FIRST GLOBAL

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India Research

Sector: Real Estate

DLF Ltd. (DLFU.IN) / DLFU.BO)

IPO

Post Issue Market Cap. (At upper price limit of Rs. 550 per share): Rs 937.4 bn, $ 23.13 bn
FY07 P/E: 48.3, FY07 EV/EBITDA: 69.3x, NPV/Share: Rs.413

To our reckoning, the NPV of DLF's business works out to Rs.413 per share, after factoring in the best- case assumption including its power business (55MW plant), which has been valued at Rs.2.2 bn. At the price band of Rs.500-550, the stock is at a premium of 21-33% to the NPV

"It is quite interesting that for the period FY07, DLF recognized an income of Rs.22.1 bn. and profit before tax (PBT) of Rs.15.7 bn. from the sale of certain commercial properties to DLF Assets Pvt. Ltd. (DAL), a company wholly owned by the promoters. This sale represented 55% of the company's income and 61% of its PBT, for the period FY07. The balance due in respect of sales to DAL is Rs. 8.5 bn approximately as of May 25, 2007."

June 7, 2007

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DLF's Business in Pictures ... (FY07)

(All figures are in Rs. Bn except where stated otherwise. All percentages are percent of Net Sales, unless stated otherwise)

Operations/value added

Net Sales Rs.26.15 bn.

Revenue Mix

- Constructed Properties/ Land & Plots Rs.22.41 bn (85.7%)
- Rent & License Fee Rs.1.55 bn (5.9%)
- Maintenance Income Rs.0.81 bn (3.1%)
- Power supply Rs.0.99 bn (3.8%)
- Other Operating Income Rs. 0.39 bn (1.5%)

Operating Cost

Rs.7.09 bn. (27.1%)

Personnel Expenses

Rs.0.92 bn. (3.5%)

SG & A Expenses

Rs.3.19 bn. (12.2%)

Operating cost includes cost of land, raw material cost (cement, steel, glass), development expenses, design and engineering expenses, and other direct operating expenses.

Land Holdings

Majority of land holdings in NCR 5269 acres (51%) and in Kolkata 2331 acres (23%) and remaining 2655 acres (27%) in other 24 cities. Major plans for residential development with 375 mn sq ft (71%) of saleable area, followed by commercial and retail space with 62 mn sq ft (11.7%) and 45 mn sq ft (8.5%) respectively, and 46 mn sq ft for plots development.

EBIDTA

Rs.14.95 bn. (57.2%)

Below Operating Line

Depreciation *Rs.0.57 bn. (2.2%)*
Interest Expenses *Rs.3.08 bn. (11.8%)*
Other Income *Rs.14.19 bn.*

Profit before Tax

Rs.25.49 bn.

Taxes

Rs.6.06 bn.

Profit after Tax

Rs. 19.41 bn. (74.2%)

Assets | **Balance Sheet** | **Liabilities**

Assets — All figures in Rs. bn.

Fixed Assets:	15.37	(8.5%)
Capital WIP:	26.49	(14.5%)
Investments:	2.10	(1.2%)
Debtors:	15.19	(8.4%)
Inventories:	57.01	(31.3%)
Oth. Curr. Assets:	0.07	(0.1%)
Loans & Adv:	52.37	(28.8%)
Cash & Bank:	4.16	(2.3%)
Goodwill:	8.94	(4.9%)

Liabilities — All figures in Rs. bn.

Equity:	12.56	(6.9%)
Reserves:	27.12	(14.9%)
Debt:	99.33	(54.6%)
Def. Tax Liability:	0.19	(0.1%)
Current Liabilities:	42.43	(23.4%)
Minority Interest:	0.09	(0.1%)

Rs.75 bn of debt on floating rate basis.

The Short Story...

The much-awaited (by Mr. K. P Singh, anyway) *DLF* IPO (price band Rs. 500-550, garnering between Rs. 87.5-96.3 bn) has finally hit the market...or at least, the final edition. DLF is one of the largest real estate developers in India with a huge land bank of 10,255 acres, pan-India presence in 31 cities, and planned development of 150 mn sq. ft. for FY07-09. The company also owns properties in some of the prime places in India, which it has given for lease and is also engaged in the power generation business through its subsidiary.

