31 December 2012

DLF

Rating: **Buy**
Target Price: ₹290
Share Price: ₹225

Debt reduction now a reality; initiating with a Buy

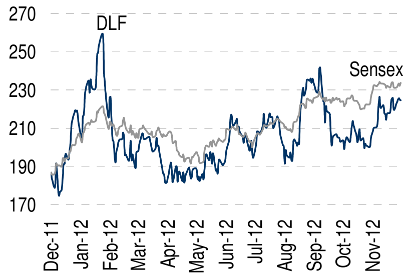
We believe that DLF, India's largest real estate company has crossed the critical junctures of interest rate overhang, adverse inflation and delayed executions. On the positive side, it should benefit from 1) Reduction in net debt (₹190bn by Mar'13 from ₹235bn a year back) due to sale of non-core assets with prospects of further reduction by FY14e; 2) Increased sales volumes and deliveries resulting in improved cash flows; 3) higher annuity income from increase in leasing and lease renewals; 4) stable margins at 40-45%. Accordingly, we initiate coverage with a Buy rating and a price target of ₹290.

- **Further debt reduction on cards.** Sale of non-core assets is as per expectations. DLF has inked deals for NTC mills, Mumbai, and Aman Resorts (ex Delhi Hotel) for ₹27bn and $300m respectively. These would de-leverage its balance sheet and reduce debt to ₹190bn by Mar'13 (from ₹235bn in FY12). It aims to reduce debt by a further ₹40bn next year from the sale of its wind turbines, issue of shares (to comply with public-shareholding norms) and other small-ticket sales.
- **Operational improvement.** After no launches in H1FY13, DLF has aimed at launches of 9-10m sq.ft in H2FY13, with ~8.5m sq.ft. likely to be in Gurgaon, msf in Lucknow and Bangalore each. This should improve cash flow through increased sales bookings. Delivery of 12-15m sq.ft. in H2FY13 is also likely to reduce costs and boost margin.
- **Annuity income leading to stability.** Annuity income in FY13 is expected to be ₹19.6bn, against ₹18bn in FY12. Going ahead, we believe leasing momentum should improve. The expected annuity income (₹22bn in FY14e) should be able to easily service the accompanying debt.
- **Valuation.** Attributing a 20% discount to the NAV of the company, we arrive at a fair value of ₹290 for the stock, implying an upside of 29%from the current levels. Hence, we recommend a buy.

Key data	DLF IN / DLF.BO
52-week high / low	₹397 / ₹186
Sensex / Nifty	19445 / 5908
3-m average volume	US$34m
Market cap	₹377bn / US$8508m
Shares outstanding	1698m

Shareholding pattern (%)	Sep '12	Jun '12	Mar '12
Promoters	78.58	78.59	78.59
- of which, Pledged	-	-	-
Free Float	21.42	21.41	21.41
- Foreign Institutions	15.99	15.78	15.61
- Domestic Institutions	1.63	1.52	1.68
- Public	3.8	4.11	4.12

Relative price performance



Source: Bloomberg

Key financials (YE Mar)	FY11	FY12	FY13e	FY14e	FY15e
Sales (₹m)	95,606	96,294	91,182	110,035	125,545
Net profit (₹m)	16,109	12,038	17,806	21,043	23,881
EPS (₹)	8.9	7.2	10.5	12.4	14.1
Growth (%)	(16.5)	(19.5)	46.0	18.2	13.5
PE (x)	25.2	31.3	21.5	18.2	16.0
PBV (x)	1.6	1.6	1.5	1.4	1.3
RoE (%)	6.4	5.0	7.1	7.8	8.2
RoCE (%)	5.6	5.8	6.8	7.1	7.4
Dividend yield (%)	1.8	1.8	1.8	1.8	2.2
Net gearing (%)	1.1	1.1	0.8	0.7	0.6

Source: Company, Anand Rathi Research

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Quick Glance – Financials and Valuations

Fig 1 – Income statement (₹m)

