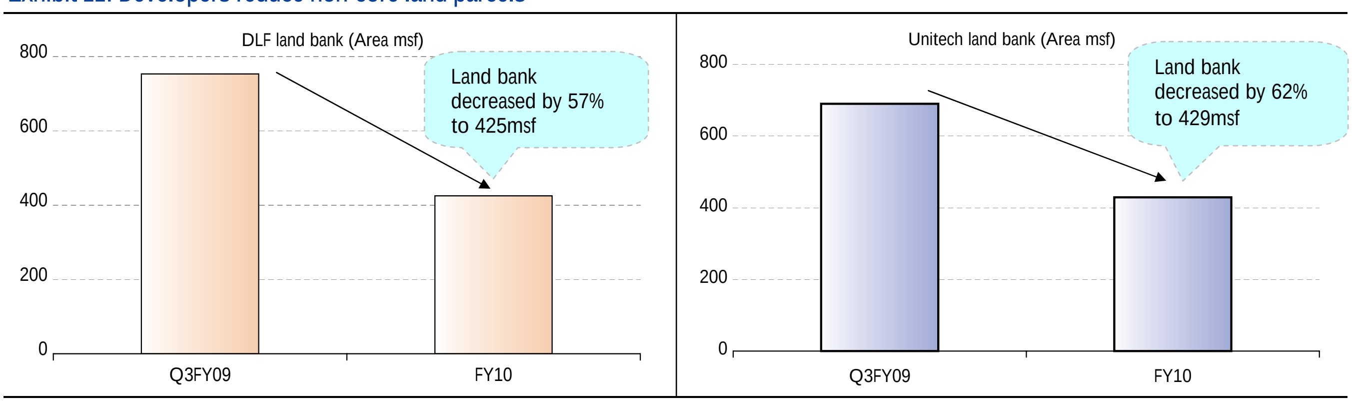
Source: IDFC-SSKI Research

❑ Developers reduce non-core and capital-intensive land parcels

DLF has cut its land bank by 57% and Unitech by 62% in last six months

Land banks are parcels of land set aside by developers until the time of development. To preserve cash, developers have stopped accreting land and are even deferring land payment to state governments/ local authorities. Non-core land parcels (10-20% of total land banks) have been reduced to generate cash and avoid locking-in 'critical' capital in a market of diminishing returns. In cases where the state government has failed to acquire/ hand over land to developers, most of them are opting out of the deal and seeking refund of earnest money.

Exhibit 11: Developers reduce non-core land parcels



Source: Company, IDFCSSKI Research

❑ Deleveraging takes centre-stage

Developers have adopted multiple strategies to deleverage their balance sheets and accelerate demand for real estate. While non-core assets are being sold off, certain ready properties are also being monetized to raise cash. Almost all development activity in the commercial property segment has been put on hold, or deferred indefinitely, in order to preserve capital and direct it to more profitable/ cash generating projects.

Sale of non-core assets

Non-core projects being monetized, investments being directed towards fast-selling core projects

Cash-strapped, developers have put non-core assets on the block. Monetization of these diversifications (part or complete stake sales in power, telecom, wind mill ventures, etc), while generating cash on the one hand, also reduces their capital needs as further investments into these investment-heavy ventures are stemmed.

A case in point is Unitech, which had ventured into the telecom business. The company has subsequently divested a 67% stake in the venture to Telenor (Telenor has already increased its stake to 49%) and put up its hotel projects on the block. DLF has also pulled out of the Dwarka Convention Centre development, put up its wind mill project for sale and lined up other hotel projects for sale.

Exhibit 12: Asset monetization plans

Company	Sale of non-core assets	Amount realized
DLF BUILDING INDIA	DLF has put on block wind mill and power generation business from dual turbine	Rs16.5bn
unitech	Unitech has successfully sold its 67% stake in Unitech Wireless to Telenor for Rs61.2bn. Post sale, debt of Rs21bn was transferred to Unitech Wireless and Unitech received Rs3.3bn from Unitech Wireless	Rs3.3bn

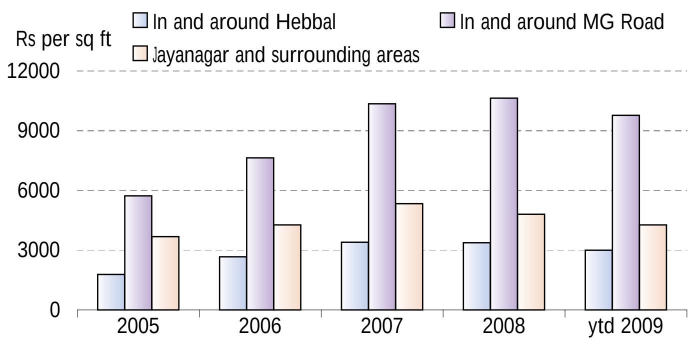
Source: Company, IDFCSSKI Research

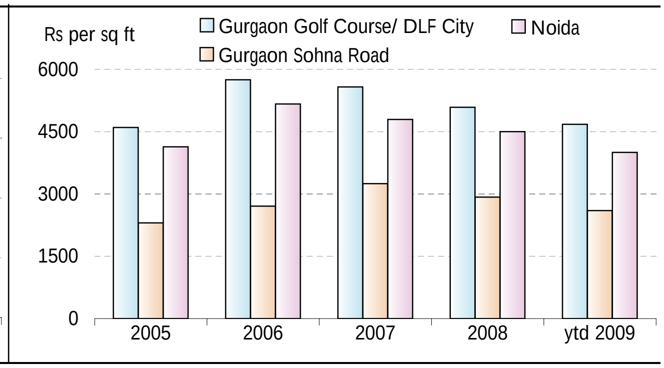
Developers blink at last – price cuts to generate volumes

Prices of residential property down 25-30% and of commercial by 40-50% from the peak

The tug-of-war between developers and customers has ended with prices of upcoming projects coming down by 25-30% and those of developed ones by 15-20% from the peak levels. The extent of price cuts, along with reduction in sizes of flats, varies depending on the location, size and other quality aspects of a project. In the residential segment, the strategy has paid off as there have been clear signs of demand picking up, albeit at a slower pace. This implies that only genuine customers are trickling back to the market for now. On the other hand, developers have reduced prices of commercial properties by 40-50% from the peak levels, but no demand uptick has been seen yet.

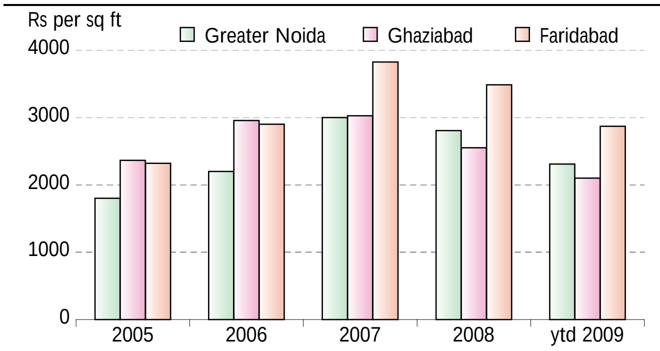
Exhibit 13: Prices of newly launched property in and around Banagalore… …in and around NCR

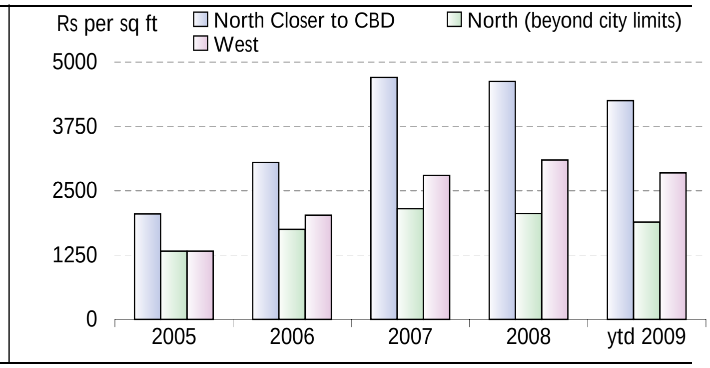




Source: Crisil, IDFCSSKI Research

Exhibit 14: Prices of newly launched properties around NCR… …in and around Kolkata





Source: Crisil, IDFCSSKI Research

Affordable houses eliciting good customer response

Curtailed commercial development plans; focus on housing…

In a bid to improve cash flows, most developers have stalled construction of capital-intensive projects and are channelizing the scarce funds into projects already under development. Also, developers have revised the product mix to focus more on development of residential properties in the near term, as demand is being seen only for these properties.

…with developers turning to 'affordable' projects

Developers have clearly changed their strategy in a bid to generate volumes. The focus has now turned from premium projects to developing affordable properties (houses with reduced specifications, sizes and at slightly inward locations) so as to tap the masses – a segment largely unaddressed during the boom time. These affordable housing projects have met with good response from customers and are fetching volumes for developers.

Exhibit 15: Newly launched properties at steep discounts to peak pricing across cities

			Sale Price (Rs/ sq ft)		Drop
Developer	Projects	Location	Launch price	Peak price	(%)
HDIL	Premier Residence	Kurla	5351	8500	37
	Metropolis	Andheri	7651	12000	36
DLF	Capital Greens	SBM, Delhi *	7000	14000	50
	West end height	Bangalore	1850	3000	38
	Lake View	Hyderabad	1850	3000	38
Unitech	Uniworld City II	Sohna Road, Gurgaon	2995	4500	33
IBREL	Indiabulls Centrum	Sec 103, Gurgaon	1950	3000	35
Purvankara projects	Cosmos Park	OMR (Siruseri IT Park)	1722	2500	31
Jai Prakash Associates	Wishtown Klassic	Sec 129, Noida	3330	4800	31
Omaxe	Eternity	Vrindavan	1700	1700	-
Lodha	Casa Bella	Dombivli, Mumbai	1800	2500	28
	Casa Essenza	Dahisar, Mumbai	4500	5800	22
Nirmal Lifestyle	City of Joy	Mulund, Mumbai	4500	6000	25

Source: Company, Media Reports, IDFCSSKI Research

Funds raised in equity paper used to repay debt and towards other softer issues

❑ Benign equity markets – lending a helping hand

The sudden recovery in capital markets world-over has once again whetted the appetite for Indian paper. This, in turn, has greatly served the purpose of Indian developers. The overwhelming response to the qualified institutional placement issues of Unitech, India Bulls Real Estate (IBREL), stake sale by DLF promoters, etc has clearly opened the door for other smaller developers. The option of raising money through sale of shares has come as a huge relief for the cash-starved real estate sector. The funds thus raised are being used to repay debt and resolve softer issues like employee benefits, payments due to suppliers, etc.

Exhibit 16: Promoters of real estate companies generate cash through stake sale or through QIP

				Promoters' stake (%)	
	Company	US $m	Rs bn	Pre QIP	Post QIP
Apr' 09	Unitech	325	16.08	64	51
May' 09	IBREL	565	27	26	17
				Stake sold %	Promoter current stake
May'09	DLF	760	38.6	9.90	78.7

Source: BSE, Media Reports, IDFC-SSKI Research

Developers announcing preferential share offers to increase promoter stakes

Given an anticipated recovery in demand over the next 12 months on the back of secular demand drivers as also a stable government and favorable policy measures, developers have also been announcing preferential share offers in order to shore up promoter stakes and use the premium amount to repay debt. Going forward, sustained buoyancy in the capital markets would mean more paper supply by developers.

DEMAND BEGINS TO RECOVER IN RESIDENTIAL SEGMENT…

The global economic meltdown, manifesting since early-2008, has dented the 'India story' with the Indian real estate sector bearing the maximum brunt. While there has been widespread demand destruction as the economic downturn converged with a credit squeeze, favorable demographic factors and an ever-increasing housing

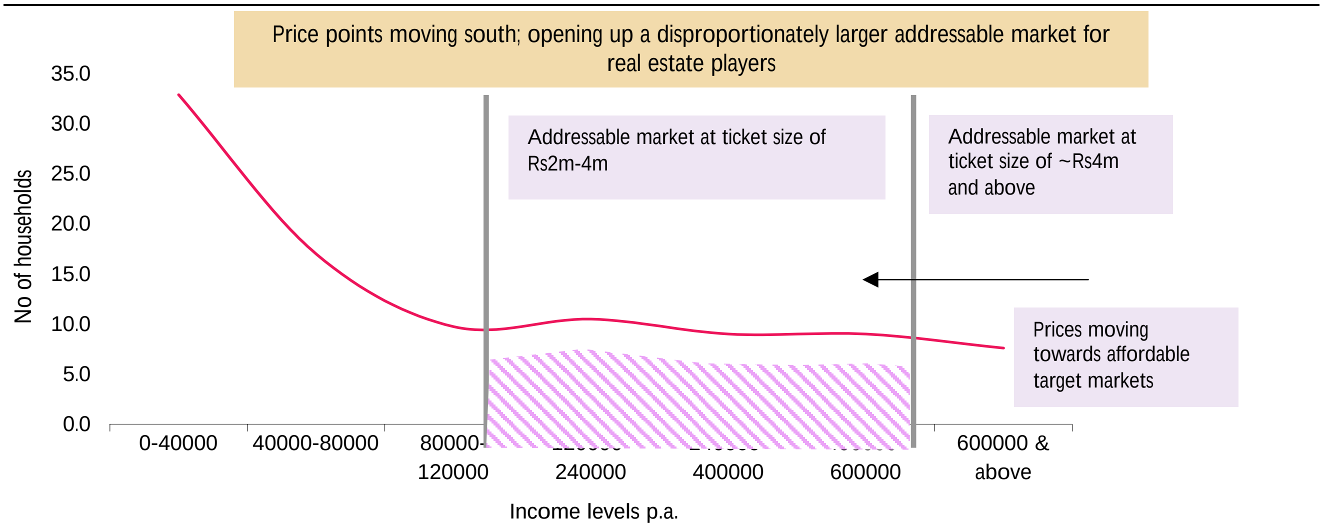
Structural demand for housing is intact

shortage impart some degree of resilience to housing demand in India (market estimated at US$45bn a year).

❑ Demand for housing property exists – at the right price

A growing middle class and increasing nuclearization of families, as also modern attitudes to home ownership (average age of a new homeowner in 2006 was 32 years vis-à-vis 45 years a decade ago), have kept structural demand for housing intact. Albeit, price tolerance has reduced than what it was a year ago. Therefore, while demand has declined significantly for premium properties, potential demand still exists for housing at the right price points.

