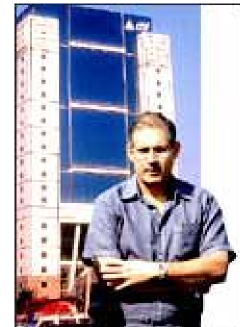
Test-case IPO

Despite the boom in real estate (and until recently, the stock markets), convincing retail investors to buy its IPO won't be easy for DLF Universal. By R. Sridharan



DLF's Singh: It's his show now

In the seven years that Rajiv Singh, 47, has been the Vice Chairman of DLF Universal, he has granted less than 40 media interviews. Almost all of them have occurred in just the past few months. If the otherwise media-shy Singh, son of DLF Chairman K.P. Singh and a mechanical engineer from MIT, has been on a publicity overdrive, it's because he has a story to sell. A difficult one, actually. Having remained a closely-held real estate company for six decades, dlf is set to go public in June-end with an offering that could raise more than Rs 13,000 crore in return for about 12 per cent of its shares. In the recent past, investors have demonstrated a huge appetite for quality IPOs (think Reliance Petroleum), but since then the stock markets have taken a turn for the worse. Singh can no longer take a smooth sailing for granted.

Even if the stock markets were irrationally exuberant, Singh, who's sitting on land worth Rs 85,300 crore, would have had a hard time selling a real estate IPO. Why? The real estate business in India is as murky as can be. Land holdings are fragmented, titles are usually unclear and disputed, regulations aren't just complex and ambiguous but ineffective, and to a large part it's a cash economy. There are additional risks in terms of lumpy earnings, since it takes an average of three years to develop a property.

Given the media's preoccupation with the sexier part of the DLF IPO story-how it may turn Singh Sr into the richest Indian in terms of the value of his share holdings in DLF (Rs 1,15,000 crore)-some important questions about the share sale have gone unanswered. Here, we attempt to answer some of the key ones:

- *Just what is DLF's EPS?* For the year ended March 31, 2006, DLF reported a net profit of Rs 199.40 crore on revenues of Rs 1,170.90 crore. Soon thereafter, DLF split its shares of Rs 10 into five, increasing the number of shares to 151.07 crore. The earnings per share, then, work out to about Rs 1.32. So, why is DLF quoting an EPS of Rs 9.09? That, as it turns out, is due to a restatement of accounts for the last five years, and the figure of Rs 9.09 is not just adjusted for the stock split and bonus issue, but also reflective of a weighted average of EPS for the past

three years.

- *Why restate accounts?* Most privately-held companies suffer from one paradox: Their capital base tends to be small, but assets and net worth disproportionately high. DLF, for instance, had just 35 lakh paid up shares until March 31, 2005, and a net worth of Rs 384 crore and net profits of Rs 68 crore, giving it an EPS of Rs 194. Had DLF not split its shares and issued bonus shares, the EPS for last year would have been Rs 554. Now, DLF thinks it deserves an earnings multiple (that is, p-e) of about 70, as is evident from the fact that it is offering 20.20 crore shares to investors and hoping to raise Rs 13,000 crore. Imagine what a P-E of 70 would have meant if the shares hadn't been split: Each share would have had to be priced above Rs 38,000. Who'd buy? Not you and me.
- *Why value a company with Rs 199 crore in profits at Rs 1,30,000 crore?* What investors discount is not past earnings, but future earnings. According to analyst projections (obviously based on plans shared by DLF), its revenues next year will touch Rs 11,219.30 crore and net profits a mammoth Rs 6,400 crore, an eye-popping 3,116 per cent increase. (So, the discounted P-E works out to a little over 20.)
- *Whoa, what's happening here?* Until recently, DLF only leased its commercial and retail buildings (the latter to a lesser extent). Going forward, it will sell these properties and become a pure developer. Next year, it will sell 16 million sq. ft of commercial, retail and residential space. According to at least one estimate, DLF, by 2015, could have revenues of about Rs 53,000 crore and a net profit of Rs 27,000 crore.
- *So are the Singhs getting out of owning properties?* Well, not exactly. The promoters are setting up another company called DLF Assets that will bid to buy the retail and commercial properties from DLF Universal. The former will also act as an underwriter of sorts, since an agreement between the two requires DLF Assets to necessarily buy a development if its open market sale price turns out to be less than 10 times the annual rental and maintenance income from it.
- *How will DLF Assets fund itself?* About Rs 1,300 crore from the IPO will go towards capitalising DLF Assets, which would then raise three times as much in debt. Using a financial structure known as Real Estate Investment Trust (REIT), DLF Assets will acquire properties from DLF Universal (as special purpose vehicles) and receive rentals from them. Since, REITs (pronounced 'REETs') are typically not taxed and required to pay

almost all of their profits as dividends, global investors buy into them and receive almost fixed income in the form of dividends. In effect, DLF Assets becomes the landlord and DLF Universal, the developer. On their part, the promoters will receive dividend income from both DLF Universal (if it pays any) and DLF Assets. Sweet deal? You bet.

- *What are the risks DLF Universal faces?* Execution. It has to deliver on its plans. Then, even as it exhausts its cheap land bank, it must replenish at current (crazy) prices. If the economy stalls, DLF will take a hit too. Besides, its revenues, despite a plan to diversify into SEZs and hotels, could remain lumpy. Then, it has to professionalise. It is still managed largely by family members. And Singh Jr, of course, can forget about a life in the shadows.