Year-end: Mar	FY11	FY12	FY13e	FY14e	FY15e
Net revenues	95,606	96,294	91,182	110,035	125,545
Revenue growth (%)	29	1	(5)	21	14
- Op. expenses	58,447	57,214	52,598	64,170	75,908
EBIDTA	**37,159**	**39,080**	**38,584**	**45,866**	**49,637**
EBITDA margins (%)	39	41	42	42	40
- Interest	17,056	22,464	20,245	16,801	15,696
- Depreciation	6,307	6,888	7,260	7,920	8,821
+ Other income	5,839	5,945	12,369	7,312	7,172
PBT	19,634	15,673	23,448	28,456	32,292
Income taxes	4504	3702	5628	7399	8396
Extra-ordinary items	(972)	160	-	-	-
Min int / inc from assoc	(7)	(227)	15	15	15
Reported net income	16,109	12,038	17,806	21,043	23,881
PAT growth (%)	(16.5)	(19.4)	46.0	18.2	13.5
Adj. FDEPS (₹/share)	9	7.2	10.5	12	14
Adj. FDEPS growth (%)	(16.5)	(19.5)	46.0	18.2	13.5

Source: Company, Anand Rathi Research

Fig 2 – Balance sheet (₹m)

Year-end: Mar	FY11	FY12	FY13e	FY14e	FY15e
Share capital	3,395	3,397	3,397	3,397	3,397
Reserves & surplus	251,838	256,921	256,735	277,778	277,778
Net worth	255,233	260,318	260,132	281,174	281,174
Minority interest	239,903	250,658	211,658	191,658	181,658
Total debt					
Def. tax liab. (net)	(1,633)	(3,349)	-	-	-
Capital employed	**493,503**	**507,627**	**471,790**	**472,832**	**462,832**
Net fixed assets	281,841	277,075	266,355	260,726	260,400
Investments	9,958	11,268	11,268	11,268	11,268
- of which, Liquid					
Net working capital	188,243	204,228	173,263	179,632	195,942
Cash and bank balance	13,461	15,062	20,909	21,212	19,110
Capital deployed	**493,502**	**507,627**	**471,795**	**472,832**	**486,832**
Net debt	0.9	0.9	0.7	0.6	0.6
Dividend Yield	1.8	1.8	1.8	1.8	2.2
Book value (₹/sh)	150	153	153	166	166

Source: Company, Anand Rathi Research

Fig 3 – Cash-flow statement (₹m)

Year-end: Mar	FY11	FY12	FY13e	FY14e	FY15e
PAT	19,634	15,673	23,448	28,456	32,292
+ Non-cash items	6,307	6,888	7,260	7,920	8,821
Cash profit	25,942	22,561	30,708	36,376	41,113
- Incr./(Decr.) in WC	(4,760)	(5,573)	(746)	(10,343)	(20,681)
Operating cash-flow	25,753	24,307	50,858	38,658	31,277
- Capex	(7,100)	(419)	3,460	(2,291)	(8,495)
Free-cash-flow	67,273	25,983	54,303	36,352	22,767
- Dividend	(8,990)	(5,952)	(6,790)	(6,721)	(8,514)
+ Equity raised	-	-	-	-	-
+ Debt raised	23,140	64,291	(39,000)	(20,000)	(10,000)
- Investments	48620	2095	-15	-15	-15
- Misc. items	(36,149)	(30,235)	15,326	(9,328)	(6,355)
Net cash-flow	4,178	1,602	5,847	304	(2,101)
+ Op. cash & bank bal.	9,282	13,461	15,062	20,909	21,212
Cl. cash & bank bal.	13,461	15,062	20,909	21,212	19,110