Exhibit 17: The middle income group – largest addressable market for real estate players

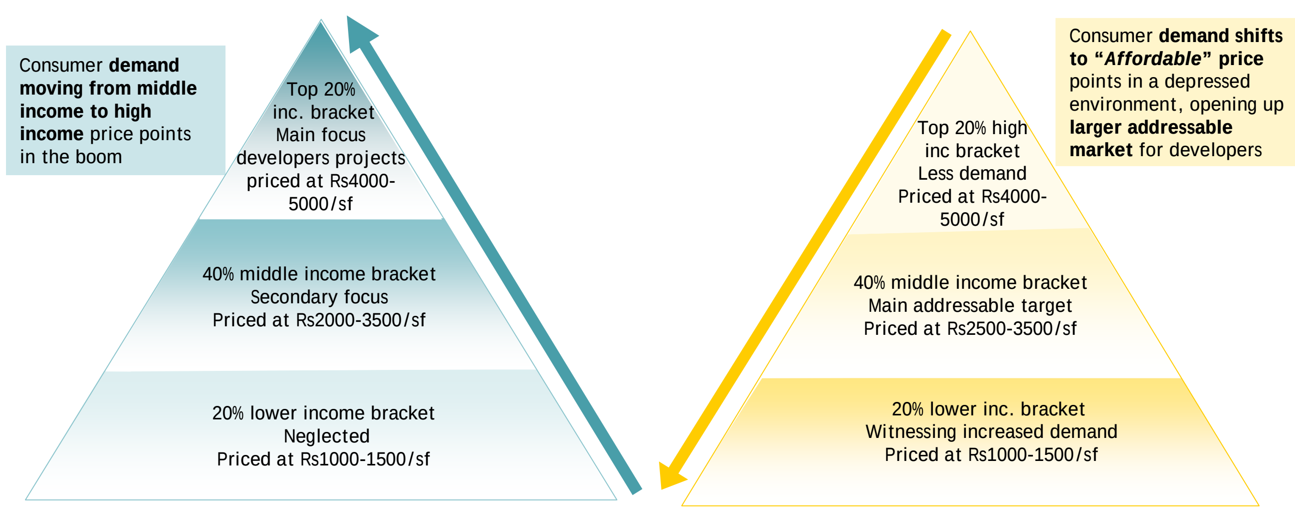


Source: IDFC-SSKI Research

Rapid urbanization – a boost to housing demand

Housing demand in India is likely to maintain steady state growth driven by rapid urbanization (more than 35 cities with population in excess of 1m; urban penetration estimated to touch 34% by 2025).

Exhibit 18: Demand led by higher income bracket over FY05-08 … …while middle income group to drive demand over FY10-12E



Source: IDFC-SSKI Research

"Definition" of Affordable Housing

Currently, there is no official definition of affordable housing provided by either the Indian government or any housing agency. The US Department of Housing and Urban Development (HUD) defines "affordable" as housing that costs (rent and utilities in an apartment or the monthly mortgage payment and housing expenses) no more than 30% of a household's monthly income. The RBI has provided a range of cheaper home loans (loans up to Rs0.5m and between Rs0.5m-2m) to indicate a range for affordable housing.

Recently, the Ministry of Housing set up a task force, under the chairmanship of Mr Deepak Parekh, for defining various aspects of affordability. The task force, which submitted its report in January 2009, suggests the following parameters for classifying affordable housing:

Exhibit 19: Recommended parameters of Affordable Housing (Ministry of Housing)

	EWS/ LIG	MIG
Size	300-600 sq. ft carpet area	Not exceeding 1,200 sq. ft carpet area
Cost	Not exceeding 4x a household's gross annual Income	Not exceeding 5x a household's gross annual income
EMI/ Rent	Not exceeding 30% of gross monthly income	Not exceeding 40% of gross monthly income

Note: EWS: Economically weaker segments, LIG: Low- income groups, MIG: Mid-income groups; Source: Ministry of Housing

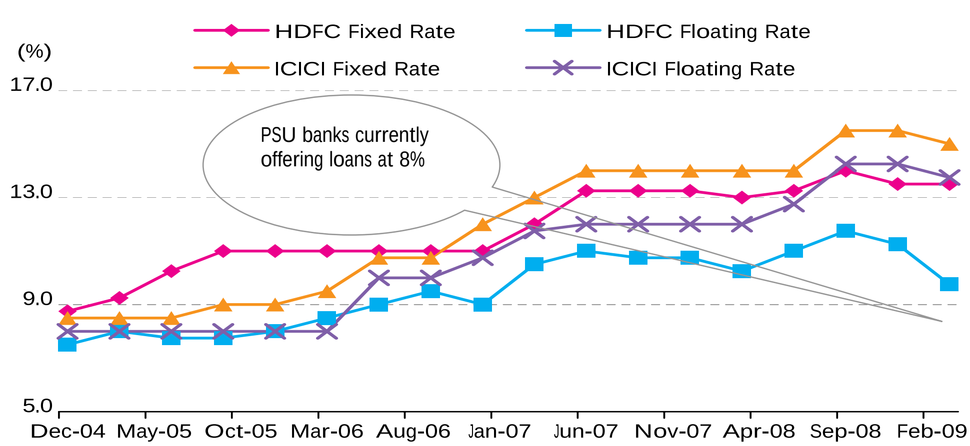
❑ Home loan rates trending down; to spur housing purchases

Increasing availability of finance at cheaper rates adds to 'affordability'

Home loan disbursements had tapered substantially post the financial crisis in FY09. However, the recent policy-induced drop in interest rates and favorable measures from the RBI, as also government boost to lending to real estate sector, have started showing results – albeit slowly.

With interest rates turning benign, we expect respite for the residential housing sector, as increasing availability of finance at cheaper rates adds to the 'affordability' factor, at least for low-ticket properties. Floating rate for housing properties have declined from the peak of 13-14% to a low of 8.0-9.25% being offered by leading financial institutions across the country.

Exhibit 20: Home loan rates – on a downtrend



Source: Bloomberg

A faster turnaround in economy to boost demand

❑ A stable government bodes well for the sector

A stable government at the Centre, along with initial signs of a recovery in global economies, has resulted in a rush of foreign capital towards all asset classes, including real estate, in India. Various real estate associations (CREDAI and NAREDCO) and developers concede that the return of the pro-reforms UPA-led coalition to power is a big positive for the sector, and would help it to recover from the downturn by implementing some or all of the reforms mentioned below:

Exhibit 21: Industry expectations on reforms

Reforms expected from new government	Comments
Bringing affordable housing/ housing under priority sector & providing infrastructure to residential townships	Developer can then avail of bank finance at lower interest rates and develop residential properties at lower cost
Encouraging banks to lend to real estate companies	
Exemption of income tax / reintroduction of section 80I (B)	Profitability of project increases; that encourages developers to develop houses at lower price points
Increasing tax rebate on home loan interest rates from Rs150,000 to ~Rs250,00-Rs300,000	A tax rebate will encourage customers at the lower end to purchase properties
Increasing limit of priority sector lending to Rs35m	
Reducing interest rate for home loans	This would enable customers to avail of easy bank finance

Source: Media Reports, IDFCSSKI Research

While these measures, we believe, may not be implemented in entirety, they would go a long way in restoring customer confidence and accelerate revival of the real estate sector. All these steps would enable developers to cut prices to gain volumes, and in turn improve cash flows to ease the pressure on balance sheets.

Demand uptick for affordable housing already evident across regions

❑ Demand for housing property is accelerating

Softer interest rates, rationalization of property prices and launch of new projects targeted at masses are all set to boost demand for housing properties in the next 12 months. An uptick in demand for affordable housing has already been witnessed in the past two months across regions.

❑ Only 'real' demand; not a speculators' market…yet

Currently, demand is being witnessed only from actual end users. In contrast, demand for housing property during the boom period was mostly driven by investors. However, this class of buyers has turned extremely 'risk-averse' in the wake of the uncertainty surrounding the realty sector. As the economy bounces back, real estate as an asset class could again be an attractive investment among investors over the medium term. This, in turn, would mean significant improvement in demand and hence stability/ slight uptick in property prices.

…BUT COMMERCIAL DEMAND WILL LAG ECONOMIC GROWTH

The real estate sector – particularly the commercial segment – largely tracks the broader economic growth. With companies deferring their capex/ expansion plans in the wake of the global economic meltdown, demand for commercial properties – offices, warehouses and retail malls – took a severe beating. In fact, there is currently an oversupply in the system; and we believe demand would take much longer to bounce back even after buyers return to the market.

Development work on almost all upcoming hotel properties has been stopped

❑ Demand for commercial property has dried up completely

A rapid expansion in the Indian economy over FY05-08 had a cascading effect on demand for commercial property to help meet the needs of businesses such as modern offices, warehouses, hotels and retail shopping centers. The burgeoning IT/ ITeS industry emerged as the key driver of the boom in the commercial real estate space over the years. However, forced by the global economic meltdown, these companies had to curtail their expansion plans and defer capex. Meanwhile, developers created huge capacities – spurred by the buoyancy in this segment of real estate. Notably, the poor sentiment has also taken a toll on business/ leisure tourism, which means lower demand for hotel properties. Resultant, development work on almost all upcoming hotel properties has been stopped.

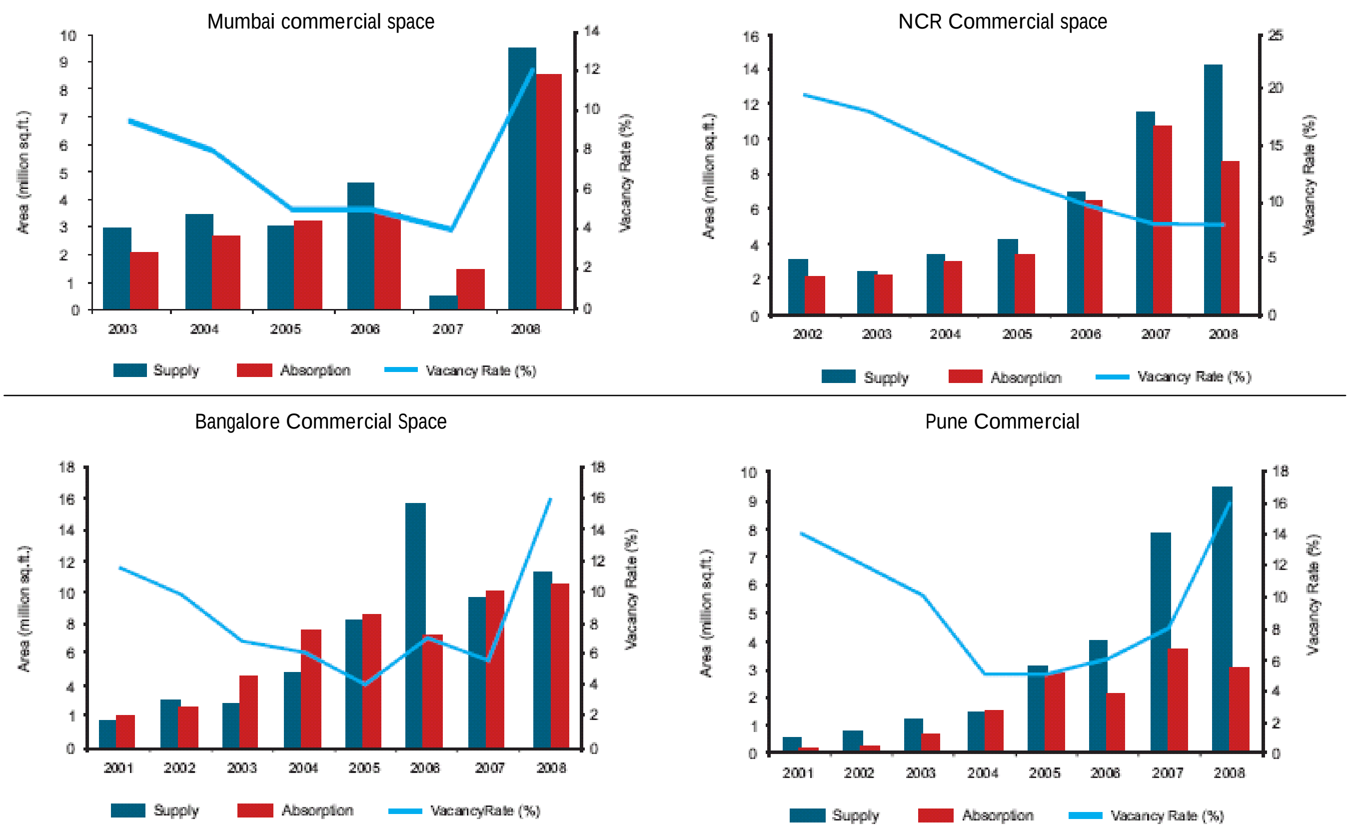
With the global markets still overcast with clouds of uncertainty, and thus any material improvement in outlook for IT/ ITeS sector (a key demand factor) some time away, we do not expect demand to return in a hurry.

We estimate demand for commercial property to revive after 12-18months

❑ Demand would revive only after oversupply gets exhausted

As developers failed to align supply with slowing demand, most locations are replete with ready commercial properties. Hence, we believe demand for commercial properties would revive only after the surplus gets used up. We estimate demand for commercial properties to revive only after 12-18 months – in line with an economic-revival driven higher growth visibility for the services sector, the key user of commercial real estate.

Exhibit 22: Supply absorption and vacancy rate of Grade A commercial space across major cities over CY03-08



Source: CUSHMAN & WAKEFIELD

SURVIVORS WOULD BE WINNERS: BUT SIZE DOES MATTER!

The stage is set for demand revival for housing properties in the short term. While this augurs well for developers, we believe well-funded and larger developers with quality land bank and strong execution skills would be the first and key beneficiaries of the upturn. Given their proven track record and the management's ability to respond proactively to changing sector dynamics, we prefer large players like DLF and Unitech in the space.

❑ Scale defines ability to raise funds…

Larger realtors the first ones to successfully raise funds capital markets

The firefighting measures adopted by developers across the space have helped the industry survive its worst-ever crisis – that of survival. Having successfully rolled over their short-term debt, the next immediate course of action for developers was to aggressively look at improving their cash flows and reducing debt. In this context, the first round of capital raising from the capital markets in the recent pull-back was dominated by real estate sector, and that too larger ones. Over Apr-May'09, leading players like Unitech, DLF and IBREL garnered Rs81.4bn from the capital market, either by stake sale or through the QIP route.

