Housing Development and Infrastructure

Neutral

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Issue Open: 28th June 2007
Issue Close: 03rd July 2007

Issue Details

Pre-Issue Equity Share Capital:
Rs180cr

Issue size: *Rs1,290cr - **Rs1,500cr

Fresh issue:
30,000,000 equity shares of Rs10 each

Post issue Equity Share Capital:
Rs21cr (excluding the Green Shoe Option)

** at lower end of price band*
*** at upper end of price band*

Offer Price Band:
Rs430-500

Book Building (excluding Reserved for Employees Portion)	
MF/QIBs	At least 60%
Retail	Up to 30%
Non-Institutional	Up to 10%

Shareholding Pattern

	Pre-Issue	Post-Issue
Promoters / Promoter Group	73.21%	62.75%
Others	26.79%	37.25%
Total	**100.0%**	**100.0%**

'A High-Concentrate Bet'

Reasons for our Neutral View

Housing Development and Infrastructure (HDIL) has sold a total 13.3million sq.ft since inception and plans to sell 112.1million sq. ft. over the next five years. A major chunk of the land projected (including ongoing) to be sold is through Residential Projects (77%). In the Residential Segment major projects are in the Vasai and Virar area, which account for nearly 73.7% of the residential projects. Our calculations reveal taking into consideration HDIL's projections that it intends to sell 44,500 residential units over the next five years in Vasai and Virar and for this to materialise approximately 18,00,000 additional population has to move into Vasai and Virar assuming that HDIL's marketshare would be 10% going forward. Currently, the Vasai and Virar population hovers around 10 lakh. We believe it would be a far fetched task for the company to evaluate market size. Moreover, these areas are on the outskirts of Mumbai hence, even if HDIL is able to meet its projections, margins would not be as high compared to areas in Mumbai.

A firm interest rate regime has been prevailing since the last 9-12 months wherein the interest rates have risen by 150bp. Impact of the same is distinctly visible in the slowing credit growth. India's credit growth and more so housing loan growth has slowed down considerably during this period, which we believe is currently at more realistic levels and will be sustained over the next few years.

Based on the prevailing property prices in the areas where HDIL has its projects and considering that HDIL would realistically be able to develop and sell all this property over the next five years, we have arrived at a net asset value (NAV) of **Rs381/391** on the lower and upper price band for the stock.

Objects of the Issue

- Acquisition of land and land development rights for HDIL's ongoing and planned projects
- Construction of HDIL's ongoing projects
- General corporate purposes

Utilisation of Net Issue proceeds

Particulars	**Rs**
Acquisition of land and development rights	128.8
Construction and Development costs for existing and Planned projects	*
General corporate purposes	*
Total	*

Source: Company RHP

Company Background

Founded in 1996, HDIL is part of the Wadhawan Group, a leading and reputed real estate developer. HDIL is a real estate development company in India with significant operations in the Mumbai Metropolitan Region (MMR). HDIL focuses on real estate development including construction and development of residential projects and more recently, commercial and retail projects, slum rehabilitation and development including clearing slum land and re-housing slum dwellers, and land development including development of infrastructure on land which the company then sells to other property developers. HDIL has an integrated in-house development team which covers all aspects of property development from project identification and inception through construction to completion and sale.

HDIL's completed portfolio consists of 23 projects covering 12.9million sq. ft. of saleable area, of which 5.7million sq. ft. was the development of land for other developers and 2.0million sq. ft. consisted of rehabilitated area. Going ahead, the company intends to undertake 32 projects totaling 112.1million sq. ft. of space in Mumbai and the MMR as well as Kochi (Cochin) and Hyderabad. Of this, 21 projects totaling 45.4million sq. ft. are currently under development, while the remaining 11 projects totaling 66.7million sq. ft. are planned for future development.

Industry

The Indian real estate sector involves development of commercial offices, industrial facilities, hotels, restaurants, cinemas, residential housing, trading spaces such as retail outlets and the purchase and sale of land and land development rights.

