

Financial Institutions Group
 Real Estate
 Equity – India

Housing Development (HDIL IN)

Overweight (V)

Target price (INR) 265.45
 Share price (INR) 265.45
 Potential return (%) 34.6

Performance	1M	3M	12M
Absolute (%)	-3.1	-4.2	-25.9
Relative [^] (%)	-6.0	-16.4	-41.7
Index [^]	BOMBAY SE IDX		
RIC	HDIL.BO		
Bloomberg	HDIL IN		
Market cap (USDm)	2,482		
Market cap (INRm)	110,163		
Enterprise value (INRm)	134,348		
Free float (%)	58		

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

OW(V): Q2 surprises positively; we retain positive outlook

- ▶ **Q2 earnings were 37% above our estimate, driven by high TDR prices; unbooked FSI sales improve FY11 earnings visibility**
- ▶ **HDIL can benefit from new residential projects if it maintains its competitive pricing strategy; however, looming concern on FSI hike should restrict HDIL from trading at peak valuation**
- ▶ **Lower TP to INR357 from INR396 as we now factor in mid-cycle valuation; retain our positive outlook and Overweight (V) rating**

Q2 earnings were above our expectation; unbooked Floor Space Index (FSI) sales improve earnings visibility. HDIL reported PAT of INR2.1bn, +44% y-o-y and 37% above our estimate, driven primarily by healthy transfer of development rights (TDR) volumes (c1m sq ft) at sustained high prices (INR3,000psf). This made up for the lower sales of INR3.7bn, +5% y-o-y, though 10% below our estimate, as the EBITDA margin at 67.5% was higher than our estimate of 53%. Also, management has indicated it has completed FSI sales of INR6.5bn, the majority of which are likely to be booked in H2 FY11, thereby improving our FY11 earnings visibility.

HDIL can attract demand by maintaining its competitive pricing strategy. Our ground-level checks found residential demand has taken a hit from high property prices. But HDIL has succeeded in attracting demand – it sold c3,500 residential units over the past 18 months – by adopting a competitive pricing strategy. We are optimistic that HDIL can continue to benefit from such a strategy in its planned new launches of 8.8m sq ft in the Mumbai market over the next 12 months.

However, FSI hike concerns could restrict HDIL from trading at peak valuation. While we remain optimistic about HDIL's business outlook, we do not foresee HDIL trading at its 12-month peak valuation for two reasons. First, looming concern about an FSI increase in the Mumbai suburbs to 1.33x from 1x (this can lower demand and pricing for TDR). Second, mid-cycle valuation, as demand is driven by competitive pricing. Hence, we are lowering our valuation multiple by increasing the target NAV discount to 20% from 10%.

Reiterating Overweight (V) rating, lowering target price to INR357 from INR396. HDIL is trading at a 35% discount to its FY12e NAV and FY12e price-to-book of 1.1x. The stock in the past 12 months has traded in a range of a 0-50% NAV discount. Our new target price values HDIL at a 20% discount to its NAV, along with a terminal value of INR47, implying a 34.6% potential return. **Risks** include slum rehabilitation projects, lower TDR volumes, and an FSI increase. **Catalysts** include successful new project launches over the next 12 months.

12 November 2010

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Figure 1. HDIL: Valuation snapshot

Year	Sales	EBITDA margin	HSBC EPS	HSBC EPS growth	P/BV	ROE
FY10a	15,021	84.3	17.6	-27.8%	1.4	11.0%
FY11e	21,096	71.7	22.7	29.1%	1.2	11.4%
FY12e	32,166	61.3	31.5	38.6%	1.1	13.5%
FY13e	39,328	52.7	34.8	10.6%	0.9	13.1%