❑ …as also higher credibility on execution

Larger developers offer higher visibility on completion of projects and/ or delivery schedules

Part of the proceeds raised from equity stake sales have been used to reduce debt and partly pay creditors. While this has provided these developers some respite on the leverage front, we believe funding for construction activity would now be more forthcoming. Also, larger developers – on the back of their credibility – are able to generate higher customer interest given the perceived risk on financial stability associated with smaller players. Thus, we believe larger developers offer higher visibility on completion of ongoing projects and/ or delivery schedules.

❑ Another round of funding quite likely

With additional funding, larger developers would be back in the reckoning

The first round of equity funding has enabled realty players to meet their immediate debt repayment obligations, pay creditors and refund some money against cancellations. Going forward, the aggressive roll-out plans of most developers, as also construction costs related to previous launches, would entail huge construction costs (though advances from sale of housing properties are front-ended). In this backdrop, we do not rule out another round of fund-raising. And if developers succeed in raising additional funds, we believe they would finally be out of the woods.

Exhibit 23: Fund raising plans of real estate developers

Company	Fund raising
Anant Raj Industries	• Raising of funds up to Rs20bn, through QIP or by way of issue of ADR / GDR / FCCB or such other similar means • Issuance of Fully Convertible Warrants in the Company to the Promoter(s) on preferential allotment basis
DLF	• The Promoter Group of DLF sold 168m equity shares to (i) infuse capital in DLF Assets Pvt. Ltd ("DAL"); and (ii) purchase of D.E.Shaw's interest in DAL
Housing Development & Infrastructure	• HDIL intends to raise upto Rs30bn (assumed rupee equivalent of USD 600 million) through QIP • HDIL intends to issue 26m Preferential Warrants in the Company to Promoter(s) on preferential allotment at a floor price of Rs 228.55 per share. Based on floor price, the amount proposed to be raise through the warrants is ~Rs5.942bn
Indiabulls Real Estate	• Indiabulls Real Estate has issued and allotted 143.5m fully paid-up Equity Shares, at a price of Rs 185 per Equity Share aggregating to Rs26.55bn through a QIP issue during the month of May 2009
Unitech	• Unitech proposes to raise long term funds upto Rs90bn either through preferential issue, QIP and / or private placement • The company intends to issue 227.5m Preferential Warrants to Promoter(s) on preferential allotment at a price of INR 50.75 per share aggregating to Rs11.5bn
Orbit Corporation	• The company proposes to raise long term funds upto Rs5bn, either through preferential issue, QIP and / or private placement • Issue of preferential allotment of warrants to Promoters of the Company
Parsvnath Developers	• The company proposes to raise long term funds upto Rs25bn either through preferential issue, QIP and / or private placement or by way of issue of ADR / GDR / FCCB or such other / similar means

Source: BSE,. Media Reports, Company, IDFC SSKI Research

Sector leaders have land bank at better locations and across cities

❑ Quality land banks – a key competitive edge

Large developers have huge land banks accreted at a more favorable cost than their smaller peers. This imparts to them the ability to offer cost-competitive projects vis-à-vis the latter. Also, their quality of land bank is far superior compared to that of smaller regional players as they have a national footprint. Importantly, larger builders – by offering lower price points – may have had to monetize some part of the land bank at lower profitability, but this has provided them the much-required leeway to remain in the fray for the longer term. As demand returns, we expect these builders to progressively monetize the land bank at an accelerated pace and at higher price points.

Buy Unitech and DLF with a price target price of Rs128 and Rs421 respectively

❑ We prefer Unitech and DLF

Unitech and DLF, India's leading real estate developers, hold large land parcels across geographies, have the ability to raise funds and the necessary wherewithal to battle tough macroeconomic conditions. Given the imminent demand revival, though first only in the residential segment, we expect these two players to be at the forefront of the recovery. Both the players have demonstrated the ability to adapt to the changing times and change tack accordingly. In the last three months, new projects have been launched and sold successfully (in fact, ahead of our estimates), which infuses confidence in their execution capabilities. We reiterate our Outperformer rating on Unitech (NAV-based priced target of Rs128) and initiate coverage on DLF with Outperformer (Rs421).

Exhibit 24: Comparative valuations table

Company	Price (Rs)	Mkt Cap (Rs bn)	Reco	EPS growth FY10-11E (%)	FY10E PE (x)	FY10E EV/EBIDTA (x)	Target (Rs)	Upside %
Unitech	87	177.8	Outperformer	23.7	16	12	128	47.7
DLF	352	597.4	Outperformer	32.9	26.9	23	421	19.6

Prices as on 15th June,2009

COMPANIES

Initiating coverage

DLF

Rs352
OUTPERFORMER

15 June 2009

BSE Sensex: 14876

Back on Track

Mkt Cap: Rs597.4bn; US$12.7bn

DLF, India's largest real estate developer, has averted the 'crisis of survival' faced due to lower demand and non-availability of funds. Having rolled over its short-term debt due by Mar-09, DLF is working on deleveraging through sale of non-core assets and reducing receivables of Rs49bn from DLF Assets (DAL – a promoter-owned company). The promoters have sold 9.9% of their stake in DLF and ~Rs16bn from the proceeds will be repaid by DAL to DLF against receivables. We expect DLF to cut its debt to ~Rs95bn by FY10 from Rs163.5bn in FY09. Also, DLF has deferred 20msf of office and 7msf of retail development; the mix has historically been tilted towards non- residential real estate (75% of ongoing projects in Q2FY09). To tide over the demand slump, DLF is currently focusing primarily on affordable housing where demand exists. Given its quality land bank, ability to scale-up quickly, and execute and deliver quality projects across segments, we initiate coverage on DLF with Outperformer and an NAV-based price target of Rs421.

Deleveraging – the way forward: Sudden demand pull-back, as for other realtors, meant inability to repay short-term borrowings availed of to fund land acquisitions as also construction activity. In FY09, net borrowings increased by Rs41bn and receivables from DAL mounted to Rs49bn. While ~Rs16bn would be repaid towards DAL receivables from proceeds of the stake sale by promoters, DLF is aggressively working on cutting debt through sale of non-core assets (we estimate ~Rs32bn to accrue in FY10).

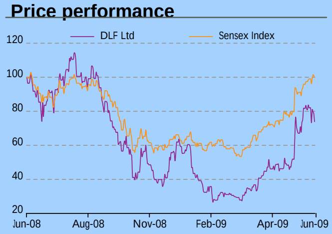
Development plans revised to maintain cash flows: To preserve cash, DLF has deferred development of capital-intensive properties including 20msf of office and 7msf of retail development. Also, land bank has been adjusted to 425msf from 751msf previously through surrendering the land and renegotiation with state governments/ land payment. DLF plans to launch more projects in affordable housing to generate cash flows and use the proceeds to repay debt and reduce gearing.

Moving in the right direction; Outperformer: DLF appears to be taking the right steps to improve its balance sheet health. Despite the recent run-up in stock price, we believe the market is still not fully valuing the premium positioning of DLF's land bank. We have assumed DLF to launch 110msf of development over the next seven years with focus on affordable housing. We initiate coverage on the stock with an Outperformer rating and NAV-based price target of Rs421–20% upside from CMP.

Stock data

Reuters	DLF.BO
Bloomberg	DLFU IN
1-yr high/low (Rs)	578/124
1-yr avg daily volumes (m)	23.8
Free Float (%)	11.5

Price performance



Performance (%)

	3-mth	6-mth	1-yr	3-yr
DLF	130.9	25.5	(26.6)	-
Sensex	69.9	51.3	(2.1)	55.9

Key financials

Year to March 31	FY08	FY09E	FY10E	FY11E
Net sales (Rs m)	144,331	100,390	66,721	85,006
Adj. net profit (Rs m)	78,142	46,284	22,229	29,551
Shares in issue (m)	1,705	1,705	1,697	1,697
Adj. EPS (Rs)	45.8	27.1	13.1	17.4
% growth	262.7	(40.8)	(51.8)	32.9
PER (x)	7.7	13.0	26.9	20.2
Price/Book (x)	3.0	2.4	2.2	2.0
EV/EBITDA (x)	7.3	13.8	23.0	16.5
RoE (%)	66.1	20.4	8.5	10.3
RoCE (%)	41.9	14.2	7.0	9.9

Ramnath S
ramnaths@idfcsski.com
91-22-6638 3380

Rajeev Desai
rajeev@idfcsski.com
91-22-6638 3231

INVESTMENT ARGUMENT

DLF is walking out of the woods – launching affordable housing projects and increasing cash flows, putting non-strategic assets on the block to bring down gearing from 0.6x in FY09 to 0.4x in FY10E. Further to reduce leverage, DLF has suspended majority of capital-intensive projects with Rs32bn estimated to be raised by monetizing non-core assets. Towards receivables (Rs49bn) from DAL, promoters have sold a 9.9% stake in DLF and would use Rs16bn from the proceeds to repay DLF. Going forward, another Rs20bn is proposed to be repaid by securitizing DAL's FY10 rental income. Further, to preserve capital, DLF has surrendered certain land parcels. DLF intends to focus on affordable and city-centric housing projects (we expect 13msf to be sold in FY10) and develop smaller commercial spaces (2-3msf). In the wake of these developments, DLF's execution capabilities and quality land bank, we see upside despite the recent run-up in the stock price. We initiate coverage on DLF with Outperformer and an NAV-based price target of Rs421.

Exhibit 1: The way forward

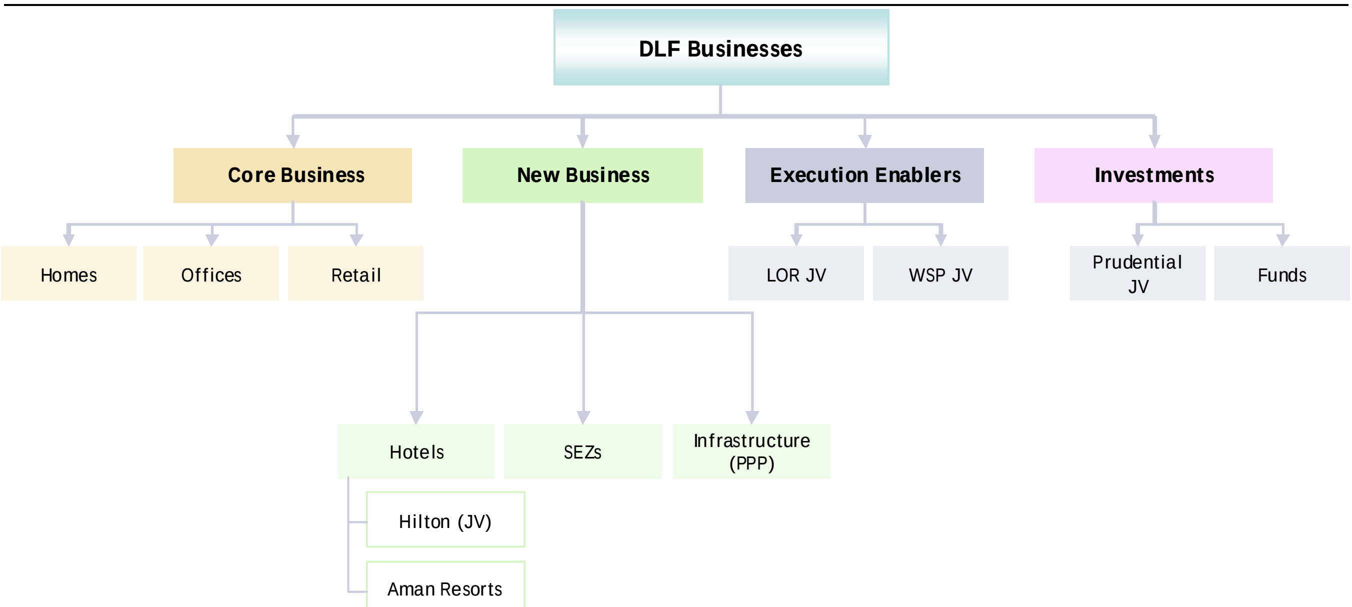
	Crisis of Confidence	Out of the woods	The way forward	
Volumes	12.42msf sold in FY09	Aggressively reduced prices by 35% from peak	We expect DLF to launch 15-16msf in FY10	
DAL	Receivables from DAL increased to Rs49bn	Receivables to come down to Rs33bn with Rs16bn to be repaid from proceeds of stake sale of DLF promoters	Promoters to consider acquisition of stake by DLF or REIT listing for DAL	Both the options to benefit DLF shareholders
Commercial properties	Hefty capital expenditure on commercial properties	Focus on "build and sell" model	Focusing on affordable and city-centric housing for now	
Monetization of assets	Exited from non-strategic land bank; total saleable area reduced to 425msf from 751msf	Monetized assets worth Rs3.1bn in YTD FY10	Asset monetization to continue; we estimate Rs32.21bn to accrue in FY10	
Debt	Total debt increased by Rs40bn to Rs163bn as of end-FY09	Debt down to Rs147bn with Rs16bn to be repaid from proceeds of stake sale	Total debt expected to reduce to Rs95bn in FY10	
Stock performance	Stock hammered to Rs136 as on 12 Mar 2009 from peak of Rs725 on 29 Apr 2008	Stock price peaked to Rs416 on 4 June 2009	We have assigned NAV-based price target of Rs421 per share	Given quality land bank in terms of location, we assign higher value to residual land bank

Source:IDFCSSKI Research

DLF: INDIA'S LEADING REALTOR

DLF, with six decades of experience, is India's largest real estate player (net sales of Rs100.3bn and earnings of Rs46bn in FY09) with a well-diversified, quality land bank. The company has land reserves of 425msf located in super metros, metros and Tier I & II cities. Of this, ~57% of the land is located in super metros (most of it in NCR; remaining in Mumbai) while 23% is in metros. With more than six decades of experience and an excellent track record, DLF has a well-established brand and has been accredited for "Development of Gurgaon" and development of 'DLF Township' (a hallmark project on 3,000 acres executed by the company). DLF has developed 238msf of property till date.