We have used the Net Present Value (NPV) approach in order to arrive at the value of the company's real estate business. As per our calculations, the NPV of DLF's business works out to Rs.413 per share, after factoring in the best-case assumption including its power business (55MW plant), which has been valued at Rs.2.2 bn. At the price band of Rs.500-550, the stock is at a premium of 21-33% to the NPV. In comparison, Unitech, which has a similar large land bank (10,332 acres), currently trades at Rs.560, while its NPV works out to around Rs.560-575 per share. As compared to this, a majority of the global real estate stocks in Hong Kong and Singapore trades at a 10-30% discount to their NPV. Considering the price band of Rs.500-550, DLF is available at a FY07 P/E band of 43.9-48.3, while Unitech has a FY07 P/E of 34.8.

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All said and done, DLF appears to be a steeply priced offering. Nothing less would have been befitting such a mega issue!

Background

- DLF has six decades of experience and a highly qualified, dedicated management team, many of whom have over 20 years of experience in their respective fields, with Mr. K.P.Singh, Executive Chairman, leading the show. Founded in 1946, the company is credited for the development of 224 mn sq.ft., including well-known colonies such as Krishna Nagar, Greater Kailash and Hauz Khas, as well as an entire integrated 3,000 acre township – DLF City.

- The promoters hold 42.04% of the pre issue equity, the promoter group holds 55.38%, while other shareholders hold 2.57%. There will be 'Net issue to public' of 12.57% (175 mn. shares of face value of Rs. 2) of the post issue capital.

- ***The company is coming out with an IPO in order to meet the cost of acquiring land (Rs.35 bn), development and construction costs for existing projects (Rs.34.9 bn) and the balance for prepayment of certain loans.***

- The company has extensive land reserves in various regions across India totalling 10,255 acres, with a saleable area of 574 mn sq.ft., with 51% in the NCR, 23% in Kolkata and the balance 27% in the remaining 24 cities. Although the company began as a principal developer in the NCR, it has forayed into other parts of the country as well, thus making it a genuinely geographically diversified player.

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- DLF's revenues come primarily from the construction of properties/ plots and the lease rentals arising out of letting commercial office space and retail space. The former contributes 85.7% of the total revenues, the latter contributes 5.9%, while 8.4% includes the balance representing maintenance income (3.1%), power supply income (3.8%), and the remaining through property management services and cinemas operations.

- DLF has always collaborated with internationally renowned architectural consultants, such as Hafeez Contractor, The Jerde Partnership Inc. and Mohit Gujral. DLF's clientele for commercial space include MNCs such as Canon, Nokia, IBM-Daksh, Sapient, Microsoft, etc.

- DLF's top management is very proactive in identifying other real estate related businesses as part of the company's growth and diversification strategy to strengthen its lateral and vertical business drivers. The company's strategic initiatives to capitalise on emerging market opportunities include the following:

  - ⇨ Entered into Joint venture with Laing O'Rourke for construction expertise and with Hilton for hotel development.
  - ⇨ Acquired share interest (19%) in Feedback Ventures for management consulting services and 51% in Ananta Satellier for architectural know-how.
  - ⇨ Signed MoU with Nakheel LLC, UAE, for two townships, each spread over 20,000 acres. And with Fortis Healthcare Ltd. to develop and manage hospitals.
  - ⇨ Entered into Joint Venture with Prudential Insurance for developing and selling life insurance products.

Huge Low Cost Land Bank

DLF has a land bank of around 10,255 acres, constituting about 574 mn sq.ft. of saleable area covering residential, commercial and retail developments. Considering the low acquisition costs of land of around Rs.175-180 per sq.ft. (First Global estimates) and the entire land stocks to be used for the next 10 years, DLF enjoy a major competitive advantage as well as a cushion against land price inflation. The balance due in respect of these lands stood at Rs.44 bn, as of April 30, 2007.