Source: Company data, HSBC

Financials & valuation

Financial statements

Year to	03/2010a	03/2011e	03/2012e	03/2013e
Profit & loss summary (INRm)				
Revenue	15,021	21,096	32,166	39,328
EBITDA	12,665	15,135	19,704	20,707
Depreciation & amortisation	-51	-146	-155	-164
Operating profit/EBIT	12,614	14,989	19,549	20,544
Net interest	-5,234	-3,421	-3,150	-3,150
PBT	7,052	11,636	16,760	18,181
HSBC PBT	7,052	11,636	16,760	18,181
Taxation	-808	-2,217	-2,888	-2,839
Net profit	6,244	9,419	13,871	15,342
HSBC net profit	6,311	9,419	13,871	15,342

Cash flow summary (INRm)

Cash flow from operations	-7,881	-6,510	6,169	5,270
Capex	-1,283	-150	-125	-125
FCF enterprise	-4,738	-5,456	6,306	5,455
Cash flow from investment	-1,283	-150	-125	-125
Dividends	-718	-1,037	-1,322	-1,543
Change in net debt	-7,517	-6,085	-6,439	-1,936
FCF equity	-9,972	-8,877	3,156	2,305

Balance sheet summary (INRm)

Tangible fixed assets	2,047	1,934	1,904	1,866
Current assets	114,561	142,753	162,519	191,276
Cash & others	9,287	9,355	15,794	17,730
Total assets	120,258	148,090	167,178	195,248
Gross debt	41,017	35,000	35,000	35,000
Net debt	31,730	25,645	19,206	17,270
Shareholders funds	70,429	94,377	110,523	124,060
Invested capital	101,425	120,987	131,297	143,136

Ratio, growth and per share analysis

Year to	03/2010a	03/2011e	03/2012e	03/2013e
Y-o-y % change				
Revenue	-14.2	40.4	52.5	22.3
EBITDA	-5.4	19.5	30.2	5.1
EBIT	-5.5	18.8	30.4	5.1
PBT	-7.9	65.0	44.0	8.5
HSBC EPS	-27.8	29.1	38.6	10.6

Ratios (%)

Revenue/IC (x)	0.2	0.2	0.3	0.3
ROIC	12.1	10.9	12.8	12.6
ROE	11.0	11.4	13.5	13.1
ROA	10.2	9.1	10.5	9.9
EBITDA margin	84.3	71.7	61.3	52.7
Operating profit margin	84.0	71.0	60.8	52.2
EBITDA/net interest (x)	2.4	4.4	6.3	6.6
Net debt/equity	45.1	27.2	17.4	13.9
Net debt/EBITDA (x)	2.5	1.7	1.0	0.8
CF from operations/net debt			32.1	30.5

Per share data (INR)

EPS reported (fully diluted)	17.40	22.71	31.47	34.81
HSBC EPS (fully diluted)	17.59	22.71	31.47	34.81
DPS	2.00	2.50	3.00	3.50
NAV	196.27	227.56	250.77	281.48
NAV (adjusted)	0.00	0.00	0.00	0.00

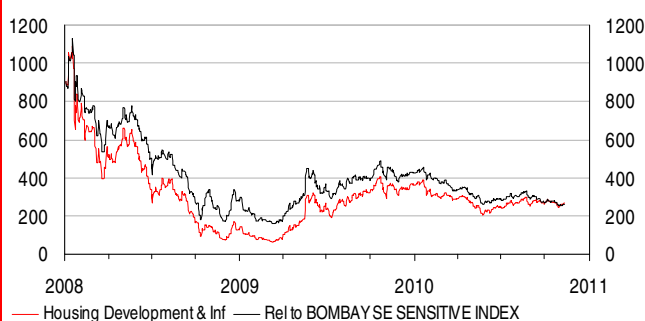
Valuation data

Year to	03/2010a	03/2011e	03/2012e	03/2013e
Premium/ (discount) to NAV	1.4	1.2	1.1	0.9
Premium/ (discount) to NAV (adj)				
PE*	15.1	11.7	8.4	7.6
FCF yield (%)	-9.1	-8.2	2.9	2.1
Dividend yield (%)	0.8	0.9	1.1	1.3