Exhibit 2: DLF – business model

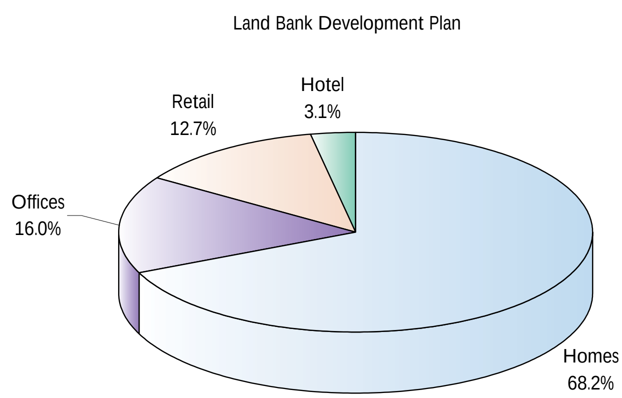


Source: Company , IDFCSSKI Research

A well-diversified, quality land bank…

DLF has tied up with global players for design and engineering (WSP Group Plc – a design, engineering and management consultancy in the UK) and execution of projects (Laing O'Rourke – UK's largest private construction company).

Exhibit 3: Land bank development plan over the next 8-10 years



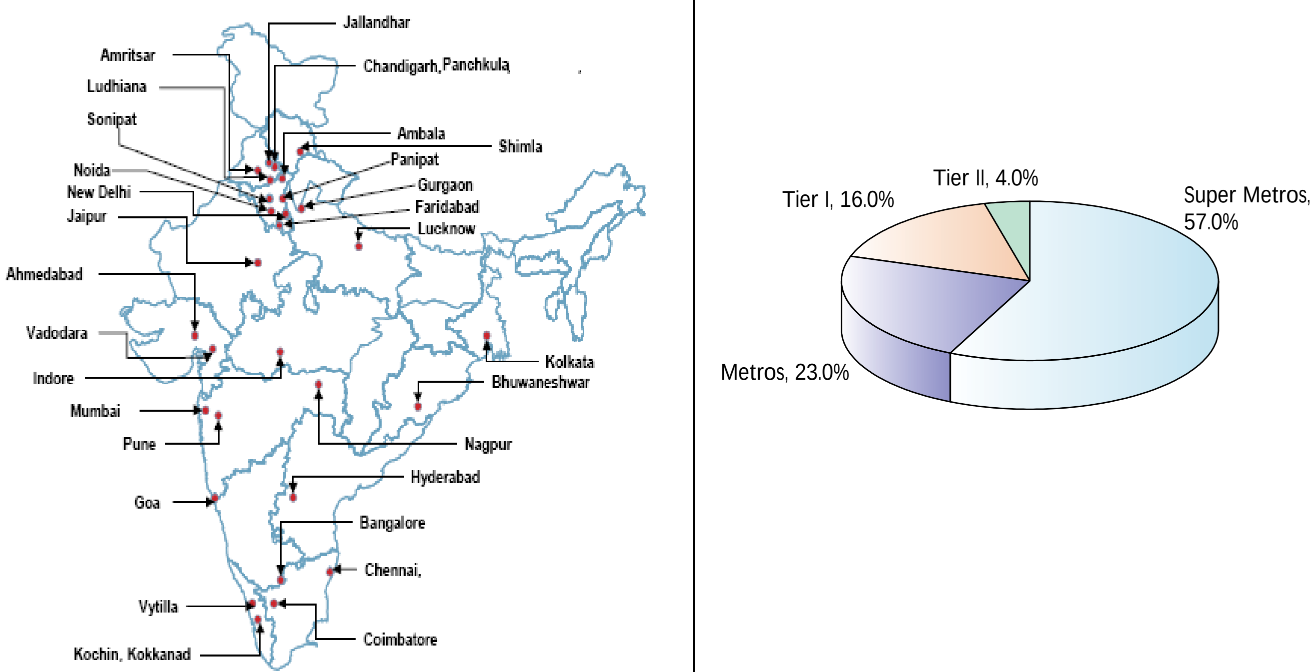
Source: Company, IDFC SSKI Research

…aggregating saleable area of 425msf

❑ Quality of land bank – a key competitive advantage

DLF's large and well-diversified land bank, aggregating saleable area of 425msf, places the company in a position of strength vis-à-vis peers. Around 57% of the land reserves are located in super metros (NCR and Mumbai), ~23% in metros and the remaining in Tier I & II cities. Besides, more than 90% of the reserves are available as large contiguous plots of land. A large portion of the company's land bank is located at prime locations and hence would fetch it higher realizations. Also, DLF has accreted the land bank at a significantly low cost, which enables it to offer cost-competitive projects. Of its total land bank of 425msf, residential land accounts for 290msf, commercial - 68msf, retail - 54msf and hotels - 13msf.

Exhibit 4: DLF land reserves – located in or near prominent cities; 90% in large **contiguous** plots



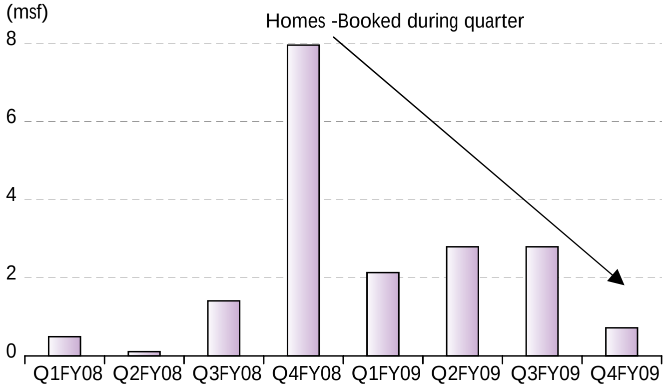
Source: Company, IDFC SSKI Research

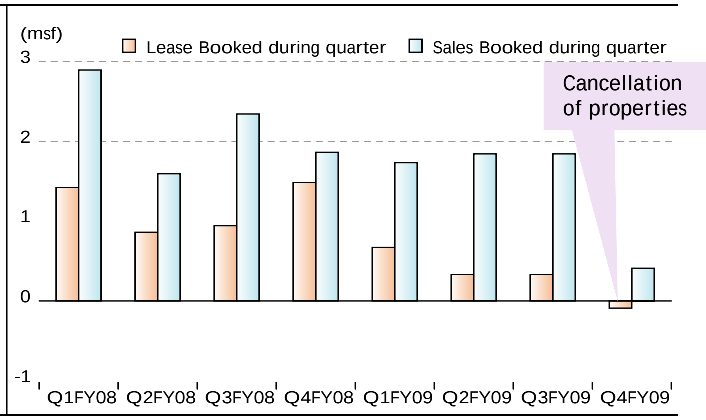
Debt of Rs41bn availed of in FY09 for development; but no takers for projects

A HUGE ASSET-LIABILITY MISMATCH IN FY09

Over FY06-08, DLF increased its area under construction to 62msf, of which ~75% comprised capital-intensive properties – 36msf of office space and 12msf of mall space. However, with the Indian economy hitting growth moderation, many corporates put their expansion plans on hold, which meant lower demand for commercial/ retail real estate projects. DLF, with its focus on these segments, was among the hardest hit and saw rental deals falling through or getting renegotiated at significantly lower rates. Even in the residential segment, the company managed to sell only 77 units of mid-income houses over Nov-Dec '08 as against average volumes of 400 units per month previously.

Exhibit 5: Significant volume decline – in residential… **…as well as office segment**

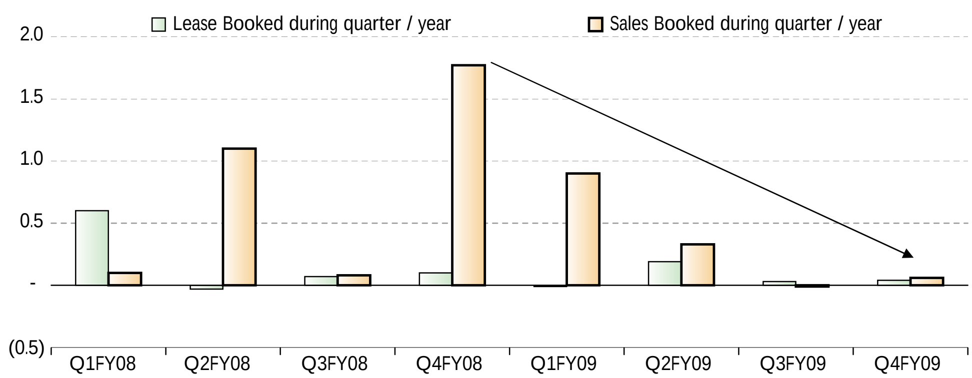




Source: Company, IDFC SSKI Research

Rental deals falling through or getting renegotiated at significantly lower rates

Exhibit 6: Decline in sales volume of retail properties

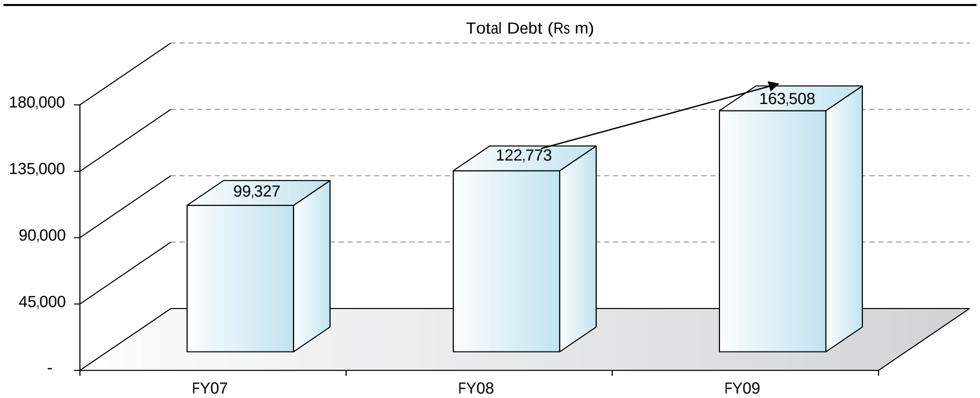


Source: Company, IDFC SSKI Research

With hardly any recourse to funding avenues, cash flows suddenly evaporated and DLF – like peers – was cash-strapped not only to repay short-term debt obligations but also to fund construction of ongoing projects. Towards both these ends, the company had to raise debt of Rs41bn in FY09, largely from state-owned banks. Hence, DLF's total debt ballooned to Rs163.5bn (gearing of 0.6x) in FY09.

Net debt ballooned to Rs163.5bn in FY09

Exhibit 7: Debt increased by Rs41bn in FY09



Source:Company , IDFCSSKI Research

Dues repayable to DLF using revenues generated by DAL via sale or lease of commercial assets

❑ The DAL boomerang – DLF's albatross

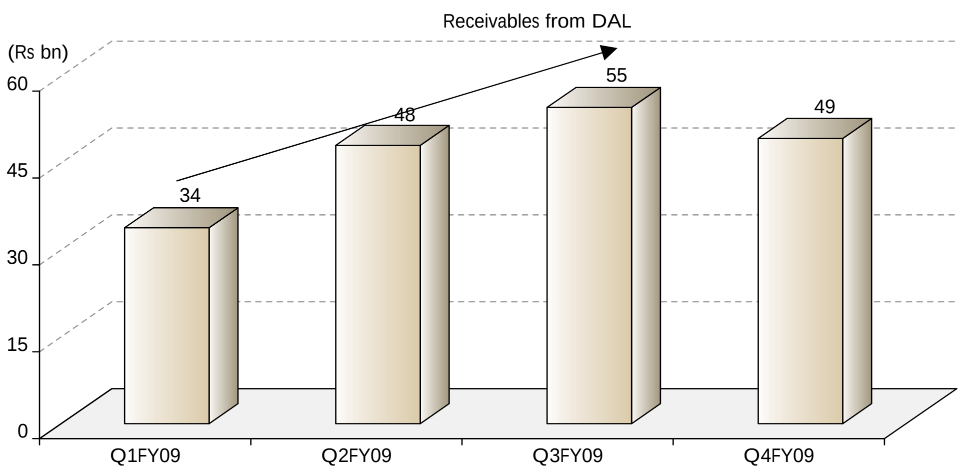
DLF Assets (DAL – owned by DLF promoters), an entity created in 2007 to purchase commercial properties from DLF, was formed with DE Shaw and Symphony Capital (stake of Lehman Brothers acquired by Symphony Capital) as strategic investors. Under the arrangement, DAL would bid for commercial assets of DLF along with third parties on a quoted cap rate basis (with approval of an independent audit committee). Dues were repayable to DLF through the revenues generated by DAL via sale or lease of commercial assets.

Receivables from DAL mounted to Rs49bn as of end-FY09

As per the agreement between DLF and DAL, DLF had agreed to sell ~19msf of commercial properties to DAL at a cap rate of 9%. DLF has so far recognized revenues for 13msf (~27 months) and delivered 5.1msf of commercial properties to DAL (~24 months) with another 2.5-3.0msf to be delivered by end-FY10E. As per the terms of the deal, DLF was supposed to deliver properties to DAL only after they were preleased. However, with a steep decline in demand for leased properties in the last few quarters, DLF delivered only 5.1msf of commercial properties to DAL. Given the continued softness in demand for commercial assets, DAL was left cash strapped. Further, with DAL unable to raise equity money or get a REIT listing and cap rates expanding significantly world-wide, receivables from DAL to DLF increased substantially to Rs49bn as of Mar-09.

DLF has so far recognized revenues for 13msf (~27 months) and delivered 5.1msf of commercial properties to DAL

Exhibit 8: Increase in receivables from DAL



Source: Company, IDFCSSKI Research

DELEVERAGING: CLEARING OUT THE CLUTTER

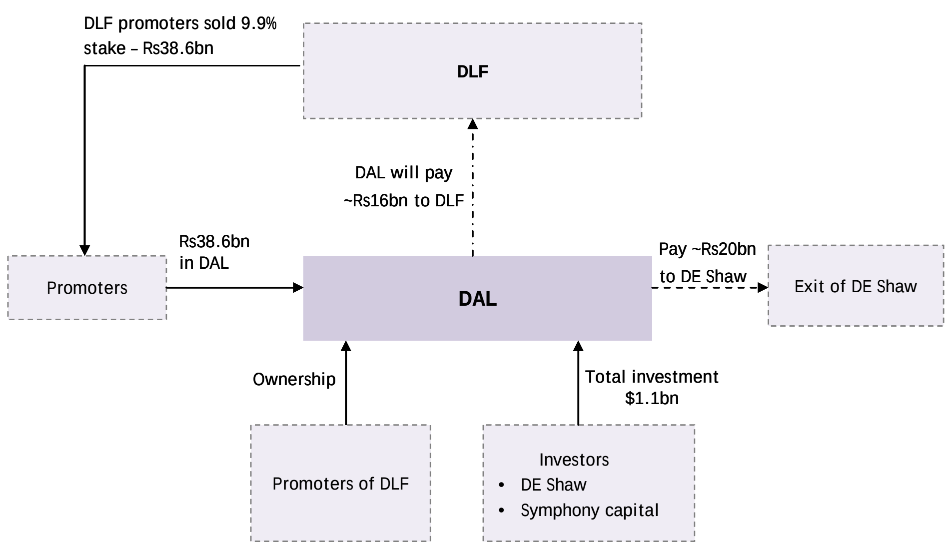
With debt reduction being the utmost priority, DLF is planning to undertake various strategies – asset monetization, sale of non-core land parcels, etc – to raise funds. We expect DLF to reduce its debt from Rs163.5bn as of end-FY09 to ~Rs95.3bn by FY10 through cash received from DAL (Rs36bn) and revenue generated from sale of assets (~Rs32bn). Further, DLF plans to launch 15-16msf of affordable residential projects in FY10, which we believe would bring in significant cash flows.

