Industry Focus

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Indian Real Estate

Risks Outweigh the Positives

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- **Initiate with Sells on HDIL and IBREL** — With deteriorating demand conditions, tight liquidity, high price/rental risks for Mumbai and both stocks outperforming the Sensex by 29-41% over the last one month, we believe risks outweigh the positives. We initiate coverage with Sell/High Risk ratings on HDIL with a Rs118 target price (40% discount to NAV) and IBREL with a Rs150 target price (35% discount to NAV).
- **Mumbai concentration, price risk, delays are key concerns** — Our thesis is based on HDIL's and IBREL's high concentration in Mumbai (89% of HDIL's Gross NAV and 42% of IBREL's Gross NAV), particularly office space, where we believe the risk of correction in rentals, demand delays and oversupply is high. In addition, low visibility on earnings and likely delays in the airport project for HDIL and IBREL's flagship mill projects amidst the current slowdown are key concerns.
- **Positives** — The Mumbai airport project is a big win for HDIL, provides visibility, access to low-cost land and contributes Rs85/share (46% of Gross NAV) while IBREL's net cash of Rs81/share is a key strength. The recent stimulus package emphasizing affordable housing and lower rates is sentiment positive, but we believe benefits for HDIL and IBREL are limited given their commercial asset mix.
- **Weak outlook for Mumbai adds to woes** — While long-term potential remains intact, we see near-term risks to prices/rentals, delays, supply overhang and volatile capital markets with deteriorating news flow on Mumbai adding to company woes.
- **HDIL a relatively higher beta play to IBREL** — HDIL is expected to offer more beta given its higher NAV sensitivity by 13% on 200bps lower cost of capital and more incentives for airport project; IBREL is more a defensive given its net cash position, though benefits are likely to have peaked with government measures easing liquidity.

Figure 1. HDIL & IBREL Valuation Summary

	HDIL	IBREL
Price (5-Jan)	143	153
Mkt Cap (US$ M)	810	816
Target Price	118	150
Est NAV	196	232
Current Disc to NAV	-27%	-34%
FY09E Net Profit (Rs m)	10,210	1,428
FY09E P/E (x)	3.8	27.7
FY09E P/B (x)	0.9	0.9
FY09E Debt/Equity	1.0	0.2

Source: Citi Investment Research estimates

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

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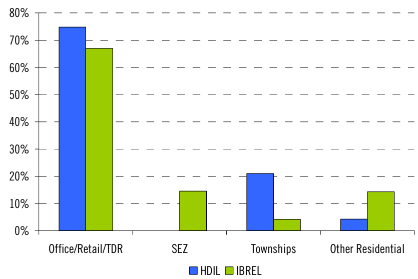
Investment Thesis

Initiating with Sells on HDIL and Indiabulls Real Estate

Our Sell rating is based on concentration of landbank in Mumbai, particularly office space, low visibility of earnings and execution and delay in HDIL's airport and IBREL's mill land projects

We initiate coverage of HDIL with a Sell/High Risk (3H) rating and target price of Rs118 at a 40% discount to our NAV of Rs196, and of Indiabulls Real Estate (IBREL) with a Sell/High Risk (3H) rating and a target price of Rs150 based on a 35% discount to NAV of Rs232. Our investment thesis and discount is based on: 1) concentration risk to Mumbai (89% of HDIL's NAV and 42% of IBREL's Gross NAV) with focus on commercial assets, where we believe price/rental risk (factoring a 25% price decline in our NAV), absorption issues and supply overhang are high; 2) adverse impact of potential delays in key airport project, flagship mill properties; and 3) low visibility on earnings and execution of projects. Further, with deteriorating news flow on the Mumbai market amidst the current slowdown and stocks having rallied 48-61% over the last one month, we believe risks outweigh the positives.

Figure 2. HDIL & IBREL Gross NAV Comparison



Source: Citi Investment Research estimates

Airport to provide HDIL visibility; IBREL's net cash position a strength....but see limited benefits from stimulus package

The Mumbai airport project will provide HDIL with visibility, access to low-cost land and contribute Rs85/share (46% of our Gross NAV). While Phase I execution is encouraging, we see correction in TDR prices/rentals, slackening office demand in Mumbai and likely delays adversely affecting company earnings. IBREL's adjusted net cash of Rs81/share is a key strength, though some benefits seem to have peaked, as recent measures are likely to ease some of the liquidity crunch. That said, the recent stimulus package emphasizing affordable housing, lower rates and government measures to relax debt restructuring likely to ease liquidity for the sector are sentiment positive, but we believe benefits for HDIL and IBREL are limited given their thrust toward commercial assets (67-75% of Gross NAV), where demand/price risks are higher.

Weak Mumbai outlook – adds to woes

While long-term potential for Mumbai is intact, in the near term there are concerns about correction in prices/rentals, lower demand and oversupply

Mumbai being the commercial hub of India has huge potential; however, inadequate infrastructure, FSI constraints and dense slum population have impeded development in Mumbai. While the potential remains intact for the long term, we see near-term risks of falling prices/rentals (office/retail rentals most at risk, hence we built in a 25% price decline in our NAV assumptions), supply overhang and delays in this slowing environment with volatile capital markets as key sentiment dampeners for the Mumbai market. With 89% of HDIL's Gross NAV and 42% of IBREL's Gross NAV contributed by Mumbai and its peripheral areas, we see these adverse conditions adding to company woes.

HDIL a relatively high beta play to IBREL

HDIL a relatively higher beta play on NAV sensitivity to lower cost of capital and more incentives on airport project; IBREL more a defensive, as cash benefits peak

HDIL is a relatively higher beta play in the current environment with 1) high NAV sensitivity of 13% on 200bps lower cost of capital versus IBREL's 5%, 2) upside risks of more benefits/incentives offered by the government to compensate for airport rehab, being a critical infrastructure project and 3) recovery in the Mumbai market. IBREL is relatively more defensive given its net cash position, though benefits are likely to have peaked with government measures easing some of the liquidity crunch; however, incremental lease for flagship Mumbai projects at higher rates (versus Rs140-210/sqft per month in our NAV estimates) and positive developments on power projects are likely upside triggers for the stock.

Valuation

Why the 35-40% discount for HDIL, IBREL?

We see tier-II developers such as HDIL, IBREL trading at high discounts – given Mumbai concentration, high risk model and delays

Property markets globally trade at discounts to NAV that have been widening on prevailing negative sentiment on property. Given the challenging operating and macro conditions, we believe it would be difficult for India to buck this trend. However, we expect tier-I developers having good asset mix, de-leveraged balance sheets with access to capital and track records to trade at lower discounts to NAVs while tier-II players, like HDIL and IBREL, with higher business risk and geographic concentration to likely trade at larger discounts.

HDIL's discount is attributed to: high sensitivity to TDR prices/rentals, likely delay in airport project and tight liquidity. IBREL's discount factors: delay in mill land projects, low visibility on townships/ SEZs and non-core businesses and transparency issues

While the level of NAV discount is a matter of subjective assessment, we believe that a 40% discount for HDIL and 35% for IBREL to the core NAV estimates is fair. This is in-line with our valuation methodology for Citi's India real estate universe. We attribute the 40% discount for HDIL toward 1) high sensitivity of softening TDR prices on NAV, 2) delays in the airport project resulting in penalties, 3) liquidity crunch and 4) concentration risk in Mumbai suburbs (89% of Gross NAV) where price risk/supply overhang is high. IBREL's 35% discount factors in 1) ~12-month delay in completing/leasing its flagship Mumbai mills property having risk of re-negotiation, 2) low execution/ absorption visibility on large townships/SEZs, 3) diversification in non-core businesses like power generation and retailing with limited track records and 4) transparency issues in the past with regard to inter-group transactions. IBREL's discount is, however, lower than HDIL's, primarily recognizing the benefits of its net cash position of Rs81/share in this liquidity strained environment.

Figure 3. Indian Real Estate Valuation Summary

	Price 5-Jan	Mkt Cap (US$ M)	Rating	Area m sq ft	Target Price	Target NAV Disc	Est NAV	Current NAV Disc	FY09E P/E(x)	FY09E P/B(x)
DLF	296	10,404	1M	753	340	-25%	453	-35%	6.7	2.0
Unitech	48	1,596	2H	696	57	-45%	103	-54%	5.1	1.5
IBREL	**153**	**816**	**3H**	**212**	**150**	**-35%**	**232**	**-34%**	**27.7**	**0.9**
HDIL	**142**	**810**	**3H**	**196**	**118**	**-40%**	**196**	**-27%**	**3.8**	**0.9**
Puravankara	56	245	3H	116	52	-50%	104	-47%	5.4	0.9
Omaxe	67	239	3H	152	52	-50%	104	-36%	6.9	0.8
Parsvnath	52	200	3H	197	42	-49%	83	-37%	4.5	0.5
Ansal Prop	36	85	3H	215	40	-50%	80	-55%	3.9	0.3

Source: Citi Investment Research estimates

Industry Outlook – Tough Times, for Now

The long-term development opportunity in India is large, driven by a severe housing shortage, economic momentum creating new demand, favorable demographics supported by a fast-evolving financial system and rising household aspirations. However, with macro economic signals weak, high prices and mortgage rates at 10%-11% (especially for loans over Rs2m) having damaged affordability, we believe the near-term fundamentals of the property market are weak. We see tougher times for developers as affordability issues bite, transactions drop while property buyers await price corrections, pre-sales slow down and the liquidity crunch intensifies.

Overview on Mumbai – huge potential....but risks emerging

Mumbai is the commercial hub of India and has huge development potential if infrastructure in the city is improved

Mumbai has traditionally been the commercial hub of India – high demand and prices and limited land supply make it a high value, high priced market versus other metro cities in India. The city has huge development potential; however, inadequate transport infrastructure, FSI constraints and dense slum population (over 1 million slums) are some of the key constraints that have historically impeded development in Mumbai. While the potential remains intact for the long term and ongoing policy and infrastructure initiatives are positives, we see near-term risks emerging of softening prices, supply overhang and execution delays for Mumbai's property market in this slowing environment and volatile capital markets, a key sentiment driver for the Mumbai property market.