Over the past three years, the amount of investment in the real estate sector and the total amount of constructed square footage has increased significantly having recovered from a severe recession between 1995 and 1999. Investment in real estate construction in India during the three-year period from financial year 2006 through 2008 is estimated to be over Rs5,106 91billion compared to investment of approximately Rs4,504billion during the three-year period from financial year 2003 through 2005 (*Source: CRIS INFAC "Construction Annual Review" - February 2006*)). Constructed square footage during the period from financial year 2006 through 2008 will be approximately 8.3million sq. ft. compared to constructed square footage of approximately 7.4million sq. ft during the period from financial year 2003 through 2005 (*Source: CRIS INFAC)*.

Residential real estate development

Demand for housing in India today exceeds supply due to various factors including: a growing population, increasing urbanisation, increasing affluence and disposable income as a result of growth in employment opportunities and work force, and a general trend away from India's tradition of joint or extended family residences towards nuclear or individual family residences. Currently in India, it is easier for home purchasers to obtain financing and favourable tax incentives, which has also increased demand for housing. According to the National Housing Bank (NHB), there was a housing shortage of 19.4 million units in 2003. CRIS INFAC has estimated that the shortage of housing units in financial year 2004 was 19.7million housing units. According to India's current "five year plan", there will be a housing shortage of approximately 22.7million housing units in financial year 2007. Housing shortage is expected to continue despite the fact that approximately 4.7million new housing units were added to India's housing supply in financial year 2005 and that new housing units are expected to increase to 5.3million annually by financial year 2010 (*Source: CRIS INFAC Construction Annual Review – February, 2006*).

Commercial Real Estate development

Capital flow into commercial property in 2004 increased by more than 40% over the previous year, leading to record levels of new office development (*Source: FICCI presentation*; *Cushman & Wakefield - November 2005 report*). Despite this, higher demand has helped stabilise the vacancy rates. The rapidly growing sectors of IT/ITES and related sectors were particularly estimated to account for over 70% of net demand in 2004. In cities with diverse economic sectors such as Mumbai, demand has been driven by other industries such as banking, finance and insurance institutions, consulting firms, pharmaceutical companies, shipping firms and other service businesses.

Retail Real Estate development

Real estate development in the retail sector is a relatively new phenomenon in India. The Indian retail market has the largest growth potential of the worldwide retail markets (*A.T. Kearney's 2005 Global Retail Development Index*). Some of the factors that contributed to the emergence and growth of the organised retail segment in India included:

- Increase in per capita income and household consumption
- Changing demographics and improved standard of living
- Changing consumption patterns and access to low-cost consumer credit
- Infrastructure improvements and increased availability of retail space.

Historically, the Indian retail sector has been dominated by small independent local retailers such as traditional neighbourhood grocery stores. However, during the 1990s, organised retail outlets gained increased acceptance due to changing demographic factors such as an increase in the number of working women, changes in the perception of branded products, the entry of international retailers into the market and growing number of retail malls.

SRS Development

The SRS was established in 1995 with a mission to re-develop and rehabilitate slum dwellers in Greater Mumbai. Through the scheme, rehabilitation flats are built free of cost for the slum dwellers by cross-subsidisation provided by free-sale flats. Developers are allowed to construct sale flats on slum land in exchange for the construction of flats for slum dwellers. Under the SRS, the real estate developers are authorized to rehabilitate land areas owned by the government upon consent of 70% of eligible slum dwellers. Initially, the slum dwellers are placed in temporary accommodation provided by the developer. The developer then proceeds to construct a building on the slum land consisting of residential units, of 225 sq. ft. each, to house the eligible slum dwellers. Housing slum dwellers in newly constructed multi-storey apartment towers frees a significant amount of land area within the slum for other development. On the cleared slum land, the developer may then construct commercial, residential or retail buildings as per the preference of the developer, subject to approvals of the site plan. In the event further construction is not possible due to insufficient space on the re-developed slum land or any applicable planning restrictions, the developer is issued a transferable development rights ("TDR") by the Government of Maharashtra (GoM) for the balance of the undeveloped building area, which the developer may use in respect of another development elsewhere in certain areas in Mumbai or may sell to a third party. The principal financial advantage of the SRS is that the developers are not required to pay any substantial, one-off land purchase costs at the beginning of each project to acquire the use of such land.

