16 May 2010 | 10 pages

DLF (DLF.BO)

Equity

FY10 Results – Consolidation to yield long-term benefits

- **Strong growth recorded in 4Q YoY** — Revenues and PAT in 4QFY10 grew 78% and 168% YoY respectively, while remaining flat to marginally down when seen QoQ. While EBITDA margins strengthened 800bps, much was nullified primarily due to higher finance charge (as a result of increased leverage due to DLF-DAL integration) and higher taxes. Keeping aside one-offs, PAT grew by 11% QoQ.
- **The going is good operationally** — 1) Resi pre-sales of 3.6 msf in 4Q (vs. 3.1msf in 3Q), with total FY10 closing at 12.5msf (vs the targeted 14-15msf); of the FY10 launches, 85% stands sold; 2) Comm pre-leasing activities gained momentum – 0.7msf leased in 4Q vs 0.4msf in 3Q; and 3) Projects under construction increased to 56msf (vs. 51msf in 3Q & 35msf in FY09) – a big thumbs-up in our view, reiterating the company's strong execution capabilities. Progress on noncore asset sales going slowly – Rs18bn during the year, of which Rs566m in 4Q.
- **DLF-DAL integration takes shape…de-leveraging is eminent** — Net debt at Mar-10 was Rs148bn as against Rs128bn in Jan-10. While Rs23bn net debt was availed in the quarter, Rs21bn was added as a result of DLF-DAL integration. We expect debt to go up by another ~Rs30bn post the recent buy-out in SC Asia – which was the last leg of the consolidation exercise, particularly for its holding in DAL (now ~55% vs 30% earlier). Avg cost of debt declined 140bps to 10.5% at Mar-10.
- **Management guidance for FY11** — 1) Targeting 15-18msf of sales (mostly resi space across India) of which 12-14 msf in mid-income/value housing segment; 2) Leasing 3-4msf of office space and increasing occupancy space in existing malls to 100%; 3) Reduce D/E to 0.65-0.75x by Jun-10 and 0.4-0.5x by Mar-11, through noncore asset sales and by increasing operating cash flows.
- **Maintain Buy** — Pipeline of strong rental annuity, likely revival in leasing activity, and attractive valuation of ~44% discount to our NAV – we maintain a Buy.

Buy/Low Risk	**1L**
Price (14 May 10)	Rs298.75
Target price	Rs464.00
Expected share price return	55.3%
Expected dividend yield	0.0%
Expected total return	**55.3%**
Market Cap	Rs507,096M US$11,200M

Price Performance (RIC: DLF.BO, BB: DLFU IN)

Statistical Abstract

Year to 31 Mar	Net Profit (RsM)	Diluted EPS (Rs)	EPS growth (%)	P/E (x)	P/B (x)	ROE (%)	Yield (%)
2008A	78,120	45.82	259.6	6.5	2.7	73.2	1.3
2009A	46,292	27.28	-40.5	11.0	2.2	22.3	0.0
2010E	19,905	11.73	-57.0	25.5	2.0	8.4	0.0
2011E	24,208	14.26	21.6	20.9	1.9	9.3	0.0
2012E	32,588	19.20	34.6	15.6	1.7	11.3	0.0

Source: Powered by dataCentral

Ashish Jagnani
+91-22-6631-9861
ashish.jagnani@citi.com

Vidhi Sodhani
vidhi.sodhani@citi.com

See Appendix A-1 for Analyst Certification, Important Disclosures and non-US research analyst disclosures.