Policy, infrastructure initiatives on cards – but slow progress

Maharashtra government has announced several infrastructure projects for Mumbai

We expect ongoing infrastructure projects - The Mumbai Urban Infrastructure project (MUIP) and Mumbai Urban Transportation Project (MUTP), Bandra Worli Sea link, Wadala truck terminal, Sion Panvel Highway expansion project and Mumbai Metro Phase I (east to west connectivity) to release congestion in the city and enhance development potential. However, progress on most infrastructure projects is slow and in many cases deadlines have repeatedly been pushed back.

Given the scarcity of land, the government is taking steps to increase FSI (Floor Space Index) in Mumbai

The government has started to take policy measures on augmenting supply in the city, through 1) higher FSI in key locations and slum rehab schemes, 2) scrapping of the Urban Land Ceiling Regulation Act, 3) land auctions at BKC, and 4) railways looking to unlock value of their large parcel of commercial real estate in prime locations of Bandra, Mumbai CST, and Mumbai Central in a phased manner and proposed redevelopment of Dharavi, being a key project. While we believe all this should help reduce the demand-supply mismatch and cool off prices/rentals addressing affordability issues in the long term, given political uncertainty, bureaucratic delays and slow progress on implementing these measures, we see no immediate impact.

Residential: High aspirations, but prices unaffordable

The sharp demand-supply imbalance in the past few years has made prices in Mumbai unaffordable

Residential demand in Mumbai has been high over the last 2-3 years driven by economic activity, growth of capital markets, financial services, increased investments by NRIs and high net worth individuals (wealth effect) and the city's ever increasing population. While buying aspirations remain high, a significant price rise over the last few years, high mortgage rates and a shortage of quality housing have made apartments unaffordable in each segment – high-end as well as mid-income segments. This does pose risk of softening prices, especially in the current slowing environment given that Mumbai prices/rentals are an outlier versus other metro cities and a few international locations.

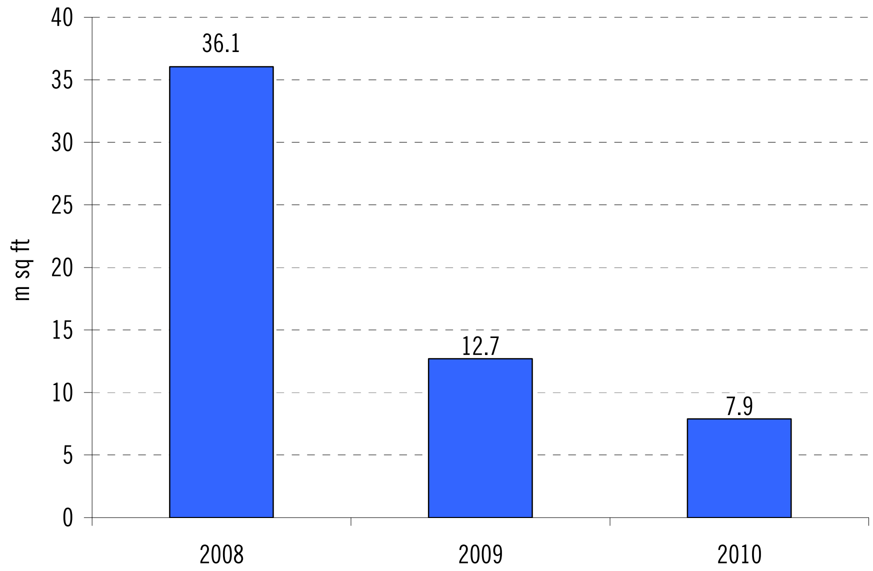
With substantial supply of ~56.6m sq ft (as per Knight Frank) in the pipeline over 2008-2010 and transaction activity down significantly, we expect prices to soften by 15-20% particularly in suburban markets, while South Mumbai prices targeting high net worth individuals and NRIs/migrants will tend to drift given supply constraints. Housing demand is now shifting from South Mumbai to the suburbs – Navi Mumbai is emerging as an attractive option due to its planned development, infrastructure, proposed international airport and affordable capital and rental values.

Figure 4. Mumbai Residential Capital Values

Location	Price Range Rs/sq ft
High-End	
Cuff Parade, Colaba, Churchgate	46,000-56,000
Alt Rd, Malabar Hill, Breach Candy	50,000-70,000
Worli, Prabhadevi, Parel	30,000-55,000
Bandra, Khar, Santacruz, Juhu	28,000-32,000
Andheri, Malad, Goregaon	10,000-14,000
Powai	16,000-20,000
Mid-End	
Cuff Parade, Colaba, Churchgate	28,000-35,000
Alt Rd, Malabar Hill, Breach Candy	35,000-45000
Worli, Prabhadevi, Parel	20,000-30,000
Bandra, Khar, Santacruz, Juhu	14,000-20,000
Andheri, Malad, Goregaon	8,000-9,500
Powai	6,400-7,400

Source: Cushman & Wakefield, CIR

Figure 5. Mumbai Residential Supply 2008-2010 (m sq ft)



Source: Knight Frank, Citi Investment Research

Office: Attractive....but significant supply overhang and rental correction risk

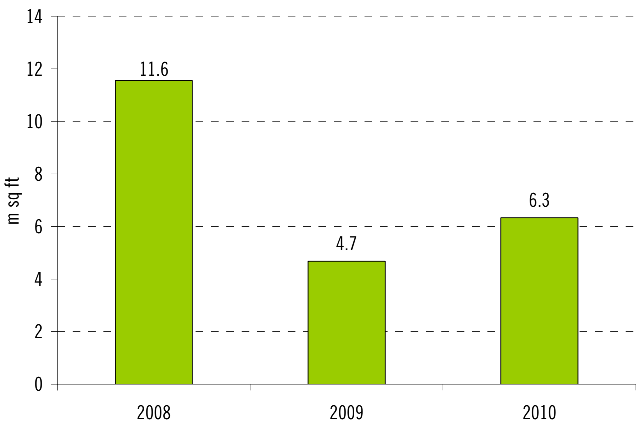
The Mumbai office market had been experiencing spiraling rentals for a while now, largely driven by strong absorption and acute shortage of Grade-A office space. This is an attractive asset class, especially for properties expected in the next 6-12 months. Demand has shifted from traditional CBD areas in Nariman Point, Fountain, Fort and Ballard Estate to emerging business hubs in Worli-Lower Parel, Bandra-Kurla, Anadheri-Malad and Navi Mumbai. That said, ~22.6m sq ft of office space (according to Knight Frank) is expected over 2008-2010, and the recent policy change of increasing the cap on space for financial institutions in Mumbai's IT Parks from 30% to 80% would significantly add to supply concerns. While timely execution of this supply remains a challenge amidst rising costs and dampened sentiments, this will remain an overhang. With limited visibility of future absorption rates given the current slowing environment, we expect the shortage premium of 20-25% currently built into rentals to be corrected as new supply comes to market, increasing the risk of downward re-negotiation on leases already signed.

Figure 6. Mumbai Office Rental Values

Location	Rs/sq ft/mth
CBD	500
Worli	400
Lower Parel	310
Bandra Kurla	385
Andheri	180
Malad	100
Powai	110
Vashi	75
Thane-Belapur Rd	45

Source: Cushman & Wakefield, CIR

Figure 7. Mumbai Office Supply 2008-2010 (m sq ft)



Source: Knight Frank, Citi Investment Research

Figure 8. Upcoming Office Projects of Select Developers in Mumbai Metropolitan Region

Developer	Location	Area (m sq ft)
Akruti City	Andheri, BKC, Kanjurmarg, Thane	2.45
DLF	Parel	1.90
HDIL/Mack Star Marketing	Andheri, Bhandup, Mulund, Turbhe	3.90
Indiabulls Real Estate	Parel	2.90
Kanakia	Andheri, Borivali, Rabale	1.77
Lodha Group	Kanjurmarg, Mahalaxmi	0.90
Man Infraprojects	Bandra, Nerul, Vile Parle	0.68
Marathon Realty	Mulund, Parel, Panvel	2.45
Neptune	Kurla, Mulund, Thane	2.54
Oberoi Constructions	Goregaon	0.70
Orbit Corp	Kalina, Parel, Sakinaka	0.83
Peninsula Land	Parel, Kurla	2.10
RNA	Bandra	0.15
Rustomjee	Andheri, Sion, Thane	4.98
Shree Naman Developers	BKC	0.26
Total		**28.50**

Source: Citi Investment Research

Retail: Upcoming supply to keep rentals in check

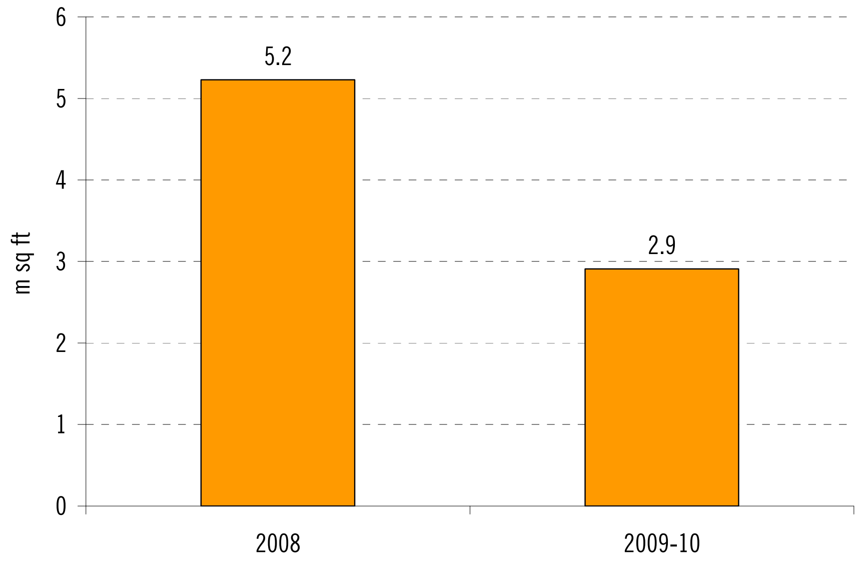
Increasing purchasing power has led to a significant growth in the organized retail market and sharp increase in rentals in Mumbai. Mumbai is expected to have the second highest density of malls and highest rentals in the country, just behind NCR. Presently, the city has ~9m sq ft of retail malls operational, most of which are in suburban areas and in Lower Parel. As per Knight Frank, the city is expected to see retail mall space doubling to ~17m sq f t by 2010.This will be distributed across major locations - Lower Parel for luxury retail and more concentrated in Central suburban markets and Navi Mumbai. Leasing activity across main streets is expected to remain restrained due to unaffordable rentals, and with an apparent postponement of expansion plans by major brands in anticipation of a correction, rentals will remain in check in our view. Malls that are efficiently designed, with better mall management and that have a brand name could at best hold rentals. However, with a huge amount of supply in the pipeline, increasing vacancy levels and pre-leasing slowing, we expect rentals to correct, particularly in suburban markets.