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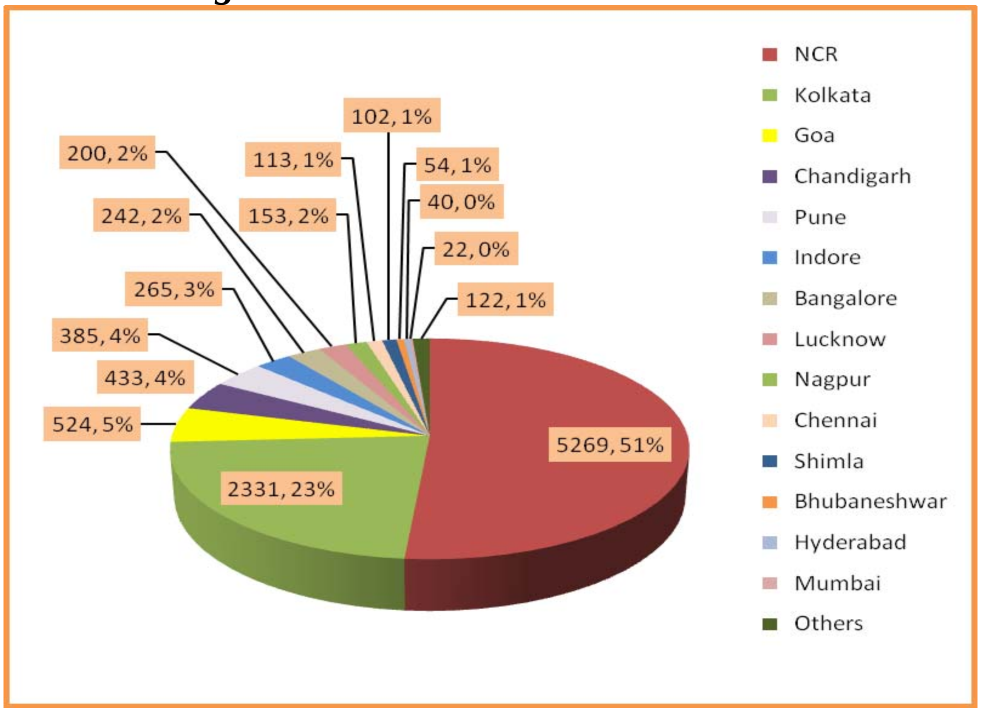
Region-wise land bank details in acres



Source: Company Red Herring Prospectus

However, DLF's land bank is highly skewed towards the NCR with 5,269 acres (51.4%), out of which approximately 95% exists in Gurgaon, we believe that it could pose an absorption risk for the company's property.

Key Risks

Uncertainty of land reserves

As of April 30, 2007 the company and its subsidiaries own 1,160 acres (11.3%) of the total land bank of 10,255 acres. The company directly owns only 0.5% while the balance 10.8% is held by the subsidiaries. The remaining 9,095 acres of land reserves are subject to agreements to purchase, development rights agreements or MoUs for acquisition. So risk is inherent in these executory contracts as sellers of land often withdraw from MoUs and sale agreements if land prices go up, resulting in disputes of uncertain outcome.

Availability of real estate financing

The RBI recently issued a notification prohibiting real estate companies from raising funds through the ECB route for developing integrated townships, while revising the interest rate limits for those who are allowed to tap the foreign markets. Moreover, the government proposes to treat FII investments in pre-IPOs of real estate companies at par with FDI with a lock-in period of 3 years in line with the prevailing FDI norms. This step might keep the foreign investors at bay. Additionally, the government is reviewing norms for investments by foreign VCs in real estate. DLF already has outstanding debt of Rs.100 bn and land payments due of Rs.44 bn. as of March 31, 2007. Considering the capital intensive nature of the real estate industry, any unfavourable change in government policies could impact the availability of finance for real estate development.

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Downside risk in execution plan

DLF's plans appear huge in comparison to its earlier developments. The company plans to make available for sale or lease 149.7 mn sq.ft. for FY07-09, while its cumulative developments, excluding plots, as of April 30, 2007, was merely 29 mn sq.ft. We view DLF's development schedule as aggressive and carrying considerable execution risk.

Snapshot of past and future developments (as of April 30, 2007)

Business Line	Completed Developments (mn sq. ft)	Under Construction (mn sq. ft)	Planned Projects (mn sq. ft)	Plan for FY07-09 (mn sq. ft)
Plots	195	-	46	-
Residential	19	7	375	69.8
Commercial	7	27	60	48.2
Retail	3	10	44	31.7
Total	**224**	**44**	**526**	**149.7**

Source: Company Red Herring Prospectus

Cyclical nature of the Indian real estate industry

The real estate industry is cyclical in nature, which might impact realization in property values and rental income over a period of time. The situation could become worse if property prices decline and property inventory also becomes illiquid over extended periods of time.