❑ Receivables from DAL to DLF to decline significantly

DAL repaying Rs16bn to DLF out of proceeds of promoter stake sale in DLF; another Rs20bn to be repaid in FY10E

To reduce receivables from DAL to DLF, promoters of DAL (also the promoters of DLF) have undertaken multiple strategies. Recently, DLF promoters sold 9.9% of their stake in DLF to qualified institutional investors and garnered Rs38.6bn from the stake sale. The funds would be utilized to buy out hedge fund DE Shaw's investment of US$ 400m at a mutually agreed price and the remaining ~Rs16bn shall be paid back to DLF towards receivables. Further, by securitizing its FY10 rental income, DAL intends to raise ~Rs20bn, which would also be paid back to DLF against receivables. Both these actions should bring receivables from DAL down to ~Rs13bn by end-FY10E.

Exhibit 9: Proceeds and allocation of stake sale by DLF promoters



Source: Company, IDFCSSKI Research

Exhibit 10: Proceeds and allocation of money from DLF's stake sale

	(Rs m)
DLF promoters sold 168m shares @ Rs230 per share	38,640
To be paid to DE Shaw investor ($400mn investment)	20,000
Payment from DAL to DLF	16,000

Source: Company, IDFC SSKI Research

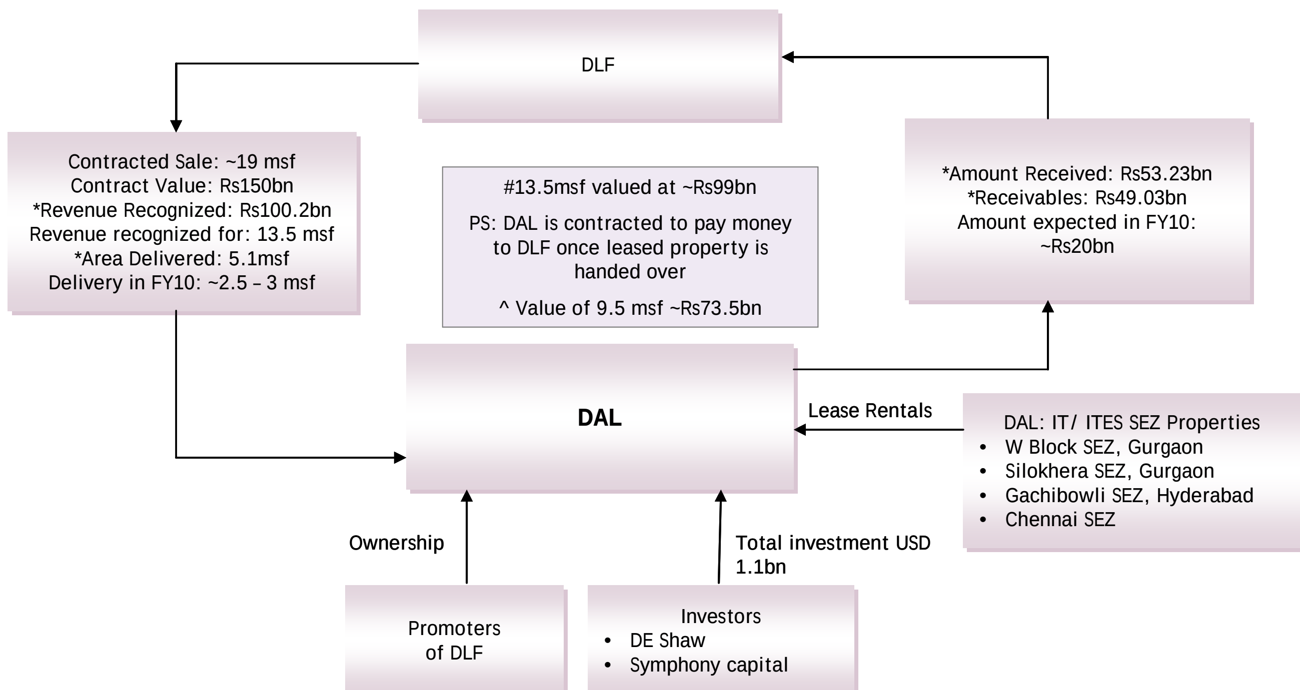
DAL: A SOLUTION IN SIGHT

In order to do away with investor apprehension as regards the DLF-DAL deal, DLF has instituted a Committee of Independent Directors to evaluate various options as regards the structure of DAL and DLF. DLF had sold assets to DAL at a 9% cap rate; which in the last 6-9 months has increased to ~12% due to the global financial crisis and subdued outlook for property prices.

Going forward, DLF might acquire a stake in DAL (either fully or partly) by purchasing the assets of DAL – valuing it at current cap rate. Once the business environment improves, the upside on cap rate could accrue to DLF shareholders.

However, it should be noted that global equity markets have again been looking up in the last few weeks. Thus, cap rates have started to tend lower to 10-11% levels. Further, with a stable government at the Centre in India, demand for commercial properties is bound to improve sooner than later with the broader economy staging a faster-than-anticipated recovery. Hence, cap rate expectations are also likely to move lower. This may again open up a REIT listing opportunity for DLF. Subsequent to this, DLF may revisit the strategy and, instead of acquiring the assets/ a stake, may opt for a REIT listing for DAL.

Exhibit 11: Structure of DAL and DLF for sale of properties



*Note: * Till FY09; ^ as per initial contract; # Contract capped for sale of 13.5msf*

DLF currently developing land at strategic locations; land repayments renegotiated and land bank realigned to 425msf

❑ DLF adopts multiple strategies to reduce leverage

DLF intends to aggressively focus on strengthening its balance sheet by repaying a chunk of its debt. Lower debt would imply reduced interest cost, and thus would improve cash flows significantly. DLF has lined up various measures to this end:

Reducing capital intensity: DLF has decided to restrict its focus largely to parcels of land at strategic locations, where customer traction would be maximum. In cases where the respective state governments have been unable to procure and hand over land to DLF, the company has surrendered such parcels and the total land bank of

DLF has been adjusted to factor in the reduction. Excluding these land parcels, DLF's total land bank now stands truncated at 425msf (751msf earlier), though still large by any standards. The company has relinquished mega township projects at Dankuni and Bidadi, and received back the invested amount of Rs3.36bn. Also, DLF is renegotiating with Delhi Development Authority (DDA) for refund of an upfront payment of Rs9bn paid for development of Dwarka Convention Centre.

Monetization of assets: DLF is scouting to sell-off all non-core business activities and use the cash thus generated to pay off part of its debt. DLF has set a target to realize ~Rs55bn from this activity. We expect the company to garner at least Rs32bn in FY10 from sale of assets (refer to the following exhibit), and thus debt to come down to this extent.

We expect asset monetization exercise to generate Rs32bn for DLF

Exhibit 12: Asset monetization expected in FY10E

	Asset	Valuation (Rs bn)
1	Wind mill	9
2	Hotel properties	5
3	Stake in captive power plants	7.5
4	Dwarka Convention Centre	4.25
5	Receipts from exiting mega township projects	3.36
6	Receipts from stake sale of Hindustan Mills	3.1
	Total	**32.21**

Potential upside to this number - refund of Rs8bn of license fees from Haryana government

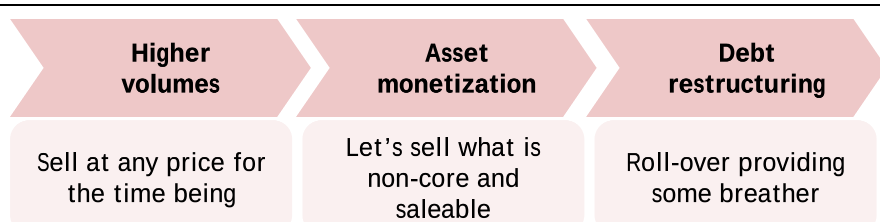
Source: Company, IDFC-SSKI Research

❑ DLF redraws strategies to overcome demand sluggishness

Development of 27msf of commercial property deferred for now

Witnessing sluggish demand for commercial properties, DLF has temporarily stopped development of 20msf of office space and 7msf of retail space. DLF intends to launch more projects in affordable housing to generate cash flows and use the proceeds to repay debt and reduce gearing. Also, to boost demand, DLF has revised its policy of receiving advance payments from customers from time-linked payment to a mix of construction and time-linked payment. Moreover, DLF will develop office space and retail malls, predominantly on the sale model, over the next few years to avoid committing any hefty investments and to generate cash flows.

Exhibit 13: DLF strategy to overcome downturn



Source:IDFCSSKI Research

❑ DLF a key beneficiary of faster-than-anticipated economic upturn

With land bank suited to commercial development and the rich experience, DLF well-placed to benefit from demand upturn

Before the crisis struck, DLF had 751msf of saleable area across key locations in the country. Till Q2FY09, DLF was among the few developers having a greater focus on development of non-residential vis-à-vis residential properties (a mix of 75:25). Though DLF has deferred construction of capital-intensive commercial properties and is focusing on the residential affordable housing segment, DLF would be among the first ones to benefit from demand bounce-back in the commercial segment. We expect demand for commercial/ a retail / hotel property to start accelerating a few quarters after the economy stages a comeback. Given the prime locations of most of its land, DLF would have the ability to scale up quickly and change the mix again in favour of commercial properties to capitalize on the demand and its brand name. We have hence assigned a higher value to DLF's residual land bank.

Outlook and Financial Analysis

DLF has seen tremendous pressure on its profitability as well as cash flows over the last six months. However, the situation is set to change materially over FY10-11, as DLF manages to shore up its top line through significantly higher sales volumes and generate cash to bring down leverage to manageable levels. We estimate the company to sell 30msf of residential properties in the next two years – notably at 'affordable' prices. Despite lower price realizations, we expect healthy EBITDA margins for DLF over the next two years in view of the lower construction costs on the back of softer raw material prices. With reduced gearing led by debt repayment, and thus a lower interest burden, we see PAT improvement of 33% over FY10-11 for DLF.

❑ Revenues expected to grow 27% over FY10-11

In housing segment, DLF plans to sell ~6-7msf in mid income housing and 8-9msf in city- centre specific in FY10

DLF sold 6.34msf of residential property in FY09 at an average rate of ~Rs3,000psf. DLF is expected to launch ~15-16msf of residential property and 2-3msf of commercial property in FY10. Out of the residential component, DLF plans to sell 6-7msf in the mid-income housing segment and 8-9msf of city-centre specific properties at affordable prices. With a volume boost provided by lower price points, we expect DLF to sell ~13msf in FY10. We expect DLF to generate additional revenues of Rs32bn through asset monetization (refer to exhibit 12 page 9). However, in FY09, DLF realized a revenue loss of Rs6.88bn due to price resets/ other benefits provided to customers, of which Rs3.02bn was recognized in FY09. The remaining revenue loss of Rs3.86bn would be recognized in FY10E.

❑ EBIDTA margins though off from peak still likely to be strong

Expect EBITDA margin of 44% for DLF in FY10E

Despite the launch of new properties at substantial discounts in city-centric locations across the country, DLF's operating margins are estimated at 44% in FY10 (though off from 57% in FY09). DLF has re-drawn/ re-designed all its new project launches, modified specifications in flats and projects, and also adopted multiple raw material sourcing strategies to reduce construction costs. With a likely revival in the broader economy over the next few quarters, and therefore expected demand acceleration, we see DLF liquidating its residual land bank faster and at more favorable terms.

❑ Debt repayment to improve leverage ratio

Total debt estimated to come down to Rs95.3bn as of end-FY10

DLF targets to reduce its total debt by 50% by Mar-10E, i.e. to Rs83bn from Rs163.5bn as of FY09. We estimate DLF to repay Rs64bn towards debt in FY10 with funds generated from sale of assets and receivables from DAL in FY10 thereby reducing year end debt to Rs95.3bn in FY10E. The significant reduction in debt would substantially reduce DLF's interest burden by Rs3.14bn to Rs16.17bn in FY10E. Of the ~Rs19bn interest paid in FY09, ~Rs15.5bn is interest capitalized and ~Rs3.57bn is recognized.

Demand hiccups likely if economy does not revive on anticipated lines…

…or lending rates move southwards

Receivables of Rs96bn due to deferred/ delayed customer payments and from DAL

KEY CONCERNS

❑ Demand may not pick up even at lower price points

If the global market turmoil were to deepen further, the downturn is bound to rub-off on India sooner or later. In such a scenario, the overall domestic economic activity may remain subdued for long, and thereby dent consumer sentiment. Even at lower price points, real estate demand may not revive on anticipated lines, as income uncertainty would then overshadow the affordability factor.

❑ Interest rates start inching up quickly again

Lending rates for home loans have declined by 200-300bp from their peak and seem to have stabilized at the current levels. In case lending rates start inching up in the later part of the year with a strong economic recovery, this could impact affordability for customers, and in turn real estate demand. Further, higher lending rates would mean increased interest burden for developers.