Figure 9. Mumbai Retail Rental Values

Location	Rs/sq ft/mth
Linking Rd	1080
Kemps Corner	760
Colaba Causeway	850
Fort Fountain	430
Lower Parel	700
Malad	525
Andheri Link Rd	415
Mulund	330
Vashi	270

Source: Cushman & Wakefield, CIR

Figure 10. Mumbai Retail Supply 2008-2010 (m sq ft)



Source: Knight Frank, Citi Investment Research

Housing Development and Infrastructure (HDIL.BO)

Initiate at Sell: High Risk-Reward Model; TDR Prices/Absorption a Concern

Sell/High Risk	3H
Price (05 Jan 09)	Rs142.35
Target price	Rs118.00
Expected share price return	-17.1%
Expected dividend yield	1.8%
Expected total return	**-15.3%**
Market Cap	Rs39,216M
	US$810M

Price Performance (RIC: HDIL.BO, BB: HDIL IN)

- **Initiate at Sell, TP Rs118** — HDIL is a slum rehab specialist. We initiate at Sell/High Risk with a Rs118 target price, based on a 40% discount (factoring HDIL's high risk-reward model) to our NAV of Rs196. With high downside risk to TDR/asset prices, absorption issues in Mumbai (its domain market) given the slowdown and the stock up 61% in the last one month, we see downside risks.

- **High risk-reward model** — HDIL's thrust and expertise in slum rehab projects (57% of Gross NAV) provide it with a large development opportunity that is profitable, but this high risk-reward model is not favored in a downturn.

- **Mumbai airport project a big win; risks remain** — The airport project will provide HDIL with visibility and contribute Rs85/share (46% of Gross NAV). While Phase I execution is encouraging, we see correction in TDR prices/rentals, slackening demand in Mumbai and delays adversely affecting company earnings.

- **Weak outlook for Mumbai a dampener** — With 89% of Gross NAV contributed by Mumbai in mostly suburban areas, we see concentration risk for HDIL. While we build in a 25% price decline factoring higher price risks, volatile capital markets and deteriorating news on leasing activity will dampen stock sentiment.

- **Risks outweigh positives** — With increasing risk to TDR prices/absorption (15% of Gross NAV), slackening office demand, likely execution delays in the airport project resulting in penalties, tight liquidity crunch and the stock at a 27% discount to NAV versus our target of 40%, we believe risks outweigh positives.

Statistical Abstract

Year to 31 Mar	Net Profit (RsM)	Diluted EPS (Rs)	EPS growth (%)	P/E (x)	P/B (x)	ROE (%)	Yield (%)
2007A	5,480	22.72	367.2	6.3	4.7	119.0	0.0
2008A	14,099	51.18	125.3	2.8	1.1	64.4	2.1
2009E	10,210	37.06	-27.6	3.8	0.9	24.8	1.8
2010E	8,140	29.55	-20.3	4.8	0.7	16.4	1.8
2011E	8,956	32.51	10.0	4.4	0.6	15.6	1.8

Source: Powered by dataCentral

Fiscal year end 31-Mar	2007	2008	2009E	2010E	2011E
Valuation Ratios					
P/E adjusted (x)	6.3	2.8	3.8	4.8	4.4
P/E reported (x)	6.3	2.8	3.8	4.8	4.4
P/BV (x)	4.7	1.1	0.9	0.7	0.6
Dividend yield (%)	0.0	2.1	1.8	1.8	1.8
Per Share Data (Rs)					
EPS adjusted	22.72	51.18	37.06	29.55	32.51
EPS reported	22.72	51.18	37.06	29.55	32.51
BVPS	30.44	132.18	166.74	193.79	223.80
NAVps ordinary	na	na	na	na	na
DPS	0.00	3.00	2.50	2.50	2.50
Profit & Loss (RsM)					
Net operating income (NOI)	**6,831**	**17,352**	**14,756**	**12,934**	**15,078**
G&A expenses	-211	-431	-730	-965	-1,158
Other Operating items	-13	-22	-50	-58	-66
EBIT including associates	**6,606**	**16,899**	**13,976**	**11,912**	**13,854**
Non-oper./net int./except.	-355	-878	-2,307	-2,609	-3,619
Pre-tax profit	**6,251**	**16,021**	**11,669**	**9,303**	**10,235**
Tax	-771	-1,922	-1,459	-1,163	-1,279
Extraord./Min. Int./Pref. Div.	0	0	0	0	0
Reported net income	**5,480**	**14,099**	**10,210**	**8,140**	**8,956**
Adjusted earnings	5,480	14,099	10,210	8,140	8,956
Adjusted EBIT	6,606	16,899	13,976	11,912	13,854
Adjusted EBITDA	6,620	16,921	14,026	11,969	13,920
Growth Rates (%)					
NOI	377.8	154.0	-15.0	-12.3	16.6
EBIT adjusted	394.8	155.8	-17.3	-14.8	16.3
EPS adjusted	367.2	125.3	-27.6	-20.3	10.0
Cash Flow (RsM)					
Operating cash flow	**-1,328**	**-39,526**	**-15,849**	**-10,678**	**-12,820**
Depreciation/amortization	13	22	50	58	66
Net working capital	-7,374	-53,449	-26,133	-18,875	-21,842
Investing cash flow	**-614**	**-265**	**-249**	**-273**	**-300**
Capital expenditure	-98	-455	-58	-63	-69
Acquisitions/disposals	0	0	0	0	0
Financing cash flow	**1,559**	**43,233**	**16,344**	**10,234**	**13,511**
Borrowings	1,737	27,327	17,033	10,923	14,200
Dividends paid	0	-491	-689	-689	-689
Change in cash	**-383**	**3,443**	**246**	**-717**	**391**
Balance Sheet (RsM)					
Total assets	**19,696**	**75,034**	**104,132**	**122,484**	**146,637**
Cash & cash equivalent	57	3,505	3,751	3,034	3,425
Net fixed assets	254	596	604	609	612
Total liabilities	**12,354**	**38,619**	**58,196**	**69,096**	**84,983**
Total Debt	3,757	31,127	48,160	59,083	73,283
Shareholders' funds	**7,342**	**36,415**	**45,936**	**53,388**	**61,655**
Profitability/Solvency Ratios					
EBIT margin adjusted (%)	54.9	71.0	56.5	53.9	50.2
ROE adjusted (%)	119.0	64.4	24.8	16.4	15.6
ROA adjusted (%)	39.5	29.8	11.4	7.2	6.7
Net debt to equity (%)	50.4	75.9	96.7	105.0	113.3
Interest coverage (x)	11.8	12.0	4.9	3.7	3.2

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Powered by: dataCentral

Company Background

HDIL is part of the Wadhawan Group (founded in 1996), and among the leading slum rehab developers having rehabilitated close to 30,000 families to date – implying a potential 40% market share (excluding airport project). It has developed ~12m sq ft of SRA projects. Its expertise and past track record in execution of these projects has built up a competitive advantage for itself in this business that has high entry barriers. The company primarily operates in the Mumbai Metropolitan Region having presence across all assets, its focus being commercial and retail projects. Historically, HDIL has followed a build-sell model strategy (given thrust on SRA projects) and intends to follow the same for most of its projects. The company raised ~Rs17bn via an initial public offering (IPO) on July 2007 at Rs500/share for funding its land acquisition and ongoing slum rehab projects. Promoters control and manage the company with a 61.5% stake.

Investment Thesis

Sell with target price of Rs118

We initiate coverage of HDIL with a Sell/High Risk rating and a target price of Rs118 at a 40% discount to our Mar'09E NAV of Rs196 – offering 15% downside. Given HDIL's high risk-reward model and negative sentiments for property, particularly the Mumbai market where we see significant price/absorption risk over the next 12 months, we believe risks outweigh the positives. We attribute the 40% discount to the following: 1) regulatory/political risks as HDIL's NAV is sensitive to higher FSI (Floor Space Index) norms and softening TDR/asset prices; 2) likely execution delays in the airport project resulting in penalties; 3) tight liquidity crunch; and 4) concentration risk in Mumbai suburbs (89% of Gross NAV) where price risk/supply overhang is high.