Financials

Profit & Loss A/c

(YE March 31)	Period ended	Period ended	Period ended
(Rs. bn)	31.03.2005	31.03.2006	31.03.2007
Operating Revenues	**6.08**	**11.54**	**26.15**
Operating Cost	3.16	5.24	7.09
Personnel Expenses	0.45	0.40	0.92
SG & A Expenses	0.79	1.14	3.19
Total Cost	**4.40**	**6.78**	**11.20**
EBIDTA	**1.68**	**4.76**	**14.95**
EBIDTA Margin (%)	**27.7%**	**41.2%**	**57.2%**
Interest Paid	0.39	1.69	3.08
Depreciation	0.33	0.36	0.57
Other Income	0.18	0.88	14.19
Profit Before Tax	**1.14**	**3.60**	**25.50**
Tax	0.26	1.67	6.06
Profit After Tax	**0.87**	**1.92**	**19.41**
PAT Margin (%)	**14.2%**	**16.6%**	**74.2%**

Source: Company Red Herring Prospectus

It is worth mentioning in this context that for the period FY07, DLF recognized an income of Rs.22.1 bn. and profit before tax (PBT) of Rs.15.7 bn. from the sale of certain commercial properties to DLF Assets Pvt. Ltd. (DAL), a company wholly owned by the promoters. This sale represented 55% of the company's income and 61% of its PBT, for the period FY07. The balance due in respect of sales to DAL is Rs. 8.5 bn approximately as of May 25, 2007.

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As per the RHP, the total income of Rs.22.1 bn from DAL was comprised of sales revenue of Rs.8.8 bn, sale of two commercial properties for Rs. 4.4 bn, and sale of shares of certain subsidiaries for Rs.6.1 bn. The sale of two commercial properties and shares was recognized under other income after deducting the associated costs leading to an increase in PAT margin from 16.6% in FY06 to 74.2% in FY07. Moreover, there appears to be some lack of clarity over the DAL transactions. The RHP remains silent regarding the area of the commercial properties sold to DAL and states that the promoters would continue to sell their commercial properties to DAL in the future as well, plus these properties were not sold through a competitive bidding process and hence, it is not possible to comment on whether the assets were sold at market value.

Balance Sheet

(YE March 31)	Period ended	Period ended	Period ended
(Rs. bn)	**31.03.2005**	**31.03.2006**	**31.03.2007**
Fixed Assets	8.25	13.02	17.79
Less: Depreciation	1.55	1.89	2.41
Net Block	**6.70**	**11.13**	**15.38**
Capital work in progress	3.51	5.91	26.50
Goodwill	0.52	8.49	8.94
Investments	0.40	8.30	2.11
Current assets, loans and advances			
Inventories	7.05	16.41	57.01
Sundry Debtors	2.85	6.58	15.20
Cash and Bank Balance	0.42	1.95	4.16
Loans and advances	6.02	10.64	52.37
Other Current assets	0.02	0.02	0.07
Total Current assets	**16.36**	**35.60**	**128.79**
Current Liabilities	9.34	18.47	42.43
Net Current assets	**7.02**	**17.14**	**86.37**
Capital Applied	**18.15**	**50.97**	**139.28**
Equity Capital	**0.04**	**0.38**	**12.56**
Total Reserves	7.44	9.12	27.12
Shareholders equity	**7.47**	**9.50**	**39.67**
Minority Interest	0.04	0.05	0.09
Secured Loans	7.95	39.56	92.05
Unsecured loans	1.72	1.76	7.28
Total Debt	**9.68**	**41.32**	**99.33**
Deferred Tax Liability	0.96	0.09	0.19
Capital Employed	**18.15**	**50.97**	**139.28**

Source: Company Red Herring Prospectus

Investment Rationale

We have valued DLF real estate business using the NPV approach based on the company's land bank and development estimates by discounting the project's cash flows, plus other miscellaneous realizations of other assets on the balance sheet as reduced by the liabilities. We have not included 554 acres of land (entered into a MoU between Dec 1, 2006 and Feb 28, 2007) due to lack of further information for valuation purpose.

As per our calculations, the NPV of DLF's business works out to Rs.413 per share, after factoring in the best-case assumption including its power business (55MW plant), which has been valued at Rs.2.2 bn. At the price band of Rs.500-550, the stock is at a premium of 21-33% to the NPV. In comparison, Unitech, which has a similar large land bank (10,332 acres), currently trades at Rs.560, while its NPV works out to around Rs.560-575 per share. As compared to this, a majority of the global real estate stocks in Hong Kong and Singapore trades at a 10-30% discount to their NPV.