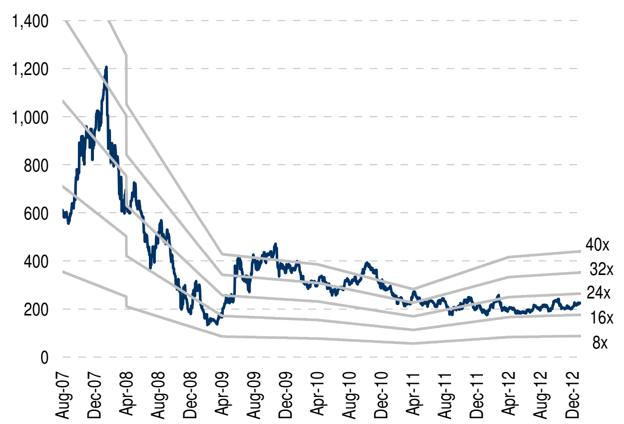
Source: Company, Anand Rathi Research

Fig 4 – Ratio analysis @ ₹225

Year-end: Mar	FY11	FY12	FY13e	FY14e	FY15e
P/E (x)	25.2	31.3	21.5	18.2	16.0
Cash P/E (x)	14.7	16.9	12.4	10.5	9.3
EV/EBITDA (x)	21.2	20.2	20.4	17.2	15.9
EV/sales (x)	8.2	8.2	8.6	7.2	6.3
P/B (x)	1.6	1.6	1.5	1.4	1.3
RoE (%)	6.4	5.0	7.1	7.8	8.2
RoCE (%)	5.6	5.8	6.8	7.1	7.4
Dividend yield (%)	1.8	1.8	1.8	1.8	2.2
Interest coverage ratio (x)	2.2	1.7	2.2	2.7	3.1
Debt to equity (x)	1.8	1.8	1.8	1.8	2.2
Debtor days	8.8	9.1	9.0	9.0	7.0
Inventory days	111.8	119.0	130.0	130.0	130.0
Payables days	138.9	121.3	119.8	119.8	109.9
Working capital days	(18.2)	6.8	19.2	19.2	27.1
Fixed asset T/O (x)	0.2	0.2	0.2	0.2	0.2

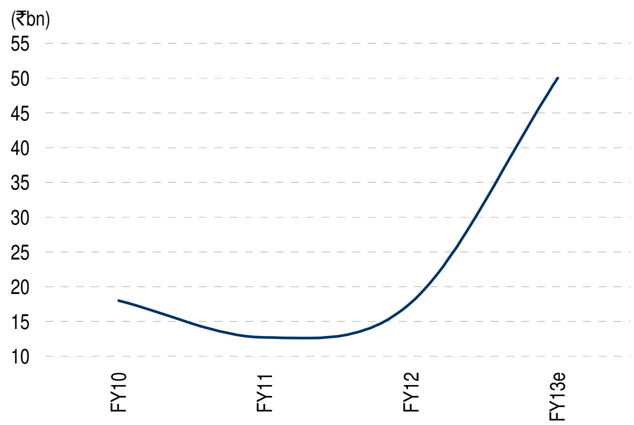
Source: Company, Anand Rathi Research

Fig 5 – PE band



Source: Bloomberg, Anand Rathi Research

Fig 6 – Non Core Assets Sale



Source: Company

Non-core asset sale to reduce debt

NTC Mills and Aman Resorts, key to reduce debt

DLF sealed a deal with Lodha Developers for the sale of its land parcel at NTC Mills, Lower Parel in the heart of Mumbai for ₹27bn. This land parcel of ₹17.5 acres land which it purchased in 2005 from NTC Mills in an auction for ₹7bn, has generated gross 4x return for the company. Assuming the cost of capital to be in the region of ~12% thereabouts the returns would be substantial on a net basis for the company.

Non Core assets sale likely to reduce Debt. Wind Turbine sale in advance stage and to reduce debt further.

The Aman Resorts deal has been reportedly inked at $300m ($/₹55) excluding the Lodi Estate Hotel in Delhi, which the company plans to monetise separately. This was acquired at an EV of $400m ($/₹41.5—42). We believe the 31% rupee depreciation would enable DLF to break even and would result in nil impact in its books.

DLF has received a ₹5bn advance in Q2FY13 against the sale of its Mumbai property. The impact of the above transactions will be completely seen in H2FY13 and reduce debt to ₹190bn by end-FY13 .

Wind turbines sale also in an advanced stage

The company has wind-turbine generating capacities of 161.2 MW for which it in an advanced stage of inking a deal and has already obtained shareholder approval. We expect this would fetch ₹10bn and further reduce its debt level in FY14e. Besides divesting itself of its wind-energy business, the company is also looking at divesting some small non-core operations to help further reduce debt.

After the above transactions, we expect D/E to be 0.8x by FY13e and 0.7x by FY14 from 1.1x in FY12

Operational improvement to follow

Project launches

Phase V launches and New Gurgaon launches key to net cash flow.

The company is expected to launch 9-10m sq.ft. in H2FY13. Of this, 1m sq.ft. each would be in Lucknow and Bangalore, 8.5m sq.ft. are likely to be in Gurgaon (6m sq.ft. in Phase V and 2.5m sq.ft. in New Gurgaon). These 9-10m sq.ft. are likely to be of project values' in between ₹112bn-120bn resulting in sales booking of ₹30bn-35bn during the H2FY13e. This would help meet the yearly target of ₹60bn and improve cash flow and margins.

Fig 7 – Expected Launches in H2FY13

Particulars	Segment	Size(msf)
Gurgaon	Luxury/Premium Group Housing	8.5
Bangalore	Group Housing	1
Lucknow	Plots	1

Source: Company,Anand Rathi Research

Delivery of 12-15m sq.ft. of projects in H2FY13

Focus on delivering 12-15 msf in FY13 likely to reduce over-run cost incurred in projects at finishing stage.