HDIL's expertise and strong track record in slum rehab projects (57% of Gross NAV) does provide the company with a competitive advantage, a large development opportunity that is highly profitable, but we believe this is a high-risk business. The airport rehab project is a big win and will provide HDIL with visibility and contribute Rs85/share (46% of our Gross NAV) to our NAV. Though the pace of Phase I execution is encouraging, we see correcting TDR prices/rentals, absorption issues and execution delays amidst deteriorating macro adversely affecting stock sentiment. A weak outlook for the Mumbai market (89% of HDIL's Gross NAV) and volatile capital markets further add to these woes. Factoring this, the company's liquidity crunch, downside risks to earnings and the stock up 61% over the last one month, risk-reward is unfavorable.

Strategic Initiatives and Strengths

Leverage on expertise in slum rehab – large opportunity, high entry barriers...but risky

HDIL is a market leader in slum rehab projects having completed 12m sq ft of slum rehab

HDIL is among the leading slum rehab developers having rehabilitated close to 30,000 families to date, implying a potential 40% market share (excluding the airport project). HDIL has developed ~12m sq ft of SRS saleable area and rehabilitation area since 1996. Its expertise in handling the slum dwellers, familiarity with the regulatory process and strong track record in execution of these projects has allowed it to build up a competitive advantage for itself in this business that has high entry barriers. The company plans to leverage on this expertise to secure marquee projects such as the Mumbai Airport project. HDIL has consciously adopted the SRS (Slum Redevelopment Scheme) route to acquire high-value, low-cost land in Mumbai. Fifty-seven percent of its Gross NAV is derived from SRS projects (~37% of landbank including the airport project). Though we see this as a large development opportunity that is highly profitable and that HDIL is best positioned to take advantage of, it is a high risk business given the downturn.

Mumbai the domain – a high value, high risk market today

The Mumbai Metropolitan Region accounts for 89% of HDIL's Gross NAV and 87% of its landbank

Mumbai has huge potential for slum redevelopment given that ~2.8bn sq ft (over 1 million slums) of space is occupied by slum dwellers, of which only ~21m sq ft has been developed so far. Mumbai has traditionally been the commercial hub of India. High demand, prices and limited supply make it attractive versus other metro cities. The city has huge development potential. However, inadequate transport infrastructure, FSI constraints and dense slum population (over 1 million slums) are some of the key constraints that have historically impeded this development in Mumbai. We see higher near-term risks emerging of softening prices/rentals, supply overhang and execution delays for Mumbai's property market in this slowing environment and volatile capital markets, a key sentiment driver for Mumbai's property market. While the company has ventured into other markets such as Hyderabad, Kochi and Pune, with 87% of HDIL's landbank (196m sq ft) and 89% of Gross NAV coming out of Mumbai and its suburbs, its fortunes remain dependent on the outlook for the Mumbai market.

Figure 1. HDIL Landbank Summary (million sq ft)

Mumbai Metropolitan Region	**171.1**
-Airport TDR	53.2
-Airport Saleable Area (airport and rehab area)	14.0
-Non Airport Slum Rehab	4.6
-Residential	68.9
-Commercial & Retail	30.3
Hyderabad	**9.0**
Kochi	**15.0**
Pune	**1.2**
Total	**196.3**

Source: Company Reports, Citi Investment Research

Airport project a big win (46% of Gross NAV)

HDIL will get 65 acres; saleable area of ~8.5m sq ft around the airport after rehabilitating slums

Given HDIL's expertise in the slum redevelopment model, MIAL (Mumbai International Airport Ltd) run by the GVK group, awarded the slum rehabilitation project to HDIL in October 2007 – a big win for the company. The agreement envisages HDIL rehabilitating ~85,000 families living in slums encroaching on 276 acres of the airport land. As per the arrangement, MIAL will use part of the freed up area to modernize and expand the existing airport; and the balance will be split for development in favor of MIAL and HDIL in a 55:45 ratio – providing HDIL with 65 acres, which converts into 8.5m sq ft saleable area assuming an FSI of 2x. Additionally, the company will be compensated via TDR (Transfer of Development Rights, similar to land rights) worth ~53m sq ft (~10m sq ft land TDRs and ~43m sq ft of construction TDRs) from government authorities for rehabilitating the slums. This apart, the project is tax exempt under the 80-IA scheme (but would be liable to the minimum alternate tax rate of ~12% versus peak rate of 34%).

Phase I execution encouraging, but TDR/FSI absorption an issue and timely completion will be key

Phase I rehabilitation of ~22,000 families over ~59 acres in Kurla began in Jun'08; targeting completion by Dec'09

Both the scale and pace of construction for Phase I of HDIL's airport rehabilitation project in Kurla are encouraging. The company has started construction for Phase I (~5.5m sq ft) for rehabilitating ~22,000 families on ~59acres in Kurla (close to the airport site), targeting to complete in 15-18 months (Dec'09). This apart, management expects to start Phase II by 1QFY10 for rehab of another ~25,000 families and targets to rehabilitate ~50,000 families by Dec'10. It has already tied-up 150 acres (of 180 acres required) for the rehab project, most of which being substantially paid. Benefiting from the recent increase in FSI to 4x on slum rehab, the company is expected to get saleable area of ~5.5m sq ft, which is also under construction along with its Phase I of rehab. It has already sold ~1.5m sq ft of land TDR available for Phase I.

Figure 2. Airport Project Valuation Assumptions

Land TDR m sq ft	10
Rehab TDR m sq ft	43
Saleable Area m sq ft	14
Rental assumptions	Rs94/sq ft per mth
Saleable area FSI sales	Rs7,500/sq ft
TDR Price Range	Rs1,350-1,800/sq ft
Families	~85,000
Timeline	9 yrs
Project NAV	~Rs85/share

Source: Company Reports, CIR

Figure 3. Recent HDIL TDR & FSI Sale Transactions

1.5m sq ft of airport TDR and 0.15m sq ft of FSI in Bandra (w) sold in 2QFY09

0.3m sq ft FSI sold in Santacruz project in 1QFY09

Andheri (Kaledonia) project sold to Mack Star Marketing in 4QFY08

Part of BKC project sold to Adani Group

Source: Company, Citi Investment Research

While all this is encouraging; we see softening demand, sharp correction in TDR prices, absorption issues, and outstanding receivables of Rs1.5bn (as of Sept'08) on TDR sales done in 2Q as early signs of a worsening environment. Further, given social-political issues and changing regulatory norms surrounding slum rehab projects, risks of execution delays remain. However, being a critical project for the city and given the government's support, we should see timely completion of this project by FY12, otherwise HDIL will be liable to a penalty (~Rs2bn) in case of delay. We expect this project to contribute Rs85/share to our NAV estimate, factoring in saleable area of ~14m sq ft and TDR sales of ~53m sq ft (revenue recognition for TDRs to start from FY09) all to be executed by 2017 (versus management guidance of 2014). However, as a conservative measure we have not built in any additional saleable area available to the company from future phases of rehab, which could be potential upsides.

Operates rehab/build-sell model, but asset mix geared toward commercial assets

HDIL operates on a rehab/build-sell model for most of its projects, particularly FSI in SRA projects and residential developments. This is in-line with its strategy for monetizing landbank at the earliest and getting maximum tax benefits on its SRA projects. Its plans to adopt a sale/lease approach for built-up office/retail projects (non-airport comm/retail projects are 22% of the landbank) has, however, been put on hold given the current liquidity crunch and demand slowdown.

With the company's asset mix relatively geared toward TDR/Comm/Retail (75% of Gross NAV) assets, we see higher risks to HDIL's model: 1) increasing price/rental pressures on back of softening demand in Mumbai's office/retail market and 2) supply overhang in office space building for which we have factored in a 25% price decline and execution delays.

Risks outweigh the Positives

Regulatory risks – likely to spoil the party

We see higher regulatory risks for HDIL given its sensitivity to policy changes on FSI norms in Mumbai. Regulatory changes proposed by the government of Maharashtra (GoM) some time back could have an adverse impact on demand and prices for TDR, directly affecting HDIL's profitability (largest TDR generator).

Figure 4. Regulatory Changes in Mumbai

Increase in rehab area (carpet) per tenement to 269 sq ft from 225 sq ft.

Increase in FSI to 4 from 2.5 for high density slum rehab projects.

Proposal to levy FSI cost (25% of ready reckoner rates) on future slum rehab projects.

Cap on space for Financial Institutions in IT Parks in Mumbai Metropolitan Region increased to 80% from 30%.

Incentive FSI to encourage earmarking of space for public parking. Additional FSI granted will be 40%-50% of the parking area.

Source: News Reports, Citi Investment Research

- Proposed increased FSI for suburban Mumbai from 1.0x to 1.33x and offer to sell the incremental 0.33x of FSI at a 20-70% discount to the government ready reckoner rate.
- Increase in rehab area for slum rehab projects from 225 sq ft to ~269 sq ft (carpet area) per tenement; and higher FSI from 2.5x to 4x for high density slum rehab projects likely to result in higher TDR generation.
- Proposal to levy FSI cost (25% of ready reckoner rates) on future slum rehab projects is likely to reduce the profitability of future SRA projects (we see no immediate impact on HDIL's NAV, as all projects are pre-Apr'08).

TDRs (Transferable Development Rights) are typically bought by developers to increase effective FSI from 1.0x to 2.0x. After these changes, we could see higher FSI and increased TDR generation adversely affecting demand and prices for TDRs (15% of Gross NAV) – a market HDIL dominates. As a conservative measure, we have factored average TDR prices of ~Rs1390/sq ft (versus ~Rs2300/sf in 2Q09) in HDIL's NAV, but dampened demand and regulatory changes on increasing FSI norms could adversely affect TDR prices/absorption.

Concentration risks in Mumbai suburbs

Makes HDIL vulnerable to price, absorption and supply overhang amidst softening demand in the city

With 87% of HDIL's landbank (196m sqft) and 89% of Gross NAV coming out of Mumbai's mostly suburban areas, we see concentration risk for HDIL. This poses risks of absorption and softening prices/rentals in the current slowing demand environment. Further, we see building supply adversely affecting the company, particularly office space in Mumbai (See Annexure 1) – this market is likely to see supply of ~29m sq ft over the next 2-3 years. While timely execution of this supply remains a challenge amidst the liquidity crunch and dampened sentiments, this will remain an overhang. Recent policy change to increase usage of non-IT space from 30% to 80% in IT-Parks in Mumbai would further add to these supply concerns and dampen rentals.