Exhibit 14: Interest rate on 20-year home loans by leading financial institutions

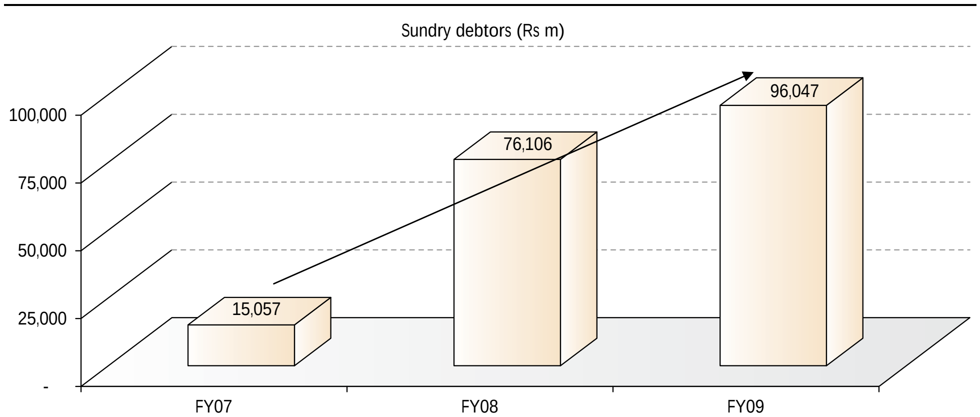
Lending institution	Interest rate (%)		
	Up to Rs0.3m	Rs0.3m to Rs10m	Rs10m and above
ICICI Bank	9.25	9.25-9.75	9.75-11
HDFC	9.25	9.75	10
SBI (year 1)	8	8	8
SBI (year 2)	10.25	10.75	11

Source: Media reports

❑ Increasing receivables over the last couple of years

In line with the industry facing deferred/ delayed customer payments despite offering projects at lower price points, DLF too has witnessed a steep rise in its receivables over the last two years to Rs96bn. While receivables form DAL has largely been addressed (Rs16bn from stake sale, Rs20bn from lease rental discounting), other receivables remain an area of concern. In FY09, DLF realized a loss of Rs6.88bn due to price resets/ other benefits provided to customers.

Exhibit 15: Steep increase in receivables



Source: IDFCSSKI Research

Demand hiccups likely if economy does not revive on anticipated lines…

❑ Asset monetization may not happen as scheduled

Though funds have started trickling into the real estate sector, DLF has placed a number of high value assets on the block so as to reduce its gearing. However, if asset monetization does not happen as planned, or at the desired valuation, the company would fall short of its targeted cash flow generation to repay long-term debt. This may lead to further restructuring/ significant dilution of equity.

VALUATIONS AND VIEW

Our NAV-based price target of Rs421 per share offers 20% upside from CMP

The cash flows generated through higher volumes, asset monetization initiatives and debt restructuring should enable DLF to eventually bring down its gearing to manageable levels. With DLF fervently working on reducing receivables from DAL, we expect the huge receivables position to come down in the coming years.

Over the last one month or so, the stock price has run up by 60% to Rs352 from Rs220 on 4 May 2009, possibly in response to the visibility on dissipation of the concern on DAL receivables. Post clearance of ~Rs16bn of receivables due to DLF, DAL is likely to repay another Rs20bn through securitization of lease rental income.

DLF appears to be adopting all the right strategies to improve the health of its balance sheet. Despite the recent run-up in stock price, we believe the market is still not fully valuing the premium positioning of DLF's land bank. We estimate an earnings expansion of 33% in FY10-11. We initiate coverage on the stock with an Outperformer rating and NAV-based price target of Rs421.

Exhibit 16: Chart of NAV Calculation

Year to March 31 (Rs m)	NAV - FY 10	NAV/ share
NAV of residential properties - 126 msf (16 msf under construction)	109,841	65
NAV of commercial properties - 20msf (under construction)	70,954	42
NAV of residual land bank - 279msf	613,800	362
Less: Debt	(95,329)	(56)
Add: Cash	15,858	9
Net NAV	715,214	421
No of shares (m)	1,697	
NAV per share (Rs)	421	

Earnings model

Year to Mar 31 (Rs m)	FY08	FY09E	FY10E	FY11E
Net sales	**144,331**	**100,390**	**66,721**	**85,006**
% growth	*447.2*	*(30.4)*	*(33.5)*	*27.4*
Operating expenses	47,220	45,526	37,073	45,869
EBITDA	**97,111**	**54,865**	**29,648**	**39,137**
% growth	*551.9*	*(43.5)*	*(46.0)*	*32.0*
Other income	2,514	4,970	4,970	4,970
Net interest	(3,101)	(3,571)	(3,106)	(2,568)
Depreciation	901	2,360	2,360	3,000
Pre-tax profit	95,888	53,694	28,942	38,329
Current Tax	17,391	7,110	6,413	8,479
Profit after tax	**78,497**	**46,584**	**22,529**	**29,851**
Minorities	(355)	(300)	(300)	(300)
Net profit after non-recurring items	78,142	46,284	22,229	29,551
% growth	*304.3*	*(40.8)*	*(52.0)*	*32.9*

Balance sheet

As on Mar 31 (Rs m)	FY08	FY09E	FY10E	FY11E
Paid-up capital	3,410	3,410	3,394	3,394
Reserves & surplus	193,470	244,790	263,421	290,017
Total shareholders' equity	200,774	253,380	272,296	299,191
Total current liabilities	72,157	77,370	86,111	93,395
Total Debt	122,773	163,508	95,329	60,328
Deferred tax liabilities	360	(340)	(340)	(340)
Total liabilities	195,290	240,537	181,100	153,383
Total equity & liabilities	**396,065**	**493,917**	**453,395**	**452,574**
Net fixed assets	100,031	137,160	124,800	115,844
Investments	9,102	13,830	13,830	13,830
Total current assets	266,001	320,807	292,645	300,780
Other non-current assets	20,931	22,120	22,120	22,120
Working capital	193,843	243,438	206,534	207,386
Total assets	**396,064**	**493,917**	**453,395**	**452,574**

Cash flow statement

Year to March 31 (Rs m)	FY08	FY09E	FY10E	FY11E
Pre-tax profit	95,888	53,694	28,942	38,329
Depreciation	901	2,360	2,360	3,000
chg in Working capital	(110,809)	(50,609)	40,781	(711)
Total tax paid	(17,391)	(7,110)	(6,413)	(8,479)
Operating cash Inflow	(31,411)	(1,665)	65,669	32,139
Capital expenditure	(59,203)	(39,644)	10,000	5,956
Free cash flow (a+b)	(90,615)	(41,309)	75,669	38,095
Chg in investments	(6,731)	(4,938)	(210)	(210)
Debt raised/(repaid)	23,445	40,735	(68,179)	(35,000)
Capital raised/(repaid)	351	-	(15)	-
Dividend (incl. tax)	(6,819)	(4,628)	(2,223)	(2,955)
Misc	98,694	3,790	936	2,311
Net chg in cash	18,325	(6,350)	5,978	2,241

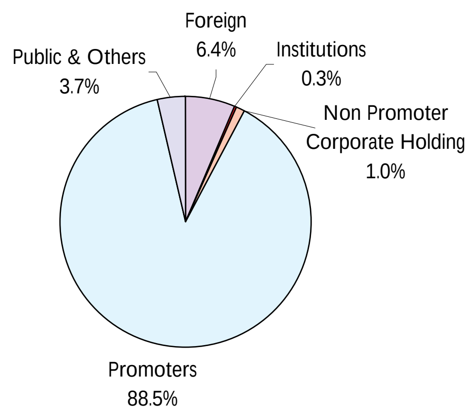
Key ratios

Year to March 31	FY08	FY09E	FY10E	FY11E
EBITDA margin (%)	67.3	54.7	44.4	46.0
EBIT margin (%)	66.7	52.3	40.9	42.5
PAT margin (%)	54.1	46.1	33.3	34.8
RoE (%)	66.1	20.4	8.5	10.3
RoCE (%)	41.9	14.2	7.0	9.9
Gearing (x)	0.6	0.6	0.4	0.2

Valuations

Year to March 31	FY08	FY09E	FY10E	FY11E
Reported EPS (Rs)	45.8	27.1	13.1	17.4
Adj. EPS (Rs)	45.8	27.1	13.1	17.4
PER (x)	7.7	13.0	26.9	20.2
Price/Book (x)	3.0	2.4	2.2	2.0
EV/Net sales (x)	4.9	7.5	10.2	7.6
EV/EBITDA (x)	7.3	13.8	23.0	16.5
EV/CE (x)	2.2	1.8	1.9	1.8

Shareholding pattern



As of March 2009

Company update

Unitech

Rs87

OUTPERFORMER

Brick by brick

Mkt Cap: Rs177.8bn; US$3.7bn

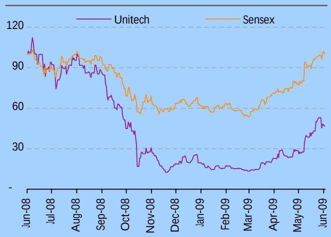
15 June 2009

BSE Sensex: 14876

Stock data

Reuters	UNTE.BO
Bloomberg	UT IN
1-yr high/low (Rs)	212/21.7
1-yr avg daily volumes (m)	94.81
Free Float (%)	35.5

Price performance



Performance (%)

	3-mth	6-mth	1-yr	3-yr
Unitech	228.1	129.4	(53.7)	33.9
Sensex	69.9	51.3	(2.1)	55.9

Ramnath S
ramnaths@idfcsski.com
91-22-6638 3380

Rajeev Desai
rajeev@idfcsski.com
91-22-6638 3231

Unitech, with a new lease of life from debt restructuring, is back in the reckoning. Having repaid ~Rs7bn of debt from the QIP proceeds, the company is going full steam ahead on improving its balance sheet health. Assets worth Rs6bn have been monetized till date in FY10. Unitech has launched 13.9msf of development in the last two months (3.2msf already sold). Going forward, Unitech aims to retain focus on affordable housing, while commercial development takes a backseat till business environment improves. Driven by cumulative sale of 30msf, we expect 13% and 24% growth in Unitech's revenues and earnings respectively over FY10-11. We revise our SOTP-based target price upwards to Rs128 per share (our earlier target of Rs94 touched on 3 June 2009) on account of faster-than-expected rollout with outperformance on project turnaround, and thereby higher visibility.

Out of the debt trap: Unitech has successfully rolled over debt of Rs25bn in FY09 as part of the debt restructuring exercise. Also, debt now stands lower by Rs7bn, repaid through the proceeds of the recent Rs16.2bn QIP, to Rs78bn. We expect Unitech to repay another Rs11bn of debt in FY10 with increased cash flows and as ongoing monetization of assets generates further funds (estimated at Rs10.9bn in FY10).

Delivery exceeds estimates; improving outlook: Unitech has launched 13.9msf since Apr-09, and already sold 3.2msf – fairly aggressive vis-à-vis our estimate of 15msf of sales for full FY10. Unitech is focusing on development of affordable housing in the near term, and has shifted from "build and lease" to "build and sell" model for commercial properties (10% of mix currently). New properties are being launched at right prices and right locations, and we see stronger demand for Unitech's projects.

Valuations still attractive; Outperformer: Unitech is on the fast track with aggressive property launches and non-core asset monetization program. Deleveraging is the key theme for now and balance sheet quality should improve over FY09-11. Based on outperformance on project launches, high visibility on residual land bank (80msf estimated to be developed over five years beyond FY11) given the anticipated economic recovery and positive developments on the telecom business, we revise our SOTP target price for Unitech upwards to Rs128 per share – 47% upside from CMP.

Key financials

Year to March 31	FY08	FY09E	FY10E	FY11E
Net sales (Rs m)	43,224	30,752	37,989	42,895
Adj. net profit (Rs m)	18,341	10,699	11,129	13,767
Shares in issue (m)	1,623	1,623	2,044	2,044
Adj. EPS (Rs)	11.3	6.6	5.4	6.7
% growth	30.6	(41.7)	(17.4)	23.7
PER (x)	7.7	13.2	16.0	12.9
Price/Book (x)	3.8	2.9	2.3	1.8
EV/EBITDA (x)	9.5	12.0	12.0	9.1
RoE (%)	64.2	25.1	17.7	15.4
RoCE (%)	21.5	12.5	11.9	12.4

INVESTMENT ARGUMENT

The wheel of fortune is turning for Unitech and the realignment to prevailing market conditions is paying off. Short-term debt has been rescheduled and total debt cut by Rs7bn to Rs78bn. Unitech is aggressively back in the fray and we expect it to sell 30msf of real estate over the next two years (13.9msf launched YTDFY10). With improving cash flows as also incremental cash from asset monetization (Rs10.9bn in FY10E), we expect gearing to come down from 1.7x in FY09E to 0.8x in FY10E. The initiatives have so far generated Rs6bn of funds with another Rs4.9bn estimated to accrue over the next nine months. Unitech has also judiciously changed the project mix to ~90% of development in residential segment for now and customer response has been good. With improving industry dynamics, Unitech is set to return to the growth path. Ability to effect faster turnaround of projects has once again come to the fore. Given that growth visibility is returning, we upgrade our target price on Unitech to Rs128 per share. Accelerated revenues booked YTDFY10 lend credibility to Unitech's plans of monetizing the residual land bank at more favourable terms.

Exhibit 1: Unitech – the way forward

	Brink of extinction	Trial by Fire	Back in the reckoning	The way forward
Volumes	3msf sold in FY09	Our estimate: 30msf to be sold in FY10 & FY11	Already launched - 13.9msf of projects; 3.2msf already sold	Would launch 40 projects, i.e. 30 msf of properties in FY10
Non-core assets	Telecom license - a capital intensive diversification	Transfer debt of Rs21bn to Unitech Wireless	Unitech Wireless repaid Rs3.3bn to Unitech	No further expenses on Telecom business
Commercial properties	Hefty capital expenditure on commercial properties	Deferred construction of commercial properties	Shift to "build and sell" against "build and lease" model	Focusing on affordable housing for now
	3 month ago	**Our report dated 13 Apr 2009**	**What has changed**	**What next...**
Monetization of assets	Sold Marriott Courtyard for Rs2.3bn	Our estimate: Asset monetization to generate Rs10.97bn in FY10	Monetized assets worth Rs6bn in YTD FY10	Asset monetization to continue; we retain our estimate of Rs10.97bn In FY10
Debt	Total debt of Rs101bn as of Q3FY09; Rs25bn of debt due for repayment by end-FY09	We estimate debt to reduce to Rs73bn in FY10 from Rs84bn in FY09	Debt down to Rs78bn with Rs7bn repayment from proceeds of QIP	Total debt expected to reduce to Rs66bn in FY10E
Stock performance	Stock hammered to Rs25 as on 9 Mar 2009 from peak of Rs330 on 15 May 2008	Our target price at Rs94 per share based on SoTP	Stock price touched Rs94.7 - our target price – 3 June 09	Upgrading our target price to Rs128 per share

NAV has revised due to decrease in discount rate for land banks and projects and increase in valuation of telecom business to Rs10 per share

UNITECH: BACK INTO THE RECKONING

Besides refinancing/ rescheduling its short-term debt of Rs25bn due for repayment by end-FY09, Unitech has also reduced its total debt (Rs84bn as of FY09E) by Rs7bn so far this year. The Rs16.2bn (~US$325m) raised by issuing new equity to qualified institutional investors (QIP) @Rs38.5 per share was partly used to repay debt. With issuance of new equity, total paid-up capital has increased to Rs4.08bn, and promoters' stake has come down from 64% earlier to 51%. Unitech has now fully aligned itself with the changed market dynamics and is focusing on residential development while deferring capital-intensive/ commercial properties. To improve the quality of the balance sheet, the company is in the process of raising funds via the ongoing monetization intiatives and defocusing on capital-intensive projects.