Positives

HDIL's Innovative Business Model
HDIL has a novel business model wherein it balances its short-term as well as long-term project initiatives. HDIL is into four segments viz., Residential, Commercial, Retail and SRS projects. HDIL is a leader in the SRS segment. Executing SRS projects allows HDIL to generate higher returns on its projects, as the cost of land is the cost of construction. Moreover, these slum-encroached land parcels are situated in prime locations of the city providing a higher upside. HDIL's SRS projects are characterised by a lower asset cycle risk as against its non-SRS projects, which involves a one-time upfront payment for the land parcel. HDIL's future initiatives involve a venture into the hospitality sector, development of a SEZ and bidding for Airport modernisation.

Experienced and Established participant in Slum Rehabilitation Schemes
HDIL is an established developer in slum rehabilitation, which primarily involves construction of residential buildings for slum dwellers and clearing public and private land for development of residential, commercial, retail and infrastructure purposes. In SRS rehabilitation flats are built free of cost to the slum dweller by cross-subsidisation provided by free-sale flats. Developers are allowed to construct sale flats on slum land in exchange for the construction of flats for slum dwellers. The main benefit is that the cost of constructing an additional building to house the slum dwellers tends to be significantly lower than the purchase cost for developable land that would be otherwise incurred by purchasing land from third parties. As a result, it is less costly to construct a building on slum land for the slum dwellers in exchange for land development rights on the resulting cleared former slum land, or in exchange for FSI/TDRs, than it is to purchase urban land from third parties for development purposes. This has significantly contributed to HDIL's Topline and Bottomline over the years.

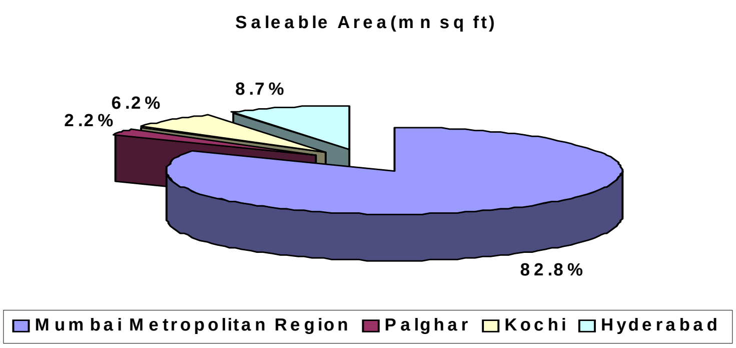
Future Initiatives
HDIL is focusing on tapping the huge potential in related businesses like Hotels, Mega Structures and SEZs. With the Hotel sector in India promising tremendous opportunities for growth, HDIL is constantly evaluating potential sites for hotel projects. The company intends to construct, develop and own its hotel properties, while entering into a management contract for the same with a leading hotel operator. HDIL is also evaluating opportunities for further development of "mega structure" projects - large-scale mixed-used retail and residential buildings, commercial hubs, malls and multiplexes as well as hotels. HDIL's ability to identify high potential land parcels, coupled with its ability to construct innovative structures of a high quality shall ensure its success in this area of real estate development. HDIL is considering the development of a special economic zone (SEZs) around 50kms north of Mumbai. The company has already received an in-principle approval from the Ministry of Commerce & Industry to develop the SEZ project. SEZs have attracted strong interest from a variety of business sectors, due to the tax and infrastructure benefits of operating within a SEZ, including major tax holidays with respect to corporate income tax. However, given the uncertainty in SEZ regulations, the company has still not decided whether it would develop the same on its own or in collaboration with others. These ventures are expected to ramp up substantially over the next three to five years and make material contribution to the overall consolidated financial performance of the company.