Fiscal year end 31-Mar	2008	2009	2010E	2011E	2012E
Valuation Ratios					
P/E adjusted (x)	6.5	11.0	25.5	20.9	15.6
P/E reported (x)	6.5	11.0	25.5	20.9	15.6
P/BV (x)	2.7	2.2	2.0	1.9	1.7
Dividend yield (%)	1.3	0.0	0.0	0.0	0.0
Per Share Data (Rs)					
EPS adjusted	45.82	27.28	11.73	14.26	19.20
EPS reported	45.82	27.28	11.73	14.26	19.20
BVPS	109.92	134.09	145.82	160.08	179.28
NAVps ordinary	na	na	na	na	na
DPS	4.00	0.00	0.00	0.00	0.00
Profit & Loss (RsM)					
Net operating income (NOI)	**100,148**	**59,472**	**33,603**	**40,684**	**54,028**
G&A expenses	-2,998	-4,592	-4,821	-5,786	-6,943
Other Operating items	-636	-2,566	-2,988	-3,262	-3,699
EBIT including associates	**96,514**	**52,315**	**25,793**	**31,637**	**43,386**
Non-oper./net int./except.	-636	1,394	747	641	65
Pre-tax profit	**95,878**	**53,708**	**26,540**	**32,278**	**43,451**
Tax	-17,391	-7,115	-6,635	-8,069	-10,863
Extraord./Min. Int./Pref. Div.	-367	-302	0	0	0
Reported net income	**78,120**	**46,292**	**19,905**	**24,208**	**32,588**
Adjusted earnings	78,120	46,292	19,905	24,208	32,588
Adjusted EBIT	96,250	52,525	25,793	31,637	43,386
Adjusted EBITDA	97,151	54,881	28,781	34,898	47,085
Growth Rates (%)					
NOI	527.9	-40.6	-43.5	21.1	32.8
EBIT adjusted	572.2	-45.4	-50.9	22.7	37.1
EPS adjusted	259.6	-40.5	-57.0	21.6	34.6
Cash Flow (RsM)					
Operating cash flow	**-26,960**	**-4,560**	**85,691**	**11,454**	**20,688**
Depreciation/amortization	901	2,355	2,988	3,262	3,699
Net working capital	-105,815	-51,290	62,797	-16,016	-15,599
Investing cash flow	**-60,142**	**-42,020**	**-16,540**	**-2,816**	**-10,591**
Capital expenditure	-47,678	-39,450	-17,065	-2,816	-10,591
Acquisitions/disposals	0	0	0	0	0
Financing cash flow	**104,368**	**37,880**	**-78,201**	**-7,000**	**-7,000**
Borrowings	23,177	41,890	-78,201	-7,000	-7,000
Dividends paid	-7,979	-4,010	0	0	0
Change in cash	**17,266**	**-8,700**	**-9,050**	**1,638**	**3,097**
Balance Sheet (RsM)					
Total assets	**396,065**	**489,320**	**433,827**	**467,966**	**510,354**
Cash & cash equivalent	21,421	11,956	5,000	6,639	9,735
Net fixed assets	100,031	136,006	150,082	149,636	156,529
Total liabilities	**195,287**	**241,445**	**166,048**	**175,979**	**185,778**
Total Debt	122,771	163,201	85,000	78,000	71,000
Shareholders' funds	**200,778**	**247,874**	**267,779**	**291,987**	**324,576**
Profitability/Solvency Ratios					
EBIT margin adjusted (%)	66.7	52.3	39.5	37.0	39.0
ROE adjusted (%)	73.2	22.3	8.4	9.3	11.3
ROA adjusted (%)	27.1	10.5	4.3	5.4	6.7
Net debt to equity (%)	50.5	61.0	29.9	24.4	18.9
Interest coverage (x)	31.3	15.4	10.5	19.5	28.7

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Update on Financial Performance

Figure 1. 4Q-FY10 and FY10 Results Analysis

PARTICULARS (Rs in mlns)	4QFY09	3QFY10	4QFY10	YoY	QoQ	FY10	YoY
Net Sales	**11,223**	**20,258**	**19,944**	**78%**	**-2%**	**74,209**	**-26%**
Total Expenditure	9,677	11,825	9,944			39,197	
Operating Profit	**1,546**	**8,433**	**10,000**	**547%**	**19%**	**35,012**	**-38%**
OPMs	14%	42%	50%			47%	
Interest	1,625	2,568	3,147	94%	23%	11,075	100%
Other Income	2,291	1,260	1,518	-34%	20%	4,333	9%
Depreciation	516	800	947			3,246	
PBT	1,695	6,325.2	7,423.6	338%	17%	25,023.6	-52%
PBT margins	15%	31%				34%	
Total Tax	-2	1,684	2,362			6,957	
Effective tax rate (%)	0%	27%	32%			28%	
PAT	1,697	4,641	5,062	198%	9%	18,067	-60%
Less: Minority Interest	99.7	28.5	27.69			98.3	
Add: Share of Associates	-6.6	-39.7	47			5.1	
Adjusted PAT	**1,591**	**4,630**	**5,136**	**223%**	**11%**	**18,171**	**-59%**
Extra-ordinary Items	0	48.9	-872.6			-870.4	
Net Profit	1,591	4,679	4,264	168%	-9%	17,300	-61%

Source: Company Reports

Update on Operational Performance

- **Pre-sales going strong:** Resi pre-sales of 3.6msf in 4Q (vs. 3.1msf in 3Q). Commercial pre-leasing activities gained momentum – 0.7msf leased in 4Q vs 0.4msf in 3Q. Cumulative in FY10, closed sales of 12.5msf, missing the targeted 14-15msf it started out with (see Fig 3 for details). Of the total FY10 launches, 85% stands sold.

