

Financial Institutions Group
 Real Estate
 Equity – India

Housing Development (HDIL IN)

Underweight (V)

Target price (INR)	82.00
Share price (INR)	97.55
Forecast dividend yield (%)	3.1
Potential return (%)	-12.8

Note: Potential return equals the percentage difference between the current share price and the target price, plus the forecast dividend yield

Performance	1M	3M	12M
Absolute (%)	34.2	7.3	-29.0
Relative ^A (%)	22.0	3.8	-29.2

Index^A BOMBAY SE IDX

RIC	HDIL.BO
Bloomberg	HDIL IN
Market cap (USDm)	831
Market cap (INRm)	40,874
Enterprise value (INRm)	73,787
Free float (%)	58

Note: (V) = volatile (please see disclosure appendix)

Downgrade to UW(V): Core earnings remain weak

- ▶ **While reported Q3 earnings were c66% above our estimate, adjusted for the tax write-back they were weak and in line**
- ▶ **Our FY13 demand outlook for Mumbai remains weak; recent sharp price run-up factors in sector revival theme**
- ▶ **Downgrade to UW(V) from N(V), raise TP to INR82 from INR73**

Q3 earnings ex-tax write-back were weak and in line with expectation. HDIL's reported earnings of INR1.6bn (-32% y-o-y, 66% above HSBC est) were supported by marginally better total income of INR4.4bn (-7% y-o-y, 19% above HSBC est). However, only 62% of the sales were cash sales, and the EBITDA margin dropped meaningfully to c40% (61% in Q3 FY11). A net tax write-back of INR220m on prior-period income helped save the day, though adjusted for which, both quality and quantity of earnings remained weak and in line with our expectation.

Weak execution despite healthy balance sheet is a concern. HDIL has guided that the majority of its residential projects under construction (mostly 80-95% pre-sold) are likely to start getting recognized from Q1 and Q2 FY13. However, our findings on recent project site visits suggest these could easily spill over to H2 FY13. The execution delay intrigues us, as HDIL has a comfortable leverage of 0.4x.

Recent stock run-up and weak Mumbai demand outlook dent investment case. HDIL's shares have climbed 83% y-t-d and outperformed the Sensex by 59%. We expect already high property prices in Mumbai to remain stable over the next 9-12 months, thereby suggesting demand will remain weak in the wake of weak affordability. HDIL's strong price performance in the backdrop of a weak outlook dents any potential investment case, we believe.

Downgrading rating to Underweight (V) from Neutral (V). We are raising our 12-month target price c10% to INR82 from INR73, as we roll forward our valuation base year to FY13e (from FY12e), while maintaining valuation at a 64% NAV discount (pegged at one standard deviation below its five-year price-to-NAV multiple mean). An earnings multiple comparison is not particularly useful for HDIL, in our view, as the company follows a project completion method, while other peer coverage companies follow the percentage of completion method of accounting. A sharp revival in Mumbai demand is a key upside risk to our view.

15 February 2011

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Figure 1. HDIL: Valuation snapshot

(INRm)	Sales	EBITDA margin	HSBC PAT	HSBC EPS (INR)	EPS growth (%)	ROE (%)	PB (x)
FY11	18,500	88.9%	8,262	19.9	24.9	10.0	0.4
FY12e	17,384	71.7%	5,970	13.6	-32.0	5.9	0.4
FY13e	28,403	63.7%	9,567	21.7	60.2	8.5	0.4
FY14e	36,429	62.6%	13,422	30.5	40.3	11.0	0.3

Source: Company data, HSBC

Financials & valuation

Financial statements

Year to	03/2011a	03/2012e	03/2013e	03/2014e
Profit & loss summary (INRM)				
Revenue	18,500	17,384	28,403	36,429
EBITDA	16,452	12,465	18,094	22,798
Depreciation & amortisation	-838	-755	-764	-767
Operating profit/EBIT	15,614	11,710	17,330	22,031
Net interest	-6,254	-5,367	-4,863	-4,688
PBT	9,859	7,404	12,557	17,691
HSBC PBT	9,859	7,404	12,557	17,691
Taxation	-1,636	-1,433	-2,990	-4,269
Net profit	8,218	5,970	9,567	13,422
HSBC net profit	8,262	5,970	9,567	13,422

Cash flow summary (INRM)