Investment concerns

Large part of Land Bank in outskirts of Mumbai

HDIL has a large portion of Land Bank on the outskirts of Mumbai ie., Vasai and Virar. This land bank accounts for a developable area of 63.8million sq. ft. in case of Residential segment (ie., 73.7% of the total developable area of this segment) and 13 million sq. ft. in case of Retail projects (ie., 68.4% of the total developable area of this segment). Evaluating the market in these areas, we believe realisations are not anywhere comparable to areas in Mumbai. Moreover being located at a place far away from the business areas of Mumbai, occupancy itself will pose to be a big challenge for the company. However, investors should note that in our calculations we have assumed that the company will be able to achieve its target even though they are quite far fetched according to us.

Exhibit 1: Land Bank



Source: RHP

Substantial tranche of undeveloped land

A large part of HDIL's land reserves consist of undeveloped land on the northern outskirts of Mumbai city. We believe that the company is faced with a significant challenge in executing its envisaged mega townships and SEZ project here over the next five – seven years.

Rising Interest Rate scenario

The real estate sector has been witnessing incredible demand thanks to the rise in credit growth over the last few years. This was due to the decrease in the mortgage rates and fast growing economy. However, now the mortgage rates have increased mainly due to tightening of liquidity by the Central Government. This, along with the run up in the property prices, has reduced the transaction volume in the last few months. This is likely to dampen residential demand and could affect the overall real estate market.

Long Gestation period for SRS projects

In SRS, execution of projects can be divided into two stages. In the first stage, developers add value by identifying and getting slum lands approved under the SRS and clear the land for construction. This entails building 70% consensus among the slum dwellers to rehabilitate and can be quite a Herculean task, taking anywhere between 12-18 months. In the second stage, the project is actually executed. There are major risks of all these projects getting delayed due to various reasons for instance non-consensus, litigations, etc., as can be presently witnessed in the case of Dharavi, the biggest slum of Asia. This could significantly affect the company's performance going ahead as 15-20% of Residential Projects are SRS projects.

Valuation

We have used the DCF method to calculate the NAV for the stock. Key assumptions in our calculations include:

- We have assumed that the company would be developing and selling 112.1million sq. ft. over the next five years.
- We have taken Cost of Equity of 14% to discount future cash flows.

Exhibit 2: Calculation of NAV

Particulars (Rs cr)	Higher Band	Lower Band
Value of Business	6,714.6	6,714.6
Add Cash	1,504.8	1,294.8
NAV	8,219.4	8,009.4
No of Shares*	21	21
NAV/Share (Rs)	**391**	**381**
IPO Price ((Rs)	**500**	**430**

*Source: Angel Research; *Excluding the Green Shoe Option*

We have a Neutral view on the IPO.