Figure 2. Pre-Sales in 4Q-FY10

Capital Greens Ph-II	Delhi	0.2 msf
DLF Valley	Panchkula	2.0 msf
New Gurgaon, Bangalore	Goa	0.4 msf
Ph-V	Gurgaon	1.0 msf

Source: Company Reports

Figure 3. Sales Tracker FY10

City	Region	Area Launched (msf)	Area Sold (msf)	Sales Vaue (Rs bn)	Avg Realisation (Rs/sf)
Delhi	Super Metro	4.6	4.2	33.0	7,835
DLF City & New Gurgaon	Gurgaon	3.5	3.1	25.5	8,173
Panchkula, Bangalore & Goa	Rest of India	5.2	3.9	9.5	2,439
New Gurgaon, Kochi, Indore	Existing Stock	-	1.3	3.5	2,652
Total		**13.2**	**12.6**	**71.5**	**5,699**

Source: Company Reports

- **Execution – A big thumbs-up:** Projects under construction increased to 56msf (vs. 51msf in 3Q & 35msf in FY09) – 2msf Capital Greens, Delhi, 0.5msf SIEL & 2.8msf BTM Extn. Bangalore. This is a big positive for DLF in our view, reiterating the company's strong execution capabilities.

Figure 4. Execution Tracker through FY10

(in msf)	Const. Status close of FY09	Additions/Handed over	Const. Status close of FY10
Super Metro	2	3	6
Gurgaon	8	13	21
Rest of India	7	5	12
Rent Co.	18	-1	17
Total	**35**	**21**	**56**

Source: Company Reports

Figure 5. Synopsis of Non-Core asset sales

Achieved	**Rs 18 bn**
Wind Power business retained	Rs 10 bn
Target over next 12-18 months	Rs 27 bn
Target in FY 10	Rs 55 bn

Source: Company Reports

- **Non-core asset sales – trudging slowly:** While non-core asset sales have been on the radar for a while now, progress has been slow – overall Rs18bn were divested during the year as against the target of Rs55bn. Rs566m came in 4Q.

  Management says there is visibility on Rs27bn set aside for divestments over the next 12-18 months: 1) Dwarka – Rs8bn, 2) TIDCO – Rs9bn, 3) Others ~Rs10bn (deals at an advanced stage for ~Rs3.0bn).

DLF-DAL Integration comes through

DLF-DAL integration has taken definite shape through the past year. The first leg took place in Dec-09 when by way of a cashless transaction, DLF merged/amalgamated its wholly-owned sub DLF Cyber City (with leased assets of 6.7msf) with Caraf Builders (an investment arm of DLF co-founders that owns DAL + 3.3msf of leased assets). It was an 'in-principle integration' at a swap ratio of 60:40.

Recently, DLF through its 60% sub Caraf Builders has bought out 95% of the CCPS (compulsory convertible Pref shares with ~42% eco interest) of SC Asia (private equity) in DLF Assets (DAL) for Rs30.84bn. This is to be the last leg of DLF's strategy to consolidate its rental annuity business, particularly its holding in DAL – and benefit from any potential monetization/listing structure of DAL going forward.

DLF's economic interest in DAL now is at ~55% vs. ~30 earlier. With a consolidated strong rental annuity of Rs15bn by FY11E (of which ~Rs7bn is currently securitized), the company continues to explore possibilities of a potential DAL listing.

Impact on Cash Flow and Balance Sheet:

- Share Capital has gone up by Rs29bn on account of CCPS held by DAL investors and CCPS of Rs16bn issued by DCCDL to the promoters.
- Loans have increased by Rs21bn on account of loans held by CARAF / DAL. We expect debt to go up by another ~Rs30bn post the recent buy-out in SC Asia.
- Current liabilities have increased by Rs6bn on account of integration. Capital reserves have increased by Rs12bn on account of integration.
- Gross Block / CWIP has increased by Rs129bn primarily on account of: Rs76bn towards addition to Fixed Assets due to assets held CARAF / DAL, and Rs53bn towards CWIP due to recognition of assets under construction by DAL in its books.

What's in store for FY11?