❑ Going full stream on development plans

Projects covering 13.9msf launched YTDFY10; 3.2msf already sold

Unitech has embarked on a strategy of aggressively monetizing its saleable land bank by marking down prices by ~35%, so as to make the properties affordable to consumers, and also reducing the specifications of its offerings in terms of flat sizes, etc. The company intends to launch 40 projects (~30msf) across the country in FY10, of which ~90% would be residential and the remaining commercial projects. Unitech has launched 13.9msf of area since the beginning of FY10 with 3.2msf succesfully sold till date.

Exhibit 2: Properties launched YTDFY10

City	Projects	Type
NCR - Gurgaon	Uniworld Gardens-II	Residential Apartments
NCR - Gurgaon	The Residences	Residential Apartments
NCR- Noida	The Willows at Grande	Residential Plots
Mumbai	Gateway	Residential Apartments
Mumbai	Woodside	Residential Apartments
Mumbai	Ascot	Residential Apartments
Kolkata	Vistas	Residential Apartments
Kolkata	KWIC Plots	Residential Plots
Kolkata	Floors	Residential Independent Floors
Kolkata	KWIC Bungalows	Residential Villas
Mohali/ Chandigarh	Singleton Floors	Residential Floors
Mohali/ Chandigarh	Executive Floors	Residential Floors
Chennai	Ananda at North Town	Residential Apartments
Chennai	Brahma at North Town	Residential Apartments
Mumbai	*The Chambers*	*Office Suites*
Kolkata	*KWIC Shops*	*Convenience Shopping*
Kolkata	*RB Connector Office*	*Office Suites*
Kolkata	*RB Connector Retail*	*Retail*
Lucknow	*Gardens Galleria*	*Retail*
Lucknow	South City Gardens	Residential Apartments
Lucknow	South City Plots	Residential Plots
NCR - Gurgaon	*Signature Towers -2*	*Office Suites*
Mohali/ Chandigarh	Plots at UniworldCity	Residential Plots
NCR - Gurgaon	Woodstock Floors	Residential Floors

Source:Company, IDFCSSKI Research

Enough demand in the system to absorb the incremental supply of units at affordable pricing

❑ Focus on affordable housing projects

Unitech has launched an affordable housing brand called "*Unihomes*", which significantly expands the scope of its addressable market. Potential demand exists at price levels of Rs0.7m-2m being in the affordable category for 40-80% of the population in India's largest cities. This implies a much broader market for Unitech in the Rs1m-2m price range than was the case earlier – when its focus was confined to premium properties.

We see enough demand in the system to absorb the incremental supply of units at affordable pricing; therefore, we believe Unitech's strategy of pricing its properties downward will spur demand in the residential segment in the near term. Other segments such as commercial and retail may take slightly longer to recover than the broader economy, as the segments typically track economic growth and oversupply has to get exhausted first.

Unitech aggressively monetizing assets to pay off debt

❑ Unitech generates cash to reduce debt …

Unitech, in line with its strategy of generating cash from monetization of assets, has successfully raised Rs6bn in the past few months from monetization of hotel property Country Inn at Gurgaon (sold for ~Rs1.9bn;Unitech's share at Rs1bn) and office property (~Rs4.5bn) at Saket, New Delhi coupled with sale of school plots at Gurgaon (~Rs250m). Also, negotiations are in an advanced stage for sale of tower manufacturing business (~Rs7.5bn). Further, Unitech is also likely to generate cash of Rs1.9bn from sale of a hotel property in Gurgaon – Mariott Executive Apartments. Going forward, Unitech is likely to sell a few more hotel properties in Gurgaon, Kolkata, Noida and Bangalore. We believe Unitech would utilize the cash received to repay the debt due in FY10, and thereby significantly reduce its gearing from existing levels. We estimate total debt in FY10 at Rs66bn.

Exhibit 3: Asset monetization program on track

Assets under monetization	Our estimation FY10E	Transactions completed in FY10	Comments
Office at Saket , New Delhi	Rs5.1bn	Rs4.5bn	Marginally lower than our estimates
Country Inn,Gurgaon	Rs1.9bn	Rs1.9bn*	In line with our estimates
School Plots	Rs1.2bn	Rs250m	Remaining school plots expected to be sold out In FY10
Mariott, Gurgaon	Rs1.9bn	-	Expected to be sold in next three months

*Source:Company, IDFCSSKI Research * Unitech's share in the project is 51%-would realise Rs1bn*

No further land bank accretion planned; model changed from lease to sale in commercial realty

❑ …and reduces capital intensity

Unitech has a large, low-cost and well-diversified land bank, which is sufficient to meet its development plans for the next 7-8 years. As a result, Unitech has no plans to acquire incremental land in the near future except for any deep-value properties. Also, the company is incurring capex only on properties that have been either pre-leased or pre-sold, and is steering clear of any developement on speculative basis.

In case of commercial properties, Unitech has changed its strategy from lease model to sale model. In some cases, such as land acquired from the Noida/ Greater Noida authorities, Unitech has got a moratorium on payment for such land of ~Rs18bn, to be paid in six equal installments every six months after a moratorium of 18 months, which means that the first installment is not payable till Q1FY11. Based on the same, we have aligned our assumptions to factor in relinquishment of these land parcels and our land bank assumptions stand pared to 9,000 acres and 429msf from 13,000 acres and 690msf respectively earlier.

❑ Positive developments on telecom venture

Unitech acquired telecom license in 2007 as a part of its diversification strategy and to gain presence in another high-growth sector. Its subsidiary Unitech Wireless (UW) has a pan-India license and spectrum in 22 circles. The telecom venture is being run by an experienced management team and Unitech expects material value accretion from this business over the longer term.

- In end-April 2009, UW signed a $500m 9-year strategic outsourcing contract with Wipro, under which Wipro will provide a range of IT solutions to UW.
- On 19 May 2009, Telenor infused a further Rs11.3bn in UW, taking its total investment in the venture to Rs23.8bn and a consequent rise in its stake from 33.5% to 49%.

Higher visibility of service rollout for UW; rapid progress on funding from Telenor

- UW has also received ~Rs2.4bn from Telenor as share application money for issuance of additional equity shares in UW in order to maintain its stake at 49% level, post the conversion of bonds amounting to Rs2.5bn issued by UW to Unitech into equity.
- On 20 May 2009, UW signed a $150m managed network services deal with Alcatel-Lucent. Alcatel-Lucent will build UW's GSM network and offer a range of services including project management, network design, integration, testing and installation. Alcatel-Lucent will also deploy and maintain its multi-standard GSM/ EDGE radio access solution for a period of five years.
- Telenor has also stated its intention to increase its stake in UW to 74% (from the proposed 67.5%), subject to regulatory approvals.

We believe the outsourcing contracts signed by UW have greatly improved the visibility of the service rollouts planned by UW (likely to commence in end-CY09). Also, the rapid progress of funding from Telenor allays concerns on UW's ability to garner the required funds to execute its rollout plans.

❑ Unitech promoters infusing capital through issue of warrants

Promoters propose to subscribe to warrants aggregating ~Rs11.54bn @Rs50.75/ share

Unitech board has approved the proposal of promoters subscribing to warrants aggregating ~Rs11.54bn. The warrants will be issued @ Rs50.75 per share – higher than the QIP allotment price of Rs38.5 per share to qualified institutional investors. An advance payment of ~Rs2.8bn (25% of the total amount) is expected to be made by June 2009. The warrants are due for conversion in FY11. With conversion of the warrants into equity, the total paid-up capital will increase to Rs4.54bn in FY11 and promoter stake from 51% to 56%.

OUTLOOK AND FINANCIAL ANALYSIS

Unitech has been under tremendous pressure in terms of both profitability and cash flows due to the downturn witnessed in the industry over the last six months. However, the situation is set to change materially over FY09-11, as Unitech manages to shore up its top line through significantly higher sales volumes (boosted by aggressive discounts) and asset monetization. With ability to repay debt, and thus a lower interest burden, we see profitability improvement ahead for Unitech. Given that the land bank has been acquired at extremely competitive rates (Rs100-150psf) as also the substantially lower cost of construction due to softer raw material prices, we estimate healthy EBITDA margins for Unitech (~49% in FY10 and FY11) despite lower average realizations. We expect Unitech to pay off ~Rs18bn of debt in FY10 (leaving total debt of ~Rs66bn on its books by the end of the year), and thereby a lower D/E of ~0.8x as of FY10.

❑ Revenues to get a boost through higher volumes

We expect Unitech to sell ~15msf in FY10 driven by higher volumes from low-cost housing projects

Unitech had sold ~10msf during the real estate boom in FY07 at ~Rs4,000psf for an average apartment size of 1,200-1,500sf. Given the sharp slowdown in demand, the company has actively reduced its average realization to Rs3,000psf for an apartment size of 800-1,000psf, which significantly reduces the average ticket size by 60% to Rs2.4m (Rs6m earlier). Hence, we expect the company to sell ~15msf in FY10 driven by higher volumes from low-cost housing projects. Unitech is also expected to generate additional revenues of ~Rs21.6bn through asset monetization over the next two years.

Exhibit 4: Asset monetization expected over FY10-11E

(Rs m)	FY10	FY11
Cash flow from CIG / URF		7,000
Saket office	5,000	
School plot sales	1,200	
Sale of hotel properties	4,770	700
CIS hotel		
Land sales (Kochi)		1,900
Surplus new inventory generated		1,000
Total	**10,970**	**10,600**

Source:Company, IDFCSSKI Research

Driven by total planned launches of ~40msf over FY09-11E and bookings of ~30msf at an average price of ~Rs3,000psf, we expect 13% growth in Unitech's revenues over FY10-11E to Rs42.89bn.

Exhibit 5: Unitech's top 10 revenue generating projects

Project (Rs psf)	Location	Development type	Construction cost	Selling price	Area (msf)
Badshahpur - 15 acres	Gurgaon	Plots	100	2,000	0.65
UW City - Vista	Kolkalla	GH	1,260	2,750	0.90
Badshahpur - 15 acres	Gurgaon	Floors	900	2,500	0.98
Grande Appts - New	Noida	GH	2,000	5,000	1.00
Nallambakkam (250 acres)	Chennai	GH	810	2,000	1.00
Uniworld Gardens 2	Gurgaon	GH	1,170	3,000	1.10
Badshahpur (Sun Breeze)-16 acres	Gurgaon	GH	1,170	2,700	1.22
Grande Plots (sq. yd)	Noida	Plots	100	5,556	1.35
KONA - Unihomes	Kolkata	GH	990	2,000	1.35
Uniworld Resorts	Gurgaon	GH	1,170	3,300	1.70
Total					**11.25**

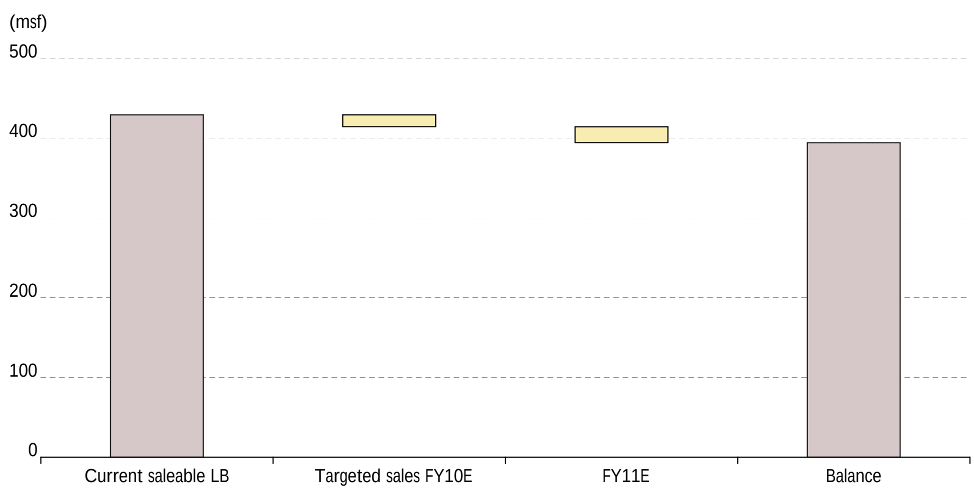
Source Company, IDFCSSKI Research, GH: Group Housing

We expect operating margin of ~49% for Unitech in FY10 and FY11

❑ EBIDTA margins still healthy despite price cuts/ discounts

Despite the launch of new properties at substantial discounts as well as migration to affordable houses, Unitech's operating margins are expected to be strong at 49% in FY10E (though off from 60% in FY09E) as construction costs have declined significantly over the last few quarters. With an expected revival in the economy, and therefore return of demand, we believe Unitech can easily increase prices of its properties over the longer term. Excluding the development of 30msf planned over FY09-11E, Unitech would have a sizeable land bank aggregating ~400msf. Thus, we expect the company to earn higher margins on this portion of the development.

Exhibit 6: Existing saleable land bank and reduction (yoy) by sales in FY10 and FY11



Source: Company, IDFCSSKI Research

❑ Additional debt repayment to improve leverage ratio

We estimate Unitech to generate ~Rs45bn of operating cash flows over FY10-11E, of which ~Rs30.5bn would likely go towards debt repayment. This, in turn, would reduce Unitech's gearing from ~0.8x in FY10E to ~0.5x by FY11E.

KEY CONCERNS

❑ Demand may not pick up despite lower price points

Demand hiccups likely if economy does not revive on anticipated lines…

If the global market turmoil were to deepen further, the downturn is bound to rub-off on India sooner or later. In such a scenario, the overall domestic economic activity may remain subdued for long, and thereby dent consumer sentiment. Even at lower price points, real estate demand may not revive on the anticipated lines, as income uncertainty would then overshadow the affordability factor.