Figure 5. Upcoming Office Projects of Select Developers in Mumbai Metropolitan Region

Developer	Location	Area (m sq ft)
Akruti City	Andheri, BKC, Kanjurmarg, Thane	2.45
DLF	Parel	1.90
HDIL/Mack Star Marketing	Andheri, Bhandup, Mulund, Turbhe	3.90
Indiabulls Real Estate	Parel	2.90
Kanakia	Andheri, Borivali, Rabale	1.77
Lodha Group	Kanjurmarg, Mahalaxmi	0.90
Man Infraprojects	Bandra, Nerul, Vile Parle	0.68
Marathon Realty	Mulund, Parel, Panvel	2.45
Neptune	Kurla, Mulund, Thane	2.54
Oberoi Constructions	Goregaon	0.70
Orbit Corp	Kalina, Parel, Sakinaka	0.83
Peninsula Land	Parel, Kurla	2.10
RNA	Bandra	0.15
Rustomjee	Andheri, Sion, Thane	4.98
Shree Naman Developers	BKC	0.26
Total		**28.50**

Source: Company Reports, ET Realty, Citi Investment Research

Potential funding constraints

High debt levels likely to lead to capital constraints raising cost of funding

We see risks emerging for HDIL, as debt levels rise to Rs39b in Sep'08 vs. Rs31b in Mar'08 and Rs17b in Dec'07, on payout for land costs and construction finance need for airport rehab. With debt/equity at ~0.9x, the company's average cost of debt at 15.5% levels and pre-sales drying up over the last 2-3months, outstanding on TDR sales – we see the liquidity crunch intensifying. Although the company has managed to roll over Rs3.5bn of the short-term debt of Rs5.5bn maturing in 2HFY09, with more construction finance needed for subsequent airport rehab phases we foresee liquidity constraints continuing for a while until the demand environment improves.

Financials

Adopts project completion method

HDIL is among the few developers that adopt a conservative method of project completion method of accounting, under which revenue on a project is recognized only when the project is fully completed, with the risks and rewards of ownership of a unit being completely passed on to the buyer. This method of accounting is quite conservative as compared with other players in the industry, who follow a percentage of completion method. However, the reported income can be lumpy in certain years, as it recognizes projects only once completed.

Downside risks to earnings

The key projects that are expected to be recognized over the next two years include Bandra SRS Scheme I, TDR sales in the Airport Phase I project and the Ghatkopar property. Rehabilitation work on the Bandra SRS scheme I is complete, whereas the airport project has started generating TDR from 2Q FY09. We forecast 5% revenue CAGR over FY08-11E. However, we estimate an EPS CAGR of -14% over FY08-11E due to: 1) lower margins on changing product mix and higher interest costs. That said, given the sharp deterioration in the demand outlook over the last 2-3 months, we see downside risks to earnings.

Figure 6. HDIL Income Statement (Rs millions)

Year to 31 Mar	FY07	FY08	FY09E	FY10E	FY11E
Total Revenues	**12,042**	**23,804**	**24,744**	**22,084**	**27,620**
YoY Growth (%)	177%	98%	4%	-11%	25%
EBITDA	**6,620**	**16,921**	**14,026**	**11,969**	**13,920**
Margin (%)	55%	71%	57%	54%	50%
Depreciation & Amortization	(13)	(22)	(50)	(58)	(66)
Other income	206	529	582	640	704
EBIT	6,812	17,428	14,558	12,552	14,559
Interest income(expense)	(561)	(1,408)	(2,890)	(3,250)	(4,324)
Profit before tax	6,251	16,021	11,669	9,303	10,235
Tax	(771)	(1,922)	(1,459)	(1,163)	(1,279)
Profit after tax	**5,480**	**14,099**	**10,210**	**8,140**	**8,956**

Source: Company Reports, Citi Investment Research estimates

EBITDA Margins – likely to fluctuate

Given the conservative accounting method followed by HDIL, it is difficult to forecast margin trends. We expect margins to be in the range of 50-57% for FY09-11E; lower than FY08 margins, which were driven by one-off transaction of land sale in 4QFY08. While we expect EBITDA margins to come down as the product mix becomes more skewed toward lower-margin projects in distant suburbs, should the company choose to sell FSI in some of its slum rehab projects, margins could be higher. Rising costs, execution delays on slum rehab projects and softness in property/TDR prices if any could adversely affect margins.

Debt levels on the rise

HDIL debt levels are on the rise – concerning in current environment

HDIL's debt levels have increased to Rs39b in Sep'08 versus Rs31b in Mar'08 and Rs17b in Dec'07, on payout for land costs and construction finance for Phase I airport rehab. With debt/equity already at ~0.9x and pre-sales/TDR sales down significantly, we see the liquidity crunch intensifying. Although the company has managed to roll over Rs3.5bn of the short-term debt of Rs5.5bn maturing in 2HFY09, with more construction finance needed for subsequent airport rehab phases, we foresee liquidity constraints continuing.

Figure 7. HDIL Balance Sheet (Rs millions)

Year to 31 Mar	FY07	FY08	FY09E	FY10E	FY11E
Source of Funds					
Equity Share Capital	1,800	2,143	2,755	2,755	2,755
Reserves	5,355	34,248	43,181	50,632	58,899
Net Worth	7,155	36,390	45,936	53,387	61,654
Deferred Liability	8	15	15	15	15
Minority Interest	0	1	1	1	1
Total Debt	3,757	31,127	48,160	59,083	73,283
Capital Employed	**10,920**	**67,534**	**94,112**	**112,486**	**134,953**
Application of Funds					
Gross Block	267	576	628	685	748
Depreciation	16	32	82	139	205
Net Fixed Assets	251	544	546	546	543
Capital WIP	3	52	58	63	69
Investments	1,578	1,915	2,106	2,317	2,548
Goodwill	23	91	91	91	91
Inventories	13,245	55,229	81,654	94,518	113,242
Sundry Debtors	3,113	566	742	994	1,243
Other Current Assets	1,239	13,108	15,184	20,921	25,477
Cash and Bank	57	3,505	3,751	3,034	3,425
Current Assets	17,653	72,408	101,332	119,467	143,386
Current Liabilities	(8,588)	(7,476)	(10,021)	(9,998)	(11,684)
Net Current Assets	9,065	64,933	91,311	109,469	131,702
Total Net Assets	**10,920**	**67,534**	**94,112**	**112,486**	**134,953**

Source: Company Reports, Citi Investment Research estimates

Valuation

We see HDIL positioned as a mid-scale developer with a high risk-high reward model - thus 40% discount to NAV is fair

Our target price of Rs118 is based on a 40% discount to an estimated core NAV of Rs196. We see HDIL positioned as a mid-scale developer with a high risk-reward model and expect it to trade at a 40% discount to NAV, which is toward the lower end of the average discount to NAV range of 35-50% for tier-II developers. While the level of NAV discount is a matter of subjective assessment, we believe that a 40% discount is fair, given HDIL's niche positioning in the slum rehab business, visibility from the airport project and its strong track record. This is in-line with our valuation methodology for Citi's India real estate universe. We attribute the discount to the following: 1) regulatory/political risks as HDIL's NAV is sensitive to higher FSI norms and softening TDR/asset prices; 2) likely execution delays in the airport project to result in penalties; 3) tight liquidity crunch; and 4) concentration risk in Mumbai suburbs (89% of Gross NAV) where price risk/supply overhang is high.

We believe an NAV-based valuation methodology is most appropriate for developers, as NAVs value landbank, along with development across asset classes factoring in spread out time frames. Our NAV estimate of Rs196 is based on the following assumptions: 1) 25% decline in current market prices, as Mumbai being high priced faces maximum downside risk; 2) development volume of 191m sq ft (based on Mar'09); 3) an average cost of capital of 18%; and 5) a lower tax rate of 26%, factoring in tax benefits for the slum rehab and airport project. We have also provided sensitivities to further TDR/price declines and airport project delay.

Figure 8. HDIL NAV Sensitivity

Price Change (excluding Airport TDR)			
	-10%	**-15%**	**-20%**
NAV/share (Rs)	153	132	110
TDR Price Change			
	-10%	**-15%**	**-20%**
NAV/share (Rs)	182	174	167
Delay in Airport project (TDR & Saleable area)			
	3 months	**6 months**	**12 months**
NAV/share (Rs)	190	184	172
Cost of Capital			
	15%	**16%**	**17%**
NAV/share (Rs)	236	222	209

Source: Citi Investment Research estimates

Figure 9. HDIL NAV Summary (Rs Millions)

Gross NAV of Residential Development	37,851
Gross NAV of Commercial Development	89,078
Gross Total NAV	**126,929**
Less: Amt outstanding for land	7,750
Less: Tax @ 26%	30,858
Less: Debt Outstanding	39,478
Less: Customer Advances	1,480
Add: Cash	4,016
Add: Cost of 2,300 acres acquired for Vasi-Virar SEZ	2,600
Net NAV	**53,979**
No. of Shares Outstanding (Millions)	275
NAV Per Share (Rs)	**196**

Source: Citi Investment Research estimates

The stock has significantly outperformed the Sensex by 41% and BSE Realty by 11% over the last one month. With the overall outlook for property weak, higher risks of a slowdown in Mumbai given changing regulatory norms, building supply and higher execution risks, we see downside risk for the stock from current levels.