In the development space, DLF is looking at 15-18msf of sales booking across various locations in the country (see Fig. 7). The Mumbai NTC mills project will be launched. Focus will remain on mid-income/value housing in terms of volume and city centre locations in Chennai and Kochi at attractive pricing.

Commercial demand continued to be subdued – enquiries have picked up, but conversion is lagging behind. In Retail space, prime location malls are seeing some enquiries as well. For FY11, DLF is looking to lease 3-4msf of office space and increasing the current occupancy levels for the operational malls.

De-leveraging will remain the priority going into FY12. Management is looking to reduce D/E to 0.65-0.75x by Jun-10 and 0.4-0.5x by Mar-11, through non-core asset sales and by increasing operating cash flows.

Figure 6. Sales Plan for FY11

Segment	Area (msf)	Locations
Luxury	1 - 1.5	Mumbai, Delhi
City Center / High end	2 - 3.0	Chennai, Cochin, Gurgaon
Mid Income/ Value Housing	15 - 12	Gurgaon, Hyderabad, Kochi, Chandigarh, etc
Total	**15 - 18**	

Source: Company Reports

DLF

Company description

DLF is one of India's oldest real estate developers. Established in Delhi in 1946, it has continued to expand and diversify its real estate businesses, and is among the largest developers in India. It has historically built its businesses in Delhi and adjoining areas, known as the National Capital Region (NCR). DLF has diversified into other geographic locations over the past few years. These expansions are spread across India, with a focus on the Northern India belt, Kolkata, Mumbai, Chennai, and a number of other large and rapidly growing cities. DLF enjoys a strong brand franchise with a good track record in execution and delivery. This is the flagship company of the KP Singh family, with the founders holding a 78.6% stake. It is one of India's largest developers, with a diversified asset portfolio and an emerging pan-India presence.

Investment strategy

We rate DLF Buy/Low Risk (1L), with a target price of Rs464. DLF's proactive measures to address receivable worries, boost pre-sales by cutting prices/launching city centre projects along with steps to ensure liquidity have differentiated it. Further, promoters bringing in additional capital to address liquidity concerns without dilution augur well and remove concerns about high receivables from DLF Assets (DAL). While risks to the company's business model are on the rise in this tough environment, given DLF's execution track record, growing rental income and geographic-asset mix, we believe it's strongly positioned vs. peers. We recommend a Buy rating for the stock and believe the stock should be a core holding for exposure to the Indian real estate sector.

Valuation

Our target price of Rs464 is based on a 15% discount to our Mar'10 NAV of Rs546. Our NAV includes Rs455 for the development portfolio and Rs91 for other asset holdings and new JV businesses (Rs73/share for the existing 11m sq ft of leased assets and 7.2m sq ft of plots and Rs18/share for DLF's share in the hotel JV). The lower discount vs. peers (30-35%) is attributed to: 1) relatively healthy balance sheet vs. peers; 2) superior business model, strong execution track record; and 3) relatively better disclosure standards. We believe an NAV-based valuation methodology is most appropriate for developers, as it factors in the varied development projects and the spread-out time frame. Our March 2010E NAV is based on: 1) 20% decline in prices from peak levels; 2) development volume of 397msf ; 3) cap rate of 10% for commercial/IT Park, IT SEZs in Super Metros and Metros, and 11% for other locations; 4) average cost of capital of 13% given tight liquidity; and 5) a tax rate of 25%.

Risks

We rate DLF Low Risk since with the funds from recent stake sale by promoters being invested in DAL, visibility of DLF's cash flows improves substantially. The main downside risks to our investment thesis and target price include: 1) The company's asset sale strategy remains contingent on capital flows; 2) Response to DLF's new mid-income project launches in FY10 is crucial for growth ahead; 3) Slowdown in the IT/ITES industry could lead to a decline in demand for commercial real estate; and 4) Slowdown in capital inflows or measures to regulate FDI in the real estate sector.

Appendix A-1

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Ratings and Target Price History
Fundamental Research

Analyst: Ashish Jagnani
Covered since August 11 2007

Date	Rating	Target Price	Closing Price
1 10-Aug-07	*1M	*725.00	584.45
2 12-Nov-07	1M	*1,046.00	871.20
3 11-Apr-08	1M	*846.00	598.00
4 15-Jul-08	1M	*585.00	426.95
5 2-Nov-08	1M	*340.00	220.25
6 1-Feb-09	1M	*240.00	177.20
7 1-Jun-09	*1L	*464.00	414.85

* Indicates change

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