The company is expected to deliver 12-15m sq.ft. in FY13. Of this, it has already delivered 2.8m sq.ft in H1FY13. We expect 10m sq.ft. further deliveries in H2FY13, which would help offset the cost overruns incurred in the finishing stage projects. Moreover, the company has tied up with a third party for a rise in cost overruns and impact of inflationary cost with regard to construction will be less with respect to new projects.

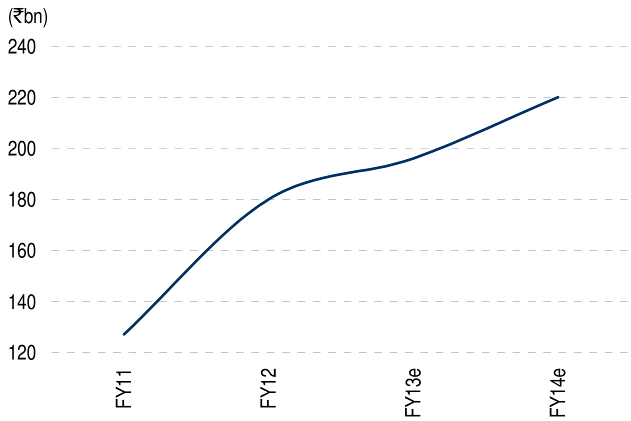
Annuity income leads to stability

Leasing portfolio to grow 15%

Annuity income likely to grow at 15% going forward.

Annuity income in FY13e is expected to be ₹19.6bn, against ₹18bn in FY12. Leasing has been subdued in the last 2-3 years due to delays and cancellation of corporate expansions. Ahead, we believe leasing momentum to improve and hence DLF is likely to lease 1m sq.ft. in H2FY13 (against 0.5m in H1FY13), taking total leasing area to 1.5m sq.ft. (net leasing of 1.41m sq.ft. in FY11). We expect annuity income to be ₹22bn in FY14 and comfortably service its debt against in its Rentl holdco. Annuity income provides stability to the overall model and the company has already lined up 7m sq.ft. as under construction of which 3-4m sq.ft. will be completed in the next 15-18 months. This would further enhance the financials and lead to stability.

Fig 8 – Net leasing rental income from 2010



Source: Company

FDI in Retail to boost leasing activity :

Both Houses of Parliament have passed FDI in multi-brand retailing, likely to help generate demand for retail space along with an increase in the lease rate. We believe that, with respect to FDI in multi-brand and single brand retailing, companies like DLF with strategically located landbank and appropriate launches are likely to benefit in the long run.

Maintaing margin between 40-48%

Cost overrun of projects likely to fall

DLF margin likely to stabilise in between 40-48%.

Most of DLF's phase V and New town Heights projects are at the finishing stage and therefore cost overruns ahead are likely to come down. Moreover, the company is now making arrangements with customers for the rise in material costs to be passed on with the rise in property prices. Any reduction in material costs would lead to price rebates for customers. This is likely to help maintain margins.

New project launches to improve margin:

New launches were almost negligible in H1FY13, which would lead to a drop in the margin to 40% in Q2FY13. Ahead, the company is expected to launch 6m sq.ft. in Phase V and 2.6m sq.ft. in New Gurgaon. We believe its margins would again rise to 45%, from Q4FY13.

Fresh share issue to reduce debt

In order to comply with SEBI guidelines of the minimum 25% shareholding, DLF planned to issue fresh shares, reducing its promoter stake from 78.58% to 75%. This money will be utilised to further reduce debt and improve operations. The company is aiming to reduce debt to ₹150bn by FY14.

Valuation and risk:

Initiate with one year target price of ₹ 290, based on NAV basis.

DLF is on track to meet its deleveraging target. It is also focusing on improving cash flows through aggressive launches and incremental annuity income. Better economic conditions along with a lower interest rate would further boost its operational performance and reduce interest cost. We initiate coverage with an NAV-based target of ₹290. Key risks: Rise in interest rates, delay in execution and rising material costs.

Fig 9 – NAV Table

Segments	NPV/share
Development properties (₹m)	167.1
Lease Properties	175
Others	128
less: Net Debt	-106
Net NPV/share	**364**
20% Discount to NAV	73
Target Price	**291**

Source: Anand Rathi Research

Appendix

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Large Caps (>US$1bn)	>15%	5-15%	<5%
Mid/Small Caps (<US$1bn)	>25%	5-25%	<5%

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	Buy	**Hold**	**Sell**
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% who are investment banking clients	5%	3%	0%

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