Cash flow from operations	-23,260	-894	5,167	9,883
Capex	-481	-1,164	-125	-50
FCF enterprise	-19,123	1,876	6,914	10,251
Cash flow from investment	-481	-1,164	-125	-50
Dividends	-1,038	-1,322	-1,543	-1,763
Change in net debt	7,802	-6,528	-984	-4,496
FCF equity	-25,377	-3,492	2,052	5,563

Balance sheet summary (INRM)

Tangible fixed assets	2,603	1,413	774	57
Current assets	155,583	160,081	179,332	186,597
Cash & others	2,297	627	1,611	6,107
Total assets	160,909	164,249	182,213	188,114
Gross debt	43,198	35,000	35,000	35,000
Net debt	40,901	34,373	33,389	28,893
Shareholders funds	94,870	109,076	116,838	128,196
Invested capital	136,090	143,535	150,724	158,356

Ratio, growth and per share analysis

Year to	03/2011a	03/2012e	03/2013e	03/2014e
Y-o-y % change				
Revenue	23.2	-6.0	63.4	28.3
EBITDA	29.8	-24.2	45.2	26.0
EBIT	30.7	-25.0	48.0	27.1
PBT	39.8	-24.9	69.6	40.9
HSBC EPS	24.9	-32.0	60.2	40.3

Ratios (%)

Revenue/IC (x)	0.2	0.1	0.2	0.2
ROIC	11.0	6.8	9.0	10.8
ROE	10.0	5.9	8.5	11.0
ROA	9.6	6.3	7.7	9.2
EBITDA margin	88.9	71.7	63.7	62.6
Operating profit margin	84.4	67.4	61.0	60.5
EBITDA/net interest (x)	2.6	2.3	3.7	4.9
Net debt/equity	43.1	31.5	28.6	22.5
Net debt/EBITDA (x)	2.5	2.8	1.8	1.3
CF from operations/net debt			15.5	34.2

Per share data (INR)

EPS reported (fully diluted)	19.80	13.55	21.71	30.45
HSBC EPS (fully diluted)	19.91	13.55	21.71	30.45
DPS	2.50	3.00	3.50	4.00
NAV	228.60	247.48	265.10	290.87
NAV (adjusted)	0.00	0.00	0.00	0.00

Valuation data

Year to	03/2011a	03/2012e	03/2013e	03/2014e
Premium/ (discount) to NAV	0.4	0.4	0.4	0.3
Premium/ (discount) to NAV (adj)				
PE*	4.9	7.2	4.5	3.2
FCF yield (%)	-62.9	-8.9	5.2	14.1
Dividend yield (%)	2.6	3.1	3.6	4.1

Note: * = Based on HSBC EPS (fully diluted)



Note: price at close of 13 Feb 2012

HDIL share price movements

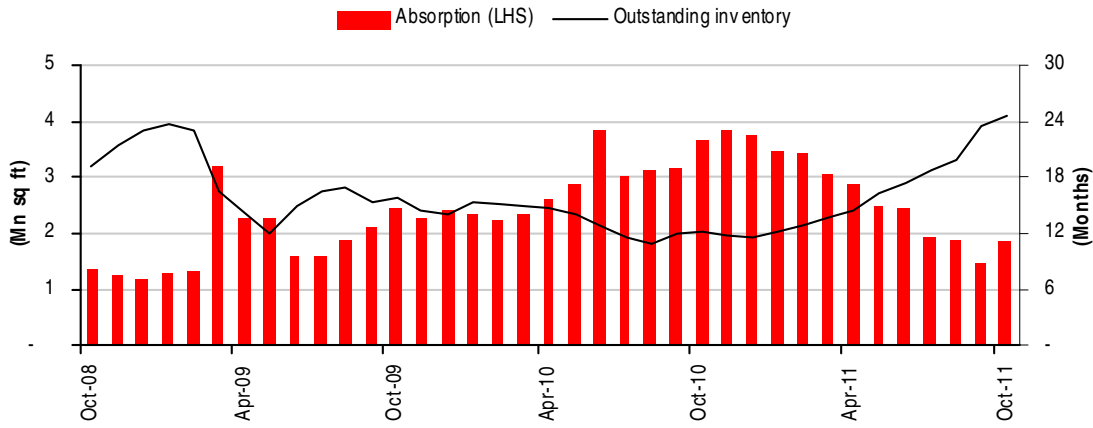
Figure 2. HDIL: Q3 FY12 consolidated earnings and balance sheet