Risks

We rate HDIL High Risk. This is different from the Speculative Risk rating assigned by our quantitative risk rating system (which measures the stock's volatility over a 260-day period). The key reasons for our High Risk rating include: 1) encouraging progress on Phase I of airport rehab project, 2) expertise and track record in slum rehab projects, a high risk-high reward business. The main upside risks to our investment thesis and target price are 1) change in regulatory policy, favoring TDR prices, 2) more benefits/incentives offered by the government to compensate for airport rehab costs, 3) significant FSI pre-sales easing its liquidity crunch and 4) meaningful recovery in demand, particularly office space in the Mumbai market.

Annexure 1

Figure 10. Upcoming Office Projects of Select Developers in Mumbai Metropolitan Region

Developer	Project	Location	Area (m sq ft)
Akruti City	Akruti Trade Point	Andheri	0.17
	Akruti Star	Andheri	0.35
	Akruti Sapphire	Andheri	0.30
	Akruti Iris	Andheri	0.65
	Akruti Topaz	BKC	0.06
	Akruti Corporate Park	Kanjurmarg	0.24
	Akruti SMC	Thane	0.17
	Akruti Greentech Park	Thane	0.50
DLF	NTC Mills	Parel	1.90
HDIL	Kaledonia (sold to Mack Star Marketing)	Andheri	0.55
	IT Park at Kilburn Premises	Bhandup	1.00
	IT Park and Office Space at Bombay Oxygen Premises	Mulund	0.75
	IT Park at Eveready Premises	Turbhe	1.60
Indiabulls Real Estate	Jupiter Mills	Parel	1.40
	Elphinstone Mills	Parel	1.50
Kanakia	215 Atrium	Andheri	0.30
	Western Edge - I	Borivali	0.42
	Western Edge - II & III	Borivali	0.74
	Sigma IT Park	Rabale	0.31
Lodha Group	iThink Techno Campus	Kanjurmarg	0.50
	Lodha Excelus	Mahalaxmi	0.40
Man Infraprojects	Man Mercury	Bandra	0.04
	IT Park	Nerul	0.55
	Man House	Vile Parle	0.09
Marathon Realty	Marathon Max Phase II	Mulund	0.05
	Nexzone	Panvel	2.10
	Futurex	Parel	0.30
Neptune Group	Evolution	Kurla	1.50
	Uptown	Mulund	0.04
	IT Park	Thane	1.00
Oberoi Constructions	Commerz	Goregaon	0.70
Orbit Corp	Orbit WTC	Kalina	0.33
	Hafeez Contractor House	Parel	0.23
	Business Park	Sakinaka	0.28
Peninsula Land	Peninsula Technopark	Kurla	0.90
	Peninsula Business Park	Parel	1.20
RNA	Bizz	Bandra	0.15
Rustomjee (Keystone Group)	Elita	Andheri	0.27
	Rustomjee Elita	Andheri	0.31
	Rustomjee Natraj	Andheri	0.28
	Rustomjee Aspiree	Sion	0.12
	IT Park	Thane	4.00
Shree Naman Developers	Naman Chambers	BKC	0.14
	Naman Centre	BKC	0.13
Total			**28.50**

Source: Company Reports, ET Realty, Citi Investment Research

Indiabulls Real Estates (INRL.BO)

Sell/High Risk	**3H**
Price (05 Jan 09)	Rs153.35
Target price	Rs150.00
Expected share price return	-2.2%
Expected dividend yield	0.0%
Expected total return	**-2.2%**
Market Cap	Rs39,491M
	US$816M

Price Performance (RIC: INRL.BO, BB: IBREL IN)

Initiate at Sell: Net-Cash Benefits Peaked; Underlying Risks High

- **Initiate with Rs150 target price** — We initiate at Sell/High Risk with a Rs150 target price based on an average 35% discount (lower than Tier-II peers) to our Rs232 NAV – recognizing its net-cash position, delays in flagship Mumbai property, low visibility on townships/SEZs (86% of landbank), large capital commitment in power/retail. However, given its limited track record, tough environment and the stock up 48% in the past month, risks outweigh positives.

- **Delays in Mumbai project; slowing market adds to worries** — With flagship Mumbai project behind schedule by ~12-mths, lease market slowing – risks of 1) more delays, 2) new leases at lower rentals, and 3) likely overhang of downward revision on rentals of existing leases are high. However with relatively better visibility on construction of these assets vs. peers, we ascribe Rs56/share in our NAV and a lower 20% discount for delays in our target.

- **Net-cash benefits have peaked** — While IBREL's adj. net cash of Rs81/share is a key strength, we believe benefits have peaked with 1) govt measures likely to ease liquidity crunch, and 2) ~Rs50 of cash/share committed to power generation capex. Building for this, we ascribe Rs56 as total net-cash/share after a ~30% discount (largely for cash pre-committed to power) in our target.

Foray into non-core businesses; too early to assign value — With power generation and retail in nascent stages; near-term capital commitment high and limited earnings visibility, we believe it is premature to assign significant value to these entities. However we attribute Rs25/share towards the cash in power venture (included in net-cash/share). Though potential to unlock greater value exists, we await more visibility on financial closure/coal linkages.

Statistical Abstract

Year to 31 Mar	Net Profit (RsM)	Diluted EPS (Rs)	EPS growth (%)	P/E (x)	P/B (x)	ROE (%)	Yield (%)
2007A	119	0.66	na	nm	1.9	na	0.0
2008A	3,959	16.44	na	9.3	0.9	13.9	8.8
2009E	1,428	5.54	-66.3	27.7	0.9	3.3	0.0
2010E	1,736	6.74	21.6	22.7	0.9	3.9	0.0
2011E	2,166	8.41	24.8	18.2	0.8	4.6	0.0

Source: Powered by dataCentral

Fiscal year end 31-Mar	2007	2008	2009E	2010E	2011E
Valuation Ratios					
P/E adjusted (x)	nm	9.3	27.7	22.7	18.2
P/E reported (x)	nm	9.3	27.7	22.7	18.2
P/BV (x)	1.9	0.9	0.9	0.9	0.8
Dividend yield (%)	0.0	8.8	0.0	0.0	0.0
Per Share Data (Rs)					
EPS adjusted	0.66	16.44	5.54	6.74	8.41
EPS reported	0.66	16.44	5.54	6.74	8.41
BVPS	80.71	176.77	170.86	177.60	186.01
NAVps ordinary	na	na	na	na	na
DPS	0.00	13.50	0.00	0.00	0.00
Profit & Loss (RsM)					
Net operating income (NOI)	**102**	**1,230**	**2,342**	**2,159**	**2,603**
G&A expenses	-107	-1,249	-1,884	-2,073	-2,280
Other Operating items	-8	-33	206	1,316	1,966
EBIT including associates	**-12**	**-53**	**664**	**1,402**	**2,288**
Non-oper./net int./except.	263	5,718	1,381	570	-17
Pre-tax profit	**250**	**5,665**	**2,044**	**1,972**	**2,271**
Tax	-119	-1,598	-573	-192	-62
Extraord./Min. Int./Pref. Div.	-12	-108	-44	-44	-44
Reported net income	**119**	**3,959**	**1,428**	**1,736**	**2,166**
Adjusted earnings	119	3,959	1,428	1,736	2,166
Adjusted EBIT	-12	-53	355	-36	188
Adjusted EBITDA	-4	-20	457	86	322
Growth Rates (%)					
NOI	na	nm	90.4	-7.8	20.6
EBIT adjusted	na	-326.6	772.7	-110.2	618.1
EPS adjusted	na	nm	-66.3	21.6	24.8
Cash Flow (RsM)					
Operating cash flow	**-5,374**	**-40,872**	**14,121**	**910**	**-1,433**
Depreciation/amortization	8	33	102	122	134
Net working capital	-10,830	-80,133	12,123	-991	-3,776
Investing cash flow	**12,797**	**1,360**	**-12,640**	**-2,252**	**-488**
Capital expenditure	-257	-2,041	-1,781	-813	-488
Acquisitions/disposals	0	0	0	0	0
Financing cash flow	**8,488**	**40,035**	**5,290**	**102**	**394**
Borrowings	1,367	1,451	5,333	146	438
Dividends paid	-70	-191	-44	-44	-44
Change in cash	**15,912**	**523**	**6,771**	**-1,239**	**-1,526**
Balance Sheet (RsM)					
Total assets	**24,018**	**81,674**	**88,731**	**105,862**	**112,967**
Cash & cash equivalent	12,129	16,219	22,989	21,751	20,225
Net fixed assets	249	2,246	3,925	4,616	4,970
Total liabilities	**6,099**	**24,854**	**30,045**	**45,439**	**50,378**
Total Debt	1,420	3,389	10,450	10,942	11,899
Shareholders' funds	**17,919**	**56,820**	**58,687**	**60,423**	**62,589**
Profitability/Solvency Ratios					
EBIT margin adjusted (%)	-8.9	-3.8	12.9	-1.1	4.5
ROE adjusted (%)	na	13.9	3.3	3.9	4.6
ROA adjusted (%)	na	7.5	1.7	1.8	2.0
Net debt to equity (%)	-59.8	-22.6	-21.4	-17.9	-13.3
Interest coverage (x)	nm	nm	0.4	0.1	0.2

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Company Background

Indiabulls Real Estate (IBREL) is a relatively recent entrant to the Indian real estate space. This is the de-merged real-estate arm of the Indiabulls Group, which started off in the financial services sector and diversified into the real estate sector in 2005. It has been credited with bringing in the first real estate FDI in India, through Farallon Capital Management LLC, for two mill lands it won at auctions in Central Mumbai. Despite its short operating history, the company has established a geographically diverse land bank of ~212m sq ft with significant presence in residential, retail, commercial and SEZ verticals in Tier-I cities and suburban locations of Mumbai, NCR and Chennai. It is also amongst the first Indian developers to list a business trust (Indiabulls Property Investment Trust (IPIT)) on the Singapore stock Exchange in Jun'08 – in which it has 45% ownership. The company is co-founded and managed by a professional board of the Indiabulls Group, which owns a 26% stake, with foreign institutional investors (FIIs) holding a ~42% stake in the company.