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Calculation of NPV for DLF Ltd.	
For entire land bank (Saleable area 574 mn sq. ft)	
Sales Realization* (Rs./ sq. ft.)	4,318
Less:	
Construction Cost to be incurred* (Rs./ sq. ft.)	1,338
SG & A Expenses (Rs./ sq. ft)	345
Operating Cash Flow before Land Cost^ (Rs./ sq. ft)	2,635
Less: *Income Tax @ 30% (Post Land Cost)(Rs./ sq. ft)*	736
Net Cash (Rs./ sq. ft)	1,898
NPV discounted @13% for 4 years# (Rs./ sq. ft.)	1,164
NPV for 574 mn sq. ft (Rs. mn)	667,988
Less:	
Outstanding dues for land (Rs. mn)	43,956
Customer advances (Rs. mn)	24,039
NPV of entire land bank (Rs. mn)	***599,993***
Other Adjustments	
Add:	
Other Miscellaneous Realizations$ (Rs. mn)	104,705
Valuation of DLF Power Ltd. (Rs. mn)	2,200
Net proceeds of IPO @ Rs. 550 per share (Rs. mn)	96,250
Less:	
Debt Outstanding (Rs. mn)	99,238
Net Present Value (Rs. mn)	***703,910***
No. Of. Shares outstanding (mn)	1704
Net Present Value / Share (Rs.)	***413***

* Weighted average for the entire land bank comprising 574 mn sq.ft.
^ Land has already been acquired and amounts unpaid (Rs. 43.9 bn) is subtracted below.
# Development period assumed at 8 years, so number of years of discounting is taken as 4.
$ Includes existing properties plus other assets on the balance sheet minus liabilities.

Source: First Global Research

The sensitivity valuation shows that an increase of 1% in sales realization will lead to an increase of approximately 1.4% in the NPV per share and vice-versa. Similarly, an increase of 1% in construction cost will lead to a decline of 0.5% in the NPV per share and vice-versa.

Peer Group Comparison

Company	Presence (in Cities)	Land Bank (in acres)	Saleable Area (Mn Sq.ft)	Completed Developments (Mn Sq.ft)
DLF	31	10255	574	25
Unitech	13	10332	401	N.A
Parsvnath	46	3000	151	4
Sobha	9	3489	137	17

Source: As per publicly available information

Comparative Valuation

Company Name	CMP (Rs.)	EV (Rs. bn)	P/E FY07	EV/EBIDTA *(x)*	EV/Sales *(x)*
DLF Floor Price	500	952	43.9	63.6	36.4
DLF Cap Price	550	1037	48.3	69.3	39.6
Unitech	560	494	34.8	24.7	15.0
Parsvnath	327	72	20.6	16.3	4.7
Sobha	925	74	41.8	28.5	6.2

Source: First Global Research

All said and done, DLF appears to be a steeply priced issue. It may work. But that probability is low.

IMPORTANT DISCLOSURES

Price Target

Price targets (if any) are derived from a subjective and/or quantitative analysis of financial and non-financial data of the concerned company using a combination of P/E, P/Sales, earnings growth, and discounted cash flow (DCF).

The risks that may impede achievement of the price target/investment thesis are –

- Uncertainty of land reserves
- Availability of real estate financing
- Downside risk in execution plan
- Cyclical nature of the Indian real estate industry

Rating system of First Global

Our rating system consists of three categories of ratings: Positive, Neutral and Negative. Within each of these categories, the rating may be absolute or relative. When assigning an absolute rating, the price target, if any, and the time period for the achievement of this price target, is given in the report. Similarly when assigning a relative rating, it will be with respect to certain market/sector index and for a certain period of time, both of which are specified in the report.

Rating in this report is relative to: CNX Nifty 50 Index

Positive Ratings

(i) Buy (B) – *This rating means that we expect the stock price to move up and achieve our specified price target, if any, over the specified time period.*

(ii) Buy at Declines (BD) – *This rating means that we expect the stock to provide a better (lower) entry price and then move up and achieve our specified price target, if any, over the specified time period.*

(ii) Outperform (OP) – *This is a relative rating, which means that we expect the stock price to outperform the specified market/sector index over the specified time period.*

Neutral Ratings

(i) Hold (H) – *This rating means that we expect no substantial move in the stock price over the specified time period.*

(ii) Marketperform (MP) – *This is a relative rating, which means that we expect the stock price to perform in line with the performance of the specified market/sector index over the specified time period.*

Negative Ratings

(i) Sell (S) – *This rating means that we expect the stock price to go down and achieve our specified price target, if any, over the specified time period.*

(ii) Sell into Strength (SS) – *This rating means that we expect the stock to provide a better (higher) exit price in the short term, by going up. Thereafter, we expect it to move down and achieve our specified price target, if any, over the specified time period.*

(iii) Underperform (UP) – *This is a relative rating, which means that we expect the stock price to underperform the specified market/sector index over the specified time period.*

(iv) Avoid (A) – *This rating means that the valuation concerns and/or the risks and uncertainties related to the stock are such that we do not recommend considering the stock for investment purposes.*

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