Exhibit 3: Summary statement of Profit and Loss, as restated

	As at 31March				(Rs cr)
Particulars	**2007**	**2006**	**2005**	**2004**	**2003**
Income					
Turnover	1203.4	422.2	64.9	5.8	9.9
Other income	13.1	18.0	10.0	1.6	0.6
Increase/(Decrease) in stock in trade	11.9	0.9	(0.1)	2.4	(0.2)
Increase/(Decrease) in work in progress	703.3	197.3	75.5	150.2	23.4
Cost of premises capitalised as investment	8.5	0.1	37.4	0.0	0.0
Cost of premises capitalised as fixed assets	15.5	0.0	0.0	1.4	0.0
Total	**1955.8**	**638.4**	**187.6**	**161.5**	**33.7**
EXPENDITURE					
Purchases	1011.6	376.7	121.3	125.2	10.8
Operating and other expenses	251.4	112.6	26.2	21.0	21.4
Employees remuneration and welfare expenses	8.4	1.1	1.0	0.3	0.2
Administrative expenses	22.2	7.9	5.0	0.9	0.7
Financial expenses	43.0	10.6	16.6	14.4	3.4
Depreciation	0.6	0.3	0.1	0.1	0.0
Preliminary expenses written off	0.4	0.1	0.0	0.0	0.0
Total	**1337.6**	**509.2**	**170.3**	**161.9**	**36.6**
Operating Profit before Tax	**618.2**	**129.1**	**17.3**	**(0.4)**	**(2.9)**
Less: Provision for taxation	76.0	15.2	2.5	0.0	0.0
Less: Provision for fringe benefit tax	0.2	0.1	0.0	0.0	0.0
Less: Deferred tax liability/(asset)	0.4	0.2	0.3	0.0	0.0
(Add)/Less : (Excess)/short provision for taxation no longer require	(0.2)	(0.3)	0.0	0.0	0.0
Operating Profit after Tax but before extra ordinary items	**541.8**	**113.9**	**14.6**	**(0.4)**	**(2.9)**
(Add) / Less: Adjustments for changes in accounting policy or any audit qualification	(0.2)	0.1	(0.1)	0.1	0.0
Restated Profit after Tax	**542.0**	**113.8**	**14.6**	**(0.5)**	**(2.9)**
Balance brought forward from previous year	103.0	11.1	(3.5)	(3.1)	(0.2)
Profit available for appropriation	**645.0**	**124.9**	**11.1**	**(3.6)**	**(3.1)**
APPROPRIATIONS					
Less: Transfer to General reserve	59.2	22.0	0.0	0.0	0.0
Less: Utilised for issue of bonus shares	98.0	0.0	0.0	0.0	0.0
Profit carried to Balance Sheet	**487.8**	**102.9**	**11.1**	**(3.6)**	**(3.1)**

Source: Company, RHP

Exhibit 4: Summary statement of Assets and Liabilities, as restated

	As at 31 March				(Rs cr)
Particulars	**2007**	**2006**	**2005**	**2004**	**2003**
Fixed Assets – A					
Gross Block	24.9	5.6	3.7	3.3	1.5
Less: Depreciation	1.3	0.6	0.4	0.2	0.1
Net Block	2.4	0.5	0.3	0.3	0.1
Capital Work in progress	0.3	1.0	0.0	0.0	0.0
Total - A	**2.7**	**1.5**	**0.3**	**0.3**	**0.1**
Investments - B	**1650.4**	**1132.8**	**576.6**	**326.5**	**80.1**
Current Assets, Loans and Advances – C					
Inventory	1152.5	437.3	239.2	163.9	43.1
Sundry Debtors	310.3	77.4	0.7	0.3	0.5
Cash and Bank Balances	4.8	39.7	1.9	0.6	1.9
Loans and Advances	231.9	124.0	34.1	3.9	24.0
Total –C	**16994.5**	**6784.2**	**2759.4**	**1685.5**	**695.1**
Total Assets (A+B+C) =D	**18647.5**	**7918.5**	**3336.3**	**2012.3**	**775.3**
Liabilities and Provisions - E					
Secured Loans	375.7	196.5	40.3	0.7	66.0
Unsecured Loans	0.0	0.0	51.1	0.0	0.0
Deferred Tax Liabilities	0.8	0.4	0.3	0.0	0.0
Current Liabilities	721.9	408.2	171.8	205.1	14.0
Provisions for tax	64.2	8.2	2.4	0.0	0.0
Provisions for retirement benefits to employees	0.3	0.0	0.0	0.0	0.0
Total –E	**1162.9**	**613.3**	**265.8**	**205.8**	**80.0**
Net Worth (D-E)	**17484.6**	**7305.2**	**3070.5**	**1806.5**	**695.4**
Net Worth represented by					
Share Capital	180.0	50.0	10.0	2.0	2.0
Reserve and Surplus	546.8	135.0	61.1	(3.5)	(3.1)
Total	**726.8**	**185.0**	**71.1**	**(1.5)**	**(1.1)**
Less: Miscellaneous Expenditure	1.3	0.6	0.0	0.0	0.0
(to the extent not written off or adjusted)					
Net Worth	**725.5**	**184.4**	**71.1**	**(1.5)**	**(1.1)**

Source: Company, RHP

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