Investment thesis

We initiate coverage of Indiabulls Real Estate (IBREL) with a Sell/High Risk (3H) rating and a target price of Rs150 based on an average 35% discount to our NAV estimate of Rs232. We see the company positioned as a Tier-II developer with geographic concentration and limited execution track record and hence expect it to trade at a reasonable discount to NAV. However, our lower discount vs. Tier-II peers (40-50%) is largely recognizing its net-cash position and a combination of: 1) net-cash benefits have peaked and sizeable cash is pre-committed to power capex, 2) delays for its flagship Mumbai properties, although it offers better visibility on construction than peers, and 3) 50% discount attributed towards to low execution visibility on large township/SEZ projects - Panvel, Nasik, Chennai, Sonepat and Gurgaon (86% of landbank) in current downturn and limited track record.

IBREL owns a sizeable land bank of 212m sq ft, almost entirely paid, across key Tier-I cities like Mumbai, Gurgaon, Chennai and well diversified across asset classes – office, retail, residential and SEZs. The company's net-cash balance sheet is a key strength, though benefits appear to have peaked with government measures likely to ease liquidity and sizeable cash pre-committed to the power business. That said, increasing pressure on leasing market in Mumbai and slowing pre-sales environment raises demand/execution risks for IBREL's portfolio. Further, with risks of large capital likely to be commitment to non-core businesses, significant high FII holding and the stock outperforming the Sensex by 29% over the past month, we believe risks outweigh the positives.

Strategy and Competitive position

Gain visibility with flagship Mumbai project

IBREL owns 45% stake in its flagship Mumbai mill properties post the REIT listing

The company has gained significant visibility from its flagship commercial project at erstwhile Jupiter and Elphinstone Mills in Lower Parel, Mumbai – acquired through landmark auction in 2005, bringing in the first real estate FDI in India. Both projects are in advanced stages of construction with the first phase of Jupiter already handed over for fit-outs. IBREL owns 45% stake in these properties through its recently listed Indiabulls Properties Investment Trust (IPIT) in Singapore.

Jupiter Mills leased partly, while Elphinstone still under construction. We see delays and pressure on lease rentals increasing

- Jupiter Mills (now One Indiabulls Centre) has ~1.43m sq ft of office space and 0.44m sq ft of retail space. Of this, 1.2m sq ft office space is already leased/committed, the first block has been handed over for fit-outs and part rentals have begun from Nov'08, while balance would be leased shortly. The management states no lease has been signed below Rs275/sq ft per month as of Oct'08; however we believe pressure on lease rentals/risk of downward renegotiations of rentals on earlier contracts are building. Retail mall is still under construction and no leases have been tied up yet.

- Elphinstone mills (1.54m sq ft) is still under construction – management expects the first tower to be ready for fit-outs soon while the second and third towers are under construction and will be completed in 6-12 months. The Company has not tied-up any leases on this yet – however, it is in discussion with some banks for sale of space in this property – which we see as a change in the company strategy in these tough times.

… but we see delays

While we do recognize the company's initiatives and initial encouraging pace of execution of these projects, there are execution delays of ~12months from the timelines highlighted during its business trust (IPIT) listing in Jun'08. Management attributes some delays to changing design plans for incorporating higher FSI of 4x (vs. 2.66x earlier) likely to be made available, which will increase lease able area to 5m sq ft (vs. 3.4m sq ft earlier across both properties). If true, this could be positive however as a conservative measure we have not included this increase FSI in our NAV estimates, for now.

Figure 1. Jupiter & Elphinstone Mills Execution Delays

	Estimated Completion during Trust IPO	Revised Estimated Completion
Jupiter Mills		
Tower 1	Mar-08	Oct-08
Tower 2	May-08	Mar-09
Retail	Jun-08	Jun-09
Elphinstone Mills		
Tower 1	Jul-08	Mar-09
Tower 2	Sep-08	Sep-09
Tower 3	Nov-08	Nov-09

Source: Company, Citi Investment Research

… a slowing market adds to worries

We believe significant delays in completion and leasing of its flagship project in a slowing Mumbai market adds to worries – any new leases at lower rates or downward revision in rates on earlier contracts will create negative sentiment for the stock. We see its strategy of exploring options for asset sale in Elphinstone mills vs. its leasing plans earlier as clear signs of tougher market conditions.

We ascribe Rs56/share towards these assets in our NAV of Rs232 factoring rentals in range of Rs140-210/sqft (after a 25% decline); and assign a 20% discount towards is contribution (Rs45/share) in our target of Rs150

Factoring all this, we ascribe Rs56 per share (factoring rentals in the range of Rs140-210/sqft, after a 25% decline) for these assets in our NAV of Rs232, assigning lower 20% discount towards its contribution (Rs45/share), in our target. This recognises better visibility on construction of these assets vs. peers. This is, however, higher than Rs32/share attributed towards IBREL's 45% stake in IPIT, the Singapore REIT which now trades at S$0.24 vs. the IPO price of S$1.0 in Jun'08 and owns the Jupiter and Elphinstone properties.

Establish footprint across cities and assets

Despite IBREL's short operating history, it has established a geographically wide footprint with land bank of ~212m sq ft largely in and around key cities – such as Mumbai Metropolitan Region (MMR), Nasik, Gurgaon and Chennai (89% of landbank). This includes, a 3,000 acre SEZ (~122m sq ft) at Nasik and several city centre properties (~11m sq ft) which are erstwhile NTC textile mills that it acquired through government auctions (provides assurance to land title) in select Tier-II and III cities for development. The company's landbank is well diversified across asset classes – commercial, residential, retail malls, large townships and SEZs. With this landbank entirely paid for, we see IBREL better positioned than its peers in the current challenging environment.

Figure 2. IBREL – Key Projects (m sq ft)

Jupiter Mills – 45% stake	0.8
Elphinstone Mills – 45% stake	0.7
Nasik SEZ	122.0
Sonepat Township - Plots	6.4
Panvel Township	31.2
Chennai Township	13.0
IT SEZs	10.5
Residential	15.8
Commercial/Retail	11.8
Total	**212.2**

Source: Company Reports, Citi Investment Research

Net-cash a strength; but benefits have peaked

The company has cash & equivalents outstanding of Rs36.3bn (Rs141/share); but adjusting for debt including debentures and minority interest in power venture, net-cash attributable to IBREL is Rs81/share, of which ~Rs2bn is advanced to its retail venture on a callable basis. While IBREL's net cash balance sheet is a key strength in the current liquidity-strained environment, going forward we believe benefits appear to have peaked with 1) recent government measures are likely to ease liquidity for the sector, and 2) ~Rs50 of net-cash/share committed to power generation capex. Building for this, we ascribe Rs56 as total net-cash/share after a ~30% discount in our target.

Figure 3. IBREL – Calculation of Adjusted Cash Balance (Rs million) as at 30th Sep 2008

Cash/Bank Balance & Liquid Mutual Funds (A)	27,280
Cash attributable to Power Subsidiary (B)	18,000
IBREL's Share (71.4%) of Cash in Power Subsidiary	12,852
IBREL's Balance Cash (A) - (B)	9,280
ICD/FMP (includes Rs2bn given to retail subsidiary)	8,650
Interest Accrued on Fixed Deposit and ICD	420
Less: Compulsorily Convertible Debentures	7,990
Less: Unsecured Loans	1,730
Less: Secured Loans	730
Adjusted Cash attributable to IBREL	**20,752**
No. of shares (millions)	257.5
Adjusted Cash attributable to per share of IBREL (Rs)	**81**

Source: Company Reports, Citi Investment Research estimates

Forays into non-core businesses

We believe it is pre-mature to assign any significant value to IBREL's foray in power generation and retailing. With both businesses still in a nascent stage, we see limited earnings visibility and significant near-term capital commitment a strain on IBREL's balance sheet. While this could prove to be an opportunity of potential value unlocking at a later date – as a conservative measure we only value ~50% of the Rs50/share of cash (Rs25 per share, included in our net-cash per share) available from the capital raising in its power business as the same is pre-committed towards the power business capex.

Big plans in Power – but pre-mature to assign value

IBREL has big plans to set-up power generation projects with aggregate capacity of 6,772MW, through its subsidiary 'Indiabulls Power'. Three projects are thermal power based totaling 5,280MW - at Amravathi (Maharashtra), Bhaiyathan (Chattisgarh) and Nasik (Maharashtra). It also plans to pursue other thermal/hydro/solar power projects in other regions of the country. We find these plans ambitious given its lack of experience in this business.

That said, the power subsidiary's 1) access to 525mt of coal – 350mt in Gidhumuri and Paturia for Bhaiyathan project and 175mt in Gare Pelma II and 2) well capitalized balance sheet with IBREL's initial investment of Rs5.9bn and 28.6% stake sale (in Feb'08) to Farallon Capital (17.9%) and an investment arm of LN Mittal (10.7%) for Rs15.8bn (valuing the power business at Rs153 per IBREL share); further adding to resources are positives. However, with capital commitment to the tune of Rs30.5b needed and none of the projects having achieved financial closure yet (though management expects it shortly), we believe it's premature to assign any significant value to the power business; however ascribe ~Rs25/share towards the cash raised on stake sale in the power venture in our NAV estimate, as a conservative measure. Though potential to unlock greater value exists, we would wait for more visibility on financials closure/coal linkages on its power projects.