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

Note: All NAV figures on this page refer to book value

Price relative



Source: HSBC

Note: price at close of 10 Nov 2010

Figure 2. HDIL: Q2 FY11 quarterly earnings and balance sheet analysis

(INRm)	Q2 FY10	Q3 FY10	Q4 FY10	Q1FY11	Q2 FY11	y-o-y	q-o-q	Comment
Net sales	3,537	4,089	4,341	4,509	3,727	5.4%	-17.4%	Sales driven by 1m sq ft TDR @ INR3,000psf and FSI sales of INR700m in Vasai-Virar region.
Other income	274	266	304	342	339	23.9%	-0.9%	
Total Income	3,811	4,355	4,645	4,851	4,065	6.7%	-16.2%	
Expenses	813	1,238	893	647	55	-93.2%	-91.4%	
EBITDA	2,998	3,117	3,751	4,205	4,010	33.8%	-4.6%	High EBITDA margin was driven by sustained high TDR prices (we had factored in TDR price of INR2,600psf).
Depreciation	9	12	22	19	16	70.2%	-15.8%	
EBIT	2,988	3,105	3,730	4,186	3,994	33.7%	-4.6%	
Interest cost	1,112	1,153	1,421	1,403	1,511	35.8%	7.7%	
PBT	1,876	1,952	2,309	2,783	2,484	32.4%	-10.8%	
Tax	390	324	530	439	355	-9.1%	-19.3%	
Adjusted PAT	1,486	1,628	1,778	2,344	2,129	43.3%	-9.2%	
Exceptional	0	0	-	-	9			PAT was 37% above our estimate.
Reported PAT	1,486	1,628	1,778	2,344	2,138	43.9%	-8.8%	
EBITDA %- excl project interest	78.7%	71.6%	80.8%	86.7%	98.6%	20.0%	12.0%	
EBITDA %- Inc project interest	54.3%	49.5%	55.4%	62.2%	66.7%	12.4%	4.5%	
PAT margin	39.0%	37.4%	38.3%	48.3%	52.6%	13.6%	4.3%	Effective tax rate was lower than our 21% estimate.
Tax rate	20.8%	16.6%	23.0%	15.8%	14.3%	-6.5%	-1.5%	
Balance sheet (INRm)	Q2 FY10	Q3 FY10	Q4 FY10	Q1FY11	Q2 FY11	Comment		
Net worth	66,441	68,069	71,177	75,861	91,120			
Debt	32,711	33,512	40,517	40,486	41,333	Comfortable leverage following the recent fund-raising.		
Deferred tax liability (net)	30	40	53	54	62			
Total	99,183	101,621	111,748	116,401	132,515			
Net block	886	1,348	1,830	1,699	1,764			
Capital WIP	123	65	-	9	-			
Investments	5,078	5,032	5,965	6,337	9,431			
Inventory	71,795	75,577	80,337	87,311	92,369	Sustained high debtors are a concern. However, management has indicated that this have come down since Q2 FY11.		
Debtors	3,309	2,274	2,007	3,645	4,531			
Loans and advances	23,431	23,361	22,081	24,583	26,776			
Cash	1,103	1,006	7,874	5,155	12,037			
Less: Creditors	6,532	7,002	8,023	11,623	13,607			
Less: Provisions	10	40	323	716	786			
Net working capital	93,096	95,177	103,953	108,356	121,320			
Total	99,183	101,621	111,748	116,401	132,515			
Debt-equity	0.49	0.49	0.57	0.53	0.45	HDIL now has sufficient liquidity to finance land purchase for Phase 3 of airport project, along with financing the construction of both Phases 2 and 3 of the airport project.		
Net debt- equity	0.48	0.48	0.46	0.47	0.32			
Free cash flow summary								
PBT	1,876	1,952	2,309	2,783	2,484			
Add: Interest	1,112	1,153	1,421	1,403	1,511			
Add: Depreciation	9	12	22	19	16			
Operating cash flow	2,998	3,117	3,751	4,205	4,010			
Less: Tax	(390)	(324)	(530)	(439)	(355)			
Less: Working capital changes	(7,472)	(2,178)	(1,909)	(7,121)	(6,082)			
Less: Capex	(40)	(415)	(439)	103	(72)			
Free Cash flows (including new land purchase)	(4,904)	200	873	(3,253)	(2,498)			
Debtor days	85	51	42	74	111			