Income statement (INRm)	Q3 FY11	Q2 FY12	Q3 FY12	y-o-y	q-o-q	Comment
Net sales	4,634	4,407	4,226	-9%	-4%	Sequential drop in sales as TDR
Other income	117	94	178	51%	89%	volumes dropped c57% and FSI
Total income	4,751	4,501	4,403	-7%	-2%	sales failed to get recognised due to
Expenses	701	745	1,243	77%	67%	slower approval process.
EBITDA	4,050	3,756	3,161	-22%	-16%	
Depreciation	202	214	216	7%	1%	
EBIT	3,848	3,542	2,945	-23%	-17%	
Interest cost	1,361	1,533	1,607	18%	5%	
PBT	2,487	2,009	1,338	-46%	-33%	Excess tax provision written back
Tax	164	524	(220)	-234%	-142%	on prior-period income related to
Adjusted PAT	2,324	1,486	1,558	-33%	5%	GuruAshish subsidiary (FSI sales).
Reported PAT	2,279	1,486	1,558	-32%	5%	
EBITDA margin- excl project int	85.2%	83.5%	71.8%	-13.5%	-12%	Limited clarity on EBITDA margin
EBITDA margin- Inc project int	60.9%	53.6%	39.7%	-21.2%	-14%	weakness, despite revenue
PAT margin	48.0%	33.0%	35.4%	-12.6%	2%	recognized from FSI sold during
Tax rate	6.6%	26.1%	-16.4%	-23.0%	-42%	past quarters.
Balance sheet (INRm)	Q2 FY12	Q3 FY12	Comment			
Net worth	98,288	100,441				
Debt	41,626	42,429				
Deferred tax liability (net)	145	149				
Total	140,060	143,020				
Net block	2,352	2,323				
Capital WIP	874	894				
Investments	518	518				
Goodwill	1,833	1,648				
Inventory	117,967	118,490				
Receivables	4,469	6,088	Co. did not make any major cash collection during Q3 FY11.			
Loans and advances	38,872	38,930				
Cash	2,179	2,029				
Less: Creditors	25,951	25,100				
Less: Provisions	3,052	2,800				
Net working capital	134,484	137,637				
Total	140,060	143,020				
Debt-equity	0.42	0.42				
Net debt- equity	0.40	0.40				

Source: Company data

Mumbai residential volume trend

Figure 5. Mumbai monthly residential data trend



Source: PropEquity, HSBC

Figure 6. HDIL: TDR sales (volumes and prices)

	4QFY10	1QFY11	2QFY11	3QFY11	4QFY11	1QFY12	2QFY12	3QFY12	2QFY12e
Volumes (m sq ft)	1.50	1.10	1.00	1.20	0.90	0.65	0.28	0.36	0.25
Avg. price (INR per sq ft)	2,700	2,950	3,000	3,100	2,600	2,500	2,500	2,500	2,400

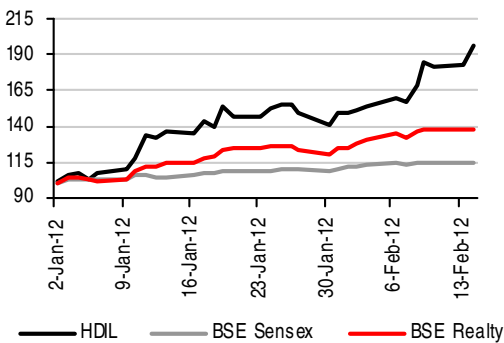
Source: Company data, HSBC

Valuation and risks

Investment summary

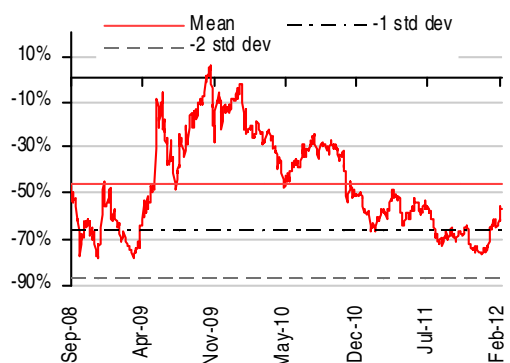
Housing Development and Infrastructure Ltd (HDIL) is India's fourth-largest real estate developer, by market capitalisation. Recent volume data for Mumbai city suggest inventory outstanding has now reached c25 months, similar to levels at the bottom of the last downward cycle in January 2009. However, despite all indications pointing to an impending price correction, a lack of new project launches will, in our view, continue to support property prices and, during the process, curtail volumes.