Figure 4. IBREL – Power Projects

Location	MW	Project Type
Amravati, Maharshtra	2640	Coal
Bhaiyathan, Chattisgarh	1320	Coal
Nasik, Maharashtra	1320	Coal
Hazaribagh, Jharkhand	1320	Coal
Arunachal Pradesh (4)	167	Hydro
Punjab	5	Solar

Source: Company Reports

Retail business – still nascent; expansion plans held back

IBREL ventured into retailing in 2007 through its subsidiary 'Indiabulls Retail' after acquiring controlling stake (63.9% stake) of Piramyd Retail for ~Rs75/share. However, operational performance since then continued to disappoint with EBITDA margins shrinking. As a result of this, retailing space stagnated at ~0.6m sq ft vs. management's target of ~4.7m sq ft by Mar'09. Given the challenging environment, the company has held back its retail expansion plans. We expect the retail business to remain sluggish and hence do not ascribe any value, however significant capital commitment to this venture would be a strain on IBREL's balance sheet and a sentiment dampener.

Shift in strategy on retail malls

Given tough market conditions, IBREL has changed its retail mall strategy for smaller cities, where it acquired old textile mills in auctions. It now plans to operate on a pre-sale model instead of build-lease model and is looking to develop commercial complexes rather than retail malls planned earlier, using pre-sales proceeds to fund construction costs for these projects. With land for these properties already acquired and paid for, we have ascribed Rs36/share in our NAV estimate – but believe risk of execution delays on valuations is high.

We see absorption issues for Townships/SEZs

Being a relatively new entrant, we find the company's plans to develop a 3,000 acre SEZ at Nasik, township projects in Panvel, Sonepat and Chennai ambitious. Although it has already acquired land for these projects, given its limited execution track record, softening demand and prices we see absorption risk for projects launched by new players like IBREL. Its recent shift in strategy to sell plots in Sonepat at Rs8000/sq yrd (lower than current market prices) vs. apartments planned earlier is a pre-cursor to tough times. With these projects contributing 86% of its landbank (~19% of Gross NAV) – any push-back on time-lines could adversely impact its valuations.

Limited track record – raises execution risk

Being a relatively new entrant to the real estate sector with no established track record of developing properties – we see high risk of execution delays for most of its projects. ~12months delays in completing of its flagship Jupiter and Elphinstone Mills properties, reflects our concern. Its other recent residential launches at Tekhand and Chennai and retail malls are all moving at a slow pace. Moreover, its landbank has several large projects such as Nasik SEZ and Panvel, Sonepat and Chennai townships which are likely to be launched in phases and have low visibility of execution timelines.

Financials

Earnings growth still some time away

We do not foresee any major projects yielding revenue on an outright sales basis in FY09E. Revenue and earnings growth for the current fiscal will primarily depend on: 1) portfolio management fees from IPIT and also erstwhile Dev Property, which had a buyback in Mar'08 and 2) other income driven by treasury returns on the cash on its balance sheet. However, with only part of Jupiter given out for client fit-outs as at Nov'08, it appears unlikely that the company will receive any meaningful rental income in FY09 – as we foresee IPIT postponing its promised dividend of 5.12 cents (Singapore $) for FY09E and 9.82 cents in FY10E in the current scenario. We expect growth to pick up in FY10E, as its recent residential launches (Tehkand, Chennai, Sonepat) contribute to earnings and dividend from Mumbai properties ramps-up. EBITDA margins are likely to remain volatile, depending on monetization of commercials properties. That said any significant stake in its commercial projects would accelerate cash flows and earnings.

Figure 5. IBREL – Income Statement (Rs millions)

Year to 31 Mar	FY07	FY08	FY09E	FY10E	FY11E
Total Revenues	**139**	**1,407**	**2,756**	**3,432**	**4,175**
YoY Growth (%)	0%	911%	96%	25%	22%
EBITDA	**(4)**	**(20)**	**457**	**86**	**322**
Margin (%)	-3%	-1%	17%	2%	8%
Depreciation & Amortization	(8)	(33)	(102)	(122)	(134)
Other income	316	6,240	2,579	2,063	1,651
EBIT	303	6,187	2,935	2,027	1,839
Interest income(expense)	(53)	(522)	(1,199)	(1,494)	(1,668)
Profit before tax	250	5,665	1,736	533	171
Tax	(119)	(1,598)	(573)	(192)	(62)
Profit after tax	131	4,067	1,163	341	110
Min Int & Share of Ass	9	(65)	308	1,438	2,100
PAT after Minority Int & Associates	140	4,002	1,471	1,780	2,210
Pref Dividend	(21)	(44)	(44)	(44)	(44)
Reported PAT	**119**	**3,959**	**1,428**	**1,736**	**2,166**

Source: Company Reports, Citi Investment Research estimates

Figure 6. IBREL – Balance Sheet (Rs millions)

Year to 31 Mar	FY07	FY08	FY09E	FY10E	FY11E
Source of Funds					
Equity Share Capital	3,322	1,857	1,857	1,857	1,857
Reserves	11,065	37,828	39,256	40,992	43,158
Share Warrants	115	2,772	2,772	2,772	2,772
Share Appln Money	0	115	115	115	115
Net Worth	14,502	42,572	44,000	45,736	47,902
Pref Share Capital	561	2,577	2,577	2,577	2,577
Deferred Liability	7	7	0	0	0
Minority Interest	2,857	11,671	12,110	12,110	12,110
Long TermDebt	1,417	3,387	8,720	8,866	9,304
Capital Employed	**19,343**	**60,214**	**67,407**	**69,289**	**71,893**
Application of Funds					
Gross Block	254	1,532	4,066	4,880	5,368
Depreciation	8	40	141	263	398
Net Fixed Assets	246	1,493	3,925	4,616	4,970
Capital WIP	2	753	0	0	0
Investments	5,944	675	11,534	12,972	12,972
Goodwill	0	213	220	220	220
Inventories	1,993	11,441	29,628	39,467	45,922
Sundry Debtors	59	1,165	2,283	2,843	3,458
Other Current Assets	3,645	49,716	18,152	23,992	25,200
Cash and Bank	12,129	16,219	22,989	21,751	20,225
Current Assets	17,825	78,541	73,052	88,053	94,804
Current Liabilities	(4,675)	(21,460)	(21,325)	(36,573)	(41,074)
Net Current Assets	13,150	57,080	51,728	51,480	53,730
Total Net Assets	**19,343**	**60,214**	**67,407**	**69,289**	**71,893**

Source: Company Reports, Citi Investment Research estimates

Valuation

Figure 7. IBREL – Target Price Calculation

	NAV Per Share	Target Disc	Target Value Per Share
Jupiter & Elphinstone Mills	56	20%	45
IBREL's share in Power Subsidiary Cash	50	50%	25
IBREL's Balance Net Cash	31	0%	31
Adjusted Cash attributable to IBREL	81		56
Other Landbank	91	50%	46
Mgmt fee from Indiabulls Properties Invt Trust	4	0%	4
Total	**232**		**150**

Source: Citi Investment Research estimates

Figure 8. IBREL – NAV Sensitivity

Price Change			
	+10%	**-5%**	**-10%**
NAV per share (Rs)	259	219	206
Execution Delay			
	6m	**12m**	**18m**
NAV per share (Rs)	222	212	202
Cost of Capital			
	14%	**15%**	**16%**
NAV per share (Rs)	249	243	237

Source: Citi Investment Research estimates

Our target price of Rs150 is based on an average 35% discount to our NAV of Rs232. Our lower discount vs. tier-II peers (40-50%) is a combination of: 1) ~30% discount on its net-cash per share, as benefits have peaked and sizeable cash is pre-committed to power capex; 2) 20% discount to its flagship Mumbai properties for delays, though these properties offer better visibility on construction than peers; and 3) 50% discount attributed for low execution visibility on large township/SEZ projects - Panvel, Nasik, Chennai, Sonepat and Gurgaon (86% of landbank) in current downturn and limited track record.

While the level of NAV discount is a matter of subjective assessment, we see the company positioned as a Tier-II developer with geographic concentration and limited execution track record, hence expect it to trade at a reasonable discount to NAV – this is in line with our valuation methodology for the sector.

We believe an NAV-based valuation methodology is most appropriate for developers, as it factors the varied development projects and spread out time frame. Our NAV estimate of Rs232 is based on the following assumptions: 1) 25% price decline in current market prices given limited operating history and lack of customer confidence; 2) development volume of 212m sq ft (based on Mar'09); 3) an average cost of capital of 17%, recognizing its strong balance-sheet (vs. 18% assumed for company's with liquidity crunch) and; 4) cash balance of Rs31.2bn is adjusted for minority stake in power venture; and 5) tax rate of 33%. We have however, provided sensitivities to our NAV on more price/rental cuts, execution delays and lower cost of capital.

Figure 9. IBREL – NAV Summary (Rs million)

Gross NAV of Residential Development	13,241
Gross NAV of Commercial Development	44,597
Gross Total NAV	**57,838**
Less: Amt outstanding for land	1,000
Less: Tax @ 33%	18,757
Less: Debt Outstanding	10,450
Add: Cash	31,202
Add: Mgmt Fee from Indiabulls Properties Invt Trust	930
Net NAV	**59,763**
No. of Shares Outstanding (Millions)	258
NAV Per Share (Rs)	**232**

Source: Citi Investment Research estimates

With the stock having outperformed the Sensex by 29% over the past month, high FII holding and risk of lower lease rentals and delays for its flagship Mumbai property high, we believe risk-reward is unfavorable at current levels.

Risks

We rate Indiabulls Real Estate High risk. This is different from the Speculative Risk rating assigned by our quantitative risk rating system (which measures the stock's volatility over a 260-day period. The key reason for a High risk rating is 1) strong balance sheet position in this liquidity-strained environment; 2) land bank almost entirely paid for; and 3) high visibility of its flagship Mumbai properties – Jupiter and Elphinstone Mills, while substantial FII holding and limited track record has added to its risk profile. Key upside risks to our target price are: 1) Better-than-expected recovery in sales for its residential projects 2) Faster than anticipated lease and execution of the two flagship projects in Mumbai – Jupiter and Elphinstone mills – at higher rentals; 3) Any positive developments on company's Nasik SEZ; and 4) more visibility on financial closure/coal linkage of its power projects would be positive triggers.

Appendix A-1

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