Source: Company data, HSBC

Competitive pricing strategy should help HDIL attract demand in new launches

Our ground-level checks across the Mumbai metropolitan region suggest that residential segment demand has been waning, primarily owing to sustained high property prices; Mumbai property prices are 20% above their last peak. However, HDIL has managed to attract demand for its projects using the competitive pricing strategy in its new launches; it has sold c3,500 units in the past 18 months. The company now plans to launch c8.8m sq ft (see Figure 3) over the next 6-12 months. We are optimistic

that HDIL will continue to attract demand in its new launches if it maintains its competitive pricing strategy. This also should allow HDIL to finance project execution with customer advances, as reflected in the current projects, which are 70% sold.

Figure 3. HDIL: Planned new project launches

Project	Location	Saleable area (m sf)
Popular Car Bazaar	Andheri-Mumbai	0.8
Ekta Nagar	Kandivali-Mumbai	1.5
Palghar Township	Palghar	11.8
Whispering Towers-Phase II	Mulund-Mumbai	0.8
Meadows-Phase II	Goregaon-Mumbai	3.6
Daulat Nagar	Santacruz-Mumbai	0.8
Premier Residency-Phase II	Kurla-Mumbai	0.8
Ghatkopar	Ghatkopar-Mumbai	0.5
Kochi	Kochi	6.3
Total		26.9

Source: Company data, HSBC

FSI hike concerns could restrict HDIL to trade at peak valuation

Lowering our target valuation to 20% discount to NAV from 10%

The BrihanMumbai Municipal Corporation (BMC) has sought clarification from the government on the rule allocating 0.33x higher FSI in Mumbai suburbs (1.0x currently), which was rejected by the Mumbai High Court in June 2010. The Maharashtra state government was likely to pass an ordinance empowering the BMC to grant the 33% extra FSI in the suburbs. The BMC was also to receive powers to exempt other development space in the building, such as the lift area and staircase area, from the FSI calculation in exchange for a premium. While the state approved the rule impacting the lift and staircase space, the decision to increase the general FSI by 0.33x FSI is pending. A potential increase in FSI should impact TDR demand, as developers would buy the additional FSI from the government, unlike TDR earlier. This is similar to demand for TDR falling by an equivalent proportion of FSI bought from the government.

We believe that a 20-30% fall in TDR demand could impact TDR prices by an equivalent proportion. While our earnings estimates already factor in lower TDR pricing of INR2,400psf (a 20% discount to current price) in FY12e and INR2,000psf over FY13-17e, lack of clarity on the FSI increase should cap valuation upside in the near to medium term. Additionally, the Mumbai property market, in our view, is closer to the cyclical peak, suggesting that valuation will reflect mid-cycle multiples, unlike early up-cycle multiples observed over the past 12 months. These two factors, we believe, will restrict HDIL from trading at peak multiples, despite our positive outlook on the company. The stock over the past 12 months has traded at a peak valuation of a 0% discount to its NAV. Our revised target valuation pegs HDIL at a 20% discount to net NAV versus 10% earlier.

Valuation

Reiterating Overweight (V) rating, lowering target price to INR357 from INR396

We are lowering our 12-month target price to INR357 from INR396. We value HDIL through a net asset value (NAV) approach, using the discounted cash flows of the company's real estate projects. Apart from the recent equity dilution, we also factored in equity dilution from 26m warrants issued to promoters at INR274per share. We are lowering our target NAV discount to 20% from 10% to factor in 1) looming

concern about an FSI hike, which can lower demand and pricing for TDR, in the Mumbai suburbs to 1.33x from 1x, and 2) mid-cycle valuation, when demand is driven by competitive pricing in Mumbai. Our new target price consists of NAV at a discount of 20% and a terminal value of INR47. Our target NAV discount of 20% is in line with HDIL's market positioning and location of operation.