Figure 3. HDIL: Relative share price movement YTD



Source: Bloomberg

Figure 4. HDIL: Price-to-NAV premium/disc



Source: HSBC

HDIL has guided for muted TDR sales volume for FY12, owing to a lack of approvals for the next phase of airport project development. Although a negative in the near to medium term, we believe this is positive in the long term, as HDIL focuses more on building its brand through developed projects. We now expect HDIL to sell only INR4.3bn in FY12 and INR7.3bn in FY13. We recently visited HDIL's Kurla East, Kurla West, Mulund, Nahur, and Andheri projects. We observed a marked slowdown in execution relative to our last project site visit four months back. We expect the execution delay to impact HDIL's revenue recognition, as it follows a project completion method of accounting, unlike its peers, which follow a percentage completion method.

Downgrade to UW rating with a revised target price of INR82

We are raising our 12-month target price 10% to INR82 from INR73, as we roll forward our base year to FY13e from FY12e. We continue to value HDIL using NAV, by discounting cash flows from its real estate projects (COE of 15.5%, risk-free rate of 7.5%, market risk premium of 5.5%, and WACC of 13.6%). With the Mumbai market remaining weak, HDIL is unlikely to witness a valuation rerating over the next 12 months, in our view. Our revised target price of INR82 factors in a 64% NAV discount (pegged at one standard deviation below its five-year price-to-NAV multiple mean). Our high target NAV discount of 64% for HDIL factors in: 1) a sustained weak MMR property market outlook, 2) project execution delays, despite a healthy balance sheet, and 3) high risk-to-reward ratio in the slum rehabilitation and redevelopment business. An earnings multiple comparison is not particularly useful for HDIL, in our view, as the company follows a project completion method, while other peer coverage companies follow the percentage of completion method of accounting.

Figure 7. HDIL: Valuation

	New (FY13)		Old (FY12)
	INRbn	Per share	Per share
Residential	53	120	114
Commercial	21	48	41
Retail	13	30	32
Gross asset value	87	198	187
Less: Net debt	12	26	15
Add: Airport project (NAV)	1	2	1
Total net asset value	100	226	204
Less: NAV discount	(64)	(145)	(130)
Target price	36	82	73

Source: HSBC

Rating rationale

Under our research model, with a volatility indicator, the Neutral band is 10ppts above and below the hurdle rate for Indian stocks of 11%, or 1-21% around the current share price. Our new target price for HDIL shares implies a potential return of -12.8%, which is below the Neutral band; therefore, we are downgrading our rating to Underweight (U) from Neutral (N). Potential return equals the percentage difference between the current share price and the target price, including the forecast dividend yield when indicated.

Key risks

The key upside risk, in our view, is a sharp revival in the Mumbai market over the next 12 months, leading to a sudden surge in demand for TDR.

Disclosure appendix

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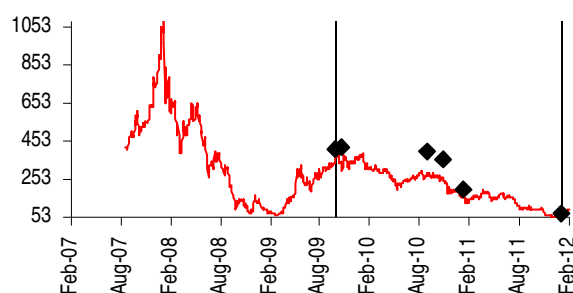
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Share price and rating changes for long-term investment opportunities

Housing Development & Inf (HDIL.BO) Share Price performance INR Vs HSBC rating history



Source: HSBC

Recommendation & price target history

From	To	Date
Neutral (V)	Overweight (V)	07 October 2009
Overweight (V)	Neutral (V)	16 January 2012
Target Price	Value	Date
Price 1	416.00	07 October 2009
Price 2	419.00	02 November 2009
Price 3	396.00	14 September 2010
Price 4	357.00	11 November 2010
Price 5	205.00	24 January 2011
Price 6	73.00	16 January 2012

Source: HSBC

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