❑ Interest rates start inching up quickly again

…or lending rates move southwards

Lending rates for home loans have declined by 200-300bp from their peak and seem to have stabilized at the current levels. In case lending rates start inching up in the later part of the year with a strong economic recovery, this could impact affordability for customers, and in turn real estate demand. Further, higher lending rates would mean increased interest burden for developers.

Exhibit 7: Interest rate on 20-year home loans by leading financial institutions

	Interest rate (%)		
	Up to Rs0.3m	Rs0.3m to Rs10m	Rs10m and above
ICICI Bank	9.25	9.25-9.75	9.75-11
HDFC	9.25	9.75	10
SBI (year 1)	8	8	8
SBI (year 2)	10.25	10.75	11

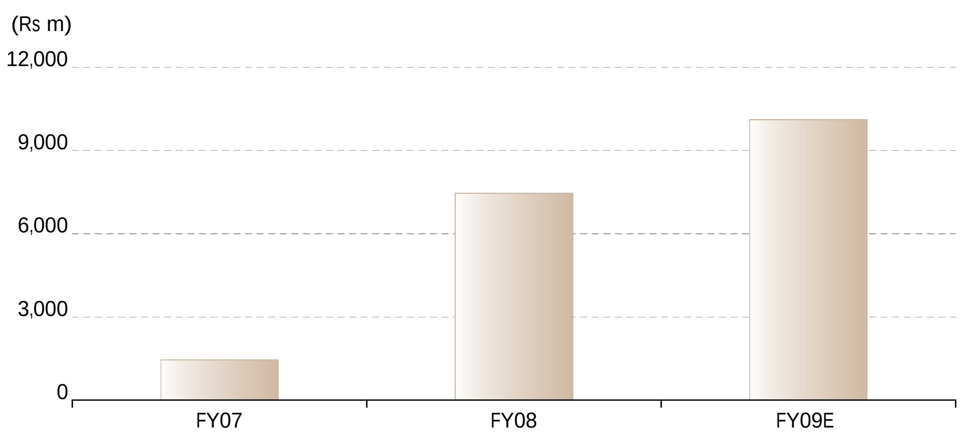
Source: Media Reports, IDFCSSKI Research

❑ Debtors have gone up over the last couple of years

Receivables of Rs10.1bn due to deferred/ delayed customer payments

In line with the industry facing deferred/ delayed customer payments despite offering projects at lower price points, Unitech too has witnessed a steep rise in its receivables over the last two years to Rs10.1bn. While the management has clearly indicated that bringing down the debtors position to acceptable levels is a key priority, it remains a cause for concern.

Exhibit 8: Receivables position over FY07-09E



Source: Company, IDFCSSKI Research

VALUATIONS AND VIEW

Given its willingness to aggressively slash prices, and therefore strong sales volumes expected to be generated within a short span, we expect a swift recovery for Unitech. Deleveraging remains the key theme for now and balance sheet quality should improve over FY09-11E. Unitech has secured some headroom on the debt front and with estimated cash generation of ~Rs45bn over FY10-11, the company is looking to cut its debt and bring down cost of funds. Thus, we expect these measures to be earnings-accretive for the company (24% earnings growth over FY10-11E).

Our NAV-based price target of Rs128 per share offers47.7% upside from CMP

Our NAV-based valuation of Unitech has four components – residual ongoing projects, projects planned over the next two years, the residual land bank and the stake in telecom venture. Against the company's stated intent of launching 30-50msf over FY09-11, we have assumed launches of 40msf over FY09-11 and revenue recognition of 15msf each year, and have separately arrived at NAV of new projects with a revised discounting rate to build in the higher visibility. The ongoing projects of 25msf have also been valued on similar lines. We assume an incremental 80msf to be developed over the next five years beyond FY11. Also, on account of faster-than-expected rollout of properties by Unitech in the past three months, we are not discounting the residual land bank. Resultant of positive developments in the telecom venture, we upgrade valuation of Unitech's stake in telecom business to Rs10 per share from our earlier estimate of Rs8.

Based on outperformance on project launches, high visibility on residual land bank given the anticipated economic recovery and positive developments on the telecom business, we revise our SOTP target price for Unitech upwards to Rs128 per share – 47% upside from CMP.

Exhibit 9: SOTP valuation of business

		FY10 (Rs m)	NAV / share (Rs)
A)	NAV of new projects - 30msf	35,709	17
B)	NAV of residual ongoing projects - 25msf	30,315	15
C)	NAV of projects launched over 5 years - 80msf	76,179	37
D)	NAV of residual land bank	146,922	72
E)	Telecom	19,841	10
	Gross NAV = A+B+C+D+E	308,966	151
	Less: Net debt as on FY10E	47,113	23
	Net NAV	261,853	128
	No. of shares (m; Rs2 paid up)	2,044	
	NAV per share (Rs)	128	

Telecom business valuation

Basis of valuation	
Number of subscribers in FY12E (m)	17
Valuation criteria EV/sub ($)	199
EV ($bn) FY12E	3.3
Estimated debt in FY12E ($ bn)	1.6
Present value of equity ($ bn)	1.28
Equity value for 33% stake ($ bn)	0.4
Per share value of Unitech (Rs)	10

Earning model

Year to Mar 31 (Rs m)	FY08	FY09E	FY10E	FY11E
Net sales	**43,224**	**30,752**	**37,989**	**42,895**
% growth	*25.5*	*(28.9)*	*23.5*	*12.9*
Operating expenses	19,536	12,246	19,141	22,000
EBITDA	**23,688**	**18,506**	**18,848**	**20,895**
% growth	*22.9*	*(21.9)*	*1.9*	*10.9*
Other income	1,649	475	510	525
Net interest	(2,804)	(5,065)	(4,880)	(3,589)
Depreciation	205	200	210	180
Pre-tax profit	22,328	13,716	14,268	17,650
Current Tax	3,987	3,018	3,139	3,883
Profit after tax	**18,341**	**10,699**	**11,129**	**13,767**
Net profit after non-recurring items	18,341	10,699	11,129	13,767
% growth	*30.6*	*(41.7)*	*4.0*	*23.7*

Balance sheet

As on Mar 31 (Rs m)	FY08	FY09E	FY10E	FY11E
Paid-up capital	3,247	3,247	4,089	4,544
Reserves & surplus	32,758	43,457	72,608	94,418
Total shareholders' equity	37,163	48,048	78,042	100,307
Total current liabilities	81,027	82,522	82,526	99,822
Total Debt	85,524	84,075	66,075	53,571
Deferred tax liabilities	60	60	60	60
Other non-current liabilities	19,136	18,286	18,286	18,286
Total liabilities	185,747	184,943	166,947	171,740
Total equity & liabilities	**222,910**	**232,991**	**244,989**	**272,046**
Net fixed assets	31,442	23,478	21,268	18,780
Investments	14,165	17,706	17,706	17,706
Total current assets	176,178	190,681	204,889	234,434
Other non-current assets	1,126	1,126	1,126	1,126
Working capital	95,151	108,160	122,363	134,612
Total assets	**222,910**	**232,991**	**244,989**	**272,046**

Cashflow statement

Year to March 31 (Rs m)	FY08	FY09E	FY10E	FY11E
Pre-tax profit	22,328	13,716	14,268	17,650
Depreciation	205	200	210	180
chg in Working capital	(39,015)	(9,152)	(34)	10,127
Total tax paid	(3,987)	(3,018)	(3,139)	(3,883)
Operating cash Inflow	(20,469)	1,746	11,306	24,074
Capital expenditure	(23,479)	7,764	2,000	2,308
Free cash flow (a+b)	(43,948)	9,510	13,306	26,382
Chg in investments	(9,617)	(3,541)	-	-
Debt raised/(repaid)	45,126	(1,448)	(18,000)	(12,504)
Capital raised/(repaid)	1,708	(0)	16,200	8,773
Dividend (incl. tax)	(406)	-	(223)	(275)
Misc	1,138	(3,147)	3,107	1,353
Net chg in cash	(5,999)	1,374	14,390	23,729

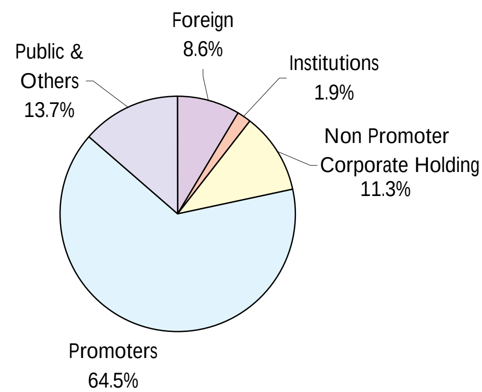
Key ratios

Year to March 31	FY08	FY09E	FY10E	FY11E
EBITDA margin (%)	54.8	60.2	49.6	48.7
EBIT margin (%)	54.3	59.5	49.1	48.3
PAT margin (%)	42.4	34.8	29.3	32.1
RoE (%)	64.2	25.1	17.7	15.4
RoCE (%)	21.5	12.5	11.9	12.4
Gearing (x)	2.3	1.7	0.8	0.5

Valuations

Year to March 31	FY08	FY09E	FY10E	FY11E
Reported EPS (Rs)	11.3	6.6	5.4	6.7
Adj. EPS (Rs)	11.3	6.6	5.4	6.7
PER (x)	7.7	13.2	16.0	12.9
Price/Book (x)	3.8	2.9	2.3	1.8
EV/Net sales (x)	5.2	7.2	6.0	4.4
EV/EBITDA (x)	9.5	12.0	12.0	9.1
EV/CE (x)	1.6	1.5	1.4	1.1

Shareholding pattern



As of March 2009

IDFC - SSKI INDIA

Analyst	Sector/Industry/Coverage	E-mail	Tel. +91-22-6638 3300
Pathik Gandotra	Head of Research; Financials, Strategy	pathik@idfcsski.com	91-22-6638 3304
Shirish Rane	Construction, Power, Cement	shirish@idfcsski.com	91-22-6638 3313
Nikhil Vora	FMCG, Media, Retailing, Mid Caps, Education	nikhilvora@idfcsski.com	91-22-6638 3308
Ramnath S	Automobiles, Auto ancillaries, Real Estate	ramnaths@idfcsski.com	91-22-6638 3380
Nitin Agarwal	Pharmaceuticals	nitinagarwal@idfcsski.com	91-22-6638 3395
Chirag Shah	Metals & Mining, Pipes, Textiles	chirag@idfcsski.com	91-22-6638 3306
Bhoomika Nair	Logistics, Engineering, Power	bhoomika@idfcsski.com	91-22-6638 3337
Hitesh Shah, CFA	IT Services	hitesh.shah@idfcsski.com	91-22-6638 3358
Bhushan Gajaria	FMCG, Retailing, Media, Mid Caps	bhushangajaria@idfcsski.com	91-22-6638 3367
Ashish Shah	Construction, Power, Cement	ashishshah@idfcsski.com	91-22-6638 3371
Salil Desai	Construction, Power, Cement	salil@idfcsski.com	91-22-6638 3373
Ritesh Shah	Metals & Mining, Pipes, Textiles	riteshshah@idfcsski.com	91-22-6638 3376
Neha Agrawal	Financials	neha@idfcsski.com	91-22-6638 3237
Swati Nangalia	Mid Caps, Media	swati@idfcsski.com	91-22-6638 3260
Sameer Bhise	Strategy, Pharmaceuticals	sameer@idfcsski.com	91-22-6638 3390
Shweta Dewan	Mid Caps, Education, FMCG	shweta.dewan@idfcsski.com	91-22-6638 3290
Nikhil Salvi	Cement, Construction	nikhil.salvi@idfcsski.com	91-22-6638 3239
Rajeev Desai	Real Estate	rajeev@idfcsski.com	91-22-6638 3231
Chinmaya Garg	Financials	chinmaya@idfcsski.com	91-22-6638 3325
Aniket Mhatre	Automobiles, Auto ancillaries	aniket@idfcsski.com	91-22-6638 3311
Probal Sen	Oil & Gas	probal@idfcsski.com	91-22-6638 3238
Rupesh Sonawale	Database Analyst	rupesh@idfcsski.com	91-22-6638 3382
Dharmesh Bhatt	Technical Analyst	dharmesh@idfcsski.com	91-22-6638 3392

Equity Sales/Dealing	Designation	E-mail	Tel. +91-22-6638 3300
Naishadh Paleja	MD, CEO	naishadh@idfcsski.com	91-22-6638 3211
Paresh Shah	MD, Dealing	paresh@idfcsski.com	91-22-6638 3341
Vishal Purohit	MD, Sales	vishal@idfcsski.com	91-22-6638 3212
Nikhil Gholani	MD, Sales	nikhil@idfcsski.com	91-22-6638 3363
Sanjay Panicker	Director, Sales	sanjay@idfcsski.com	91-22-6638 3368
V Navin Roy	Director, Sales	navin@idfcsski.com	91-22-6638 3370
Suchit Sehgal	AVP, Sales	suchit@idfcsski.com	91-22-6638 3247
Pawan Sharma	MD, Derivatives	pawan.sharma@idfcsski.com	91-22-6638 3213
Dipesh Shah	Director, Derivatives	dipeshshah@idfcsski.com	91-22-6638 3245
Jignesh Shah	AVP, Derivatives	jignesh@idfcsski.com	91 22 6638 3321
Sunil Pandit	Director, Sales trading	suniil@idfcsski.com	91-22-6638 3299
Mukesh Chaturvedi	SVP, Sales trading	mukesh@idfcsski.com	91-22-6638 3298
Viren Sompura	VP, Sales trading	viren@idfcsski.com	91-22-6638 3277
Rajashekhar Hiremath	VP, Sales trading	rajashekhar@idfcsski.com	91-22-6638 3243

Explanation of Ratings:

1. Outperformer: More than 10% to Index
2. Neutral: Within 0-10% to Index
3. Underperformer: Less than 10% to Index

Disclosure of interest:

1. IDFC - SSKI and its affiliates may have received compensation from the company covered herein in the past twelve months for Issue Management, Capital Structure, Mergers & Acquisitions, Buyback of shares and Other corporate advisory services.
2. Affiliates of IDFC - SSKI may have mandate from the subject company.
3. IDFC - SSKI and its affiliates may hold paid up capital of the company.
4. IDFC - SSKI and its affiliates, their directors and employees may from time to time have positions in or options in the company and buy or sell the securities of the company(ies) mentioned herein.