We value HDIL's large industry peer Unitech at a 10% discount to NAV and the industry leader DLF at par with NAV. We believe that the NAV discount is justified, given HDIL's business positioning and high exposure to slum rehabilitation projects, which carry a delay risk. Our new target price implies an FY12e PB of 1.4x, against the stock's trading at 1.1x and large peers' trading at a weighted average 1.6x. A PE comparison is not particularly useful, in our view, as HDIL follows a project completion method, while other peer coverage companies follow the percentage of completion method of accounting.

Figure 4. HDIL: Target price calculation

Particulars	INRbn	Per share
Residential	63	143
Commercial	21	48
Retail	18	40
Gross asset value	102	230
Less: Net debt	37	84
Add: Airport project (NAV)	33	74
Total net asset value	171	388
Less: NAV discount	(34)	(78)
Add: Terminal value	21	47
Target value	157	357

Source: HSBC

Rating rationale

Under our research model, for stocks with a volatility indicator, the Neutral rating band is 10ppt above and below our hurdle rate for Indian stocks of 10.5%, or 0.5-20.5% around the current share price. Our new target price of INR357 implies a potential return of 34.6%, which is above the Neutral band; thus, we reiterate our Overweight (V) rating on the stock.

Investment summary

Housing Development and Infrastructure Ltd (HDIL) is India's third-largest real estate developer, measured by market capitalisation. We like the locations of HDIL's land bank (195m sq ft), given the strong focus on the city of Mumbai (36%, including TDR and FSI sales) and the Mumbai metropolitan region (43%). HDIL is a direct play on Mumbai, one of India's most resilient property markets, and is one of the few developers that have met their project timelines during the recent business down cycle, highlighting HDIL's strong execution ability. Mumbai contributes c90% to HDIL's NAV, more than any other large listed real estate company operating in India's two most important cities, Mumbai and Delhi.

Risks

We see these key risks: Slum rehabilitation projects have a long gestation period and are subject to delays, lower TDR volumes and pricing could come in lower than we estimate, and an FSI increase in the Mumbai suburbs could lower demand for TDR and hence our valuation.

Disclosure appendix

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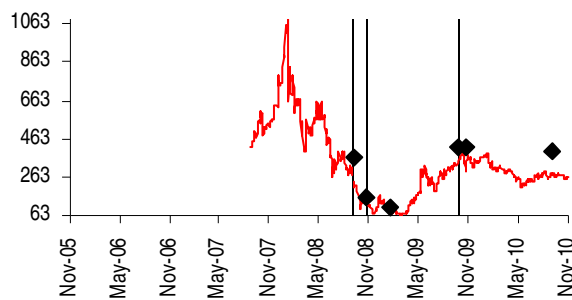
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As of 11 November 2010, the distribution of all ratings published is as follows:

Overweight (Buy)	48%	(21% of these provided with Investment Banking Services)
Neutral (Hold)	37%	(19% of these provided with Investment Banking Services)
Underweight (Sell)	15%	(19% of these provided with Investment Banking Services)

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
N/A	Overweight (V)	14 September 2008
Overweight (V)	Neutral (V)	03 November 2008
Neutral (V)	Overweight (V)	07 October 2009
Target Price	Value	Date
Price 1	365.00	14 September 2008
Price 2	154.00	03 November 2008
Price 3	100.00	29 January 2009
Price 4	416.00	07 October 2009
Price 5	419.00	02 November 2009
Price 6	396.00	14 September 2010

Source: HSBC

HSBC & Analyst disclosures

Disclosure checklist

Company	Ticker	Recent price	Price Date	Disclosure
HOUSING DEVELOPMENT & INF	HDIL.BO	265.45	11-Nov-2010	4

Source: HSBC

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